Interest Rates Continue to be on Rising Trajectory in July

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Synopsis

- Private Sector Banks (PVB) and Public Sector Banks (PSB) have maintained high spreads between lending and deposit rates, with PVBs seeing higher spreads until July, as banks have raised their rates amid RBI's tightening moves.
- The difference between the 10-year G-sec yield and the lending rates for SCBs is likely to sustain.
- Lending rates on fresh loans witnessed a rise in tandem with the repo rate, while deposit rates' rise has albeit slower has also started to pick up.
- CareEdge expects the uptick in deposit rate to pick up as the credit growth has remained high and the liquidity has been narrowing in the banking system.

Rate Rise Continues

Credit offtake, which showed an improving trend in the latter half of FY22, has continued in FY23. Further, RBI has been working on reducing the liquidity surplus in the banking system which has been consistently reducing from Rs 7 lakh crore at the beginning of 2022. 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 140 bps and additional hikes are anticipated in the current fiscal.

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

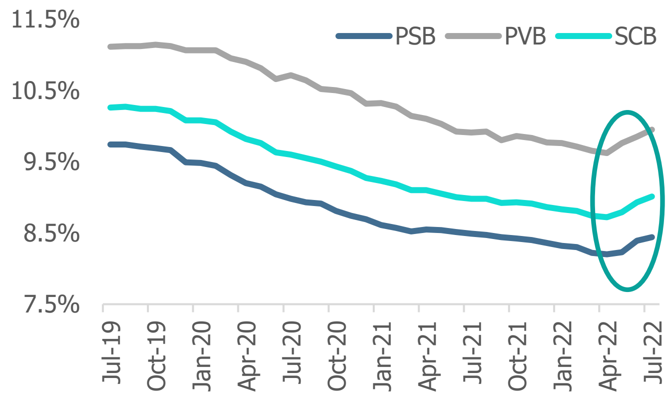


Figure 2: Evolution of WALR Fresh Loans

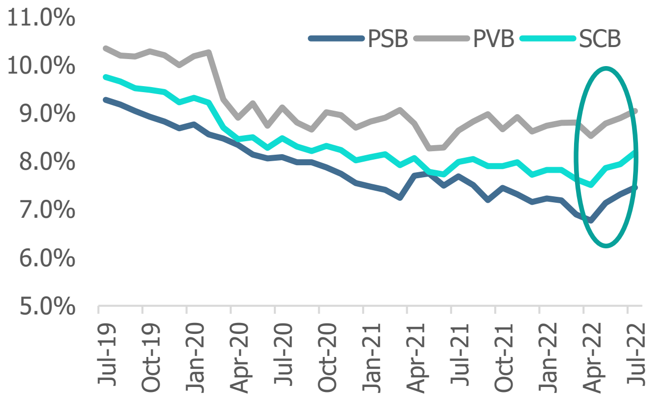
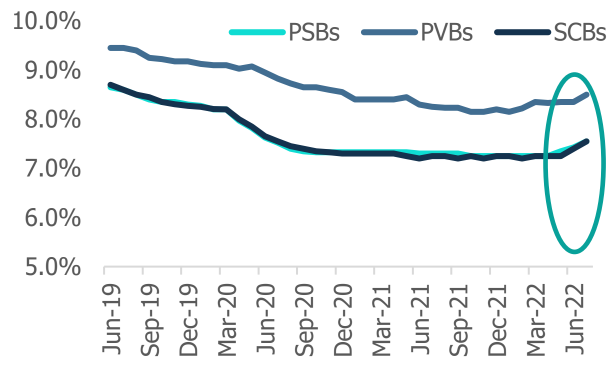
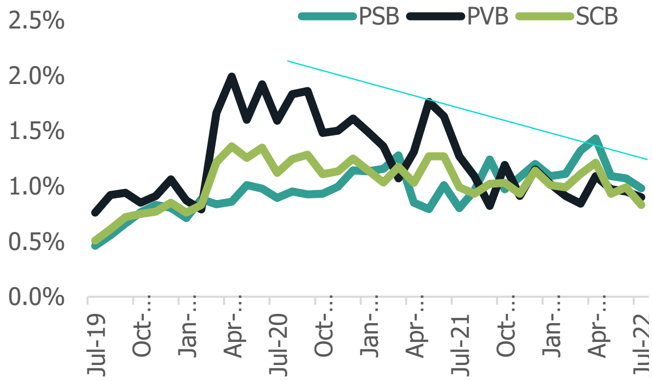


