The changing nature of the financial system: implications for resilience and long-term growth in emerging market economies[1]

Central Bank of Argentina

Introduction

In Argentina, the financial system is small, short-term and transactional, while largely bank- based. A key factor for financial development and intermediation has been the elusive quest for macroeconomic stability and, particularly, fostering a stable local currency in which long-term financial contracts can be denominated. As a result of successive macroeconomic crises, savings in Argentina are not channelled through the financial system, with currency substitution standing out among the system's features. This note reviews the current structure of the Argentine financial system, its recent evolution, the economic effects of its main features, and the key points looking ahead. In order to foster financial development, these include restoring fiscal and external balances as anchors of macroeconomic stability and leveraging on new technologies.

1) Financial sector structure

Argentina's domestic financial sector is small compared to other emerging market economies (EMEs), and mainly bank-based (Graph 1). **Local capital markets complement banks in providing access to financing, though the size of these markets is small**, especially in terms of financing to the private sector.[2] The development of domestic capital markets remains a relevant policy objective.[3]

The main **investment alternatives** in domestic capital markets are government bonds (with outstanding stock representing around 62% of GDP as of December

[1] Central Bank of Argentina (BCRA). Note prepared for the Meeting of BIS Deputy Governors, Basel, 18–19 March 2024. Information is current as of December 2023.

[2] As well as, for instance, facilitating investment diversification and the possibility of hedging.

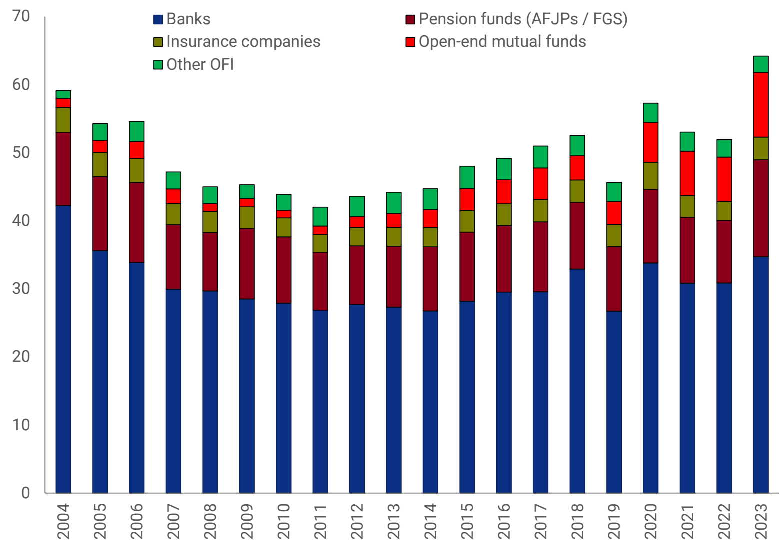
[3] Note that, after registering significant volatility in both FX and government debt markets (that translated to the whole spectrum of securities) during 2018–19, by 2020 Argentina's public debt was restructured. On the other hand, several large corporations have made progress in terms of rescheduling their FX bonds since 2020. Certain new instruments have been developed in recent years (eg eCheck, trading of SME receivables – *factura de crédito electronica* — green bonds, etc) while others have been promoted (closed funds and special purpose vehicles (SPVs) related to real estate development, infrastructure funds, mutual funds related to sustainable finance, etc). The stocks of these instruments are in general negligible in terms of GDP.

2023).[4,5] The weight of other (less liquid) alternatives, like provincial and corporate bonds, is more modest (in a 5%-7% range of GDP in both cases, including debt issued in domestic and international markets). In turn, the market capitalisation of listed domestic firms represented around 12% of GDP as of December 2023. Trade in derivatives is concentrated in USD/ARS futures/forwards and options on stocks (and the volumes are not significant).[6]

The main **institutional investors** are the FGS (sovereign pension reserve fund that manages the assets from the nationalisation of private pension funds in 2008), which represents 14% of GDP, open-end mutual funds (9.5% of GDP) and insurance companies (with a portfolio of financial assets representing around 3% of GDP).[7] Government bonds are the securities with the highest weight in the portfolios of these investors, representing 71% of the FGS portfolio (followed by stocks, which represent 14%) and 39% of the insurance companies' portfolio (followed by investments in mutual funds and corporate bonds, with weights of 33% and 13%, respectively).

Argentina's financial sector – main players, breakdown in terms of assets % of GDP

Graph 1



Estimation based on non-consolidated assets.

Source: BCRA based on National Social Security Administration (ANSES), Sustainability Guarantee Fund (FGS), National Securities Commission (CNV), Superintendence of Insurance (SSN) and Cámara Argentina de Fondos Comunes de Inversión (CAFCI).

4 Outstanding bonds net of non-marketable securities and of public sector position in bonds.

5 All figures as of December 2023 unless otherwise noted.

6 Other derivatives, for instance interest rate derivatives, have a negligible volume, while CDS are not traded locally.

7 Before 2008, a defined contribution private pension scheme was in place. This system switched to a public defined benefit scheme in 2008, and the former private pension funds' investments were transferred to the FGS. The FGS is an Argentine sovereign pension reserve fund (public institution) with the mission of preserving capital to, eventually, help pay the benefits of the current pension scheme and meet future commitments made by the "Historical Reparation" Law (Law 27,260). Note that the FGS per se has no direct liabilities (therefore, there is no intermediation involved). For more information see: fgs.anses.gob.ar/pregunta-frecuente.

