Banking Interest Rates on an Uptrend in FY23

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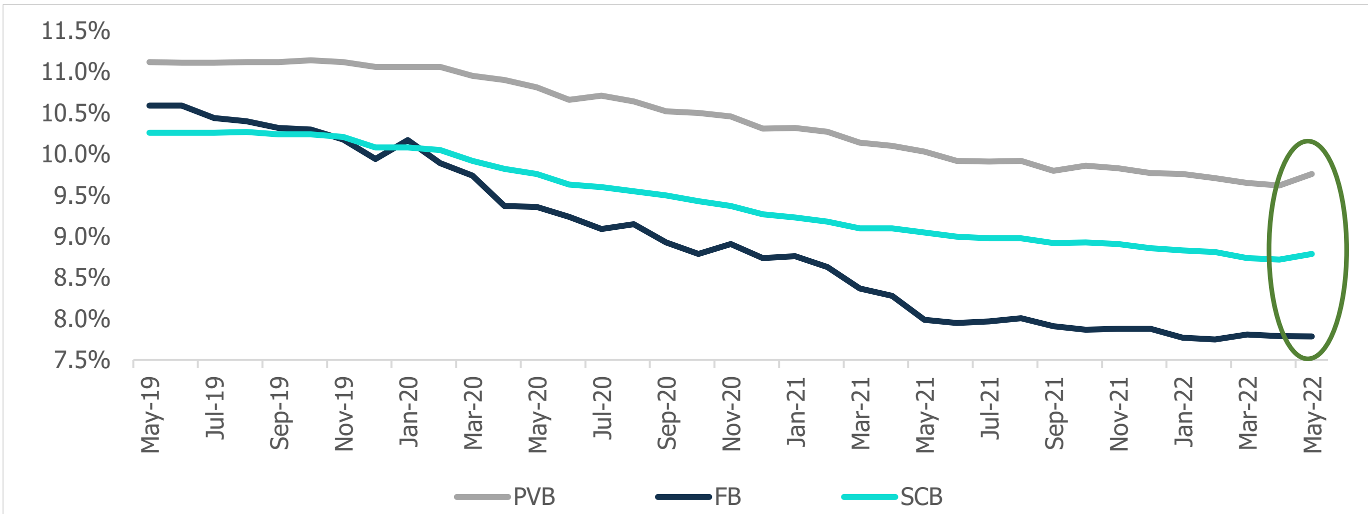
Lending and Deposit Rates Rise m-o-m in May-22

Credit offtake has been showing signs of improvement since August 2021 and stood at 9.6% for March 2022 versus the 5.6% witnessed at the FY21 end. The trend has continued in Q1FY23. The onset of the Russia-Ukraine conflict disrupted the global supply chain and along with other factors such as commodity prices has resulted in an inflationary trend. Consequently, RBI increased the repo rate twice by 40 basis points (bps) to 4.40% in May 2022 and 50 bps to 4.9% in June 2022 and additional rate hikes are anticipated throughout FY23. In view of this tightening interest rate scenario, many banks have raised their lending as well as deposit rates.

