How serious a threat are mutual funds to bank deposits?

Mutual funds have an inherent advantage when it comes to investing as they offer a variety of products depending on the preferences of the investors. Hence there are equity schemes besides conventional debt options. For those who are less conservative, there are hybrid schemes; while index funds and ETFs provide more aggressive avenues for putting funds for investment. However, all of these investments carry a certain degree of risk as they are market oriented, and to that extent are less predictable.

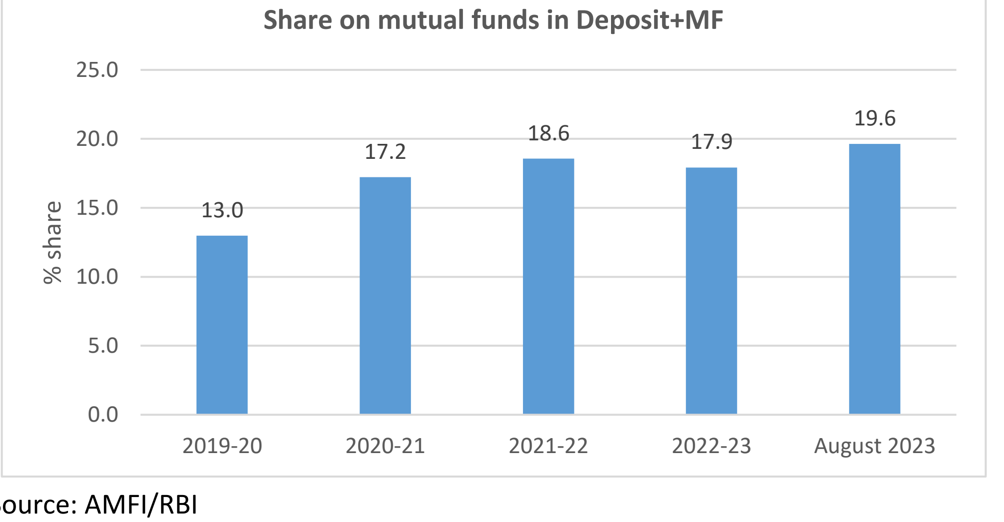
Bank deposits have the advantage of being safe and offer conservative but assured returns. In the period of the pandemic when interest rates were lowered significantly by the RBI which caused deposits rates to come down, investors – both retail and corporates, put more funds in the mutual funds schemes. This has led to a remarkable increase in the AUM (assets under management) of mutual funds. While banks still dominate the financial landscape, the growing share of mutual funds cannot be ignored.

For August 2023, y-o-y growth for bank deposits was 12.3% (excluding HDFC merger) while that for mutual funds was 18.6%.

How has the share of mutual funds in sum of AUM of mutual funds and deposits with banks moved?

Taking 2019-20 as the base year after which there was a sea change in the financial landscape with rates being kept at an all-time low, there was a sharp increase in growth in AUM of mutual funds in the next three years. There was a CAGR of 24.8% from Rs 20.26 lakh crore to Rs 39.42 lakh crore in this period. In case of bank deposits growth was just 10% from Rs 135.67 crore in FY20 to Rs 180.44 lakh crore in FY23

The share of mutual funds in combined outstanding amount increased smartly as seen in the chart below.

