



Swiss Re

# Turbulent times – navigating a challenging environment

Global insurance review 2012 and outlook 2013-14  
Swiss Re, London, 11 December 2012

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## Agenda

- Macroeconomic environment
- Key risks to the outlook
- Life market in advanced economies
- Non-life market in advanced economies
- Emerging markets
- Conclusions

# Macroeconomic environment

Dr. Kurt Karl

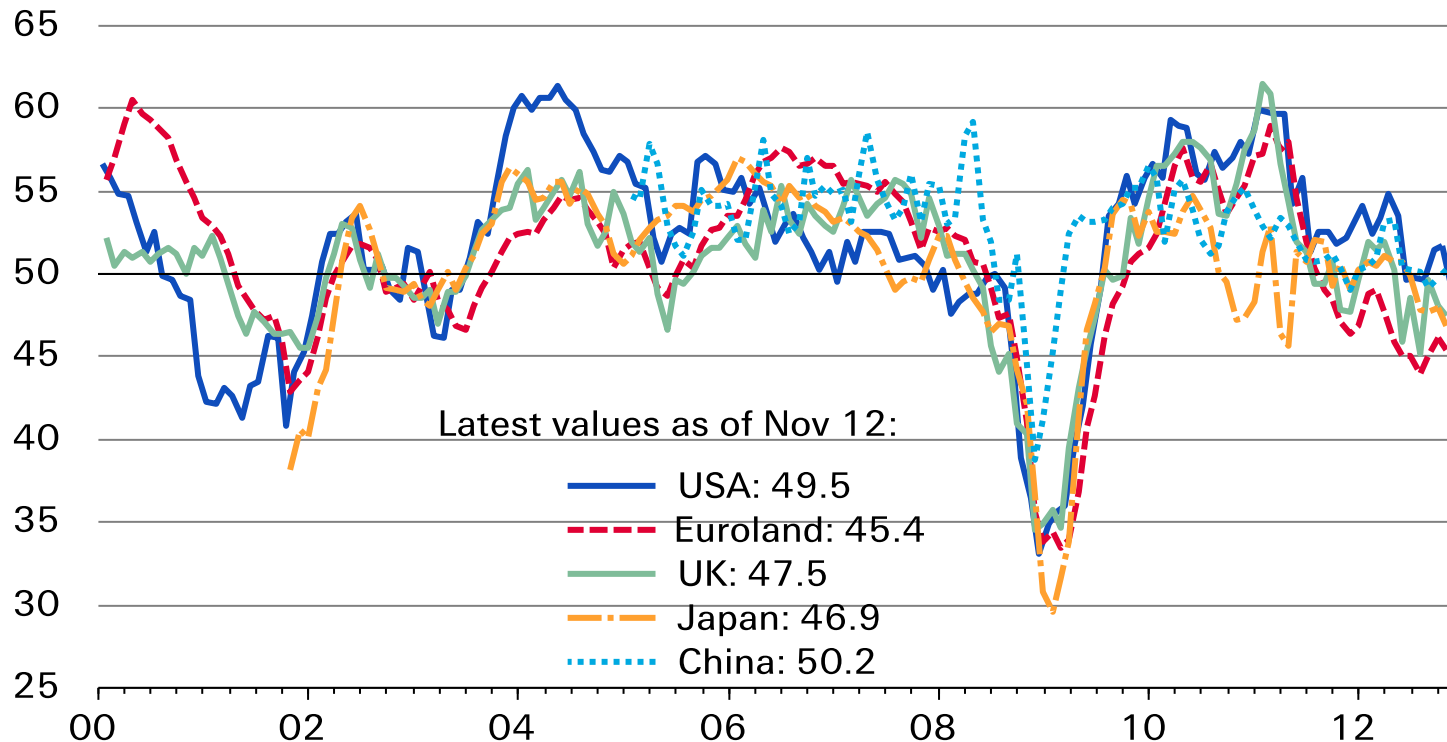


# Global Outlook: Economic and financial outlook

- A modest US expansion is expected to continue through 2013 and into 2014, driven by consumer spending, business investment and an improvement in residential construction.
- Europe is in a mild recession which is expected to end soon. Growth is hampered by fiscal austerity and tight credit conditions in the peripheral economies.
- Emerging market economies have ample room to cushion the slowdown in growth by loosening monetary policy as long as inflation remains contained.
- The top two key risks that could derail global growth are: 1) a policy error in the Euro area or 2) a policy error in the US on the "fiscal cliff." Other risks include an oil price shock and a hard landing in China.
- Inflation risks are well contained for now, but the long-term outlook is more uncertain.
- Weak growth, high unemployment and low inflationary pressures will allow the major central banks to have loose monetary policies into 2015.
- Yields on long-term government bonds will remain low, but are likely to increase slightly as growth momentum picks up in 2013.
- Key steps have been taken to tackle the Euro area debt crisis. Nevertheless, financial markets are likely to remain volatile since implementation risks around the on-going reform processes remain high.

# PMIs have stabilised recently, but remain fairly weak, with China barely expanding

Purchasing Managers Indices, monthly data



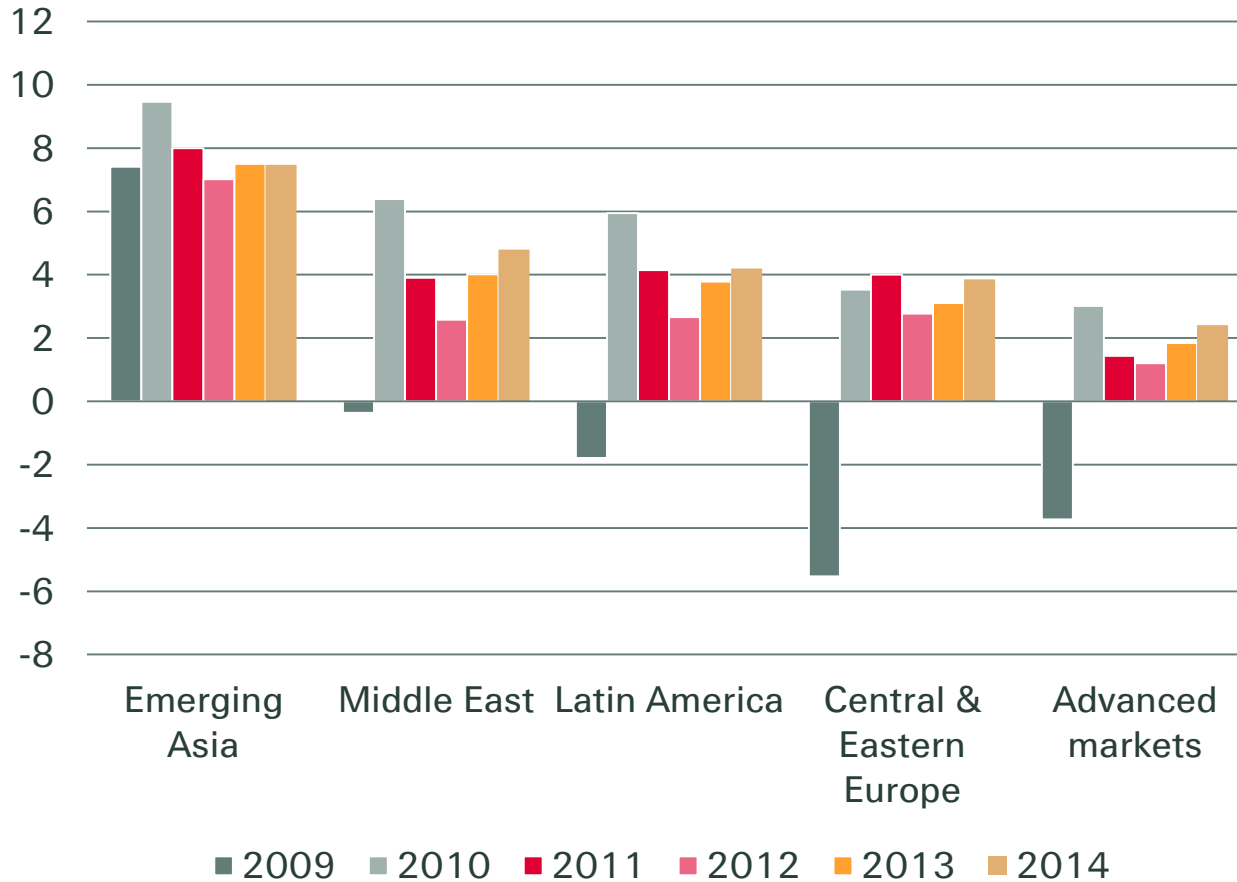
PMIs are survey based indicators. Values above 50 indicate economic expansion, values below 50 contraction

