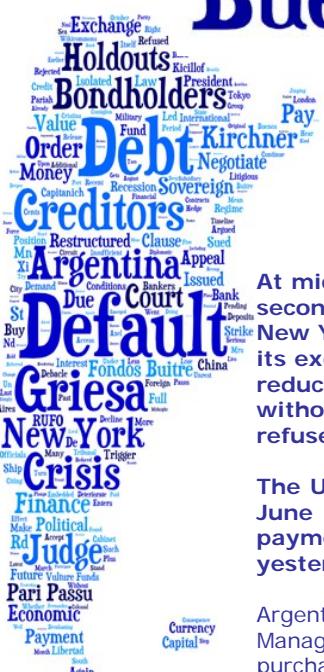


# Buenos Aires Briefing

Laura Mojonnier and Dr. Kristin Wesemann, July 2014/2

## Special Edition: Argentina Defaults Once Again

  
At midnight on 30th July 2014, Argentina went into formal default for the second time in less than 13 years. This most recent crisis emerged after a New York judge ruled in 2012 that Argentina could not make payments to its exchange bondholders – the almost 93% of its creditors who accepted reduced-value bonds after the country's colossal default in 2001-2002 – without first paying \$1.5bn to a group of litigious hedge funds who refused to participate in earlier debt swaps.

The US Supreme Court rejected Argentina's appeal of this ruling on 16th June 2014, rendering the country unable to make a \$539mn interest payment due at the end of the month. A 30-day grace period ended yesterday.

Argentine officials have referred to these holdout creditors – led by Elliott Management and Aurelius Capital – as “fondos buitre”, or “vulture funds”, as they purchased heavily discounted bonds after the country’s 2001 default and then sued to recoup their original nominal value plus past-due compound interest. Argentina has argued that it is unable to pay the holdout creditors in full because doing so could trigger \$120bn to \$500bn in additional claims from exchange creditors.

This claim is based on the Rights Upon Future Offers (RUFO) clause embedded in the country’s restructured bond deals, which gives the exchange bondholders the right to demand parity with any deals Argentina strikes with the holdouts. Argentina says it simply does not have that kind of money. The RUFO clause expires on 31st December 2014.

How has Argentina found itself in such a precarious position yet again? And more importantly, what does this turn of events mean for the country’s future – politically, economically, and socially? Will Argentina plunge deeper into recession? Will this latest debacle force a political regime change after more than a decade of Kirchner rule?

First, a timeline of events to explain what has led to current events, and then some predictions for what lies ahead for the beleaguered South American nation. Argentine officials have taken to calling the holdout creditors “fondos buitre”, or “vulture funds”, turning the issue into a populist rallying cry.

**23rd December 2001:** Argentina announces plans to stop payment on approximately \$US100bn in external debt, triggering the largest sovereign default in history. Social unrest due to deteriorating economic conditions causes a political crisis, with the country witnessing five presidents in 10 days. Argentina’s deep recession and subsequent default in 2001-2002 caused mass social unrest in the country.

**2005 and 2010:** In two rounds of negotiations, Argentina gets 93% of its creditors to accept new bonds valued at 30 cents on the dollar, known as “exchange bonds”. These new bonds are issued in Buenos Aires, New York, Tokyo, and London.



**23rd February 2012:** New York District Court Judge Thomas Griesa rules that Argentina cannot continue to make payments to exchange creditors who hold New York-issued bonds without first servicing debts owed to a group of holdout creditors who sued to be paid in full. Griesa bases his ruling on the pari passu clause in its bond contracts, which dictates that all of the country's bonds would "rank at least equally" with its other debts.

**5th March 2012:** Pending appeal, Judge Griesa issues a stay on the ruling

**2nd October 2012:** An Argentine military ship, the Libertad, is detained in a Ghanaian port, after a local court ruled in favor of the hedge fund NML Capital, a subsidiary of Elliott Management, which demands \$20mn for the ship's release. On 19th December the diplomatic crisis comes to an end when the UN Tribunal for the Law of the Sea orders Ghana to release the ship, citing its immunity as a military vessel.

