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Second Half 2007

CENTRAL BANK OF ARGENTINA



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Preface

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

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

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

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

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

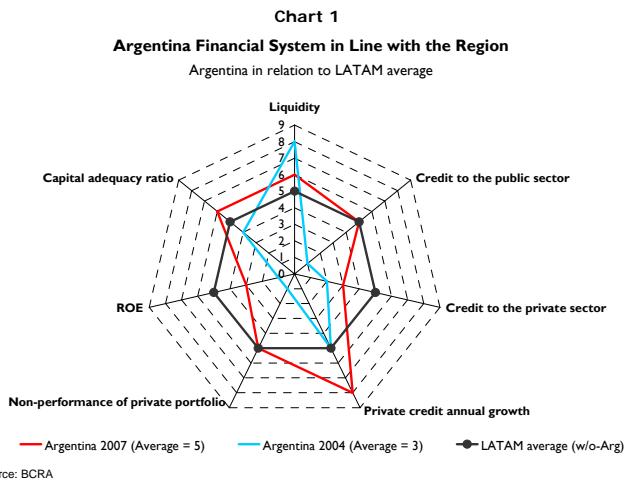
The date of publication of the next issue of the **FSB**, with statistics that cover at the end of December 2007, will be on March 31, 2008, on the Central Bank website.

Buenos Aires, September 27, 2007

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CENTRAL BANK OUTLOOK



During 2007 the efficacy of the Central Bank policies targeted at promoting monetary and financial stability conditions can still be observed. The deepening of the financial intermediation transactions with the private sector and the consolidation of the process to bring banking balance sheets back to normal, in particular, prove the effectiveness of the financial policy that the Central Bank designed. In this period, the domestic financial system has already come in line with the major financial systems in Latin America. In the first part of 2007 the funds channeled towards the private sector have increased, reducing exposure to the public sector. Likewise, and in a limited risk framework, longer maturity or transactions and a greater access to loans have been achieved. The positive trend in deposits and the utilization of capital markets as a source of funding underlie the growth rate of loans to the private sector. These developments contribute towards strengthening the recurrent sources of funds for the financial system, which added to the capital contribution are driving the consolidation of solvency levels, placing banks in a sound relative position to act as a buffer factor to face the current international financial stress context.

The Central Bank established incentives to normalize the financial system assets. The reduction of banking exposure to the public sector, the increased financing to the private sector (avoiding currency mismatches) and setting up prudential liquid assets were the major focal points of the Central Bank policy. Specifically, in order to stimulate the lower exposure to the public sector it defined: maximum limits based on bank capital depending on the jurisdiction, an overall cap at 40% of total assets as from January 2006 and of 35% since July 2007, and it eliminated the bias in minimum capital requirements.

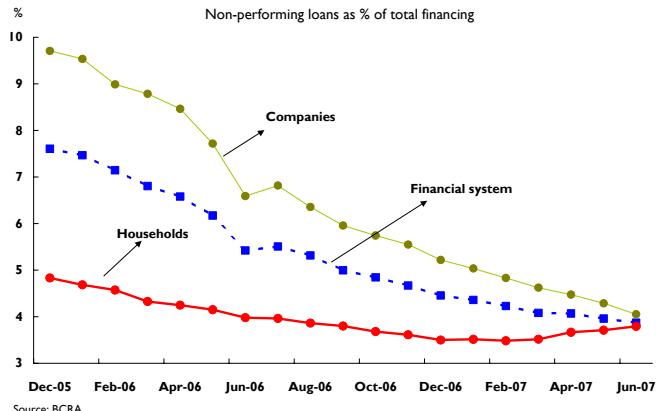
Meanwhile, in order to promote volume, access and longer maturities for loan transactions with the private sector, the Central Bank defined: guidelines to assess debtors with more weighting on future payments capacity than past performance, elimination of the margins to discount documents, more flexible capital requirements on the mortgage loans for smaller amounts, the inclusion of specific documentation to substitute for evidence of earnings when assessing debtors, and admitting the use of screening tools and credit scoring models, while the Origination Manual was relaunched, in order to favor the homogenization of the mortgage loans for subsequent securitization. The need to improve the transparency levels was also emphasized with more publicity and clearer information about the total financial costs of the products, opening up a Bank Client Web Page in the context of the Central Bank's Transparency Regime and with progress in the project to set up a corporate Balance Sheet Centre of information.

During the first half of 2007 the financial system reduced its exposure to the public sector by 4.6 p.p., to 17% of total assets. The sale of public sector assets and the scheduled debt amortizations remain the main mechanisms that reduce the financial system exposure to the public sector. In this sense, the significance of this process is noteworthy, as it enabled

Chart 2

Non-Performing Credit to Companies and Households

Non-performing loans as % of total financing



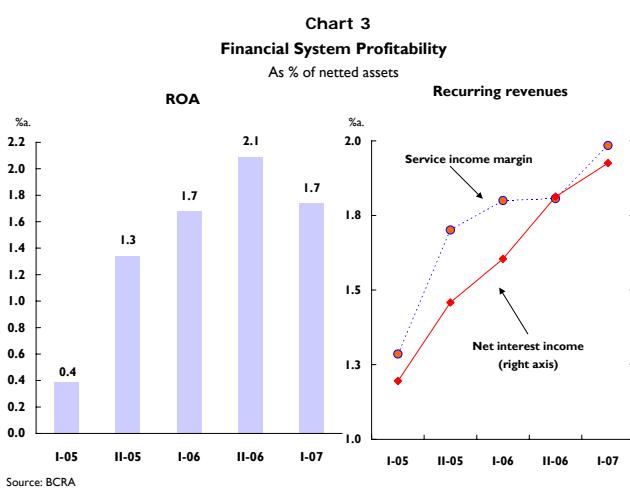
Source: BCRA

continuity of the trend to expand loans to the private sector and consolidate bank soundness (for instance, by mitigating the negative impact on balance sheets of the current volatilities on the capital markets). Simultaneously, the financial system expanded its credit lines to the private sector at a rate of around 38% y.o.y., to reach an equivalent of almost 33% of total assets. It therefore reversed the situation recorded prior to the 2001-2002 crisis, with loans to the private sector that almost doubled credit to the public sector.

The progress in expanding finance to the private sector was accompanied by more coverage at a geographical level and extending the maturities of the transactions. As regards the longer maturity, all lending lines recorded increases. In particular, the combined effect of an increase in their weighting in overall new transactions and in the maturities at which mortgage loans were granted account for most of the change above. During the first half of 2007, albeit from a low level (1.5% of the GDP), the mortgage loans exhibited a 32%a. expansion, compared with 10%a. in the first half of 2006.

The deepening of the financial intermediation process with the private sector developed within a limited risks framework. Firstly, while the financial system dedicated the largest share of its funds to finance the private sector it simultaneously built up liquid assets for amounts that maintained prudential liquidity indicators at adequate levels. Although the domestic financial markets started to partially reflect the effects of a more turbulent international context, the rises that were observed in the interest rates on the call money market were related to the sales of debt securities by foreign investors, and to a lesser extent by some overreaction by certain financial entities. In this context the Central Bank continues providing tools to consolidate the financial system to face the liquidity risk and to help avoid abrupt interest rate changes affecting credit: adding to the already established role as a lender of last resort were repo offers, Lebac and Nobac repurchases (through direct purchases and by auctions on the secondary market), moderation in the sales of these securities on the primary market, repo auctions, the two-month minimum cash reserve positions (July-August and October-November), and taking part in the dollar futures market.

While the financial system was able to strengthen its position to face the liquidity risk it also achieved more soundness to face counterparty risk. In the first place, although exposure to private sector risk grew, the framework of sound revenue prospects, the adequate financial positions of firms and families and appropriate provisions booked by the banks were crystallized in the reduced levels of credit risk exposure to this sector. In this context, the aggregate non-performance of the private sector loans was 3.9% in mid 2007, which meant a new historical minimum in line with the major economies in the region. In particular the arrears in corporate loans kept falling in the first half of the year, while non-performance of households, although showing a slight increase in the period (especially due to the impact of consumer lines, such as personal loans and credit cards), still remained at low levels. In second place, the reduction in the weighting of public sector assets, together with the sustained primary fiscal surplus, lower levels and a better



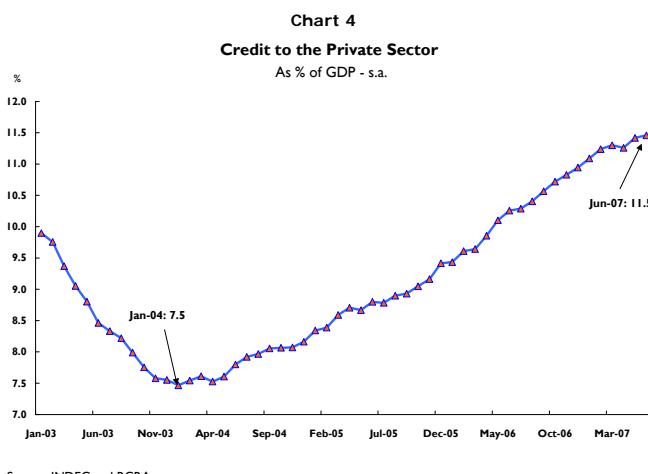
debt profile of sovereign debt, were reflected by a declining banks exposure to public sector credit risk.

In the first half of 2007 banks exhibited a small increase in their exposure to foreign currency risk, a change associated with the slight growth of the mismatch in dollar items. Despite the above, the stress tests indicate that the banks still exhibit a solid position to face this risk, with adequate capital levels for extreme negative shock events. Looking ahead at the second half of 2007 and in the context of the turmoil on financial markets, the Central Bank led an intervention policy on the foreign exchange market to avoid an excessive volatility of the dollar affecting the real economy and expectations: interventions were carried out on the futures market and interventions on the spot market were coordinated with public banks.

Together with the normalization of the financial system assets the financial policy designed by the Central Bank also stimulated the normalization of their liabilities and lengthening their maturities. In this framework private sector deposits are consolidating as the main source of funds for the financial system, with a similar development for time and sight deposits. In addition, the financial system started taking advantage of benefits from complementarities with the capital markets. In 2007 there have been fresh issues of corporate bonds by large, medium and small banks. Finally, and due to the multiple tools generated by the Central Bank, the rediscounts for illiquidity that the Central Bank granted in the 2001-2002 crisis continued its accelerated cancellation.

With the purpose of continuing the incentives for the migration of savings in sight accounts to time deposits, the Central Bank introduced a number of regulatory changes. In fact it decided that sight deposits in pesos with a remuneration of over 15% of the BADLAR rate will be subject to a 100% minimum cash reserve requirement rate. It also increased the reserve requirement on sight deposits (from 15% to 19%), eliminated the remuneration of reserve requirements on this kind of deposit (current accounts and savings accounts), and eliminated the reserve on time deposits with more than 180 days remaining to maturity. It also authorized time deposits operations at a variable interest rate together with an ensured minimum fixed interest rate and expanded the range of eligible assets and indicators for time deposits with variable remuneration. It also granted facilities to include hybrid debt instruments (with a minimum 30 year term) to set up regulatory capital.

The deepening of the financial intermediation process with the private sector during the first half of 2007 boosted the financial system's accrued profits. In this scenario, on aggregate the financial entities maintain stable profitability levels compared to the same period last year, recording a ROA of 1.7%a. and a ROE of 12.8%a. in the first half of 2007. The profits earned by banks in the first half of the year were mainly associated with recurring income origins: interest and services results. Although a certain temporary decline in the financial system's profitability is expected in the second half of the year due to the impacts of the volatilities that are still visible on financial markets, the measures that the Central Bank has adopted will help to mitigate this situation. In fact, with the purpose of preventing the short



term changes in yields temporarily affecting the financial institution results the possibility of booking Central Bank securities in investment accounts (for holdings held to maturity) was authorized as well as both sovereign bonds and those issued by the Central Bank in available to sell accounts.

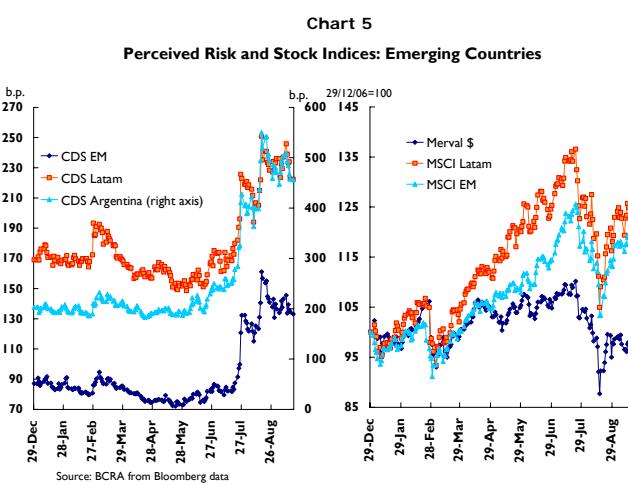
Through profits and fresh capital contributions the financial system strengthened its solvency levels in the first half of 2007. In this framework net assets increased \$2.6 billion (16.5% a.) with fresh capitalizations that totaled \$960 million in the period (all carried out by private foreign banks). Although current profit rates are expected to reflect the effects of a more volatile scenario, both the improvement in the capacity to generate profits achieved during the past three years and the capitalizations it has received place the financial system in a relatively strong position to absorb the possible negative impacts of the current international context.

In this framework the Central Bank continues developing its risk-based supervisory scheme. During 2007 the cycle of on-site inspections continued according to the 2006-2007 schedule. This plan includes notifying the CAMELBIG ratings to financial entities and their calculation for minimum capital regulations. The Central Bank, through the SEFyC undertakes this procedure along the lines of its Supervision Manual, bearing in mind the most recent international standards.

There are issues still pending despite the favorable developments in recent years. The small penetration in the domestic economy is one of the principal historical limitations of the financial system that was deepened during the 2001-2002 crisis. Although the present level of credit to the private sector has increased 4 p.p. from its post-crisis minimum it is still only 11.5% of GDP, significantly lower than seen in other economies, whether developed or emerging. The limited access to credit by certain socio-economic strata of the population (and to formal financial services in general) also stands out. Finally, the need to continue deepening the supply of medium and long term credit for investment is still present on the financial system agenda. Due to the characteristics of the pending issues mentioned above, achieving relatively adequate levels is considered a medium term challenge.

In order to help improve depth and access to financial services the Central Bank has adopted a number of measures, of which the following stand out: authorizing a kind of mobile operating outlet in locations where no branches are already installed, broadening the range of services that the special outlets can provide, promoting mutual guarantee society (SGR) assurances, encouraging micro-loans that allow for longer maturities (from 24 to 36 months), raising the installment amount (\$200 to \$300) and making the payment period more flexible, increasing the amount for domiciliary infrastructure works, establishing capital requirements according to the character of a jurisdiction and regulating the operations of the new Credit Unions.

Looking ahead at the second half of the year and in line with concerns at the international level (fundamentally as regards the problems in the sub-prime mortgage sector in USA. and its impact on world growth), it is noteworthy that during July and



August, in a scenario of much turbulence on the global markets, investors sought refuge in assets that are regarded as relatively less risky, which was reflected in a significant worsening of emerging country assets (including Argentine bonds and equity). Although some recovery was recorded later, a global scenario of more uncertainty is finally ratified, without being able to define precisely the final impact on emerging economies in general and the domestic economy in particular yet. In this manner, although the ultimate impact on countries in the region will depend on the depth and the duration of the current deterioration of the global markets, the improvement of Argentina's macroeconomic fundamentals, including the greater soundness of the financial system, enables the domestic economy to at present be clearly better prepared to face a highly volatile environment.

During the rest of 2007 the Central Bank will continue developing its financial policy with the purpose of promoting a favorable framework for the continuity of the conditions that make for monetary and financial stability.

I. INTERNATIONAL CONTEXT

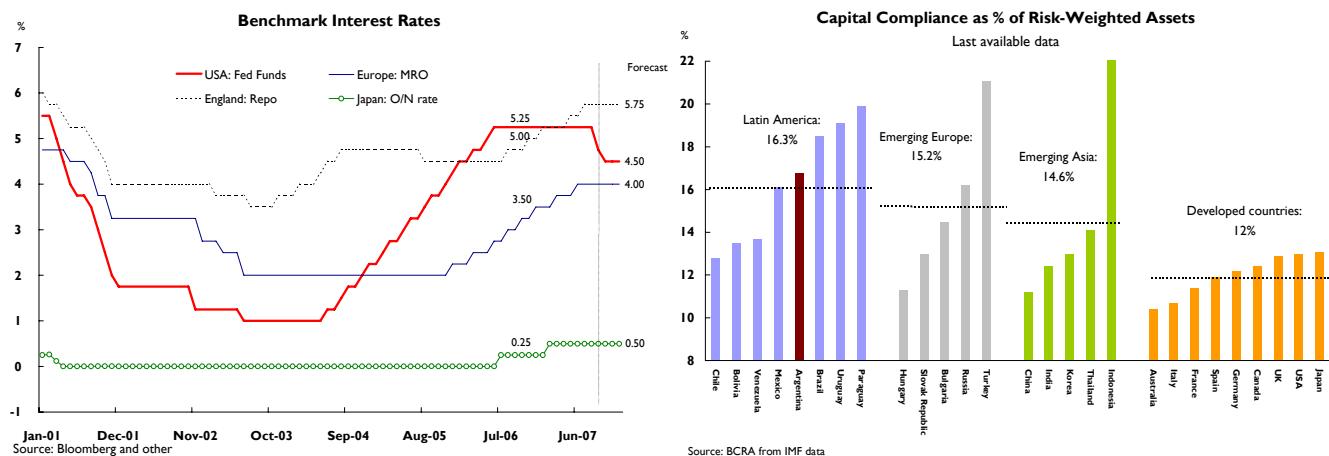
Summary

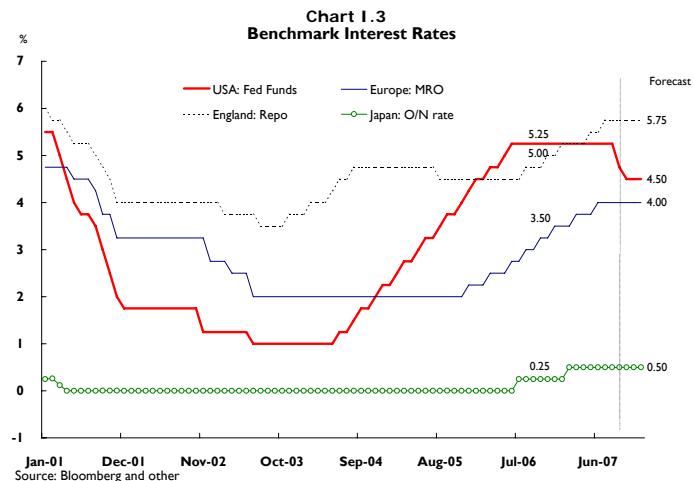
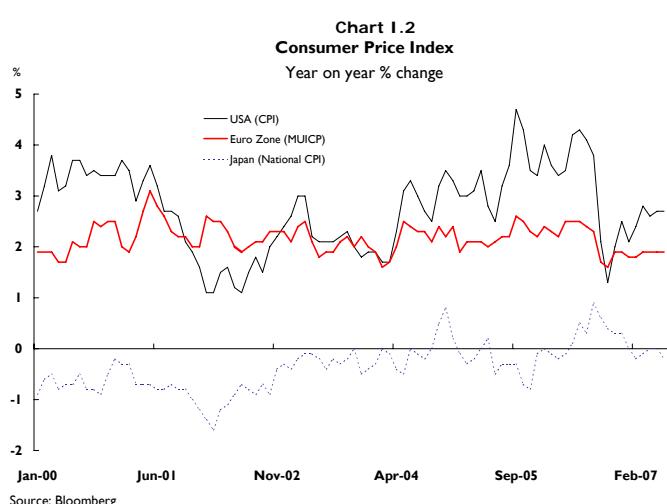
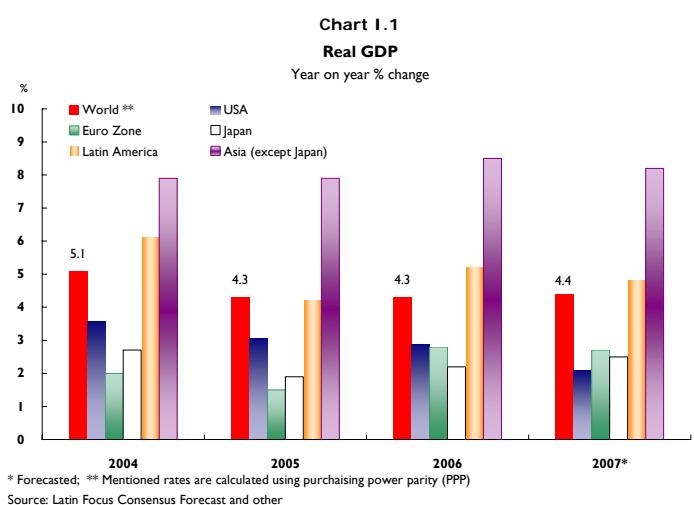
The deepening of the recent turmoil in the global financial markets, consequence of the USA real estate sector weakness, is leading to downgrades in worldwide growth's estimates. As a result of these turbulences and among other measures aimed at liquidity injection, the USA Federal Reserve reduced the Fed Funds interest rate, while the market expectation of an increase in the European Central Bank's MRO rate was postponed.

Furthermore, the main Central Banks still acknowledge that inflationary risks persist. It is expected that in 2007, both the USA and the Euro Zone will show inflation rates higher to last year's and those predicted months ago. The inflationary pressures are partly related to the evolution of raw materials prices that experienced sustained increases in the first half of 2007. During the recent global financial markets turmoil, commodity prices were barely affected, responding more to each product characteristics.

This period of global volatility was preceded by an increasing risk appetite. In particular, during the first half there was a noticeable dynamism in mergers and acquisitions at global level, together with good corporative earnings, which had driven the stock-market indices of developed and emerging countries to historical maximums. In this context, the trading volumes of emerging debt reached a new maximum in the first half of this year, whereas the EMBI+ spread marked a new historical minimum. At the beginning of the second half of 2007, the USA mortgage crisis expanded towards Europe, while generally hitting emerging markets within a searching process of higher quality assets.

The Latin American financial systems show strength and low direct exposure to the developed countries credit risk. Nevertheless, the continuity of the turbulence in the international markets could impact somehow in the financial markets of the region, mainly through the deceleration of the worldwide growth, extraordinary movements in asset prices and interest rates increases (and its consequences on credit risk).





I.1. International financial markets

Although the global economy is expected to grow in 2007, the volatility of global financial markets is lowering growth projections

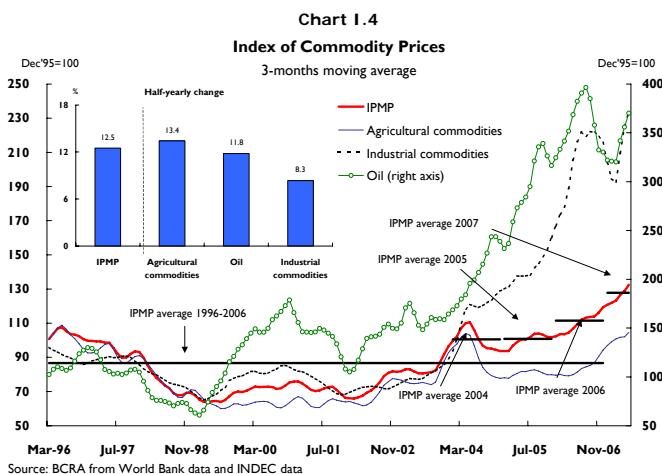
In the first half of 2007, the global economy kept on growing steadily and the expected growth for 2007 is 4.4%, 0.1 p.p more than in the previous year (see Chart I.1), with similar rates among the main economies of the world and also high rates of variation in historical terms in the main emerging regions are expected. However, a deepening of the USA real estate sector weakness and recent volatility in the global financial markets is leading to downward revision in growth forecasts, which remained unaltered for the global economy since February of 2006.

After the USA GDP deceleration in the first three months of this year, the economy increased its rate of expansion in the second quarter. For 2007, the expected growth is 2.1% which is lower than the rate registered last year (2.9%), and to the estimated figure in December of 2006 (2.4%). It is worth mentioning, that the last change in the annual growth of the American economy in 2007 was registered at the beginning of June, reason why even these expectations would not reflect the greater weakness of the real estate market and the recent events in the global financial markets.

Even though growth expectations for both the Euro Zone and Japan were revised upwards, during the first half of the year the expansion rates were reduced. Consequently, the expected growth for 2007 in the Euro Zone is 2.7%, slightly inferior rate than that recorded the previous year (2.8%), and for Japan 2.5%, 0.3 p.p higher than to 2006. On the other hand, Latin America continued showing a favorable performance; the expected growth for 2007 is 4.8%, the fourth consecutive year over 4%. In the meantime, Emerging Asia continued growing solidly with an expected expansion of 8.2% in 2007, driven by China's sustained strength in spite of the measures adopted by the Government which aimed at decelerating the economic growth.

Given the inflationary risks, the main Central Banks maintained the tightening bias in their monetary policies during the first half of 2007, although there already were hints of change by the Fed

The evolution of the retail prices during the first half showed a different behavior between USA and the Euro Zone (see Chart I.2), although expected inflation rates for both regions during 2007 are 3.3% y.o.y. and 2.2% y.o.y., respectively, higher than to last year's and to that predicted months back. In fact, the USA inflation rate accelerated in the first six months of the year, affected by the increase of the prices of food and energy, and the core inflation showed a decreasing tendency reaching 1.9% y.o.y. in June, consistent with the core price index of the *Personal Consumption Expenditure* (PCE). In the Euro Zone the headline and the core inflation was around 1.9% y.o.y.. On the other hand, in Japan during the first half inflation stopped being positive, although y.o.y. would end the year in 0.1%.



The persistence of inflationary risks led the USA and the Euro Zone to preserve the tightening bias in their monetary policies with respect to the rate of reference during the first six months of this year. In fact, the USA Federal Reserve kept the Fed Funds annual rate at 5.25% and the European Central Bank (BCE) in two opportunities raised its reference interest rate (Main Refinancing Operations, MRO) up to 4% annual in the first half (see Chart I.3). At the same time, the Bank of Japan (BoJ) continued with the upward bias of its rate of reference initiated in 2006, increasing the overnight interest rate of the call market from 0.25% to 0.50% in annual terms last February. Nevertheless, as the result of the recent turbulences of the international financial markets, the USA Federal Reserve reduced the Fed Funds rate to 4.75%, while the market postponed increases in MRO by the BCE.

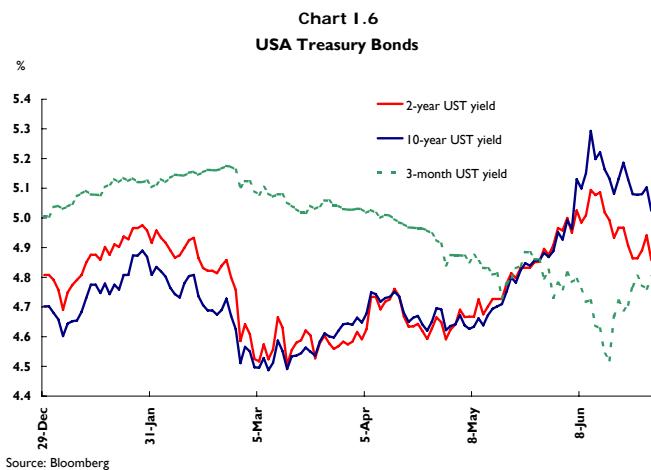
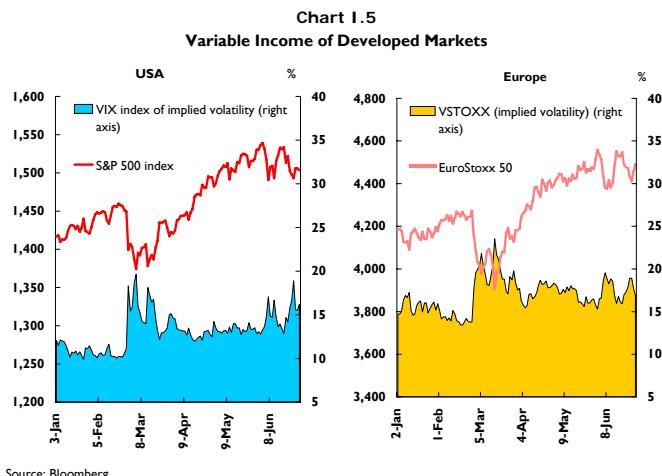
In this context, Central Banks still acknowledge that certain inflationary risks persist, partially related to the evolution of the raw material prices. Particularly, primary products showed price increases in the first half of the year. The oil and the industrial products accumulated 11.8% and 8.3% increase during the first half, respectively, promoted by the growth of the worldwide demand, in a context of restricted supply (see Chart I.4). On the other hand, the commodity price index (IPMP), that represents the average price evolution of the more relevant basic primary products in the Argentine exports, showed an increment of 12.5% in June in relation to December of 2006. In particular, the agricultural raw materials registered a 13.4% rise, mainly driven by the increases of the soy complex and the wheat.

In the midst of the turbulences in the global financial markets, commodity prices responded mainly to each product characteristics

The variations in commodities prices were moderate at the beginning of the second half of 2007 and they responded to each product characteristics, more than to the global financial markets turbulences. The agricultural raw materials prices stayed in historically high levels values driven by the food consumption growth in emerging countries and the strong demand of energy basic materials by developed countries. Additionally, beyond certain margin volatility, the energy and metal prices show similar values to those of the middle of the year due to strong demand and low stocks.

The recent period of volatility was preceded by a growing risk appetite of investors

The volatility period took place after a pronounced dynamism in the mergers and acquisitions market was observed, together with good corporative profits that had driven the American stock market indices during the first half of 2007, which had reached historical maximums. A similar behavior was observed in the European stock markets (see Chart I.5). On the other hand, the yield curve of the Treasuries ended the first half with a positive slope, after a rise in the medium and long-term yields was observed together with a fall in the short-term ones (see Chart I.6).



BOX 1: THE SITUATION IN THE USA HOUSING SECTOR AND ITS IMPACT ON FINANCIAL MARKETS

The weakness in the housing sector and in the sub prime mortgage market implies a risk to the USA economic growth. Cooling of the construction sector has a direct effect over the activity level and there is also a possibility that consumption and investment will be affected. This has generated an increasing anxiety in the markets, aggravated more recently by the proliferation of news about problems among financial institutions and investment funds with exposure to the sub prime sector. This situation caused an international crisis of confidence that ended up hitting the short term credit markets negatively forcing different monetary authorities to intervene, without a clear knowledge of the length of the normalization process

Towards the second quarter of 2007, the residential construction pointed to eighteen months with negative contribution to the economic growth. This was consistent with the weakness of the housing market sales since the end of 2005¹, which translated into an increasing inventory of buildings for sale, forcing losses in its prices. The housing S&P/Case Shiller index dropped 2.8% y.o.y in the second quarter (see Chart B.1.1), after six consecutive months of interannual losses. This turned into a negative wealth effect for households along with a lower capacity to finance (home equity withdrawal), factors that would also impact the consumption evolution. The labor market is also vulnerable to the developments of the real estate market, especially in those sectors related to construction and some fields of the financial sector.

Chart B.I.1
USA Housing Market Indicators

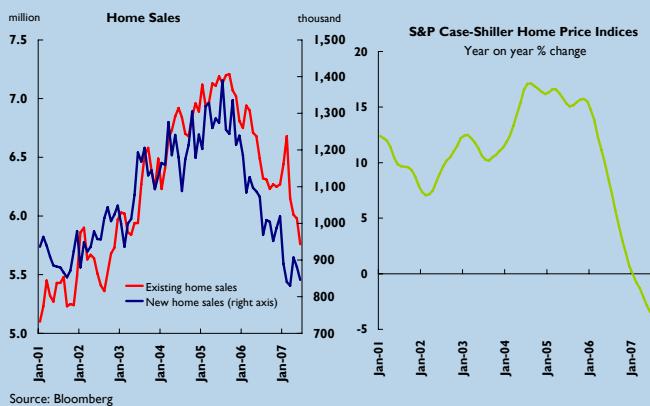
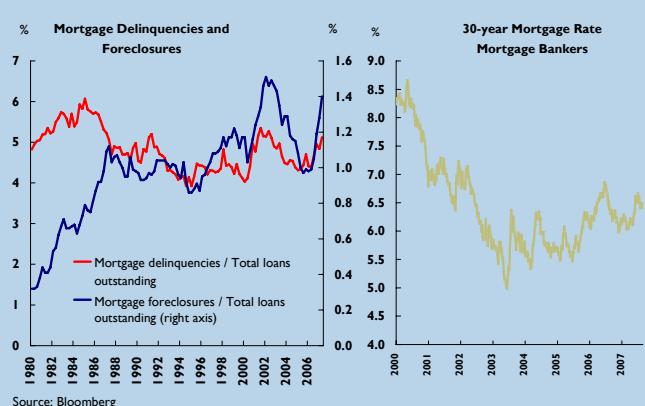


Chart B.I.2
Mortgage Markets Indicators



With moderate economic growth, falling house prices and increases in the mortgage interest rates, mortgage delinquencies increased, especially in the sub prime segment² (see Chart B.I.2). The number of new foreclosures grew. The situation might worsen because of tighter loan approval standards, motivated by the real estate market decline and the limited demand of structured instruments.

A good number of the structured products, that experienced a remarkable growth over the last years, have collateral sub prime debt³. The uncertainty regarding the performance of these products and their impact on the participants of the financial system with major holdings was worsened by the news of significant losses in several hedge funds. These funds had to face considerable number of investor withdrawals, forcing in many cases the freezing of their accounts, as much in the USA as in Europe. Then, the liquidity lack in the structured products markets and the implicit problems of valuation became evident.

While the negative news related to the evolution of the sub prime sector proliferated, there was a greater aversion to risk, a search for safer assets and an increase in market volatility. The credit markets became more restrictive, with spread increases and a strong drop of corporate bonds issues (both investment grade and higher risk), which reached minimum in

¹ Sales of used homes fell 8% in 2006 and, so far this year, it accumulated a decline of more than 8% reaching 20% below its cycle peak of September 2005. On the other hand, sales of new homes are 38% below its maximum of July 2005. So, inventories of existing homes for sale reached more than 9 months of supply (National Association of Real Estate Agents).

² See Box 1 of the Financial Stability Bulletin in the first half of 2007.

³ According to the IMF, the securitized mortgage sub prime loans value is over us\$ 800,000 million, almost 14% of the financial instruments with mortgage backed securities.

July since October of 2002⁴. This was worrisome, in particular, in terms of the impact on mergers and acquisitions (based on leveraged transactions) that had been driving the stock-market indices.

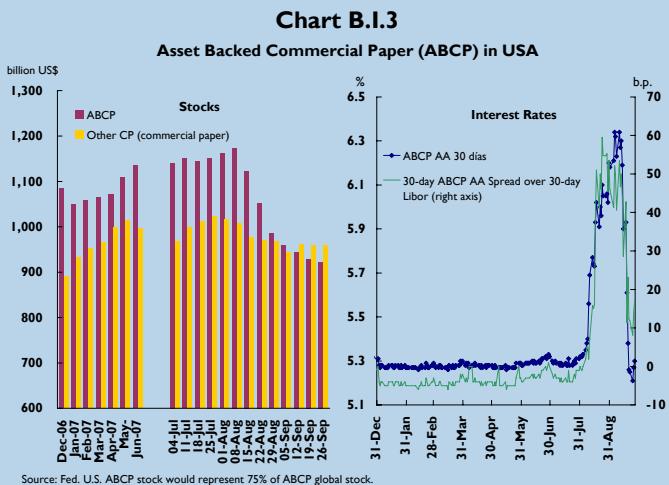
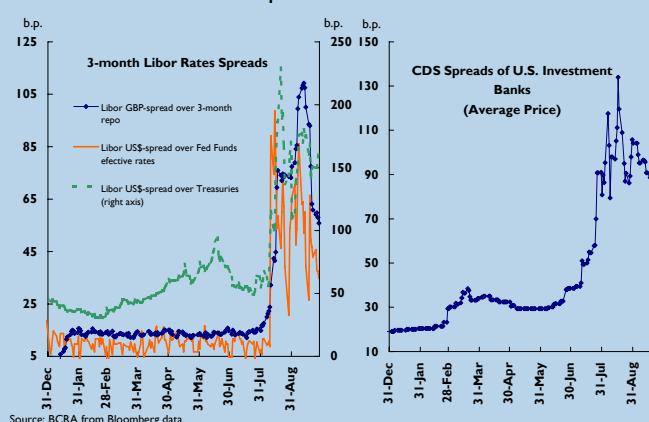


Chart B.I.4
Interbank Rate Spreads and Financial Perceived Risk



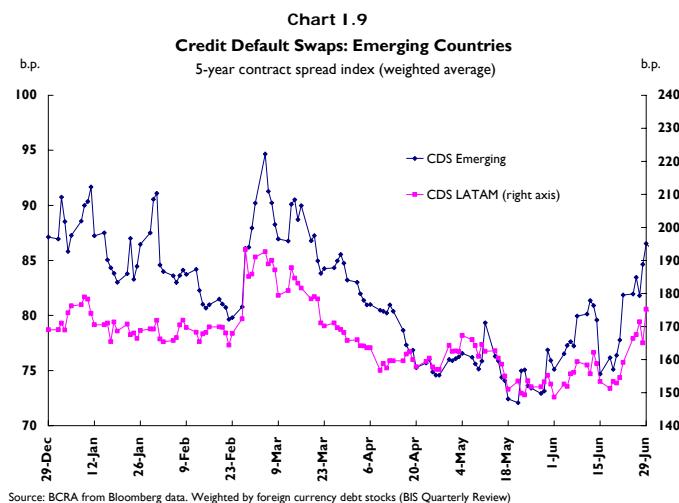
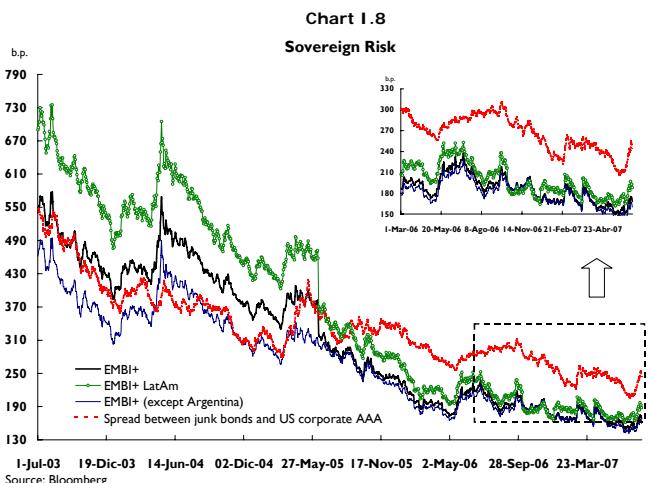
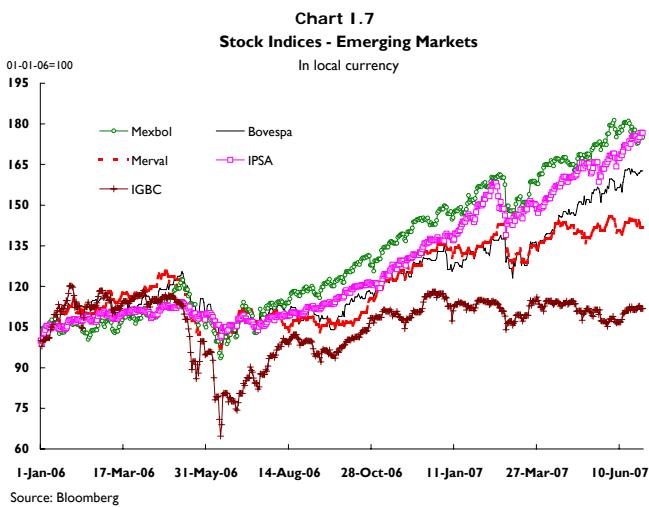
The downturn intensified in August, when the problems reached the short term credit markets. With a greater risk aversion and investors avoiding assets linked to the mortgage sector, a contraction in the commercial paper market took place in USA and Europe, specifically in Asset Backed Commercial Paper (collateralized corporate debt with maturities shorter than 9 months). The issuers of this type of papers⁵ faced problems to carry out the roll over of their portfolio, which translated in a strong contraction of the stock in circulation (almost 20% in August) and a significant increase of the interest rates spreads over market benchmarks (see Chart B.1.3) in the issues that managed to be done (at very short term).

Given that most of the vehicles used to issue commercial papers have arranged facilities liquidity with banks (not only Americans but also, in many cases, Europeans) the chances of materialization of contingent liabilities exacerbated the preexisting distrust in the interbank markets (as a result of the uncertainty about the exposure of each party to the problems in the sub prime sector). With financial institutions trying to extend its liquidity and encountering a more defensive pricing, there was a sharp increase in the interbank rate spreads (especially in the 3 month Libor rates in dollars, euros and pounds) against reference instruments (see Chart B.1.4).

With the aim of avoiding a generalized break down in the financial markets, the Central Banks of the main economies were forced to act: they injected liquidity, making flexible the conditions under which assistances are granted (in the case of the Fed, trimming the discount interest rate and extending the set of eligible assets accepted as collateral, including commercial paper guaranteed by banks). In the market, growth projections began to be revised and the monetary policy perspective was adjusted (with high expectations in reducing the benchmark rates in the USA, which occurred last September 18 with a 50 cut of b.p.) as well as delaying the rising rates policy in Europe. Towards mid September, the credit markets continued showing high spreads and it was considered that it would take several months to get back to normal. The generalized distrust would only quiet down to the extent the financial reports of the financial agents become public (the first financial reports that were released showed mixed results) and as soon as the value of complex structured products become more transparent.

