O/s PSB Spreads Continue to Fall, Hit Fresh 10-year Low of 2.31%

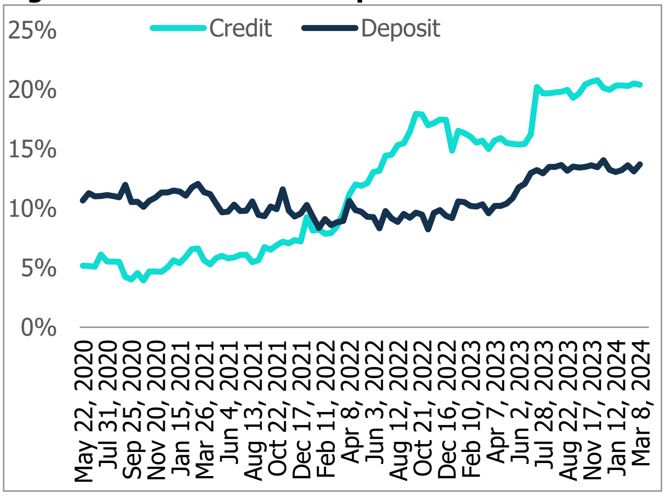
April 03, 2024 I BFSI Research

Overview

- In February 2024, the spread of SCBs between the weighted average lending rate (WALR – Lending Rate) and weighted average domestic term deposit rate (WADTDR – Deposit Rate) (the net interest rate spread) stood at 2.92% and 2.95% for Fresh and Outstanding rates, respectively. Meanwhile, o/s spreads of PSBs touched a new 10-year low of 2.31%, while PVBs continued to maintain a higher spread as compared to PSBs.
  - The Lending Rate on outstanding rupee loans of scheduled commercial banks (SCBs) decreased by 2 bps sequentially to 9.81%. In comparison, the Deposit Rate on o/s rupee term deposits increased marginally by 1 bps to 6.86% in February 2024. Meanwhile, the one-year median MCLR of SCBs remained flat m-o-m and stood at 8.80% as of March 2024.
  - The Lending Rate on fresh rupee loans of SCBs decreased sequentially by 7 basis points (bps) to 9.36% in February 2024, while the Deposit Rate (Fresh) of SCBs increased by 1 bps to 6.44% in February 2024.

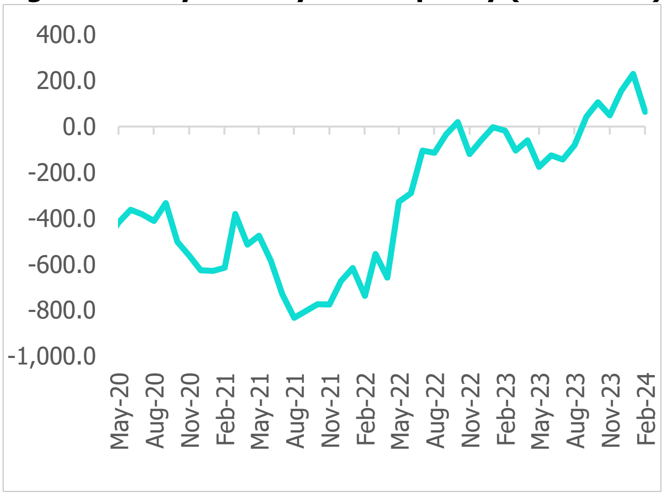
Large Gap Between Credit and Deposit Growth Persists, while Liquidity Remains Tight

Fig 1: Credit Offtake vs Deposit Growth



Source: CMIE, RBI; Note: Data post HDFC Merger in July

Fig 2: Monthly Bank System Liquidity (Rs lakh cr)



