Lending Rate Rise Persists as RBI Ups Repo Rate; Still Below Pre-Covid Levels

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Synopsis

- Lending rates on fresh loans witnessed a rise in tandem with the repo rate, while deposit rates, albeit slower, also started to pick up.
- Private Sector Banks (PVB) and Public Sector Banks (PSB) have maintained high spreads between lending and deposit rates, with PVBs seeing higher spreads, as banks raised rates amid RBI's tightening moves.
- While banks are increasing their lending yields, CareEdge expects the uptick in the deposit rate to pick up given the widening gap between credit and deposit growth and faster deployment of surplus liquidity.

Rate Rise Continues

Credit offtake, which showed an advancing trend in the latter half of FY22, has continued in FY23. Further, RBI has indicated a withdrawal of the accommodative stance and hence liquidity in the system has been tightening. Additionally, the Russia-Ukraine conflict disrupted global supply chains, which along with high food, fuel, and commodity prices aggravated the existing inflationary trends. Hence, RBI has already increased the repo rate by 190 bps in H1FY23 and additional hikes are anticipated in the current fiscal.

Figure 1: Evolution of WALR O/s (Lending) Loans

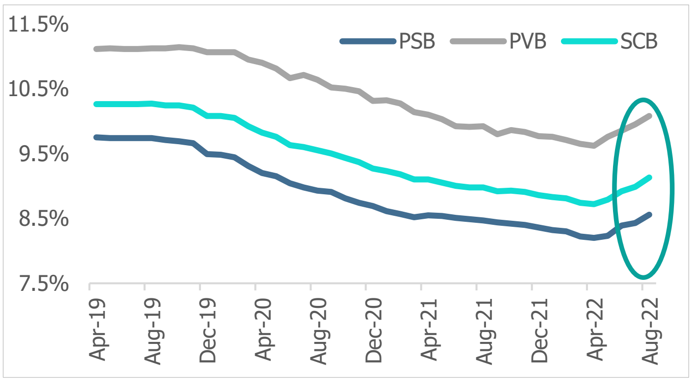
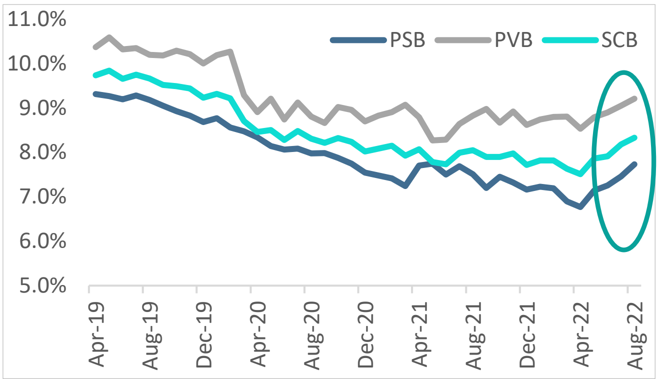
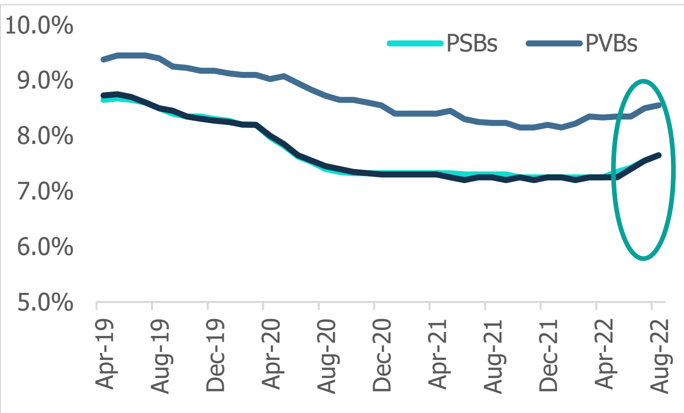


Figure 2: Evolution of WALR Fresh Loans



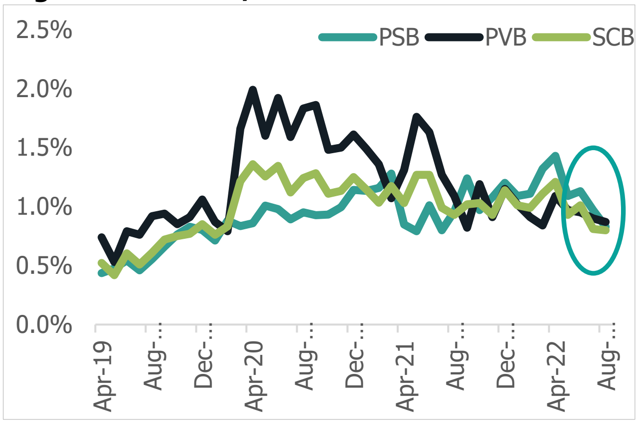
Source: RBI

Figure 3: Movement in 1-Year MCLR (Median)



