Central Bank of Argentina

Report on BANKS

SEPTEMBER 2003

Year 1 - No. 1

CONTENTS

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Based on information available as of October 29, 2003

Summary

- In the first nine months of 2003 netted assets held by private banks fell 5% in real terms, while in September there was no significant variation.
- Funds obtained by private banks, basically from deposits ($465 million), were used for the purchase of Central Bank bills (Lebac), to increase holdings of liquid assets and settle other liabilities. The total for lending to the private sector remained constant.
- Liquidity indicators are at high levels in historical terms (28%), having increased significantly in 2003.
- Foreign currency mismatching exposure remained stable over the course of the year, with a significant difference between groups of entities.
- The gap between indexed assets and liabilities increased in 2003 as a result of the drop in volume and replacement of CEDRO certificates.
- Lending to the public sector totals 48% of total netted assets, will little change over the course of 2003.
- Given the decline in non-performance and the rise in the coverage ratio, exposure of net worth to private sector credit risk fell 1.7 p.p. in September, for a total in the year to date of 4 p.p. There continues to be a significant disparity between homogenous groups.
- In 2003 losses were reduced systematically, leading to a ROA for the third quarter 2.5 p.p. higher than that for the first half of the year.
- Losses reported in September by private banks were equivalent to 4.2% of netted assets in annualized terms.
- Results for the month under review reflect in particular the impact of the appreciation of the peso and the lack of recovery in interest margins.
- There has been a notable diversity in profitability in bank groups defined on the basis of type of business. In particular, retail banks with a regional scope recorded positive figures in the third quarter (ROE of 3.5%)
- Given the changes noted in the principal variables for the economic context, the improvements registered in comparison to the first half of this year are likely to be maintained in October 2003.

The purpose of this report is to provide a *monthly update* of the information available on the banking sector, highlighting the principal changes in relevant variables defining its situation. The description concentrates on the private bank segment – with a breakdown by homogeneous sub-group – although information is provided on the official bank segment in the case of certain variables. To be able to provide an annual perspective, this first issue of the report evaluates the development of the principal variables in the first nine months of 2003.

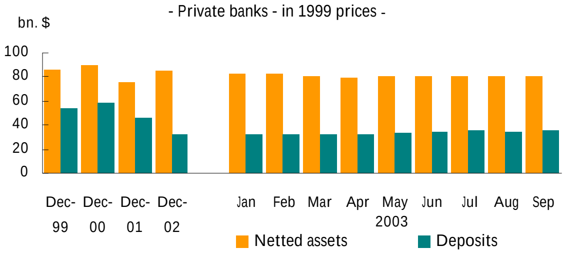
Context

1. With the aim of providing a context for the changes that have taken place in the banking sector during September 2003, details are provided of the behavior of the principal macroeconomic indicators influencing the financial intermediation process. The Consumer Price Index (CPI) remained stable, with a monthly variation of only 0.04 percentage points (p.p.), with a similar performance by the Reference Stabilization Coefficient (CER), which recorded a rise from 1.443 to 1.445 between ends. The local currency appreciated by 1.4% against the US dollar between the ends of August and September – the reference $/US$ exchange rate fell from 2.95 to 2.91. In the same period the local currency depreciated 1% against the Brazilian real and 4.5% against the euro. The financial market continued to evidence a significant level of liquidity, reflected in the continued low level recorded by benchmark interest rates. In effect, cut-off rates on 3-month Central Bank Bills (LEBAC) in pesos dropped from 4.2% at the end of the previous month to 3.5% at the end of September, while fixed term interest rates for 30-44 day deposits remained almost unchanged at the levels recorded in August (4.5%).

Activity level and flow of funds

Netted assets and deposits

- Private banks - in 1999 prices -



2. The level of banking service activity, measured by consolidated netted assets, did not record a significant variation in real terms – deflated according to the IPC – between August and September 2003. In 2003 to date, the banking sector recorded a significant decline in real terms in the balance of its asset portfolio, which fell by 4.5% (-$8.0 billion) between September this year and December 2002, largely a reflection of the effects of the nominal appreciation of the peso (16%) and retail inflation (2.6%) recorded during the period[1]. In the same period, the decline in the level of intermediation in the private banking sector was more marked (-6%), while in the case of official entities the decline was only 1.3%. This differential behavior was translated into an increase of one p.p. in the participation of this latter group in total banking assets – 38% in September 2003.

3. On the basis of aggregate information from the financial statements submitted by the entities, total deposits for the consolidated banking system increased 1% ($960 million) in September. In terms of the performance in the first nine months of 2003, it can be seen that these deposits increased by 19% in nominal terms and 16% at constant prices. Considering the private sector alone, these deposits recorded a variation in the month under analysis of 0.8% in current prices, while between December 2002 and September 2003 they recorded an increase of 12% and almost 9% in current and constant prices respectively. The corresponding variations for 2003 to date in relation to the official banking sector were 30% and 27%,

[1]Excluding the effect of the real appreciation of the peso, consolidated assets record an increase of 2% in the first nine months of 2003.

with an increase in their participation in total system deposits of 4.p.p. (almost 44% in September 2003).

4. Next, an estimate is provided of the principal flow of funds by the private banks segment[2]. The main reason for presenting this report is that these movements, by influencing the composition of assets and liabilities, lead to changes in the exposure to certain risks – private and public sector lending, liquidity, mismatching, etc. – impacting on the profitability of the sector.

5. In the aggregate, the private banking segment gained funds in September, basically from a rise in deposits from the private non-financial sector, a reduction in its participation in financial trusts and increased net borrowing from the rest of the financial system. These resources were applied to the purchase of Central Bank bills, to increasing holdings of liquid assets, and to a lesser extent, to the settlement of foreign lines of credit, corporate bonds and subordinated obligations, and net payments for current transactions. Loans to the private non-financial sector in particular, after isolating the effect of variations not related to genuine movements of funds, did not record any significant net total change during September 2003, although certain lines did record a positive movement.

Estimated sources and uses of funds

Private Banks - September 2003

In millions of pesos

Source		Use	
Private sector deposits	465	LEBAC	455
Unquoted trusts	95	Liquid Assets	260
Financial sector (net)	90	Foreign lines, bonds and sub. debt	110
Other credit due to financial intermediation, sundry	60	Current net outflows	50
Other net liabilities	165		

6. In terms of the items representing a source of funds for the private bank aggregate in the month under review, mention should be made of the movement recorded by deposits. Following a negative performance in August, deposits originating from the private sector contributed approximately $465 million, mainly reflecting the positive behavior of total term deposits ($730 million). This performance arose from a heterogeneous behavior within the private bank segment, as half these entities recorded an increase in such deposits. Within this sub-group, 70% increased the balance of their lending to the private sector, allocating an average of 60% of the funds from that source.

7. As regards uses, increased holdings of LEBAC bills – generally for longer terms – were the principal use of the funds gained during September, accounting for almost $450 million[3]. This policy, adopted by a significant number of entities, is consistent with the very comfortable liquidity position that existed. In a similar manner, the next most important use of funds was the increase that took place in liquid assets, in which private banks applied $260 million. Within this heading, the widespread rise in foreign currency balances in the current accounts of the larger private banks held at the Central Bank explained much of the total increase for the segment. Lastly, a small number of private banks repaid foreign credit lines, corporate bonds and subordinated debt for slightly over $100 million in September – an estimate arrived at following exclusion of the effect of exchange rate movements[4].

