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The future of the euro

An economic perspective on the eurozone crisis

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Executive summary

The eurozone will face significant challenges in 2012. Austerity measures put in place by some members in an attempt to contain the consequences of the sovereign debt crisis will lead to a stagnation in GDP or a recession in all countries in the Economic and Monetary Union (EMU). A number of key economies need to refinance large amounts of government bonds that come due in the first quarter – Spain and Italy alone have to roll over €149 billion of bonds. Countries already excluded from capital markets will need additional funds from the European Financial Stability Facility (EFSF), the International Monetary Fund (IMF), and the European Commission. While reducing public debt levels and reversing the trend of diverging competitiveness within the eurozone need to be key priorities for policymakers, the near-term development of the eurozone depends on resolving acute refinancing and liquidity issues.

We see three possible broad scenarios for 2012.[1] Most likely, some governments will have to pay high premiums for newly issued debt or even struggle to find buyers. The European Central Bank (ECB) may therefore need to scale up its Securities Market Programme and play a stronger role than before. In an optimistic scenario, the liquidity squeeze would prove temporary and investors would begin to regain confidence in the solvency of all EMU members and start reinvesting. However, we cannot rule out events continuing to erode the trust of investors, making debt rollover impossible. If not counteracted by adequate liquidity support, this might lead to the break-up of EMU.

CEOs need to think carefully about how events in the eurozone might unfold and how they should respond. This paper explores the benefits that the euro has brought to EMU member countries, but also stresses fundamental flaws in the way EMU operates. It discusses scenarios for how policy might evolve and what we believe is necessary to return the eurozone to stability and growth. Finally, it offers some thoughts on how companies should think about positioning themselves.

Our key findings include:

Significant benefits. Four levers have brought substantial benefits to EMU members: the removal of nominal exchange rates within the eurozone lowered transaction costs, trade within the eurozone increased, competitiveness rose as firms benefited from economies of scale and scope, and investment and consumption were boosted by low interest rates. Together, these levers brought an estimated €330 billion in additional GDP in 2010 – 3.6 percent of eurozone GDP that year. However, the 17 EMU members benefited to different degrees, with almost half of the overall benefits accruing to Germany.

Fundamental flaws. The eurozone has lacked sufficient adjustment mechanisms to cope with the diverging performance of its members. Without the possibility of currency devaluation, members face an uphill battle to balance any loss of competitiveness due to increases in unit labour costs. Alternative options should have been deployed. These options are highlighted in Optimum Currency Area theory, which finds that workable monetary unions need flexibility in real wages and a high degree of capital and labour mobility to cope with temporary and asymmetric shocks. Alternatively, fiscal transfers between member coun-

[1] McKinsey & Company's German Office prepared this paper, based on in-house research, extensive discussions with clients across industries, and a large number of interviews with leading academics and economists.

tries can help to reduce economic imbalances. None of these mechanisms are sufficiently in place in the eurozone, and this has resulted in diverging competitiveness. Large and eventually unsustainable current account imbalances have emerged, particularly between Northern and Southern EMU members.

Markets created the illusion of permanently easy access to funds. Before the sovereign debt crisis became critical, sovereign bond yields declined and risk premiums of individual EMU members fell virtually to zero. Access to funds was apparently unlimited and inexpensive, creating the illusion of cheap money. Without taking a judgment on whether this is appropriate or not, markets have returned to pricing risk at levels similar to those seen before the introduction of the euro.

Scenarios. This paper discusses four scenarios for how policy might evolve:

- *Monetary bridging.* This scenario focuses on short-term policy action and particularly the provision of liquidity – essentially reactive crisis management that does not address achieving long-term fiscal stability or restoring competitiveness and growth. This scenario would not, in our view, regain the trust of the financial markets and would merely buy time for additional policy efforts aimed at putting in place a sustainable solution in the medium term.

- *Fiscal pact plus.* This scenario builds on the fiscal pact as agreed at the December 9 European Union (EU) summit, but complements this with three aspects that are essential to return the eurozone to stability. First, a more effective structure for EMU governance has to be created in order to ensure the coordination of economic policy, the consistent implementation of common regulatory rules and the supervision of pan-EMU financial institutions, the restructuring of the eurozone banking sector, and the monitoring of extensive structural reforms in highly indebted EMU member states. Second, investment in growth-supporting infrastructure and education, as well as in renewal, is necessary to strengthen the eurozone's productive capacity. This requires targeted fiscal stimulus in some countries to encourage new industries to develop and become front runners in innovation. Third, the EMU needs to re-establish investor confidence in the bond markets. To do so, it needs to support illiquid but solvent member countries in returning to a sustainable path with a new stabilisation facility – either with IMF backing or in the form of a newly created European Monetary Fund (EMF) with direct access to ECB financing – while at the same time enforcing strict conditionality on governments that receive support.

- *Closer fiscal union.* This scenario takes fiscal coordination beyond the arrangements on which Europeans have agreed. Countries in violation of debt and deficit limits would concede some of their fiscal sovereignty. Ultimately, this might also entail joint and several liabilities, elements of EMU-level taxation, the issue of eurobonds, an enlarged degree of joint economic government, and a substantial move towards more fiscal federalism, including increased permanent transfer payments.

- *Northern euro/euro break-up.* This scenario assumes that struggling economies leave EMU, leading to an immediate default, overshooting devaluation, and an implosion of the financial system. The remaining members might form a Northern euro – the N-euro. They would face the challenge of a substantial currency appreciation as well as a capital-strapped financial sector in need of bailout support. A break-up would have prohibitive costs.

The first scenario would not lead to a sustainable outcome. We believe that EMU will need to move in the direction of the second or third scenario. Failing to implement necessary changes may lead to the break-up of the euro – the most undesirable option with very high economic and social costs.

Corporate response. The four scenarios can be a good starting point for a company-specific analysis with the caveat that events are moving quickly and that these scenarios may need to be adapted. There is no standard recipe for how to deal with the euro crisis, but companies should assess two broad questions. First, from a precautionary perspective, how would the unlikely but possible event of a eurozone break-up affect their operations, and what emergency measures should they take? Second, to what extent should companies revise their medium-term operational and strategic planning in light of the likely difficult economic conditions facing the eurozone under all scenarios?

A challenging 2012 ahead

In order to substantiate our perspective for 2012, in this section we briefly review the main measures on which policymakers have so far decided, up to and including agreements taken at the December 9 summit.

October 26. Addressing challenging market conditions was the focus of the October 26 EU summit at which several measures were agreed with the aim of containing immediate pressure. The summit decided on a 50 percent haircut on Greek sovereign debt for private investors, a further leveraging of the EFSF, a second Greek rescue package, and a mandatory bank recapitalisation (to achieve a 9 percent core capital ratio by June 2012).[2]

December 9. In principle, the summit was an important step towards addressing the problem of structural deficits. Private sector involvement has been shelved, and the Greek case will be treated as an exception. A new fiscal rule was agreed (almost unanimously) by EU member states, including those outside the eurozone. The new fiscal rule states, "General government budgets shall be balanced or in surplus; this principle shall be deemed to be respected if, as a rule, the annual structural deficit does not exceed 0.5 percent of nominal GDP. Such a rule will also be introduced in member states' national legal systems at constitutional or equivalent level. The rule will contain an automatic correction mechanism that shall be triggered in the event of deviation." This is essentially a reinforced Stability and Growth Pact with a quasi-automatic corrective arm. Moreover, EMU members, some of them very reluctantly, intend, via their national central banks, to increase their contributions to the IMF for further support of current liquidity needs of individual EMU member countries. However, given that the agreement is purely intergovernmental, serious issues – especially with regard to the implementation of the agreed fiscal rule – remain. With an exclusive emphasis on austerity, these measures may fall further far short of supporting the way back to a sustainable growth path. Yet returning to growth is necessary to achieve the required primary surpluses in public budgets.

