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High interest rates affect banks profitability

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BEIRUT: Profits of banks will be drastically affected if some lenders continue to offer higher interest rates in an “irrational” manner, bankers have warned. “Some of the leading Lebanese banks are vying to lure more deposits by offering high interest rates on Lebanese pound deposits.

“But this trend will eventually affect the profitability of the lenders because the cost of deposits is very high,” the chairman of a medium-sized bank told The Daily Star.

A number of leading banks have offered hefty returns on deposits, and these interest rates have exceeded 10 to 12 percent in some cases, depending on the size of the deposits and the maturity period.

Central Bank Governor Riad Salameh met a few days ago with the Association of Banks in Lebanon to discuss the interest rates amid signs that some of the small and medium-sized banks were irritated by what they called an “unfair” competition from the big lenders.

According to the unaudited consolidated net profits of the Alpha Group of banks, profits reached $1.7 billion in the first nine months of 2018, constituting a drop of 13.8 percent from net earnings of $2 billion in the same period of 2017.

The Alpha Group consists of 15 banks, with deposits in excess of $2 billion each.

The decline in the banks’ net profits is due to a decrease of $326.6 million in net gains on financial assets, a drop of $175.3 million in net gains on financial investments, a decline of $259.5 million in other operating income and a decrease of $88 million in operating expenses - which were partly offset by an increase of $463.8 million in net interest income.

A number of leading banks saw their profits decline in the first nine months of last year - some of whom are still offering high interest rates on deposits.

“In 2016 Salameh launched his financial engineering [program] because it was a necessity at that time. But what I don’t understand is why some of these banks are still raising the interest rates on deposits. This behavior is irrational and I do not agree with the argument that the market set the rates in Lebanon,” another banker explained.

He added nearly all the small and medium-sized banks declined to offer high interest rates on deposits.

“Only some of the big players have joined this trend, and this has created a chaos in the market,” the banker said.

Some of the small and medium-sized banks have applied conservative lending policies and reduced operating expenses in a bid to maintain reasonable profit growth.

But one banker said this conservative policy may not help the economy, which badly needs more loans to the private sector to achieve higher growth. A source close to Banque du Liban insisted that BDL can’t set a ceiling for the interest rates, as this is determined by the market only.

He suggested that some banks may not be too happy with current market conditions and have reservations on raising the interest rates in such a manner.

However, most bankers believe that the interest rates will eventually fall once the new government is formed and once the ministers show unwavering determination to implement reforms and reduce the spiraling fiscal deficit.

“One of the banks which has offered high interest rates and also benefited from the financial engineering of BDL has seen its profits plunge by 40 to 50 percent this year.

“This clearly shows that offering higher yields will not reflect positively on the banks’ balance sheets,” another banker said.

Economist Ghazi Wazni warned that the phenomenal increase in interest rates will also reflect negatively on the economy and the government's budget deficit this year.
"Raising the interest rates in this fashion will deprive the productive sectors from cash. Investors will prefer to deposit their money in the banks in order to reap a profit, instead of investing in productive sectors," Wazni said.
He added that high interest rates will cause economic contraction at a time when the economy is already witnessing slow growth.
"It is also not healthy for the public finances because it will raise the cost of debt servicing. In 2019, the government has to tap the market for LL11 trillion in bonds [$7.3 billion] and [to deal with] a deficit of LL9 trillion.
"We should also take into account that the interest on T-bills will average 10.5 percent this year instead of 7.5 percent in 2018," he added.
Customer deposits in 2018 registered a growth of only 3 percent compared to nearly 5 percent in 2017. The balance of payment deficit in 2018 reached $4.8 billion and this indicates capital outflow is on the rise.