

Cypriot Bailout Sends Shivers Throughout the Euro Zone

By [LONDON THOMAS Jr.](#) and [LIZ ALDERMAN](#)

Published: March 17, 2013

- Facebook
- [Twitter](#)**LONDON** — Europe’s decision to force depositors in Cypriot banks to share in the cost of the latest euro zone bailout has sparked outrage in Cyprus and fears that a run on deposits over the weekend might spread to larger countries at risk like Spain and Italy.

[Enlarge This Image](#)



Petros Karadjias/Associated Press

People lined up to use an ATM machine outside of a Laiki Bank branch in Larnaca, Cyprus, on Saturday.

Related

- [Cyprus Goes After the Little Guy](#) (March 18, 2013)

Under an emergency deal reached early Saturday in Brussels, a one-time tax of 9.9 percent is to be levied on Cypriot bank deposits of more than 100,000 euros, or \$130,000, effective Tuesday. That will hit wealthy depositors — mostly Russians who have put vast sums into Cyprus’s banks in recent years. But smaller deposits will also be taxed, at 6.75 percent, **meaning that the banks will be confiscating money directly from retirees and ordinary workers to help pay the tab for the 10 billion euro bailout or \$13 billion.**

Most of the 10 billion euros will go to bail out Cypriot banks, which took a blow when their substantial holdings of Greek government bonds were written down as part of that country’s second bailout. The island’s banks are also laden with loans made to Greek companies and individuals, which have turned sour as Greece endures its fourth year of economic and financial crisis.

The deposit tax, which is expected to raise 5.8 billion euros, **was part of a bailout agreement reached in the early hours of Saturday morning after 10 hours of talks among finance ministers from euro countries and representatives of the**

International Monetary Fund and the European Central Bank. *(Looks like the savers/depositors didn't get to vote!)*

The Cypriot bailout follows those for Greece, Portugal, Ireland and the Spanish banking sector — and is the **first where bank depositors will be touched.**

Public officials in Spain and Italy did their best over the weekend to portray the situation in Cyprus as unique, and to insist that deposits in those countries remained safe.

The economy of Cyprus represents not even half a percent of the combined output of the 17 countries that use the euro. **Yet the impact of this weekend's unexpected decision in Brussels to impose across-the-board losses on bank depositors could not be more far reaching.**

After five years of bailouts financed largely by austerity-weary European taxpayers, wealthy nations like Germany and the Netherlands have decreed that from now on when a bank or country fails, it will be bond investors and perhaps even bank depositors who will be forced to pick up a big share of the bill.

The measure to tax depositors has created considerable political turmoil for the newly elected Cypriot president, Nicos Anastasiades, who asked Parliament on Sunday to postpone an emergency vote until Monday amid signs that a majority of the legislature's 56 lawmakers would not approve it. That puts the entire aid package of 10 billion euros in jeopardy.

The European Central Bank sent two representatives to Nicosia on Saturday to assure executives of Cypriot banks that the central bank was “here for them — as long as the bill goes through Sunday or Monday morning, before financial markets in Europe open,” said Aliko Stylianou, a press officer for the central bank of Cyprus.

Mr. Anastasiades's cabinet met at the presidential palace Sunday with the heads of the Cypriot central bank and the Finance Ministry to discuss how to implement the assessment, should Parliament approve it.

The government also **extended a bank holiday that was put in place to try to stop a run on the banks.** The holiday was supposed to end Monday night. Now, banks will not be opening their doors Tuesday, as planned. There was talk that they might not open Wednesday, either.

To some degree, this policy shift was foreshadowed last month when the Netherlands forced investors of a failing Dutch bank to pay for their share of its government bailout by writing 1.8 billion euros worth of high-risk bonds down to zero. The strategy was the work of [Jeroen Dijsselbloem](#), the doctrinaire finance minister of the Netherlands, who was recently tapped to lead the Eurogroup, the body of euro zone finance chiefs that organized the Cyprus bailout.

