

Market recap

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Industry developments

US reinsurers saw a 28 % increase in net written premiums and an improvement in their combined ratio during the first quarter of 2003, an industry group said. A survey of 29 US. property - casualty reinsurers shows net written premiums rose to \$8.5 billion from \$6.7 billion, according to the Reinsurance Association of America. The combined ratio improved to 96.4 from 101.8 reported by a similar group of reinsurers in the first quarter of 2002, the association said. The ratio is attributable to a 71.3 loss ratio and a 25.1 expense ratio.

(Bestwire - June 3, 2003)

In its annual report on the underwriting results of the US reinsurance market, the Reinsurance Association of America found that US reinsurers saw an increase in net premium written and had an aggregate net profit, after a net loss in 2001. The aggregate combined ratio, while down sharply from the year before, was still above the historical average, as was the industry's underwriting loss. The report, based on data from 50 US reinsurers, showed that total net premiums written in 2002 rose to \$30.8 billion from \$27.2 billion the year before. Net income was \$1.3 billion, compared with a \$3 billion net loss in 2001. The aggregate combined ratio fell to 117.4 from 139.3, and the industry's underwriting loss narrowed to \$5.6 billion from \$11.2 billion. While the underwriting loss narrowed considerably, it was still the second-highest over the past 10 years, eclipsed only by the 2001 result that included the Sept. 11 terrorist attack. Even 1993's underwriting loss, which would have reflected some of the damage from 1992's Hurricane Andrew, was only \$1.14 billion. The 2002 combined ratio was also the second-highest in the past decade.

(Bestwire - June 19, 2003)

A new study by Willis Group Holdings Ltd. shows the global reinsurance market returning to a state of greater balance after nearly two full years of increased hardening. Despite a challenging year for renewals and for certain classes of coverage, an influx of \$8 billion in capital raised for Bermuda-based start-ups since Sept. 11, 2001, helped open capacity, with the supply going mostly to those classes of coverage able to show the greatest transparency of risk and best able to model their exposures.

(Bestwire - June 3, 2003)

Property - casualty insurance rates are likely to remain strong, boosting earnings through 2003, if not 2004, analysts said May 29. In a research note, Jay A. Cohen, a Merrill Lynch insurance analyst, said first-quarter results were an indication that improved underwriting - and higher rates - are working their way down to the bottom lines at insurers. "Some of the upside surprise in the quarter, especially among reinsurers was due to lack of large catastrophic losses," Cohen said. "Still, excluding the impact of weather, it appears that underlying underwriting results were solid and we saw more upward estimate revisions than downward revision in reaction to earnings releases. We expect the same pattern to continue over the next three quarters." "While some property insurance and reinsurance markets have predictably stabilized at very profitable levels, casualty markets continue to show strong upward momentum," said

Industry developments

Ronald W. Frank, a Smith Barney insurance analyst. "Low interest rates, capital damage from asbestos liabilities and investment portfolios and last, but not least, rating agency pressure all argue for an extended hard market."
(Dow Jones Newswires - May 29, 2003)

Property - casualty insurance rates, particularly in the casualty business, are likely to continue to increase beyond this year, American International Group's (AIG) chairman said June 5. Speaking at Sanford C. Bernstein & Co.'s Strategic Decisions Conference, M.R. Greenberg said he expects rates will continue to rise for some time. Greenberg said not enough new capacity, or new entrants, are in the insurance industry to pressure rates. Also, the amount of capital raised by the industry is still inadequate to meet its needs, so rates will continue to rise, he said.
(Dow Jones Newswires - June 5, 2003)

Despite substantial rate increases over the past three years, property-casualty insurers will not see any dramatic improvement in their financial results by 2004, according to Conning Research & Consulting, Inc. "Property - casualty Forecast and Analysis by Line of Insurance, First Quarter 2003" also finds that P-C insurance rates will continue to increase in 2003 and 2004 but at a more moderate pace. "Much of the benefit of the rate increases was offset by the industry's declining investment yields," said Michael Weinstein, Director of Research at Conning. "With lower investment returns, insurers have no choice but to focus their efforts on reducing losses and other costs if they want to achieve sustainable returns on equity." Conning anticipates that the insurance industry's statutory returns on surplus will increase but only into the low single digits as the industry adds to its loss reserves and attempts to shore up its capital base.
(PR Newswire - June 2, 2003)

According to the A.M. Best special report, "P/C Premium Growth Solid in 2002," robust price increases across all sectors in 2002 resulted in an overall 15.1 % increase in net premiums written for the property/casualty insurance industry last year. The need for rate increases continues to be exacerbated by poorly performing equity markets and the need for further reserve strengthening. Given the depth of price decreases during the soft market, and the large reserve deficiencies that have built up, returns will remain modest. In addition, pricing in a number of large-market segments--particularly homeowners, commercial multiple-peril, medical malpractice and workers' compensation--are still below adequate levels. These business lines will need further double-digit rate increases to achieve economic break-even combined ratios.
(Bestwire - June 13, 2003)

