Fasten your seatbelts

WITH TREASURERS AND CFOs FEARING THE CONSEQUENCES OF WHAT LOOKS TO BE AN INCREASINGLY LIKELY BREAKUP OF THE EURO ZONE, IT'S TIME TO GET DOWN TO SERIOUS CONTINGENCY PLANNING. **PETER WILLIAMS** REPORTS.

As the mass downgrading in mid-January of the credit ratings of nine euro zone countries by Standard & Poor's illustrated, a sense of crisis hangs over the euro. And while we hope for the best, it is no more than sensible risk management to prepare for the worse. So the ACT, working with Deloitte, has produced a briefing paper on contingency planning for the euro.

It is clear that a breakup of the euro is worrying chief financial officers (CFOs) and treasurers. As well as compiling a euro contingency planning briefing with the ACT, Deloitte in its regular survey of CFOs found that UK corporates see a euro breakup as posing the biggest threat to their business in 2012; respondents put the chance of one or more countries exiting the euro in 2012 at 37% on average. According to Deloitte, UK corporates are unconvinced by the response of European politicians and policymakers to the crisis. CFOs believe a collapse of the euro would have a severe effect on UK businesses, causing a new credit crunch and driving major swings in asset prices and exchange rates.

Ian Stewart, Deloitte chief economist, says: "Against such a backdrop it is no surprise that a return to recession in the UK is, after the euro, the second biggest concern for CFOs in 2012. CFOs are now working on the assumption that Britain will fall back into recession. They see a 54% chance of the UK suffering a double dip, up from just 27% a year ago. The majority of respondents [64%] expect a prolonged period of weakness lasting more than a year. Moreover, financial stress is already affecting big UK corporates, with CFOs reporting the sharpest decline in credit availability since the third quarter of 2008."

The ACT/Deloitte paper (see Technical Update, page 09) helps treasurers consider the implications for their own companies. The possibility of a breakup of the euro is now being openly and widely discussed, even though a few months ago such a move seemed unimaginable.

The ACT notes: "The negative consequences of some scenarios are so severe that we sincerely hope that such final outcomes will be avoided. There is a strong imperative on Europe to find a solution to avoid the worst outcomes. Even so it behoves treasurers to be briefing themselves on the issues and possibilities."

The briefing paper notes that there has been a change in market sentiment, with media reports now regularly contemplating a country seceding from the euro or a wider euro event such as breakup.

Treasurers may have already been asked by boards for a brief on the implications of a euro breakup or unilateral secession by one country, irrespective of the legality of such a move. One of the challenges for corporates is that there are a range of outcomes and in such a fast-moving scenario it is not easy to ascertain which seem most likely. Contingency planning therefore remains a challenge.

Perhaps the problem is best summed up by Martin Sorrell, head of the world's biggest advertising agency WPP. He told Reuters news agency: "The complexity fills everybody with such appalling fear and is so complicated that the last thing in the world you want to happen is that. But the honest answer is that, like everybody else, you try and contingency plan for any breakup of the euro zone."

The time for testing your systems and planning the possible scenarios is now.

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The scenarios

The are three basic euro zone scenarios:

- Fiscal compact is agreed and targets are met.
- Germany and France lead move to fiscal compact and one or more weaker economies leave.
- Northern/stronger economies abandon the euro, forming new currencies which appreciate strongly while others continue to use euro or revert to a domestic currency.

Many questions remain unanswered – mostly of a legal nature – in these "what if" scenarios. It has been widely reported that there is no legal or jurisdictional basis for a euro collapse or unilateral secession, or expulsion. If a country were to leave the euro zone it would have to introduce legislation, and economic and fiscal measures in order to protect its financial credibility – possibly at the expense of non-domiciled corporates.