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Article

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Assessment of Argentina's Creditworthiness After the Debt Restructuring

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Argentina's 2020 debt restructuring was the second largest sovereign restructuring in history, after Greece's in 2012. The sovereign's latest default was triggered by extending maturities on short-term debt in August 2019, followed by another postponement of short-term debt payments in December 2019 and long-term debt payments in February 2020. In August 2019, the government also announced its intention to restructure its long-term debt. This article compares Argentina's sovereign debt crisis with prior sovereign bond defaults and sets forth Moody's view that significant challenges result in Argentina's creditworthiness remaining weak even after the debt restructuring and despite sizeable losses for investors. These challenges include Argentina's large share of foreign-currency debt amid its dependence on external foreign-exchange financing and limited domestic funding options, and subdued economic prospects as the coronavirus pandemic deepened the country's multi-year recession and also affected Argentina's main trading partners.

Keywords: Sovereign debt restructuring; sovereign debt default; country risk; creditworthiness; debt crisis.

JEL codes: F34, H63, H12, H81

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I. Introduction

Argentina defaulted in August 2019 as it extended maturities on more than $8 billion of short-term debt and signaled its intent to restructure portions of its medium- and long-term debt. The decision followed a severe market reaction to the outcome of national primary elections on 11 August, which signaled a change in government and the increased likelihood of significant policy shifts. Consequently, government bond spreads more than doubled and the exchange rate jumped from about 45 pesos to the dollar to just under 60 by year-end.

By December 2019, a new administration was in power. The new government announced it would further restructure the short-term debt, pushing all short-term debt payments to late 2020. Amid complete market closure and a deepening economic crisis, the government announced it would set forth a restructuring offer to bondholders in the first quarter of 2020. In February 2020, facing limited demand for its peso debt, the government postponed a $1.47 billion principal payment on a dollar-subscribed peso-payable bond (AF20) to September.

On 5 April, the government announced it would delay payment on about $10 billion of local legislation foreign-currency debt. On 16 April, the government announced a debt restructuring proposal affecting almost $70 billion of foreign-legislation debt. After prolonged negotiations with bondholders, in September 2020 the government restructured foreign-currency obligations owed to private creditors under foreign and domestic legislation, bringing an end to the country's prolonged default.

On 28 September 2020, Moody’s affirmed Argentina’s sovereign bond rating at Ca and changed the outlook on the ratings to stable from negative. The outlook change reflected a materially lower risk that future losses would exceed those incorporated in Argentina's Ca rating (Moody’s [28 September 2020]). In April 2020, Moody’s downgraded Argentina’s sovereign bond rating to Ca from Caa2, reflecting the expectation that private creditors would likely incur substantial losses in the debt restructuring process as the economic and financial shock stemming from the coronavirus pandemic compounded the government’s funding stress. The rating had been on review for downgrade since August 2019, when it was downgraded to Caa2 from B2 to reflect the rising expectation of losses for investors because of mounting pressures on the government’s finances (Moody’s [3 April 2020]).

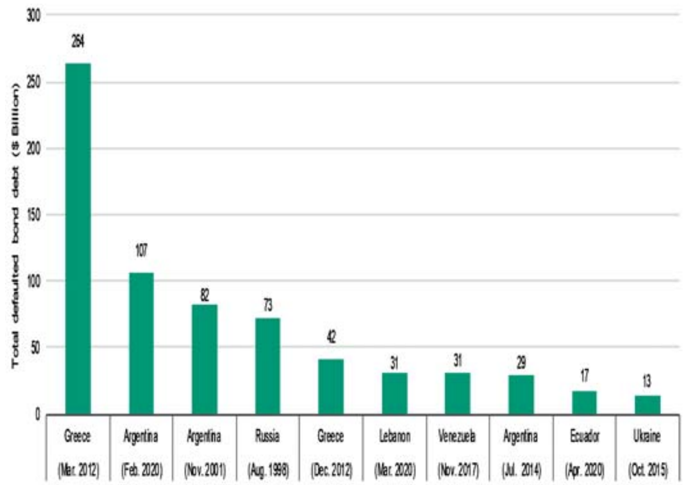

FIGURE 1. Sovereign Debt Outstandings in Nominal Values

Bracket refers to the date of first default. For Argentina 2020, the $107 billion include $15 billion of local legislation foreign-currency debt held by public entities. For Venezuela, total amount of defaulted debt excludes debt obligations under PDVSA. Source: Moody's Investors Service.

