Banking Interest Rates may have Bottomed Out

April 04, 2022 | BFSI Research

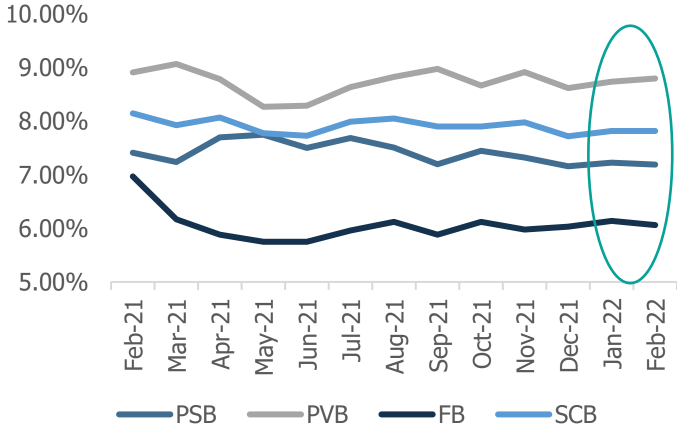
Ratings • Advisory • Research • Risk Solutions

Banking Interest Rates seem to have bottomed out

The credit growth had been muted in the earlier part of the year due to the Covid-19 outbreak and balance sheet deleveraging by large corporates. As a part of policy support, the Reserve Bank of India (RBI) had reduced policy rates in the earlier part of the pandemic and consequently, interest rates in the banking system have generally trended lower. However, the interest rate transmission has been uneven with public sector banks (PSB) passing the rate cuts quicker than the private sector banks (PVBs). The credit offtake has improved recently as business activities are picking up and corporates are showing interest in re-leveraging. Credit growth has continued to be bolstered by Retail and Micro, Small and Medium Enterprises (MSME) segments. The rates (lending and deposit) have dipped, and the spread has been maintained. Further, with rising G-sec (government security) yields, the spread between G-sec and lending rates have narrowed.

Movement in Lending Rates - (Weighted Average Lending Rate - WALR)

Figure 1: WALR Fresh Loans Evolution

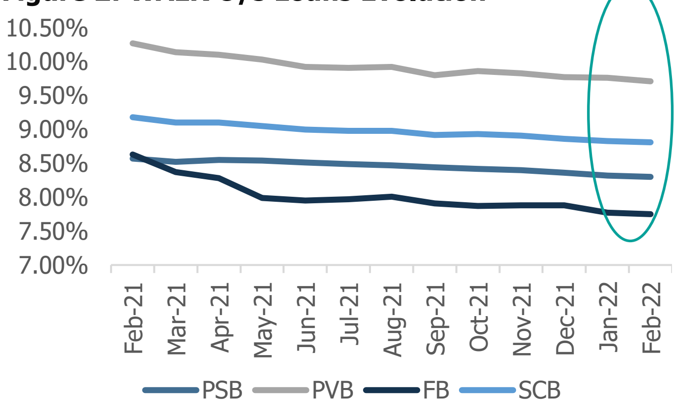


Source: RBI

The interest rates have generally trended lower when compared to February 2021 even as the bank rate has held steady. The decline in PSBs has been more than PVBs, and PVB rates continue to be significantly higher compared to the PSB rates. **However, on m-o-m basis, the diverging movement was witnessed as the SCB (scheduled commercial banks) rate held steady, PSB and FB (foreign banks) saw a reduction of 4 bps and 8 bps, respectively, and PVB witnessed an increase of 6 bps.**

Movement in Lending Rates - (WALR)

Figure 2: WALR O/s Loans Evolution

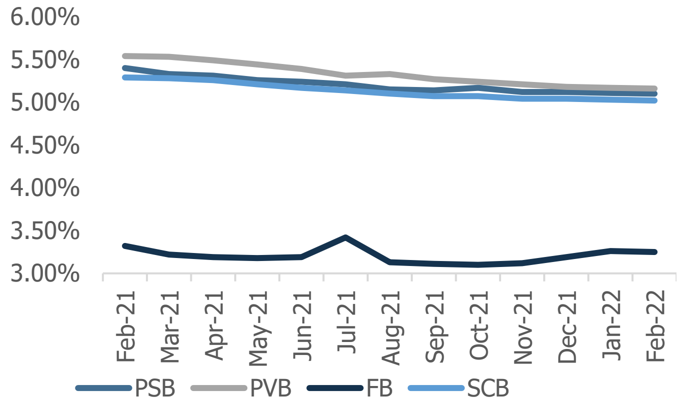


Source: RBI

Interest rate transmission continued between February 2021 and February 2022 as lending rates declined. WALR on outstanding loans declined by 27 bps, 56 bps, 88 bps, and 37 bps for PSB, PVB, FBs, and SCB, respectively, between February 2021 and February 2022. **On m-o-m basis, rates declined by 2 bps for PSB, FB, and SCB, while PVB declined by 5 bps.** The decline in PSBs has been lower as compared to PVBs, and the absolute PVB rates continue to be significantly higher compared to the PSB rates.

