



Study of Economic Development with Perspective of Banking Competition and Interest Rate Spread: A Comparative Analysis of SBI and HDFC Bank

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Abstract:

This paper considers the banking behaviour and economic development by using a comparative analysis of Interest Rate Spread (IRS) of State Bank of India (SBI) and HDFC Bank. Interest Rate Spread- the difference between the Average Lending Rate (ALR) and the Average Deposit Rate (ADR) is an important measure of determining credit access, efficiency of financial intermediaries and the cost of capital as a whole in an economy. Through the analysis of the IRS tendencies in 2019-2024, the researcher indicates that variations in the model of both public and private banks determine the developmental results. With an SBI under financial-inclusion mandate, they have a lower IRS to spread credit to agriculture, MSMEs, and rural areas- thus inclusive economic development despite poor profitability. Conversely, HDFC Bank follows a margin-based strategy and has increased IRS where efficiency, risk-adjusted lending and high financial returns take precedence. These opposite strategies are manifestations of wider topics of state versus market developmental strategies. The paper states that IRS not only serves as a measure of profitability but also as a variable of growth in terms of development that impacts investment, consumption, and growth of regions. The results indicate that balanced competition which implies that the public banks make credit available and the private banks to promote efficiency is reinforcing financial intermediation and sustaining economic development in India.

Keywords: Interest Rate Spread (IRS), Economic Development, Financial Intermediation, Public vs Private Banks, Lending and Deposit Rates, Banking Competition, Credit Accessibility, Inclusive Growth

Introduction:

Economic development in emerging economies like India is deeply intertwined with the efficiency, competitiveness, and inclusiveness of the banking sector. The structure of interest rate spreads and the intensity of banking competition play a pivotal role in determining credit availability, cost of borrowing, investment levels, and the extent to which growth reaches underserved segments of the economy.

This paper presents a study of economic development with perspective of banking competition and interest rate spread through a comparative examination of two dominant yet contrasting banking models in India: State Bank of India (SBI), the largest public sector bank with a strong mandate for financial inclusion and policy-driven lending, and HDFC Bank, a leading private sector bank renowned for operational efficiency, profitability, and market-responsive strategies.

A central focus is the Interest Rate Spread (IRS) — the difference between average lending and deposit rates — which serves as both a barometer of banking sector competition and a critical transmission channel influencing resource allocation and economic growth. By analysing the evolution, determinants, and consequences of IRS in these two institutions, this study aims to:

- Investigate how differing levels and trends of interest rate spreads reflect the intensity of competition between public and private sector banks.
- Evaluate the impact of ownership-driven pricing strategies on credit accessibility, financial intermediation efficiency, and inclusive growth.
- Explore the broader implications of banking competition and interest rate dynamics for sustainable and inclusive economic development in India.

Through this comparative lens of SBI and HDFC Bank, the study sheds light on how banking sector behaviour shapes the quality,

pace, and inclusiveness of economic development in a developing economy.

Interest Rate Spread as a Competitive Indicator:

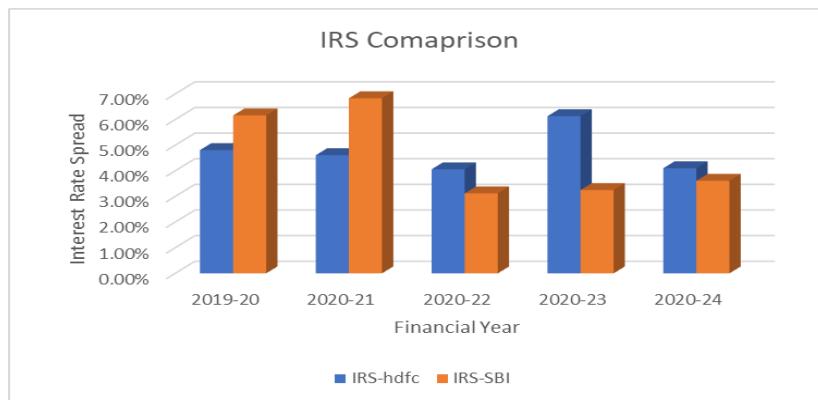
The Interest Rate Spread (IRS) serves as a critical measure of banking competition, reflecting the pricing power, profitability strategy, and risk appetite of different banks. A higher IRS suggests greater control over pricing and often indicates weaker competitive pressure, whereas a lower IRS signals intense competition, with banks sacrificing margins to attract deposits and expand lending volumes. In the Indian context, IRS reveals stark differences between public and private sector banks: public banks frequently maintain lower spreads due to social mandates and priority-sector obligations, while private banks can sustain wider spreads when shielded by superior efficiency or brand strength. Thus, IRS not only captures the intensity of market rivalry but also serves as a vital link between banking sector behaviour and broader economic development outcomes.

