Appendix of Bank Indonesia Press Release No. 23/129/DKom

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

May 2021

BANK INDONESIA

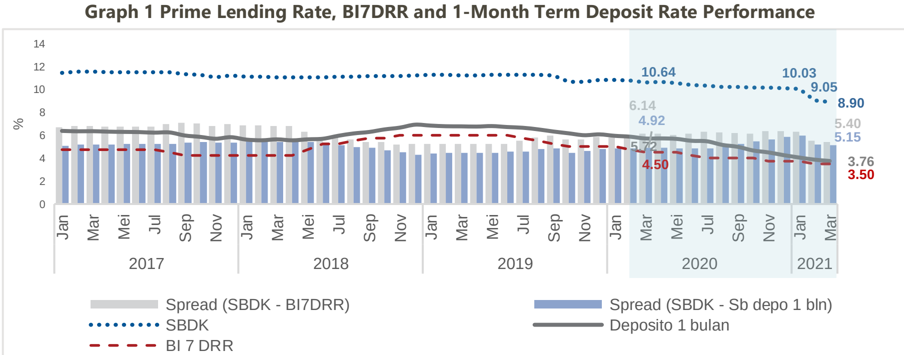
Key Takeaway: Lower Lending Rates on New Loans Must Follow PLR Reductions

- **Bank Indonesia appreciates banking industry efforts to lower prime lending rates (PLR), state-owned banks in particular. Nevertheless, such reductions must be followed by efforts to lower lending rates on new loans. PLR decreased 174bps in the period from March 2020 to March 2021, accompanied by a modest 59bps (yoy) decline in lending rates on new loans.**
- **By bank group, regional government banks, national private commercial banks and state-owned banks recorded moderate 34bps, 52bps and 55bps (yoy) lending rates reductions on new loans in the reporting period, contrasting the significant 158bps (yoy) decrease at foreign bank branches.**
- **In March 2021, therefore, regional government banks and national private commercial banks offered the highest lending rates on new loans at 10.05% and 9.32% respectively, compared with 8.70% and 5.34% at state-owned banks and foreign bank branches.**

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

The banking industry continues to respond to policy rate reductions by Bank Indonesia, albeit less significantly than in the previous period, while deposit rates remain more responsive. The banking industry lowered prime lending rates (PLR) in March 2021 by 15bps (mtm), down from 98bps (mtm) in February 2021. Consequently, from March 2020 to March 2021, PLR recorded a 174bps (yoy) decline in response to a 100bps lower BI7DRR in the same period, thus narrowing the spread between the PLR and BI7DRR from 6.14% in March 2020 to 5.40% in March 2021 (decreasing 74bps). On the other hand, deposit rates were more responsive, falling 196bps (yoy) and widening the spread between the PLR and 1-month term deposit (TD) rate from 4.92% to 5.15% (increasing 23 bps) (Graph 1).

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



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

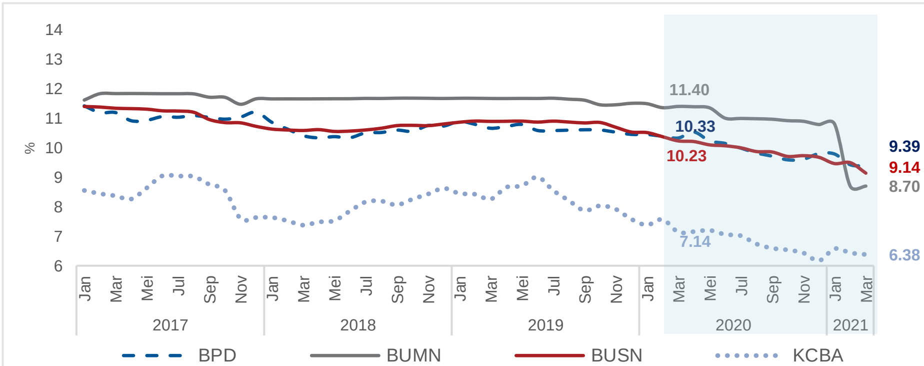
By bank group, state-owned banks were the main driver of lower PLR. The PLR published by state-owned banks experienced the deepest decline of all bank groups, namely 270bps (yoy) during the period from March 2020 to March 2021. Meanwhile, the prime lending rates offered by national private commercial banks, regional government banks and foreign bank branches decreased respectively by 109bps (yoy), 94bps (yoy) and 76bps (yoy). Therefore, the PLR at state-owned banks and foreign bank

[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 March 2021.

branches in March 2021 were recorded at 8.70% and 6.38%, below regional government banks and national private commercial banks at 9.39% and 9.14% (Graph 2). Bank Indonesia appreciates the efforts made by all bank groups to accelerate PLR reductions as part of the joint efforts to revive lending/financing to the corporate sector and accelerate the national economic recovery.

