Financial Stability Report

Second Half 2014

BANCO CENTRAL
DE LA REPÚBLICA ARGENTINA

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Preface

Pursuant to the latest amendment of its Charter, the Central Bank's mandate and objectives were enlarged. Section 3° provides that the purpose of "the Bank is to promote —within the Framework of its powers and the policies set by the National Government— monetary and financial stability, employment, and economic development with social equality".

Financial stability, one of the express objectives of the new mandate, is a critical condition to ensure the financial system contribution towards economic and social development. As widely shown throughout history and ratified by the latest international crisis, there are serious negative externalities which result from an ill-functioning process of financial intermediation. Hence, the protection of financial stability by Central Banks has once more come to the fore.

A transparent communication (public-oriented) strategy has been designed with a view to promoting financial stability and complementing regulatory and supervisory powers. In this sense, the ***Financial Stability Report*** *(**FSR**) gives a comprehensive assessment of the development of financial system conditions. The* ***FSR*** *combines several channels of information on the subject gathered by the Central Bank in a single publication. In addition, the Central Bank discloses —between* ***BEF*** *half-yearly publications— a monthly* ***Report on Banks*** *so as to keep the public informed of the latest developments of the financial system. The Central Bank mainly resorts to these publications to disclose its outlook for the financial sector.*

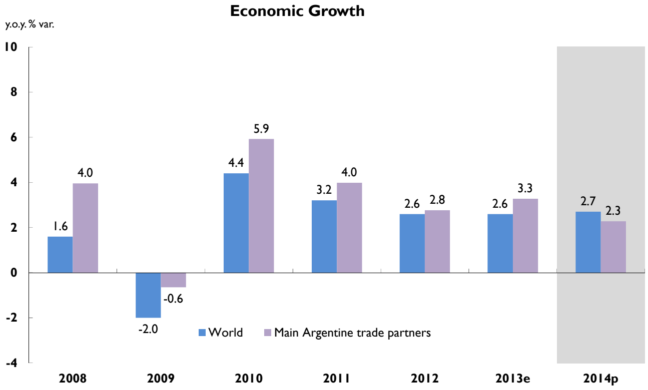
Buenos Aires, November 10, 2014

Contents

Central Bank Outlook

Global growth expectations for 2014 continued to be weak in recent months and were revised downward for both developed and emerging economies. The evolution of activity levels in industrialized countries was still more mixed during the period under analysis. Recovery is evidently more sustained in the United States and the United Kingdom if compared to the situation in the Euro Zone and Japan. As a result, the expectation about the bias to be followed by monetary policies in developed countries in the near future was modified: a lower expansionary pace is estimated for the first group (where an increase in short-term interest rates is expected to begin in 2015) while a loose monetary policy is estimated to prevail in the second group (where the European Central Bank and the Bank of Japan continue to implement stimulus measures). World trade volume has reflected this moderation in the growth pace –especially after the second quarter of the year—, and capital flows started to go once again towards developed countries, mainly the United States, thus contributing to an appreciation of the US dollar.

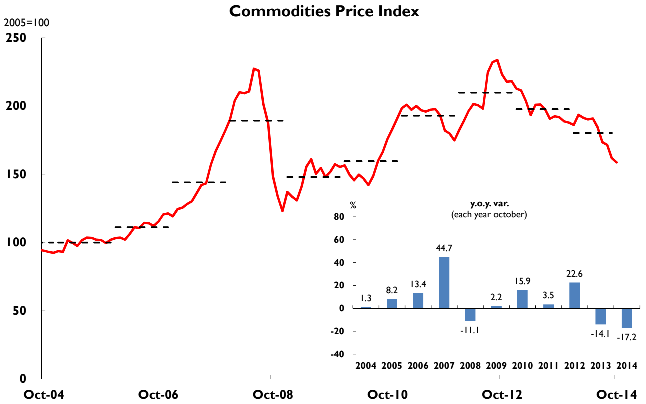
Chart 1
Economic Growth



*Weighted by share in Argentine exports, accounting for 80% of total
Source: BCRA from FocusEconomics and FMI
p:Projected

The leading emerging nations continue to exhibit a higher growth pace than advanced countries. However, the moderation in the economic activity was widespread in this group of nations, where some disparity was observed in macroeconomic performance and economic policy bias. On the one hand, the countries that are less dependent on external capital flows adopted some stimulus measures to invigorate the economic activity through an expansionary monetary policy. On the other, benchmark interest rates in the countries that are in need of external capital flows went up against the levels recorded last year, with a view to lessening the pressures on their domestic currencies.

Chart 2
Commodities Price Index



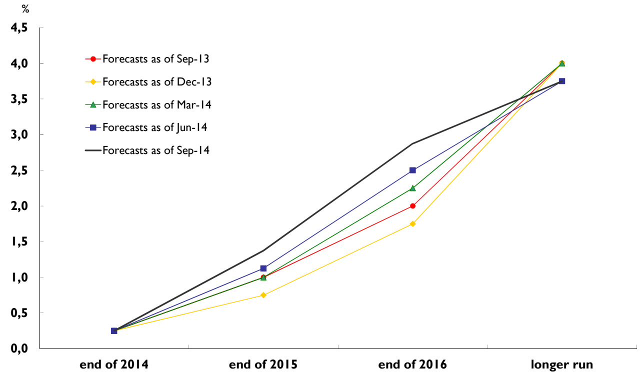
Source: BCRA

The growth pace of Argentina's main trading partners continued to stand below the global average. Commodity prices fell if compared to those recorded last year: the Commodity Price Index —that follows the evolution of the international prices of commodities that are more relevant for Argentine exports— continued to exhibit year-on-year (y.o.y.) reductions (-17.2% y.o.y. as of October).

A heightened caution was observed in the financial markets of developed economies –with fluctuations in the prices of the main instruments– mainly due to the dissimilar expectations about stimulus policies in the different countries and regions, added to the onset of several risk sources worldwide. This was remarkably

Chart 3

Fed Funds Rate Target - FOMC Forecasts (Median)

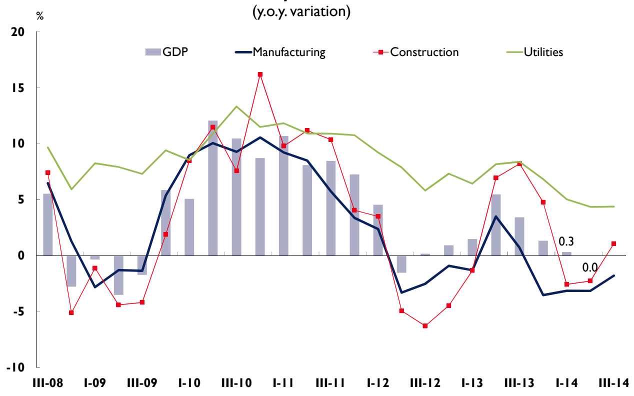


Source: Federal Reserve

Chart 4

Activity Indicators

(y.o.y. variation)



Source: INDEC

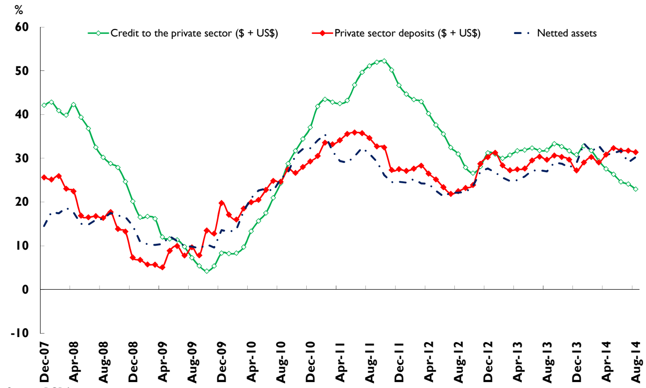
evident in September and October, characterized by an increase in volatility and price reductions in instruments deemed as relatively more risky, even though an improvement was seen by the end of October. In this context, the assets of emerging economies recorded lower relative prices in recent months, with drops in stock market indexes, increases in sovereign debt spreads and currency depreciation against the US dollar.

The potential future challenges for the international financial stability include the size of the contractionary bias that the US monetary policy might adopt in 2015 (with its impact on capital flows), commodity prices and the dissimilar global economic recovery. In turn, the changes in the expectations about the US monetary policy might particularly affect the financial markets, after years of abundant liquidity in global markets, an increasing leverage in some segments and sizable expansions in higher risk asset prices. In addition, a context of uncertainty still prevails in terms of geopolitical conflicts in several countries and the epidemiological situation caused by the Ebola virus.

With respect to Argentina, the indicators available for the second half of 2014 are signaling an incipient improvement in the economic activity relative to the first half of the year. Even though the external demand continued to go down —mainly from Brazil— and private consumption was relatively fragile, investment stood out as the demand component with the most remarkable momentum. It is worth mentioning that a change of direction was observed in the decreasing trend of the construction business, mainly due to the higher momentum observed in oil constructions and housing unit works. In turn, the production levels of the industrial sector and trade-related activities continued to go down in year-on-year terms, even though their performance tended to improve in recent times. In the first half of 2014, the main labor market indicators mirrored the reduced momentum of the economic activity in general.

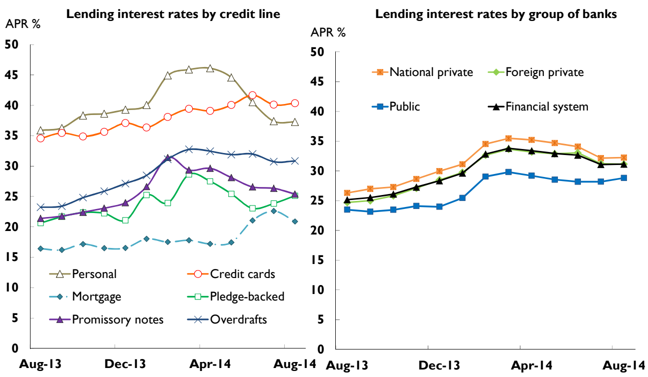
In this context, new public policies and measures were implemented to drive credit, lessen the deterioration of the labor market and help the most vulnerable sectors. Child allowances were raised as from mid-2014, while social security benefits were increased as from September, which added to a rise in the Minimum Wage. In addition, the Fund for Argentine Economic Development (FON.DE.AR.) was regulated, which coincided with the launch of the Employment Incentive Plan (PRO.EMPLEAR) and the second stage of the Pension Inclusion Plan.

Chart 5
Financial Intermediation
y.o.y. % variation- Financial system



Source: BCRA

Chart 6
Lending Interest Rates Operated with Private Sector*



*Note: Weighted average by operated value.
Source: BCRA

As from early 2014, the Central Bank of Argentina adopted a series of measures intended to limit the volatility of the nominal exchange rate. One of these regulatory changes consisted in reintroducing the limit to the positive net global position in foreign currency of financial institutions as from February 2014, originally at 30% of the Adjusted Stockholders' Equity (RPC) of each bank and then reduced to 20%. Even more, with a view to improving financial conditions and promoting economic development and bilateral trade, the Central Bank of Argentina signed in July a new swap agreement for domestic currencies with the People's Bank of China. Recently, the BCRA has requested a first currency swap for an amount equivalent to US$814 million, which was credited on October 30, 2014. The BCRA will be entitled to request additional swaps for up to a maximum amount equivalent to around US$11 billion. Unlike the swap agreed upon between both central banks in 2009, this is a trade and financial agreement which has significantly improved the conditions for use, with more flexible terms, lower costs and authorization for uses other than those that had been previously agreed upon.

Throughout the year, some volatility has been observed in the domestic financial markets, mainly related to external and idiosyncratic factors, such as, in the latter case, the evolution of the Argentine debt litigation before the courts of New York and, more recently, the changes in the implicit exchange rates in capital market transactions. Despite this context, the price of Argentine sovereign bonds and shares has improved since late May.

Due in part to the effect of the general performance of the domestic economy, the momentum of the financial intermediation moderated in 2014. Bank loans to companies and households went up 22.9% y.o.y. in nominal terms in August 2014, on the basis of an increase in deposits from the private sector of 31.4% y.o.y., within a context of increasing holdings of more liquid assets by the ensemble of financial institutions.

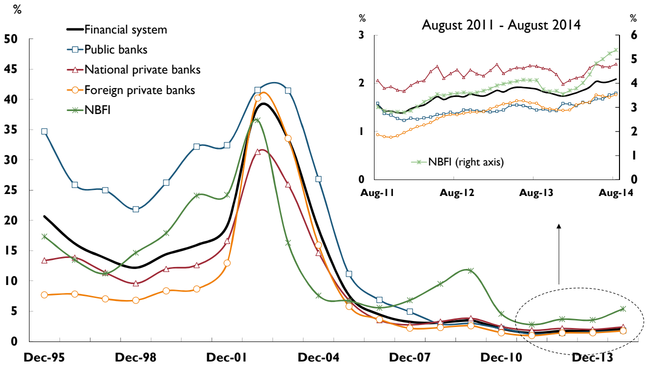
The nominal increase of the total lending stock to the private sector was mainly driven by companies. Financing to the productive sector went up 25.2% y.o.y. in August, accounting for 61.3% of the year-on-year rise of total loans to the private sector. This performance was underpinned by the measures that were timely adopted by the BCRA, such as the Credit Line for Productive Investment (LCIP). Regarding this initiative, the fifth tranche of LCIP became effective in the second half of the year and it is expected to award over $28 billion mainly to micro, small and medium-sized enterprises (MiPyMes). It has a fixed interest rate of up to 19.5% annual percentage rate for, at least, the first three years. From the time it was implemented by mid-2012 up to August 2014, partially incorporating this fifth tranche of LCIP, loans for productive purposes for approximately $103 billion have been awarded so far, out of which two thirds have been provided to MiPyMEs.

In turn, the stock of loans to households grew 20.5% y.o.y. in August. Since July 2014, personal loans reflected the momentum given by the Plan for the Purchase of National Vehicles (PRO.CRE.AUTO), fostered by the National Government and devoted to finance the purchase of new national automobiles by families. In addition, last September and for the purpose of reinvigorating consumption, the National Government launched the so-called “Ahora 12” Plan to facilitate the purchase of goods and services with a credit card in 12 installments with 0% interest rate.

Chart 7

Private Sector Non-performing Financing

Non-performing portfolio / Total financing (%)

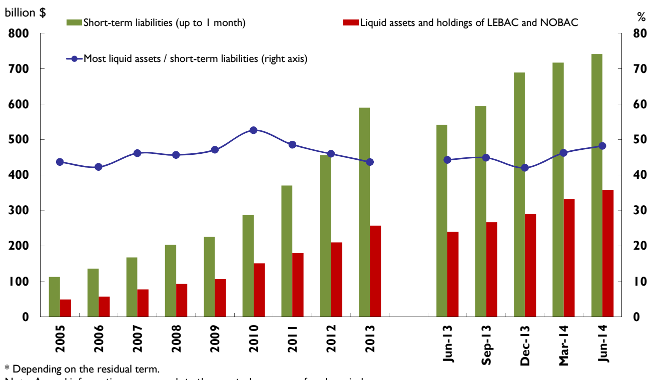


Source: BCRA

Lending interest rates for transactions in pesos started to go down gradually after their increasing trend of late 2013 and early 2014. The interest rates on personal loans, promissory notes and pledge-backed loans recorded the highest relative reductions. In this sense, since mid-2013, the BCRA regulated the interest rates applicable to personal loans and pledge-backed loans in credit transactions for natural persons. In addition, the interest rate of personal lending was also impacted by the effect of the loans granted within the framework of the Plan for the Purchase of National Vehicles (PRO.CRE.AUTO), while the transactions under the fourth tranche of LCIP reflected in part on the interest rates applicable to promissory notes.

Chart 8

Most Liquid Asset in Terms of Short Term Liabilities*



* Depending on the residual term.
Note: Annual information corresponds to the quarterly average of each period.
Source: BCRA

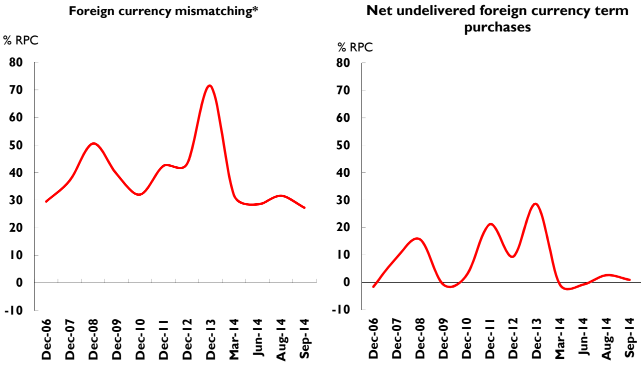
Deposits from the private sector continue to be the main source of resources for banks. Such deposits accounted for 56.3% of total funding (liabilities and net worth) in August 2014, up 1.3 percentage points (p.p.) against 2013 year-end. The main contributor to this increase was the segment in pesos, which encompasses almost one half of total funding.

After the increase recorded by the end of last year and in the first months of 2014, the funding cost for time deposits started to go down gradually. With a view to improving saving instruments in pesos, the Central Bank established, as from early October, a minimum limit to the rate on time deposits in domestic currency of natural persons, to the extent that the amount of the deposit does not exceed the coverage provided by deposit guarantee scheme, which was increased from $120,000 to $350,000.

Chart 9

Foreign Currency Mismatching

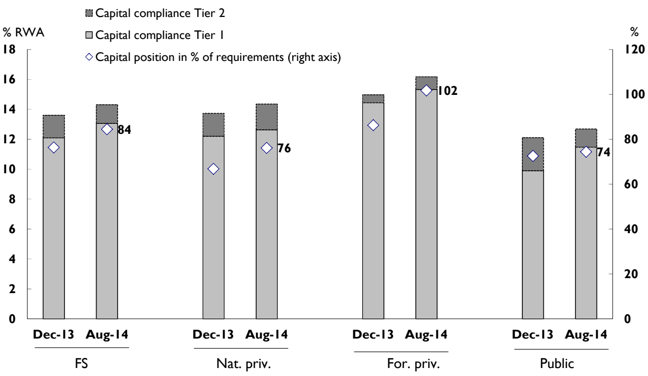
Financial system



*Note: (Assets - Liabilities + Net undelivered foreign currency term purchases) / RPC.
Source: BCRA

Chart 10

Capital Compliance and Excess of the Requirement (Position)



Source: BCRA

Within this framework of reduced momentum in the banking activity, the map of risks taken by the institutions experienced marginal changes during last year, even though a context of moderate exposure and sizable coverage at aggregate level still prevails.

In 2014, the financial system reduced slightly its exposure to the private sector as a result of the deceleration observed in bank financing. Starting from reduced levels, the portfolio delinquency rate went up slightly, mainly accounted for by loans to households. In turn, the loan loss provisions ratio in the lending to companies remained virtually unchanged and stood below the ratio corresponding to lending to families. The limited indebtedness and financial burden levels of the private sector led to a low repayment risk for financial entities. It is worth mentioning that both the financial system and the ensemble of banks continued to record an aggregate provisioning level which stands above the total stock of non-performing loans.

Considering the liquidity risk taken by banks due to the term mismatching they operate with, there were some signals along the year of a slight decrease in their exposure and a higher coverage. The reduction of the relative weight of liabilities with a shorter residual term in total liabilities and the reduced level of concentration of deposits are in line with a slight drop in the exposure to this risk. In terms of coverage margins, the share of higher-liquidity assets has gone up in the banking balance sheet —mainly LEBAC holdings—, as a result of which an increase was observed in the ratio against short-term liabilities.

As from February 2014, the financial system has significantly reduced its exposure to foreign currency risk. In terms of its macroprudential role, the BCRA implemented the abovementioned measures to reduce the foreign currency mismatch that the sector had accumulated by the end of 2013. This added up to a gradual drop in the peso-dollar nominal exchange rate volatility.

Despite the fact that interest rates were somewhat more volatile, the exposure of the financial system to this risk is estimated to have fallen slightly along the year. When comparing the situation prevailing in mid-2014 with that of late 2013, the lower relative sensitivity of bank assets against liabilities would have fallen slightly, vis-à-vis the increases in the interest rates. In turn, due to the fact that financial asset prices were more variable, the exposure of the ensemble of banks to the market risk went up slightly, even though it keeps a low relative share in the sector's general map of risks. In the first half of the year, the events reported by banks in relation to operational risk occurred mainly in the retail banking business and the marketing & sale of products, in which treasuries are involved.

The indicators related to this sector's capital position to face the risks inherent in their activity show a remarkable soundness in the ensemble of institutions. The regulatory capital compliance reached 14.3% of total risk-weighted assets, and the capital with a better capacity for loss absorption —Tier 1— accounted for 90% of the regulatory compliance. In turn, the excess capital compliance accounted for 84% of the regulatory requirement for the financial system, up 8 p.p. against the figure recorded by the end of last year. Book profits boosted the improvement observed in solvency indicators.

I. International Context

Summary

After a disappointing global growth pace at the beginning of the year, an increased momentum in the economic activity and international trade transactions became evident during the third quarter of 2014. Nevertheless, the forecasts for the current year were revised downwards both for the most relevant emerging economies and for advanced nations. As a result, the world economy would expand 2.7% this year, slightly above the pace recorded in 2013.

Among developed nations –still adversely impacted by the public and private debt reduction processes and the residual imbalances of the international financial crisis– heterogeneity prevailed in terms of macroeconomic performance. For the near future, a scenario of less expansionary monetary policies is expected for the United Kingdom and the United States –where the Federal Reserve (FED) has announced the end of the stimulus package related to the financial asset purchase program. In addition, in the Euro Zone and Japan, a scenario of extraordinarily loose conditions is foreseen during a protracted period with a view to supporting the economic activity and aligning inflation expectations with the targets of the monetary authorities.

Most capital flows started to go once again towards developed countries, particularly the United States, thus contributing to a significant relative appreciation of the US dollar.

Main emerging economies continued exhibiting mixed performances. While some countries kept on implementing additional fiscal, credit and monetary stimulus measures, other nations adopted more restrictive schemes to cope with inflationary pressures, the weakening of their currencies and the rising costs of foreign financing.

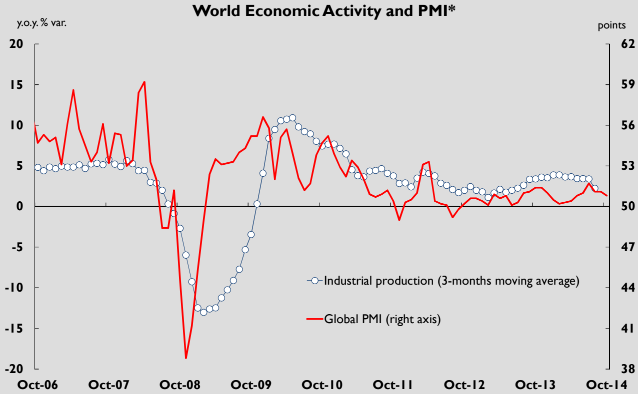
The appreciation of the US currency and the abundant and widespread supply of commodities –within a context of a weakening global demand– contributed to new drops in the international prices of commodities.

Against this backdrop, since late May, the financial markets of the United States and Europe have accumulated a heterogeneous balance, even though caution prevailed in recent months accompanied by increasing volatility and drops in the prices of relatively higher risk assets. In the case of assets of emerging economies, the balance since late May has been negative, with contractions in stock market indexes, widening in debt spreads and depreciation of currencies against the US dollar.

Towards the future, there is still some concern about the bias to be finally adopted by the US monetary authority, given its impact on portfolio flows and on the weak recovery of the global economy. As a legacy of the extraordinary financial liquidity of international markets, the current high indebtedness levels and the high asset prices pose new threats to the world's financial stability. Finally, there are also potential uncertainty factors at global level, such as the deceleration of large economies and the geopolitical conflicts in several countries.

Chart I.1

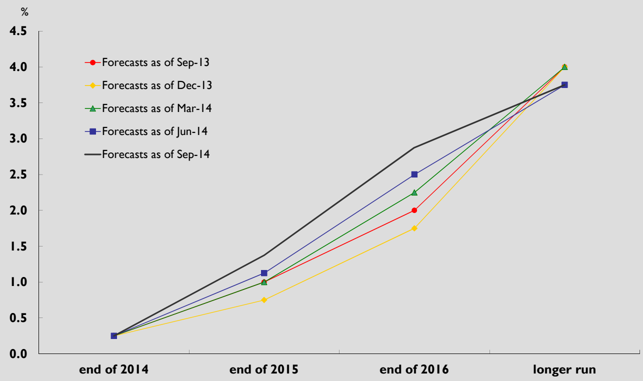
World Economic Activity and PMI*



*Purchasing Managers Index
Source: BCRA based on Bloomberg and Netherlands Bureau for Economic Policy Analysis

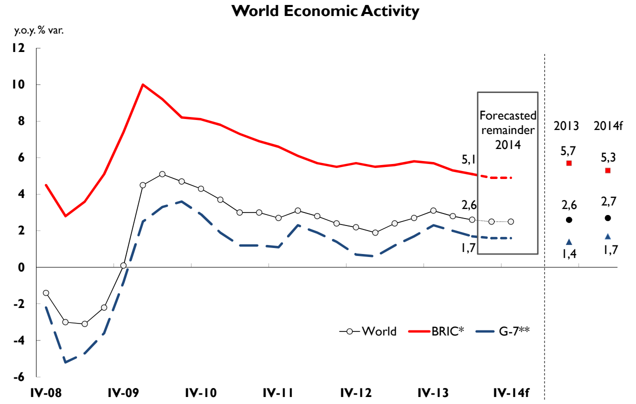
Chart I.2

Fed Funds Rate Target - FOMC Forecasts (Median)



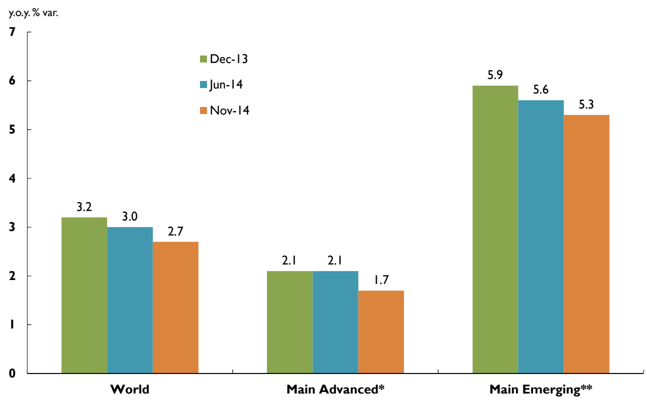
Source: Federal Reserve

Chart I.3
World Economic Activity



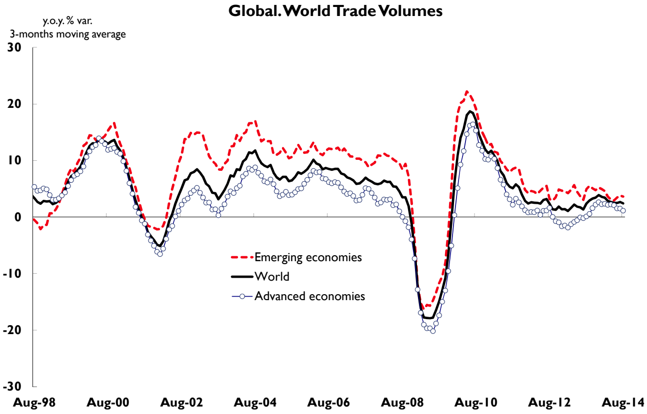
*Brazil, Russia, India and China **United States, Japan, Germany, France, Italy, United Kingdom and Canada
Source: FocusEconomics f: Forecasted

Chart I.4
Global. Evolution of 2014 Growth Forecasts



Source: FocusEconomics *G-7 **Brazil, Russia, India and China

Chart I.5
Global. World Trade Volumes



Source: Netherlands Bureau for Economic Policy Analysis

International Context

According to partial and leading indicators, the global activity would have experienced some momentum as from the third quarter of 2014 (see Chart I.1), after the weak performance exhibited during the first half of the year.

If the forecasts of the main international analysts hold true, the expansion rate of global economy would stand at 2.7% in 2014, slightly above the 2.6% change of 2013 (see Chart I.3). Recently, the expectation about the global growth pace went down again, due to downward revisions of the main emerging countries' expansion estimates –in line with the previous periods– and also to lower expectations for advanced nations (see Chart I.4).

Trade volumes worldwide followed the performance observed in the global economic activity since their growth pace moderated in the first months of the year (see Chart I.5), even though they would have started to stabilize, or even reverse, in the second quarter.

Capital flows would be going once again towards developed countries, where perspectives would be more favorable, and especially towards the United States. These trends contributed to a marked appreciation of the US dollar in recent months.

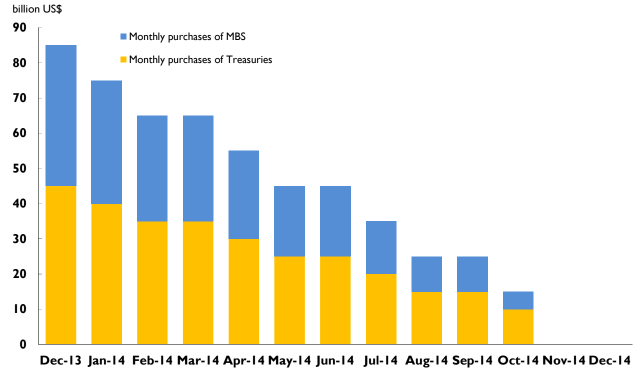
The ensemble of advanced nations would have recorded a 1.7% jump in their economic activity in the third quarter of the current year, thus regaining momentum after the reduced dynamism observed in the first half. According to the forecasts for the last three months of the year, the estimated growth of this group of nations for 2014 would stand at 1.7%, up 0.3 percentage points (p.p.) against the rise of 2013.

As from the second half of 2014, the United States experienced a marked growth pace after recording a negative performance between January and March. Consumption spending was on the rise, mainly driven by improvements in households' equity, an increased access to bank loans and a sound job creation (with a 1.3 p.p. drop of the unemployment rate in year-on-year terms to 5.9% at present). The investments made by companies showed signals of an increased momentum, with positive estimates underpinned by favorable expectations of the corporate sector for the short term, while some uncertainty still prevailed in the real estate sector.

Within this context where, in addition, inflation is contained but it is already showing incipient upward pressures, the FED continued moderating its monthly purchase of assets, which would come to an end by late October (see Chart I.6). Likewise, a debate about the

Chart I.6

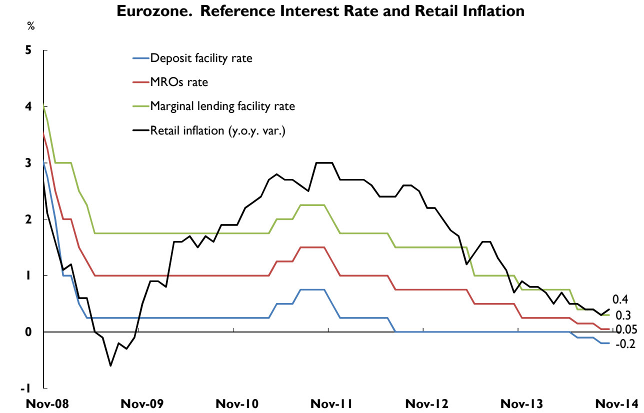
Evolution of Federal Reserve's Monthly Asset Purchases



Source: Federal Reserve

Chart I.7

Eurozone. Reference Interest Rate and Retail Inflation



Source: ECB

potential beginning of a cycle of increases in the short-term interest rates in 2015 gained momentum (see Box 1). Even though the rises are expected to be gradual, both the members of the FED's Federal Open Market Committee (FOMC) and market analysts have raised their forecasts for short-term interest rates in the US for the next two years (see Chart I.2). On the other hand, after the implementation of sizable stimulus packages, in recent months the FED gave some signs of concern about prices in specific segments of the US financial markets[1].

The potential increases in the US short-term interest rates are expected to occur after the rise of the benchmark interest rate in the United Kingdom, which is estimated to occur in early 2015. The UK economy would keep a sound recovery trend without inconveniences after the confirmation of the rejection to Scotland's independence.

In the Euro Zone, a 0.8% growth is anticipated for 2014, after the 0.4% fall of its GDP in 2013. The recent weak economic performance was largely due to the behavior of investors and to some deterioration of external demand because of the sanctions applied to Russia within the framework of its conflict with Ukraine. Despite the anticipated improvement, the deterioration of labor markets is expected to continue while the excessively low retail price variation rate (0.4% y.o.y. in October) is giving signs of a potential deflationary process.

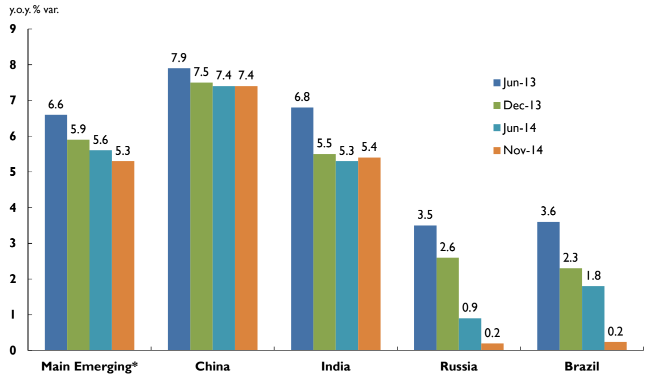
Within this framework, the ECB continued widening the monetary and financial stimulus measures. In June 2014, the institution announced cuts to interest rates, new long-term operations related to the implementation of new financing operations, such as the targeted longer-term refinancing operations (T-LTRO) and a deeper analysis to make progress on a potential purchase program of asset-backed securities (ABS), among other measures. In September, new cuts to interest rates were decided (see Chart I.7); in addition, an ABS purchase program and a covered bonds purchase program were set in motion. On the other hand, the first auction of T-LTRO operations was held in September, which received a lower-than-expected demand. If the current context of slow growth pace and inflation were to continue, the announcement of a more comprehensive and sizable asset purchase program cannot be disregarded in the near future.

In Japan, after the declining economic activity context observed in the second quarter of the year –mainly related to the increase in consumption taxes– and the

[1] By mid-July, Yellen explicitly said that even though, in general, the indicators were in line with historical averages, in some sectors (small enterprises of social media, biotechnology), some valuation metrics were standing at substantially high levels.

Chart I.8

Main Emerging Countries. Evolution of 2014 Growth Forecasts



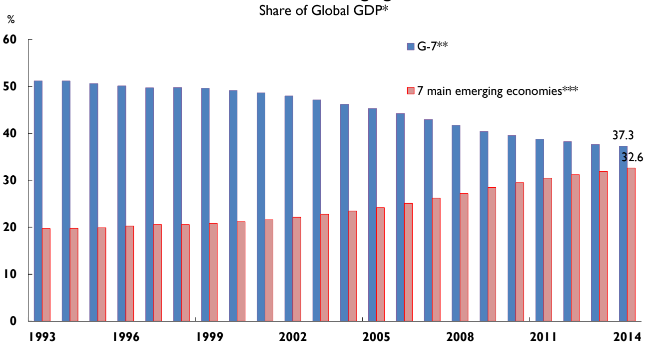
Source: FocusEconomics and Central Bank of Brazil

*BRIC

Chart I.9

Main Advanced and Emerging Economies

Share of Global GDP*

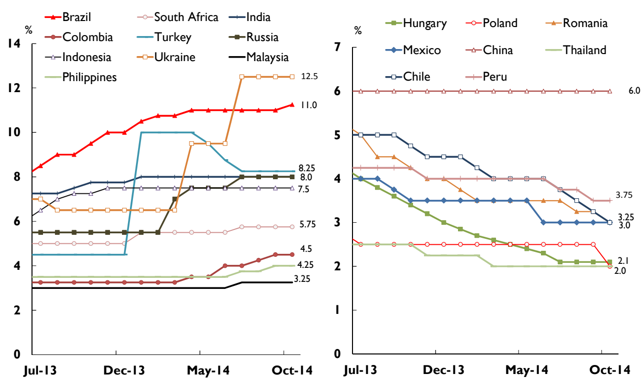


*GDP adjusted by Purchasing Power Parity (PPP).
**Includes Germany, Canada, United States, France, Italy, Japan and United Kingdom.
***Includes Brazil, China, India, Indonesia, Mexico, Russia and Turkey.

Source: IMF

Chart I.10

Selected Emerging Economies. Reference Interest Rate



Source: Datastream

outlook of a weak performance in the short-term, by late October, the Central Bank of Japan decided to deepen its non-conventional monetary expansion measures by speeding up the pace of sovereign bond purchases – thereby extending the average term of the portfolio of these instruments[2]– so as to expand the monetary base at an annual pace of approximately ¥80 trillion (between ¥10 and ¥20 trillion above the purchases performed so far). Moreover, the institution decided to triple the purchases of exchange-traded funds (ETF) in the market and of instruments related to the real estate sector (J-REIT – Japanese Real Estate Investment Trusts).

The ensemble of the main emerging economies would have grown around 5.1% in the third quarter of the year and, after successive downward revisions to the forecasts, an expansion of 5.3% for 2014 is currently estimated, 0.4 p.p. below the change observed in 2013 (see Chart I.8). Even though the moderation observed was widespread, heterogeneity continued to prevail in terms of economic performance and economic policy responses among developing countries. Despite this performance, the main emerging countries continue gaining share in the world GDP according to the measurement of the Purchasing Power Parity indicator (PPP; see Chart I.9)[3].

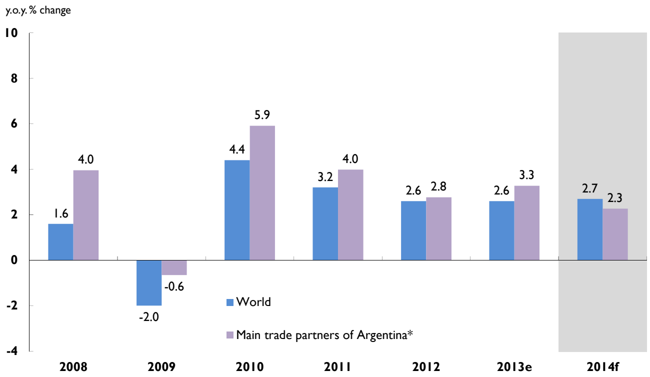
Within a context of widespread appreciation of the US dollar, the emerging economies that are more dependent on external capital flows have kept their benchmark interest rate above the levels observed one year ago. With this type of measure, they sought to reduce the pressures on the value of their currencies and/or on their domestic prices (such as in South Africa, Brazil, Russia, Ukraine, Colombia, the Philippines and Malaysia). Turkey was an exception since it has continued to gradually reduce its benchmark interest rate after the marked rise of 5.5 p.p. implemented in January 2014. On the opposite front, countries such as Hungary, Poland, Chile, Peru, Romania and Mexico implemented new cuts to their benchmark interest rates so as to invigorate the economic activity in their respective countries (see Chart I.10).

The growth rate of Argentina's main trading partners continued to stand below the global average, and especially remarkable was the moderation in the expansion pace among Argentina's emerging partners (see Chart I.11). Brazil fell into a period of economic recession in the first half of 2014 upon recording two consecutive quarters of activity contraction after the modest expansion of 2.3% in 2013. Despite this, the inflation rate stood above the upper target value set by the Central Bank of Brazil. As a result, the monetary

[2] Extending the maximum terms around 3 years up to a range of 7 to 10 years.
[3] Estimations of variables that address the homogenization of the purchasing power of each currency.

Chart I.11

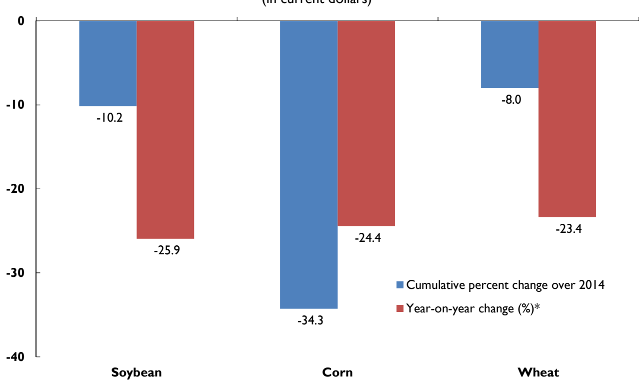
Economic Growth



*Weighted by their share in Argentine exports, which together reach 80% of total.
Source: BCRA from FocusEconomics and IMF data e: Estimated f: Forecasted

Chart I.12

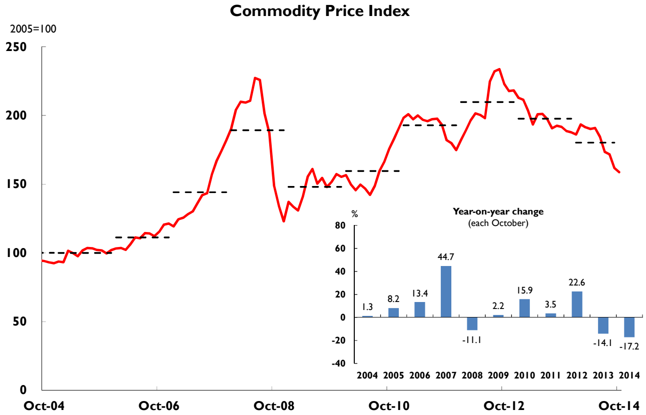
International Prices of Major Grains
(in current dollars)



Source: CBOT and KBOT * First 10 months of the year average

Chart I.13

Commodity Price Index



Source: BCRA

authority increased the benchmark interest rate by 25 basis points (bp) to 11.25% by late October.

Meanwhile, the economic growth pace of China continued to moderate after recording a 7.4% increase of its GDP in the third quarter of 2014 in line with the pace of the first half but standing below the figures recorded in 2013 (7.7%). It is worth pointing out that this sustained growth pace resulted in part from the fact that the government kept its measures devoted to boost the economic activity[4].

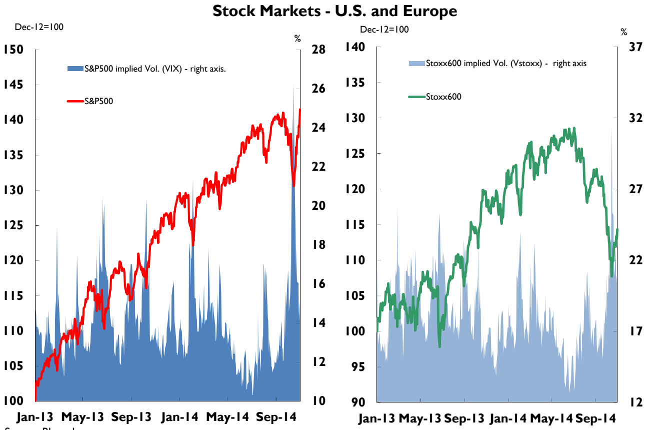
The international prices of commodities went down due to: 1) the abundant agricultural, energy and mining global supply; 2) the fragile performance of global economic activity, particularly in China; and 3) the widespread appreciation of the US dollar and the sharp drop of crude oil price. The decline in the prices of the main grains (see Chart I.12) was especially remarkable. Within this context, the Commodity Price Index (IPMP) – that follows the evolution of the international prices of the most relevant commodities for Argentina's exports– continued exhibiting year-on-year drops, as it had occurred in 2013 (-10% y.o.y. in the first ten months of 2014). Nevertheless, these prices are still high if measured in historical terms (see Chart I.13). With a view to the future, the prices of the main grains are expected to remain at levels similar to, or slightly higher than, the minimum values they recorded recently, also depending on the evolution of crops in the leading producing regions worldwide. In turn, the performance of industrial commodities will be impacted by the evolution of the economic activity in the leading purchasing economies (especially China) as well as by the geopolitical tensions in several countries (Russia, Ukraine, Syria, Palestine and Libya).

