BASTION
ADVISORY

Interest Rate Hedging: Now vs. Then

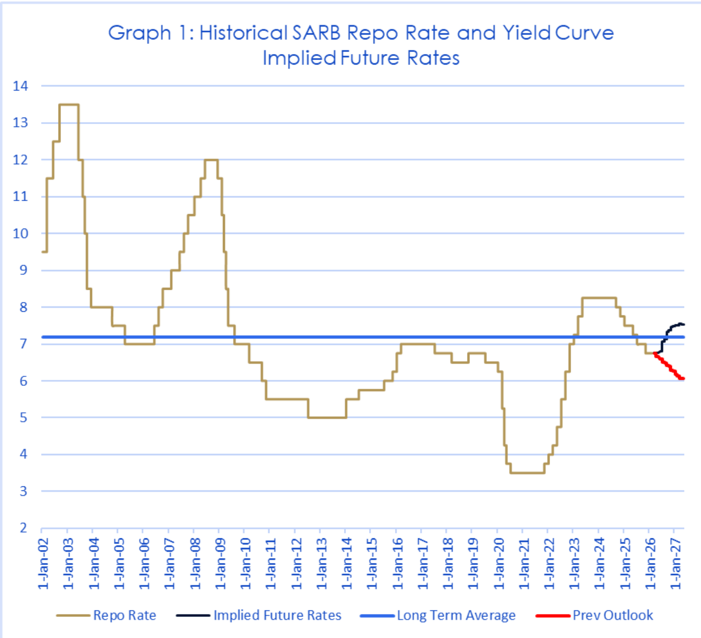
1 April 2026 vs. 1 February 2026

The past month has significantly changed the outlook for inflation, growth and interest rates in South Africa and globally. As usual, the smaller free-floating emerging market economies relying on international interest in their bond and currency markets are the first to the feel the brunt of any global economic crisis. The benign currency and interest rate outlook in early February has reversed quickly. This should remind the reader of geared companies and projects that a percentage of hedging, especially when markets are in your favour, is a prudent approach to financial risk management.

SA Interest Rate Cycle – Now vs. Then

The SARB kept rates unchanged at 6.75% at the March MPC meeting. As shown in Graph 1, the current repo rate rate remains 43 basis points below the **long-term average of 7.18%** (**blue line**). The **black line** illustrates the forecasted rates implied by the current yield curve, suggesting that the market now anticipates short-term rate hikes. As a basis of comparison the **red line** reflects the 1 Feb expectations implied by the yield curve following the January MPC Meeting. The change is 1.25%.

These revised hiking expectations are driven by the US-Iran war and its potential impact on inflation driven by $100+/barrel fuel prices echoed by commentary from the SARB MPC committee on 26 March, included below for reference;



'Moving to prices, inflation was 3.0% for February, with core inflation also at 3.0%. This is precisely in line with our target. Higher energy prices will raise inflation in the near term. We expect headline will soon accelerate to around 4%, with fuel inflation over 18% for the second quarter. Our baseline forecast then has a gradual unwinding of the shock, taking inflation back to 3% late next year.

The ongoing Middle East conflict is a clear instance of a supply shock, which raises prices while weakening demand. The standard response to a supply shock is to look through first-round effects, which are unavoidable and cannot be stopped by interest rate changes. At the same time, central banks should be alert to second-round effects, where an initial shock triggers broad price increases. Getting policy right means ensuring that the price response to supply shocks is transitory, and not persistent.

Given global uncertainty, it is useful to consider scenarios. For this meeting we looked at two alternatives, both with more adverse assumptions than our baseline. The first scenario assumes that the conflict lasts another two months or so, with oil prices averaging nearly US$100 per barrel for this period and the rand about 5% weaker against the dollar. The second, more extreme scenario has the war lasting over a year, with oil prices staying above US$100 per barrel and the rand 10% weaker.

In both scenarios inflation is higher, exceeding 4% in the first version and 5% in the second. Both call for higher interest rates this year, with one hike in the first scenario and several more in the other.' SARB MPC Statement 26 March 2026

Interest Rate Swap Market

While it takes time for policy rates set by the MPC to change trajectory, the traded interest rate swap market adjusts immediately to new and revised rate expectations. On 1 February, market participants were pricing in expectations of two to three interest rate cuts over the following 12 months, which was reflected in the lower yield curve. Borrowers were able to lock in fixed rates for two to three years at 6.30 to 6.40% vs. the prevailing 6.75%.

Graph 2 and Table 1 represent the current 3-month JIBAR fixed rate yield curve. Expectations of short-term interest rates, together with RSA government bond yields at longer maturities influence these term rates. The current yield curve (gold) when compared to the curve from 1 February 2026 (Black) and from six months ago (Grey) illustrates the progression in market-implied rate expectations.

