Report on Banks

JUNE 2004

Central Bank of Argentina

Year I – No. 10

Contents

Note: This report contains information from June 2004 balance sheets available on 28/07/04. Description centers mainly on the behavior of the main financial variables for the private bank aggregate (including breakdowns by uniform sub-groups), except for certain variables that explicitly refer to public banks and the entire financial system. Figures provided (particularly in the case of profitability) are preliminary, and may be subject to change.

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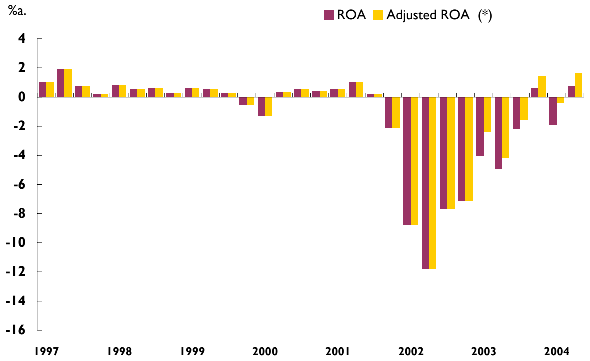
Summary

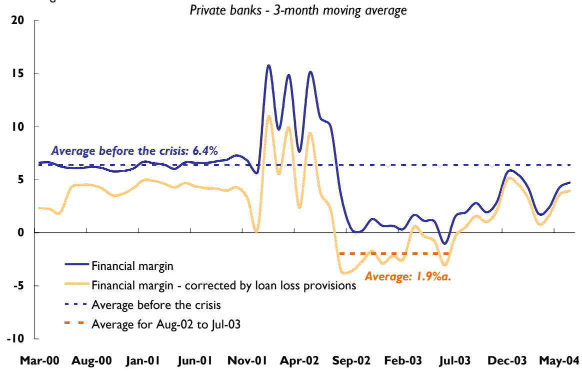
- For the second month in succession the financial system recorded a profit ($170 million) in June. Private banks recorded profits for $45 million, ending the quarter with an annualized (a.) profit of 0.3% of assets, compared to losses of 2.2%a. and 6%a. in the previous quarter and in the same period of 2003, respectively.
- Excluding the effect of the amortization of payments under court orders and adjustments to the valuation of public sector assets, private banks have recorded an accumulated profit in 2004 to date of $300 million, equivalent to 0.5%a. of assets. This is 0.2 percentage points (p.p.) of assets above the result recorded in the previous half, and close to pre-crisis levels.
- Out of a total of 61 private banks, 52 (85%) recorded a profit after adjustments in the second quarter of 2004. This was possible despite a negative impact from the downward adjustment to CER/CVS compensation made by several banks.
- June profits reflect both the consolidation of progress achieved in terms of financial margins (increased interest income, CER adjustment and results from the holding of financial assets) as well as income from services and increased sundry income.
- In June private bank financial margins remained at a high level (close to 4%a. of assets) compared to previous months. The sum of this spread and income from services amounted to 140% of operating costs for the month. In the second quarter of 2004 these costs were cut by an amount equivalent to 0.5 p.p. of assets, compared to the same period of 2003.
- The activity level of private banks continued to grow. The increase in lending has remained firm, with a rise of $1.2 billion in lending to the private sector in June which absorbed more than half the deposits gained during the month. The busiest lines were overdrafts and promissory notes.
- A strong increase in deposits – particularly those adjusted by CER – enabled private banks to more than offset the outflow of funds during May caused by the need to make income tax payments. Their liquidity ratio (liquid assets over total deposits) remained steady at 27.6%.
- The significant growth in CER-adjusted time deposits meant that between the end of April and the end of June the net asset position in CER-adjusted instruments for the private bank aggregate fell by over $700 million (-5%), reducing a source of volatility in financial institution's results.
- Private bank portfolio quality continued to improve: non-performance fell a further percentage point to 21%, for a total reduction of 16 p.p. since June 2003. Progress in June was driven by the commercial portfolio which, from a higher non-performance level (25%) than that of the consumer loan portfolio (14%), has been recovering at a faster rate. Private banks with a nationwide coverage have led this improvement.
- This gain in portfolio quality has led to an improvement in solvency ratios: the non-performing portfolio net of provisions stands at less than 4% of private bank net worth at the end of June 2004, 0.6 p.p. lower than a month earlier.

Chart 1
Annualized quarterly profit
Total system



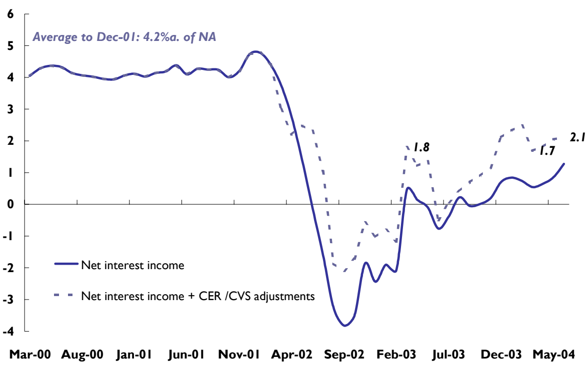
(*) Net of the amortization of court-ordered releases and adjustments to the valuation of public sector assets

Chart 2
Financial margin
Private banks - 3-month moving average



Financial margin: Interest income + CER/CVS adjustments + gains on securities + exchg. rate differences + other financial results.

Chart 3
Net interest income and CER/CVS adjustments
Private banks - 3month moving average



Profitability: *Positive results continue*

For the second month in succession, the financial system managed to show a profit in June. Posting a gain of almost $170 million, **the system as a whole accumulated a profit of close to $360 million in the second quarter of 2004**, 0.8% of assets in annualized terms (a.). The improvement is particularly evident compared to the previous quarter or to the same period of 2003, when losses were recorded for 1.9%a. and 5%a. of assets, respectively. Although for 2004 to date the accumulated result is still a loss of almost $500 million (-0.6%a. of assets), this value becomes a profit of a similar magnitude if it is adjusted to exclude the effect of the amortization of payments under court orders and adjustments to the valuation of public sector assets under the terms of Com. "A" 3911 (see Chart 1).

