Forex Focus: Euro Crisis Rumbles On

By Katie Martin

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LONDON (Dow Jones)--So, the euro-zone debt crisis is over, right?

Greece demonstrated last week that it can auction short-term debt with reasonable success and at a more modest yield than it would have to pay to access emergency backstops. The euro is back up at $1.30. Even Monday's downgrade to Irish debt by Moody's failed to have a lasting impact. Panic over.

Don't you believe it.

Let's not forget that Greece shelved plans to auction some one-year debt last week. Hardly long-term stuff. And the euro is up mostly because the dollar is down. As for Moody's ... where has it been for the past few months? Of course Ireland has a heavy debt burden. This is old news.

No, this crisis is far from over. It has calmed down, for sure. Investors are no longer in skittish mood. Greek government debt is no longer one of the top three in the world in terms of default insurance costs. A decline in the single currency to parity against the dollar or even lower within the next few months now looks a bit far-fetched. But this one is going to run and run.

A hefty reminder of that came over the weekend, when the International Monetary Fund and the European Union decided to play hardball with Hungary. The emergency lenders are not satisfied with Hungary's book-balancing plans. Hungary has refused to keep slashing. So that's that. The Eastern European straggler is not getting the next instalment of its EUR20 billion credit line just yet.

This could be worse; Hungary is not in terribly urgent need of the funds and the lenders have not walked away for good.

Still, the country's currency and bonds have come under huge strain as investors are nervous. And it matters for the euro zone: the cost of insuring government debt from euro-member Austria against default has climbed, as its banks are so heavily exposed to the Central and Eastern European region.

What's more, it's also a cautionary tale for Greece. If Greece wants to be eligible for multilateral aid not just this year but every year until this mess is over, then it has to make brutal cuts in public spending for the long haul. Protests over these cutbacks have already been violent on a number of occasions.

"Hungary said it was already in the fifth year of austerity measures and it was not possible to tighten the screws any further. That's critical because it's exactly the problem the euro zone faces; austerity measures ... are not one-offs, they are multiyear projects," said Simon Penn, an analyst at UBS in London.

"The IMF and EU have not fudged a solution. Hungary won't play ball so the funding line is suspended," he added. "Remember, Greece's fiscal position is far worse than Hungary's."

In addition, investors are still nursing doubts over the sustainability of the single currency project as a whole.

Monday, Alan Brown, chief investment officer at Schroders, wrote that Germany's insistence that Greece and other errant euro members must "sit on the naughty step for a decade or more" could kill the currency entirely.

Greece could well decide that the austerity measures it is forced to comply with are simply too harsh, and conclude that binning the euro "could be the lesser of two evils," he said.

The idea, often repeated, that too much political capital has been invested in the single currency to allow it to fail, and that a Greek withdrawal from the currency would be ruinous for the country, are not necessarily true, Brown added.

"It is at least conceivable that the euro could break up by way of the strong countries rising out of the euro, leaving Portugal, Italy, Ireland, Greece and Spain with the euro," he said. "The revaluation effects now would be entirely benign with those economies in an unchanged position and with the countries that left the euro with assets denominated in an appreciating new currency," he said. Sure, Germany's exports may suffer, but it needs to boost domestic demand anyway.

"It pays to remember that we have seen currency regimes come and go before," he said, pointing to the Gold Standard and a number of currency unions that rose and fell in the past.

A breakup of the euro may not happen just yet, but it is "highly likely in the medium term," he said. "This tragedy [or pantomime] has many more acts to come. Stay alert," he said. Indeed.

In early European trading hours Tuesday, the dollar's downtrend was still in full swing, with the euro at $1.3012, having earlier hit $1.3029--its highest level since May, according to trading system EBS. Late in New York Monday, the euro was at $1.2945.

The dollar was at Y86.96 against the yen, little changed from Y86.86, while the euro was at Y113.15 from Y112.45. The pound was up at $1.53 from $1.5231.

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