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Today's Uncertain Economy: Implications for P/C Insurance

Tri-State CPCUs
September 17, 2020

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Economic Outlook

The Strength of the Economy
Will Influence the Insurance Environment

July 29 Statement by the Federal Reserve Open Market Committee

The path of the economy will depend significantly on the course of the virus.

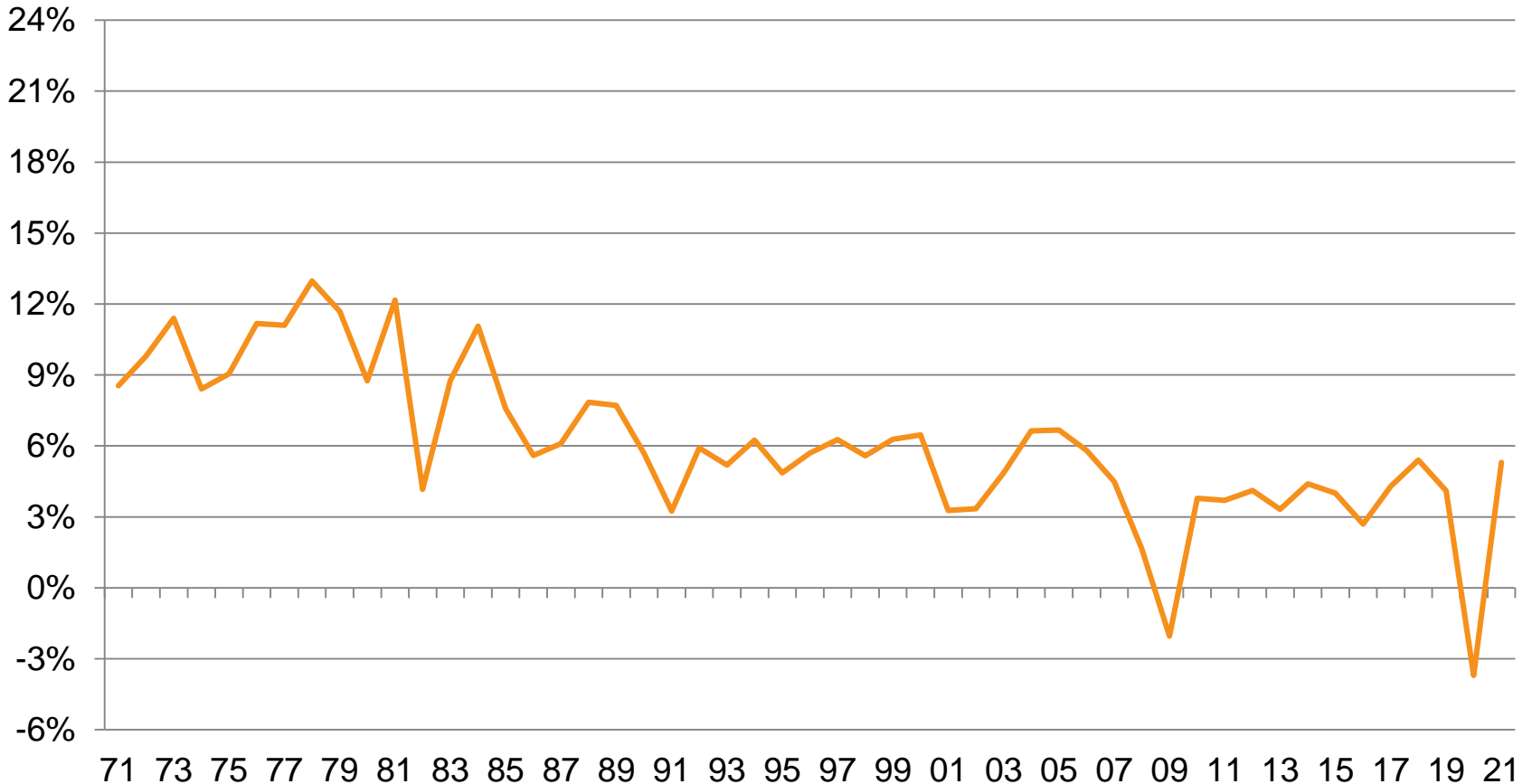
The ongoing public health crisis will weigh heavily on economic activity, employment, and inflation in the near term,

and [it] poses **considerable risks to the economic outlook over the medium term.**



The Economy Drives P/C Insurance Industry Premiums:

Nominal GDP: Annual Change, 1971-2021F

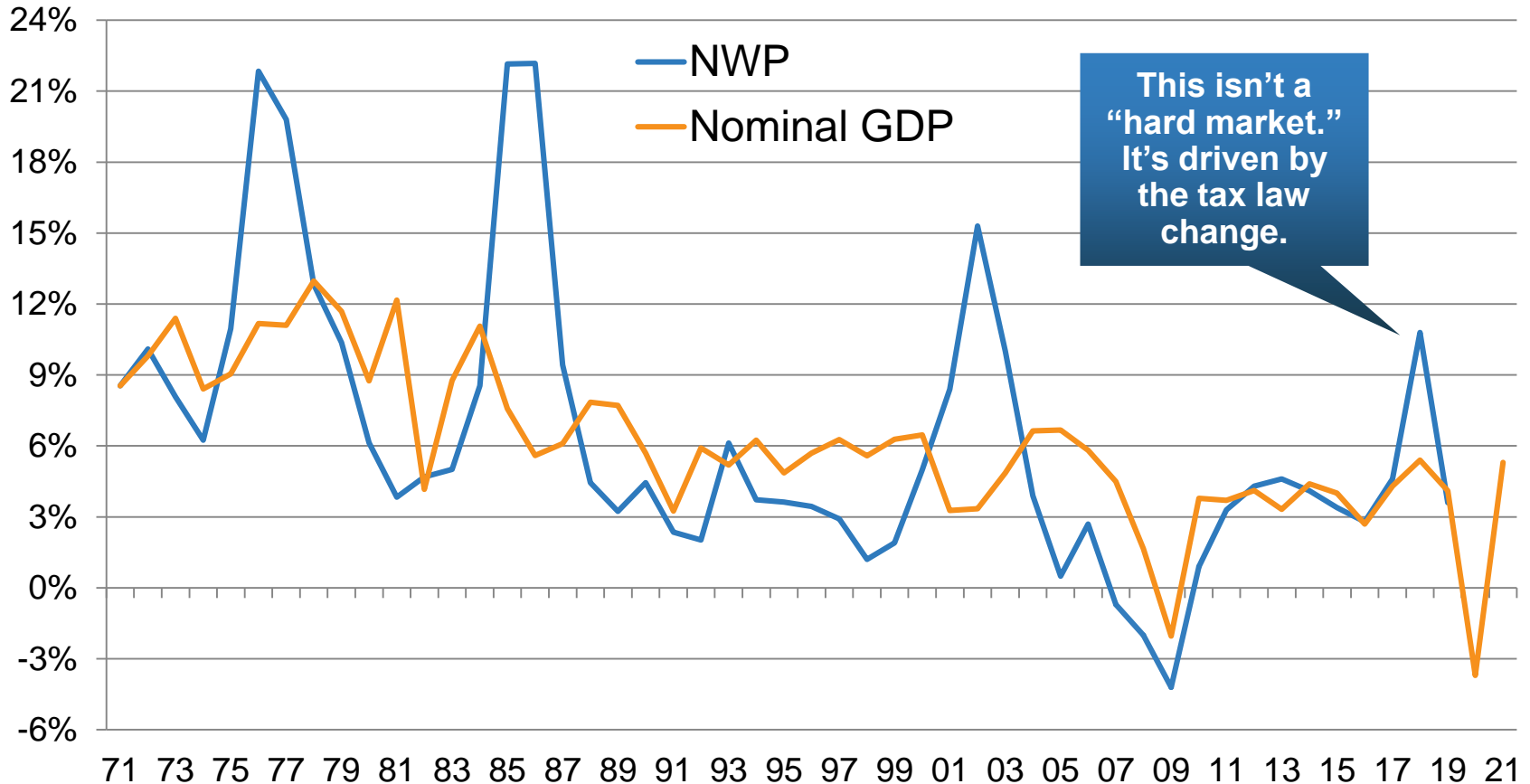


The U.S. economy's annual growth—not adjusted for inflation—has slowed over the last five decades.



