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Small states reject Cyprus comparisons

By James Fontanella-Khan in Brussels, Kester Eddy in Budapest and Richard Milne in Oslo

Luxembourg and Malta defended their finance-driven economies on Wednesday in the wake of the Cypriot bailout, saying that their banking sectors could not be compared with that of Cyprus, which was bloated and on the verge of collapse.

The decision of EU finance ministers to force Cyprus to restructure and downsize its banking sector for a €10bn rescue package has shaken eurozone countries with outsized or heavily lossmaking financial systems.

"Luxembourg is therefore concerned about recent statements and declarations that were made since the crisis in Cyprus sharpened," the EU's second smallest state said in a statement on Wednesday.

Financial services groups based in the landlocked country – known for being the EU's largest tax haven – had assets of over 22 times its gross domestic product in the fourth quarter of 2012, according to the European Central Bank.

Josef Bonnici, governor of the Central Bank of Malta, also warned that comparing Malta with Cyprus – both have a financial sector that is about eight times their country's GDP – would be misleading.

"The problems facing Cypriot banks include losses made on their holdings of Greek bonds, whereas Maltese domestic banks have limited exposure to securities issued by the [eurozone bailout] programme countries," Mr Bonnici, who is also a member of the ECB's governing council, told Reuters.

Yields on Slovenia's benchmark dollar bond rose to a record 6.25 per cent on Wednesday on fears that the indebted former Yugoslav republic could also follow Cyprus and request a bailout.

Alenka Bratusek, its centre-left prime minister, insisted on Wednesday that neither Slovenia nor its banking sector were comparable to Cyprus and that the Alpine country would solve its problems without external aid.

"Our banking system is stable and safe and comparisons with Cyprus aren't valid. Deposits here are safe and the government is guaranteeing them," she told parliament, although she admitted that her cabinet was working "vigorously" to address the troubled state finances with measures that could include tax increases.

The country's largely state-owned banks made heavy losses last year and non-performing loans surpassed 20 per cent in the main banks. The solution, proposed by the former centre-right government is recapitalisation and spinning off bad loans into a bad-bank – all expected to cost approximately €4bn.

Remarks from Luxembourg, Malta and Slovenia follow comments by Jeroen Dijsselbloem, the Dutch finance minister who also leads the Eurogroup of eurozone finance ministers, that countries with an over-leveraged banking sector would not be rescued automatically if in trouble.

"Strengthen your banks, fix your balance sheets, and realise if a bank gets in trouble, the response will no longer automatically be: we'll come and take away your problems, " Mr Dijsselbloem said in an interview with the Financial Times and Reuters when asked about countries' such as Luxembourg and Malta.

Luxembourg said it fully supported the adjustment program for Cyprus, but it stressed that the decision to downsize the Mediterranean island's banking sector was an exceptional, one-off measure.

During bailout negotiations over the weekend, Luxembourg was among the countries that most boldly defended Cyprus's demands to save its two biggest and most troubled banks, as it feared that its own banking system could be questioned.

Although not a eurozone member, Latvia is also desperately playing down any comparisons with Cyprus, pointing out that its banks' assets are about 130 per cent of GDP.

The country is also seen as a potential future trouble spot because of the extremely high level of bank deposits from non-residents, most of them presumed to be Russian. Almost half of the country's total deposits – Lat6.1bn ($11.1bn) out of Lat12.5bn at the end of 2012 – came from non-residents.

Finance ministers on Monday agreed to rescue Cyprus after it consented to shut down its second-largest lender Laiki bank, wiping out its shareholders and bondholders, and restructure Bank of Cyprus, the island's largest financial institution.