⁴ According to Dealogic data.

⁵ In USA, between a quarter and a fifth of these instruments would be mortgage-backed securities.



In the first part of the year, investors showed an increasing appetite for riskier assets. The most representative stock markets of the region (like Mexico and Brazil) also reached new historical maximums (see Chart I.7), following the behavior of the raw materials, whereas the EMBI+ spread marked a new historical minimum of 149 b.p. at the beginning of June (see Chart I.8).

Similarly, during the first part of the year the spreads of the credit default swaps (derivatives that reflect the expectations of risk for debt securities) fell for the emerging countries (see Chart I.9), reaching new minimums for the instruments of Brazil and Mexico which are considered the benchmarks of the region. This favorable context was ideal for different countries to issue debt, as in the case of Mexico (that again issued 30- year local currency bonds) and Brazil (issued a new Global bond in Brazilian currency due in 2028, with several re-openings throughout the half), whereas several governments of the region performed swaps and debt repurchase operations, improving the profile not only in terms of the maturities but also reducing the liabilities in foreign currency. This evolution was reflected in the credit ratings improvements of Latin America.

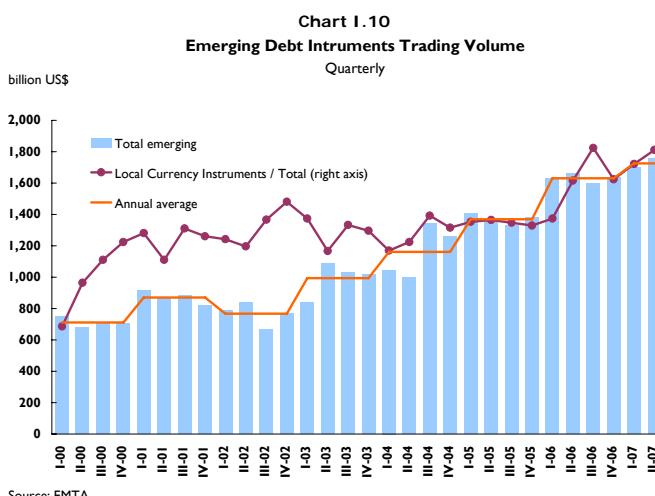
The negotiated volumes of emerging debt reached a new maximum in the first half of this year, near US\$3.45 trillions⁶. This volume represents an increase of 5% with respect to the same period of 2006 and 6.7% with respect to the previous half. Of the traded volumes, 62% correspond to instruments issued in local currency (see Chart I.10), which is consistent with the interest in international markets for instruments denominated in currencies other than the dollar (with sovereign issues in local currency showing greater dynamism than those in dollars and offerings in local currency with high bid-to-cover ratios, and policies for dealing with liabilities that aim to reduce the proportion of debt in foreign currency. The negotiated amounts of this type of instruments grew 24% with respect to the same period of 2006 and 9% when compared to the immediately previous half.

The second half of 2007 began with a generalized correction in the emerging markets and a marked process of flight to quality

The market volatilities recorded at the beginning of the second half of the year translated into a generalized correction in the emerging markets and in a process of flight to quality of higher intensity than the observed during February-March of 2007. Thus, the EMBI+ spread surpassed 200 b.p. for the first time since December of 2006, whereas the currencies of the region showed a depreciation tendency and the stock-market indices surrendered part of the gains accumulated during this year.

A possible deepening of the weakness of the USA real estate market, and its potential impact on global financial markets and global growth are the main risk factors for the world-wide economy that could affect the financial systems of the region. In this scenario, capital flows to the region could be reduced if liquidity at international level decreases, whereas a lower world-

⁶ Million of million.



wide economic growth would imply a fall in the demand of raw materials.

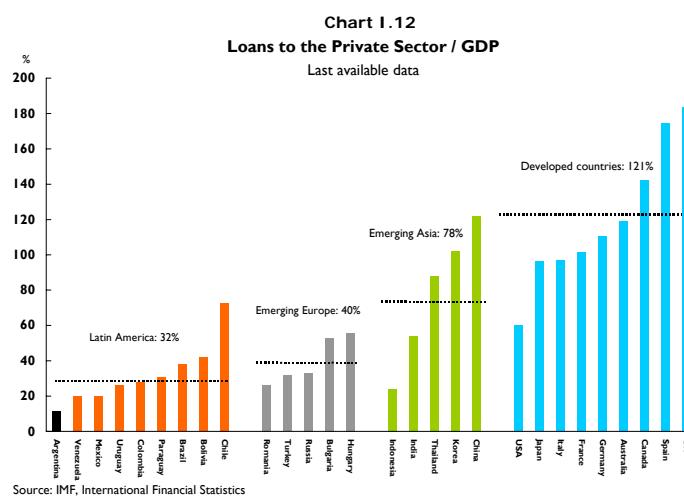
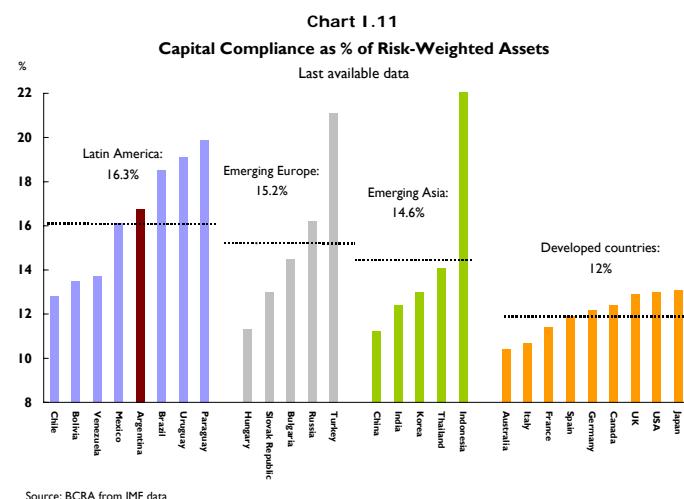
I.2. Latin American banking systems

The Latin American financial systems show strength and low direct exposure to the credit risk of developed countries

Latin American financial systems are well prepared, essentially as a result of the progress made in recent periods and because of their low direct exposure to the credit risk of developed countries. In particular, positive results and capital injections led to strengthen the solvency levels of financial entities in the region, setting them above international standards (see Chart I.11).

Overall, the improvements of the Latin American financial systems resulted from the expansion of the financial intermediation with the private sector. In fact, there was a steady increase in financing to the private sector in recent years (see Chart B.3.1), mainly funded by private sector deposits, in a context of bounded credit risk. In most cases, despite the growth, credit to the private sector still has a low participation in Latin American economies when compared with other developed and emerging countries (see Chart I.12).

Moreover, although steady growth has prevailed, Latin America financial systems are still vulnerable on some fronts. One of those is associated with the current banking operations in Latin America and refers to the growth of consumer loans (see Box 3). In addition, another of the recurring topics is the high level of poverty and geographical disparities in access to financial services, which drives the debate on micro finance, credit to SMEs and the wider regional availability of such financial



II. DOMESTIC CONTEXT

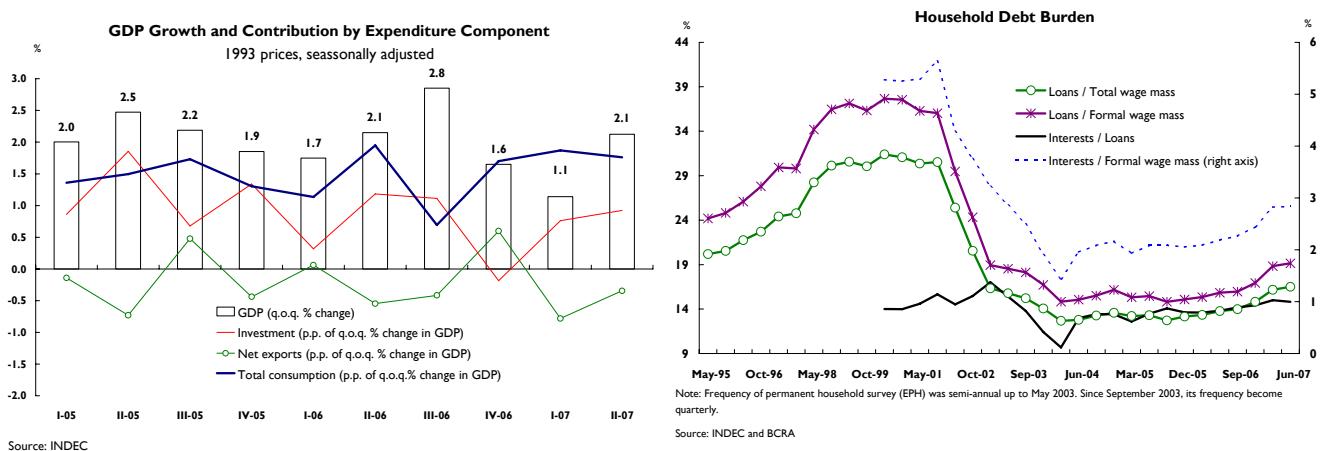
Summary

The economic framework in which the financial system develops is exhibiting an annual growth rate of over 8%, totaling five consecutive years of expansion. The six-month performance was driven by private consumption especially, while investment continued growth at double digit rates. If this trajectory persists investment at constant prices will rise to about 23% of the GDP in 2007, its highest level in recent decades. This macroeconomic momentum happened in the framework of a monetary policy led by the Central Bank that remains within the guidelines set by the Monetary Program. A context of economic and monetary stability was therefore generated, which defined a favorable context to strengthen the financial system, as observed during the first half of 2007.

The consolidation of private sector incomes, combined with the low debt and interest rate levels, contributed towards sustaining the sound payment capacity of firms, households and the public sector. The public sector, in particular, maintained its primary surplus, a development that occurred together with lower debt levels in terms of the GDP and progress towards normalizing payments that made its payment capacity more robust.

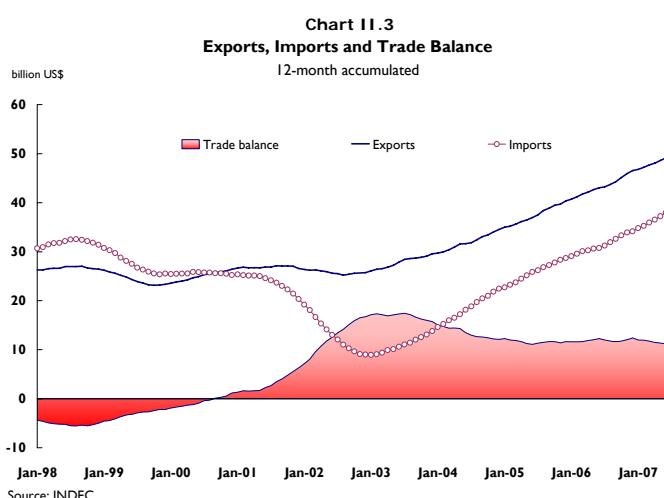
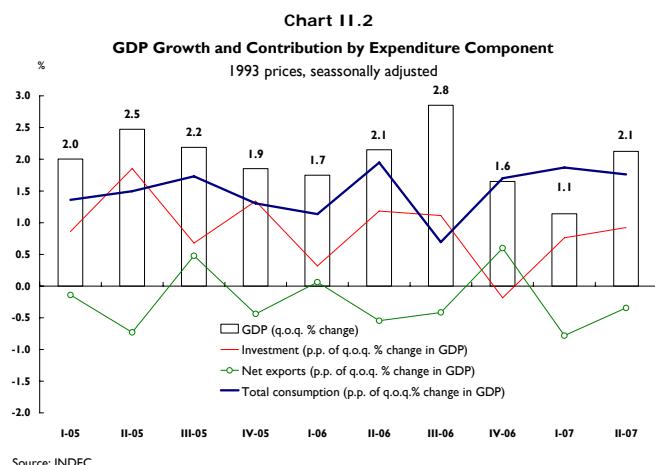
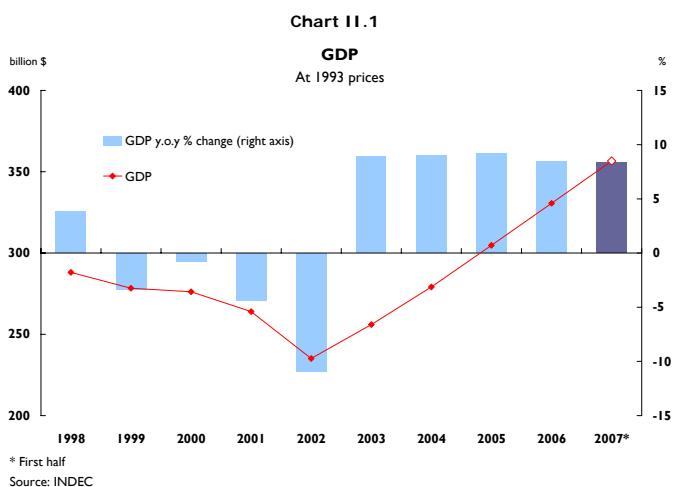
Meanwhile, all economic sectors continued growing in the first half of the year, with a notable performance of farm production (with record crop volumes) and a deceleration in the rate of manufacturing expansion. In this context the debt levels of most economic sectors continued reducing their weighting in GDP terms. This trend was boosted by the decline of foreign debts that reduced corporate exposure to exchange rate volatilities. This resulted in an overall improvement in the economic and financial position of firms, which was reflected by limited sector credit risk levels.

Although household debt, led by the consumer lines (personal loans and credit cards), continued growing faster than incomes, it is relatively low. The persistent fall of unemployment, higher incomes and increasingly formal labor allow households to maintain a sound payment capacity, and therefore a credit risk level that remains relatively low and stable.



II.1 Domestic conditions

The sound performance of the fundamental economic variables still provides an adequate framework for the development of the financial system



The Argentine economy continued developing positively during the first half of 2007, to accumulate five years of sustained growth. During the first half of the year the GDP expanded at an 8.4% year-on-year (y.o.y.) rate (see Chart II.1), an advance at a similar pace as the average in 2006. Economic activity was mainly driven by the service producing sectors and the record harvest of agricultural products. This resulted in falling unemployment, a trend mostly led by job creation. Meanwhile, the fiscal⁷ and external surpluses remain high in historical terms.

The GDP change was still driven by domestic absorption, especially by the increase in private consumption (see Chart II.2). This change is associated with the growth of the aggregate payroll, to which decisions like the income tax changes and larger transfers of funds to the social security system are adding. Meanwhile, gross domestic fixed investment (IBIF) also developed positively, expanding at double digit rates, led by the performance of investment in durable production equipment.

The IBIF growth comes in a context of more fixed capacity usage and the adjustment of the relative prices of the labor and capital factors, a condition that is favoring a growing addition of machines and equipment to the productive process. Adding to this was a greater stimulus of construction spending at the margin, although less than during previous years. Investment therefore continues exhibiting the highest growth rate in the economy (exhibiting higher year-on-year changes than the GDP), a path that may lead to it be about 23%⁸ of the GDP in 2007, at the highest level in recent decades.

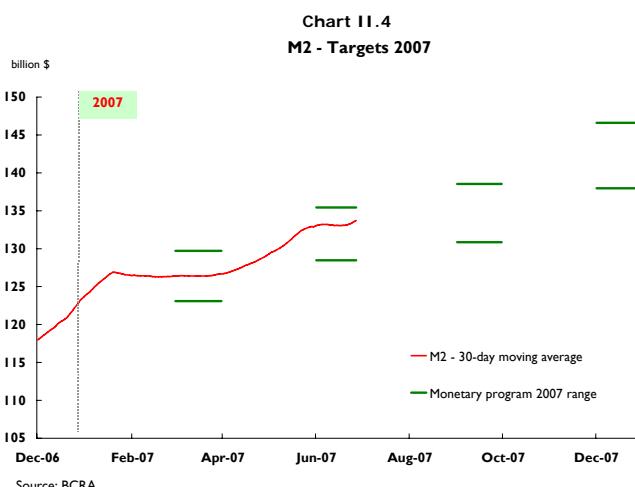
The trade balance surplus is still driving the current account positive performance

The current account continued exhibiting positive results for the fifth consecutive year. Its balance is mostly explained by the surplus on the trade balance (see Chart II.3), that is partly offset by net outflows on the balance of real services and by investment earnings, although on a smaller scale. The trade surplus is still driven by exports, which in the first half of the year recorded a 12.3% y.o.y. increase, led by the rising prices, and to a lesser extent by a growth in the quantities shipped.

Whereas during 2006 the manufactures of industrial origin (MOI) led the export increase, the expansion of sales in 2007 so far was in almost equal share due to the manufactures of agricultural origin (MOA) and MOI. Simultaneously, imports continued exhibiting a sustained growth. In the first half of 2007 its rise was 28% y.o.y. which was almost entirely explained by the growth of the quantities imported (22% y.o.y.).

⁷ For a detailed development of the public sector, see Section II.2.1.

⁸ At 1993 prices.



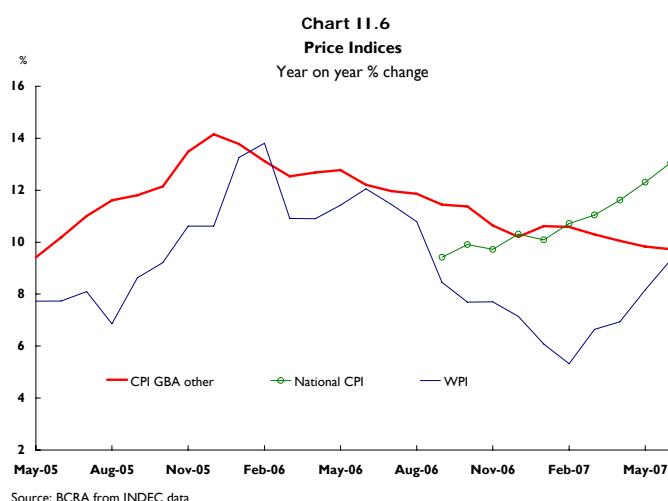
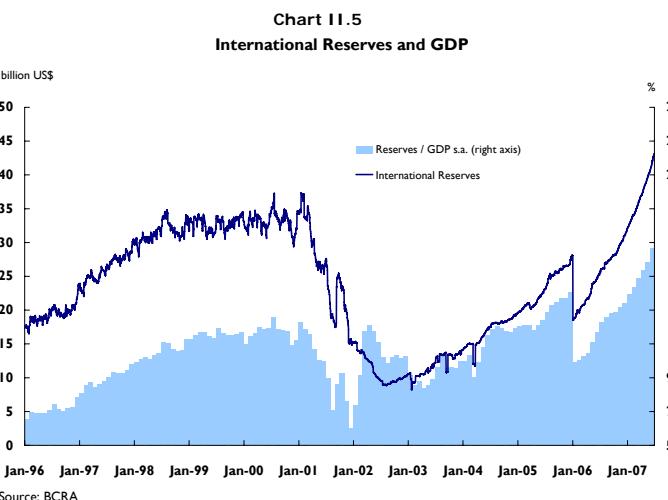
Effective Central Bank response to a more volatile international context

During the first half of 2007 the Central Bank continued carrying out a strict control over the development of the monetary aggregates, a condition that was reflected by a deceleration in the rate of growth of transactional money (M2). In this manner, in June 2007 the year-on-year rate of growth was 1 p.p. lower than the same month last year, with the average M2 balance being \$135.4 billion (see Chart II.4). The Central Bank thus completed 16 consecutive quarters of compliance with the targets set by the Monetary Program (MP).

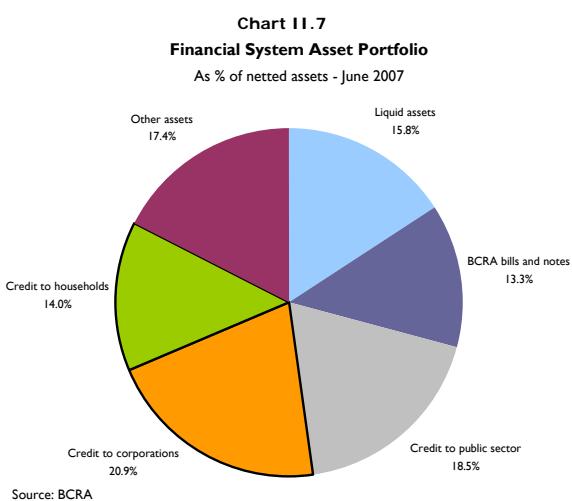
In the first half of 2007 the Central Bank persisted in its strategy of accumulating international reserves for prudential reasons, which meant that they rose to US\$43.2 billion at the end of June (see Chart II.5). This increase occurred without neglecting the equilibrium on the monetary market. In this manner the Central Bank maintained its aggressive sterilization policy that enabled it to absorb around 80% of the monetary expansion generated by the foreign currency purchases during the first half of 2007. The most important sterilization instruments employed were primary issues of Central Bank bills (LEBAC) and notes (NOBAC), pre-cancellation of illiquidity assistance and the arrangement of reverse repos. It is worth noting that the different absorption mechanisms were undertaken without jeopardizing the quasi-fiscal surplus.

As from the second half of July the turbulence on the international financial markets affected the exchange rate and the domestic interest rates. In this context the Central Bank engaged in attacking both fronts simultaneously. On one hand it led interventions on the foreign exchange market within the framework of the managed floating strategy, whose purpose consists in avoiding the volatilities of the exchange rate affecting the spending, savings and investment decisions of consumers and producers, without providing an exchange rate insurance that would favor an inflow of speculative capitals. On the other hand, it injected liquidity into the market in order to avoid abrupt changes in the interest rates affecting credit dynamics.

Direct interventions on the foreign exchange market, coordinated with public banks, were thus combined with the repurchase of LEBAC and NOBAC on the secondary market, and regulatory changes were adopted that included two periods of bi-monthly calculation (July-August and October-November 2007) to set up minimum cash reserve requirements in pesos, and the reduction of the minimum daily requirement under this regime⁹. This is all contributing towards normalizing the monetary and foreign exchange markets, proving that the Central Bank has instruments available that are apt for use to encourage a predictable horizon.



⁹ From 50% to 40% of the previous month's requirement.



The deceleration of the CPI GBA offset the faster rise in the rest of the country

In the first half of the year the CPI GBA exhibited a reduction in its rate of growth in year-on-year terms. In particular, it accumulated an 8.8% y.o.y. rise to June 2007, with a decline of 2.3 percentage points (p.p.) from the rate observed a year ago. On the other hand, the retail prices measured at a national level continued with a relatively stable year-on-year growth of around 10% since the beginning of the year. This condition happened to the extent that the variation of the CPI GBA compensated the performance of the CPI for the rest of Argentina, with the gap broadening between the rates of year-on-year growth of these indicators (see Chart II.6).

In June 2007 the National CPI rose 10.5% y.o.y., determined by an 8.8% y.o.y. increase in the greater Buenos Aires (GBA) metropolitan area and a 13.1% y.o.y. increase in the rest of the country. The larger changes in consumer prices outside Buenos Aires can be explained by developments in the headings associated with certain public services and in food and beverages. In addition, wholesale prices exhibit a higher increase at the margin than during previous periods, mainly in response to more expensive primary products and foodstuffs.

II.2 Financial system debtors

The development of the private sector share in bank portfolios consolidates the significance of monitoring the economic and financial conditions of households and corporations

In the first half of 2007 the expansion of loans to the private sector continued, to offset the accelerated reduction in bank credit for the public sector (see Chart II.7). The financial system thus deepens its independence from the government's financial needs, opting for investment alternatives in the private sector with a better risk-to-yield ratio. These dynamics spurs an ever increasing monitoring of economic and financial development of firms and families.

Looking ahead at the end of 2007 it is estimated that, although at a slower pace, the expansion of the banking funds for the private sector will continue.

II.2.1 Public sector

The sound performance of the national public sector¹⁰ is reflected by a sound and stable repayment capacity of this sector

During the first half of 2007 the primary surplus of the national non-financial public sector totaled \$14.3 billion, increasing \$1.74 billion from the same period in 2006, although when measured in GDP terms a slight reduction was seen (0.2 p.p.) (see Chart II.8). In revenue terms this behavior reflects the performance of national tax collection and the extraordinary income of \$2.83 billion due to the pension reform (Law Nbr.

¹⁰ For a more detailed analysis of the public sector revenues and expenditures see the Inflation Reports for the second and third quarters of 2007.

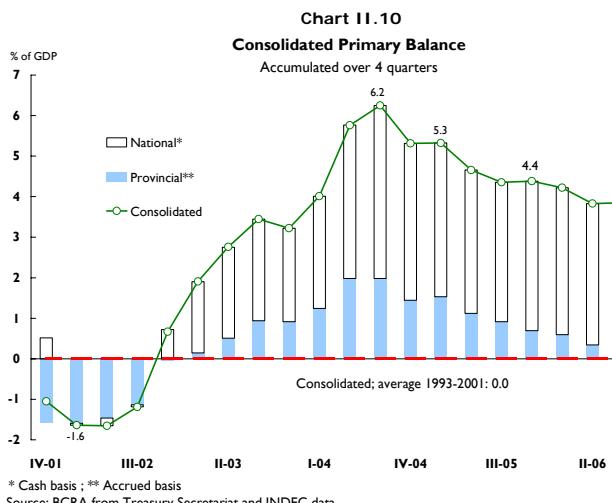


Table II.1
 Bond Issues in 2006 and 2007

Bond	Issue date	Issue amount ¹	Issue price ²	Yield ²	Spread over US Treasury Bond ³
2006					
In dollars					
BODEN 2012*	19-Jan-06	312	80.0	8.5	418
BODEN 2012*	27-Jan-06	308	81.1	8.3	381
BODEN 2012*	14-Feb-06	308	81.1	7.8	311
BODEN 2012*	21-Feb-06	307	81.4	7.6	298
BONAR V	22-Mar-06	500	94.5	8.4	367
BONAR V	3-May-06	500	96.4	8.1	338
BODEN 2012*	9-May-06	239	83.7	7.5	253
BODEN 2012*	7-Jun-06	243	82.5	8.3	334
BODEN 2012*	27-Jun-06	245	81.6	9.1	393
BODEN 2012*	17-Jul-06	482	83.0	8.6	348
BONAR V	26-Jul-06	500	97.3	8.3	333
BONAR VII	7-Sep-06	500	92.7	8.4	364
BODEN 2012*	31-Oct-06	420	71.5	7.4	272
BONAR VII	30-Nov-06	500	96.3	8.0	356
Total 2006		5,365			
2007					
In dollars					
BONAR VII	25-Jan-07	500	99.0	7.7	287
BODEN 2015*	13-Feb-07	779	96.3	8.0	320
BONAR VII	15-Feb-07	500	99.5	7.7	303
BONAR X	12-Apr-07	750	90.3	8.5	372
BONAR X	10-May-07	750	90.9	8.4	378
In dollars 2007		3,279			
In pesos 2007		BONAR ARG \$ V	7-Jun-07	1,500	95.6
In pesos 2007					11.7
In pesos 2007				1,500	

(1) Nominal value, in million; (2) In %; (3) In basis points

(*) Private placements

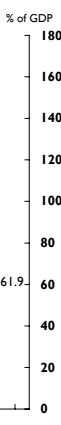
Source: Finance Secretariat

26,222)¹¹. National tax revenue in particular kept growing at high rates in nominal terms and as a percentage of the GDP. In fact, it totaled approximately \$92.1 billion in the first six months of 2007 (31% y.o.y.), mainly driven by social security and income tax revenues (see Chart II.9). On the other hand, total spending grew 40% y.o.y., exceeding the growth rate of revenues. This increase in expenditure was mostly accounted for by the outlays in social security benefits, capital expenditures and the larger transfers to the private sector. The pension increase was due to increases in the amount of the benefits and the addition of approximately 1.2 million additional beneficiaries.

¹² Interest payments meanwhile grew 43% from the first half of 2006. One of the principal reasons was that the increase in the weighting of the new securities, like the BONAR bonds issued at market interest rates that are higher than the interest rates paid on BODEN and the Guaranteed Loans. Other reasons are the CER adjustments and restructuring debt owed to the Spanish government. The financial surplus therefore fell by 2.2% y.o.y. in the first half of 2007, to add up to \$7.85 billion.

In 2006 the provincial primary surplus added up to 0.5% of the GDP and the financial surplus was 0.1%, exhibiting falls from the 2005 balances (0.7% and 0.3%, respectively). This worsening was due to the increase of primary spending associated with an increase in government employee wages, which account for half the primary spending of the provinces. It is noteworthy that the primary and financial results of the provincial public sector remain in line with the forecasts estimated in the 2007 national budget for that year¹². The consolidated non-financial public sectors (nation and provinces) during 2006 recorded a primary surplus equivalent to 4% of the GDP, after it had totaled 4.4% in 2005 (see Chart II.10). It is estimated that these figures will continue falling in 2007, although they will still be high in historical terms.

Progress towards normalization of government debt payments and relatively lower debt levels

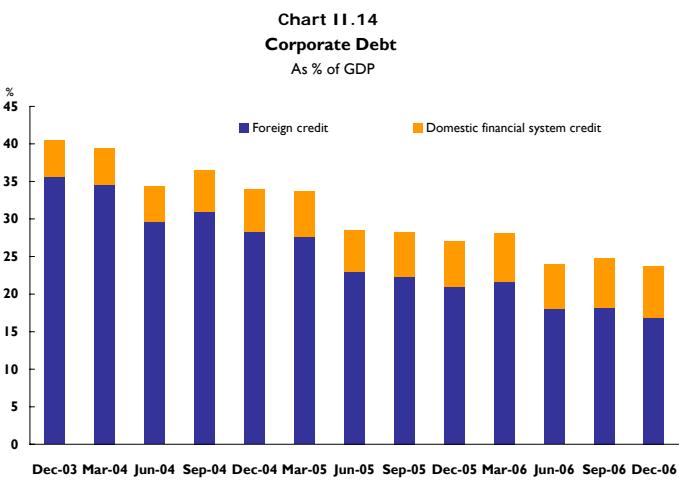
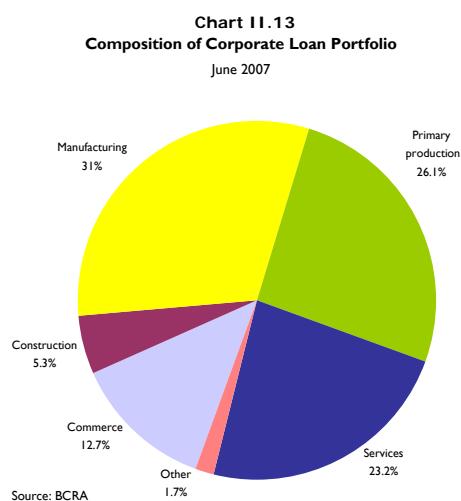
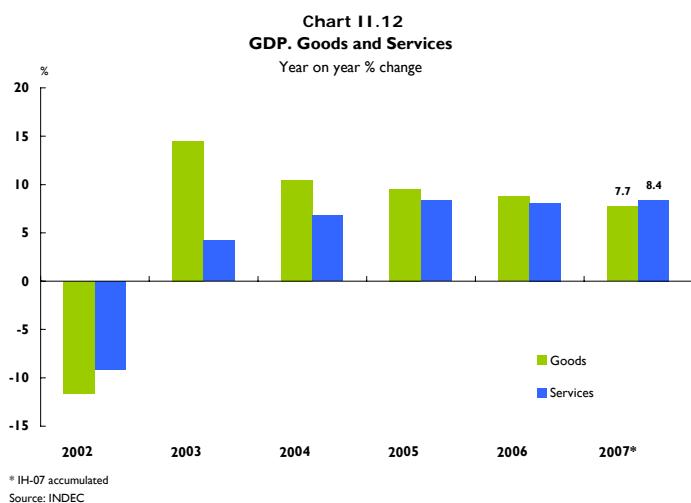


In the framework of the 2007 debt issuance program, during the first half of 2007 the government financed itself on the capital markets through dollar denominated debt with a face value (FV) of US\$3.28 billion, of which US\$2.5 billion was placed at auctions and US\$779 million were direct sales to Venezuela. In addition, the government sold a new security denominated in domestic currency for FV \$1.5 billion, which was a bullet bond, amortized in full on maturity at a five-year term, and with a nominal annual interest rate of 10.5%, payable at six month intervals (see Table II.1). The average yield at the auctions in USA dollars during the first half of 2007 was the same as recorded a year earlier (a 8.2% annual rate), while the average duration lengthened to three years.

Source: Finance Secretariat and INDEC

¹¹ Social Security Secretariat Resolution No. 135/2007 instructed the transfer of all stocks in the individual capitalization accounts due to the mandatory contributions and the concepts related to these of the workers affiliated to special regimes regulated by Laws No. 22,731 (National Foreign Service officials) and No. 24,018 (magistrates and law court and public officials) and Decrees No. 137/2005 (teachers at the initial, primary, technical high school, and provincial higher non-university teachers affiliated to pension funds who have been transferred to the nation) and Decree No. 160/2005 (science and technology researchers).

¹² The 2007 national budget had estimated primary and financial surpluses of 0.4% of the GDP and 0.1% of the GDP in 2006, respectively.



The debt issues, together with the primary surplus and the use of accounts, enabled the National Treasury to cover its financial requirements in the first half of the year. In this period the Treasury did not require any temporary advances from the Central Bank in net terms, so that the stock remained at the same level as the end of 2006.

During the first quarter of 2007 the sovereign debt stock was US\$136.3 billion (61.9% of the GDP), exhibiting a US\$8.4 billion increase from the same quarter in 2006 (see Chart II.11). However, in GDP terms the fall was significant (8.5 p.p.), due to the growth of output. Although the ratio of sovereign debt to the GDP remains high when compared to the levels recorded prior to the 2001-2002 crisis, its restructuring enabled an improvement of the short and medium term debt profile (a lengthening of the average maturity and lower interest rates) and reduced the exposure to exchange rate risk by increasing the share of peso-denominated debt.

The national government has also continued with progress to bring arrears in sovereign debt services back to normal. In January 2007 it agreed on an arrangement to cancel US\$983 million in debt incurred with Spain¹³. At present 95% of the total stock of sovereign debt is therefore in a normal payment condition¹⁴.

II.2.2 Corporate sector

The sound performance recorded by the goods and services sectors, combined with lower debt levels, strengthens the economic and financial position of firms

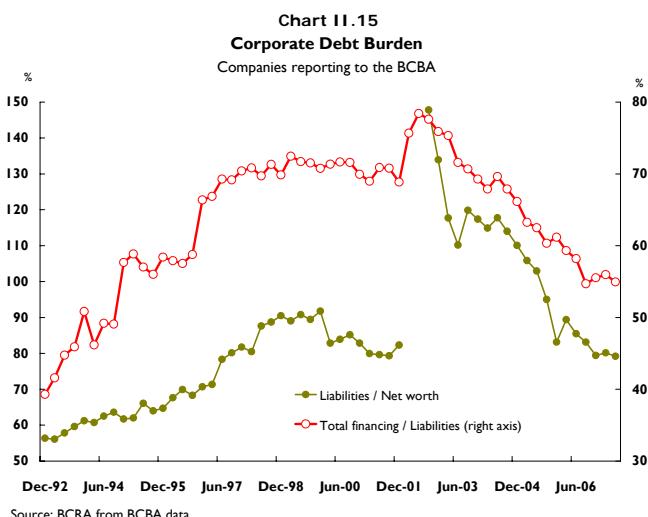
Economic activity continued rising in the first half of 2007 to record a more than 8% year-on-year growth. This change was mainly driven by service sectors (see Chart II.12). These sectors are still being favored by an increase in household consumption, based on the continuity of the expansion of employment, wages and credit.

Sectors related to goods production also recorded an increase, although slightly more moderate. The performance of the agricultural sector stands out, achieving in the 2006-2007 season a new historical maximum output. Meanwhile, both construction and manufacturing kept growing, although at a lower rate than seen a year ago.

In this framework firms continued expanding the use of finance from the domestic financial system. Primary goods production, in particular, keeps increasing its share of credit funded by banks, accumulating 26.1% of the total (see Chart II.13), in line with the noteworthy momentum exhibited by the sector. At a more moderate growth rate, manufacturing remains the principal corporate debtor of the financial sector. Likewise, loans to services and commerce grow persistently, driven by the increase in their activity during 2007 to date.

¹³ Decree No. 268/2007 details the manner in which payments will be cancelled and the amounts to be carried out quarterly until the end of 2012.

¹⁴ Excluded from the calculation is the balance of the eligible sovereign bonds not submitted to the 2005 debt exchange (holdouts), which on March 31, 2007, totalled FV US\$26.5 billion.



The growth of the different sectors that produce goods and services, in a framework of smaller external debt levels, are factors that are crystallized in the recovery of the payment capacity of the corporate sector. Specifically, the weighting of foreign and domestic¹⁵ corporate debt in the GDP was around 23.6% at the end of 2006 (see Chart II.14), lower than its pre-crisis levels.

The firms with access to the domestic capital markets (in general the relatively larger firms) have maintained their financial positions relatively stable in 2007 so far (see Chart II.15). The degree of leverage in this group of firms did not exhibit any changes between the beginning and the end of the first half of the year, remaining slightly below their pre-crisis levels, exhibiting a certain margin to obtain new funding without affecting their payment capacity. The declining trend in the financial system's share of finance halted in this period.

Looking ahead to the end of 2007, it is estimated that all productive sectors will maintain a positive trend, a condition that will enable them to continue improving their economic and financial position. In this framework, the corporate sector is forecast to continue increasing its demand for loans from the financial sector, although the volatilities on the international financial markets might moderate this trend.

II.2.2.1 Manufacturing

Despite the deceleration, the payment capacity of industry remains solid

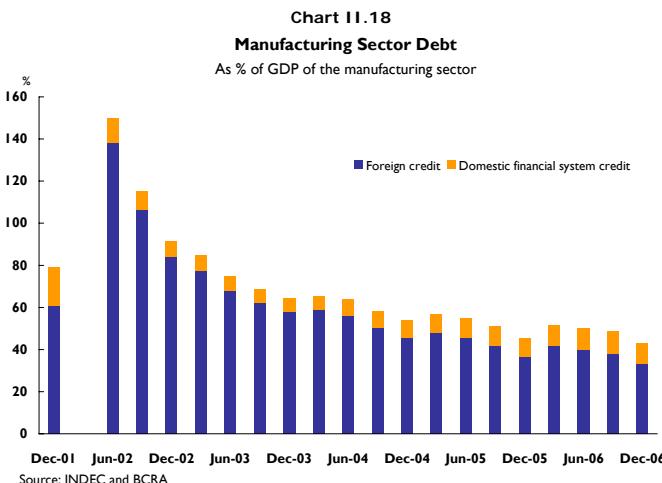
In the first half of 2007 manufacturing output continued developing positively, benefiting from the growth trend in demand at both the domestic and external levels. However, the sector exhibited a slower rate of growth than the year before, and in the first six months of 2007 accumulated a 6.4% y.o.y. increase, whereas in the same period in 2006 the rise had been 7.8% y.o.y. (see Chart II.16).

The greater industrial activity was extensive to all branches of manufacturing, with the exception of the base metal industries, and was led by automobile production, non-metallic minerals and chemical products, which accounted for about two thirds of the sector's expansion in the semester (see Chart II.17).

The favorable development of industry was accompanied by a slight drop in fixed capacity use. In this sense, in recent months the larger industrial production was associated with the expansion of the production possibilities frontier and the incorporation of new workers, in a context of gains in labor productivity.

Total manufacturing sector debt exhibited some reduction throughout 2006, due to the slight decline of its external exposure, a change that was partly offset by the increase in domestic finance (see Chart II.18). Although the external resources are equivalent to a third of the share of the sector's

¹⁵ For foreign debt is total debt, whereas domestic debt only considers debt owed to the financial system.



output, it is slightly less than half the share recorded in 2001, so it therefore reduces its exposure to exchange rate volatility and enables it to continue consolidating its financial position.

The growth of industrial activity expected in coming months, in a framework of increased internal and external demand, declining levels of foreign debt with a heavier weighting of liabilities in domestic currency, add up to a context that will enable an improvement of the sector solvency indicators. In this manner, manufacturing can undertake investments that expand its productive capacity, in a framework of sound payment capacity, whose financing is increasingly switched to the domestic financial system (see Chart II.13).

II.2.2.2 Primary sector

Record harvests in a context of favorable commodity prices, strengthen farm solidness

High yields, the expansion of the area planted and the high international prices boosted agricultural production. The 2006/07 harvest reached a new historical maximum with about 95 million metric tons being harvested, which was 23% higher than the previous crop cycle, and surpassed the record achieved during 2004/05 by 12%. Maize and soybeans were the crops that contributed most towards growth (see Table II.2). The prospects for the 2007/08 harvest maintain a favorable bias, with a similar volume to the previous harvest being expected, at prices around current levels or slightly higher.

The volume of beef obtained from cattle slaughter during the first half of the year recorded a 7.4% y.o.y. rise, which enabled it to return to similar levels to 2005 following the decline recorded last year (see Chart II.19). The increase in output was mainly targeted at supplying the domestic market, while the volumes exported remained stable. Milk production for dairy processing fell sharply in the first half of the year as the consequence of floods, frosts and the smaller number of active dairy farms in connection with the smaller profits in the sector. The dairy supply was reduced 13% y.o.y. from the year before, in a context in which dairy farms were 3% fewer. However, it is forecast that output could slowly return to normal during the rest of the year.

The debt levels at firms in the primary sector remains moderate (at approximately 38% of their output) (see Chart II.20), depending in equal shares on domestic and external resources. The low level of debt in foreign currency, added to the large share of dollar revenues in the aggregate, boost the solidness of the agricultural sector to face the exchange rate risk. This context, combined with the positive prospects for the development of primary activity in coming months, consolidate the sound economic and financial position of these firms.