Sources: Datastream, Bloomberg



# Real growth in GDP is expected to improve into 2014

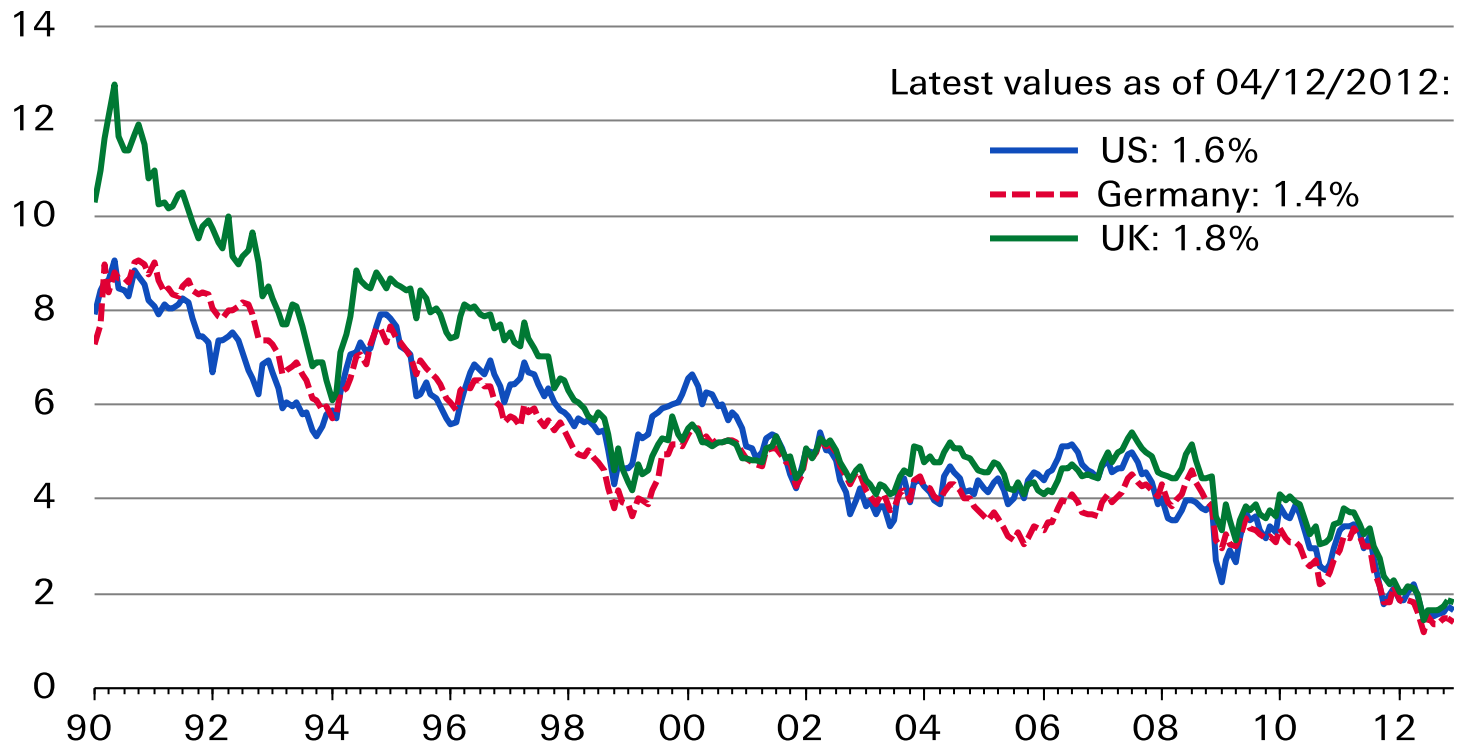
Real GDP growth, %



Source: Swiss Re Economic Research & Consulting

# Yields in safe haven countries have dropped to extreme lows due to increased risk aversion and loose monetary policy

10yr government bond yields, monthly data

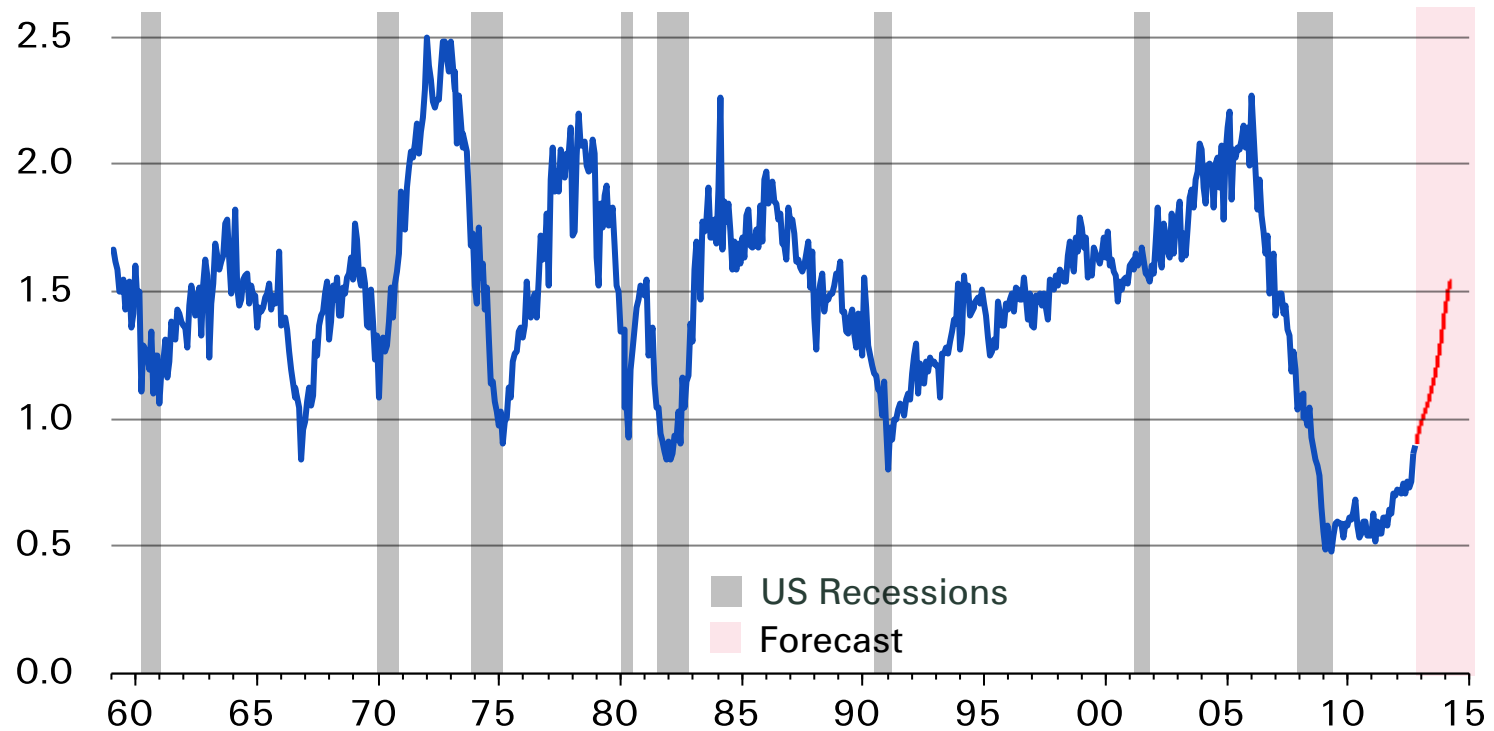


Source: Datastream



# Housing set to take off in the US

House starts in the US, millions



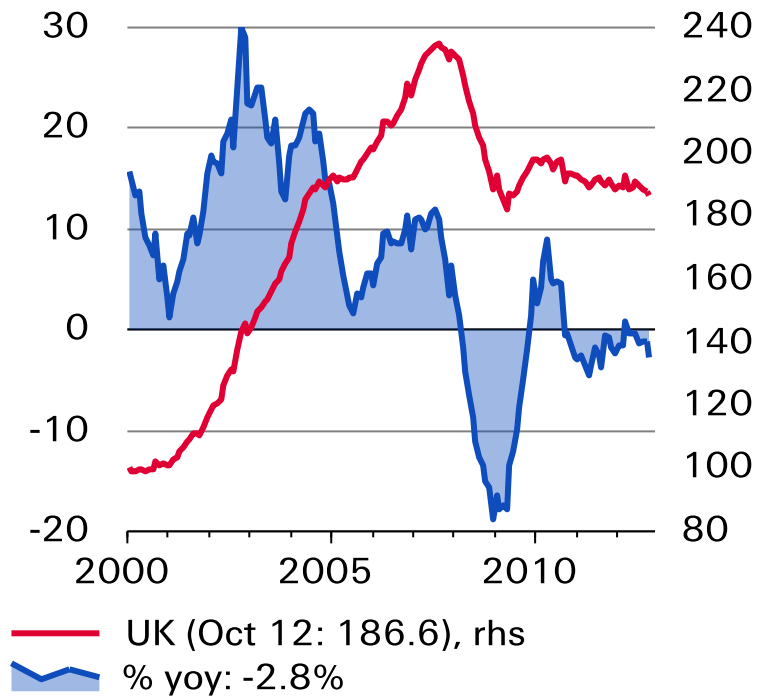
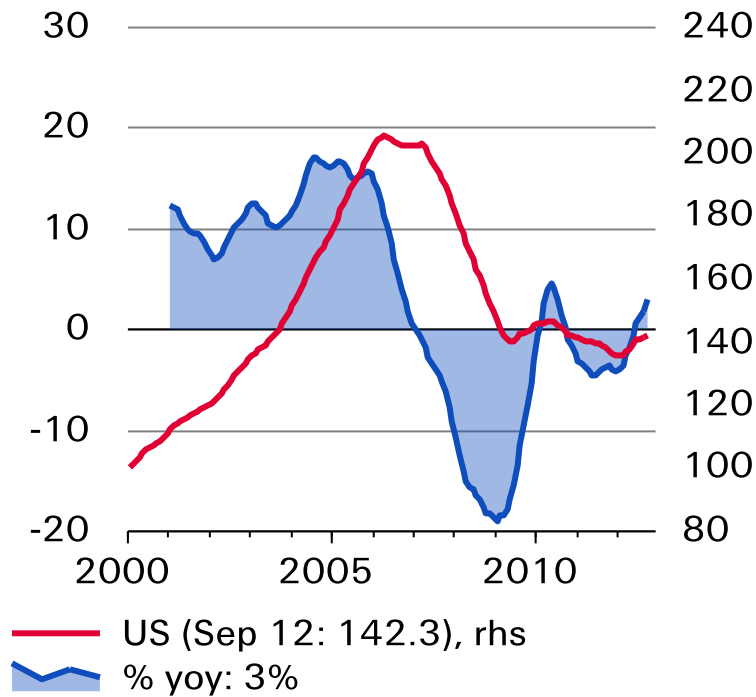
Sources: Datastream, Swiss Re Economic Research and Consulting, NBER





# US housing prices have increased recently whereas UK prices have been roughly flat

House prices, index (right axis) and %-change yoy (left axis), monthly data



For the US the seasonally adjusted S&P/Case-Shiller 20-city composite index is shown. For the UK we show the Halifax all houses price index.

Source: Datastream

# Key risks to the outlook



## Recent key achievements in the Euro area crisis resolution process

- **European level** – Building the institutions for a stable monetary union
  - ESM in co-ordination with ECB's "Outright Monetary Transactions" programme (OMT) has good chance to become an effective "Lender of last resort" for solvent, but illiquid governments
  - Banking union: an important and necessary step -> But implementation will be difficult since it involves a significant transfer of sovereignty and fiscal resources to the supra-national level.
- **National level** – More focus on growth and less on immediate fiscal austerity
  - Bank recapitalization in Spain is on-going -> But will it be enough?
  - Immediate Grexit avoided (once again) -> But an agreement over Greece's debt sustainability and how to fund the country until 2016 remain elusive...
  - ESM/OMT conditionality should provide the right incentives to continue with reforms -> But will the ECB really stop intervening if a country does not comply?

