

MV Capital Management Midweek Market Commentary

Cyprus: Fury Unites the 1% and the 99%

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Cyprus is a tiny country by most measures, with a population of just over 1.1 million. Most Cypriots who have local bank accounts hold well under €100,000 in those accounts. They are Cyprus's own 99%.

Russia is a very large country, with a population over 140 million. A tiny – but extremely influential – subset of that population also have bank accounts in Cyprus, most of which are very, very much larger than €100,000. Call them the 1%, who rose to the commanding heights of the statist capitalism that has defined Russia's economy since the early 2000s. In this system Cyprus is a sort of combined Delaware and Cayman Islands – an address for moneyed Russian businesses to register office addresses and also to deposit large sums of the personal wealth of the individuals who run those businesses.

So if nothing else, this week's tempest in the Eurozone has given us the rather awkward spectacle of the 1% and the 99% uniting under one banner, venting their wrath against the System. That system being, in this case, the European policymaking troika of the ECB, EU and IMF and their seemingly ham-handed efforts to impose a 9.9% tax on Cypriot bank accounts. These are the modest checking and savings accounts of the 99% and the opaque multimillion dollar holdings of the 1% alike. What have we learned this week – and what should we be worried about going forward?

We've learned that Russians tread carefully with a minimum of bluster when faced with the fear of losing lots of their hard earned (or ill-gotten) wealth. It's hard to overstate the importance of Cyprus's banking system for just about anyone in Russia with, say, more than \$500,000 in personal liquid wealth. After some heated statements earlier in the week Russian Prime Minister Dmitri Medvedev has softpedaled, telling the Cypriot government to figure out their deal with the EU before expecting help from Russia. Putin himself has mostly remained mum. We imagine that a deal will be done – as we write this on Friday afternoon the parties are still locked in talks, with a variety of alternatives percolating up including a structure exempting small accounts, nationalizing the pension system or collateralizing future bond issues. World markets are taking the events in stride – US stocks have resumed their winning ways after a three day retreat earlier in the week. Market reaction is much more muted than in other Euro crises.

The other thing we've learned is that people really, really don't like it when the Man shows up to take a slice out of their own personal (and mostly modest) fortunes. That's a new tool to come out of the policymaking arsenal, and it looks to be a pretty bad one. What are the 99% thinking about now elsewhere along the Mediterranean coast – in Athens or Naples or Seville? Maybe they'll come a-tithing for us – 10% here, 10% there – to maintain the sanctity of bank balance sheets and bond ratings. Very little could be more destructive than massive runs on the banking systems of troubled Eurozone economies. However the deal works out in Cyprus, the specter of the bank tax is now firmly and squarely in the policy mix. It's something that policymakers may yet come to regret.

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