Report on Banks

AUGUST 2004

Central Bank of Argentina

Year I – No. 12

Contents

Note: This report contains information from August 2004 balance sheets available on 22/09/04. Description centers mainly on the behavior of the main financial variables for the private bank aggregate (including breakdowns by uniform sub-groups), except for certain variables that explicitly refer to public banks and the entire financial system. Figures provided (particularly in the case of profitability) are preliminary, and may be subject to change.

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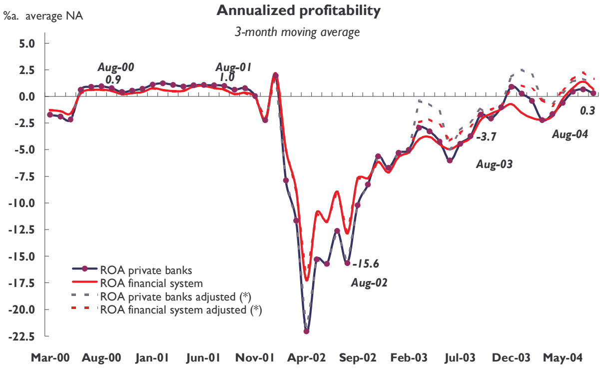
Summary

- The financial system recovered its profitability during the month, recording profits for $140 million. Excluding the amortization of court orders and adjustments to the valuation of public sector assets, the system achieved a profit of $320 million in August. So far in 2004, the financial system has accumulated a positive result of $1.1 billion, equivalent to 0.8% of assets in annualized terms (a.). This compares favorably with adjusted losses for $3.3 billion in the same period of the previous year (-2.7%a. of assets).
- Private banks showed a profit of $65 million (0.7%a. of assets). A total of 70% of private banks (42 out of 61) showed positive results (5 more than in July). In 2004 to date, private banks have accumulated losses of 0.7%a., which becomes a profit of 0.7%a. if the amortization of court orders and adjustments to the valuation of public sector assets are removed from the calculation.
- Improved results were a reflection of the lower impact from extraordinary adjustments; unlike July, this month there were no significant portfolio sales at below book value, nor significant adjustments to capitalized compensation.
- The main income and expenditure headings for private banks remained steady, as the improvements achieved in recent months have become consolidated. Loan loss provisions have remained low (0.4%a. of assets), and there have been slight increases in gains from securities and from exchange rate differences. Further efficiency gains have been registered. The ratio of income to operating costs went up from 119% to 140%.
- Private sector deposits have been the main source of private bank funding in August. Time deposits grew by almost $700 million, with a rise in deposits in pesos not subject to adjustment ($370 million) that for the first time this year exceeded CER-adjusted deposits (which rose by $270 million).
- In the year to date total consolidated financial system deposits have increased by 21%, with a sharp increase in deposits by the public sector. Deposits in pesos rose by 16% in the period. The private bank segment saw an annual increase of 13%, with more than 70% of the growth explained by deposits by the private non-financial sector.
- Given the perception by banks of a lower credit risk, loans to the private sector represented the main use of funds by private banks ($475 million). Commercial loans accounted for most of this growth, having increased by $280 million. In 2004 to date, these loans have increased by 29%, while the total went up by 15%.
- The quality of loans to the private sector has continued to recover. In the case of private banks, non-performance fell to 19.6%, a monthly drop of 0.8 p.p., or 11 p.p. since December 2003. Both the commercial portfolio and the consumer loan portfolio registered lower non-performance levels. The commercial portfolio continues to register the largest improvement, although its non-performance level is higher (23.3%, almost 10 p.p. higher than in the case of consumer loans)
- The potential impact on private bank net worth from additional losses from private sector uncollectability has been significantly restricted. Net worth exposure to credit risk remains at a low level (3.5% of net worth).

Chart 1
Annualized profitability
3-month moving average



(*) Excluding amortization payments for court-ordered releases and adjustments to the valuation of public sector assets

Chart 2
Historical volatility of results
Private banks - standard deviation over 6 months

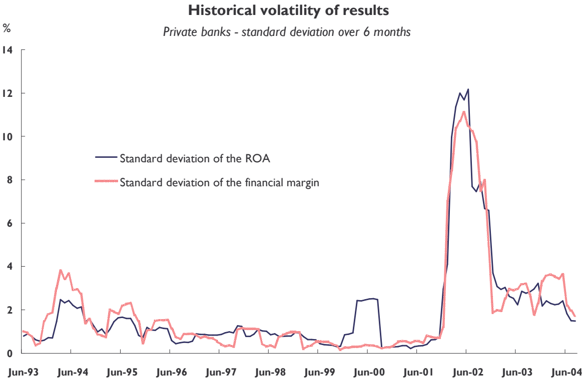
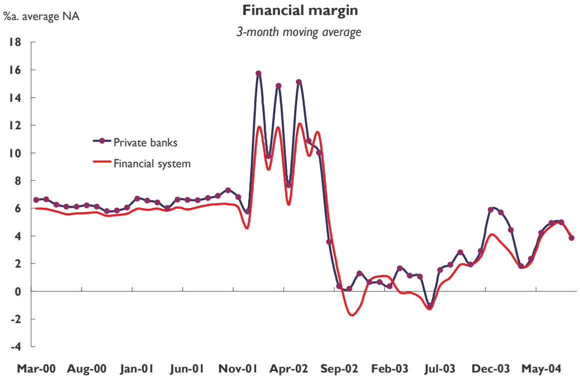


Chart 3
Financial margin
3-month moving average



Profitability*: back in black*

Financial system results recovered in August, after a temporary drop in the previous month. Profits totaled $140 million for the system aggregate, with an annualized (a.) return of 0.8% in terms of assets, one percentage point (p.p.) above the result for July. In the last three months, profitability has amounted to 0.7%a. of assets (see Chart 1), marking a significant improvement compared to the same period in 2003, when losses reached a level of 3.9%a.. In 2004 to date, the financial system has accumulated a loss of close to $520 million (-0.4%a. of assets). **The accumulated result for 2004 is transformed into a profit of almost $1.1 billion (0.8%a.) if the main effects arising from the gradual recognition of the impact of the recent crisis are excluded**: the amortization of court-ordered payments and the adjustment to the valuation of public sector assets. **This shows a substantial improvement compared to the accumulated adjusted result for the same period of the previous year, a loss of $3.3 billion or 2.7%a. of assets.**

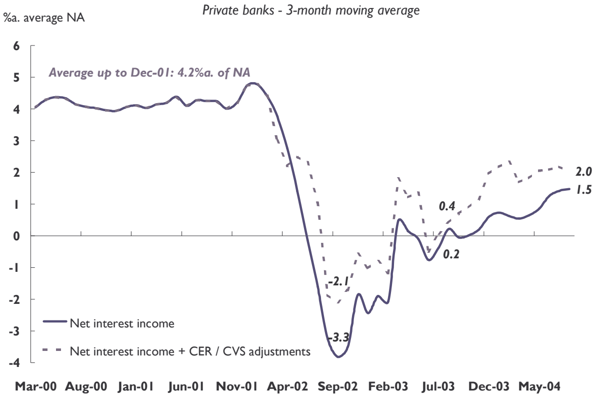
Improved results were recorded in August by both public banks (a profit of $60 million) and private banks (a profit of $65 million). While in the case of public banks results rose by 0.2 p.p. to 0.9%a. of their assets, in the case of private banks the improvement was in excess of 1 p.p. (to 0.7%a.). Almost 70% of private banks (42 institutions, 5 more than in July) showed profits. Although the accumulated total for the year for private banks remains a loss for close to $520 million (-0.7%a. of assets, 3 p.p. less than in the same period of 2003), this loss is transformed into a profit of a similar size (0.7%a.) if the effect of the amortization of court-ordered payments and the adjustment to the valuation of public sector assets is excluded from the calculation.

