



# Financial Stability Bulletin

Second Half 2006

CENTRAL BANK OF ARGENTINA





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# FINANCIAL STABILITY BULLETIN

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Central Bank  
of Argentina

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*Second Half 2006*

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Central Bank of Argentina

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## *Preface*

***Financial stability** is a state of affairs in which the financial services sector can channel the savings of the population and provide a nationwide payments system in a manner that is efficient, secure and sustainable over time. In the framework of the execution of consistent and stable macroeconomic policies, the resilience of the financial sector in the face of negative shocks serves to define the degree of approach towards a **financial stability** configuration.*

*The strong interrelationship between **financial stability** and sustained economic growth explains why the former is a social good that the state has to generate and protect. This is why the promotion of **financial stability** is one of the principal functions of most central banks.*

*The Central Bank of Argentina, according to article 4 of its charter, has a mandate “to supervise the sound operation of the financial market”. It is the Central Bank understanding that in order to enhance the effectiveness of the policies that it undertakes its usual regulatory and supervisory powers must be complemented by a communications strategy that is transparent and accessible to the general public.*

*With this purpose in mind it publishes the **Financial Stability Bulletin (FSB)** that presents an overall assessment of developments in the conditions of financial stability. In the **FSB** the different channels of information that are available on the subject are merged, to provide the Central Bank’s views on the outlook for the financial system. Furthermore, between each half-yearly issue of the **FSB**, the Central Bank releases a monthly **Report on Banks** to keep the public up to date about the more recent developments in the financial system.*

*According to the depth of detail that the reader requires, the **FSB** can be approached in two different ways. Reading the Central Bank Outlook and the Balance of Risks, together with the summary and main topics of each chapter, enables the reader to grasp the gist of the **FSB**. Naturally, a full reading of the **FSB** provides an in depth evaluation of the issues it covers, enriched by the coverage of special topics that are included in the Boxes.*

*The date of publication of the next issue of the **FSB**, with statistics that cover at the end of December 2006, will be on March 29, 2007, on the Central Bank website.*

*Buenos Aires, September 28, 2006*





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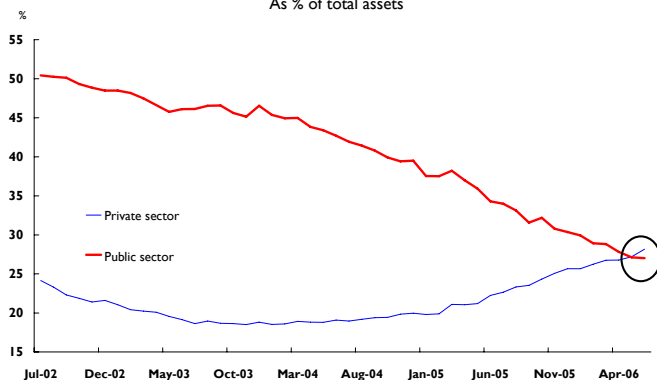






## CENTRAL BANK OUTLOOK

**Chart 1**  
**Public and Private Sector Credit Risk Exposure**  
As % of total assets

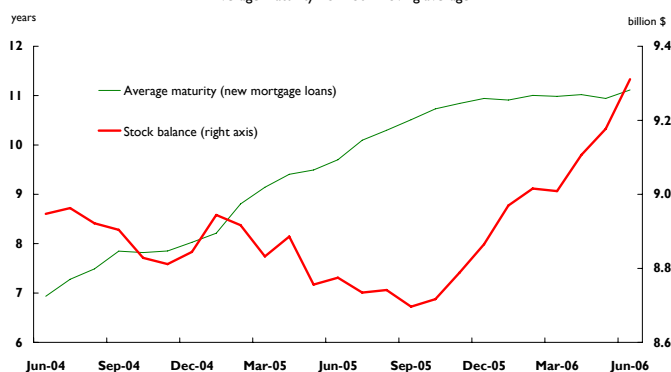


Source: BCRA

In the first half of 2006 the positive trend of the domestic financial markets consolidated. The financial institutions stood out in this process and they are leaving behind most of the legacies of the crisis, while they open out towards a new configuration for the sector. In this period, based on the new regulatory framework set by the Central Bank the system consolidated its sound performance in various dimensions: it increased its independence from the financial requirements of the public sector, focused its resources on the private sector, deepened the normalization of its assets and liabilities, made its balance of risks more robust, improved its results and strengthened its solvency levels. This favorable momentum, added to the economic growth, the shift towards the private sector by non bank financial intermediaries (pension funds – AFJP-, insurance companies, and mutual funds) and the greater liquidity on the domestic capital market, are defining a renewed financial architecture that accompanies the economy towards a sustained development path in a context of financial stability.

For the first time since the crisis the share of the financial system credit for the private sector exceeded its exposure to the public sector. In this manner, since the second half of 2002, when it peaked at a maximum of 50% of total assets, the financial system's exposure to the public sector has reduced rapidly. This process accelerated during 2005, totaling a contraction of 12.5 p.p. in the exposure to the public sector in the past 18 months, until it reached a figure of 27% of assets in June 2006.

**Chart 2**  
**Mortgage Loans to Households**  
Average maturity - 3-moth moving average



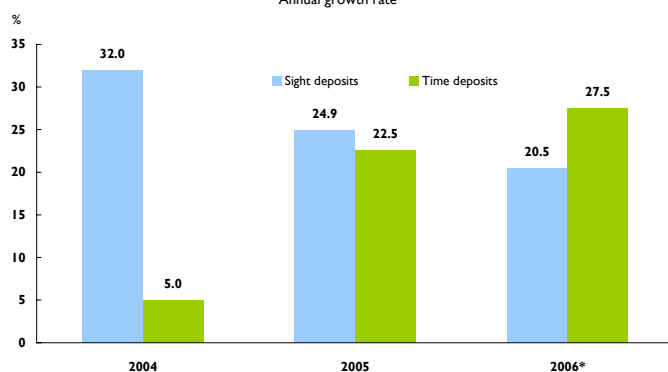
Source: BCRA

The current strategy focused on the recovery of private sector assets is developing on the basis of the monetary and financial policy carried out by the Central Bank. During 2006, this Institution increased its incentives to reduce the holdings of government assets: it reduced the maximum overall share of public sector assets in total assets from 40% to 35%, applicable as from July 2007. This measure adds to the limits in terms of capital and jurisdictions, to the guidelines for marking government securities to market prices and to the elimination of the pro-public sector bias in capital requirements. With these measures the Central Bank is building the foundations for an independent monetary and financial system from the financial needs of the public sector. This component is especially relevant for emerging countries in order to consolidate the confidence of the economic agents in their respective Central Banks and financial systems.

Meanwhile, the ongoing expansion of credit for business and families at a rate that exceeds the principal countries in the region, and in an environment with a low associated risk, noticeably sharpened the process of crowding in the private sector. With growth rates that reached 39% in 2005 and 40% annualized (a.) by mid 2006, the private sector is gradually recovering its weighting in bank portfolios, and at present accounts for about 27.5% of assets. The personal loans to families and commercial credit for exports were the leaders of this process: grew 31% and 49% in the first half of 2006.



**Chart 3**  
**Private Deposits**  
Annual growth rate



\* Half-yearly annualized.  
Source: BCRA

The Central Bank targeted a substantial share of its financial policy to define a framework that stimulates the prudent expansion of private credit, in a context of positive expectations of economic growth and the strategies of financial institutions with the purpose of financing private projects. This pro-credit policy has deepened in the past two years and focused on: adjusting the effects of the crisis to the new favorable macroeconomic context, promoting finance for small and medium enterprises –SMEs–, expanding access to loans on both a geographical and social basis, and extending the maturity on which credit is offered in order to encourage loans for productive investment. In this line, the recent developments of the Central Bank's pro-credit policy have centered on: making access to mortgage loans easier, promoting micro-credit transactions and encouraging the expansion of the transparency of information about the costs of financial services.

The Central Bank made significant progress in regulations to boost the budding dynamics of mortgage credit, which grew 10%a. in the period. In this sense it made the capital requirement for mortgage loans up to \$200,000 more flexible (unique family ownership for permanent occupancy), with incentives to finance 100% of the value (or 90% for amounts of over \$200,000 and up to \$300,000). It also encouraged including in the assessment of the payment capacity of the debtors their receipts for rental payments and utility payments, among others, in line with the recommendation to adopt screening systems and credit scoring models to assess granting these loans.

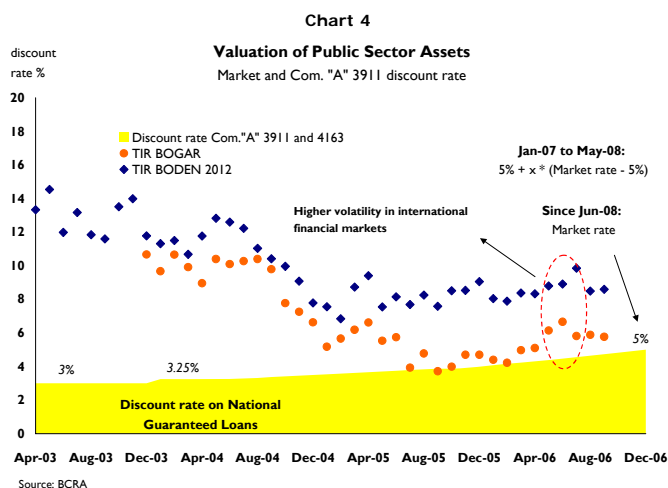
As confirmation of the positive trend of activity in the financial sector as a whole, the non-bank financial intermediaries (NBFI) increased their shift towards the private sector. The growing availability of funds, mainly due to the strengthening of the labor market, added to the possibility of supplying medium and long term finance, are providing a favorable situation for the NBFI to complement financial sector activities. The latter happens especially for financing infrastructure projects, and by contributing to assign funds to the longer term mortgage loans, in tandem with the rest of the capital market.

Simultaneously with the improvement in asset quality, the financial system has achieved noticeable progress in normalizing the structure of its liabilities. The expansion of private sector deposits at a growth rate of about 23%a. is driving this, added to the rapid cancellation of rediscounts under the matching scheme. At the time this FSB was published, only two financial institutions owed debts to the Central Bank under the matching scheme, while the cancellations to date are around two thirds of the original amount of this assistance for illiquidity granted due to the recent crisis.

On the other hand, the financial institutions are gradually increasing the average term for private deposits: for the first time since the crisis the growth of time deposits exceeds those at sight (savings accounts and current account). This event was stimulated by the financial policy that the Central Bank adopted, which was accompanied by the bank strategies (with rising interest rates on time deposits). During 2006 this financial policy orientation was deepened, reinforcing the prudential regulations, and providing incentives for the migration from sight to time



deposits: the minimum reserve requirement on sight deposits was raised twice (from 15% to 17% and later to 19%) and was reduced on time deposits, the remuneration on reserves requirements for sight deposits was eliminated, a 100% reserve requirement was set for sight deposits with a remuneration higher than 35% (this limit was originally 75% and then 50%) of the BADLAR rate (private banks), and the remuneration of the reverse repos that the time deposit mutual funds arrange with the Central Bank was reduced from 2.55% to 0.5%, and the arrangement of time deposits with variable interest rates with a guaranteed minimum fixed interest rate (with a minimum 180 day term) was authorized.



As the financial system is normalizing the assets and liabilities that were affected by the crisis, it is improving its overall balance of risks. The banking system continues to strengthen its position in order to face the major risks inherent to the financial intermediation activity: liquidity, public and private sector credit, and currency risk. Although the credit expansion contracted the liquidity indicators, the levels recorded are in line with the current context of financial stability and the Central Bank's reserve requirements, which are compatible with other economies of the region. The deepening of the inter-bank liquidity markets added to the effective powers of the Central Bank to act as a lender of last resort are strengthening the framework to manage liquidity risk.

Due to both the fall of the exposure to the public sector and the soundness of fiscal accounts, the financial system faces a smaller government credit risk. On the other hand, the favorable economic and financial performance of the productive activities and the strength of the payment capacity of households, in a context of growing exposure to the private sector, are the foundations of a robust financial system in the face of private sector credit risk.

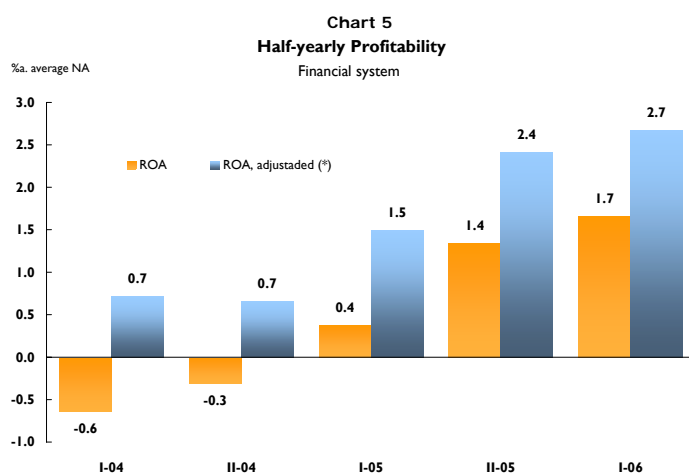
The banking system also exhibits a better position to face currency risk. A smaller exposure (mismatch between assets and liabilities), a relative contraction of the volatility of the nominal exchange rate, and more coverage possibilities are the pillars of this. The foreign currency (FX) stress test exercises that consist of testing the financial system for an extremely negative event result in a great bank strength to face FX risk. Given the lessons learned from the 2001-2002 crisis, a regulatory framework was built in order to achieve a sound administration of FX risk: the deposits received in U.S. dollars can only be used to fund lines in dollars, which must be granted to firms whose revenues are correlated with the dollar, limits were set on FX positions, capital requirements were established to cover FX mismatches, while the markets for FX coverage are still promoted.

These favorable developments of the financial system and the sound prospects for next year are intimately associated with the notable domestic macroeconomic performance marked by: solid growth, financial stability, prudent fiscal policy and consistent and transparent monetary policy. Meanwhile, Argentina operates in a scenario of global economic expansion which, although it has faced some volatility on the international financial markets, continues to register favorable growth expectations. In particular, this framework was favorable for the healthy



expansion of the financial systems of both developed and emerging economies: expanding private credit, lower non performance loans and more solvency.

Although initially the volatilities on the international financial markets were felt by the Latin American markets and a limited fly to quality process was noted, the fundamentals of the emerging economies have proved that the region is better prepared to face negative shocks: fiscal and current account surpluses, reserve accumulation policies, low inflation and flexible exchange rate regimes are the main determining factors. Although with some volatility due to the international context, the domestic capital market (both primary and secondary markets) exhibited an intense activity during the first half of 2006: the sovereign bonds, equities, corporate bonds, financial trusts and the foreign currency derivatives markets reflect the sound growth rate. The volatility of the fixed income and equity markets, added to the larger share of government securities marked to market by the financial institutions, increased the market risk of the financial system, although as yet on a very small scale. At present, this migration of the bond portfolio to market values is being carried out at a reduced cost, because the book value consistent with the scheme that the Central Bank defined due to the crisis is close to the sales price.



Source: BCRA (\*) Excluding amortization of payments for court ordered releases and the effects of Com. "A" 3911.

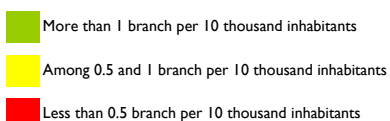
This solid Central Bank financial policy, combined with a positive macroeconomic context and prudent risk management strategies, is stimulating the normalization of profit levels in a framework of competition within the financial system. In the first half of 2006 the banking system posted larger profits than those accrued during all 2005, to reach a level of \$1.8 billion (1.7%a. of assets). This growth was largely led by sources of revenue that are more genuine than those related to the factors inherited from the crisis (CER adjustments or exchange rate mismatches). Trading activity, investment in financial instruments, interest and financial services results were the main leaders of semi annual profits. The recovery of margins added to the ongoing capitalization process (\$14 billion accumulated since the crisis, an amount equivalent to two thirds of the equity prior to the crisis) still drives the solvency of the financial system: its net worth rose 10% in the first half of 2006 and 26% in the past 18 months. In this manner, the capital compliance is equivalent to 16.5% of the assets at risk, which amply exceeds the domestic capital requirements and the minimum recommended by the Basle Committee.

Together with the normalization of the financial institutions' balance sheets and activity, the Central Bank strengthened its supervision schedule focused on risk. This system marked the new cycle of on-site inspections in the 2006 – 2007 timetable, in which the communication of the CAMELBIG ratings assigned by the Superintendence of Financial and Exchange Institutions (SEFyC) are included. Through the SEFyC the Central Bank carries out this procedure in a manner consistent with the guidelines defined in its Supervision Manual, which considers the most recent international standards in this field.

Despite the outstanding dynamics of the financial system observed in the post-crisis period, there are still issues pending, of which some are historical limitations in the structure of the



Chart 6  
Banking Coverage



Source: BCRA and INDEC

domestic banking system. The small penetration of the financial system in the economy, including aspects regarding the low levels of use of banking services (both regional and among population strata) and also the intensity with which financial services are used, the reduced time horizon of liabilities and the supply of bank credit, and the exposure to interest rate risk can be considered among the major challenges for the domestic banks.

Although financing is growing strongly, its share of economic activity is still low: the loans to the private sector were 10% of GDP in June 2006. However, even before the crisis bank penetration was low compared to economies at similar development levels. The Central Bank's financial policy is defining a framework that allows a greater credit penetration in the economy. Reaching historical and international penetration levels is viewed as a medium term process. The favorable expectations for the domestic economy are also slowly expanding the limited time horizon remaining from the 2001–2002 crisis. The Central Bank financial policy has also focused on this point, providing incentives to generate the migration of savings deposits from sight to time accounts. The increase of liquidity on the capital market, continually encouraged by the Central Bank, will determine the definite take off of medium and long term credit. Specifically, more depth in the markets for derivatives will contribute to provide coverage to face interest rate and currency risks.

The low levels of use of banking services have been one of the historical characteristics of the financial system. Although the regions of Argentina with most economic production exhibit relatively adequate levels of bank coverage, in a context of high non formal employment, a poor national distribution can be observed. In the past year the Central Bank has authorized the opening of 137 new branches to attend customers. The setting up of new branches in the geographical zones with least bank coverage, fix with the new dimension of the Central Bank's financial policy that enhance access to financial services in regions not yet served by banks. Meanwhile, the Central Bank is working to improve access of the lower social levels of the population. Among other measures it has extended the periods for the installments of loans granted to micro-enterprises (weekly, fortnightly and monthly), has enabled banks to provide an initial grace period for payment of capital services, has raised the maximum limit of the installment payment from \$200 to \$300 in order to cover a broader population range, has extended the maximum term for loans from 24 to 36 months, and has expanded the amount of finance available for house repairing from \$3,000 to \$6,000.

Consistent with the favorable domestic economic and financial context and the adequate Central Bank financial policies, the financial system is expected to deepen its normalization process and sharpen its traditional financial intermediation levels during the 2006–2007 period in a scenario with limited risks. Meanwhile, this positive development will contribute to gradually leave behind some of the principal historical limitations in the structure of the financial system. In this context of expansion of the financial system, the Central Bank will consolidate its micro and macro-financial monitoring



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processes with the purpose of support for a new regulatory framework for the development of banking activity in a context of financial stability.



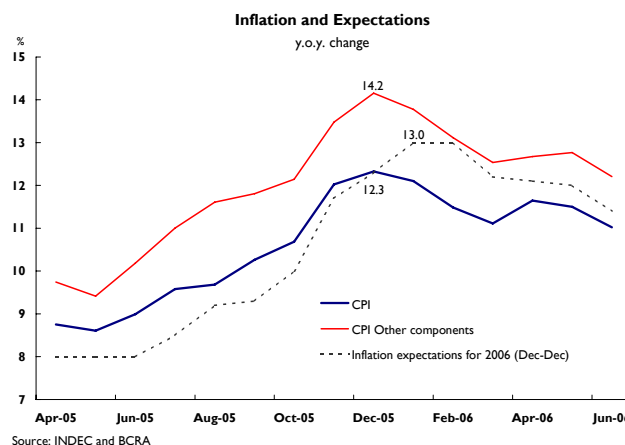
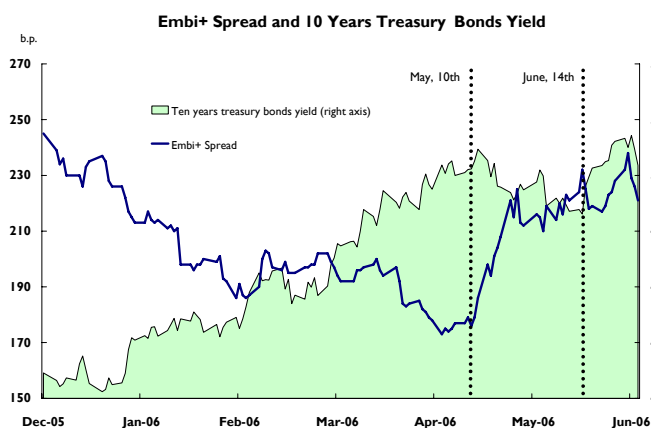
# I. ECONOMIC AND FINANCIAL CONTEXT

## Summary

*Despite greater volatility in financial markets and the weakening of economic growth in the US, the outlook for the world economy in 2006 remains encouraging. Although international conditions pose some challenges, the current context continues to encourage growth in both developed and emerging economies, and sets up the appropriate framework for the further strengthening of financial systems.*

*The first half of 2006 was marked by increases in benchmark interest rates in both the US and Europe, as well as overall high commodity prices. In particular, prices on the main export commodities from emerging economies sustained an upward trend. Although greater volatility on global financial markets had an effect on Latin America's sovereign risk, stock indexes and exchange rates, the effect did not stem from worsening fundamentals. The main economies in Latin America have continued to display relatively strong macroeconomic performance, in line with countercyclical policies such as the accumulation of international reserves. In particular, economic fundamentals made Argentina robust to the effects of an unfavorable international context, and subsequently allowed for gradual recovery. Relative to this framework, financial systems are performing well and are stepping up the flow of financing to the private sector, within a context of lower delinquency and growing solvency levels.*

*In line with economic performance since 2003, the Argentine economy grew by 3.7% s.a. during the first half of 2006 – accumulating 17 consecutive quarters of economic growth. Growth during the first half was driven by investment, while consumption levels remained high. The economy is expected to grow by about 7.5% to 8%, with the investment rate at approximately 21.7% of output (at constant prices). Retail price inflation slowed down during the period, which led to lower inflation expectations for the future. This outcome follows from strict compliance with the Monetary Program for 2006 and the favorable performance of investment, which is expected to keep pace with output growth. Macroeconomic performance so far provides an adequate environment for the further deepening of domestic financial intermediation.*





## I.1. International conditions

*The region has successfully withstood volatility on international financial markets*

World economic growth during the first half of 2006 was stronger and more spread out across regions than in earlier periods. World GDP is forecast to grow 4.3% in 2006 – a faster pace than in 2005 – based on the strong outlook of the world's economies and despite greater financial market volatility and a weakening of the United States economy. Economic activity in the US slowed down – by more than expected – in the second quarter, with annualized growth coming to 2.5% following 5.6% growth during the first quarter. Growth in US output through 2006 is forecast at 3.4%. The euro zone and Japan continue to perform favorably, and aggregate economic activity is forecast to grow by 2% and 2.6%, respectively, in 2006 (see Chart I.1). Emerging economies in Asia are expected to grow by 7.3%, while growth in Latin America is forecast at 4.2%, a higher forecast than that at the start of the year. World growth is forecast to remain strong in 2007, at a slightly slower pace than in 2006.

The behavior of international financial markets was mostly driven by two factors: increases in benchmark interest rates carried out by the central banks of Europe and the US (see Chart I.2) and generally high commodity prices, particularly for oil. The first half can be divided into two distinct periods, with a turning point on May 10 (see Chart I.3). After that date – following the Fed's decision to raise its target interest rate above 5% (with signs that there would be further increases) – capital markets entered a phase of higher volatility.

Higher energy prices continued to put pressure on consumer price indexes across the world's largest economies, while core inflation was slightly higher than wanted, particularly in the US. In this context, the Fed increased its benchmark rate by 25 b.p. on each of its four meetings over the first half of the year, driving the Fed Funds rate to 5.25% at the end of June. Although the upward cycle in short term interest rates had not been initially transmitted to long term rates, these started rising as from early 2006 and the yield curve has remained almost flat (see Chart I.4). The ECB continued to gradually tighten its monetary policy, as it has since December 2005. It raised the benchmark rate by 25 b.p. on two of its meetings, taking it to an annual 2.75% by the end of June.

Although the prices of certain commodities were also affected by the higher degree of volatility – in particular, there were substantial declines in metal prices – the commodities price index (IPMP) that tracks the path of Argentina's main export commodities increased over the first half, and by June was 6.9% above its average for 2005 (see Chart I.5). Oil prices increased over the first half, and underwent some episodes of geopolitically-induced high volatility, but the commodity's fundamentals remain unchanged. During the first quarter, oil averaged US\$63.3 per barrel, whereas in the second quarter it averaged US\$70.4 with a peak of US\$74.6 on May 2.

Chart I.1  
Gross Domestic Product  
y.o.y. change

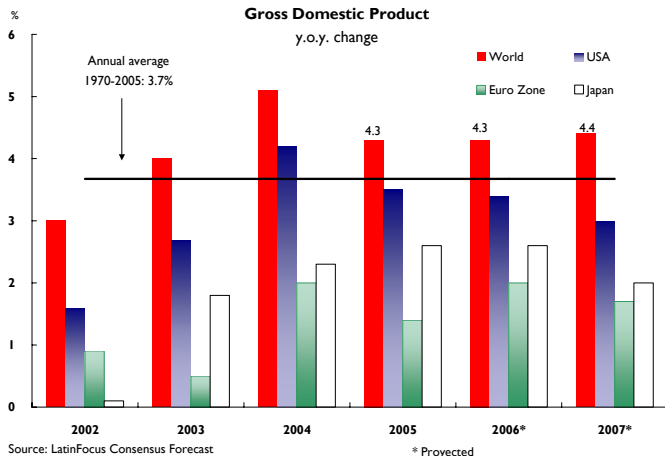


Chart I.2  
Benchmark Interest Rates

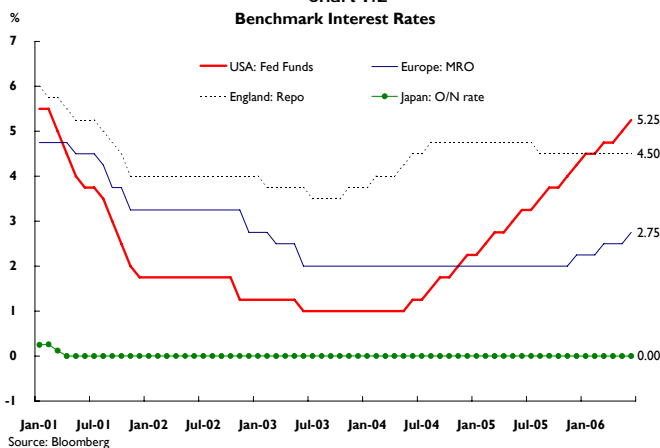
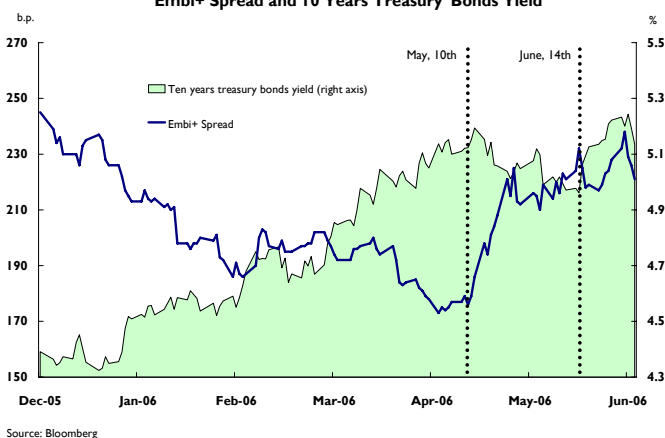


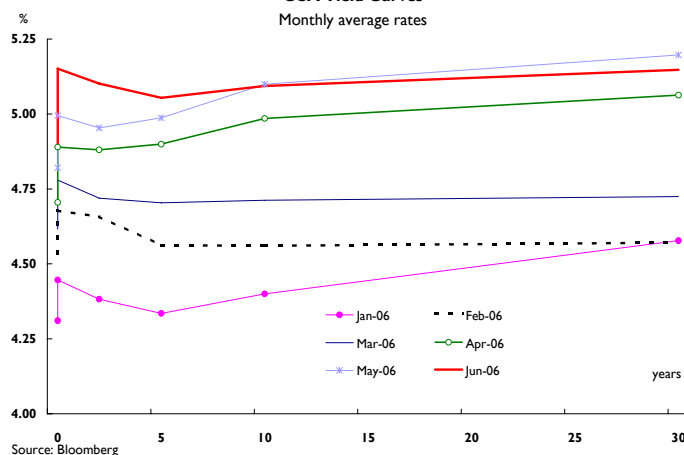
Chart I.3  
Embi+ Spread and 10 Years Treasury Bonds Yield





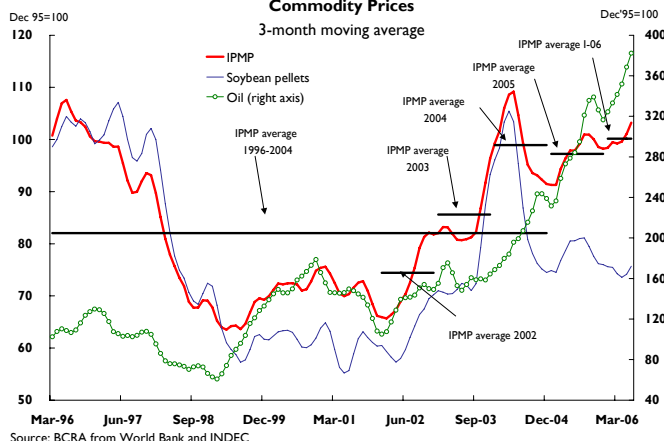


**Chart I.4**  
**USA Yield Curves**  
Monthly average rates



The higher volatility on global financial markets had distinctive effects depending on asset class (in particular, stock markets declined) and country (economies with large current account deficits were particularly affected). In this framework, the effect on Latin America occurred mainly through the impact on the region's sovereign risk premiums, stock indexes and exchange rates. The former had been on a downward trend since the end of 2005, reaching a record low 194 b.p. during the first days of May and outperforming the spread between junk and AAA corporate bonds in the US. Although both types of risk premium were affected during the episodes of high volatility, the region's sovereign risk spread has continued to improve since June, whereas corporate risk spreads continue to increase (see Chart I.6). A similar pattern was displayed by spreads on credit default swaps (CDS), which are an alternative measure of sovereign credit risk (see Box 1). Prices on these financial instruments declined through March, after which they underwent a period of high volatility that peaked in May and which was followed by a downward trend starting towards the end of June.

**Chart I.5**  
**Commodity Prices**  
3-month moving average



The drop in financial asset prices that occurred at a global level did not follow in the region from a worsening of fundamentals. In fact, Latin American economies continued to make progress in terms of key macroeconomic variables and conducted countercyclical policies such as the accumulation of international reserves as well as improving the financial conditions of their liabilities, among others. This behavior will help the region's economies in facing external shocks. Although there was a certain decline in capital flows towards emerging economies – mainly in May and early June – this trend is currently turning around. Starting in mid June, prices on international financial asset started to turn around from the downward trend that had been in place since early May.

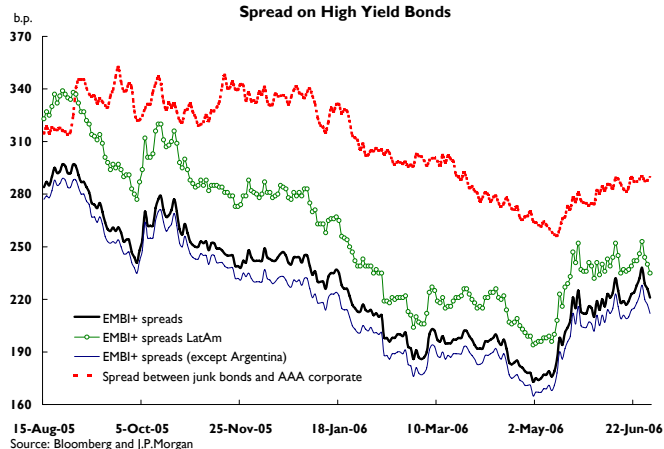
### *Financial systems in Latin America continued gaining strength*

The financial systems of both developed and emerging economies performed favorably during the first half of 2006, in a context of growing financing to households and corporations (see Chart I.7). Additionally, the downward trend in portfolio delinquency continued broadly across emerging regions, although levels still lag behind those of developed countries (see Chart I.8). Sustained banking profitability continues to drive improvements in the solvency of financial institutions (see Chart I.9), enabling these countries to be better prepared for potentially adverse international conditions.

For Latin America in particular, the sustained improvement in economic activity, higher worker earnings and the availability of new banking products (particularly targeted at households) are helping banks obtain higher profits. This leads to increased bank solvency, which in turn increases economies' resilience to negative shocks.

Although starting from what are in many cases considerably low levels, credit lines to households (personal and mortgage)

**Chart I.6**  
**Spread on High Yield Bonds**





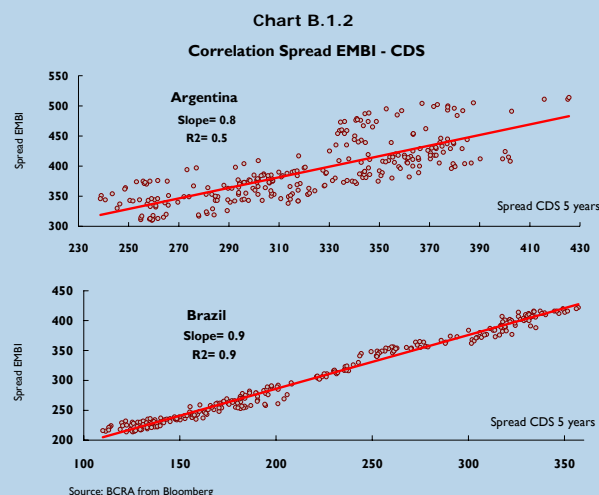
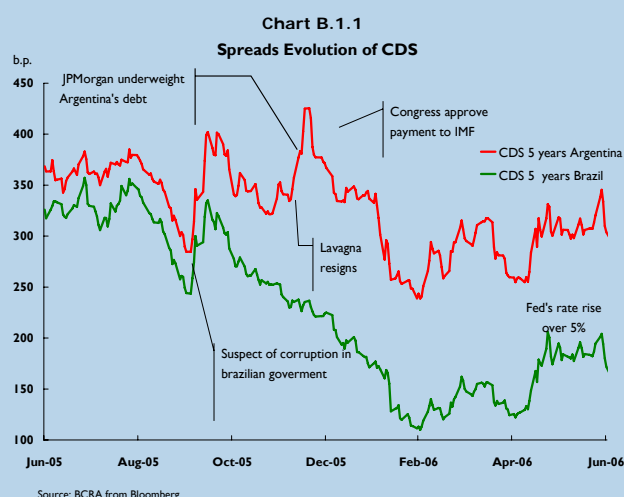
## BOX 1: THE MARKET FOR SOVEREIGN CREDIT DEFAULT SWAPS

*Credit default swaps are flexible financial instruments for hedging and investing that allow for trading in credit risk, which market is growing strongly. The prices on these assets act as alternative measures of credit risk, providing additional information to that obtained from yield curves*

Credit derivatives are financial contracts whose payments are explicitly tied to the credit risk of one or more reference entities (corporate or government). These instruments enlarge the set of risk management alternatives on the market, allowing for a partial or complete transfer of an asset's credit risk without divesting the underlying asset itself. Credit default swaps (CDS) stand out among all credit derivatives as being the most representative and having the highest growth in recent years. Traded volume in CDS has grown at exponential rates, with trading in 2005 almost 20 times that in 2001<sup>1</sup>. Trading in these derivatives is concentrated mostly in London and New York. Although the larger share of CDS references corporate debt, sovereign CDS are the most relevant to emerging economies.

CDS are private contracts and are traded over the counter<sup>2</sup>. In a standard sovereign CDS, a "protection buyer" agrees to make periodic payments (the price of which is expressed as a spread on a nominal amount) over a set period. If a "credit event" (default, restructuring, etc.) occurs within the period, the protection buyer swaps eligible assets<sup>3</sup> issued by the government in exchange for their par value<sup>4</sup>. The actual loss to the seller is the difference between asset par value and recovery value.

In addition to serving as a hedging instrument, CDS also constitute an investment alternative, equivalent to a synthetic position in the underlying asset's risk. CDS also enable directional and relative value trading strategies, and serve as a basis for the development of new financial products. Lastly, CDS prices have valuable information content, and are becoming increasingly used as indicators of a specific issuer's expected credit risk.



In fact, prices on sovereign CDS are very sensitive to changes in a country's risk outlook (see Chart B.1.1) and are highly correlated to widely used indicators such as the EMBI risk spread (see Chart B.1.2). Unlike the latter, which measures risk for a basket of securities of differing maturities, CDS prices provide an approximation to expected risk over different maturities. Since CDS prices may also exist for segments of the yield curve in which there are no bonds on the market, they can provide information that is valuable in pricing new debt issues. CDS spreads may also react more rapidly to changes in expectations than observed margins on fixed-income securities<sup>5</sup>.

Due to the nature of the contract, the price on a CDS must bear relation to the implicit credit risk on the underlying securities (a higher probability of default implies a greater CDS spread). In turn, a fixed-income security's credit risk is implicit in the spread between its yield and that on a risk-free interest rate. In principle, both values (the CDS

<sup>1</sup> International Swaps and Derivatives Association (ISDA).

<sup>2</sup> Although in principle this allows for contracts with specific features, in practice they are drafted following ISDA recommendations.

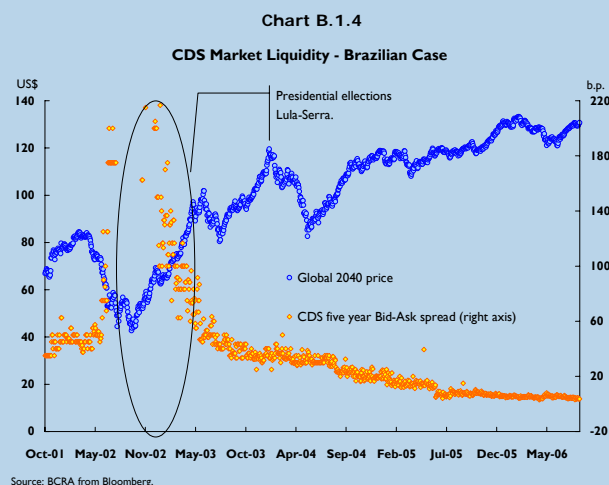
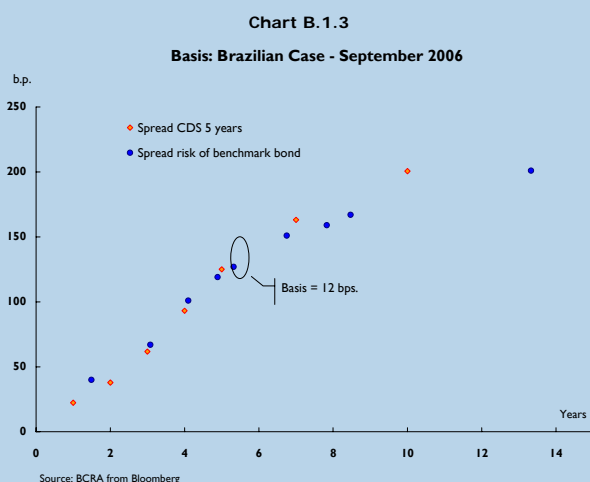
<sup>3</sup> For emerging economies in general, debt issued under international law in a currency different to that of the issuing country. For Argentina in particular, debt issued after 2005, with the exception of bonds issued under the framework of the sovereign debt swap.