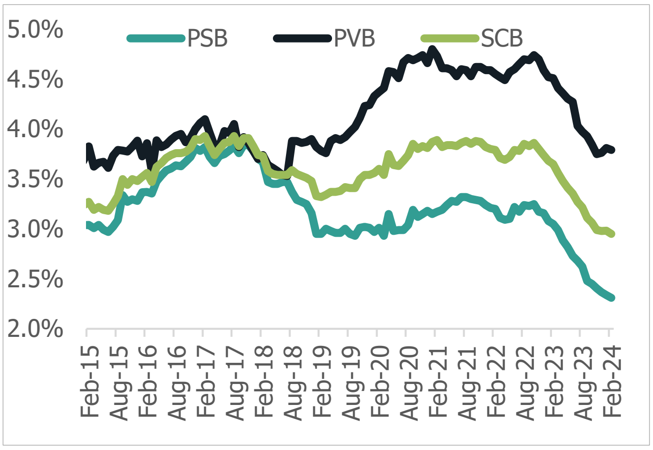
Source: RBI, CMIE

Credit offtake increased by 20.4% y-o-y as of March 08, 2024. It is important to note that the y-o-y figures are not directly comparable, as the data reported by the RBI as of March 08, 2024, includes the impact of the merger of HDFC with HDFC Bank. Meanwhile, deposits rose at 13.7% y-o-y as of March 08, 2024). Meanwhile, deposit growth is expected to improve compared to earlier periods as banks look to shore up their liability franchise and ensure that deposit growth does not constrain the credit offtake.

Meanwhile, Liquidity continues to remain tight in the system. RBI has been conducting both VRR & VRRR auctions to manage liquidity, in line with its accommodation withdrawal stance while also meeting the credit needs of the economy. (Source: Economic Pathway)

Spread Compression Continues for o/s PSBs

Figure 3: Evolution of Spreads (Outstanding)



Source: RBI; Note: Data post HDFC Merger in July

The spread of SCBs between the outstanding Lending Rate and outstanding Deposit Rate (the net interest rate spread) stood at 2.95% as of February 2024, and o/s spreads dropped by 3 bps on an m-o-m basis.

- The o/s PSB spreads have been compressing over the last year touching 2.31% (10-year low).
- PVBs spread marginally declined by 2 bps and stood at 3.79% as of February 2024 end.

Outstanding Business: Deposit Rates Rises Marginally, However Lending Rates Drop

Fig 4: Evolution of WALR O/s (Lending) Rate

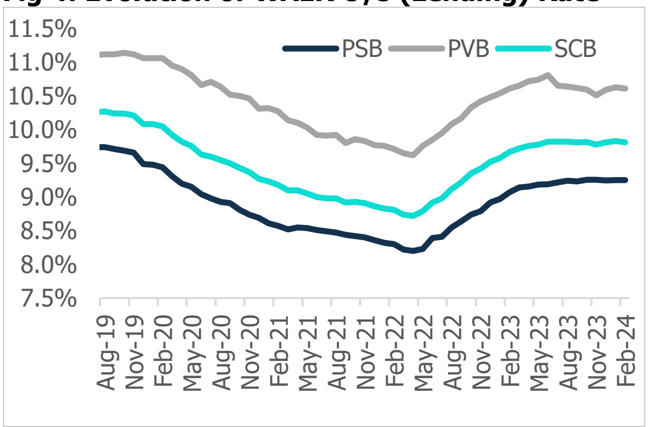
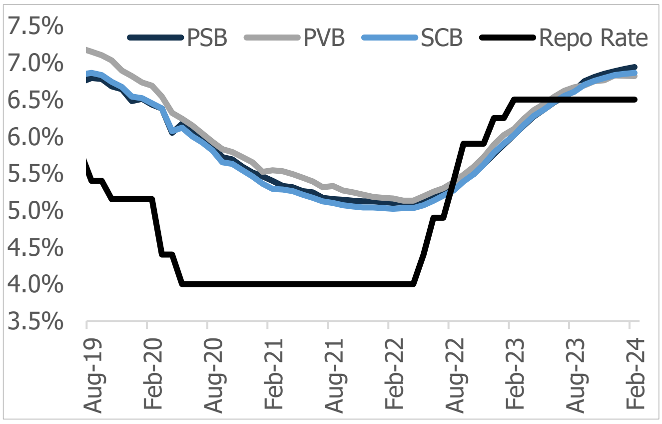


