Box 2 Changes in selected interest rates charged by banks since 2019[1]

In response to the declaration of the coronavirus disease 2019 (COVID-19) pandemic, the South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) started easing monetary policy at its March 2020 meeting by, among other factors, lowering the repurchase (repo) rate from 6.25% to a multi-decade low of 3.50% in July. However, headline consumer price inflation accelerated to well above the midpoint of the inflation target range during the post-pandemic period, resulting in the steady increase in the repo rate from November 2021 to 8.25% in May 2023.

This box provides a brief overview of the changes in the interest rates offered and charged by private sector banks before and after the pandemic[2] by analysing the extent to which the weighted average interest rates of banks changed relative to changes in the repo rate as determined by the MPC. The analysis benefits from the extended pause in the repo rate since May 2023, which has made it easier to determine whether the interest rate margins[3] of private sector banks have reverted to levels similar to their pre-COVID-19 levels. Due to the slight lag between changes in the repo rate and the rates charged by private banks, a pause in the repo rate has allowed for the previous rate changes to fully filter through to the various credit products of banks, enabling a comparison of where the margins have settled relative to the pre-COVID-19 period.

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1 This box relates to the weighted average bank deposit and lending rates on pages S–30 and S–31 in this edition of the *Quarterly Bulletin (QB)*. The calculation of weighted average interest rates includes:
- the weighting of interest rates based on the outstanding balance at month-end applicable per interest rate category;
- a mix of different interest rates on existing and new loans/deposits, with rates on existing products dominating the outcome due to their relative size; and
- a mix of different term durations, where fixed-term interest rates take longer to reflect changes than flexible interest rates, with the former affected by the length of the term that applied at the time of fixing the interest rate.

2 The focus is mainly on the various lending rates charged by banks to both households and companies, with only a brief reference made to deposit rates.

3 The margin is calculated as the difference between the relevant interest rate set by private sector banks and the repo rate.

Changes in interest rates by private sector banks in South Africa tend to correlate well with movements in the repo rate. However, the magnitude of changes applied by banks can sometimes differ from those in the repo rate as per the prevailing economic and market conditions, such as the COVID-19-related lockdowns or specific business decisions by banks.

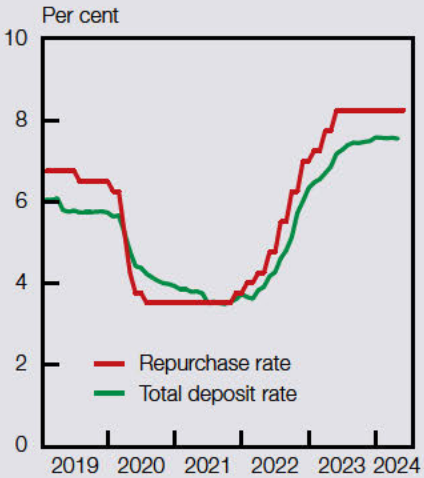
The analysis shows that private sector banks applied a definite deposit rate advantage during the COVID-19 lockdown period, which has since reversed after the monetary policy tightening cycle. Moreover, it seems that stricter lending criteria and risk aversion affect trends in lending rates as changes in monetary policy have not translated into increases of similar magnitude in banks' lending rates for selected categories of credit, predominantly due to banks avoiding high credit-risk borrowers.

There are various factors which play a critical role in shaping banks' loan book pricing strategy, including, but not limited to:

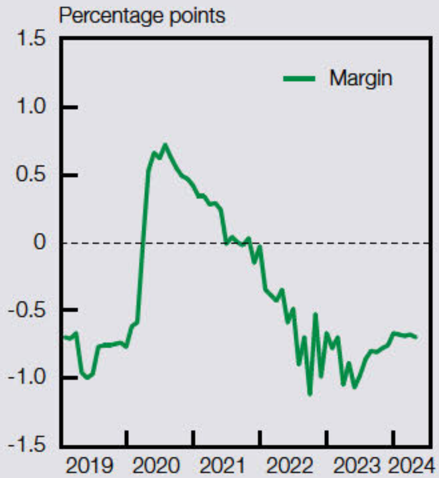
- supply and demand dynamics;
- changes in the client mix; and
- shifts in the maturity profile of the loan book.

