Financial Stability Report

June 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, the 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 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 monetary 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 edition of the IEF will be published on November 11, 2020.

Autonomous City of Buenos Aires, June 10, 2020.

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Executive summary

As a consequence of the COVID-19 pandemic and the health measures taken to contain it, the Argentine financial system has been facing since February 2020 an unprecedented and particularly challenging operating context. In this adverse scenario, the ensemble of financial institutions continued to show a significant level of resilience which, together with the policy actions implemented, allowed to maintain financial stability conditions. The financial system continued to operate without disruption both in terms of financial intermediation and provision of means of payment, maintaining broad liquidity and solvency margins, above the requirements set by local regulation, with a prudential regulatory framework in line with international standards.

When the shock triggered by the pandemic hit, the Argentine economy was already conditioned by a recessionary process that began in mid-2018, high inflation levels and unsustainable public debt. A set of policies have been implemented since December 2019 with new priorities, seeking to stabilize the economy, including fiscal, debt, exchange market and monetary policy dimensions, among others. The BCRA sharply reduced monetary policy interest rates and introduced incentives to improve access to financing for businesses (especially MSMEs) and households. Starting in March, specific actions to mitigate the economic and financial effects of the pandemic complemented the above, to boost savings in domestic currency, ease the financial situation of the private sector, strengthen the chain of payments and avoid credit procyclicality, always trying to maintain the soundness of the financial system. Progress was made through different lines of action to recover debt sustainability and further changes were introduced to access the exchange market.

Accompanying economic activity dynamics, financial intermediation continued to show a relatively weak performance since the last Financial Stability Report (IEF). In response to the most recently introduced measures, credit has shown some rebound, especially commercial lines in pesos. The non-performing portfolio indicator continued to increase in late 2019 and early this year. This dynamic is explained by the business segment since households have been showing better credit performance. This occurs in a context of limited credit risk exposure in the financial system, diversified portfolios and high provisioning. Following this, at the end of the first quarter, we estimate that the eventual impact on net worth from a hypothetical and unlikely scenario of non-recovery of non-performing loans would be shallow/insignificant for the financial system.

The financial system's funding, mainly deposits, has shown less pressure in recent months. Private sector deposits in pesos increased their share in funding -led by sight deposits-, while those in foreign currency continued to decline, but at a much slower rate than in the last months of 2019. The financial system's liquidity ratios increased following deposits and credit dynamics. All of this is accompanied by an increase in the regulatory solvency indicators of the financial system, complemented by reduced leverage. In the current context, the financial system posted positive income in uniform currency in the first quarter of 2020.

The sources of vulnerability faced by the ensemble of financial institutions remain relatively limited. It is a shallow financial system, still with traditional intermediation, largely transactional, and with a moderate degree of interconnection among institutions. In a context where households and businesses show reduced debt levels in aggregate terms, the financial system maintains low net worth exposure to credit risk. Existing

macroprudential regulations limit both the possibility of currency mismatches and exposure to the public sector. As to the latter, and within the framework of the different actions implemented to recover debt sustainability, it is worth noting that the limited exposure to the public sector consists largely of instruments in domestic currency, which are being swapped successfully. The implementation of social lockdown measures, including teleworking and greater use of e-banking, makes the financial system more exposed to certain types of disruptive events, though unlikely. Depending on the relative strength factors shown by the ensemble of financial institutions, should the aforementioned risks materialized, they would have to reach extreme levels to affect local financial stability conditions.

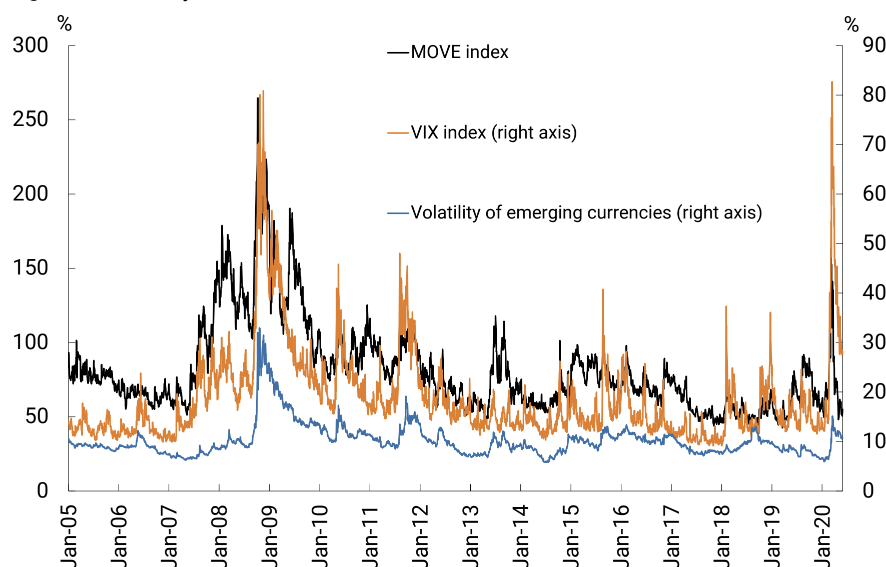
The financial system will continue to face a challenging scenario in the coming months since the pandemic is still an ongoing phenomenon. Although health measures are expected to be gradually eased, it remains to be seen what will be the duration, intensity and spread of the COVID-19 impact on the evolution of the Argentine economy, while the possibility of further tensions in international markets (which could trigger greater volatility in local markets) is not ruled out. In this context, the BCRA has been reinforcing monitoring processes, while continuing to implement measures, if necessary, within the current macroprudential policy approach to promote financial system stability.

Financial system stability analysis

1. Context

The COVID-19 pandemic, together with the preventive health measures that had to be implemented, have meant an unprecedented shock since February, with a strong impact on global growth expectations and commodity prices. Growing uncertainty had a fast and noticeable impact on financial markets, with volatility peaks not seen since the 2008-2009 global crisis (see Figure 1). There were significant portfolio reallocations with a particularly adverse effect on emerging economies' instruments (stocks, debt instruments and currencies). Given the policy responses implemented to date to mitigate the effects of the pandemic (see Exhibit 1), global financial markets have tended since April to limit their loss with no episodes of systemic disruption, although the context remains challenging (see Exhibit 2).

Figure 1 | Volatility in international markets

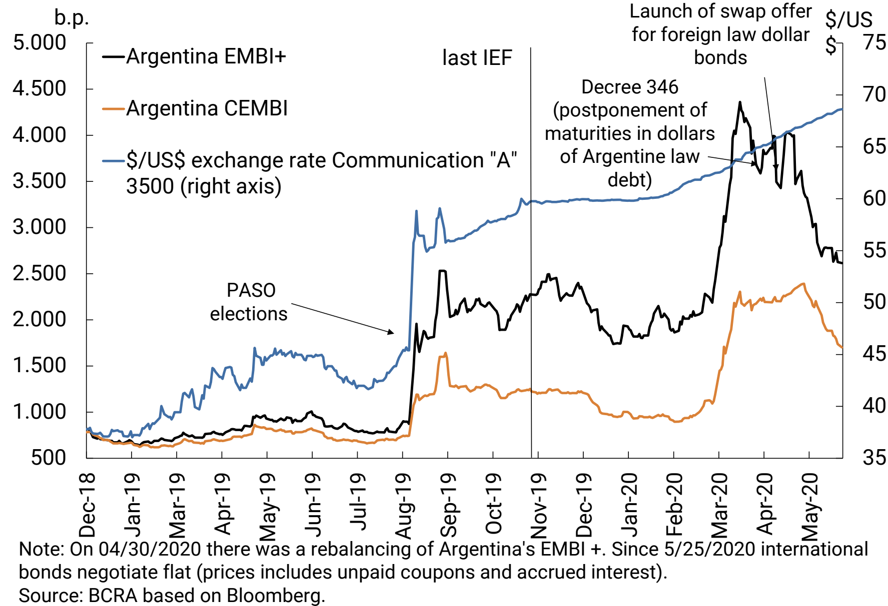


Source: BCRA based on Bloomberg.

In Argentina, this stress scenario implied the deterioration of an already vulnerable economic and social situation, given the recessionary process that began in 2018, still high inflation rates, a shortage of foreign exchange and unsustainable public debt levels, among other factors.[1] The downturn of the macroeconomic scenario had already been setting up a volatile performance in certain financial markets variables (see Figure 2). As described throughout this report, despite this adverse context, the financial system continued to show an adequate degree of resilience, maintaining financial stability conditions.

1 For further details, see the February and May editions of the Monetary Policy Report (IPOM).

Figure 2 | Debt yield and exchange rate spread

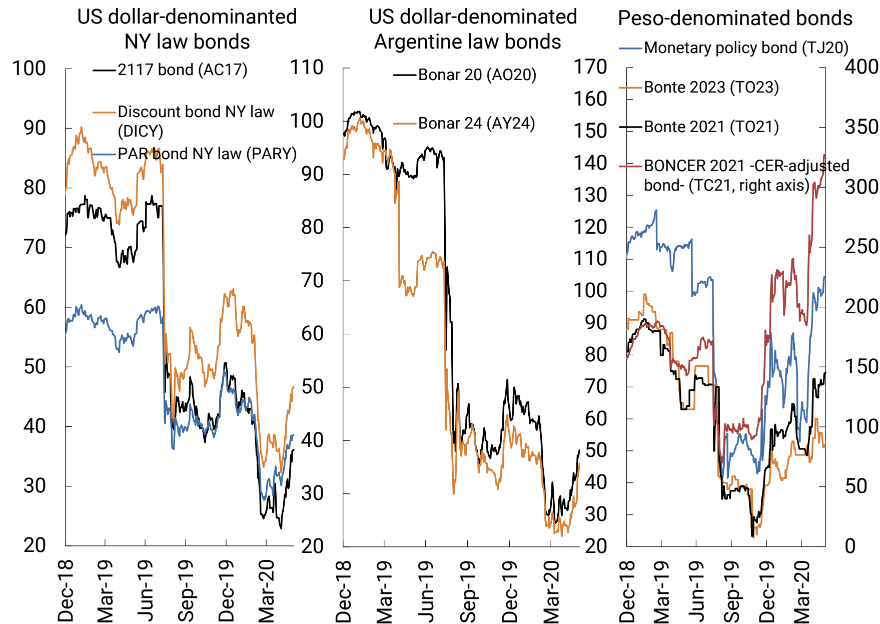


Note: On 04/30/2020 there was a rebalancing of Argentina's EMBI +. Since 5/25/2020 international bonds negotiate flat (prices includes unpaid coupons and accrued interest).
Source: BCRA based on Bloomberg.

Following the release of the last IEF (Nov-19), since the end of last year, domestic vulnerability has been faced with a new set of economic policy priorities. In this context, the Law of Social Solidarity and Productive Reactivation was passed in late 2019, including, among others, exchange market, fiscal and public debt measures. This was complemented by new BCRA monetary policy guidelines, namely a sustained reduction in reference interest rates and new incentives to improve access to financing for businesses, especially MSMEs. Additional actions have been implemented since mid-March to mitigate the effects of the adverse COVID-19 shock. On the other hand, progress was made on a comprehensive strategy to recover public debt sustainability, including the launch of a swap of government bonds issued under foreign law[2] and the implementation of various swaps in the local market (see Exhibit 3), which influenced the evolution of prices and yields in debt markets (see Figure 3). More recently, changes to the regulatory framework applicable to the foreign exchange market were implemented.[3]

2 The Province of Buenos Aires also presented a debt restructuring proposal. Additionally, another 5 provinces (Córdoba, Río Negro, Chubut, Mendoza and Neuquén) announced the intention to renegotiate their bonds issued under foreign law, with different levels of progress to date.
3 Among other measures, access to the Single Free Exchange Market (MULC) is limited to those agents that trade securities settled in foreign currency (Communications "A" 7001 and 7030).

Figure 3 | Fixed-income markets: price evolution



Source: BCRA based on Bloomberg

2. Main strengths of the financial system under current risks

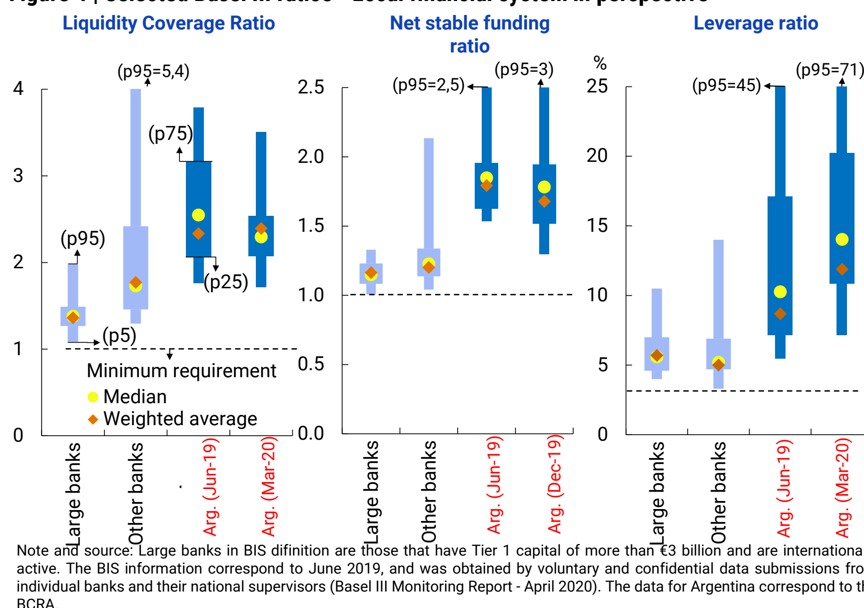
The financial system continued to conduct its intermediation and payment services provision functions in a particularly challenging operating context. The BCRA thus sought to mitigate the adverse effects by readjusting the operation of the sector to social, preventive and compulsory lockdown (ASPO), by designing and implementing a broad set of measures to boost savings in domestic currency, promote credit and ease the financial situation of companies and households (see Exhibit 4).

The ensemble of financial institutions remained strength signs in the first quarter of the year, within a prudential regulatory framework in line with international standards. High liquidity coverage, capital and provisioning ratios prevailed, with moderate exposure to banking risks, in a context of reduced credit depth in the economy. Financial institutions still perform unsophisticated traditional intermediation transactions, with limited transformation of terms and low direct interconnection among them. The financial system's net worth mismatches remain low. Below are the main strengths of the sector, which will be addressed in greater detail in the following sections when assessing potential vulnerabilities.

i. Broad aggregate liquidity and solvency margins. The ensemble of financial institutions' liquidity levels are still high in historical terms. At the end of the first quarter of 2020, broad liquidity (considering items in domestic and foreign currency) stood at 64.6% of total deposits, increasing against the last IEF and in a year-on-year comparison (see Table 1). Furthermore, in terms of the internationally recommended regulatory standards, financial system liquidity ratios far exceed local requirements, as well as the values observed in other economies (see Figure 4).

The Regulatory Capital (RC) represented 21.8% of risk-weighted assets (RWA) in March 2020, expanding in the last six months and compared to March 2019. Local financial institutions show low levels of relative leverage, while, in aggregate, they fully comply with the additional capital margins established by local regulations. Furthermore, despite the relatively adverse operating environment, the financial system posted positive income in uniform currency in the first quarter of the year.

