



# **Economic Trends, Challenges, and Opportunities Affecting the P/C and Surety LOB**

**New Jersey Surety Association  
September 13, 2012**

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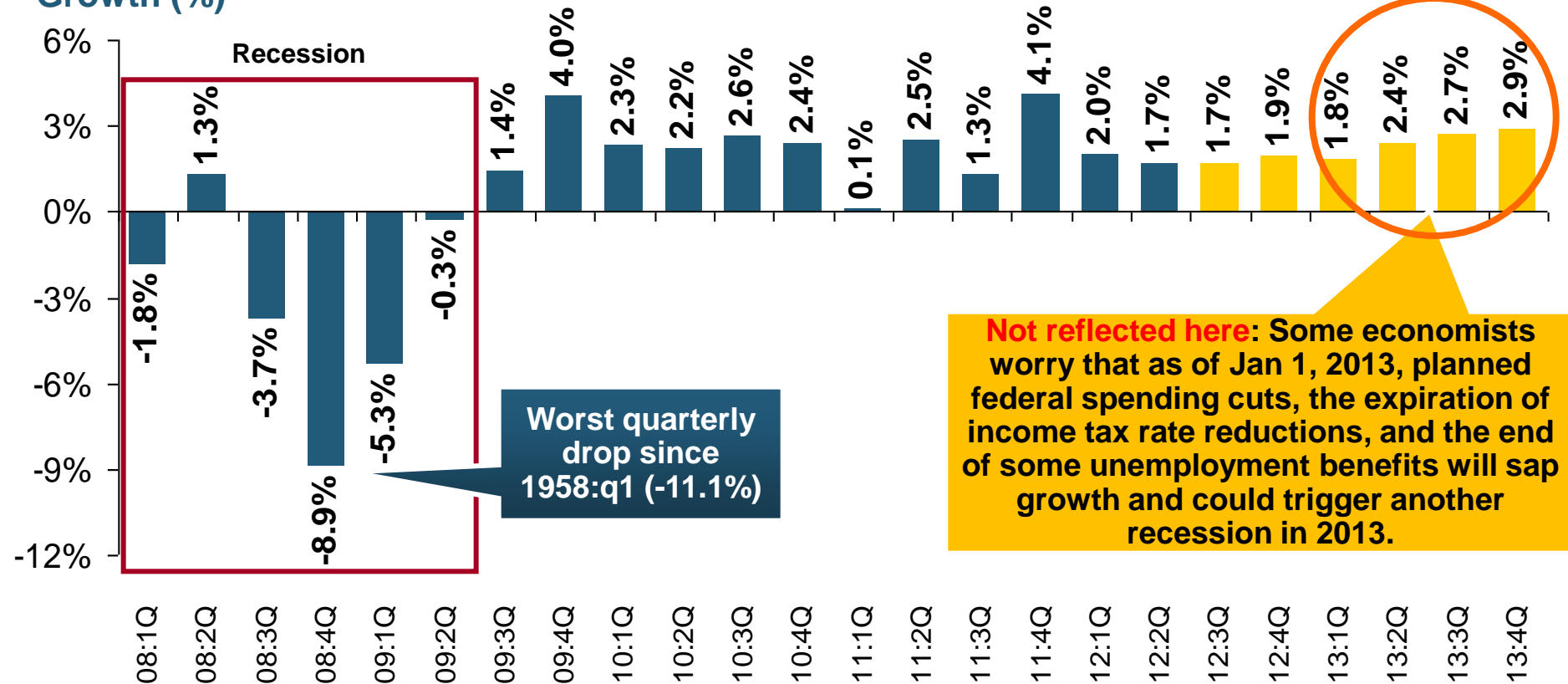
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# **Economics 2012: Most Signs Are Weak but Positive**

**Favorable Consequences  
for P/C Insurers,  
if Current Trends Continue**

# The US Economy is Forecast to Keep Growing\*, but Slowly

## Real GDP Growth (%)



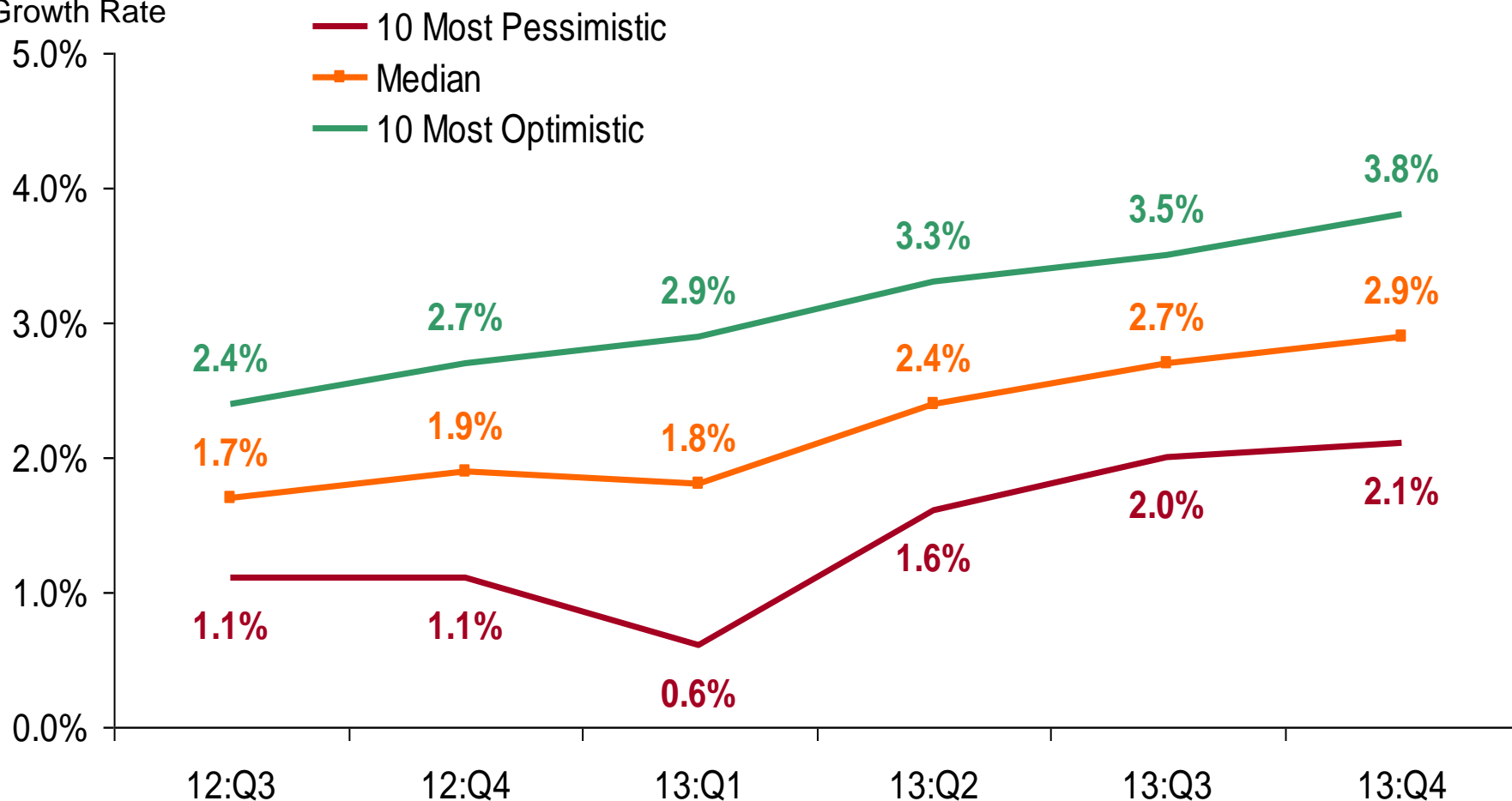
**Demand for insurance continues to be affected by a sluggish economy**

\* Estimates/Forecasts from Blue Chip Economic Indicators

Sources: US Department of Commerce, <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm> ; Blue Chip Economic Indicators 8/2012 issue (forecasts); Insurance Information Institute.

# August 2012 Forecasts of Quarterly US Real GDP for 2012-13

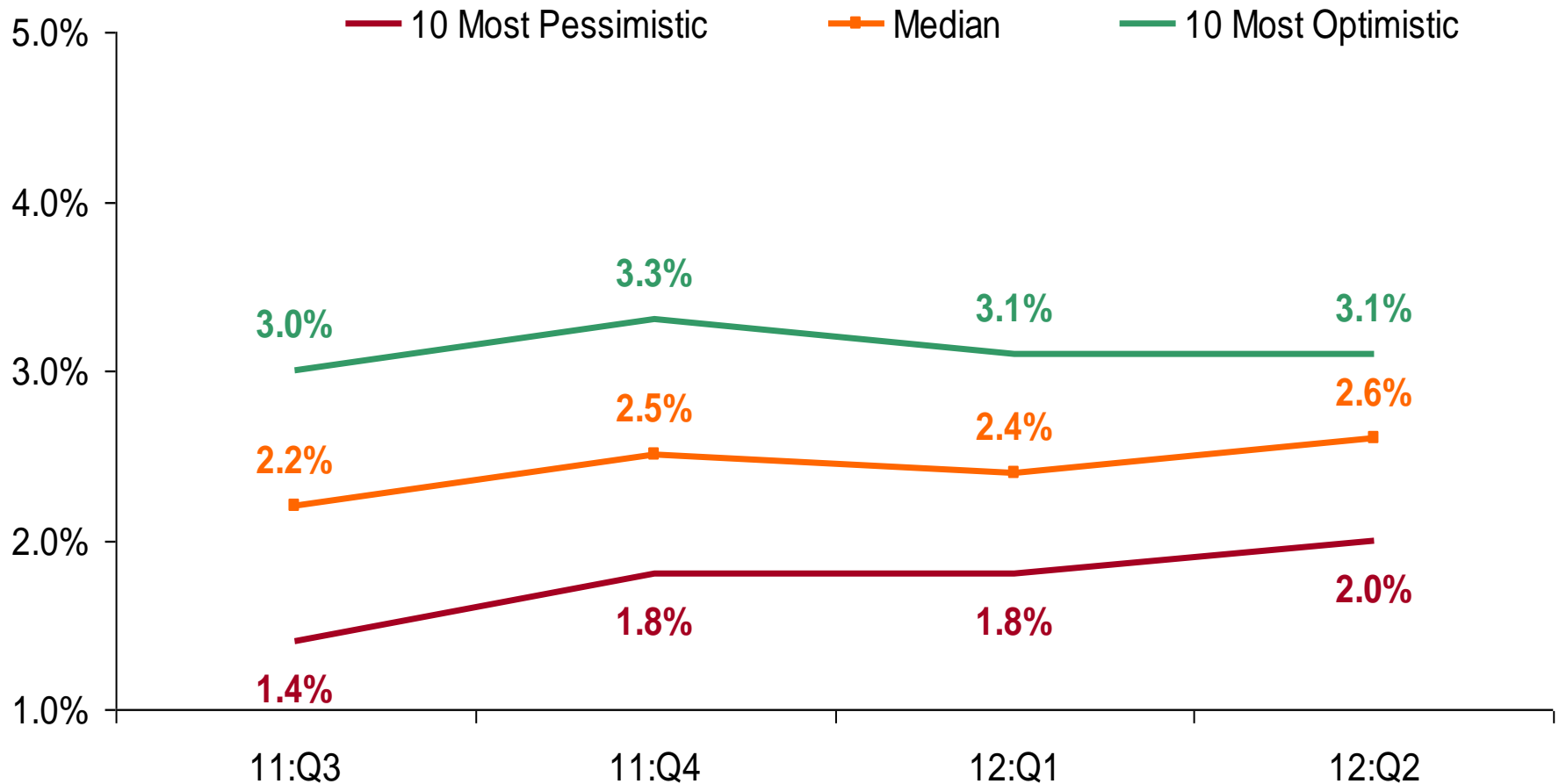
Real GDP Annual  
Growth Rate



**As of early August 2012, virtually every forecast predicts improving growth throughout the 6-quarter period, except for 2013:Q1. But this might change.**

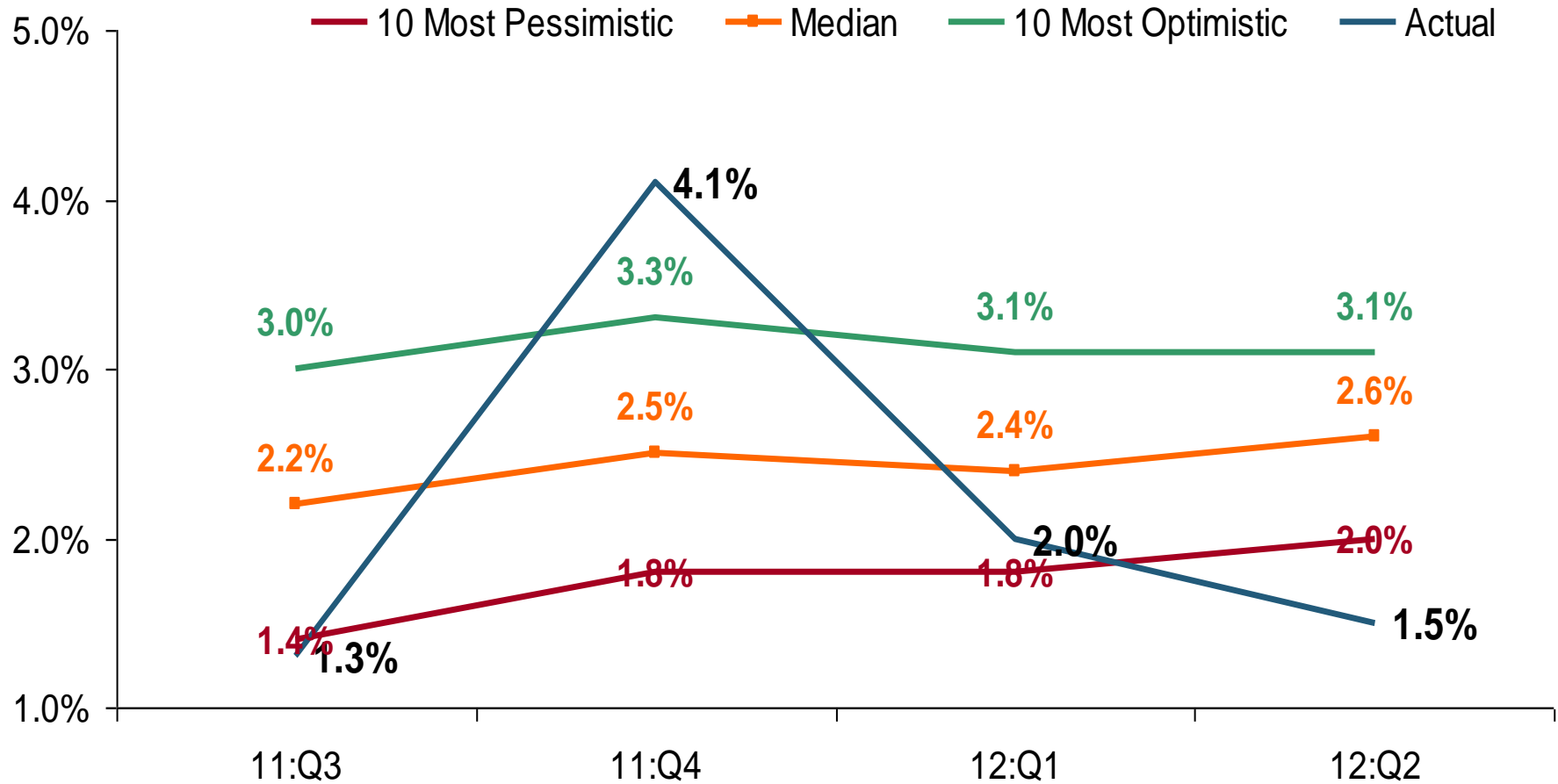
# A Look Back: August 2011 Forecast of US Real GDP for Next 4 Quarters

Real GDP Annual  
Growth Rate



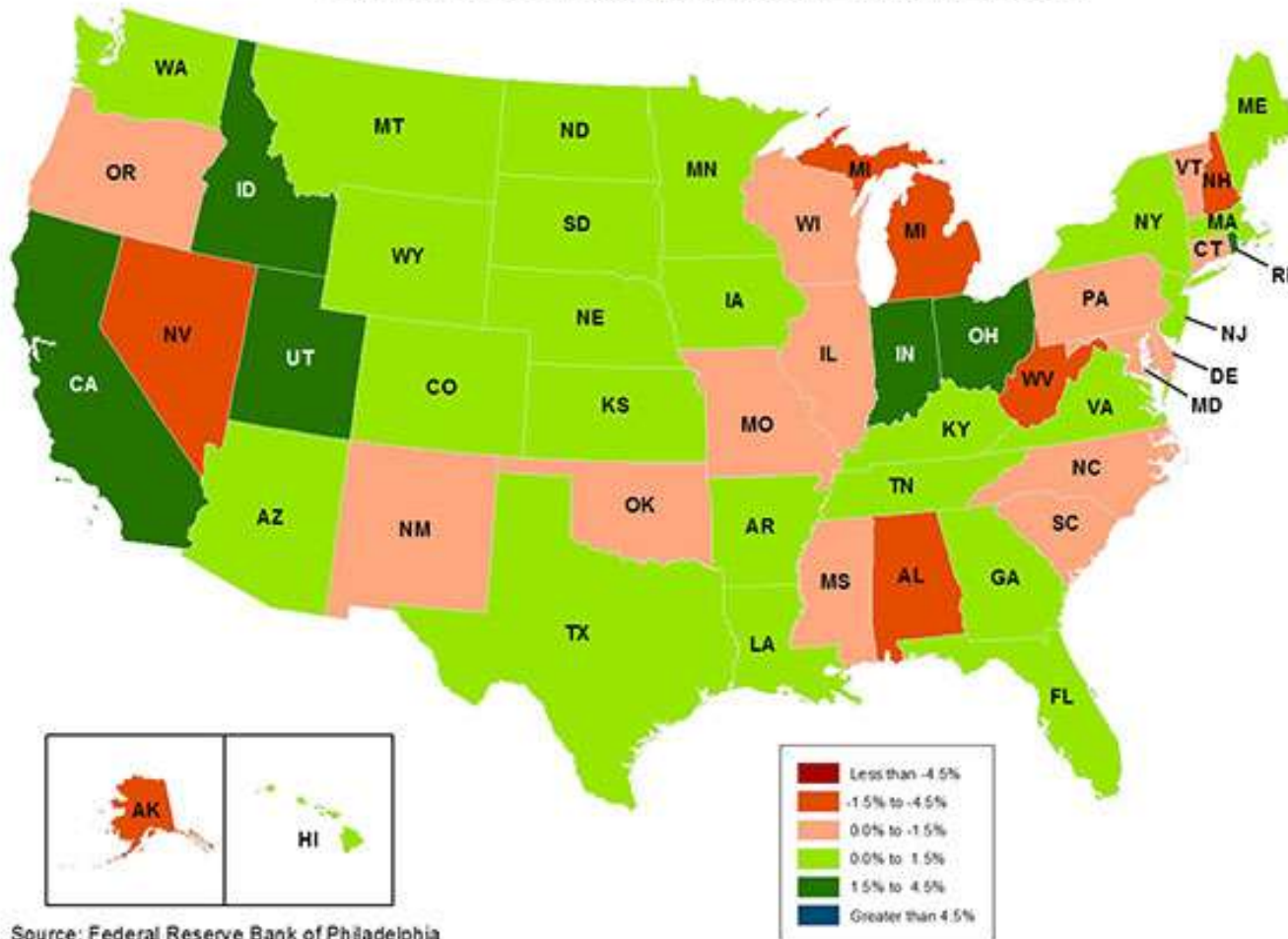
# Off Target: August 2011 Forecasts for Next 4 Quarters vs. Actual US Real GDP