The aggregate weighted average deposit rates of households and companies show that banks provided depositors with an interest rate advantage during the COVID-19 lockdown period when the margin between banks' deposit rates and the repo rate narrowed notably and was positive for more than a year from around April 2020. However, this advantage has since dissipated as deposit rates have once again moved below the repo rate, with the margin currently comparable to its pre-COVID-19 levels. Due to the magnitude of corporate deposits, their interest rate margin is generally more favourable than that of households.

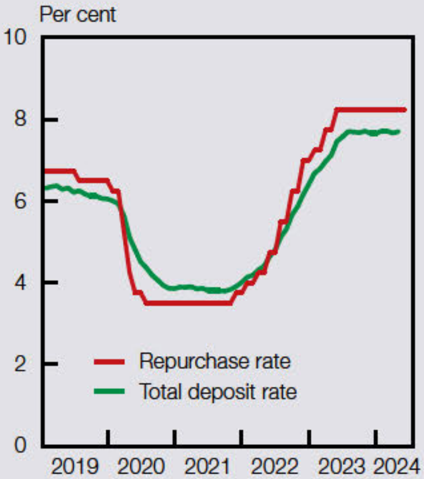
Households: total deposit rate and repurchase rate



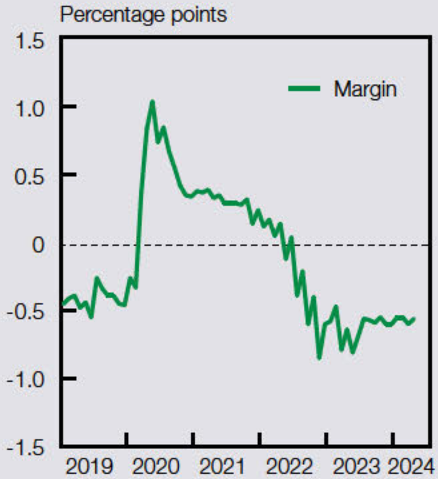
Households: interest rate margin to repurchase rate



Companies: total deposit rate and repurchase rate



Companies: interest rate margin to repurchase rate

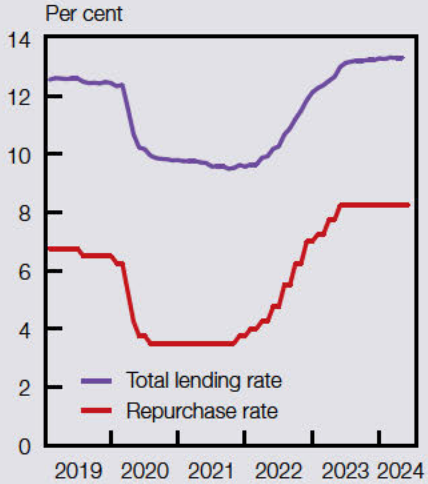


Source: SARB

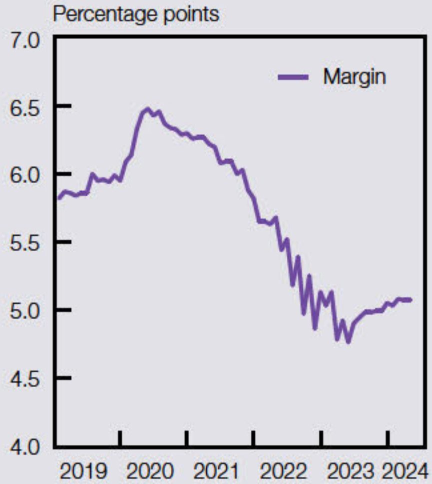
The margin between the aggregate weighted average lending rate charged by banks to both households and companies and the repo rate initially increased at the onset of the COVID-19 pandemic, followed by a progressive narrowing in the margin to below pre-COVID-19 levels during the course of 2022 and 2023. Of note is the fact that the current level of the margin for corporates is close to its pre-pandemic level, while the margin for households has settled at a lower level than before COVID-19, indicating a shift to lower relative interest rates charged by banks to households.

