ARMSTRONG
INTERNATIONAL

COVID - 19

IMPACT ON ACTUARIAL ASSUMPTIONS

UPDATE FOR 2022

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GLOBAL CENTRAL BANK POLICIES

2 YEARS AFTER ONSET OF COVID - 19

In early 2020, global economies plunged into crisis after the outbreak of COVID-19 pandemic. In India, as urgent fiscal policy measures, the Reserve Bank of India (RBI) cut the repo rate by 115 basis points during March-May 2020, to ease the stress on the economy. The repo rate has been kept at 4% since then, and the RBI has indicated to continue with the accommodative stance in face of the emerging Omicron variant.

Globally, the Federal Reserve Board (Fed) of the USA cut the federal funds rate to a range of 0 to 0.5%. The Fed also resumed purchasing debt securities as part of its quantitative easing program.

These measures resulted in an increase in inflation, which rose to 6.8% in 2021 – the highest since 1982. As a result, the Federal Reserve has indicated expectations of controlling inflation in 2022, and has began cutting down on purchasing debt securities and wind down QE in 2022. Simultaneously, in December 2021's Federal Open Market Committee (FOMC) meeting, the Federal Reserve signalled that it may raise interest rates in 2022. The market expects 2 or 3 separate rate hikes events in 2022, with hikes anywhere between 0.5% to 1%.

IMPACT ON SETTING ASSUMPTIONS

The pandemic has significantly changed the work environment globally. From slowdowns in productions to rising cost of input goods, supply shortages and shipping delays, almost all regular workflows have seen various degrees of interruptions. Many industries have adopted either a complete work from home polices or are transitioning to a hybrid model. While digital businesses have flourished, manufacturing and small business segment faced greater hardships.

From an accounting perspective, policies adopted by various governments to prevent the spread of COVID-19 had a direct impact on operations, cash flow and measurement of assets/liabilities and impairments. Further outbreaks caused progressive strain on their operations and difficulties in fulfilling contractual obligations.

In our Employee Benefits practice, we have seen a great impact on discount rate models, as the repo rate was reduced and remained low throughout the pandemic. Salary escalation rates have reduced in manufacturing based industries, while they have risen in the IT industry. However, heading into 2022 with high inflation and possible rate hikes on the horizon, this scenario could change rapidly.

Demographic Challenges

The Covid pandemic has affected birth rates globally, posing a demographic challenge. This may result in a fall in global working population in the future.

The effect is already visible in China where there are signs of population starting to shrink. This may adversely affect growth as well as global share of GDP. Global debt trap is showing signs of deepening.

Combined with increasing inflation, population decline and fall in productivity could lead to additional stress on the economy which is already fragile. In this context, a scenario where interest rates are hiked and reduction in government stimulus could lead to negative consequences, which should be navigated carefully.

Impact on Pensions and Gratuity Schemes

The funding levels of many pension schemes have been adversely impacted by Covid-19. This change has been largely driven by rising inflation coupled with a significant fall in gilt yields. However as the pandemic situation was brought in control in 2021, and the economy re-opened in phases following vaccination drives, the financial positions of funds started to improve.

However, the emergence of newer strains like Omicron can act as headwinds and cause further stress to funds, and can add deficits to pensions and gratuity schemes.

Defined benefit plans may opt to use their improved positions from 2021 to engage in de-risking activities throughout 2022, as the global economy changes course from a period of loose monetary policy to a much more tighter stance.

Evolving situation with new variants

Emergence of new variants of COVID-19 pose additional risks that have to be managed carefully.

Operational Disruptions	New variants are resulting in disruptions in travel and restrictions being put across various countries. Global supply chain shortages and shipping delays are still visible, and further strain to the economy could worsen this situation.
Liquidity	Central banks have infused massive amounts of liquidity into the economy during 2020 and 2021 to combat the pandemic. This has caused rising commodity prices and inflation. As a result, liquidity is being tightened slowly. However, emergence of newer variants and their impact could jeopardise plans if the economy faces additional stress due to operational disruptions.
Asset Valuations	Asset valuations have remained high due to an abundance of liquidity as a result of fiscal measures. Rate hikes could see a deflationary situation and could lead to a correction in asset prices.

Geopolitical risks continue to persist such as Russia-Ukraine tensions which could lead to potential sanctions, Iran nuclear stubbornness and China-USA clash over stock listings and other trade concerns. OPEC has boosted oil supplies resulting in an increase in Saudi volumes.

The Euro has seen internal problems and is yet to stabilise. The Chinese Yuan has not been able to catch up with the US dollar, which has retained its position as the leader among global settlement currencies. However, there is an increasing demand for an alternative to US dollar. Russia and China have indicated desire to establish independent financial systems to facilitate trade.

Due to the economic impact of COVID-19, developing countries could not catch up with developed countries as they did not have the leeway to enact fiscal and liquidity measures.

Sustainability

Climate change has become an increasingly visible part of public policy discussions. Political pressure to cut investments in oil and mining have grown due to increasing awareness and focus among politicians and legislators. Investments in clean energy and solar technology are being prioritised.

With supply constraints and increasing demand for solar panels, associated commodity prices have shown an increase of 40%. In these sectors, India is dependent on commodity imports but rapidly taking strides to become both self sufficient as well as a global leader.

Digital Trends

Digital revolution has been making rapid strides and disruptions have impacted businesses across all industry verticals. Processing power of a smartphone is now equivalent to that of a super computer in the 90's.

China has cracked down on Big Tech. However, in USA, Apple recently crossed landmark $3 Trillion in Market Cap. India has seen listing of several tech companies. Data Localisation, Privacy, and Data Protection Nationalism are growing challenges. Data is competing with goods and services as a contributor to growth. The impact of above factors on global interest rate scenario is worth assessing.

Possibility of Interest Rate Hikes in 2022

Following the rate cuts in 2020, RBI has indicated that it may follow the US Fed's approach and hike rates in 2022. Onset of Omicron in December 2021 could be a factor that may affect the RBI's decision.

Discount Rate

The 10 year yields on G-Secs has risen to a 2 year high of 6.53% as on 7th January 2022. This represents an increase of around 85 basis points from the COVID-19 depths of July 2020. The increase in discounting rate will lead to a decrease in liabilities to be reported.

Salary Growth Rate

In our practice, we have seen a reduction in estimated salary growth rates as a result of the pandemic. Several companies continue to operate in a low salary growth rates environment. However, tech companies have been able to increase their salary growth rates. If discount rate rises, this could be offset by increase in salary growth rates as covid pandemic turns into a manageable endemic.

Attrition Rate

Lower attrition rate will continue to be a prevailing factor through the present climate. However, this can vary considering impact on the specific industry.

THANK YOU

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