MONTHLY
REPORT

ECONVIEWS
ECONOMÍA Y FINANZAS

March 2023
Issue #225

Washington… **we have some problems**

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A **banking system** focused on lending to the **government**

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THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- Despite the banking crisis sparked by Silicon Valley Bank's failure, the Federal Reserve hiked 25 bps to 5% in March, citing worries on inflation and a strong labor market. Core CPI accelerated for the third straight month in February and new nonfarm payrolls came in at 311,000, 50% above expectations.
- Argentine monthly inflation surprised at 6.6% in February, well above even the more negative market estimates, with food and beverage prices up 10%. The year-on-year variation reached 102.5%, finally breaching the three-digit mark.
- After February's CPI print, the Central Bank half-heartedly raised its policy rate from 75 to 78%, but left the overnight repo rates unchanged at 72%, more of a bet to rein in the parallel FX rates than lower inflation. However, the BCS rose 3% to ARS 405 in the following days. In the last days it lowered to ARS 397.
- With a tough international climate, sovereign dollar bonds fell another 12% in the last month and country risk shot up 280 bps to 2,458. Yields on peso debt are highly unstable, with an 8 point spread between 2023 and 2024 inflation adjusted bonds reflecting market fears of a new reprofiling or default.
- The Treasury reported an ARS 228 billion primary deficit in February and accumulated 432 billion or 0.3% of GDP in two months, the highest in the last decades and already 14% of the 1.9% IMF target for the full year.

FIGURE OF THE MONTH

Monthly core inflation was

7.7%

in February, the highest mark in over 20 years.

TO BE ALERT

Argentina is expected to lose around USD

22bn

in agricultural exports due to the drought.

WHAT'S COMING NEXT?

- Despite Fed Chair Powell's commitment to higher rates, markets are still betting that he will be forced to cut them to 4.25% by December and 3% in late 2024, pushed by the banking crisis and weakening activity.
- March was hotter and drier than expected and the BCBA cut its harvest estimates for corn and soybeans to 36 and 25 million tons, with expected export losses of USD 22 billion. This is the worst drought in the last 50 years and will hurt activity, inflation, and the FX rate.
- The Central Bank keeps losing reserves at an alarming pace: it sold USD 1.1 billion in January and February and 1.7 billion in March alone, with net reserves slipping to around 1.1 billion. The official exchange rate is depreciating at 105% annualized, and a few weeks ago there were rumors of an exchange rate decoupling.
- After the ARS 4.3 trillion debt swap of maturities between March and June, the Treasury will likely focus on Q3's ARS 8.9 trillion maturities, though a high proportion already in public sector hands, and attempt to swap them for 2024 and 2025 bonds.
- On March 17th, the Central Bank transferred ARS 130 billion to the Treasury, after a brief hiatus in monetary assistance. We believe this source of financing could reach 4% of GDP in 2023, well above the IMF target of 0.6% of GDP, as the drought also means less tax revenues.

SUMMARY OF MAIN INDICATORS

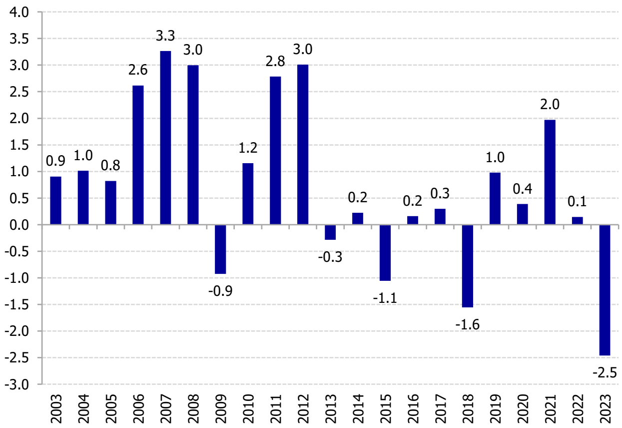
	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	-1.0%	-0.7%	Inflation (monthly)	6.6%	6.0%
Consumer confidence (MoM)	-6.1%	7.3%	FX spread (21day avg.)	91.8%	94.4%
Industrial activity (MoM s.a.)	0.7%	-1.2%	Country risk (bps 21day avg.)	2,164	1,905
International accounts			**External data**		
Current Account (USD BN)	-3.03	-0.83	Soybean price (per ton, 21day avg.)	557.3	558.9
CB Reserves (USD BN 21day avg.)	38.60	41.48	Brazilian activity (MoM s.a.)	0.3%	-0.8%
Primary balance (ARS BN)	-228.13	-203.94	Financial Conditions Index	21.2	16.5

Source: Econviews base on multiple sources - Based on working days only

GRAPH OF THE MONTH:

The Central Bank is losing reserves at a record pace

In billion USD - Accumulated net purchases up to the 22nd of March



Source: Econviews based on BCRA

FEB 23rd	MAR 7th	MAR 9th	MAR 10th	MAR 13th	MAR 22nd	MAR 23rd
Econviews Monthly #224: politics and economy, the two-way highway + special report on ESG.	Government announces **new preferential "Malbec dollar" for wine exports** after soybeans, signals to regional goods.	Treasury goes through with **peso-debt swap,** extending maturities for ARS 4.3 trillion in Q2, mostly in public sector hands.	**Silicon Valley Bank failure sparks panic in world markets**: bank stocks fall nearly 10% during the next week.	Due to impact of drought, **IMF announces a readjustment of 2023 reserves target**, but not the monetary or fiscal ones.	To face lack of dollars, **Minister Massa instructs Treasury to buy USD bonds from govt agencies**, to sell at 25-50% market rates.	**Econviews Monthly #225**

POLITICS

Presidential ambitions of Minister Massa start to dissipate as the economy is not going well. 3 decades-record inflation, meager net international reserves, and energy shortages complicate Massa's position. VP Cristina Kirchner spoke out in a conference about her situation and argued that she will not compete in elections due to her ban by the Justice, but actually, nothing prevents her from competing. Opposition leader Mauricio Macri also announced he will not compete for Juntos por el Cambio; Horacio Rodríguez Larreta and Patricia Bullrich are now the main contenders for the main opposition party. June is the deadline to enroll in the lists and there is still uncertainty about who will be the candidates.