8. Continuing with analysis of the private bank segment, although as indicated the total level of lending to the private non-financial sector recorded no change in September, short term consumer credit – basically in the form of credit card lending – rose for the second month in a row, with an increase in the last two months equivalent to 10% of the balance at July 2003. In addition, the balance of this variable in terms of the total for the

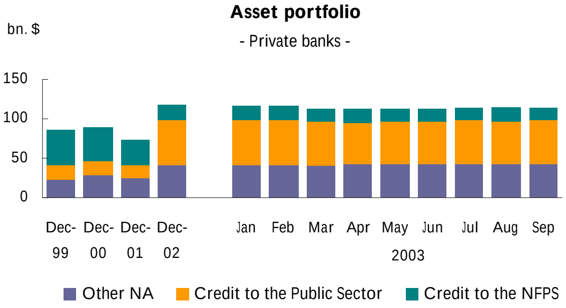
[2] For the criteria used in the preparation of this report, see the note on methodology.

[3] In addition, it should be noted that the participation by the official banking sector in the primary market for LEBAC did not result in any significant variation in their total holdings during September.

[4] It should be noted that almost all the aggregate variations recorded during the month under the headings of Government Securities -excluding holdings of Lebac- and Loans to the non-financial public sector have been due to the recording on the books of the exchange of provincial debt for national government debt.

year has also risen by 3% compared to the total at the end of 2002 – excluding the effects of the change in the exchange rate. As regards official bank lending to the private sector, note should be taken of the incipient increase recorded in overdraft balances (3%) and personal loans (4%, including credit cards).

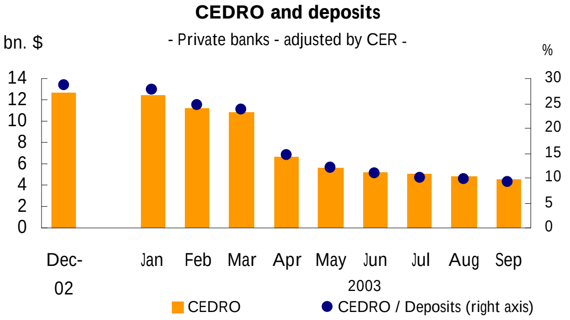
Balance sheet structure



9. In terms of private bank **asset structure**, there has been a notable increase in the share of total netted assets (NA) accounted for by lending to the public sector, which totaled approximately 48% in September 2003 – 52% if holdings of Lebac were to be included[5] – with no significant variation over the course of the year. Loans to the private non-financial sector accounted for close to 20% of NA in the month under review, showing a drop of 2.5 p.p. in their share of the total since December 2002. Grouping private sector financial entities together according to the scope of their operations, it can be seen that there has been a certain disparity regarding the proportion of lending to the public and private sectors. In the case of private banks operating nationwide, lending to the public sector accounted for 53% of their NA at September 2003, whereas only 29% of the assets of specialized private banks were to be found in the public sector in that month. In the case of this latter group of banks, private sector lending represented 55% of their assets, well above the percentage recorded for the rest of the private banks. As will be seen later, this significant difference in the composition of assets is one of the main causes for the disparity recorded in the profitability of private sector banks.

10. The total balance of private bank **liquid assets** remained stable as a share of NA – at around 12%[6], or 2.6 p.p. above the share in 2002. In the case of sub-groups of regional banks and those classified as wholesale, the liquid component of assets was greater – at almost 17% and 18% respectively. Lastly, other receivables from financial intermediation and the rest of the assets for the aggregate private bank segment have remained at their August levels, at close to 6% and 15% of the total respectively.

11. After the changes recorded since December 2001, the **funding structure** (liabilities plus net worth) has continued to recover steadily towards its historical structure. Although in September deposits maintained their weighting compared to the previous month (44% of total assets) this ratio has risen by 6,1 p.p. in the year to date. Central Bank liabilities accounted for 15% of total funding in the first nine months of the year for the private bank aggregate, the same percentage as in August and only 0.7 p.p. higher than in December 2002. At the same time, the joint share accounted for by foreign credit lines, corporate bonds and subordinated debt recorded a drop of 4.5 p.p. in 2003 to date, in September representing 19.3% of the total of liabilities and net worth for the private bank total. This drop reflects both the appreciation of the peso during the current year and the decline of the amount in dollars (-10%).



12. During 2003 the Executive Branch and the Central Bank continued their joint efforts to return the financial system to normal[7]. In particular, one of the main concerns, for both the authorities and the market, involved the impact on liquidity of the payments derived from the maturity of the CEDRO rescheduled deposits. In 2003 in particular, the acceptance of

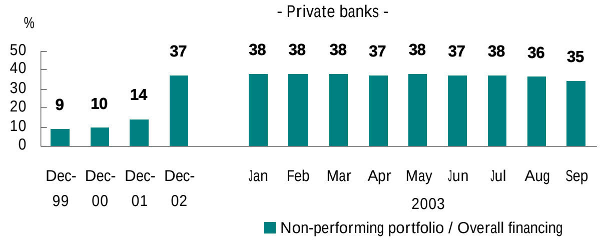
[5] Estimated on the basis of information from the SisCen.
[6] If Lebac holdings were to be included, the share accounted for by liquid assets thus defined would total 16% of assets.
[7] For further details on the performance by rescheduled deposits during 2002, refer to the 2002 edition of the Bulletin of Monetary and Financial Affairs available in English at www.bcra.gov.ar.

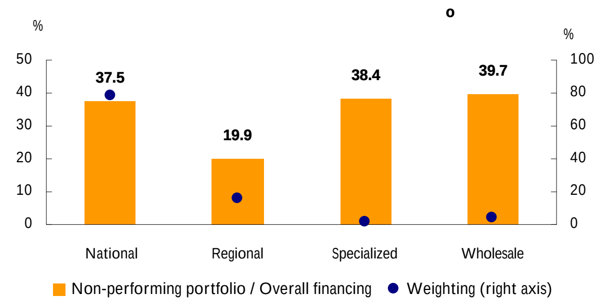
various government proposals significantly limited the level of underlying uncertainty in relation to the maturity of a large balance of deposits. The advance return of these CEDRO certificates promoted by a large group of entities – centered on the month of February – and the Canje III exchange proposal – mainly in April – resulted in a drop in the ratio of CEDRO certificates to total deposits of 20 p.p., to a level of 9% in September 2003. Lastly, as informed in detail below, it should be noted that the behavior of this variable was influenced by the release from rescheduling as a result of court orders.