What does this mean for 2012? The most likely case is that we will see a continued liquidity squeeze in a number of EMU countries. While Greece, Portugal, and Ireland are already relying on the EFSF, the IMF, and bilateral loans for their refinancing, other eurozone coun-

[2] Since then, additional steps have been taken to address concerns about the rollover risk, such as moving up the start of the new European Stability Mechanism (ESM) by a year, to July 2012.

tries – especially Spain and Italy – will have to pay high premiums to roll over maturing debt. In 2012, Spain and Italy have to refinance record levels of €148 billion and €327 billion respectively (€36 billion and €113 billion of which is due in the first quarter). This would be a substantial drain on the stability facility's remaining funding power of €395 billion and may necessitate an extension of the EFSF/ESM.[3] Moreover, rising spreads in interbank money markets between unsecured and secured funds, and increased use of the ECB's deposit facility are signs that liquidity has also become an issue for financial institutions. All of this indicates that the ECB may have to decide further measures in addition to those that it already has taken.[4] In an optimistic scenario, the liquidity squeeze would prove to be temporary and investors would regain trust in the creditworthiness of the currently fragile EMU members so that they could once again issue bonds at comparably attractive coupon rates. In such a case, the economic outlook would gradually improve, in particular in the liquidity-squeezed economies, with positive ripple effects in Northern Europe.

However, uncertainty is still substantial, and the reluctance to invest in some EMU countries' sovereign debt remains significant. Political support for the new fiscal pact or measures announced by some governments may waver. Moreover, unsustainable fiscal policy and the urgent need for medium-term consolidation in a number of Western economies might add further problems. One should therefore be prepared for deficit targets not being achieved. All this could increase pressure – and call for ever bolder intervention or eventually trigger a break-up of EMU.

The reform the euro needs and why it is worthwhile

Over its first ten years, EMU membership brought significant benefits. The removal of nominal exchange rates lowered transaction costs and boosted trade within the eurozone; competitiveness rose as firms were able to profit more from economies of scale and scope; and interest rates were low, stimulating investment and consumption.

But alongside these economic benefits, it is clear that EMU has fundamental flaws. The eurozone has lacked sufficient adjustment mechanisms to cope with heterogeneity and to rebalance divergence among its constituent economies, shortcomings that could impose large costs on the single currency area.

The benefits of the euro

Being part of the EMU has significantly contributed to higher growth in the eurozone countries, fundamentally by driving and buttressing the integration of markets

[3] The EFSF still has €396.3 billion at its disposal but has already made large commitments, including up to €100 billion for a second Greek aid programme.

[4] In view of the systemic dearth of liquidity, the ECB has responded with a number of drastic measures, including continuing its full-allotment-at-fixed-rate policy, renewing a swap facility with the US Federal Reserve and other central banks, and extending the duration of its repo facilities for up to three years. The ECB has further cut the policy rate to 1 percent and loosened the eligibility criteria for collateral to less secure assets (accepting single-A-rated collateral for refinancing). In addition, the ECB has purchased more than €200 billion of GIIPS (Greece, Italy, Ireland, Portugal, and Spain) government bonds in secondary markets. This is done to support the transmission of monetary policy, but it might also entice banks to invest more of this liquidity in European sovereigns.

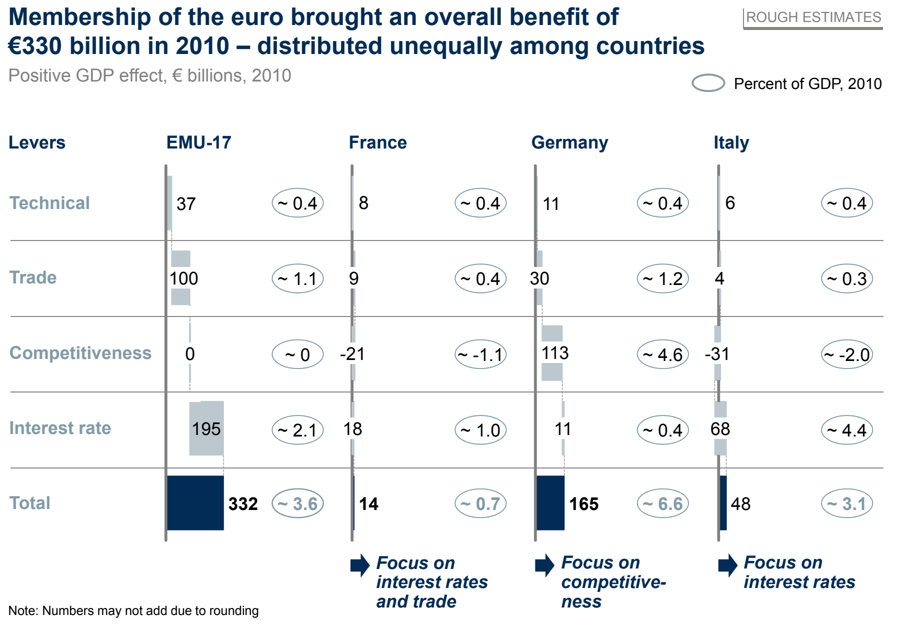

Exhibit 1

for goods and services that had been emphasised with the EU's Single Market Programme. By increasing price transparency and doing away with the need for hedging, a common currency effectively reduces economic distance, thereby making the exchange of goods and services easier and creating consumer surplus. With increasing economic proximity, markets integrate and trade intensifies. The abolition of exchange rate uncertainty and the introduction of common payment systems have increased the functional proximity between the economies of the eurozone.

We undertook a comprehensive retrospective analysis of the possible benefits of the euro since its introduction.[5] The result is a quantitative estimate of the economic benefits of the euro. Despite a great deal of discussion, such a calculation has been attempted only to a limited extent until now.

We estimate that the total benefits to the eurozone amounted to an annual €330 billion in 2010, or 3.6 percent of eurozone GDP in that year (Exhibit 1).[6] To arrive at this figure, we considered four levers in particular detail.

1. Technical lever. Eurozone economies have received benefits from the reduction of transaction and hedging costs that effectively operate like a tax on trade, reducing the profitability of exports and imports. Eurozone countries have benefited, in aggregate by about 0.4 percent of GDP – around €40 billion.[7]

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5 We have supplemented our analysis with conversations with a large number of business leaders, business economists, politicians, and academics.

6 This number is to be interpreted as the additional GDP compared with a growth path in a scenario without the introduction of the euro.

7 M. Emerson, D. Gros, A. Italianer, J. Pisani-Ferry, and H. Reichenbach, *One market, one money: An evaluation of the potential benefits and costs of forming an economic and monetary union* (Oxford: Oxford University Press, 1992).

2. Trade. Currency unions potentially create and divert trade. While initial estimates of the boost to intra-EMU trade were very high indeed, we concur with recent evidence pointing to a 15 percent increase in intra-EMU trade as a result of the introduction the euro. Putting this into perspective, this 15 percent increase accounts for half of the overall increase in intra-EMU trade volume of €600 billion since 1999. The rest is likely to have come from the further development of the EU's single market, more intense globalisation, and strong growth in the wake of the EU's enlargement to Eastern Europe. Intra-EMU trade increased in particular because countries specialised in production processes that best fit their respective strengths. Such specialisation generates efficiency gains that increase output beyond the levels attainable when countries produce a broad range of goods that are not necessarily aligned with their relative strengths.[8] In total, gains from additional trade contributed about €100 billion in additional GDP.