IMF

The government and IMF technical staff reached an agreement on the fourth revision. After the approval of the IMF´s board, the country will receive roughly USD 5.3 billion. The press release included some clues about the next economic policy decisions. On the fiscal front, subsidies to high-income households will be eliminated and capital expenditures controlled. Regarding the FX policy, it will be forbidden to use international reserves to reduce market exchange rates. The country was also asked to make more rational its FX policy. Finally, due to the drought, there will be a modification in the net international reserves accumulation target. Currently, we are well below the objective, and it is impossible to be met.

ECONOMIC ACTIVITY

The economy grew 5.2% in 2022, most of it explained by the statistical carryover that left 2021. Regarding the components of the aggregate demand, investment was that of a higher increase (10.9% y/y), followed by private consumption (9.4%). Exports increased by 5.8% and public consumption by 1.8%. From the supply side Hotels and restaurants had the best performance growing 35% while Agriculture and livestock appear at the bottom of the list with a fall of 4.1%. Due to the worsening of the drought and all the spillovers of that on sectors such as transport, fuel, and consumption, we reduced our forecast for the GDP to -4.5% for 2023.

INFLATION

Well above all forecasts, February inflation was 6.6% and annual variation was 102.5%. That is the highest mark since 1990. Only in the first two months of the year, it has accumulated 13.1%. Another worrisome figure was that core inflation printed 7.7%. Seasonal prices only increased by 3.3% and regulated prices by 5.1%. The key was in Foods and Beverages which grew 9.8% and contributed 2.8 p.p. to the headline inflation. Inside this item, the most important increase was seen in beef. We think that without confidence, more money printing, scarce reserves, and probably utility tariff increases it is very unlikely that inflation decelerates. In this way, we increased our forecast for 2023 to 115%.

MONETARY SECTOR

The Central Bank increased again the monetary policy rate which now stands at 78% APR or 113.31% effective. We think that the aim of this hike is not to reduce inflation but avoid an increase in market exchange rates. This decision will not be costless as remunerated liabilities will pay additional interest for around ARS 500 billion this year. According to our estimates, the stock of Leliqs and Repos will be ARS 27.2 trillion at the end of 2023. The drainage of reserves continues and the BCRA lost USD 2,643 million in the first three months of the year. Net reserves are only USD 1.1 billion. With the next IMF disbursement, they will grow but it will be temporary.

FISCAL ACCOUNTS

The primary deficit of the first two months of the year was worse than expected and it already accumulates 0.27% of GDP. With this result, the target set in the IMF program for the first quarter is impossible to be met. In February, total revenues contracted 8.3% y/y in real terms. Export and import duties fell 72.8% and 36.3% respectively. The anticipation of exports in December due to the soybean dollar is the main driver of this decrease. Primary expenditures decreased by 3.7% in real terms, most of it explained by the contraction of 6% of social expenditures. With a smaller GDP and lower revenues (due to the drought and lower activity) we expect a primary deficit of 3.6% for 2023.

I. Washington… we have some problems

Events are taking place at high speed. The severe drought, probably the worst in six decades, is creating new challenges for economic policies. Exports are likely to drop by over USD 20 billion and it remains unclear how the Central Bank will manage a drastic shortage of dollars. But the story does not end there. The Treasury is losing much needed tax revenues and the primary deficit is now likely to widen to 3.6% of GDP, well above the 1.9% of GDP target that is in the IMF program. In addition, the drought is making the recession worse, and now we estimate that the economy will contract around 4.5% this year after growing 5.2% in 2022.

The challenges have reached new, more complex levels. One key issue is to figure out how can the Central Bank survive with reserves that amount to less than one week of imports, which immediately leads to questions regarding what might happen to the exchange rate. But there are also questions about inflation, which has been creeping up in an environment in which the Central Bank's priority seems to be on reserves and the exchange rate front. There are also concerns about the ability of the government to rollover domestic debt, though in most scenarios and to the extent that the FX restrictions remain in pace, it should not face major problems to manage it.

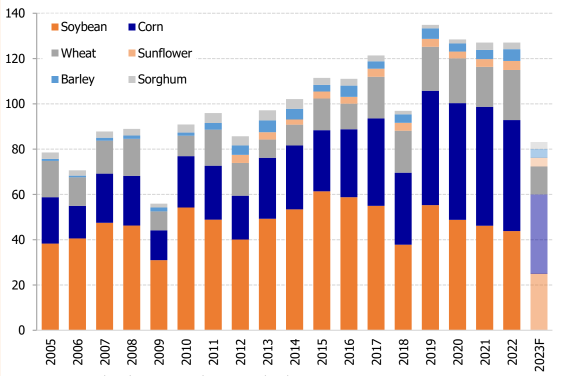
The drought has brought to the surface in a clearer way the vulnerabilities of the economy. It has increased the risk of an event that could be a step devaluation or something similar prior to the elections or an acceleration of inflation, that perhaps could go up one step higher, or even a domestic credit event.

There are also questions on the political front, where the frustration with high inflation, the difficulties to stabilize the parallel exchange rate and the deepening of the recession are creating havoc in the government coalition, especially because the elections are around the corner. The risks are threefold. Would there be a split of the government coalition? Would that affect the ability to govern during the election period? Would a decision of Minister Sergio Massa to slam the door generate greater uncertainty in an economy that is extremely fragile?

Much of the discussion within the governing coalition is about the IMF program, despite the fact that the Fund has been a dove rather than a hawk and that the limited adjustment that there has been taking place in the fiscal accounts is mainly because there is no access to new financing. There is little chance to increase expenditures in the current environment without rapidly facing a sharp rise in inflation, while the lack of reserves is an obstacle to an increase in economic activity.

