Interest rate survey

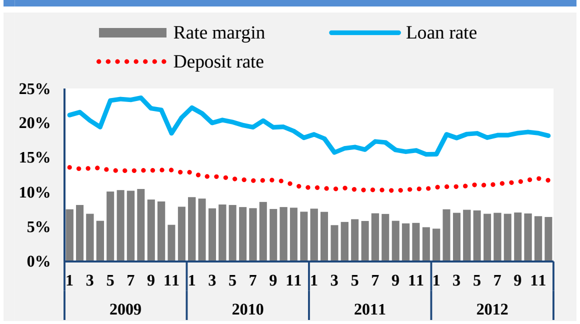
/2013- III quarter/

In September 2013, interest rate survey has been conducted among the banks' executive officers. (hereinafter referred to as "Bank")

As of August 2013, total loan outstanding increased by 46.8 percent from the same period of previous year reaching MNT 9.7 trillion. Hereof, 16.3 percent or MNT 1.6 trillion of total loan was issued by government implemented "Price stability and Housing Program". Total deposit increased by 21.6 percent amounting MNT 5.4 trillion at the end of August 2013.

Weighted average lending rate was 18.9 percent, while deposit rate being 12.2 percent. At the end of August 2013, year-on-year inflation rate recorded at 9.4 percent.

Figure 1. Loan, deposit rate

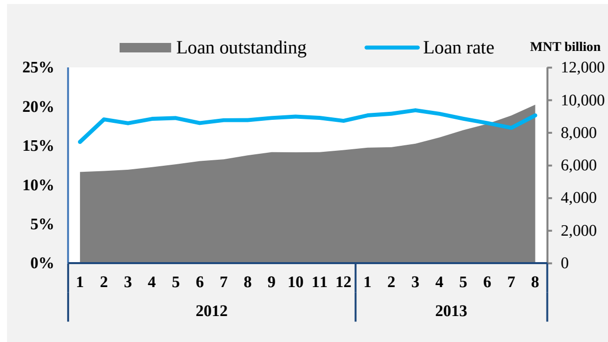


Loan interest rate

Weighted average rate of issued loan in the reporting month has been constantly dropping from 19.1 percent to 17.3 percent since March 2013. However, loan rate has risen by 1.6 percentage point to 18.9 percent at the end of August 2013.

Due to the start of new school year, consumption loan, namely salary loan, pension loan and herder loan issued with high interest rate made impact on loan rate increment.

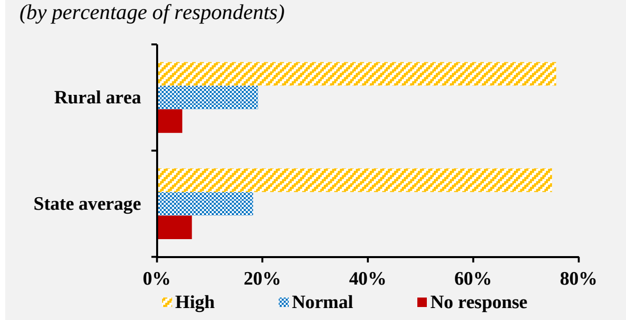
Figure 2. Loan outstanding, loan rate



According to the nationwide socio-economic, banking and finance survey conducted in 2013, 70 percent of respondents answered that lending rate is high.

Figure 3. Loan rate in your opinion?

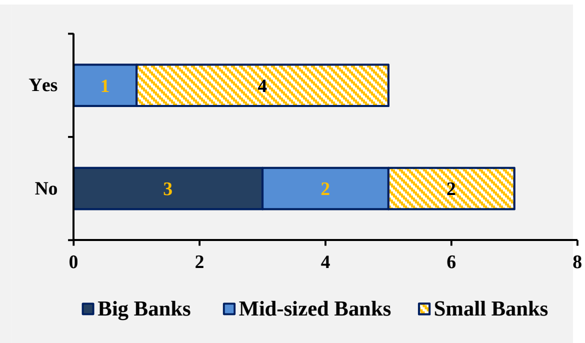
(by percentage of respondents)



