Financial Stability Report

December 2020

BANCO CENTRAL
DE LA REPÚBLICA ARGENTINA

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Preface

The purpose of the Central Bank of Argentina (BCRA) "is to promote monetary stability, financial stability, employment and economic development with social equity, to the extent of its powers and within the framework of the policies established by the National Government" (Article 3 of the Charter). In general terms, there are financial stability conditions when the financial system as a whole can provide services for financial intermediation, hedging and payments in an adequate, efficient and ongoing manner, even in adverse operating contexts.

For the financial system to contribute to economic development with social equity, financial stability is a priority –by providing adequate means to save, enhancing the possibilities of production and consumption and allocating resources more efficiently—, and the system must be deep and inclusive.

In its regular transactions, the financial system is exposed to different types of risks that the system needs to manage. The interaction among exogenous risk factors, vulnerability sources and elements of resilience defines a specific level of systemic financial risk. Within the context of such interaction, an eventual materialization of the risk factors will result in some impact on the financial system and on the economy at large.

The policies of the BCRA seek to limit systemic risk, preserve stability and promote higher levels of depth and inclusion in the financial system. Thus, the BCRA implements a micro and macroprudential approach tending to limit such vulnerabilities and to enhance the resilience of the system. This includes the continuous monitoring of the financial system's soundness and the exercise of its powers as regulator, supervisor and liquidity provider of last resort.

In this context, the BCRA publishes its Financial Stability Report (IEF) every six months to inform about its assessment of the stability conditions and explain the policy measures implemented to such effect. The IEF is underpinned by the assessment of the domestic and global macroeconomic conditions made in the Monetary Policy Report (IPOM). The Financial Stability Report provides information and analysis to the different agents of the financial system and is designed to be an instrument to encourage public debate on aspects related to financial stability and, especially, on the Central Bank's actions on such matter.

The next issue of the IEF will be published in June 2021.

Autonomous City of Buenos Aires, December 17, 2020.

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About the use of inclusive language in the Spanish version of this report

The Central Bank of Argentina is committed to encouraging the use of a non-discriminatory language that promotes the acceptance of all gender identities. It should be noted that all those who have contributed to this report acknowledge that language influences on ideas, feelings, ways of thinking, as well as principles and core values.

Therefore, efforts have been made to avoid sexist and binary language.

Executive summary

Since the release of the last issue of the IEF in June, the financial system continued to operate relatively normally and without disruption, despite going through an economic scenario marked by an extraordinary event. The pandemic triggered an unprecedented combination of external and internal shocks to an economy that was previously going through a nearly two-year recession, with high inflation and unsustainable levels of public debt. Faced with this challenging context, the ensemble of financial institutions continued to show an adequate level of resilience.[1] This performance continued thanks to the combination of previously established coverage to address stress situations -high and growing levels of liquidity, provisioning and capital-, the benefits of a regulatory framework and supervision in line with international standards, as well as the specific actions promoted by the BCRA to mitigate a pro-cyclical credit dynamic, protect households and businesses in need and preserve financial stability.

Some positive signals have recently emerged on the financial system's operating framework. On the one hand, various economic sectors began to gradually recover their activity, which is allowing the BCRA to adjust the set of measures taken to face the shock, as well as moving towards the harmonization of policy interest rates. The improvement in activity was partly favored by the monetary, credit boost (with subsidized rates) and fiscal measures taken to prevent the shock from having permanent consequences on the productive sector, and by the gradual easing of health restrictions. On the other hand, progress was made in the normalization of public debt markets. In addition to the measures being taken to rebuild the yield curve in pesos and to enhance the role of capital markets, we should also add the successful restructuring of both international and domestic bonds, and debt swaps to improve the composition and sustainability of public debt. In this context, since the release of the last IEF, financial intermediation activity in domestic currency with the private sector has shown increases, reflected in both the stock of credit and deposits in real terms (with a certain slowdown at the margin). This performance was driven by the actions of the BCRA, intended to promote financing, as well as saving alternatives in domestic currency. In this sense, the BCRA continues to make efforts to develop saving and investment instruments that allow obtaining positive returns regarding inflation and the exchange rate.

Despite the recent dynamism, the system continues to maintain a low depth in the economy (partly the other side of the private sector's low leverage) and a limited transformation of terms. Furthermore, a considerable share of transactions continues to be focused on low complexity products, mostly transactional, while the ensemble of institutions shows a reduced level of direct interconnection. In the current challenging context, these features limit the sources of vulnerability derived from the usual risk exposures of this activity, while highlighting the important potential for future sector development.

1 The concept of resilience is used in the IEF, as the capacity of the system to maintain without disruption the process of intermediation and provision of payment services in the economy, even in the case of possible stress scenarios of different origin.

In this scenario, the financial system is expected to continue to operate with relative normality in the coming months, facing the challenges still caused by the pandemic smoothly and thus maintaining its strength. For the next few months, there are at least three expected exogenous risk factors for the financial system, given the exposures derived from its operations, which need to be monitored. First, the risk of a weaker-than-expected local economic recovery. The eventual materialization of this situation will depend on the development of a range of factors, among which are the evolution of the pandemic, as well as external determinants associated with global economic growth, international trade evolution and the course of commodity prices. Second, the risk of new episodes of volatility in financial markets should not be completely ruled out, although less in a context in which negotiations with the IMF are on track and the temporary mismatch between supply and demand factors in the currency market continues to be normalized. Third, the financial system is exposed to an operational risk factor that grows at the margin (due to structural and contextual issues), from a greater reliance on technological resources, which will continue to be addressed with prudential actions appropriate to the new reality.

Given a possible materialization of the aforementioned risk factors, it should be noted that the system shows limited sources of vulnerability and important coverage elements, which should provide a significant degree of resilience. Thus, an aspect to monitor in the sector would be the loan portfolio quality development. Although within the framework of the financial relief measures promoted by the BCRA the non-performing ratio remained low, it should be noted that the current shock is of unprecedented characteristics and that in the short or medium-term it could have some impact on debtors' payment capacity. This could eventually be reflected in institutions' profitability, thus influencing, at least to some extent, credit dynamics. In this context, the ensemble of institutions has increased their relative levels of provisioning in recent months, which, added to the comfortable and growing levels of solvency, have reduced the balance sheet exposure to credit risk to minimum levels by historical standards.

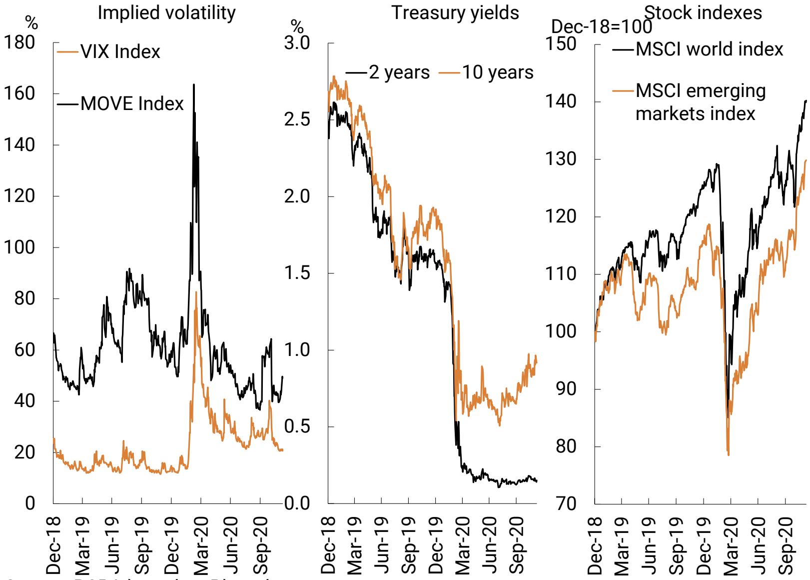
Another potential source of vulnerability for the system given the aforementioned risks is associated with a deterioration in intermediation activity dynamics. The eventual materialization of lower-than-expected economic growth could affect credit supply and demand, as well as the provision of other services, which could have an impact on the sector's sources of net income, with a possible effect on the dynamics of internal capital generation. Once again, it is worth considering that the system's solvency indicators are at high levels, both in terms of recent history and international comparison. The set of BCRA policy actions aimed at sustaining the flow of financing to the private sector should thus be highlighted. Finally, it is worth mentioning that funding in pesos through deposits has grown significantly since the last IEF, thus increasing its share on the system's liabilities. Deposits in foreign currency showed uneven performance throughout the semester, with slight growth until mid-September, before presenting a temporary decrease. If new episodes of volatility materialize in the coming months, the funding of the ensemble of institutions could be affected, both in terms of level and composition, although the aggregate maintains liquidity coverage above the last 10-year average, showing the capacity margin available to cope with these circumstances.

The coordinated actions between the BCRA and the National Government will continue to encourage the economy to recover its normal operation in the coming months, in a still challenging scenario. In parallel, the BCRA will continue to monitor possible deviations from the expected path and, eventually, will be able to implement the necessary measures to maintain financial stability, thus protecting households and businesses and seeking to avoid potential lasting adverse effects, while the foundations are established for a sustainable process of growth and greater inclusion of the Argentine financial system.

1. International and local context

The COVID-19 pandemic continued to create a challenging global context in the second half of 2020. The health situation showed certain improvements, the stricter distancing measures were eased (with differences by region and country) and the expected markets' volatility is more contained compared to the worst of the pandemic[2], although the situation is dynamic and various risk remain. While the worst of the shock at the global level was observed in the first half of the year -heterogeneously across regions and sectors- global economic growth expectations remain weak and with downside risks.[3] Despite this, the rapid and robust stimulus measures implemented by governments, together with the absence of disruptive episodes in international financial markets, led markets, including those from emerging economies, to undergo a recovery trend since May (see Exhibit 1).

Figure 1 | International financial markets - selected variables



Source: BCRA based on Bloomberg

More recently, given the resurgence of COVID-19 in the northern hemisphere and some concerns regarding the continuity and effectiveness of economic policy stimulus, certain signs of greater caution began to be observed in financial markets in September-October. However, there was no evidence of a widespread increase in risk aversion or a search for shelter in assets considered safer as observed in the middle of the first semester (see Figure 1). As early as November, announcements linked to progress in vaccine testing (leading to the approval of different versions of the vaccine in the UK and the US) began to generate optimism, although it remains to be confirmed when doses will be available massively.

2 The VIX index (expected US stocks volatility), generally used as a proxy for uncertainty perceived in the markets, reached a peak above 80% in March, while averaging 26% in July-November and falling to 20-21% in early December (average of 15% in 2019, and historical average around 20%).

3 Compared to the outlook at the time the previous IEF was released, the decline for 2020 would be less pronounced, though a weaker recovery is also expected for 2021. For further details, see IPOM November 2020 issue.

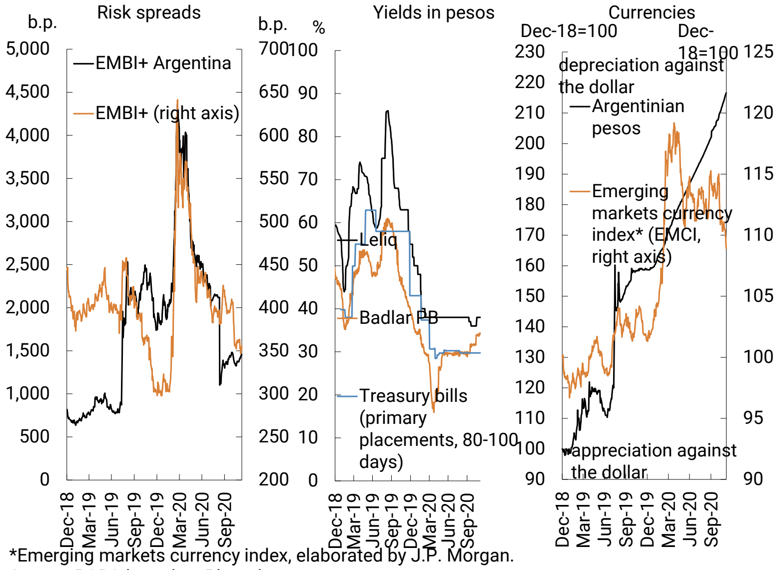
In this scenario, the pandemic implied for Argentina a combination of unprecedented external and internal shocks to an economy that had already been experiencing almost two years of recession, with high inflation and unsustainable public debt. However, as explained in the next sections of this Report, the financial system continued to show an adequate degree of resilience during 2020, a situation that is expected to continue in the coming months. This occurs in a local context that is gradually showing signs of recomposition, which continues to be dynamic. In this sense, given the set of (monetary, financial, fiscal and income) policy measures aimed at preventing these temporary shocks from leaving permanent consequences in the economy, adding the gradual progress in easing health policies, there have been signs of greater dynamism in domestic demand and an incipient economic recovery, gaining strength in the second half of the year (although unevenly among sectors), since the last issue of the IEF. This trend could accelerate if the possibility of massively available vaccines is confirmed in the coming months.

In turn, there has been progress locally in recent months in the normalization of public debt markets. In addition to the measures being taken to rebuild the yield curve in pesos, significant achievements were made in restoring debt sustainability: the successful restructuring of foreign currency bonds under foreign and local law (in August and September), various local instrument swaps and conversion operations (expanding the menu of Treasury financing instruments), the beginning of talks to readjust the financial commitments with the IMF, and the submission of a multi-year fiscal path to Congress. Following this, certain improvement in the prices of different assets was observed in the markets, although not without volatility (see Figure 2).

In mid-September, a number of measures were announced to promote better foreign exchange management and lay down the guidelines for a renegotiation of private external debt in line with the normal operation of the exchange market.[4] In October, the BCRA updated its monetary policy guidelines, including measures to harmonize monetary policy interest rates (initiating a process of increases in different interest rates), develop savings and investment instruments in pesos that allow obtaining positive returns on inflation and the exchange rate, and adjust exchange market regulations to avoid temporary imbalances that may affect the international foreign currency position.[5] More recently, in November and December, the Ministry of Economy carried out two auctions for the conversion of peso-denominated securities into dollar-denominated securities (each for US$750 million), to continue normalizing the debt market in pesos.

4 See Communication "A" 7106.
5 See "Actualización de lineamientos de Política Monetaria" ("Updating of Monetary Policy Guidelines") and "Actualización de los lineamientos: las nuevas medidas" ("Updating of guidelines: new measures").

Figure 2 | Argentine financial markets - selected variables

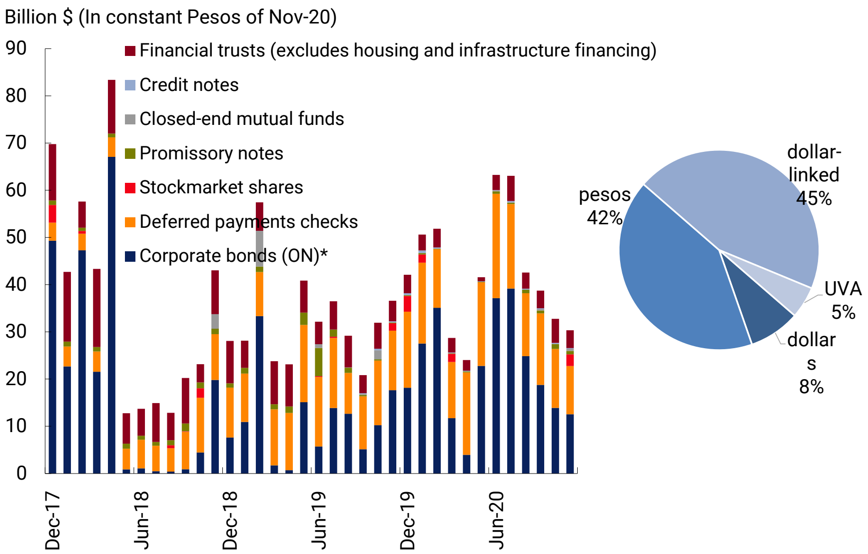


*Emerging markets currency index, elaborated by J.P. Morgan.
Source: BCRA based on Bloomberg

Once the situation of a large part of the debt has been regularized and with the economy in the process of recovery, the fiscal, external and monetary situation is expected to continue the improvement path.[6] In this context, the conditions would be in place to continue promoting the development of the capital market, to achieve growing importance in public and private sector financing. In this sense, while the public sector shows a sustained and growing level of debt refinancing in local markets, private sector financing in the local market has increased by close to 30% in real terms so far this year compared to the same period in 2019 (see Figure 3). This was mainly due to the increase observed in corporate bonds (with a lower weighting of issues in dollars and greater dynamism of dollar-linked and peso-denominated ones -in nominal terms and UVA-) and in deferred-payment checks (where *E-CHEQs* increased their relevance).

