Weathering COVID-19

Impact on Banking in India – Part 1

Private and confidential

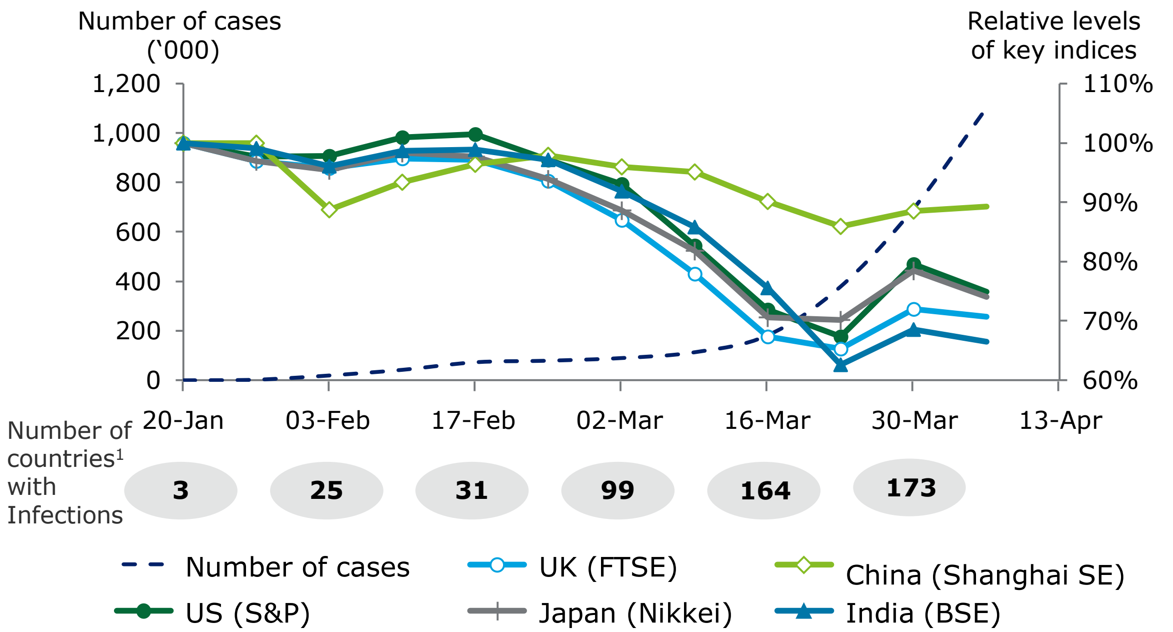
April 2020

Contents

COVID-19 has emerged as the black swan event of the century, with significant macroeconomic impact both globally and in India

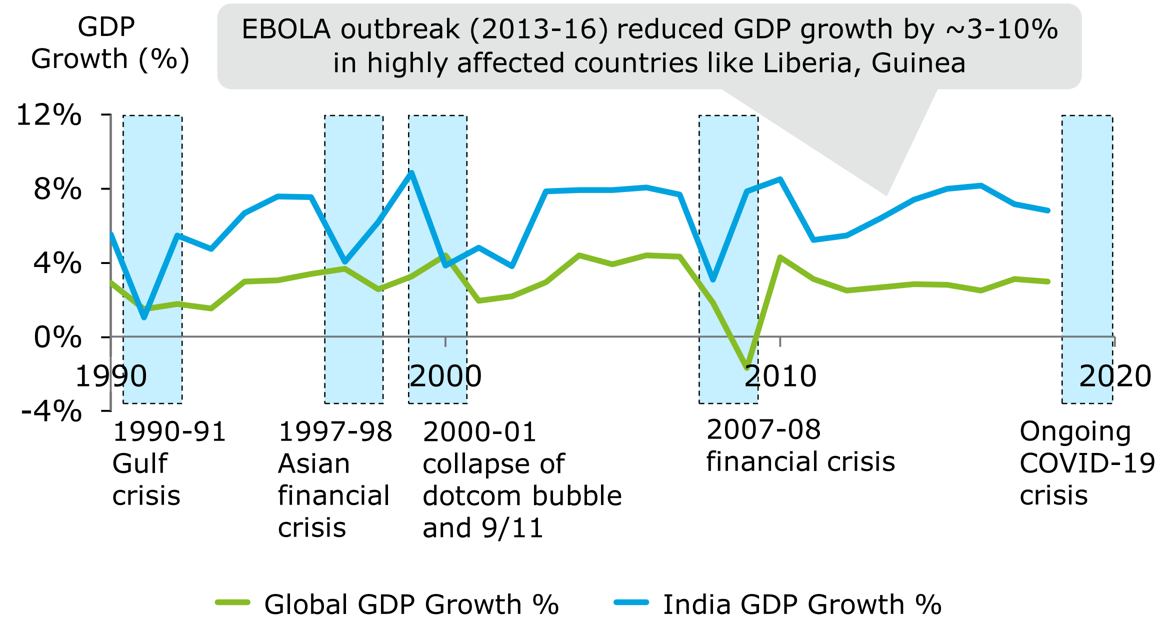
Exponential spread of COVID-19 has led to a significant fall in major indices…

