Banks breach interest rate spread to maximise profit

Commercial banks have breached the interest rate spread to maximise their profits.

The third quarter review of the monetary policy has stated that the weighted interest rate spread overshot the regulatory cap of five per cent and stood at 5.46 per cent.

Reportedly, Agricultural Development Bank, Nepal SBI Bank and Standard Chartered Bank crossed the regulatory ceiling of five per cent interest rate spread in the third quarter.

Interest rate spread was initially introduced to put moral pressure on banks. However, since the last fiscal, Nepal Rastra Bank — the central regulatory and monetary authority — started taking action against banks that violated the rule.

Banks have to allocate the profit generated from the margin that is above the five per cent regulatory cap to the interest spread reserve and banks cannot allocate dividends from that reserve, according to Nara Bahadur Thapa, executive director of the Research Department of NRB.

Commercial banks generated Rs 36.26 billion in profit in the third quarter of this fiscal which is a growth of 15.45 per cent, according to the unaudited financial statements published by them.

Banks have been facing public criticism for raising lending rates rampantly to generate profit. The interest rate spread is a tool to gauge the efficiency of the banks. Banks that are efficient have less gap between the interest rate on credit and interest rate on deposits.

Thapa said the central bank would take action against banks that have breached the regulatory cap of interest rate spread.

However, the banks claim that the central bank has calculated the weighted interest rate spread from the difference of the weighted interest rate on credit and deposits.

But the investment made by the banks in the treasury also needs to be counted in weighted average interest rate on deposits and investment (in treasury bills).

As per the third quarter review of the Monetary Policy, 2017-18, average weighted lending rate stands at 12.10 per cent whereas the deposit rate stands at 6.64 per cent. Weighted average interest rate in 91-day treasury bills stands at 4.98 per cent.

Deposit rate offered by the banks to depositors is higher than the interest rate that banks earn on treasury bills from the central bank. And the formula of weighted interest rate spread calculation adjusts the difference of deposit rate and treasury bills rate, according to Bhuvan Kumar Dahal, CEO of Sanima Bank.

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Likewise, the third quarter review of the monetary policy states that commercial banks have made investment of 21.7 per cent in the priority sector as directed by the central bank till the end of the third quarter. Banks have to invest 25 per cent of the total loan portfolio to agriculture (10 per cent), hydro-power (five per cent), tourism (five per cent) and export-oriented and micro, small and medium enterprises (five per cent) by the end of the fiscal year as per the instruction of the central bank.

Source: The Himalayan Times, 24th May 2018