



sigma 6/2023:
Global economic and insurance outlook

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Key letter

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How will 2024 look like?

1969 : 2008 : 2022

What it will not be...

Global economy is slowing down with Europe in stagflation



- **Economic growth: US-Euro area growth divergence to continue** as monetary policy tightening filters through faster in Europe. China economic activity is stabilizing, but large structural headwinds remain



- **Inflation: Inflation normalisation to continue gradually, but with upside risks from energy and food inflation.** Labour markets still too tight to be consistent with 2% inflation over medium term



- **Monetary policy and interest rates: Regime shift to higher interest rates with real rates and the term premium turning positive.** We have revised higher our bond yield assumptions, especially in the US



- **Key economic risks: Middle-East tensions underscore stagflationary risks. Financial stability risks remain** amid the uncertain and variable lags of monetary policy

	2022	2023E		2024F		2025F	
	Actual	SRI	Consensus	SRI	Consensus	SRI	Consensus
Real GDP growth, annual avg., %							
US	2.1	2.4	2.3	1.1	1.0	1.9	1.8
UK	4.5	0.5	0.4	0.2	0.4	1.2	1.3
Euro area	3.4	0.4	0.5	0.3	0.7	1.2	1.5
China	3.0	5.1	5.2	4.5	4.5	4.4	4.5
Global	2.8	2.6	2.8	2.2	2.6	2.7	3.0
Inflation, all-items CPI, annual avg., %							
US	8.0	4.2	4.2	2.7	2.7	2.4	2.3
UK	9.0	7.4	7.4	3.3	3.1	2.3	2.2
Euro area	8.4	5.6	5.6	2.7	2.7	2.1	2.1
China	2.0	0.6	0.5	1.8	1.8	2.0	2.0
Global	7.9	5.9	6.1	5.1	4.4	3.4	3.4
Policy rate, year-end, %							
US *	4.4	5.4	5.6	4.6	4.5	3.3	3.3
UK	3.5	5.3	5.3	4.5	4.6	3.0	3.5
Euro area	2.5	4.5	4.5	3.8	3.8	2.5	3.2
Yield, 10-year govt bond, year-end, %							
US	3.9	4.7	4.5	4.2	3.8	4.2	3.6
UK	3.7	4.4	4.1	4.0	3.6	4.2	3.8
Euro area	2.6	2.7	2.6	2.4	2.3	2.6	2.3

E = estimates, E = estimates, F = forecasts.

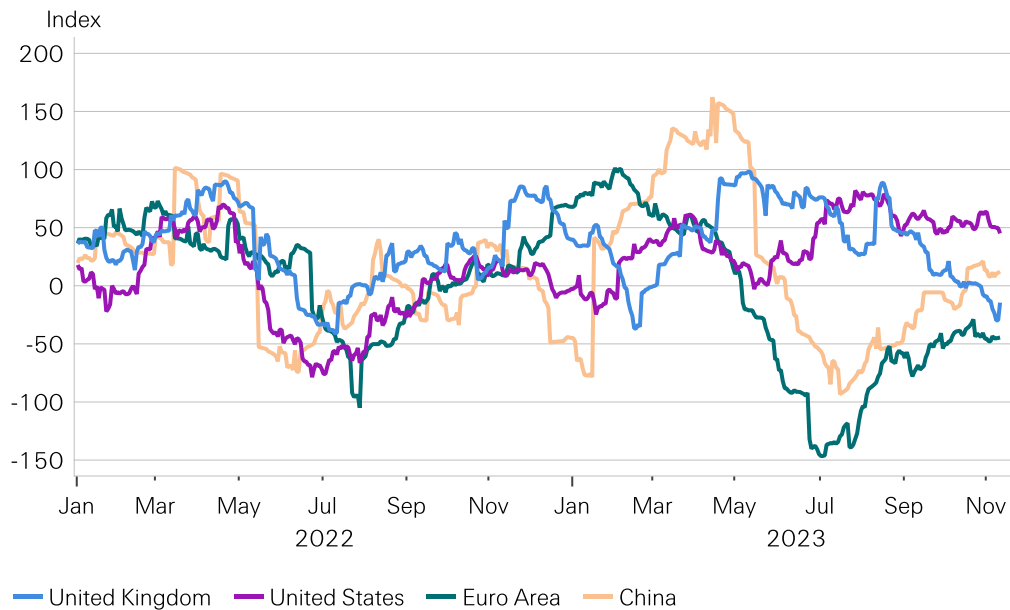
Note: Euro area policy rate refers to the interest rate on the main refinancing operations; data as of 13 November 2023. * US policy rate consensus is taken as the mid-point of the range.