The Economy Drives P/C Insurance Industry Premiums:

Net Premium Growth (All P/C Lines) vs. Nominal GDP: Annual Change, 1971-2021

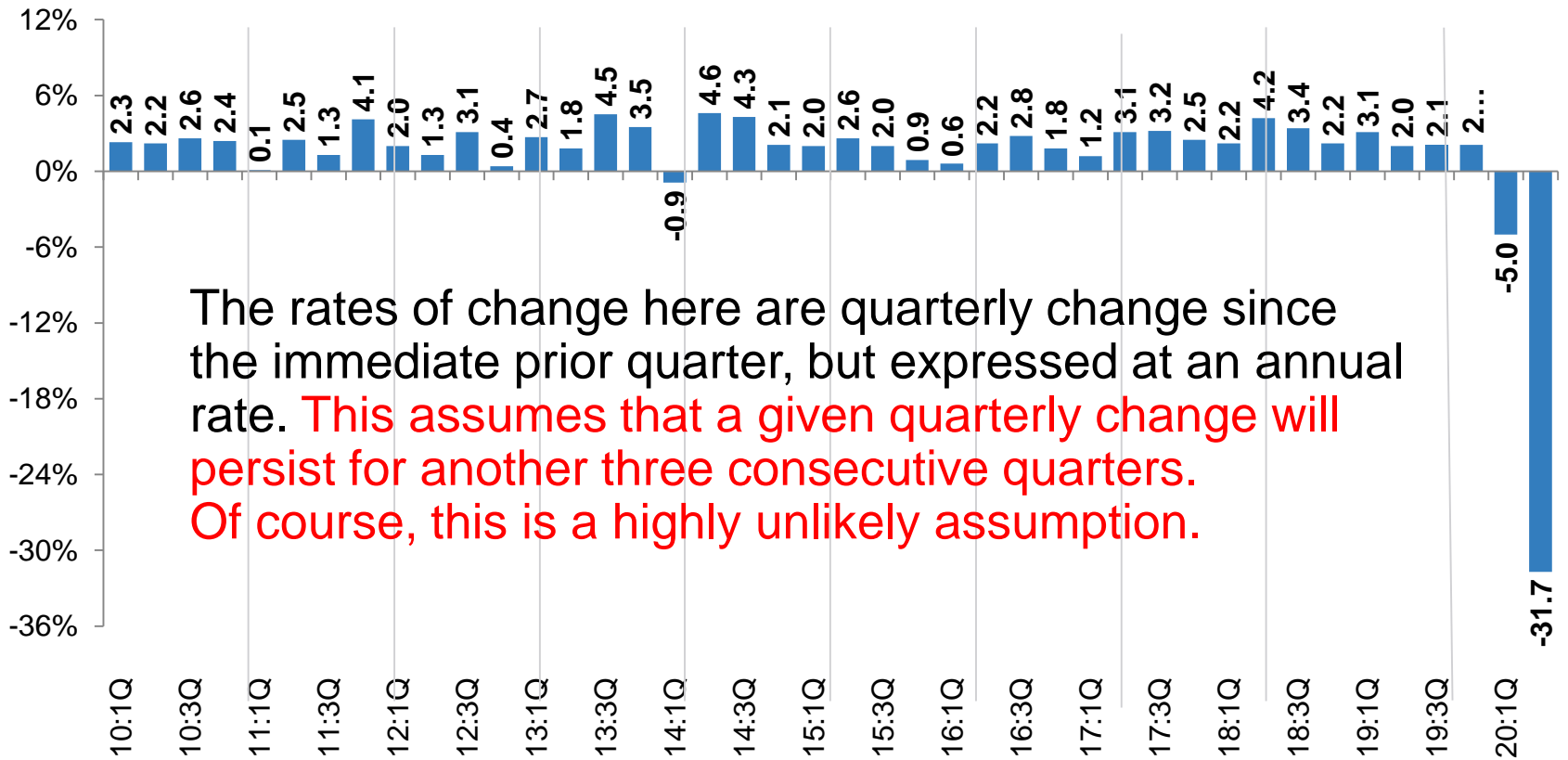


Except for the three “hard markets” in this 50-year period, Net Written Premiums track Nominal GDP—not year by year but fairly well.



Sources: A.M. Best (1971-2013), ISO (2014-19); U.S. Commerce Dept., Bureau of Economic Analysis; I.I.I. 2020 and 2021 are Blue Chip median forecasts, Sept. 2020 issue

U.S. Real GDP Growth,* Quarterly, 2010-2020

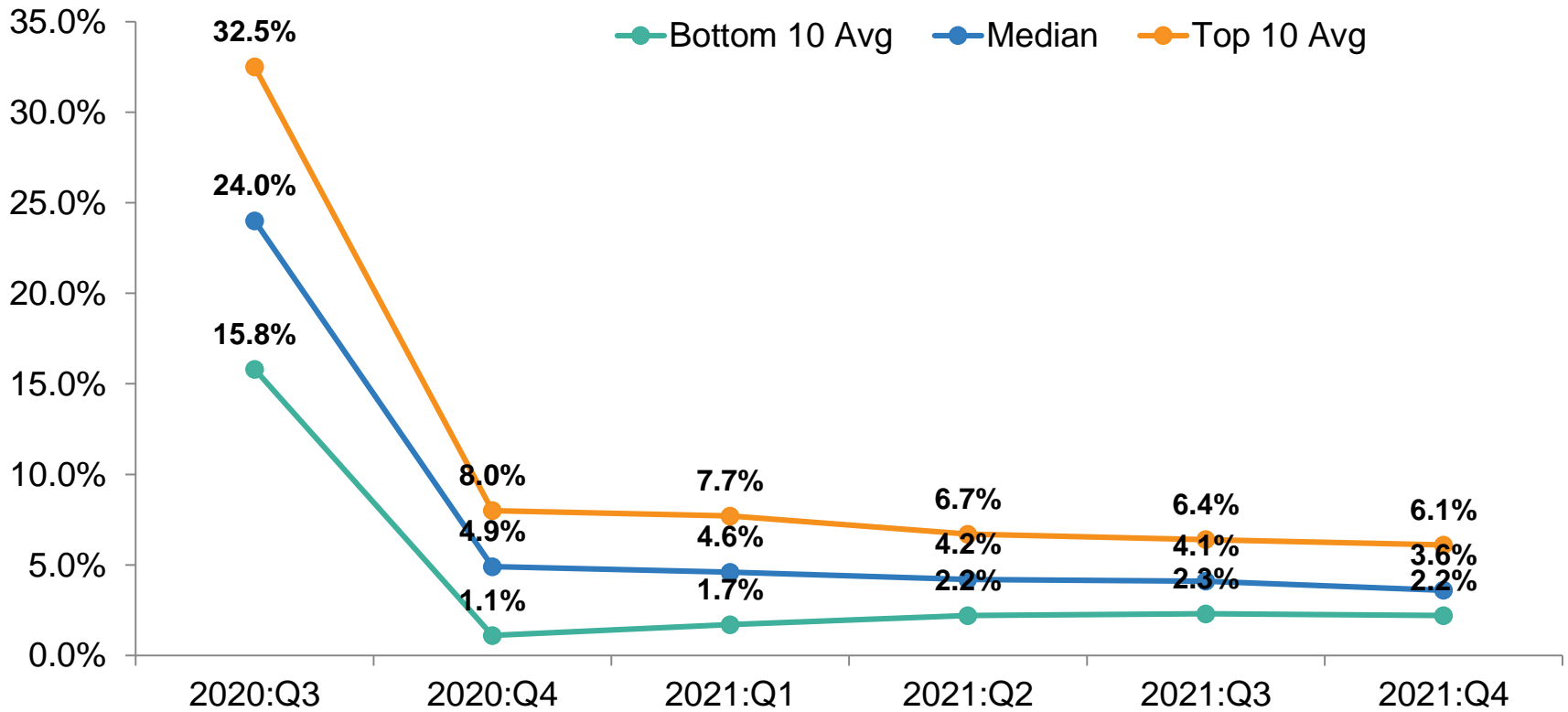


In the last decade, the economy (as measured by real GDP) rarely grew faster than 3% (at an annual rate) in a calendar quarter.