Private banks account for $45 million of the profit for June (0.5%a. of assets). This group has thus recorded a profit for the quarter of almost $76 million (0.3%a. of assets); this represents a marked improvement compared to the first quarter losses and those recorded in the same period of the previous year. Second quarter profits were able to offset some of the losses from previous periods, so that the accumulated total loss for the year has been reduced to $560 million (1%a. of assets). Excluding the amortization of payments under court orders and adjustments to the valuation of public sector assets, private banks obtained a profit of close to $300 million (0.5%a.). This is the second quarter (the first having been the last quarter of 2003) in which the adjusted profitability indicator has recorded a profit since the losses recorded as from the last quarter of 2001.

As analyzed in the May issue of this Report, the positive results in that month were largely due to two factors that had a significant impact on the financial margin[1]: gains from the revaluation of assets denominated in foreign currency (exchange rate differences) and results from the restructuring of the debt of one of the larger financial institutions. Nevertheless, **the fact that financial margin has been running at levels higher than those recorded at the beginning of the year, added to the sundry gains recorded in June, allowed private banks to record a profit for a second time.**

The financial margin in June was higher than the level recorded in the first four months of the year. This spread, which can be interpreted as the yield obtained on the total portfolio of yield-bearing assets (which together with income from services form the core of banking net income) reached 4.7%a. of assets, approaching pre-crisis levels (6.5%), a long way from the negative margin in the same quarter of 2003 (see Chart 2).

The recovery in financial margin has been due in part to increased interest and CER adjustment income, which together totaled 2.3%a. of assets[2] (2.1%a. in the second quarter, compared to 1.7%a. in the first, see Chart 3). In addition, the behavior of this spread in June

[1] Financial income less financial expense. Includes interest income, CER and CVS adjustment, gains from securities, exchange rate differences and other financial results. It excludes adjustments to the valuation of government securities (Com. "A" 3911).
[2] An increase in interest income was recorded, offset by a drop in CER accrual, but this change has been due to an accounting reclassification: one large bank corrected downwards its total interest payable, and increased CER adjustments due.

Chart 4
Operating costs
Private banks - 3 month-moving average

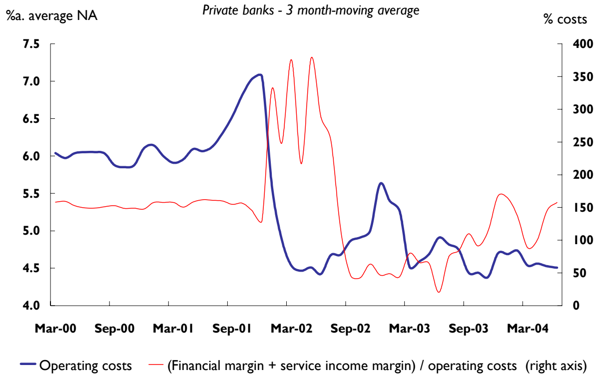


Chart 5
Loan loss provisions
Private banks - 3 month-moving average

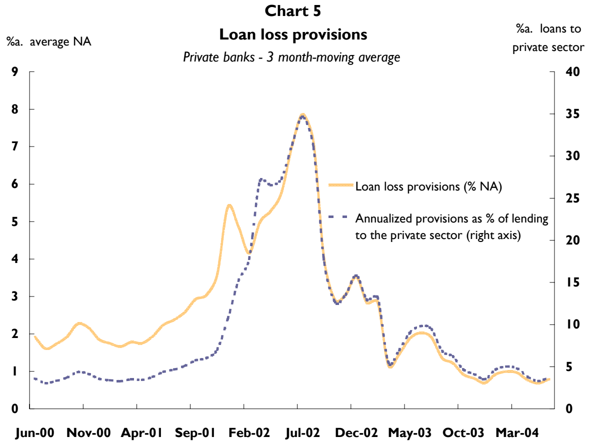


Table 1
Profitability by group
Annualized ROA in % - by type and area coverage

	Q2 2003	Q1 2004	Q2 2004	% share of NA (June)*
Public	-3.2	-1.4	1.4	*38.6*
Private	-6.0	-2.2	0.3	*60.6*
Retail	-6.4	-2.0	0.3	*57.9*
National coverage	-7.3	-2.7	-0.6	*46.2*
Regional coverage	-2.2	0.8	3.9	*11.2*
Specialized	-1.1	1.3	1.7	*0.5*
Wholesale	2.3	-6.4	-0.8	*2.7*
Non-bank institutions	-1.5	-2.0	6.3	*0.7*
TOTAL	-5.0	-1.9	0.8	*100*
TOTAL (**)	-4.2	-0.4	1.6	*100*

(*) Percentage share of total NA according to June figures.
(**) Net of the amortization of court-ordered releases and adjustments to the valuation of public sector assets (Com "A" 3911 and 4084).

recorded the effect of **an increase in gains from securities.** This heading rose by 0.5 percentage points (p.p.) compared to May, driven by income from government securities and the effect of a debt repurchase transaction. The persistence of a sounder income base was also made possible by **consolidation of the improvement achieved in income from services,** (which has remained at levels of close to 2.5%a. of assets, almost 0.5 p.p. above the level recorded a year earlier).

Nevertheless, **progress in terms of income was partly offset by increases in the cost structure. There was a seasonal increase of 8% in operating costs in June** (0.3 p.p of assets). Although there were increases because of higher payroll costs, fees and service charges and related taxes, operating costs in June were still 10% lower year-on-year. Despite this temporary increase, the ratio of coverage of operating costs by recurring income[3] ended at a level of close to 140% (the second highest in the first half, after the value in May). This notable recovery over recent months is shown on Chart 4, which displays the quarterly moving average of the ratio. **In addition, loan loss provisions increased by 0.4 p.p. to a level of slightly over 1%a. of assets. This movement has largely reflected the increased provisions made in relation to compensation for CER/CVS originally estimated and accounted as an asset.** The aggregate adjustment to compensation for CER/CVS in June has been estimated at 0.5%a. of assets. In recent months, several banks have revised their estimates of the compensation receivable downward under the regulations introduced by Law No. 25,796, with an impact on various income statement accounts (loan loss provisions, income from government securities and sundry losses). As shown on Chart 5, the level of loan loss provisions remains relatively low compared to the heavy provisions set up in recent years.