Credit, liquidity, and currency mismatching risk

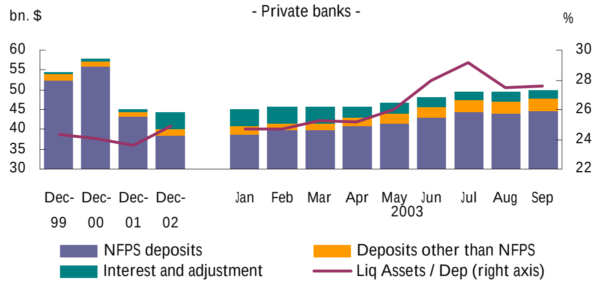
Non-financial private sector portfolio quality

- Private banks -





Deposits and liquidity



13. In terms of asset quality, at September 2003 an improvement was observed in the **non-performance of the portfolio of loans** to the private non-financial sector granted by the private bank segment. This indicator fell 1.6 p.p. compared to August, to a level of 34.8%. Observing the behavior over 2003 to date, after reaching a peak (38%) in the early months of the year, the level of non-performance began to decline slowly, so that by the month under review it had fallen by 2.6p.p. in relation to December 2002[8]. The levels recorded by this indicator during 2003 mainly reflect the impact of changes in the macroeconomic context.

14. Both the level and the changes in the quality of the loan portfolio record a significant disparity within the sector. The sub-group of retail banks with a national scope – those with the largest weighting – at the end of September recorded a non-performing level of 37.5% for their portfolio of lending to the non-financial private sector, with a 1.3p.p. decline in this ratio in the first nine months of 2003. In a similar manner, the non-performance of specialized banks and wholesale banks increased close to 2 and 6p.p. respectively in comparison to December 2002, until reaching a level of 38.4% in the first group and 39.7% in the second. On the other hand, regional banks recorded a marked improvement in the quality of this type of lending, as their non-performing ratio fell almost 9p.p. in the first nine months of the year, to a level of 19.9%, making it the sub-group with the best portfolio quality. Lastly, in September official banks recorded the highest level of non-performance for their portfolio exposed to the non-financial private sector (52%), almost 7p.p. above the non-performing level recorded at the end of 2002.

15. Given the behavior observed in the balances for liquid assets and private bank deposits, **systemic liquidity indicators** for the month under review remained stable compared to the previous period. The liquid assets to total deposits ratio reached a level of approximately 28% in September 2003, almost 3 p.p. above the level recorded at December 2002[9].

16. Breaking down liquidity by currency, it can be seen that 85% of the growth in foreign currency deposits in private banks in September for the equivalent of US$100 million (9.4%) was used to increase the balance of liquidity in dollars, causing it to rise by 6.0%, so that the **liquidity ratio in dollars** stood at 130%. In the first nine months of 2003, the private banks aggregate evidenced a slow but steady policy aimed at gaining deposits in

[8] It should be noted that if the effect of changes in balances from the writing-off from the balance sheet (and recording in memorandum accounts) of loans classified as unrecoverable were to have been excluded from the non-performing indicator, the ratio would have remained stable at around 37% between December 2002 and September 2003. In addition, if the non-performing portfolio were to include loans classified in category 2.b -under negotiation with special monitoring or subject to refinancing agreement- the resulting indicator would have risen from 39.1% to 39.4%.

[9] See Glossary for a definition. If Lebac holdings were to be included in the definition of liquid assets, the liquidity ratio would rise to 37% in September 2003, almost 6 p.p. higher than the level recorded in December 2002.

dollars – resulting in an increase of close to 130%. As in the case of September, during the remaining months of the year a large part of the funds obtained in this form were not used to finance foreign trade activities, leading to an annual rise in liquid assets in dollars of over 100%. On the whole, the private bank segment continued with this strategy, which provided it, at a relatively low cost[10], with liquidity cover for the expected outflow of CEDRO deposits following court orders.

17. The **structure of private bank deposits** in September 2003 according to their contractual demand terms recorded no major change compared to the previous month, with a drop of only 1 p.p. in the share accounted for by sight deposits – current account and savings account balances – to a level of 42% of the total. Nevertheless, on the basis of the figures for the year to date, these deposits have increased their relative importance by almost 5 p.p. – following a variation in terms of constant currency of 25%, compared to approximately 10% for total deposits.

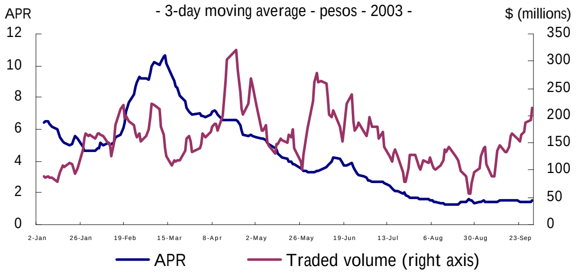
Minimum cash position

- as a share of group deposit totals -

18. In terms of the evaluation of liquidity levels in the context of the prudential regulations in force, at September private banks recorded an **excess in their minimum cash position** equivalent to 5% of total deposits – in other words, compliance was one third higher than the corresponding requirement. Official banks recorded an excess in their liquidity position of slightly more than 6% of the segment's deposits. During 2003 excess compliance by the private bank segment remained relatively unaltered, while in the case of official banks, the difference between levels of compliance and requirement grew significantly, with a notable increase in compliance of 10p.p. of deposits.

Call money between private banks

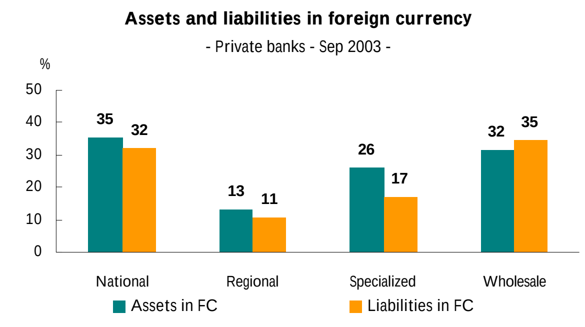
- 3-day moving average - pesos - 2003 -



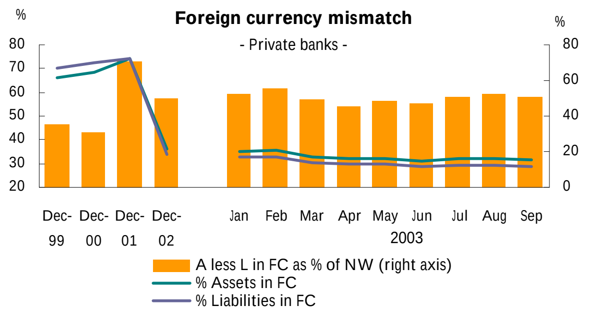
19. In view of the comfortable liquidity position shown by the system, the **call money market** continued to record historically low interest rates, with an increase in the monthly value of trades on the basis of specific daily needs of a reduced number of entities. Throughout September, interest rates for these loans stood at close to 1.5%, similar to those of the previous month and significantly lower than the maximums for the year recorded in March (averaging 11%). In the month under review the average daily trading volume ($150 million) was higher than in August and July, although lower than in the second quarter of the year – when the average was 30% above current levels. It should be noted that only 8 entities accounted for an average of 85% of the loan requests.

20. Volumes traded on the **secondary LEBAC market** recorded a rising trend in recent months, influencing the liquidity of these instruments, and as a consequence contributing to improving entity loan portfolio management policies. Average volumes traded on this market increased strongly in comparison to August, growing from approximately $31 million to $82 million in September. This increase was driven by various factors. Both the high level of bank liquidity – reflected in the ratio between tenders for the purchase of Lebac bills on the primary market and the level of bills awarded – and the active participation by the Central Bank favored transactions on the secondary market. This was particularly evident from the growth in the volume traded on the Electronic Open Market (MAE), which handled demand not satisfied by the primary market. In September the Central Bank began to intervene in the secondary market by means of the LECE sessions created for Lebac trading, providing the market with liquidity.