The scope of non-bank financial activities is relatively modest (aggregated other financial intermediary (OFI) assets reported represent around 12% of GDP, with open-end mutual funds acting as the main player) and relatively unsophisticated vis-à-vis the situation of developed economies or other EMEs in the region.[8]

The main non-bank financial players are traditional **capital market investment vehicles and agents** (representing almost 90% of reported OFI assets). These include mainly **open-end mutual funds** (with a portfolio of around 9.5% of GDP). Fifty-two per cent of the outstanding stock of open-end mutual funds corresponds to MMFs (money market funds, which invest mostly in bank deposits), while fixed income funds account for 31%. The remainder consist of blend funds, SME funds, infrastructure funds, equity funds, total return funds and green finance funds. The aggregate investment portfolio of mutual funds includes 54% of liquidity (usually sight deposits in banks) and time deposits, 23% of government-related fixed income, and 11% of corporate debt, among others.

Open-end mutual funds represent one of the most dynamic elements of domestic capital markets in the last decade (increasing their size from the equivalent of 2% of GDP as of December 2012 to almost 9.5% of GDP as of December 2023). In particular**, since 2018 MMFs have grown remarkably: they were on average 22% of total mutual funds in 2013–18, and doubled their share to an average of 49% of total mutual funds in 2019–23**. This was due to several factors, including an increasing demand for liquidity in a context of high volatility in domestic markets and the reprofiling of treasury bills in 2018–19 (that led to reallocation from fixed income funds to MMFs).[9] The increasing demand for CPI-adjusted bonds has influenced the dynamics of fixed income funds (especially since 2021).

Other OFIs are:

- **Structured finance vehicles** (with a stock of less than 1% of GDP). These vehicles are mostly related to securitisation of consumer loans and credit card receivables, though there are also other types of operations (infrastructure, agribusiness, etc).
- Other OFIs also relates to capital markets, including central counterparties (CCPs), non-bank clearing and settlement agents and closed-end funds, all with a negligible GDP share (0.1–0.3% of GDP in each case as of December 2022 –last data available—).
- Total OFI assets also include different types of **non-bank loan providers**, mostly related to personal loans and consumer credit (usually small and medium-sized loans) and with a diverse (but generally low) degree of interconnection with the banking system. These include: **credit card systems** (consumer financing), with financing of 0.5% of GDP; **other credit providers** (0.3% of GDP), a heterogeneous segment, comprising for this exercise information about 200 agents that provide data to the BCRA (a significant part comprised by large

8 Following, for instance, the concepts used in the Financial Stability Board's annual non-bank financial intermediation (NBFI) monitoring exercise, OFIs include all non-bank entities except pension funds and insurance companies.

9 While not the main factor, the presence of e-wallets that started to offer their users the possibility of investing account balances in MMFs partially explains this trend. For instance, the main domestic e-commerce fintech (that also offers payment solutions) had started to do this by 2018.

retailers, while other types of credit providers included in this category are non-bank loan providers – mostly personal and consumer loans – online personal loan providers and microfinance entities); and **credit unions**, with a stock of financial assets that amount to 0.3% of GDP (in this last case, data as of December 2022).[10]

2) Banking sector: main features and recent evolution

The Argentine financial system's structural characteristics help keep systemic risks contained: (i) limited credit to private sector depth in the economy; (ii) largely traditional financial intermediation (with low relevance of complex transactions and short-term bias); (iii) relatively high coverage margins (liquidity, provisions and capital); (iv) low interconnectedness among financial institutions; and v) low foreign currency credit risk given regulatory measures taken after the demise of the currency board in 2002. The **regulatory and supervisory framework is in line with international standards and best practices**.

In recent years, the evolution of the banking system reflects fiscal and monetary interactions. **The primary fiscal deficit reached almost 6% of GDP during the pandemic, ranging between 2 and 3% of GDP in the following years. With limited access of the government to sovereign debt markets, direct and indirect monetary financing from the central bank was increasingly used to cover the fiscal deficit**. Direct financing involved temporary loans and the transfer of central bank profits. Indirect financing took place through central bank purchases of government bonds in the secondary market.

Much of the monetary expansion to finance the National Treasury was sterilised through the issuance of BCRA bills (remunerated liabilities). Moreover, remunerated liabilities also continued to grow endogenously through the rising interest rate. All this led to remunerated monetary liabilities reaching ARS 24.8 trillion as of November 2023, almost three times the monetary base, and generating an annualised quasi-fiscal deficit close to 10% of GDP at the end of 2023 (Graph 2).

The demand for loans – weakened by the situation of the economy – competed with the issuance of the BCRA's remunerated liabilities, so private credit found little room to develop. Commercial banks started to act less and less as financial intermediaries, losing their role as agents that take deposits and provide credit to the private sector. The monetary financing of fiscal deficits and their subsequent sterilisation crowded out private credit, which reached a historical minimum of 7% of GDP by end-2023.

[10] In recent years a fintech segment has started to emerge (internet-based lending, P2P lending schemes and crowdfunding platforms). Since data about this segment were limited and heterogeneous, efforts were made to monitor their evolution. Fintech agents are included in the "other credit providers" aggregates. This is still a small (though dynamic) segment.