The prevailing subdued economic conditions, elevated consumer price inflation and the cumulative 475 basis points increase in the repo rate since November 2021 have resulted in an escalation of impaired advances and triggered a tightening of lending standards imposed by banks. This resulted in private sector banks progressively limiting their exposure to high credit-risk clients and focusing more on clients with a better track record of repaying debt. The reduction in new loans to high-risk clients, who are usually charged higher interest rates, resulted in a decrease in the aggregate interest rates of selected loan categories relative to the repo rate. Consequently, the quality of banks' loan books improved, with a concomitant narrowing in the margin, as previous high-risk loans matured and were replaced predominantly by new low-risk profile lending.

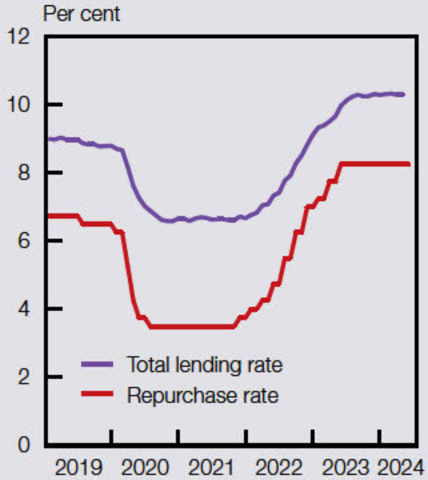
Households: total lending rate and repurchase rate



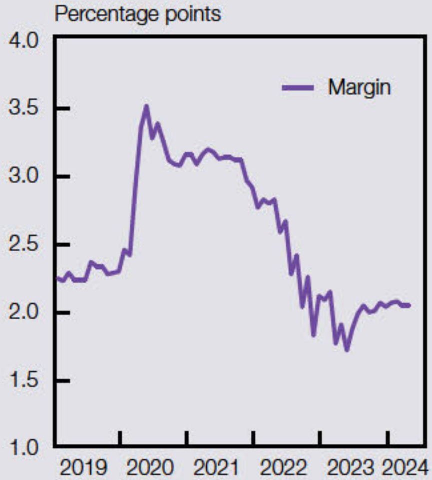
Households: interest rate margin to repurchase rate



Companies: total lending rate and repurchase rate



Companies: interest rate margin to repurchase rate

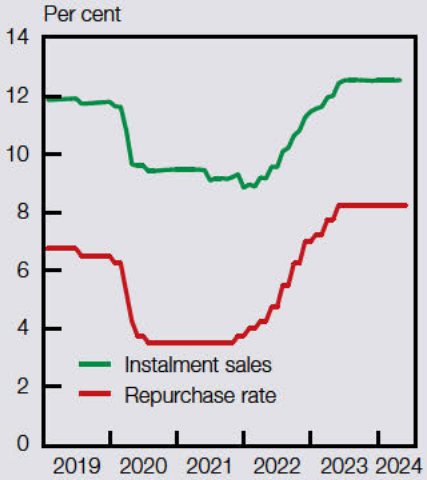


Source: SARB

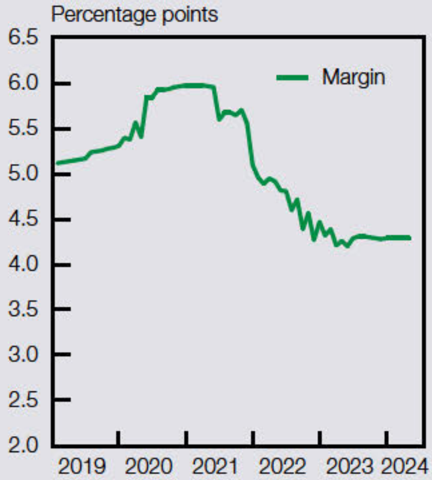
In addition, there has been considerable margin pressure in the industry as competition for market share intensified, with banks focusing more on low- and medium-risk loans, which generally attract lower interest rates. This shift towards lower-risk clients was most visible in instalment sale credit and general loans – sometimes referred to as term loans or unsecured loans – in the case of households. Additionally, some banks have increased their lending volumes through digital channels, with the behavioural data gathered through these channels contributing to better-informed pricing models.