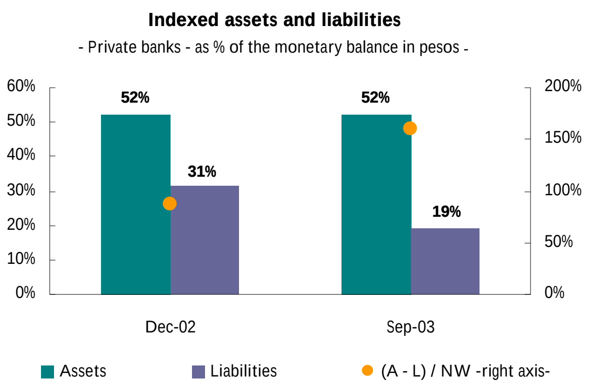
[10] As an example, it can be said that in September the monthly average interest rate for term deposits for 30 to 44 days in pesos was 4.5%, while for placements in dollars it was 0.7%.



21. The structure of private sector bank balance sheets on the basis of currency at the end of September 2003 did not show any significant change in comparison to the previous month, with 32% of assets and 29% of total liabilities in foreign currency items – valued in local currency for balance sheet disclosure purposes[12]. Compared to December 2002, these figures have represented a lower relative weight for assets and liabilities, as at that time they accounted for 36% and 34% respectively. It should be noted that almost 70% of the asset items in foreign currency in September corresponded to the public sector (basically securities and compensation to be received). The largest liability item was accounted for by foreign credit lines, followed by corporate bonds and subordinated loans, which together accounted for 34%. Here too there was a marked disparity within the private bank group, being one of the factors leading to a different profitability and risk structure for each entity. In particular, private regional banks have recorded the lowest percentages of assets and liabilities in foreign currency.



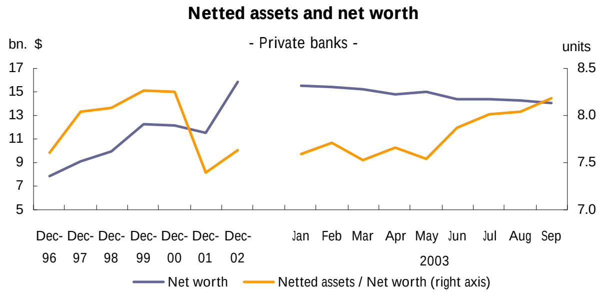
22. Total private sector foreign currency mismatching – defined in this instance as the difference between the total balances of assets and liabilities denominated in foreign currency[11] – at the end of September amounted to approximately US$2.5 billion, a level similar to that recorded in August and only slightly higher than the level at the beginning of the year (US$2.4 billion). Measurement of this global difference in terms of Net Worth – an approximation of the exposure of net worth to mismatching – shows that this indicator reached almost 51% (similar to the level at December 2002). Slightly more than 80% of the absolute amount of private bank mismatching is explained by the performance of retail entities with a national reach, for which the mismatching has represented slightly more than 70% of their NW. At the other end of the scale, regional banks recorded a mismatching amounting to only 22% of their NW.

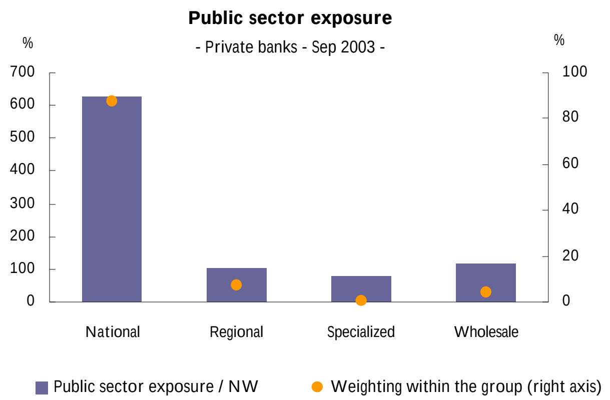


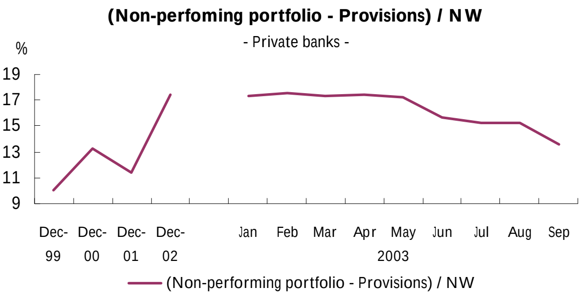
23. In the case of the net position in monetary assets in pesos restated by the CER or CVS indexes, it should be noted in the first place that the figures estimate here, based on balance sheet information, do not include the effects of the Central Bank rediscount settlement procedure laid down by Decree No.739/03[12], as the operation had not yet been consummated. Therefore, reflecting mainly the effect of the replacement of funding by means of CEDRO deposits, in the year to date private banks have recorded an increase in the gap between index-linked monetary assets and liabilities – in pesos – (CER and CVS). Monetary liabilities in pesos restated by the CER went from accounting for 31% to close to 19% of the total in the period, increasing by over 60% the difference between indexed assets and liabilities. Measured in terms of net worth, it is estimated that mismatching increased from 87% to 160% between the months analyzed. Lastly, if restated liabilities were to include all the Central Bank liabilities subject to the application of Decree 739/03, the mismatching in indexed pesos would be relatively stable over the course of the year – the proportion of indexed liabilities would total 33% in September, while the mismatching in terms of Net Worth would total around 90%.

[11] This is not the same as the regulatory definition of the global foreign exchange position, calculated on the basis of assets and liabilities from banking business and securities in foreign currency, estimated on the basis of adjusted stockholders' equity (Com. "A" 3889).

[12] At the date of writing this report, the terms for complying with the requirements laid down to be able to participate in the procedure established in the mentioned decree had not yet expired.







Solvency

24. On the basis of the information available at the time of writing this report, and until compliance with minimum capital requirements is reintroduced in 2004, certain indicators of a general nature have been included here to contribute to the analysis of the evolution of **banking system solvency**. At September 2003 netted assets for the aggregate banking system were equivalent to 8.4 times its net worth, with a monthly rise in this leverage measure of 0.3p.p. compared to August. On the basis of a historical comparison, the above ratio is higher than those at the end of 2002 and 2001 – which were 7.1 and 6.7 times respectively. In turn, the monthly variation in the leverage indicator for the private bank segment[13] was similar to that for the total of the system, while analysis from a historical perspective shows that after the reduction seen in 2001 there was a trend towards alignment with the level of the 90s. Lastly, it can be seen that on the basis of the market variance in the above indicator among banks, retail entities with a national scope recorded a level of netted assets of close to 12 times net worth, while the same ratio for wholesale and financial non-banking entities was in the order of two times.