<sup>4</sup> The protection buyer hands over securities for a total nominal value equivalent to the notional value on the contract. This practice is referred to as "physical settlement". The alternative practice is cash settlement, in which the protection seller makes a cash payment for the difference between the securities' par and recovery values.

<sup>5</sup> Due to the greater liquidity and the absence of restrictions on short sells in the CDS market. See "An empirical analysis of the dynamic relation between investment-grade bonds and credit default swaps" (Bianco and Brennan, Journal of Finance, Vol 60, Issue 5, 2004). The analysis focuses on corporate CDS.



price and the security's spread) should be similar over comparable periods, as otherwise the difference could be arbitrated. The difference between the CDS spread and the spread on the security is termed "basis", and in practice it is often positive (see Chart B.1.3). Part of the basis is explained by fundamentals and technical factors<sup>6</sup>. If a fraction of it remains after adjusting for these factors, it can be arbitrated by means of trading strategies<sup>7</sup>.



The use of CDS has gained acceptance due to a number of factors: progress in contract standardization (the definition of credit risk was initially open to substantial disagreement), their performance in the wake of several notorious credit events (Argentina, Enron, Worldcom, Parmalat, etc.) and the creation of CDS indexes. Although the market for CDS exhibits growing liquidity, it tends to contract suddenly at critical times (see Chart B.1.4) since most economic agents start demanding protection. This feature of the CDS market may improve as it continues to grow and the user base diversifies further. Banks currently account for most market involvement, acting as net buyers of risk exposure. Other large participants in the market are insurance companies (as net sellers of risk exposure), hedge funds, mutual funds and large corporations.

Although trading exists for a large range of governments, most trading is limited to a certain number of reference countries for which sovereign bonds are most liquid (Brazil, Mexico, Russia and Turkey, among others). Something similar occurs with maturities: although periods ranging from 1 to 10 years are listed, the most representative contracts have 5-year periods.

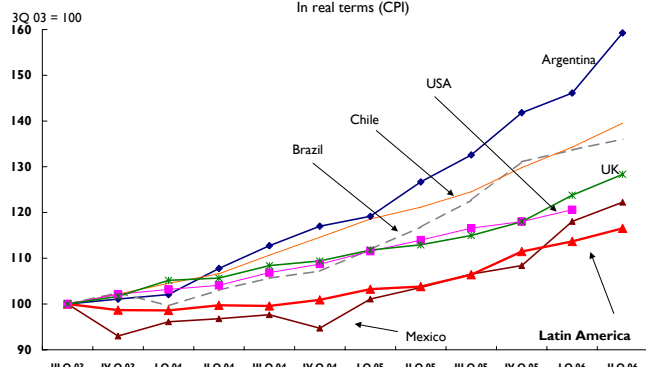
The effect that the increased use of CDS has on financial stability is a topic of current debate. Their positive effect could come about due to improved risk management at the micro level, as well as a greater diversification of risks at the macro level. However, the latter would generate benefits only to the extent that credit risk is eventually transferred to agents with a greater relative capacity to manage it. This is difficult to verify in practice, since available information is heterogeneous and highly aggregate, and does not identify the destination of transferred risk precisely. At the micro level, the main risk is the possibility that incentive are created: protection buyers may be less inclined to make monitoring efforts on the reference entity, and could have an effect on the generation and availability of information and analysis on debtors.

<sup>6</sup> For example, factors that cause the basis to increase include the existence of very solvent investors with access to relatively cheaper funding (on the repo market), the possibility of delivering the cheapest asset (the so-called "cheapest to delivery" option) and security prices below par value.

<sup>7</sup> A positive basis can be captured by selling hedging on the CDS market (a long position in risk exposure) jointly with a short sell of the underlying asset through the repo market (a short position in risk exposure).



**Chart I.7**  
**Lending to the Private Sector**  
In real terms (CPI)



Note: The second quarter of 2006 data for Argentina corresponds to June. For the rest of the countries the growth corresponds to Jan-Apr 2006 semi-annualized.  
Source: BCRA from FMI data.

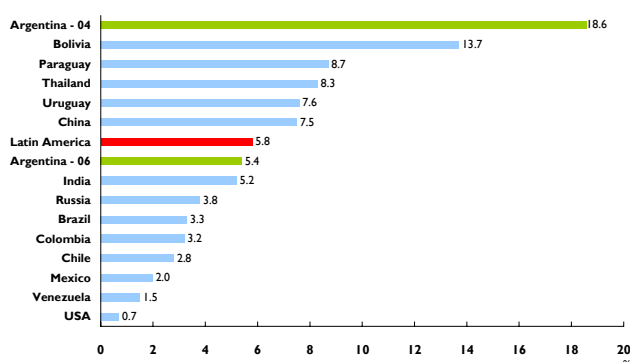
continue to grow at a strong pace across emerging economies (particularly in Latin America) and at a higher rate than credit to corporations. This expansion contributes to the diversification of financial institutions' risks. Growth in these credit lines has occurred under low interest rate conditions. Although not a risk factor over the short term, there are signs that these conditions may gradually turn around.

*Although further periods of high volatility cannot be ruled out, international conditions are expected to remain favorable*

The outlook for the second half of 2006 is positive: emerging markets are expected to keep recovering from recent turbulence after the correction in emerging market asset prices concludes, aided by lower pressure on the Fed to continue raising its interest rate. The strength of the region's macroeconomic indicators allows for a measure of optimism.

However, further volatility could still arise from a number of latent risk factors: an abrupt correction to "global imbalances", a deepening of geopolitical conflict, further rises in the price of oil (and other commodities), or a sudden correction in asset prices (particularly real estate in the US). All factors considered, international conditions remain favorable to Argentina despite the reduction in international liquidity and the possibility of continued volatility in world financial markets. Argentina is currently better prepared than in the past to deal with adverse changes to international conditions.

**Chart I.8**  
**Non-Performing Private Portfolio**  
Non-performing portfolio / Total Financing - 2005



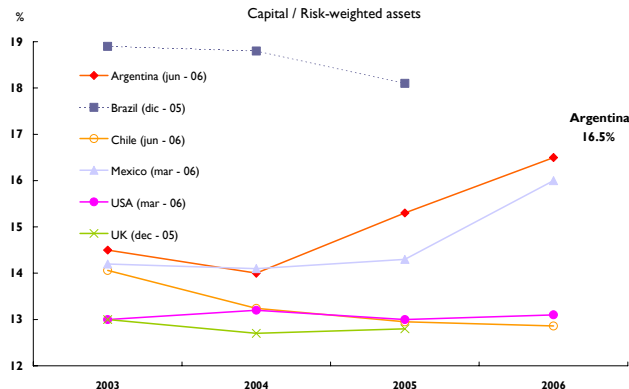
Source: BCRA from Central Banks data and Superintendences of Banks

## I.2. Domestic conditions

*Macroeconomic conditions are expected to remain encouraging to financial stability*

The economy continued to grow at a high pace during 2006, as has been the case since 2003, accumulating a total 17 quarters of continuous economic growth. Economic activity levels are currently 11.9% higher than in the pre-crisis peak (the second quarter of 1998). GDP increased by 3.7% s.a. (8.3% y.o.y.) during the first half of 2006. However, growth was not evenly spread out: a larger increase was registered in the second quarter (2.1% s.a., similar to average growth since mid 2002), after a temporary slowdown in the first quarter (1.5% s.a.). Growth in GDP during the first half was driven by a substantial increase in investment, while private consumption levels remained high (see Chart I.10).

**Chart I.9**  
**Solvency**  
Capital / Risk-weighted assets



Source: BCRA and IMF

Investment was driven mostly by construction, following temporary adverse conditions during the first quarter. There was also substantial growth in spending on durable production equipment, which increased by 16.8% y.o.y. during the first half and is expected to reach the same level as in 1998 by the end of the year (at constant prices). The investment rate is expected to rise further – to 21.7% of GDP at constant prices in 2006 – causing the stock of capital to increase by 4.5%, the highest increase since the end of the crisis (see Chart I.11).

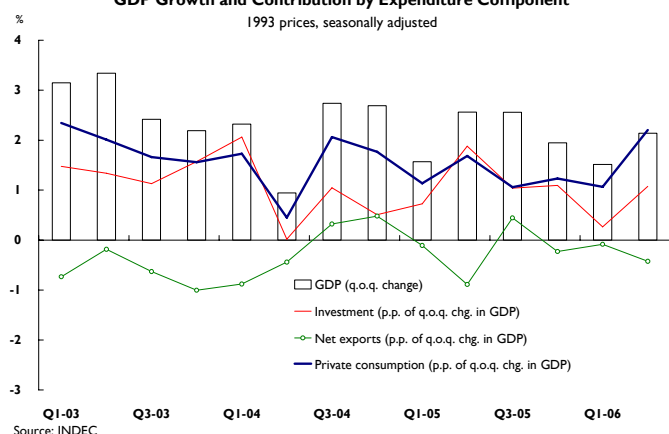
GDP is forecast to grow by 7.5% to 8% y.o.y. during 2006, based on the statistical carryover effect from the second quarter



Chart I.10

### GDP Growth and Contribution by Expenditure Component

1993 prices, seasonally adjusted



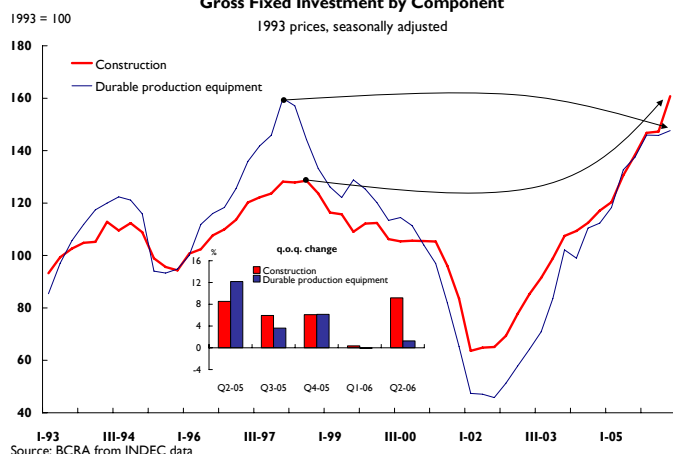
(in excess of 6% s.a.) and expected increased in consumption and investment over the second half of the year. As a result, the statistical carryover effect for 2007 would be greater than 2 p.p..

The current account surplus has continued to perform as expected, driven by a substantial surplus in the trade balance for goods, an improvement in the balance for real services and lower interest accrual on public debt. The trade surplus is expected to remain at historically high levels throughout 2006, exceeding US\$10 billion by the end of the year. This balance is consistent with exports of close to US\$44.3 billion and imports of US\$33.5 billion. Consequently, the current account surplus would amount to 2.9% of GDP in 2006 (see Chart I.12).

Chart I.11

### Gross Fixed Investment by Component

1993 prices, seasonally adjusted



The Non Financial Public Sector (NFPS) accumulated a surplus of about \$12.6 billion in the first half, an increase of about \$1 billion y.o.y., or 8.6% y.o.y.. The increase in national primary spending slowed down in the second quarter compared to the first, as spending grew by 22% y.o.y.. This outcome was driven by a slowdown in the rate of increase in tax revenues, leading to a lower increase in automatic transfers to provinces. Tax revenue in 2006 is forecast to be approximately 22.5% of GDP, allowing the NFPS annual primary balance to attain the guideline of 3.3% of GDP set down in the 2006 national budget. The national government continued issuing dollar-denominated bonds during the first half, for approximately \$9.1 billion in par value, and financial requirements through the end of the year are almost covered.

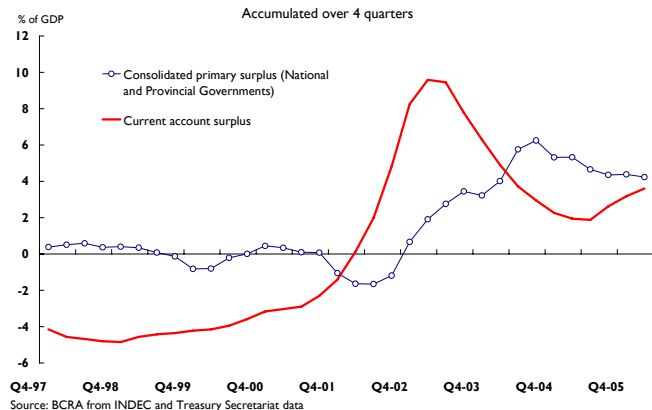
*Inflation expectations are slowing down, mainly due to effective monetary policy and a recovery in investment*

Retail prices continued to slow down, as they have since the start of the year, and this caused inflation expectations to decline further (see Chart I.13). The consumer price index (CPI) increased by 1.9% during the second quarter and 4.9% during the first half of 2006. These increases were below market expectations and the corresponding increases in 2005, which were 2% in the second quarter and 6.1% in the first half. The slowdown in the rate of change of overall consumer prices was aided by the performance of core inflation, which was 5.4% during the first half, down from 7.2% a year earlier. Inflation is expected to end the year within the (8% to 11%) range set forth in the 2006 Monetary Program.

Chart I.12

### Current Account and Fiscal Account Balances

Accumulated over 4 quarters

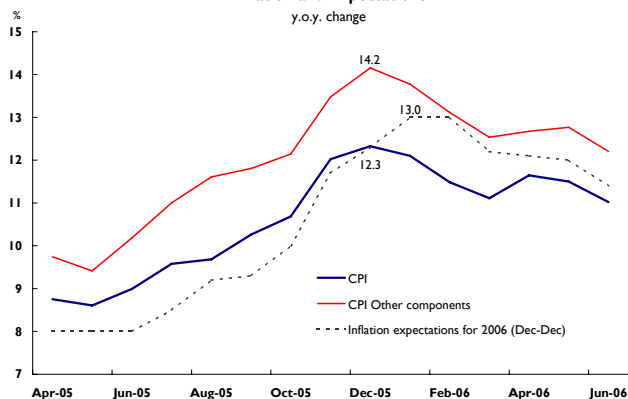


Growth in monetary aggregates was kept under strict control during the first half, as shown by the ease with which monetary program targets were fulfilled during the first two quarters (see Chart I.14). The average level for M2 came to \$106.2 billion in March, close to the monetary program's lower bound for the first quarter, and to \$109.8 billion in June, also very close to the lower bound – 1.8% above the lower bound and 5.1% below the upper bound of the target range. The Central Bank has therefore completed twelve consecutive quarters of monetary program compliance.

The Central Bank maintained its prudential reserve accumulation policy during the first half, as a countercyclical insurance mechanism aimed at protecting the economy from external shocks and dampening exchange rate volatility. The stock of



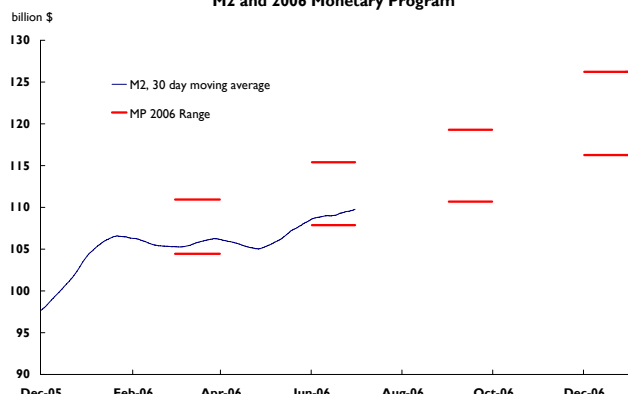
**Chart I.13**  
**Inflation and Expectations**  
y.o.y. change



Source: INDEC and BCRA

international reserves reached almost US\$25.5 billion at the end of the first half, increasing by US\$6.9 billion since the settlement of all outstanding debt with the International Monetary Fund (IMF) on January 3 this year. The prudential reserve accumulation strategy was accompanied by a sterilization policy characterized by depth and quality, as required to make it compatible with the aim of monetary equilibrium. During the first half of 2006, close to \$13 billion in foreign currency purchases were sterilized: 65% of the sterilization was carried out through early settlements on rediscounts, whereas the rest was carried out through public sector transactions.

**Chart I.14**  
**M2 and 2006 Monetary Program**



Source: BCRA



## II. CAPITAL MARKETS

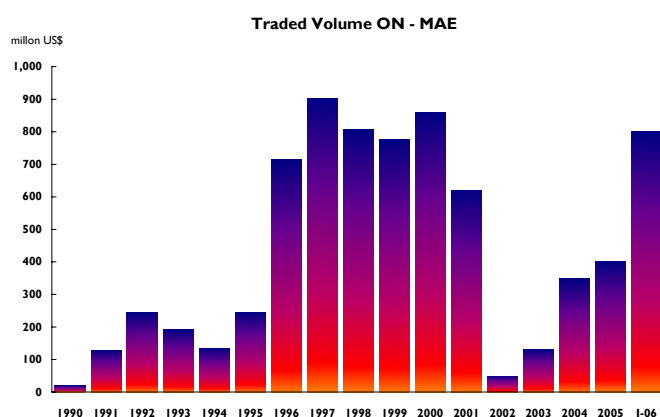
### Summary

*In the first months of the year, the combination of strong fundamentals for the Argentine economy and a favorable global context for emerging markets supported the good performance of the domestic capital market. The latter was characterized by the growth in prices, traded volumes and amounts of new debt issued. Following the deterioration of the international financial outlook, the fundamentals determined the economy's strength to cushion the effects of an adverse environment and, afterwards, allowed a gradual recovery.*

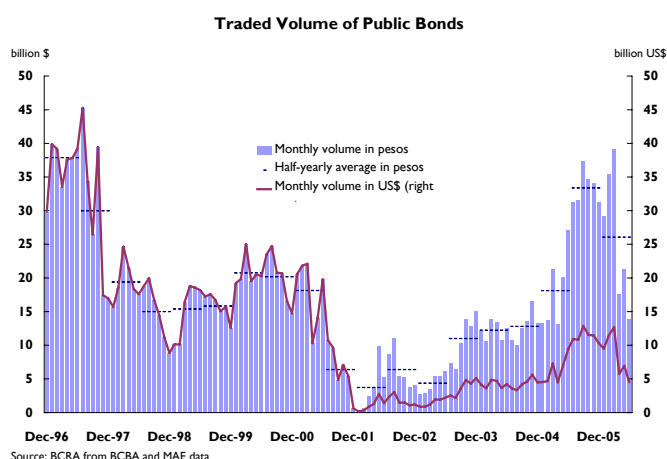
*Government securities experienced an intense level of activity in the first months of the year. Overall rises in bond prices led to historical lows in spreads for dollar-denominated bonds. These trends, which reversed course in May 2006, would gradually be coming back by the end of the period. As regards primary markets, the Government performed private placements of BODEN 2012 and open market auctions of BONAR V, while the Central Bank, in line with the 2006 Monetary Program, continued with the auctions of LEBAC and NOBAC.*

*Private sector debt was also involved in this dynamism. Genuine issuance of corporate bonds carried on, furthering the consolidation of this instrument as a source of financial resources. At the same time, debt swap transactions aimed at normalizing defaulted liabilities took place over the period, reaching close to 80% of firms with liabilities in post-crisis restructuring. Such intense activity in the primary market went together with growing traded volumes. In addition, the amount of financial trusts issued remained at elevated levels, while traded volumes of deferred-payment checks kept growing as a financing source for SME, though traded volumes are still low.*

*Additionally, the Merval stock index reached a new historic high record, with volumes similar to the levels exhibited in 2005 on average, albeit experiencing a contraction in traded volumes towards the end of the period. Moreover, the derivatives market keeps growing, basically the exchange rate market, even when the development of other relevant instruments of this market, like CER and BADLAR futures, is still incipient.*



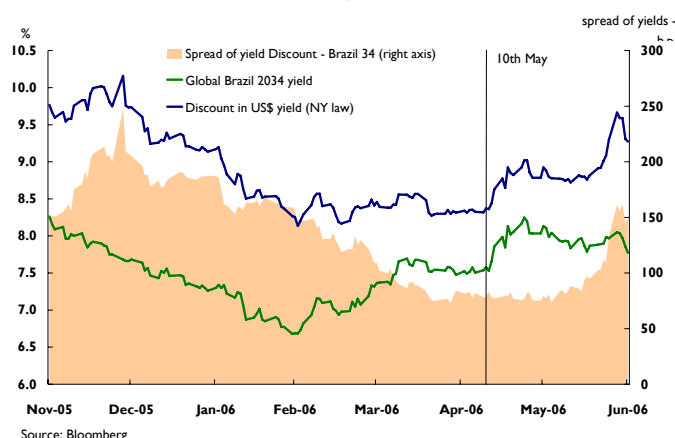
Note: First half of 2006 is annualized.  
Source: MAE



Source: BCRA from BCBA and MAE data

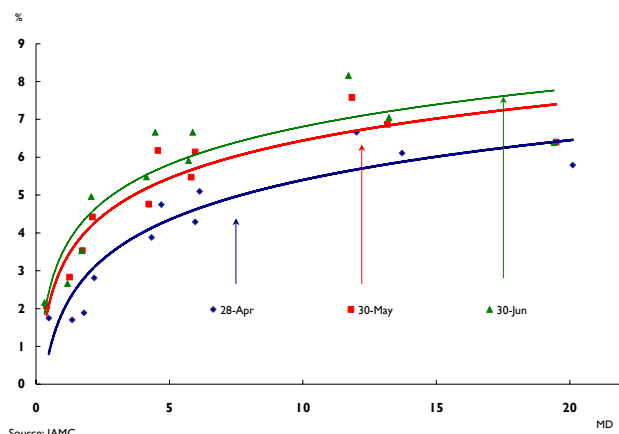


Chart II.1  
Yields of Discount in US\$ and Global Brazil 2034



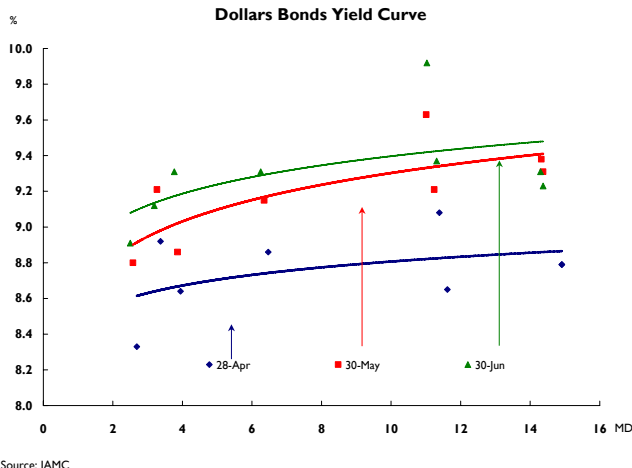
Source: Bloomberg

Chart II.2  
CER Adjusted Bonds in Pesos Yield Curve



Source: IAMC

Chart II.3  
Dollars Bonds Yield Curve



Source: IAMC

## II.1. Public sector fixed income

*Replicating the global trends, domestic financial assets exhibited an excellent performance until May 2006*

Fixed income and equity assets in Argentina started the year recording higher prices and traded volumes. Taking into consideration the relatively lower starting point for Argentine fixed income assets prices at the beginning of the year, in the first months of 2006 they portrayed a better relative performance than those of fixed income assets from other countries in the region. For instance, the spread between the yields of the dollar-denominated Argentine Discount bond and the Brazilian one with maturity in 2034, fell from a maximum of 250 b.p. (recorded towards the end of 2005) to 75 b.p. in April 2006 (see Chart II.1). That trend started reversing course in mid-June. In addition, GPD-linked units, that were stripped from the bonds they were attached to and started to be traded separately by the end of 2005, recorded considerable gains in their prices. Lastly, as Standard & Poor's raised the credit rating of the country on March 23rd<sup>8</sup>, the positive setting was further strengthened.

In line with the developments observed at the international level (see Page 14), as from May 10<sup>th</sup> a strong increase in capital markets' volatility was evident, in a framework defined by price corrections and massive sales of emerging market assets. Nevertheless, the strength of macroeconomic fundamentals served as a cushion against the impact of this negative shock. The yield curve for CER-adjusted pesos steepened (see chart II.2) as investors flew to bonds with shorter duration, given their lower risk. In addition, the market's interest in assets linked to the BADLAR rate (basically, instruments issued by the Central Bank, NOBAC with variable coupon) grew considerably, as expectations for inflation rates relative to domestic interest rates fell. The yield curve for dollar-denominated assets remained essentially flat, though it experienced a minor steepening (see Chart II.3)

This environment, characterized by higher required returns, did not have a material impact on the placement of public sector debt. Like in most emerging market economies, by the time volatility rose, Argentina had already met virtually all its financing needs for the year. This was possible due to the new debt profile (that emerged from the restructuring process concluded in 2005), the early payment of all outstanding debt with the IMF, and a series of debt placements by the National Treasury.

As in 2005, debt auction processes took place in the domestic market<sup>9</sup>. In the first half of 2006 the Government issued debt through auction processes and private placements (Venezuela Government). Given that in mid-2005 the issuance of adjustable securities was put off, in 2006 only dollar-denominated

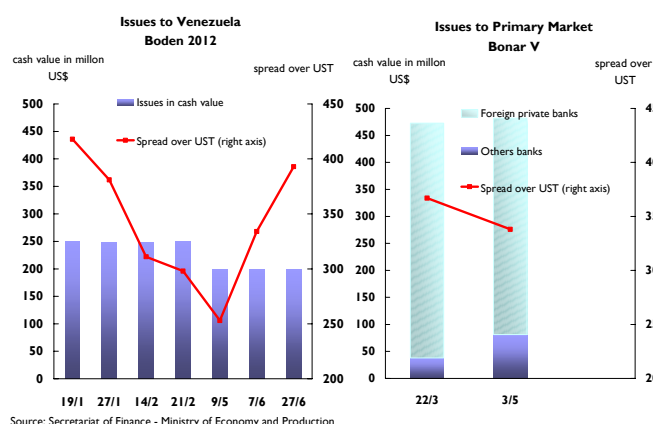
<sup>8</sup> The rating for long-term debt in foreign currency was raised from B- to B.

<sup>9</sup> To undertake a global debt placement would require the support of a financial structure capable of protecting the proceeds from potential legal actions from holdouts.





Chart II.4  
Issues First Half 2006



securities were issued (see Chart II.4). Total cumulative issuance to June reached US\$2.55 billion cash value<sup>10</sup>.

Sixty two per cent of that total was privately placed with the Government of Venezuela (BODEN 2012), while the remaining is made up of two US\$500 million of face value issues of BONAR V (with maturity in 2011). Foreign banks were noteworthy participants at these auctions: they subscribed close to 80% of the total amount issued<sup>11</sup>. Additionally, the bid volume / auctioned volume ratios exhibited a positive trend, reflecting the market's interest in these instruments.

*Despite volatility, the depth of the secondary markets grows progressively*

At the same time, the Central Bank continued to auction LEBAC and NOBAC on a regular basis, in line with the current Monetary Program. Until June 2006 the outstanding stock of assets issued by the Monetary Authority was close to \$32.3 billion, with a \$5.9 billion increase in 2006. Over the year, a remarkable change in the composition of outstanding assets of this type took place: the share of NOBAC securities with variable coupon (spread over BADLAR rate) of the total outstanding grew from 12% in late 2005 to 56% in June 2006. This increase was at the expense of both CER-adjustable and fixed coupon securities, which saw their shares in the total fall by half. With regards to yields, cut off rates exhibit in 2006 a mild uptrend at the successive auctions that was not present in the spreads over the related BADLAR rate, which in fact experienced a declining trend over the period (see Chart II.5), with the sole exception of what happened in the volatile context from May onwards. These instruments bear a good deal of acceptance among local financial entities, as their addition to their portfolios provide a certain degree of hedging against an eventual increase in interest rates paid to depositors. In addition, the average life of the portfolio of Central Bank bills and notes rose almost 100 days over the period, and thus its duration is now close to one year.

Chart II.5  
Spread over BADLAR in NOBAC Auctions  
Variable coupon BADLAR private banks rate + 2.5%

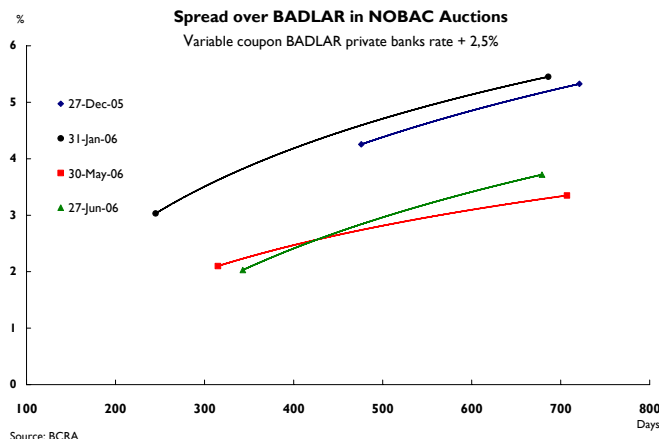
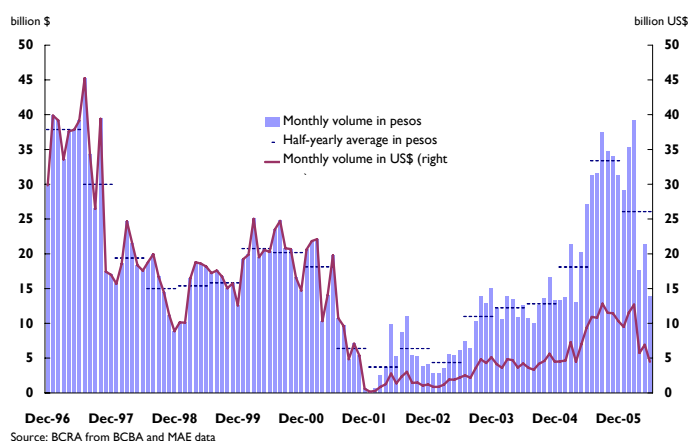


Chart II.6  
Traded Volume of Public Bonds



Even when traded volumes for fixed income assets in the local market still exhibit significant volatility, in perspective their behavior has tended to go together with that of prices. Over the first quarter a growing trend is noticeable, as the traded volumes in Central Bank and Government securities climbed from a daily average of approximately \$1.5 billion in late 2005 (BCBA and MAE) to almost \$1.65 billion in the January-March period, to fall back to \$1 billion (see Chart II.6).

## II.2. Other fixed income instruments

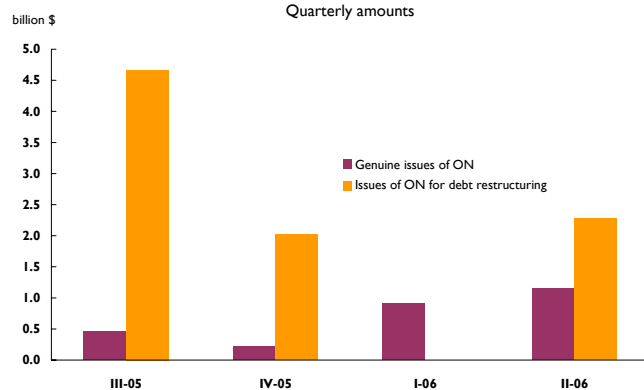
*Genuine ON issuance activity is picking up, while the market for financial trusts keeps growing strongly*

<sup>10</sup> These placements account for the increase in the national public debt stock in 2006, which stood at US\$128.6 billion at the beginning of the period. This figure excludes holdouts bearing approximately US\$23.5 billion of bonds, but includes the debt with the Paris Club and other bilateral (past-due and pending debt), for a total of US\$6.45 billion. The settlement of these obligations is still pending. Lastly, Government securities and provincial guaranteed debt (BOGAR) accounted for US\$73.6 billion of the debt stock.

<sup>11</sup> These placements are not subject to the non-remunerated deposit, as required to other capital transactions, because they are public offers in the primary market.

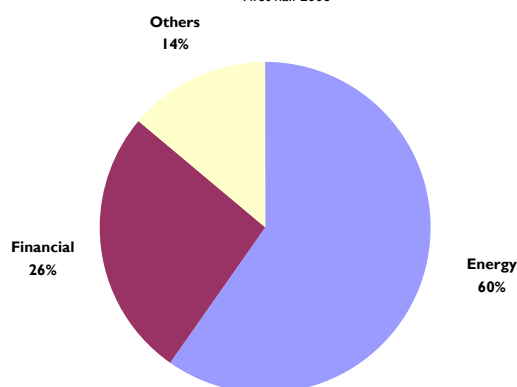


**Chart II.7**  
**Corporate Bonds Issues**  
Quarterly amounts



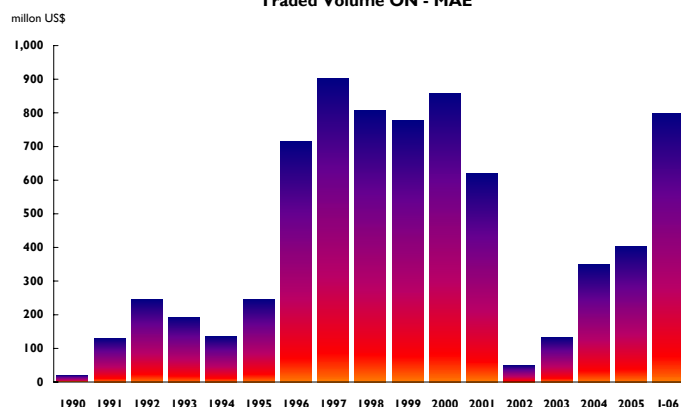
Source: BCRA from Bolsar, MAE and Fundación Capital

**Chart II.8**  
**Corporate Bonds Issues by Sector**  
First half 2006



Source: BCRA from Bolsar, MAE and Fundación Capital

**Chart II.9**  
**Traded Volume ON - MAE**



Note: First half of 2006 is annualized.  
Source: MAE

The issuance of corporate bonds (ON) used to be a significant source of financial resources for the productive sector in the years prior to the 2001-2002 crisis. Private sector defaults following this period led to a sharp deceleration in the pace of issuance. Nevertheless, in the past few years issuance has been picking up pace (see Chart II.7), even when the level is still below that observed in the past decade in the domestic market and the current levels of issuance witnessed in other countries in the region.

The growth of this market is particularly important for the domestic financial system, to the extent that it represents a medium and long-term financing source for those firms that bear a greater relevance for the system, complementing the financing provided by the bank sector. Additionally, the prices of ONs provide valuable information. Firstly, they reveal the current market perception of the credit risk associated with issuing companies (including banks) and related sectors. In addition, yield curves derived from secondary market trading prices provide a reference, or benchmark, for banking corporate credit with longer maturities. Finally, for the specific case of banks, they provide a certain type of funding that fosters the improvement of longer-dated credit supply.

In the first half of 2006, total issuance reached an estimated \$4.3 billion, taking into account both genuine issuance as well as that related to debt restructuring processes. Genuine issuance year to date has reached \$1.9 billion, representing a remarkable growth when compared with the \$1.2 billion issued in 2005<sup>12</sup>. Roughly 90% of the amount issued in 2006 was denominated in US dollars, while the remaining 10% was denominated in both euros and pesos.

Issuance by members of the bank system accounted for a significant share of the total issued in the first half of the year, only second to those performed by firms in the energy sector (see Chart II.8), where the bulk of issuance related to debt restructuring processes took place. As a matter of fact, the largest genuine issuance, for US\$250 million and maturity in 2016, was executed by a financial institution, in the framework of a Global Issuance Program authorizing a maximum of US\$1.2 billion. The yield of these securities issued (April) was 9.89%.

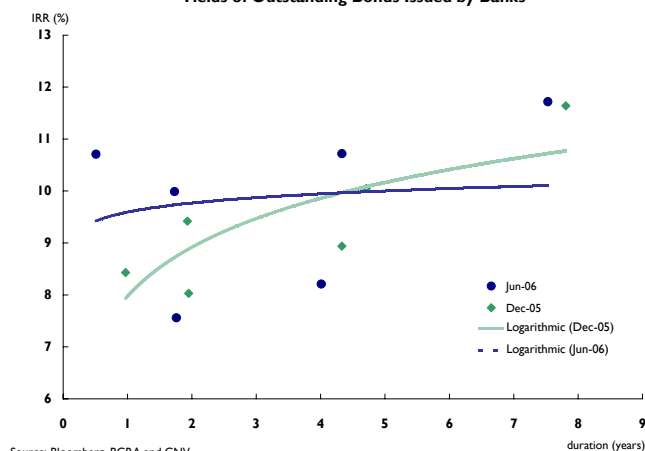
With regards to secondary market trading, while traded volumes increased (see Chart II.9), yield curves moved replicating the overall behavior of the different kinds of assets. In the specific case of the banking sector, the yield curve flattened over the period, although dispersion among individual securities was significant (see Chart II.10).

The remarkable dynamism of financial trusts was still present over the first half of 2006, being one of the fastest growing instruments in 2005, with total issuance in excess of \$5 billion (see Chart II.11). Over this period, 82 individual issuances for an approximate total of \$3.2 billion took place. In this manner, issuance grew 90% as compared with the \$1.7 billion issued in the same period of 2005.

<sup>12</sup> The total for 2005 was \$8.4 billion, when issuance related to debt restructuring processes is accounted for.



Chart II.10  
Yields of Outstanding Bonds Issued by Banks



This growth is linked, to a large extent, to the activity of financial entities, as the securitization of consumption financing (credit card coupons and personal loans) accounted for over 60% of the total issued in the first half of the year (see Chart II.12). In the cases where financing had originally been provided by banks, the securitization of those assets frees lending capacity of the entities involved. Guaranteed Loans make up another of the leading underlying assets in the period (accounting for 32% of the securities issued). Additionally, other types of financial trusts, as is the case of those linked to mortgages, let the financial system improve their supply in this segment of the market.

Lastly, trading of deferred-payment checks in the stock exchange (financing related to the SME segment) keeps showing one of the highest rates of growth (see Chart II.13). Nevertheless, total outstanding amounts are, in relative terms, comparatively low (\$185 million in the first half of 2006).

### II.3. Equities

*The Merval index reached a new historic record, while traded volume in the first half of the year remained stable*

The leading stock index (Merval), measured in pesos, reached in late April a new historic record of 1,943 points, only to fall markedly in May and June (see Chart II.14) to levels close to 1,500. Then, it recovered and traded sideways in the range between 1,600 and 1,750. Accordingly, in the first half of the year it rose 9% in dollar terms, below the 19% gained by the leading index in Brazil (the appreciation of the real accounted for a significant share in this outcome). The behavior of the Merval is strongly linked to the performance of TENARIS (as its weight within the index is close to one third), which is, in turn, highly correlated with the price of crude oil.

With regards to traded volumes in equities, while in the January-May period the average daily volume was similar to that of the second half of 2005 (in the range of \$78 million per day), in June it fell to \$54 million per day. Total traded volume in the first half of 2006 was similar to those recorded in the previous year.

### II.4. Derivatives markets

*The foreign exchange derivatives market reflects greater dynamism, the development of other derivative instruments is still pending*

The foreign exchange derivatives market (in essence, peso-dollar futures) traded volumes have experienced a sustained rate of increase over the past years, alongside the growth of the export sector (see Chart II.15). The expansion of this market is particularly useful for financial entities, as by means of these instruments they are able to hedge some of their foreign currency positions.