Impact of COVID-19: Number of cases and movement of global indices[2,3,4]



…indicating its macroeconomic impact and potential to significantly affect GDP growth rates

Historical global and Indian GDP growth rates[5]



Given the rapidly evolving COVID-19 situation, whether the economy recovers sharply (as in the case of past disruptions) or slips into a prolonged recession, is yet to be seen.

Note: [1]Countries as classified by WHO, [2]Value as of end of the day
Source: [3]WHO data, [4]Exchange data, [5]World Bank data, News articles

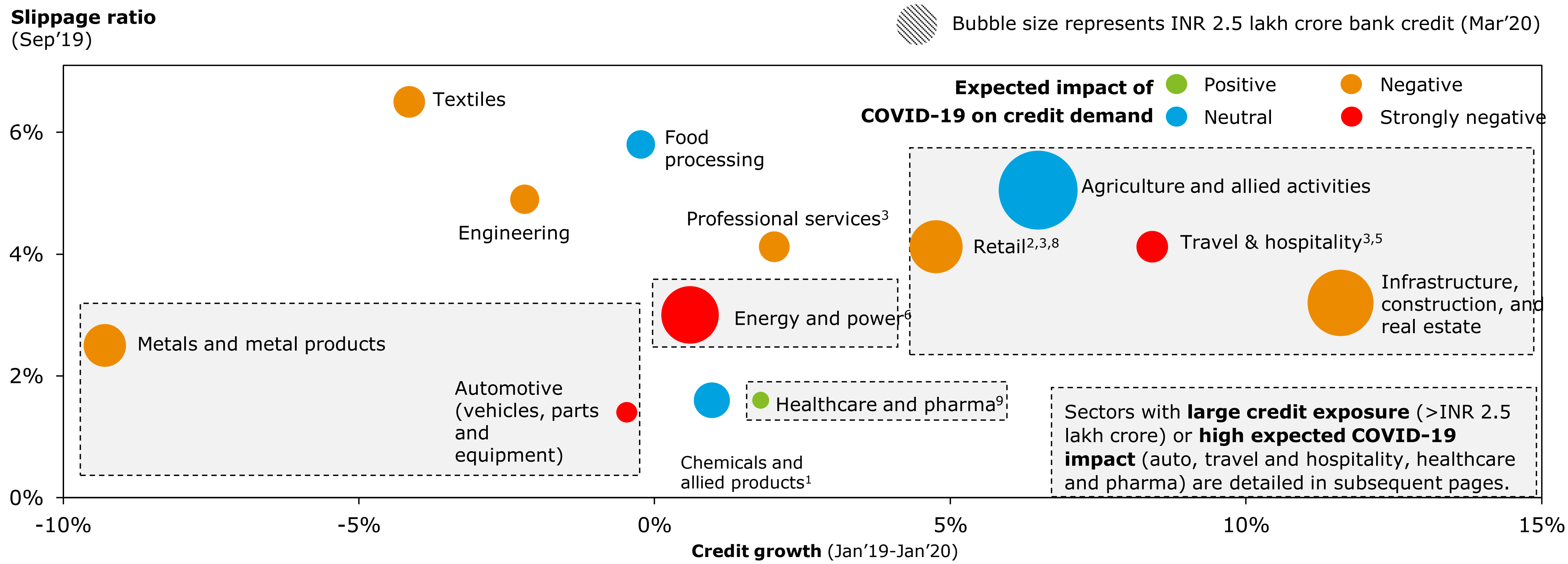
Duration and scale of the COVID-19 pandemic will determine economic impact, and could lead to one of three widely varying scenarios