Central bank's remunerated liabilities – as percentage of GDP Graph 2

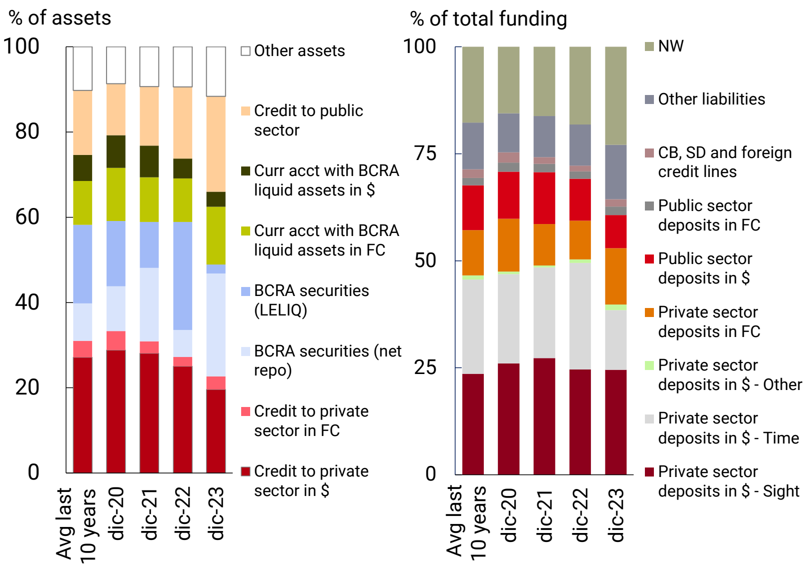
Calculated using 3 months moving average of GDP.

Source: BCRA.

As a result, the **banking system's balance sheet** has shown an increase in the relative share of the BCRA's instrument holdings (mostly net repo for the BCRA) and loans to the public sector (Graph 3). Liquid resources (including monetary regulation instruments) accounted more than 43% of assets in December 2023.

Composition of assets and total funding

Financial system – share in percent Graph 3



FC: Foreign currency. NW: Net worth. CB: Corporate bonds. SD: Subordinated debt.

Source: BCRA

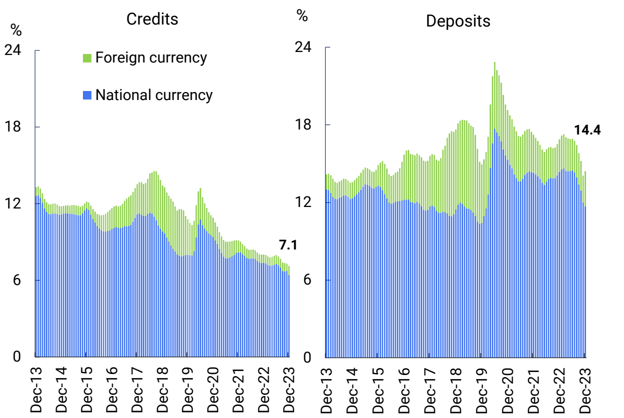
Following weak performance of financial intermediation activity, the stock of credit in domestic currency to the private sector reduced its share in total assets, accounting for approximately 19.6% in December 2023 (-7.6 pp in comparison to the average of the last 10 years).

With regard to **funding sources**, total deposits (in domestic and foreign currency) accounted 62.7% of total funding as of December 2023. Private sector deposits in pesos stood at 39.8% of total funding, below the average of the last 10 years. The remaining funding of the ensemble of financial institutions consisted in net worth (22.9%; +5.2 pp compared to the average of the last 10 years) and, to a lesser extent, in foreign credit lines, corporate bonds and subordinated debt, which remained small (only 1.7% of the total).

The depth of the financial system remains limited (and is decreasing; Graph 4), well below credit and deposit levels of previous years, and those of other economies (Graph 5).

Financial system intermediation as a percentage of GDP – private sector

Graph 4

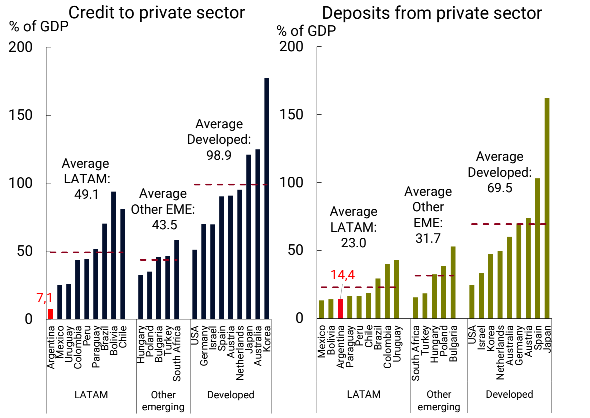


Quarterly averages of both the numerator and denominator are considered.

Source: BCRA, INDEC.

