2024

CORPORATE RISK MANAGEMENT OUTLOOK

MANAGING MACRO-ECONOMIC AND GEOPOLITICAL UNCERTAINTY

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Introduction

After several tumultuous years, the global economy is at a crossroads. The transition from post-pandemic shocks to relative macroeconomic stability will be characterised by a myriad of uncertainties, including growth, inflation, monetary and fiscal policy, geopolitics and various disruptions brought by the energy transition and artificial intelligence.

This paper aims to provide CFOs, Finance Directors and corporate risk managers with the necessary insight and tactical considerations across FX, rates, commodity, credit and equity markets not just to protect their businesses in 2024, but also take advantage of potentially favourable market developments.

The document is split into three sections.

In the first part, we share our views on how the macroeconomic transition could play out in 2024. We think there are an unusually broad range of plausible macroeconomic outcomes this year, so we have chosen a scenario-based approach to help assess how the various outcomes could impact on day-to-day risk management activities. Our base case is a soft landing with central banks pivoting to rate cuts in Q2 (BNP Paribas Markets 360 base case), but we also explore two tail-risk scenarios: a recession and a resurgence of inflationary pressures.

The second part focuses on geopolitical risks, which bring an additional layer of uncertainty this year. The ongoing conflicts in Ukraine and Gaza, increasing tensions between superpowers and rising protectionism are potential catalysts for new shocks to supply chains, raw material prices, inflation and global growth. Against this turbulent backdrop, over four billion people in 70 countries will be eligible to vote in elections this year, adding local regulatory and policy uncertainty. The most closely-watched will undoubtedly be in the United States where a finely-balanced contest between Joe Biden and Donald Trump could be the source of financial market volatility later in the year.

The final section looks ahead and asks how risk managers can play their part in repositioning their businesses for medium-term growth. For the past four years, responding to crises and building resilience has taken priority. We think 2024 will be the year when finance leaders shift from surviving to thriving. Several megatrends such as decarbonisation and artificial intelligence will accelerate investment and M&A as well as offer new opportunities for growth. Capturing this growth will require careful positioning at a time when inflation is still volatile, interest rates are still high and commodities are still susceptible to shocks.

Navigating the macroeconomic transition

The COVID pandemic outbreak in 2020 followed by the invasion of Ukraine in 2022 triggered a series of shocks which have defined the macroeconomic agenda for the past four years. We expect 2024 to be a year of transition to an era of greater medium-term visibility and relative macroeconomic stability. With risk factors to growth, inflation, monetary and fiscal policy still looming, however, the path to this transition is still unclear and we face an unusually broad range of plausible macroeconomic outcomes.

For this reason, we set out here our base case for economic developments in 2024, as well as two tail-risk scenarios.

Base case: soft landing and central bank pivot

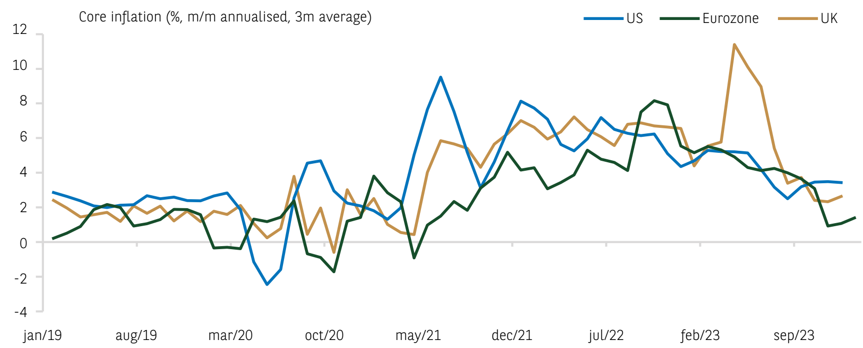
2024 should be a year of slower growth, cushioned by the start of a monetary easing cycle

In our base case, we expect restrictive monetary policy to continue weighing on economic activity and erode consumption and services, especially in developed markets. Amid tight labour markets, wage growth remains above levels consistent with a 2% inflation target, but we expect the activity slowdown to create the slack needed for services disinflation, while goods disinflation is likely to continue its 2023 trend.

Ongoing disinflation should lead most central banks to start easing, to avoid real rate increases or to stave off a material rise in unemployment. We expect the ECB to start cutting by 25bp in April this year, and the US Federal Reserve and the Bank of England to cut in June. We forecast year-end policy rates at 2.75%, 4.50% and 4.25% respectively. With monetary policy gradually providing support to activity, we do not anticipate a sharp recession in developed markets, with the US economy poised to grow at 2.0% in 2024 (vs. 2.5% in 2023) with a shallow deceleration in H1, then a small acceleration in H2. While the eurozone economy is currently stagnating, we expect some recovery this year, with GDP growth averaging 0.7% for 2024 (vs. 0.5% in 2023).

Japan and China are key outliers to this lower growth and disinflation story: in contrast to other G10 central banks, the Bank of Japan is likely to tighten monetary policy in 2024 as inflation finally picks up amid wage pressure and JPY weakness. We expect the policy rate to end the year at 0.25%. China's economy is likely to bottom out, but the recovery will be limited by structural factors: on the demand side, youth unemployment and property-sector headwinds are undermining household confidence, while manufacturing over-capacity, deflation and concerns over tariffs are weighing on the business outlook. China's fiscal policy support is also likely to be limited by the reduction of off-balance sheet debt at local level.

