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Argentina Defaults: The Day After

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</blog/2014/08/argentina-defaults-the-day-after/#idc-container>)

Argentina has defaulted. The long-running court drama that ran for over ten years and pitted Argentina against a small group of holdout creditors was decided decisively in favor of the holdouts in June, and Argentina subsequently refused to make payments as required by the courts. As a result, neither the holdouts nor the holders of restructured external debt will get paid, resulting in S&P placing the country in “selective default.” (Payment on the restructured bonds was due June 30, and the grace period for making those payments expired yesterday.)

There is a great deal of back-and-forth on who is to blame, focusing mostly on the equity/ethical/moral implications of creditors (or vultures?) being rewarded for a litigating their contractual rights against a distressed sovereign that has carried out an internationally supported restructuring. That’s a big question, not answered here (though I do believe that Argentina’s problems are mostly of their own making, and this court case a convenient scapegoat). Here are a few thoughts on what to look for in coming days.

What comes next?

Negotiations will continue, and there will continue to be talk of a possible deal that would end the default, including a plan where local banks buy the debt and sell it to the government. I’m deeply skeptical. Over the last 10 years, Argentina essentially has not budged from the position that holdouts would get no better deal than those that restructured. As the court cases went against them, that offer became less and less attractive to the creditors, the courts became more resistant to stays and other rulings to protect Argentina, and the gap between the parties became so vast that it is hard to imagine any side caving now. Indeed, the political cost within Argentina of the government now paying off the holdouts seems extraordinarily high, suggesting that we may need a new government before a negotiated solution is possible.

Credit Default Swaps (CDS) will be triggered. In the Greek restructuring, there was a lot of concern that triggering CDS would have systemic effects. It didn’t. The relevant committee (ISDA) likely will judge this to be a credit event, and those who sold insurance through credit default swaps will pay out. Because some creditors may have significant CDS protection, triggering makes it easier to know who is a true creditor of the country and can align interests in a negotiation.

Watch local markets. What is the cost of default for Argentina? This is a local market story—today’s selloff in global equity markets has less to do with Argentina and more to do with Russian sanctions and U.S. monetary policy concerns. Argentina has long been excluded from international markets, and though there was hope that they would re-access those markets, on the day after default little has changed. Local debt is still being paid. The economy is still a mess. So, from that perspective, the position of the country hasn’t changed much. Yet, many

expect local market turmoil, including exchange rate pressures and higher interest rates, which could be a tough economic hit. Any of a number of triggers can start a run/crisis, and if one it happens the government has limited resources to defend against it. A domestic crisis could put pressure on all parties—Argentina, its creditors, and the courts—to compromise.

Look for innovative legal approaches. I'm convinced that the legal situation will remain murky for some time, given the complexity and diversity of debt contracts, and the differing incentives to accelerate/litigate. But we should take the time to explore creative approaches that may be possible post default. My favorite is [Anna Gelpern's](http://www.creditslips.org/creditslips/2014/07/injunction-math-acceleration-and-the-incredible-shrinking-payment-percentage.html#more) (<http://www.creditslips.org/creditslips/2014/07/injunction-math-acceleration-and-the-incredible-shrinking-payment-percentage.html#more>), who notes that once all debt is accelerated the court's remedy allows for interest payments only to all creditors. I have no idea whether it would work, but watch this space.

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