

# Building Better Economic Risk Scenarios

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### World Economic Forum: Examples of Global Economic Risk



- Chronic fiscal imbalances
- Severe income disparity
- Extreme volatility in energy and food prices
- Recurring liquidity crises
- Major financial systemic failure
- Adverse unintended consequences of regulation
- Unmanageable inflation/deflation
- Chronic labor market imbalances
  - "Hard landing" of emerging economies

Source: World Economic Forum, Global Risks 2013; Insurance Information Institute.

### Examples of Economic Risk, Domestic Edition



- Persistently Low Interest Rates
- Severe income disparity
  - Pressure to expand government programs
- Mismanagement of population aging
- Persistently high and soaring health care costs
- Major financial systemic failure
- Adverse unintended consequences of regulation
- Unmanageable inflation/deflation
- Chronic labor market imbalances



## **Perspective: Past and Present**

## It Helps to Remember Where We Are and Where We've Been

### A Continued Weak Recovery is Forecast: Real GDP Growth, Yearly, 1970-2014F



Forecasts from Blue Chip Economic Indicators, 5/2013 issue, median of range of 52 forecasts. Sources: (GDP) U.S. Department of Commerce at http://www.bea.gov/national/xls/gdpchg.xls. INSURANCE

# May 2013 Forecasts of Quarterly US Real GDP for 2013-14



## Virtually all forecasts see the economy improving through 2014, but the drag of the sequester and other threats could undermine that growth

Sources: Blue Chip Economic Indicators (5/13); Insurance Information Institute

### Length of US Business Cycles, 1929–Present\*



**Month Recession Started** 

#### Based on recent history, the current "expansion" has 3-6 more years to go.

\* Through May 2013 \*\* Post-WW II period through end of most recent expansion. Sources: National Bureau of Economic Research; Insurance Information Institute.

### State-by-State Leading Indicators, 2013:Q2-Q3





March 2013 State Leading Indexes: 6-Month Forecast

Near-term growth forecasts vary widely by state. Strongest growth = dark green; weakest = beige

Sources: Federal Reserve Bank of Philadelphia at www.philadelphiafed.org/index.cfm; Insurance Information Institute. Next release is May 28, 2013

Source: Federal Reserve Bank of Philadelphia

### Leading Indicator Indexes Vary Widely by State and Region



Data from March 2013

Sources: Federal Reserve Bank of Philadelphia at <u>www.philadelphiafed.org/index.cfm</u>; Insurance Information Institute.

### Leading Indicator Indexes Vary Widely by State and Region





Data for March 2013

Sources: Federal Reserve Bank of Philadelphia at <u>www.philadelphiafed.org/index.cfm</u>; Insurance Information Institute.

### Households Are Still\* Reducing Their Financial Obligations





### **Consumer Sentiment is Rising But Still Below Usual Post-Recession Level**





### Unemployment and Underemployment Rates: Stubbornly High in 2012, But Falling



## Stubbornly high unemployment and underemployment constrain overall economic growth, but the job market is now clearly improving.

Source: US Bureau of Labor Statistics; Insurance Information Institute.

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### Unemployment Rates Vary Widely by State and Region\*

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\*Provisional figures for April 2013, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute.

# Unemployment Rates Vary Widely by State and Region\* (cont'd)



\*Provisional figures for April 2013, seasonally adjusted. Sources: US Bureau of Labor Statistics; Insurance Information Institute

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# Monthly Change in Private Employment, 2010 - 2013



Private employers added 1.2 million jobs in just the last six months.

Seasonally adjusted. Mar 2013 and Apr 2013 are preliminary data Sources: US Bureau of Labor Statistics; Insurance Information Institute NSURANCE

### Growth of Private Employment in February 2013, by BLS report month



## There is a great deal of variation in employment growth by industry, indicating a very uneven and slow recovery

Sources: US Bureau of Labor Statistics Consumer Expenditure Survey; Insurance Information Institute.

### Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2013:Q1



Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

Sources: research.stlouisfed.org/fred2/series/WASCUR; National Bureau of Economic Research (recession dates); Insurance Information Institute.

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### Demographic Components of Economic Risk

## **Population Components Matter... A Lot**

# Spending on Life and Personal Insurance, 2011, by Age of Consumer Unit



Sources: US Bureau of Labor Statistics Consumer Expenditure Survey; Insurance Information Institute.

### Spending on Pensions and Social Security, 2011, by Age of Consumer Unit



Sources: US Bureau of Labor Statistics Consumer Expenditure Survey; Insurance Information Institute.

### Projection of U.S. Population Age Groups, 2015 - 2060

■18-24 ■25-44 ■45-64 ■65-84 ■85+



The 18-24 segment won't grow, and the 45-64 segment won't grow until 2040, but the 25-44 segment will grow slowly and the 65-84 segment will double, with significant effects on P/C operations.

Sources: US Census Bureau; Insurance Information Institute.

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### Number of "Discouraged Workers": Elevated, but Dropping Jan 1994 – Sept. 2012





1/31/1994 6/30/1996 11/30/1998 4/30/2001 9/30/2003 3/1/2006 7/31/2008 12/31/2010

## In recent good times, the number of discouraged workers ranged from 200,000-400,000 (1995-2000) or from 300,000-500,000 (2002-2007).

Notes: Recessions indicated by gray shaded columns. Data are seasonally adjusted. Sources: Bureau of Labor Statistics; National Bureau of Economic Research (recession dates).