Inflation momentum in developed economies
(Graph n°1)



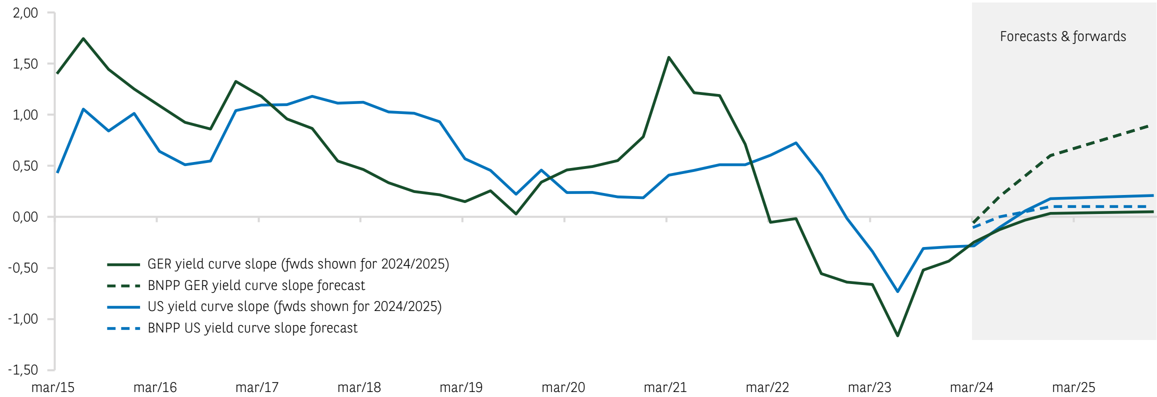
Sources: Macrobond, BNP Paribas

Central bank cuts likely to drive rates down, weigh on the USD and lower FX volatility

The short end of the yield curve is likely to benefit from the expectations and realization of interest-rate cuts. However, fiscal deficits and supply and demand dynamics should keep term premium under upside pressure. As a result, yield curves are likely to bull-steepen (short-term yields dropping more than long-term yields) and become upward-sloping (short-term yields lower than long-term yields) in Q2 2024 in the US, Q3 2024 in the eurozone and Q1 2025 in the UK. Compared to current levels currently priced by the market, we expect more steepening in the US and less steepening in the eurozone.

High levels of monetary policy synchronisation (apart from Japan and China) should limit FX volatility, apart from during elections (see below). In line with long-term fair-value levels, we expect the USD to weaken and engage in a bumpy long-term bear trend as investors who are currently overweight USD assets with low hedging ratios could now turn to non-USD fixed income or equity assets with positive returns. At the end of 2024, we forecast EURUSD at 1.15 and GBPUSD at 1.32. Reduced interest rate differentials should also support the JPY which we forecast at 135 vs. the USD. We expect the RMB to be range-bound vs USD between 7.10 and 7.30 until the Fed starts its easing cycle and then to strengthen towards 7.00 by the end of 2024.

BNPP expects rate curves to steepen (higher difference between long-term yields and short-term yields) in both the US and eurozone
(Graph n°2)



Sources: Bloomberg, BNP Paribas. "yield curve slope" estimated by difference between 10y and 2y points

Energy prices will be capped by slowing demand, but geopolitics could trigger upside volatility

We expect oil prices to be range-bound, floored by the prospects of OPEC+ production cuts and capped by expectations of an economic slowdown. We forecast Brent at USD 78/bbl in Q1 2024 and USD 83/bbl in Q4 2024, mirroring growth expectations. A mild winter and high storage levels should trigger a fall in gas prices in Q2 2024. As the storage season kicks off and winter consumption supports prices amid limited incremental LNG supplies, we expect prices to rise in Q3 and Q4 2024. Moreover, we expect EU carbon prices to be supported by the start of the economic recovery and the prospect of market tightness in the years ahead. USD weakness should also support higher and more volatile USD-denominated base metal prices in H2 despite lukewarm fundamentals.

Corporate credit spread range-bound, capped by rate cuts and floored by pressure on earnings

In 2023, corporate credit spreads were floored by tighter financial conditions and capped by resilient earnings. This year, the range should also hold, though for opposite reasons. By the middle of 2024, about USD130bn of corporate bonds will be maturing each month across the US and Europe, with investors expecting some sectors to reduce leverage. Earnings are also likely to come under pressure as margins normalise and financing costs rise as debt is refinanced. However, expectations of earlier central bank easing should support the credit markets. We anticipate wider dispersion across ratings (investment grade faring better than high yield) and across sectors (according to their exposure to a potential economic slowdown) in 2024.

We see downside risk on equities as earnings could disappoint

As with credit, central bank easing is likely to support equities. However, we expect the profit cycle to come under pressure. Corporate profit growth has already slowed and the combination of a slowdown in demand, normalisation of price inflation and the rising cost of debt upon refinancing may lead to margin disappointment. We see risks skewed to the downside in the US (where earnings expectations are optimistic), balanced in Europe (where valuations look consistent with the economic cycle) and we see upside in Japan. At end-2024, we forecast the S&P 500 at 5150 end-2024, EuroStoxx 50 at 4800, NIKKEI 225 at 35000 and MSCI China at 57.5.

The above outlook is our base case, however we also share two tail risk scenarios for corporate risk managers to plan for the unexpected.

