

# Economic outlook – Update

March 28, 2022

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# Key macro points



## Inflation (CPI)

- Europe more affected from economic spillovers of Russia-Ukraine conflict, but US more at risk for longer and higher inflation (incl. wages)
- US/Euro Area CPI inflation forecasts revised up by 1.3-2.0% this year and by 0.3-0.6% next year, with future risks skewed to more upward revisions to our forecasts
- Higher inflation post-COVID with 10Y average being 0.3-0.4% higher than previously expected



## Growth

- Our largest GDP growth revision has been to Europe, with it most affected by the economic spillovers of the conflict. The Euro Area is likely to contract in the near-term; our full-year 2022 real GDP growth forecast for the Euro Area has been lowered by 1.5%pt to 2.5%
- Next year below trend growth in the US



## Interest rates

- Central banks will not derail their rate hikes. Fed much behind the curve. Yield curve to flatten and possibly invert in the US



## Risks

- Downside scenarios at 30-40% for “1970s-style stagflation” and “global recession”



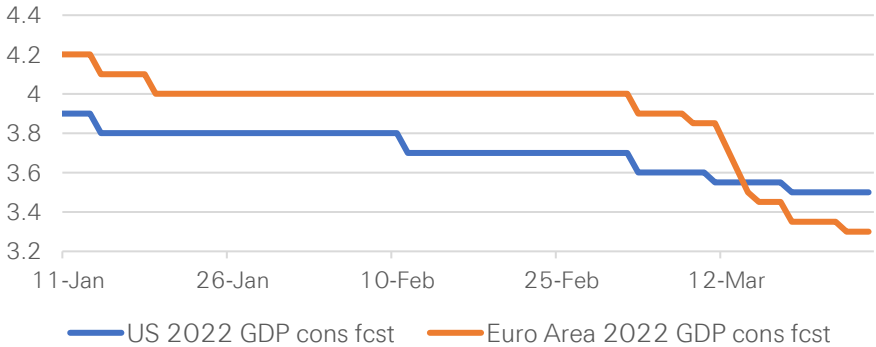
## Bottom-line

- Higher inflation for longer and weaker growth, especially in Europe
- Do not bet on a “soft-landing” in the US
- Consensus growth expectations have yet to change to reflect new economic reality

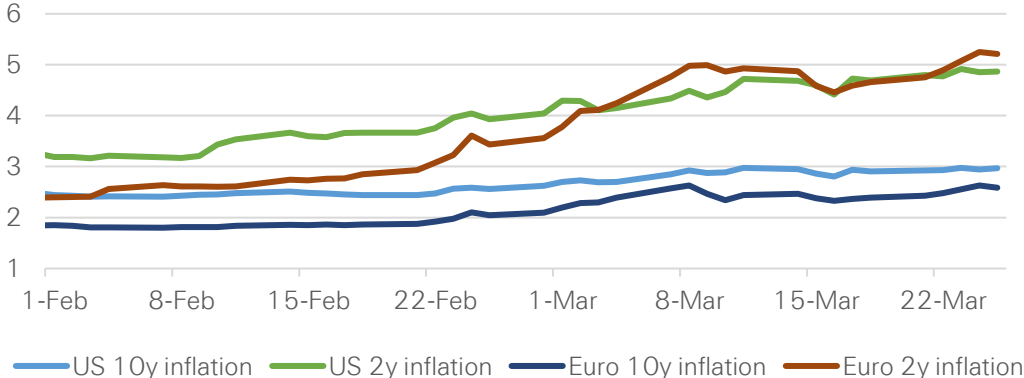
# Consensus forecasts and markets: lower growth, higher inflation and continued market stress

- **Growth expectations have come down**, especially for the Euro Area, whilst **inflation measures have increased markedly**
- **Financial markets have been very volatile. Significant further financial market downside in case of more severe outcome**