The change in profitability for private banks in August reflects the lack of any large negative adjustments, enabling an improvement in the interest rate margin and sundry results (two of the headings most affected by the non-recurring adjustments made in July). In general terms, the rest of the components of the profitability structure remained stable. **Although the main income lines have succeeded in remaining above the levels obtained up to the end of the previous year, it should not be forgotten that the strengthening of the profitability of the banking business is a process that is still taking place (see the Financial Stability Bulletin for the second half of 2004, Chapter V[1]).** This is particularly true in terms of the volatility to which banking results remain subject; currently such levels are similar to those seen during the Tequila crisis (see Chart 2).

The financial margin for private banks increased by 1 p.p. in August, to a level of 3.9%a.. In July this margin had been adversely affected by a large sale of assets at under book value. The main components of the financial margin did not change compared with the previous month, with a consolidation of the progress achieved in recent months that has helped to improve significantly on the level

[1] Available at the Central Bank Website: www.bcra.gov.ar/pdfs/polmon/bef0204e.PDF

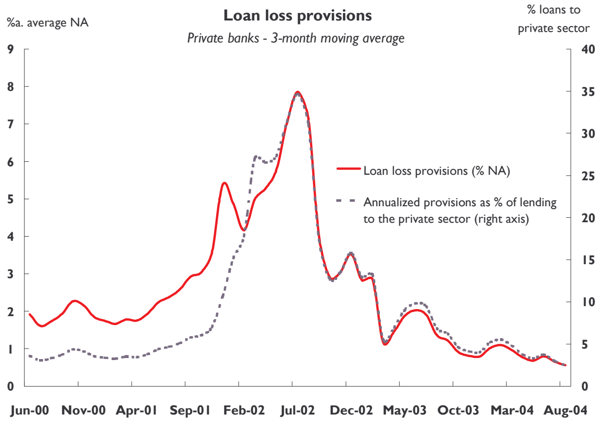
Chart 4
Net interest income
Private banks - 3-month moving average



obtained during the first quarter of the year, when this margin did not exceed 2%a. of assets (see Chart 3).

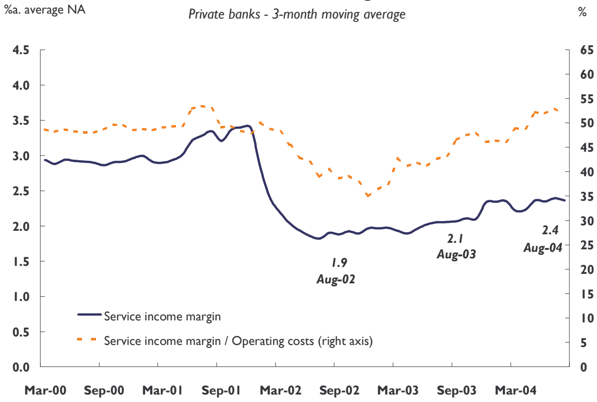
The sum of the main elements determining the yield on private bank interest-bearing assets (income from interest and accrued CER) remained at around 2%a. in August (see Chart 4), with a slight monthly drop. This decline was explained by **a slight reduction in CER accrual,** as interest results remained steady: while in the case of income, higher interest on overdrafts and promissory notes offset the fall in the collection of interest on mortgage loans, interest payments on time deposits increased, this effect being offset by a decline in other interest payments. In turn, **income from government securities increased slightly in August**, reaching a level of 1.1%a.. Also, **adjustment for the restatement of items in foreign currency (exchange rate differences) increased slightly,** remaining at close to 1%a. of assets. In relation to this latter factor, there has been a notable drop in the volatility of the exchange rate in recent months compared with the previous year, leading to lower changes due to exchange rate differences.

Chart 5
Loan loss provisions
Private banks - 3-month moving average



Loan loss provisions, a component of the cost structure of banks that to a certain extent allows for correction of the financial margin on the basis of the losses expected from lack of repayment, increased 0.2 p.p. in August in the case of private banks, reaching a level of 0.4%a. of their assets. This level is still low when compared with recent years: **provisions for July and August were the lowest since the outbreak of the crisis at the end of 2001** (see Chart 5). Levels in the last two months are even below those in the period prior to the crisis, whether measured as a percentage of assets or as a share of the stock of loans. This current behavior by loan provisions is affected by various factors, including the drop in credit risk under conditions in which the fundamental variables of most economic agents have recovered, financial intermediation remains low (measured in terms of lending to the private sector), and the over-reaction in the setting up of provisions at the peak of the crisis, when significant provisions of a general nature were set up at a time of considerable macroeconomic uncertainty.

Chart 6
Service income margin
Private banks - 3-month moving average



The increase in the financial margin easily surpassed **the slight drop in net commission income (income from services)**, which for private banks ended the month at a level of 2.3%a. of assets. Nevertheless, income from services continues to reflect gains in year-on-year terms: both for August or if accumulated over the last three months, income from services increased by 0.3 and 0.5 p.p. compared to the same period in 2003 and 2002 respectively (see Chart 6). In a context in which **operating costs have remained stable** – having shown no monthly variation and continuing to stand at 4.5%a. – there were efficiency gains as **the ratio of income to costs went up from 119% in July to 140% in August.** In the last three months, this efficiency ratio has reached a level of 137%, significantly higher than in the same period of the previous year, when the financial margin and income from services barely covered three-quarters of total operating costs (see Chart 7). This progress in year-on-year terms is largely explained by the renewed momentum of income, in particular interest income, CER adjustment, gains from securities and income from services.

