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Quarterly P/C industry snapshot: Second quarter 2018

Information and analysis provided by the Insurance Information Institute

2018-2020 overview:
The insurance industry and the economy

P/C insurance markets

- 2018 combined ratios for catastrophe-affected lines of business will likely improve (due to reversion to the mean). Personal auto and commercial auto likely will be closer to 100.
- There is no sign of a hard market in 2018, but premium in both personal and commercial lines will likely continue to rise.

Financial markets

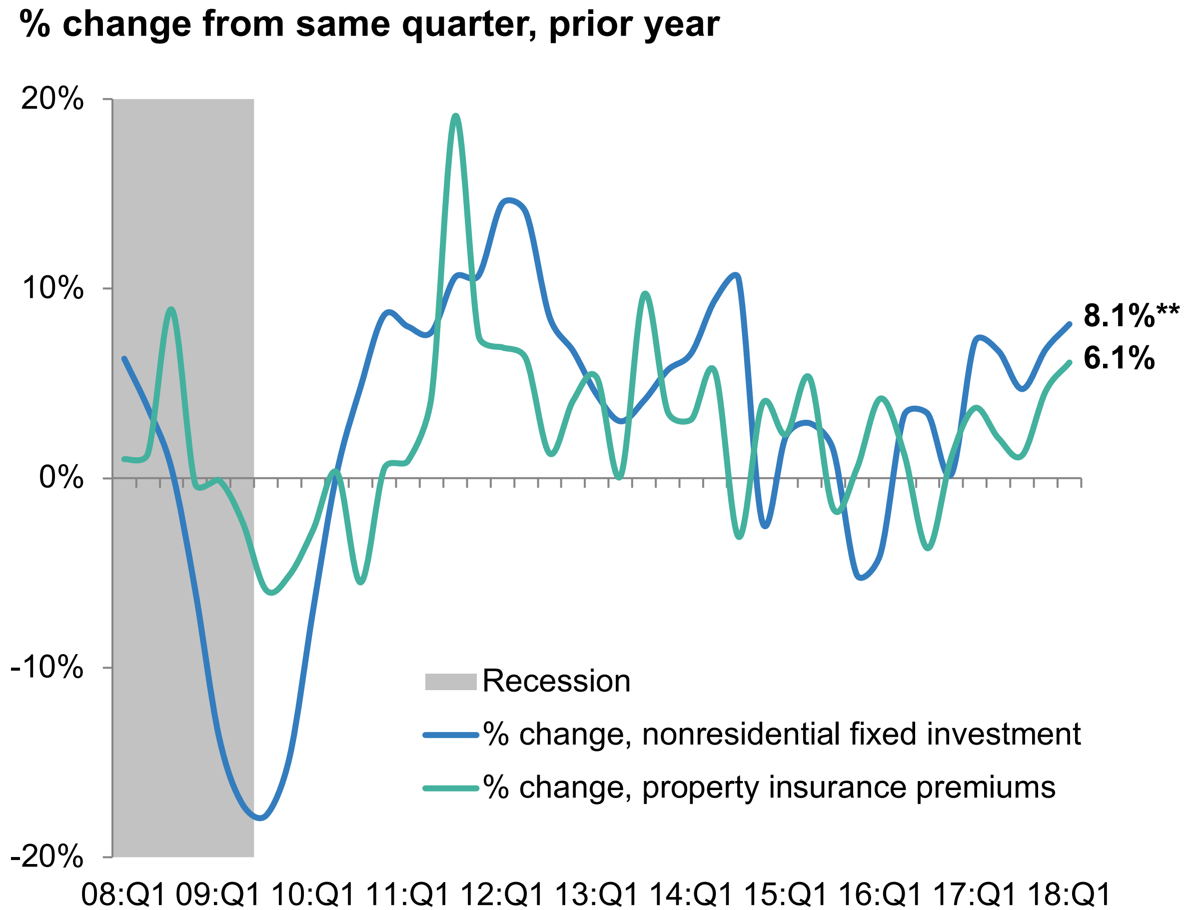
- In the U.S., short-term interest rates are finally rising, and this is expected to continue. Long-term rates have not changed as much, so the yield curve is flatter.
- Although bond yields anticipate inflation continuing to be near 2% for five or more years, more direct measures see prices rising closer to 3%, with prices in some sectors (lately, e.g., lumber) rising much faster.

The U.S. economy

- Real GDP growth has shown unexpected strength in recent calendar quarters. Both personal consumption (+4.7%) and business nonresidential fixed investment (8.1%) are rising, heralding a growing exposure base.
- This is the second longest expansion since WWII, and many forecasters say it will become the longest when it persists into July 2019. There are virtually no signs of another recession.

Commercial lines trends as of 2018:Q1

Property premiums* grow as investment does



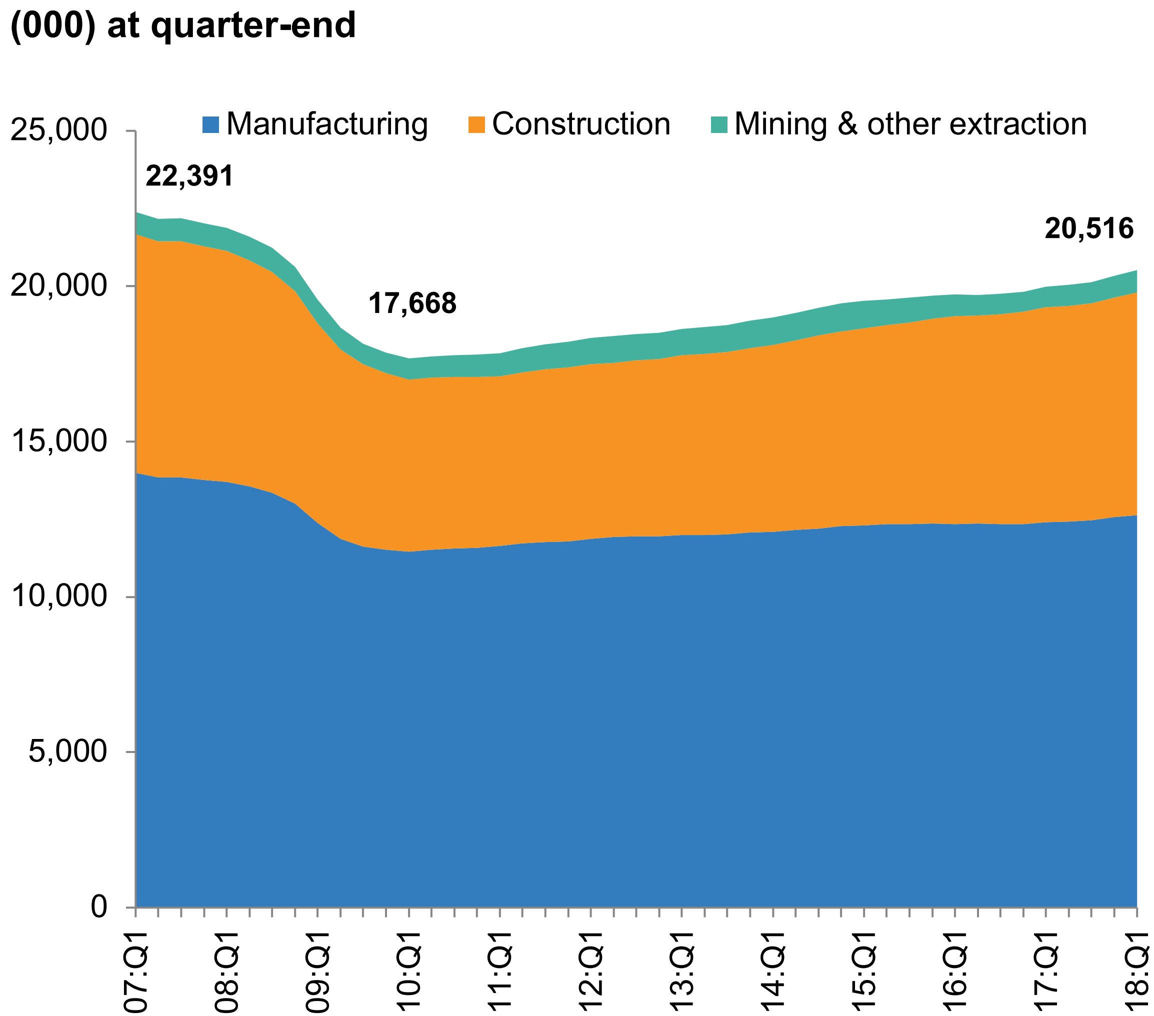
- **Investment in structures, equipment and software is expected to grow at least partly due to the provisions of the Tax Cuts and Jobs Act.**
- **Premiums for commercial property insurance should grow nicely due to an expanding exposure base.**

*Commercial property direct premiums written (fire, allied lines, CMP, inland marine, burglary and theft); business fixed investment (structures, equipment, and software). **Preliminary.

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

Sources: https://fred.stlouisfed.org/series/PNFI#0; National Bureau of Economic Research (recession dates); Insurance Information Institute.