Buoyed by improvements in both underwriting results and investment performance, the American property - casualty industry saw net income rise 20.6 % in the first quarter and record results in combined underwriting ratios, according to recent studies. A joint effort of the Insurance Services Office Inc. and the National Association of Independent Insurers, the quarterly survey of property - casualty insurers found first-quarter earnings of \$6.4 billion, up from \$5.3 billion in first quarter 2002. A.M. Best Co. had previously commented on the market's results in its special report "P/C Industry Reports Combined Ratio Below 100". A.M. Best noted first quarter 2003 was the industry's strongest first-quarter underwriting performance in the most recent five-year period. A.M. Best also noted the industry's combined ratio was driven by a 1.9 point decline in the loss-adjustment expense ratio and a 0.7 point decline in the expense-plus-policyholder-dividend ratio. While price increases and improved underwriting have helped the results, A.M. Best says "history indicates that the sustainability of these

Industry developments

first-quarter results throughout the year are improbable." Underwriting losses were \$1.5 billion, down 59.9 % from \$3.6 billion a year ago. Combined ratio for the market was a record 99.5, an improvement of 2.6 percentage points from last year's 102.2, and the best ratio ISO has seen since it began compiling its records in 1986 (Bestwire - June 23, 2003)

The 20 % year-on-year jump in net earnings of US insurers to US \$6.4 billion for the first quarter of this year translates to a return on equity (ROE) of 8.8 %, notes the Insurance Information Institute's (III) chief economist Robert Hartwig. This follows the industry's dismal ROE of 1 % for the 2002 financial year and the record-low negative return of 2.4 % posted for the prior year. "The first quarter of 2003 got property and casualty insurers off to their best start in years, setting the stage for what could become the industry's first reasonably profitable performance since 1997." But, despite the strong 12.7 % rise in net written premiums to US\$101.3 billion for the first quarter of this year - which should see the industry breaking through the US\$400 billion mark for the full year - there remain several challenges before insurers, Hartwig says. Firstly, the rise in net written premiums for the latest reporting period is moderately lower than the growth achieved during 2002, he observes, which suggests that rates may be decelerating. Another factor is that, while the industry was able to bring the combined ratio down to 99.5 % by the end of the first quarter of this year, the weak investment environment requires a far greater reduction in operating costs in order to achieve the necessary 15 % ROE expected by shareholders. The fact that the industry only managed to produce an 8.8 % ROE for the latest reporting period on the back of a combined ratio of less than 100 % is indicative of the negative impact the investment environment has had on insurers' returns, he adds. On a positive note, Hartwig sees the 1.4 % increase in insurers' surplus to US\$289 billion for the first quarter of this year as a right step in addressing reserving concerns. (Canadian Underwriter Online - June 26, 2003)

Catastrophe losses for property - casualty insurers have been mounting over the past decade, even during years without large events, according to the article, "Opting for a Room With a View Might Be Flirting With Danger," in the June 16 issue of BestWeek. Over the past 12 years, insurers paid more than \$100 billion in catastrophe - related losses - about \$700 million a month-according to the Insurance Information Institute (III). Experts say the relocation of many Americans to high - risk areas - including into areas that once were unpopulated or marginally suitable - is partly to blame. In 2002, the industry had \$6 billion in losses without a single large event, said Robert Hartwig, senior vice president and chief economist at III. (Bestwire - June 16, 2003)

A new study suggests reserves in US commercial lines could be deficient by as much as US\$20 billion. The report, by investment bank Cochran, Caronia Securities LLC, says reserves for 1997 to 2001 could be deficient by US\$13-\$20 billion. This is equivalent to 10-15 % of total commercial lines surplus, and also about the same as all of 2002 commercial lines earnings in the United States The figures, however, do not include asbestos and environmental claims, as well as most directors' and officers' claims, which could add US\$35 billion or more. "IBNR has sunk to startling low levels - approximately 60 % of the historical norm. The industry is depleting its cushion against losses from prior years and may have to fund prior period claims with future earnings," the report's author, Adam Klauber, notes. (Canadian Underwriter Online - June 16, 2003)

Industry developments

Insurance trade groups touted a new study concluding that drivers with bad credit are costlier to insurers, even as a critic warned that such studies are flawed and could lead to premium increases for minorities and lower-income drivers. The new study, which analyzed credit scores and claims for the owners of about 2.7 million cars, shows a strong correlation between low credit scores and a higher propensity to file auto claims, the trade groups told a committee of the National Association of Insurance Commissioners in New York.