Tail risk A: Recession

Central banks likely to respond by larger-than-anticipated easing, generating V-shaped recovery

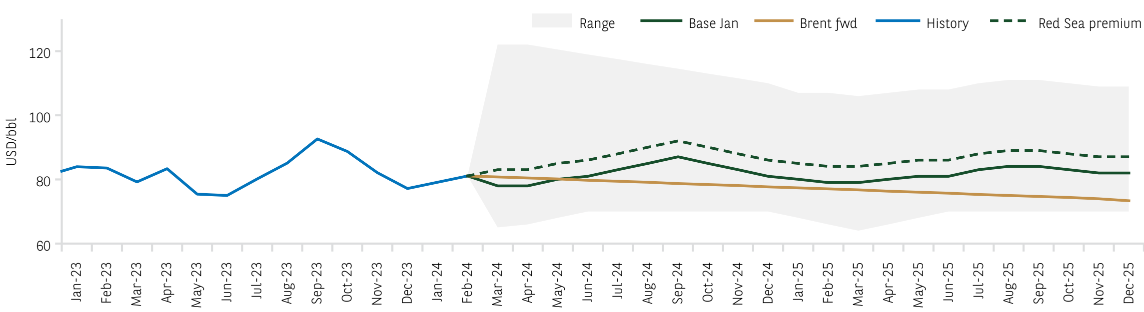
In this scenario, we believe the delayed effect of tighter monetary conditions would slow down the economy more than anticipated, leading to recession. Early-warning signals would be a fast-deteriorating labour market and a sharp decline in consumer spending on services. The slack created by rising unemployment and a slowdown in economic activity would accelerate disinflation. Real rates would rise, due to lower inflation, triggering a more decisive central bank pivot. In line with its dual mandate (sustainable employment and price stability), the Fed would be likely to cut rates more than envisaged and the ECB would engage in more aggressive easing to adjust real rates. The so-called 'central bank put' (expectation that central banks will ease monetary policy and support markets) is more effective at current interest rate levels than at zero rates and would support markets and investment. A V-shape economic cycle would be likely to unfold, in our view. The yield curve would steepen with short-term rates dropping faster than long-term rates. Interest rate differentials between the US and the rest of the world would narrow, with the JPY likely to rally thanks to a narrowing differential and its status as a safe-haven. The RMB would be supported by improving carry. Energy and metals prices would be expected to decline with softening demand. Credit spreads would probably widen on the back of weaker corporate earnings. Equities would be likely to suffer, and we would expect a 10-20% fall and higher volatility across equity markets.

Tail risk B: Inflation re-ignition

If inflation re-accelerates, wide risk-off sentiment could unfold as the central bank pivot – already priced in – would be compromised

We think this scenario would occur if geopolitical events severely affected supply chains and energy prices. A prolonged Red Sea crisis would allow higher freight costs to filter through into the economy, while an escalation of Middle-East tensions could lead to a disruption of oil and gas flows through the Strait of Hormuz, which could push Brent up to USD120 per barrel temporarily before demand destruction moderates the peak. Such events could reignite price pressures, compounding structural inflationary trends such as more regional value chains and climate mitigation costs, especially in the energy sector. Should inflation re-ignite, the central bank pivot currently factored in would not materialise and the narrative of higher rates for longer could resurface. We believe extended stagflation would be likely to unfold with the global economy at the bottom of a U-shaped economic cycle. Risky assets (corporate credit and equities) would come under pressure, as investors could not rely on the 'central bank put'. The yield curve could invert further, driven by higher short-term yields. The JPY and RMB would weaken due to punitive carry vs the USD. Energy prices would be likely to rally. Corporate credit spreads would widen, and equities would be likely to enter a bear market, driven by higher yields.

Brent price scenarios – Hormuz constraints would drive prices up
(Graph n°3)



Current base case versus Oil and gas forecast update: There is light at the end of the tunnel, dated 8 December
Sources: SPGCI, BNP Paribas

Risk management considerations

	Base case: Soft landing and central bank pivot	Tail risk: recession	Tail risk: Inflation re-ignition
FX	Structurally bearish USD, with moderate volatility: • Given the structurally bearish USD outlook, exporters across APAC including Japan may consider to lock in current levels. • With interest rate spreads expected to narrow, corporates could consider separating out the spot and carry components of their hedging strategies to capture the "best in both". • Lowered FX volatility would help corporates to buy protection cheaper than in 2023 and diversify risk profile. • Opportunistic net investment hedging of USD assets would also become relevant.	This will present a decisive global easing cycle, triggering the USD going through a three-phase route of stronger, weaker and then stronger again. • Option based solutions which protect corporates but retain opportunities to participate in case of trend reversals may be of interest, especially due to the timing uncertainty. • Narrow interest rate differential especially to JPY and CNY would support those currencies and corporates may consider carry optimisation strategies.	The USD would likely be supported as a safe haven currency amid higher volatility. Against this backdrop: • Exporters may wish to hedge with participating strategies, whereas importers could consider locking in levels to protect against EM blowouts. • With a higher USDJPY spot, Japanese importers may wish to use options over vanilla hedges to achieve better entry points. • Importers may consider a change in the tenor mix, such as prolonging tenor to obtain more discounts, or shortening tenor and roll to stay agile while taking short-end rates differentials.
Rates	With lower front-end rates and steeper curve: • Corporates with surplus cash may consider yield enhancement solutions as rates are expected to fall • Multinational corporates with cash trapped onshore in EM countries may look for similar solutions in local currencies. • Japan rates are largely expected to continue the upward trend and coupled with JPY appreciation may provide attractive investment opportunities in JPY assets.	Rates curves would be likely to steepen sharply from the front-end and JPY rates are likely to remain low. • Corporates may consider locking in and receiving higher USD fixed rate as rates are expected to fall. • Corporates looking to pre-hedge debt issuances could consider collars to benefit from a negative skew.	With central banks delaying their pivot, rates would be likely to bear-flatten with further curve inversion: • Pre-hedging debt issuance would allow corporates to benefit from attractive forward rate levels. • In a stressed scenario, corporates could anticipate potential debt market shutdowns and uncertainty on issuance windows by embedding flexibility in their rates hedging strategies.

