Assessment of Policy Rate Transmission to Prime Lending Rates in Banking Industry
December 2021

Lending Rates on New Loans Continue to Decrease in line with Prime Lending Rates and Improving Risk Perception

- The cost of loanable funds (CoLF) continues to facilitate lower prime lending rates in the banking industry (PLR) amid stable profit margins and overhead costs (OHC) compared with conditions one month earlier.
- The trend of lower interest rates on new loans persists, primarily driven by national private commercial banks and state-owned banks. By sector, lower lending rates on new loans were dominated by construction and mining.
- Banks have responded to the BI7DRR reductions implemented since July 2019 by reducing interest rates, yet by a smaller increment than the 1-month term deposit rate. This has increased the interest rate spread, particularly at state-owned banks, regional government banks and national private commercial banks.

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

The banking industry continues to make smaller incremental reductions to prime lending rates (PLR). In October 2021, the banking industry lowered prime lending rates by 4bps (mtm) in line with the historically low BI7DRR held since March 2021. The spread between PLR and BI7DRR narrowed, therefore, from 6.14% in October 2020 to 5.21% in October 2021. During the same period, the 1-month term deposit rate decreased 151bps (yoy), thus widening the spread

[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 October 2021.

between the BI7DRR and 1-month term deposit rate from 5.46% in October 2020 to 5.54% in October 2021 (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, regional government banks, foreign bank branches and national private commercial banks recorded 17bps, 13bps and 5bps (mtm) reductions in the PLR. Meanwhile, PLR at state-owned banks remained unchanged compared with conditions one month earlier. Compared with the same period one year earlier, however, national private commercial banks, regional government banks and foreign bank branches lowered PLR by 91bps, 65bps and 42bps (yoy), contrasting the 222bps (yoy) reduction at state-owned banks (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 4bps (mtm) in October 2021 (Graph 3), primarily attributable to the cost of funds. All bank groups reported a lower CoLF, led by regional government banks (8bps mtm), followed by national private commercial banks, foreign bank branches and state-owned banks at 5bps, 4bps and 2bps (mtm) respectively (Graph 4). In the

[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.

same period, overhead costs (OHC) were stable industry wide. By bank group, however, regional government banks reported 12bps (mtm) lower overhead costs, contrasting the respective 3bps, 1bps and 1bps (mtm) increases at state-owned banks, national private commercial banks and foreign bank branches (Graph 5).

Graph 3 Prime Lending Rate by Component

CoLF; OHC; Profit Margin

Source: Financial Services Authority (OJK), processed

Graph 4 CoLF Components 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 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 by Bank Group

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

Source: Financial Services Authority (OJK), processed

The profit margin component was also stable compared with conditions one month earlier. For the industry as a whole, profit margin was steady at 2.59% (Graph 3), in line with stable profit margins at state-owned banks and national private commercial banks and a 9bps (mtm) decline at foreign bank branches. On the other hand, however, regional government banks recorded a 2bps (mtm) higher profit margin in the reporting period (Graph 6).

Risk Premium

The risk premium in the banking industry continues to decline, albeit marginally. Improving risk perception in the banking industry was reflected by a 1bps decline in the risk premium in October 2021 (Graph 7). A lower risk premium was confirmed by regional government banks and national private commercial banks, decreasing 1bps (mtm), while state-owned banks and foreign bank branches maintained the same risk premium compared with conditions one month earlier (Graph 8).

Graph 7 Risk Premium

PLR (rhs); Risk Premium

Source: Financial Services Authority (OJK), processed

Graph 8 Risk Premium by Bank Group

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

Source: Financial Services Authority (OJK), processed

Interest Rates on New Loans

Interest rates on new loans continued to track a downward trend. Compared with the same period one year earlier, interest rates on new loans fell 61bps (yoy) (Graph 9) in line with improving risk perception in the banking industry, supported by a lower risk premium (Graph 7) and Loans at Risk (LaR)[4] (Graph 16). Compared with conditions one month earlier, interest rates on new loans decreased 44bps (mtm) in November 2021 (Graph 9). Interest rates on new loans decreased at nearly all bank groups, led by national private commercial banks (49bps), followed by state-owned banks (41bps) and foreign bank branches (22bps mtm), contrasting higher rates reported by regional government banks (28bps mtm) (Graph 10).