After increasing during the COVID-19 period, the margin between the weighted average flexible rate on instalment sale credit to households and the repo rate has decreased noticeably since the second half of 2021. The margin has stabilised at a much lower level than before COVID-19, resulting from competitive pricing and the focus on lower-risk clients. Similarly to households, the margin between the weighted average flexible interest rate on instalment sale credit to corporates and the repo rate also narrowed sharply in the period after the pandemic to settle well below its pre-COVID-19 level.

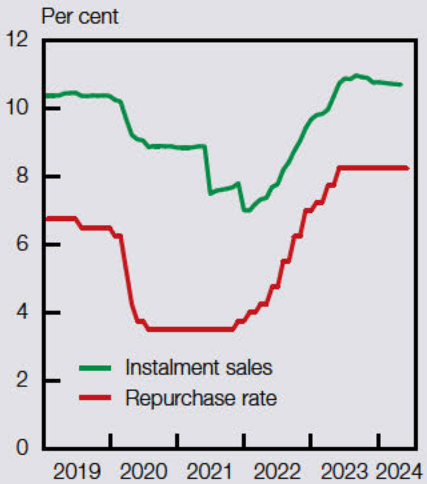
Households: instalment sales flexible rate and repurchase rate



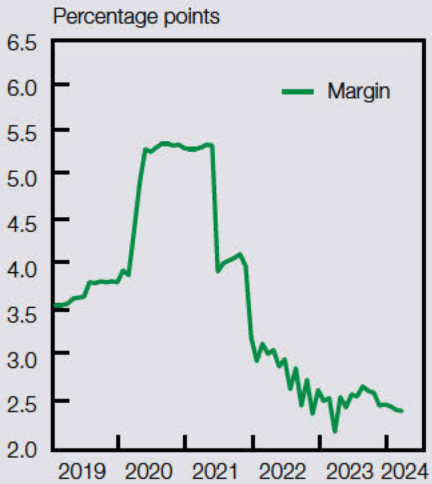
Households: interest rate margin to repurchase rate



Companies: instalment sales flexible rate and repurchase rate



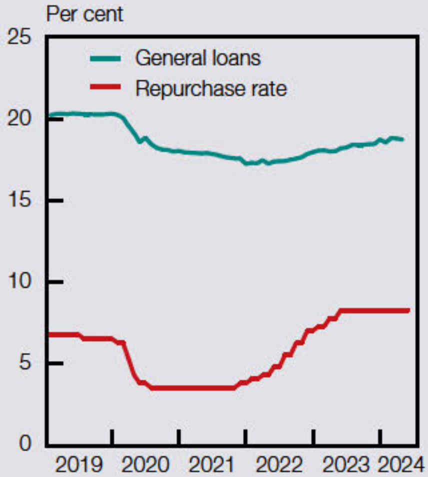
Companies: interest rate margin to repurchase rate



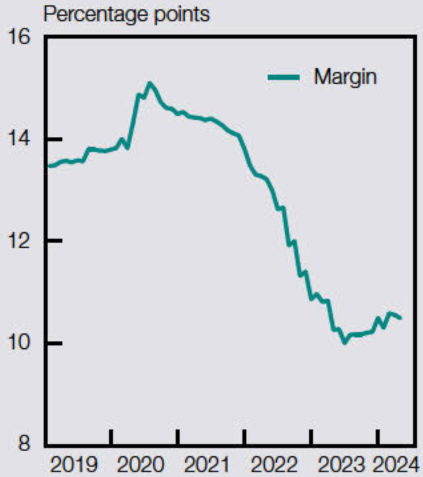
Source: SARB

In the case of general loans to households, most banks adjusted their credit policies to specifically reduce exposure to high-risk clients, while writing new business at lower margins compared to the existing advances. Some banks also did not increase lending rates in line with the increases in the repo rate on a portfolio of loans to vulnerable customers. For corporates, the margin between the repo rate and interest rates on general loans briefly increased markedly but then declined, and has since returned to pre-COVID-19 levels from the end of 2022.