*Seasonally adjusted at an annual rate
Sources: U.S. Department of Commerce; Insurance Information Institute.

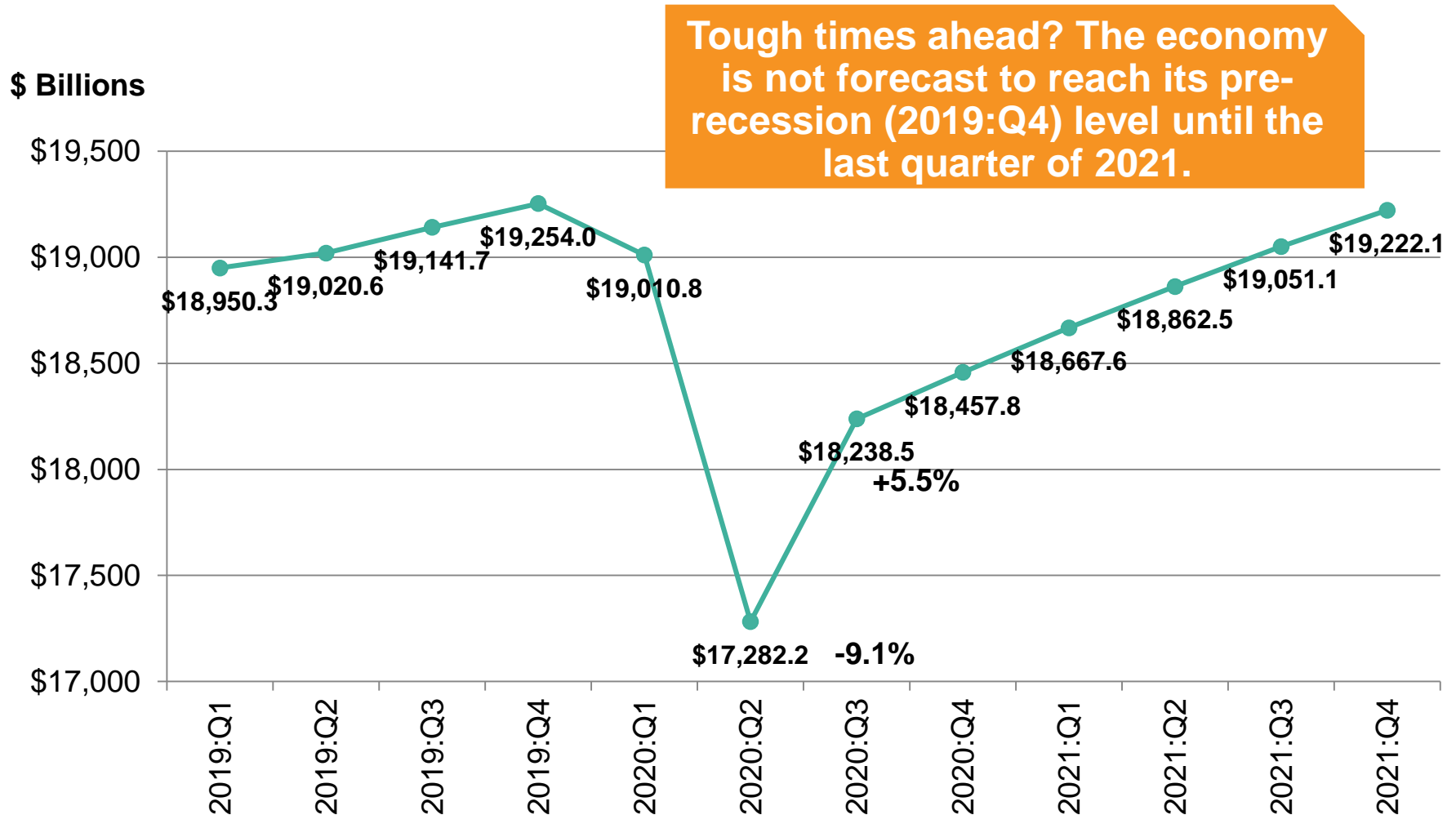
Quarterly U.S. Real GDP Growth (at annual rates): Range of Forecasts, 2020-2021



Tough times ahead?
Forecasts expect U.S. growth to recover slowly through 2021.

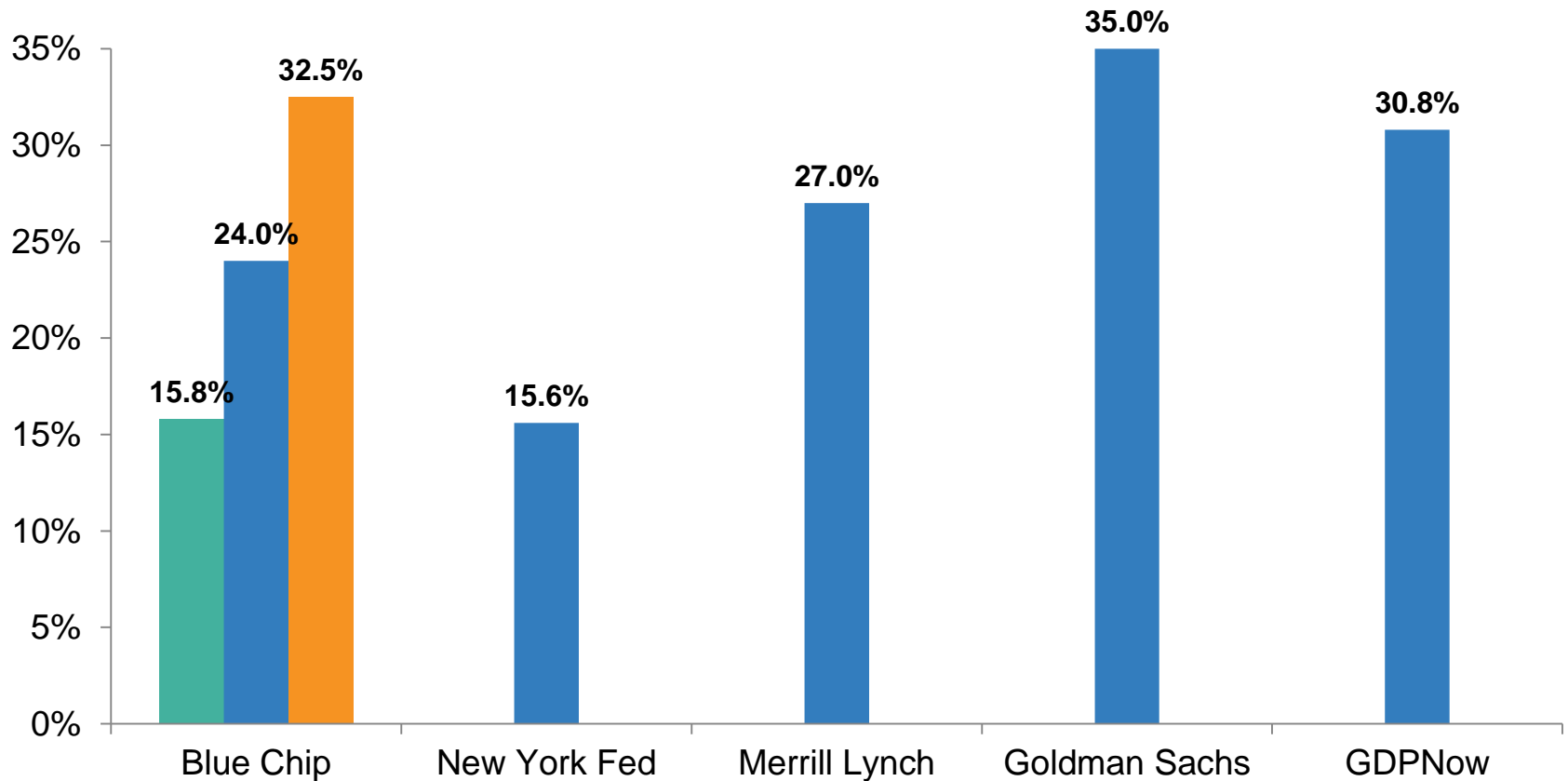


Quarterly U.S. Real GDP: Actual and Forecasts, 2019-2021F



Sources: Blue Chip Economic Indicators, Sept. 2020 issue; Insurance Information Institute. Plot points for 2020:Q3 and later are estimates and forecasts.