6 In recent months, the Treasury reduced the need of BCRA assistance. Additionally, the approval of the 2021 Budget is expected to help achieve greater certainty on the fiscal path in a context still marked by the pandemic.

Figure 3 | Domestic financing in the capital market



*Excludes swap operations and debt restructurings.
Source: BCRA based on BCBA, CNV, MAVSA and INDEC.

2. Main strengths of the financial system given current risks

The financial system as a whole continued to operate with high solvency and liquidity margins since the release of the last IEF. These features helped to sustain seamlessly the financial intermediation process with companies and households, as well as an adequate payment service provision to the economy. In recent months, financial intermediation in pesos grew in real terms (with some deceleration at the margin), which mainly reflected the effect of the measures implemented by the National Government and the BCRA to moderate the economic and financial effects of the pandemic and the health and social isolation policies taken at the beginning of it. The measures that were adopted contributed to providing liquidity to companies and households, avoiding exacerbating a stress situation with a possible impact on financial stability.

The financial system continues to maintain a set of structural characteristics that help to generate a limited exposure to risks from a systemic perspective. These include a still very low depth of bank financing in the economy (both in a historical and global comparison), prevailing low complex traditional financial intermediation transactions, reduced transformation of terms and low direct interconnection among financial institutions. When analyzing the sector' strengths, the existence of a prudential regulatory framework in line with the international standards proposed by the Basel Committee should be weighed. Below are the main features that provide resilience to the financial system (see Table 1). Further details are included in subsequent sections.

i. Adequate liquidity margins at the aggregate level. So far in 2020 the system's liquidity ratios, both for the aggregate and by currency, have continued to be at relatively high levels compared to what has been observed in recent years. By the end of the third quarter, total broad liquidity[7] represented 66% of total deposits, increasing slightly against March (cut-off date of the previous IEF).

The levels observed for the liquidity ratios arising within the framework of the Basel Committee recommendations —Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)[8]— also remained high at the aggregate level, above the minimum required by local regulations and those included in international standards.

Table 1 | Main indicators of financial system soundness

	Financial system			State-owned banks			Domestic private banks			Branches and subsidiaries of foreign banks			Non-bank financial institutions		
	Sep-19	Mar-20	Sep-20	Sep-19	Mar-20	Sep-20	Sep-19	Mar-20	Sep-20	Sep-19	Mar-20	Sep-20	Sep-19	Mar-20	Sep-20
Liquidity															
Liquidity Coverage Ratio	2.1	2.2	2.2	1.7	1.9	2.1	2.3	2.3	2.0	2.2	2.3	2.5	-	-	-
Net Stable Funding Ratio (1)	1.6	1.8	1.9	1.5	1.6	1.7	1.9	1.9	1.9	1.7	2.0	2.0	-	-	-
Broad liquidity / Deposits (%)	57.6	64.6	66.0	46.2	51.6	56.5	68.0	72.6	71.0	63.9	74.6	74.4	70.1	71.1	42.5
In $	57.9	62.0	61.6	47.9	50.0	54.6	67.1	70.3	64.9	66.8	72.5	69.2	44.6	39.9	28.2
In US$	56.9	73.0	84.2	40.7	58.1	65.8	69.9	80.0	98.3	59.7	79.8	90.3	239.2	660.8	254.6
Solvency															
Regulatory capital / RWA (%)	16.3	22.0	23.7	13.6	18.8	19.7	19.8	25.7	27.9	15.8	21.8	24.0	16.6	17.7	18.7
Regulatory capital Tier 1 / RWA (%)	14.1	19.9	21.7	12.7	17.9	18.8	16.0	22.2	24.4	13.9	19.9	22.2	14.9	16.0	16.9
Leverage ratio (%)	9.1	12.0	11.8	7.6	9.8	9.3	10.5	13.9	13.4	9.2	12.3	13.0	20.7	23.0	21.7
Capital conservation buffer (% verification)	90	100	100	73	100	100	99	100	100	99	100	100	88	89	89
Domestic systemically important banks buffers (% verification)	100	100	100	100	100	100	100	100	100	100	100	100	-	-	-
Profitability															
ROE at current values (quarterly %a.)	43.8	-	-	29.7	-	-	63.6	-	-	37.7	-	-	45.6	-	-
ROE in homogeneous currency (quarterly %a.)	-	14.3	13.6	-	7.6	19.8	-	16.7	12.0	-	18.9	10.5	-	1.0	-10.4
ROA at current values (quarterly %a.)	5.0	-	-	2.9	-	-	7.9	-	-	4.6	-	-	6.9	-	-
ROA in homogeneous currency (quarterly %a.)	-	2.2	2.0	-	1.0	2.4	-	2.9	1.9	-	3.0	1.7	-	0.2	-1.9
Private sector credit															
Private sector exposure / Assets (%)	41.9	36.2	33.1	38.2	33.5	30.9	42.1	37.4	32.5	44.2	36.2	34.5	82.2	78.2	80.8
Non-performing loan ratio (%)	4.8	5.3	4.5	5.2	7.7	7.5	4.6	4.2	3.3	4.2	3.6	2.3	8.3	6.8	5.6
Provisions / Non-performing loans (%)	79	82	105	70	66	75	96	89	129	77	118	191	51	54	66
(Non-performing loans - Adjusted provisions) / Net worth (%)	3.6	2.3	-0.5	6.1	7.3	5.3	0.6	1.0	-1.9	3.3	-1.5	-4.5	22.5	15.7	9.0
Public sector credit															
Exposure / Assets (2)	9.7	9.2	10.9	18.7	18.5	18.0	4.1	4.2	9.2	4.6	3.6	4.5	0.8	0.1	0.3
Net exposure / activos (%) (3)	-1.7	-1.8	-2.0	-5.4	-4.9	-7.3	-2.3	-2.1	-1.0	3.5	2.0	3.4	0.8	0.1	0.3
Currency risk															
(Assets - Liabilities + Net undelivered purchases in foreign currency) / Regulatory capital (%)	13.4	10.5	10.2	34.2	26.4	28.0	6.7	4.0	2.7	2.2	4.3	3.5	21.9	8.2	19.0
Deposits in US$ / Total deposits - Private sector (%)	33	25	21	25	20	17	34	25	20	41	30	25	9	5	6
Loans in US$ / Total loans - Private sector (%)	30	21	15	26	20	16	29	20	12	37	24	16	121	118	25

(1) June 2020 last available data securities) + Loans to the public sector
(2) Position in government securities (not including BCRA
(3) Position in government securities (not including BCRA securities) + Loans to the public sector - Deposits from public sector
RWA: Risk weighted assets. Adjusted provisions: net provisions of the minimum provisions established on the portfolio in regular situation (estimated).
Source: BCRA

ii. High solvency levels. The financial system's regulatory capital indicators, both at the aggregate level and by ensemble of financial institutions, have increased since the last release of the IEF. The adjusted stakeholders' equity (ASE) of the system totaled 23.7% of risk-weighted assets (RWA) in September, above other countries in the region. The level of this solvency ratio increased by 1.8 p.p. against the value registered in March and 7.4 p.p. y.o.y. (see Figure 4). Tier 1 capital —with the greatest capacity to face eventual losses— of local institutions at aggregate level accounted for 92% of the adjusted stakeholders' equity. The capital position (ASE net of the minimum regulatory requirement) of the ensemble of financial institutions stood at 179% of the regulatory requirement

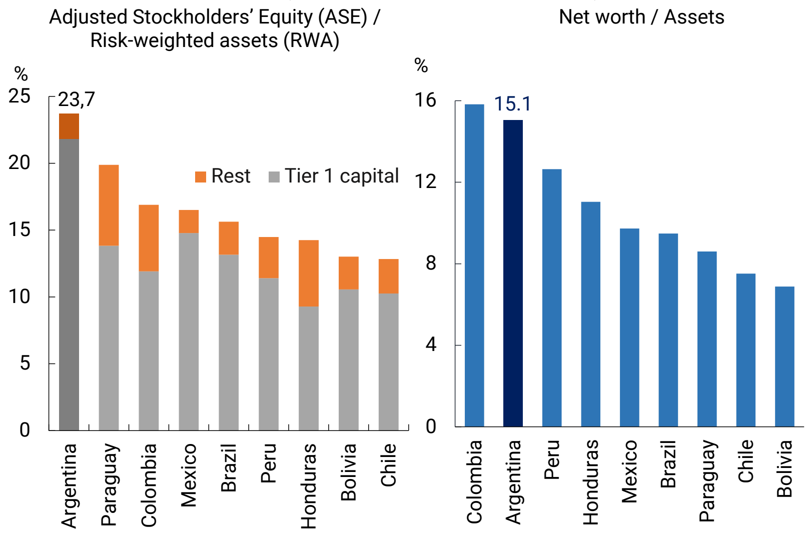
7 Considering the stock of liquid assets, concepts included in the compliance within the minimum cash regime and BCRA instruments, both in domestic and foreign currency items.
8 The Liquidity Coverage Ratio (LCR) assesses the liquidity available to face a potential outflow in a short-term stress scenario. The Net Stable Funding Ratio (NSFR) assesses financial institutions possibility to finance their activities with sufficiently stable sources to mitigate the risk of future stress situations arising from their funding.

in September. Within this framework, it should be noted that almost all the financial institutions continued to comply with 100% of the additional capital buffers.[9]

The system continued to show moderate leverage both by historical and regional standards. In terms of the international standards recommended by the Basel Committee, the leverage ratio — the ratio of the best quality capital to a broad measure of exposures— reached 11.8% in September, far exceeding the regulatory minimum threshold of 3% (in line with the international recommendation).

While the dynamics in terms of domestic capital generation continued in the period, the performance of soundness indicators for the sector also gathered the momentum of the macroprudential policies adopted promptly by this Institution. In particular, the possibility of dividends distribution to institutions was suspended amid the pandemic scenario, in line with the initiatives by other central banks from emerging and developed economies.[10]

Figure 4 | Solvency indicators
International comparison (Latest available information)



Source: BCRA y IFS (IMF)

iii. The financial system continued showing positive results, although to the downside (in uniform currency). In the first nine months of the year, the ensemble of financial institutions accrued total comprehensive income in uniform currency equivalent to 2.5% annualized (a.) of assets (ROA) and 16.9% a. of equity (ROE). However, a decrease in profitability has been observed so far in 2020 and against 2019 (see Section 3.2 and Box. Financial system's y.o.y. profitability performance in uniform currency), deepening as of August 2020.

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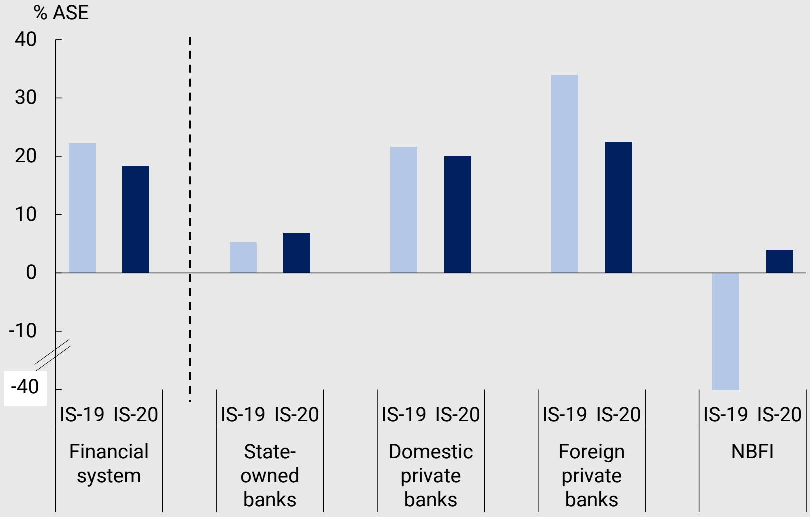
9 Consisting of 2.5% of the ASE for all institutions, with an additional 1% of the ASE for systemically important ones.
10 For further details, see Regulatory annex.

Box. Financial system's y.o.y. profitability performance in uniform currency

To better understand the recent dynamics of the sector in terms of endogenous solvency generation,[11] profitability indicators are built and compared here using data from the quarter/annual information regime.[12] With the available information, the aggregate system's ROE in uniform currency is estimated to have fallen 3.9 p.p., y.o.y. (maintaining a positive level) during the first half of 2020 (see Figure 5).[13] This aggregate performance mainly reflected the behavior of the relatively larger private institutions.[14] Although their relative share in the financial system is small[15], the year-on-year ROE increase of non-banking financial institutions stands out. The ROE distribution by institution shows less dispersion in 2020 compared to the previous year.

Figure 5 | ROE estimate in uniform currency
First semester - By groups of institutions



NBFI: Non-Banking Financial Institutions. Source BCRA.

The elements behind the year-on-year reduction in the aggregate system's ROE especially highlight the lower financial margin[16] and net income from services. These were partially offset by a reduction in non-financial expenses.

11 Since 2020, financial institutions present their financial statements in uniform currency. With this change, the profitability indicators built based on the Balance Sheet Monthly Accounting Information Regime are not directly comparable between 2020 and the previous years. For further details see Communication "A" 6651 and Exhibit 5 of the IEF I-20.
12 It should be noted that upon submitting this information for the current year, institutions had to report a base of comparison for 2019 using the same accounting criteria. Upon the release of the IEF, data was available up to the second quarter of 2020 for 61 of the 75 financial institutions (79% of financial system's total assets).
13 Similar reductions are obtained when comparing 1Q20 and 2Q20 against the same periods of 2019. Although the information from 3Q20 is not yet available from the quarterly financial statements and, therefore, a year-on-year comparison cannot be made for this period, Section 3.2 of this Report includes the profitability based on the monthly accounting information regime and compared with the first two quarters of 2020. Based on this information, the ROE for the third quarter of 2020 is lower than in the two previous periods.
14 Even though all the 10 largest private institutions in terms of assets present a positive real ROE during the first half of 2020, 7 of them recorded a lower ROE compared to the first half of 2019.
15 They represent 3% of the financial system's total loans to the private sector.
16 This concept was influenced by falls in interest income (from loans and securities, such as LELIQ), from trading and buying and selling of securities, which were buffered by lower interest expenses from deposits.

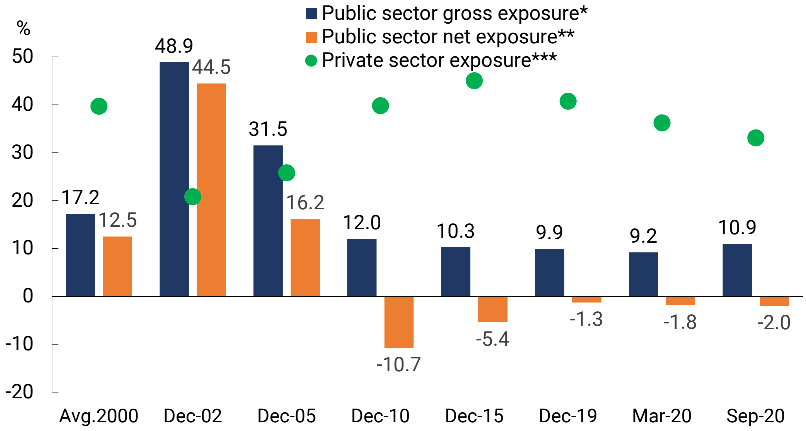
iv. High and growing provisioning ratios. The stock of provisions accounted for by the ensemble of institutions increased throughout 2020, both in absolute values and in terms of total and non-performing credit. The financial system's level of provisions reached 127% of the non-performing portfolio in September. It should be noted that, given the temporary financial relief measures for debtors introduced by the BCRA, the traditional indicators used to measure the degree of exposure and coverage against credit risk (for example, the estimated ratio for the not provisioned non-performing portfolio in terms of regulatory capital) may not be fully comparable with those verified in the pre-COVID-19 period. However, to illustrate the relatively moderate exposure and high current coverage against credit risk, it should be considered that the ratio between regulatory capital and private sector credit (net of total provisions) at the aggregate level is currently at the maximum level of the last 15 years (see Figure 10).

v. Low weighting of items in foreign currency and reduced currency mismatch in the financial system's balance sheet. In a scenario of reduced financial intermediation in foreign currency throughout 2020, and given the current regulatory framework, the share of assets and liabilities in this currency in the system's balance sheet continued to decline. Assets in foreign currency represented 19.1% of total assets in September (down 3.6 p.p. against March), while liabilities in this currency reached 17.9% of total funding (-3.5 p.p.). The difference between assets and liabilities in foreign currency (including net off-balance-sheet forward purchases) in the sector remains low, around 10% of the ASE.

vi. Limited exposure to maturity mismatches risk. Financial institutions operations continue to be focused on transactional activities, showing limited maturity mismatch. For further details see Section 3.3.

vii. Low to moderate system's exposure to the public sector. Loans to the public sector totaled 10.9% of total assets at the end of the third quarter of the year, a value still low from a historical perspective and when compared with other emerging and developed economies (see Figure 6). When considering public sector's total deposits, the financial system maintains a negative net exposure (debt position) concerning said sector.

