

Banking Interest Rates Bottom Out, will Grow as Yields Rise

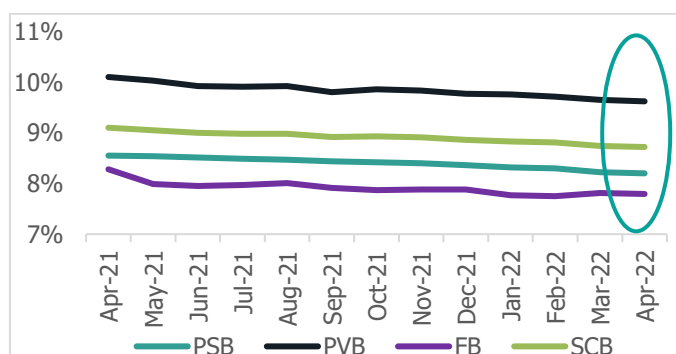
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Lending Rates of SCBs Fall in Apr-22; Deposit Rate Stays Flat m-o-m

The positive momentum in credit offtake since the end of August 2021 ensured the credit growth stood at 9.6% in FY22, higher than the 5.6% growth seen at the end of FY21. Credit growth was muted pre-Covid, reflective of macro adjustments such as cleaning up of NPAs, risk aversion post the large NBFC defaults, etc. Further, Covid-19 led to lockdowns that impacted credit growth during FY21. Given the situation, the Reserve Bank of India (RBI) had reduced interest rates in the earlier part of the pandemic and consequently, banking system rates have generally trended lower. With the Covid-19 pandemic settling, credit offtake has increased.

Weighted Average Lending Rates (WALR) on outstanding loans (O/s) of Scheduled Commercial Banks (SCBs) stood at 8.72% in April 2022 and saw a decline of 38 bps year-on-year (y-o-y). Weighted Average Domestic Term Deposit Rates (WADTDR) of SCBs also declined by 23 bps y-o-y to 5.03% in April 2022, however, was similar from March 2022. The spread of SCBs between WALR (O/s) and WADTDR generally trended lower since February 2021 which declined by 15 bps and y-o-y 2 bps m-o-m to 3.69% in April 2022 due to the reduction in WALR. The credit offtake has shown healthy improvement in the recent months and witnessed double-digit growth in April 2022 due to improved economic activities, higher working capital requirements driven by inflation, and stable job markets.

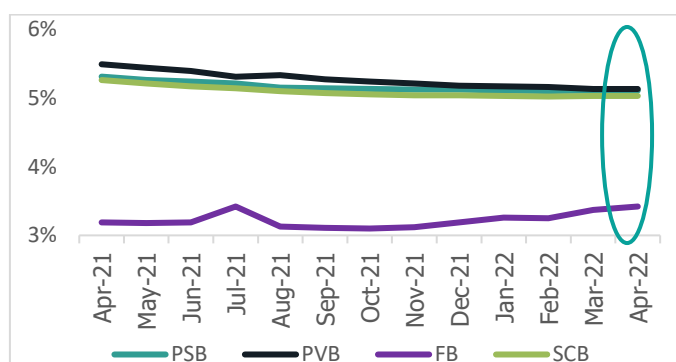
Figure 1: Evolution of WALR O/s Loans



Source: RBI

Interest rate transmission continued between April 2021 and April 2022. WALR on O/s loans for PSBs, PVBs, FBs, and SCBs declined by 35 bps, 48 bps, 49 bps, and 38 bps y-o-y, respectively, in April 2022. On a m-o-m basis, PSBs, PVBs, FBs and SCBs declined by 2 bps, 3 bps, 2 bps, and 2 bps, respectively, in April 2022. PVB rates continue to be significantly higher compared to the PSB rates.

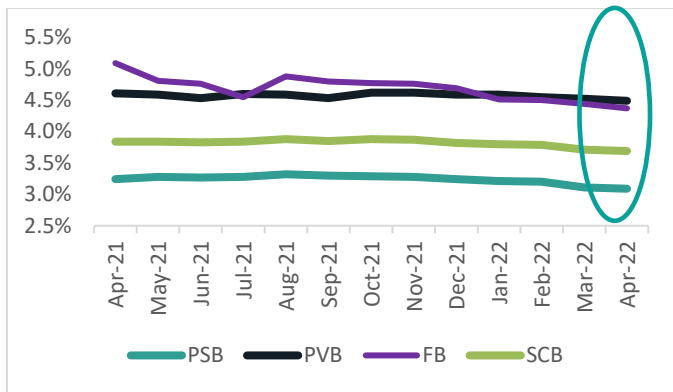
Figure 2: WADTDR Evolution



Source: RBI

As can be seen in figure 2, the deposit rate has been on a general downtrend except for FBs. PSBs, PVBs, and SCBs witnessed a decline in their deposit rates by 20 bps, 36 bps, and 23 bps, y-o-y respectively, in April 2022. However, FBs reported a rise of 23 bps in the same period. Sequentially, the rates were stable for all groups except for FBs in April 2022. FBs deposit rates increased 5 bps m-o-m to 3.42%. However, WADTDR for FBs continues to be significantly lower than the other categories.

