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Bank Deposits or Mutual Funds?

It has been a matter of debate whether Bank deposits are still the preferred choice of instrument of financial savings. With a changing financial landscape, volatility in the interest rate regime and risk taking appetite increasing, there has tended to be a change in the pattern of deployment of financial savings. RBI's recent report on financial assets of households show that there has been a shift in pattern, where mutual funds and equity witnessed sharp increase in FY22 with shares of 6.3% and 1.9% in overall financial assets respectively (ratio was 2.6% and 1.1% in FY20), while share of bank deposits declined to 25.5% in FY22 from 34.4% in FY20.

However it must be pointed out that the quantum of bank deposits is much larger, about 4.1 times than that of mutual funds denoted by AUM (assets under management). In this context, we examine whether there has been any substitution between bank deposits, mutual funds- debt and equity in the past 6 years.

Key conclusions:

- Since FY16 (till Sep-22), total bank deposits have shown an accretion of Rs 77 lakh crore. Within that, term deposits have increased by Rs 66 lakh crore. A secure interest rate regime and risk averse sentiment have worked in favour of garnering bank deposits at a faster pace.

- On the other hand, net AUM of Mutual funds rose by Rs 26.1 lakh crore, in the same period, which is just about 1/3rd of the pace of accretion in bank deposits. Most of the mobilization was in equity funds, which increased by Rs 10.8 lakh crore. Debt funds rose at a much slower pace of Rs 4.8 lakh crore. The balance was from 'others' component which comprises hybrid schemes among others.

- The 'substitution analysis' shows that the larger part of substitution that has taken place between bank deposits and Mutual Funds has been mainly with equity funds.

Table 1. How Bank deposits and MFs have moved?

Growth rates (YoY)	O/S Bank Deposits	w/w Term Deposits	AUM-MF (Debt)	AUM-MF (Equity)	Others	Total AUM	Sensex	WAD TDR
Mar-17	15.3%	12.3%	37.3%	40.7%	114.8%	42.3%	16.9%	6.97%
Mar-18	6.2%	6.1%	5.6%	37.9%	84.2%	21.7%	11.3%	6.67%
Mar-19	10.0%	10.0%	2.7%	19.0%	28.0%	11.4%	17.3%	6.89%
Mar-20	7.9%	8.0%	1.2%	-32.4%	37.8%	-6.4%	-23.8%	6.38%
Mar-21	11.4%	10.9%	23.1%	66.0%	55.5%	41.2%	68.0%	5.28%
Mar-22	8.9%	8.6%	-7.0%	37.2%	49.7%	19.5%	18.3%	5.03%
FYTD23	2.5%	2.9%	-14.1%	13.8%	21.7%	4.6%	0.6%	5.29%*

Source: SEBI, Bank of Baroda Research, Note: FYTD: Apr-Sep, *: As on Aug-22 WADTDR: weighted average domestic term deposit rates

- The above table shows that, bank deposits have grown at double digit rate in 3 out of 6 years. In these years (except Mar-21), interest rates on term deposits (Weighted Average Domestic Term Deposit Rate-WADTR) remained favourable in the range of 6.89-6.97%.
- Equity Mutual Funds have also shown steady growth and the movements corroborate with those in Sensex. For example in FY20 when Sensex fell sharply by 23.8%, AUM-MF (Equity) also declined by 32.4%. In FY21, as Sensex rose by 68%, AUM-MF (Equity) also picked up by 66%. In FY23 however, while the Sensex has moved up marginally equity funds have witnessed high growth of 13.8% as risk appetite has increased in a regime of low interest rates. Interestingly, the WADTDR has increased during this period though low at 5.29%.
- In case of debt Mutual Funds, growth was in double digits for only 2 years where even bank deposits grew at a similar rate. In FY21 as consumption was restricted, savings increased in all the three avenues i.e. deposits, debt funds and equity funds.