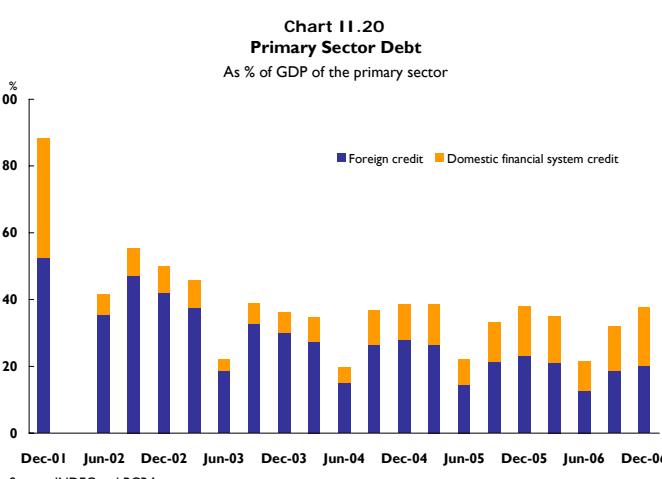
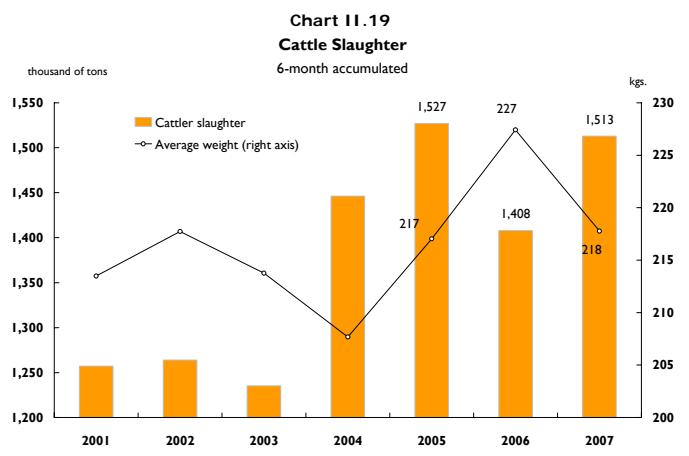
II.2.2.3 Services

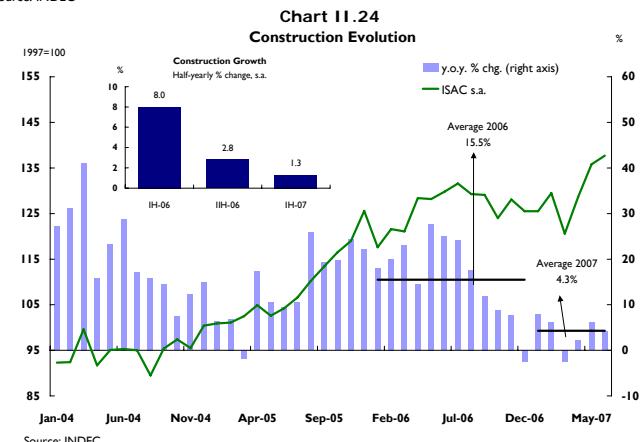
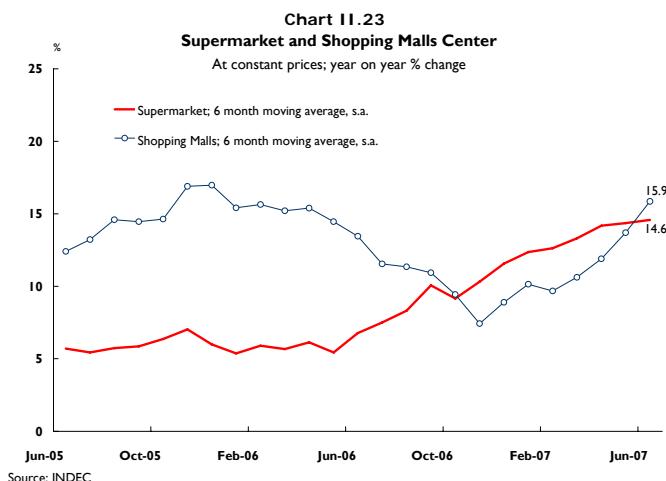
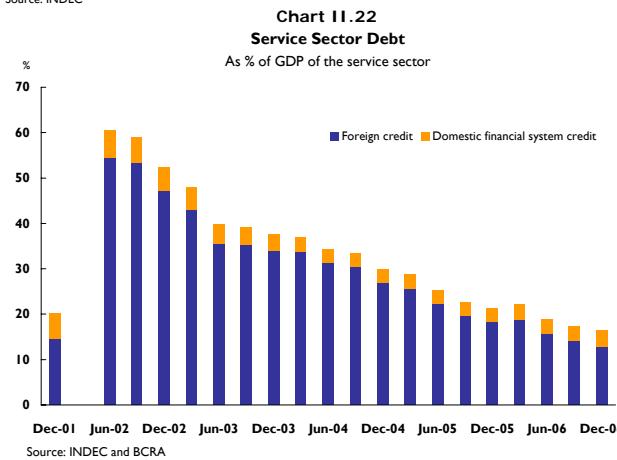
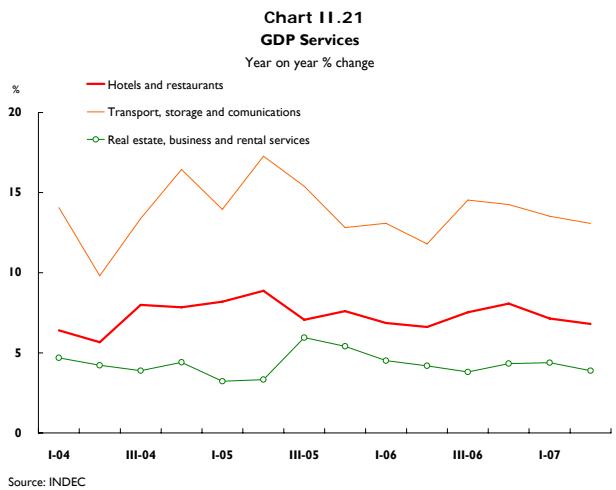
The economic and financial position of service firms continues improving

Table II.2
Grain and Cotton Production

	2005-06		2006-07		Chg. %	Chg. Tns
	thousand tns	Structure %	thousand tns	Structure %		
Cereals	31,629	41.2	42,175	44.6	33	10,547
Corn	14,446	18.8	22,000	23.2	52	7,554
Wheat	12,574	16.4	14,563	15.4	16	1,988
Grain sorghum	2,328	3.0	3,000	3.2	29	672
Rice	1,193	1.6	1,060	1.1	-11	-133
Brewing barley	795	1.0	1,266	1.3	59	471
Oat	227	0.3	243	0.3	7	16
Rye	33	0.0	17	0.0	-47	-16
Other	33	0.0	27	0.0	-18	-6
Oilseeds and oleaginous fruits	44,728	58.3	51,904	54.8	16	7,176
Soybean	40,500	52.8	47,600	50.3	18	7,100
Sunflower	3,800	4.9	3,620	3.8	-5	-180
Peanut	347	0.5	580	0.6	67	233
Other	81	0.1	104	0.1	29	23
Cotton	418	0.5	550	0.6	31	132
Total	76,775	100.0	94,629	100.0	23	17,855

Source: BCRA from SAGPyA and USDA data





The sectors that produce services have led economic growth during 2007 so far (see Chart II.21). The utilities in particular continue exhibiting a significant growth in their activity in the first half of the year, recording a 16% y.o.y. increase, a development largely driven by telecommunications. A sharp rise in passenger transport was also seen, which came together with the growth of employment and tourism.

In this context of expansion of its activity, the service corporations continued increasing their weighting in domestic finance in terms of the sector's output. This change was more than offset by the fall of its debt in foreign currency, which at the end of 2006 was 78% of the total (see Chart II.22), almost 12 p.p. less than two years ago. Although the exposure of this typically non-tradable sector to changes in the peso-USA dollar exchange rate is gradually reducing, some exposure to the exchange rate risk thus persists.

II.2.2.4 Commerce

The larger investment requirements, in a framework of sound payment capacity by the sector, will allow for firms dedicated to commerce to increase their debt and maintain a relatively solid financial position

Retail trade continued along a growth path. The retail sales in the first six months of 2007 exhibit a larger increase relative to previous years. In this period supermarket sales measured at constant prices grew 14% y.o.y., in particular, while at shopping malls the change was 15.5% y.o.y. (see Chart II.23).

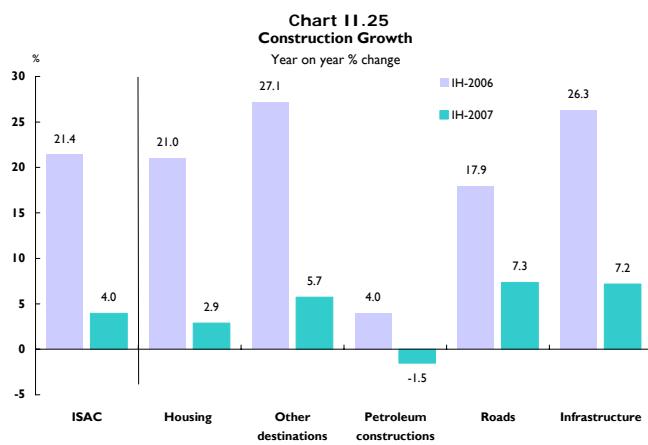
Increased investments in the sector were seen in this framework, because both supermarkets and shopping malls exhibited a growth in the number of operating outlets and of the sales area. Maintaining the percentage of shop occupancy at over 93% predicts that the rate of investment in this kind of undertaking will not fall. In this sense, the reduced debt levels in this sector (almost 22% at the end of 2006), provide a favorable financial position to continue covering these investment needs with third party funds.

II.2.2.5 Construction

In a context of a moderate deceleration of construction, the degree of funding through the financial system remains low

During the first half of 2007 construction exhibited a rising trend (see Chart II.24), with a 4% y.o.y. growth. This expansion was more moderate than the years before, reflecting the maturity that the sector is exhibiting in certain segments.

The largest contribution towards the growth of construction at present is coming from public works, mostly in highway and infrastructure works (see Chart II.25). The higher economic activity, especially in manufacturing, commerce and tourism, favors the expansion of industrial plants and a larger investment in buildings for tourism. On the other hand, household construction, which had expanded significantly in 2006, is

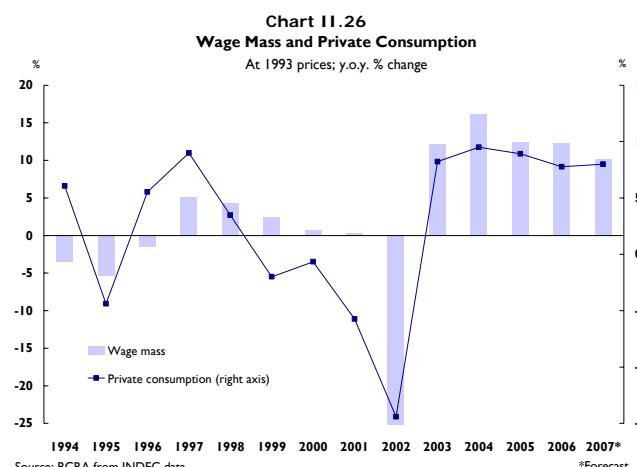


growing at a slower pace, exhibiting some exhaustion of the undertakings targeted at higher income families.

Unlike the falls recorded in previous periods, some stability is observed in the debt levels of construction firms, remaining at low levels, which enables them to have a solid financial position. Looking ahead to the end of 2007, although construction activity is expected to continue expanding, the slight setbacks exhibited in building permits and in corporate prospects for the sector in recent months indicate a slower growth rate than during recent years.

II.2.3 Household sector

Although still at low levels, household debt is increasing



During the first half of 2007 household spending remained on its rising trend, mainly spurred by the larger disposable income (see Chart II.26), in a context of higher family debt. Nominal wages grew at a slightly faster pace than during 2006, while improvements in pensioners' earnings were granted as well as for family allowances.

Labor conditions also continued improving in the first half of 2007. Unemployment exhibited a further fall, based on the sustained growth of employment. The unemployment rate in the second quarter of the year was therefore 8.5% of the workforce (see Chart II.27), which was the lowest rate since October 1992. The unemployment rate thus fell about 16 p.p. from the maximum recorded in May 2002. The employment rate totaled 42.4% of the population, remaining 0.6 p.p. above the rate in the same period in 2006, to mark a new historical record. Likewise, the growth of employment was concentrated in the formal segment, which is reflected by a more solid payment indicator for the household sector, to the extent that it means better wages and a lower probability of layoffs.

Total household debt continued growing faster than the expansion of family earnings (see Chart II.28), although it is still less than the values observed in the pre-crisis period. In this framework, households maintain a sound repayment capacity, driven by the trajectory of the fall of the unemployment rate, wage improvements, good earnings prospects and relatively lower interest rates in coming months.

It is noteworthy that the increase in household debt is partly led by the consumer lines. In fact, while the longer term lines (mortgages) have started to gain more momentum recently, the trajectory of the appreciation of household debt has mainly been driven by the personal loans and credit cards. In perspective, these short and medium term credit lines have already achieved a significant share, in terms of both the aggregate payroll, of output and relative to household consumption (see Chart II.29).

During the second half of the year the trend of falling unemployment is expected to continue, driven by the growth of the number those employed (mainly in the formal sector) in a context of wage recovery, which favors the level of real family

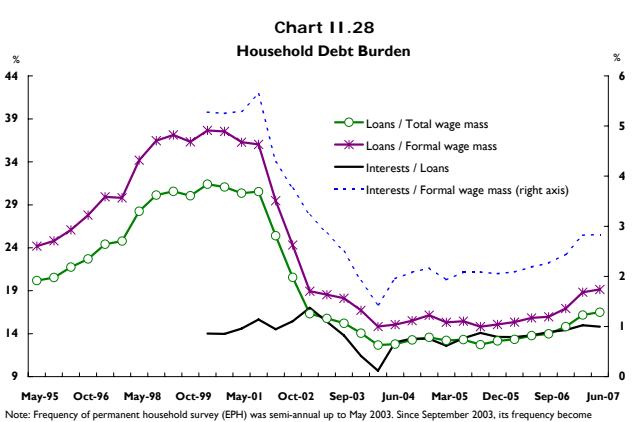
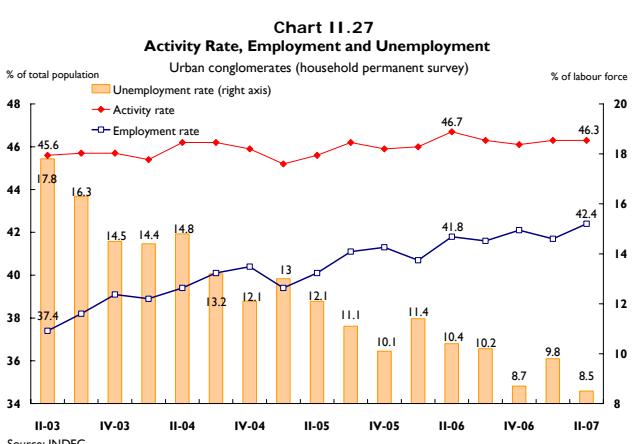
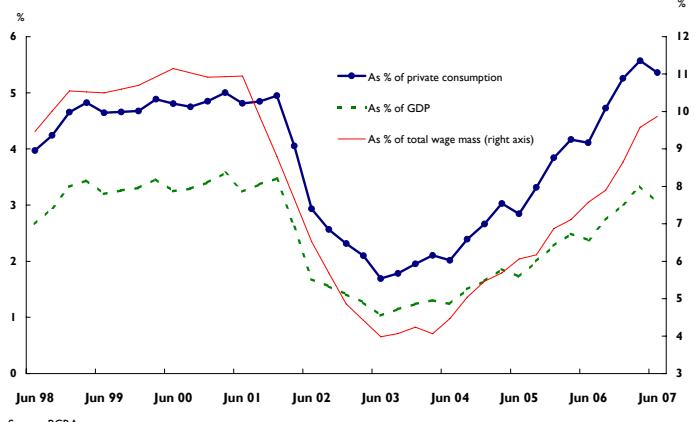


Chart II.29
Household Consumption Debt Burden



Source: BCRA

income. In addition, the recent tax changes and pension raises % will also boost the disposable income of families.

III. CAPITAL MARKETS

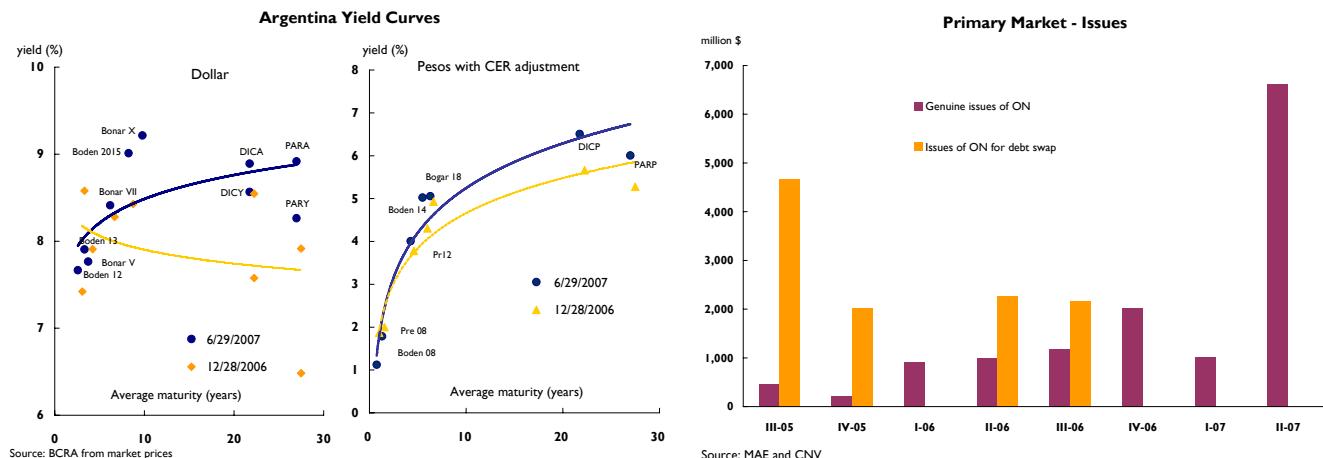
Summary

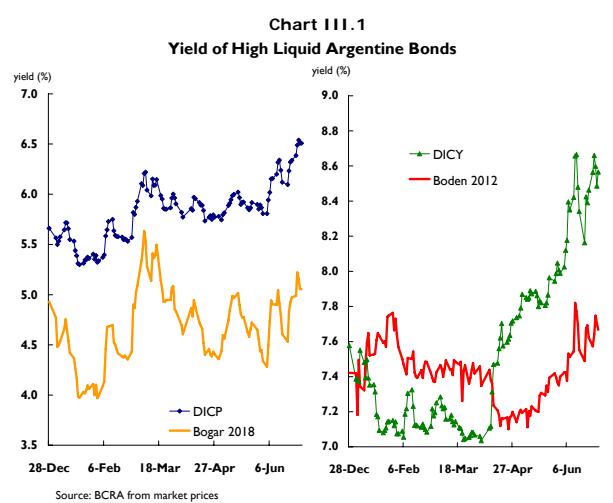
In line with the international concern (mainly because of the sub prime mortgage sector crisis and its impact on USA growth), the first half of the year has shown a more volatile behavior for the main Argentine capital market variables. Although several variables recorded improvement over the six-month period, the half ended with signs of slight deterioration, which is expected to have been intensified in the first months of the second half, in a context of global market turbulence (leading to sharp deterioration for most emerging countries in July and August, with some subsequent recovery). As a result, the scenario has become one of greater uncertainty, with no indication as to the scope or length of the international problems and their eventual impact on emerging markets in general and in the Argentine market in particular. Nevertheless, the strength of the macroeconomic fundamentals of the region gives them greater margin to be able to face periods of high volatility.

In the first half of 2007 government securities kept pace with the development of international markets, with a deterioration during the period of high volatility in February and March, a subsequently partial recovery and an erratic behavior in May and June (which towards July and August led to some weakness, in line with the rest of emerging country debt). Both bonds in dollars and those in pesos with CER adjustment ended the half with an increase in yields (more marked in the longer bonds). As the result of the international market turbulences combined with some local uncertainty, the country's securities ended up recording a relative weakness compared with other emerging countries bonds (a similar behavior was recorded by the CDS). Nevertheless, the Government was able to place debt on the market, being able to finance itself in pesos at a fixed rate for the first time since the 2001-2002 crisis.

During the first half, in the context of the Monetary Program, Lebac bills played a notable role (in the context of a drop in interest rates). Primary market yields did not show significant variations during the first six months of the year (except for a certain decline in longer-term instruments), while on the secondary market there was a trend towards lower yields that was to be partially reversed in the last months of the period. At the start of the second half, yields increased significantly, in line with the global markets deterioration.

Private debt placements recorded a growth in the first half of 2007, with ON issues for close to \$7.6 billion (almost double the amount in the same period of 2006). There was a notable progress by peso placements at fixed rates, led by financial entities. Financial trusts continued to make significant issues, keeping pace with the dynamism observed in consumption. Deferred payment check negotiation continued to increase, with interest rates declining during the half. The Merval hit new records, but with rising volatility (in line with international markets), and its performance was less positive than that of the rest of the markets in the region. In the case of derivatives, forward and futures dollar trading reached new highs, while some futures deals took place over the most liquid bond on the market (the Discount bond in pesos).





III.1. Public sector fixed income

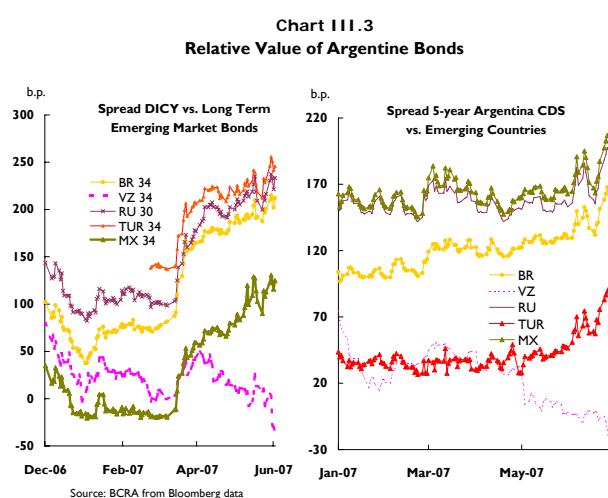
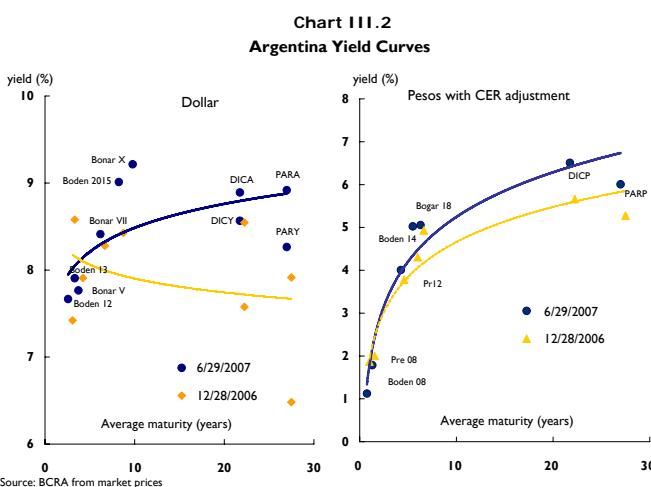
The period of international markets volatility at the end of February affected the prices of Argentine government bonds, which displayed significant volatility during the half, and a greater deterioration than that shown in the case of other countries in the region

Although at the beginning of the half the prices of Argentine government securities continued the upward dynamic registered during the second half of 2006 (achieving historically low spreads over USA Treasuries), there was some deterioration towards the end of February, in line with the increased volatility on international markets (see Chart III.1). As a consequence of factors unrelated to the region (the collapse of stock markets in China and the concern regarding possible contraction measures by its government, signs of weakening growth in the USA in general and in the housing and mortgage markets in particular), at the end of February and the beginning of March there were signs of turbulence at international level that Argentine bonds did not escape. Although there was some price recovery towards the end of April, during May and June Argentine bonds were once again to display an erratic behavior (as a result of the volatility on global financial markets), ending the half-year showing some deterioration.

Towards the end of June yields on instruments denominated in dollars and in pesos adjusted by CER recorded an upward trend compared with the levels posted at the end of 2006 (see Chart III.2). In the case of yields in dollars the rise took place across the entire curve, with a few exceptions in the shorter segment (while in the longer segment yields recorded a rise averaging 100 b.p. for the half). Instruments in pesos adjusted by CER also lost ground in the first half of the year (with yield increases for the half of close to 70 b.p. in bonds with a longer duration).

Although during the periods of increased volatility during the half emerging country bonds evidenced certain relative strength, the performance by Argentine securities was weaker than that of other countries. This situation was to become accentuated during the second half of the period, as the turbulence on financial markets worsened. As a result, towards the end of June, with the exception of a comparable Venezuelan bond, the yield differential for the Discount bond compared with similar bonds with a comparable duration issued by other emerging countries widened. In comparison with Brazil and Mexico, for example (see Chart III.3), this differential was almost doubled.

A similar behavior can be noted using traditional risk perception measures, such as the prices of credit default swaps (CDS) or the spread of the EMBI. Prices of five-year CDS¹⁶, which recorded a drop for the six months for Brazil and Mexico, rose 50 b.p. in the case of Argentina (see Chart III.4). In the case of the EMBI+ spread, whereas towards the end of August the figure for Argentina was even lower than that for Brazil, towards the middle of the year the Argentine spread had risen until it was double that for Brazil. For Argentina, the rise in the EMBI+ for



¹⁶ Those with greatest liquidity.

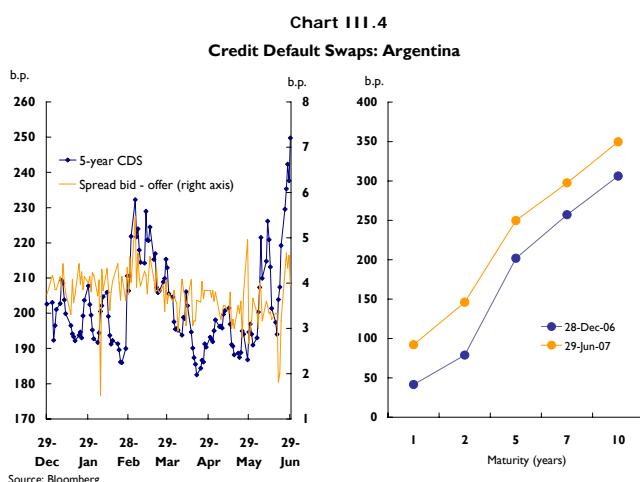


Table III.1
Sovereign Bond Issuances
IH-2007

Instrument	Currency	Auction or private placement date	Issue Amount (face value in million of original currency)	Bid to cover	Yield	Spread o/UST (b.p.)	Average maturity (years)	Coupon rate
Bonar VII	USD	Jan-07	500	3.46	7.71%	287	7	7.0%
Boden 2015 (private placement)	USD	Feb-07	779	-	8.02%	320	9	7.0%
Bonar VII	USD	Feb-07	500	4.30	7.71%	303	7	7.0%
Bonar X	USD	Apr-07	750	2.01	8.46%	372	10	7.0%
Bonar X	USD	May-07	750	2.50	8.44%	378	10	7.0%
Bonar ARG \$ V	Pesos	Jun-07	1,500	3.51	11.70%	-	5	10.5%
Total amount			3,766 million US\$					

Note: All instruments are bullet

Source: Finance Secretariat

the half (almost 100 b.p.) reflected the deterioration in the price of longer-term bonds in dollars¹⁷.

Prices will have deteriorated even further in the first months of the second half, in view of the renewed turbulence on international markets (see Box 1), in a context in which Argentine bonds (together with those of other countries such as Venezuela and Ecuador) have magnified the deterioration observed in emerging country assets. Although by September significant improvement took place, the scope and length of this period of market volatility was still not clear.

The Government has continued to finance itself in the market, reducing the proportion of direct placements and even succeeding in issuing fixed interest peso debt

During the first half of 2007 the Government continued to borrow mainly on the market, placing instruments governed by local law for terms of up to 10 years. Taking advantage of liquidity conditions that were still favorable for much of the six-month period, the equivalent to US\$3.8 billion face value was placed, 79% being obtained by means of 5 auctions, while the rest corresponded to a direct placement of BODEN 15 to the Government of Venezuela¹⁸ (see Table III.1). The auctions in dollars were for two instruments (BONAR VII and BONAR X), with spreads over USA Treasuries averaging 295 b.p. and 375 b.p. respectively¹⁹. In every case, bids received were for at least double the amounts auctioned (although the auctions in January and February obtained higher bid-to-offer rates).

In the context of still growing interest by international investors in emerging country bond issues denominated in local currency, in the first half of June the Government placed a bond in pesos at a fixed interest rate (the first of its kind since the Government began to borrow on the market once again). A total of \$1.5 billion in 5-year Bonar V were placed with a 10.5% coupon and a bullet repayment at maturity. The yield was 11.7% (within the expected range), while the bid-to-offer rate was almost 3.5. As a result, the market now has a new medium-term benchmark in pesos, which represents progress in terms of the development of a yield curve (which could in turn contribute to increase the dynamism of corporate issues in pesos at fixed interest rates).

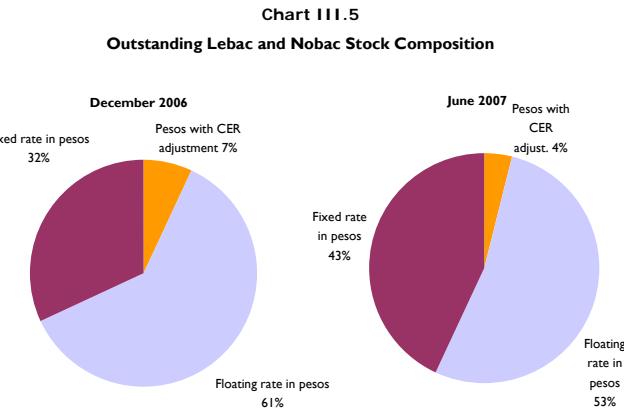
Lebac bills increased their relative importance, with declining yields for the half (although with a rising trend after the end of the period)

Within the framework of the 2007 Monetary Program, the Central Bank continued with its weekly Lebac and Nobac tenders. As a result, in mid-2007, the outstanding stock of these assets issued by this Institution totaled close to \$61.3 billion, an increase of 49% for the half-year. One of the most significant events during the period was the loss of ground by variable-interest notes at the auctions, at the same time as bill placements

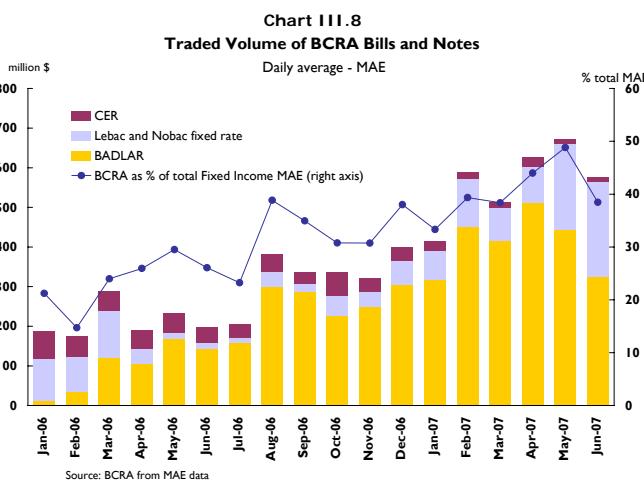
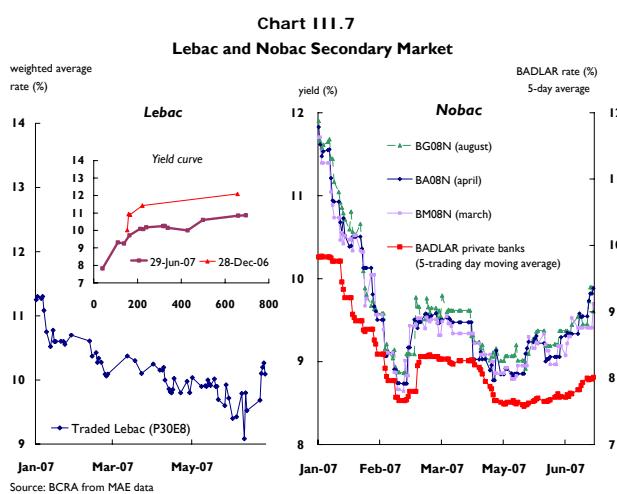
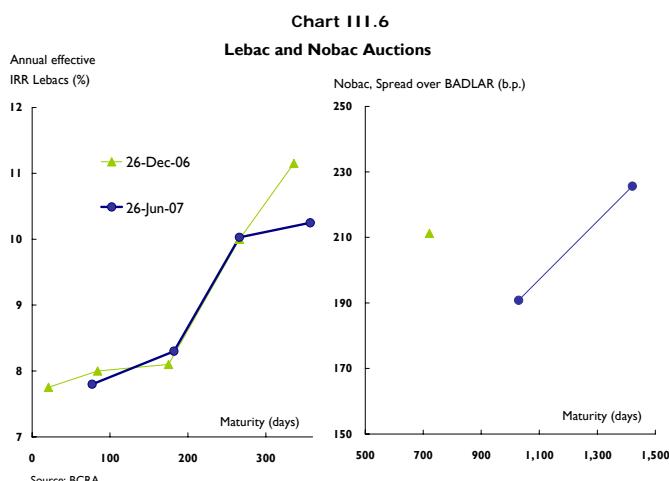
¹⁷ In the case of Argentina the index represents a basket of Par bonds and Discount bonds in dollars, both governed by the laws of New York.

¹⁸ The Government of Venezuela made a Southern Bond issue during the half (in February) for US\$1.5 billion, using Venezuelan and Argentinean bonds (Boden 2015).

¹⁹ The Bonar V matures in 2011 while the Bonar VII matures in 2013.



Source: BCRA



gained in dynamism. As a result, at June 2007 Lebac bills accounted for 43% of the total outstanding, while at the end of the previous year their proportion was 32% (see Chart III.5). This took place in the context of a decline in the reference variable interest rate in the first months of the year, at the same time as there was stronger demand for fixed interest rate instruments (a similar phenomenon can be seen, for example, in placements of corporate debt in pesos).

In addition, in the first half of the year there was a 24 days lengthening in the duration of the outstanding portfolio, to a level of 377 days by the end of June. The composition of the portfolio in terms of duration showed an increase in the weighting of instruments with remaining terms of between 6 and 12 months by the middle of 2007 (rising from 27% to 38%), while those with more than one year term accounted for 39% of the total (49% at the end of 2006).

Yields of bills on the primary market did not record significant change between ends of the half-year, with those for the last auction in June being similar to those seen at the end of 2006. Only in the case of Lebac for terms of almost one year there was a notable difference, with a decline of 95 b.p.²⁰ (see Chart III.6). Notes, for their part, showed some spread contraction in half-yearly terms, with a spread at almost three years that in mid-2007 was lower than that recorded by the 2-year Nobac auctioned at the end of 2006 (in the context of a decline in the BADLAR rate between ends for the half).

Lebac yields on the secondary market tended downward, with a declining movement by the entire curve, despite a slight rebound towards the end of the half. For example, the most liquid Lebac (maturing in January 2008) recorded a yield of close to 10%²¹, almost 100 b.p. lower than its level at the end of 2006 (see Chart III.7). Nobac yields on the secondary market matched the performance of the BADLAR rate for the period, falling back in the first few months, increasing in March (with a subsequent correction) ending the period showing an upward trend, although below the levels observed at the end of 2006. As a result notes recorded a drop of almost 200 b.p. in their spread between ends of the period under review.

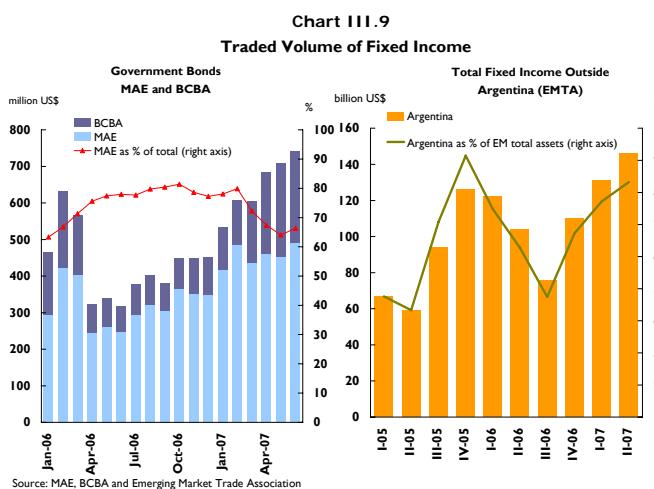
In line with the trend observed over the course of the previous year, and consistent with the increase in the stock outstanding, in the first half of 2007 the trading of Central Bank instruments maintained its upward trend (see Chart III.8). Central Bank issues reached a level of 38% of total fixed income instruments traded at the end of the period²². Although the floating-rate notes continued to be the most traded, Lebac bills recorded rising liquidity, a trend that is expected to be maintained for the rest of the year.

Fixed income asset trading volumes continued to grow in the first half of 2007 on both domestic and foreign markets

²⁰ Based on a linear interpolation for a 336 day term.

²¹ AEIRR weighted by volume traded.

²² Based on MAE trading.



On the domestic market, fixed income asset trading volumes continued to grow, in line with the situation observed in the second half of 2006. By mid-2007 the average daily trading volume reached US\$742 million, 130% more than in the same month of 2006 and 65% more than at the end of that year. Volumes of Argentine Government securities traded abroad achieved greater dynamism, with a still growing demand for emerging market issues in general²³. Although their relative importance is still low, Argentine fixed income instruments increased its participation in total emerging market issues traded: in the first six months of 2007 its participation amounted to 8% of the total volume traded (see Chart III.9).

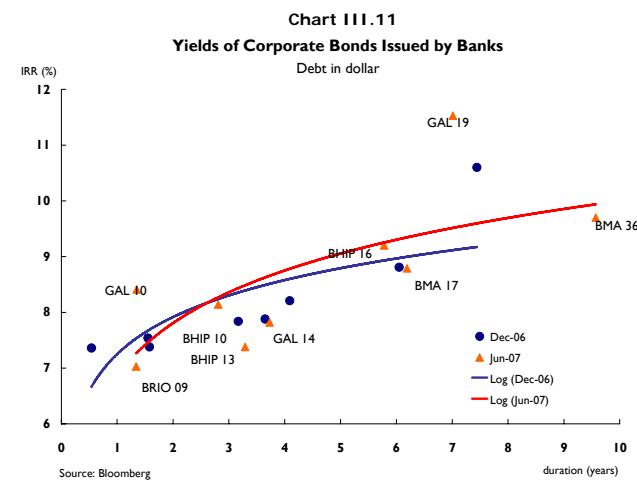
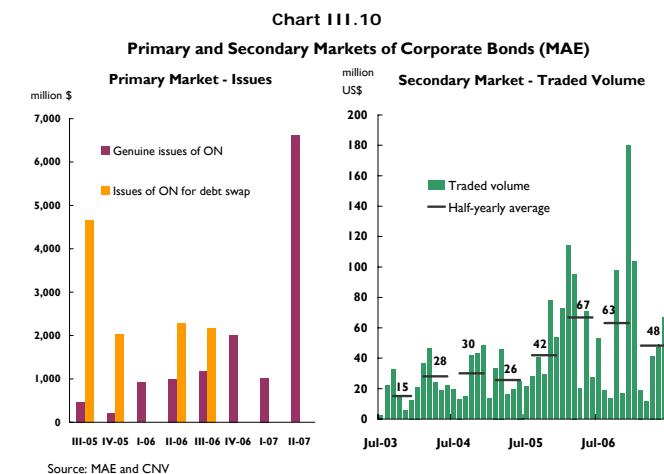
III.2. Private sector fixed income

Genuine corporate debt issuance increased significantly, with a rising volume of issues in pesos at fixed rates, led by financial entities

Corporate bond (ON) issuance intensified in the first half of 2007: issues during the period totaled approximately \$7.6 billion, equivalent to an increase in the order of 82% compared with the same period of the previous year (see Chart III.10). Almost all these issues represented genuine financing transactions (that is to say, they were not linked to the restructuring of liabilities)²⁴. The increase was due to significant issues by various sectors in addition to the financial system, including oil, gas and infrastructure.