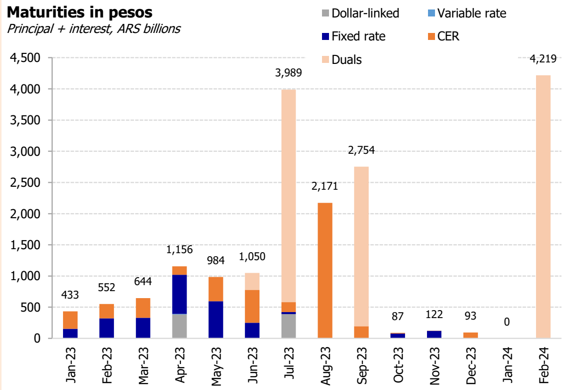
It is important to recognize these risks, especially because the government cannot figure a way out of the constraint imposed by the low level of reserves. A devaluation is the obvious answer, though it is unlikely to happen because of the adamant opposition of Alberto Fernandez and Cristina Kirchner which is based on ideology rather than economics.

Harvest forecast
Production, in metric tons



Source: Econviews based on MAGyP and Bs As Cereal Exchange

Maturities in pesos
Principal + interest, ARS billions



*Maturities of dollar-linked and dual bonds adjusted by FX forecast, CER bonds and bills adjusted by projected inflation.
Source: Econviews based on Min. of Economy

Net and Liquid International Reserves

In billion USD

Gross reserves	**37.6**
Reserve requirements in USD	12.6
Swaps (incl. China)	20.8
SDRs	0.0
BIS	3.0
Net reserves	**1.1**
Gold	3.8
Liquid net reserves	**-2.7**

Source: Own estimates based on BCRA and IMF
Up to Mar-23

Markets are becoming nervous about the risks especially about the pressures on the parallel exchange rates. The authorities are becoming frustrated and concerned and are searching for ways to control the exchange rate with no dollars, an almost impossible task. Unfortunately, there is always some creativity in the search for alternative policies, even if they rarely work and many times generate collateral damage. In this case the idea is to use government bonds (that the Treasury does not have but that are held by ANSES and other public entities) to control de BCS exchange rate, though we believe that in this case they do not have the ammunition to deal with the situation and could even backfire.

The Central Bank is opposed to a formal split of the foreign exchange market which could be a transitory way out until there is a more comprehensive solution, probably implemented by a new government. The furthest the Central Bank is ready to go is to have a special exchange rate for soybean, where third season of the soybean dollar seems all but unavoidable. Of course, effectively there are already multiple exchange rates, though the Central Bank argues that there is only one exchange rate because they are generated by imposing additional taxes for certain transactions such as tourism or cultural events, which have creative names such as dollar Qatar or dollar Coldplay. All these partial measures have proven ineffective to control the drop in reserves.

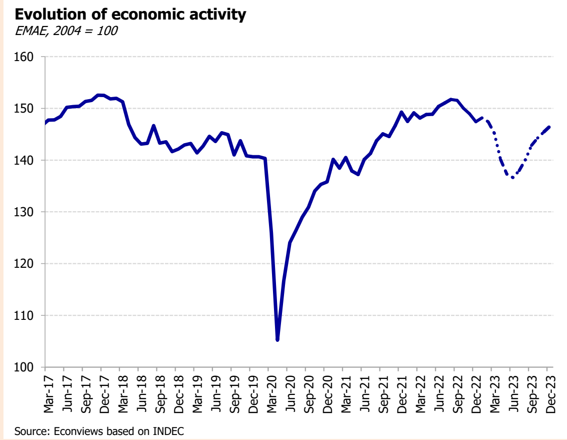
The underlying problem has always been the overvaluation of the currency and the large spread between the official and the parallel exchange rates. The government is concerned about the evolution of the parallel exchange rates and the FX spread, however, without dollars it is difficult to intervene in the market.

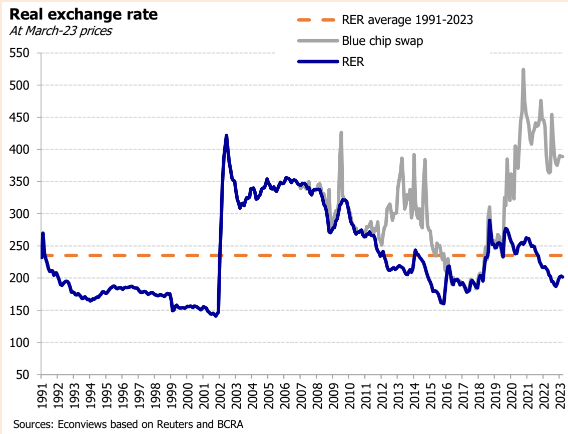
Last week the government announced that it would force public sector entities like ANSES (social security) and other agencies to sell the dollar denominated bonds issued under domestic legislation (Bonares). They would have to use the proceeds to buy newly issued Treasury bonds that would be denominated in pesos and adjusted based either on inflation or on the exchange rate (dollar link), whichever is higher. The announcement disoriented the markets because it was unclear the purpose as well as the implications it might have.

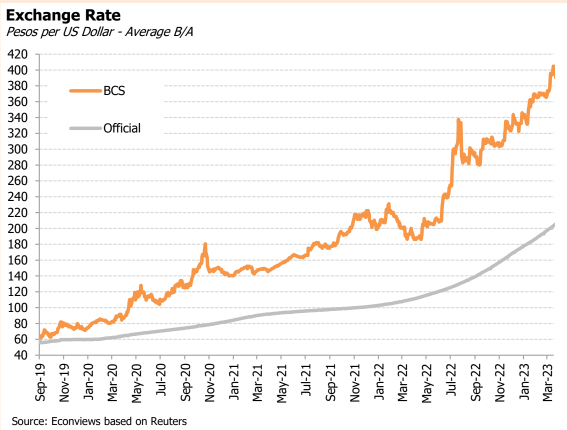
It now seems clear that the government wants to have an instrument to intervene in the blue-chip-swap market. **Unfortunately, we believe that in the way it is structured will not work, while it will have some negative side effects**. The Treasury wants to coordinate the sale of the dollar denominated bonds with the purpose of setting the price in pesos of the instruments, which is not enough to control de BCS. In order to achieve the objective (as is explained in the technical note below), they would need a second tranche, namely to buy the bonds in the market using dollars (which the Central Bank does not have).