International financial markets have experienced a changing context since late May. Even though markets initially extended the positive trend observed during the first months of the year, a heightened caution has been observed as from late July, within an environment of higher volatility episodes and fluctuations in prices in September and October. All this occurred within a context where more differences are expected in terms of monetary policy by the main central banks. In turn, as regards emerging countries, there were also increasing doubts about the evolution of large economies such as a China and Brazil. (In the latter case, the volatility inherent in pre-election periods added up to the prevailing situation). In addition, a context of uncertainty still prevails in terms of geopolitical conflicts (such as the conflictive situation between Ukraine and Russia, now accompanied by tensions in

[4] Chinese authorities implemented a series of limited fiscal and credit stimuli such as tax exemptions for SMEs, intensification of infrastructure works and changes to the minimum reserve requirements of banks so as to channel more loans to regional economies and the rural sector

Chart I.14

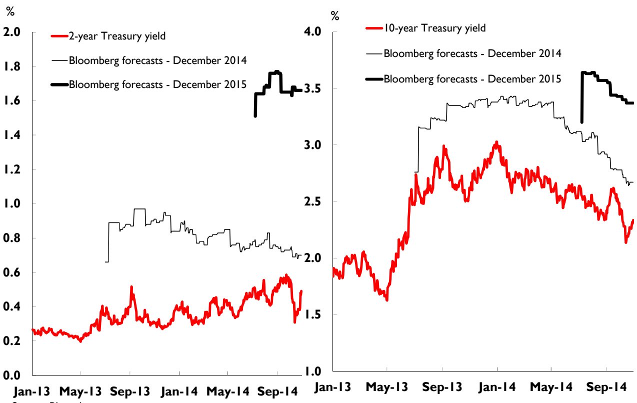
Stock Markets - U.S. and Europe



Source: Bloomberg

Chart I.15

US Treasuries Yields and Expectations



Source: Bloomberg

the Middle East), added to the epidemiological crisis caused by the Ebola virus.

The stock market indexes of the main developed nations had mixed results from late May to late October. In the United States, the S&P500 index accumulated a rise of almost 5% in the period under analysis and reached new historical peaks, even though from mid-September to mid-October, a temporary downward correction was observed (see Chart I.14). Then, so far in 2014, the S&P500 has recorded an expansion of over 9%. On the other hand, the EuroStoxx 600 measured in US dollars fell over 10% since the end of May, mainly as a result of the evolution of the exchange rate[5] (it accumulates a drop of almost 7% in dollars in 2014). This occurred within a context of an expected volatility that is still standing below its historical averages, despite its recent increases. The VIX (United States) and Vstoxx (Europe) have traded, on average, slightly below the values observed in the first five months of the year, despite the fact that the expected volatility tended to go up by late July and in early August and more sharply from mid-September to mid-October.

As regards the yields of US Treasuries, changes were observed in the yield curve in recent months (see Chart I.15). Two-year bond yields –exhibiting a strong correlation with the expectations of short-term interest rates– widened more than 10 basis points since the end of May, while 10-year bond yields contracted almost 15 basis points in the same period (mainly due to the reductions observed from mid-September to mid-October within a context of a flight to quality process). In the case of Germany's long-term debt, within a context of a deeper expansionary policy by the ECB (without disregarding the possibility of a larger asset purchase program), yields have fallen over 50 bp since the end of May to historical minimum levels, a trend that was accompanied by the long-term debt yields of the more vulnerable European economies (see Chart I.16)[6]. So far this year, the 10-year bond yields have recorded a drop of almost 70 bp for the United States and of nearly 110 bp for Germany.

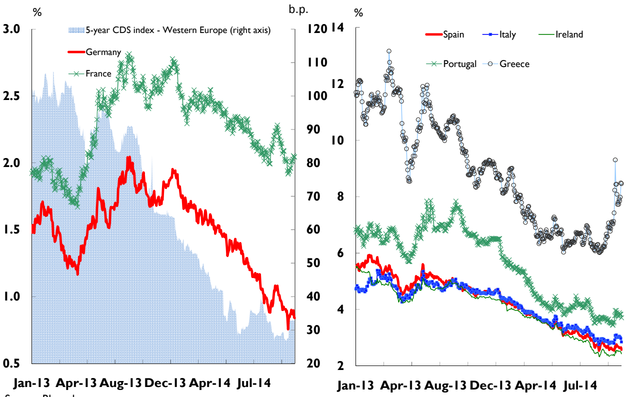
In the currency market, the US dollar has intensified its trend towards appreciation against the remaining currencies of the leading advanced nations since the end of May. The dollar index against the most widely used currencies in the US trading transactions expanded over 8% between June and October (a result that mirrors the

[5] The EuroStoxx 600 measured in euros closed the June-October period with a drop of over 2% and, so far in 2014, it has accumulated profits of over 2.5%. It should be highlighted that, although in the first half, the perceived risk over the Portuguese banking heightened remarkably, by mid-2014 this trend had started to moderate after the official intervention of the Banco Espirito Santo.

[6] Except for Greece. In this case, the long-term debt yields tended to widen in October within a context of doubts regarding the capacity of the country to get financing in the markets.

Chart I.16

European Sovereign Debt. 10-year Bonds Yields



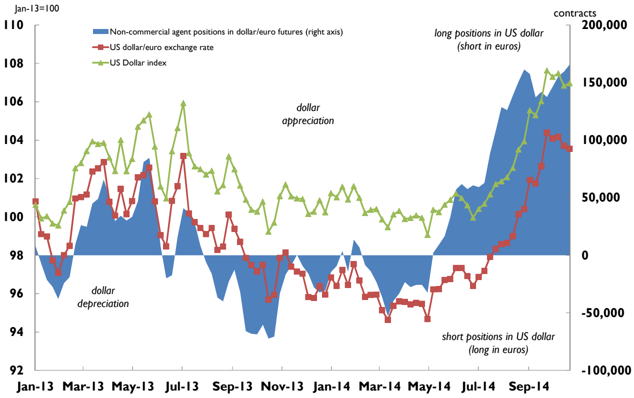
Source: Bloomberg

performance observed from the beginning of July to late October). This evolution was mainly due to the sharp appreciation of the US dollar against the euro and the yen (within a range of 8-10.5%) because of the divergent expectations regarding monetary policy of the different countries and regions involved. The dollar/euro exchange rate ended October close to USD/€1.25, a level not seen since September 2012. It is worth stating that, since mid-May, a strong positioning was observed in speculative investors in derivatives in favor of the US currency rather than the euro (see Chart I.17). Regarding the British pound, the US dollar has appreciated 4.5% since late May, during months when the exchange rate volatility was in part affected by the referendum on independence held in Scotland during the second fortnight of September. So far in 2014, the US dollar accumulates an appreciation of almost 9% against the euro, 3.5% against the British pound and 7% against the yen, approximately.

With reference to emerging economies' assets and accompanying the caution generated by several factors – tensions with a potential geopolitical effect, potential changes in the short-term interest rates by the FED before it had been previously anticipated and, more recently, the fall in commodity prices– the stock indexes measured in US dollars have gone down since the end of May. This resulted mainly from the contraction observed from mid-September to mid-October because the favorable performance recorded since February extended up to virtually the 9th month of the year. According to the Morgan Stanley Capital International (MSCI) Index, emerging markets accumulate, in aggregate, drops of over 1% measured in dollars from June to October. However, so far in 2014, this index posted a return of over 1%. The balance for the June-October period exhibited some heterogeneity according to the region. While for the aggregate of emerging Asia indexes an expansion was recorded (1.2%), Latin America experienced a drop of over 2.5%[7] and in the case of EMEA –the group that was hardest hit by the conflicts between Russia and Ukraine and the Middle East political tensions–, the fall reached almost 7.5% (see Chart I.18).

Chart I.17

US Dollar/euro, US Dollar Index and Non-commercial Agents Positions



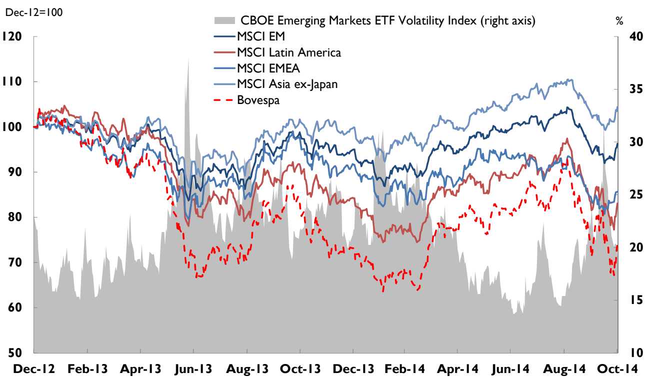
Source: Bloomberg

Since the end of May, the balance was also unfavorable for the prices in emerging debt markets, against the situation observed during the first five months of 2014. While the yields of long-term Treasuries contracted over 10 bp in the June-October period, the EMBI+ spread widened 25 bp (accumulating a drop of over 10 bp so far in 2014), given the upward trend recorded from July to

[7] During the June-October period, the Bovespa Index measured in dollars fell over 3%. However, this negative result is explained by the evolution of the exchange rate (measured in the Brazilian currency, the Bovespa accumulated an expansion of over 6.5%).

Chart I.18

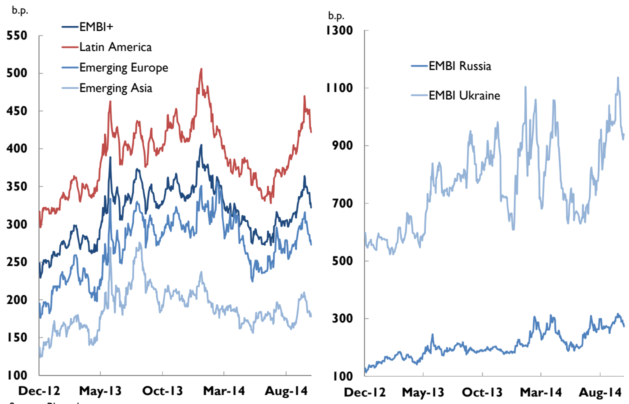
Emerging Economies Stock Markets and Expected Volatility



Source: Bloomberg

Chart I.19

Emerging Economies - Sovereign Risk Spreads (EMBI+)



Source: Bloomberg

mid-October, which was remarkably stronger in Latin America and Emerging Europe (see Chart I.19).

Nevertheless, the gross debt issuance in international markets by governments and companies recorded –in aggregate terms– a year-on-year rise of almost 25% in the June-October period (see Chart I.20). This rise mainly results from corporate debt transactions, even though the issue of sovereign debt has also gone up. So far in 2014, the aggregate of emerging countries' issues recorded an increase of 6% against the same period of 2013[8]. It should be mentioned that, last year, the aggregate of emerging economies' agents obtained a record-high financing amount in international debt markets.

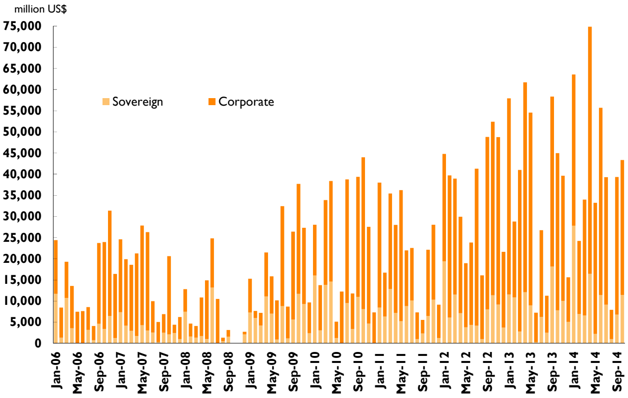
In line with the situation observed in April and May, the funds specializing in emerging assets (whose flows are considered a proxy to the data of portfolio movements) continued recording inflows in recent months. This was evident for both funds investing in equities and in debt, although the behavior was uneven because funds investing in debt closed August with outflows and those investing in equities recorded redemptions in October. This trend has taken an opposite direction if compared to the sustained outflows form these funds observed from mid-2013 to the first quarter of 2014. Based on the sizable redemptions seen at the beginning of the year, these funds have accumulated higher net outflows so far in 2014 than in the same period of 2013.

In the June-October period, emerging economies' currencies depreciated over 6%, on average, against the US dollar. This outcome mirrored the trend towards appreciation of the US dollar seen from July to early October, a trend that was accompanied by a higher expected volatility for emerging currencies. In turn, this latter trend was more marked in September and early October. So far in 2014, the currencies of emerging economies depreciated 10% on average against the US dollar. At regional level, as from late May, EMEA currencies experienced the highest depreciation (over 8%), reflecting the impact of geopolitical tensions. For example, the Russian ruble has depreciated almost 23% against the dollar since the end of May (see Chart I.21)[9]. The depreciation accumulated by Latin American currencies was slightly lower (6%). In this sense, the recent volatility observed in the case of the Brazilian real stood out (see Chart I.22), since it depreciated over 9% against the dollar since late May, mirroring the

[8] Unlike what happened in the June-October period, for the aggregate of 2014, the momentum observed in the issue of sovereign debt stood out, given the transactions performed between January and April.
[9] This was due, in part, to the conflict with Ukraine and the economic sanctions applied to Russia. This trend towards a depreciation of the ruble was more marked in the last two months within a context of a declining oil price and speculations about potential changes to the intervention policy in the foreign exchange market as well as eventual capital controls.

Chart I.20

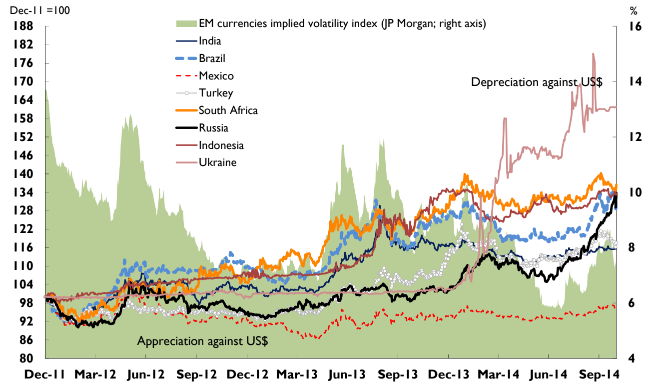
Emerging Economies. International Markets Debt Issuance



Source: BCRA based on Bloomberg

Chart I.21

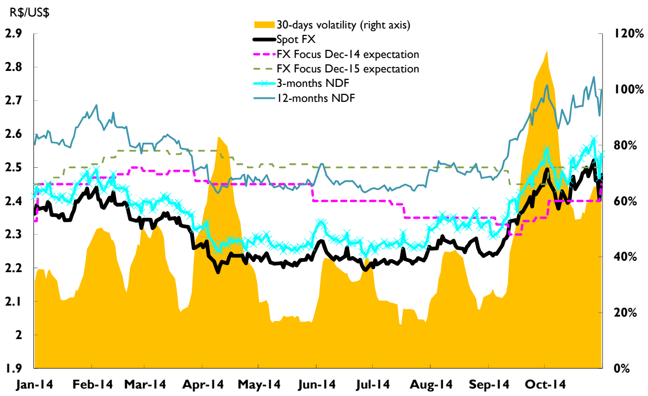
Emerging Economies. Exchange Rates Against US Dollar



Source: Bloomberg

Chart I.22

Brazil: Foreign Exchange and Expectations



Source: Bloomberg

performance observed in September and October, within the framework of the first and second round of the presidential elections (which were held in early and late October, respectively). The evolution of the real was also impacted by the ongoing downward revisions of the economic growth estimates (for instance, according to data of the Focus survey of the Central Bank of Brazil).

In perspective, after a long period characterized by an increasing liquidity in international markets, low expected volatility and positioning in relatively higher risk assets (impacting on their price), the evolution of the main economies will be followed closely, as well as their interrelation with the changes introduced in the policies to be implemented and their impact on the international financial markets. In this sense, as it has become evident from mid-September to mid-October, financial markets show a significant sensitivity to changes in the bias of the information released about the evolution of the world economy and the risks involved.

The performance of the US economy and the signs to be given by the FED regarding the changes to the measures applied will be especially relevant. The future rise of the interest rates in the United States might result in an excessively contractive bias that may end up affecting the global economic recovery, characterized by low inflation levels –and even the risk of deflation– among advanced nations. In turn, in Europe, special attention need to be paid to its economic performance and sociopolitical[10] factors, the evolution of the most vulnerable countries (such as Greece), the situation of the financial system (after the submission of the results of the comprehensive assessment of the system by late October), the implementation of already announced policies and the possibility of implementing new measures.

Among emerging countries, the focus will be on the performance of large economies, the evolution of indebtedness levels (particularly, the financing in foreign currency of the corporate sector) and the potential impact of changes in the international context and the responsiveness to these changes. Finally, attention will be specifically paid to the evolution of other risks such as those related to geopolitical issues (Eastern Europe and the Middle East)[11].

[10] For instance, the situation in Spain vis-à-vis the possibility of a referendum on the independence of Catalonia.

[11] Another example of a current risk is the Ebola virus crisis, which may give rise to disruptions in international trade and severely affect the health of the population of Northwest Africa.

Box 1 / Expectations about the US monetary policy and its impact on emerging economies' assets

Since the US Federal Reserve (FED) has continued reducing its large-scale purchases of financial instruments (coming to an end by late October), the expectations kept focusing on the rises of short-term interest rates anticipated for 2015. Even though, at least initially, the interest rate increases are expected to be gradual, along the year the level anticipated for 2015 has gone up. Global financial markets, including the instruments of emerging countries, might be affected by the changes in the expectations about the timing and size of this process aimed at increasing short-term interest rates and by the potential reaction of long-term debt yields

Since the beginning of 2014, the US FED has moved forward in the progressive reduction of the monetary stimulus measures implemented since the eruption of the financial crisis with peak in 2008-2009, based on the improvements observed in the economic conditions of the United States[12]. The beginning of this "tapering" process, of which signs had been given since 2013, became effective in January 2014 with the reduction of the monthly purchases of financial instruments (Treasuries and mortgage-related assets). Although the FED is no longer purchasing instruments since late October, given the remarkable amounts in the balance sheet of the FED and the reinvestment policy implemented, this institution will continue impacting on the US long-term debt markets[13].

The FED's large-scale program of instrument purchases allowed the institution to exert downward pressures on long-term asset yields. This supplemented other previous lines of action, related to the short-term interest rate (FED Funds –FF– rates), including keeping it at historically low levels and a forward guidance scheme, with announcements on the perspectives about the evolution of interest rates in the future. As a result, even though the FED has been announcing that it expects to keep the FF interest rates at their current range for a considerable time after the completion of the assets purchase program, once the expectations about a reduction in the acquisition of financial instruments consolidated, the focus started to be on the timing and the size of a future period of interest rate rises.

According to the forecasts made by the members themselves of the Federal Open Market Committee (FOMC), the cycle of FF rate increases is expected to begin by the end of 2015. It should be highlighted that during 2014 the levels expected for these interest rates target by end of 2015 and 2016 have been revised upward (even though this evolution was also accompanied by some volatility), at the same time that opinions showed an increasingly larger dispersion. For instance, from its current range of 0-0.25%, the target level for late 2015 estimated by FOMC members went up from 0.75% by the end of December to 1.375% in the latest survey of September 2014 (see Table B.1.1). In turn, for late 2016, the level anticipated for the interest rate target went from 1.75% (forecasts made at the end of last year) to 2.875% (according to estimates of September 2014). Finally, the levels expected for the long-term were revised slightly downward from 4% to 3.75%[14].

Table I.1

Forecasts and Expectations about Fed Funds Rate Evolution

Variable	End of 2013	Last data	Date of data
Fed Funds, end of 2015			
FOMC Expectations (median)	0,75%	1,375%	Sep-14
Primary Dealers Expectations (median)	0,50%	1,00%	Sep-14
Bloomberg Expectations (average)	n/a	0,95%	averg. last week Oct-14
Reuters Expectations (average)	n/a	0,96%	Oct-14
Fed Funds Futures	0,63%	0,53%	average Oct-14
Fed Funds, end of 2016			
FOMC Expectations (median)	1,75%	2,875%	Sep-14
Primary Dealers Expectations (median)	1,75%	2,25%	Sep-14
Fed Funds Futures	n/a	1,47%	average Oct-14
Other			
2-year US$ swaps rates	0,43%	0,68%	average Oct-14
2-year treasury yield	0,34%	0,43%	average Oct-14

Source BCRA based on Federal Reserve, Bloomberg and Reuters.

Market expectations accompanied the adjustment to the forecasts of the FOMC members, even though differences were observed in terms of levels. For instance, according to the survey performed by the New York FED, primary dealers expect the FF rate to close 2015 at 1%, in line with the surveys by Bloomberg/Reuters, but above the implicit values of the

[12] See Box "Expectations about the evolution of the US monetary policy" in the previous issue of the Financial Stability Report.

[13] The FOMC has adopted a policy of reinvesting the flows of its Treasuries holdings by taking part in auctions of new instruments. As regards the debt maturity of public agencies and instruments related to portfolio mortgages, they are reinvested in agencies' assets related to mortgages.

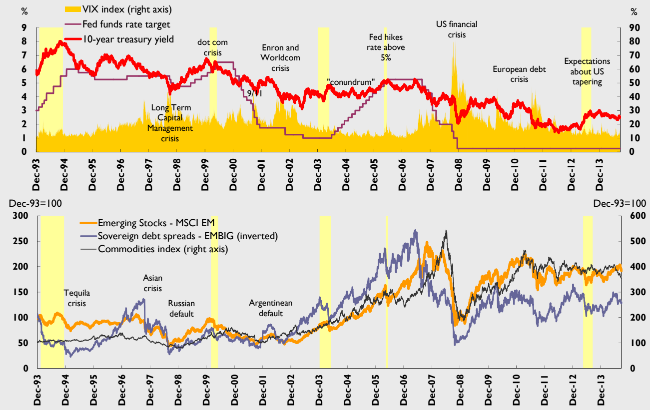
[14] The communications by the FED anticipate that once employment and inflation rates are close to levels consistent with the institution's mandate, the FF rates will stand below the figure the FOMC considers normal for the long term.

futures markets of these interest rates[15]. It should be mentioned that according to the median expectation of primary dealers, the rises in the rates would start in the second or third quarters of 2015[16]. This means that, considering different sources (including estimates by FOMC members), between 1 and 4 increases of 25 bp in the FF rates are expected for 2015 while, by late 2013, between 1 and 2 rises of the same magnitude had been estimated. In turn, for 2016, primary dealers' forecasts and the FED Funds futures prices indicate that there would be between 4 and 5 additional increases of 25 bp (6 rises according to the forecasts of the FOMC members).

At the FOMC meeting held by late October, it was stated that the measures to be taken about short-term interest rate will depend on the evolution of the economy and, particularly, on its pace of progress in terms of unemployment and inflation targets. For the time being, the rates increases are expected to be implemented gradually, even though any change in the expectations about the evolution of this cycle might generate a sudden portfolio rebalancing, with a potential impact on portfolio flows and financial instrument prices at global level. The risk becomes especially relevant after several years of short-term interest rates at historically low levels worldwide, low expected volatility on average, widespread search for better yields and, consequently, higher positioning in assets of a higher relative risk (including instruments of emerging economies).

Chart B.1.1

US Monetary Policy and Prices of Emerging Assets



Source: BCRA based on Bloomberg.

In the last 20 years (a period of sound growth and consolidation of emerging nations' instruments as a special class of assets), there were three cycles of increases in short-term rates in the United States. Coinciding with these cycles, corresponding to years 1994-1995, 1999-2000 and 2004-2006, the yields of the 10-year Treasuries went up between 100 and 200 bp (bp; see Chart B.1.1). A similar movement was observed by mid-2013 (within the framework of adjustment of expectations about the tapering process), when the yields of the 10-year Treasuries went up 123 bp. During these episodes, the assets of emerging economies experienced periods of widespread sales with divergent timing, length and intensity[17]. It should be mentioned that the drops in the prices of emerging economies' assets have been more marked in the cases in which the rises of short-term interest rates were accompanied by a more significant widening in the yields of long-term Treasuries[18].

As regards the incidence on private capital flows towards emerging economies, in the abovementioned cycles there was a reduced momentum in foreign direct investment and some impact on portfolio flows, either by reducing the inflows or turning them into outflows (see Chart B.1.2)[19]. Another stylized fact is that the negative effect on capital flows tended to become more evident towards the end of the cycle of interest rate rises. On the other hand, there are also cases of late effects related to crises linked in part to the impact on specific markets of prior increases of short-term rates[20].

[15] FF rates futures for December 2015 which, in September, stood on average close to 0.75%, were revised downwards in October, reaching an average above 0.50%.

[16] By the end of 2013, the cycle was expected to begin in the last quarter of 2015.

[17] These periods did not necessarily coincide with drops in the prices of commodities. For instance, by mid-2013, when the prices of shares and bonds of emerging economies tended to contract, commodity prices were not particularly affected. A similar phenomenon was observed in the periods of falling prices of emerging economies assets of 1994 and early 2004.

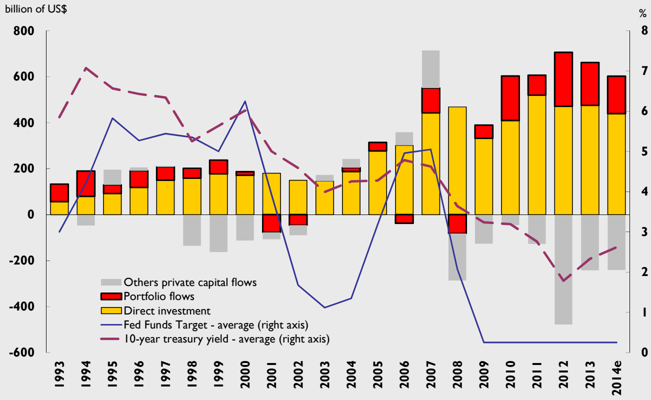
[18] In this sense, the 2004-2006 period of rises in short-term rates had a temporary negative effect on the prices of emerging assets before the beginning of the cycle and by the end of it (when the short-term interest rate went up over 5%). However, throughout the period, this class of assets accumulated a price improvement, in line with the performance observed in commodity prices. This coincides with what Greenspan called conundrum by the end of 2005 due to the cuts observed in the yields of long-term Treasuries within a context of rises in the short-term interest rates by the end of 2004. In perspective, it has been observed that a trend to lower yields in the long section of the US curve coincides with lower and more stable inflation rates in advanced nations in the last 20 years.

[19] For more information on the debate regarding the incidence of international and domestic factors on the demand of emerging assets (and related capital flows), see the respective boxes in the July 2013, October 2013 and August 2014 issues of the Macroeconomic and Monetary Policy Report.

[20] An example of this is the financial crisis of the United States itself, with its peak in 2008-2009, after the cycle of rises in short-term interest rates of 2004-2006. Another example is the period 2000-2001 after the burst of the dotcom bubble in the United States, after the upward cycle in rates of 1999-2000. In both cases, this coincided with periods of drops in commodity prices.

Chart B.1.2

Net Private Financial Flows to Emerging Economies



Source: BCRA based on IMF (WEO) and Bloomberg.

Based on the abovementioned factors, the measures to be adopted by the FED regarding the long-term asset portfolio and, in more general terms, the management of expectations about the introduction of changes to the bias of the implemented policies will be crucial for the evolution of the emerging economies assets. In this respect, it should be highlighted that the current context is very different because of the unprecedented expansion of the FED's assets in recent years. As reported in the latest meetings of the FOMC, a broad debate of a prudential nature is being held regarding how to proceed for the eventual normalization of the institution's balance sheet. Even though it has been already stated that the reduction in asset holding will be performed gradually and predictably (no longer reinvesting the flows received for the portfolio assets), the communication about how this normalization will be carried out in practice has become especially relevant.

II. Local Context

Summary

The indicators available for the second half of 2014 are signaling an incipient improvement in the economic activity if compared to the performance observed in the first half of the year. Even though external demand fell once again, sharply impacted by a decrease in purchases from Brazil, and private consumption exhibited a similar performance to that of the first half of the year, investment has shown a more marked momentum. On the supply side, the production levels of the industrial sector and trade-related activities continued to go down in year-on-year terms, with a slight deceleration on the downward trend. The remaining services continued to be on the rise, mainly driven by communications. In turn, it is worth mentioning that a change of direction was observed in the decreasing trend of the construction business, mainly due to the higher momentum observed in oil constructions and housing unit works.

The main labor market indicators mirrored the reduced momentum of the economic activity in the first half of 2014. Based on the information available by the end of such period, the employment rate recorded a year-on-year decline, while the unemployment rate went up slightly, all of this within a context of a lower labor force participation rate. Vis-à-vis this situation, the authorities decided to intensify and promote new policies aimed at financing investment and consumption, sustaining employment level and quality and providing economic aid to the most vulnerable households.

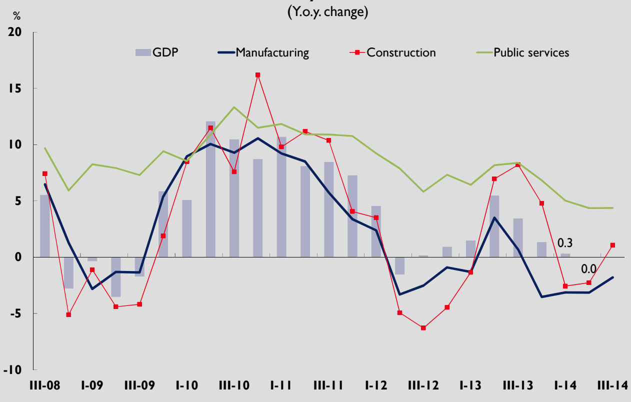
The monthly growth pace of the Urban National Consumer Price Index (IPCNu) has stabilized since mid-year, after the deceleration observed in previous months. This evolution was mainly due to seasonal factors but also to the monetary and foreign exchange policies and the price agreements, within a framework of a weak performance of aggregate demand.

So far in 2014, the Central Bank of Argentina has adopted a series of measures to reduce exchange rate volatility and was once again a net purchase of foreign currency. One of these measures consisted in reintroducing the limit to the positive net global position in foreign currency of financial institutions as from February 2014, originally at 30% of their capital and then reduced to 20% in September. This allowed for increasing foreign currency supply, and contributed to remove the pressures that impacted on the foreign exchange market. Likewise and with a view to improving financial conditions and promoting economic development and bilateral trade, the Central Bank of Argentina signed in July a new swap agreement for domestic currencies with the People's Bank of China. On the other hand, with a view to encouraging saving in domestic currency and driving credit to the private sector, the BCRA adopted a series of regulations, including a minimum limit to the interest rate on time deposits in domestic currency of natural persons and the increase of the coverage amount corresponding to the deposit guarantee scheme.

Generally speaking, the prices of sovereign bonds and shares have gone up since late May, despite some episodes of increased volatility and price fluctuations, mainly related to external and idiosyncratic factors, such as, in the latter case, the evolution of the Argentine debt litigation before the courts of New York and, in October, a downward correction of the implicit exchange rates in capital market transactions. Regarding financing through capital market instruments, a remarkable momentum was observed in recent months, even though the amounts have dropped relative to the figures recorded in previous months.

Chart II.1

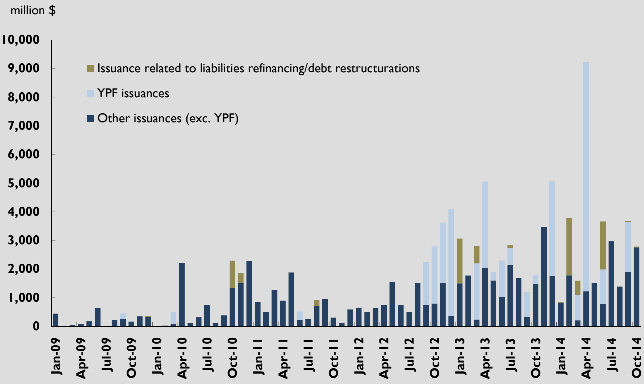
Activity Indicators
(Y.o.y. change)



Source: INDEC

Chart II.2

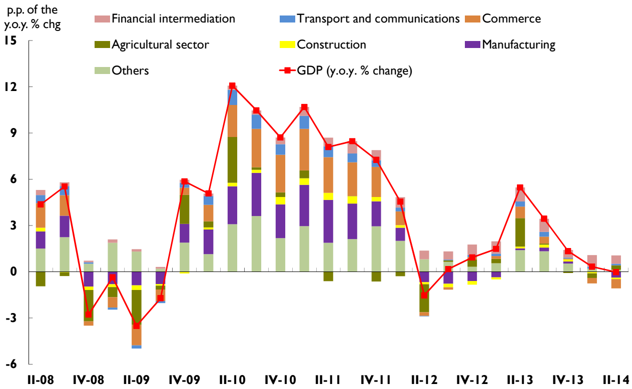
Private Sector Financing - Corporate Bonds Issuance



Source: BCRA based on BCBA, CNV and IAMC

Chart II.3

Contribution to GDP Growth by Economic Sector

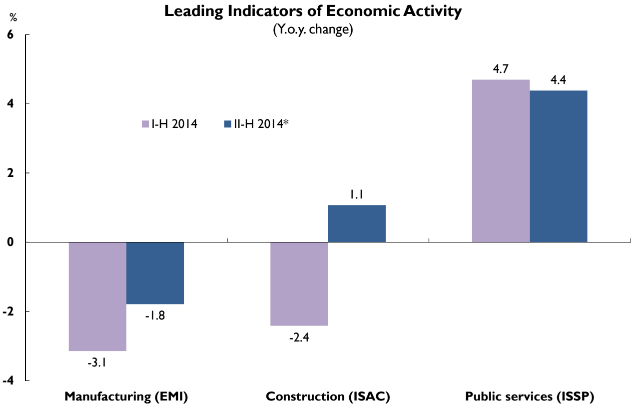


Source: INDEC

Chart II.4

Leading Indicators of Economic Activity

(Y.o.y. change)



Source: INDEC

* Data to September

II.1 Macroeconomic context

During the first half of 2014, the production of goods and services stood at virtually the same level as one year ago, since GDP grew only 0.1% y.o.y. This means that the deceleration of economic growth, a process that started by mid-2013, has remained unchanged during the first six months of the current year. This reduced expansion was mainly due to drops in the manufacturing segment, the construction business and trade-related activities; nevertheless, this reduction was offset by an increase in the production of services, especially in the area of communications (see Chart II.3).

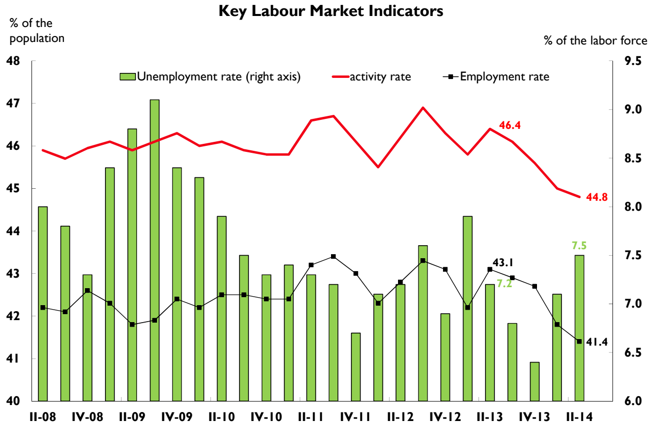
The leading indicators available are showing some signals of recovery in the economic activity so far in this second half of the year. On the demand side, this evolution was mainly driven by the performance of private spending for investment purposes.

From the standpoint of supply, the construction business exhibited the most remarkable marginal improvement. According to the Summarized Construction Activity Indicator (ISAC), the sector grew 1.1% y.o.y. at the beginning of the second half of the year (versus -2.4% y.o.y. from January to June). In turn, the industrial sector, measured by the Monthly Industrial Indicator (EMI), has shown a reduction in its year-on-year decline pace, from 3.1% in the first half of 2014 down to 1.8% between July and September (see Charts II.1 and II.4). On the other hand, services continued to be on the rise and have grown 4.4% y.o.y. on average so far in the second half of 2014.

The fragile economic performance observed throughout the first six months of the year impacted on the labor market, as evidenced by a slight increase of unemployment and a drop in the employment and activity rates. In the 31 urban conglomerates surveyed, the unemployment rate stood at 7.5% of the labor force, up 0.3 p.p. in the second half of the year against the data recorded one year ago. In turn, the employment rate went down in the same period to 41.4% (-1.7 p.p. y.o.y.), due to a decline in the number of employed workers, while the activity rate fell 1.6 p.p. y.o.y. down to 44.8% (see Chart II.5).

Households' nominal labor income continued to be on the rise driven by the effective implementation of the wage increases resulting from the latest collective bargaining agreements and also by the continuity of the public income transfer policies to the most vulnerable sectors (see Chart II.6). Regarding the latter, child

Chart II.5
Key Labour Market Indicators

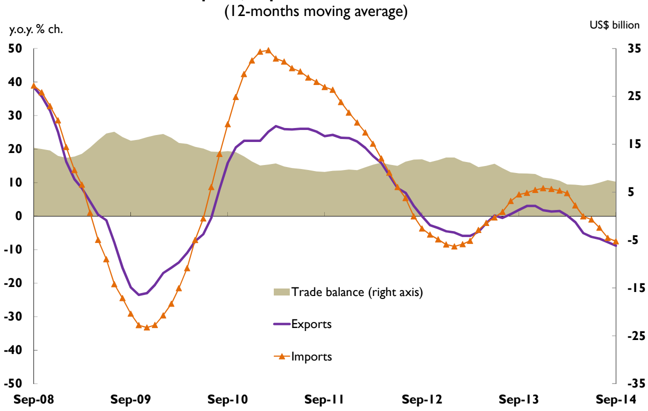


Source: INDEC

Chart II.6
Average Annual Wage and Minimum Retirement Income

Source: Ministry of Economy and Public Finance and INDEC. * Data to September 2014

Chart II.7
Exports, Imports and Trade Balance
(12-months moving average)



Source: INDEC

allowances were raised as from June[21], while pension and retirement benefits were raised 17.21% as from September[22], which added to a rise in the Minimum Wage.

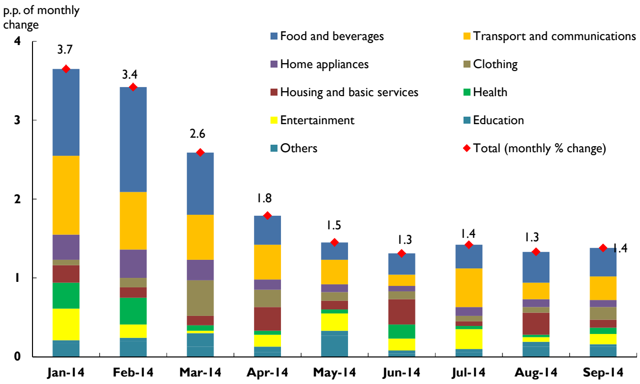
Given the impact of the economic activity evolution on the labor market, the authorities decided to intensify the policies aimed at financing investment and consumption, sustaining employment level and quality and providing economic aid to the most vulnerable families, in addition to continue with the plans already in place. The main measures include: 1) extension of BCRA credit lines and application of maximum interest rates on loans and minimum interest rates on deposits from natural persons; 2) regulation of the Fund for Argentine Economic Development (FON.DE.AR.); 3) launch of soft loan programs for the purchase of national vehicles (PRO.CRE.AUTO)[23]; 4) launch of the Employment Incentive Plan called PRO.EMPLEAR; 5) implementation of the so-called “AHORA 12” program to facilitate the purchase of goods and services with credit cards in 12 installments with 0% interest rate, with a view to fostering consumption and domestic production, and 6) the second stage of the Pension Inclusion Plan.

In turn, exports went down 10.4% y.o.y. between July and September —recording a drop similar to that of the first half of the year— mainly due to a reduction in the volumes shipped. Unlike what happened in the first six months of the year, all export items recorded a widespread year-on-year decline. Once again, a contraction in the sale of manufactures —reflecting the decrease in the transportation material to Brazil— was the main reason behind the drop of external sales. In turn, a new contraction in imports has deepened the trend observed in the first half of 2014. All import uses went down in year-on-year terms, except for capital goods. The combination of import and export performance resulted in an accumulated trade surplus of US$5.79 billion in 2014, down around US$800 million against the figures recorded in the same period of 2013 (see Chart II.7).

With reference to prices, the National Urban Consumer Price Index (IPCNu) recorded a decline in the monthly growth pace at the beginning of the year and, more recently, some stability was observed in the rate of increase. Several factors were behind this performance, including the monetary and foreign exchange policies

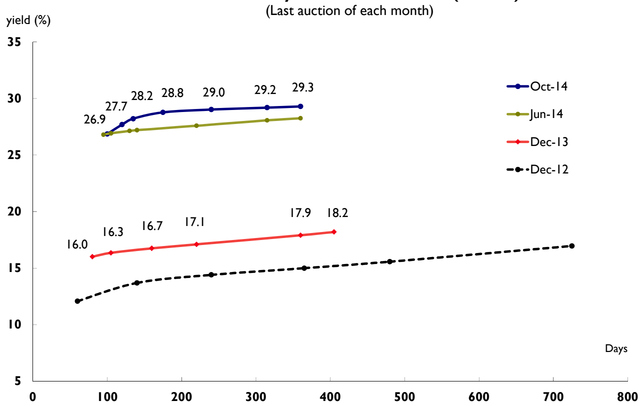
[21] An adjustment to the wage scales related to family allowances was also included as from June and October.
[22] Within the framework of the Law on Social Security Mobility, the rise granted in September added up to the 11.31% increase in retirements and pensions that became effective last March.
[23] Since its launch in June and up to September 23, the Program granted loans for around de $1.4 billion with around 14,000 transactions.

Chart II.8
National Urban Consumer Price Index (IPCNu)



Source: INDEC

Chart II.9
BCRA Primary Market Yield Curves (LEBAC)
(Last auction of each month)



Source: BCRA

and the price agreements, within a context of a fragile economic activity. As a result, the annualized rate of the 3-month moving average of the monthly change contracted up to levels close to 18% in the third quarter of the year, an evolution which was also affected by seasonal factors. In the aggregate of the first nine months of 2014, the IPCNu posted an increase of 19.8%, mainly due to the price increases of food & beverages, as well as transportation and communications (see Chart II.8).

II.2 Monetary Context

In recent times, the Central Bank of Argentina has implemented a series of measures aimed at promoting saving in domestic currency. In early 2014, it decided to increase the interest rates it pays on its instruments in the primary market. Thus, in June, the interest rates on the LEBACs at 95 and 105 days stood at 26.8% and 26.9%, respectively, while the interest rate for instruments at 360 days stood at 28.3% (see Chart II.9). So far in this second half of the year, these rates have shown minor changes, standing in October slightly above the figures recorded by mid-year.