Real GDP Annual  
Growth Rate



# State-by-State Leading Indicators for 2d Half of 2012

July 2012 State Leading Indexes: 6-Month Forecast



Source: Federal Reserve Bank of Philadelphia

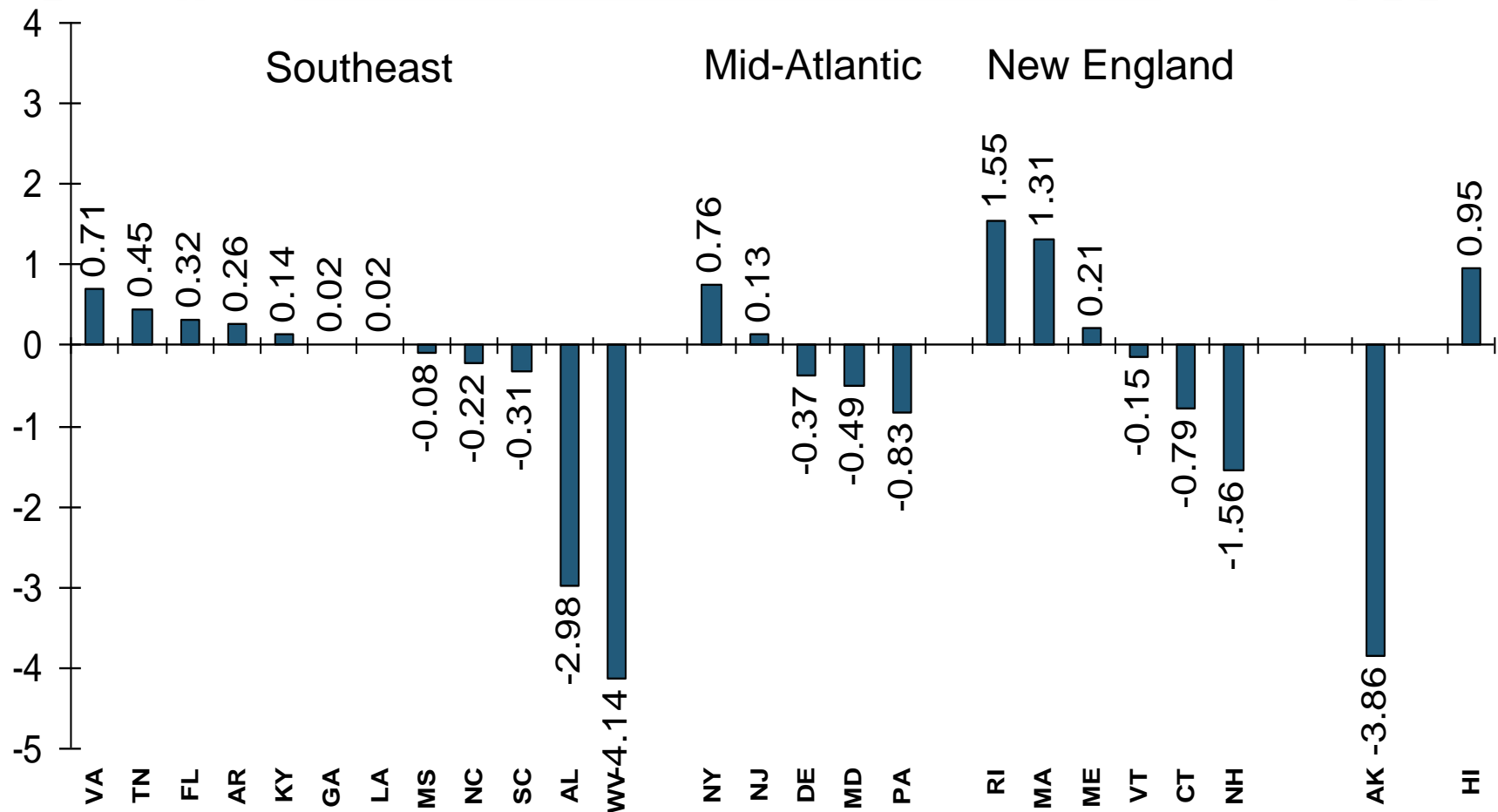
## 5 Fastest Growing States

Ohio	3.2%
Idaho	2.5%
California	2.4%
Indiana	1.7%
Rhode Island	1.6%

## 5 Slowest Growing States

West Virginia	-4.1%
Alaska	-3.9%
Michigan	-3.4%
Alabama	-3.0%
Nevada	-2.0%

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

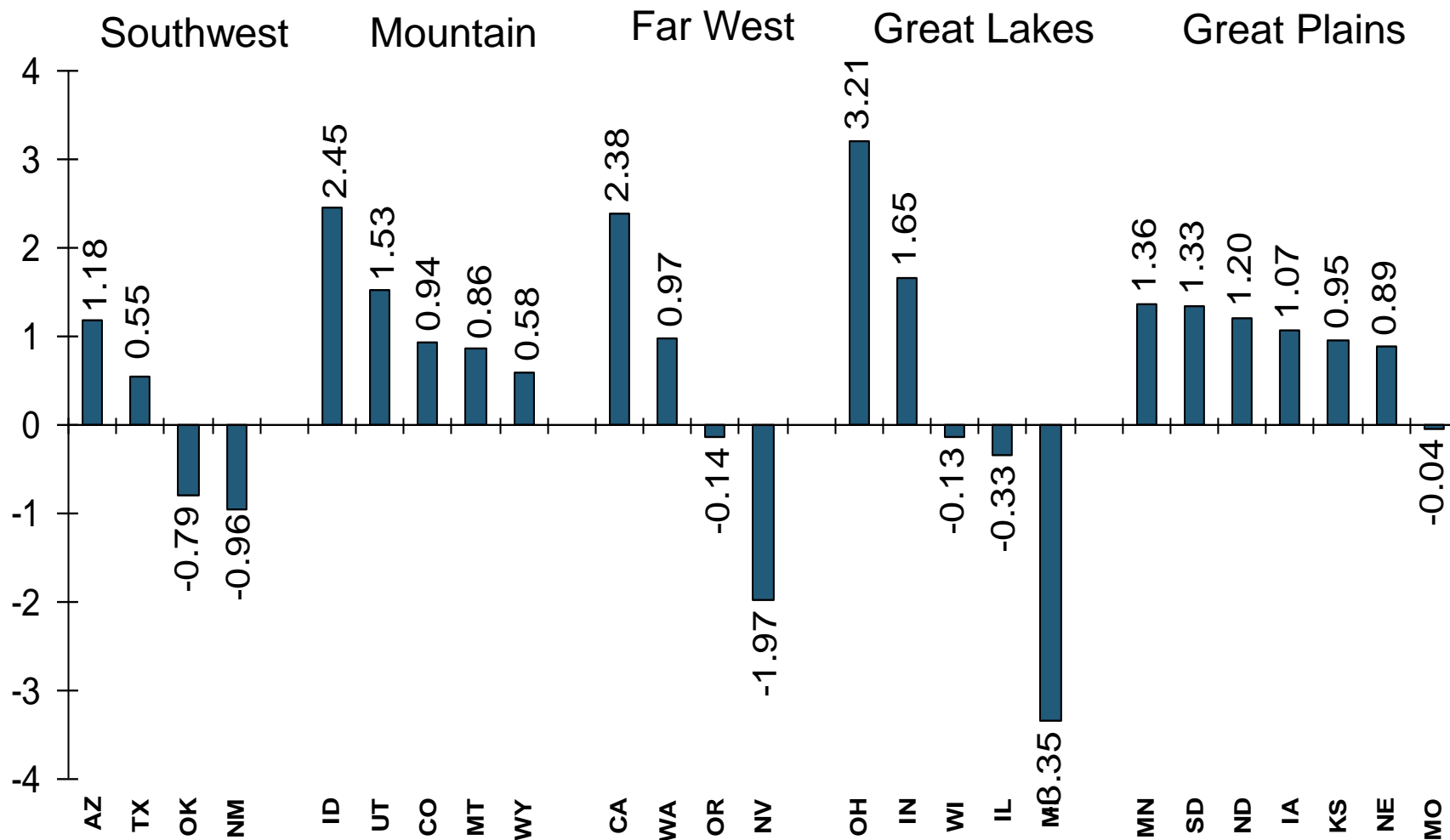


\*Data for July-December; next release to be posted October 2, 2012.

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



# Leading Indicator Indexes Vary Widely by State and Region\*(cont'd)



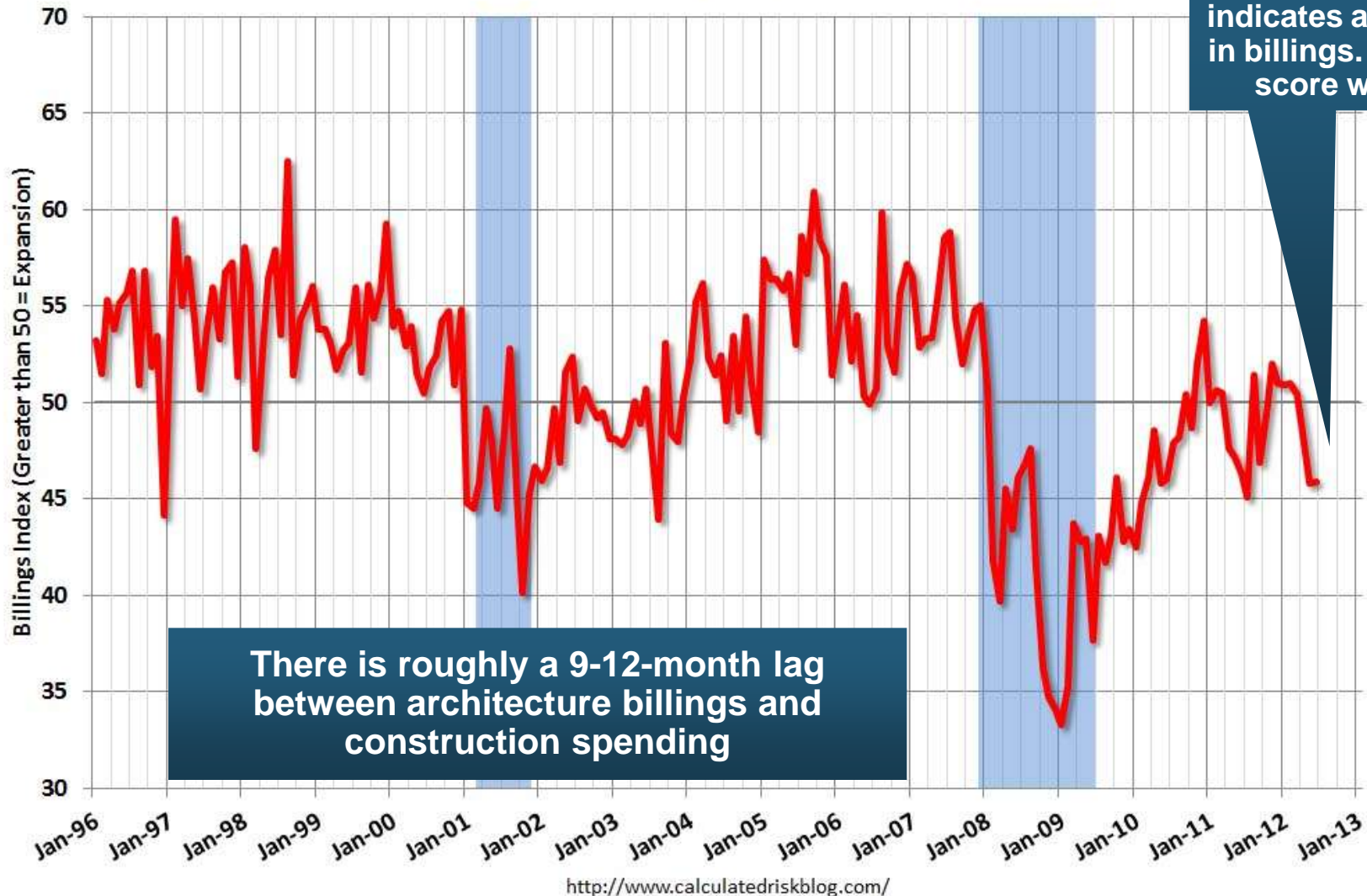
\*Data for July-December; next release to be posted October 2, 2012.

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

# Construction Trends

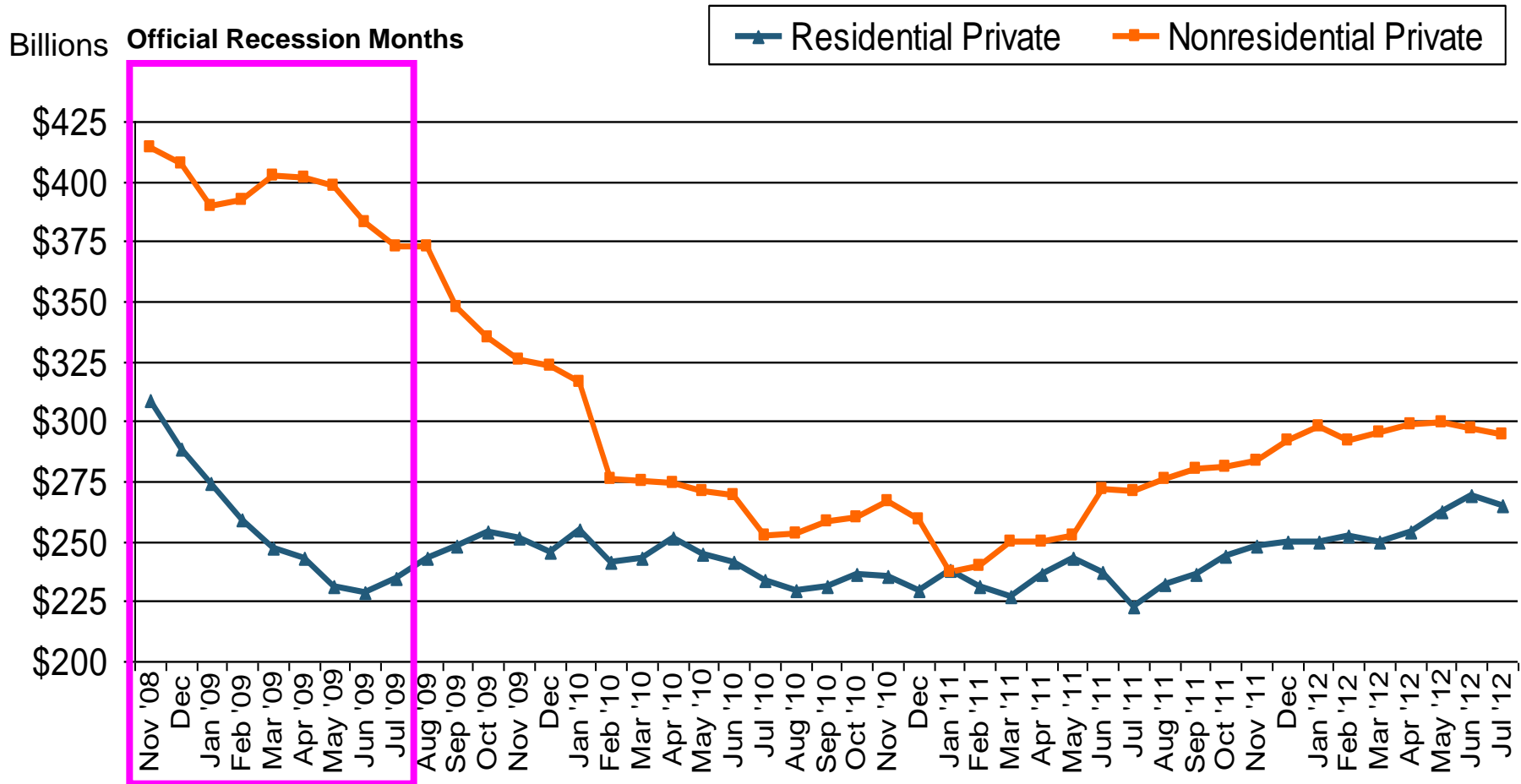
# The Architecture Billings Index is a Leading Indicator of Construction

Architecture Billings Index



# PRIVATE CONSTRUCTION

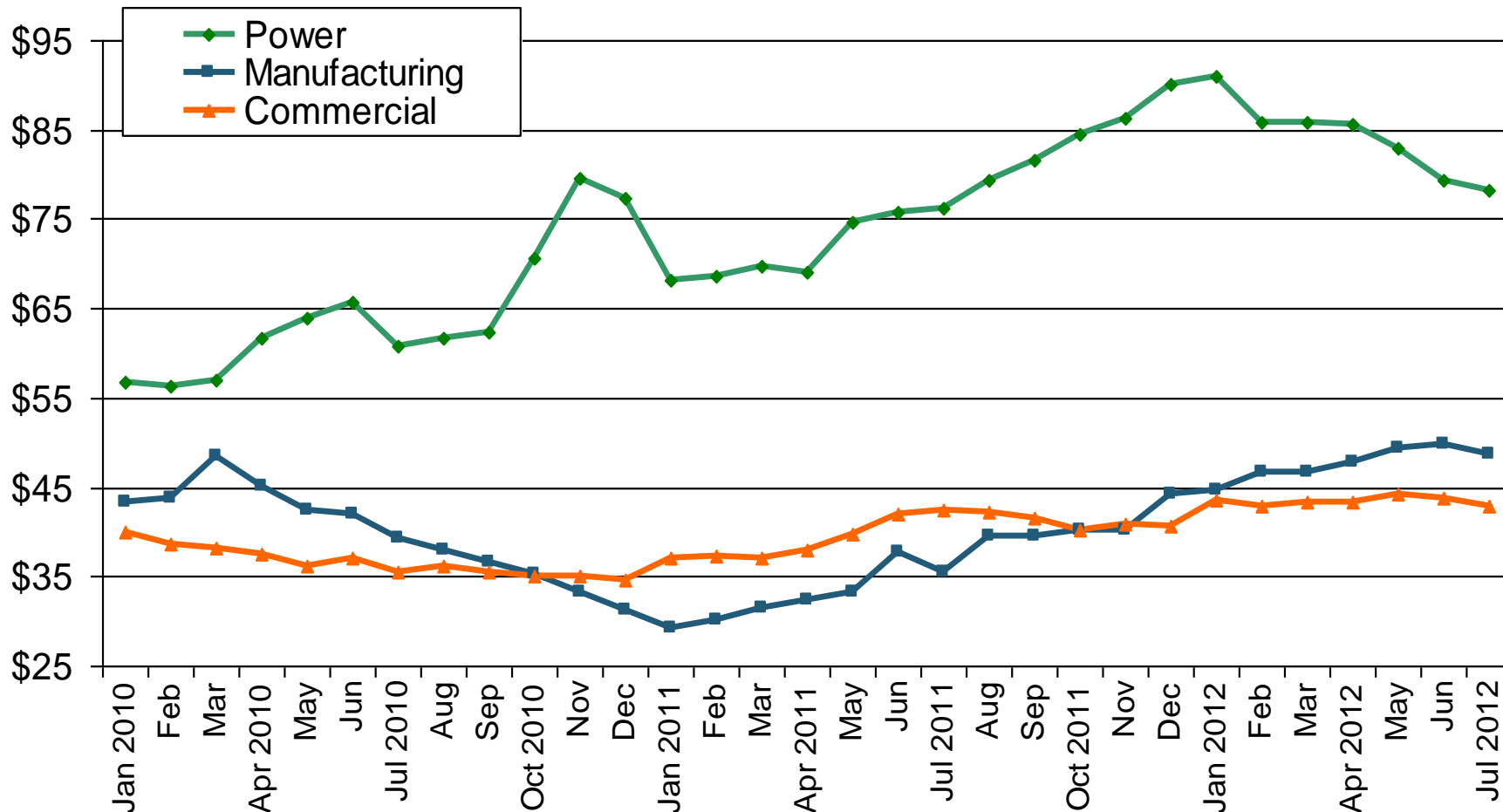
# Value\* of Private Construction “Put In Place”



Since the recession started in Dec 2007, private nonresidential construction activity plunged by 41% (as of Jan 2011), then rose by 26% (as of July 2012), but is still down 25% vs. Dec 2007.