3. Competitiveness. Several effects are at work here. In Northern Europe, in particular, companies redesigned their value chains, investing in fellow eurozone economies. This strategy, which was strongly supported by the vanishing of exchange rate uncertainty, allowed them to reap the benefits from economies of scale and scope. Smaller, highly specialised companies benefited from a stable market that allowed them to export products easily on a larger, more cost-effective scale. In addition, some eurozone economies, such as Germany with its Agenda 2010, were able to boost their productivity by embarking on structural reform processes, especially with an eye to enhancing the flexibility of labour markets.[9] The gains in competitiveness that such economies have achieved were not offset by an appreciation of their currency against their trade partners, as would have been the case under flexible exchange rates. These factors resulted in higher output overall compared with the pre-euro era, as increased competition has set incentives to raise productivity in all EMU countries. The subsequent output gains that are common to all eurozone countries are not reflected in the small average change in the overall eurozone current account balance. Therefore, this figure underestimates the impact on competitiveness.

4. Interest rate. Since the euro was launched, rates on ten-year government bonds of eurozone economies have never been higher than around 6 percent, with very small differences among EMU countries. While this low level of interest rates (and interest rate volatility) reflected a general trend of low inflation as well as the so-called Great Moderation, spreads amongst single EMU member countries declined significantly.[10] Pre-euro, Greece's ten-year bonds had yields of up to 25 percent, while German government bond yields were nearer to 8 percent. These spreads reflected exchange rate risks, expected divergences in inflation rates, and differential creditworthiness. From 2001 onwards, the spread between government bonds shrank virtually to zero. Quite obviously, eurozone sovereigns' liabilities were treated as almost perfect substitutes. The no-bailout clause, Article 125 of the Treaty on the Functioning of the European

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8 To calculate the effect of increased trade within EMU, we used a trade-to-GDP multiplier to transform additional trade volumes into increases of GDP, consistent with the approach taken in academic literature.

9 Germany's Agenda 2010, introduced by then-chancellor Gerhard Schröder in 2003, has been the cornerstone of German reforms to regain its competitive position. It included action to make Germany's social system and labour market more flexible, which leant considerable support to wage moderation. Moreover, in response to the financial crisis, German companies managed to hang on to labour by adjusting hours worked rather than employment levels.

10 The Great Moderation refers to a period of low volatility in economic output and inflation, spanning from the mid-1980s to the late-2000s.

Union, was judged as not enforceable given the drastic consequences of a sovereign default on financial institutions. In total, the relative interest rate advantage delivered around €195 billion in additional GDP.

Looking at the geographical distribution of the benefits, a breakdown of data shows that all EMU countries felt a positive impact but to very different extents and based on different levers. The clear winners included Austria, Germany, Finland, and the Netherlands. Germany received half of the total benefits from the first decade of the euro's existence. Its euro membership contributed to an increase of an estimated 6.6 percent of Germany's 2010 GDP. This economy has felt the largest benefit from enhanced competitiveness and, to a modest degree, additional intra-EMU trade. Most other countries benefited from the euro, too, but to a much smaller extent. In Italy, euro membership was responsible for an estimated 3.1 percent of 2010 GDP. Italy enjoyed lower interest rates than would have been possible outside the single currency, delivering a benefit of an estimated 4.4 percent of GDP in 2010. However, this plus was cut to 3.1 percent because of Italy's weak competitive performance. The overall benefit to France was only 0.7 percent of GDP in 2010. France has benefited most from a lower interest rate than would otherwise have been the case and additional intra-EMU trade. Counteracting these positive effects was a loss of competitiveness equivalent to 1.1 percent of GDP.

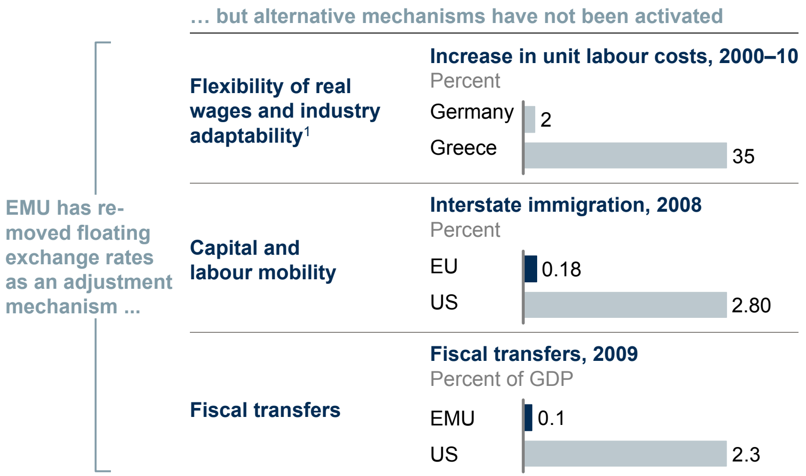
The first and second levers are comparatively stable and have the potential to increase further, while the third and fourth levers are contingent on policies pursued. They could therefore reverse for any individual member of the eurozone. We should also note that the benefits we have estimated are a snapshot of 2010. They do not take into account the potential additional costs of keeping the eurozone together. In order to understand the underlying reasons for these costs, we now turn to a discussion of the fundamental flaws of the eurozone.

The euro's fundamental flaws

Over the past decade, and even after the collapse of Lehman Brothers in 2008 and the bailout of AIG, there was a widespread perception that EMU was a success. However, the start of the sovereign debt crisis, triggered by Greece's confession that it had falsified its sovereign debt statistics, has brought into the spotlight fundamental flaws in the construction of Europe's Economic and Monetary Union – in particular a lack of sufficient adjustment mechanisms to cope with the diverging performance of its members.

Before the introduction of the euro, countries could potentially balance any loss of competitiveness due to increases in unit labour costs by a depreciation of their nominal exchange rate. With no ability to compensate for differences in country-specific price and cost developments through exchange rate adjustment, EMU needs to rely on other forms of adjustment that are well known in the theory of optimal currency areas. Three main mechanisms exist, none of which is present sufficiently in the eurozone (Exhibit 2).

Flexibility of real wages. If wages in a member country of a currency union are perfectly flexible, they fully reflect the relative productivity of that country. In economies with below-par productivity growth, real wages would fall in relative terms in order to maintain the level of competitiveness. In the eurozone, the development of wages has not been aligned with that of productivity over the past decade. Unit labour costs (a useful gauge of competitiveness) have diverged. Between 2000 and 2010, for instance, unit labour costs in Greece increased by 35 percent, compared with only 2 percent in Germany. This



1 Countries in EMU relying on globally less competitive industries have not been able to reorient activities towards more attractive sectors

SOURCE: European Commission; Eurostat; OECD; US Census Bureau; Tax Foundation; Bureau of Economic Analysis; McKinsey

Exhibit 2

amounts to a decisive disadvantage, in particular in price-sensitive industries. There is, therefore, a close link between the flexibility of real wages and the adaptability of industries to changing demand and supply. Some EMU countries have historically been strong in labour-intensive industries, such as shipbuilding and textiles, that are exposed to intense price competition and are thus particularly sensitive to exchange rate effects. The euro introduced a hard currency to all countries and emphasised the need for wage restraints to restore competitiveness in these industries – often beyond levels that can be reached realistically in developed economies. Consequently, the euro caused an imminent need for structural change towards new industries that are less focused on cost to avoid price competition with emerging low-cost countries.

Capital and labour mobility. EMU has led to a high degree of capital mobility and consequently deep integration of capital markets. As a consequence, intra-eurozone capital flows have increased substantially since the introduction of the euro. To the contrary, cross-border mobility of labour is low. Labour mobility means that unemployed migrate from low-growth regions to those that are booming, effectively redistributing labour to areas that can best absorb it and reducing unemployment in less competitive regions. The additional labour in well-performing areas eases upward pressure on wage inflation and preserves their competitiveness. However, in 2008, just 0.18 percent of the EU working population moved between member states, compared with 2.8 percent in the United States.