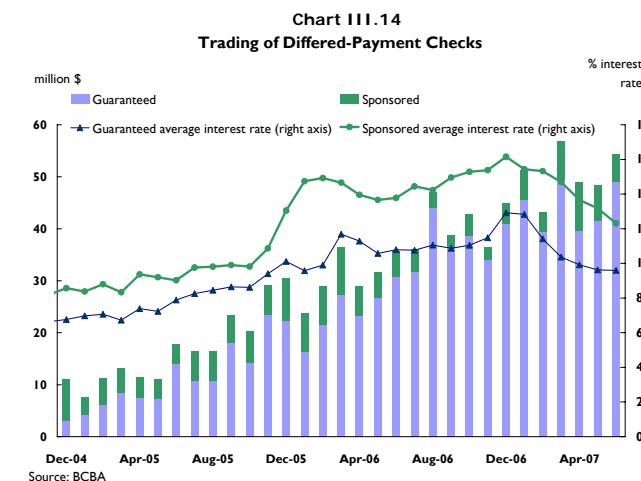
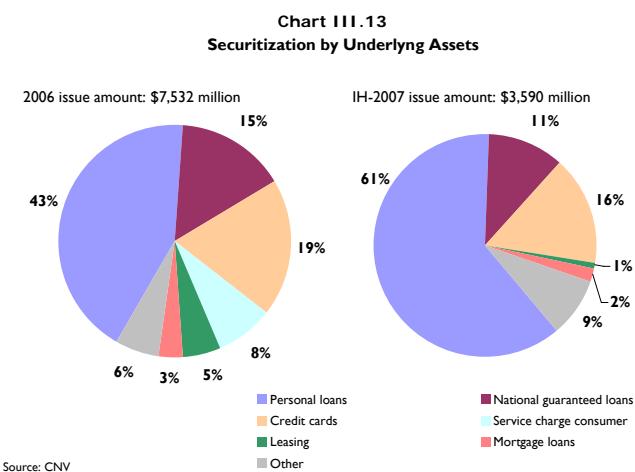
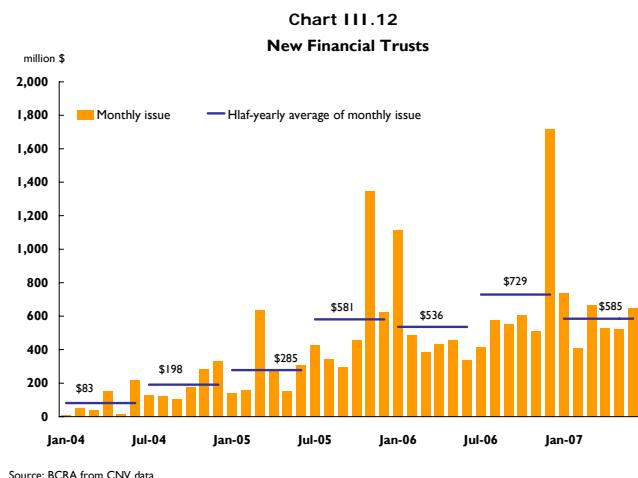
Notably during the period, certain companies were successful in obtaining long-term financing at fixed interest rates. In some cases this financing was arranged directly in domestic currency or through instruments tied to the peso (that is to say that amortization and interest coupons are calculated in pesos but are paid for in dollars at the rate of exchange in force at the date of payment). Almost one quarter of the corporate debt issued during the half was in local currency (including debt that was peso-linked), which is in line with what has been observed in relation to emerging country debt (both sovereign and corporate). At international level there has been a growing demand for assets in emerging country currencies, with the aim of diversifying portfolios and on the basis of expectations for the appreciation of domestic currencies (notably in the case of countries such as Brazil and Mexico).

Local currency debt issuance was led by financial entities. Total debt placed in the first half of 2007 totaled over \$1.9 billion (6 placements) and 76% of this amount corresponds to issues made in pesos (or tied to the peso). Terms for the placements in pesos vary between 3 and 5 years (in dollars, on the other hand, the terms for issues by financial entities in the half lengthened to 10 years). The larger bank issues in pesos were at fixed interest rates. In addition, unlike the situation in previous periods, this half smaller financial entities also issued debt, implying an



²³ As per EMTA data.

²⁴ The only exception was an issue by Autopistas del Sol during May, which was partly made in connection with a restructuring of liabilities. Excluding that transaction, genuine issues were up 264% in the half compared with the same period of 2006.



expansion of the universe of institutions making use of such financing instruments.

In the case of secondary market trading, following a significant increase during the previous year, in the first half of 2007 the volume of corporate bonds traded on the domestic market posted a decline. Monthly average trading volume during the half-year was US\$48 million, whereas the monthly average for 2006 was US\$65 million. The traded volume of corporate bonds did not exceed 1% of total bond trading, in line with past experience.

Corporate debt yield curves shifted upwards between ends for the six-month period, matching the overall behavior of fixed income assets. Analysis based exclusively on financial institution dollar-denominated debt issues (see Chart III.11) shows a more complete curve, with increased observations in the middle segment of the curve. Financial institution debt yields recorded a mixed performance during the half (with certain improvements in the shorter-term instruments and increases in the longer-term ones), which was translated into some increase in the slope of the corresponding curve.

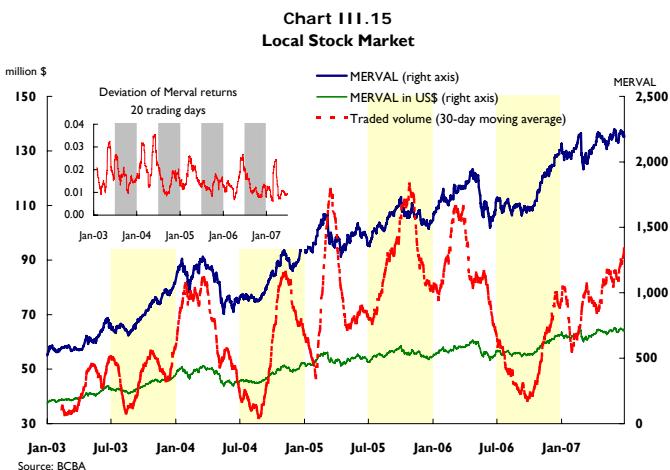
Financial trusts recorded a slight year-on-year increase, and there has been greater growth in consumer lending

Issuance of financial trusts continued to consolidate its growth. The average volume issued in the first half of 2007 reached a monthly \$585 million (see Chart III.12), an increase of 9% compared with the same period of 2006 (although showing a drop of almost 20% compared with the immediately preceding six months, following a record issuance level in December 2006²⁵).

As in 2006, and consistent with the role played by consumption in the expansion of the domestic economy, as well as by the lending granted by the financial system most of the instruments issued during the first half of 2007 had consumer loans (personal loans and credit card coupons) as their underlying asset (see Chart III.13). In the period analyzed, such items formed the underlying asset for 77% of the total issued, exceeding the proportion recorded in 2006 (62%). This increased weighting was partly due to the absence this half of any securitization of tariff charges, and a reduction in financial trusts issued with Secured Loans as their underlying assets (in line with declining interest in CER-adjusted assets).

Trading of deferred-payment checks continued to increase during the period, when the total amount traded reached over \$300 million, an increase of 64% compared with the same period of the previous year and 23% compared with the immediately preceding six months (see Chart III.14). In line with the trend observed in recent years, most deals have involved guaranteed checks (87% of the total traded in the first half of 2007). Nevertheless, contrary to experience until this year, average interest rates for both sponsored and guaranteed checks showed a marked downward trend in the period under analysis (with drops of between 300 b.p. and 400 b.p.), a

²⁵ The Gas I Trust was issued in that month.



movement that amplified the behavior of domestic reference interest rates.

III.3. Equities

The Merval stock-market index reached a new high (although showing signs of greater volatility), while corporate share subscriptions increased

After gaining 22% in the second half of 2006, the Merval ended the half with an increase of 4.8% (see Chart III.15). This performance was more modest than that observed in the main reference bourses, and in regional stock-market indexes. For example, the Dow Jones set new all-time records with a rise of 7.6% in the period, while the MSCI, which groups together Latin American markets, went up 25%.

Stable crude oil prices meant that the share with the greatest weighting in the Merval index (highly correlated with oil prices) ended the half almost unchanged²⁶. Bank stocks outperformed the Merval in the early months of the year (see Chart III.16). This situation was reversed mid-way through the half, however, as prices began to stabilize, and then declined slightly. This behavior will have been exacerbated in the first months of the second half of the year, in view of the turbulence on international markets, which had a greater impact on financial sector stock.

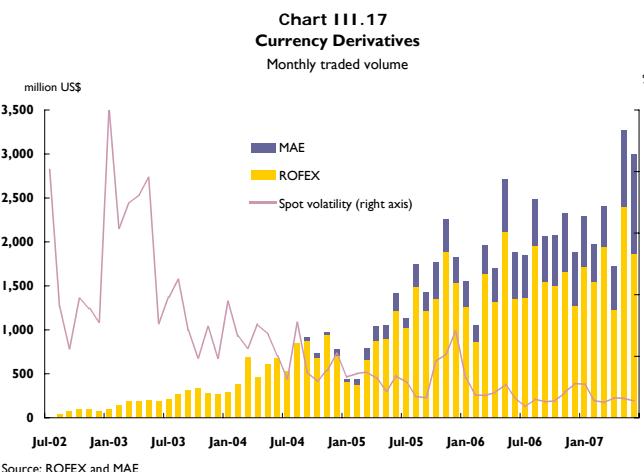
In the first half of 2007 there was an increase in genuine financing received by companies from the market by means of share subscriptions, with one major transaction (in addition to an IPO by a leading company). As a consequence, share subscriptions during the six months totaled an amount of close to U\$500 million, almost three times the amount obtained from capital increases in the same period of 2006. Subsequently, the first months of the second half recorded capitalization by banking institutions.

Regarding the volume traded, stock-market activity rose from a daily average of \$55 million in the second half of 2006 to \$79 million per day in the first half of the year (although this was still an average of \$6 million per day less than in the same period of the previous year).

III.4. Derivatives

Futures and forwards markets continue to increase, with some futures trading based on the Discount bond in pesos

Trading in exchange rate derivatives reached a new high during the first half of 2007, totaling approximately US\$2.45 billion per month on average for the period, 35% more than in the same half of 2006 (see Chart III.17).



²⁶ Although oil prices also have a significant impact on the Brazilian stock-market index (via Petrobras), the better performance by the Bovespa was due to the sharp rise in metals and commodities prices, as well as the prospect for stronger cuts in the reference interest rate in that country (as from June the Brazilian Central Bank began to make cuts in its reference interest rate of 50 b.p., instead of 25 b.p.).



This rise in trading volumes (particularly marked in May and June) exceeded the monthly record set in May 2006, which had reflected the period of volatility in the spot exchange rate during that month. In 2007, however, increased trading took place in the context of still low volatility in historical terms, considering the period from July 2002 to June 2006.

As regards of the financial futures contracts, for the first time transactions were recorded making use of the Discount bond in Pesos (DICP), although trading volume was light (4,657 contracts in total, each contract based on an underlying asset of bonds for 10,000 pesos face value).

It is expected that the dynamism achieved by the amounts traded on derivatives markets will gain strength in the second half of the year, in view of the increased volatility shown by the exchange rate during a period of turbulence on international markets.

IV. FINANCIAL INTERMEDIARIES

Summary

In a favorable macroeconomic context, domestic financial intermediation continued on their expansive trend during the first half of 2007. The momentum attained by financial intermediation with the private sector was the main driver of this expansion.

Although the assets growth of the institutional investors was mainly explained by the dynamics of the pension funds (AFJP), their contribution was considerably reduced compared to previous periods. The latter was due to the transfer of individual accounts from the AFJP's balances to the pay-as-you-go pension system, resulting from the modification of social security legislation. As the transfer of these accounts continues in the future, combined with volatility on capital markets, it should result in a reduction of the pension fund portfolio during the second half of 2007, partially compensated by individual contributions. Generally, institutional investors increased their exposure to the private sector during the first half of 2007, most noticeably by mutual funds.

During this period, favored by the Central Bank financial policy, the financial system consolidated the process of balance sheet normalization and of financial intermediation growth. Increased financing to the private sector was accompanied by a generalized extension of maturities of all credit lines and an acceleration of transactions with longer term maturities, of which an increase in mortgage loans was noticeable (32%a. in the first six months of 2007). Also during 2007, penetration of private sector credit grew in the Argentine regions with lesser relative access to financial services. In addition, banking exposure to the public sector continued its reduction to be about half of the exposure to the private sector.

In line with incentives established by the Central Bank, private sector deposits are systematically the main source of bank funding. In addition, the financial system continued taking advantage of the benefits of complementarities with the capital markets as banks placed new corporate bond issues in 2007. On the other hand, due to multiple mechanisms generated by the Central Bank, rediscounts disbursed by the Central Bank during the 2001-2002 crisis are being reduced at an accelerated pace and only one financial institution remains with this type of assistance.

Evaluating progress experienced during the past three years, in so far as a positive context for the local economy continues, an expansion of the financial system intermediation levels and a strengthening of its balance sheets is anticipated. An increase in loan lines for the private sector is estimated, although possibly at lower growth levels, as well as a smaller exposure to the public sector within a context of a relatively stable increase of deposits.

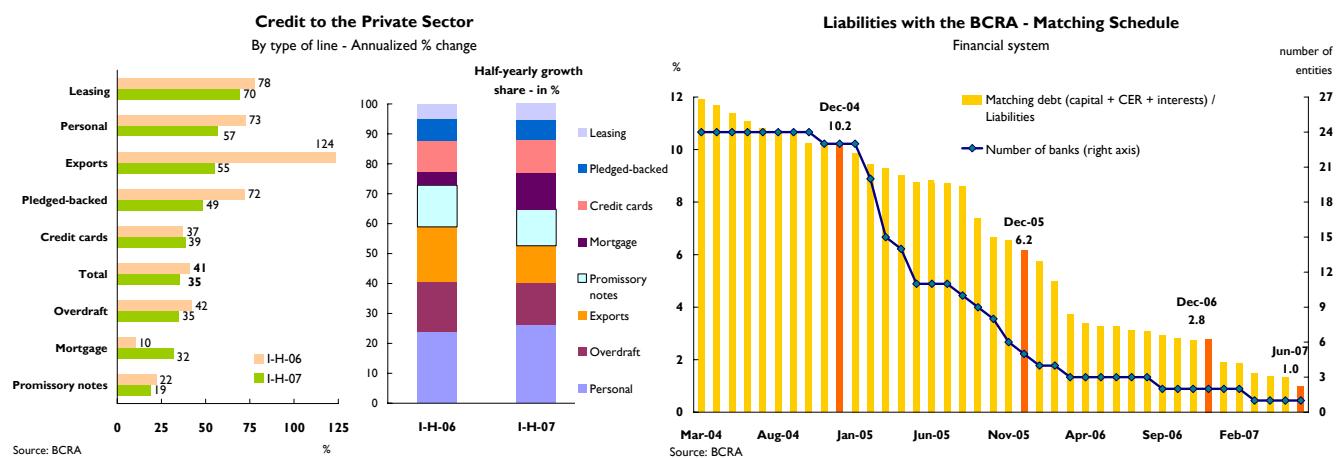
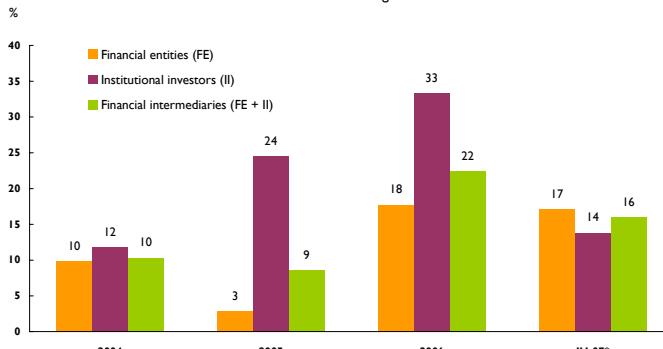


Chart IV.1
Local Financial Intermediaries Growth
 Total consolidated assets growth rate



IV.1. Institutional investors

Domestic financial intermediaries continued on an expansive trend during the first six months of 2007

Consolidated assets of domestic financial intermediaries (financial entities and institutional investors) grew 16%.a. during the first six months of 2007 (see Chart IV.1). The momentum of the financial intermediation with the private sector was the main cause of this expansion in a favorable macroeconomic context. While banks maintained the growth levels they had achieved in 2006, institutional investors (pension funds, insurance companies and mutual funds) reduced their growth rate. In addition, in contrast with previous years, the expansion of institutional investor assets during the first half of 2007 was slightly lower than at financial entities.

Although the relative size of the local financial system is smaller than those of similar economies or developed ones (see Chart IV.2) its rate of expansion is higher which demonstrates its high growth potential.

Institutional investors increased their exposure to the private sector during the first half and new factors to be monitored emerged

Consolidated assets of institutional investors²⁷ totaled \$143 billion in June 2007, achieving a 14.8%.a increase in the first half. Although most of this growth was due to increased pension funds assets, these institutional investors reduced considerably their share in comparison with earlier periods.

The expansion rate of the pension fund portfolio was reduced to less than half compared to the expansion registered last year, growing 14.4%.a in the first half of 2007 to reach \$96 billion by June 2007. This lower growth rate of the pension fund portfolio was partly due to the balances transferred from Special Regimes contributor accounts to the pay-as-you-go pension system carried out in May as a result of legislative reforms to the social security regime. The growth of the pension fund portfolio during 2007 was mainly due to the nominal revaluation of its assets, and to a lesser extent to an increase in individual contributions as a result of an improvement in income levels and also to the fact that pension fund membership grew slightly during the period.

For the second half of 2007, pension fund portfolio is expected to fall, fundamentally as a result of the continued transfer of contributors' balances from pension funds to the pay-as-you-go pension regime. Together with the fall in portfolios owing to these balance transfers, should be consider the reduction in the contributions that the AFJP will register without these contributors. In addition, the international markets volatility is expected to have a negative impact on pension fund portfolios.

During 2007 pension funds increased their exposure to the private sector (see Chart IV.3) mainly through the purchase of shares and variable income mutual funds. The pension funds

Chart IV.2
Financial System Scale
 Assets as % of GDP - Last available data

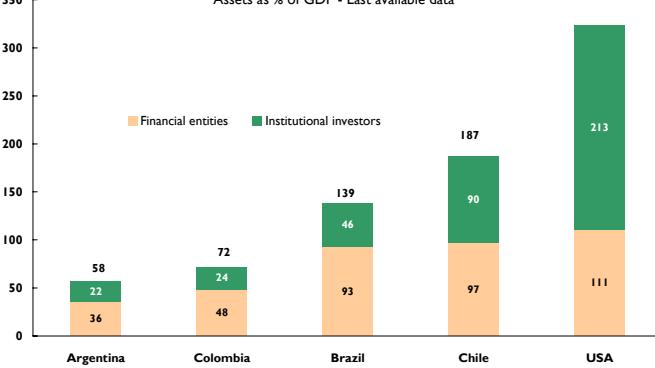
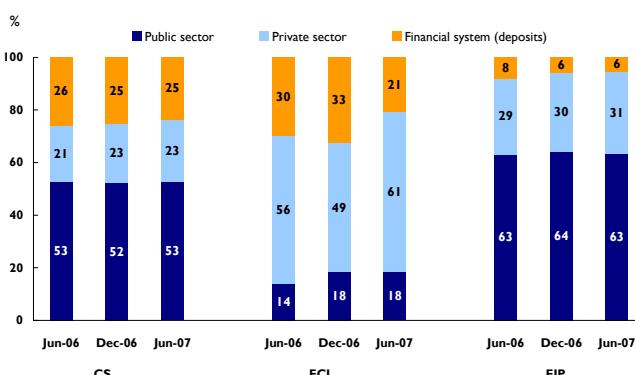
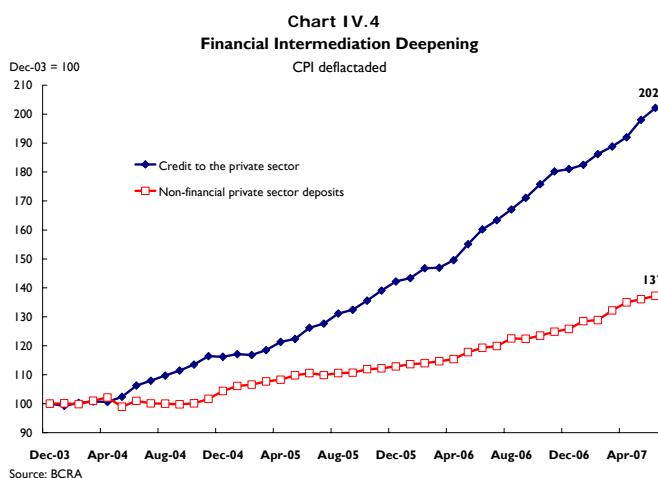


Chart IV.3
Institutional Investors Portfolio Composition
 As % of total investments



²⁷ In order to avoid duplications, pension fund, insurance company and mutual fund portfolios are consolidated.



also increased their nominal holdings of sovereign bonds (mainly the GDP warrants and Bonar bonds) and Central Bank Nobacs. Deposits in the financial system maintained of their participation in the pension fund portfolio.

Meanwhile, the mutual fund portfolio was \$23 billion in June 2007, registering an increase of 44.8%^a in the first half of 2007. Mutual funds increased their exposure to the non financial private sector by 12 p.p. in 2007, mainly by purchasing more shares. This heavier weighting of the private sector was at the expense of the participation of deposits in the financial system, and, to a lesser extent, the reduction of the exposure to the public sector. This change in the mutual fund portfolio composition increased their exposure to volatility of the variable income market.

As regards insurance companies, their assets totaled \$37 billion in June 2007, increasing 14.1%^a during the first half of 2007. In line with their performance in recent years, the insurance market continues to be driven by companies in the retirement and general insurance segments. Differentiating themselves from the rest of the institutional investors, the insurance company portfolio breakdown remained at similar levels to 2006, with exposure to the public sector dominating and accounting for more than half of their investments.

Table IV.1
Balance Sheet
Financial system - An % of netted assets

	Jun-06	Dec-06	Jun-07	y.o.y. change Jun-07 (%)
Assets	100	100	100	17.7
Liquid assets	16.1	15.7	15.8	15.6
Lebac and Nobac	9.7	10.4	13.3	60.3
Lending to the private sector	29.2	32.0	34.3	38.0
Lending to the public sector	28.5	24.4	18.5	-23.6
Other assets	16.4	17.5	18.0	30.3
Liabilities + Net worth	100	100	100	17.7
Public sector deposits	18.0	18.6	18.2	18.3
Private sector deposits	50.0	50.7	53.1	25.0
Liabilities with the BCRA	5.1	3.1	1.4	-68.6
ON, OS and foreign lines of credit	5.5	5.1	4.9	3.6
Other liabilities	8.2	9.0	9.1	29.9
Net worth	13.2	13.4	13.4	19.4

Source: BCRA

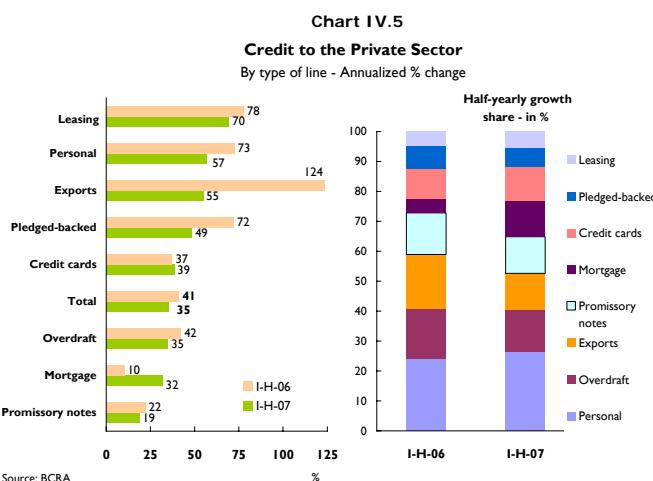
IV.2. Financial entities

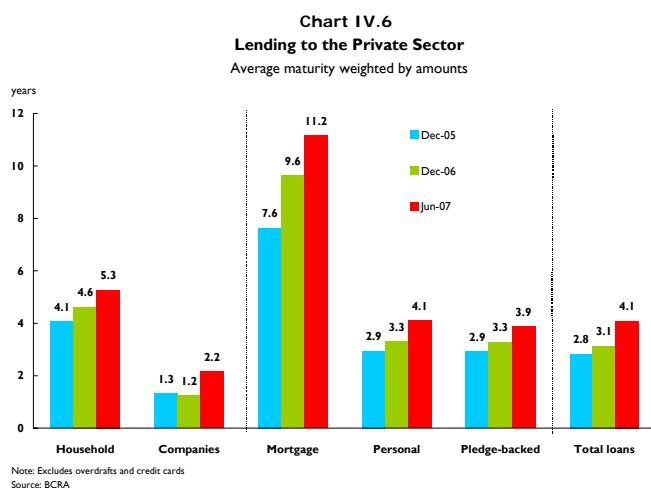
Driven by Central Bank financial policy, the financial system consolidated its process of balance sheet normalization and financial intermediation growth in 2007

Anchored by Central Bank financial policy, the financial system consolidates the process of balance sheet strengthening and normalization during the first half of 2007. During the first half of the year, private sector credit consolidated its growth trend in a framework of limited counterparty risk, with funding being mainly supplied by private sector deposits.

Credit to the private sector deflated by the CPI GBA have doubled their outstanding balances over the past three and a half years (see Chart IV.4), leading asset growth in the financial system during this period. In this manner, private sector financing gained share relative to the aggregate equity structure of banks, reaching 34.3% of assets in June, or 5.1 p.p. above the level of the same month of 2006 (see Table VI.1).

In particular, during the past 12 months, credit to the private sector rose 38% (35.2% during the first half of 2007). A slight decline in the growth rate of financing to the private sector is observed when comparing the trend of the first six months of 2007 with the same period of the previous year (see Chart IV.5). The most dynamic credit lines during the first half of 2006 reduced their growth rate during 2007. Mortgage loans, which had also experienced tepid growth during the first part of 2006, also showed an important acceleration in 2007. In this way, a lower dispersion of the growth rates of the different credit lines in the first half of 2007 was noticeable.





Growth of loans to the private sector was accompanied by a generalized extension of maturities for these transactions, especially of mortgage loans

With specific reference to mortgage loans, these increased 32% a. during the first half of 2007 (against 10% a. in the first half of 2006). This sustained increase was in line with the incentives established by the Central Bank. Particularly, with the aim of facilitating access to mortgage loans and their subsequent securitization, in March 2007, regulations included in the “Mortgage Loan Origination and Management Manual” were modified. Permission was granted for client files to contain only identification data when credit assignment is done by means of screening or credit scoring. Also, in order to drive funding of mortgage loans for small amounts, capital requirements for these types of credit lines were made more flexible.

It is worth noting that because the mortgage market is still at an initial stage of development, it still exhibits a certain degree of concentration, with seven financial entities granting 85% of the new loans during 2007. On the demand side of these credit lines, three quarters of new loans settled in 2007 were granted to families and the remaining to firms. For the remainder of 2007, the pattern of mortgage loan growth is expected that to stay in line with economic perspectives.

Mortgage loan growth during the first half of 2007 was achieved together with a 19 month extension of the average maturity for these transactions, reaching almost 11.2 years (see Chart IV.6) which is an important factor to extend the average maturity of fresh private sector financings.

Excluding current account overdrafts and credit card financing lines, during the first half of 2007, the average maturity of loans to the private sector reached 4.1 years, which is 11 months longer than at the end of 2006. This longer average maturity was generalized in all credit lines and was seen in loans to families and to firms. As volatility in global markets has reduced and the terms for funding have lengthened, the maturity of loans is expected to continue extending during 2007.

During 2007 the penetration of private sector financing grew in regions of Argentina with relatively less access to credit

Together with the sustained growth and longer maturities, a broader credit penetration was noticeable at a geographic level. This development is partly due to measures adopted by the Central Bank to increase the geographic coverage of the financial system. Approval was granted to establish a new type of mobile operating branch in districts that lack an established one, and to expand the range of services that the special outlets can provide. New capital requirements were established in accordance with the regional characteristics and new operating regulations were approved for saving and loans cooperatives.

Although credit for the private sector is still concentrated in Buenos Aires city, the share of growth observed during the first half of 2007 was distributed more evenly than during the same period last year (see Chart IV.7). Three regions (Ciudad de Buenos Aires, Pampeana and Centro) which concentrated the

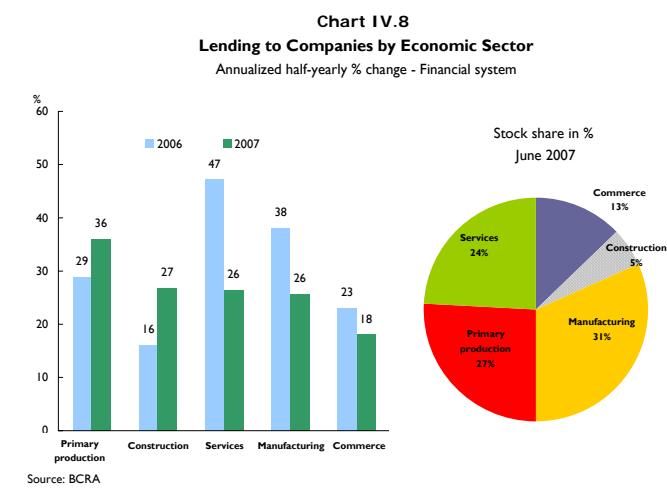


Chart IV.9
Lending to Companies by Amount Range
Annualized half-yearly % change - Financial system

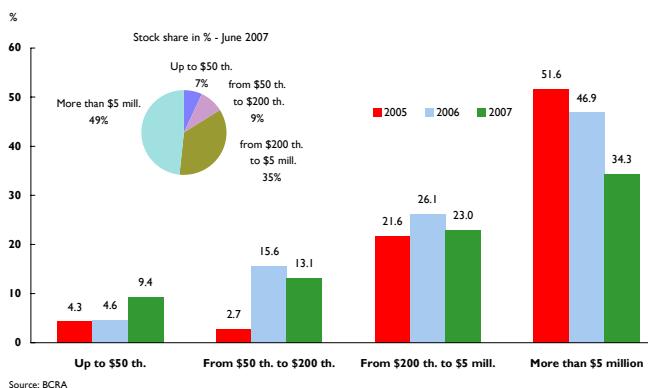


Chart IV.10
Public and Private Sector Exposure
As % of total assets - Financial system

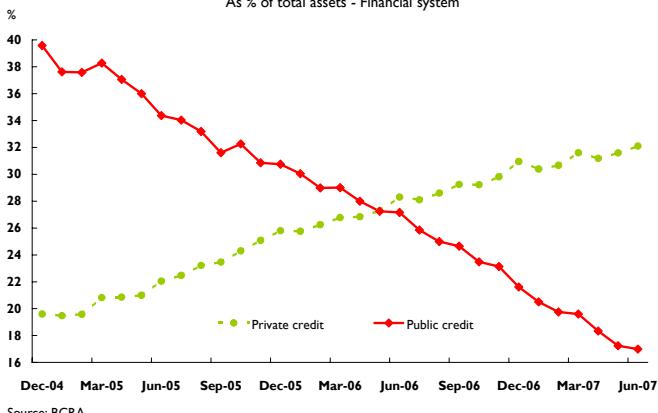
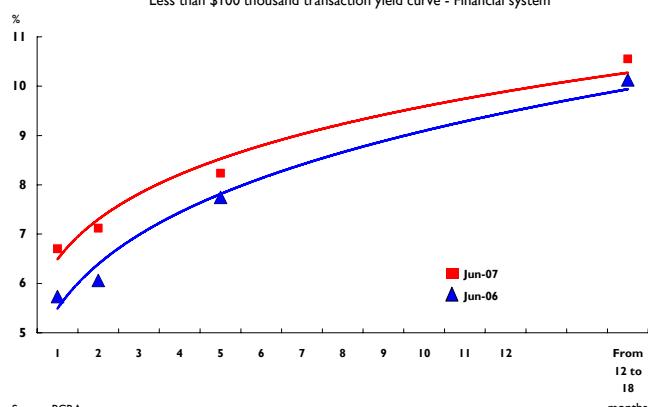


Chart IV.11
Private Time Deposits in Pesos
Less than \$100 thousand transaction yield curve - Financial system



most credit growth to the private sector in the first half of 2006 reduced their share by 7 p.p., a participation that was occupied by the rest of the regions. According to the incentives developed by the Central Bank and given the increasing dynamics of the different geographical regions in Argentina, for the rest of 2007 a relatively more homogeneous growth rate in loans to the private sector is anticipated.

Primary production, industry and services explained the major part of the increase in credit to corporations in the first half of 2007

Primary production, manufacturing industry and suppliers of services accounted for 83% of the credit growth to companies during the first half of 2007. A more homogeneous increase of credit to the different productive sectors is noticeable when the evolution during the first half of 2007 and the same period of 2006 are compared (see Chart IV.8). As long as the dynamic framework for different production activities is maintained, it is estimated that a growing supply of financial resources to corporations will be maintained for the remainder of 2007.

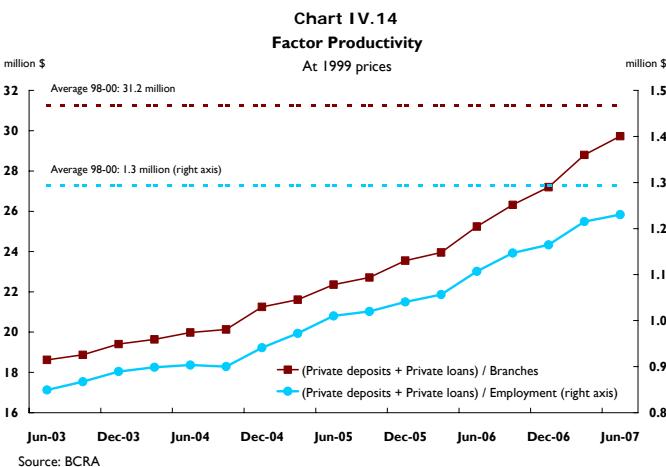
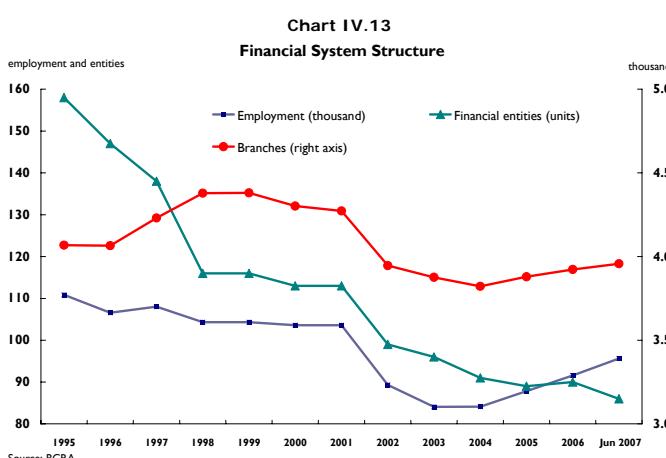
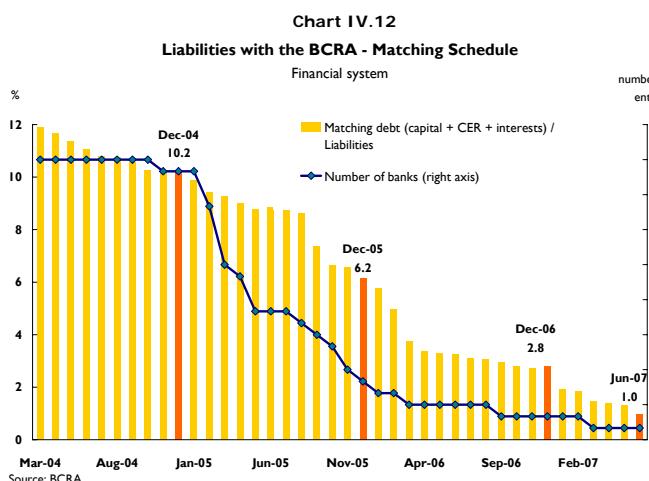
Considering the distribution of loans by size, the increase of credit assistance during the first half of 2007 was evenly distributed in all its dimensions (see Chart IV.9). Furthermore, when the dynamics of the different loans sizes are compared, there is a noticeable reduction of the gap between growth rates of larger and smaller loans. Actually, although loans with balances of less than \$50,000 (mainly related to micro-enterprises) represent only 7% of the total stock of loans to firms, unlike the larger loan categories, during the first half they registered an increase in the rate of growth with respect to the same period the previous year. On the other hand credit lines of over \$5 million (mainly channeled to large corporations) reduced their expansion rate, but nevertheless exhibited more momentum in 2007, and represented nearly half of total loans.

The efficacy of Central Bank financial policy was reflected by the reduction of public sector exposure

Exposure of the public sector in the financial system dropped by 4.6 p.p. of total assets in 2007 (see Chart IV.10) to reach a 17% level, in line with regulatory changes decided by the Central Bank, which privileged the application of resources to the private sector. The Central Bank established capital requirements for public sector asset holdings, as well as a maximum limit of 40% of the asset in its individual exposure as from 2006, to reach 35% in July 2007, together with the gradual convergence to market prices for sovereign bonds. In this manner, the financial system continues consolidating its independence from the financing needs of the public sector.

In a context of sustained normalization of the financial system liabilities, private sector deposits are systematically the main source of funding

In line with the performance exhibited in recent years, in the first half of 2007 total deposits rose 24% a., mainly driven by the increase of private sector deposits (28.5% a.), and to a lesser extent by the increase of public sector deposits (10.8% a.). The



increase in private sector deposits during the half was stimulated by both sight deposits as well as by time deposits, which grew at a similar rate. On the other hand, private sector deposits were equivalent to 53.1% of total bank funding (liabilities plus net worth), exceeding the June 2006 value by 3.2 p.p.

The increase in time deposits happened in a context of slightly higher borrowing rates (see Chart IV.11), especially at the short end of the yield curve. In order to continue stimulating migration of savings from sight deposits to time deposits, the Central Bank introduced a number of changes to rules. In fact it decided that sight deposits in pesos with a remuneration of over 15% of the BADLAR rate will be subject to a 100% minimum cash reserve requirement. It also increased the minimum cash reserve requirement on sight deposits (from 15% to 19%), eliminated the remuneration on the reserves for these types of deposits (current accounts and savings accounts) and eliminated the reserve requirement for time deposits with a remaining term to maturity of over 180 days. In addition, it approved payment of variable interest rates on time deposits with a guaranteed minimum fixed interest rate and broadened the range of eligible assets and indicators available for floating rate term investments.

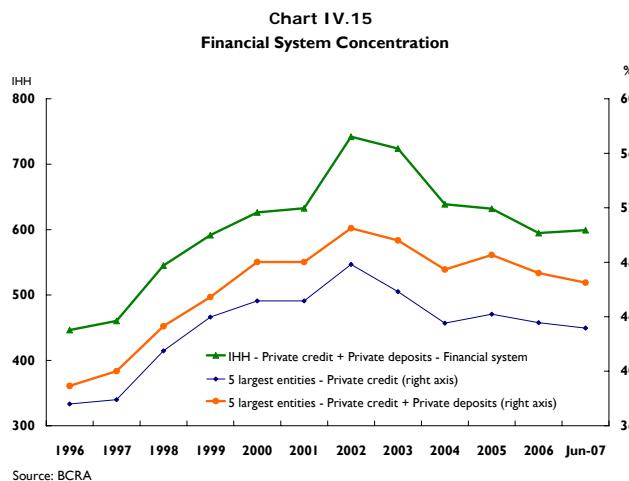
Quality of liabilities improves: financial entities issue corporate bonds, and simultaneously prepay rediscounts for illiquidity

In order to take advantage of the complementary benefits with the capital markets, during the first half of 2007, a growing dynamism by the banks was observed, which allowed them to obtain funding by placing of bond issues. During 2007 five financial entities have sold bond issues unrelated to debt restructuring processes and obtained funding amounting to \$1.9 billion. Issues were placed on a fixed interest rate basis, most of them in pesos and maturities ranged between 3 to 10 years. Although it is expected that because of international volatility some financial entities will postpone new issues, looking ahead an increase in long term financing is a key factor to stimulate the supply of credit on a long term basis to encourage productive investment.

In addition to the progress made on the maturity of the funds obtained, advances for illiquidity reasons granted by the Central bank during the 2001-2002 crisis are being reduced at an accelerated pace and have practically been eliminated from bank balance sheets. In fact, the only bank with outstanding balances for this facility is paying the remaining debt with the Central Bank in advance, which reduced the balance under the matching scheme to an amount equivalent to 1% of the financial systems liabilities in June, 9 p.p. below the level at the end of 2004 (see Chart IV.12).

Although banks achieved improvements in factor productivity, it is still below the levels prior to the 2001-2002 crisis

In line with the positive recovery observed in the last three years, and driven by favorable sector perspectives, financial entities registered strong increases of staff, the number of branches and ATMs during the first half of 2007. Particularly, the system headcount grew 4.4% (4,000 employees) in the first

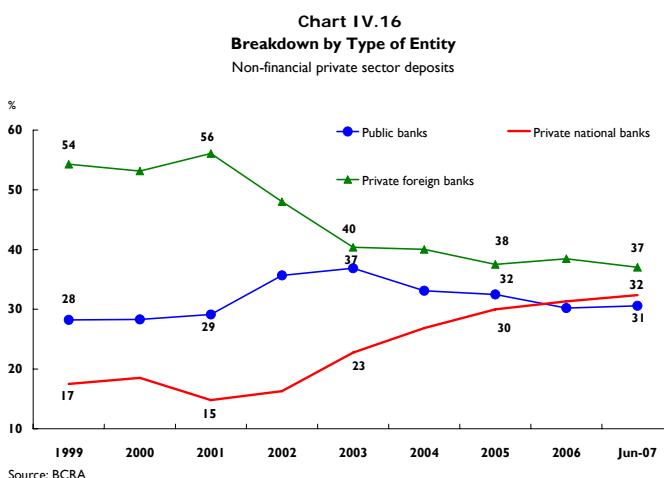


half of the year (see Chart IV.13) to reach 95,600 employees, with this increase being larger than the creation of formal employment of the economy.

In a framework of growing normalization of bank activities, the financial system achieved a sustained increase of the productive factors that it employs, combined with strengthening of its productivity indicators (see Chart IV.14), which practically reached the levels prior to the 2001-2002 crisis.

Together with the strategies at foreign-owned bank headquarters, the local financial system continued its structural resizing process and reached 87 financial entities in June, 3 less than at the end of 2006. In a framework of great dynamism, this meant that during the first half of 2007 a slight increase of consolidation of the financial system measured in Hirschman Herfindahl Index (HHI) terms persisted. Nevertheless, five of the principal financial entities reduced their shares of both loans to the private sector and in private deposits (see Chart IV.15). On a regional basis the degree of concentration in the financial system is still low.