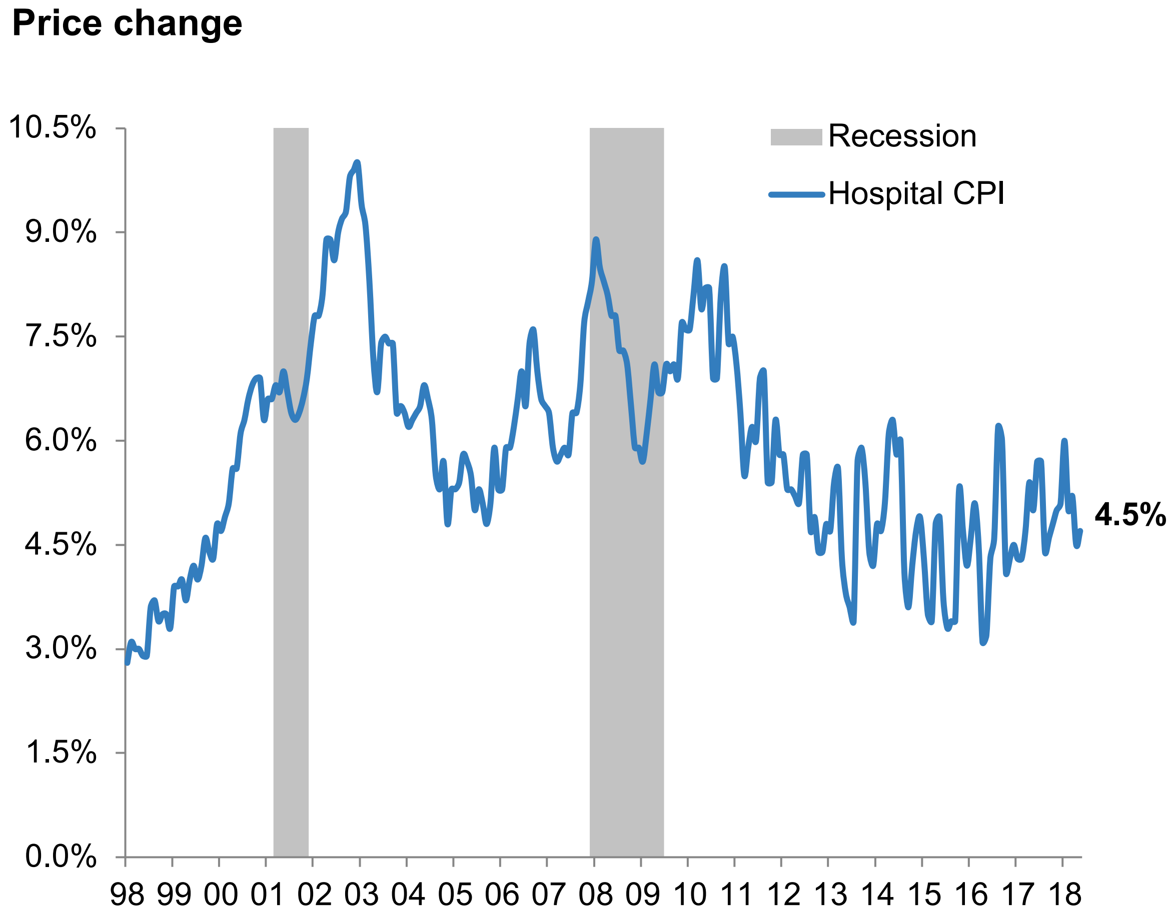
As hiring goes, exposures follow



- **Of these industries, construction is enjoying the fastest growth. This is expected to continue for at least the short-term.**
- **At the end of 2018:Q1, employment in these three industries that are the heart of workers composition exposure, at 20.5 million, was not quite back to the level reached before the Great Recession.**

Sources: U.S. Bureau of Labor Statistics; Insurance Information Institute.

Hospital costs forecast injury costs

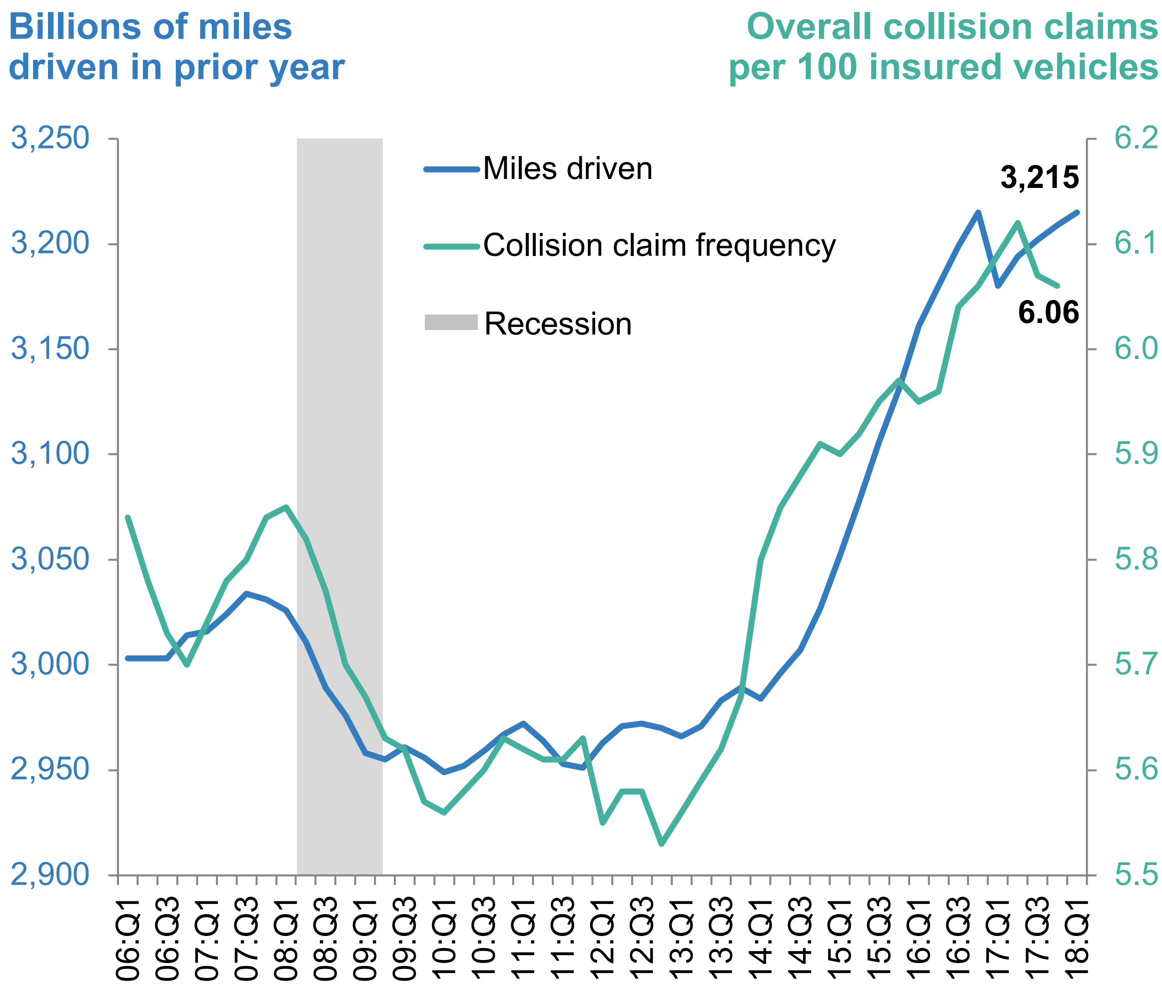


- **For the past five years, prices for hospital services grew more moderately than before, lately at rates ranging between 3% and 6%.**
- **Even with these more modest increases, prices for hospital care rose on average several percentage points faster than inflation generally.**

*Percentage change from same month in prior year through May 2018; seasonally adjusted.
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Personal lines trends as of 2018:Q1