Source: Bloomberg, Swiss Re Institute

Major economies are diverging with the US > Europe but likely with the slowest growth in advanced economies since the 1980s outside major recession periods

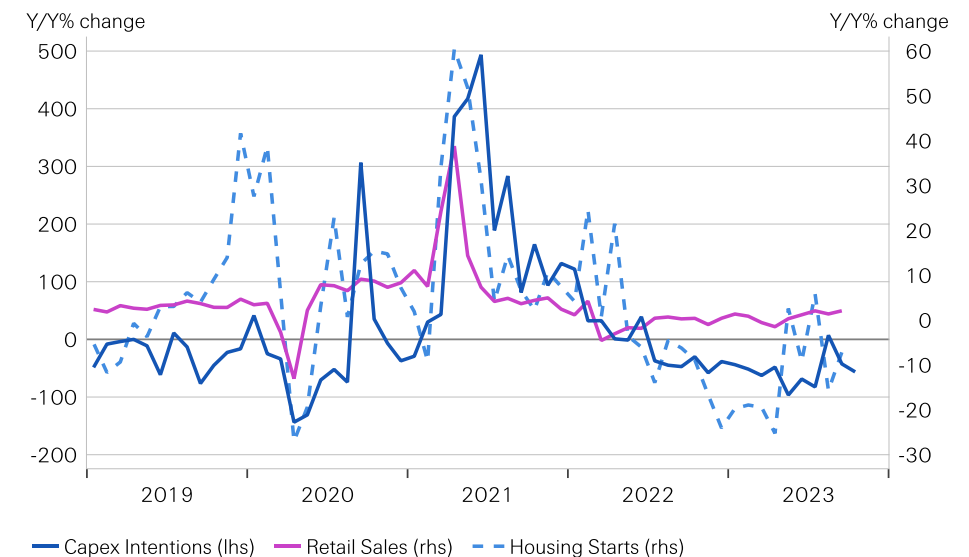
- **Economic resilience in the US** reinforces interest rates staying restrictive for longer, heightening the risk of a hard landing. In **Europe**, economic stagnation continues with Germany already in recession and the **UK** stagnating. **China's** recovery faces challenges from multiple domestic factors
- We see it a tall order for **sequential global GDP growth rates** to move higher from here next year given the **full impact of higher interest rates on the real economy is still to come**

Economic Surprise Index



Source: Citi, Macrobond, Swiss Re Institute

US data remains firm, but we expect weakness will mount

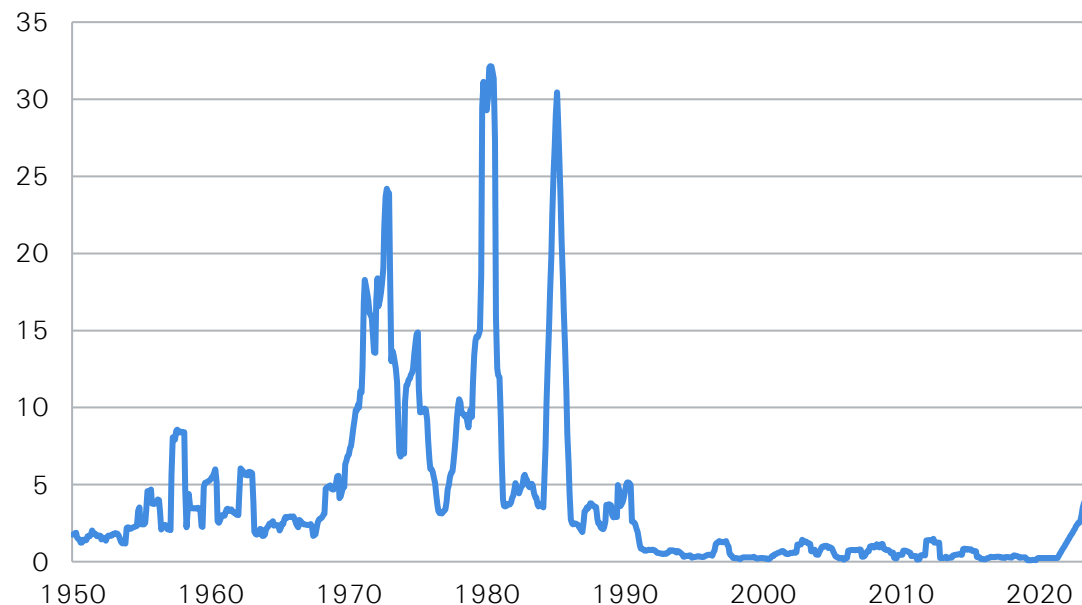


Source: U.S. Census Bureau, U.S. Bureau of Economic Analysis (BEA), Federal Reserve Bank of New York, Macrobond, Swiss Re Institute