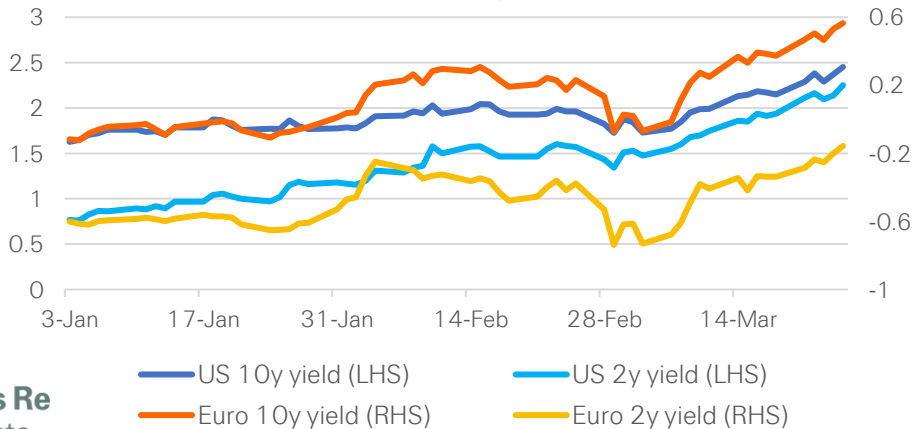
**Consensus 2022 GDP forecasts**



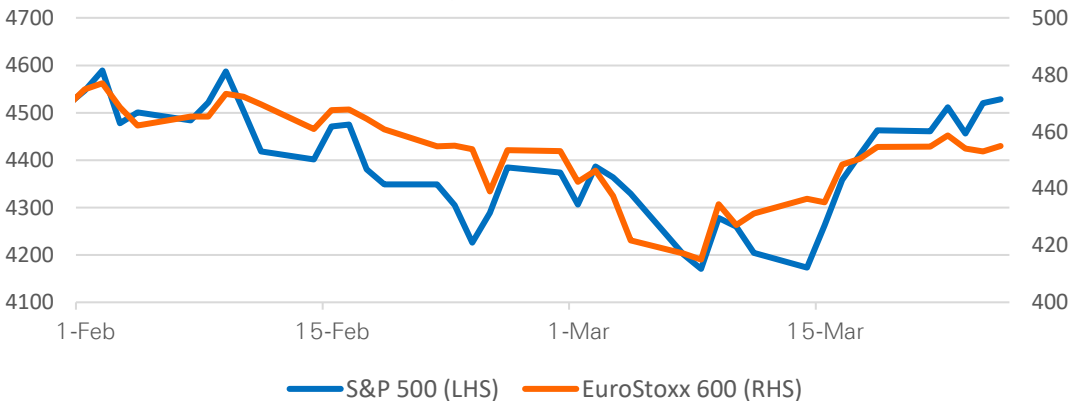
**Inflation market expectations (in %)**



**Sovereign bond yields (in %)**



**Equities (levels)**



# Economic outlook: No 1970s style-stagflation, but do not bet on “soft landing” given regime shift with both high stagflation and recession risks



Lower growth



More inflation



Faster monetary tightening



Heightened geopolitical and internal political risks

	Swiss Re Institute		Consensus	
	2022	2023	2022	2023
<b>Real GDP (% change)</b>				
US	3.1 (-0.2)	1.4 (-0.1)	3.5 (-0.3)	2.3 (-0.2)
Eurozone	2.5 (-1.5)	2.2 (-0.2)	3.3 (-0.7)	2.5
China	5.1	5.3	5.1 (-0.1)	5.2 (+0.1)
<b>CPI (% change)</b>				
US	6.9 (+1.3)	3.2 (+0.6)	6.2 (+1.4)	2.6 (+0.2)
Eurozone	6.3 (+2.0)	2.1 (+0.3)	5.3 (+2.2)	2.0 (+0.4)
China	2.3	2.4	2.2	2.2
<b>Central bank rate (%)</b>				
US	1.63 (+0.5)	1.63	1.55 (+0.40)	2.20 (+0.40)
Eurozone	0.00	0.25 (+0.25)	0.10 (+0.10)	0.65 (+0.60)
China	2.00	2.20	2.38 (-0.09)	2.33 (-0.07)
<b>10y Gov. Bond Yield (%)</b>				
US	2.0 (+0.2)	2.00	2.30 (+0.15)	2.59 (+0.15)
Eurozone	0.20	0.40	0.50 (+0.35)	0.70 (+0.35)
China	2.70	2.60	2.87 (+0.09)	2.90 (-0.02)

Source: Bloomberg, Swiss Re Institute  
 Note: Revisions in brackets, relative to February