Source: Bank of Mongolia, Nationwide Survey of Socio-Economic8 Banking & Finance

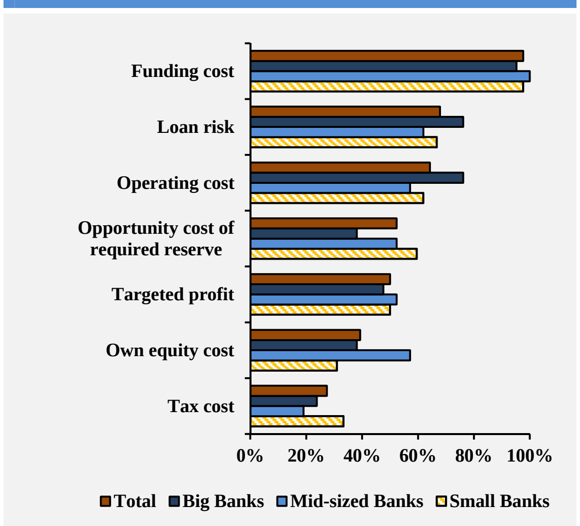
Most of the banks with smaller assets see that lending rate is high due to high funding cost, pressure of setting high lending rate from bigger banks, excessive demand for loan, risk management in economy itself is low and so forth. On the other hand, for banks with bigger assets, current lending rate does not seem to be high, considering the current economic situation.

Figure 4. Is loan interest rate set high in current developments?



Banks set their interest rate based on funding cost, operating cost, risk premium, interest rate set by other banks and central bank rate. Among these factors, cost management, notably funding cost management plays the most important role, followed by business risk premium, operating cost bank's targeted profit margin. Tax cost and bank's own capital cost are less influential, according to the survey.

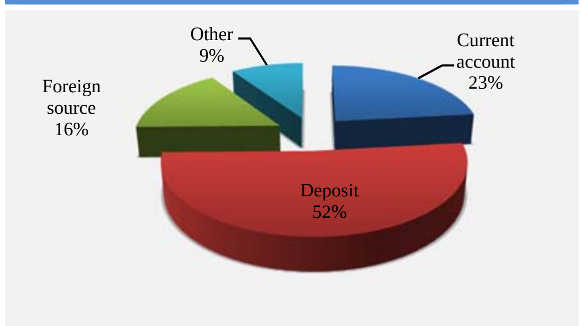
Figure 5. Which factors can influence on setting the loan rate?



Following the funding cost being the most influential factor on setting the interest rate, survey indicates that risk premium and operating cost may be important for banks with bigger assets, while banks with smaller assets take the opportunity cost for required reserve and targeted profit margin as influential factors.

As of August 2013, banks have attracted funds with total of MNT 14.6 trillion (excluding loan and deposit funded by Bank of Mongolia). Among this funding, deposit takes 52 percent, current account with 23 percent, 16 percent from foreign financial institutions and 9 percent from other sources.

Figure 6. Total funds by ratio

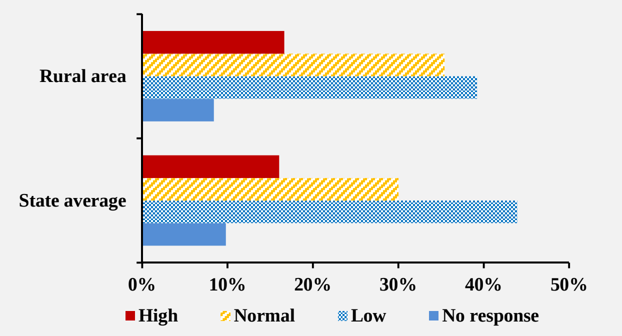


Main reason for funding cost being high is because deposit rate is set high and not likely to drop apparently.

According to the nationwide socio-economic banking and finance survey conducted in 2013, 44 percent of citizens answered that deposit rate is low, 30 percent said normal and 16 percent said high.