Lastly, **profit totals have also reflected the improvement in income from long-term investments, and – to a lesser extent – increased loan recovery.** These factors had a positive impact on the sundries heading[4], which in May had recorded non-recurring losses, mainly due to charges for other provisions made by one bank that recorded the results of its restructuring of liabilities in that month.

Comparing the quarterly development of the various sub-groups that make up the private bank aggregate shows that **while the improvement was widespread, significant differences persist.** The best performance was recorded by regional retail banks, with a rise of almost 3 p.p. in their ROA to a level of 3.9%a. (see Table 1). Specialized retail banks recorded lower growth, with a rising ROA at around 1.7%a. Although they did not record profits, retail banks with a nationwide coverage (the bank sub-group with the greatest weighting) succeeded in reducing their losses to almost one fifth of the level recorded in the first quarter of the year.

At the end of the second quarter of the year, public banks recorded a profit equivalent to 1.4%a. of assets, fully recovering the losses

[3] Financial margin and income from services.
[4] The table in the statistical exhibit shows the amortization of payments made under court orders as an item separate from sundry income, although according to the Central Bank's Financial Institution Accounting Manual (see www.bcra.gov.ar/pdfs/comytexord/manual.pdf) it forms part of this heading. If the sundry heading is taken to include the amortization of court-ordered payments (close to $100 million per month for private banks) the balance of the heading is almost nil as a share of assets in June.

Chart 6
Adjusted ROA for private banks
Net of the amortization of court-ordered releases and adjustments to the valuation of public sector assets

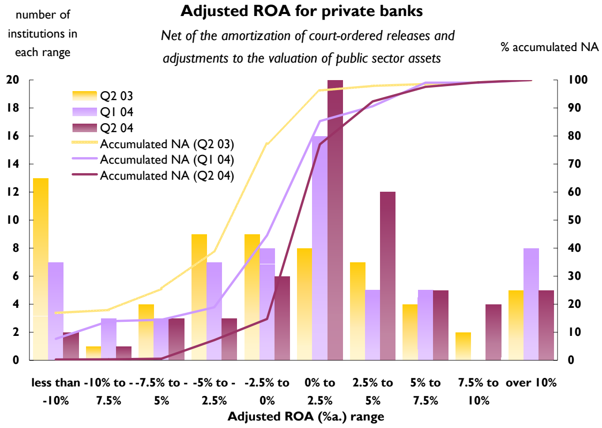


Chart 7
Netted assets and net worth
Private banks

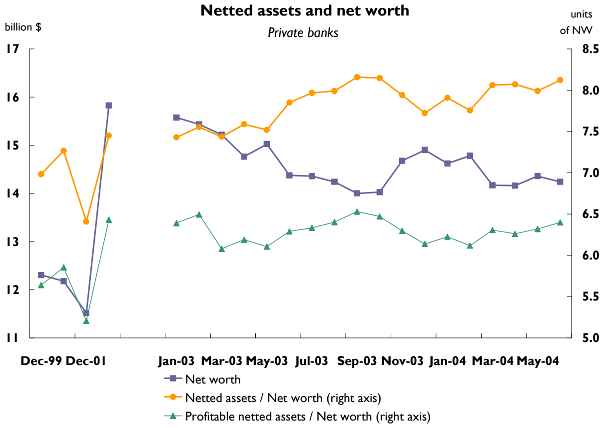


Table 2
Main developments in July

	Jun	Jul	Chg.%
Prices			
Exchange rate ($/US$)[1]	2.96	2.98	0.52
CPI	147.32	148.00	0.46
CER[1]	149.83	150.72	0.59
	%		Chg.(p.p.)
Average percentage rates			
Lending			
Private banks			
Overdraft	11.8	10.5	-1.3
Promissory notes	9.5	9.0	-0.5
Mortgage	9.9	10.1	0.3
Pledge-backed	11.0	12.5	1.5
Personal	30.9	32.5	1.6
Public banks			
Overdraft	18.1	16.9	-1.2
Promissory notes	11.8	11.4	-0.3
Mortgage	8.3	8.2	-0.1
Pledge-backed	14.7	13.6	-1.1
Personal	14.8	14.9	0.1
30- to 44-day time deposit	2.6	2.7	0.1
6-month LEBAC in pesos, w/o CER	6.2	6.9	0.6
	million $		Chg.%
Balance[1] - Private banks			
Peso deposits - Private sector	45,376	44,992	-0.8
Sight deposits	25,554	25,201	-1.4
Time deposits	17,529	17,671	0.8
Peso loans - Private sector	21,272	22,727	6.8
Overdraft	5,666	5,552	-2.0
Promissory notes	3,767	4,118	9.3
Mortgage	5,217	5,339	2.3
Pledge-backed	542	933	72.1
Personal	1,678	1,986	18.3

(1) End of month figure.

booked in the first quarter of the year. Improved financial margins were the main driver behind this change, supported by increased interest income and a rise in CER adjustments: the net position in instruments accruing CER is almost twice as large in terms of assets for public banks (close to 23% of assets) compared to private banks. In addition, public banks, like private banks, recorded gains on the revaluation of their assets and liabilities in foreign currency following changes in the exchange rate.

Taken individually, private banks display a disparity in performance. Chart 6 analyzes changes in quarterly adjusted profitability, comparing against the same quarter in 2003 and the first quarter of 2004. It can be seen how **the number of private banks recording losses has fallen over the period, so that 52 of 61 private banks recorded adjusted profits over the last quarter**. In addition, it can be noted that **whereas during the second quarter of 2003 banks with losses on an adjusted basis represented close to 80% of total private bank assets, towards the first quarter of 2004 this percentage fell to 45%, and in the following quarter it was close to 15%.**

As regards solvency, **private banks recorded a slight increase in their leverage ratio in June** [5] (see Chart 7). This growth resulted from a rise in assets in a context in which net worth dropped by $120 million. The change in net worth was a result of two contrasting effects: an increase from the profits for the month and a decline from adjustments for losses attributable to previous years. **In regulatory terms, the drop in net worth led to a fall of 0.5 p.p. for the month in the ratio of capital requirement compliance over risk-weighted assets, which fell to 15.4%, well above the minimum requirement.**

