MANUFACTURING SECTOR REVIEW

SECTOR SENTIMENT — 23 FEBRUARY 2016

Speaking to our leading manufacturing clients, sentiment in the sector is that a key concern is the potential fragility of not just the UK economy but also the global outlook. Whilst a continued fall in Sterling helps our competitiveness in international markets, it's the fall in overall demand that concerns the manufacturing community and their confidence to keep investing, developing & growing their markets.

BUDGET / TARGET RATES AND PERCENTAGES HEDGED - UPDATE

Budget / Target Rates:

- The 2016 Annual Manufacturing Report, published by *The Manufacturer* magazine, identified that in comparison with their past three annual reports, concerns about exchange rate fluctuations have increased, with particular concerns about Sterling strength against the Euro. Sterling has weakened since the date of the survey, perhaps lessening these worries.
- We have recently spoken to multinational manufacturers who are repatriating USD receivables. Those with long-term hedging horizons out to 4 years have seen current low GBPUSD rates as a great opportunity to increase hedging over and above their maximum policy requirements below a 1.5000 spot rate.
- A number of clients have indicated that levels sub-1.5000 are appealing compared to rates achieved over the past twelve months. We are seeing manufacturers reviewing their hedging policies to allow them to hedge a percentage of their exposures using cylinders.
- Some of our clients selling EUR to purchase GBP entered into trades in H2 2015 that allow them to benefit from GBPEUR weakness in 2016. Even though such hedges have protection rates close to the 1.4000 level, they are comfortable at current levels as they have participation down below 1.3000.

CURRENCY MARKET UPDATE

- Clients are focused on some of the possible effects of economic uncertainty on GBPUSD and GBPEUR, with consideration given to the forthcoming 23rd June referendum on British membership of the European Union. At time of writing, there is much speculation about the outcome of the vote, with various senior members of the Conservative party publicly announcing their intentions to campaign for In or Out.
- The first weeks of 2016 have seen volatile financial markets; we present below an overview of the effects of this volatility on GBPUSD and GBPEUR. We compare recent movements to last year to put the moves in context.
- *All data sourced from Bloomberg and Lloyds Banking analytics, as of 23 February 2016. Support and resistance levels below are derived by Lloyds analysts using technical analysis tools.*

GBPUSD Spot Volatility:

- In 2015, GBPUSD had an intraday trading range of 1.5930-1.4566, a 1,364 USD pip range.
- Since the start of 2016 we have seen moves from as high as 1.4816 down to 1.4058, a 758 USD pip range. This move represents 56% of the range over the whole of 2015.
- This recent low of 1.4058 was last observed on 18th March 2009
- Since the inception of the Euro in 1999, GBPUSD has traded below 1.5000 on 805 trading days out of 4,473. By comparison, more recently spot has traded below this level every day since mid-December 2015.

Short Term Technical Environment:

- Key short term **SUPPORT AREAS** (where you may see market interest to *buy* GBP in the event that spot trades *lower*) are 1.4000, 1.3650-1.3500 and 1.2800
- Key short term **RESISTANCE AREAS** (where you may see market interest to *sell* GBP in the event that spot trades *higher*) are 1.4650-1.4700, 1.4900-1.4950, 1.5150-1.5175 and 1.5800-1.6000

GBPUSD Client Sentiments:

- Clients selling GBP to purchase USD are believed to have covered the minimum of their requirements in line with their hedging policies as they hope for rates a little higher. Conversations with clients lead us to believe that many will have a renewed interest in purchasing USD should the rate move back to around 1.5000.
- Whilst clients selling USD to purchase GBP have yet to be tempted by the lowest rates we have seen in six years, we have seen increased requests for market updates as treasury managers seek assistance in understanding the motivations behind market movements. Many have indicated they are waiting to see the potential impact on Sterling of the lead up to the UK's EU membership referendum.
- We have seen limited restructuring activity as existing hedges are serving primary purpose of protection, and rates have been accounted for in the budgeting process.
- A few exporters (sell USD / buy GBP) hedged around the 1.5500 to 1.6000 region are starting to face a squeeze in light of mark to market numbers and look at solutions to cap future MTM.
- Some exporters made a conscious decision not to add to their hedging in Q4 2015, as the majority consensus was of USD strength to come in 2016. These clients have begun to come to market for their 2016/17 hedging, with the move below the 2010 election low a psychological entry point for a few.

GBPEUR Spot Volatility:

- In 2015, GBPEUR had an intraday trading range of 1.4417-1.2699, a 1,718 EUR pip range.
- Since the start of 2016 we have seen moves from as high as 1.3675 down to 1.2663, a 1,012 EUR pip range. This move represents 59% of the range over the whole of 2015.
- 2015 saw Sterling strength against EUR at levels not seen since late 2007.

Short Term Technical Environment:

- Key short term **SUPPORT AREAS** (where you may see market interest to *buy* GBP in the event that spot trades *lower*) are 1.2900-1.2805, 1.2350-1.2310, 1.1825-1.1790 and 1.1120-1.1000
- Key short term **RESISTANCE AREAS** (where you may see market interest to *sell* GBP in the event that spot trades *higher*) are 1.3600-1.3700, 1.4200, 1.4750-1.4800 and 1.5300-1.5350

GBPEUR Client Sentiments:

- In contrast to GBPUSD we are seeing greater volumes of trades from EUR sellers and some restructuring activity.
- This is of a consequence of 2015 seeing EUR at its weakest against Sterling since 2007, which led to clients being a little lighter on cover in hope of better rates in the future. This is very similar behaviour to that displayed by our buyers of USD this year, and driven by similar events.
- A number of EUR sellers are looking to top up cover to more aspirational proportions of needs. An exchange rate of 1.2500 looks to be a desired level for these clients.
- Our EUR importers (sell GBP / buy EUR) have been largely unchanged, with some evidence of opportunist transacting on intraday rises.
- Sharp FX moves are highlighting to some clients the mismatch between the tenor they look to hedge and the pricing pressures they are under within their business. For example, some exporters set prices on a semi-annual basis but have traditionally hedged for 12 month periods.

LLOYDS BANKING GROUP'S COMMITMENT TO THE SECTOR

Lloyds Banking Group recognises the fundamental role that manufacturing plays in the UK economy. The Group has made a commitment of £1 billion in funding support for the sector each year from 2014 to 2017. Since 2014 the Group has provided £2.47 billion against this pledge.

We are supporting the industry through our sponsorship of the Lloyds Bank Advanced Manufacturing Training Centre, offering over 1,000 apprenticeships to help address the skills gap in the sector. Clive Hickman, Managing Director, said, "MTC has experienced over 25% growth during 2015 based on high value manufacturing market demand and our expectation is for similar growth of activities in 2016."

We at Lloyds recognise that manufacturing businesses have unique banking needs, and we are here to help you find the right financial package for your business in keeping with our pledge to Help Britain Prosper.

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