# Value\* of Nonresidential Private Construction “Put In Place,” by Sector

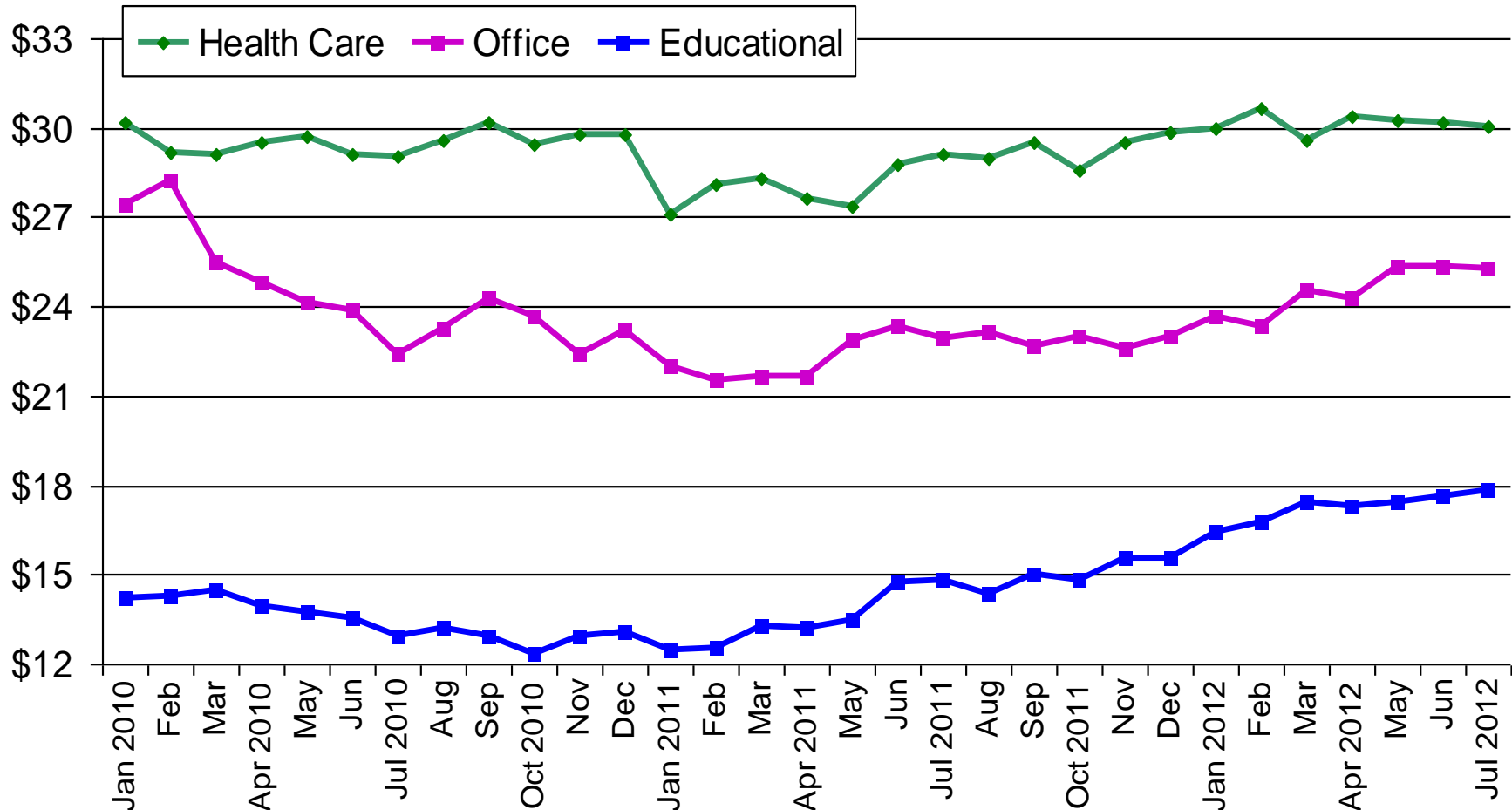
\$ Millions



**Power-related construction rose in 2010-11 but since then dropped off. Manufacturing construction took an opposite path.**

# Value\* of Nonresidential Private Construction “Put In Place,” by Sector

\$ Millions



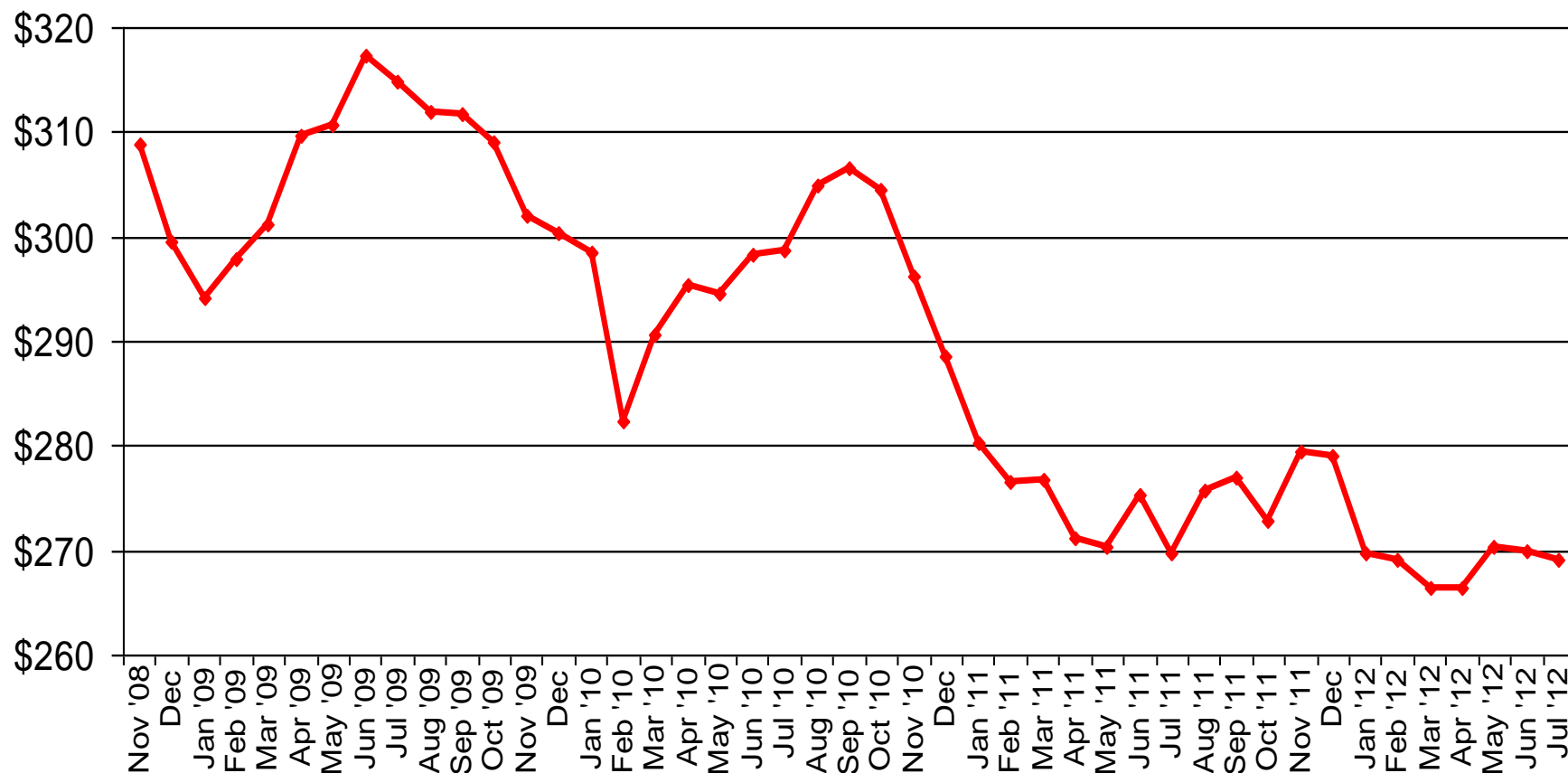
**Private health-care construction has been virtually flat since July 2010, but private educational construction rose 37.7% in that time.**

# PUBLIC CONSTRUCTION



# Value\* of Nonresidential Public Construction “Put In Place”

Billions

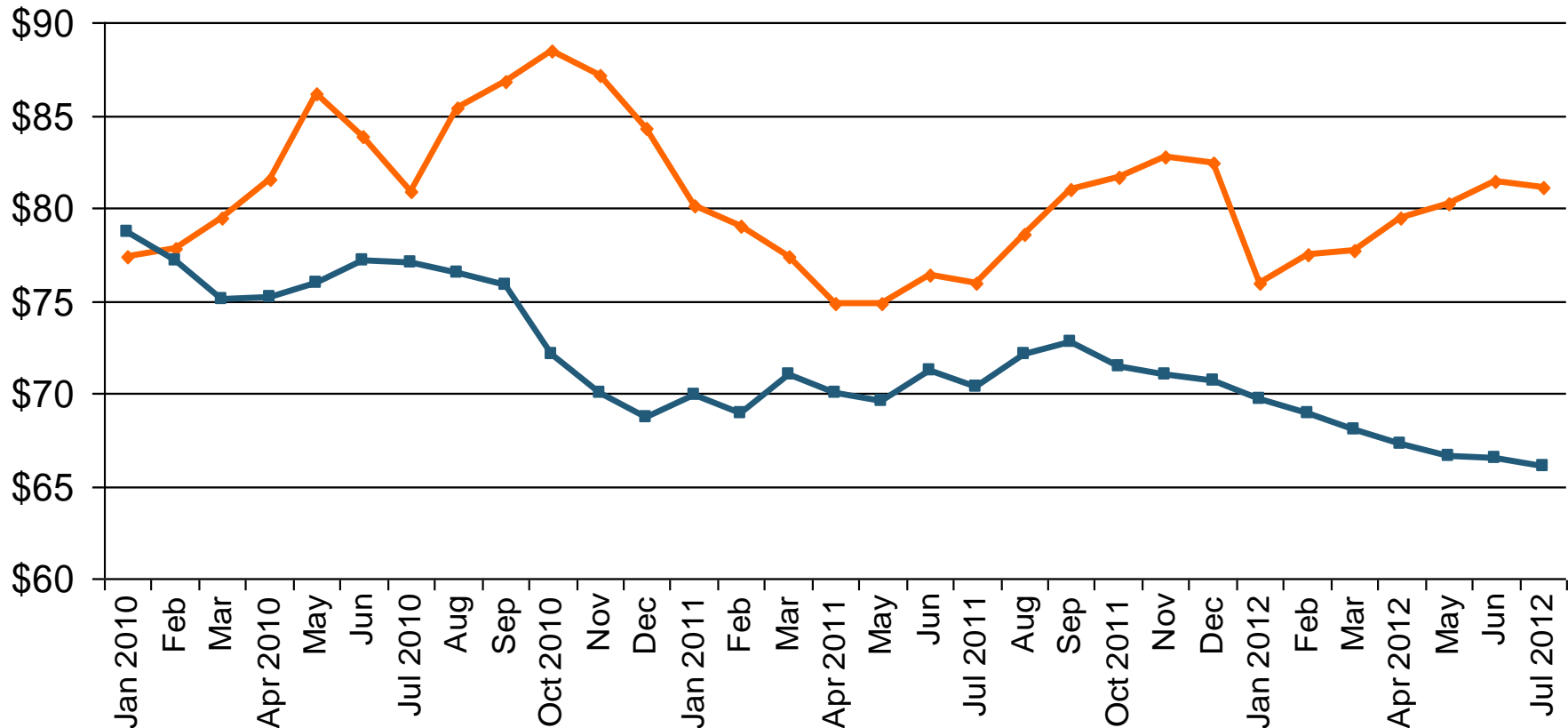


**Since the recession started, private residential and nonresidential construction together are down \$300 billion (annual rate), a drop of 38%. Public construction has hardly moved.**

# Value\* of Nonresidential Public Construction “Put In Place,” by Sector

\$ Millions

— Highway & Street — Educational

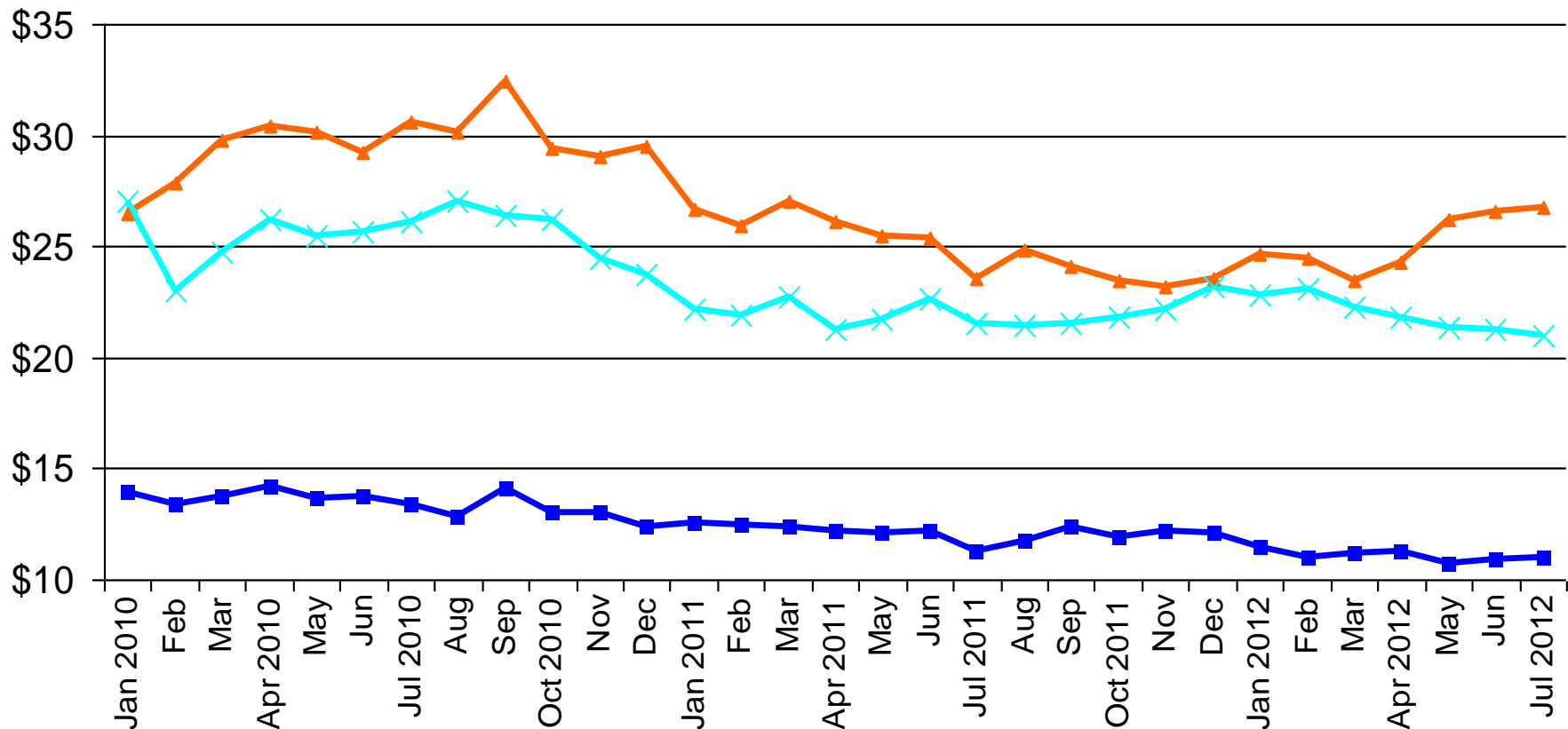


**In 2010, Highway & Street construction rose with federal stimulus, but was virtually flat since then. Since the start of 2010, public spending for Educational construction is down \$12.6B (-16.0%).**

# Value\* of Nonresidential Public Construction “Put In Place,” by Sector

\$ Millions

—▲— Transportation —×— Sewage & Waste Disposal —■— Office



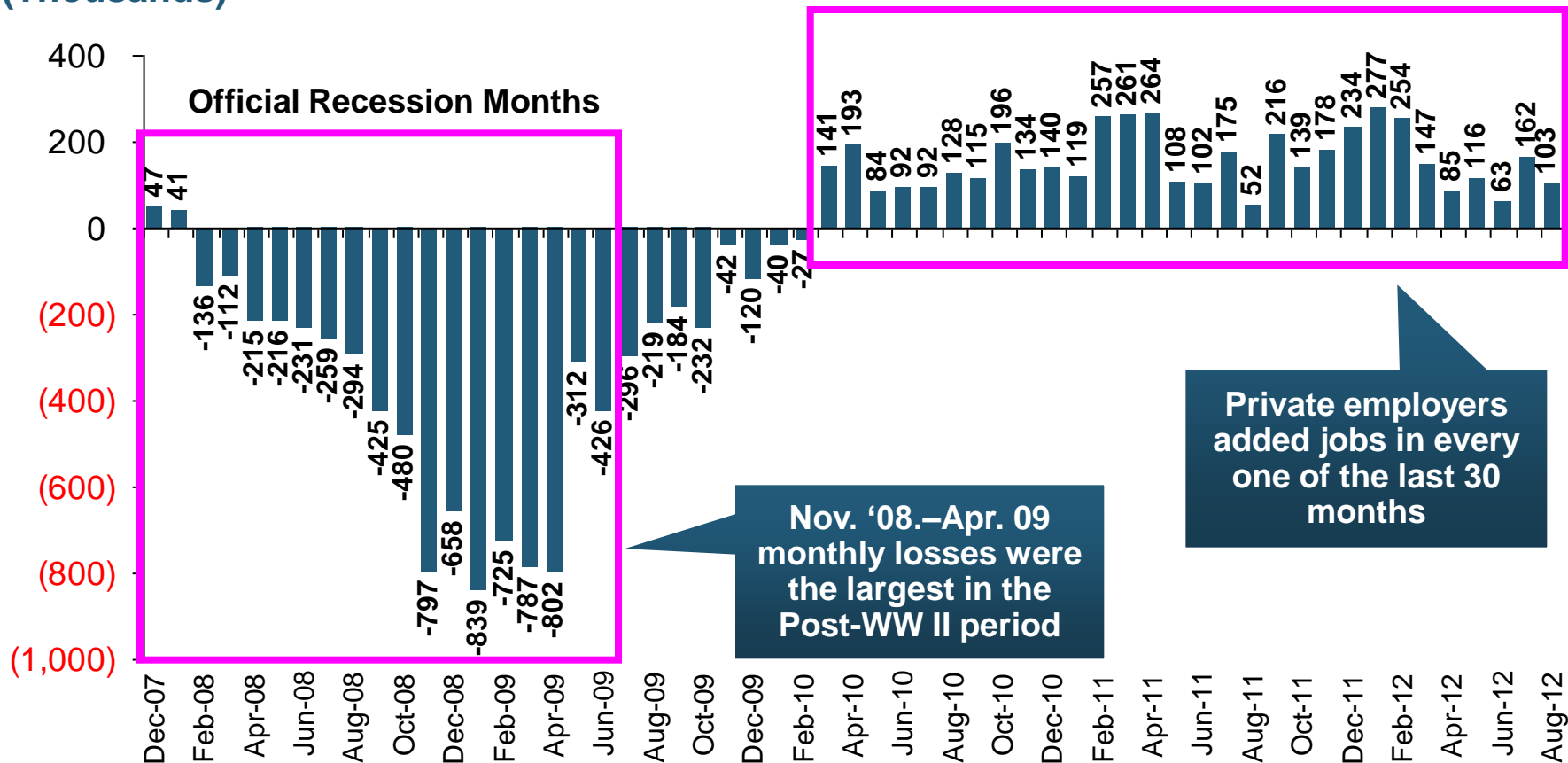
**Since July 2010, public Sewage & Waste construction is down significantly (-\$5.2B, or -19.7%), public Office construction is down \$2.4B (-17.7%), and Transportation construction is down \$3.8B (-12.4%).**

# The Labor Market

# Monthly Change in Private Employment\*

December 2007 through August 2012

(Thousands)