The transaction has other problems

1. The public sector would sell dollar bonds that are now are now part of its holding (though not of the Treasury) thus increasing the stock of debt held by the private sector (typically referred to net debt)







2. The sale of these bonds amounts to issuing new debt (or borrowing) at rates that range between 28% and 48% depending on whether it sell bonds that mature in 2035 or 2030.

The drought, the shortage of reserves, the higher rates of inflation, the political tension within the administration are complicating the transition on the way to the elections. The bottom line is that the economic scenario has become more uncertain, and we cannot rule out higher rates of inflation or new desperate measures to increase reserves or to control the exchange rate. However, if the outcome in the end is that this administration will have to effect the devaluation, even if it is disguised through multiple exchange rates, it could help the next government by having done one of the politically costly policy measures.

Technical note How is the BCS determined in the market

How is the BCS exchange rate determined in the market? The basic idea is that someone who wants to buy BCS first buys a dollar denominated bond (under foreign or domestic legislation) with pesos that are trapped in Argentina. Then she or he sells the bond and obtains dollars either abroad (this is the BCS) or in in Argentina (the so-called dollar MEP). In some occasion the Central Bank intervened in this market by selling bonds against pesos and then buying the bonds against dollars. The intervention did work because the Central Bank was on both sides of the trade. In fact, the bonds were just a vehicle to set the BCS exchange rate, because the fundamental element was that the Central Bank sold dollars and got pesos (a process that led to a loss in reserves). The difference was that instead of doing it directly in a traditional FX market, it did it in two steps. If the transactions could be done instantaneous (say the individual buys the bonds with pesos and immediately sell it against dollars with no change in the parity of the bonds) the price of the bond would be irrelevant. The exchange rate in the BCS, as any FX market, it the ratio between pesos and dollars of the transaction, and it is independent of the price at which the bond trades in the market.

In the past the government tried to put sand in the wheel by forcing the buyers of BCS to first buy the bond and then having to "park" it for two or three days before being allowed to sell it. The objective of the parking was to introduce some risk in the transaction because the price of the bond could change during the parking period and hence there would not be uncertainty about the actual BCS that one would get (which would not happen if the transaction were done immediately).

The transaction that the government seems to have in mind now is to sell dollar bonds against pesos, which in effect could stabilize the price of bonds in pesos (the first tranche). However, it will not be enough to stabilize the BCS because it does not have the second tranche (i.e., the sale of the bond against dollars). As a result, independently of the amount of bonds that they have they do not have the ability of setting the BCS exchange rate. It can at best set the price of the bond in pesos and affect the parity of the bond that it uses to intervene, which does not amount to fixing the BCS.

II. A banking system focused on lending to the government

The Argentine financial system, made of 63 banks and 14 non-bank financial companies, had profits for ARS 631 billion in 2022, the second best year since 2010. At market rates profits represented USD less than 2 billion. Paradoxically, high profits come at a time when the banks' core business is shrinking. Credit to the private sector is a mere 9% of GDP, an all-time low and the smallest of a list of 43 countries listed in the BIS ranking. Profits rose by 57% for the entire sector, but just 9% for private banks in 2022.

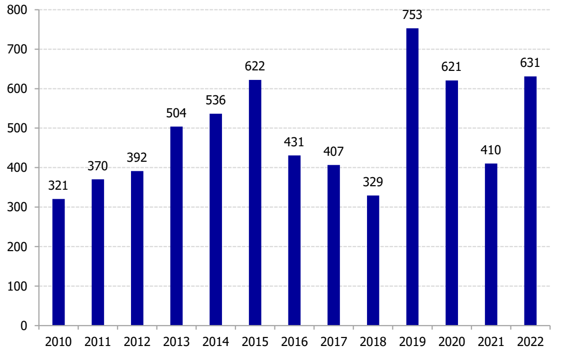
There have two main reasons to explain the better bottom line.

- **NPLs have been extremely low throughout the year**. Inflation has reduced debt to income ratios for most borrowers, which in turn has made the payment of loans easier. Bad loans are just 3.09% of total loans in the system, but substantially less in private institutions: 2.08% for local banks and 1.44% in foreign banks. NPLs in public banks are much higher at 5.16%, but a substantial decrease from the end of 2021 (6.59%). Total losses for delinquency have decreased by 12.6% in 2022 reaching ARS 266 billion in constant money. However, prospects are less bright for the short term. NPL ratios increased in December and January and given that we expect a recession with a fall of GDP of at least 4 points in 2023, the situation will get worse even with low credit penetration. Still, nobody thinks it will be dramatic, since the average borrower is far from being a risky firm or household.

- **Inflation is a great ally of banking profits**. Around 50% of the banks deposits are sight deposits, which means clients receive almost 0% for their money while banks place those pesos at overnight accounts that pay 72% of nominal interest rate, over 100% of effective rate. This is clearly seen when splitting the system by type of banks. Public banks earned ARS 290 billion. Locally owned private banks cashed 160 billion and foreign owned banks made 191 billion. Non-banks lost 19 billion. They do not take deposits and therefore cannot make the easy profit of passing on the free money to the Central Bank.

