



# Report on BANKS

NOVEMBER 2003

Year 1 - No. 3

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**Based on information available as of  
January 6, 2004.**

## SUMMARY

- The banking sector continued to show positive signs: deposits continued to grow, the improvement in lending was deepened, foreign liabilities were partly rescheduled and it clearly moved away from sector-wide losses.
- Deposits continued along an upward trend in November, with real growth of 2.2% for the system (3.3% for public banks). Most deposits were made in sight accounts.
- Funds obtained by private banks during the month were applied to increase holdings of liquid assets, to the settlement of CEDRO certificates, increase lending to the private sector, and to increase holdings of Central Bank bills (LEBAC).
- The growth trend in the balance of lending to the private sector was strengthened: between August and November the aggregate balance of short-term lines of credit grew by \$900 million.
- Private banks recorded an increase in equity at the expense of non-resident financing, as a result of the capitalization of the foreign debt and the settlement of foreign lines of credit through the swap of public securities. The fall in the balance of foreign credit was of US\$600 million over the past two months.
- The quality of the private sector loan portfolio continued to improve. There was a noticeable decline in the non-performing commercial portfolio attributable to consumption and housing, which declined by 2.2 p.p.
- Capital compliance of assets at risk by private banks was at 14%, recording a monthly growth of 1 p.p.
- For the first time since the end of 2001, the banking system recorded accounting profits with a monthly result of \$45 million (\$60 million for private banks). All sub-groups of retail banks recorded profits.
- The depreciation of the peso and the increase in the Reference Stabilization Coefficient (CER) and the Wage Variation Coefficient (CVS), combined with the stability recorded in loan loss provisions, interest results and the remaining operative headings, led the improvement in aggregate profits.
- Profits of close to zero are expected for private banks in the last month of the year, conditioned by the existence of seasonal adjustments and/or adjustments related to balance closing. Profitability in the second half of 2003, in annualized terms, would be of around -1.3% of NA, resulting in a substantial improvement with respect to the first half of the year (-4.5%).

This report, based on November balance sheet information available on January 6, 2004, highlights changes to the main variables describing the state of the banking system. The description concentrates on the private bank segment – with a breakdown by uniform sub-group – although information is provided on the public bank segment in the case of certain variables.

## Context

**1. Financial institutions operated during November in a context characterized by price stability, a slight depreciation of the peso and a continuing decline in interest rates.** The Consumer Price Index (CPI) recorded a monthly rise of 0.2%, while the Reference Stabilization Coefficient<sup>1</sup> (CER) increased 0.5% (see Chart 1). The peso depreciated against the US dollar, recording a drop of 3.7% in its value as the \$/US dollar reference exchange rate increased from 2.88 to 2.99. The peso also depreciated against the Brazilian real and the euro, with variations of -1.4% and -7.3% respectively (see Chart 2). The financial market continued to show a slight downward trend in interest rates, in line with the significant liquidity held by institutions. Cut-off rates on 6-month Central Bank bills (LEBAC) in pesos fell from 5.7% to 4.9% and those on 18-month bills fell from 15.4% to 11.8%, while time deposit rates on 30-44 day deposits in pesos dropped slightly from 4.6% to 4.3%. Lastly, interest rates in the call money market remained at around 1.6%.

## Activity level and flow of funds

**2. The level of financial intermediation in the banking system, measured by the level of consolidated netted assets (NA), grew by approximately 2.2% in November 2003.** This change is reduced to 2%<sup>2</sup> if the slight increase in the general price level is taken into account. The private bank segment recorded an increase of 2% at current prices and of 1.7% in real terms during November (see Chart 3). Lastly, financial intermediation of public banks showed a slightly greater growth, of 2.6% in nominal and 2.3% in real terms. The NA and lending to the private sector of the consolidated financial system in November were at 46% and 9% of GDP.

**3.** Total deposits in the financial system performed favorably<sup>3</sup>. The stock **increased by 2.5%, with public institutions the main source of growth (3.5%)**. These figures remained positive in real terms, at 2.2% for the total system, while for the private bank and public institutions segments the growth was of 1.7% and 3.3% respectively.

**4.** In order to interpret the types of transactions that banks are carrying out in managing their assets and liabilities, a table of the source and uses of funds is presented. Given that decisions related to the source and use of resources imply changes in the level and

Chart 1  
CER and CVS  
- 2003 -

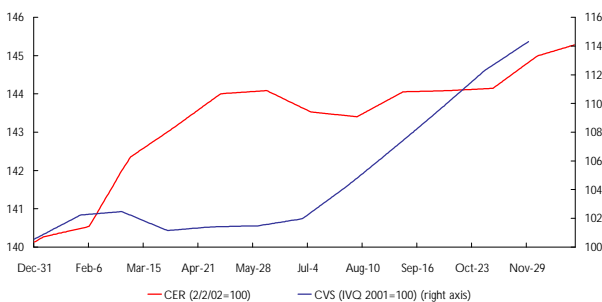


Chart 2  
Exchange rates  
- 2003 -

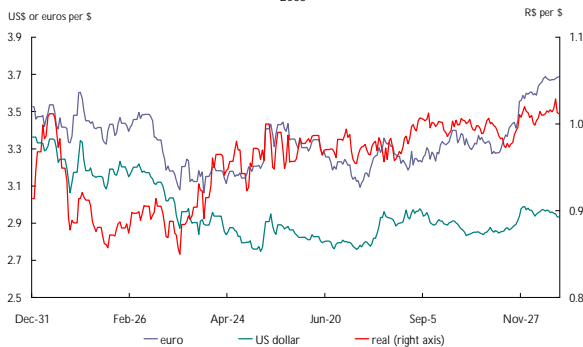
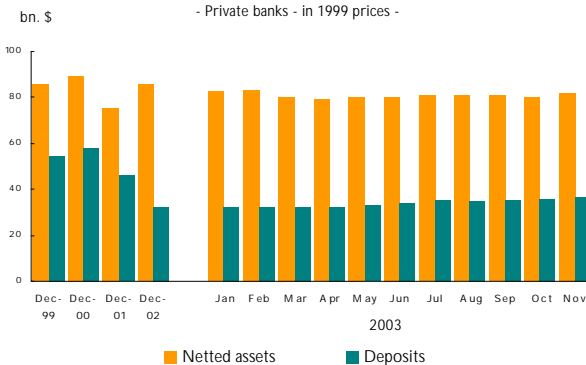


Chart 3  
Netted assets and deposits  
- Private banks - in 1999 prices -



<sup>1</sup> Calculated as the geometric mean rate of change of the CPI with a one-month lag, which increased 0.6%.

<sup>2</sup> Deflated by the CPI.