Figure 6 | Exposure to public and private sector



*(Position in government securities (not including Central Bank securities) + Loans to the public sector) / Total assets. **(Position in government securities (not including Central Bank securities) + Loans to the public sector - Deposits from public sector) / Total assets.*** Total financing to private sector / Total assets
Source: BCRA

viii. Credit assistance programs were implemented to promote better financial conditions for companies and households. The BCRA together with the National Government implemented measures that provided liquidity to the non-financial private sector (see Exhibit 2), avoiding exacerbating a situation of tension that would translate into widespread solvency problems, eventually affecting financial stability conditions and the real economy. It should be noted that the normalization of the activity that is starting to be observed will allow to continue reducing and focusing the efforts of credit assistance towards the most affected sectors, adapting to the needs at any given time.

Based on the aforementioned strengths, the system is expected to show resilience to short- and medium-term challenges. Among the system's main exogenous risks that could eventually be faced, the following stand out:

i. Risk of weaker-than-expected economic recovery. During the pandemic, the evolution of the local economy has been showing a pattern of strong initial deterioration followed by a rebound from the third quarter, although with a certain slowdown over time. The dynamics of economic activity will therefore depend on several factors, including the evolution of the pandemic (rate of progressive opening of activities, access to vaccines, the impact of the context on private consumption) and the effectiveness of the implemented measures (for example, those aimed at protecting households' income and supporting businesses, which would be increasingly targeted).

More limited evolution of the economy could respond to external factors (worsening of the second wave of infections in the Northern Hemisphere and stricter lockdown measures), with an impact on global growth expectations, international trade and commodity prices (directly impacting the level of local activity through the commercial channel). There could be greater volatility in external markets, due to changes in risk aversion (for example, due to widespread global sovereign and/or corporate defaults), with an impact on portfolio flows to emerging markets and on the prices of different assets (with an effect on the exchange rate and interest rates through the financial channel, which currently has less weight due to capital controls in Argentina). Economic growth could also be conditioned by changes in some local matters, such as the evolution of the epidemiological situation, progress in easing health isolation measures, or an increase in the remaining uncertainty. A relatively more deteriorated economy would have a direct impact on financial intermediation (mainly on the supply and demand of loans, with an effect on institutions' sources of income) and on the payment capacity of financial system's debtors (although the implemented relief measures would outweigh part of these effects).

ii. Risk of new episodes of volatility in local financial markets. Added to the period of greatest volatility in March-April (beginning of the COVID-19 pandemic) was the stress in debt markets (in the context of the renegotiation process that concluded in August and September) and, more recently, temporary imbalances in the supply and demand of foreign currency with an impact on the exchange market (with a downward trend in the spread between the implicit exchange rate in the purchase and sale of securities and the official exchange rate). The eventual reemergence of some volatility in the markets cannot be ruled out. This could depend on external factors, taking into account that several vulnerability components are still present globally, aggravated by the spread of the pandemic[17], or local elements. Greater volatility in interest rates and the exchange rate would affect both the context in which financial intermediation takes place (including the evolution and composition of bank funding) and the credit risk faced by the system.

iii. Operational risks linked to greater dependence on technological resources, for example, greater use of digital channels and teleworking. Although no high-impact disruptive events have been observed so far, the dynamics imposed by the pandemic implies a greater exposure to operational risks, such as those associated with scams or fraud linked to social engineering (phishing or ransomware), the possibility of suffering other types of information security attacks, or problems in the provision of intermediation and payment services, as a result of the need for new users to employ remote services. In this sense, providing services in this modality implied a great effort for the private and public sectors, who, among other challenges, addressed the strengthening of the dissemination of preventive aspects related to information security.[18]

As mentioned in the previous IEF, there is a need to face a set of challenges in the short term related to the post-pandemic at a global level. On the one hand, there is the situation of certain pre-existing vulnerabilities (for example, debt sustainability). On the other hand, global stimulus measures should gradually unwind, a process that, if not carried out in an orderly and coordinated manner, could have, to a certain extent, negative implications for financial markets (including those from emerging economies). Additionally, there is the incidence of more permanent changes in the

17 Including non-bank financial intermediation growth (with a greater weight of agents with procyclical behavior, with a direct impact on portfolio flows globally), the widespread leverage increase, and the possibility of further aversion to risk generating liquidity tensions, with rapid assets revaluation (given that there is certain disconnection between the price recovery in recent months and the weakness of economic expectations) and proliferation of credit events globally.
18 In particular, the BCRA organized several awareness campaigns for users, several banks followed suit and hopefully further campaigns will help to be more alert and improve public awareness on the risks of this type of tools.

business models of the financial sector in particular (including the impact of modifications in sector regulations and the non-banking financial sector's agenda -see Exhibit 3-) and the corporate sector in general (permanent impact on productive capacity).

The next section analyzes the sources of vulnerability identified for the Argentine financial system, given its exposure to the aforementioned risk factors. The strengths of the financial system to deal with these risks, should they materialize, are listed in each case. Finally, a series of issues related to financial stability, relevant to the current situation, are developed in greater detail.

3. Sources of vulnerability and specific resilience factors of the financial system

3.1 Private sector credit quality performance

The economic downturn accumulated over two years, deepened by the COVID-19 shock and the health measures implemented to protect the population, have had a heterogeneous impact on the income of the different economic sectors and regions of the country.[19] This could trigger significant tension on the payment capacity of the Argentine financial system's debtors, becoming one of the sources of vulnerability on the sector' solvency given its credit exposures.

This aspect became more relevant within the financial system's map of vulnerabilities compared to the previous IEF, although with a moderate weighting due to the relief measures promoted by the BCRA together with the National Government since late March.[20] These temporary measures, aimed at mitigating the adverse financial effects of the shock on households and businesses, have been broadly in line with the actions implemented in other emerging and developed economies (see Exhibit 4).

The possible materialization of the risk factors detailed in Section 2, especially in terms of the evolution of economic activity or episodes of volatility in the financial markets, could further disrupt debtors' payment capacity, implying certain deterioration in the quality of assets, profitability and the solvency of the overall system.

Under the effect of the aforementioned measures, and in a scenario in which the stock of loans to the private sector in real terms stopped falling as a result of the measures to stimulate credit at subsidized rates promoted by the BCRA, the non-performing ratio of loans to the private sector was 4.5% in September (down 0.8 p.p against the previous issue of the IEF) (see Figure 7). In this context,

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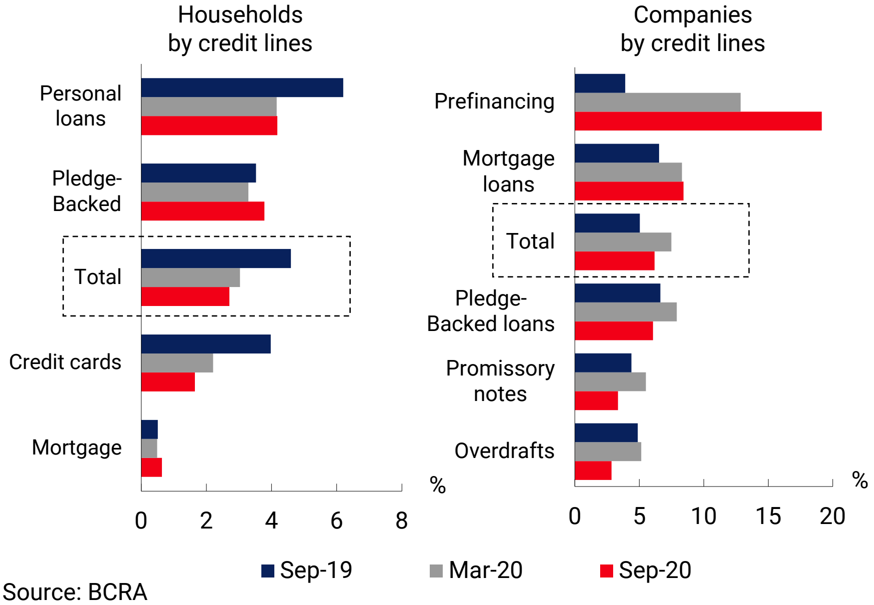
19 For further details, see the IPOM November 2020 issue.
20 For a comprehensive analysis of the relief measures taken, see Regulatory annex of the 1H20 IEF and this issue of the IEF, as well as the 2020 Report on Banks issues. Overall, since the end of the first quarter of the year, a modification has been in force that makes the parameters to classify financial system debtors more flexible, as well as financial relief measures for borrowers through an automatic unpaid installments deferral mechanism, accruing only a compensatory interest rate. Specific measures were added to this for April and September in the case of unpaid balances of credit card obligations, as well as the freezing of pledge-backed and UVA mortgage loan installments, promoted by the National Executive Branch (PEN).

the delinquency ratio of loans to companies totaled 6.2% at the end of the third quarter of the year,[21] and that of loans to households 2.7%. While the non-performing ratio of loans to companies fell 1.3 p.p. compared to March 2020 (see Figure 8), mainly driven by the performance of promissory notes and cash advances, that corresponding to households remained basically unchanged (with certain heterogeneous behavior when analyzing by credit lines).

Figure 7 | Non-Performing loans to the private sector
Non-performing loans / Total loans (%) – Financial system



Source: BCRA

The ratios including information on debtors' classification should be interpreted taking into account the impact of the regulatory actions implemented to mitigate the consequences of the shock. These effects could gradually begin to unwind during 2021, as the BCRA assesses the suitability of advancing in the staged readjustment of the regulatory measures taken to ease the effects of the pandemic scenario.

Given the aforementioned constraints on the information of traditional indicators, it is also relevant to monitor the evolution of banks' loan loss provisions to define their reaction in the current context and to regulatory changes. This type of variable is a proxy to the expected credit risk losses, an indicator that is even more sensitive in Group A institutions.[22]

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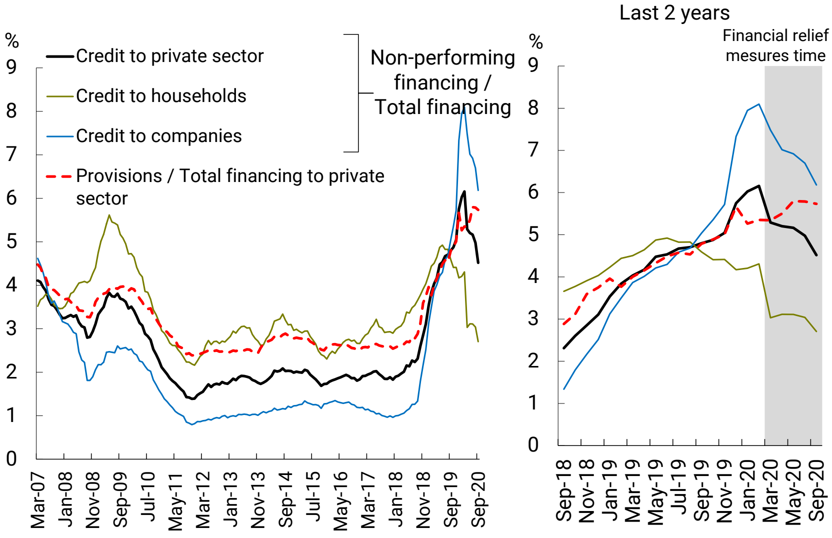
21 Considering the non-performing ratio of the different credit assistance lines, there has been greater heterogeneity since September 2020 in the segment of loans to companies, compared to that of loans to households. In particular, the non-performing loan ratio for pre-financing exports was the highest due to a combination of factors. On the one hand, the non-performing stock increased since the end of 2019 (especially in the second half of that year) driven by a limited number of companies and, on the other hand, the total stock of loans through this line was significantly reduced.
22 It should be noted that as of 2020, with the implementation of the International Financial Reporting Standards (IFRS), Group A financial institutions must make a provision for expected credit loss. Based on the regulations, the remaining institutions must do so from 2021 through a prorating mechanism in up to five years (see Regulatory annex).

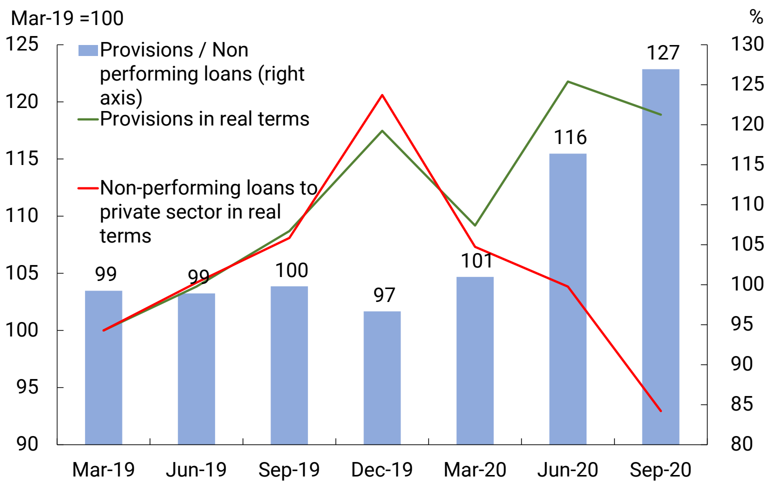
Figure 8 | Loans to the private sector, situation and provisioning
Financial system



Source: BCRA

In this sense, before the first quarter of 2020, a positive correlation was observed between the provisioning stock and the non-performing stock in the overall financial system, which changed thereafter. Thus, in the last six months, the total provisioning stock in real terms grew at an annualized rate of 18.5%, while the non-performing stock fell at an annualized rate of 25% in the same period (see Figure 9).[23] Based on this performance, the accounting provisioning stock in September represented 127% of the financial system's non-performing loans to the private sector, 26 p.p. more than six months ago. With this evolution, the ratio between the stock of provisions and total loans to the private sector continued to show a growing trend (see Figure 8), even within the context of regulatory changes.

Figure 9 | Provisioning and non-performance
Financial System



Source: BCRA

23 The stock of provisions grew at a faster rate than that observed for the total stock of loans to the private sector (considering domestic and foreign currency), which was 2.4% annualized in real terms in the period.

If the risk factors detailed above are confirmed, especially those referring to the evolution of economic activity and possible episodes of financial stress, this potential source of vulnerability for the ensemble of institutions would remain in the coming quarters. However, the financial system has elements of resilience that would help mitigate its possible effects.

3.1.1 Specific elements of resilience

Moderate gross exposure of the financial system to the private sector. The stock of total loans to the private sector -in domestic and foreign currency- represented only 33.1% of the financial system's assets in September, decreasing concerning the previous IEF and year-on-year, mainly due to the performance of the foreign currency segment.

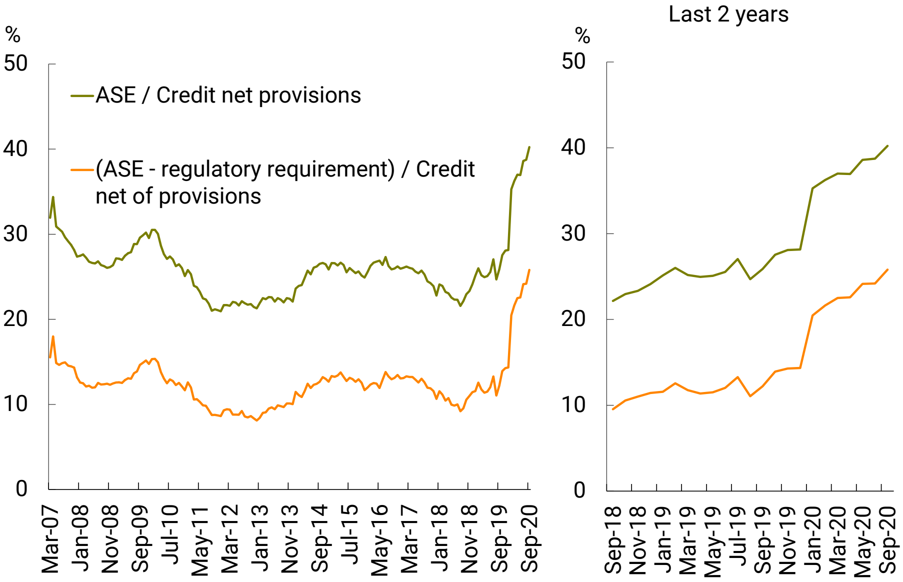
Limited concentration of debtor portfolio. From moderate levels, and within the framework of current prudential regulations, the level of debtors concentration has been falling in recent months. For example, in September the 100 most important debtors (in terms of stock) from the private sector in the financial system accounted for 17% of the total stock of loans to the sector, down 4 p.p. against last year.