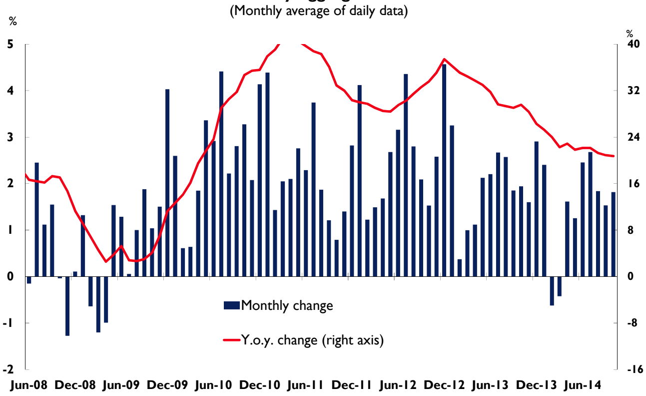
In the first half of the year, the monetary base went up 1.2% ($4.42 billion). The monetary expansion resulting from foreign exchange purchases by the BCRA and by public sector transactions was largely sterilized, mostly through the issue of LEBACs and NOBACs (around $58.5 billion). As a result, the monetary base recorded a 17.7% y.o.y. change in June, which turned out to be the lowest since early 2010. In the following months, the monetary base accelerated its pace slightly, accumulating a year-on-year increase of 19.8% by the end of October.

In the first six months of the year, the money market interest rates followed the pace of the BCRA benchmark interest rates and the liquidity conditions of the market; as a result, after a marked increase at the beginning of the year, this trend first stabilized and then partially reversed. However, they still stand above the levels recorded last December. Within a context of higher returns, time deposits in pesos from the private sector grew sizably during the first half of the year. Even though the rise was widespread and involved different amount segments, especially remarkable were time deposits below $1 million, which recorded the highest year-on-year increase of recent years (41.6%). Deposits corresponding to the wholesale segment have also shown a remarkable momentum (33.1% y.o.y.). As from July, some moderation started to be observed in the growth pace of time deposits from the private sector.

Chart II.10

Monetary Aggregates - M3

(Monthly average of daily data)

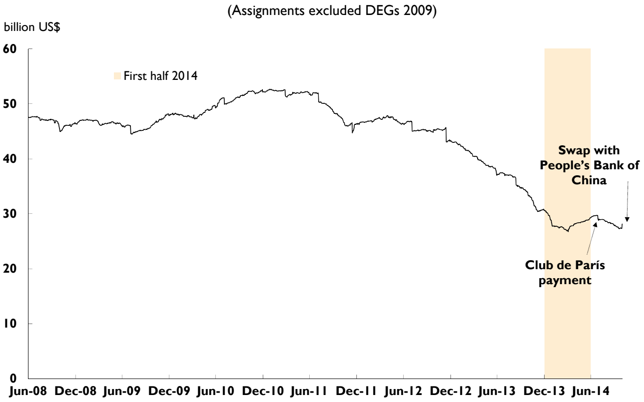


Note: M3 includes cash held by public, and the total amount of deposits in pesos. Source: BCRA

Chart II.11

BCRA International Reserves

(Assignments excluded DEGs 2009)



Source: BCRA

With a view to deepening the stimulus to saving in pesos, the BCRA established a minimum level for the interest rates payable on time deposits made by natural persons, provided total time deposits per natural person with the institution do not exceed the coverage provided by the deposit guarantee scheme[24]. Thus, these minimum interest rates are considered to be a proportion of the predetermined cut-off rate of the LEBAC with a term closer to 90 days[25]. In turn, for the purpose of providing a greater protection to savers, the amount for the deposit guarantee coverage was raised, per depositor, from $120,000 a $350,000[26].

Within this context, some moderation has been observed in the expansion pace of most monetary aggregates in pesos. In June, the broadest monetary aggregate in pesos (M3[27]) posted a 22.1% y.o.y. change (down 4.2 p.p. against the figure recorded in December), and remained relatively stable in the following months (see Chart II.10).

It is worth mentioning that, as from January, the BCRA has allowed residing individuals, upon prior authorization by the Federal Administration of Public Revenue (AFIP), to access the formation of freely-available foreign assets[28]. In addition, in February 2014[29], the BCRA reintroduced the top limit to banks' positive Net Global Position in Foreign Currency (PGNME). At the beginning, the limit was established at a level equivalent to 30% of the Adjusted Stockholders' Equity (RPC) of each financial institution[30] and, as from September 2014, it was reduced to 20%[31]. Also in February, a limit was established to the term net position in foreign currency at 10% of RPC[32].

Likewise, in July, the BCRA signed with the People's Bank of China a new swap agreement for domestic currencies for an amount equivalent to 11 billion dollars and a 3-year term, with a view to improving financial conditions and promoting economic development and bilateral trade. The BCRA may request the People's Bank of China disbursements for up to 70 billion Chinese yuans and deposit the equivalent amount in pesos, with a refund term of up to 12 months. Thus, on October 30, the BCRA decided to activate the first tranche of the swap agreement and requested an

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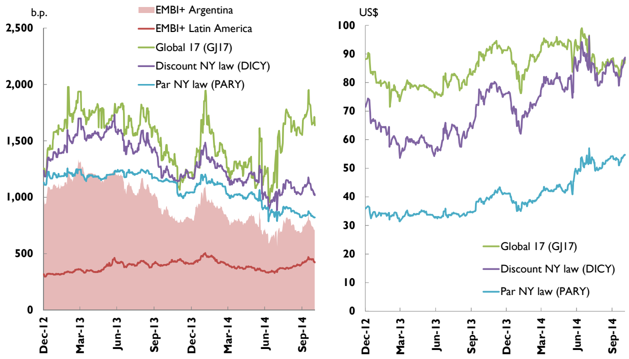
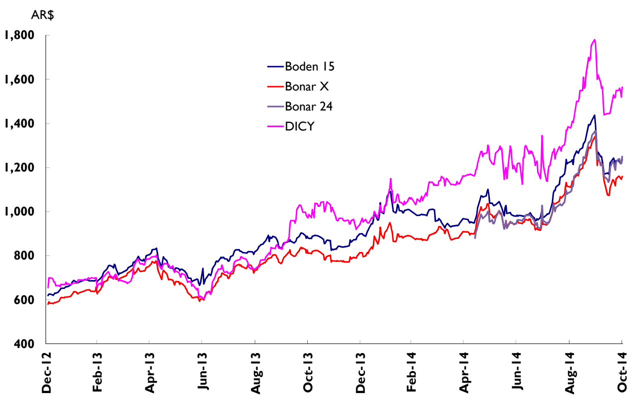
[24] See Communication "A" 5640.
[25] In order to determine the benchmark interest rate, the simple average of the cut-off rates corresponding to the second month immediately prior to the month when the deposits are made is considered.
[26] See Communication "A" 5641 and Communication "A" 5651.
[27] It includes cash held by the public, settlement checks in pesos and total deposits in pesos.
[28] See Communication "A" 5526.
[29] Communication "A" 5536.
[30] Corresponding to the previous month or its own liquid resources, whichever the lower.
[31] Communication "A" 5627.
[32] From the previous month.

Chart II.12
Sovereign Risk Spreads, EMBI+ Argentina Components and Prices in External Markets



Source: Bloomberg and Reuters

Chart II.13
Most Liquid Sovereign Dollar-denominated Bond Prices



Source: BCBA and MAE

exchange of domestic currencies for an amount equivalent to US$814 million.

Unlike the swap agreed upon between both central banks in 2009, this is an agreement which has significantly improved the conditions for use, with more flexible terms, lower costs and authorization for uses other than those that had been previously agreed upon. The agreement that has been recently signed aims at facilitating investments in the currency of the country providing the funds and strengthening the level of international reserves of the country requesting the disbursement. As a result, this instrument will strengthen the relationship with the world's second largest economy and, at the same time, the BCRA will have an additional support to implement its financial, foreign exchange and monetary policies. The progress made is based on the internationalization process that the Chinese yuan has achieved in recent years. Its payment volume has displaced other traditional reserve currencies, such as the Swiss franc. At present, the yuan may be freely converted to dollars, euros or any other currency in international marketplaces such as Hong Kong, London or Singapore. As a result, several central banks have shown an increasing interest in investing part of their international reserves in the Chinese currency.

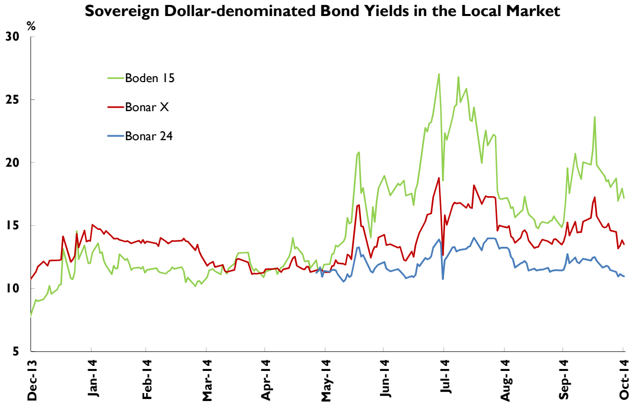
The level of international reserves has stabilized since late January and the BCRA became once again a net purchaser in the foreign exchange market. Within a context of higher seasonal settlement of foreign currency by exporters, international reserves went up from February to June and reached US$29.28 billion by the end of June. In turn, by late October, they were standing at approximately US$28.1 billion, mainly due to effect of debt payment in foreign currency (see Chart II.11).

II.3 Capital Markets

As from late May 2014, the Argentine financial assets exhibited a largely positive performance in the domestic market, while a favorable balance was also evident in external markets, even though with some exceptions. This is remarkable if we take into account that there were episodes of increasing volatility and that the prices of these instruments experienced some deterioration during this period, due to the combined effect of a heightened caution in global financial markets and the evolution of the litigation related to the Argentine sovereign debt in the US courts. Added to this, there was a downward bias in the implicit $/US$ exchange rate in capital market transactions in October.

Chart II.14

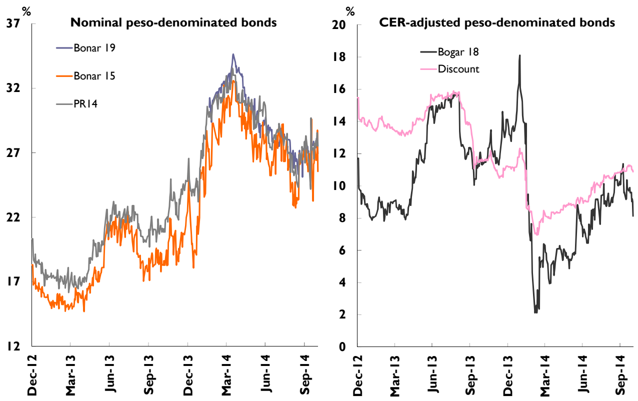
Sovereign Dollar-denominated Bond Yields in the Local Market



Source: BCBA

Chart II.15

Sovereign Peso-denominated Bond Yields



Source: BCBA and MAE

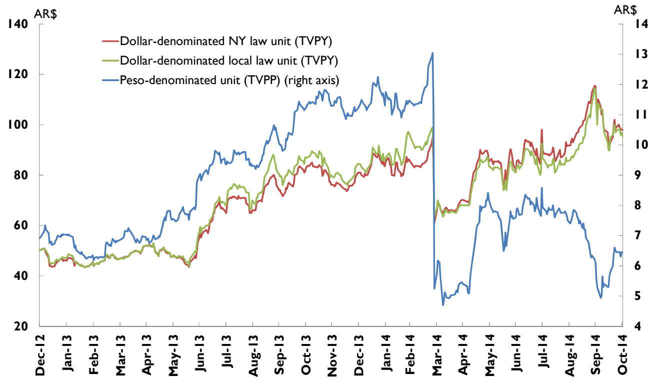
In this sense, in June, the US Supreme Court rejected the petition for a writ of *certiorari* filed by the Republic of Argentina, upholding as final the ruling by the Court of Appeals that confirmed the first instance decision ordering the implementation of the *pari passu* clause in such a way that, upholding Judge Griesa's criterion, either previously to or simultaneously with, any payment to the bondholders that had agreed to the debt restructuring of 2005 and 2010, Argentina must pay the claims to the plaintiffs. This final resolution lifted the suspension (stay) of the effects of Judge Griesa's ruling. Notwithstanding the resolution, by the end of June, the Republic of Argentina made the corresponding deposit upon maturity of the coupons of the different series of the Discount Bond. However, the funds deposited have not been transferred yet by virtue of an order of the judge hearing the case. On several occasions, the Republic of Argentina requested a new stay, which was not granted. In addition, in conversations held with the Special Master appointed to this effect, the Republic of Argentina offered the claimants once again the possibility of entering the debt swap in similar conditions to those offered to 2005 and 2010 agreeing bondholders, but its proposal was rejected. More recently, in September, Law 26.984 was enacted in Argentina with a view to implementing legal instruments that may allow for the collection of the services corresponding to the bonds issued in the 2005 and 2010 swap transactions (see Box 2).

As a result of this situation, the prices of Argentine sovereign bonds in dollars have shown a fluctuating performance in external markets in recent months (see Chart II.12), and have accumulated, as from late May, reductions in the shorter-term instruments (many of them subject to domestic laws) but also improvements in the longer-term instruments (most of them subject to international laws). As a result, the EMBI+ spread for Argentina narrowed 130 bp since late May, while the same indicator for Latin America widened by almost 50 bp. According to EMBI+, the spread of the Argentine bonds narrowed more than 100 bp.

In the domestic market, the prices of sovereign bonds in dollars have shown remarkable increases since the end of May, mirroring the upward trend seen in the August-September period. These prices, expressed in domestic currency for transactions with the highest liquidity, accumulate increases within a 15%-30% range since late May for instruments such as Boden 15, Bonar X, Bonar 24 or Discount under New York Law[33] (see Chart II.13). Since these are prices in pesos of assets denominated in foreign currency, the evolution was largely explained by the increase in the implicit

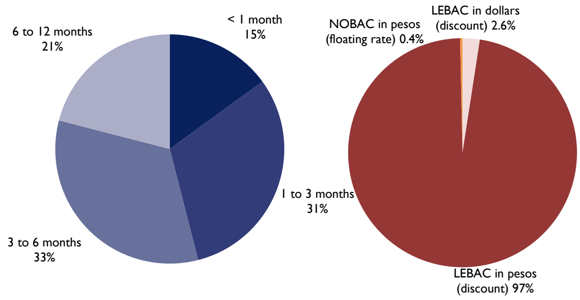
[33] So far in 2014, the prices of these instruments (for transactions in pesos) have shown a 50% expansion on average.

Chart II.16
GDP-linked Units



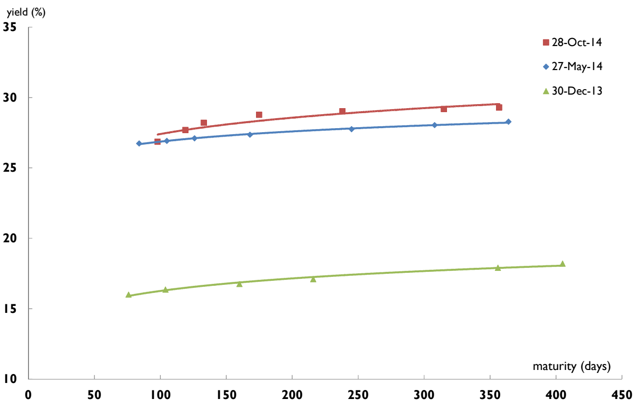
Source: BCBA

Chart II.17
LEBAC and NOBAC Stock Composition
Outstanding stock by type of interest rate and maturity as of end of Oct-14



Source: BCRA

Chart II.18
LEBAC Auctions



Source: BCRA

exchange rates in transactions made in pesos with capital market instruments; the rises were more marked in August-September and they went down, at least in part, in October. In turn, the yields of bonds in dollars with a higher liquidity have exhibited a mixed performance in recent months[34] (see Chart II.14), on the basis of the news about the litigation for the Argentine debt in the Courts of New York.

In recent months, the yields of instruments denominated in domestic currency have exhibited mixed changes. Among the series in nominal pesos, there were cuts in the yields of around 300 bp on average for the instruments with a higher traded volume, within a context of an ongoing decline in the Private Bank BADLAR. In turn, the yields of bonds in pesos subject to CER have widened, with increases of over 200 bp (see Chart II.15).

In turn, the prices of GDP-linked units exhibited a mixed performance, which depended on the denomination currency (see Chart II.16). Thus, the units in pesos have recorded a negative evolution since late May, especially because of the performance observed between mid-July and October, while the prices of the units denominated in dollars (with prices expressed in pesos) grew around 15% on average during this period, due to the marked increases observed from the first weeks of August to late September. This mixed performance was also noticeable in the aggregate recorded so far in 2014.

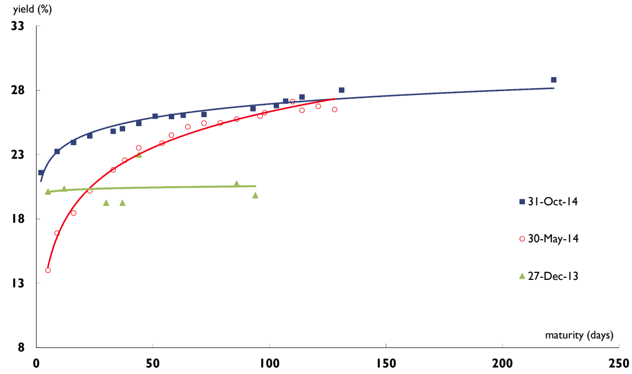
Regarding the BCRA instruments, the nominal outstanding stock of bills and notes continued to be on the rise. Thus, by the end of October, it stood at $243.88 billion. The main reason behind this growth was the performance observed in bills, which virtually accounted for the entire outstanding stock (the weighting of notes continued to lose ground and ended up accounting for only 0.5% of such stock, see Chart II.17[35]). In terms of total deposits in pesos, the stock of these instruments reached a level close to 30%, still below the historical maximum values[36]. Regarding the segment in foreign currency, the stock of bills stood around US$713 million by the end of October.

The growth pace of BCRA instrument stock in pesos occurred in a context where the auction interest rates went up to levels slightly above those recorded by the end of May, in line with the increases of late August[37]

[34] For the calculation of yields in dollars, the prices of transactions made in foreign currency in domestic marketplaces are used (even though transactions with a higher liquidity are made in pesos).
[35] Since early June, there were no transactions in the auction of notes.
[36] 36% in July 2007.
[37] In turn, the interest rates for the segment in dollars remained unchanged.

Chart II.19

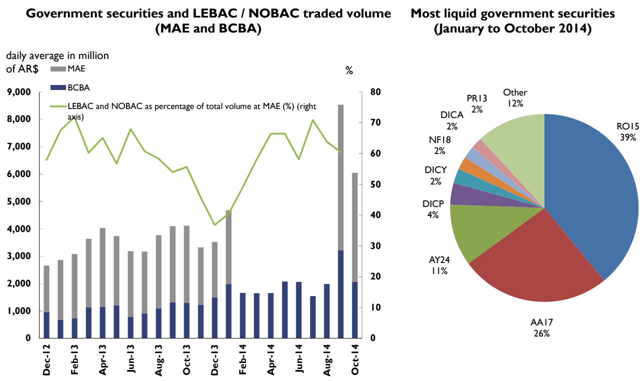
LEBAC Secondary Market



Source: BCRA based on MAE

Chart II.20

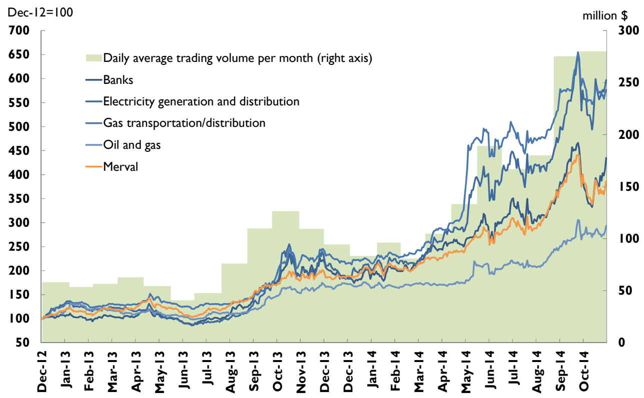
Fixed Income Instruments - Traded Volume



Source: MAE and BCBA

Chart II.21

Local Stock Market



Source: BCRA from BCBA data

(see Chart II.18). In October, the average term (weighted by amount) of auctions in pesos was close to a 200-day residual term, against an average of 160 days in May and over 260 days in December 2013. Thus, the average term of the BCRA outstanding portfolio of instruments shortened from 125 days by the end of May to 117 days by the end of October.

In the secondary market, and in line with the performance observed in auctions, the yields required on the bills have widened (see Chart II.19). Increases were more marked for instruments with a term of up to 3 months. In the case of notes, which recorded only a few transactions in the secondary markets, no direct comparison may be made among different time periods[38].

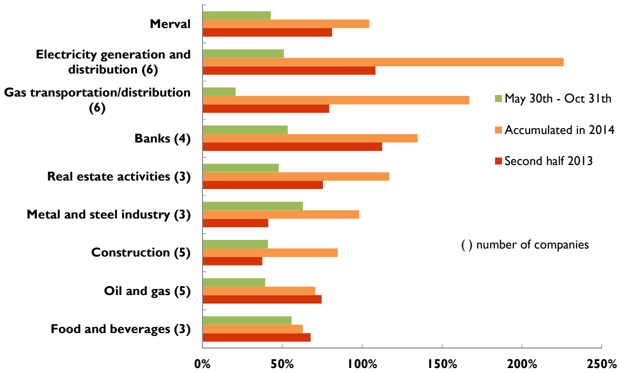
In the domestic marketplace, the volume traded in fixed income instruments (BCRA bills and notes and sovereign bonds) averaged $6.5 billion a day in the period from June to October. It is worth mentioning that, in September, there were rounds with maximum peaks but in October the volumes traded were once again closer to the average. This resulted in an increase of over 20% against the average volume recorded between January and May, and also in a year-on-year rise of almost 80% (see Chart II.20). On an instrument-by-instrument basis, there was a sharper increase of transactions with BCRA instruments in the Electronic Over-the-Counter Market (MAE) from late May to late September. Among bonds in dollars, Boden 15, Bonar X and Bonar 24 accounted for a large part of the transactions made between June and October, and the weighting of these instruments has increased its share relative to total transactions if compared with the performance recorded in the January-May period. Likewise, the volume traded in bonds in pesos lost ground against their performance in the first five months of the year.

In the secondary stock market, the Merval Index confirmed the upward trend started by mid-2013, reaching new historical peaks in nominal terms during September, even though a downward correction was observed in October[39] (see Chart II.21). Thus, measured in domestic currency, the index has posted a 43% rise (36% if measured in dollars using the wholesale exchange rate[40]) since late May. As a result, so far this year, it has accumulated an increase of over 100% (57% in dollars). At sectoral level, the stock price increase of

[38] In October, there were virtually no transactions.
[39] In turn, in the primary market, there were no transactions since the end of May. So far this year, two underwritings and one initial public offering for a total of $318 million were performed, against one transaction for $555 million throughout 2013.
[40] In turn, in the US Stock Exchange, the ADRs of Argentine shares have largely shown price increases (in dollars). As from late May, the ADRs of Argentine shares with higher liquidity went up over 10% on average.

Chart II.22

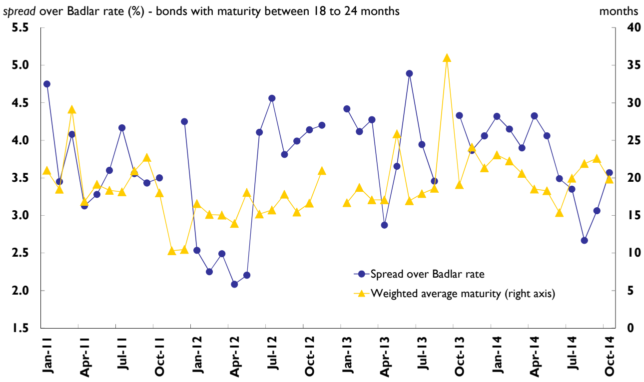
Local Stock Price Performance by Sector*



*Simple average of the returns of each stocks.
Source: BCRA from Bloomberg data

Chart II.23

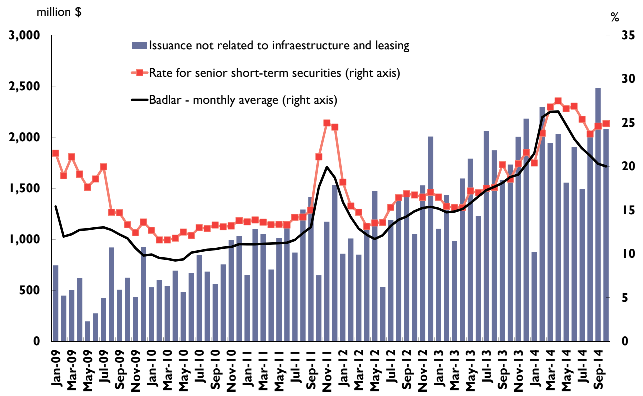
Financial Sector - Cost and Maturity of Peso-denominated Bonds



Source: BCRA based on BCBA, CNV and IAMC

Chart II.24

Issuance of Instruments by Financial Trusts and Financing Rates



Source: BCRA based on CNV, BCBA and BCRA

companies related to metallurgy, food & beverages, electricity and financial activities, with hikes within a range of 50-65%, was highly remarkable (see Chart II.22). Improvements in prices were accompanied by higher traded volumes: the daily average of transactions reached nearly $220 million in the last five months, more than doubling the amount recorded in the January-May period.

Gross financing flow to the private sector and for infrastructure and housing works through capital market instruments has kept a good momentum since late May, even though it decelerated if compared to the first months of the year (when large specific transactions were made). Thus, the flow went from almost $30 billion in the January-May period (with a strong weight of one YPF transaction for US$1 billion) down to $27.4 billion in the June-October period. In the latter period, the amounts went down 23% in year-on-year terms (in October there was a highly significant trust transaction related to housing units). In turn, so far this year, the gross financing amount exceeded $57.3 billion, slightly below the figure recorded in the same period of 2013[41].

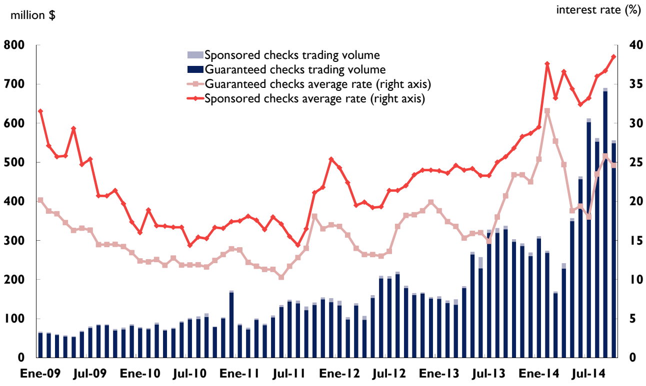
Financing through corporate bonds amounted to $14.5 billion between June and October, out of which almost $3 billion corresponded to issues by YPF and around $1.75 billion to restructuring or refinancing of other companies' obligations (see Chart II.2). Even though there has been a decline relative to the financing of $17 billion recorded in the January-May period, if we leave aside YPF issues and those related to liabilities management[42], a sizable increase can be observed in this period, from $5.5 billion to almost $9.8 billion. In year-on-year terms, an improvement has been observed as well, if the value is compared against that of June-October 2013 ($6.7 billion) (regardless of YPF transactions for over $3 billion and liabilities management for around $100 million).

In the last five months, issues of corporate bonds in domestic currency continued to prevail; there were only seven issues of dollar-linked bonds in the primary market (one of the them corresponding to YPF) and another four issues in dollars (corresponding to refinancing of interest and debt). In line with the prevailing trend, issues by oil companies (mainly YPF) and by the financial sector continued to account for the overall amounts obtained in the markets (two thirds of the volume issued along the period). Regarding the

[41] Leaving aside infrastructure issues, from January to October 2014, the financing amount reached almost $54.7 billion against $42.3 billion in the same period of last year.
[42] In the January-May period, $8.9 billion corresponded to YPF issues and $2.5 billion to liabilities management transactions.

Chart II.25

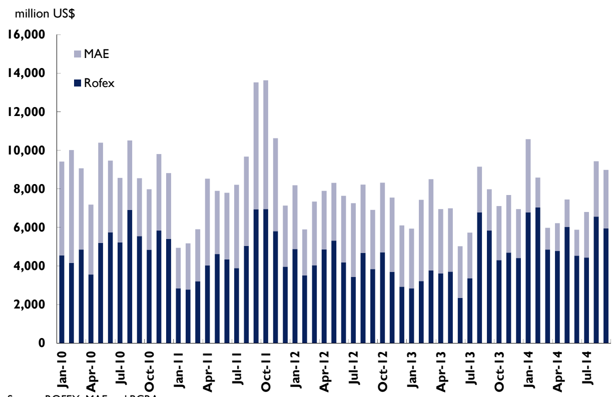
Trading of Deferred Payment Checks



Source: IAMC

Chart II.26

Dollar Future Contracts Trading Volume



Source: ROFEX, MAE and BCRA

transactions by financial sector's companies[43], a trend towards an extension of issue terms was observed for transactions in pesos up to September (the most relevant transactions), together with a decline in financing costs until August, resulting from a decrease in the Private Bank BADLAR (see Chart II.23).

In the June-October period, issues of financial trusts unrelated to infrastructure and housing[44] amounted to around $10 billion, standing above the $8.7 billion of the previous five months. In turn, this implies an increase against the same period of 2013, when around $8.5 billion had been issued (excluding infrastructure and housing). The yield of senior instruments tended to contract in recent months (see Chart II.24), in line with the Private Bank BADLAR.

Regarding the deferred payment checks, a remarkable increase was observed in the volume traded at the Stock Exchange. From June to October, transactions were traded for around $2.9 billion, with record-high volumes in some months, against $1.35 billion in the previous five months and also against $1.6 billion in the period June-October 2013 (see Chart II.25). There was a remarkable extension in the average term of the guaranteed check segment during this period, reaching a maximum of over 7 months on average between June and October. Regarding financing cost, discount rates for the guaranteed segment went up from 18.8% on average in May to nearly 25% on average in October.

Likewise, the amount traded in exchange rate derivatives went up between June and September if compared to the previous four months, within a context of a relatively stable performance of the wholesale exchange rate. This volume went up more markedly in the last two months (see Chart II.26). In turn, the implicit rates in the dollar futures trading contracts with short-term maturity remained virtually unchanged during good part of the period. Even though there were periods with higher volatility, the values recorded did not reach those observed in January. Lastly, regarding BADLAR futures, there have been no transactions since October last year.

[43] Including banks and non-banking financial institutions, in addition to financial groups, credit card closed systems and others.
[44] During the period, there were no transactions related to financing of infrastructure and housing.

Box 2 / Sovereign Payment Act

Law 26.984 was enforced in September 2014 with a view to solving the problems raised by the obstruction –originated in the judicial orders issued under the litigation process for the Argentine sovereign debt in the Courts of New York— of the funds deposited by the Republic of Argentina so that holders of the bonds issued in the 2005 and 2010 debt restructuring process may collect their claims. Thus, among other things, the Act authorized the adoption of measures to have a new trust agent to allow for the collection of the restructured bonds debt services. On the other hand, the new legislation has opened the door for new restructuring processes, either for the bondholders not ruled by Argentine legislation that may require a change in the applicable law and jurisdiction, or for bondholders who did not agree to the debt swaps already made (in conditions similar to those of the 2010 debt restructuring)

In response to the obstruction to the collection of the funds paid by Argentina by the end of June 2014 (related to Discount bond services), resulting from judicial orders issued by the Courts of New York, the National Congress enacted Law 26.984 on Sovereign Payment and Debt Restructuring in September 2014. This Act declares of public interest the debt swaps of 2005 and 2006, and seeks to implement legal instruments to allow for the collection of debt services corresponding to all instruments issued in such restructuring processes. As a result, the objective is to make the payments under fair, equitable, lawful and sustainable conditions to all sovereign debt bondholders.

To this effect, Law 26.984 authorized the adoption of the measures required to remove the Bank of New York Mellon as trust agent under the trust agreement related to the distribution of funds allocated to the payment of the restructured bonds. Therefore, the Bank of New York Mellon was replaced by Nación Fideicomisos[45]; upon maturity of each service corresponding to the instruments under the restructurings made, the payments will be deposited in special accounts of Nación Fideicomisos at the BCRA. These funds will be kept in a trust fund to be applied to the payment of the instruments, will be distributed via the new entities to be appointed to these effects (the new law states that the currencies deposited are freely available for bondholders). In fact, by the end of September, the Republic of Argentina deposited in these special accounts the amounts corresponding to the interest on Par bonds subject to the legislation of New York and of England and Wales.

On the other hand, if the bondholders requested a change in the legislation and jurisdiction applicable to the bonds not ruled by the Argentine law, then the new Law 26.984 has authorized the implementation of a swap involving the delivery of new instruments subject to identical financial terms and conditions, and for the same nominal value as that of the previous bonds, but governed by the legislation and jurisdiction of Argentina or France[46].

Likewise, in terms of the situation with the current holdouts (bondholders that did not agree to the restructurings already made), the implementation of a new swap transaction was authorized under the framework of Law 26.886, effective as from September 2013. This Act establishes that the financial terms and conditions to be offered cannot be better than those offered to bondholders of the 2010 restructuring (Executive Order No. 563/10)[47]. In turn, in order to prove the willingness to pay and the payment capacity under equitable conditions for all creditors, a special account of Nación Fideicomisos was opened at the BCRA where, upon maturity, a deposit would be made of the funds equivalent to the amounts that Argentina would have to pay for the services of the new instruments that might be issued in the future to replace those that are still out of the debt restructuring processes[48].

Lastly, the new Act created, within the sphere of the National Congress, a permanent two-house committee in charge of investigating the origin, evolution and current status of the Argentine foreign debt and also of following up the steps taken and the payments made.

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[45] All of this regardless of the right of the bondholders of 2005 and 2010 debt swaps to appoint a new trust agent that may guarantee a collection channel for the services applicable to the bonds.

[46] The Act explains that, in case the jurisdiction is extended in favor of the French Courts, the Republic of Argentina does not relinquish its right to immunity regarding judgments resulting from the extension clauses.

[47] This Act specifically prohibits offering public debt bondholders that have brought judicial actions a more favorable treatment than that afforded to those who opted otherwise.

[48] The funds deposited will be delivered to bondholders that have not yet agreed to a swap but that may participate in a future restructuring process, together with the new public bonds, at the time of their issue.

III. Debtors Performance

Summary

The corporate sector is the main debtor of the domestic financial system, and it showed a lesser momentum in levels of activity so far in 2014. This evolution went hand-in-hand with a marginal increase of aggregate indebtedness, which accounted for 21.8% of GDP by mid-2014. This was mainly due to the component of external resources, influenced by the evolution of the peso-dollar exchange rate during the period. In turn, the weight of financing from the domestic financial system went down slightly during this period, and by mid-2014, it accounted for almost 38% of the total.

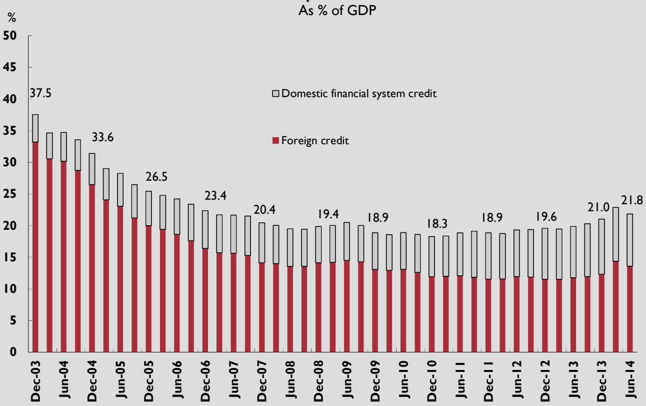
The levels of indebtedness of the corporate sector continue to be low, which helps to keep the financial capacity of companies in spite of a low-growth context for their levels of activity. The public incentive policies encouraged by the Government also help to maintain such low indebtedness level, since such policies allow companies to get financing in favorable financial conditions through the Credit Line for Productive Investment (LCIP), and at the same time they help to sustain the demand for their products because they encourage the consumption by households (for example, the "Ahora 12" Program, to purchase products in up to 12 fixed monthly installments at 0% interest rate) and the acquisition of durable goods (PRO.CRE.AUTO, for the purchase of cars, among other initiatives).

The aggregate level of indebtedness of households in terms of the wage bill went down so far in 2014, an evolution that is mainly due to the deceleration of credit given to the sector and the sustained increase of their nominal income. Thus, the leverage of households stood at 21% of the wage bill —net of contributions— in August, with a 3.7% fall so far in 2014. It is worth considering that the financial burden of households stands at moderate levels (see Box 3), a situation that if combined with the low level of indebtedness, contributes to sustaining the payment capacity of households. Moreover, this context of low indebtedness and burden of services would allow foreseeing a recovery of consumption by households in the medium term.

The public sector continues to be a debtor without significant relevance in banks' stocks and when considering its deposits in the aggregate of the financial system, it is a net creditor of such entities. Taking into account the evolution of income and expense of the non-financial public sector (SPNF), the primary and financial results in the aggregate of the past twelve months up to August represented approximately -0.6% and -2.2% of GDP, respectively.

Chart III.1

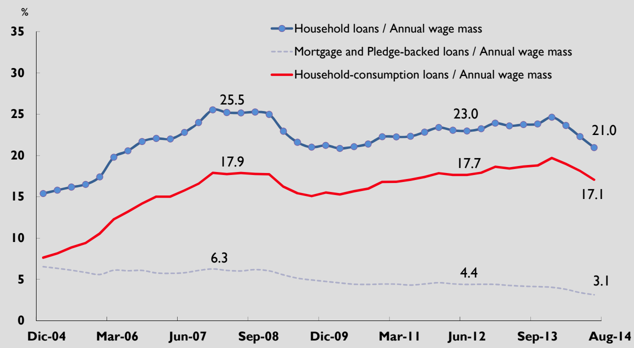
Corporate Debt
As % of GDP



Note: Data subject to subsequent changes.
Source: BCRA and INDEC

Chart III.2

Household Debt
As % of formal wage mass net of contributions

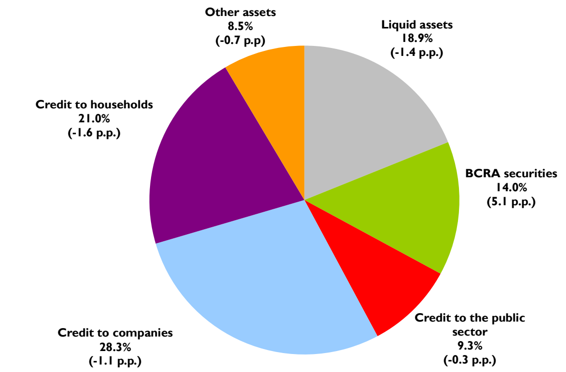


Note: Loans to households include financial system financing, financial trusts for comsumption loans asunderlyng assets (credit cards and personal loans), collateralized loans (mortgage and pledge-backed) and the stock of non-bank credit cards. Data subject to subsequent changes. Annual wage mass: average of 4 quarters.
Source: BCRA, INDEC and CNV.

Chart III.3

Financial System Assets Portfolio

As % of netted assets to August 2014 - (p.p. change respect to December 2013)

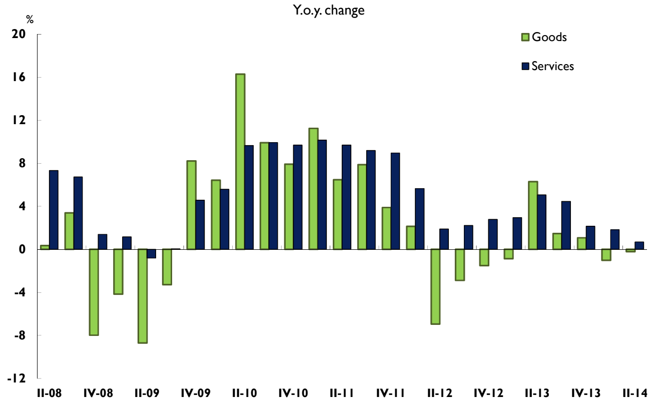


Source: BCRA

Chart III.4

GDP. Goods and Services

Y.o.y. change

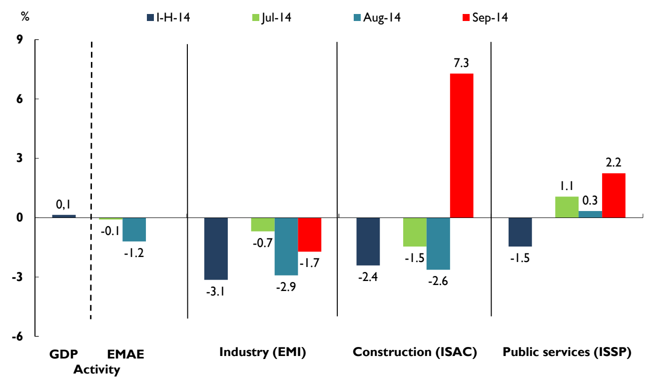


Source: INDEC

Chart III.5

Activity Indicators

Y.o.y. % change



Source: INDEC

III.1 Financial System Debtors

So far in 2014, there was a reduction in the relative weighting of loans to companies and households in bank assets, even though they are still the main debtors of the financial system (see Chart III.3). This occurred together with a gradual deceleration in the growth of lending to the private sector (see Chapter IV), a performance that may be associated in part to a reduced momentum of the macroeconomic context. Thus, lending to companies stood slightly above 28% of bank assets in August 2014 (with a 1.1 p.p. fall in the 2014 aggregate); in turn, this level stands at 21% for households (-1.6 p.p. in the same period).

In turn, the weighting of more liquid assets evidenced a sustained growth pace in the total, in particular BCRA securities held by banks.

III.2 Corporate Sector

During the first half of 2014, the level of activity was similar to that recorded in the same period of 2013, with a 0.6% year-on-year (y.o.y.) reduction in the production of goods which was offset by a 1.2% y.o.y. growth in the supply of services (see Chart III.4).