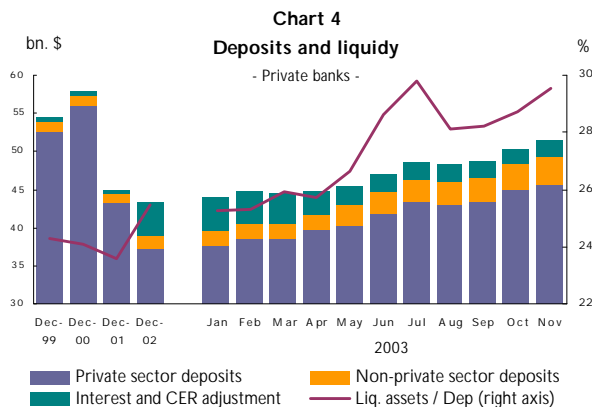
<sup>3</sup> Unless otherwise specified, this report includes end of month balances for the different balance sheet entries

**Table 1**  
**Estimated sources and uses of funds**  
 Private banks - November 2003  
 In millions of pesos

Source		Use	
Private sector deposits	770	Liquid assets	535
Public sector deposits	170	CEDRO	340
Repos	195	Loans to the private sector	220
Other	150	LEBAC	190

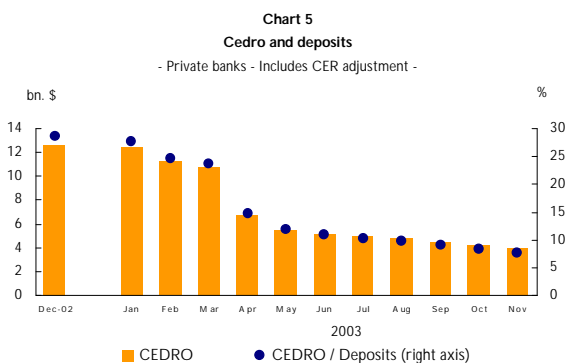
composition of assets and liabilities, they naturally have an impact on the institutions' liquidity, solvency and profitability. During November, private institutions (as a group) gained funds from deposits and repos with the private sector. **Resources gained by private banks were applied to increase holdings of liquid assets** (partly according to regulation), **to the settlement of rescheduled deposits** (especially due to court orders), **to increase net lending to the private sector and to increase holdings of LEBAC** (see Table 1).

**5. In November, the main source of funds for private banks was the increase in deposits<sup>4</sup>.** Deposits by the private non-financial sector<sup>5</sup> contributed with approximately \$770 million (excluding CEDRO certificates). Additionally, as pointed out in the October issue of this report, the placement of sight deposits (current accounts and savings accounts) was the most frequent choice among private banks clients, accounting for 90% of the increase in total placements in this segment. The rise in private sector deposits was a relatively wide-ranging result within the private banking sector, taking place in more than 60% of these institutions. The private institutions segment recorded a rise in deposits originating in the public sector for almost \$170 million during the month (see Chart 4).



**6.** The last item representing a source of funds for the sector during November was a single medium-term financing through a repo, which must be analyzed in view of its size relative to the entire system. A financial institution obtained **financing through a repo with foreign institutions, by offering sovereign debt (BODEN 2012) as collateral** for around \$195 million<sup>6</sup>.

**7. For the third month in a row, funds obtained in November by the private bank aggregate were largely applied to increase liquid assets** (cash in banks, current accounts with the Central Bank and other liquid assets). This use of funds was estimated in around \$535 million. Although the change in liquid assets was led by a small group of institutions with a large effect on the system, it should be noted that it is a broad-based phenomenon. In analyzing the impact on private banks profitability, it should be noted that the rise in liquid assets matched the rise in private sight deposits – which have a low net cost.



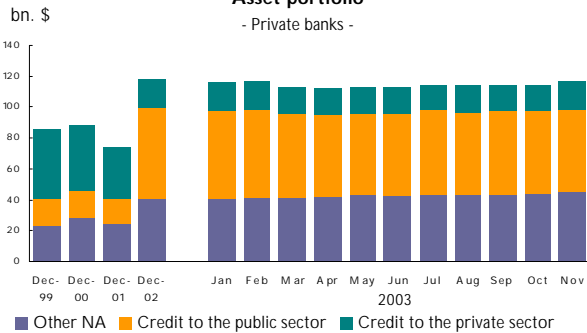
**8.** The second use of resources by size was the completion of the settlement of CEDRO liabilities. During November, **private banks used funds to pay rescheduled deposits by a total approximate amount of \$340 million** (including CER adjustment and exchange rate difference from the early settlement of those certificates as a result of court orders). As shown in Chart 5, the outstanding stock of CEDRO (including CER adjustment) accounted for less than 9% of total private sector deposits in pesos in November 2003, almost 0.7 p.p. less than the previous month and 24 p.p. less than at the beginning of the year.

<sup>4</sup> It should be noted that in the estimation of the source of funds derived from the rise recorded in the deposits line, the effects of variations in the exchange rate, CER adjustment on principal and accrued but uncollected interest are removed. For further details see the notes on methodology at the end of this report.

<sup>5</sup> Henceforth, when referring to the private non-financial sector the term private sector will be used.

<sup>6</sup> In relation to this item, the table showing sources and uses of funds does not include the reduction in the balance of public bonds due to the spot sale as there is an associated repurchase agreement.

**Chart 6**  
**Asset portfolio**  
- Private banks -



**9.** Lending to the private sector continued to show signs of a break in its downward trend (see following section). The movement in **credit lines granted by private banks implied a use of resources by almost \$220 million**<sup>7</sup>. Consumer loans – including personal loans and credit card lending – again drove the monthly change, totaling almost \$100 million. The decline in longer term lines continued to slow down, with signs that it might be possible to observe growth in the stock during the first months of 2004. The amount of the contraction in both pledge and mortgage loans was almost a third of that recorded between September and October (see Chart 6).

**10.** As throughout the rest of 2003, the investment in LEBAC was an important use of funds during November. **The LEBAC portfolio of private institutions increased by around \$190 million.** Unlike the results of previous months, however, the purchase of LEBAC represented for private institutions a slightly lower amount than the resources used to finance consumption and production activities.

### Lending to the private sector

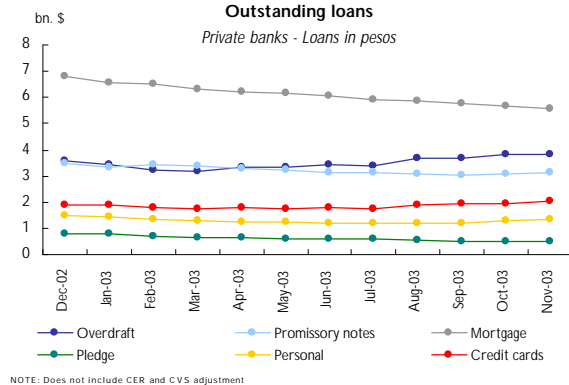
**11.** The stock of private bank loans granted to the private sector recorded a change of behavior as of August 2003. After a clear negative trend since 1999 (a trend that was accelerated as of 2001), financial system lending – both overall and from private banks – to the private sector showed towards the second quarter of 2003 a slowdown in its decline, recording increases as from August.

**12.** The increase in financing was led by **short term lines of credit, related both to the commercial portfolio (overdraft) and the consumer portfolio (credit cards and personal loans).** These lines **jointly increased by around \$900 between August and November for private banks.** This change of behavior is explained by both the adjustment of the prudential regulation framework and the consolidation of a more favorable macroeconomic context, which translated into a significant growth in output. Both factors have influenced supply and demand for bank credit (see Chart 7).