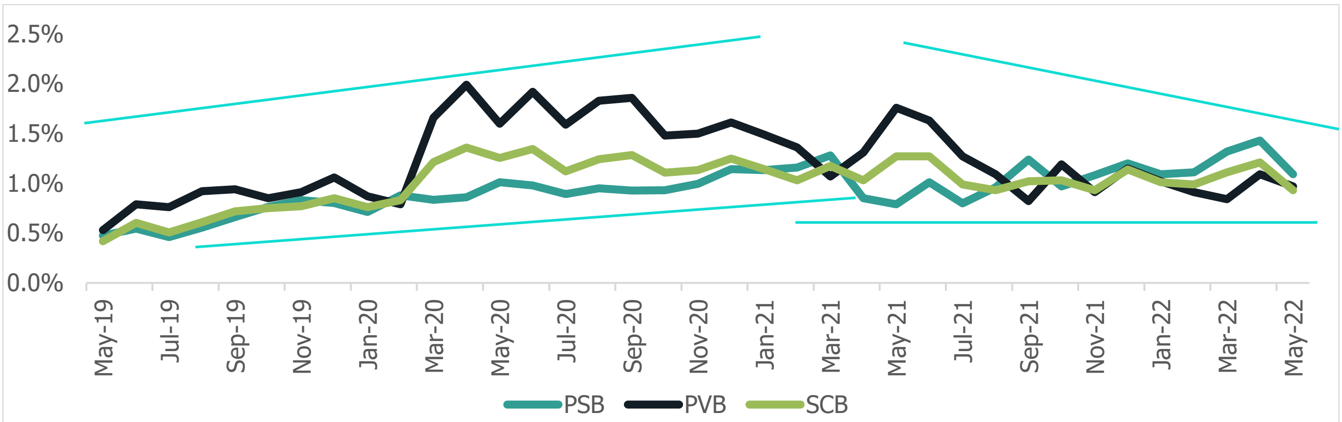
Figure 1: Evolution of WALR O/s (lending) Loans



Source: RBI

In May 2022, WALR on O/s loans for PSBs, PVBs, and SCBs increased by 3 bps, 14 bps, and 7 bps, m-o-m, respectively, on account of a hike in the policy rate in early May. WALR on fresh loans incorporated the rising interest rates faster as it increased for PSBs, PVBs and SCBs by 37 bps, 26 bps, and 35 bps m-o-m, respectively, in May 2022.

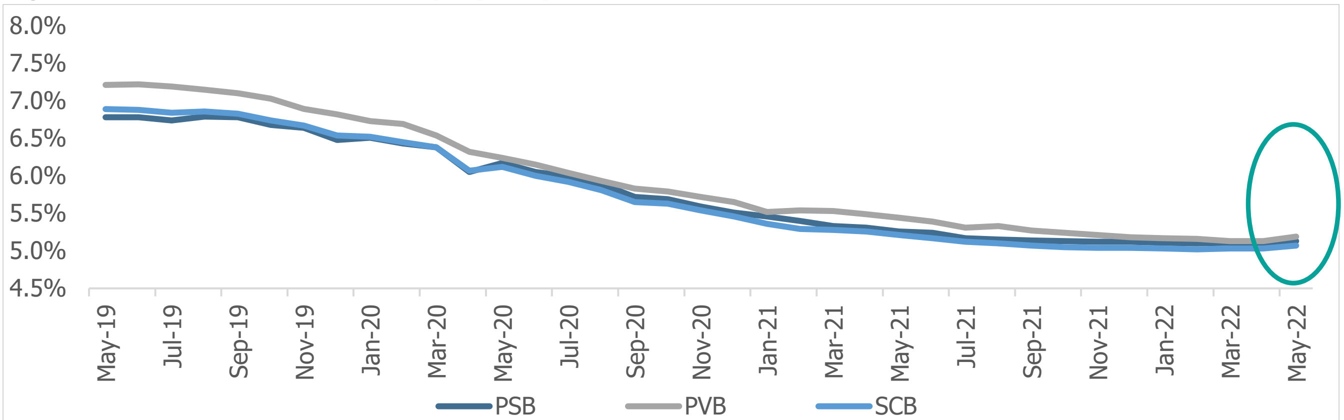
Figure 2: Spread between WALR o/s loans and WALR Fresh loans



Source: RBI

Spread between WALR (O/s) loans and WALR fresh loans for PSBs, PVBs, and SCBs dropped by 34 bps, 12 bps and 28, bps, m-o-m, respectively, in May 2022 due to a higher rise of WALR on fresh loans as compared to WALR on (O/s) loans. The rising policy rate is expected to have a faster impact on the lending rate of fresh loans as new loans can be priced at newer rates, while older loans are re-priced over the year based on repricing dates for specific loans. Consequently, the spread is likely to narrow in the near term and then stabilise over the medium term.