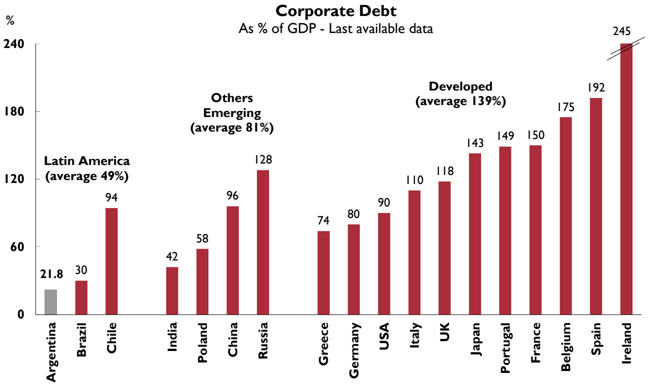
The supply leading indicators show a reversal of such trend so far in the second half of the year. As regards industrial activity, which explains almost 60% of GDP of goods, the monthly industrial indicator (EMI) revealed that production of some segments improved on the margin, whereas the activity of the construction business stood above the level shown one year ago. Within the farming sector, agricultural production was favored in recent months by the sowing of wheat and the harvest of corn—the latter due to the delay in harvesting tasks relative to previous years—, whereas the livestock and dairy production sectors would have reduced their levels of activity if compared to the level recorded a year ago. The supply of services kept on rising despite the fact that commercial and transportation activities exhibited a weak performance (see Chart III.5).

The corporate sector leverage stood at around 21.8% of GDP by mid-2014; even though this indicator is showing a moderate 0.8 p.p. increase during this half (see Chart III.1), it still stands at reduced values in international terms (see Chart III.6). On the margin, a slight drop is observed in the level of indebtedness with the domestic financial system, but this evolution was largely offset by the higher valuation of external indebtedness as a result of the evolution of the peso-dollar exchange rate during the period; in fact, when analyzing data in original currency, external indebtedness would have shown no significant changes in the first half of 2014.

Chart III.6

Corporate Debt

As % of GDP - Last available data



Note: Last available data 2011; except India, Brazil and China (2008); Poland (2009); Russia (2010), and Argentina (June 2014). Source: FMI GFSR and FSI (Financial Soundness Indicators); McKinsey Global Institute (year 2008); Financial Stability Reports and BCRA.

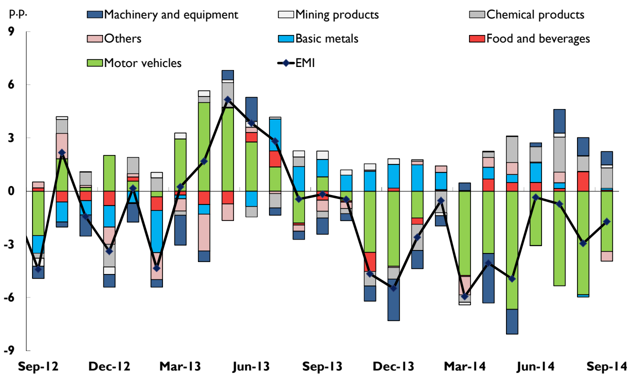
Approximately 62.2% of the estimated aggregate debt of the corporate sector is originated in commercial and financial lending from foreign sources. Especially, it is estimated that 62% of these sources of funds would be made up by commercial debt (which share is relatively more important in industrial and service companies), and approximately 40% of such debt is related to companies within the same group. In turn, in the remaining 38%, made up by financial debt —with a relative higher share in primary sectors, especially those related to oil and mining—, almost 57% is related to transactions performed within the same group.

Among financial resources obtained in the aggregate of domestic banks, the highest weighting still corresponds to funds taken by companies in the industrial sector (almost 41% of the total) and of services (20%), even though the commercial and construction sectors are gradually gaining a higher share on the margin. It is worth considering that micro, small and medium-sized enterprises (MiPyMES) are playing a more relevant role in this financing, to a large extent as a result of the public policies promoted by the BCRA (see Chapter IV).

Chart III.7

Industry. Sectorial Evolution

Contribution to y.o.y. change



Source: BCRA from INDEC data.

The deceleration observed in the activity of several productive sectors in recent months might pose challenges as regards financial positioning. The higher relative weight of external indebtedness resulting from the exchange rate increase at the beginning of the year might likewise impact on the situation of some specific cases as well, even though this would be offset by a slightly higher competitiveness at international level. The public policies implemented to mitigate this scenario have contributed both to reducing the financial burden of companies, especially through a deeper Credit Line for Productive Investment which provides lending for productive purposes in advantageous conditions, as well as to encouraging the demand of domestic products by households (see Chapter II and IV).

Productive Sectors

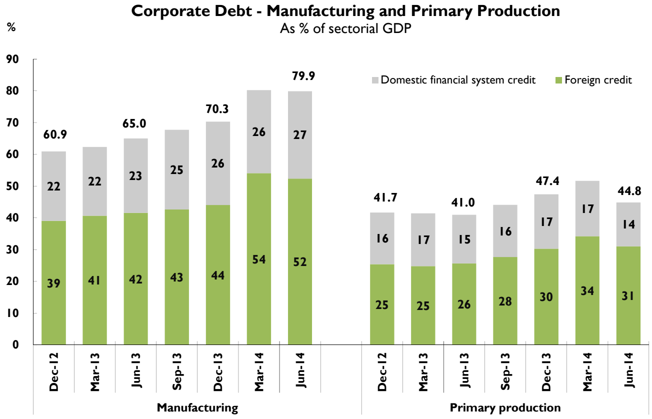
Industry

The activity of manufacturing industry contracted 3.1% y.o.y. during the first half of 2014, especially due to the fall in production of the automotive and related sectors (rubber and plastic, among others). Data corresponding to the third quarter showed a moderation in the pace of

Chart III.8

Corporate Debt - Manufacturing and Primary Production

As % of sectorial GDP



Note: Data subject to subsequent changes.
Source: BCRA and INDEC

decline exhibited so far by this sector, which basically resulted from the recovery of some branches of the metal-mechanical industry and of chemical and food products (see Chart III.7). Such performance allowed for partially offsetting the declining trend of the automotive sector, thus reducing the rate of decline of the monthly industrial indicator (EMI) down to -1.8% y.o.y. from July to September.

The level of use of the installed capacity (UCI) of the industrial sector went down 2% y.o.y. so far in 2014, whereas the level of formal occupation contracted 1% y.o.y. during the first half.

This context of lower manufacturing activity was combined with a higher level of sectoral indebtedness during the period up to almost 80% of GDP (see Chart III.8). This latter movement was mainly explained by the component of external funds (totaling approximately 52% of GDP by mid-2014), in line with the evolution of the peso-dollar exchange rate in the first half. Approximately 85% of external leverage of the industrial sector is explained by lines related to the commercial activity —linked to imports and exports—, whereas only the rest corresponds to financial loans or debt securities, among other instruments.

Agricultural Sector

The agricultural activity expanded slightly during the first half of 2014 (+0.2% y.o.y.). Even though the agricultural production for the 2013/14 cycle grew around 5% if compared to the previous cycle up to a record of 111 million tons of grains, the activity of the livestock sector stood below the levels recorded during the same period of 2013.

Table III.1

Grain Production - Major Crops

	2012/13 thousands tns	2013/14 thousands tns (e)	% Change 2013/14 vs. 2012/13	Diff. in thousands tns 2013/14
Cereals	**51,191**	**52,648**	**2.8**	**1,457**
Corn	32,119	33,000	2.7	881
Wheat	8,025	9,200	14.6	1,175
Others	11,047	10,448	-5.4	-599
Oilseeds	**53,632**	**56,695**	**5.7**	**3,064**
Soybean	49,306	53,400	8.3	4,094
Others	4,325	3,295	-23.8	-1,030
Rest	**639**	**1,610**	**151.9**	**971**
Total	**105,462**	**110,953**	**5.2**	**5,491**

e: Estimated

Source: MAGyP

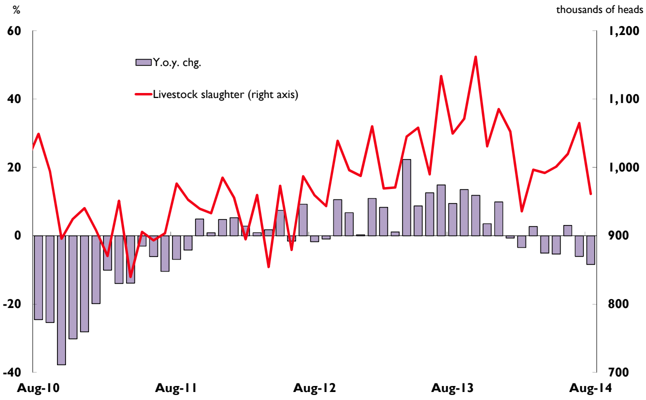
As regards the harvest of grains, soybean was the main driving force and its production totaled 53.4 million tons in the 2013/14 cycle (+8.3%). The higher momentum of the agricultural activity was also a consequence of the recovery of the wheat harvest with respect to the previous cycle (see Table III.1). Bovine slaughtering posted a drop of around 3% y.o.y. between January and August, after growing around 10% y.o.y. in 2013. Poultry slaughtering also posted drops in this period, whereas milk production continued falling.

The estimated level of indebtedness of companies related to primary production fell in the first half of 2014, reaching a level of 44.8% (see Chart III.8). This reduction was mainly originated in the lesser use of financing from the domestic financial system; this movement was only partially offset by a greater component of foreign funds. Such funds represent over 69% of the total, and most of them originate in the oil and mining sectors and consist of financial debt.

It is worth stating that so far in the second half of the year, the agricultural activity was favored by the delayed harvest of corn and the sowing of wheat for the 2014/15 cycle, in the latter case with very good initial conditions of humidity in soils, the need for rotation of crops and the positive price differential estimated with respect to other alternatives[49]. As to livestock activity, the available partial data allow to foresee a new drop in production (see Chart III.9).

Chart III.9

Livestock Slaughter



Source: BCRA from MAGyP data

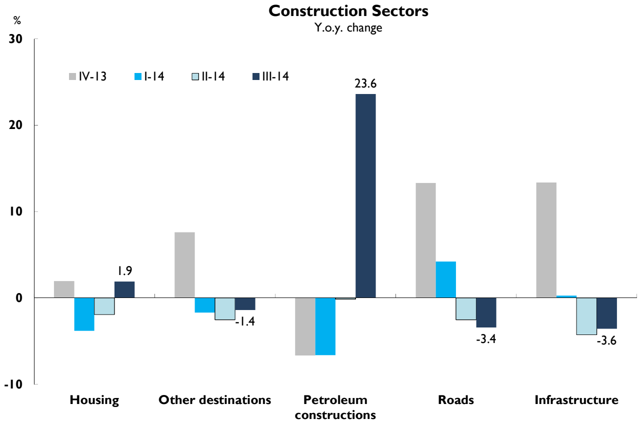
Construction Sector

During the first half of the year, the construction business lost momentum and posted negative change rates with respect to the same period of 2013. This contraction was widespread along the different types of works, both works developed by the public sector and in the private sphere and, because of their impact, the decrease of works for housing purposes stood out. Nevertheless, in recent months, there has been a remarkable progress of works intended for housing together with a sound recovery of oil constructions which allowed the sector to record a 1.1% y.o.y. growth rate in the third quarter of 2014 (see Chart III.10). The indebtedness level of companies of this sector gradually reduced on the margin, down to approximately 12.7% of GDP (see Chart III.11). Thus, construction still stands among the productive sectors with lower relative leverage, with a moderate share of funds from abroad.

Chart III.10

Construction Sectors

Y.o.y. change



Source: INDEC

Commercial Sector

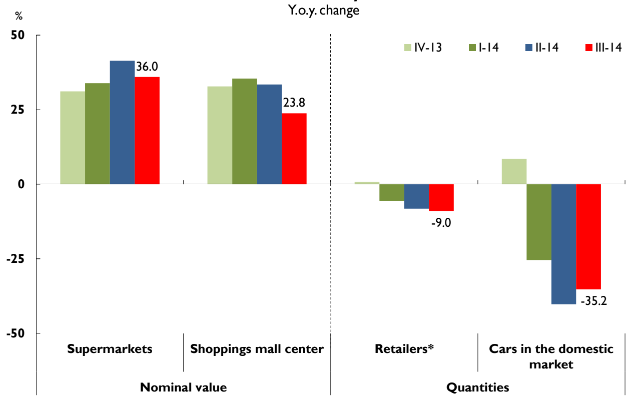
In the first half, the commercial activity fell if compared to figures recorded one year ago, in line with the performance of the production of goods. The decline also extended to the third quarter of 2014, even though drops lessened in some activities. According to partial indicators, during the last three months, there was a moderation in the pace of decline in amounts sold of durable goods, including motor vehicles and home appliances. In parallel, the pace of rising billing in the main malls went down for a value above 10 p.p. if compared to the first half. In relation to sales of mass consumer products, the amount of food sold by small and medium-sized shops fell around 4% y.o.y. in the third quarter (versus -2.8% recorded in the first half of 2014) whereas the amounts sold by large supermarket chains moderated slightly (see Chart III.11). Commercial companies reached an indebtedness level of

[49] Source: Ministry of Agriculture, Livestock and Fishing (MAGyP).

Chart III.11

Commercial Activity Indicators

Y.o.y. change



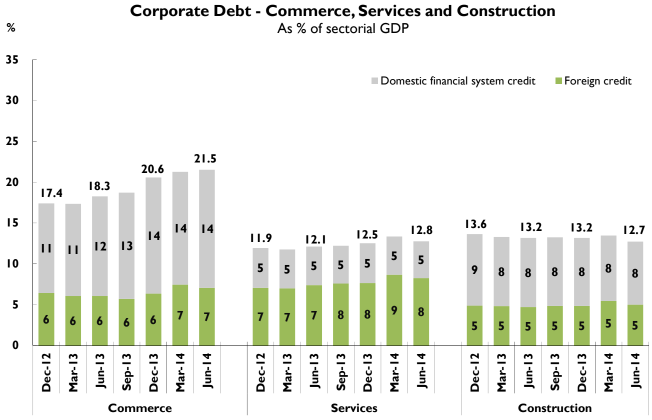
Source: INDEC, CAME and ADEFA

*Relieved by CAME. More than 400 stores

Chart III.12

Corporate Debt - Commerce, Services and Construction

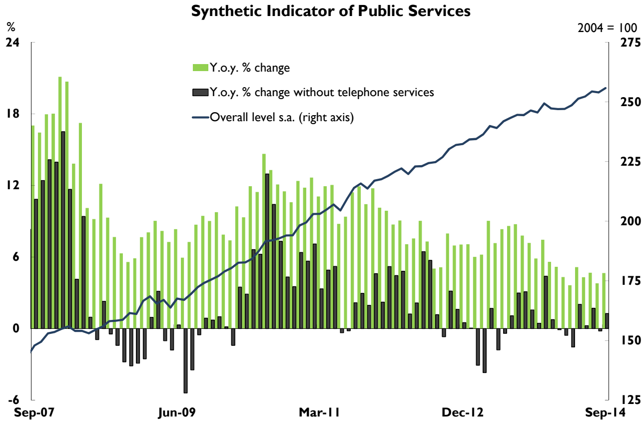
As % of sectorial GDP



Note: Data subject to subsequent changes.
Source: BCRA and INDEC

Chart III.13

Synthetic Indicator of Public Services



Source: INDEC

around 21.5% of GDP by mid-2014 (see Chart III.12), posting an increase of almost 1 p.p. in the first half of 2014. This evolution was mainly driven by the component of external financing (totaling one third of the total stock).

Other Services

The consumption of public services continued expanding; it has kept the deceleration trend started by mid-2013, but with some stabilization on the margin (see Chart III.13).

According to the Summarized Public Services Indicator, telephone items continued to lead the contribution to the year-on-year increase of the indicator, whereas the other segments of services posted a dissimilar performance throughout 2014. Cargo transportation contracted remarkably, in line with the performance of exports of primary products. The number of cars going past toll booths also posted a negative sign if compared to the value recorded one year ago. Conversely, the number of users of urban transportation services went up —with an outstanding recent increase in the demand for domestic flights— and the consumption of electricity also continued to record a positive sign.

The sectoral indebtedness posted a slight increase during the first half of 2014, up to 12.8% of GDP (see Chart III.12). This performance was influenced by a reduction in the weighting of domestic financing and a rise of foreign financial resources, in the latter case driven by the evolution of the peso-dollar exchange rate.

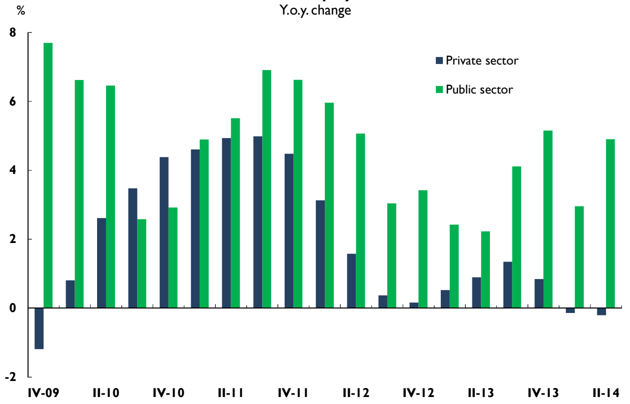
III.3 Households

Nominal income of households kept on rising in recent months, while the labor market started to reflect the weaker performance of the economic activity. Against this backdrop, public policies aimed at supporting lower-income sectors were intensified and new measures were taken in order to facilitate access to credit and to encourage social inclusion.

Based on data from the Household Permanent Survey (EPH) as of the second quarter of this year, the unemployment rate[50] went up 0.3 p.p. relative to the previous year, and stood at 7.5% of the labor force (PEA). The rise of unemployment occurred in spite of the fact that labor share contracted, in a context where the employment rate reached the minimum level of recent years. In the private sector, the level of formal employment shrank 0.2% y.o.y. in the first half, mainly

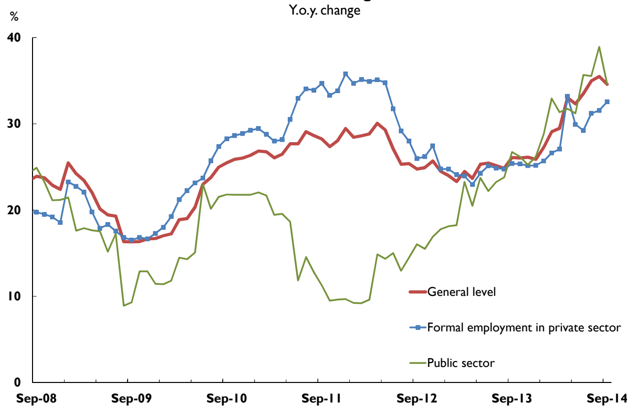
[50] In the 31 urban agglomerations surveyed.

Chart III.14
Formal Employment
Y.o.y. change



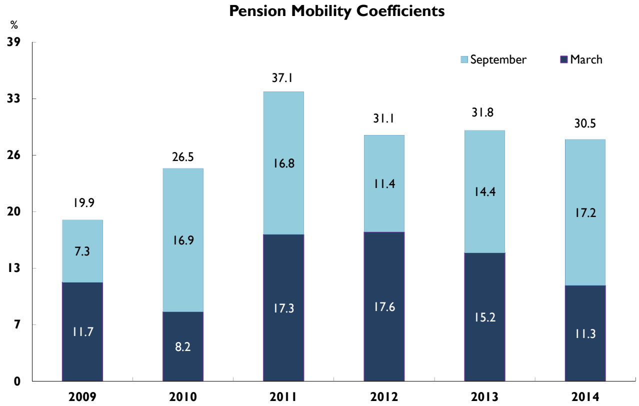
Source: INDEC

Chart III.15
Nominal Wage
Y.o.y. change



Source: INDEC

Chart III.16
Pension Mobility Coefficients



Source: BCRA from Ministry of Labor, Employment and Social Security, ANSeS and Ministry of Economy and Public Finance.

as a consequence of dismissals in the sectors of industry, agriculture and construction. Such reduction was more than offset by the public sector, where registered job creation reached 3.9% of the headcount in the first half of 2013 (see Chart III.14).

The quality of employment posted signs of improvement. Informal employment reached 33.1% of wage earners in the second quarter of 2014, a figure which entailed a 1.4 p.p. fall if compared to the same period of 2013. Meanwhile, the underemployment rate went down 0.3 p.p. in the second quarter, down to 9.4% of PEA.

With respect to wage income, according to the Wages Index of INDEC, there was a persistent acceleration in the pace of average salary rise of the economy, impacted by the coming into effect of wage increases agreed under the latest collective bargaining agreements. Thus, wages posted a nominal 34.6% y.o.y. increase in September 2014, if compared to a 33.5% y.o.y. rise recorded in June and a 25.9% y.o.y. rise in December 2013 (see Chart III.15).

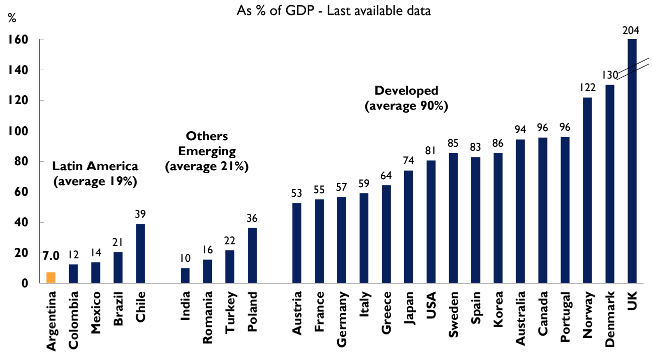
As regards the income policies implemented throughout this year, the monetary transfers for lower-income households were adjusted, with a remarkable increase up to 40% in amounts of family allowances as from June—including among such benefits the Universal Child Allowance for Social Protection— and the implementation of new associated wage tables. In addition, a new increase of the Minimum Wage came into force, and retirement and pension payments were adjusted by application of the Social Security Mobility Act (+11.31% in March and +17.21% in September; see Chart III.16). Besides, a set of new initiatives was implemented to favor the consumption of households (see Chapters II and IV).

The deceleration of lending to the private sector so far in 2014 (see Chapter IV), in addition to the increase in the nominal income of households, resulted in a decline of aggregate indebtedness of this sector. Thus, the estimated debt of households owed to the financial system stood approximately at 21% of annual income as of past August, with a 3.7 p.p. reduction so far in 2014—an evolution especially originated in the performance of consumption lines (see Chart III.2), and it stood below the values recorded in other economies (see Chart III.17). Thus, the limited levels of leverage of households have contributed to sustaining moderate levels of average burden of debt services of the households sector (see Box 3).

Chart III.17

Household Debt

As % of GDP - Last available data

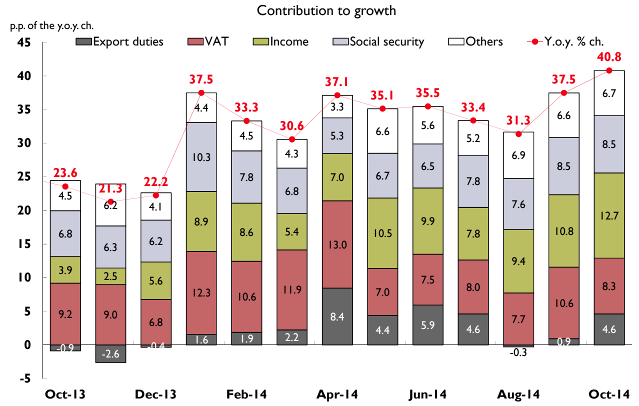


Note 1: Last available data 2014, except India (2008); Mexico (2009); Colombia, Chile and Japan (2010); United Kingdom (2011) ; Spain, Germany, Italy, Korea and Norway (2013) and Argentina (Aug-14). Data from Argentina is subject to future changes.
Note 2: In the case of Argentina, it includes bank debt, financial trusts for comsuption loans as underlyng assets (credit cards and personal loans), real collateralized loans (mortgages and pledge-backed) and the stock of non-bank credit cards.
Source: FMI, McKinsey Global Institute (year 2008), Financial Stability Reports and BCRA

Chart III.18

National Tax Revenue

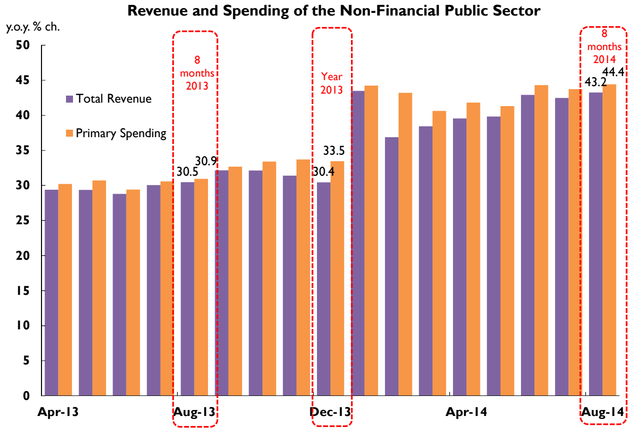
Contribution to growth



Source: BCRA from Treasury Secretariat data

Chart III.19

Revenue and Spending of the Non-Financial Public Sector



Source: BCRA from Treasury Secretariat data

III.4 Public Sector

Between July and October 2014, the national tax collection kept a dynamic expansion pace (36% y.o.y.), with a remarkable contribution of tax associated to the domestic market, whereas taxes related to foreign trade posted some deceleration (see Chart III.18). The primary spending of the non-financial public sector (SPNF) continued growing at an accelerated pace, slightly above the variation of revenue (see Chart III.19). Social security benefits continued to be the segment contributing the most to the year-on-year rise of primary spending, followed by current transfers to the private sector and capital expenditures.

The higher social security spending was due to the increase of benefit amounts and the higher number of beneficiaries[51]. Meanwhile, capital expenditures contemplate the contributions to the Argentine Bicentennial Credit for Housing Program (PRO.CRE.AR). In turn, the increase of transfers to the private sector was mostly due to transfers made for family allowances —including the Universal Child Allowance for Social Protection (AUH)[52]— and subsidies for energy and passenger transportation.

As a result of the evolution of income and expenses, the primary and financial results of the SPNF in the aggregate of the last 12 months up to August, accounted for approximately -0.6% and -2.2% of GDP, respectively (see Chart III.20).

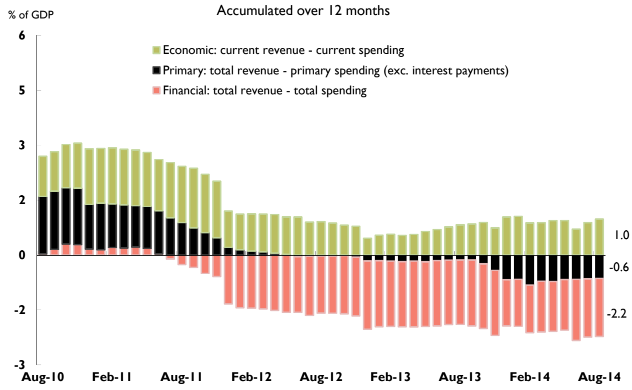
During the first months of the second half, the National Treasury (TN) continued to mainly meet its funding needs through financial investments and loans from other public entities. Besides, the TN issued new debt in domestic currency in the market by the end of September for an original nominal value of $10 billion[53] and another issue by the end of October for an amount equivalent to US$983 million for a new bond the payments of which will be made in pesos according to the US dollar exchange rate (dollar-linked)[54].

[51] In addition to the increases of social security benefit amounts in March and September 2014, Law No. 26.970 was enacted, corresponding to the second tranche of the Social Security Inclusion Plan, which might entail up to around 470,000 additional retirement and pension beneficiaries, who were excluded since they could not prove enough years of contributions made.
[52] After the adjustment of wage ranges for collection of benefits and the increases granted during 2013, as from June 2014, the government established a new rise for family allowance amounts, up to 40% in case of AUH and of lower-income beneficiaries, and it also amended, as from June and October, the related wage tables.
[53] An issue was made of BONAR $ 2016 (Private Badlar + 200 basis points —bp—), for an actual value of $9.71 billion, with an implied rate spread of 385 bp over Badlar.
[54] An issue was made of BONAD 1.75% 2016, dollar-linked, for an actual value of $8.35 billion.

Chart III.20

Non-Financial National Public Sector Balances

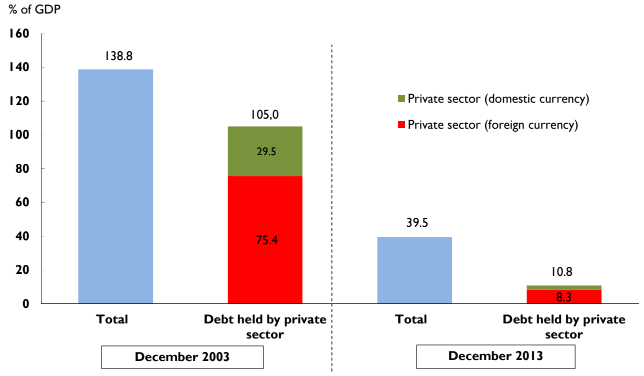
Accumulated over 12 months



Source: BCRA from Treasury Secretariat and INDEC data

Chart III.21

National Public Debt*

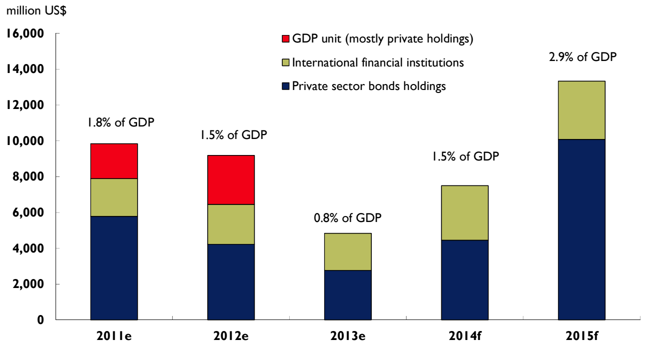


*Excludes holdouts; **Estimated
Source: BCRA from Treasury Secretariat and INDEC data

Chart III.22

National Public Debt Services in Foreign Currency Excluding Intra Public Sector Payments

(capital and interest)



*GDP unit obligations are not projected for the period 2014-2015. e: Estimadted, f: Forecast
Source: BCRA from Treasury Secretariat and INDEC data

The continuity of the funding strategy and of the operations for liabilities management —among which the most outstanding are the 2005 and 2010 debt restructurings— allowed for a significant improvement of the different solvency indicators since 2003. Such improvement would be kept even when the regularization of debt with the Paris Club, in addition to the agreements with REPSOL, would result in an increase of public sector liabilities. In December 2013, latest information available, the national public debt rose to 39.5% of GDP (see Chart III.21). Taking into account only obligations to private creditors —with a higher rollover risk— debt accounts for only 10.8% (out of which, 8.3 percentage points of GDP correspond to obligations denominated in foreign currency).

As regards maturities in foreign currency, it is estimated that in 2014 services aimed at private holders of public debt and those related to bilateral debt and owed to international organizations would represent a value equal to 1.5% of GDP, going up to just below 3% of GDP in 2015 (see Chart III.22).

The situation of the Argentine debt continued to be conditioned by the evolution of the current proceedings before the courts of New York, with several pieces of news in recent months (see Section II.3). As an answer to recent events, in September, Law No. 26984 was enacted, known as Sovereign Payment and Debt Restructuring Act (see Box 2).

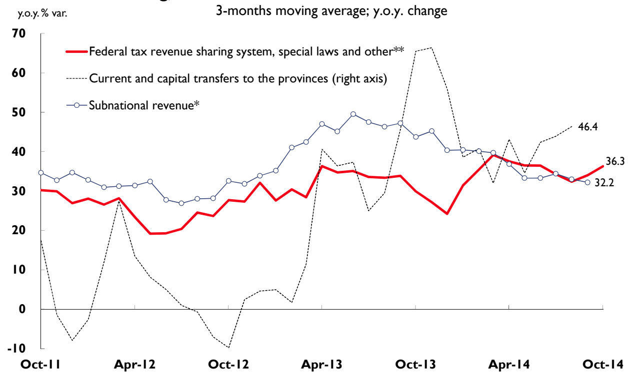
So far in 2014, tax revenue of national original received by the provinces recorded a faster expansion pace than in the second half of 2013, in line with the evolution of the national tax collection. In turn, budget transfers of national origin kept posting significant year-on-year increases. Finally, the tax resources of the provinces continued to show high year-on-year change rates, even though there is a continued trend of moderation of the expansion pace which began by mid-2013 (see Chart III.23). According to official estimates on the performance of 2014 subnational public accounts, the financial result of the consolidated amount of all jurisdictions would stand at a practically balanced level, with improvements if compared to the previous year. This performance would be impacted by the robust increase of tax revenue, both from national origin —federal tax revenue sharing, special laws and other automatic distribution funds— as well as revenue originated in the provinces.

The Federal Program of Debt Reduction of the Argentine Provinces continued to be implemented, with quarterly extensions —based on bilateral agreements—

Chart III.23

Sharing, Transfers to Provinces and Subnational Collection

3-months moving average; y.o.y. change



* Estimate based on available information.
** From Apr-09 provides for the distribution of resources Federal Solidarity Fund (Decree No. 206/2009).
Source: BCRA from Treasury Secretariat data

Table III.2

Dollar Linked Debt Placements of the Subnational Juridictions

Date	Jurisdiction	Currency	Amount in million (currency of origin)	Term (years)	Annual rate of return
Mar-13	CABA	*dollar-linked*	100.0	5.0	4.0%
May-13	CABA	*dollar-linked*	216.0	6.0	4.0%
May-13	Mendoza	*dollar-linked*	94.6	3.0	3.0%
Jun-13	Neuquén	*dollar-linked*	131.4	3.0	3.0%
Jul-13	Entre Ríos	*dollar-linked*	89.0	3.0	4.8%
Aug-13	PBA	*dollar-linked*	200.0	1.5	4.2%
Oct-13	Neuquén	*dollar-linked*	198.6	5.0	3.0%
Oct-13	Chubut	*dollar-linked*	220.0	5.8	4.0%
Oct-13	Mendoza	*dollar-linked*	55.4	5.0	2.8%
Dec-13	Mendoza	*dollar-linked*	69.9	5.0	2.8%
Dec-13	CABA	*dollar-linked*	113.2	6.0	2.0%
Dec-13	Entre Ríos	*dollar-linked*	63.9	3.0	2.3%
Total 2013			**1,552.0**		
Jan-14	CABA	*dollar-linked*	146.0	6.0	2.0%
May-14	CABA	*dollar-linked*	100.0	2.0	4.8%
May-14	Neuquén (*)	*dollar-linked*	24.7	2.5	2.9%
Jun-14	CABA	*dollar-linked*	75.9	2.0	2.5%
Aug-14	CABA	*dollar-linked*	64.6	2.0	0.4%
Sep-14	CABA	*dollar-linked*	111.1	4.7	2.3%
Accum. 2014			**522.3**		

(*) Designated as a letter according to the issuance prospectus.
Source: BCRA from Provinces data.

of the grace period to the ensemble of participating provinces, which entails savings of debt service for an amount equal to 0.2% of GDP.

In recent months, only the City of Buenos Aires kept on issuing bonds in the domestic market, with instruments whose payments of services are made in pesos according to the US dollar exchange rate (*dollar-linked*; see Table III.2).

Box 3 / Household Financial Burden Indicator

From a macroprudential standpoint, the higher use of credit instruments by households poses new challenges when monitoring the financial system's exposure to credit risk. In particular, the regular indicators used to assess the performance of such risk —levels of exposure, indebtedness and non-performance of loans— can be supplemented by new ratios which provide more information on the recent and expected evolution of the financial position and, therefore, of the households' repayment capacity. The Household Financial Burden Indicator (ICF), which measures the household financial commitments (payments of principal and interest) according to their income, allows for improving the diagnosis on such aspect. The first ICF estimates for Argentina performed by the BCRA show that current values stand at moderate levels, in line with the values recorded in other countries of the region

The monitoring of indebtedness conditions of the different loan-taking sectors is a key tool when assessing the credit risk facing the financial system. Even though the deepening of banks in the economy and the extended use of lending enable households to smooth out their intertemporal consumption and enable companies to improve their investment possibilities, the high levels of indebtedness may entail a greater sensitivity of debtors to potential negative shocks in the level of activity and, therefore, generate amplification effects of the business cycle.

In the case of households, there is a variety of indicators allowing for conducting such monitoring. Most of them intend to find a correspondence between the stock of loans & services deriving from such debt and some estimate of income or wealth of the sector. Given that several indicators capture different aspects of household indebtedness, a complete diagnosis of the credit risk of this sector must consider them on a supplementary basis and together with other ratios, such as the non-performance ratio.

At present, in our country, to monitor the evolution of debt taken by households, the indicator relating the stock of debt to wage income is mainly used. By definition, this ratio allows to assess the relative importance of the level of households' total indebtedness, taking into account all future capital commitments. This indicator must be supplemented by other indicators taking into consideration the financial conditions agreed to obtain such funds (interest rates and granting terms), so as to provide information on the financial position of the sector.

The Household Financial Burden Indicator (ICF) is a ratio showing the obligations for debt services —for interest and capital amortization— measured in terms of income available to households. Thus, even though with the restraints inherent in the calculation, it entails a proxy of the percentage of income the families would have committed to the payment of financial obligations previously undertaken, assuming, in this respect, that there is no possibility of a debt roll-over or that such roll-over can only be limited[55]. Moreover, this indicator allows for measuring any alterations that may occur in the payment capacity of households upon any changes in the stock of loans, the level of income or the financial conditions of loans taken. In turn, it is a tool that might help to explain, together with other variables, the evolution of credit and household consumption.

The methods to estimate the financial burden of households may be grouped in two large classes. On the one hand, there are estimates using microdata coming from household financial surveys. Since it uses data at individual level, this type of estimate makes it possible to analyze the financial burden by the debtor's social and economic level[56]. The second group is formed by aggregate estimates, i.e., a calculation is made of the amount of interest and amortizations payable by the ensemble of households in a certain period and is measured in terms of the available income of the total number of families. In turn, the total amount of the debt service —the aggregate amount— may be obtained through different ways, according to the type of information available. One of such methods is to take the amounts of services of loans to households as reported by financial entities[57]. A second option is to calculate the ratio with information from sectoral financial accounts of

[55] This type of assumption contributes to dimensioning scenarios of financial tensions in the economy, which in general occur very rarely.

[56] Countries such as Colombia, Chile and the United States conduct these surveys on a regular basis.

[57] It is worth stating that this method to calculate services would not be completely satisfactory for several reasons –see, for example, in Cifuentes, R., and Cox, P. (2005), *Indicadores de deuda y carga financiera de los hogares en Chile: metodología y comparación internacional*, in Financial Statiblity Report). On the one hand, it is based on information of past commitments. On the other hand, it includes possible voluntary expenditures, and does not take into account information of defaulted payments (see Maki, D. (1999). *The Growth of Consumer Credit and the Household Debt Service Burden.* Washington DC: Board of Governors of the Federal Reserve System). Finally, the information provided by entities is usually related to debt interest, excluding payments of capital amortization.

national accounts, in cases where the account is calculated with the detail of expenditures of debt service by sector. It is worth pointing out that this type of information is rather infrequent among countries[58]. A third option is to estimate the burden taking into account data provided by financial entities in relation to stocks, series of gross amounts given by period, term and interest rates of loans to households[59].

By virtue of the information available, in order to estimate the ICF of households, Argentina chose the method which incorporates information of amounts granted and of financial conditions operated in each period.

As regards the interpretation of the value assumed by the ICF, it is appropriate to state some considerations[60]. First, since it is the quotient of two aggregate numbers, it states the weight of the service of loans of the population as a whole, but not necessarily of the obligations of an average household[61]. Second, it must be highlighted that it includes no expectations as to income and wealth of borrowers, and any changes recorded in such indicator in terms of a sign of vulnerability for the financial system must be prudently interpreted. Thus, it may happen that an increase in the actual value of ICF is posting the effect of a perception of improved solvency by households, thus enabling them to commit a higher part of their actual income to debt service taken[62], not necessarily changing the payment capacity of the sector.

The several methods used in different countries to estimate an ICF make it really necessary to be very cautious when making international comparisons for analytical purposes. Moreover, since it is an estimate based on aggregates, it is only a proxy to debt service to be faced by households. Notwithstanding the above, it is understood that it is possible to obtain relevant information regarding the financial position of households, as long as medium term temporal series are generated which may allow for detecting any significant fluctuations over time.

[58] In many cases the payment of capital amortizations is also excluded, thus underestimating the household financial burden.
[59] This option, which includes information on average balance and interest rates and terms, is used by countries such as Chile, Brazil, the United States and Romania.
[60] These comments are also applicable to the method developed in this box.
[61] This interpretation is more correct for the median of debt ratio obtained from household surveys, mainly due to the fact that the denominator only takes into account households with actual debts.
[62] Dynan, K., Johnson, K., and Pence, K. (2003). *Recent Changes to a Measure of U.S. Household Debt Service.* http://www.federalreserve.gov/pubs/bulletin/2003/1003lead.pdf: Federal Reserve.

The calculation of the numerator of the ICF for Argentina is made separately for the different types of loans to households, which are later on added up to obtain the total financial burden. The first division made is between loan debt and credit card debt ("revolving" debt). The first set is related to obligations deriving from loans borrowed by households, with a definite amount and agreed repayment structure —term and interest rate— such as mortgage, pledge and personal loans. Instead, credit card debt, *a priori*, does not have a defined term for cancellation.

Taking into consideration that in our financial system most payments of loans and credit card due dates are mainly made on a monthly basis, such frequency was chosen to calculate the indicator.

The calculation of the financial burden from loan debt —taking into account lending from financial entities— was made separately for mortgage, pledge and personal loans, with the same calculation method for these three situations. Using the information regarding loans granted in the past to natural persons, especially the agreed amount, interest rate and term, an estimation was made of the flows of amortization and interest to be due each month[63]. Thus, all obligations are included which derive from the borrowings by households, regardless of the fact that they were later on securitized by entities and not taking into account if they are actually paid by debtors, since the concept of financial burden entails that accrued but not actual payments are taken into account.

The credit card debt, due to its intrinsic features, was treated differently. On the one hand, the debt balance is determined by: 1) the use made of such credit line in each period —the maximum amount of which is given by the lending limit provided by the issuer to each user— 2) the periodic cancellations of balances that are made. On the other hand, as to term, even though in principle the balance is due on the date stated in the monthly settlement, its revolving nature causes that these balances may be, in turn, rolled over. In general, credit cards usually establish a "minimum payment", which allows for determining a term for the balance of the revolving debt. The criterion adopted here is that, since cancellations exceeding the "minimum payment" are voluntary, in principle, they are not considered part of the

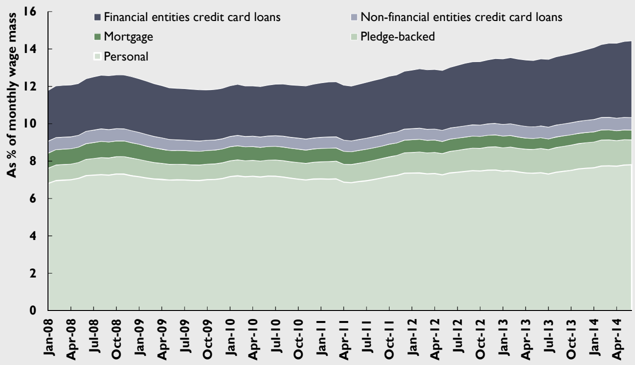
[63] It was assumed that loans were granted under the French amortization modality, which is commonly used in the domestic financial system. This method assumes that no advance amortizations of loans are made —either total or partial— which would entail, for periods following the period in which such voluntary payment is made, a reduction in the debt burden.

household financial burden[64]. Upon establishing a term for the revolving debt, by virtue of the required minimum payment, it was possible to determine the amount for each month. For the total debt amount, the financed amount of prior monthly settlements was taken into account. For this type of debt, information was included both for cards issued by financial entities and for non-banking cards. With respect to the "minimum payment" required by entities, it was established on the basis of information deriving from supervisory activities.