	Base case: Soft landing and central bank pivot	Tail risk : recession	Tail risk: Inflation re-ignition
Rates	• Corporates intending to issue JPY debt may consider pre-hedging their rates exposure. • Low CNY interest rates present an opportunity for corporates to use the RMB as a funding currency. Corporates could consider CNY issuances or swapping existing USD borrowings to CNY.		• Swaps or caps to fixed can hedge term loan floating rate exposure. • If USDJPY CCS widens on global hawkish trends, using offshore funding may be attractive for Japanese corporates.
Commodities	In mostly range-bound markets: • Consumers and producers could use this opportunity to implement methodical forward-thinking hedge strategies (utilising swaps/options) across the commodity space. • Corporates may consider working capital solutions aimed at improving liquidity access and assets performance, such as gas prepay or post-pay.	With commodity prices likely to decline: • Consumers may look to blend and extend existing hedges to benefit from lower entry points. • Inventory financing solutions could allow corporates to benefit from a likely steep contango in forward curves. • Corporates may look to restructure existing hedging portfolios to optimise cash resources and adjust strikes to the desired protection levels.	Commodity prices, in particular energy, would be set to rally amid high volatility: • Consumers concerned by such a scenario may consider protecting from material cost base increases by extending hedge tenors and quantum. • In such a scenario, producers could further benefit from the commodity rally by hedging shorter- to medium-term exposures. • Corporates may consider liquidity swap strategies to manage commodity price volatility. • Unhedged consumers could benefit from likely backwardation in forward curves by extending hedge durations. • Corporates could also look to monetise their commodity inventory through outright sales or leasebacks.

<table>
<tr><th></th><th>Base case: Soft landing and central bank pivot</th><th>Tail risk : recession</th><th>Tail risk: Inflation re-ignition</th></tr>
<tr><td>Credit</td><td>Amid range-bound markets, corporates may consider opportunistically taking advantage of spread levels through debt issuance / debt buy-backs.

Corporates could review their debt maturity profile in light of the trade-off between lower short-end and more expensive long-end debt, taking the upcoming maturity wall into account.</td><td>Corporates may be concerned about refinancing at the bottom of the likely V-shaped economic cycle and could adjust debt maturity profiles accordingly.

With spreads likely to sharply widen, corporates could consider pre-hedging credit spreads through iTraxx solutions.</td><td>Credit markets may be driven by systemic rather than idiosyncratic factors, making iTraxx option hedges more relevant for corporates ahead of debt issuances.</td></tr>
<tr><td>Equity</td><td>Amid downside risk for equity markets:
Corporates could opportunistically consider share buy-back programmes to optimise their capital structure.
Corporates may look to offset potential dilution from share-based compensation plans.
Against a backdrop of choppy capital markets, promoters, owner-managers and financial sponsors will likely start exploring non-traditional equity derivative solutions to monetise or exit their stakes.</td><td>With equities poised to suffer in a recessionary environment and an increase in volatility:
Once the central bank put materialises, share buyback and dilution management solutions would become more relevant.
The IPO market may remain muted with sponsors looking to NAV loans, private investment back-leverage and private placements to raise proceeds.</td><td>Amid likely bear markets for equities:
Corporates could consider reinforcing their capital structure through equity capital markets when there is a market window.
The IPO market may remain muted with sponsors looking to NAV loans, private investment back-leverage and private placements to raise proceeds.
In view of the elevated volatility, traditional equity-backed financing may be converted into non-traditional equity derivative-based financing solutions.</td></tr>
</table>

Managing geopolitical risks in 2024

Increasing multi-polarity amid rumbling conflicts

The global environment is likely to remain volatile in 2024, with continued instability driven by Russia's invasion of Ukraine and the Israel-Hamas conflict, against a backdrop of US-China tension.

In this divided world, the persistent tension and increasing protectionism threaten to raise structural inflation and lower economic output. High government intervention in economies will persist, in our view. While companies continue to reduce supply chain dependency, further restrictions to trade and investment, such as the broad imposition of tariffs, still have the potential to trigger a wider global economic shock.

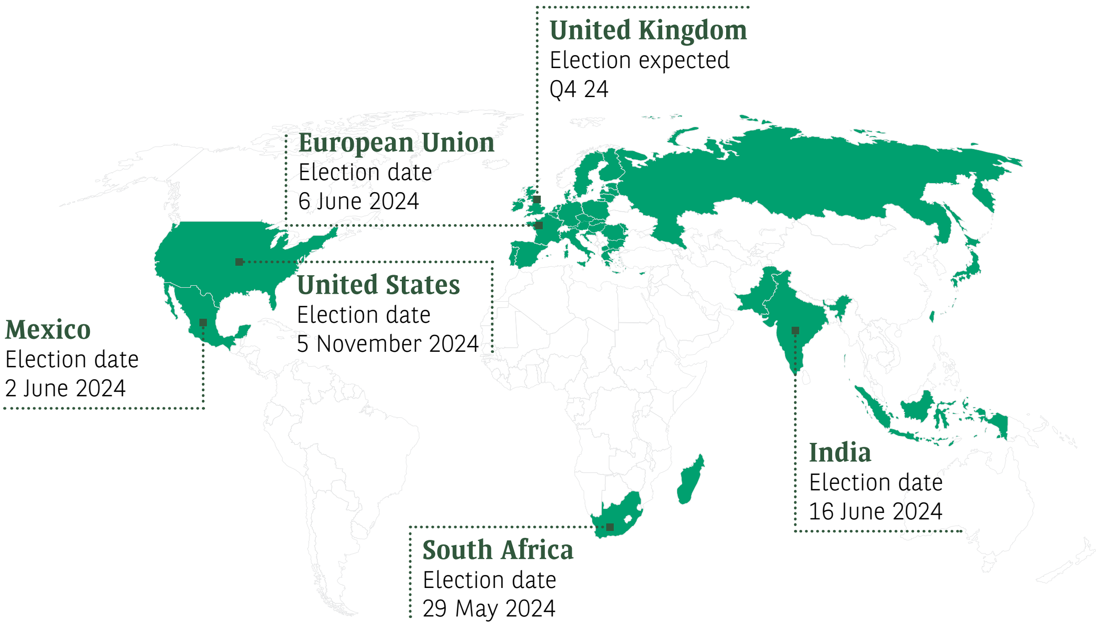
The consequences of the Israel-Hamas conflict are likely to define 2024. The pursuit of peace will continue, but we believe a severe escalation will remain a risk for some time. The attacks on ships in the Red Sea also threaten to disrupt the supply chains of industrial companies across Europe. Re-routing via the Cape of Good Hope adds more than two weeks to journeys, delaying arrivals of goods and bringing production lines to a halt. Were Iran to get directly involved in the conflict, leading to prolonged disruption of shipping in the Middle East, we could see the cost of certain supplies climb sharply to potentially add 50-100bp to current levels of inflation around the world, while also affecting global growth.