Argentina's 2020 debt restructuring was the second largest sovereign restructuring in history. This article compares Argentina's sovereign debt crisis with prior sovereign bond defaults and reflects Moody's view that key challenges result in the sovereign's creditworthiness remaining weak even after the debt restructuring and despite sizeable losses to investors. These challenges include Argentina's large share of foreign-currency debt amid dependence on external foreign-exchange financing and limited domestic funding options, and subdued economic prospects as the coronavirus pandemic deepened the country's multi-year recession and also affected Argentina's main trading partners. We review these challenges below.

II. Argentina's Default

Argentina's general government debt totaled about $323 billion, or 90% of GDP as of year-end 2019. The total restructured debt stock amounts to about $107 billion, equivalent to a third of the government's total

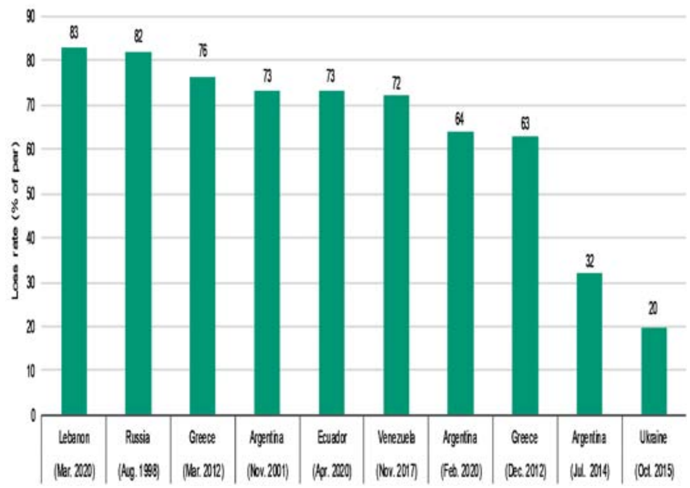

FIGURE 2. Loss Rates, Percent of Par Value of Debt

Ten largest sovereign defaults since 1993. Loss rate is defined as 100 minus the average trading price (in % of PAR), 30-day post default or around closing date of distressed exchange. Source: Moody's Investors Service.

debt. As Figure 1 shows, the amount surpassed that of Argentina's 2001 default, making it the second largest sovereign default behind Greece's in 2012. Argentina's 2001 default itself had been the largest sovereign default in history up to that time.

The historical track record of large sovereign bond debt restructurings warrants a cautious stance on potential recoveries. There is usually a high level of uncertainty around expected losses given that historically, loss rates for sovereigns have varied widely. For example, the loss rates in the nine largest sovereign bond defaults have ranged from 82% in Russia in 1998 to 10% in Jamaica in 2010, as Figure 2 shows. Nevertheless, the largest restructurings have garnered high loss rates – 82%, 76% and 73%, respectively, in the Russian, Greek and Argentinean 2001 defaults. The average historical sovereign loss rate was 48% during the 1998-2019 period, while the value-weighted loss rate over the same period was 60% (Moody's [May 2020]). Argentina's 2020 debt restructuring also resulted in significant investor losses, of 64%, as a result of the country's deteriorating economic and financial conditions, made worse by the coronavirus pandemic.

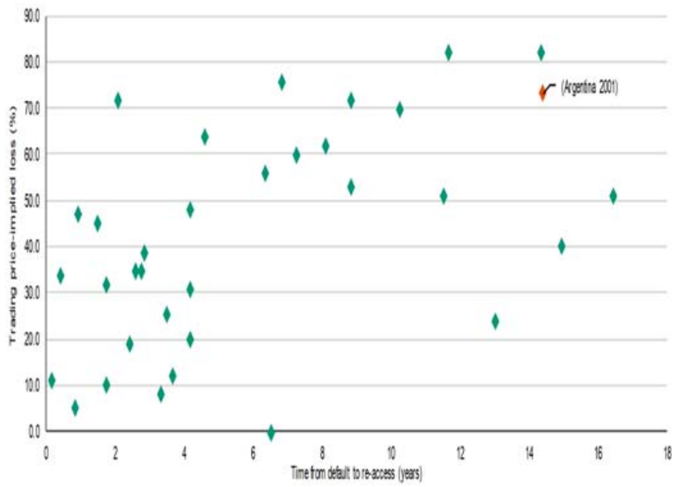

FIGURE 3.Implied Losses for Investors (%)

Sovereign bond defaults during 1997 – 2019. Re-access is defined as the date of first issue of international bond by the sovereign following the debt exchange. Calculations are as of December 2019. Source: Moody's Investors Service. "Sovereign Defaults Series: Market Re-Access and Credit Standing After Sovereign Default", October 2013.