On the other hand, the financial system continues its trend towards a more uniform distribution of the market by type of bank. Particularly, the private sector domestic capital banks continued increasing their share of private deposits, to overtake the public sector banks by a small margin (see Chart IV.16). Although they reduced their participation slightly in 2007, foreign owned banks retained the largest portion of private deposits.



V. RISK MANAGEMENT

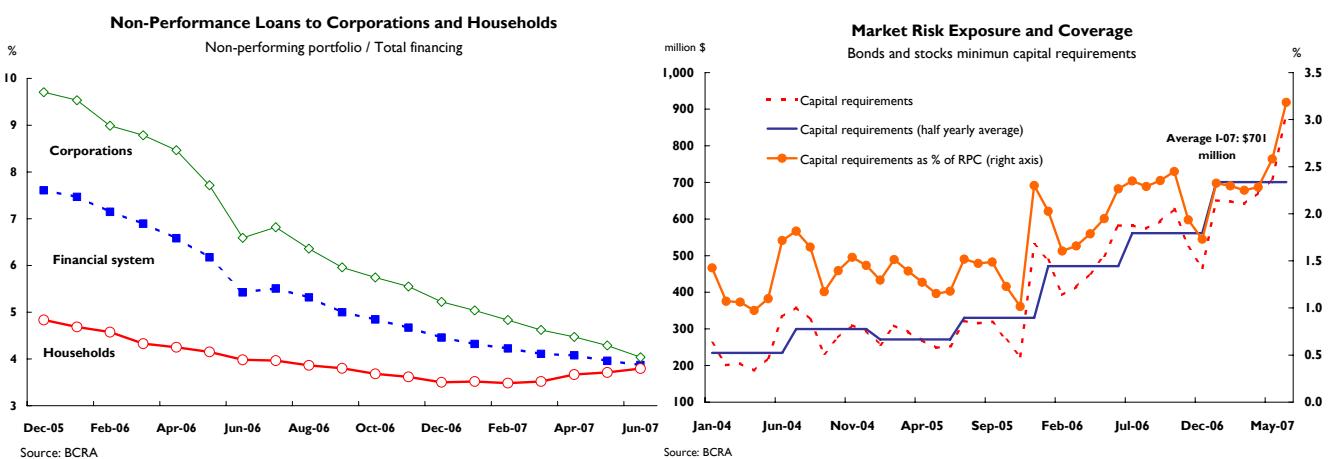
Summary

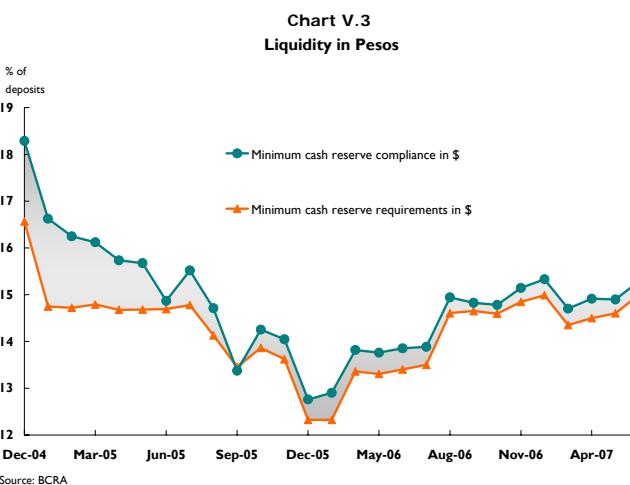
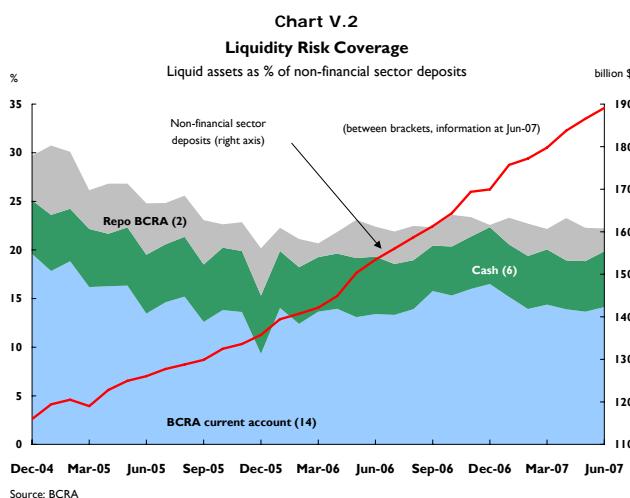
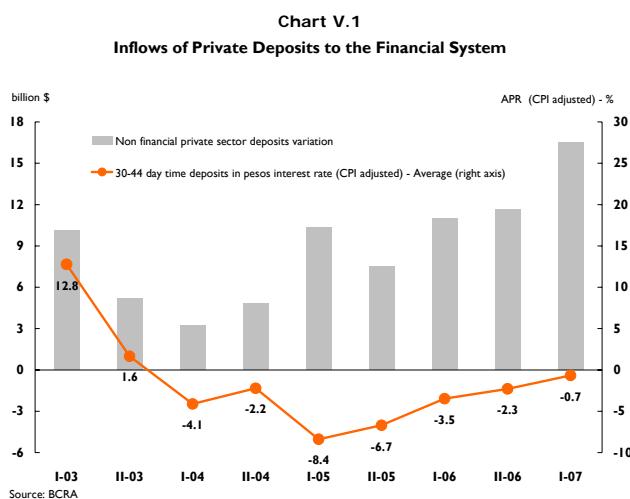
The financial system continues to show an adequate management of its risks, a situation that ensures it a sound position to confront the turbulences on international financial markets that worsened at the end of July. Liquidity levels remained satisfactory, and the Central Bank continues to provide the tools for the financial system to gain strength to confront this risk: in addition to its role as a lender of last resort, the bank has been offering reverse repos, direct repurchases and auctions on the secondary market for Lebac and Nobac bills and notes, scaled placement of these instruments on the primary market, swap auctions, authorization of bi-monthly positions (July-August and October-November) together with other advances in the regulations on minimum cash reserve requirements and participation in the dollar futures market. As a result, during the rest of the year it is expected that banks will continue to maintain adequate levels of liquid assets, in the context of an increase in funding by means of deposits.

The reduction of bank exposure to the public sector, combined with the maintaining of positive primary results and lower levels of government indebtedness, are reflected in a declining bank exposure to the public sector credit risk. Exposure to the private sector, on the other hand, has continued to grow, in the context of good prospects for company and household income, resulting in lower levels of repayment risk for these sectors. Private sector portfolio non-performance stood at a historically low 3.9%, in line with the levels in the rest of the Latin American region. Delinquency in lending to companies continued to decline in the first part of the year, with good performance being recorded by new credit lines. Household non-performance increased slightly during the period, reflecting in particular the impact of consumer credit lines (personal loans and credit cards). Despite this movement, in coming months it is expected that companies and households credit risk will remain at a low level.

In the first part of 2007 banks showed a slight increase in their exposure to foreign currency risk because of a slight increase in the mismatching of dollar items. Nevertheless, stress tests suggest that banks continue to show a sound position in the face of this risk, with adequate capital levels in the event of extreme negative shocks. Exposure to the risk from the real rate of interest continues to decline, with a falling level of mismatching of CER-adjusted items, a development that is expected to persist. Exposure to market risk recorded an increase in the half, given the greater weighting of assets with a market listing in bank portfolios, although this risk item continues to account for a small portion of the financial system balance of risks.

Although the size of its impact is still uncertain, the effects of turbulence on international financial markets will be responsible for a slight materialization in the exposure to market and interest rate risk in the second half of 2007.





V.1. Liquidity risk

Recovery in confidence in the financial system over the last three years has been behind the good current liquidity level

Banks continued to normalize their liabilities through the taking of deposits from the private sector. Deposits from companies and individuals rose to approximately 55% of total bank liabilities. This trend is in line with the gradual rise in interest rates paid on deposits (see Chart V.1).

At the end of the first half of 2007 financial system liquid assets formed by cash, deposits held in current accounts at the Central Bank and cash repos with the Central Bank totaled slightly over 22% of the non-financial sector deposits, slightly less than that recorded at the end of 2006 (see Chart V.2). This small drop in the level of this indicator is in line with the consolidation of the process of balance sheet normalization, mainly through the application of funding to credit lines for companies and households (see page 43) and the accelerated reduction in liabilities linked to the liquidity assistance granted by the Central Bank during the crisis in 2001-2002.

As a result, financial entities ended the first half of the year with adequate liquidity levels, in excess of the requirements in pesos established by the Central Bank, with a safety margin that has remained stable in year-on-year terms (see Chart V.3). Foreign currency liquidity indicators also showed a drop, a trend derived from the growth in lending lines in dollars, mainly used in the financing of export transactions, which have risen at a faster rate than the growth in foreign currency deposits. As a result, in mid-2007 banks maintained a foreign currency liquidity position equivalent to slightly over one quarter of the requirement in such currency (see Chart V.4).

External volatility was reflected in inter-bank liquidity markets

In the first part of 2007 there was a slight reduction in amounts traded on the call market in comparison with the second half of 2006, while there was greater dynamism in inter-bank repo transactions (see Chart V.5). These latter operations increased by 6% on average compared with the immediately preceding period, although it is a market that still operates on a reduced scale.

At the end of July the volatility on international financial markets following the problems that developed in the US mortgage loan market began to have its repercussions locally. This rarified international context led to a fall in the resources available in the call market during July, influencing the evolution of totals and interest rates. The situation of uncertainty and lower liquidity led to greater volatility in call rates (see Chart V.6). In this context, the Central Bank introduced measures that are helping to normalize the market, mainly by means of the offering of reverse repos, Lebac and Nobac repurchases (both by means of direct purchases and tenders on the secondary market) and the scaling of the placing of such instruments on the primary market, repo auctions, two- monthly



BOX 2: IMPORTANCE OF THE USE OF STRESS-TEST TECHNIQUES IN FINANCIAL INSTITUTION RISK MANAGEMENT

Financial innovation and the stress events of recent times have led to the development of new techniques that form part of the risk management systems of financial entities around the world. The development of stress-test models is becoming increasingly widespread and is being recommended as standard practice by the main specialized international agencies. Consequently, the Central Bank encourages banks to incorporate stress-test mechanisms to their risk management processes, and to this end is beginning to gather information and to monitor current practice in this regard

The process of innovation in financial products and the events taking place in the financial crises at world-wide level are promoting changes in risk management methodology. Given that risk-taking is an inherent element in financial activity, financial entities design risk management systems with the aim of diagnosing and measuring their exposures, to then generate the necessary cover in the face of expected losses from the materialization of such risks. Traditionally, the design of risk exposure is based on historical data that is used to assign a given probability of materialization to each risk. In such a manner, banks calculate, for example, their reserves of liquid assets and loan loss provisions, to protect themselves from the expected losses from their balance sheet exposure to liquidity and credit risks respectively. Nevertheless, the main element characteristic of these crises is the presence of shocks that are by their very nature unexpected, and for which one cannot determine a historical pattern. This difficulty in dealing with uncertainty caused the finance industry to generate new tools to complement those that already exist, to enable the financial system to establish parameters for the setting up of capital levels (taking into account their cost) that would be sufficient to absorb the losses caused by negative shocks.

On this basis, growing use has been made of stress tests, which are employed to put the soundness of the financial system to the test in the face of extreme, although possible, adverse movements, for example in exchange rates, interest rates, or the prices of the different financial assets, among others. Within the various stress test designs there are two major groups, depending on the purpose of the analysis. On the one hand, the technique can focus on the system as a whole (top-down), providing a more macroeconomic view in the sense that it reaches conclusions on the effects of movements in the economic context on financial stability. Another view is provided by the technique focusing on the exposure of each portfolio in particular, using information at financial institution level (bottom-up). Despite this distinction, both versions are complementary, and the development within a context of appropriate supervision of these techniques within bank risk management systems to assist in promoting conditions for financial stability will be significant.

Specifically, from a financial institution risk management perspective, stress test studies complement the main risk evaluation techniques such as the value at risk methodology (VaR). Their use around the world in the evaluation of risk for financial entities and other firms providing financial services is helping to strengthen the overall context of financial stability by improving the soundness of each individual financial institution, mitigating the systemic effects provoked by possible contagion.

Stress-tests also have certain limitations, however. In particular, these models do not provide an exact measure of the losses from a shock, nor do they assign any probability to the scenario tested; furthermore, results are dependent on the choice of magnitude for the shock and in most cases they are unable to capture a wide range or any interaction between the various risks. Nevertheless, these models provide valid benefits by explaining first order effects of extreme phenomena, becoming a complementary tool within risk management systems.

At international level, the importance of being able to count on stress-test tools has been made manifest by various specialized agencies. So it is that the *Committee on the Global Financial System* (CGFS) and the *Basel Committee on Banking Supervision* (BCBS) –both within the sphere of the *Bank for International Settlements* (BIS)–, as well as the World Bank and the IMF, stress the need for banking supervisors to systematize the identification, impact and monitoring of the exposure of financial entities to shocks, in addition to the need for banks to develop and implement adequate risk management systems. In particular, the recommendations made by the Basel II proposals assign special relevance to the development of stress-test techniques, associating the results of these tests to the determination of capital adequacy levels in the more advanced developments of the technique.

Similarly, the BCBS details the basic guidelines that should be observed by country banking supervision systems with the aim of contributing to the strengthening of the international financial system (*Core Principles for Effective Banking Supervision*; Oct. 2006 revision). These principles develop the requirements that will enable the supervisor to confirm that financial entities permanently perform adequate risk management, which in general terms implies identifying, measuring and monitoring the risks assumed. Financial entities must implement effective policies and procedures for the



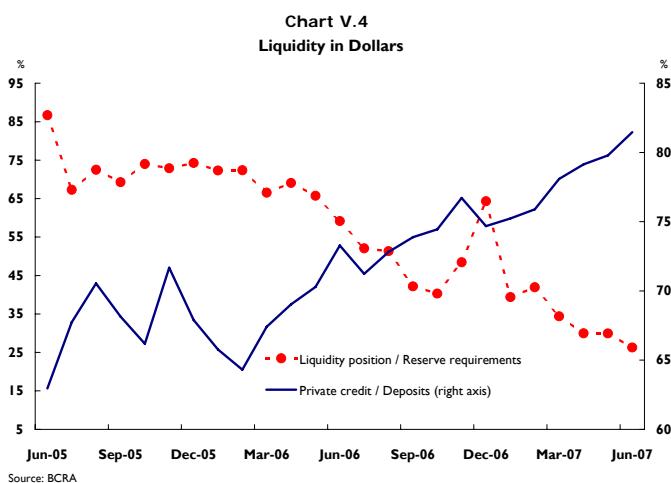
management of their risks, with the active participation of the board and the highest levels of management, as well as the establishing of controls that ensure compliance with such policies and procedures. Risk administration has been transformed into a cultural fact that must permeate the various levels of an organization.

To be able to identify vulnerable aspects it is important that banks should include stress-test exercises among the methodologies used, to then define contingency plans to face the potential effects of adverse situations. In addition, the models designed should be subjected to regular validation and testing to ensure they are constantly adapted to the purpose for which they were created. The approaches adopted should be included in every financial institution's policies and procedures, and the results must be continuously taken into account in the risk-taking strategy implicit in the development of their business.

Recognizing the growing importance of the regular performance of stress tests by financial entities, as part of the regular exercises it carries out the Central Bank performed a survey of the stress-test models used by banks. The information requirement was intended to determine the policies and treatment by financial entities of the matter, overall features of each of the tests performed, risks covered, types of scenario envisaged, regularity of execution, and use of the results obtained.

In addition, concrete tasks have currently been begun for evaluation of the methodologies implemented by banks, to complement the survey performed in 2006, obtaining greater information on the intentions pursued and the methodologies developed by the financial entities currently making use of such models. These evaluation tasks have a short-term objective of establishing at supervisor level and as a directive to the financial system, good practice principles that the financial entities should adopt that will be monitored by the Central Bank via the SEFyC.

As part of the Central Bank's regulation and supervision tasks, the basic objective will be to monitor the effective incorporation of these methodologies in the risk management processes of all banks carrying out activities within the Argentine financial system. The adequate incorporation of this international standard will ensure financial entities are better prepared to face negative shocks, thus promoting conditions consistent with a scenario of local financial stability.



positions (July-August and October-November, together with other changes to minimum cash reserve requirements and in the participation on the dollar futures market (see page 23).

Time deposit interest rates continued to record gradual increases in the first half of the year, a development in line with the incentives established by means of the Central Bank interest rate on its repo transactions. These increases in the Central Bank reference rate have had an impact on both the extension of the financial system funding terms and the gaining of new deposits.

Within the framework of similar growth by all types of private sector deposits in the first half of 2007 (see page 45), the ratio of private sector time deposits to sight deposits remained at 88% on average, a similar figure to that of the immediately preceding six months, and higher than in the same period of 2006. In the specific instance of the new private sector deposits, average duration of these placements remained without significant change in the first half of the year (at approximately 50 days). With the aim of increasing the duration of the credit offer in the context of a steady term risk, this consolidation of the average maturity of private sector deposits in the financial system should be accompanied by an increase in the funds obtained by means of medium and long-term debt placement on capital markets (see page 46).

Current liquidity levels and the new measures launched by the Central Bank have kept the banking system in a sound position in the face of the turbulent international financial context

For the rest of 2007 it is estimated that notwithstanding specific liquidity situations, the financial system will continue to see an increase in its financial intermediation volumes, receiving deposits and generating new lending for the private sector. As a result, it is forecasted that financial entities will be able to gradually reduce their levels of liquid assets, although they will remain comfortable. The financial system will thus be able to face the context of increased volatility with greater ease.

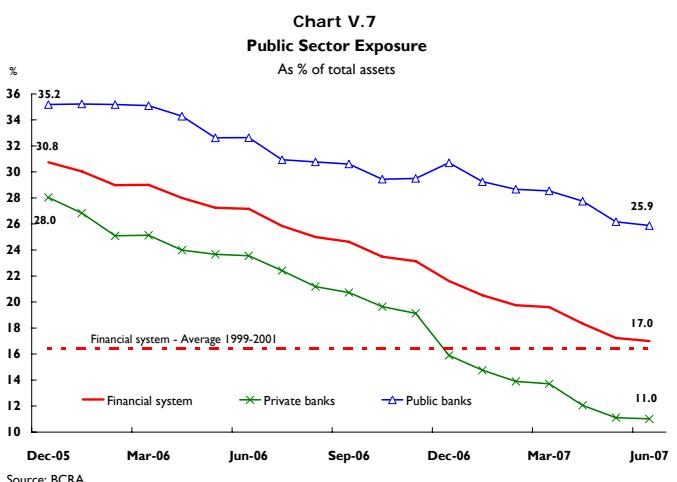
In this area, the recovery of the Central Bank's role as a lender of last resort provides banks with an appropriate level of cover in the face of sudden outflows of deposits. In addition, the remaining measures implemented by the Central Bank recently will continue to be effective when it comes to promoting short-term liquidity tools for banks, helping to normalize inter-bank liquidity markets.

V.2. Credit risk

V.2.1. Public sector²⁸

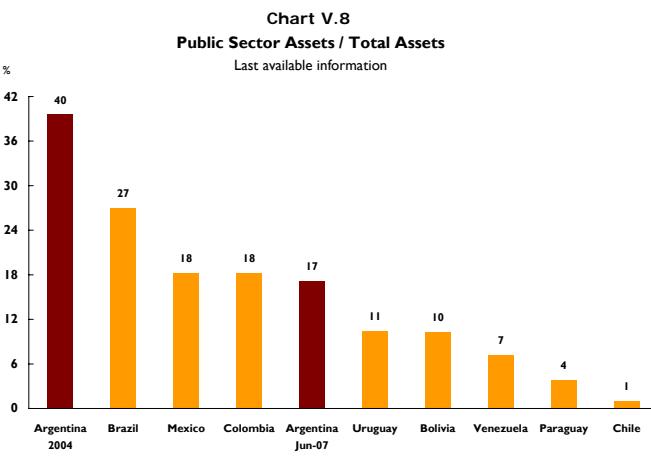
Declining levels of exposure to the public sector, combined with positive fiscal results and lower indebtedness, ensure that banks are well situated in the face of credit risk from this sector

²⁸ The concept of credit to the public sector used (see definition in the Glossary) excludes the holding of securities issued by the Central Bank.



Driven by the Central Bank's financial policy, over the first part of 2007 the financial sector continued to improve its position in the face of the public sector credit risk. Bank exposure to the public sector totaled 17% of total assets in the middle of the year (18.5% of netted assets), showing a drop of almost 4.6 p.p. in 2007 to date, for a total decline of over 17 p.p. in the last two years (see Chart V.7). Private banks continued to lead this process, recording an exposure of 11% by mid- 2007 (11.9% of netted assets), with reductions of 4.9 p.p. in 2007 and 22.4 p.p. since mid-2005.

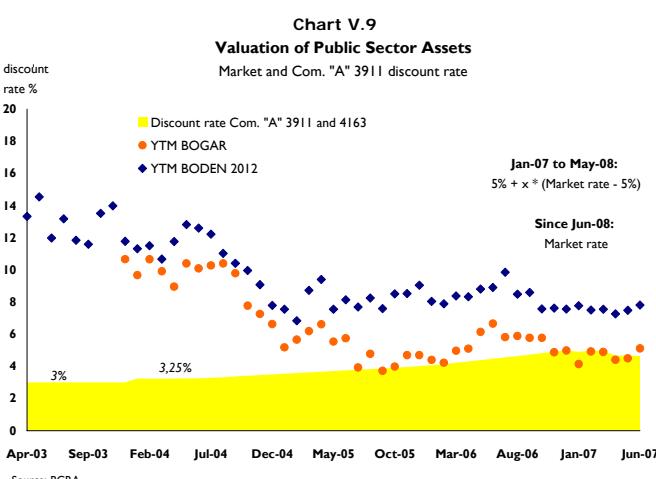
This steady decline in bank exposure to the public sector continued to be driven both by the channeling of resources to satisfy the credit needs of companies and households, and by the regulatory incentives introduced by the Central Bank. As a result, the exposure of banks to government securities and loans already stands at levels similar to the average for 2000-2001 and below those of the larger economies in the region (see Chart V.8).



The regulations implemented by the Central Bank, the sale of securities by banks, the aligning of their book value to market prices (see Chart V.9) and the natural amortization of these assets have constituted the main mechanisms that have reduced the exposure of the financial system to the public sector. The receipt of pending compensations from the government, part of which were paid in cash, also contributed to this trend, as did the scheduled amortization of government debt.

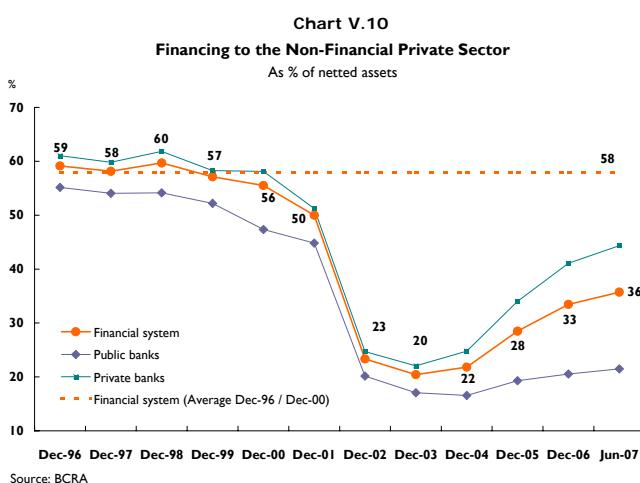
In this context, the Government's good repayment capacity, reflected in both the levels of the surplus and the debt servicing profile, reduces the exposure of banks to credit risk from this sector. The national public sector recorded a primary surplus during the first half of 2007 (see page 24) and continued to lower its level of indebtedness.

For the rest of 2007 a gradual reduction in exposure to the public sector is expected, in a context of relatively low levels of credit risk of this sector



Looking towards the end of the year, a scenario of gradual reduction in exposure of the financial system to the public sector is anticipated, for various reasons. On the one hand, the continued improvement in the risk-return ratio for the portfolio of loans to companies and households encourages banks to transfer resources to those sectors, compensating for the relatively lower yields on public sector debt. On the other, as from July a new Central Bank limit on exposure to the public sector will come into effect (35% of assets). Nevertheless, the turbulence seen in emerging country bond markets in the first part of the second half of 2007 constitute a barrier to the sale of these securities by banks, offsetting the above-mentioned effects.

The reduction in public sector exposure expected for coming months, added to the continuity expected for good performance by fiscal accounts, lead to forecasts of a relative strengthening of the financial system in the face of its public sector credit risk exposure.



V.2.2. Private sector

Exposure to households and companies continues to increase, in a context of reduced credit risk

In the first part of 2007 the financial system continued to increase its balance sheet exposure to the private sector credit risk. Banks continued to increase their lending to the private sector in 2007 to date, in the context of growth in productive activities and in household incomes and employment. This development, added to its still moderate levels of indebtedness (see Section II.2) are consolidating the financial position of the private sector, leading to a drop in banks balance sheet exposure to this sector's credit risk.

By the middle of the year lending by financial entities to corporations and families totaled close to 33% of total bank assets (almost 36% of netted assets) (see Chart V.10). Although this is still below pre-crisis levels, it represents increases of over 2 p.p. and 11 p.p. of total assets in the first half of 2007 and in the last two years, respectively. This trend continues to be led by private banks, with exposure in excess of 41% of their assets.

The significant increase in private sector lending with a low implicit risk contributed to continue reducing private sector non-performance levels, already at low historical and regional levels. Non-performance stood at 3.9% of private sector lending (see Chart V.11), 0.6 p.p. lower than at the end of 2006 and almost 36 p.p. less than the maximum post-crisis level. Specifically as regards the first half of the year, the performance of loans to companies improved, while delinquency in lending to households posted a slight deterioration (see Chart V.12).

Starting from higher levels, public banks led the decline in delinquency in the first part of 2007, to a level of 5.5% of private sector lending, almost 1.4 p.p. less than at the end of the previous year. Private financial entities recorded a drop of 0.4 p.p. in their delinquency to a level of 3.2%, a movement driven by private banks with national and regional coverage.

Loans outstanding at the end of last year recorded improvements in their performance during the course of 2007. While 88.6% of the loan lines maintained their situation²⁹, approximately 2.4% improved their classification, while only 1% posted a deterioration³⁰. Furthermore, loans that at the end of 2006 were classified as being in situation 1, representing close to 93% of the total (see Table V.1), showing a slight 0.9 p.p. quality deterioration, although only 0.2 p.p. fell into the non-performing category.

The remaining loan segments improved their performance. Almost 43% of loans in situation 2 at the end of 2006 improved their classification, whereas only 3.6% became non-performing. Approximately 41% of the lines in situation 3 improved to normal, with only a limited deterioration (4.1% of the total). The remaining categories also showed widespread performance

²⁹ For details of the characteristics defining each situation, see the Ordered Text for “Debtor Classification.”

³⁰ The rest corresponds to settlements during the period.

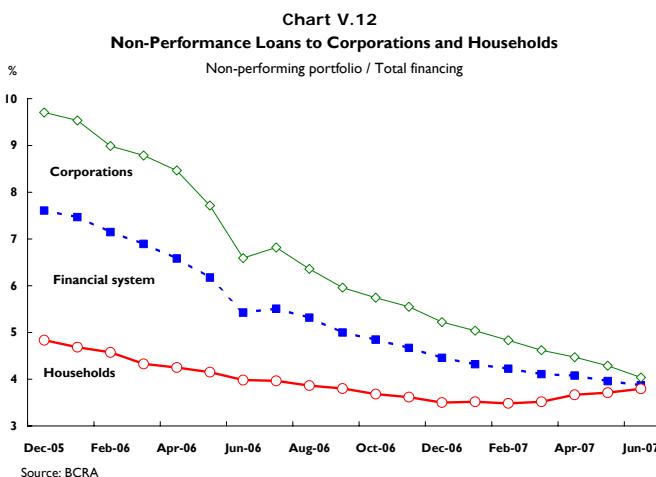
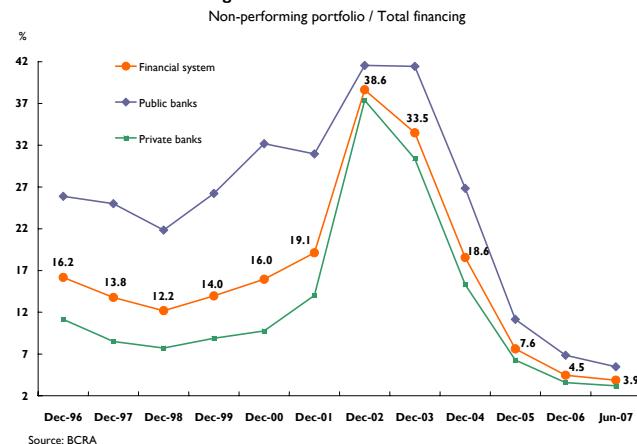


Table V.1
Transition Matrix December 2006 / June 2007
As % of private financing

		June 2007							
		Performing		Non-Performing				Write off (%)	TOTAL
		1	2	3	4	5	6		
December 2006	1	92.0	0.6	0.1	0.1	0.0	0.0	7.1	92.6
	2	42.6	45.1	2.7	0.4	0.4	0.0	8.7	2.2
	3	32.1	9.0	42.9	3.7	0.3	0.0	11.9	1.4
	4	8.1	8.3	11.3	50.9	2.4	0.0	19.1	2.0
	5	1.2	0.6	0.9	16.0	44.5	0.0	36.8	1.7
	6	7.4	0.2	0.1	7.9	2.4	61.1	20.9	0.1
	TOTAL	86.8	1.9	1.0	1.4	0.9	0.1	8.0	100.0

Figures based on debtor information at the start of the exercise

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

Source: BCRA

upgrades. As a result, only 0.3% of performing lines at December 2006 are currently in arrears, while close to 18% of the non-performing lines now record regular payments³¹.

Much of the non-performing total is accounted for by loans granted prior to the crisis

It is estimated that private sector loans granted until 2004, with a low weighting in the total (15%), record a delinquency of over 11% (see Chart V.13). Loans originating in 2005 and 2006 (almost half total current loans) show a non-performing rate of 3%, while loans granted in 2007 (slightly over one third of the total) record a reduced delinquency rate of only 2.3%. As a result, more than 40% of the total non-performance observed in mid-2007 is explained by lines that existed in 2004 (with a reduced weighting in the total), the rest coming from the loans granted in recent periods.

The continued provisioning process carried out by the financial system has resulted in a net worth exposure to private sector credit risk remaining at notably low levels (see Chart V.14), for both public and private financial entities. As a result, significant coverage by banks by means of provisions, combined with their steadily improving solvency, have led to the financial system being fully covered against possible episodes in which the expected uncollectibility rate of the portfolio in arrears might materialize.

It is estimated that private sector credit risk will continue at relatively low levels in coming months

Despite growing volatility at international level, it is estimated that the fundamentals of the Argentine economy are in a relatively good state. This situation, combined with the still low levels of company and household indebtedness, is expected to have positive repercussions on their financial position, moderating the credit risk faced by the financial system.

During coming months, the main weakness in the face of private sector credit risk would be linked to the volatility of international financial markets. Such events could end up having an influence on income for certain sectors, and on interest rates on domestic loans, with a consequent impact on the financial position of the private sector, partially affecting the perception of the credit risk faced by banks.

Corporations

Banks have reinforced their position in the face of the credit risk represented by corporations, a trend supported by the sound economic and financial position of this sector

Financial entities have continued to increase their channeling of resources to companies, in the context of the limited credit risk represented by this sector. The relatively good prospects for demand, both domestic and external, in the corporate sector, combined with their low and falling levels of indebtedness

³¹ Almost 23% were either settled or transferred to memorandum accounts during the period.

Chart V.15
Financial Intermediation Spread - Corporations
 Spread between lending rate and less than 59 days time deposits rate

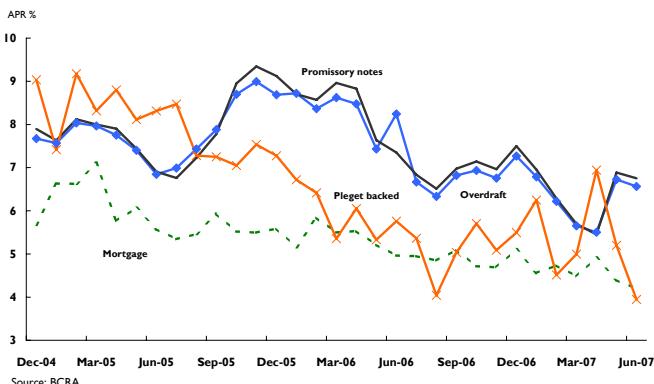


Chart V.16
Non-Performing Loans by Economic Sectors
 Non-performing loans / Total loans

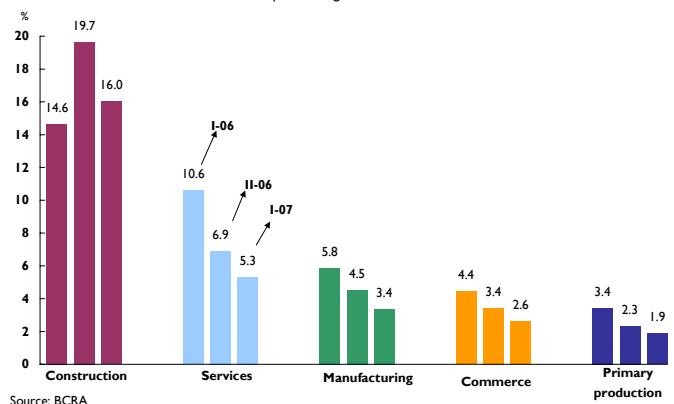
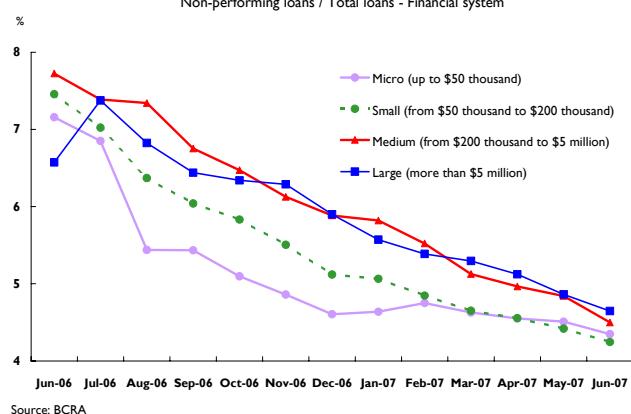


Chart V.17
Non-Performing Portfolio by Amount Range
 Non-performing loans / Total loans - Financial system



(confronting a lower exchange rate risk because of the drop in liabilities in foreign currency) create a scenario in which corporate financial position has been reinforced (see page 26), which gives rise to a strengthening of the banking sector's position in the face of the credit risk represented by companies. Exposure of the financial system to companies maintained its growth in 2007 to date, reaching 20.9% of netted assets, approximately 1 p.p. more than at the end of 2006. This trend took place together with a gradual reduction in interest rate spreads (see Chart V.15), a movement that has also in part been driven by growing competition among banks for the best borrowing candidates.

The improvement in company payment capacity has been reflected in the steady fall in non-performance levels. In the first part of 2007 non-performance in lending to companies fell 1.2 p.p. to 4.1% of the total, a trend driven by manufacturing industry (where non-performance fell 1.2 p.p. to 3.4%) and services (down 1.7 p.p. to 5.2%) (see Chart V.16).

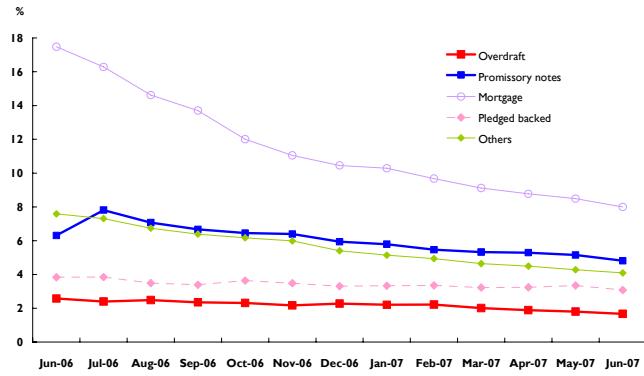
Within this framework, lines of all sizes to companies according to their residual stock continue to improve their performance, converging on the lowest non-performance values in the case of micro and small segments. Non-performance in the mid-size and large segments fell 1.4 p.p. and 1.3 p.p. to 4% and 4.1%, respectively (see Chart V.17). The performance of smaller lines has also been positive, reaching non-performance levels of 3.8% in the case of micro-size loans and 3.7% in the case of small loans. Large debtors account for a major proportion of total non-performance. If the ten largest non-performing debtors are excluded, delinquency in the segment would total only 1.7% of such loans, less than half the current figure.

In line with the results for recent halves, mortgage lines to companies show the largest drops in terms of non-performance (down 2.5 p.p. to a level of 8%), while current account overdrafts continue to record the best performance (a delinquency rate of 1.7%) (see Chart V.18). Promissory notes and pledge-backed loans also evidenced improvement, with low non-performance levels (4.8% and 3.1%, respectively).

It has been calculated that over half of all non-performance relates to lines in existence in 2004

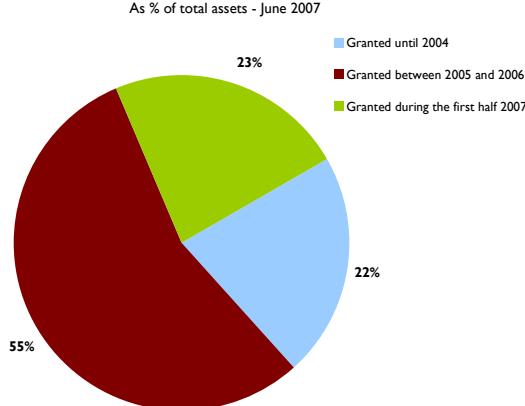
The current level of non-performance mainly concerns larger companies which borrowed in the pre-crisis period. Whereas the portfolio of loans in existence at the end of 2004 records an irregularity of approximately 16% (with a weighting of 14% of total loans), delinquency for loans granted as from 2005 stands at a low level, in the order of 2.1%. As a result, although these latter loans account for a share of over 85% of the total portfolio, their low non-performance rate means that they only account for less than half the total non-performing balance (see Chart V.19). In particular, mortgage, pledge-backed and promissory note lines in existence in 2004 show higher non-performance levels (see Chart V.20) (with a high relative share in the case of the first-named), while the lines granted in the last two-and-a-half years register a significantly better performance.

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



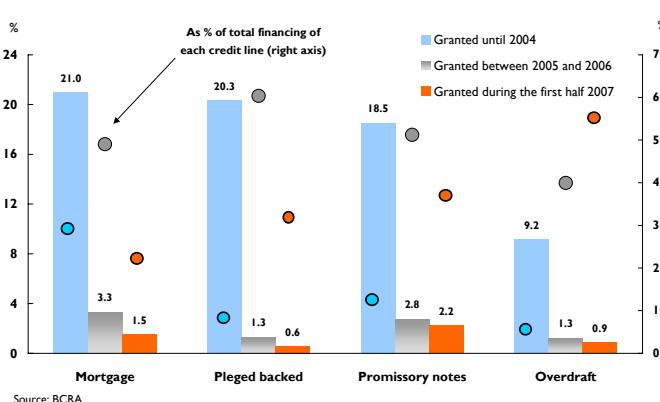
Source: BCRA

Chart V.19
Corporate Financing - Non-Performing Loans Compositions
As % of total assets - June 2007



Source: BCRA

Chart V.20
Corporate Financing by Granted Period
Non-performing loans as % of total financing - Financial system - June 2007



Source: BCRA

In coming months banks will continue solid in the face of their exposure to the credit risk represented by companies, in a scenario of economic growth and moderate indebtedness in the sector

Further increases in activity levels in the various productive sectors are anticipated for the rest of the year, in line with the gradual maturing of investments to increase installed capacity and levels of productivity. On the basis of the trend seen in recent years, it is estimated that companies will increase the obtaining of resources via the financial system (see Chart V.21), maintaining moderate levels of total indebtedness. This scenario could be partly affected by the volatility seen in international financial markets, with higher interest rates being charged on loans that would be reflected in a slight increase in corporate credit risk.

Households

Banks have increased their exposure to households, in the context of a relatively low credit risk

Bank exposure to households continued to expand in the first part of 2007, a movement driven by both the encouraging outlook for family income and bank lending strategies. As a result, in mid-2007, loans to households reached 40% of the private sector loan portfolio held by banks, almost 14% of their netted assets, 1.5 p.p. and 3.8 p.p. above the values at the end of 2006 and 2005 respectively.

Growth in lending to households continues to take place in a context of a relatively low repayment risk. This assertion is supported by the steady increase in worker wage mass (lower levels of unemployment and higher real wages), and the low (if growing) level of indebtedness. In this context, household delinquency stands at a low level (3.8%, with a slight increase for the half-year). In the context of a competitive environment in this segment of the credit market, interest rate spreads on new loans have shown signs of stability during 2007 (see Chart V.22).

Although still at a low level, in the first part of 2007 there was a slight increase in household portfolio non-performance, driven by consumer lines

In the first part of 2007 non-performance levels for household loans behaved unevenly (see Chart V.23). Mortgage lines continued to record declines in their delinquency, following the trend recorded in recent years. Both personal loans and credit card lending recorded deterioration in their performance, although still showing low non-performance levels. These movements were responsible for the slight rise in household non-performance in 2007 to date.