Fig 5: Evolution of WADTDR O/s Deposit Rate



Source: RBI; Note: Data post HDFC Merger in July

The lending Rate on outstanding rates for SCBs decreased by 2 bps on an m-o-m basis and stood at 9.81% for SCBs. PSBs remained flat at 9.25%, whereas PVBs saw a decrease of 2 bps over the month. One of the reasons for the current slower trajectory of the PVB rates over the last few months has been the merger between HDFC and HDFC Bank where housing finance assets have impacted the lending rates. If this impact is ignored, then the rates would have been higher by 2 bps for SCBs and 12 bps for PVBs. Meanwhile, outstanding deposit rates saw a m-o-m uptick by 3 bps and 2 bps for PSBs and SCBs respectively. Whereas PVBs saw a marginal decline of 1 bps on the O/s Deposit Rate and continue to remain above their pre-pandemic levels (compared with March 2020).

When we compare pre covid o/s deposit rates for PSBs and PVBs, there is a divergence in trend wherein PSBs have marginally higher deposit rates compared to PVBs.

Fig 6: Movement in 1-Year MCLR (Median)

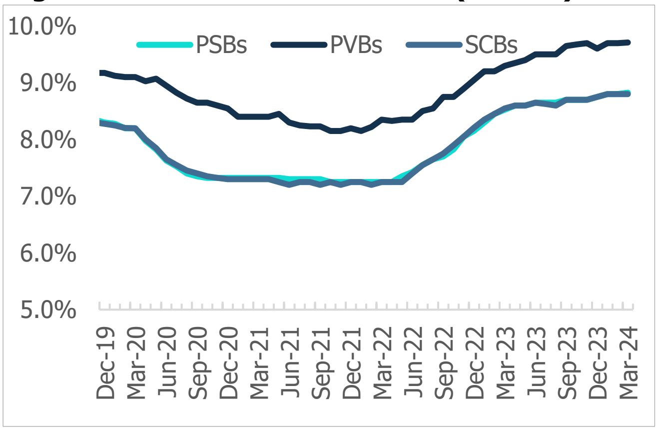
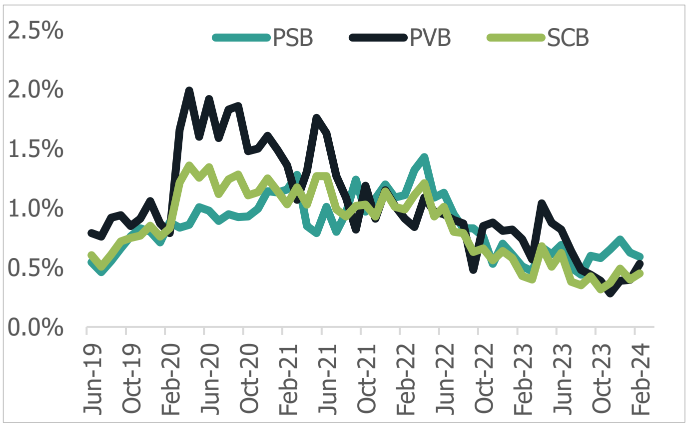


Fig 7: Lending Rate: O/s vs Fresh



Source: RBI, Note: Data post HDFC Merger in July

- On an m-o-m basis in March 2024, 1-year median MCLR of PSBs and SCBs increased by 2 bps each, while PVBs remained flat.
- On a y-o-y basis as of March 2024, 1 Year median MCLR of SCBs increased by 35 bps, meanwhile when we compare pre-pandemic levels, the MCLR median for SCBs is above 50 bps (compared with March 20).