Trading activity was highest in May, in the framework of an increase in overall uncertainty, which led to greater monthly

Chart II.11  
New Financial Trusts

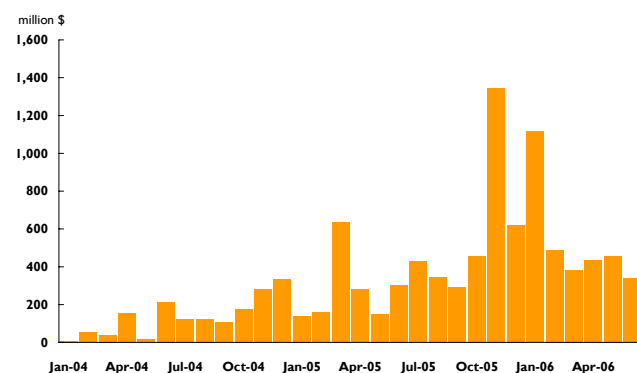
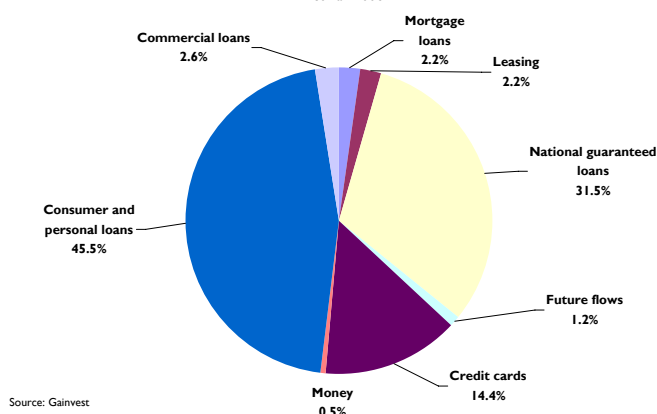
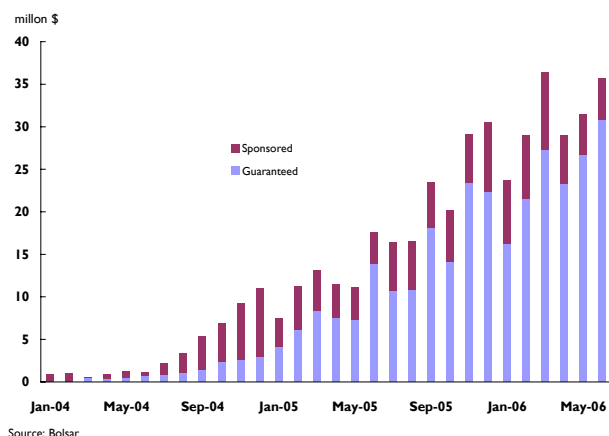


Chart II.12  
Securitization by Underlying Assets  
First half 2006





**Chart II.13**  
**Trading of Deferred-Payments Checks**

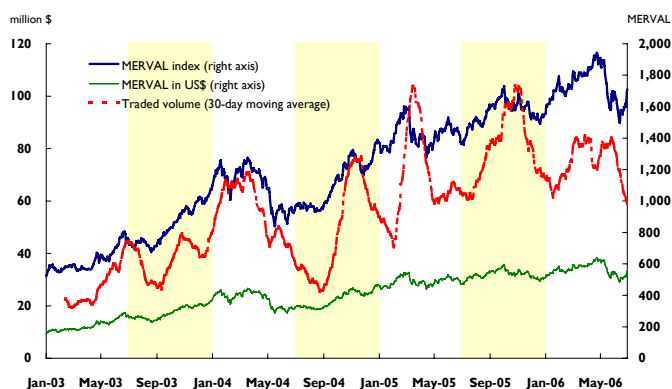


Source: Bolsar

volatility in the foreign exchange spot market. The high correlation between traded volumes in the MAE and Rofex markets (with coincident maximum and minimum monthly traded volumes) prove how agents arbitrated between those markets.

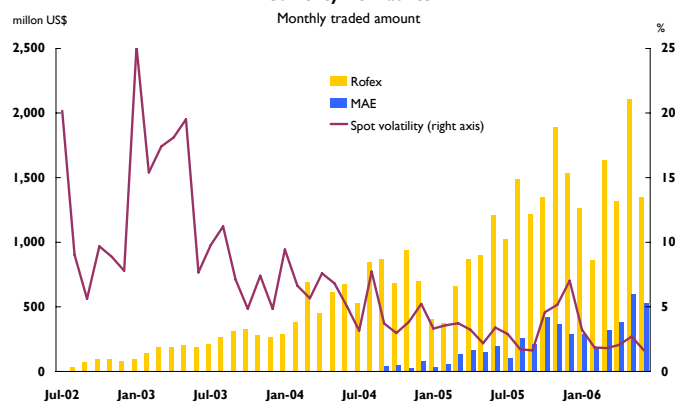
Additional derivative instruments exist in the local market, like futures on CER and BADLAR, which in principle could be used by financial entities to improve their management of risk, by permitting them to hedge against eventual changes in nominal and real interest rates. Nevertheless, trading activity in these instruments is still at an early stage. The market for futures on the BADLAR rate was only active a few days at the beginning of the year (MAE). Similarly, futures on CER register only a few trades over the first months of the year, and volumes were not significant.

**Chart II.14**  
**Local Stock Markets**



Source: BCBA

**Chart II.15**  
**Currency Derivatives**



Source: Rofex and MAE

### III. FINANCIAL SYSTEM DEBTORS

#### Summary

*During the first part of 2006 a trend that had been accelerating in the last two years was confirmed: exposure to the private sector exceeded that to the public sector, so that the private sector became the main debtor of the financial system. This return to normality by financial intermediation is switching the focus of bank credit risk evaluation from the public sector towards companies and households.*

*Continued favorable economic development conditions, rising economic agent income levels and the relatively low level of indebtedness combine to create a framework of adequate economic and financial solvency for leading financial system debtors, with a positive impact on the determination of counterpart risk. In particular, National Public Sector saving remained high during the period, and in addition, borrowing requirements for 2006 were fully covered, debt levels were lowered, and the maturity horizon for liabilities was broadened as a result of the settlement in full of the debt with the IMF.*

*The manufacturing sector continues to grow at a healthy rate, reaching a level of capacity utilization that is driving investment needs. At present, the expansion of company production capacity is taking place without any deterioration in the financial position of firms. The low-intensity use made of financial system credit lines and the broad growth by productive activity in various sectors is evidence of this. Manufacturing industry, the service sector, and despite the current circumstantial deterioration, primary production, have accounted for most of company borrowing, while commerce is in a sound position to become a taker of credit. Construction, one of the drivers behind current economic growth, is developing with a low level of local bank financing.*

*The economic and financial performance of households has been strengthened in particular by the reduction in unemployment, rising formal employment, higher real wages, and their relatively low level of indebtedness. Although consumer credit lines grew rapidly in recent years, the increase was in line with the changing income levels of salaried workers, so that the aggregate financial position remained relatively constant. Based on these developments, it is expected that the household sector will continue to be an active taker of bank credit in coming years.*

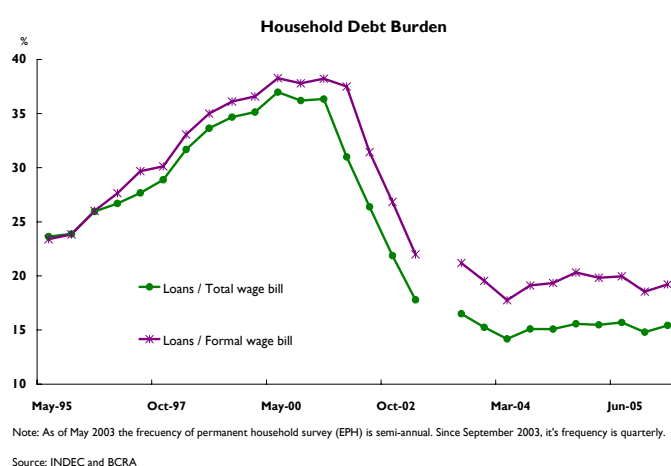
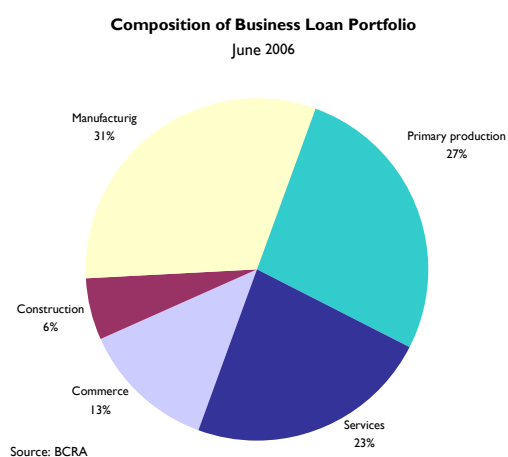
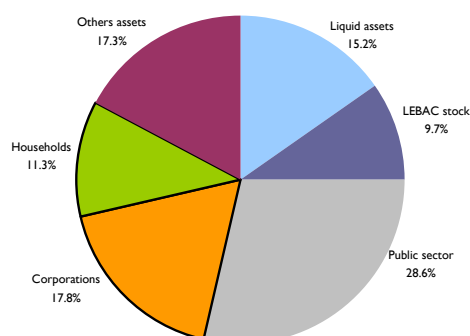


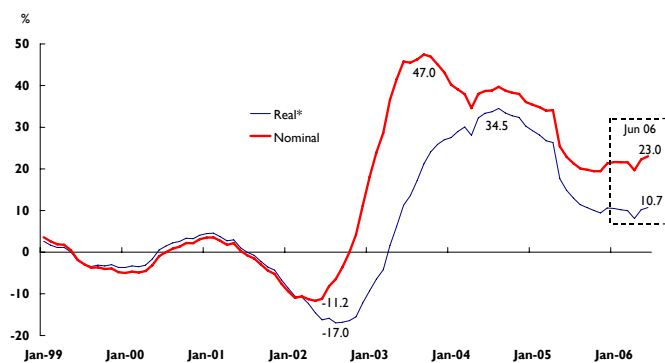


Chart III.1  
Financial System Asset Portfolio  
As % of netted assets - June 2006



Source: BCRA

Chart III.2  
National Tax Revenue  
12 month moving average - y.o.y. change %



\*Deflated by CPI  
Source: BCRA from INDEC and Treasury Secretariat data

Table III.1  
Bond Issues in 2005 and 2006

Bond	Date of issue	Amount of issue <sup>1</sup>	Cut price <sup>2</sup>	Yield <sup>2</sup>	Spread vs. Treasury <sup>3</sup>
<b>In pesos</b>					
Boden 2014*	04-May-05	1,000	78.7	6.4	-
Boden 2014*	07-Jul-05	1,000	85.5	5.4	-
Boden 2014*	11-Jul-05	1,000	87.3	5.1	-
<b>2005 Total</b>		<b>3,000</b>			
<b>In dollars</b>					
Boden 2012**	06-May-05	117	85.6	9.5	565
Boden 2012**	13-Jun-05	221	90.5	7.8	400
Boden 2012	18-Jul-05	442	91.3	7.8	389
Boden 2012**	26-Jul-05	219	91.2	8.0	399
Boden 2012	03-Aug-05	350	78.2	7.8	389
Boden 2012**	26-Sep-05	189	79.5	7.7	359
Boden 2012**	26-Sep-05	50	79.5	7.7	359
Boden 2015	26-Oct-05	632	89.1	8.8	417
Boden 2012**	13-Dec-05	496	78.7	8.8	440
Boden 2012**	16-Dec-05	270	77.7	9.2	487
<b>2005 Total</b>		<b>2,986</b>			
Boden 2012**	19-Jan-06	312	80.0	8.5	418
Boden 2012**	27-Jan-06	308	81.1	8.3	381
Boden 2012**	14-Feb-06	308	81.1	7.8	311
Boden 2012**	21-Feb-06	307	81.4	7.6	298
Bonar V	22-Mar-06	500	94.5	8.4	367
Bonar V	03-May-06	500	96.4	8.1	338
Boden 2012**	09-May-06	239	83.7	7.5	253
Boden 2012**	07-Jun-06	243	82.5	8.3	334
Boden 2012**	27-Jun-06	245	81.6	9.1	393
<b>2006 Total</b>		<b>2,963</b>			

(1) Face value, in millions; (2) in %; (3) in basic points

(\*) CER adjusted; (\*\*) Private allocations

Source: Secretariat of Finance

### III.1. Financial system assets portfolio

*The weighting of exposure to private sector credit risk exceeded that of the Government*

In June 2006, for the first time since the crisis in 2001-2002, exposure of the financial system to the private sector (companies and households) exceeded exposure to the public sector. Although the trend is sharply downward, the banking sector continues to be strongly dependent on the payment capacity of the Federal Government. The current crowding-in dynamic of the private sector is increasing the need for detailed monitoring of economic and financial performance by companies in first place, and households in second place (see Chart III.1).

### III.2. Public sector

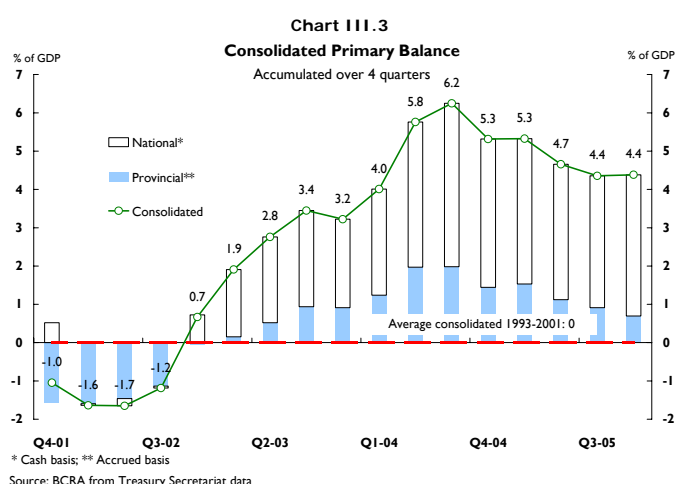
*In the first half of 2006 national public accounts developed positively*

After recording a primary surplus of 3.7% of GDP in 2005, saving by the Non-Financial National Public Sector (NFPS) continued at a high level in the first half of 2006, totaling almost \$12.6 billion, a year-on-year (y.o.y.) increase of \$1 billion (9%), although down by approximately 0.5 p.p. of GDP in annualized terms. The nominal increase in the surplus reflected the sound performance by tax revenue, with growth in the half-yearly average of 21.6% y.o.y. (see Chart III.2). Primary spending showed signs of acceleration in the first half of the year, rising by 25.1% y.o.y.. As a result, given the sharp reduction in interest payments, the financial surplus increased 38.1% y.o.y. at June 2006 (more than \$8 billion), allowing the NFPS to continue to reduce its liabilities.

In addition, in the context of the 2006 Debt Issue Program, in the first half of the year the Government issued debt in dollars for almost US\$3 billion face value (FV), of which close to US\$2 billion corresponded to direct subscriptions by Venezuela (see Table III.1). Despite increased external volatility, the average yield on placements was similar to that in the second half of 2005, and the average spread in relation to US Treasuries dropped 60 basis points (b.p.), falling to under 350 b.p. in the first half of 2006. As a result, the new debt issues, together with the high financial surplus and the use of cash accounts allowed the National Treasury (TGN) to meet repayments of sovereign debt, in addition to settling in net terms \$2.4 billion in the form of temporary advances from the Central Bank. Within this framework, the Government was able to almost fully satisfy its borrowing requirements for 2006.

The Provinces posted a primary surplus of 0.7% of GDP and a financial result of 0.3% of GDP in 2005, lower than the totals for 2004 (1.4% and 1.1% of GDP, respectively). As a result, the primary surplus for the consolidated public sector (Nation and Provinces) totaled 4.4% of GDP last year, following a total of 5.3% of GDP in 2004. In a context of rising spending, it is expected that consolidated fiscal results will continue to decline this year, and the primary surplus will be less than 4% of GDP.



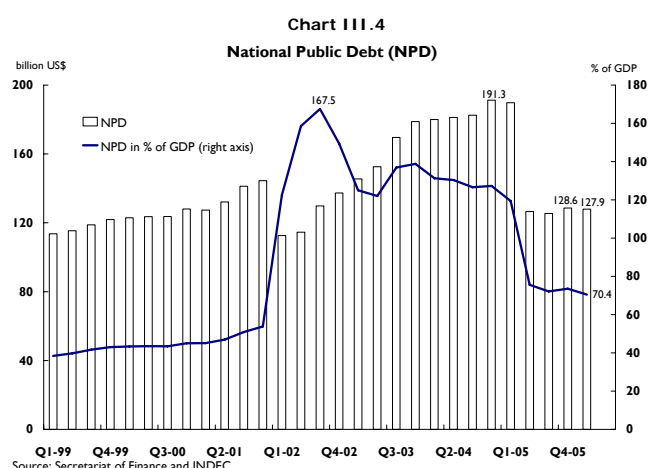


Nevertheless, the primary surplus will remain very high in historical terms, and will continue well above the average for the last decade (see Chart III.3).

### *The favorable dynamic of the fiscal situation and the reduction in public debt improved the Government's payment capacity*

In line with the development seen in the last part of 2005, during the first quarter of 2006 the stock of National Public Debt (NPD) did not record significant change, the most notable element being the settlement in full of the liability with the International Monetary Fund (IMF). At the end of March this year the DPN balance amounted to US\$127.94 billion (70.4% of GDP), a drop of US\$700 million compared with December 2005, while in terms of GDP the drop was 3.1 p.p. as a result of the strong growth in economic activity level (see Chart III.4).

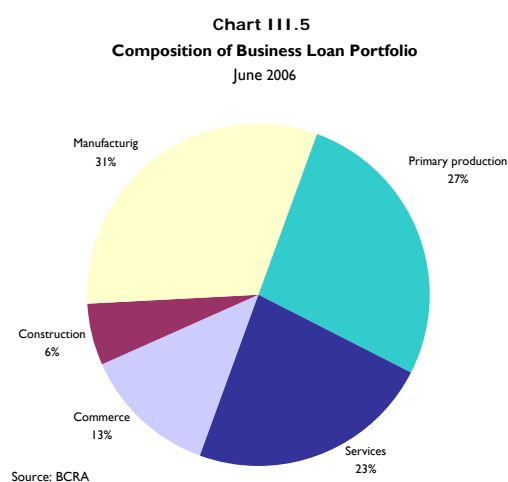
As payment to the IMF took place using Central Bank international reserves, for which the TGN delivered a Bill due in 2016, settlement of the IMF debt was offset by an increase in government securities in foreign currency. Nevertheless, this operation widened the maturity horizon for Government liabilities, reducing borrowing requirements through to 2009 and improving the public sector's payment capacity. Analysis of the debt by currency shows an increase in dollar-denominated liabilities (rising from 36.4% at the end of 2005 to 40.7% in the first quarter of 2006), with a decline in the debt denominated in pesos and in yens. Average interest rates weighted by type of instrument for total NPD remained steady during the first three months of the year.



## III.3. Corporations

*Companies continue to succeed in combining growth with investment and low indebtedness. Penetration by the financial system is still low*

While financial system exposure to productive sectors increased in the first half of 2006, its composition remained similar to that observed at the end of 2005. Industry and primary production continued to be the main debt sectors of local banks (see Chart III.5).

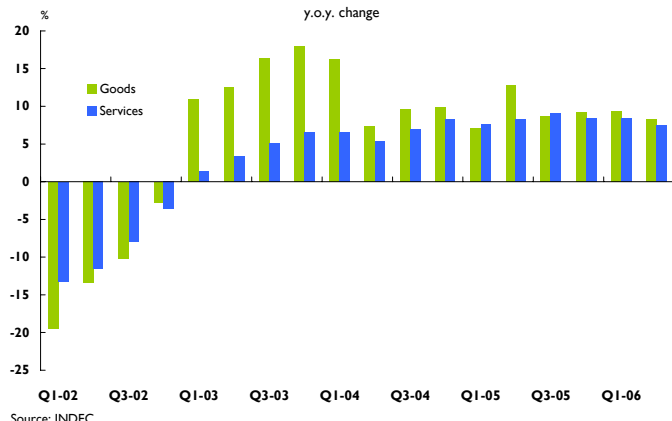


Local supply of goods and real services continued to expand in the first half of the year, with a notable performance by construction, communications services and manufacturing industry (see Chart III.6). The latter grew at a rate similar to that shown last year, following the maturing of productive investment in various sectors and a strong contribution from the automobile industry and producers of construction materials. On the other hand, the agricultural sector saw a decline in its level of activity, as a consequence of lower grain harvest and a drop in the number of animals slaughtered.

In part due to the rise in productive activity, and in part to the steady reduction in borrowing abroad, companies have succeeded in improving their financial position (see Chart III.7). The debt to GDP ratio for companies is barely over 27%, whereas prior to the crisis it was closer to 34%. This consolidation in the position of corporations in recent years is a



**Chart III.6**  
**GDP. Goods and Services**  
y.o.y. change



sign on the one hand of the process of investment that has been evident in the growth in output, and on the other, the low use made by companies of third party funding. The stage has been set for a future increase in corporate borrowing from the financial system and on the capital market.

The companies gaining access to the local capital market are an example of the financial position consolidation that has taken place in the productive sector. Although during the first quarter of 2006 there was a slight increase in leverage for this group of companies, in the second quarter this phenomenon was almost entirely neutralized, revealing the increased solvency and ability to raise new funds of the companies listed on the Buenos Aires Stock Exchange (see Chart III.8). In turn, these firms deepened the declining trend in the weighting of financial loans, revealing a greater relative preference for other types of liability.

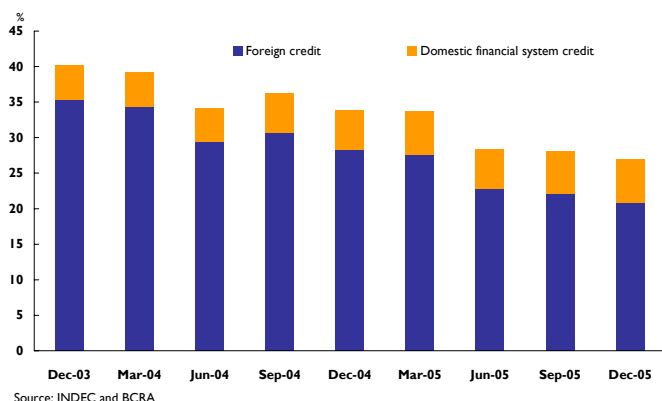
### III.3.1. Manufacturing

*The economic and financial performance of the manufacturing sector continues to improve*

Manufacturing activity continues along the growth path on which it embarked in mid-2002. In the first half, industrial production increased 7.4% y.o.y. (see Chart III.9). In addition to the impulse derived from the domestic market, there was an increase in export sales, with notable growth by sales of Manufactures of Industrial Origin (MOI), mainly transport-related.

The sharp rise in manufacturing output continues to be widespread across the various sectors of manufacturing industry. The headings that contributed most to the growth in activity during the half were the processing of non-metallic minerals and the manufacture of vehicles, two of the main drivers behind industrial growth in the last two years.

**Chart III.7**  
**Corporate Debt**  
As % of GDP



Manufacturing industry is investing to increase installed capacity, which in 2005 rose by approximately 7.5% compared with 2004. Growth in manufacturing activity is taking place at a time when capacity utilization (UIC) has remained relatively steady, a sign of the maturing of certain productive investments by some companies, and increased worker productivity. Average UCI level in the first half of the year was similar to that observed in the same period of 2004 and 2005, while output continued to rise at a rate in excess of 7% y.o.y. (see Chart III.10).

In this context, the change in manufacturing industry profit margins, measured as the difference between the increase in wholesale prices by the sector and in industrial costs, fell slightly in the first half of the year. Higher costs for wages and certain services were mainly responsible for this cutback in margins, which nevertheless remain high in historical terms.

This combination of sustained growth in industrial activity, high margins, and the need for investment by the economic sector that is the main financial system debtor, provides a notably favorable framework for growth in the demand for credit. In addition, despite that fact that industry records the highest indebtedness levels among productive sectors and positive levels of

**Chart III.8**  
**Corporate Debt Burden**  
Companies reporting to the BCBA

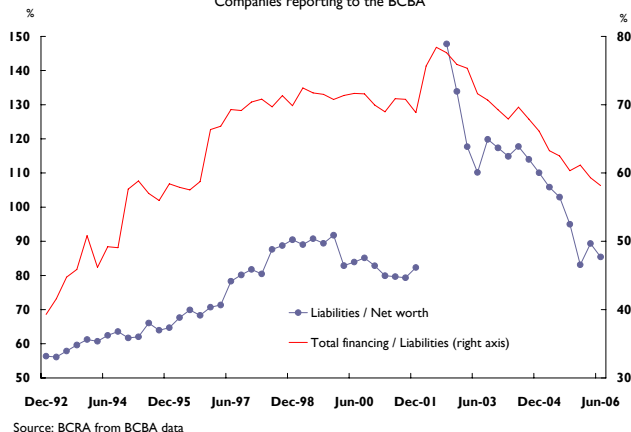
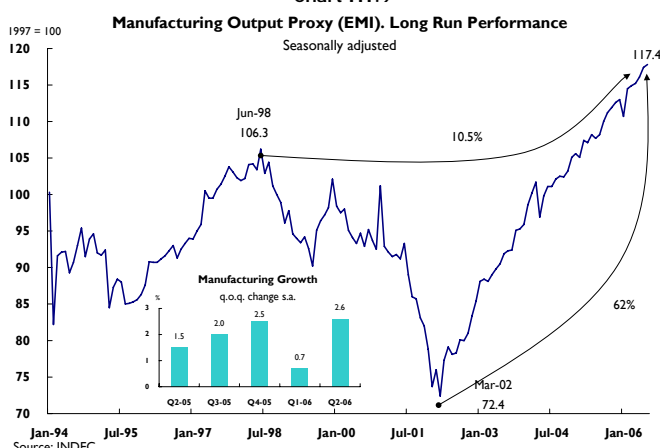






Chart III.9



investment, the growth in its activity is gradually improving solvency indicators, which now stand at a better level than in the pre-crisis period (see Chart III.11).

The rate of manufacturing industry growth is expected to continue high during the remainder of the year, as the flow of investment towards various industrial sectors is making it possible to increase productive capacity, accompanying the upward trend in domestic and external demand.

### III.3.2. Primary sector

*Agricultural sector growth halted in the first half of 2006, although its solvency remains at satisfactory levels*

Despite a record soybean harvest, lower grain volumes and unfavorable weather for the sowing of the fine grain crop last year had a negative impact on the farming sector. The 2005/06 season produced a harvest of slightly over 75 million tons, 11% below the level reached by the previous harvest (see Table III.2). This figure was reached thanks to a record oilseed harvest that only partially offset the drop recorded by the grain harvest. In the case of the 2006/07 season, wheat-growing has been affected by the weather, and as a result the planted area has been smaller than normal. There is expected to be an increase in the area sown with corn and soybean as from October, based on the good outlook for prices, backed by increased world demand for this product as a substitute for fossil fuels.

In the case of the livestock sector, in the first half of 2006 there was a drop in the supply of beef as a result of a decline in domestic demand and lower export shipments, (see Chart III.12). This behavior was partially offset by the upward trends shown by both the poultry and dairy sectors. The supply of poultry products rose by 17% in the first half of the year, encouraged by lower relative prices compared with substitute products, and greater external demand. Raw milk production grew 11.2% y.o.y. in the half, lowering the pressure on domestic prices, because of the increased availability of raw material from higher dairy farm productivity.

Chart III.10

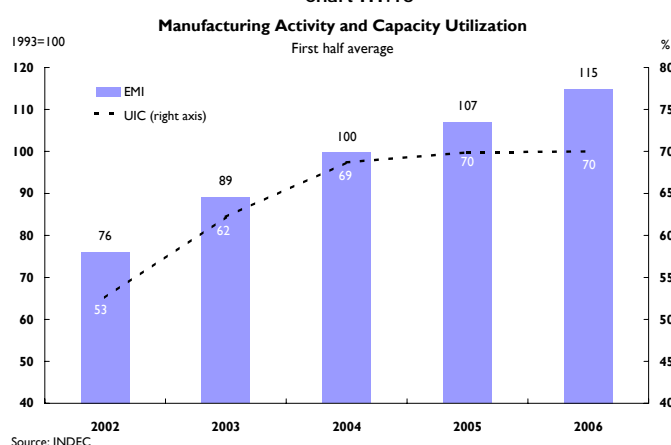
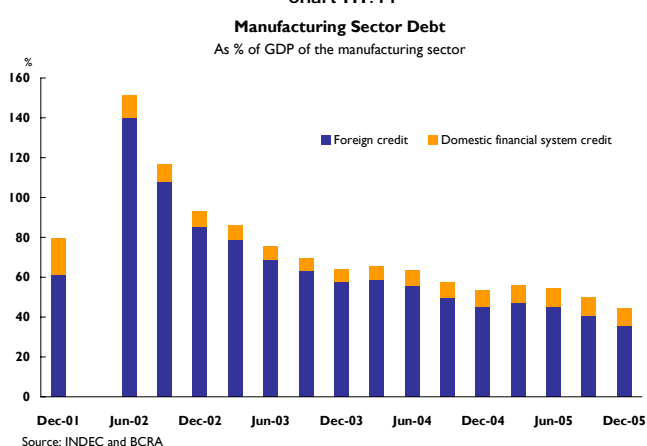


Chart III.11



Despite the drop in agricultural and beef production for circumstantial reasons, the solvency of the primary products sector remains healthier than in the pre-crisis period, when the indebtedness of the primary sector was twice its current level. Furthermore, in the post-crisis period this sector lowered the weighting of its liabilities abroad, gradually increasing its borrowing from the domestic financial system (see Chart III.13).

### III.3.3. Services

*Lower relative indebtedness levels leave margin for financing investments with a low credit risk*

In the first half of 2006 service sectors again contributed positively to the growth of the economy. Construction-related activities (real estate and rentals) and communications, continued to evolve favorably.



**Table III.2**  
**Oleaginous and Grain Productions**

	2003-04		2004-05		2005-06 (estimated)		% chg 2005-06 / 2004-05	Chg 2004-05 / 2003-04
	million tons	%	million tons	%	million tons	%		
<b>Cereals</b>	<b>34,142</b>	<b>49</b>	<b>41,858</b>	<b>49</b>	<b>30,014</b>	<b>41</b>	<b>-28</b>	<b>-11,845</b>
Corn	14,951	21	20,483	24	13,800	19	-33	-6,683
Wheat	14,563	21	15,970	19	12,098	16	-24	-3,872
Grain sorghum	2,165	3	2,894	3	2,000	3	-31	-894
Rice	1,060	2	956	1	1,040	1	9	84
Brewing barley	1,002	1	886	1	796	1	-10	-90
Oat	332	0	536	1	219	0	-59	-317
Rye	37	0	92	0	29	0	-68	-63
Others	33	0	41	0	31	0	-25	-10
<b>Oleaginous</b>	<b>35,098</b>	<b>50</b>	<b>42,658</b>	<b>50</b>	<b>43,647</b>	<b>59</b>	<b>2</b>	<b>989</b>
Soybean	31,577	45	38,300	45	39,500	53	3	1,200
Sunflower	3,161	5	3,800	4	3,800	5	0	0
Peanut	293	0	445	1	274	0	-38	-171
Others	68	0	113	0	73	0	-36	-40
<b>Cotton</b>	<b>350</b>	<b>1</b>	<b>448</b>	<b>1</b>	<b>315</b>	<b>0</b>	<b>-30</b>	<b>-133</b>
<b>Total</b>	<b>69,590</b>	<b>100</b>	<b>84,964</b>	<b>100</b>	<b>73,975</b>	<b>100</b>	<b>-13</b>	<b>-10,989</b>

Source: BCRA from SAGPyA and USDA data

The service sector grew 12.9% y.o.y. in the first six months of 2006, in line with the growth seen in the previous year (20.6% y.o.y.), encouraged by the positive development of demand for telephone services, which rose 19.8% y.o.y.. Toll station usage also showed a positive performance, up 8.5% y.o.y.. Consumption of energy services and transport only recorded a slight improvement of less than 3% y.o.y. in the first six months (see Chart III.14).

Although growth in service companies is being driven by the telephone segment, the sector as a whole shows a low level of indebtedness, equivalent to only 22% of sector GDP. This sound financial position offers a margin for obtaining further financing for investment, in the context of rising activity and a good repayment capacity.

### III.3.4. Commerce

*A favorable financial situation clears the way for growth in commercial activity*

In the first half of 2006 retail sales continued to rise, in line with the marked upward trend in private consumption. Supermarket sales were up 6.8% y.o.y., slightly above the average rate of growth in the last two years, while mall sales slowed mildly in the first half, after growing 13.2% y.o.y. in 2005 (see Chart III.15).

In both cases, part of the impulse came from the significant increase in the consumption of durable consumer goods, particularly household appliances and cars, as a result of significant sales promotions by retail chains, and the increased availability of financing.

With the recovery in consumption, supermarket chains have revived expansion plans nationwide, with a particular focus on cities in the interior. In addition, investment is slowly beginning to appear to expand the availability of property for other types of stores. Making greater use of the local financial system than other productive sectors, commerce records an indebtedness margin similar to that of the service sector, so that it can be expected that such investment needs will not encounter barriers for their financing based on the sector's payment capacity.

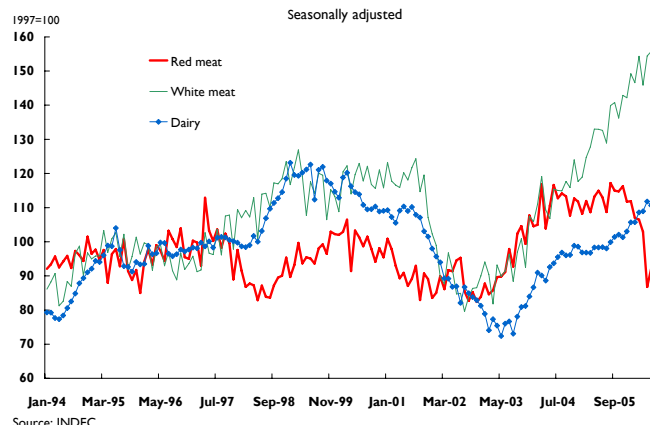
### III.3.5. Construction

*Although construction is one of the drivers behind current economic growth, it acts almost independently from the financial system*

One of the pillars of economic growth has been the flow of investment that has been allocated to construction, and this has remained firm in the first half of 2006. During the period, activity in the construction sector recorded a rise of 21.2% y.o.y., making progress at one of the fastest rates seen in recent years, to stand at close to 14% s.a. (seasonally adjusted) higher than the pre-crisis maximum (see Chart III.16).

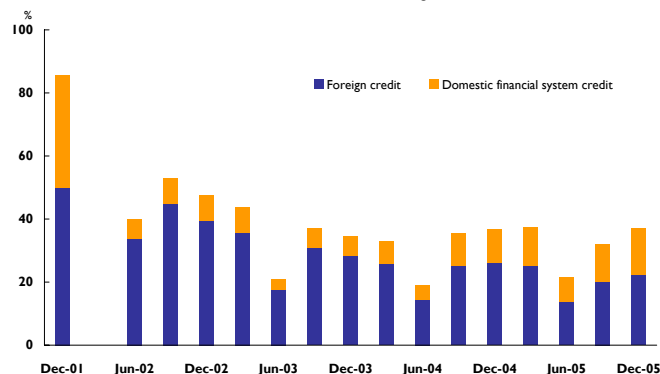
Increased levels of construction took place in all types of developments, with a notable surge in house-building and

**Chart III.12**  
**Livestock Industrial Production**  
Seasonally adjusted



Source: INDEC

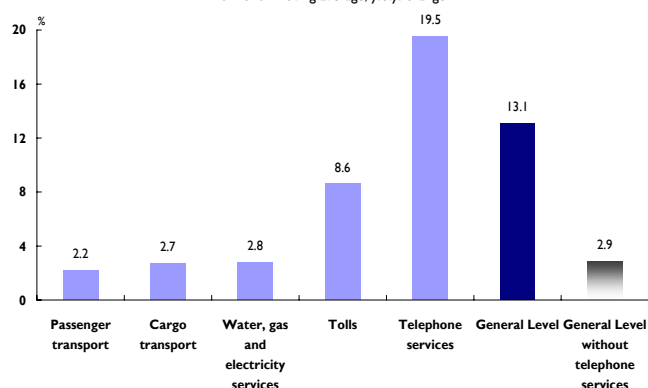
**Chart III.13**  
**Primary Sector Debt**  
As % of GDP of the manufacturing sector



Source: INDEC and BCRA



**Chart III.14**  
**ISSP. Breakdown by Sector**  
6 month moving average, y.o.y. change



Source: BCRA from INDEC data

infrastructure works. In this latter instance, there has been a notable contribution by the Government to the building of public works, particularly in the highway and energy sectors. Scarcity of available commercial and manufacturing units, together with significant growth in hotel construction, gave rise to an increase in developments for commerce, industry and tourism.

The outlook for the construction sector remains favorable, and the sector is expected to maintain the upward trend of recent years. Nevertheless, construction companies record a low use of financing for the carrying out of their developments. Mechanisms such as sale “as from the hole” (before the building has been completed) and the setting up of financial trusts are widely used in the construction sector as a way to self-finance the activity, so that only a few infrastructure construction companies resort to bank borrowing or capital markets.

### III.4. Households

*Growth in income, added to low levels of indebtedness, mean that there is a reduced credit risk associated with lending to households*

Private sector consumption levels continued to increase at above the average for the economy in the first half of the year (around 8.3% y.o.y.), following the increase in the wage mass (because of both rising employment and higher real wages) and growth in consumer credit for households (see Chart III.17).

Labor indicators continue to improve, in line with economic growth (see Chart III.18). The unemployment rate fell again in the second quarter, reaching 10.4% of the economically active population (PEA), a y.o.y. drop of 1.7 p.p.. This dynamic was encouraged by a further significant increase in employment centered on the registered worker sector, in a context of further increase in the market for formally-employed workers. It is expected that the demand for labor will continue to rise in the second half of the year, so that the unemployment rate could end 2006 below 10%. This gain in employment and the increased registration of workers is also leading to an improvement in the main social indicators for the distribution of income and the financial situation of households. Furthermore, mainly as a result of numerous collective bargaining agreements, in recent months an increase has been recorded in real wages in the formal private sector and the public sector, with the general index showing a rise of 3.1% in the first half of 2006.

Notwithstanding the growth in consumer loans, these favorable labor market developments are helping to preserve household payment capacity. Family indebtedness levels are currently well below those recorded in the pre-crisis period, leading to positive expectations regarding the growth in consumer lending with a low associated credit risk (see Chart III.19).

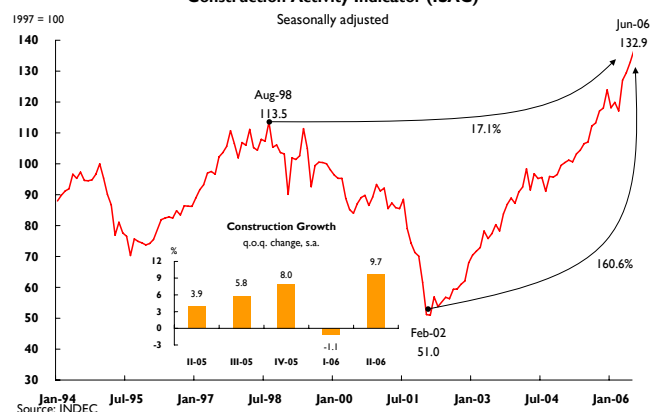
In the second half of the year, it is likely that the dynamic of private consumption will continue upward, bearing in mind that staggered rises in private and public sector wages that must still be implemented, the pension increase, and the recent increase in

**Chart III.15**  
**Supermarket and Shopping Mall Sales**  
In real terms, seasonally adjusted



Source: INDEC

**Chart III.16**  
**Construction Activity Indicator (ISAC)**  
Seasonally adjusted



Source: INDEC



the minimum wage. It is therefore expected that per capita consumption levels will reach a new record in 2006.