At present, exposure to households credit risk is becoming increasingly linked to the steady rise in consumer lending, mainly in the form of personal loans and credit card lending. These lines currently represent almost two-thirds of total lending to the sector, achieving shares in terms of output and the wage

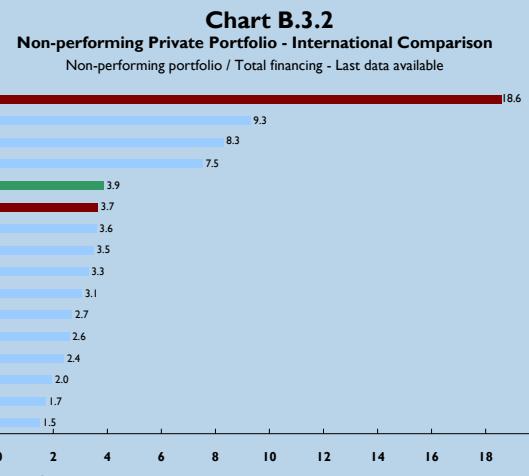
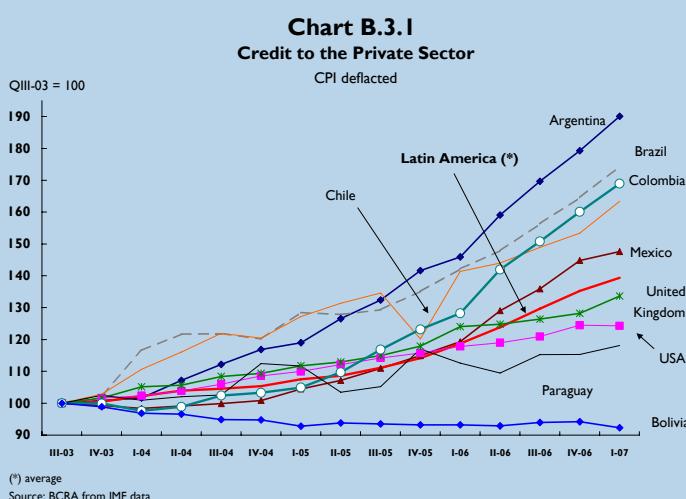
BOX 3: DEVELOPMENT OF LENDING TO HOUSEHOLDS IN LATIN AMERICA

The steady increase seen in recent years in lending to the private sector, led by consumer loans, generates the need for increased monitoring of the payment capacity of households. Although a favorable macroeconomic context continues to be recorded in most of the economies in the region, consensus exists as to the need to be able to count on closer monitoring of consumer lending, with the aim of promoting a framework of financial stability

In the last five years there has been a significant development and strengthening of Latin American financial systems, a process driven by a combination of favorable international and domestic conditions. The positive global scenario, based on ample levels of liquidity, increased flows of capital towards emerging economies and high commodity prices, favored the growth of Latin American economies. Most of these economies embarked on a course for improved organization of their fiscal and monetary accounts and public sector borrowing, generating a framework of stability suitable for the development of productive activities, a situation that resulted in improved income levels for the population and a reduction in unemployment.

This favorable regional scenario enabled a deepening of formal financial intermediation activity. Latin American financial systems expanded their deposit-taking from the private sector, mainly using such resources to fund the lending needs of companies and households (see Chart B.3.1), at the same time as they reduced their lending to the public sector³². This recovery by banking activity, combined with the improvement recorded in the payment capacity of private sector debtors was reflected in low relative delinquency levels (see Chart B.3.2) and the strengthening of bank profitability and solvency levels.

In such a context, most of the financial systems in the region have been recording a significant increase in lending to households, although levels are still low when compared with those recorded in developed countries (see Chart B.3.3). On the one hand, this expansion reflects the effects of a macroeconomic environment that is leading to lower interest rates and longer lending terms, enabling households to satisfy their housing needs and renew their stock of durable consumer goods, many of which have been lagging because of the effects of a succession of economic crises.



On the other, banks have tended to focus on credit origination strategies that could be considered relatively more risky, possibly more profitable, and with a more standardized implementation. Credit lines closely linked to household consumption, such as personal loans and credit card lending, received a special impulse. In the case of the former, there was an auspicious increase in the granting of loans for which repayment takes place by means of withholdings from wages, in some cases at lower interest rates because of the relatively lower repayment risk. Although levels are still low in international terms (see Chart B.3.4), the placing of credit cards has grown considerably in the region (particularly in Mexico and Argentina) on the basis of strategies designed to gain an increase in customers, whether or not users of banking services, for whom there are generally fewer credit references.

Part of this increase recorded by consumer finance is the result of an improvement in current and expected household income levels in the region (higher wages and lower unemployment), with indebtedness levels that are still moderate, a

³² For further detail on the development of Latin American financial systems, see Chapter II of the FSB.

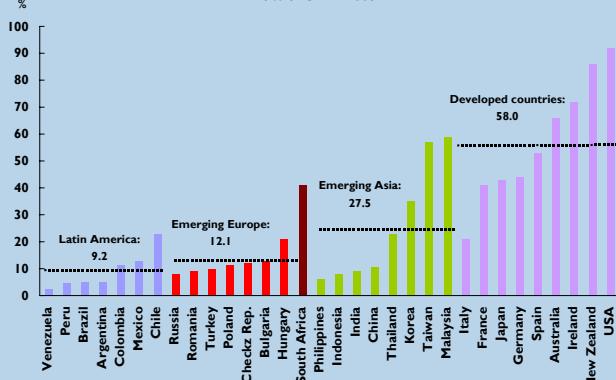
situation that provides households with a sound financial position. Nevertheless, continued growth by these lines could carry with it certain risks. In adverse macroeconomic circumstances, the financial weakness of households (generally linked to the economic cycle) could generate increases in delinquency and the cost of setting up provisions, with repercussions on the profitability of the sector.

Incipiently, a few signs of such risks have begun to be seen in Latin American financial systems. In Chile³³ for example it has been noted that financial entities tend to adopt somewhat aggressive commercial policies, reaching into household segments for which payment behavior is less well-known. This is reflected in a greater growth rate for debt than for disposable income, and in part in the uncertainty by banks in relation to the increased household credit risk (particularly in the case of consumer credit lines), a trend that is evident in the increased costs of provisions. A similar situation can be seen in Colombia³⁴, where there has been significant growth in the consumer portfolio accompanied by deterioration in its credit quality, a fact that increases the loan loss expectations of financial entities, and thus the level of their provisions. In Mexico³⁵, in recent years there has been a significant increase in household lending, with a rate of growth in the burden of servicing of household liabilities that has exceeded that of their income. This began to be evident in increased levels of non-performance, particularly in the case of consumer credit, a movement that was partly driven by credit cards, which in some cases were placed in sectors considered to be of higher risk, on which there was little prior credit history available.

In Argentina household lending delinquency increased slightly in the first part of 2007 from 3.5% to 3.8%, which implies that it has remained at a historically low level. This movement was driven by consumer loan lines, which recorded an increase of 0.7 p.p. in their delinquency (to 3.6%). It is estimated that the rate has been higher for new personal loans and credit card lending, both when compared with older consumer loans and with other credit lines regardless of the period of their origination (see Chart V.24). In this context, growth in household indebtedness continues to exceed income growth, although it still stands below pre-crisis levels. Although this trend merits close attention, households still maintain good repayment capacity, backed by the fall in unemployment, improvement in wages and the sound prospects for future income.

Chart B.3.3

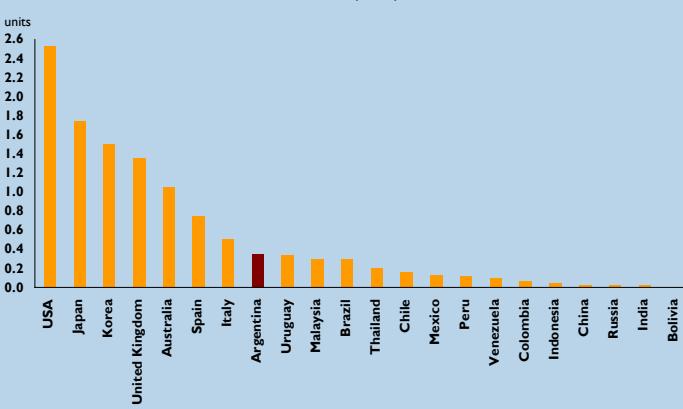
Credit to Households
As % of GDP - 2005



Source: Global Financial Stability Report (IMF), September 2006

Chart B.3.4

Credit Cards
Credit cards per capita



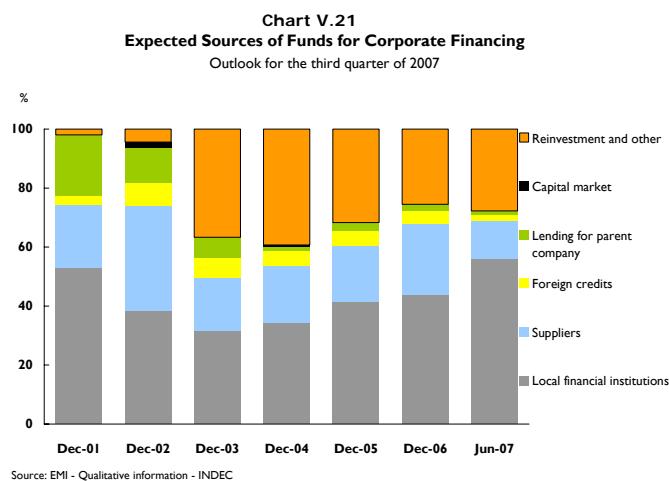
Source: BCRA, CEMLA (2005) and Schmitt (2007)

As a result of the steady increase in lending to households in most countries in Latin America, and in a context of a deterioration in their quality, there is a need to make progress towards a closer monitoring of debtors, and in particular of those for whom there are limited credit records. Doing so would improve the tools used to perform a more rigorous evaluation of credit risk, taking advantage of the current good level of financial stability in the region.

³³ Financial Stability Bulletin – First half of 2007

³⁴ Financial Stability Report, March 2007

³⁵ Financial System Report 2006



mass that exceed pre-crisis levels (see page 30). This trend is mainly being driven by bank lending strategy, with actions targeting both existing customers with a widening product range and an increase in the debtor base.

It is expected that new personal loans and credit card lending will evolve at a lower rate, both when compared with previous lending levels and compared with other credit lines (see Chart V.24). For their part, new pledge-backed loans and mortgages record significantly lower delinquency levels.

The increase in exposure to household credit risk associated with the growth in consumer lending is not a phenomenon specific to Argentina, as it follows the trend registered in other countries in the region that have also benefited from the positive macroeconomic context of recent years, following the effects of the crisis that registered the region (see Box 3). This drives the need for increased credit risk monitoring, particularly in anticipation of less favorable scenarios that reflect the impact of the current uncertainty on international markets.

Financial trusts are one of the mechanisms that financial entities can count on to reduce their exposure to credit risk. Over the course of 2007 securitization was carried out using consumer credit (personal loans and credit card lending) for approximately \$790 million, a figure that totaled \$1.35 billion in 2006. As a result, banks could continue to transfer part of this risk to other players in the economy, enabling them to maintain their generation of credit for the private sector in a context of limited risk.

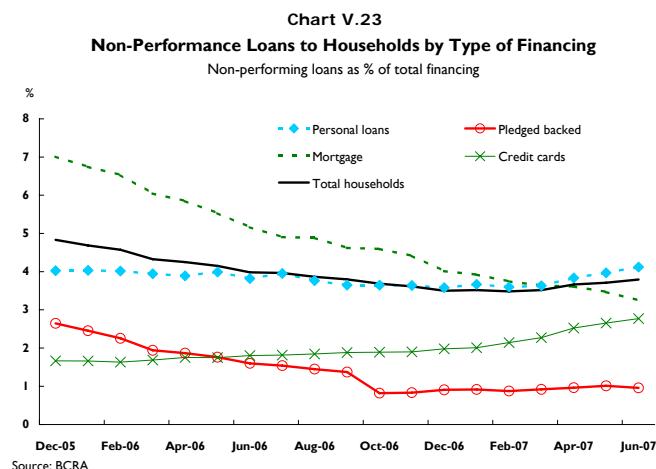
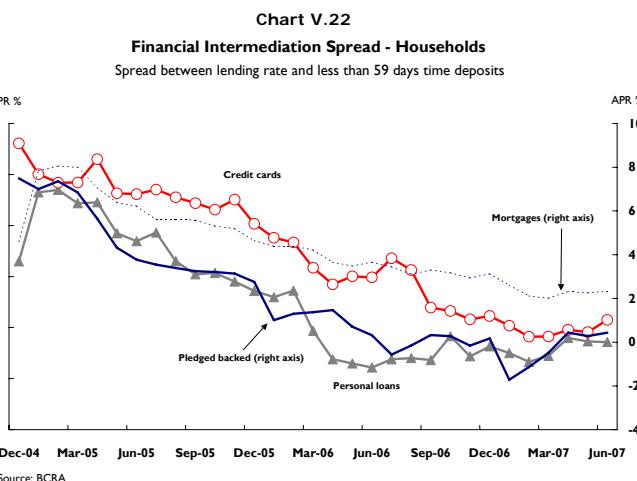
For the rest of 2007 it is expected that exposure to households will increase, in a context of relative stability in the financial situation of that sector

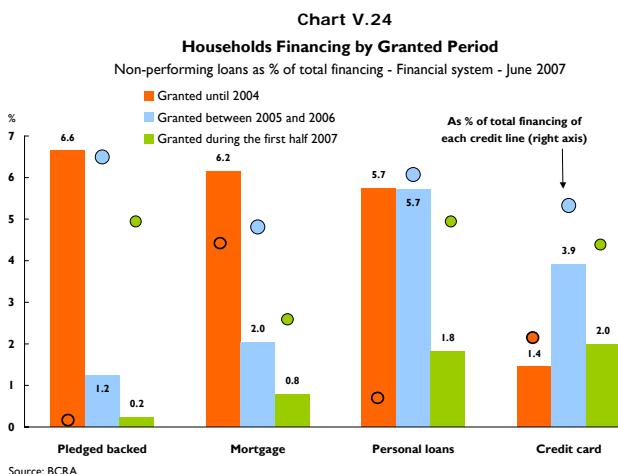
Although it is estimated that households will continue to increase their bank borrowing, it is expected that the rate of increase will be lower in coming months. Furthermore, it is expected that obligations entered into with leading retail stores (household appliance stores in particular) that provide additional financing will also continue to rise. This scenario of increased indebtedness will probably take place in the context of rising family income and lower levels of unemployment, preserving the sector's payment capacity. Nevertheless, the more volatile international context could impact to some extent on lending interest rates, possibly reflected in a slight increase in the risk of lending to households.

V.3. Currency risk

Slight increase in exposure to foreign currency risk in the six-month period

Unlike in previous periods, over the course of the first part of 2007 banks slightly increased their foreign currency mismatching. Nevertheless, this risk from foreign currency remains very limited, as a consequence of the regulations established by the Central Bank. Borrowers are only allowed to receive foreign currency loans if their income is positively





correlated with the exchange rate, lines that must be funded by deposits in the same currency, and financial entities must comply with capital requirements calculated on their foreign currency asset positions. As a result, the Central Bank has helped to strengthen the financial system against such volatility, particularly in view of the increased uncertainty at the start of the second half of 2007.

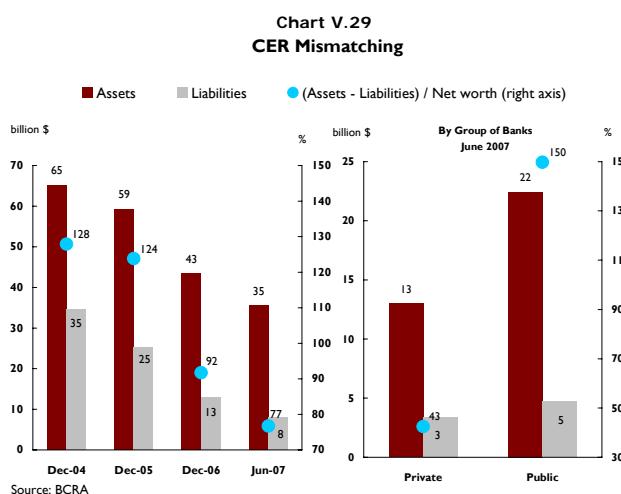
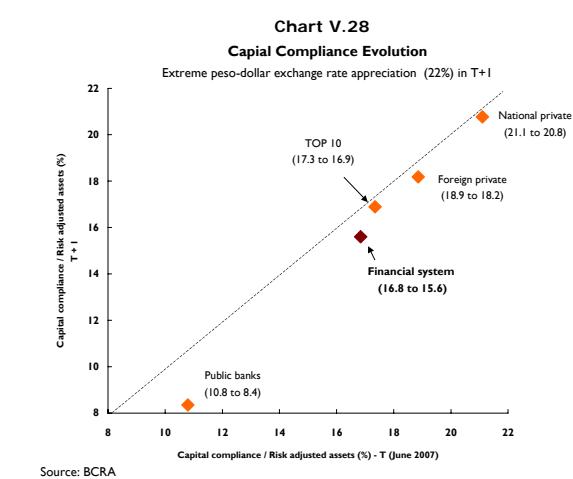
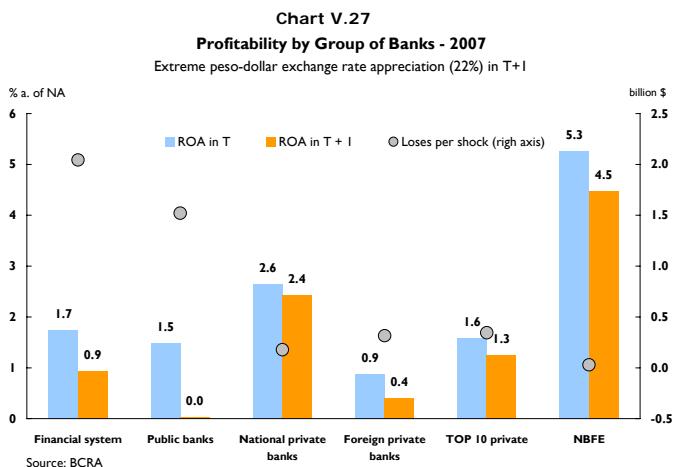
In the first half of the year the mismatching between bank foreign currency assets and liabilities increased slightly to approximately US\$3.2 billion. Rising spot and future foreign currency purchases, in a context of a steady increase in foreign trade financing explain part of this movement. As a result, foreign currency mismatching rose to represent 27.6% of bank net worth by mid-year (see Chart V.25), 2 p.p. above the level at the end of 2006, representing drops of 10 p.p. and 29 p.p. compared with the end of 2005 and 2004, respectively.

Official banks have shown a gradually downward trend in their foreign currency mismatching levels, although they remain high (at almost 58% of their net worth) (see Chart V.26). Private banks (domestic and foreign) posted increases in this mismatching as a result of their higher lending to exporting businesses, although exposure to this risk remains low in terms of net worth. It should be noted that during the six months foreign currency mismatch risk hedging instruments continued to develop (see page 39), although beginning to reflect the effects of the more volatile international context.

Stress tests to measure the immediate impact on the financial system balance sheet continued to show sound results in the event of the materialization of episodes of extreme volatility in the peso-dollar exchange rate. Given that the financial system maintains an active position in foreign currency items, it is useful to test its strength in a situation of extreme appreciation in the value of the currency. The current context of volatility on international financial markets would lead to the consideration that such a scenario has a very low probability of occurrence. Therefore, an extreme nominal appreciation is introduced³⁶ and an analysis is performed of first round effects on results for 2007 (annualizing the profits recorded in the first half of the year), without considering second round effects.

As might be expected, the low mismatching shown by private domestic and foreign banks would be manifest in small deteriorations in their profitability levels (see Chart V.27) and their solvency (see Chart V.28), so that after the shock their capital compliance levels would be in line with local requirements and internationally recommended levels. Official banks, with a greater exposure to this risk, would see their profits almost entirely disappear if a currency appreciation materialize, although their capital compliance would continue to exceed 8% of their assets at risk. As a result, the financial system as a whole would continue to record positive results in the order of approximately 0.9% of their assets, with a comfortable aggregate level of solvency of almost 15.6%.

³⁶ Equivalent to a fall of 22% in the current value of the US currency, the maximum monthly appreciation recorded in Argentina since the 70s, and consistent with the appreciation of the Brazilian real against the dollar in the second quarter of 2003.



For the rest of the year it is expected that the financial system will continue to record a reduced exposure to the risk from foreign currency, a development explained mainly by the moderate mismatching in most bank groups, in a scenario estimated to show greater volatility.

V.4. Interest rate risk

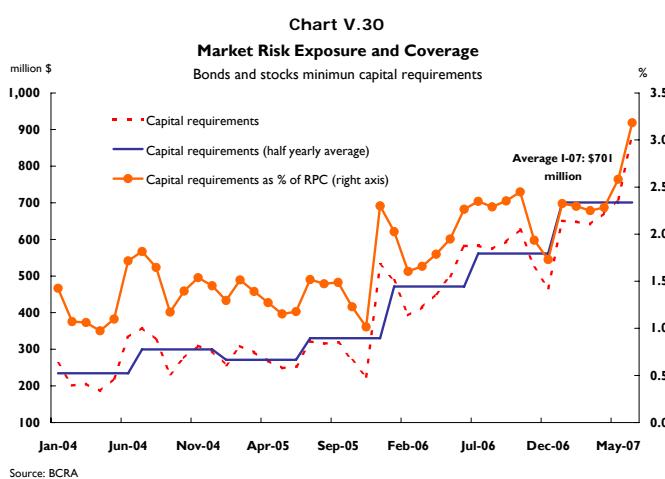
Bank exposure to interest rate risk continues to return to normal levels

Financial entities are succeeding in mitigating their exposure to interest rate risk, mainly as a result of the incentives established by the Central Bank and an economic context that encourages the normalization of their financial situation. There have thus been improvements both because of reductions in the term to maturity of total assets and because of the reduction in the proportion of assets at fixed interest in the total, both of which are linked to declining exposure to the public sector, as well as a gradual consolidation of longer-term funding from corporate bond issuance on capital markets (see page 46), helping to ease the maturity mismatching situation. Nevertheless, the recovery in the duration of certain lending lines to the private sector, driven in particular by the dynamic of mortgages, could partially offset this trend.

Exposure to the real interest rate risk, originating from the balance sheet mismatching of CER-adjusted items (at fixed interest rates), which exposes financial entities in the event of possible increases in the nominal interest rate in excess of the increase in inflation, continued to decline in the first half of 2007. While this exposure exceeded financial system net worth twelve months ago (see Chart V.29), it currently stands at more moderate levels (almost 77% of net worth or \$27.3 billion), a trend led by private banks. As a result of the crisis in 2001-2002, official banks continue to show mismatching in excess of their net worth, while private banks were quickly able to mitigate this risk, with a gap with adjustable items equivalent to less than half their net worth.

The schedule for amortization of government securities and the adjustable Central Bank instruments that still remain, as well as the sale of part of this portfolio, explain almost all the reduction in CER-adjusted assets during the first part of 2007. In exposure terms, this movement was partly compensated for by the early settlement of bank liabilities to the Central Bank under the so-called matching system, the decline in deposits with yields tied to CER, a movement particularly linked to changes in strategy by Pension Fund portfolios, and by the very dynamic of the CER itself. In turn, the steady consolidation of bank capital in the context of growing activity in the sector, is helping to preserve the downward trend in this risk faced by banks.

In this context, CER futures and interest rate swap markets, which allow banks to protect themselves against interest rate risk, developed favorably in the first part of 2007. This path is being promoted by the Central Bank, which at the beginning of 2007 introduced a notes swap trading session that enables the exchange of securities for different terms or rates.



Greater volatility on international financial markets during the second part of 2007 could encourage some materializing of interest rate risk

Towards the end of 2007 it is expected that bank exposure to interest rate risk will continue its gradual decline, a trend that will probably be influenced by the narrowing of the gap between assets and liabilities that are adjusted by CER. The very dynamic of scheduled bonds and public sector loans amortizations may be only partly offset by rediscount repayments under the matching system. Greater volatility on international markets as from July (see page 33) could lead to the materializing of interest rate risk, but only in a scenario of higher international interest rates that would drive up domestic interest rates.

V.5. Market risk³⁷

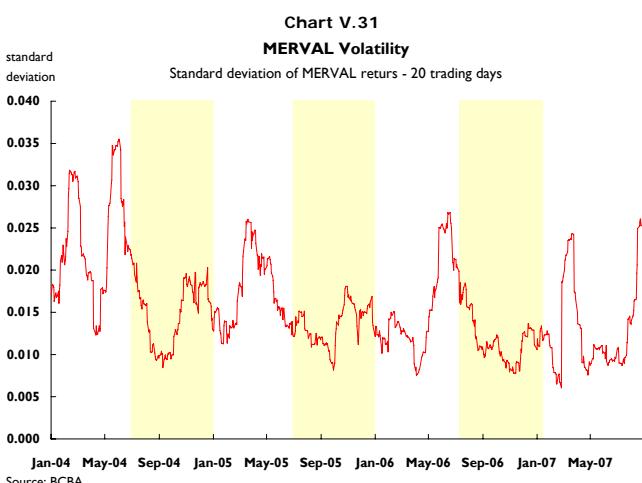
Bond and share market volatility is reflected in a gradual increase in bank exposure to market risk

In the first part of 2007 financial entities increased their exposure to market risk, a trend mainly explained by two factors. First, there has been an increase in the share of government securities in portfolio that have been marked to market, and second, there has been an increase in the holding of Central Bank securities with a market price.

In this context, although the exposure to market risk recorded an increase in recent periods, it remains low, with a value at risk of only 3.2% of regulatory capital (see Chart V.30). Exposure to market risk by banks continues to be mainly explained by government securities (94% of the total).

Some increase in exposure to market risk is expected in coming months

For the period of greater volatility begun in July, with an impact on both the bond market (see page 33) and equities (see Chart V.31), it is expected that there will be an increase in bank exposure to market risk. Nevertheless, this will be partly offset by the measures implemented by the Central Bank with the aim of ensuring adequate liquidity levels are maintained and avoiding excessive balance sheet fluctuations for banks with investments in government securities that are being held to maturity, and in those securities that held for sale.



³⁷ In this section, market risk exposure includes the balance sheet impact of price volatility associated with both bonds and shares.

VI. SOLVENCY

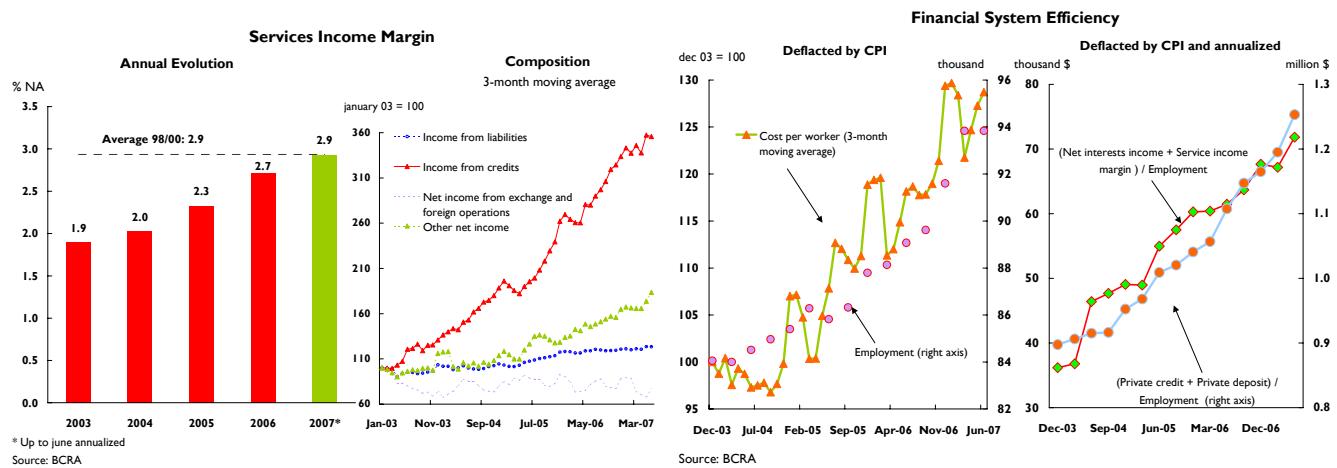
Summary

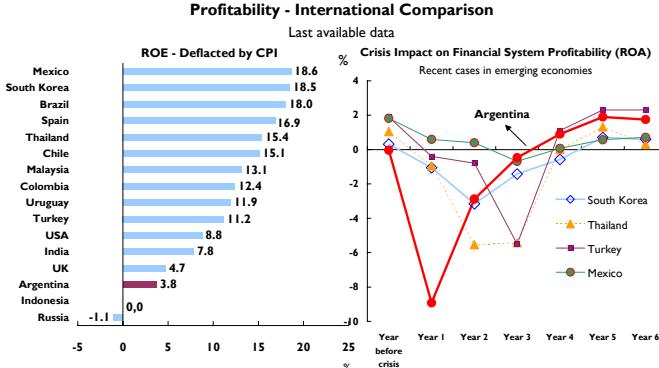
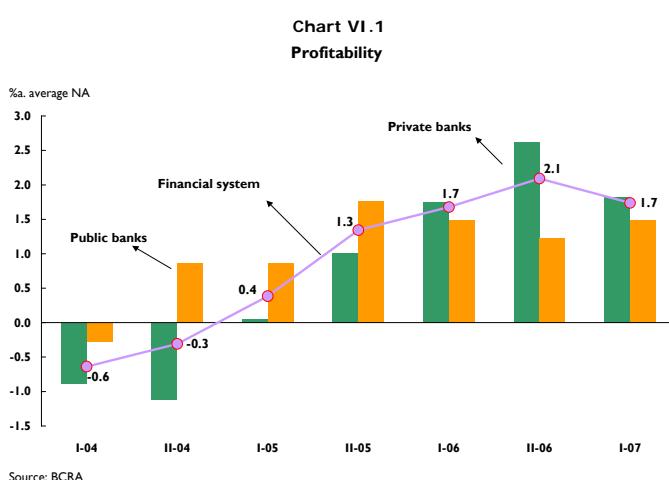
The expansion of the levels of financial intermediation with the private sector during the first half of 2007 had positive effects on the accounting profits of the financial system. In this scenario, the financial entities on aggregate maintained stable profitability levels compared with the same period last year, recording a ROA of 1.7%a. and a ROE of 12.8%a. in the first half of 2007. This momentum enabled the solidness of the financial system to become more robust, a process that was consolidated by the fresh capital contributions.

Profits earned by the banking system in the first half of the year were mainly associated with their recurring revenue sources, a sign of the sharp recovery of financial intermediation activity. In particular, during this period an increase in the interest and service results was recorded with the latter reaching their pre-crisis levels. Gains on securities also expanded during the half, although with higher volatility. On the other hand, the smaller CER growth partly explained the fall of results accrued on this index. In a framework of scarce materialization of the private sector credit risk exposure, the loan loss provisions remained at historically low levels. On the other hand, the expansion of operating costs, in a context of more employment and higher wages in the sector, did not impede continued efficiency improvements in the financial system.

Based on profits and the fresh capital contributions, the banks strengthened their solvency levels in the first half of 2007. In this framework, equity grew by \$2.6 billion (7.9% or 16.5%a.) with fresh capitalizations that totaled \$960 million in the period (carried out entirely by private foreign owned banks). As a result, the capital compliance was 16.8% of assets at risk, exceeding the minima required at both a domestic level and by international standards.

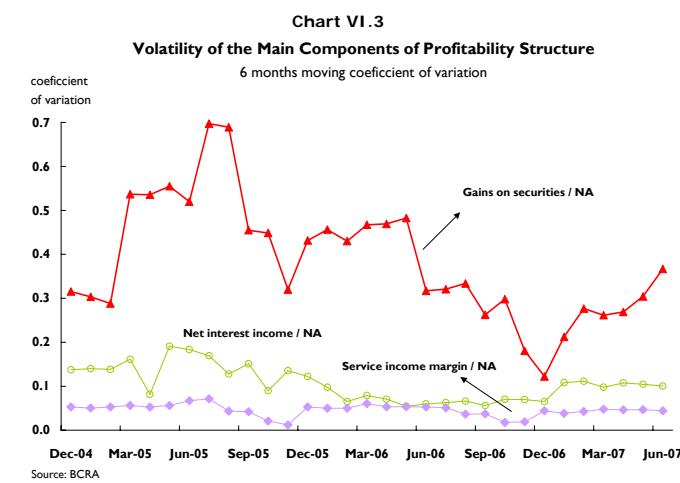
During the rest of 2007 the banking system is expected to continue accruing positive results, a change mainly associated with the recurring revenue sources. However, the volatilities on the international financial markets are expected to have some impact on second half results. The operating costs could continue increasing gradually, but without hindering gains in efficiency still being recorded. These developments should continue to strengthen the financial system solvency.





Note: ROE data corresponds to the following date: 2007 Argentina (up to june annualized), Accumulates and annualized dates for the rest of the countries. Uruguay, Brazil, USA, Russia and Mexico (mar-07), Chile and Colombia (may-07), South Korea, Malaysia, UK, Turkey and Spain (dic-06), Indonesia (nov-06), Thailand (sep-06), India (mar-06).

Source: BCRA from IMF.



VI.1. Profitability

The recurring revenues of the banking system boosted profitability in the first half of 2007

The expansion of financial intermediation with the private sector continued boosting banking profits in the first six months of 2007. Specifically, during the first half of the year financial entities reached a ROA of 1.7%³⁸ and a ROE of 12.8%^{a.}, similar figures to those recorded in the same period of 2006 and slightly below those of the half before (see Chart VI.1). The ROE deflated by the CPI GBA, in particular, was 3.8%^{a.} at the end of the first half of 2007, a smaller value than that recorded in other economies in the region and in developed countries. However, in terms of ROA it exhibits a marked recovery compared with other financial systems that have suffered financial crises in recent years (see Chart VI.2).

The sustained profitability of the financial system came in a framework of limited volatility. These moderate levels of volatility of results were mostly explained by the more stable revenue sources of the banks (see Chart VI.3). In fact, interest results and net service revenues grew by 0.5 p.p. of assets (to 4.9%^{a.}) in the first six months of 2007 from the same period in 2006, at the expense of the more volatile headings, like profits from securities.

Qualitative improvement in banks financial margin composition

The financial margin of the financial system remained stable in the first six months of the year, registering a change in its composition (see Table VI.1). Compared with the second half of 2006 increases were seen in the net interest revenues, in particular, and to a lesser extent in the profits from exchange rate differences. On the other hand, the results due to holding and trading securities dropped back in the first months of 2007, while CER adjustments showed no changes. The revenues from services continued expanding while operating costs grew slightly in the half, in a scenario of more employment and higher wage levels in the sector. On the other hand, although miscellaneous results reduced their share of assets³⁹, the headings in connection with the amortization of the court payment orders and the accrual of adjustments to the valuation of government securities reduced their impact on bank results.

Associated with the sustained growth in the volume of financial intermediation, interest results gained share in the profit structure of banks: they grew by 0.2 p.p. of assets in the first half of 2007 to 2%^{a.} compared with the second half of 2006 (see Chart VI.4). The growth of loans to firms and households continued driving the interest results of the financial system. This trend, combined with a heterogeneous development in lending interest rates was reflected in larger revenues from loans

³⁸ Hereafter, unless otherwise indicated, in Chapter VI the idea of assets netted out for accounting duplications generated by the repo transactions, futures sales and cash deals pending settlement is employed.

³⁹ This was mainly in connection with an adjustment to its balance sheet made by a foreign owned bank, a registration that was partly offset by larger profits from permanent shares and the recovery of loans that were in non-performing conditions.

Table VI.1
Profitability Structure: Financial System
 In annualized terms - As % of average netted assets

	2003	2004	2005	2006	I-06	II-06	I-07
Financial margin	1.1	3.1	4.6	5.7	5.8	5.7	5.7
Net interest income	0.5	0.9	1.5	1.8	1.8	1.8	2.0
CER and CVS adjustments	1.3	1.0	1.5	1.3	1.6	1.1	1.1
Gains on securities	1.1	1.0	1.2	2.1	1.7	2.4	2.1
Foreign exchange price adjustments	-0.5	0.4	0.4	0.4	0.5	0.3	0.4
Other financial income	-0.3	-0.2	0.1	0.1	0.1	0.1	0.1
Service income margin	1.9	2.0	2.3	2.7	2.6	2.8	2.9
Operating costs	-4.2	-4.1	-4.6	-5.1	-5.0	-5.1	-5.2
Loans loss provisions (%)	-1.1	-0.8	-0.6	-0.5	-0.6	-0.5	-0.6
Adjustments to the valuation of gov. securities (%)	-0.4	-0.2	-0.2	-0.3	-0.4	-0.3	0.0
Tax charges	-0.3	-0.3	-0.4	-0.5	-0.4	-0.5	-0.5
Amortization payments for court-ordered releases	-0.6	-0.9	-0.9	-0.7	-0.8	-0.7	-0.9
Other	0.9	0.8	0.8	0.9	0.8	1.1	0.9
Monetary results	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income tax	-0.2	-0.1	-0.3	-0.3	-0.4	-0.3	-0.5
ROA	-2.9	-0.5	0.9	1.9	1.7	2.1	1.7
ROE	-22.7	-4.2	7.0	14.3	12.7	15.6	12.8
Adjusted ROA (**) (%)	-1.9	0.7	2.0	3.0	2.8	3.1	2.7

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

releases and the effects of Com "A" 3911 and complementary communications.

Source: BCRA

(see Chart VI.5). Interests accrued on deposits expanded at a slower pace in a context of a larger stock of private sector time deposits. Meanwhile, considering that some of the assets are adjusted by the CER, one finds that the yield accrued from interest plus CER was 3.1%a., slightly higher than that recorded in the second half of 2006.

On the other hand, profits from exchange rate differences grew 0.1 p.p. on assets to 0.4%a., a trend that was partly explained by a slight increase in the average peso-dollar exchange rate between the ends of the six month period.

The increase in uncertainty present on the international capital markets began to be reflected by the financial system profits, recording a smaller weighting of gains on securities. The falling prices of the major sovereign securities valued at market prices in bank portfolios (see page 33), in particular, led a 0.3 p.p. fall of the aggregate gains on securities, to end at 2.1%a. of assets in the first half of 2007.

The growth of loans to the private sector boosted banks service results

Net service revenues consolidated as the main source of funds for the financial system in the first half of 2007. In fact, the service results of the financial system rose to 2.9%a. in the first six months of the year, to reach the level recorded in the pre-crisis period (see Chart VI.6). This trend was driven by private banks in particular, a group that accrued net revenues from services of 3.6%a. of their assets. On the other hand, although a growing development in almost all lines that make up this heading of the profits and loss statement is observed, the revenues associated with loans have been the most dynamic since 2003, mostly driven by the growth of the stock of loans to the private sector.

This growth of loans for the private sector is still accompanied by a low credit risk of this sector, a scenario that is crystallized in lower levels of arrears and loan loss provisions that continue standing at historically low levels. In fact, loan loss provisions were 0.6%a. of assets in the first half of 2007, a slightly higher value than recorded in the second half of 2006⁴⁰. Meanwhile, loan loss provisions in terms of loans to the private sector were 1.7%a. in the first months of 2007.

The financial system is recording improvements in its efficiency

The operating costs were 5.2%a. of assets, or 0.1 p.p. higher than the previous half. This change, together with the increase in service results and the stability of the financial margin led the coverage ratio of the operating costs with net revenues to 164%, a similar figure to that recorded six months before.

The expansion of the financial system's management costs was mainly associated with the growth of employment and higher wages in the sector (see Chart VI.7), in a context of a persistent

⁴⁰ The slight growth of loan loss provisions in the first half of 2007 was partly explained by an adjustment carried out by one bank in February and by a specific increase at one financial institution that merged in March.

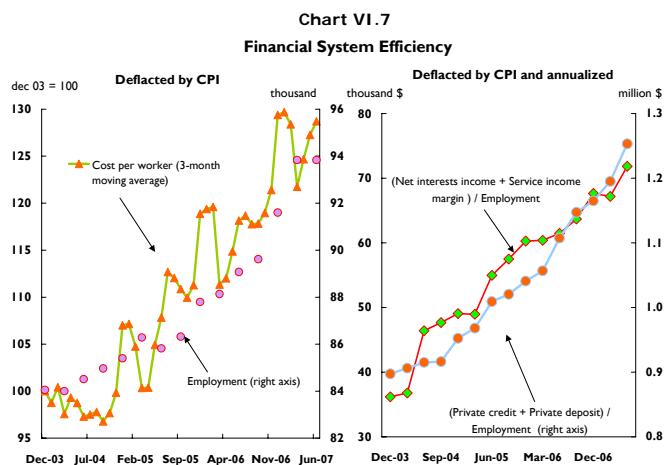
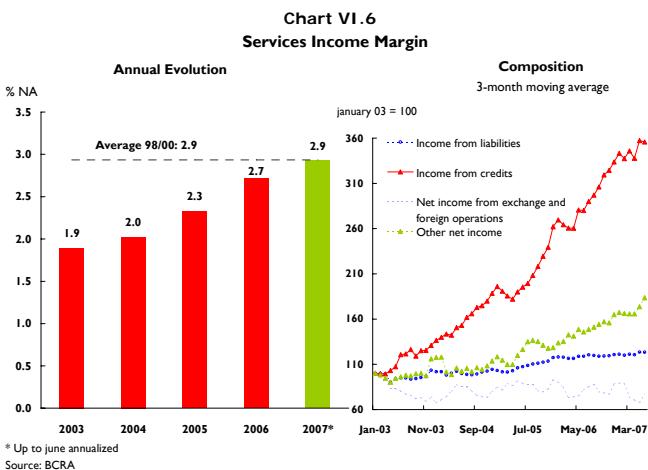


Table VI.2
Profitability Structure: Private Banks
In annualized terms - As % of average netted assets

	2003	2004	2005	2006	I-06	II-06	I-07
Financial margin	2.3	2.9	4.3	5.8	5.6	6.0	5.9
Net interest income	0.1	1.0	1.7	2.1	2.1	2.1	2.3
CER and CVS adjustments	0.9	0.8	1.0	0.6	0.8	0.5	0.5
Gains on securities	1.7	0.8	1.0	2.4	1.9	2.8	2.3
Foreign exchange price adjustments	-0.3	0.6	0.5	0.5	0.7	0.5	0.5
Other financial income	-0.2	-0.3	0.1	0.1	0.1	0.1	0.2
Service income margin	2.0	2.4	2.7	3.3	3.2	3.4	3.6
Operating costs	-4.6	-4.6	-5.1	-5.8	-5.6	-5.9	-6.0
Loans loss provisions (%)	-1.3	-0.9	-0.6	-0.5	-0.5	-0.6	-0.7
Adjustments to the valuation of gov. securities (%)	-0.6	0.0	-0.2	-0.1	-0.2	-0.1	0.0
Tax charges	-0.3	-0.3	-0.4	-0.6	-0.5	-0.6	-0.7
Amortization payments for court-ordered releases	-0.7	-1.0	-1.0	-0.9	-0.9	-0.9	-1.1
Other	1.0	0.7	0.9	1.2	0.8	1.6	0.9
Monetary results	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income tax	-0.3	-0.2	-0.2	-0.3	-0.2	-0.4	-0.3
ROA	-2.5	-1.0	0.5	2.2	1.8	2.6	1.8
ROE	-19.1	-8.1	4.1	15.3	12.3	18.0	12.3
Adjusted ROA (**)	-1.2	0.2	1.6	3.2	2.8	3.6	2.8

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

Source: BCRA

increase of financial intermediation. The gradual growth in the number of employees has not blocked the improvements in the labor factor efficiency. In fact, the net revenues from interest and services (deflated by the CPI GBA) in terms of employment have expanded 15% in the past 12 months, while the funds under management per worker increased 11% in the same period, a sign that productivity gains are still being recorded by the financial system.