SBI vs. HDFC Bank - Interest Rate Spread Trends:

Year	SBI IRS	HDFC Bank IRS
2019-2020	6.16%	4.81%
2020-2021	6.83%	4.61%
2021-2022	3.12%	4.06%
2022-2023	3.25%	6.13%
2023-2024	3.61%	4.10%

Comparing the IRS trends of HDFC Bank (private) and SBI (public) provides valuable insights into their contrasting business models. HDFC Bank's IRS peaked at 6.13% in 2022-23, indicating a strong profit-driven approach, whereas SBI's IRS has

generally remained lower, dropping to 3.12% in 2021-22 before rising slightly to 3.61% in 2023-24. This difference reflects their distinct objectives—HDFC prioritizes profitability and selective lending, while SBI focuses on financial inclusion and credit expansion.



Risk management also plays a role in IRS variations. HDFC, as a private bank, maintains a higher spread by targeting lower-risk borrowers and optimizing lending rates. SBI, on the other hand, caters to a broader customer base, including riskier segments such as MSMEs, agricultural loans, and priority sector lending, often resulting in a narrower IRS. These contrasting strategies highlight how banking competition in India is shaped not just by market forces but also by policy obligations and risk-taking behaviour.

Evolution of Lending and Deposit Rates:

An average lending rate, or interest rate, is the cost of borrowing money, expressed as a percentage of the principal amount, typically charged by lenders to borrowers.

Why it matters:

- For Borrowers: Higher interest rates mean a higher cost of borrowing, and therefore, a higher total amount to be repaid.

SBI vs. HDFC Bank - ALR and ADR Trends:

Year	SBI ALR	HDFC Bank ALR	SBI ADR	HDFC Bank ADR
2019-2020	11.07%	9.24%	4.91%	4.43%
2020-2021	10.66%	8.37%	3.83%	3.76%
2021-2022	6.99%	7.20%	3.87%	3.14%
2022-2023	6.92%	10.10%	3.67%	3.97%
2023-2024	8.35%	10.40%	4.74%	6.30%

The trends in lending and deposit rates provide deeper insights into how SBI and HDFC Bank navigate competition, regulatory

- For Lenders: Interest rates are the lender's return on their investment (the money they lend).

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The average deposit rate refers to the average interest rate that banks offer on deposits, such as savings accounts, fixed deposits, and recurring deposits, over a given period. It represents the cost that banks incur to attract funds from depositors.

Significance:

- A lower average deposit rate means banks can secure funds at a cheaper cost.
- A higher average deposit rate suggests banks are paying more to attract deposits, which can impact lending rates.
- It influences the interest rate spread (difference between lending and deposit rates).