**13.** In addition to the increase in loan balances – which follows from greater supply due to lower funding costs and relative credit risk – there have been **significant cuts in interest rates on short term loans throughout the year.** For certain loans, this downward trend resulted in rates that by the end of the year have almost halved what they were at the beginning of the period (see Chart 8).

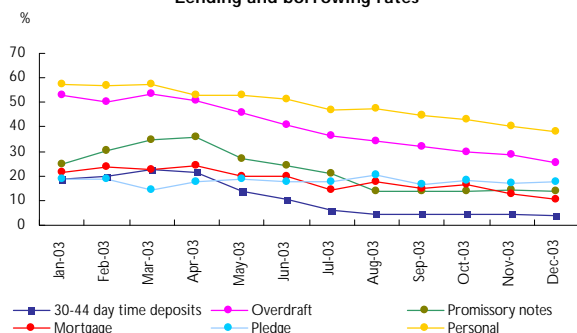
**14.** Increases in short term portfolios balanced out net decreases in long-term financing, basically mortgage and pledge loans. Loans granted in December were still less than required to compensate for the natural payment of installments on loans granted in the 1990s. The buildup of these products is extremely important in terms of the acceleration of the incipient recovery in the loan market, and has

**Chart 7**  
**Outstanding loans**  
Private banks - Loans in pesos



NOTE: Does not include CER and CVS adjustment

**Chart 8**  
**Lending and borrowing rates**



<sup>7</sup>The use of resources is constructed to exclude the effect of exchange rate variations, CER and CVS adjustment, earned interest and the effect of writing off loan losses. For further details see the notes on methodology at the end of this report.

been the objective of several changes in regulation made by the Central Bank during the year. It is expected that the balance of lending to the private sector, which is currently at 6% of GDP for private banks and almost 9% for the financial system as a whole, will progress to ratios similar to those observed before credit began contracting, i.e. over 15% of GDP for private banks and more than 20% for the system as a whole.

### Balance sheet structure

**15.** During November, the changes to the balance sheet structure of private banks resulted from both business flows and individual capitalization transactions and debt swaps undertaken by the sector. In this context, **the main changes to the balance sheet structure were greater liquidity among assets, and a shift in the funding structure towards equity and against non-resident financing.**

**16.** Driven by the increase of cash holdings in pesos and in current accounts held at the Central Bank, the share of liquid assets in total netted assets increased during November by 0.4 p.p., continuing the trend observed as of the second half of 2002. As shown in Chart 9, the annual variation is of 4 p.p.

**17.** Private banks as a group increased the share of equity in total funding (liabilities plus net worth), resulting basically from the capitalization of non-resident debt (see item 27). Additionally, the settlement of lines of credit with non-residents through swaps of public bonds bolstered the trend to reduce the relative share of this kind of funding (see Chart 10). As was observed in October, during **November the outstanding financing received by domestic private banks from foreign financial institutions saw a marked decline which (measured in US dollars) reached 8%**, causing their share in total funding to drop by 0.6 p.p. These developments occurred mainly in banks which are branches of foreign institutions as well as in domestic banks under foreign control. Particularly, the last two months recorded a drop of almost US\$600 million in the balance of this liabilities heading, of which almost two thirds is related to reductions explained by swaps of public securities.

**18.** Taking a longer view, the balance of the foreign lines of credit and the balance of all dollar liabilities excluding deposits have recorded a marked decline since the second half of 2002. They have decreased in terms of the original currency by almost 28% and 24% respectively as of November, recording the joint effect of genuine settlement, direct capitalization, and swaps for public bonds (see Chart 11).

**19.** **The change in these liabilities is mostly explained by the requirement established by the Central Bank to normalize foreign liabilities to obtain refinancing of Central Bank advances and rediscounts<sup>8</sup>.** In general terms, at the conclusion of the legal term established for the presentation of proposals, foreign liabilities involved in repurchase offers and/or refinancing totaled around US\$

Chart 9  
ASSET STRUCTURE - PRIVATE BANKS

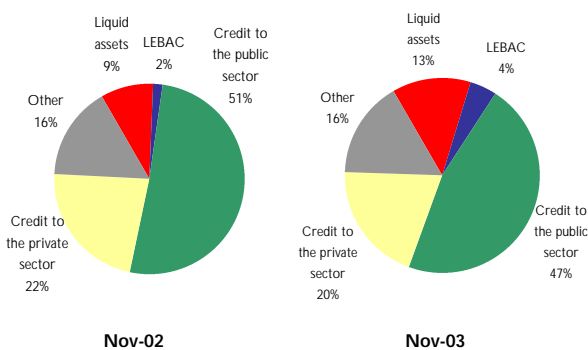


Chart 10  
TOTAL FUNDING STRUCTURE - PRIVATE BANKS

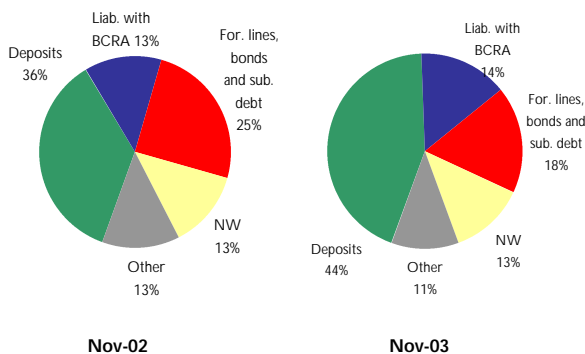
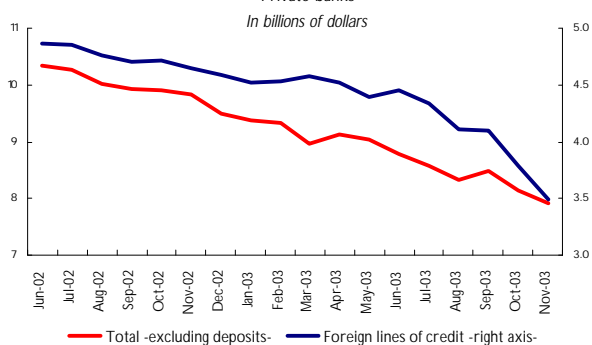


Chart 11  
Foreign currency liabilities  
Private banks



<sup>8</sup> Requirement set forth in Com. A 3940, within the framework of the refinancing of advances and rediscounts established in Chapter II of Decree 739/03

Chart 12

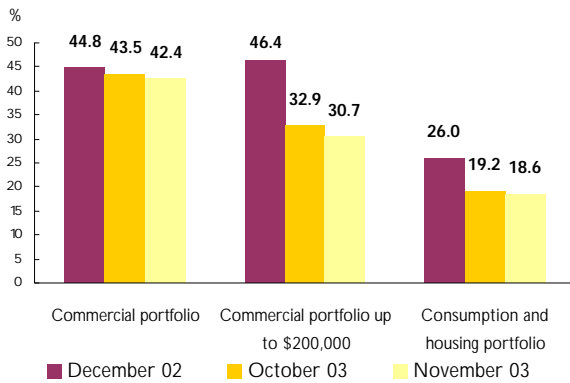
**Non-performing portfolios by type of lending**  
 Private banks lending to private sector


Table 2

**Non-performing portfolio by group (2003)**

As a % of non-financial private sector lending

	Dec-02	Oct-03	Nov-03	Share of lending to private sector (Nov '03)
Public	44.9	49.5	49.0	28.9
Private	37.5	33.6	32.7	69.0
Retail	37.7	33.5	32.6	66.1
National coverage	38.8	36.6	35.7	53.3
Regional coverage	27.7	18.7	18.3	11.4
Specialized	36.5	34.9	33.2	1.4
Wholesale	33.7	35.3	33.6	2.9
Private sector	36.6	19.2	17.5	2.1
<b>TOTAL</b>	<b>39.6</b>	<b>37.9</b>	<b>37.1</b>	<b>100.0</b>

6 billion, accounting for almost 45% of the total foreign debt of the financial system and 69% for the sub-group of institutions that was in the process of refinancing Central Bank facilities.