Financial system intermediation as a percentage of GDP – international comparison

Graph 5

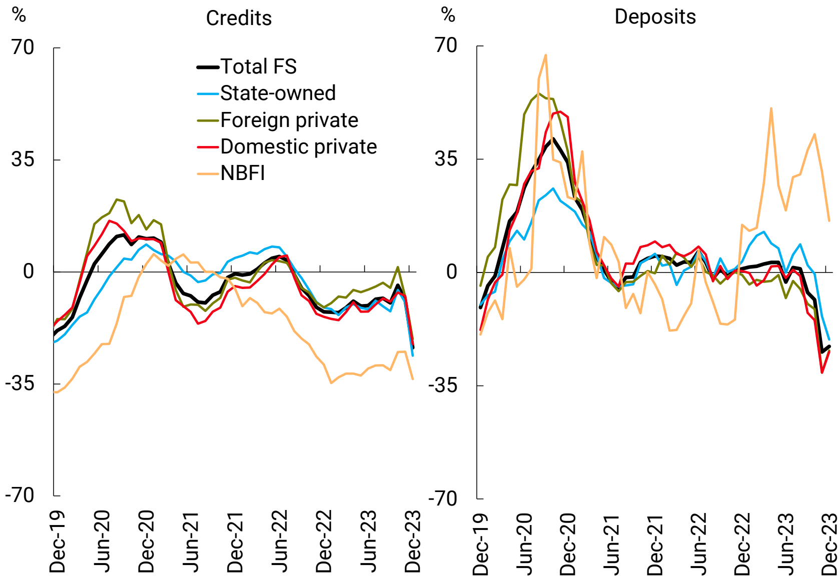


Sources: BCRA; IMF, International Financial Statistics; INDEC.

Financial intermediation with the private sector has been weak in recent years (Graph 6). Financing in pesos to the private sector has dropped 23.7% year on year in real terms. This credit performance was widespread across all groups of financial institutions and all credit segments, with commercial lines showing the smallest relative drop (-19.7% in real terms). The real stock of deposits in pesos from the private sector accumulated a 22.8% drop year on year in December 2023.

Financial system intermediation – private sector

Year-on-year variation in real terms, in per cent | Graph 6



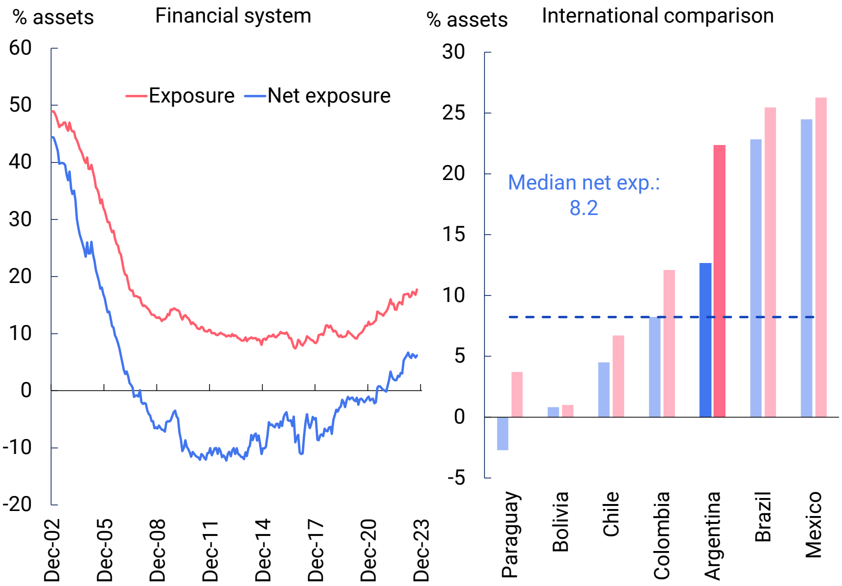
Not seasonally adjusted. Commercials include overdraft, promissory notes and leasing. Real guarantee: mortgages and pledge-backed. Consumption: personal and credit cards. Capital adjustments are included in each segment. The total also includes accrued interest.

Source: BCRA.

As previously noted, **the exposure of the financial system to the non-financial public sector has increased in recent years**, standing at 22.4% in December 2023 (+11.1 pp compared to the average of the last 10 years). Taking into account the funding obtained by the financial system from the public sector (through deposits), this indicator reached 12.7% of total assets on aggregate. This level is above the median of other economies in the region (8.2% for the median, Graph 7). Since the local crisis of 2001–02, all financial institutions must verify regulatory limits on financing to the non-financial public sector (for each level of government and for the total), set according to the entity's regulatory capital and total assets.

Credit to the public sector and public sector deposits in terms of financial system assets

Graph 7



Exposure: (Position in government securities (not including BCRA securities) + Loans to the public sector) / total assets. Net exposure: (Position in government securities (not including BCRA securities) + Loans to the public sector – Public sector deposits) / total assets. Public sector includes all jurisdictions (national, provincial and municipal). Data to December 2022, except Argentina, as of September 2023.

Sources: BCRA; IMF, International Financial Statistics.

The ratio of non-performing loans to the private sector reached 1.9% at the beginning of 2024, falling 1.3 pp in a year-on-year comparison, standing below the local average of the last 10 years and the average of Latin American countries (3%).[11] The performance was explained by the corporate financing segment, mainly due to the effect of the transfer of non-performing credit (defaulted 5 years ago) to off-balance sheet accounts. **Provisions** accounted for 3.6% of lending to the private sector and 191% of non-performing loans in early 2024.

