

Greek Insolvency Overwhelmed by Argentina's Default Risk

By Drew Benson - Nov 16, 2012 5:04 AM CT

Argentina's bond yields are eclipsing those of Greece for the first time since the European nation's debt restructuring in March, as speculation increases the South American country will opt to default rather than settle with its so-called holdout creditors.

Yields on Argentina's euro-denominated bonds due in 2033 surged 4.15 percentage points to a five-month high of 16.93% after a U.S. court ruled Oct. 26 the country must pay holders of debt from its record USD 95 billion default in 2001 when it makes payments on restructured notes. The notes yield 0.91%age point more than similar-maturity bonds sold by Greece after it restructured more than USD 200 billion of debt.

While Greece has contracted for 17 straight quarters and its bailout funds from the European Union have been frozen since June, Argentine bonds are considered less creditworthy because investors doubt President Cristina Fernandez de Kirchner will comply with the ruling and trigger a default as soon as next month, according to TCW Corp Inc. Based on credit-default swaps, the implied probability that Argentina will renege on its debt over the next 12 months has now surged to 63%.

“What's being priced in isn't a solvency issue for Argentina but instead a risk of technical default,” Marcela Meirelles, a Latin America strategist at TCW Corp Inc., said in a telephone interview from Los Angeles. “There's uncertainty regarding how the government will react.”

Alfredo Scoccimarro, a spokesman for Fernandez, didn't return a telephone call seeking comment.

'Vulture Funds'

Fernandez has vowed to never pay investors she has dubbed “vulture funds.” Economy Minister Hernan Lorenzino said Nov. 5 that “the actions of the vulture funds aren't going to impede” the government from paying the 93% of investors who tendered defaulted bonds for new debt in 2005 and 2010.

Billionaire hedge fund manager Paul Singer is among creditors who rejected the offers that paid 30 cents on the dollar and have sought to compel Argentina to repay them in full for almost 11 years.

In its Oct. 26 ruling, the appeals court upheld orders issued by U.S. District Judge Thomas Griesa and sent the case back to him to clarify how a payment formula he set is intended to work. He said on Nov. 9 that he will determine how much Argentina must pay on its defaulted debt by Dec. 1, one day before USD 42 million in interest is due.

Argentina asked the U.S. appeals court to reconsider its decision on Nov. 11, according to a court filing.

Greek Restructuring

Peter Truell, a spokesman for Singer's New York-based hedge fund Elliott Management Corp., declined to comment on the ongoing litigation.

Greece forced holders of notes issued under domestic law to accept a 53.5% loss on the face value of its securities, while continuing to pay overseas bonds.

If Argentina's appeal is denied, the government may choose to default on some of the international bonds and pay holders of local notes, according to Claudia Calich, who helps manage USD 2.4 billion of emerging market debt, including Argentine bonds, at Invesco Advisers Inc.

"There is the potential for the government to let some bonds go into technical default and accumulate arrears while they pay others, especially local law bonds," Calich said in a telephone interview from New York.

Alberto Bernal, the head of fixed income research at Bulltack Capital Markets, says that Argentina will probably continue to pay interest on its euro-denominated bonds because they wouldn't be subject to the jurisdiction of U.S. courts.

'No Sense'

"It makes no sense," Bernal said in a telephone interview from Miami. "At these levels, I wouldn't sell my euro-denominated bonds. You already took a huge hit and you're going to get paid."

The cost to insure Argentine debt against default rose 132 basis points to 2,656 basis points yesterday, according to data compiled by Bloomberg. The credit-default swaps imply a 84.8% probability Argentina will default in five years, based on the assumption investors will recover 25% of the par value of the bond.

The extra yield investors demand to hold Argentine government dollar bonds instead of U.S. Treasuries narrowed 35 basis points to 1,240 basis points at 5:59 a.m. New York time, according to JPMorgan Chase & Co. US Treasuries are yielding 0.25% annually.

The peso fell 0.1% to 4.7938 ARS/USD yesterday.

'Weak Sponsorship'

While Argentina's economy continues to expand and the country has enough foreign reserves to pay debt, Fernandez's seizure of oil producer YPF SA in April and the

tightening of foreign-exchange restrictions had already eroded demand for the nation's debt, according to TCW's Meirelles.

“Even before the recent court decision, you had weak sponsorship of the credit,” Meirelles said. “Now you overlay the risk of a technical default driven by a court ruling. It's a particularly negative combination that explains why bonds are down so much.”