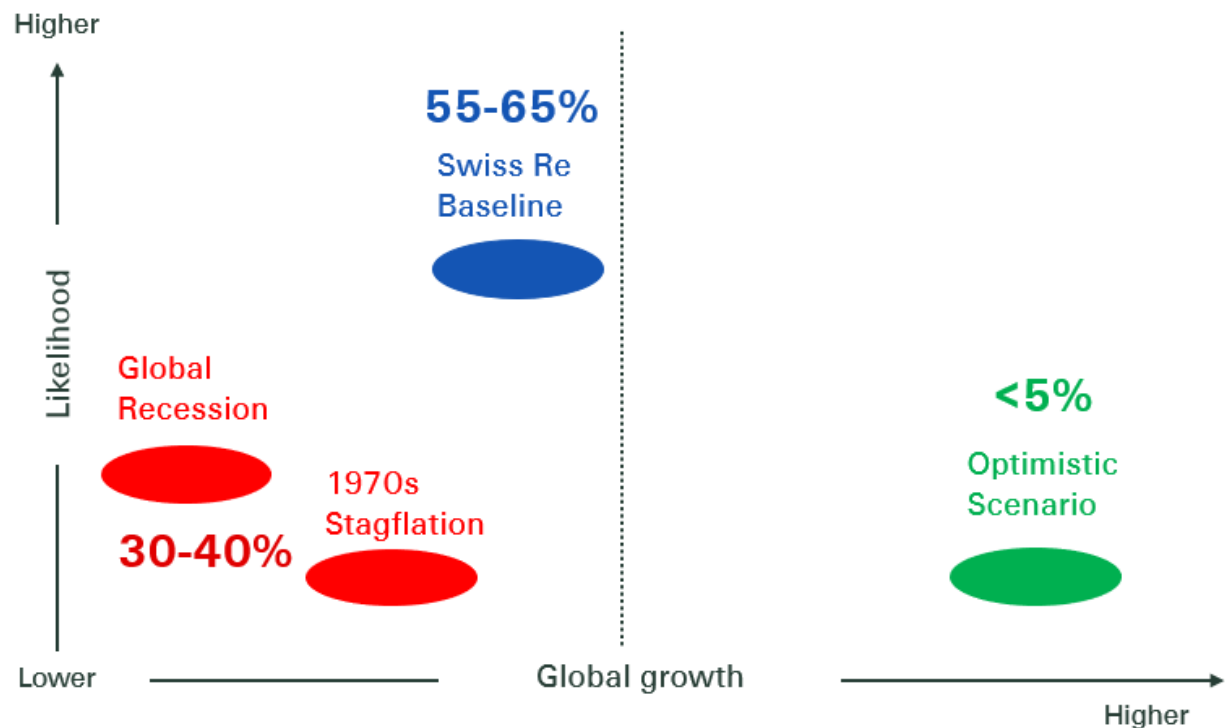
# Baseline and alternative scenarios: forecast changes in focus

- **Forecast changes:** significantly higher inflation and lower growth expected in Europe. The ECB will also likely start lifting interest rates
- **Alternative scenarios:** downside risks have increased considerably. Tail-risk stagflation scenario is now a 1970s type scenario

## Baseline revisions










Variable	US		Euro area	
	2022	2023	2022	2023
GDP growth	3.1 (↓0.2ppt)	1.4 (↓0.1ppt)	2.5 (↓1.5ppt)	2.2 (↓0.2ppt)
Inflation	6.9 (↑1.3ppt)	3.2 (↑0.6ppt)	6.3 (↑2.0ppt)	2.1 (↑0.3ppt)
Policy rate	1.63 (↑0.5ppt)	1.63 (=)	0.00 (=)	0.25 (↑0.25ppt)
10y yield	2.00 (↑0.2ppt)	2.00 (=)	0.20 (=)	0.40 (=)

## Probability assessment of baseline and alternative scenarios, likelihood and relative to global trend growth



**Notes:** Downside scenario is combined likelihood for either of the downside scenarios or combinations thereof playing out. Left (right) axis for global growth is below (above) trend growth

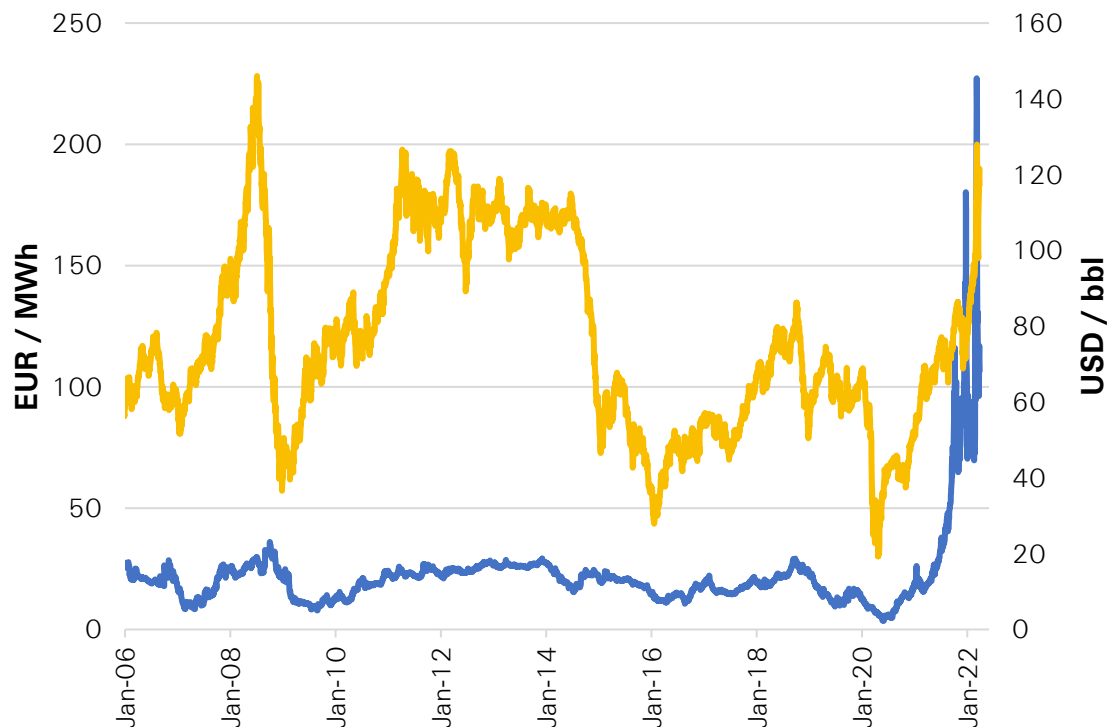
# Alternative scenarios: Elevated geopolitical uncertainty makes a stagflation and recession scenario more likely