(The Wall Street Journal - June 23, 2003)

Continued rate increases in the global reinsurance market have failed to stem the downward pressure on ratings and the market outlook remains negative for the sixth successive year, Standard & Poor's Ratings Services said in a report published May 27. The negative outlook indicates that the number of insurer financial strength ratings lowered over the short to medium term is likely to outweigh those that remain the same or are raised. "Despite further price increases during the January 2003 renewal season, the market continues to suffer from a diminished quality of capital, reduced financial flexibility (defined as the ability to source capital relative to requirements), prior-year liabilities, the overhang of reinsurance recoverables, and the likelihood that many companies' operating performance will fall short of expectations," said Standard & Poor's credit analyst Stephen Searby. To compound the pressure on ratings, the hard market conditions of recent years have proved difficult for reinsurers to capitalize on. While participants need to rebuild and restructure their capital bases and put in place foundations to reduce future loss volatility, the ease of entry for new players and increased competition in the market have dampened the ability of existing players to recover.

(Dow Jones Newswires - May 29, 2003)

The Bank of Canada has launched an unprecedented review of auto insurance premiums amid concern that soaring rates have become the biggest factor behind Canada's inflation figures. Car insurance premiums have jumped across Canada in the past year, according to the latest figures from Statistics Canada, and the bank has held meetings with industry bosses in Ottawa to ask them to explain the huge rate increases. "This is the first time that we have had this kind of discussion [with the Bank of Canada] about auto insurance," said Paul Kovacs, chief economist at the Insurance Bureau of Canada, who met with central bank officials in early June. "Auto insurance has in general been a very stable area and it's unusual for the Bank of Canada to turn some attention to this. The Department of Finance has also asked questions about this and certainly a number of provincial officials have questioned what's happening in auto insurance."

(The Globe and Mail - June 5, 2003)

The Australian Senate agreed June 16 to government plans to establish a reinsurance pool eventually worth A\$10.3 billion to cover owners of commercial property against the risk of terrorism. Under the scheme, office buildings and infrastructure facilities will be covered for damage from terrorist strikes, such as explosion, biological and chemical attack, impact of aircraft, and flood and fire, but won't extend to nuclear attack.

(Dow Jones Newswires - June 16, 2003)

A major earthquake in California could cost insurers twice the \$35-40 billion of the Sep 11 attack, making natural disasters the single largest risk to sector finances, a leading industry executive said on May 29. "Natural catastrophes remain the biggest threat to the insurance industry," Werner Schaad, chief underwriting officer for Swiss Re's Property & Casualty Business Group, told a seminar in London. Recent

Industry developments - Company notes

catastrophes - such as last year's floods that left central Europe under water and the 1999 Lothar and Martin storms that battered France and northern Europe - surprised insurers by costing so much, Schaad said. The bill from the Sep 11 attack in the United States could be eclipsed by a severe earthquake in California or Japan, which could cost up to \$75 billion, and a major European storm has the potential to inflict a \$35 billion hit to the industry's already-precarious finances, Schaad said.
(Reuters - May 29, 2003)

Company notes

Munich Re said June 2 that weak capital markets continued to affect first-quarter figures. In the quarter, the company had writedowns of 880 million Euros with a net loss of 238 million Euros, lower than in the two previous quarters, the company said. In the first quarter, the Munich Re Group took advantage of the continuing positive trend in its reinsurance business to return to the profit zone: its operating result (before amortization of goodwill) rose to 123 million Euros, following 1.6 billion Euros in the preceding quarter. The situation on the capital markets led to writedowns and losses on the disposal of investments totalling 2.3 billion Euros. Dr. Hans-Jurgen Schinzler, Chairman of the Board of Management, is positive in his outlook for the rest of 2003: "We are making good progress, despite the uncertainties regarding capital market trends."
(Dow Jones Newswires - June 2, 2003)

A German court handed struggling Gerling Group a second victory in its dispute with Germany's financial services regulator over the reinsurer's effort to sell off a subsidiary. The Hessen Higher Administrative Court in Kassel dismissed an appeal by the Federal Financial Supervisory Agency, or BaFin, that had attempted to block the sale of Gerling Reinsurance Group to an investment group led by businessman Achim Kann, Gerling said. The company said the decision, which upholds a lower court ruling, would make closing of the sale possible.
(Bestwire - June 16, 2003)

Fairfax Financial Holdings Ltd. said June 6 its chairman and chief executive officer Prem Watsa is buying up about \$54.5 million worth of the company's stock because he views the shares as undervalued despite a sharp recent run-up. In a brief statement, Fairfax said Mr. Watsa-already the company's controlling shareholder-intends to buy up as many as 250,000 subordinate voting shares, noting that "he considers the current market trading price of Fairfax shares, which is below book value, to be attractive." Fairfax shares were trading at \$216.62 up \$11.62 or about 5.6 % in Toronto late morning June 6.
(The Globe and Mail - June 6, 2003)

