

Treasury Trends

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WE LIVE IN INTEREST-ING TIMES

Notwithstanding the current disruptions caused by events in the Middle East, over the next 12–24 months, central banks around the globe will be navigating a complex policy environment where inflation, growth, and labour market dynamics push them in different directions. At present, the Federal Reserve appears poised for modest easing, the ECB for cautious stability, while the RBA/RBNZ face renewed tightening pressures as inflation threatens to rebound.

These divergent paths create heightened volatility in interest rate expectations, yield curves, and currency markets – directly impacting corporate hedging strategies and ordinary treasury risk management.

The New Interest Rate Reality

Global interest rate regimes have undergone a seismic shift since the post-COVID recovery. After an extended era of ultra-low rates and quantitative easing, central banks were forced into aggressive tightening cycles to combat inflationary pressures, before easing to various degrees. Their strategies remain fluid and reactive, contributing to what many refer to as a volatile interest rate environment.

Geopolitical shocks, policy unpredictability, and distorted yield curves have weakened traditional forecasting models. Consequently, managing interest rate risk now requires a more dynamic and unconventional approach, striking a balance between robust risk frameworks and strategic agility.

Treasury is Not a Silo

Treasury functions need to work closely with strategic planning and finance to ensure that capital allocation, debt issuance timing, and/or foreign investment decisions reflect the anticipated interest rate paths. As a result, treasury policies should be proactively updated, with clear risk frameworks, governance structures, and hedging guidelines.

To ensure strategic alignment, organisations should:

- Reaffirm hedging objectives – clearly articulate whether the priority is cost certainty, earnings smoothing, or capital protection.
- Confirm risk tolerances – especially around interest rate and currency exposures.
- Align hedging instruments with policy language and

Key Points

- **Update policy proactively:** Treasury policies should reflect the shifting reality of global monetary policy.
- **Beware forecast reliance:** Over-reliance on external rate forecasts presents material risks for borrowers and investors.
- **Manage your business:** Anchor decisions to internal exposures and cash flow, not market guesses.
- **Hope is not a strategy:** Robust strategies are designed to perform acceptably across a range of rate environments.

compliance – ensuring that permissible instruments in policy cover necessary tools (e.g. swaps, options, currency overlays).

- Have a plan around future hedging needs, which will involve assessment of change in the shape of the yield curve – if appropriate, lock in longer maturities ahead of time.
- Ensure capital budgeting that incorporates discount rates is adjusted for the expected long-term cost of capital.
- Diarise training or summary sessions with relevant staff, management, and those in governance positions.

Inherent Dangers in Relying on Forecasts

Bank interest rate forecasts are widely used by organisations when shaping hedging and investment strategies. While forecasts can provide helpful context, over-reliance on them presents material risks for both borrowers and investors. The core danger lies in allowing external market views to override the fundamental principle of treasury risk management: managing risk relative to your own business, not to a forecast.

Forecasts are opinions, not risk management tools. Forecasts are inherently uncertain and frequently revised. They are based on macroeconomic assumptions, central bank signalling, and market positioning, all of which can change rapidly.

When organisations anchor hedging decisions to a single interest rate view, they effectively substitute speculation for risk control. A forecast that proves incorrect can leave a business over-exposed at precisely the wrong point in the cycle. More importantly, bank and/or other third-party forecasts are not tailored to individual balance sheets. They do not reflect specific instances of an organisation's cash flow volatility, leverage, covenant structure, or liquidity buffers.



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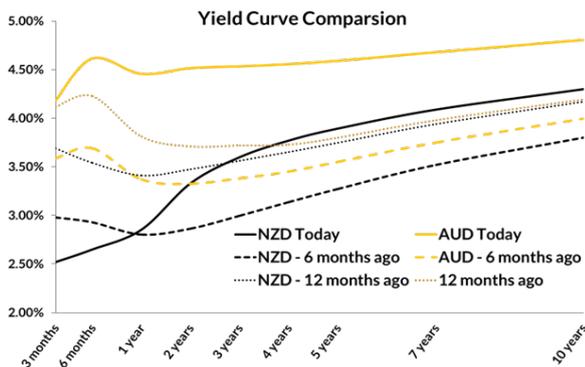
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A 'correct' market forecast can still be a poor outcome if it increases earnings volatility or threatens debt service capacity.

These rapidly changing rate expectations heavily distort market pricing. As the comparison below shows, the New Zealand and Australian yield curves have transformed over the past year.



Risks for Borrowers and Investors

For borrowers, reliance on forecasts often leads to timing risk – delaying hedging in anticipation of rate cuts or prematurely fixing rates ahead of expected hikes. If cuts fail to materialise, floating-rate debt costs may rise beyond budget tolerance. Conversely, fixing aggressively ahead of expected increases can lock in higher interest expense than necessary, eroding competitiveness and margins. This behaviour can also result in concentrated risk positions, such as excessive exposure at one point on the yield curve or over-reliance on a single hedging instrument.

On the investment side, forecast-driven strategies can lead to inappropriate duration risk. Extending duration based on expected rate cuts exposes surplus cash or a broader investment portfolio to market losses if rates stay higher for longer. Shortening duration in anticipation of rising rates may sacrifice yield needed to meet return or liability-matching objectives. Again, the key risk is misalignment: investment decisions driven by rate views rather than by liquidity needs, capital preservation requirements, or liability profiles.

Strategy - Not 'Set and Forget'

Rather than making 'big calls', we generally favour a staged or stepped approach ('little, and often'), phasing in protection across different tenors to benefit from curve movements. This reduces regret risk and improves optionality. You need to be prepared to revise hedging positions as conditions shift. A significant change in a debt forecast, for example, should prompt at least a review of the associated hedging strategy.

Instead of relying on a single 'house view' of where rates are heading, treasurers should lean heavily into stress testing and scenario analysis. What happens to your debt covenants if the RBNZ is forced to hike rates back above 4.00%? Conversely, how does your interest income look if rates plummet back to 2.00%? By modelling these extreme but plausible scenarios, organisations can identify hidden vulnerabilities in their balance sheets before they become critical issues. This proactive approach allows management to establish pre-agreed action plans, ensuring that when the market inevitably pivots, the business is executing a considered strategy rather than making reactive, panic-driven decisions.

Hope is Never a Good Strategy

It is important to remember that effective interest rate risk management starts with internal exposure analysis, not external predictions. Treasury strategies should be anchored to:

- Cash flow sensitivity to rate movements.
- Earnings and covenant tolerances.
- Liquidity and refinancing timelines.
- Long-term funding and investment objectives.

Forecasts can inform scenario analysis, but they should not dictate outcomes. Robust strategies are designed to perform acceptably across a range of rate environments, not to win a forecasting contest. In short, forecasts may change – your risk may not.

Successful treasury management focuses on controlling risk consistently, regardless of where rates ultimately go. If you are concerned as to what changes in interest rates will have on your funding costs or interest returns, please speak with your advisor or contact us as below.

WHAT WE DO



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