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Global Economic And Insurance Market Outlook 2020/2021

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(*sigma* 6/2019)

2020/21: Low for (even) longer

<2%

US growth, US 10y yield

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1. Economic Environment

"Global growth continues to slow. Interest rates remain low for longer. The likelihood for a US recession in 2020 is unchanged at 35%. Trade war remains #1 risk."

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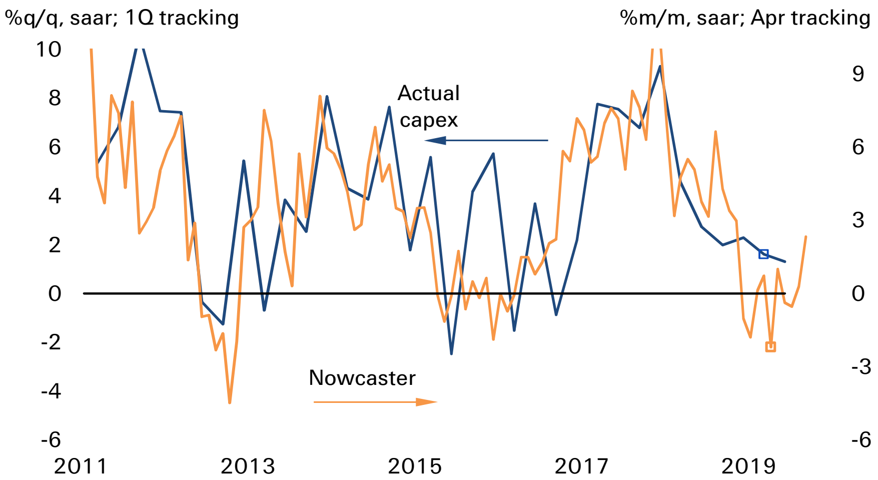
Global capex is key to monitor with weakness in manufacturing sector risking to spill over to service sector

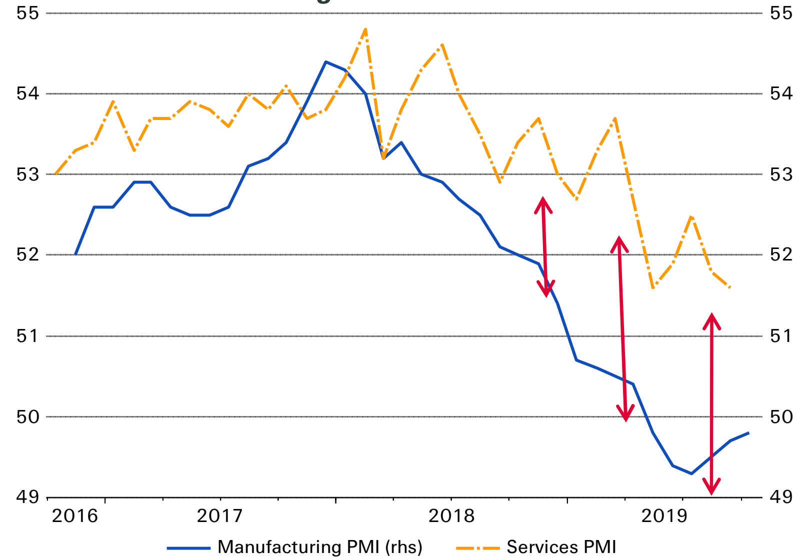
- Leading indicators such as PMIs suggest that **global capex growth remained weak in 2H 2019**, though a subsequent stabilization is our base case
- **Elevated uncertainty** (trade, Brexit, geopolitics) and weak business confidence likely to further **constrain capex**
- **Capex/manufacturing weakness risks increasingly spilling over to services sector**

Global capex growth and "nowcast", in %



Sources: Datastream, JP Morgan, Swiss Re Institute

Global purchasing managers indices for the manufacturing and the services sectors



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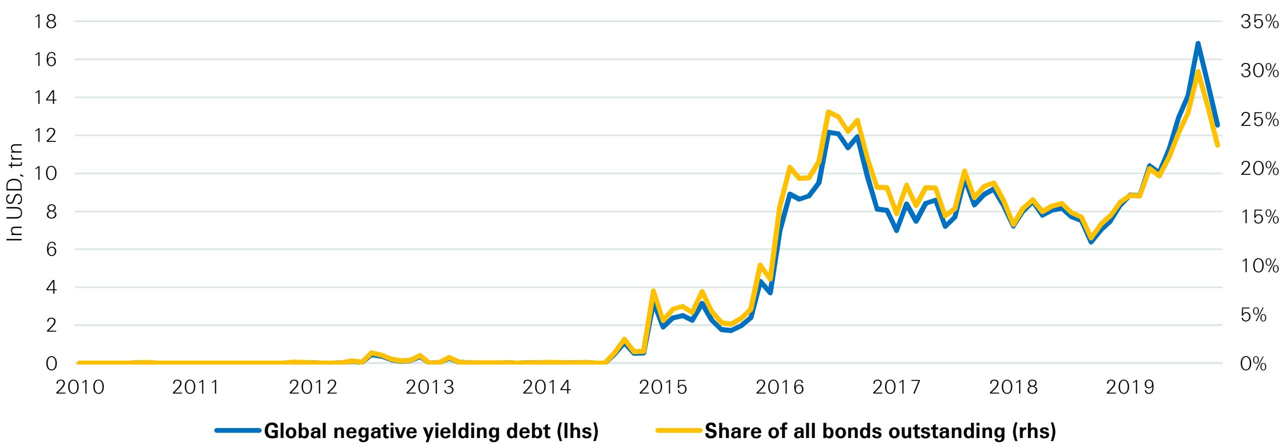
Yields will remain low (and even negative) for longer

- **Unconventional monetary policy and negative yields are here to stay.** About 25% of global bonds (USD 13 trillion) have negative yields
- **QE adds to downside yield pressure, increasing the scarcity of German Bunds** and keeping yields in negative territory in Germany and very low elsewhere, including in the US
- **Central banks will continue to remain accommodative,** but (finally) there is a **healthy debate on benefits vs costs. We are reaching the limits of the rate-cut cycle in "non-recessionary times"**

Negative yielding debt has spiked, (USD trillion (lhs) and percent of all outstanding bonds (rhs))



