

Indian Households: What do their Savings tell us about their Risk Appetite?

Indians save more of their disposable income (28.8%) than their US counterparts (-0.4%), but they invest it much more conservatively.....

- A look at where Indians have chosen to channel their savings indicates that Indian households are, by nature, risk averse. Most of their money lies in bank deposits (55%), as opposed to US residents, who put only 15% of their savings in banks. Even when Indians do dip their feet in the stock market, they are not yet comfortable investing directly, preferring the mutual fund route.
- As the table below shows, US households had about 16% of their financial assets invested directly in corporate securities and another 11% via mutual funds plus a huge part of the 27% they allocate to pension funds. So US households financial assets are about 40-50% in debt and equity securities, compared to about 6% for Indian households.

Table 1: Comparison of Distribution of Financial Assets between US and India

	Deposits	Corporate Securities	Mutual Funds	Life Insurance	Pension Funds
United States (2005)	15.3%	15.8%	10.9%	2.9%	27.7%
India (2006-07)	55.7%	1.4%	4.8%	15.0%	9.2%

Source: US Census, RBI

.....But Indian risk appetite is poised for an increase.....

- *In coming years, as deposit rates drop and Indians become more market savvy with higher risk appetite, greater share of financial assets would be contributed to 'shares and debentures' and we expect to see a decline in share in 'bank deposits'.*

Table 2: Forecasted Distribution of Financial Assets in India (% of Total)

	2006-07	2007-08F	2008-09F	2009-10F
Financial Assets (Rs Crore) of which	758,751	940,665	1,158,900	1,474,963
Deposits	55.7%	52.0%	48.0%	46.0%
Share and Debentures (includes mutual funds)	6.3%	7.5%	9.0%	10.5%
Mutual Funds (Other than UTI)	4.8%	5.4%	6.0%	7.0%
Insurance Funds	15.0%	16.0%	17.0%	19.0%
Provident and Pension Funds	9.2%	9.0%	9.3%	9.5%

Bank deposits and mutual funds are preferred over other financial instruments

- The share of bank deposits has increased from 37.2% in 2004-05 to 55.7% in 2006-07 as seen in chart 1 below.
- The 'shares and debentures' account for 6.3% of financial savings in 2006-07. The share of mutual funds has increased from 0.4% in 2004-05 to 4.8% in 2006-07.
- Insurance schemes are increasing their share in long-term savings over provident and pension funds.

Chart 1: Trend in Distribution of Financial Savings

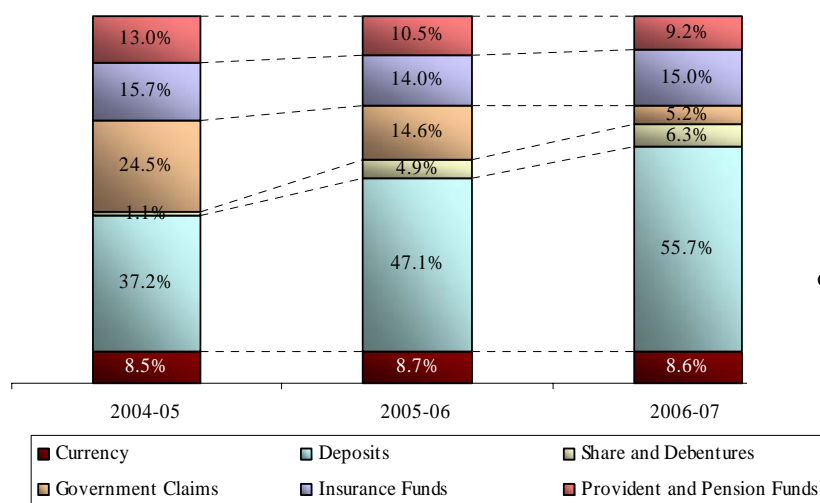
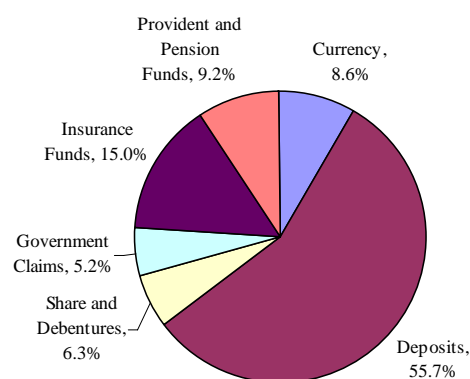


Chart 2: Distribution of financial savings, 2006-07



Source: RBI

High deposit rate and bullish stock market made bank deposits and mutual funds more attractive for risk-averse Indian households.

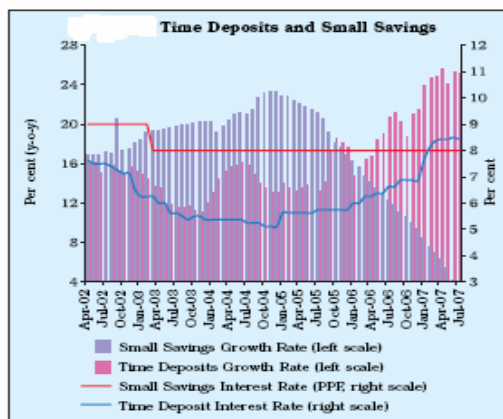
- High interest rates in bank deposits are attracting more savings compared to other instruments. As seen in the table below the 1-year deposit rate for banks was high around 9% in March 2007.

