Note on the changes in and margins between bank lending and deposit rates for households and corporates since the onset of COVID-19[1, 2]

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Introduction

Globally, the coronavirus disease 2019 (COVID-19) significantly affected economic activity and financial markets. The South African Reserve Bank's (SARB) policy responses included the adjustment of the repurchase (repo) rate as well as other regulatory interventions that were implemented at the time to ensure the orderly functioning of the financial markets.[3]

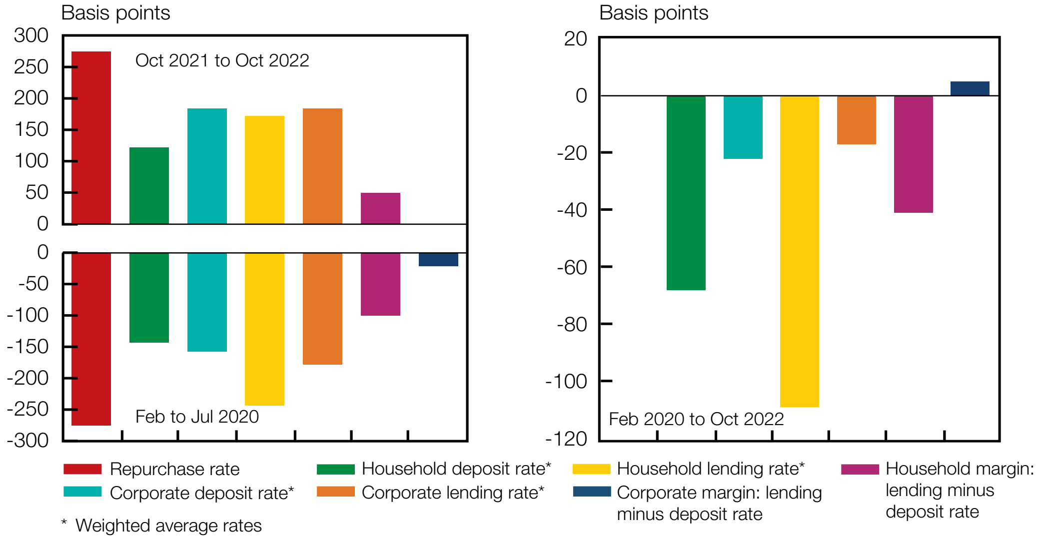
The SARB's Monetary Policy Committee (MPC) lowered the repo rate further at four successive meetings in March, April, May and July 2020, bringing the repo rate from 6.25% on 17 January 2020 to a multi-decade low of 3.50% on 24 July 2020, where it remained until 18 November 2021. The lower repo rate significantly reduced borrowing costs, although more so for households than for corporates. With the deposit rates offered by banks having declined less when compared with lending rates, households benefitted. This reflected the banks' focus on household deposits as a source of stable funding.[4]

Cumulative changes in interest rates

Basis points

Net cumulative changes in interest rates

Basis points



* Weighted average rates

Source: SARB

Following the stabilisation of new COVID-19 infections and the resumption of almost all economic activity, the repo rate was increased from 19 November 2021 in response to mounting inflationary pressures. To date, the cumulative increase of 350 basis points in the repo rate following seven consecutive increases rendered a rate of 7.00% as from 25 November 2022, exceeding the pre-pandemic level of 6.25%.[5] Consequently, the higher repo rate increased borrowing costs slightly more than deposit rates.

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1 This note relates to the lending and deposit rate statistics published on pages S–30 and S–31 in this edition of the *Quarterly Bulletin (QB)*. The note also follows the 'Note on the changes in bank deposit and lending rates since the onset of the COVID-19 pandemic' in the June 2021 edition of the *QB*, available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/quarterly-bulletins/articles-and-notes/2021/NoteonthechangesinbankdepositandlendingratessincetheonsetoftheCOVID19pandemic

2 The analysis is based on the total weighted average interest rates on both new and existing deposits and loans reported by banks in the BA930 survey, unless specifically defined differently.

