

# Eurozone not out of the woods yet: panellist

**The problem is not one of liquidity but of solvency**

By **LYNN KAN**

[SINGAPORE] The risk of insolvency spreading in the eurozone is still in the air, despite the best efforts of the European Central Bank to calm fears with a 440 billion euro (S\$766 billion) stability fund and bond buying, said a panellist at a business outlook forum held at the Singapore campus of the University of Chicago Booth School of Business yesterday.

Speaking under the Chatham House Rule which disallows the naming of speakers to encourage freedom of speech, the academic said that eurozone officials have been skirting the issue on how to deal with rising debt burdens, but the solutions boil down to whether debt is refinanced and whether Germany agrees to fund those debts.

"The Europeans are delusional in thinking that they're facing a liquidity issue when they have a solvency issue. This can only end with more money or restructuring (debt)."

He warned that Asia would not be untouched should the eurozone crumble. The effect on Asia will be "jarring for a short peri-

od" even though Asia "was nowhere near the crime".

Another speaker highlighted that in Asia, governments and central banks are wringing their hands over capital influx and more importantly, flow reversals which would be "disruptive".

"Attention has turned from 'hot' money flows to reversals. A lot of these flows are coming in for good reason, but there's a concern that there would be a diminishing of risk appetite like in Europe and there will be a huge outflow," he said.

Central banks would then have to be careful of how they handle the ebbing away of capital.

"So far, we've seen it happening for selected cities - Hong Kong, Korea, Malaysia - and for short periods. Capital controls can be erected as a short term solution for selective money flows," he said.

"But when there's a wall of liquidity coming at Asia, these controls can no longer be used as a diversion, the liquidity will come in."

He stressed: "Banks would need to go back to conventional macro tools to deal with this in the long term - which means exchange rate flexibility and tighter monetary policy."

The third panellist at the

event said that there was a risk of an inflation spiral in China, and that monetary policy should shift from reflation - as it is now - to re-balancing.

He expects inflation to peak at close to 6 per cent in the first half of 2011, then quickly recede.

"Once inflation recedes, the thinking is that China's policy should shift back, away from reflation to re-balancing and allow more appreciation of the renminbi," he said.

The other Asian central banks will closely watch Beijing as they take their monetary policy cues from the giant.

"We're talking about a very stuck regime in Asia for the next six months," he said.

He added that the bear market of China in 2010 would also continue for the first six months of 2011. "The breakout would come when policy there is normalised."

Where investors should mine are places where "bond yields are too high" such as Indonesia and the Philippines.

He was also neutral on commodities and gold in the year 2011, saying that he thought it unlikely that gold would reach US\$2,000 per ounce or that oil would touch US\$150 per barrel.