	Short-term Disruption	Medium-term Disruption	Long-term Disruption
Description	**Globally** the outbreak to be is contained by **May** In India, current **lockdown** sees **strong success,** and the outbreak is to be controlled by June	Current **lockdown** has **partial success**, limited control on outbreak, and **restrictions untill September**	Current **lockdown** is **unsuccessful** leading to **restrictions in India** lasting through **FY21**
India: Macro economic impact	• **Slowdown in urban India** followed by a **sharp 'V' shaped recovery** in Q2 and Q3'21 • **Short-term demand-supply impact** normalcy in most sectors starting Q2'21 • **Job losses** restricted to **informally employed**	• **Slowdown in urban India**, followed by a **slow 'U' shaped recovery** by Q4'21 • Extended period of **low demand and production** before recovering recovery in Q3'21 • **Moderate** levels of **unemployment** through FY21	• **Prolonged recession** with slowdown in **urban and rural areas,** leading to a new normal • Steep **decline in production capacity** with permanent impact • **Large-scale unemployment**
India: Financial sector impact	• **Temporary disruption** to **disbursals** and **collections** in highly impacted affected sectors • **Curtailed operations**	• **Shift to digital channels,** akin to **demonetisation** effect • **Increased stress - lack of economic activity**	• Steep **fall in rates** due to **influx of deposits** and **drop in credit demand** • **Stress** in banking due to a strong **industry downturn** and **business closures**
Indian GDP Growth (FY21)	• **3-5%**	• **2-4%**	• **<1%**
Implications	**Tactical mitigations**	**Sustained interventions**	**Structural shifts in policy and industry**

Source: Moody's, News articles, Monitor Deloitte analysis

While the overall impact of COVID-19 on credit growth is expected to be negative across most sectors …

Bank credit and risk (slippage) for key sectors, 2019-20[7,10]



Note: [1]Chemicals and Allied Products includes Petroleum and other fuels, [2]Trade includes both retail & wholesale trade, [3]Slippage ratio for services sector considered as sub-sector level data unavailable, [4]Slippage ratio for personal loans sector considered as sub-sector level data unavailable, [5]Includes travel and tourism only, [6]Includes power infrastructure, [7]Only commercial sectors with credit exposure >1,00,000 Cr. considered with exceptions of Pharmaceuticals and Vehicles, Parts & Equipment, [8]Includes wholesale, [9]Includes drugs & pharmaceuticals
Source: [10]RBI data, Monitor Deloitte Analysis

… the degree and nature of the impact on key sectors is likely to vary based on the scenario that unfolds (1/2)

