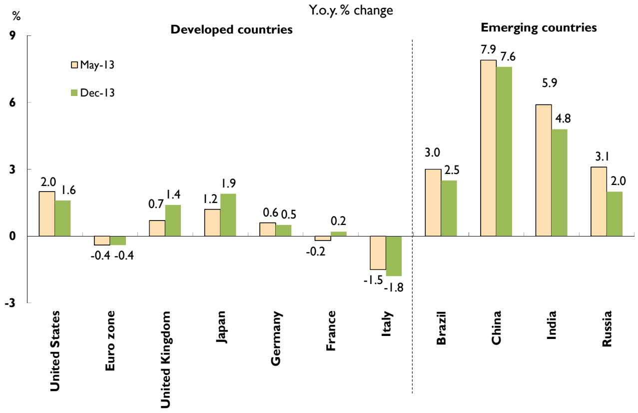
Central Bank Outlook
December 2013

This document is posted to follow the Financial Stability Report Second Half 2013 published in Spanish in December 2013. The full English version of the Report will be available on the Central Bank's website during the next few months.

Chart 1
Evolution of 2013 Growth Forecasts
Y.o.y. % change



Source: FocusEconomics and Central Bank of Brazil

During the second half of 2013, the international financial markets have experienced high volatility levels, which resulted in part from the perception that the US Federal Reserve (FED) would moderate its stimulus policies before the beginning of 2014. Throughout this period, some changes were observed in the portfolios of international investors that impacted adversely on the capital flows to developing countries. As a result, the deterioration of the financial conditions affected the already weak economic performance at global level, particularly in the nations that depend markedly on external financing.

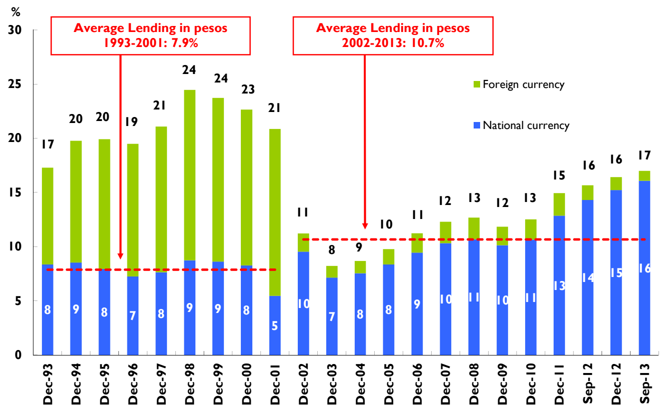
The main advanced nations have kept their expansionary monetary policies during the second half of 2013, while their fiscal policies have maintained the contractionary bias. In turn, most emerging countries failed to use fiscal instruments with countercyclical purpose, even though they have adopted measures tending to reduce the adverse effects of the capital outflows they had to face. In terms of the economic activity, heterogeneity prevailed during this period: while some advanced countries recorded an incipient recovery, the economic activity of emerging economies continued slowing down, though they have managed to keep expansion rates above those of the advanced world.

In the abovementioned context, there were downward revisions in growth forecasts, particularly for emerging nations. Additionally, the international prices of commodities continued to go down and, against this backdrop, the price evolution of Argentina's main export products would continue to be depressed. In short, the global scenario still exhibits a high level of uncertainty.

During the first half of 2013, Argentina regained momentum and accumulated a 5.8% y.o.y (year-on-year) growth of its GDP. The performance of primary production in the first place, and the evolution of the industry together its related services in the second place, have been the main factors behind this recovery. According to the leading indicators, during the second half of 2013, construction would expand its share in total GDP growth. On the demand side, private consumption continued shoring up the economic activity, with a 7.7% annual expansion in the first six-month period of 2013. The combination of stability of the labor market, public income policies and increase of lending has underpinned such evolution. In turn, investment also gained momentum as from the second

Chart 2

Credit to the Private Sector in Terms of GDP

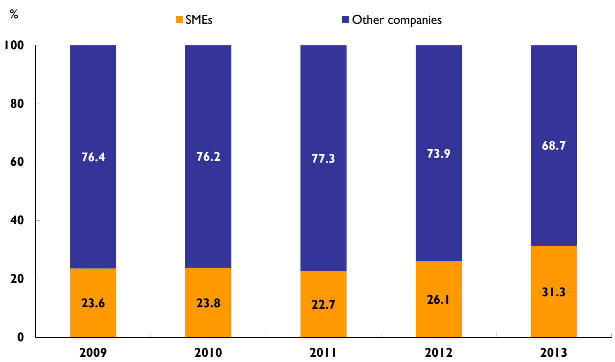


Source: BCRA and INDEC

Chart 3

Credit in Pesos to Legal Persons

Share in total stock at the end of September each year



Source: BCRA

quarter, and levels of around 23% of GDP are currently estimated for the whole year.