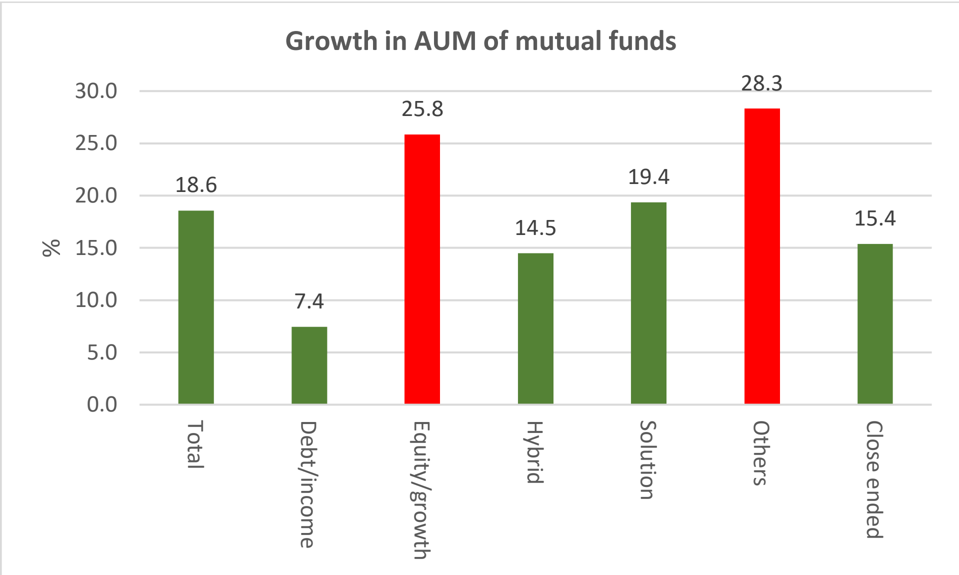


Source: AMFI/RBI

The share of mutual funds is now close to 20% against 13% before the pandemic set in. Clearly there has been a shift in the investor preference to mutual funds and the returns can be considered to be the foremost consideration. The Sensex had moved from almost 30,000 in March 2020 to 58,992 in March 2023 with a CAGR of almost 26% per annum. As of August the Sensex was at 64,831. Debt instruments especially in corporate bonds give higher return than bank deposits and also carried advantage on taxation on long term capital-gains.

What is the picture in FY24 so far?

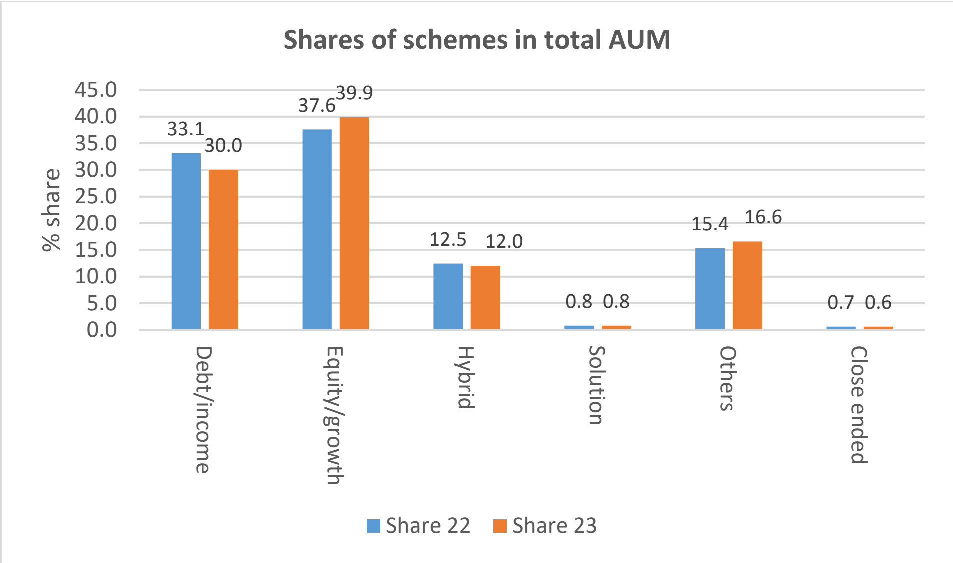
The chart below gives the growth in various categories of investments in mutual funds for August 2023 over August 2022. During this period the growth in bank deposits was 12.3%.



Source: AMFI/RBI

Interestingly the highest growth rates in mutual fund schemes was in equity and 'others' category. This is indicative of higher risk taking appetite of investors who have preferred to invest in growth oriented schemes as well as indices and ETFs in anticipation of higher returns especially at a time when inflation has been high. Cumulative inflation has been 18.3% in the three years ending 2022-23. Growth in AUM under debt was the lowest at 7.4% this year so far.

There has also been hence a shift within mutual funds across different schemes which comes out in the chart below. Debt or income schemes have lost a bit of momentum which may be attributed partly to the fact that banks have also started increasing deposit rates thus lowering the difference in yields. Another factor militating against these schemes has been the government's decision to remove the long term indexation benefit for debt schemes which hence removes the tax advantage which was hitherto there.



Source: AMFI

The decline in share of debt and income schemes in AUM was shared by equity schemes and the 'others' category.

Concluding remarks

With time there has definitely been a change in the composition of funds channelled to deposits and mutual funds. The pandemic can be considered to be a turning point where under the force of circumstances, investors took more risk via the mutual funds route. And with the markets being supportive as the economy has only been showing signs of recovery along with the India Growth story spreading, the returns have been impressive. In this environment preference for market oriented savings avenues has increased.

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