MARKET UPDATE

Rates higher for longer: the energy shock and what it means for borrowers

November 2026

For many borrowers and investors, 2026 has not gone to plan. Financing budgets, valuations and hedging strategies set at the start of the year have been tested by an energy shock that pushed inflation higher and central banks into raising rates. After an era of benign rates, interest rate exposure has re-emerged as a key consideration for clients, who are not just looking at immediate exposures but at how their exposures evolve throughout the interest rate cycle. We look back at what happened, its impact and how our clients are responding.

~105bp

Fed year-end pricing above January expectations

5.70%

Peak 30-year US Treasury yield, highest since 2002

6.03%

Peak 30-year UK Gilt yield, highest since 1998

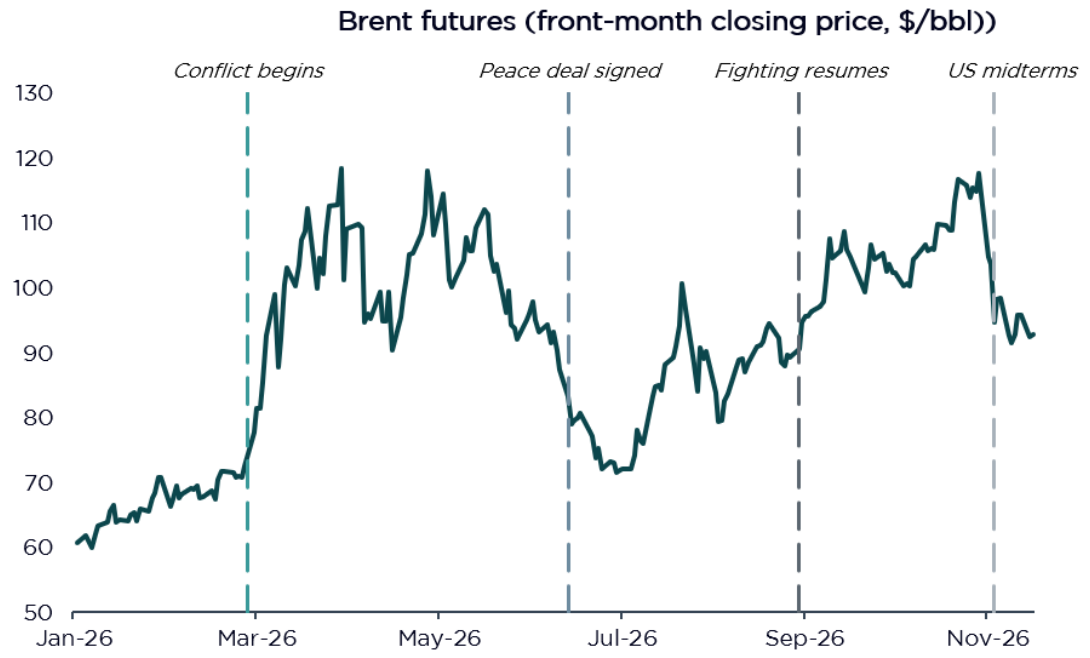
What happened and why

In January 2026, markets expected the Fed and BoE to cut by around 40bps by mid-2026 and the ECB to hold.[1] Inflation was nearing target and Brent had traded steadily at $60–70/bbl. On 28 February 2026, the US-Iran conflict began, rapidly escalating and expanding across the Middle East. Iran retaliated and closed the Strait of Hormuz, which carried around 20% of the world's oil and gas pre-conflict. Prices surged, gas most of all, as attacks later knocked out a sixth of Qatar's LNG export capacity for up to five years, a loss that reopening the strait would not reverse. A short-lived June peace deal brought oil back below its pre-war level, but gas saw little relief, and both rose again once the conflict resumed in late August.

[1]Source: Bloomberg as of 1 January 2026.