Chart 7
Operating costs
Private banks - 3-month moving average

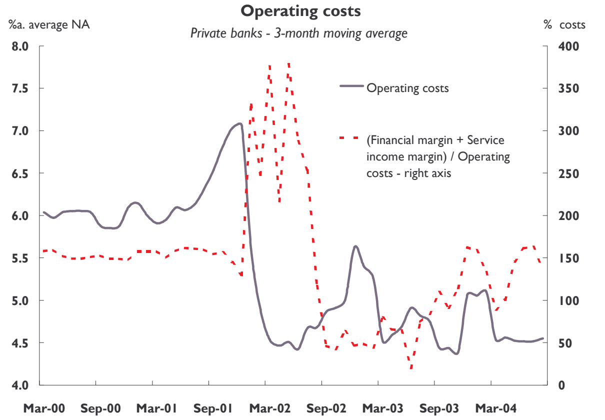


Chart 8
Netted assets and net worth
Private banks

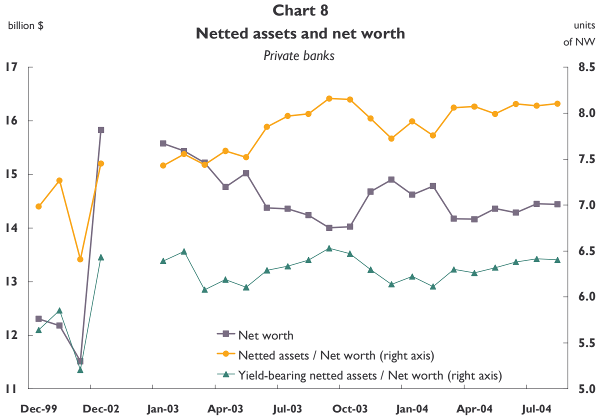


Table 1
Main developments in September

	Aug	Sep	Chg. %
Prices			
Exchange rate ($/US$)[1]	3.00	2.98	-0.59
CPI	148.51	149.45	0.63
CER[1]	151.44	152.00	0.37
	%		Chg. (p.p.)
Average percentage rates			
Lending			
Private banks			
Overdraft	12.4	12.0	-0.4
Promissory notes	9.0	10.1	1.1
Mortgage	10.4	10.4	0.0
Pledge-backed	12.5	13.4	0.9
Personal	31.0	29.5	-1.6
Public banks			
Overdraft	16.6	11.4	-5.2
Promissory notes	9.9	8.7	-1.2
Mortgage	8.4	8.6	0.2
Pledge-backed	14.2	14.1	-0.1
Personal	13.7	13.0	-0.7
30- to 44-day time deposit	3.7	4.0	0.3
6-month LEBAC in pesos, w/o CER	6.9	6.8	-0.1
	million $		Chg. %
Balance[1] - Private banks			
Peso deposits - Private sector	45,731	45,909	0.4
Sight deposits	25,236	25,298	0.2
Time deposits	18,550	18,872	1.7
Peso loans - Private sector	22,128	22,418	1.3
Overdraft	5,591	5,554	-0.7
Promissory notes	4,104	4,294	4.6
Mortgage	5,274	5,262	-0.2
Pledge-backed	661	687	3.9
Personal	1,845	1,969	6.7

(1) End of month figure.

In August there were lower downward adjustments to compensation totals capitalized by banks, ensuring that sundry income became one of the drivers behind the improvement in results, rising almost 1 p.p. to 0.8%a. of assets. Nevertheless, given the volatility shown by such adjustments, the likelihood of further adjustments with a negative impact on bank income statements cannot be ruled out. Lastly, the main factors derived from the gradual recognition of the effects of the recent crisis have continued to show a stable performance: **while the amortization of court-ordered payments rose slightly – up to close to 1%a.. – adjustments to the valuation of public sector assets represented a loss of 0.1%a. of assets**.

Private bank net worth remained steady during the month, with profits being offset by negative adjustments to the results of previous years. In view of the behavior of netted assets, the leverage ratio – defined here as netted assets over net worth – remained at the level of the previous month (see Chart 8). **Regarding compliance with minimum capital regulations, the ratio of capital requirement compliance over risk-weighted assets dropped 0.3 p.p. to 15.1% as a result of the increased volume of lending to the private sector.** In 2004 to date this ratio has increased by 1.4 p.p. as a result of increased levels of compliance that have offset the rise in risk-weighted assets.

Outlook for September

Profitability in September might be consistent with the recovery being seen in recent months. In the case of the financial margin – and the yield on interest-bearing assets in particular – it is expected that performance will be similar to that in August. Interest income could post a slight rise during the month, given the growth registered in the balance of promissory note acceptances and personal loans (see Table 1). The increase in the latter line is particularly encouraging, given its greater relative yield (although the downward trend in the rate of interest charged on such loans may persist). Although the rates of interest paid on time deposits have maintained their slight upward trend, the less marked increase in their balance encourages hopes for a higher interest income. The component of the yield on interest-bearing assets related to CER accrual should remain at current levels, possibly recording a slight fall as the index has gone up by almost 0.4% in the month, a lower change than that seen in August (close to 0.5%). The change in the exchange rate – which was down from 3 $/US$ to 2.98 $/US$ – suggests that banks will end up registering some losses from the restatement of assets and liabilities denominated in foreign currency. This latter factor, together with possible non-recurring adjustments (such as corrections to compensation receivable or increases in loan loss provisions) could restrict the potential for further progress on profits during September.

Chart 9
Netted assets and deposits
- at August 04 prices -
- Consolidated system -

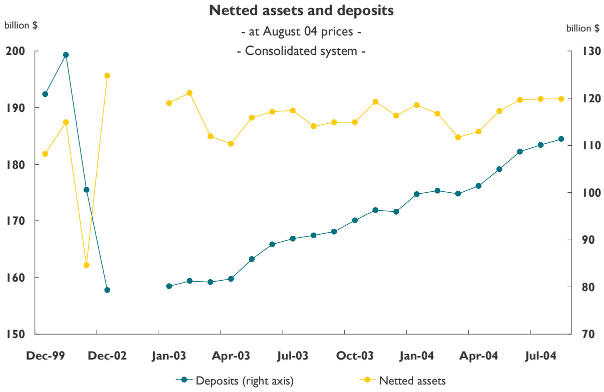


Table 2
Estimated sources and uses of funds
Private banks - August 2004
million pesos

Source		Uses	
Private sector deposits (excluding CEDRO)	545	Loans to non-financial private sector	476
Public sector deposits (excluding CEDRO)	310	Liquid assets [1]	300
Credit to the public sector	260	Reverse repos with the Central Bank	-195
LEBAC stock (net of repos)	115	Outstanding bonds and foreign lines of credit	305
Sales of corporate bonds and stakes in trusts	80	CEDRO	225
Other	95	BCRA rediscounts	100

1 Minimum cash compliance (cash, current account with the BCRA and special collateral accounts), other liquid assets (with foreign branches or head offices) and reverse repos with the Central Bank

Table 3
Loans to the private sector by group of banks
% change based on balance sheet totals

	2004	Aug04/Aug03	Share of total
Public banks			**(Aug-04)**
Total loans	***8%***	***8%***	***27%***
Commercial	10%	11%	18%
Consumer	53%	82%	22%
Other	-1%	-4%	38%
Domestic private banks			
Total loans	***20%***	***24%***	***31%***
Commercial	32%	44%	36%
Consumer	24%	43%	35%
Other	7%	8%	25%
Foreign controlled private banks			
Total loans	***12%***	***8%***	***40%***
Commercial	25%	19%	46%
Consumer	19%	38%	34%
Other	-2%	-8%	37%
Total private banks			
Total loans	***15%***	***17%***	***71%***
Commercial	29%	30%	82%
Consumer	21%	40%	70%
Other	1%	-2%	61%
Total system			
Total loans	***14%***	***16%***	***100%***
Commercial	25%	27%	100%
Consumer	30%	51%	100%
Other	1%	1%	100%

Notes:
Does not include accrued interest or CER/CVS adjustments.
Commercial loans include overdraft and acceptance of promissory notes.
Consumer loans include credit card and personal loans.
"Other" includes pledge-backed loans and mortgages.
"Total system" includes data from public banks, private banks and non-banking institutions.
Balance sheet totals adjusted by transfers between loan portfolios and trust funds.
Not adjusted by loans written off the balance sheet.
The private bank group includes three financial institutions currently undergoing a restructuring process and under administration of a national public bank.

Activity*: time deposits recover*

Total deposits in the consolidated financial system continued their recovery: the balance at the end of the month ($111 billion[2]) rose by 1.4% compared to July, with accumulated growth for the year at 21%, equivalent to an increase in real terms of 16%[3] (see Chart 9)**.** In the case of deposits denominated in pesos, the variation in the first 8 months of the year was 16%. More than half the annual increase was due to the behavior of the public sector, with balances in August that almost doubled the levels of December 2003. This performance for the system as a whole has been strongly influenced by public banks, as in the case of **private banks the impulse behind deposit growth, for both the month and the year, has come from the private non-financial sector. If private banks are viewed on their own, more than three quarters of the annual increase (13%) is explained by deposits originating from the private sector.**

Deposits have provided the main source of funds for private banks during the month, with a gain of $855 million. Of this total, $545 million (64%) were provided by the private non-financial sector (see Table 2). Time deposits were the most dynamic segment (with growth of almost $700 million) in a context in which interest rates have been higher than the low point reached in previous months. The rise in such deposits more than offset the drop in sight deposits (savings and current accounts), which fell by $110 million. Included in this growth in time deposits, **there was an increase of $370 million in peso deposits not subject to adjustment, with growth that for the first time this year has been higher than that by deposits adjusted according to CER (which went up by $270 million).**

Payments received from the public sector represented an inflow of funds for $260 million for private banks, mainly as a result of loan repayments. These settlements, together with the payment of part of the pending swap of rescheduled deposits[4] using government securities held in bank portfolios, led to a drop of 1% in exposure to the public sector.

