Thriving in an Economic Downturn: What Lies Ahead?

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Presentation Outline

• Isn’t the Downturn Over?
  ➢ The Housing Market: Still a Source of Downward Pressure
  ➢ A Full-employment Economy? It’s Many Years Away

• Interest and Inflation Rate Expectations

• The New Financial Anxiety

• Individual Life Insurance: Status Report
  ➢ Sales, Lapse, Policy Loan Trends

• A Financial Security Budget Target?
  • Q & A
Wait a Minute: Isn’t the Downturn Over?
Real Quarterly GDP Changes (annualized), 2005:Q3-2010:Q4

Red bars are actual; Yellow bars are forecasts/estimates

Spike due almost entirely to the weak dollar (growing exports and slowing imports)

The Q1:2009 decline was the steepest since the Q1:1982 drop of 6.4%

Sources: US Department of Commerce, Bureau of Economic Analysis (actual) at http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm
Blue Chip Economic Indicators 10/09 issue (forecasts).
Total Industrial Production, monthly
Mar 2001-Sept 2009 (Index 2002=100)*

March 2001- November 2001 recession

Recession began December 2007

Hurricane Katrina

Industrial production turned up in July

Source: http://www.federalreserve.gov/releases/g17/ipdisk/ip_sa.txt. *seasonally adjusted
Job loss is slowing. Only 263,000 jobs lost in September.
But Problems Remain
Housing is Still a Source of Downward Pressure
**High Ratio of Unsold-Homes Inventory to Sales Will Likely Keep Prices Falling**

<table>
<thead>
<tr>
<th>Month</th>
<th>Inventory of unsold homes</th>
<th>Number of homes sold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-09</td>
<td>3.6</td>
<td>4.1</td>
</tr>
<tr>
<td>Feb-09</td>
<td>3.8</td>
<td>4.5</td>
</tr>
<tr>
<td>Mar-09</td>
<td>3.9</td>
<td>4.6</td>
</tr>
<tr>
<td>Apr-09</td>
<td>3.9</td>
<td>4.7</td>
</tr>
<tr>
<td>May-09</td>
<td>3.8</td>
<td>4.8</td>
</tr>
<tr>
<td>Jun-09</td>
<td>4.1</td>
<td>5.2</td>
</tr>
<tr>
<td>Jul-09</td>
<td>3.6</td>
<td>5.1</td>
</tr>
<tr>
<td>Aug-09</td>
<td>3.6</td>
<td>5.0</td>
</tr>
</tbody>
</table>

# of house sales fell; inventory was roughly constant

# of house sales is slightly higher

Source: [http://www.realtor.org/research/research/ehsdata](http://www.realtor.org/research/research/ehsdata)
Many People’s Main Asset (Their Home) Has Lost 6 Years of Appreciation

Home prices in July 2009 were about equal to August 2003

Current recession began in Dec ‘07

July 2009 index value was 144.23: home prices were 30% below their July 2006 peak

*Case-Shiller Home Price Index (20-city composite); January 2000=100. Not seasonally adjusted
Source: http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_History_072820.xls
“Shadow” Inventory of Unsold Homes: It’s Worse Than You Think

• Zillow.com’s latest Homeowner Confidence Survey (published August 18, 2009) asked homeowners how likely they would put their homes on the market if they saw signs of a turnaround in the next 12 months:
  - **Very likely**, 8% (7.5 million homes)
  - **Likely**, 9% (7.5 million homes)
  - But Adam York, economist for Wells Fargo Securities, “contends that the amount of homes that have not yet been listed for sale could be around 4-5 million.

“Millions” More Foreclosures are Likely

“[A]ny modification program seeking to avoid preventable foreclosures has limits, HAMP included. Even before the current crisis, when home prices were climbing, there were still many hundreds of thousands of foreclosures. Therefore, even if HAMP is a total success, we should still expect millions of foreclosures, as President Obama noted when he launched the program in February.”