Graph 2 Prime Lending Rates by Bank Group



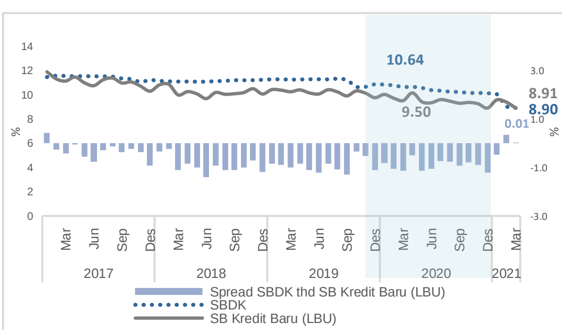
Source: Financial Services Authority (OJK), processed

Prime Lending Rates and Lending Rates on New Loans

Lending rates on new loans appear more rigid and have not experienced a commensurate decline compared with prime lending rates, despite limited reductions. PLR fell 174bps in the period from March 2020 to March 2021, contrasting the modest 59bps decrease in lending rates on new loans (Graph 3). By bank group, regional government banks, national private commercial banks and state-owned banks have recorded moderate reductions in lending rates on new loans at just 34bps (yoy), 52bps (yoy) and 55bps (yoy) respectively. Such rigidity is blamed on the cost structure (cost of funds, overhead costs), borrower risk profile and net interest margin. On the other hand, foreign bank branches lowered lending rates on new loans significantly by 158bps (yoy) in the same period (Graph 4).

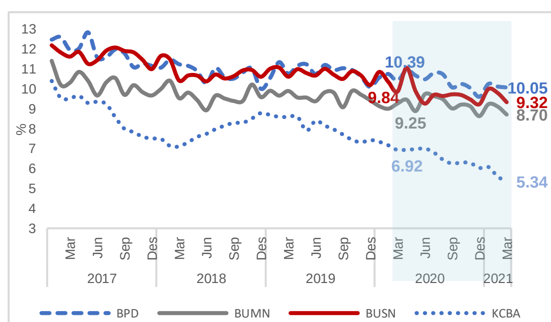
The lending rates on new loans published by regional government banks and national private commercial banks remain the highest. Given more rigidity, lending rates on new loans at regional government banks were highest in March 2021 at 10.05%, followed by national private commercial banks at 9.32% and state-owned banks at 8.70% (Graph 4). Conversely, foreign bank branches offered the lowest lending rate on new loans at 5.34% in line with the dominance of corporate loans at such banks, which afford lower interest rates than individual loans.

Graph 3 Prime Lending Rates and Lending Rates on New Loans



Source: Financial Services Authority (OJK), processed

Graph 4 Lending Rates on New Loans by Bank Group

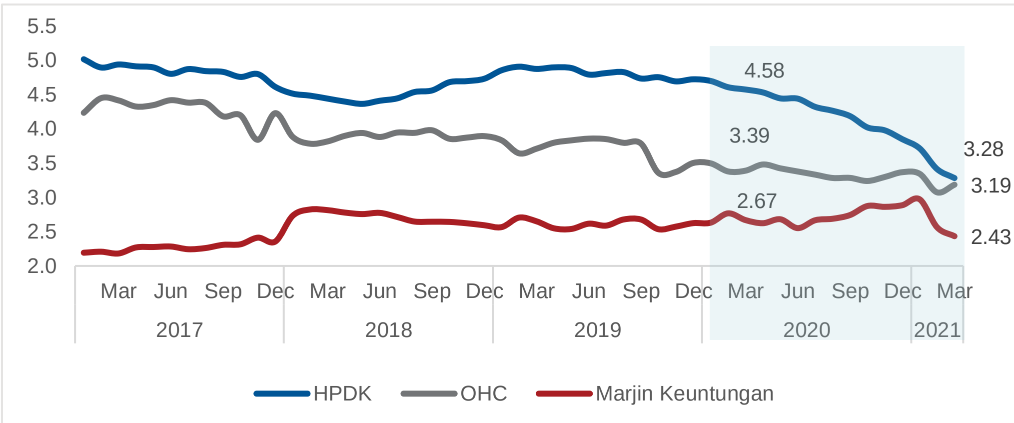


Source: Commercial Bank Reports, processed

Prime Lending Rate by Component

By PLR component[3], the cost of loanable funds (CoLF) experienced the largest decline compared with overhead costs (OHC) and profit margin. The CoLF recorded a 129bps (yoy) decrease between March 2020 and March 2021, while the OHC and profit margin recorded respective declines of 20bps and 24bps (yoy) (Graph 5).