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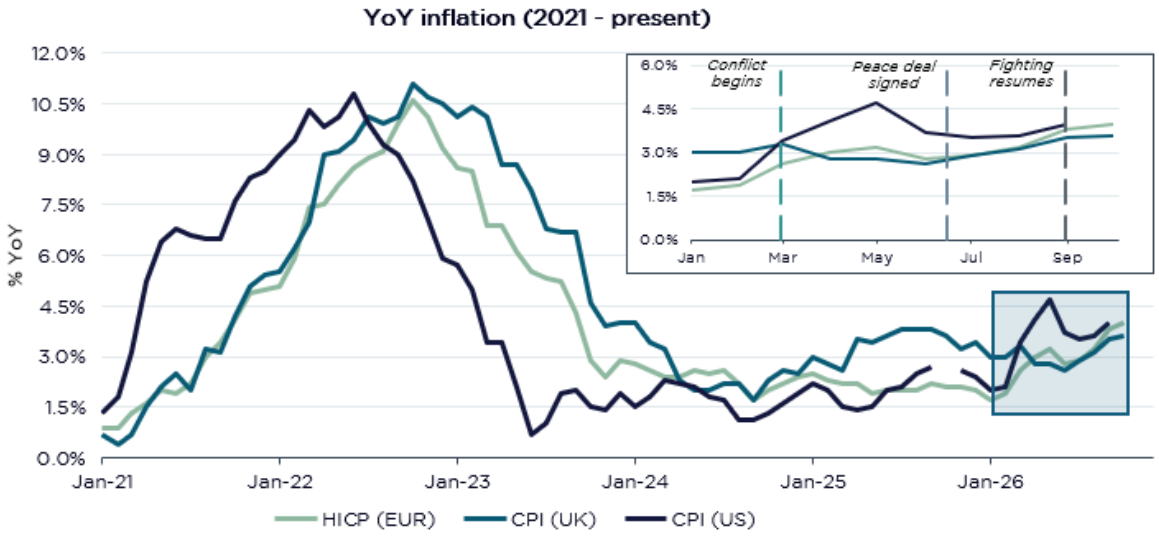
Figure 1 **Brent futures, front-month closing price ($/bbl.)**



Source: Bloomberg as of 17 November 2026.

Energy prices are a major input into headline inflation, with all three economies now running above their respective 2% targets.

Figure 2 **Year-on-year inflation, 2021 to present**



Source: ONS (UK CPI), Eurostat (HICP) and US Bureau of Labor Statistics (US CPI).

In the UK, the increase in headline inflation has started to spread into core inflation too. US and euro-area households expect inflation well above 2% next year. Central banks can look through energy shocks, as monetary policy (higher rates) won't impact oil prices, but will act once a shock spreads into second-round effects. This year all three central banks have been forced into action. The ECB, most exposed to gas, hiked first, in June and September, warning that persistently high energy prices risked pushing up wider inflation. The Fed, shielded by domestic gas supply, and the BoE, close to cutting in February, held out longer, but by the end of the year all three major central banks had begun hiking.

Table 1 **Implied vs. actual rates by major central banks**

	ECB	BoE	Fed
July expected	1.97%	3.38%	3.35%
July actual	2.25%	3.75%	3.75%
Gap (bp)	**27.7**	**36.6**	**40.5**
December expected	1.95%	3.36%	3.15%
December current pricing	2.70%	4.14%	4.20%
Gap (bp)	**74.5**	**77.6**	**104.6**

Source: Bloomberg as of 1 January 2026 and 6 November 2026.

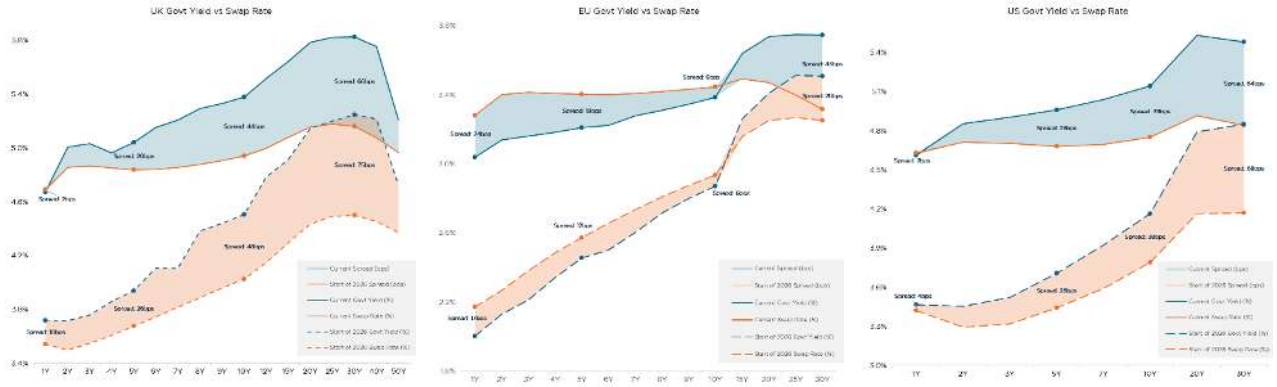
Rate expectations have swung with energy prices and year-end rates are now as much as 100bps above what markets had priced in January. With no clear resolution to the conflict in sight, geopolitical risks will continue to weigh on financial markets.