LEBAC and NOBAC holdings by private banks fell during the month by approximately $115 million. The total for this source of funds has been netted from the holding of bills that banks receive under reverse repos with the Central Bank. **This drop in holdings of Central Bank bills included a reduction in bills denominated in pesos, that was partly offset by an increase in CER-adjusted bills and notes – which have maintained their upward trend –** while there was little change in the holdings of dollar-denominated bills. Sources of funds in August were completed by the proceeds from the sale and collection of principal at maturity on corporate bonds and participations in trusts, for a total approximate amount of $80 million.

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[2] Excludes financial sector deposits, as well as rescheduled deposits to be exchanged for government securities.
[3] Deflated by the CPI, which increased 4.1% in the year to date.
[4] As per Decree No. 1.836 issued in 2002.

Chart 10
Deposits and liquidity
- Private banks -

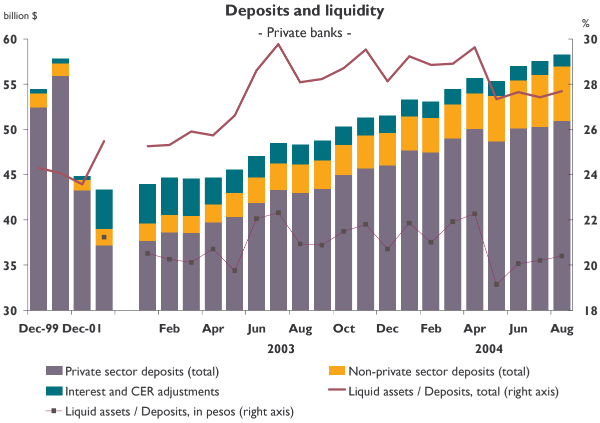
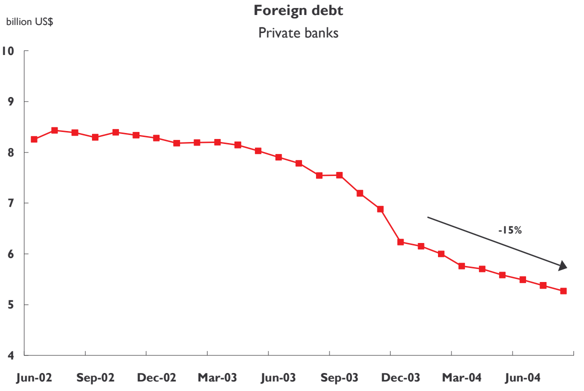


Chart 11
Foreign debt
Private banks



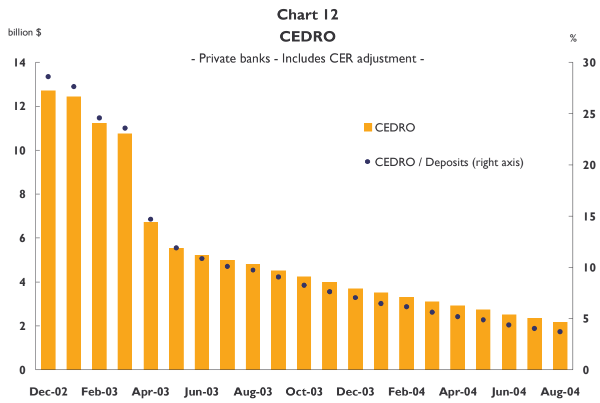
As has been the case in recent months, loans to the private sector represented the main use of funds by private banks ($475 million during the month). Commercial lines (overdrafts and promissory notes) saw the biggest change, with growth of $280 million, followed by consumer credit (credit cards and personal loans). Collateralized lending again registered an increase, driven by pledge-backed loans, which went up almost $50 million, strengthening the upward trend seen in the last six months.

One year after the start of the recovery in lending to the private sector, the system as a whole has recorded a rise of 16%[5] in total loans, showing certain differences between groups of banks. Domestic private banks (holding almost one third of all loans granted to the private sector) have shown the largest relative increase in the total and in commercial loans. In the case of consumer loans, public banks have led the way (with an increase of 2.6 p.p. in their share of the total for such loans). **The disparities recorded by group of banks for the various credit lines diminish when the period for analysis is restricted to the current year[6]** (see Table 3). Although commercial lines have risen 44% year-on-year for domestic private banks (36% of the total balance), 25 p.p. more than the relative increase recorded by foreign banks (holding 46% of the balance of commercial loans), in 2004 to date the difference in the growth of this type of loan between the two groups was only 7 p.p..

In the case of collateralized loans, growth was driven by pledged-backed loans, which rose by nearly 5% for the system as a whole, in line with rising sales of cars and equipment on credit. **The gap between mortgage loan repayments and new loans continues to narrow. In addition, there has been a significant and rising number of banks recording an increase in the balance of such loans.**

Another use of funds by private banks during August was to increase holdings of liquid assets[7], which took up $300 million. Unlike the situation in the previous month, in August the increase was explained by larger balances in Central Bank current accounts (up $470 million), offsetting the fall in the net balance of repos using LEBAC as the underlying asset carried out with the Central Bank (-$195 million). Public banks remained the most active in the repo market, and were the only group trading in repos (reverse repos from the standpoint of the Central Bank) although in insignificant amounts. In view of the performance by liquid assets and total deposits, the overall liquidity ratio rose by 0.3 p.p. during the month to 27.7% at the end of August (see Chart 10). In terms of assets and liabilities denominated exclusively in pesos (with and without CER adjustment), the ratio of liquid assets to total deposits for private banks reached a level of 20.4% by the end of August, with an increase of 0.2 p.p. compared to the previous month.

[5] This figure does not include adjustment for accrued interest or CER/CVS. Changes in balance sheet totals as a result of the setting up or liquidation of financial trusts have also been disregarded. The average exchange rate for the period was used for the conversion into pesos of loans denominated in foreign currency.
[6] Differences between banks persist even when changes in balances are adjusted to eliminate the effect of loans written off from balance sheets as uncollectible.
[7] The balance of liquid assets includes minimum capital requirement compliance, other liquid funds, and Central Bank repos.



The foreign debt of private banks (including corporate and subordinated bonds and direct lines of credit) continued to decline. The use of funds took place as a result of the settlement of outstanding foreign lines of credit and payment of securities issued by certain banks under the debt restructuring carried out in previous months. **The balance fell by 2% during the month and has already fallen by 15% during 2004** (see Chart 11).

Payment of the sixth installment of the Central Bank's framework for the repayment of liquidity rediscounts required the disbursement of $100 million by private banks. Since this program began, private banks have paid back more that $580 million, including principal, interest and CER adjustment (a similar amount to that paid by the public bank segment). **The uses of funds table is completed with CEDRO repayments, which in august generated an outflow of funds for $225 million** (this calculation includes adjustment for CER and the difference in the rate of exchange in the case of payments made according to court orders). Since December 2003 the share accounted for by CEDRO in total deposits fell 3.3 p.p. to a level of 3.7% (see Chart 12). During August a group of private banks also repaid rescheduled deposits under the so-called Second Swap (*Canje II*)[8].