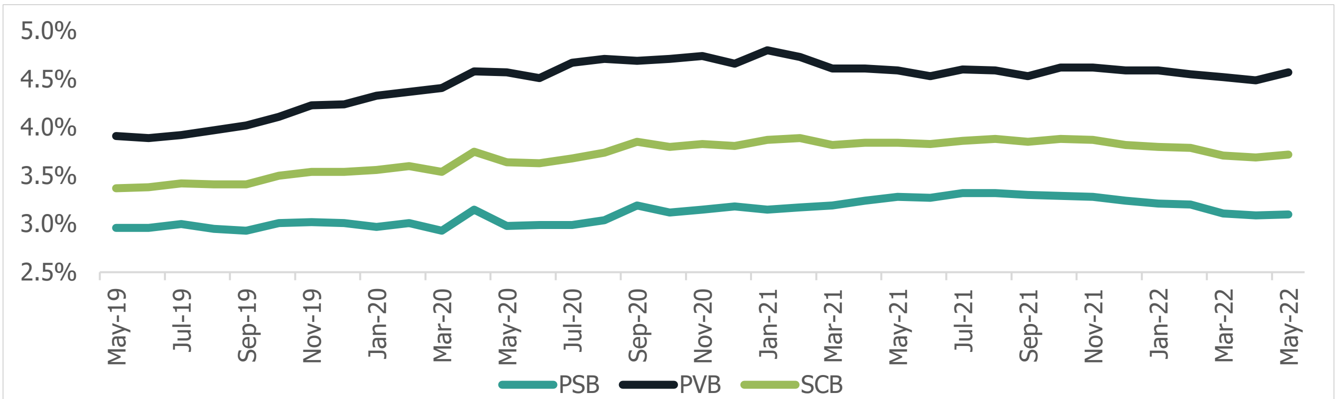
Figure 3: Evolution of WADTDR (Deposit) Rates have Bottomed Out



Source: RBI

Deposit rates for PSBs, PVBs and SCBs witnessed a rise by 2 bps, 6 bps, and 4 bps m-o-m respectively, in May 2022. The rise in deposit rates, however, was slower than the increase in repo rate (40 bps). Repricing of liabilities usually happens after a lag, compared to the repricing of assets, also because fixed deposits generally do not have floating rates. At present, liquidity with banks is high, hence there is not enough reason to substantially increase deposit rates. It will take three-six months for deposit rates to catch up with lending rates. The deposit rates are expected to increase in the next three-six months as the credit growth picks up and excess liquidity gets absorbed.

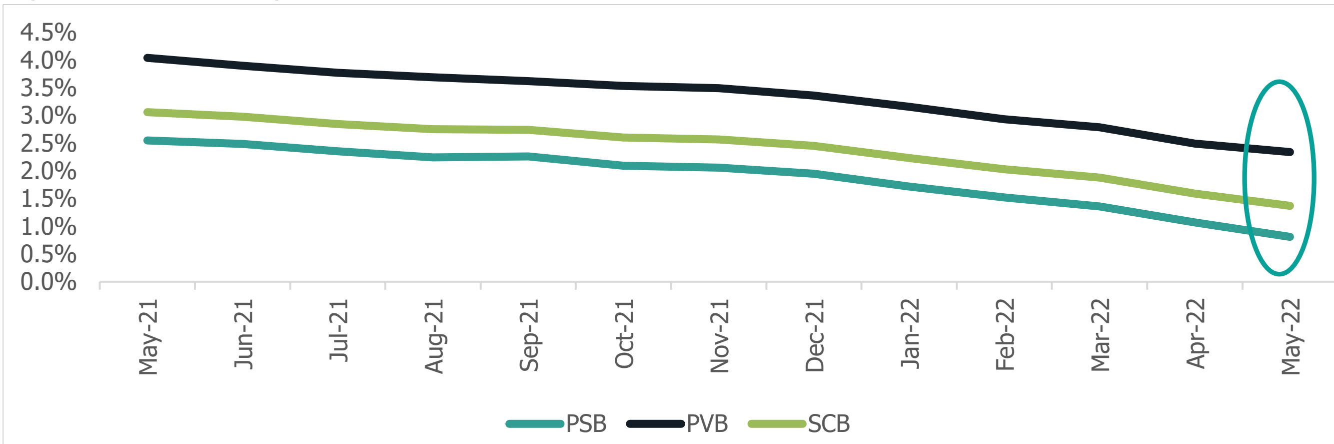
Figure 4: Movement in Spread between WALR (O/s) and WADTDR