	Golden 20s		1970s-like Stagflation		Global Recession		
Narrative	 Further digitalisation		 Wage-price spirals developing		 Lasting commodity price shock		
	 Continued infrastructure spending		 Persistent supply disruptions		 Abrupt tightening of financial conditions		
	 Geopolitical harmony		 Fiscal dominance & loss of central bank independence		 Hurtful geopolitical developments		
Top signposts	1 Strong productivity growth		Persistent supply disruptions		Demand slowdown		
	2 Tightening labour market		Unanchored inflation expectations		Abrupt market/financial conditions stress		
	3 High sentiment		Public policy responses		Tightening of policy followed by easing		
Key US forecasts <sup>1</sup>		2022	2023	2022	2023	2022	2023
	Real GDP growth	4.7%	3.1%	1.6%	0.9%	-1.0%	1.0%
	Inflation	6.4%	3.0%	13.0%	8.5%	6.0%	2.2%
	10y yields	3.8%	4.3%	2.8%	5.5%	0.3%	0.3%
	Investment grade credit	80bp	80bp	225bp	305bp	200bp	160bp
Equities	15%	10%	-40%	-10%	-20%	6%	

# Ukraine/Russia crisis is the latest threat to the global economy, but especially to Europe

- **The Russia-Ukraine conflict is set to affect inflation and growth via:** 1) higher energy prices, 2) broader supply concerns (esp. for wheat and other agricultural goods, metals, and insulated wires), 3) disrupted trade links, 4) banking and financial market volatility, 5) broader sentiment, 6) changing fiscal spending from a number of European economies

## Brent and Natural gas price evolution



— TTF Natural Gas (LHS)

— Brent (RHS)

## Sensitivities on Swiss Re Eurozone forecasts to energy prices relative to pre-invasion forecasts:

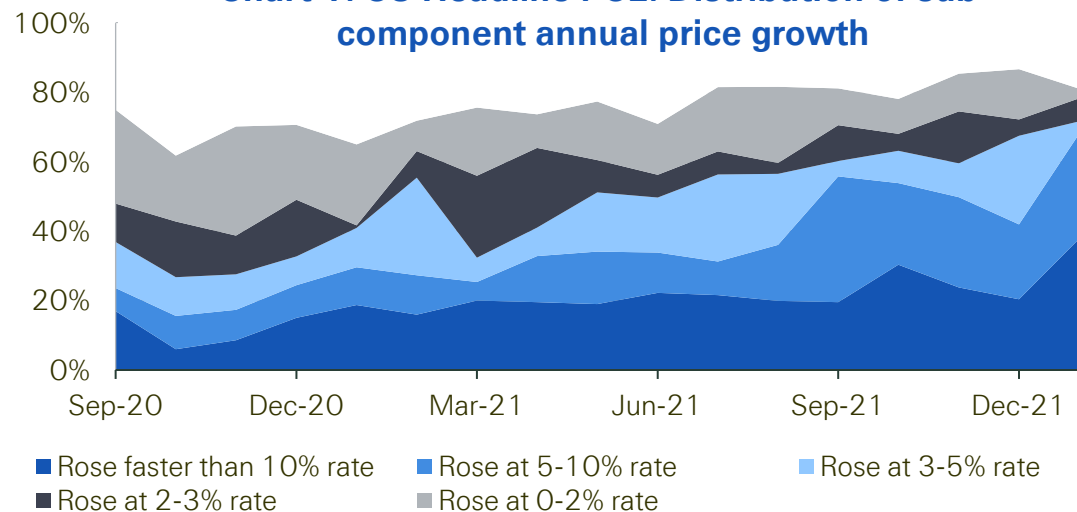
	2022 GDP	2022 CPI
<b>Downside scenario 1:</b>		
• 50% increase in gas prices*	-1 ppt	+1 ppt
• 25% increase in oil prices*		
<b>Severe downside scenario 2:</b>		
• 100% increase in gas prices*	≥ -2ppt	≥ +2ppt
• 50% increase in oil prices*		

\* % increase in oil prices is assumed to stay on average at these greater levels throughout all of 2022. Note these assumptions exclude second-round effects of higher energy prices, which if included would imply greater hits to GDP and CPI.

