Note on the changes in bank deposit and lending rates since the onset of the COVID-19 pandemic[1, 2]

by D H Meyer and L Morope

Introduction

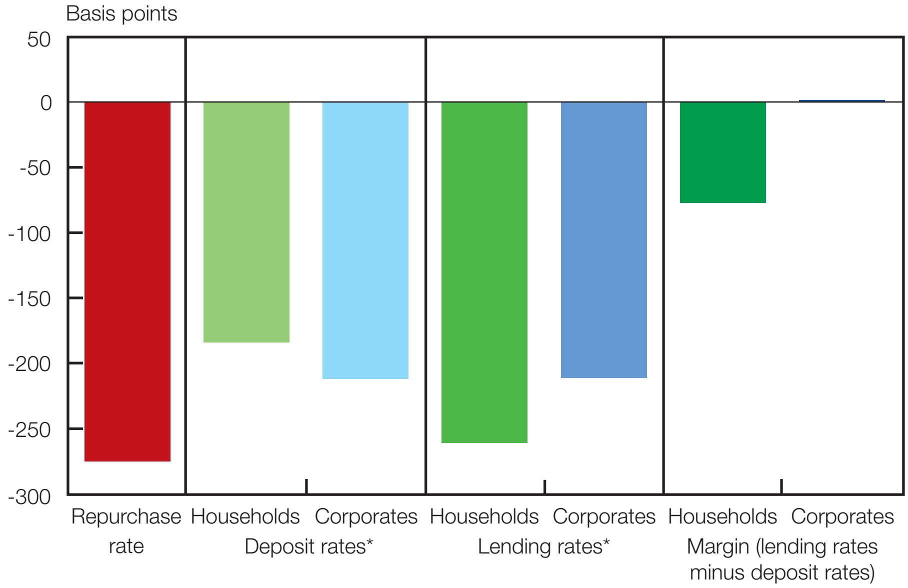
The South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) has lowered the repurchase (repo) rate by a cumulative 275 basis points since announcing a rate of 6.25% on 17 January 2020 through four consecutive reductions, from March to June 2020, to mitigate against the economic impact of the coronavirus disease 2019 (COVID-19). The private sector banks followed these reductions in the repo rate, and adjusted their weighted average deposit and lending interest rates lower in broad alignment with the repo rate while also tightening credit standards.

Households benefitted comparatively more than corporates from the lower weighted average interest rates offered by banks. The deposit rate offered to households declined by much less than both the repo rate and the rate offered to corporates. However, the lending rate for households declined by almost the same magnitude as the repo rate and by more than that for corporates. On balance, the change in the margin between households' lending and deposit rates indicates the comparative advantage that households experienced over the period, compared to that of corporates. Although banks did not pass on the full magnitude of the repo rate decline, the relative changes supported strong growth in household deposits while also assisting credit extension.

1 This note relates to the lending and deposit rate statistics published on pages S–11 and S–30 respectively in this edition of the *Quarterly Bulletin (QB).* The note also follows the box on 'Drivers of households' borrowing and deposit rates' in the March 2019 edition of the *QB*. See https://www.resbank.co.za/content/dam/sarb/publications/quarterly-bulletins/boxes/2019/9248/04Drivers-of-households--borrowing-and-deposit-rates.pdf

2 The analysis is based on weighted average interest rates on both new and existing deposits and loans reported by banks in the BA 930 survey.

Cumulative changes in interest rates from January 2020 to April 2021



* Weighted average deposit and lending rates
Source: SARB

Deposit rates

Banks are inclined to offer interest rates on deposits at levels below the repo rate to contain funding costs, while depositors seek the highest possible return on deposits of different maturities.

Banks' weighted average interest rate on deposits[3] of both households and companies generally followed the reductions in the repo rate, from 6.25% on 17 January 2020 to a low of 3.50% effective from 24 July 2020, with two changes of 100 basis points each followed by 50 and then 25 basis points.