Figure 7 Deposit rate in your opinion?

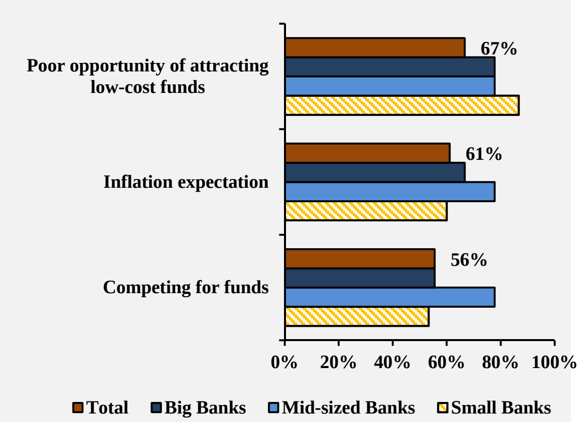
(by percentage of respondents)



Source: Bank of Mongolia, Nationwide Survey of Social Economic & Financial System

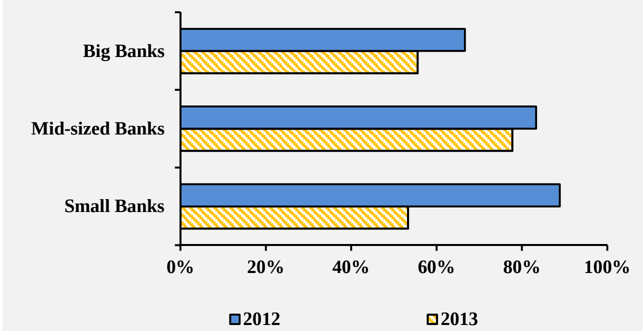
On the other hand, 64 percent of banks answered that deposit rate is high and also indicated that high inflation expectation and strict deposit rate competitiveness in banking system are ultimately resulting the high funding cost.

Figure 8. Main factors that affect deposit rate



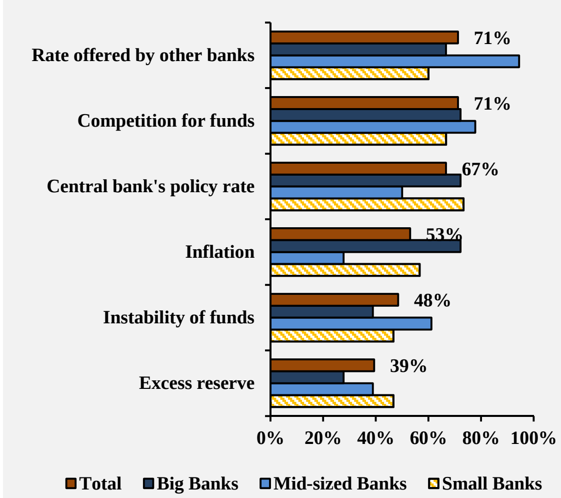
Comparing the results with same survey taken in 2012, banks answered deposit rate is less affected by competition for low-cost funding. Thus, low-cost fund placed in banks from central bank may have cooled down the deposit rate competition among banks.

Figure 9. Competing for funds



Despite the rate offered by other banks and keen competition to attract funds being the most influential on setting the rate, banks note that central bank's policy rate and inflation might as well be important factors. Banks with middle-size assets also restrain in unstable state of attracting funds.

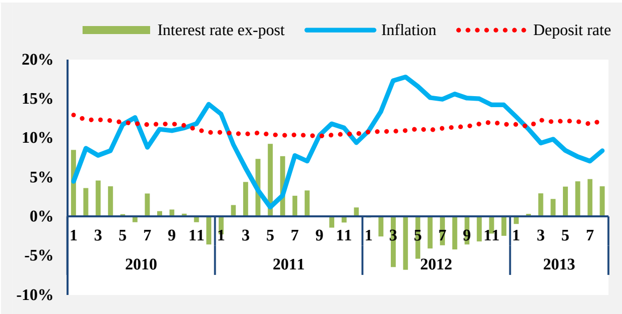
Figure 10. Main components on setting the deposit rate



Most banks are setting their deposit rate high, perforce, in order not to be taken away its big savings owners.

