Swiss Re
Institute

News release

Driven by strength in emerging Asia, insurance markets will grow despite weakening global economic growth, *sigma* says

- Global economic growth will weaken in 2020 and 2021; the engine of global growth will be emerging Asia
- Insurance markets continue to grow at trend due to very strong demand in emerging Asia, particularly China; non-life and life premiums will increase by around 3% in 2020 and 2021
- SRI forecasts slowdown in US economic growth to 1.6% in 2020, and 0.9% in the euro area, both below consensus
- The main risk to the growth outlook is escalation of US/China trade tensions; the euro area is at risk of "Japanification"
- Low and negative interest rates are here to stay; a new policy mix is needed, including fiscal spending in infrastructure and sustainable investments
- Non-life and life insurer profits are trending up; however, rising social inflation, particularly in US liability, is a growing drain

London, 13 November 2019 – Insurance markets continue to support resilience, with global premiums forecast to increase by 3% annually in real terms in 2020 and 2021, despite a slowing world economy. In its latest *sigma*, "Sustaining resilience amid slowing growth: global economic and insurance market outlook 2020/21," Swiss Re Institute (SRI) forecasts US and euro area growth next year of 1.6% and 0.9%, respectively, below consensus. The main engine of the global economy will be emerging Asia, with near 6% growth in both India and China. The contribution of insurance to resilience will be greatest in this region as well. In China, non-life premiums are forecast to grow by 9% in 2020, and life premiums by 11%.

"Our outlook on global growth has deteriorated from a year ago", Jerome Jean Haegeli, Group Chief Economist at Swiss Re, says. "The US/China trade conflict has been more far reaching than anticipated. In a broader sense, geopolitical developments have not improved. Rather, we have seen more polarisation across the world, all of which has added to the environment of uncertainty, including for business. Going forward, the US/China trade conflict poses the top risk to global growth."

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Japanification: coming to you?

Due to the environment of worsening trade and geopolitical developments over the last year, SRI has lowered its growth forecasts for advanced markets. SRI forecasts that gross domestic product (GDP) growth in the US will slow to 1.6% in 2020 from 2.3% this year, as the effects of fiscal stimulus fade and trade tensions with China continue. This is below the consensus forecast for 2020 of 1.8%. The risk of recession in the US remains elevated at 35%, but this is not SRI's base-case scenario. According to *sigma* analysis, the US economy is the most resilient compared to the other G4 nations, and growth there is expected to strengthen slightly to 1.8% in 2021.[1]

Table 1: Forecasts for real GDP growth, inflation, interest rates and 10-year yields

		2018	2019E		2020F		2021F	
		Actual	SRI	Consensus	SRI	Consensus	SRI	Consensus
Real GDP growth, annual avg., %	US	2.9	2.3	2.3	1.6	1.8	1.8	1.8
	UK	1.4	1.3	1.2	1.0	1.1	1.3	1.5
	Euro area	1.9	1.1	1.1	0.9	1.1	1.0	1.3
	Japan	0.8	1.0	1.0	0.5	0.2	0.7	0.8
	China	6.6	6.2	6.1*	5.9	5.8*	5.8	5.9*
Inflation, all-items CPI, annual avg., %	US	2.4	1.8	1.8	2.3	2.1	2.3	2.1
	UK	2.5	2.0	2.0	2.0	2.1	2.0	2.0
	Euro area	1.8	1.2	1.3	1.2	1.3	1.3	1.5
	Japan	1.0	0.8	0.6	1.2	0.8	1.0	0.9
	China	2.1	2.5	2.3*	2.6	2.4*	2.5	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, year-end, %	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

E = estimates, F = forecasts.
Note: Euro area policy rate refers to the interest rate on the main refinancing operations. *China data from IMF.
Source: Consesus Economics, Bloomberg, IMF, Swiss Re Institute

On aggregate, emerging market growth should improve modestly over the next two years. While Asia will remain the motor of global growth, particularly emerging Asia, there is positive momentum in other regions as well. The outlook for some large Latin American countries, notably Brazil, has improved compared to last year, and growth in Africa is also strengthening moderately. The ongoing trade dispute with the US will weigh on growth in China, but with ramped up fiscal and monetary easing, SRI forecasts a 6.1% gain in GDP there next year.

Low and negative interest rates are here to stay

Decisive monetary policy action was crucial, needed and successful in response to the global financial crisis. However, "in the long term, negative interest rates are negative, leading to higher household savings, misallocation of capital, higher debt levels and leverage and lower bank and also insurer profitability," Haegeli says. "In the short-term, the low growth environment does not necessarily mean financial markets will perform badly, not while

[1] See *sigma* 5/2019: Indexing resilience – a primer for insurance markets and economies, Swiss Re Institute

central banks remain in accommodative mode. Long-term loose monetary policy, however, raises the spectre of financial instability."