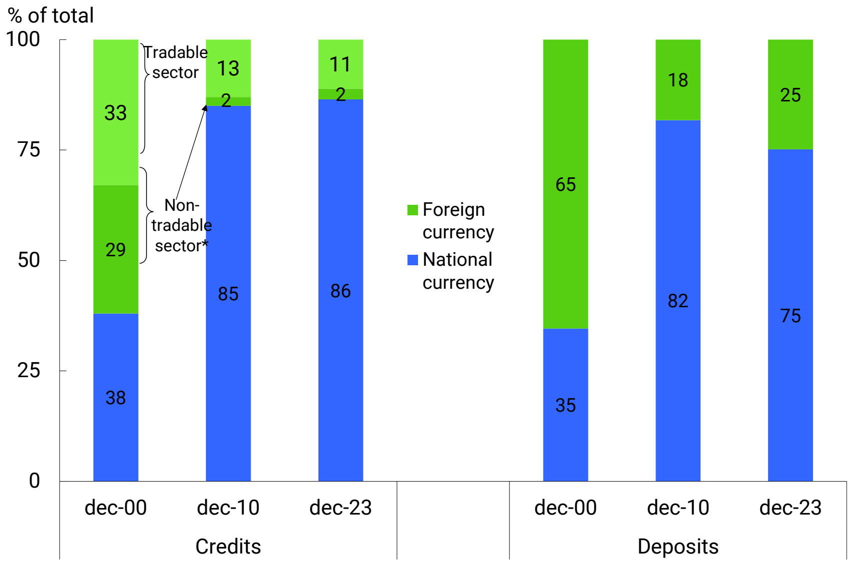
Given the regulatory measures taken after the abandonment of the convertibility regime in 2002, there is **low foreign currency credit risk**. Foreign currency lending to the private sector and deposits remains limited (Graph 8). The stock of loans to the private sector in foreign currency accounted for 13.5% of total loans to the private sector in December 2023, standing below the levels of the late 2010s and 2000s. **Macroprudential** regulations limit the application of deposits in foreign currency only to debtors whose income is correlated with the exchange rate and define that deposits in foreign currency not applied to loans are kept in available accounts at the BCRA. In turn, the stock of deposits in foreign currency totalled 25% of private sector deposits in December 2023, standing above the level of December 2020, but below the value of December 2010.

The banking system as a whole continues to operate with high liquidity margins. The aggregate banking system's broad liquidity stood at 88.6% in terms of

[11] Average for the last information available in the IMF's *Financial Soundness Indicators* (IMF FSI) of the following countries: Bolivia, Brazil, Chile, Colombia, Mexico, Paraguay and Peru.

total deposits in December 2023 (88.5% for items in pesos and 88.7% for those in foreign currency).[12]

Financial intermediation with the private sector by currency Financial system Graph 8



Non-tradable sector financing estimation considers loans in foreign currency to households, construction sector, gas, water, electricity and other services.

Source: BCRA.

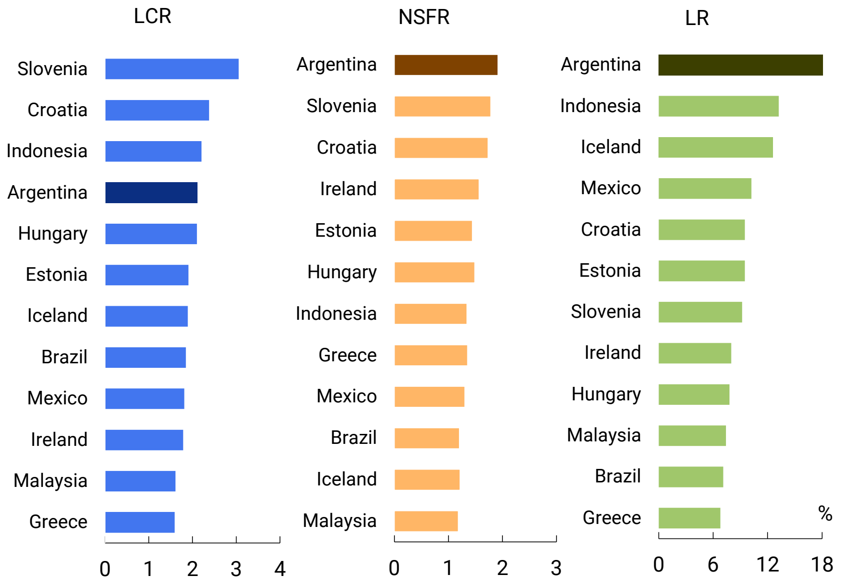
Liquidity ratios defined by Basel Committee recommendations – the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) have also remained high at the aggregate level, above the minimum required by local regulations and those included in international standards (Graph 9).

Capital ratios are standing at high levels. In recent years the regulatory capital (RC) for the aggregate financial system has increased in terms of risk-weighted assets (RWAs), standing at 32.5% in December 2023. Common Equity Tier 1 – with greater capacity to absorb potential losses – explained 98% of the RC, standing above the average of other countries. Additionally, there was high compliance with the additional regulatory capital buffers by institutions in the last few years.

According to the definition of the **Basel Committee's guidelines, the leverage ratio (LR)** has remained sizeably above the minimum requirements, reaching 18.3% for the financial system (Graph 9). This ratio has kept exceeding – on average – the ratios observed in other countries.

[12] Takes into account the stock of liquid assets, concepts included in compliance within the minimum cash regime and BCRA instruments, in both domestic and foreign currency items.

Basel III ratios for liquidity and leverage Domestic financial system in perspective Graph 9



Latest available information.

Sources: Central Banks; IMF, Financial Soundness Indicators; and BCRA.

3) The banking system's features and implications for financial stability, growth and monetary policy

The main characteristics of the Argentine banking system have an impact on financial stability, the growth potential of the economy and the transmission of monetary policy. Among its strengths, the banking system's high resilience to shocks stands out. The drought of early 2023 weighed on exports and activity, and on FX and prices. On top of this, financial and market volatility, typical of presidential election years, only added to this pressure. Indeed, FX market pressure led to higher depreciation and acceleration of (already high) inflation. Before the change of government on 11 December, the central bank had hiked interest rates several times since August, as well as devaluing the official exchange rate.