Institutions have not shown a significant bias to loosening credit standards in recent years. In particular, the results of the 3Q2020 Credit Conditions Survey -ECC- show a slight tightening bias of the credit standards associated with loans to companies. Regarding loans to households in the same period, the ensemble of institutions showed a bias towards a certain easing of credit standards for credit card and other consumer loans, while there were no significant changes for pledge-backed loans and mortgages were moderately restricted.

High degree of resistance against credit risk materialization. The eventual impact on assets for the ensemble of institutions would remain relatively low amidst non-repayment by debtors with non-performing loans. This is inferred by estimating that the stock of regulatory provisions attributable to the private sector non-performing portfolio (following the criteria of the minimum loan loss provisions standards) exceeded those loans as of September 2020 (the ratio between both concepts was 105% in the third quarter, increasing against the last IEF). However, as aforementioned, the non-performing ratio is affected by the relief measures implemented (which will be readjusted in the coming months while closely monitoring their potential impact on the situation of households and businesses).

An alternative way of providing a first-order approximation to the resistance position of the financial system at the aggregate level given a possible credit risk materialization is to show the regulatory capital (or the regulatory capital position) equivalent in terms of the total credit net of provisions. This indicator, without the above-mentioned limitations, could be read as a simple stress exercise (sensitivity analysis) that shows hypothetically and to an extreme (unlikely) how much the quality of the system's loan portfolio should deteriorate to observe a significant impact on its capital level. This proportion is estimated to have reached the highest level in recent years in September 2020

Figure 10 | Regulatory capital (ASE) and capital position (ASE - Requirement), in terms of the stock of loans to the private sector net of provisions
Financial System



Source: BCRA

(see Figure 10), reflecting low gross exposure to the private sector, high provisioning and greater capital levels.

Although increasing so far in 2020, private sector debt levels remain limited. The broad stock of loans by June 2020 was equivalent to 8.8% and 15.6% of GDP for households and non-financial private sector businesses, respectively (see Figure 11).[24] This implies a 1.2 p.p. rise against late 2019 in terms of GDP for households and 4.3 p.p. for businesses[25], although low, in aggregate terms, compared to other emerging countries.

24 Stock as of June as a percentage of GDP for the second quarter (seasonally-adjusted).
25 It should be considered that part of this effect is explained by the deterioration in GDP performance during 2020, which is expected to start recovering in the coming quarters.

Figure 11 | Broad financing to households and businesses

Source: BCRA based on INDEC, CNV, MAE, ANSES and INAES

The increase in 2020 for both households and businesses is partly explained by the policies implemented by the BCRA in the current pandemic context. Indeed, in the case of households, the main dynamics in the year were observed in the credit segment of financial institutions (followed, with much less weighting, by loans from the Sustainability Guarantee Fund -FGS- and those from mutual associations and cooperatives), while nominal amounts fell for the rest of the sources monitored (credit card systems, financial trusts, other credit providing institutions that present information to the BCRA[26]). In the case of the corporate sector, most of the growth is observed in loans granted by financial institutions (due to the policies implemented) and foreign financing.[27] The latter case (foreign loans and bonds), although increasing, is partly influenced by the evolution of the exchange rate. Local capital market financing (local corporate bonds and deferred checks) also grew strongly[28], in a context in which greater capital markets growth is being promoted, accompanying the normalization of public debt markets (although the weighting of local market instruments over total financing is still limited).

26 The BCRA recently strengthened the regulation for other non-financial credit providers (OPNFC), extending the regulatory boundary to credit Fintech companies and companies financing the sale of household appliances, among others, in terms of users' protection. Since December 2020, OPNFC are obliged to register in the "Other non-financial credit providers register", even when no financing was granted by financial institutions, and are subject to the Financial Institutions Law (regarding the protection of financial services users) for the financing granted. With that scope, and under a gradual implementation scheme, regulations on the protection of financial services users, provisions on expressing and advertising interest rates and sending information by electronic means are applied. In addition, BCRA's transparency and claims information regimes should be complied with on a monthly basis, beginning in March 2021.
27 Including loans and corporate bonds issued in international markets. Corporate bonds issued abroad (total stock, excluding the financial sector) amounted to almost US$16 billion in September. This stock of corporate bonds issued abroad is explained almost entirely by debt in dollars, implying payments for more than US$1.3 billion (9% of the stock of international corporate bonds estimated by September). About 80% of this stock in dollars (international corporate bonds) belongs to the 10 companies with the largest debt in dollar-denominated bonds. Almost half of the non-financial private sector's bonds in dollars is accounted for by the oil and gas sector, followed by 30% by the electric power sector and 6% by the telecommunications sector. It should be noted that in mid-September the BCRA set out the guidelines for private financial debt refinancing, so these figures could change along this process.
28 As mentioned in Section 1, the growth in corporate bonds issuance in the local market in 2020 was led by dollar-linked transactions (replacing issuance in dollars, which registered a sharp drop in their weighting), followed by transactions in pesos (UVA operations showed dynamism, but mostly concentrated in the financial sector). The SME segment also showed significant dynamism, led by deferred-payment checks (accounting for more than a third of the financing to the private sector -including the financial sector- through the local capital market).

Financial system's financing to publicly-traded companies in a relatively more vulnerable situation continues to explain a marginal percentage of the sector's total financing. The corporate sector (with a focus on the group of publicly-traded companies) continues to show signs of deterioration (see Box. Financial situation of publicly-traded companies), with weakening liquidity and profitability indicators in year-on-year terms and increasing leverage. However, this sample of companies has a low share over the total stock of loans.

Box. Financial situation of publicly-traded companies

Based on the balance sheets presented quarterly by publicly-traded companies to the National Securities Commission (CNV), a number of indicators are monitored to have a first approximation to the financial situation of the Argentine corporate sector, considering its link with the financial system and the local capital market. It should be noted that the publicly-traded companies considered constitute a segment of relatively large/medium size firms within the entire non-financial corporate sector with activity at the local level.[29]

With the latest available information (balance sheets in uniform currency up to 2Q20 of 131 firms), the main indicators of (non-financial) publicly-traded companies, in terms of the median, show a weakening in the first half of 2020 against the same period of 2019, extending the deterioration observed since 2018 (in a downturn context). In the first half of 2020, the worst of the pandemic, the year-on-year decline in profitability and interest coverage is noteworthy, while liquidity shows a more limited drop (see Table 2).[30] Leverage was slightly tilted to the upside, although short-term debt shows an increasing weight in the first half of 2020.[31]

In this framework, there were 16 publicly-traded companies with a relatively vulnerable position (identified using a simple methodology based on the main financial indicators[32]) in 2Q2020 (12% of the total, 4 companies more than a year ago). These companies' debt represents almost 17% of the total financing (banks and markets) of publicly-traded companies (against almost 6% in 2Q2019). However, at the aggregate level, the weight of these relatively more vulnerable companies waters down. As to the financial system, the weight of loans to these most vulnerable publicly-traded companies over total loans to companies is limited, although increasing (representing 3.5%

29 Companies from the financial sector and those under the simplified regime for SMEs are not included. Considering the total assets of the segment of publicly-traded companies, 48% of the total is explained by primary production activities (including oil and gas), 36% by services, 13% by industry, 2% by construction and 1% by commerce.
30 For further information on reading and interpreting corporate sector indicators, see "Financial situation of the corporate sector" in the IEF for the first half of 2017, "Publicly-traded companies and currency mismatch" in the IEF for the first half of 2018 and "Financial situation of publicly-traded companies" in IEF of the first half of 2019.
31 In this context of certain deterioration in the main indicators, some companies have conducted voluntary corporate bonds restructuring during the year to improve the payment profile (especially among large companies with corporate bonds in dollars). As part of the guidelines set forth by Communication "A" 7106 regarding financial debt in foreign currency, additional corporate bonds restructurings are expected. On the other hand, in some specific cases (many of them SMEs) there were problems of default or delinquency, although a not very significant share of the stock of outstanding corporate bonds.
32 Companies showing vulnerability in at least two of the three most relevant financial ratios (interest coverage, leverage and liquidity). For further details on the methodology see IEF for the first half of 2019.

of total financial system's loans to companies in 2Q2020, against 1.4% in the 2Q2019). In turn, the stock of corporate bonds of the relatively more vulnerable companies represents 9% of the total stock of corporate bonds in June 2020 (6% a year ago). In the case of these companies, 84% of their debt in bonds was denominated in dollars in June. Even so, the weight of their maturities on the total maturities of corporate bonds in dollars of the corporate sector in 2021 is limited (less than 6% over almost US$1.8 billion).[33]

Table 2 | Summary of indicators on non-financial corporate sector's financial situation based on the analysis of publicly-traded companies' financial statements

	Quarter (median)							Semester**		
Main indicators	**IV-18**	**I-19**	**II-19**	**III-19**	**IV-19**	**I-20**	**II-20**	**IS-19**	**IIS-19**	**IS-20**
Profitability (ROE) (%)	14.0	5.8	6.6	0.4	14.4	(1.0)	3.3	6.2	7.4	1.1
Interest coverage: EBIT/interests paid (times)	2.58	2.16	1.56	1.79	1.61	0.95	1.07	1.86	1.70	1.01
Leverage: Liabilities/assets (%)	60.0	57.0	58.0	57.0	57.8	57.1	57.9	57.5	57.4	57.5
Current liquidity: Current assets/ current liabilities (%)	118.0	122.0	116.0	113.0	116.9	113.3	109.7	119.0	115.0	111.5
Acid test: (current assets - inventory)/ current liabilities (%)	94.0	91.0	79.0	76.0	83.0	82.7	82.8	85.0	79.5	82.8
Short term debt / total debt (%)	53.0	52.0	51.0	50.0	59.9	54.4	57.5	51.5	55.0	56.0
Currency mismatch - companies that have debt in dollars: (foreign currency liabilities less foreign currency assets)/total assets* (%)	26.9	23.7	26.3	28.7	28.1	23.4	25.7	25.0	28.4	24.5

(*) ME: Foreign currency. Foreign currency liabilities less foreign currency assets expressed in pesos using the prevailing exchange rate at each time, divided by total assets (in pesos). (**) Median simple average of 2 quarters
Source: BCRA based on CNV

Households continue to present moderate levels of debt service burden that the relief measures implemented by the BCRA together with the National Executive Branch sought in part to temper.

Low currency mismatch of the financial system and its debtors (macroprudential regulations). The difference between foreign currency assets and liabilities -including net off-balance sheet forward purchases- was equivalent to 10.2% of the ASE for the financial system in September 2020, down 0.4 p.p. and 3.3 p.p. against March 2020 and September 2019, respectively.

As to financial system's debtors, in line with the low burden of debt in the corporate sector at the aggregate level, the stock of corporate bonds issued by these firms in foreign currency represents a low value (and mainly explained by few cases, namely the energy sector). Despite its low relevance, the corporate sector with debt in corporate bonds continues to be monitored.

3.2 Moderate growth of financial intermediation

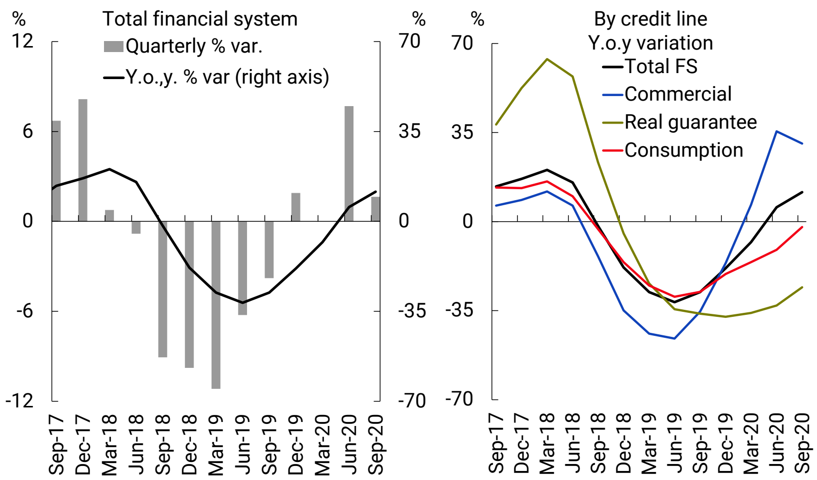
During the months since the release of the last IEF, financial institutions' intermediation with the private sector showed outstanding dynamism in national currency, with increases in both the stock of loans and deposits (mainly time deposits) in real terms. This performance, to a large extent, has reflected the actions of the BCRA through different measures implemented to provide liquidity to

33 These estimates are prepared with information available in September. As aforementioned, within the framework of BCRA Communication "A" 7106, they may vary depending on the restructuring companies are conducting.

the private sector given the shock, as well as to promote saving alternatives in domestic currency in the financial system. Furthermore, financial intermediation in foreign currency continued to decline in recent months, a trend that strengthened in part in mid-September, and has then stabilized since November. However, the rates of declines of deposits in this denomination were tempered with respect to those observed in the second half of 2019.

The stock of loans in pesos in real terms channeled to the private sector accumulated a 9.5% rise between the end of the first and third quarters of the year (+11.6% y.o.y., see Figure 12). Commercial lines (mainly promissory notes) had a greater relative increase in real terms in the last six months, followed by credit card financing. On the other hand, loans in foreign currency were down 32.4% against March in currency of origin (-54.3% y.o.y.).

Figure 12 | Stock of loans in pesos to the private sector in real terms*

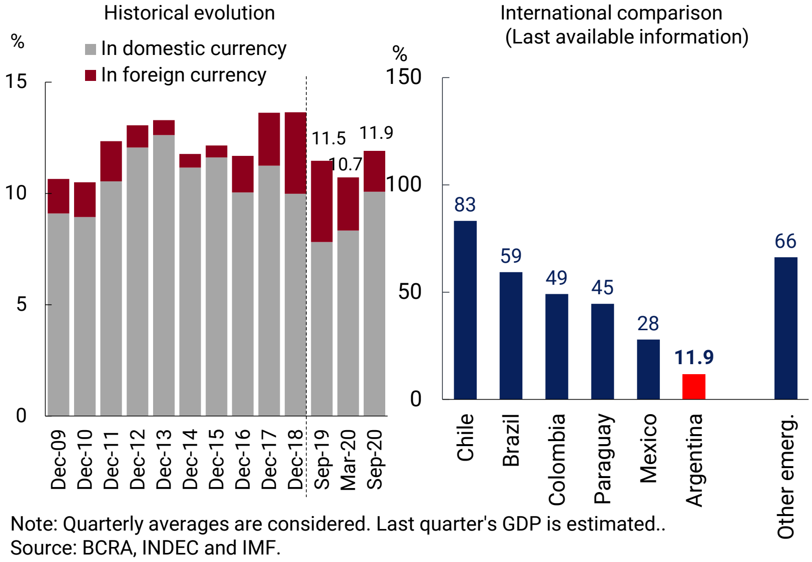


*Not seasonally adjusted. Note: Commercial includes overdraft, promissory notes and leasing. Real guarantee: mortgages and pledge-backed. Consumption: Personal and credit cards. Source: BCRA

As a result of this credit dynamics, amidst a decline in economic activity, total loans (in domestic and foreign currency) to the private sector in terms of gross domestic product increased 1.2 p.p. compared to March (+1.7 p.p. in pesos), representing 11.9% in September (10.1% in pesos) (see Figure 13). These records continue to be significantly low against historic values and those observed in other economies in the region, indicating the wide growth margin the sector has in the coming years.[34]

34 This would lead to greater use of the benefits in terms of efficiency, generally linked to a larger business scale.

Figure 13 | Stock of loans to the private sector in terms of GDP

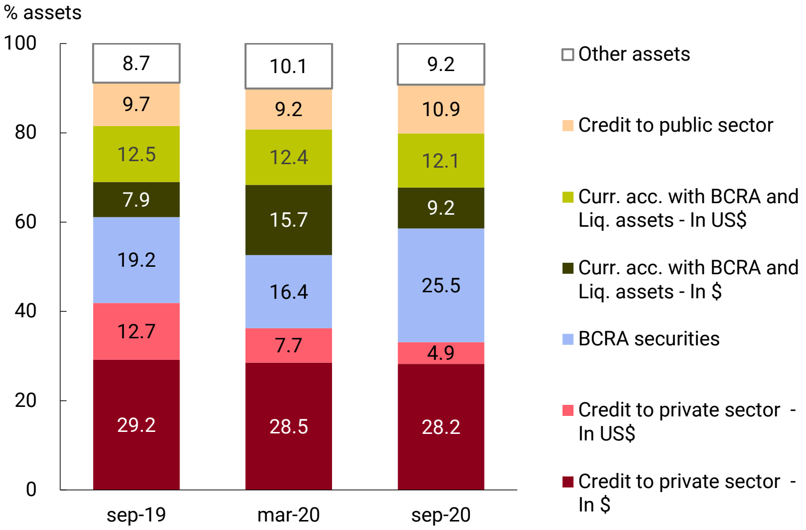


Note: Quarterly averages are considered. Last quarter's GDP is estimated..
Source: BCRA, INDEC and IMF.

