Assessment of Policy Rate Transmission to Prime Lending Rates in Banking Industry

March 2022

Lending Rates on New Loans Continue to Decrease, Driven by Regional Government Banks and State-Owned Banks

- **At the beginning of 2022, the cost of loanable funds (CoLF) continued to facilitate lower prime lending rates in the banking industry, coupled with slightly lower overhead costs (OHC) and profit margins.**
- **The banking industry recorded another period of lower lending rates on new loans in line with marginal improvements in risk perception, primarily driven by regional government banks and state-owned banks.**
- **On the other hand, profit margins have remained more rigid as banks strive to maintain profitability and capital growth amid very early signs of recovery in the intermediation function and persistent credit risk.**

Response of Prime Lending Rates[1] and Deposit Rates to BI7DRR[2]

---

[1] The Prime Lending Rate (PLR) is published by banks in accordance with OJK Regulation (POJK) No. 37/POJK.03/2019, dated 19th December 2019, concerning Bank Report Transparency and Publication. The PLR is used as a base for setting the interest rate charged by the bank to debtors but does not consider the individual borrower's risk premium component. Therefore, the interest rate that is charged to debtors is not necessarily equal to the PLR.

[2] Using data available at end of January 2022.

A consistently low policy rate continues to edge down lending rates in the banking industry. In January 2022, the banking industry lowered prime lending rates by 6bps (mtm) to 8.64% despite the BI7DRR being held at the same level since March 2021. Compared with conditions in January 2021, the prime lending rate has decreased by 139bps (yoy), thus narrowing the spread between the PLR and BI7DRR from 6.28% in January 2021 to 5.14% in January 2022. During the same period, the spread between the PLR and 1-month term deposit rate shrank from 5.97% to 5.71% (Graph 1).

Graph 1 Prime Lending Rate, BI7DRR and 1-Month Term Deposit Rate

Spread (PLR – BI7DRR); Spread (PLR – 1-Month TD Rate); PLR; 1-Month TD Rate; BI7DRR

Source: Financial Services Authority (OJK) and Commercial Bank Reports, processed

Broad-based PLR declines were reported across all bank groups, except state-owned banks. Compared with conditions one month earlier, foreign bank branches, regional government banks and national private commercial banks recorded 45bps, 34bps and 4bps (mtm) reductions in the PLR, bringing the annual decrease to 86bps, 108bps and 78bps (yoy) respectively. Meanwhile, PLR at state-owned banks remained unchanged compared with conditions in previous months after falling 210bps (mtm) in February 2021 (Graph 2).

Graph 2 Prime Lending Rates by Bank Group

Regional Government Banks; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches

Source: Financial Services Authority (OJK), processed

Prime Lending Rate by Component

By component[3], the cost of loanable funds (CoLF) was still the main driver of the lower PLR. Maintaining the current trend, CoLF fell a further 3bps (mtm) in January 2022 (Graph 3). Nearly all bank groups reported a lower CoLF, led by regional government banks (11bps mtm), followed by national private commercial banks (4bps mtm) and state-owned banks (2bps mtm), contrasting the 6bps (mtm) increase recorded at foreign bank branches (Graph 4). In the same period, overhead costs (OHC) decreased marginally by 1bps (mtm) industry wide (Graph 3). OHC rigidity stemmed from state-owned banks, where OHC climbed 14bps (mtm). Meanwhile, foreign bank branches, regional government banks and national private commercial banks reversed the previous increase to record 47bps (mtm), 30bps (mtm) and 13bps (mtm) lower OHC respectively (Graph 5).

Graph 3 Prime Lending Rate by Component

CoLF; OHC; Profit Margin

Source: Financial Services Authority (OJK), processed

Graph 4 CoLF Component by Bank Group

Regional Government Banks; National Private Commercial Banks; State-Owned Banks; Foreign Bank Branches

Source: Financial Services Authority (OJK), processed

---

[3] Pursuant to OJK Regulation (POJK) No. 37/POJK.03/2019 concerning Bank Report Transparency and Publication, the PLR consists of three components, namely; (i) the cost of loanable funds (CoLF), including the cost of funds, cost of services, regulatory costs and other costs; (ii) overhead costs (OHC), including labour costs, education and training costs, research and development costs, rental costs, promotion and marketing costs, maintenance and repair costs, fixed asset and inventory depreciation costs as well as other overhead costs; and (iii) profit margin, which is determined by the respective bank for lending activity.

Graph 5 OHC Component by Bank Group

Regional Government Banks; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches

Source: Financial Services Authority (OJK), processed

Graph 6 Profit Margin Component by Bank Group

Regional Government Banks; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches

Source: Financial Services Authority (OJK), processed

Profit margins have also narrowed slightly. Overall, profit margin in the banking industry stood at 2.62% in the reporting period, down slightly by 1bps (mtm) (Graph 3). On one hand, state-owned banks and foreign bank branches recorded 13bps and 4bps (mtm) lower profit margins (Graph 6), contrasting the 13bps (mtm) increase at national private commercial banks in January 2022. On the other hand, the profit margin of regional government banks increased 6bps (mtm) after retreating one month earlier.