SECTOR	Short-term Disruption	Medium-term Disruption	Long-term Disruption
Agriculture and allied activities	▬ **Relatively unscathed** due to essential nature	↓ **Losses** in **current season** due to **supply chain disruptions**	↓↓ **Decline** in **area under cultivation** ▬ Shift to **less intensive** and cash crops ↑↑ Focus on **scientific storage**
Automotive	↓ **Estimated INR 15k cr revenue loss** in March’20, with further losses in April’20 ↓ **Heavy discounting** to liquidate stock after lockdown	↓↓ Overall **revenue loss** of >**~INR 1.5 trillion**[1] ↓↓ **Recovery** of volumes only by **FY22** ↑ **Fall in production** due to shutdowns and import restrictions, and labour unavailability	↓↓↓ **Recovery** of volumes only by **FY23** ↑ Growth in **penetration in the long-term** due to **aversion** to **public transport** ↓↓ **Closure** of small and medium **dealers**
Energy and power	↓ **~20% reduction in power demand** due to office and factory shutdown ↓ **Falling oil prices** due to oversupply (~USD 35-40/BBL) ↓ **20-25% reduction** in refinery **utilisation**	↓↓ **Extended** periods of **volatile oil prices** (~USD 20-25/BBL) ↓↓ **35-40% reduction** in refinery **utilisation** ↓↓ **Reduction/ postponement in capacity additions** due to financial viability concerns and global supply chain disruptions	↓↓↓ **Extended** periods of **low oil prices** (sub ~USD 20/BBL) ↓↓↓ **50-55% reduction** in refinery **utilisation,** leading to scaling-down of operations ↓↓↓ **Decline in the renewable energy** sector due to lack of competitive prices
Healthcare and pharma	↑ Growth in **COVID19 related care** and **testing,** including medical device ↓ **Decline** in **other non-emergency** therapeutic areas and **pharma exports** ↓ **Sub-scale manufacturing operations**	↑ **Growth** for **hospitals** and **clinics** ↓↓ **Further slowdown** in **pharma manufacturing** due to import disruptions ↓ **Decline in pharma exports** due to the ongoing export ban and resumption of operations by Chinese players	↑↑ Growth in **domestic manufacturing of drugs and devices** to decrease reliance on imports ↑↑ Increased **government healthcare spend**

Note: [1]Assuming negligible sales in Q1’21 due to lockdowns
Source: Industry publications, Bloomberg, News articles, Monitor Deloitte analysis

Impact: ↑ Positive ▬ Neutral ↓ Negative

… the degree and nature of the impact on key sectors is likely to vary based on the scenario that unfolds (2/2)

SECTOR	Short-term Disruption	Medium-term Disruption	Long-term Disruption
Infrastructure, construction and real estate	↓ **8-10% revenue erosion** for real estate companies ↓ **Temporary halt** in **construction activities**	↓↓ Over **40% reduction** in **new unit sales** in seven major metros[1] ↓↓ **Fall** in **prices** due to reduced demand	↓↓ **Reduction** in **overall infrastructure required** due to lower activity ↓↓ Significant **slowdown in affordable housing** due to reduced affordability
Metals and metal products	↓ **Scaling down** while maintaining **bare minimum activity** as it requires 'continuity of process'	↓↓ **Demand reduction** due to **disruptions** in end-use industries: **construction and auto** ↓↓ Complete **shutdown** at many plants	↓↓↓ **Capacity shrinkage** due to **mounting losses** and **disruptions in import supply chain disruptions**
Retail	↓↓ Possibility of **60-80% fall** in Q1'21 sales ↑ **Increase** in **online** channels ↓ **Decline** in **physical** channels ↑ **Growth in essentials** due to **panic buying**	↓↓ **Decline** in sales of **non-essential** products ↓↓ Significant **shortages** due to **supply chain and labour disruptions** ↓↓ Significant **decline** in **fashion** and **accessories** market	↑ **Re-emergence** of **small store** formats ↓↓ **Collapse** of **large** formats, leading to **stress in CPG companies** extending credit ↓↓ **Structural changes** in consumption levels and patterns
Travel and hospitality	↓ At least **~30% reduction** in **revenues** for the year ↓ Widespread **cancellations/amendments** ↓ **Temporary reduction** of operations	↓↓ Large-scale **layoffs** and **pay cuts** ↑ Additional **funding of** over **~INR 4k cr** required	↓↓ **Scaling down** of ops (fewer flights, etc.) ↓↓↓ **High bankruptcy rate** especially among **SMEs** and **airlines** ↑↑ Additional **funding of** over **~INR 15k cr** required