Source: RBI

Figure 4: WALR o/s Loans vs WALR Fresh Loans



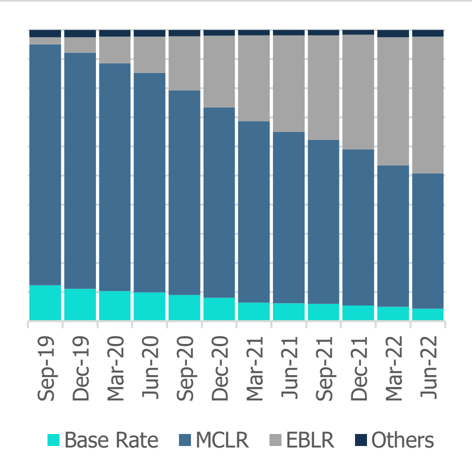
Source: RBI

- Weighted Average Lending Rate (WALR) on fresh loans reflects the rising interest rate cycle faster as it increased for PSBs, PVBs and SCBs by 27 bps, 16 bps, and 15 bps m-o-m, respectively. Meanwhile, the elevated rates continue to be lower than the pre-pandemic rates by 75-90 bps. The spread between WALR O/s loans and WALR fresh loans for PSBs and PVBs narrowed on a m-o-m, respectively, in August 2022 due to a higher rise of WALR on fresh loans as compared to WALR on O/s loans.
- On a m-o-m basis given the tightening interest rate scenario, the 1-year median MCLR of SCBs increased by 10 bps from 7.65% in August 2022 to 7.75% in September 2022 (lower than the 8.25 in March 2020).

Rate hikes and expectations for further rises have prompted banks to raise rates. The rising policy rate also has had a faster impact on the lending rate of fresh loans as new loans are being priced at newer rates, while older loans are re-priced based on repricing dates for specific loans. Consequently, the spread between WALR O/s loans and WALR fresh loans is narrowing in the near term and is expected to stabilise over the medium term.

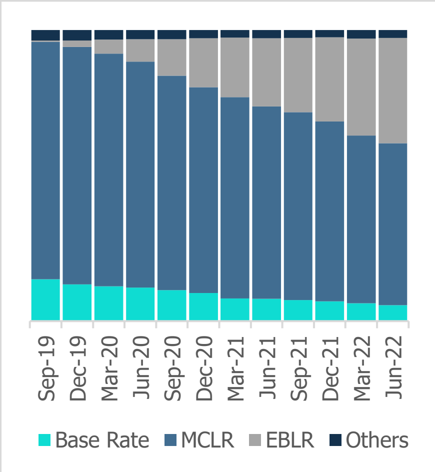
Share of Outstanding Floating Rate Rupee Loans across Interest Rate Benchmarks