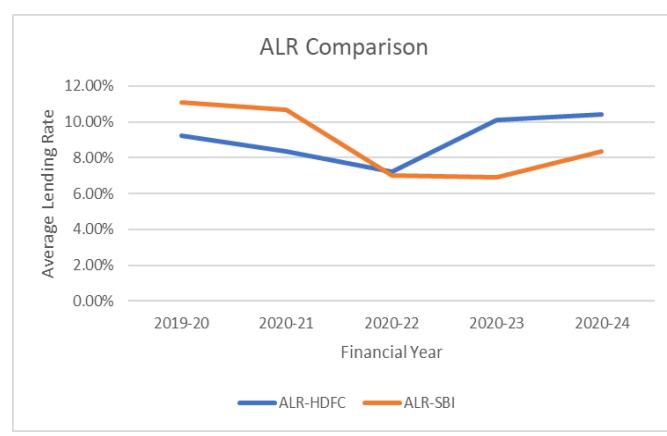
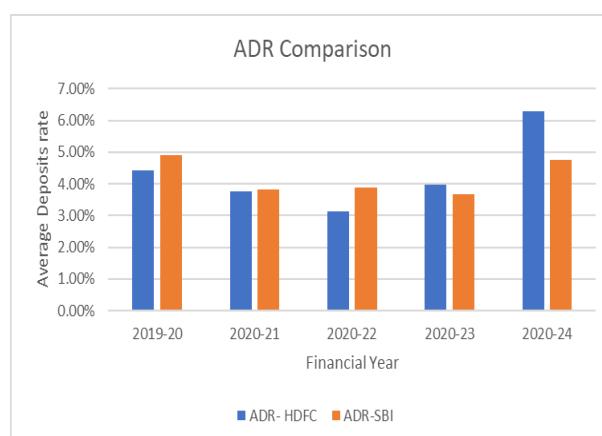
constraints, and profitability pressures. SBI's lending rates have seen a decline, with its Average Lending Rate (ALR) falling from

11.07% in 2019-20 to 6.99% in 2021-22, before slightly increasing to 8.35% in 2023-24. This reflects its approach to credit expansion, supporting economic growth even at the cost of lower margins.

In contrast, HDFC Bank has maintained relatively stable or increasing lending rates, with an ALR of 10.40% in 2023-24, ensuring a higher IRS and profitability margins. This suggests that HDFC

aligns its rates more with market demand rather than regulatory objectives.

Another crucial factor is the deposit rate strategy. SBI has gradually reduced its deposit rates, from 4.91% in 2019-20 to 3.67% in 2022-23, helping to control funding costs. Meanwhile, HDFC Bank's deposit rates have been increasing, reaching 6.30% in 2023-24, indicating that private banks face stronger competition in mobilizing deposits.



These figures reveal how public and private banks adopt different strategies, with SBI aligning more with RBI's policy goals and HDFC adjusting to market forces for profitability.

Public vs. Private Sector Profitability Models:

The profitability models of public and private sector banks vary significantly due to differences in business objectives, risk appetite, market positioning, and regulatory obligations. While public sector banks (PSBs) like State Bank of India (SBI) focus on financial inclusion, credit expansion, and economic stability, private banks like HDFC Bank prioritize profitability, efficiency, and high-margin lending. This contrast is particularly evident in their interest rate spread (IRS) strategies, which influence overall banking competition.

SBI's Volume-Driven Profitability Model:

SBI, India's largest public sector bank, operates on a volume-driven profitability model, where lower interest rate spreads (IRS) are compensated by higher loan disbursements.

- **Competitive Lending Rates & Market Reach:** SBI maintains lower lending rates to enhance credit accessibility, particularly for priority sectors such as agriculture, MSMEs, and infrastructure projects. This strategy ensures high credit offtake despite lower margins.
- **Stable Deposits & Government Support:** Unlike private banks, SBI benefits from a large base of low-cost deposits, particularly current and savings account (CASA) deposits, which reduce its overall cost of funds. Additionally, government backing and periodic capital infusion strengthen its financial stability.

- Counter-Cyclical Resilience: SBI's model is more resilient during economic downturns, as it can rely on regulatory support and stable government deposits, ensuring liquidity even in adverse market conditions.

Despite these advantages, SBI faces challenges in profitability, particularly in a rising interest rate environment, where deposit costs increase, and regulatory constraints limit aggressive pricing strategies.

HDFC Bank's Margin-Driven Profitability Model:

HDFC Bank, as a leading private sector bank, follows a margin-driven approach, focusing on high-return lending segments to maximize net interest margins (NIMs).