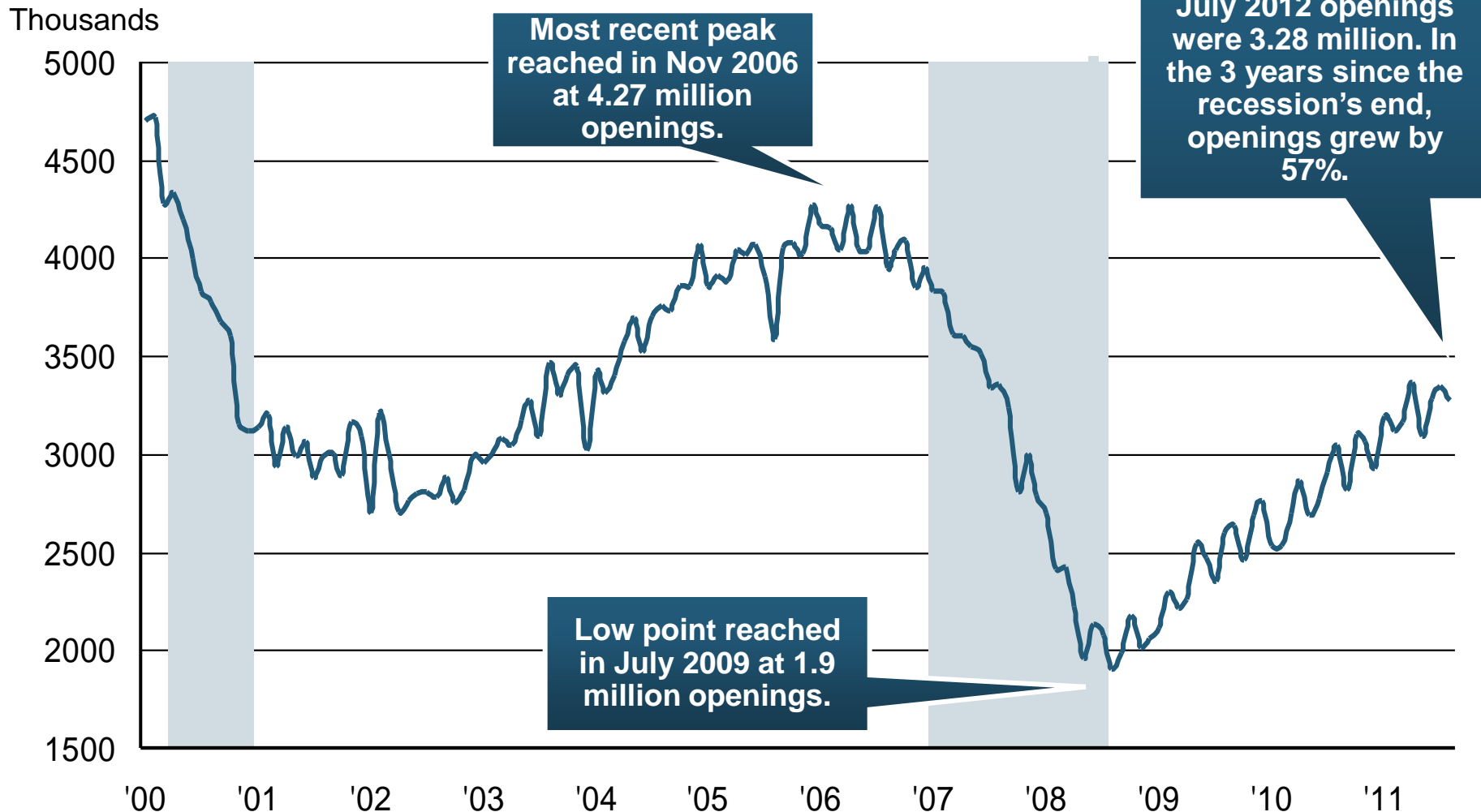


**At the rate of private-sector employment growth in the last six months, the “headline” unemployment rate could be under 8% by 2012 year-end.**

\*seasonally adjusted

Sources: U.S. Bureau of Labor Statistics: <http://www.bls.gov/ces/home.htm>; Insurance Information Institute.

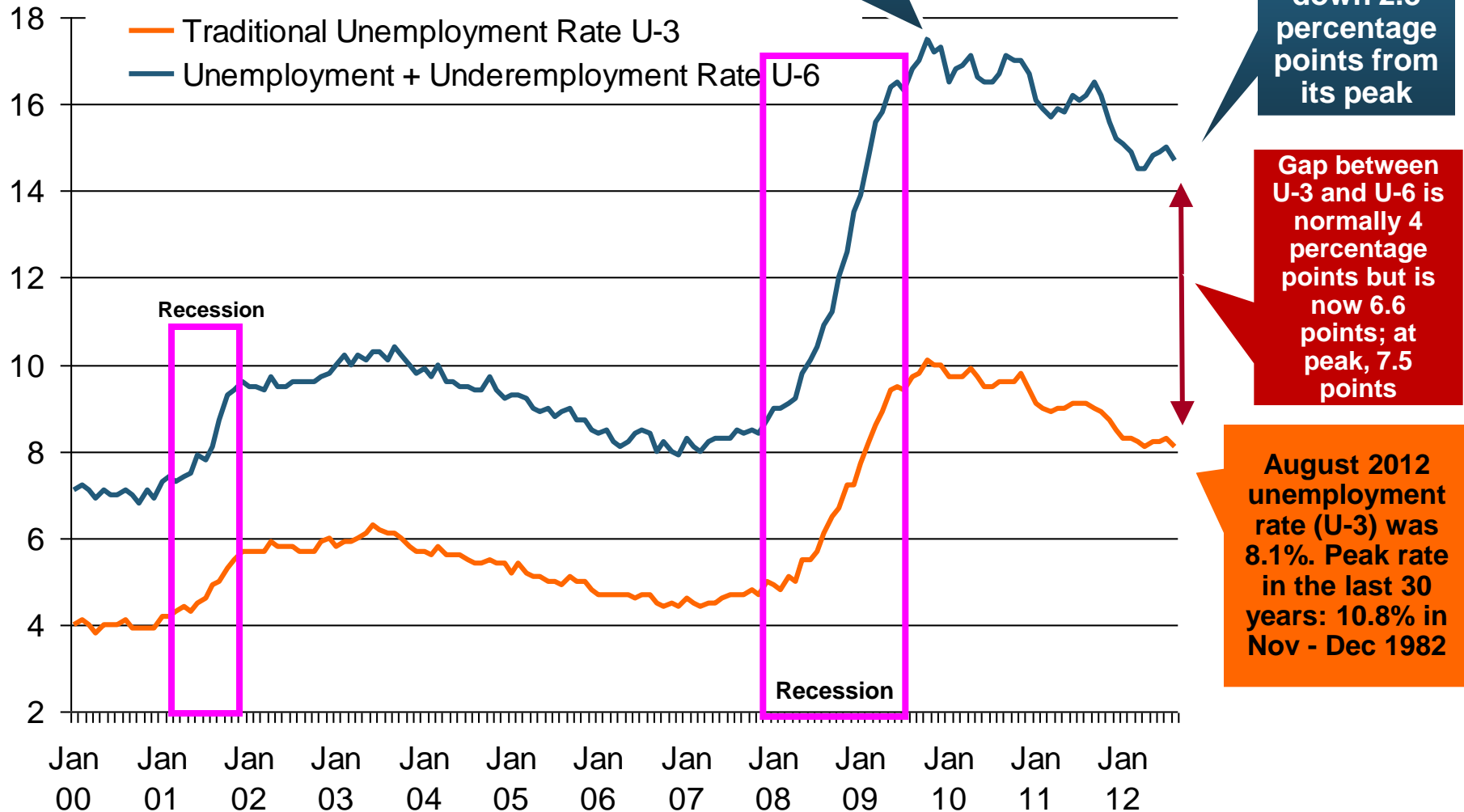
# This Looks Good: Increasing Job Openings in the Private Sector\*



\*Monthly, December 2000 through July 2012; data published Sept. 11, 2012. Note: Recessions indicated by gray shaded columns. Sources: US Bureau of Labor Statistics <http://www.bls.gov>; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

# Unemployment and Underemployment Rate “Normality”: Years to Go

January 2000 through August 2012,  
Seasonally Adjusted (%)



# Number of “Discouraged Workers”: Elevated, but Dropping Jan 1994 – August 2012



**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).**

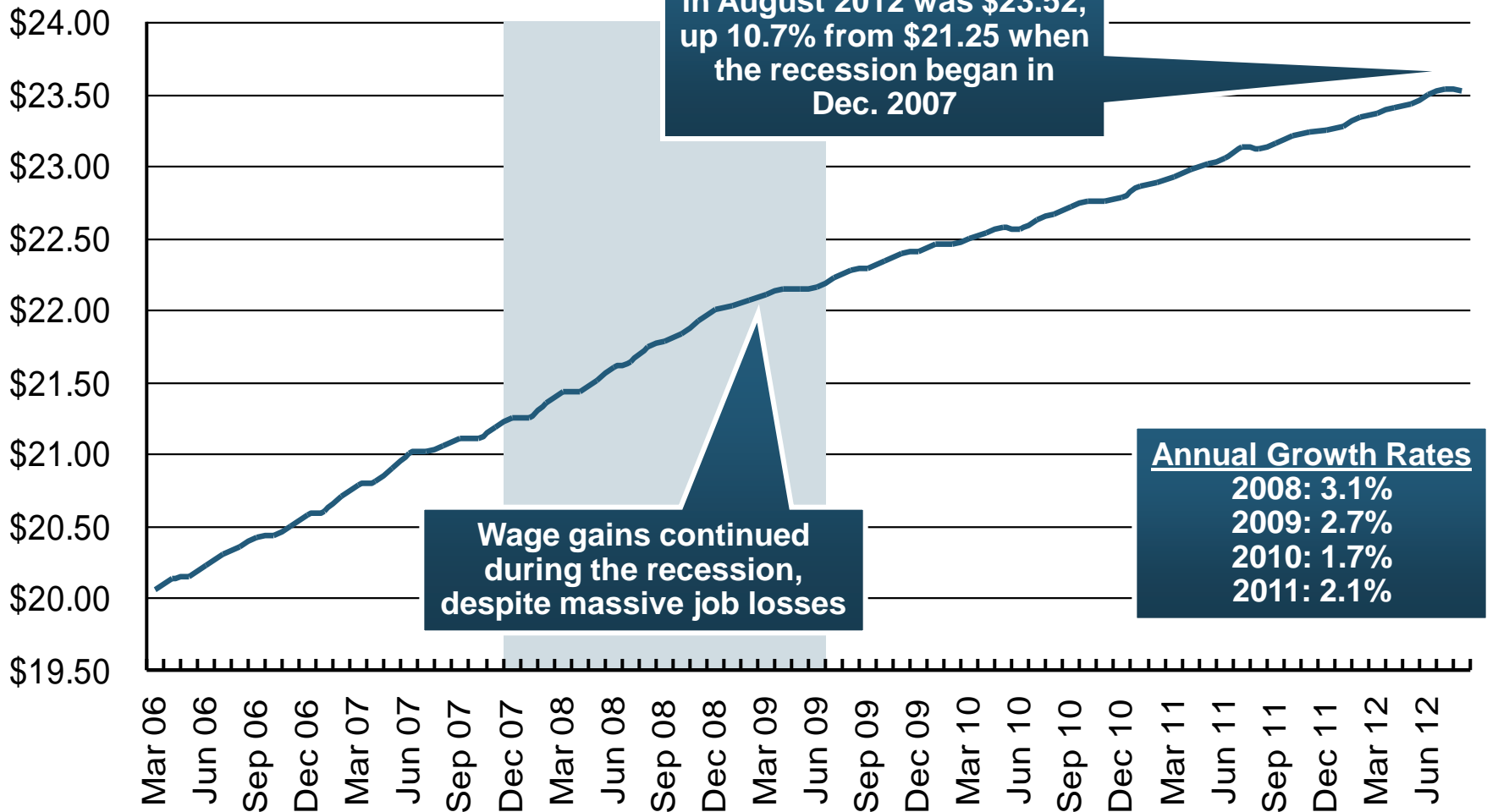
Notes: Recessions indicated by gray shaded columns. Data are seasonally adjusted.

Sources: Bureau of Labor Statistics; National Bureau of Economic Research (recession dates).



# Average Hourly Earnings,\* Private Sector Workers, Monthly, March 2006—August 2012

## Hourly Wage



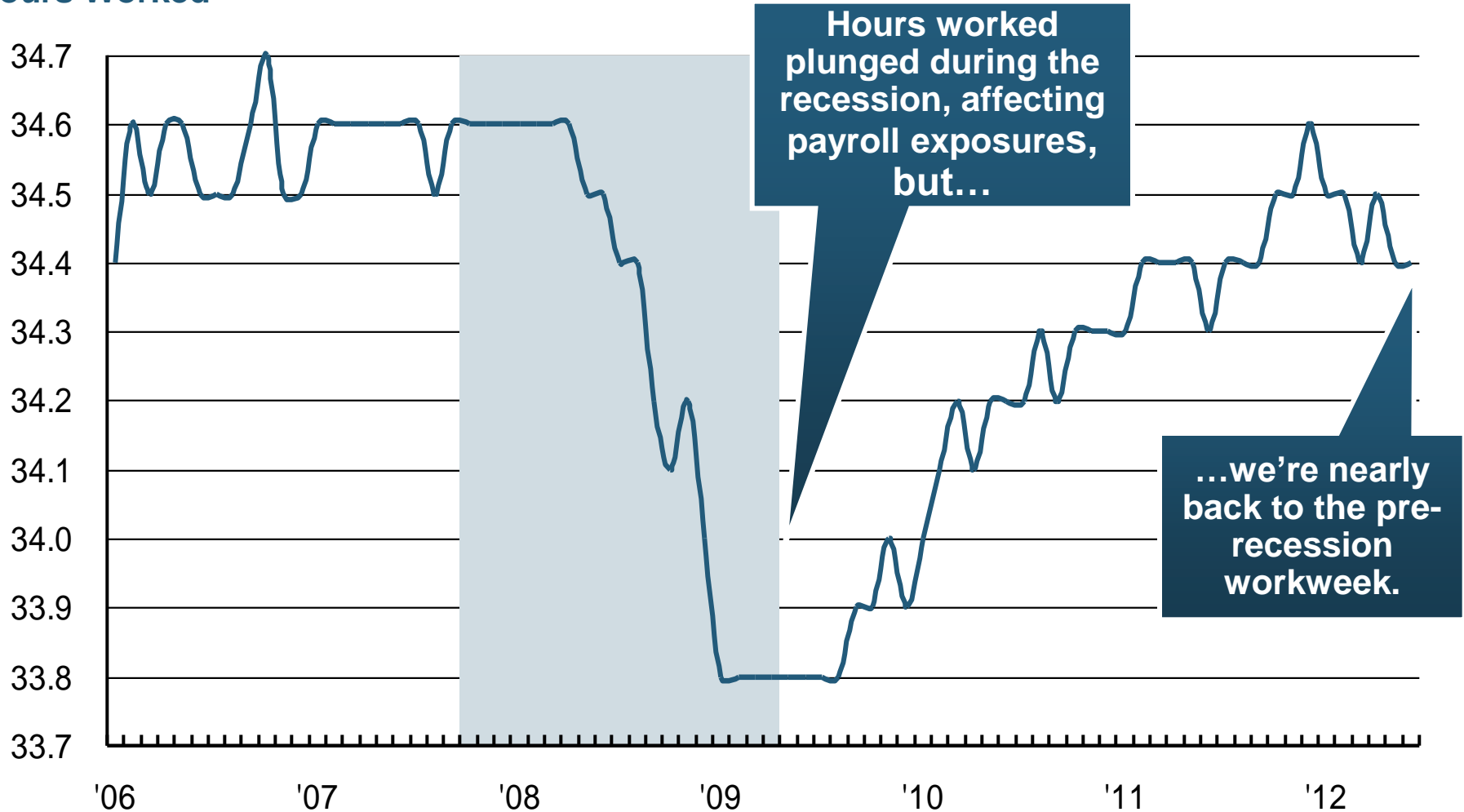
\*Seasonally adjusted

Recession indicated by gray shaded column.

Sources: US Bureau of Labor Statistics at <http://www.bls.gov/data/#employment>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

# Average Weekly Hours, All Private Workers, March 2006—August 2012

## Hours Worked



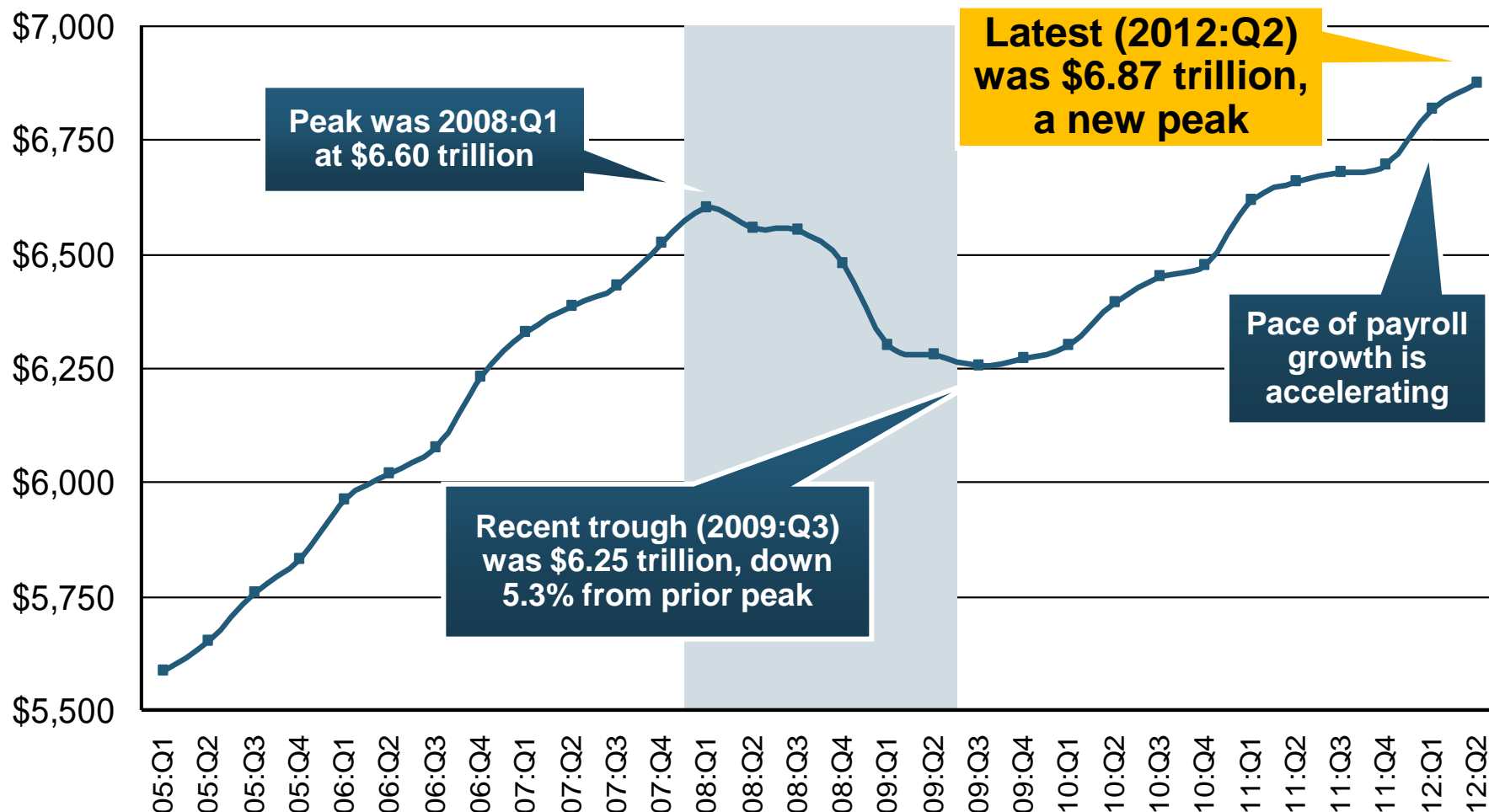
\*Seasonally adjusted

Notes: Recessions indicated by gray shaded columns. This BLS data set starts in March 2006.