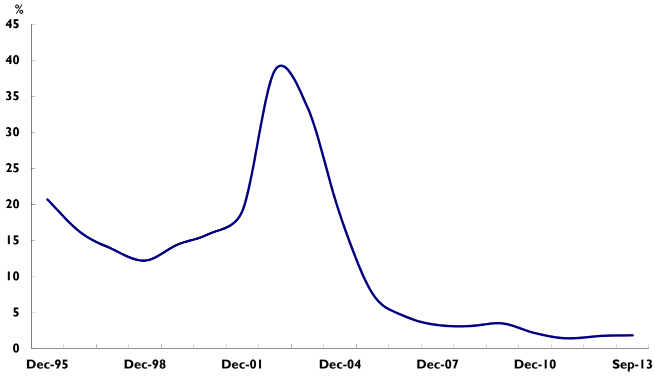
Within this framework, during the first nine months of 2013, the domestic financial system continued expanding its intermediation activity with the private sector and, at the same time, it managed to consolidate the growth of the payment system. Therefore, the year-on-year expansion pace of bank financing to the private sector –both in pesos and in foreign currency– accelerated to 33.3% y.o.y. in September, up 5.4 p.p. against the same month of 2012. Credit deepening consolidated in the economy, reaching around 17% of GDP. Last year, lending to the private sector has also gained weight in the total assets of the aggregate financial system and accounted for 52% of total netted assets. This performance was boosted by loans in pesos, equivalent to 95% of the total stock as at September 2013 and, in particular, by the credit lines for companies, which went up 35.5% y.o.y.

This positive evolution has been due in part to the programs implemented by the Central Bank, such as the "Credit Line for Productive Investment (LCIP)" and the "Bicentenary Productive Financing Program (PFPB)". Within the framework of the LCIP, from mid-2012 to October 2013, the amount of loans awarded exceeds $45 billion, out of which $42 billion have been already disbursed; moreover, 58% of such amount has been provided to micro, small and medium-sized enterprises (MiPyMEs). Complementarily, the Central Bank continued with its auction of funds through the PFPB; as from its launching, $5.78 billion were effectively disbursed (over 75% of the amount awarded to institutions). It is worth pointing out that more than half of the transactions arranged through this line have been channeled to MiPyMEs.

In line with the goals of the abovementioned measures, the segment of lending to MiPyMEs is gaining weight. The flow of financing to this segment has increased its share in the total amount of loans in pesos granted to legal persons, accounting for 41.4% in the third quarter of 2013, up 11.3 p.p. against the value recorded in the same period of 2012. Loans to small and medium-sized enterprises have also gained ground relative to the total stock of loans (both in pesos and in foreign currency) granted to legal persons and accounted for 31.3% of the total in September 2013.

LCIP and PFPB programs have helped MiPyMEs to effectively improve their productive capacity because, on the one hand, they have access to bank loans and, on the other, the credit conditions are better with

Chart 4
Private Sector Non-performing Financing
Non-performing portfolio / Total financing (%) - Financial system



Source: BCRA

affordable interest rates and extended terms for repayment. In particular, for this group of companies, an increase of the share of longer-term loans in the total lending granted became evident in the last three quarters.

In turn, lending to households increased 31.4% y.o.y. by the end of the third quarter, evidencing some deceleration of its expansion pace if compared to the same period of 2012.

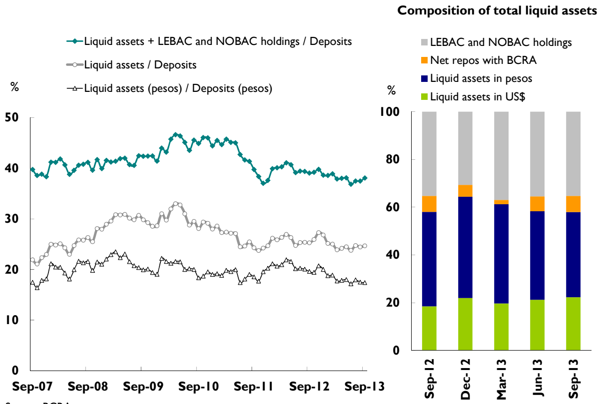
The taking of deposits from the private sector has consolidated as the main funding source for financial institutions. Deposits have jumped 30.6% y.o.y. as at September and have increased their share in the total stock of deposits, accounting for to 71.8%. In turn, time deposits in pesos have experienced a higher growth in recent months (up 40.2% y.o.y.).

In line with the rise of financial intermediation, the use of electronic means of payment (alternative to cash) deepened in 2013. Instant transfers of funds through home banking and mobile banking, business e-banking and ATMs gained ground along the year. In fact, these instant transactions went up 78.5% y.o.y. in amounts and 47% y.o.y. in number as at September 2013. The use of these instruments entails an improvement in terms of security, efficiency and agility for the transactions made in the economy.