Figure 4 | Selected Basel III ratios - Local financial system in perspective



Note and source: Large banks in BIS difinition are those that have Tier 1 capital of more than €3 billion and are internationally active. The BIS information correspond to June 2019, and was obtained by voluntary and confidential data submissions from individual banks and their national supervisors (Basel III Monitoring Report - April 2020). The data for Argentina correspond to the BCRA.

ii. Progress in the implementation of international accounting and financial reporting standards. The local financial system is in line with the best internationally recommended standards on the matter. As of 2020, financial institutions must present financial statements in uniform currency following International Accounting Standard —IAS— 29 and consider the provisions on the impairment of financial assets outlined in International Financial Reporting Standard —IFRS— 9 (see Exhibit 5).

iii. High provisioning of the non-performing portfolio, combined with moderate and decreasing exposure to credit risk. Although higher non-performing ratios are observed, the financial system's non-performing portfolio provisioning is estimated to still be high, around 81% in March 2020 (see Table 1). In this context, the net worth exposure to credit risk (non-performing portfolio net of provisions attributable to that portfolio) of the ensemble of financial institutions remained relatively low, around 2.5% of net worth. Furthermore, the system's private sector loan portfolio maintained relatively low levels of concentration in early 2020, similar to the average of recent years.[4]

iv. Low exposure to the consolidated public sector. At the end of the first quarter of the year, loans to the public sector represented 9.2% of the financial system's total assets. The stock of public sector deposits continues to exceed the ensemble of financial institutions loans to the public sector.

4 See Exhibit 5 of the IEF IH-19 for further details.

v. Moderate maturity and currency mismatches, and low weighting of assets and liabilities in foreign currency. Assets in foreign currency represented 22.7% of the financial system's total assets in March 2020, while liabilities in the same denomination totaled 21.4% of total funding (liabilities plus net worth). The ensemble of financial institutions and their debtors maintained low foreign currency mismatches on their balance sheets, reflecting the effects of local macroprudential regulations. On the other hand, the financial system maintains limited transformation of terms, mostly focused on transactional operations. In a context of less financial intermediation with the private sector, the estimated term of the financial system's investment portfolio in domestic currency was reduced in the last part of 2019 —the latest available information corresponds to December—, bringing down the difference between the lending and borrowing portfolios' terms.

vi. Local financial institutions have not requested financial assistance from the BCRA to face the COVID-19 shock. In the context of the pandemic outbreak, the BCRA and the Superintendence of Financial and Foreign Exchange Institutions (SEFyC) have reinforced the monitoring of financial institutions performance (both their main financial indicators and their operating activities), foreseeing possible measures to face situations of greater stress.

Table 1 | Main indicators of financial system soundness

	Finacial system				State-owned banks			Domestic private banks			Foreign private banks			
	Mar-19	Sep-19	Dec-19	Mar-20	Mar-19	Sep-19	Mar-20	Mar-19	Sep-19	Mar-20	Mar-19	Sep-19	Dec-19	Mar-20
Liquidity														
Liquidity Coverage Ratio	2.2	2.3	2.1	2.4	1.7	1.7	2.1	2.4	2.3	2.5	2.6	2.2	2.5	2.5
Net Stable Funding Ratio (1)	1.7	1.6	1.7	1.7	1.5	1.5	1.5	2.0	1.9	1.9	1.8	1.7	1.8	1.8
Broad liquidity / Deposits (%)	58.9	57.6	60.1	64.6	48.6	46.2	51.6	68.2	68.0	72.7	64.3	63.9	71.1	74.6
In $	59.7	57.9	58.1	62.0	43.9	47.9	50.1	74.4	67.1	70.4	72.6	66.8	69.7	72.5
In US$	57.3	56.9	65.6	73.0	61.0	40.7	58.1	55.5	69.9	80.0	55.1	59.7	73.6	79.8
Solvency														
Regulatory capital / RWA (%)	16.0	16.3	17.6	21.8	14.0	13.6	18.7	19.0	19.8	25.7	15.5	15.8	18.1	21.4
Regulatory capital Tier 1 / RWA (%)	14.0	14.1	15.4	19.8	13.1	12.7	17.8	15.5	16.0	22.3	13.7	13.9	16.2	19.5
Leverage ratio (%)	8.6	9.1	9.8	11.9	7.6	7.6	9.7	9.3	10.5	14.0	9.0	9.2	10.0	12.0
Capital conservation buffer (% verification)	89	90	90	100	71	73	100	100	99	100	100	99	100	100
Domestic systemically important banks buffers (% verification)	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Profitability														
ROE at current values (quarterly %a.)	41.9	43.8	53.4	-	20.9	29.7	-	50.1	63.6	-	60.7	37.7	86.4	-
ROE in homogeneous currency (quarterly %a.)	-	-	-	13.5	-	-	4.5	-	-	14.5	-	-	-	21.3
ROA at current values (quarterly %a.)	4.6	5.0	6.9	-	2.1	2.9	-	5.7	7.9	-	6.9	4.6	12.3	-
ROA in homogeneous currency (quarterly %a.)	-	-	-	2.0	-	-	0.5	-	-	2.5	-	-	-	3.4
Private sector credit														
Private sector exposure / Assets (%)	39.5	41.9	40.8	36.2	34.7	38.2	33.5	40.8	42.1	37.4	41.7	44.2	40.5	36.3
Non-performing loan ratio (%)	4.0	4.8	5.7	5.3	3.8	5.2	7.7	4.1	4.6	4.2	3.8	4.2	4.1	3.6
Provisions / Non-performing loans (%)	74	79	79	81	74	70	65	80	96	85	71	77	81	118
(Non-performing loans - Adjusted provisions) / Net worth (%)	3.9	3.6	3.8	2.5	3.6	6.1	8.1	2.8	0.6	1.3	4.1	3.3	2.2	-1.5
Public sector credit														
Exposure / Assets (2)	9.7	9.7	9.9	9.2	19.9	18.7	18.5	4.0	4.1	4.2	3.2	4.6	3.9	3.6
Net exposure / activos (%) (3)	-3.7	-1.7	-1.3	-1.8	-9.1	-5.4	-4.9	-3.0	-2.3	-2.1	2.2	3.5	2.9	2.0
Balance sheet in foreign currency														
(Assets - Liabilities + Net undelivered purchases in foreign currency) / Regulatory capital (%)	7.4	13.4	9.1	10.8	33.6	34.2	26.8	2.1	6.7	3.9	-11.8	2.2	-0.3	4.9
Deposits in US$ / Total deposits - Private sector (%)	37	33	29	25	27	25	20	35	34	25	48	41	35	30
Loans in US$ / Total loans - Private sector (%)	30	30	24	21	22	26	20	32	29	20	38	37	27	24

(1) December 2019 last available data. (2) Position in government securities (not including BCRA securities) + Loans to the public sector.
(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

The aforementioned characteristics would be providing adequate soundness to the ensemble of financial institutions' balance sheet. In a challenging operating context, the financial system is expected to remain resilient to the eventual materialization of stress factors in the coming months. The main risk factors (exogenous to the system) to take into account when assessing financial stability are the following:

i. Possible greater-than-expected deterioration in economic activity. While the recession in the Argentine economy was exacerbated by the pandemic, according to the latest REM measures, the impact of COVID-19

is expected to be temporary and mostly concentrated in the second quarter of the year, with gradual recovery from the third quarter.[5] However, the duration and intensity of the shock is not yet clear, both to the commercial channel (based on the effect of the pandemic at the global level) and the financial channel (possible growing tensions in international financial markets, affecting exchange rates and interest rates).[6] Added to this is the direct impact of social lockdown measures on the level of local economic activity. These measures are expected to be further eased gradually and at different speeds among regions and economic segments, although there is a risk that a resurgence of COVID-19 infections may slow down the scheduled process of progressive opening. Another important effect, linked to the pandemic, is the precautionary behavior of households and companies in their consumption and investment decisions. Thus, although various stimulus and financial relief policies have been implemented at the local level (and new initiatives have not been ruled out), if the economic activity takes longer to recover, it could directly limit financial intermediation (which had already been showing weak dynamics), potentially reflecting on both the supply and demand of credit and financial institutions' sources of revenue. Although special emphasis is being made on easing the financial situation of the private sector and strengthening the payment chain, an eventual greater-than-expected economic deterioration could affect its payment capacity, which had already been showing a weakening trend since mid-2018 (see Section 3.2).

ii. Possible volatility rebound in local financial markets. In line with the previous point, despite the recomposition of international financial markets conditions as of April, vulnerability factors and concerns about a potential decoupling from latent conditions in the real economy prevail, so the possibility of new episodes of financial stress at the global level cannot be ruled out (second-round effects, with adjustments in the appetite for risk assets). Additionally, there could be greater volatility in the markets linked to local factors. Although exchange market regulations have reduced its volatility, new episodes of tension could influence the exchange rate and local interest rates, affecting the financial intermediation environment and the credit risk faced by financial institutions.

iii. Potential impact from increased operational risk in the context of the pandemic. Given the preventive measures implemented to address the pandemic (mobility restrictions, teleworking with remote access to information, increased use of digital channels, etc.), the financial system faces significant challenges in terms of greater exposure to operational risks (unlikely disruptive events that may affect the provision of intermediation and payment services). Exposure to these risks, particularly those associated with fraud or cybersecurity attacks, has grown in recent times mainly due to the greater dependence of the system on technological infrastructure. The current context defined by the pandemic has exacerbated this phenomenon. It is worth noting the actions carried out by the BCRA, as well as institutions' internal policies to address and mitigate the aforementioned risk (see Exhibit 6).

Concerning medium-term challenges, once the tensions generated by the pandemic are overcome, the lasting effects of the pandemic (and of the government measures taken so far) on global economic and financial activity, and emerging countries, in particular, are still unknown. The subsequent effects of the stimuli implemented in recent months (extension of low-interest rates in international markets) and, depending on the

5 See results of the May 2020 Market Expectations Survey (REM). On the other hand, available high-frequency indicators of economic activity lead us to anticipate a recovery from May (see May 2020 IPOM).
6 As to commercial and financial channels, the first one has a greater relative weight in Argentina given the importance of exports, on the one hand, and especially foreign exchange market, regulations, on the other.

challenges observed, possible additional changes to business models, risk management and regulatory frameworks should be assessed.

The next section analyzes the identified Argentine financial system' sources of vulnerability, given its exposure to the aforementioned risk factors. In each case, we will describe the financial system most specific strengths, allowing it to deal with possible adverse scenarios. Finally, there is a description of macroprudential policy actions implemented in recent months with a focus on strengthening financial stability conditions in the current scenario.

3. Financial system vulnerabilities and specific resilience factors

3.1 Financial intermediation performance

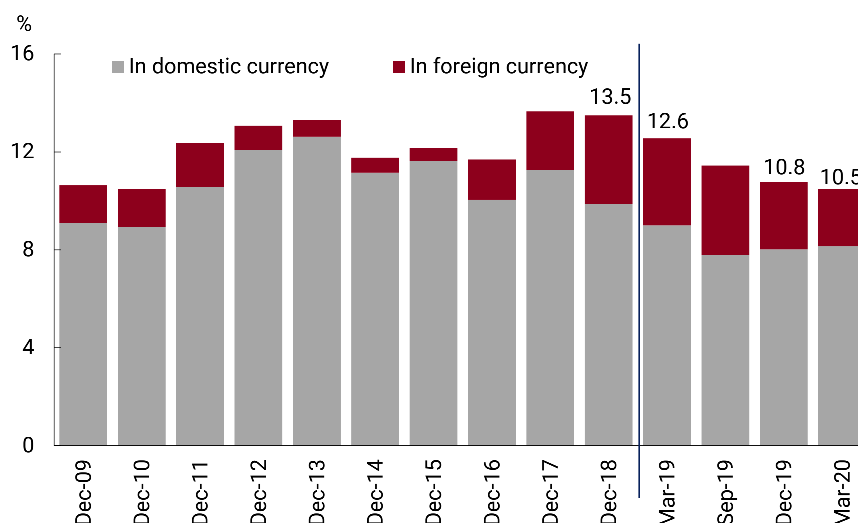
In line with economic activity dynamics (see Section 1)[7], the financial intermediation of the ensemble of financial institutions with the private sector has been showing a relatively weak performance. Since the end of 2019, and particularly since the outbreak of COVID-19, the BCRA has implemented a set of policy actions to promote companies and households' savings and credit in pesos (see Exhibit 4). The stock of loans in real terms showed a rebound from late March to early April, mainly in commercial lines. This behavior was mainly observed at the margin, while the measures implemented by the BCRA seek to avoid a further procyclical dynamic of credit that could affect debtors and economic activity in aggregate terms, with an impact on financial stability conditions.

The stock of credit in pesos to the private sector increased 1.9% in real terms between the end of the first quarter of 2020 and last September —when the last IEF was released— (-8.1% y.o.y.), while loans in foreign currency fell 32.5% in the same period (-42.6% y.o.y.) —in currency of origin—. However, from mid-March —the beginning of the BCRA measures due to the lockdown— and until the end of May, total credit to the private sector in pesos increased by about 17% in nominal terms, especially due to commercial lines that expanded 40% in the same period.

7 For further details see May 2020 IPOM.

In this context, total loans to the private sector —both in domestic and foreign currency— measured in terms of GDP, remained at historically low relative levels (see Figure 5), decreasing slightly in the first quarter of 2020 compared to the third and the first quarter of the previous year. In this scenario, it is estimated that this indicator has accumulated a reduction of close to 3 p.p. since the end of 2018. It should be noted that this evolution does not yet incorporate the full effect of the measures introduced by the BCRA given the COVID-19 pandemic.

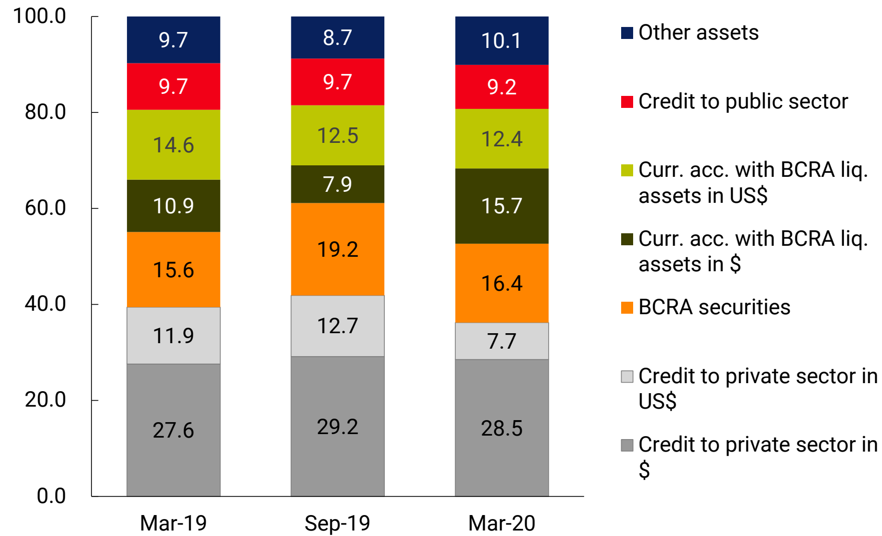
Figure 5 | Loans to the private sector in terms of GDP
Financial System



Note: quarterly averages are considered. Last quarter´s GDP is estimated.
Source: BCRA e INDEC

When analyzing the financial system's balance sheet, loans to the private sector reduced their weighting in total assets in the last quarters (see Figure 6), reaching the lowest level in the last 12 years (down 15 p.p. against the recent high of late 2017). Based on the performance of private sector deposits in pesos (see Section 3.3), the increase in sector assets in real terms in the last six months (+4.1%) responds mainly to a rise of the most liquid items in domestic currency (current account at the BCRA and other liquid assets). As a result, the share of the most liquid components in total assets grew compared to IEF IIH-19. Additionally, the share of monetary regulatory instruments in financial system assets went down in the same period.