Figure 5: SCBs



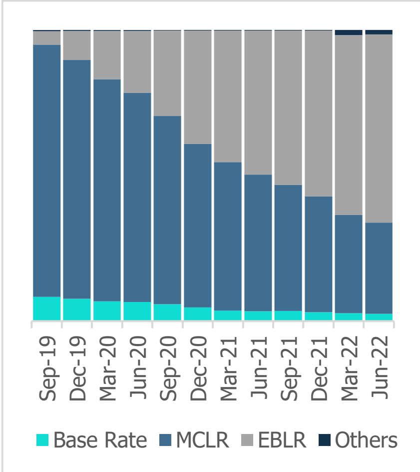
Source: RBI

Figure 6: PSBs



Source: RBI

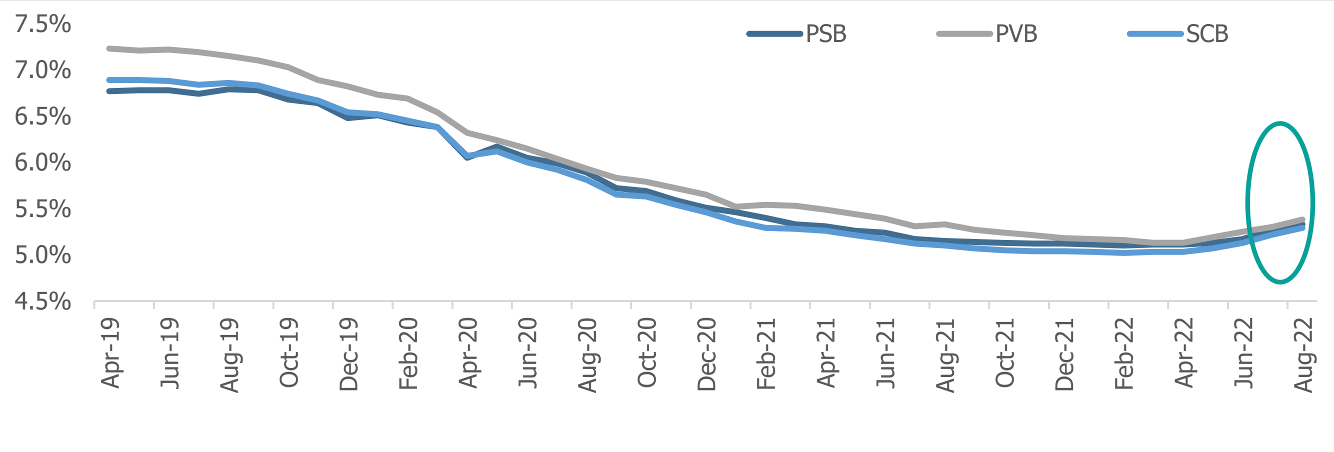
Figure 7: PVBs



Source: RBI

The share of External Benchmark based Lending Rate (EBLR) linked loans in total outstanding floating rate rupee loans of SCBs was 46.9% at end-June 2022 while that of MCLR-linked loans was 46.5%. Compared with PCBs, PVBs have a higher share of EBLR, consequently, the lending rate transmission is faster in PVBs. Banks with a higher mix of floating-rate book stands to benefit from the rising rate cycle.

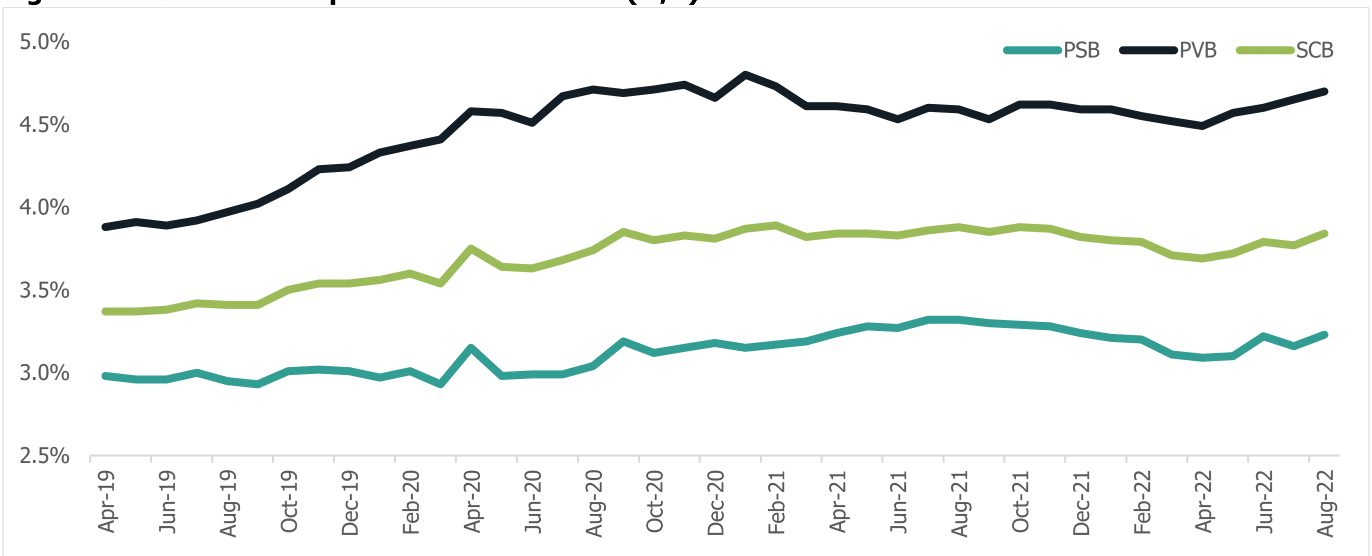
Figure 8: WADTDR (Deposit) Rates Continue to Rise, Remain Below Pre-Pandemic Levels