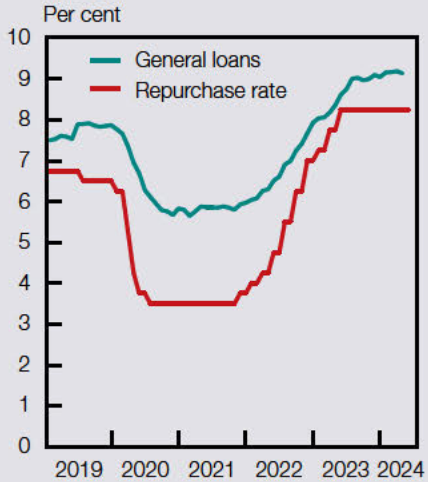
Households: general loans and repurchase rate



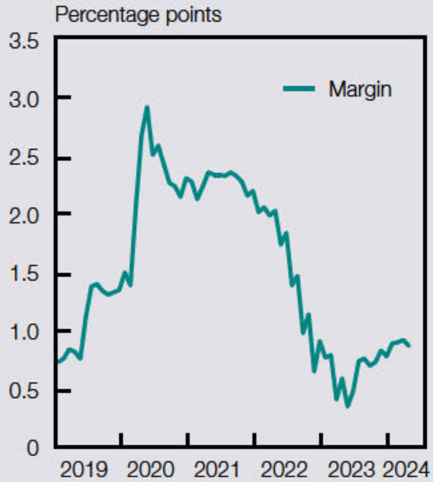
Households: interest rate margin to repurchase rate



Companies: general loans and repurchase rate



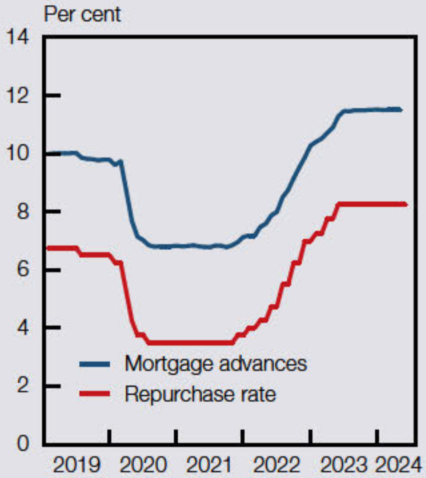
Companies: interest rate margin to repurchase rate



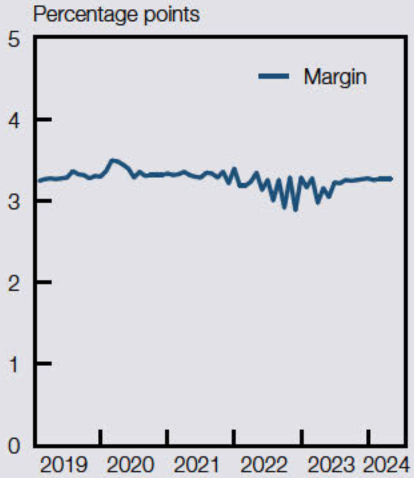
Source: SARB

The margin between flexible interest rates on mortgage advances to households and the repo rate remained fairly stable although it fluctuated slightly lower in 2022, and has recently moved closer to its pre-COVID-19 level. For companies, the margin between flexible interest rates on mortgage advances and the repo rate has trended slightly higher in recent years, stabilising slightly above its pre-COVID-19 level.