**20.** These programs by the financial system for the management of the portfolio of debts with non-residents (which are currently at individually different stages in terms of formal implementation), have contributed to normalize most of the banks' foreign transactions following the crisis, to improve (as shall be described later) their solvency, to improve liquidity against deposits and to rebuild their capacity to generate profitability.

**Credit, liquidity and currency mismatching risk**

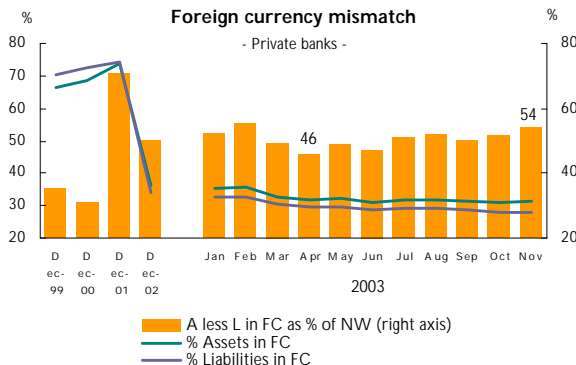
**21.** During November the quality of the portfolio of loans to the private sector continued to show a process of steady improvement. Particularly, the private banking segment reduced the level of non-performance almost 1 p.p. reaching a level of 32.7% with improvement in all types of loans. The largest improvement was in the non-performance of the under \$200,000 commercial portfolio (attributable to consumption and housing), falling by more than 2.2 p.p. to 30.7% (see Chart 12).

**22.** As shown in Table 2, all sub-groups of institutions recorded an improvement in the quality of their loans to the private sector compared to October. Specialized retail banks and wholesale banks stand out: their private loan portfolios recorded the most noticeable improvement in non-performance, which fell almost 2.2 p.p. to a level of 33.2% and 33.6% respectively.

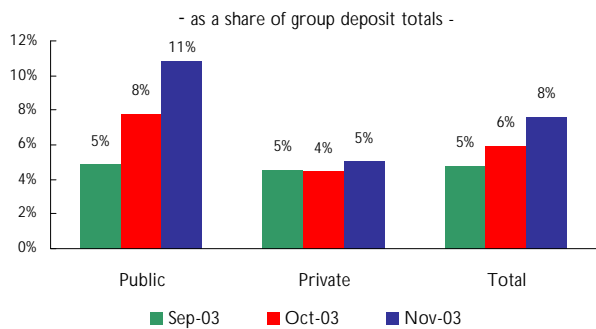
**23.** In individual terms, out of a total of 56 private institutions for which information was available in November, 30 cases recorded an improvement in the quality of their portfolio of loans to the private sector between October and November, while 18 showed an impairment in the portfolio. Compared to a year earlier, 38 institutions have improved while only 12 have poorer portfolio quality.

**24.** Changes in November to the composition of the balance sheet by currency and the total net position in foreign currency of private banks were mainly related to changes in the balance of foreign credit lines, as explained in previous paragraphs. The result was an increase in the foreign currency mismatch between assets and liabilities of 2.6 p.p. in terms of net worth, reaching slightly over 54% and accumulating a growth of almost 8.8 p.p. as of the beginning of the second quarter of 2003 (see Chart 13).

**25.** Given the performance of total deposits, the growth in the holdings of liquid assets caused the value of the systemic liquidity indicator to increase by almost 1 p.p. for private banks, reaching 29.5% of total deposits. The ratio for the consolidated banking system reached 31% in the same period, sustained by the behavior of public banks, whose liquidity approached 32% of total deposits. Breaking down liquidity by currency, it can be observed that the liquidity ratio for dollar deposits increased by almost 4 p.p. for

 Chart 13  
 Foreign currency mismatch - Private banks -


**Chart 14**  
Excess liquidity compliance



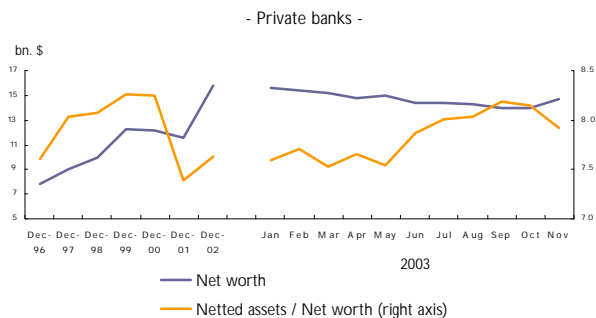
private banks (to a level of 133%) while it came down 11 p.p. for public institutions (120% in November).

**26.** In terms of the evaluation of liquidity levels in the framework of prudential regulations, **during November the liquidity position of institutions remained on an upward path.** Excess compliance in terms of total deposits for all institutions within the system increased by 2 p.p., following basically the behavior of public banks, which had a 3 p.p. increase. During November the excess compliance in this sub-group (11%) was clearly above that of private banks (see Chart 14).

## Solvency

**27.** In the context of a narrowing of current losses, the **capital contributions being made to private institutions began in November to show in an increase of accounting net worth.** This heading grew by 5% for the private banking segment, partly reducing the downward path observed during the first ten months of 2003. As pointed out in the previous section, the growth of the net worth recorded the effect of the capitalization of non-resident debt by institutions. The growth in equity caused the leverage ratio of private banks (here defined as netted asset/net worth) to fall to 7.9 times during the month, restraining the rising trend recorded by this heading in the last months (see Chart 15).

**Chart 15**  
Netted assets and net worth

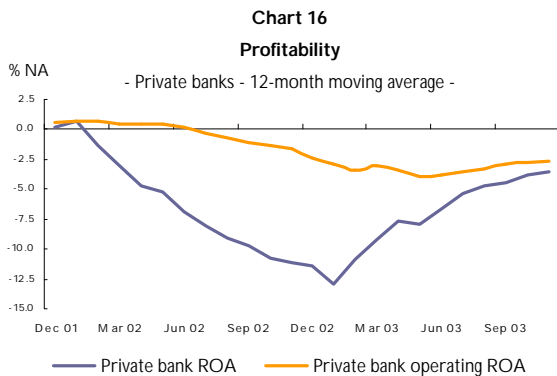


**28.** In accordance with a more favorable new macroeconomic context, and as a response to the new regulation framework by the Central Bank, **private banks over the last two years have followed a capitalization process with an impact on net worth of almost US\$ 1.6 billion (approximately 27% of the sector consolidated net worth to October).** This amount includes both the **new capital contributions and figures involved in the recapitalization and profits from swaps at discount and debt repurchase as part of foreign liabilities rescheduling.** Almost three quarters of the total amount was concentrated in institutions that refinanced Central Bank facilities within the framework of so-called “matching”.