# CPI forecasts have been raised significantly for the US and Europe for 2022, but CPI inflation is also expected to be structurally higher post-covid in the long-term

- **We recently also raised our long-term 10-year ahead CPI forecasts in the US and Europe** (see Table 1). Deglobalization, Decarbonization, restructuring of energy supply chains, and somewhat more tolerance of central banks is likely to leave structural inflation risks to the upside. The Russia-Ukraine conflict has reinforced several of these themes. Look out also for the **broadening out of price pressures** to categories that are harder to reverse (e.g. rents, wages).

**Chart 1: US Headline PCE: Distribution of sub-component annual price growth**



Source: [Trimmed Mean PCE Inflation Rate - Dallasfed.org](https://www.dallasfed.org/outlook/trimmed-mean-pce-inflation-rate), Swiss Re Institute

**Table 1: Long-term CPI forecasts across key markets vs. history**

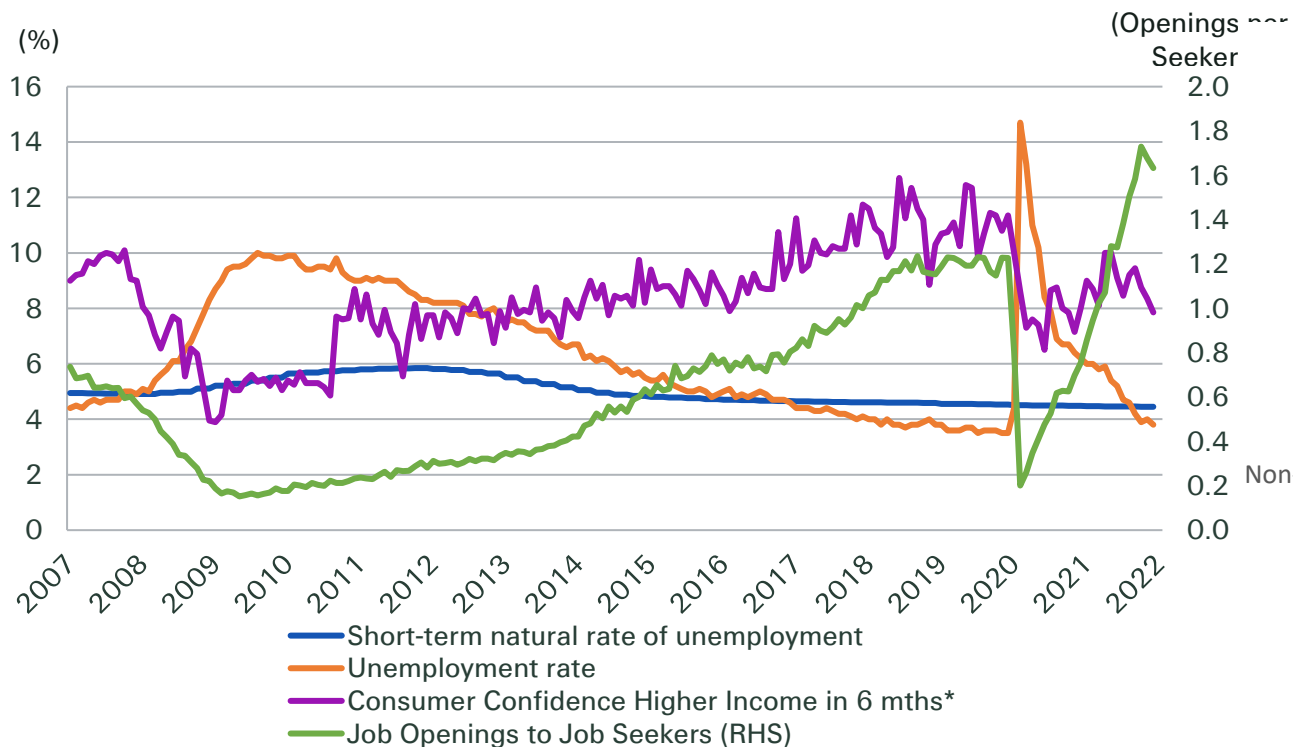
	Next 10yr average (2022-2031)		Average CPI rate over prior cycle (2010-2019)	Average CPI rate over last two cycles (2000-2019)
	New forecast as of Mar 2022	Prior forecast as of Nov 2021		
<b>US</b>	2.9	2.5	1.8	2.2
<b>UK</b>	2.9	2.1	2.2	2.0
<b>Germany</b>	2.5	2.0	1.3	1.4
<b>China</b>	2.3	2.3	2.6	2.2

