Celebrating Analytical Excellence: Argentina & Ecuador Debt Restructuring Prospects

Created on May 25, 2021

We spoke to [EMPLOYEE NAME] of the Fitch Ratings' Sovereigns group, who won an ACE Award in the Research category for his work on Argentina and Ecuador Debt Restructuring Prospects.

[EMPLOYEE NAME],
Senior Director, Sovereign Rating

Q.Congratulations on your ACE Award! Can you tell us about the reports that earned you this recognition?

As background, our rating scale does a good job of signaling default risk — we have the B category to signal when we see vulnerability to default, and then the C category when we're really starting to talk about default being a strong possibility or a probability. But once a default actually happens and a sovereign enters or exits the restructuring process, our rating movements can often be mechanical; on their own, they don't really say a lot about how deep a hole we think the sovereign is in, how protracted a situation it could be, or how thorough a restructuring we think they need. The idea behind these reports was to offer that value beyond the rating — not necessarily predicting what the eventual restructurings would look like, but telling the market what we thought a good restructuring should look like to optimize post-restructuring creditworthiness. In addition, I wanted to set a good precedent for our analytical offerings around sovereign defaults going forward, given that there is likely to be a higher number following the pandemic.

Q.How do you determine what a debt restructuring should look like?

Whenever you look at a debt restructuring, there are two related issues at play that really determine what sort of debt restructuring you need: solvency versus liquidity. Is this sovereign in a situation where its economic growth prospects and ability to raise taxes or cut spending are good enough in the long-term so that it only needs to postpone debt repayments in order to get back on its feet and be able to pay down the road? Or do they have more fundamental solvency problems that would require some sort of permanent forgiveness, rather than a mere postponement of debt repayments? I wanted to highlight what we thought the real fundamental problem was in both of these cases.

Q.How does this play out with Argentina and Ecuador?

With Argentina, we wanted to push back against a narrative that had emerged in the market, furthered by the incoming government of Argentina, that the country only had a liquidity problem and did not have a solvency problem. Early on, the government pointed to Uruguay's “friendly” 2003

debt restructuring — where Uruguay only asked for a postponement of the payments rather than coupon reductions or a haircut on principal — as the example it wanted to emulate.

But there were a few issues with this. First of all, many market players looked only at traditional solvency metrics like Argentina's debt to GDP, or interest payments to GDP, that didn't show Argentina's debt problems as being as bad as some emerging markets, like Brazil. But we wanted to highlight some other metrics that showed just how much weaker Argentina's debt tolerance was; its unique vulnerabilities meant the level of debt it could manage safely was probably quite a bit lower than some of its neighbors. Argentina is very good at borrowing dollars but very bad at earning dollars to pay that debt back. By other metrics that highlight this issue, namely external interest payments as a share of export earnings, Argentina is one of the worst in the world. Also, we wanted to show that Argentina needed to introduce some belt-tightening initiatives to achieve long-term solvency — more than a lot of people thought, due to some issues with the fiscal data — and such initiatives would be increasingly difficult to implement due to political considerations.

Our research painted a more nuanced picture of Argentina really having some underlying solvency problems. The government eventually came around to this view and pursued a hardball negotiation, where they came in with an extremely aggressive offer and eventually met creditors halfway after many months.

Ecuador took a very different approach. It did not play hardball, but made quite a reasonable offer from the outset that was ultimately accepted. There seemed to be more consensus among Ecuador's government, the market and the IMF that there were solvency issues instead of just liquidity ones, as opposed to Argentina where there were a lot of mixed signals and views around those issues. As a result, Ecuador had a much smoother debt restructuring process. And based on the objectives the government very transparently laid out, we were able to predict fairly accurately the type of restructuring that was ultimately achieved.

Q.What do you think was the key to writing these award-winning reports?

The sort of analysis that went into these reports, especially the one on Argentina, benefitted from the years of experience I have — not just as a Sovereigns Analyst, but also my years focusing specifically on Argentina. That country is without a doubt one of the most complicated in the world in so many ways: volatile politics, erratic policymaking, messy data issues, etc. While a lot of this analysis of liquidity versus insolvency, or "debt sustainability analysis" as it's called, can take a cookie cutter approach that can be applied to any country, you lose a lot of the nuance that matters a lot for solvency. That sort of nuance calls for good experience looking at a broad swath of sovereigns and looking pretty in-depth for a number of years at Argentina itself.

Q.What advice would you give colleagues starting out as a Sovereigns Analyst?

Obviously all analysts — in Sovereigns or any other group — want to be laser-focused on the rating and getting the rating right. But in light of this particular award, one piece of advice I would offer is to relish opportunities to provide value that the rating doesn't necessarily offer. Certainly, when a credit is entering and exiting default, that's an incomparable moment to do great work as an analyst. It takes additional effort beyond just where the rating goes, but analysts should take advantage of those rare opportunities to shine.

Specifically for analysts in the Sovereigns group, I would say to be mindful of the fact that a lot of the data we work with is not subject to very strict oversight, as it may be in other groups where accounting standards are in place. We were able to add a lot of value in Ecuador and Argentina with our strict scrutiny of the fiscal data, which understated the amount of borrowing both sovereigns needed and led to fundamental problems in both of their IMF programs as this became apparent. Issues like these call for keen awareness, but also present an opportunity for you to add a lot of value as an analyst by digging deeper than other people — and even the IMF sometimes!

Q.What does this award mean to you?

It really means a lot, because it was something that I worked very hard on; it wasn't something essential to get the rating right, but something I thought was very important to be able to add value and earn a lot of respect in the market. It's nice to get validation that all the extra hard work didn't go unnoticed and was worth it.