Kingsway Financial Services Inc announced that it has agreed to issue 6,100,000 Common shares from treasury on a bought deal basis to a syndicate of underwriters led by Scotia Capital Inc. The shares will be publicly offered in Canada only at a price of \$16.70 per share. In addition, the underwriters have been granted an underwriters' option for up to an additional 610,000 shares to be issued from treasury. Kingsway will use the net proceeds of the offering for general corporate purposes. The offering was to close on or about July 3, 2003.
(Canadian Corporate News - June 17, 2003)

Acquisitions - Legal developments

Acquisitions

Bank One Corp. agreed to pay about \$500 million in cash to acquire Zurich Life, Zurich Financial Services AG's US life insurance and annuity underwriting unit. Bank One expects the transaction to close in the third quarter, pending regulatory approvals. Zurich Financial has been selling off businesses as it seeks to restructure after over-expanding during the bull-market years. The Swiss firm posted a \$3.4 billion loss for 2002 and has been sharpening its focus on insurance.
(Dow Jones Newswires - May 30, 2003)

Royal & SunAlliance USA on June 9 announced the sale of Royal Specialty Underwriting, Inc. (RSUI), its excess and surplus lines business, to Alleghany Insurance Holdings LLC, a subsidiary of Alleghany Corp., for approximately \$115 million. It was hoped that the transaction would close sometime in July, subject to appropriate government approvals. The sale is a significant step forward in the execution of Royal & SunAlliance's US restructuring plan, announced in November 2002. In addition to the up-front purchase price, the announced transaction would release approximately \$500 million of capital into Royal & SunAlliance's US operation. The operating profit of the business underwritten by RSUI for the first quarter of 2003 was around \$83 million.
(Businesswire - June 9, 2003)

Legal developments

Thousands of hemophiliacs filed a class-action lawsuit against Bayer Corp. and other companies, claiming they exposed patients to HIV and hepatitis C by selling products made with blood from sick, high-risk donors. The lawsuits, filed in federal court, allege the companies continued distributing the blood-clotting products in Asia and Latin America in 1984 and 1985, even after they stopped selling them in the United States because of the known risk of HIV and hepatitis transmission. The suit was filed June 2 on behalf of hemophiliacs who received the products, said attorney Robert Nelson.
(The New York Times - June 3, 2003)

Alaska Airlines has taken legal responsibility for a January 2000 jet crash that killed all 88 aboard, and Boeing said it would not contest liability over the plane's design. Both positions were declared in filings June 2 in US District Court in San Francisco, where wrongful death suits stemming from the crash of Flight 261 are pending. As a result, the only issue before a jury if the cases go to trial will be what damages should be paid to survivors of the victims who have yet to settle with the two companies, The Seattle Times reported. Cases brought by survivors have been settled for undisclosed sums. There are 16.5 wrongful death suits pending; the half represents some members of one victim's family.
(Associated Press - June 3, 2003)

A quirk in New York State law, a \$140 million malpractice judgment and a recent ruling by the state's highest court have hospitals and insurers saying that malpractice premiums for hospitals are about to soar, and they are petitioning the Legislature to change the law. In a suit filed on behalf of a child who suffered permanent brain damage after surgery, a Manhattan jury found New York-Presbyterian Hospital liable for \$40 million in damages over the child's expected life span. But a 1985 state law required the judge in the case to increase that verdict to \$140 million - one of the largest malpractice awards ever made by a New York court. The problem with the law is that it requires the judge to apply an annual 4 % increase in the amount of the award, even if the jury has already adjusted the annual amount for inflation. Critics say that means a double adjustment for inflation in some cases, like this one. An Appellate

Legal developments - Accidents and natural catastrophes

Division panel grudgingly upheld the increase, and in April, the State Court of Appeals, the state's highest, did so as well. In a unanimous decision judges on the Court of Appeals took the unusual step of pleading with the Legislature to consider amending the law.

(The New York Times - June 3, 2003)

The South Florida Business Journal reported that Englewood, Colorado-based real estate investment trust Archstone-Smith filed a \$30 million lawsuit in Miami-Dade County Circuit Court over mold and mildew problems at its Harbor House South building. The suit was against the building's architect and contractors. Archstone itself has been subject to two class-action lawsuits and various personal injury and property damage claims as a result of the problems. Archstone reportedly spent \$11.3 million in late 2002 for mold and water damage repairs in the 452-unit Harbor House South, and \$1.7 million more in legal costs.

(Insurance Journal - June 12, 2003)

Thousands of Texas homeowners, desperate for some kind of insurance in the fallout from the mold crisis, are either resorting to unlicensed insurers or taking a barebones policy from a state-run plan. Some 82,000 homeowners-more than double the number of a year ago-are now in last-resort markets because they have been rejected by mainstream insurers such as Farmers Insurance Group or State Farm Group. The premiums written amount to more than \$86 million. The numbers from the Texas Department of Insurance and the Surplus Lines Stamping Office of Texas, which oversees unlicensed out-of-state insurers, suggest that many homeowners are facing an availability crisis.