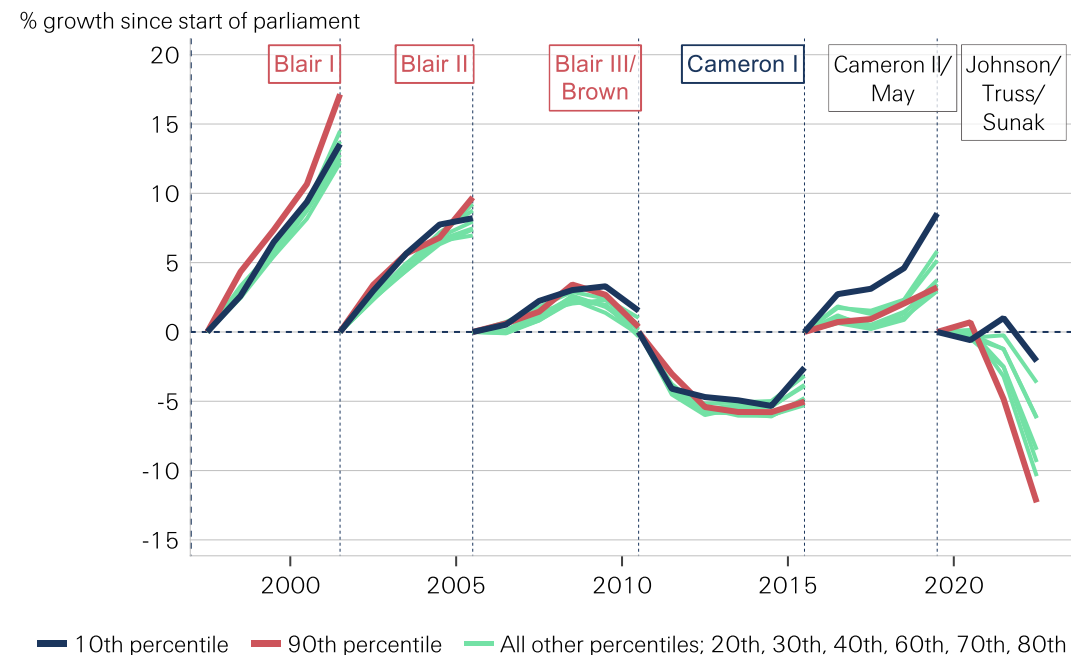
The cost-of-living crisis is not over in the UK with another “winter of discontent” adding to stagflation risks

- The **UK** – among other countries – has seen the **highest number of strikes in decades, yet the scale of industrial action is still well below the levels seen in the 1970s** stagflation episode
- **Risks for further strikes remain with the “cost of living” crisis not over** just because inflation rates are easing. First, the **overall price level** in absolute terms remains high and that is what matters for consumers. Second, **rising wages** have still not fully recouped the price surge of the past couple years and income inequalities have worsened (see Right chart). A **new wave of strikes would in turn feed into the stickiness of core services inflation**










UK working days lost to strikes
(rolling 12-month total, millions)



UK real income growth by parliament
Real income growth by income percentile



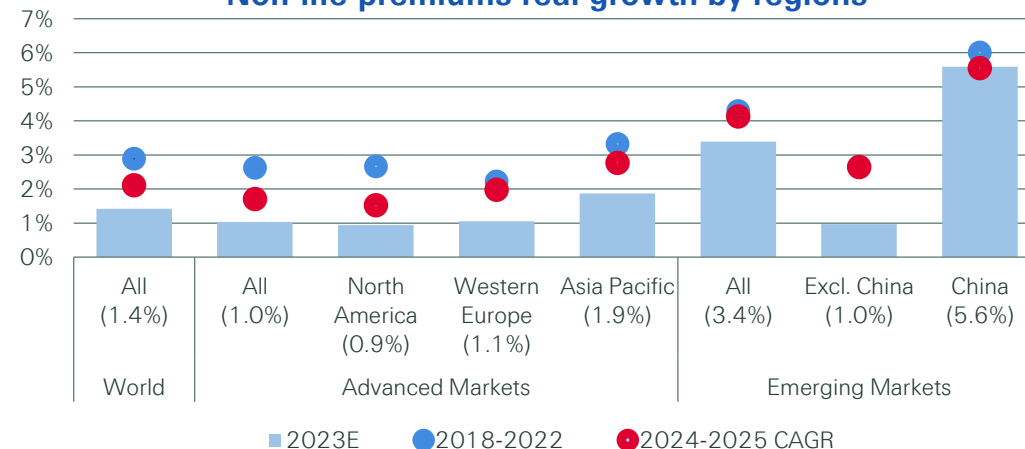
We attach a 10-20% probability for adverse global economic outcomes over the next 3 years with downside risks higher than upside potential

	Prob: 5-10%		Prob: 10-20%			
	Productivity revival		1970s-style structural stagflation		Severe global recession	
Narrative	 Tech driven productivity growth		 Commodity shocks, wage-price increases		 Significant global financial system stress	
	 Higher capital investment		 Lacklustre growth and runaway inflation		 Abrupt tightening in financial conditions	
	 Benign financial conditions		 Central banks lose credibility		 Severe economic contractions	
Top signposts	1 Higher capital investment		1 Renewed energy/supply disruptions		1 Unexpected monetary policy moves	
	2 Resilient growth, benign inflation		2 Economic reacceleration		2 Pockets of financial market stress	
	3 Manageable energy pressures		3 Unanchored inflation expectations		3 Sharp slowdown in demand	
Key US forecasts	2024	2025	2024	2025	2024	2025
Real GDP growth	3.2%	2.7%	-1.4%	0.1%	-2.5%	0.5%
Inflation	2.8%	2.6%	10.0%	7%	1.5%	1%
10y yields	5.0%	4.6%	6.2%	5%	1.2%	1.8%
USD IG spreads	90bps	110bps	230bps	190bps	280 bps	210bps