The conflict in Ukraine is also likely to remain a source of volatility for energy and soft commodity prices and growth, especially if escalation disrupts the current stalemate.

Election-mania

Against this backdrop of conflict, over four billion people in 70 countries will head to the polls in 2024. Election-mania will generate local regulatory and policy uncertainty as well as increased currency volatility, particularly in emerging markets.

Main 2024 election risks
(Graph n°4)



Source: BNP Paribas M360 – countries painted green will hold national elections in 2024.

Most ballots will be cast in Asia. Following the Taiwanese elections in January, the aftermath of Indonesia's elections in February will be watched closely considering the country's growing significance for mineral supplies. India's election in May will see Prime Minister Modi's BJP party face opposition from an alliance of over 20 political parties.

Attention turns to Europe ahead of the summer. In June, citizens of the 27 EU member states will vote in the European Parliament elections. The outcome will shape Europe's approach to climate change, immigration and support for Ukraine in the coming years. A UK general election is also very likely in 2024, with the opposition Labour Party currently leading in the polls, though a major fiscal shift is unlikely, in our view.

A host of elections across Africa (including South Africa, Senegal and Rwanda) will be watched closely for signs of regional instability, before attention turns to Mexico, where the ruling Morena party will look to defend its policies on energy and investment. Whilst the party is currently ahead in the polls and expected to remain in government, a more fragmented Congress is likely.

Barring any unforeseen circumstances, the grand finale to this year of election-mania will be a rematch between Joe Biden and Donald Trump for the US presidency.

A finely balanced election race and a divided US government are the most likely outcome. However, the risk of a Republican sweep and a more assertive – and likely inflationary – policy agenda is sizable and would be the strongest market mover. In a divided government, a Republican presidency would likely prove more market-moving than a Democratic one, considering that a dramatic rise in volatility is usually observed when the party of the president changes.

Risk management considerations for geopolitical risk

In the US elections, a 'red wave' scenario would be likely to support the USD and see higher US and global yields due to increased risk premia, tax cuts, higher tariffs and uncertainty about leadership of the US Federal Reserve. Corporates might wish to anticipate these potential outcomes by considering pre-hedging their debt issuances ahead of November. In a stressed post-election environment, treasurers might consider using the flexibility of options to achieve more attractive hedging levels across rates and FX. US corporates could also look to extend net investment hedging on high positive carry currency pairs like the EUR, CHF, CNY and JPY.

US election outcomes: likely market impacts across asset classes

Outcome	FX	Rates	Commodity	Credit	Equity
Democrat sweep or White House and split congress	Status quo with USD bearish trend likely continuing in medium-term	Mild sell-off: Market adjusts to more hawkish (than under Trump) Fed stance but continued flattening as less deficit spending expected	Despite record high US gas and oil production, clean energy subsidies to be expanded with impact on commodity markets	Status quo with spreads driven by monetary policy; IG outperforms HY	Decreased volatility, likely neutral to negative due to additional tax hikes and regulation
Republican sweep or White House and split congress	'America first' with likely increase in tariffs leading to USD strength outweighing negative impact of Fed easing	Rally: Dovish Fed chair and fiscal stimulus likely but also some curve steepening as deficit spending and tax cuts made permanent	Rollback regulations on oil and gas drilling leading to increased supply, but bullish scenario likely if instability perceived	Spread volatility driven by monetary policy; HY outperforms IG	Viewed as positive on tax cut and de-regulation expectations

Specific tail risks to look out in the UK elections would include a hung parliament which could force Labour to enter a coalition with the Liberal Democrats (likely leading to a stronger GBP on the back of closer EU-UK relations) or with the SNP (likely weighing on the GBP due to potential debates about a second independence referendum for Scotland). GBP volatility could spike in both scenarios.

Other market-moving election-related tail risks include a potential coalition in South Africa, with an ANC minority likely to weigh heavily on ZAR, in our view. In Mexico, if the incumbent coalition secures a qualified majority in Congress – and therefore the ability to pass constitutional reform and delay fiscal reform – we believe the peso would be likely to depreciate. Corporates with material exposure to the MXN or ZAR may therefore consider increasing hedge ratios and tenors to protect against such events.

Corporates concerned about an escalation of current conflicts or a spike in global trade tensions could look to protect against an increase in energy and agricultural commodity prices, as well as against a re-ignition of inflation described above.

More broadly, corporates with significant businesses or assets in countries and regions exposed to geopolitical risk may look to initiate or add to existing net investment hedging strategies to protect against a sharp depreciation of local currencies. In the current low volatility environment, corporates might consider implementing net investment hedging through options, or purchasing USD calls to protect at low cost against a wider range of extreme events.

We will regularly update our thoughts on these risks and other key 2024 elections.

