J-J ROSA's Blog

Economic analysis and social organization

TUESDAY, MARCH 19, 2013

Cyprus and the Sutton Principle

William "Willie" Sutton *(June 30, 1901 – November 2, 1980) was a prolific American bank robber. During his forty-year criminal career he stole an estimated $2 million, and eventually spent more than half of his adult life in prison. For his talent at executing robberies in disguises, he gained two nicknames, "Willie the Actor" and "Slick Willie." Sutton is known, albeit apocryphally, for the urban legend that he said that he robbed banks "because that's where the money is."* (From Wikipedia, the free encyclopedia).

That very principle is what the Eurozone governments, and especially the northern ones (the decision to expropriate savers in Cyprus banks was imposed by Germany, Holland, Finland, Austria, and Slovakia, whose only care is to assuage bail-out fatigue at home and avoid their own political crises), have decided to apply to the ailing Cypriot banking sector, desperately looking for funds.

Eurozone banks that profited handsomely from the creation of the single currency now suffer from its crisis (see the fall in their shares value), and in return the euro is now at risk of suffering serious distrust -- as a store of value -- in international markets and among the world's largest investors.

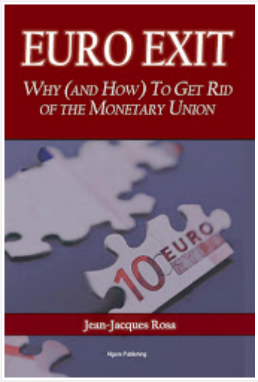
How is the euro responsible for the mess? In the first place, the entry of Cyprus in the Eurozone in 2008 allowed local financial institutions to develop at an accelerated pace, comparable to what happened in Island and Ireland, because they now could operate with the benefit of a stable currency, a "world-class money" managed in a conservative German way by the ECB. So the overblown financial sector is a direct consequence of the euro.

Today, Cypriot banks have outstanding loans or other money at risk totaling €152 billion, or eight times the size of the country's gross domestic product, according to the International Monetary Fund. It means that a rescue in case of difficulty is well beyond the capacity of the island's economy and of its government. It is the same kind of extreme vulnerability to financial shocks that devastated Ireland.

And second, because of the proximity to Cyprus and a common language, Greece had seemed a logical place for Cypriot banks to expand by extending loans to Greek businesses and consumers and loading up on Greek government debt. A natural, but reckless investment policy.

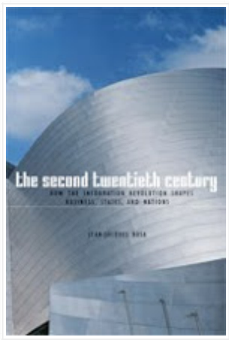
With the crisis of the Eurozone economies under the inadequate conservative monetary policy attuned to German needs but not to the southern Europe

EURO EXIT



THE EURO CRISIS

THE SECOND TWENTIETH CENTURY STILL GOING ON



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predicament, and given the deepening of the Greek deflationary spiral under the troika-imposed austerity policy, the Greek "haircuts" had large impact on Cypriot banks that suffered heavy losses.

Since the small size of the local economy compared to the size of its banking sector made it impossible for the government to bail out the banks by taxing the economy, foreign help was needed. And that is the second reason why the euro is responsible for what happens to Cyprus, even though Cyprus bankers were wrong to concentrate their investments in Greece.

Cyprus asked for Russian help and a European bailout. But northern governments, and especially the German one, do not want to tax their nationals to save Cypriot banks and do not want that the ECB further monetizes the Cyprus government 's debts. So they came to think that the Sutton principle could do the trick.

Let us add that the main other reason for the bank levy policy of the eurocrats is that large depositors in Cyprus banks are foreign to the European Union and to the Eurozone, and thus do not vote in the coming elections, so that robbing them is particularly tempting for politicians. They now try to justify the move by explaining that a bail-out for "Russian oligarchs, money-launderers, and tax evaders" is out of the question, but this is just an excuse for taxing people without representation, that is for trampling democratic principles. When you want to kill your dog you accuse it of having rabies.

Mr. Poutine is of another opinion and Chinese and other investors may think twice from now on before committing more funds to euro instruments. This is going to have some consequences on the refinancing costs of Spanish, Portuguese, and Italian governments.

Posted by Jean-Jacques Rosa at 10:33 AM No comments: Links to this post

SATURDAY, MARCH 16, 2013

American Stocks Slightly Overvalued

... according to the Robert Shiller's Price/Earnings Index, the CAPE (Cyclically adjusted price earnings ratio). Shiller is the Yale economist whose "Case-Shiller home price index" reported the largest price drop in its history by the end of 2008, reflecting the bursting of the housing bubble. Shiller had previously -- and correctly -- warned of the coming financial crisis in his book *Irrational Exuberance* published in 2000.

Have a look at the history of the CAPE since 1880, here.

He comments, however, that he has not "an alarmist view about this". "The market is high but it's not horrible" he says. "Whether we have a bubble, no bubble or the forming of a bubble", he adds, it's "quite a risky environment right now" and it could be any one of those. "It has been a bit bubbly, but I kind of give them all equal probability," warning of "big movements one way or the other."

The Baseline Scenario

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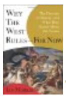

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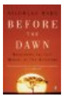

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