Source: Treasury Assistant Secretary for Financial Institutions Michael S. Barr, Written Testimony on Stabilizing the Housing Market before the House Financial Services Committee, Subcommittee on Housing and Community Opportunity (emphasis added)
At Midyear 2009, Over 40% of Subprime Loans Were Delinquent or in Foreclosure
(2005:Q1-2009:Q2)

U.S. All Subprime Loans Delinquent and in Foreclosure: Source: MBA Q2 2009 Delinquency Survey

http://www.calculatedriskblog.com/
The Percent of Delinquent Prime Loans and Prime Loans in Foreclosure Is Still Rising Sharply
(2005:Q1-2009:Q2)
Fewer People/Organizations are Borrowing
Households and Businesses Are Still “Deleveraging”
Percent Change in Debt Growth (Quarterly since 2004 at Annualized Rate)

Source: Federal Reserve Board, at [http://www.federalreserve.gov/releases/z1/Current/z1r-2.pdf](http://www.federalreserve.gov/releases/z1/Current/z1r-2.pdf)
A Full-Employment Economy is Still Many Years Away
Unemployment and Underemployment Rates: Rocketing Up in 2008-9
January 2000 through September 2009, seasonally adjusted

Traditional Unemployment Rate U-3
Unemployment + Underemployment Rate U-6

9.8% Sept. 2009 unemployment rate (U-3) was the highest monthly rate since 1983. Peak rate in the last 30 years: 10.8% in Nov-Dec 1982.

U-6 went from 9.2% in April 2008 to 17.0% in Sept. 2009.

U.S. Unemployment Rate Forecasts
Quarterly, 2009:Q4 to 2010:Q4

Unemployment is now expected to peak in late 2009:Q4 or 2010:Q1.

Sources: Blue Chip Economic Indicators (10/09); Insurance Info. Inst.
When Might All of the Lost Jobs Be Regained? 2016?

Long Road Back | How long it would take to regain the job level at the start of this recession?
Assuming the average monthly pace of the most recent expansion, it would take 86 months, or not until December 2016

1 million jobs gained

Cumulative change since December 2007

Note: The starting point for adding jobs back includes 824,000 jobs lost between March 2008 and March 2009 announced Friday by the Labor Department (payroll figures)

Interest Rates Will Likely Stay Low for the Foreseeable Future
2009-2010 Inflation Forecast: Low Rates Ahead

Average inflation rate, 1992-2007: 2.67%

Sources: US Bureau of Labor Statistics (actual, blue bars); Blue Chip Economic Indicators, 10/2009 issue, (forecasts, yellow bars)
Theory: Re-ignited Inflation Won’t Threaten Until the Economy Returns to a Full-Employment Level—Likely a Few Years Away

The markets are starting to worry that the flood of money for the recovery will re-ignite inflation (the spread between 10-Year TIPS and 10-Year T-Notes is widening).

Source: Cooper, “Hints of Recovery—And Fears of Inflation,” BusinessWeek, May 11, 2009, p. 8
**Bond Yields Tend to Reflect Expected Inflation, but the Relationship is a Loose One**

Sources: US Bureau of Labor Statistics (history); Blue Chip Economic Indicators, 10./2009 issue (forecasts)
Net Rate on L/H General Account Assets Tends to Follow 10-Year US T-Note

*estimates/forecasts from October 2009 issue of Blue Chip Economic Indicators

Sources: ACLI Life Insurers Fact Book 2008, p. 34; http://federalreserve.gov/releases/h15/data/Annual/H15_TCMNOM_Y10.txt
What's the Longer-Term Forecast for Interest Rates?
Will Federal Deficit Spending Ultimately Re-ignite Severe Inflation?

Deficit hit $1.6 trillion in FY 2009 (11% of GDP), by far a post-WW II high

In the 70s and 80s, When the Deficit Rose, Only High Interest Rates Dampened Inflation
Will Inflation and Interest Rates Repeat the 1980-85 Pattern?