Repositioning for medium-term growth

From surviving to thriving

The last four years tested the mettle of finance leaders. Faced with a confluence of crises and disruptions, they focused on responding to shocks and building near-term resilience. Many companies were forced to restructure their balance sheets, reconfigure their supply chains and reposition their businesses to defend market share in a more turbulent world.

This broad investment in resilience should provide a foundation for management teams to shift approaches and priorities in 2024: from surviving to thriving. Positioning for growth and new business-building will likely again become the most effective way to generate value for shareholders.

Funding the capex supercycle

The megatrends of energy transition, clean mobility and digitalisation stand to accelerate capex spending in 2024.

Despite higher volatility, higher interest rates, high inflation and elevated geopolitical tensions, infrastructure assets continue to attract investors seeking long-term income, stable cash flows and diversification. Renewable energy is a vital part of the puzzle, but decarbonisation is gaining speed across infrastructure assets, from transportation to the phase-out of coal in the utility mix. The first carbon capture and storage projects are beginning to come to the market for financing, and there are interesting early opportunities throughout the battery storage and green hydrogen value chains. This will require large volumes of new debt as well as solutions to manage new exposures to inflation, interest rate and commodity markets.

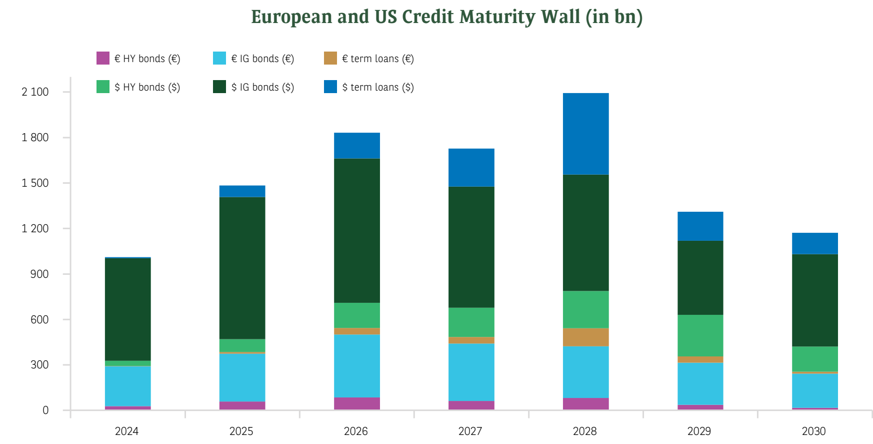
The innovation agenda in 2024 seems likely to be dominated by AI, which is already bringing both rapid advances and significant disruption across industries. Whilst ChatGPT has grabbed the headlines, the real innovation and productivity gains are likely to come from specific applications in sectors such as healthcare, education, software, banking and chemicals. Whilst many companies are rushing to invest in infrastructure for training AI models to improve business processes, AI's diverse potential looks likely to force profound change in the way companies operate, fund themselves and manage risk.

Dealing with debt maturities

This requirement to invest comes at a challenging time for some companies. The recent pace and scale of interest rate rises have pushed marginal funding costs sharply higher. Whilst many well-rated blue-chips have gradually lengthened debt maturities and taken advantage of attractive post-COVID funding windows to manage their borrowing profiles, others will need to scale a steepening refinancing wall in 2025 and 2026 to position for medium-term growth.

For example, the volume of US HY bonds maturing will treble between 2024 and 2025, and surge tenfold between 2024 and 2028. Many of these bonds were issued in 2020-2021 with 3-4% coupons, but in current market conditions cannot be refinanced below 8-9% due to a combination of higher interest rates and wider credit spreads. Against this backdrop, some companies will need to continue reducing their balance sheet leverage before turning their attention to investment opportunities.

Debt maturity wall in years ahead
(Graph n°5)



Source: Markit iBoxx, ICE BofA, Bloomberg, LCD ELLI, LCD LSTA

After a stronger start, we expect capital markets to remain active throughout 2024 with issuance likely to reach higher levels than 2023 across all client segments: sovereign issuers financing large public deficits, financial institutions increasing capital and liquidity buffers ahead of the Basel IV implementation and many corporates refinancing bonds and loans issued during the COVID crisis.

Many of these new financings will have higher coupons than was seen over the last 10 years. As such, corporate issuers will have to be opportunistic in terms of how and when they tap bond and loan markets, given fierce competition across the credit spectrum and the volatile macro and (geo)political environments. There may be a real advantage to capitalise on a strong market window to de-risk upcoming maturities, even though this may not correspond to optimal windows from an interest rate risk management perspective. This dichotomy could bring corporate treasurers to consider decoupling interest rate hedging from debt issuance.

Moreover, we expect continued diversification through private placements and synthetic foreign currency debt. Vanilla and structured private placements can offer access to different investor bases and provide an attractive pricing point for long-dated borrowers. Similarly, currencies like CHF and JPY re-emerged in 2023 as a way to broaden investor bases geographically.

Equity-linked considerations

Equity markets also offer diversification opportunities. One of the key trends in 2023 was a resurgence of convertible bond financings. According to Bloomberg, volumes rose throughout the year to USD 110bn, up 21% on 2022. This trend should continue in 2024 thanks to the strong performance of equity markets, which makes potential dilution at a premium to the current price an acceptable risk for many boards that are keen to keep the cash coupons of new financings at reasonable levels.

While the convertible bond market has historically been particularly attractive for non-rated issuers, it could attract a much broader range of borrowers in 2024. As managing dilution risk for shareholders also ranks high on the CFO agenda, we still expect corporates to consider solutions to mitigate this risk, notably in the US via derivative overlays (e.g. capped calls and call spreads), which are contracts that corporates can enter into simultaneously with the financing in order to increase the effective conversion price of the notes.