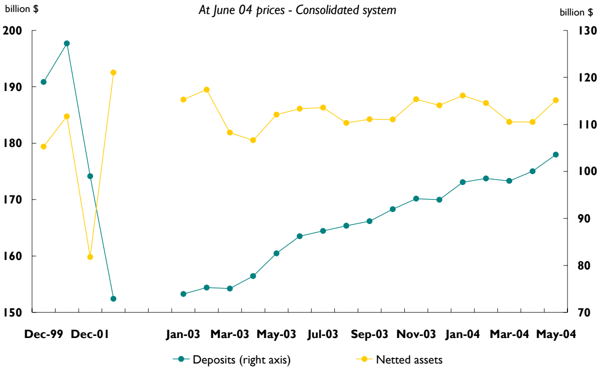
Outlook for July

It is likely that there will be further signs of a steady recovery in profitability in July. Given the increase that took place in loan totals in July[6] (see Table 2), and despite the slight decline in interest rates charged on certain lines (overdrafts and promissory note acceptances), it is expected that there will be an increase in interest income. Partially offsetting the latter, interest outlays are expected to rise, based on the slight increase in time deposit totals and the moderate increase from June to July in average interest rates paid. CER adjustments should record a slight fall, because this coefficient rose by just under 0.6% over the month, following two months during which the increase was close to 0.8%. Other reasons to support a positive outlook for profitability in July include the exchange rate, which went from 2.96 to 2.98 pesos per dollar over the month, which will imply the accrual of gains from the revaluation of the banks' net asset position in foreign-currency denominated instruments. A moderate drop is also expected in operating costs, after the seasonal rise that took place in June. Nevertheless, these gains may be offset by the effects of additional downward revisions of bookkeeping balances for compensation receivable (for the mismatched conversion of assets and liabilities into pesos and the application of CER/CVS).

[5] Defined as the quotient between netted assets and net worth.
[6] A significant increase in the stock of loans remains even after adjusting for changes of an accounting nature (see footnote 9).

Activity level: *lending increase remains firm*

Chart 8
Netted assets and deposits
At June 04 prices - Consolidated system



Banking sector activity levels again showed signs of growth in June, as netted assets recorded an increase of 2%. This increase was driven by loans to the private sector, which rose by 4% during the month, for a total annualized increase of 29% in the second quarter of 2004[7] (compared to 8% in the previous quarter). Deposits[8] grew 3%, with a significant rise for private banks. This more than offset the drop in such deposits in May, when liquidity requirements were higher to make income tax payments (see Chart 8).

An increase in private sector deposits was the main source of resources within the flow of funds of the private bank segment. Total deposits[9] increased by almost $2.0 billion, over $1.5 billion coming from the private sector (see Table 3). **Time deposits recorded their largest increase since September 2003: $750 million.** A significant portion was accounted for by CER-adjusted time deposits, which went up by $535 million. This behavior was not exclusive to private banks: public banks recorded an increase of more than 100% in the total for CER adjusted deposits.

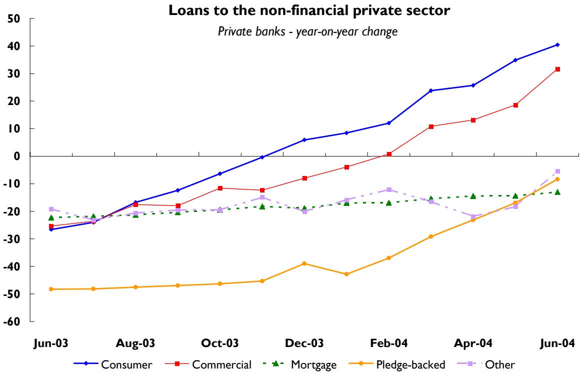
Table 3
Estimated sources and uses of funds
Private banks - June 2004
million pesos

Sources		Uses	
Private sector deposits (excluding CEDRO)	1,555	Loans to non-financial private sector	1,170
Public sector deposits (excluding CEDRO)	375	Liquid assets [1]	640
LEBAC stock (net of repos)	280	Reverse repos with the Central Bank	80
		CEDRO	295
		BCRA rediscounts	95
		Other	10

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

Private banks generated additional funds by disposing of LEBAC holdings for $280 million[10]. The stock of CER-adjusted bills in pesos held in bank portfolios rose by more than $200 million, while holdings of unadjusted bills declined. CER-adjusted LEBAC remained attractive to investors. In June there was an increase in the volume of bills issued through Central Bank auctions compared to the previous month, despite a drop in cut-off rates (in the first week of June the bills paid 1% on one-year deposits, while one month earlier the rate had been 1.3%).

Chart 9
Loans to the non-financial private sector
Private banks - year-on-year change



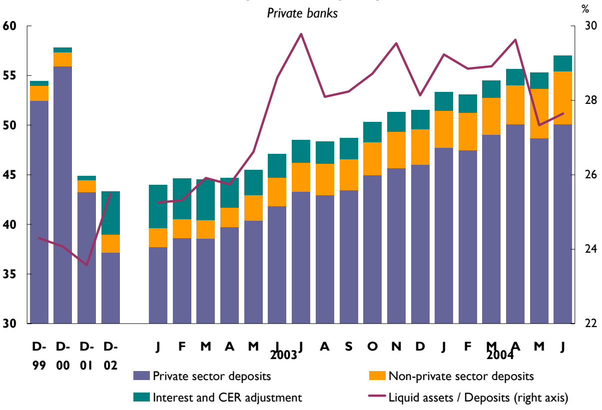
Over half the funds taken in by private banks were used to grant loans to the private sector, consolidating the trend towards increased lending seen in recent months. **In June, funds for $1.2 billion were allocated to this type of asset[11], with significant increases in commercial credit lines: current account overdrafts and promissory note acceptances** (see Chart 9). The estimation of the flow of funds for the month excludes the increase in balance sheet totals attributable to the redemption of financial trusts with private sector loan portfolios as underlying assets. Collateralized loans have performed in a manner similar to that of previous months: pledge-backed loans recorded positive flows for the fourth month in succession ($20 million in June), with the decline in mortgage loans shrinking gradually.