Sources: US Bureau of Labor Statistics at <http://www.bls.gov/data/#employment>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

# Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2012:Q2

Billions

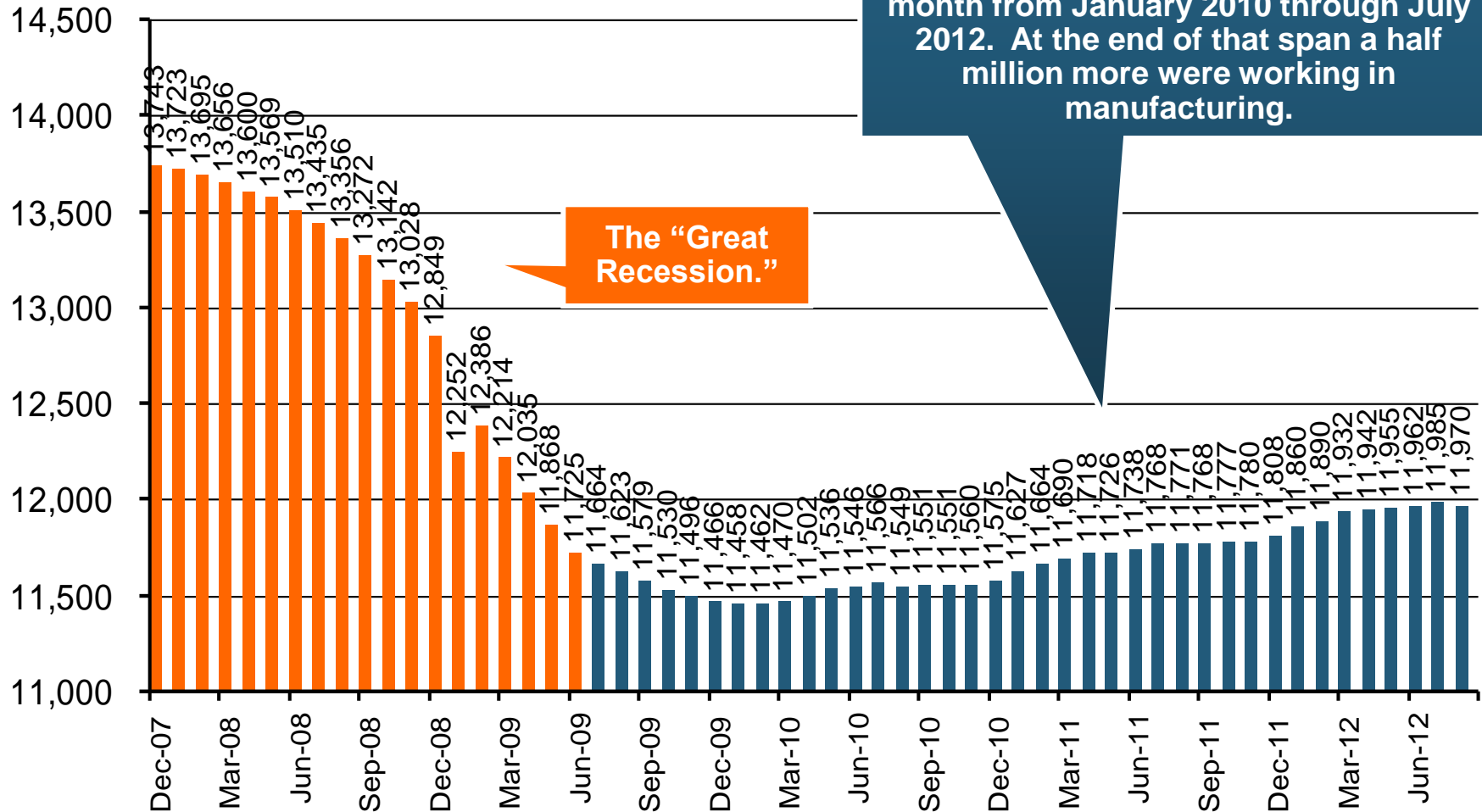


Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

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

# Manufacturing Employment, Dec. 2007—August 2012\*

(Thousands)

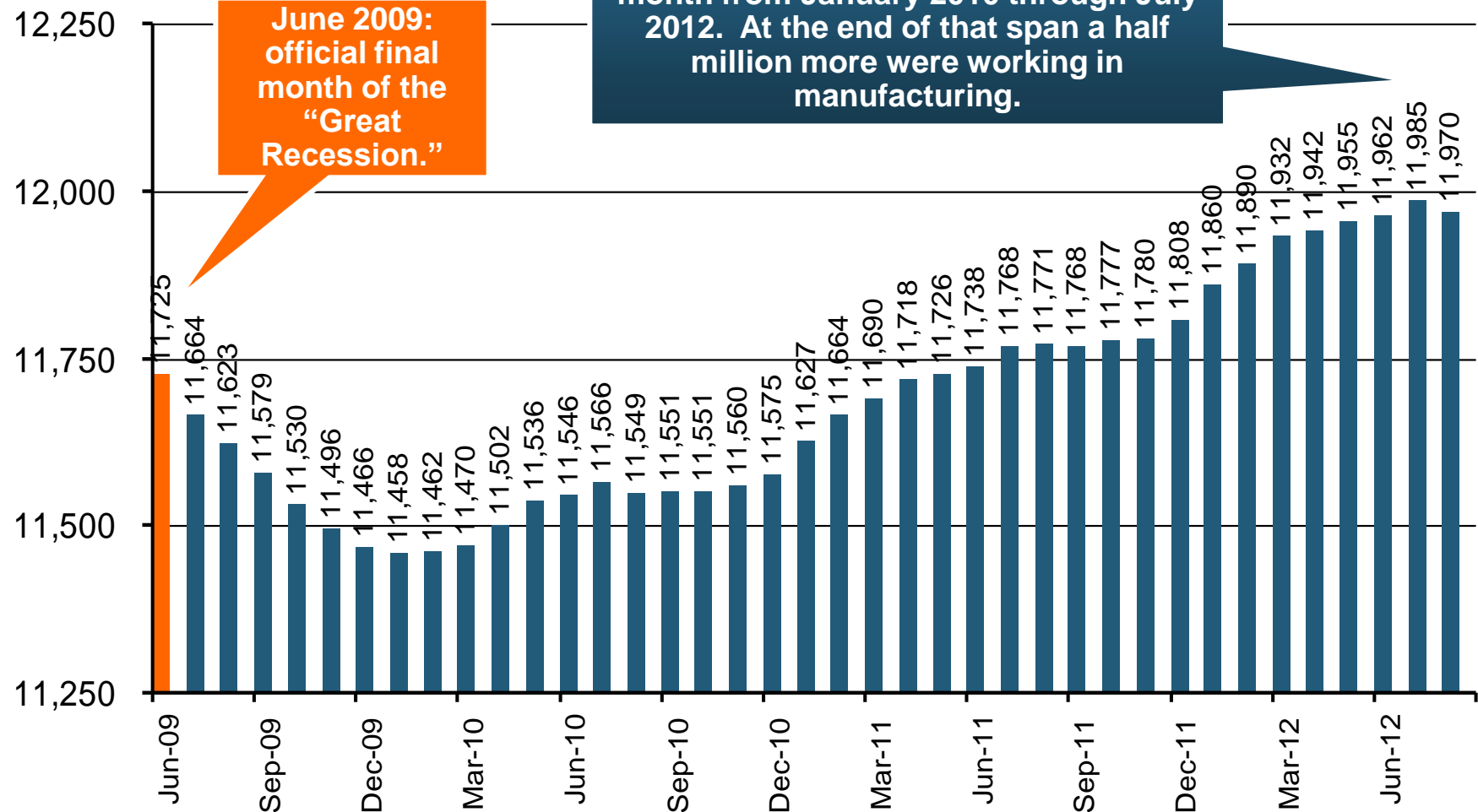


\*Seasonally adjusted; the July and August 2012 data are preliminary

Sources: US Bureau of Labor Statistics at <http://data.bls.gov>; Insurance Information Institute.

# Manufacturing Employment, June 2009—August 2012\*

(Thousands)

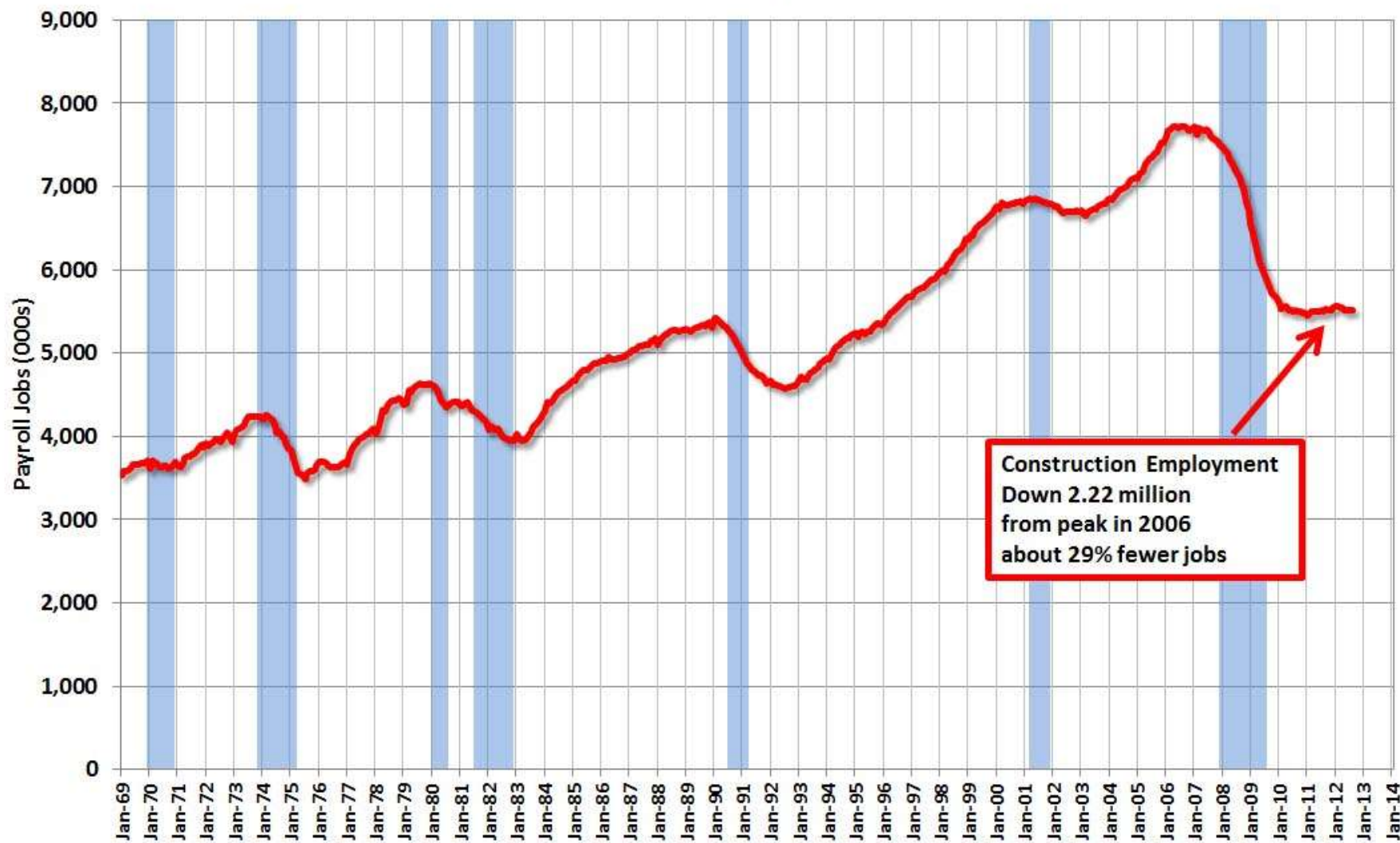


\*Seasonally adjusted; the July and August 2012 data are preliminary

Sources: US Bureau of Labor Statistics at <http://data.bls.gov>; Insurance Information Institute.

# Construction Employment, Jan. 1969—Aug. 2012\*

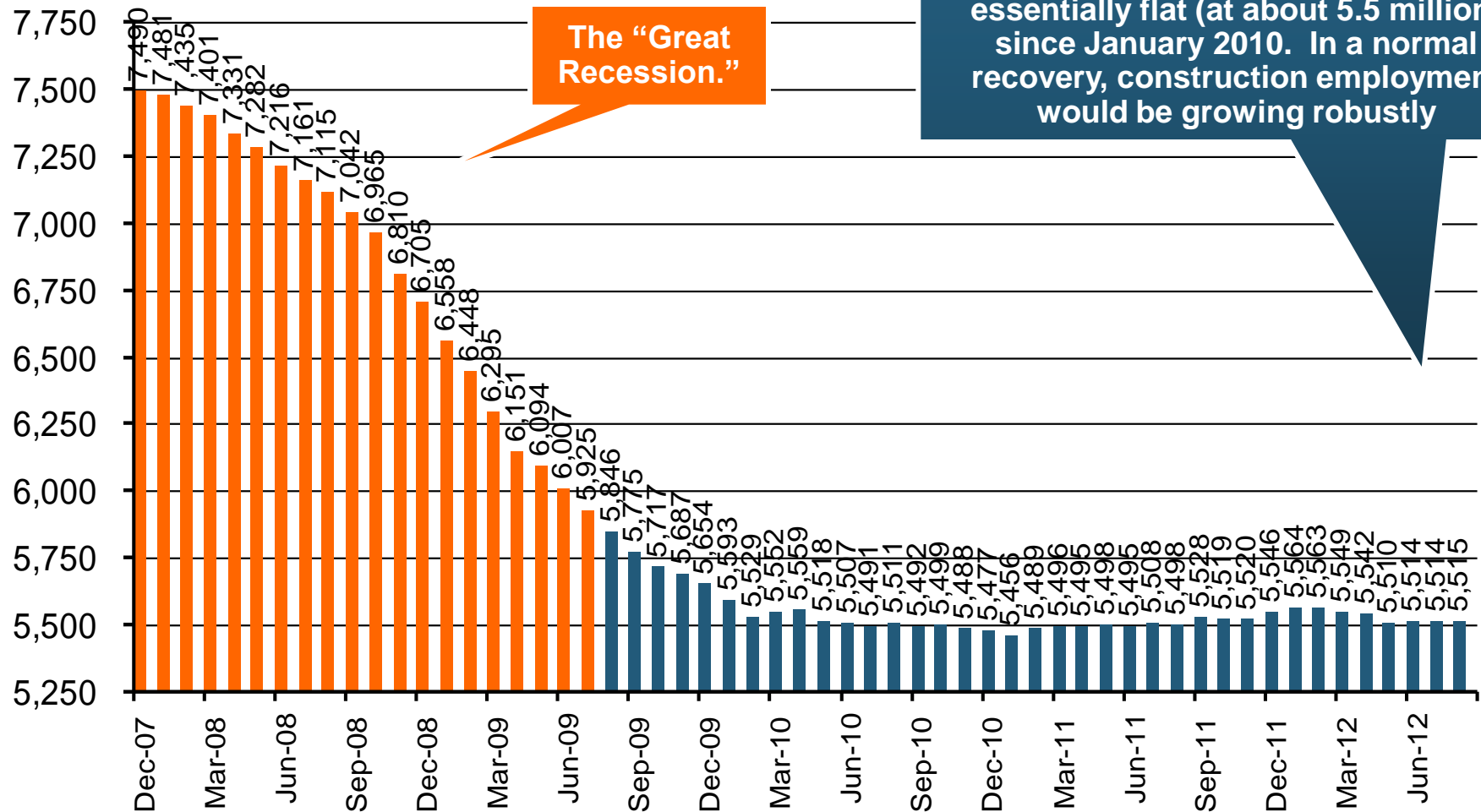
Construction Payroll Jobs, Source: BLS



<http://www.calculatedriskblog.com/>

# Construction Employment, Dec. 2007—August 2012\*

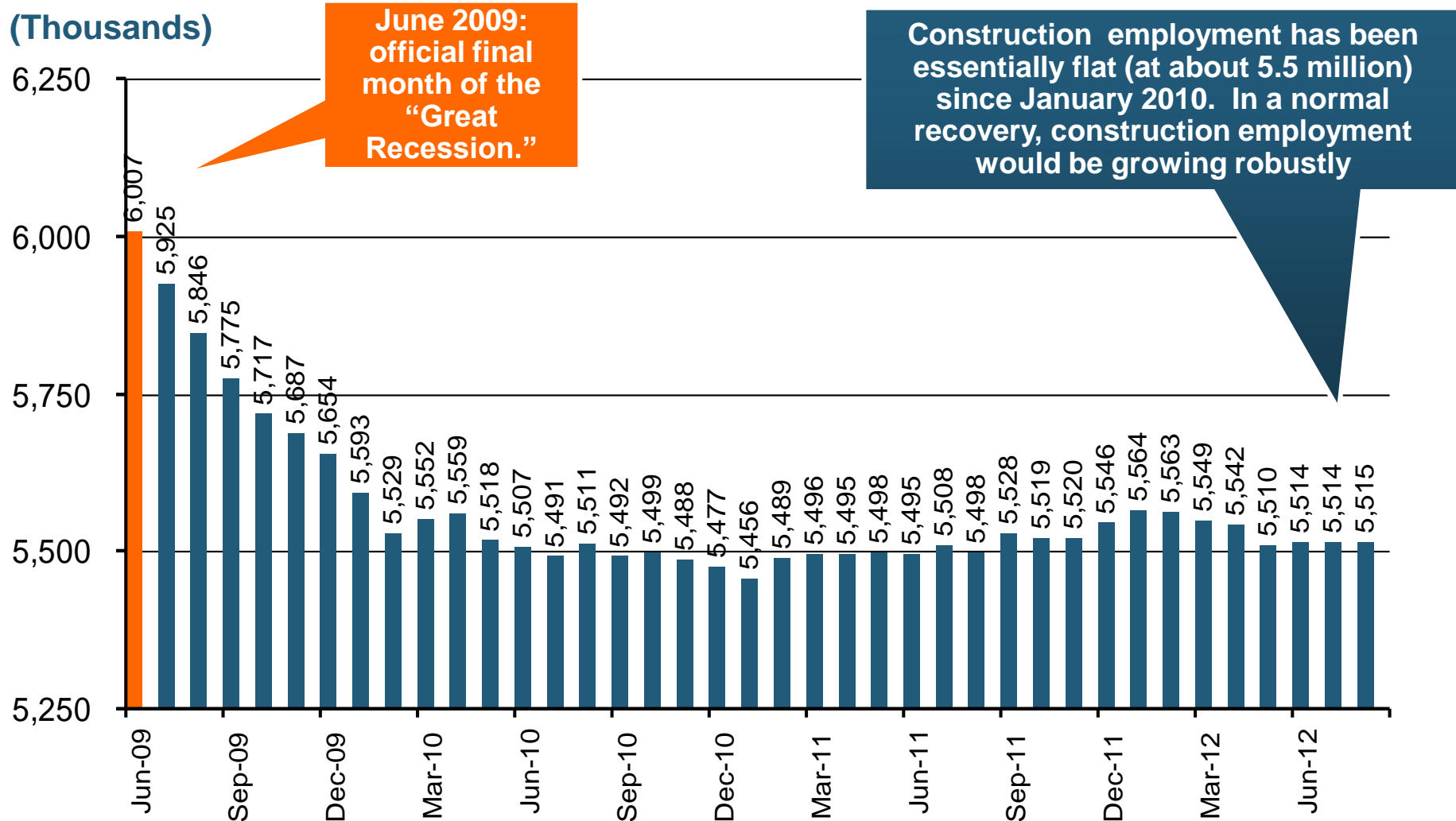
(Thousands)



\*Seasonally adjusted; July and August 2012 are preliminary data

Sources: US Bureau of Labor Statistics at <http://data.bls.gov>; Insurance Information Institute.