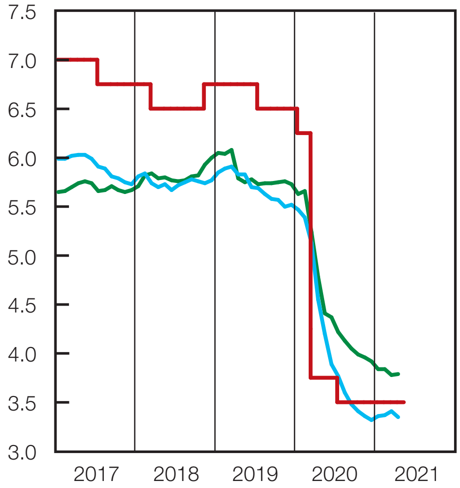
3 The weighted average interest rate on the deposits of households and corporates is calculated as the aggregate of the average interest rates per institutional sector and the deposit categories of each reporting bank as weighted based on outstanding balances. The deposit categories include cheque, transmission and other demand deposits, other short- and medium-term deposits as well as long-term deposits.

Banks have historically offered households lower rates on deposits than corporates due to the latter's large placements. In recent years, the deposit rates for households and corporates have become more closely aligned, as banks have targeted stable household deposits which qualify for the net stable funding requirement.[4] To attract and retain household deposits, the interest rate offered by banks has consistently exceeded that on corporate deposits from June 2019 and more markedly so from June 2020.

4 The net stable funding ratio (NSFR) became a minimum standard Basel III requirement from January 2018, and reflects the amount of available stable funding relative to the amount of required stable funding. The NSFR encourages stable sources of funding for long-term assets and therefore household deposits.

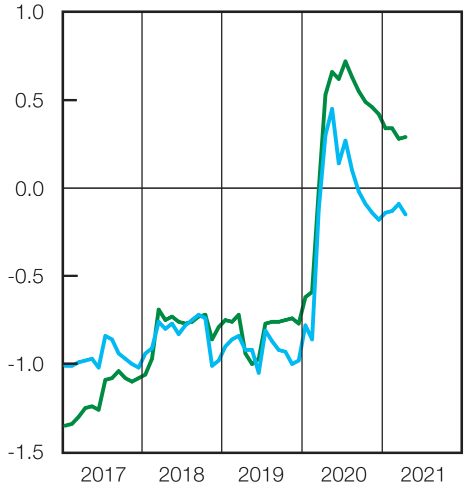
Repurchase rate and interest rates on deposits*

Per cent



Margins between deposit rates* and the repurchase rate

Percentage points



Repurchase rate — Corporates — Households

* Weighted average interest rates

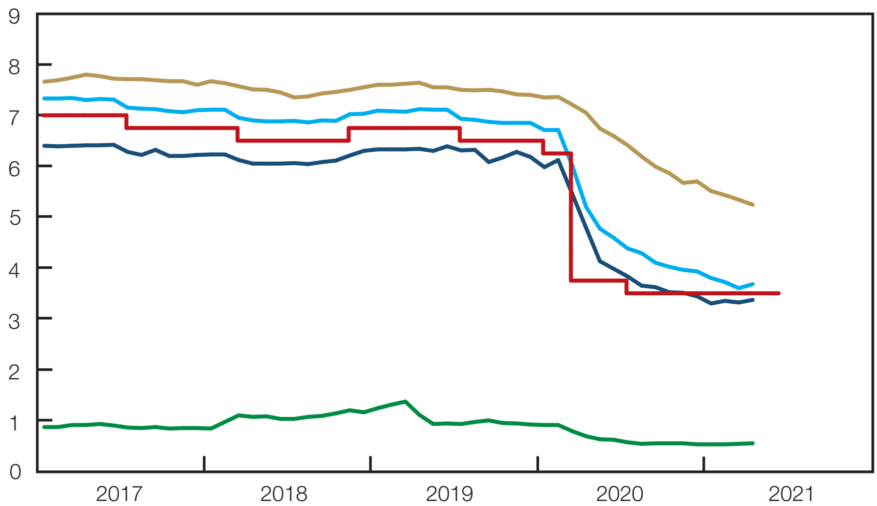
Source: SARB

Although the weighted average interest rates on deposits by both households and companies followed the repo rate lower, their margins[5] to the repo rate have recently turned positive, with those of households remaining substantially in excess of those for corporates. On balance, the household sector has benefitted more than corporates from changes in deposit rates, in particular since the COVID-19-related lockdown, with the margin between deposit rates and the repo rate switching from negative to positive.

5 The margin is calculated by subtracting the respective weighted average deposit rates for households and corporates from the repo rate.