Fiscal transfers. A high degree of intra-regional labour mobility and adequate adjustment of wages to evolving productivity should be largely sufficient to prevent imbalances from arising within a single currency system. In reality, however, all lasting monetary unions in history have also used fiscal transfers to compensate for regional divergences and to deal with temporary imbalances. However, as EMU currently stands, transfers from the EU budget are too small to work as an adjustment mechanism. In 2009, eurozone members made gross contributions to the EU budget of €77.2 billion but net transfer payments among EMU members totalled

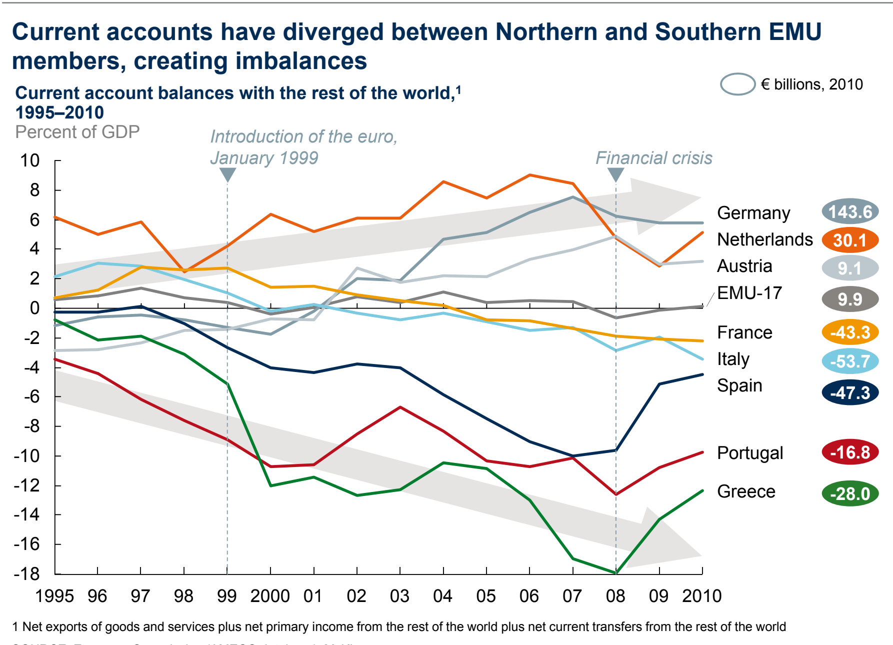


Exhibit 3

only €6.9 billion, or less than 0.1 percent of eurozone GDP – much smaller than conventional wisdom might suggest.[11] Transfer payments in other currency unions are significantly higher. In the United States, net transfers between states account for 2.3 percent of GDP.[12]

The three missing adjustment mechanisms have led to increasing heterogeneity among the countries of the eurozone, particularly in terms of their competitiveness, and this has been reflected in the development of the current accounts of EMU members. Large current account imbalances have emerged in the eurozone, particularly between North and South (Exhibit 3). In the Netherlands, Germany, and Austria, the average surplus between 1999 and 2010 was 6, 4, and 2 percent of their respective GDP. Meanwhile, Greece, Portugal, and Spain had average deficits of 12, 10, and 6 percent of their respective GDP.

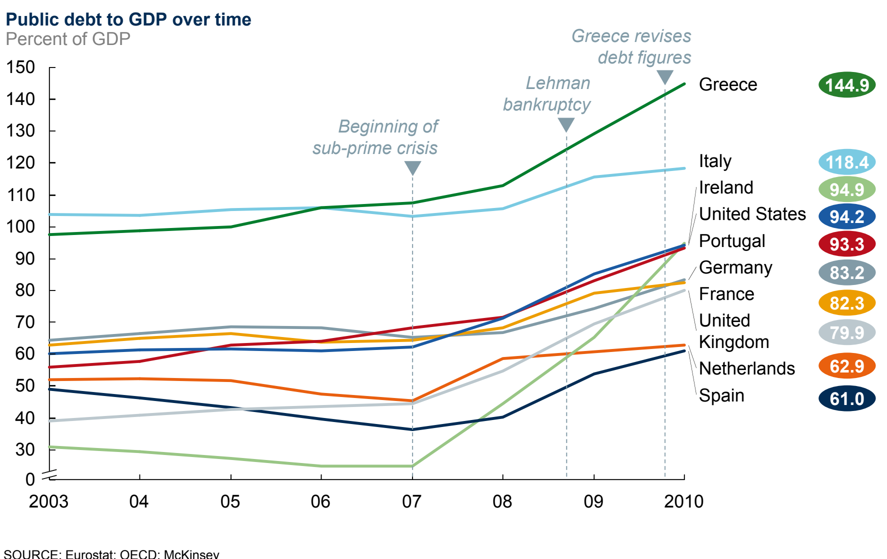
Not every current account deficit is an imbalance. If capital inflows, filling the gap between regional savings and capital expenditures, mainly serve to fund productive investment, this is a gainful activity. Debt that is accumulated over time can be serviced with revenues generated by these investments. However, if deficits are mainly run to fund consumption, public or private, or real estate expenditures, such deficits are less benign. Ultimately, deficits translate into ever-increasing net external

11 Net contributions to the EU totalled €20 billion, of which €6.9 billion can be ascribed to EMU countries, assuming that contributions are split up proportionately among net receiving countries.

12 There are two forms of fiscal transfers, both of which include a significant redistributive element. The first is an insurance mechanism aimed at temporarily balancing out asymmetric shocks to specific regions. These transfers are intended to support adjustment and might refer to a common unemployment insurance scheme or a monetary-union-wide fund to cope with regional banking crises. The second is redistributive fiscal transfers that permanently increase public spending and infrastructure provision in structurally weak regions. Fiscal transfers of the first type are practically non-existent within EMU.

debt, which may become unsustainable. This has happened in Southern European countries. In Greece, consumption was responsible for 92 percent of GDP growth between 2000 and 2008, compared with 72 percent in Northern European economies during the same period. Southern Europe had large, mainly private, foreign debts. Private debt levels increased even more dramatically than public debts, but, as the global banking crisis unfolded, a great deal of this private debt became public due to public bailouts of ailing financial institutions aimed at containing systemic externalities. Sovereign debt levels, which had been relatively stable before the banking crisis and, in some cases, even improved, now increased strongly. Some countries were more severely affected than others. For example, in Ireland, where the government was forced into a large-scale bailout of the severely hit financial sector, public debt increased from less than 30 percent to more than 90 percent and is likely to reach more than 110 percent in 2012 (Exhibit 4).

The financial and economic crisis of 2008 and 2009 triggered increasing public debt ratios in the eurozone



SOURCE: Eurostat; OECD; McKinsey

Exhibit 4

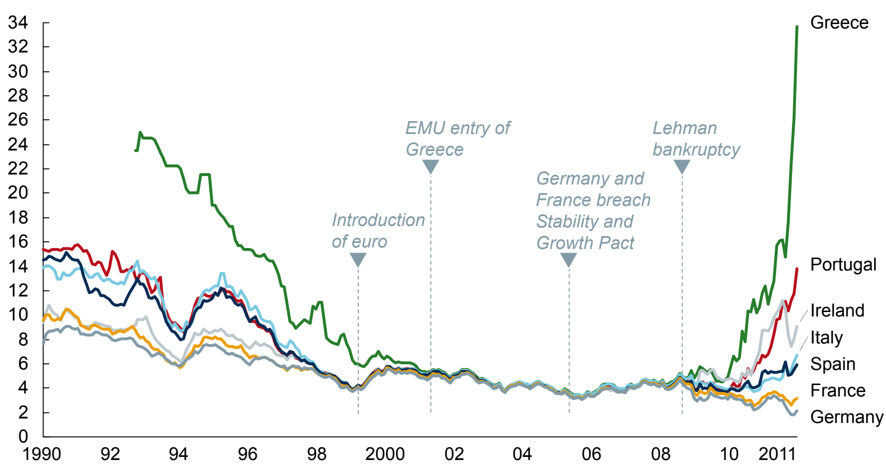
Today, almost all economies of the eurozone no longer meet the debt and deficit criteria laid down in the Stability and Growth Pact. In 2010, the weighted average fiscal deficit was 6.2 percent – more than double the 3.0 percent upper limit of the Stability and Growth Pact. Average debt in the eurozone was 85 percent of GDP, compared with the prescribed ceiling of 60 percent. This is, however, in line with what one would expect in response to a deep banking crisis.