Financial System's Total Result

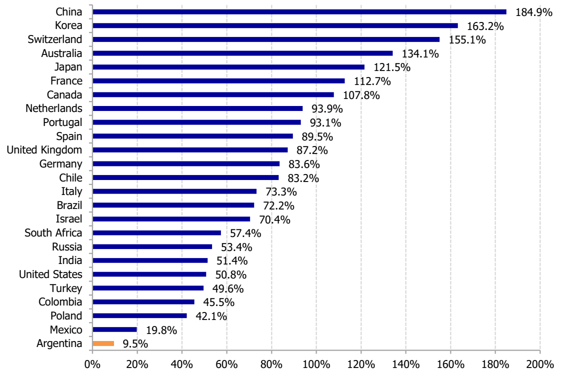
Accumulated of the year - In billion ARS of Dec-22



Note: 2010-19 own estimates
Source: Econviews based on BCRA

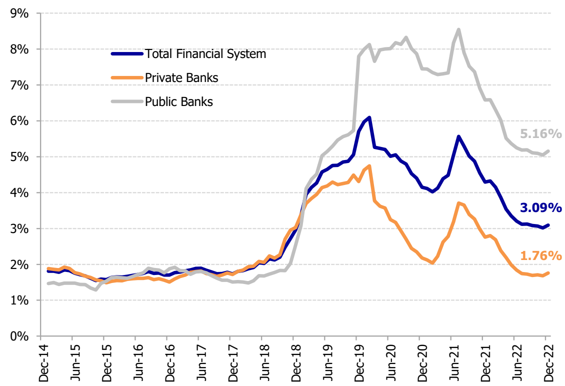
Bank credit to the private non-financial sector

As % of GDP - Q3 2022



Source: Econviews based on BIS

Irregular Portfolio



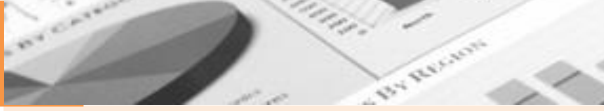
Source: Econviews based on BCRA

Income Statement

Accum. Up to December - in million ARS of Dec-22

	Private Banks		Public Banks	Non-bank financial entities	Total Financial System
	National	Foreign			
Financial margin	1,669,353	1,594,954	1,889,288	48,367	5,201,963
Interest income	1,014,157	953,753	825,854	111,382	2,905,147
Interest expenses	-1,805,912	-1,274,656	-2,242,899	-78,126	-5,401,592
Securities	2,128,333	1,377,259	2,341,682	10,950	5,858,224
Repos	193,631	311,024	268,503	2,223	775,381
Others	139,143	227,574	696,148	1,938	1,064,804
Service-Related Income	217,194	217,032	123,629	4,031	561,886
Bad debt charges	-68,300	-72,674	-115,457	-9,721	-266,151
Administration expenses	-703,371	-627,165	-687,196	-33,168	-2,050,899
Monetary result	-740,728	-689,194	-672,778	-27,784	-2,130,483
Others	-211,728	-232,267	-239,886	-1,220	-685,101
Total Result	**162,421**	**190,687**	**297,600**	**-19,493**	**631,214**

Source: Econviews based on BCRA



The exposure on Central Bank paper is so important (and to a lesser extent in treasury securities) that investment in these instruments represented over 100% of profits. This means that lending to firms and households yielded losses for the banks. This is accurate from an accounting point of view, but not so accurate in real life. Most of these loans that banks provide at subsidized rates generate a relief in terms of reserve requirements, which in turn means using Central Bank paper with 75% (now 78%) of nominal rates as part of the reserve requirement. Actually, reserve requirements in cash (an opportunity cost for the banks) is just 5% of total deposits when the regulation stipulates up to 25% requirement for term deposits and 45% for sight deposits in large banks and lower requirements for small institutions. Well accounted, banks do not subsidize loans as it may appear. Those who understand the system better are local players: securities represent 127% of profits for public banks and 123% for locally owned private banks. So important subsidized loans have become that interest income is at its worst time since at least 2010.

Actually, the average interest rate earned by bank loans to the private sector (i.e, risky assets) is below the policy rate. This is not just a "duration effect". The marginal rate is also lower. This tells the story of low demand for market-priced loans and crossed subsidy between giving cheap loans

As of January 2023, well over 50% of banking assets were invested in government securities including treasury bills and bonds, Central Bank 28-day paper and reverse repos, which are overnight investments. Loans only represented 30% of total asset. Banks always have some exposure to the government, but the nature of the business, which is to manage risks, means that the private sector has to have the lion's share of their balance sheets. Argentina was "normal" in that sense until Covid broke out. Lines crossed and even when the pandemic is long gone, Argentina not only did not return to business as usual, but it also kept on increasing public sector paper at the expense of private credit. In economic textbook this was traditionally called "crowding out".

This pattern of lending to the government rather than to companies and household is widespread. In Public Banks the exposure to the public sector reached 56.5% of assets with loans to the private sector just below the 30% mark. Foreign-owned institutions where public exposure is just below 50% while loans to the private sector are at 32.2% of their balances. Locally owned banks only lent 27.9% of its assets and have 53.6% in government paper.

Financial System Assets in National Currency

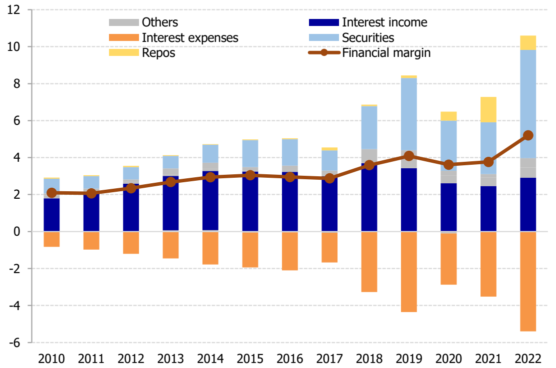
As % of total - Jan- 23

	Private Banks			Public Banks	Total
	National	Foreign	Total		
Cash	4.9%	7.9%	6.3%	5.8%	6.1%
Government Securities	11.6%	11.4%	11.5%	15.4%	12.9%
Leliq / Lebac	32.5%	25.0%	29.0%	30.4%	29.3%
Repos	9.3%	13.0%	11.1%	9.3%	10.4%
Loans to private sector	27.9%	32.2%	29.9%	29.7%	30.1%
Loans to public sector	0.2%	0.0%	0.1%	1.5%	0.6%
Fixed assets	6.3%	5.8%	6.0%	5.4%	5.8%
Others	7.4%	4.7%	6.1%	2.6%	4.8%