### Effect of Discouraged Workers on Unemployment Rate



- Civilian Labor Force: 155.238 (000)
- Unemployed: 11.659 (000)
- Unemployment Rate: 7.510%
- Unemployed + 400,000 Discouraged: 12.059
- Adjusted Unemployment Rate: 7.768%

### Number of "Discouraged Workers," Monthly, 2007-2013





\*"Discouraged workers are persons marginally attached to the labor force who did not actively look for work in the prior four weeks for reasons such as thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination" BLS; data are not seasonally adjusted Note: Recession months in gold Source: U.S. Bureau of Labor Statistics: *Employment Situation*, various months; Insurance Information Institute.

### Number of "Discouraged Workers,"\* by Age Group, Annual Averages, 2006-2012





\*"Discouraged workers are persons marginally attached to the labor force who did not actively look for work in the prior four weeks for reasons such as thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination" BLS; data are not seasonally adjusted Source: U.S. Bureau of Labor Statistics: *Employment Situation*, various months; Insurance Information Institute.

# Number of Workers Age 65-69, 70-74, and 75+, Quarterly, 1998-2012





Source: US Bureau of Labor Statistics, US Department of Labor; Insurance Information Institute.

### Labor Force Participation Rate, Ages 65-69, Quarterly, 1998:Q1-2013:Q1



The switch from DB pension plans (with early-retirement incentives) to DC plans (with, in effect, later-retirement incentives) might be partly responsible for raising this rate.

Not seasonally adjusted. Sources: US Bureau of Labor Statistics, US Department of Labor; Insurance Information Institute.

### Labor Force Participation Rate, Ages 70-74, Quarterly, 1998:Q1-2013:Q1



The labor force participation rate for workers 70-74 grew by about 50% since 1998. Growth stalled during and after the Great Recession but has since resumed.

Source: US Bureau of Labor Statistics, US Department of Labor; Insurance Information Institute.

### Labor Force Participation Rate, Ages 70-74, Quarterly, 1998:Q1-2013:Q1



The labor force participation rate for men 70-74 grew by about 50% since 1998, but for women 70-74 it nearly doubled (from about 9% to about 15.5%).

Source: US Bureau of Labor Statistics, US Department of Labor; Insurance Information Institute.

### Labor Force Participation Rate, Quarterly Ages 75 and over, 1998-2013:Q1



Sources: US Bureau of Labor Statistics, US Department of Labor; Insurance Information Institute.

### Labor Force Participation Rate, Quarterly Ages 75 and over, 1998-2013:Q1



Sources: US Bureau of Labor Statistics, US Department of Labor; Insurance Information Institute.

#### Annual Expenditure on Life and Personal Insurance, by Age of Consumer Unit, 1991-2011



#### As the age-composition of the population changes, premium volume will follow.

Sources: Bureau of Labor Statistics Consumer Expenditure Surveys; Insurance Information Institute

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### Annual Expenditure on Pensions and Social Security, by Age of Consumer Unit, 1991-2011



## As the age-composition of the population changes, premium volume will follow.

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Sources: Bureau of Labor Statistics Consumer Expenditure Surveys; Insurance Information Institute

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### Changes in Households, 2000 to 2010



The number of householders living alone rose by nearly 4 million from 2000 to 2010 (+14.6%). Single-parent households rose by 1.4 million (+14.4%). Married couples w/own kids fell by 5.0%. Will these trends continue?

Sources: U.S. Census Bureau at <u>http://www.census.gov/construction/chars/pdf/medavgsqft.pdf</u> and "Households and Families: 2010", Census Brief issued April 2012; Insurance Information Institute

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### **Investments and Interest Rates**

### U.S. Treasury Security Yields\*: A Long Downward Trend, 1990–2013



## Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

\*Monthly, constant maturity, nominal rates, through March 2013.

Sources: Federal Reserve Bank at <a href="http://www.federalreserve.gov/releases/h15/data.htm">http://www.federalreserve.gov/releases/h15/data.htm</a>. National Bureau of Economic Research (recession dates); Insurance Information Institutes.

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# **Distribution of Bond Maturities**,





The main shift over these years has been from bonds with intermediate maturities to bonds with longer maturities. The industry added to its holdings of over-20-year bonds (from 16.5% in 2003 to 20.2% in 2012) and trimmed bonds in the 1-5-year and the 5-10-year categories (from 59.9% to 55.2%).

### Distribution of Bond Maturities, P/C Insurance Industry. 2003-2011





The main shift over these years has been from bonds with longer maturities to bonds with shorter maturities. The industry first trimmed its holdings of over-10-year bonds (from 24.6% in 2003 to 16.9% in 2011) and then trimmed bonds in the 5-10-year category. Falling average maturity of the P/C industry's bond portfolio is contributing to a drop in investment income along with lower yields.

Sources: SNL Financial; Insurance Information Institute.



## Inflation

### Change\* in the Consumer Price Index, 2004–2013



1/31/20041/31/20051/31/20061/31/20071/31/20081/31/20091/31/20101/31/20111/30/20121/31/2013

#### Over the last decade, prices generally rose about 2% per year.

\*Monthly, year-over-year, through April 2013. Not seasonally adjusted.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

### Prices for Hospital Services: 12-Month Change,\* 1998–2013





 $1/31/19 \pm 1/20 \pm 1/20$ 

## Cyclical peaks in PP Auto tend to occur approximately every 10 years (early 1990s, early 2000s, and possibly the early 2010s)

\*Percentage change from same month in prior year; through April 2013; seasonally adjusted Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

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## Thank you for your time and your attention!