The markets return to considering country risk

Capital markets have put a considerably lower price on risk on investing in the eurozone – and all its member countries – over the past decade than they did prior to 1999. Before the introduction of the euro, spreads on the bond yields of different European governments were high, reflecting inflation rate differentials and the perception that default and exchange rate risks were very different, depending on the European country. Greek bonds were trading 17 percentage points higher than German bonds in

1993.[13] But, remarkably, this country risk premium almost ceased to exist when EMU came into being. Given the fact that exchange rate risk was significantly lower – or even absent for investors within the eurozone – a smaller country risk premium was understandable. It is less easy to justify a zero-risk premium. This was apparently based on the perception that, in a crisis, eurozone governments could not, given the self-defeating consequences, abide by the no-bailout clause in the Treaty on the Functioning of the European Union. An immediate upshot of this non-pricing of differential default risk – treating every sovereign indiscriminately the same – engendered the illusion of cheap money, particularly in Southern Europe, leading to a real estate investment boom, strong consumption, and rising debts relative to income (Exhibit 5).

Capital markets did not account for different credit qualities, creating the illusion of permanently cheap funds



SOURCE: Thomson Reuters Datastream; Eurostat; McKinsey

Exhibit 5

It can be argued that, in response to the sovereign debt crisis, financial markets are now pricing risk at more adequate levels. Ireland, Portugal, and Greece, with their highly indebted economies, were the first countries to experience sharply higher rates from the autumn of 2009 onwards. But the contagion has now spread to other very large eurozone economies, including Italy, Spain and, although on a reduced scale, France. Tensions in sovereign debt markets are also reflected in interbank money markets where spreads between unsecured and collateralised funds have been widening strongly. Moreover, instead of taking out loans to other banks, many financial institutions are making increasing use of the deposit option at the ECB and accepting opportunity costs that are non-negligible. This behaviour illustrates that financial markets have lost confidence in the stability of the eurozone and are now assessing the underlying solvency of individual states within EMU. Regaining the trust of investors will take time. Governments will need to prove the credibility of their respective consolidation packages. Austerity alone will probably not do. Solvency requires a convincing medium-term growth perspective.

[13] This, however, does not take into account differences in inflation, which had been considerable in some countries prior to joining EMU.

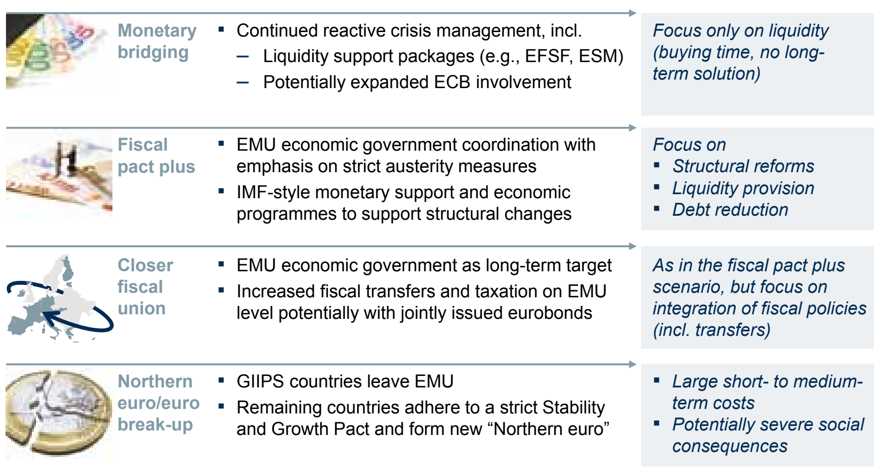
The future of the euro: Possible destinations and ways of getting there

Despite the considerable benefits that membership of the single currency has brought in aggregate over the past ten years, the crisis has placed a large question mark over the form EMU might take in the future and what its institutional underpinnings should look like. Based on our analysis of the fundamental flaws in the way EMU operates today, we find three key issues that the eurozone needs to address. These issues form the basis of the four scenarios we discuss in this section.

Stabilisation of government bond markets and interbank lending. To be credible, a no-bailout rule requires that externalities are manageable at reasonable costs. In particular, this implies a robust, European-wide bank restructuring and resolution scheme. A common regulatory rule book, including mechanisms for prompt corrective action, as well as the coordinated and consistent implementation of these supervisory rules are also required. However, without a backstop facility to prevent a liquidity problem from becoming a solvency issue, it will be difficult to restore trust in eurozone governments' ability to honour their debt. Despite potential moral hazard, policymakers therefore need to establish some form of lender of last resort for governments or issue jointly guaranteed public debt. Otherwise, volatility and interest rates will remain high and funding liquidity for government bonds low.

A robust line on public finances. Governments need to take a robust and smart line on public finances. This means simultaneously addressing requirements for the stabilisation of short-term output and long-term sustainability issues. Consolidating public debt will not suffice in most cases, unless eurozone governments aim collectively to achieve primary surpluses on an unprecedented scale. Fiscal health requires long-term efforts to cut implicit and explicit public liabilities relative to GDP. To achieve this, belt-tightening should be complemented by strategies to support growth.

We have developed four possible scenarios for the future of the euro



SOURCE: McKinsey

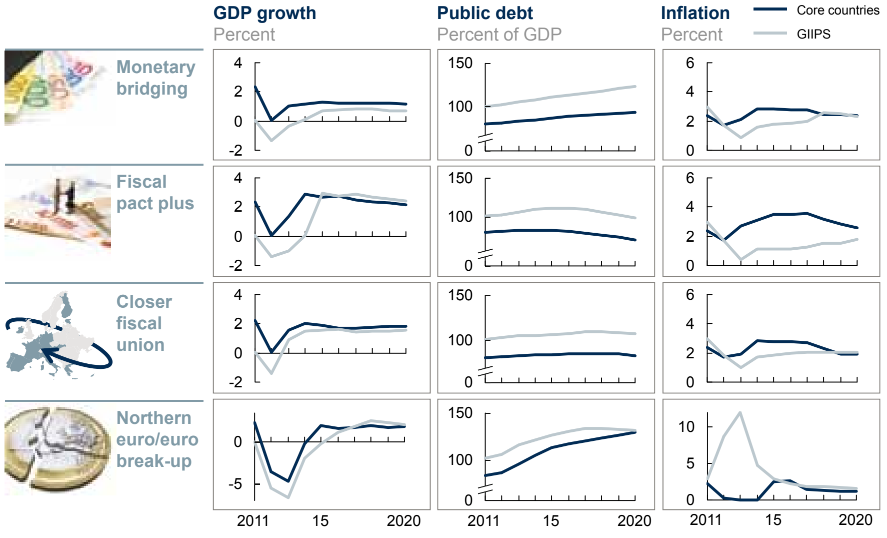
Exhibit 6

Governments also need to commit to sustainable long-term public finances by, for example, introducing constitutional or other credible forms of debt brakes and clear implementation plans to reassure markets.