A striking revelation in the table is that growth in AUM has been higher than that of deposits in all the year barring FY20 which was affected by the month-end panic caused by the announcement of the lockdown. This was due to both a lower base as well as increasing interest of households in mutual funds.

It can also be seen that interest rate movements can also be related to the preferences of savers. In FY17 for instance the WADTDR had come down from 7.73% to 6.97%. Growth in deposits, though in double digits slowed down while there was acceleration in growth in debt funds as well as overall AUM. In FY18 as WADTDR came down further there was shift to equity funds. Bank deposits regained space when WADTDR increased in FY19. Lower WADTDR in FY20 reversed this gain while in FY21 overall savings in all avenues increased even while interest rates came down. In FY22 and FY23 (YTD) while growth rates have slowed down across all avenues, equity funds as well as overall AUM of mutual funds have performed better even while the stock market gave lower growth in returns.

To get a better idea on substitution of bank deposits with mutual funds, the relative shares in total is examined in the following section.

Explaining the substitution

The table below shows how different instruments have fared. In absolute terms, bank deposits clearly dominate with share of around 80%. However, if we look closely, *over the years, AUM-MF (Equity) has gained in importance*. We have used two ratios to see the degree of substitution.

1) Term Deposit/(Term deposit + debt AUM),

2) Term Deposit/(Term Deposit + AUM).

The first ratio has increased to 92.3 in Sep’22 from 89.8 in FY17. This shows that term deposits remained the preferred choice of instrument compared to debt Mutual funds. The conclusion is significant because debt mutual funds do carry tax benefits that are not available on bank deposits. Besides often the returns are higher than interest paid on deposits. Yet due to the flexibility provided on bank deposits, they score over debt mutual funds.

The second ratio which incorporates the entire AUM as denominator, shows that mutual funds as a whole have gained share when equity and other schemes are also included. Savers are becoming less risk averse and channeling funds to the stock market based instruments. This has been supported by the capital markets giving steady returns as denoted by Sensex movements. The ratio of term deposits to sum of deposits and AUM of mutual funds moved from a high ratio of 87.3 in FY16 to 79.3 in FY22.

Table 2. Degree of substitution between Bank Deposits and MFs

(Rs lakh crore)	O/S Bank Deposits	Term Deposits	AUM-MF (Debt)	AUM-MF (Equity)	Others	Total AUM	Term Deposit/(Term deposit+debt AUM), %	Term Deposit/(Term Deposit+AUM), %
Mar-16	93.3	84.4	7.8	3.9	0.6	12.3	91.5	87.3
Mar-17	107.6	94.8	10.7	5.4	1.4	17.5	89.8	84.4
Mar-18	114.3	100.6	11.3	7.5	3	21.4	89.9	82.5
Mar-19	125.7	110.6	11.7	8.9	3	23.8	90.5	82.3
Mar-20	135.7	119.5	11.8	6.0	4	22.3	91.0	84.3
Mar-21	151.1	132.5	14.5	10.0	7	31.4	90.1	80.8
Mar-22	164.7	143.9	13.5	13.7	10	37.6	91.4	79.3
Apr-22	166.2	146.3	13.9	13.7	10	38.0	91.3	79.4
May-22	165.7	145.9	13.4	13.4	10	37.2	91.6	79.7
Jun-22	165.7	146.2	12.5	12.9	10	35.6	92.1	80.4
Jul-22	169.7	149.3	12.6	14.2	11	37.7	92.2	79.8
Aug-22	169.9	149.7	13.2	14.8	11	39.3	91.9	79.2
Sep-22	170.3	150.5	12.6	14.7	11	38.4	92.3	79.7

Source: SEBI, Bank of Baroda Research

To conclude it can be said that bank deposits would face competition from mutual funds as households get more market savvy and are willing to take their chances in the capital market. Mutual funds provide a safer way by pooling resources and investing the same based on professional judgment. Within various mutual funds schemes, debt funds have still not caught on relative to equity and hybrid ones. A rather under developed secondary market and a more complex market to understand could be the reasons behind this phenomenon.

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