M&A for growth amidst heightened scrutiny

Mergers and acquisitions activity fell in 2023. Soaring interest rates and inflation, supply chain disruptions, the aftermath of the 2022 energy crisis and heightened geopolitical tensions were not conducive to deal-making.

We expect M&A activity to recover gradually in 2024 as the macroeconomic environment stabilises and inorganic growth becomes essential for harnessing innovation and growth opportunities. However, corporates engaging in M&A should expect an increasingly complex regulatory environment across developed and developing economies.

In the US, for instance, merger control guidelines adopted in December 2023 formalise the Biden administration's stricter competition enforcement stance, placing greater emphasis on market share. In addition, the new merger filing form proposed in June 2023, if and when fully implemented, is likely to require significantly more time and effort from M&A parties ahead of US antitrust filings. In the EU, the recently adopted Foreign Subsidies Regulation has introduced a new filing obligation for most M&A transactions with an EU nexus, with wide-ranging information requirements.

In parallel, M&A transactions will face close scrutiny at the global level over national security. CFIUS in the US, for example, is subjecting more and more transactions to investigation and mitigation measures. FDI control regimes have been extended in Europe (with 2023 providing evidence of intra-EU transactions being blocked), China and Japan. Both the EU and the US are considering scrutinising certain outbound investments on national security grounds.

The new value chains created as part of the green transition are also bringing increasing overlap between typical infrastructure or project financing considerations and large-scale corporate investment projects, creating new hedging challenges for corporates (for instance, in non-recourse or JV setups). Financing transformational capex usually embeds long-dated interest rate, inflation, currency or raw materials exposures that also drive hedging discussions.

Risk management considerations to reposition for growth

Risk managers tasked with supporting this repositioning should look first to understand and quantify interest rate and credit risks associated with refinancing existing maturities or issuing new debt in the coming 3-4 years. Interest rate risks can for instance be managed with forward-starting swaps, caps, collars or swaptions linked to the financing reference rate, whilst credit risk associated with bond issuance can be proxy-hedged with credit indices such as iTRAXX. Corporates engaged in balance sheet deleveraging may also consider securing the terms of their debt buybacks through pre-hedging solutions.

With capital, credit and interest rate markets susceptible to volatility, an agile and flexible risk management approach will be important. This can be achieved by embedding time flexibility in hedges entered into ahead of a new issue, reviewing dynamically the future fixed/floating debt mix (or maturity of hedges) depending on market dynamics or with more frequent use of option-based strategies, etc. Options can also offer an attractive way of reducing future interest cost if there are levels at which a company would be happy to lock-in interest rates for future borrowings.

Companies looking to diversify funding sources through foreign currency, private placements ('PPs') or equity markets will need to work closely with their hedging partners to analyse the most cost-efficient, post-hedge financing instrument. In order to create synthetic foreign currency debt, companies will for instance need to enter into a cross-currency swap with an initial and final exchange. Understanding the mechanics of such a hedge and the embedded costs is an essential part of the foreign currency funding process. Similarly, vanilla and structured PPs usually require a hedge to convert the payoff requested by the investor to the one required by the company. In many emerging markets, funding variations are often numerous and complex. Understanding and mapping out the onshore and offshore routes as well as the tax implications of each can help in choosing the most cost-efficient structure.

For companies embarking on inorganic growth strategies, the current M&A environment described above creates an additional layer of complexity. Protecting potential future investments against adverse market moves will be a key theme and we expect more corporates to consider hedging solutions at earlier stages of the acquisition process.

Faced with longer timelines and uncertain regulatory and market developments, deal contingent solutions (i.e. derivatives that extinguish at no cost in case the underlying project / M&A does not materialize) are likely to remain an attractive way of managing exposures which will arise in the event of an underlying transaction completing.

Such solutions are best tailored to the situation and require careful preparation. Corporates may, for example, consider aligning their hedging strategy to the various potential outcomes of a public M&A process. They might also engage in hedging strategies well ahead of signing legally binding commitments, for instance by entering into net investment hedging soon after deciding on potential divestment of a foreign currency asset.

Decarbonisation: New financial risks

The green transition will continue to shape business agendas in 2024, along with climate and biodiversity risks. After a challenging 2023, we expect progress to resume this year as companies seek to accelerate their efforts to reduce emissions, transition to low-carbon processes and practices and embrace sustainable energy solutions.

For CFOs and finance directors, the energy transition not only brings new investment risks, but also new approaches to risk management, such as:

- Setting up financial metrics that reflect a company's specific journey towards sustainability and commitment to ESG principles;
- Implementing a cost-effective renewable energy investments strategy;
- Reviewing risk management policy to incorporate new financial risks stemming from the energy transition, a rapidly shifting regulatory landscape, new market volatility regimes and potential disruption of traditional energy sources.

Corporate treasurers are accordingly looking to design, update and implement a comprehensive carbon risk management strategy which requires access to carbon markets across the globe, whether voluntary (VERs) or compliance-based (EU-ETS, UK-ETS, nEHS, California ETS, etc.). These markets are quickly expanding their scope, both in terms of sectors (shipping and at a later stage construction and transportation to be integrated to the EU-ETS, phased entry into force of the EU Carbon Border Adjustment Mechanism) and country coverage. Corporates are therefore keen to benefit from sharing of knowledge with experienced practitioners as they navigate these new requirements.

Companies are also increasingly considering ad-hoc hedging solutions to mitigate price volatility and liquidity risks. For instance, BNP Paribas and some of its clients have already co-developed working capital solutions linked to environmental certificates. In 2024, we expect corporates will seek to develop similar risk management solutions tied to green power contracts, considering their rapid growth.