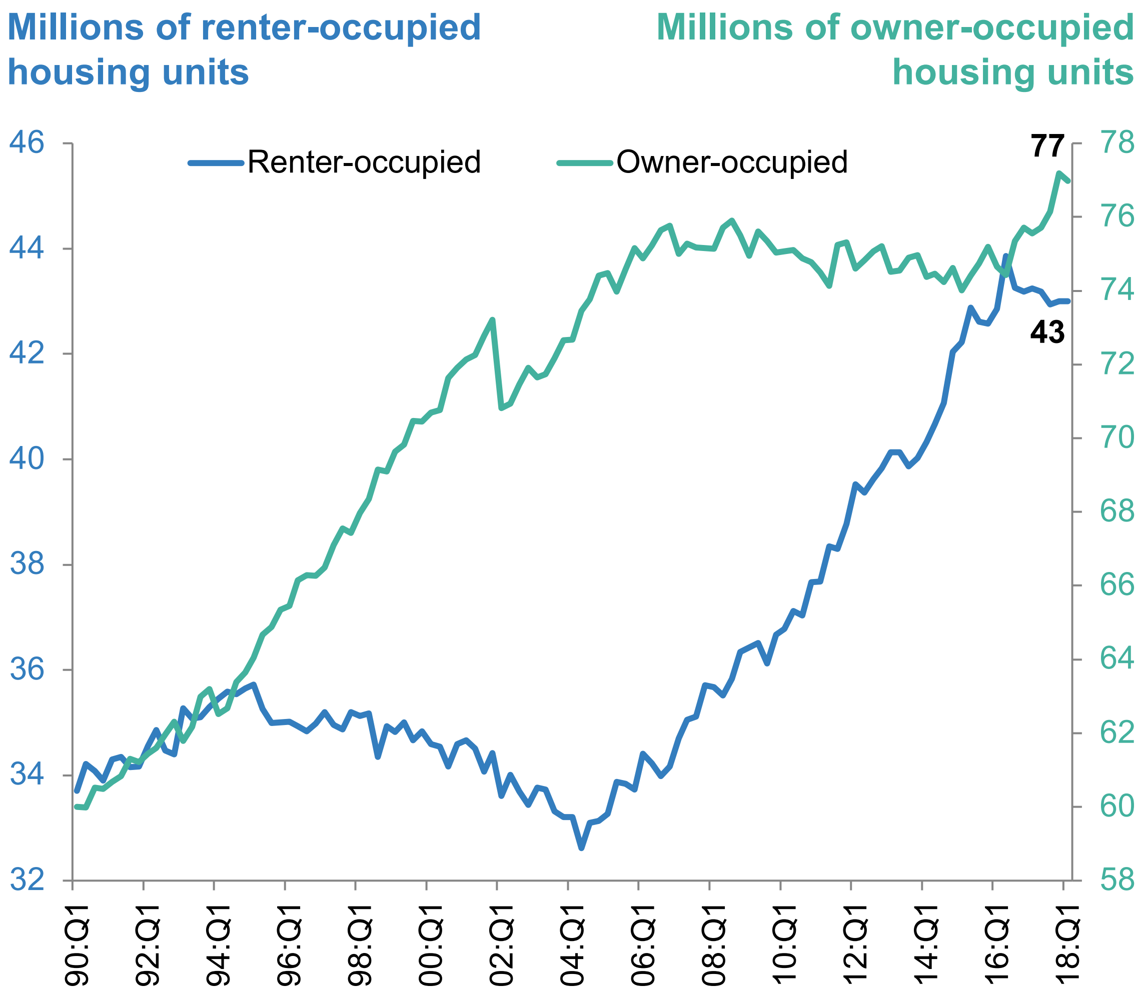
Driving patterns predict claim frequency



- **The sharp rise in collision frequency in 2014-2016 appears to have peaked in the last year. However, claim severity will likely continue to rise as 2018 will see another 17 million new cars on the road.**
- **The only force that could derail the relationship between miles driven and frequency would be a sharp and persistent rise in the cost of gasoline.**

Sources: Federal Highway Administration; Rolling four-quarter average frequency from Fast Track Monitoring System; Insurance Institute for Highway Safety; Insurance Information Institute.

To rent or to buy?

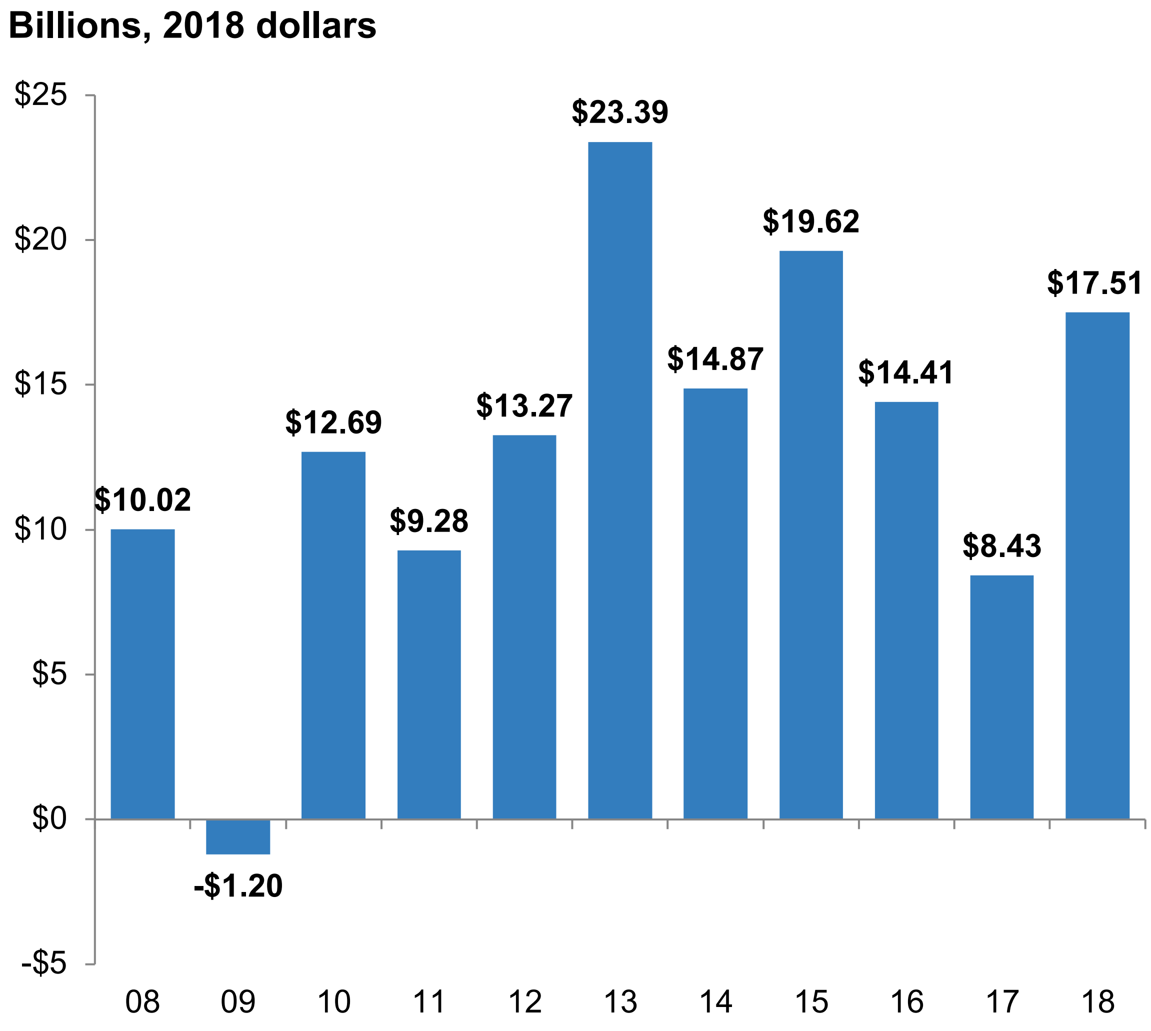


- **From 2004 to 2016:Q4, the number of renter-occupied housing units grew by about 10.5 million units (+34%), but there was no growth in the number of owner-occupied housing units for 12 years. This streak appears to have ended in 2016:Q4. This is good news for homeowners insurance premium growth.**

Sources: U.S. Census Bureau at http://www.census.gov/housing/hvs/data/histtabs.html, Table 8; Insurance Information Institute.