But it is one thing to wipe out bondholders, who presumably were aware that their investment carried risk. It is quite another to force a loss on depositors, including small Cypriot savers whose deposits were insured by the very government that will now try to seize part of the balance in the form of a one-time tax.

“This is the first time that senior creditors have taken a loss in a euro zone bank rescue,” said Adam Lerrick, a sovereign debt expert at the American Enterprise Institute who has long argued that debt-heavy countries in Europe must make private investors — including bank depositors, if need be — share the cost of bank bailouts. **“It prevented the insolvency from being transferred from the banking system to the government.”**

While such a notion may please the purists, it carries with it significant financial risks. Indeed, as many Cypriots flocked to remove what little of their savings they could, Europe must now confront the prospect that jittery savers in Spain and particularly Italy — where banks have been hit hard by an onslaught of loan losses — will rush to do the same.

The bank depositors in those countries, and the banks’ bondholders, will no doubt be edgy. Deposits could flee those countries, as they did Greece and Spain last year, at the height of their fiscal troubles.

The result could create a new wave of investor contagion in the euro area that will challenge the European Central Bank head, Mario Draghi, to make good on his promise to do whatever it takes to protect the euro.

Economists warn that the shock to Cyprus could lead not only to bank runs in other euro zone countries, but an economic collapse on a par with what happened in Greece. That country required not one bailout, but two, as policy makers underestimated the extent to which the Greek economy would suffer from the austerity measures imposed by the government, which were a requirement to receive those bailouts.

“There has been a huge shock, and fall in G.D.P. will be very large just as it was in Greece,” said Alexandros Apostolides, an economist based in Nicosia. **“Why would someone keep their deposits in a bank here if he cannot be assured that there will not be another bailout?”**

Indeed, throughout the weekend many Cypriots were withdrawing as much as they could from bank cash machines before the special tax could be imposed.

“Why should I leave my money in Cyprus?” said an investment banker who for the previous two days was withdrawing the maximum €2,000 he is allowed to from his foreign bank account in Nicosia. “I have already instructed my bank to send my entire savings to London when the banks open on Tuesday. A precedent has been set — what is to stop them from doing this again?”

Stelios Platis, the managing director of MAP, a Cyprus-based financial services firm and a former economic adviser to Mr. Anastasiades, said the effect would be the same “whether the Parliament approves the measure or not.”

“As soon as banks in Cyprus reopen, people will rush to take all their money out, because they don’t believe this is a one-off deal,” he said. “When a bank run happens, the E.C.B. will have to pump in liquidity,” he added, “and what you will have is a shell of a banking system supported by E.C.B.-eligible Cyprus bonds, which will rocket the debt of Cyprus out of control.”

More than perhaps any other euro zone member, Cyprus had become dependent on the ability of its many banks to offer clients around the world high-yielding, lightly taxed savings accounts. The strategy was so successful that overall bank deposits had grown to more than three times the size of the economy.

Of the roughly 70 billion euros in deposits on the island, analysts estimate that half this amount represents large, uninsured depositors — with Russians making up more than 20 billion euros of this amount.

The other 35 billion euros comprises government-insured deposits from Cypriots.

In Nicosia, the lines at cash machines Saturday disappeared temporarily, mainly because A.T.M.’s had been drained. But on Sunday, at a main branch of Laiki Bank, employees were seen inside the darkened building hovering over computers and filling machines with cash.

As word got out, groups of people arrived in a steady stream to withdraw money. Many expressed anxiety over what they said were dictates from Brussels and Berlin that would have implications far beyond Cyprus's shores.

"They are trying to make an experiment with a small country," said Stefan Kourbelis, a manager at the Centrum Hotel in Nicosia's main square, echoing a widely held view. "If it works, the next one could be Spain, Italy and others. If things go badly, they can just say, 'Who cares about Cyprus?'" he said.

Liz Alderman reported from Nicosia and Landon Thomas