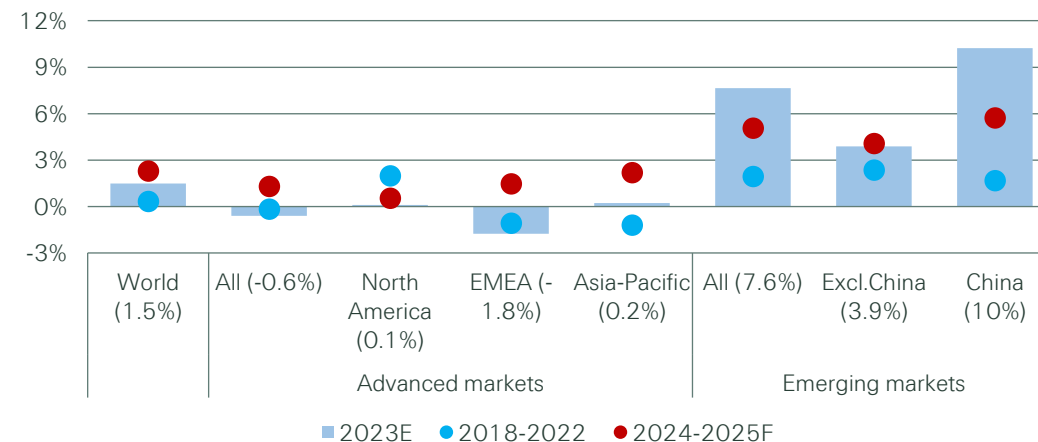
For the global primary insurance markets further hardening is expected for Non-Life, while high interest rates continue to support Life savings business

- Premiums growth:** The global real premiums over 2024-25 to grow by 2.2% after a moderate recovery of 1.5% in 2023, higher than the avg. of the past five years (2018–2022: 1.6%), but still lower than the pre-covid trend (2018-19: 2.8%). EMs are the main contributor for growth
- Pricing:** The shift of inflation into wages and healthcare costs this year is reflected in increased casualty claims. Despite the economic disinflation, rising frequency and severity of claims continue to fuel rate hardening in non-life business, especially for personal lines
- Profitability:** The P&C industry still doesn't earn its costs of capital even though its ROE will rise to ~10% in 2024-25*. Looking forward, the higher interest rates regime is supportive for the global savings life insurance premiums earned by almost doubling USD 4trn in 10Y
- Risk outlook:** In-force savings business are vulnerable to mass lapse risks while disinflation pace will not be even, especially keeping costs for personal lines elevated

Non-life premiums real growth by regions



Life premiums real growth by regions

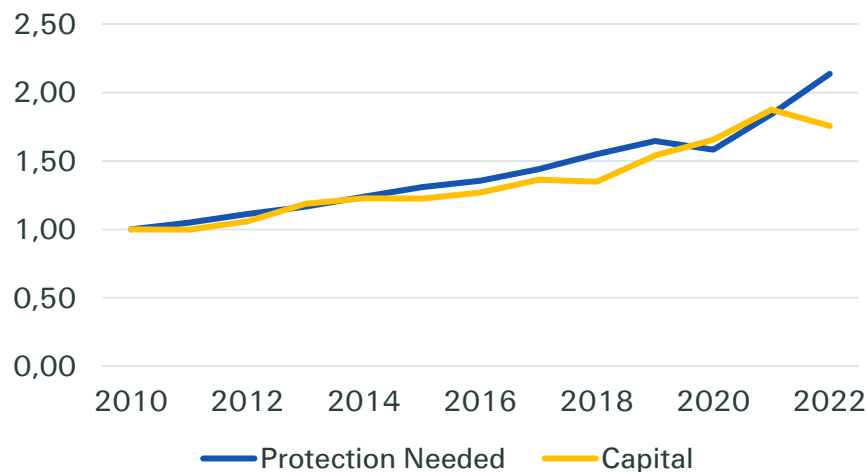


*UW profitability gap is estimated at 2% in 2024-25, down from 4% this year. 10Y average RoE for direct market P&C is 6.8%

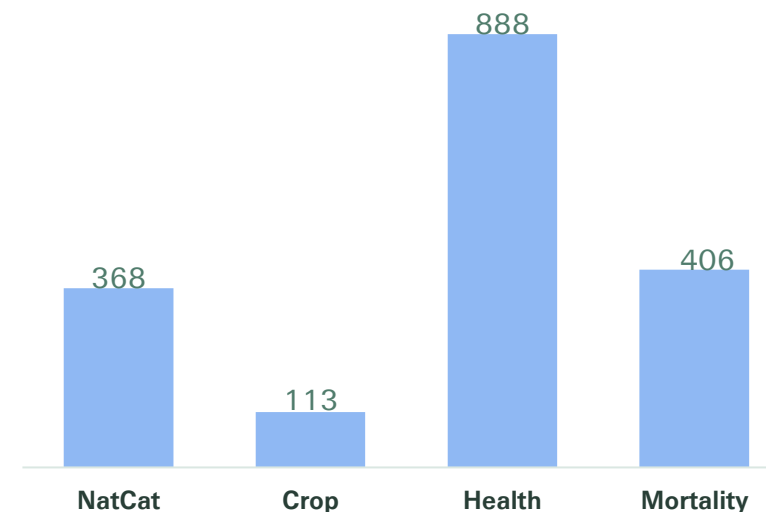
Finally, (nominal) financial repression has ended! Insurers' role in narrowing protection gaps is strengthened