Fig 8: MCLR Rates (in %) Remained Broadly Flat on a m-o-m basis

Banks	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	YoY
	Public Sector Banks													
Bob	8.55	8.60	8.60	8.65	8.65	8.65	8.70	8.70	8.75	8.75	8.80	8.80	8.80	0.25
BoI	8.50	8.60	8.60	8.65	8.65	8.70	8.70	8.70	8.75	8.80	8.80	8.80	8.85	0.35
BoM	8.40	8.50	8.50	8.50	8.50	8.60	8.60	8.70	8.70	8.70	8.70	8.80	8.80	0.40
Canara	8.60	8.65	8.65	8.65	8.65	8.70	8.70	8.70	8.75	8.75	8.80	8.85	8.90	0.30
CBI	8.45	8.45	8.45	8.60	8.60	8.60	8.60	8.65	8.70	8.70	8.70	8.75	8.75	0.30
Indian	8.55	8.60	8.60	8.65	8.65	8.65	8.70	8.70	8.75	8.75	8.80	8.85	8.85	0.30
IOB	8.60	8.60	8.65	8.65	8.65	8.70	8.70	8.70	8.70	8.75	8.80	8.80	8.80	0.20
PSB	8.60	8.65	8.65	8.65	8.70	8.90	8.90	8.90	8.95	8.95	8.95	8.95	8.95	0.35
PNB	8.50	8.50	8.50	8.60	8.60	8.60	8.65	8.65	8.65	8.65	8.70	8.80	8.80	0.30
SBI	8.50	8.50	8.50	8.50	8.55	8.55	8.55	8.55	8.55	8.65	8.65	8.65	8.65	0.15
UCO	8.50	8.60	8.60	8.65	8.65	8.65	8.70	8.70	8.70	8.75	8.75	8.80	8.85	0.35
UBI	8.65	8.65	8.65	8.65	8.65	8.65	8.70	8.70	8.70	8.80	8.80	8.90	8.90	0.25
	Private Sector Banks													
HDFC	8.95	8.95	9.05	9.05	9.05	9.10	9.15	9.20	9.20	9.20	9.20	9.30	9.30	0.35
ICICI.	8.75	8.75	8.75	8.85	8.85	8.90	8.95	8.95	9.00	9.00	9.00	9.10	9.10	0.35
Axis	8.95	8.95	9.10	9.10	9.10	9.15	9.15	9.15	9.20	9.25	9.25	9.30	9.30	0.35
IndusInd	10.15	10.20	10.20	10.20	10.25	10.25	10.30	10.30	10.35	10.25	10.25	10.40	10.40	0.25
Kotak	9.05	9.10	9.20	9.20	9.25	9.30	9.30	9.35	9.35	9.35	9.35	9.45	9.45	0.40
Yes.	10.10	10.15	10.00	10.05	10.15	10.15	10.25	10.25	10.40	10.50	10.50	10.50	10.60	0.50

