Key Takeaways

- Prime lending rate response to lower policy rate (BI7DRR) still rigid.
- Greater prime lending rate rigidity at state-owned banks compared with other bank groups.
- Prime lending rate rigidity found across all credit segments, excluding micro loans

**Prime Lending Rate and Deposit Rate Response to BI7DRR¹**

Bank Indonesia has maintained an accommodative monetary and macroprudential policy stance in order to stimulate economic growth. Prior to the Covid-19 pandemic, from June 2019 until February 2020, Bank Indonesia lowered the BI7DRR (BI 7-Day Reverse Repo Rate) five times by a total of 125bps from 6.00% to 4.75%. The accommodative monetary policy stance was subsequently maintained in line with economic moderation triggered by the pandemic. From March 2020, Bank Indonesia lowered the policy rate another four times (100bps) to a level of 3.75% in November 2020. In terms of liquidity, accommodative monetary and macroprudential policy significantly boosted liquidity in the banking industry in order to maintain financial system stability and the bank intermediation function.

Notwithstanding, the lending rate response to a lower policy rate and loose liquidity conditions in the banking industry remains rigid. This is reflected by significant rigidity in the Prime Lending Rate (PLR)² in response to the lower policy rate. In response to the 225bps reduction in the BI7DRR policy rate since June 2019, the prime lending rate has only come down by 116bps. Consequently, the spread between the prime lending rate and BI7DRR has tended to widen from 5.27% in June 2019 to 6.36% in December 2020 (Graph 1). Furthermore, in line with the less rigid decrease in the deposit rate (245bps) in response to the lower policy rate, the spread between the prime lending rate and 1-month term deposit (TD) rate has also increased.

**Graph 1 BI7DRR, 1-Month Deposit Rate and Prime Lending Rate Developments**

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

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¹ Assessment period until December 2020 based on data availability.
² The prime lending rate is the base rate 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 prime lending rate is also published by OJK on its official website. The prime lending rate is used as the basis for determining the interest rate to be charged by the bank to the customer yet does not include the risk premium. Therefore, the interest rate charged by the bank to the borrower is not necessarily the same as the prime lending rate.
By bank group, the PLR of state-owned banks is more rigid than other bank groups. The PLR of state-owned banks is less responsive to the BI7DRR than national private commercial banks, regional government banks and foreign bank branches. In contrast, the PLR of foreign bank branches is most responsive to the policy rate. Therefore, the PLR of state-owned banks is relatively high (10.70%) compared with other bank groups (Graph 2).

### Graph 2 PLR by Bank Group

![Graph 2 PLR by Bank Group](image)

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

**PRL by Credit Segment**

PLR rigidity is a facet of nearly all credit segments, affecting consumer loans, corporate loans and retail loans. The rigid banking industry response, as reflected by smaller increments of prime lending rate reductions, has been observable in non-housing consumer loans (67bps) as well as housing loans (57bps) since June 2019 (Graph 3). For housing loans, the rigidity is caused, amongst others, by the medium-long term tenors.

### Graph 3 PLR by Credit Segment

![Graph 3 PLR by Credit Segment](image)

Source: Financial Services Authority (OJK), processed
The prime lending rate for micro loans is considerably more responsive to BI/DRR reductions. The prime lending rate for micro loans has fallen 276bps since June 2019 (Graph 3), significantly further than any other credit segment. This is inextricably linked to government policy to stimulate financing to micro enterprises through interest rate subsidies amidst pandemic-driven economic moderation.

### Background of Transparency Policy for Prime Lending Rates

The objective of this assessment and the reason prime lending rates are published are to strengthen and accelerate monetary and macroprudential policy transmission in Bank Indonesia. Since June 2019, Bank Indonesia has lowered the policy rate by 225bps and maintained an accommodative macroprudential policy stance, however the lending rate response has been rigid. Therefore, Bank Indonesia has identified sufficient room for lending rates to fall in line with the policy rate. Through transparency, the public and business community can observe and compare the lending rates offered by different banks. Furthermore, more effective policy rate transmission to lending rates in the banking industry, namely through commensurate reductions, is expected to boost demand for loans and stimulate economic recovery.

As a preliminary measure, Bank Indonesia has published this Assessment of Policy Rate Transmission to Prime Lending Rates in the Banking Industry. There are several factors that determine the formation of prime lending rates specific to each individual bank, including the cost of funds for credit, overhead costs and profit margin. Although the factors are diverse, through this publication, Bank Indonesia expects to provide greater public understanding concerning prime lending rates in Indonesia, including statistical information on PLR distribution. In addition to improving monetary policy transmission effectiveness, Bank Indonesia is also seeking to expand the dissemination of information to consumers, including corporates and households. Finally, this publication aims to increase governance, market discipline and competition in the formation of prime lending rates to ensure the base rate offered is more competitive and stimulates demand for loans, while accelerating economic recovery.

Similar publications are common international practice. Central banks in other countries, including Malaysia, India and China, have also launched lending rate transparency policy initiatives by publishing the External Benchmark Rate, Loan Prime Rate and Base Rate. The International Monetary Fund (IMF) also requires member countries to submit a reference lending rate and reference deposit rate for publication as a Financial Soundness Indicator (FSI).