Repurchase rate and selected interest rates* on household deposits

Per cent



Fixed deposits up to a year
Repurchase rate
Cheque accounts
Notice deposits (32–91 days)
Call deposits

* Weighted average interest rates

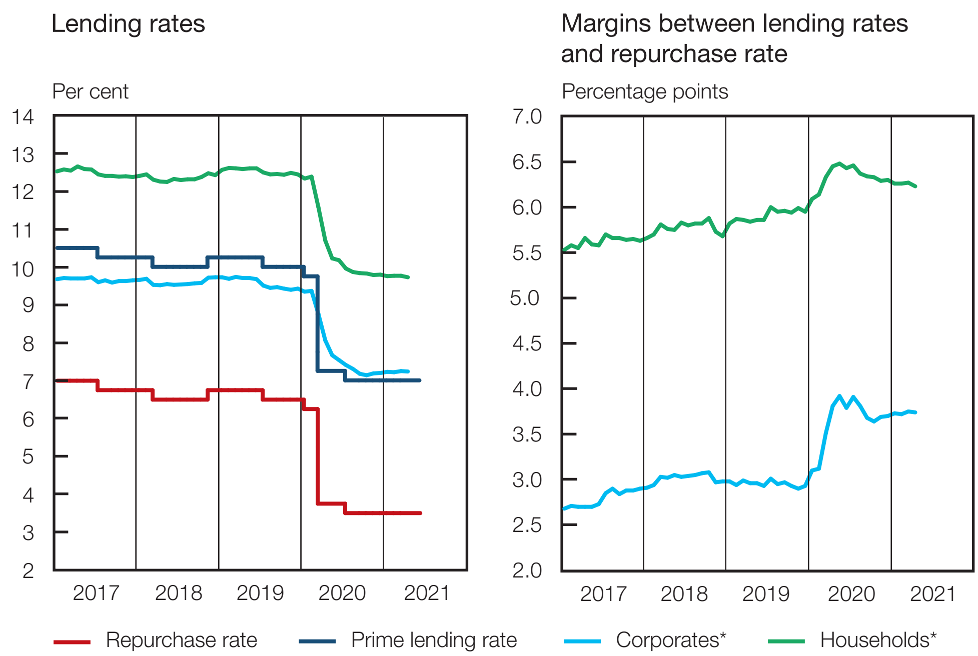
Source: SARB

For this reason, the focus now shifts to the changes in the household sector's different types of deposit rates. The weighted average interest rate on fixed deposits up to a year has remained above the repo rate throughout the COVID-19 pandemic thus far, and has declined by only 211 basis points since January 2020 compared with the 275 basis points decline in the repo rate. The weighted average interest rate on notice deposits of 32–91 days has decreased by 303 basis points, while rates on call deposits have decreased by 261 basis points over the same period and for a while exceeded the repo rate. The rate on cheque accounts, which is far below the repo rate, has decreased by only 36 basis points.

Lending rates

The weighted average interest rate on bank loans reflects the cost of borrowing in the economy, inclusive of a markup for risk. Lending rates are therefore at a premium to the repo rate and, in the case of households, at a substantial premium to the prime lending rate,[6] due to them being regarded as higher risk than corporates, to whom lending rates are usually offered at a slight discount to the prime lending rate. However, since the national lockdown, lending rates to corporates have been slightly higher than the prime lending rate.

6 The prime lending rate is the repo rate *plus* a constant margin of 350 basis points. For more information on the prime lending rate, see 'The role of the prime rate and the prime-repurchase rate spread in the South African banking system', available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/2010/4279