In 2013, the map of exposure to, and coverage of, risks inherent in the financial system have remained practically unchanged. First of all, the ensemble of banks has gradually increased its exposure to the private sector and, at the same time, both companies and households have kept their repayment capacity due to a combination of positive evolution of their income and moderate indebtedness levels. As a result, it is estimated that the credit risk faced by the financial system stood at low levels, as evidenced by the reduced delinquency rate of loans throughout the year. In fact, during the third quarter, the non-performance indicator of the loans to households went down, thus reversing the slightly increasing pattern seen since late 2011. Additionally, the accounting provisions for the non-performing portfolio are still sizable.

Secondly and from a systemic perspective, the exposure of banks to liquidity risks continued to be low. Both the term and the concentration of bank funding have not recorded remarkable changes in 2013 and their level is in line with the average of recent years. Additionally, the indicators of coverage with more liquid assets have kept their soundness and the

Chart 5
Liquidity
Financial system



Source: BCRA

inter-financial markets operated favorably. In turn, the risk that the aggregate financial system may suffer a negative effect due to an increase in the interest rates is still moderate, and this situation is widespread among financial institutions. As from 2013, the Central Bank included this risk in Pillar II according with Basel's standards, and the Superintendence of Financial and Foreign Exchange Institutions (SEFyC) may require banks both a reduction of their exposure and an additional capital amount.

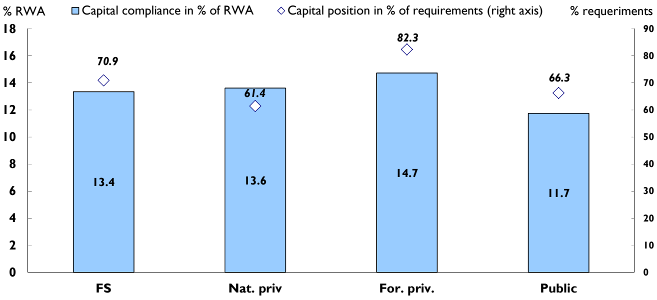
Lastly, market and currency risks' have a low weighting in the financial system's risk map. As regards the former, even though there was a slight increase in the position of institutions in bonds in dollars during 2013 –the segment that exhibited the highest volatility–, the amount and complexity of the assets portfolio at market value are still moderate against the levels observed in previous years. As a result, this reduces the risk that price fluctuations in the main instruments may have a significant impact on the sector. On the currency risk front, aggregate bank balance sheets evidenced low and decreasing dollarization levels, due in part to the macroprudential measures timely introduced by the Central Bank of Argentina. Besides, the sector as a whole has kept a positive foreign currency mismatching (assets in excess of liabilities), a situation that only exposes them to a potential nominal appreciation of the peso.

Within a context of limited risks, the financial system is strengthening its solvency position. Based on the book profits resulting from their transactions, the ensemble of banks continued exhibiting high capitalization levels throughout 2013. In these sense, the sector's leverage went down slightly in 2013 and stood below the average recorded in the countries of the region. The ensemble of banks' regulatory capital compliance accounted for 13.4% of the risk-weighted assets (RWA), with a share of almost 90% of the capital with a better capacity to absorb losses (Tier 1). In turn, the compliance in excess of the requirement reached 70.9% of the regulatory requirement at systemic level by September 2013.

In terms of banks' regulation and supervision, the Central Bank has made a remarkable progress in recent years regarding the convergence with international standards defined in Basel II, 2.5 and III. With a view to the future, the Central Bank will continue working to complete such process within the terms and conditions considered appropriate for the specific characteristics of our financial and economic system and our legal framework in force, and also taking into account the

Chart 6

Capital Requirements and Capital Compliance by Group of Banks
September 2013*



* According to Communication "A" 5369, since February 2013 methodological changes in some indicators were carried out. Among others changes, risk weighing coefficients considered to determine capital requirements were redefined, concepts included in the different segments of capital compliance were rearranged and new minimum limits in terms of the Total Risk Weighted Assets (RWA) were added. A wider definition of RWA is considered since Communication "A" 5369, including not only credit risk, but also market and operational risk.

Source: BCRA

experience gained from the crises suffered by Argentina. Specially, the BCRA is considering the implementation of an information disclosure requirement for the banks to describe in detail the development of their processes for the assessment of their economic capital adequacy based on the risk profile (Internal Capital Adequacy Assessment Process – ICAAP). In addition, a preliminary review of the ICAAP processes of the institutions which already have internal assessment procedures in place will be developed. The agenda also includes the definitions of the Argentine methodology guidelines to determine the entities considered to be systemically important at domestic level as well as to establish special requirements and follow-up procedures for this group. In this sense, during 2014, the Central Bank will also make progress in the process of incorporating the liquidity coverage ratio (LCR) and the leverage ratio (LR).

By early 2014, the domestic financial system is expected to keep its credit expansion pace especially with reference to loans devoted to the productive sector, taking account of the boost given by the measures adopted by the Central Bank. Besides, the growing activity of the ensemble of financial institutions is expected to develop within a framework of limited risks and high coverage levels in terms of liquidity and solvency.