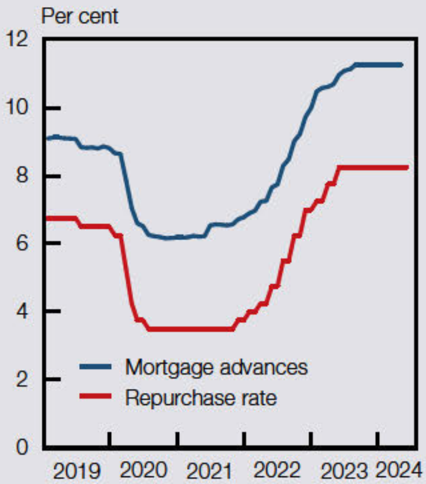
Households: mortgage advances flexible rate and repurchase rate



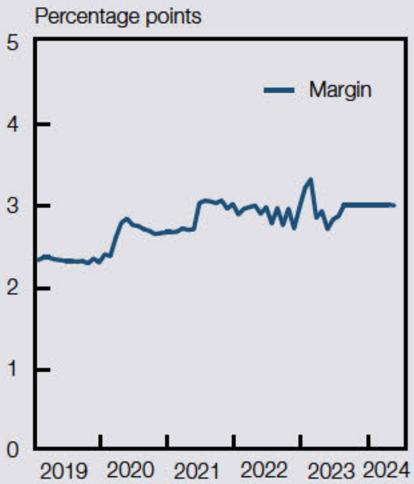
Households: interest rate margin to repurchase rate



Companies: mortgage advances flexible rate and repurchase rate



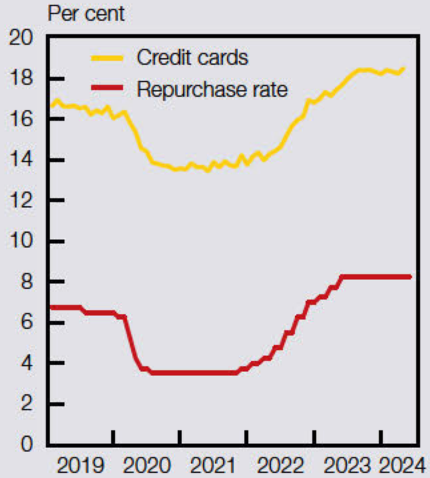
Companies: interest rate margin to repurchase rate



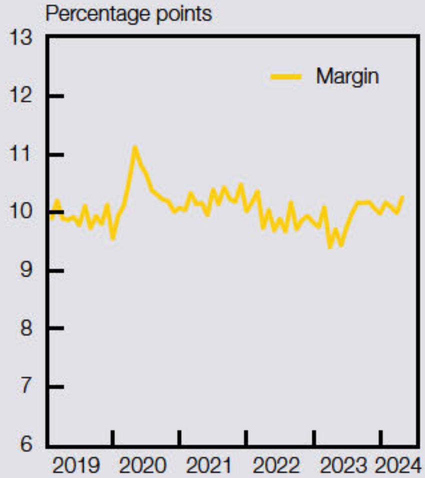
Source: SARB

The margin between interest rates on credit card loans to households and the repo rate has not deviated much over the past four years, remaining relatively high at around 10 percentage points. By contrast, the margin between interest rates on credit card loans to corporates (with a relative size of only 0.4% of total credit extension to companies) and the repo rate initially increased notably during the COVID-19 lockdown, but has since declined significantly and has settled well below the pre-COVID-19 level since the beginning of 2022.

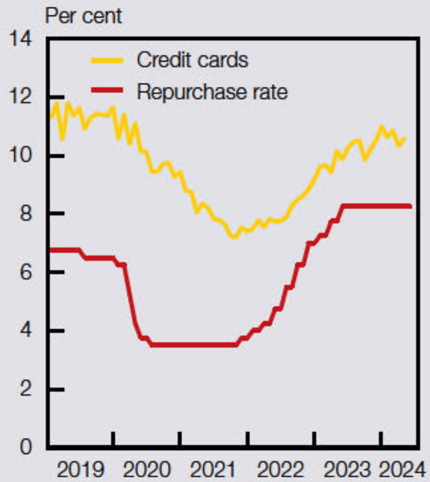
Households: credit card rate and repurchase rate