Sources: Bloomberg, Swiss Re Institute

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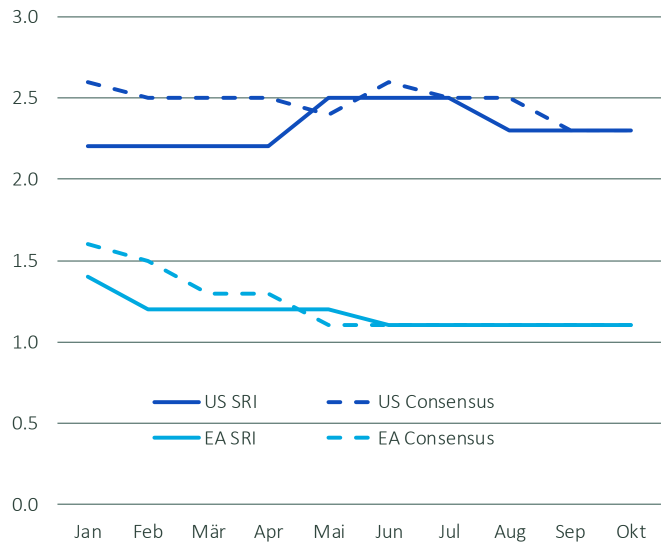
Our forecasts for growth and yields remain below market consensus

- Forecasts for 2019 were **below market consensus** at the start of the year. By now, consensus has caught up with our forecasts for 2019. **We remain more cautious for the 2020 growth outlook than Consensus**
- **2020 real GDP forecasts for the US and Europe are ~50bps below the IMF's projections**
- Our **yield projections are also below Consensus** for the major markets

Real GDP projections for 2019: SRI vs Consensus



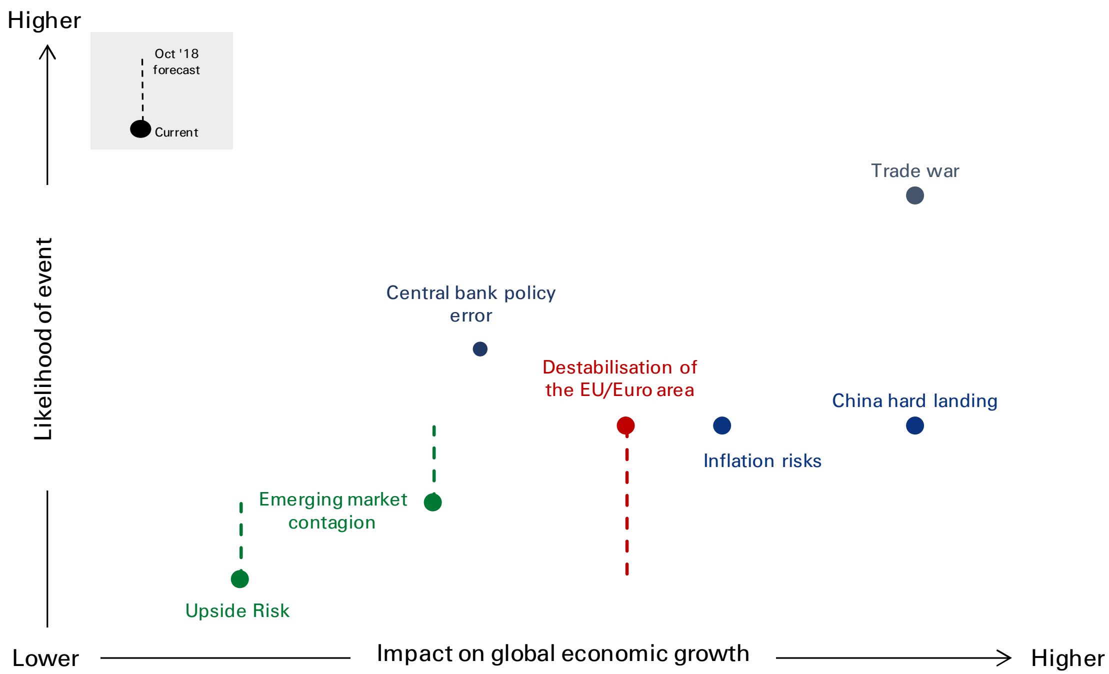
Sources: Bloomberg, Swiss Re Institute
Note: Consensus refers to survey data available by the first week of each month.

Economic forecast overview

		2018	2019E			2020F			2021F		
		Actual	SRI	Consensus	IMF	SRI	Consensus	IMF	SRI	Consensus	IMF
Real GDP growth, annual avg., %	US	2.9	2.3	2.3	2.4	1.6	1.8	2.1	1.8	1.8	1.7
	UK	1.4	1.3	1.2	1.2	1.0	1.1	1.4	1.3	1.5	1.5
	Euro area	1.9	1.1	1.1	1.2	0.9	1.1	1.4	1.0	1.3	1.4
	Japan	0.8	1.0	1.0	0.9	0.5	0.2	0.5	0.7	0.8	0.5
	China	6.6	6.2	6.1	6.1	6.1	5.9	5.8	5.8	5.8	5.9
Inflation, all-items CPI,	US	2.4	1.8	1.8	1.8	2.3	2.1	2.3	2.3	2.1	2.4
	UK	2.5	2.0	2.0	1.8	2.0	2.1	1.9	2.0	2.0	2.0
	Euro area	1.8	1.2	1.3	1.2	1.2	1.3	1.4	1.3	1.5	1.5
	Japan	1.0	0.8	0.6	1.0	1.2	0.8	1.3	1.0	0.9	0.7
	China	2.1	2.5	2.5	2.3	2.6	2.4	2.4	2.5	2.2	2.8
Policy rate, year-end, %	US	2.38	1.63	1.63		1.38	1.38		1.38	1.53	
	UK	0.75	0.75	0.75		0.75	0.70		0.75	0.95	
	Euro area	0.00	0.00	0.00		0.00	0.00		0.00	0.00	
	Japan	-0.06	-0.06	-0.10		-0.06	0.00		0.00	0.00	
Yield, 10-year govt bond,	US	2.7	1.4	1.6		1.4	1.9		1.5	2.2	
	UK	1.3	0.5	0.6		0.7	0.9		0.9	1.3	
	Euro area	0.2	-0.6	-0.6		-0.6	-0.4		-0.4	0.0	
	Japan	0.0	-0.3	-0.2		0.0	-0.1		0.0	0.0	