- **100bps additional investment yield is roughly equivalent to 250bps improvement in the combined ratio** for the avg. non-life business. **In the US, the 250bps rise in reinvestment yields*** in 2023 is translated to roughly **625bps of combined ratio (CR)** which indicates **the US P&C industry can cover additional ~USD50bn claims**
- After the decline in asset markets in 2022, **a gap has opened between US industry capital and nominal nat cat protection needed**
- **To narrow the global nat cat protection gap, P&C industry capital needs to outgrow nat cat exposures**, which accumulate at a long-term pace of **5-7% per year in real terms**

US: nominal nat cat protection needed and P&C industry capital index, 2010 = 100



Global protection gaps, USD 1.8 Trillion in 2023



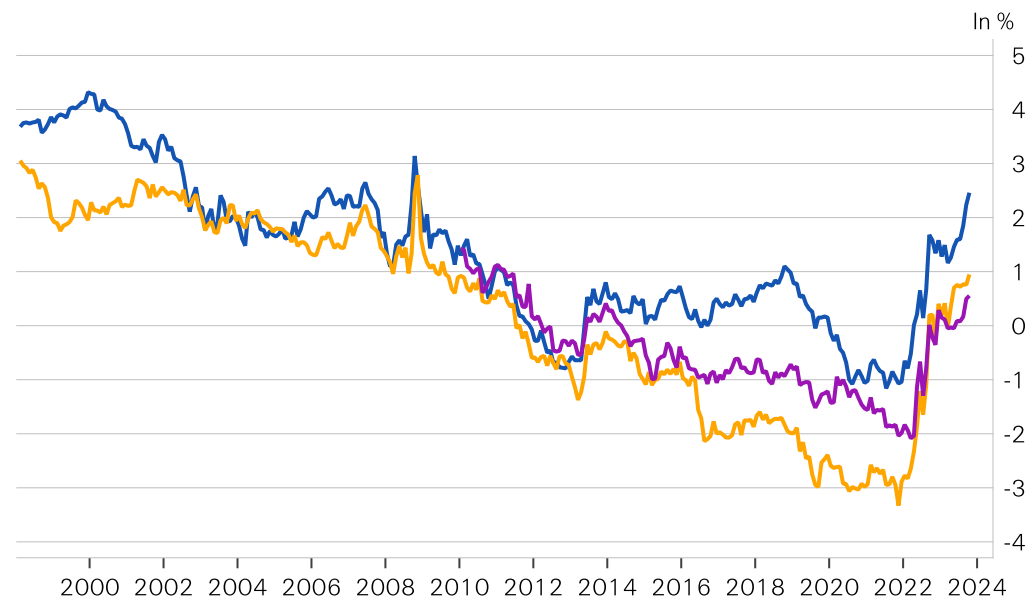
Figures are shown in annual premium equivalent terms.
Source: *sigma 2/2023*: Restoring resilience: the need to reload shock-absorbing capacity

Theme 1: The economic pain of higher interest rates still to come

Regime shift in bond markets is for real with the economic pain yet to come and the US exporting its strong USD and high interest rates mix

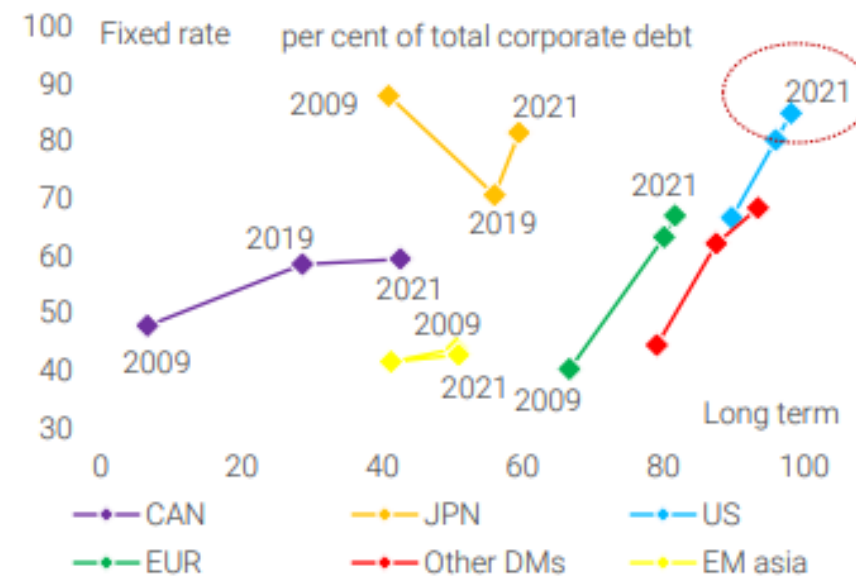
- **Longer-dated real sovereign bond yields have now adjusted to what we see as being “fair value”.** Given structurally higher and more volatile inflation, nominal and real interest rates will remain higher for longer with the **term premium possibly adjusting further** to compensate investors of the **increased fiscal and debt risks** in both the US and Europe
- **Higher interest rates are affecting different economies with variables lags.** The **pass-through is slower particularly in the US** due to **greater fixed rate and longer duration mortgage and corporate debt.** The **corporate funding mix** is also more reliant on **capital markets than banks**