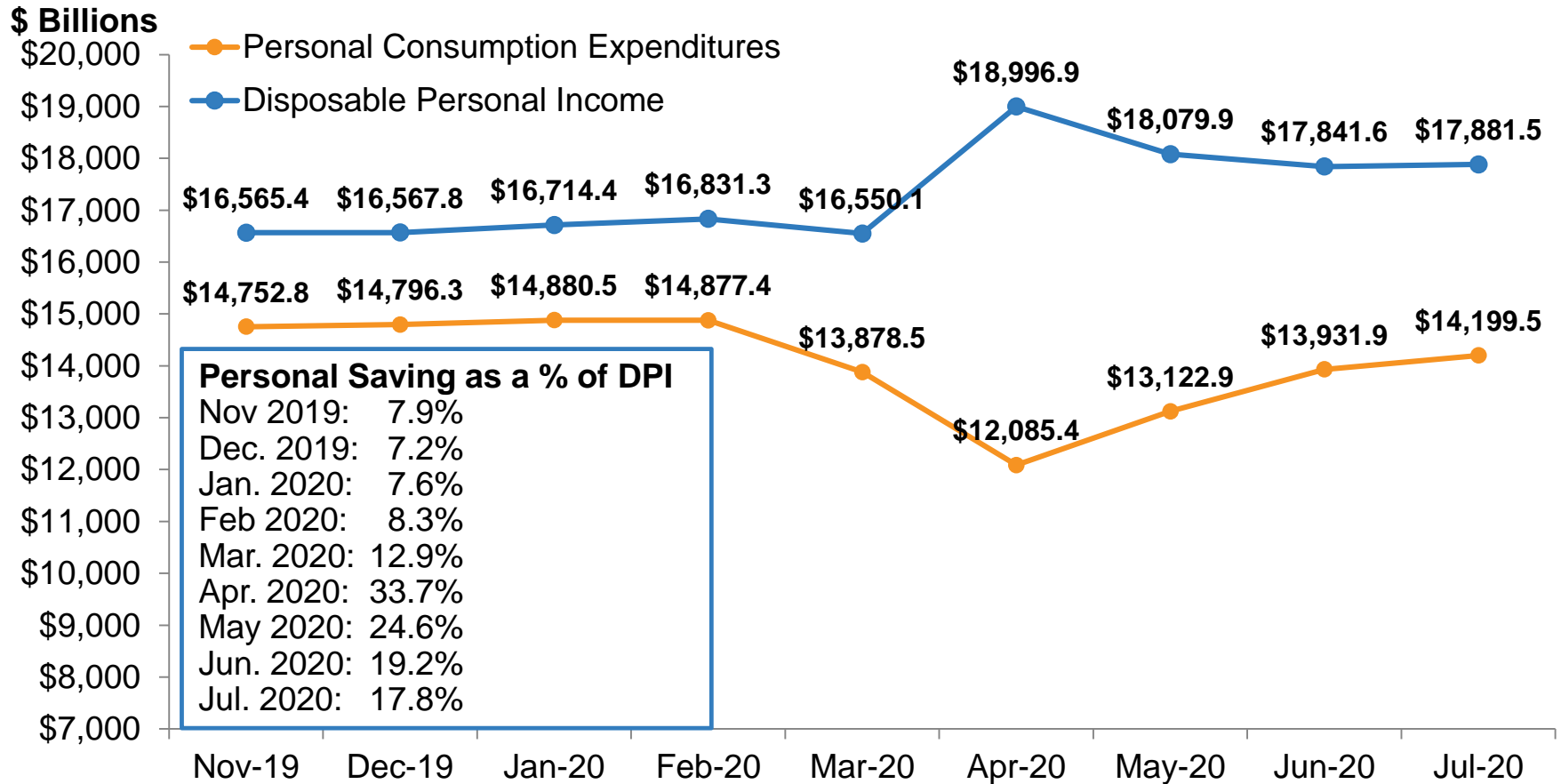
U.S. Real GDP Growth (at annual rate): mid-September Range of Forecasts for 2020:Q3



With two weeks to go in the quarter, forecasts differ widely for U.S. growth in 2020:Q3, from a modest recovery (New York Fed) to a bonfire (Goldman Sachs).



Hiring Depends on People Having Income and Spending It*

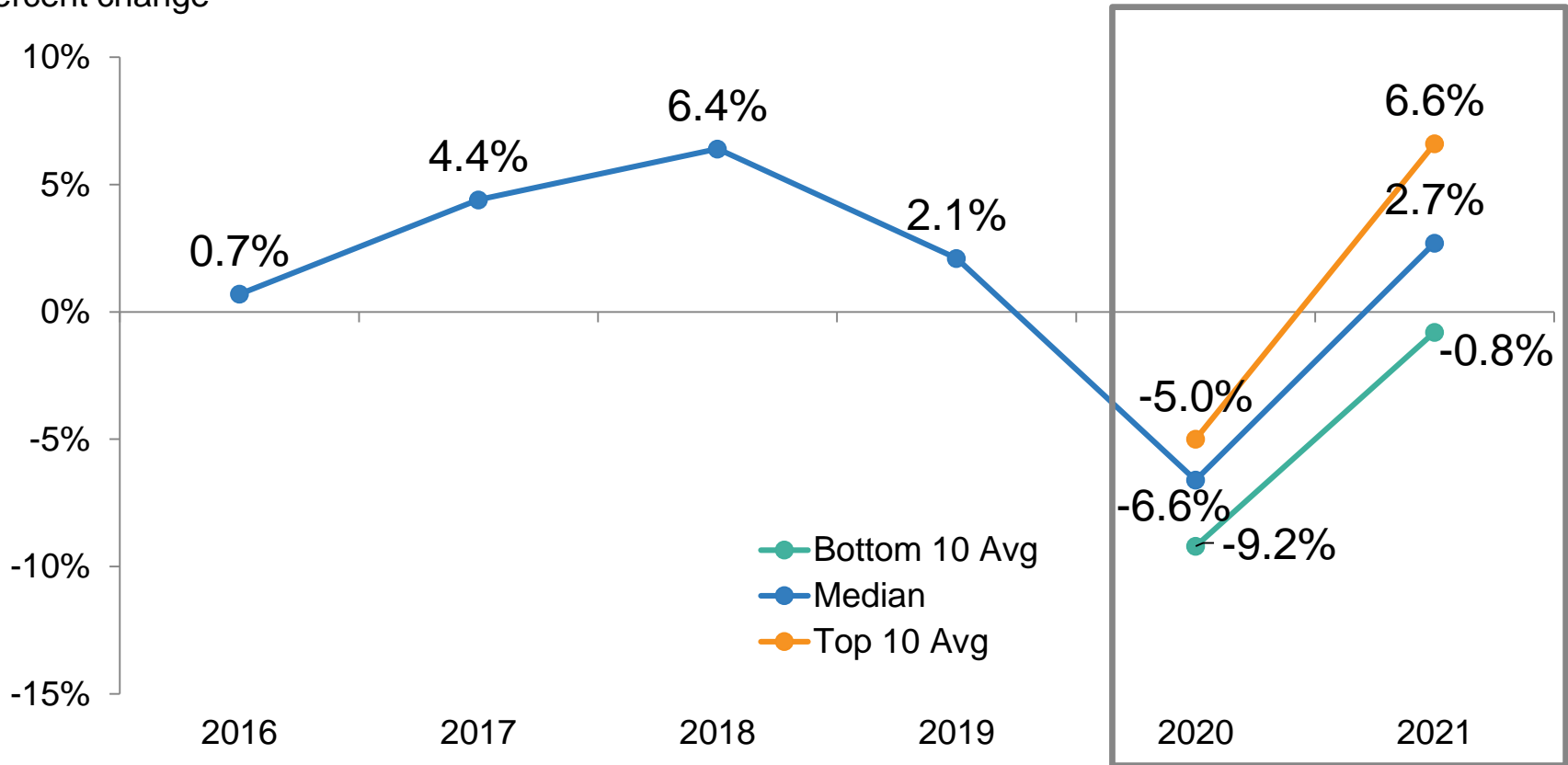


In 2020:Q2 we had the largest drop in credit card balances in history--\$75 billion. Consumption (70% of the economy) is cautious.