Interest rates on new loans decreased in nearly all economic sectors. The deepest declines occurred in the construction sector and manufacturing industry at 156bps and 119bps (yoy) respectively (Table 1). On a monthly basis, interest rates on new loans followed a downward trend in the construction and mining sectors, falling 125bps and 90bps (mtm) (Table 1).

Graph 9 Lending 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 10 Interest Rates on New Loans by Bank Group

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

Table 1 Interest Rates on New Loans by Economic Sector

Agriculture; Mining; Manufacturing; Electricity, Gas and Water Supply; Construction; Trade; Transportation; Corporate Services; Social Services; Others; Total

Source: Commercial Bank Reports, processed

Interest Rate Spread

[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).

The banking industry has responded to a lower BI7DRR by reducing lending rates, though in smaller increments. Since July 2019, Bank Indonesia has lowered the BI7DRR by 250bps, with the banking industry responding through lower lending rates, recording a 148bps decline in the weighted average Rp lending rate and 142bps in the interest rate on new Rp loans (Graph 11). During the same period, the 1-month term deposit rate experienced a much deeper decline of 366bps. This increased the spread between the 1-month term deposit rate and the weighted average Rp lending rate as well as the interest rate on new Rp loans from 4.04% and 3.34% in June 2019 (prior to the BI7DRR reductions) to 6.22% and 5.58% in November 2021 (Graph 11).

Graph 11 Lending Rate, Deposit Rate and BI7DRR

Spread Between Lending Rate and 1-Month Term Deposit Rate; Spread Between Lending Rate on New Loans and 1-Month Term Deposit Rate; Lending Rate; Lending Rate on New Loans; 1-Month Term Deposit Rate; BI7DRR

Graph 12 Interest Rate Spread at Regional Government Banks

Spread Between Lending Rate and 1-Month Term Deposit Rate; Spread Between Lending Rate on New Loans and 1-Month Term Deposit Rate; Lending Rate; Lending Rate on New Loans; 1-Month Term Deposit Rate

Source: Commercial Bank Reports, processed

A wider spread between lending rates and 1-month term deposit rates was reported across nearly all bank groups. Spread between the weighted average Rp lending rate and the lending rate on new Rp loans against the 1-month term deposit rate have increased since June 2019 at regional government banks (Graph 12), state-owned banks (Graph 13) and national private commercial banks (Graph 14). Meanwhile, interest rate spread at foreign bank branches has remained relatively stable since June 2019 (Graph 15). The increase in spread is attributed to a restrained return on assets (ROA) in the banking industry compared to pre-pandemic conditions, impacted by higher banking reserves to absorb relatively higher credit risk (Graph 16).

Graph 13 Interest Rate Spread at State-Owned Banks

Spread Between Lending Rate and 1-Month Term Deposit Rate; Spread Between Lending Rate on New Loans and 1-Month Term Deposit Rate; Lending Rate; Lending Rate on New Loans; 1-Month Term Deposit Rate

Source: Commercial Bank Reports, processed

Graph 14 Interest Rate Spread at National Private Commercial Banks

Spread Between Lending Rate and 1-Month Term Deposit Rate; Spread Between Lending Rate on New Loans and 1-Month Term Deposit Rate; Lending Rate; Lending Rate on New Loans; 1-Month Term Deposit Rate

Source: Commercial Bank Reports, processed

Graph 15 Interest Rate Spread at Foreign Bank Branches

Spread Between Lending Rate and 1-Month Term Deposit Rate; Spread Between Lending Rate on New Loans and 1-Month Term Deposit Rate; Lending Rate; Lending Rate on New Loans; 1-Month Term Deposit Rate

Source: Commercial Bank Reports, processed

Graph 16 Banking Industry LaR

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

Source: Commercial Bank Reports, processed

Graph 17 Banking Industry ROA

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

Source: Financial Services Authority (OJK), 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).