

January 14, 2004

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After Huge Default, Argentina Squeezes Small Bondholders

Offer of 25 Cents on the Dollar Angers Creditors, Including Many European Retirees

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DEBT OVERHAUL

- [Argentine Companies Make Serious Headway in Digging Out of Debt¹](#)

01/05/03

In Rome, Gianfranco Lucifora turned on his satellite TV and watched the news from Argentina. A Buenos Aires fashion show filled the screen. "There's my interest payment," said Mr. Lucifora, a 65-year-old retired construction manager. When the scene shifted to a traffic jam of late-model cars, he clutched his chest. "They should be paying me, not buying cars," he said.

A few years ago, Mr. Lucifora, like hundreds of thousands of small investors in Europe and Japan, sank part of his life savings into Argentine government bonds. In the midst of a brutal recession, Argentina halted payments on its \$88 billion in bonds in late 2001 -- the largest sovereign-debt default in history.

Now, as Argentina pulls out of its crisis, the country is playing hardball with investors, offering them 25 cents on the dollar for their holdings. So far, it has been winning the battle. The International Monetary Fund signed off on a plan in September that gives Argentina considerable leeway to set terms with its bondholders. And last week the IMF took a step toward releasing a \$330 million loan disbursement to Argentina that had been held up in December.

The bondholders -- many of whom are elderly and financially unsophisticated -- feel as though they're being hung out to dry by the IMF, and its main shareholder, the U.S. "Argentina doesn't want to pay its debt, and Washington doesn't want to force it to pay," says Rome attorney Claudio Pugelli, who heads a small group of investors who lost money on Argentina. "So the easiest thing is to send the bill to the bondholders in Europe, little people no one will ever see."

HOLDING THE BAG


Distribution of \$88 billion in Argentine bonds held overseas, by percentage in each country



Source: Argentine Finance Ministry

Bush administration and IMF officials have indicated that it's important to maintain a working relationship with Argentina, Latin America's third-largest economy. And they have suggested that it was necessary to give the benefit of the doubt to the leftist Argentine President Nestor Kirchner, who took office in May of 2003.

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But recent public statements by several Bush Administration officials have indicated that the U.S. will

expect the Argentine leader to do more to repair his country's economy and its relationship with the international financial community. In advance of a meeting Tuesday between Mr. Kirchner and President Bush at a summit in Monterrey, Mexico, National Security Adviser Condoleezza Rice said the U.S. president would tell Mr. Kirchner he faces "some difficult decisions and some difficult steps."

But the combative Mr. Kirchner vowed last week in Argentina to "win by a knockout" in his meeting with his American counterpart. He says he won't yield to pressure to give investors a better deal, calling his current offer "unmovable." The offer demands a 75% nominal reduction in the value of debt, which rises to more than 90% when unpaid interest is factored in, bondholders say. The proposal is unprecedented in recent history: In 20 national-debt restructurings since 1990, the average write-off was only 36%, according to a committee of institutional bondholders.

The Argentine government has professed sympathy for such small investors. But it says it must clean up the financial mess made by previous administrations, along with banks and the IMF, which allowed Argentina to overload on debt. But Mr. Kirchner has argued that the Argentine populace suffered tremendously during the crisis and needs relief.

About 44% of Argentina's private debt is held by small investors, including 450,000 Italians, 35,000 Japanese and 150,000 Germans and Central Europeans. Europeans such as Mr. Lucifora have long had a preference for fixed-income investments over stock.

In the late 1990s, local banks began promoting Argentine bonds as an alternative to Italian T-bills, whose yields declined as Italy adopted the euro. Since the IMF and major Western governments held up Argentina as a model of free-market reform during the 1990s, Mr. Lucifora said he thought the bonds were safe, and put \$150,000 in Argentina.

With his Argentine bonds now worth only a fraction of what he paid for them, Mr. Lucifora has cut

every nonessential expense -- including vacations, eating out and newspaper subscriptions -- and keeps the thermostat low. He spends hours logged onto a bondholders' chat room, attends seminars on suing Argentina and studies Spanish so that he can fire off e-mails to the Argentine media.

Mr. Lucifora and other bondholders don't know where to turn. Banks in Italy, Central Europe and Japan have formed negotiating groups to represent holders of Argentine bonds. But in Italy, where retail investors poured \$14 billion into Argentine bonds, many of the retail investors are infuriated at the banks for having sold them the shaky bonds in the first place. "The doctor who gave me the poison now says he's going to give me the cure," says Raimondo Iallonardo, a graphic designer from Milan, who lost his son's college-tuition money in Argentine bonds.

Some individual bondholders have formed negotiating groups of their own. Other European bondholders have challenged Argentina in court, with little success. German creditors tried unsuccessfully to obtain a court order seizing an Argentine naval training vessel, La Libertad, that was due to dock in Bremerhaven in 2002. When Argentina's Mr. Kirchner was preparing to visit Italy last year, a provincial lawyer, Mauro Sandri, threatened to have the presidential plane, Tango 01, impounded. Bondholders claimed credit when Mr. Kirchner cancelled his visit, though Argentine officials attributed it to scheduling conflicts.

Mr. Kirchner's tight-fisted stance has made Argentina a bad word in Japan, as well. Japanese investors were attracted to Argentine bonds during the late 1990s, after Japan's real-estate and stock bubbles popped and local interest rates dropped to virtually zero. When an Argentine official visited Japan last year to discuss the debt restructuring, an investor demanded that part of Patagonia be ceded in lieu of debt payments.