- Targeting High-Yield Segments: HDFC Bank emphasizes retail loans (personal, home, auto), corporate lending, and credit cards, which generate higher yields compared to traditional business loans.

Profitability Approach: SBI vs. HDFC Bank:

Factor	SBI (Public)	HDFC Bank (Private)
IRS Strategy	Lower IRS, high volume	Higher IRS, margin-driven
Loan Portfolio	Government-backed, diverse	High-yield retail and corporate loans
Profitability Approach	Focus on financial inclusion	Maximizing returns on assets
Risk Appetite	Broader, includes priority sector	Selective, lower-risk borrowers

The contrasting profitability models highlight how public banks ensure economic stability, while private banks optimize efficiency and revenue growth.

Policy and Regulation Impact on IRS:

The Reserve Bank of India (RBI) plays a crucial role in shaping banking competition through its monetary policies, repo rate adjustments, and regulatory

- **Interest Rate Spread (IRS) Trends:**
 1. 2022-23: HDFC's IRS peaked at 6.13%, driven by strong loan demand and controlled deposit costs.
 2. 2023-24: The IRS declined to 4.10%, reflecting rising deposit costs, competitive lending rates, and market adjustments.
- **Challenges of Regulatory & Market Pressures:**
 1. Monetary Policy Sensitivity: RBI's rate hikes or liquidity tightening measures can compress margins, forcing HDFC to recalibrate its lending and deposit rate strategies.
 2. Competition from PSBs & Fintechs: As PSBs improve efficiency and fintech players offer low-cost digital credit, HDFC must diversify revenue streams beyond traditional lending, focusing on fee-based services and digital banking innovations.

mandates. Public sector banks like SBI align closely with government policies, ensuring credit expansion even at lower spreads. This explains why SBI's IRS remained below 4% in 2021-22 and 2022-23, reflecting its role in economic support during uncertain times.

Private banks like HDFC, however, respond more flexibly to market conditions, adjusting rates based on demand and profitability goals. HDFC's IRS peaked at

6.13% in 2022-23, indicating its ability to maintain higher spreads despite regulatory constraints.

Key Regulatory Measures Impacting IRS:

Several monetary and regulatory policies directly influence a bank's ability to manage its interest rate spread:

1) Repo Rate Changes & Monetary Policy:

- The repo rate (the rate at which banks borrow from the RBI) significantly impacts both lending and deposit rates.
- Higher repo rates → Increased borrowing costs → Higher lending rates → Wider IRS (if deposit costs rise at a slower pace).
- Lower repo rates → Cheaper borrowing → Reduced lending rates → Lower IRS, especially for PSBs, which must align with economic stimulus policies.
- Example: The RBI's aggressive repo rate hikes in 2022 (from 4% to 6.5%) forced banks to raise lending rates, but deposit rates lagged, allowing private banks to maintain wider IRS.

2) Financial Inclusion & Priority Sector Lending (PSL) Mandates:

- Public sector banks must lend at lower rates to agriculture, MSMEs, and weaker sections, limiting their ability to charge high spreads.
- Private banks have more flexibility to focus on high-yield segments like personal and corporate loans, maintaining higher IRS.

Impact of RBI Policies on IRS Trends

Year	Repo Rate (%)	SBI IRS	HDFC Bank IRS
2019-2020	5.15%	6.16%	4.81%
2020-2021	4.00%	6.83%	4.61%
2021-2022	4.00%	3.12%	4.06%
2022-2023	6.50%	3.25%	6.13%
2023-2024	6.50%	3.61%	4.10%

- Example: SBI's focus on low-margin sectors like rural credit keeps its IRS constrained, while HDFC charges premium rates on unsecured loans, supporting higher IRS.

3) Liquidity Regulations & Capital Adequacy Norms:

- RBI mandates minimum capital adequacy ratios (CAR) under Basel III norms, affecting how banks price loans and deposits.
- Higher capital requirements force banks to retain more funds, reducing their ability to offer competitive lending rates.
- Liquidity Coverage Ratio (LCR) norms ensure banks hold sufficient liquid assets, but compliance often increases costs, reducing IRS.