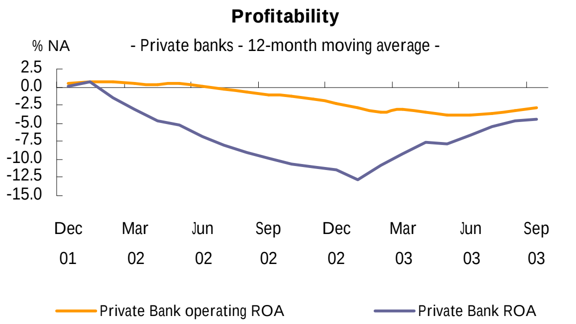
25. **Exposure to net worth to public sector credit risk** –estimated on the basis of the ratio between the sum of loans to the public sector plus government securities and Net Worth – at September represented 392% in the case of private banks, while in August it was 380%. This variation is almost entirely explained by a drop in NW (3%), as a result of the losses recorded in the month by this group of banks. This ratio has increased 20 p.p. in 2003 to date. It should be noted that there are very different levels of exposure to the public sector among the various bank categories. Regional banks were below the aggregate in September, with levels of less than 100% of its NW; in the case of private banks with a national reach, exposure exceeded 600% of its NW.

26. In the case of net worth exposure to counterpart risk in relation to the private non-financial sector, at September 2003 the portfolio of non-performing loans by private banks not covered by allowances fell by 1.7p.p. of net worth compared to the previous month to a level of 13.6%. In line with the gradual return to normal of the financial system, over the course of the first 9 months of 2003 this exposure has recorded a slow decline, at September standing at a level of almost 4p.p. below that of December last year. On the other hand, 78.4% of non-performing loans by private banks to the private non-financial sector were covered by allowances in the month in question, an increase in this coverage of 4.p.p. compared to the end of 2002. In terms of the guarantees for these loans, at September 2003, 24% of the loans to the private non-financial system were secured with preferred or self-liquidating preferred guarantees, a drop of 2p.p. in comparison to December 2002.

27. **Exposure to private sector counterpart risk** was uneven across the various bank sub-groups. Whereas retail banks with a national reach recorded a level of exposure of 22.3%, higher than the average for the aggregate, this indicator was much lower in the case of regional banks (2%) and wholesale banks (5%) in September 2003. The same discrepancy was evident in the ratio of allowances to non-performing loans to the private non-financial sector: regional banks recorded the highest coverage (91%) while wholesale banks recorded the lowest (75%).

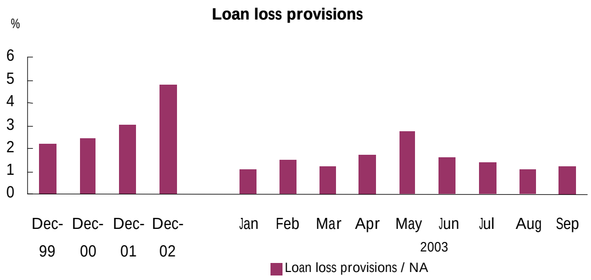
[13] In this case, the group of private entities excludes one entity which over the historical period analyzed was transformed from an official entity into a private bank, which had levels of netted assets and net worth that significantly affected the leverage defined here.

Profitability

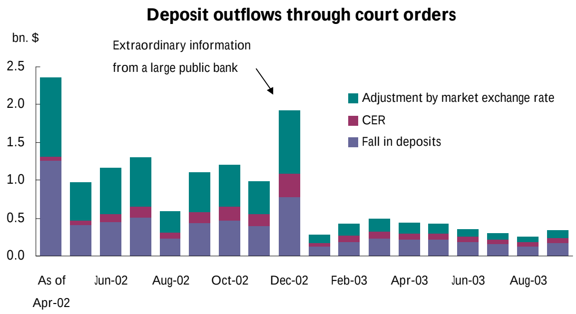


28. During September 2003, financial entities recorded book loses of close to $400 million, a reduction of close to 40% in negative results compared to the monthly average for the first half of the year. September losses – on an annualized basis – were equivalent to 2.8% of netted assets (NA) and 23.5% measured in terms of net worth (NW). The private bank segment recorded higher losses than the system as a whole, with negative results equivalent to 4.2% of NA and 35.3% of NW for the segment. On the basis of a quarterly comparison, both the private bank segment and the banking system in general has shown an improvement in results. In particular, the growth in profitability between the second and third quarters of 2003 for the private bank total amounted to 3.7p.p. of NA and 27.3p.p. of NW.

29. As indicated previously, banking entities are exposed to the risk from currency mismatching. The results for the month have recorded the effects of the reduction in the rate of exchange. In September, as a result of the significant net supply of dollars from foreign trade transactions, an appreciation of the Argentine peso of 1.4% took place. As a consequence, given the aggregate mismatching recorded by private banks, this movement was translated into an accounting loss[14] of almost 1.1% of NA. This negative result compares to the exchange difference gain of – 0.6p.p. of NW during August.



30. The cost related to exposure to counterpart risk contributed to a worsening of aggregate profitability during September. While in August loan loss provisions were close to 1.1% of NA, in the month under review they reached 2.3%. This behavior was largely influenced by the actions of a single major foreign bank[15]. Excluding this entity, loan loss provisions in September fell to 0.6% of NA, compared to the average of 1.6% recorded in the first half of 2003. Consequently, on an overall basis, the relatively favorable performance of loan loss provisions would be continuing to reflect the recovery and increasing provisions for the private sector loan portfolio – especially in the case of entities with a large exposure to the corporate sector – that began in mid-2001, and the changes made through to the end of 2002 in relation to debtor reclassification, and the recovery of the domestic economy. This situation was reflected in the "Sundries" heading that records the effects of the release of provisions – accounted for by 3 entities with a nationwide scope – enabling a higher profit to be recorded of 1.9 p.p. of NA compared to the previous month.



31. In addition, the "Other" heading reflects the losses from the monthly amortization of amounts capitalized because of disbursements in payment of court orders in relation to the conversion of deposits into pesos and their rescheduling. On this line, the negative results for the private bank segment involved from the above item amount to the equivalent of 0.8% of NA. Although the outflow of deposits from court orders continues, the marginal contribution from the amounts withdrawn does not generate any substantial increase in the figure mentioned. During 2002 the effect on average monthly liquidity from the payment of deposits following court injunctions was close to $700 million, whereas this same indicator recorded a level of $200 million in the first nine months of this year. The above, added to the low relative level of CEDRO holdings at present, leads to the

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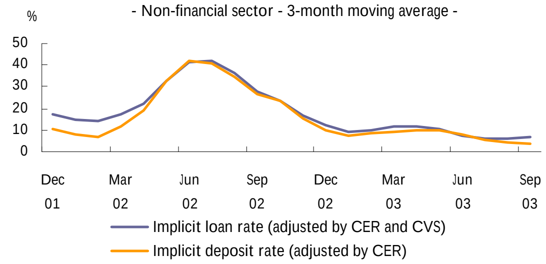
[14] This is recorded under the heading of "Other financial results" which also includes the valuation adjustments for government securities -as per Com. "A" 3911- in the corresponding months and the results derived from exchange trading transactions.

[15] The entity in question, with high exposure to large companies in an irregular condition, has undertaken a recovery program, reclassifying its portfolio and transferring loan balances to memorandum accounts.

conclusion that this monthly accrual will record a stable trend based on reduced total values in the next few months.