The total assets of the financial system increased by 10.7% in real terms between March and September (15.3% y.o.y., in real terms), with changes in its composition. In a context of monetary expansion to face the pandemic scenario, BCRA holdings (LELIQ and repo) augmented in the last few months in the institutions' aggregate balance sheet, representing 25.5% of assets in September (see Figure 14). Total loans to the private sector lost some share in assets between March and September, mainly due to the segment's performance in foreign currency. Starting from low values, financing to the public sector slightly increased its share in assets, weighing 10.9% in September.

Going forward, if the economic activity evolved more moderately than expected (see Section 1) —amidst gradual readjustment and targeting of official stimulus measures—, the intermediation activity of the ensemble of financial institutions could be relatively affected (reflecting on credit supply and demand, and the provision of other services) with a possible impact on the sector's net inflows. Likewise, less credit to the private sector, or with tighter financial conditions, could lead to some tension on the payment capacity of debtors, which could affect to some extent the financial system's capital.

Figure 14 | Financial System's asset composition
% share in the total



Source: BCRA

The development of above vulnerability next year will largely depend on the evolution of the aforementioned risk factors, the materialization of which will be conditioned by the health situation (potential effects of a new wave of infections, progress in mass vaccination, effect on the pace of activity opening, etc.) and the effectiveness of the implemented measures (which would be increasingly targeted), among other elements.

3.2.1 Specific elements of resilience

The system's profitability remains at positive levels in uniform currency, albeit declining. In the third quarter, the ensemble of financial institutions presented total comprehensive income in uniform currency equivalent to 2% annualized (a.) of assets (ROA) or 13.6% a. of equity (ROE). These indicators were lower than those observed in the first two quarters of the year (see Table 3).

Institutions' financial margin was 10.4% a. of assets in the third quarter of 2020, down against the first and second quarters of the year. This performance was mainly explained by higher expenses for interest on deposits at the margin, partly due to the effect of the different measures promoted by the BCRA to stimulate savings in local currency. Besides, there was a reduction in income from interests in the financial system at the aggregate level. These variations were tempered by higher income from securities and repo premium. On the other hand, service income showed a certain downward trend in recent quarters and higher inflation adjustments, partly offset by the gradual reduction in administrative expenses.[35]

35 For further details on the monthly evolution of the financial system's profitability, see the 2020 issues of the Report on Banks.

Compared to 2019, there was also a decrease in overall profitability in uniform currency of the ensemble of financial institutions (for further details, see Box. Financial system's y.o.y. profitability performance in uniform currency).

Table 3 | Financial system's profitability - In uniform currency

Y.o.y - % of net assets	IQ-20	IIQ-20	IIIQ-20	2020*
Financial margin	**12.2**	**11.3**	**10.4**	**11.3**
Interest income	10.3	8.2	7.7	8.7
CER and CVS adjustments	1.8	1.2	1.0	1.3
Foreign exchange price adjustments	0.7	0.7	0.9	0.8
Gains on securities	9.3	7.3	8.5	8.3
Returns on repo	0.9	1.0	1.4	1.1
Interest expense	-10.3	-7.0	-8.7	-8.6
Other financial income	-0.4	-0.2	-0.4	-0.3
Service income margin	**2.0**	**1.9**	**1.8**	**1.9**
Loan loss provisions	**-1.6**	**-2.1**	**-1.1**	**-1.6**
Operating costs	**-7.0**	**-6.5**	**-6.4**	**-6.6**
Net Monetary Position	**-0.2**	**-0.1**	**0.3**	**0.0**
Tax charges	**-2.0**	**-1.8**	**-1.8**	**-1.9**
Results	**3.5**	**2.7**	**3.2**	**3.1**
Other Comprehensive Income (OCI)	**-1.4**	**0.7**	**-1.2**	**-0.6**
Return on assets (ROA)	**2.2**	**3.3**	**2.0**	**2.5**
Return on equity (ROE)	**14.3**	**23.2**	**13.6**	**16.9**

*MEMO (estimates) ** - In% a. of netted assets:*	IQ-20	IIQ-20	IIIQ-20	2020*
i. Total monetary position, including the effect of the inflation adjustment on the securities in OCI (e)	**-2.9**	**-2.0**	**-2.9**	**-2.6**
i. Total monetary position, including the effect of the inflation adjustment on the securities in OCI (e)	**10.7**	**9.9**	**10.2**	**10.3**
iii. OCI without gains on securities or the effect of the adjustment for inflation in this portfolio (e)	**-0.1**	**0.1**	**0.1**	**0.0**

* Accumulated 9 months.** In these estimates the effect of income tax on the portfolio of securities in ORI is adjusted.
Source: BCRA

Risk-oriented supervision of institutions. Under the pandemic scenario, the Superintendency of Financial and Exchange Institutions (SEFyC) continues, within the framework of its functions, monitoring the performance of institutions to anticipate and address eventual vulnerability situations, aiming to sustain adequate levels of liquidity and solvency in the ensemble of institutions. In this regard, it should be noted that the institutions identified as being of domestic systemic importance, show adequate indicators of financial soundness (see Section 4).

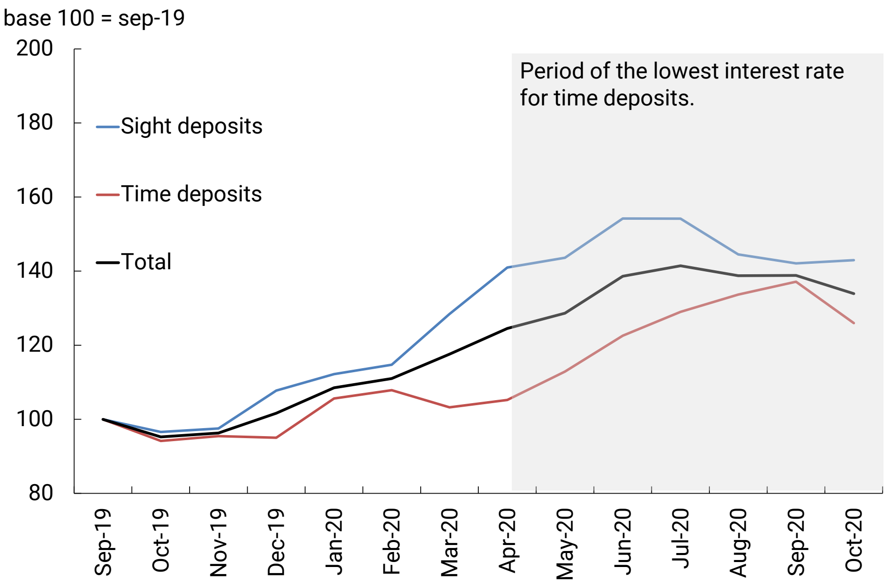
Credit assistance focused on MSMEs. Since March, the BCRA has been implementing a set of credit assistance programs for small and medium-sized enterprises. In mid-October, the BCRA approved a new financing scheme to continue improving access conditions for those companies affected by the consequences of the pandemic, including MSMEs wishing to expand their production processes (see Exhibit 2). The normalization of the activity that has already begun (although with certain heterogeneity at the sectoral level) will help to reduce and target credit assistance efforts, depending on the needs of this stage.

Progress in terms of regulatory proportionality. In September, the classification of financial institutions was modified based on the size of their assets. Namely, the BCRA established that Group "B" consists of those financial institutions with assets below 1% and greater than or equal to 0.25% of the total assets of the financial system, and a new Group "C" was created consisting of institutions with assets below 0.25% of total financial system assets.[36] The BCRA thus continues to adjust local prudential regulation, taking into account the intrinsic characteristics of the Argentine financial system.

3.3 Institutions funding and liquidity performance

In recent months, certain changes have been observed in the composition of the financial system's total funding, in a context in which private sector deposits continue to be its main component. On the one hand, private sector deposits in pesos showed a significant 18.1% increase in real terms between March and September (see Figure 15), moderating this performance to a certain extent at the margin. Within this segment, time deposits went up 32.8% in real terms and sight deposits grew 10.7% in real terms in the six months to September, a behavior that reflects the effect of the measures timely implemented by the BCRA and the National Government jointly, to promote savings in domestic currency and face the onset of the pandemic. In this sense, minimum interest rates were established for domestic currency time deposits since mid-April (with successive modifications in their scope and level) and the collection of certain social assistance programs, such as the Emergency Household Income (IFE) and extraordinary subsidies to the most vulnerable groups of the population were established through sight accounts.[37]

Figure 15 | Private sector deposits in domestic currency
Financial system - Evolution in uniform currency



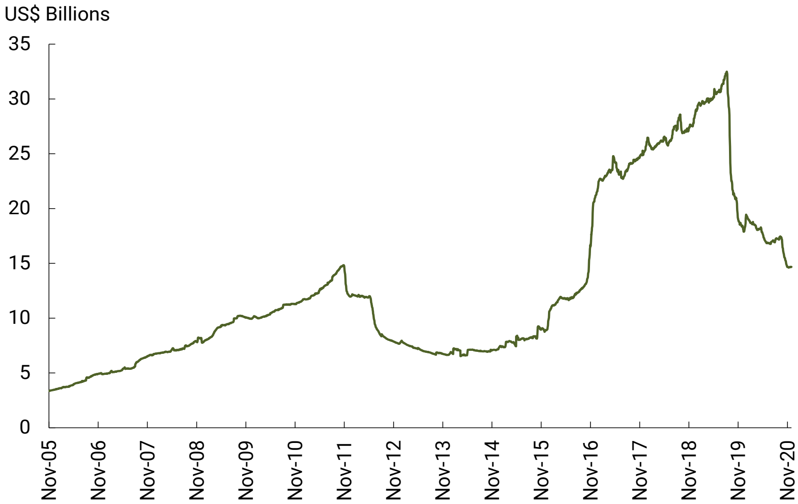
Source: BCRA

36 Communication "A" 7108.
37 For further details, see different issues of the Report on Banks, as well as the Regulatory annex of this IEF and IEF 1H20.

In October, time deposits in pesos showed certain deceleration, mainly due to investment decisions by medium and large market participants (for example, channeling resources to different tenders carried out by the Ministry of Economy in recent months).

On the other hand, after growing gradually since the release of the last IEF the stock of private sector deposits in foreign currency until mid-September showed a further decline, before stabilizing in November (see Figure 16). This performance reflected certain materialization of the risk factors raised in the last IEF. However, in this scenario, the current prudential regulatory framework (minimum liquidity requirements by currency, limits on mismatch, among others), added to the sector' specific elements of resilience, acted as expected, avoiding adverse effects on financial system agents.

Figure 16 | Private sector deposits in foreign currency
Financial system - In currency of origin

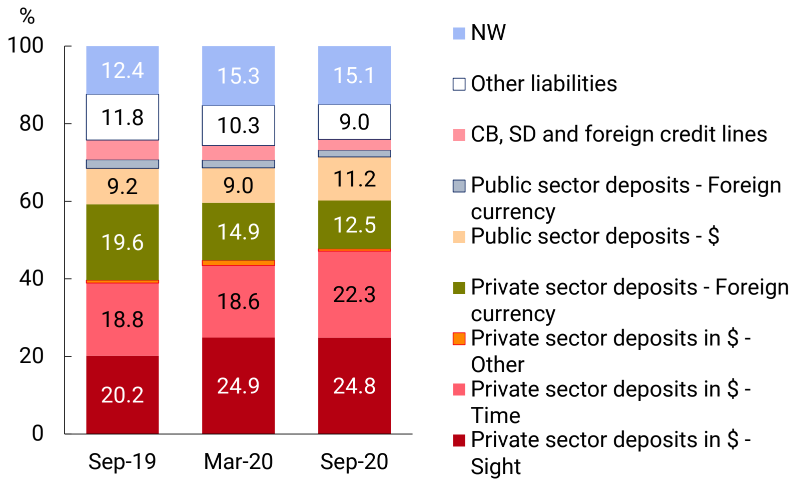


Source: BCRA

As a result of the aforementioned performance, the private sector stock of deposits in pesos reached about 47.7% of the system's total funding -liabilities and net worth- in September, increasing its weight by 3 p.p. compared to March (see Figure 17) mainly due to term deposits. Therefore, the weighting of term deposits showed a significant increase of almost 5 p.p. between March and September, reaching almost 47% of total private sector deposits in pesos.

Total deposits in pesos reached 58.9% of total funding when including public sector deposits in the same denomination, which also increased their weighting in the period (+5.2 p.p. against last March). In turn, dollar deposits reduced their weight in total funding, especially due to private sector deposits. Of the remaining 27% of funding, 15 p.p. is made up of the institutions' capital and the rest corresponds to other liabilities, such as corporate bonds, subordinated debt, foreign credit lines, among others.

Figure 17 | Composition of the Financial System's funding
Financial System



Source: BCRA

On the other hand, the expansion of the stock of deposits so far this year occurred in tandem with a greater share of deposits by the institutions' main clients over their total deposits, which is partly explained by deposits from large institutional investors (as is the case of mutual funds -FCI-).[38]

Should a scenario of greater financial volatility materialize in the coming months (see Section 1), further changes in the funding of institutions could not be ruled out, both in terms of level and composition.

3.3.1 Specific elements of resilience and mitigating measures

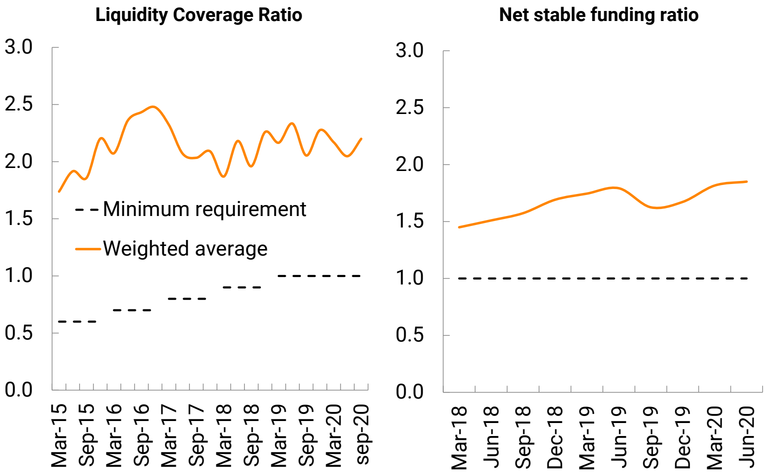
Adequate levels of liquidity. The financial system continued developing its activity, maintaining liquidity levels above the average of the last 10 years. As to the last IEF, the coverage of deposits with liquid assets remained stable in the segment in pesos (around 62%) and grew in foreign currency (+11.4 p.p. to 84.3%).[39]

It should be noted that the ensemble of financial institutions comfortably meets the regulatory liquidity requirements derived from the international standards recommended by the Basel Committee (see Figure 18). In September, the value observed for the so-called Liquidity Coverage Ratio (LCR) was around 2.2 for the group of banks with the largest relative size (obliged to comply with this requirement), similar to the record observed upon releasing the previous IEF, and well

38 With data until June 2020 (latest available information), for the group of 18 institutions in group A (i.e., those with a larger relative size and explaining about 89% of the financial system's total assets), the median of the ratio built according to the stock of deposits of the 160 main clients of each institution in terms of their total deposits reached 44%, up 12.6 p.p. against late 2019.
39 In a context of decreasing deposits and financing to the private sector in said currency.

above the minimum regulatory threshold at the local level (set at 1 since 2019). In turn, the Net Stable Funding Ratio (NSFR) totaled 1.9 in the middle of the year (latest available information) for the same group of institutions mentioned above. This value was 0.2 times higher than that registered by late 2019 and also comfortably exceeded the minimum requirement.