Source: Swiss Re Institute

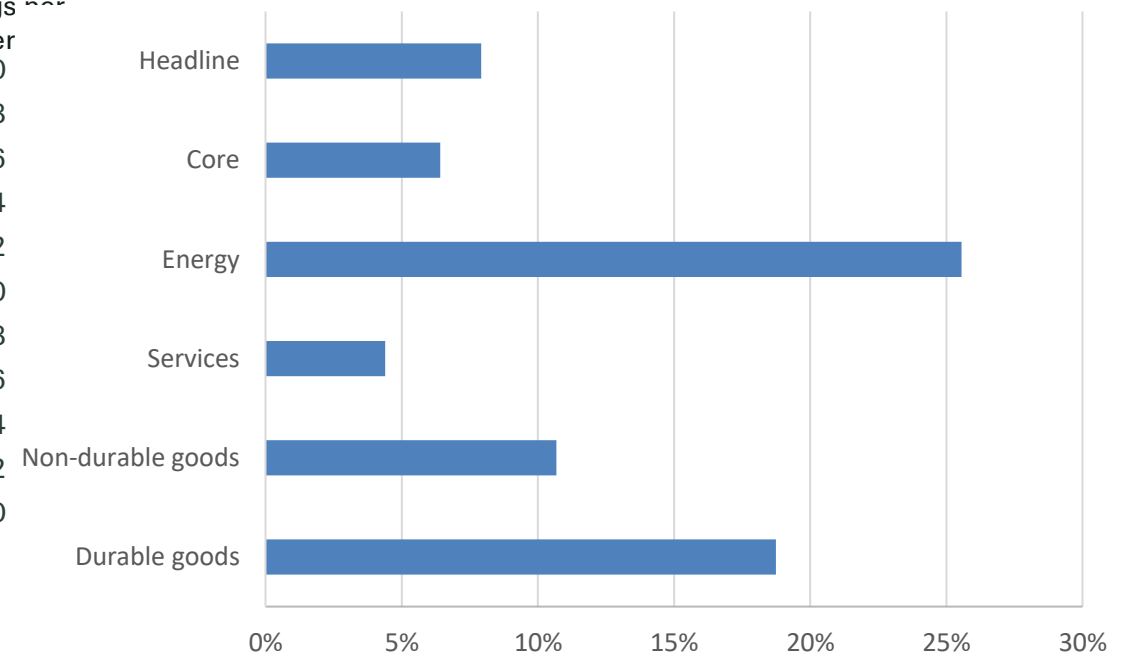
# Historically tight US labour market another indication of US economy overheating

- **Tight labour market:** Unemployment rate below 4% whilst **ratio of job openings to job seekers is at all-time highs**. Coupled with higher wage inflation, this environment accelerates the Fed's monetary tightening schedule
- **Inflation to remain elevated:** Excess demand is driving inflation in many sectors, especially in goods and construction. US economy likely to experience **elevated inflation until demand softens in H2 2022**

### Labour Market Indicators



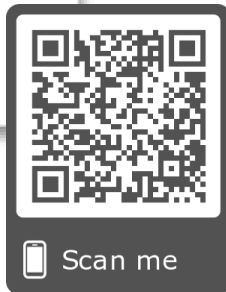
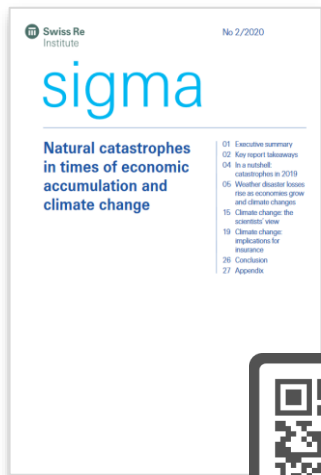
### Inflation of key sectors (YoY)



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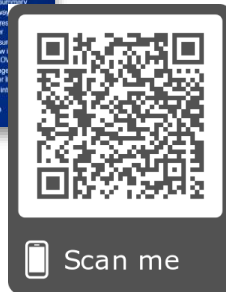
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## Expertise Publications

- Expert analysis of specific risk topics in regional markets and the global (re)insurance industry



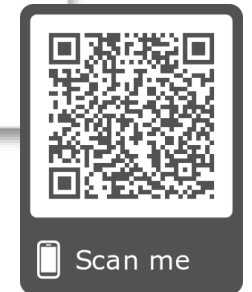
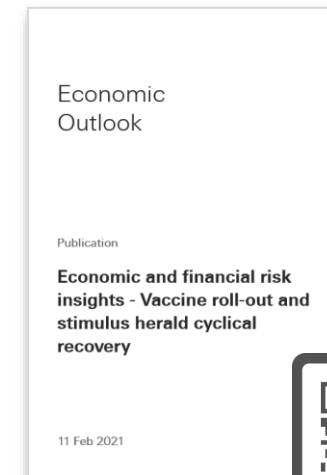
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- Key findings on macro developments and market events, and their implications for the (re)insurance industry



## Economic Outlook

- Monthly newsletters on global economic and financial market risk landscape.