A competitiveness and growth agenda to address the structural flaws of the eurozone. The critical issue of structurally renewing those EMU economies that have lost significant competitiveness over the past years is being overlooked.[14] Beyond reducing deficits, restoring industry competitiveness by increasing productivity is the core challenge to overcome the crisis. Governments need to design and pursue a growth agenda that encourages new industries to develop and become front runners in innovation. Governments would need to invest in growth enablers including education, R&D, and infrastructure, and to reform labour markets, regulation, and tax and social security systems. Moreover, institutional change will be necessary, including, as we have discussed, a common framework to put in place adjustment mechanisms to rebalance differences in regional performance as they occur, as well as a consistent implementation of financial market regulation and supervision. Addressing these structural problems would help not only to improve the competitiveness of struggling eurozone economies, but also to restore market confidence and reduce sovereign debt levels and deficits through potentially higher growth.

The four broad scenarios we outline show the range of potential directions EMU could take (Exhibit 6). Each involves different policy combinations. We examine the implications of each (Exhibit 7).[15]

The four scenarios have different macroeconomic implications – with a Northern euro/euro break-up scenario having prohibitive costs



SOURCE: Oxford Economics; McKinsey

Exhibit 7

[14] In the decade from 2000 to 2010, Greek unit labour costs increased by 35 percent, Italian costs by 31 percent, and Spain's by 29 percent. In contrast, the OECD average increase was 19 percent, with a 13 percent increase in Poland, 15 percent in Sweden, and 17 percent in the United States.

[15] We carried out extensive macroeconomic simulations in conjunction with Oxford Economics.

Scenario 1: Monetary bridging

This scenario is characterised by ineffectual implementation of existing agreements and reactive crisis management that tries to address ad hoc liquidity problems and budgetary deficits. This scenario does not focus on long-term fiscal stability or on restoring competitiveness and growth. Instead, governments introduce reforms of short duration that address only the most acute problems. The fiscal pact in its current state will not – or only to a limited extent – be ratified, and slow-growth, high-debt eurozone economies will not be able to meet tough limits on deficits.[16] The interventions of the EFSF and ESM will not be sufficient to reassure market participants, and this would force the ECB to increase its intervention to stabilise markets, a position

Inflation effects

The ECB is clearly a decisive player in efforts to stabilise the eurozone. It is not entirely implausible that circumstances could arise in which the ECB may have to ponder a rather unpalatable choice: either to use its ability to create unlimited funds and to deploy them in secondary markets, or to let the euro fall by the wayside. But would an ECB intervention lead, by necessity, to higher inflation? The ECB could control the monetary base (currency and bank deposits) in particular through its repo financing or sterilisation measures.[17] It is important to note, of course, that not any increase in the stock of central bank money is inflationary. A larger monetary base only leads to a commensurate increase in money supply, as for example measured by the broad monetary aggregate M3, if banks extend more loans.[18] Currently, the monetary wherewithal to fund inflation is not available (the money multiplier has been decreasing substantially). At the same time, as soon as an inflationary threat lurks, the central bank has the capacity to shrink its supply of central bank money, at least when it is independent or autonomous, as the ECB is. If there were a threat of bank lending outpacing the eurozone economies' ability to increase their productive capacity, sterilisation could be conducted to align the growth of money with the growth of output. Such sterilisation would become more demanding as the volume of purchases increased. Indeed, the non-inflationary capacity to create money, based on a simple discounting formula, is between €2 trillion and €3 trillion.[19] Over a short-run perspective, inflation largely depends on the economic environment. The existence of very substantial output gaps, further accentuated by current austerity measures as well as the attempts of banks to deleverage, makes inflation over the foreseeable future highly unlikely.

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[16] Applying the deficit rule retrospectively in 2009, for example, would have required eurozone countries to reduce fiscal deficits by €370 billion. This shows that any deficit rule can be meant as a long-term instrument only to revert budgets to sustainable levels.

[17] In reality (and under normal circumstances) modern central banking is of course about controlling short-term interest rates, the so-called policy rate. With interest rates at almost zero liquidity management, as an unconventional policy, became important in order to stabilise money markets.

[18] M3 is the broadest definition of money supply provided by the ECB and, according to monetarist theory, decisive over the longer-run (low-frequency data) for inflation perspectives.

[19] See also Willem Buiter (Citibank) and Goldman Sachs. These are rather conservative estimates, based, for example, on an inflation rate of 2 percent.

that is difficult to align with the central bank's statutory obligations. Important aspects of the discussion on the role of the ECB relate to inflation and currency effects (see text box "Inflation effects" on the left page).

Our analysis finds that, in this scenario, interest rate volatility would remain high and access to markets fragile. This would compromise consumer and industry confidence and constrain future economic growth. We think that the eurozone could experience volatility as high, and consumer and industry confidence as low, as they were in 2008 and 2009 after the bankruptcy of Lehman Brothers and the unravelling of the sub-prime mortgage bubble. Eurozone GDP growth would be weak, with average annual growth of 0.6 percent from 2011 to 2016. Debt levels would increase to an average of 89 percent of GDP in 2016 in the core countries and to an average of 113 percent in the GIIPS countries. Unemployment in the eurozone would increase to 11.4 percent in 2016.

In our view, financial markets still appear to be deeply uncertain about whether eurozone governments can do enough, despite the different monetary measures taken. Uncertainty remains high and investors critical. We believe that this scenario merely buys time, but with diminishing effectiveness, and that, at some point, politicians would need to agree on a path towards a logically consistent and economically sustainable solution. This would be a bifurcation point since it would either imply going down the road of a "fiscal pact plus" or closer fiscal union, or accepting the exit option of the break-up of the eurozone. The next three scenarios can be considered to offer stable end states for the eurozone.

Scenario 2: Fiscal pact plus

This scenario builds on the current policy proposals that focus on the so-called fiscal pact of the December 9 summit, including strict limits on budget deficits and proposals for strict enforcement for the eurozone. Countries are expected to observe a limit on cyclically adjusted deficits of 0.5 percent of GDP and to introduce constitutional debt brakes. Each country remains responsible for its own budget. However, the details still need to be hammered out. In this scenario, we complement the status quo with three aspects that are essential for attaining a sustainable, holistic solution. These are the promotion of policy coordination, the provision of liquidity, and a long-term growth agenda based on structural reforms to regain competitiveness (see text box "Lessons from Nordic countries" on the next page).

Effective EMU governance. Given the interdependence of EMU member countries, a higher degree of policy coordination is needed. In this scenario, adjustment mechanisms to compensate for diverging regional developments are strengthened largely by sufficient cross-border labour mobility and by adequate flexibility of real wages. Given its integrated financial markets and institutions, EMU also needs pan-European tools for the common supervision and restructuring of the banking sector. Such arrangements would still fall short of the level of policy integration that has underpinned all other working monetary unions.

A monetary and stabilisation mechanism. This mechanism would address liquidity and public finance issues, ensuring that countries that can plausibly respect their inter-temporal budget constraints do not become insolvent when temporary liquidity problems occur. Because of conditionality advantages, one solution would be for the eurozone to rely on IMF support, an approach that the EU was discussing at the time

Lessons from Nordic countries

Nordic countries all faced financial and subsequently economic crises in recent decades.[20] But today Sweden, Finland, Denmark, and Norway are among the most robust economies in Europe. Even Iceland is on its way to recovery. The steps taken by Nordic governments provide examples of what a European policy mix may include. As in our fiscal pact plus scenario, Nordic governments' policy measures focused on re-establishing market confidence, reducing fiscal deficits over the medium term, and supporting economic growth. Finland and Sweden, for instance, proved that even large fiscal deficits of up to 12 percent can be removed over a three- to four-year period. Quick decisions and fair burden sharing were key elements in their reforms. The determination of governments to return to sustainable debt levels convinced investors and eased market uncertainty, and this partly offset the negative impact of austerity measures on domestic demand, as did currency devaluations, which are, of course, not available in the eurozone case. Spending cuts and tax increases were supplemented with investment specifically aimed at promoting growth. Finland, for instance, increased R&D funding by 80 percent in the midst of its crisis. While emergency measures can help to stabilise a financial crisis, the example of Nordic countries demonstrates that a macroeconomic and sovereign debt crisis necessitates fundamental reform.

of writing. Alternatively, the eurozone could develop its EFSF/ESM mechanism into a full EMF.[21] In contrast to the IMF, this fund would have a clearly defined European remit and the capacity to act in ways that would not conflict with non-European interests. Such a fund could provide loans to liquidity-constrained, but solvent, countries. Receiving countries would have to agree to tailor-made adjustment programmes. The fund could be equipped with a bank license giving it access to ECB funding. This would provide it with more capacity to intervene than the current EFSF/ESM mechanism. In the long run, funding would come from contributions made on the basis of fiscal discipline, rather than GDP. Countries with higher deficits and debt levels would contribute more as the probability increases that they would receive money from the fund. The fund could use – incrementally – a range of credible enforcement mechanisms, from cutting off non-compliant countries to preventing countries from accessing EU structural funds. In terms of its governance, such a fund would be similar to the IMF in that it would limit veto powers and direct government involvement.