Figure 18 | Basel liquidity ratios
Group A of financial institutions



*Obligated financial entities are group A (Comunication "A" 6835) and they share is 88,7% of total assets at Sep-20. Source: BCRA

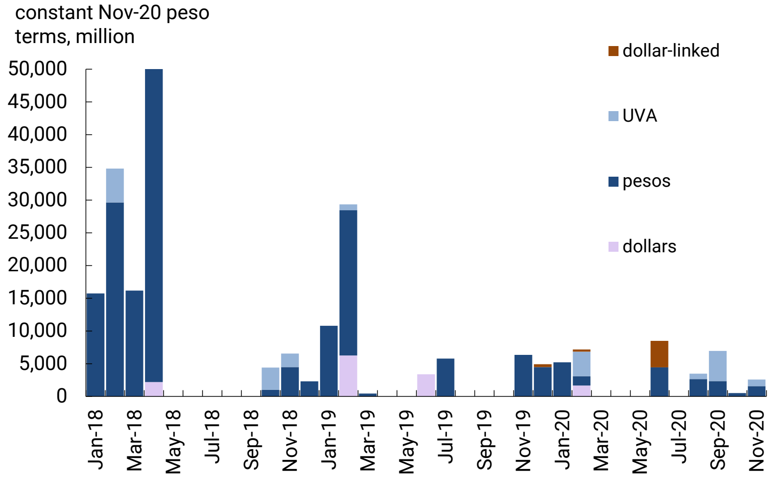
Low transformation of terms. The financial system is characterized by having a high weight of transactional activities in its normal operations. Given the greater relevance of BCRA instruments and short/medium-term financing lines in institutions' assets, the average maturity of the assets portfolio in domestic currency went down in the last six months. The estimated maturity of liabilities increased slightly compared to last March, in line with the aforementioned better relative performance of time deposits in domestic currency. From low levels, the difference between the maturity of assets and that of liabilities decreased slightly compared to the last IEF.

The financial system's funding through the capital market remains limited. Funding through corporate bonds in the capital market continued to be a small share of the institutions' total funding (approximately 2% of liabilities plus net worth). Although greater funding diversification allows the system better risk management, in more challenging situations, refinancing through markets may imply a vulnerability. Thus, in 2021 these corporate bonds imply maturities that represent only a quarter of the total outstanding stock of corporate bonds in the system's portfolio, the majority being in pesos.[40] In perspective, the dynamics of corporate bond issuance by institutions has decreased since 2018. After the release of the last IEF, the amount placed between May and October fell 18% in real terms compared to the previous 6 months.[41] Most of the transactions in recent months were in pesos, followed by UVA and dollar-linked ones (see Figure 19). Issuance in

40 In the second half of 2021, there are maturities in dollars for a total of US$100 million corresponding to two institutions.
41 A year-on-year decrease is also observed considering operations throughout 2020 until October.

pesos went from an average term of 7 months to 17 months (longer terms were also observed in UVA and dollar-linked issuance).[42]

Figure 19 | Financial system corporate bonds issuance



Source: BCRA based on CNV and BCBA.
Note: includes local and international placements. Excludes swap operations and debt restructurings.

4. Other matters of financial system stability

4.1 Domestic systemically important banks (DSIBS)

From a systemic risk perspective and in line with international recommendations on the matter, since 2014 the BCRA has used and published a methodology to identify those domestic systemically important financial institutions.[43] Given the relevance of these institutions in the sector, a hypothetical scenario of tension in any of them (regardless of the causes) could spread and impact a considerable part of the Argentine financial system. In other words, it could eventually manifest itself systemically and have a significant impact on the real sector of the economy. That is why this type of institution is subject at the local level, in line with international recommendations on the matter, to special regulatory treatment (they have to verify a greater margin of capital conservation compared to the other institutions[44]), as well as closer supervision.

It should be noted that, at the local level, this group of institutions continues to represent approximately half of the financial system's assets. As when the previous IEF was released, all domestic systemically important institutions observed by the end of the third quarter the entire capital conservation margin. Its liquidity and solvency ratios presented a growing evolution in the

42 Additionally, an exchange operation in the international market in dollars was carried out in October. Some institutions also conducted corporate bond repurchase operations, although not large.
43 The criteria used to establish the systemic importance of an institution was based on its size, degree of interconnection, business substitutability and complexity. For further details on the methodology used, see here.
44 For further detail, see Section 4.1. of the Amended Text of the rules on "Results distribution".

last two quarters, in line with that observed in the system, while its profitability indicators were slightly higher than those registered at the aggregate level, although with a downward trend compared to 2019 (see Table 4). The indicators relating to private sector credit risk exposure and currency mismatch evolved in the same direction as those registered for the ensemble of institutions (slight decrease compared to what was observed upon the release of the previous IEF).

Table 4 | Main soundness indicators for DSIBS

	Sep-19	Mar-20	Sep-20
Liquidity			
Broad liquidity (%)	55.0	55.7	56.7
In $	55.1	51.8	51.2
In US$	54.7	67.6	78.9
Solvency			
Regulatory capital / RWA (%)	16.1	21.6	23.3
Profitability			
ROE at current values (quarterly %a.)	43.4	-	-
ROE in homogeneous currency (quarterly %a.)	-	12.8	16.6
Private sector credit			
Exposure / Assets	42.0	37.0	35.4
Non-performing loan ratio (%)	3.9	5.0	4.3
(Non-performing loans - Adjusted provisions) / Net worth (%)	2.6	2.7	-0.1
Public sector credit			
Exposure / Assets	14.2	13.9	15.5
Foreign currency position			
(Assets - Liabilities + Net undelivered purchases in foreign currenc	23.3	17.4	15.1

(1) Position in government securities (not including BCRA securities) + Loans to the public sector
RWA: Risk-Weighted Asset.
Adjusted provisions: net provisions of the minimum provisions established on the portfolio in regular situation (estimated).
Source: BCRA

4.2 Interconnection in the financial system

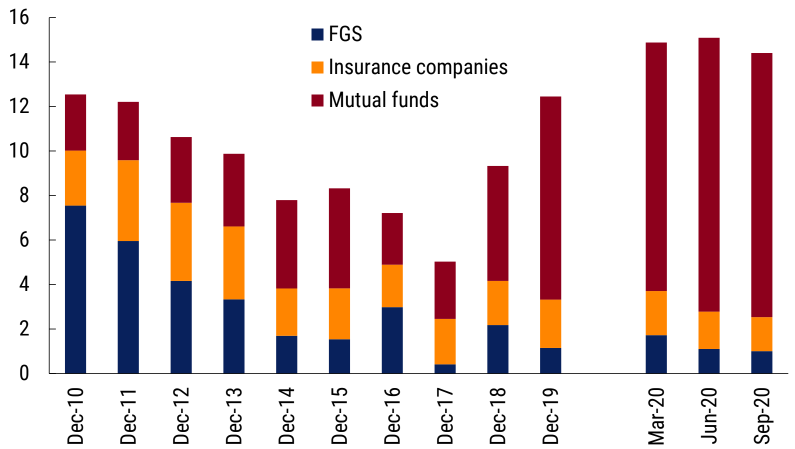
The interconnection between the financial system and the institutional investor base (Sustainability Guarantee Fund -FGS-, mutual funds -FCI- and insurance companies) maintained the upward trend that began in 2018, although it continues to be relatively low against the levels observed in other economies. The most important institutional investor continues to be the FGS (its investment portfolio is equivalent to 12% of GDP), followed by FCIs (with managed assets equivalent to 7% of GDP) and insurance companies (with a portfolio representing 4% of GDP).[45] [46] The FCIs are the main source of direct interconnection with the financial system through funding (their time deposits and liquid assets represent 12% of total deposits in the financial system), while the main indirect source is the holding of public securities (due to the risk that overlapping portfolios

45 See Exhibit 1 "Institutional investors in Argentina" in the IEF 1H16, for a detail on the historical composition .
46 Data until June 2020 are used for the FGS, September 2020 for the FCIs and investments and liquid assets until March 2020 for insurance companies (latest available data for each sector).

eventually imply to the same types of assets). Considering the three main categories of institutional investors, the weighting on total deposits of the financial system is around 14%[47] (12% at the end of 2019). As in the previous period, the increase in direct interconnection was driven by the performance of money market funds (see Figure 20).[48]

Figure 20 | Direct interconnection between institutional investors and the financial system

% of total deposits

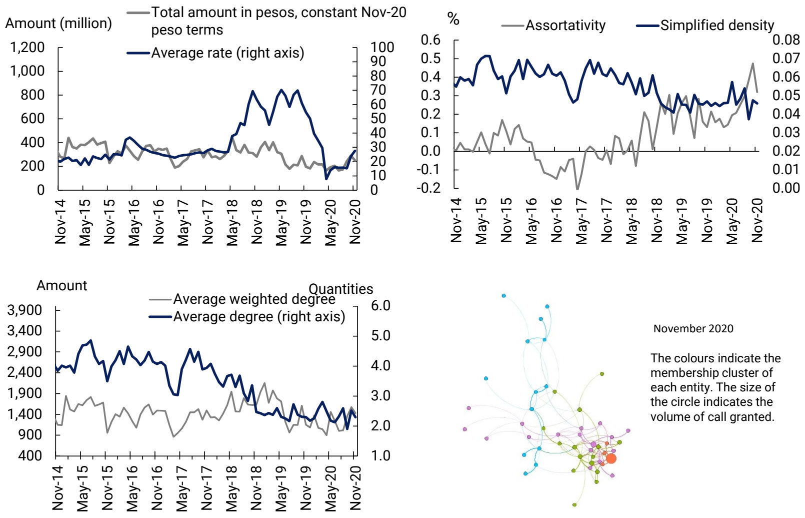


Note: last available data of 2020: March for insurance companies, June for FGS and September for mutual funds. Last data is repeated if necessary. Source: BCRA based on FGS, SSN and CAFCI.

Concerning other sources of direct interconnection and in terms of intra-financial system analysis, the market for unsecured inter-financial loans is monitored using the network analysis methodology.[49] In a context of growing traded amounts in real terms (together with higher nominal interest rates) in recent months, interconnection through the call market went up following the historical minimum values of April, although the size of this market continues to be relatively small in Argentina (an increase in the network's weighted average degree and density was observed).[50] In turn, institutions have started to connect with others with different characteristics than their own (lower assortativity) (see Figure 21). In a long-term comparison, a lower level of relative interconnection is observed, with an average degree and density below the 5-year average.

47 Calculated based on the latest available information in each case, see previous footnote.
48 The increase in money market funds together with fixed income funds explained the growth of FCIs in recent months: up 1.7 p.p. of GDP since the end of April. The net worth of money market FCIs grew 20% in nominal terms since the end of April, mainly due to new subscriptions and portfolio performance to a lesser extent.
49 The unsecured inter-financial loans (call) market in the Argentine financial system is relatively small (the average daily amount traded is less than 1% compared to the stock of private sector deposits). Nevertheless, it is one of the main sources of direct interconnection among financial institutions, through which they manage their liquidity, while these transactions offer price signals (rates) from unsecured transactions.
50 See Exhibit 3 from the IEF 2H18 for the definition of average degree, density and the main terminology used in network analysis and IEF 1H19 for the definition of assortatativity.

Figure 21 | Network metrics and graph for the call market



5. Main macroprudential policy measures

Since the release of the last IEF in June, the BCRA has maintained its prudential policy scheme focused on tempering the economic and financial impact of the shock, promoting liquidity provision to households and the productive sector, as well as tools that allow financial relief to the aforementioned sectors. These measures, which were in line with what was observed in other developed and emerging economies in the context of the pandemic, continue seeking to avoid a scenario of lasting damage to the Argentine economy, which could have a correlation in the levels of activity and employment, with the consequent impact on local financial stability conditions.

In this sense, the measures continued to aim at:

i. Promoting financing to the private sector under favorable financial conditions, thus reducing credit pro-cyclical dynamics commonly observed in other tightening periods. This was done by strengthening flexible credit lines to businesses and self-employed and members of the simplified tax regime -*monotributistas*- (see Exhibit 2), initiatives implemented together with the National Executive Branch. Besides, household consumption continued to be promoted by strengthening existing benefits under the "*Ahora 12*" Plan (12 interest-free installments);

ii. Sustaining financial relief measures for households and businesses, extending until the end of the year the modifications in the classification criteria of debtors, as well as easing the payment conditions of current loan installments (including credit cards), among other elements;

iii. Promoting bank savings through time deposits in pesos, by adjusting, in successive opportunities, the minimum interest rates that protect private sector depositors against price variations in the economy, launching early-payment UVA time deposits at market rates, as well as implementing saving alternatives through variable-return time deposits for certain sectors of the economy;

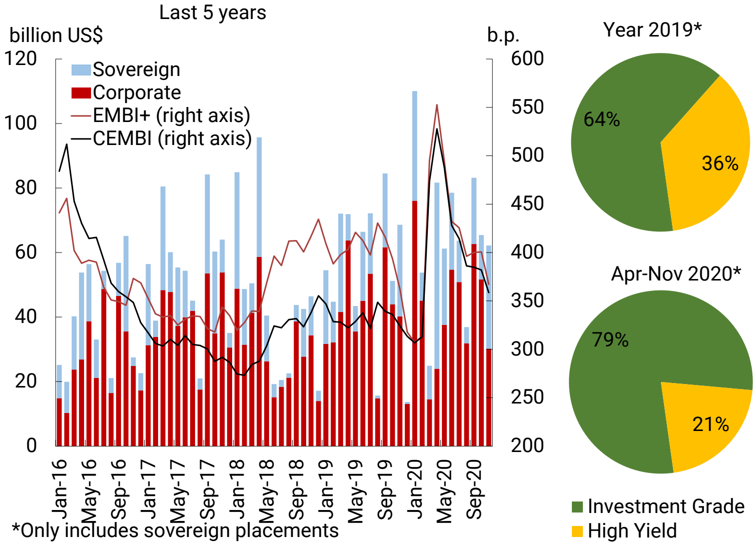
iv. Contributing to strengthening institutions’ solvency levels by extending the suspension of dividends distribution;

v. Maintaining regulations on the foreign exchange market that seek to prevent temporary imbalances from affecting the economy's international reserve position. Likewise, in the medium term, they are aimed at maintaining macroprudential regulations compatible with boosting capital inflows to the real economy.

Exhibit 1 / COVID-19 and risks to financial stability in emerging economies

After the release of the IEF last June, the financial assets of emerging economies continued to follow the recovery trend observed until the end of August in developed economy markets. However, several of the main indicators for emerging markets did not reach pre-pandemic values.[51] The EMBI+ spread for emerging sovereign bonds was about 90 bp above its January average levels in early September, while currencies registered a depreciation close to 10% against the dollar in the same period. Emerging currencies volatility remained at twice the level seen at the beginning of the year.

Figure A.1.1 | Emerging debt issues in international markets



*Only includes sovereign placements
Source: BCRA based on Bloomberg

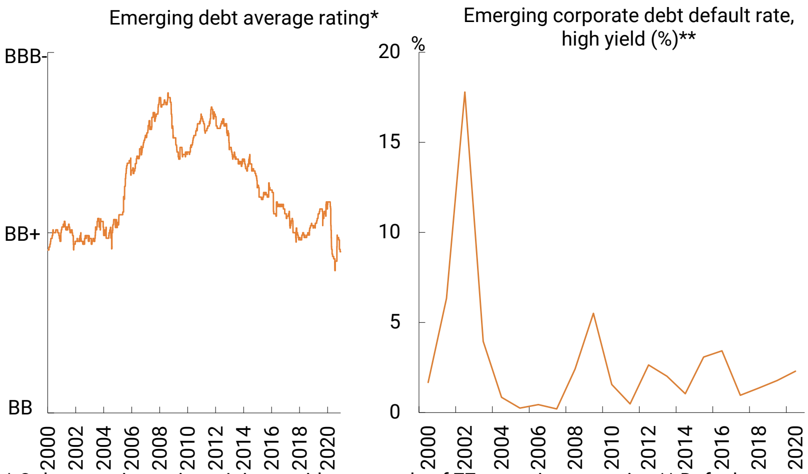
Following signs of COVID-19 resurgence in the northern hemisphere, late October saw an increase in risk aversion in global markets. The persistent uncertainty (added to a certain disconnection between improvement in financial markets and downside risks linked to global growth expectations) means that -while vaccine approval creates a more optimistic vision- the possibility of new events of this nature cannot be ruled out, with the consequent impact on emerging economies.