Chart B.3.1

Household Debt Service Ratio

2008-2014



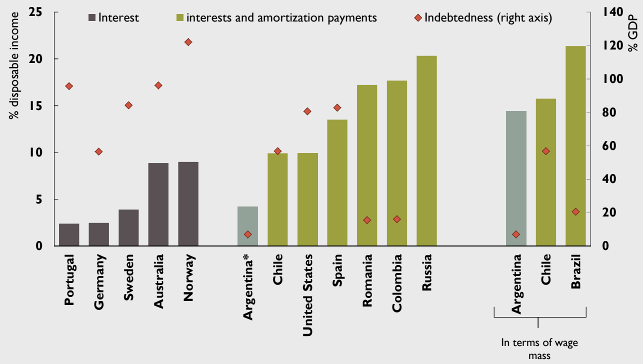
Source: BCRA

Finally, upon the estimation of financial burden values of each type of debt for each month, the ratio is calculated measuring it in terms of the total monthly wage bill[65], as indicator of the household income (see Chart B.3.1). Considering the latest information available, this indicator would stand around 14.4% of the wage bill, out of which 12.6 p.p. are explained by consumption lines —personal and credit cards— and with a slight increase recorded in recent years.

For the purposes of an international comparison, a ratio using GDP as denominator must be added to the ratio in terms of the wage bill[66]. It must be taken into account that there are some differences as to the methods among the countries for ICF calculation. A preliminary comparison shows that current levels of the indicator for Argentina are lower than those recorded in other countries of the region and developed countries (see Chart B.3.2). This situation would be partly explained by the low indebtedness levels of the ensemble of households prevailing in Argentina if compared to the rest of countries.

Chart B.3.2

Household Debt Indicators - International Comparison



* in terms of GDP. Data to 2014, except Germany and Colombia (2013); Chile (2011). Source: IMF and Central Banks

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64 The use of this criterion allows for making a more homogeneous comparison of the indicator at international level. In addition to this criterion, there are other indicators for internal monitoring for this type of debt with broader definitions of financial burden.

65 Net of contributions.

66 In general, the international comparison is made in terms of Available Income. When this piece of information is not available, GDP is used as an alternative.

IV. Financial Sector

Summary

Within the framework of strengthened liquidity and solvency systemic levels, the financial intermediation activity of the ensemble of financial entities with the private sector has expanded more moderately during the first eight months of 2014 if compared to previous years. Thus, in August, total lending to companies and households went up 22.9% year-on-year (y.o.y.) in nominal terms, down almost 8 percentage points (p.p.) against the values recorded in the same month of 2013.

So far in 2014, loans to companies continued to account for the highest growth pace of total lending to the private sector. Loans to the productive sector went up 25.2% y.o.y. in August 2014 and their share in the total lending stock soared and ended up accounting for 57.3%. The evolution of bank loans to companies reflected the effect of the measures designed by the BCRA to promote financing for productive purposes, especially through the Credit Line for Productive Investment (LCIP). Within this framework, and in order to continue fostering investment for productive purposes, the BCRA extended this tool in the second half of the year by over $28 billion worth of banking resources intended primarily for micro, small and medium-sized companies (MiPyMEs). As a result, as from the implementation of LCIP up to August this year —incorporating the fifth tranche on a partial basis— loans for approximately $103 billion have been awarded, and two-thirds of this amount have corresponded to lending to MiPyMEs. In turn, lending to households went up 20.5% y.o.y. in the period under analysis.

Total deposits from companies and households went up 31.4% y.o.y. in August 2014, up 1.7 p.p. against the value recorded in the same period of 2013. In turn, the balance sheet stock of total deposits from the public sector continued to be on the rise, even though its expansion has moderated as from the second quarter of the year. In this context, total deposits (including domestic and foreign currency, public and private sectors) grew 26.6% y.o.y., exceeding the expansion pace observed by the end of 2013.

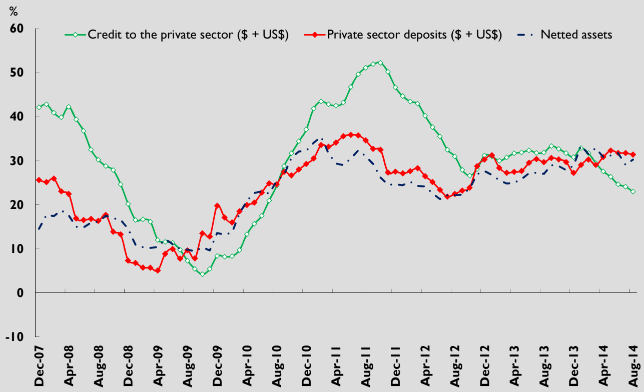
The financial system consolidated net worth continued to expand throughout 2014, posting a year-on-year increase of 44.2% in August. As a result of a higher relative growth of the net worth relative to bank assets, the leverage of this sector has gone down so far this year. Thus, netted assets stood at 7.7 times the financial system net worth. The financial system regulatory capital compliance stood at 14.3% of risk-weighted assets in August, up 0.7 p.p. against 2013 year-end. Tier 1 Capital, the top-quality capital in terms of loss absorption, accounted for 13.3% of risk-weighted assets (over 90% of total capital compliance), up 0.8 p.p. against the levels recorded by the end of 2013. Banks' book profits in terms of assets (return on assets -ROA) stood at 4.7% in annualized terms (a.) in 2014, up 1.8 p.p. and 1.3 p.p. against the first eight months of 2013 and against last year as a whole, respectively.

The aggregate portfolio of institutional investors (Sustainability Guarantee Fund [FGS], insurance companies and mutual funds) continued to exhibit a remarkable momentum, with an increase of 24% in the first half of the year, which exceeds that of the two previous six-month periods. Thus, this portfolio reaches an amount equivalent to 15% of GDP.

Chart IV.1

Financial Intermediation

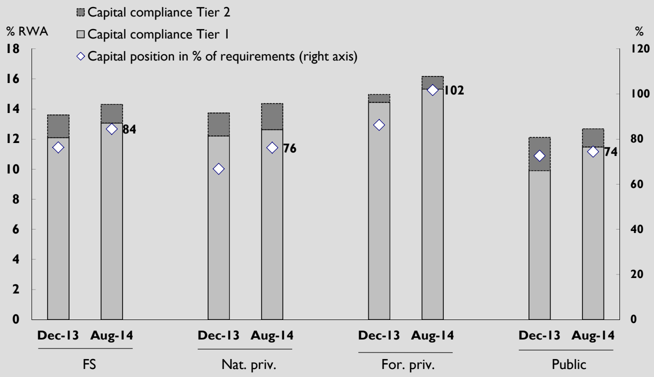
Y.o.y. % variation - Financial system



Source: BCRA

Chart IV.2

Capital Compliance and Excess of the Requirement (Position)



Source: BCRA

IV.1 Financial institutions[67]

IV.1.1 *Activity*

So far in 2014, banks' financial intermediation activity with the private sector has grown more moderately relative to previous periods (see Chart IV.1). In August 2014, which is the latest information available, the stock of loans and deposits (including both domestic and foreign currency) of companies and households as a whole recorded nominal increases of 22.9% y.o.y. and 31.4% y.o.y., respectively.

Netted assets[68] of the ensemble of financial institutions expanded 30.3% y.o.y. in August 2014, standing above the level observed in the same period of last year and also above the value recorded at 2013 year-end closing. This expansion was mainly driven by public banks and, to a lesser extent, by national and foreign private banks. Despite the fact that loans grew more moderately on the margin, they still recorded the highest relative share in netted assets, totaling 49% in August. In the first eight months of the year, monetary regulation instruments —LEBACs and NOBACs (not related to repos)— gained momentum and their share went up 5.1 p.p. in banks' total netted assets, accounting for 14% in August (see Table IV.1). In particular, the year-on-year increase of LEBAC and NOBAC holdings deepened in the second quarter of 2014, a trend that continued to prevail in the third quarter of the year. In turn, deposits from the private sector in domestic and foreign currency gained relative weight and stood at 56% of banks' total funding, up 1.3 p.p. against the value recorded by the end of 2013. Following the opposite direction, the weighting of deposits from the public sector in total funding went down from January to August.

Table IV.1

Financial system

	As % of netted assets					Stock variation*
	Ago-13	Dic-13	Ago-14	Change in p.p.		Last 12 months (%)
				Aug-14 vs. Dec-13	Aug-14 vs. Aug-13	Aug-14
Assets	100	100	100			
Liquid assets	19	20	19	-1,4	-0,4	30
BCRA securities	10	9	14	5,1	4,0	128
Total credit to the public sector	10	10	9	-0,3	-0,4	27
Total credit to the private sector	53	52	49	-2,7	-4,1	23
Credit in $ to the private sector	50	49	46	-3,3	-4,2	20
Credit in US$ to the private sector*	3	3	3	0,6	0,1	-3
Other assets	8	10	9	-0,7	0,9	-2
Liabilities + Net Worth	100	100	100			
Public sector deposits	22	20	18	-2,2	-3,3	13
Private sector deposits	57	55	56	1,3	-0,7	31
Outs. bonds, sub. debt and foreign lines of credits	2	2	3	0,5	0,5	63
Other liabilities	7	11	10	-0,8	2,3	38
Net worth	12	12	13	1,2	1,0	44

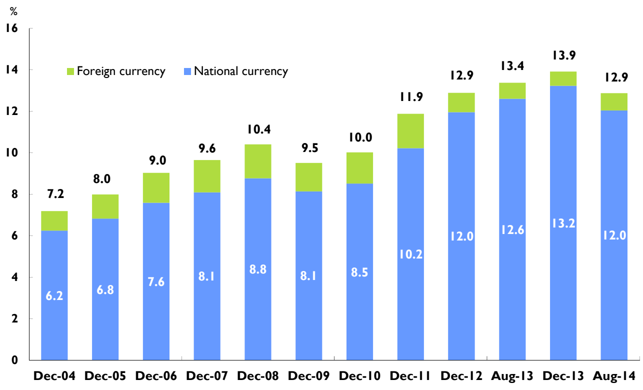
*Variations in currency of origin

Source: BCRA

Bank lending to the private sector stood at 12.9%[69] of GDP in August 2014, down 1 p.p. against the level observed by the end of 2013 and down 0.5 p.p. against the value of the same month of last year (see Chart IV.3). This ratio has recorded an increase of over 3 p.p. of GDP since late 2009, a performance that has been mainly driven by financing in pesos.

Chart IV.3

Credit to the Private Sector in Terms of GDP



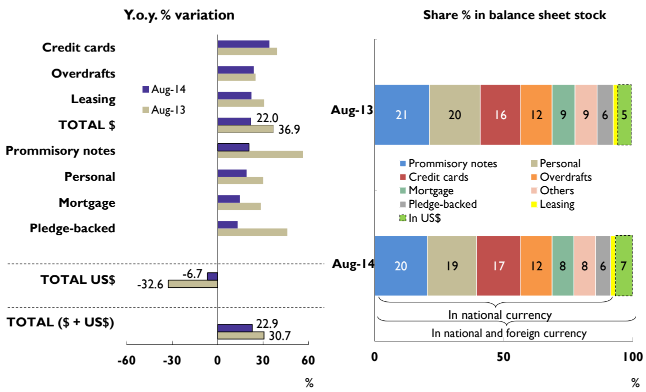
Note: estimated from the new GDP series with based in 2004
Source: BCRA and INDEC

From January to August 2014, lending in pesos to the private sector slowed down slightly on the margin. As result, the stock of loans in domestic currency to companies and households went up 22% y.o.y. in August in nominal terms, losing almost 15 p.p. against the value recorded one year ago (see Chart IV.4). In the

[67] The analysis of this section includes financial institutions supervised and regulated by the BCRA exclusively (Law N° 21,526).
[68] Assets are expressed net of accounting duplications from repo, forward and spot transactions to be settled.
[69] Data estimated on the basis of the new GDP series with base year 2004.

Chart IV.4

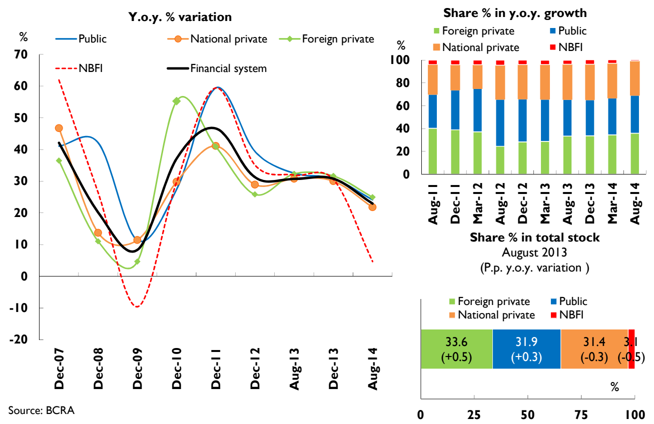
Credit to Private Sector in Currency of Origin



Note: Total includes balance sheet stock, including accrued interest and CER adjustment
Source: BCRA

Chart IV.5

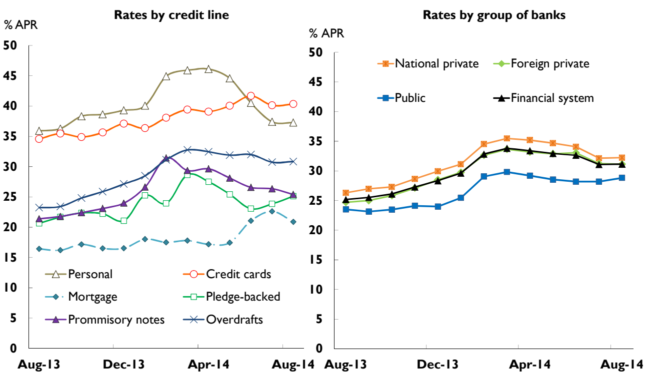
Credit to the Private Sector by Group of Financial Institutions



Source: BCRA

Chart IV.6

Lending Interest Rates Operated in Pesos*



*Nota: Average weighted by amount operated
Source: BCRA

eighth month of the year, loans in foreign currency to the private sector went down 6.7% y.o.y.[70], and this means that their year-on-year pace of decline has moderated against the same period of 2013. Thus, total credit (in domestic and foreign currency[71]) to companies and households went up 22.9% y.o.y. in nominal terms in August 2014 (down 8 p.p. against the value recorded one year ago).

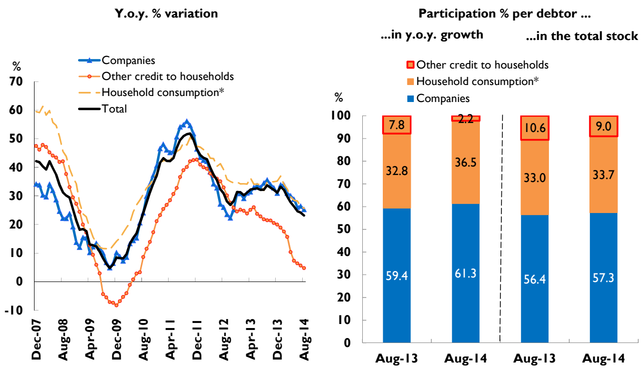
The moderation in the growth pace of lending to companies and households was widespread among all groups of financial institutions throughout 2014 (see Chart IV.5). Loans granted by foreign private banks and public banks were the most dynamic and expanded 25% y.o.y. and 24.1% y.o.y., respectively, in August. As a result, these groups of banks contributed all together over 69% of the year-on-year increase of total funding to the private sector, expanding their share in the total stock of loans.

Lending interest rates in pesos went down in most credit lines and in all groups of banks as from the second quarter of 2014 (see Chart IV.6). Between March and August, the interest rates on personal loans, promissory notes and pledge-backed loans have recorded the highest relative drops. These reductions originated in the regulatory measures implemented by the BCRA as from early June 2014, aimed at regulating the interest rates on credit transactions made by natural persons[72]. In particular, the BCRA ordered that the interest rates applicable to personal and pledge-backed loans given by financial entities to natural persons cannot exceed a level resulting from multiplying the "benchmark interest rate" (simple average of LEBACs cut-off rates, with a term around 90 days) and a multiplication factor that will stand between 1.25 and 2.00, depending on the type of loan and on the classification of the originating bank. The Central Bank will release each month the maximum interest rate that the institutions may apply on each loan granted and/or re-agreed. In turn, the official launch of the PRO.CRE.AUTO Program by mid-year, intended to invigorate the automotive market of new national vehicles by means of personal loans to families under favorable financial conditions granted by Banco de la Nación Argentina, also helped explain the evolution of market interest rates in the period. In turn, the reduction of the lending interest rates in pesos for promissory notes was in part due to the effect of the loans granted within the framework of the LCIP fourth tranche.

[70] Change observed in the currency of origin.
[71] Expressed in pesos at the exchange rate of each period being mentioned.
[72] Communication "A" 5590.

Chart IV.7

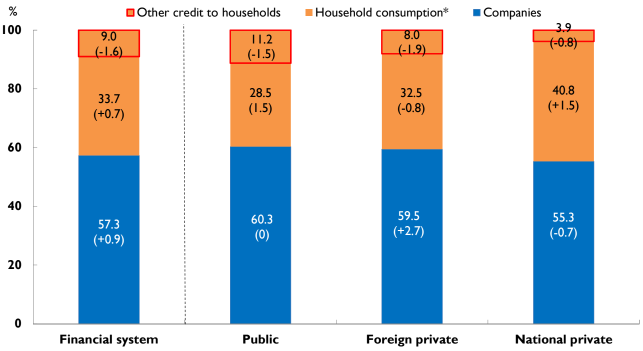
Total Credit to the Private Sector by Type of Debtor



* Includes personal loans and financing through credit cards issued to families.
Source: BCRA

Chart IV.8

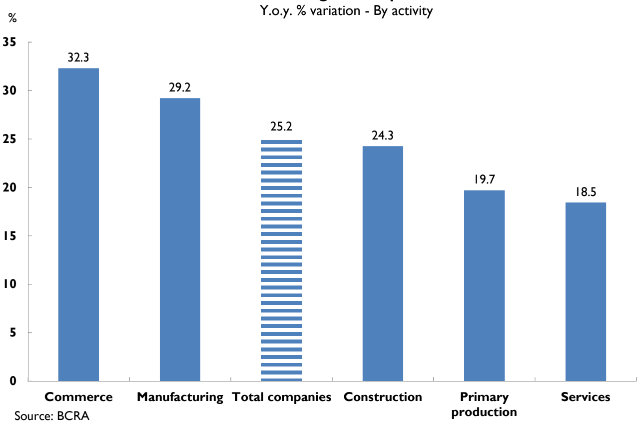
Total Credit to the Private Sector by Group of Banks
Share % in the total stock - August 2014
(P.p. y.o.y. variation)



* Includes personal loans and financing through credit cards issued to families.
Source: BCRA

Chart IV.9

Financing to Companies
Y.o.y. % variation - By activity



Source: BCRA

In 2014, the growth pace of lending to companies has exceeded the increase recorded in loans to households (see Chart IV.7). In August, financing to the productive sector went up 25.2% y.o.y. in nominal terms and accounted for 61.3% of the year-on-year growth of total loans to the private sector, up 1.9 p.p. against the value recorded in the same period of 2013. As a result, the share of lending to companies grew in the total stock, accounting for 57.3% in August 2014. Loans provided by foreign private banks have exhibited the highest year-on-year relative performance (31.2% y.o.y. in that period), and their share in the total stock of loans to the private sector went up 2.7 p.p. (see Chart IV.8). Nevertheless, it is worth mentioning that public banks continue to have a slightly higher share in lending to the productive sector.

Loans to the trading and industrial sectors have continued to exhibit higher relative increases along the year, reaching changes of 32.3% y.o.y. and 29.2% y.o.y., respectively, in August 2014, even though they have stood below the values recorded one year ago (64.2% y.o.y. and 36.8% y.o.y. in 2013) (see Chart IV.9). Thus, industry and trade were the activities that contributed the most to the year-on-year increase in loans to companies; as a result, their share in total lending stock ended up accounting for 41.1% and 16.7%, respectively (see Chart IV.10).

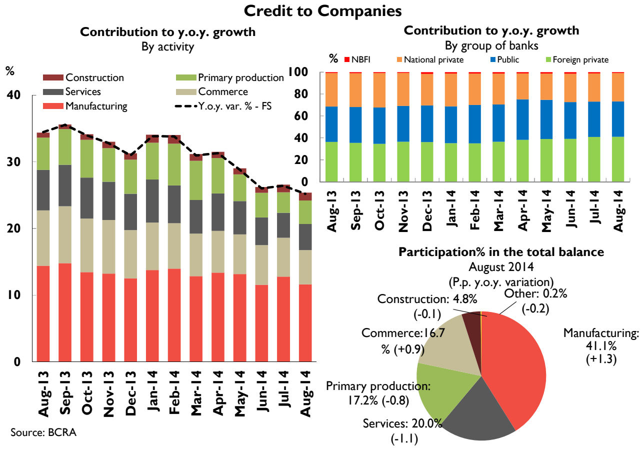
One of the main reasons behind the evolution of lending to companies was the "Credit Line for Productive investment" (LCIP), driven by the BCRA. From the time it was implemented by mid-2012 up to August 2014[73], partially incorporating the fifth tranche of LCIP, loans for productive investment for approximately 103 billion have been awarded so far, out of which around two thirds have been provided to MiPyMEs.

With a view to continue promoting investment for productive purposes, by the end of June 2014, the BCRA ordered the extension of LCIP for the second half of 2014[74]. On this occasion, the value taken as benchmark was an amount equivalent to 5.5% of deposits in pesos from the private sector corresponding to May 2014 of banks operating as financial agents of the national, provincial and/or local governments and the financial institutions whose stock of deposits in domestic currency from the non-financial private sector were at least 1% of total deposits from such sector. As a result, in this tranche of LCIP, the amount of bank resources mainly addressed to MiPyMEs would exceed $28 billion. It has a fixed interest rate of up to 19.5%

[73] Latest preliminary information available.
[74] Communication "A" 5600 and Communication "P" 50410.

Chart IV.10

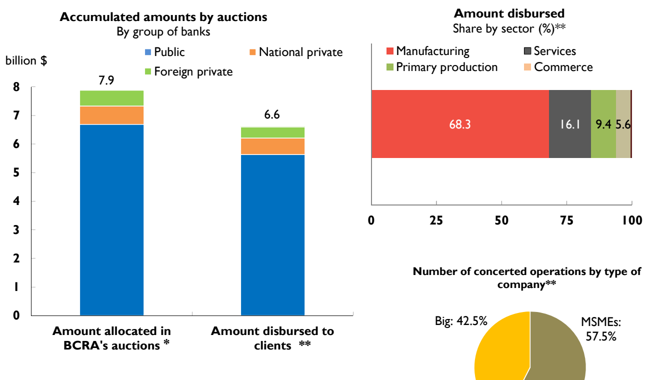
Credit to Companies



Source: BCRA

Chart IV.11

Bicentenary Productive Financing Program



* Includes the 27 auctions

**Amount disbursed up to September 30th,2014

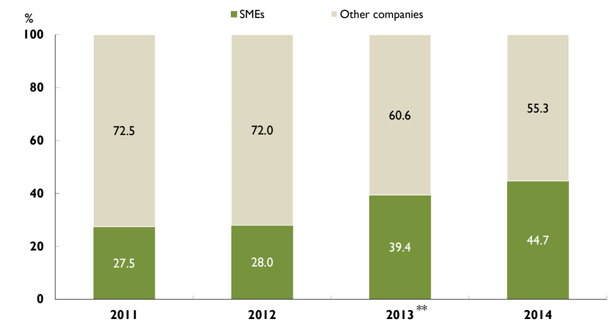
Source: BCRA

Chart IV.12

Granted Credits in Pesos to Legal Persons*

Share by debtor's size

Accumulated granted values - First 8 months



* Overdrafts excluded.

** From the end of April the Ministry of Small and Medium Companies and Regional Development through Resolution N° 50/13, establishes a new classification of MiPYMES.

Source: BCRA

annual percentage rate[75] for, at least, the first three years. In addition, the same as in the fourth tranche of LCIP, this fifth tranche also allows for channeling a proportion of the quota to the discount of deferred payment checks to MiPyMEs[76] and to project financing of some clients not falling under the category of MiPyMEs[77]. Likewise, on this occasion, up to 15% of this quota may be allocated to loans in pesos to natural persons granted as from June 11, 2014 which may be incorporated through transfer, assignment or as claims related to trusts, provided that the originator and assignor of credits assigned or under the trust —as applicable— is a financial institution that does not participate in LCIP[78].

In addition, banks continued to provide credit to companies through the Bicentennial Productive Financing Program (PFPB)[79] along 2014. As from its launch in mid-2010 up to August 2014, the BCRA has awarded $7.88 billion in gross terms via this program (see Chart IV.11). The amount effectively disbursed reaches $6.59 billion, and most of the funds were given to industrial companies and service providers. Out of the total transactions agreed upon within the framework of the PFPB, over 57% were made with MiPyMEs.

Under the framework of the abovementioned programs devoted to provide loans for productive purposes, so far this year and following the trend observed since mid-2012, MiPyMES continued recording the highest relative growth in the segment of loans provided to legal persons. As a result, in the aggregate of 2014, lending to this category of companies gained relevance in the total credit provided to legal persons and accounted for 44.7%, up 5.3 p.p. against the value recorded in the same period of 2013 (see Chart IV.12).

In the last two years, the share of lending to companies in the total stock of credit was on the rise in almost all the regions of the country. The highest relative increases were observed in the Pampas, the North-West region (NOA) and the North-East region (NEA) (see Chart IV.13).

From January to August 2014, the expansion pace of the stock of loans to households moderated in year-on-year terms, going up 20.5% y.o.y. in August (see Chart IV.14). In particular, consumption lines were the most

[75] Once the term has elapsed, a variable rate may be applied which cannot exceed the total BADLAR in pesos plus 300 bp.

[76] In these cases, the financing interest rate cannot exceed the abovementioned rate.

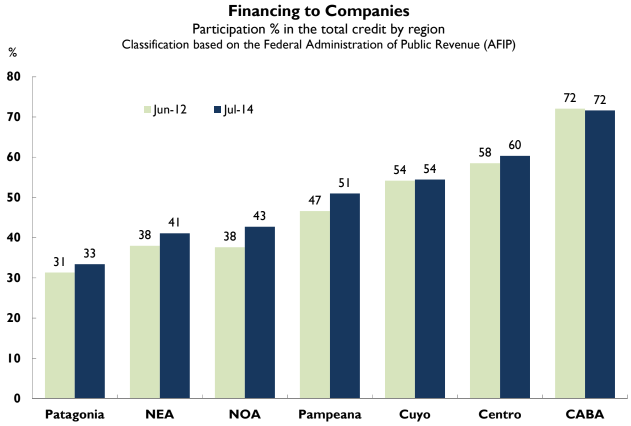
[77] Up to 15% of the amount corresponding to the fifth tranche may be allocated. It includes mortgages and projects devoted to expanding the productive capacity, increasing direct and formal employment, import substitution, expansion of export capacity, investment in capital goods and infrastructure works. In the latter cases, the interest rate will be freely agreed upon.

[78] According to item "X" 4.2 of Communication "A" 5590.

[79] Communication "A" 5089.

Chart IV.13

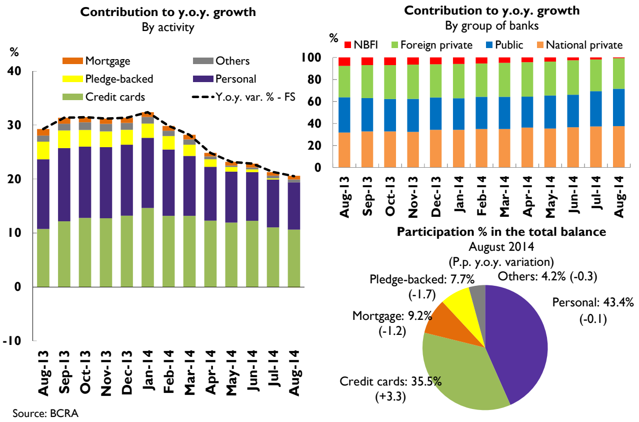
Financing to Companies



Source: BCRA

Chart IV.14

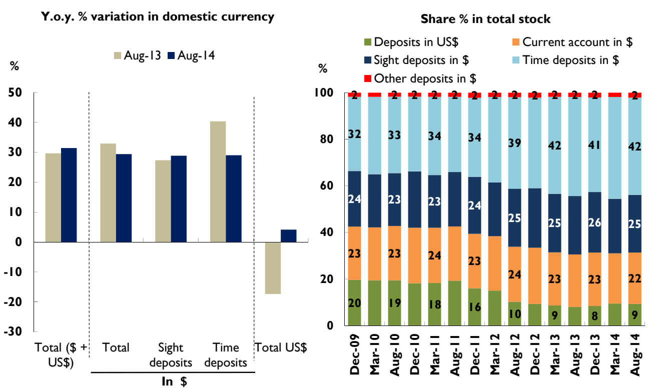
Credit to Households



Source: BCRA

Chart IV.15

Non-Financial Private Sector Deposits in the Financial System



Source: BCRA

dynamic in this period, especially in terms of lending through credit cards, which went up 33% y.o.y. and accounted for 52% of the year-on-year growth of loans to families. As a result of this performance, credit cards gained share in the total stock of credit provided to households and accounted for 35.5% of the loans provided to this sector, up 3.3 p.p. against the value recorded one year ago. In turn, as from July 2014, personal loans exhibited a higher relative monthly expansion, an evolution that was mainly driven by the PRO.CRE.AUTO Program, which was launched in June 2014 by the National Government. Through this plan, families may have access to personal loans for the purchase of national new vehicles, at subsidized interest rates for a maximum term of 5 years, granted by Banco de la Nación Argentina[80]. The year-on-year expansion of bank loans to households was mainly boosted by private national banks and, to a lesser extent, by public banks, which accounted, all together, for over 71% of the growth seen in the last 12 months in the lending to this segment.

The BCRA continued promoting measures that have tended to protect the users of financial services. In particular, by mid-June 2014, it ordered that financial institutions and non-financial issuers of credit cards have a prior authorization by the BCRA to raise the cost of charges and commission fees of basic financial products and services[81].

In addition, by mid-September and for the purpose of reinvigorating consumption, the National Government launched the so-called “Ahora 12”[82] Plan to facilitate the purchase of goods and services with a credit card in 12 installments with 0% interest rate. In order to boost the effective implementation of this program, the BCRA ordered, as from October 2014, a reduction of the minimum capital requirement[83] by an amount equivalent to 16% (i) of the loans that financial entities provide through such program and (ii) of the credits at a 0% interest rate that banks provide to non-financial issuers of credit cards that have adhered to such program. Likewise, it was established that financing provided under item (ii) may be assigned to partially complete the quota of the fifth tranche of LCIP.

Deposits in domestic currency from companies and households went up 29.4% y.o.y. in August 2014, standing slightly below the change observed in the same month of 2013. However, it is worth mentioning that in

[80] The annual interest rate will stand at 17% for clients of this institution and at 19% for non-clients.
[81] Communication “A” 5591. For more information, see Financial Stability Report corresponding to the First Half of 2014.
[82] Joint Resolution No. 671/2014 and 267/2014 from the Ministry of Economy and Public Finance, and the Ministry of Industry.
[83] Communication “A” 5638.

the second quarter of the year, the growth pace of deposits in local currency of the private sector accelerated and recorded an increase of 45.7%a.[84], up 27 p.p. against the value recorded in the first three months of 2014 and up nearly 10 p.p. against the same period of last year. In turn, the year-on-year expansion pace of time deposits from this sector slowed down to 29% in August 2014, even though they have kept a 42% share in total deposits from the private sector (see Chart IV.15). Meanwhile, from January to August 2014, sight deposits gained momentum and grew 28.8% year-on-year in August, accounting for more than a half of the year-on-year increase of deposits in pesos from the private sector. As from May 2014, deposits in foreign currency recorded slight year-on-year increases and reached a 4.2% year-on-year rise in August[85].

Total deposits (in domestic and foreign currency) from the private sector accelerated at a pace of 31.4% y.o.y. as of August this year, up 1.7 p.p. against the value observed in the same period of 2013. This performance was mainly driven by private banks and accounted for almost 58% of the year-on-year increase of total deposits from companies and households.

In turn, during the first eight months of the year, the balance sheet stock of total deposits from the public sector continued to be on the rise, even though it decelerated slightly as from the second quarter of the year. As a result, public sector deposits went up 12.7% y.o.y. in August, standing slightly below the changes observed by the end of 2013 and also below the values recorded one year ago.

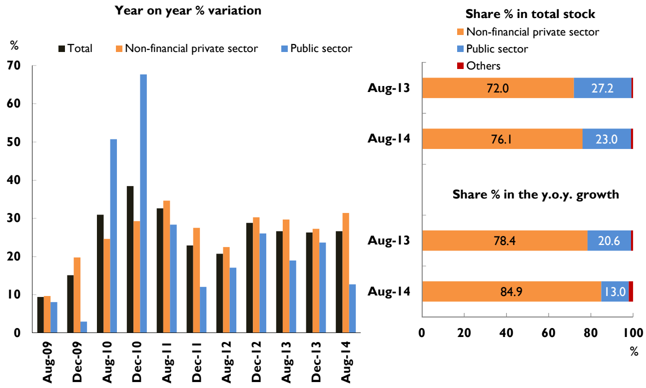
As a result of the evolution of deposits from the public and private sectors, total deposits (including domestic and foreign currency, and the public and private sectors) went up 26.6% y.o.y. in August 2014, standing slightly above the expansion rate recorded by the end of 2013 and in line with the value recorded in the same month of 2013 (see Chart IV.16). Deposits from companies and households accounted for 84.9% of the year-on-year increase of total deposits, and their share went up 4.1 p.p. in the total stock of deposits against the value recorded in 2013.

As a result of the performance observed from January to August 2014, deposits from companies and households have consolidated as the main funding source (liabilities plus net worth) of the financial system (see Chart IV.17). Thus, private sector's total deposits accounted for 56.3% of total netted assets in August 2014, up 1.3

Chart IV.16

Total Deposits of Financial System

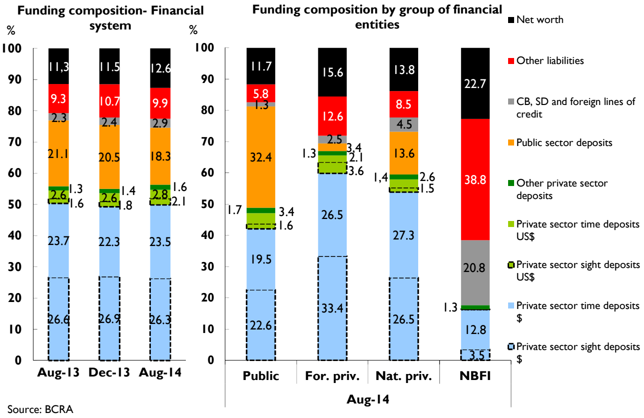
Includes deposits in pesos and foreign currency



Source: BCRA

Chart IV.17

Balance Sheet Composition



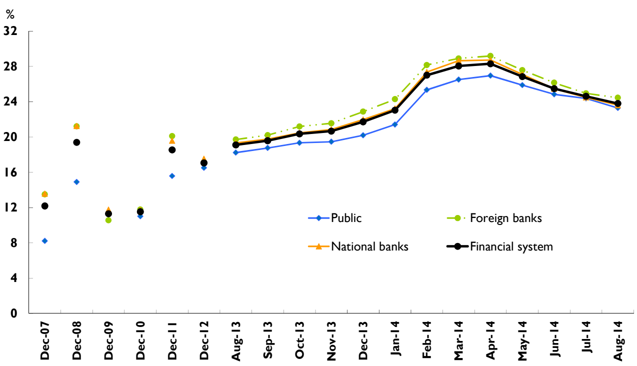
Source: BCRA

Chart IV.18

Estimation of Average Funding Costs by Deposits in Pesos

By private sector time deposits

Weighted by 1 - month traded volume and adjusted by cash requirements



Source: BCRA

[84] The quarterly increase was driven in part by the effective collection of the semiannual complementary wage.
[85] Considering changes in the currency of origin.

p.p. against 2013 year-end value and up 0.5 p.p. against the figure recorded in August 2013. This performance was mainly driven by deposits in domestic currency from the private sector, which accounted for 49.8% of total funding. In particular, so far in 2014, the share of time deposits in pesos of companies and households went up 1.2 p.p. in total funding, to 23.5%. In the opposite direction, in this same period, the relative weight of public sector deposits in total funding fell slightly down to 18.3% in August 2014.

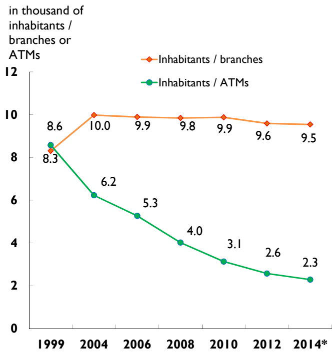
In the first quarter of 2014, the estimated funding cost in terms of time deposits in domestic currency recorded a widespread increase in the ensemble of banks (see Chart IV.18). However, between May and August this year, a gradual decline in the interest rates on private sector's time deposits was observed, resulting in a drop in funding cost. This evolution was mainly driven by domestic and foreign private banks. It is worth mentioning that in early October 2014 and with a view to improving the interest in saving instruments in pesos available to the public, the BCRA established a minimum limit to the interest rate on time deposits in pesos of natural persons, provided the amount deposited does not exceed $350,000[86] —new value of the coverage by the deposit guarantee scheme. In particular, this rate cannot be lower than that resulting from multiplying the latest "benchmark borrowing rate" (simple average of the LEBACs cutoff rate for 90 days) and the coefficient applicable on the basis of the original term of the deposit[87].

Twenty-three financial institutions have issued corporate bonds (ON) and short-term securities (VCP) so far in 2014, taking funds for a total amount of $5.88 billion, slightly below the value recorded in the same period of 2013. It is worth mentioning that all instruments were issued in domestic currency. Thus, in the first eight months of the year, the share of corporate bonds, subordinated debt (OS) and foreign credit lines of the ensemble of banks in total funding went up slightly, accounting for 3% in August 2014 (see Table IV.1).

Throughout 2014, the improvement of intermediation activity of the ensemble of banks continued to impact on the sector's operating structure. A year-on-year comparison reveals that the number of branches throughout the country grew 1.2% y.o.y. in May 2014 —latest information available—, reaching a total of 4,363 units. The increase in bank branches was widespread and encompassed all regions of the country,

Chart IV.19

Financial System Regional Coverage



Thousand inhabitants by branches

Region	Dec-10	May-14
CABA	3.7	3.7
Patagonia	7.5	6.6
Centro	8.1	7.8
Pampeana	11.6	11.4
Cuyo	12.6	12.3
NEA	18.0	16.7
NOA	20.7	19.0
Argentina	**9.8**	**9.5**

Thousand inhabitants by ATMs

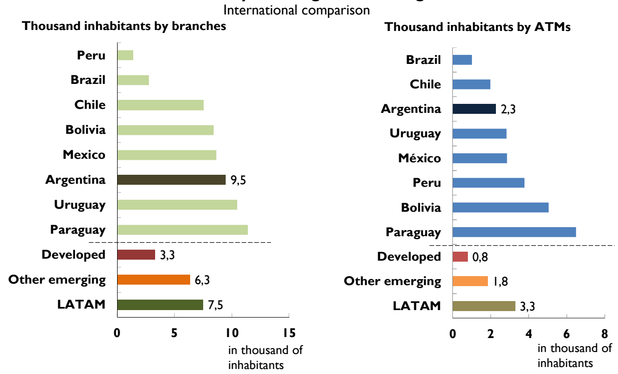
Region	Dec-10	May-14
CABA	1.1	0.8
Patagonia	2.8	1.9
Centro	3.8	2.0
Pampeana	4.2	2.8
Cuyo	4.7	2.8
NOA	5.8	3.5
NEA	6.8	4.3
Argentina	**4.0**	**2.3**

* To May
Note I: December each year and the latest data available. Note II: Branches in the country.

Source: BCRA and INDEC

Chart IV.20

Financial System Regional Coverage
International comparison

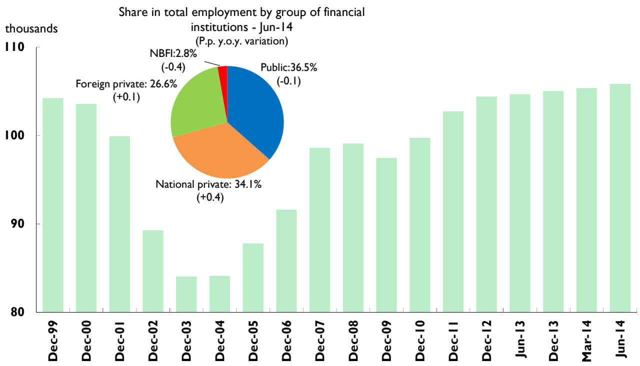


Note: Developed: UK, Korea, USA, Germany, France, Portugal and Spain. Other emerging: Indonesia, South Africa, Talandia, Czech Republic, Croatia and Russia.. Data for 2013, excluding the UK, Germany and Korea 2012, USA 2009 and Argentina in May 2014.
Source: FAS (Financial Access Survey), WEO (World Economic Outlook Database, IMF) and BCRA.

[86] Communication "A" 5640.
[87] The coefficient will be 87% for the shortest term (from 30 to 44 days); 89% for the term between 45 and 59 days, and 93% for a term equal to, or longer than, 60 days.

Chart IV.21

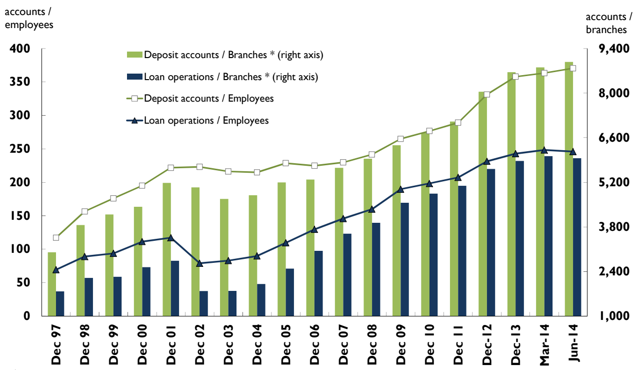
Evolution of Employment in the Financial System



* For the calculation of the ratio, the financial institutions that do not have data on the number of accounts are deleted.
Note: as of December each year. Latest information available.
Source: BCRA

Chart IV.22

Number of Accounts in Terms of Employees and Branches
Financial system



* Latest information available to May 2014
Source: BCRA

mainly boosted by domestic and foreign private banks. In turn, the number of ATMs and self-service ATMs expanded at a pace of 7.2% year-on-year, totaling 18,174 units. The year-on-year rise in the number of ATMs was led by domestic private banks and public banks, and the highest relative increase was observed in the Central-West region (Cuyo) as well as in the North-West (NOA) and North-East (NEA) regions.

