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Haircut of Greek government bonds (psi) and the loss to the banking sector of Cyprus as a result of losing their subsidiaries in Greece.

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ABSTRACT

During the last 30 years the Cypriot economy faced an extreme growth, either characterized as a miracle or a bubble. In the last decade, the economic euphoria arrived after the accession to the EU and to Euro zone, low interest rates and easy access to bank lending have caused rapid growth driven by extreme bank lending, reflection of which was the direct increase in property values and private and public sector debt. Nowadays, Cyprus suffers from an unprecedented financial crisis that resulted in asking financial assistance from IMF and Europe. Successive downgrades of creditworthiness as well as strict public finances had a major negative impact on Cypriot banks' performance. Besides, Cypriot banks owned a significant volume of Greek governmental bonds, a haircut of which worsened the situation. The primary conclusion of my thesis is a multi-variable description of the Cypriot banks' problems. That means that it is undeniable that Greek government bonds PSI (haircut) had a major negative impact on Cypriot banks. Nonetheless, there is strong evidence that the problems faced by most of the Cypriot banks started since the financial crisis turmoil in 2008 (two years before PSI) and they were driven by the overwhelming and irrational – in some cases – growth of the domestic banking system and the total economy. So, I adopt the approach that Greek bonds' PSI extended the problems of Cypriot banks that anyway would come in view.

Keywords:

Cypriot banks, Haircut, PSI, Greek debt, Recapitalization