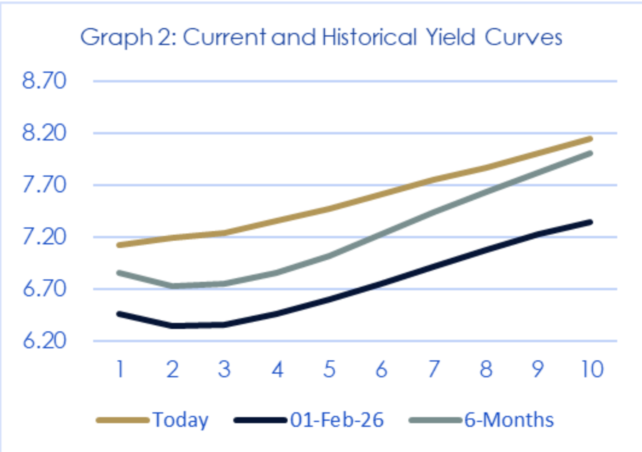


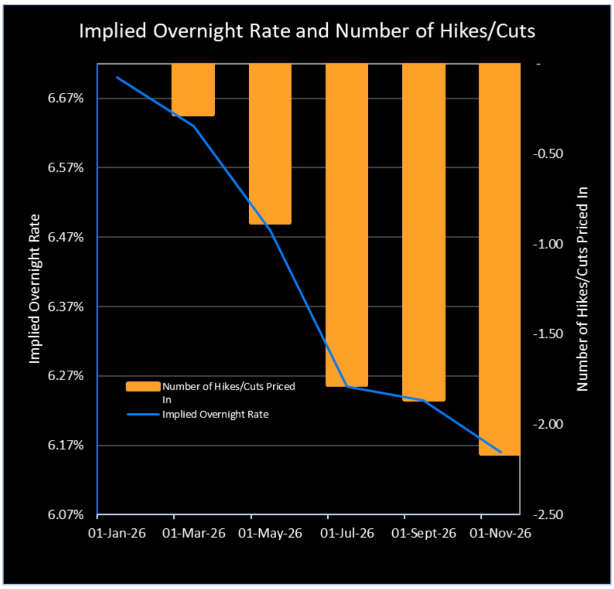
Table 1: Historic Yield Curves

Years	Today	01-Feb-26	6-Months
1	7.12	6.46	6.86
2	7.19	6.34	6.72
3	7.24	6.36	6.75
4	7.35	6.46	6.85
5	7.47	6.60	7.02
6	7.61	6.75	7.22
7	7.75	6.92	7.43
8	7.86	7.07	7.63
9	8.00	7.22	7.82
10	8.14	7.34	8.00

Through 2025 and early 2026, the yield curve had been gradually shifting lower. However, as the US-Iran war developed, the curve has moved higher and changed shape. Previously, the "sweet spot" was in the 2–3 year range, but the curve now appears almost linear, pricing future interest rate hikes.

This is reflected clearly in the short-term rate expectations implied by the FRA market. The graphs below show South Africa's implied overnight rate over the coming year. The market was previously pricing in two additional rate cuts this year; however, it is now indicating just under two and a half hikes, bringing the implied rate to 7.29% from 6.75% by year-end. In contrast, US short-term rates are largely flat, with expectations of rate cuts this year having been fully eroded. Unlike South Africa, the US is not currently pricing in immediate rate hikes

1 February 2026



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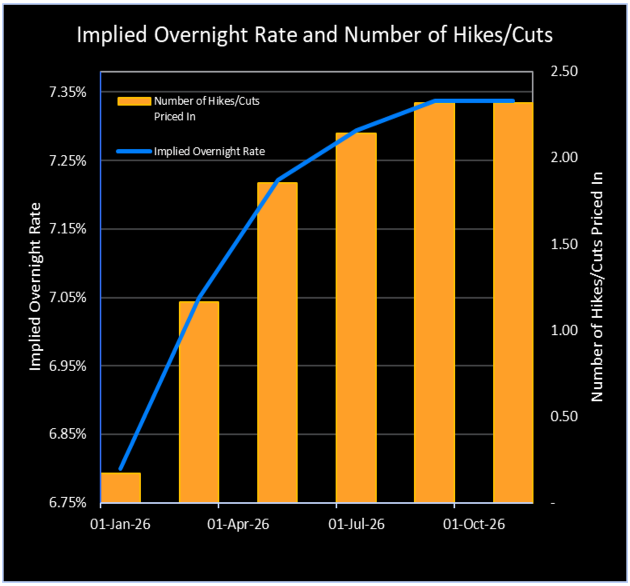


Interest Rate Hedging Strategies Now?