Economic and financial trends as of 2018:Q1

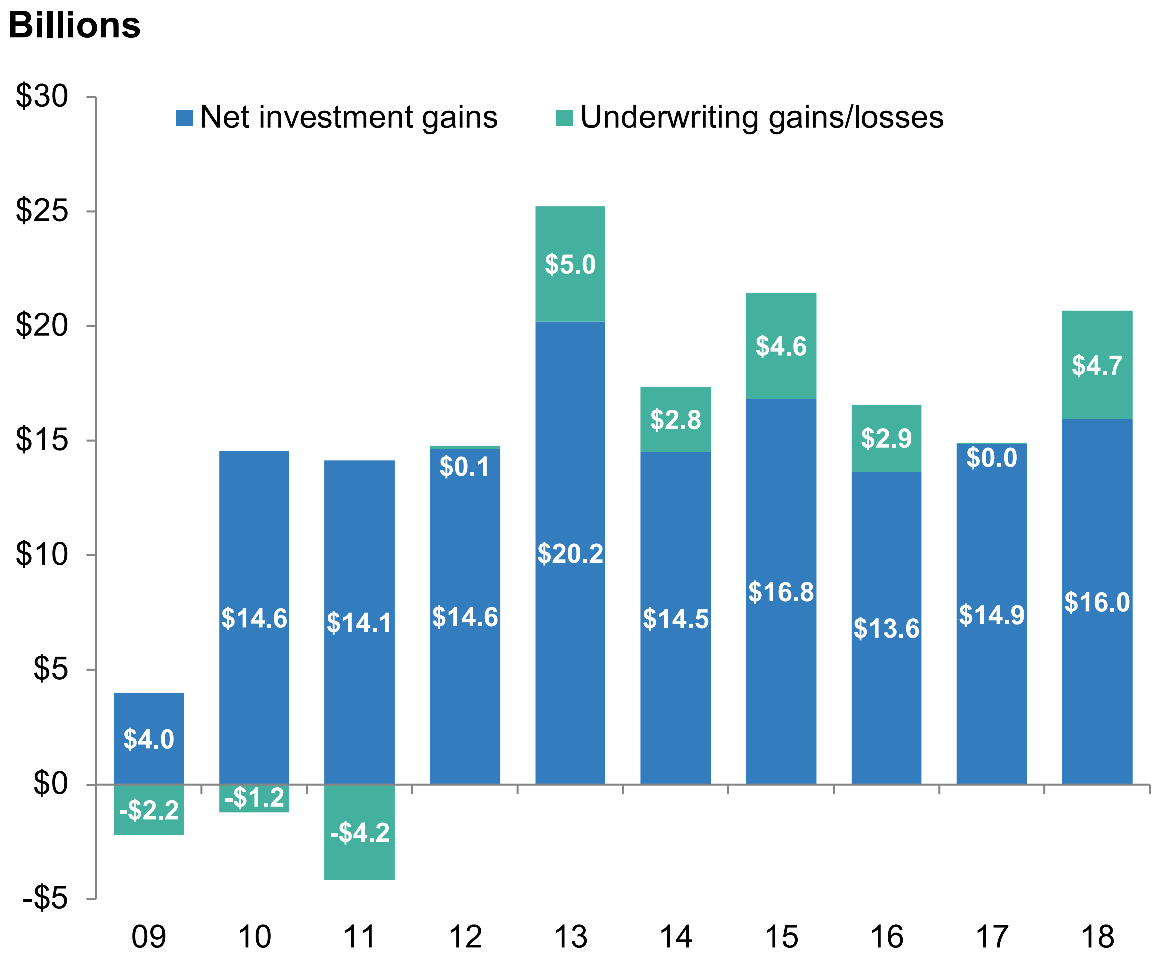
P/C industry net income after taxes*



- In the first quarter of the year, net income varied over the last decade. 2018 had the third-highest profit in the last 11 years.
- Why did profits spike in 2018? Favorable conditions: Earned premiums grew by more than 9%, but claims grew by only 3%.

*Through first quarter. Adjusted for inflation using the BLS CPI calculator to 2018 dollars.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

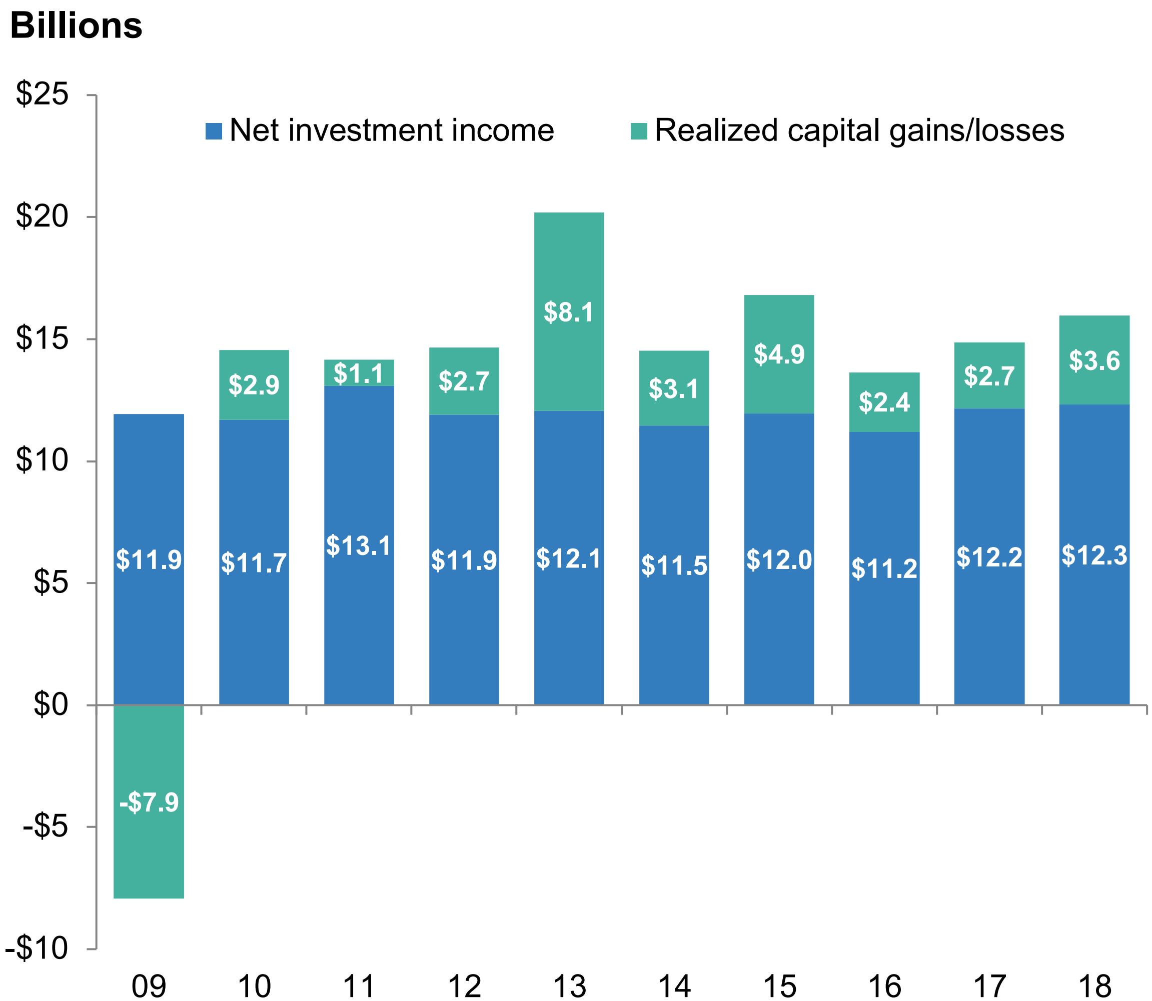
Key sources of P/C insurer profits



- In the first quarter of 2018, underwriting gains were stronger than any recent prior year except 2013.
- In the first quarter of 2018, investment gains were comparable to or better than most recent first quarters.

Through first quarter. Data are before taxes and exclude extraordinary items.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