Investment in growth and renewal. Investment in growth and renewal serves two purposes. First, it creates trust in the long-term sustainability of current nominal debt levels. Second, it provides the basis for the future growth and prosperity of the eurozone in a competitive environment. Areas for such investments would be productive infrastructure that reduces the user cost of capital, and education that increases the skill base and inno-

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[20] Denmark experienced a crisis in 1982, Norway in 1992, Sweden and Finland in 1993, and Iceland in 2008.

[21] The idea of an EMF was first floated in a 2009 paper published by Daniel Gros, Director of the Centre for European Policy Studies (CEPS) in Brussels, and Thomas Mayer, Chief Economist of Deutsche Bank. The authors calculated that, if such a fund had been launched alongside the euro in 1999, it would have accumulated €120 billion by now.

vation capacities. One form this investment could take would be subsidised restructuring programmes for reviving eurozone economic growth – a new version of the Marshall Plan for Europe's reconstruction after World War II. Such a plan could start with existing unused funds at the European Commission to build a "seed fund" of around €200 billion. This growth fund could become the nucleus of a new European growth agenda to strengthen the eurozone's ability to thrive in an era of increased global competition.

This scenario would address the entire spectrum of essential issues. In particular, it would combine short-term liquidity provision and efforts to produce long-term sustainability that would allow the eurozone to outgrow current debt levels. An IMF-style institution could provide sufficient liquidity to reassure markets in the short term and soften what would otherwise potentially be a very hard landing.

Nevertheless, growth in the near term would be weak, particularly in those eurozone economies that have adopted, or will adopt, austerity measures. In this scenario, we would expect annual average GDP growth from 2011 to 2016 of 1.5 percent in the eurozone, with only 0.7 percent in the GIIPS countries and 1.9 percent in the other eurozone countries. However, in the medium to long term, we see higher growth than in any other scenarios in all eurozone countries, with an annual average growth rate of close to 2 percent in the eurozone between 2011 and 2021.[22] Strict conditionality, in addition to incentives to spur fiscal discipline, would help to keep overall debt levels at 89 percent of GDP by 2016 (still higher than the 80 percent of 2010 but lower than in the monetary bridging scenario), and unemployment would be at approximately 11 percent in 2016 after a peak of 12.6 percent in 2014 (driven by temporarily higher unemployment in the GIIPS countries). Policy coordination on a common growth strategy and the sustained implementation of adjustment levers would help to ensure stable growth.

Scenario 3: Closer fiscal union

Monetary unions usually form when countries do – from the United States to the political union of England, Scotland, Wales, and Northern Ireland – and they are complemented with fiscal unions. But EMU is a monetary union among nation states that continue to maintain control over their own national budgets and taxation policy. During the current crisis, discussion of a European fiscal union is now commonplace. Outside the eurozone, fiscal union means a single national budget. Our view is that full fiscal union, where power over national budgets shifts completely to the supranational level, is a non-starter in Europe for political reasons. On the grounds of "no taxation without representation", eurozone electorates may oppose such a shift of powers to the supranational level. We would therefore envisage that any move towards closer fiscal union would, for political reasons, entail a gradual process. While fiscal unions can take a variety of forms, this scenario describes a relatively fully-fledged type of fiscal union that is markedly different from the fiscal arrangements described in the other scenarios.

Beyond the EU summit's proposed fiscal discipline measures that would require countries in violation of debt and deficit limits to concede some of their fiscal sovereignty, a number of elements would strengthen the integration of the eurozone substantially. These elements may include, over different time horizons, joint and several liabilities of EMU mem-

[22] Economic projections based on the scenarios described have been provided by Oxford Economics.

bers, an enlarged degree of joint economic government, elements of EMU-level taxation, the issue of eurobonds, and a move towards more fiscal federalism, including higher permanent transfer payments.

The degree of fiscal integration in this scenario would be much greater than that we envisage in a fiscal pact plus case. From a temporary transfer scheme, the eurozone would evolve towards a permanent redistribution system (see text box “Fiscal transfers” below). If we look at current transfer volumes in Switzerland, the United States, and Germany, eurozone transfers could be in the range of €70 billion to €300 billion. While the fiscal pact plus scenario maintains individual liability except under EMF conditions in the case of liquidity constraints, the path towards closer fiscal union would finally imply collective liability for at least some sovereign debt. Thus, fiscal union would integrate national budgets. While a fiscal pact plus scenario would leave budget responsibility at the national level as long as a country did not infringe budgetary and imbalance rules, under a closer fiscal union there could be an EMU-wide tax to build a pool for transfers. While a fiscal pact plus scenario could be implemented through treaty negotiations, the degree of fiscal integration called for in this scenario would likely need constitutional changes and therefore entail referenda in many member countries.

While transfer payments may further help to reduce debt in highly indebted eurozone countries, this would involve redistribution from those economies with stronger fiscal positions. Experience shows that a permanent redistribution system would provide no lasting incentive for structural reforms and therefore hinder higher growth. Nevertheless, it is clear that financial markets would welcome the clarity of this scenario and in particular the commitment to bailing out members that run into trouble.

We judge the closer fiscal union scenario to be slightly less positive for the eurozone economy than the fiscal pact plus scenario. With a closer fiscal union, we see the overall average annual growth rate between 2011 and 2016 being 1.3 percent but only 0.8 percent in the GIIPS countries. In this scenario, we would see debt levels at 91 percent in 2016 for the eurozone as a whole compared with 80 percent in 2010 and 89 percent in the fiscal pact plus scenario. With a projected level of 11.3 percent, unemployment levels in 2016 would be similar to the ones in the fiscal pact plus scenario but still higher than the 10.1 percent of 2010.

Fiscal transfers

Fiscal transfers can take two forms. The eurozone could introduce an insurance-based fiscal transfer mechanism that would be appropriate to deal with temporary shocks. Such a mechanism should support adjustment processes. Eurozone-wide unemployment schemes (with differentiated benefit levels) or funds to deal with banking crises fall under this heading. Insurance-based mechanisms can be effective in addressing regional asymmetries with relatively low resource requirements. More ambitious would be a bigger eurozone budget, which could act as an automatic stabiliser that effectively recycles tax revenues from high-performing parts of the monetary union to those that are underperforming. While in place in the United States, such an automatic stabiliser would be a highly contentious issue among Europe’s publics.

Scenario 4: Northern euro/euro break-up

The fourth scenario is a break-up of the EMU as struggling economies are closed off from access to funds and therefore forced to leave. Those that remain form a Northern euro – the N-euro. Different constellations are possible, but we assume that the new eurozone would include Germany, France, Luxembourg, Belgium, Austria, Finland, the Netherlands, Estonia, Slovakia, and Slovenia.[23] We assume that an N-eurozone would substantially strengthen the provisions of the Stability and Growth Pact. Limits on debt as a share of GDP would be codified in members' constitutions, and violations would be identified by an independent authority such as Eurostat, the EU's statistics agency. Whichever independent authority was chosen to play the role would automatically implement sanctions, and these would be legally enforceable at the European Court of Justice. Also codified into constitutions would be a no-bailout rule. A mechanism or procedure would deal with macroeconomic imbalances between member states. Even if the N-eurozone was much more economically homogeneous than today's EMU, the currency zone would need workable mechanisms for economic adjustment in case of asymmetric economic shocks.