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# Appendix

# Additional sensitivity analysis to oil and gas prices

- The oil price shock implied by futures still has a modest impact on inflation and growth that could be much worse should oil prices increase further and stay persistently elevated. But don't be fooled, the joint impact with also other elevated commodity prices (e.g. natural gas) can be very large, with some regions more highly exposed (see chart on right-hand side)

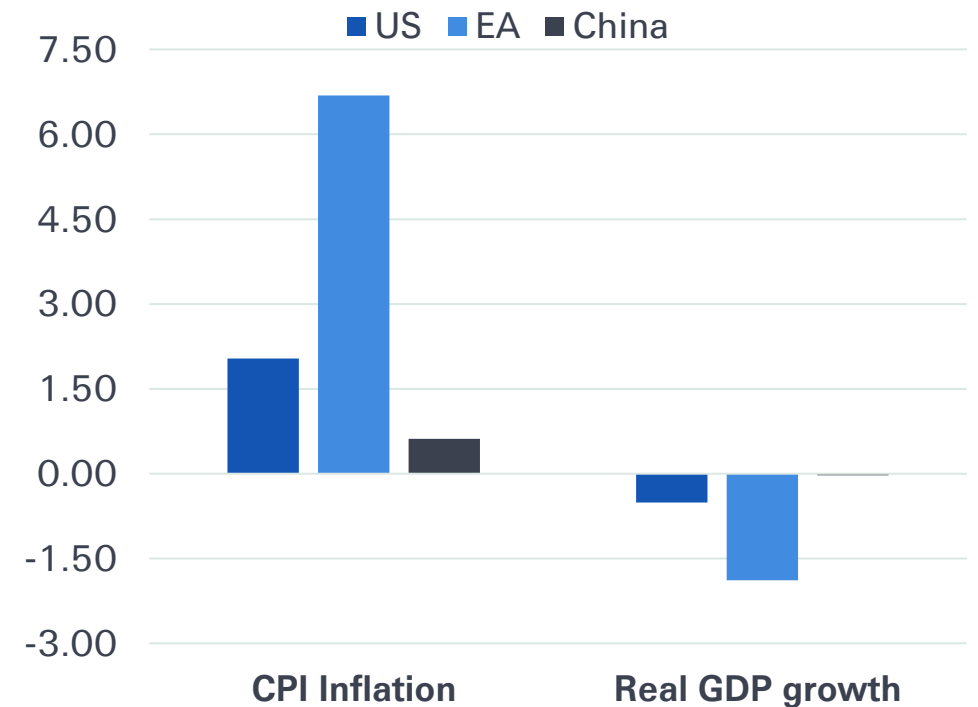
**Table 1: Annual 2022 inflation sensitivities vs. pre-invasion baseline in %pts**

	US	Euro Area	China
Oil futures	+0.63	+0.48	+0.55
Oil futures persistence	+0.87	+0.63	+0.73
Oil extreme to 140	+2.07	+1.50	+1.79

**Table 2: Annual 2022 GDP growth sensitivities vs. pre-invasion baseline in %pts**

	US	Euro Area	China
Oil futures	-0.18	-0.15	-0.16
Oil futures persistence	-0.24	-0.18	-0.20
Oil extreme to 140	-0.61	-0.44	-0.49

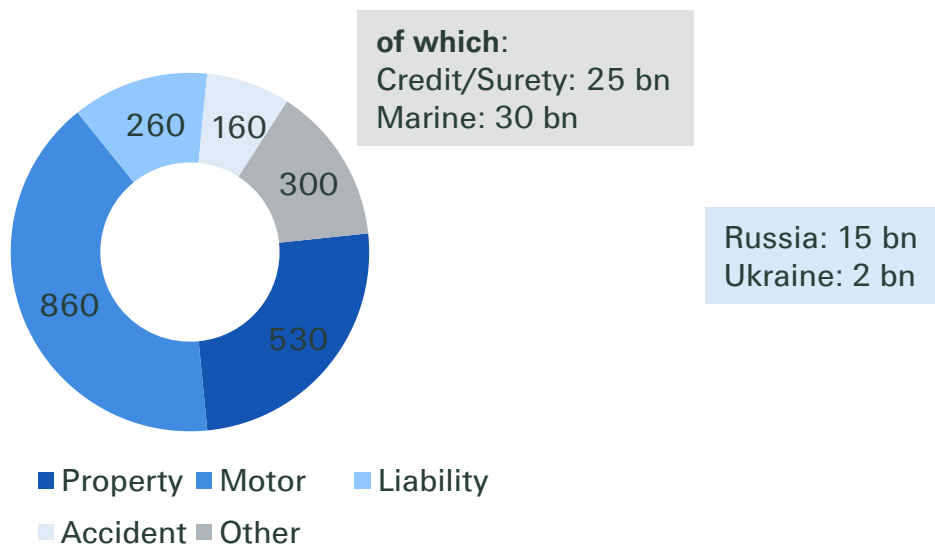
**Joint impact of oil and natural gas futures on 2022 CPI inflation and GDP growth vs. pre-invasion baseline\* in %pts**