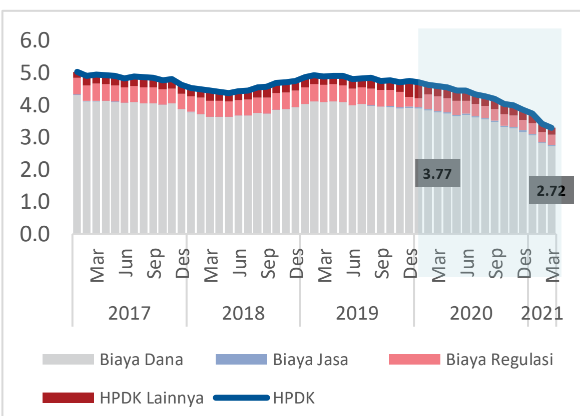
Graph 5 Prime Lending Rate Performance by Component



Source: Financial Services Authority (OJK), processed

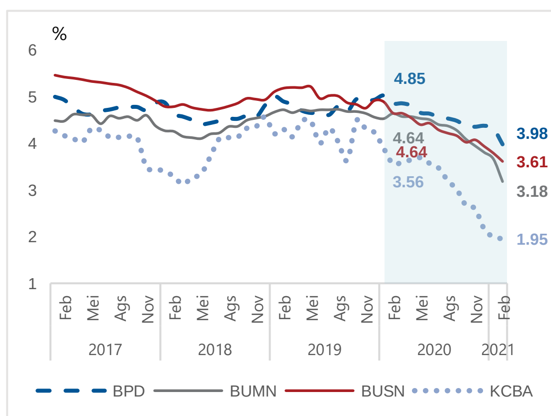
The CoLF component decreased across all bank groups. The lower CoLF was primarily driven by a 106bps decline in the cost of funds to 2.72% (Graph 6) in line with loose liquidity conditions in the banking industry. Foreign bank branches, state-owned banks and national private commercial banks recorded respective CoLF declines of 173bps, 155bps and 114bps (yoy) between March 2020 and March 2021. Meanwhile, a more subdued 96bps (yoy) decrease in the CoLF was recorded at regional government banks (Graph 7) with the rigidity caused by a high cost of funds given the dependence on large depositors, as reflected in the dominant share of special rates to total deposits compared with other bank groups (Graph 8).

Graph 6 CoLF Components



Source: Financial Services Authority (OJK), processed

Graph 7 CoLF Components by Bank Group



Source: Financial Services Authority (OJK), processed

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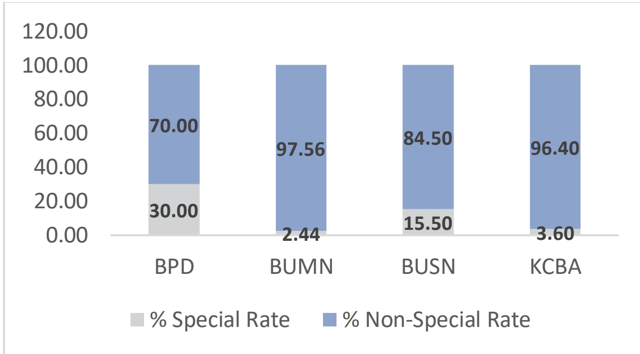
[3] Pursuant to OJK Regulation (POJK) No. 37/POJK.03/2019 concerning Bank Report Transparency and Publication, the PLR consists of three components, namely; (i) the cost of loanable funds (CoLF), including the cost of funds, cost of services, regulatory costs and other costs; (ii) overhead costs (OHC), 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 8 Share of Special Rate to Total Deposits, February 2021