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 3.72% in May 2022. The spread for PSBs, PVBs and SCBs increased by 1 bps, 8 bps and 3 bps m-o-m, respectively in May 2022 due to a higher rise in lending rates as compared to deposit rates. The spread for PSBs and SCBs was in a downtrend for the last 1 year, however, it was stable for PVBs. Both PSBs and PVBs pay deposit holders at broadly similar rates, however, PVBs charge a higher lending rate resulting in higher spreads.

Figure 5: Contracting Trend in Spread between WALR (O/s) and 10-Year G-Sec

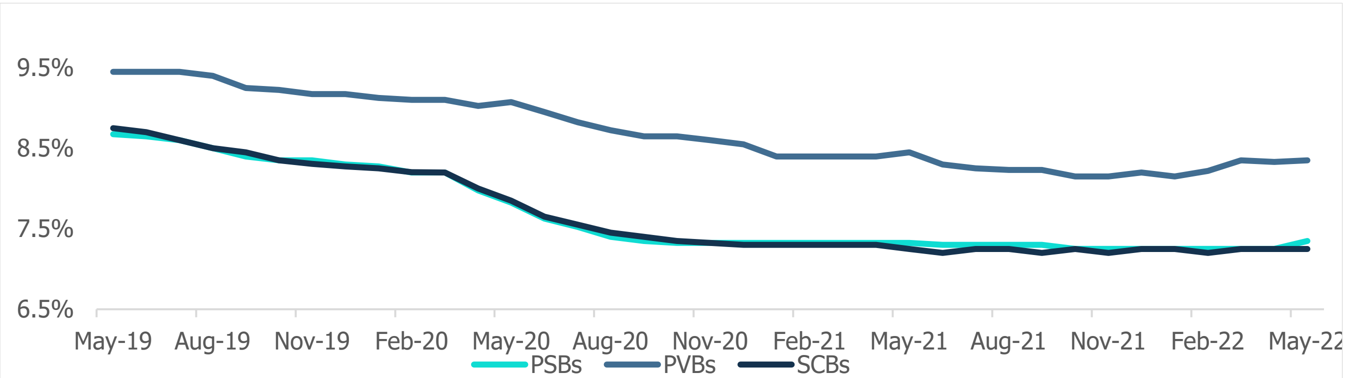


Source: RBI

The spread between the 10-year G-sec yield and the lending rates has been contracting due to rising yields in the capital market. Meanwhile, even though the G-Sec yields have risen, lending rates have not grown at the same pace consequently, the spread is likely to narrow in the near term.

The spread for SCBs came in at 1.37% in May 2022 dropping by 22 bps m-o-m whereas PSBs and PVBs dropped by 26 bps and 15 bps, respectively in the same period. The elevated yields on G-sec bonds are encouraging corporate borrowers to shift borrowings to the banking system from the capital market.

Figure 6: Movement in 1 Year MCLR (Median)



Source: RBI

The median MCLR of PSBs and PVBs increased by 10 bps and 2 bps to 7.35% and 8.35% m-o-m, respectively in May 2022 due to the beginning trend of the rising policy rate (interest). Given 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.

Conclusion

In May 2022, PVBs and PSBs continue to maintain high spreads between lending and deposit rates, with PVBs seeing relatively higher spreads. Given the tightening interest rate scenario, many banks have also raised their MCLR and deposit rates. WALR on fresh loans witnessed a rise in tandem with the repo rate during May 2022, however, WADTDR's rise was slower. WADTDR is expected to go up in the next three to six months as the credit growth picks or liquidity gets absorbed from the banking system. Overall, the banking interest rates have bottomed out and are expected to rise further in FY23.

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