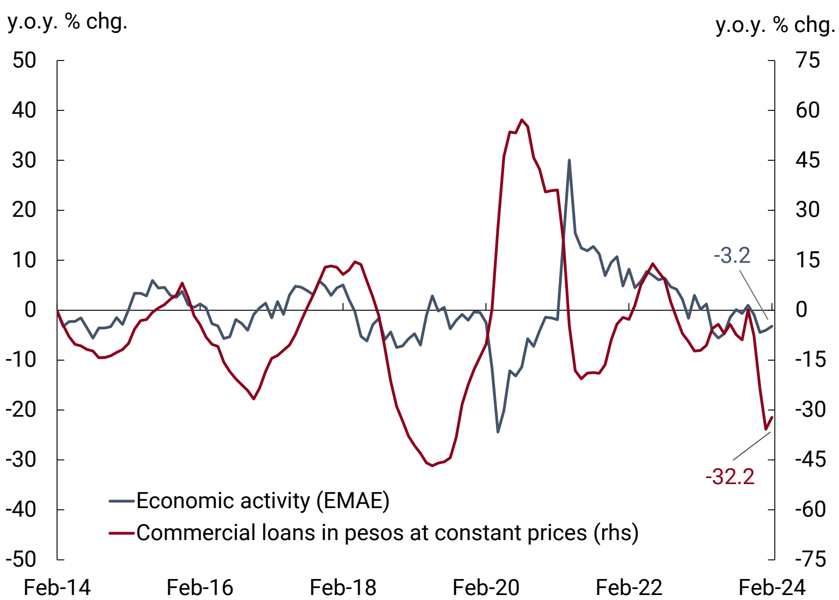
With higher domestic and global uncertainty, total financial intermediation with the private sector was weak during 2023 in a year-on-year comparison, but the financial system remained resilient. Within the prudential regulatory framework in force**, financial institutions' risk coverage margins – in terms of liquidity, provisions and capital – have been high compared to both previous years and other countries.** In fact, this is one of the main strengths of the Argentine financial system. Other aspects that limit vulnerabilities are the currently moderate exposure to private sector credit risk, and the low share of loans and deposits in foreign currency in the aggregate balance sheet.

Given these features, the Argentine financial system is expected to sustain its resilience if an adverse scenario is observed. A scenario in which risk factors materialise would have to be *highly* extreme to have a significant impact on local financial stability. The main potential exogenous risk factors in the short and medium term are the short-term impact of recent fiscal, monetary and exchange rate measures to stabilize the economy, with weaker than expected growth and decelerating but still high inflation; and a more adverse external context related to a "higher for longer" scenario, which may be amplified by global vulnerabilities and could raise new adverse external shocks. **Among the weaknesses of the financial system, low market development is notable. This feature has a negative impact on both monetary policy implementation and growth.** Low financial deepness means that maturity transformation is carried out to a very limited extent.

Reduced intermediation implies that companies and households rely on their own funds for key production and investment decisions (including real estate, which is a largely cash-driven market). It also means that credit typically follows growth. In fact, empirical evidence corroborates that Granger causality runs from GDP to credit in many EMEs, while the often-claimed causality from credit to GDP is a feature observable much less frequently – this behaviour is observed only in financially developed countries (Bebczuk et al (2011)). Indeed, the evidence for Argentina also suggests that real GDP Granger-causes credit, but not the other way around (Errea (2020) and own estimates for 2004–19; Graph 10).

Bank loans to the private sector and economic rate growth, year-on-year percentage variation in real terms

Graph 10



Sources: BCRA.

In its conventional form, monetary policy influences private sector decisions through intertemporal substitution. This allows policymakers to regulate aggregate demand and hence inflation dynamics. **However, under low financial intermediation, interest rate changes have a subdued impact on consumption.**

In shallow financial markets, maturity decisions may be compressed to less than a year, with scarcely any long-term credit to speak of. In Argentina, the average maturity of the most representative lines of loans to companies ranges from less than two months to one year. This in turn lessens the influence that monetary policy may have on aggregate demand through credit. Short bond maturities also constrain the transmission from short-term to long-term interest rates. Finally, the menu of instruments available for open market operations is also limited.

Rather than intertemporal substitution through financial intermediation, private sector decisions are about currency substitution. In other words, consumers and companies decide not so much about whether to borrow or lend at shorter or longer terms as about saving in either local or foreign currency. Financial decisions across currencies tend to dominate those over time.

The exchange rate channel of monetary policy thus becomes more important. While pass- through is endogenous and dependent on the monetary policy stance, exchange rate pass-through coefficients in Argentina continue to be four to eight times higher than in other Latin American countries. Consequently, exchange rate policy loses effectiveness to deal with negative external shocks.

Currency factors also have a financial stability dimension. As savings decisions are not so much about how to smooth intertemporal consumption over time, but about how to allocate wealth in local or foreign currency, exchange rate swings may have a much greater impact on financial stability than could be expected. In Argentina, there is a robust negative relationship between savings in local currency and FX volatility.