Within the framework of the BCRA authorization policies for the opening of new branches[88] tending to promote the expansion of the financial infrastructure especially to areas with fewer banking services available to the public, in the first part of the year the BCRA authorized the opening of 14 new branches in areas with a limited financial coverage. As a result, from early 2011 to mid-2014, the opening of 130 new branches in areas with limited banking services was authorized by the BCRA.

Proof of the ongoing expansion of branches and ATMs throughout the country is a better access of the population to financial services. In particular, the indicators of inhabitants per branch and per ATM have improved in recent years, leading to a gradual decrease of these ratios in all areas of the Argentine territory but mainly in the regions with fewer banking resources available, such as the North-West and North-East (see Chart IV.19). In fact, the number of inhabitants per branch and per ATM reached 9,500 and 2,300, respectively, standing below the values recorded one year ago. Even though the progress made in banking infrastructure is significant, there is still room for improvement if compared to other countries of the region and also to other emerging and developed economies (see Chart IV.20).

Within this improved framework in terms of number of branches and ATMs, staffing of the financial system also improved in the first half of 2014 (see Chart IV.21). Thus, in June 2014 (latest information available), the number of bank employees went up 1.1% y.o.y., in line with the change observed in the same month of 2013, reaching a total of 105,836 workers. In the first six months of 2014, almost all groups of financial entities increased their employment levels, especially at foreign private banks.

The expansion of infrastructure and of the provision of financial services has been accompanied by an improvement in some operating efficiency indicators. So far in 2014, the number of deposit accounts and loan transactions relative to the number of branches and

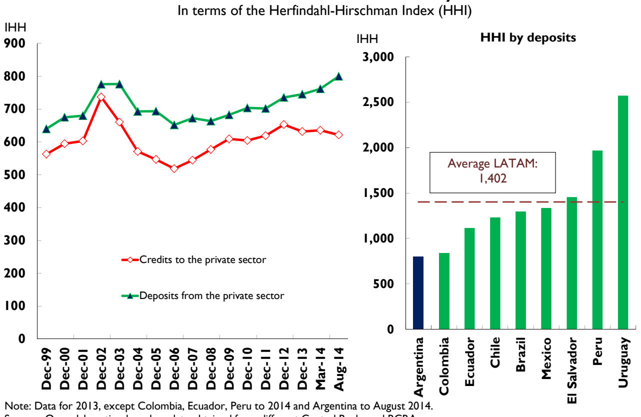
[88] Communication "A" 5168 and Communication "A" 5355.

employees has been on the rise (see Chart IV.22). In particular, both the deposit-to-branch ratio and the deposit-to-employee ratio expanded almost 9% y.o.y. in June, standing above the values recorded in the same month of 2013.

Even though, in recent years, the Argentine financial market has shown an increasing trend towards concentration, these values are still low against the values of other Latin American economies (see Chart IV.23).

Chart IV.23

Concentration Level of the Financial System
In terms of the Herfindahl-Hirschman Index (HHI)



Note: Data for 2013, except Colombia, Ecuador, Peru to 2014 and Argentina to August 2014.
Source: Own elaboration based on data obtained from different Central Banks and BCRA

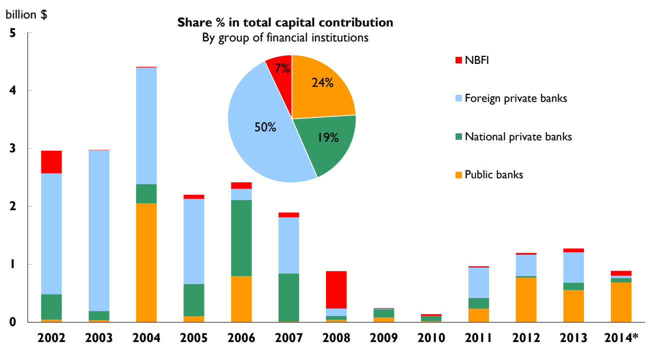
IV.1.2 *Capital Position*

The consolidated financial system net worth has continued to expand throughout 2014, reaching a year-on-year increase of 44.2% in August. This growth was mainly boosted by book profits accrued and, to a lesser extent, by new capital contributions. So far in 2014, the banking sector received capitalizations for almost $780 million (see Chart IV.24), which were channeled mainly to public banks. In turn, from January to August 2014, some financial institutions distributed dividends for an estimated total amount of $1.91 billion. This value turned out to be significantly higher than those observed in 2012 and 2013 ($780 million and $230 million, respectively).

As a result of a higher growth of banks' net worth relative to their assets, the financial system leverage has gone down so far this year. Thus, netted assets accounted for 7.7 times the net worth of the domestic financial system in August 2014 (see Chart IV.25), a level which is significantly lower than that of the average corresponding to the region and to other emerging and developed economies.

Chart IV.24

Capital Contributions
2002-2014



* to August
Source: BCRA

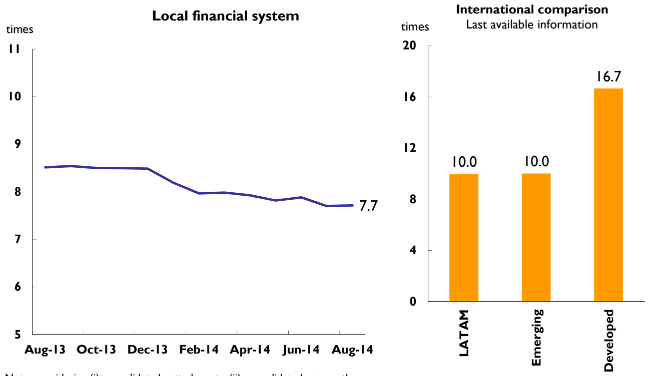
In terms of regulations, the financial system regulatory capital compliance stood at 14.3% of total risk-weighted assets (RWA) in August 2014, up 0.7 p.p. against the figure recorded by the end of 2013. It is worth mentioning that Tier 1 capital compliance[89] (more than 90% of total compliance), which is a top-quality capital in terms of its capacity for loss absorption, accounted for 13.3% of APR, up 0.8 p.p. against the level recorded by the end of last year. In turn, the capital compliance in excess of the regulatory requirement (capital position) stood at 84% in August 2014 for the financial system (see Chart IV.2), thus accumulating an increase of 8 p.p. against the value recorded by the end of last year. In addition, all groups of banks have exhibited a surplus in their capital position.

[89] Defined as basic net worth (common equity plus additional capital) net of deductible accounts. See Communication "A" 5369.

Chart IV.25

Financial System Leverage

Assets (no weighted to risk) / Net worth



Note: considering (i) consolidated netted assets; (ii) consolidated net worth.
Source: BCRA and IMF (Financial Soundness Indicators)

Table IV.2

Profitability Structure: Financial System

Annualized indicators as % average netted assets

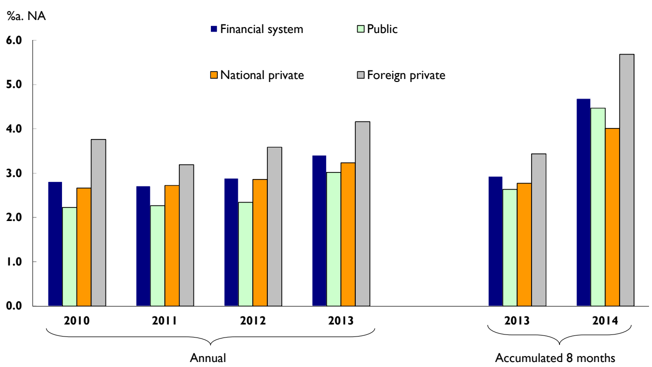
	Annual			Accumulated 8 months	
	2011	2012	2013	2013	2014
Financial margin	8.0	9.2	10.3	9.7	12.3
Net interest income	4.6	5.7	5.9	5.9	5.7
CER and CVS adjustments	0.3	0.3	0.3	0.3	0.5
Gains on securities	2.6	2.6	2.6	2.4	3.9
Foreign exchange price adjustments	0.6	0.6	1.3	1.0	1.7
Other financial income	0.0	0.0	0.3	0.1	0.5
Service income margin	3.9	4.2	4.3	4.3	4.2
Operating costs	-6.7	-7.0	-7.1	-7.2	-7.3
Loan loss provission	-0.7	-0.9	-1.1	-1.0	-1.0
Effects of the 2001-2002 crisis (*)	-0.1	-0.1	-0.1	-0.1	-0.1
Tax charges	-1.1	-1.3	-1.6	-1.6	-1.8
Other	0.5	0.4	0.3	0.3	0.5
Total results before income taxes	3.9	4.3	5.0	4.5	6.9
Income tax	-1.2	-1.5	-1.6	-1.5	-2.2
ROA	**2.7**	**2.9**	**3.4**	**2.9**	**4.7**
Adjusted ROA (**)	**2.8**	**3.0**	**3.5**	**3.0**	**4.8**
ROE	25.3	25.7	29.5	25.4	37.4
ROE (before income tax)	36.5	39.0	43.8	38.8	55.2

(*) Includes amortization payments for court-ordered and adjustment of public sector assets.
(**) Excluding the effects of the 2001-2002 crisis.
Source: BCRA

Chart IV.26

Profitability by Group of Banks

As % of netted assets



Source: BCRA

The financial system book profits have reached $33.42 billion so far in 2014. Thus, between January and August, banks' return on assets (ROA) reached 4.7% on an annualized basis (see Table IV.2), up 1.8 p.p. and 1.3 p.p. against the value recorded in the first eight months of 2013 and throughout last year, respectively. The increase in the accumulated accounting benefits was mainly driven by the financial margin growth, and was offset in part by higher expenses derived from taxes and operating costs. It is worth considering that profitability levels improved in all groups of banks in year-on-year terms (see Chart IV.26).

Banks' financial margin stood at 12.3%a. of assets in the aggregate of eight months up to August 2014, up 2.6 p.p. against the same period of 2013. This improvement was mainly due to results from securities and from the items related to the evolution of the exchange rate —exchange rate differences and adjustments for forward transactions in foreign currency— (see Chart IV.27). In year-on-year terms, the financial margin of the ensemble of banks went up, but the foreign private banks have shown the highest relative growth and have surpassed domestic private banks and public banks in terms of assets.

So far in 2014, net income from interest of the financial system went down 0.2 p.p. of assets in year-on-year terms and stood at 5.7%a. (see Chart IV.28). This evolution was mainly due to the increase of expenses for deposits and other interest paid, which was partially offset by higher income from loans. It is worth mentioning that throughout 2014, an increasing weighting of time deposits in banks' balance sheets was observed within a context of higher borrowing interest rates, which added up to the measures adopted by the BCRA by mid-year devoted to regulating interest rates in loan transactions with natural persons (see Section IV.1.1).

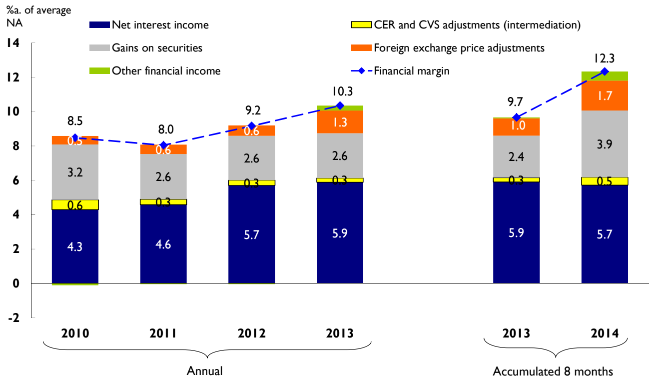
Given the banks' positive mismatching in foreign currency and the evolution observed in the nominal peso-dollar exchange rate throughout the year (see Section V.5), profits accumulated from exchange rate differences stood at 1.7%a. of assets so far in 2014, up 0.7 p.p. in year-on-year terms. Profits for this item were observed in the ensemble of institutions, but foreign private banks were the most dynamic in year-on-year terms. Likewise, so far this year, the "other financial results" item reflected profits derived from adjustments to forward transactions in foreign currency.

Income derived from securities has driven the year-on-year increase in the accumulated book profits of the

Chart IV.27

Financial Margin Composition

Financial system



Source: BCRA

Table IV.3

Profitability Structure by Group of Banks

Accumulated 8 months of 2014 - Annualized indicators as % average netted assets

	Private banks - Total	Private banks - National	Private banks - Foreign	Public banks	NBFI
Financial margin	13.6	12.3	15.0	10.6	13.0
Net interest income	7.2	6.3	8.2	3.4	11.8
CER and CVS adjustment	0.2	0.1	0.2	0.9	0.0
Gains on securities	3.5	4.2	2.8	4.5	0.4
Foreign exchange price adjustements	1.7	0.9	2.5	1.8	0.8
Other financial income	1.0	0.7	1.3	-0.1	0.1
Service income margin	5.4	5.3	5.6	2.5	7.7
Operating costs	-8.7	-8.8	-8.6	-5.4	-8.7
Loan loss provisions	-1.3	-1.3	-1.3	-0.5	-2.1
Efects of the 2001-2002 crisis (*)	0.0	0.0	0.0	-0.2	0.0
Tax charges	-2.3	-2.4	-2.3	-1.0	-2.8
Others	0.7	0.9	0.5	0.3	1.3
Monetary	0.0	0.0	0.0	0.0	0.0
Total result before income tax	7.4	6.0	8.8	6.2	7.3
Income tax	-2.6	-2.0	-3.1	-1.8	-2.6
ROA	**4.8**	**4.0**	**5.7**	**4.5**	**4.8**
Adjusted ROA (**)	**4.9**	**4.0**	**5.7**	**4.7**	**4.8**
ROE	36.2	33.9	38.1	40.6	22.4
ROE (before income tax)	55.5	50.9	59.1	56.6	51.7

(*) Includes amortization payments for court-ordered and adjustment of public sector assets.

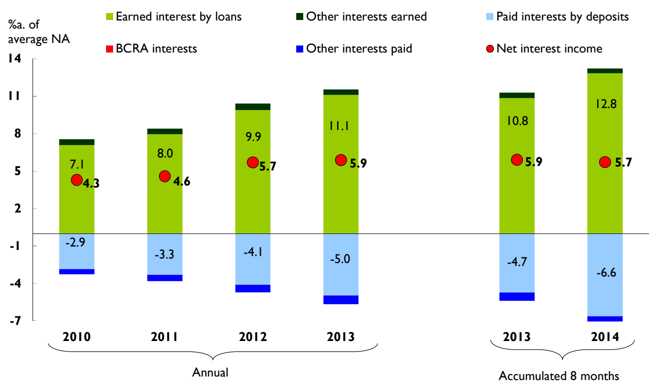
(**) Excluding the effects of the 2001-2002 crisis.

Source: BCRA

Chart IV.28

Net Interest Income

Financial system



Source: BCRA

financial system. Thus, in the first eight months of 2014, this net income from securities stood at 3.9%a. of assets, up 1.5 p.p. against the same period of 2013. Domestic private banks were the most dynamic in this segment of the income statement (up 2 p.p. of assets to 4.2%a.), even though public financial entities have shown the highest relative weight (4.5%a. of assets) (see Table IV.3). This performance was related to the increase in the stock of BCRA bills & notes held by banks within a context of higher auction interest rates, as well as to a price recovery of sovereign bonds held by institutions (see Section II.3).

Likewise, net income from CER-adjusted items stood at 0.5%a. of assets in the aggregate of eight months up to August, with an increase on the margin relative to the same period of 2013 and 2012. This performance occurred within the framework of the new methodology for the calculation of the Consumer Price Index, which has taken as reference the National Urban CPI (IPCNu) since the beginning of the year. A breakdown as per group of banks shows that public entities have had the highest weighting from this income in their income statements, evidencing a higher mismatching between assets and liabilities in items adjusted by CER (see Chapter V).

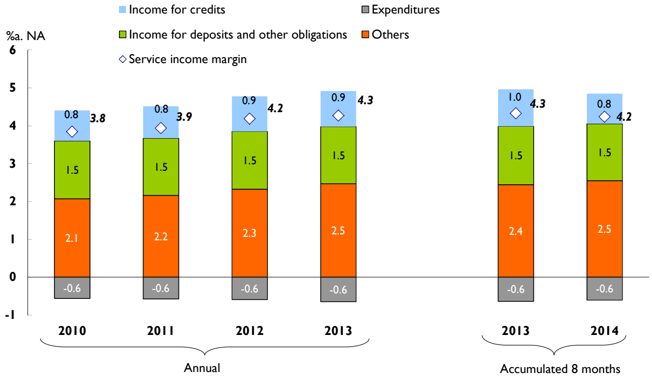
Net income from services of the financial system has totaled 4.2%a. of assets so far in 2014 (see Chart IV.29) and has dropped slightly if compared to the first eight months of last year. The year-on-year reduction of this item in the income statement affected mainly the private financial institutions, both domestic and foreign, and was mainly driven by lower income from commissions related to loan transactions.

In terms of the main profitability sources that make up the income statement of the financial system, the most volatile sources have gained share in recent months. Thus, the results from securities and from exchange rate differences have accounted for 34% of total resources of this sector. In turn, the most stable net income, i.e. income from interest and services, has reduced its weighting down to 61% of the total (see Chart IV.30).

Operating costs have stood at 7.3%a. of assets so far this year, with a slight increase against the same period of 2013 (see Chart IV.31). The year-on-year rise was widespread among the ensemble of financial institutions, even though foreign private banks have shown the highest relative momentum. These expenses were largely due to staff-related items (wages and social security contributions), which account for over 60% of total operating costs at systemic level.

Chart IV.29

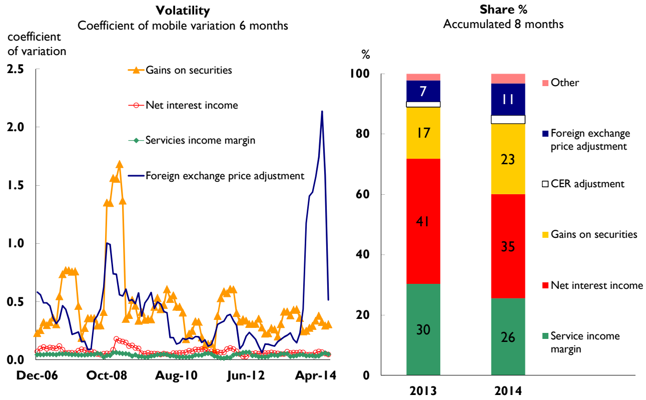
Service Income Margin
As % of netted assets



Source: BCRA

Chart IV.30

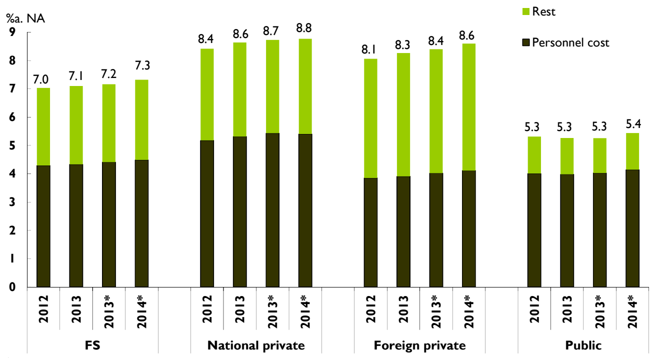
Major Sources of Financial System Income



Source: BCRA

Chart IV.31

Operating Costs
As % of netted assets



* Accumulated 8 months
Source: BCRA

Loan loss provisions of the financial system have stood at 1%a. of assets so far this year, remaining almost unchanged relative to the level recorded in the same period of 2013 and showing only minor changes in the different groups of banks (see Chart IV.32).

The coverage of operating costs with income from interest and from services (net of loan loss provisions) stood at 122% for the ensemble of banks from January to August 2014, down 7 p.p. against the same period of 2013. The year-on-year reduction of this indicator was mainly observed in the domestic private banks.

In turn, so far in 2014, tax-related expenditures (income tax and other taxes) amounted to a sum equivalent to 4%a. of assets for the financial system, up 0.9 p.p. against the same period of 2013. These expenses went up in all groups of banks but they had a higher weighting in domestic and foreign private banks. In addition, adjustments for loans to the public sector and the amortization of the court ordered releases (an effect of the 2001-2002 crisis) accounted all together for only 0.1% of assets, in line with what was observed in previous years.

IV.2 Institutional Investors

The aggregate portfolio of the three main groups of institutional investors of the domestic market amounted to over $621 billion[90] by June 2014. This figure includes the Sustainability Guarantee Fund (FGS), insurance companies and mutual funds. Total investments of these three types of agents have exhibited a 24% increase so far in 2014 (standing above the figure recorded in the two previous six-month periods) and a 49% increase in year-on-year terms. This portfolio accounts for 15% of GDP and has been keeping an upward trend since 2011 (see Chart IV.33).

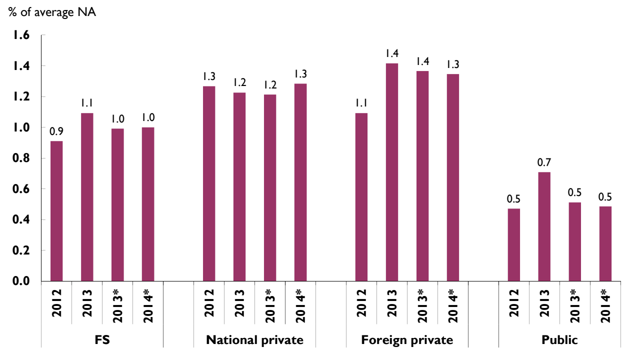
The portfolio of the Sustainability Guarantee Fund (FGS) —leading institutional investor of the domestic marketplace— amounted in August to over $440 billion[91], recording a 35% rise so far in 2014 and a 52% rise in year-on-year terms (see Table IV.4). In line with the performance observed in the prices traded in the secondary markets, from January to August, the main expansion in terms of amount corresponded to sovereign bonds and corporate bonds[92], accounting for almost two

[90] Latest information available in aggregate terms. The amount corresponds to the addition of unconsolidated portfolios.
[91] Latest information available. As of June (last month with available data for the three groups of institutional investors mentioned above), FGS portfolio accounted for two thirds of the aggregate portfolio managed by the institutional investors considered in this report.
[92] Most of this item is made up by sovereign bonds. According to data submitted before the Two-House Committee of the National Congress, by mid-May, corporate bonds accounted for only 3% of this segment.

Chart IV.32

Loan Loss Provisions

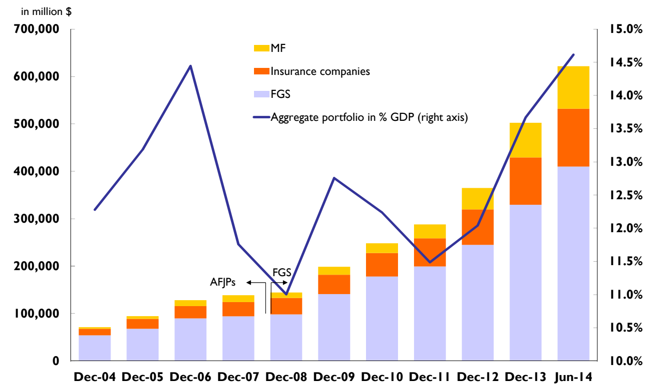
As % of netted assets



* Accumulated 8 months
Source: BCRA

Chart IV.33

Evolution Portfolio Institutional Investors



Source: BCRA based on ANSES, SSN and Argentina Chamber of FCI

Table IV.4

Evolution of Social Security Fund (FGS) Investment Portfolio

in million $

	Dec-12	Aug-13	Dec-13	Aug-14	Var. Aug-14 vs Aug-13 (%)	Var. since Dic-13 (%)
Cash, sight deposits and other*	22,631	23,041	25,378	27,861	21%	10%
Time deposits	14,908	14,082	15,996	14,787	5%	-8%
Sovereign bonds	159,434	193,400	215,584	295,940	53%	37%
Stocks	15,905	23,688	27,838	49,378	108%	77%
Corporate bonds and subsovereign government bonds	31,921	37,965	44,677	55,445	46%	24%
Total FGS	**244,799**	**292,176**	**329,472**	**443,410**	**52%**	**35%**

(*) "Other" includes Mutual Funds, Direct Investment Funds, Foreign Securities, Futures and Options, among others.
Source: FGS- ANSeS

thirds of the total portfolio and, to a lesser extent, to share holding. It is worth mentioning that shares have been the segment with the highest increase in percentage terms so far in 2014, thus extending the trend observed last year. In both cases, bonds and shares, the five leading instruments of the portfolio account for almost two thirds of the respective segment (see Chart IV.34). Other segments with remarkable expansions include productive and infrastructure projects (also exhibiting a significant increase in year-on-year terms) as well as cash and cash equivalents, among others. The amount corresponding to productive and infrastructure projects has grown 24% so far this year, and was also the item with the highest weighting in the portfolio after the aggregate of sovereign bonds and corporate bonds[93]. Only time deposits went down, recording an 8% drop so far this year (even though they have grown 5% in year-on-year terms), accounting for less than 5% of the total portfolio. In this context, the share of FGS time deposits in the total amount of the system went from over 5% by the end of 2013 down to 3% in August 2014.

In turn, the investment portfolio of insurance companies went up 22% from January to August 2014 (43% y.o.y.) reaching a level that exceeded $122 billion. The improvement was widespread among all subgroups of companies (see Chart IV.35), but it was more remarkable in the segment of general insurers (which holds the highest share in the total).

So far this year, the increase recorded in the portfolio of insurance companies was largely explained, in terms of amounts, by sovereign bonds and mutual funds, which were the items with the highest percentage growth in this period (see Table IV.5). Together with time deposits (which have also grown in recent months, even though more moderately), these are the three segments with the highest weighting, accounting for almost three fourths of the total investment portfolio of insurance companies. In turn, after growing markedly in 2013, investment in corporate bonds continued to exhibit a remarkable momentum, reaching a 17% weighting (it was 10% by the end of 2012). It is worth mentioning that corporate bonds and mutual funds have been the most dynamic in terms of weighting since 2012, because of the enforcement of Resolution No. 37,163/12 (as amended) of the National Insurance Superintendence ("paragraph k")[94]. Shares have also gone up so far in 2014, even though in this case the weighting in the total is more

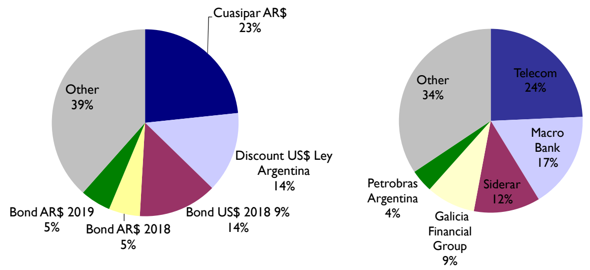
[93] Productive and infrastructure projects accounted for 13% of the total portfolio. Its maximum ceiling according to the regulation is 20% of the portfolio.

[94] The list of authorized investments included in paragraph k comprises Corporate Bonds and, to a lesser extent, Financial Trusts, Mutual Funds for investment in Infrastructure and Mutual Funds for SMEs. The increase in the weighting of Corporate Bonds and Mutual Funds (and, to a lesser extent, of "other investments in the country") acted to the detriment of the weighting of sovereign bonds and time deposits (which have nevertheless recorded increases since 2012 in terms of amounts).

Chart IV.34

FGS: Holdings of Public Bonds and Stocks

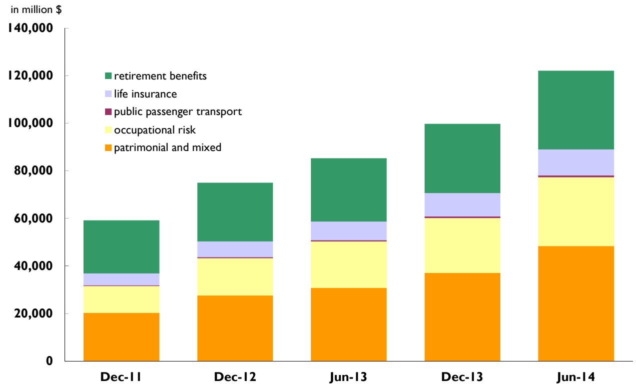
Aug-14



Source: ANSES-FGS

Chart IV.35

Evolution of Portfolio Insurance Companies by Segment



Source: CSN

Table IV.5

Evolution of Portfolio Insurance Companies

in million $

	Dec-12	Jun-13	Dec-13	Mar-14	Jun-14	Var. Jun-14 vs Jun-13 (%)	Var. since Dec-13 (%)
Publics bonds	28,892	28,333	31,176	36,388	40,275	42%	29%
Stocks	4,175	2,721	3,314	3,749	3,907	44%	18%
Outstanding bonds	7,807	13,199	16,931	19,307	20,211	53%	19%
MF	11,421	14,574	19,228	21,379	25,830	77%	34%
Financial Trusts	2,719	2,643	3,212	3,429	2,330	-12%	-27%
Time deposits	18,643	20,287	21,644	24,130	24,534	21%	13%
Other investments in the country	897	3,198	3,801	4,267	4,553	42%	20%
Foreign investments abroad	447	320	433	435	400	25%	-8%
Total portfolio	**75,000**	**85,275**	**99,740**	**113,083**	**122,039**	**43%**	**22%**

Source: SSN

marginal (3%). Lastly, the only items recording drops were the financial trusts, which have gone down 27%, and foreign investment, with an 8% drop. In both cases, these are segments that account for less than 2% of the total portfolio.

By the end of October, the net worth of the mutual funds amounted to over $136.4 billion. This entails a rise of 87% so far 2014 and of 96% if compared to the same month of 2013. Even though this upward trend was widespread among all subgroups of mutual funds, the growth was mainly explained by the segments of fixed income and money markets. These two subgroups, which have the highest weighting in the total, accounted for 76% of the increase observed so far this year. Likewise, mutual funds related to infrastructure and equities recorded the highest percentage increases along the year, with change rates close to 200% and 140%, respectively.

V. Financial System Risks

Summary

During 2014 minor changes were observed in the financial system risk map. These developments occurred in a context of strengthened of the sector's soundness. The aggregate exposure to liquidity risk has declined slightly so far in 2014. For example, at systemic level, the share of liabilities with a shorter residual term in total liabilities shrank, while there was a slight reduction in the degree of concentration of deposits. On the other hand, as from the beginning of 2014 an increase was observed in the coverage of short-term liabilities with liquid assets, after the increase of LEBAC holdings in the banks' portfolio.

As regards credit risk, on the one hand, the exposure of the financial system to the private sector went down slightly so far in 2014, in a context of some deceleration of financial intermediation. On the other hand, from low levels, the non-performance of credit went up on the margin, up to 2.1% of the total portfolio by August 2014, mainly due to the performance of loans to households, whereas the productive sector posted no significant changes as regards non-performing loans. Even when the economic activity exhibited a lesser momentum, the credit risk faced by the ensemble of banks stood at limited levels. This phenomenon is consistent with both a labor market recording only a slight deterioration and with the moderate levels of indebtedness and financial burden of companies and households. In turn, the coverage of the non-performing portfolio with loss loan provisions stood at high levels.

In the first half of 2014, the business lines of retail banking and of trading and sale of products —with the intervention of treasuries— were the most relevant reasons behind the events related to operational risk, as reported by the entities. By the end of 2014, the regulatory capital requirement will be in force to cover this type of risk, thus completing the last stage of the implementation of the schedule started in 2012.

Starting from reduced levels, the financial system exposure to market risk rose in year-to-date terms, mainly due to the higher volatility of prices of financial assets mostly in foreign currency positions. As regards the portfolio of securities listed in the market, the increase of holdings in pesos also contributed to explaining the higher capital requirement to cover this risk.

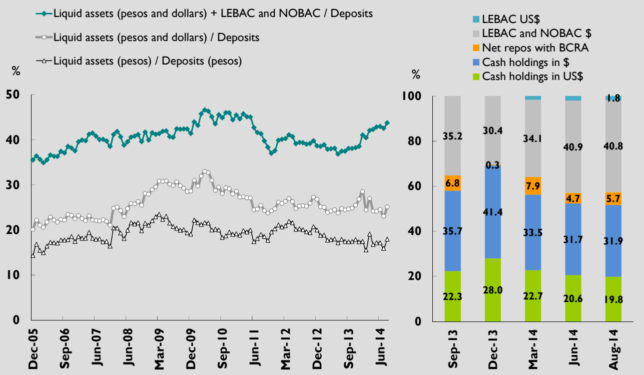
Throughout 2014, the financial system considerably reduced its balance exposure to foreign currency risk. Following the measures adopted by the BCRA under a macroprudencial approach, the currency mismatch of the sector shrank remarkably as a result of a reduction of forward net purchases. This occurred within a framework characterized by a gradual decrease of the peso-dollar nominal exchange rate volatility after the values recorded by the end of 2013 and the beginning of this year.

In the first eight months of 2014, the exposure of banks to interest rate risk posted a slight decline. The duration of assets net of liabilities of the domestic currency portfolio of the banking book decreased slightly in 2014. Thus, if compared to the value recorded at the end of 2013, the economic value of the financial system was less sensitive to changes in interest rates.

Chart V.1

Liquidity

Financial system

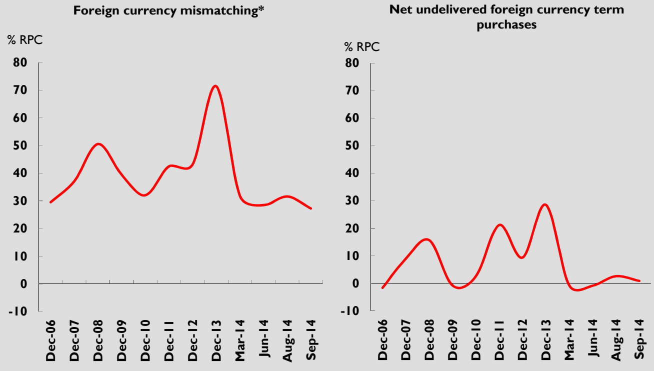


Source: BCRA

Chart V.2

Foreign Currency Mismatching

Financial system

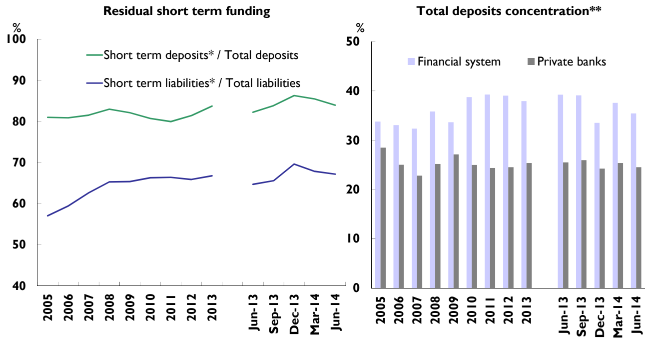


*Note: (Assets - Liabilities + Net undelivered foreign currency term purchases) / RPC

Source: BCRA

Chart V.3

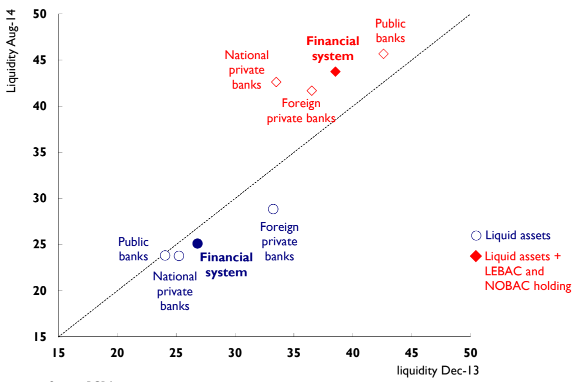
Liquidity Risk Exposure
Financial system



*Residual term less than 1 month.**Balance of the 110 largest customers of each entity as a percentage of total deposits.
Note: The annual information corresponds to the quarterly average of each period.
Source: BCRA

Chart V.4

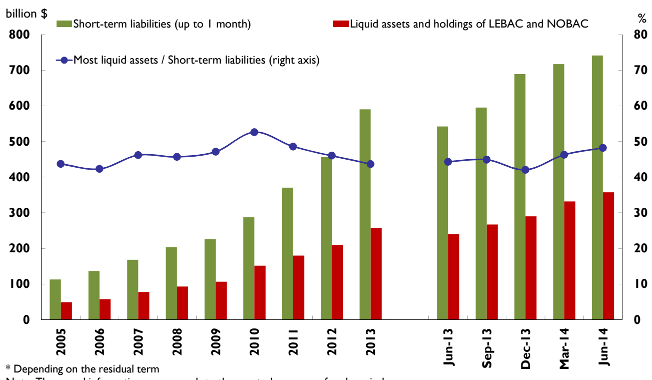
Liquidity by Group of Banks
% of non-financial deposits



Source: BCRA

Chart V.5

Most Liquid Asset in Terms of Short Term Liabilities*



* Depending on the residual term
Note: The annual information corresponds to the quarterly average of each period.
Source: BCRA

V.1 Liquidity risk

The exposure to liquidity risk posted a slight reduction so far in 2014. In this sense, for example, the relative weight of short-term liabilities kept on declining after the peak posted by the end of 2013. The value of this indicator fell 2.5 p.p. in the year, down to a level of 67.2%, a dynamics that was mainly observed in deposits (see Chart V.3). On the other hand, the levels of concentration in deposits in the financial system reduced slightly, both in recent months and if compared to 2013 average (see Chart V.3).

In terms of coverage, the level of liquid assets —including items in pesos and dollars— with respect to total deposits went down 1.7 p.p. so far in 2014, even though this performance is reversed when considering the holding of monetary regulation instruments not related to repo transactions (see Chart V.1). Thus, the broad liquidity ratio (including LEBAC and NOBAC) expanded 5.2 p.p. of deposits as of August 2014 up to 43.8%. The performance of liquidity indicators was widespread among the different groups of banks (see Chart V.4). Thus, so far in 2014, there was a variation in the composition of the main liquid assets: a reduction of cash and cash equivalents in pesos (-9.4 p.p.) and in dollars (-8.2 p.p.) which was offset by increases both of LEBAC in domestic currency (+10.4 p.p.) and in foreign currency[95] (+1.8 p.p.) as well as in repo transactions with the BCRA (+5.4 p.p.; see Chart V.1).

In turn, as from the beginning of the year a hike was recorded in the high-liquidity assets/short-term liabilities ratio (see Chart V.5). In the first half of 2014 —latest information available—, this coverage reached a level of 48.2%, up 2 p.p. and 6.2 p.p. against the values of the first quarter of 2014 and the end of 2013, respectively. This evolution reflects mainly the increase of LEBAC holdings in banks' portfolio.

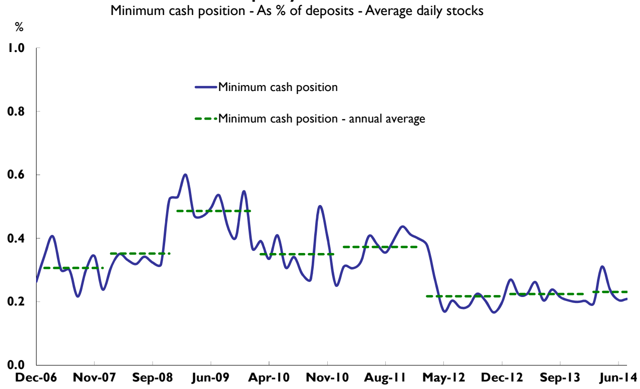
Banks posted a minimum cash position —compliance in excess of the requirement— equal to 0.2% of deposits for the average of the year, which is similar to the values recorded in 2013 and 2012 (see Chart V.6). Throughout 2014, the BCRA decided to adjust the regulations on minimum cash for the purpose of expanding the access to loans for production, to increase the access to banking services by the people and to encourage social inclusion. Thus, it is worth recalling that under the Credit Line for Productive Investment (LCIP) at the beginning of 2014, the requirement of minimum cash was reduced for banks granting financing to micro, small and medium-sized

[95] At the beginning of 2014, the BCRA began to auction dollar-denominated bills for the purpose that financial institutions encourage the placement of time deposits in foreign currency from the private sector. The interest rate offered for such deposits is related to the performance of such LEBACs.

Chart V.6

Liquidity in Pesos

Minimum cash position - As % of deposits - Average daily stocks

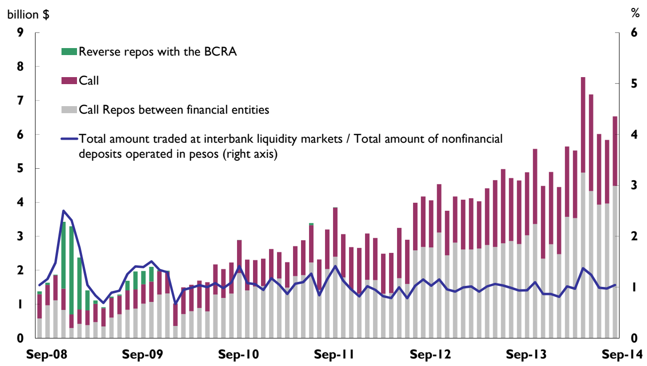


Note: Decembers reflect requirements, integration and position of the quarterly period (December to February).
Source: BCRA

Chart V.7

Interbank Liquidity Markets

Daily average traded

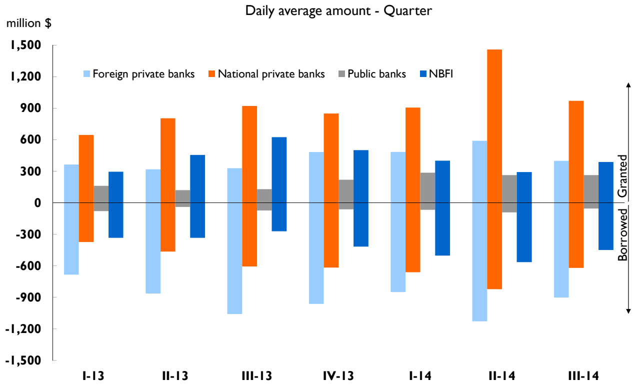


Source: BCRA

Chart V.8

Call Market

Daily average amount - Quarter



Source: BCRA

enterprises[96]. Likewise, effective as from September 2014, the weightings applicable for calculation of reduction of capital required were modified taking into account the zone categories where the ATMs of each entity[97] are. In addition, a reduction was established of the minimum cash requirement in pesos taking into account the transfers made by the National Social Security Administration for payment of social security benefits[98]. Finally, by mid-September 2014, and effective as from October, the minimum cash requirement was reduced[99] in an amount equal to 16% of financing in pesos granted by the entity according to the provisions of the official financing plan in installments called “Ahora 12”[100].

Liquidity in dollars continued standing at high levels, and at the end of August it reached 105.1% of deposits in such denomination (not including LEBAC in foreign currency). After the increase in reserve requirements on deposits in dollars established by the BCRA at the beginning of 2014[101], the excess compliance over the requirement was significantly reduced, standing at around 90% of the requirement (almost 400 p.p. less than by the end of 2013).