The pandemic has had a direct effect on emerging market asset prices, partly due to the characteristics of these economies. On the one hand, several emerging countries highlight the importance of commodities production (establishing an important correlation with global growth) and other sectors directly affected by the COVID-19 crisis (such as tourism). While policy responses in this group of economies were swift and forceful, in line with developed countries, their room for maneuver is more restricted, given the lower availability of resources as a percentage of GDP and a greater informality. On the other hand, the financial markets in these economies tend to show less depth and liquidity than in developed countries.

[51] Even if aggregate variables are mentioned for emerging economies, at country level they show heterogeneity.

With economic activity globally weakening, a further downward adjustment in growth expectations would add greater pressure on the credit risk associated with the emerging economies agents. While for sovereign states this is partly linked to the fiscal effort made under the pandemic, for businesses it is particularly due to a context of relatively high and growing debt and increasing currency mismatches, as well as lower revenues and sectoral profitability. With certain heterogeneity among countries, a fragile situation emerged against possible scenarios of renewed increase in refinancing costs in international markets and greater volatility in foreign exchange markets.

Figure A.1.2 | Emerging debt credit situation



* Only sovereign ratings. It is consider a sample of 77 emerging countries.** Default rate is calculated as % of issuers that go into default. Data for 2020 correspond to May (accumulated 12 months).
Source: BCRA based on Bloomberg and S&P Global

While emerging countries debt placement quickly regained dynamism thanks to the implementation of strong policy measures[52] (see Figure A.1.1), transactions show greater relative dynamism in the sovereign segment than in the corporate one, with a bias towards countries with a better debt rating.[53] However, with economic activity conditioned by existing uncertainty, the trend of increasing emerging debt rating downgrades could accelerate (see Figure A.1.2), with potential procyclical effects.[54] Going forward, it will be necessary to monitor the final impact on the sustainability of each country's higher debt level.

Growth in emerging countries debt placements is also linked to the increase observed in recent years in non-bank financial intermediation (NBFI) globally[55], particularly given the growth of investment funds that relatively increased their position in emerging economy assets (see Exhibit 3). In contexts of strong risk aversion and widespread search for liquidity, like in March this year, these funds can generate abrupt portfolio outflows from emerging countries (see Figure A.1.3),

[52] They included both the widespread injection of liquidity (and asset purchases), and specific measures linked to short-term offshore financing markets in dollars.

[53] Evidence that investors differentiate between countries based on perceived risk. For example, while sovereign placements in investment-grade countries accounted for less than 65% of total sovereign placements in 2019, this percentage rose to about 80% in April-November.

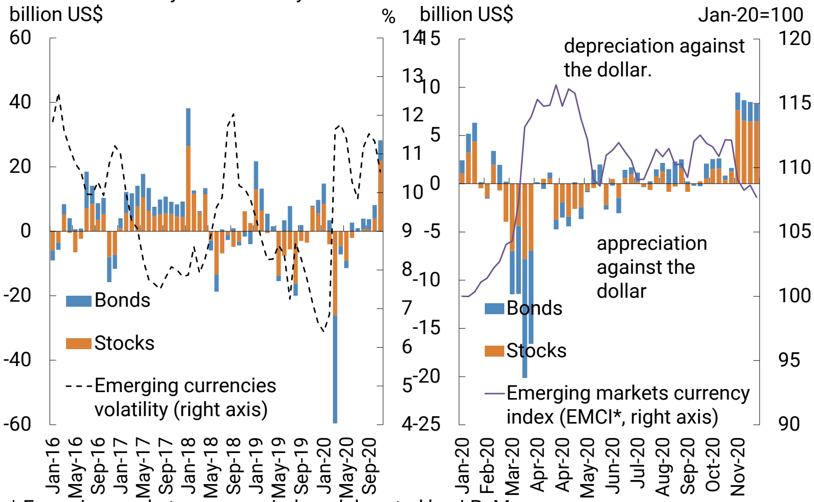
[54] For further detail, see IPOM August 2020.

[55] See Section "COVID-19 and challenges to global financial stability" in IEF IH20.

involving contagion effects that can be disruptive to financial asset prices and exchange rates, putting pressure on the rest of the relevant macroeconomic variables of these economies (on international reserves and inflation, for example).

Figure A.1.3 | Flows to especialized funds in emerging markets

Last 5 years - monthly data



* Emerging markets currency index, elaborated by J.P. Morgan.

Source: BCRA based on Bloomberg, J.P. Morgan and Standard Chartered.

Concerning banks in emerging economies, their resilience has generally improved as a result of regulatory changes implemented following the global crisis that peaked in 2008-2009. This does not mean that there are no specific countries (or individual banks in certain countries) in a situation of greater relative weakness, which may be in trouble if the context worsens, especially regarding credit risk (liquidity problems for the private sector that may result in solvency problems).

The different fragility factors of emerging economies and their interrelationship with trends observed in international markets are being closely monitored through different international fora (FSB, BIS, IMF). The possibility of contagion effects with an impact on emerging economies would create room for globally coordinated policy actions. Thus, an agenda[56] that aims to achieve a better understanding of the role of NBFI and its link with variables such as liquidity, agents' leverage and interconnection between different markets and different countries (including emerging ones) is taking shape. This agenda could eventually lead to future policy actions and adjustments in macroprudential regulation to improve the resilience of the broad financial sector globally.

[56] For example, the FSB has developed a holistic review of the vulnerabilities exposed in markets after the COVID-19 shock, generating a future agenda (See "Holistic Review of the March Market Turmoil".

Exhibit 2 / Measures adopted by the BCRA to sustain financing flows to the private sector

Following the release of the IEF 1H20 last June, the BCRA continued to advance in its objective of making improvements to the measures implemented to strengthen the channeling of credit to households and businesses, given the evolution of the pandemic that began in March.[57] The tools designed to this end, which in all cases took into account the initial liquidity and solvency conditions of the financial system, gradually began to be readjusted at the margin. These changes reflect the developments in the economic and financial situation of the domestic private sector, which largely convey the changes in the health measures in force in different jurisdictions of the country.

Among the different credit assistance initiatives implemented by the BCRA throughout 2020, the special line to MSMEs and Health Care Providers at a nominal interest rate of 24% stood out, both for its magnitude and broad scope (*MyPyME 24%*).[58] This initiative was implemented before the onset of the health restrictions, seeking to contribute to the financing of working capital needs as well as the acquisition of capital goods by MSMEs and health care providers, with costs that were significantly lower than prevailing market prices. To promote the granting of these loans in a scenario of high uncertainty caused by the unprecedented, institutions' minimum cash requirements were reduced. As of May, this credit line was extended through the so-called *MiPyME 24% Plus* line,[59] for companies without access to bank financing (i.e., very small businesses with greater difficulties to access formal credit). Both initiatives accumulated disbursements, on an aggregate basis, for just over $540 billion until early November (with only over 10% of the total guaranteed by the Argentine Guarantee Fund - FoGar).

As a result, the *MyPyME 24%* and the *MyPyME 24% Plus* credit lines benefited approximately 114,000 MSMEs until the end of the third quarter of the year, companies that employed almost 1.6 million people[60] and which were mostly incorporated as legal persons. It is worth noting that these lines allowed access to financing under favorable conditions for MSMEs from all regions of the country (see Table A.2.1). Thus, these debtors in aggregate registered a stock of loans equivalent to almost 24% of the total stock of loans for the entire financial system in September[61] (with relative maximum levels in the northeastern (NEA) and northwestern (NOA) regions), with non-performing ratios below those observed in the entire financial system. The scope of these debtors grew to 43% of the total financing in the case of legal persons, representing almost a third of this type of debtors in the entire system. Furthermore, approximately 15% of the total number of companies reached by the *MyPyME 24%* and the *MyPyME 24% Plus* credit lines together, were not included as recipients of credit in the

57 See different 2020 issues of the Report on Banks, as well as the Regulatory annex of this IEF and IEF 1H20, for a detailed list of all the regulatory changes associated with the credit lines promoted by the BCRA.

58 Communication "A" 6937 and amendments.

59 Communication "A" 7006 and amendments.

60 Employed.

61 All the loans taken by these debtors (*MyPyME 24%* and the *MyPyME 24% Plus* credit lines) are considered, both within the framework of the lines promoted by the BCRA and through other types of assistance.

financial system at the beginning of the pandemic, a figure that rises to 21% for legal persons only. This illustrates the ability of these credit assistance policies to drive greater inclusion.

Table A.2.1

Credit line for MSMEs' productive investment (1)
Data as of September 2020

Region (2)	Total MSMEs debtor (human and legal persons)	Total MSMEs debtor (legal persons)			Non-performing loans in % total loans	
	Stock of MSMEs loans that took the lines in % of total loans (3)	Stock of MSMEs loans that took the lines in % of total loans to legal person (3)	Number of companies that took the lines in % oftotal number of companies	Number of employees of the companies that took the lines in % of total number of employees (4)	Total MSMEs debtor (human and legal persons)	Total MSMEs debtor (legal persons)
NOA	30	76	24	16	2.3	1.5
NEA	22	64	27	26	6.9	8.2
Cuyo	28	65	23	21	4.1	4.3
Patagonia	19	59	25	21	2.3	2.5
Center	22	38	21	19	2.2	2.4
Total country	**23**	**43**	**22**	**19**	**2.5**	**2.7**

Notes:
(1) In the cases of refering to both financing and non performing ratios, total financing taken by these debtors (who took 24% MSMEs and 24% MSMEs Plus) is considered, both within the framework of the lines promoted by the BCRA and through other types of assistance.
(2) Classification based on the debtor's tax registration (AFIP)
NOA: Salta, Jujuy, Tucuman, Catamarca and Santiago del Estero. NEA: Formosa, Chaco, Misiones and Corrientes. Cuyo: Mendoza, San Juan, San Luis and La Rioja. Patagonia: La Pampa, Neuquen, Rio Negro, Chubut, Santa Cruz and Tierra del Fuego. Center: Cordoba, Santa Fe, Entre Rios, Bs.As. and CABA.
(3) Total financing of the debtors in those entities in which they took out these lines is contemplated.
(4) Employees in a dependency relationship are considered, on which the employer's tax registration is provided.
Source: BCRA

To further financing channels for the companies that saw their activity most affected by the shock, and thus target the actions of public policies, two relevant modifications were subsequently implemented. First, the BCRA and the National Executive Branch (PEN) implemented in August a new credit line at subsidized interest rates for businesses that had a relatively weaker sales performance -in real terms-, thus providing them with an additional tool to pay their workers' wages.[62] These loans are available to all those companies registered under the "Emergency Assistance to Work and Production Program" (ATP), offering interest rates significantly below the market, while granting regulatory benefits in terms of minimum cash requirements for granting institutions. More than 11,000 loans totaling $7.1 billion have been granted under this program since its launch until early December, benefiting approximately 340,000 workers.

Second, and also to adjust credit incentive measures to the gradual economic recovery,[63] the BCRA implemented in mid-October a new scheme called the Financing Line for MSMEs' Productive Investment.[64] It is intended both for companies affected by the consequences of the pandemic, as well as for the rest of the MSMEs that wish to expand their production processes for the coming

62 See Communication "A" 7082 and amendments.
63 See IPOM November 2020 for further details.
64 See Communication "A" 7140 and amendments.

years.[65] It consists mainly of a line to finance MSMEs' investment projects with a maximum 30% APR and an average term of 24 months or more, and another line to finance working capital, checks and electronic invoices of the same business segment with a maximum 35% APR. Loans for around $104 billion were granted through this new scheme (approximately 9% corresponding to investment projects) since mid-Octohber, channeled to almost 30,000 companies.

It should be noted that the BCRA's actions were also aimed at addressing the situation of households whose main sources of income were linked to self-employment activities. A 0% rate credit line has been promoted together the National Executive Branch (PEN) since April, aimed at easing part of the economic effects of the shock on the members of the simplified tax regime *(monotributistas)* and the self-employed,[66] which was later expanded in August to include those who work on culture-related activities[67]. In all cases, the interest rate is 0%, the loan is credited to the applicant's credit card and there is a grace period to start repaying (in 12 equal and consecutive installments). Close to $67 billion have been granted until the beginning of December (almost entirely disbursed) through about 565 thousand loans. The implementation of this credit assistance program led to 250,000 new credit cards issued among the population.

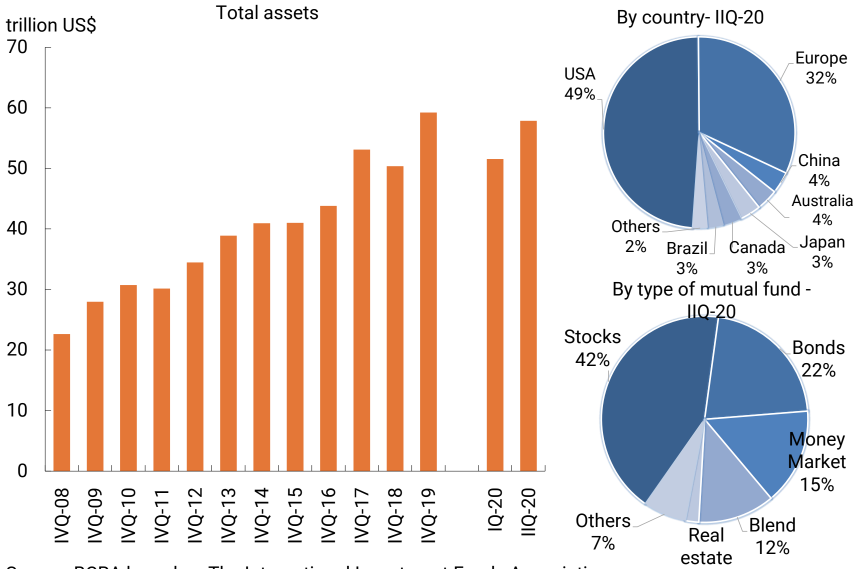
This wide range of credit initiatives promoted by the BCRA, added to the measures specially designed to mitigate the financial burden of the private sector due to the shock, have sought to promote a framework of financial sustainability for the complex production fabric of the local economy. These initiatives drove much of the recovery in the stock of loans in pesos in real terms observed since last March, after almost 2 years of a sustained decline in the flow of financing to the private sector (see Section 3.2). It has, therefore, helped to mitigate the procyclical behavior of credit that the financial system generally presents, thus reducing potential adverse effects over time that lead to the conditions of domestic financial stability and consequently, the country's future growth possibilities.

65 It covers Group A financial institutions, as well as those not included in this group that are financial agents of the National, provincial, Autonomous City of Buenos Aires and/or municipal administrations.
66 See Communication "A" 6993 and amendments.
67 See Communication "A" 7082.

Exhibit 3 / Investment funds and financial stability at a global level

Non-bank financial intermediation (NBFI) has grown in recent decades fairly more than banking globally. The FSB's mapping of the financial sector in broad terms[68] shows that while NBFI occurs in different ways, almost half of it is represented by investment funds, worldwide.

