

Strong US dollar could lead to increase in restructurings, lawyers say after pound hits record low

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The British pound's collapse following the UK government's adoption of a tax cutting budget will impact all industries exposed to sterling income with dollar or euro costs, restructuring lawyers have warned – but they noted that most businesses should have hedged against currency fluctuations.

On 26 September, the British pound dropped to a record low against the dollar reaching US\$1.03, after UK Chancellor Kwasi Kwarteng announced a new budget providing £45 billion (US\$48.8 billion) in tax cuts three days prior.

As GRR was going to press, the Bank of England [said](#) it was "very closely" monitoring developments in financial markets and that it would "not hesitate to change interest rates by as much as needed to return inflation to the 2% target sustainability in the medium term".

Shearman & Sterling partner **Alexander Wood** in London says the pound's collapse "is yet another shock to the economy that will impact consumers, business and ultimately market confidence".

Wood points out that the cost of certain key goods like oil and gas, which are based on dollar prices, and other foreign-manufactured goods will increase, from their already high levels caused by the Russia-Ukraine war.

"This will add to the cost-of-living crisis and inflationary pressures meaning that the Bank of England will be more likely to continue to increase interest rates, further putting pressure on corporate borrowers," Wood says.

Businesses paying for non-sterling imports with sterling revenue will also see their cost base increase, which will affect profit margins, he adds, noting that the cost of foreign supplies and even acquisitions, including strategic investments, will increase as well.

Wood notes that British government bonds – GILTs – have also been affected by the pound's collapse, pushing yields to a record high, and points out that parties like financial institutions holding such instruments will see significant volatility in their value.

Reuters [reported](#) that British government bond prices, which have been under pressure for months because of higher inflation and rising interest rates, collapsed on 26 September, pushing yields to their highest in over a decade, amid speculation that the Bank of England might need to take emergency action after sterling's collapse.

Typically, gilt yields rise or fall just a few basis points per day, but on 26 September the two-year gilt yield rose 54 basis points, the five-year gilt yield jumped more than 44 basis points and 10-year yields went up 33 basis points.

From Hong Kong, Appleby partner **David Bulley** tells GRR that while the pound's depreciation is unlikely to drive insolvencies and restructurings in and of itself, the Bank of England (BoE) is likely to have to accelerate policy tightening "in order to defend the currency and limit imported inflation given the pricing of commodities in US dollars".

Bulley explains that money markets are now pricing in around 200bps [basis points] of increases by November, and some are expecting an emergency statement in the next 24 to 48 hours from the BoE.

The Bank of England already [raised](#) interest rates by 0.5% to 2.25% on 22 September – its [second](#) 0.5% raise since 4 August.

But Bulley notes that sterling's weakness is "also a dollar strength story" and that is likely to drive additional restructuring work, as companies that have issued US dollar-denominated bonds but earn in local currencies will come under increasing pressure in trying to service that debt from their local revenue.

The strong dollar is a particular issue for Chinese and Latin American companies, he says.

Chinese companies have generally entered into lower levels of forex hedging because of the People's Bank of China setting a daily mid-point fix for dollar: yuan value, Bulley says, noting that hedging rates did increase in the wake of a 4% devaluation of the yuan by the People's Bank in August 2015.

Meanwhile, Bulley says Latin American companies may also suffer because hedging markets are "thin" and companies often hedge long-term dollar debt with short, often three-month swaps.

Hogan Lovells' head of restructuring, **Tom Astle** in London, agrees that "any industry exposed to sterling income but with dollar or euro costs will feel this – significant importers and the travel sector may be the most exposed".

"Most should have hedged against currency market movements, but this may be a question of degree and the scale of the shift here may not have been foreseen," he notes, adding that hedging only tends to cover only a limited period and "won't insulate forever".

Businesses will need to find a way to pass on their increased costs, Astle says, or they would see it come out of their bottom line.

Cleary Gottlieb Steen & Hamilton partner **Jim Ho** in London says the immediate knock-on effect on big businesses "may not be as great as feared" because of forex hedges – but "the major point of concern is whether this would have longer-term effect on the UK economy".

"It remains to be seen whether investor confidence in the UK is permanently shaken and whether the energy crisis and inflationary pressures persist," he adds.

Ho notes that from the perspective of foreign investors, UK assets are now appearing relatively cheaper "so they might look at UK targets with more interest".

The global markets appear to be pessimistic on the UK's growth outlook and public borrowing, McDermott Will & Emery partner **Aymen Mahmoud** in London adds, pointing to the pound's historic lows, as well as the fact the FTSE 100 Index is trading below 7000 for the first time since March and that two-year gilts trading at around 4%.

Although it's "difficult to imagine this dynamic being so sustained that it leads to a huge number of insolvent liquidations," Mahmoud says that confidence in sterling-denominated bonds needs to be shored up to avoid a "glut of restructurings".

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