INTEREST RATE STRATEGIES FOR AN UNPREDICTABLE ENVIRONMENT

A conversation with Tina Hwang, Senior Vice President, Managing Director, PNC's Capital Markets Group

We are in uncharted territory. Interest rates have been static for longer than at any point in history. Now they're moving up. Following the March 2017 increase in the target range for the federal funds rate by the Federal Reserve, PNC's economists are predicting additional increases in 2017 and 2018. A new administration in Washington and political changes in Europe may also affect interest rates.

What does the future hold for interest rates? How will the new interest rate environment affect your borrowing strategies and how can you mitigate the risks? We asked Tina Hwang from PNC's Capital Markets group to weigh in.

Q Will interest rates continue to move higher or will there be pullback with the new administration in Washington?

Continued moderate real GDP growth, rising inflation and a strong labor market are among the fundamentals that suggest that interest rates may continue moving higher over the course of the next few years.

> You will want to work with your financial institution to tailor a solution that aligns with your company's risk tolerance and loan strategy.

In addition, the new administration may modify fiscal policy, including infrastructure spending, tax reform and changes to trade policy, increasing the likelihood that interest rates will continue to rise.

On the other hand, as with any market environment, certain key events, natural fund flows over the calendar year, and other factors such as the divergence of rates in the U.S. versus other developed economies could affect the upward trend.

Q What is PNC's forecast for the Fed's tightening in 2017 and the direction of longer-term rates?

PNC's economics team, led by Chief Economist Stu Hoffman, forecasts that the Federal Open Market Committee (FOMC) will raise the fed funds target rate two additional times in 2017, for a total of three increases in 2017.

PNC's forecast reflects a tightening path similar to the now famous "FOMC dot chart." That chart displays the opinion of each participant in the Open Market Committee meeting as to where the fed funds rate will land this year and in the longer term.

On the topic of long-term rates, PNC anticipates that the 10-year Treasury will drift higher and finish the year at 3.02%, while the 30-year bond yield should increase by a similar magnitude and end at 3.75% as 2017 comes to a close, based on the March baseline rate forecast.

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Q Have PNC's clients adjusted how much of their debt they hold in fixed versus floating rates given the coming increases?

Some clients with pre-existing interest rate risk policies have tended to maintain a particular mix of fixed and variable rate debt exposures. However, we have seen a noticeable increase in companies hedging additional portions of their debt. These hedges have been associated with a variety of borrowings, including:

- Core outstandings under bank revolving credit facilities
- Bank term loans that fund capital expenditures or acquisitions
- Institutional term loans where LIBOR is now exceeding the LIBOR floor levels in these deals
- Future maturities of obligations which may subject companies to interest rate risk.

Driving this shift is the view that the interest rate market will be subject to a wider dispersion of outcomes than before last year's election. It also results from the perception that the new administration's policies may provide for upside risks to forecasts compared to previous expectations.

Q Will there be any change to the regulatory environment given the new administration?

There were many suggestions and discussions on the campaign trail and chatter out of both Washington and Wall Street regarding deregulation following the election. Markets have taken the view that there could be a rollback of particular regulations, but we are not currently speculating on specific changes to existing policies.

Q Are there any different strategies that may be more beneficial to mitigate my risk now versus prior to the election?

Ultimately, the most important consideration is how the current market environment may affect your company's cash flows and/or value of assets/liabilities. The most commonly utilized strategy to mitigate interest rate risk continues to be the interest rate swap, a solution that synthetically converts variable interest rate exposures to a fixed rate.

Following the changes to the market environment since the U.S. election, potential modifications in how the swap is customized can include:

- The term of the contract (lengthen/shorten the hedge time frame)
- When it becomes effective (begin hedging maturities that may be 1, 2 or 3 years in the future given the increase to rate risk)
- How much of your debt is covered (increase/decrease fixed or hedged exposure given the anticipated increase to rate risk)

However, you will want to work with your financial institution to tailor a solution that aligns with your company's risk tolerance and loan strategy.

ABOUT TINA HWANG

Tina Hwang serves as regional manager for the northeast and mid-Atlantic territories for PNC's Derivative Products group. Hwang and her teams address the risk management needs of PNC's clients, working collaboratively to properly identify, structure and execute interest rate and currency swaps across multiple lines of business.

She has more than 28 years of experience in the financial industry. Prior to joining PNC, she worked for a number of major banks and securities companies, specializing in derivatives and other financial products.

She holds bachelor of arts degrees in economics and East Asian studies from Dickinson College, Carlisle, Pennsylvania.

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