

Banking Interest Rates: Spread narrows as Deposit Rates inch up and Lending rates dip marginally

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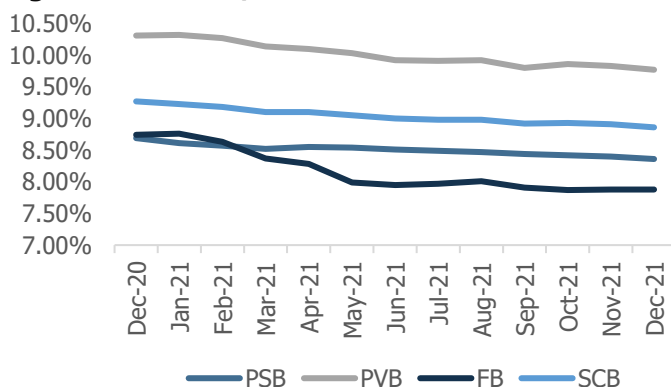
Banking interest rates have generally trended downward

The credit growth had been muted from February 2020 to July 2021 due to the Covid-19 outbreak and deleveraging of balance sheet by large corporates. However, the credit offtake seems to have improved recently as business activities are picking up and corporates are showing interest for re-leveraging. Credit growth has been buttressed by retail and MSME loans.

As a part of policy support, 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 PSBs passing the rate cuts quicker than the PVBs

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

Figure 1: WALR O/s Loans Evolution



Interest rate transmission continued between December 2020 and December 2021 as lending rates declined, while the bank rate has held steady for the similar period. The figure 2 below captures the quantum of this change. The decline in PSBs has been lower as compared to PVBs, but the absolute PVB rates continue to be significantly higher compared to the PSB rates.

Source: RBI

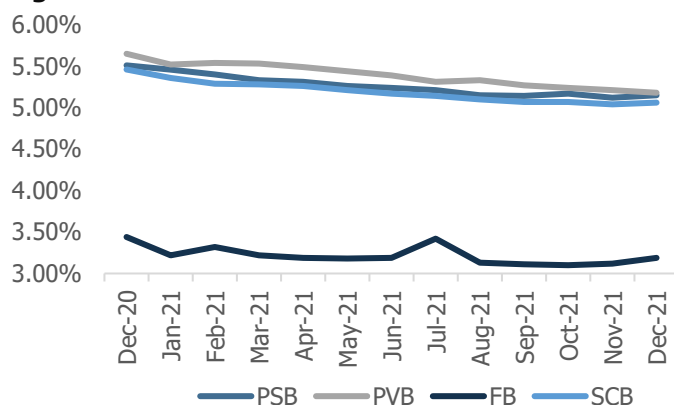
Figure 2: Decline in lending rates over the last 12 months (December 2020 to December 2021)

	Outstanding loans
PSBs	33 bps
PVBs	54 bps
FBs	86 bps
SCBs	41 bps

The spread between the 10-year Gsec yield and the lending rates have been declining due to rising Gsec yields. PVBs have a higher spread compared to PSBs. Further, lending rates for PVBs continues to remain higher as compared to others.

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

Figure 3: WADTDR Evolution

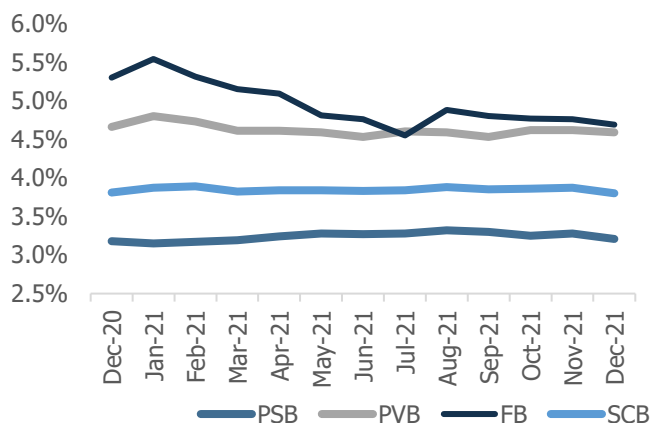


As can be seen in figure 3, the deposit rate has been on a continual downtrend and has declined by 36 bps, 47 bps, 25 bps, and 40 bps for PSB, PVB, FB, and SCB, respectively, between December 2020 and December 2021, while the bank rate has held steady for the similar period. However, it seems that the rates have reached a bottom as the PSB, FBs and SCB rates increased on a m-o-m basis by 3 bps, 7 bps and 2 bps, respectively, while on the other hand, PVBs rates reduced by 3 bps. Further the rates for FBs continue to be significantly lower than the other categories.