Private bank mortgage loan totals rose during the month, although the increase was largely due to the actions of banks that wound up trusts, as mentioned in the previous paragraph. If an adjustment is

[7] Excluding accrued interest and CER/CVS adjustment.
[8] Not including CEDRO.
[9] The calculation excludes unpaid accrued interest, CER adjustments, and changes in items in dollars as a result of exchange rate variations.
[10] Net of the increase in LEBAC holdings as a result banks' reverse repos with the Central Bank.
[11] In calculating monthly flows, adjustments to balances from CER and CVS, uncollected accrued interest and the effect of exchange rate variations on items in foreign currency have been excluded. Loans considered to be unrecoverable written off from balance sheets in the month under review have been added back.

made for this bookkeeping increase, mortgage loans failed to achieve a positive net flow for the private bank segment in June; repayment and settlement totals are still higher than the total for new loans granted. Nevertheless, **the number of banks recording an increase in their mortgage lending has continued to rise in June.** In the year to date, and especially in the last quarter, regional banks have been particularly active, and are the only sub-group to have recorded growth in the total for such lending.

Chart 10
Deposits and liquidity
Private banks

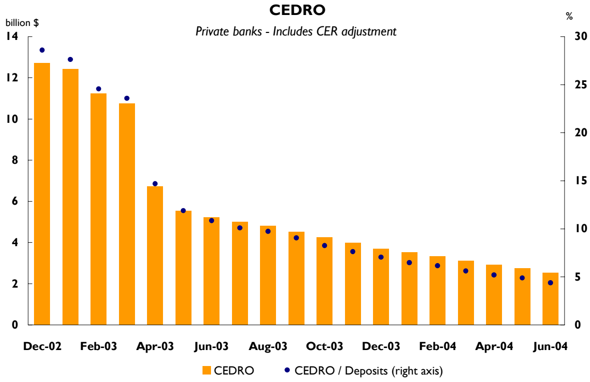


Funds taken in by private banks during June were also used to increase holdings of **liquid assets. A total of $640 million was used to purchase such assets, after a sharp drop in the previous month to meet the outflow of deposits as income tax payments became due.** This figure includes $80 million from the increase in reverse repos carried out by private banks with the Central Bank.

In the last week of May the Central Bank began to carry out repos using LEBAC as the underlying asset. Since then, banks have performed reverse repo transactions with the Central Bank, receiving LEBAC against the delivery of pesos, with a commitment to sell them back at a given price. In June the financial sector increased its participation in this market, ending the month with a balance of unsettled reverse repos with the Central Bank of just over $900 million, compared to $200 million at the end of May. **Almost $300 million out of the stock of repos with the Central Bank arose from transactions by private banks, an increase of $80 million during the month.** Private banks with a nationwide coverage were the most active in this field, accounting for over 60% of the repo transactions entered into by private banks during the month (both by value and number of operations).

Given the changes in liquid assets and total deposits, the liquidity ratio[12] for private banks remained relatively stable compared to May (27.6%), rising by only 0.3 p.p. (see Chart 10). Public banks, holding an almost 50% share of public sector deposits, record higher liquidity ratios. In June their ratio stood at 34%, with a decline for the month of 1 p.p.

Chart 11
CEDRO
Private banks - Includes CER adjustment



Private bank CEDRO totals continued to drop in June. A total of approximately $295 million was used to meet maturities of these certificates, as well as to settle the liabilities arising out of legal claims (this calculation includes CER adjustment and the exchange rate difference in the case of court-ordered payments). **These certificates account for only 4.4% of total deposits, having fallen by 2.7 p.p. in 2004 to date** (see Chart 11). The detail of the main uses of funds is completed by the payment of the fourth installment of the system implemented by the Central Bank for the repayment of the rediscounts it had granted to meet liquidity shortages. This payment required the use of $95 million by private banks in June.

[12] Defined here as the ratio between the stock of liquid assets (including repos with the Central Bank) and total deposits (including CEDRO).

CER-adjusted assets and liabilities: *fall in net position*

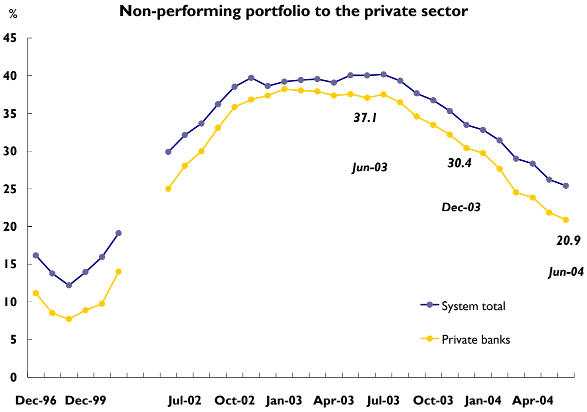
Table 4
Change in CER-adjusted balances
Private banks
million pesos

	QI 04	Q2 04	HI 04	May-Jun
1. LEBAC	575	245	820	105
2. Time deposits	300	1,155	1,455	965
3. BCRA rediscounts	-70	-200	-270	-130
Position (1-2-3)	**345**	**-710**	**-365**	**-730**

Following the conversion into pesos of certain foreign currency balances at the beginning of 2002, various assets and liabilities have been adjusted by the CER coefficient. **The gradual reduction in liabilities adjusted by CER** (mainly as a result of the early settlement of CEDRO) **means that the banking sector as a whole now records a significant asset position in instruments subject to adjustment.** In such a situation, bank net worth is exposed to changes in the real rate of interest.

As indicated in previous reports, during 2004 banks have recorded changes to their holdings of instruments subject to CER-adjustment. Private banks added $575 million in adjustable LEBAC to their portfolios in the first quarter. This rise in the balance of assets adjusted by CER was not matched by any similar increase in CER-adjusted liabilities, leading to an increase in the already significant net asset position in such instruments. This trend began to be reversed in the second quarter, and in particular in the last two months of the period. Although CER-adjusted LEBAC continued to increase in the portfolios of private banks between April and June, this increase was more than offset by increased funding through adjustable time deposits. Totals for such deposits grew at a faster rate in the last two months, in the context of real rates of interest of close to zero for these instruments: out of a total of $1.16 billion for the whole of the second quarter, almost $965 million were recorded in May and June (see Table 4).