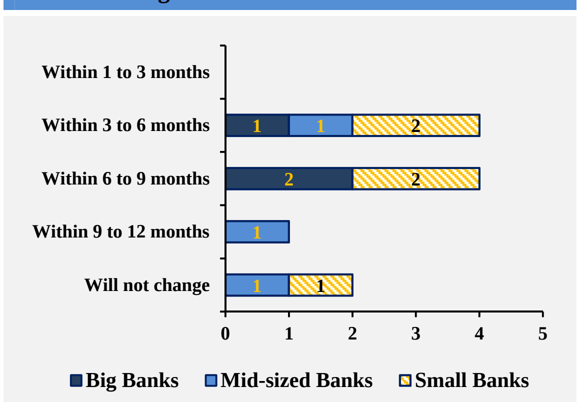
Among banks which have been involved in the survey, 54 percent have answered that they are not coordinating its deposit rate with inflation rate.

Figure 11. Inflation, deposit rate



However, survey also shows that if inflation is consistently moving toward stable state, 36 percent of banks will be able to lower its deposit rate within 3-6 months, another 36 percent within 6-9 months and 9 percent said within 9-12 months.

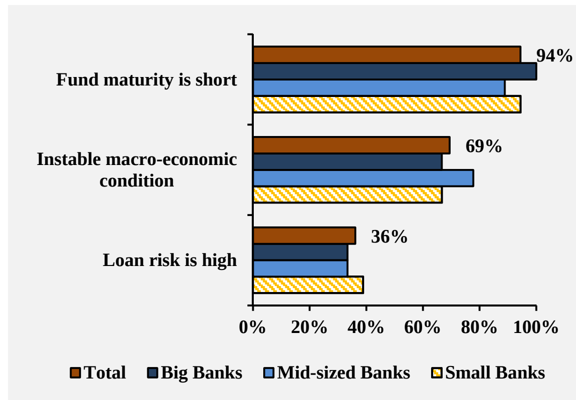
Figure 12. If the inflation rate stabilizes, will banks change its interest rate?



Loan average term

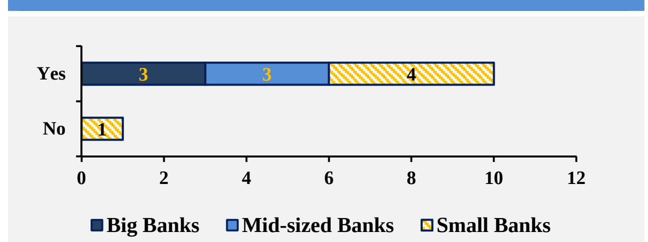
Banks see that term of loan mainly depends on maturity of funds which were attracted. Thus, reason why most of the loans being issued with short maturity is due to inconsistent macro-economic environment, causing high business risk.

Figure 13. Main reasons of short loan average term



Loan term can be lengthened if the macro-economic environment is in steady pace, banks mention.

Figure 14. Will your bank extend your loan term in case macro-economic condition restores?



*Answer "No" may also refer to response that says loan term will depend on fund maturity.

Survey also indicates that short maturity of banks' funds is related to deposit term. About 90 percent of total deposit has maturity within 1 year.

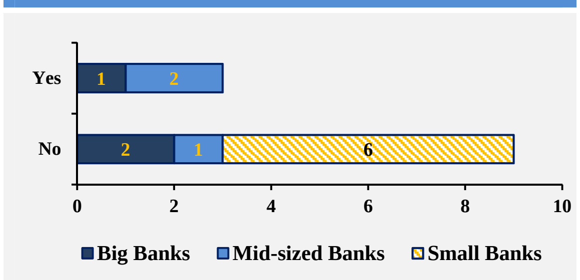
Main factors that distract deposit maturity from being lengthened are companies' asset scheduling is mostly set in short-term, inflation expectation is high, strong exchange rate fluctuation and instable macro-economic, as well as business environment.