Figure 6 | Composition of Total Assets
Financial System



Source: BCRA

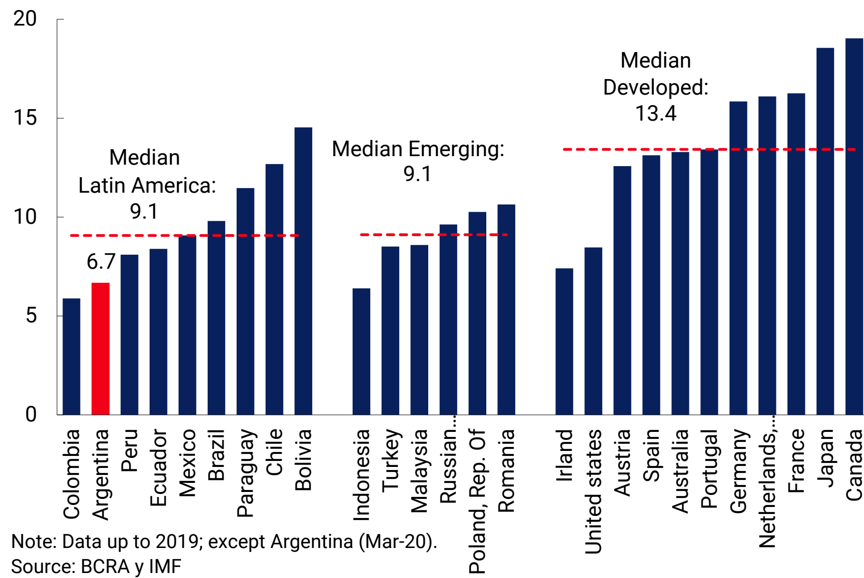
Should the exogenous risks mentioned in the previous section materialize, a relatively more fragile behavior of the financial intermediation process could have some impact on the sector's traditional sources of return, such as net income from interests and income from services. It should be noted that the financial system's return in real terms stood at positive levels in the first quarter of the year, while solvency levels remain relatively comfortable, as detailed below.

3.1.1 Specific elements of resilience

Low leverage of the financial system and high regulatory solvency ratios. The leverage of the ensemble of financial institutions continued to be limited in the first quarter of 2020, among the lowest compared with the countries of the region, and other emerging and developed economies (see Figure 7). As of March, the local financial system's ratio between total assets and net worth fell 1.4 and 2.4 times against the level recorded in the previous IEF and a year-on-year comparison, respectively.

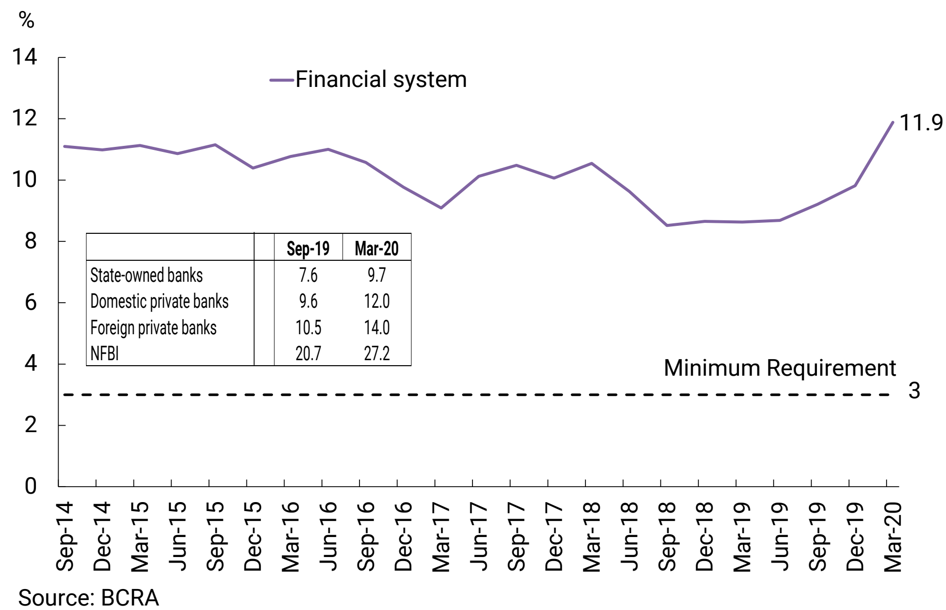
When considering the leverage ratio recommended by the Basel Committee —defined as the ratio between the highest quality regulatory capital and a broad measure of exposures— the local financial system shows increasing levels of slack compared to the minimum threshold required (see Figure 8), adequately positioned globally (see Figure 4). This shows the sector' soundness, as well as the absence of limitations in terms of capital availability to resume the expansion of investment and consumer financing amidst economic recovery.

Figure 7 | Financial system's leverage
International Comparison - Assets / Equity



Note: Data up to 2019; except Argentina (Mar-20).
Source: BCRA y IMF

Figure 8 | Basel leverage ratio



	Sep-19	Mar-20
State-owned banks	7.6	9.7
Domestic private banks	9.6	12.0
Foreign private banks	10.5	14.0
NFBI	20.7	27.2

Source: BCRA

The capital compliance of the ensemble of financial institutions stood at 21.8% of risk-weighted assets (APR) towards the end of the first quarter, up 5.5 p.p. against last September. There was a large excess of regulatory capital above the legally required level in March, reaching 153% of the requirement (up 66 p.p. against the record 6 months ago). Furthermore, Tier 1 capital covers more than 90% of the capital

compliance.[8] In turn, as of March, financial institutions fully met capital conservation buffers (including the additional one for local systemic banks).

Positive aggregate profitability indicators in real terms in the first quarter of 2020. The financial system closed the first quarter of the year with annualized income (a.) —measured in uniform currency— equivalent to 2% of assets (ROA) and 13.5% of equity (ROE) (see Table 2). As part of the improvements introduced in the financial information criteria, certain indicators, such as profitability, may not be directly compared with those of previous periods (which were not stated in uniform currency, see Exhibit 5).

In this sense, the financial margin of the ensemble of financial institutions reached 11.9% a. of assets in the first quarter of the year. Income from loans interests contributed the most to the financial margin in this period, followed by those from securities, while expenses for deposit interest explained the main expenditures in this segment of the income statement. Income from services was another positive component for the financial system, totaling 2% a. of assets in the first 3 months of the year. Loss loan provisions were 1.6% a. of assets in the first quarter, and administrative expenses reached 6.9% a. The financial system recorded quarterly losses in "Other Comprehensive Income" (OCI) of around 1.4% a. of assets, and monetary loss —including inflation adjustment effect— for the equivalent of 0.1% a. of assets in the same period.

Table 2 | Financial system's profitability

Annualized (a.) - In %a. of netted assets	Profitability							
	At current values							Homogeneous currency
	Annual			Quartterly				
	2017	2018	2019	IQ-19	IIQ-19	IIIQ-19	IVQ-19	IQ-20
Financial margin	**10.1**	**10.8**	**13.7**	**11.5**	**13.0**	**14.2**	**15.9**	**11.9**
Interest income	10.5	11.2	11.4	11.0	10.8	11.3	12.5	10.2
CER and CVS adjustments	0.3	1.5	2.1	1.5	2.1	1.7	3.0	1.8
Foreign exchange price adjustments	0.8	0.9	1.2	0.7	0.6	1.9	1.5	0.6
Gains on securities	3.8	7.3	13.0	11.7	13.9	14.3	11.9	9.2
Returns on repo	0.5	0.2	0.5	0.1	0.1	0.5	1.2	0.9
Interest expense	-5.7	-10.2	-14.4	-13.4	-14.5	-15.5	-14.3	-10.2
Other financial results	-0.2	-0.1	0.0	0.0	0.1	0.0	0.0	-0.5
Service income margin	**2.8**	**2.2**	**2.1**	**2.1**	**2.0**	**2.0**	**2.3**	**2.0**
Loan loss provisions	**-1.0**	**-1.4**	**-2.0**	**-2.0**	**-1.6**	**-1.7**	**-2.7**	**-1.6**
Operating costs	**-7.1**	**-6.3**	**-7.1**	**-6.1**	**-6.7**	**-6.9**	**-8.5**	**-6.9**
Monetary position	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-0.1**
Tax and others	**-2.0**	**-2.1**	**-1.8**	**-1.5**	**-2.0**	**-1.5**	**-2.2**	**-1.9**
Results	**2.7**	**3.2**	**4.9**	**4.1**	**4.7**	**6.1**	**4.8**	**3.4**
Other Comprehensive Income (OCI)	**-**	**0.8**	**0.3**	**0.5**	**-0.3**	**-1.3**	**2.2**	**-1.4**
Revaluation of Properties, plants, equipment and intangible assets	-	0.5	0.4	0.2	0.1	0.0	1.1	0.0
Exchange differences on translation of financial statements	-	0.3	0.3	0.3	0.0	0.7	0.1	-0.1
Results on securities (marked to market)	-	0.0	-0.4	0.0	-0.3	-2.1	0.9	-1.3
Others	-	0.0	0.0	0.0	0.0	0.1	0.0	0.0
Return on assets (ROA)	**2.7**	**4.1**	**5.2**	**4.6**	**4.3**	**4.8**	**7.0**	**2.0**
Return on equity (ROE) - In %	**23.4**	**36.1**	**45.2**	**41.9**	**40.2**	**42.0**	**54.3**	**13.5**

Source: BCRA

Given REM's economic activity forecasts for the remainder of the year, a scenario partly tempered by the policy actions taken by the Executive Branch together with the BCRA —starting to show through greater financial intermediation—, negative profitability levels are not expected for the sector in the aggregate of 2020.

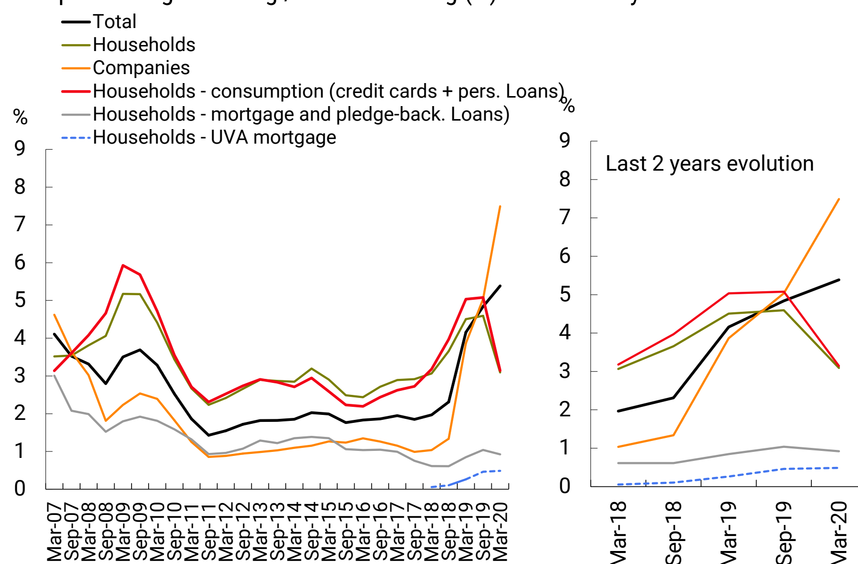
8 Considered best-quality capital, consisting mainly of ordinary shares and income (loss).

Risk-oriented supervision. The SEFyC's monitoring is focused on identifying and addressing possible situations of vulnerability in the current challenging context. From a macroprudential perspective, it is worth noting the appropriate soundness indicators for systemically important institutions (for further details, see Section 4).

3.2 Quality performance of loans to the private sector

The quality of the financial system's credit portfolio has experienced a moderate deterioration since the release of the last IEF, mainly due to corporate financing, since non-performing loans to households fell (see Figure 9). Non-performing loans to the private sector reached 5.3% in March, up 0.5 p.p. against September 2019 and 1.3 p.p., y.o.y. Non-performing loans moderated partly as a result of the change in debtor classification parameters established by the BCRA at the end of March, a measure included in a broader set of instruments implemented to mitigate the economic and financial impact of the pandemic on households and companies.[9]

Figure 9 | Non-Performing loans to the private sector
Non-performing financing / Total financing (%) - Financial system



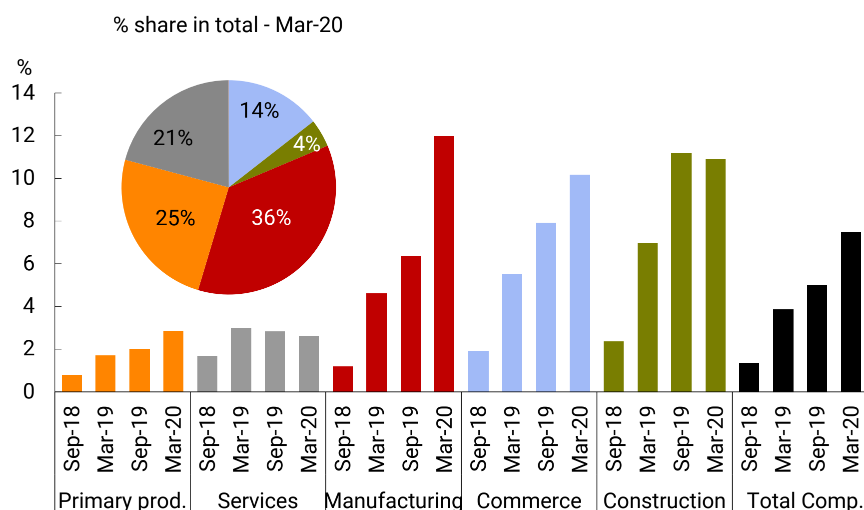
Source: BCRA

The increase in non-performing loans to companies between September 2019 and March 2020 was mainly explained by the industry financing segment[10], and to a lesser extent, by loans to the commercial sector and primary production (see Figure 10). In turn, the decrease in non-performing loans to households recorded in the last six months -downward path observed before the change in debtor classification parameters- responds mainly to consumer loans performance. Among loans to households, mortgages continue to present a low non-performing ratio (non-performing ratio of 0.49% for the UVA segment and 0.63% for the rest).

9 It should be noted that in March 2020 the ratio of non-performing loans to the private sector fell by 0.83 p.p., m.o.m. (6.16% in February and 5.33% in March) within the framework of the changes to debtor classification parameters (Communication "A" 6938). This reduction in the non-performing ratio was reflected in loans to households (from 4.3% in February to 3.1% in March) and, to a lesser extent, in loans to companies (from 8.1% to 7.5% in the same period). For further details, see March 2020 Report on Banks.
10 The credit situation of a number of companies declined in the referenced period, namely the case of a specific large company in December (for further details, see December 2019 Report on Banks).

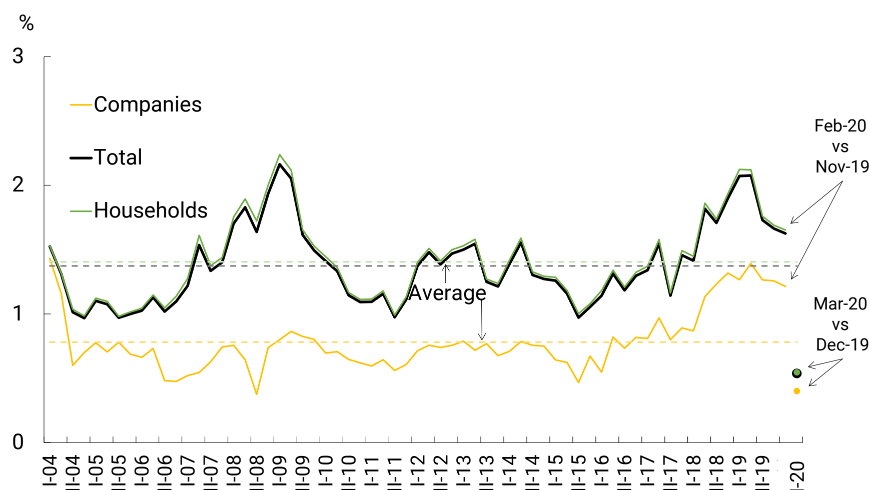
The indicators designed to capture the movement of debtors towards worse credit situations[11] fell in March of this year, amidst the effective change in debtor classification parameters (see Figure 11). Before this change, this indicator was at high levels in early 2020, although lower than the peaks at the end of 2018.