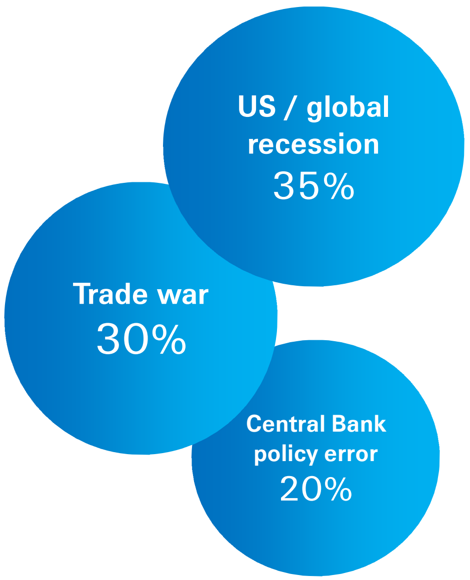
Downside risks are elevated

- The **recession likelihood** for the US economy is **unchanged at 35% since the beginning of the year**
- **Trade tensions are the biggest risk factor for the global economy on the down- as well as upside**



Source: Swiss Re Institute

Top macro risks for 2020 (likelihood)



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Our core macro views: loyal companions for coming years

- Low and negative rates are here to stay and do more harm than good in Europe
- Bad macro does not mean bad markets (*as long as inflation remains moderate*)
- Global economy is less resilient that in 2007
- Europe is more at risk of "Japanification" than the US
- USD yield curve is just one deep recession away from negative territory
- Some form of helicopter money in the next recession is likely

2. Insurance markets

"Life and non-life insurance premiums are expected at trend growth in 2020/2021. Rate trends for commercial lines are firming while low interest rates are an industry challenge."

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Insurance market dashboard

- **Global non-life**: we expect **steady premium growth and profits (ROE**) in 2020/21 and **flat combined ratios**. Rate trends of commercial lines are firming, but **social inflation is putting significant upward pressure on liability loss costs**, especially in the US
- **Global life:** expect **about-trend premium growth** of 3% through 2021 with emerging markets and China being the key driver
- Insurers have reported healthy profits (ROE) in 2019, partly due to realised gains from the investment portfolio
- **Investment outlook is challenging** with low interest rates

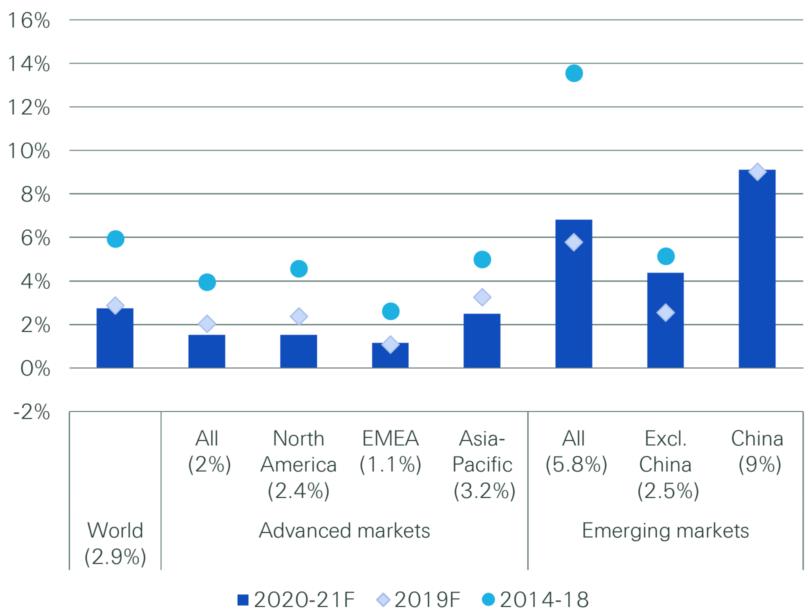
			World			Advanced markets						Emerging markets	
						North America		EMEA		Asia-Pacific			
			2014-18	2019	2020-21	2019	2020-21	2019	2020-21	2019	2020-21	2019	2020-21
Non-life, direct													
Premium growth (real)		CAGR	3.1%	2.9%	yellow	light green	yellow	yellow	yellow	light green	yellow	red	orange
Profitability	ROE	Average	7.2%	7.2%	yellow	orange	yellow	orange	orange	yellow	orange		
	Underwriting results*	Average	1.0%	1.9%	light green	light green	light green	light green	yellow	dark green	dark green		
	Investment results*	Average	10.4%	9.5%	orange	orange	orange	red	red	red	red		
Life, direct													
Premium growth (real)		CAGR	2.7%	2.3%	dark green	dark green	light green	orange	orange	orange	light green	yellow	yellow
Profitability	ROE	Average	9.4%	10.2%		light green		dark green		yellow			
Total (Stock market indicators)													
Price to book	Insurance sector	Average	1.2	1.3		dark green		red		red			
	Total market	Average	2.1	2.1		dark green		red		red			
Stock prices	Insurance sector	CAGR	1%	14%		dark green		dark green		dark green			
	Total market	CAGR	1.6%	12.3%		dark green		dark green		dark green			

Deviation from long-term trend	Colour
< -1.5%	red
-1.5% - -0.5%	orange
-0.5% - 0.5%	yellow
0.5% - 1.5%	light green
>1.5%	dark green

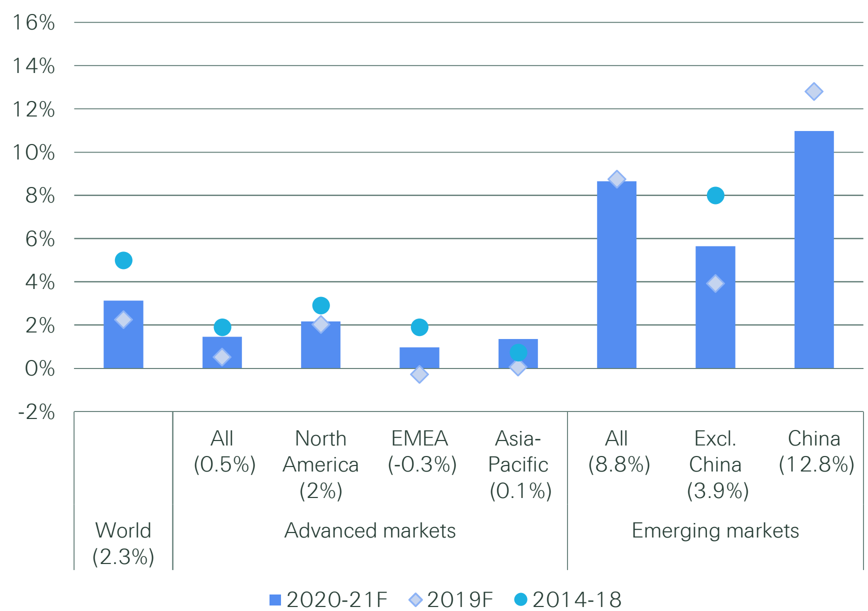
* as a % of net premiums earned, CAGR = compound average growth rate. Colouring based on deviation from long-term trend for each region. Regional stock market indicators contain the advanced and emerging markets.
Sources: Bloomberg, Thomson Reuters, Swiss Re Institute