Repayment of restructured debt will require that Argentina tap international capital markets that today remain closed. We expect Argentina's market access to remain very limited as long as the government fails to address long-standing macro-economic imbalances. The losses incurred by investors in past sovereign debt restructurings have been highly correlated with the length of market exclusion, as Figure 3 shows.

Argentina itself had experienced one of the longest periods of lack of access to international market financing following the 2001 default. On average, between 1997 and 2019, sovereign governments remained out of international capital markets for 6.1 years after default and 4.9 years after final default resolution. Default resolution itself has been relatively quick, taking slightly over one year on average, meaning that the length of market exclusion has generally not been driven by an inability to resolve the default but by the length of time it took for countries to rebuild their ability and reputation to service debt (Moody's [May 2020] and [2013]).

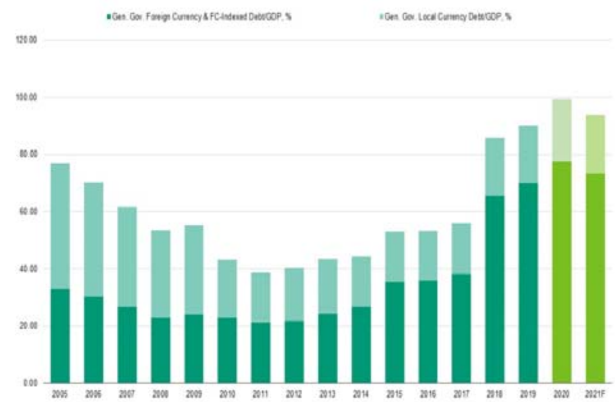

FIGURE 4.Government Debt to GDP Ratios for Argentina

Source: Moody's Investors Service

III. Argentina's Creditworthiness after Debt Restructuring

Argentina's total debt as of year-end 2020 was $320 billion (100% of GDP), according to government figures. On 4 September 2020, Argentina finished restructuring $107 billion of its debt, including $66 billion in foreign-currency debt issued under foreign legislation and $41 billion in foreign-currency debt issued under domestic legislation ($15 billion of local legislation foreign-currency debt was held by public entities). The debt restructuring extended upcoming maturities and reduced interest payments. As a result, Argentina's annual debt service on the newly restructured debt will remain below $5 billion until 2024 but will spike markedly thereafter. Meanwhile, interest rate reductions will cut the average interest on foreign law bonds between 2020-30 to 3% from 7%, significantly reducing the cost of the government's debt, which had risen substantially over the last five years.

The remainder of the debt is owed to multilateral or bilateral agencies, including the IMF, as well as to other government entities. Argentina has large upcoming payments to the IMF, which will total more than $20 billion per year in both 2022 and 2023. The government aims to negotiate a new agreement with the IMF to reprofile $44 billion in debt payments to the IMF. Reaching an agreement with the IMF, and delivering on the targets, will not be easy as the government will have to commit to multiyear fiscal consolidation targets and multiple structural reforms aimed at jumpstarting economic growth. In addition to policy implementation challenges, the authorities will also encounter strong social and political opposition that could further complicate this endeavor.

Argentina currently faces a series of macroeconomic imbalances that may deepen and prolong an already extensive economic crisis brought by the coronavirus pandemic. Key challenges remain the exposure to foreign-currency risk and the difficulties in restarting the economy.

As Figure 4 shows, Argentina's external indebtedness grew rapidly between 2013 and 2019, which has resulted in about 80% of government debt denominated in or being indexed to foreign currency. The increase in foreign-currency exposure occurred in the context of limited domestic funding options, given that the banking system has remained small since the 2001-02 financial crisis. As a result, the government's repayment profile is highly exposed to volatility in market sentiment and exchange rate fluctuations.