Figure 10 | Non-performing loans to companies by activity
Non-performing financing / Total financing (%) - Financial system



Source: BCRA

Figure 11 | Estimated probability of default (EPD) - Number of loans
Credit to the private sector



Note: The default probability is calculated as a percentage of the non performing credits in a three-month basis. In March 2020 came into effect the Com. "A" 6938. Source: BCRA.

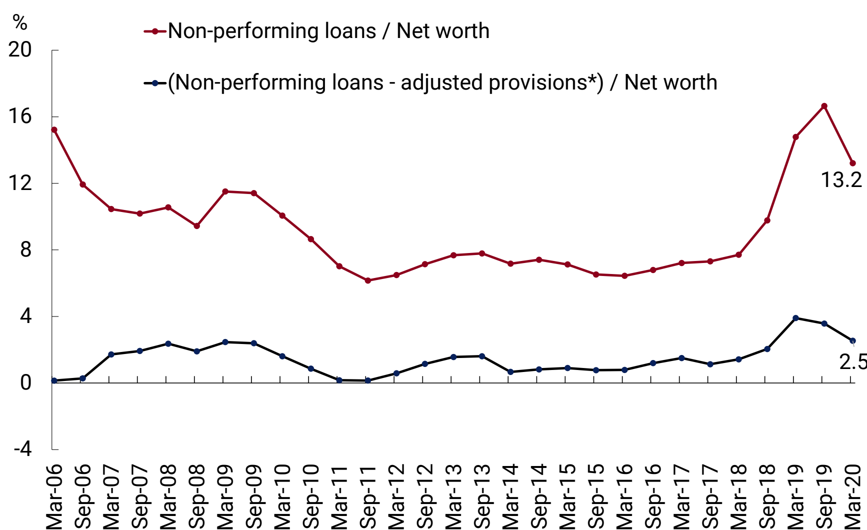
11 Estimates based on micro data from the Debtors Database (BCRA). The Estimated Probability of Default (EPD) is defined as the share of performing loans (1 and 2, according to debtor classification regulations) that become non-performing loans (3, 4, 5 or 6) at the end of the period under analysis. Three-month comparison is used.

Going forward, some increase in non-performing loans could be expected, as aggregate economic activity gradually moves towards normality after the shock. Although the persistent situation could eventually affect some profitability indicators, the financial system presents the following resilience pillars to address this scenario.

3.2.1 Specific elements of resilience

Low net worth exposure to private sector credit risk. Credit to the private sector reduced its share in the total assets of the financial system compared to the previous IEF (see Section 3.1). Within this framework, provisioning remained high[12], reaching almost 100% of the non-performing portfolio in March. This level totaled 81% excluding minimum regulatory provisions for the performing portfolio.[13] The non-performing portfolio, net of provisions attributable to this portfolio in the financial system's net worth (an indicator of net worth exposure to credit risk), stood at 2.5% in the first quarter of 2020, moderate both historically (see Figure 12), and compared to other economies. The possible net worth impact from non-performing portfolio debtors' failure to pay, remains low for the ensemble of financial institutions.

Figure 12 | Low Net Worth exposure to private sector credit risk.
Financial System



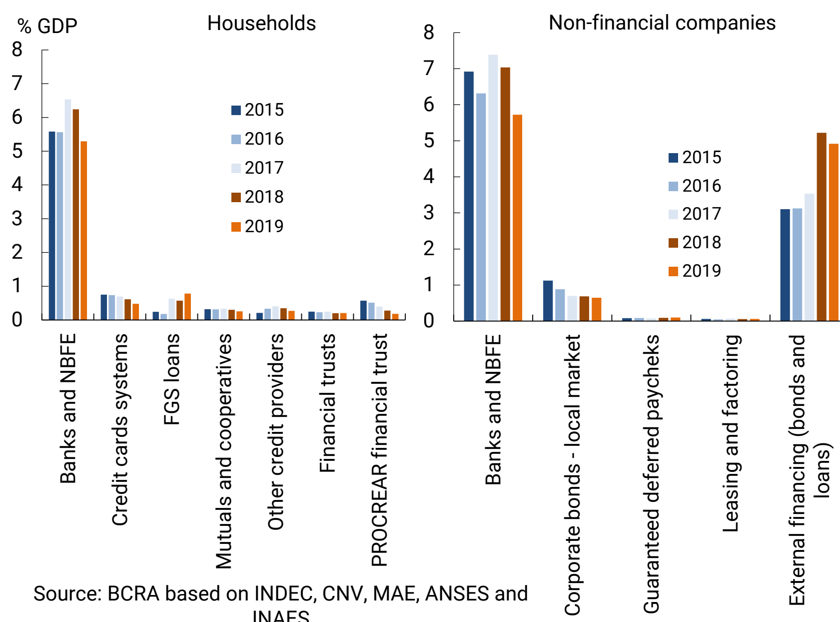
*Adjusted provisions: net provisions of estimation of the minimum provisions established on the portfolio in regular situation. Source: BCRA

12 It should be noted that as of January 2020, financial institutions must consider financial assets impairment provisions included in point 5.5 of IFRS 9. This triggered a change in the calculation (generally an increase) of loss loan provisions from the largest local financial institutions (belonging to Group "A"). For further details on the regulatory changes, see Exhibit 5.

13 Both this ratio and the previous one stood at levels higher than those recorded upon the release of the last IEF. This was partly due to the enforcement of IFRS 9 mentioned in the previous footnote (leading, broadly, to higher provisioning) and due to the aforementioned change to credit rating parameters (namely, lower non-performing balance).

Limited levels of private-sector debt and financial burden. The broad financing balance[14] is estimated at 7.5% of GDP for households and 11.5% of GDP for companies at the end of 2019 (see Figure 13).[15] These levels are relatively low compared to other economies. In particular, the median household debt for some emerging economies was estimated at around 16.5% of GDP and 62.9% of GDP for developed ones (see Figure 14).

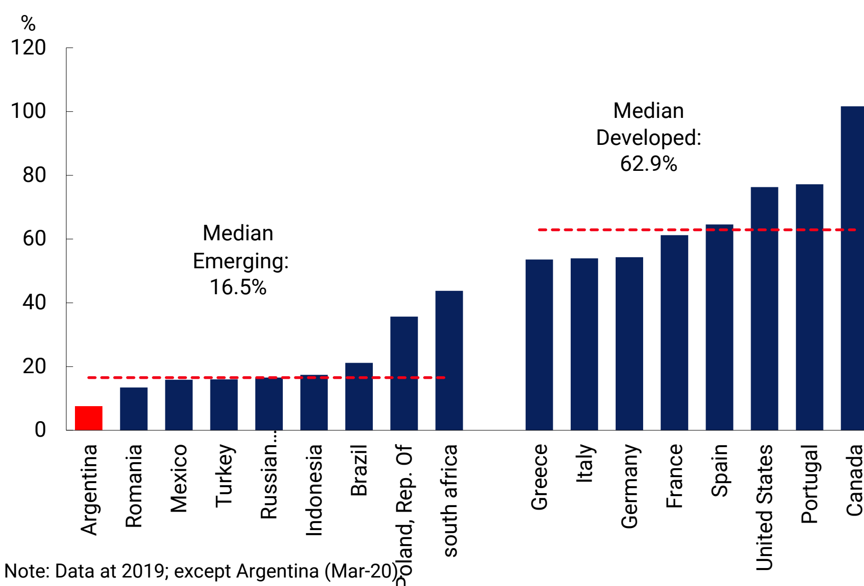
Figure 13 | Broad financing to households and businesses in % GDP



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

Figure 14 | Household debt - International comparison

As % of GDP



Note: Data at 2019; except Argentina (Mar-20).
Source: BCRA y IMF.

14 Taking into account financing from the financial system, in addition to that from local capital market (corporate bonds, deferred payment checks, financial trusts), through other non-banking institutions (mutual funds and credit cooperatives, credit card systems, other financing providers registered with the BCRA) and the Sustainability Guarantee Fund (FGS). In the case of businesses, foreign financing (through corporate bonds and loans) is added to the local one. End-of-year balances are used in terms of last quarter GDP.
15 If companies include "commercial loans and advances" (international accounts), the weight of corporate debt amounts to 18% of GDP.

Loans to households in terms of GDP have experienced a downward path in recent years in Argentina, while there is no defined trend for companies (the stock in domestic currency tends to decrease as a percentage of GDP, while the stock in foreign currency increased following the evolution of the exchange rate). The financial system is the main source of financing for households (more than 70% of the total estimated household debt), followed by the FGS (10% of the total), non-bank credit card systems (6%) and other providers -large retail chains, financial companies- registered with the BCRA (4%).[16] In line with the previous IEF, the financial burden of household debt at the aggregate level is moderate.

On the other hand, 57% of non-financial private sector financing comes basically from loans from the ensemble of financial institutions (with a limited capital market instruments complementary role[17]), while 43% comes from foreign sources (bonds or loans). Regarding the latter, the stock of corporate bonds in dollars (mostly under international law) is estimated as of March 2020 at approximately US$17 billion (4% of GDP).[18] This stock shows a significant concentration in a few companies (70% of the total is explained by 10 firms). Almost half of the stock of corporate bonds in dollars comes from companies in the oil and gas sector (with part of their revenues in foreign currency, although now affected by the decline in commodity prices), followed by firms in the electricity sector. The rest are diversified in different sectors.[19]

Following this, it should be noted that the corporate sector has been facing an adverse economic context since 2018, with an impact on its financial situation. For example, considering the balance sheets presented to the National Securities Commission (CNV) by listed companies[20], the median of these firms showed certain deterioration in 2019 in profitability, liquidity and interest coverage with revenues, with no changes in their leverage. Given the exacerbated recessionary scenario in 2020 due to the pandemic (see Section 1), a certain impact on the sector's payment capacity is expected.[21]

Diversification of financial institutions' portfolio of debtors. The concentration of the private sector portfolio of debtors in the financial system remains at moderate levels, even lower than those observed six months ago -last IEF-. Namely, the 100 and 50 main debtors of the private sector in the financial system aggregate represent 19.6% and 15.1% of the total stock of loans, down 1.5 pp and 1.3 pp against September 2019 values. In line with international recommendations, the local regulatory framework includes prudential regulations that promote this diversification of debtors.[22]

Limited currency mismatch in the balance sheet of the financial system (see Table 1) and of the debtors. Both results reflect the effect of current macroprudential regulations. The foreign currency mismatch for the

16 The rest, with even lower weights, is explained by mutual funds and credit cooperatives (total loans granted according to INAES, 3% of the total), consumer financial trust portfolio loans (3%) and PROCREAR financial trust loans (2%).
17 Among capital market instruments, the most relevant are domestic corporate bonds (corporate bonds held by foreign investors, mostly under international law, are considered external financing). The domestic stock of corporate bonds (under Argentine law, mostly in pesos) is equivalent to 0.6% of GDP as of December 2019.
18 For further details, see Exhibit 1 of the IEF IH-18.
19 It should be noted that less than US$900 million of this stock of corporate bonds in dollars will mature between June and the end of 2020. In recent years, several companies have been issuing debt to refinance or swap existing bonds.
20 Companies from the financial sector and those under the simplified regime for SMEs are not included. Data as of the last quarter of 2019.
21 In the case of listed companies, there have been specific cases of companies (6 in total, several of them SMEs), which could not meet corporate bonds payments, triggering a negotiation with creditors. Additionally, payments were made with guarantees for other 5 corporate bonds (in 3 cases by mutual guarantee societies (SGR) because they were SME corporate bonds). With respect to large companies (they account for a large part of the stock of corporate bonds in foreign currency) bond amortizations have been met without inconvenience so far. Some companies have implemented voluntary bond swap transactions.
22 For further details, see Exhibit 5 of the IEF IIH-19.

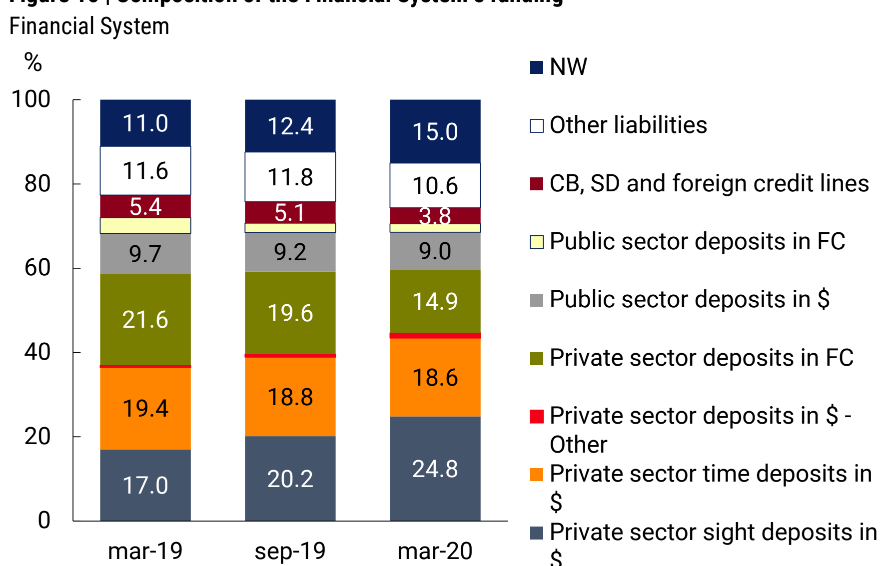
financial system was 10.8% of the Regulatory Capital in the first quarter of 2020, below the average of the last 10 years.

Reduced exposure of the financial system to the public sector. Financial system lending to the public sector (including all levels of government) remained low. The gross exposure of the ensemble of financial institutions to the public sector totaled 9.2% of total assets as of March 2020, falling slightly compared to the last IEF and in a year-on-year comparison (see Table 1). Considering total public sector deposits, the system maintained a negative net exposure (debtor position) to the public sector.

3.3 Financial institutions funding and liquidity in a context of financial volatility

Financial institutions funding structure consists mainly of deposits from the private and public sectors (close to 70%, see Figure 15). Principal (around 15%) and, to a lesser extent, other instruments such as corporate bonds, subordinated debt, foreign credit lines and other liabilities, complete the rest of the financial system's total funding. The weighting of total deposits in total funding did not change significantly against the release of the last IEF, though its composition was modified. Private sector deposits in domestic currency increased their relative weight in total funding by 5.1 p.p. (to 44.7% in March), mainly due to sight deposits. Private sector deposits in foreign currency decreased their relative share in total funding by 4.8 p.p. in the last six months (to 14.9% in March). The rest of the concepts showed minor changes. Looking ahead to the next few months, greater financial volatility could lead to certain changes in the level and/or composition of the financial system's funding.