Global non-life and life premiums will grow at trend by around 3% in real terms over 2020 and 2021, unchanged from last year's projections

Global non-life insurance premium growth in real terms, actual and forecast



Global life insurance premium growth in real terms, actual and forecast



Source: Swiss Re Institute

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3. Key themes

"Negative interest rates, global Japanification and risk of a recession are key challenges. The latter is not as bad as conventional thinking suggests for the insurance industry."

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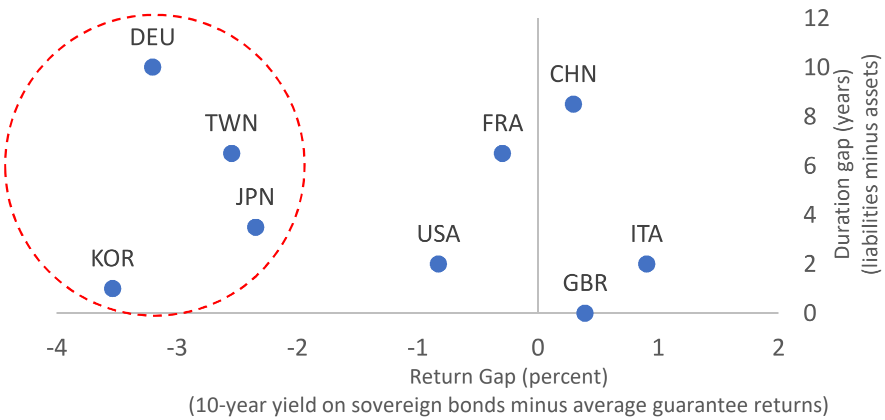
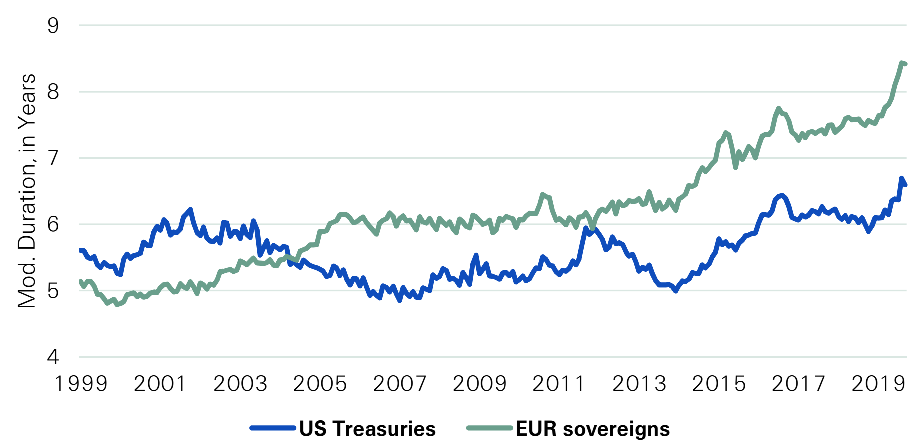
Negative rates are negative... and here to stay

- 13trn of negative yielding bonds are **problematic for economic stability and the long-term investor community, including insurers**. Investment flows into less liquid instruments. **German life insurers have a duration gap of 10 year**
- **Financial markets, in particular total-return investors, are exposed to the longer bond market duration**: a sudden 100bps increase in interest rates would lead to **market losses of at least USD 1.2trn**

Life insurers guaranteed return spreads (%) and duration mismatches (years)



Aggregate sovereign bond index durations have increased



Sources: IMF GFSR, October 2019, Chapter 3, and Swiss Re Institute based on Barclays' data

Helicopter money: comes in different shapes & is likely at the next recession

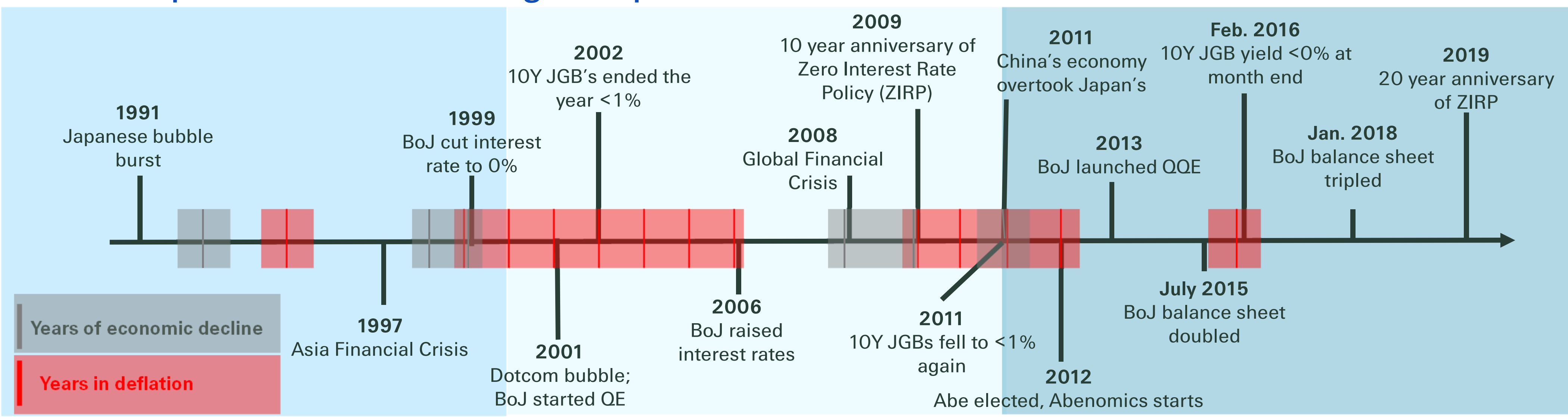
Fiscal expansion is positive if used for increasing sustainable infrastructure and green investment