# Construction Employment, June 2009—August 2012\*



\*Seasonally adjusted; July and August 2012 are preliminary data

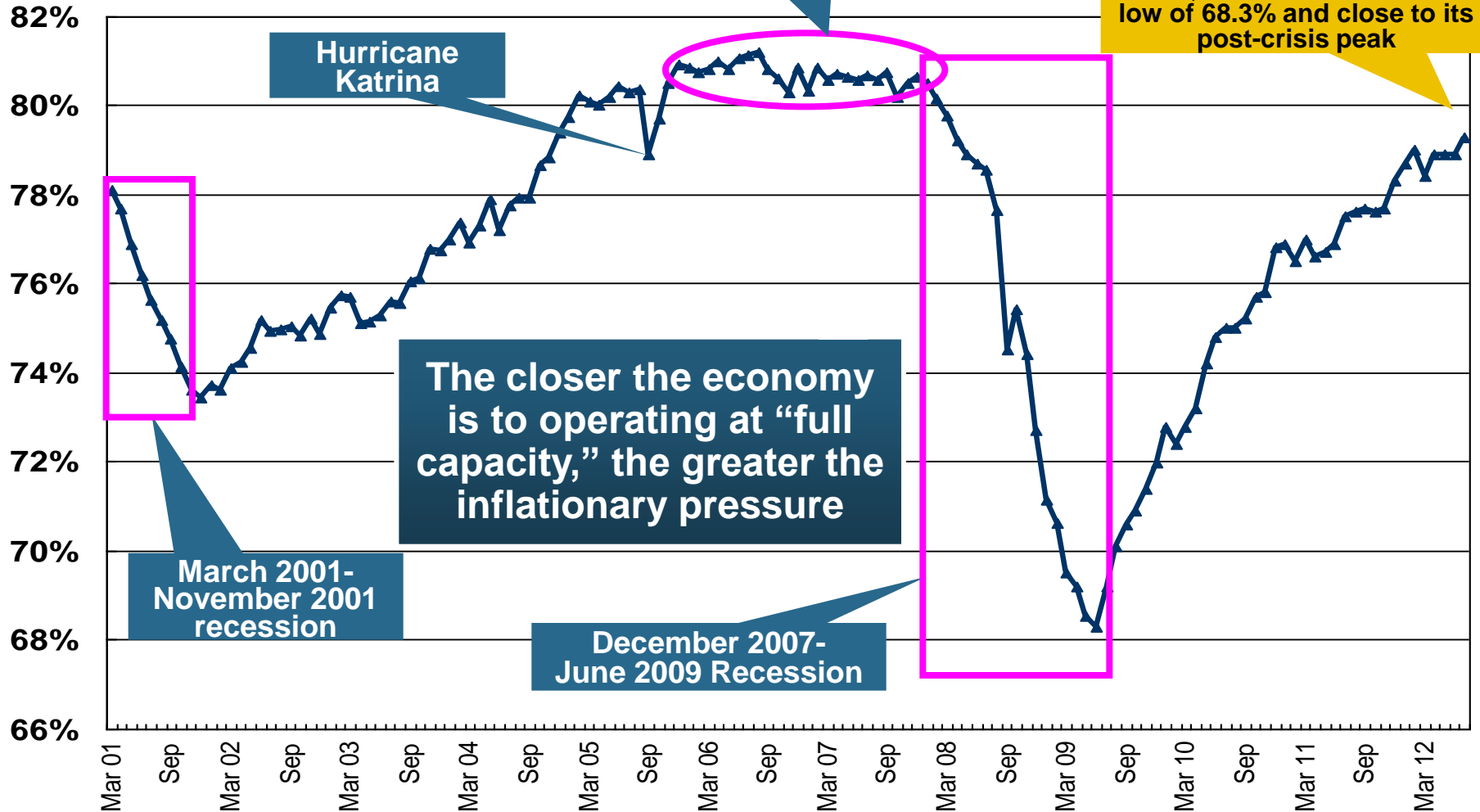
Sources: US Bureau of Labor Statistics at <http://data.bls.gov>; Insurance Information Institute.



# Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

March 2001 through July 2012

Percent of  
Industrial Capacity



Source: Federal Reserve Board statistical releases at <http://www.federalreserve.gov/releases/g17/Current/default.htm>.

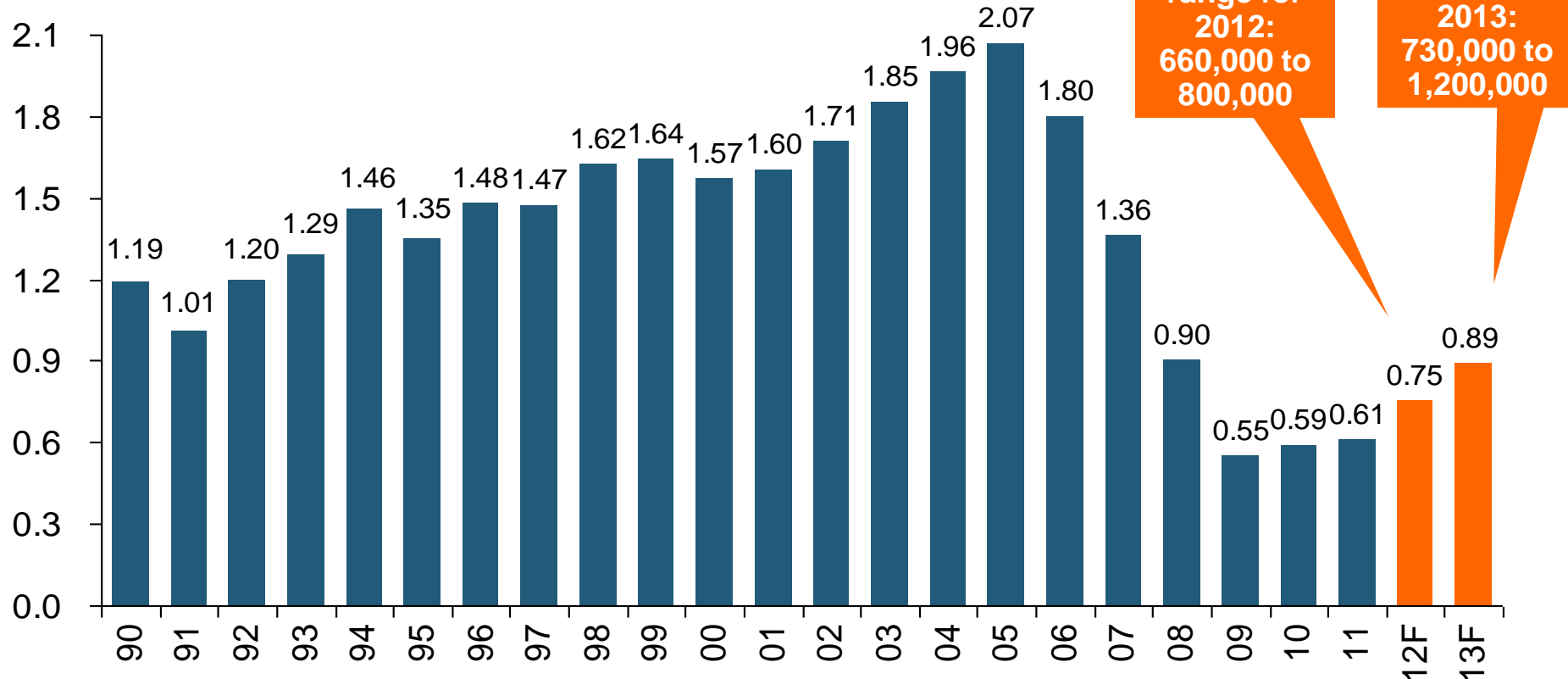


# **The Strength of the Economy Will Influence P/C Insurer Growth Opportunities**

**Growth Will Expand the Exposure Base  
and Fuel Confidence**

# Construction of Private Housing Is Picking Up

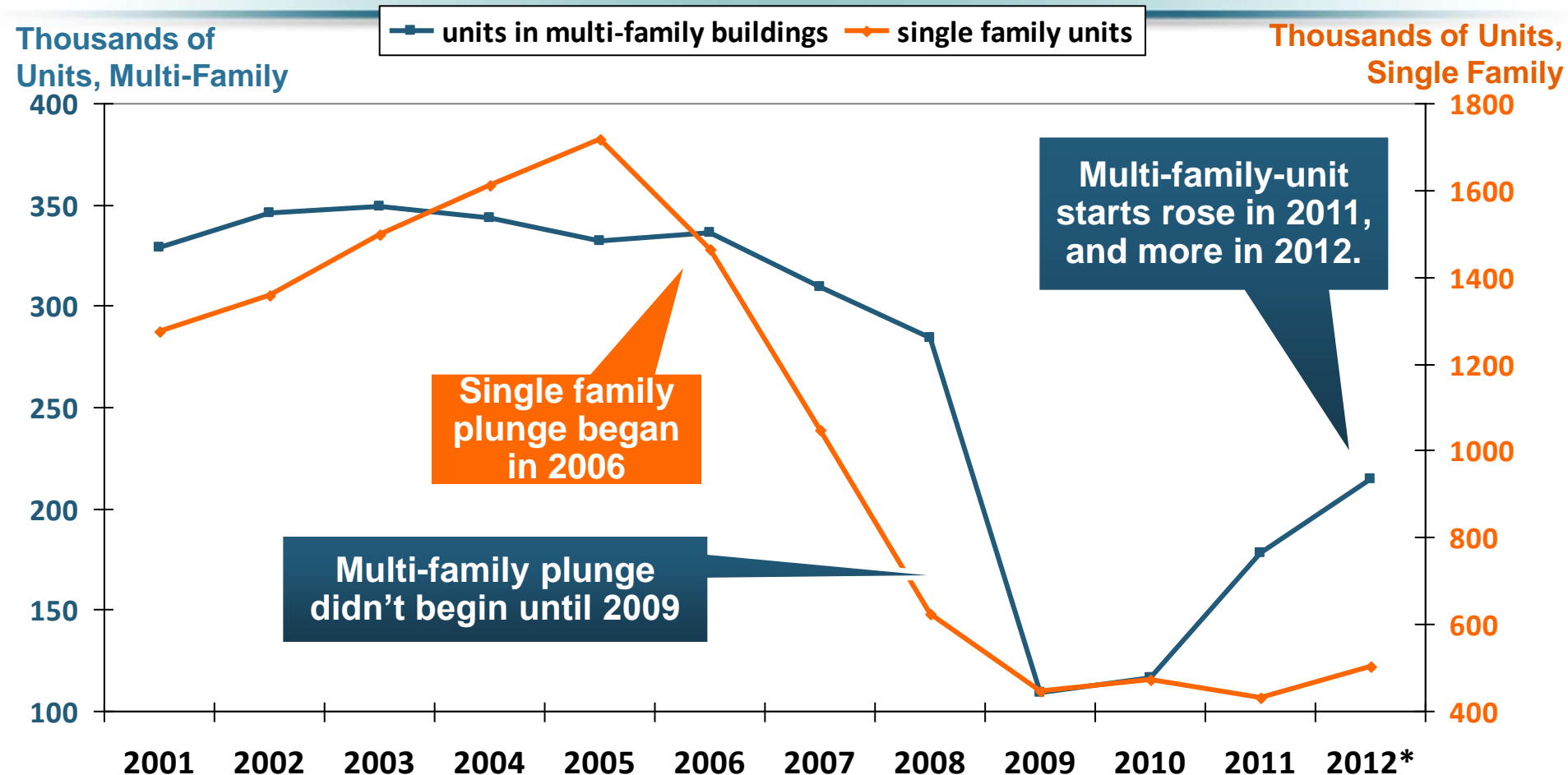
Housing Starts,  
Millions of Units



**Weak home construction forecast implies little exposure growth likely for Homeowners insurers and insurers with a residential construction book of business for the next few years.**

Sources: U.S. Census Bureau and Department of Housing and Urban Development (history) at <http://www.census.gov/const/newresconst.pdf> ; Blue Chip Economic Indicators (8/2012), forecasts; Insurance Information Institute.

# But the Pickup is Mostly in Multi-Family Housing Starts



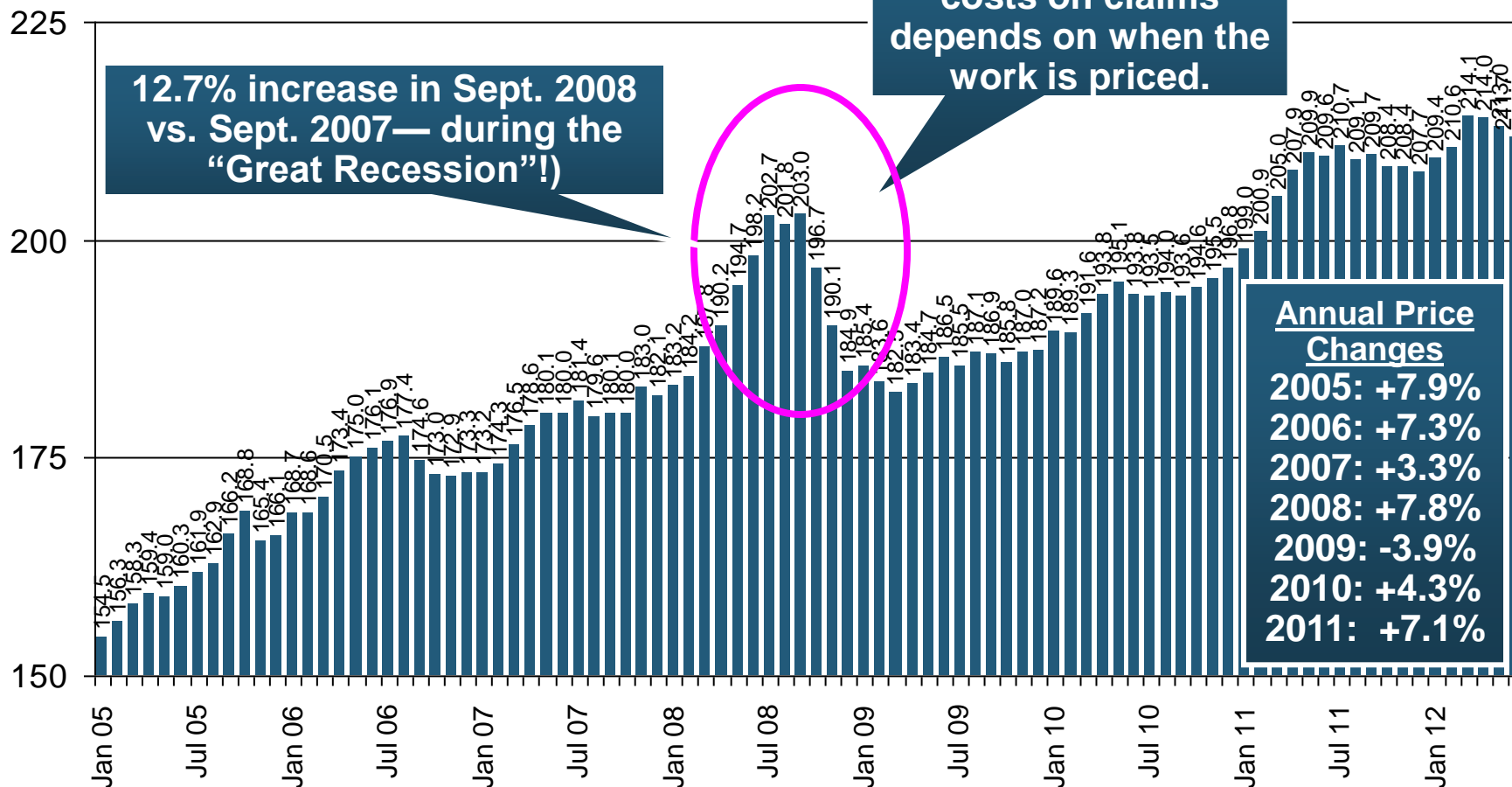
**Multi-unit starts, currently at a seasonally-adjusted annual rate of 215,000, are double the 2009 rate. Average annual rate for 2001-2006: 339,000.**

\*January-July 2012 data, annualized, seasonally-adjusted, preliminary (July)

Source: US Census Bureau at <http://www.census.gov/construction/nrc/pdf/newresconst.pdf>

# Price Index for Residential Maintenance & Repair, Monthly, 2002-2012

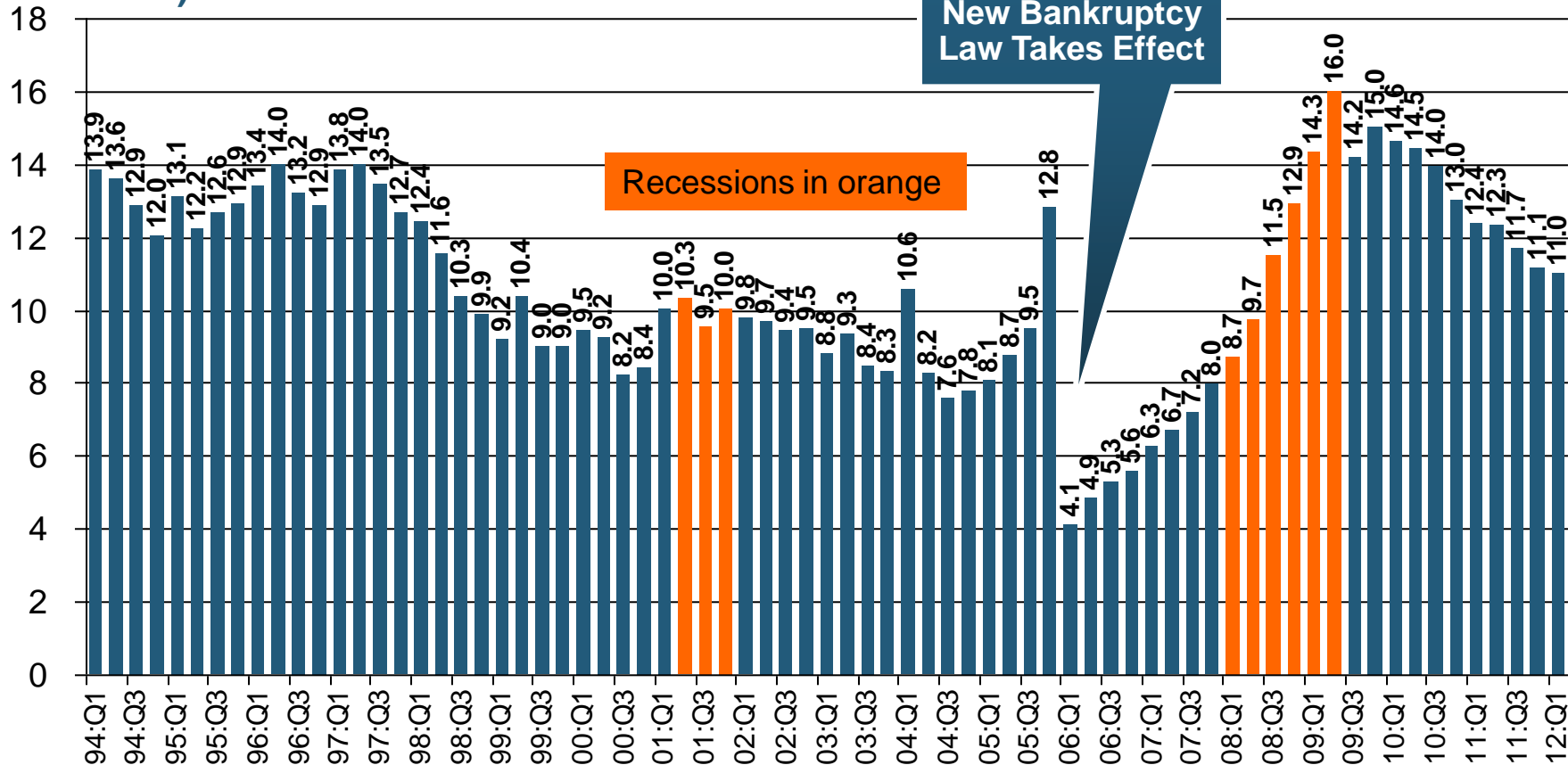
Price Index



**Prices for residential maintenance & repair rose by nearly 40% since December 2004 (through June 2012).**

# Business Bankruptcy Filings: Falling but Still High in 2012 (1994:Q1 – 2012:Q1)

(Thousands)