Movement in Deposit Rates - Weighted Average Domestic Term Deposit Rates (WADTDR)

Figure 3: WADTDR Evolution

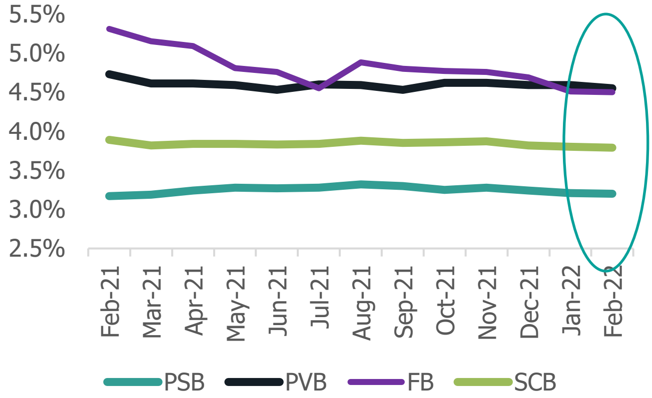


Source: RBI

As can be seen in figure 3, the deposit rate has been on a general downtrend and has declined by 30 bps, 38 bps, 7 bps, and 27 bps for PSB, PVB, FB, and SCB, respectively, between February 2021 and February 2022, and the bank rate held steady for the similar period. On m-o-m basis, rates declined by 1 bps for PSB, PVB, FB, and SCB. However, the rates for FBs continue to be significantly lower than the other categories.

Movement in Spread between Lending and Deposit Rates

Figure 4: Movement in Spread between WALR and WADTDR

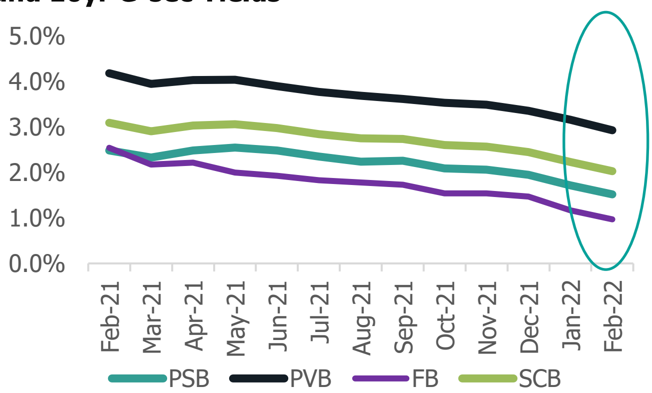


Note: Difference between Outstanding Rupee Term Deposits and Outstanding Rupee Loans; Source: RBI

The net interest rate spread which is the difference between the average lending rate and the deposit rate is a key determinant of a financial institution's profitability. The lending rates of FBs are generally lower than the PVBs and the PSBs and the spread for these banks is generally higher as FBs pay even lower rates to deposit holders when compared with PSBs and PVBs. However, with aggressive pricing on deposits, the FB spread has fallen below the PVB spread for the last two months. Both PSBs and PVBs pay deposit holders at broadly similar rates, however, PVBs charge a higher lending rate resulting in larger spreads.

Movement in Spread between Lending Rates and 10yr G-sec Yields

Figure 5: Movement in Spread between WALR and 10yr G-sec Yields



Note: Difference between Outstanding Rupee Term Deposits and Outstanding Rupee Loans; Source: RBI

The spread between the 10-year G-sec yield and the lending rates have been trending down due to interest transmission to the borrowers as well as rising G-sec yields. PVBs continue to have a higher spread compared to PSBs. This narrowing spread might induce corporate borrowers to return to bank borrowing as the cost of market borrowing rises in tune with G-sec yields.

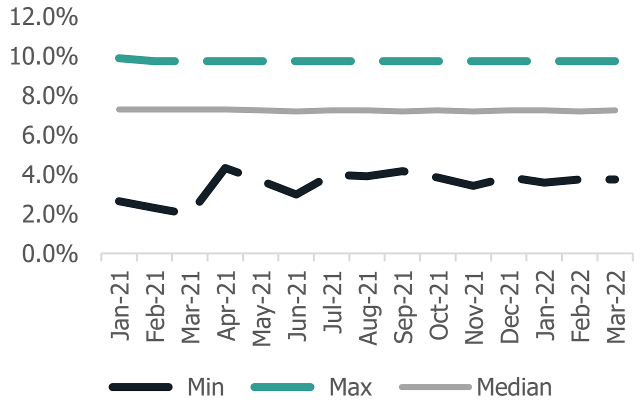
Conclusion

If we analyse the spreads of both PVBs and PSBs, we can see that both the groups continue to maintain high spreads with PVBs continuing to have relatively higher spreads. Further, we can observe that on m-o-m basis, lending, as well as deposit rates for all categories, declined, barring lending rates on fresh loans of PVBs which witnessed an increase of 6 bps. Additionally, with G-sec yields rising, bond yields could also see an increase, pushing some corporates to the banking system for their borrowing requirements.