Helicopter money could have different shapes

- Coordinated QE & fiscal expansion
- Cash transfers to the government
- Haircuts on central-bank held debt
- Cash transfers/tax cuts to households

Source: Swiss Re Institute

Europe most at risk though "Japanification" is not a worst case



	1991-2000			2001-2010			2011-2019		
CAGR, %	**Japan**	**US**	**Eurozone**	**Japan**	**US**	**Eurozone**	**Japan**	**US**	**Eurozone**
Labour Productivity	1.9	1.7	1.4	1.0	2.0	0.7	0.8	0.5	0.7
Real GDP per Capita	0.8	2.3	1.7	0.5	0.8	0.6	1.2	1.4	0.8
Real GDP	1.0	3.4	1.9	0.6	1.6	1.0	1.0	2.1	1.1
Inflation	0.5	2.4	2.1	-0.2	2.1	1.8	0.7	1.4	1.0
Savings rate*	31	19	23	27	17	23	26	19	23
Current account*	2.3	-1.7	-1.1	3.3	-4.4	-0.9	2.7	-2.4	0.8

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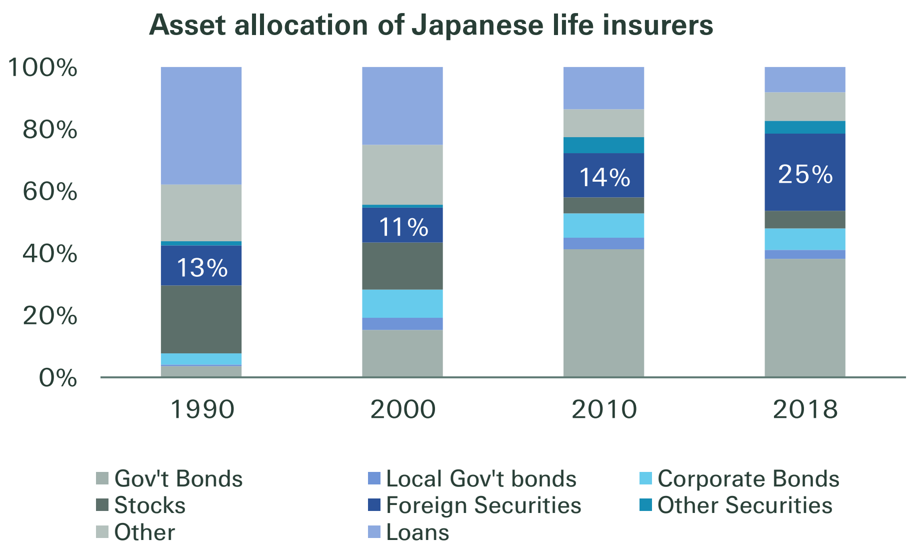
Note: * Savings rate (Gross Savings) and Current account are % of GDP and an average over the period.
Gross savings from World Bank for Japan from 1996 onwards only. Current account for Eurozone from 1998 onwards only. The colouring presents a countries position relative to the other two within the decade.
Sources: World Bank, OECD, national statistics, Datastream and Swiss Re Institute

Insurance markets: Japanese life insurers made major changes to deal with low growth, low inflation and QE



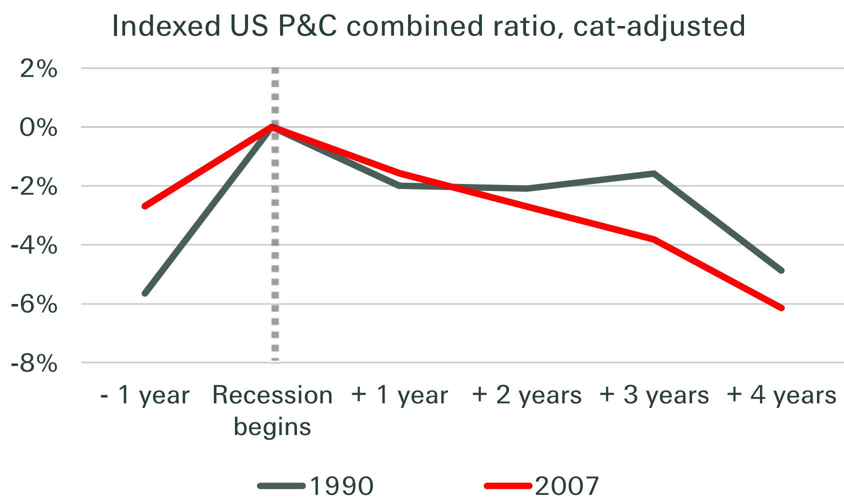
Sources: Japanese Life Insurance Association, Swiss Re Institute

Asset allocation	• **Increased illiquid** and **overseas assets** as well as **duration**
Product mix and pricing	• **Switch to unit-linked** to **reduce insurers' investment risk** • Sold more **protection products (less interest rate sensitive)** • Shifted to **higher margin health insurance solutions** • **Charged higher prices** or lower guaranteed rates (also retrospectively)
Industry structure	• **Consolidation** of mid-sized life insurers • Expansion to **overseas** markets

Theme 3: Recession Scenario

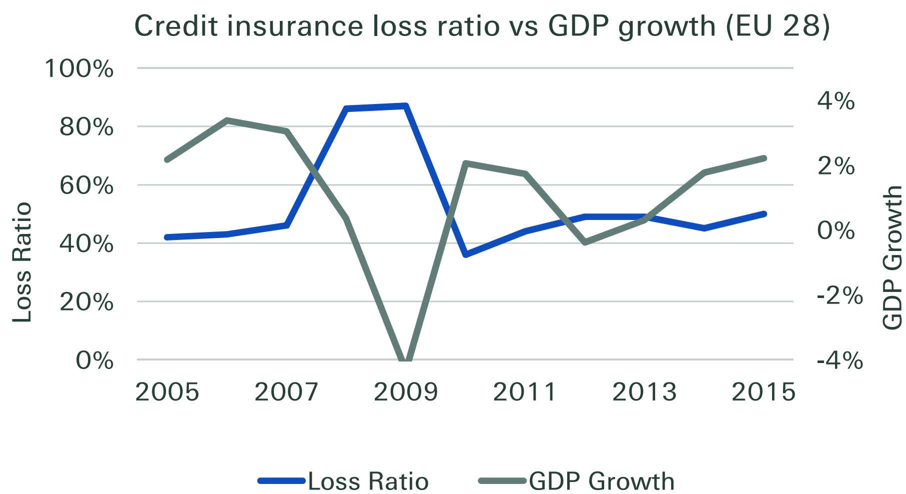
Underwriting results normally benefit from the disinflationary impact of a recession

P&C combined ratio improved by 2 to 4 percentage points in the three years after recession ...