Use of bank services: *considerable geographical disparity*

Table 4
Bank use by province
Selected ratios - June 2004

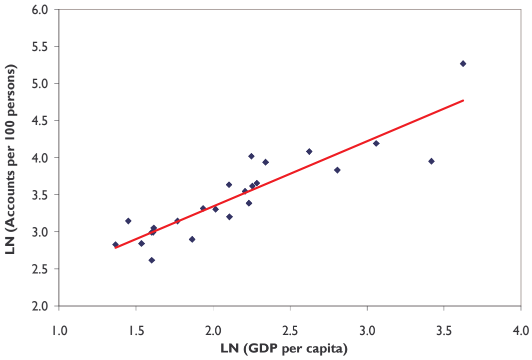
sorted by accounts per 100 persons	Accounts per100 persons	Persons / Branch	Persons / ATM	Surface area / Branch	Deposits / Person	Loans / Person
		Thousand		per 1.000Km^2	thousand $	
City of Bs As	194	4	2	0.0	14.4	2.0
Santa Cruz	66	6	4	6.6	1.5	0.6
Chubut	59	10	6	5.1	1.7	0.4
Santa Fe	56	7	6	0.3	1.6	0.2
T. del Fuego	52	9	3	1.7	1.9	0.8
La Pampa	51	7	6	3.3	1.7	0.6
Neuquen	46	11	4	2.0	1.2	0.4
Río Negro	39	10	6	3.8	1.2	0.2
Córdoba	38	8	7	0.4	1.7	0.2
Mendoza	37	13	8	1.2	1.2	0.2
Bs As prov.	35	13	6	0.3	1.2	0.2
San Luis	30	11	8	2.1	0.7	0.1
Entre Ríos	27	10	9	0.7	1.0	0.2
Catamarca	27	22	8	6.4	0.4	0.2
Chaco	25	17	18	1.6	0.5	0.2
Formosa	23	32	14	4.5	0.2	0.2
San Juan	23	21	8	2.9	0.8	0.2
Jujuy	21	24	10	2.0	0.5	0.1
Misiones	20	18	13	0.5	0.4	0.2
Salta	20	23	12	3.2	0.5	0.2
La Rioja	18	14	12	3.9	0.4	0.3
Tucuman	17	23	12	0.4	0.7	0.2
Sgo. Estero	17	31	21	5.1	0.4	0.1
Corrientes	14	17	12	1.5	0.5	0.1
TOTAL	**45**	**11**	**6**	**0.8**	**2.1**	**0.4**

In general, the depth of a financial system is linked to growth and the level of equality of the economic system. **As a result of the crisis in 2001/2002, financial deepening in Argentina has been significantly curtailed,** both due to the use of bank services by the population, as well as by the intensity of use of financial channels (average deposits and loans, turnover of sight accounts, etc.). Bank services use in Argentina has two key features: a relatively low aggregate level – despite the strong growth observed over the last decade – and, in particular, a highly uneven geographical distribution.

The current degree of bank service use in Argentina is relatively low compared to developed countries as well as many economies with a comparable level of development. For example, the number of deposit accounts per 100 inhabitants in Argentina currently stands at 45, while in most European countries it is in excess of 100 units. This aggregate number of deposit accounts has been rising considerably in the last ten years (in December 1994 the total was 28), especially until 2000, remaining relatively stable as from then. Despite this growth for the country as a whole, **local use of bank services has shown a significant disparity at provincial level,** as can be seen from the breakdown of principal indicators by political district. In terms of the number of accounts per inhabitant, the district with the highest level (the city of Buenos Aires) records a level 14 times higher than that of the district with the lowest level (the province of Corrientes). This disparity persists if other indicators are used, such as inhabitants per

[8] Established by Decree No.1.836 dated 2002.

Chart 13
Bank use and relative development

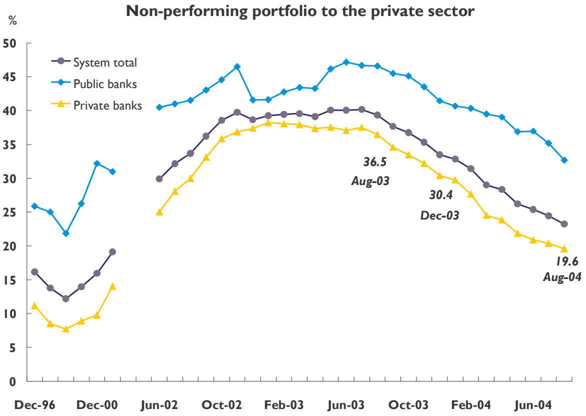


branch, inhabitants per automatic teller machine, and average surface area covered per branch (se Table 3).

There is also a significant disparity in the intensity of use of banking services, measured both by the number of debits per deposit account and by average deposit. This fact, together with the varying level of banking service use, leads to marked differences in financial system depth in each individual province[9].

The degree of bank use at a provincial level bears a statistically significant correlation to the level of relative economic growth. GDP per inhabitant is a relevant explanatory variable for the level of bank use, both from a statistical and an economic point of view (see Chart 13)[10]. **Nevertheless, an important share of the variance for the deposit accounts per inhabitant variable (taken as a proxy for bank use) is not explained by relative income.**

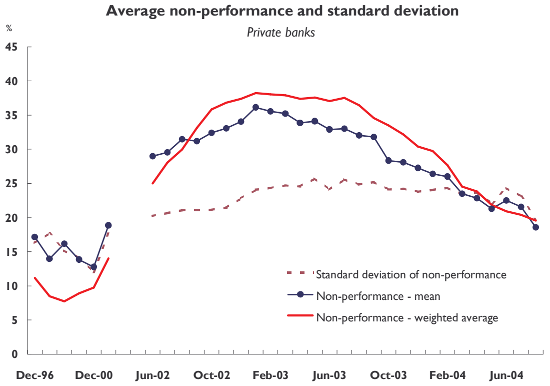
Chart 14
Non-performing portfolio to the private sector



Portfolio quality: *another month of progress*

In August the financial system continued to show signs of improvement in the quality of its private sector loan portfolio[11]: there was a drop for the month of 1.2 p.p. in the level of delinquency, to a level of 23.2% (10 p.p. below its level at the end of 2003). Public banks recorded a greater improvement in their non-performance (around 2.5 p.p., almost three times the improvement recorded by private banks), although there is still significant difference in the level of non-performance between these two sub-groups of banks: whereas non-performance for public banks stands at 32.7%, in the case of private banks this indicator totals 19.6% (see Chart 14).

Chart 15
Average non-performance and standard deviation
Private banks

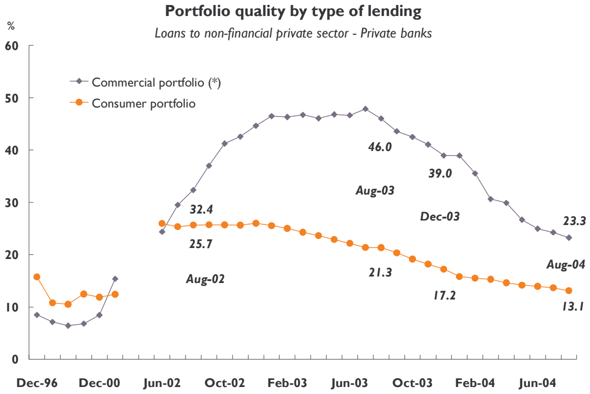


In 2004 to date, private banks have lowered their non-performance rate by almost 11 p.p., a cut of more than one third compared to its level at the end of last year. Nevertheless**, significant progress must still be made in portfolio non-performance to reach the minimal levels reached prior to the crisis (close to 8%).** Furthermore, there is still a significant dispersion in non-performance within the private bank sub-group (see Chart 15), although this is a feature that existed prior to the crisis, largely explained by the higher non-performance ratios recorded by a significant number of smaller institutions.