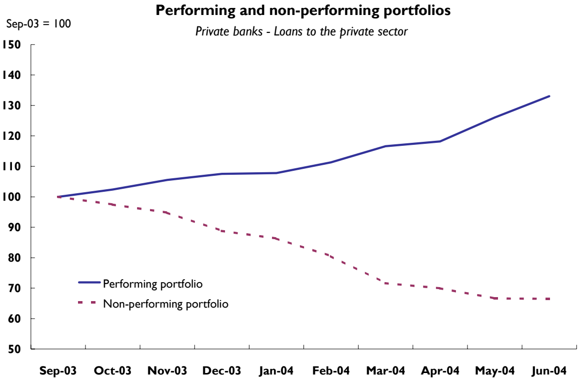
Chart 12
Non-performing portfolio to the private sector



As a result of this performance by adjustable assets and liabilities, **the net aggregate asset position in inflation-indexed instruments held by private banks fell by approximately $730 million in the last two months (equivalent to 5% of the position existing at the end of April 2004) and $365 million over the first half as a whole. With the cut-back in the indexing mismatch between assets and liabilities, a significant source of volatility in bank results has been reduced.**

Portfolio quality: *steady recovery*

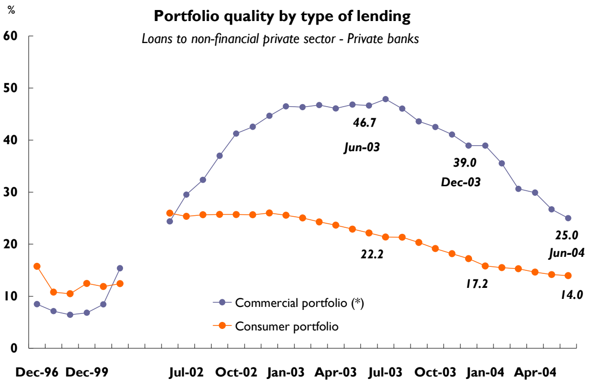
Chart 13
Performing and non-performing portfolios
Private banks - Loans to the private sector



The process of recovery by the financial system portfolio continued steadily in June, when **there was a drop of one additional point in the non-performance level of the private bank loan portfolio, to 20.9%** (see Chart 12). As a result, in 2004 to date the non-performing portfolio of loans to the private sector by this group of banks has fallen by 9.5 p.p. (the drop is 16 p.p. year-on-year). For the system as a whole, non-performing loan totals declined by 8 p.p. to a level of close to 25%.

As in May, **the improvement in the delinquency indicator for June** for private bank loans to the private sector **reflected the combined effect of an increase in total lending and a drop in the amount rated as non-performing** (Chart 13). **In both cases, the improvement was driven by the commercial portfolio, for which the level of non-performance fell almost 2 p.p.,** to 25% (see Chart 14). As a result, this segment with the greatest weighting (accounting for almost 60%

Chart 14
Portfolio quality by type of lending
Loans to non-financial private sector - Private banks



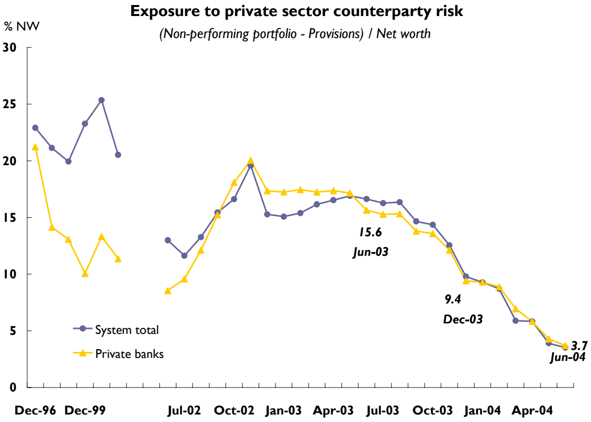
(*) Includes commercial portfolio up to $200,000.

Non-performing portfolio by group
As a % of non-financial private sector lending

	Dec-02	Dec-03	Mar-04	Jun-04	Share of lending to private sector(*)
Public	41.6	41.4	39.5	37.0	*29.0*
Private	37.4	30.4	24.5	20.9	*69.4*
Retail	37.5	30.3	24.5	20.9	*66.7*
National coverage	38.7	33.4	27.7	22.9	*50.5*
Regional coverage	27.6	15.8	12.3	14.5	*14.8*
Specialized	36.5	31.2	17.4	14.6	*1.3*
Wholesale	33.7	31.9	25.6	21.1	*2.7*
Non-bank institutions	36.5	16.3	18.0	12.1	*1.6*
TOTAL	**38.6**	**33.5**	**29.0**	**25.4**	*100.0*

(*) According to June figures.

Chart 15
Exposure to private sector counterparty risk
(Non-performing portfolio - Provisions) / Net worth



of the portfolio of loans to the private sector) has recovered by one third in the year to date (with a 14 p.p. drop in non-performance). It is expected that progress in this segment will cause a further drop in coming months. The ongoing process of corporate debt restructuring also suggests there will be further improvements in coming months.

The consumer lending portfolio (which is of higher quality) once again recorded a more moderate improvement in non-performance, with a drop of only 0.2 p.p. to 14%. The cumulative improvement in this segment in the first half of 2004 totals 3 p.p., a drop in non-performance of one fifth compared to the end of 2003. Although this progress may be more modest, non-performance levels are approaching the usual parameters for emerging economies (where non-performance indicators are of one digit) and this has made consumer lines particularly attractive to banks in terms of increasing their lending.

The end of the second quarter provides an opportunity to compare the improvements in portfolio quality recorded by the various sub-groups of banks. Table 5 shows that **the improvement was widespread**[13]**. The group that led the improvement was precisely the one with the greatest weighting, retail banks with a nationwide coverage.** Although this group of large private banks records the worst portfolio quality indicators among private banks (because of its larger role in the commercial sector, which was most affected by corporate default), it achieved a quarterly reduction in its non-performance levels of almost 5 p.p., better than all the other sub-groups.

Lastly, in June there was an additional reduction in the potential loss from private sector credit risk. **The indicator for loans net of provisions as a percentage of net worth ended the first half of 2004 at a level of 3.7%, less than half the rate at the end of last year.** This change has reflected the impact of a drop in the amount of the portfolio classified as non-performing and a certain increase in provisions, thus compensating for the slight decline in net worth (see Chart 15). As has been frequently explained in previous issues of this report, this indicator is at minimal levels compared to recent years, a result of both increased coverage by provisions and the fall in lending to the private sector as a percentage of net worth.