Figure 15 | Composition of the Financial System's funding
Financial System

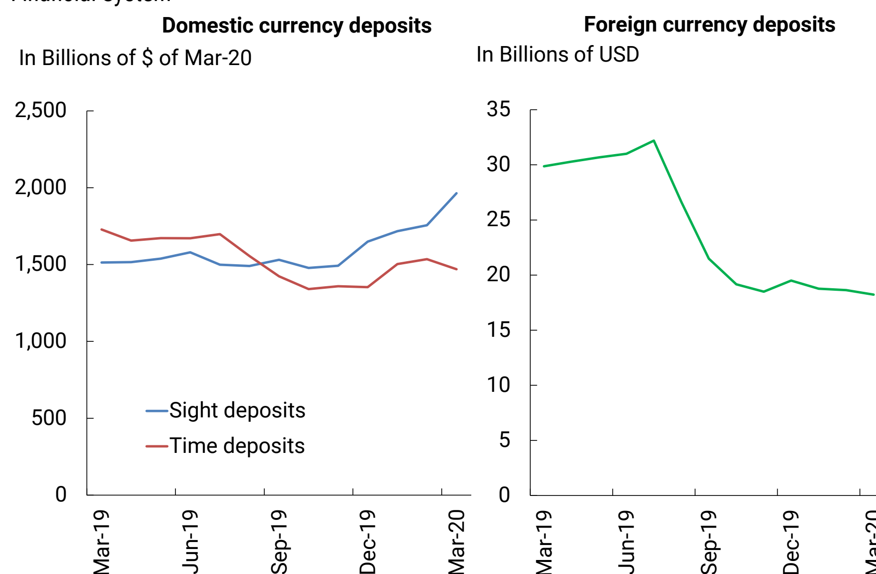


Source: BCRA

The stock of total private sector deposits climbed 4.7% in real terms in the last six months to March (accumulating a 9.7% y.o.y. reduction). In particular, private sector deposits in domestic currency gained momentum since the beginning of the year, totaling a real increase of 17.4% in the last six months. Within this segment, sight deposits explained this performance, growing 28.3% in real terms compared to the last IEF, while time deposits increased 3.3% in real terms in the same period (see Figure 16). At the end of the first

quarter of this year, the dynamics of deposits began to be affected by greater precautionary demand for liquidity by households and companies in the context of the new COVID-19 pandemic[23]. On the other hand, although households and companies' deposits in foreign currency continued to show a slightly downward path, the monthly rate of reduction is much lower than that observed between November and July 2019, when they fell by almost 43%.[24]

Figure 16 | Stock of private sector deposits
Financial System



Source: BCRA

3.3.1 Specific elements of resilience and mitigating measures

High and growing levels of liquidity. The financial system as a whole operates with high levels of liquidity, both in domestic and foreign currency. As of March, deposits in pesos coverage with liquid assets in the same denomination reached 62% for the ensemble of financial institutions, up 4.2 p.p. against the level observed in the last IEF.[25] This dynamic was observed in all the ensemble of financial institutions. On the other hand, liquid assets in foreign currency totaled 73% of deposits in that denomination at the end of the first quarter, up 16 p.p. against September 2019 (this performance was observed in the ensemble of institutions).

Furthermore, the liquidity indicators that follow Basel Committee international standards continue to comfortably exceed the minimum requirements in all financial institutions.[26] In this sense, the Liquidity Coverage Ratio (LCR) in March was around 2.4 for the ensemble of financial institutions, widely exceeding the minimum regulatory threshold (set at 1 as of 2019).[27] In turn, the Net Stable Funding Ratio (NSFR) of the ensemble of financial institutions totaled 1.7 by the end of 2019 -the latest available information-, well above

23 The performance of private sector deposits in pesos was similar by type of depositor (natural/legal persons).
24 For further information on this point, see Exhibit 4 of the IEF IIH-19.
25 This increase in liquidity in recent months is also observed when comparing shorter-term deposits in the financial system.
26 Group A institutions (financial institutions that together represent about 90% of the total assets of the financial system) should comply with these requirements.
27 The LCR considers the liquidity available to face potential outflows in the event of a possible stress scenario. See Amended Text -AT- "Liquidity Coverage Ratio".

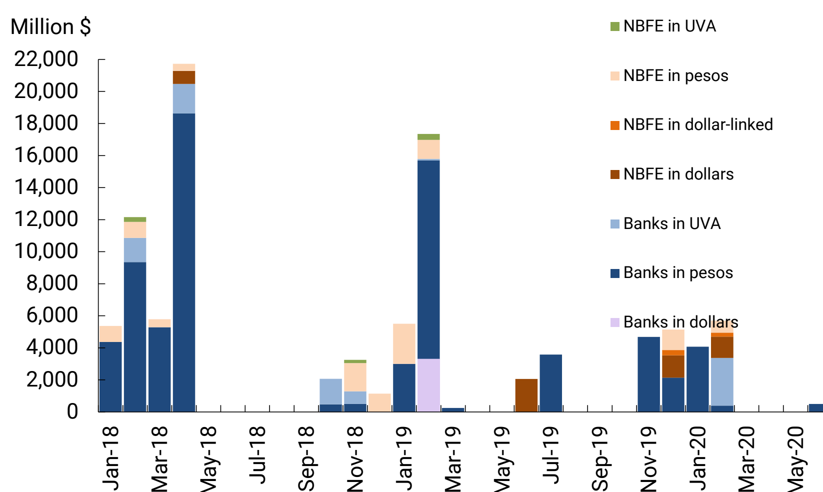
the regulatory minimum (equivalent to 1 since its implementation).[28] The local financial system shows a high level for both ratios -LCR and NSFR- when compared internationally (see Figure 4).[29]

Moderate concentration of deposits prevails. One of the indicators used to characterize the exposure to liquidity risk assumed by financial institutions is the degree of funding concentration. In this sense, the share of the main depositors in the total stock of deposits did not show significant changes in recent months.

Recent measures to promote savings in domestic currency. The measures implemented by the BCRA to face the effects of the pandemic aimed at promoting the performance of private sector deposits in pesos, especially time deposits. Namely, financial institutions must grant a minimum interest rate to all private sector time deposits in pesos. This minimum interest rate was equivalent to 70% of the LELIQs interest rate, targeting a segment of natural persons' deposits, later reaching all depositors at 79% of the LELIQ rate.[30] This measure should be added to the introduction, at the beginning of the year, of 90-day early payment UVA time deposits.

Limited funding with corporate bonds. As previously mentioned, the financial system's funding consists mainly of deposits. Capital market instruments, such as corporate bonds and subordinated bonds, represent a very limited share of total funding (2.3% of the system's liabilities plus net worth as of March). Namely, almost half of the stock of corporate bonds issued by financial institutions maturing between June and late December is payable in pesos and a third in dollars, equivalent to only 1% and 1.3% of total deposits in each currency as of March.[31] Although private-sector bond issuing in the domestic market has shown a decline in recent months, transactions continue to be recorded. Bank deposits since the last IEF were all in pesos (at a weighted average term of 7 months), including a (24-month) UVA deposit (see Figure 17).

Figure 17 | Financial system corporate bonds issuance



Source: BCRA based on CNV and BCBA.

28 The purpose of the NSFR is for institutions to have a stable term funding structure, in line with the terms of the businesses to which it applies. See AT "Net Stable Funding Ratio".
29 For further details see *Basel III Monitoring Report* April 2020.
30 For further details see Communications "A" 7000, "A" 7018 and "A" 7027.
31 These maturities include payments in pesos for approximately $42 billion (in pesos, in UVA and dollar-linked), and the amortization of a corporate bond in foreign currency for US$280 million in November 2020.

Financial sector security network liquid assets. In case of special need, financial institutions may access the different liquidity windows in pesos provided by the BCRA.[32]

Deposit guarantee insurance system. Additionally, to safeguard household and companies' savings against potential adverse financial situations in a financial institution, there is a deposit insurance that guarantees the return of up to $1.5 million of those deposits that meet certain requirements regarding the agreed interest rate.[33] Currently, institutions contribute the equivalent of 0.015% of their deposits to this fund, which accumulated an available stock of 3.4% of deposits in the financial system as of March. This level is similar to the records of recent months and above those observed in previous years.

4. Other matters of financial system stability

4.1 Domestic systemically important banks (DSIBS)

Given the relative share of certain institutions within the local financial system, they are specially monitored from a systemic risk perspective. Following international guidelines, indicators showing the different features of systemically important banks (SDIBs), such as their size, degree of interconnection, complexity and degree of substitution of their activities, are used to define these institutions.[34] In addition to having differential treatment for compliance with certain financial regulations, these institutions are subject to closer monitoring by the BCRA, while having to observe, in particular, a greater capital conservation buffer.

The group of domestic SIBs represents approximately half of the assets of the whole financial system. As of March 2020, all DSIBS complied with 100% of the current capital conservation buffer. Considered as a whole, DSIBS increased their solvency and liquidity ratios in the last six months and recorded positive quarterly profitability indicators in uniform currency (see Table 3). Compared to the last IEF, this group of financial institutions showed an increase in non-performing loans to the private sector (to 5% as of March, in line with the indicator for the ensemble of financial institutions), maintaining a moderate net worth exposure to credit risk (2.7%). Additionally, the exposure to the public sector in terms of aggregate assets, as well as the difference between assets and liabilities in foreign currency and regulatory capital for these institutions went down against last September.

32 For further details, see AT "BCRA liquidity window"
33 For further details see AT of "Deposit insurance system implementation".
34 Click here to find details on the methodology used to determine systemic banks in Argentina.

Table 3 | Main soundness indicators for DSIBS

	Mar-19	Sep-19	Mar-20
Liquidity			
Broad liquidity (%)	52.5	49.1	55.7
In $	49.2	46.4	51.8
In US$	57.5	54.7	67.6
Solvency			
Regulatory capital / RWA (%)	15.9	16.2	21.4
Profitability			
ROE at current values (quarterly %a.)	40.4	43.4	-
ROE in homogeneous currency (quarterly %a.)	-	-	12.8
Private sector credit			
Exposure / Assets	38.3	42.0	37.0
Non-performing loan ratio (%)	3.2	3.9	5.0
(Non-performing loans - Adjusted provisions) / Net worth (%)	2.2	2.6	2.7
Public sector credit			
Exposure / Assets	13.8	14.2	13.9
Foreign currency position			
(Assets - Liabilities + Net undelivered purchases in foreign currency) / Regulatory capital (%)	17.2	23.2	17.5

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

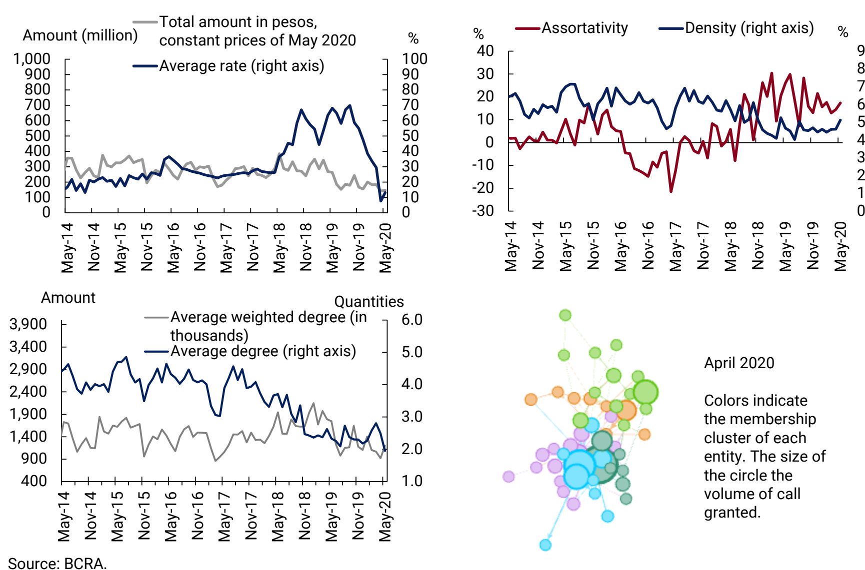
4.2 Interconnection in the financial system

A growing but limited interconnection between the financial system and institutional investors has been observed since the last IEF, mainly due to the dynamics in money market mutual funds purchases. The relatively most important institutional investor in the local market is the Sustainability Guarantee Fund -FGS- (with a portfolio of funds equivalent to 10% of GDP), followed by mutual funds -FCI- and insurance companies (with portfolios representing 4% and 3% of GDP, respectively).[35] The most relevant direct interconnection between institutional investors and the financial system occurs through funding from the latter. In recent months, deposits from institutional investors show a growing trend over total deposits in the financial system, but their weighting is still low (11% of the total as of March 2020, against 6% six months ago). This increase is largely explained by FCI, given the relevance of money market FCI.[36] The latter, used to channel excess liquidity, have been growing strongly since September[37], largely due to new purchases. At the beginning of the year, the increase in deposits due to new money market FCI purchases was added to the effect of the transfer to deposits of the stock of repos held by FCI with the BCRA[38].

35 Calculation as of April (FGS) and March (FCI) 2020. December 2019 for insurance companies (investment portfolio plus liquid assets).
36 Liquid assets and time deposits account for 99% of the money market FCI portfolio, while for other important segments of the sector, such as fixed and mixed income funds, their weighting is much more limited, representing 23% of the total portfolio of fixed income funds and 16% of the total portfolio of mixed income funds.
37 While money market funds portfolio represented 33% of FCI's total portfolio by August 2019, by March 2020 its weighting was 51%. It should be noted that, following the reprofiling of Treasury bills in late August 2019, there was a significant transfer from fixed income funds to money market funds in September.
38 The interest rate of BCRA repos with the FCI was gradually reduced as of January 10, expiring in February. See Monthly Monetary Report for January and February.

On the other hand, the call money market is analyzed as another source of direct interconnection.[39] Thus, amidst sharp drops in LELIQ's interest rate in recent months, interest rates in the call market also showed a downward trend. In this context, there was both an increase in the nominal spread against the LELIQ rate, and a fall in the amount traded in this market (in real terms). According to the call market tracking through the network analysis methodology, there were slight changes in the main metrics with a network bias toward a lower degree of interconnection, following the trend observed in the previous period (see Figure 18). Likewise, network density, weighted average degree and assortativity present lower volatility.[40]

Figure 18 | Network metrics and graph for the call market



Source: BCRA.

5. Main macroprudential policy measures

As highlighted throughout the different sections of this Chapter, the COVID-19 outbreak led the BCRA to redirect a large part of its prudential policies to mitigate the economic and financial impact of the pandemic. Thus, preventing households and companies from facing extremely serious financial situations. In terms of the macroprudential approach, this scenario could compromise their payment capacity, generating a direct adverse effect on the economy in general and on the financial system in particular.

As a result, the BCRA implemented a set of measures to avoid exacerbating credit procyclicality. As described in detail in Exhibit 4 of this report (as well as in the Regulatory Annex), the pillars of this strategy, so far, have been the following:

39 The unsecured inter-financial loans (call) market in the Argentine financial system is small (the average daily amount traded is 1,9% compared to the stock of private sector deposits). Nevertheless, it is one of the main sources of direct interconnection among financial institutions where they manage their liquidity, besides these transactions offer price signals (rates) from unsecured transactions.
40 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 assortativity.

i. Boosting credit to the private sector, through the introduction of credit lines under favorable conditions (measures implemented together with different public sector bodies), as well as the strengthening of incentives from the 12-installment *Ahora 12* program.
ii. Easing households and companies financial situation, mainly by redesigning debtor classification criteria, more flexible payment conditions for existing loans, limits on credit card interest rates, more flexible transactions with checks, among others.
iii. Strengthening bank savings in pesos, by introducing tools such as the early payment UVA time deposits, and minimum interest rate time deposits that protect private sector credits.[41]
iv. Ensuring institutions' solvency by suspending dividends distribution.

In addition, foreign exchange market regulations were readjusted, easing the conditions for those individuals who were abroad at the time of the COVID-19 outbreak, and incorporating additional conditions for those agents who want to access the Single Free Exchange Market (MULC) and trade, at the same time, securities settled in foreign currency.

Finally, financial information criteria required from financial institutions were improved (see Exhibit 5).

41 In this context, financial institutions were allowed to fully comply with the minimum cash requirements from time deposits they receive (except for the share that may be complied with through public sector bonds) through LELIQs, while extending the surplus position allowed in LELIQ. For further details, see Regulatory Annex.