The volume in the interbank market rose on a steady basis from January to mid-2014, when it recorded the maximum peak, and then experienced a decrease on the margin. Thus, the call money market even reached 1% of the total amount traded in non-financial deposits as of August (see Chart V.7). The momentum recorded was mainly driven by repo transactions among financial entities. In relation to the call market, an increase was recorded in volumes traded if compared to 2013, especially in the second quarter of the year. In the aggregate of 2014, there has been an outstanding net borrowing position of foreign private banks which was supplied to a large extent by private local banks —net lenders. In turn, in 2014, public banks posted a lending position higher than the position recorded in previous periods, whereas Non-Bank Financial Institutions (NBFIs) reversed their position and became net borrowers of funds (see Chart V.8).

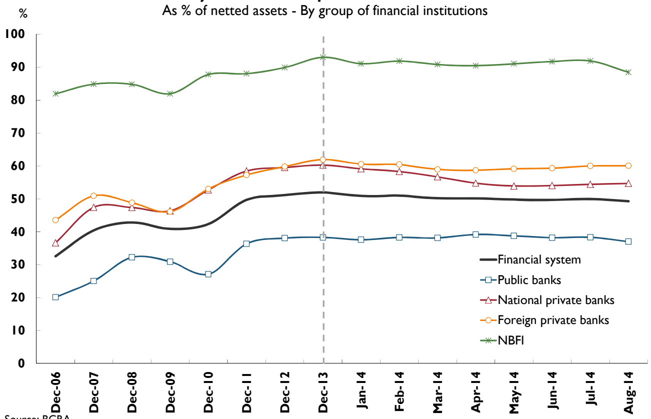
It is worth stating that, as a measure of the financial system security network which mitigates the liquidity risk and as part of the macroprudential regulatory scheme, at the beginning of October (effective as from

[96] Communication “A” 5524.
[97] Communication “A” 5623.
[98] Communication “A” 5623.
[99] Communication “A” 5631.
[100] Joint Resolution No. 671/2014 and 267/2014 of the Ministry of Economy and Public Finance and of the Ministry of Industry. This Plan is intended to encourage the demand for goods and services by granting financing facilities in installments, addressed to users and consumers, for the purchase of goods and services from several sectors of economy.
[101] Communication “A” 5534.

Chart V.9

Financial System Gross Exposure to the Private Sector

As % of netted assets - By group of financial institutions

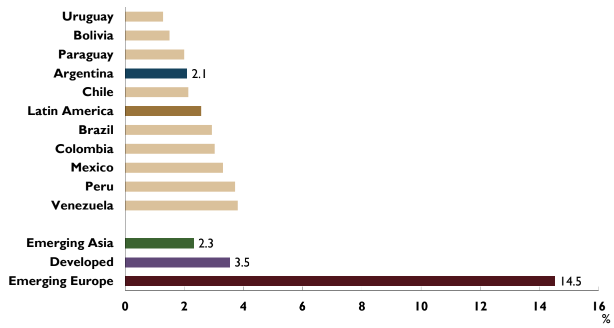


Source: BCRA

Chart V.10

Non-performing Financing. International Comparison

Non-performing financing / Total financing (%)

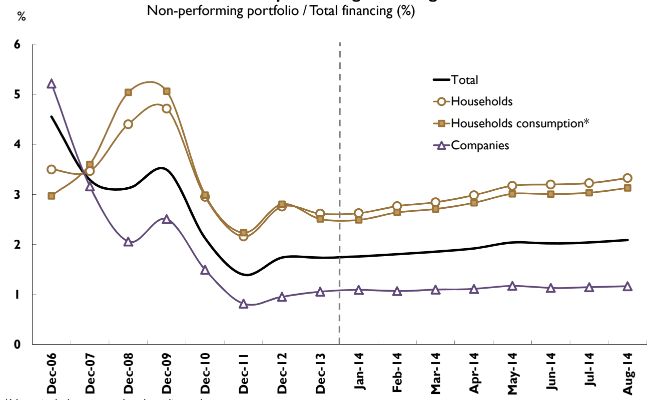


*Note: Private sector non-performing loans as percentage of total private sector financing. Note: Emerging Europe: Turkey, Russia, Romania, Bulgaria and Hungary. Emerging Asia: China, India and Indonesia. Developed: Korea, Spain,USA, UK, France, Japan, Italy, Canada, Australia and Germany. Data to 2014 except Italy, France, Spain, Turkey, China, Uruguay, Paraguay and Bolivia (2013), Bulgaria (2012) and Venezuela (2010). Source: BCRA, IMF and Central Banks.

Chart V.11

Private Sector Non-performing Financing

Non-performing portfolio / Total financing (%)



*Note: includes personal and credit cards.
Source: BCRA

November) the BCRA decided to increase the coverage of deposit guarantee from $120,000 up to $350,000 per holder[102]. Given this higher coverage level, the Deposit Guarantee Fund was strengthened, thus increasing the monthly contribution made by financial entities to such fund.

At the end of 2013, the BCRA published the reporting regime of the Liquidity Coverage Ratio (LCR), through Communication "A" 5494, which established that banks had to deliver the first report in the first half of 2014. Data collected will serve to fix the national discretion parameters. At international level, it is established that the LCR would be applicable as from January 2015, with a minimum 60% requirement which will gradually increase 10 p.p. each year until reaching 100% by early 2018[103].

V.2 Credit Risk

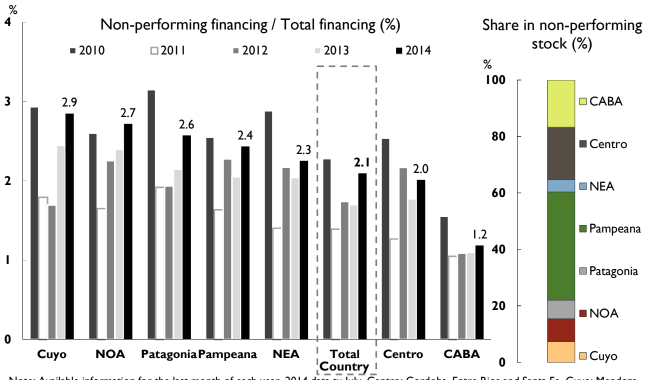
V.2.1 Private Sector

Financial system gross exposure to the private sector went down 2.7 p.p. of netted assets so far in 2014, down to 49.3% (see Chart V.9). All ensembles of financial entities contributed to the reduction in such indicator, in particular national private banks, in a context of deceleration in economic activity, and of the financial intermediation (see Chapter II and IV). Within this context, the non-performance ratio of loans to the private sector rose slightly in 2014, nevertheless standing at a range of reduced values. The moderate levels of indebtedness of companies and households, together with a labor market posting only minor deterioration, contributed to maintaining a reduced position of the financial sector with respect to risk of lending to the private sector. In turn, all the ensembles of banks keep a sizable provisioning level.

A comparison in the medium and long run shows that the non-performance of loans to the private sector currently stands at reduced levels (see Chart 7, Central Bank Outlook); this indicator is favorably compared to the levels of other emerging and developed economies (see Chart V.10). The non-performance ratio of loans to the private sector rose 0.4 p.p. during 2014, standing at 2.1% of total loans to the private sector in August. This behavior occurred in a context of some deceleration in growth rates of total lending (see Chapter IV), combined with a slight rise in the pace of the increase of non-performing loans stock. The increase of such ratio was recorded in all ensembles of financial entities, where

[102] Communication "A" 5641.
[103] For further detail, see Box 3 of the Financial Stability Report, First Half 2014.

Chart V.12
Private Sector Non-performing Financing by Region



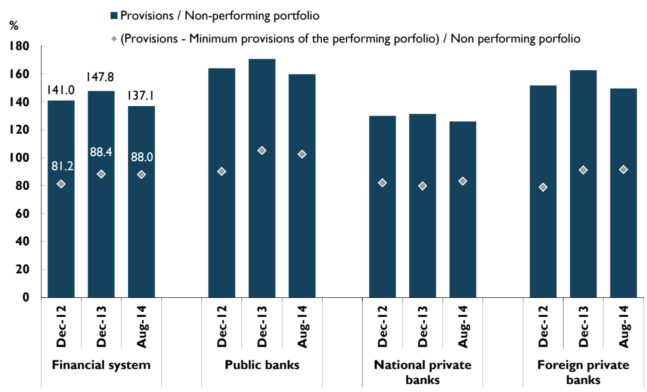
Note: Available information for the last month of each year. 2014 data to July. Centro: Cordoba, Entre Rios and Santa Fe. Cuyo: Mendoza, La Rioja, San Juan, San Luis. NEA: Corrientes, Chaco, Formosa, Misiones. NOA: Catamarca, Jujuy, Salta, Santiago del Estero, Tucuman, Pampeana: Buenos Aires, La Pampa. Patagonia: Chubut, Neuquén, Río Negro, Santa Cruz, Tierra del Fuego. Source: BCRA

Table V.I
Private Sector Financing Evolution / December 2013 to June 2014
As % of the credit stock at initial time - December 2013

December 2013		June 2014: Performing (93.7%)	June 2014: Non-performing (2.2%)	June 2014: Drop of Balance* (4.14%)
Performing	98.3	93.49	1.11	3.66
Non Performing	1.7	0.20	1.06	0.48

(*) Debt cancellation, financial trusts constitution or written off and booked in memorandum
Source: BCRA

Chart V.13
Non-performing Portfolio Coverage with Provisions by Group of Banks



Source: BCRA

national private banks and NBFI stood out. In turn, public banks posted the lowest relative expansion (0.2 p.p.) in such indicator so far in 2014. The private sector portfolio with preferred guarantees posted an increase in non-performance on the margin that, even though slightly exceeding the increase recorded in loans without such collateral, maintains a lower non-performance level (1.7% vis-à-vis 2.2%).

Lending to households drove the slight increase in non-performance during 2014, whereas non-performance of loans to the productive sector barely posted changes with respect to the end of 2013 (see Chart V.11). The evolution of non-performance ratios at territorial level shows that all regions contributed to the increase in non-performance in the first eight months of the year, with lower relative increases in the Central region and the City of Buenos Aires (CABA; see Chart V.12).

Lending already effective as of December 2013 and, which by the end of the second half of 2014 was still in stock, posted a slight deterioration throughout the first half of the year. In particular, in this period, 1.1% of loans “alive” by the end of 2013 went from performing to non-performing. In turn, only 0.2% of such total posted any improvement in such classification, going from non-performing to performing (see Table V.1).

The minor increase of the non-performance ratio faced by the financial system took place in a context of high level of the non-performing portfolio with accounting provisions, reaching 137.1% in August 2014 (see Chart V.13). Even though this level stood below that recorded in December 2013, it still continued to exceed 100% in all ensembles of banks. If excluding provisions for performing loans, the hedging would reach 88%, almost 40 p.p. above the regulatory requirement for the non-performing portfolio.

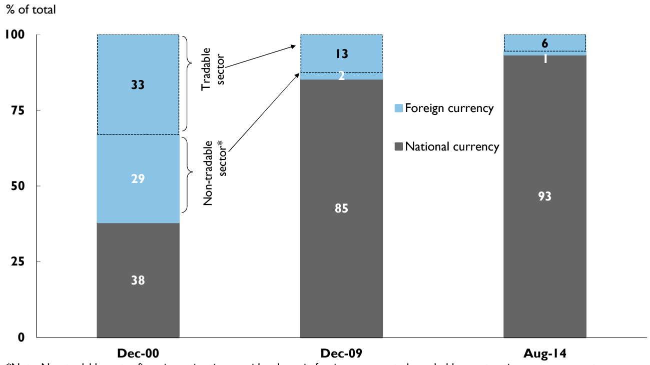
During 2014, there was still a very low share of loans denominated in foreign currency in the total of the portfolio of lending to the private sector. As of August, these loans represented 7% of the total lending to such sector (see Chart V.14). On the other hand, the proportion of loans in foreign currency channeled to tradable sectors would exceed 80% of the total in the same denomination, thus reducing any possible risk associated to the debtor’s currency mismatch. This occurs in a context of the prudential regulations implemented by the BCRA[104].

[104] See page 66 of the Financial Stability Report of the First Half 2013.

Chart V.14

Credit to Private Sector by Currency

Financial system

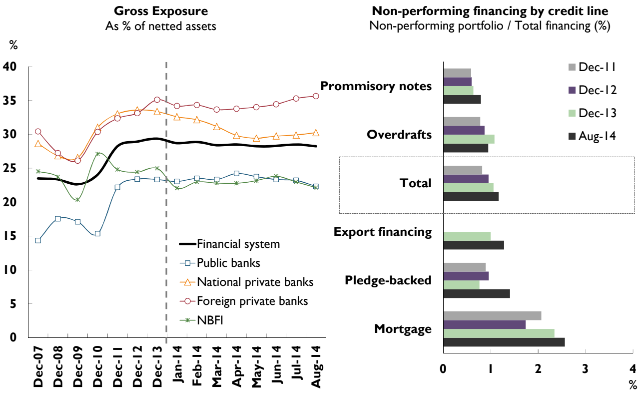


*Note: Non-tradable sector financing estimation considers loans in foreign currency to households, construction sector, gas, water, electricity and other services. (June 2014 last available information).

Source: BCRA

Chart V.15

Companies' Financing

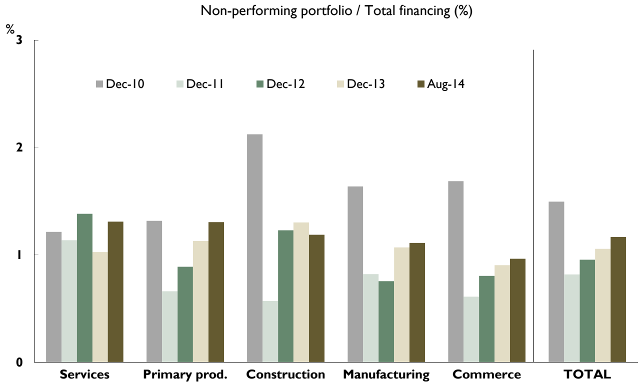


Note: Export financing credit line's information is available from 2013. Source: BCRA

Chart V.16

Companies' Non-performing Financing by Economic Activity

Non-performing portfolio / Total financing (%)



Source: BCRA

Companies

In a context of smoothed pace of year-on-year growth of bank lending to companies (see Chapter IV), during the first eight months of 2014, the financial system exposure to the productive sector shrank in an amount equal to 1.1 p.p. of total assets, representing 28.2%. This decrease was mainly explained by national private banks (see Chart V.15). The performance of loans to companies and of the level of aggregate exposure of bank balances to this sector are in line with the recent momentum recorded in the main productive segments (see Chapter III).

Throughout the year, the level of delinquency in financing to companies stood at a range of low values and did not present significant changes. The non-performance ratio of loans to companies reached 1.2% as of August 2014, just 0.1 p.p. and 0.2 p.p. above the values of December and August 2013, respectively. This slight increase mainly reflected the behavior of pledge and mortgage loans and export financing. In turn, the more representative credit lines for total lending to companies —promissory notes and overdrafts, which account for around 60% of the total stock—, continued with a delinquency level lower than the average and, as a whole, the non-performance ratio did not vary with respect to the end of 2013 (see Chart V.15).

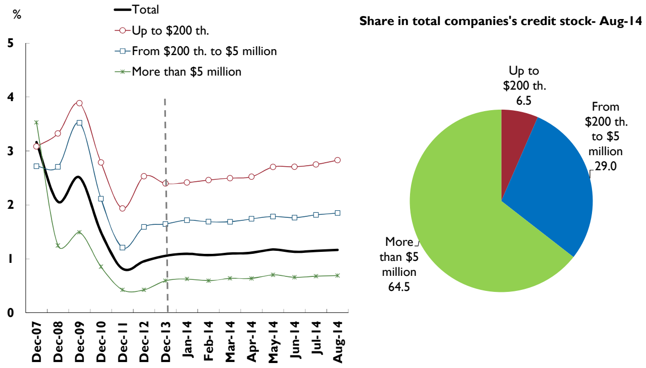
The non-performance ratios continue to be low in all activity sectors. If compared to previous years, the dispersion of non-performance levels among the different productive segments has declined, and as of August 2014, the delinquency indicator for the different sectors stood at a range from 1% to 1.3% (see Chart V.16). Except for the construction business, the other groups of companies by activity recorded a slight increase of delinquency from January to August 2014. Taking into consideration the loans to companies by segments of residual stock, the minor increase of non-performance during the year was mostly explained by smaller segments (up to $5 million), accounting for 35.5% of total stock (see Chart V.17).

The sustainability of the payment capacity of the sector is partly underpinned by rather low levels of indebtedness (see Chapter III). Another sign of the steady payment capacity of companies is the reduction recorded in recent months in the bouncing of checks due to lack of funds in terms of total cleared amounts, a ratio which stood below the peaks recorded at the end of 2013 and at the beginning of 2014 (see Chart V.18)

Chart V.17

Companies' Non-performing Financing by Residual Stock Range

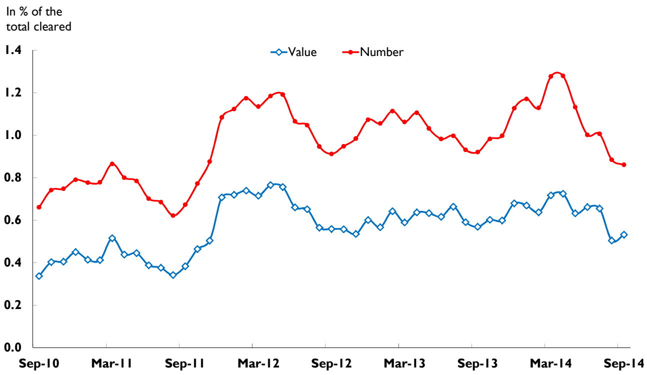
Non-performing portfolio / Total financing (%)



Source: BCRA

Chart V.18

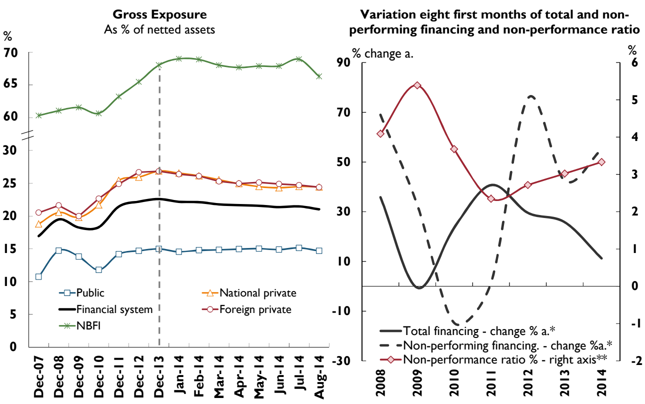
Bounced Checks for Non-sufficient Funds



Source: BCRA

Chart V.19

Households Financing



*Change December - August annualized / ** Non- performance ratio to August of each year. Source: BCRA

Households

During the first eight months of 2014, the exposure of the banking sector to households went down by 1.6 p.p. of assets, thus reaching 21% (see Chart V.19). This behavior was mainly due to private banking —both national and foreign— followed by NBFIs. In 2014, there was a moderate materialization of credit risk of households faced by the financial system. The weak performance of the economic activity (see Chapter III) would partly explain some level of deterioration in the households' payment capacity. This effect would be mitigated by reduced levels of indebtedness and financial burden of this sector, which is added to the positive effect of active income policies by the public sector.

As a token of the credit risk materialized in this segment, during 2014 the non-performance ratio of loans to households posted a minor increase —especially during the first quarter (see Chart V.11)—, in a context of increase of the annual variation of the non-performing stock and some deceleration in total lending (see Chart V.19). The marginal deterioration of the portfolio could partly explain certain restriction on the process of origination of loans by entities, eventually affecting the supply of loans to the sector. This increase in the non-performance of households was present in all ensembles of financial entities, mainly in private banks and NBFIs. It is worth stating that credit lines, except for mortgage loans, posted a higher non-performance, in particular loans for consumption —personal loans and credit cards—, followed by pledge loans.

When taking into account the year of incorporation (estimated) of the debtor to the financial system, it is noted that the increase recorded in the first half of 2014 of the aggregate ratio of non-performing loans to consumption of households would mainly result from the behavior of lending corresponding to debtors who entered the system from 2012 to 2013. These subjects of credit explained 20% of the stock of loans for consumption by mid-2014 (see Chart V.20).

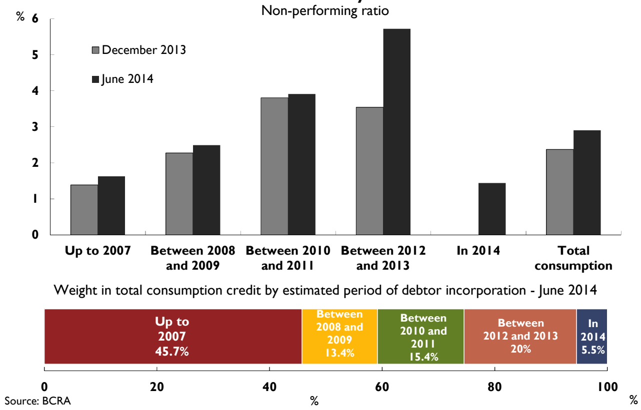
V.2.2 Public Sector

The financial system exposure to the public sector posted no significant changes if compared to the levels recorded last year. As of August 2014, lending to the public sector of the ensemble of financial entities stood below 9% of total assets, down 0.2 p.p. against the level recorded 12 months ago. Public banks continued to be the reason behind most part of this exposure and also boosted the recent decrease.

Chart V.20

Consumption Households' Credit by Estimated Period of Debtor Incorporation to the Financial System

Non-performing ratio

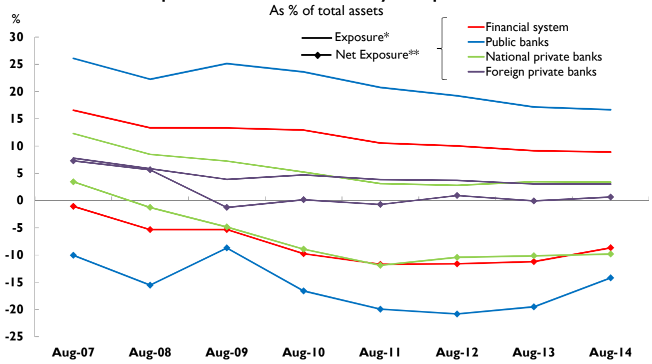


Source: BCRA

Chart V.21

Exposure to the Public Sector by Group of Banks

As % of total assets

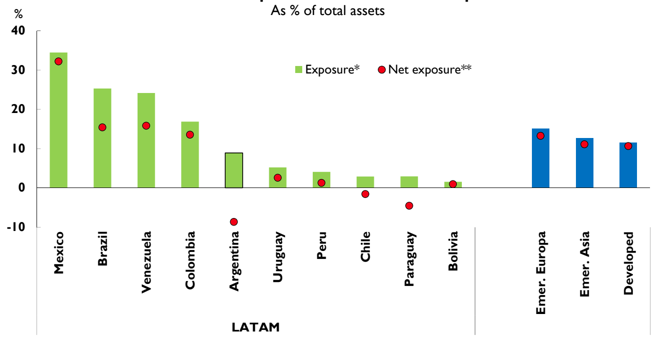


* (Position in government securities (not including Lebac or Nobac) + Loans to the public sector) / Total Assets .
** (Position in government securities (not including Lebac or Nobac) + Loans to the public sector - Public sector deposits) / Total Assets
Public sector includes all jurisdictions (national, provincial and municipal). Source: BCRA

Chart V.22

Public Sector Exposure - International Comparison

As % of total assets



* (Position in government securities (not including Lebac or Nobac) + Loans to the public sector) / Total Assets .
** (Position in government securities (not including Lebac or Nobac) + Loans to the public sector - Public sector deposits) / Total Assets
Emerging Europe: Turkey, Russia, Romania, Bulgary and Hungary. Emerging Asia: China,Thailandia, India and Indonesia. Developed: Korea, Spain, USA, UK, France, Japan, Italy, Canada and Germany. Data up to 2014 except: Mexico, Japan, USA and Chile to 2013; Australia and Korea to 2012; Canada to 2008 and Argentina August 2014. Source IMF and BCRA.

Deposits from the public sector accounted for 17.6% of total funding —liabilities and net worth— of the financial system as of August and, hence, they continued exceeding the bank loans to this sector. Thus, the ensemble of financial entities kept on posting a negative net exposure to the public sector —or a net borrowing position with respect to this sector—, for an amount equal to 8.7% of total bank assets (see Chart V.21). It is worth considering that, if compared to the level of August 2013, deposits of the public sector reduced their relative importance in bank funding by 2.8 p.p. This explained a slight year-on-year decline of the net borrowing exposure of the financial system aggregate with the public sector, a behavior that was mainly due to public banks.

The local levels of the financial system exposure to the public sector stand below the average for the region (see Chart V.22). In turn, in terms of records of net exposure to the public sector, Argentina is one among a few cases where the financial system, in aggregate terms, becomes a net borrower of such sector.

V.3 Operational Risk

The capital requirement for operational risk will be in full force and effect by the end of 2014 for smaller institutions —Groups B and C—[105] and, upon such coming into full force and effect, the implementation will be completed of the gradual schedule started in 2012. According to such schedule, relatively large financial institutions —Group A— have been complying with the total requirement since December 2012. The aim of the required hedge is for banks to maintain sufficient reserves to face any unexpected losses that may be generated due to failures in processes, personnel and/or systems, or else, because of any external events.

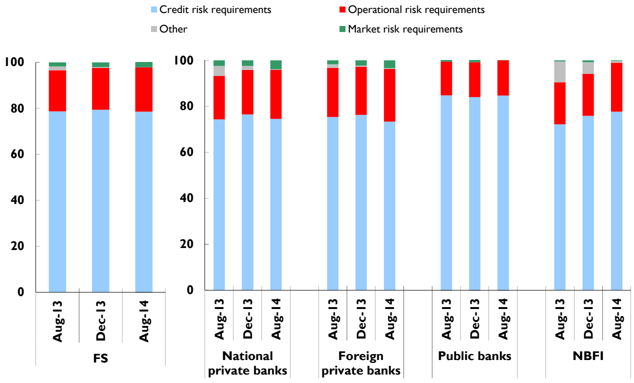
In the domestic prudential regulation, according to the basic indicator approach[106], the capital requirement for operational risk was established at a level equivalent to 15% of the average positive gross income recorded in the past three years. Taking into account the aggregate financial system, as of August 2014, this requirement grew 40.4% y.o.y., exceeding the growth of the other capital requirements. This growth was due to the development of the gradual schedule of implementation and because of the increase of gross income, in a context of improvement in gains of certain items of the financial margin (see Chapter IV). Thus, in August the capital

[105] According to Consolidated Text on Financial Institutions Minimum Capitals.
[106] For further detail, see Box 3 of the Financial Stability Report corresponding to the First Half of 2012.

Chart V.23

Capital Requirements by Group of Banks

Share in regulatory requirements

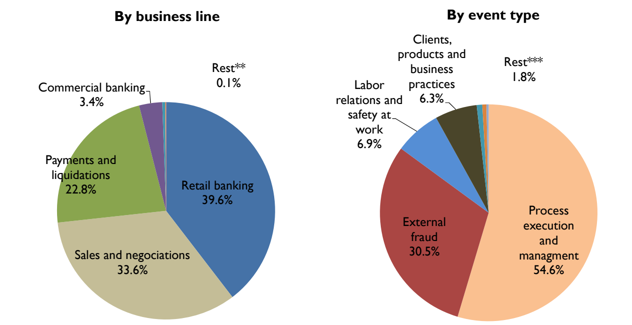


Note: Requierements are ajusted by exemptions and the efects of the Com. "A" 5396. Source: BCRA

Chart V.24

Informed Operational Risk Event Classification*

June 2014 - Events with start date during the first semester are considered - Financial system

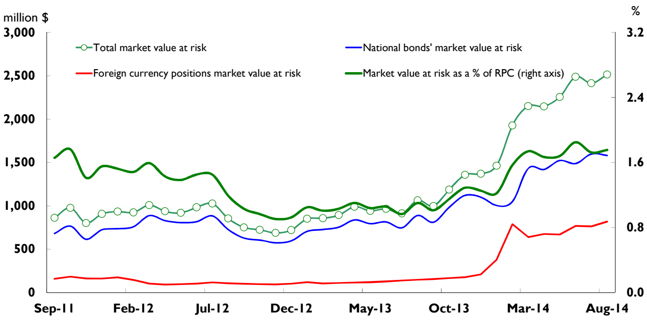


* Operational risk events database (IR for Quarterly / Annual Supervision).
** Rest: Agency services, Asset administration and intermediation . *** Rest: Impact in business and technological failures, internal fraud and material assets damages. Source: BCRA

Chart V.25

Market Value at Risk

Total, national bonds'* and foreign currency positions ' capital requirements



*Included positions: (i) public bonds, LEBAC and NOBAC considerated in the list of volatilities (issued by this Institution) and recorded to fair market value and (ii) share of MF which concern the securities and instruments mentioned previously.
Source: BCRA

requirement for operational risk explained 19.3% of the total capital requirement, 1.4 p.p. higher than the value in the same period of 2013 (see Chart V.23). This increase was reflected to a larger extent in private banks and NBFIs.

Taking into consideration the first half of 2014, financial institutions informed that business lines concentrating operational risk events were (i) retail banking, (ii) trading and sales (treasury) and (iii) payments and settlements (by external customers) (see Chart V.24). The types of events related to such losses were mainly as follows: (i) failures in execution, management and completion of processes (mainly, technical problems to perform transfers) and (ii) external fraud.

V.4 Market Risk

Any financial system is exposed to a risk associated with losses that may result from changes in market prices of assets and/or liabilities valued at typical price. In the case of Argentina, this type of assets represents only a reduced weighting within total assets of the ensemble of banks, thus limiting the exposure to such risk.

As of August 2014, the value at risk —which is the basis for the capital requirement according to domestic prudential regulation— of positions included was only 1.8% of the Adjusted Stockholders' Equity (RPC), and 3.1% of the total capital requirement. This capital requirement recorded an increase so far in 2014, which evolution was partly due to the component recorded in foreign currency positions (see Chart V.25). Even though as from last year there has been a reduction in the mismatching of foreign currency —position— (see Section V.5), the volatility observed[107] in such assets was behind the increase in their value at risk[108].

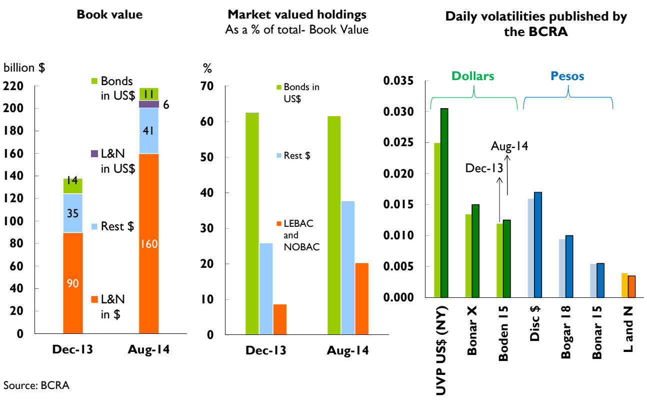
As regards the portfolio of securities, so far in 2014 there has been an increase in the holdings of LEBACs and NOBACs in the stock of the ensemble of banks. Both in this instrument and in the other bonds in pesos, an increase was recorded in the share of assets valued at market price, whereas for bonds in dollars the percentage was slightly reduced. In parallel, the volatility observed in most of the main instruments held by banks went up (see Chart V.26).

Upon breaking down the portfolio of national bonds[109] —which account for almost two thirds of the value at market risk—, an increase was recorded in the value at

[107] According to monthly Communications "B", which state a detail of daily volatilities for the market risk calculation.
[108] In particular, the volatility went from 0.05% by the end of 2013 up to 0.5% as of August.
[109] Sovereign bonds, LEBACs and NOBACs and, to a lesser extent, mutual funds' unit shares.

Chart V.26

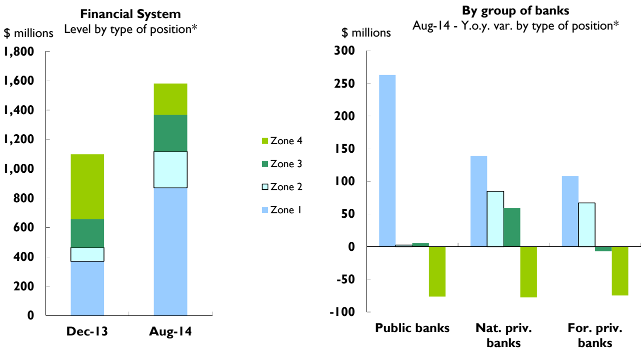
Public Bonds, LEBAC and NOBAC in Banks' Porfolio



Source: BCRA

Chart V.27

Capital Requirements due to National Bonds

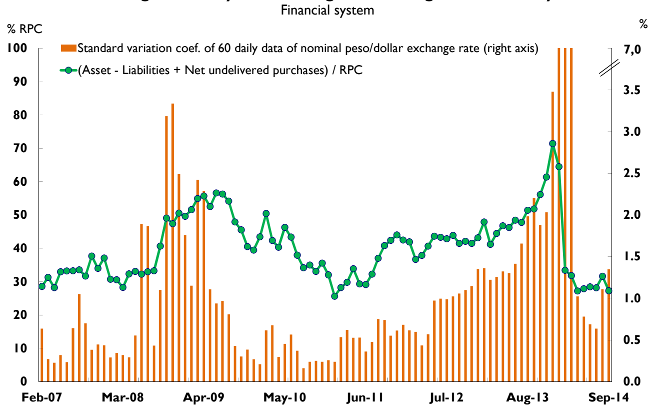


*Types of position by Compiled texts of Financial institution minimum capital requirements. Section 6. Bonds are classified depending their currency and their average term ("modified duration", MD): Zone 1 (pesos, MD less than 2.5 years), Zone 2 (pesos, MD more than 2.5 years), Zone 3 (dollars, MD less than 2.5 years) and Zone 4 (dollars, MD more than 2.5 years). Source: BCRA

Chart V.28

Foreign Currency Mismatching and Exchange Rate Volatility

Financial system



Source: BCRA

risk of assets in pesos, especially assets with an estimated modified duration shorter than 2.5 years (see Chart V.27). The increase in the capital requirement for market risk in the segment of national bonds was generalized among all ensembles of banks.

V.5 Currency Risk

As already stated above, at the beginning of 2014 the Central Bank adopted several measures intended to reduce the mismatching of foreign currency of financial institutions. As part of the macroprudential approach, these measures were aimed at avoiding any undesired consequence on the exchange market in general and on banks' balance sheets in particular from the high exposure to the currency risk reached by the financial system by the end of 2013 (see Chapter II).

Following such measures, the currency mismatching[110] of the financial system went down remarkably, in a context which was hand in hand with a reduction of the volatility of the peso-dollar nominal exchange rate (see Chart V.28). In September 2014, this mismatching accounted for 27.3% of the RPC of the ensemble of financial institutions[111], less than half the level by the end of 2013. Throughout 2014, all ensembles of banks showed a decrease in this indicator, with a more remarkable change in private banks. In particular, this group of banks was behind the significant drop recorded in the period in foreign currency forward net purchases (see Chart V.2). Following this decline, at aggregate level, foreign currency forward net purchases at present only represent 3.2% of total mismatching (see Chart V.29), quite below the 40% percentage recorded in December 2013.

V.6 Interest Rate Risk

Banks are exposed to interest rate risk by virtue of the traditional financial intermediation activity, since income levels react more slowly than expenditures upon any changes of interest rates in economy, i.e., bank assets are in general less sensitive than bank liabilities.

So far in 2014, a slight decline was recorded in the level of exposure of banks to interest rate risk. Specifically, the duration of assets net of liabilities in the domestic currency segment of the banking book[112] went down slightly throughout 2014 (see Chart V.30). Both assets and liabilities reduced their duration in 2014, which

[110] It is defined as Foreign Currency Assets – Foreign Currency Liabilities + Net Undelivered Foreign Currency Term Purchases.

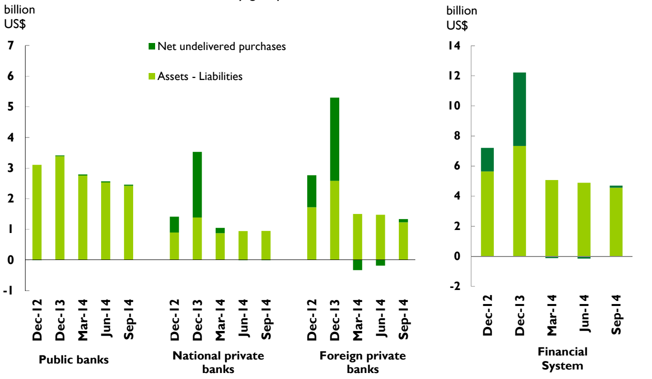
[111] This mismatching does not exactly consider the regulatory definition set by the Foreign Currency Global Net Position –PGNME- (mainly, because it does not consider regulatory extinctions to the limit or any franchises granted), even though similar values are recorded at aggregate level.

[112] It includes all assets and liabilities for financial intermediation not taken into consideration for market risk assessment.

Chart V.29

Foreign Currency Mismatching* Composition

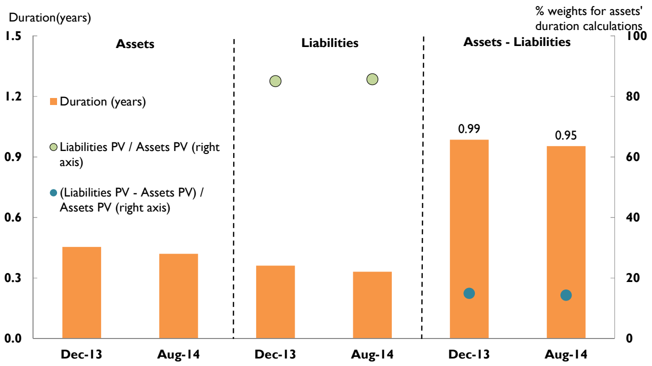
By group of financial institutions



*Note: (Assets - Liabilites + Net undelivered purchases) / RPC.
Source: BCRA

Chart V.30

Estimated Domestic Currency Banking Book Portfolio Duration

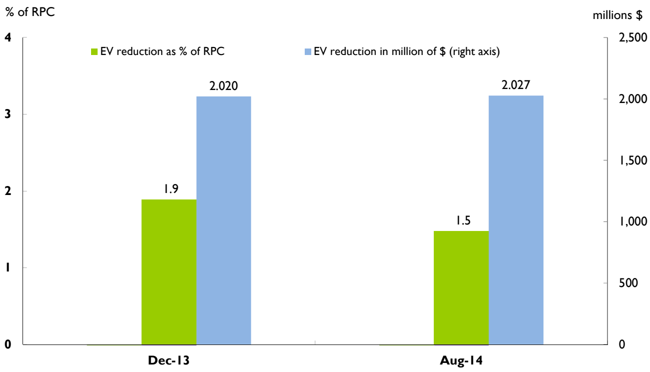


Source: BCRA

Chart V.31

Economic Value Estimated Reduction Caused by an Increase on the Interest Rate

Financial system - Domestic and foreign currency - By a 200 bp increase on the interest rate



Source: BCRA

duration was relatively longer for assets. Thus, as of August 2014, the economic value of the ensemble of banks was less sensitive to interest rate changes if compared to the end of 2013.

One of the criteria established by the BCRA[113] for interest risk rate management assesses the change in economic value upon a 200 bp variation in such variable. According to such criteria —taking into consideration an interest rate hike— it is estimated that the economic value of the banking book[114] of the financial system would have gone down only 1.5% of the RPC ($2.03 billion), 0.4 p.p. below the value recorded by the end of 2013 (see Chart V.31).

It is worth recalling that in order to adapt the domestic regulations to international standards, as from the beginning of 2013 the interest rate risk started to be considered for Pillar II. Within this context, financial institutions must assess the capital adequacy for this risk. Thus, whenever the capital is not sufficient for the interest rate risk level, the local supervisor may require banks either to increase their capital or to reduce their risk —or both.

[113] Communication “A” 5398. At the same time, the Superintendence of Financial and Exchange Institutions (SEFyC) uses an alternative criterion: an increase equal to the 99th percentile of the moving distribution of the past 5 years of annual changes in the interest rate.
[114] Considering information from the Reporting System of Minimum Capital Requirement and Compliance of the BCRA.

Box 4 / Basel Committee’s Leverage Ratio

At the 2009 Pittsburgh Summit, G20 leaders intended to mitigate the pro-cyclicality inherent in financial systems and to improve the capital basis on which they develop their financial intermediation activity. The goal was to make a contribution to the recovery of the economic growth in a sustainable and balanced manner. The crisis that broke out in 2008 had originated in the excessive leverage of financial institutions, among other reasons. To strengthen the system’s stability, the G20 opted for encouraging a set of macroprudential regulation and supervision measures that, as a whole, are usually known as “Basel III”. Such measures include the requirement to banks for more and better capital and the implementation of countercyclical capital reserves, as well as the establishment of a limit to leverage

Following the decision of G20 Leaders, the Basel Committee on Banking Supervision (BCBS) undertook the task of developing an international standard to measure and limit the banking system’s leverage. The crisis has left two important lessons. On the one hand, capital requirements based on risk had not been enough to support the disorganized growth of bank assets related to financial intermediation and, on the other hand, the risk implicit in off balance sheet exposures had been significantly underestimated.

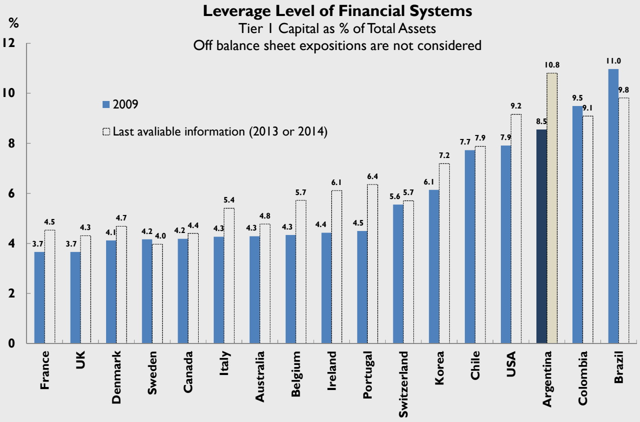
In measurements based on risks, the amount of exposures is weighted by the estimated probability that the loss may occur. Since loans and other financial assets considered to be low or no risk assets require banks to provide either just some or no capital, these measures are not always appropriate to limit their total leverage. This type of measure would neither be effective to maintain a proper relationship between banks’ capital and the maximum loss they may suffer, i.e., the exposure not weighted by risk. Besides, measurements based on risks present a pro-cyclical bias, since the credit rating of debtors with a reputation of lower risk in booming periods is the most liable to suffering downgrades —worsening— in the downturn of the economic cycle. This situation is more pronounced in systemic crisis events during which in general the correlation among debtors also changes, given the fact that expectations become unfavorable for almost all sectors of economy.

Thus, the BCBS noted that, in many cases, banks had leveraged in excess whereas, apparently, they held sound capital ratios in terms of risk. In this respect, Chart B.4.1 shows the relationship between Tier 1 capital and total assets not weighted by risk (not including off balance sheet exposures) for financial systems of a selected set of countries for 2009 and the latest period available.