The behavior of the non-performance indicator for private banks in August continued to reflect the trend that had been seen in previous months: **while loan totals continued to increase, the amount rated as non-performing continues downward**. As mentioned in the first section of this report, under these conditions banks were able to reduce their provisioning efforts, with a positive impact on the

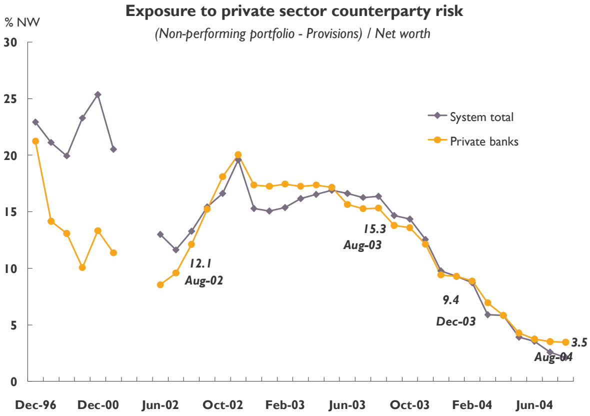
[9] A more detailed study of the current state of the use of bank services in Argentina, as well as the operation of the financial system in each province, can be found in the Central Bank's Financial Stability Bulletin for the second half of 2004 (Box 2, page 29).
[10] Estimating an ordinary least-squares regression in natural logarithms of deposit accounts per inhabitant, shows per capita GDP to be a statistically significant variable at 99% confidence level.
[11] For an analysis of the latest trends in terms of credit risk, see the Financial Stability Bulletin for the second half of 2004 (Chapters II and IV).

Chart 16
Portfolio quality by type of lending
Loans to non-financial private sector - Private banks



(*) Includes commercial portfolio up to $200,000

Chart 17
Exposure to private sector counterparty risk
(Non-performing portfolio - Provisions) / Net worth



profitability of banking business. Also, in the context of lower private sector credit risk, there is a greater incentive for banks to consolidate their growth in lending to this sector.

As in previous months, the upward trend in lending and the drop in the amount rated as non-performing was more notable in the commercial loan segment, which has continued to lead the process of recovery in bank portfolio quality. **In August the commercial loan portfolio recorded a drop of 1 p.p. in its non-performance to a level of 23.3%** (see Chart 16). This level continues to be high in both historical terms and in relation to international non-performance standards, largely due to the significant balance of loans that must still be restructured. The rate of decline being shown by this indicator is notable, nevertheless: in 2004 to date, it has already dropped 40% compared with the level at the end of the previous year, and today it stands at almost half the peak reached during the height of the crisis.

In the case of the consumer loan portfolio, the drop in the indicator was somewhat slighter (0.5 p.p.), falling to a level of 13%, very close to its level at the end of 2001. As a result, despite currently showing less pronounced improvement in non-performance, the trend towards an improvement in portfolio quality persists, with a drop in non-performance of one quarter compared to its level at the end of the previous year.

Lastly, given the current level of lending, the potential impact on private bank net worth from additional losses from the uncollectibility levels of companies and households remains limited. In August the level of delinquent loans not covered by provisions, measured in terms of the net worth for this group remained stable (see Chart 17). This indicator recorded a level of 3.5% during the month, almost 12 p.p. less than one year earlier. **The low level of this indicator of net exposure provides an opportunity for banks to increase lending to the private sector without compromising their solvency, in a context of prudent risk management policies.**

Latest regulations

This section contains a summary of the main regulations related to the business of financial intermediation issued during the month (referenced by the date on which they came into force).

Communication "A" 4182 – Aug/6/04
Deposit rescheduling. This communication adjusts the requirements set out for banks with outstanding Central Bank credit liabilities that wish to improve their offer for the early settlement of rescheduled deposits.

Communication "A" 4183 – Aug/6/04
The Central Bank has regulated Law 25,783 modifying the Financial Institutions Law on matters relating to Credit Unions, to provide a stimulus to institutions that target the sectors of the population that are not at present making use of bank services and are unable to gain access to institutional credit. Credit unions have been made subject to rules differing from those for the rest of the financial system: they must operate from a single office and deal only with their members, who should put up a minimum capital of $200 and be located within the district corresponding to the institution; they shall be allowed to grant loans and other forms of credit for short and medium terms to urban and rural businesses as well as to sole-proprietor businesses, professionals, craftsmen, employees, workers, individuals and non-governmental organizations. In addition, procedures for obtaining approval have been simplified, and basic minimum capital requirements have been eased, being set at between $100,000 and $1 million on the basis of the size of the population in the district in which they are to be located, incorporating specific criteria that take into account the reality of small localities. Special loan types have been created with a significant reduction in the requirements necessary for the granting of loans, together with the setting of maximum loan amounts and duration. Credit Unions shall be able to offer services in relation to bills of exchange, to be debited to the corresponding sight accounts. A centralized rejected bill of exchange register has been set up (similar to the existing register for rejected checks), the main objective of which is to encourage the correct use of such payment and credit instruments. Credit Union funding will be based on a very fragmented deposit structure, and therefore the Central Bank, making use of its regulatory mandate, has raised the limit on time deposits from $10,000 (as set forth in the Law) to $12,000, allowing the sale of portfolio, repurchase agreements and call money loans. Subject to the general limitations and scope laid down for all other financial institutions, Credit Union deposits shall be covered by the deposit guarantee scheme. The calculation of the prudential ratios required has been significantly simplified, with a reduction in the volume and complexity of the accounting and information regimes to be observed.

Communication "A" 4187 – Aug/10/04
The "Regime on the Rescheduling of Deposits" has been extended to include the possibility for holders of "National Government Bonds in US Dollar at Libor due 2012", "National Government Bonds in pesos at 2% due 2007" and "National Government Bonds in US dollars at Libor due 2005" to deliver them to financial institutions in payment of their loans. Banks may receive these bonds up to the amount of the advances that they still hold pending repayment to the Central Bank. Holders of these securities who originally exercised their option to receive them in exchange for their rescheduled deposits shall be able to use them for the settlement of loans secured by mortgages on sole family dwellings, or secured or unsecured personal loans, assigning priority to those who opt to do so between September 15, 2004 and October 15, 2004. Furthermore, institutions shall be able to make early settlement of the advances and rediscounts received from the Central Bank using the bonds of customers who were to have exercised this option.

Notes on methodology

(a) Aggregate balance sheet information is taken from the Monthly Accounting Information System (non-consolidated balances). To calculate data for the system aggregate, for institutions not providing data for the month under review, the latest information available is repeated in the aggregate balance sheet. When estimating income flows, however, consideration is given exclusively to those institutions providing data on the month in question.

(b) Due to the possible lack of data for a number of banks at the time of writing this Report, and given the possibility of subsequent corrections to the data provided by financial institutions, the data included – particularly for the last month mentioned – is of a preliminary nature. As the latest available data is always used, data related to earlier periods may not coincide with what had been previously mentioned in earlier issues of the Report. In these cases, the latter version should be considered as that of the best quality.