Exhibit 1 / Prudential approach to the COVID-19 shock by central banks and supervisory bodies

In response to the strong economic impact triggered by the pandemic, a wide range of central banks and supervisory bodies from emerging and developed countries began to design and implement mitigating policy actions. Overall, these actions are aimed at sustaining financial intermediation -especially in terms of credit to the real sector-, easing the excessive financial burden to which different agents of the economy may be exposed, as well as reducing tensions in financial markets. The objective is thus to preserve financial stability at a global level. Argentina is no stranger to this new scenario, having implemented in the last three months an extensive public policy program that, considering the particular features of the local economy, is in line with the tools used internationally (see Exhibit 4).

At first, the measures implemented globally to face COVID-19 sought to ensure financial institutions' business continuity in operational terms.[42] Subsequently, progress was made towards the implementation of financial relief and economic stimulus tools for the private sector. Regarding this last set of initiatives, without attempting a thorough analysis at the country level, they share a set of strategic elements and guidelines described below.[43]

First, in the context of monetary stimulus measures with added impact,[44] several administrations and central banks promoted the introduction of new credit lines, under favorable financial conditions for private sector debtors (both businesses and households). In many cases, these initiatives were complemented by efforts to provide -partial or full- government guarantees to loans to the private sector.[45]

Sovereign authorities also promoted the restructuring of the financial conditions of part of the current obligations with the financial system before the shock, as well as the implementation of additional tax relief to companies (for example, through tax deferrals, channeling of resources to pay salaries, among others). On the other hand, some sovereign agencies eased their classifications and regulatory definitions on restructured loans in the context of COVID-19, considering them as normal performance.[46] Furthermore, certain countries have decided -or are considering- to make capital injections in certain non-financial companies in the economy, which are strategic from the sovereign point of view. Although all these measures have a broad scope on the corporate sector, they have been especially channeled in many countries to relatively smaller enterprises, a segment that generally suffers more the impact of the pandemic shock.[47]

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42 Furthermore, different sovereign regulatory and supervisory authorities took actions to reduce the operational burden in the normal tasks of financial institutions, for example, temporarily postponing periodic stress tests, as well as different supervisory tasks within financial institutions, to effectively comply with social lockdown initiatives taken to reduce the spread of the pandemic among the population.
43 The purpose of this Exhibit is an overview of the measures taken at the international level, without a listing or detailed description by country. For further details at the country and regional level, see "COVID-19 pandemic: Financial stability implications and policy measures taken" FSB - April 2020,"Policy measures in response to the COVID-19 pandemic" European Systemic Risk Board, Central Banks and Supervisory Bodies websites.
44 It should be noted that, to temper the volatility recorded in financial markets early this year, several central banks injected liquidity in recent months. For further details on these measures, see IPOM of May 2020.
45 Directly provided by the government or alternatively through specific instruments as agencies and governmental financial institutions, among others.
46 Additionally, in certain cases, guidance was given to implement accounting regulations, emphasizing the flexibility provided by the standards when evaluating the impact of credit losses.
47 In some cases, specific limits were defined for companies accessing these benefits, such as share repurchase terms, changes in workers compensations, repayment of other debts, or access to certain markets (e.g. the exchange market).

Additionally, other actions were taken regarding international regulatory frameworks, to ensure that financial institutions maintain their levels of credit to the productive sector and households. In jurisdictions where, prior to COVID-19, countercyclical capital buffers were effective, given the new context, the corresponding authorities reduced and even disabled them completely. Regulatory authorities also reduced other current capital margin requirements (such as those used on domestic systemically important banks).[48] Likewise, some regulatory authorities began to recommend and encourage financial institutions to use the aforementioned capital buffers and liquidity margins to sustain credit to the private sector. These initiatives were in line with the recommendations of the Basel Committee on Banking Supervision (BCBS) and other international organizations, encouraging the use of capital and liquidity margins driven from Basel III in case of a shock as the current one,[49] as well as the different degrees of flexibility currently in force in international standards.

Finally, several economies established temporary restrictions on financial institutions' dividends distribution, share repurchase and bonds payment to some of their authorities so they may preserve the levels of capital necessary to maintain credit to the private sector.

48 In certain countries , the leverage ratio has been temporarily modified (e.g. excluding certain items from the calculations).
49 See "Basel Committee coordinates policy and supervisory response to Covid-19", March 2020.

Exhibit 2 / COVID-19 and challenges to global financial stability

The COVID-19 pandemic forced the implementation of a series of health measures worldwide, generating great uncertainty regarding the evolution of global economic activity that worsened over time, given the difficulties in defining the duration and extent of the shock.[50] As to financial markets, the pandemic acted as a trigger for an abrupt and significant change in investors' risk perception, exacerbating uncertainty.

As mentioned in previous editions of the IEF, the increasing vulnerability in global financial markets in recent years turned them susceptible to an eventual sudden stop in response to a change in risk aversion.[51] Namely:

- **A long period of international interest rates at historically low levels and search for higher yields**. With available funding and perceived risk at unusually low levels, investors widely looked for segments of greater relative risk, including riskier -high yield- stock market and debt market, from both developed and emerging economies. In recent years, the possibility of overvaluation signs and, eventually, a potential price correction, increasing the market risk faced by investors in certain segments, began to be considered. The search for higher yields also implied a growing positioning in less liquid and/or more complex segments, with strong growth in recent years,[52] whose performance under stress situations has not yet been properly tested.
- **Growth in non-bank financial intermediation worldwide, led by investment fund activity**. The search for higher yields was offset by a growing weighting of "other financial intermediaries", as the FSB calls them in its annual global monitoring on the subject (see Figure A.2).[53] Almost half of this non-bank financing occurred through a growing positioning in different types of investment funds: classic open investment funds (including money market funds) and so-called exchange-traded funds (ETFs), in addition to hedge funds, among other alternatives.[54] Given that most of these funds include the possibility of redeeming relatively quickly, their positioning in lower relative liquidity segments triggers possible growing tensions in an adverse situation. The greater interconnection between different market segments leading to investment funds growth[55] is also evidenced in portfolio flows between countries (for example, through funds investing in assets from emerging economies).

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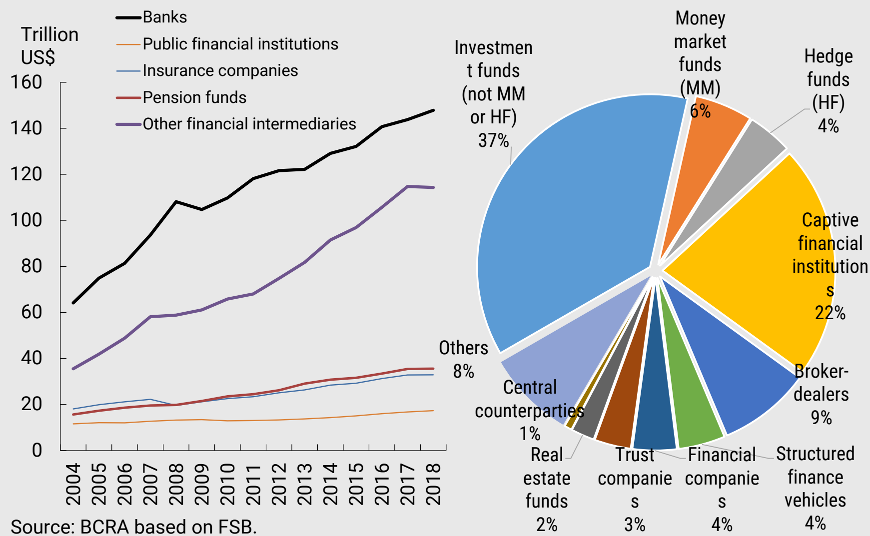
50 See IPOM for May.
51 In general, the risks weighed as potential triggers of a sudden stop, prior to the pandemic scenario, were mostly linked to geopolitical factors (such as tensions between China and the United States, Brexit and conflicts in the Middle East).
52 This covers not only high-yield bonds from developed and emerging economies, but also other high-growth segments such as leveraged loans and the structured products derived from them (collateralized loan obligations -CLOs-).
53 See "Global monitoring report on non-bank financial intermediation 2019", published by the FSB and "Non-bank financing in Argentina" in IEF IH-19. In Figure A.2.1, according to data from this FSB monitoring, public financial institutions are those government financial institutions not included in other items. In turn, the category of "captive financial institutions" includes institutions from economic groups that finance said group.
54 In the specific case of emerging economies, there was also a significant growth in financing granted by finance companies and other non-bank credit providers (such as credit cooperatives).
55 For example, money market funds are often highly interconnected with the banking sector.

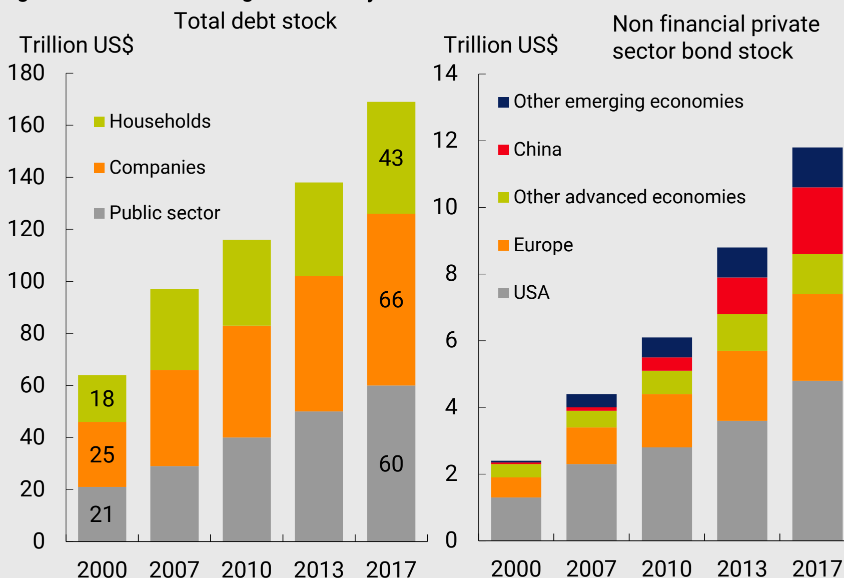
Figure A.2.1 | Evolution of global financial intermediation and composition of the Other Financial Intermediaries



Source: BCRA based on FSB.

- Widespread leverage growth in both the public and private sectors (although with diversity among countries). With investors seeking higher yields, there was a boom in both public and private debt issuing in international markets (a phenomenon that in certain countries was accompanied by a growth in domestic financial markets). This growing global leverage (see Figure A.2) translates into a rise in credit risk, with a greater vulnerability of debtors to more adverse contexts in terms of economic growth and available alternatives to refinance.

Figure A.2.2 | Amount of global debt by sector and debt in bonds



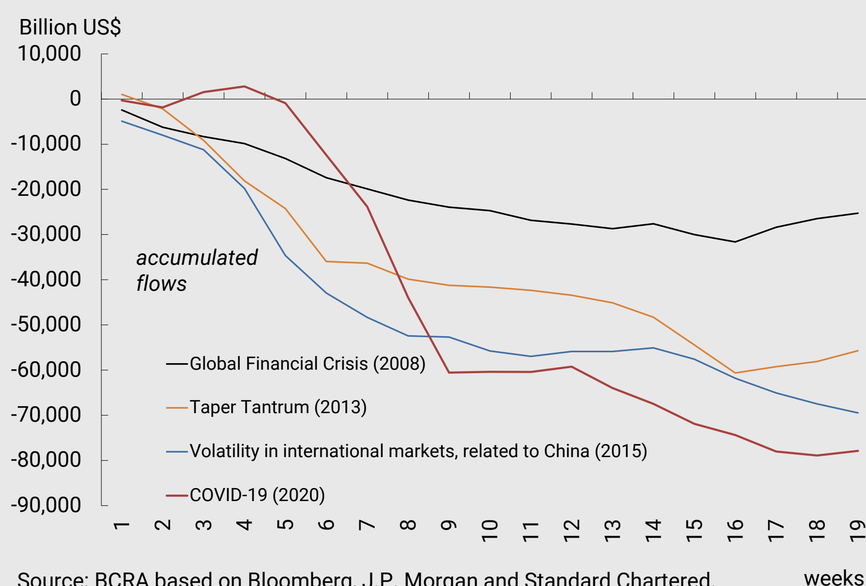
Source: BCRA based on McKinsey Global Institute.

Given these vulnerabilities, once volatility in financial markets began to increase globally in February due to the spread of COVID-19, it reached in a few weeks levels not seen since the 2008-2009 international financial

crisis. The VIX index went from an average below 14% in January to peaking above 80% by mid-March (contracting later to levels below 30% in mid-May).[56] This was accompanied by a significant decline in equity prices (for example, the US S&P500 contracted almost 30% between mid-February and mid-March), together with signs of repositioning in liquid and short-term lower relative risk assets.[57]

This behavior had a clear impact on markets of emerging economies, with stronger outflows of investment funds specialized in these economies than those observed in previous crises (see Figure A.2)[58] and increased pressure on currency markets. Emerging currencies depreciated an average of 12% against the dollar between mid-February and the end of April[59] (see Figure A.2.), although in specific cases such as the Brazilian real, the Mexican peso or the South African rand they depreciated close to above 30%. This implied significant declines in emerging stock indices (the MSCI EM index measured in dollars fell by more than 30%) and a jump in sovereign and corporate debt spreads in dollars (the *EMBI* spread doubled from almost 300 bps to more than 600 bps in the second half of March, and the CEMBI showed a similar behavior).

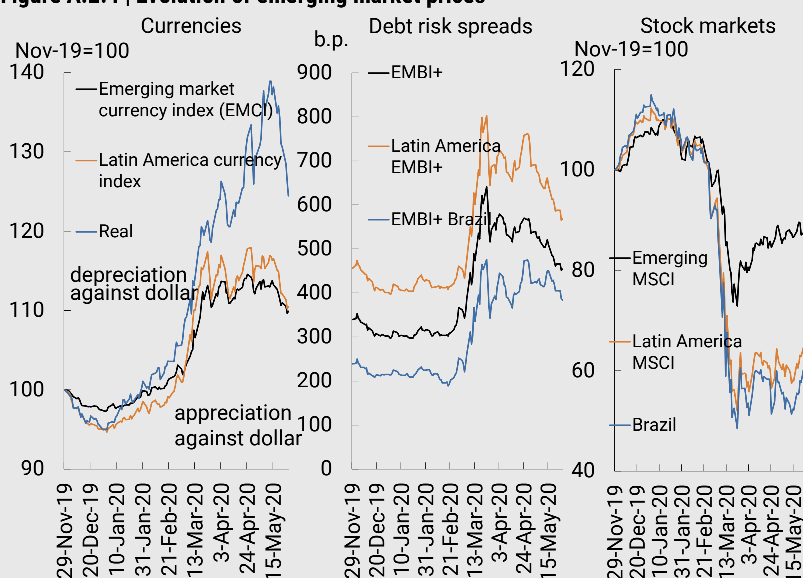
Figure A.2.3 | Weekly outflows from funds specialized in emerging assets compared to previous periods of turbulence



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

56 The VIX reflects the expected volatility for US stocks (implied volatility derived from options on the S&P500, in percentage). It is considered one of the best proxies to measure global risk aversion (in periods of high risk aversion, VIX shows values well above its historical mean -around 19%-).
57 10-year US Treasury yields went from 1.6% in mid-February to 0.6% at the end of April. The US Federal Reserve announced on March 23 the purchase of treasury securities in the amounts needed to ensure proper economic performance. Thus, Federal Reserve treasuries increased from US$2.6 trillion in mid-March to US$4 trillion at the end of April.
58 As evidenced by high-frequency estimates such as those prepared by the Institute of International Finance (IIF) Emerging Portfolio Fund Research (EPFR). Initially, the strongest outflows were linked to the sale of shares, although bonds were also observed later.
59 Emerging currencies considered according to JPMorgan EMCI index.