(The Dallas Morning News - June 9, 2003)

The Archdiocese of Louisville, Kentucky, has agreed to pay \$25.7 million in sexual abuse cases, reports published June 11 said. The settlement is the second-largest payout for the Roman Catholic Church in the United States, the Louisville Courier-Journal said. The Archdiocese of Louisville and an order of Franciscans will pay \$25.7 million to 243 plaintiffs who alleged child sexual abuse in 240 suits. Insurance will not cover the costs. (UPI - June 11, 2003)

Accidents and natural catastrophes

A 4.5-magnitude earthquake rocked western Kentucky and southern Illinois the morning of June 6, causing no serious damage or injuries, officials said. The quake was centred near Blandville, KY, about 15 miles southeast of Cairo, IL, and 25 miles southwest of Paducah, Kentucky. The western Kentucky area, between the Ohio, Tennessee and Mississippi rivers, is part of the New Madrid Seismic Zone, a series of faults beneath the crust in a weak spot known as the Reelfoot Rift.

(CNN - June 6, 2003)

Insurance companies will pay Missouri and Kansas tornado victims about \$600 million for losses suffered in May storms, officials in the two states estimated June 17. The total represents more than a fourth of a potential record \$2.2 billion in insured losses that the insurance industry calculates were caused by tornadoes and thunderstorms throughout the United States between May 2 - 11. Missouri's share of that total is expected to reach or exceed \$500 million.

(Kansas City Star - June 17, 2003)

A strong earthquake struck Taiwan June 9, triggering rock slides on mountainside highways, but no major damage or injuries were immediately reported from the quake

Accidents and natural catastrophes - Miscellaneous

and a series of aftershocks. The 6.3-magnitude tremor was centered at sea about 15 miles east of the northeastern coastal town of Ilan, the Central Weather Bureau said. Ilan is about 70 miles southeast of the capital of Taipei. The tremor lasted for more than 30 seconds and swayed buildings in the capital.
(Associated Press - June 9, 2003)

Miscellaneous

The US Congress on June 12 approved moving virtually all national class-action lawsuits from state court into federal court, a move supporters hope will curb frivolous lawsuits but opponents fear will allow big businesses to escape multimillion-dollar verdicts for misdeeds. Pushing the bill through on a 253-170 vote, majority Republicans argued that trial lawyers increasingly abuse such lawsuits to profit from multimillion-dollar settlements. Victims, on the other hand, often get virtually worthless coupons, GOP lawmakers maintain.
(The New York Times - June 12, 2003)

Federal reserve selected interest rates

Instruments	May	June
Federal funds	1.26	1.22
Commercial paper		
Non-financial		
1 month	1.21	1.06
2 month	1.20	1.03
3 month	1.19	1.01
Financial		
1 month	1.24	1.08
2 month	1.22	1.04
3 month	1.20	1.02
CDs (secondary market)		
1 month	1.26	1.10
3 month	1.22	1.04
6 month	1.19	1.02
Bank prime loan	4.25	4.22
Discount window borrowing	2.25	2.20
U.S. gov't securities		
T-bill (secondary market)		
4 week	1.06	0.96
3 month	1.07	0.92
6 month	1.08	0.92
Treasury constant maturities		
1 month	1.08	0.97
3 month	1.09	0.94
6 month	1.11	0.94
1 year	1.18	1.01
2 year	1.42	1.23
3 year	1.75	1.51
5 year	2.52	2.27
7 year	3.07	2.84
10 year	3.57	3.33
20 year	4.52	4.34
Interest rate swaps		
1 year	1.26	1.09
2 year	1.60	1.40
3 year	2.05	1.80
4 year	2.47	2.19
5 year	2.84	2.56
7 year	3.38	3.11
10 year	3.91	3.66
30 year	4.81	4.64
Treasury long-term average (25 years and above)	4.61	4.45
Corporate bonds		
Moody's seasoned		
Aaa	5.22	4.97
Baa	6.38	6.19
State and local bonds	4.41	4.33
Conventional mortgages	5.48	5.23

US economic outlook

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Modest gains point to stronger second-half growth.

The economy is gradually improving, with stable confidence and modest gains in output, particularly services. The Conference Board's index of consumer sentiment has remained between 80 and 85 for the past three months, as consumer expectations have improved. Industrial production rose in May by a modest 0.1%, with manufacturing up 0.2%. The Institute of Supply Management's (ISM) non-manufacturing index surged to above 60, indicating robust service sector expansion. Nevertheless, we are not out of the woods yet - the ISM manufacturing index remained in the doldrums and private sector employment fell again in June by 31,000. Also, the unemployment rate jumped to 6.4%, though this was due to an increase in the labor force. Low interest rates, the weak dollar, tax cuts, and an projected decline in oil prices should boost growth in the second half of the

year above 3%. Real GDP will increase by 2.2% this year and 3.5% next year.

