

# Grexit a question of 'when and how' – not 'whether'

**It'll happen this year or by early 2013: Cornell professor**

By **VIKRAM KHANNA**

[SINGAPORE] It is "economically and politically untenable" for Greece to remain in the eurozone and there is a more than even chance that it will exit this year or by early 2013, according to eminent economist Eswar Prasad, Tolani Professor of Trade Policy at Cornell University.

Prof Prasad – a former International Monetary Fund official who has advised governments, including those of China, India and the United States – said that pressures in the eurozone could intensify in the coming weeks and that Asian economies could be hit by the fallout.

In an exclusive interview with BT last week, he said that the question about a Greek exit (dubbed "Gréxit") from the eurozone is not one of "whether", but "when and how".

"If it happens now, it will be enormously disruptive to global trade and finance. But if it happens late in the year – when markets, households, financial institutions have had some time to adjust – it would be less painful. But it would still be painful."

Prof Prasad, who also holds the New Century Chair in International Economics at Washington's Brookings Institution, said that the only way Greece can remain in the eurozone "is basically by Germany committing to write big cheques in perpetuity – because, as of now, there isn't a hope in hell that Greece is

going to be able to implement the reforms needed to boost its competitiveness.

"Even if they do everything that is needed on the fiscal front, they would still end up, after five years, with a debt of 130 per cent of GDP and an economy that is not competitive.

"So, as far as the eye can see, Greece will need fiscal support from the stronger countries. And I'm not sure they will have the stomach for that. So my sense is that we are in the initial stages of the endgame."

Prof Prasad pointed out that what was going on right now was an attempt to ringfence the rest of the eurozone.

The 100 billion euro (\$161 billion) bailout for Spanish banks last week was "an interesting move", he said, "because it is the first time the eurozone has done more than what is seen as the bare minimum". "The IMF said that about US\$45 billion was needed for Spanish banks. The eurozone pledged US\$125 billion."

However, he added that the actual amount that would be needed for Spain is likely to be even higher. "Spain's housing market is still doing very badly and its financial system will need more money, as will the rest of the economy. That's what we're seeing in financial markets – the spreads for Spain have not shrunk at all."

After the Spanish bailout, yields on 10-year Spanish sovereign bonds fell briefly but soon went back up to more than 7 per cent, which is considered an unsustainable rate for Spain to bear.

On whether a eurozone

banking union would be able to salvage the situation, Prof Prasad was doubtful. Under such a union – which has been proposed by the European Commission and supported by the peripheral countries – the eurozone would have common depository insurance and a pan-European financial regulator.

"In principle, it's a good idea if one were starting from scratch," he said. "But right now, banks already have huge exposures to sovereign debt and the sovereigns are weak.

"So somebody has to write a cheque if you want to start with a clean slate. And if you don't start with a clean slate, there will be enormous asymmetries across banks in different countries; it's not easy to run a banking union where you have banks with very different levels of risk in their portfolios on the asset side.

"A Spanish bank holding Spanish government bonds is in a very different position from a German bank holding German government bonds."

Prof Prasad was also sceptical about the idea of a pan-European financial regulator being implemented effectively and working in practice.

In the likely event of the eurozone crisis intensifying, Asia could find itself in the line of fire, he said.

One channel through which it would be affected is the financial one. While Asian banks' direct exposure to eurozone debt is limited, they could be exposed through their connections with other financial institutions, which in turn are exposed. However, institu-



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**Prof Prasad:** *Points out that what's going on right now is an attempt to ringfence the rest of the eurozone*

tions have had time to prepare, cut down their exposure and make contingency plans. "But, of course, with a really bad shock, even the best-laid contingency plans can turn out to be insufficient," said Prof Prasad.

A deepening eurozone crisis might also trigger capital flight to the United States, which would drive up the dollar and set back the US economy – which would mean a slowdown in both the US and the eurozone. "With Japan also not really strong, this would mean the advanced economies would not provide much support to growth in the next year or so."

This would affect economies with large trade exposure, he said – including a lot of Asian economies. Even China would be hard hit, as the US and Europe

account for 45 per cent of its exports.

Still, Prof Prasad suggested, the region would not be as badly affected as during the Asian crisis of 1997/98, because it is much less dependent on foreign capital than it was then.

To cushion the shock, he suggested that Asian countries should "create more room for fiscal policies" and then use them aggressively. Some countries such as India would benefit from accelerating reforms, which would provide more confidence to foreign investors.

"For a country like Singapore, there isn't very much it can do, except monitor the situation closely. If all hell breaks loose, MAS (the Monetary Authority of Singapore) could step in – in a big way – to provide liquidity."