Positive results in all groups of financial entities

In the first half of 2007 private banks achieved a ROA of 1.8%a. and a ROE of 12.3%a. (see Table VI.2), values which although lower than those recorded in the second half of 2006 were similar to those recorded in the same period last year. With a similar performance to the financial system as a whole, the greatest profits of the private financial entities were associated with the sharp increase in the volume of financial intermediation: both the interest results and the net service revenues expanded 0.2 p.p. of assets to 2.3%a. and 3.6%a., respectively, to reach the highest post-crisis levels. Affected by the more volatile development of the international capital markets, private banks' gains on securities exhibited a fall during the first half of 2007.

The different groups of private banks continued recording positive results in the first half of 2007. The retail financial entities with a nationwide scope attained a ROA of 1.6%a. (see Table VI.3), with the results from interest and the net service revenues being the most dynamic lines. The smaller profits relative to the second half of 2006 were in connection with the miscellaneous results and in the revenues from holding and trading securities. The regional private banks also recorded smaller profits (ROA at 3.8%a.), explained by the same factors that affected the profitability of the private retail banks with a nationwide scope. The specialized and wholesale banks saw slightly smaller accounting profits than at the end of 2006, due fundamentally to the performance of the gains on securities.

The government-owned banks reached a ROA of 1.5%a. in the first six months of 2007, or 0.3 p.p. of assets more than in the second half of last year (see Table VI.4). This development was associated with the higher miscellaneous profits and CER adjustments, while the losses for adjustments to the valuation of government securities were reduced.

Looking ahead to the end of 2007, banks are expected to continue deepening their recurring revenue sources

Interest based results and the net revenues from services, in particular, continued expanding in a context of a sustained growth of both loans and private sector deposits. On the other hand, the greater uncertainty regarding the depth, scope and duration of the unfavorable situation on the international capital markets will exhibit some negative impact on the results from securities in the second half of 2007.

Loan loss provisions are meanwhile forecasted to remain at historically low levels. The CER adjustments are estimated to continue reducing their weighting in the banking results, in a

Table VI.3

Profitability Structure by Type of Bank First Half 2007
In annualized terms - As % of average netted assets

	Private				
	Retail			Wholesale	
	Total	National coverage	Regional coverage		
Financial margin	5.9	5.5	7.0	14.9	6.6
Net interest income	2.5	2.2	3.2	11.7	-1.0
CER and CVS adjustments	0.6	0.7	0.1	-0.2	0.0
Gains on securities	2.2	1.9	3.0	3.0	6.3
Foreign exchange price adjustments	0.5	0.5	0.4	1.0	1.2
Other financial income	0.2	0.2	0.3	-0.6	0.0
Service income margin	3.7	3.8	3.4	6.6	2.3
Operating costs	-5.9	-5.7	-6.3	-14.4	-7.0
Loans loss provisions (%)	-0.7	-0.7	-0.4	-4.7	-0.6
Adjustments to the valuation of gov. securities (%)	0.0	0.0	0.0	0.0	0.0
Tax charges	-0.7	-0.7	-0.6	-0.9	-0.4
Amortization payments for court-ordered releases	-1.0	-1.3	-0.2	-0.2	0.0
Other	0.9	0.8	1.4	1.6	0.8
Monetary results	0.0	0.0	0.0	0.0	0.0
Income tax	-0.2	-0.1	-0.6	-0.4	-1.0
ROA	2.1	1.6	3.8	2.4	0.7
ROE	14.6	12.7	20.7	12.1	3.3
Adjusted ROA (**) (%)	3.4	2.8	5.9	3.2	2.3
Weight in total assets (%)	58.9	46.9	11.1	0.9	3.3

(*) Com. "A" 391 and complementary communications. (**) Excluding amortization of payment for court ordered releases and the effects of Com "A" 3911 and complementary communications.

Source: BCRA

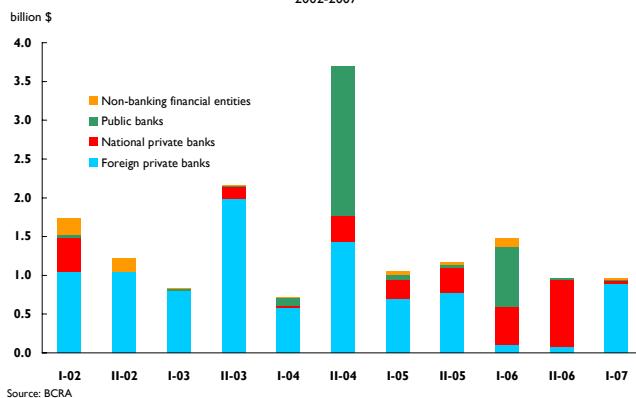
Table VI.4
Profitability Structure: Public Banks
In annualized terms - As % of average netted assets

	2003	2004	2005	2006	I-06	II-06	I-07
Financial margin	-0.9	3.3	4.9	5.2	5.7	4.8	5.0
Net interest income	-1.7	0.5	0.9	1.0	1.0	1.0	1.0
CER and CVS adjustments	1.8	1.4	2.3	2.3	2.9	1.8	2.0
Gains on securities	0.1	1.3	1.3	1.6	1.4	1.9	1.7
Foreign exchange price adjustments	-0.7	0.2	0.2	0.2	0.3	0.1	0.2
Other financial income	-0.4	-0.1	0.1	0.0	0.1	0.0	0.0
Service income margin	1.5	1.5	1.6	1.7	1.7	1.8	1.8
Operating costs	-3.4	-3.2	-3.5	-3.8	-3.7	-3.8	-3.9
Loans loss provisions (%)	-0.9	-0.6	-0.5	-0.4	-0.5	-0.3	-0.2
Adjustments to the valuation of gov. securities (%)	-0.1	-0.4	-0.3	-0.6	-0.6	-0.6	-0.1
Tax charges	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3
Amortization payments for court-ordered releases	-0.5	-0.7	-0.9	-0.6	-0.6	-0.5	-0.7
Other	0.7	0.7	0.6	0.5	0.6	0.4	0.8
Monetary results	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Income tax	0.0	-0.1	-0.4	-0.4	-0.6	-0.2	-0.8
ROA	-3.5	0.3	1.3	1.4	1.5	1.2	1.5
ROE	-31.8	3.9	12.4	12.3	13.6	11.1	13.5
Adjusted ROA (**) (%)	-3.0	1.4	2.4	2.6	2.8	2.4	2.3

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

Source: BCRA

Chart VI.8
Capital Contributions
2002-2007



context of a smaller mismatch in the items adjusted by the CER. Operating costs should continue increasing gradually, at a similar rate as the expansion of employment in the sector. Despite the larger payroll it is expected that efficiency improvements will continue.

VI.2. Capital position

More profits and fresh capital contributions support financial system solvency

The financial system continued improving its solvency in the first half of 2007, in a framework of book profits and new injections of fresh capital. Specifically, the financial system received fresh capital contributions of approximately \$960 million in the first half of the year (see Chart VI.8). Therefore, the capitalization flows that banks have accumulated since the beginning of 2002 totals \$16 billion (US\$5.4 billion). By July the financial entities received \$800 million in fresh capital, with a large share of this being shares issued on the local stock exchange, in Brazil and in the USA. Finally, in line with the present prospects for the sector, banks have capitalization commitments for \$180 million pending for the final five months of 2007.

In the first half of 2007 foreign owned private banks received all the new capital contributions, partly in the context of the mergers that were carried out in this period. In perspective, it is noteworthy that from 2002 to date the foreign owned private banks account for almost 59% of the total capitalizations undertaken, while public banks received 19% of the capital contributions and the national private banks channeled 18% of them.

The net worth of the financial system continued expanding in the first half of 2007, but at a more moderate rate than the second half of 2006⁴¹. During the first six months of the year in particular, the net assets of the banking system grew \$2.6 billion, or 7.9% (16.5% a.) (see Chart VI.9), a change mostly accounted for by the private sector banks. On the other hand, equity in terms of assets remained stable during the half, attaining a 13.4% level in June 2007, whereas compared to profit-making assets⁴² it was 16.6%.

The private sector banks boosted the improvements in the capital position of the financial system

In the first half of 2007 the financial system still exhibited adequate levels of capital compliance, exceeding the minima both required domestically and recommended at an international level. Specifically, the excess of capital compliance of the financial system was 92% of the requirement, while the capital compliance grew 0.1 p.p. of the risk-weighted assets in the

⁴¹ The smaller growth of bank net worth in the first half of 2007 was partly in connection with two changes recorded in May: cash dividends distributed made by a private bank and an adjustment to the income tax accrued for 2006, which affected the results for periods prior to May 2007.

⁴² Profit-making assets: Total assets less other cash holdings, minimum cash reserves requirements, fixed assets and miscellaneous, branches abroad and capitalized losses from court payment orders.

BOX 4: DOMESTIC FINANCIAL STABILITY CONDITIONS IN A FRAMEWORK OF GREATER VOLATILITY ON INTERNATIONAL MARKETS

The more volatile context on the international financial markets has generalized towards emerging economies due to the process of searching for better quality assets observed at a global level. In this framework, the Argentine financial system does not exhibit an exposure to mortgage risk and has solid solvency indicators, in a framework with new instruments that the Central Bank made available in order to avoid adverse impacts that affect the normal flow of domestic financial intermediation

In mid 2007 a period of financial stress was unleashed in the USA which generalized towards global markets. In a framework of ample international liquidity levels, in recent years the North American market for more risky mortgages (sub prime) deepened while the use of structured products has grown, to become a profitable investment alternative for financial entities, especially for investors who buy risk⁴³.

As regards the direct exposure to products related to loans with mortgage guarantees in both the Argentine financial system and the rest of the countries in the region (see Chart B.4.1) a small share of the GDP is seen. In the Argentine financial system, following the 2001-2002 crisis it was only in 2006 that mortgage loans started to be channeled along a clearly expansive path, together with better domestic economic perspectives. Although starting from low levels, this resulted in the mortgage loans exhibiting a 16.7% growth in 2006 and 31.9% a. in the first half of 2007, so that these loans are at present 1.5% of the GDP and 13% of the total portfolio dedicated to the private sector (see Chart B.4.2). In the light of these numbers, it is evident that the domestic mortgage market is still small, with a level of structured products with these loans as underlying assets which still have a very little volume of about 7.2% of the outstanding stock of mortgage loans⁴⁴. The current scope of the mortgage loans therefore makes it less likely that weaknesses in the real estate market may have a sizable impact on the banks and the rest of the investors.

Chart B.4.1

Mortgage Credit Deepening - International Comparison
As % of GDP - Last available data

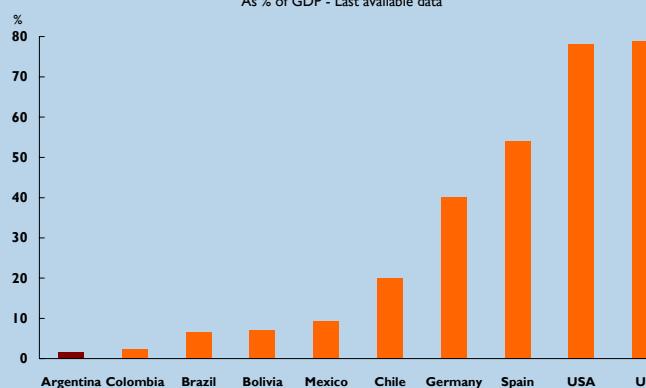
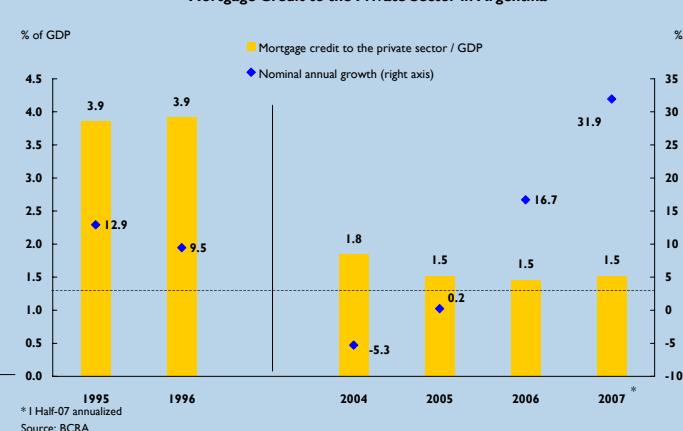


Chart B.4.2

Mortgage Credit to the Private Sector in Argentina



Source: BCRA and Central Banks of corresponding countries

Although like the rest of the emerging economies, Argentina has received the impact of the process of seeking better quality assets as a result of the uncertainty on the international financial market, the solid conditions of the domestic financial system added to the tools that the Central Bank provided generate an adequate framework to absorb the negative effects of the current international context. Facing a more uncertain context, banks tend to assume more conservative strategies in their liquidity terms, a situation that will probably have an impact on the financial interest rates. This affected the interest rates on deposits, and to the extent that these volatilities deepen and persist will have some impact on the interest rate and credit risk. In the latter case, in a scenario of persistent stress the heaviest burden of the private sector services could partly affect their repayment capacity and therefore raise the repayment risk faced by the financial entities.

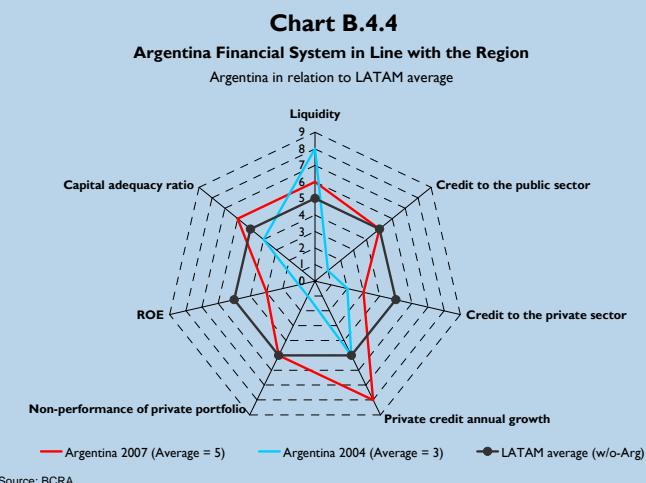
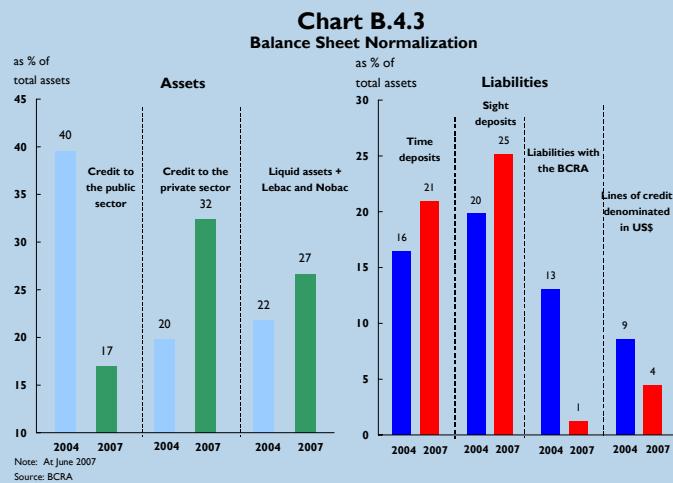
In this scenario the sound solidness conditions of the domestic financial system, added to the measures that the Central Bank has adopted, make for an adequate context to face the external volatilities. During the past three years the financial system has channeled along a path of consolidation and normalization of its balance sheets (see Chart B.4.3), which thus enabled it to have sound position to face the main external volatilities at present. The favorable domestic context combined with the financial policy that the Central Bank has adopted helped to consolidate bank credit to the private

⁴³ For a more detailed analysis, see Box 1.

⁴⁴ Securizations carried out since 2005 are considered.

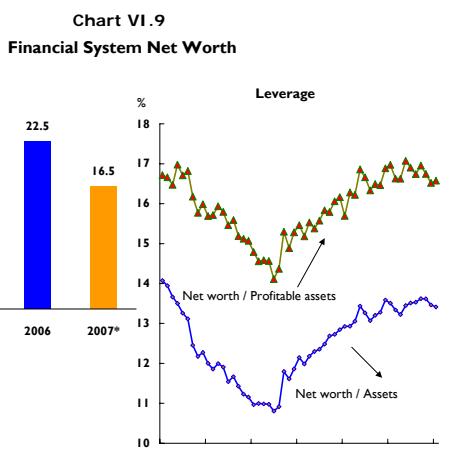
sector, reducing the exposure to the public sector. The use of funding from private deposits also gained share in bank liabilities.

The deepening of the financial intermediation process with the private sector boosted the accounting profits of the financial system; with the latter being led by the recurrent revenue sources especially (interest and services results) (see Chart 3). These profits, added to the fresh capital contributions, allowed for the more robust solvency levels of the banks that are at present higher than the domestic capital requirements and international standards. The financial system was thus able to remain aligned with the major Latin American financial systems (see Chart B.4.4), restoring their post-crisis position.



In the light of the increased external volatility, the Central Bank designed a number of measures to mitigate the domestic impacts of the greater external volatility. On one hand it strengthened the banks' exposure to liquidity risk (see Page 23) to thus avoid the possible effects on the interest rate impacting on the momentum of the market for loans to the private sector and on the credit risk faced by the banks. Likewise, it minimized the effect of short term external volatilities on banking balance sheets, especially through changes in the pricing criteria for their holdings of sovereign securities.

As a result, the domestic financial system is in a sound relative position to absorb the negative and temporary short term effects of the present international context, a statement backed by other factors. On one hand, the scale and characteristics of the domestic mortgage market makes it a superfluous source of risks for banks. On the other hand, the financial system have strengthened their relative solvency position in recent years, a process led by the deepening of the financial intermediation with the private sector. Finally, the Central Bank has undertaken a number of measures that blocks the negative effects of the short term volatilities on the international financial markets. It therefore builds a framework of sound financial stability terms that enable the banking system to face the present financial stress moment more solidly.



first half of the year to total 16.8% in June 2007 (see Chart VI.10).

Unlike what had been recorded in the previous half, in the first part of 2007 the private financial entities led the improvement of the solvency indicators. Within this group of banks performance was heterogeneous: the retail banks with a national scope and the wholesale banks increased their capital compliance, while the regional and the specialized moved back slightly (see Table VI.5). These changes were partly because, although all banking groups in general expanded their loans to the private sector, the private sector retail banks and the wholesale banks were those that received most of the fresh capitalizations during the half-year period. On the other hand, public banks recorded a slight fall in their capital compliance ratio, a change that was partly in connection with the adjustment undertaken by a public sector bank in May this year.

A gradual consolidation of bank solvency is forecast by the end of 2007

The larger volumes of financial intermediation projected over the next few months should lead to sustained banking profitability. This trend may be consolidated by possible capital contributions. In this line, the financial entities are expected to continue maintaining adequate capital levels.

Finally, given the current levels of banking exposure to the different kinds of risks, it is worth noting that the financial system is in a favorable position to face a possible external shock, like the present context of volatilities on the international financial markets.

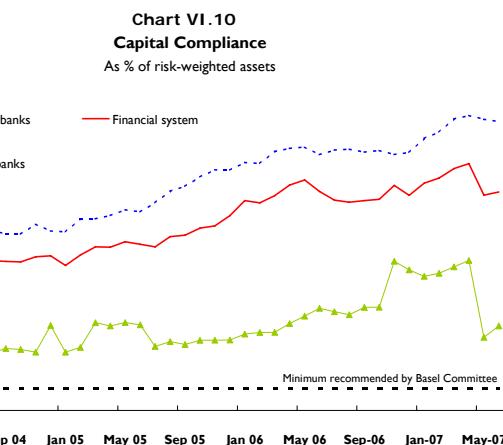


Table VI.5
Capital Requirements by Group of Banks

Group of banks	Capital compliance / Assets at risk (*)	
	Dec-06	Jun-07
Public banks	12.4	10.8
Private banks	18.6	20.0
National coverage	16.5	17.2
Regional coverage	24.5	23.7
Specialized	26.5	22.5
Wholesale	37.9	50.8
Non-bank entities	39.6	35.0
Financial system	16.7	16.8

(*) Assets weighted by credit risk

Source: BCRA

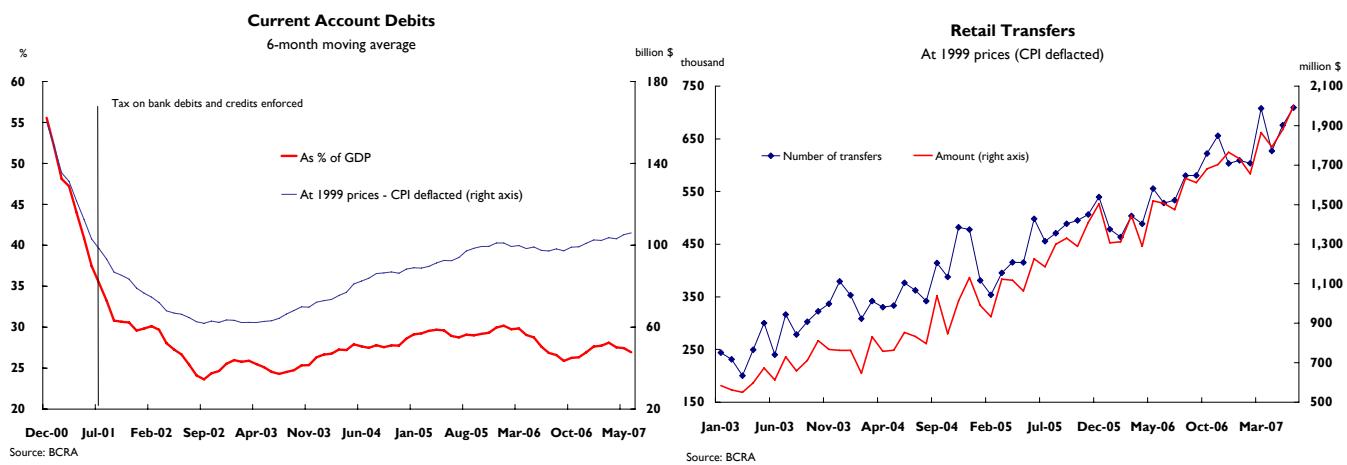
VII. PAYMENTS SYSTEM

Summary

The National Payments System (NPS) continues to keep pace with the development of the economy, contributing mechanisms for the carrying out of transactions that are increasingly adapted to company and household needs. Although cash still represents the principal means of payment in the economy, alternative mechanisms are gaining share. So-called bank money (mainly cards, direct debits and bank transfers) is becoming more widespread as it is increasingly being adopted by the population as a cultural habit, with the growth of the formal economy (and in formal employment in particular), and a greater use of banking services.

In the first half of 2007 the number of debit and credit cards available for use continued to rise, the latter in particular driven by bank strategy for their placement. Check clearing, retail transfers and direct debits continued to increase in both volume of transactions and amount. During the half there was a slight decline in the rejected checks to total clearing ratio (to 1.9%). Transactions processed through the high-value clearing system (Electronic Means of Payment) also maintained their growth.

The Central Bank is reinforcing its aim of achieving greater efficiency and agility for the NPS, in a context of lower risks and the strengthening of the means for the carrying out of transactions in the economy. Implementation of a series of measures is about to be concluded that will assist in the development of the NPS, including the final stage of the procedures for the Uniform Federal Clearing (UFC) system and the standardization of all documents suitable for clearing. In addition, progress has been made on the analysis of alternatives to improve purchase and sale of property mechanisms, a proposal to reformulate the Check Law, exploration of mechanisms to improve Central Bank supervisory tasks in the area of the NPS, and the optimizing of electronic payment means.



VII.1. National Payments System

The greater volume of transactions in the economy is helping promote a growing use of electronic payment means

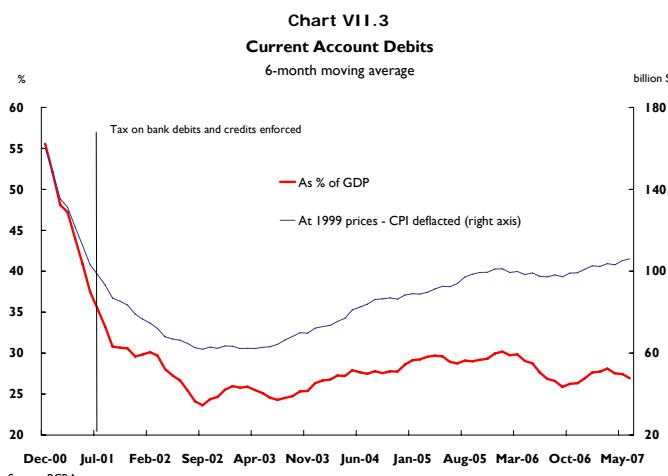
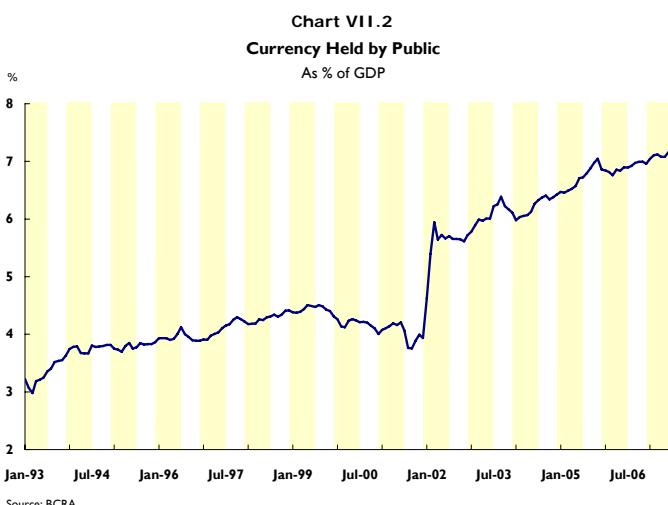
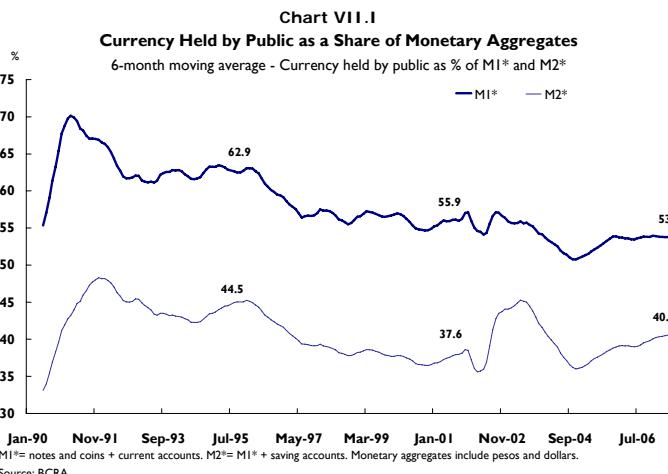
The National Payments System (NPS) continues to keep pace with the steady economic growth, contributing mechanisms for the carrying out of transactions that are increasingly adapted to the needs of the various agents in the economy. Although cash still represents the principal means of payment used by the private sector to carry out its routine transactions, the various electronic means available are gradually acquiring a greater weight. There is plenty of scope for the development of so-called bank money (mainly cards, direct debits and bank transfers), instruments that in developed economies have achieved a high degree of cash substitution.

Cash use continued to increase in the first part of 2007 (see Chart VII.1), in line with the growth in economic activity. Notes and coins in circulation held by the public averaged \$53.85 billion in the first half of 2007, almost 26% more than in the same period of 2006 (15% deflated by the IPC GBA index). As a result, cash in circulation totaled around 7.2% of GDP in mid-2007 (see Chart VII.2), 0.3 p.p. more than in the previous year.

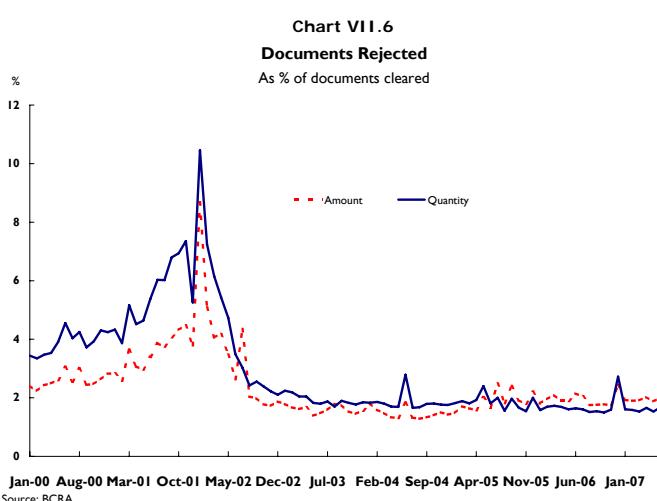
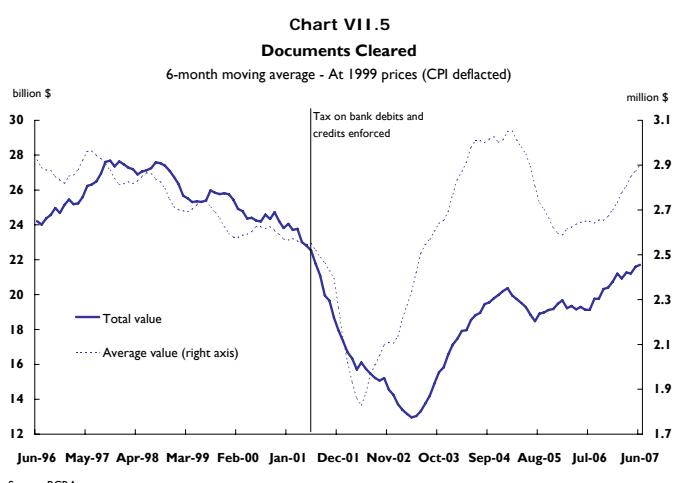
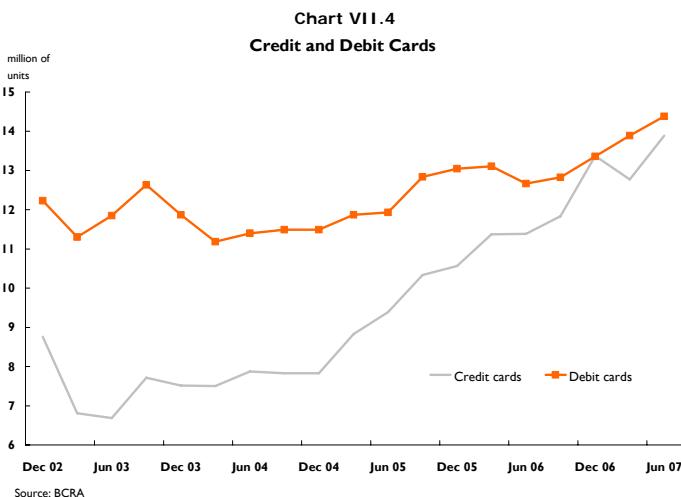
Improvements in family and company income continue to drive the increase in private sector sight deposits (current accounts and savings accounts). Sight deposits, in particular, recorded growth of 26% by mid-2007, compared with the same period of the previous year, although with a slight reduction in current account debits in terms of GDP. This trend continues to expand the funds base that enables increased use of bank payment means (see Chart VII.3), although this development continues to be influenced by the existence of the tax on bank debits and credits (IDCCB)⁴⁵.

The private sector is progressively making greater use of debit and credit cards as means of payment, as they provide greater security than the carrying of cash, as well as offering tax benefits in the case of certain transactions. By mid-2007, the number of debit cards totaled approximately 14.4 million (see Chart VII.4), having grown by slightly over 13.5% in the last 12 months. It should be noted that this growth can partly be linked to the improvement in the level of formal employment, with the consequent increase in the practice of making wage payments through bank accounts. The number of credit cards grew close to 22% since mid 2006, to 13.9 million, reflecting the placement strategies adopted by financial entities.

The number of checks cleared has continued to rise after the drop that took place as a result of the crisis in 2001-2002 and the introduction of the IDCCB. During the first half of 2007 approximately 45 million documents in pesos were processed through the electronic clearing system, almost 4% more than in the first half of 2006. The value of these items totaled \$249 billion, 24% more than in the same period of the previous year (13.5% deflated by the IPC GBA index) (see Chart VII.5).



⁴⁵ Law 25.413



Average transaction value continued to increase in the first part of 2007, with an increase of 19% compared with the first half of 2006 (9.5% deflated by the IPC GBA index), reaching a share in GDP of 5.1%. The monthly average in the half-year for truncated checks, that is to say, for which no document image is forwarded –those for amounts of up to \$5.000- stood at approximately 85% of all documents cleared.

During the course of 2007 a slight drop was recorded in the number of rejected checks compared with the same period of the previous year, totaling 1.9% of the monthly average for documents processed (see Chart VII.6). Nevertheless, compared with the first part of 2006, the quantity and total value of rejected checks recorded increases of approximately 2% and 19%, respectively.

Retail transfers have continued to be a strongly-expanding payment means, given the public's need for payment mechanisms that are more efficient than cash. In the first half of 2007 just over 3.9 million transfers were made, 30% more than in the same period of the previous year. This growth is similar to that observed in total amounts processed (deflated by the IPC GBA index) using this payment mechanism (see Chart VII.7), with gradually increased weighting in terms of GDP.

In addition, the use of direct debits by companies and households to pay normal utilities (energy, gas, healthcare installments, credit cards, among others) has continued to grow. In the first half of 2007 the number of transactions by means of direct debits totaled almost 11.7 million, with a year-on-year increase of approximately 33.5%. The clearing of such transactions was for an amount of almost \$4.7 billion in the first part of 2007 (see Chart VII.8), 75% more than in the first half of last year (58.5% more if deflated by the IPC GBA index). Although starting from a low level, this mechanism continues to gradually gain greater weighting in the output of the economy.

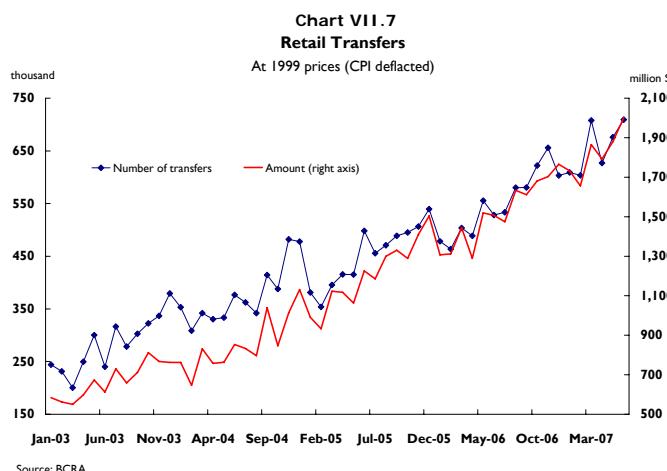
Transactions in pesos using the Electronic Means of Payment (MEP) system (for high-value payments), totaled close to 676 thousand in the first half of 2007, for a value of \$1.1 trillion⁴⁶. This has represented an increase of almost 8% in quantity and 33% in amount (22% deflated by the IPC GBA index) (see Chart VII.9) compared with the same half of 2006. Transactions in foreign currency continued to account for a small proportion of the total.

VII.2. Modernization of the payments system

The Central Bank continues to promote measures to make the National Payments System more efficient, agile and secure

The Central Bank is continuing to expand its actions to achieve greater efficiency, agility and security for the NPS, providing the means for the performing of transactions within the economy. In particular, a series of measures have been defined for the development of the payment system, including implementation

⁴⁶ Million of million.



of the final stage of the Uniform Federal Clearing (UFC) procedures, the standardization of all documents suitable for clearing, analysis of alternatives to improve purchase and sale of property mechanisms, study of a proposal to reformulate the Check Law⁴⁷, exploration of mechanisms to improve Central Bank supervisory tasks in the area of the NPS, and the optimizing of electronic payment means.

The UFC system began to be introduced in 2005, with the transmission of check images and other clearing documents in a unified manner nationwide. In general terms, through the UFC, checks drawn for amounts of up to \$5,000 are transmitted only as electronic information (a record), while in the case of larger amounts the depository institution must transmit electronic files with images of the documents, observing certain technical characteristics laid down in the regulations.

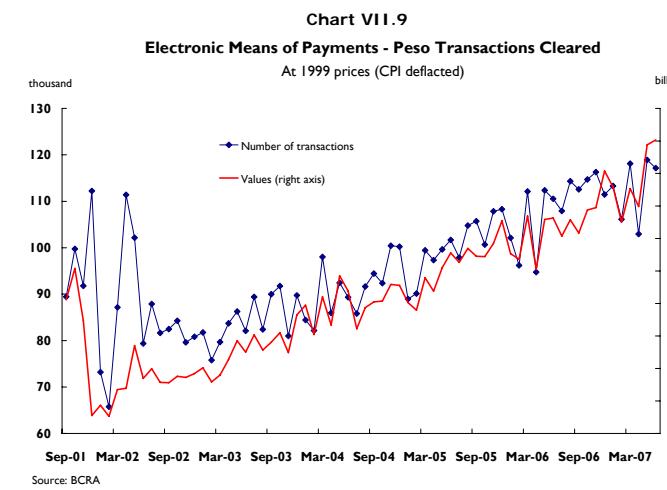
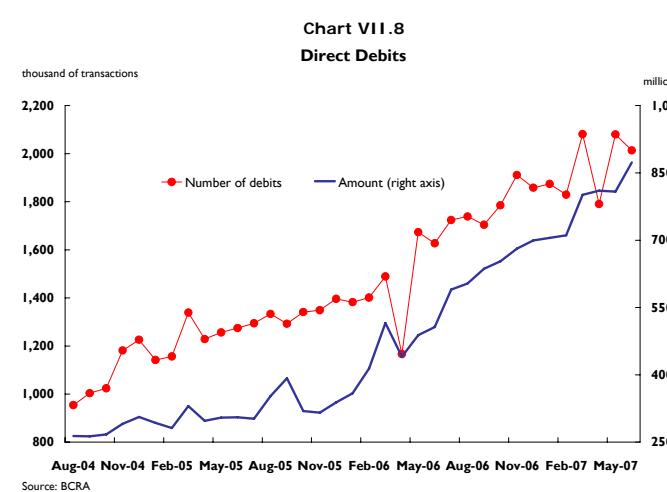
In this framework, as from November last year the UFC system entered its final implementation stage, with the total elimination of the physical movement of documents. In view of this new operating system, the Central Bank's regulations have been implemented by means of the signing of new truncation agreements with banks, which in addition to establishing general procedures, describe in detail the responsibilities of the depository and drawn-on institutions.

The introduction of the UFC has led to a significant reduction in operating risk and in the cost of transactions involving documents, at the same time as enabling the interconnection of all the financial centers in the country in a single daily clearing-house session. In addition, all financial system customers receive the credit for their funds in the same single term, regardless of where the checks are deposited or their value. This mechanism has therefore provided the payment chain with increased agility, greatly facilitating commercial business.

Continued improvements to the electronic clearing system for means of payment have given rise to the need for standardization of all the documents subject to clearing, whether in use or to be introduced in the near future. This standardization, which can be considered as a continuation of the process that began with checks, has been designed on the basis of the models and security measures that have been laid down for checks. Both the unifying of design and the obligation to include certain security features are intended to provide depository banks with more means to verify and control the documents, helping to mitigate fraud-related operating risk.

Consequently, the Central Bank is working on a standardized model for nominative time deposit, drafting the guidelines for bills of exchange that can be cleared that are to be issued by Credit Unions in accordance with the terms of Law 26.173.

In addition, the Central Bank is working on measures to improve property sale and purchase mechanisms. Currently these transactions take place mainly in cash, giving rise to a high risk because of the physical movement of money, in addition to



⁴⁷ Law 24.452 and its modifications.



encouraging in some cases transactions that violate tax obligations. In this context, the Central Bank is analyzing various alternatives aimed at improving this procedure as regards identification of the parties involved, providing them with greater security and offering a greater degree of fiscal transparency, at the same time as stimulating the inclusion of this money within the banking system.

Lastly, work on the improvement of electronic means of payment continues to be fostered, with measures currently under study to provide greater security and efficiency for direct debits. On this matter, an analysis is being performed of their various operating and commercial aspects in relation to system adherence, withdrawal and reversals of this product, with the aim of speeding the process and avoiding inconvenience to the customer. Analysis is being made of the advisability of adopting a system of validation to be implemented by the electronic clearing-houses for direct debits submitted by banks, with the aim of extending controls over the system.