Table 1: One-year Deposit Rate of Banks (%)

Domestic Deposit Rate	March 2004	March 2005	March 2006	March 2007	June 2007	July 2007
Up to 1 year	3.75-5.25	2.75-6.00	2.25-6.50	2.75-8.75	2.75-8.75	2.75-8.50
Public Sector Bank	3.75-5.25	2.75-6.00	2.25-6.50	2.75-8.75	2.75-8.75	2.75-8.50
Private Sector Banks	5.00-6.50	3.00-6.25	3.50-7.25	3.00-9.00	3.00-9.50	1.00-9.25
Foreign Banks	2.75-7.75	3.00-6.25	3.00-6.15	3.00-9.50	0.25-9.00	0.25-8.50

Source: RBI

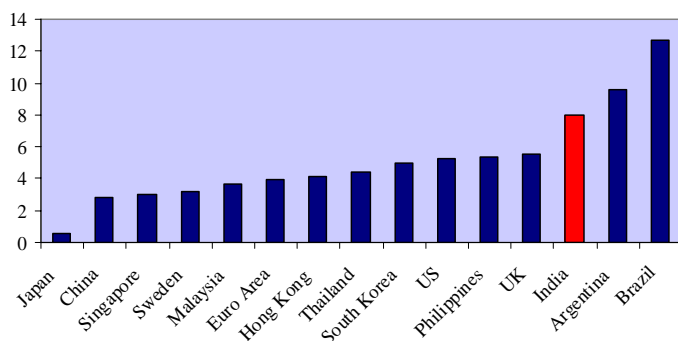
Chart 3: Growth rate of time deposit accelerates as that of small savings declines



Source: RBI

- Growth in scheduled commercial banks' time deposits accelerated to 24.9% at end-March 2007 from 16.4% a year earlier due to stronger economic activity, higher interest rates and extension of tax benefits under Section 80C for deposits (announced in Feb, 2006 and notification issued on July 28, 2006) with maturity of five years and above.
- In contrast, postal deposits witnessed a deceleration to 11.2% in March 2007 from 17.2% a year ago, partly attributable to rising interest rate differential in favour of bank deposits against the backdrop of 2006 unchanged interest rates on postal deposits.

Chart 4: Comparison of Short Term Interest Rate, March 2007 (%)



- Short term interest rate of India is quite high compared to other economies as seen in chart 3.
- Data for India refer to 91-day Treasury Bills rate and for others 3-month money market rates.

- Last two years, both the stock markets and index funds were giving high returns of above 30%. This along with opportunities to directly invest in stock market by retail investors increased investment in shares and debentures.

Table 2: High Annual Return of Stock Market

	Annual Return (Jan-Dec)			
	2004	2005	2006	2007*
BSE SENSEX	15.9%	43.3%	39.0%	10.4%
NIFTY	15.0%	37.9%	32.2%	10.9%

*Till July, 2007

Table 3: The 1,2,3 and 5-year return of index funds (%)

	1-Year	2-Year	3-Year	5-Year
S&P CNX Nifty	49.04	39.99	40.59	30.89
BSE Sensex	48.38	43.20	43.28	33.72
BSE 100	50.67	40.51	41.80	33.95
BSE 200	51.00	38.19	40.53	33.80
S&P CNX 500	51.65	36.38	40.97	34.55

India's household savings are quite high compared to other economies

- In 2005, India and Korea had an almost identical national-savings-to-GDP ratio of about 33%. However, in Korea, households accounted for just a fifth of the overall rate, compared with 69% in India.
- Household thrift in India is even more than in China, where the bulk of the country's 50% savings rate comes from companies and the government.
- According to McKinsey report, India's household savings is expected to plateau and then gradually decline in coming years. However, this is not a consensus view. Economist of Deutsche Bank believes that as the demographic bulge raises the share of working-age adults in the population and the overall propensity to save rises sharply.

Table 3: Comparison with Thailand and Taiwan

Year	Thailand		Taiwan		India	
	Household Savings/ Disposable Income	Household Savings /GDP	Household Savings/ Disposable Income	Household Savings /GDP	Household Savings/ Disposable Income	Household Savings /GDP
2003	7.3	4.8	24.4	17.3	28.7	23.8
2004	7.6	5.0	22.3	15.5	27.5	21.6
2005	NA	NA	21.6	14.8	28.8	22.3

Table 4: Comparison with some OECD countries

	2005	2006	2007	2008
Household net saving rates as a percentage of household disposable income				
Australia	-2.9	-1.7	-0.8	-1.2
Canada	1.2	1.5	1.1	1.3
France	11.8	11.5	11.5	11.2
Germany	10.6	10.5	10.3	10.1
Italy	10.6	10.2	9.5	10
Japan	2.9	2.9	2.9	2.9
Korea	4.3	3.5	3.2	3.3
United States	-0.4	-0.2	0.9	1.7

Source: OECD