 *Data are seasonally adjusted at an annual rate
Sources: bea.gov, Personal Income and Outlays, published August 28, 2020, Table 1; Insurance Information Institute.

Growth in Non-Residential Fixed Investment: History and Range of Forecasts, 2020-2021

Year-over-Year percent change



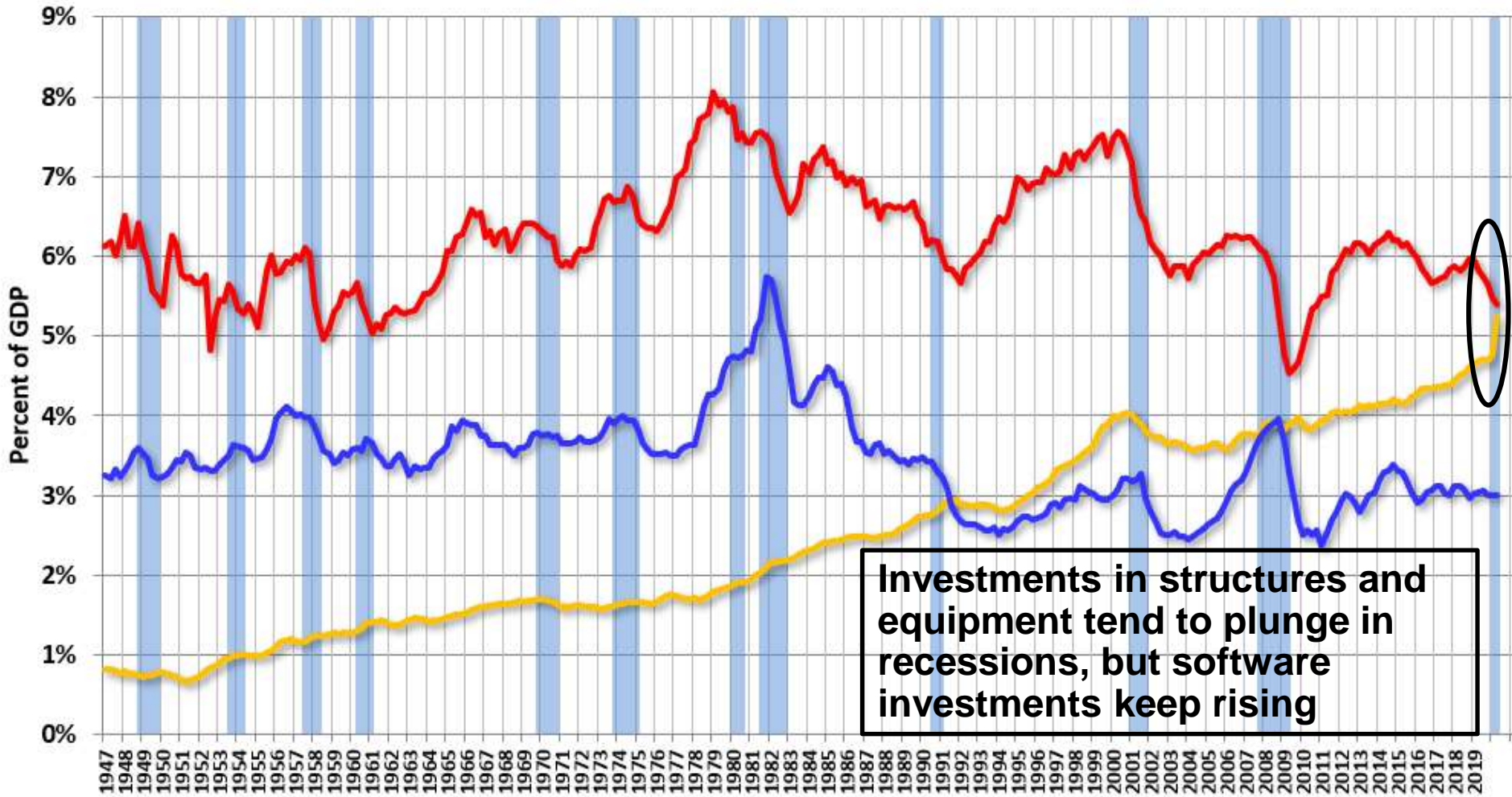
Forecasts expect business investment (in structures, equipment, and software) to plunge this year and most see a recovery in 2021.



Sources: Blue Chip Economic Indicators, Sept. 2020 issue; Insurance Information Institute.

Non-Residential Investment as Percent of GDP

recession Intellectual property products Structures Equipment



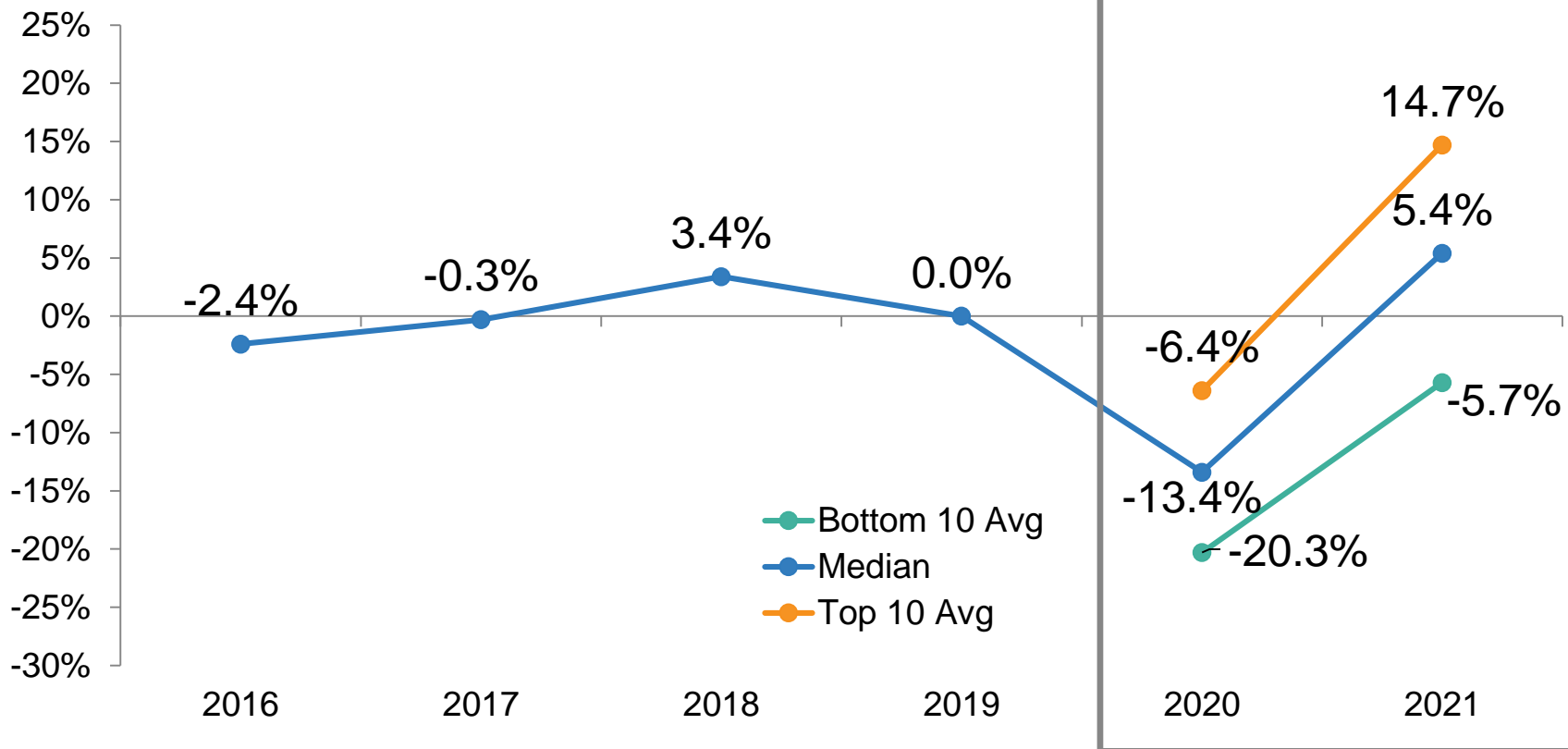
Investments in structures and equipment tend to plunge in recessions, but software investments keep rising