Sources: A.M. Best, SNL, Swiss Re Institute

... though trade credit insurance typically suffers as insolvencies rise



Source: International Credit Insurance & Surety Association

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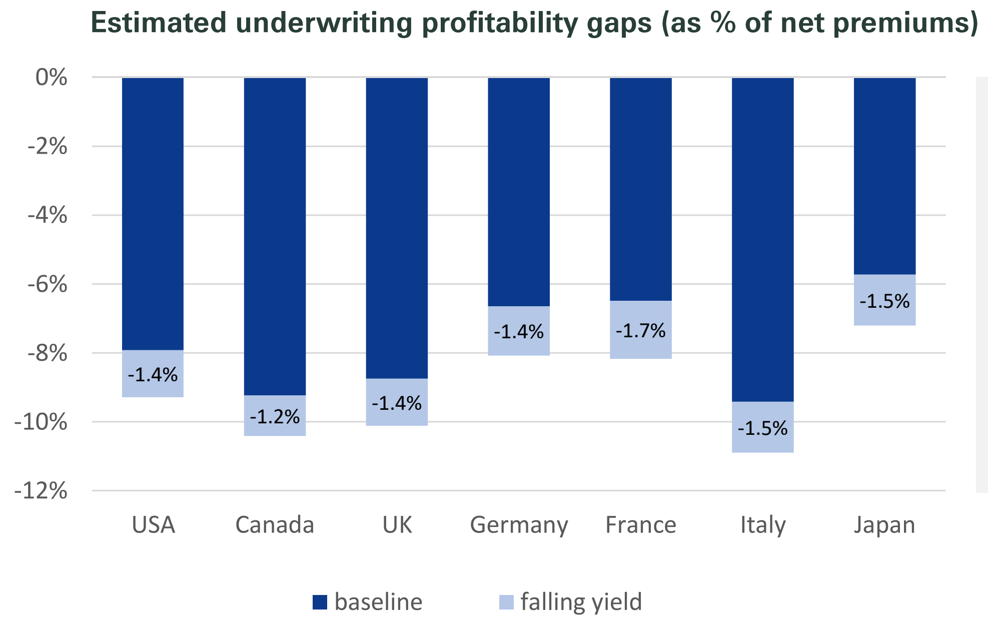
Theme 3: Recession Scenario

Reaching industry target RoE of 10% needs improvement of UW margins, falling investment yields widen the gap



- **Current rate increases fall short** of what is needed to restore a sustainable profitability level
- **Underwriting margins need to improve** by about 5 to 9 percentage points in major western markets and Japan to deliver a target ROE of 10%*
- A **drop of yield curve by 50 bps** due to a recession would **widen the profitability gap by another 1.2% to 1.5%**

Source: Swiss Re Institute

Note: * RoE targets are set to approximate long-term average returns, adjusted for outliers from extreme cat events and the financial crisis (*sigma* 4/2018, p 29/30)

Key takeaways

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Key takeaways

1. Global growth is slowing, interest rates will remain low and negative for even longer, recession risk remains elevated

2. Insurance premiums continue to grow at trend. Insurers should continue to realign their product mix and investment activities prudently

3. "Japanification" of economies is not the "worst case" with Europe more at risk than the US. Meanwhile, a US recession is not as bad for insurers as one may think, but "stagflation" is

Q&A

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Appendix

Central banks coming to the rescue (again) but the rate-cutting cycle nearing its limit for "non-recessionary times"

- **Global growth decelerating with some improving data as of late. US GDP growth softened to a three-year low of 1.9% in Q3 whilst the Chinese economy slowed to 6.0%.** We **see a 35% likelihood of a US recession in 2020**, unchanged since the beginning of the year
- **Core inflation pressures remain absent in the EZ and benign in the US, despite tight labour markets**
- **Central banks will continue to remain accommodative,** but the benefits of monetary easing are getting smaller and the associated costs are on the rise

Key indicators – Ratings

Factor	US			EZ			China		
	Latest value	Recent trend*	View (6-12m)	Latest value	Recent trend*	View (6-12m)	Latest value	Recent trend*	View (6-12m)
PMIs/econ. momentum	54.7			50.6			52		
Inflation	1.7			0.7			3.0		
10y real yield	0.2			-1.2			0.3		
Financial conditions									
Bank lending conditions									

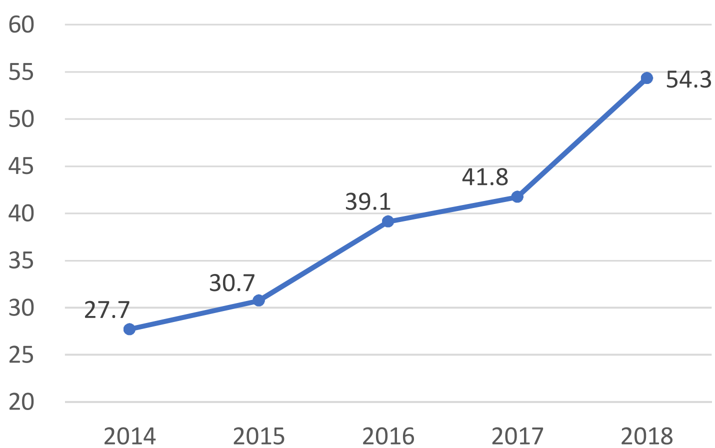
* Colored ratings are based percentile rankings of on historical data (from 2010, using 3-month moving averages).
Sources: Bloomberg, JPM, Goldman Sachs, Swiss Re Institute. Latest value for financial market variables is as of 7/11/2019

