

JULY 2012 NHJ SECURITY MEMO

SPORT RELIEF FROM SOME OLYMPIAN SCALE RISKS

ABROAD

Euro Zone Crisis: surprise, surprise, it got worse – yet again! Our last month's 'limp along with a patch and mend' best-case scenario appears less likely. David Cameron has pushed UK austerity expectations out to 2020 and, along with many others, openly discusses euro zone break up as a serious scenario. Roger Bootle of Capital Economics neatly summed things up when he said that Gotterdammerung 'may not be imminent but it is inexorable'. With Spanish 10 year bond yields having been back over 7%, Italy's heading that way and Mario Monti in deep trouble, a climax could come sooner than many are contemplating notwithstanding Mario Draghi's latest ECB statement regarding assistance to bond-markets. Put aside the credit and liquidity crunches and numerous other banking woes – the big issue is this euro zone can is fast approaching the end of the road. Experts are struggling to see how Spain cannot default. With pension and other massive fund movements automatically triggered at such key moments, nobody is in charge and able to prevent contagion. 'Eurogeddon' – generic description for some form of euro zone break-up and major financial seizure – is even now looking less remote. Expect to read more about 'fund and deposit flight' in the autumn. The outflow of funds into some safe havens is beyond the capacity of some banks to handle it all. Key banks are now gaming Italy, Spain, France, and Germany exiting the euro, and some have switched to believing that a northern European country exit is more likely than a southern European country exit. This is a significant shift. Significantly increasing direct German liabilities to 'peripheral' euro zone countries, and fundamental German national interest and politics are converging, and doubts mount that Germany can or is willing to really do 'whatever it takes' to maintain this euro. Across Europe more and more people are beginning to wonder whether a much more radical forest fire new beginning approach might be better all-round, and preferable to a lost decade of grim austerity and some very unpleasant political developments. It is all way beyond it being about 'the economy stupid'. Unpalatable words including extremism, protectionism, protest, disorder, even revolution in some cases, are appearing more often than a few months ago. So, here is the NHJ pre-summer recess bottom line: current euro zone break up by mid 2013 is a 50% plus likelihood. Be ready for a big announcement – Italy could be the catalyst - quite possibly with Germany, or another northern nation leading the way. It will most likely be described as just a pause in the European project - normal business temporarily suspended in Europe's wider interest. It might not happen quite yet, but any organisation and company worth their salt should, if they have not already started, begin doing serious contingency planning for the much worse scenarios. It is worth recalling that last November major banks had very few - in some cases zero - risk specialists focusing specifically on the euro zone. Today some have whole departments of these people. Worryingly, most governments have done very little beyond financial and economic modelling and contingency planning - they resemble rabbits paralysed in the headlights. It's not only the direct economic impacts that need to be looked

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at, but also the social and political secondary effects that governments and most companies have not worked through.

Syria. Some headlines talk of endgame – and this may well be true for Assad sooner rather than later. But with deeply disturbing continuing vetoes from Russia and China, and some experts pointing towards a middle eastern 21st century equivalent to the Spanish Civil War and spill over effects in Lebanon and beyond, we should not expect a Libya-style timeline or endgame to this particular Arab revolution. The really big issue is the security – or insecurity – of possibly the world's biggest stocks of mustard, sarin and other chemical weapons and the potential for their use either by desperate Assad forces, or – more worryingly - their capture and use by al-Quaida, Hezbollah, or other non-state extremists. The US or Israel would intervene in certain circumstances in an attempt to secure stockpiles. Talk of a 'no fly zone' is on the increase, but it should be remembered that Syrian air defences are by an order of magnitude better than Libyan air defences, and were significantly up-graded since Israel bombed Syria's nuclear facility in 2007.

Climate and Global Summit Downers. Record-breaking wet weather, less arctic ice, a massive iceberg breaking off a glacier in Greenland have put climate back on the top agenda. The speed Greenland glaciers are melting has apparently doubled within a decade, and at today's rate of 3mm rise per year our grandchildren can expect a 2 metre rise in sea levels by 2100 (though presumably a constant rate of rise is most unlikely?). Meanwhile, as the jet stream remained locked to our south causing all our wet weather, the news from the Rio summit was spectacularly disappointing. No less a figure than the UN's Special Representative for Food Security, likened the summit to a kind of funeral procession to the notion that 192 countries can get together and achieve anything meaningful to save the world. The Arms Trade Treaty negotiations are ongoing as we write, but we are not optimistic that these discussions will produce success. The deteriorating global geopolitical situation – we are seeing knock-on effects of small arms proliferation in the Sahel areas already – demands effective multilateral responses at a time when global governance frameworks and strong leadership from key countries is missing. The loss of a dynamic and strong UK champion is particularly noticeable and sad.

HOME

In one sense it is 'the Olympics stupid' and more sport – Wimbledon, masters Golf, cricket against West Indies and South Africa, and Wiggo in the Tour de France – that have made this an epic sporting summer and helped us forget the weather and some of the gloom. Barring 'Gotterdammerung', we are intending to go into sport and relax mode and take a security memo break next month. Given recent economic data, and despite E&Y ITEM Club's optimistic forecast of a return to growth in the second half of the year, we are not convinced this will happen. So, here follows some pre-recess hard pounding before ending on some good news to cheer you up as you get into Olympics and holiday mood.

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Coalition Re-launch. This may last about as long as a euro zone bail-out. Indeed, reinforced by Lord Ashcroft's findings and conclusion that one third of those who voted Tory in 2010 will not do so again, and based upon multiple other indicators, we suggest that David Cameron is now in his last chance saloon as leader. He and George Osborne are not an election-winning duo. To survive – most of the 2010 cohort of Tory MPs currently face electoral annihilation remember – Cameron must pull out all the stops (nation can live with the Eton bit but we need to see the very best of Eton leadership skills) and demonstrate that he is a toughie. This means moving George Osborne, as well as at least Teresa May before she attempts to deny any knowledge or responsibility for the next security fiasco – riots, border agency, and G4S have been more than enough for one Home Secretary. However, we expect few major surprises in the reshuffle.

National Security. Having previously lamented (October 2011 Perfect Storm NHJ Security Memo) the absence of any discussion in the National Security Council of the security implications of a potential euro zone crisis, it was good to see the parliamentary joint committee on the national security strategy report to this effect this month and castigate the government for its lack of effective strategic planning.

Defence Cuts. Some of our last security memo comments made it into the Daily Telegraph this month and Tim and Nigel were both interviewed on Radio 4's PM programme on 5 July: http://nhjstrategic.com/nhj_strategic_consultancy_media_talks.htm

21st Century Society is Very Fragile. We cannot let up on our quest to improve UK national resilience. There is a balance to be struck here. We cannot afford to do everything, but the present balance invites a massive sudden shock sooner or later. In the month that has seen Jonathan Evans tell us of one major London company that has taken a cyber hit of some £800 million, major disruption for large numbers of National Westminster, Ulster Bank and some other customers, and the G4S fiasco we should heed the warning calls. We must review our 'just in time' most critical vulnerabilities and consider what now should go into 'just in case' category.

Cheerful Good News Holiday Thinking: here are just a few of the good news points we include in our talks: more Africans now living on more than \$2 a day, the coming end of oil dependency on the middle east, the vast potential of genetics, renewables, and information technology which should swamp the gloom and (serious) risks associated with each of them, the Higgs Boson and model international co-operation behind its discovery, the Olympics opening ceremony, the energy and ingenuity of swathes of youth...and much more. Enjoy the sport, the sun, and if in London some amazing non-olympics arts and exhibitions!

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