Impact on core sectors is likely to also affect banking across the spectrum of banking services

Note: [1]Includes Delhi NCR, Mumbai, Bengaluru, Chennai, Hyderabad, Kolkata, and Pune
Source: Industry publications, Bloomberg, News articles, Monitor Deloitte analysis

Impact: ↑ Positive — Neutral ↓ Negative

For banking, a short-term disruption is likely to lead to accessibility concerns, in addition to scaling-down of SME/corporate customers, and increased defaults by retail customers

Short-term disruption

Inability to **access data** / infrastructure, leading to reduced serviceability

Temporary **correction in valuation** of FIs, with an expected reduction in returns

Difficulty in **accessing branches** for routine operations

Default in loan payments

Scaling down of non-essential operations

Significant **reduction** in domestic and cross-border **trade**

A more prolonged crisis is likely to increase customer preference towards digital channels and products such as insurance, in addition to defaults by SMEs/corporates

Medium-term disruption

Increasing **preference for distributed workforce**/ shared services

Accumulation of **surplus capital** due to limited deployment opportunities

Rising need and **preference** for **digital transactions**

Growing **preference** for health and life **insurance policies**

Increased **loan defaults** due to reduced revenue and margins

A full-blown pandemic is likely to lead to a significant reduction in demand from SMEs/ corporates, structural shifts in customer behaviour, and transformation of employee roles

Long-term disruption

Need to **build new skills** to adapt to a changing business environment

Push of shareholders to **invest capital in inorganic growth** opportunities

Loss of trust in **structured savings** instruments (e.g., MFs and ULIPs)

Flight to safety with **preference for big banks** and **asset-backed instruments** (e.g., gold)

Declaration of **insolvency** by small/non-digital players

Rampant **lay-offs** in the private sector due to decreased margins

While the government and RBI have already swung into action, prolonged disruption could lead to further initiatives facilitating structural changes in the industry

	Short-term initiatives underway	Indicative structural changes (medium/ long-term)	
Government	**INR 1.7 trillion relief package** for the poor that includes cash transfer and food security	Institution of larger **corporate bail-out packages**	Call for **emergency/drastic measures for economic survival**
	Strengthening administrative machinery to effectively distribute benefits of welfare programs	Increasing **empowerment of local bodies** for effective crisis management of crisis	Push for **priority sector lending** by banks
RBI	**Three-month moratorium** for term loans	**Relaxation** of **asset classification** norms	Institution of **operating limits for customers** for structural strengthening
	Reduction in **repo rate by 90 bps**	Further repo rate reduction to 2-3%	Sustained repo rate reduction to near-zero levels
	Liquidity infusion through **INR 25k cr** long-term repo operations (LTRO)	Further infusion of domestic liquidity (through dollar swaps, LTROs, etc.)	

Financial institutions are beginning to respond to some of the immediate imperatives to facilitate business continuity

Deploying targeted offerings

- **COVID-19 insurance**
- **Loan term relaxation**
- **Third-party data partnerships for trade finance**
- **Plug and play non-financial services for SMEs**

Revamping internal systems

- **Migration to cloud systems to enable employee remote access**

Increasing customer access

- **Comprehensive digital platform**
- **Digital trade financing**
- **Home delivery of cash**

Managing talent

- **Assurance of employee job security**

Source: Company websites, News articles

However, a focused approach targeting new opportunities while addressing immediate and constantly evolving needs would be critical for driving growth in the long run

A

RESPOND

Tactical initiatives to react to the needs of employees, customers, and communities, and maintain business continuity

- i. Facilitate a conducive **working environment for employees**
- ii. Enhance **customer centricity** through digital channels and customised offerings
- iii. Support the **government and communities' COVID-19 response** strategies through partnerships
- iv. Work towards ensuring **business continuity** despite limited operations

Immediate priority – detailed here

B

RECOVER

Tactical and strategic interventions to prepare the platform for profitable growth as the economy recuperates