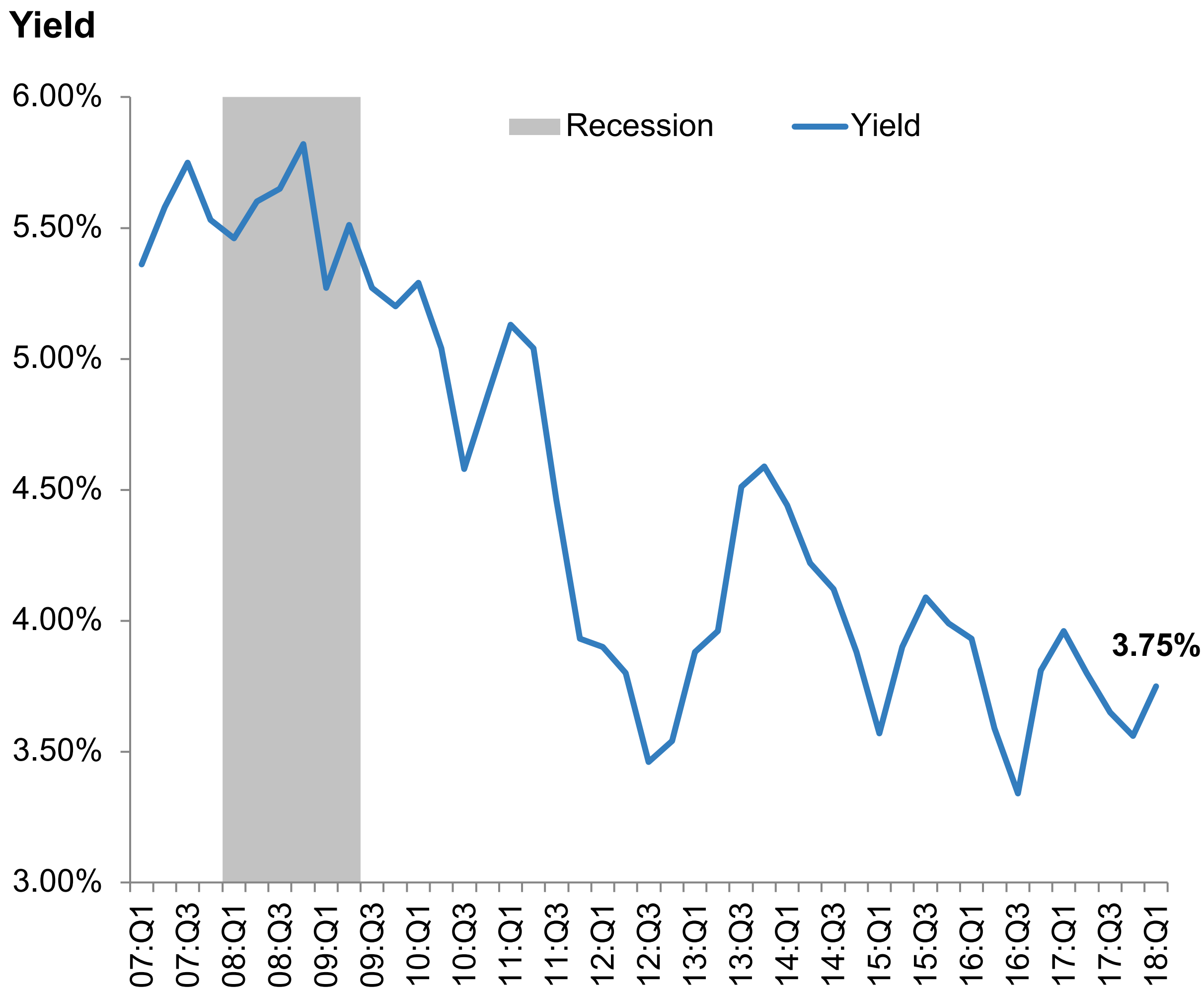
Sources of investment gains



- **2018:Q1 had the third-highest realized capital gains in the last 10 years.**
- **Net investment income in the first calendar quarter of each year has been steady, but realized capital gains/losses have been quite variable.**

Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

Bond yields

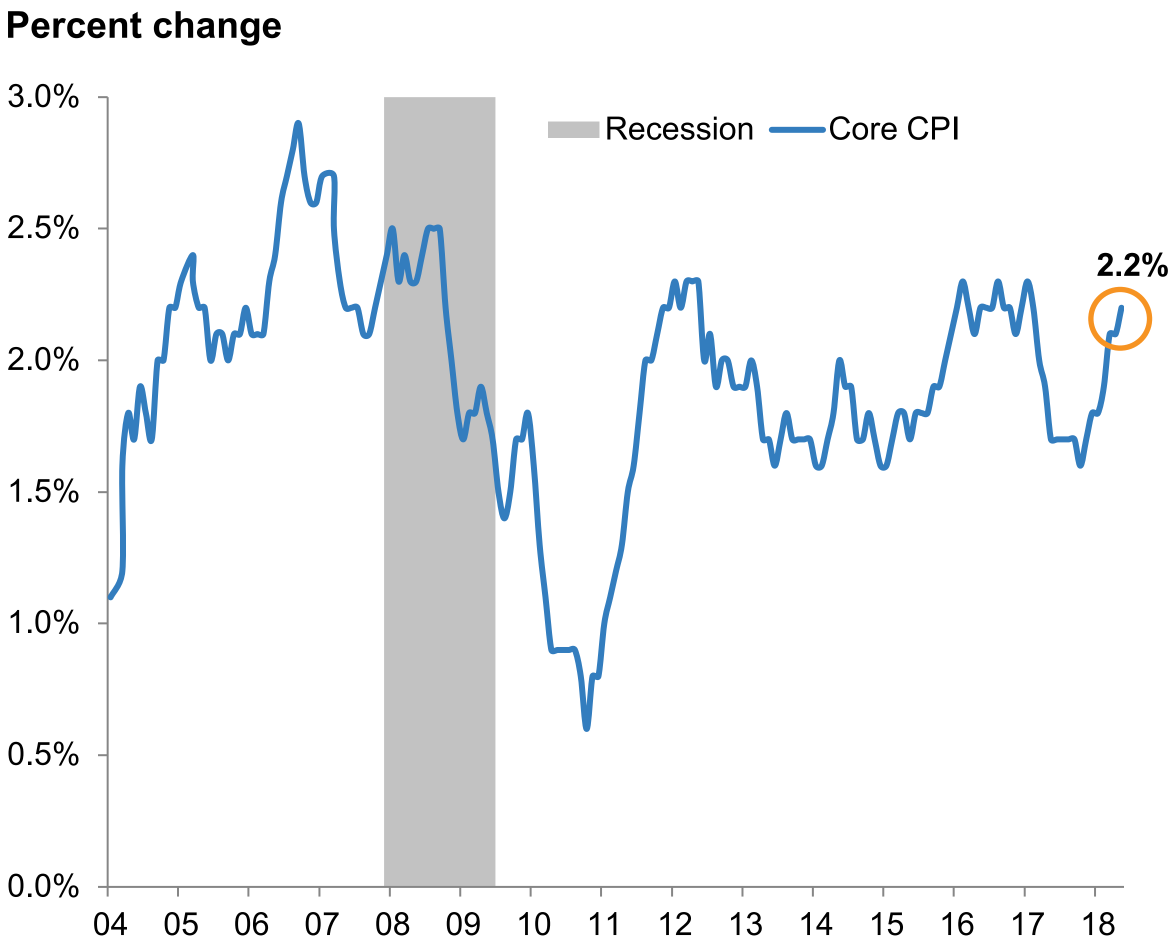


- **Top investment-grade bond yields have ranged from 3.5% to 4.5% for the last three years. These yields probably will not rise much above 5.0% through 2018.**

Note: Recession indicated by gray shaded column.

Sources: https://fred.stlouisfed.org/series/AAA#0 ; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Change* in the core** Consumer Price Index



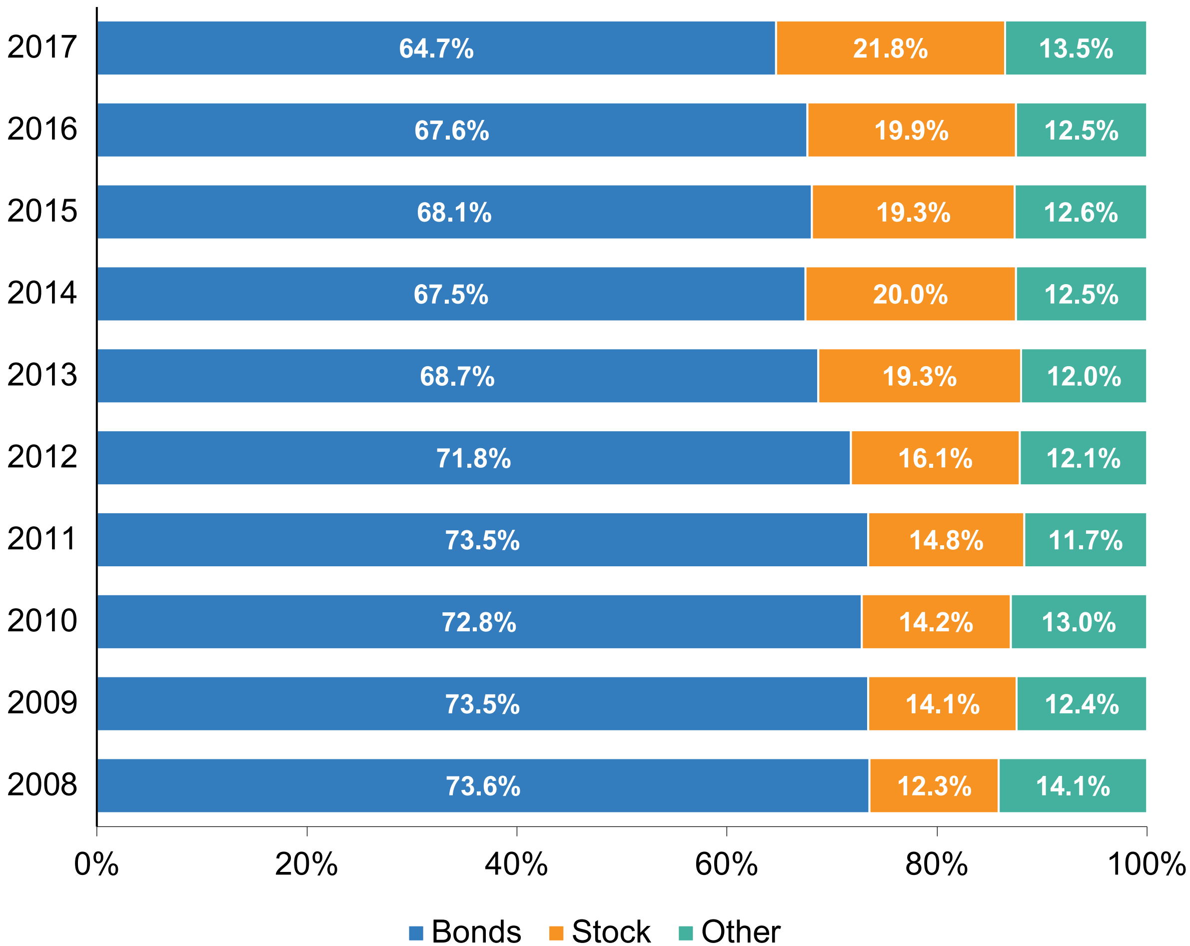
- Over the last decade, prices tracked by the core CPI have generally risen about 2% per year.
- Lately, however, the core CPI has been rising past the 2% mark. With the economy near full employment, higher core CPI rates seem likely in the near future.

