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

October 2022

PLR Starting to Rise,

Accompanied by Upward Trend of Interest Rates on New Loans

- **Rigidity notwithstanding, PLR increased in the reporting period. Higher PLR were reported by foreign bank branches, regional development banks and national private commercial banks due to increases in terms of cost of loanable funds (CoLF) and overhead costs. Conversely, profit margins maintained a downward trend across all bank groups.**
- **On a monthly basis, interest rates on new loans decreased in line with seasonal trends towards the end of the year, supported by improving credit risk. Annually, however, interest rates on new loans tracked an upward trend, primarily driven by consumer loans.**
- **In response to BI7DRR hikes, interest rates on new loans are currently experiencing a 4-month lag effect. Nevertheless, greater rigidity is expected this year due to ample liquidity and improving profitability in the banking industry amid a relatively wide interest rate spread.**

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

Prime lending rates in the banking industry are beginning to rise. In August 2022, the banking industry raised prime lending rates by 4bps (mtm) in line with the increase in the BI7DRR to 3.75% in the same period. Nevertheless, the prime lending rate has decreased by 17bps (yoy) annually, thus narrowing the spread between the PLR and BI7DRR from 5.27% in August 2021 to 4.85% in August 2022. On the other hand, the spread between the PLR and 1-month term deposit rate continued to increase from 5.43% in August 2021 to 5.70% in August 2022 given a deeper 44bps (yoy) reduction 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 (Antasena), processed

All bank groups recorded higher Prime Lending Rates (PLR). Departing from conditions one month earlier, all bank groups recorded a monthly increase in August 2022, namely foreign bank branches (21bps), regional development banks (12bps) and national private commercial banks (4bps). Annually, however, PLR at the three aforementioned bank groups maintained a

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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 August 2022.

downward trend. Meanwhile, PLR at state-owned banks remained relatively rigid on monthly and annual bases (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[3]

By component, the cost of loanable funds (CoLF) has shown early signs of limited increases. In August 2022, the CoLF component increased just 1bps on average for the industry to 2.61% (Graph 3). This was attributable to increases in the CoLF at foreign bank branches (26bps mtm), followed by regional development banks (3bps mtm) (Graph 4). Meanwhile, the CoLF at national private commercial banks and state-owned banks were relatively stable on a monthly basis. On the other hand, the OHC component continued to track an upward trend (5bps mtm) as intermediation activity began to increase (Graph 3). Regional development banks (25bps mtm) and national private commercial banks (6bps mtm) reported a higher OHC component in the reporting period (Graph 5).

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[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.

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

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

Source: Financial Services Authority (OJK), processed

In contrast, profit margin maintained a downward trend. In August 2022, profit margins in the banking industry posted a 3bps (mtm) decrease after declining 2bps (mtm) in July 2022 (Graph 3). All bank groups reported a lower profit margin, namely regional development banks (17bps mtm), foreign bank branches (3bps mtm) as well as national private commercial banks and state-owned banks at 2bps (mtm) apiece. Annually, however, national private commercial banks and foreign bank branches recorded a higher profit margin compared with conditions in the same period one year earlier (Graph 6).

Risk Premium and Interest Rates on New Loans

Interest rates on new loans maintained an upward trend despite decreasing on a monthly basis in line with seasonal trends. Departing from previous conditions, lending rates on new loans decreased 17bps (mtm) to 8.94% (Graph 7) in September 2022, which is consistent with seasonal trends at the end of the year and supported by improving risk perception in the banking industry (Graph 8). Notwithstanding, interest rates on new loans are still higher than in the same period one year earlier at 8.61% given higher interest rates on new consumer loans (Graph 9).

Graph 7 Interest Rates on Rupiah Loans

Weighted Average Interest Rate; Lending Rates on New Loans; PLR

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

Graph 8 Risk Premium and LaR Indicators

Risk Premium; LaR (rhs)

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

Graph 9 Interest Rates on New Loans by Loan Type

Investment Loans; Consumer Loans; Working Capital Loans

Source: Commercial Bank Reports (Antasena), processed

Graph 10 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

Interest Rate Response on New Loans

Interest rates on new loans have responded to the higher BI7DRR. Based on event analysis, when Bank Indonesia raised the BI7DRR in May 2018, interest rates on new loans responded in September 2018, implying a 4-month lag effect (Graph 11). The lag effect is apparent across all bank groups, the length of which is influenced by relatively low credit risk (NPL) (Graph 12). The lag effect is expected to be longer this year due to ample liquidity and improving profitability in the banking industry amid a wide interest rate spread (Graph 13).

Graph 11 Trend of Interest Rates on New Loans

Liquid Assets to Third-Party Funds (rhs); BI7DRR; NPL; Interest Rate on New Loans MA(3); Interest Rate on New Loans

Source: Commercial Bank Reports (Antasena), processed

Graph 12 Trend of Interest Rates on New Loans by Bank Group

Regional Development Banks; State-Owned Banks; National Private Commercial Banks; Foreign Bank Branches; BI7DRR

Source: Commercial Bank Reports (Antasena), processed

Graph 13 Trend of ROA by Bank Group

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

Source: Commercial Bank Reports (Antasena), 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).