Chart III.17

## Private Consumption and Real Labor Income

Constant prices

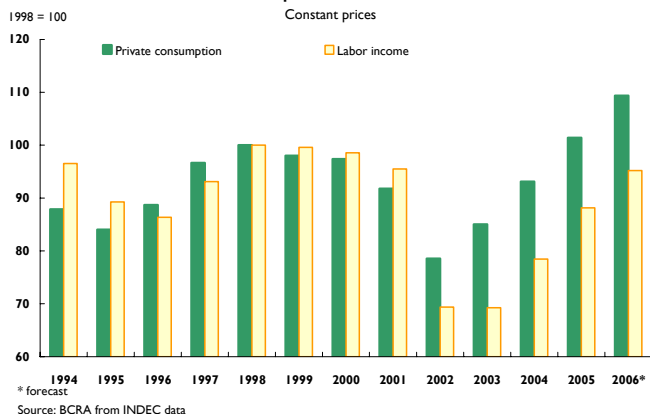
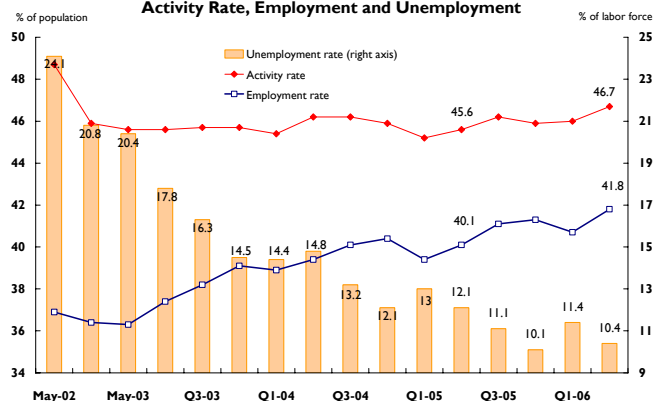
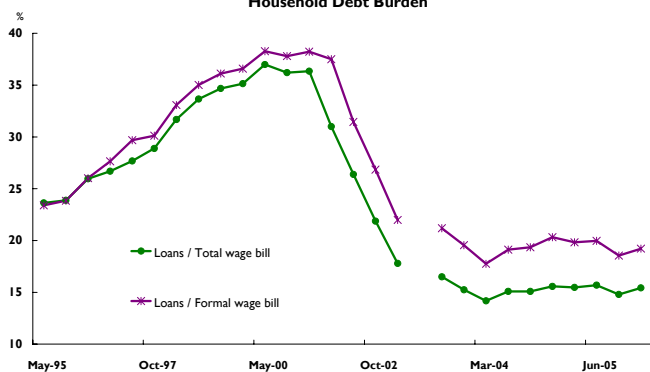


Chart III.18

## Activity Rate, Employment and Unemployment

Chart III.19  
Household Debt Burden

Note: As of May 2003 the frequency of permanent household survey (EPH) is semi-annual. Since September 2003, it's frequency is quarterly.

Source: INDEC and BCRA

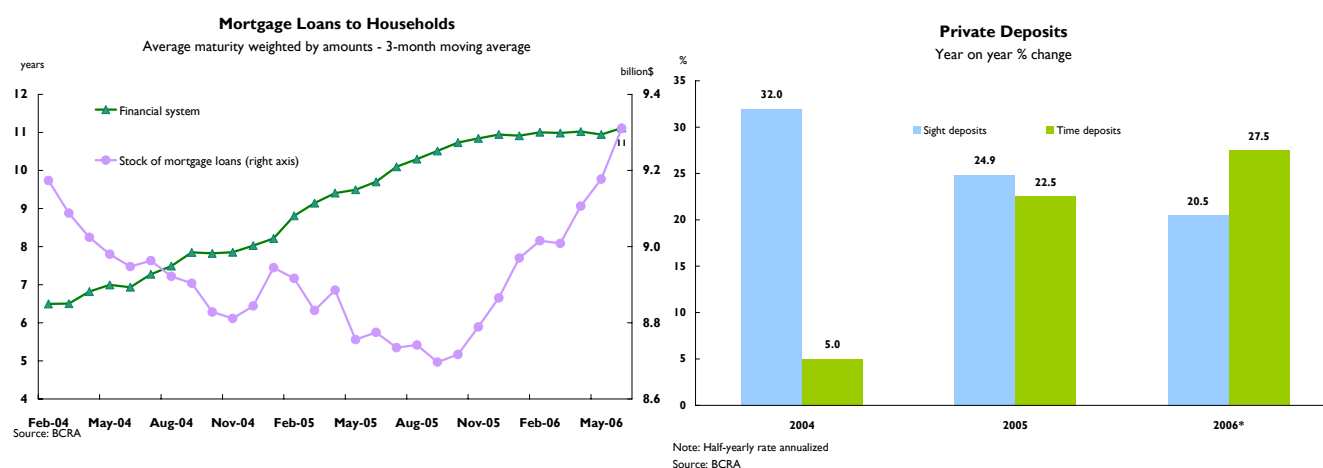
## IV. FINANCIAL INFRASTRUCTURE

### Summary

*In the first months of 2006 the growth path of all the domestic financial intermediaries was maintained. In particular, the non-bank financial intermediaries (NBFIs) recorded a significant momentum, with a portfolio investment that continues to increase its funding of the private sector. The growth of both the number of contributors and of the average revenue subject to contributions led the expansion of the pension funds, while the positive medium term prospects encourage the deepening of the insurance markets and the mutual funds.*

*The financial institutions credit granted to the private sector, for the first time since the crisis in 2001–2002, exceeded their exposure to the public sector. This trend was especially affected by the regulations the Central Bank adopted in an encouraging macroeconomic framework. The credit lines that led the change during the first half were those for exports, pledge backed and personal loans. The growth of the mortgage loans accelerated in the first half of 2006, due to both the larger volumes granted and the gradual extension of their terms to maturity. On the other hand, the introduction of a new (foreign) financial institution to the domestic market provides a sign of the favorable prospects that prevail in the sector.*

*Boosted by the measures that the Central Bank adopted, the financial system swiftly normalized the structure of its debts. In this sense, the increase in private time deposits stood out during the half, as they surpassed the sight deposits. Also, under the matching scheme the debts owed by the financial institutions to the Central Bank continued to fall, and by September 2006 only two of the original 24 debtor banks remained. This change is in the framework laid down in the 2006 Monetary Program, to become a systematic monetary contraction factor.*





## IV.1. Financial intermediaries

### *A sustained expansion of the bank and non bank financial intermediaries*

During the first half of 2006 a robust growth of about 9% (19%a.) of the assets of the domestic financial intermediaries was seen. The momentum of domestic economic activity made it possible to lay the grounds for deepening the banking sector and the non banking financial intermediaries (NBFI). In this manner, at mid year the domestic financial intermediaries accounted for slightly more than half the GDP (see Chart IV.1). Although it should be noted that this scale is small compared to both other countries in the region and those in developed countries, the scarce depth is specifically influenced by the 2001–2002 crisis. In this context the domestic financial services sector still exhibits a strong potential for growth.

## IV.2. Non-bank financial intermediaries

### *Despite their significant share of public assets, the NBFI deepened their private finance*

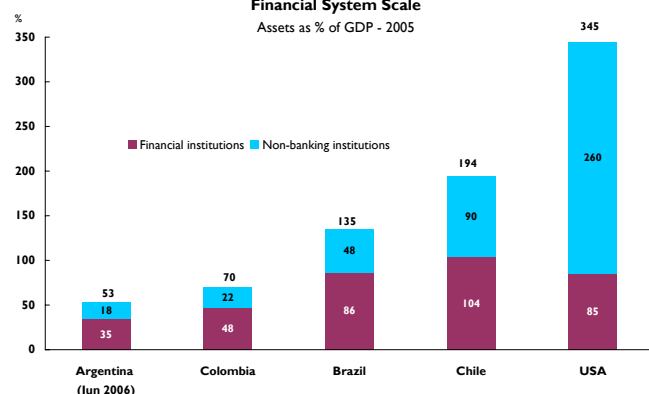
By mid 2006 the assets of the NBFI totaled approximately \$119 billion (11% more than at the end of the year before) (see Chart IV.2), boosted in particular by the pension funds. In this manner, the NBFI accounted for 18% of the GDP, about half the bank assets.

The pension fund (PF) portfolios grew 10% in the first half of the year, to a total of \$74.9 billion. This change was led by the larger number of workers who contribute, the growth of their average revenue and the profits earned on investments. During the first months of 2006 the PF exhibited a slight increase in their finance for the private sector (to almost 29% of total investments) (see Chart IV.3); while the share of government bonds<sup>13</sup> in their portfolios (63% of total investments) only registered a slower growth. The PF increased their holdings of sovereign bonds and tradable GDP-linked securities during the period. They also purchased financial trusts, mainly those with Guaranteed Loans to the public sector as the underlying asset. On the other hand, among the private sector investments, the investment in mutual funds stood out, while shareholdings also grew. Meanwhile, the PF deposits in the financial system recorded a fall during the period, with a shift from deposits adjustable by CER to non-adjustable time deposits.

At the end of March 2006 the assets of insurance companies were \$30.3 billion pesos, and exhibited a 9% growth compared with September of the year before. The insurance market thus continues growing, led specifically by the retirement and general insurance branches. During the period both private and public sector investments grew, while bank deposits exhibited a sharp contraction.

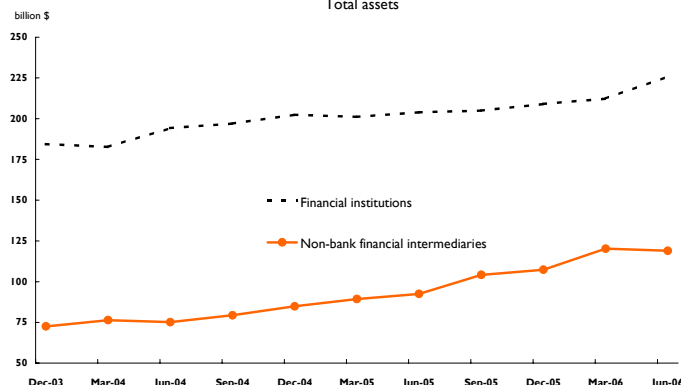
The net assets of mutual funds grew 26% in the first half of the year to a total of \$13.9 billion. In a manner similar to the second

Chart IV.1  
Financial System Scale  
Assets as % of GDP - 2005



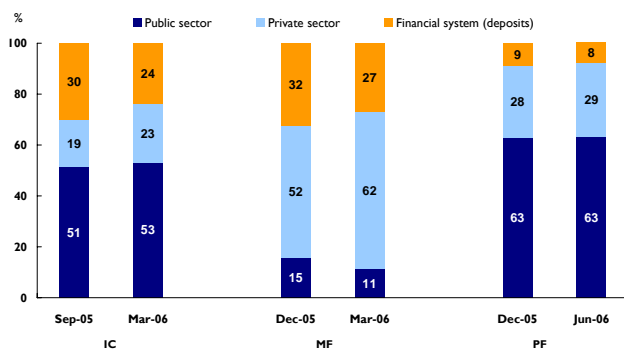
Source: BCRA from Superintendencias, Central Banks and IMF

Chart IV.2  
Financial Sector Scale  
Total assets



Note: Insurance companies, last information as of March 2006.  
Source: BCRA

Chart IV.3  
Non-Bank Financial Intermediaries Portfolio Composition  
As % of total investment



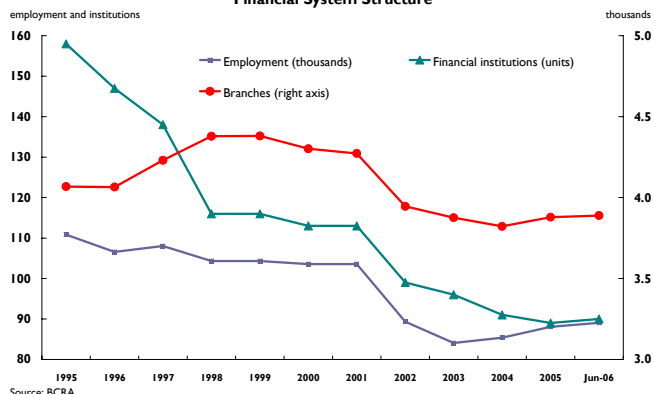
Source: BCRA from BCRA, SAJP, SSN and Cámara Argentina de FCI

<sup>13</sup> This includes the shares of financial trusts that have sovereign bonds as underlying assets, and the tradable sovereign debt securities linked to the GDP.



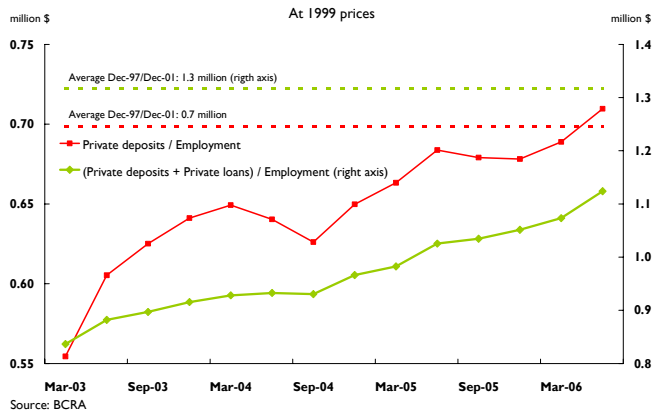


Chart IV.4  
Financial System Structure



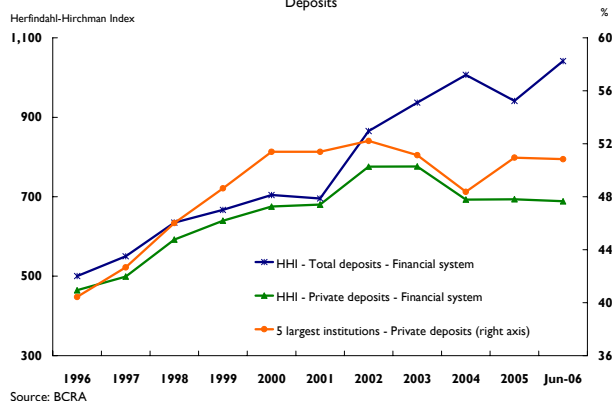
Source: BCRA

Chart IV.5  
Factor Productivity  
At 1999 prices



Source: BCRA

Chart IV.6  
Financial System Concentration  
Deposits



Source: BCRA

half of 2005, the expansion was led by equity funds, which reached 47% of the net assets of the sector. In the first quarter of 2006 the mutual funds significantly increased their shareholdings in line with the positive development of the Merval index in the period<sup>14</sup>. In this manner private finance exhibited an almost 10 p.p. increase in the period to 62% of the total investment portfolio, while exposure to the government recorded a fall.

### IV.3. Financial entities

*The financial system continues expanding its level of employment, while it improves its productivity indicators*

In the first half of 2006 the structure of the financial system continued on the trend which began at the end of 2004, with a recovery of staff and of branches. The employment level increased 1.1% in the period, while the number of branches exhibited a 0.2% increase (see Chart IV.4). Although the financial system structure maintained its rescaling process following the crisis in 2001–2002, in May this year a new (foreign) institution joined the local market, an encouraging sign of the prospects for the sector.

The growing volume of financial intermediation observed in the first months of 2006 boosted the increase of labor productivity (see Chart IV.5). In fact, the ratio between private sector deposits and the employment level was higher than the value attained in the years before the crisis. On the other hand, if the balance of private sector deposits and loans managed by banks is considered there is still a considerable efficiency gap compared with the pre-crisis average (see Page 61).

*The concentration of the financial system remains at similar levels to recent years*

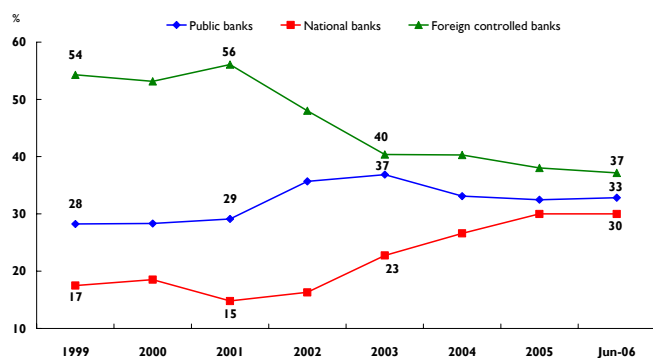
In the first half of 2006 the degree of concentration of the financial system remained stable (see Chart IV.6). Concentration measured in terms of private sector deposits remained at similar levels to recent years, below the levels observed in 2002 and 2003. Due to the channeling of public sector funds to the government owned banks a slight growth in the concentration of total deposits in the financial system was seen. The financial system exhibited a pattern of medium term consolidation, a process that may probably continue in the next few years, in line with the advantages of scale economies and the international trends (see Chart IV.4).

Although in the first months of 2006 the different groups of banks did not record significant changes in their market shares (see Chart IV.7), in the past four years a gradual convergence towards a more even market distribution by homogeneous groups of banks can be noted. In the post-crisis period, national private financial institutions gained a share of the total private sector deposits at the expense of foreign owned banks. However, the latter are still the group with the largest market weighting.

<sup>14</sup> This index reflects a reversal in the second quarter of the year. See Chapter II “Capital Market”.



**Chart IV.7**  
Breakdown by Type of Institution  
Non-financial private sector deposits



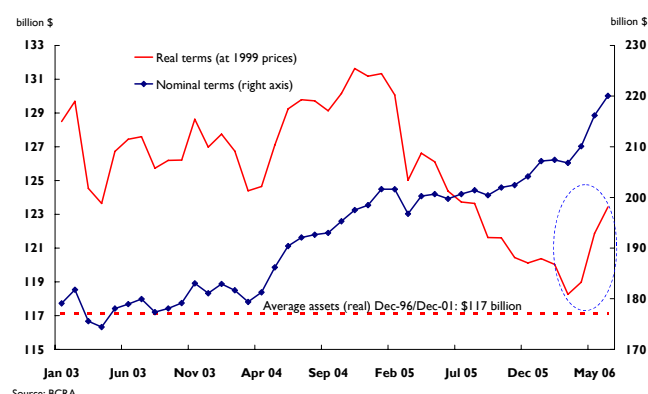
Source: BCRA

*Due especially to the activities of the private banks, credit for the private sector surpassed exposure to the public sector, for the first time since the crisis*

The financial system assets<sup>15</sup> grew 7.8% (16%a.) in the first half of 2006, which was much higher than the 2.2% increase recorded in the latter part of last year. In real terms, the assets grew 2.8% (5.6%a.); while in the previous half they had registered a fall (see Chart IV.8). The consolidation of the recovery of traditional financial intermediation was reflected in a sustained growth of both deposits and private sector loans (see Chart IV.9).

The increased activity of the financial system was accompanied by a growing normalization of its principal components. In this manner, in the first half of 2006 and for the first time since the 2001–2002 crisis, the loans to the private sector (29.1% of netted assets, 27.5% of total assets) surpassed the exposure to the public sector (28.6% of netted assets, 27% of total assets) (see Table IV.1). This was due to both a significant increase of the former, and a sustained decline of the latter.

**Chart IV.8**  
Netted Assets of Financial System

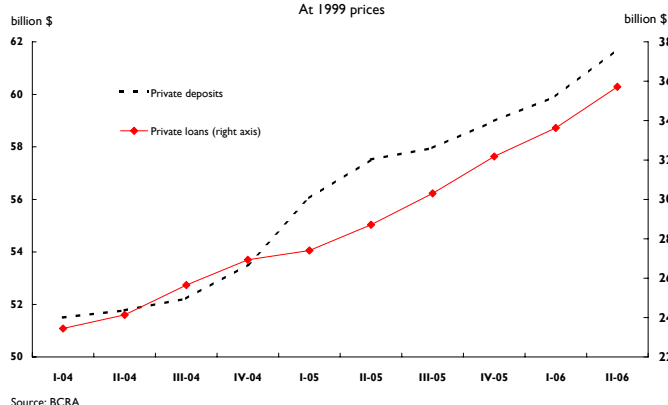


Source: BCRA

The fall of the bank exposure to the government was led by the different strategies that the financial institutions carried out in order to adjust their assets, which were specifically stimulated by the regulations adopted by the Central Bank. In fact, the principal measures adopted were: the gradual convergence to market prices for sovereign bonds, the application as from January 2006 of a maximum limit of 40% of assets as individual exposure, dropping to 35% as from July 2007 and making capital requirements homogeneous for public sector and private sector assets (see Box 3).

The significant expansion of 18% (40%a.) for the loans to the private sector led the increase of financial sector assets in the first half. However, the private and public sector banks have exhibited an uneven behavior. On one hand, while the private financial institutions increased the balance of their private loans more than the rise of private deposits (with funds originated in the lower exposure to the public sector), at public banks this application was for less than half the fresh private sector deposits. Public banks channeled most of their funds to increasing its liquid assets.

**Chart IV.9**  
Financial Intermediation  
At 1999 prices



Source: BCRA

*A significant expansion of export, pledge backed and personal loans*

In the first half of 2006 a generalized increase of all credit lines was observed (see Chart IV.10) in a context where the lending rates exhibit an uneven performance. Among the credit lines associated with the commercial activities the 49% growth (\$1.8 billion) of loans to pre-finance and finance exports (denominated in dollars) stand out. These credits are being funded with the larger deposits in foreign currency (see Chart IV.11). Meanwhile, promissory notes and overdrafts also increased during the first half: 19% (\$1.4 billion) and 10% (\$1.6 billion), respectively.

<sup>15</sup> Assets net of book duplications originated in repo transactions, futures sales and cash deals with pending settlements.





**Table IV.1**  
**Balance Sheet**

Total system - % of netted assets

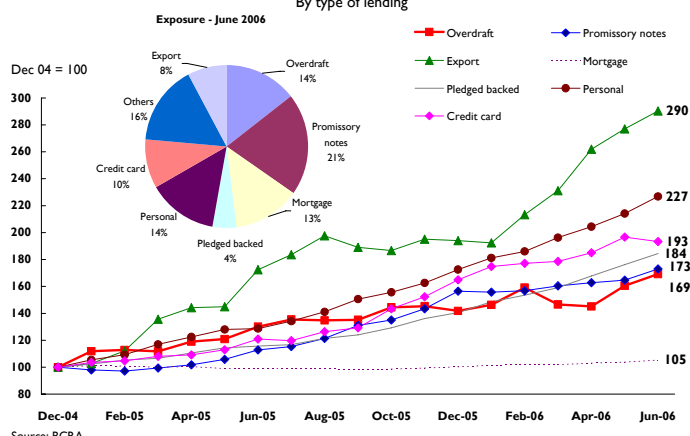
	Jun-05	Dec-05	Jun-06	Half-yearly change t-06 (%)
<b>Assets</b>	100	100	100	8.1
Liquid Assets	15.3	13.3	15.2	24.0
LEBAC / NOBAC	9.1	10.1	9.7	4.2
Lending to the private sector	23.1	26.7	29.1	17.8
Lending to the public sector	36.6	32.4	28.6	-4.3
Other assets	15.8	17.6	17.3	6.4
<b>Liabilities + Net Worth</b>	100	100	100	8.1
Public sector deposits	15.5	16.5	17.9	17.8
Private sector deposits	46.2	48.6	49.9	11.1
Liabilities with the BCRA	11.1	8.1	5.1	-32.8
Outstanding bonds, subordinated debt and foreign credit	6.6	6.0	5.5	-1.2
Other liabilities	8.2	7.8	8.3	14.7
Net Worth	12.3	13.0	13.3	10.5

Source: BCRA

Boosted by a favorable economic context for the growth of household debt, including lower lending rate, the personal loans recorded a sharp growth of 31% (\$2.3 billion) in the first half of 2006, while credit card finance rose 17% (\$1 billion).

The growing levels of corporate sales and employment in the economy, added to favorable expectations, are incentives for the economic agents to gradually extend their planning horizons. In this manner, in a scenario of lower interest rates pledge-backed loans exhibited a 31% growth (\$750 million) in the first half of 2006. A larger balance of mortgage loans was also recorded, as they grew 5% (\$450 million), accompanied by a gradual extension of their duration (see Chart IV.12). It should be noted that the development of mortgage credits after the 2001-2002 crisis was encouraging, especially when compared with the performances seen in other economies that suffered from adverse financial situations (see Chart IV.13). Looking ahead at the coming periods, the growth of mortgage loans for families is expected to continue deepening, in the context of an active and prudent pro-credit Central Bank policy.

**Chart IV.10**  
**Loans to the Private Sector**  
By type of lending



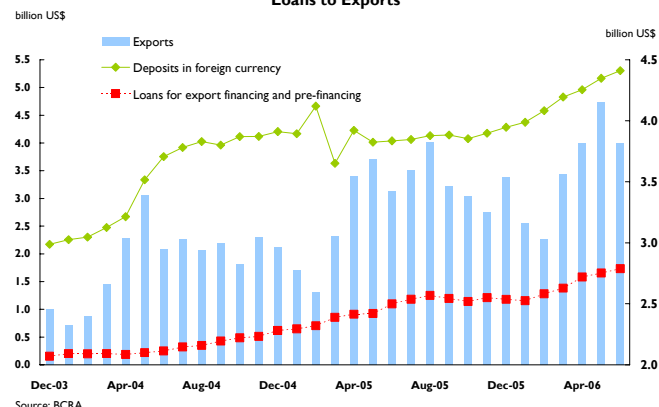
*An active Central Bank role to improve the depth (greater access and intensity of use) of the financial system, in a context of sound risk management*

During the early months of 2006 the Central Bank adopted a number of measures with the purpose of increasing medium and long term finance. On one hand, as from February 2006 the sight deposits in pesos with a remuneration of more than 75% the BADLAR rate are subject to a minimum cash requirement of 100%. It also increased the reserve requirement on sight deposits 2 p.p. (from 15% to 17%) and eliminated their remuneration. These measures favor the migration of savings in sight deposits to time deposits. In addition, a new form of time deposit at a variable interest rate for 180 days with a fixed minimum interest rate was added.

The measures that the Central Bank adopted during 2006 also had the purpose of stimulating granting micro-credits and mortgage loans. As regards the former, and bearing in mind the particular characteristics that the principal economic sectors exhibit, the periods of the financial installments were extended (weekly, fortnightly or monthly) allowing the banks to grant an initial grace period for the payment of capital services. The maximum limit of the installment payment was also raised (from \$200 to \$300) with the purpose of coverage for a broader range of the population, and the maximum term for loans was extended (from 24 to 36 months) and the amount of finance available for domiciliary infrastructure expanded (from \$3,000 to \$6,000).

As regards the mortgage credits, the reduction of the capital requirement for mortgage loans of up to \$200,000 stands out, as 100% of the value can be financed (90% when the amount is between \$200,000 and \$300,000). On the other hand, the regulations adopted by the Central Bank also encourage the banks to include the rent receipts and utility payments, among others, when assessing the payment capacity of the debtors, in

**Chart IV.11**  
**Loans to Exports**



Source: BCRA



## BOX 2: DIVERSIFYING FINANCIAL TOOLS: LEASING

*Based on the consolidation of the growth of loans at the end of 2004, alternative credit instruments like leasing gained momentum. This provides a number of advantages for both corporations and banks, which contribute to productive activity and improve the management of credit risk*

At an international level, financial leasing is a well developed financial instrument, channeled specifically to small and medium enterprises (SME)<sup>16</sup>. With the leasing contract, the “lessor” (usually a bank) transfers the possession of a certain good to the “lessee” (a business or a family) to be used for a set period of time, in return for a periodic payment, providing a purchase option when the contract ends. The banks, leasing firms, manufacturers and/or suppliers of equipment, are the main institutions that provide this kind of finance. Thus, the lessor acquires the specific good (according to the lessee’s requirements), which are usually movable goods (automobiles, machinery, computers, etc.), real estate, trademarks, patents and/or software.

The development of leasing mechanisms is associated with a number of advantages for corporations, especially for the SME segment:

- It focuses on the cash flow generated by using the asset and not on the credit history of the debtor nor on the collaterals available (in both cases, limited or non-existent for SME);
- Financial terms are extended, because they are related to the economic life of the asset;
- It allows the lessee company to add the assets it needs, without immobilizing working capital;
- It exhibits lower interest rates than the unsecured loans, because if the lessee does not pay, the lessor can claim back its asset in court;
- The lease payments amortize part of the asset value, with a residual value when the leasing contract ends, at which time the lessee has an opportunity to purchase the asset<sup>17</sup>;
- It allows for renewal of a firm’s production equipment, which allows for the use of technology that improves its productivity;
- It smoothes the cash flow, contributing to match the rental payments with the revenues obtained by using the asset;
- It finances the full value of the asset, including the Value Added Tax,
- As it is not accounted for as a debt, it improves the corporate debt ratios, and does not affect their credit limits in the financial system;
- There are benefits for Income Tax purposes and it does not pay the Presumed Minimum Income Tax.

On the other hand, the main advantages for the institutions that grant such credits are:

- Separation of the legal ownership of the asset and its economic use;
- The risks posed by the asset (accidents or damages) are transferred to the lessee, with this being the party that must pay the insurance for the asset;
- It allows for a greater monitoring of the investment to which the assets will be applied;
- Diversification of bank finance lines.

With reference to the separation of the property from the economic use of the asset, there is evidence (usually in economies with poor levels of creditor protection) that the judicial systems tend to recognize the legal property faster in leasing contracts. In this manner, the loss due to default in the case of leasing compared to a secured credit line is less, which reduces the exposure to credit risk for the lessor. In the specific case of Argentina, the legal framework sets specific procedures for eviction from real estate<sup>18</sup> or to recover an asset, if the lease is not paid by the lessee. On the other hand, because the lessor purchases an asset with a number of specific characters (compatible with the requirements of the lessee company), should a contract be terminated it could generate difficulties later to sell the asset or to enter into a new contract with the same good.

The corporate leasing market in Argentina is mainly channeled as direct transactions with banks (almost 80% of the total), while the remainder are concentrated in two leasing companies (owned by banks). In addition, there are some smaller scale companies specialized in leasing. In this manner, the domestic market bank for leases have almost tripled in the past two years to reach a total of \$1.8 billion pesos (see Chart B.2.1) (almost \$2.2 billion when the two financial conglomerates are consolidated).

<sup>16</sup> In Argentina, leasing is deepening in the framework defined by Law 25,248 in 2000.

<sup>17</sup> Otherwise, it can consider the contract as cancelled and opt for a new leasing of a more modern production asset.

<sup>18</sup> Different procedures over time are set, according to the amount of the lease contract that has been already paid.



Chart B.2.1

## Leasing to Companies

Evolution and in % of mortgage loans and pledged backed loans to companies

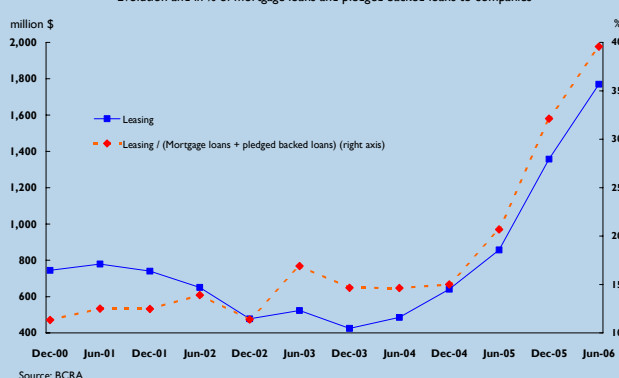
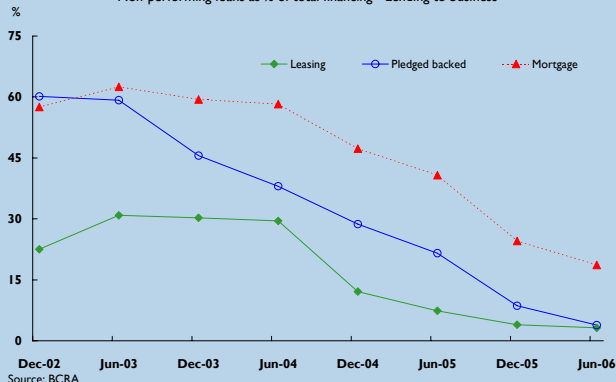


Chart B.2.2

## Non-Performance

Non-performing loans as % of total financing - Lending to business



In this framework, bank leasing is gaining a growing share when compared with the other business with secured loans (mortgages and pledges) to reach a total amount of about 40%, and exhibit a lower portfolio risk in order to face a financial stress scenario (see Chart B.2.2). The principal branches of business entering into lease contracts are: services, primary production and manufacturing (see Chart B.2.3), and it is estimated that more than 80% of the total stock is channeled to SME finance (less than \$2.5 million) (see Chart B.2.4).

Chart B.2.3

## Leasing to Companies by Economic Sector

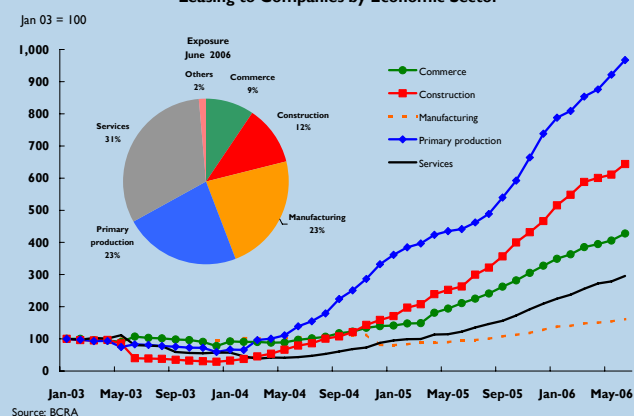
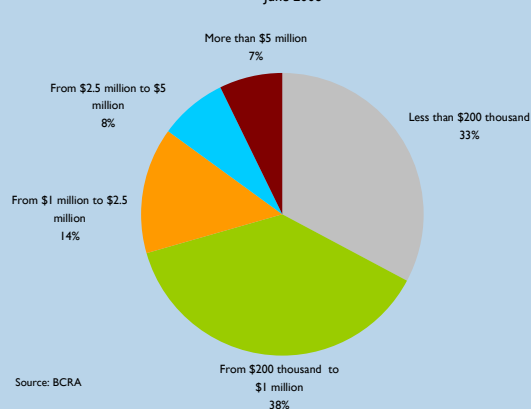


Chart B.2.4

## Leasing to Companies by Amount Bracket

June 2006

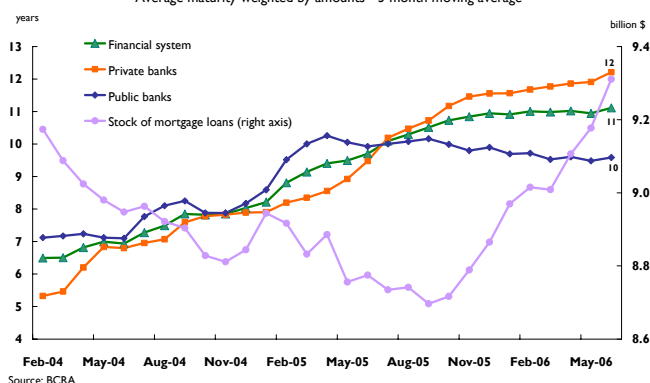


The greater demand for domestic private finance, especially for SME, stimulates the development and deepening of alternative credit instruments to bank loans, including leasing. The persistence of an adequate and stable regulatory framework, combined with an expansive economic context, allows for strengthening the sources of medium and long term business finance, diversifying the banking risks.



Chart IV.12  
Mortgage Loans to Households

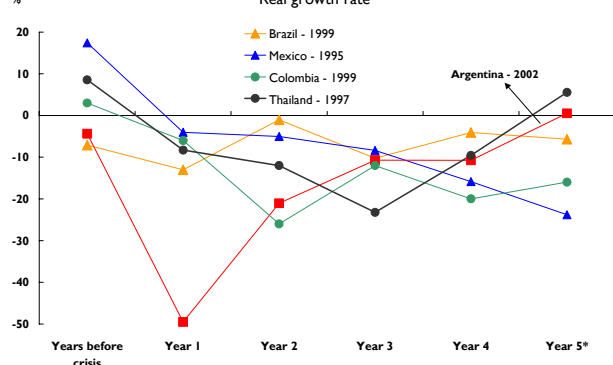
Average maturity weighted by amounts - 3-month moving average



Source: BCRA

Chart IV.13  
Crisis Impact on Mortgage Loans

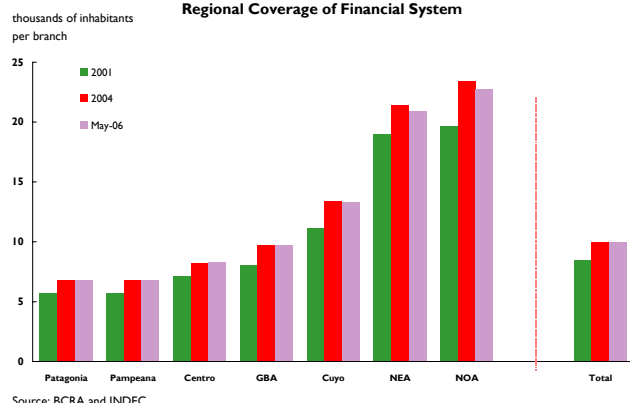
Real growth rate



\*Argentina's information at June of 2006. Half year annualized.  
Source: BCRA from Central Bank data and Superintendence of Banks

Chart IV.14

Regional Coverage of Financial System



Source: BCRA and INDEC

line with the recommendation to adopt screening systems and credit scoring models to assess granting these loans.

Although it has always been a pending issue for the financial system, after the 2001-2002 crisis the contraction of its regional scope became evident, in a trend that has slightly reversed since the end of 2004 (see Chart IV.14). In this manner, the North East (NEA) and North West (NOA) regions<sup>19</sup> of Argentina exhibit the least coverage by the domestic financial system, with over 20,000 inhabitants for each bank branch. On the other hand, Patagonia and the Pampas regions exhibit the highest degree of bank coverage: in the former this situation is partly explained by the high concentration of population, while in the latter it is mainly due to the weighting of a large scale public sector bank. In this framework the Central Bank is adopting measures that tend to moderate these geographical differences (see Page 60, BEF II-05). On the other hand, both the public financial institutions and the private ones tend to concentrate their activity in the Greater Buenos Aires metropolitan area and in the Centre and Pampas regions (see Chart IV.15). However, the former banks are at 917 localities in Argentina, which is 28% more than the private sector banks.

*As liabilities return to normal, time deposits grow at a faster rate than sight deposits*

During the first half of 2006 the financial institutions exhibited a marked normalization of their liabilities. In this manner, the private sector deposits accounted for half the liabilities of the financial system, growing 11% (23%a.) in the period to approach the average pre-crisis level in real terms (see Chart IV.16). If total deposits are considered, the current level at constant prices has exceeded, boosted by public sector deposits, the average recorded in the years prior to the crisis.

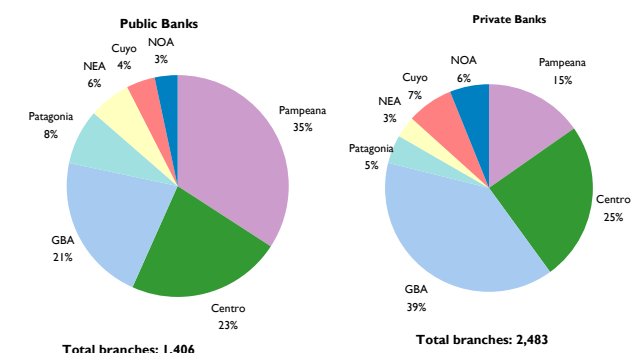
In the first half of 2006 time deposits grew 12.9% (\$5.55 billion), which was more than the expansion of sight deposits by 9.9% (\$5.15 billion). This greater momentum of time deposits was explained by both the regulations adopted by the Central Bank, the favorable prospects for the economy and the higher interest rates offered. On the other hand, the decline of inflation expectations for this year, together with the existence of more investment alternatives, meant that the time deposits adjustable with the CER dropped 12% in the first half.

Although the increase of the maturity of funding with deposits is a relevant element to extend the terms of the loans, there are other factors that contribute to the definite take off of medium and long term credit. In the first months of 2006 the long term financial instruments used by the banks (corporate bonds –ON–, subordinated bonds –OS–, and commercial lines from abroad) only exhibited a slight decline, while it should be noted that a sizeable financial institution made a significant issue of long term bonds on the foreign market. The development of the

<sup>19</sup> The criteria used to separate the Argentine territory into different geographical regions has been the following: NOA Region (Catamarca, Tucumán, Jujuy, Salta and Santiago del Estero), NEA Region (Corrientes, Formosa, Chaco and Misiones), Cuyo Region (Mendoza, San Juan, La Rioja and San Luis), Pampeana Region (Buenos Aires and La Pampa), Centro Region (Córdoba, Santa Fe and Entre Ríos), and Patagonia Region (Santa Cruz, Chubut, Río Negro, Neuquén and Tierra del Fuego). The Gran Buenos Aires Region (GBA) is made up by the Ciudad Autónoma de Buenos Aires and 24 municipal districts in the Gran Buenos Aires.