# Impact of Ukraine-Russia war on the P&C insurance industry

- **The insurance outlook** from the war in Ukraine on the global P&C industry will be likely 'substantial':
  - **The profitability** will significantly suffer from the **higher inflationary pressure on claims** due to much higher energy prices and further impacts on already disrupted value chains
  - from the mid- and long-term perspective: lower growth scenario will drag down the premiums development, especially in European markets

## Global P&C insurance industry 2022, Premiums in USD bn



## Economic inflation impact on P&C lines

Line of business	Impact	Current CPI Inflation elasticity* (qualitative assessment)	Exposure
Property	High	> 1	Small, regional
Motor, physical damage	High	> 1	Small, regional
Motor, bodily injury	Average	~ 1	Large, global
Liability	Average	~ 1	Large, global
Marine/aviation/transport	Average	~ 1	Large, global
Credit/surety/political risk/cyber	Low	< 1	Large, global

\* Change in claims (%) due to a change in CPI by 1%

## Area and extent of impacts

Area of impact	Impact	Exposure
Losses to directly exposed lines of business (i.e. property, motor physical damage)	High	Small, regional
Indirect losses from higher claims inflation (i.e. motor, bodily injury, liability)	Varies by LoB	Large, global
Less premium growth new business, economic slowdown (i.e. cyber insurance, trade credit insurance)	Small	Large, global
More premium growth new business, rate hardening (i.e. marine and aviation war risk, political risk)	Varies by LoB	Large, global
Higher investment income, higher interest rates	Small	Large, global
Investment income, volatility of risky assets	Mixed	Medium, global

Source: Swiss Re Institute

# Impact of war in Ukraine on the global P&C insurance industry

- The **direct country impact** of the war in Ukraine on the global P&C industry will be **comparably small and limited, while the impact on niche markets could be large depending on how long geopolitical uncertainty and economic outcomes develop**
  - Claims might occur in niche markets like trade credit, political risk, marine and aviation war, and cyber. Too early to assess now, depending on provided covers and policy wordings
- The **indirect impact** will be **widespread**, mainly come via **higher inflationary pressure on claims** due to much higher energy prices and further impacts on already disrupted value chains. The periods of severe or prolonged inflation shocks will be problematic for re/insurance industry

The insurance industry is counting the cost of Russia-Ukraine war (direct impact)

Line of business	Coverage/Channel	Premiums outlook	Price outlook	Losses/Claims outlook	Mitigating factor
Trade Credit Insurance	For the nonpayment of accounts receivables that arise from the sales of goods or services.	-1	1	-1	Ukraine and Russia were considered a high-risk country by some insurers prior to the recent war. As a result, insurers' exposures there are modest.
Marine and Aviation war risk	Cargo war risks have typically been included within the "all risks" without a separate rate, while marine hull war risks are usually require a standalone war coverage policy.	1	1	-1	Best practices developed by UKMTO (United Kingdom Maritime Trade Operations), BMP5 and UKHO (The UK Hydrographic Office), and BIMCO Maritime Security Committee.
Cyber insurance	Most cyber policies contain exclusions from losses resulting from Acts of War, but cyberattacks stemming from overseas threats are not applied	-1	1	-1	Given warning period before, insurers would have been able to take steps to limit any exposures they might have on their books
Political risk insurance (PRI)	For losses caused by government actions including war, expropriation and forced sales of asset	1	1	-1	The total insured limit for PRI insurance across Ukraine and Russia is manageable due to low insurance penetration

The insurance industry is counting the cost of Russia-Ukraine war (indirect impact)

Line of Business	Channel	Premiums outlook	Price outlook	Losses/Claims outlook	Mitigating factor
General liability, medical malpractice, and workers' compensation	Through wages/medical prices/cost; claims with long settlement periods are exposed to inflationary risks between loss occurrence and loss settlement	-1	1	-1	A regular adjustment of the premium rates is needed; or shortening the tail
Umbrella, excess liability, and non-proportional reinsurance	Given feature of XL business of fixed deductibles	-1	1	-1	Index clauses are needed to link limits and deductibles with an inflation-related price index
Motor, Accident	Rising repair / replacement cost		1		A regular adjustment of the premium rates is needed
Property insurance	Rising repair / replacement cost		1		A regular adjustment of the premium rates is needed; or automated by indexing



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