Source: RBI

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 is the difference between the average lending rate and the deposit rate. The net interest rate spread is a key determinant of a financial institution's profitability. The lending rates of FBs are generally lower than the PVBs and the PSBs; the spread for these banks is higher as FBs pay even lower rates to deposit holders when compared with PSBs and PVBs. The spread between lending rates and deposit rates has been the highest for FBs, followed by PVBs, while PSBs have had the least spread. However, the difference between PSBs and FBs spreads has narrowed. Both PSBs and PVBs pay deposit holders at similar rates, however, PVBs charge a higher lending rate resulting in larger spreads.

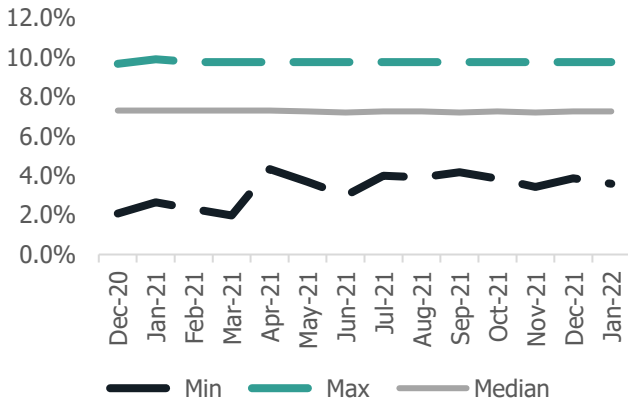
Concluding remarks

If we study the spreads of both PVBs and PSBs, we can see that both the groups have high spreads with PVBs continuing to have relatively higher spreads. However, we can see that several banks have increased their Term Deposit rates and hence the spreads have narrowed. Consequently, lending rates may also witness some pressure as any decrease in the lending rate spread over deposit rate, would indicate pressure on NIMs and any improvement in spreads would indicate an expansion in the retail lending spreads. Further with G sec yields rising, bond yields would also witness an increase, pushing some corporates to the banking system for their borrowing requirements.

Annexure

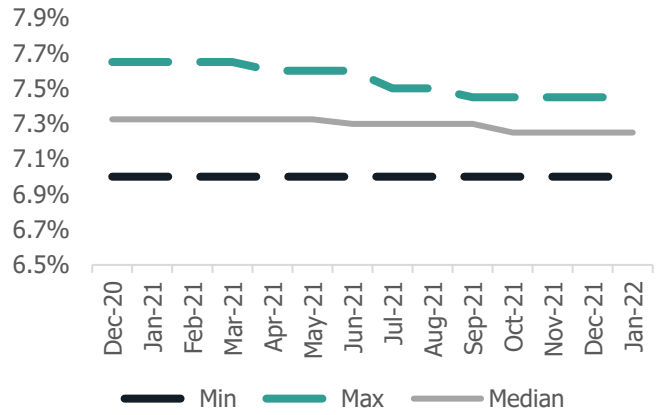
Movement in Bank Group-wise MCLR (1 Year): PSB rates corridor narrows, while PVB continue to travel in a similar corridor. Foreign Banks maintain the highest variation.

Figure 5: Movement in 1 Year MCLR: Scheduled Commercial Banks



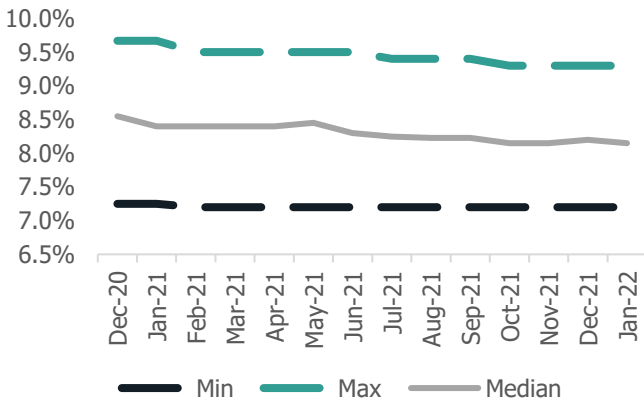
Source: RBI

Figure 6: Movement in 1 Year MCLR: Public Sector Banks



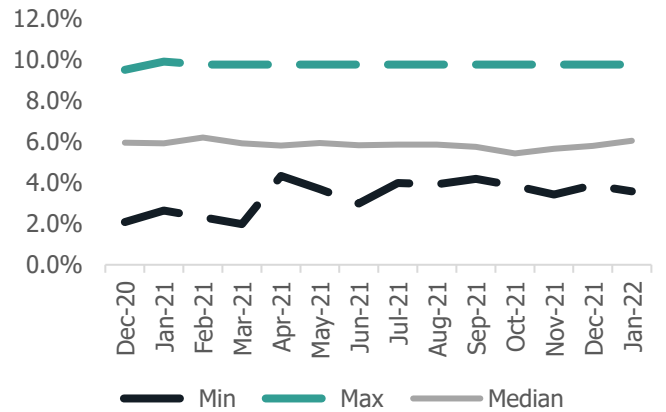
Source: RBI

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



Source: RBI

Figure 8: Movement in 1 Year MCLR: Foreign Banks



Source: RBI

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