

Recent Sovereign Defaults and Greece Today

by: Jessica Ludwig, Consultant
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With sovereign borrowing dating back to the B.C. era, the world has a long history of sovereign defaults and their nasty aftershocks. Though corporate default rates rose during the height of the debt crisis in 2008, Ecuador was surprisingly the only rated country to default in December of that year and more recently, Jamaica defaulted in 2010 after a negotiated debt exchange. In light of the ongoing Eurozone crisis and unstable global markets, this article first recounts several notable sovereign defaults and examines the current Greek financial crisis.

Russia and the 1990s

During the 1990s, the most sizeable default of the decade occurred in Russia when the government devalued the ruble and defaulted on its Treasury and foreign currency obligations. A growing fiscal deficit was amplified as oil prices plummeted in response to reduced demand from Asian countries that were battling their own financial crisis. Even with an emergency loan of \$22.6 billion from the International Monetary Fund (IMF) and World Bank in July 1998, investor confidence ultimately deteriorated even further, Russian Treasuries and securities were sold in Bank-run fashion and on August 17, 1998, Russia defaulted on a total of \$72.7 billion. Debt restructuring followed over the next two years and despite the massive default number, Russia recovered quickly due in large part to the rapid surge in oil prices. The chart below highlights the sovereign defaults of the 1990s.

Sovereign Defaults of the 1990s ¹		
Date	Country	Total Default (\$)
July 1998	Venezuela	\$270.0 million
August 1998	Russia	\$72.7 billion
September 1998	Ukraine	\$1.3 billion
July 1999	Pakistan	\$1.6 billion
August 1999	Ecuador	\$6.6 billion



Argentina and the 2000s

The following decade resulted in over double the number of sovereign defaults with Argentina's economic crisis leading to a massive \$82 billion default, exceeding Russia's 1998 default. The origins of Argentina's economic woes began long before in the 1980s when the currency was pegged to the U.S. dollar, inflation ran rampant and government debt and corruption escalated unchecked. In 1999, Brazil devalued its real, further hampering Argentina's economy as foreign investors and buyers of Argentine products looked to other countries where they had greater purchasing power. Over the course of December 2001 to January 2002, citizen rioting and a run on the banks ensued causing Argentina to default on its debt after the International Monetary Fund (IMF) failed to bail out the country despite years of fiscal support. Eventually the Argentine peso was devalued, banks commenced business again and their debt was restructured.

Ecuador was the only rated country to default during the global meltdown in 2008. The \$3.2 billion default was especially unique in that it is widely believed that Ecuador had the financial resources to pay its debt obligations, however in December 2008 President Rafael Correa declared select bond offerings to be illegal and illegitimate. Unlike its default in 1999, the 2008 default was considered a moral default. A few other countries, such as Iceland, came close to defaulting over the past couple years but Jamaica remains the last rated country to default.

Sovereign Defaults of the 2000s ¹		
Date	Country	Total Default (\$)
January 2000	Ukraine	\$1.1 billion
September 2000	Peru	\$4.9 billion
November 2001	Argentina	\$82.3 billion
June 2002	Moldova	\$145.0 million
July 2003	Nicaragua	\$320 million
May 2003	Uruguay	\$5.7 billion
April 2005	Dominican Republic	\$1.6 billion
December 2006	Belize	\$242 million
December 2008	Ecuador	\$3.2 billion
February 2010	Jamaica	\$7.9 billion



The Eurozone and Greece Today

While it may feel unprecedented for a European country to default, history shows quite the opposite. As detailed in the economists Carmen Reinhart and Kenneth Rogoff's book, *This Time Is Different: Eight Centuries of Financial Folly*, defaults and debt restructurings were a frequent occurrence throughout the nineteenth century and before the Second World War. According to their findings, Spain leads the eurozone with thirteen defaults since 1476, Germany and France both stand at eight apiece and Greece has defaulted five times since its independence in 1829.

Shifting the spotlight on Greece's ongoing debt crisis, near-term pressure was temporarily alleviated by Europe's third comprehensive package announced early on October 27th. The European summit laid the groundwork for relieving the dark cloud that has plagued Europe and the global markets for much of the past two years. First, Greece's rescue package now includes a much larger bond haircut than initially agreed upon at 50%. Numerous European banks and financial institutions would be required to supplement their capitalization levels to maintain a core Tier 1 capital ratio of 9%. Finally, the European Financial Stability Facility (EFSF) may write first-loss insurance on any new Italian and Spanish government bonds that are written down and also create special purpose vehicles financed by external investors, such as sovereign wealth funds. The two EFSF components extend EFSF's fiscal reach to approximately one trillion euros.

The summit produced some optimism initially and investors reacted encouragingly to Europe's commitment to remaining integrated. Conversely, numerous economists believe these measures still fail to provide an adequate firewall around the indebted peripheral countries and the eurozone's problems may ultimately intensify should any number of future events occur—French downgrade, Greece's writedown is not deemed voluntary and is recognized as a default triggering credit default swaps (CDS), credit dries up with the banks further fueling the economic downturn, lack of foreign interest in the EFSF's special purpose vehicles and the list goes on.

Furthermore, Greek Prime Minister George Papandreou just last night threatened to derail the entire package, proclaiming a referendum on the bailout. A voter rejection of the Greek bailout terms would test France and Germany whose constituents are already enraged at the seemingly unlimited subsidy provided to Greece. It is feared that a Greek default and eurozone dismissal would follow, resulting in a European financial meltdown and market panic worldwide. The national referendum is believed to be set for January 2012. Will Greece become the first European country post-World War II to default? About the only certainty at the moment is that the European debt crisis is anything but over and markets around the world will continue to get whipsawed on a daily basis. Stay tuned.



UPDATE November 8: On Thursday, November 3rd George Papandreou backed down from the national referendum declared just a couple days prior amidst political turmoil and unrelenting market volatility. After narrowly surviving the Greek confidence vote, Papandreou agreed to step down on Sunday and an interim national unity government will be tasked to first secure the latest bailout package which, in its absence, would likely lead to financial and economic catastrophe and preclude its membership from the European Union. While Greece's political parties failed to reach consensus on Monday, it is expected that the head of the new interim government will be announced on Tuesday and formal elections would follow in February 2012.

Meanwhile, the yield on Italian 10-year bonds approached 7% yesterday, fueling concerns that the selloff will continue in the absence of a tangible plan for support. While the 7% threshold does not explicitly signify anything, the yields could not be sustained for long and Greece, Ireland and Portugal sought bailouts shortly after their debt reached similar levels. Despite the eurozone's best efforts to calm investors and restore confidence, its intentions thus far have failed as uncertainty abounds both in Greece and the European periphery.

1. "Sovereign Default and Recovery Rates, 1983-2010 Moody's Investors Services (May 10, 2011).