

## CRISIS WATCH DAVID POWELL, BLOOMBERG ECONOMIST

### Banking Crisis, Bailout of Cyprus Unlikely to Be Repeated for Malta

Comparisons between the dangers posed by the banking systems of Cyprus and Malta appear to be misplaced, though the rapid expansion of the Maltese financial sector has the potential to someday become a problem.

The Cypriot banking system became too large for the state to honor its deposit guarantee without external assistance. The ratio of deposits to GDP stands at 259 percent. That calculation divides the size of the deposit base, excluding the holdings of monetary financial institutions and central government, in February, the latest reporting period, by nominal gross domestic product of 2012. This measure of the deposit base is used because, according to the EU webpage, guarantee schemes in Europe exclude the holdings of financial institutions and public authorities.

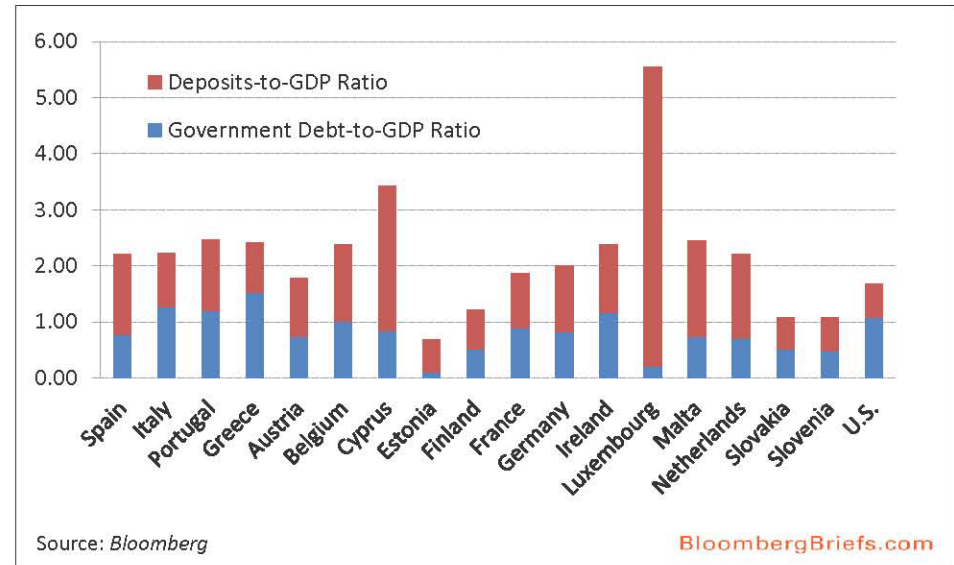
The only country of the euro area with a higher reading is Luxembourg, though the banking systems of the two countries are hard to compare. That ratio stands at 534 percent. One major difference between the two nations is the home countries of the banks.

The three largest banks by deposits in Cyprus are Cypriot. They are the Bank of Cyprus, the Cyprus Popular Bank and the Hellenic Bank, according to data from the Central Bank of Cyprus. That left the government of Cyprus responsible for the deposit guarantees of all three banks. The deposits of the largest bank alone are about 95.6 percent of GDP.

Only one of the three largest banks in Luxembourg is Luxembourgish. The biggest financial institutions by deposits are the Banque et Caisse d'Epargne de l'Etat, Societe Generale Bank & Trust and BGL BNP Paribas, according to a report published by KPMG. The latter two are French. The deposits of the only bank on that list that is Luxembourgish measure 56.3 percent of GDP. In the event of a crisis, the French government seems highly unlikely to force its Luxembourgish counterpart to honor the deposit guarantees of French banks operating in Luxembourg.

Malta is the next country on the list of nations with the highest deposit-to-GDP ratios. It measures 173 percent. That

#### Banking System of Cyprus Larger Than That of Malta



is 86 percentage points lower than the figure for Cyprus.

The figure for Malta is distorted by the presence of foreign banks like the number for Luxembourg. The two largest banks in Malta are Bank of Valletta and HSBC Malta. The deposits of the former are about 86 percent of GDP and those of the latter are about 69 percent of GDP.

The state of Cyprus was also more indebted before the bailout than that of Malta. The gross government debt-to-GDP ratio of the former stood at 84 percent and that of the latter measured 73.1 percent at the end of 2012.

The addition of the current government debt-to-GDP ratio to the deposit-to-GDP ratio provides a better measure of the government's ability to honor its deposit guarantees than just the latter. The sum of those two figures for Cyprus is 343 percent. It is 246 percent for Malta.

A thorough analysis of the asset composition of the banks in Cyprus and those in Malta would provide additional insight in the vulnerabilities of the systems, though that is beyond the scope of this article. Press reports have indicated Cypriot banks faced large losses on their

holdings of Greek government bonds. Maltese Central Bank Governor Josef Bonnici wrote in the Times of Malta that "Maltese domestic banks have limited exposure to securities issued by the program countries."

The most worrying aspect of the Maltese banking system is the recent speed of growth. The ratio of deposits to GDP rose to 172 percent at the end of 2012 from 141 percent at the end of 2005.

The growth of the banking sector has far outpaced that of the real economy. The deposit base has grown by 66.8 percent and the real economy has expanded by 37 percent during that period. Another 20 years of growth at that speed would leave Malta with the same deposit-to-GDP ratio as that of Cyprus today, though Malta would still benefit from the presence of international banks.

The growth of the Maltese banking system could pose systematic risks as large as those in Cyprus decades down the road, if the current pace is maintained, though that appears like a long horizon for a monetary union plagued by many clear and present dangers.