**March-August 2013:** Argentina attempts to negotiate with the "holdout" creditors, offering to pay them 20 cents on the dollar. On 23rd August, the US Second Circuit Court of Appeals rules that Argentina's offer is insufficient and that the country must pay the full value of what they owe the holdouts.

October- November 2014: the US Supreme Court and the Second Circuit Court decline to hear Argentina's appeals. The country contests Griesa's novel interpretation of the pari passu clause.

**16th June 2014:** The US Supreme Court again refuses to hear Argentina's appeal, propelling Griesa's original 2012 ruling into full effect.

27th June 2014: Argentina deposits \$539 million into a New York bank to try to make an interest payment to the exchange bondholders, but Griesa orders that the money be returned.

**30th June 2014:** Argentina is unable to make an interest payment to its exchange bondholders, triggering technical default, as well as a 30-day grace period before the country enters into formal default.

**22nd July 2014:** Judge Griesa refuses to suspend his ruling to give Argentina more time to strike a deal, ordering the country to continue its negotiations with the holdouts under the supervision of mediator Daniel Pollack. Argentina argues that the RUFO clause embedded in its restructured exchange bonds means that full payment to the holdout creditors could trigger an additional \$120bn-\$500bn in claims on the country. The country's foreign currency reserves stand at about \$30bn.

**29th July 2014:** With the 30th July deadline looming, Argentine bankers fly to New York in an attempt to strike a last-minute deal with the holdout creditors, offering either to provide a promissory note to be exchanged for securities in 2015, once the RUEO clause expires, or to buy the holdouts' debt outright.

**30th July 2014:** The 30-day grace period ends and Argentina enters into formal default. Argentina argues that it is technically not in default.

**31st July 2014:** In a furious press statement, Argentine Cabinet Chief Jorge Capitanich insists that Argentina is not in de-default, citing the \$539mn it deposited into a New York bank on 27th June, in time for the 30th June interest payment. Capitanich urges exchange bondholders to demand their money from Griesa. Negotiations continue as Standard & Poor's classifies Argentina's credit rating as "selective default".



Konrad  
Adenauer  
Stiftung



# WHAT LIES AHEAD FOR ARGENTINA?

#### ECONOMIC ISOLATION TO CONTINUE

While Argentina's default is serious, solidifying the country's status as an economic and financial pariah in the international system, its consequences will not be re-motely as grave as last time. Its total foreign issued debt stands at about \$US29bn, compared to \$US81bn in 2001. The default is expected to have minimal contagion effect, as the country has been economically isolated in recent years both because of its inability to access dollar-financing markets, and its protectionist, inward looking political regime under the leadership of President Cristina Fernandez de Kirchner.

But the cost for the domestic economic conditions in Argentina will be serious. The country is already in a recession, suffering from crippling inflation and a rapidly devaluating currency. Access to capital will grow even tighter, and as a consequence the country may miss out on many opportunities for development of its natural resources, such as shale gas formations in Vaca Muerta.

## A DEEPENED FRIENDSHIP WITH CHINA

China has already begun to step in to fill the vacuum left by Western creditors, with President Xi Jinping striking a series of deals with President Kirchner on a 19th July state visit to Buenos Aires, including a \$2.1bn loan to buy railroad equipment, and \$4.7bn in financing for hydroelectric dams in the south of the country. But this may not be enough to prevent Argentina's continued downward slide, especially as by entering into default, "acceleration clauses" allow all of the country's bond-holders to demand immediate full payment. More international court battles may be on the horizon.

## FAREWELL TO THE KIRCHNERS?

With presidential elections scheduled for 2015, and Mrs. Kirchner ineligible to run for reelection, many wonder whether or not the country's Partido Justicialista (PJ) will be ejected after more than a decade in power. For the moment, Mrs. Kirchner has managed to make the fight against the "fondos buitre" a rallying point for populist sentiment. But it is uncertain whether or not the people's support will continue if conditions in the country deteriorate.

WALL STREET MAY LOSE ITS APPEAL

Finally, analysts are also debating whether Griesa's order could be applied to exchange bonds issued in other countries, including the UK, Japan, and Argentina itself. In fact, by essentially superseding Argentina's sovereignty, Griesa's ruling could have serious implications for future of sovereign debt restructurings, and at the very least, make New York an unattractive place to conduct international finance.