Figure A.2.4 | Evolution of emerging market prices



Source: BCRA based on Bloomberg.

Although this shows tensions in global financial markets (with an impact on the real economy) in a context of vulnerabilities prior to COVID-19, it should be noted that no disruptive situations have been observed at a systemic level so far. Markets' volatility has been diminishing since mid-March[60], partly in response to the policy actions implemented in developed and emerging economies (although the VIX index remains above its historical average). On the other hand, it should be noted that after the international financial crisis that peaked in 2008-2009, an effort of greater global coordination was made to implement new standards on prudential regulation and financial sector supervision, resulting in higher resilience.[61]

This is an ongoing episode and, given the aforementioned vulnerabilities, different sectors are permanently monitoring several key factors to understand the evolution of tensions, the impact on financial stability worldwide is being monitored from different spheres (as a disruption in financial markets would imply second-round effects, aggravating the initial shock) and the possible need for new policy measures. The main variables monitored include: a) permanent availability of financing to the corporate sector and households through financial institutions and markets (in response to the measures implemented by the different central banks to inject liquidity and boost credit); b) the evolution of the credit risk of different economic agents and its impact on different counterparties, in an interconnected system; c) the evolution of open investment funds globally as well as potential tensions in specific market segments in the event of greater redemptions, including effects on emerging economies; and d) the existence of currency mismatches between different agents (particularly in dollars, given the boom in debt issuing in this currency in recent years) and the possibility of refinancing in this currency.[62]

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60 This was accompanied by some recovery in the prices of assets with higher relative risk, such as developed economies' stocks and emerging economies' instruments. According to EPFR data, outflows from investment funds specialized in emerging markets continued in May.
61 See "*Progress in implementation of G20 financial regulatory reforms*" published by the FSB in mid-2019.
62 In the case of Argentina, this IEF mentions various aspects to monitor related to these dimensions, especially concerning the availability of financing and the evolution of credit risk (targeted by several of the policy measures of the last months).

Exhibit 3 / Policy actions to restore the sustainability of public debt in Argentina

In the second half of 2019, with no access to international markets and unable to refinance short-term debt maturities in foreign currency, the National Executive Branch decided to reschedule short-term Treasury Bills (LETES) denominated in dollars and announced the intention of advancing in a voluntary extension of the terms of some government bonds.[63] In December, after the change of administration and through Law No. 27.541 on "Social Solidarity and Productive Reactivation", the National Executive Branch was empowered to carry out the necessary actions to recover national public debt sustainability. At the end of last year, communication channels with creditors and financial institutions began to be established for a new maturity profile.

At the end of January, a timeline of actions was defined to manage the process of restoring the sustainability of external public debt, enacting in February Law 27.544 on "Restoring the sustainability of public debt issued under foreign law". This Law authorized the National Ministry of Economy to carry out several operations to achieve this objective following section 65 of Law No. 24.156 on Financial Administration and Control Systems of the National Public Sector. The restructuring perimeter of the debt in foreign currency with the private sector was defined in early March (Executive Order 250/2020). National Authorities made two presentations in March on the debt sustainability framework, including general criteria and underlying macroeconomic assumptions[64] to guide a constructive and good faith interaction with Argentine debt holders. These presentations included an explanation of the guidelines of a comprehensive strategy to address payments to different creditors for a total debt balance of US$323 billion at the end of 2019, consisting of:

- **Debt with the public sector (including the Central Bank, Banco de la Nación Argentina -BNA- and the National Social Security System -ANSeS-).** This debt, which represented 40% of the total at the end of 2019, will be refinanced in the future considering the objective of safeguarding monetary and financial stability;
- **Debt with official creditors.** Discussions began with the IMF seeking a new program that would allow refinancing the line already granted by this institution in 2018 and 2019 (14% of total debt as of December 2019). Similarly, progress will be made in the dialogue with other international organizations and official bilateral creditors to agree on a refinancing;
- **Debt with the private sector.** A strategy was proposed for instruments in domestic currency and foreign currency (37% of the total including both types).

Concerning the latter group of creditors, the main guidelines and progress for the different existing segments are detailed below.

1. **Debt with the private sector: government bonds in domestic currency**

Since the end of 2019, measures began to be implemented to rebuild a yield curve in pesos, refinance the debt at sustainable rates, and extend maturities. New short-term bills in pesos with Private Banks BADLAR

63 See IEF IIH-19.
64 See IPOM May 2020.

coupon plus a margin (LEBAD) were issued. Since March, bills in pesos began to be issued at a discount in refinancing auctions. Peso-denominated CER-adjusted bonds and bills at a discount (BONCER and LECER) were also issued. The term of peso-denominated government placements was successfully extended, while the cost of financing decreased. This line of work will be maintained through new auctions for instruments in pesos, following a month by month timetable.

In parallel, constructive discussions advanced with pre-existing bondholders to renew debt service obligations, while ensuring the sustainability of the debt in general. The latter implied several auctions of new short-term bills and bonds through integration in kind and pre-existing instruments swap.[65] Overall, a fixed basket of instruments, including bills at a discount and new BONCERs were offered in the latest swap and exchange of assets. The new BONCERs were issued with 1 to 4-year terms and coupons in a range of 1% to 1.5% (on CER-adjusted capital). Close to half of the principal and interest maturities of 2020 government bonds in pesos have been rescheduled so far as a result of swap transactions.

Regarding the secondary market for new instruments, liquidity is still very limited in the case of LEBADs and bills at discount in pesos. In turn, operations with new BONCERs and, to a lesser extent, Badlar+100bp Bond maturing in August 2021 became more dynamic.

2. Debt with the private sector: government bonds in foreign currency under domestic law

For this segment, including both 2005 and 2010 swap bonds issued under Argentine law (US$3.5 billion) as well as BONAR (US$10.2 billion) and LETES (US$3.9 billion) subsequently issued under the same legislation, Executive Order 346/2020 of April 5 established the deferral of payments of interest and amortization of principal until the end of 2020 or until a previous date, whichever the Ministry of Economy determined, considering the degree of progress and execution of the process to restore public debt sustainability. Likewise, the Ministry of Economy was authorized to carry out the necessary swaps and/or restructurings of these government bonds. In this sense, two asset swaps were conducted in May, offering BONCER to LETES holders. As a result, approximately half of the LETES held by the private sector were swapped.[66] A fixed BONCER portfolio was delivered maturing in 2022, 2023 and 2024 and with interest coupons with a 1.2% to 1.5% range.

3. Debt with the private sector: government bonds in foreign currency under foreign law

These include both bonds from the 2005 and 2010 swaps issued under foreign law and global bonds issued from 2016 onwards (BIRAD bonds). In this case, a swap proposal was formally presented on April 17 for 21 pre-existing bonds with a balance of US$66.238 billion[67] (of which US$41.548 billion were issued between

65 In chronological order, LECAP were swapped for LEBAD in mid-January, the Dual Bond AF20 was swapped in early February for a range of bonds, LECAP, LELINK and (old) LECER were swapped for LEDES and (new) LECER, Dual Bond 2020 for BONCER 2022 and other instruments during March plus the refinancing by means of integration in kind of the BOGATO 2020 bond for LEDES and BONCER. Furthermore, there was an asset swap in March, including, in addition to LECAP, some of the LEBADs and recently issued short-term bills at discount and BOTAPO (maturing in June 2020) for a basket of BONCER, to improve the maturity profile. Most recently, the BONCER 2020 was swapped.
66 The eligible bonds in both operations were 12 LETES, including the Dual Bonus 2020 as eligible bond. In the first operation, since the offers received exceeded the maximum amount to be issued, an 81% prorating factor was applied to the offers.
67 Exchange rate corresponding to December 31, 2019.

2016 and 2019), with an acceptance deadline on May 8, subsequently extended three times, to May 22[68], June 2 and June 12. In early June, dialogue with creditors continued, discussing proposals to reach an agreement[69].

The swap proposal for new bonds contemplates eligible bonds issued in 3 different currencies (dollars, euros and Swiss francs) and two laws (see Table A.3.1). For each eligible bond, alternative bonds are offered in exchange (at least two, depending on the eligible bond), with different financial conditions both concerning the nominal haircut applied (ranging from 0% to 12% in the series in dollars, and from 0% to 18% in the series in euros and in the series in Swiss francs). The bonds issued in the 2005 and 2010 international swaps have 3 alternative swap options, two of which have no nominal haircut. The new bonds have a 3-year grace period in which no interest is accrued, and will subsequently pay a step-up coupon from 0.5% to a maximum of 4.875%. On the other hand, there is a maximum limit for the issuing of the new shorter-term bonds (maturing in 2030 and 2036 both in dollars and in euros) proposing thus a cascade scheme for swap allocation (not applicable in certain cases).

Table A.3.1 Example for eligible bonds in dollars: summary of financial conditions of new bonds and swap options

New bonds:	US$ 2030 bond	US$ 2036 bond	US$ 2039 bond	US$ 2043 bond	US$ 2047 bond
Maturity	Nov-30	Nov-36	Nov-39	Nov-43	Nov-47
Nominal haircut	12%	5%	Without haircut	Without haircut	5%
Coupon (semi-annual frequency)	No payments during first 3 years, then step up 0,5%-1,75%	No payments during first 3 years, then step up 0,5%-3,875%	No payments during first 3 years, then step up 0,6%-4,5%	No payments during first 3 years, then step up 0,6%-4,875%	No payments during first 3 years, then step up 0,5%-4,75%
Principal repayment (annual payments)	5 payments, beginning in 2026	6 payments, beginning in 2031	11 payments, beginning in 2029	14 payments, beginning in 2030	20 payments, beginning in 2028
Average life (years)	8.5	14	14.5	17	18
Eligible bonds for new bonds:	BIRAD 2021 BIRAD 2022 BIRAD 2023 BIRAD 2026 BIRAD 2027 BIRAD Jan-2028 BIRAD Jul-2028 BIRAD 2036	BIRAD 2021 BIRAD 2022 BIRAD 2023 BIRAD 2026 BIRAD 2027 BIRAD Jan-2028 BIRAD Jul-2028 BIRAD 2036 BIRAD 2046 BIRAD 2048 BIRAD 2117	Discount bonds 2005 and 2010 Par bonds 2005 and 2010	Discount bonds 2005 and 2010 Par bonds 2005 and 2010	BIRAD 2021 BIRAD 2022 BIRAD 2023 BIRAD 2026 BIRAD 2027 BIRAD Jan-2028 BIRAD Jul-2028 BIRAD 2036 BIRAD 2046 BIRAD 2048 BIRAD 2117 Discount bond 2005 and 2010 Par bonds 2005 and 2010

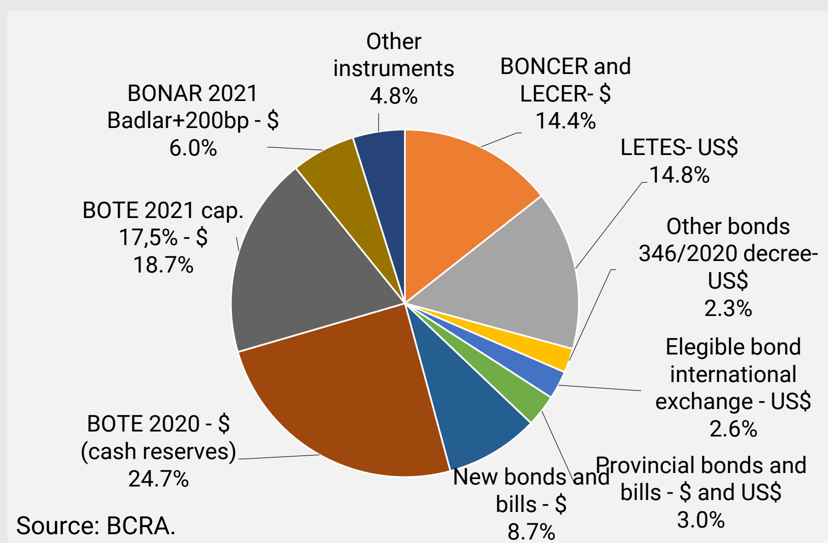
Source: BCRA based on MECON.

Regarding the possible implications of these measures for the financial system, first of all, it is important to bear in mind that financial institutions exposure to the public sector is limited.[70] As of April 2020, the set of

68 On April 22, when coupons from 3 series of eligible global bonds expired (BIRAD 2021, 2026 and 2046), the Ministry of Economy announced that they would not be paid and that the 30-day grace period would be used (which expired on May 22, the first date of the term extension).
69 On May 28, certain parameters were presented to contribute to the debate, although the proposal had not been modified upon the release of this report.
70 See Exhibit 1 "Low exposure of the financial system to the public sector risk" in IEF IIH-19.

instruments in pesos has a higher weight ($533 billion at book value and approximately $835 billion at residual value) in the government bond portfolio of the financial system (for a total of $671 billion at book value)[71]. Bond holding resulting from the aforementioned refinancing and swap of instruments in pesos represents around 19% of the total book value of the bond portfolio. In turn, dollar bond holding under domestic law included in the reprofiling of Executive Order 346/2020 amounted to $115 billion at book value (17% of the total book value and US$ 2.3 billion at residual value), consisting almost entirely of LETES at the end of April (87%). As mentioned above, these LETES began to be swapped in May through asset swaps for BONCER[72]. Finally, the financial system has a very limited position in bonds eligible for the swap of government bonds under foreign law ($18 billion at book value or US$ 275 million at residual value), equivalent to only 2.6% of the total bond portfolio book value (see Figure A.3.1).

Figure A.3.1 | Composition of the government bond portfolio of the financial system
Book value as of April 2020



71 Excluding LELIQ, including provincial and municipal bonds.
72 Communication "A" 7014 of May 14, established that public sector debt instruments received in exchange for others shall be measured at the time of initial recognition at the book value of the instruments in exchange at such date.

Exhibit 4 / Main measures taken by the BCRA to mitigate the economic impact of COVID-19 on companies and households

Anticipating the economic impact that the pandemic would unleash, in parallel to the beginning of the social lockdown implemented by the Government, the BCRA designed a set of tools to temper its effects on both companies -especially MSMEs- and households. These initiatives, which complement the fiscal efforts introduced by the National Executive Branch (PEN), were implemented considering the strengths that the financial system has developed in recent years, especially in terms of the sector's broad liquidity (see Section 2). This Institution has thus implemented in the last three months a program that includes tools both to address financing conditions for all components of the private sector, and to strengthen bank funding, especially by channeling savings in pesos.

I. Tools to ease businesses' financial situation

I.i. MSMEs credit line. This credit line was designed to finance MSMEs working capital needs, especially for the payment of salaries and health service providers purchasing of inputs.[73] It was implemented on March 20 with an annual nominal interest rate of up to 24%, below-market rates. The BCRA included a regulatory incentive for it, as institutions offering it obtain a reduction in their minimum cash requirements for the equivalent of 40% of the loans. At the time this IEF was released, the financial system accumulated disbursements for almost $236 billion (equivalent to 12% of the total financing in domestic currency at the beginning of the lockdown -March 20-), directly benefiting an estimated total of 144,000 firms.[74] The resources were mainly channeled to finance the payment of salaries, coverage of checks and other working capital needs of MSMEs (see Table A.4.1). To further boost this initiative, the Government promoted the granting of guarantees through the Argentine Guarantee Fund (FOGAR).[75]

I.ii. Credit line for MSMEs without financing. In May, this credit line was extended at an interest rate of up to 24%,[76] enabling access to those MSMEs without bank financing (almost 200,000 in the country). Institutions must grant said credits to companies with FOGAR guarantees (accessing the aforementioned regulatory benefits).

It should be noted that both measures contribute to reinforcing the efforts the BCRA had already begun to implement in early 2020 when greater regulatory incentives were introduced for institutions to channel below-market interest rate resources to MSMEs.[77]

73Communications "A" 6937, 6943 and amendments.
74Information on the number of companies is not consolidated.
75 Executive Order 325/2020.
76Communication "A" 7006.
77 Communications "A" 6858 and 6901.