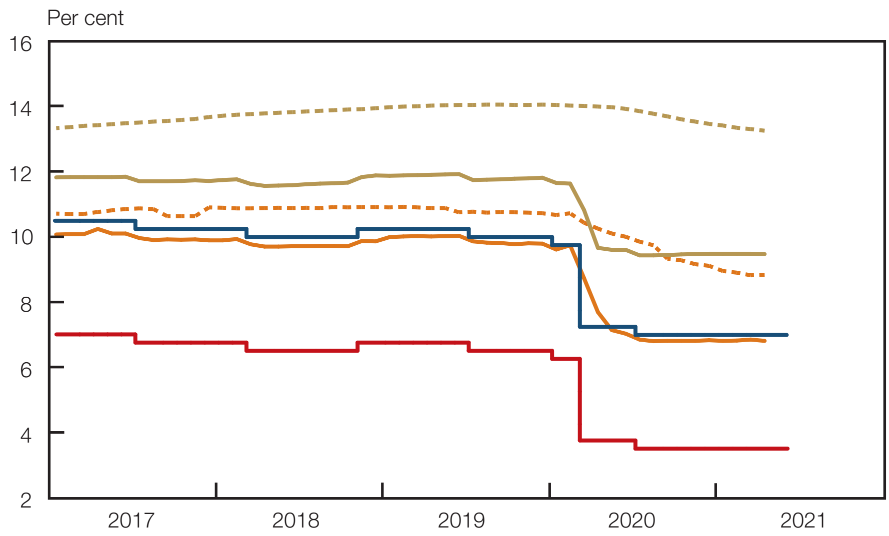
* Weighted average interest rates
Source: SARB

Lending rates, similarly to deposit rates, follow the movements in the repo rate. During the COVID-19 pandemic, the weighted average lending rate[7] has been reflecting a noticeable increase in the risk premium following the national lockdown from March 2020, along with a visible difference between the rates for households and companies. The margin between the weighted average lending rate to companies and the repo rate has increased much more than that for households.

7 The weighted average lending rates of households and corporates are calculated as the aggregate of the average interest rates per institutional sector and the lending categories of each reporting bank as weighted based on outstanding balances.

Flexible lending rates are more closely aligned with the repo rate than fixed rates due to the extended maturity of some agreements. Borrowing at flexible rates is also cheaper than at fixed rates, as the option of locking into fixed-rate agreements requires a premium. There is also a marked difference between rates that apply to instalment sales that are significantly higher than interest rates on mortgage loans, with the latter, on a flexible weighted average basis, priced in close proximity of the prime lending rate.

Repurchase and selected lending rates* to households

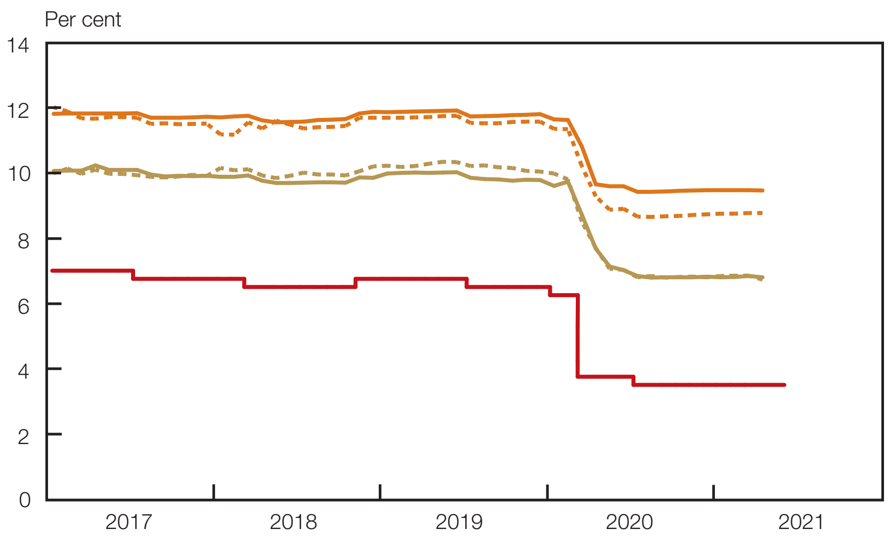


Instalment sales: fixed rate
Mortgage advances: fixed rate
Mortgage advances: flexible rates
Instalment sales: flexible rates
Prime lending rate
Repurchase rates

* Weighted average interest rates
Source: SARB

The weighted average flexible interest rate on new loans is an early indicator of changes in lending conditions to households, in particular for instalment sale credit (mostly vehicle purchases), whereas new and existing flexible interest rates for mortgage advances have followed similar paths as banks passed on interest rate changes in similar magnitudes. However, on balance, more interest rate relief was provided on longer-term mortgage credit than on shorter-term instalment sale credit.

New and existing lending rates* to households and the repurchase rate



Existing instalment sales
Existing mortgage advances
Repurchase rate
New instalment sales
New mortgage advances

* Weighted deposit and lending rates
Source: SARB