For the reasons just outlined, FX intervention policy becomes a relevant monetary policy tool. In a relatively small foreign exchange market like that of Argentina, very small movements can easily become amplified. This reinforces the motivation for central bank intervention when such movements are unrelated to economic fundamentals. It can – as is the case in Argentina now – serve as a complementary anchor for expectations.

4) Challenges/looking ahead

Looking ahead the main challenges for the banking system in Argentina are to increase financial deepening and intermediation. In this context, a key factor for financial development and intermediation has been the elusive quest for macroeconomic stability and, particularly, fostering a stable local currency in which long-term financial contracts can be denominated. As a result of successive macroeconomic crises, savings in Argentina (which are broadly in line with those of other Latin American countries) are not channelled through the financial system, which is short-term and transactional.

Accelerating inflation in recent years and restrictions over the FX market have only worsened the problem of underdevelopment of the financial system, to a point that stabilisation measures are imperative to lower inflation sustainably. In this context, the new administration that took office on December

2023 has decided a series of measures towards a regime that ensures macroeconomic stability by restoring fiscal and external balances.

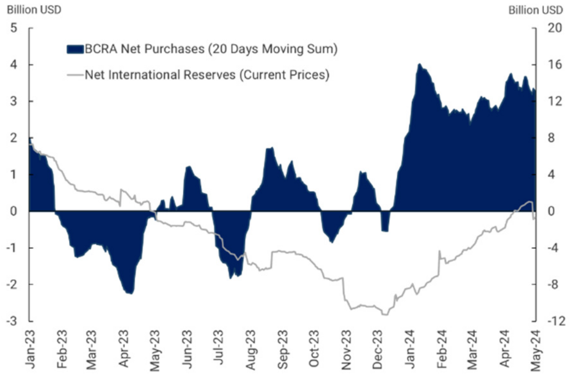
One of the pillars is to eliminate the fiscal deficit and its monetary financing. Another one is the accumulation of international reserves. Along with the reduction of imbalances, other central elements are cutting red tape and correcting relative prices, especially the exchange rate and public utility prices. The main measures taken so far include the following:

- **A fiscal consolidation program, aiming at fiscal-financial balance in 2024.** This will eliminate the fiscal deficit as one of the sources of money supply growth.
- **Distorted relative prices were corrected, especially the exchange rate, as a prerequisite to reducing inflation.** The official exchange rate was depreciated, along with a crawling peg of 2%. This is essential to restore external balance, while gradual FX depreciation serves as a complementary anchor for inflation expectations. Public utility prices have also been raised, to reduce the impact of subsidies on public accounts. Price controls have been eliminated.
- **The Central Bank's balance sheet is being cleaned up, reducing quasi-fiscal deficit generated by interest payments on its remunerated liabilities.** The monetary policy rate was changed from the interest rate of the 28 days liquidity bill (Leliq) to the one-day repos rate and was reduced several times from 133% to 40% (annual rate).
- **The debt of importers reached an all-time high of USD 58 billion towards the end of 2023 due to inconsistent and discretionary management of foreign exchange and foreign trade policy.** This problem is being solved with the issuance of voluntary instruments, the Bonds for the Reconstruction of a Free Argentina (BOPREAL), which provide deferred access to foreign currency predictably through the Free Exchange Market.
- **Some FX market restrictions have been eliminated**. Achieving fiscal and external balances, together with the strengthening of the Central Bank's balance sheet will help to progressively eliminate them.

Although the results in terms of well-being (lower inflation, economic growth, improvement in income and living conditions) will take some time, the actions implemented since December 10, 2023 are already beginning to generate some positive results.

Official FX depreciation and lower access restrictions to the FX market helped unlock foreign trade flows. This allowed for a fast reversal of the trade deficit and, together with the stop of monetary financing to the Treasury, for the BCRA to accumulate international reserves again (Graph 11). Also, a **quick agreement with the International Monetary Fund also made it possible to clear up the uncertainty surrounding disbursements** with a view to meeting principal maturities. The impact on the financial markets was immediate: the FX stabilized, the FX gap decreased and country risk fell sharply (Graph 12).

BCRA USD purchases and net international reserves – USD billion	Graph 11	Exchange rate gaps – Parallel FX rate vs official FX rate, in percentage	Graph 12



Source: BCRA.

Sources: BCRA.

The higher FX rate and the correction of relative prices (public utilities, transportation costs and other regulated prices) inevitably generated a discrete jump in the price level by late 2023. This is essentially the reflection of trends that were repressed by unsustainable regulations and interventions.

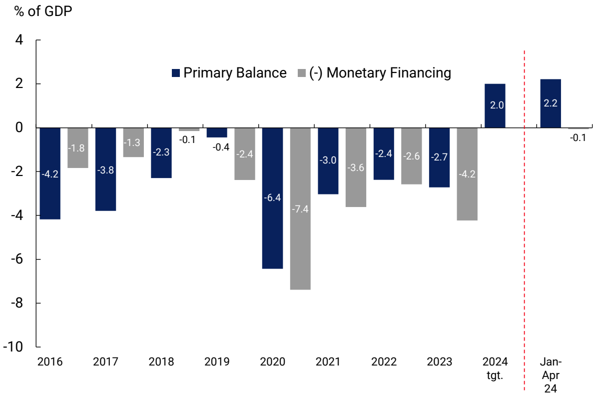
However, thanks to the firm commitment to achieve fiscal balance, the decision to stop the monetary financing to the National Treasury and the stabilization of the exchange rate, inflation expectations and inflation are already showing signs of slowing down (Graph 13 and Graph 14). It had gone from 12.8% monthly in November to 25.5% in December and then dropped to 8.8% in April. Retail inflation shows significantly lower exchange rate pass-through compared to previous experiences; and a lower trajectory than expected.