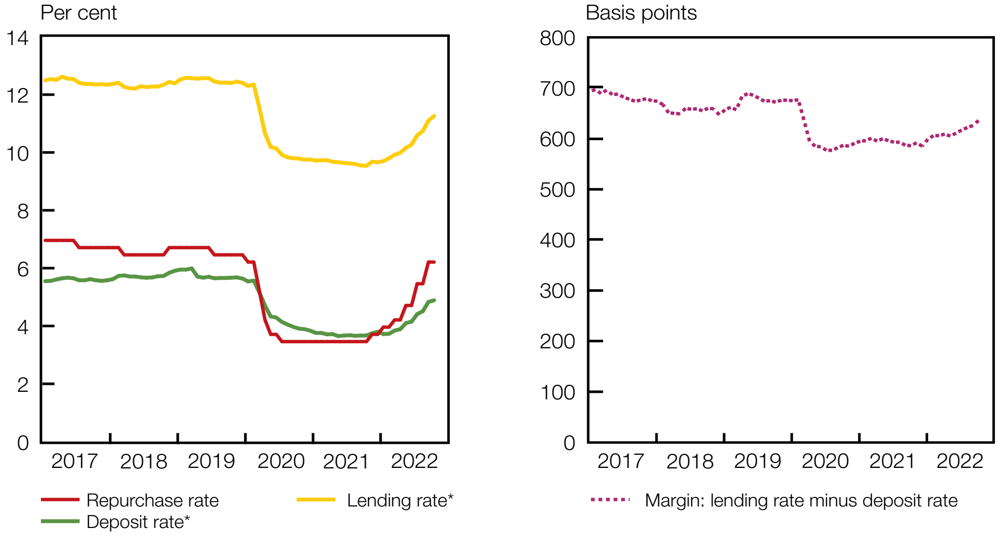
3 For more information on the SARB's policy responses during the COVID-19 pandemic, see https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/Our-response-to-COVID-19

4 The net stable funding ratio (NSFR) requires banks to pursue more stable sources of funding, such as household deposits. The NSFR became a minimum standard Basel III requirement from January 2018.

5 The analysis in this note will only incorporate changes up to October 2022, the latest date for which deposit and lending rates of banks are available.

Over the period October 2021 to October 2022, the change in the lending rates of households and corporates was fairly similar but the increase in the deposit rates of households lagged those of corporates. However, over the extended period from February 2020 to October 2022, on a cumulative net basis, the decline in household lending rates exceeded that in their deposit rates, rendering a net benefit to the household sector. By contrast, the change in corporate deposit rates was marginally more than their lending rates, resulting in a small positive margin for the corporate sector over the same period.