10-year real yields, in %



Germany UK US

Corporate bond market term structure

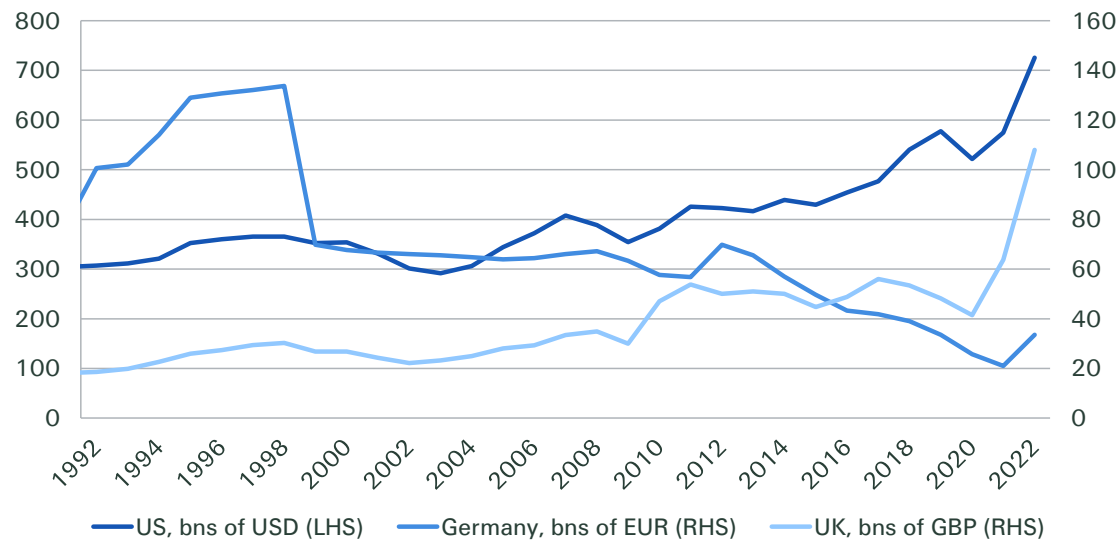


Source: BIS, TS Lombard

Theme 2: Fiscal risks have yet to be discounted with politicisation of central banks likely meaning higher tolerance for inflation misses

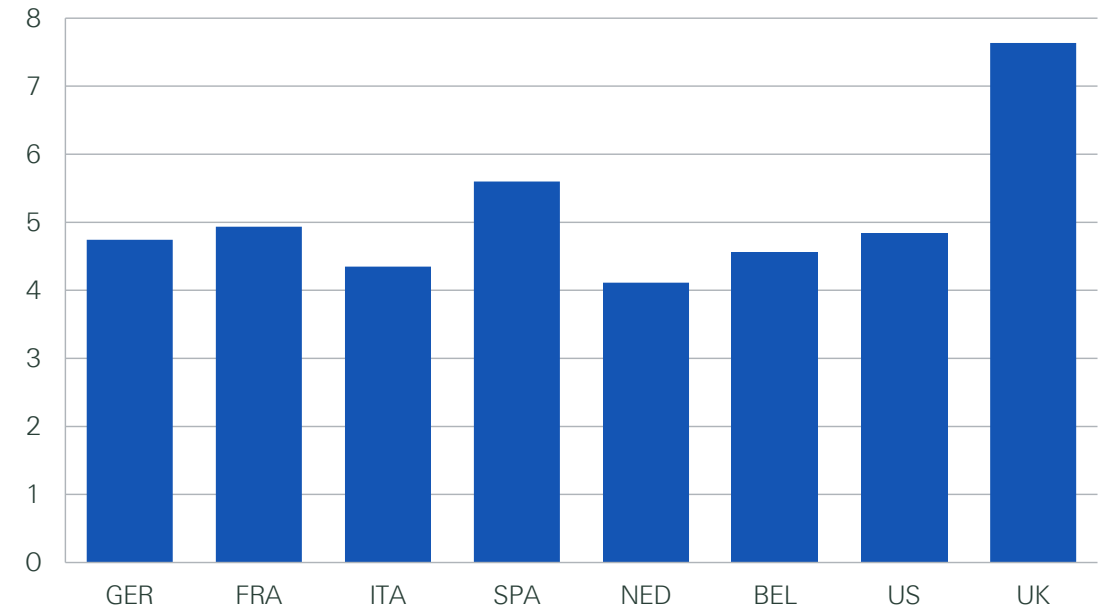
- The **US national debt** is now **122% of gross domestic product** and on an **unsustainable trajectory**. A structurally higher interest rate regime means the **US government will have to spend more on interest payments than other budget categories**, potentially crowding out investment for other priorities
- Central banks **do not face the same liquidity constraints** as private financial institutions, but **substantial losses on asset holdings** do 1) reduce a source of government revenue, potentially **widening budget deficits** and 2) raise vulnerability to **political scrutiny** that threatens **long-term independence**

Public debt service costs have risen sharply



Source: PUSF, Federal Reserve, Ministry of Finance

Unrealized losses on asset holdings, % of GDP



Source: IMF, Federal Reserve, Financial Times, TS Lombard

Theme 3: Rise in industrial policy is here to stay with insurance helping to de-risk the multi-polar global economy