4) Deposit Rate Regulations & Market Competition:

- PSBs benefit from government deposits, enabling them to keep deposit rates lower. Private banks, in contrast, compete aggressively for deposits, raising costs and narrowing spreads.
- Example: HDFC Bank had to raise deposit rates in 2023-24 due to competition, shrinking its IRS. SBI, with a stable CASA deposit base, maintained a lower cost of funds.

This data shows how SBI's IRS closely follows policy changes, while HDFC's IRS fluctuates based on market strategies.

Deposit Mobilization and Cost of Funds:

Deposit mobilization is key to a bank's funding strategy, directly impacting its Interest Rate Spread (IRS). A lower Average Deposit Rate (ADR) allows for a higher IRS, while a rising ADR increases funding costs, squeezing margins.

The Role of Average Deposit Rate (ADR) in IRS

The Average Deposit Rate (ADR)—the weighted average interest rate a bank pays on its deposit base—directly impacts IRS dynamics.

- Lower ADR → Lower cost of funds → Higher IRS, as banks can lend at competitive rates while maintaining profitability.
- Higher ADR → Rising funding costs → Margin compression, requiring banks to either increase lending rates or optimize operational efficiency.

The differentiation between public and private banks is evident in their deposit mobilization strategies and corresponding cost structures.

SBI vs. HDFC Bank: Trends in Deposit Mobilization:

SBI's Deposit Strategy: Stability Through Low-Cost Deposits:

State Bank of India (SBI), as the largest public sector bank, benefits from government-linked deposits, a vast branch network, and a strong CASA (Current Account and Savings Account) deposit base.

ADR Trends:

- 2019-20: 4.91% (higher cost of deposits, pre-pandemic normalcy).

- 2022-23: 3.67% (decline reflecting RBI's low-interest-rate regime and strong CASA mobilization).
- 2023-24: 4.74% (increase due to rising deposit competition and RBI's monetary tightening).

Key Factors Influencing SBI's ADR:

- Strong CASA Base: SBI maintains a high proportion of low-cost savings and current accounts, reducing overall funding costs.
- Government Deposits & Institutional Backing: SBI benefits from bulk government deposits, ensuring liquidity at stable rates.
- Rural & Semi-Urban Market Dominance: A significant portion of SBI's deposits come from rural and semi-urban branches, where competition is lower, keeping deposit rates relatively low.

HDFC Bank's Deposit Strategy: Competitive Pricing & Premium Customer Segments

HDFC Bank, as a leading private sector bank, relies more on market-driven deposit mobilization, where it competes aggressively for high-value deposits.

1. ADR Trends:

- 2023-24: 6.30% (highest among major banks, reflecting competitive deposit acquisition strategies).

2. Key Factors Influencing HDFC Bank's ADR:

- Intense Competition for Retail Deposits: HDFC must offer higher interest rates to attract retail and corporate deposits, particularly in an environment where RBI's rate hikes have increased competition.

- Lower CASA Ratio vs. PSBs: Unlike SBI, HDFC has a lower CASA ratio, requiring it to rely more on term deposits, which have higher interest costs.
- Premium Banking Services & Wealth Management: HDFC targets high-net-worth individuals (HNWIs) and corporate clients, who demand higher returns on deposits, raising ADR.

Impact of Rising Deposit Costs on Banking Strategies

With rising deposit costs, banks must adapt their lending and operational strategies to sustain profitability:

1. Adjusting Lending Rates:

- a) Higher deposit rates may force banks to increase lending rates to maintain IRS, potentially affecting credit demand and loan growth.
- b) Public banks (SBI): More constrained in raising lending rates due to government mandates on priority sector lending (PSL).

- c) Private banks (HDFC): More flexible in pricing loans, allowing them to adjust lending rates dynamically.

2. Optimizing Deposit Mix:

- a) Banks must balance CASA deposits with higher-yielding term deposits to optimize funding costs.
- b) SBI: Focuses on expanding low-cost CASA deposits through financial inclusion initiatives.
- c) HDFC: Diversifies funding sources, including bulk deposits and foreign borrowings, to remain competitive.