Deflation revisited: how could we get there?

Economic Research & Consulting (ER&C) believes the risk from deflation is small but rising. Falling inflation - sometimes called disinflation - is a result of below-trend growth. ER&C estimates the trend growth of the US economy to be 3.1%. When growth falls below 3.1%, unemployment rises and inflation declines. The impact is cumulative - the longer we remain below trend growth, the further inflation falls. Since the second quarter of 2000, the economy has grown at a 1.3% annual rate, unemployment has risen from about 4% to 6.4%, and inflation has declined from over 2.5% to close to 1.5%. Growth has been below 2% for the past three quarters, increasing the risk of deflation. As Alan Blinder, former vice chair of the Federal Reserve, said recently, "we are one recession away from deflation."

US Forecast Summary

	History		Forecast →					Annual Data			
	02Q4	03Q1	03Q2	03Q3	03Q4	04Q1	04Q2	2001	2002	2003	2004
Real GDP, % Change, SAAR	1.4	1.9	1.6	3.1	3.2	3.9	3.7	0.3	2.4	2.2	3.5
% Change, Year Ago	2.9	2.1	2.2	2.0	2.4	2.9	3.5				
CPI, % Change, SAAR	2.4	3.7	-0.3	0.2	2.0	1.7	1.5	2.8	1.6	1.9	1.4
% Change, Year Ago	2.3	2.8	1.9	1.5	1.4	0.9	1.4				
Core CPI, % Change, SAAR	1.8	1.3	1.0	1.7	1.8	1.5	1.6	2.7	2.3	1.6	1.5
% Change, Year Ago	2.1	1.8	1.5	1.4	1.5	1.5	1.7				
			End of Period				End of Period				
Fed Funds Rate (Target)	1.25	1.25	1.25	1.00	1.00	1.00	1.25	1.75	1.25	1.00	2.50
3-Month Treasury Bill	1.2	1.2	1.2	1.0	1.0	1.1	1.3	1.7	1.2	1.0	2.6
10-Year Treasury Note	3.8	3.8	3.3	3.3	3.7	4.1	4.5	5.1	3.8	3.7	5.0

Forecast prepared by Swiss Re Economic Research & Consulting, New York

There are two types of deflation: transitory and insidious.

It is worth noting the distinction between temporary deflation and the much more insidious semi-permanent deflation that Japan is experiencing. We last had temporary deflation in 1954-55 after the post-Korean war recession. Year-over-year consumer price inflation was negative for 12 consecutive months. The economy gained strength, growth rose above trend, and inflation accelerated. The insidious form of deflation is more prolonged. Consumers and businesses begin to expect prices to fall, prompting them to delay purchases, perpetuating the cycle. The probability of the temporary deflation is about 15%, while the probability of the more permanent variety is only 3%. It takes a long time to change inflation expectations. In Japan, for example, it took five years.

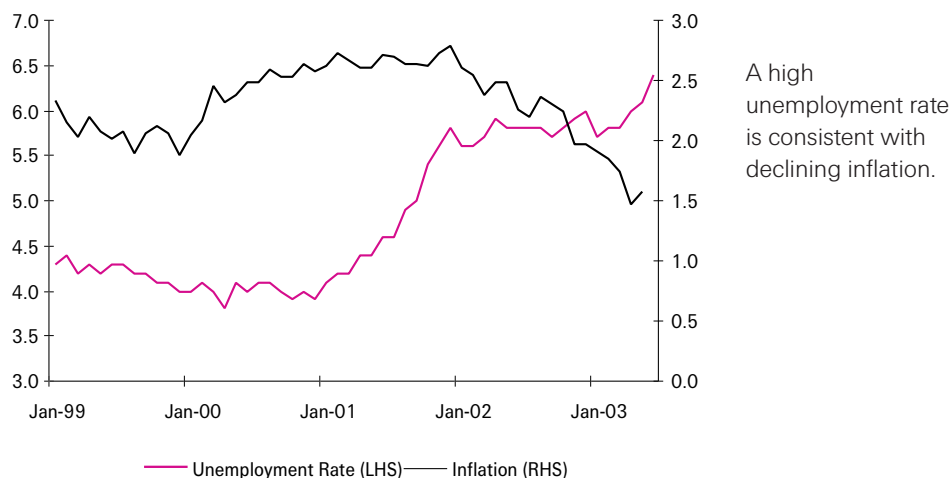
Manufacturing output was up slightly in May, but the ISM report for May was weak.