The lack of a well-developed local currency debt market is a key reason behind the repeated Argentine defaults. This lack of local market funding was common in Latin America in the past, but while domestic credit as a share of GDP has increased during the last decade in countries such as Brazil, Chile, Colombia and Costa Rica, it has remained low in Argentina. This has been driven by periods of high inflation, negative real interest rates, deposit freezes and capital controls, and the nationalization of the private pension system. As a result, Argentina remains dependent on international capital markets for financing its government debt, which remains at over $300 billion even after restructuring. Delaying principal and interest payments for several years forward only delays the need to tap international capital markets.

At the same time, as Figure 5 illustrates, the economy has significantly dollarized. Moody's Dollarization Vulnerability Indicator, which measures total foreign-currency deposits in the domestic banking system relative to official foreign-exchange reserves and foreign assets of domestic banks, has risen from about 20% in 2008 to more than 60% in 2016. As of 2020, the level remained at about 55%. High dollarization not only exposes the economy to exchange rate risks but also increases the pass-through from exchange rate depreciation to inflation and complicates the authorities' efforts to control inflation.

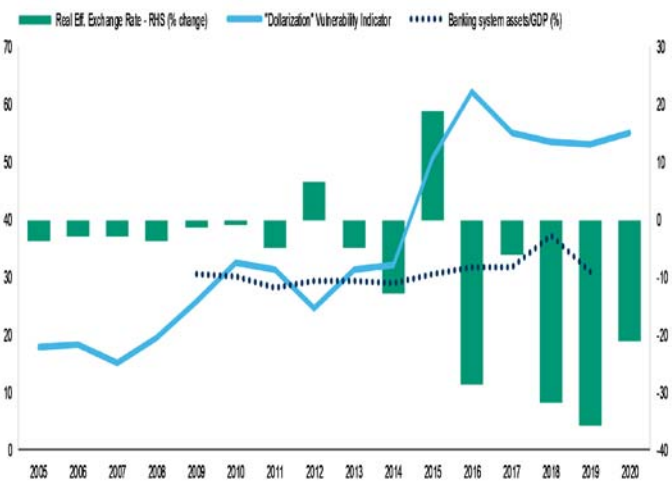

FIGURE 5 Dollarization Vulnerability Metrics for Argentina

Dollarization Vulnerability Indicator = total foreign-currency deposits in the domestic banking system / (official foreign-exchange reserves + foreign assets of domestic banks). Source: Moody s Investors Service

Argentina's historically high External Vulnerability Indicator, which measures the ratio of external debt payments and non-resident deposits to official reserves, has averaged around 200% since 2012, a reflection of the sovereign's comparatively high exposure to external shocks. Reserve buffers have materially weakened and a large proportion of the sovereign's foreign-exchange reserves are borrowed, which limits the extent of Argentina's buffers in the event of another currency crisis or liquidity constraints. The significant depreciation of the peso exposed this vulnerability and manifested in a material weakening of the sovereign's debt and interest burdens. In Moody’s view, debt will approximate 94% of GDP by 2021, up from 57% in 2017, the year before Argentina's currency crisis erupted. Interest payments consumed 18% of revenue in 2019, up from 11% in 2017. The debt restructuring would reduce interest payments-to-revenue to about 8% in 2021 and 2022 but will spike markedly after 2024 (Moody’s [October 2020]). Despite these fiscal challenges, other public-sector entities hold about 35% of Argentina’s government debt, which partially reduces the sovereign's exposure to rollover risk.

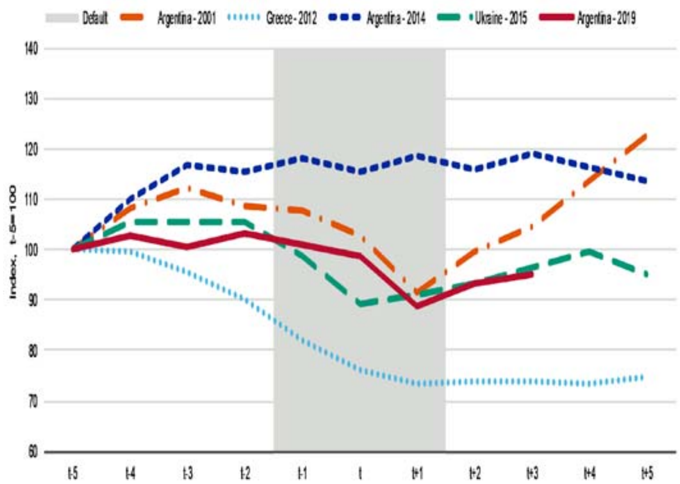

FIGURE 6. Real GDP Around Default (Index, $t - 5 = 100$)

t refers to the year of initial default. Sources: Moody's Investors Service.