 **Slow progress on all fronts. Risks mostly political.**




## Three scenarios for the Euro area: Our assessment remains broadly unchanged



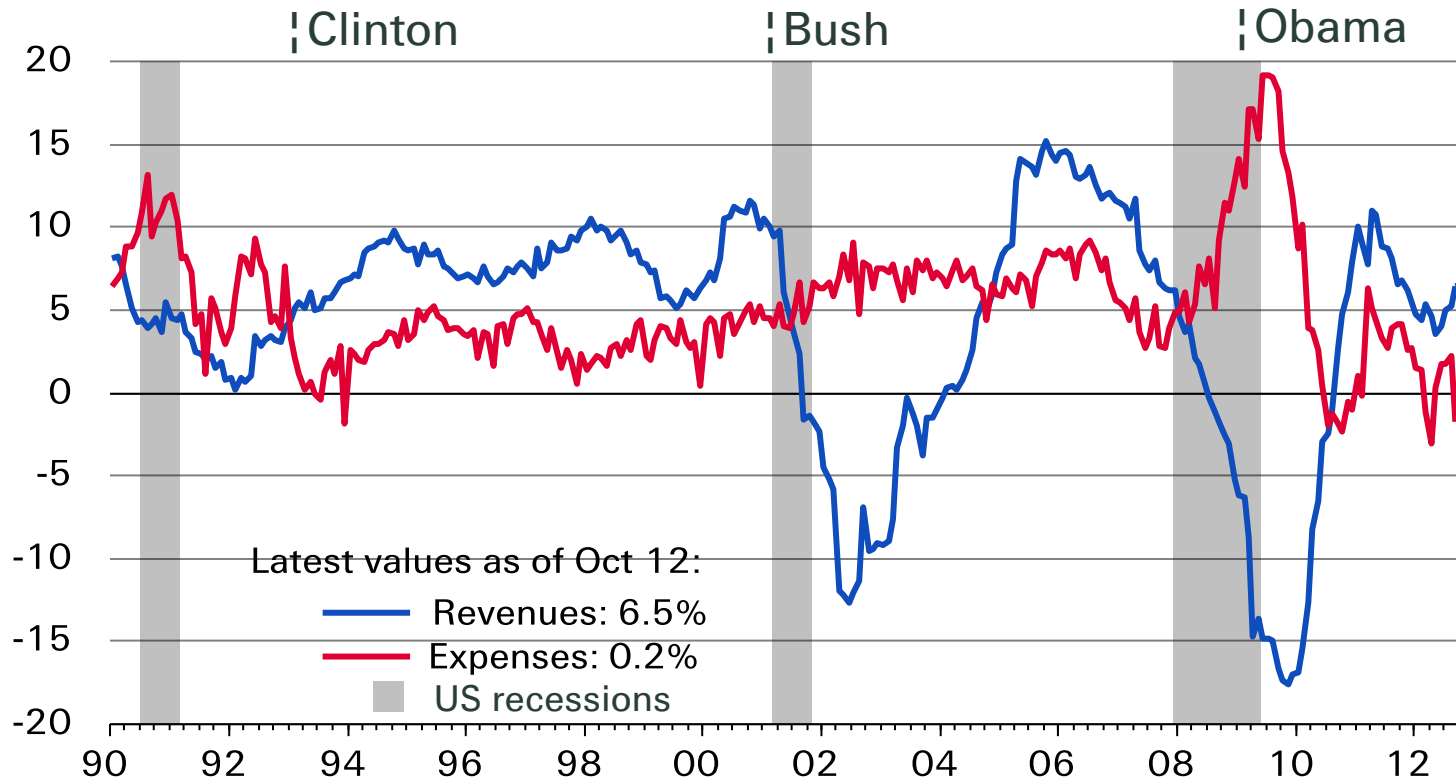


## Risk of "fiscal cliff"

- In the US, a number of federal government tax increases and spending cuts are scheduled to begin in January 2013
    - these amount to a "fiscal cliff" of about USD 600 to 750 bn (4 – 5% of GDP)
    - if allowed to happen, the cliff would cause a recession
  - Uncertainty around fiscal prospects has probably reduced business investment and hiring
  - Our baseline outlook assumes about USD 150 bn of deficit reduction measures
    - this would keep growth moderate while lowering the deficit by USD 300 bn, or 2% of GDP in Fiscal Year 2013 (it fell USD 200 bn in FY 2011)
  - Hopefully, Congress will come up with a reasonable budget which puts the US deficit on a trajectory towards being balanced
-  **It's Congress so there are no guarantees!**

# Growth rates of federal government revenue and spending: Solving the deficit problem is very feasible. Balanced by 2019?

12-month moving average, % change y-o-y



When revenues are growing faster than spending, the deficit is generally declining and vice versa.

Sources: Datastream, Swiss Re Economic Research and Consulting; NBER

# Life & Health market in advanced economies





## L&H primary market: Navigating choppy waters

- Premiums stagnated in 2012 in advanced economies and also in two key emerging markets – India and China – due to regulatory changes
- Capacity increased under GAAP accounting, but is down from economic/risk-based viewpoint
- Interest rates are a significant challenge
- Regional results 2012
  - UK – mortgage-linked life sales were down, but group life sales were up (employment growth and improved benefits)
  - US – protection sales stabilised after three years of declines, annuity sales contracted
  - The potential is large for risk products – the protection gap is huge worldwide
- Outlook in 2013-14
  - An improvement in the macro environment is needed
  - Premium growth will be moderately positive
  - Profitability will be low until interest rates rise
  - Regulatory changes are a threat to capitalization and profits