Return on loans and cost of deposits

- Non-financial sector - 3-month moving average -



32. **Operating profit** recorded a slight improvement during September, from -2.4% in August to -1.9% of NA. The reduction of losses arising from traditional banking activities by private sector banks has taken place because of the restatement of principal according to the CVS index,[16] and in certain specific instances because of the calculation of CER accrual on loans that improved their credit category. On the other hand, the **interest rate margin** for the private banking sector recorded a deterioration of approximately 0.3p.p. of NA. As detailed in previous sections, the monthly change in balances has helped to explain the decline in net interest income accrued. The increase in term deposits, added to the lack of growth in the total balance of loans to the private non-financial sector, explains this result. Lastly, the remaining components of operating margin – income from services, general operating expenses and taxes on interest and services – did not show significant month on month changes.

33. Private bank sector results from the **holding of financial assets** in September showed a partial deterioration in the monthly comparison. Net profits under this heading reached 0.8% of NA, a drop of 0.8p.p.. In particular, lower profits under the heading of "income from assets" were a result of the behavior of investment in government securities.

34. As can be seen from previous paragraphs, **private bank segment results** have recorded significant progress compared to the first half of 2003 and the third quarter of the same year. During that period ROA went from -4.5% to -2.3%. This achievement was however basically a product of the depreciation of local currency in the July-September period and the adjustment to the value of public sector lending[17] performed during the first half of 2003, which together were responsible for an increase of 3.6p.p. of NA in the same period. In addition, when excluding the extraordinary effect of the entity mentioned previously, it can be seen that there has been a decline in loan loss provisions. In terms of this latter income statement item, there has been a notable improvement in the first nine months of 2003 compared to the same period of 2002 amounting to 3.9p.p. of NA. Lastly, it should be pointed out that both year-on-year and year to date comparison still does not show signs of any improvement in profitability of traditional banking business for the private bank segment.

Profitability by group (2003)

Annualized ROE as % - by type and area coverage

	H1	Q3	Improvement (p.p.)
Public	-35.8	-24.3	11.4
Private	-33.7	-18.7	15.0
Retail	-38.1	-20.3	17.7
National coverage	-54.8	-33.2	21.5
Regional coverage	-3.7	3.5	7.2
Specialized	-2.1	5.5	7.6
Wholesale	1.1	-7.7	-8.8
Non-bank entities	-19.4	11.3	30.7
TOTAL	**-33.8**	**-18.7**	**15.1**

35. So far, analysis has focused on the private bank segment viewed as an average entity, weighted by size, by definition reflecting the situation of the entities with the greatest relative weight. The existence of a **significant disparity between the components of the segment** – given the differences in operations and the geographical spread of the banking business – justifies an analysis of profitability by uniform sub-segment. This shows that retail entities with activities, and therefore exposure, extending across the entire local economy, record the heaviest losses and have a determinant effect on the entire private bank segment, given their greater weighting. In addition, these entities have shown an improvement in their profitability during 2003, which rose from -54.8% of NW in the first six months to -33.2% of NW in the third quarter[18]. On the other hand, private wholesale banks – mainly active in the providing of financial services to major corporations and investors, with an almost non-existent demand on deposits from the public – have informed slightly unfavorable results in the third quarter of 2003, while regional retail banks recorded profits 3.5% of NW in this last

[16] This index recorded a monthly increase of 2.4%.
[17] Estimated at 1.2% of NA.
[18] The mentioned sub-segment includes 7 of the 10 largest banking entities.

period, compared to a loss of a similar size in the first half of the year. The more favorable and less volatile figures for this latter group of banks, compared to retail banks with a national coverage, have largely been due to the inherent features of their financial business[19], particularly factors relating to their lower exposure to the public sector – generating a greater interest rate spread and without losses from the default on Argentine debt – and to the corporate sector – with a high level of non-performance.

Outlook for October

36. To conclude, an attempt is made to provide an indication of the development that can be expected in various items of the income statement for the private bank segment in October, on the basis of information available at the time of writing this Report[20]. In first place, given the relevance in the context of an erosion of net operating profits attributable to exchange differences, particular attention should be paid to the performance of the exchange rate. Thus, given the appreciation of the peso recorded in the month of October – when the $/US$ reference exchange rate went from 2.91 to 2.88 between ends for the month – it is expected that private banks will continue to record exchange difference losses, although they will be lower than those seen in the previous month[21].

Main developments in October

	Sep	Oct	Chg %
Prices			
Exchange Rate ($/US$)	2.91	2.88	-1.15
CPI	141.12	141.95	0.59
CER	144.48	144.53	0.03
CVS	109.49	112.27	2.54
	%		Chg p.p.
Average Percentage Rates			
Lending	29.1	26.9	-2.2
Private Banks	28.9	26.7	-2.2
Overdraft	31.9	29.8	-2.1
Documents	13.1	13.2	0.1
Mortgage	15.2	16.1	0.8
Pledge-backed	15.4	15.7	0.3
Personal	45.2	43.4	-1.7
Public Banks	34.6	31.7	-3.0
Advances	35.3	32.7	-2.6
Documents	15.7	14.8	-0.8
Mortgage	13.5	18.3	4.8
Pledge-backed	20.1	19.7	-0.4
Personal	19.1	18.9	-0.3
30- to 44-day time deposit	4.5	4.6	0.1
6-month LEBAC in pesos, w/o CER	6.3	5.7	-0.6
	Millions		Chg %
Balances - Public Banks			
Peso deposits -Private sector	40,173	41,503	3.3
Peso loans - Private sector	17,777	17,844	0.4
Overdraft	3,678	3,873	5.3
Documents	3,031	3,066	1.1
Mortgage	5,817	5,658	-2.7
Pledge-backed	519	476	-8.3
Personal	1,211	1,295	6.9

37. In terms of operating profits, given the stability of income from services and administrative costs headings, the main determinant of variations in the current context will be interest income and the result from the accrual of the CER and CVS indexes. As regards the first of these factors, in October there was an overall decline in the interest rate spread on the cost of funding. On the one hand, the monthly average rate payable on 30 to 44-day term deposits remained relatively stable – rising only 0.1 p.p. to 4.6% – while on the other, during September, the downward trend in rates of interest on current account overdrafts and personal loans was preserved, with both dropping 2p.p. on average (to an annualized 30% and 43% respectively). As a result, given the movement in the spread and the ratio of deposits to private loans, it is estimated that the result from interest will continue at close to zero as a percentage of NA, similar to the level recorded in September.

38. In the case of the second factor mentioned – the accrual of CER and CVS – it should be noted that the rise recorded in recent months has been especially influenced by the evolution of the CVS, which has risen by close to 2.4% per month since July. Decree 393/03 established that as from July a sum of $24 per month should be incorporated to basic salaries of workers in the private sector, over a total of 8 months. As the change in the CVS in October amounted to 2.5%, and the CER ratio did not record any significant change in the month – remaining at around 1.445 since September, it can be expected that the joint accrual for CER and CVS will either be lower or the same as that for the month of September.

39. To conclude, on the basis of certain variables with an influence on the income of private banks, it can be expected that aggregate operating profits for private banks in October 2003 will be similar or slightly lower than the

[19] This topic is developed further in the first sections of this Report.