*Monthly, year-over-year, through May 2018, seasonally adjusted. **CPI less food and energy.
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Snapshot special topic

Insurance industry investment trends

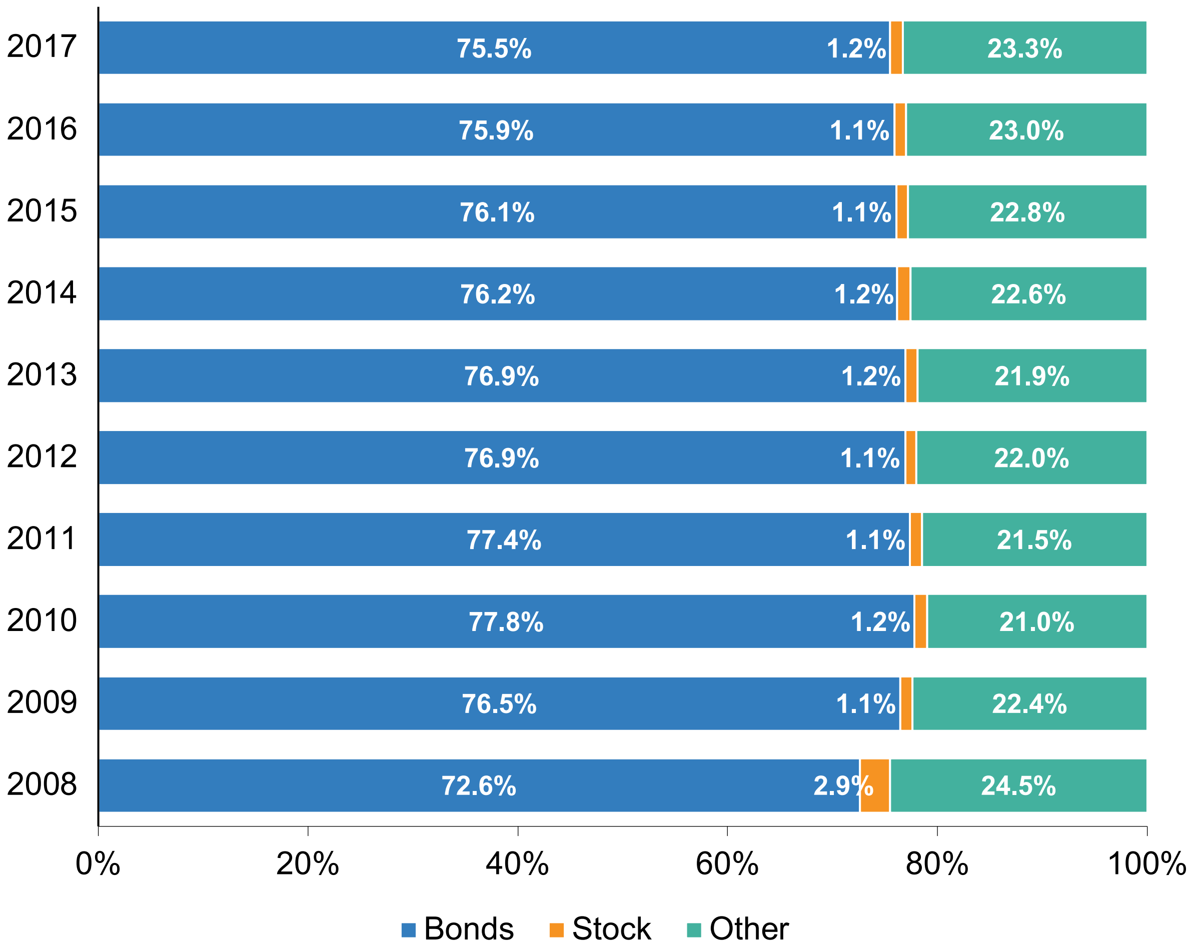
The changing mix of invested assets, P/C industry, 2008-2017



- From 2008 to 2017, P/C portfolios shifted out of bonds (74% of invested assets in 2008 to 65% in 2017) into common stock (up from 12% to 22%).
- The U.S. economy now hovers near full employment, and inflation and interest rates are rising slowly. It would not be surprising to see the decade-long shift out of bonds begin to reverse.

Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

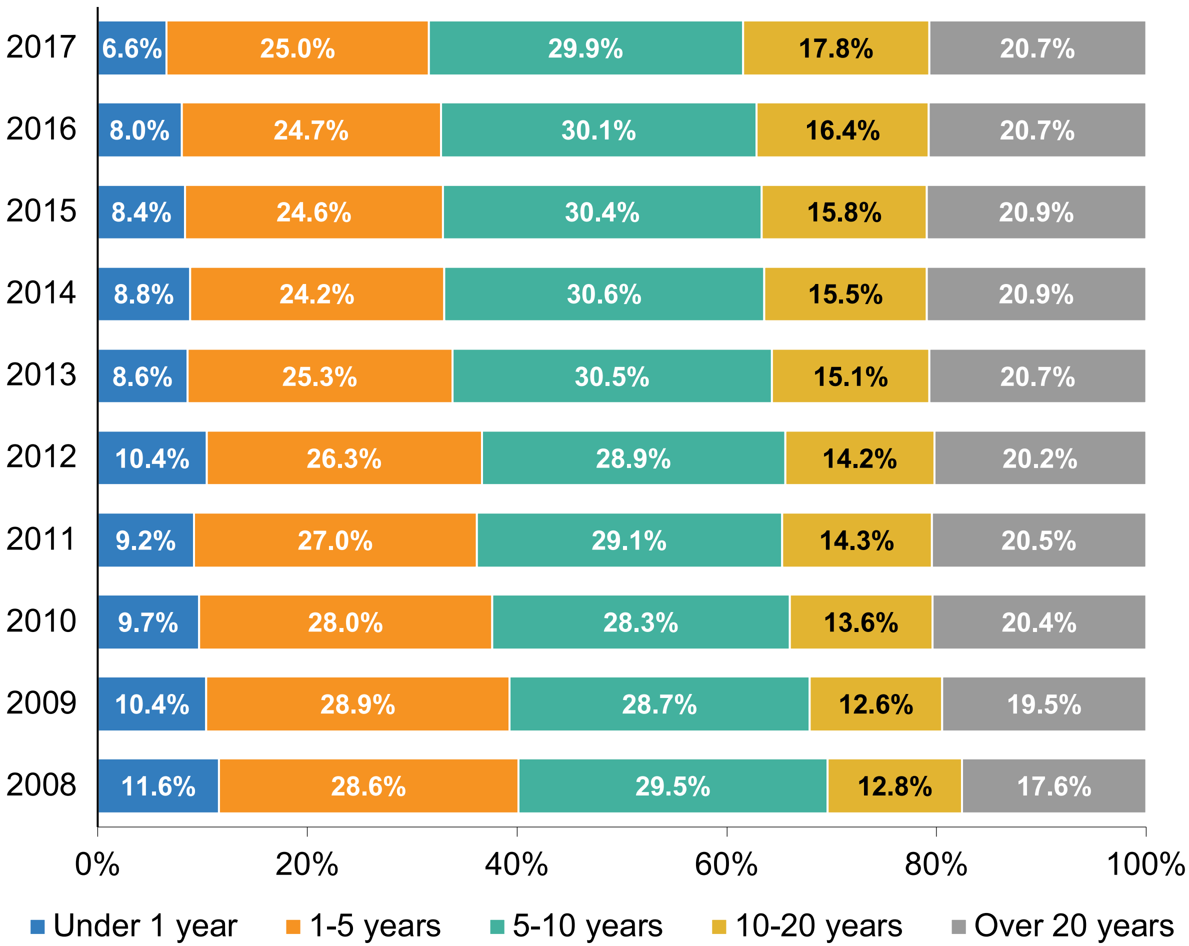
The unchanging mix of invested assets, life/annuity industry*, 2008-2017



- In contrast to P/C investment portfolios, the breakdown of major asset categories of the life/annuity industry has not changed much the past decade.
- However, the composition of bond holdings has changed, as seen in the next slide.