BALANCE OF RISK

In the first part of 2007 the financial system continued to increase its strength, placing itself in a sound relative position to be able to face any possible negative effects generated by the turbulence in world financial markets. Driven by the regulatory and supervisory framework designed by the Central Bank within a favorable macroeconomic scenario, the progress recorded in bank risk management during the last 3 years reinforces this statement. Although as part of its business strategy it can be seen that the financial system is increasing its exposure to some risks, while at the same time is reducing its exposure to others, and has improved its solvency levels, leading to an adequate risk balance. To sum up, the financial system demonstrates strength in the face of the private and the public sector credit risk, liquidity risk and foreign currency risk, while it needs to continue to work on additional reductions in its exposure to the interest rate and market risks.

Bank exposure to the private sector credit risk remains solid. Although the financial system continues to increase its exposure to the private sector, good income levels, low indebtedness and the relatively low burden represented by private sector debt servicing have been responsible for this situation. Despite some increase in the rate of household loan delinquency, non-performing levels are low, and the increase has been only slight. Nevertheless, this situation highlights the need for closer monitoring of risk management policies in relation to new consumer credit lines being granted. Banks have continued with their active provisioning process, establishing adequate protection against expected losses.

Reduction in exposure to the public sector, added to sound fiscal accounts and the declining level of Government indebtedness, have led to a lower financial system exposure to the public sector counterpart risk.

Despite the allocation of most of its sources of funds to the private sector financing, the financial system succeeded in maintaining sufficient liquid assets so that it could continue to record adequate liquidity indicators, **strengthening its position in the face of liquidity risk.** This, added to the actions taken by the Central Bank making use of its varied range of tools, helped to reduce the volatility on money markets at the beginning of the second half of 2007 caused by the financial stress on international financial markets.

Banks posted a slight deterioration in its foreign currency risk exposure. This has mainly been due to the increase in the active foreign currency position. Nevertheless, stress tests continue to show the financial system in a sound position in the face of movements in the peso-dollar exchange rate. This has been reinforced by the policies developed by the Central Bank in the second half of 2007 to prevent excessive exchange rate volatility generating distortions in the expectations of economic agents.

Balance sheet exposure to interest rate risk continues to decline gradually. In the first half of 2007 a reduction was recorded in the mismatching of CER-adjusted items, which has improved the position of banks in the face of the real rate of interest risk. It is expected that this process of reduction in CER mismatching will continue.

Exposure to market risk rose in the first half of 2007, given the greater weighting of assets that were marked to market in bank portfolios. Although market risk continues to account for a low share of the financial system risk balance, the impact of the turbulence on international financial markets would imply some increase in the exposure to this type of risk. In this regard also, the Central Bank has promoted a series of measures to help prevent short-term movements from temporarily affecting bank results.

As long as financial institutions maintain a sound risk balance, growth in financial intermediation activities with the private sector will reinforce its sources of income, in particular by increasing the flow of recurring income. **Profits recorded, added to the steady capitalization process, are improving bank solvency levels, helping to set up a first barrier against any possible losses derived from negative shocks.** Although it is to be hoped that it was only a temporary phenomenon, one example of this can be seen from the limited losses recorded at the beginning of the second half of 2007 because of the effect of the turbulence on financial markets. In this adverse context, banks have demonstrated strength, absorbing their losses without their solvency levels showing signs of having been affected.

The sound macroeconomic performance of recent years has generated a favorable context for the development of the financial system, within the framework of an appropriate global balance of risks. Although the second half of 2007 could be noted for increased market volatility, **the financial system is better prepared than in the past to absorb negative shocks derived from this scenario.** In a context in which the depth and permanence of the current international stress remains uncertain, **the Central Bank continues to act to promote conditions that favor the continuity of the stable monetary and financial situation.**

STATISTICS ANNEX: FINANCIAL SYSTEM

Chart 1: Financial Soundness Indicators

As %	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	Jun 06	2006	Jun 07
1- Liquidity	22.3	26.1	23.1	25.0	23.4	19.6	22.8	29.1	29.6	20.1	22.2	22.5	22.1
2- Lending to the public sector	16.9	16.2	16.2	18.0	17.3	23.0	48.5	46.5	39.6	30.8	27.2	21.6	17.0
3- Lending to the private sector	50.8	47.7	48.4	44.9	39.9	42.7	20.8	18.1	19.6	25.8	28.3	31.0	32.1
4- Private non-performing loans	16.2	13.8	12.2	14.0	16.0	19.1	38.6	33.5	18.6	7.6	5.4	4.5	3.9
5- Net worth exposure to private sector	24.9	22.5	20.6	24.7	26.2	21.9	17.3	12.4	-1.0	-4.1	-4.1	-3.3	-3.1
6- ROA	0.6	1.0	0.5	0.2	0.0	0.0	-8.9	-2.9	-0.5	0.9	1.7	1.9	1.7
7- ROE	4.1	6.3	3.9	1.7	0.0	-0.2	-59.2	-22.7	-4.2	7.0	12.7	14.3	12.8
8- Efficiency	142	136	138	142	147	143	189	69	125	151	168	167	164
9- Capital compliance	23.8	20.8	20.3	21.0	20.1	21.4	-	14.5	14.0	15.3	16.9	16.7	16.8
10- Excess capital compliance	64	73	49	54	58	54	-	116	185	173	134	132	92

Source: BCRA

Chart 2: Balance Sheet

In million of current pesos	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Dec 05	Jun 06	Dec 06	Jun 07	Change (%)	
										Half yearly	Inter annual
Assets											
Liquid assets ¹	163,550	123,743	187,532	186,873	212,562	221,962	239,165	258,742	289,450	11.9	21.0
Public bonds	20,278	13,005	17,138	27,575	29,154	20,819	29,670	37,991	37,579	-1.1	26.7
Lebac/Nobac	0	0	-	-	17,755	28,340	27,792	29,091	44,504	53.0	60.1
Portfolio	0	0	-	-	11,803	21,067	21,949	25,570	35,189	37.6	60.3
Repo	0	0	-	-	5,953	7,273	5,842	3,521	9,315	164.5	59.4
Private bonds	633	543	332	198	387	389	800	813	795	-2.2	-0.6
Loans	83,277	77,351	84,792	68,042	73,617	84,171	92,102	103,611	112,084	8.2	21.7
Public sector	15,164	22,694	44,337	33,228	30,866	25,836	23,033	20,815	16,734	-19.6	-27.3
Private sector	64,464	52,039	38,470	33,398	41,054	55,885	65,841	77,834	89,922	15.5	36.6
Financial sector	3,649	2,617	1,985	1,417	1,697	2,450	3,228	4,962	5,427	9.4	68.2
Provisions over loans	-6,907	-6,987	-11,952	-9,374	-7,500	-4,930	-4,249	-3,999	-4,013	0.3	-5.6
Other netted credits due to financial intermediation	42,361	21,485	39,089	27,030	32,554	26,721	26,347	26,030	35,707	37.2	35.5
Corporate bonds and subordinated debt	794	751	1,708	1,569	1,018	873	815	773	724	-6.3	-11.1
Unquoted trusts	2,053	2,065	6,698	4,133	3,145	3,883	4,545	4,881	4,753	-2.6	4.6
Compensation receivable	0	0	17,111	14,937	15,467	5,841	5,150	763	367	-52.0	-92.9
Other	39,514	18,669	13,572	6,392	12,924	16,124	15,838	19,613	29,863	52.3	88.6
Leasing	786	771	567	397	611	1,384	1,846	2,262	2,945	30.2	59.5
Shares in other companies	2,645	2,688	4,653	4,591	3,871	4,532	4,728	6,378	6,836	7.2	44.6
Fixed assets and miscellaneous	4,939	4,804	8,636	8,164	7,782	7,546	7,491	7,638	7,628	-0.1	1.8
Foreign branches	1,115	1,057	3,522	3,144	3,524	3,647	3,832	2,788	2,884	3.4	-24.7
Other assets	3,950	5,334	9,338	12,043	13,180	10,950	10,299	10,835	10,075	-7.0	-2.2
Liabilities											
Deposits	146,267	107,261	161,446	164,923	188,683	195,044	209,373	225,773	253,871	12.4	21.3
Public sector ²	86,506	66,458	75,001	94,635	116,655	136,492	155,072	170,898	190,281	11.3	22.7
Public sector ²	7,204	950	8,381	16,040	31,649	34,019	40,493	45,410	47,805	5.3	18.1
Private sector ²	78,397	43,270	59,698	74,951	83,000	100,809	111,799	123,431	139,935	13.4	25.2
Current account	6,438	7,158	11,462	15,071	18,219	23,487	24,376	26,900	32,054	19.2	31.5
Savings account	13,008	14,757	10,523	16,809	23,866	29,078	33,348	36,442	40,654	11.6	21.9
Time deposit	53,915	18,012	19,080	33,285	34,944	42,822	48,359	54,338	60,515	11.4	25.1
CEDRO	0	0	12,328	3,217	1,046	17	16	13	13	-5.8	-23.1
Other netted liabilities due to financial intermediation	55,297	36,019	75,737	61,690	64,928	52,072	47,606	46,037	54,976	19.4	15.5
Interbanking obligations	3,545	2,550	1,649	1,317	1,461	2,164	2,983	4,578	4,864	6.2	63.1
BCRA lines	102	4,470	27,837	27,491	27,726	17,005	11,434	7,686	3,585	-53.4	-68.6
Outstanding bonds	4,954	3,777	9,096	6,675	7,922	6,548	6,762	6,603	8,003	21.2	18.4
Foreign lines of credit	8,813	7,927	25,199	15,196	8,884	4,684	4,461	4,240	3,255	-23.2	-27.0
Other	37,883	17,295	11,955	11,012	18,934	21,671	21,966	22,930	35,269	53.8	60.6
Subordinated debts	2,255	2,260	3,712	2,028	1,415	1,381	1,243	1,642	1,657	0.9	33.3
Other liabilities	2,210	2,524	6,997	6,569	5,685	5,099	5,452	7,196	6,957	-3.3	27.6
Net worth	17,283	16,483	26,086	21,950	23,879	26,918	29,792	32,969	35,579	7.9	19.4
Memo											
Netted assets	129,815	110,275	185,356	184,371	202,447	208,275	225,659	245,149	265,264	8.2	17.6
Consolidated netted assets	125,093	106,576	181,253	181,077	198,462	203,286	219,649	236,216	255,472	8.2	16.3

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

Source: BCRA

Methodological note (chart 1):

1.- (Cash compliance according to BCRA + Other cash holdings + Central Bank repos) / Total deposits; **2.-** (Public bonds position (without LEBAC and NOBAC) + Loans to the public sector + Compensation receivable) / Netted assets; **3.-** (Loans to the private sector + Leases) / Netted assets; **4.-** Non-performing loans to the non-financial private sector / Loans to the non-financial private sector; **5.-** (Total non-performing loans - Provisions) / Net worth. The non-performing loans includes loans classified in situation 3,4,5 and 6; **6.-** Accumulated annual results / Average monthly netted assets - % Annualized; **7.-** Accumulated annual results / Average monthly net worth - % Annualized; **8.-** (Financial margin (Net interest income + CER and CVS adjustments + Gains on securities + Foreign exchange price adjustments + Other financial income) + Service income margin) / Operating costs; **9.-** Capital compliance (Responsabilidad Patrimonial Computable) / Risk - adjusted assets according to the regulation of BCRA about Minimum Capital Compliance; **10.-** (Capital compliance minus requirements, included forbearances) / Capital requirements.

Chart 3: Profitability Structure

In millions of current pesos	Annual								Half year			Change (%)	
	1999	2000	2001	2002 ¹	2003	2004	2005	2006	I-06	II-06	I-07	I-07 / II-06	I-07 / I-06
Financial margin	6,967	7,291	6,943	13,991	1,965	6,075	9,475	12,956	6,232	6,724	7,297	9	17
Net interest income	5,396	5,106	4,625	-3,624	-943	1,753	3,069	4,095	1,948	2,147	2,545	19	31
CER and CVS adjustments	0	0	0	8,298	2,315	1,944	3,051	3,008	1,758	1,250	1,449	16	-18
Foreign exchange rate adjustments	227	185	268	5,977	-890	866	751	928	561	368	499	36	-11
Gains on securities	1,112	1,481	1,490	3,639	1,962	1,887	2,371	4,703	1,849	2,854	2,660	-7	44
Other financial income	232	519	559	-299	-480	-375	233	222	116	105	144	36	24
Service income margin	3,623	3,582	3,604	4,011	3,415	3,904	4,781	6,162	2,819	3,343	3,751	12	33
Loan loss provisions	-2,565	-3,056	-3,096	-10,007	-2,089	-1,511	-1,173	-1,174	-595	-579	-721	25	21
Operating costs	-7,432	-7,375	-7,362	-9,520	-7,760	-7,998	-9,437	-11,477	-5,377	-6,099	-6,721	10	25
Tax charges	-497	-528	-571	-691	-473	-584	-737	-1,078	-479	-599	-681	14	42
Income tax	-421	-446	-262	-509	-305	-275	-581	-765	-402	-363	-619	70	54
Adjustments to the valuation of government securities ²	0	0	0	0	-701	-320	-410	-747	-382	-365	-36	-90	-91
Amortization payments for court-ordered releases	0	0	0	0	-1,124	-1,686	-1,867	-1,698	-819	-879	-1,162	32	42
Other	617	535	702	-3,880	1,738	1,497	1,729	2,123	819	1,304	1,120	-14	37
Monetary results	0	0	0	-12,558	69	0	0	0	0	0	0	0	0
Total results	291	3	-42	-19,162	-5,265	-898	1,780	4,302	1,816	2,486	2,229	-10	23
Adjusted results ³	-	-	-	-	-3,440	1,337	4,057	6,746	3,016	3,730	3,427	-8	14
Annualized indicators - As % of netted assets										change in p.p.			
Financial margin	5.6	5.7	5.7	6.5	1.1	3.1	4.6	5.7	5.8	5.7	5.7	0.0	-0.1
Net interest income	4.3	4.0	3.8	-1.7	-0.5	0.9	1.5	1.8	1.8	1.8	2.0	0.2	0.2
CER and CVS adjustments	0.0	0.0	0.0	3.9	1.3	1.0	1.5	1.3	1.6	1.1	1.1	0.1	-0.5
Foreign exchange rate adjustments	0.2	0.1	0.2	2.8	-0.5	0.4	0.4	0.4	0.5	0.3	0.4	0.1	-0.1
Gains on securities	0.9	1.2	1.2	1.7	1.1	1.0	1.2	2.1	1.7	2.4	2.1	-0.3	0.4
Other financial income	0.2	0.4	0.5	-0.1	-0.3	-0.2	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Service income margin	2.9	2.8	3.0	1.9	1.9	2.0	2.3	2.7	2.6	2.8	2.9	0.1	0.3
Loan loss provisions	-2.1	-2.4	-2.6	-4.7	-1.1	-0.8	-0.6	-0.5	-0.6	-0.5	-0.6	-0.1	0.0
Operating costs	-5.9	-5.8	-6.1	-4.4	-4.2	-4.1	-4.6	-5.1	-5.0	-5.1	-5.2	-0.1	-0.3
Tax charges	-0.4	-0.4	-0.5	-0.3	-0.3	-0.3	-0.4	-0.5	-0.4	-0.5	-0.5	0.0	-0.1
Income tax	-0.3	-0.3	-0.2	-0.2	-0.2	-0.1	-0.3	-0.3	-0.4	-0.3	-0.5	-0.2	-0.1
Adjustments to the valuation of government securities ²	0.0	0.0	0.0	0.0	-0.4	-0.2	-0.2	-0.3	-0.4	-0.3	0.0	0.3	0.3
Amortization payments for court-ordered releases	0.0	0.0	0.0	0.0	-0.6	-0.9	-0.9	-0.7	-0.8	-0.7	-0.9	-0.2	-0.1
Other	0.5	0.4	0.6	-1.8	0.9	0.8	0.8	0.9	0.8	1.1	0.9	-0.2	0.1
Monetary results	0.0	0.0	0.0	-5.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ROA	0.2	0.0	0.0	-8.9	-2.9	-0.5	0.9	1.9	1.7	2.1	1.7	-0.4	0.1
ROA adjusted ³	-	-	-	-	-1.9	0.7	2.0	3.0	2.8	3.1	2.7	-0.5	-0.1
ROE	1.7	0.0	-0.2	-59.2	-22.7	-4.2	7.0	14.3	12.7	15.6	12.8	-2.8	0.1

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

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

Source: BCRA

Chart 4: Portfolio Quality

As percentages	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Dec 05	Jun 06	Dec 06	Apr 07	May 07	Jun 07
Non-performing loans (overall)	12.9	13.1	18.1	17.7	10.7	5.2	4.0	3.4	3.2	3.2	3.1
Non-performing loans to the non-financial private sector	16.0	19.1	38.6	33.5	18.6	7.6	5.4	4.5	4.1	4.0	3.9
Commercial portfolio (%)	14.9	20.7	44.0	38.0	22.8	9.3	6.3	5.0	4.3	4.1	3.9
Consumption and housing portfolio	17.3	17.5	31.4	28.0	11.0	4.8	4.1	3.5	3.7	3.7	3.8
Provisions / Total non-performing loans	61	66	74	79	103	125	132	130	131	130	130
(Total non-performing - Provisions) / Overall financing	5.0	4.4	4.7	3.7	-0.3	-1.3	-1.3	-1.0	-1.0	-1.0	-0.9
(Total non-performing - Provisions) / Net worth	26.2	21.6	17.2	11.9	-1.0	-4.1	-4.0	-3.3	-3.2	-3.1	-3.1

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

Source: BCRA

Chart 5: International Indicators

	GDP	Liquid assets / Private deposits	Private loans / Total assets	Non-performing loans to the private sector	Provisions / Non-performing loans	ROA	ROE	Real ROE	Capital compliance / Risk weighted assets
2006/2007: Last available data	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Argentina	231	26.9	30.4	3.9	130	1.7	12.8	3.8	16.8
Australia	1,221	0.9	87.6	0.6	205	1.8	25.3	21.9	10.4
Brazil	1,075	8.6	37.6	4.6	153	2.1	21.6	18.0	18.5
Chile	145	6.2	84.1	2.4	191	1.2	18.4	15.1	12.8
Spain	1,237	1.6	76.7	1.3	252	1.0	19.9	16.9	11.9
USA	13,247	0.8	56.9	0.8	130	1.2	11.4	8.8	13.0
Japan	4,331	1.8	52.5	2.4	30	0.4	18.5	18.7	13.1
Mexico	828	14.9	24.9	2.0	195	3.2	23.5	18.6	16.1
United Kingdom	2,389	1.4	44.3	0.9	56	0.5	8.9	4.7	12.9

Source: BCRA; International Financial Statistics (March 2007) and Global Financial Stability Report (September 2007) - International Monetary Fund; Central Banks of corresponding countries

Methodological note (chart 5):

- 1.- GDP 2006 – in billion of US\$; 2.- Cash in banks plus deposits in the monetary authority / Private deposits (%); 3.- Loans to the private sector / Total assets (%); 4.- Non-performing loans to the private sector / Total loans to the private sector (%); 5.- Provisions / Non-performing loans (%); 6.- Total results / Netted assets (%); 7.- Total results / Net worth (%); 8.- Total results / Net worth (%) (deflated by CPI); 9.- Capital compliance / Risk - adjusted assets (%).

STATISTICS ANNEX: PRIVATE BANKS

Chart 6: Financial Soundness Indicators

As %	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	Jun 06	2006	Jun 07
1- Liquidity	23.6	26.9	22.8	24.3	24.1	23.6	24.8	27.6	29.2	21.5	21.8	23.7	23.8
2- Lending to the public sector	13.5	13.7	13.6	16.1	14.7	20.8	49.4	47.1	41.2	28.0	23.5	15.9	11.0
3- Lending to the private sector	51.0	46.7	47.6	44.6	38.4	45.4	22.4	19.9	22.5	31.1	35.4	37.9	40.3
4- Private non-performing loans	11.1	8.5	7.7	8.9	9.8	14.0	37.4	30.4	15.3	6.3	4.8	3.6	3.2
5- Net worth exposure to private sector	21.6	14.3	13.2	11.5	13.4	11.4	18.6	11.2	1.9	-2.2	-2.1	-3.0	-2.9
6- ROA	0.6	0.7	0.5	0.3	0.1	0.2	-11.3	-2.5	-1.0	0.5	1.8	2.2	1.8
7- ROE	4.1	6.3	4.3	2.3	0.8	1.4	-79.0	-19.1	-8.1	4.1	12.3	15.3	12.3
8- Efficiency	144	135	139	146	152	151	168	93	115	136	156	159	159
9- Capital compliance	15.9	15.4	14.6	18.9	18.0	17.6	-	14.0	15.1	17.8	18.5	18.6	20.0
10- Excess capital compliance	33	47	27	60	49	43	-	88	157	155	118	116	93

Source: BCRA

Chart 7: Balance Sheet

In millions of current pesos	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Dec 05	Jun 06	Dec 06	Jun 07	Change (%)	
										Half yearly	Inter annual
Assets											
Liquid assets ¹	119,371	82,344	118,906	116,633	128,065	129,680	136,557	152,414	166,408	9.2	21.9
Public bonds	13,920	10,576	11,044	14,500	15,893	14,074	17,555	22,226	23,293	4.8	32.7
Lebac/Nobac	0	0	-	-	8,359	15,227	14,019	15,952	22,229	39.4	58.6
Portfolio	0	0	-	-	5,611	12,899	12,998	14,220	18,668	31.3	43.6
Repo	0	0	-	-	2,749	2,328	1,021	1,732	3,561	105.6	248.8
Private bonds	563	451	273	172	333	307	692	683	639	-6.4	-7.6
Loans	56,035	52,319	51,774	47,017	50,741	56,565	61,028	69,294	74,876	8.1	22.7
Public sector	8,172	13,803	25,056	23,571	21,420	15,954	12,341	10,036	6,461	-35.6	-47.6
Private sector	45,103	36,636	26,074	22,816	28,213	39,031	46,584	55,632	64,311	15.6	38.1
Financial sector	2,760	1,880	644	630	1,107	1,580	2,103	3,626	4,104	13.2	95.2
Provisions over loans	-3,248	-3,957	-7,463	-5,225	-3,717	-2,482	-2,240	-2,227	-2,293	3.0	2.4
Other netted credits due to financial intermediation	36,600	13,037	27,212	22,148	25,753	16,873	16,374	18,387	20,136	9.5	23.0
Corporate bonds and subordinated debt	724	665	1,514	1,394	829	675	644	618	583	-5.7	-9.5
Unquoted trusts	1,609	1,637	6,205	3,571	2,362	2,444	2,947	2,982	3,403	14.1	15.5
Compensation receivable	0	0	15,971	13,812	14,657	5,575	4,883	760	366	-51.8	-92.5
Other	34,267	10,735	3,523	3,370	7,905	8,179	7,900	14,027	15,783	12.5	99.8
Leasing	776	752	553	387	592	1,356	1,780	2,126	2,743	29.0	54.0
Shares in other companies	1,651	1,703	3,123	2,791	1,892	2,416	2,578	4,042	4,433	9.7	72.0
Fixed assets and miscellaneous	3,225	3,150	5,198	4,902	4,678	4,575	4,536	4,677	4,676	0.0	3.1
Foreign branches	75	112	-109	-136	-53	-148	-122	-139	-145	4.6	18.9
Other assets	2,190	2,574	7,549	7,816	7,137	6,178	5,648	5,682	5,753	1.2	1.9
Liabilities	107,193	70,829	103,079	101,732	113,285	112,600	118,194	131,476	143,830	9.4	21.7
Deposits	57,833	44,863	44,445	52,625	62,685	75,668	83,487	94,095	105,833	12.5	26.8
Public sector ²	1,276	950	1,636	3,077	6,039	6,946	6,951	7,029	7,730	10.0	11.2
Private sector ²	55,917	43,270	38,289	47,097	55,384	67,859	74,820	85,714	96,668	12.8	29.2
Current account	4,960	7,158	8,905	11,588	13,966	17,946	18,236	20,604	24,317	18.0	33.3
Savings account	9,409	14,757	6,309	10,547	14,842	18,362	20,366	23,165	25,485	10.0	25.1
Time deposit	39,030	18,012	11,083	18,710	22,729	27,736	32,327	38,043	42,582	11.9	31.7
CEDRO	0	0	9,016	2,409	798	3	2	1	1	-39.9	-65.2
Other netted liabilities due to financial intermediation	46,271	22,629	49,341	42,367	45,083	32,349	30,283	31,750	32,598	2.7	7.6
Interbanking obligations	2,293	1,514	836	726	1,070	1,488	2,123	3,383	3,204	-5.3	50.9
BCRA lines	83	1,758	16,624	17,030	17,768	10,088	7,072	3,689	730	-80.2	-89.7
Outstanding bonds	4,939	3,703	9,073	6,674	7,922	6,548	6,762	6,413	7,813	21.8	15.5
Foreign lines of credit	5,491	4,644	15,434	9,998	5,444	2,696	2,478	2,249	1,286	-42.8	-48.1
Other	33,466	11,010	7,374	7,939	12,878	11,530	11,847	16,015	19,564	22.2	65.1
Subordinated debts	1,668	1,700	3,622	1,850	1,304	1,319	1,183	1,642	1,653	0.7	39.8
Other liabilities	1,420	1,637	5,671	4,890	4,213	3,264	3,242	3,989	3,745	-6.1	15.5
Net worth	12,178	11,515	15,827	14,900	14,780	17,080	18,363	20,938	22,578	7.8	23.0
Memo											
Netted assets	88,501	73,796	117,928	115,091	121,889	123,271	130,290	143,807	154,184	7.2	18.3

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

Source: BCRA

Methodological note (chart 6):

1.- (Cash compliance according to BCRA + Other cash holdings + Central Bank repos) / Total deposits; **2.-** (Public bonds position (without LEBAC and NOBAC) + Loans to the public sector + Compensation receivable) / Netted assets; **3.-** (Loans to the private sector + Leases) / Netted assets; **4.-** Non-performing loans to the non-financial private sector / Loans to the non-financial private sector; **5.-** (Total non-performing loans - Provisions) / Net worth. The non-performing loans includes loans classified in situation 3,4,5 and 6; **6.-** Accumulated annual results / Average monthly netted assets - % Annualized; **7.-** Accumulated annual results / Average monthly net worth - % Annualized; **8.-** (Financial margin (Net interest income + CER and CVS adjustments + Gains on securities + Foreign exchange price adjustments + Other financial income) + Service income margin) / Operating costs; **9.-** Capital compliance (Responsabilidad Patrimonial Computable) / Risk - adjusted assets according to the regulation of BCRA about Minimum Capital Compliance; **10.-** (Capital compliance minus requirements, included forbearances) / Capital requirements.

Chart 8: Profitability Structure

In millions of current pesos	Annual								Half year			Change (%)	
	1999	2000	2001	2002 ¹	2003	2004	2005	2006	I-06	II-06	I-07	I-07 / II-06	I-07 / I-06
Financial margin	5,176	5,441	5,282	10,628	2,575	3,415	5,253	7,672	3,545	4,126	4,407	7	24
Net interest income	3,819	3,598	3,519	-304	107	1,214	2,069	2,772	1,330	1,442	1,742	21	31
CER and CVS adjustments	0	0	0	1,476	1,082	900	1,215	854	498	357	401	12	-19
Foreign exchange rate adjustments	213	160	256	6,189	-312	666	576	725	412	313	387	24	-6
Gains on securities	908	1,232	962	3,464	1,892	959	1,259	3,132	1,219	1,913	1,747	-9	43
Other financial income	236	450	546	-197	-195	-322	134	188	86	102	131	28	53
Service income margin	2,598	2,554	2,598	2,782	2,341	2,774	3,350	4,379	2,016	2,363	2,713	15	35
Loan loss provisions	-1,872	-2,173	-2,464	-6,923	-1,461	-1,036	-714	-713	-326	-387	-518	34	59
Operating costs	-5,326	-5,263	-5,224	-6,726	-5,310	-5,382	-6,303	-7,598	-3,565	-4,034	-4,475	11	26
Tax charges	-368	-379	-418	-512	-366	-393	-509	-760	-343	-417	-486	17	42
Income tax	-386	-393	-216	-337	-295	-202	-217	-365	-107	-258	-192	-26	79
Adjustments to the valuation of government securities ²	0	0	0	0	-665	-51	-201	-170	-102	-68	20	-129	-119
Amortization payments for court-ordered releases	0	0	0	0	-791	-1,147	-1,168	-1,161	-539	-622	-781	26	45
Other	447	307	615	-4,164	1,178	846	1,156	1,626	528	1,097	666	-39	26
Monetary results	0	0	0	-10,531	-20	0	0	0	0	0	0	0	0
Total results	269	93	174	-15,784	-2,813	-1,176	648	2,910	1,109	1,802	1,353	-25	22
Adjusted results ³	-	-	-	-	-1,357	252	2,016	4,242	1,749	2,492	2,115	-15	21
Annualized indicators- As % of netted assets										change in p.p.			
Financial margin	6.1	6.2	6.4	7.6	2.3	2.9	4.3	5.8	5.6	6.0	5.9	-0.1	0.3
Net interest income	4.5	4.1	4.3	-0.2	0.1	1.0	1.7	2.1	2.1	2.1	2.3	0.2	0.2
CER and CVS adjustments	0.0	0.0	0.0	1.1	0.9	0.8	1.0	0.6	0.8	0.5	0.5	0.0	-0.2
Foreign exchange rate adjustments	0.3	0.2	0.3	4.4	-0.3	0.6	0.5	0.5	0.7	0.5	0.5	0.1	-0.1
Gains on securities	1.1	1.4	1.2	2.5	1.7	0.8	1.0	2.4	1.9	2.8	2.3	-0.4	0.4
Other financial income	0.3	0.5	0.7	-0.1	-0.2	-0.3	0.1	0.1	0.1	0.1	0.2	0.0	0.0
Service income margin	3.1	2.9	3.2	2.0	2.0	2.4	2.7	3.3	3.2	3.4	3.6	0.2	0.5
Loan loss provisions	-2.2	-2.5	-3.0	-5.0	-1.3	-0.9	-0.6	-0.5	-0.5	-0.6	-0.7	-0.1	-0.2
Operating costs	-6.3	-6.0	-6.4	-4.8	-4.6	-4.6	-5.1	-5.8	-5.6	-5.9	-6.0	-0.2	-0.4
Tax charges	-0.4	-0.4	-0.5	-0.4	-0.3	-0.3	-0.4	-0.6	-0.5	-0.6	-0.7	0.0	-0.1
Income tax	-0.5	-0.4	-0.3	-0.2	-0.3	-0.2	-0.2	-0.3	-0.2	-0.4	-0.3	0.1	-0.1
Adjustments to the valuation of government securities ²	0.0	0.0	0.0	0.0	-0.6	0.0	-0.2	-0.1	-0.2	-0.1	0.0	0.1	0.2
Amortization payments for court-ordered releases	0.0	0.0	0.0	0.0	-0.7	-1.0	-1.0	-0.9	-0.9	-0.9	-1.1	-0.1	-0.2
Other	0.5	0.4	0.7	-3.0	1.0	0.7	0.9	1.2	0.8	1.6	0.9	-0.7	0.1
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
ROA	0.3	0.1	0.2	-11.3	-2.5	-1.0	0.5	2.2	1.8	2.6	1.8	-0.8	0.1
ROA adjusted ³	-	-	-	-	-1.2	0.2	1.6	3.2	2.8	3.6	2.8	-0.8	0.1
ROE	2.3	0.8	1.4	-79.0	-19.1	-8.1	4.1	15.3	12.3	18.0	12.3	-5.7	-0.1

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

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

Source: BCRA

Chart 9: Portfolio Quality

As percentages	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Dec 05	Jun 06	Dec 06	Apr 07	May 07	Jun 07
Non-performing loans (overall)	8.3	9.9	19.8	15.7	8.9	4.4	3.7	2.9	2.8	2.8	2.8
Non-performing loans to the non-financial private sector	9.8	14.0	37.4	30.4	15.3	6.3	4.8	3.6	3.3	3.2	3.2
Commercial portfolio (*)	8.4	15.4	44.7	39.0	18.2	7.3	5.3	3.8	3.3	3.1	3.0
Consumption and housing portfolio	11.9	12.4	26.0	17.2	10.0	4.2	3.8	3.2	3.3	3.4	3.5
Provisions / Total non-performing loans	68	76	73	79	96	115	116	130	132	132	130
(Total non-performing - Provisions) / Overall financing	2.7	2.4	5.3	3.3	0.4	-0.6	-0.6	-0.9	-0.9	-0.9	-0.8
(Total non-performing - Provisions) / Net worth	13.4	11.4	18.6	11.2	1.3	-2.2	-2.1	-3.0	-3.0	-3.0	-2.9

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

Source: BCRA



ABBREVIATIONS AND ACRONYMS

\$: Argentine pesos.	Credit to the public sector: includes the position in government securities (excluding LEBAC and NOBAC), loans to the public sector and compensation receivable.
%a.: annualized percentage.	
a.: annualized.	
AEIRR: Annual Effective Internal Rate of Return	
AFJP: <i>Administradora de Fondos de Jubilaciones y Pensiones.</i>	
ANSES: <i>Administración Nacional de Seguridad Social.</i> National Social Security Administration.	
APE: <i>Acuerdos Preventivos Extra-judiciales.</i> Preliminary out-of-court agreements.	
APR: Annual Percentage Rate.	
b.p.: basis points.	
BADLAR: Interest rate for time deposits over one million pesos between 30 and 35 days for the average of financial entities.	
BCBA: <i>Bolsa de Comercio de Buenos Aires.</i> Buenos Aires Stock Exchange.	
BCRA: <i>Banco Central de la República Argentina.</i> Central Bank of Argentina.	
BIS: Bank of International Settlements.	
BM: Monetary Base. Defined as money in circulation plus current account deposits in pesos by financial entities in the BCRA.	
Boden: <i>Bonos del Estado Nacional.</i> Federal Bonds.	
Bogar: <i>Bonos Garantizados.</i> Guaranteed Bonds.	
BoJ: Bank of Japan.	
Bonar: <i>Bonos de la Nación Argentina.</i> Argentine National Bonds.	
BOVESPA: São Paulo Stock Exchange.	
CAMEL: Capital, Assets, Management, Earnings and Liquidity.	
Cdad. de Bs. As.: <i>Ciudad de Buenos Aires.</i> Buenos Aires City.	
CDS: Credit Default Swaps	
CEC: <i>Cámaras Electrónicas de Compensación.</i> Electronic Clearing Houses.	
CEDEM: <i>Centro de Estudios para el Desarrollo Económico Metropolitano.</i> Study Center for Metropolitan Economic Development.	
CEDRO: <i>Certificado de Depósito Reprogramado.</i> Rescheduled Deposit Certificate.	
CER: <i>Coeficiente de Estabilización de Referencia.</i> Reference Stabilization Coefficient.	
CIMPRA: <i>Comisión Interbancaria para Medios de Pago de la República Argentina.</i>	
CNV: <i>Comisión Nacional de Valores.</i> National Securities Commission	
CPI: Consumer Price Index.	
CPI Others: <i>CPI excluidos los bienes y servicios con alta estacionalidad, volatilidad o los sujetos a regulación o alto componente impositivo.</i> CPI excluded goods and services with high bills, seasonal and irregular components, regulated prices or high tax components	
	CVS: <i>Coeficiente de Variación Salarial.</i> Wage variation coefficient.
	DGF: Deposit Guarantee Fund.
	Disc: Discount bond.
	EB: Executive Branch.
	ECB: European Central Bank.
	EMBI: Emerging Markets Bond Index.
	EMI: <i>Estimador Mensual Industrial.</i> Monthly Industrial Indicator
	EPH: <i>Encuesta Permanente de Hogares.</i> Permanent Household Survey.
	Fed: Federal Reserve of USA.
	FOMC: Federal Open Market Committee (USA).
	FS: Financial Stability.
	FSB: Financial Stability Bulletin.
	FT: Financial trust.
	FUCO: <i>Fondo Unificado de Cuentas Corrientes Oficiales.</i> Unified Official Current Account Fund.
	FV: Face value.
	GDP: Gross Domestic Product.
	HHI: Herfindahl-Hirschman Index.
	IADB: Inter-American Development Bank.
	IAMC: <i>Instituto Argentino de Mercado de Capitales.</i>
	ICs: Insurance Companies.
	IDCCB: <i>Impuesto a los Débitos y Créditos en Cuentas Bancarias.</i> Tax on Current Account Debits and Credits.
	IFI: International Financial Institutions: IMF, IADB and WB.
	IFS: International Financial Statistics.
	IMF: International Monetary Fund.
	INDEC: <i>Instituto Nacional de Estadísticas y Censos.</i> National Institute of Statistics and Censuses.
	IndeR: <i>Instituto Nacional de Reaseguros.</i> National Institute of Reinsurance.
	IPMP: <i>Índice de Precios de las Materias Primas.</i> Central Bank Commodities Price Index.
	IPSA: <i>Índice de Precios Selectivo de Acciones.</i> Chile Stock Exchange Index.
	IRR: Internal Rate of Return.
	ISAC: <i>Índice Sintético de Actividad de la Construcción.</i> Construction Activity Index.
	ISDA: International Swaps and Derivates Association.
	ISSP: <i>Índice Sintético de Servicios Públicos.</i> Synthetic Indicator of Public Services.
	Lebac: <i>Letras del Banco Central de la República Argentina.</i> BCRA
	components, regulated prices or high tax LIBOR: London Interbank Offered Rate.



m.a.: Moving average.	Par: Par bond.
M2: Currency held by public + quasi-monies + \$ saving and current accounts.	PGN: <i>Préstamos Garantizados Nacionales.</i> National Guaranteed Loans.
M3: Currency held by public + quasi-monies + \$ total deposits.	PF: Pension Funds.
MAE: <i>Mercado Abierto Electrónico.</i> Electronic over-the-counter market.	PPP: Purchasing power parity.
MAS: Mutual Assurance Societies.	PPS: Provincial public sector.
MC: Minimum cash.	PS: Price Stability.
MEC: Electronic Open Market.	PV: Par Value.
MECON: Ministerio de Economía y Producción. Ministry of Economy and Production.	q.o.q: quarter-on-quarter % change.
MEP: <i>Medio Electrónico de Pagos.</i> Electronic Means of Payment.	REM: BCRA Market expectation survey.
MERCOSUR: <i>Mercado Común del Sur.</i> Southern Common Market.	ROA: Return on Assets.
MERVAL: <i>Mercado de Valores de Buenos Aires.</i> Executes, settles and guarantees security trades at the BCBA.	ROE: Return on Equity.
MEXBOL: <i>Índice de la Bolsa Mexicana de Valores.</i> México Stock Exchange Index.	Rofex: Rosario Futures Exchange.
MF: Mutual Funds.	RPC: <i>Responsabilidad Patrimonial Computable.</i> Adjusted stockholder's equity, calculated towards meeting capital regulations.
MIPyME: <i>Micro, Pequeñas y Medianas Empresas.</i> Micro, Small and Medium Sized Enterprises.	RTGS: Real-Time Gross Settlement.
MOA: <i>Manufacturas de Origen Agropecuario.</i> Manufactures of Agricultural Origin.	s.a.: Seasonally adjusted.
MOI: <i>Manufacturas de Origen Industrial.</i> Manufactures of Industrial Origin.	SAFJP: <i>Superintendencia de Administradoras de Fondos de Jubilaciones y Pensiones.</i> Superintendency of Retirement and Pension Funds Administrations.
MP: Monetary Program.	SAGPyA: <i>Secretaría de Agricultura, Ganadería, Pesca y Alimentos.</i> Secretariat for agriculture, livestock, fisheries, and food.
MR: Market rate.	SEDESA: <i>Seguro de Depósitos Sociedad Anónima.</i>
MRO: Main refinancing operations.	SEFyC: Superintendence of Financial and Exchange Institutions.
MSCI: Morgan Stanley Capital International.	SIOPEL: <i>Sistema de Operaciones Electrónicas.</i> Trading software used on the over-the-counter market.
NA: Netted assets.	SME: Small and Medium Enterprises.
NACHA: National Automated Clearinghouse Association.	SSN: <i>Superintendencia de Seguros de la Nación.</i>
NBFE: Non-Bank Financial Entities (under Central Bank scope)	TA: <i>Adelantos transitorios del BCRA al Tesoro.</i> Temporary advances.
NBFI: Non-Bank Financial Intermediaries (out of Central Bank scope)	TD: Time Deposits.
NDP: National public debt.	TFC: Total financial cost.
NFPS: Non-financial national public sector's.	TGN: <i>Tesorería General de la Nación.</i> National Treasury
Nobac: <i>Notas del Banco Central.</i> BCRA notes.	UFC: Uniform Federal Clearing.
NPS: National Payments System.	UIC: Use of Installed Capacity.
NW: Net worth.	UK: United Kingdom.
O/N: Overnight rate.	US\$: United States dollar.
OCT: <i>Operaciones Compensadas a Término.</i> Futures Settlement Round.	USA: United States of America.
OECD: Organization for Economic Co-operation and Development.	UTDT: Universidad Torcuato Di Tella.
ON: <i>Obligaciones Negociables.</i> Corporate bonds.	VaR: Value at Risk.
ONCCA: <i>Oficina Nacional de Control Comercial Agropecuario</i>	VAT: Value added Tax.
OS: <i>Obligaciones Subordinadas.</i> Subordinated debt.	WB: World Bank.
P / BV: Price over book value.	WPI: Wholesale Price Index.
p.p.: Percentage point.	y.o.y.: year-on-year.



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