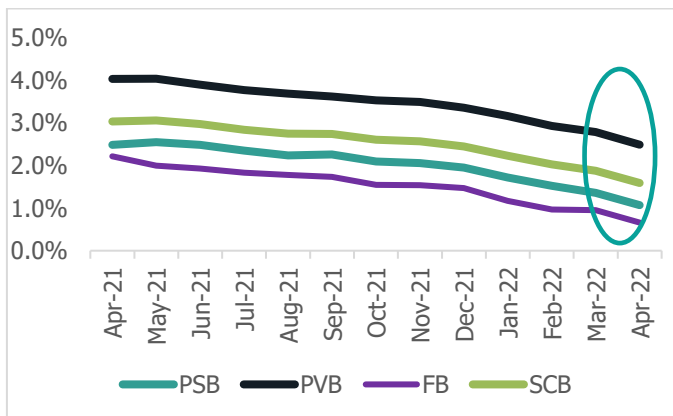
Figure 3: Movement in Spread between WALR (O/s) and WADTDR



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. SCB's spread between WALR (O/s) and WADTDR stood at 3.69% in April 2022, declining by 2 bps m-o-m and 15 bps y-o-y primarily due to a decline in WALR on loans (O/s). 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 compared with PSBs and PVBs. However, with aggressive pricing on deposits, their spread has fallen below the PVBs spread for the last four months in a row. Both PSBs and PVBs pay deposit holders at broadly similar rates, however, PVBs charge a higher lending rate resulting in higher spreads.

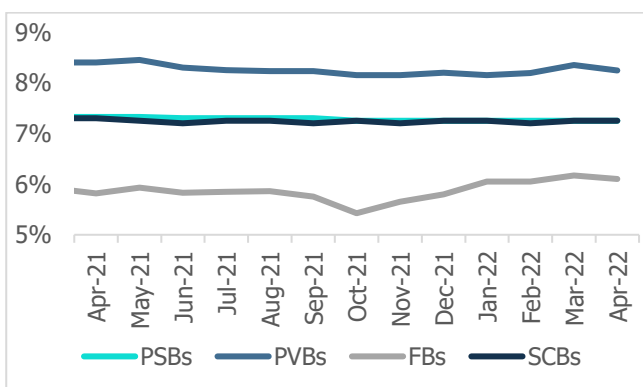
Figure 4: Contracting Trend in Spread between WALR (O/s) and 10 Year G-Sec



Source: RBI

The spread between the 10-year G-sec yield and the lending rates has been contracting due to interest transmission to the borrowers as well as rising G-sec yields. PVBs continue to have a higher spread compared to PSBs.

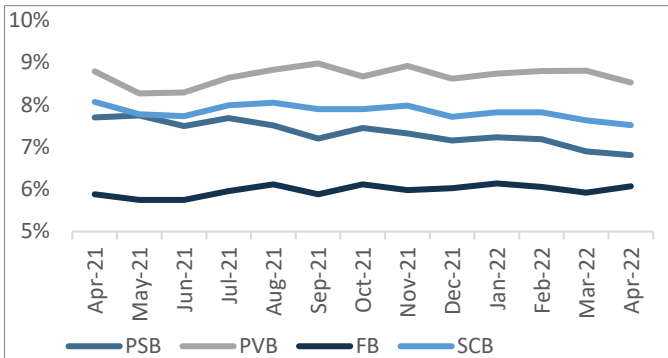
Figure 5: Movement in 1 Year MCLR (Median)



Note: Source: RBI

Median SCB and PSB MCLR remained unchanged m-o-m at 7.25% in April 2022. PVBs witnessed a drop of 11 bps m-o-m to 8.24% in April 2022, while FBs decreased by 07 bps m-o-m to 6.10%. The minimum MCLR of PSBs and FBs increased by 10 bps and 30 bps m-o-m to 7.10% and 4.05%, respectively, in April 2022 indicative of the narrowing of the rate corridor. However, PVBs saw no changes in the month. In view of the tightening interest rate scenario, some banks increased MCLRs before the RBI announcement (repo rate hike by 40 bps on May 4, 2022) and others have followed suit post the announcement.

Figure 6: Evolution of WALR Fresh Loans



Interest rate transmission continued between April 2021 and April 2022. WALR on Fresh loans for PSBs, PVBs, and SCBs declined by 89 bps, 26 bps, and 55 bps y-o-y, respectively, in April 2022. On a m-o-m basis, PSBs, PVBs, and SCBs declined by 9 bps, 28 bps, and 11 bps, respectively, in April 2022. Meanwhile, the rate cycle seems to have turned for FBs as they registered a rise in both y-o-y and m-o-m basis by 19 bps and 15 bps, respectively. Other segments may follow in May 2022 as RBI has already raised rates in May 2022.

Conclusion

The spread between WALR O/s and WADTDR of PVBs and PSBs continue to maintain high spreads with PVBs seeing relatively higher spreads. WALR on outstanding loans has declined y-o-y and m-o-m for all groups, even though the bank rate was steady (bank rate increased in early May 2022), whereas WADTDR of all groups also witnessed a drop (y-o-y) except for FBs, which increased by 23 bps in April 2022.

In one of the key developments for the sector, RBI has increased the repo rate and CRR in the first week of May 2022. Given that inflation continues to remain above RBI’s target, additional hikes are anticipated during the year. Many banks have also raised their MCLR and deposit rates. Thus, the banking interest rate has bottomed out and would rise in the period ahead.

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