Source: Econviews based on BCRA

Financial margin by components

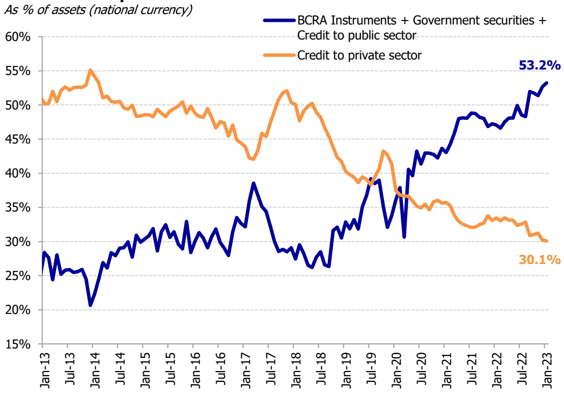
In trillion ARS



Source: Econviews based on BCRA

Banks became public-sector lenders

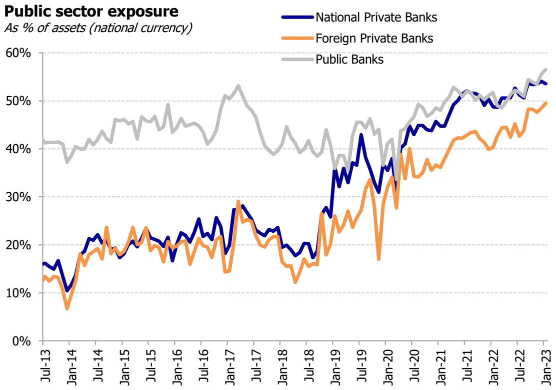
As % of assets (national currency)



Source: Econviews based on BCRA

Public sector exposure

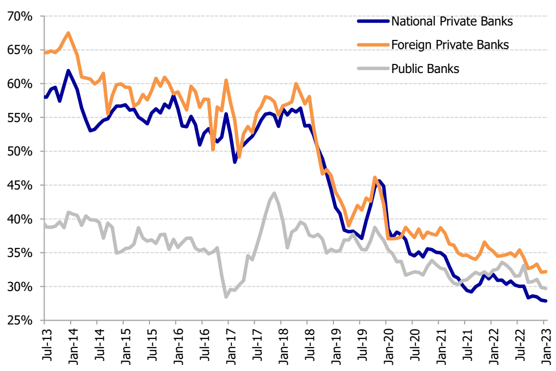
As % of assets (national currency)



Note: Government securities + Credit to public sector + BCRA Instruments
Source: Econviews based on BCRA

Credit to private sector

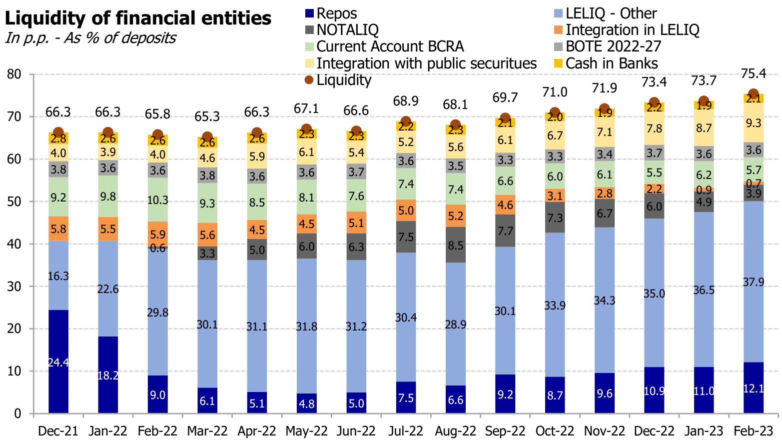
As % of assets



Source: Econviews based on BCRA

In terms of liquidity, the situation is quite comfortable. Around three-quarters of deposits are backed up by liquid assets. As of February, liquidity (as a share of deposits) was made of 5.7% in reserve requirements, 2.1% in cash held in branches. Over 12% of deposits is backed up by reverse repos (overnight investments) and the rest is made of different bonds, most of which can be used to gain access to the liquidity window, no questions asked. This 75% of back up is 10 points above the liquidity held a year ago.

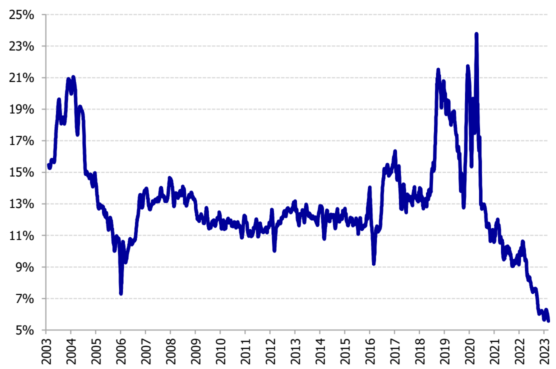
Liquidity of financial entities
In p.p. - As % of deposits



Source: Econviews based on BCRA

This strategy of lending to the government can be seen also as survival. Demand for credit has been limited to concessional lending, this is loans with rates lower than expected inflation. Banks of certain size (Class A in the Central Bank jargon) are forced by regulation to lend at subsidized rates for 7.5% of their deposit base. Credit cards have also a regulation on their interest rate, but the yield has not been that bad (effective of around 110%) and the amount subject to this rate has been diluting for inflation, so for many debtors it is more and more a market rate.

