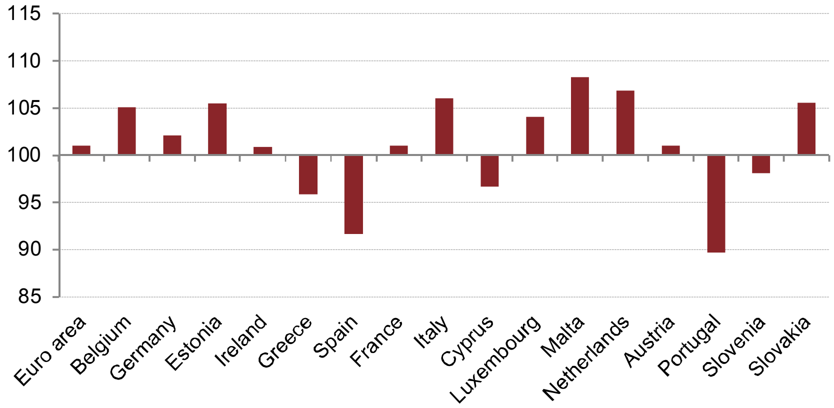
Another red line crossed

- **The Cyprus bail-out has raised fears of contagion**
- **It is arguably right to bail-in depositors and bondholders**
- **But a greater concern is the abandonment of another principle**

The Cyprus bail-out over the past weekend has raised concerns about contagion. By bailing in depositors and junior bondholders it is feared that there could be a run on Italian and possibly Spanish banks for fears of depositors there too ultimately being forced to bail in. These fears are legitimate, notably so for Spain, where bank deposits in January were down close to 10% from a year earlier.

Deposits held by other general government/other EA residents, Jan 2013 with January 2012=100



Arguably, it is right to bail in depositors and bondholders. But that aside, a more important concern should be that another red line that been crossed. The ECB progressively abandoned successive requirements for the quality and scope of collateral. Terms for bail-out packages have been eased. Now the idea that private sector involvement in the Greek bail-out was an exception, a unique case, has also been dropped.

These measures may all have been right (In fact, most of them were.). But that does not deter from the fact that abandoning one principle after another both highlights the depth of the EA problems; and creates substantial uncertainty about the impact and scope of future measures. This is the real danger.

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