**29.** In terms of the regulation on minimum capital, financial institutions continued to show favorable capitalization indicators. It is therefore likely that they will be able to meet without difficulty the requirements that will come into force as of January 2004. **Compliance reached 14% of assets at risk for private financial institutions, a percentage similar to the system total and which implies a 1p.p. improvement against October.** Total excess compliance (total compliance less requirements) as a percentage of total requirement improved by 13 p.p., ending the month at 104%<sup>9</sup>. These improvements basically reflect the behavior of a single institution that, as indicated before, received a capital contribution from its headquarters.

<sup>9</sup> This percentage includes forbearances. If they are not included in the estimation, the excess is of 91% of the requirement (increasing 11 p.p. against October).

## Profitability



**30.** In the context of the observed improvements in profitability in the second half of 2003, **the banking system obtained almost \$45 million in profits during November, which can be taken as the first positive monthly result for the sector since the end of 2001.** This figure is based on the behavior of the private banking segment, which recorded a positive result of \$60 million in the same period. The annualized return of this sub-group was equivalent to 0.6% of netted assets (NA) and 5.1% of net worth, i.e., 2 p.p. and 15 p.p. more than the ratios recorded in the previous month respectively (see Chart 16).

**31.** The monthly improvement in the sector profitability is maintained (although it becomes slightly negative) if the effect of a single retail private institution that registered a significant amount of extraordinary profits is removed<sup>10</sup>. Excluding this bank, the annualized return for the month under review shows a rise of 0.7 p.p. and 6 p.p. for the ROA and ROE of private banks respectively.

**32.** Profitability clearly improved during the second half of 2003, so that losses accumulated by private banks during the July/November period were 75% lower on an annualized basis than those recorded during the first half. This was translated into significant rises of both the ROA (which went from -4.5% to -1%), and the ROE (which went from -34% to -9%) in the private banking segment. Although similar results are obtained when considering the total financial system, it should be noted that the improvement in the profitability of public banks was slightly lower (the ROA in public banks went from -4.5 to -2%).

**33.** As was anticipated in the previous Report on Banks, **the depreciation of the peso against the dollar resulted in important gains from exchange rate differences.** In the heading defined here as “Other financial results” (mainly explained by exchange rate differences<sup>11</sup>), private banks recorded annualized profits in November of 1.8% of NA, against a 0.2% loss during October in the course of exchange appreciation.

**34.** Another line in the profitability structure of private banks that showed a significant positive change in November was gains from securities, going from 1.3% in October to 2.5% a month later<sup>12</sup>. This rise is due to extraordinary behavior by a major institution. Excluding this institution, these results dropped 0.2 p.p. between October and November, reaching a level of 1.1% in terms of NA.

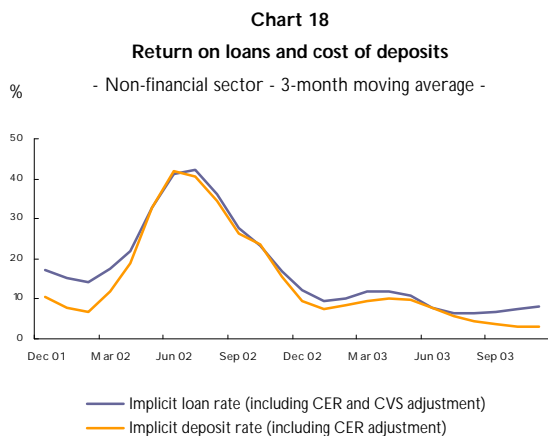
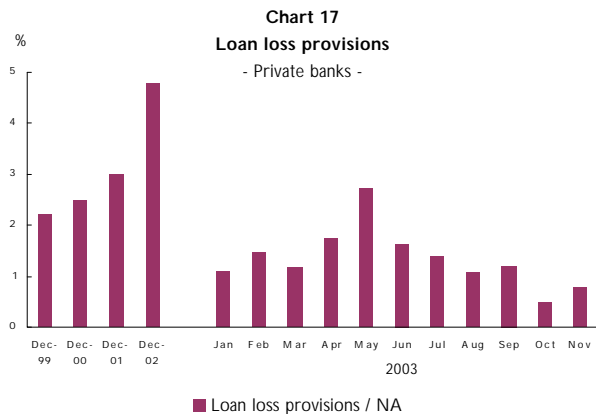
**35.** As anticipated in the previous issue of this Report, **another heading that contributed to the recovery of private bank profits**

<sup>10</sup> This bank applied an adjustment of extraordinary nature to its results from other loans by financial intermediation (here included in the so-called gains from securities) in view of the compensation that it expects to receive due to the asymmetric CER/CVS indexation.

<sup>11</sup> Net exchange differences account for almost 80% of the other financial results. Additionally, and to a lesser extent, the improvement recorded by the other financial results during November reflects the increase in premiums in foreign exchange forward transactions arranged by wholesale banks.

<sup>12</sup> See the glossary for the definition of “gains from securities”.





was the net restatement by indexation, as a result of the net positive balance in assets and liabilities denominated in pesos and adjustable by the CER or CVS indexes. Recording the increase in both the CER (0.5%, due to the CPI change in October) as well as CVS (which incorporates a \$24 increment to the baseline wage), the net income accrued by these headings rose by almost 0.4 p.p. between October and November. This variation is obtained after removing a large positive restatement, applied by a major institution, on accrued interest from lending to the public sector, with a balancing record in a restatement for a similar amount accrued by the CER index. This reclassification from CER adjustment to interest collected was related to the compensation to be received for asymmetric indexation between CER/CVS.

**36.** The previously mentioned positive effects contributed to balance out the **negative performance of certain lines of profitability – in particular the “Others” heading** – which moved from a zero level in October to losses of -1.3% in November. This change is explained by a drop in results due to long-term investment in corporations (mostly for one major retail institution), the writing-off of provisions, and an increase in losses from foreign branches.

**37.** **Loan loss provisions remained low in terms of the levels recorded during the last months, although they showed a slight deterioration in November** (see Chart 17). Up to November loan loss provisions accounted for 0.8% of NA, with an increase of almost 0.3 p.p. over the previous month. This was below the level registered during the first three quarters (15%), and was substantially lower than the level recorded in 2002 (5% of NA). There are still important institutions making downward corrections on loan loss provisions accumulated over the accounting year, so in these cases monthly provision flows have the opposite sign than usual.

**38.** During November, **the private bank aggregate continued to show a favorable performance in the margin derived from traditional intermediation, although it did not reach a positive value.** The interest income for this group of institutions (after correcting for a few simple reclassifications) remained at -0.1% between October and November 2003<sup>13</sup>. Although this level is increasingly further away from the significant negative margin recorded during 2002 and a large portion of 2003, there is still work to be done in rebuilding the main source of bank income, which becomes evident considering that prior to the crisis in 2001 the interest margin accounted – on average – for close to 4.5% of NA. The rebuilding of interest income is closely related to progress that is achieved in terms of financial intermediation. The projections for lending to the private sector included in the 2004 Monetary Program may be taken as indicative, as described in the Outlook for December section.