Argentina's efforts to justify its position have often made matters worse. On a trip to Germany last year, Argentine debt negotiator Guillermo Nielsen said that, given the magnitude of the economic catastrophe that rocked Argentina, it should get the same treatment as post-World War II Germany, which received a 77% debt write-down. Investor Stefan Engelsberger presented Mr. Nielsen with a photograph of the bombed-out city of Frankfurt to show how much more dire Germany's situation had been.

Mr. Engelsberger, a 37-year-old craft-shop owner, is founder of the 300-member First German Society of Bondholders. Mr. Engelsberger even sells a special Argentine bondholders beer stein, emblazoned with the German eagle looming over the Argentine Congress, "always prepared to prevent any shady activities," he says. He has sold only 150 of the 600 steins he produced. "I'm losing money on this too," he says.

In the early 1990s, Argentina captured the attention of international investors by pegging its peso to the dollar in order to cure chronic inflation. The move, part of a larger economic program that included privatizing state-owned industries, helped revive the country's economy. For a while, the Argentine economy grew even faster than China's and foreign capital poured into the country.

But around 1998, as Argentina's government failed to get spending under control and economic growth began to slow, big investors began souring on the country. To meet the country's gaping financing needs, Argentina's government and investment bankers sought out retail investors. "When the institutional

investors started to understand that Argentina was poised for a crisis and they were not in a position to continue the permanent refinancing of Argentina ... it's quite clear that the government and the banks targeted the retailers," says Argentine Finance Minister Roberto Lavagna.

It all came crashing down for Argentina in December 2001, when street demonstrations in Buenos Aires ousted the government. In an atmosphere giddy with nationalistic defiance, Adolfo Rodríguez Saa, one of five presidents in a two-week period, declared the default, saying, "We have made paying the so-called foreign debt a priority over the debt the country has with its own people." The next year would be horrendous economically in Argentina, with schools cultivating vegetable gardens so cafeterias could put food on the table.

As the domestic economy improved last year, thanks to a more stable currency and stronger prices for soybeans, oil and other commodities, Mr. Kirchner vowed to stand tough in debt negotiations. Investors maintain that the U.S., through a policy of benign neglect, encouraged that strategy. "With what's happening in Iraq and Afghanistan, you can be sure Mr. Bush didn't want to start a battle with Argentina, just to defend some retirees in Europe," says Mr. Sandri, the Italian lawyer.

Administration officials have said that President Bush's meetings with Latin American presidents over the past couple of days are a sign of his commitment to the region.

Locked in a stalemate with the IMF over how much money should be set aside for private bondholders, Argentina, the IMF's third-largest borrower, briefly missed a \$2.9 billion payment -- putting it in the company of countries such as Iraq and Sudan. The IMF gave in to Mr. Kirchner's determined approach. In September it conceded to an agreement that, after 2004, doesn't specify the size of the primary budget surplus, the indicator that essentially determines how much money is available to repay creditors.

Creditors wouldn't let the matter rest. Citing an improved economy that has allowed Argentina to raise pensions, unemployment benefits and public-sector wages in recent weeks, bondholders have been pressing the Argentines to better their offer. "It doesn't get much better than not paying and growing at more than 5%," says Adam Lerrick, a Carnegie Mellon University economist who heads the Argentine Bond Restructuring Agency, which represents retail creditors in Germany and Central Europe.

Argentine officials point out that not all of the pain from the bond blowup is being exported. At least 38% of Argentina's bonds are held by Argentines themselves, both pension funds and individual investors. Argentine officials also maintain that there are conflicting interests among the investor-negotiating groups. Some of them are charging fees to investors. Others were formed by the banks that sold the bonds in the first place. "Some groups are just trying to get money from the investors," Argentina's Mr. Lavagna scoffs. "And other groups are trying to cover the banks."

Elio Lannutti, who leads an Italian consumer-rights group, says there have been 10,000 complaints against banks from Italians who bought Argentine bonds. Italian bondholders have filed more than 300 suits against the banks, claiming that the banks didn't warn them of the risk the bonds posed.

Nicola Stock, the Italian banker who is president of Task Force Argentina, the bondholders negotiating group created by local banks, says the blame for the mess rests with Argentina and not the banks. "The

things went bad when Argentina went into default," he says.

With negotiations going nowhere, more attention is being focused on court actions against Argentina. A U.S. district court in Manhattan last year awarded a \$700 million judgment against Argentina to an investment company controlled by Styrofoam-cup mogul Kenneth Dart. Collecting the money will be difficult, legal analysts say. But the judgment could offer Mr. Dart leverage to disrupt Argentina's financial dealings with the rest of the world, and obstruct any effort by Argentina to re-enter capital markets, analysts say. A lawyer for the Darts wouldn't comment.

Mr. Lavagna, the finance minister, says that such threats don't worry Argentina because it's not interested in tapping international capital markets anytime in the near future. "A country that got a tremendous amount of external financing and has this tremendous amount of external debt is like an alcoholic," he says, adding that Argentina is going on the wagon for now.

Mr. Lavagna doesn't mention it, but Argentina also has a financial ace in the hole: at least \$130 billion in assets held offshore by Argentines, part of that squirreled out of the country just before the collapse. Argentine citizens and businesses could draw on those funds to keep businesses going or start new ones.

In the face of Argentina's obstinacy, three 60-something retirees from the Italian airline Alitalia spend lots of time debating how much of their \$500,000 Argentine investment they can salvage. Mauricio Cutino, a former purser, says he'd settle for 40% of his money.

"If this negotiation stretches out too long, I'll be dead," says Mr. Cutino. His friend, Gino Paronuzzi, is infuriated.

"Don't be defeatist, because that's just what the Argentines want," says Mr. Paronuzzi, who wants all his money back.

---- Peter Mayer in Rome contributed to this article.

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Updated January 14, 2004