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



Where is the Stock Market Headed? Recent Corporate Profits History and Range of Forecasts

Year-over-Year percent change



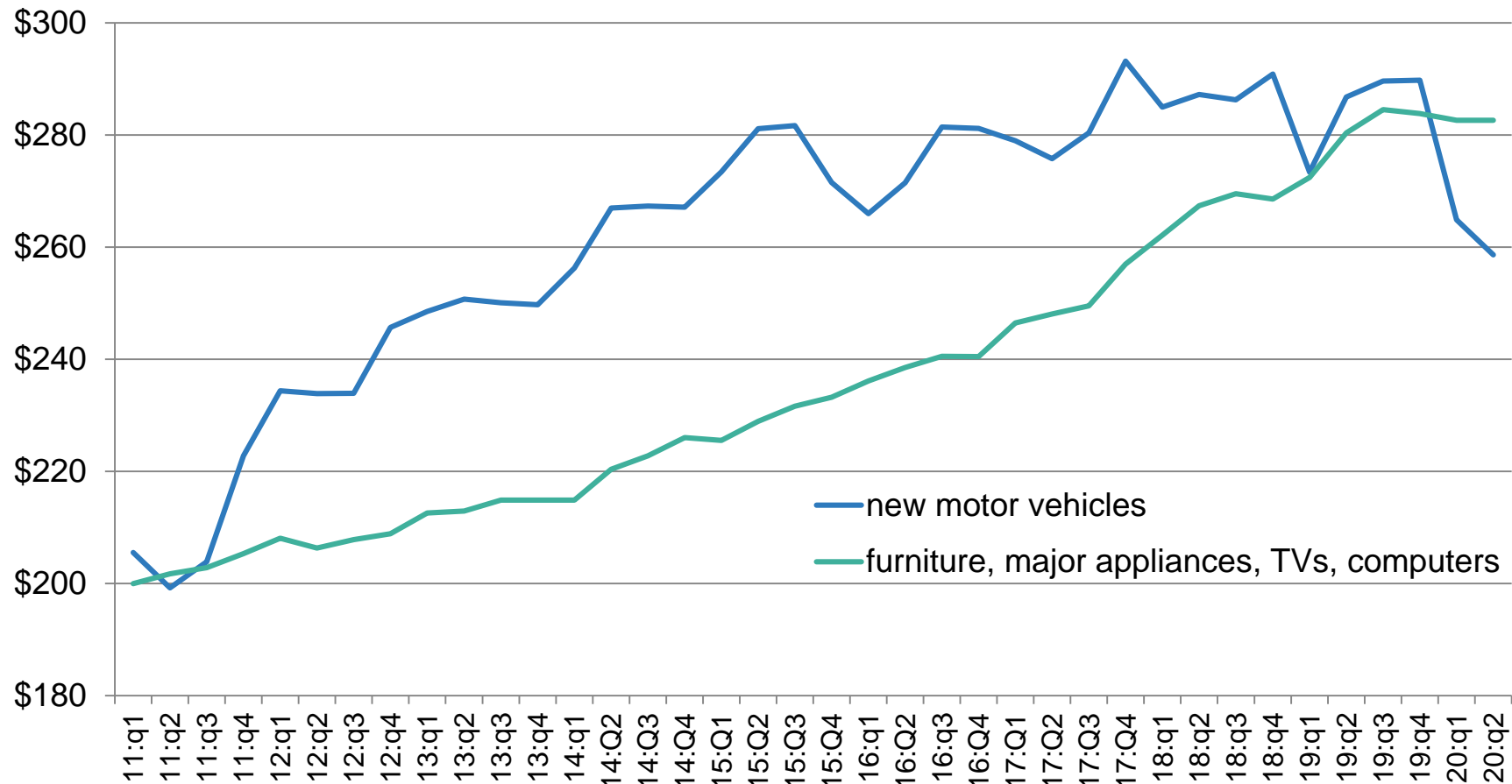
Forecasts expect corporate profits to plunge this year but most see a recovery in 2021.



Sources: Blue Chip Economic Indicators, Sept. 2020 issue; Insurance Information Institute.

Personal Consumption Expenditures: Durable Goods subcategories, Quarterly

\$ Billions



**2020:Q2 vs. 2019:Q4: motor vehicles -10.7%;
furniture, major appliances, TVs, computers -0.4%**

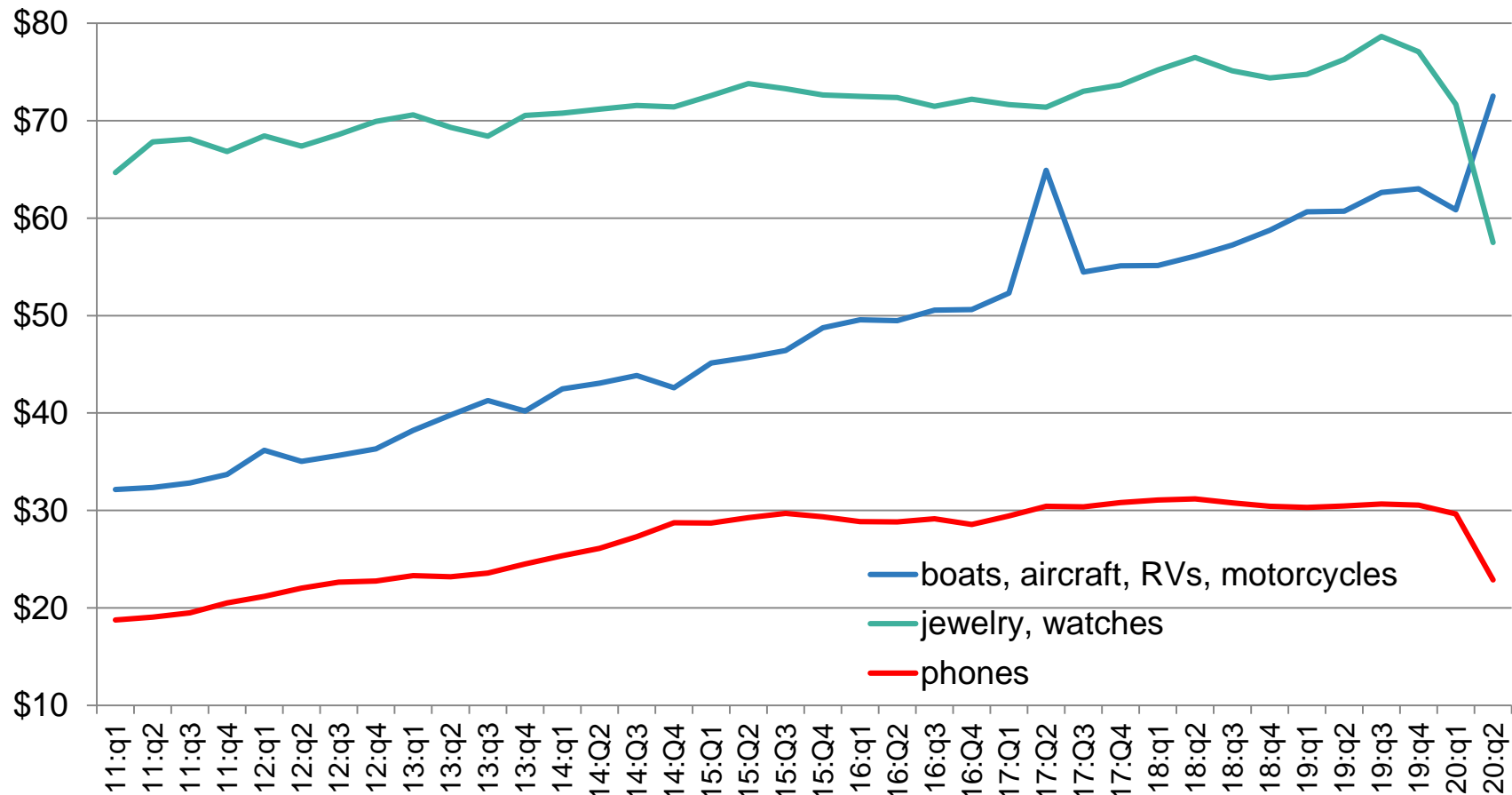


Data are seasonally-adjusted, annualized.

