Global growth expectations for 2014 continued to be weak in recent months and were revised downward for both developed and emerging economies. The evolution of activity levels in industrialized countries was still more mixed during the period under analysis. Recovery is evidently more sustained in the United States and the United Kingdom if compared to the situation in the Euro Zone and Japan. As a result, the expectation about the bias to be followed by monetary policies in developed countries in the near future was modified: a lower expansionary pace is estimated for the first group (where an increase in short-term interest rates is expected to begin in 2015) while a loose monetary policy is estimated to prevail in the second group (where the European Central Bank and the Bank of Japan continue to implement stimulus measures). World trade volume has reflected this moderation in the growth pace—especially after the second quarter of the year—, and capital flows started to go once again towards developed countries, mainly the United States, thus contributing to an appreciation of the US dollar.

The leading emerging nations continue to exhibit a higher growth pace than advanced countries. However, the moderation in the economic activity was widespread in this group of nations, where some disparity was observed in macroeconomic performance and economic policy bias. On the one hand, the countries that are less dependent on external capital flows adopted some stimulus measures to invigorate the economic activity through an expansionary monetary policy. On the other, benchmark interest rates in the countries that are in need of external capital flows went up against the levels recorded last year, with a view to lessening the pressures on their domestic currencies.

The growth pace of Argentina’s main trading partners continued to stand below the global average. Commodity prices fell if compared to those recorded last year: the Commodity Price Index—that follows the evolution of the international prices of commodities that are more relevant for Argentine exports—continued to exhibit year-on-year (y.o.y.) reductions (-17.2% y.o.y. as of October).

A heightened caution was observed in the financial markets of developed economies—with fluctuations in the prices of the main instruments—mainly due to the dissimilar expectations about stimulus policies in the different countries and regions, added to the onset of several risk sources worldwide. This was remarkably evident in September and October, characterized by an increase in volatility and price reductions in...
instruments deemed as relatively more risky, even though an improvement was seen by the end of October. In this context, the assets of emerging economies recorded lower relative prices in recent months, with drops in stock market indexes, increases in sovereign debt spreads and currency depreciation against the US dollar.

The potential future challenges for the international financial stability include the size of the contractionary bias that the US monetary policy might adopt in 2015 (with its impact on capital flows), commodity prices and the dissimilar global economic recovery. In turn, the changes in the expectations about the US monetary policy might particularly affect the financial markets, after years of abundant liquidity in global markets, an increasing leverage in some segments and sizable expansions in higher risk asset prices. In addition, a context of uncertainty still prevails in terms of geopolitical conflicts in several countries and the epidemiological situation caused by the Ebola virus.

With respect to Argentina, the indicators available for the second half of 2014 are signaling an incipient improvement in the economic activity relative to the first half of the year. Even though the external demand continued to go down —mainly from Brazil— and private consumption was relatively fragile, investment stood out as the demand component with the most remarkable momentum. It is worth mentioning that a change of direction was observed in the decreasing trend of the construction business, mainly due to the higher momentum observed in oil constructions and housing unit works. In turn, the production levels of the industrial sector and trade-related activities continued to go down in year-on-year terms, even though their performance tended to improve in recent times. In the first half of 2014, the main labor market indicators mirrored the reduced momentum of the economic activity in general.

In this context, new public policies and measures were implemented to drive credit, lessen the deterioration of the labor market and help the most vulnerable sectors. Child allowances were raised as from mid-2014, while social security benefits were increased as from September, which added to a rise in the Minimum Wage. In addition, the Fund for Argentine Economic Development (FON.DE.AR.) was regulated, which coincided with the launch of the Employment Incentive Plan (PRO.EMPL.EAR) and the second stage of the Pension Inclusion Plan.
As from early 2014, the Central Bank of Argentina adopted a series of measures intended to limit the volatility of the nominal exchange rate. One of these regulatory changes consisted in reintroducing the limit to the positive net global position in foreign currency of financial institutions as from February 2014, originally at 30% of the Adjusted Stockholders’ Equity (RPC) of each bank and then reduced to 20%. Even more, with a view to improving financial conditions and promoting economic development and bilateral trade, the Central Bank of Argentina signed in July a new swap agreement for domestic currencies with the People’s Bank of China. Recently, the BCRA has requested a first currency swap for an amount equivalent to US$814 million, which was credited on October 30, 2014. The BCRA will be entitled to request additional swaps for up to a maximum amount equivalent to around US$11 billion. Unlike the swap agreed upon between both central banks in 2009, this is a trade and financial agreement which has significantly improved the conditions for use, with more flexible terms, lower costs and authorization for uses other than those that had been previously agreed upon.

Throughout the year, some volatility has been observed in the domestic financial markets, mainly related to external and idiosyncratic factors, such as, in the latter case, the evolution of the Argentine debt litigation before the courts of New York and, more recently, the changes in the implicit exchange rates in capital market transactions. Despite this context, the price of Argentine sovereign bonds and shares has improved since late May.

Due in part to the effect of the general performance of the domestic economy, the momentum of the financial intermediation moderated in 2014. Bank loans to companies and households went up 22.9% y.o.y. in nominal terms in August 2014, on the basis of an increase in deposits from the private sector of 31.4% y.o.y., within a context of increasing holdings of more liquid assets by the ensemble of financial institutions.