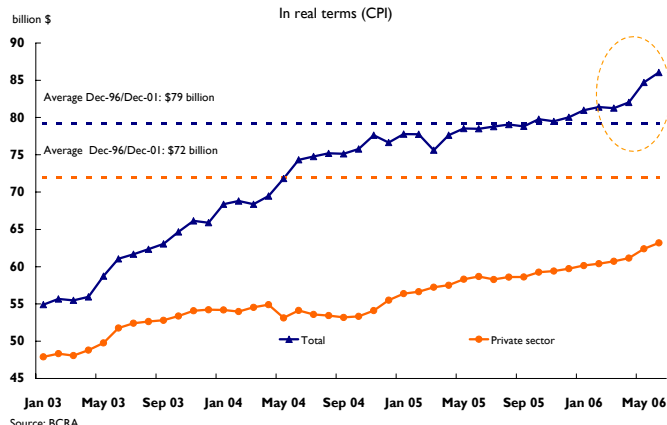


**Chart IV.15**  
**Geographic Coverage by Group of Banks**  
In % of branches - May 2006



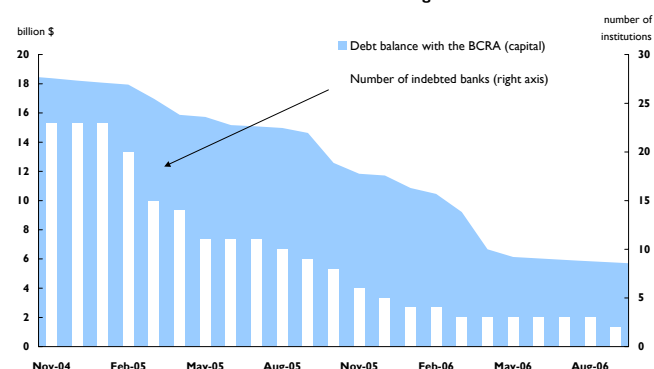
Source: BCRA

**Chart IV.16**  
**Deposits**  
In real terms (CPI)



Source: BCRA

**Chart IV.17**  
**Liabilities with the BCRA - Matching Schedule**



Note: Considering that banks which brought forward 100% of the installments will not recall them.

Source: BCRA

capital market will be the key to extend the maturity of the credit supply (see Page 24).

During 2006 the financial system accelerated the process of normalizing its debts with the Central Bank. In fact, under the scheme usually known as “matching” the financial institutions made payments of almost \$6.4 billion to the Central Bank between January and September, of which 80% was voluntary pre-cancellation of debts (see Chart IV.17). In this scenario, it should be noted that the debt that the financial institutions owe to the Central Bank is only 5% of total bank funding. Also, of the 24 financial institutions that at the outset were indebted to the Central Bank, only two of them still owed debts in September 2006<sup>20</sup>.

In a context of continuity of the current economic conditions in coming periods, the volume of financial intermediation is expected to continue expanding at a significant rate, and thus increase the depth of the banking system. In this manner, credit for the private sector is expected to grow in a more generalized manner, although the private banks should be the main actors of this development. On the other hand, further contractions of the exposure of banks to the public sector are forecast, in line with the incentives defined by the Central Bank. The liabilities normalization process is forecast to continue, with private deposits being more relevant. In this framework, and with the expected growth of the demand for medium and long term finance, in particular for the private sector, the strength of the banking system during the coming periods will to a large extent be related to their capacity to extend the maturity of their liabilities. In this context, the financial system can contribute to achieve a sustainable economic growth in a financial stability framework.

<sup>20</sup> For this analysis the financial institutions that paid 100% of the installments in advance are considered as not indebted.



## V. RISK MANAGEMENT

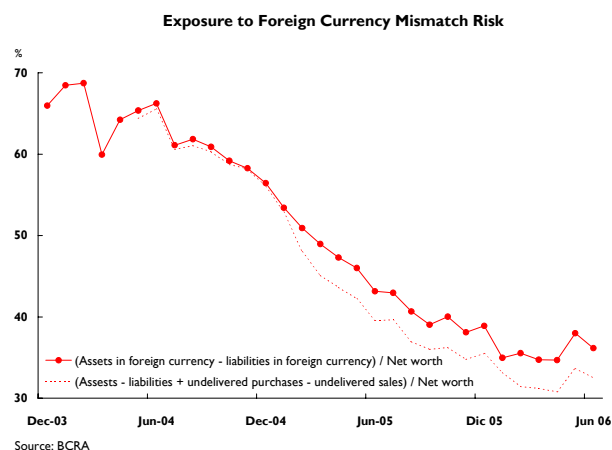
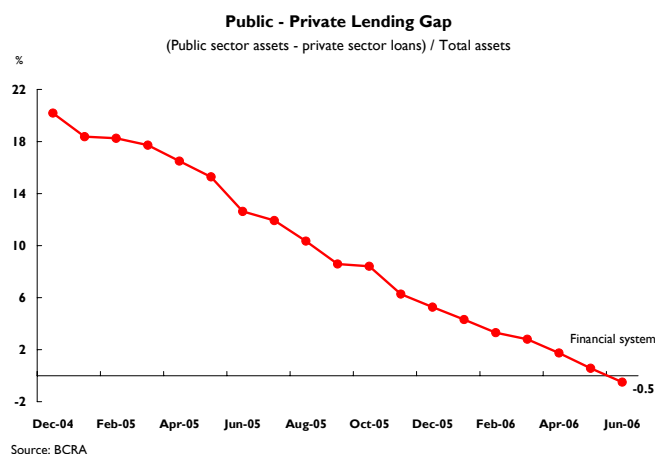
### Summary

*Financial institutions have continued to strengthen their position in relation to the risks derived from the 2001-2002 crisis, in general carrying out a prudent administration of the new risks inherent to the rise in intermediation activity. Bank liquidity has continued to improve, in line with the rising flow of lending to the private sector. At the same time, interbank markets and the market for repo with the Central Bank continue to deepen, providing alternatives for hedging bank exposure to such risk. In coming periods it is expected that the operation of these markets will gain in depth and efficiency, given the growing proportion of deposits being channeled into private sector lending.*

*Over the course of the first half of 2006 there has been a significant reduction in balance sheet exposure to credit risk faced by financial institutions. In particular, bank exposure to the public sector dropped 3.4 p.p. in the period, to 27% of total assets, at the same time as the strength of fiscal accounts lowered the credit risk from the Government. Private sector lending portfolio delinquency fell 2.2 p.p. in the half, reaching a level of 5.4%, while provisions amply exceeded the delinquent portfolio.*

*Although the financial system held its active position in foreign currency steady (the difference between assets and liabilities in dollars totals US\$3.5 billion), capital growth led to a reduction in net worth exposure to currency risk (to 36%). Combined with lower volatility in the peso-dollar exchange rate, this has reinforced the strength of the financial system in the face of such a risk.*

*Larger proportions of government securities holdings that have been marked to market, and the context of greater volatility in the first part of 2006, explain the increase observed in bank risk from listed assets. In view of the method for calculation (based on value at risk), these situations led to an increase in capital requirements for this type of risk. In addition, the risk from real interest rate has persisted, mainly because of the accelerated settlement of rediscounts under the matching mechanism.*







## V.1. Liquidity risk

***Banks continue to strengthen their cover against liquidity risk, despite the fact that increased lending to the private sector lowers liquidity indicators***

Private sector deposits have strengthened their position as the leading source of financial system funds. In the first half of 2006 they rose by \$11 billion (11%), exceeding in annualized terms the increase recorded in 2005 (see Chart V.1). Simultaneously with this growth, banks have been applying an even greater proportion of funds to the granting of loans to the private sector, causing a drop in liquid assets. This process, which gained strength in the last 12 months (June 2005-2006), has driven the trend towards the normalization of bank liquidity levels<sup>21</sup>, and constitutes a necessary element to consolidate traditional intermediation business and the solvency of the banking system.

In mid-2006 financial system liquid assets (cash, current accounts at the Central Bank and cash repos with the Central Bank) stood at 22.4% of non-financial sector deposits (see Chart V.2). The process of normalization of banking activity resulted in a year-on-year reduction of 2.4 p.p. in the indicator. In addition, by incorporating holdings of Central Bank securities to liquid assets, the ratio shows a reduction of 2.8 p.p. in the same period, ending at a level of 36.7%.

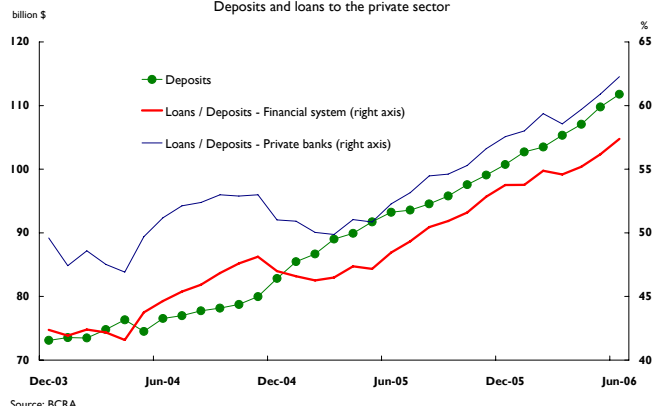
In line with the normalization of liquidity indicators and without neglecting to maintain an adequate level of coverage, the financial system is achieving efficiency gains in its liquidity management policies. At the same time as there has been a systematic observance of the peso liquidity requirements established by the Central Bank (see Chart V.3), banks gradually lowered the precautionary margin between compliance and requirements for liquidity in pesos and reduced their repos with the Central Bank (especially in the case of private financial institutions). This has been the counterpart to the improvement in levels of intermediation within the framework of limited liquidity risk.

Growth of financing in dollars, driven by the surge in foreign trade and measures by the Central Bank to develop a prudent framework for this market, is leading to the normalization of foreign currency liquidity indicators. Towards the end of 2004, the financial system held liquid assets in dollars for almost half the amount of deposits in dollars (see Chart V.4). This excess in dollars has gradually been reduced until reaching 20% of deposits in that currency by the middle of 2006.

***Interbank markets have continued to deepen, leading to greater efficiency in the administration of bank liquidity***

In the first half of 2006 banks made increasing use of interbank liquidity markets. Repos between financial institutions increased threefold compared with the same period of the previous year, while the volume of call transactions rose almost 150% in the same period (see Chart V.5). Furthermore, although volumes were small, in the early months of 2006 repos with the Central

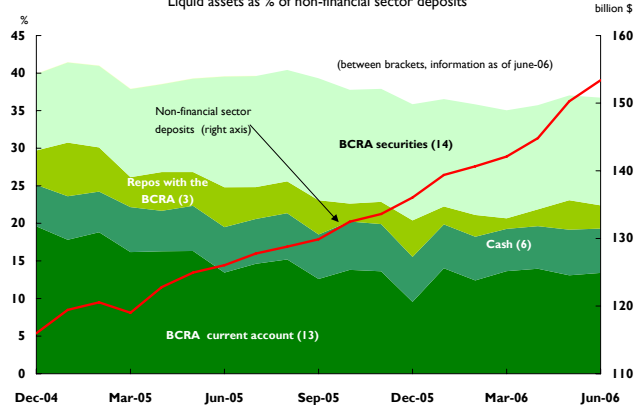
**Chart V.1**  
Sources and Uses of Funds: Deposits and Loans  
Deposits and loans to the private sector



Source: BCRA

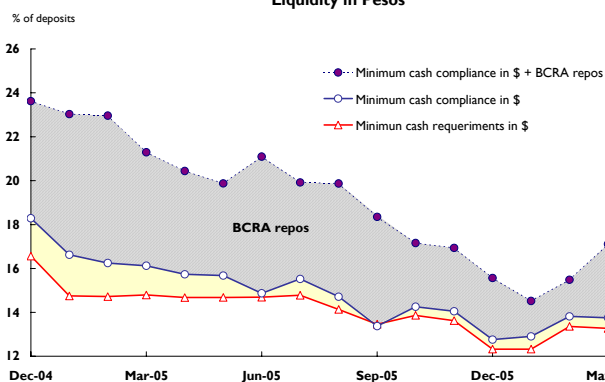
**Chart V.2**  
Liquidity Risk Coverage

Liquid assets as % of non-financial sector deposits



Source: BCRA

**Chart V.3**  
Liquidity in Pesos



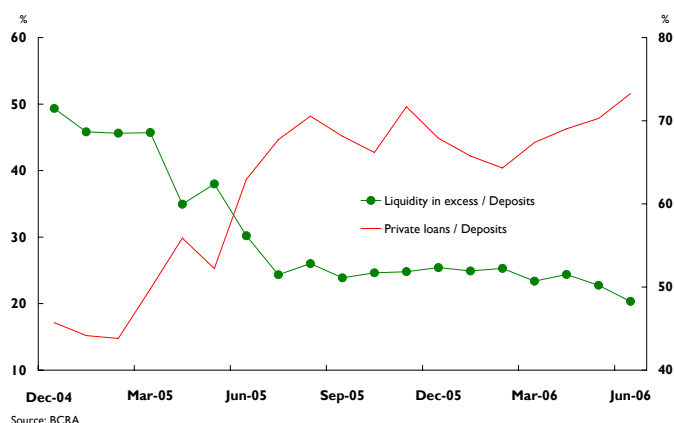
Note: The data of Dec-05 corresponds to the quarterly average December 2005 - February 2006.

Source: BCRA

<sup>21</sup> For an international comparison of liquid reserve levels, see FSB I-06, page 44.



Chart V.4  
Liquidity in Dollars

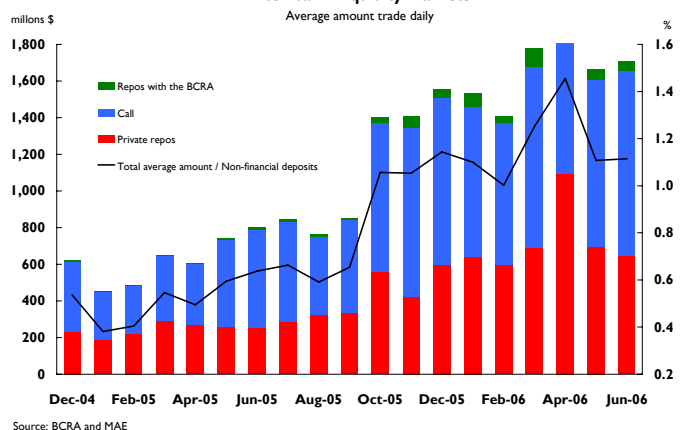


Bank were registered. As a result, amounts traded on interbank markets gained in significance in relation to deposits, rising from a six-month average of 0.5% in the first part of 2005 to 1.2% in the same period of 2006.

In harmony with a situation noted for increases in interest rates on Central Bank repos, a significant switch of funds into private sector lending, and a greater demand for interbank liquidity, interest rates traveled a path of gradual growth (see Chart V.6). These increases in interest rates on time deposits took place at the same time as policies were introduced by the Central Bank to encourage the extended maturity of financial system liabilities, thus providing an impulse to medium and long-term lending.

In addition to the interbank liquidity markets, liquidity risk hedging has been strengthened by the gradual but continuous development of the local capital market. This has been particularly encouraged by the improvement in the liquidity of listed government securities held in bank portfolios, and growth in asset securitization (see pages 22 and 25).

Chart V.5  
Inter-bank Liquidity Markets  
Average amount trade daily

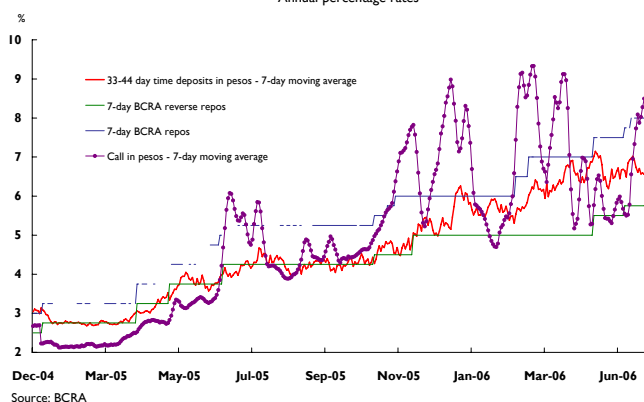


*It is estimated that in the second half of 2006 liquidity levels will continue their return to normality, and hedging mechanisms will be strengthened*

The positive trend seen in liquidity risk hedging is likely to continue in the second half of 2006. Banks are expected to continue to finance productive activity and private sector consumption, applying a greater proportion of deposits to loans, particularly in the market for foreign currency credit.

The use of market instruments can be expected to intensify. In first place, bank liquidity markets will be directly influenced by an increase in the demand for liquidity. In second place, there could be a greater interest by financial institutions in deepening the domestic fixed income market and trading activity. Lastly, the possibility of offloading assets onto financial trusts could be another of the financial system options for achieving an increase in their portfolio liquidity.

Chart V.6  
Interest Rates  
Annual percentage rates



The strength of the coverage achieved by banks in the face of liquidity risk will be further reinforced by the recovery by the Central Bank of its role as a lender of last resort. Although based on previously-established guidelines consistent with the current Monetary Program, the possibility of gaining access to funds from the Central Bank in the case of individual liquidity problems closes the circle for liquidity risk cover.

## V.2. Credit risk

### V.2.1. Public sector<sup>22</sup>

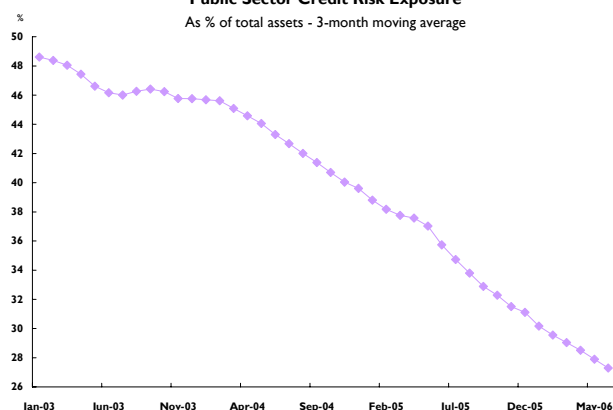
*Encouraged by Central Bank regulations and the healthy state of fiscal accounts, the financial system gains strength in the face of public sector credit risk*

In the first half of 2006 a sharp decline was recorded in bank exposure to the public sector. Lending to the Government as a

<sup>22</sup> The concept of credit for the public sector used in the FSB (see definition in the Glossary) excludes the holding of securities issued by the Central Bank.

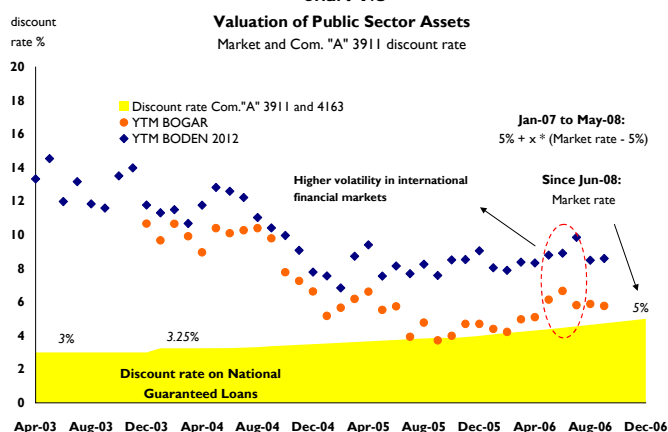


**Chart V.7**  
**Public Sector Credit Risk Exposure**  
As % of total assets - 3-month moving average



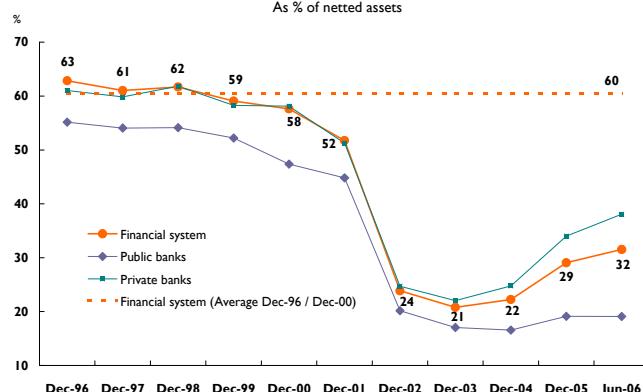
Source: BCRA

**Chart V.8**  
**Valuation of Public Sector Assets**  
Market and Com. "A" 3911 discount rate



Source: BCRA

**Chart V.9**  
**Financing to the Non-Financial Private Sector**  
As % of netted assets



Source: BCRA

proportion of total financial system assets stood at 27% (28.6% of netted assets) in the middle of this year, posting a drop of 3.4 p.p. and 7.3 p.p. in the last six and twelve months respectively (see Chart V.7). The reduction in exposure of private banks to the public sector during the first part of 2006 was 4 p.p., to 24.1% of total assets (25.2% of netted assets), accumulating a fall of over 9 p.p. in the last twelve months. This rapid process of reduction in exposure to the public sector was given a particular impulse by the regulatory framework provided by the Central Bank (see Box 3).

This sharp drop in exposure to the Government was also matched by lower public sector credit risk, given the healthy state of fiscal accounts in the first six months of 2006. Notable growth in national tax revenue and the continuing fiscal surplus ensure that the Government's payment capacity can be considered sound (see Page 28).

### *The strength of the financial system in the face of the risk represented by government lending is expected to increase*

Bank exposure to the public sector can be expected to continue to decline during the remainder of 2006. This would be explained by the strategy adopted by banks (mainly those in the private sector) for ensuring they hold a lower stock of public sector assets in their portfolios, as well as by the effects of Central Bank regulations. On the one hand, in a context of higher levels of employment and wages, and an improved outlook for productive activity, banks should have incentives to develop lending to the private sector, to the detriment of lending to the public sector. On the other, financial institutions will continue to adapt to a regulatory framework setting increasingly demanding limits on individual exposure to the government sector. Lastly, it is expected that the high fiscal surplus forecasted for the rest of the year, in an international scenario favorable to emerging economies, will continue to have a positive effect on government security prices, and therefore on the quality of financial institution assets<sup>23</sup> (see Chart V.8).

In a situation where the Government has virtually satisfied all its borrowing requirements for 2006, it is foreseen that the public sector will continue to evidence a sound financial position. These developments will be facilitated by continued robust domestic economic growth and a favorable international context.

## V.2.2. Private sector

### *The marked increase in lending to the private sector has taken place in a context of declining credit risk*

Although the financial system increased its exposure to the private sector in the first half of 2006, it was able to strengthen its position with regard to the credit risk for this sector. This has been due to factors related to both the supply and demand for loans. Households and companies increased their

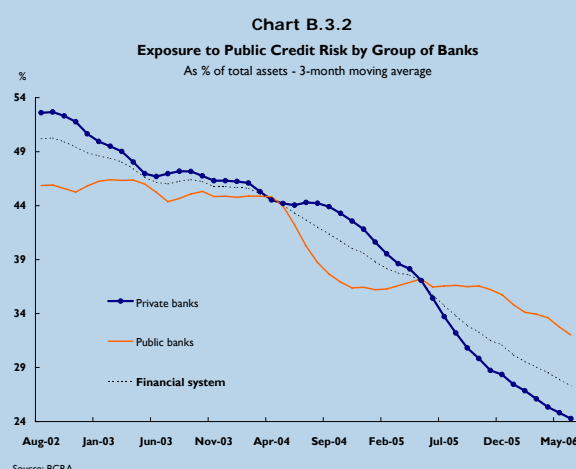
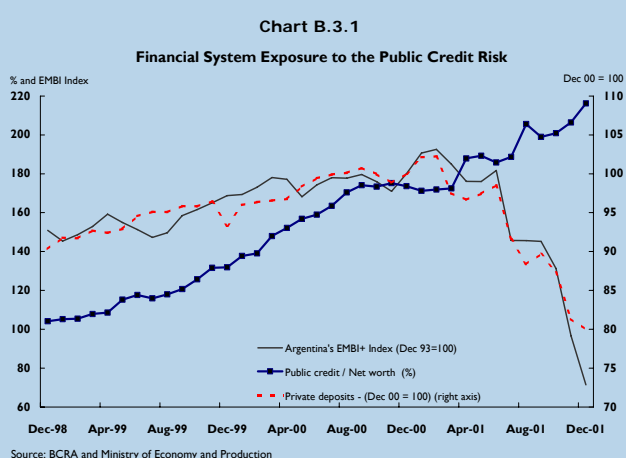
<sup>23</sup> Com. "A" 3911 and modifications.



### BOX 3: REDUCTION IN EXPOSURE TO PUBLIC SECTOR REINFORCED

*Financial sector exposure to the public sector observed an accelerated growth as a result of the 2001-2002 crisis, rising as high as half the system's assets. Nevertheless, this trend then began to be reversed, with a marked decline as from the end of 2004. At present, the benefits from the active strategy by the Central Bank to that end can be seen, with encouragement being provided for the construction of a financial system with a greater degree of freedom to the financial requirements of the public sector*

Development of the domestic economy in the second half of the previous decade was strongly influenced by a series of major external shocks, and neither economic policy nor the exchange rate system were prepared to face them. As a result, during that period bank exposure to the public sector began to increase at the same time as the vulnerability of both public accounts and external accounts was growing (see Chart B.3.1). This situation was further encouraged by the banking regulation framework, under which no maximum limit was established on public sector financing, and a relatively lower capital requirement was set on such assets, leading to a bias in credit that caused a crowding out of the private sector.



On the basis of the incentives provided by the Central Bank, steps began to be taken to reduce bank exposure to the Government and increase lending to the private sector, and this pattern has accelerated in the last two years. There has been a fall of 13 p.p. in the exposure of banks to public sector risk since the end of 2004, to a level of 27% in June 2006 (see Chart B.3.2). The downward trend was particularly strong in private banks, although public banks also participated in the process. This behavior was mainly a result of the sale of government bonds and loans (including the setting up of financial trusts using such items as underlying assets). The reduction in financial system exposure to the public sector, added to the marked growth in lending to the private sector that took place, particularly as from 2005, has meant that by the end of the first half of 2006, for the first time since the crisis in 2001-2002, private sector loans exceeded exposure to the public sector (see Chart B.3.3), a situation that in the case of private banks has existed since the end of 2005.

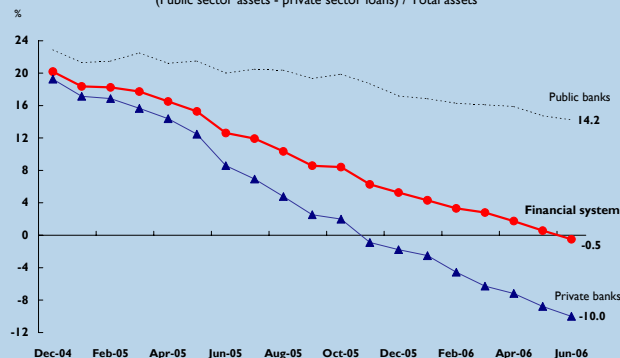
To achieve this restructuring of bank exposure to the public sector, the Central Bank promoted a series of regulatory changes to set a firm basis for healthy development of the banking system in the mid to long term. These measures included establishing of a schedule of discount interest rates on government securities held in bank portfolios to gradually adjust their book valuation to market values, the setting of a cap of 40% of total assets for individual bank exposure to public sector risk (as from 2006), a limit that was recently lowered to 35% as from July 2007, and the introduction of maximum limits on lending (in terms of net worth) according to the level of government (national, provincial or municipal). In addition, capital requirements on holdings of public sector assets were unified with those for the private sector (with a schedule for compliance through to 2009), a margin was set for the trading of such securities to encourage regular trading (with a direct effect on the deepening of capital markets), and a broad framework of measures was promoted placing emphasis on achieving healthy growth in lending to the private sector.



Chart B.3.3

## Public and Private Lending Gap

(Public sector assets - private sector loans) / Total assets

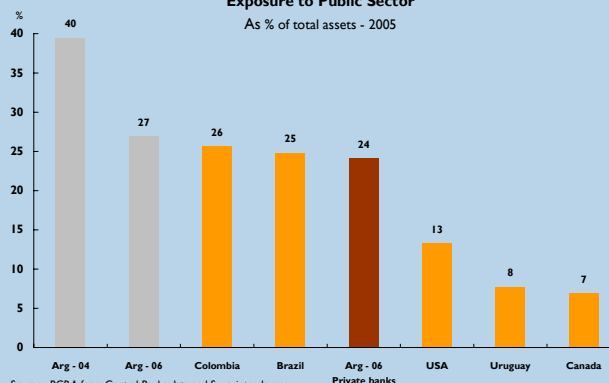


Source: BCRA

Chart B.3.4

## Exposure to Public Sector

As % of total assets - 2005



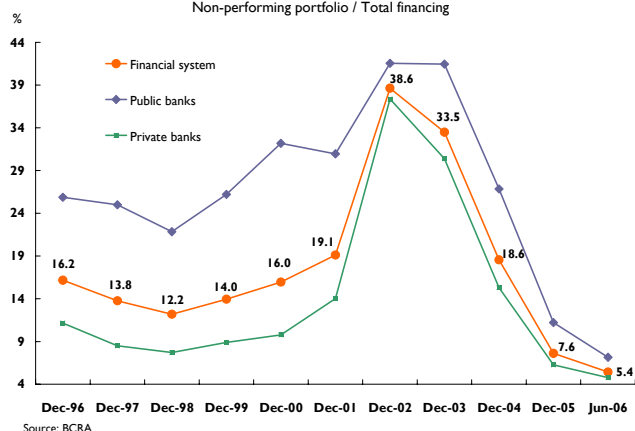
Source: BCRA from Central Banks data and Superintendences

Private banks

In such a context, this steady fall in financial system exposure to the Government (see chart B.3.4), which is expected to persist into the medium term, provides significant benefits for financial intermediation activity. On the one hand, and most significantly, it releases funds that can be used to continue to increase bank lending to the private sector (currently in the order of 10% of GDP), and these resources will help underpin the growth in economic activity. In addition, the gradual reduction in mismatching of terms on bank balance sheets (government securities in bank portfolios have a long term to maturity) will help to consolidate longer-term lending to the private sector. As a result, the regulatory changes promoted by the Central Bank will assist in creating a situation that will enable a reversal of the crowding-out of private lending, at the same time as contributing to a diversification of bank portfolios, encouraging the autonomy of the financial system and monetary policy in relation to the public sector.



**Chart V.10**  
Non-Performing Credit to the Non-Financial Private Sector  
Non-performing portfolio / Total financing



**Table V.1**  
Transition Matrix December 2005 / June 2006  
Weighted by amount - In %

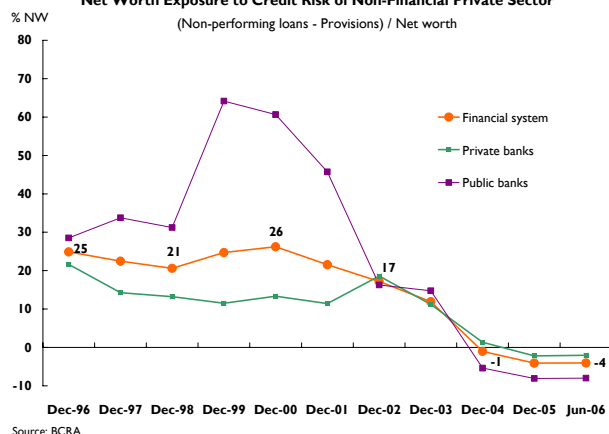
		June 2006								TOTAL
		1	2.a	2.b	3	4	5	6	Write off (*)	
December 2005	1	92.6	1.1	0.0	0.5	0.2	0.1	0.0	5.5	88.6
	2.a	27.5	52.6	2.7	7.2	5.6	0.6	0.0	3.7	2.6
	2.b	5.0	0.1	92.8	0.8	0.0	0.4	0.0	0.8	0.9
	3	8.8	17.9	0.0	50.2	12.9	5.6	0.0	4.5	2.1
	4	4.1	1.5	0.0	1.7	60.8	24.0	0.3	7.5	2.2
	5	2.8	0.3	0.0	0.4	0.8	55.2	0.0	40.5	3.4
	6	11.2	0.2	0.0	0.0	0.2	0.7	65.7	21.9	0.2
	TOTAL	83.2	2.7	0.9	1.7	2.0	2.6	0.2	6.7	100.0

Figures based on debtor information at the start of the exercise

(\*) Includes both repaid financing and that charged-off from balance

Source: BCRA

**Chart V.11**  
Net Worth Exposure to Credit Risk of Non-Financial Private Sector  
(Non-performing loans - Provisions) / Net worth



requirements for financing at a time of growing financial health, explained by higher income, economic growth and a low level of indebtedness (see Pages 29 and 33). Financial institutions increased the supply of funds in a prudent manner, within the framework of a gradual decline in loans rated as non-performing<sup>24</sup> (in situations 3 to 6).

Robust growth in lending to families and companies during the period resulted in rising financial system exposure to private sector credit risk. Lending to the private sector reached 29% of total assets (32% of netted assets), almost 3 p.p. more than in the second half of 2005 (see Chart V.9). Increased banking exposure was led by private banks, as public sector banks held their exposure steady during the period.

In the first half of 2006 private sector credit portfolio non-performance continued to accelerate its downward trend, recording historically low ratios and converging on delinquency levels seen in other countries in the region (see Page 14). The non-performance ratio dropped 2.2 p.p. in the first half of 2006 to a level of 5.4%, reaching its lowest point for the last ten years (see Chart V.10). Portfolio quality improvement was mainly explained by the drop of 4 p.p. in public bank loan non-performance (to 7.2%), while in the case of private financial institutions, the decline was 1.5 p.p. (dropping to 4.8%). This improvement for private banks was mainly accounted for by nationwide retail banks and regional institutions.

While the non-performing loan stock dropped 17% in the first half of 2006, total loans increased by the same proportion. On an annual basis, the reduction in non-performing loans (42%) was slightly larger than the total growth in loans (40%), providing a clear sign of the strengthening of the financial position of private agents.

Notable stability was recorded in debtor classification: 95% retained their rating<sup>25</sup>, 1.8% improved it (\$950 million), while 3.2% (\$1.7 billion) of loans saw a decline in their rating. In the case of top-quality loans (in situation 1), a slight deterioration took place during the half: 1.9% experienced a reduction in their classification (see Table V.1). Lastly, the proportion of non-performing loans at the end of 2005 that were classified as performing in mid-2006 (10%) was greater than the proportion that moved in the opposite direction (7%).

Lower perceived private sector credit risk was behind the 11% drop in provisions, so that exposure of net worth to credit risk has remained steady (see Chart V.11). This performance also benefited from the significant decline in non-performing loans and the increase in financial system net worth.

*Exposure to the private sector is expected to continue to rise, in a framework of the reduction in credit risk*

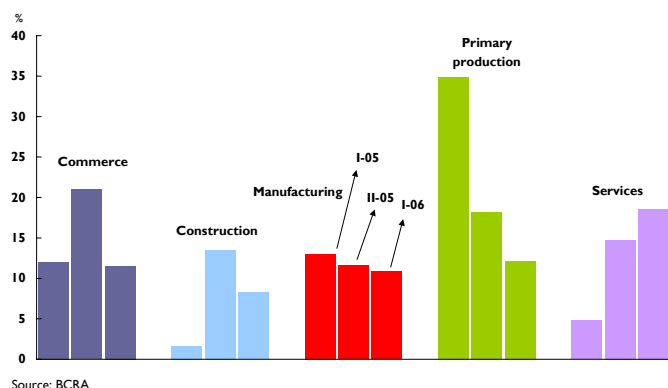
<sup>24</sup> The loans heading includes loans (excluding provisions), other credits from financial intermediation, assets under financial leases and sundry credits linked to the sale of immobilized assets (see ordered text on "Clasificación de Deudores" available at [www.bcr.gov.ar](http://www.bcr.gov.ar)).

<sup>25</sup> This figure has been determined by calculating the percentage of loans granted that retained their classification compared with total loans (net of repayments).





**Chart V.12**  
Changes in Financing by Economic Sector  
Financial system



Although the share of bank assets accounted for by loans to companies and households still only totals slightly over half pre-crisis average values, in coming periods it is expected that the financial system will continue to gradually increase its exposure to the private sector, within the framework of declining credit risk. These developments will continue to be encouraged by the pro-credit policy implemented by the Central Bank.

Lastly, in a scenario of continued favorable conditions, both locally and internationally, during the rest of 2006 it is expected that there will be a drop in delinquency levels. Although it is foreseen that the non-performance ratio will continue to decline, given the improvement seen in recent years its pace will be lower than that recorded in recent periods, converging on values in line with those recorded by other financial systems in the region.

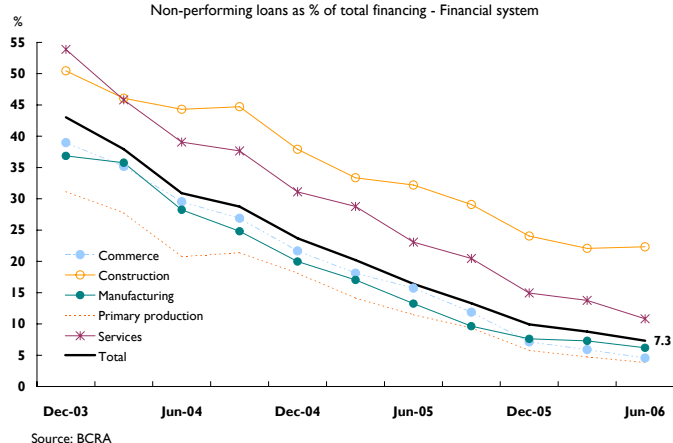
### Corporations

#### *Strengthening of the financial system in the face of corporations' credit risk*

Driven by higher production levels and a healthy financial position for corporations, banks have gained in strength in relation to the counterpart risk represented by companies. Although growth in corporate lending (13%) was widespread across all sectors, it was led by services (19%), followed by primary production (12%) and industry (11%) (see Chart V.12). While bank lending to these latter two sectors accounts for almost 60% of the resources allocated to companies, the services sector was the only one that succeeded in increasing its weighting in the period (1.1 p.p.), to 23% of loans.

These movements generated an increase in bank exposure to corporate credit risk (which rose 0.7 p.p. to 17.8% of assets). Manufacturing industry and services were the sectors that explained most of this increase (see Chart V.13). The notable performance by these two sectors (recording high levels of production together with healthy profit margins and low indebtedness) leads to predictions for a decline in credit risk in coming periods.

**Chart V.14**  
Non-Performance by Economic Sector  
Non-performing loans as % of total financing - Financial system



The overall increase in lending to companies took place in the context of a reduction in their delinquency, which dropped 2.6 p.p. to 7.3% (see Chart V.14). Although the improvement in portfolio quality was observed in all sectors, services led the way (with a drop in non-performance from 14.9% to 10.8%). Progress in the quality of loans to the primary production sector and commerce was also significant.

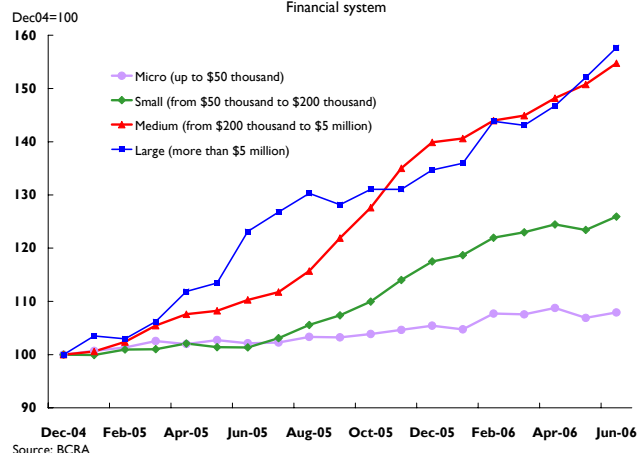
#### *Uniformity in non-performance levels of loans according to debtor size has been accentuated*

In the first half of 2006 loans for over \$200 thousand explained almost all the increase in the balance of loans to companies. Lines for over \$5 million (mainly associated with large corporations) and between \$200 thousand and \$5 million (mid-size companies) recorded notable growth (see Chart V.15). Loans for between \$50 and \$200 thousand (small companies) and those for less than \$50 thousand (micro-undertakings) grew





**Chart V.15**  
**Lending to Companies by Amount Range**  
Financial system



at a more moderate rate during the period. Although loans to micro-undertakings account for only 6% of the total, the number of such debtors is equivalent to almost 90% of the total.