Sources: US Bureau of Economic Analysis, NIPA, Table 2.4.5U; Insurance Information Institute.

Personal Consumption Expenditures: Durable Goods subcategories, Quarterly

\$ Billions



**2020:Q2 vs. 2019:Q4: recreational vehicles +15.1%;
jewelry, watches -25.4%; phones -25.1%**

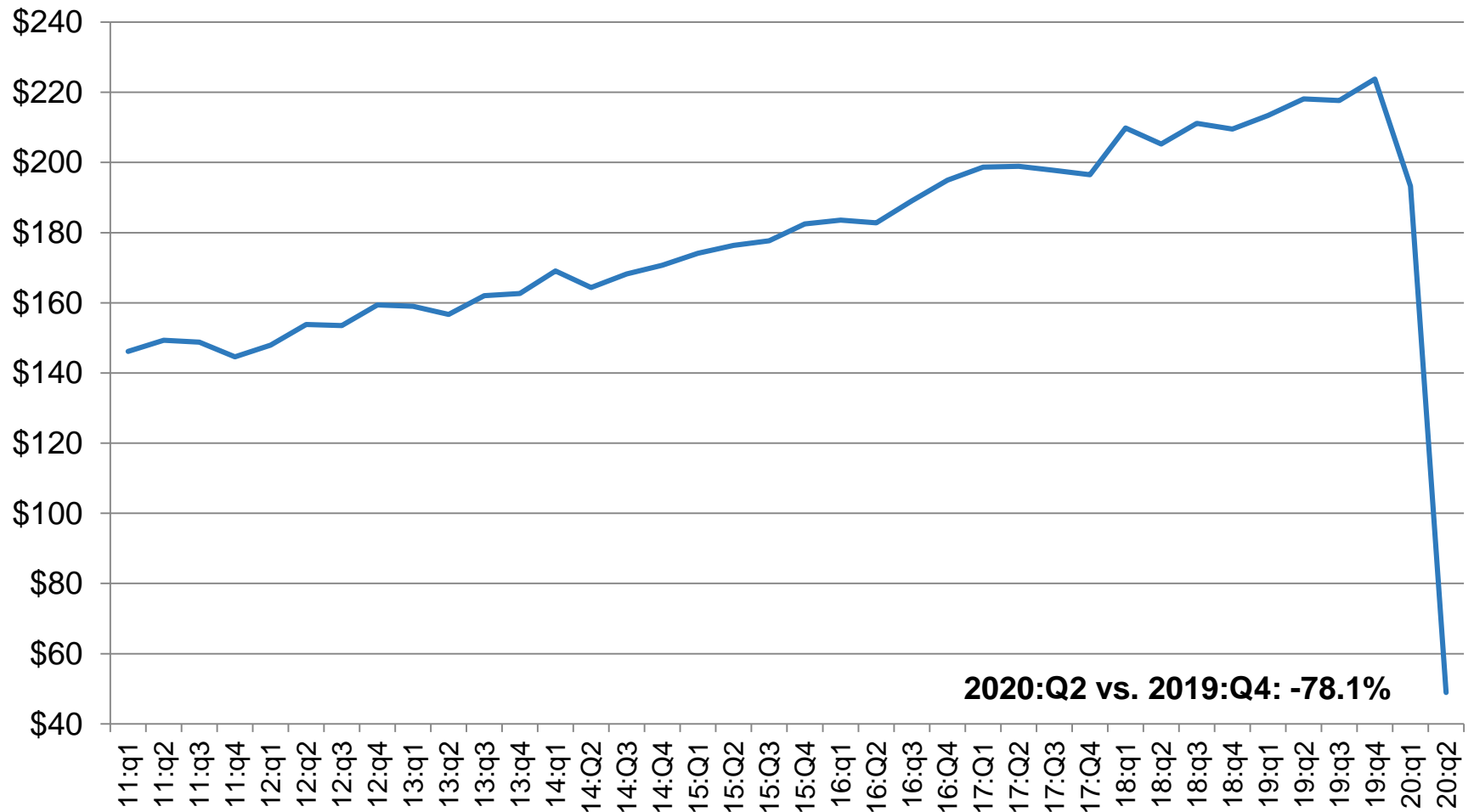


Data are seasonally-adjusted, annualized.

Sources: US Bureau of Economic Analysis, NIPA, Table 2.4.5U; Insurance Information Institute.

Personal Consumption Expenditures: Theaters, Amusement Parks, Museums, Membership Clubs, etc., Quarterly