Household sector

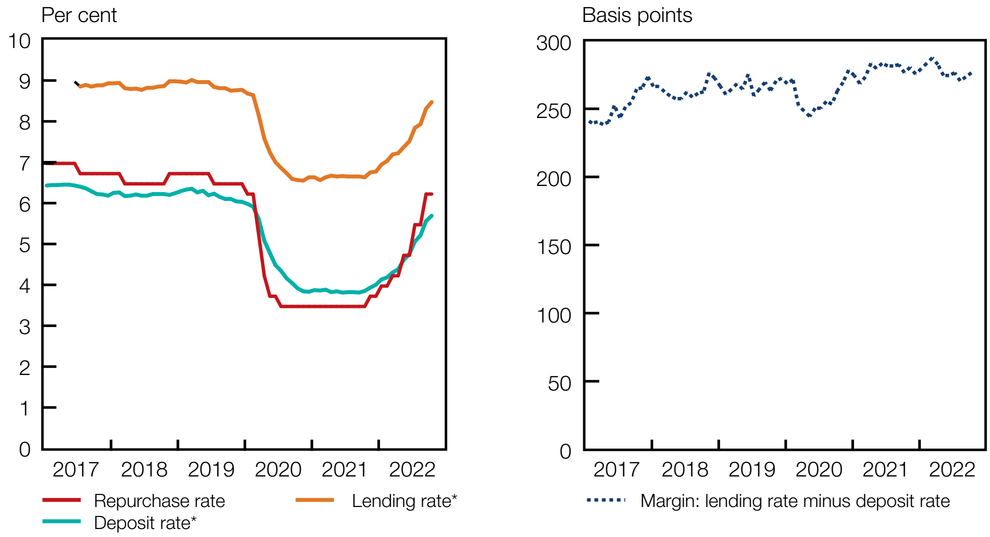


* Weighted average rates

Source: SARB

The margin between the lending and deposit rates of households averaged 673 basis points between 2017 and 2019, before narrowing by 100 basis points from February to July 2020. By October 2022, the margin still fluctuated below pre-COVID-19 levels.

Corporate sector



* Weighted average rates

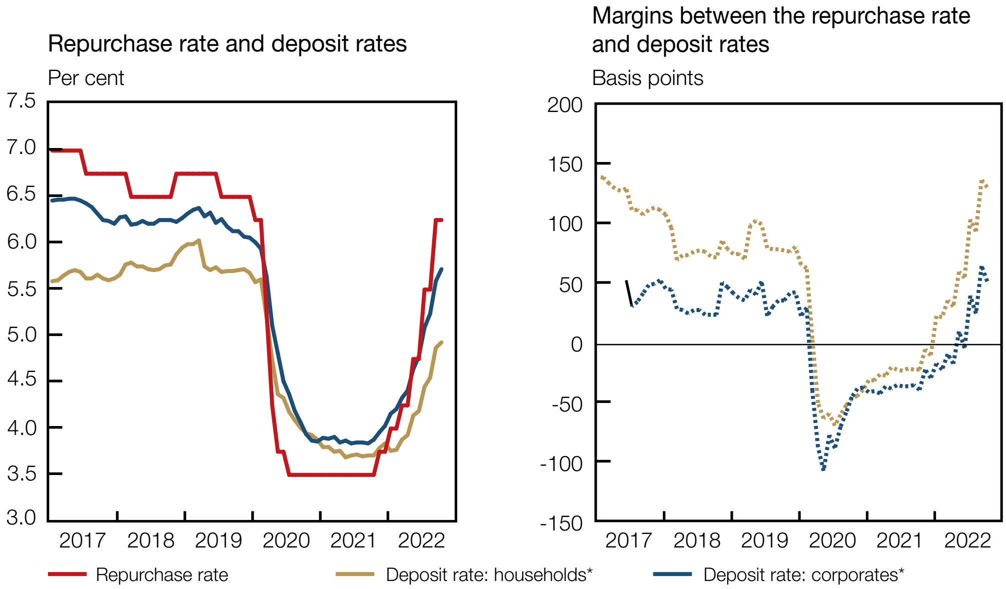
Source: SARB

The corporate sector also benefitted from lower borrowing rates, but the margin between lending and deposit rates narrowed by only 21 basis points from February 2020 to July 2020. However, in October 2022 the margin again exceeded that recorded in February 2020.

Deposit rates

The repo rate as a measure of funding costs influences deposit rates offered by banks. Along with the increase in the repo rate from November 2021, banks' weighted average interest rate on household and corporate deposits[6] also increased.

Generally, banks offer households lower interest rates on deposits compared to what they offer corporates, due to the larger value of corporate deposits. In October 2022, the weighted average deposit rate for households was 4.93% and for corporates 5.72%, up from 3.71% and 3.88% respectively in October 2021. Since the start of the pandemic, the respective margins between the repo rate and the deposit rates for households and corporates have moved much closer together. This was maintained into the subsequent interest rate tightening cycle as banks targeted the relatively stable deposits of households. However, the respective margins again drifted apart in recent months as the repo rate returned to pre-pandemic levels.