Non-life insurance: concerns around social inflation are rising

US liability claims trends

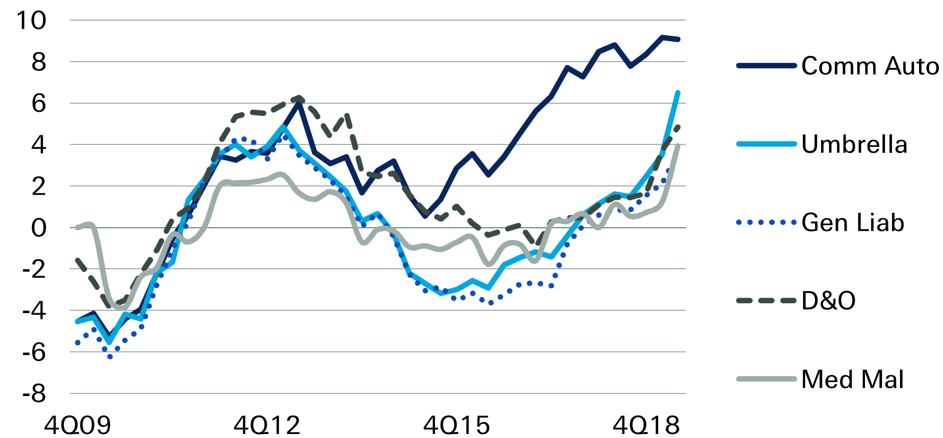
- Increasing frequency of **severe large losses** which are impacted by the emerging influence of **litigation funding**
- **Social inflation appears to be spreading** across various liability lines
- Further potential pressure points lie ahead in the form of opioid litigation and reviver statutes
- **Rate trends are firming; enough to catch up with claims trends?**

Top 50 US single plaintiff bodily injury verdicts in USD millions, median 2014-2018



Sources: Shaub, Ahmuty, Citrin & Spratt, Swiss Re Institute

US commercial liability rate changes



Sources: Council of Insurance Agents and Brokers, Swiss Re Institute

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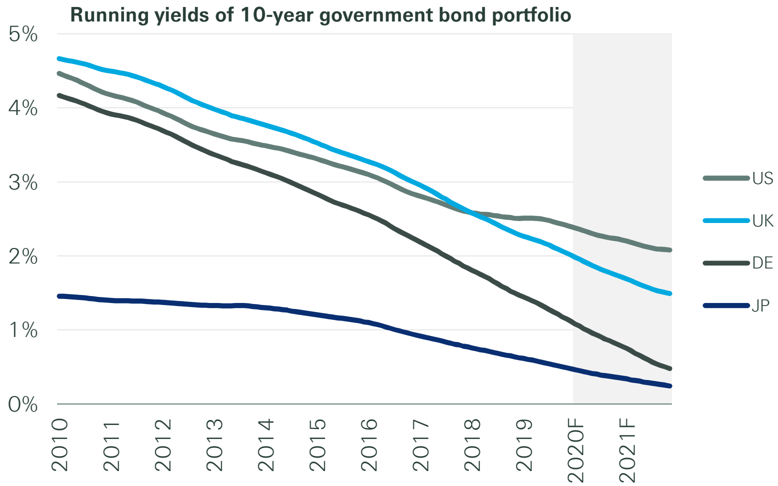
Life insurance: need to adapt to lower yields for longer

- We expect the **low and negative interest rates** are here to stay, the yields of life insurers' bond portfolios will decline further
- Life insurers should continue to **realign** their **investment activities** and **product mix**
- Recent developments in vaping and opioid usages may affect future **mortality trends**

Life saving business



Note: DE: Germany. JP: Japan
Source: Swiss Re Institute

Life risk business

Opioids

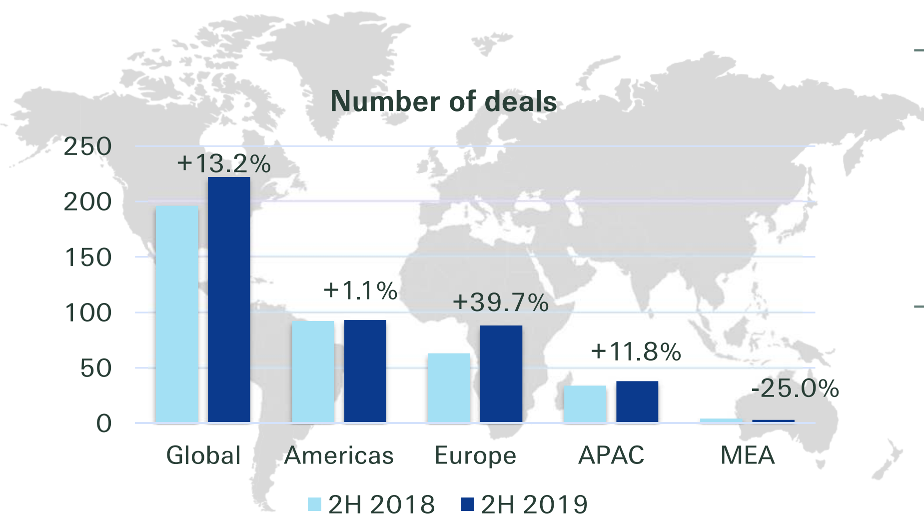
- The opioids crisis continues in the US, but is also becoming evident throughout the world
- A recent OECD study found that the average of opioid-related deaths in 25 OECD countries has increased by more than 20% between 2011 and 2016

e-cigarettes

- The number of smokers substituting conventional tobacco cigarettes with e-cigarettes is likely to increase
- First evidence has emerged that suggests vaping could carry greater health risks than initially thought, impacting future mortality improvement