<sup>13</sup> This figure was obtained after correcting figures arising from the aggregation of balance sheets. This was done in order to avoid mistaken conclusions over apparent improvements in certain lines of the income statement, in view of certain changes derived from simple reclassifications of some sources of accrued income. See item 35.

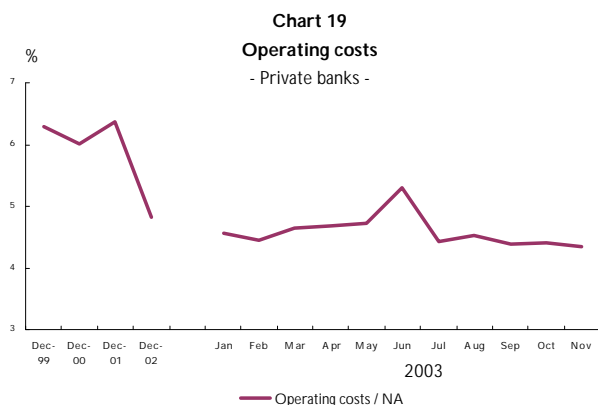
**39.** A closer look at **the breakdown of loan related interest income – which accounts for close to 95% of all interest income – shows that its composition remained stable in recent months.** In accordance with the asset structure of private institutions, in November the interest on *Préstamos Garantizados* plus the interest accrued on *Pagarés 2007* and *2012* accounted for almost 30% of interest accrued on loans. Mortgage loans accounted for 19% of this income, and only 1% was related to pledge-backed loans. The interest on overdrafts and acceptance of promissory notes had a weighting of 14% and 13% respectively. Lastly, interest income from credit card services accounted for almost 7%, with the remainder explained by personal loans, call loans and others (see Chart 18).

**40.** **The composition of interest outlays has also shown signs of stability.** Without major changes compared to previous months, 40% of interest outlays in November were related to paying interest on deposits. Additionally, slightly over 20% of expenses corresponded to the payment of interest on Central Bank facilities – including advances and rediscounts. Lastly, interest on call money accounted for less than 10% of interest expenses by private banks, and interests on other liabilities due to financial intermediation (including foreign lines of credit) accounted for 30%.

**41.** Except for the changes recorded in profits due to CER and CVS, **the remaining operating headings (service income and operating costs) continued to show a stable behavior.** Operating costs of private institutions remained at a level of 4.4% of NA for the third month in a row (see Chart 19), while income from services declined slightly to 2% of NA, remaining within the range seen during the last months (between 2 and 2.2%). As a result of the performance of these headings during November, the coverage of operating costs with net operating income, including adjustment for indexation, was slightly above 70%. Although it remains below one hundred per cent, the ratio improved against previous months as the accumulated value through October was around 60%.

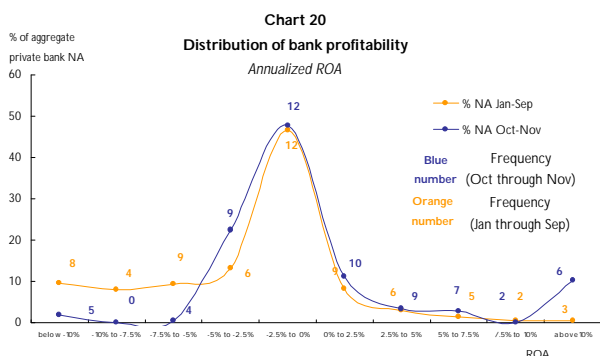
**42.** Breaking down the private bank sector aggregate by market segments, it can be observed that all the sub-groups of private retail institutions recorded positive results in November. As shown in Table 3, specialized banks recorded the highest profitability during the month, with a ROA of 10.2% against -4.1% in the previous month due to both the depreciation of the peso and the increase in the sundry profits category. Regional banks improved by nearly 2 p.p. of the ROA (reaching a level of 2.4%), caused not only by the depreciation of the peso but also by a larger adjustment accrued from the CER and CVS indexes. Lastly, the improvement in retail banks with a national coverage resulted from a single institution that accrued a large accounting profit of a non recurring nature. If this institution is removed from the sample, the sub-group records a negative ROA (-1.1%), although 1 p.p. above the previous month. **Public bank profitability also improved in November to an almost nil ROA (-0.6%), an increase of almost 2.5 p.p. from October.**

**43.** In terms of the individual profitability, out of a total of **64 private banks, 39 recorded positive results.** Out of the 25 banks that recorded losses – 11 institutions less than in October – 12 had



**Table 3**  
**Profitability by group (2003)**  
Annualized ROA as % - by type and area coverage

	Q1	Q3	October	November
Public	-4.5	-1.9	-3.1	-0.6
Private	-4.5	-1.7	-1.2	0.6
Retail	-4.7	-1.6	-1.1	0.9
National coverage	-5.4	-2.3	-1.4	0.4
Regional coverage	-1.2	1.9	0.3	2.4
Specialized	-0.9	1.8	-4.1	10.2
Wholesale	0.3	-4.6	-3.9	-3.9
Non-bank institutions	-11.7	7.5	-13.7	14.2
<b>TOTAL</b>	<b>-4.5</b>	<b>-1.7</b>	<b>-2.0</b>	<b>0.3</b>





profits improve from the previous month. Combining October and November, 34 institutions recorded a positive ROA, adding 9 more institutions to the number of cases recording profits in the first three quarters of the year. During October and November, institutions recording profits accounted for almost 30% of private bank NA, almost twice the figure for banks recording profits during the first three quarters of the year (see Chart 20).

### Outlook for December

**44.** Based on the information available at the time of writing (see Table 4), profitability for December can be expected to come in at close to zero, due to the booking of extraordinary losses (related to balance closing) and/or seasonal factors. It is possible that a number of factors may give rise to accounting profits, the most important of which include the recording of compensation for asymmetric CER/ CVS indexation and the positive net worth effect derived from non-resident debt rescheduling by certain institutions.

**45.** The path of the exchange rate between the beginning and end of December limits the possibility that the private bank sector aggregate will record profits from “exchange rate differences”. In addition to the effect of restatements of foreign currency assets and liabilities, this heading includes profits from trading in foreign exchange. As a result, **the “Other financial results” heading is not expected to contribute positively in December.**

**46.** **The expected seasonal increase in operating costs also limits the possibility of an improvement in profitability for the last month of 2003.** A historical analysis of operating costs shows that a rise of between 10% and 15% may be expected in December, provided that there is no extraordinary increase in the level of amortizations. This would result in operating costs approaching an annualized level of 5% of NA in December. This increase may be partially balanced out by an increase in service income, which tends to rise in the last month of the year<sup>14</sup>.

