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Argentina's Debt Crisis

By Nahal Bahri, J.D. Candidate 2015 | August 4, 2014

Last week, Argentina defaulted on its debt for the third time in three decades, setting the country up for a debate on how to move forward. This default is Argentina's second default in 13 years, and its spiral is causing concern not only in Latin America, but also in the U.S. and Europe. The Argentine stock market has taken a slight hit, which may have global repercussions.

Argentina's previous default occurred in 2001 when "the government stopped payment on more than $100 billion in debt – the world's largest sovereign default, and by the end of the crisis the country's economy had shrunk by a fifth." Unemployment reached over 20% and the country was thrown into chaos after riots occurred and the government saw five presidents come and go within the matter of weeks. Today, U.S. hedge fund managers are "demanding the country pay interest on debt payments it defaulted on in 2001, and U.S. courts have now blocked payments to other bondholders until agreement with the "hold-outs" is reached."

As a result of the default, the Buenos Aires Stock Exchange Merval Index was down 6.7% last week, and Argentine bonds fell by 7%. By missing its $539 million interest payment, the government may need to gear up for another recession but not one as severe as that in 2001. This time around, Argentina's debt is held by a smaller group of investors, mostly hedge funds, which may limit the repercussions that such a default would typically have on the markets.

Analysts believe that the impact of this default could be primarily contained within the country, except for some minor impacts felt elsewhere in the region. Argentina's markets have already fell, and the default could encourage "investors in credit default swaps [to] seek[] payment" while Argentine bonds could be downgraded by rating agencies.

However, there is some good news: "U.S. stocks are trading for roughly 17 times their earnings over the past 12 months, says S&P Dow Jones Indices . . . [which is] much higher than their average 16.7 valuation on that basis over the past 10 years."

In the coming days, discussions will continue between banks and hedge fund managers who invested heavily in Argentina's debt. Some banks, including Citigroup, have already discussed the possibility of buying "the defaulted debt from Elliott Management."