Sources: OECD, Swiss Re Institute

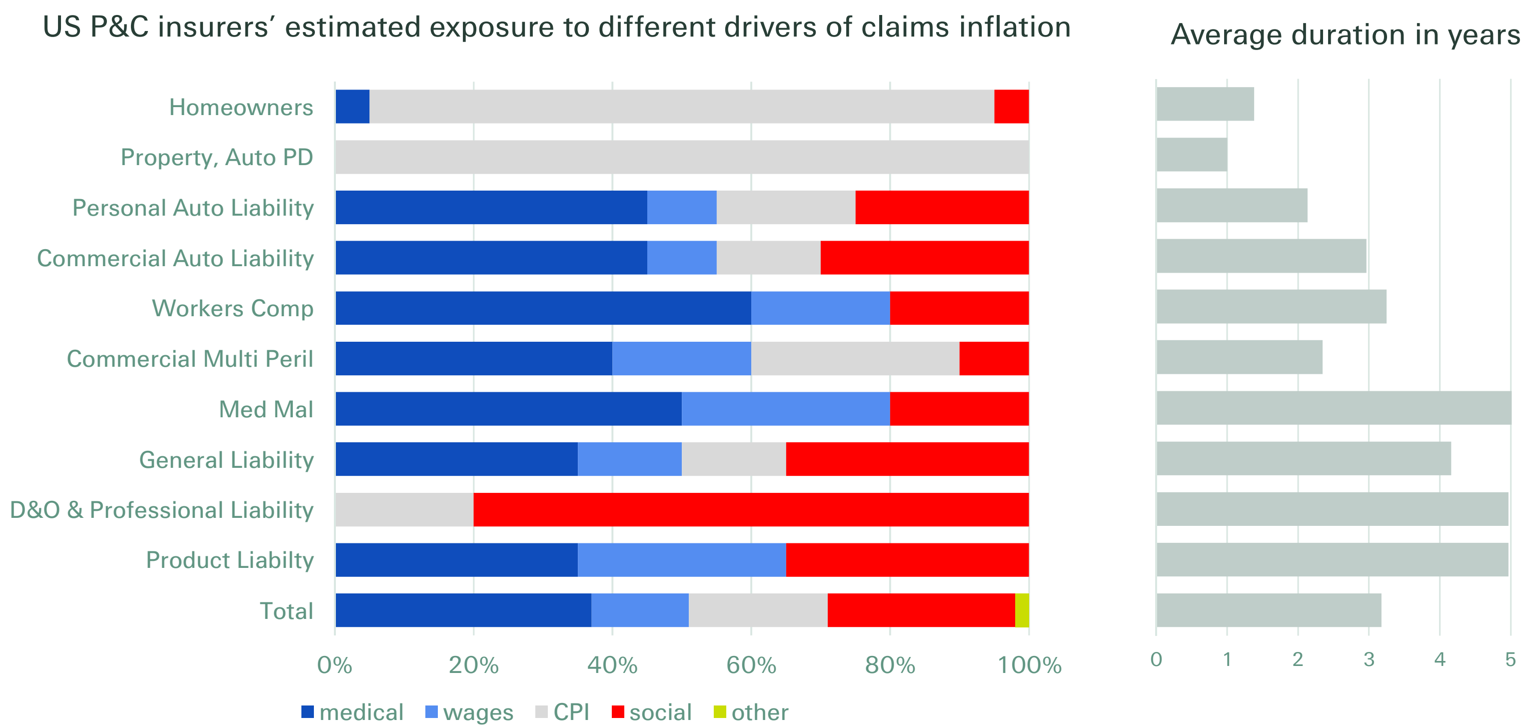
Key themes drive global insurance M&A activity



Note: % growth 2H 2019 / 2H 2018
Sources: Clyde & Co, Insurance M&A mid-year update, August 2019, Swiss Re Institute

InsurTech	• **Strong InsurTech in**vestment remains a key growth driver of M&A activities in all regions
Portfolio optimization	• Mid-sized companies operating in the highly commoditised personal lines are seeking to **diversify their portfolio and/or customer base** • Some insurers **divest underperforming lines or exit certain markets** to better support future strategic direction
Legislative changes	• In the **US,** (re)insurers are re-evaluating their international business models under the new tax laws • In **APAC**, recent legislative changes have triggered market consolidations in Australia and India. In China, a slew of new and more foreign friendly regulations has led to increase foreign interest • In **Europe,** a surge in pending deals (mostly to refocus growth area) that has been put on hold due to Brexit preparations

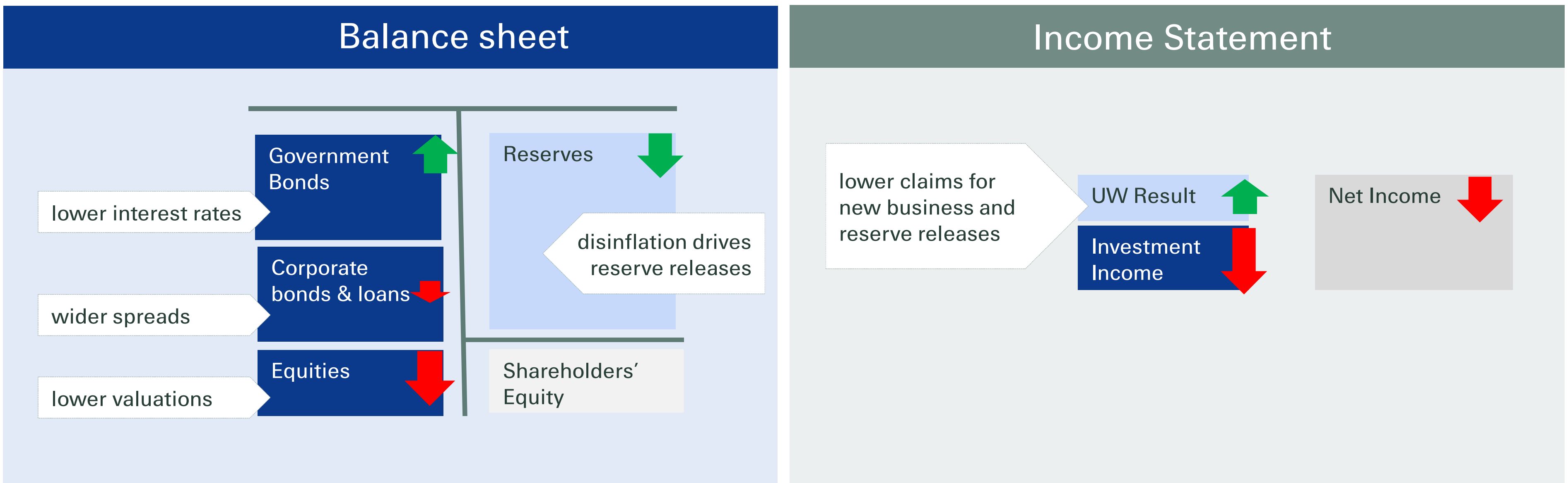
Not all inflation is created equal - mix of business greatly affects vulnerabilities to different types of inflation



Sources: IBNR weekly #28, 2019, SNL, Swiss Re Institute

Theme 3: Recession Scenario

Moderate and sustained recession leads to a decline in net income, investment losses are partially offset by improvement in non-life underwriting returns



Source: Swiss Re Institute

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