# Swiss Re predicts a continued but fragile global economic recovery in 2010
Insurance proved its resilience throughout the crisis and is set for growth
Challenges ahead include regulatory changes, low asset returns and climate change

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**London, 1 December 2009 – Swiss Re's economists predict that insurance and reinsurance will continue their recoveries in 2010, based on the assumption of a "U-shaped" recovery. Balance sheets will further strengthen and profits will increase. Growth will be positive but quite sluggish both in life and non-life insurance. This outlook could be muted by looming regulatory challenges, along with the trend for higher claims for catastrophic events, increasingly driven by climate change.**

"The global economy grew in the second half of 2009, but the recovery is fragile. Growth will generally be below trend in the major economies in 2010, but will accelerate modestly in 2011. Monetary policy will shift to tightening in late 2010 at the earliest, and reductions in fiscal stimulus will follow shortly afterwards. As a consequence, growth and inflation are subdued," said Thomas Hess, Swiss Re's Chief Economist, at the company's Economic Forum press conference in London this morning.

By 2011, real GDP growth in OECD countries is expected to be close to its trend of about 2% to 2.5%. Emerging market growth will be substantially higher at 6%. Oil prices are expected to remain fairly close to current levels, rising slightly in 2011 and 2012 when economic activity accelerates. A reduction in monetary easing will push up yields on government bonds, particularly in 2011.

## Regulatory challenges for insurers

Given the dimension of the crisis, comparable with the 1930s, the insurance industry did remarkably well. For Thomas Hess, "the crisis was proof of the resilience of the global insurance industry. Insurance and reinsurance functioned routinely throughout the crisis, even at the peak of this extremely severe financial situation, meeting their claims obligations fully and without delay. Taxpayer support, as far as insurers were concerned, was confined to very few companies, and was almost entirely due to the banking-type operations of these companies."
He continued: "Even the financial guarantee insurers, devastated by the crisis, received no government assistance. The non-life and life and health (re)insurance operations remained well capitalised."

According to Swiss Re's chief economist, regulatory initiatives in the insurance sector need to address the problems that are distinct for the insurance industry. The banking system's excessive leverage and capital reserves too low for the risks assumed were not insurance industry problems. Accordingly, the regulatory response should clearly differentiate between the two industries. While it is agreed that banking needs higher capital requirements, it may prove to be counterproductive for insurance. In particular, it may push life insurers into even more conservative investments. According to Thomas Hess, "this could lead to old age provisions being financed by low-risk assets only, such as government bonds. With life insurers and pension funds being prevented from taking risk, an essential source of financing for the real economy will fall away."

**Primary insurers' balance sheets recovered in 2009, gradual improvements expected in 2010**

Since March 2009, balance sheets of non-life and, even more so, of life insurers have recovered substantially. By November 2009, capital was almost at levels achieved in late 2007. Due to the severe global recession, premiums in non-life decreased by estimated 0.3% in 2009, adjusted for inflation. Life insurers are struggling to earn the guaranteed rates promised in prior years, since interest rates are expected to remain low for the foreseeable future. Demand for both non-life and life insurance is expected to improve along with the economy and capital markets in 2010.

**Reinsurance showed resilience throughout the crisis**

Non-life reinsurance remained robust throughout the crisis. Capital has almost returned to end-2007 levels. Overall, slightly improved top-line growth is expected in 2010 compared with 2009. Profits will improve or remain stable on average: better investment returns compared with 2008 will compensate for slightly lower underwriting results. As primary life insurers continue to recapitalise in 2010, life reinsurance is still projected to show robust growth. Profits in life reinsurance are also expected to improve, primarily due to better investment results.

**Emerging markets: Growth, resilience and improving regulations**

"The emerging markets, though by no means decoupled from the financial storm, weathered its effects fairly well, with the exception of Eastern Europe," said Clarence Wong, Swiss Re's chief economist in Asia. Insurance lines in emerging markets are expected to grow much more robustly than in the developed economies. "The regulatory response to the crisis in emerging markets has been very encouraging. Authorities are continuing to liberalise regulation and move towards a risk-based capital regime," he added.

**Continued trend towards increasing natural catastrophe losses**

Matt Weber, Member of Swiss Re's Executive Board and Head of the Property & Specialty Division, highlighted the drivers of continued growth in the natural catastrophe insurance business: "Despite an unusually low hurricane season this year, overall natural catastrophe losses have increased significantly over the past decades and are expected to grow further. Europe has seen above-average losses in 2009, and the impact of climate change is likely to cause more frequent and more severe storms and floods around the globe in the future."

According to Swiss Re, by the end of this century, currently once-in-a-millennium storm surge events could well strike Northern Europe on average once every 30 years.

Worldwide average insured natural catastrophe losses between 1970 and 1989 were USD 5.1 billion per annum; these losses went up to USD 27.1billion per annum between1990 and 2009. Matt Weber said: "As a result, we see increasing demand for natural catastrophe cover. In this environment, and in combination with potential catastrophe events, both intelligent cycle and sound risk management remain crucial elements of Swiss Re's business approach. To ensure this, we are continuously optimising our own natural catastrophe models for all relevant markets and perils."

Strong public-private partnerships will be essential in tackling the substantially increasing risk posed by natural catastrophes. Swiss Re continues to demonstrate its leadership in this area through innovative risk transfer solutions such as catastrophe bonds, weather derivatives and parametric covers that enable the transfer of emerging and existing risks. "The cat ILS market is an outstanding example of Swiss Re's leadership in innovation. Year-to-date, new issuances have provided more than USD 2.2 billion in capacity, with 45% underwritten by Swiss Re," said Matt Weber.

**Low asset returns in 2010: (re)insurers forced to focus on underwriting profitability**

While the corporate bond market and equity markets are expected to continue improving in 2010, insurers' investment income will continue to suffer from the low interest rate environment. Insurance and reinsurance companies mostly invest in high-quality fixed income assets and yields, particularly on government bonds. Rates on these assets are very low by historical standards. Unlike banks, insurance companies do not tend to have very high leverage ratios. But even P&C insurers have asset leverage and this magnifies the impact of declines in investment yields on return on equity (ROE). For example, P&C insurers in the US had asset leverage – assets as a percent of equity – of 278% in 2008. To maintain the same ROE after a 1% point drop in investment yields requires about a 3% point improvement in the combined ratio.

Thomas Hess concluded: "The implication is clear: low investment yields will force (re)insurers to focus on underwriting profitability. This will give companies with a strong combined ratio history a competitive advantage."

## Notes to editors

**Materials from today's event**
Copies of presenters' slides, photographs and other materials from today's event are available at www.swissre.com under 'Media Centre'. An audio recording will be posted within 24 hours of this Media Information being issued.

The company's latest Focus report *Effects of Climate Change: Increasing Coastal Flood Damage in Europe* announced at the event today, shows storm surge exposure will increase significantly and stresses the need for strengthening sea defences and fostering strong public-private partnerships to manage residual risks.

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