Swiss Re Institute

Issue 18/2021

Economic Insights

World insurance outlook: strong demand to offset inflation risk impacts

Key takeaways

- Strong economic recovery, rising risk awareness and digitalisation will continue to drive insurance demand.
- Hard rates will also contribute to premium volume growth. We forecast that global premiums will exceed the USD 7 trillion mark for the first time by the end of 2022.
- We expect medium-term inflation to remain above pre-pandemic levels.
- Policymakers will be more accepting of higher levels of inflation whilst the risk to the growth outlook remains skewed to the downside.
- Higher inflation could impact insurer earnings. For example, increases in medical costs and wages could push up claims in workers' compensation and other lines of liability business.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

Managing Editor
Jérôme Haegeli
Swiss Re Group Chief Economist

Authors
Fernando Casanova Aizpún
Xin Dai

We welcome your feedback. For any comments or questions, please contact: institute@swissre.com

In a nutshell

We expect inflation to remain higher over the coming years than of late. This could be a key downside risk for markets and also insurers, given potential for consequential claims inflation. Still, the overall outlook for the insurance sector remains positive. Strong economic growth, hard rates, rising risk awareness and accelerating digitalisation will continue to drive demand.

We expect global inflation pressures to remain elevated over the next one to three years, presenting a medium-term risk to insurers' earnings. Even with inflation risks, the outlook for primary insurance market is positive. We forecast that global premiums will rise by an above-trend 3.3% in 2021 and 3.9% in 2022, a much faster rebound than from the global financial crisis of 2008-09. Positive cyclical economic momentum and ongoing hard market conditions in non-life will continue to support insurance market growth. Demand will also benefit from rising risk awareness and an acceleration in digitalisation, both direct consequences of the pandemic. We expect global total premium volumes to be 10% higher than pre-crisis levels by end 2021, and that total market size will surpass USD 7 trillion by the end of 2022.[1]

To date, the insurance sector has proven resilient to the disruptions wrought by COVID-19, with premium growth stronger than GDP outcomes (see Figure 1 (LHS)). Growth wise, lines of business more closely intertwined with economic activity (eg, commercial lines, trade, and credit insurance) have fared worse due to business interruptions, and restrictions on mobility and travel. With restrictions on mobility, growth in motor premiums has slowed, but on the flipside, claims have also fallen: with fewer drivers on the road there have been less accidents. Mortality and medical-related insurance products, meanwhile, have outperformed over the course of the pandemic.

The recent increase in inflation has been driven by the reopening of markets and base effects from pandemic-related disruptions. The strong global economic recovery from the COVID-19 crisis continues, but the peak has likely passed. For example, momentum in the US and China is fading, while growth in Europe in strengthening as the effects of more widespread vaccinations gain traction. Recovery in the emerging markets is slower and more fragile, due to the more modest stimulus packages and slower pace of vaccination in the emerging relative to advanced economies.

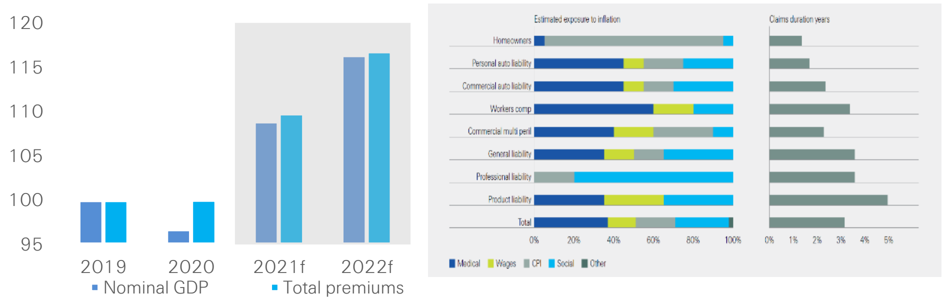
We believe a slowing growth environment will render the current high levels of inflation temporary. However, inflation will likely remain higher than pre-COVID 19 times. For one, the leading central banks have indicated greater tolerance for inflation but also, uncertainties around the delta variant prevail. As a result, the risk to the outlook remains skewed to the downside, making us believe the Federal Reserve will only start tapering early next year, and the

[1] *sigma* 3/2021 - World Insurance: the recovery gains pace, Swiss Re Institute, 14 July 2021.

20 August 2021

European Central Bank later still. We also expect the People's Bank of China to remain on hold through 2021.

Figure 1
Global nominal GDP and total insurance premiums (2019 = 100, LHS)); claims sensitivity to inflation in US casualty (RHS).



Source: IBNR weekly #32, 2017, SNL, Swiss Re Institute

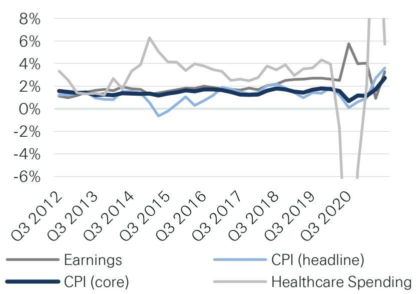
Accommodative monetary policy will safeguard the economic recovery but also fuel elevated levels of inflation. This could offset some of the earnings impact of strong demand and hard rates. Higher levels of inflation have implication for both sides of insurers' balance sheets. On the asset side, gradual normalisation of monetary and fiscal policy will push bond yields higher; equity performance, however, could falter should there be an abrupt increase in interest rates. On the liability side, non-life insurers are most vulnerable to inflation risk. Exposures vary according to the origins of claims inflation. For example, claims in general liability, workers' compensation, and medical malpractice are mostly for cases of bodily injury. In the US, medical costs have risen by more than general CPI and wage inflation, and this could see a rise in claims in workers' compensation and liability lines. Property, specialty, and professional liability lines, meanwhile, are more exposed to CPI and/or social inflation (see Figure 1 (RHS)).

Figure 2: US inflation forecasts

Inflation index	Impact on claims inflation	Medium-term forecast*
General (CPI)	Low	2.5%-3.0%
Medical cost	High	4 – 5%

**2020-2022
Source: Swiss Re Institute

Figure 3: US inflation indicators, year-on-year



Note: Average Hourly Earnings, Headline CPI, Core CPI, and PCE Healthcare Expenditure.
Source: Refinitiv

Claims inflation in long-term liabilities will also directly impact estimates for technical provisions.[2] In the context of Solvency II risk-based capital requirements for insurers, all material risks need to be considered in the calculation of solvency capital requirements and the Own Risk and Solvency Assessment (ORSA). If inflation risks persist and lead to higher claims in excess of assumptions used in their financial modelling, insurers may need to increase reserves, which would also impact profitability.

[2] Wüthrich, M.V. "Accounting Year Effects Modeling in the Stochastic Chain Ladder Reserving Method", *North American Actuarial Journal*, vol 14, 2010; Ahlgrim and D'Arcy, "The Effect of Deflation or High Inflation on the Insurance Industry, *Canadian Institute of Actuaries, and Society of Actuaries,* 2012; S. D'Arcy, A. Au, L. Zhang, "Property-Liability Insurance Loss Reserve Ranges Based on Economic Value", *Variance*, vol 3, 2009.