Figure A.3.1 | Open-end mutual funds

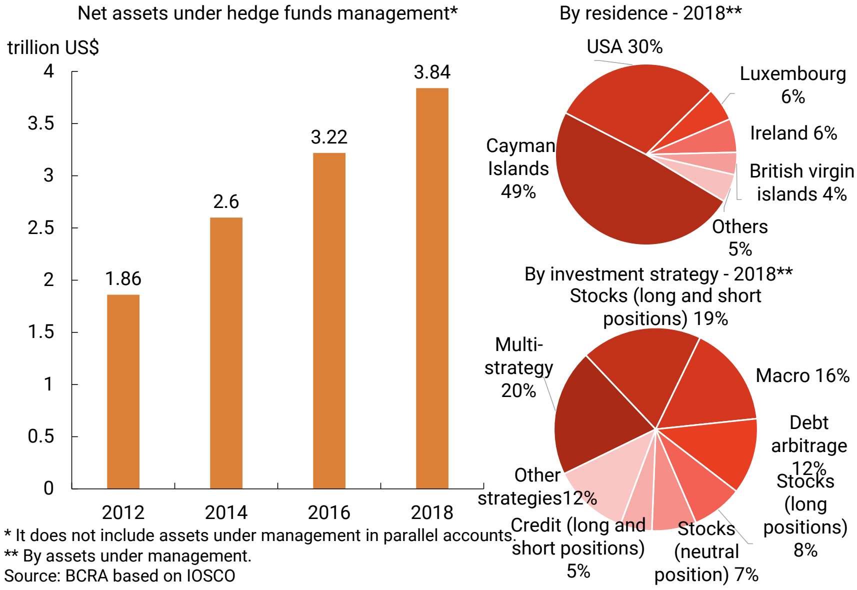


Source: BCRA based on The International Investment Funds Association

The main component of the fund industry is the so-called open-end funds, its simplest version. According to the IIFA[69], these funds reached a balance above US$59 trillion by the end of 2019 globally, more than double the figure of a decade ago (see Figure A.3.1). The composition by type shows that as of June 2020 equities account for 42% of total assets, followed by bonds (22%), money market (15%) and mixed (12%), among others.[70] Another more complex and riskier segment of the fund industry is that of hedge funds (HFs). These funds have much more flexibility than open-end funds: they have fewer restrictions on borrowing, can put together short positions, can use derivatives for speculative purposes, and can follow more complex strategies.[71] According to the IOSCO, HFs reached a balance of almost US$4 trillion by the end of 2018 (which would be added to almost US$0.6 trillion in managed assets in parallel accounts), more than twice the amounts observed by 2012 (see Figure A.3.2).[72] The HF industry shows a strong concentration in few jurisdictions: nearly 80% of the managed funds tracked by the IOSCO are in the US and the Cayman Islands. These funds follow different strategies and have a broad presence in financial markets.[73]

[68] See "Global Monitoring Report on Non-Bank Financial Intermediation 2020".
[69] International Investment Funds Association. See "Worlwide regulated open-end fund assets and flows" (2Q2020).
[70] It is noteworthy that exchange traded funds or the ETF segment -with relevant dynamism in recent years- accounts for 11% of the total stock. These ratings do not include funds of funds.
[71] Other distinctive features include performance-based fees, a minimum holding period (with certain allowed redemptions) and the use of a significant portion of own funds.
[72] Based on IOSCO's Hedge Funds survey ("Report on the Fifth IOSCO Hedge Funds Survey" (April 2020).
[73] Based on gross asset exposure (not net value), which magnifies the percentage linked to strategies that use more derivatives, considering long and short positions in securities and derivatives markets, IOSCO's survey shows that the largest net HF positions in asset markets are in equities, followed (to a lesser extent) by liquid positions, positions in developed economies sovereign bonds and -with less weight- corporate bonds and structured products. In the case of derivatives, equity derivatives stand out, followed by fixed income, CDS and commodity derivatives.

Figure A.3.2 | Hedge funds



* It does not include assets under management in parallel accounts.
** By assets under management.
Source: BCRA based on IOSCO

The action of investment funds, even the simplest and most regulated ones (such as open-end funds), entails several vulnerabilities for both advanced and emerging economies:

Term and liquidity mismatch. This responds to the difference between investment liquidity and redemption conditions. This vulnerability is most noticeable in the case of open-end funds, which can be redeemed in the short term. In situations of stress, there may be incentives from investors to rescue their holdings earlier than the rest, especially in funds that invest in riskier or less liquid assets (encouraging procyclical behavior).

Leverage. The use of debt or derivatives makes portfolios riskier and more sensitive to changes in the context (i.e. more prone to deleverage in stress scenarios, generating contagion effects). This risk is by definition more connected to HFs.

Interconnection with other segments of the financial sector. Connections with the banking sector (most noticeable in the case of money markets funds) are particularly relevant. In general, both open-end funds and HFs invest in a wide range of instruments, and in recent years the bias has shifted to riskier and less liquid instruments, looking for higher yields. Procyclical behavior is evident in stress scenarios, increasing imbalances between liquidity supply and demand, with emergency sales and a contagion effect on prices and yields of different instruments and markets.

Interconnection between jurisdictions: As mentioned in Exhibit 1, the growth of transnational funds in recent decades was followed by significant capital inflows to emerging markets linked to funds, affecting markets with heterogeneous size and liquidity, and generating a greater incidence of external factors on their evolution. In stress scenarios, the action of funds shows an amplifier effect, with abrupt redemptions -especially in open-end funds- that are disruptive for emerging economies.[74]

[74] Since these are large funds, it should be considered that even if they allocate a marginal share to certain markets, such as emerging ones, their presence may have systemic effects (including the impact on foreign exchange markets) to the extent that emerging markets have lower depth and liquidity.

Herd behavior problem. An important share of open-end funds follows passive investment strategies, with portfolios replicating the composition of certain indices[75]. This can fuel the procyclical characteristics of the fund industry in situations where significant rebalances of these indices occur.

Other risks. In addition to the aforementioned factors, there is, for example, the degree of concentration in different segments of the fund industry, the opacity existing in some of the transactions (most noticeable in the case of HFs) and the operational risk of each segment.

Regulatory standards normally applied so far appeal to different types of measures that, given their micro-prudential approach, do not cover all these dimensions.[76] Following the 2008-2009 global crisis, an agenda was addressed to improve risk monitoring and regulation in the fund industry. One of its central points was to expand the regulatory boundaries: in 2009, the IOSCO established principles to monitor and regulate HFs.[77] As to open-end funds (which were already being supervised), progress was made in money market funds. In the middle of the last decade, the FSB and the IOSCO launched a proposal to identify systemically important institutions globally, including asset managers and investment funds, among others. More recently, in 2017, the FSB issued several recommendations to work on risks associated with the asset management industry.[78] However, progress on the agenda linked to the funds industry has been uneven, in many cases it is at a very early stage (especially regarding systemic implications).

Given the persistence of vulnerabilities, during the stress peak of COVID-19, the investment fund industry was one of the main monitoring nodes internationally. Market tensions, with a direct impact on fund dynamics, were largely mitigated by significant liquidity injections and asset purchases by monetary authorities and measures in some cases targeted to specific segments, in addition to the temporary adjustment of certain regulations.[79] The robust nature of these actions (along with those specific to improve access to global dollar funding) helped to limit transnational effects. However, it is important to work not only on the effects but also on the origins of vulnerabilities, also considering how regulatory arbitrage contribute to market dynamics. The FSB, with the participation of international organizations (IOSCO, BIS, etc.), is currently proposing an international agenda to strengthen fund industry regulations, to increase its resilience, with an emphasis on liquidity issues and contagion channels. The aim is to consider not only micro aspects but also systemic risk.

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75 Another practice that can also generate herd effects is performance measurement based on industry aggregate.
76 Including risk management schemes, asset allocation restrictions, liquidity requirements, leverage limits and measures related to valuation and redemption policies, among others.
77 See “Hedge funds oversight” (IOSCO, 2009).
78 See “Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities” (FSB, 2017).
79 For example, temporary suspension of redemptions on certain funds, especially real estate ones.

Exhibit 4 / COVID-19. Use of regulatory flexibility

The crisis caused by COVID-19 has characteristics that differentiate it from the latest global crises: it was completely unexpected, of a non-financial nature, affecting all economic sectors and regions in the world, and with uncertain duration since it depends on a scientific development (effective vaccines massively applied). In this context, the actions of the authorities worldwide were also unique: from the beginning of the shock, public policies focused on guaranteeing the functioning of essential sectors, providing resources to those affected and trying to limit the scope of economic and financial disruptions.

The proposed policy objectives required, among other things, that the flow of credit to the economy be maintained. To this end, national regulators counted on the resilience of the banking sector, which unlike the 2008-2009 crisis, acted as buffers, and implemented a number of policy flexibilities to channel resources to counter the impact of the pandemic. These regulatory flexibilities seek to offset the increased demand for liquidity (for example, companies turn to banks to request funds), as well as to sustain banks' capital (in a context in which lockdown measures affect aggregate supply and demand, generating an increase in credit risk).

From the beginning of the crisis, international organizations involved in financial stability understood their extraordinary nature and, as a result, took a relevant role. On the one hand, they provided guidelines to apply regulatory flexibilities[80] and, on the other, they published the measures adopted by the jurisdictions to avoid creating further distortions between them. However, each jurisdiction used the combination of measures that best suited their situation, which not only considered global developments but also took into account the policy tools they had at their disposal.

Thus, the flexibilities established by national regulatory bodies and ratified by international organizations mainly comprised the use of the macroprudential buffers provided for in Basel III: the countercyclical capital buffer and the liquidity coverage ratio (LCR). Both were designed to have additional resources to those established in the microprudential regulation, seeking to maintain intermediation in periods of stress such as the current one.

The countercyclical capital buffer was designed so that when activated (created or increased) responds to the accumulation of banking systemic risks associated with excessive increases in credit or with asset-price bubbles. Its deactivation (released or reduced) can be done immediately after a severe adverse shock. The non-financial nature of the crisis meant that not all jurisdictions had this tool previously available (or it existed at extremely low levels). Given the impossibility of releasing capital (or only for an insignificant amount), other flexibilities were used to "save" the use of banks' capital.

Thus, one of the points addressed was the treatment of credit risk. International organizations guidelines established that loans subject to a COVID-19 moratorium (granted by the government or voluntarily by banks), may not be considered problematic or non-performing loans[81]. This is intended to mitigate the increase in capital requirements driven by an extraordinary situation, which is considered to be temporary and mainly liquidity related, rather than a significant increase in credit

80 On April 15, the Financial Stability Board (FSB) encouraged authorities and institutions to use flexibility within existing international standards and for this it lists a series of principles. https://www.fsb.org/wp-content/uploads/P150420.pdf.
81 https://www.bis.org/press/p200403.htm.

risk. Government-guaranteed loans may carry the same level of risk (ie risk-weight) as loans to sovereign states when calculating capital adequacy. Since the government is usually the lowest credit risk agent, government guarantees allow the expansion of credit to the private sector with a minimum cost in terms of required capital. Similar considerations were also taken into account to quantify expected losses,[82] since their increase requires higher provisioning and, therefore, further use of institutions' capital. Besides, measures were taken to mitigate the increase in capital requirements derived from market risk due to the significant, but generally temporary, increase in market volatility.

Some jurisdictions also considered the increase of assets on institutions' balance sheets and its impact on the leverage ratio (Basel III). Since this ratio is a non-risk sensitive measure, any increase in assets correlates with capital requirements. In some cases, it was established that the increase in Central Banks's government bond holdings or reserves should not be considered in calculating the ratio numerator; while in others, it was the government-guaranteed loans granted during this crisis. All these examples have a dual purpose: facilitate the operability of central banks and governments emergency programs and support institutions lending capacity. Finally, following international organizations recommendations, many jurisdictions established restrictions on dividend distribution (there were even cases in which the outstanding dividend payments for 2019 were canceled to preserve the existing capital).

In Argentina, as in the rest of the countries, the purpose of regulatory flexibility measures was to promote credit. The elements used can be summarized as follows: (i) lower reserve requirements on funding to finance households and MSMEs; (ii) regulations limiting LELIQ holdings by institutions to expand lending capacity; (iii) temporary easing of debtor classification rules to mitigate the impact on provisions, added to the exceptional refinancing of debtor installments in the shock scenario, and (iv) suspension of dividend payment to safeguard capital.

The duration of the crisis shows that the combination and type of public policy actions should be adjusted not only to the characteristics of the jurisdictions but also to the phases of the crisis. Therefore, when the shock started, the flexibility available in international standards was used and, in some cases, it has subsequently gone further to respond to extreme financial conditions. As signs of improvement begin to emerge in economic sectors, policy actions are expected to be more targeted.[83] In any case, there is consensus in the international regulatory community that support policies should be gradually eliminated, subject to the evolution of the real economy and closely monitored to avoid medium-term damage to households and the production fabric of the countries. Unwinding temporary measures will not be an easy task and should be carried out considering financial stability in the medium and long term.

82 The impairment approach of "IFRS 9 Financial Instruments" is based on the fact that the provisions are adjusted according to expected credit losses (ECL). In view of COVID-19, the IASB published a statement providing guidance on how to consider relief measures to respond to adverse economic impacts, such as public guarantees or payment moratoriums. The existence of these reliefs will not automatically mean that the loans have suffered a significant risk increase. Several other authorities (e.g. ECB, Bank of England) have also provided additional guidance on this issue.

83 This is already foreseen in the National Government's Emergency Assistance Program for Work and Production.

Abreviations and Acronyms

€: Euro
a.: Annualized.
AEIRR: Annual Effective Internal Rate of Return.
AFIP: *Administración Federal de Ingresos Públicos*. Argentina's Federal Tax Authority.
ANSES: *Administración Nacional de Seguridad Social*. Social Security Administration.
APR: Annual Percentage Rate.
ATM: Automated teller machine.
b.p.: basics points.
BADLAR: Interest rate for time deposits over one million pesos between 30 and 35 days for the average of financial institutions.
BCBA: *Bolsa de Comercio de Buenos Aires*. Buenos Aires Stock Exchange.
BCBS: Basel Committee on Banking Supervision.
BCRA: *Banco Central de la República Argentina*. Central Bank of Argentina.
BIS: Bank of International Settlements.
BoE: Bank of England.
Bonar: *Bonos de la Nación Argentina*. Argentine National Bonds.
CABA: *Ciudad Autónoma de Buenos Aires*. Autonomous city of Buenos Aires.
CCP: Central counterparty.
CDS: Credit Default Swaps.
CEMBI: Corporate Emerging Markets Bond Index
CER: Coeficiente de Estabilización de Referencia. Reference Stabilization Coefficient.
CNV: *Comisión Nacional de Valores*. National Securities Commission.
CPI: Consumer Price Index.
CVS: *Coeficiente de Variación Salarial*. Wage variation coefficient.
D-SIBs: Domestic systemically important banks.
DEBIN: *Débito Inmediato*. Immediate Debit.
ECAI: External Credit Assessment Institution.
ECB: European Central Bank.
ECC: *Encuesta de Condiciones Crediticias*. Lending standards survey.
EMBI: Emerging Markets Bond Index.
EPH: *Encuesta Permanente de Hogares*. Permanent Household Survey.
EU: European Union.
Fed: Federal Reserve of US.
FGS: *Fondo de Garantía de Sustentabilidad*. Sustainability Guaranty Fund.
FSB: Financial Stability Board.
GDP: Gross Domestic Product.
IADB: Inter-American Development Bank.
IAMC: *Instituto Argentino de Mercado de Capitales*. Argentine Capital Markets Institute.
IBIF: *Inversión Bruta Interna Fija*. Gross domestic fixed investment.
IMF: International Monetary Fund.
INDEC: *Instituto Nacional de Estadísticas y Censos*. National Institute of Statistics and Censuses.
IPMP: *Índice de Precios de las Materias Primas*. Central Bank Commodities Price Index.
IPOM: *Informe de Política Monetaria*. Monetary Policy Report.
IRR: Internal Rate of Return.
LCR: Liquidity Coverage Ratio.
Lebac: *Letras del Banco Central de la República Argentina*. BCRA Bills.
LETES: *Letras del Tesoro en dólares estadounidenses*. US$ Treasury Bills.
LIBOR: London Interbank Offered Rate.
LR: Leverage Ratio.
MAE: *Mercado Abierto Electrónico*. Electronic over-the-counter market.
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.
MF: Mutual Funds.
MoT: Ministry of Treasury.
MSCI: Morgan Stanley Capital International.
MULC: *Mercado Único y Libre de Cambios*. Single free exchange market.
NBFI: Non-Bank Financial.
NPD: National public debt.
NFPS: Non-financial national public sector's.
NW: Net worth.
OB: *Obligaciones Negociables*. Corporate bonds.
OECD: Organization for Economic Cooperation and Development.
OPEP: Organization of the Petroleum Exporting Countries.
PEN: *Poder Ejecutivo Nacional*. Executive Branch.
PGNME: *Posición Global Neta de Moneda Extranjera*. Net Global Position in Foreign Currency.
p.p.: Percentage point.
PPM: *Plataforma de Pagos Móviles*. Mobile Payment Platform.
REM: *Relevamiento de Expectativas de Mercado*. BCRA Market expectation survey.
ROA: Return on Assets.
ROE: Return on Equity.
Rofex: Rosario Futures Exchange.
RPC: *Responsabilidad Patrimonial Computable*. Adjusted stockholder's equity, calculated towards meeting capital regulations.
RWAs: Risk Weighted Assets.
S&P: Standard and Poors.
s.a.: Seasonally adjusted.
SEFyC: Superintendence of Financial and Exchange Institutions.
SME: Small and Medium Enterprises.
TCR: *Tipo de cambio real*. Real Exchange rate.
TN: *Tesoro Nacional*. National Treasury.
US$: United States dollar.
US: United States of America.
UTDT: *Universidad Torcuato Di Tella*. Torcuato Di Tella University.
UVA: *Unidad de Valor Adquisitivo*. Acquisition Value Unit.
UVI: *Unidad de Vivienda*. Dwellings Unit.
VAT: Value Added Tax.
WB: World Bank.
WPI: Wholesale Price Index.
y.o.y.: year-on-year.