* Weighted average interest rates
Source: SARB

Lending rates

Households' cost of borrowing exceeds that of corporates due to the lower risk premium of corporates. This is also evident from the difference in margins between the repo rate and their respective weighted average lending rates.[7] However, at the onset of the pandemic, corporates' risk premium increased more than that of households. The interest rate margin between the repo rate and corporate sector loans increased by 110 basis points between February and May 2020, whereas that of households increased by only 34 basis points.

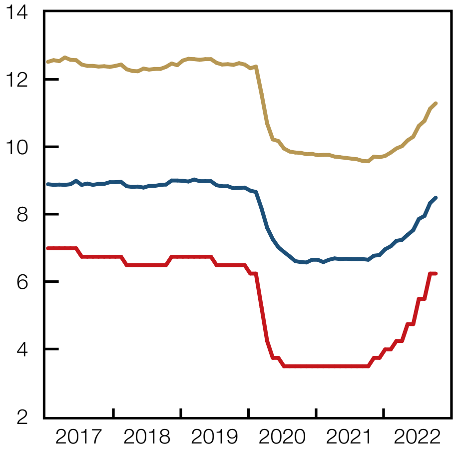
The margin between the repo rate and corporate sector lending rates only returned to pre-COVID-19 levels from July 2022, whereas for the household sector it had already narrowed to its pre-pandemic level in December 2021, and then narrowed further to levels last recorded in 2011.

6 The weighted average interest rate on the deposits of households and corporates is calculated based on the weighted outstanding balances of the deposit categories of each reporting bank. The deposit categories include current account, transmission and other demand deposits, other short- and medium-term deposits as well as long-term deposits.

7 The weighted average lending rate of households and corporates is calculated based on the weighted outstanding balances of the loan categories of each reporting bank. The loan categories include overdrafts, instalment sale financing, mortgage advances, credit card advances and general loans.

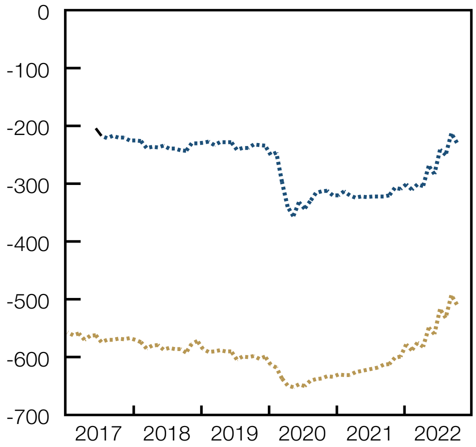
Repurchase rate and lending rates

Per cent



Margins between the repurchase rate and lending rates

Basis points



Repurchase rate   Lending rate: households*   Lending rate: corporates*

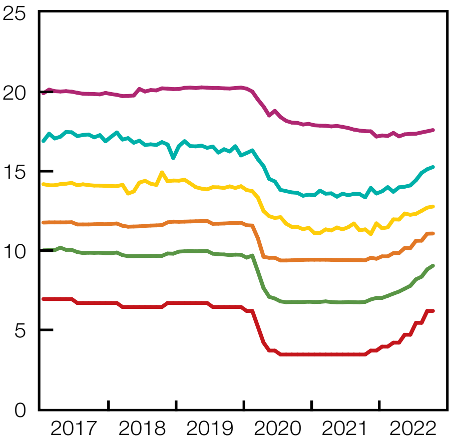
* Weighted average interest rates

Source: SARB

The decline in the margin of the repo rate to the total household lending rate is explained by the movements in the interest rates of the underlying credit categories. Although bank lending rates follow changes in the repo rate with a lag,[8] two credit categories clearly stand out. The decline in the weighted average flexible rate on mortgage advances (accounting for 99% of household mortgage loans) from February to July 2020 slightly exceeded the decline in the repo rate, at 289 basis points compared with 275 basis points. This mortgage rate subsequently increased by only 228 basis points from October 2021 compared with an increase of 275 basis points in the repo rate. On a net basis, the weighted average rate for flexible rate household mortgage loans is now 61 basis points lower than prior to the COVID-19 pandemic.