As more and more companies commit to 100% renewable electricity by 2050 (if not before), they also incur new financial exposures to manage. Last year saw a paradigm shift in energy procurement strategies as a result of price volatility in Europe, with increased use of long-term contracts and corporate power purchase agreements ('PPAs') as a hedging tool. In 2024, we expect corporates to display growing sensitivity to price and volume profile risks as they refine their understanding of PPA-related market risks.

We therefore anticipate continued interest from corporates in financial and physical hedging solutions on European wholesale power markets to reduce price risk and secure energy-linked cash flows. We also expect corporates to gradually commit to using green energy "24/7" via an optimised portfolio of wind and solar PPAs, which will also require solutions to smooth the negative impact of power cannibalisation risk, i.e. the negative correlation between power prices and renewables energy production.

Investment in low-carbon solutions also comes with increased raw material sourcing needs, in particular for 'green metals' such as copper, nickel, zinc, aluminium and cobalt. For a wide range of applications including electric vehicles and energy storage systems, lithium plays a specific role in corporate procurement strategies given its significant impact on the total cost of end products. In recent years, lithium demand has grown at approximately 20% per year and prices are expected to remain very volatile. Corporates are therefore looking to protect against lithium price volatility through financial hedges, with these efforts benefiting from increasingly clear indexation in commercial contracts – an important enabler for hedge accounting treatment. BNP Paribas is proud to be a key participant in the nascent lithium hedging market.

For some companies, the transition to clean energy will also alter considerably other core financial risks. For example, traditional oil and gas companies currently accelerating their investments in renewables find themselves creating new long-term interest rate risks from their project finance activities, FX exposures from multi-currency Capex, Opex and dividends (as projects generate local currency revenues rather than USD) or even revenue inflation exposures from Contracts for Difference or long-term inflation-linked PPAs. Moreover, the current competitive renewable landscape means many of these risk factors could make new projects unviable if they are not managed carefully.

Technologies

Harnessing the potential of AI and large language models to enhance and transform business models became top of mind across executive teams in 2023, and we likewise expect to see a greater adoption of digital innovation by corporate treasuries this year. New technologies will help treasurers navigate the complexities of financial risk management more effectively by improving efficiency through automation and enhancing decision-making processes, thanks to rule-based strategies.

In this context, BNP Paribas strives to become a partner of choice for corporates when it comes to digital innovation. As well as developing and investing in its own technology, BNP Paribas has partnered with fintechs to deliver state-of-the-art risk management services to clients across the globe. We are, for instance, in the process of leveraging our acquisition of Kantox to transform currency hedging workflows for corporates by offering a fully automated solution across exposures identification, rules-based market execution and streamlined trade reporting.

As we enter 2024, we intend to release the new Kantox "In-House FX" module, which enables companies to centralise FX management of subsidiaries, maximise exposure netting for the group and enhance available liquidity. These solutions help to free time for treasurers to focus on more strategic aspects of risk management.

Introducing new technology in risk management practices also provides many benefits when it comes to decision-making processes. Corporates with upcoming redemptions and high cash balances are for instance turning to innovative FX risk management strategies to reduce their cost of carry and/or optimise their fixed/floating ratio on a net debt basis through systematic strategies.

We also see that corporates willing to hedge net assets in foreign currencies are increasingly considering innovative strategies such as the dynamic hedging program (DHP). This model is based on pre-defined market signals to support our clients through decisions around FX execution and choice of hedging instruments. It was also designed to automate execution of our clients' multiple hedges in a single swap, with the strategy's performance paid at predefined dates, hence reducing operational and settlement risks. This solution has consistently outperformed the use of simple linear instruments over past years.

Conclusion

In conclusion, 2024 is expected to be a year of transition with slower growth, disinflation, lower interest rates and a return to positive yield curves. In this context, the USD is likely to enter a long-term bear trend and volatility will continue to fall gradually. Such a scenario should be beneficial to corporate treasuries as the cost of debt should normalise, input cost inflation should moderate and lower FX volatility should reduce the cost of hedging programmes.

In the unlikely event a V-shaped recession were to create additional uncertainty, central banks have the ability to address it forcefully and stimulate growth with aggressive easing policies. Corporate risk managers could take advantage of lower rates, inflation and commodity prices to lock-in favourable market parameters. For those with a strong capital structure, there may also be an opportunity to buy back equity cheaply.

An inflation resurgence scenario would be more disruptive. Rates would remain higher for longer, triggering risk-off sentiment and increasing volatility across asset classes. This scenario would need a careful, forward-looking risk management approach to protect the business and its cashflows from adverse financial market conditions.

Regardless of the macroeconomic path we follow in 2024, geopolitics is highly likely to play a key role. US elections stakes are high as they will impact fiscal and monetary policies, global trade, the energy transition and global security. This is a source of market instability and the market is already moving to price it. Corporate risk managers will need to build agility and flexibility into hedging programmes to protect competitiveness.

2024 also comes with opportunities. Two megatrends, namely energy transition and artificial intelligence will drive investment and generate growth. This expansion will bring new risks in inflation, interest rate and commodity markets, as well as the need for large volumes of new debt. As corporate risk managers reposition for medium-term growth, they will need to refinance existing debt and source new funding at historically high levels of interest rates. As such, interest rates are likely to remain a driver of strategic decision-making for some time. Furthermore, the era of benign inflation is behind us and even if it were to return to target rapidly, echoes of the past two years' price pressures will keep inflation and commodity prices sensitive to geopolitical tensions and more volatile than before. Consequently, we strongly believe that inflation has become a treasury risk parameter in its own right and that companies exposed to commodity input costs should put in place hedging programmes to mitigate the impact of potential supply chain shocks on their financials and competitiveness.

Corporate treasuries were instrumental in building resilience during the crises and shocks of the past 4 years. In 2024, a longer-term, forward-looking risk management strategy should allow many companies to capture growth and capitalise on the mega trends of decarbonisation and digitalisation.

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