In line with the favorable economic context, there has been a certain degree of uniformity in the quality of the portfolio by debtor size, converging on a 7% non-performance rate. Loans to small companies and micro-undertakings recorded the largest declines in non-performance (4.7 and 3.7 p.p., to levels of 7.4% and 7% respectively) during the period. Loans to large companies saw a drop of 2 p.p. in their delinquency during the period, to a ratio of 7% (see Chart V.16).

#### *Lower spreads and non-performance lead to a drop in corporate credit risk*

The increase in lending was in line with the lower credit risk scenario, reflected in the decline in delinquency rates and the lower cost of company borrowing (see Chart V.17). The lines showing the greatest growth in the first part of 2006 were those that recorded major improvement in their delinquency levels. Export credit lines cut their non-performance by 3 p.p. to 8%, while current account overdrafts posted a drop in non-performance of 1 p.p., reaching historically low levels (2.7%) (see Chart V.18). In addition, there was a notable improvement in portfolio quality in the case of lines with pledge and mortgage collateral. The former recorded a reduction of 4.8 p.p. in non-performance to 3.9%, while the latter lowered it by 6 p.p. to 18.7%.

#### *Companies expect to make an increased use of bank financing*

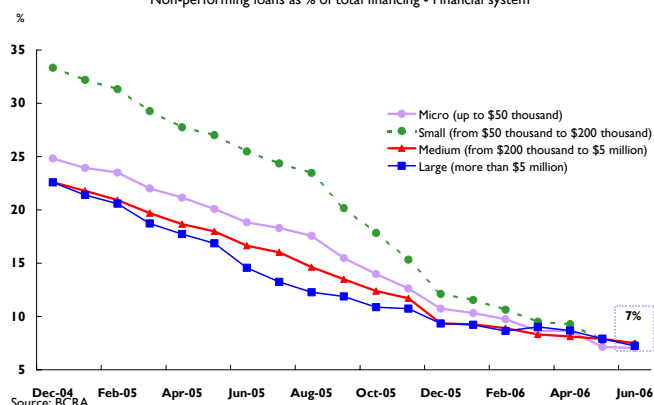
For the rest of 2006 companies expect to continue to increase the intensity with which they will make use of formal bank credit, making a correspondingly lower use of own funds and supplier credit, a trend that has been seen in the last two years (see Chart V.19). Companies will be able to gain access to loans that are generally granted on better terms than financing from suppliers, at the same time as they avoid the need to withhold profits to finance their working capital requirements and their investments to expand productive capacity. On a complementary basis, in view of the predictions for growth, it is expected that lending to the services, industrial and commercial sectors will continue rise.

#### *Households*

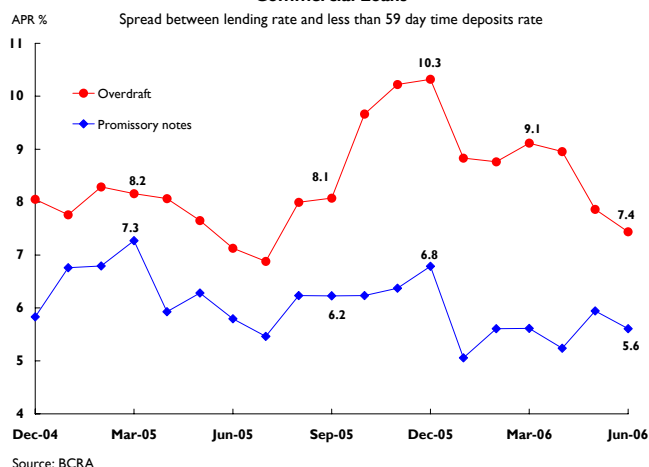
#### *Increased demand for credit by households has been matched by lower credit risk*

The increased in lending to households (19%) during the first six months of 2006 led to an increase in bank exposure to credit risk for this segment (with a rise of 1.1 p.p. to 11.3%) (see Chart V.20). This increased exposure (mainly derived from the rise in personal loans) took place at the same time as a drop in the counterpart risk, as lower delinquency (down 0.8 p.p. to 4%) combined with a reduction in the interest rate spread on consumer loan lines (see Chart V.21).

**Chart V.16**  
**Non-Performance Portfolio by Amount Range**  
Non-performing loans as % of total financing - Financial system

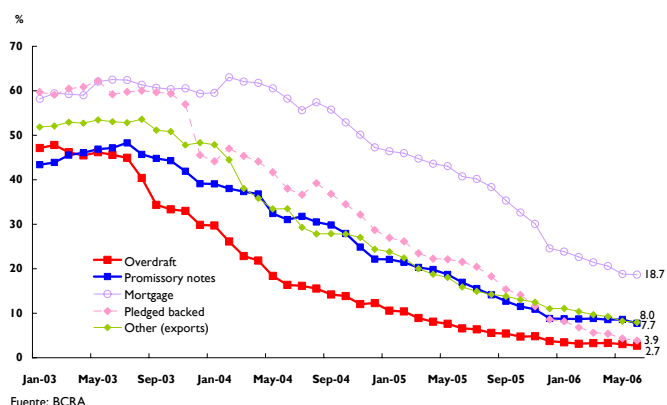


**Chart V.17**  
**Commercial Loans**  
Spread between lending rate and less than 59 day time deposits rate





**Chart V.18**  
Non-Performance Lending to Business by Type of Financing  
Non-performing loans as % of total financing - Financial system



Improved portfolio quality took place mainly in mortgage and pledge-backed lines, which saw a drop in their non-performance of 1.7 p.p. and 1,1 p.p. in the first half of the year, to 5.3% and 1.6% respectively (see Chart V.22).

Favorable forecasts for the development of private sector consumption, together with still low levels of household indebtedness, augur well for further growth in demand for bank credit with a low repayment risk. Although the increase will be widespread across all credit lines, recent measures to encourage mortgage lending are likely to result in this sector acquiring greater dynamism. In a context of growing volumes of financial intermediation, lengthening terms to maturity for private sector deposits, and lower credit risk for households, it is estimated that financial institutions will increase the supply of funds for consumers lending.

### V.3. Interest rate risk

#### *Financial system real interest rate risk remained steady*

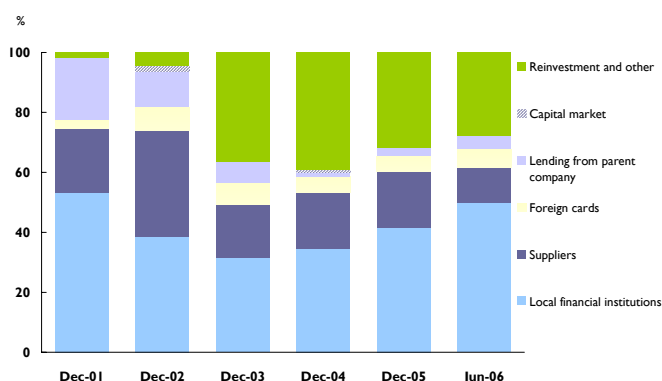
As has been pointed out in previous FSB reports, mitigation of exposure to interest rate risk, largely resulting from the mismatches inherited from the 2001-2002 crisis, remains pending. Once again, attention is focused on real interest rate risk<sup>26</sup>, generated by the mismatching on the balance sheet of items at fixed interest rates adjusted by CER. In this instance, during the first half of 2006 banks increased their real interest rate exposure: CER mismatching totaled almost \$44 billion, 146% of net worth (see Chart V.23).

Principal restatements from the positive change in CER (see Chart V.24) and the settlement of rediscounts under the matching mechanism were responsible for this process. Nevertheless, increased financial system capital helped offset these effects. The long life of assets (almost entirely corresponding to the public sector) and the accelerated normalization of liabilities have constituted the main barriers to a reduction in the mismatching of items adjusted by CER.

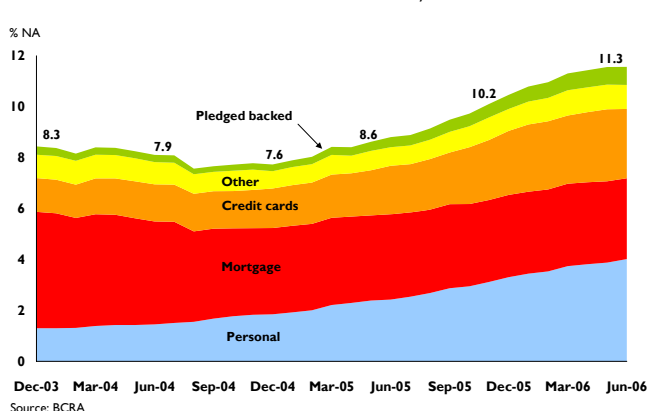
In addition, the financial system, and public banks in particular, are posting gains derived from their positive CER position (see Page 62), creating an incentive not to take greater action to mitigate the risk assumed.

Although interest rate risk is one of the topics pending solution on the financial system balance of risks, stress-test exercises indicate that banks in aggregate terms do not show signs of significant weakness in the face of extreme shocks leading to increases in interest rates<sup>27</sup>. In terms of uniform groups of institutions, public banks, holding a relatively larger position in Government assets, record a relatively lower resistance compared with private institutions in interest rate stress scenarios. In these exercises it is noted that official banks would absorb a large part of the interest rate shock.

**Chart V.19**  
Expected Sources of Funds for Financing  
Outlook for the third quarter of 2006



**Chart V.20**  
Exposure to Households by Type of Financing  
As % of netted assets - Financial system

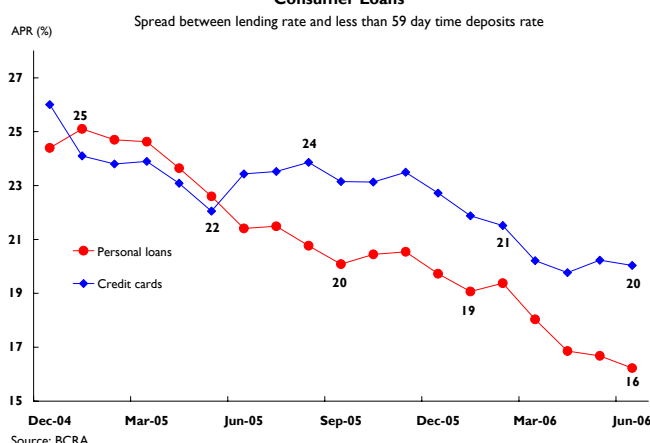


<sup>26</sup> Exposure of balance sheet to shocks where interest rate increases exceed inflation.

<sup>27</sup> In this case, an overall exercise is performed on interest rate risk that includes the effects that take place from exposure to real interest rate risk. The exercise performed considers the behavior of interest rates during 2001, the period prior to the imposing of the so-called "corralito" withdrawal restrictions.



**Chart V.21**  
**Consumer Loans**



The Central Bank continues to work to develop market solutions (such as CER futures and interest rate swaps) to deal with such potential problems, but these markets are still at an incipient stage. The main challenge in developing these markets is to achieve a level of liquidity that is consistent with the size of the needs of financial institutions.

During the rest of the year it is expected that the upward dynamic of CER mismatching will continue hand-in-hand with further adjustments to principal and additional settlement of rediscounts. Nevertheless, the positive trend in bank solvency, added to the low probability of a scenario developing in which there would be an abrupt increase in real interest rates, lead to considering that this risk should have only a moderate weighting on the overall banking balance of risks.

## V.4. Market risk

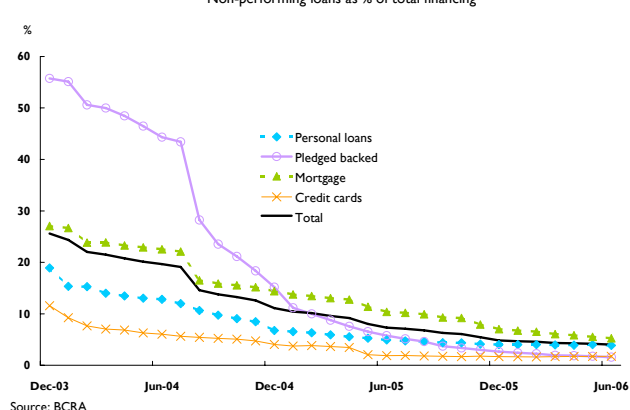
*Greater proportions of holdings at market price and increasing volatility explain the increase in market risk*

In the first half of 2006 the financial system recorded a slight increase in the exposure to market risk. This situation is explained by a greater exposure to holdings of government securities that had been marked to market and a more volatile financial context. For this same reason, the market risk capital requirement established by the Central Bank rose during the period from a monthly average of \$470 million in the second half of last year to almost \$600 million. This has reversed the downward trend seen since the crisis in 2001-2002, which began from levels that were very high in historical terms<sup>28</sup> (see Chart V.25). This requirement continues to represent only a small part, amounting to close to 5%, of total capital requirement.

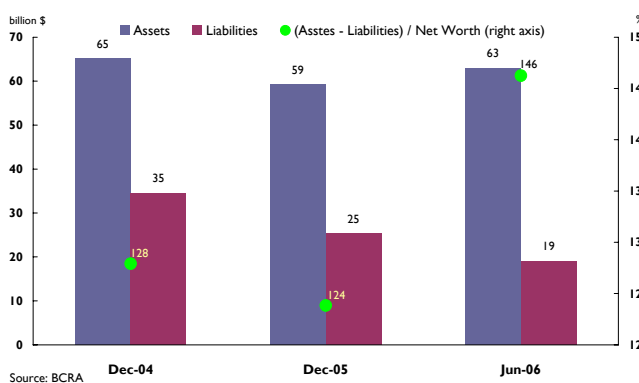
Although the composition of this requirement changed gradually in the post-crisis scenario, between December 2005 and June 2006 it remained steady (see Chart V.26). During this period the trend of reduction in the foreign currency requirement while the requirement for government securities increased was halted, although the volatility used to calculate value at risk for the position in dollars showed a slight drop towards the end of the period (see Chart V.27). In the first half of 2006 there was an increase in the market risk requirement related to exchange rate, shares and bonds.

Looking forward, although it is expected that exchange rate volatility will remain restricted and the foreign currency position is unlikely to record any significant increase (limiting growth in the market risk requirement related to foreign currency), the evolution of risk from bond-holdings is more uncertain. In so far as an increasing proportion of such assets becomes valued on the basis of current quotations, this will result in an increase in market risk. Lastly, although the price correction seen in the May-June period is not expected to continue, it should be taken into account that markets are expected to operate with a significant level of uncertainty in the short and medium term.

**Chart V.22**  
**Non-Performance Loans to Households by Type of Financing**



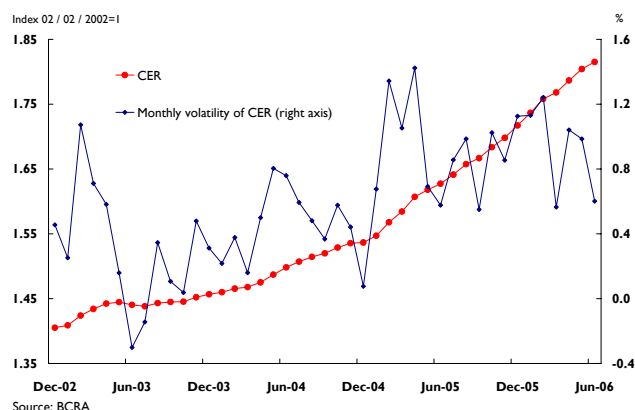
**Chart V.23**  
**CER Mismatching**



<sup>28</sup> Market risk requirements had already recorded a significant increase at the end of the previous half, as various institutions started to mark to market a greater portion of their assets.



Chart V.24  
CER Mismatch Risk

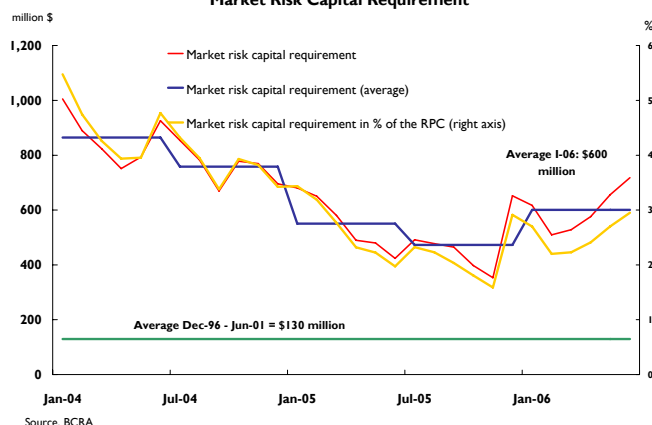


### V.4.1. Currency risk

#### *Foreign currency risk is losing weight in the financial system balance of risks*

The lessons learnt in the 90s and the high currency mismatching recorded by banks following the measures adopted to confront the crisis in 2001-2002, led the Central Bank to closely monitor this type of risk. At present it can be seen that the weighting of the volatility of the peso-dollar exchange rate on the balance of risks has dropped considerably. Whereas in 2004 foreign currency mismatching peaks were reached of close to 70% of financial system net worth, by mid-2006 this figure had been cut by half. Measures taken by the Ministry of Economy and Productions and regulations issued by the Central Bank came together and were effective. Loans in foreign currency are required to be funded out of deposits in the same currency, and in general terms, it is only possible to lend dollars to those debtors whose income is linked to the development of the peso-dollar exchange rate.

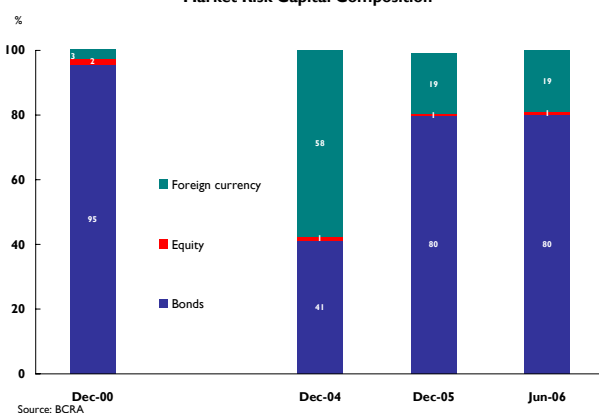
Chart V.25  
Market Risk Capital Requirement



During the first half of 2006, faced by a slight upward trend in the exchange rate, banks maintained the foreign currency positions that they had held at the end of 2005, approximately US\$3.5 billion. Nevertheless, financial system capital growth led to a reduction of 3 p.p. in net worth exposure to currency risk in the half, to 36% of net worth (see Chart V.28). This, added to the reduction in the volatility of the peso-dollar exchange rate in relation to 2005, reinforces the argument that the financial system has gained strength to confront the risk from foreign currency.

It should be noted that foreign currency exposure levels vary widely within the financial system (see Chart V.29). Public banks show greater vulnerability than private financial institutions. Foreign banks and the larger private banks record an almost balanced position in their foreign currency positions.

Chart V.26  
Market Risk Capital Composition



The Central Bank continues to promote market solutions to assist the financial system to generate coverage in the face of the main risks faced by financial intermediation. The deepening of currency futures markets (see Page 25) is helping to improve the situation of the financial system in the face of this risk (by including net future sales without delivery, net worth exposure to foreign currency risk drops by 3 p.p.).

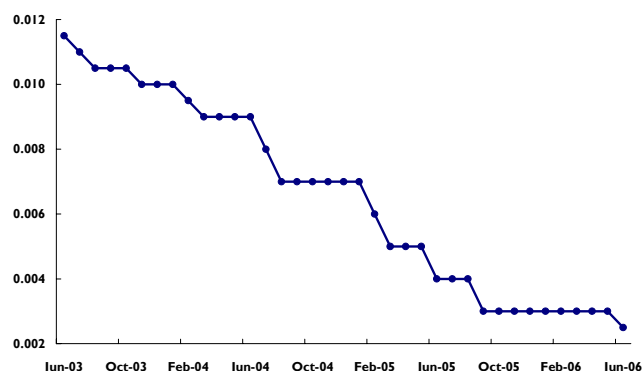
#### *Stress-test exercises show a high resilience by the financial system to variations in the peso-dollar exchange rate*

With the aim of evaluating the impact on net worth of a negative exchange rate shock, a hypothetical stress test exercise was performed. The size of the impact chosen amounted to an appreciation in the peso-dollar exchange rate of 22%, equivalent to the maximum monthly appreciation recorded in Argentina since the 70s,<sup>29</sup> and consistent with the appreciation of the Brazilian real against the dollar in the second quarter of 2003. The exercise consisted in applying a negative shock (with a very low associated probability of occurrence) that takes place in full

<sup>29</sup> If a longer time period than one month is observed, the maximum variation remains at the same level.

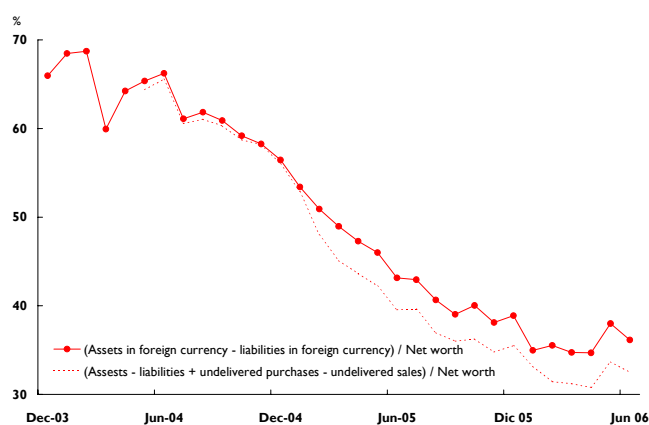


Chart V.27  
Foreign Currency Market Risk  
Volatility used to calculate the value at risk of dollar position



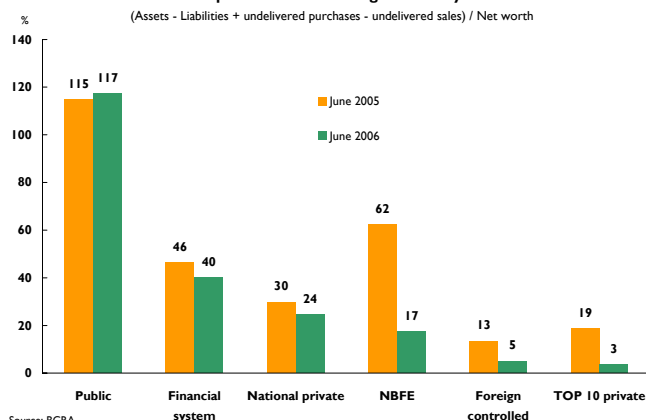
Source: BCRA

Chart V.28  
Exposure to Foreign Currency Mismatch Risk



Source: BCRA

Chart V.29  
Open Position in Foreign Currency  
(Assets - Liabilities + undelivered purchases - undelivered sales) / Net worth



Source: BCRA

during the period, to evaluate the impact on profitability and solvency of financial institutions, recording the immediate effects on balances and disregarding the flow effects derived from the financial position of banks and post-shock adjustment policies<sup>30</sup>.

The exchange rate shock would cause losses for almost all financial institutions. Public banks, however, would be harder hit by a sudden appreciation in the value of the peso against the dollar, recording losses equivalent to 1.8% a. of their assets in the case of an appreciation of 22%, an amount that exceeds their expected profits for 2006 (see Chart V.30). Although to a lesser extent than public banks, private institutions would also post losses, in this case 0.6% a. of assets, well below the profitability of the first half of 2006 (on an annualized basis) for private banks.

Nevertheless, even though the solvency of public banks would be diminished in a situation of extreme stress, it would remain at satisfactory levels (see Chart V.31). The exercise shows that the financial system would have a high level of resilience in the face of a negative exchange rate shock, as solvency levels for both the system and for the various groups of banks would remain in line with local capital requirements and with minimum levels recommended internationally.

#### V.4.2. Risk from marked to market assets

*Although bank exposure to volatility in the price of financial assets has increased, stress-test exercises show adequate protection against this risk*

In absolute terms, the increase centered on fixed income assets (bonds), which continue to represent a large portion of the market risk requirement. The increase in market risk from the holding of government securities is explained by two main factors. On the one hand, there was a steady switch to the market valuation of assets, for various reasons, including the release of assets assigned in guarantee (for example, with the acceleration in the repayment of debt under the matching scheme) and departure from the valuation mechanism established by the Central Bank in the post-crisis period<sup>31</sup>. In addition, there was an increase in the volatility of certain government securities that were widely held in bank portfolios (see Chart V.32), as seen in domestic and international financial markets during the half (see Page 14).

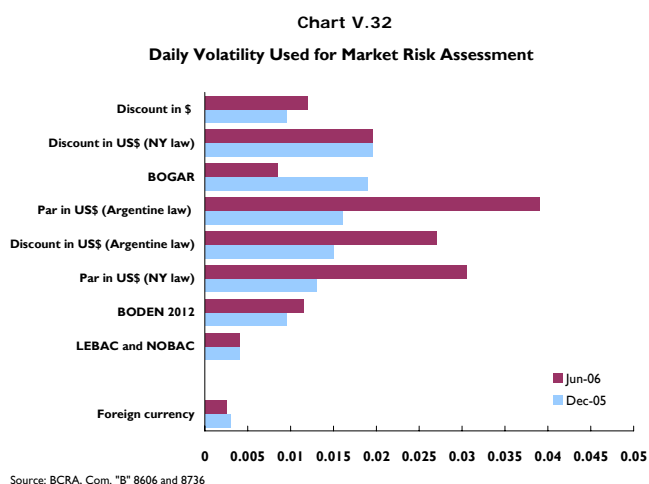
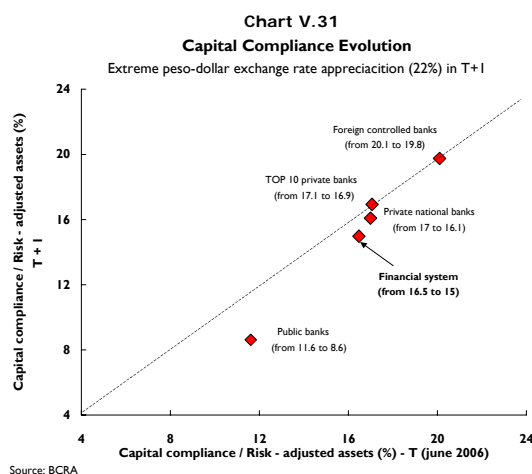
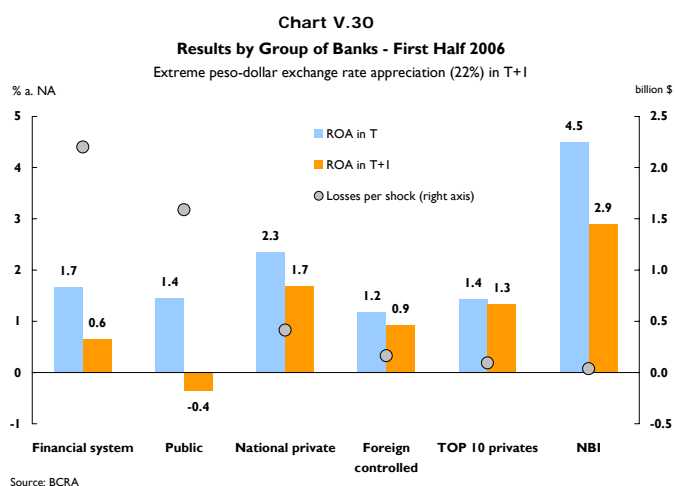
Despite the slight increase in market risk recorded by financial institutions in the first part of 2006, the financial system continued to show firm resilience in the stress-test exercises. This was in line with the situation described regarding the relative level of the value at risk of the position in assets listed on the market. It is estimated that in a scenario of extreme deterioration in local economic and financial conditions, the effect of price volatility on listed assets on bank solvency would

<sup>30</sup> The impact on flows needs to be viewed over time, and would take place in parallel with an adjustment to balance sheet structure of the financial system to mitigate such effects.

<sup>31</sup> Financial institutions had the choice of recording Secured Loans and certain specific government securities (bonds received as compensation according to Decree 905/02 and BOGAR) at their technical value or at present value (as per Com. "A"3911 and its modifications). Having chosen this method of recording, they could subsequently make the switch to market value. This switch was to be definitive, and should be applied to the entire portfolio.



be low<sup>32</sup>. While in these stress scenarios public and private domestic banks would face reduced impacts, foreign banks would absorb the largest proportion of the shock.



<sup>32</sup> The exercises have been performed following the historical simulation method. Yields recorded at December 2003 (worst case scenario) were considered for the price risk for the trading portfolio.



## VI. SOLVENCY

### Summary

*In a context of adequate competition the financial system sharpened the expansion of its profitability in the first months of 2006, a development led specifically by the private sector banks. Both the profit rate and the further capitalization processes speed up the restoration of the sector's solvency. In this context, the financial institutions exhibited book profits of about \$1.8 billion (1.7%a. of assets) in the first half of 2006, which was more than the profits recorded during all 2005. The financial system thus definitely moves away from the context of losses in the post-crisis period (2002- 2004).*

*The expansion of the financial margin continues to lead the increase of bank profits. During the first months of 2006 the increase in profits for holding and trading securities stood out, and also the growth of interest and services incomes. This half yearly recovery was in line with the greater deepening of bank lending activity (with reduced levels of credit risk) in a framework in which the financial system continued to expand its transactional services. While the cost structure remains on a gradual rise, the banking system exhibits gradual improvements of efficiency. However there is still a considerable path to cover in this aspect in order to reach pre-crisis levels.*

*While during the first half of 2006 the profitability consolidated as the principal driver of bank solvency, the flow of fresh capitalizations has not lost relevance. During the period the financial system received new capital injections of \$1.46 billion (in particular for public sector banks); they contributed to an 11% increase in the net worth of the financial system. Meanwhile, capital compliance in terms of assets at risk was 16.5%, which was amply above the domestic requirements and the international recommendations.*

*Due to the consolidation of the positive macroeconomic context, a gradual deepening of banking intermediation activity is foreseen over the coming periods, which would thus boost the main pillars of profitability. The different groups of banks are expected to improve their soundness, to strengthen the sector's position to face possible adverse scenarios, to contribute towards ensuring a framework of financial stability.*

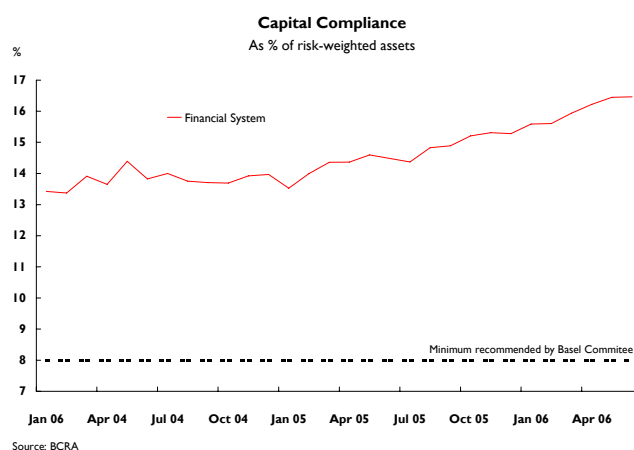
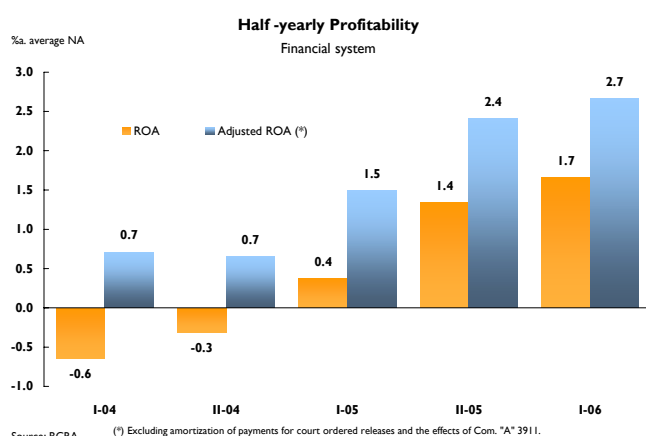
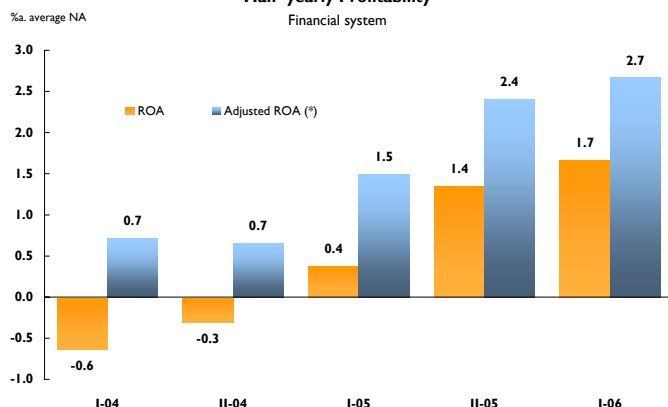






Chart VI.1  
Half -yearly Profitability  
Financial system



Source: BCRA (\*) Excluding amortization of payments for court ordered releases and the effects of Com. "A" 3911.

Table VI.1

Profitability Structure: Total System  
In annualized terms - As % of average netted assets

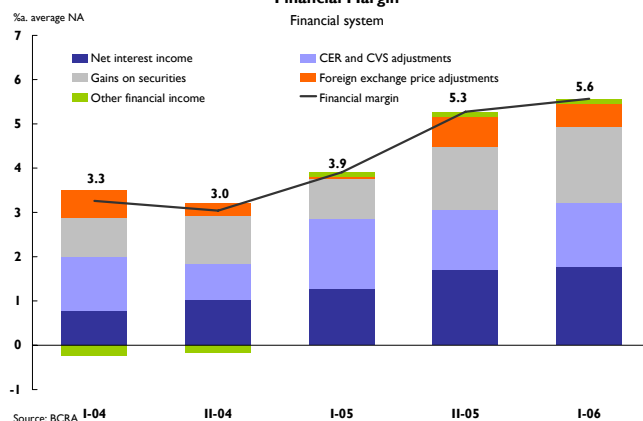
	2002	2003	2004	2005	I-05	II-05	I-06
Financial margin	6.5	1.1	3.1	4.6	3.9	5.3	5.6
Net interest income	-1.7	-0.5	0.9	1.5	1.3	1.7	1.8
CER and CVS adjustments	3.9	1.3	1.0	1.5	1.6	1.4	1.4
Gains on securities	1.7	1.1	1.0	1.2	0.9	1.4	1.7
Foreign exchange price adjustments	2.7	-0.5	0.4	0.4	0.0	0.7	0.5
Other financial income	-0.1	-0.3	-0.2	0.1	0.1	0.1	0.1
Service income margin	1.9	1.9	2.0	2.3	2.2	2.5	2.6
Operating costs	-4.4	-4.2	-4.1	-4.6	-4.3	-4.9	-5.0
Loans loss provisions (*)	-4.7	-1.1	-0.8	-0.6	-0.6	-0.5	-0.5
Adjustments to the valuation of government securities (*)	0.0	-0.4	-0.2	-0.2	-0.2	-0.2	-0.3
Tax charges	-0.3	-0.3	-0.3	-0.4	-0.3	-0.4	-0.4
Amortization payments for court-ordered releases	0.0	-0.6	-0.9	-0.9	-1.0	-0.9	-0.8
Other	-1.8	0.9	0.8	0.8	0.8	0.8	0.8
Monetary results	-5.8	0.0	0.0	0.0	0.0	0.0	0.0
Income tax	-0.2	-0.2	-0.1	-0.3	-0.2	-0.3	-0.4
<b>ROA</b>	<b>-8.9</b>	<b>-2.9</b>	<b>-0.5</b>	<b>0.9</b>	<b>0.4</b>	<b>1.4</b>	<b>1.7</b>
<b>ROE</b>	<b>-59.2</b>	<b>-22.7</b>	<b>-4.2</b>	<b>7.1</b>	<b>3.2</b>	<b>10.7</b>	<b>12.5</b>
<b>Adjusted ROA (**)</b>	<b>-8.9</b>	<b>-1.9</b>	<b>0.7</b>	<b>2.0</b>	<b>1.5</b>	<b>2.4</b>	<b>2.7</b>

(\*) Com. "A" 3911 and complementary communications.

(\*\*) Excluding amortization of payment for court ordered releases and the effects of Com "A" 3911 and complementary communications.

Source: BCRA

Chart VI.2  
Financial Margin  
Financial system



Source: BCRA

## VI.1. Profitability

*The profits recorded by the banking system in the first half of 2006 were more than those seen in the full previous year*

During the first months of 2006 the financial system accrued accounting profits of about \$1.8 billion, or 1.7% annualized (a.) of assets<sup>33</sup>. In this manner, the half year profits exceeded the results for all 2005. If the main items associated with the gradual acknowledgement of the effects of the recent crisis are excluded (amortization of court – ordered payments and adjustments to the valuation of public sector assets), the positive results for the first half of the year total \$2.9 billion (2.7%a. of assets) (see Chart VI.1). In this manner the financial system has been able to recover part of the deterioration of its solvency following the 2001–2002 crisis, to consolidate profit-making as the principal source of its stronger equity position.

Despite the effect of the more volatile sources of revenue, especially those associated with the fluctuations of the nominal peso-U.S. dollar exchange rate, in the prices of sovereign bonds marked to market and in the adjustments with the Reference Stabilization Coefficient (CER), the volatility of the profit rate tends to remain below the pre-crisis levels. In this context, the financial system continues to consolidate the more stable revenue sources, mainly associated with the growing volume of credit and the supply of financial services.

*Profits are boosted by both the holding and trading of securities and by the stronger results from interest and services*

The expansion of the financial margin of banks during the first half of 2006 drove the improvement in the financial system's profit making (see Table VI.1). While the growth in the profits from financial assets was remarkable in the period, interest results were affirmed as the main pillar of the financial margin. Incomes from services sustained their growth rate in the half year period, to consolidate as a solid source of funds. On the other hand, in a context of a gradual recovery of both the staff employed by the sector and in their earnings, operating costs continued to record a gradual increase.

The growth of the financial margin was 0.3 p.p. in the first half of 2006, to reach a level of 5.6%a. of assets. Unlike the second half of 2005, the 0.3 p.p. increase in the gains on securities (1.7%a. of assets) boosted the improvement of the financial margin (see Chart VI.2). However, these results exhibited a volatile performance during the half year period, due to both the fluctuations in the prices of sovereign bonds (see Page 22) held in the portfolio marked to market prices, and in the profits earned for trading.

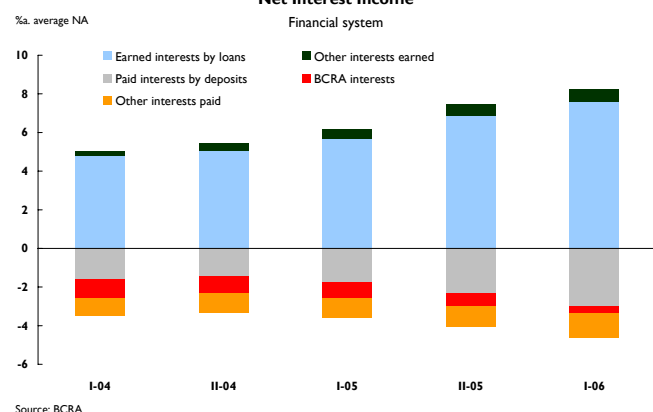
In the first half of 2006 the results from exchange rate differences<sup>34</sup> (another of the volatile components of the bank financial margin) totaled 0.5%a. of assets, 0.2 p.p. less than

<sup>33</sup> Unless otherwise indicated, during the rest of Chapter VI the concept of assets net of accounting duplications generated by repo transactions, term sales and unsettled spot transactions is used.

<sup>34</sup> Includes the purchase and sale of foreign currency activities by the financial institutions.



