Treasury Trends

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Treasury in a World of Increasing Geopolitical Uncertainty

Key Points

- It is always important to identify treasury risk
- Treasury's ability to support thinking across a business should be utilised
- Ensure policy and procedures documents, and strategies, remain current
- Consider a treasury healthcheck to support good governance

Utilise treasury's wider risk focus

In today's interconnected global economy, corporate treasury functions face an evolving set of risks, particularly in the context of rising geopolitical uncertainties. Political instability, trade disputes, economic sanctions, and regulatory changes all impact financial markets, supply chains, and currency valuations.

Management and directors need to be comfortable that all key risks are being identified in a timely manner within and across their respective businesses, sometimes requiring 'outside the square' thinking, and ensuring that all policy and procedures documents are 'current'. Treasury is in a unique position given its relevance to almost every facet of a business. Its understanding of risk creation and identification should not be underestimated for the wider good. Accepting there is value in treasury having input to many areas of operation, key areas to consider in the treasury arena include:

Foreign Exchange (FX) Risk

Fluctuations in exchange rates significantly impact multinational organisations as well as 'local' operators dealing with overseas suppliers and customers, whether transactions are in foreign currency or in local currency (creates indirect FX risk). Geopolitical events such as Brexit, trade wars, and sanctions can cause rapid change to base levels and ongoing currency fluctuations.

Interest Rate Risk

Changes in interest rates, often influenced by government policies, inflation concerns, and central bank interventions, pose risks to corporate debt financing and investment portfolios.

Liquidity Risk

Geopolitical uncertainty can disrupt financial markets and lead to sudden and unexpected liquidity shortages. For instance, banking crises, sanctions on financial institutions, or capital controls can limit access to funding and cash management services.

Supply Chain and Commodity Price Risk

Global supply chains are heavily affected by geopolitical tensions, such as trade restrictions, tariffs, and conflicts. Price volatility in raw materials, energy, and commodities can significantly impact corporate financial planning and profitability.

Regulatory and Compliance Risks

Increasing regulations, particularly in cross-border transactions, pose challenges for treasury operations. Sanctions, anti-money laundering ("AML") laws, and changes in tax policies can affect the ability to conduct business efficiently.

Strategies to Mitigate Treasury Risk

Implement Robust FX Risk Management

- Hedging Strategies: Organisations should operate within an approved set of policy controls and, as appropriate, employ forward contracts, options, and swaps to mitigate foreign exchange exposure. As always, ensuring the exposure numbers are up to date is the cornerstone of any hedging strategy.
- Diversification: Where possible, operating in multiple markets and transacting in different currencies can reduce reliance on a single economy.

Manage Interest Rate Exposure

- Hedging Strategies: Borrowers and investors can utilise hedging instruments within their portfolios to reduce interest volatility. Hedge accounting issues need to be considered ahead of entering into any hedging and, ideally, all hedging is part of a treasury plan.
- Strategic Debt Management: Building in a degree of flexibility to funding plans can be beneficial as it affords the opportunity to take

advantage of favourable market conditions to refinance, access a different market or new product, etc.

- Scenario Planning: Conducting stress tests based on different interest rate environments helps in better decision-making.

Strengthen Liquidity Management

- Maintaining Adequate Cash Reserves: Organisations should hold sufficient cash buffers to manage unexpected geopolitical shocks.
- Diversified Funding Sources: Where possible, establishing relationships with multiple banks and accessing capital markets can prevent overreliance on a single funding source.
- Centralised Cash Management: Implementing global liquidity structures, such as cash pooling, helps optimise cash usage and reduces financial inefficiencies.

Address Supply Chain and Commodity Risks

- Supplier Diversification: Reducing dependency on a single supplier or region can enhance supply chain resilience.
- Commodity Hedging: Using futures contracts and commodity swaps can help stabilise input costs.
- Nearshoring and Reshoring Strategies: Bringing production closer to key markets reduces exposure to geopolitical risks.

Enhance Compliance and Regulatory Preparedness

- Regular Compliance Audits: Keeping up with evolving regulations ensures that treasury functions remain compliant with international financial laws.
- Sanctions Screening Tools: Implementing automated compliance systems can prevent unintentional breaches of trade sanctions.
- Collaboration with Legal and Regulatory Experts: Working closely with legal teams ensures a proactive approach to regulatory changes.