Source: RBI, Note: Data post HDFC Merger in July

Lending Rates (WALR (o/s)) of SCBs According to Occupation

Figure 9: Agriculture

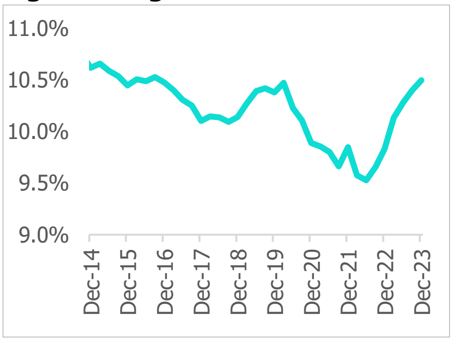


Figure 10: Industry

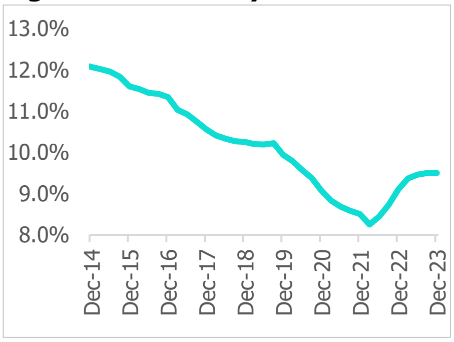


Figure 11: Transport

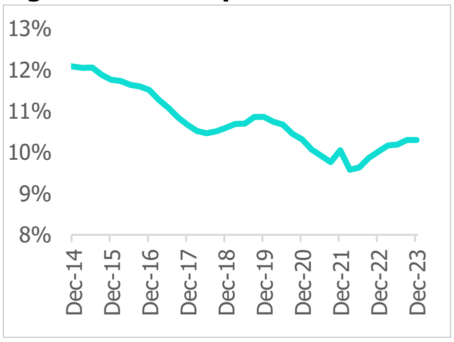


Figure 12: Prof & Other Services

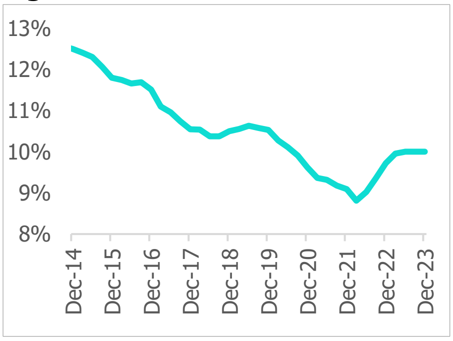


Figure 13: Personal

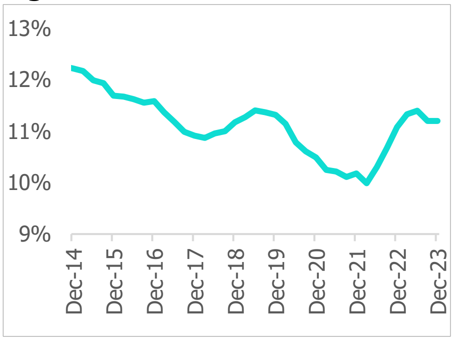


Figure 14: Housing

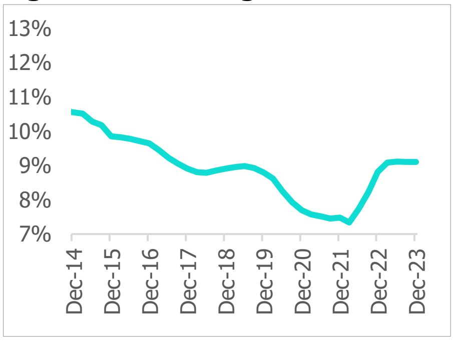


Figure 15: Credit Cards

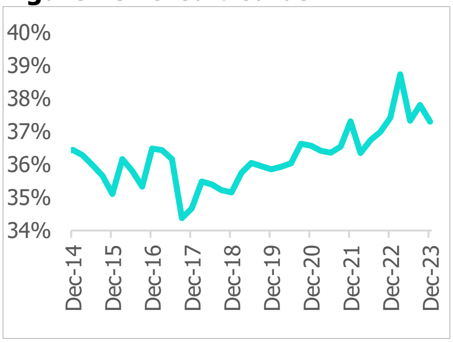


Figure 16: Trade

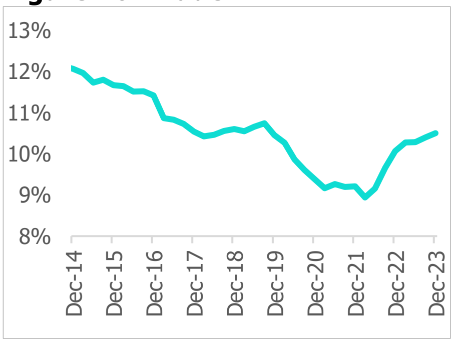


Figure 17: Finance

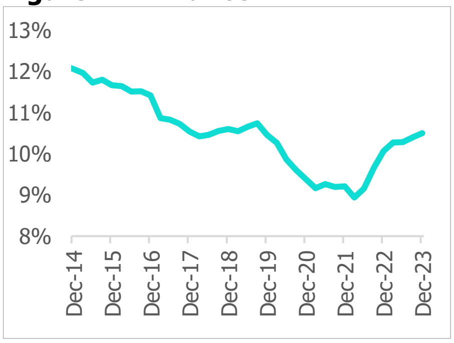


Figure 18: All Others

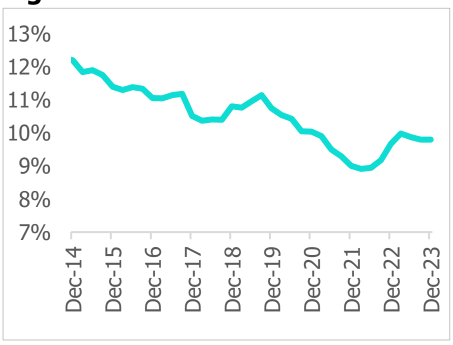
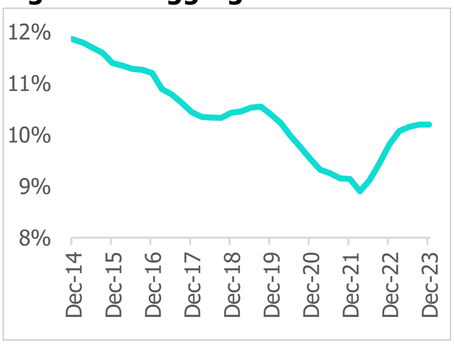


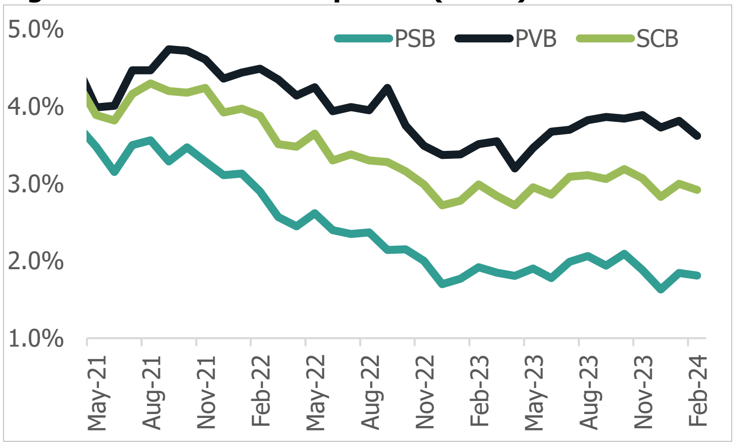
Figure 19: Aggregate



The figures on interest rates and borrower mix continue to show that the loan portfolio is moving to higher interest rate buckets compared to the rates that prevailed during the Covid pandemic, on q-o-q basis sectors like agriculture and trade have seen a marginal increase, however, Credit cards have dropped over a similar period, rest of the sectors broadly remained flat.

Fresh Spreads Sees a Downward Trend

Figure 20: Evolution of Spreads (Fresh)



Source: RBI; Note: Data post HDFC Merger in July

We witnessed a downward trend in the spread of SCBs Fresh business decreased by 8 bps on an m-o-m basis and stood at 2.92% as of February 2024. PVBs saw a sharp decline of 19 bps over the month and stood at 3.62%, PSBs dropped by 4 bps over the month and stood at 1.81%, however PVBs continue to maintain a higher spread given that they charge more as compared to PSBs. The spread between outstanding Lending Rate and Deposit Rate continues to be lower than the spread between fresh Lending Rate and Deposit Rate.

Fresh Rates Remain Volatile: Lending sees a Sequential Drop, whereas Deposit Increases Marginally