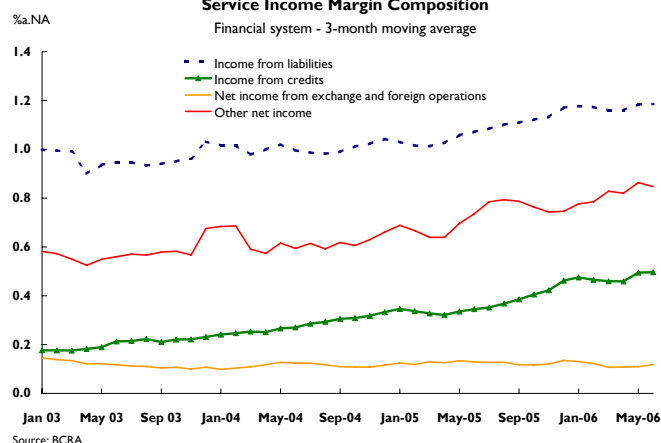
**Chart VI.3**  
**Net Interest Income**  
Financial system



during the previous periods. In this aspect, the increase of the nominal peso-dollar exchange rate between the beginning and the end of the first half of 2006 (\$0.06 per U.S. dollar) was less than that observed in the previous period (\$0.14 per dollar), in a framework where the financial system continues to exhibit a asset position in foreign currency (see Page 56).

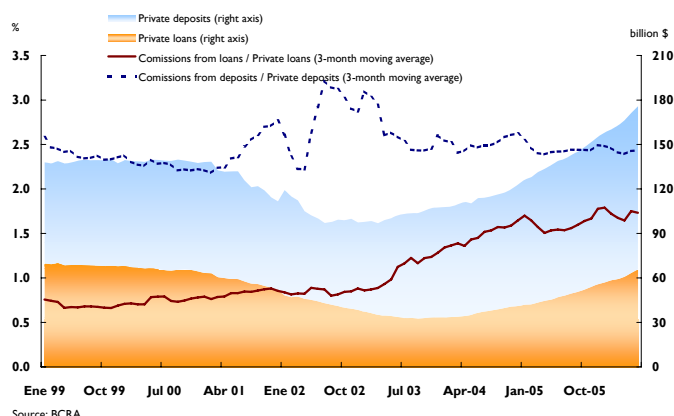
The principal components of the banking financial margin, the net interest income and CER adjustments, exhibited an uneven performance in the first half of 2006. Specifically, the interest income grew 0.1 p.p. in the period to reach a level of 1.8%a. of assets, to affirm them as the main component of the financial margin. This expansion was originated in the larger accrual of interest in connection with the growing lending activity of the banks (see Chart VI.3) (backed by the sustained improvement in the quality of the private sector portfolio), in a context of lending rates that showed an uneven behavior in the period. The smaller interest payments on debts owed to the Central Bank under the matching schedule were partly offset by the higher interests paid for deposits. The positive results in connection with CER adjustments remained stable in the first part of 2006.

**Chart VI.4**  
**Service Income Margin Composition**  
Financial system - 3-month moving average



The financial system incomes from services sustained their expansive pattern in the first half of 2006, to increase by 0.1 p.p. in the period to a level of 2.6%a. of assets. The banks thus continued to make efforts to broaden the base of their less volatile revenues. The commissions in connection with liabilities (mainly deposits) continued to be the principal component of service revenues (see Chart VI.4), while they maintain a relatively stable level in terms of private sector deposits. On the other hand, the revenues from commissions associated with credit transactions exhibited a significant expansion in the first six months, to show a rising trend in terms of the total stock of private sector loans (see Chart VI.5).

**Chart VI.5**  
**Service Income**



The continuity of the favorable macroeconomic scenario is helping to maintain the loan loss provisions at historically low levels. The loan loss provisions therefore remained stable during the first half of 2006 at a level of 0.5%a. of assets, or 0.1 p.p. less than the same period in 2005, sustaining the declining trend that began after the 2001 – 2002 crisis (see Chart VI.6). As regards the balance of private sector loans, the loan loss provisions were reduced by approximately 0.3%a. in the first half, to remain at a level of 1.8%a..

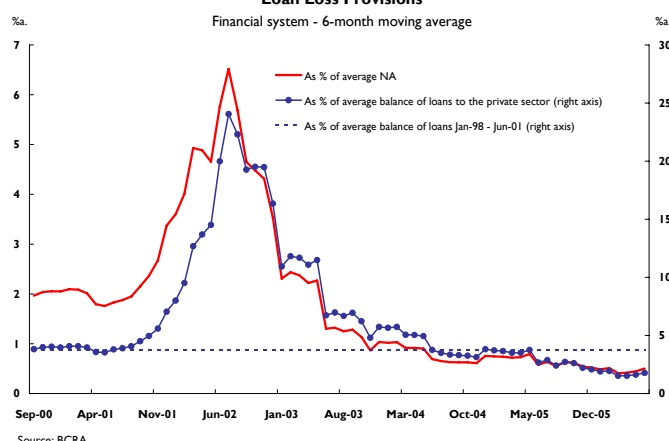
***Although improvements in efficiency are observed, a long way must still be covered***

Operating costs exhibited a slight increase of 0.1 p.p. in the first half of 2006, to reach 5%a. of assets. As has been evident since 2004, the improved prospects for banking activity boost the sustained increase of the staff employed (see Page 37), in a scenario with rising wages in the sector.

Despite this trend, the financial institutions exhibited some improvements in their efficiency: the coverage of operating costs with revenues (financial margin and service results) totaled 165% in the first half of 2006, which amply surpassed the figures recorded before the crisis (see Chart VI.7). In this framework, the efficiency of the labor factor of the financial



**Chart VI.6**  
**Loan Loss Provisions**

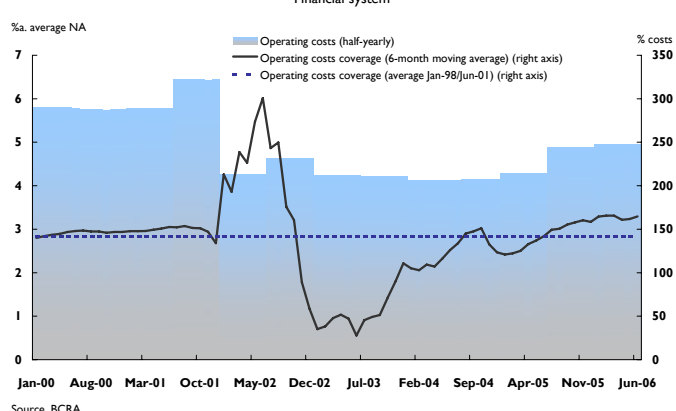


system, measured as the ratio between the outlays on staff and the addition of deposits to private loans, exhibits a gradual improvement (see Chart VI.8). While the public sector banks show a gradual worsening of this indicator (mainly due to their relatively larger staffing), the private sector financial institutions exhibited a moderately improved trend. However, in both groups of financial institutions a considerable efficiency gap still exists when compared with the period prior to the crisis.

In this context, a gradual increase in the implicit interest rate gap between loans and deposits in the banking system is observed (see Chart VI.9), a sign of the growing needs for funds to face the increase in the bank cost structure.

*The outstanding profit performance of the private sector banking system is driven mainly by the revenues from financial intermediation and trading*

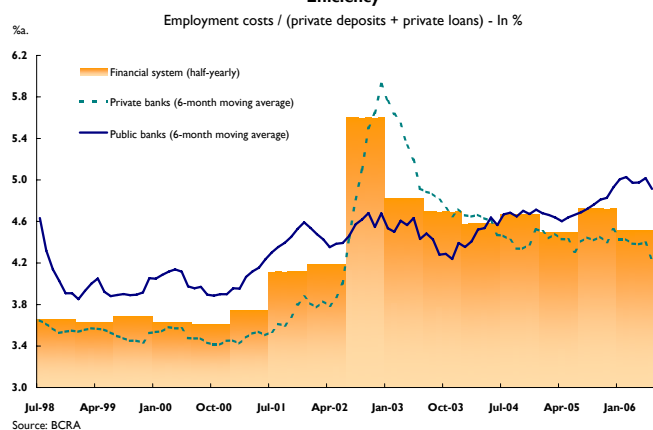
**Chart VI.7**  
**Operating Costs and Efficiency**



Unlike the previous half, when the government owned financial institutions had a positive profitability gap, in the first half of 2006 the private sector banks led in generating profits. This group of banks therefore obtained positive results of about \$1.1 billion, or 1.8%a. of their assets (see Table VI.2). The ROA of the private sector banks was 2.8%a. of their assets in the period without including the effect of court - ordered payment and adjustments to the valuations of public sector assets. The expansion of the profit rate of these financial institutions was associated with the significant growth of the gains on securities and the incomes from services, in a context in which interest earnings continued to consolidate as the principal component of the financial margin.

In comparison with private banks, the profitability of public institutions is at present based on weaker pillars. This group of financial institutions exhibited a 0.3 p.p. fall in their profit rate in the first half to a level of 1.5%a. of their assets (about \$640 million), a figure that expands to 2.5%a. of assets without the effect of court orders and adjustments in the value of public sector assets (see Table VI.3). This semi annual shift was specifically influenced by the smaller accrual of exchange rate differences and by the larger outlays in connection with income tax. On the other hand, the CER adjustments continued expanding, to become the main component of the public sector banks' financial margin.

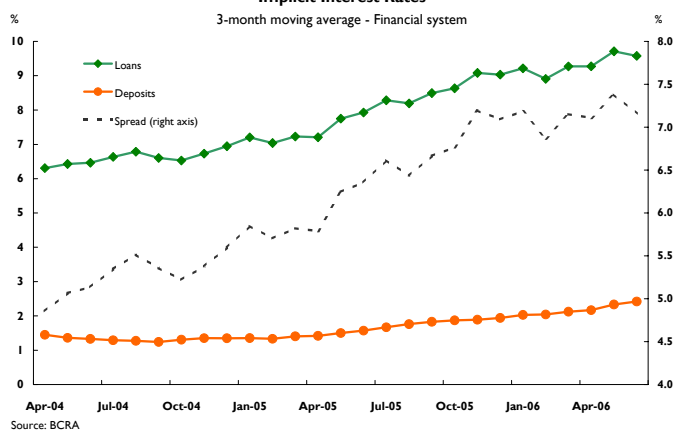
**Chart VI.8**  
**Efficiency**



The different groups of private sector banks exhibited an uneven performance in their profit making during the first half of 2006. On one hand, the retail banks with a national scope recorded an expansion of their profit rate (by 0.9 p.p. to a level of 1.4%a. on assets), a development especially accounted for by the increased results from holding and trading securities, and to a lesser extent by the results from services and interest earnings during the period (see Table VI.4). On the other hand, although the group of regional retail banks exhibited a slight fall of 0.3 p.p. in their ROA to 3.4%a., they still lead in bank profit rates. This fall was partly led by the smaller accrual of CER adjustments and gains on securities. Finally, the specialized banking system moderated the high profits seen until the end of 2005, in a context of fewer incomes from interest and exchange rate differences.



**Chart VI.9**  
**Implicit Interest Rates**  
3-month moving average - Financial system



*Looking ahead to the second half of 2006 the banking system is expected to consolidate the growth of profits from interests and services*

Due to profits in the financial system for the third consecutive half, in an environment of growing expansion of economic activity, during the second half of 2006 the positive results of financial institutions are expected to continue becoming more robust. Meanwhile, it is likely that certain sources of volatility of bank balance sheets will persist, mostly originated by the balance mismatches that still exist.

In aggregate terms a further expansion of the bank financial margin is forecast, mainly explained by the sustained recovery of the traditional financial intermediation of the private sector banks. Meanwhile, the gradual recovery of the domestic fixed income market should make the sources of bank revenues more robust. In line with the trend visible since the 2001–2002 crisis the financial institutions should also continue to expand their service revenue base, in hand with the growing use of banks by the economy. The financial system should therefore continue consolidating solid revenue pillars, a situation compatible with a gradual rescaling of the costs structure, in terms of both a future expansion of the workforce and its wages.

The sustained decline in credit risk, due to both the successive improvements in the quality of the loan portfolio and the small implicit risk of the new loans should allow for loan loss provisions to remain at moderate levels. In a similar manner to previous periods, the appropriate degree of provisions exhibited by the banking system enables it to absorb the balance effect of expected future losses.

It is also worth noting that a group of financial institutions has recently exhibited improvements in their risk ratings, while they also recorded new issues of shares and corporate bonds abroad, signs of the good domestic business climate which has a positive influence on the future development of the banking system.

**Table VI.2**  
**Profitability Structure: Private Banks**  
In annualized terms - As % of average netted assets

	2003	2004	2005	I-05	II-05	I-06
<b>Financial margin</b>	2.3	2.9	4.3	3.6	5.0	5.6
Net interest income	0.1	1.0	1.7	1.4	2.0	2.1
CER and CVS adjustments	0.9	0.8	1.0	1.1	0.8	0.8
Gain on securities	1.7	0.8	1.0	0.7	1.3	1.9
Foreign exchange price adjustments	-0.3	0.6	0.5	0.2	0.7	0.7
Other financial income	-0.2	-0.3	0.1	0.1	0.1	0.1
<b>Service income margin</b>	2.0	2.4	2.7	2.5	2.9	3.2
Operating costs	-4.6	-4.6	-5.1	-4.8	-5.5	-5.6
Loans loss provisions	-1.3	-0.9	-0.6	-0.6	-0.6	-0.5
Adjustments to the valuation of government securities (*)	-0.6	0.0	-0.2	-0.1	-0.2	-0.2
Tax charges	-0.3	-0.3	-0.4	-0.4	-0.5	-0.5
Amortization payments for court-ordered releases	-0.7	-1.0	-1.0	-1.0	-0.9	-0.9
Other	1.0	0.7	0.9	0.8	1.0	0.8
Monetary results	0.0	0.0	0.0	0.0	0.0	0.0
Income tax	-0.3	-0.2	-0.2	-0.1	-0.2	-0.2
<b>ROA</b>	-2.5	-1.0	0.5	0.0	1.0	1.8
<b>ROE</b>	-19.1	-8.1	4.1	0.4	7.6	12.4
<b>Adjusted ROA (**)</b>	-1.2	0.2	1.6	1.1	2.2	2.8

(\*) Com. "A" 3911 and complementary communications.

(\*\*) Excluding amortization of payment for court ordered releases and the effects of Com "A" 3911 and complementary communications.

Source: BCRA

**Table VI.3**  
**Profitability Structure: Public Banks**  
In annualized terms - As % of average netted assets

	2003	2004	2005	I-05	II-05	I-06
<b>Financial margin</b>	-0.9	3.3	4.8	4.2	5.5	5.2
Net interest income	-1.7	0.5	0.9	0.8	1.0	1.0
CER and CVS adjustments	1.8	1.4	2.2	2.3	2.2	2.4
Gain on securities	0.1	1.3	1.3	1.2	1.5	1.4
Foreign exchange price adjustments	-0.7	0.2	0.2	-0.2	0.6	0.4
Other financial income	-0.4	-0.1	0.1	0.1	0.1	0.1
<b>Service income margin</b>	1.5	1.5	1.6	1.6	1.7	1.7
Operating costs	-3.4	-3.2	-3.5	-3.3	-3.7	-3.7
Loans loss provisions	-0.9	-0.6	-0.5	-0.5	-0.4	-0.4
Adjustments to the valuation of government securities (*)	-0.1	-0.4	-0.2	-0.2	-0.2	-0.4
Tax charges	-0.1	-0.2	-0.3	-0.2	-0.3	-0.3
Amortization payments for court-ordered releases	-0.5	-0.7	-0.9	-0.9	-0.8	-0.6
Other	0.7	0.7	0.5	0.7	0.4	0.7
Monetary results	0.1	0.0	0.0	0.0	0.0	0.0
Income tax	0.0	-0.1	-0.3	-0.4	-0.3	-0.6
<b>ROA</b>	-3.5	0.3	1.3	0.9	1.8	1.5
<b>ROE</b>	-31.8	3.9	12.5	8.2	16.5	13.0
<b>Adjusted ROA (**)</b>	-3.0	1.4	2.4	2.0	2.8	2.5

(\*) Com. "A" 3911 and complementary communications.

(\*\*) Excluding amortization of payment for court ordered releases and the effects of Com "A" 3911 and complementary communications.

Source: BCRA

## VI.2. Capital position

*While the capitalization process continues, the profitability of the financial system consolidates as the principal factor to strengthen solvency*

The banking system continued to strengthen its solvency in the first months of 2006 in a context of increasing book profits and the receipt of capitalizations. Due to the favorable growth of economic activity, in the framework designed by the Central Bank in order to restore the solvency of the banks the financial system applied new capital contributions of approximately \$1.46 billion in the first half of the year (see Chart VI.10), led mainly by the public sector banks. As a result, the flow of capitalizations accumulated by the banks since the beginning of 2002 totals almost \$14 billion, or more than two thirds of their net worth after the last crisis. In this manner, and in line with the encouraging perspectives that exist in the sector, the banks have pending capitalization commitments of approximately \$100 million.



**Table VI.4**  
**Profitability Structure by Type of Bank - First Half 2006**  
In annualized terms - As % of average netted assets

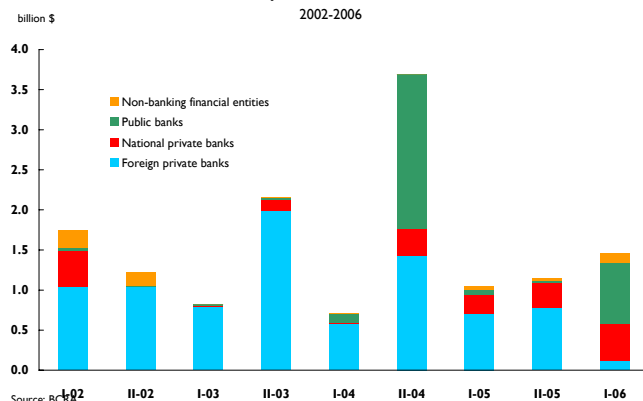
	Private				
	Retail				Wholesale
	Total	National coverage	Regional coverage	Specialized	
Financial margin	5.5	5.1	6.7	17.4	7.1
Net interest income	2.2	1.9	2.6	14.2	0.5
CER and CVS adjustments	0.8	0.9	0.8	-0.6	0.0
Gain on securities	1.8	1.6	2.6	3.0	4.7
Foreign exchange price adjustments	0.6	0.6	0.5	1.3	1.8
Other financial income	0.1	0.1	0.2	-0.4	0.1
Service income margin	3.2	3.2	3.3	4.1	2.3
Operating costs	-5.5	-5.2	-6.3	-16.0	-7.5
Loans loss provisions	-0.5	-0.5	-0.5	-3.9	-0.6
Adjustments to the valuation of government securities (*)	-0.2	-0.2	0.0	0.0	-0.1
Tax charges	-0.5	-0.6	-0.5	-0.9	-0.4
Amortization payments for court-ordered releases	-0.9	-1.0	-0.3	-0.3	0.0
Other	0.8	0.6	1.6	2.0	1.9
Monetary results	0.0	0.0	0.0	0.0	0.0
Income tax	-0.1	0.0	-0.5	-0.4	-0.9
<b>ROA</b>	<b>1.8</b>	<b>1.4</b>	<b>3.4</b>	<b>2.1</b>	<b>1.8</b>
<b>ROE</b>	<b>13.0</b>	<b>10.7</b>	<b>23.4</b>	<b>7.4</b>	<b>6.9</b>
<b>Adjusted ROA (**)</b>	<b>2.8</b>	<b>2.6</b>	<b>3.7</b>	<b>2.4</b>	<b>1.9</b>
Weight in total assets (%)	55.4	44.7	9.9	0.7	3.0

(\*) Com. "A" 3911 and complementary communications.

(\*\*) Excluding amortization of payment for court ordered releases and the effects of Com "A" 3911 and complementary communications.

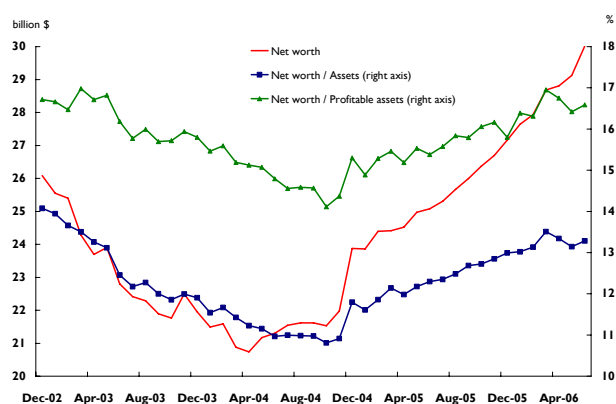
Source: BCRA

**Chart VI.10**  
**Capital Contributions**  
2002-2006



Source: BCRA

**Chart VI.11**  
**Financial System Leverage**



Source: BCRA

Unlike the previous periods, the public sector banks<sup>35</sup> generated more than half the fresh capital contributions received in the first half of 2006. In addition, the national private financial institutions made significant capital contributions, while in March a private bank issued a considerable number of shares abroad. On the other hand, the foreign owned banks reduced the rate of their capitalizations during the first half, although they still maintain a share of approximately 60% of all the contributions received in the 2002 – 2006 period.

During the first half of 2006 the financial institutions increased their net worth by approximately 11%, or almost \$2.85 billion (see Chart VI.11). The public sector banks accounted for almost half the capital increase of the financial system during this period. The net worth of the banking system in terms of assets grew 0.3 p.p. in the first half of the year, to stand at a level of about 13.3% at mid 2006.

The principal indicators of the financial institutions that are listed on the domestic stock exchange exhibited an uneven performance in the first half of the year: while until April they exhibited a generalized improvement, the volatility of the financial markets towards the end of the period led to their decline. However, from the beginning to the end of the period the market capitalization of the main financial institutions developed favorably (see Chart VI.12).

The financial system is amply adequate to the minimum domestic requirements and the international recommendations. In this manner the capital compliance of the financial system rose 1.2 p.p. more than the risk weighted assets to stand at 16.5% at the end of June 2006 (see Chart VI.13). In this framework the private sector financial institutions exhibited higher levels of capital compliance than the public sector and exhibited a faster growth rate. The level of the bank strength ratios compares favorably with the possible adverse scenarios, while it allows for deepening the loans for the private sector in a manner suitable for a financial stability framework. With the exception of the private sector specialized and wholesale financial institutions (with high capital levels due to the characteristics of their strategies), all groups of banks exhibited an improvement in their capital compliance ratios during the period, with a positive impact on their solvency (see Table VI.5). This situation is reflected in surplus capital positions for all bank segments.

***During the coming months the financial system will continue to increase its resilience to possible adverse shocks***

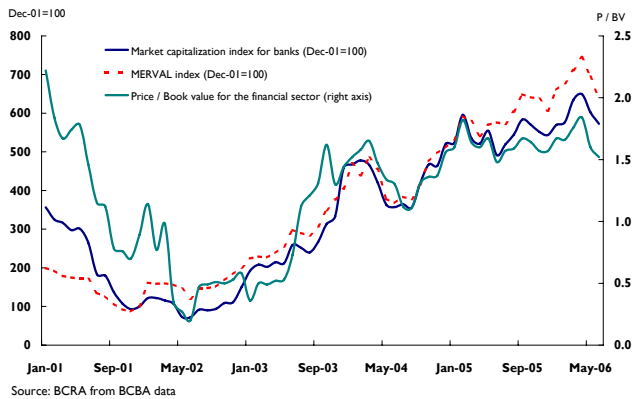
The financial institutions are expected to continue to support a prudent behavior in terms of capital compliance, a strategy with foresight regarding the scheme for gradual adjustment that the Central Bank adopted in a timely manner in order to regulate the adverse effects of the 2001–2002 crisis. Specifically, a timetable was set to readjust the minimum capital requirements for public sector credit risk (higher than the suggested international requirements) and for interest rate risk. This scenario allows for

<sup>35</sup> In some cases in the framework of contribution programs in instalments.

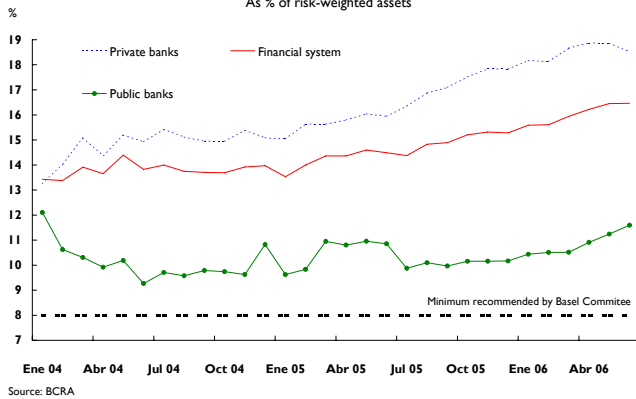


an estimate that financial stability conditions will strengthen during the rest of 2006.

**Chart VI.12**  
**Market Capitalization Index for Financial Institution**



**Chart VI.13**  
**Capital Compliance**  
As % of risk-weighted assets



**Table VI.5**  
**Minimum Capital by Group of Banks**  
June 2006 - In %

Group of Banks	Capital in excess / Capital requirements (*)	Capital / Assets at risk (**)
Public banks	154	11.6
Private banks	123	18.5
National coverage	114	17.0
Regional coverage	123	19.7
Specialized	204	30.1
Wholesale	216	38.4
Non-bank institutions	262	55.5
<b>Total</b>	<b>135</b>	<b>16.5</b>

(\*) Includes capital requirements arising from credit risk, interest rate risk, market risk additional requirements and forebearances.

(\*\*) Assets weighted by credit risk

Source: BCRA





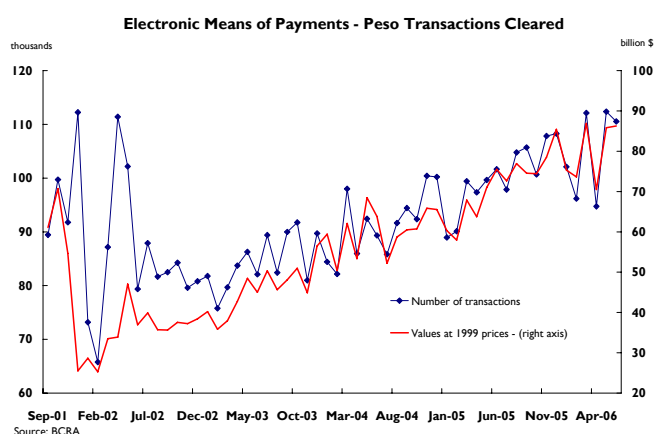
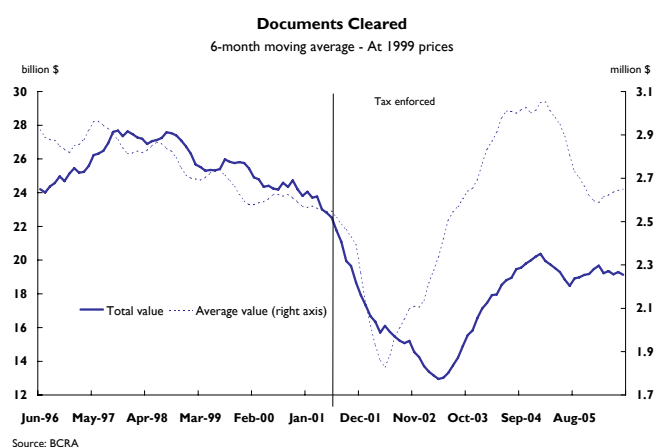
## VII. PAYMENTS SYSTEM

### Summary

*The National Payments System continues to show progress in terms of efficiency and depth. Although the use of cash still predominates in transactions in the economy, there has been a notable increase in the use of alternative means of payment such as “banking” money. This gradual enhancement of alternative means of payment is a reflection of increased economic activity and a greater use by the economy of the banking system.*

*During the first half of 2006 there was an increase in the number of debit and credit cards in use in the economy, as well as greater dynamism in the case of document clearing, retail transfers, direct debits and transactions processed by the high value clearing houses.*

*The Central Bank is promoting the modernization of bank technology currently in use, and in particular that related to the processing and execution of interbank collections and payments. This progress contributes to strengthening confidence in financial services, mainly by providing agile, secure and efficient payment mechanisms. To this end, a series of measures have been adopted with the aim of improving the payments system in general and document clearing in particular, including progress on the Uniform Federal Clearing (CFU) system, analysis of a draft Payments System Bill, improvements to the Check Law, encouragement to the use of electronic payment mechanisms and better systems for transfers processed by the Electronic Means of Payment (MEP) system.*





## VII.1. National Payments System

*Electronic means of payment continue to increase their reach, in line with the increase in economic activity and greater use of formal payment systems*

The National Payments System (NPS) continues its steady transformation and deepening. Although locally cash is still the main instrument used to carry out transactions, a significant increase has been recorded in the use of alternative means of payment such as “banking” money, “plastic” or “electronic” money (debit and credit cards, transfers and direct debits). Nevertheless, the share of total operations accounted for by such methods remains modest when compared with developed economies, an indication of potential growth within a framework of increased economic activity and lower levels of informality.

Use of cash increased in a year-on-year basis in the first half of 2006, accompanying economic growth (see Chart VII.1). Banknotes and coins in circulation (in the hands of the public and held by financial institutions) averaged almost \$43 billion in the first half of 2006, 29% above the amount recorded in the same period of 2005 in nominal terms (16% in real terms). Cash in circulation totaled 6.9% of GDP (see Chart VII.2).

Although regulations introduced by the Central Bank in recent periods have specifically encouraged the setting up of time deposits (see Page 39), sight deposits have shown an upward trend. Strong performance by company sales and the gradual increase in wages have been responsible for this increase in sight deposits in banks. In mid-2006 current account totals were 4% higher than at the end of 2005 and 16% higher than in the same period of the previous year, while in the case of savings accounts such increases were 15 and 24% respectively. This trend opens up the possibility of achieving a more fluid use of bank payment means (checks, transfers and direct debits) (see Chart VII.3), although the existence of the tax on bank debits and credits (IDCCB) partly counteracts this effect. It is expected that these transactions, channeled via low value clearing houses, will continue to increase in the mid-term, largely driven by the greater use of banking services by economic agents.

In addition, the availability of credit and debit cards (commonly known as “plastic”) in the economy continued to increase, with a reduction in cultural barriers to their daily use. The number of debit cards has increased by more than 10% in the last 12 months<sup>36</sup>, to 13.1 million, while credit cards increased almost 29% (to 11.4 million) in the same period.

In the specific case of debit cards, although their increased use at the end of 2001 and in early 2002 was explained by restrictions on the withdrawal of deposits, subsequent dynamism was mainly caused by the widespread payment of wages and pensions into savings accounts. Furthermore, the availability of discounts at major store chains and partial value-added tax refunds encouraged their use.

Chart VII.1

Currency Circulation As a Share of Monetary Aggregates  
6-month moving average

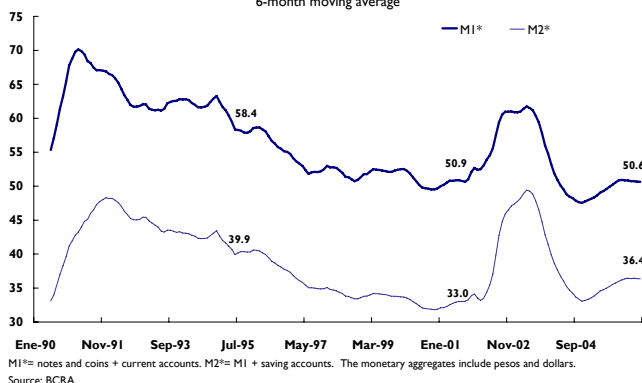


Chart VII.2

Currency in Circulation  
In % of GDP

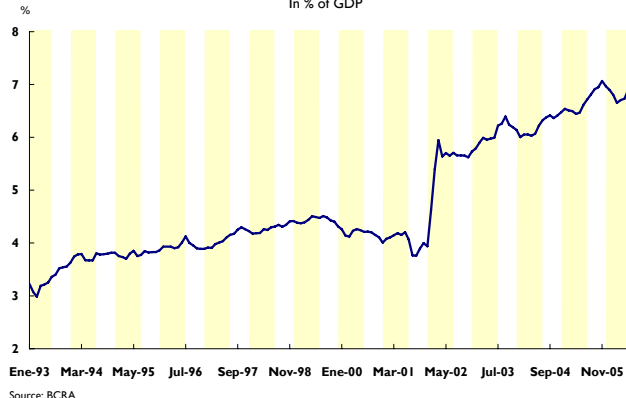
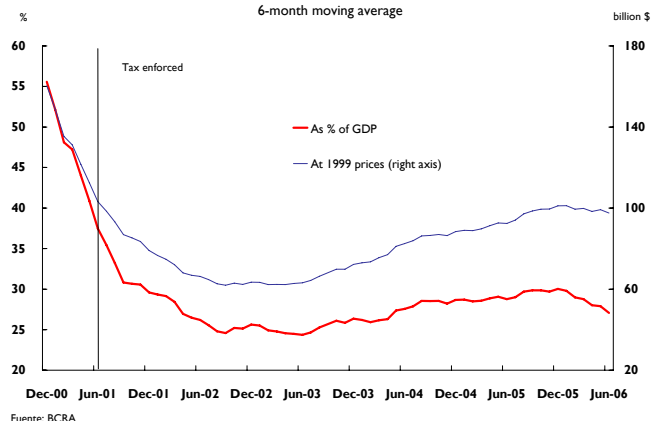


Chart VII.3  
Current Account Debits  
6-month moving average

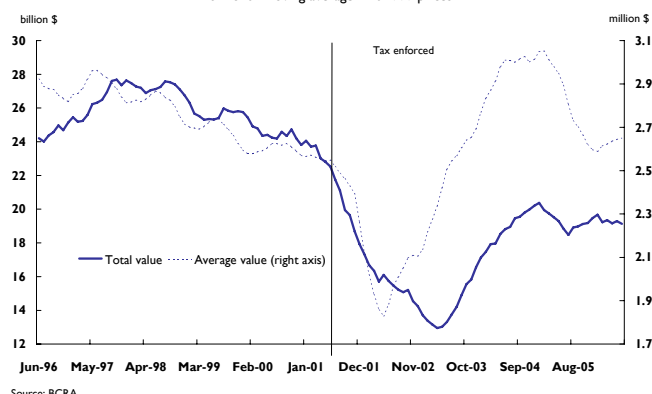


<sup>36</sup> Latest available information corresponds to March 2006.



**Chart VII.4**  
**Documents Cleared**

6-month moving average - At 1999 prices



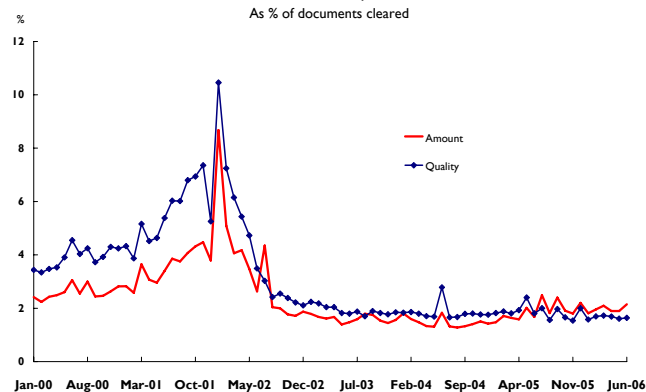
Source: BCRA

The number of checks issued per inhabitant is higher than that seen in developed countries (given the increased use of electronic money in those economies), but below the levels seen in other countries in the region. Although there has been a substantial decline in check clearing as from 1998 (at the start of the recession, followed by the imposing of the IDCCB) until mid-2003, it is currently showing growth, as volume was up 11% in the first half of 2006 compared with the same period of the previous year (see Chart VII.4), while amounts in real terms increased 1.5%.

In the first half of the year there was a slight increase in the number of rejected checks compared with the same period of 2005, to a level of 2% of the monthly average number of checks cleared (see Chart VII.5). The number and amount of rejected checks rose by 12% and 11% respectively in the first part of 2006 compared with the same period of the previous year. Check rejection is below the levels recorded five years earlier, reflecting the impact of growing participation of large companies with a better payment capacity.

**Chart VII.5**  
**Documents Rejected**

As % of documents cleared



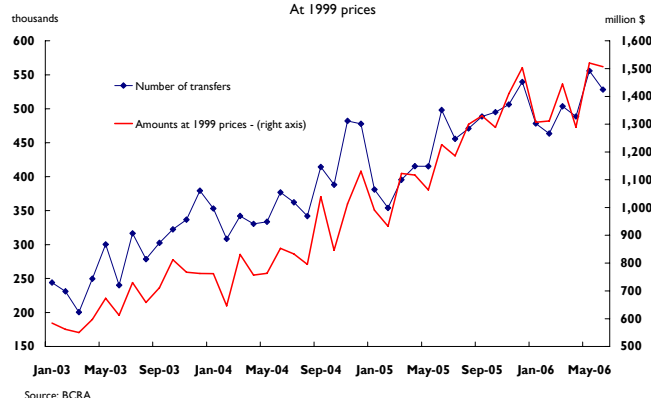
Source: BCRA

Retail transfers still represent a relatively less-used means of payment, although volume has been increasing steadily in recent years. In the first half of 2006 the average number of transfers was 500,000 per month, with a 23% increase in the number of transfers compared with the same period of 2005. Transfer volumes increased by 30% in real terms (see Chart VII.6).

Direct debits, mainly under agreements for the payment of bills for electricity and gas, cable television, school fees, etc., continue to show an upward trend. In the first half of 2006 a monthly average of 1.5 million transactions (18% more than in the same period of 2005), for an amount of \$2.7 billion were cleared (see Chart VII.7).

In the case of high-value payment systems, a total of 628,000 transactions were processed via the Electronic Means of Payment system (MEP), for a value of almost \$840 billion, 21% higher in real terms than the value recorded in the same half of 2005 (see Chart VII.8). Transactions in US dollars remain at a low level, although showing an upward trend.

**Chart VII.6**  
**Retail Transfers**  
At 1999 prices



Source: BCRA

## VII.2. Modernization of the payments system

### *The Central Bank continues to promote measures to strengthen the National Payments System*

In mid-2005 a Uniform Federal Clearing (UFC) system began to be introduced, allowing the electronic simultaneous clearing of value items (mainly checks, drafts and certificates of deposit) between banks. This has enabled the setting up of nation-wide 48-hour clearing for documents for under \$5,000 (significantly faster than the previous times), by means of truncation and electronic transmission of the main data for crediting purposes, and has added dynamism to the payment chain for individuals and companies across the country.

Currently the UFC is in the final stages of development, at the end of which images of checks and other clearing documents



will be transmitted digitally, eliminating the need to physically transfer the documents. As a result, up to a certain amount (currently \$5,000) only the electronic record will be transmitted, while for higher amounts the depository financial institutions will in addition be required to transmit images of the documents. This stage will be implemented before the end of 2006.

Once the UFC is fully operational it will significantly speed the check clearing system nationwide, lowering the inherent operating risks and the costs of operation, and efficiently interconnecting all the country's financial institutions. This will act as an incentive to substitute cash through the use of documents, encouraging the use of the banking system and achieving a greater level of formality in commercial operations.

In addition, in line with the growth of payment systems in developed as well as in emerging economies, certain intrinsic risks have begun to come to the fore that need to be adequately controlled to preserve the stability of the Payments System. In particular, international recommendations indicate the need for a sound legal foundation to ensure that clearing and settlement of transfer orders processed by the Payment Systems are definitive and irrevocable. As a result, the Central Bank has promoted a Payments Systems Bill that will among other matters ensure the uninterrupted operation of the daily interbank settlement process, reduce legal risks and establish that transfers of funds and value items accepted by the payments systems are firm, irrevocable, and valid before third parties.

Under Argentine legislation, there is a legal void in the Checks Law with regard to document truncation, the process whereby original documents are retained by the financial institutions where they are deposited,<sup>37</sup> a system that began to be used at the end of 1998.

Given the spread of electronic check clearing and the need to verify the correct operation of the mechanism, a bill has been drafted to adjust the Checks Law that includes a definition of the truncation concept and the control responsibility of financial institutions under the system's clearing procedures.

In addition, the Central Bank continues to encourage the use of electronic means of payment in everyday transactions within the economy. To this end, an agreement is being negotiated with the Bank Associations and utility service providers on a mechanism that will result in benefits for the customers that use it (complementing the discounts granted by certain commercial chains and the sales made using credit or debt cards), and a new system of commissions that would be applied to all existing electronic payment methods.

Lastly, in accordance with the regulatory framework established by Law 25,246 on "Prevention of Money-Laundering," the Central Bank has promoted a change in the operations in which customers and/or third parties participate. This change consists in requiring the financial institutions originating such transactions to confirm the "know your customer" principle when the transactions are recorded.