The nominal increase of the total lending stock to the private sector was mainly driven by companies. Financing to the productive sector went up 25.2% y.o.y. in August, accounting for 61.3% of the year-on-year rise of total loans to the private sector. This performance was underpinned by the measures that were timely adopted by the BCRA, such as the Credit Line for Productive Investment (LCIP). Regarding this initiative, the fifth tranche of LCIP became effective in the second half of the year and it is expected to award over $28 billion mainly to micro, small and medium-
sized enterprises (MiPyMes). It has a fixed interest rate of up to 19.5% annual percentage rate for, at least, the first three years. From the time it was implemented by mid-2012 up to August 2014, partially incorporating this fifth tranche of LCIP, loans for productive purposes for approximately $103 billion have been awarded so far, out of which two thirds have been provided to MiPyMEs.

In turn, the stock of loans to households grew 20.5% y.o.y. in August. Since July 2014, personal loans reflected the momentum given by the Plan for the Purchase of National Vehicles (PRO.CRE.AUTO), fostered by the National Government and devoted to finance the purchase of new national automobiles by families. In addition, last September and for the purpose of reinvigorating consumption, the National Government launched the so-called “Ahora 12” Plan to facilitate the purchase of goods and services with a credit card in 12 installments with 0% interest rate.

Lending interest rates for transactions in pesos started to go down gradually after their increasing trend of late 2013 and early 2014. The interest rates on personal loans, promissory notes and pledge-backed loans recorded the highest relative reductions. In this sense, since mid-2013, the BCRA regulated the interest rates applicable to personal loans and pledge-backed loans in credit transactions for natural persons. In addition, the interest rate of personal lending was also impacted by the effect of the loans granted within the framework of the Plan for the Purchase of National Vehicles (PRO.CRE.AUTO), while the transactions under the fourth tranche of LCIP reflected in part on the interest rates applicable to promissory notes.

Deposits from the private sector continue to be the main source of resources for banks. Such deposits accounted for 56.3% of total funding (liabilities and net worth) in August 2014, up 1.3 percentage points (p.p.) against 2013 year-end. The main contributor to this increase was the segment in pesos, which encompasses almost one half of total funding.

After the increase recorded by the end of last year and in the first months of 2014, the funding cost for time deposits started to go down gradually. With a view to improving saving instruments in pesos, the Central Bank established, as from early October, a minimum limit to the rate on time deposits in domestic currency of natural persons, to the extent that the amount of the deposit does not exceed the coverage provided by deposit guarantee scheme, which was increased from $120,000 to $350,000.
Within this framework of reduced momentum in the banking activity, the map of risks taken by the institutions experienced marginal changes during last year, even though a context of moderate exposure and sizable coverage at aggregate level still prevails.

In 2014, the financial system reduced slightly its exposure to the private sector as a result of the deceleration observed in bank financing. Starting from reduced levels, the portfolio delinquency rate went up slightly, mainly accounted for by loans to households. In turn, the loan loss provisions ratio in the lending to companies remained virtually unchanged and stood below the ratio corresponding to lending to families. The limited indebtedness and financial burden levels of the private sector led to a low repayment risk for financial entities. It is worth mentioning that both the financial system and the ensemble of banks continued to record an aggregate provisioning level which stands above the total stock of non-performing loans.

Considering the liquidity risk taken by banks due to the term mismatching they operate with, there were some signals along the year of a slight decrease in their exposure and a higher coverage. The reduction of the relative weight of liabilities with a shorter residual term in total liabilities and the reduced level of concentration of deposits are in line with a slight drop in the exposure to this risk. In terms of coverage margins, the share of higher-liquidity assets has gone up in the banking balance sheet —mainly LEBAC holdings—, as a result of which an increase was observed in the ratio against short-term liabilities.

As from February 2014, the financial system has significantly reduced its exposure to foreign currency risk. In terms of its macroprudential role, the BCRA implemented the abovementioned measures to reduce the foreign currency mismatch that the sector had accumulated by the end of 2013. This added up to a gradual drop in the peso-dollar nominal exchange rate volatility.

Despite the fact that interest rates were somewhat more volatile, the exposure of the financial system to this risk is estimated to have fallen slightly along the year. When comparing the situation prevailing in mid-2014 with that of late 2013, the lower relative sensitivity of bank assets against liabilities would have fallen slightly, vis-à-vis the increases in the interest rates. In turn, due to the fact that financial asset prices were more variable, the exposure of the ensemble of banks to the market risk went up slightly, even though it keeps a low relative share in the sector’s general map of risks. In the first
half of the year, the events reported by banks in relation to operational risk occurred mainly in the retail banking business and the marketing & sale of products, in which treasuries are involved.

The indicators related to this sector’s capital position to face the risks inherent in their activity show a remarkable soundness in the ensemble of institutions. The regulatory capital compliance reached 14.3% of total risk-weighted assets, and the capital with a better capacity for loss absorption —Tier 1— accounted for 90% of the regulatory compliance. In turn, the excess capital compliance accounted for 84% of the regulatory requirement for the financial system, up 8 p.p. against the figure recorded by the end of last year. Book profits boosted the improvement observed in solvency indicators.