Fig 21: Evolution of Lending Rate Fresh Loans

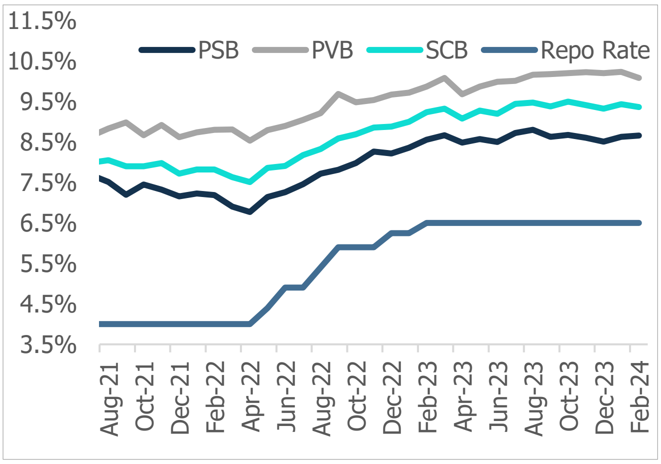
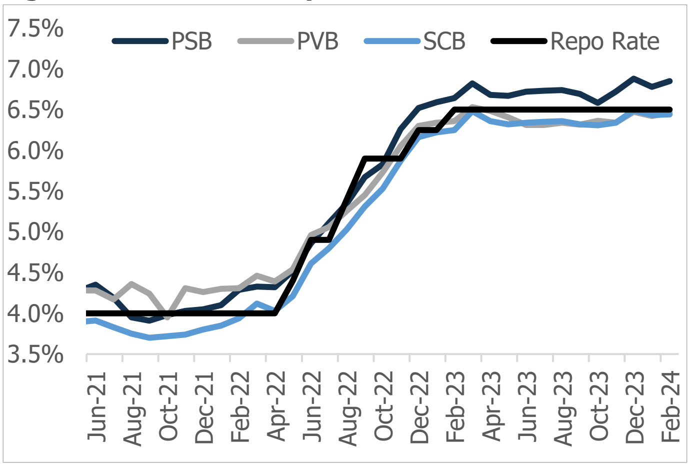


Fig 22: Evolution of Deposit Rate Fresh



Source: RBI, Note: Data post HDFC Merger in July

The lending Rate on fresh loans on an m-o-m basis for PVBs and SCBs decreased by 15 and 7 bps respectively, whereas PSBs grew by 3 bps. On the other hand, fresh deposit rates saw a marginal uptick on an m-o-m basis wherein SCBs grew by 1 bps, PSBs & PVBs saw an increase of 7 and 4 bps respectively, however, FBs dropped by 13 bps in February 2024. When compared to April 2022, (before commencing of rate hikes in May 2022) repo rate increased by 250 bps to 6.5% as of February 2024, Fresh Lending Rate and Deposit Rate have increased by 185 bps and 241 bps to 9.36% and 6.44% as of February 2024 from April 2022. Meanwhile, the Short-term Weighted Average Call Rate (WACR) stood at 6.52% as of March 15, 2024, compared to 6.42% on March 17, 2023, due to liquidity and pressure on short-term rates, also rates are moving towards the repo rate.

Outstanding Floating Rate Rupee Loans across Interest Rate Benchmarks - Private Banks Continue to Have a Higher Share of EBLR loans, while Public Banks have a higher MCLR Share