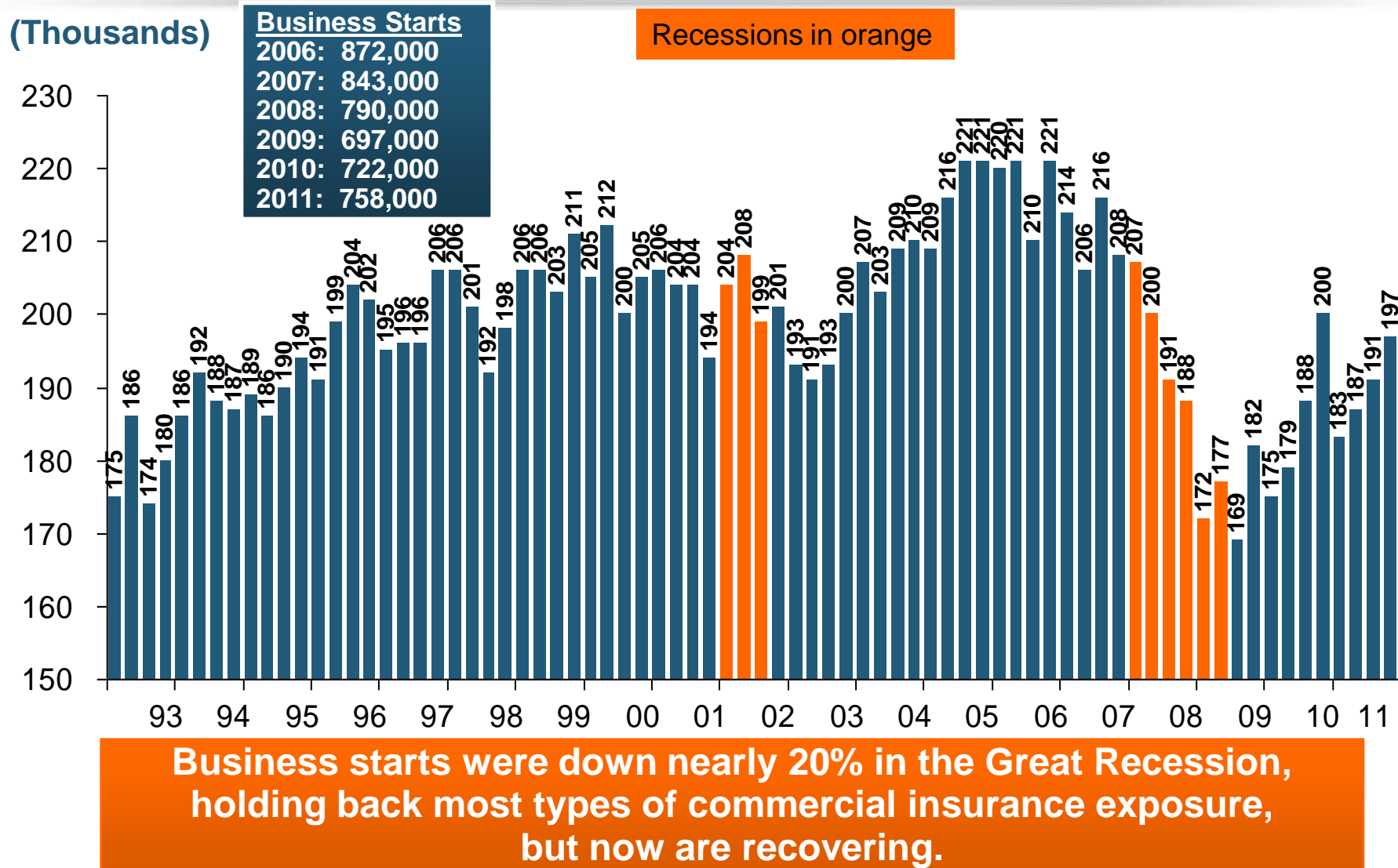
**Business bankruptcies were down 46.5% in 2012:Q1 vs. recent peak in 2009:Q2 but were still higher than 2008:Q2, early in the Great Recession. Bankruptcies restrict exposure growth in all commercial lines.**

Sources: American Bankruptcy Institute at

<http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=61633> ;

Insurance Information Institute

# Private Sector Business Starts, 1993:Q2 – 2011:Q4\*



\* Data through Dec 31, 2011 are the latest available as of August 2, 2012; Seasonally adjusted.

Sources: Bureau of Labor Statistics, <http://www.bls.gov/news.release/cewbd.t08.htm>. NBER (recession dates)

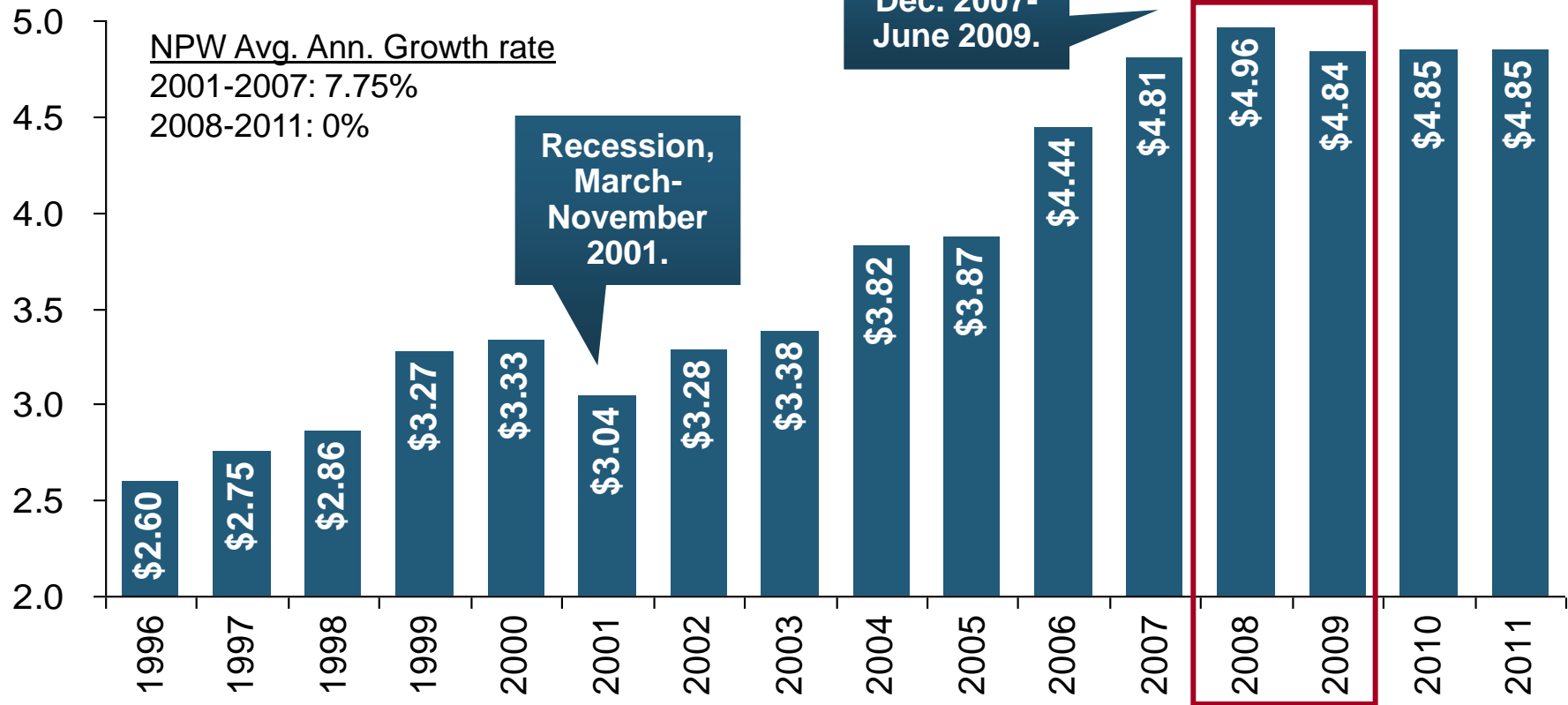
# Surety Industry Trends



# Surety: Net Premiums Written

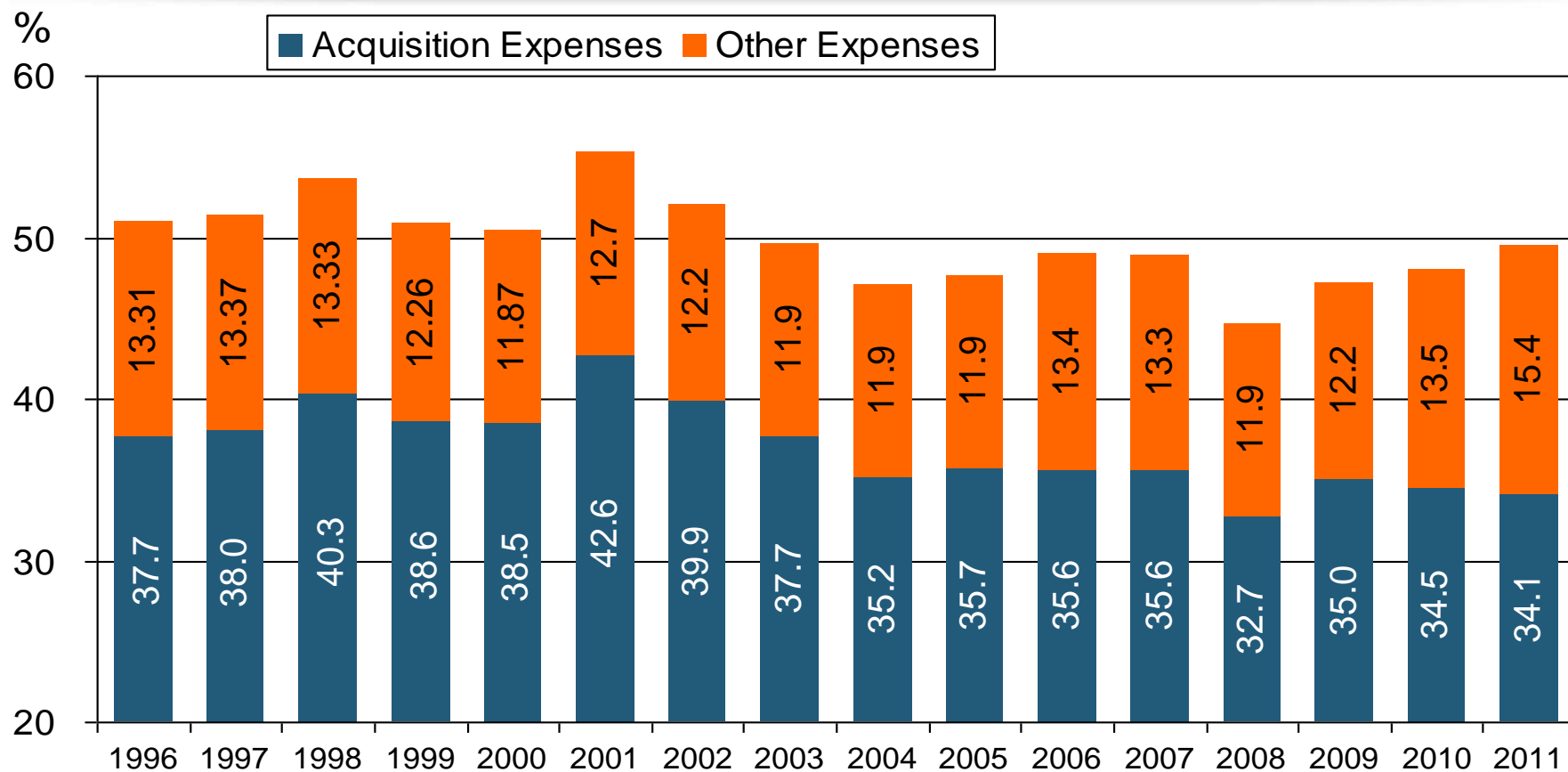
\$ Billions

NPW Avg. Ann. Growth rate  
2001-2007: 7.75%  
2008-2011: 0%



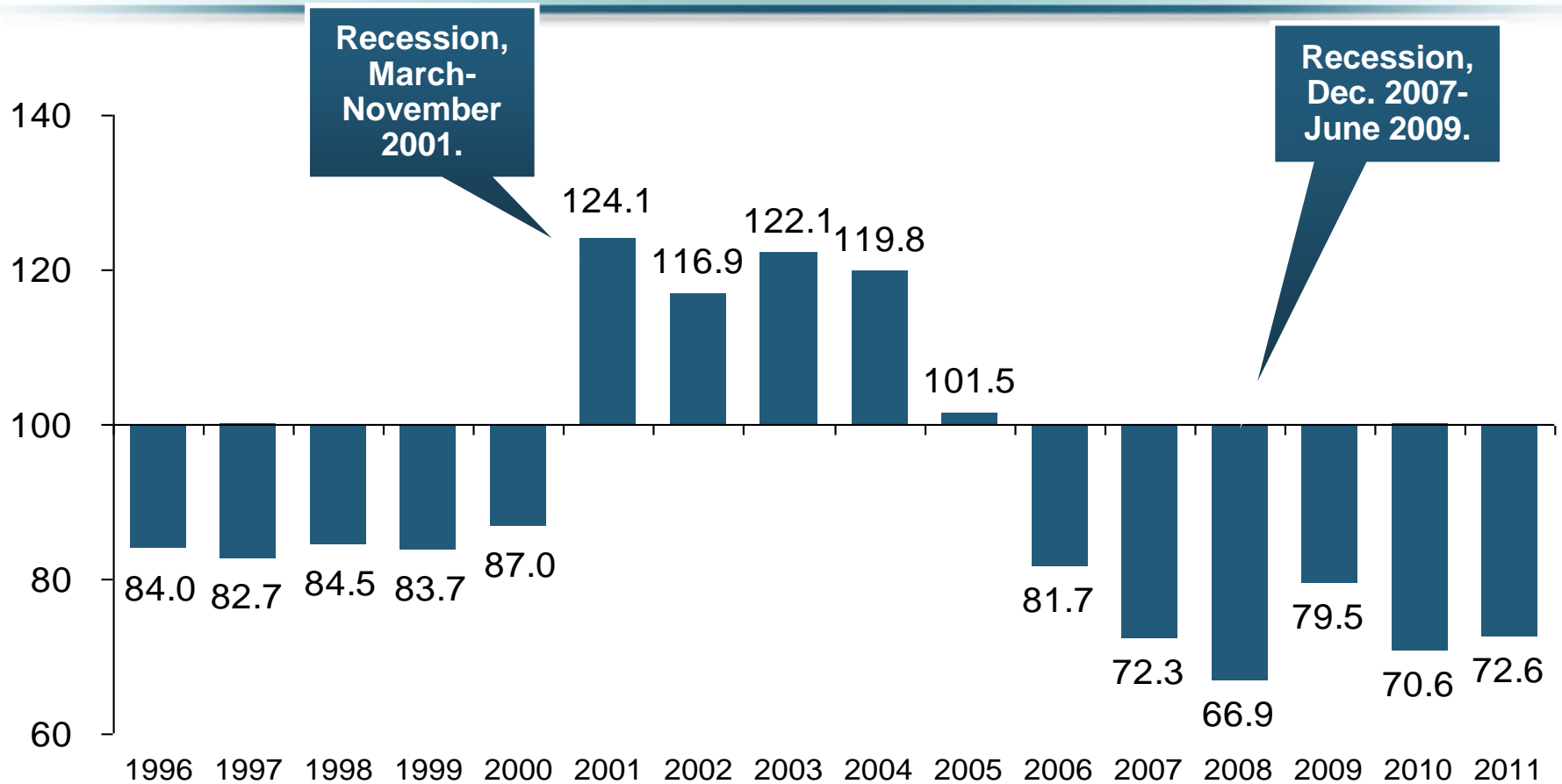
Within two years after the 2001 recession, surety NPW surpassed its prior peak. The 2007-09 recession has had a much more persistent lid on surety premiums.

# Surety: Expense Ratios



**Since 2003, total expenses have been consistently below 50%, mainly because of a drop in acquisition expenses.**

# Surety: Combined Ratio

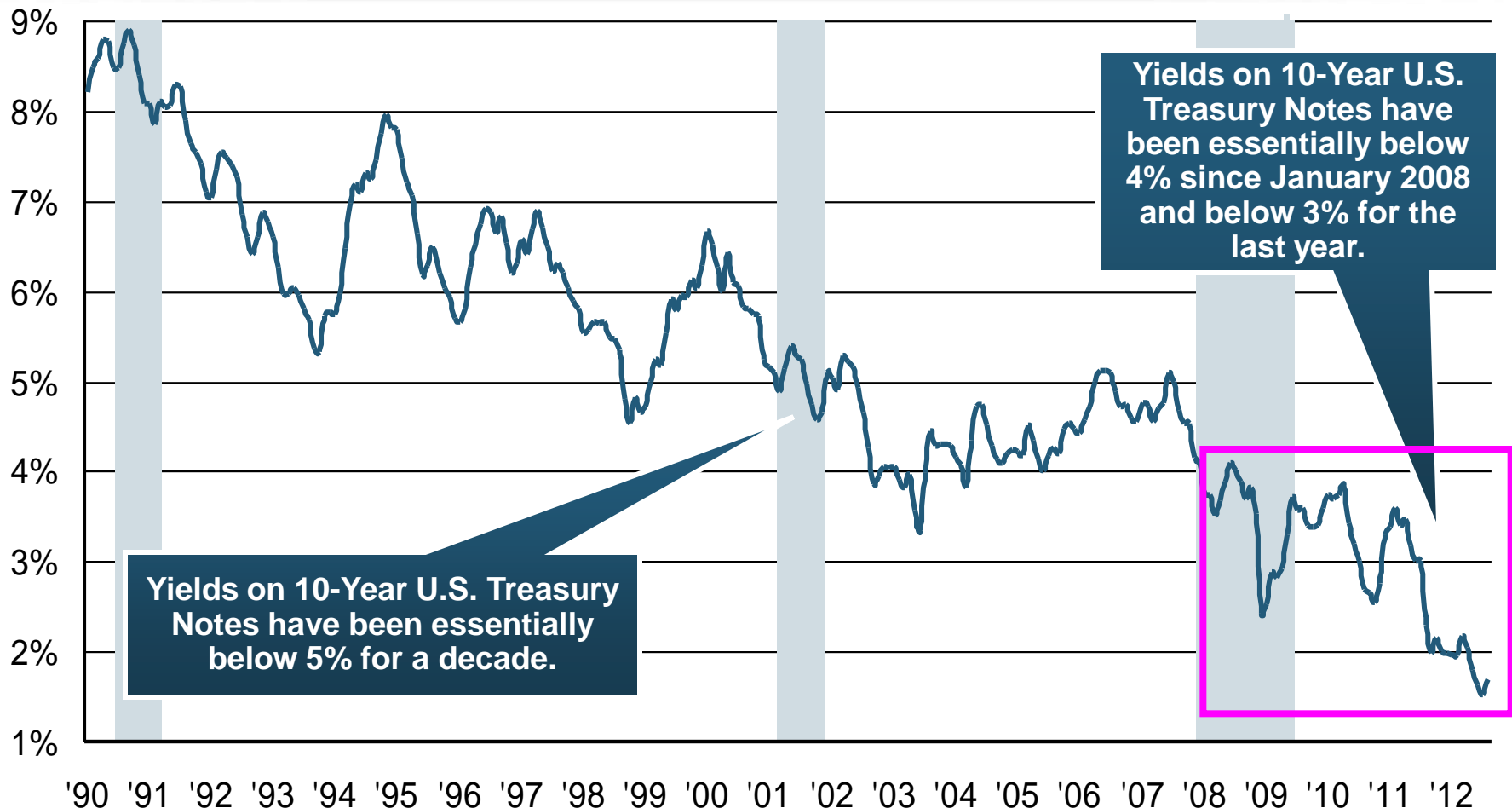


**Remarkable: profitable combined ratios throughout the most severe recession since the 1930s.**

# **Investments: The New Reality**

## **Investment Performance is a Key Driver of Profitability**

# U.S. 10-Year Treasury Note Yields: A Long Downward Trend, 1990–2012\*



**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, through August 2012.

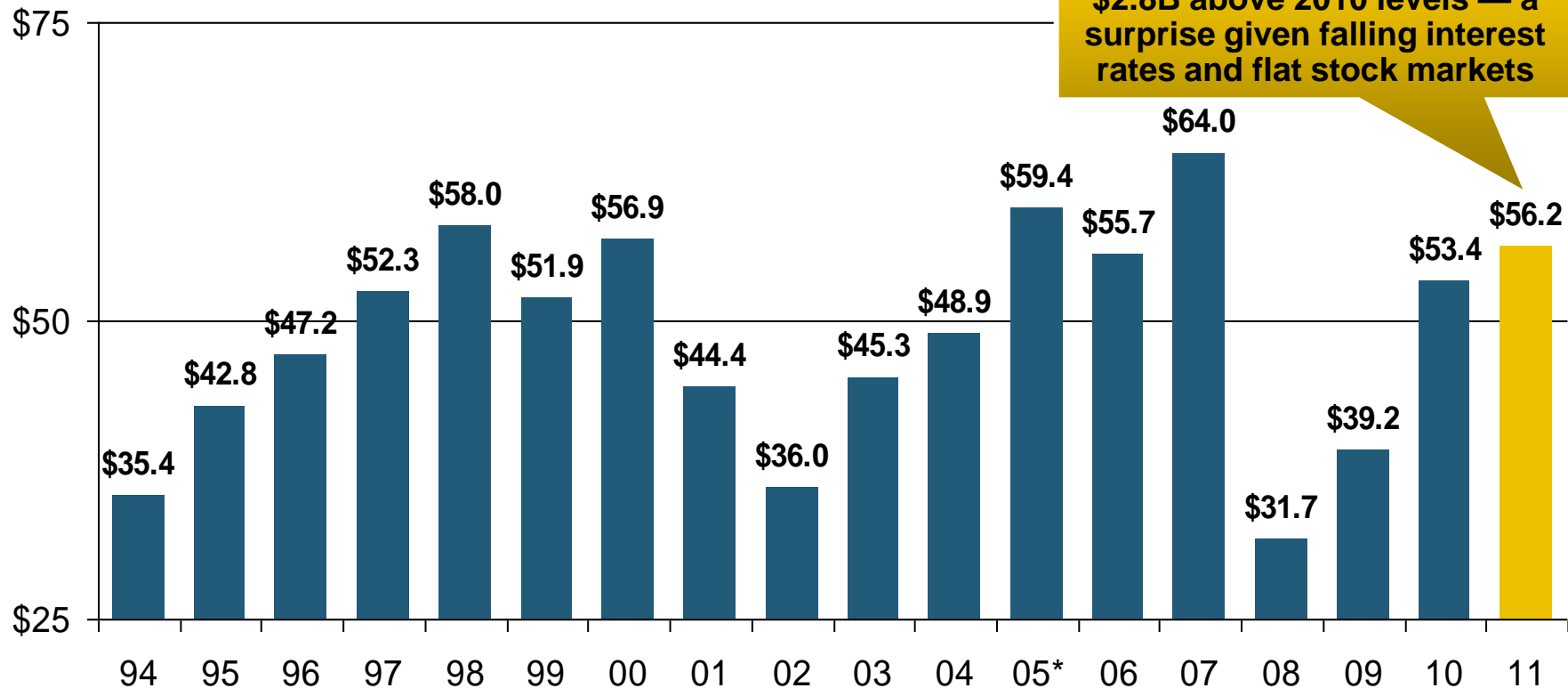
Note: Recessions indicated by gray shaded columns.