Repurchase rate and selected lending rates* to households

Per cent



General loans   Credit cards
Overdrafts   Instalment sales: flexible rate
Mortgage advances: flexible rate   Repurchase rate

* Weighted average rates

Source: SARB

Changes in the repurchase rate and lending rates

Basis points

	Decrease Feb–Jul 2020	Increase Oct 2021–Oct 2022	Net change Feb 2020–Oct 2022
General loans	-161	7	-154
Credit cards	-249	191	-58
Overdrafts	-164	144	-20
Instalment sales: flexible rate	-220	169	-51
Mortgage loans: flexible rate	-289	228	-61
Repo rate	-275	275	0

8 Because these are weighted average rates over the days within a normal month, the date at which the change in the repo rate is effective will affect the visibility of the full pass-through. MPC meetings are often held around the middle of or later in a month, with the repo rate becoming effective from the Friday after the MPC decision, which means that even if banks implement the change immediately, the average rate for the full month will consist of a mix of the old and new rates. Therefore, there might be a delay of a month or two for the full effect to become visible.

Similarly, interest rates on general loans to households, which did not decline as much as those on mortgage advances, also did not increase nearly as much, with interest rates on these loans now 154 basis points lower than before the pandemic. This partly explains the higher year-on-year growth rates in general loans since the start of 2022.

The lower-weighted average interest rates on bank deposits and loans since the onset of the COVID-19 pandemic also impacted the national accounts statistics. The level of the financial intermediate services indirectly measured (FISIM)[9, 10, 11] in the output of banks decreased during the period of lower average interest rates. When interest rates increased in the second half of 2022, FISIM output also began to increase. Simultaneously, the intermediate cost related to household FISIM, which forms part of the final consumption expenditure by households, decreased in the second quarter of 2021 and then began to increase in tandem with the average interest rates paid by households as the repo rate increased. The reference rate used in the estimation of FISIM is closely correlated with the repo rate.

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9 For more detail on FISIM and output, see 'Note on the output of the finance, insurance, real estate and business services sector' on page 83 in the September 2017 edition of the *QB,* available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/quarterly-bulletins/articles-and-notes/2017/7983 and page 14 of 'South Africa's national accounts 1946–2021: an overview of sources, methods and outcomes', a supplement to the December 2021 edition of the *QB*, available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/quarterly-bulletins/supplements/2022/SouthAfricasnationalaccounts19462021Anoverviewofsourcesmethodsandoutcomes

10 FISIM, as defined by the *System of National Accounts (SNA) 2008*, is the indirect measurement of service charges levied by financial institutions on loans and deposits. It is derived from the level of loans and deposits of financial institutions and the difference between lending and borrowing rates relative to a reference rate. This is based on the principle that both borrowers and depositors pay a fee to the financial intermediary for services provided, with the depositor receiving a lower rate of interest than that paid by borrowers – the difference being the combined fees implicitly charged by the financial intermediary. The reference rate is the rate of interest at which lending and borrowing takes place without including any service charges and should reflect the risk and maturity structure of both deposits and loans.

11 $FISIM = FISIM_L + FISIM_D = (r_L - rr)\, Y_L + (rr - r_D)\, Y_D$

where:

$FISIM_L$ = FISIM on loans made by financial institutions

$FISIM_D$ = FISIM on deposits held by financial institutions

r_L = lending rate of interest

r_D = deposit rate of interest

rr = reference rate of interest

Y_L = average stock of loans

Y_D = average stock of deposits