With monetary policy options largely exhausted, new growth recipes are needed to offset increasing headwinds from demographics, protectionism and political uncertainty. To improve productivity, supply-side reform efforts need to be stepped up and public investment increased. Fiscal stimulus will likely pick up the baton in the coming years. Fiscal stimulus can increase the productive capacity of an economy, for example through spending on infrastructure projects and in sustainable investments.

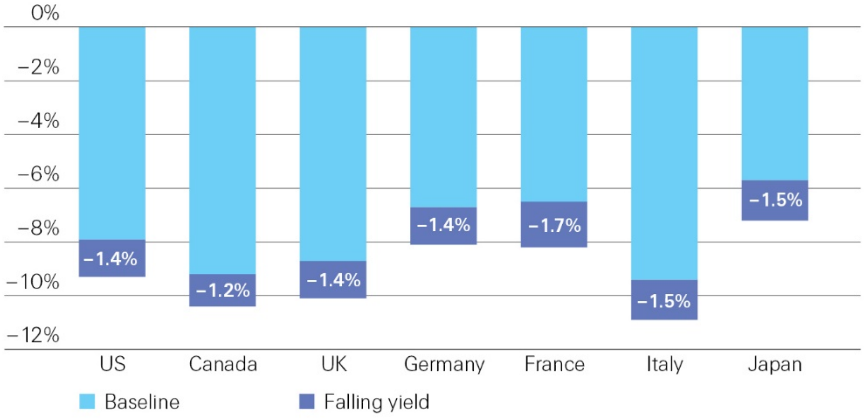
Insurance supports resilience

Insurance is a key contributor to economic resilience, more so when growth slows: when households and businesses have access to financial compensation for loss events, the underlying capacity of an economy to absorb shocks is enhanced. Encouragingly, the global insurance sector continues to grow at trend. Non-life and life premiums are forecast to increase by around 3% in both 2020 and 2021. By closing existing protection gaps, the insurance industry can further support macroeconomic resilience.

Emerging Asia is seen as the main driver of industry growth led by China, where non-life premiums are forecast to grow by 9% in 2020 and life premiums by 11%. Further out, SRI forecasts that China will account for 60% of all insurance premiums in Asia over the next 10 years. Expanding risk pools will include non-motor personal, and medical and health covers. "The exponential growth of mid-market private medical in China, with premiums up 1500% over the last two years, offers an indication of the size of potential," Haegeli continues. "Resilience levels in other emerging markets could be strengthened significantly by taking learnings from the China experience."

Pricing in non-life insurance has strengthened, driven by rising loss costs in property catastrophe and US casualty, and SRI expects this to continue. Profitability has been trending up in both non-life and life insurance, although this is partly due to realised gains from the investment portfolio. However, in the case of a recession, demand for insurance typically falls with economic slowdown, and profitability would also be impacted. For example, for the non-life sector overall, the analysis shows that a 50 basis-point drop in the yield curve, a plausible scenario in current low market yield levels, would widen the estimated existing sector margin gap of 6-9% of premiums by 1.2-1.5% (see Figure 1).

Figure 1: Estimated baseline profitability gap as % of net premiums, and additional interest rate impact in recession scenario



Source: Swiss Re Institute

A claims disinflation effect could in part offset the interest rate impact. Certain lines of business, like casualty, tend to benefit from reduced claims severity via economic drivers (e.g, wage inflation and medical expenses). On the other hand, social inflation, the impact of changes in the tort system through which most liability claims are settled, is putting upward pressure on loss costs. This is becoming an especially prevalent theme in US liability insurance. Further, the low interest rate environment means that investment returns remain weak, which will continue to undermine profitability, particularly for life insurers.

The experience of insurers in Japan in three decades of low growth and low interest rates offers pointers for peers in other regions facing a similar scenario of economic inertia. In search of yield, Japan's insurers have invested much more of their assets abroad. Non-life insurers have also turned more aggressive in their investment strategy by significantly reducing cash and reserves, and increasing their exposure to equities. On the life side, insurers have also changed their product mix to write more higher-margin health products and less interest-rate sensitive savings products.

Swiss Re Institute

Notes to editors

Swiss Re
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How to order this sigma study:
The English version of the sigma No 6/2019, "Sustaining resilience amid in a slowing growth: global economic and insurance market outlook 2020/21" is available in printed format and electronically. You can download the electronic version of sigma from the Swiss Re Institute website: https://www.swissre.com/institute/ . For printed copies, please send your orders, complete with your full postal address to https://www.swissre.com/institute/ .