Figure 3: Movement in 1-Year MCLR (Median)



Source: RBI

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

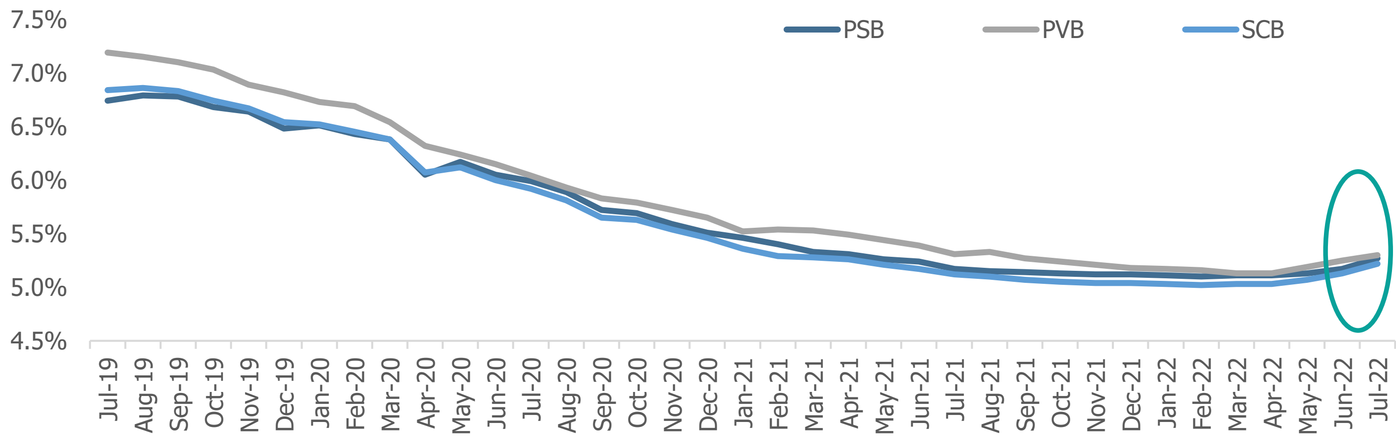


Source: RBI

- Weighted Average Lending Rate (WALR) on fresh loans reflects the rising interest rate cycle faster as it increased for PSBs, PVBs and SCBs by 14 bps, 15 bps, and 24 bps m-o-m, respectively. The spread between WALR O/s loans and WALR fresh loans for PSBs and PVBs narrowed on a m-o-m, respectively, in July 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, 1-year median MCLR of SCBs increased by 10 bps from 7.55% in July 2022 to 7.65% in August 2022.

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.

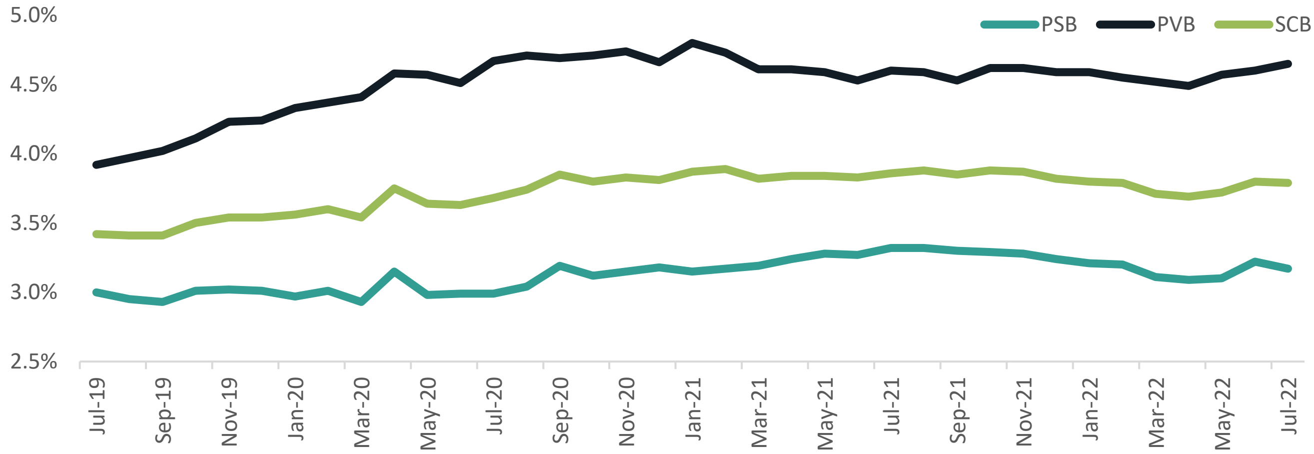
Figure 5: WADTDR (Deposit) Rates Continue to Rise, but Remain Below Pre-Pandemic Levels