Sources: Federal Reserve Bank at <http://www.federalreserve.gov/releases/h15/data.htm>.

National Bureau of Economic Research (recession dates); Insurance Information Institutes.

# Property/Casualty Insurance Industry Investment Gain<sup>1</sup>: 1994–2011

(\$ Billions)



**Investment Gains Recovered Significantly in 2011  
Due to Realized Investment Gains;  
The Financial Crisis Caused Investment Gains to Fall by 50% in 2008**

<sup>1</sup> Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

\* 2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.

# Key Takaways

# Takeaways:

## Insurance Industry Predictions for 2012

- **P/C Insurance Exposures Will Grow With the U.S. Economy**
  - ◆ Personal and commercial exposure growth is certain in 2012
  - ◆ But restoration of destroyed exposure will take until mid-decade
  - ◆ Wage growth is also positive and could modestly accelerate
- **P/C Industry Growth in 2012 Will Be Strongest Since 2004**
  - ◆ Growth likely to exceed A.M. Best projection of +3.8% for 2012
  - ◆ No traditional “hard market” emerges in 2012
- **Underwriting Fundamentals Deteriorate Modestly**
  - ◆ Some pressure from claim frequency, severity in some key lines
  - ◆ But WC will be tough to fix
- **Industry Capacity Hits a New Record by Year-End 2012 (Barring Meg-CAT)**
- **Investment Environment Is/Remains Much More Favorable**
  - ◆ Return of realized capital gains
  - ◆ But Interest rates remain low



**Insurance Information Institute Online:**

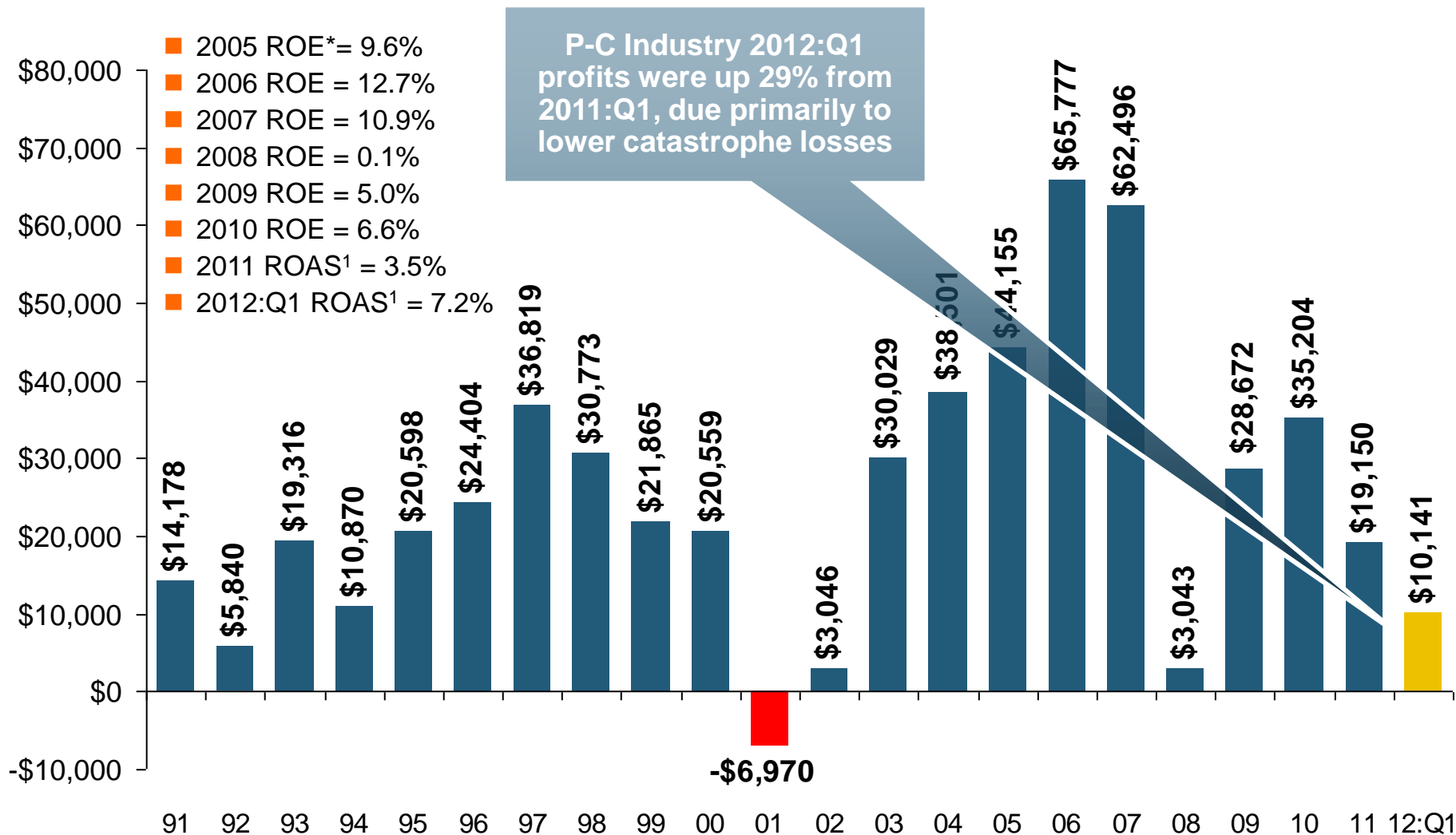
**[www.iii.org](http://www.iii.org)**

***Thank you for your time  
and your attention!***

# **P/C Insurance Industry Financial Overview**

**Profit Recovery Was Set Back  
in 2011 by High Catastrophe  
Loss & Other Factors**

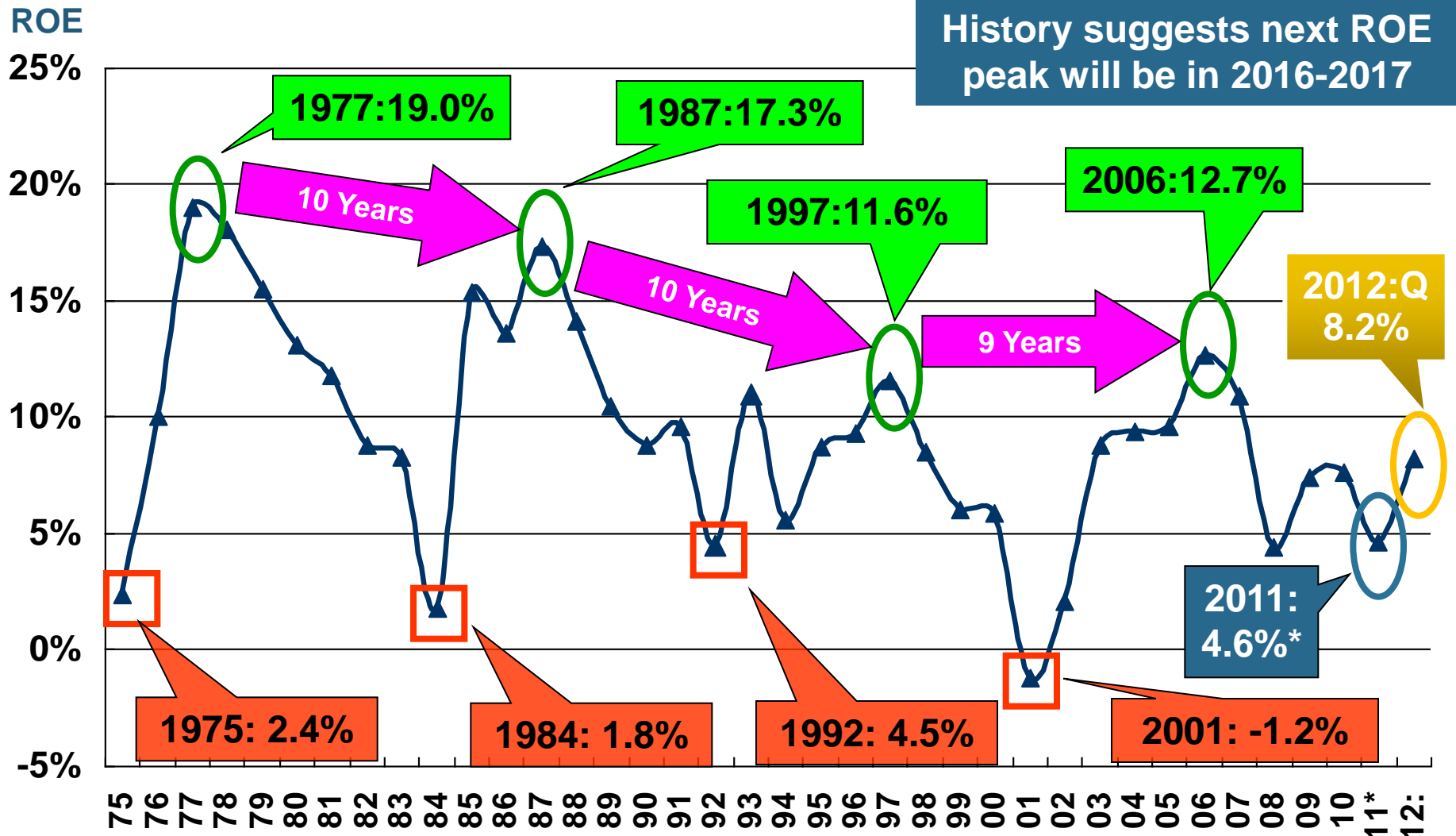
# P/C Net Income After Taxes 1991–2012:Q1 (\$ Millions)



\* ROE figures are GAAP; <sup>1</sup>Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 8.2% ROAS for 2012:Q1, 4.6% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

Sources: A.M. Best, ISO, Insurance Information Institute

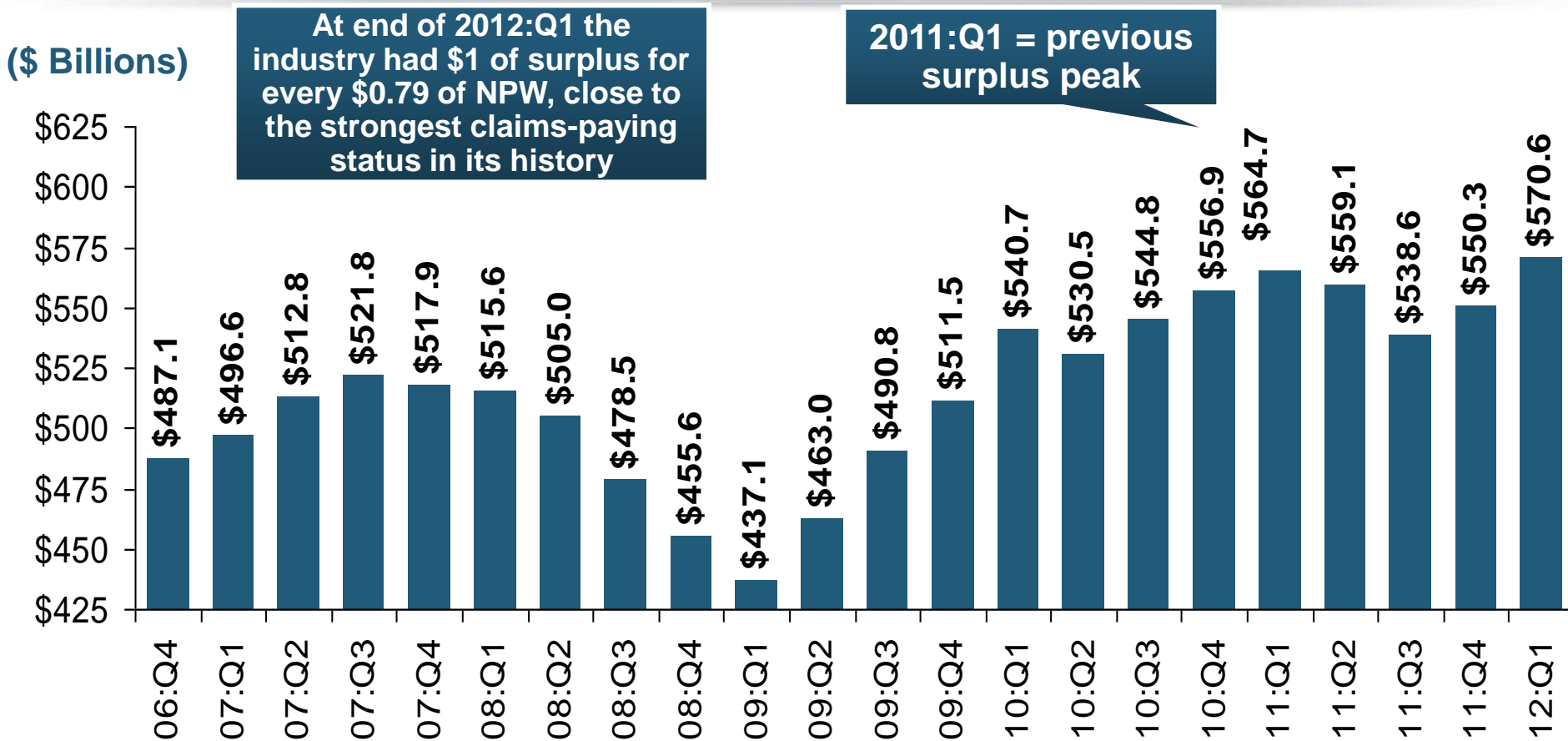
# Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2012:Q1\*



\*Profitability = P/C insurer ROEs. 2011 figure is an estimate based on ROAS data. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. 2012:Q1 ROAS = 7.2% including M&FG.

Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

# Policyholder Surplus, 2006:Q4–2012:Q1



Note: Beginning in 2010:Q1 figures include \$22.5B of paid-in capital from a holding company parent to a subsidiary insurer. It was a single investment in a non-insurance business.

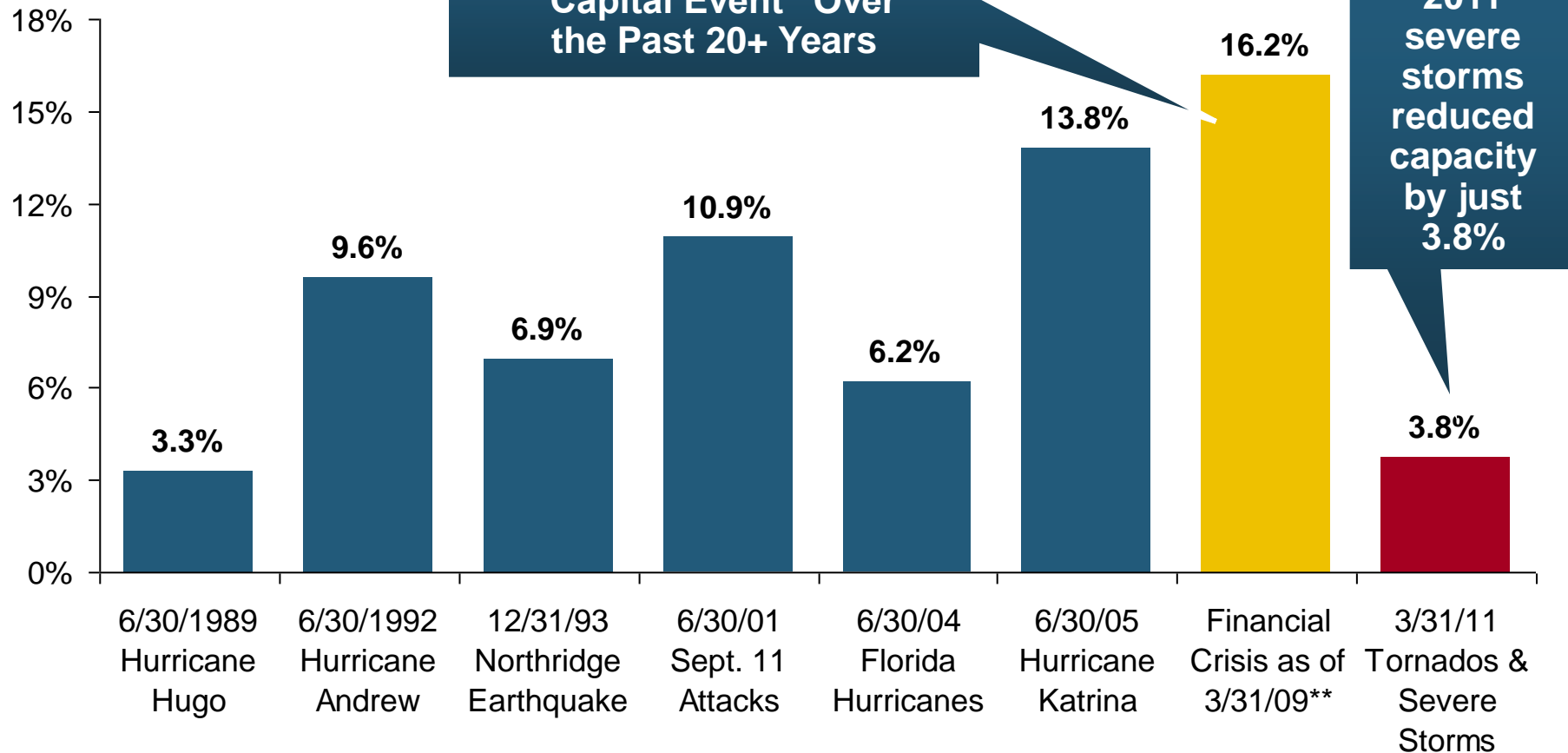
## Quarterly Surplus Changes Since 2011:Q1 Peak

**11:Q2: -\$5.6B (-1.0%)**  
**11:Q3: -\$26.1B (-4.6%)**  
**11:Q4: -\$14.4B (-2.6%)**

Source: ISO; A.M .Best.

# Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989\*

(Percent)



\* Ratio is for end-of-quarter surplus immediately after the event. Date shown is end of quarter prior to event

\*\* Date of maximum capital erosion; As of 9/30/09 (latest available) ratio = 5.9%

Source: PCS; Insurance Information Institute