Impact

Cost of debt has risen

Higher energy prices have fed directly into the cost of debt. Central bank increases have been felt at longer tenors on the swap curve, impacting interest costs for unhedged debt. 30-year US Treasuries hit 5.70% (highest since 2002), while UK 30-year Gilts peaked at 6.03%, their highest since 1998. This is having an enormous impact on the cost of fixing new or refinanced debt.

Figure 3 **Government bond yields vs swap rates: start of 2026 compared with now (UK, EU, US)**



Source: Bloomberg as of 17 November 2026.

Reading the chart

Government bond yields and swap rates have risen across the UK, EU and US this year, most at the short end, where they are up by around 100bps. Conflict-driven energy price rises have lifted inflation expectations and pushed markets to price rate hikes, flattening curves. Swap rates have generally risen faster than government bond yields, especially at the short end, as swaps have priced central bank rate expectations directly, while safe-haven demand has supported government bonds. The exception is the long end of the EU curve, where heavier German borrowing has pushed Bund yields up faster than swaps.

In project finance, higher interest payments tend to lower a project's debt capacity and coverage ratios, which in turn reduces the debt sizing capabilities of the project, leaving sponsors to fund it with larger equity injections. For existing assets, a lower DSCR reduces headroom against lender covenants, leaving less room to absorb a weaker year or unexpected cost.

Pressure on valuations

Higher rates also feed into valuations. As assets are valued on their expected future cash flows, a rise in risk-free rates can push up the discount rate investors apply, reducing what those cash flows are worth today. Buyers who require a higher return may then price below seller expectations, widening the bid-ask spread. Assets offering stable, contracted revenues are still attracting strong interest, while those more exposed to rate risk are being priced at a discount.

Positive MTM position of existing swaps

For borrowers who did fix their rates before this year's rises, the situation is different. Higher rates have turned existing hedges into valuable assets, with swaps fixed below today's market levels now carrying a significant positive mark-to-market (MTM). In our experience, this value often goes unrecognised.

What are our clients doing?

With further hikes priced into 2027, Centrus is working closely with clients to protect financing costs and unlock value in existing hedges.

Locking in rates ahead of financial close

Waiting until financial close leaves projects exposed to market moves, often on a date driven by operational rather than market factors. Our clients are using two main approaches to reduce market exposures in advance.

- **Pre-hedging** fixes the rate ahead of close through an unsecured swap with a short-dated mandatory break date just beyond financial close. It is typically cheaper and more flexible, but if the financing falls through, the MTM must still be settled at the break date, which could result in a cost or a gain for the borrower.
- **Deal contingent hedging** locks in the rate in advance of signing, with the hedge only going live if the underlying transaction closes. If the deal fails, the hedge terminates at no cost, removing the MTM risk of a pre-hedge with no underlying debt to offset. The bank prices this contingency into the fixed rate, so the cost is marginally higher than for a standard hedge. A slightly higher level of due diligence is required, as the hedge provider needs to properly assess the probability of the deal closing.

With both approaches, the hedging bank does not always need to be one of the lenders, as hedges can typically be novated to the final hedging group at close. A sponsor guarantee or collateral can also reduce credit charges. We have put both approaches into practice this year across battery storage and renewables financings in Europe.

Getting trade ready: policy, documentation and bank lines

Where current rates sit above budgeted levels, some clients are preparing to hedge quickly should rates retreat. This means having target levels and approvals in place, ISDAs negotiated, credit lines agreed and counterparties lined up in advance. In volatile markets, the ability to act quickly can be as valuable as the hedge itself.

Swap restructuring to use positive MTM

Many existing swaps now carry a positive MTM, which can be put to work to release cash, extend protection or support new and refinanced debt. Each approach involves a balance between the cash released, future interest costs and the protection retained, and there is no single right answer. Any changes must fit within existing loan and hedging documents, and the impact of bank charges and hedge accounting should be assessed before execution. Restructuring is particularly worth considering alongside a refinancing, when debt and hedging terms are already being renegotiated. This year, Centrus has advised on a number of MTM restructurings, including partial unwinds of in-the-money swaps on large-scale renewable energy portfolios, releasing funds for construction while maintaining hedging coverage.

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CONCLUSION

Rates higher for longer is a reason to act now

2026 has shown how quickly the rate outlook can change and, with the energy shock unresolved, volatility is likely to persist. The Centrus view is that rate risk can no longer be an afterthought in the financing process. Hedging, debt financing and transaction planning are interconnected decisions that need to be considered at the earliest stage. With further hikes priced into 2027, now is the ideal time to engage with Centrus to review your hedging strategy and secure long-term value.

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