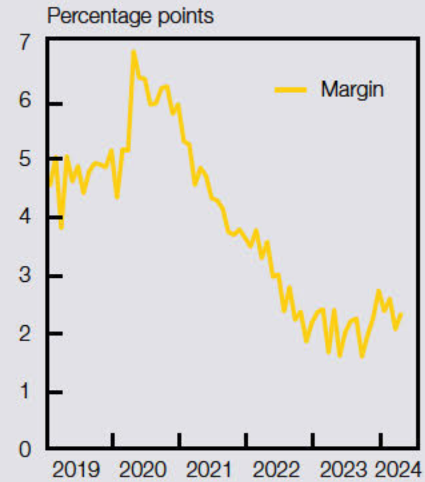
Households: interest rate margin to repurchase rate



Companies: credit card rate and repurchase rate



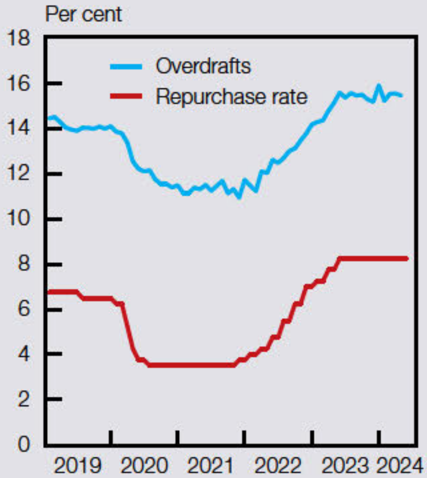
Companies: interest rate margin to repurchase rate



Source: SARB

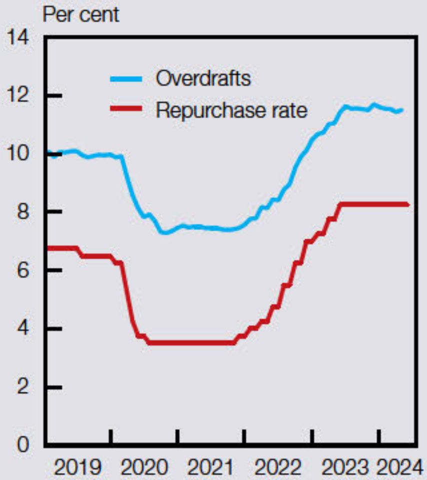
The margin between interest rates on overdrafts to households and the repo rate initially increased slightly during the pandemic but has since fluctuated lower, to be roughly in line with its pre-COVID-19 level. Overdrafts became more expensive for companies as they were the hardest-hit in the aftermath of the COVID-19 pandemic, with their interest rate margin to the repo rate also increasing during the pandemic and only returning to its pre-COVID-19 level from around mid-2022.

Households: overdraft rate and repurchase rate

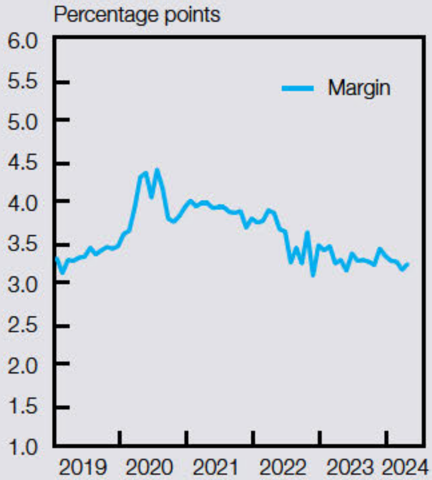


Households: interest rate margin to repurchase rate

Companies: overdraft rate and repurchase rate



Companies: interest rate margin to repurchase rate



Source: SARB

The prolonged period of higher interest rates after the COVID-19 pandemic has translated into a more competitive trading environment, as affordability pressures on both consumers and businesses contributed to the more competitive pricing of loans by banks, which provided concessions on certain lending products to grow market share in certain categories of credit, notably instalment sale credit and general loans. During the COVID-19 pandemic, the uncertainty and heightened risk initially led to an upward adjustment in the pricing of credit, but when the situation stabilised, interest rate margins largely began to revert to pre-COVID-19 levels. However, for selected credit categories, banks were willing to offer more competitive pricing to lower-risk customers.