[13] From the table it can be seen that only private regional retail banks – which record the best levels of portfolio quality – have posted a slight quarterly increase. This does not represent a genuine deterioration, and is the result of the previously mentioned transfer from trust funds to the loan portfolio of an institution currently up for sale. If the ratio is adjusted to exclude this effect, portfolio quality also improves for this sub-group, dropping from 12.3% to 9.9%.

Latest regulations

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

Communication "A" 4150 – June/1/04
To determine the global net position in foreign currency the calculation should include forward transactions performed within a framework agreement in the context of self-regulated domestic markets, under the methodology of margin settlement without delivery of the underlying asset (non-deliverable forwards).

Communication "A" 4152 – June /2/04
This communication lifts the deferment on the distribution of earnings. Nevertheless, it is established that banks seeking to make such distributions should request prior authorization from the Superintendence of Financial and Exchange Institutions, once certain requirements have been complied with.

Communication "A" 4153 – June/10 /04
Banks are authorized to use certain cash holdings and/or securities to collateralize foreign lines of credit for the settlement of transactions through Euroclear and Cedel and futures, options and other derivatives transactions, for an amount of up to 5 percent of adjusted stockholders' equity. This communication also places futures, options and other derivatives transactions entered into with the Central Bank through official markets in Argentina within the limit mentioned above.

Communication "A" 4155 – June/18 /04
Mortgage Refinancing System established by Law 25,798. This communication defines the treatment to be granted to the provisions set up on loans eligible for assignment to the Mortgage Refinancing Trust set up by Law 25,798.
It also establishes the treatment to be give to the valuation of debt instruments received by financial institutions in the context of the mentioned refinancing system, which is similar to that granted to secured loans and other debt instruments of the non-financial public sector.

Notes on methodology

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

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

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

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

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

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

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

Glossary

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

Statistics

Balance sheet - Private banks

In current pesos (millions)	Dec 99	Dec 00	Dec 01	Dec 02	Jun 03	Dec 03	May 04	Jun 04	Change (%) Month on month	Change (%) Accum. 2004	Change (%) Year on year
Netted assets	**85,918**	**88,501**	**73,796**	**117,928**	**112,860**	**115,093**	**114,767**	**115,686**	**0.8**	**0.5**	**2.5**
Liquid assets	13,228	13,920	10,576	11,044	13,474	14,500	14,909	15,461	3.7	6.6	14.8
Public bonds	6,433	7,583	1,627	19,751	17,053	22,047	19,444	19,720	1.4	-10.6	15.6
Private bonds	410	563	451	273	179	172	188	211	12.2	22.7	18.3
Loans	56,916	56,035	52,319	51,774	50,362	47,230	50,188	51,792	3.2	9.7	2.8
Public sector	6,389	8,172	13,803	25,056	26,372	23,784	25,058	25,094	0.1	5.5	-4.8
Private sector	47,705	45,103	36,636	26,074	22,927	22,816	24,199	25,651	6.0	12.4	11.9
Financial sector	2,823	2,760	1,880	644	1,063	630	931	1,047	12.4	66.1	-1.5
Provisions over loans	-3,119	-3,248	-3,957	-7,463	-6,371	-5,223	-4,355	-4,483	2.9	-14.2	-29.6
Other netted credits due to financial intermediation	4,470	5,730	4,489	26,235	21,733	20,670	19,744	18,218	-7.7	-11.9	-16.2
Purchases (net)	487	1,103	807	380	337	698	539	479	-11.2	-31.4	41.8
Corporate bonds and subordinated debt	1,022	724	665	1,514	1,331	1,394	987	1,054	6.7	-24.4	-20.9
Unquoted trusts	958	1,609	1,637	6,205	4,993	3,573	3,221	2,510	-22.1	-29.7	-49.7
Compensation receivable	0	0	0	15,971	13,629	13,812	13,644	12,828	-6.0	-7.1	-5.9
BCRA	12	35	865	377	334	415	311	403	29.8	-2.8	20.8
Assets under financial leases	796	776	752	553	495	387	415	438	5.7	13.3	-11.4
Shares and participation	1,371	1,651	1,703	3,123	3,211	2,791	1,504	1,524	1.3	-45.4	-52.6
Fixed assets and sundry	3,246	3,225	3,150	5,198	4,944	4,902	4,873	4,863	-0.2	-0.8	-1.6
Foreign branches	48	75	112	-109	-102	-136	-66	-71	6.8	-48.1	-30.4
Other assets	2,120	2,190	2,574	7,549	7,883	7,753	7,924	8,013	1.1	3.3	1.6
Netted liabilities	**73,615**	**76,322**	**62,281**	**102,101**	**98,484**	**100,192**	**100,406**	**101,446**	**1.0**	**1.3**	**3.0**
Deposits	54,447	57,833	44,863	44,445	48,169	52,625	56,126	57,717	2.8	9.7	19.8
Public sector (1)	1,342	1,276	950	1,636	2,594	3,077	4,739	5,113	7.9	66.2	97.1
Private sector (1)	52,460	55,917	43,270	38,289	42,953	47,097	49,503	50,821	2.7	7.9	18.3
Current account	5,022	4,960	7,158	8,905	8,653	11,588	12,837	12,754	-0.6	10.1	47.4
Savings account	9,702	9,409	14,757	6,309	7,360	10,547	12,553	13,411	6.8	27.1	82.2
Time deposit	35,218	39,030	18,012	11,083	20,068	18,710	18,430	19,177	4.1	2.5	-4.4
CEDRO	0	0	0	9,016	3,501	2,409	1,698	1,544	-9.1	-35.9	-55.9
Other netted liabilities due to financial intermediation	16,185	15,401	14,082	48,364	43,682	40,825	37,975	37,767	-0.5	-7.5	-13.5
Call money	2,146	2,293	1,514	836	1,191	726	1,046	1,155	10.4	59.1	-3.0
BCRA lines	274	83	1,758	16,624	16,913	17,030	16,499	15,945	-3.4	-6.4	-5.7
Outstanding bonds	4,990	4,939	3,703	9,073	6,962	6,674	8,097	8,036	-0.7	20.4	15.4
Foreign lines of credit	6,680	5,491	4,644	15,434	12,485	9,998	6,736	6,854	1.7	-31.4	-45.1
Sales (net)	492	510	99	349	220	168	179	76	-57.8	-55.1	-65.7
Subordinated debts	1,683	1,668	1,700	3,622	3,006	1,850	1,906	1,669	-12.5	-9.8	-44.5
Other liabilities	1,299	1,420	1,637	5,671	3,626	4,891	4,400	4,293	-2.4	-12.2	18.4
Net worth	**12,304**	**12,178**	**11,515**	**15,827**	**14,377**	**14,902**	**14,361**	**14,240**	**-0.8**	**-4.4**	**-0.9**

