Document of the Inter-American Development Bank

Argentina

**Promoting risk mitigation instruments and finance for renewable energy and energy efficiency investments**

**(AR-L1280)**

**Financial Sector Overview**

1. General Overview
   1. Argentina’s economy has a long history of crisis and contraction, including the most recent -1.8% recession in 2016. But important progress has been made over the past year to restore macroeconomic stability, sustained and equitable growth and boost job creation. In fact, projections already show a rebound in Argentina’s economy to a 2.7% growth in 2017, and close to 3% over the medium term[[1]](#footnote-1).
   2. Nonetheless, debt financing is still quite insufficient to fund investment and consumption and the economy is yet to achieve greater integration with global financial markets. Partly due to the prevailing financial repression of the last decade, levels of financial intermediation in Argentina remain low. An underdeveloped (small and mostly transactional)[[2]](#footnote-2) financial system, combined with limited access to international capital markets, affects competitiveness of local firms[[3]](#footnote-3).
   3. According to its most recent [*Informe de Estabilidad Financiera*](http://www.bcra.gov.ar/Pdfs/PublicacionesEstadisticas/bef0216e.pdf) (BCRA, 2016), Argentina’s financial system has become robust, showing limited risks on its overall activity, good levels of liquidity and solvency (liquid assets are equivalent to 47% of deposits and non-performing loans below 2%), and with regulatory and supervision frameworks that are in line with international standards. A renewed stability of the system sets a funding base for expansion of the intermediation activity so as to achieve the depth levels comparable to those in other emerging markets of the region. The growth in the amounts of credit and in volume of deposits, although moderate, shows some signs of recovery in that sense.
   4. Argentina’s financial system consists of 63 banks and 14 finance companies. Bank assets (US$176 billion) as of December 2016, accounted for 98% of total system assets. Argentina’s financial system is relatively liquid but lacks depth. Of those US$176 billion in bank assets, US$75 billion (42%) are in the loan portfolio. From a sector perspective, primary activities account for 12% of total loans, industry (15%), wholesale commerce and services (35%), consumption (34%), others (4%). Consumer lending has risen steadily in recent years as a result of the recovery in the domestic economy.
   5. However, lending interest rates are significantly high (rates have grown continuously from below 20% in 2013 to over 25% in 2016) and large intermediation spreads of the banking system (over 10% in 2016), in part due to high levels of operational and administrative costs of the system, need to be monitored. As of 2015, the ratio of domestic credit to private sector (as a % of GDP) stood at 14.7%, well below peers in the region such as Colombia (47.1%), Peru (37.4%) and Chile (111%)[[4]](#footnote-4).
2. Financial System Performance and long term credit
   1. The main indicators of Argentina’s financial system performance show that it has performed well in recent years. Despite its substantial progress, the financial system still has structural weaknesses that prevent it from meeting the demand for credit among domestic productive sectors. The unmet demand for medium and long-term credit is particularly acute despite gradual increases in the loan portfolio of LFIs. Firms, and especially SMEs, require considerably more financing than the amount effectively available in the financial sector.
   2. An analysis of loan maturities in the financial system reveals that by the end of 2016, 92.8%[[5]](#footnote-5) of the portfolio is concentrated in loans of up to one year, 6.7 % of one to four years, and longer-term loans (more than 4 years) account for 0.5 % of total portfolio. These indicators show steadiness as to previous years, as long˗term credit has maintained these level since 2011, when it represented 0.6 % of total credit. Despite the improvements in the financial system, the deposit structure still restricts medium and long-term lending by intermediary LFIs, both to individuals and businesses, as a way to control the risk of term mismatches on their balance sheets. By the end of 2016, 0.01% of deposits displayed a maturity over 2 years, 0.7% between 1-2 years and 99.3% of deposits had maturities of less than one year[[6]](#footnote-6). The same patterns are observed since 2011. The financial system does not meet the need for productive lending, especially long-term, defined as credit with maturities longer than one year. The financial sector offers less attractive instruments, adjusted for inflation and with variable rates, and long˗term lending is scarce.
   3. In keeping with their conservative risk management policy, and in line with the Central Bank regulatory guidance, the banks in the system have elected to maintain high liquidity levels, in part to prevent the deleterious effects of previous recurrent financial crisis. This liquidity, however, is generally only short-term, given the structure of the terms of deposits (see above). Nevertheless, the supply of long-term funding remains very limited and is closely associated with long-term liabilities. Loans from private banks have an average total portfolio in arrears of 1.57%.
   4. The lack of availability of long-term credit directly undermines firms’ capacity to invest in new projects. The financing needs of Argentina’s private sector are equivalent to about 17% of GDP, of which only 16% is provided by the financial sector.[[7]](#footnote-7) In the case of the technologies targeted by the proposed Project, incremental risks of these relatively unknown SE investments produce even greater deficiencies in the availability of adequate financing for SMEs across all sectors of the economy. There is usually an incompatibility between the time it takes for SMEs to see a return on longer-term investments and the structure of the conditions offered by the banking system, generating mismatches in loan amortization periods for those SMEs. In addition, interest rates tend to be higher due mostly to the lack of capacity or experience with SE lending in local financial institutions, who often have limited comprehension of the risks and opportunities of these projects and are hesitant to offer these loans. Capacity building is challenged by a lack of information, risk assessment skills, and track record for SE projects within the investor community; a lack of network effects (investors, investment opportunities) found in established markets; and a lack of familiarity with and skills related to project-finance structures.
   5. The lack of investment also translates into low competitiveness, especially for SMEs, which have very limited access to credit, face high transaction costs, and in many cases, lack appropriate collateral to comply with banking requirements. As these SMEs employ approximately 65% of the country’s labor force, the lack of credit has a direct impact on creation on new employment, as insufficient investment funding has an impact in productivity, innovation, equipment obsolescence, and capital stock. Inadequate access to finance is a critical obstacle to narrowing technology gaps and boosting productivity and growth.

1. [Article IV Consultation with Argentina](http://www.imf.org/en/News/Articles/2016/11/10/PR16500-IMF-Executive-Board-Concludes-Article-Consultation-with-Argentina). IMF, 2016. [↑](#footnote-ref-1)
2. [IMF Working Paper 16/5](https://www.imf.org/external/pubs/ft/wp/2016/wp1605.pdf). IMF, 2016. The 2013 Country Rankings of Financial Development place Argentina in the position 65 out of 183 countries analysed. In terms of financial market depth, the country underperforms significantly, reaching only the 103rd position. The methodology provides an index of development which combines data from depth, access and efficiency of financial institutions and financial markets. [↑](#footnote-ref-2)
3. [Country Report No.16/347](http://www.imf.org/external/pubs/ft/scr/2016/cr16347.pdf). IMF 2016. [↑](#footnote-ref-3)
4. <http://data.worldbank.org/indicator>, accessed on February 2017. [↑](#footnote-ref-4)
5. This distribution of the loan portfolio by maturity was estimated from data on disbursements by the system. Only disbursements to firms were considered in order to obtain values more closely linked to productive investment (in local currency, which represents 90% of total disbursements). [↑](#footnote-ref-5)
6. “Deposits by residual term at maturity”. Financial Entity Report. Central Bank of Argentina (BCRA). [↑](#footnote-ref-6)
7. IMF, World Bank and Ministry of Labor - Observatory of Employment and Business Dynamics (OEDE). [↑](#footnote-ref-7)