Annexure

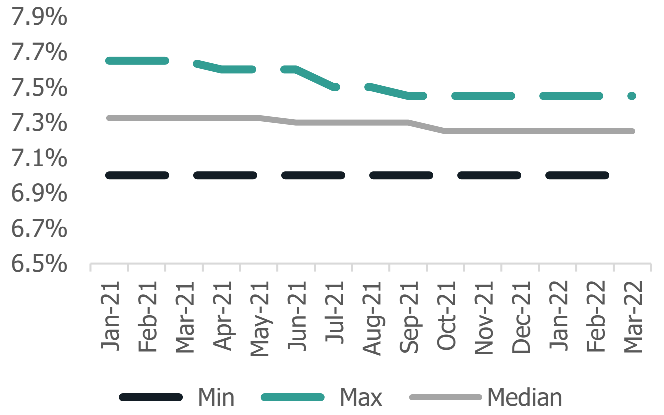
Movement in Bank Group-wise MCLR (1 Year): PSB rates continue to travel in a similar corridor, while the PVB corridor narrows. Foreign Banks maintain the highest variation.

Figure 6: Movement in 1 Year MCLR: Scheduled Commercial Banks



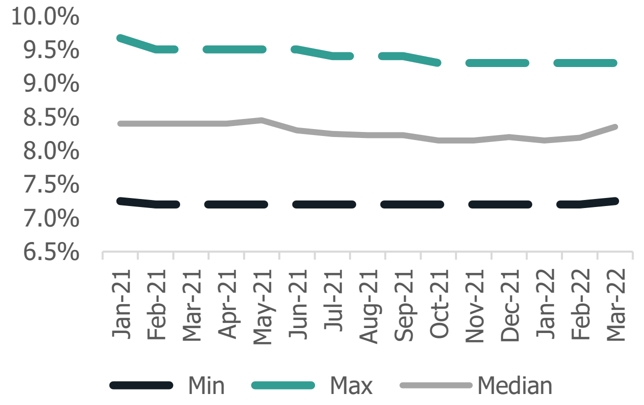
Source: RBI

Figure 7: Movement in 1 Year MCLR: Public Sector Banks



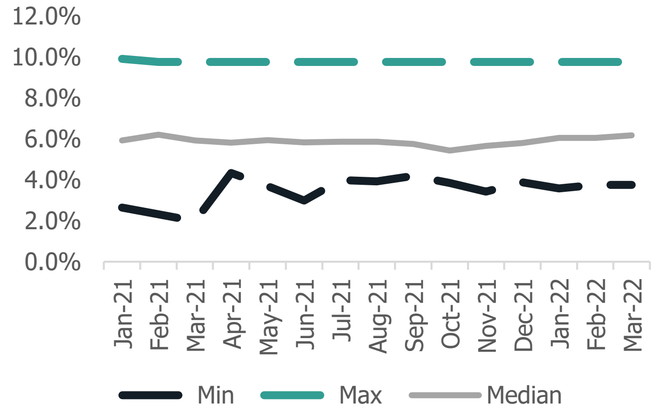
Source: RBI

Figure 8: Movement in 1 Year MCLR: Private Sector Banks



Source: RBI

Figure 9: Movement in 1 Year MCLR: Foreign Banks



Source: RBI

Contact

Sanjay Agarwal	Senior Director	sanjay.agarwal@careedge.in	+91-22-6754 3582 / +91-81080 07676
Saurabh Bhalerao	Associate Director – BFSI Research	saurabh.bhalerao@careedge.in	+91-22-6754 3519 / +91-90049 52514
Mradul Mishra	Media Relations	mradul.mishra@careedge.in	+91-22-6754 3596

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Phone : +91 - 22 - 6754 3456 I CIN: L67190MH1993PLC071691

Connect :

Locations: Ahmedabad I Andheri-Mumbai I Bengaluru I Chennai I Coimbatore I Hyderabad I Kolkata I New Delhi I Pune

About:

CareEdge (CARE Group) is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics capability and detailed research methods. CareEdge (CARE Ratings Limited) is one of the leading credit rating agencies in India. It has an impressive track record of rating companies for almost three decades and has played a pivotal role in developing the corporate debt market in India. CareEdge provides near real time research on all domestic and global economic developments. The wholly owned subsidiaries include CareEdge Advisory & Research arm focused on providing advisory and consultancy services and CareEdge Risk solutions a platform that provides risk management solutions