BANCO CENTRAL DEL URUGUAY

FINANCIAL STABILITY REPORT SEPTEMBER 2010

EXECUTIVE SUMMARY

The main effect of the international financial crisis on the local financial system has been the decline of banks' returns from their financial investments abroad, due to low international interest rates. As a result, institutions have redirected part of these investments, increasing the supply of credit to the domestic sector, which has allowed them to maintain their net interest margin close to that of 2009. Nonetheless, part of their investment had also needed to be assigned to increase provisions, since loan losses were greater than estimated. Return on assets (ROA) remains low (0.14% in local currency) but the last two quarters it presented a significant improvement. If we consider banks results measured in US dollars (relevant from the point of view of the foreign stakeholders) the annual return on equity (ROE) of the last rolling year was 13.1%.

The solvency of financial institutions based in Uruguay has two characteristics that are worth mentioning: first, the high level of capital, that is twice above the minimum required by the prudential regulation (on average 2.13 times the regulatory requirement), and second, the prudential regime of statistical provisions established by the Superintendence of Financial Services. This has forced banks to assume portfolio losses at the up phase of the economic cycle, enabling them to cope with the rising delinquencies in the down phase of the cycle without requiring additional capital.

At the same time, the system's liquidity remained high, with 30 and 91 days liquidity ratios close to 65%. It is worth to highlight that these ratios were calculated without including credits to non-financial sector even if their term were smaller than 91 days, so the liquidity definition used by the Superintendence of Financial Services is more exigent than other standard criteria internationally used.

Credits to local private sector experienced a significant growth during 2010's third quarter. The increase of lending in domestic currency was $ 6,958 million while the growth of that denominated in foreign currency was U$S 70 million, resulting in a total growth of U$S 423 million, equivalent to an annualized rate of 32%. Up to September 2010, credits to local private sector in domestic currency rose $ 12,353 million, while that denominated in foreign currency increased by U$S 447 million, leading to a total credit growth rate of approximately 20%.

Despite this growth acceleration, credit delinquency rates remained stable at historically low levels, recording levels of approximately 1.2% (2.4% in the case of credit to households in national currency).

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The average interest rate of loans denominated in foreign currency reached its historically lowest value of 5.5%. On the other hand, in September 2010 average interest rates for loans to companies and households in domestic currency were 12.0% and 37.2% respectively.

Deposits of non-financial private sector (NFS) continued growing both in local and foreign currency, showing at the last rolling year an increase of U$S 2,505 million, which represented an annual growth rate of 18% (depurated from the exchange rate effect). In the third quarter, deposits' increase was U$S 741 million, which is equivalent to an annualized growth rate of approximately 20%. Demand deposits and savings accounts represented just about 82% of total deposits which is explained mainly by the low levels of interest rates offered for time deposits.

In September 2010, interest rates paid for time deposits in foreign currency were on average at the level of international reference rates, registering levels below 50 basis points. The rate for fixed-term deposits in local currency (mostly concentrated between 30 and 180 days) was on average 4.9%, remaining at levels similar to those of the previous quarter.