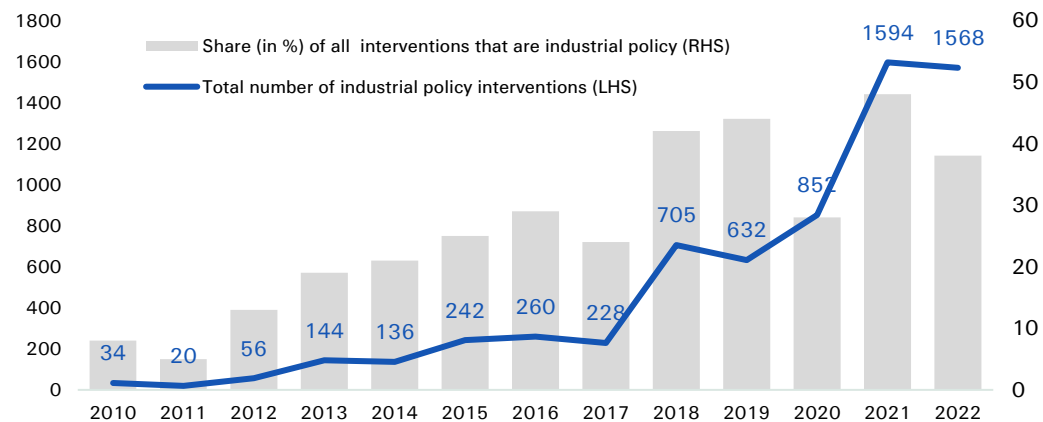
Governments are committing to more industrial policies,...

- **Macro benefits:** new investments in infrastructure and tech. **Positive public externalities** (supply chain resilience; green transition)
- **Drawbacks:** Implementation risks with governments constrained by debt levels and election cycles. **Risks triggering a global subsidy race and escalating protectionism**

... in turn generating higher demand for commercial insurance coverage

- **Property, engineering, and liability insurance to profit** as increased cover losses/damages in the construction phase. **Marine and trade credit** can benefit from reshaped trade flows. **Surety business** more relevant to public investment
- **As long-term investors,** insurance companies can also support **infrastructure financing**

Number of industrial policy interventions, global count



Source: R. Juhász, N. Lane and D. Rodrik, "The New Economics of Industrial Policy", NBER Working Paper 31538, 2023. This paper used natural language processing to classify industrial policies at a "country-industry-year" level using a publicly available policy inventory (the Global Trade Alert database or GTA; Evenet 2009). The number of total interventions is counted without being weighted by the size or impact of the policies.

Impact of rising industrial policy on premium outlook for major commercial insurance lines

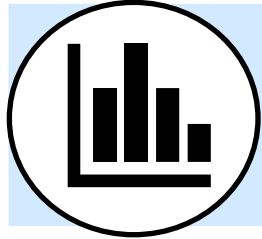
Key drivers in industrial policy strategies	Implications for risk pool	Risk pools					
		Engineering	Property	Liability/PA*	Marine**	Trade credit	Others***
Infrastructure investment	Construction and maintenance-related risks, including business interruption, contingent business interruption, non-damage business interruption coverage	High impact	High impact	Medium impact	Medium impact	Low/no impact	Low/no impact
Reconfiguration of supply chains	Supply-chain risks, protectionism, political risks, re/friend-shoring, parallel supply chains	Low/no impact	Low/no impact	Low/no impact	High impact	High impact	Medium impact
Economic development	Income elasticities for all lines	High impact	High impact	High impact	High impact	High impact	High impact

High impact
Medium impact
Low/no impact

*Liability/PA includes single project professional indemnity, product liability and employer liability/personal accident, the latter can be purchased in lieu of employer's liability, and vice versa.
 ** Marine includes construction-related marine coverage, such as project cargo and cover for delayed start-up.
 *** Others include surety insurance more relevant to public investment, and cyber insurance etc.

Source: Swiss Re Institute

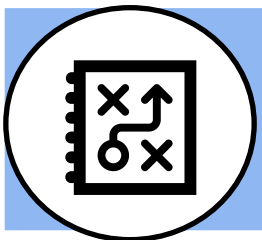
Key takeaways



Global economic activity to slow considerably next year, as the lagged impact of higher interest rates filters through. We see inflation and interest rates moderating in 2024-25, but flag upside risks to both



Economic growth slowdown and geopolitical reinforce the insurance industry's essential role in risk transfer. Profitability is recovering, but the industry is unlikely to earn its cost of capital over 2024-25 in most markets

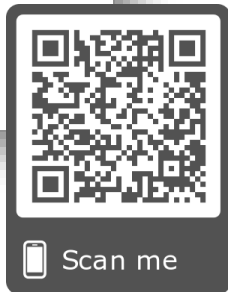


Uncertainty around the economic outlook is high as recession and inflation risks remain elevated. Carefully monitoring of two distinct tail risk scenarios is key: a 1970s-style stagflation scenario and a severe global recession

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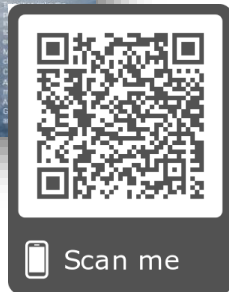
- Market information for managers and specialist in the (re)insurance industry



