Assessment of Policy Rate Transmission to Prime Lending Rates in the Banking Industry April 2023

Banking Industry Continues Response to Policy Rate Hikes

- **The banking industry continued responding to the higher policy rate through deposit rates, as reflected by an increase in the cost of loanable funds (CoLF) component.**
- **Consistent with the CoLF, interest rates on new loans tracked an upward trend.**
- **Interest rates for downstream[1] sectors are more competitive than non-downstream sectors in line with mitigated credit risk. Incentive support is required to induce lending to sectors associated with downstreaming activities in line with future demand for financing, which will accelerate.**

Response of Prime Lending Rates[2] and Deposit Rates to BI7DRR[3]

In general, the Prime Lending Rate (PLR) remained stable. The PLR was relatively stable compared with conditions one month earlier at 8.78% in February 2023. The banking industry

[1] Downstream sectors refer to the 21 commodities listed in the Strategic Investment Roadmap for Downstreaming published by the Indonesia Investment Coordinating Board (BKPM).

[2] 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.

[3] Utilising data available at end of February 2023.

strived to offset the increase in the 1-month term deposit rate (from 3.95% in January 2023 to 4.12% in February 2023) by adjusting the PLR spread to deposit rates (from 4.83% in January 2023 to 4.67% in February 2023) (Graph 1) as well as by increasing efficiency.

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

State-owned banks and national private commercial banks maintained stable prime lending rates. PLR at state-owned banks and national private commercial banks were relatively stable at 8.72% and 8.88% respectively, while PLR at regional development banks increased by 6bps (mtm) and PLR at foreign bank branches decreased by 18bps (mtm) in the reporting period (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 upward CoLF[4] trend persisted. Industrywide, the CoLF component increased 16bps from 3.08% in January 2023 to 3.24% and February 2023 (Graph 3). Monthly increases were

[4] 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

reported by all bank groups, namely state-owned banks (20bps), national private commercial banks (14bps), foreign bank branches (9bps) and regional development banks (3bps) (Graph 4). On the other hand, the overhead cost (OHC) component decreased from 3.27% in January 2023 to 3.16% in the reporting period (Graph 3). Lower OHC were confirmed by state-owned banks and national private commercial banks, decreasing by 21bps and 4bps respectively, in contrast to regional development banks, which reported a 6bps increase (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

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

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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.

Source: Financial Services Authority (OJK), processed

Profit margins maintained a downward trend. In February 2023, profit margins in the banking industry posted a 5bps (mtm) decrease after declining 3bps (mtm) the month earlier (Graph 3). Foreign bank branches (27bps), national private commercial banks (10bps) and regional development banks (3bps) recorded narrower profit margins, while profit margins at state-owned banks were relatively rigid (Graph 6).

Lending Rates on New Loans

Interest rates on new loans tracked an upward trend in the reporting period. Based on a 3-month moving average, interest rates on new loans continued tracking an upward trend, as reflected by higher lending rates on rupiah loans compared with conditions one month earlier (Graph 7). All bank groups reported higher interest rates on new loans based on a 3-month moving average, particularly state-owned banks and national private commercial banks (Graph 8).

Graph 7 Interest Rates on Rupiah Loans

Lending Rates on Rupiah Loans; Lending Rates on New Loans; PLR; 3-Month Moving Average (Lending Rates on New Loans)

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

Graph 8 Interest Rates on New Loans by Bank Group

3-Month Moving Average (Regional Development Banks); 3-Month Moving Average (State-Owned Banks); 3-Month Moving Average (National Private Commercial Banks); 3-Month Moving Average (Foreign Bank Branches)

Source: Commercial Bank Reports (Antasena), processed

Lending Rates in Downstream Sectors

Lending rates in downstream sectors were more competitive than non-downstream sectors. Based on the long-term trend, lending rates offered to downstream industries tended to be lower than lending rates for non-downstream industries (Graph 9). This was in line with a low NPL as a proxy of credit risk, particularly in the downstream subsectors of the upstream sector (Graph 10). Notwithstanding, several major upstream subsectors maintained a low NPL yet with less competitive lending rates than the downstream industries (Quadrant IV, Graph 12), including the oil and gas industry and palm oil industry. Incentive support is required to induce lending to the downstream sector due to the comparatively low credit share, which will attract lenders to the sector (Graph 11).

Graph 9 Lending Rates in Downstream Sectors

Lending Rates in Downstream Sectors; Lending Rates in Upstream Sectors; Lending Rates in Non-Downstream Sectors

Source: Commercial Bank Reports (Antasena), processed

Graph 10 NPL Ratio of Downstream Sectors

Lending Rates in Downstream Sectors; Lending Rates in Upstream Sectors; Lending Rates in Non-Downstream Sectors

Source: Commercial Bank Reports (Antasena), processed

Graph 11 Credit Share of Downstream Sectors

Downstream Sectors; Upstream Sectors

Source: Commercial Bank Reports (Antasena), processed

Graph 12 Lending Rate Trends in Downstream Sectors

Source: Commercial Bank Reports (Antasena), processed

Appendix 1 – List of PLR and PLR vs BI7DRR Spread by Bank per Credit Segment in February 2023

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).