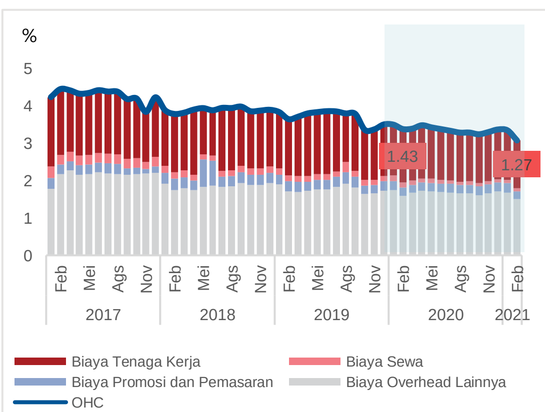


Special Rate: Deposits with an interest rate higher than IDIC rate

Source: Commercial Bank Reports, processed

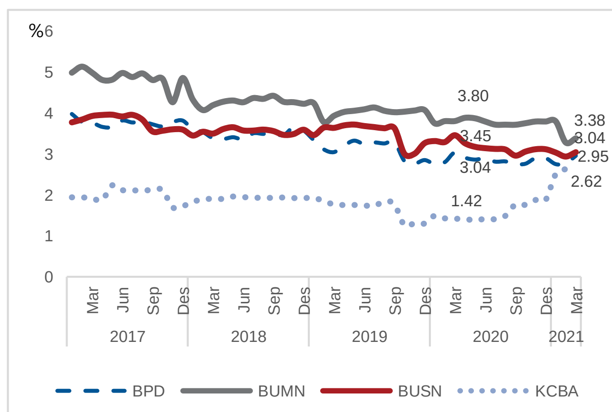
Through efficiency gains, state-owned banks, national private commercial banks and regional government banks effectively reduced their overhead costs (OHC), contrasting the higher OHC reported by foreign bank branches. Lower OHC in the banking industry were primarily attributable to a 20bps (yoy) decrease in labour costs (Graph 9) as the banking industry strived to improve efficiency through digitalisation, amongst others. The OHC reported by state-owned banks, national private commercial banks and regional government banks decreased respectively by 42bps, 41bps and 8bps (yoy), contrasting the corresponding 120bps (yoy) increase recorded at foreign bank branches (Graph 10).

Graph 9 OHC Components



Source: Financial Services Authority (OJK), processed

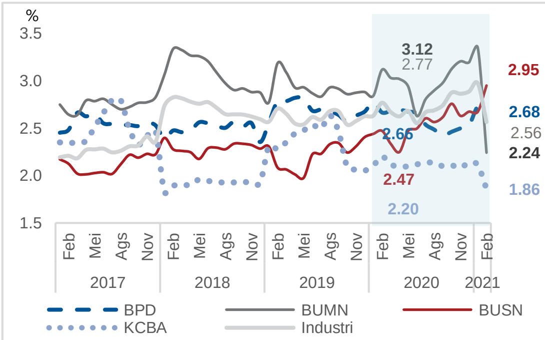
Graph 10 OHC Components by Bank Group



Source: Financial Services Authority (OJK), processed

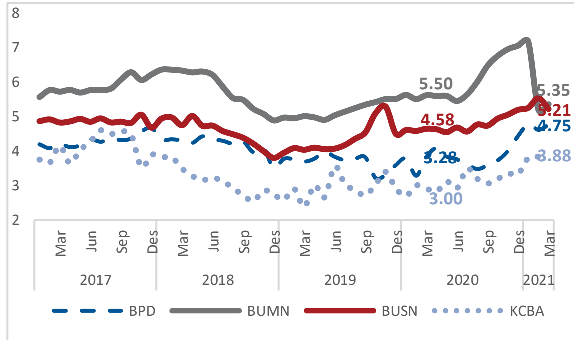
Defying wider profit margins at national private commercial banks, profit margins at state-owned banks, foreign bank branches and regional government banks narrowed. **P**rofit margins at state-owned banks, foreign bank branches and regional government banks decreased respectively by 73bps, 22bps and 15bps (yoy), while profit margins at national private commercial banks increased by 26bps (yoy) (Graph 11). Therefore, the spread between PLR and 1-month term deposit rates at national private commercial banks was widest at 5.35% (Graph 12).

Graph 11 Profit Margin by Bank Group



Source: Financial Services Authority (OJK), processed

Graph 12 Spread between PLR and 1-Month TD Rates



Source: Financial Services Authority (OJK), processed

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, revive 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).