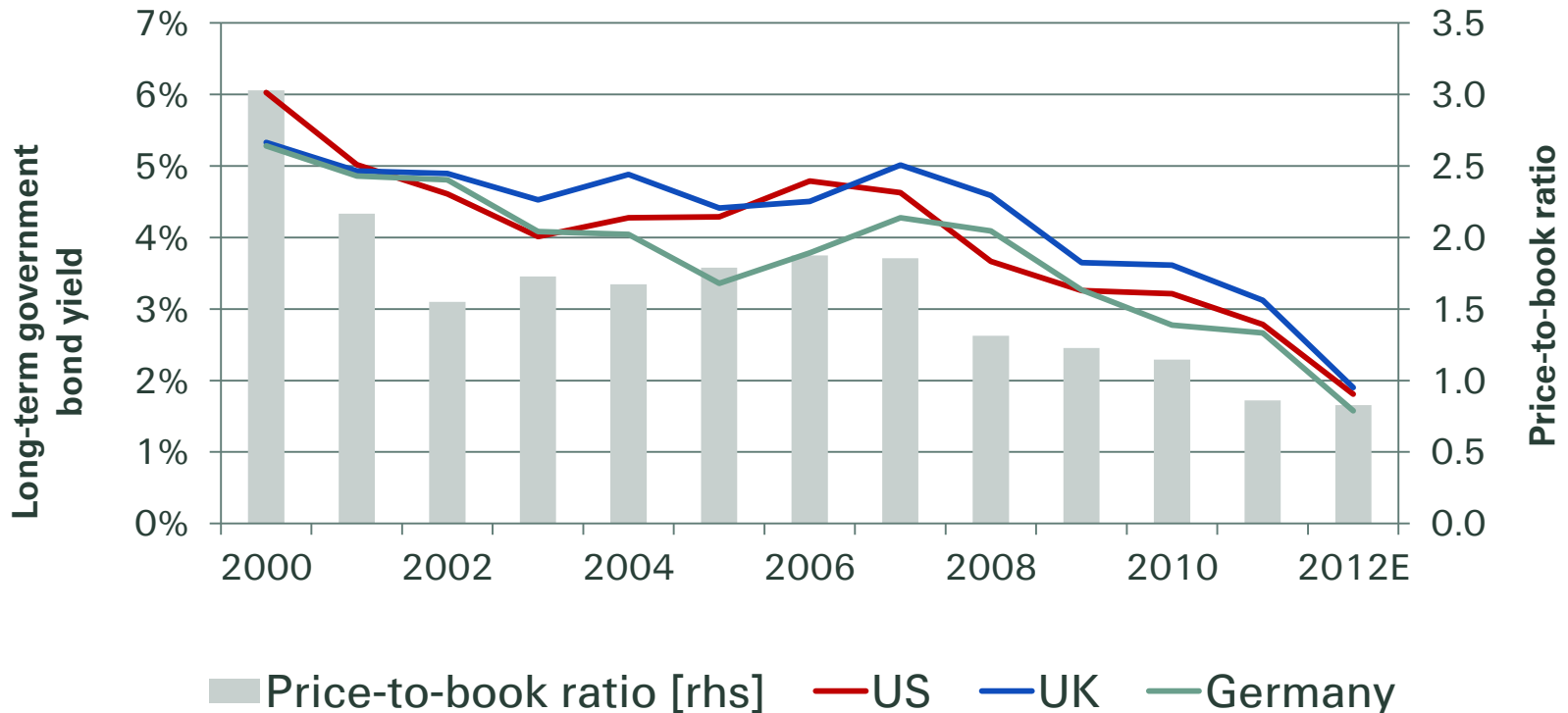


## L&H reinsurance market: Being a large player helps

- Reinsurance continues to contract in US and UK as regulatory motive recedes
- Less affected by the low interest rates because of low exposure to savings products
- Mortality and morbidity products are growing very slowly and shrank last year in advanced economies, but grew in emerging markets
- Top reinsurers grew premiums by 10% through consolidation and large transactions
- Outlook in 2013-14
  - Several more years of declines in cession rates in US and UK expected
  - Block deals and capital relief solutions will continue to be in strong demand
  - The market for longevity risk transfer will continue to have strong momentum

# Negative impact of low interest rates is reflected in declining valuations for insurance companies

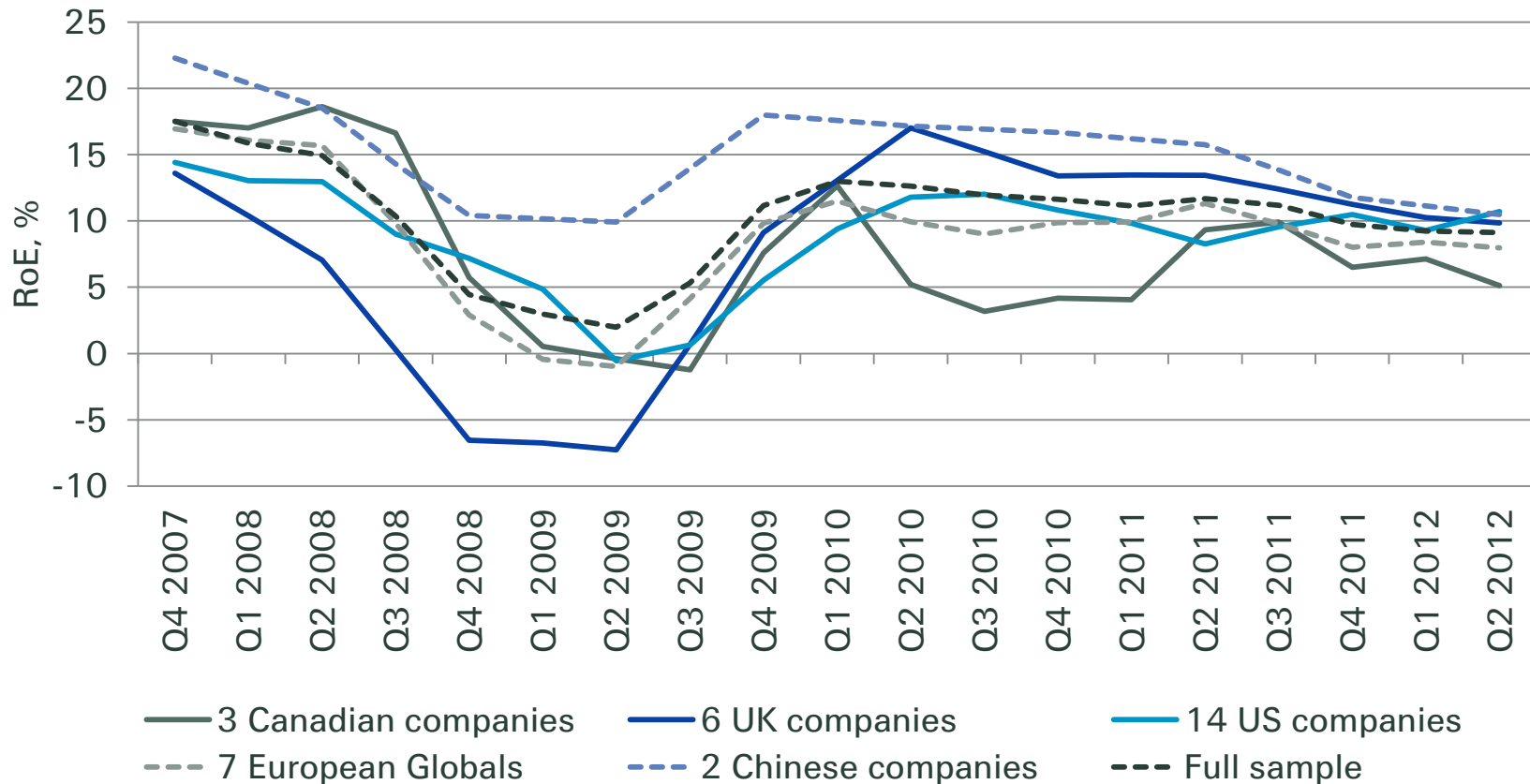
## Insurer price-to-book values and long-term interest rates



Note: Based on IFRS/US GAAP data. The company sample includes Generali, Prudential PLC, Great-West Life, Aflac, Lincoln, Protective Life, Torchmark, Legal & General, Swiss Life, Allianz, AXA, CNP, Helvetia, Hartford, Met Life, and Sun Life.