[20] This exercise should be understood as a first approximation of a fundamentally qualitative nature in relation to the movements expected during the coming month for certain profitability headings, given the change actually recorded in certain prices and volumes -data obtained from information regimes other than that based on the Trial Balance. In particular, it should be noted that it is not intended to make a specific estimate of the end result for the sector for the month in question, in so far as no forecast is provided of a series of income statement headings that have a significant influence on the total, but are subject to significant volatility.

[21] This will be the case as long as the amount in dollars of their position in foreign currency assets is maintained.

level recorded in the previous month. It should be pointed out that we do not analyze net profits, which will in addition be influenced by changes in loan loss provisions, income from assets, and the sundries heading.

40. From a quarterly perspective, factors such as growth in the levels of lending activity, the exchange rate and inflation, together with the positive impact of the compensation arising from the reimbursement from the excess conversion of balances in dollars – deposited with the Deutsche Bank N.Y. – provide grounds for considering that the last quarter of 2003 will not only be the most profitable since early 2002, but that for the first time since then there will be gains for the banking sector as a whole. Lastly, as a result of the behavior of the above variables, it can be concluded that profitability levels in 2003 will well exceed the indicators for 2002. In this regard, although it is expected that the current year will conclude with losses, they will be in the order of 3% of NA, implying an improvement of close to 10 p.p. on the ROA for the previous year.

Notes on Methodology

(a) Trial balance information is taken from the Monthly Accounting Information System – non-consolidated balances. To calculate data for the aggregate for the system, in the case of the Trial Balance, for those entities not providing data for the reference month the latest information available is repeated. When estimating income flows, however, consideration is given exclusively to those entities providing data on the month in question.

(b) Data on deposits and loans relate to balance sheet information and do not necessarily agree with those gathered by the Centralized System of Information Requirements (SISCEN). Reasons for discrepancies include the exact date taken into account for the calculation of monthly variances and the items included in the definition adopted in each case – for example, SISCEN figures on deposits and loans do not include information on such transactions in the form of government securities and do not take into account transactions with residents abroad, nor do they include amounts accrued for interest and CER.

(c) Qualitative information on specific transactions involving specific banks has been taken from the notes to the financial statements of the banks, or obtained on the basis of inquiries made of the supervisors at the Superintendency of Financial and Exchange Entities.

(d) Estimates of main sources and uses of funds: This table summarizes aggregate principal movements of funds in the corresponding period, derived mainly from policies in relation to the loan and deposit portfolios of the entities. In view of the source of this information – the main variations in the aggregate balance sheet headings for the entity aggregate – and the purpose of the table, when preparing it certain changes have been made, mainly on the grounds that changes related to the revaluation of items (from the exchange rate, inflation adjustment, etc.) should be eliminated, as should those related to the accrual of provisions, depreciation and amortization, changes in the way certain transactions are recorded and the elimination from the balance sheet of assets for which recovery is doubtful (those 100% provided for). In particular, balances of foreign currency items at the end of the period are restated at the exchange rate at the beginning of the period.

(e) The profitability indicators provided have been calculated on the basis of monthly results estimated on the basis of the changes in the amount of accumulated results during the year in progress. Unless otherwise indicated, profitability ratios have been annualized.

(f) Initially, the breakdown by group of banks was determined on the basis of the majority existing in decision-making – in terms of shareholders' meeting votes – distinguishing between privately-owned entities and official entities. With the aim of deepening the analysis, private entities were further broken down according to their geographical and commercial reach. As a result, wholesale banks were defined as those specializing in the large corporation and investor segment, which usually do not depend for their funding on deposits from the private non-financial sector. Retail banks were divided into those carrying out business at national level, those located in specific geographical regions – municipal, provincial or regional entities – and institutions specializing in a financial sector niche market – generally smaller entities. Lastly, it should be noted that this grouping has been carried out solely for analytical purposes and does not represent the only methodological criterion for grouping, while in addition, the detailing of the characteristics of each group of entities has been established in a general manner.

Glossary

Income from assets: Includes income from government securities, short-term investments, corporate bonds, subordinated debt and options. In the case of government securities, it includes the results accrued from income, quotation differences, exponential increase on the basis of the internal rate of return (IRR), and from sales, as well as the charge for impairment to value.

Income from services: Commissions collected less commissions paid. Includes commissions on liabilities, credits, securities, guarantees granted, rental of safe deposit boxes and foreign trade and exchange transactions, excluding in the case of the latter results from the trading of foreign currency, which are recorded in the “Exchange difference” accounts (here included under the heading “Other financial results”). Outflows include commissions paid, contributions to the Banking Social Services Institute (ISSB), other contributions on service income and charges accrued for gross income tax.

Interest income (interest margin): Interest collected less interest paid on financial intermediation, on an accrual basis – taken from balance sheet – rather than on a cash basis. Includes interest on loans of government securities and premiums on repos and reverse repos.

Liquid assets: Minimum cash compliance – cash, current account at Central Bank and special accounts in guarantee – and other liquid items, including correspondent accounts.

Net operating revenue: Interest income plus net adjustments according to the CER and CVS indexes in relation to financial intermediation plus service income.

Net worth exposure to counterpart risk: :Non-performing portfolio net of allowances in terms of net worth.

Netted assets and liabilities: Those net of accounting duplications inherent to the recording of swaps, whether term or unsettled spot transactions.

Non-performing portfolio: Portfolio in categories 3 to 6, as per the debtor classification system.

Operating costs: Includes remuneration, social security payments, services and fees, sundry expenses, taxes and amortization.

Operating profits: Result from interest and net adjustments according to the CER and CVS indexes in relation to intermediation plus service income, less tax charges in relation to interest and services and operating costs.

Other financial results: Income from financial leasing, adjustments to valuation of credit to the public sector, contribution to the deposit guarantee fund, interest on liquid funds, difference in market price of gold and foreign exchange, premiums on the sale of foreign currency and other unidentified income (net).

Private sector credit: Loans to the private sector and private sector securities.

Public sector credit: Loans to the public sector, holdings of government securities and compensation receivable from the Federal Government.

ROA: Net profits as a percentage of netted assets. When referring to accumulated results the denominator includes the average netted assets for the reference months.

ROE: Net profits as a percentage of net worth. When referring to accumulated results the denominator includes the average net worth for the reference months.

Other: In the profitability structure, sundry gains – including gains from long-term investments, loan recoveries and release of allowances – and sundry losses – including losses on long-term investments, amortization of differences from court orders, loss on sale or impairment of fixed assets, amortization of goodwill.