(c) Data on deposits and loans relate to balance sheet information and do not necessarily agree with those gathered by the centralized System of Information Requirements (SISCEN). Reasons for discrepancies include the exact date taken into account for the calculation of monthly variances and the items included in the definition adopted in each case.

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

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

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

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

Glossary

%a.: annualized percentage.
Adjusted profit: Total profit excluding payments made due to court-ordered releases and adjustments to the valuation of public sector assets according to Com. "A" 3911 and 4084.
ASE: Adjusted stockholders' equity, for *Responabilidad Patrimonial Computable* in Spanish. The measure for compliance with bank capital regulations.
Consolidated (or aggregate) assets and liabilities: Those arising from excluding operations between financial system institutions.
Exchange rate adjustment differences: Income arising from the monthly restatement of assets and liabilities in foreign currency. Also includes results from the purchase and sale of foreign currency, which arise from the difference between agreed upon price (net of direct expenses from the transaction) and book value.
Financial margin: Income less outlays of a financial nature. Includes interest income, gains from securities, CER/CVS adjustments, exchange rate differences and other financial results.
Gains from securities: Includes income from government securities, short-term investments, corporate bonds, subordinated debt and options. In the case of government securities, it includes the results accrued from income, quotation differences, exponential increase on the basis of the internal rate of return (IRR), and from sales, as well as the charge for impairment to value.
Income from services: Commissions collected less commissions paid. Includes commissions on liabilities, credits, securities, guarantees granted, rental of safe-deposit boxes and foreign trade and exchange transactions, excluding in the case of the latter results from the trading of foreign currency, which are recorded in the "Exchange difference" accounts (here included under the heading "Other financial results"). Outflows include commissions paid, contributions to the Banking Social Services Institute (ISSB), other contributions on service income and charges accrued for gross income tax.
Interest income (interest margin): Interest collected less interest paid on financial intermediation, on an accrual basis – taken from balance sheet – rather than on a cash basis. Includes interest on loans of government securities and premiums on repos and reverse repos.
Liquid assets: Minimum cash compliance – cash, current account at Central Bank and special accounts in guarantee – and other liquid items, including correspondent accounts.
Liquidity ratio: Liquid assets over total deposits.
MAE: Mercado Abierto Electrónico. Electronic over-the-counter market.
Net worth exposure to counterparty risk: :Non-performing portfolio net of allowances in terms of net worth.
Netted assets (NA) and liabilities: Those net of accounting duplications inherent to the recording of swaps, whether term or unsettled spot transactions.
NFPS: Non financial private sector.
Non-performing portfolio: Portfolio in categories 3 to 6, as per the debtor classification system.
Operating costs: Includes remuneration, social security payments, services and fees, sundry expenses, taxes and amortization.
Other financial results: Income from financial leasing, adjustments to valuation of credit to the public sector, contribution to the deposit guarantee fund, interest on liquid funds, difference in market price of gold and foreign exchange, premiums on the sale of foreign currency and other unidentified income (net).
Private sector credit: Loans to the private sector and private sector securities.
Public sector credit: Loans to the public sector, holdings of government securities and compensation receivable from the Federal Government.
ROA: Net profits as a percentage of netted assets. When referring to accumulated results the denominator includes the average netted assets for the reference months.
ROE: Net profits as a percentage of net worth. When referring to accumulated results the denominator includes the average net worth for the reference months.
Other: In the profitability structure, sundry gains – including gains from long-term investments, loan recoveries and release of allowances – and sundry losses – including losses on long-term investments, amortization of differences from court orders, loss on sale or impairment of fixed assets, amortization of goodwill.

Statistics

Profitability structure - Private banks

Private banks - in annualized terms

In current pesos (millions)	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	May 04	Jun 04	Jul 04	Aug 04	Change (%) Month on month	Accum. 2004	Year on year
Netted assets	**85,918**	**88,501**	**73,796**	**117,928**	**115,091**	**114,767**	**115,701**	**116,764**	**117,030**	**0.2**	**1.7**	**2.8**
Liquid assets	13,228	13,920	10,576	11,044	14,500	14,909	15,464	15,013	15,553	3.6	7.3	14.5
Public bonds	6,433	7,583	1,627	19,751	22,260	19,444	19,377	20,355	19,723	-3.1	-11.4	-0.5
Private bonds	410	563	451	273	172	188	211	202	223	10.4	29.2	29.3
Loans	56,916	56,035	52,319	51,774	47,017	50,188	51,777	52,123	52,827	1.4	12.4	8.5
Public sector	6,389	8,172	13,803	25,056	23,571	25,058	25,094	24,986	24,883	-0.4	5.6	-1.6
Private sector	47,705	45,103	36,636	26,074	22,816	24,199	25,635	26,232	26,683	1.7	16.9	18.1
Financial sector	2,823	2,760	1,880	644	630	931	1,048	905	1,261	39.3	100.2	54.8
Provisions over loans	-3,119	-3,248	-3,957	-7,463	-5,225	-4,355	-4,487	-4,473	-4,349	-2.8	-16.8	-28.7
Other netted credits due to financial intermediation	4,470	5,730	4,489	26,235	20,607	19,744	18,558	18,805	18,572	-1.2	-9.9	-10.9
Purchases (net)	487	1,103	807	380	698	539	481	606	627	3.5	-10.1	72.3
Corporate bonds and subordinated debt	1,022	724	665	1,514	1,394	987	1,053	938	895	-4.6	-35.8	-35.8
Unquoted trusts	958	1,609	1,637	6,205	3,571	3,221	2,511	2,347	2,140	-8.8	-40.1	-53.1
Compensation receivable	0	0	0	15,971	13,812	13,644	13,174	13,716	13,811	0.7	0.0	5.9
BCRA	12	35	865	377	415	311	406	316	304	-3.9	-26.8	-2.7
Assets under financial leases	796	776	752	553	387	415	438	464	497	7.1	28.6	16.4
Shares and participation	1,371	1,651	1,703	3,123	2,791	1,504	1,528	1,559	1,567	0.5	-43.9	-50.6
Fixed assets and sundry	3,246	3,225	3,150	5,198	4,902	4,873	4,859	4,826	4,806	-0.4	-2.0	-5.6
Foreign branches	48	75	112	-109	-136	-66	-71	-70	-69	-0.9	-49.1	-47.1
Other assets	2,120	2,190	2,574	7,549	7,816	7,924	8,047	7,960	7,681	-3.5	-1.7	-7.0
Netted liabilities	**73,615**	**76,322**	**62,281**	**102,101**	**100,191**	**100,406**	**101,416**	**102,312**	**102,587**	**0.3**	**2.4**	**3.0**
Deposits	54,447	57,833	44,863	44,445	52,625	56,126	57,720	58,249	58,442	0.3	11.1	18.2
Public sector (1)	1,342	1,276	950	1,636	3,077	4,739	5,114	5,436	5,744	5.7	86.7	102.4
Private sector (1)	52,460	55,917	43,270	38,289	47,097	49,503	50,821	51,011	51,118	0.2	8.5	16.0
Current account	5,022	4,960	7,158	8,905	11,588	12,837	12,754	12,548	12,483	-0.5	7.7	24.6
Savings account	9,702	9,409	14,757	6,309	10,547	12,553	13,411	13,812	13,787	-0.2	30.7	47.3
Time deposit	35,218	39,030	18,012	11,083	18,710	18,430	19,177	19,710	20,426	3.6	9.2	13.8
CEDRO	0	0	0	9,016	2,409	1,698	1,544	1,417	1,296	-8.5	-46.2	-59.6
Other netted liabilities due to financial intermediation	16,185	15,401	14,082	48,364	40,825	37,975	37,797	38,560	38,716	0.4	-5.2	-10.5
Call money	2,146	2,293	1,514	836	726	1,046	1,155	1,315	1,670	27.0	130.0	86.3
BCRA lines	274	83	1,758	16,624	17,030	16,499	15,940	16,712	16,695	-0.1	-2.0	-0.8
Outstanding bonds	4,990	4,939	3,703	9,073	6,674	8,097	8,026	8,053	7,991	-0.8	19.7	10.5
Foreign lines of credit	6,680	5,491	4,644	15,434	9,998	6,736	6,853	6,880	6,725	-2.3	-32.7	-44.6
Sales (net)	492	510	99	349	168	179	81	169	158	-6.5	-6.2	-28.9
Subordinated debts	1,683	1,668	1,700	3,622	1,850	1,906	1,669	1,362	1,381	1.4	-25.4	-56.3
Other liabilities	1,299	1,420	1,637	5,671	4,890	4,400	4,231	4,142	4,048	-2.3	-17.2	9.4
Net worth	**12,304**	**12,178**	**11,515**	**15,827**	**14,900**	**14,361**	**14,285**	**14,452**	**14,443**	**-0.1**	**-3.1**	**1.4**