Sources: Bloomberg, Swiss Re Economic Research & Consulting

# Return on equity of 32 global composite and life insurance companies (IFRS/US GAAP data), %

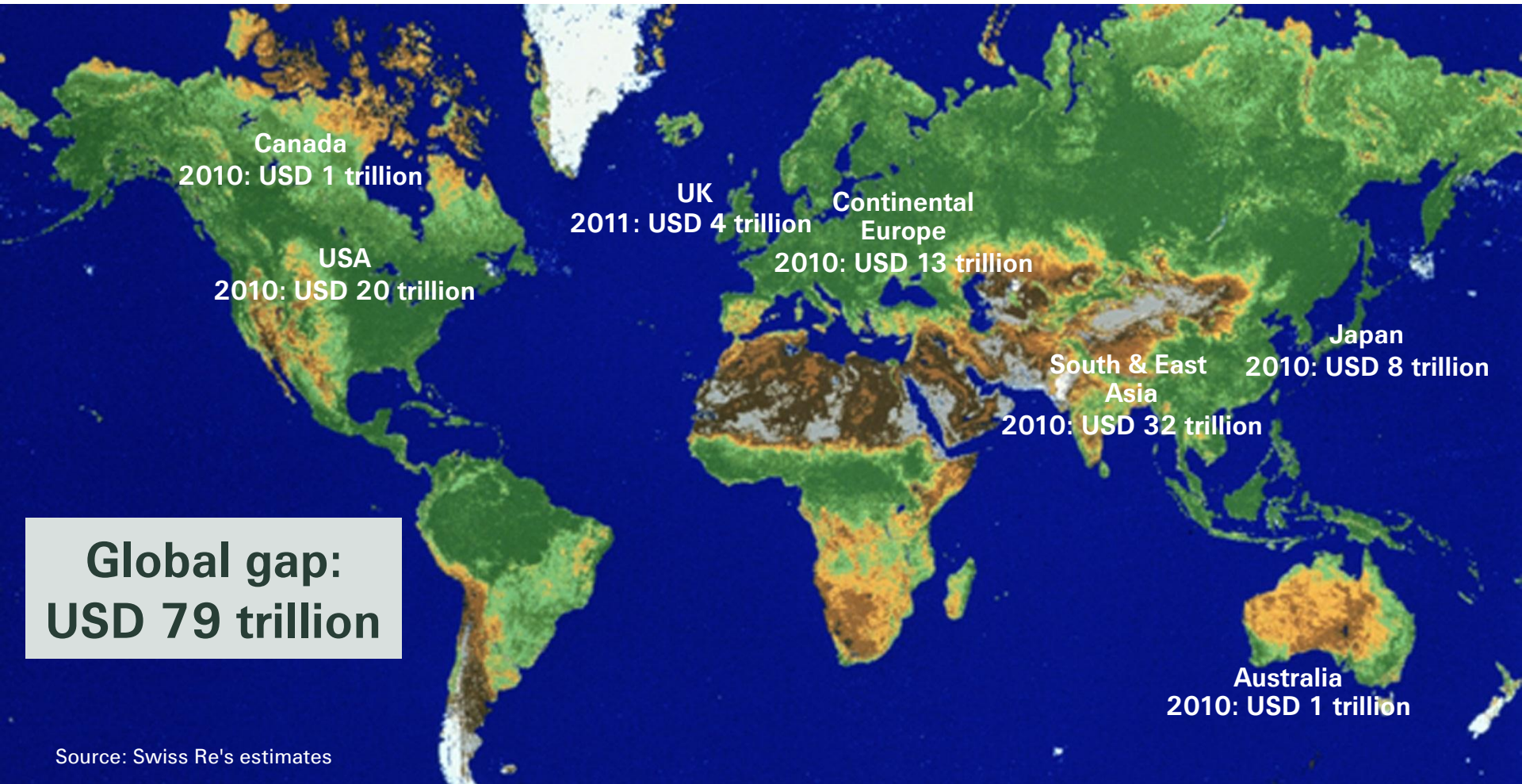


Note: Based on IFRS/US GAAP data. Missing Q1/Q3 values are interpolated. Companies in the sample include: AFLAC; Allianz; Assurant Inc; Aviva; AXA; China Life; CNP; Delphi Financial; Generali; Genworth Financial; Great-West Lifeco; Hartford; Legal & General; Lincoln National; Manulife; Metlife Group; Phoenix Companies; Ping An; Principal Financial Group; Protective Life; Prudential (UK); Prudential (US); St. James Place; StanCorp Financial Group; Standard Life; Storebrand ASA; Sun Life; Swiss Life; Torchmark; Zurich.

Sources: Bloomberg, Swiss Re Economic Research & Consulting



# There is a huge and growing protection gap in many markets



# Non-life market in advanced economies

Dr. Thomas Holzheu





## P&C primary market: Weak, but rates are likely to rise

- Premium growth accelerated modestly in 2012, but profitability eroded – ROE at 5% – due to underwriting results and low investment yields
- Capitalisation is overstated, due to low interest rates
- Insurers are cautious and putting less capital at risk when faced with a weak economy and low interest rates
- Regional results 2012
  - US – underwriting results deteriorated from high cat losses, casualty prices stable to up slightly
  - Europe – underwriting results continue to improve: low cat losses and motor prices up
  - Japan and Australia – back to normal u/w results, post 2011 high cat losses
- Outlook in 2013-14
  - Improving premium growth
  - Stable to rising prices
  - Broad-scale price rises are coming (increased adverse development), but when?
  - Underwriting profits are expected to improve, but only moderately





## P&C reinsurance market: Largely following the primary market

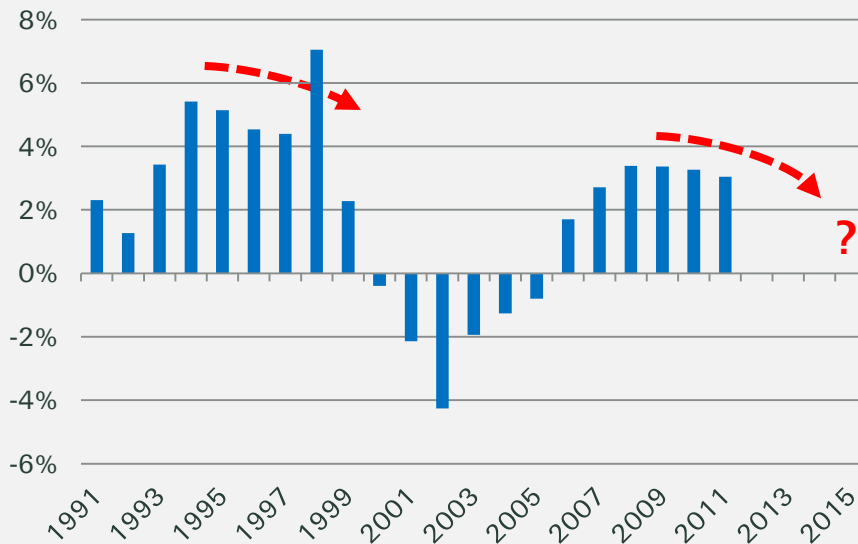
- Higher combined ratio compared to primary sector due to elevated cat losses, profitability eroded – ROE 4% to 5%
- Capitalisation is sufficient, but not as strong as it appears due to low interest rates
- Underwriting results are increasingly volatile due to a shift toward property business and the risk profile of high growth markets
- Property cat rates were up in 2012
- Broad market turn is still coming
- Outlook in 2013-14
  - Premium growth will remain subdued in advanced economies, but strong in emerging markets
  - Prices stable to slightly firmer
  - Average combined ratio at 97%, assuming average cat loss year
  - Profitability moderate, but improving