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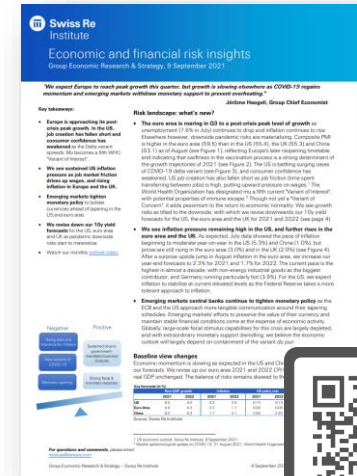
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Middle East conflict: a direct war escalation could be a route to a 1970s style stagflation

	Confined War: Israel - Hamas	Proxy War: Israel – Hamas, Lebanon, Syria	Direct War: Israel – Hamas, Lebanon, Syria, Iran
Narrative	<ul style="list-style-type: none"> Long-lasting localised conflict, concentrated in Gaza and Israel Existential threat to Hamas and potential Israeli occupation of Gaza strip Interactions with rest of Middle East stays confined to rhetoric 	<ul style="list-style-type: none"> Expanded two fronts war, ie Hamas, Lebanon Hezbollah and Syrian militants More significant output losses for Israeli economy due to labor force mobilization Greater urgency to dismantle Hamas and other militant groups including Hezbollah 	<ul style="list-style-type: none"> Iran enters directly into war, reshuffling power relations in the area Long-term conflict involving several actors from Middle East but also some Western intervention Supply bottlenecks in global trade, oil shipments via Strait of Hormuz disrupted
Top 3 signposts	<ol style="list-style-type: none"> Ground invasion of Gaza strip Opening of Rafah crossing to Egypt Minimal military aid sent to Israel 	<ul style="list-style-type: none"> Escalating military conflicts to the north of Israel and Lebanon, minor US military engagement Increased volatility in oil prices, but no material oil suppliers disrupted Broader international responses to the conflict (e.g., some sanctions, arms provisions) 	<ul style="list-style-type: none"> Iran directly attacks Israel, significant interventions from the US and EU economies Significant sanctions on Iran and disruption of tanker traffic through Hormuz strait Oil prices rise more sharply as Iranian oil supply is cut (both price and supply shock)
Key forecasts impact	<ul style="list-style-type: none"> Real GDP growth → Confined to Israel, with limited spillovers to broader region Inflation → Slight increase in oil price volatility but muted inflation impact Policy rate → No policy implications 10-year yield → Initial flight to safety, but since quickly reversed 	<ul style="list-style-type: none"> Broader economic losses but primarily confined to exposed countries Sentiment-driven fears on oil supply dislocations add to oil price volatility and threaten to slow global disinflation process Central banks delay interest rate cuts further into 2024, potentially 2025 Greater inflation expectations may raise bond yields on a temporary basis 	<ul style="list-style-type: none"> Global downturn due to energy price surge and shocks, 1970's stagflation redux Oil prices surge toward 150 USD/barrel on a sustained basis and reignite headline and core inflation in Advanced Markets Central banks will react with raising rates if inflation expectations deanchor due to persistently higher energy prices Repricing of inflation expectations and increase in US defence spending would raise issuance and raise yields

Downside risks to the outlook remain elevated

Risk scenario	Impact	Trend
 Inflation risks. Headline inflation is falling, but we expect inflation to remain elevated through 2024 before a return to target in H1 2025. However, continued moderation in headline and core measures is necessary to keep inflation expectations down.	●	=
 Political risks and social unrest. After a somewhat troubled start to the year, the political landscape in LatAm seems to be stabilizing, except in Peru. But political risks will remain elevated in the region. Successive shocks (e.g., pandemic in 2020, high inflation in 2022, economic slowdown in 2024) increase the potential for social unrest and political divisions.	●	=
 Global liquidity issues. As the monetary tightening cycle is close to an end, simultaneous quantitative tightening in the US and Europe could remove liquidity too abruptly, leading to significant financial market turbulence. This could result in a disorderly tightening in financial conditions and limit regional central banks interest rates cuts.	●	=
 Debt sustainability. The pandemic has prompted higher debt levels in both advanced and emerging economies, and most countries need to pursue fiscal consolidation. Higher sovereign credit risk could lead to downgrades, waves of capital outflows and exchange rates depreciation.	●	=
 Stronger global growth. A more pro-growth stance by China's government could lead to stronger real economy growth, which could also benefit the global economic outlook. Productivity gains from technological innovation, e.g., AI, fiscal incentives like the US Inflation Reduction Act or the EU Green Deal, could boost longer-term global growth.	●	↗
 Commodity prices. Pressures on commodities prices have eased as demand slows down and supply normalises. However, limited increases in supply means prices will remain elevated in level terms.	●	=
 Geopolitical risks. Global geopolitical risk is elevated as the US approaches its 2024 presidential elections. The new war in the Middle East raises non-linear political and economic risks, while the war in Ukraine persists into year three. Trade restrictions and continuing global fragmentation is here to stay. US-China tensions are also key to monitor and their ties with Latin America.	●	=

Note: Green color: positive impact on growth; red: negative impact on growth



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