Figure 23: PSBs

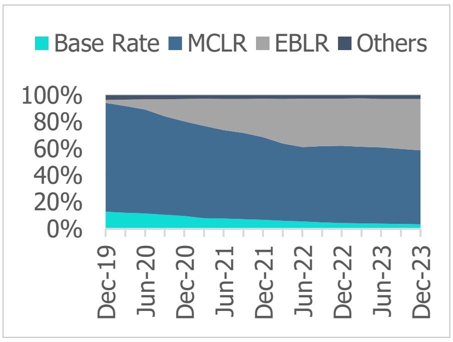


Figure 24: PVBs

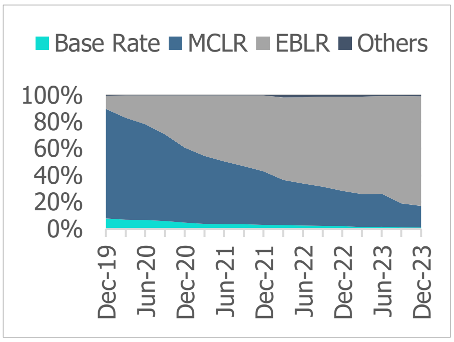
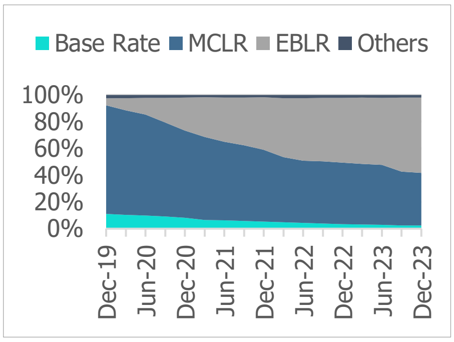


Figure 25: SCBs



Source: RBI, Note: Data post HDFC Merger in July

The share of External Benchmark Lending Rate (EBLR) linked loans in total outstanding floating rate rupee loans of SCBs stood at 56.2% at end-December 2023 (vs. 55.5% in September 2023), while that of MCLR linked loans was 39.4% in December 2023 (vs 40.1% in September 2023). Compared with PSBs, PVBs have a higher share of EBLR (ELBR share as of June 23, PVBs-82.0%, PSBs-38.5%), hence, the lending rate transmission is faster in PVBs compared to PSBs. Further, if rates are reduced, PVBs would be impacted faster compared to PSBs.

Conclusion

In February 2024, there has been pressure on o/s spreads due to growing competition among banks. Also, fresh spreads have decreased, Spreads between the outstanding Lending Rate and Deposit Rate have been hovering below pre-pandemic levels since June 2023, which is exerting pressure on NIMs. The spread between the outstanding lending & deposit rates has narrowed compared to the spread between fresh lending & deposit rates. Furthermore, with RBI turning the heat on unsecured lending products, banks' exposure to high-yield products such as unsecured personal loans which have remained high but at a reduced rate, lending rates could also witness some pressure. Further, with yields on capital market offerings remaining elevated, interest rates on deposits are likely to increase in the current period. Additionally, as the Credit to Deposit ratio remains elevated, growth in the liability franchise would play a significant role in sustaining loan growth. The competition for deposits is likely to remain intense resulting in a rise in funding costs in the coming periods as CASA share remains under pressure.

The outlook for bank credit offtake continued to be positive due to the economic expansion, rise in capital expenditure, growth in retail credit and the anticipated expansion in capex spending especially by the private sector. The growth is anticipated to be broad-based across the segments. The personal loan segment is expected to continue doing well compared with the industry and service segments. The medium-term prospects look promising with diminished corporate stress and a substantial buffer for provisions. This growth would be coming off a high base in FY24 which would impinge marginally on the growth rate. Further, the HDFC merger effect is anticipated to dissipate by the end of Q1FY25 and the headline numbers would show the removal of the base effect. Hence, based on GDP forecasts, sectoral credit growth expectations, and management expectations, CareEdge estimates the credit growth to be in the range of 14%-14.5% during FY25. However, elevated interest rates and global uncertainties could adversely impact credit growth. Further ebbing inflation could also reduce the working capital demand.

Deposit growth although improving has lagged credit growth for FY24 and consequently is anticipated to play a leading role in FY25 as banks take further efforts to shore up their liability franchise and ensure that lagging deposit growth does not constrain the credit offtake. Further with rate cuts anticipated in the later part of FY25, some amounts might flow back into the banking system thereby improving the CASA ratios to a certain extent. Hence, based on GDP forecasts and management expectations, CareEdge estimates the deposit growth to be in the range of 13%-13.5% during FY25.

Further, as the credit offtake moderates compared to the last year but remains higher compared to the increasing deposit growth, the credit-to-deposit ratio is also slated to continue to remain elevated at above 81% in FY25. PSBs continue to have a lower Credit to Deposit ratio compared to PVBs leaving some headroom for credit growth in the near term, hence PSBs could catch up to a certain extent with the PVBs in the near term. However, branch expansion to source retail deposits would be a key source of competitive strength.

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