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Don’t cry for rogue debtor Argentina

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José Barrionuevo, the former Barclays Capital emerging markets strategist who came up with the quantitative model that Argentina used to rationalise its punishing 2005 debt restructuring, recently wrote a guest post justifying that infamous transaction: “The framework we proposed offered a way out of default through debt sustainability, and concluded that Argentina would need roughly a 67 per cent write-off to make its outstanding debt sustainable immediately.”

The fact is that Argentina’s economy was sufficiently recovered by early 2005, largely thanks to an intervening commodity export boom, such that the government in Buenos Aires needed only a modest amount of debt-service relief from its creditors in order to regain fiscal viability. This is especially evident with the benefit of hindsight.

For example, the government’s tax revenues had already doubled in dollar terms between 2002 and 2004 and the country’s official international reserves had recovered similarly, from under $10bn in early 2003 to over $20bn by early 2005. And yet, Barrionuevo’s original simulation model was never updated to reflect the strong economic rebound under way. It was also loaded with excessively pessimistic assumptions as to what the future would bring in terms of crucial variables such as exports and tax revenues. And, unlike all prior sovereign debt restructurings, the model was never allowed to be subjected to a reality check – much less a negotiation – on the part of either private or official creditors, such as the IMF.

During 2006-2012, the economy ended up growing twice as quickly as the government’s forecasts vintage late 2004, with actual export earnings and tax revenues outperforming the gloomy official assumptions by even greater multiples. The fact that Argentina offered GDP warrants on which they later paid proved to be a small consolation, given the massive haircuts that bondholders were forced to accept.

Moreover, the self-imposed goal of making the public debt sustainable “immediately” through a massive write-off was completely misguided. Sustainability is always an objective which is to be attained over a period of several years, as we have witnessed in all the economic adjustment programmes around the periphery of Europe, where a reduction in debt ratios is to be accomplished gradually.

Indeed, by the time Argentina had settled on its demand for massive debt forgiveness, next-door Uruguay had already successfully refinanced its public debt in a creditor-friendly manner and had returned to the international capital markets, despite having had to face fiscal, currency, banking, and economic shocks fully comparable to those in Argentina. The difference was that in Uruguay the authorities used updated figures and incorporated realistic assumptions, did not aim for instantaneous cuts in their debt-to-GDP ratios and, above all, followed more sensible, confidence-building economic policies.

Therefore, it should be clear to all by now that Argentina and its financial advisers did have much smarter choices nine years ago: they should have put forth a more reasonable and credible proposal based on negotiations or at least consultations along the lines of the Uruguay refinancing, in order to avoid a holdout problem and restore their access to capital markets.

This brings us to the current holdout litigation which has tied Argentina in knots. Barrionuevo is again excessively pessimistic when forecasting the future now, in mid-2014. “A [US] Supreme Court decision adverse to Argentina would not just throw overboard its restructuring and that of Greece. It would do away with the possibility of giving many other poor countries a historic opportunity to deal with daunting debt in a sustainable way and get back on the path to growth,” he claims.

Nothing need be further from the truth. The New York District Court of Appeals has rightly dismissed those kinds of warnings as “speculative, hyperbolic, and almost entirely of the Republic’s own making.” First, the 2005 restructuring need not be affected by a ruling that is adverse to Argentina if the government were to decide to follow the court’s order to pay the litigants alongside the exchange bondholders. Second, the restructuring of Greek debt is a done and settled deal. Third, sovereigns facing external financial difficulties need not fear repercussions from the Argentina-related litigation. All they must do in order to restructure their debts successfully is avoid copying Argentina’s rogue-debtor behaviour.

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http://blogs.ft.com/beyond-brics/2014/06/12/guest-post-dont-cry-for-rogue-debtor-argentina/