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

Profitability structure - Private banks

Private banks - in annualized terms

As % of	Anual					First 6 months		Monthly						Last
netted assets	1999	2000	2001	2002	2003	2003	2004	Jan-04	Feb-04	Mar-04	Apr-04	May-04	Jun-04	6 months
Margen financiero	6.1	6.2	6.4	7.6	2.3	0.3	3.3	1.2	1.7	2.6	2.8	7.3	4.1	3.3
Net interest income	4.5	4.1	4.3	-0.2	0.1	-0.1	0.9	0.4	0.4	0.8	0.7	1.0	2.1	0.9
Restatement by CER and CVS	0.0	0.0	0.0	1.1	0.9	0.8	1.0	1.0	1.2	1.3	1.0	1.3	0.2	1.0
Gains on securities	1.1	1.4	1.2	2.5	1.7	1.3	0.8	-0.5	0.0	1.2	1.1	1.4	1.9	0.8
Foreign exchange price adjustments	0.3	0.2	0.3	4.4	-0.3	-1.5	0.8	0.6	0.2	-0.6	0.1	3.8	0.6	0.8
Other financial income	0.3	0.5	0.7	-0.1	-0.2	-0.2	-0.3	-0.3	-0.2	-0.1	-0.2	-0.2	-0.6	-0.3
Service income margin	3.1	2.9	3.2	2.0	2.0	2.0	2.3	2.2	2.0	2.4	2.3	2.4	2.4	2.3
Loan loss provisions	-2.2	-2.5	-3.0	-5.0	-1.3	-1.6	-0.9	-1.2	-1.0	-0.7	-0.6	-0.7	-1.1	-0.9
Operating costs	-6.3	-6.0	-6.4	-4.8	-4.6	-4.7	-4.5	-4.4	-4.5	-4.7	-4.5	-4.4	-4.7	-4.5
Tax charges	-0.4	-0.4	-0.5	-0.4	-0.3	-0.3	-0.3	-0.3	-0.4	-0.3	-0.3	-0.4	-0.3	-0.3
Income tax	-0.5	-0.4	-0.3	-0.2	-0.3	-0.4	-0.4	0.0	0.0	-2.0	-0.2	0.0	-0.1	-0.4
Adjustments to the valuation of government securities (*)	0.0	0.0	0.0	0.0	-0.6	-1.2	-0.1	-0.7	-0.1	0.0	0.0	-0.1	0.1	-0.1
Amortization payments for court-ordered releases	0.0	0.0	0.0	0.0	-0.7	-0.6	-0.9	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0	-0.9
Other	0.5	0.4	0.7	-3.0	1.0	2.0	0.7	1.0	1.7	1.6	0.0	-1.4	1.1	0.7
Monetary results	0.0	0.0	0.0	-7.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ROA before income tax	0.8	0.6	0.5	-11.1	-2.2	-4.1	-0.6	-3.0	-1.4	-0.1	-1.3	1.8	0.5	-0.6
ROA before monetary results	0.3	0.1	0.2	-3.8	-2.4	-4.4	-1.0	-3.1	-1.4	-2.2	-1.4	1.8	0.5	-1.0
ROA	0.3	0.1	0.2	-11.3	-2.5	-4.5	-1.0	-3.1	-1.4	-2.2	-1.4	1.8	0.5	-1.0
ROA adjusted (**)	0.3	0.1	0.2	-11.3	-1.2	-2.7	0.5	0.5	-0.1	-1.3	-0.5	2.8	1.4	0.5
Indicators (%)														
ROE	**2.3**	**0.8**	**1.4**	**-79.0**	**-19.1**	**-33.8**	**-7.8**	**-24.5**	**-10.9**	**-17.5**	**-11.6**	**14.1**	**3.7**	**-7.8**
Margen financiero + service income margin / Operating costs	146.0	151.9	150.9	199.3	93.8	49.1	123.0	77.1	83.0	105.2	113.4	222.1	138.9	123.0
Interest income (with CER and CVS) / loans	..	13.9	16.1	24.7	9.0	9.8	10.4	7.7	8.3	8.2	7.9	9.6	10.1	10.4
Interest payments (with CER and CVS) / deposits	..	5.7	7.8	21.9	5.8	8.6	2.7	2.4	2.1	1.7	2.1	2.5	2.6	2.7

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

(*) Com. "A" 3911. Adjustments to the valuation of government securities according to Com. "A" 4084 are included under the "gains from securities" heading.

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

Portfolio quality - Private banks

As percentages	Dic 99	Dic 00	Dic 01	Dic 02	Dic 03	Ene 04	Feb 04	Mar 04	Abr 04	May 04	Jun 04
Non-performing loans (overall)(1)	7.6	8.3	9.9	19.8	15.7	15.4	14.4	12.5	12.2	11.5	11.2
Non-performing loans to the non-financial private sector	8.9	9.8	14.0	37.4	30.4	29.7	27.7	24.5	23.8	21.8	20.9
Commercial portfolio	6.2	7.6	15.2	44.5	39.9	39.9	36.4	31.1	30.4	27.0	25.0
Commercial portfolio up to $200,000	11.7	14.6	16.4	46.4	26.8	26.5	24.8	24.8	23.4	22.3	24.9
Consumption and housing portfolio	12.5	11.9	12.4	26.0	17.2	15.8	15.5	15.3	14.6	14.2	14.0
Provisions / Non-performing loans	72.2	67.7	75.8	74.8	81.8	81.9	81.2	84.2	86.4	89.4	90.8
(Non-performing - Provisions) / Overall financing	2.5	3.2	3.4	9.4	5.5	5.4	5.2	3.9	3.2	2.3	1.9
(Non-performing - Provisions) / Net worth	10.1	13.3	11.4	17.4	9.4	9.3	8.9	6.9	5.8	4.3	3.7

(1) As a percentage of each lending category.