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

Profitability structure - Private banks

Private banks - in annualized terms

As % of netted assets	Annual 1999	2000	2001	2002	2003	First 8 months 2003	2004	Monthly Jan-04	Feb-04	Mar-04	Apr-04	May-04	Jun-04	Last 6 months
Financial margin	6.1	6.2	6.4	7.6	2.3	1.1	3.4	1.2	1.7	2.6	2.8	7.3	4.8	4.0
Net interest income	4.5	4.1	4.3	-0.2	0.1	-0.1	1.0	0.4	0.4	0.8	0.7	1.0	2.0	1.2
Restatement by CER and CVS	0.0	0.0	0.0	1.1	0.9	0.7	0.9	1.0	1.2	1.3	1.0	1.3	0.2	0.9
Gains on securities	1.1	1.4	1.2	2.5	1.7	1.3	0.9	-0.5	0.0	1.2	1.1	1.4	1.8	1.3
Foreign exchange price adjustments	0.3	0.2	0.3	4.4	-0.3	-0.5	1.0	0.6	0.2	-0.6	0.1	3.8	1.4	1.1
Other financial income	0.3	0.5	0.7	-0.1	-0.2	-0.2	-0.4	-0.3	-0.2	-0.1	-0.2	-0.2	-0.7	-0.4
Service income margin	3.1	2.9	3.2	2.0	2.0	2.0	2.3	2.2	2.0	2.4	2.3	2.4	2.3	2.4
Loan loss provisions	-2.2	-2.5	-3.0	-5.0	-1.3	-1.5	-0.7	-1.2	-1.0	-0.7	-0.6	-0.7	-1.1	-0.6
Operating costs	-6.3	-6.0	-6.4	-4.8	-4.6	-4.7	-4.5	-4.4	-4.5	-4.7	-4.5	-4.4	-4.7	-4.5
Tax charges	-0.4	-0.4	-0.5	-0.4	-0.3	-0.3	-0.3	-0.3	-0.4	-0.3	-0.3	-0.4	-0.3	-0.3
Income tax	-0.5	-0.4	-0.3	-0.2	-0.3	-0.3	-0.3	0.0	0.0	-2.0	-0.2	0.0	-0.2	-0.4
Adjustments to the valuation of government securities (*)	0.0	0.0	0.0	0.0	-0.6	-0.9	-0.1	-0.7	-0.1	0.0	0.0	-0.1	0.1	0.0
Amortization payments for court-ordered releases	0.0	0.0	0.0	0.0	-0.7	-0.7	-0.9	-0.9	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0
Other	0.5	0.4	0.7	-3.0	1.0	1.5	0.6	1.1	1.7	1.7	-0.1	-1.4	1.1	0.3
Monetary results	0.0	0.0	0.0	-7.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ROA before income tax	0.8	0.6	0.5	-11.1	-2.2	-3.4	-0.4	-3.0	-1.4	-0.1	-1.3	1.8	1.2	0.3
ROA before monetary results	0.3	0.1	0.2	-3.8	-2.4	-3.7	-0.7	-3.1	-1.4	-2.1	-1.5	1.8	1.0	-0.1
ROA	0.3	0.1	0.2	-11.3	-2.5	-3.7	-0.7	-3.1	-1.4	-2.1	-1.5	1.8	1.0	-0.1
ROA adjusted (**)	0.3	0.1	0.2	-11.3	-1.2	-2.2	0.7	0.6	-0.1	-1.2	-0.5	2.8	1.9	0.8
Indicators (%)														
ROE	**2.3**	**0.8**	**1.4**	**-79.0**	**-19.1**	**-28.2**	**-5.4**	**-24.3**	**-10.9**	**-17.2**	**-11.9**	**14.1**	**8.4**	**-1.2**
Financial margin + service income margin / Operating costs	146.0	151.9	150.9	199.3	93.8	66.9	126.1	76.5	83.1	105.7	112.9	222.1	150.7	141.2
Interest income (with CER and CVS) / loans	..	13.9	16.1	24.7	9.0	8.9	8.6	7.7	8.3	8.2	7.9	9.6	10.0	8.9
Interest payments (with CER and CVS) / deposits	..	5.7	7.8	21.9	5.8	7.4	2.3	2.4	2.1	1.7	2.1	2.5	2.6	2.2

Note: interest income and the loan balances correspond to non-financial sector transactions.
(*) Com. "A" 3911. Adjustments to the valuation of government securities according to Com. "A" 4084 are included under the "gains from securities" heading.
(**) Excluding amortization of payments for court-ordered releases and the effects of Com. "A" 3911 and 4084.

Portfolio quality - Private banks

As percentages	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	Jan 04	Feb 04	Mar 04	Apr 04	May 04	Jun 04	Jul 04	Aug 04
Non-performing loans (overall)(1)	7.6	8.3	9.9	19.8	15.7	15.4	14.4	12.5	12.2	11.5	11.2	10.8	10.4
Non-performing loans to the non-financial private secto	8.9	9.8	14.0	37.4	30.4	29.7	27.7	24.5	23.8	21.8	20.9	20.4	19.6
Commercial portfolio	6.2	7.6	15.2	44.5	39.9	39.9	36.4	31.1	30.4	27.0	25.0	24.2	23.4
Commercial portfolio up to $200,000	11.7	14.6	16.4	46.4	26.8	26.5	24.8	24.8	23.4	22.3	24.9	24.8	22.8
Consumption and housing portfolio	12.5	11.9	12.4	26.0	17.2	15.8	15.5	15.3	14.6	14.2	13.9	13.7	13.0
Provisions / Non-performing loans	72.2	67.7	75.8	74.8	81.8	81.9	81.2	84.2	86.4	89.4	90.9	91.2	91.3
(Non-performing - Provisions) / Overall financing	2.5	3.2	3.4	9.4	5.5	5.4	5.2	3.9	3.2	2.3	1.9	1.8	1.7
(Non-performing - Provisions) / Net worth	10.1	13.3	11.4	17.4	9.4	9.3	8.9	6.9	5.8	4.3	3.7	3.5	3.4

(1) As a percentage of each lending category.