Analysts predict worsening Euro debt crisis

Finance reporter David Taylor

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Ireland has become the latest European nation to have its debt downgraded to junk status.

That means the Irish government may now be reliant on another financial bailout to fund its spending.

It is the latest in a string of economic shocks to hit the eurozone this week, but analysts are warning the situation in Europe could get a lot worse.

Moody's now rates Ireland at Ba1, which is the highest speculative grade rating and below what the market would describe as investment grade.

While Ireland is only a relatively small economy, economists warn things could get ugly as the debt crisis continues to spread.

"Ireland is still a relatively small economy within the euro area, but the key issue is, does this flow across to other parts of the euro area and, in particular, to some of the larger economies?" said Paul Bloxham, HSBC's chief economist.

"We've seen concerns raised this week, particularly about Italy, and of course there's ongoing issues with Spain. If it were to flow through to those other larger economies it does become a much bigger problem."

PHOTO: Analysts say Europe's debt crisis still has a long way to run. (Herwig Prammer, file photo: Reuters)

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He says Irish debt yields rose to a decade high last night, indicating investors were very reluctant to throw money in the country's direction.

There are increasing signs that markets are getting nervous about the capacity of many European countries to pay off their debt.

"I think if you saw this situation become contagious - as they say, contagion, it sets in and it moves across the different countries," Paul Bloxham explained.

"If it moves from just being an issue in the peripheral countries to an issue with the banking systems in the larger countries, the core countries - France, Germany, even potentially Italy, which is obviously a very large country within the region - then I think that would potentially see the bond markets start to really punish the governments in those areas.

"And that would potentially lead to some freezing up in terms of liquidity, similar to what we saw during the global financial crisis."

European finance ministers are putting on a brave face, saying they will insist the private sector should come to the rescue.

"Talks with the private sector representatives will go on in the coming days in order to conclude them as soon as possible," said the president of the Euro Group Jean-Claude Juncker.

Other international economists are not as confident about resolving the euro debt crisis.

James Henry is a lawyer, investigative journalist and former chief economist at McKinsey and Co.

"Italy in particular has to roll over about $250 billion of debt just to finance itself in the next year, and Spain is looking at a situation where they have 20-25 per cent unemployment already, and that's another sleeper," he warned.

"So there's a lot to be concerned about here."

Paul Bloxham says the Australian banking sector is safe, at least for now.

"At this stage it doesn't look like it's a big financial deal for Australia but, of course, there's always the risk that it could become one," he added.

Fund manager Roger Montgomery disagrees, but he says Australian bank profits will ultimately be mainly determined by the health of the domestic economy.

"The bulk of our banks' earnings come from Australia and ultimately sentiment towards them will be dependent on house prices in Australia and growth in credit. Everything else is really just navel gazing," he said.

For Roger Montgomery the central issue is debt, and he says it will take many years for it to be paid off.

"It can take five years, and the reason why I think it will take a while is by virtue of the fact that we've just taken on too much debt," he added.

"And when I say 'we', I mean governments, countries, businesses and individuals, and it just takes time to pay that debt down."

He says the road ahead is likely to be a rocky one.

"Until that time we're going to see in the United States more frequent recessions. We're going to see all of these convulsions that we're seeing in Europe as governments over there try and work out how they're going to get those debt levels down," he concluded.

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