Over time, as inflation goes down, activity recovers, and the general outlook improves, money held by banks will gradually go to private sector credit, which is at historic lows (barely 4.6% of GDP). **Macroeconomic stabilisation will allow for genuine credit supply to the private sector, an essential input for financing investment and growth**. The BCRA will keep micro- and macroprudential regulation updated, based on international standards, while recognising the characteristics of the Argentine financial market. In addition, it will continue to monitor banks' performance, aiming to keep adequate levels of liquidity and solvency.

Finally, the BCRA will continue promote financial inclusion and the modernisation of payment methods: access to and use of financial services (transactions, payments, savings and credit) at a reasonable cost, in a manner which is safe for the consumer and sustainable for suppliers.

Primary balance of NFPS and deficit monetization – percentage of GDP

Graph 13

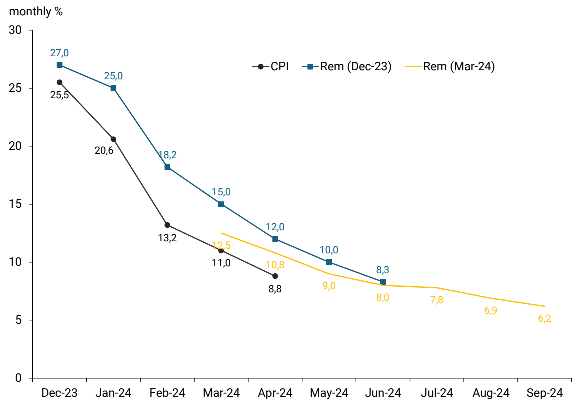


For 2021 SDR allocation of USD427.4 billion is not considered. For 2022 excess primary income from primary debt placements is not Included. Jan to Apr-24: seasonally adjusted annualized fiscal balance (April data estimated). Monetary financing since 10th Dec-23 up to Apr-24.

Sources: BCRA, Mecon and INDEC.

Inflation and inflation expectations - monthly percentage change

Graph 14



Sources: BCRA and INDEC.

A key and related concern in this process is to actually develop capital markets in local currency with a broad domestic investor base. This is a challenge at multiple levels: a) broadening access to equity markets to more companies, including SMEs; b) recreating the local currency bond markets; c) fostering a strong domestic investor base. In particular, b) and c) are interrelated.

Over and above the key issue of macroeconomic stabilisation for financial market development, there are innovations that entail different "initial conditions" for policies. One of these is the development of digital technology applied to payments and credit. The ongoing digital transformation is causing a revolution in payment systems and, potentially, in different forms of money. This is reflected in an increase in the holdings and use of cryptoassets, as a phenomenon that is rapidly expanding on a global scale and that appears to have accelerated with the pandemic.

This process has a series of benefits related to improvement in local and international financial transactions in terms of cost and speed and to its decentralised operations registry technology. But without adequate regulation, these developments also pose potential risks for monetary policy, financial stability, consumer rights and the environment.

Cryptoassets (including so-called stablecoins) do not currently show significant levels of domestic adoption and use in Argentina. Nevertheless, the speed of developments and the risks and challenges they pose for users, investors and the financial system as a whole suggests the need for a precautionary approach. **Stablecoins may also entail additional financial risks, especially for EMEs**. For instance, the existence of a stablecoin pegged to a foreign currency might lead to a relatively more volatile demand for assets denominated in domestic currency; it could even be the case that a stablecoin displaces the domestic currency for domestic transactions (or currency substitution).

Other innovations such as CBDCs also pose risks to financial stability related to international spillovers and capital flows, and to disintermediation of the domestic financial system. In the case of retail CBDCs, their implementation has to be analysed in relation to the fast payment systems in place.

Argentina has a fast payment system (FPS), which has proved successful in terms of lower payment costs and financial inclusion, by facilitating interoperability and instant payments in a secure and competitive environment. This FPS is operated by the private sector and not by the central bank, although it operates according to the BCRA's regulation and is subject to its oversight and supervision. It was first launched in 2012, comprising push transfers only, and in later years new functionalities were incorporated. In fact, back in 2020 it was completely overhauled and renamed Transferencias 3.0: among other amendments, interoperability was reinforced and a new payment instrument – Pay with Transfer – was developed, allowing users to make instant payments with electronic wallets triggered by QR codes. Nearly 99% of adults have an account and the quantity of instant transfers per adult has grown fivefold in the last two years, while the quantity of instant transfers between payment providers and banks – indicating interoperability – has grown threefold in the last year. Instant transfers initiated in mobile devices explain the dynamic, and merchants pay a fee of 0.8% of the transaction value for an instant payment, almost three times below the cost of a credit card payment – available between eight and 18 days after.

Retail CBDCs´ adoption might require significant investment in infrastructure and technology, which may not be cost-effective if an interoperable FPS is already in place, widespread and being used massively by individuals and firms. Although the issuance of an rCBDC eliminates the operational costs of physical money, its advantages for financial inclusion and formalising the economy may be larger in jurisdictions where the financial system is not so widespread and FPS are not in place.

All in all, stabilising the economy is a necessary condition to foster financial development in Argentina. At the same time, new technologies, if properly applied, can help to catalyse such development.

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