The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Russian Lenders Face Billions in Losses Due to Cypriot Levy

By Irina Filatova

March 18, 2013

Demonstrators protesting against the deposit levy as Cypriot President Nicos Anastasiades' convoy drives to the parliament in Nikosia on Monday. **Yorgos Karahalis**

The proposal by the Cypriot authorities to introduce a levy on the country's bank deposits as part of a plan to bail out its economy drew harsh criticism from Moscow on Monday, with the largest Russian lenders facing multibillion-dollar losses as a result of the measure.

President Vladimir Putin warned of possible negative implications of the proposed move, which is pending approval by the Cypriot parliament. He said it would be "unfair, unprofessional and dangerous," his spokesman, Dmitry Peskov, told journalists.

The government of Cyprus on Saturday agreed to introduce a 6.75 percent tax on bank deposits of below 100,000 euros ($130,738) and a 9.9 percent tax on those above that amount in a move expected to secure 5.8 billion of the 10 billion euros it needs to cope with the sovereign debt crisis.

The measure is widely expected to become a severe blow for Russia, which accounts for nearly a third of the 70 billion euros deposited in Cyprus' banks.

Meanwhile, the Russian authorities are unlikely to confine themselves to mere assertions, with a decisive reaction to the move being already contemplated.

Russia might change its mind on easing the terms of the 2.5 billion euro loan it had provided to Cyprus, since the levy had been agreed upon without consulting Moscow, Finance Minister Anton Siluanov said Monday.

"We agreed with the Euro Group colleagues that we will coordinate our actions," he told Interfax, referring to the finance ministers of the euro-zone countries. "Our role is a possible easing of the terms of the loan that had been provided earlier. ... We wanted the decision to be made jointly, and now we'll be closely following the situation and also consider the issue of our participation."

In 2011, Russia provided a 4 1/2-year loan to Cyprus, but the latter asked Moscow to extend the maturity to five years.

There are three factors that could play a critical role in Russia's decision to prolong the loan: the size of the loss by domestic savers due to the levy; Cyprus' diminishing role as a major investor in the Russian economy; and the cost of prolonging the period of loan repayment, Morgan Stanley analysts said in a research note.

Russian residents contributed the largest share of deposits by non-EU residents with Cypriot banks, which accounted for 21 billion euros as of late January, Morgan Stanley said. This is 31 percent of Cypriot bank accounts.

"The levy is probably a negative surprise in Russia, and Russia's support may prove difficult to secure without further concessions," the note said. "In our view, Russia may only agree to adjust its 2.5 billion euro loan ... when it has clarity on the impact of the measures on Russian interests and it has secured some mitigation of the levy's impact on Russian depositors."

The issue is likely to be discussed during Cypriot Finance Minister Michael Sarris' upcoming visit to Moscow. The visit was initially scheduled for Monday but was later postponed to Wednesday, Interfax reported, citing a source in the Russian Finance Ministry.

Meanwhile, the Cypriot parliament postponed the discussion of the controversial plan to Tuesday. The lawmakers were initially slated to consider the issue on Monday.

The possible approval of the plan might result in Russia reviewing its relations with Nicosia, Prime Minister Dmitry Medvedev warned on Monday. He said the bailout looked like property confiscation.

Domestic banks are likely to be among those to be hit most, since they might see tens of billions of dollars in losses if the levy is introduced, according to estimates by Moody's Investors Service.

The rating agency identified a few "contagion channels," which pose potential risks for Russian banks, with loans they had provided to Moscow-linked Cypriot companies being the main channel.

According to Moody's estimates, loans by domestic banks to such firms reached $30 billion to $40 billion at the end of last year. The high risk of default of Cypriot banks increases the chances that the island's government will introduce a moratorium on external payment, making loan repayments to Russia impossible, Moody's said.

The move is expected to affect the largest domestic lenders like Gazprombank, Nomos Bank, Sberbank, Alfa-Bank and VTB, with the latter being more exposed than the others, since it has a large Cypriot subsidiary, Russian Commercial Bank, Moody's said.

VTB told Reuters that it would evaluate possible effects after studying the text of the bill on the deposit levy.

In addition to the loans to Cyprus-based companies, Russian banks had $12 billion deposited with local banks at the end of 2012, while corporate deposits accounted for $19 billion, which Moody's said was another "contagion channel" for Russia.

Siluanov said it would be unfair to make depositors responsible for the problems of the banking sector. His deputy, Sergei Shatalov, said earlier Monday that a more acceptable option would be to introduce a 10 percent tax on the interest earned by depositors.

The Cypriot parliament agreed to an unprecedented measure that undermined the trust of investors, attracted to the country thanks to its favorable tax regime, said Vyacheslav Smolyaninov, chief strategist at UralSib Capital.

As a result, investors now might withdraw their funds from the country to direct them to less risky jurisdictions, with Luxembourg and the Netherlands being the most likely locations for the money to flow, Smolyaninov said.

This also means that Cyprus is likely to lose its status as one of the largest investors into the Russian economy.

"The money withdrawn from Cyprus will flow to Russia from other jurisdictions, so new countries could appear among big investors in Russia," Smolyaninov said.

Cyprus was the second-biggest investor into the Russian economy last year after the Netherlands, with direct investment by the former reaching $16.5 billion, according to the State Statistics Service. The Netherlands contributed $21.1 billion.

Contact the author at irina.filatova@imedia.ru

Related articles:

- Cyprus Eyes Russian Aid
- Moody's Says Russia Risks Billions of Dollars If Cyprus Defaults
- In Cyprus Port, Russian Money Flows Freely

Original url:
https://www.themoscowtimes.com/2013/03/18/russian-lenders-face-billions-in-losses-due-to-cypriot-levy-a22457