Chart VII.7  
Direct Debits

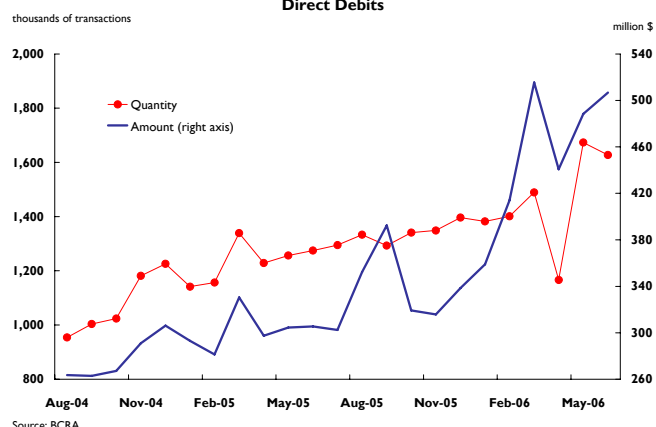
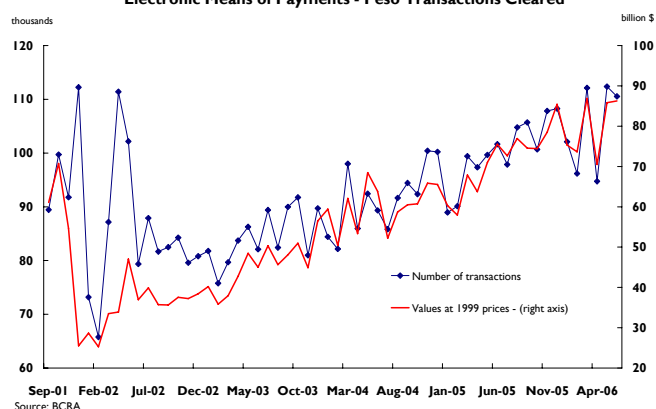


Chart VII.8  
Electronic Means of Payments - Peso Transactions Cleared



<sup>37</sup> Those that receive a check drawn on another bank for collection



## BALANCE OF RISKS

Four years after the crisis, **the financial system is deepening its traditional intermediation activity, gradually transforming its overall risk structure.** Normalization of assets and liabilities, financial services growth and rising solvency levels are outlining an improvement in the balance of risks for banks. This situation has been reinforced by the favorable economic context, both local and international, as well as by the monitoring and supervision activity that form part of the Central Bank's financial policy.

In the first half of 2006 **there was a notable strengthening of the private credit crowding-in process.** This movement of funds from the public sector to the private sector is producing an increase in exposure to credit risk from companies and households. Nevertheless, an improvement has been noted in aggregate payment capacity for both companies (in all branches of economic activity) and households. Growth in incomes, improved solvency, and the positive outlook have altered the risk-return ratio derived from lending to the private sector.

**The financial system is rapidly reinforcing its position in the face of the public sector repayment risk.** Declining exposure to the Government, improved fiscal accounts, and the optimistic outlook for Latin American sovereign debt are the main elements explaining this situation. The independence of the financial system from the payment capacity of the public sector, as well as the encouragement of lending to the private sector, are fundamental components of the current financial policy of the Central Bank.

Having achieved indicators that are more in line with a context of financial stability and are similar to those recorded by other financial systems in the region, **the local banking system demonstrates greater strength in the face of the risk from liquidity.** Adequate levels of coverage by liquid assets, the deepening of interbank liquidity markets, and the powers of the Central Bank to act as a lender of last resort form a solid front of resilience in the face of negative liquidity shocks.

The reduction in the impact on balance sheet of foreign currency mismatching and the low volatility of the peso-dollar exchange rate explain **the strengthening of the financial system in the face of the risk from foreign currency.** Stress-test exercises determine an effect on the system of little significance in the case of an external shock with a very low associated probability. As part of the lesson learned from the 2001-2002 crisis, current Central Bank financial policy focuses on establishing a regulatory framework that will mitigate credit risk related to the link between debtor income and the currency in which the loan is denominated.

**The overall financial system balance of risks has shown improvement,** although certain specific factors still persist.

The financial system records **exposure to real interest rate risk.** This feature is one of the legacies from the crisis that is proving hardest to overcome, as it arises mainly as a consequence of the mismatching between long-term CER-adjusted assets (basically corresponding to the public sector), and CER-adjusted liabilities that are being rapidly settled as part of the normalization process (obligations to the Central Bank under the matching mechanism).

Although it has a low weighting in the overall financial system balance of risks, in the first half of 2006 **there was an increase in exposure to the risk from listed assets** (impact on net worth of financial asset price volatility). The larger number of financial institutions marking their government bonds to market, together with the increase in capital market volatility, have been responsible for this situation. As a result, market risk capital requirement has been recording a rising trend.

In the first half of 2006 bank profits exceeded those recorded for the whole of 2005. This improvement in profitability levels in a context of competition and continued capitalization has consolidated the health of the financial system. Favorable levels of solvency, well in excess of local regulatory requirements and minimum internationally-recommended levels, help to build up **an appropriate level of strength to confront events that could give rise to the risk of losses.** Furthermore, current solvency levels are consistent with a dynamic of increased penetration by the financial system in the economy.

**Prospects for the development of financial activity are favorable, as growth is taking place in a context of relatively low risk.** Although private sector indebtedness levels are still low, steady growth will result in banks increasing efforts to evaluate projects to be financed. In addition, growth in lending to the private sector will help promote improvements in the administration of bank liquidity and the deepening of money markets. It is expected that exposure to the public sector will continue to decline, so that it loses weight in the balance of risks, as will the risk from foreign currency. The risks from real interest rates and listed assets will continue to be the main balance of risk challenges that will need to be overcome. In this positive situation, **the Central Bank is committed to the development of a financial policy based on creation of a sound framework for banking growth consistent with a scenario of financial stability.**







## STATISTICS ANNEX: FINANCIAL SYSTEM

### Chart 1: Financial Soundness Indicators

As %	1996	1997	1998	1999	2000	2001	2002	2003	2004	Jun 05	2005	Jun 06
1.- Liquidity	22.3	26.1	23.1	25.0	23.4	19.6	22.8	29.1	29.6	24.7	20.1	22.1
2.- Lending to the public sector	19.2	19.2	19.3	21.8	21.8	25.8	49.1	47.2	41.5	36.9	32.4	28.6
3.- Lending to the private sector	57.8	56.2	57.2	53.7	49.7	47.2	20.8	18.1	20.3	23.1	26.7	29.1
4.- Private non-performing loans	16.2	13.8	12.2	14.0	16.0	19.1	38.6	33.5	18.6	13.0	7.6	5.4
5.- Net worth exposure to private sector	24.9	22.5	20.6	24.7	26.2	21.9	17.3	12.4	-1.0	-2.8	-4.1	-4.0
6.- ROA	0.6	1.0	0.5	0.2	0.0	0.0	-8.9	-2.9	-0.5	0.4	0.9	1.7
7.- Adjusted ROA	-	-	-	-	-	-	-	-1.9	0.7	1.5	2.0	2.7
8.- Efficiency	142	136	138	142	147	143	189	69	125	142	151	165
9.- Capital compliance	23.8	20.8	20.3	21.0	20.1	21.4	-	14.5	14.0	14.5	15.3	16.5
10.- Excess capital compliance	64	73	49	54	58	54	-	116	185	163	173	135

### Chart 2: Balance Sheet

In million of current pesos	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Jun 05	Dec 05	Jun 06	Change (%)	
										Half yearly	Inter annual
<b>Assets</b>	<b>153,140</b>	<b>163,550</b>	<b>123,743</b>	<b>187,532</b>	<b>186,873</b>	<b>212,562</b>	<b>217,694</b>	<b>222,732</b>	<b>239,434</b>	<b>7.5</b>	<b>9.7</b>
Liquid assets <sup>1</sup>	20,423	20,278	13,005	17,138	27,575	29,154	24,607	21,166	29,647	40.1	20.5
Public bonds	8,531	10,474	3,694	31,418	45,062	55,382	61,551	66,733	66,301	-0.6	7.7
Lebac/Nobac	0	0	0	-	-	17,755	26,043	28,340	27,791	-1.9	6.7
Portfolio	0	0	0	-	-	11,803	18,570	21,067	21,949	4.2	18.2
Repo	0	0	0	-	-	5,953	7,472	7,273	5,842	-19.7	-21.8
Private bonds	477	633	543	332	198	387	441	387	843	117.6	91.1
Loans	83,850	83,277	77,351	84,792	68,042	73,617	77,825	83,664	90,974	8.7	16.9
Public sector	12,138	15,164	22,694	44,337	33,228	30,866	28,559	25,317	21,906	-13.5	-23.3
Private sector	67,934	64,464	52,039	38,470	33,398	41,054	47,170	55,898	65,844	17.8	39.6
Financial sector	3,778	3,649	2,617	1,985	1,417	1,697	2,095	2,450	3,224	31.6	53.9
Provisions over loans	-6,001	-6,907	-6,987	-11,952	-9,374	-7,500	-6,460	-4,953	-4,288	-13.4	-33.6
Other netted credits due to financial intermediation	33,679	42,361	21,485	39,089	27,030	32,554	31,743	26,746	26,317	-1.6	-17.1
Corporate bonds and subordinated debt	1,115	794	751	1,708	1,569	1,018	818	873	779	-10.7	-4.7
Unquoted trusts	1,336	2,053	2,065	6,698	4,133	3,145	3,105	3,888	4,538	16.7	46.2
Compensation receivable	0	0	0	17,111	14,937	15,467	11,689	5,841	5,150	-11.8	-55.9
Other	31,228	39,514	18,669	13,572	6,392	12,924	16,131	16,144	15,850	-1.8	-1.7
Assets under financial leases	814	786	771	567	397	611	846	1,384	1,856	34.1	119.3
Shares and participation	1,838	2,645	2,688	4,653	4,591	3,871	4,037	4,525	4,720	4.3	16.9
Fixed assets and miscellaneous	4,973	4,939	4,804	8,636	8,164	7,782	7,614	7,546	7,490	-0.7	-1.6
Foreign branches	996	1,115	1,057	3,522	3,144	3,524	3,468	3,652	3,832	4.9	10.5
Other assets	3,560	3,950	5,334	9,338	12,043	13,180	12,022	11,882	11,743	-1.2	-2.3
<b>Liabilities</b>	<b>136,252</b>	<b>146,267</b>	<b>107,261</b>	<b>161,446</b>	<b>164,923</b>	<b>188,683</b>	<b>192,614</b>	<b>195,571</b>	<b>209,419</b>	<b>7.1</b>	<b>8.7</b>
Deposits	81,572	86,506	66,458	75,001	94,635	116,655	126,868	136,778	155,000	13.3	22.2
Public sector <sup>2</sup>	7,232	7,204	950	8,381	16,040	31,649	31,511	34,320	40,421	17.8	28.3
Private sector <sup>2</sup>	73,443	78,397	43,270	59,698	74,951	83,000	93,323	100,794	111,799	10.9	19.8
Current account	6,478	6,438	7,158	11,462	15,071	18,219	20,982	23,475	24,344	3.7	16.0
Savings account	13,047	13,008	14,757	10,523	16,809	23,866	26,848	29,077	33,345	14.7	24.2
Time deposit	48,915	53,915	18,012	19,080	33,285	34,944	39,935	42,822	48,359	12.9	21.1
CEDRO	0	0	0	12,328	3,217	1,046	400	17	16	-6.0	-95.9
Other netted liabilities due to financial intermediation	50,361	55,297	36,019	75,737	61,690	64,928	60,279	52,071	47,603	-8.6	-21.0
Call money	3,793	3,545	2,550	1,649	1,317	1,461	1,894	2,164	2,983	37.8	57.5
BCRA lines	315	102	4,470	27,837	27,491	27,726	22,655	17,005	11,434	-32.8	-49.5
Outstanding bonds	5,087	4,954	3,777	9,096	6,675	7,922	6,112	6,548	6,762	3.3	10.6
Foreign lines of credit	10,279	8,813	7,927	25,199	15,196	8,884	6,009	4,684	4,470	-4.6	-25.6
Other	30,886	37,883	17,295	11,955	11,012	18,934	23,608	21,670	21,954	1.3	-7.0
Subordinated debts	2,206	2,255	2,260	3,712	2,028	1,415	1,334	1,381	1,243	-10.0	-6.8
Other liabilities	2,113	2,210	2,524	6,997	6,569	5,685	4,134	5,341	5,573	4.3	34.8
<b>Net worth</b>	<b>16,888</b>	<b>17,283</b>	<b>16,483</b>	<b>26,086</b>	<b>21,950</b>	<b>23,879</b>	<b>25,080</b>	<b>27,161</b>	<b>30,015</b>	<b>10.5</b>	<b>18.6</b>
<b>Memo</b>											
<b>Netted assets</b>	<b>126,432</b>	<b>129,815</b>	<b>110,275</b>	<b>185,356</b>	<b>184,371</b>	<b>202,447</b>	<b>203,952</b>	<b>209,044</b>	<b>225,934</b>	<b>8.1</b>	<b>10.8</b>
<b>Consolidated netted assets</b>	<b>122,270</b>	<b>125,093</b>	<b>106,576</b>	<b>181,253</b>	<b>181,077</b>	<b>198,462</b>	<b>199,718</b>	<b>204,160</b>	<b>220,048</b>	<b>7.8</b>	<b>10.2</b>

(1) Includes margin accounts with the BCRA; (2) Does not include accrual on interest or CER.

Source: BCRA

### Methodological note (chart 1):

**1.-** (Cash compliance according to BCRA + Other cash holdings + Central Bank repos) / Total deposits; **2.-** (Public bonds position (without LEBAC and NOBAC) + Loans to the public sector + Compensation receivable) / Netted assets; **3.-** Loans to the private sector / Netted assets; **4.-** Non-performing loans to the non-financial private sector / Loans to the non-financial private sector; **5.-** (Total non-performing loans - 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 - Amortization of Court ordered payments - Adjustments to the valuation of government securities) / Average monthly netted assets - % 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; **9.-** Capital compliance (Responsabilidad Patrimonial Computable) / Risk - adjusted assets according to the regulation of BCRA about Minimum Capital Compliance; **10.-** (Capital compliance minus requirements, included forbearances) / Capital requirements.



Chart 3: Profitability Structure

In millions of current pesos	Annual							Half year			Half year change %	
	1999	2000	2001	2002 <sup>1</sup>	2003	2004	2005	I-05	II-05	I-06	I-06 / I-05	I-06 / II-05
Financial margin	6,967	7,291	6,943	13,991	1,965	6,075	9,441	3,993	5,449	6,039	51	11
Net interest income	5,396	5,106	4,625	-3,624	-943	1,753	3,063	1,314	1,750	1,926	47	10
CER and CVS adjustments	0	0	0	8,298	2,315	1,944	3,021	1,602	1,419	1,568	-2	10
Foreign exchange price adjustments	227	185	268	5,977	-890	866	751	40	711	579	1,350	-18
Gains on securities	1,112	1,481	1,490	3,639	1,962	1,887	2,373	921	1,452	1,849	101	27
Other financial income	232	519	559	-299	-480	-375	233	116	117	116	0	-1
Service income margin	3,623	3,582	3,604	4,011	3,415	3,904	4,781	2,243	2,538	2,819	26	11
Loan loss provisions	-2,565	-3,056	-3,096	-10,007	-2,089	-1,511	-1,130	-590	-539	-563	-5	4
Operating costs	-7,432	-7,375	-7,362	-9,520	-7,760	-7,998	-9,432	-4,390	-5,041	-5,379	23	7
Tax charges	-497	-528	-571	-691	-473	-584	-737	-327	-410	-479	46	17
Income tax	-421	-446	-262	-509	-305	-275	-530	-248	-282	-402	62	43
Adjustments to the valuation of government securities	0	0	0	0	-701	-320	-366	-165	-201	-272	65	35
Amortization payments for court-ordered releases	0	0	0	0	-1,124	-1,686	-1,867	-971	-896	-819	-16	-9
Other	617	535	702	-3,880	1,738	1,497	1,629	850	779	855	1	10
Monetary results	0	0	0	-12,558	69	0	0	0	0	0	0	0
<b>Total results</b>	<b>291</b>	<b>3</b>	<b>-42</b>	<b>-19,162</b>	<b>-5,265</b>	<b>-898</b>	<b>1,790</b>	<b>394</b>	<b>1,396</b>	<b>1,799</b>	<b>357</b>	<b>29</b>
Adjusted results <sup>3</sup>	-	-	-	-	-3,440	1,337	4,023	1,529	2,493	2,890	89	145
Annualized indicators - As % of netted assets											change in p.p.	
Financial margin	5.6	5.7	5.7	6.5	1.1	3.1	4.6	3.9	5.3	5.6	1.7	0.3
Net interest income	4.3	4.0	3.8	-1.7	-0.5	0.9	1.5	1.3	1.7	1.8	0.5	0.1
CER and CVS adjustments	0.0	0.0	0.0	3.9	1.3	1.0	1.5	1.6	1.4	1.4	-0.1	0.1
Foreign exchange price adjustments	0.2	0.1	0.2	2.8	-0.5	0.4	0.4	0.0	0.7	0.5	0.5	-0.2
Gains on securities	0.9	1.2	1.2	1.7	1.1	1.0	1.2	0.9	1.4	1.7	0.8	0.3
Other financial income	0.2	0.4	0.5	-0.1	-0.3	-0.2	0.1	0.1	0.1	0.1	0.0	0.0
Service income margin	2.9	2.8	3.0	1.9	1.9	2.0	2.3	2.2	2.5	2.6	0.4	0.1
Loan loss provisions	-2.1	-2.4	-2.6	-4.7	-1.1	-0.8	-0.5	-0.6	-0.5	-0.5	0.1	0.0
Operating costs	-5.9	-5.8	-6.1	-4.4	-4.2	-4.1	-4.6	-4.3	-4.9	-5.0	-0.7	-0.1
Tax charges	-0.4	-0.4	-0.5	-0.3	-0.3	-0.3	-0.4	-0.3	-0.4	-0.4	-0.1	0.0
Income tax	-0.3	-0.3	-0.2	-0.2	-0.2	-0.1	-0.3	-0.2	-0.3	-0.4	-0.1	-0.1
Adjustments to the valuation of government securities	0.0	0.0	0.0	0.0	-0.4	-0.2	-0.2	-0.2	-0.2	-0.3	-0.1	-0.1
Amortization payments for court-ordered releases	0.0	0.0	0.0	0.0	-0.6	-0.9	-0.9	-1.0	-0.9	-0.8	0.2	0.1
Other	0.5	0.4	0.6	-1.8	0.9	0.8	0.8	0.8	0.8	0.8	0.0	0.0
Monetary results	0.0	0.0	0.0	-5.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>ROA</b>	<b>0.2</b>	<b>0.0</b>	<b>0.0</b>	<b>-8.9</b>	<b>-2.9</b>	<b>-0.5</b>	<b>0.9</b>	<b>0.4</b>	<b>1.4</b>	<b>1.7</b>	<b>1.3</b>	<b>0.3</b>
ROA adjusted <sup>3</sup>	-	-	-	-	-1.9	0.7	2.0	1.5	2.4	2.7	1.2	0.3
ROE	1.7	0.0	-0.2	-59.2	-22.7	-4.2	7.1	3.2	10.7	12.5	9.3	1.9

(1) Information in currency of december 2002. (2) Com. "A" 3911. Adjustments to the valuation of government unlisted securities according to Com. "A" 4084 are included under the "gains on securities" heading.  
 (3) Excluding amortization of payments for court-ordered releases and the effects of Com. "A" 3911 and 4084.

Source: BCRA

Chart 4: Portfolio Quality

As percentages	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Jun 05	Dec 05	Jun 06
Non-performing loans (overall)	11.5	12.9	13.1	18.1	17.7	10.7	7.9	5.2	4.0
<b>Non-performing loans to the non-financial private sector</b>	<b>14.0</b>	<b>16.0</b>	<b>19.1</b>	<b>38.6</b>	<b>33.5</b>	<b>18.6</b>	<b>13.0</b>	<b>7.6</b>	<b>5.4</b>
Commercial portfolio (*)	12.1	14.9	20.7	44.0	38.0	22.8	16.2	9.3	6.3
Consumption and housing portfolio	16.6	17.3	17.5	31.4	28.0	11.0	7.4	4.8	4.1
Provisions / Total non-performing loans	59.6	61.1	66.4	73.8	79.2	102.9	110.8	125.1	132.5
(Total non-performing - Provisions) / Overall financing	4.7	5.0	4.4	4.7	3.7	-0.3	-0.9	-1.3	-1.3
(Total non-performing - Provisions) / Net worth	24.7	26.2	21.6	17.2	11.9	-1.0	-2.8	-4.2	-4.1

(\*) Include commercial loans treated as consumer loans for classification purposes.

Source: BCRA

Chart 5: International Indicators

	GDP	Liquid assets / Private deposits	Private loans / Total assets	Non-performing loans to the private sector	Provisions / Non-performing loans	ROA	ROE	Real ROE	Capital compliance / APR
2005/2006: latest information available	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Argentina	182	22.1	27.5	5.4	127	1.7	12.5	1.3	16.5
Australia	1,224	0.9	88.2	-	198	1.8	25.5	21.8	10.3
Brazil	816	28.8	50.4	4.4	145	2.3	24.5	18.0	17.4
Chile	117	7.6	80.9	0.9	181	1.4	19.2	15.0	13.2
Spain	1,105	1.2	75.3	-	253	0.9	16.9	12.9	12.2
USA	12,487	2.3	72.8	0.7	160	1.4	13.1	9.8	13.1
Japan	4,483	2.9	60.2	-	49	0.5	12.6	13.2	11.6
Mexico	766	15.6	22.0	1.7	232	2.4	19.0	14.8	16.0
UK	1,468	1.9	44.5	1.0	81	0.8	11.8	9.2	12.8

Source: BCRA; International Financial Statistics (July 2006) and Global Financial Stability Report (September 2006) - International Monetary Fund.

### Methodological note (chart 5):

1.- GDP 2005 – in billion of US\$; 2.- Cash in banks plus deposits in the monetary authority / Private deposits (%); 3.- Loans to the private sector / Total assets (%); 4.- Non-performing loans to the private sector / Total loans to the private sector (%); 5.- Provisions / Non-performing loans (%); 6.- Total results / Netted assets (%); 7.- Total results / Net worth (%); 8.- Total results / Net worth (%) (deflated by CPI); 9.- Capital compliance / Risk - adjusted assets (%).



## STATISTICS ANNEX: PRIVATE BANKS

### Chart 6: Financial Soundness Indicators

As %	1996	1997	1998	1999	2000	2001	2002	2003	2004	Jun 05	2005	Jun 06
1.- Liquidity	23.6	26.9	22.8	24.3	24.1	23.6	24.8	27.6	29.2	24.8	21.1	21.7
2.- Lending to the public sector	15.9	16.9	17.0	20.4	19.9	23.2	49.9	47.7	43.1	33.8	29.4	25.2
3.- Lending to the private sector	59.5	57.4	58.9	55.5	51.0	49.6	22.1	19.8	23.1	26.6	31.7	35.8
4.- Private non-performing loans	11.1	8.5	7.7	8.9	9.8	14.0	37.4	30.4	15.3	10.4	6.3	4.8
5.- Net worth exposure to private sector	21.6	14.3	13.2	11.5	13.4	11.4	18.6	11.2	1.9	0.3	-2.2	-2.1
6.- ROA	0.6	0.7	0.5	0.3	0.1	0.2	-10.7	-2.5	-1.0	0.0	0.5	1.8
7.- Adjusted ROA	-	-	-	-	-	-	-	-1.2	0.2	1.1	1.6	2.8
8.- Efficiency	144	135	139	146	152	151	168	93	115	129	136	156
9.- Capital compliance	15.9	15.4	14.6	18.9	18.0	17.6	-	14.0	15.1	15.9	17.8	18.5
10.- Excess capital compliance	33	47	27	60	49	43	-	88	157	147	155	125

Source: BCRA

### Chart 7: Balance Sheet

In millions of current pesos	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Jun 05	Dec 05	Jun 06	Change (%)	
										Half yearly	Inter annual
<b>Assets</b>	<b>108,778</b>	<b>119,371</b>	<b>82,344</b>	<b>118,906</b>	<b>116,633</b>	<b>128,065</b>	<b>130,819</b>	<b>129,680</b>	<b>136,547</b>	<b>5.3</b>	<b>4.4</b>
Liquid assets <sup>1</sup>	13,228	13,920	10,576	11,044	14,500	15,893	14,987	14,074	17,555	24.7	17.1
Public bonds	6,433	7,583	1,627	19,751	22,260	24,817	27,442	29,966	28,728	-4.1	4.7
Lebac/Nobac	0	0	0	-	-	8,359	13,468	15,227	14,018	-7.9	4.1
Portfolio	0	0	0	-	-	5,611	10,626	12,899	12,998	0.8	22.3
Repo	0	0	0	-	-	2,749	2,842	2,328	1,021	-56.2	-64.1
Private bonds	410	563	451	273	172	333	364	307	734	139.2	102.0
Loans	56,916	56,035	52,319	51,774	47,017	50,741	52,776	56,565	61,028	7.9	15.6
Public sector	6,389	8,172	13,803	25,056	23,571	21,420	18,928	15,954	12,341	-22.6	-34.8
Private sector	47,705	45,103	36,636	26,074	22,816	28,213	32,542	39,031	46,587	19.4	43.2
Financial sector	2,823	2,760	1,880	644	630	1,107	1,306	1,580	2,099	32.9	60.7
Provisions over loans	-3,119	-3,248	-3,957	-7,463	-5,225	-3,717	-3,061	-2,482	-2,241	-9.7	-26.8
Other netted credits due to financial intermediation	27,330	36,600	13,037	27,212	22,148	25,753	24,375	16,873	16,318	-3.3	-33.1
Corporate bonds and subordinated debt	1,022	724	665	1,514	1,394	829	625	675	609	-9.9	-2.7
Unquoted trusts	958	1,609	1,637	6,205	3,571	2,362	2,171	2,444	2,940	20.3	35.4
Compensation receivable	0	0	0	15,971	13,812	14,657	11,257	5,575	4,883	-12.4	-56.6
Other	25,350	34,267	10,735	3,523	3,370	7,905	10,322	8,179	7,887	-3.6	-23.6
Assets under financial leases	796	776	752	553	387	592	827	1,356	1,791	32.1	116.5
Shares and participation	1,371	1,651	1,703	3,123	2,791	1,892	2,030	2,416	2,578	6.7	27.0
Fixed assets and miscellaneous	3,246	3,225	3,150	5,198	4,902	4,678	4,597	4,575	4,535	-0.9	-1.3
Foreign branches	48	75	112	-109	-136	-53	-74	-148	-122	-17.4	65.2
Other assets	2,120	2,190	2,574	7,549	7,816	7,137	6,556	6,178	5,642	-8.7	-13.9
<b>Liabilities</b>	<b>96,474</b>	<b>107,193</b>	<b>70,829</b>	<b>103,079</b>	<b>101,732</b>	<b>113,285</b>	<b>115,155</b>	<b>112,600</b>	<b>118,170</b>	<b>4.9</b>	<b>2.6</b>
Deposits	54,447	57,833	44,863	44,445	52,625	62,685	70,655	75,668	83,487	10.3	18.2
Public sector <sup>2</sup>	1,342	1,276	950	1,636	3,077	6,039	7,122	6,946	6,951	0.1	-2.4
Private sector <sup>2</sup>	52,460	55,917	43,270	38,289	47,097	55,384	62,309	67,859	74,820	10.3	20.1
Current account	5,022	4,960	7,158	8,905	11,588	13,966	15,564	17,946	18,236	1.6	17.2
Savings account	9,702	9,409	14,757	6,309	10,547	14,842	16,921	18,362	20,366	10.9	20.4
Time deposit	35,218	39,030	18,012	11,083	18,710	22,729	26,084	27,736	32,327	16.6	23.9
CEDRO	0	0	0	9,016	2,409	798	328	3	2	-15.2	-99.3
Other netted liabilities due to financial intermediation	39,045	46,271	22,629	49,341	42,367	45,083	40,480	32,349	30,287	-6.4	-25.2
Call money	2,146	2,293	1,514	836	726	1,070	1,386	1,488	2,123	42.7	53.2
BCRA lines	274	83	1,758	16,624	17,030	17,768	13,266	10,088	7,072	-29.9	-46.7
Outstanding bonds	4,990	4,939	3,703	9,073	6,674	7,922	6,112	6,548	6,762	3.3	10.6
Foreign lines of credit	6,680	5,491	4,644	15,434	9,998	5,444	4,016	2,696	2,488	-7.7	-38.0
Other	24,954	33,466	11,010	7,374	7,939	12,878	15,700	11,530	11,842	2.7	-24.6
Subordinated debts	1,683	1,668	1,700	3,622	1,850	1,304	1,235	1,319	1,183	-10.3	-4.2
Other liabilities	1,299	1,420	1,637	5,671	4,890	4,213	2,786	3,264	3,214	-1.6	15.4
<b>Net worth</b>	<b>12,304</b>	<b>12,178</b>	<b>11,515</b>	<b>15,827</b>	<b>14,900</b>	<b>14,780</b>	<b>15,664</b>	<b>17,080</b>	<b>18,377</b>	<b>7.6</b>	<b>17.3</b>
<b>Memo</b>											
<b>Netted assets</b>	<b>85,918</b>	<b>88,501</b>	<b>73,796</b>	<b>117,928</b>	<b>115,091</b>	<b>121,889</b>	<b>122,149</b>	<b>123,271</b>	<b>130,286</b>	<b>5.7</b>	<b>6.7</b>

(1) Includes margin accounts with the BCRA; (2) Does not include accrual on interest or CER.

Source: BCRA

### Methodological note (chart 6):

**1.-** (Cash compliance according to BCRA + Other cash holdings + Central Bank repos) / Total deposits; **2.-** (Public bonds position (without LEBAC and NOBAC) + Loans to the public sector + Compensation receivable) / Netted assets; **3.-** Loans to the private sector / Netted assets; **4.-** Non-performing loans to the non-financial private sector / Loans to the non-financial private sector; **5.-** (Total non-performing loans - 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 - Amortization of Court ordered payments - Adjustments to the valuation of government securities) / Average monthly netted assets - % 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; **9.-** Capital compliance (Responsabilidad Patrimonial Computable) / Risk - adjusted assets according to the regulation of BCRA about Minimum Capital Compliance; **10.-** (Capital compliance minus requirements, included forbearances) / Capital requirements.



Chart 8: Profitability Structure

In millions of current pesos	Annual							Half year			Half year change %	
	1999	2000	2001	2002 <sup>1</sup>	2003	2004	2005	I-05	II-05	I-06	I-06 / I-05	I-06 / II-05
Financial margin	5,176	5,441	5,282	10,628	2,575	3,415	5,253	2,222	3,031	3,545	60	17
Net interest income	3,819	3,598	3,519	-304	107	1,214	2,069	868	1,200	1,330	53	11
CER and CVS adjustments	0	0	0	1,476	1,082	900	1,215	705	511	498	-29	-2
Foreign exchange price adjustments	213	160	256	6,189	-312	666	576	139	436	412	196	-6
Gains on securities	908	1,232	962	3,464	1,892	959	1,259	446	813	1,219	173	50
Other financial income	236	450	546	-197	-195	-322	134	63	70	86	35	21
Service income margin	2,598	2,554	2,598	2,782	2,341	2,774	3,350	1,562	1,789	2,016	29	13
Loan loss provisions	-1,872	-2,173	-2,464	-6,923	-1,461	-1,036	-714	-356	-358	-326	-9	-9
Operating costs	-5,326	-5,263	-5,224	-6,726	-5,310	-5,382	-6,303	-2,933	-3,370	-3,565	22	6
Tax charges	-368	-379	-418	-512	-366	-393	-509	-222	-287	-343	55	19
Income tax	-386	-393	-216	-337	-295	-202	-217	-87	-130	-107	23	-18
Adjustments to the valuation of government securities	0	0	0	0	-665	-51	-201	-82	-118	-102	24	-14
Amortization payments for court-ordered releases	0	0	0	0	-791	-1,147	-1,168	-593	-575	-539	-9	-6
Other	447	307	615	-4,164	1,178	846	1,156	517	639	528	2	-17
Monetary results	0	0	0	-10,531	-20	0	0	0	0	0	0	0
<b>Total results</b>	<b>269</b>	<b>93</b>	<b>174</b>	<b>-15,784</b>	<b>-2,813</b>	<b>-1,176</b>	<b>648</b>	<b>27</b>	<b>621</b>	<b>1,109</b>	<b>4,001</b>	<b>79</b>
Adjusted results <sup>3</sup>	-	-	-	-	-1,357	252	2,016	703	1,313	1,749	149	33
Annualized indicators- As % of netted assets											change in p.p.	
Financial margin	6.1	6.2	6.4	7.6	2.3	2.9	4.3	3.6	5.0	5.6	2.0	0.6
Net interest income	4.5	4.1	4.3	-0.2	0.1	1.0	1.7	1.4	2.0	2.1	0.7	0.1
CER and CVS adjustments	0.0	0.0	0.0	1.1	0.9	0.8	1.0	1.1	0.8	0.8	-0.4	0.0
Foreign exchange price adjustments	0.3	0.2	0.3	4.4	-0.3	0.6	0.5	0.2	0.7	0.7	0.4	-0.1
Gains on securities	1.1	1.4	1.2	2.5	1.7	0.8	1.0	0.7	1.3	1.9	1.2	0.6
Other financial income	0.3	0.5	0.7	-0.1	-0.2	-0.3	0.1	0.1	0.1	0.1	0.0	0.0
Service income margin	3.1	2.9	3.2	2.0	2.0	2.4	2.7	2.5	2.9	3.2	0.6	0.3
Loan loss provisions	-2.2	-2.5	-3.0	-5.0	-1.3	-0.9	-0.6	-0.6	-0.6	-0.5	0.1	0.1
Operating costs	-6.3	-6.0	-6.4	-4.8	-4.6	-4.6	-5.1	-4.8	-5.5	-5.6	-0.9	-0.1
Tax charges	-0.4	-0.4	-0.5	-0.4	-0.3	-0.3	-0.4	-0.4	-0.5	-0.5	-0.2	-0.1
Income tax	-0.5	-0.4	-0.3	-0.2	-0.3	-0.2	-0.2	-0.1	-0.2	-0.2	0.0	0.0
Adjustments to the valuation of government securities	0.0	0.0	0.0	0.0	-0.6	0.0	-0.2	-0.1	-0.2	-0.2	0.0	0.0
Amortization payments for court-ordered releases	0.0	0.0	0.0	0.0	-0.7	-1.0	-1.0	-1.0	-0.9	-0.9	0.1	0.1
Other	0.5	0.4	0.7	-3.0	1.0	0.7	0.9	0.8	1.0	0.8	0.0	-0.2
Monetary results	0.0	0.0	0.0	-7.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>ROA</b>	<b>0.3</b>	<b>0.1</b>	<b>0.2</b>	<b>-11.3</b>	<b>-2.5</b>	<b>-1.0</b>	<b>0.5</b>	<b>0.0</b>	<b>1.0</b>	<b>1.8</b>	<b>1.7</b>	<b>0.7</b>
ROA adjusted <sup>3</sup>	-	-	-	-	-1.2	0.2	1.6	1.1	2.2	2.8	1.6	0.6
ROE	2.3	0.8	1.4	-79.0	-19.1	-8.1	4.1	0.4	7.6	12.3	12.0	4.8

(1) Information in currency of december 2002. (2) Com. "A" 3911. Adjustments to the valuation of government unlisted securities according to Com. "A" 4084 are included under the "gains on securities" heading.

(3) Excluding amortization of payments for court-ordered releases and the effects of Com. "A" 3911 and 4084.

Source: BCRA

Chart 9: Portfolio Quality

As percentages	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Jun 05	Dec 05	Jun 06
Non-performing loans (overall)	7.6	8.3	9.9	19.8	15.7	8.9	6.5	4.4	3.7
<b>Non-performing loans to the non-financial private sector</b>	<b>8.9</b>	<b>9.8</b>	<b>14.0</b>	<b>37.4</b>	<b>30.4</b>	<b>15.3</b>	<b>10.5</b>	<b>6.3</b>	<b>4.8</b>
Commercial portfolio (*)	6.8	8.4	15.4	44.7	39.0	18.2	12.5	7.3	5.3
Consumption and housing portfolio	12.5	11.9	12.4	26.0	17.2	10.0	6.6	4.2	3.8
Provisions / Total non-performing loans	69.4	67.7	75.7	73.4	79.0	95.7	98.8	114.6	116.2
(Total non-performing - Provisions) / Overall financing	2.3	2.7	2.4	5.3	3.3	0.4	0.1	-0.6	-0.6
(Total non-performing - Provisions) / Net worth	11.5	13.4	11.4	18.6	11.2	1.3	0.3	-2.2	-2.1

(\*) Include commercial loans treated as consumer loans for classification purposes.

Source: BCRA



## ABBREVIATIONS AND ACRONYMS

**\$:** Argentine pesos.

**%a.:** annualized porcentaje.

**a.:** annualized.

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

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

**APR:** Annual Percentage Rate.

**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.

**BMB:** Broad Monetary Base. Defined as money in circulation plus current account deposits in pesos by financial institutions in the BCRA plus the stock of quasi-monies.

**BODEN:** *Bonos Optativos del Estado Nacional.* Optional Federal Bonds.

**BOGAR:** *Bonos Garantizados.* Guaranteed Bonds.

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

**BOVESPA:** São Paulo Stock Exchange.

**b.p.:** basis points.

**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.

**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.

**EB:** Executive Branch.

**EMI:** *Estimador Mensual Industrial.* Monthly Industrial Indicator

**EMBI:** Emerging Markets Bond Index.

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

**FS:** Financial Stability.

**FSB:** Financial Stability Bulletin.

**FOMC:** Federal Open Market Committee (USA).

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

**GDP:** Gross Domestic Product.

**HHI:** Herfindahl-Hirschman Index.

**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.

**M0:** Banknotes and coins.

**M1:** M0 plus peso and US dollar current accounts net of FUCO.

**M2:** M1 plus peso and US dollar savings accounts (at 50% of their balance).



**M3:** M2 (with US dollar savings accounts at 100% of their balance) plus peso and US dollar time deposits including CEDRO with CER.

**m.a.:** Moving average.

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

**MAS:** Mutual Assurance Societies.

**MC:** Minimum cash.

**MFs:** Mutual Investment Funds.

**MR:** Market rate.

**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.

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

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

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

**MRO:** *Main refinancing operations*.

**NA:** Netted assets.

**NACHA:** National Automated Clearinghouse Association.

**NDA:** Net Domestic Assets.

**NIR:** Net International Reserves, which are the difference between the BCRA's gross international reserves and liabilities with the IMF.

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

**NPS:** National Payments System.

**NW:** Net worth.

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

**NBFE:** Non-Bank Financial Entities (under Central Bank scope)

**NFPS:** Non-financial national public sector's.

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

**OECD:** Organization for Economic Co-operation and Development.

**ON:** *Obligaciones Negociables*. Corporate bonds.

**OS:** *Obligaciones Subordinadas*. Subordinated debt.

**O/N:** Overnight rate.

**P / BV:** Price over book value.

**p.p.:** Percentage Point.

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

**PFs:** Pension Funds.

**PS:** Price Stability.

**PV:** Par Value.

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

**REM:** BCRA Market expectation survey.

**RIN:** *Reservas Internacionales Netas*. Net International Reserves.

**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.

**SME:** Small and Medium Enterprises.

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

**SSN:** *Superintendencia de Seguros de la Nación*.

**TD:** Time Deposits.

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

**UFC:** Uniform Federal Clearing.

**UIC:** Use of Installed Capacity.

**US\$:** United States dollar.

**USA:** United States of America.

**UTDT:** Universidad Torcuato Di Tella.

**VAR:** Value at Risk.

**VAT:** Value added Tax.

**WPI:** Wholesale Price Index.

**y.o.y.:** year-on-year.





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