**47.** **Interest income is expected to improve slightly in December due to the drop in paid interest.** Deposits shifted towards sight placements and against time deposits in December. Additionally, there was a fall in interest rates paid on time deposits, with a 0.5 p.p. decline in the average rate on 30-44 day deposits – a larger change than in the preceding month – so that a drop in interest outlays may be expected. The future path of interest income is less clear. Lending interest rates during December show signs of remaining on a downward trend – particularly due to the fall by more than 3 p.p. in overdraft rates, the credit line with the highest value in terms of new lending. As regards the volume of lending, although there has been some growth in the balance of loans in pesos to the private sector, it has been almost entirely counterbalanced by the decline of loans in dollars.

**Table 4**  
**Main developments in December**

	Nov	Dic	Chg. (%)
<b>Prices</b>			
Exchange Rate (\$/US\$)	2.99	2.93	-1.83
CPI	142.30	142.60	0.21
CER	145.23	145.68	0.31
	%		Chg. (p.p.)
<b>Average Percentage Rates</b>			
Lending	25.9	23.1	-2.8
Private Banks	25.8	23.0	-2.7
Overdraft	28.6	25.2	-3.4
Promissory notes	13.9	14.2	0.3
Mortgage	12.3	10.6	-1.7
Pledge-backed	15.9	17.0	1.1
Personal	42.6	42.5	-0.1
Public Banks	28.5	25.0	-3.4
Overdraft	29.0	25.7	-3.3
Promissory notes	14.9	13.0	-1.9
Mortgage	14.0	8.1	-5.9
Pledge-backed	17.7	18.1	0.5
Personal	16.0	15.9	-0.1
30- to 44-day time deposit	4.3	3.8	-0.5
6-month LEBAC in pesos, w/o CER	4.9	3.7	-1.2
	Millions		Chg. (%)
<b>Balance - Private banks</b>			
Peso deposits - Private sector	41,916	41,943	0.1
Sight deposits	21,162	22,493	6.3
Time deposits	18,273	17,159	-6.1
Peso loans - Private sector	17,929	18,313	2.1
Overdraft	3,854	4,037	4.7
Promissory notes	3,113	3,316	6.5
Mortgage	5,580	5,509	-1.3
Pledge-backed	487	473	-2.9
Personal	1,354	1,369	1.1

<sup>14</sup> The analysis of the behavior of the different headings based on historical data shall be considered with caution in relation to structural changes introduced as of the year 2001 – and the persistence of book adjustments related to these changes- could alter the model of behavior of certain headings.



**48.** The path for the CER and CVS indexes suggests that the adjustments accrued by these headings will remain without major changes during the last month of the year. As to the CER index, the daily series grew between the end of the month of November and the end of the year by close to 0.3%, below the 0.5% monthly increase recorded a month earlier. Given the staggered \$24 monthly increments to the baseline private sector wage, it is expected that the CVS index will grow by a percentage similar to the one recorded in the last months (around 2%).

**49.** Although in historical terms loan loss provisions have a propensity to increase in June and December – as banks close the accounting year<sup>15</sup> – the behavior recorded over the past months in this line of the profitability structure would suggest that the calculation of provisions will not increase noticeably in December, and may even record a drop.

**50.** In this way, and provided there are no major extraordinary results in December, **it is expected that private banks end the year with an accumulated ROA of approximately 3%**, given the losses recorded especially during the first half of the year (4.5%), **and the negative result of around 1% of NA in the last quarter.**

**51.** The rebuilding of profits for the consolidated financial system depends directly on the rebuilding of financial intermediation. In line with the assumptions described in the Monetary Program for 2004, based on the performance expected for output during 2004 and on regulation changes implemented to help rebuild financial intermediation, **the Central Bank forecasts an annual increase in credit to the private sector of between 10% – in the worst scenarios – and 60%.** The broadness of this range is related to uncertainty over the development of certain relevant factors. Nevertheless, the positive nature of expectations on lending should be stressed, as a result of the turning point in the credit market during the last quarter of 2003. The improved expectations for private sector credit during 2004 are consistent with developments in a number of factors that condition the demand for credit. These include expected improvements in employment and real wages, which directly affect households' expected flow of funds. The behavior of lending rates is also expected to have a favorable impact on the demand for credit, as these rates are likely to continue along a downward trend as observed in 2003.

**52.** As the expected recovery in the interest margin takes place in 2004, there will be an **impact due to foreign liability rescheduling** – a large portion of which is already concluded or mostly underway. In general terms, these debt rescheduling programs – which are being widely accepted – are showing **important benefits for banks in terms of the extension of maturities and reductions on principal and/or interest.**

<sup>15</sup> In the 1990s it was frequent for increases of up to 100% to be registered in monthly provisions for the last month of the year.



### ***Latest regulations***

This section contains a summary of the main regulations related to the business of financial intermediation issued during the month (taking as a reference the date in which they come into force).

#### ***Communication “A” 4043 (Nov-10-2003)***

Established the calculation method to determine the balance amounts in foreign currency current accounts with the BCRA that were not subject to conversion into pesos through Article 10 of Decree 214/02.

Decree 214/02 (as modified by Decrees 410/02 and 1267/02) ruled that the balances at the close of operations on Feb-01-02 of financial institutions' dollar-denominated or other foreign currency-denominated accounts which were computable towards reserve requirements (with the exception of cash held by banks) should be converted to pesos at the rate of \$1.40 for each US dollar. This included the balances of accounts opened to that effect in the Deutsche Bank in New York, following the transfer of those funds to accounts indicated by the BCRA.

It likewise stated that the amounts not subject to conversion into pesos would arise in the circumstance that the balances of the accounts opened with the BCRA were not related to reserves requirements or to the treatment corresponding to liabilities that are computable in determining these requirements.

The Communication includes the methodology for determining the amount subject to repayment – *Importe susceptible a reintegro* or ISR – by the BCRA (if the result is positive), or to be repaid by financial institutions (if the result is negative). According to estimates, the total impact of the measure will be of between \$350 and \$400 million.

#### ***Communication “A” 4051 (Nov-27-2003)***

With the purpose of bringing the financial system back to normal and reestablishing its role in the intermediation between saving and investment, the Central Bank reduced as of December 2003 the reserve ratios on sight deposits from 23% to 20%, with an expansive effect (through the reduced requirement) estimated at around \$1 billion.



