8th Aug 2011 - Post-Debt Crisis: What's Next for Corporate Treasury?

Nobody is happy with the compromise solution to the looming U.S. debt ceiling crisis. U.S. markets fell due to more bad economic news, then the markets fell yet again after Standard & Poor's dropped its credit rating for U.S. Treasuries.

Where does all this leave corporate treasury? What's next for U.S. Treasuries and the U.S. dollar? In the event of a credit downgrade, many corporates and analysts alike see possible major setbacks in the long term, while others are more skeptical. But given the risks, corporates might want to take precautions going forward.

Timothy T. Hesler, CTP, McKinsey & Co., said that corporate treasury, which has seen a heightened role since the Great Recession, is likely to be tested even further. "With nervousness about economic uncertainty in most regions, companies need to make tangible plans for the treatment of their excess cash and pay even more attention and scrutiny to the most value creating options, as creditworthiness becomes a critical topic again," he said. "They should also enhance the effectiveness of their capital project analyses and debt planning activity."

Still, some corporates are a bit more doubtful and see no need to panic. "I may be in the minority, but I say 'stay the course' and 'this too shall pass,'" said Kevin Boyle, a member of AFP's Risk Editorial Advisory Board. "I just view this as a lot of noise going on right now in Washington, with the greater issue being worldwide economic weakness. Even though things are challenging on the home front, they are no better in most of the world, and in many places much worse."

Easton Dickson, CTP, Senior Manager, Treasury, Rogers Corp., said he won't bolt from U.S. Treasuries. "But I will focus on diversification and stress testing," he said. "Dollar weakness is expected but I will take advantage of long euro exposure."

Sunita Parasuraman, Corporate Treasury, Facebook, said that the current influx of bad economic news, combined with a downgrade of the U.S. AAA sovereign rating would create fears around the world that the global economy is plunging into a deep recession. But in the near-term, this would likely result in U.S. Treasuries to rise as rates fall, and the U.S. dollar to strengthen, as it is still the world's reserve currency.

"However, longer-term, the focus has to shift to the fundamental weakness of the U.S. economy and the mess that the deficit is, which is what the downgrade reflects," said Parasuraman. "That will cause U.S. dollar weakness and investors will demand higher interest rates on U.S. Treasuries, causing Treasuries to fall. When this reversal will happen is hard to predict; maybe three months from now."

Gareth Sylvester, President of Klarity FX, sees the greater concern now to be the Sovereign debt crisis in Europe, which could have severe implications for the future. "I think that the euro is showing signs of vulnerability and if that story continues to gain momentum, then we could see the euro once again on the backfoot as markets are very nervous about the European union," he said.

But while the U.S. is also struggling, Sylvester agreed that the U.S. dollar will edge out many of its competitors for the time being, even with the threat of an eventual credit downgrade. "What's the next best alternative if you're not going to invest in the U.S. economy and the U.S. bond market? There really isn't one," he said. "From a medium-term perspective, the FX markets are going to be more neutral. I don't think there's going to be an underlying bullish or bearish trend toward the U.S. dollar. But until there is a next best alternative to the U.S. market, if we do see an economic slowdown, you're going to see a demand for the U.S. dollar still there."

By Andrew Deichler