Table A.4.1 | MSMEs credit line

		Loans - Amount		Loans - Quantity		Average amount
		In mill. $	In %	In quantity	In %	In mill. $
MSMEs	Payroll payments	53,145	22.5	51,980	36.1	1.0
	Coverage deferred checks	53,229	22.6	29,070	20.2	1.8
	Other working capital	113,864	48.3	62,125	43.1	1.8
	Other	8,997	3.8	570	0.4	15.8
Health service companies		6,694	2.8	258	0.2	25.9
TOTAL		**235,929**	**100.0**	**144,003**	**100.0**	**1.6**

Note: Information as of 8/6. Source: BCRA

II. Tools to ease households financial situation

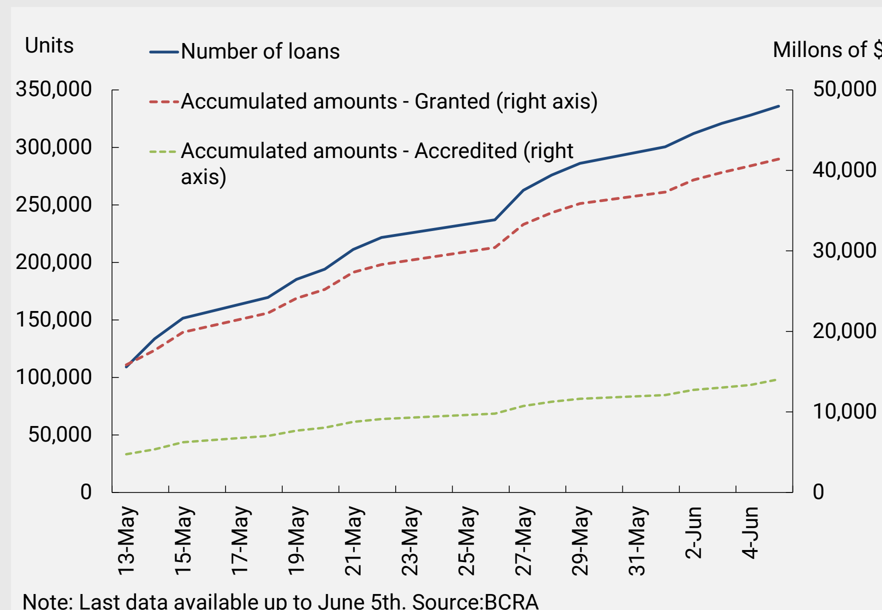
II.i Boosting *AHORA 12* (12 interest-free installments program). Also in parallel with the beginning of the social lockdown, the BCRA sought to encourage the growth of credit card financing within the framework of the *AHORA 12* program.[78] Regulatory benefits were, therefore, strengthened for those institutions promoting the use of this tool that improves financial conditions for household consumption, an initiative to which the BCRA had already been contributing since the beginning of the year.[79] In this sense, bank financing through this program grew in the first months of the year, reaching in March more than 30% of total credit card financing in pesos.

II.ii Credit card interest rate caps. To improve households' financial conditions, this Institution has also introduced a significant reduction in credit cards financing rates, establishing a limit that currently stands at 43% ANR,[80] below-market rates observed at the end of 2019 (almost 70%).[81] In addition, outstanding credit card debts as of April 30 were automatically refinanced with a one-year term.

II.iii Zero interest rate credit line for members of the simplified tax regime -*monotributistas*- and self-employed. In April, the National Executive Branch and the BCRA implemented a no-cost credit line for members of the simplified tax regime and the self-employed to support the financial capacity of households whose income was closely related to independent activities (affected by lockdown measures).[82] Each individual may thus access resources for up to $150,000, with a 7-month term before starting to make the established 12 interest-free payments. Institutions are obliged to credit this line to those who request it - provided certain requirements are met-, thus obtaining a significant regulatory incentive: reduction of the minimum cash requirement by 60% of these credits. In turn, the National Productive Development Fund covers all financial costs. This credit line increased swiftly (see Figure A.4.1), currently reaching a granted volume over $41 billion -$14 billion credited- to 336,000 individuals (equivalent to almost 3% of all natural persons that took bank financing as to March 2020).

78 Communication "A" 6937.
79 Communications "A" 6857 and 6910.
80 Communications "A" 6911, 6949 and 6964.
81 Furthermore, the BCRA established in mid-April that financial institutions shall automatically refinance in 9 monthly installments and with a 3-month grace period outstanding credit card balances expiring that month (Communication "A" 6964).
82 Executive Order 376/20 and Communication "A" 6993.

Figure A.4.1 | Evolution of zero interest rate credit line
Financial System



Note: Last data available up to June 5th. Source:BCRA

III. Instruments with an impact on the entire private sector

III.i. Easing of bank debtor classification parameters. The purpose of this measure is to avoid further deterioration of debtors economic-financial capacity due to the effects of the pandemic.[83]

III.ii. Reduction of current loan maturities burden. The BCRA established the elimination of punitive interest on unpaid loan installments until the middle of the year, as well as the possibility of requesting the institution to defer their payment.[84]

III.iii. Flexibility in check transactions. A set of measures were taken to ease the financial situation of the private sector that frequently uses this payment instrument.[85]

IV. Measures to strengthen savings in pesos and funding sources to promote financing

IV.i. Suspension of institutions' dividends distribution. To ensure that the sector has adequate resources to promote credit to the private sector, in a challenging economic scenario, the BCRA decided to suspend institutions' dividends distribution until the end of the year.[86]

IV.ii. Strengthening of bank savings in pesos. To strengthen bank savings in pesos, a minimum interest rate was established by mid-April to benefit depositors, a tool that was later increased and extended in scope.[87] Currently, the minimum interest rate sits at 30% for households and businesses time deposits, above the

83Communication "A" 6938.
84 Additionally, Executive Order 319/20 established temporary freezing on (mortgage/pledge-backed) UVA loan installments.
85 Communications "A" 6942 and 6950.
86 Communications "A" 6939 and "A" 7035.
87 Communications "A" 6980, 7000, 7018 and 7027.

rates observed before it became effective (20% for retail time deposits and 15% for the wholesale segment, in mid-April).[88] These measures are added to the introduction of early-payment UVA time deposits in February.[89]

88 For further details on the financial regulations adopted by the BCRA, see Regulatory Annex
89 Communication "A" 6871.

Exhibit 5 / Progress in the financial reporting criteria applicable to financial institutions

The BCRA promotes constant updating of the regulatory and accounting framework to be implemented by local financial institutions, helping to ensure that it is in line with the best international practices and recommendations on the matter. In this context, as of January 2020, financial institutions must consider the provisions regarding the impairment of financial assets included in IFRS 9 paragraph 5.5,[90] at the time of presenting their financial statements in uniform currency, following the International Accounting Standard - IAS- 29.[91] Both developments represent a relevant milestone in the process of continuous improvement in the financial information financial institutions operating domestically should provide.

As of January of this year, loss loan provisions from the largest local financial institutions (Group “A”, that is, those institutions whose assets amount to at least 1% of the total assets of the system) should be calculated according to the expected credit losses estimate as per IFRS 9.[92] In turn, the BCRA had originally provided that smaller institutions (Group “B”) had the option of prorating the impact of the expected credit losses estimate over 5 years.[93] However, given the local effects of the COVID-19 pandemic, the BCRA recently decided -among other measures taken to face this new scenario- to postpone until 2021 the application of expected credit losses calculation for smaller entities.[94]

Based on this new regulation on provisions, the expected credit loss is calculated as the difference between the contractual cash flows that a customer owes to an institution and the cash flows that the institution expects to receive from the customer.[95] In those cases in which the credit risk of a financial instrument has not increased significantly since its incorporation -initial recognition-, institutions shall record losses on that instrument for an amount equivalent to the expected credit impairment in the following 12 months (value correction). On the other hand, for those instruments in which the risk has increased significantly, the value correction shall be estimated based on the expected credit losses throughout the life of the asset.

The initial impact on the institutions that applied this new methodology (Group “A”), was reflected in the accounting in the form of adjustments to income (loss) from previous years, that is, in accumulated income (loss) that had not been allocated until January 2020. Since then, the effects of this new methodology have been materializing periodically in financial asset forecasts, monthly incorporated in profits for loss loan provisions. It should be noted that IFRS 9 regulations on the impairment of financial assets apply mainly to those instruments measured at amortized cost, at fair value with changes in other comprehensive income, accounts receivable from leases and loan agreements.

90 Communication "A" 6430.
91 Communication "A" 6651.
92 Exposures to the Non-Financial Public Sector are excluded.
93 Communication "A" 6778.
94 Communication "A" 6938.
95 The flows are discounted at the original effective interest rate.

Furthermore, the BCRA established the restatement in uniform currency of the financial statements as of the fiscal years beginning in January 2020, disseminating the procedure for its implementation[96] within the framework established by IAS 29.[97] The comprehensive adjustment for inflation includes: (i) a procedure at the beginning of the first implementation period, through which the initial adjustment is obtained in the Unassigned Profits from institutions, and (ii) a monthly mechanism to determine both profits for the net monetary position, such as the accounting balances in uniform currency at the end of each fiscal year.

The mechanism consists of the restatement of non-monetary items -among which are mainly fixed assets- and equity items, by the coefficient arising from the change in the general price index.[98] As a counterpart, the loss or gain resulting from the exposure of monetary bank items to price fluctuations is simultaneously determined. Generally speaking, monetary items consist of cash, as well as assets and liabilities receivable or payable through a fixed or determinable number of monetary units.[99]

In this context, some aspects should be considered by users of financial information based on the local application of IAS 29. Namely: 1. the profits or losses generated by monetary items measured at amortized cost or at fair value with changes in income (loss) are recorded separately (while those originated by items measured at fair value with changes in other comprehensive income -OCI- are netted directly from the change in the balance of the latter[100]); 2. the monetary income (loss) generated by the balances corresponding to deferred tax assets/liabilities is incorporated directly into the accounting charge for Income Tax, thus stated in real terms; and 3. the change in the accumulated income (loss) of the period and other comprehensive income, will include both profits/losses of each monthly period, as well as the effect of the restatement of the accumulated income (loss) at the beginning of the period (the latter effect would be the accumulated profit/loss at the end of the previous month, at prices of the current period).

Given the aforementioned changes and the information available on bank balance sheets, certain concepts are not directly comparable as of January 2020 and the previous months/years (not stated in uniform currency). As of June of this year, when financial institutions begin to report quarterly financial statements, part of the aforementioned comparisons could be made.

96 Communication "A" 6849.
97 IAS 29: "Financial Reporting in Hyperinflationary Economies".
98 The National Consumer Price Index (CPI) published by INDEC is used.
99 It should be noted that monetary and non-monetary items already stated at the measuring unit at the balance sheet date (such as those at fair values) are not restated.
100 As a result, OCI is stated in real terms.

Exhibit 6 / Technology and security challenges and risks faced by financial institutions in the context of COVID-19

The COVID-19 pandemic led financial institutions to face a wide range of financial and operational challenges triggered by the social isolation measures introduced by governments to protect citizens' well-being. To continue providing the financial intermediation services and means of payment necessary for the development of people's activities, now in a more challenging context, financial institutions had to enable their business continuity plans, taking extra precautions to avoid health risks for their employees, customers and suppliers. The initiatives were generally accompanied by different measures introduced by the regulatory and supervisory authorities, as in the Argentine case those taken by the BCRA in terms of limiting services offered in branches, implementing shift systems -with priority to pensioners and beneficiaries of social plans-, as well as a wide set of prevention tools for daily transactions.[101]

Overall, continuity plans incorporate the actions that financial institutions shall take to face extreme adverse events that, though of low probability of occurrence, should they materialize could have a significant impact on their operations and business.[102] Although continuity plans are designed to operate for limited periods, the unusual characteristics of the current pandemic required a broader range of response actions and called for greater flexibility from institutions to adapt in a very short time.

In this scenario, it became clear that the measures included in a traditional continuity plan, such as enabling remote access only to those users who operate critical services or having an alternative data processing site, do not respond to the challenges arising in today's extraordinary context. The pandemic outbreak required, among other initiatives, enabling remote work for as many personnel as possible. Therefore, organizations have to carefully analyze associated risks, implementing appropriate solutions and controls in limited timeframes.

Since there is no accurate information on the timing and how pre-pandemic operation conditions will return, organizations began to face the need to make substantive planning decisions (for example, in terms of expanding, or not, remote work permanently). Besides these difficulties, the effects of the pandemic are making clear the importance of decisions on technology and security, and as they are closely linked to the strategic vision of the business, affecting eventually investments, operational plans and efforts made by financial institutions.

In this context, it should be noted that remote work expands the borders of organizations in terms of IT security. This situation requires, among other actions, reviewing the types of remote access available, the authentication methods, the use of cloud services and users' equipment, all following the level of criticality of the service provided. It also implies strengthening training and awareness campaigns on the safe use of

101 See Regulatory Annex and Amended Tex "Financial Services in the context of the Health Emergency Pursuant to Executive Order No. 260/2020 - COVID-19".
102 In the case of financial institutions operating in Argentina, the BCRA established that they shall implement a framework to manage operational risk as a comprehensive discipline and separate from other risks. Among other considerations, the regulations established that institutions shall have contingency and business continuity plans ensuring the continuation of their operating capacity and the reduction of losses in the event of business interruption (AT "Guidelines for Risk Management in Financial Institutions").

workstations, the security control and monitoring of this new frontier and the confidentiality of the information exchanged in an organization through the use of messaging and videoconferencing tools (which must be aligned with information security policies).

On the other hand, the health measures implemented promote the use of digital financial services, with electronic payment being one of the most relevant. This drive for digitization presents the challenge of including the greatest number of citizens, within a framework of security and appropriate technological capabilities. As a result, both the number of employees and customers connected and operating digital tools online increased significantly with the pandemic, generating new opportunities for fraud, that is, cybersecurity attacks. Security awareness remains thus a powerful prevention tool. Work should also be done on the adequate suppliers service provision (especially critical services), since the same difficulties suffered by an institution could affect its suppliers, hampering normal services.

Situations like the current one makes financial systems more vulnerable, triggering an additional risk on financial stability. Different central banks, including the BCRA, have implemented a broad set of measures to address this scenario. These include distancing measures in the general operation and that with customers, urging them to use telephone and digital channels as in the Argentine case[103], testing on the capacity of critical technological infrastructures assessing the impact of the increasing use of digital services and remote work, and their continuity plans. Furthermore, there are additional efforts for banks to be vigilant about cyber threats, since there are signs of growing levels of crime globally, thus taking advantage of the context of the pandemic for email scams, phishing and malware.[104] In this sense, the BCRA issued guidelines that, addressing all banking operations, focus on the need for a new, more comprehensive -holistic- approach to cybersecurity and cyber resilience, and contribute to guiding organizations on decision making in this current context.[105] With this approach, which considers organizations as part of an ecosystem (where what happens to one member of this environment could affect several), a more resilient financial system is promoted, better prepared to respond and recover from an incident, thus strengthening financial stability.

The effects of the pandemic made clear the usefulness and benefits of having digital services in all organizations, especially in financial institutions. On the other hand, the lesson learned is that progress in this regard is still pending and that the greater the migration to digital services, the greater the emergence of new risks and challenges that have not yet been fully addressed.

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103 See Regulatory Annex and Amended Tex "Financial Services in the context of the Health Emergency Pursuant to Executive Order No. 260/2020 - COVID-19".
104 See Cybersecurity Glossary
105 Central Bank guidelines on cybersecurity for the financial ecosystem.

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.
RC: Regulatory Capital
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.