- i. **Recalibrate risk** assessment models for each scenario
- ii. Engage **in partnerships** to **optimise processes** and **enhance experience**
- iii. **Reskill employees** on new processes/ways of working

C

THRIVE

Strategies and business model innovations to drive growth and share gain in a drastically different environment

- i. **Reprioritise sectors and customer segments** based on **growth and risk profiles**
- ii. Design **innovative business models** for the new industry environment
- iii. Build robust **digital ecosystems** leveraging latest technologies (e.g., IoT)

To be covered in subsequent reports

Respond: Employee engagement | Facilitate a conducive working environment for employees

i Use technology to adapt to new ways of working

Provide remote access infrastructure
Strengthen tech infrastructure for remote access (e.g., VPN, security tokens, network bandwidth, laptops, and cloud-based systems)

Facilitate communication and feedback channels
Create tech-enabled platforms to manage communication with employees and obtain their pulse/feedback.

Increase use of existing digital workflows
Reduce physical interactions using document scanning, OCR, etc.

Provide 'empathy packages' to boost morale

Assure job security
Communicate constantly to assure job security.

Provide COVID-19 cover
Provide COVID-19 insurance for employees and their families.

Establish COVID-19 employee helpdesk
Set-up an employee support centre offering constant check-ins, counseling, etc.

Respond: Customer engagement | Enhance customer centricity through digital channels and customised offerings

ii Enhance digital channel adoption and usage

Target existing customers
Run SMS/email campaigns to make customers aware of digital channels and increase adoption.

Build awareness through partnerships
Tie-up with other players in digital ecosystem (e.g., online delivery apps) to increase digital adoption.

Create digital champions
Train front-line staff to move customers to digital.

Understand and cater to emerging needs

Check-in with customers
Keep in constant touch with customers through SMS/ Whatsapp/calls to assure support through the crisis.

Determine emerging needs
Identify key customer archetypes and their emerging needs in the current situation.

Customise offerings
Offer specific products (e.g., distribute insurance covering COVID-19 and customised loans).

Reach out to priority customers
Understand priority customers' needs and pain points to identify products and services to be deployed.

Respond: Regulatory and community engagement | Support national/state COVID-19 response strategies through partnerships

iii Support regulators in policy formulation

Engage with RBI
Work with industry bodies to identify key risks/assistance required, and engage with RBI to contribute towards required policy changes.

Partner with governments and NGOs

Partner with state/ central governments
Support central and state governments in COVID-19 relief initiatives (e.g., awareness building).

Partner with local bodies
Partner with local bodies to act as nodal points for public assistance in select micro-markets.

Offer direct support to communities*

Create ecosystem
Act as an aggregator of customer grievances and direct them to appropriate agencies (e.g., local govt. helpline).

Provide helpline
Use existing contact centre infrastructure to offer COVID-19 related alerts and guidance on government schemes.

*Impact of these initiatives on banks' infrastructure and employees' well-being to be assessed

Respond: Business continuity | Work towards ensuring business continuity despite limited operations

iv

Maintain operational stability

Optimise network
Optimise the number of branches/ATMs in operation and redeploy staff based on the government's mandate and footfall.

Maintain liquidity
Ensure optimum liquidity and credit deployment, given changing rates and bond yields.

Use community influencers
Work with residential welfare associations, SME groups, etc., for retail and SME offerings.

Assess and manage risk exposure

Assess vulnerabilities
Identify strategic risks based on exposure to each sector/ geography, to aid sector-specific strategy formulation.

Manage risk
Identify initiatives to drive collections, and work with customers and industry bodies.

Monitor sectoral policies
Assess policies affecting high-exposure sectors and their implications.

Build quick response capabilities

Create critical response team (CRT)
Deploy centralised nodal team supported by localised teams to quickly address emergencies.

Deploy standard playbook
Create standardised guidelines for the CRT to tackle specific situations.

Scale-up gradually
After the lockdown, scale up operations gradually while adhering to social distancing norms (e.g., rotational work from home).

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ACKNOWLEDGEMENTS

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