IV. Restarting the Economy

Argentina's economy has been in recession for the past three years. The coronavirus pandemic deepened the recession in 2020 and complicated the subsequent economic recovery. Moody's estimates the economy to contract by 10% in 2020, its third consecutive year of recession, before rebounding to 5% growth in 2021. Our expectations for continued growth volatility extend a pattern of stop-and-go growth dynamics that have persisted since 2011. Argentina's economy grew at an annual average rate of just 0.4% in 2011-19. In Moody's view, despite the growth recovery we expect in 2021, economic risks remain tilted to the downside, and will be largely dependent on the degree to which the coronavirus is successfully contained in the coming months.

The extent of the economic crisis in Argentina has been nearly as severe as during its 2001-02 crisis or as in some other large sovereign default crises. As Figure 6 shows, the country's real GDP has so far contracted by 15% between 2017 and 2020 compared to peak-to-trough contraction of about 20% in the five-year period around Argentina's 2001 default, over 25% during Greece's 2012 default and over 15% during Ukraine's 2015 default. The coronavirus crisis contributed to a

10% real GDP contraction in 2020, before a recovery of about 5% growth in 2021 and 2% in 2022.

Argentina has a large economy (with nominal GDP at about $400 billion in 2021) and comparatively high wealth levels ($22,997 GDP per capita in PPP terms in 2019). However, the economy has declined by 0.3% annually on average over the five years prior to the coronavirus pandemic. A long history of volatile growth, high and unruly inflation, and frequent economic and exchange rate shocks have resulted in nominal GDP compression and lower purchasing power than metrics imply.

High and volatile inflation has been another challenge. End-of-year inflation reached 57% in 2019, the highest level in almost three decades, and Moody's expects inflation to be about 36% in 2020 and to remain about 50% in 2021 and 40% in 2022. Indeed, despite a strict monetary program, strong pass-through from the peso depreciation and high financial volatility remain impediments to lower and more stable prices.

The coronavirus pandemic further deepened and prolonged Argentina's multi-year recession. Argentina's economy is estimated to contract by about 10% in 2020, as quarantines and other restrictions brought domestic economic activity to a standstill. Business activity in Argentina declined significantly, with the slowdown occurring across all sectors. High foreign currency exposure in the context of limited domestic funding options underlines the difficulties in restarting the economy. International reserves have been under pressure. At present, the level of gross reserves stands at over $40 billion, but net liquid reserves (excluding dollar deposits held at the central bank, gold and swaps with other central banks) are estimated below $10 billion. A persistently weaker currency and lower real incomes will continue to weigh on the consumer sector, affecting imports of vehicles and other capital goods.

In Moody's view, virus containment efforts will result in further pressures on the government's fiscal accounts in the coming months. Meanwhile, financial conditions have tightened going into 2021 and will put additional pressure on dollar reserves and liquidity. The coronavirus crisis only compounded the already deep economic and budgetary challenges that the government faced. Elevated credit risks remain present unless the authorities address the fundamental macroeconomic imbalances that continue to undermine the sovereign credit profile, raising questions about Argentina's capacity to meet future debt obligations, which are set to rise sharply after 2024.

V. Concluding Remarks

Argentina faced a large debt restructuring, which resulted in significant investor losses following the country's deteriorating economic and financial conditions. These conditions worsened as a result of the coronavirus pandemic.

Even after the debt restructuring, a number of challenges to Argentina’s credit profile remain. The sovereign is effectively unable to access market-based funding and is grappling with strained dollar-based liquidity and extremely tight financial conditions. The coronavirus crisis compounded the effects of these factors. Amid limited domestic funding options, the sovereign relies heavily on external foreign-currency financing, which has resulted in a large share of foreign-currency debt. As a result, the country’s credit profile has large exposure to exchange rate fluctuations and will remain dependent on market confidence.

In Moody’s view, the risk of future debt restructurings remains high as debt payments are set to rise materially and Argentina's ability to meet them remains uncertain.

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