3. Operational Efficiency & Digital Banking:

- a) Cost-cutting measures & digital banking expansion are crucial to offset rising deposit costs.
- b) SBI and HDFC both invest in AI-driven financial services, branch rationalization, and digital-only banking products to improve cost efficiencies.

Comparative Analysis of Deposit Mobilization Strategies:

Factor	SBI (Public Sector Model)	HDFC Bank (Private Sector Model)
Deposit Cost (ADR)	Lower (3.67% - 4.74%)	Higher (6.30%)
Key Deposit Sources	Government deposits, retail CASA, rural banking	Retail & corporate term deposits, HNWIs
Primary Strategy	Leverage CASA deposits for cost efficiency	Offer competitive deposit rates to attract premium customers
Flexibility in Raising Lending Rates	Limited due to public mandate	More flexible, adjusts to market demand
Impact on IRS	Stable but lower IRS	Higher but volatile IRS

The Role of Banking Sector Consolidation:

Banking consolidation has reshaped competition, particularly for public sector banks (PSBs) like SBI, which must balance low IRS for credit expansion with profitability. As PSBs consolidate, they gain economies of scale, potentially lowering costs and

increasing competitive pressure on private banks.

HDFC, with a margin-driven approach, faces risks if PSBs become more efficient and offer competitive lending rates. Additionally, fintechs and foreign banks add

pressure, challenging private banks' pricing power.

The future of IRS and banking competition depends on how well banks adapt to regulatory changes, technological advancements, and evolving market conditions. Efficient capital management and competitive pricing will determine long-term profitability.

Key Takeaways:

1. IRS is a crucial measure of banking competition, reflecting the strategic priorities of public and private banks.
2. Public banks like SBI operate on volume-driven models, prioritizing financial inclusion and credit expansion, often at the cost of lower margins.
3. Private banks like HDFC Bank focus on optimizing profitability, balancing higher deposit costs with stronger lending margins.
4. Regulatory policies, repo rate changes, and market dynamics shape IRS movements, influencing banking strategies.

Conclusion:

The analysis of Interest Rate Spread (IRS) between SBI and HDFC Bank provides deep insights into the competitive dynamics of the Indian banking sector. The contrast between a public sector giant and a market-driven private bank highlights how different institutions navigate profitability, financial inclusion, and regulatory pressures.

SBI's lower IRS and declining lending rates demonstrate a strategy focused on credit expansion, financial accessibility, and economic development. By aligning with RBI policies and government mandates, SBI plays a crucial role in macro-level financial stability, even if it operates with lower profit margins.

On the other hand, HDFC Bank's higher and more volatile IRS reflects a profit-centric approach, where pricing power and risk-adjusted lending ensure strong financial returns. Its ability to adjust deposit and lending rates in response to market competition allows for greater flexibility and sustained profitability.

The Road Ahead:

As India's financial landscape evolves, banks must adapt to technological disruptions, changing consumer preferences, and heightened competition. The emergence of fintech, digital banking, and alternative lending models will further reshape IRS dynamics. Going forward, balancing profitability with financial inclusion will be the defining challenge for banks, requiring a blend of strategic pricing, risk management, and operational efficiency.

In essence, IRS trends not only reflect individual bank strategies but also serve as a mirror to the broader economic and financial policies shaping India's banking sector. The interplay between public sector obligations and private sector efficiencies will determine the future of banking competition and financial stability in India.

The future of interest rate spread (IRS) and banking competition will largely depend on how well banks adapt to:

1. Regulatory Changes: The RBI's monetary policy decisions, capital requirements, and liquidity norms will influence lending and deposit rate adjustments.
2. Technological Advancements: AI-driven credit assessment, blockchain-based settlements, and digital banking innovations may enhance efficiency and reduce costs, impacting banks' ability to price loans competitively.

3. Evolving Market Conditions: Consumer preferences are shifting toward flexible, digital financial products. Banks must align their deposit and lending strategies to remain relevant.
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