Manufacturing output increased 0.2% in May, its first gain since January. June's manufacturing ISM index was up only slightly to 49.8 vs. 49.4 in May. This level, close to 50, means that output was close to flat in June. Though the survey is designed such that a reading of 50 is meant to mean no change in manufacturing output, historically the breakeven point has been 48.4. For the quarter, the manufacturing ISM averaged 48.2, which previously has been associated with real GDP growth of 1.8%.

Confidence stagnated as new home sales set a record.

Consumer confidence was down slightly in June. The Conference Board index slipped to 83.5 from 83.8 in May, while the Michigan index declined to 89.7 from 92.1. Even as confidence has leveled off, new home sales activity exploded to a record pace of 1.16 million units in May, 10% above the previous record set in December. Existing home sales were also up in May, to a 5.92 million unit pace from 5.85 million in April.

Unemployment rate and inflation, percent



Inflation will continue to moderate.

Inflation is expected to continue moderating well into next year. Even with growth accelerating to above trend in the second half of this year and in 2003, it will take a long time for excess production and labor capacity to be absorbed. When the unemployment rate approaches 4%, unlikely to happen before 2006, labor will be in short supply. It may take equally long for production capacity to become stretched. After the last business cycle concluded, inflation continued to fall for eight years - through the end of 1999. All items CPI inflation is expected to decline to 1.5% next year from close to 2% this year, while core inflation - which excludes food and energy prices - will decline from 1.6% to 1.5%.

Deficits will increase due to Medicare legislation.

The Medicare legislation, which provides a new prescription drug entitlement, is likely to become law, adding another \$20 to \$40 billion per year to the deficit. Still, because of the current weak state of the economy, interest rates are unlikely to rise immediately. In a couple of years, after the economy has strengthened, interest rates will be pushed up by about 25 basis points for every \$100 billion in deficits, according to Fed estimates. Projected

deficits of around \$400 billion this fiscal year and next will therefore add a percentage point to the yield on the 10-year Treasury note.

The Fed is on hold for now.

As we have projected for several months, the Fed finally cut interest rates again on June 25, lowering the target federal funds rate to 1.0%. The initial market reaction was negative - stocks fell, bond yields rose. With inflation subdued, growth prospects uncertain, and the fed funds rate low, the yield on the 10-year Treasury note is expected to range mostly between 3.2% and 3.7% for a few months before rising to the 3.5% to 4.0% range by year-end. If growth accelerates at the pace currently expected, the Fed will be on hold until the middle of next year.

US Property & Casualty Quarterly

Second Quarter
 July, 2003

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The combined ratio for 1Q03 fell below 100%.

The hard market is well under way with rate increases materializing in top line growth and, finally, increased profits. The P&C industry reported improvements in their first quarter underwriting results in all main segments: personal lines, commercial lines and reinsurance. The industry combined ratio dropped to 99.5%, down from 102.2% for last year's first quarter. At 74.7%, the loss ratio was down 2.2 points from first-quarter 2002. This improvement reflects the favorable pricing environment and tightening of terms and conditions, despite A&E reserve additions in the amount of 3.3% of NPE and cat losses worth 1.5% of NPE. The first-quarter 2003 expense ratio improved by 0.6 points to 24.4%.

All business segments continue to have strong growth.

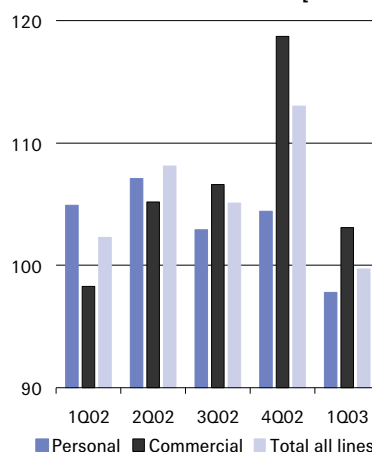
A.M. Best reported net premium growth of 12.9% compared to the first quarter of last year while NPE grew by 14.1%. All segments continue their

momentum from last year with growth in the double-digits. Year-over-year, first quarter personal lines' NPW were up by 10%, commercial lines NPW by 15% and reinsurance NPW by 14%, according to A.M. Best.

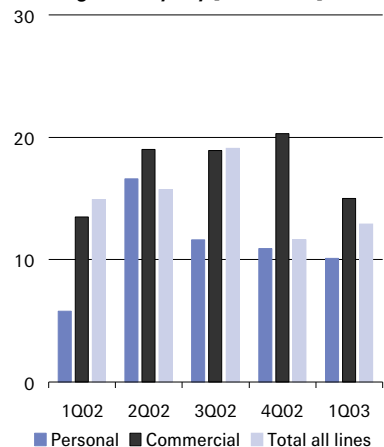
Premium rates are still rising.

