

A Fat Eurozone on Stilts

If the recent bailout of Cyprus wouldn't make you question the future of the Euro, what would? Would it be the potential insolvencies of Greece, Slovenia, Italy, or Spain, all of which are looming possibilities? Or would it be the precedent set by the Cyprus debacle—namely, that depositors must help foot the bill for bank and/or national insolvencies—that would instill the most doubt in you?

Realistically, “all of the above” would be a good answer. There are several countries in Europe that are in dire financial straits, and the new recipe for bailouts should worry depositors in any of those countries. Depositors holding upwards of 100,000 euros in Cypriot banks could face a “haircut” of up to 60% of their deposits, which undoubtedly will make many people, including many rich Russians, angry at and skeptical of European banking systems. And why shouldn't they be? A bank is supposed to be a safe place to put money above all, and it's because of banks that advanced economics are capable of existing. Trust in the banks and trust in the financial system leads to growth, but what happens when that trust is lost? We may soon see.

There's been no greater damage done to the trust in European banking systems than the bickering over the details of the Cyprus bailout which were made, for stability's sake, far too public. The fact that finance ministers even considered a levy on insured deposits lends credence to the fact that any option is on the table, no matter who it may hurt.

Certainly, Cyprus is tiny, representing 1.1 million people and 0.2% of the Eurozone economy, and doesn't itself seem capable of torpedoing Europe's economy. But like lab rats, small nations or regions can serve as experiment zones to be used in the wider public. This week, the experiment—the levy on depositors—was confirmed as the prototype for future bailouts by Jeroen Dijsselbloem, the current Dutch finance minister.¹ This should send shivers up the spine of depositors in any distressed European economy, especially considering the nature of the announcement of the original Cyprus deal. It was announced after businesses had closed on Friday, without warning, and left people no options but to sit and wring their hands.

All of this, bear in mind, was over a mere six billion euros that Cyprus needed to cough up—the cost of roughly three B-2 bombers. That six billion was in addition to the 10 billion that the troika offered. Certainly the troika, largely funded by Germany, could have conceded the extra 6 billion and prevented the precipitation of a calamity. There are two likely reasons that they chose not to: first, Cyprus was very much an offshore haven for Russian money, acting as the Cayman Islands of the Mediterranean. It would be difficult to sell voters in Germany, for example, on the necessity of bailing out what are perceived to be Russian oligarchs and mobsters. Second, they wanted to make an example of Cyprus, to punish it for its profligacy and make known the limits of their leniency as benefactors.

¹ <http://www.ft.com/intl/cms/s/0/f75a1b28-9550-11e2-a4fa-00144feabdc0.html#axzz2PO6TJh6R>

The problem is, all this conflicts with ECB President Mario Draghi's promise to do "whatever it takes" to save the Euro because it undermines peoples' faith in the Euro itself. Euro bank deposits are guaranteed up to 100,000 Euros, but that pledge is extended only as long as the country is solvent. Uninsured depositors holding upwards of 100,000 in a bank must be considering their options. Why would any reasonable person hold onto Euros in a bank when they could stand to lose a heart-wrenching 60% of their savings? The choices are few: you can spread out your deposits to a number of banks, holding accounts below 100,000, and expect very low or negative real interest rates while twiddling your thumbs and praying for a Eurozone recovery and the continued solvency of your nation; or you can choose another place to put your money.

Given the current bailout model, the 'wait-and-see' style of money management here may well end up disastrous. Nervous depositors in Cypriot banks who waited too long to move their money must be gnashing their teeth to learn of the developments regarding their very own money that are entirely out of their control. The lack of transparency in many teetering nations' banks as exemplified, not least, by the financial skulduggery of Greece during the past decade, should leave people wondering where the banks and governments actually stand in terms of solvency.