Source: RBI

Deposit rates for PSBs, PVBs and SCBs too witnessed a rise by 6 bps, 8 bps, and 7 bps m-o-m respectively, in August 2022, however, they continue to be lower than their pre-pandemic levels (as of March 2020) by over 100 bps, indicating the distance the deposit rates have yet to traverse for their uptrends. Banks have raised lending rates in-line with an increase in repo rate over the last few months. However, an increase in deposit rates is much lower than the rise in lending yields. Generally, the repricing of liabilities usually happens after a lag compared to the repricing of assets. Further, assets are largely priced on variable rates while interest rates on deposits are largely fixed for the tenure of the deposit. Hence the rise in deposit rates has been slower than the increase in repo rate. Although banks maintain significant levels of investments in G-Secs which can be used to fund credit growth, the focus on deposits is also likely to increase going further. As competitive intensity picks up on the deposit side, a sharper increase in deposit rates is anticipated, thus driving an increase in funding costs.

Figure 9: Movement in Spread between WALR (O/s) and WADTDR



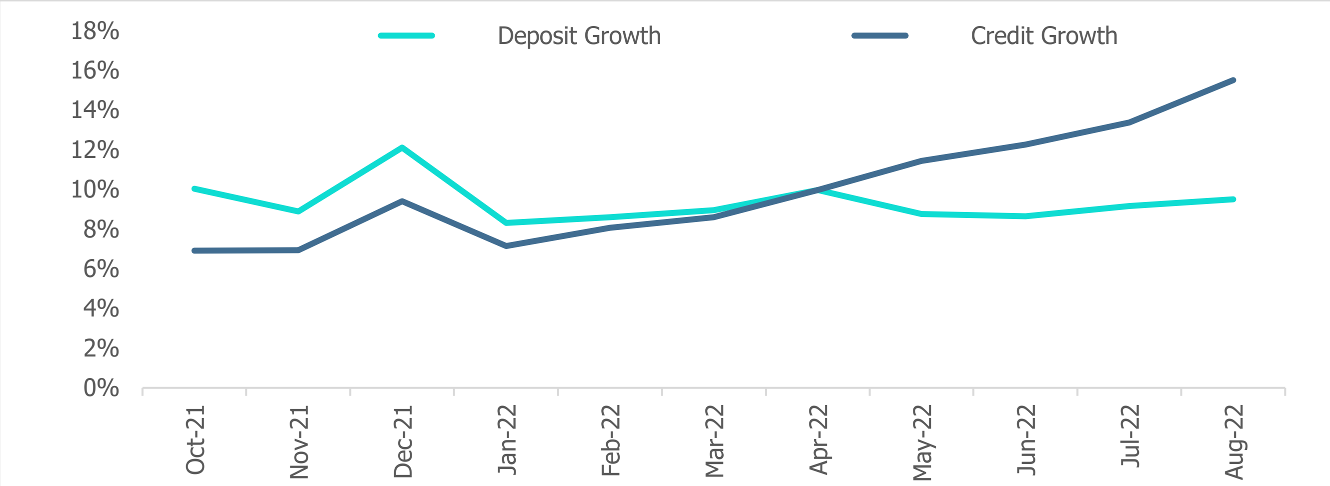
Source: RBI

- Spread of SCBs between WALR (O/s) and WADTDR (the net interest rate spread) stood at 3.84% in August. The spread for PVBs, PSBs and SCBs widened by 7 bps and 5 bps and 7 bps m-o-m, respectively, in August 2022 due to a higher rise in lending rates as compared to deposit rates. On a y-o-y basis, PSB spread narrowed, PVB spreads rose, while the spreads of both PSB and PVBs have continued to remain elevated compared to the pre-pandemic levels.

- PVBs continue to maintain a higher spread given that they charge more as compared to PSBs while paying out at a similar rate.

Widening credit and deposit growth gap along with lowering liquidity to put pressure on deposit rates

Figure 10: Credit Offtake surpasses Deposit Growth



Source: RBI

Credit demand has been recording double-digit growth driven by increased working capital requirements and demand revival. The gap between credit offtake and deposit growth is at the highest over the past 10 years (excluding the 2016 deposit growth during demonetization). Meanwhile, lower deposit mobilisation and pick-up in credit demand have pushed the credit deposit ratio to 73.3% in August 2022. The banking system liquidity moved into a deficit for the first time in nearly 40 months in September, mainly due to advance tax outflows. Liquidity could remain pressured with credit demand outpacing deposit growth, RBI's forex intervention and festive season currency demand. Tightening liquidity conditions has pushed the short-term interest rates higher. The weighted average call money rate has risen from 3.25% at the start of FY23 to 5.55% by end-September 2022.

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