# Continuous reserve releases

## Reserve levels are declining

### US core reserve releases as a % of NPE



Sources: A.M. Best, Swiss Re Economic Research & Consulting

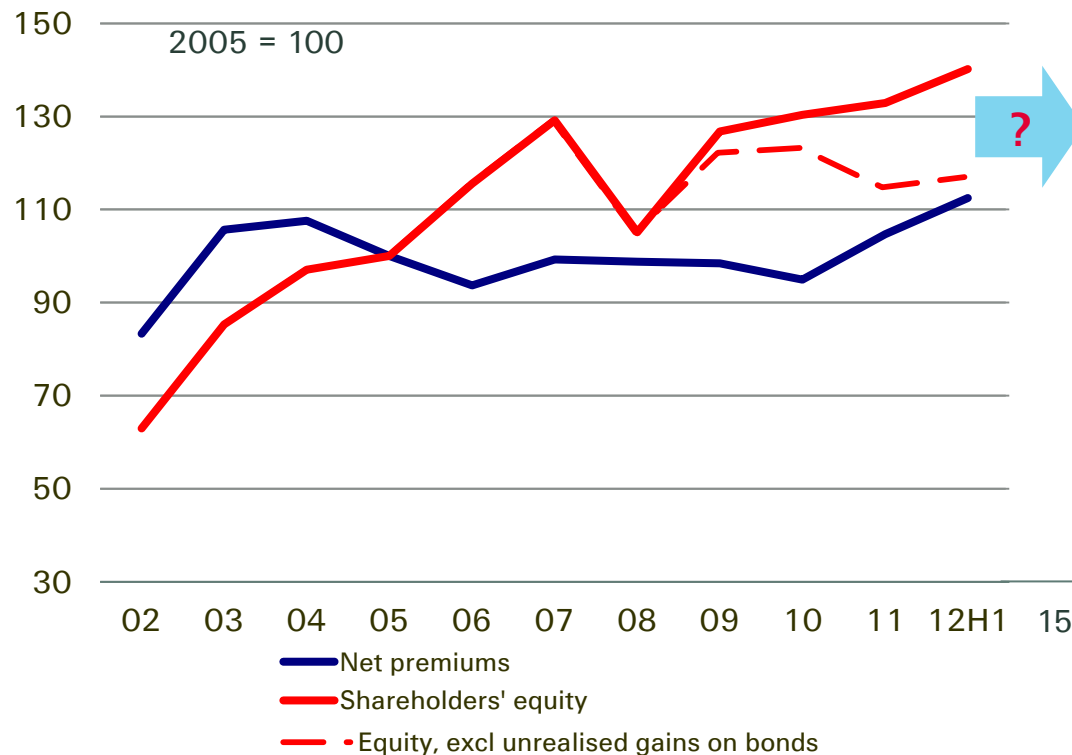
- Global P&C industry has enjoyed substantial reserve releases since 2004
- Pace of releases is winding down
- US: data shows net releases of comparatively unseasoned years in 2011
- US: only small reserve buffers remain; will be depleted within the next 12 months if releases continue at the same level
- Europe: reserve releases are slowing. Reserving trends are somewhat more stable than in the US, but also declining

- Reserve releases expected to end within the next three years



# Reinsurance industry capitalisation

## Is there any excess capital?



- Relevant capital adequacy ratios are not public
- Very rough approximation is to use premiums as measure for risk and GAAP/IFRS capital as measure for available capital
- Taking out artificial effect of unrealised gains due to lowered interest rates indicates that capital is tightening, rather than increasing
- Results similar for primary P&C

■ Falling interest rates have significantly inflated GAAP capital – relevant capital adequacy has probably decreased recently

Sources: Swiss Re Economic Research & Consulting; aggregate of leading reinsurers