How to navigate Treasury Risk

Case Study 1: Managing FX Risks as the company expanded, and entered new markets

A recent review for an exporter highlighted that FX impacts on the business were significant, having previously been ignored as considered immaterial. The company had seen expansion in existing markets and the extension into new territories. The Board took an active interest in setting practical guidelines for management to operate in, putting in place for the first time a treasury policy. To support policy implementation, and particularly for the recording of all FX transactions and the reporting against the policy, a 'small' treasury management system/solution was added to the mix.

With workshops run for the team 'in the field', an upskilling across the organisation of factors that impacted directly on the business' financial performance, has meant there is greater transparency around FX which has led to stronger management of the risk.

Case Study 2: Diversifying Supply Chains to Mitigate Trade War Risks

A local manufacturer heavily reliant on Chinese suppliers adapted to trade tensions by diversifying its supply chain to include Southeast Asian and Latin American partners. This strategic move, ahead of time having recognised the real or potential risk, has reduced its exposure to tariff increases and potential supply disruptions.

Case Study 3: Strengthening Liquidity Amid Sanctions

A local trading entity with operations in Russia encountered banking restrictions due to sanctions. By securing alternative banking relationships and enhancing its cash pooling strategy, financial stability and operational continuity have been secured.

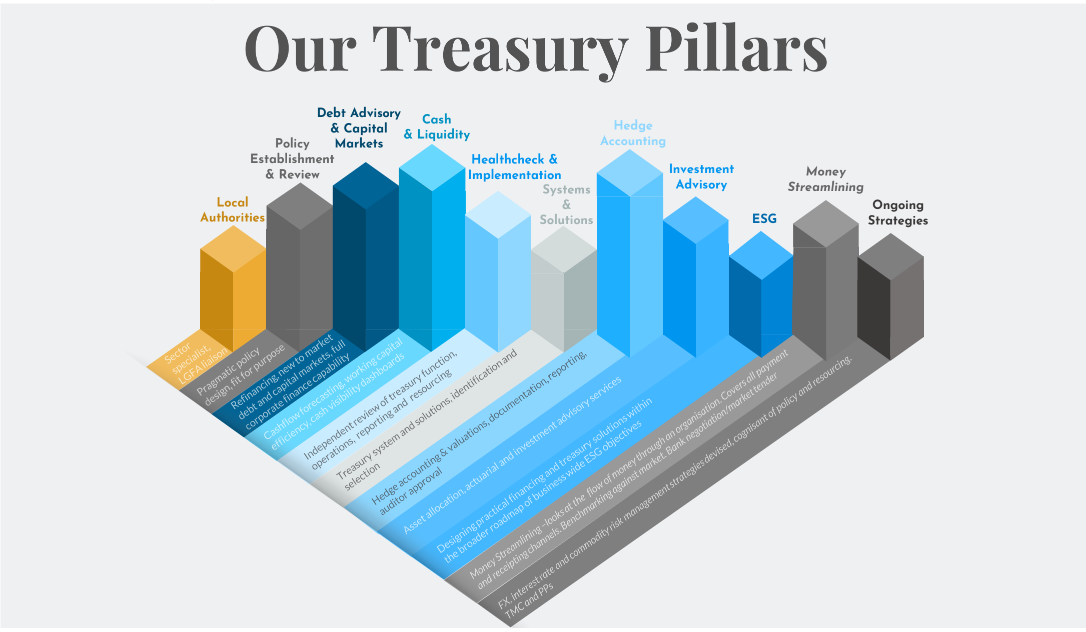
Time for a Treasury Healthcheck?

The corporate treasury landscape is becoming increasingly complex due to geopolitical uncertainties. Organisations need to adopt a proactive and multifaceted approach to risk management, recognising that risks that have perhaps always existed can and do change over time, and new risks emerge. Taking a step back from time to time, to review your risk register as well as the plans of action to manage such risks, is prudent.

Confirmation that what you think you are doing is what you are actually doing is a great comfort to most.

A treasury healthcheck can assist to ensure all is current and what is being done remains fit for purpose across all things treasury and banking whatever the operating environment. Please talk to your advisor if you would like more detail as to what might or could be in scope for such a review.

WHAT WE DO



BANCORP TREASURY & BARRINGTON TREASURY NZ

- Auckland
- Wellington
- Christchurch

Phone: +64 99127600

BARRINGTON TREASURY

- Sydney
- Melbourne
- Brisbane
- Gold Coast
- Perth
- Adelaide

Phone: 1800425079

BARRINGTON ASSET CONSULTING

- Sydney
- Melbourne

Phone: 1800425079

PMC TREASURY

- London
- New York
- Singapore

Phone: +64 99127600