How Well Are Most People Handling Recent Circumstances?
Not Well
They’re Living
Close to the Edge

Source: Jacob Hacker, *The Great Risk Shift*, rev. ed., Oxford University Press, New York, p. 102, citing a Gallup survey published in April 2003. Hacker notes that these results are after controlling for demographic variables such as age, income, race, education, and gender.
**Trend: Growing Chance That a Family’s Income Will Drop By 50% or More**

- The income instability risk has been rising for three decades
- Even at its most recent “best” (at the height of the prosperity of the 1990s), the risk level exceeded all pre-1980 levels

Was the 2002 spike in lapse rates related to the March 2001-November 2001 recession?

2008-09 recession; curve will likely continue up in 2009

Ordinary Life Insurance Lapse Rates, 1996-2008

Sources: NAIC Annual Statements, p. 26 line 15 (lapses) and average of lines 1 and 21, from National Underwriter Highline Data; I.I.I. calculations
Policy Loans Increase During/Following a Recession, but Also in Boom Times

The Older Generations Might Boost Economic Growth and Life/Annuity Purchases by Continuing to Work
More Workers Are Delaying Their Planned Retirement

Age When Workers Plan to Retire

Percent of Workers

- 50% before age 65
- 41% at age 65
- 26% age 66 or older
- 10% never retire

Past and Projected Labor Force Participation Rates, by Age Group

<table>
<thead>
<tr>
<th>Age Group</th>
<th>2006</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>55-64 men</td>
<td>69.6%</td>
<td>70.1%</td>
</tr>
<tr>
<td>55-64 women</td>
<td>58.2%</td>
<td>63.5%</td>
</tr>
<tr>
<td>65-74 men</td>
<td>28.8%</td>
<td>34.6%</td>
</tr>
<tr>
<td>65-74 women</td>
<td>19.2%</td>
<td>25.1%</td>
</tr>
<tr>
<td>75+ men</td>
<td>9.5%</td>
<td>14.7%</td>
</tr>
<tr>
<td>75+ women</td>
<td>4.4%</td>
<td>7.6%</td>
</tr>
</tbody>
</table>

Labor force participation by workers—especially women—age 55 and over has grown in spite of the current recession.

seasonally adjusted quarterly averages
People Over 60 are Increasingly Buying Individual Life Insurance

They’re the only age group like this
The 0-44 age group still represents the majority of the premium volume, but this has been declining over time.

Ages 60 and over is the only group consistently increasing life insurance applications.

*vs. same month, prior year
Source: MIB Life Index, monthly releases
Not Just Retirees: Many People Don’t Know Where They’re Going or How to Get There

Retirees Need A Financial Roadmap

Source: National Underwriter (L/H), June xx, 2008, p. xx
Conclusion: People Need Help Constructing Their Own Financial Safety Net
Step 1: Give Them a Spending Target

What Percent of Income Should People Spend to Assure Their Financial Security?
As a Percent of Personal (Gross) Income, Personal Insurance Premiums Are Down


L-H Industry Profitability
2006 net income rose only 0.8% despite 10.5% net premium growth, because surrenders grew 20.4%, disability benefits grew 21.6%, and total expenses grew 13.1%.

Source: NAIC Annual Statements, p.4, line 35, from National Underwriter HighlineData.
Effect of Realized Capital Gains/Losses on Net Income, 1995-2008

Source: NAIC Annual Statement data, Summary of Operations and Exhibit of Capital Gains (Losses) from Highline National Underwriter
• The capital markets are still weighed down by the housing market and lenders’ reluctance to lend
• Given the present and likely future unemployment picture, the economy is unlikely to show signs of recovery in the near term
• Sales of individual life insurance policies have been trending down for 6 years
• Trend toward increasing labor force participation by those over 55 seems likely to continue
  ➢ These people have been increasingly buying life insurance
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