### ***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 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.



## Glossary

**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.

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

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

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

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

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

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

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

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

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

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

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

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



**Balance sheet**

Private banks

In current pesos (millions)	Dec 99	Dec 00	Dec 01	Dec 02	Nov 03	Change (%)		
						Month-on-month	Up to Nov 03	Year-on-year
<b>Netted Assets</b>	<b>85,918</b>	<b>88,501</b>	<b>73,796</b>	<b>117,928</b>	<b>116,574</b>	<b>2.0</b>	<b>-1.1</b>	<b>-4.5</b>
Liquid assets	13,228	13,920	10,576	11,044	15,158	4.9	37.2	39.7
Public bonds	6,433	7,583	1,627	19,751	21,809	0.0	10.4	10.7
Private bonds	410	563	451	273	173	0.6	-36.7	-35.3
Loans	56,916	56,035	52,319	51,774	47,408	1.0	-8.4	-11.8
Public sector	6,389	8,172	13,803	25,056	23,660	0.0	-5.6	-10.4
Private sector	47,705	45,103	36,636	26,074	22,921	1.6	-12.1	-14.2
Financial sector	2,823	2,760	1,880	644	828	15.1	28.5	31.5
Provisions over loans	-3,119	-3,248	-3,957	-7,463	-5,496	-2.2	-26.4	-24.0
Other netted credits due to financial intermediation	4,470	5,730	4,489	26,235	21,107	4.9	-19.5	-26.9
Purchases (net)	487	1,103	807	380	655	76.5	72.6	25.2
Corporate bonds and subordinated debt	1,022	724	665	1,514	1,433	3.2	-5.4	-9.1
Unquoted trusts	958	1,609	1,637	6,205	3,855	0.4	-37.9	-36.7
Compensation receivable	0	0	0	15,971	13,518	4.8	-15.4	-26.3
BCRA	12	35	865	377	1,631	2.1	332.8	278.8
Assets under financial leases	796	776	752	553	386	-1.7	-30.3	-35.5
Shares and participation	1,371	1,651	1,703	3,123	3,370	-0.4	7.9	3.3
Fixed assets and sundry	3,246	3,225	3,150	5,198	4,937	-1.4	-5.0	-6.7
Foreign branches	48	75	112	-109	-134	9.9	23.1	876.0
Other assets	2,120	2,190	2,574	7,549	7,855	1.5	4.1	16.8
<b>Netted Liabilities</b>	<b>73,615</b>	<b>76,322</b>	<b>62,281</b>	<b>102,101</b>	<b>101,897</b>	<b>1.6</b>	<b>-0.2</b>	<b>-4.1</b>
Deposits	54,447	57,833	44,863	44,445	52,411	2.0	17.9	14.2
Public sector (1)	1,342	1,276	950	1,636	3,109	6.0	90.1	144.9
Private sector (1)	52,460	55,917	43,270	38,289	46,782	1.5	22.2	28.1
Current account	5,022	4,960	7,158	8,905	10,864	3.8	22.0	48.4
Savings account	9,702	9,409	14,757	6,309	10,162	3.2	61.1	67.7
Time deposit	35,218	39,030	18,012	11,083	19,419	0.5	75.2	187.2
CEDRO	0	0	0	9,016	2,621	-6.6	-70.9	-78.3
Other netted liabilities due to financial intermediation	16,185	15,401	14,082	48,364	42,457	0.7	-12.2	-15.7
Call money	2,146	2,293	1,514	836	986	15.4	17.9	21.8
BCRA lines	274	83	1,758	16,624	16,891	0.3	1.6	6.1
Outstanding bonds	4,990	4,939	3,703	9,073	7,301	3.5	-19.5	-25.0
Foreign lines of credit	6,680	5,491	4,644	15,434	10,428	-4.5	-32.4	-37.7
Sales (net)	492	510	99	349	212	-11.4	-39.2	-48.0
Subordinated debts	1,683	1,668	1,700	3,622	3,102	6.0	-14.4	-27.7
Other liabilities	1,299	1,420	1,637	5,671	3,927	4.0	-30.8	-31.0
<b>Net Worth</b>	<b>12,304</b>	<b>12,178</b>	<b>11,515</b>	<b>15,827</b>	<b>14,677</b>	<b>4.6</b>	<b>-7.3</b>	<b>-7.2</b>

(1) Does not include accrual on interest or CER

**Profitability structure**

Private banks - in annualized terms

As % of	Yearly				Up to November		2003		Monthly	
	1999	2000	2001	2002	2002	2003	H1	H2 *	Oct-03	Nov-03
netted assets										
Net interest income	4.5	4.1	4.3	-0.2	-0.6	0.0	-0.1	0.1	0.0	0.7
Restatement by CER and CVS	0.0	0.0	0.0	1.1	1.3	0.7	0.8	0.7	0.7	0.4
Other financial income	0.5	0.7	1.0	4.3	4.3	-1.0	-2.7	0.9	-0.2	1.8
Service income margin	3.1	2.9	3.2	2.0	2.0	2.0	2.0	2.1	2.2	2.0
Gains on securities	1.1	1.4	1.2	2.5	2.2	1.4	1.3	1.4	1.3	2.5
Operating costs	-6.3	-6.0	-6.4	-4.8	-4.7	-4.6	-4.7	-4.4	-4.4	-4.4
Loan-loss provisions	-2.2	-2.5	-3.0	-5.0	-5.2	-1.3	-1.6	-1.0	-0.5	-0.8
Tax charges	-0.4	-0.4	-0.5	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3
Income tax	-0.5	-0.4	-0.3	-0.2	-0.1	-0.2	-0.4	-0.1	0.0	0.0
Other	0.5	0.4	0.7	-3.0	-2.7	0.5	1.4	-1.1	0.0	-1.3
Monetary results	0.0	0.0	0.0	-7.5	-8.4	0.0	-0.1	0.0	0.0	0.0
ROA before income tax	0.8	0.6	0.5	-11.1	-12.2	-3.1	-4.1	-1.1	-1.2	0.7
ROA before monetary results	0.3	0.1	0.2	-3.8	-3.9	-3.3	-4.4	-1.1	-1.2	0.6
<b>ROA</b>	<b>0.3</b>	<b>0.1</b>	<b>0.2</b>	<b>-11.3</b>	<b>-12.3</b>	<b>-3.0</b>	<b>-4.5</b>	<b>-1.1</b>	<b>-1.2</b>	<b>0.6</b>
<b>Indicators (%)</b>										
<b>ROE</b>	<b>2.3</b>	<b>0.8</b>	<b>1.4</b>	<b>-79.2</b>	<b>-85.5</b>	<b>-23.0</b>	<b>-33.9</b>	<b>-9.2</b>	<b>-10.0</b>	<b>5.1</b>
Operating profit / NA	0.9	0.6	0.6	-2.3	-2.4	-2.1	-2.4	-1.9	-1.8	-1.5
Operating revenue / operating costs	120.5	116.9	117.1	59.0	57.0	60.1	56.1	65.0	65.7	72.2
Interest income (with CER and CVS) / loans	..	13.9	16.1	24.7	27.7	8.7	9.8	7.4	6.9	9.5
Interest payments (with CER and CVS) / deposits	..	5.7	7.8	21.9	24.9	6.1	8.6	3.4	2.9	3.2

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

\* Up to November

**Portfolio quality**

Private banks

As percentages	Dec 99	Dec 00	Dec 01	Dec 02	Oct 03	Nov 03
Non-performing loans (overall)	7.6	8.3	9.9	19.9	17.4	16.9
Loans to the non-financial private sector	8.9	9.8	14.0	37.4	33.6	32.7
Commercial portfolio	6.2	7.6	15.2	44.5	43.5	42.4
Commercial portfolio up to \$200,000	11.7	14.6	16.4	47.1	32.9	30.7
Consumption and housing portfolio	12.5	11.9	12.4	26.1	19.2	18.6
Provisions / Non-performing loans	69.4	67.7	75.7	73.3	75.0	75.3
(Non-performing - Provisions) / Overall financing	2.3	2.7	2.4	5.3	4.3	4.2
(Non-performing - Provisions) / Net worth	11.5	13.4	11.4	18.7	15.6	14.4