Then, at the peak of the crisis, institutions were forced to sell assets. In turn, this sale reinforced a downward pressure on prices and an upward pressure on losses in the financial sector. To sum up, the accelerated and pro-cyclical deleveraging worsened the vicious cycle of losses, drop of banking capital and contraction of available credit.

Chart B.4.1

Leverage Level of Financial Systems
Tier 1 Capital as % of Total Assets
Off balance sheet expositions are not considered



Source: Financial Soundness Indicators - IMF

Therefore, the Basel III framework introduces a new leverage ratio which is known to be relatively easy to calculate, transparent as to the components and, most important of it all, independent from the perception of risk level. Nevertheless, it is worth considering that this ratio does not replace but supplements the Basel II traditional capital requirements.

This supplementary nature must be pointed out since, even though the leverage ratio makes the capitalization level of the banking system independent from requirements sensitive to risk, it does not constitute an efficient instrument for financial regulation if applied in isolation. In particular, an isolated application might lead banks to replace lower risk assets by other less secure assets but with higher yields, a situation which tends to be contrary to the interests of bank regulators and supervisors, the purpose of which is to cause the financial intermediation process to grow in a healthy and sustainable fashion.

One of the issues that the BCBS had to solve was how to incorporate the measurement of exposure, on an homogeneous and transparent basis, the leverage implicit in securities financing transactions (SFTs) and in derivatives and other off balance sheet exposures. In this respect, in July 2014 the International Accounting Standards Board (IASB) published the final version of

International Financial Reporting Standard (IFRS) 9 “Financial Instruments”. It had published partial versions before, in order to replace International Accounting Standard (IAS) 39 effective until then.

The amendment of accounting of financial instruments is one of the items of the Norwalk Agreement of 2002. On this occasion, the IASB, with international scope, and the Financial Accounting Standards Board (FASB), of the United States, agreed to progress towards a unified accounting scheme. After the outbreak of the international crisis, tasks speeded up, in particular because G20 Leaders claimed for efforts to find a common way to assess and expose financial instruments. Nevertheless, nowadays there are still certain differences, even in models for financial assets and liabilities offsetting[115].

In the event of progressing in the implementation of a universal measure to limit the leverage of banks, the manner to calculate exposure cannot be left just to the accounting system applicable in each country nor to the criterion of each institution as to how to record off balance sheet transactions. Therefore, the BCBS took the precaution to define which of such transactions have to be computed and the manner to measure exposures originated in derivative instruments and in SFTs. To assure transparency, the BCBS has established that as from 2015 banks from the adhering jurisdictions will publish, together with their financial statements, information relating to the leverage ratio and its components. The information must be posted following a default table and line format, so that any stakeholder may read and understand the contents.

In principle, the minimum leverage ratio for any ensemble of banks –applying Basel II consolidation criteria– would be fixed at:

$$\mathrm{R}atio = \frac{\text{Capital measure}}{\text{Exposure measure}} \geq 3\%$$

However, such minimum is not final since the Committee intends to assess on a semiannual basis any information provided by disclosure requirements to determine whether the calibration is appropriate throughout a whole credit cycle and for all models of banking business. The ratio will be finally determined in 2017, with a view to integrating it to Basel Pillar I (minimum capital requirement) on January 1st, 2018.

As regards the components, it must be noted that, for the time being, the capital measure may be made up exclusively by capital with the greater ability to absorb losses, i.e. Tier 1 capital. During the observation period, the Committee will also assess whether the total regulatory capital provides for a more efficient measure.

According to the definition of the rules implemented in Argentina, Tier 1 capital comprises:

1) Ordinary capital (CO_{n1}) i.e., capital stock, non-capitalized contributions and equity adjustments, statutory reserves and retained earnings. The results of the current fiscal year may be computed as a whole once the auditors’ report on the quarterly financial statements for the last fiscal year is issued and, then onwards, 100% of losses but only 50% of profits must be computed.

2) Tier 1 additional capital (CA_{n1}) consisting of debt instruments with depositors and other general creditors who prevail in the distribution of funds in case of bankruptcy only with respect to shareholders. Even though these instruments must not contemplate the repayment of capital –except in case of winding up– they may be redeemed after 5 years of issue, provided that the financial institution is authorized by the Superintendence of Financial and Exchange Institutions (SEFyC). In the event that the financial institution has a regularization and strengthening plan turned down, has an authorization to operate revoked or is subject to restructuring to defend the depositors’ interests or it is decided to recapitalize such institution with public funds or from SEDESA, these instruments must absorb the losses through a reduction or conversion into ordinary capital.

The exposure measure covers, as aforesaid, derivatives, SFTs and other assets of the balance sheet, as well as certain off balance sheet exposures.

Exposures recorded in the balance sheet, except for derivatives, are included net of specific provisions and of valuation adjustments. Loans and deposits should not be netted and the value of exposure cannot be reduced due to the existence of any real or personal guarantees or the use of risk mitigation techniques.

To calculate the exposure generated by derivatives, the Current Exposure Method (CEM) must be used which is outlined in our regulation on “Minimum Capitals of Financial Institutions.” The exposure results from the addition of the replacement cost of the contract at market price, if with a positive value, and from an additional amount for the future potential exposure during the rest of its life, which is calculated by applying a factor to the notional value taking into account the characteristics of each instrument.

[115] In the case of IASB, they are outlined in IAS 32 “Financial Instruments: Presentation” and in IFRS 7 “Financial Instruments: Disclosures.”

SFTs are transactions whose value depends on the market value of other assets and on the margins agreed upon. The most common examples in our market are repo and reverse repo transactions. The exposure measure is equal to credits originated in repo transactions (not computing securities received) plus the credit risk measure, equivalent to current exposure with each counterparty (without increases by future potential exposure).

Off balance sheet transactions are commitments to be converted into assets of the financial institution only to a proportion. Therefore, the exposure is calculated by multiplying notional amounts by the credit conversion factors (CCF) of the regulations on “Minimum Capitals of Financial Institutions,” subject to a 10% lower limit.

Finally, it should be considered that the BCRA has recently prepared and published a set of communications[116] whereby progress was made in the process of design and local implementation of this leverage ratio. On the one hand, it was established that banks have to provide the Central Bank with information on their capital and exposures —both in and off balance sheet exposures— regarding the third quarter of 2014 onwards, in order to assess their leverage level. On the other hand, publication requirements were determined for this information on leverage as from the first quarter of 2015. The analysis of such information would allow to make progress in the adjustment of regulatory and technical standards to be introduced in the next years, thus continuing with the process of local convergence to Basel III standards

[116] Communications “A” 5606 and “A” 5610.

VI. Payment System

Summary

During 2014, the Central Bank of Argentina (BCRA) continued improving the National Payment System through several measures tending to offer quicker, more secure, agile, efficient and economical means of payment and to broaden the access of the population to banking services. As a result, and as it has been observed in recent periods, the use of electronic means of payment alternative to cash continued going up.

In this context, and in line with what has happened in recent years, there was a remarkable increase in the use of bank transfers, mainly boosted by immediate transfers, which jumped 25.1 % in year-on-year (y.o.y.) terms in number during the current year, accounting for almost all the increase observed in bank transfers to third parties. As from the implementation of the regulatory changes by the Central Bank of Argentina in the second half of 2013, transfers made without fees for banking users reached 96.4% of total immediate transfers.

The number of credit and debit cards held by the public exhibited an annualized (a.) increase of 4.6% (5.1%a. and 4%a. respectively) during the first half of 2014. The growth observed in this market has been driven by the group of private banks. This performance implied a slight rise in the ratio of cards per inhabitant to 0.75 (in the case of credit cards) and 0.73 (for debit cards) by mid-2014.

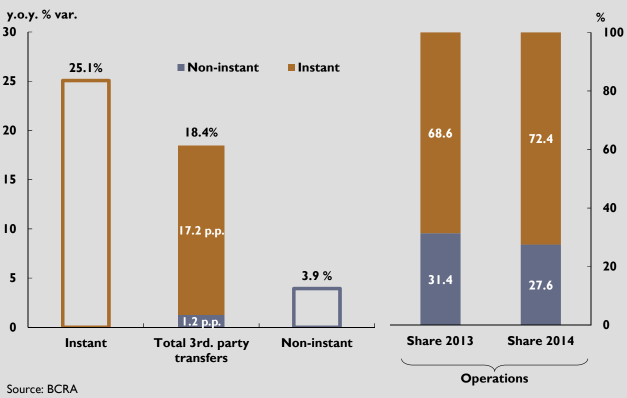
The use of checks as method of payment went down in year-on-year terms from January to August, both in terms of the number of documents cleared (-2.98%) and in the total amount cleared relative to the GDP. As a result, the trend of relative stagnation observed for this instrument in recent periods continues to prevail, evidencing some level of replacement by the online payment system.

In turn, transactions through the Electronic Means of Payment (MEP) —a high-value payment system— also expanded during 2014, in terms of both number and amount of transactions relative to GDP.

Chart VI.1

Third Party Transfers by Type

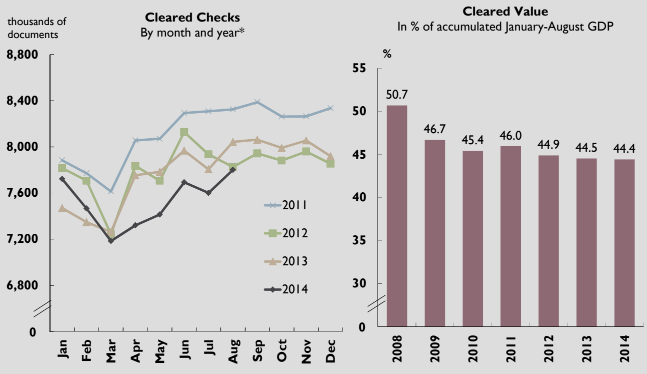
Number of operations - Accumulated January - August



Source: BCRA

Chart VI.2

Checks

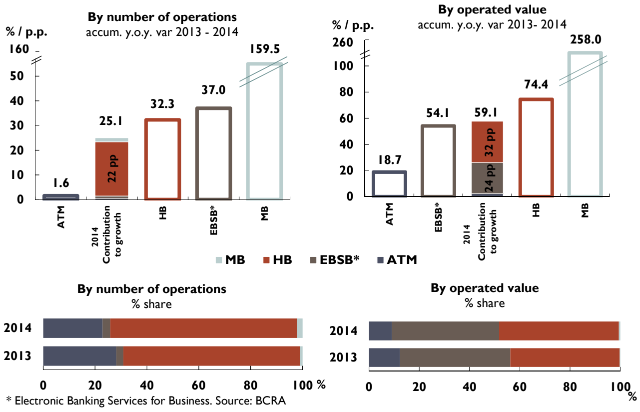


*Note: moving average three months. Source: BCRA

Chart VI.3

Instant Transfers by Channel

Accumulated January - August



* Electronic Banking Services for Business. Source: BCRA

VI.1 National Payment System

Throughout the current year, the BCRA continued improving the National Payment System (SNP) and implementing several measures with a view to ensuring the security, efficiency and reliability of the means of payment so as to expand the access of population to the banking system. As a result and following the trend observed in recent periods, the use of electronic means of payment as an alternative to cash continued widening.

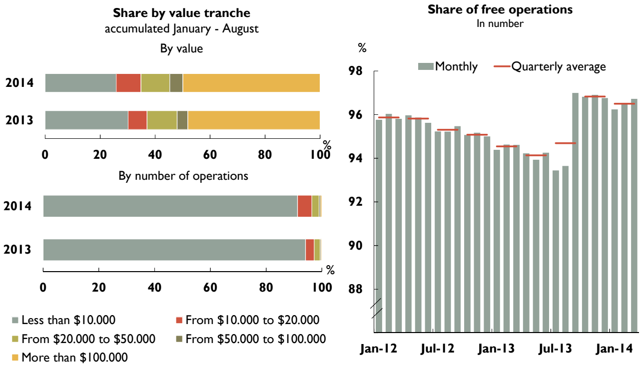
In 2014, transfers to third parties[117] continued to be on the rise though at a slower pace if compared to previous periods. The increase in terms of the number of transactions performed so far this year reached 18.4% y.o.y. (see Chart VI.I), 14.6 p.p. below the figure recorded in 2013. The same as in recent years, this rise was mainly boosted by the evolution of immediate transfers –a tool that has been especially promoted by the BCRA since April 2011. Immediate bank transfers posted a 25.1% y.o.y. growth and accounted for almost all the increase of transfers made to third parties (17.2 p.p. out of 18.4%). Consequently, during the first eight months of the year, the share of immediate transfers in total bank transfers to third parties went up 3.8 p.p. to 72.4% of total bank transfers.

As regards the different channels available to make immediate transfers, home-banking transactions stood out once again and accounted for 22 p.p. of the 25.1% y.o.y. growth in the number of immediate transactions made between January and August 2014 (see Chart VI.I3). In terms of amount, corporate banking and home banking contributed the most to the year-on-year jump in the total amount transferred, with 24 p.p. and 32 p.p. respectively, over a total change of 59.1% y.o.y during the first eight months of the current year. In turn, transfers made through ATMs recorded a lower growth pace than the immediate transfer total –both in amount and number–, thus losing share against the remaining channels. Likewise, mobile banking continued experiencing a growth pace that is quite above the average, thus increasing its share in the total, even though it still stands at low levels (2% in number and 0.6% in amount).

Immediate transfers in the low amount segment (up to $20,000) continued to be the most representative in terms of the number of transactions so far in 2014 (see Chart VI.4). Within these low amount segment, the

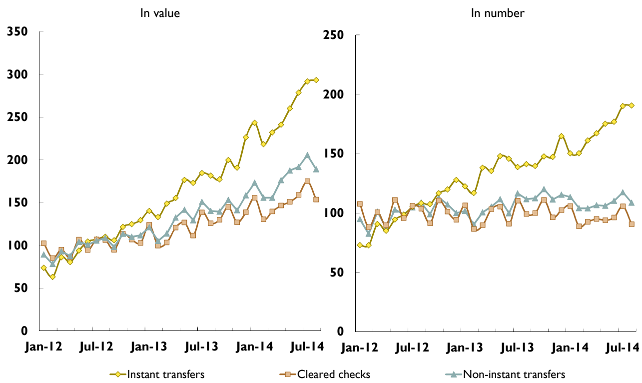
[117] Transfers made by banks on behalf and to the order of their clients, excluding wages, payments to suppliers, family allowances, pensions and retirements and garnishment of social security benefits.

Chart VI.4
Instant Transfers by Value Tranche



Source: BCRA

Chart VI.5
Use of Means of Payment's Evolution
index number / base: 2012 = 100



Source: BCRA

tranche between $10,000 and $20,000 gained share in line with the change introduced in the maximum daily amount for free-of-charge transfers, which was extended from $10,000 to $20,000 as from September 2013[118]. Therefore, the share of immediate transactions at no cost for users reached 96.4% of the total so far this year (34.9% in amount transferred), accounting for an increase of 2.3 p.p. (4.7 p.p. in amount) in aggregate between January and August.

During the first eight months of 2014, the use of checks went up 27.4% in terms of the total amount cleared while in terms of the total number of checks the year-on-year change stood at -2.9%. The reason behind this drop is a medium-term trend of gradual reduction in the use of this instrument (see Chart VI.2). The use of checks (cleared amount) exhibits a relative stagnation in GDP terms, with a slight year-on-year fall from January to August against the same period of 2013.

A comparison of the evolution of the main means of payment –alternative to cash– reveals different performances among them. Particularly, the growth pace of immediate transfers has exceeded the pace exhibited by checks and non-immediate transfers in terms of both number of transactions and amounts cleared or transferred. Taking the year 2012 as a basis for comparison –the first year of complete effective use of immediate transfers–, it can be observed that while checks and the remaining transfers to third parties have flattened in terms of number, immediate transfers have gone up remarkably (see Chart VI.5). In terms of the amount transacted, this type of transfer is also standing above the remaining means of payment under analysis.

The number of credit and debit cards continued to be on the rise during 2014[119], even though with a slight deceleration with respect to the growth pace they exhibited in previous years (see Chart VI.6). In annualized terms, there was a 4.6%a. increase in 2014 for all cards, mainly driven by credit cards which, with a 5.1%a. jump, accounted for 56% of total change. In turn, debit cards grew at a 4%a. pace during the first half of the current year. Private banks recorded once again the highest relative expansion (80.1% in credit cards and 65.9% in debit cards), and also boosted the rise in the total amount of cards so far this year. The cards/population ratio continued to increase along the year and reached 0.75 (credit cards) and 0.73 (debit cards) per person. If this ratio is compared to that of other emerging and developed nations, Argentina shows an intermediate level in the card/population ratio.

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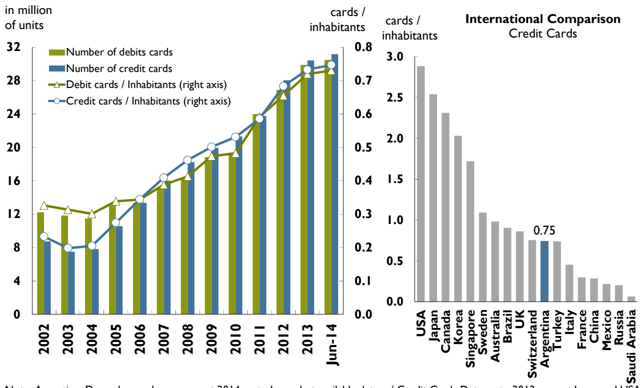
[118] See Communication "A" 5473.
[119] The latest available data correspond to June.

Chart VI.6

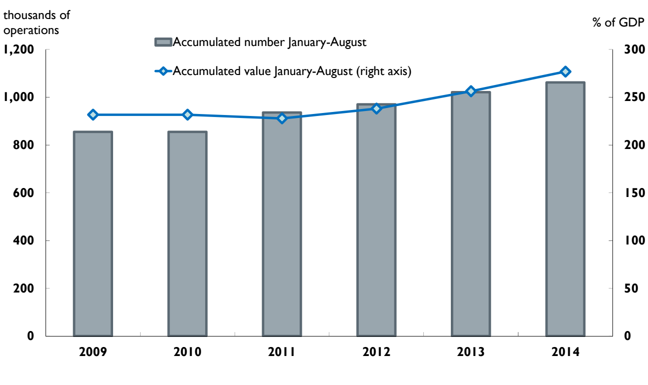
Credit and Debit Cards



Note: Argentine: December each year-except 2014 up to June - last available datum / Credit Cards Data up to 2013, except Japan and USA up to 2012, Saudi Arabia up to 2009. Source: BCRA and BIS.

Chart VI.7

Electronic Means of Payment - Peso Transactions Cleared



Source: BCRA

Transactions made through Electronic Means of Payment (MEP)[120] continued with their upward trend during the first eight months of the year, in terms of both number of transactions (4% y.o.y.) and amount transferred relative to GDP (see Chart VI.7).

VI.2 Payment System Modernization

During 2014, the Central Bank continued working on the implementation and analysis of different measures to optimize the use of electronic means of payment. To this effect, it provided new tools devoted to improving the security and efficiency of transactions.

Within this context, several changes have been introduced in the regulatory framework of the Certificates of Deposit for Investment (CEDIN) with a view to promoting their use. In this sense, changes include maximum commission fees that institutions may charge at the time of the underwriting, as well as verification and payment of such instruments so as to create incentives for their acceptance and spreading[121]. Likewise, their scope of application was also widened and new mechanisms were established so that the verification of the certificate and its application as well as collection can all be performed at the time the CEDIN is submitted. Moreover, several measures were implemented to spread information about the use of these certificates and to train the personnel in charge of effectively applying this operation[122].

In terms of the application of international standards, the Central Bank continues participating in forums regarding the "Western Hemisphere Payment and Securities Clearance and Settlement Initiative", coordinated by CEMLA, where the activities inherent in the regional integration of payment systems are dealt with. Likewise, the Central Bank continues collaborating in the analysis of new infrastructure principles for the financial markets driven by CPMI (Committee on Payment and Market Infrastructures) and IOSCO (International Organization of Securities Commissions).

[120] High-value payment system.
[121] Communication "A" 5613.
[122] Communication "A" 5628.

Statistics Annex* – Financial System

Chart 1 | Financial Soundness Indicators

As %	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009	Dec 2010	Dec 2011	Dec 2012	Aug 2013	Dec 2013	Aug 2014
1.- Liquidity	20.1	22.5	23.0	27.9	28.6	28.0	24.7	26.8	24.4	26.8	25.1
2.- Credit to the public sector	31.5	22.5	16.3	12.7	14.4	12.1	10.7	9.7	9.1	9.4	8.9
3.- Credit to the private sector	25.8	31.0	38.2	39.4	38.3	39.8	47.4	49.5	50.0	50.9	47.1
4.- Private non-performing loans	7.6	4.5	3.2	3.1	3.5	2.1	1.4	1.7	1.9	1.7	2.1
5.- Net worth exposure to the private sector	-2.5	-0.8	-1.5	-1.7	-1.3	-3.2	-4.3	-3.1	-2.7	-3.5	-2.8
6.- ROA	0.9	1.9	1.5	1.6	2.3	2.8	2.7	2.9	2.9	3.4	4.7
7.- ROE	7.0	14.3	11.0	13.4	19.2	24.4	25.3	25.7	25.4	29.5	37.4
8.- Efficiency	151	167	160	167	185	179	179	190	195	206	226
9a.- Capital compliance	-	-	-	-	-	-	-	-	13.4	13.6	14.3
9b.- Capital compliance (credit risk)	15.9	16.9	16.9	16.9	18.8	17.7	15.6	17.1	-	-	-
10a.- Capital compliance Tier 1	-	-	-	-	-	-	-	-	12.0	12.5	13.3
10b.- Capital compliance Tier 1 (credit risk)	14.1	14.1	14.6	14.2	14.5	13.0	11.0	11.9	-	-	-
11.- Excess capital compliance	169	134	93	90	100	87	69	59	71	76	84

Note: According to Communication "A" 5369, since February 2013 methodological changes in some indicators were carried out. Among others changes, risk weighing coefficients considered to determine capital requirements were redefined, concepts included in the different segments of capital compliance were rearranged and new minimum limits in terms of the Total Risk Weighted Assets (RWA) were added. A wider definition of RWA is considered since Communication "A" 5369, including not only credit risk, but also market and operational risk.

Source: BCRA

Methodological note

1.- (Minimum cash compliance at the BCRA + Other cash holding + Financial entities net credit balance by LEBAC and NOBAC repo operations against the BCRA) / Total deposits; **2.-** (Public bonds position (without LEBAC and NOBAC) + Loans to the public sector + Compensation receivable) / Total assets; **3.-** (Loans to the private sector + Leases) / Total assets; **4.-** Non-performing loans to the non-financial private sector / Loans to the non-financial private sector; **5.-** (Total nonperforming private sector financing – Private sector financing loss provisions) / Net worth. The non-performing loans includes loans classified in situation 3,4,5 and 6; **6.-** Accumulated annual results / Average monthly netted assets - % Annualized; **7.-** Accumulated annual results / Average monthly net worth - % Annualized; **8.-** (Financial margin (Net interest income + CER and CVS adjustments + Gains on securities + Foreign exchange price adjustments + Other financial income) + Service income margin) / Operating costs; **9a.-** Capital compliance / Total risk weighted assets, according to the BCRA rule on minimum capital (Com. "A" 5369). Includes exemptions; **9b.-** Capital compliance / Credit risk weighted assets. Includes exemptions; **10a.-** Capital compliance Tier 1 (net of deductions) / Total risk weighted assets, according to the BCRA rule on minimum capital (Com. "A" 5369); **10b.-** Capital compliance Tier 1 (net of total deductions) / Credit risk weighted assets; **11.-** (Capital compliance - Capital requirement) / Capital requirement. Exemptions are

*Note | Data available in Excel in www.bcra.gob.ar

Statistics Annex* – Financial System (cont.)

Chart 2 | Balance Sheet

In million of current pesos	Dec 08	Dec 09	Dec 10	Dec 11	Dec 12	Aug 13	Dec 13	Aug 14	Change (in %) 2014	Change (in %) Last 12 months
Assets	**346,762**	**387,381**	**510,304**	**628,381**	**790,026**	**911,742**	**1,004,892**	**1,188,996**	**18.3**	**30.4**
Cash disposal[1]	58,676	71,067	93,085	104,389	148,254	149,406	200,925	194,909	-3.0	30.5
Public bonds	65,255	86,318	117,951	112,906	123,491	154,122	141,494	241,932	71.0	57.0
Lebac/Nobac	37,093	43,867	76,948	71,050	84,057	107,216	89,641	186,333	107.9	73.8
Portfolio	25,652	34,748	61,855	59,664	70,569	88,780	88,091	160,653	82.4	81.0
Repo[2]	11,442	9,119	15,093	11,386	13,488	18,436	1,550	25,680	1,556.9	39.3
Private bonds	203	307	209	212	251	432	434	879	102.5	103.4
Loans	154,719	169,868	230,127	332,317	433,925	500,308	563,344	613,000	8.8	22.5
Public sector	17,083	20,570	25,907	31,346	39,951	41,576	48,438	51,436	6.2	23.7
Private sector	132,844	145,247	199,202	291,708	383,674	447,429	501,857	550,185	9.6	23.0
Financial sector	4,793	4,052	5,018	9,263	10,299	11,303	13,049	11,379	-12.8	0.7
Provisions over loans	-4,744	-5,824	-6,232	-7,173	-9,596	-11,477	-12,388	-16,027	29.4	39.6
Other netted credits due to financial intermediation	38,152	33,498	39,009	40,805	38,769	57,501	42,435	72,752	71.4	26.5
Corporate bonds and subordinated debt	912	1,146	1,433	1,657	2,255	3,505	5,421	5,199	-4.1	48.4
Unquoted trusts	5,714	5,942	6,824	7,967	10,822	12,057	12,656	12,891	1.9	6.9
Leasing	3,935	2,933	3,936	6,222	7,203	8,207	9,460	9,988	5.6	21.7
Shares in other companies	7,236	6,711	7,921	9,123	11,682	13,467	15,205	19,089	25.5	41.7
Fixed assets and miscellaneous	7,903	8,239	9,071	10,111	11,251	12,584	14,226	16,619	16.8	32.1
Foreign branches	3,153	3,926	3,283	3,525	4,354	4,918	5,611	7,220	28.7	46.8
Other assets	12,275	10,337	11,943	15,944	20,441	22,274	24,933	28,636	14.9	28.6
Liabilities	**305,382**	**339,047**	**452,752**	**558,264**	**699,205**	**803,644**	**883,889**	**1,034,033**	**17.0**	**28.7**
Deposits	236,217	271,853	376,344	462,517	595,764	680,728	752,422	861,885	14.5	26.6
Public sector [3]	67,151	69,143	115,954	129,885	163,691	185,443	202,434	209,012	3.2	12.7
Private sector[3]	166,378	199,278	257,595	328,463	427,857	490,174	544,332	644,046	18.3	31.4
Current account	39,619	45,752	61,306	76,804	103,192	110,809	125,237	141,560	13.0	27.8
Savings account	50,966	62,807	82,575	103,636	125,210	136,872	158,523	183,678	15.9	34.2
Time deposit	69,484	83,967	104,492	135,082	183,736	226,325	241,281	294,585	22.1	30.2
Other netted liabilities due to financial intermediation	57,662	52,114	60,029	76,038	75,106	92,329	92,634	126,497	36.6	37.0
Interbanking obligations	3,895	3,251	4,201	7,947	8,329	9,105	10,596	8,905	-16.0	-2.2
BCRA lines	1,885	270	262	1,920	3,535	4,524	4,693	4,620	-1.6	2.1
Outstanding bonds	5,984	5,033	3,432	6,856	9,101	12,147	14,198	17,156	20.8	41.2
Foreign lines of credit	4,541	3,369	3,897	6,467	4,992	5,157	6,328	11,732	85.4	127.5
Other	13,974	14,891	17,426	24,137	26,280	26,189	41,345	38,130	-7.8	45.6
Subordinated debts	1,763	1,922	2,165	2,065	2,647	2,997	3,425	4,158	21.4	38.8
Other liabilities	9,740	13,159	14,213	17,644	25,688	27,590	35,407	41,492	17.2	50.4
Net worth	**41,380**	**48,335**	**57,552**	**70,117**	**90,820**	**108,098**	**121,800**	**154,963**	**27.2**	**43.4**
Memo										
Netted assets	321,075	364,726	482,532	601,380	767,744	878,271	990,614	1,143,973	15.5	30.3
Consolidated netted assets	312,002	357,118	472,934	586,805	750,598	859,395	969,247	1,122,646	15.8	30.6

(1) Includes margin accounts with the BCRA. (2) Booked value from balance sheet (it includes all the counterparts). (3) Does not include accrual on interest or CER.

Source: BCRA

Statistics Annex* – Financial System (cont.)

Chart 3 | Profitability Structure

Amount in million of pesos	Annual						First 8 months		Last 12
	2008	2009	2010	2011	2012	2013	2013	2014	months
Financial margin	20,462	28,937	35,490	43,670	61,667	88,509	52,492	87,982	123,999
Net interest income	9,573	14,488	17,963	24,903	38,365	50,336	32,081	40,808	59,063
CER and CVS adjustments	2,822	1,196	2,434	1,725	2,080	2,153	1,381	3,299	4,072
Foreign exchange price adjustments	2,307	2,588	2,100	3,025	4,127	11,287	5,446	12,455	18,296
Gains on securities	4,398	11,004	13,449	14,228	17,356	22,280	13,265	27,642	36,656
Other financial income	1,362	-339	-457	-211	-261	2,454	318	3,777	5,913
Service income margin	10,870	13,052	16,089	21,391	28,172	36,503	23,507	30,233	43,229
Loan loss provisions	-2,839	-3,814	-3,267	-3,736	-6,127	-9,349	-5,387	-7,136	-11,098
Operating costs	-18,767	-22,710	-28,756	-36,365	-47,318	-60,722	-38,921	-52,228	-74,029
Tax charges	-2,318	-3,272	-4,120	-6,047	-8,981	-13,916	-8,910	-12,628	-17,635
Adjust. to the valuation of gov. Securities[1]	-1,757	-262	-214	-336	-338	-377	-243	-665	-799
Amort. payments for court-ordered releases	-994	-703	-635	-290	-274	-128	-76	-52	-105
Other	1,441	918	2,079	2,963	2,475	2,576	1,779	3,863	4,659
Total results before tax[2]	6,100	12,145	16,665	21,251	29,276	43,094	24,242	49,369	68,222
Income tax	-1,342	-4,226	-4,904	-6,531	-9,861	-13,951	-8,335	-15,945	-21,561
Total result[2]	**4,757**	**7,920**	**11,761**	**14,720**	**19,415**	**29,143**	**15,907**	**33,425**	**46,660**
Adjusted Result[3]	7,508	8,885	12,610	15,345	20,027	29,649	16,226	34,142	47,564
Annualized indicators - As % of netted assets									
Financial margin	6.7	8.6	8.5	8.0	9.2	10.3	9.7	12.3	12.1
Net interest income	3.1	4.3	4.3	4.6	5.7	5.9	5.9	5.7	5.8
CER and CVS adjustments	0.9	0.4	0.6	0.3	0.3	0.3	0.3	0.5	0.4
Foreign exchange price adjustments	0.8	0.8	0.5	0.6	0.6	1.3	1.0	1.7	1.8
Gains on securities	1.4	3.3	3.2	2.6	2.6	2.6	2.4	3.9	3.6
Other financial income	0.4	-0.1	-0.1	0.0	0.0	0.3	0.1	0.5	0.6
Service income margin	3.6	3.9	3.8	3.9	4.2	4.3	4.3	4.2	4.2
Loan loss provisions	-0.9	-1.1	-0.8	-0.7	-0.9	-1.1	-1.0	-1.0	-1.1
Operating costs	-6.1	-6.7	-6.9	-6.7	-7.0	-7.1	-7.2	-7.3	-7.2
Tax charges	-0.8	-1.0	-1.0	-1.1	-1.3	-1.6	-1.6	-1.8	-1.7
Adjust. to the valuation of gov. Securities[1]	-0.6	-0.1	-0.1	-0.1	-0.1	0.0	0.0	-0.1	-0.1
Amort. payments for court-ordered releases	-0.3	-0.2	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Other	0.5	0.3	0.5	0.5	0.4	0.3	0.3	0.5	0.5
Total results before tax[2]	2.0	3.6	4.0	3.9	4.3	5.0	4.5	6.9	6.7
Income tax	-0.4	-1.3	-1.2	-1.2	-1.5	-1.6	-1.5	-2.2	-2.1
ROA[2]	**1.6**	**2.3**	**2.8**	**2.7**	**2.9**	**3.4**	**2.9**	**4.7**	**4.5**
ROA adjusted[3]	2.5	2.6	3.0	2.8	3.0	3.5	3.0	4.8	4.6
ROE before tax	*17.2*	*29.5*	*34.5*	*36.5*	*38.8*	*43.7*	*38.8*	*55.2*	*54.3*
ROE [2]	*13.4*	*19.2*	*24.4*	*25.3*	*25.7*	*29.5*	*25.4*	*37.4*	*37.2*

(1) Com. "A" 3911. Adjustments to the valuation of government unlisted securities according to Com. "A" 4084 are included under the "gains from securities" heading.
(2) As of January 2008, data to calculate financial system consolidated result is available. This indicator excludes results and asset headings related to shares and participation in other local financial entities.
(3) Excluding amortization of payments for court-ordered releases and the effects of Com. "A" 3911 and 4084.
Source: BCRA

Chart 4 | Porfolio Quality

As percentage	Dec 05	Dec 06	Dec 07	Dec 08	Dec 09	Dec 10	Dec 11	Dec 12	Aug 13	Dec 13	Aug 14
Non-performing loans (overall)	**5.2**	**3.4**	**2.7**	**2.7**	**3.0**	**1.8**	**1.2**	**1.5**	**1.7**	**1.5**	**1.9**
Provisions / Non-performing loans	115	108	115	117	115	148	176	144	137	150	139
(Total non-perfoming - Provisions) / Overall financing	-0.8	-0.3	-0.4	-0.5	-0.5	-0.9	-0.9	-0.7	-0.6	-0.8	-0.7
(Total non-perfoming - Provisions) / Net worth	-2.6	-0.9	-1.6	-1.8	-1.7	-3.6	-4.6	-3.4	-3.0	-3.7	-3.0
Non-performing loans to the non-financial private sector	**7.6**	**4.5**	**3.2**	**3.1**	**3.5**	**2.1**	**1.4**	**1.7**	**1.9**	**1.7**	**2.1**
Provisions / Non-performing loans	115	108	114	116	112	143	171	141	134	148	137
(Total non-perfoming - Provisions) / Overall financing	-1.1	-0.3	-0.5	-0.5	-0.4	-0.9	-1.0	-0.7	-0.6	-0.8	-0.8
(Total non-perfoming - Provisions) / Net worth	-2.5	-0.8	-1.5	-1.7	-1.3	-3.2	-4.3	-3.1	-2.7	-3.5	-2.8

Source: BCRA

Abbreviations and Accronyms

AEIRR: Annual Effective Internal Rate of Return

AFJP: *Administradora de Fondos de Jubilaciones y Pensiones.*

ANSES: *Administración Nacional de Seguridad Social*. National Social Security Administration.

APE: *Acuerdos Preventivos Extra-judiciales.* Preliminary out-of-court agreements.

APR: Annual Percentage Rate.

b.p.: basis points.

BADLAR: Interest rate for time deposits over one million pesos between 30 and 35 days for the average of financial institutions.

BCBA: *Bolsa de Comercio de Buenos Aires.* Buenos Aires Stock Exchange.

BCRA: *Banco Central de la República Argentina*. Central Bank of Argentina.

BIS: Bank of International Settlements.

BM: Monetary Base. Defined as money in circulation plus current account deposits in pesos by financial institutions in the BCRA.

Boden: *Bonos del Estado Nacional.*Federal Bonds.

Bogar: *Bonos Garantizados.* Guaranteed Bonds.

BoJ: Bank of Japan.

Bonar: *Bonos de la Nación Argentina.* Argentine National Bonds.

BOVESPA: São Paulo Stock Exchange.

CAMEL: Capital, Assets, Management, Earnings and Liquidity.

Cdad. de Bs. As.: *Ciudad de Buenos Aires. Buenos Aires City.*

CDS: Credit Default Swaps

CEC: *Cámaras Electrónicas de Compensación.* Electronic Clearing Houses.

CEDEM: *Centro de Estudios para el Desarrollo Económico Metropolitano.* Study Center for Metropolitan Economic Development.

CEDRO: *Certificado de Depósito Reprogramado.* Rescheduled Deposit Certificate.

CER: *Coeficiente de Estabilización de Referencia.* Reference Stabilization Coefficient.

CIMPRA: *Comisión Interbancaria para Medios de Pago de la República Argentina.*

CNV: *Comisión Nacional de Valores.* National Securities Commission

CPI: Consumer Price Index.

CPI Others: *CPI excluidos los bienes y servicios con alta estacionalidad, volatilidad o los sujetos a regulación o alto componente impositivo*. CPI excluded goods and services with high seasonal and irregular components, regulated prices or high tax components

Credit to the public sector: includes the position in government securities (excluding LEBAC and NOBAC), loans to the public sector and compensation receivable.

CVS: *Coeficiente de Variación Salarial.* Wage variation coefficient.

DGF: Deposit Guarantee Fund.

Disc: Discount bond.

EB: Executive Branch.

ECB: European Central Bank.

EMBI: Emerging Markets Bond Index.

EMI: *Estimador Mensual Industrial.* Monthly Industrial Indicator

EPH: *Encuesta Permanente de Hogares.* Permanent Household Survey.

Fed: Federal Reserve of US.

FOMC: Federal Open Market Committee (US).

FS: Financial Stability.

FSR: Financial Stability Report.

FT: Financial trust.

FUCO: *Fondo Unificado de Cuentas Corrientes Oficiales.* Unified Official Current Account Fund.

FV: Face value.

GDP: Gross Domestic Product.

HHI: Herfindahl-Hirschman Index.

IADB: Inter-American Development Bank.

IAMC: *Instituto Argentino de Mercado de Capitales.*

ICs: Insurance Companies.

IDCCB: *Impuesto a los Débitos y Créditos en Cuentas Bancarias*. Tax on Current Account Debits and Credits.

IFI: International Financial Institutions: IMF, IADB and WB.

IFS: International Financial Statistics.

IMF: International Monetary Fund.

INDEC: *Instituto Nacional de Estadísticas y Censos.* National Institute of Statistics and Censuses.

IndeR: *Instituto Nacional de Reaseguros.* National Institute of Reinsurance.

IPMP: *Índice de Precios de las Materias Primas*. Central Bank Commodities Price Index.

IPSA: *Índice de Precios Selectivo de Acciones*. Chile Stock Exchange Index.

IRR: Internal Rate of Return.

ISAC: *Índice Sintético de Actividad de la Construcción.* Construction Activity Index.

ISDA: International Swaps and Derivates Association.

ISSP: *Índice Sintético de Servicios Públicos.* Synthetic Indicator of Public Services.

Lebac: *Letras del Banco Central de la República Argentina.* BCRA bills.

LIBOR: London Interbank Offered Rate**.**

m.a.: Moving average.

M2: Currency held by public + quasi-monies + $ saving and current accounts.

M3: Currency held by public + quasi-monies + $ total deposits.

MAE: *Mercado Abierto Electrónico*. Electronic over-the-counter market.

MAS: Mutual Assurance Societes.

MC: Minimum cash.

MEC: Electronic Open Market.

MECON: Ministerio de Economía y Producción. Ministry of Economy and Production.

MEP: *Medio Electrónico de Pagos*. Electronic Means of Payment.

MERCOSUR*: Mercado Común del Sur***.** Southern Common Market.

MERVAL: *Mercado de Valores de Buenos Aires.* Executes, settles and guarantees security trades at the BCBA.

MEXBOL: *Índice de la Bolsa Mexicana de Valores.* México Stock Exchange Index.

MF: Mutual Funds.

MIPyME: *Micro, Pequeñas y Medianas Empresas.* Micro, Small and Medium Sized Enterprises.

MOA: *Manufacturas de Origen Agropecuario.* Manufactures of Agricultural Origin.

MOI: *Manufacturas de Origen Industrial.* Manufactures of Industrial Origin.

MP: Monetary Program.

MR: Market rate.

MRO: *Main refinancing operations.*

MSCI: Morgan Stanley Capital International.

NA: Netted assets.

NACHA: National Automated Clearinghouse Association.

NBFI: Non-Bank Financial Institutions (under Central Bank scope)

NBFI : Non-Bank Financial Intermediaries (out of Central Bank scope)

NDP: National public debt.

NFPS: Non-financial national public sector's.

Nobac: *Notas del Banco Central*. BCRA notes.

NPS: National Payments System.

NW: Net worth.

O/N: Overnight rate.

OCT : *Operaciones Compensadas a Término***.** Futures Settlement Round.

OECD: Organization for Economic Co-operation and Development.

ON: *Obligaciones Negociables*. Corporate bonds.

ONCCA: *Oficina Nacional de Control Comercial Agropecuario*

OS: *Obligaciones Subordinadas*. Subordinated debt.

P / BV : Price over book value.

p.p.: Percentage point.

Par: Par bond.

PGN: *Préstamos Garantizados Nacionales.* National Guaranteed Loans.

PF: Pension Funds.

PPP: Purchasing power parity.

PPS: Provincial public sector.

PS: Price Stability.

PV: Par Value.

q.o.q: quarter-on-quarter % change.

REM: BCRA Market expectation survey.

ROA: Return on Assets.

ROE: Return on Equity.

Rofex: Rosario Futures Exchange.

RPC: *Responsabilidad Patrimonial Computable*. Adjusted stockholder's equity, calculated towards meeting capital regulations.

RTGS: Real-Time Gross Settlement.

s.a.: Seasonally adjusted.

SAFJP: *Superintendencia de Administradoras de Fondos de Jubilaciones y Pensiones.* Superintendency of Retirement and Pension Funds Administrations.

SAGPyA: *Secretaría de Agricultura, Ganadería, Pesca y Alimentos.* Secretariat for agriculture, livestock, fisheries, and food.

SEDESA: *Seguro de Depósitos Sociedad Anónima.*

SEFyC: Superintendence of Financial and Exchange Institutions.

SIOPEL: *Sistema de Operaciones Electrónicas.* Trading software used on the over-the-counter market.

SME: Small and Medium Enterprises.

SSN: *Superintendencia de Seguros de la Nación.*

TA: *Adelantos transitorios del BCRA al Tesoro*. Temporary advances.

TD: Time Deposits.

TFC: Total financial cost.

TGN: *Tesorería General de la Nación.* National Treasury

UFC: Uniform Federal Clearing.

UIC: Use of Installed Capacity.

UK: United Kingdom.

US$: United States dollar.

US: United States of America.

UTDT: Universidad Torcuato Di Tella.

VaR: Value at Risk.

VAT: Value added Tax.

WB: World Bank.

WPI: Wholesale Price Index.

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