Source: RBI

Deposit rates for PSBs, PVBs and SCBs too witnessed a rise by 10 bps, 5 bps, and 9 bps m-o-m respectively, in July 2022. 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. Reducing liquidity and rising credit offtake have already created demand for deposits, which have prompted banks to further raise rates across both retail as well as bulk categories and tenures.

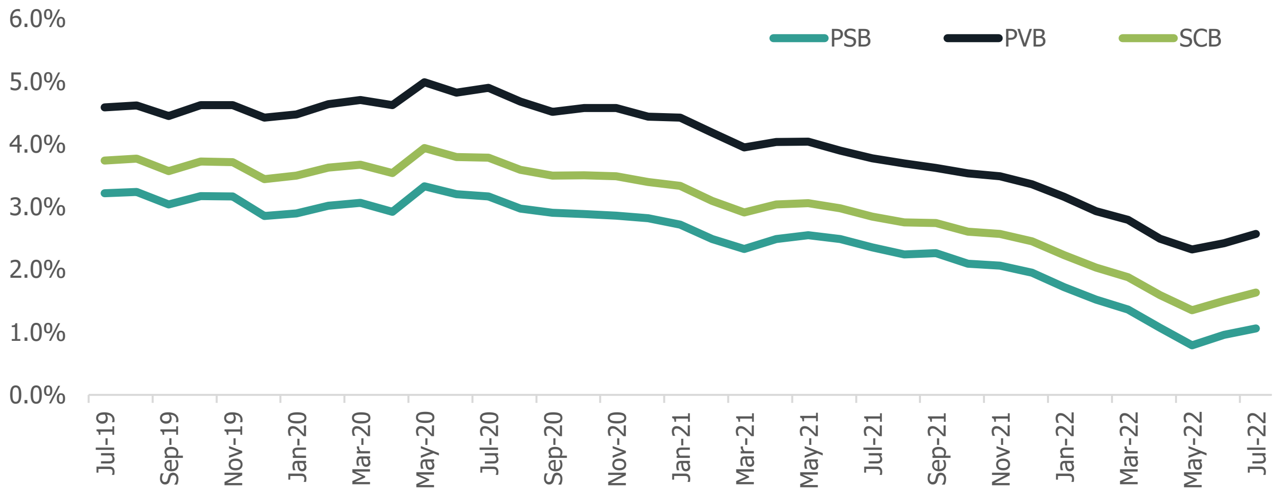
Figure 6: Movement in Spread between WALR (O/s) and WADTDR



Source: RBI

- Spread of SCBs between WALR (O/s) and WADTDR (the net interest rate spread) stood at 3.79% in July. The spread for PVBs increased by 5 bps, while it contracted by 5 bps and 1 bps m-o-m, respectively, for PSB and SCBs in July 2022 due to a higher rise in deposit rates as compared to lending rates.
- PVBs maintain a higher spread given that they charge more as compared to PSBs, while paying out at a similar rate.

Figure 7: Blip in Contraction of Spread between WALR (O/s) and 10-Year G-Sec



Source: RBI, CMIE

- The spread between the 10-year G-sec yield and the lending rates for SCBs expanded to 1.6% in July 2022 rising by 13 bps m-o-m whereas PSBs and PVBs rose by 10 bps and 15 bps, respectively, in the same period. This spread is likely to sustain as both bank lending rates and the 10-year G-sec would rise. The G-sec yields could be impacted by issuances, global market developments such as US Federal Reserve's rate hikes, inflation, and supply chain disruptions.

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