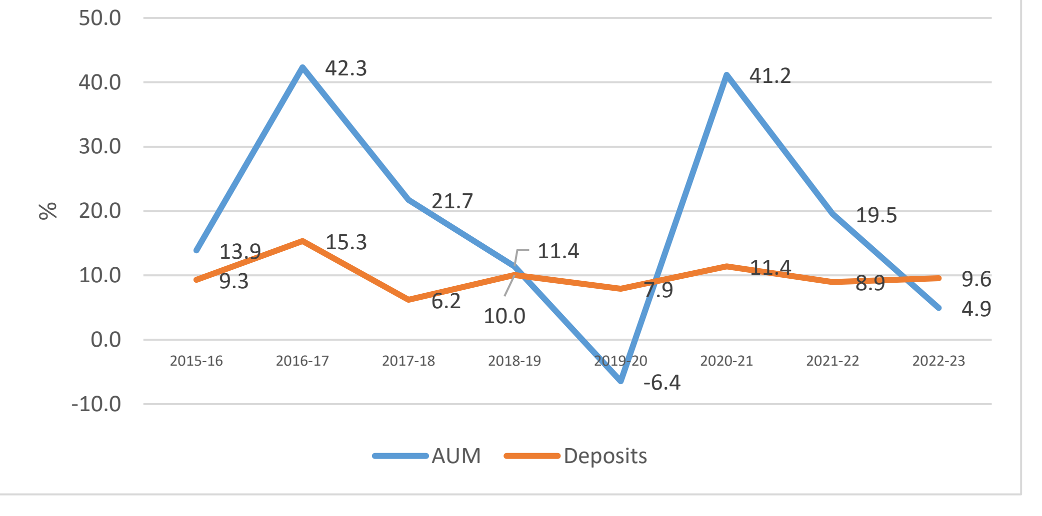
27th April 2023

Banks regain space in 2022-23

It is often argued that bank deposits face competition from mutual funds especially at the retail end. This was one of the reasons that it was felt that the then existing tax benefits accorded to debt mutual funds, which are considered to be close substitutes, made bank deposits less attractive. In the last few years it was observed that mutual funds had gained in strength against bank deposits, though arguably the risk factor in mutual funds is higher. This could also mean that households have become less risk-averse especially at a time when the repo rate was held at a low of 4% by the RBI. However, in FY23 it was observed that funds flowed back to the banking sector and mutual funds witnessed slower growth.

Chart 1 shows that growth in AUM of mutual funds tended to exceed that of deposits in all years except 2019-20 before 2022-23. The base effect did help to push up the growth rate for AUM of mutual funds. This was also associated with a certain degree of robustness in stock markets (for equity based investment) and higher effective returns on debt schemes.

Chart 1: Growth in AUM of mutual funds and Bank deposits



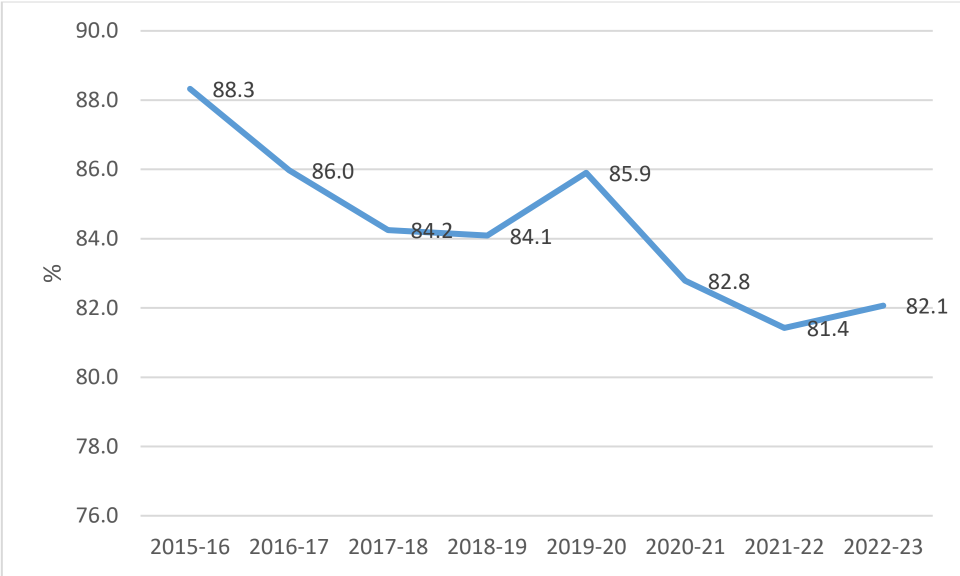
Source: BoB Research

In absolute terms AUM of mutual funds increased from Rs 10.8 lakh crore in FY15 to Rs 39.42 lakh crore in FY23, which is a CAGR of 17.51% or 3.64 times. Outstanding deposits with the banking system increased during this period by CAGR of 9.8% from Rs 85.33 lakh crore to Rs 180.4 lakh crore which is 2.1 times.

The consequence of faster growth in the AUM of mutual funds relative to deposits also meant that the share of mutual funds in the sum of mutual funds and deposits increased and that of deposits came down. Deposits share came down from 88.3% to 84.1% in FY19 and then rose appreciably in FY20 to 85.9% before declining in the next two years to 81.4%.

There has however been a turnaround in FY23 which can be attributed to both the relatively somber performance of the market as well as rising interest rate scene. The share of banks rose to 82.1%.

Chart 2: Share of banks in Bank deposits plus AUM of mutual funds



Source: BoB Research

The lower growth in AUM in FY23 of 4.9% compared with 9.6% in deposits can be seen mainly in the income oriented schemes (Table 1). As banks kept increasing their deposit rates there was a tendency for households to prefer the safe haven of deposits. However, growth in AUM under equity schemes was higher indicating also the increase in risk taking culture. Interestingly the growth in AUM under hybrid schemes was flat. This does indicate that those inclined towards markets preferred to go for pure equity rather than take a more nuanced hedge bet on hybrid schemes which have a debt component.

Table 1: Growth in various categories of mutual funds in 2022-23

Scheme Category	Mar-22	Mar-23	Change
Open ended			
Income oriented schemes	12,98,961	11,81,982	-9.0
Growth/Equity Oriented Schemes	13,65,456	15,17,083	11.1
Hybrid Schemes	4,79,918	4,78,917	-0.2
Solution oriented	29,537	32,334	9.5
Other Schemes	5,21,928	6,97,522	33.6
Closed-ended			
Income/Debt Oriented Schemes	52,063	26,994	-48.2
Growth/Equity Oriented Schemes	8,273	6,200	-25.1
Interval Schemes	547	999	82.8
Grand Total	**37,56,683**	**39,42,031**	**4.9**
Fund of Funds Scheme (Domestic)	48,362	66,590	37.7

Source: SEBI

Concluding remarks

The outlook for 2023-24 will be tilted in favour of bank deposits. This is notwithstanding the fact that the present interest rate cycle of rising repo rate may have ended as the RBI is expected to take a long pause before evaluating options. Bank deposit rates may not go up in a concerted manner and would be based more on the asset-liability management requirements. However, with the tax benefit on debt mutual funds being withdrawn, the returns on debt schemes would be less attractive than before. Interest in the equity segment would however be driven a lot by how the stock market performs. This would remain buoyant provided business is able to register better financial performance.

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
dipanwita.mazumdar@bankofbaroda.com