Banks also noted that they will be able to provide deposit products and services with 3 to 5 years of maturity when in positive economic condition.

Availability on reduction of interest rate

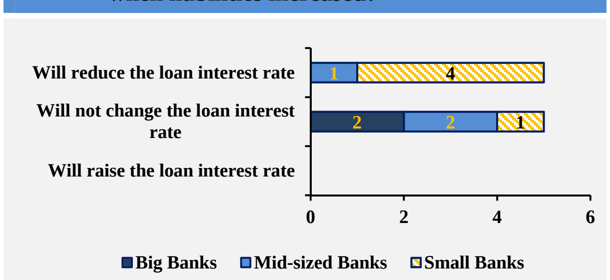
Banks have responded to the question on whether they can reduce its lending rate or not. Majority of responding banks have answered that lending rate cannot be reduced, notably 9 banks, considering the economic conditions in nowadays. Three banks, on the other hand, have answered that lending rate can be reduced if only banks are been enabled with the chance to attract low-cost funds.

Figure 15 Is your bank available for reducing interest rate?



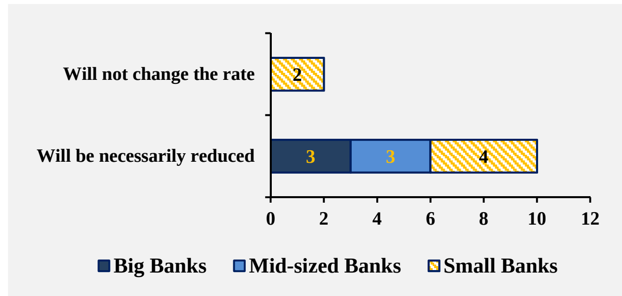
According to the survey, 58 percent of banks will not be intended to reduce its interest even when the liabilities are increased. However, 42 percent of responding banks see that interest rate can be reduced regarding the liabilities with low cost are increased.

Figure 16. Will your bank change the loan interest rate when liabilities increased?



Banks (83 percent) will be coordinated and reduce the interest rate too at the point market rate is reduced.

Figure 17. Will your bank reduce the loan interest rate when market rate is reduced.



In order to lower the lending rate, banks should take actions such as enhancing the availability of attracting low-cost funds, attracting funds with long-term maturity in the international market, cutting the operating cost and improving the risk management.

As for decision makers, (Central bank, Parliament, Government) measures that should be taken firsthand are strengthening the macro-economic stability, stabilizing the foreign exchange, improving legal environment to support the FDI, to stop the excessive growth of inflation, to enhance the funding source with long maturity and low rate, and to reassess the business environment.

Summary

- Considering the economic condition in current development, banks don’t view that current loan interest rate is high. Thus, banks are not intending to reduce the lending rate in the near future.
- In order to proceed the interest rate reduction, some actions can be taken, for instance, attracting low-cost funds with long maturity, reassesing the lenders’risk and improving the risk management.
- All banks concern that funding cost is the main factor for setting the interest rate. Hence, banks with bigger assets concern on business risk and the operating cost as an influencing factor, while other banks with smaller assets concern on targeting profit and opportunity cost of required reserve.
- Main reasons for interest rate having short maturity and still not being reduced can be given as funds with high-cost, high business risk, instable and inconsistent macro-economic, business environment.
- Deposit rate, which takes the biggest portion in banks’ funding source, is not dropping due to shortage of low-cost fund, high inflation expectation and strong competing incentive in the market.
- Stable macro-economic condition can be the essential factor that contributes to lengthen the maturity of loan products.
- From perspectives of decision makers, following measures can be done such as strengthening the macro-economic stability, stabilizing the foreign exchange, improving legal environment to support the FDI, to stop the excessive growth of inflation, to enhance the funding source with long maturity and low rate, and to reassess the business environment.