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

May 2022

Smaller Interest Rate Reductions, including PLR and Rates on New Loans

- **PLR reductions are fading, reflecting the policy rate that has remained on hold for one year. Compared with conditions one year earlier, however, prime lending rates have experienced deep declines, thus narrowing the spread between PLR and BI7DRR.**
- **Lending rates on new loans in the banking industry remain rigid compared with conditions one month earlier. By bank group, however, lending rates on new loans are dynamic, with state-owned banks and regional government banks continuing to lower rates, contrasting higher lending rates on new loans recorded at foreign bank branches.**
- **The banking industry continued to provide financing support to priority sectors by offering lower lending rates than to non-priority sectors. Compared with one year earlier, lending rates to priority sectors have also declined more significantly than non-priority sectors.**

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

Prime lending rate reductions are fading. In March 2022, the banking industry lowered prime lending rates by 1bps (mtm) compared with 3bps one month earlier, given that the BI7DRR has been held at the same level since March 2021. Compared with conditions in March 2021, the prime lending rate has decreased by 30bps (yoy), thus narrowing the spread between the PLR and BI7DRR from 5.40% in March 2021 to 5.10% in March 2022. Notwithstanding, the spread between the PLR and 1-month term deposit rate continued to increase from 5.15% in March 2021 to 5.75% in March 2022 given deeper reductions in deposit rates (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 recorded across all bank groups, except state-owned banks that reported a moderate increase. Compared with conditions one month earlier, regional government banks and foreign bank branches led PLR reductions at 5bps (mtm), followed by national private commercial banks at 1bps (mtm). Compared with conditions in

[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 March 2022.

the same period one year earlier, therefore, those three bank groups recorded annual reductions of 95bps (yoy), 72bps (yoy) and 49bps (yoy). Meanwhile, prime lending rates at state-owned banks experienced a slight bump compared with conditions in the previous month to 8.71% in March 2022 from 8.70% 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) also recorded a smaller decline in the reporting period. Maintaining the current trend, CoLF fell a further 2bps (mtm) in March 2022 (Graph 3) compared with 15bps one month earlier. All bank groups reported a lower CoLF, except foreign bank branches that recorded a 2bps (mtm) increase. The deepest CoLF decline was recorded at state-owned banks (3bps mtm), followed by regional government banks (2bps mtm) and state-owned banks (1bps mtm) (Graph 4). Conversely, overhead costs (OHC) were rigid in March 2022. OHC rigidity was prompted by higher OHC at foreign bank

[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) 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.

branches (18bps mtm), accompanied by a slight increase at national private commercial banks (2bps mtm). In contrast, state-owned banks (2bps mtm) and regional government banks (1bps mtm) recorded lower OHC in the reporting period (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; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches

Source: Financial Services Authority (OJK), processed

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 continued to track an upward trend. Profit margins in the banking industry increased by an average of 1bps (mtm) in March 2022 (Graph 3). National private commercial banks (3bps mtm) and state-owned banks (2bps mtm) recorded higher profit margins in the reporting period. Contrasting conditions one month earlier, however, foreign bank branches recorded a 24bps mtm decrease, while profit margins at regional government banks continued to fall by a further 5bps mtm in the reporting period (Graph 6).

Risk Premium and Interest Rates on New Loans

Interest rates on new loans were rigid in the reporting period. In April 2022, lending rates on new loans stood at 8.74%, unchanged on the previous month (Graph 7). The rigidity stemmed from a slightly higher risk premium in the banking industry (Graph 8), particularly amongst state-owned banks (Graph 9), while Loans at Risk (LaR)[4] continued to decrease (Graph 8). Different bank groups experienced different dynamics in terms of lending rates on new loans. Foreign bank branches experienced rigidity, while state-owned banks (55bps) and regional government banks (5bps) lowered interest rates on new loans, with state-owned banks accelerating the reduction from just 4bps one month earlier. In contrast, however, national private commercial banks increased interest rates on new loans by 26bps mtm after lowering lending rates significantly by 63 bps in the previous period (Graph 10).

Graph 7 Interest Rates on New Rupiah 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

[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).

Source: Commercial Bank Reports, processed

Graph 10 Interest Rates on New Rupiah Loans by Bank Group

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

Source: Commercial Bank Reports, processed

Lending Rates for Priority Sectors[5]

The banking industry is offering lower lending rates to priority sectors than non-priority sectors. In general, loans disbursed to priority sectors have a lower interest rate than loans extended to non-priority sectors (Graph 11). Compared with conditions in April 2020 (beginning of pandemic), the weighted average lending rate offered to priority sectors has fallen 120bps (Graph 11). During the same period, the average lending rate on new loans offered to priority sectors has fallen 181bps compared with just 40bps for non-priority sectors (Graph 12). Interest rates decreased despite a higher LaR in terms of priority sectors (Graph 13), indicating bank efforts to maintain credit growth in priority sectors amid the economic slowdown (Graph 14). In addition, lower lending rates to priority sectors were also influenced

[5] According to Bank Indonesia Regulation (PBI) No. 24/5/PBI/2022 concerning Incentives for Banks Extending Funds for Specific and Inclusive Economic Activities, priority sectors are those contributing to economic growth, namely resilient sectors, growth drivers and/or slow starters.

The list of priority sectors refers to Board of Governors Regulation (PADG) No. 24/4/PADG/2022 concerning Incentive Implementation Regulations for Banks Extending Funds for Specific and Inclusive Economic Activities

by the composition of loans, dominated by productive loans (investment loans and working capital loans). Conversely, non-priority sectors are dominated by consumer loans, particularly multipurpose loans that are typically uncollateralised.

Graph 11 Weighted Average Interest Rate on Rupiah Loans to Priority Sectors

Spread of Interest Rates on Rupiah Loans to Priority Sectors; Spread of Interest Rates on Rupiah Loans to Non-Priority Sectors; Interest Rates on Rupiah Loans to Priority Sectors; Interest Rates on Rupiah Loans to Non-Priority Sectors

Source: Commercial Bank Reports, processed

Graph 12 Interest Rates on New Rupiah Loans to Priority Sectors

Spread of Interest Rates on New Rupiah Loans to Priority Sectors; Spread of Interest Rates on New Rupiah Loans to Non-Priority Sectors; Interest Rates on New Rupiah Loans to Priority Sectors; Interest Rates on New Rupiah Loans to Non-Priority Sectors

Source: Commercial Bank Reports, processed

Graph 13 LaR in Priority Sectors

Priority Sectors; Non-Priority Sectors

Source: Commercial Bank Reports, processed

Graph 14 Credit Growth in Priority Sectors

Loans to Priority Sectors; Loans to Non-Priority Sectors

Source: Commercial Bank Reports, 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

Appendix 3 of Press Release No. 24/136/DKom

Reference Deposit Rate for publication as a reference spread between lending rates and deposit rates as one of the Financial Soundness Indicators (FSI).