Risk Premium and Interest Rates on New Loans

In line with lower prime lending rates, interest rates on new loans continued to track a downward trend supported by improving risk perception. In February 2022, lending rates on new loans stood at 9.09%, down 23bps (mtm) or 30bps (yoy) (Graph 7). The decline was consistent with improving risk perception in the banking industry, supported by lower risk premium and Loans at Risk (LaR)[4] indicators (Graph 8). On a monthly basis, nearly all bank

[4] Loans at Risk (LaR) include restructured outstanding loans with a collectability score of 1, outstanding loans with a collectability score of 2 as well as non-performing loans (NPL).

groups lowered interest rates on new loans in February 2022, led by regional government banks at 58bps (mtm), followed by state-owned banks and national private commercial banks at 20bps (mtm) and 5bps (mtm) respectively. Meanwhile, foreign bank branches recorded no change in lending rates on new loans (Graph 10).

Graph 7 Interest Rates on New Loans

Spread Between PLR and Lending Rates on New Loans (rhs); Lending Rates on New Loans; PLR

Source: Financial Services Authority (OJK) and Commercial Bank Reports, processed

Graph 8 Risk Premium and LaR Indicators

Risk Premium; LaR (rhs)

Source: Financial Services Authority (OJK) and Commercial Bank Reports, processed

Graph 9 Risk Premium by Bank Group

Regional Government Banks; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches

Source: Financial Services Authority (OJK), processed

Graph 10 Interest Rates on New Rp Loans by Bank Group

Regional Government Banks; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches

Source: Commercial Bank Reports, processed

Profit Margin Developments

Profit margin rigidity stems from bank efforts to maintain profitability amid requirements to fulfil provisions for impairment losses and internal policies. After narrowing in March 2021, profit margins in the banking industry began to track an upward trend through to the beginning of 2022 (Graph 3). Against a backdrop of persistent credit risk and a sluggish intermediation function in terms of new loan disbursements, banks have increased profit margins in order to maintain profitability, as reflected by a higher net interest margin (NIM) and return on assets (ROA) in 2021 compared with conditions in 2020 (Graph 11). The relatively high NIM is consistent with the high cost of credit to provisions for impairment losses and overhead costs. Furthermore, data shows that the higher ROA is influenced by the dividend payout ratio (Graph 12), where the ROA at banks paying out dividends on an average basis tends to be higher than at banks without dividend payouts (Graph 13), as a effort to maintain capital growth amid limited internal funds due to dividend payout policy.

Graph 11 Return on Assets (ROA) and Net Interest Margin (NIM)

ROA; NIM

Source: Financial Services Authority (OJK), processed

Graph 12 Dividend Payout Ratio

Source: Bank Annual Financial Statements, Indonesia Stock Exchange (IDX), processed

Graph 13 Comparison of Banks Paying and Not Paying Out Dividends

With Dividend Payout; Without Dividend Payout

ROA; Capital Growth (% yoy); CAR

Source: Bank Performance Data, (average for 2018-2020), processed

Appendix 1 – List of PLR and PLR-BI7DRR Spread by Bank per Credit Segment

Box: Background of Prime Lending Rate Transparency Policy in the Banking Industry

The goal of publishing prime lending rates and this assessment is to strengthen and accelerate monetary and macroprudential policy transmission from Bank Indonesia. Since June 2019, Bank Indonesia has lowered the reference rate by 225bps and relaxed macroprudential policy, yet prime lending rates remain rigid. Therefore, Bank Indonesia acknowledges the opportunity for the banking industry to implement further PLR reductions in line with the policy rate. Through transparency, the public and corporate sector can compare the PLR published by different banks. Faster policy rate transmission to interest rates in the banking industry in the form of commensurate lending rates is expected to revive demand for loans and help drive the economic recovery.

As a preliminary measure, Bank Indonesia is publishing the **Assessment of Policy Rate Transmission to Prime Lending Rates in the Banking Industry**. Several factors influence PLR setting that are specific to each respective bank, namely the cost of loanable funds, overhead costs and profit margin. Although the determinants are quite diverse, this publication aims to expand public understanding of prime lending rates in the banking industry in Indonesia, including statistical information concerning the distribution of prime lending rates. In addition to expediting more effective monetary policy transmission, Bank Indonesia also strives to increase the dissemination of information to corporate and household borrowers through this publication. Furthermore, this assessment aims to increase governance, market discipline and competition when setting prime lending rates in the banking industry to ensure more competitive rates, restore demand for loans and accelerate the economic recovery.

Similar publications are a common international practice. Other central banks in Malaysia, India and China, amongst others, also promote PLR transparency through publications such as the External Benchmark Rate, Loan Prime Rate and Base Rate. Moreover, the International Monetary Fund (IMF) also requests of its members to submit a Reference Lending Rate and Reference Deposit Rate for publication as a reference spread between lending rates and deposit rates as one of the Financial Soundness Indicators (FSI).