Balance Sheet

Private banks

In current pesos (millions)	Dec 99	Dec 00	Dec 01	Dec 02	Aug 03	Sep 03	Change (%) Month-on-month	Change (%) Up to Sep 03	Change (%) Year-on-year
Netted Assets	**85,918**	**88,501**	**73,796**	**117,928**	**113,815**	**114,333**	**0.2**	**-3.0**	**-8.1**
Liquid assets	13,228	13,920	10,576	11,044	13,580	13,871	1.4	25.6	49.0
Public bonds	6,433	7,583	1,627	19,751	19,828	21,596	8.5	9.3	-6.9
Private bonds	410	563	451	273	172	173	0.7	-36.7	-53.6
Loans	56,916	56,035	52,319	51,774	48,677	47,792	-2.0	-7.7	-12.8
Public sector	6,389	8,172	13,803	25,056	25,278	24,424	-3.6	-2.5	-6.8
Private sector	47,705	45,103	36,636	26,074	22,585	22,375	-1.0	-14.2	-19.9
Financial sector	2,823	2,760	1,880	644	815	993	21.8	54.1	55.5
Charges over loans	-3,119	-3,248	-3,957	-7,463	-6,103	-5,882	-3.8	-21.2	-17.5
Other netted credits due to financial intermediation	4,470	5,730	4,489	26,235	20,842	19,995	-4.0	-23.8	-29.8
Purchases (net)	487	1,103	807	380	364	368	1.1	-3.1	-42.2
Corporate bonds and subordinated debt	1,022	724	665	1,514	1,393	1,370	-1.7	-9.5	-14.6
Unquoted trusts	958	1,609	1,637	6,205	4,564	3,938	-13.4	-36.5	-35.8
Compensation receivable	0	0	0	15,971	13,047	12,915	-1.0	-19.1	-27.4
BCRA	12	35	865	377	1,505	1,566	3.8	315.7	20.1
Assets under financial leases	796	776	752	553	427	409	-4.2	-26.1	-34.3
Shares and participation	1,371	1,651	1,703	3,123	3,173	3,192	0.6	2.2	-0.4
Fixed assets and sundry	3,246	3,225	3,150	5,198	5,093	5,076	-0.6	-2.3	-6.6
Foreign branches	48	75	112	-109	-131	-132	1.2	21.2	1262.7
Other assets	2,120	2,190	2,574	7,549	8,258	8,243	-0.4	9.2	36.0
Netted Liabilities	**73,615**	**76,322**	**62,281**	**102,101**	**99,572**	**100,460**	**0.6**	**-1.6**	**-6.4**
Deposits	54,447	57,833	44,863	44,445	49,445	50,085	0.8	12.7	10.4
Public sector (1)	1,342	1,276	950	1,636	2,808	2,974	5.9	81.8	134.3
Private sector (1)	52,460	55,917	43,270	38,289	44,468	44,159	-0.7	15.3	20.9
Current account	5,022	4,960	7,158	8,905	9,636	10,026	4.0	12.6	37.0
Savings account	9,702	9,409	14,757	6,309	8,683	9,377	8.0	48.6	54.8
Time deposit	35,218	39,030	18,012	11,083	19,397	18,000	-7.2	62.4	166.2
CEDRO	0	0	0	9,016	3,352	3,207	-4.3	-64.4	-73.5
Other netted liabilities due to financial intermediation	16,185	15,401	14,082	48,364	43,266	43,486	0.4	-10.1	-16.2
Call money	2,146	2,293	1,514	836	896	1,157	29.1	38.4	33.8
BCRA lines	274	83	1,758	16,624	16,830	16,875	0.1	1.5	5.0
Outstanding bonds	4,990	4,939	3,703	9,073	7,233	7,103	-1.8	-21.7	-29.6
Foreign lines of credit	6,680	5,491	4,644	15,434	12,133	11,904	-1.9	-22.9	-32.0
Sales (net)	492	510	99	349	222	226	2.7	-35.2	-59.6
Subordinated debts	1,683	1,668	1,700	3,622	3,163	3,104	-1.9	-14.3	-29.9
Other liabilities	1,299	1,420	1,637	5,671	3,698	3,785	2.4	-33.3	-32.5
Net Worth	**12,304**	**12,178**	**11,515**	**15,827**	**14,243**	**13,837**	**-2.7**	**-12.3**	**-18.7**

(1) Does not include accrual on interest or CER.

Profitability Structure

Private banks - In annualized terms

As % of netted assets	Yearly 1999	Yearly 2000	Yearly 2001	Yearly 2002	Up to Sep 2002	Up to Sep 2003	2003 H1	2003 Q3	Intermonthly Aug-03	Intermonthly Sep-03
Net interest income	4.5	4.1	4.3	-0.2	-0.4	-0.1	-0.1	0.0	0.2	-0.1
Restatement by CER and CVS	0.0	0.0	0.0	1.1	1.2	0.7	0.8	0.5	0.2	0.9
Other financial income	0.5	0.7	1.0	4.3	5.2	-1.5	-2.7	0.9	0.6	-1.1
Service income margin	3.1	2.9	3.2	2.0	2.0	2.0	2.0	2.1	2.0	2.1
Gains on securities	1.1	1.4	1.2	2.5	2.3	1.3	1.3	1.2	1.6	0.8
Operating costs	-6.3	-6.0	-6.4	-4.8	-4.6	-4.6	-4.7	-4.4	-4.5	-4.4
Loan-loss charges	-2.2	-2.5	-3.0	-5.0	-5.5	-1.6	-1.6	-1.6	-1.1	-2.3
Tax charges	-0.4	-0.4	-0.5	-0.4	-0.4	-0.3	-0.3	-0.3	-0.2	-0.5
Income tax	-0.5	-0.4	-0.3	-0.2	-0.1	-0.3	-0.4	-0.1	0.0	-0.4
Other	0.5	0.4	0.7	-3.0	-3.1	0.8	1.4	-0.4	-1.3	0.6
Monetary results	0.0	0.0	0.0	-7.5	-9.3	-0.1	-0.1	0.0	0.0	0.0
ROA before income tax	0.8	0.6	0.5	-11.1	-12.6	-3.5	-4.1	-2.2	-2.5	-3.9
ROA before monetary results	0.3	0.1	0.2	-3.8	-3.5	-3.7	-4.4	-2.3	-2.5	-4.2
ROA	**0.3**	**0.1**	**0.2**	**-11.3**	**-12.8**	**-3.8**	**-4.5**	**-2.3**	**-2.5**	**-4.2**
Indicators (%)										
ROE	**2.3**	**0.8**	**1.4**	**-79.2**	**-88.2**	**-29.1**	**-33.9**	**-18.7**	**-20.1**	**-35.3**
Operating profit / NA	0.9	0.6	0.6	-2.3	-2.2	-2.3	-2.4	-2.2	-2.4	-1.9
Operating revenue / operating costs	120.5	116.9	117.1	59.0	60.2	56.1	56.1	56.1	52.0	67.0
Interest income (with CER and CVS) / loans	..	13.9	16.1	24.7	28.9	8.6	9.8	6.2	6.7	6.6
Interest payments (with CER and CVS) / deposits	..	5.7	7.8	21.9	26.1	6.8	8.6	3.6	3.8	2.8

Note: interest income and the loan balances correspond to non-financial sector transactions.

Portfolio Quality

Private banks

As percentages	Dec 99	Dec 00	Dec 01	Dec 02	Sep 03
Non-performing loans (overall)	7.6	8.3	9.9	19.9	17.3
Loans to the non-financial private sector	8.9	9.8	14.0	37.4	34.8
Commercial portfolio	6.2	7.6	15.2	44.5	44.2
Commercial portfolio up to $200.000	11.7	14.6	16.4	47.1	34.9
Consumption and housing portfolio	12.5	11.9	12.4	26.1	20.7
Provisions / Non-performing loans	69.4	67.7	75.7	73.3	77.3
(Non-performing - Provisions) / Overall financing	2.3	2.7	2.4	5.3	3.9
(Non-performing - Provisions) / Net worth	11.5	13.4	11.4	18.7	14.5