The extent to which any interest rate hedging should be considered in light of the risk profile of the borrower and current conditions for interest rate hedging:

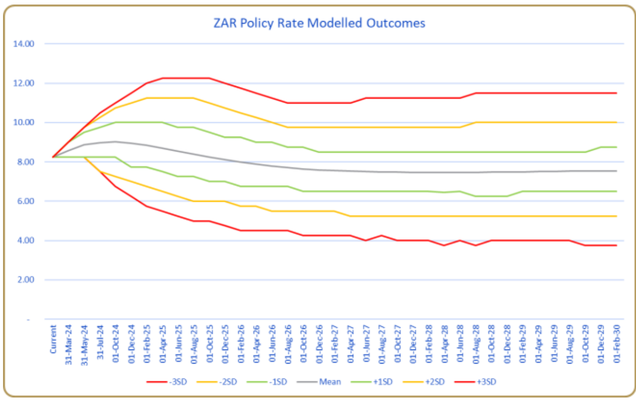
1. Higher geared/higher risk borrowers should always try and have a 'sufficient amount' (see below) of interest rate hedging for a rolling 2/3-year basis. As one will note from earlier interest rate cycles, 2 years of fixed rate will generally get you through most crises unscathed. Referring to graph 1, the hiking cycle post covid was 5% in 2022/23, the hiking cycle in 2015/16 was 2%.
2. For borrowers with lower gearing, we typically recommend a 25%-30%/two-to-three-year interest rate hedging strategy, but perhaps on a more 'opportunistic' basis. Existing clients will have been advised when we see deep discounts in the hedging markets against prevailing rates and when we believe there is very little downside to entering fixed interest rates at 0.50% less than prevailing rates. Further cuts by our generally hawkish SARB MPC are always risky to wait for.

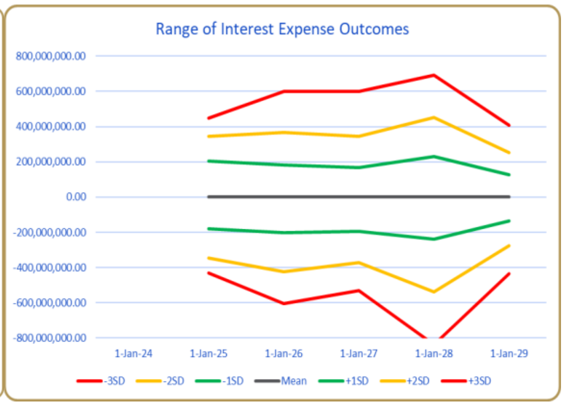
Based on this brief description it would still make sense for higher risk borrowers to consider interest rate hedging at 50bps premium to current rates if rate hikes of potentially up to 2% would prejudice your business.

A 'sufficient amount' of Interest rate hedging

Further analysis may be required based on project or company specific metrics, Bastion can run a future looking interest rate scenario engine to stress-test cash flows against interest costs or any other corporate metric. This process will quickly determine whether hedging is necessary and give guidelines on quantum and duration.

This method statistically determines the optimal hedging based on the borrower's risk profile. The process begins with Bastion obtaining the details of the term debt package. Using this model, Bastion conducts scenario analysis by applying a range of 1,000 or more potential future interest rate scenarios over the relevant period. The results are then reviewed across varying standard deviations of certainty to assess the range of potential interest rate cost outcomes and the likelihood of covenant breaches. The outputs would look something like this:





The borrower, in consultation with Bastion, would determine the appropriate standard deviation measure from the mean for interest costs and Bastion would design appropriate hedges to manage the risk within this range taking into account the costs or benefits of the hedges.

Conclusion

Then (1 Feb 2026):

Interest rate levels remain attractive relative to current floating rates and long-term neutral levels, particularly in the 2-to-3-year segment of the swap curve. While the SARB has paused its easing cycle, forward markets continue to price in further rate cuts over time, albeit at a more measured pace given global and domestic risks.

Now: 2 April 2026:

As indicated by the SARB, sustained higher oil prices, will result in inflationary pressures which would necessitate higher interest rates in order to curb inflation to the 3% target level going forward. There is wide ranging commentary on the War in Iran and the Strait of Hormuz. Even if the war itself ends, it is unlikely that normal shipping will resume in the Strait. As a result, there is a high risk of higher oil prices for longer. The most recent peak in WTI Crude was $120/barrel in early 2022 which correlated with the inflation spike and higher interest rates reflected in Graph 1.

Please contact Bastion directly to discuss any specific interest rate hedging questions that may be relevant to your organization.

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