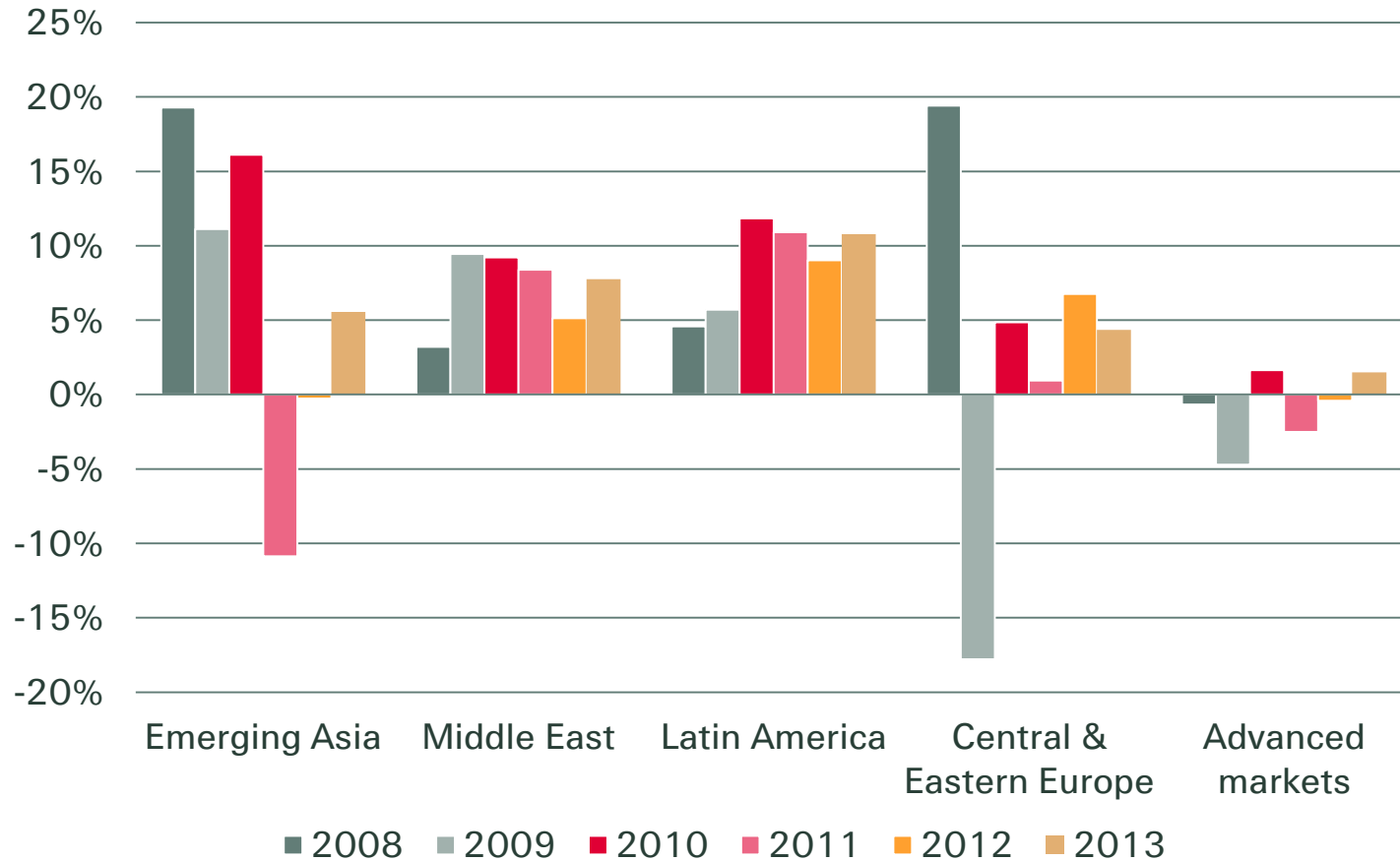
# Emerging markets



## Premium growth will strengthen in 2013 and beyond

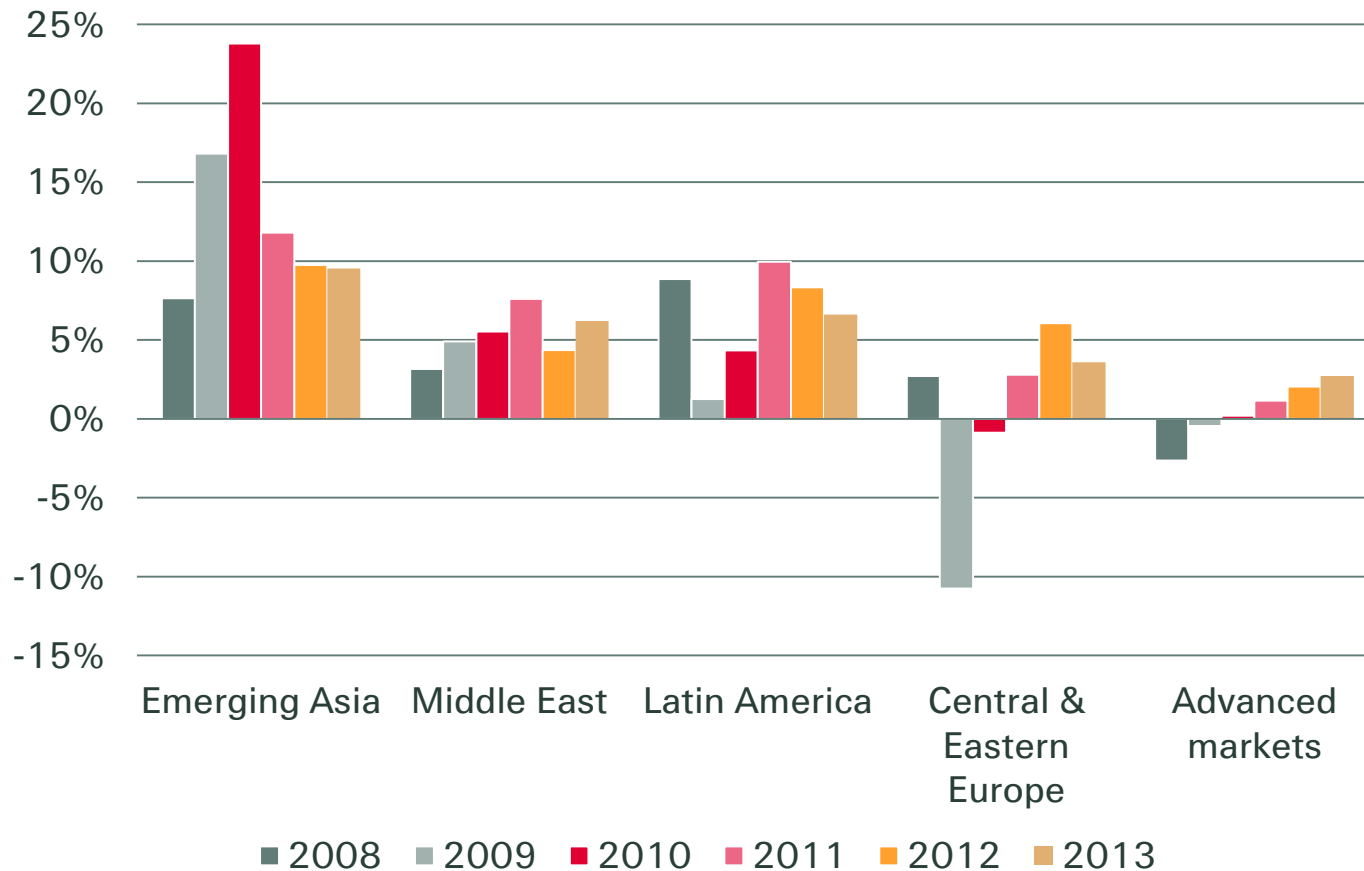
- Life premium growth is expected to improve further in Asia now that India and China are putting the regulatory changes behind them
- Life premium growth remained strong in LatAm and recovered in CEE
- Non-life premium growth has been moderate, except in CEE where it was robust this year
- The motor business has been a key driver of non-life premium growth
- Profitability likely improved this year due to low cat losses and stable motor results
- Outlook in 2013-14
  - Economic activity will be below average and regulatory changes will remain challenging
  - Prospects for life risk products are improving
  - Microinsurance is growing, but from a very low base
  - Non-life business will continue to grow at a rapid, steady pace along with economic activity
  - M&A activities will likely change the competitive landscape over the next several years

# Real growth in life premiums fell in 2011, stabilised in 2012 and is expected to grow next year



Source: Swiss Re Economic Research & Consulting

## Real growth in non-life premiums remains robust in EMs



Source: Swiss Re Economic Research & Consulting



# Conclusions



## Conclusions

- The economic and financial outlook is uncertain, particularly in Europe, but is expected to improve over the next two years
- P&C
  - Rates, particularly casualty rates, are expected to continue improving. A strong hard market would require severe adverse developments, but this is not expected.
  - Premium growth will be constrained by modest economic growth
  - Profitability will remain challenging due to low interest rates
  - Reinsurance lines remain heavily dependent on Cat prices, which are likely to remain fairly firm due to Sandy
- L&H
  - Low interest rates severely affect the L&H savings business, reducing profitability
  - Global premium growth has been weak due to the economic environment and regulatory changes (India, China, and Europe especially)
  - UK and US reinsurance cession rates declining due to regulatory changes
- EMs: Growth expected to resume for both P&C and L&H

# Appendix



## Global economic outlook: Global growth improves in 2013 and 2014

		2011	2012	2013	2014
Real GDP growth, annual avg., %	US	1.7	2.2	2.5	3.3
	Euro area	1.5	-0.4	0.4	1.3
	UK	0.9	-0.2	1.6	1.8
	Japan	-0.7	2.0	1.6	1.5
	China	9.3	7.7	8.2	8.0
Inflation, all-items CPI, annual avg., %	US	3.1	2.0	2.0	2.1
	Euro area	2.7	2.4	1.9	1.9
	UK	4.5	2.6	2.0	2.0
	Japan	-0.3	-0.1	0.1	1.0
	China	5.4	2.9	3.4	3.1
Policy rate, year-end, %	US	0.25	0.25	0.25	0.25
	Euro area	1.00	0.75	0.75	0.75
	UK	0.50	0.50	0.50	0.50
	Japan	0.08	0.10	0.10	0.13
Yield, 10-year govt bond, year-end, %	US	1.9	2.0	2.6	3.0
	Euro area	1.8	1.6	2.3	2.8
	UK	2.0	1.9	2.5	3.3
	Japan	1.0	1.0	1.0	1.2

Source: Swiss Re Economic Research & Consulting



## Real non-life reinsurance premium growth, advanced and emerging markets

	2010	2011	2012	2013	2014
World	-3.5%	8.0%	3.4%	4.9%	5.7%
Advanced markets	-4.3%	5.9%	2.1%	3.8%	4.9%
Emerging markets	-0.2%	15.5%	7.7%	8.5%	7.8%

Source: Swiss Re Economic Research & Consulting



## Real traditional life reinsurance premium growth, advanced and emerging markets

	2010	2011	2012	2013	2014
World	2.1%	0.5%	-1.6%	-0.7%	-0.4%
Advanced markets	1.8%	-0.4%	-2.1%	-1.3%	-1.0%
Emerging markets	7.0%	16.3%	4.8%	6.3%	6.3%

Source: Swiss Re Economic Research & Consulting





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