Premium rates are still rising and will continue to drive top line growth. According to the latest Fox-Pitt, Kelton pricing survey, commercial property-casualty rates increased around 20% in the first half of 2003, after a 25% increase during the second half of 2002. Personal lines average rate increases were in the low single digits during the first half of the year. The market is particularly hard in workers' comp, medical malpractice, professional liability, and D&O. Rates will continue to increase, especially for the longer-tailed liability lines. Pressure to increase rates will continue to come from a tight capital base, deficient loss reserves, high loss-cost trends, and low investment income.

US insurers' combined ratio [A.M. Best]



NPW growth, y-o-y [A.M. Best]



The industry posted the best technical result in five years.

The P&C industry posted a small first quarter underwriting loss of \$1.5 billion - the best technical result in five years - plus an investment result of \$10.5 billion. Reported net income was up 30% to \$6.8 billion. The annualized ROE is 9.3%.

Investment result is stabilizing.

The decline in investment result has ceased. While current investment income stagnated compared to previous year's first quarter, realized capital gains were up and helped to push up the total investment return by 8.2% year-over-year. However, the investment result did not keep up with the strong premium growth and the ratio of investment results to NPE was down slightly to 10.8% compared to 11.2% one year earlier. The stabilization of investment results was due to solid asset growth while investment yields kept falling. Interest rates should have bottomed out. Nevertheless, average investment yields will be declining for a few more quarters, since maturing bonds have to be replaced at lower current interest rates. With inflation subdued, economic growth prospects uncertain, and the fed funds rate low, the yield on the 10-year Treasury note is expected to range mostly between 3.3% and 3.8% for a few months before rising to the 3.5% to 4.0% range by year-end and around 5.0% by the

end of 2004. With a strong cash flow to invest and interest rates on the rise, the industry's investment returns will improve for the next few years.

The surplus grew by 1.4%, fueled by operating profits.

According to ISO, the industry's first quarter surplus rose by 1.4% or \$3.9 billion to \$289.2 billion, from \$285.2 billion at year-end 2002. Additions to surplus in the first quarter were driven by \$6.4 billion in net income after taxes. Typically for a first quarter, new funds were low at only \$0.2 billion, compared to \$11.3 billion for the fourth quarter of 2002. With \$1.9 billion in dividends to shareholders, insurers continued with a low level of payouts to shareholders in order to restore their capital strength. Industry surplus suffered from \$1.8 billion in unrealized capital losses on investments, reflecting the 3.5% decline in the Wilshire 5000 index. Since stock markets were up 16.0% in the second quarter, insurers may post some capital gains for second-quarter 2003.

Shortfall of core reserves is estimated around \$35 billion.

Despite this marginal growth in surplus, there is still a decline in the average quality of P&C capital. Because of the industry's equity gearing and declining solvency margins, investors and rating agencies' disposition towards insurers has turned negative: A large fraction of

insurers got downgraded, some of them more than once. The bias is still negative, despite the tremendous improvements in underwriting conditions that the industry has experienced and the sound profit opportunities for the next few years. After being criticized for the lag in translating deteriorating market conditions into rating changes, rating agencies are now particularly watchful. Recent capital losses and adverse reserve developments have highlighted the intrinsic risks associated with the P&C business and left several players vulnerable. Fox-Pitt, Kelton estimates that the shortfall of core reserves (other than A&E) is still at 9% to 10% of reserves or approximately \$35 billion.

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Property/Casualty Industry		Quarterly data (1)					Annual data (2)			Forecast (3)	
		1Q02	2Q02	3Q02	4Q02	1Q03	2000	2001	2002	2003	2004
Loss ratio	%	76.9	82.1	79.4	85.9	74.7	81.2	88.4	81.3	77.4	76.6
Expense ratio	%	25.0	25.4	24.9	27.2	24.4	27.8	26.4	25.3	25.0	24.8
Policyholder dividend ratio	%	0.4	0.4	0.4	0.4	0.4	1.2	0.8	0.6	0.8	0.9
Combined ratio	%	102.3	107.8	104.8	113.4	99.5	110.2	115.6	107.2	103.2	102.3
Total investment result	in % of NPE	12.9	9.3	13.7	6.7	10.8	19.4	14.2	12.6	11.9	12.5
Net profit after tax in	in % of NPE	6.2	-0.5	5.2	-7.1	6.8	7.0	-2.2	3.3	6.6	8.3
Premium growth	% change y-o-y	10.3	11.9	13.3	13.9	12.2	4.4	8.9	15.3	11.0	8.0
Surplus growth	% change y-o-y	-2.8	-5.2	-3.1	-1.5	-2.0	-4.5	-8.0	-1.5	8.1	8.7

[1] Source: ISO; [2] Source: A.M. Best, 2002 data are preliminary; [3] Forecasts by Economic Research & Consulting;