Bank's current account in BCRA
As % of total deposits - 21 days moving average

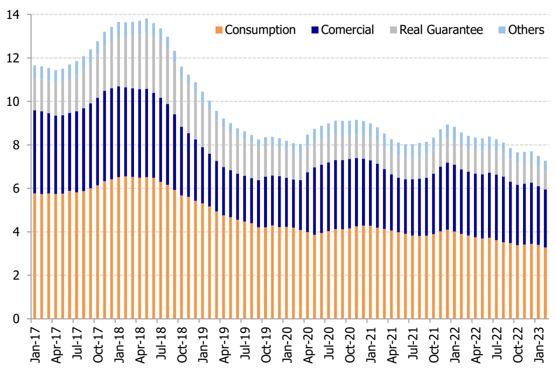


Source: Econviews based on BCRA

Banks are at times quite conservative as well. In some cases, they are slow to adjust credit limits to inflation. So, it is mostly a demand problem, but there are also some supply-side elements. In personal banking, financial players tend to concentrate in formal employees. Outstanding consumer loans to payroll is 35% below the peak of August 2018. The ratio at the end of last year is similar to that of 2006 when the system was still digesting the bomb of the 2002 crisis.

As of February 2023, total loans in pesos to the private sector reached ARS 7.3 trillion, of which 29.2% were credit card balances. Factoring and cheque-discounts represented 25% of total loans and personal loans were almost 16%. The remainder is distributed between advances (11%), car loans (6.6%), household and commercial mortgages (5.3%) and others.

Credit to the private sector in pesos
In trillion ARS of Feb-23



Source: Econviews based on BCRA

If we go back 5 years, the distribution of loans was not the same. There are three areas with significant differences compared to 2018. Mortgages had a market share of twice their current stance, led by inflation-linked mortgages, a product that today looks defunct. In consumption credit, personal loans used to be more important than credit card balances. But the fact that credit cards have a regulated interest rate has made them cheaper. The rise of inflation also boosted the use of credit cards, more so when the government sponsors the use of interest-free instalments for home appliances and other big-ticket items.

The structure and challenges for banks

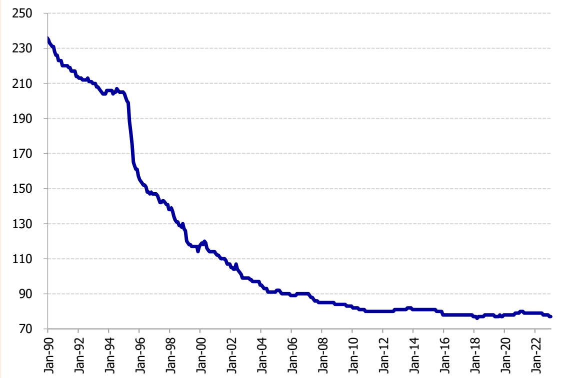
While the number of Argentine banks has been steadily going down, which may increase economies of scale, banks face a number of challenges going forward including a huge shift in how people operate. In 1990 Argentina had 235 financial entities. Following the adjustment of the currency board and the shock of the Tequila crisis, the number had shrank to 118 by year 2000. By 2002 after the biggest crisis in Argentine history there were less than 100 financial players in the system for the first time in decades. Since then, the number of players has been going down, but very gradually, as departures were matched by the entrance of some digital players.

Banks have over 4,600 branches, a number that has been stable. And this is a problem. Central Bank does not allow bank to close branches and this impacts on cost structures. Even when most in the formal sector embraced home and phone banking, the administrative cost of running a bank has not decreased lately.

Total bank employees reach 98,798, according to Central Bank statistics. This number has been decreasing since the first quarter of 2017 when it peaked at 110,561. This means that there are 21 employees per branch (including headquarters), but this number is unequal as government-owned banks have 36 people, private locally owned have 18 people and foreign banks have 20 on average.

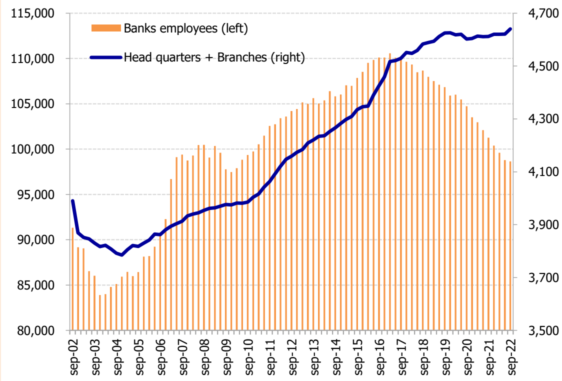
Banco Nacion, fully owned by the Federal government, is Argentina's largest institution. There are three publicly owned institutions in the top 10. Among the private banks, Galicia and Santander are the largest measured by assets, loans or deposits. There are 4 international institutions in the top 10: on top of Santander, we have BBVA, ICBC and HSBC. Top 10 banks represent almost 75% of assets and top 20 institutions surpass 91% of assets with 57 entities taking just 9%.

Number of financial entities



Source: Econviews based on BCRA

Despite fewer employees the number of branches stands high



Financial Entities Ranking - By Assets

Dec 2022

	Million ARS	% of total
Top 10	**23,825,732**	**74.3%**
Banco de la Nación Argentina	*6,743,510*	*21.0%*
Galicia	*2,943,299*	*9.2%*
Banco de la Provincia de Bs. As.	*2,802,339*	*8.7%*
Santander	*2,687,982*	*8.4%*
Macro	*2,057,886*	*6.4%*
BBVA	*1,925,848*	*6.0%*
Credicoop	*1,287,673*	*4.0%*
ICBC	*1,206,065*	*3.8%*
Banco Ciudad de Bs. As.	*1,095,258*	*3.4%*
HSBC	*1,075,872*	*3.4%*
11 to 20	**5,380,629**	**16.8%**
21 to 30	**1,667,504**	**5.2%**
31 onwards	**1,213,952**	**3.8%**
Total (77 entities)	**32,087,818**	**100.0%**

Source: Econviews based on BCRA

Financial Entities Ranking - By Loans

Dec 2022

	Million ARS	% of total
Top 10	**6,693,539**	**78.0%**
Banco de la Nación Argentina	*1,726,082*	*20.1%*
Galicia	*936,778*	*10.9%*
Santander	*869,357*	*10.1%*
Banco de la Provincia de Bs. As.	*770,974*	*9.0%*
BBVA	*666,038*	*7.8%*
Macro	*596,249*	*6.9%*
ICBC	*312,831*	*3.6%*
HSBC	*308,720*	*3.6%*
Banco Ciudad de Bs. As.	*255,934*	*3.0%*
Patagonia	*250,577*	*2.9%*
11 to 20	**1,177,587**	**13.7%**
21 to 30	**356,863**	**4.2%**
31 onwards	**357,504**	**4.2%**
Total (77 entities)	**8,585,492**	**100.0%**