However, this scenario would come at prohibitive costs, not least because of the pronounced interdependence of the assets and liabilities of European financial institutions. Governments would have to engage in significant bailout schemes to rescue the heavily damaged financial sector. A break-up would be a very significant shock to the nonfinancial corporate sector, too. In the long term, it would mean irreversibly lost opportunities mainly at the microeconomic level. It would reduce the effective size of the market in which a shared currency acted as a catalyst for more trade and closer economic and business integration. The result would be lower economies of scale and higher costs of managing integrated supply chains. It is by no means certain that the degree of integration that Europe has attained through the single market mechanism – including countries outside the eurozone – would remain. Uncertainty would be reintroduced.

Of the four scenarios, the Northern euro has the most negative effect on eurozone growth and – depending on the magnitude of the shock to the financial sector – could be even worse than the effects we describe. Our analysis suggests that a break-up would be followed by a severe recession, with GDP falling by more than what was witnessed during the recession of 2008 and 2009. In this scenario, the average annual growth rate for N-euro countries between 2011 and 2016 would be minus 0.9 percent, with a severe recession in 2012 and 2013. Average annual growth in GIIPS countries between 2011 and 2016 would be minus 2.7 percent, with a severe recession lasting until 2015. Government debt in 2016 would be an estimated 110 percent of GDP compared with 80 percent in 2010 for N-euro countries but 129 percent for GIIPS countries compared with 98 percent in 2010. The unemployment rate would reach unprecedented highs in GIIPS countries at approximately 24 percent compared with 13.4 percent in 2010. This scenario would also cause a liquidity crisis similar to or worse than the one that unfolded in the wake of the Lehman bankruptcy. Governments would therefore need to bail out the financial sector, and this would lead to a further build-up of public debt.

[23] We assume that the exit of single countries would lead to strong contagion effects and the eventual exit of all GIIPS countries.

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Compared with the other three scenarios, a monetary bridging scenario does not solve any fundamental issues and is therefore not sufficient to foster stability. In contrast, either the fiscal pact plus or closer fiscal union scenario could potentially provide sustainable solutions. If neither of these two stable outcomes can be achieved, the eurozone may find itself in a break-up scenario. If we compare the respective merits of the fiscal pact plus and closer fiscal union scenarios, our view is that the former is preferable because it has a stronger focus on growth and incentives and would be much less difficult to implement from a political perspective. None of the four scenarios would bring about a significant reduction in debt levels.[24] The process of deleveraging will be prolonged and, while it continues, growth in the eurozone is likely to be weak. It is, therefore, very important to put in place monetary measures that re-establish confidence quickly. Governments adopting austerity agendas should pursue competitiveness and growth policies in parallel that can provide a platform for an exit out of recession. This combination, incorporated in a fiscal pact plus scenario, would, in our view, be a framework that could prepare the eurozone for the challenges of increasing global competition.

How companies should respond

The implications of the 2008 global financial crisis differed significantly among industries and regions in Europe. While European financial institutions felt a sharply negative impact from a drop in liquidity and large write-downs, the real economy suffered from lower private and public spending. The euro crisis, too, will have a variety of implications for companies, depending partly on the industry and the region where they are operating. It is vital that managers understand the potential industry- and company-specific implications of the euro crisis. Doing so could help companies to conceive strategic responses that can reduce their risks and improve their competitive position.

The four scenarios we have presented can be a good starting point for a company-specific analysis, although, given how fast events are developing, these scenarios may have to be adapted. Some companies have already compiled their own scenarios that could be equally useful for an impact assessment that is most relevant to the profile of their particular business.

Given the high degree of uncertainty about future developments, there is no standard recipe for how to deal with the euro crisis. Nevertheless, it is strongly advisable that companies assess two broad questions. First, how would a break-up of the eurozone affect their operations, and what emergency measures should they take? Second, to what extent should companies revise their medium-term operational and strategic planning?

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[24] Nevertheless, it should be noted that the trend of increasing sovereign debt is clearly reversed in the fiscal pact plus scenario.

Implications of a eurozone break-up

At the time of writing, a break-up of the eurozone still appeared to be highly unlikely, given considerable political will to avoid such a development. But we cannot rule out this possibility. In a break-up scenario, the GDP of the eurozone is expected to decline sharply, and the repercussions of this contraction on companies would be immense. Managers should therefore be prepared and assess the potential implications of a break-up for their businesses.

Relevant questions to ask include what impact the reintroduction of national currencies would have, whether, and to what degree, investments in eurozone countries would need to be written down, and how refinancing rates would be affected. A break-up could, at minimum, have an impact similar to the 2008 financial crisis, during which refinancing rates increased significantly – to a point at which capital access for some organisations became impossible. In particular, this meant a drying-up of trade finance that subsequently led to an unprecedented implosion of cross-border trade in the final quarter of 2008 and the first half of 2009. Analysing a company's value chain can reveal further issues. For instance, companies sourcing input factors from countries outside their sales markets would suddenly be exposed to a return of exchange rate fluctuations. The introduction of capital controls to avoid capital flight from countries leaving EMU could further complicate the operations of multinational organisations. Finally, a break-up would certainly trigger long-lasting legal disputes as most contracts are not designed for such an eventuality.

Understanding the business implications of a eurozone break-up is important. But companies should go one step further and assess the potential measures they can take. A number of options can help companies to reduce their exposure in advance of a break-up. For example, managers can decide to limit the maximum amount of assets allocated with a single bank. Another option may be to localise supply chains to hedge against exchange rate movements. While these measures are precautionary, companies may also define a set of actions that would be taken only in the case of a break-up. Such an emergency plan could include the suspension of capital expenditure to ensure that there is sufficient liquidity for a company's operation, or updating IT systems so that they can handle transactions in new national currencies.

Medium-term operational and strategic planning

In addition to analysing the break-up case, companies should review their operational and strategic planning in light of the difficult economic development under all four scenarios.

To plan future production capacity, it would be relevant for companies to ask what regional growth in their sales markets looks like, how this translates into demand changes, and to what extent the crisis affects their suppliers. For example, the threat of supply chain disruptions may require an increase in inventories. Companies should also consider looking at the impact of the crisis on corporate pension plans or potential changes in counterparty risk. Even if a company is operating in relatively stable markets, the crisis may push its debtors into bankruptcy, requiring a write-down of outstanding claims. Managers should also assess to what extent a loss of revenue caused by a decline in domestic demand could be offset through productivity and wage adjustments.

On a broader strategic level, companies need to consider, for instance, the potential impact of regulatory changes or shifts in competition. While the crisis appears to have largely negative implications, there may also be some opportunities, such as acquisition options or potential for new product development. Some companies may even be able to design strategies to benefit from price volatility.

As with their analysis of a break-up scenario, managers should use their insights to design concrete action plans and allocate measures to specific business units. Overall, the efficiency of potential measures differs significantly among companies. That is why a careful evaluation of individual exposures and impacts is necessary.

By carrying out analyses along these lines, companies should have a clearer understanding of the specific implications of the crisis for their business and be able to take action not only to reduce their exposure but also to seize new opportunities. All indications are that the crisis will not be resolved in the short term. Indeed, we expect the journey to stabilisation and recovery in the eurozone to be a long one. In this context, a thorough assessment of the implications for individual companies and the potential mitigation measures they can take is clearly desirable.

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