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

February 2023

Banking Industry Responds to Higher Policy Rate

- **The higher policy rate was partially transmitted to lending and deposit rates in banking industry, as reflected by an increase in the cost of loanable funds (CoLF), accompanied by increases in the prime lending rate (PLR) and lending rate on new loans in the reporting period.**
- **The banking industry has responded to a total increase of 200bps in the BI7DRR since July 2022 by raising the lending rate on new loans by 178bps. The lending rate response on new productive loans has been more restrained in line with bank efforts to maintain the quality of productive loans.**

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

The banking industry has continued responding to the higher BI7DRR. The banking industry responded to a 25bps BI7DRR hike in December 2022 by raising the PLR 4bps (mtm)

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[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] Utilising data available at end of December 2022.

from 8.68% in November 2022 to 8.72% in the reporting period. Deposit rates are more responsive to the BI7DRR, as reflected by an increase in the 1-month term deposit rate by 25bps (mtm) from 3.72% in November 2022 to 3.97% in December 2022. Consequently, the spread between the PLR and 1-month term deposit rate narrowed from 4.96% in November 2022 to 4.75% in December 2022 (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: Commercial Bank Reports (Antasena) and Financial Services Authority (OJK), processed

In general, all bank groups raised the PLR in the reporting period. In December 2022, foreign bank branches, regional development banks, national private commercial banks and state-owned banks raised the PLR by 23bps, 13bps, 3bps and 1bps (mtm) respectively (Graph 2).

Graph 2 Prime Lending Rates by Bank Group

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

Source: Financial Services Authority (OJK), processed

Prime Lending Rate by Component

The banking industry responded again to the higher policy rate through an increase in the cost of loanable funds (CoLF)[3] component of the prime lending rate. In December

[3] Pursuant to Circular Letter (SEOJK) No. 9/SEOJK.03/2020 concerning Transparency and Publication of Commercial Bank Reports, the PLR consists of three components, namely; (i)

2022, the CoLF component increased 11bps on average for the industry to 2.95% from 2.84% in November 2022 (Graph 3). This was attributable to monthly increases in the CoLF across all bank groups, led by foreign bank branches (37bps), followed by regional development banks (13bps), state-owned banks (11bps) and national private commercial banks (10bps) (Graph 4). Meanwhile, the overhead cost (OHC) component trended stable at 3.31% (Graph 3), except at foreign bank branches that decreased 7bps (mtm) and at regional development banks that increased 4bps (mtm) (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 Development Banks; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches

Source: Financial Services Authority (OJK), processed

Graph 5 OHC Component by Bank Group

Regional Development 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

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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.

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

Source: Financial Services Authority (OJK), processed

Profit margins maintained a downward trend. In December 2022, profit margins in the banking industry posted a 7bps (mtm) decrease after declining 6bps (mtm) the month earlier (Graph 3). All bank groups recorded narrower profit margins, namely state-owned banks (9bps mtm), national private commercial banks (7bps mtm), foreign bank branches (6bps mtm) and regional development banks (4bps mtm) (Graph 6).

Lending Rates on New Loans

Interest rates on new loans increased in the reporting period. Lending rates on new loans increased 146bps (mtm) from 9.19% to 10.65% (Graph 7), driven by all bank groups, namely state-owned banks (278bps), regional development banks (103bps), national private commercial banks (46bps) and foreign bank branches (31bps). The banking industry has responded to the 200bps hike in the BI7DRR rate since July 2022 by raising lending rates on new loans by 178bps (Table 1), primarily driven by the consumer loan segment.

Graph 7 Interest Rates on Rupiah Loans

Weighted Average Interest Rate; Lending Rates on New Loans; Lending Rates on New Loans (excluding digital banks); PLR

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

Graph 8 Interest Rates on New Loans by Bank Group

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

Source: Commercial Bank Reports (Antasena), processed

Table 1 Interest Rates on New Loans by Loan Type

Investment Loans; Consumer Loans; Working Capital Loans

Source: Commercial Bank Reports (Antasena), processed

Graph 9 LaR by Loan Type

Investment Loans; Productive Loans

Source: Commercial Bank Reports (Antasena), processed

Lending Rates

The lending rate response on productive loans has been more muted than consumer loans (Table 1). The more subdued response of lending rates on productive loans was in line with bank efforts to maintain the quality of productive loans and repayment capacity due to persistently high credit risk, as reflected by LaR (Graph 9) and Quadrant II (Graph 10). Lending rates on new productive loans for economic sectors in Quadrant IV (Graph 10) tended to be more responsive to the higher policy rate, indicating a more selective banking industry when determining the pricing strategy.

Graph 10 Lending Rates on Productive Loans

1. Bubble size indicates subsector credit share to total credit disbursed to priority sectors, referring to the Board of Governors Regulation (PADG) concerning the RR Incentives.
2. X-axis indicates delta of lending rates July 2022-January 2023, with 0.37% midpoint (Delta of weighted average lending rate for priority sectors).
3. Y-axis indicates LaR of priority sectors, with 16.66% midpoint, namely industrywide LaR for priority sectors.

Appendix 1 – List of PLR and PLR-BI7DRR Spread by Bank per Credit Segment in December 2022

Box: Overview 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).