*The chart is based on data for general accounts only.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

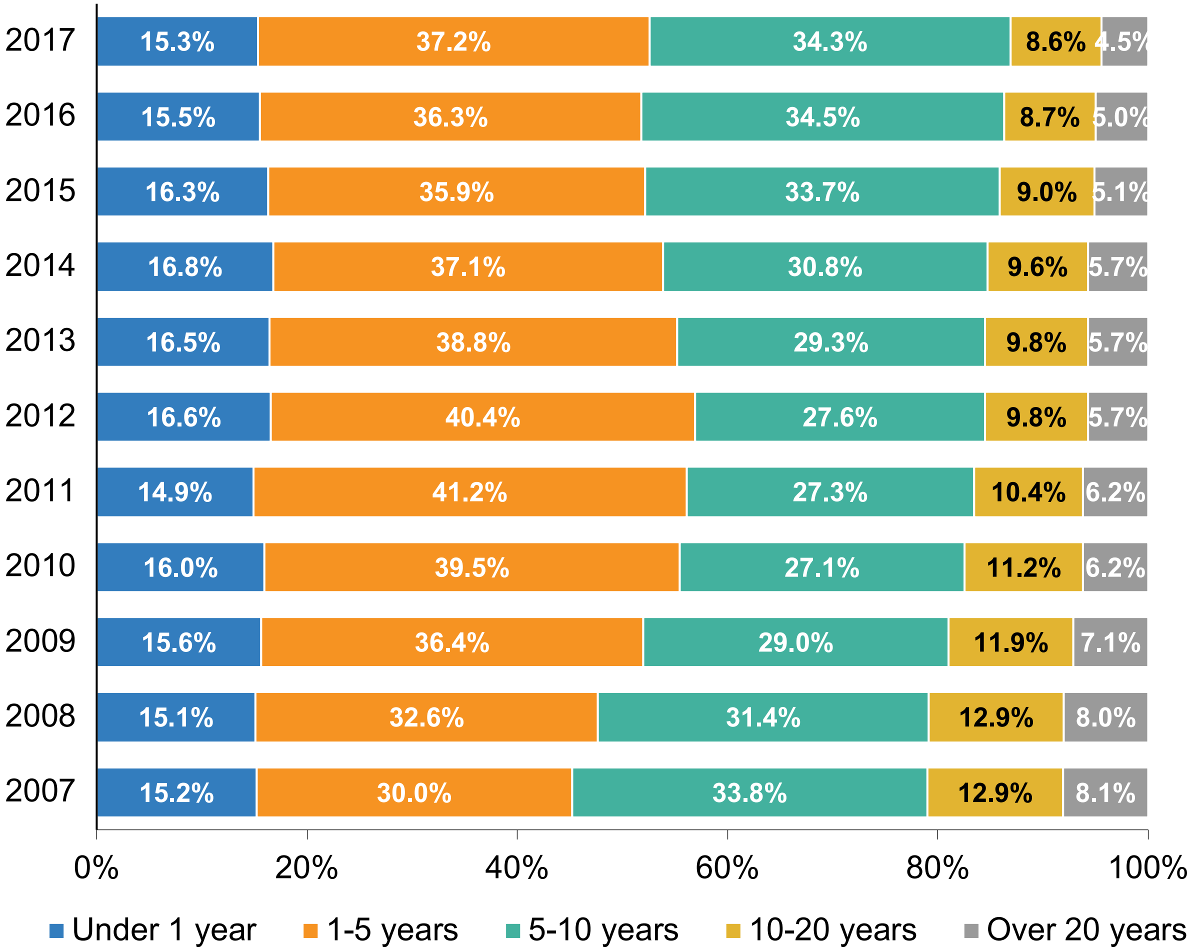
Longer bond maturities, life/annuity insurance industry,* 2008-2017



- **Life/annuity companies moved from bonds with short maturities (under 5 years) to bonds with longer maturities (10 years or more). The percent of bonds with 5- to 10-year maturities has not changed.**
- **The shift increases portfolio yield, but also interest-rate risk.**

*General account assets only.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

Shorter bond maturities, P/C insurance industry, 2007-2017

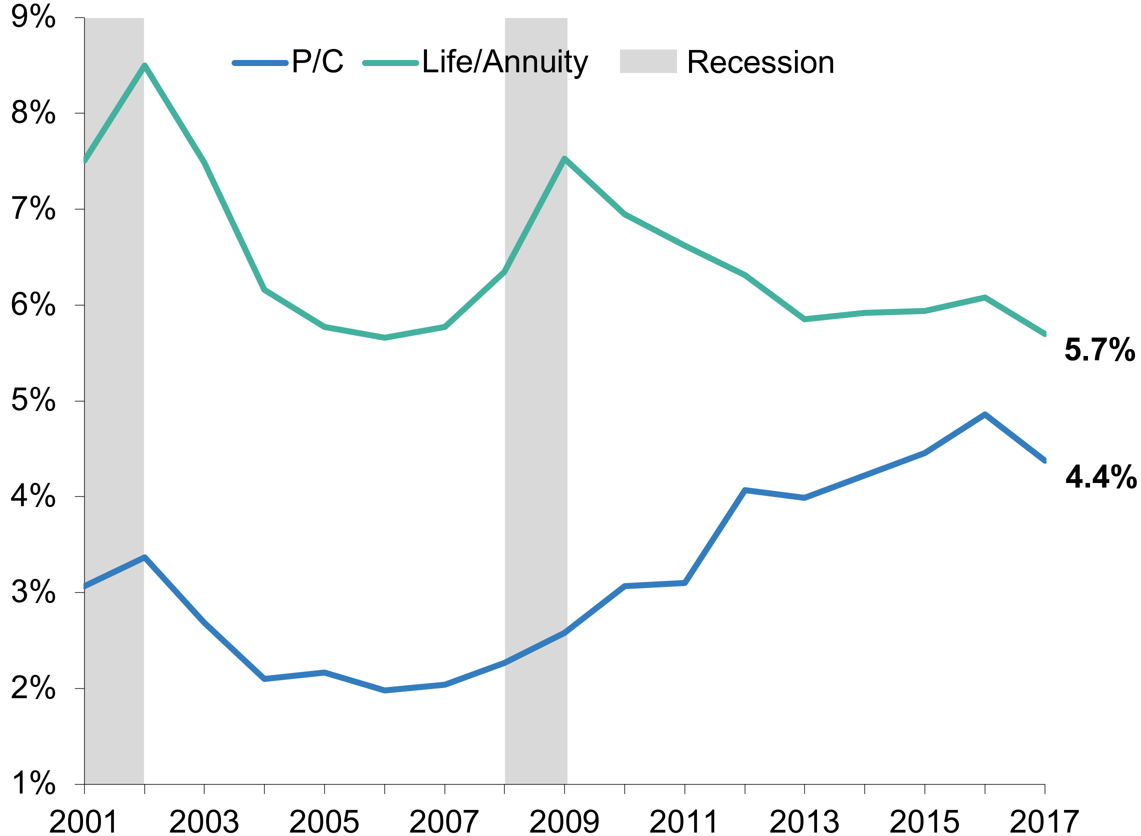


- **P/C investments shifted from bonds with longer maturities (10 years or more) to bonds with shorter maturities (1 to 5 years). This is the opposite of the trend in the life/annuity industry.**
- **Falling average maturity of the P/C industry's bond portfolio dampens investment income with lower yields.**

Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

The appetite for risky bonds*

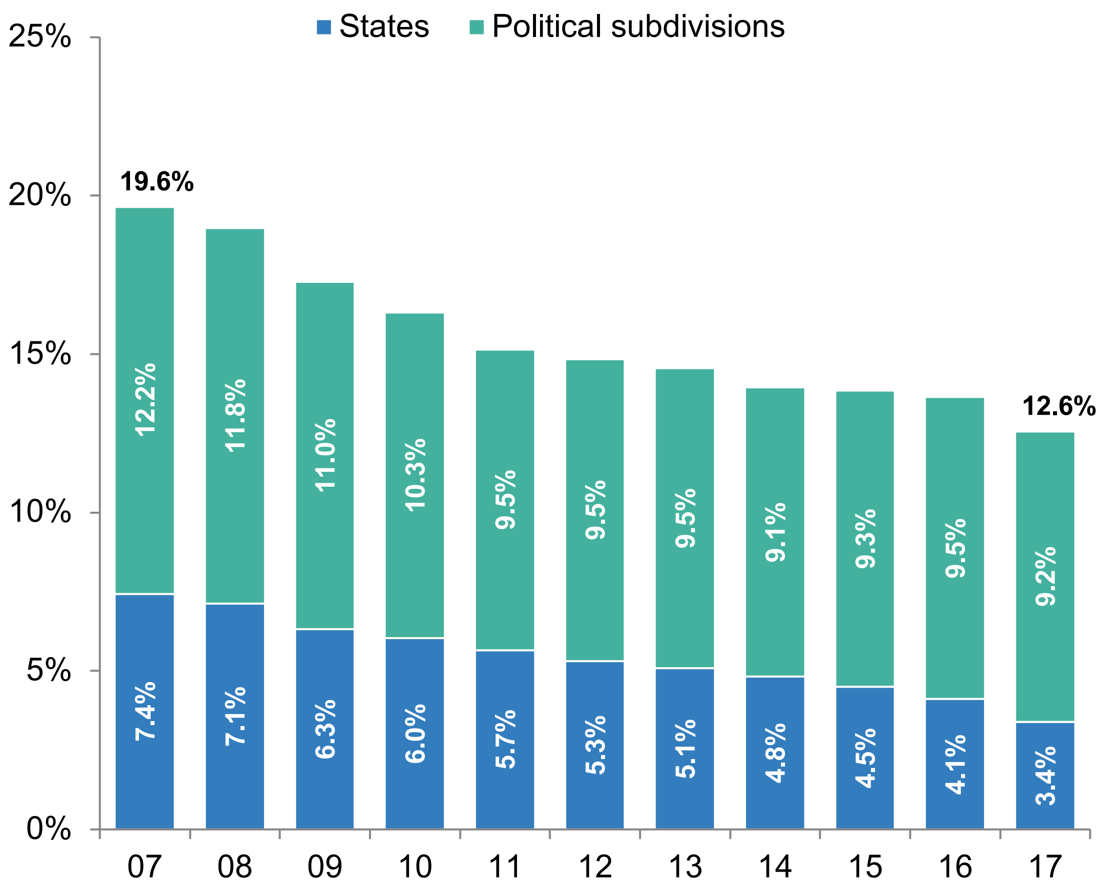
Below investment grade bonds as a percent of total bonds