Source: Econviews based on BCRA

Financial Entities Ranking - By Deposits

Dec 2022

	Million ARS	% of total
Top 10	**17,613,878**	**75.7%**
Banco de la Nación Argentina	*5,230,060*	*22.5%*
Banco de la Provincia de Bs. As.	*2,304,998*	*9.9%*
Galicia	*2,122,306*	*9.1%*
Santander	*2,005,166*	*8.6%*
BBVA	*1,303,724*	*5.6%*
Macro	*1,287,669*	*5.5%*
Credicoop	*963,981*	*4.1%*
Banco Ciudad de Bs. As.	*844,853*	*3.6%*
ICBC	*793,131*	*3.4%*
HSBC	*757,989*	*3.3%*
11 to 20	**3,923,801**	**16.9%**
21 to 30	**1,063,491**	**4.6%**
31 onwards	**663,350**	**2.9%**
Total (77 entities)	**23,264,519**	**100.0%**

Source: Econviews based on BCRA

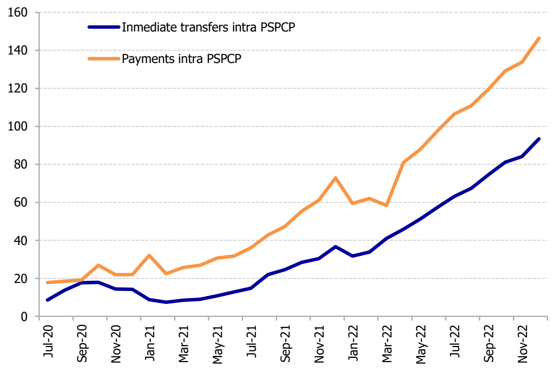
The first challenge is the short term. Once the macro framework stabilizes, hopefully in 2024, banks will have to return to their natural function. The government will gradually reduce its participation in banks' balances and financial players will need to seek clients to lend and manage risk. Macro stabilization implies a reduction of inflation, and this is also a problem, as banks and government are partners in cashing the inflation tax.

For the medium term, banks face important competition from new players. These "fintechs" do not have fixed assets, they face almost no labor contingencies, no unions, no costs associated with physical security and more. True, they do not enjoy the reputation of banks and eventually payment companies end up using banks, but at the very least banks end up sharing fees with new players. Operating through PSPCP or "virtual wallets" is easy. Accounts can be opened easily through the mobile phone.

According to official data, Argentina has 15.8 million of payment accounts with deposits for 114 billion pesos to what we need to add some 154 billion invested in mutual funds through these applications. This represents just 1.5% of total bank deposits (private sector), but it is a number that is bound to grow. Transactions in payments apps have increased by 150% in the last year, a good number to reflect the challenge for traditional players.

In a nutshell, banks are liquid and profitable, despite the noticeable macroeconomic fragility. NPL ratios are extremely low by all standards. It is true that banks are heavily exposed to the public sector, but unlike in 2001 the government can print the pesos to pay what it owes, and the FX restrictions mean that the risk of a bank run is minimal. Still, sooner rather than later banks will need to adjust their business models to be able to compete with new players and with a tougher environment when inflation recedes and FX restrictions are lifted (at one point in 2024 for both).

Virtual wallets are growing fast
Quantity of operations - In millions



Source: Econviews based on BCRA

Base Scenario

	2019	2020	2021	2022 E	2023 E
Inflation (eop)	53.8%	36.1%	50.9%	94.8%	115.0%
Exchange rate ARS/USD (eop)	59.9	84.1	102.8	177.1	460.6
Exchange rate ARS/USD (eop, YoY)	58.4%	40.5%	22.1%	72.4%	160.0%
Real exchange rate ARS/USD (eop, Dec-01=100)	151.5	158.3	137.1	129.4	162.8
Paralell exchange rate ARS/USD (eop)	74.6	140.3	203.1	340.8	667.8
Spread with official exchange rate (eop)	24.6%	66.8%	97.7%	92.4%	45.0%
Gross reserves (USD billion, eop)	44.8	39.4	39.7	44.9	36.4
Net international reserves (USD billion, eop)	12.6	3.8	2.3	7.7	0.1
Policy rate (eop)	55.0%	38.0%	38.0%	75.0%	80.0%
GDP (YoY)	-2.0%	-9.9%	10.4%	5.2%	-4.5%
Formal wages in real terms (aop, YoY)	-6.0%	-1.9%	0.4%	0.3%	-2.0%
Primary result (% GDP)*	-0.2%	-6.4%	-3.3%	-2.7%	-3.6%
Fiscal result (% GDP)*	-3.6%	-8.4%	-4.8%	-4.1%	-5.5%
EMBI Argentina (spread in bps, eop)	1,744	1,350	1,703	2,196	1,500
Public net debt (% GDP)	43.6%	52.7%	42.1%	35.0%	38.5%
Current account (% GDP)	-0.8%	0.8%	1.4%	-0.9%	-2.3%

Source: EconViews

*Excludes rents from primary debt issuance in 2022; PIPs below the line in 2019

(+54 11) 5252-1035
Av. La Pampa 1534 – 8A
Buenos Aires
www.econviews.com
www.facebook.com/econviews
Twitter: @econviews

Miguel A. Kiguel
Director
mkiguel@econviews.com

Andrés Borenstein
Chief Economist
aborenstein@econviews.com

Isaías Marini
Economist
imarini@econviews.com

Alejandro Giacoia
Economist
agiacoia@econviews.com

Melina Sommer
Economist
msommer@econviews.com

Rafael Aguilar
Analyst
raguilar@econviews.com