- **The P/C industry's percentage of below-investment-grade bonds, now at 4.4%, has *<u>risen</u>* virtually every year since 2007.**
- **In contrast, the life/annuity industry's percentage, now at 5.7%, has *<u>fallen</u>* virtually every year since 2009.**

*Bonds classified by the NAIC as 3-6, as percent of total bonds; data based on life/annuity general account assets.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

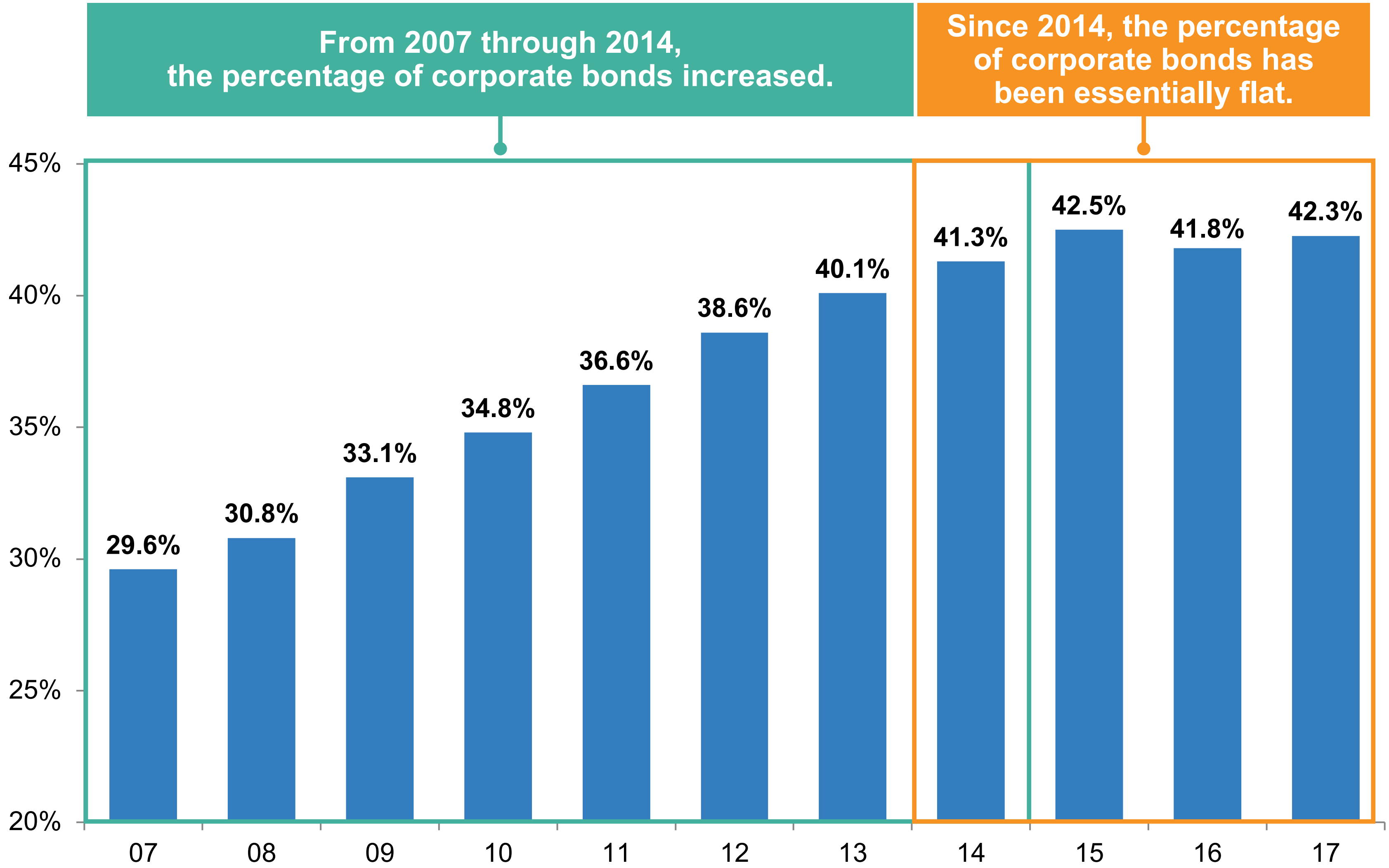
P/C industry: Percent of muni bond investments among total bonds



- Throughout the last decade, there was a downtrend in owning munis—even before the new tax law. The tax rate cuts could make munis even less attractive relative to higher-yielding taxable bonds.

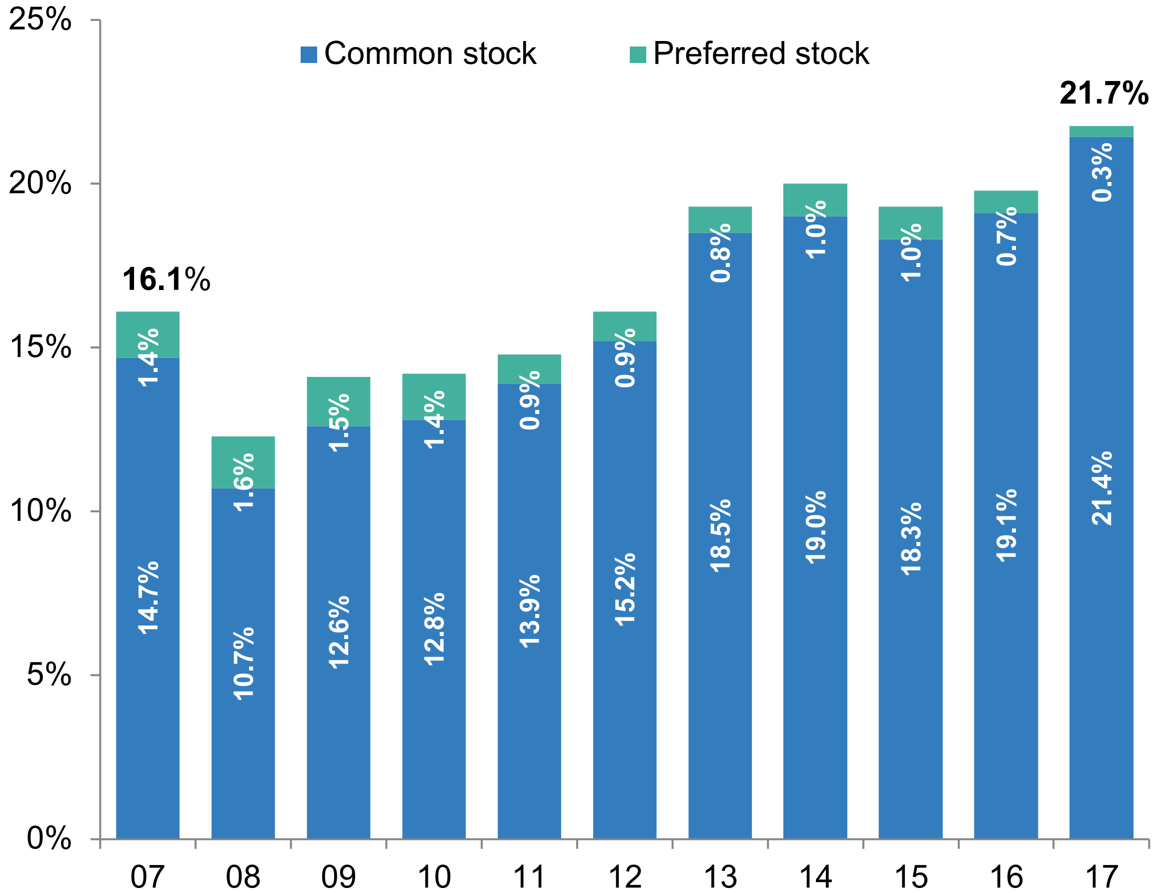
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

P/C industry: Percent of corporate bonds to total bonds



Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

P/C industry: Rising stock holdings as a percent of invested assets



- **In the last decade, stock dividends were generally competitive with bond coupons, but had greater appreciation potential, so that increasing stock ownership seemed prudent. That trend seems to be ending now. If so, will the trend of increasing stock ownership reverse?**

Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

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