\$ Billions

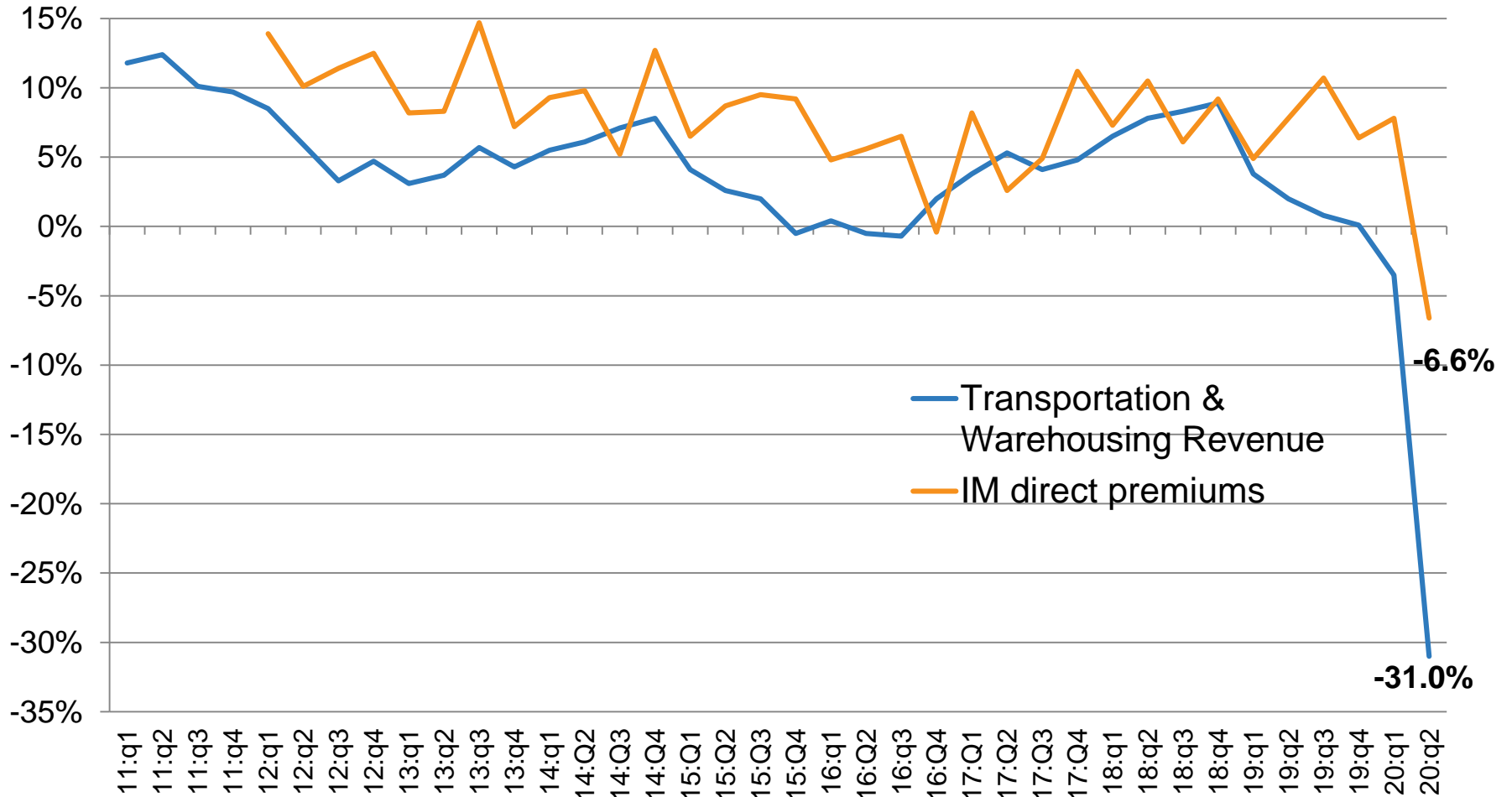


Data are seasonally-adjusted, annualized.

Sources: US Bureau of Economic Analysis, NIPA, Table 2.4.5U; Insurance Information Institute.

Total Business Revenue for Transportation and Warehousing vs. IM Direct Premiums, Quarterly

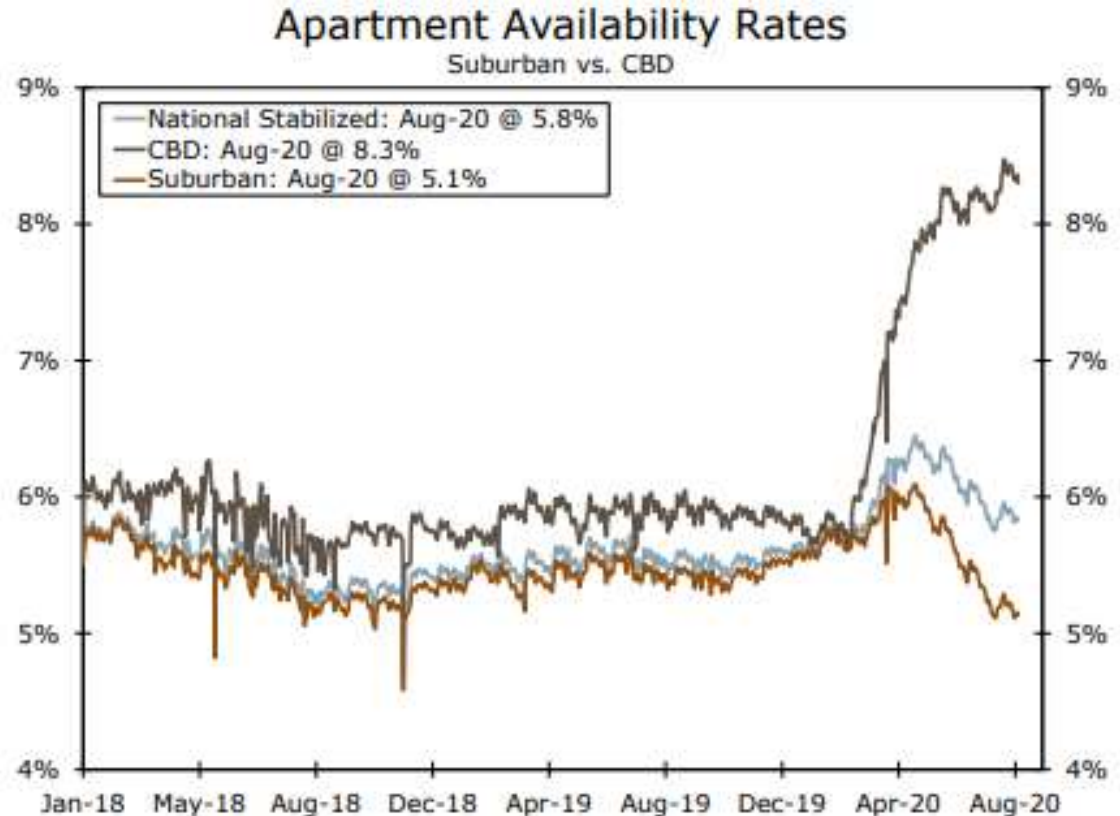
Percent Change from Prior Year



Sources: FRED <https://fred.stlouisfed.org/series/REV4849YTAXABL144QNSA#0>; S&P Global; Insurance Information Institute.

CBD Renters Moving to Suburban Apartments

- ▲ Rising [inner-city] apartment vacancy [availability] rates
 - a skyrocketing apartment availability rate in central business districts (CBD) mirrored by a declining rate for suburban properties

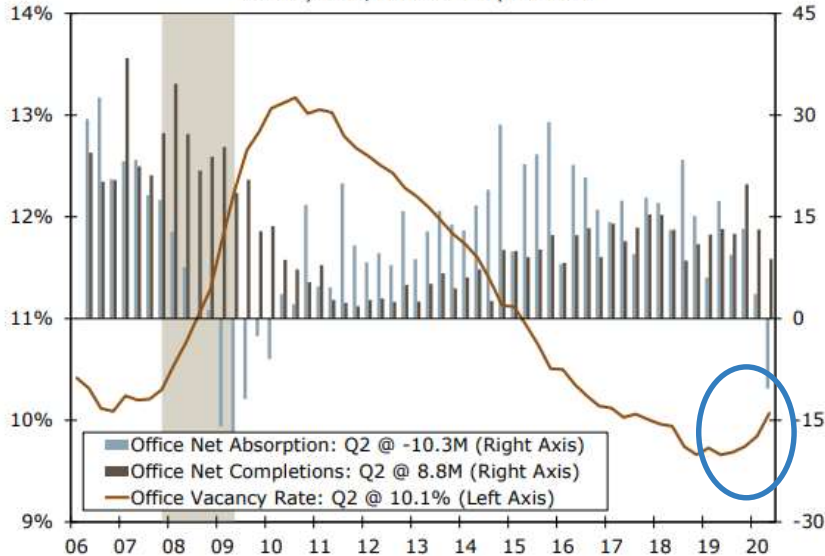


Source: CoStar, Inc., STR and Wells Fargo Securities

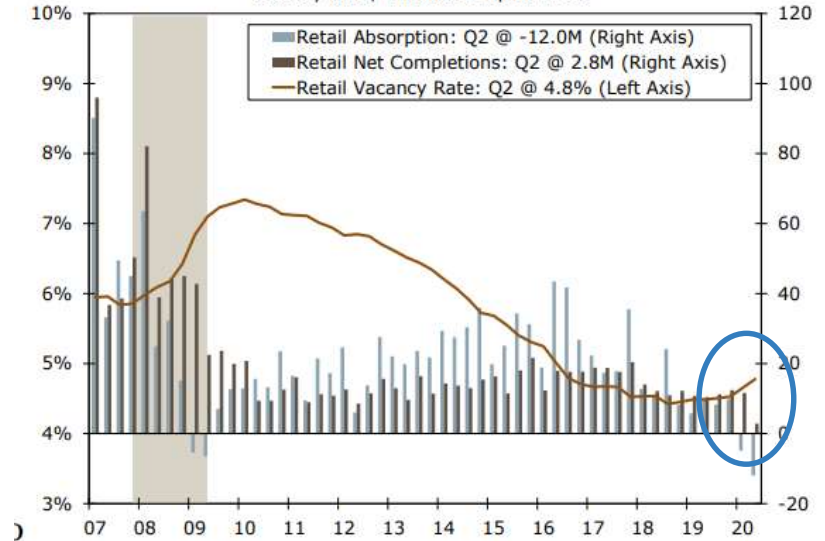


Property Insurance: Property Vacancies Rising

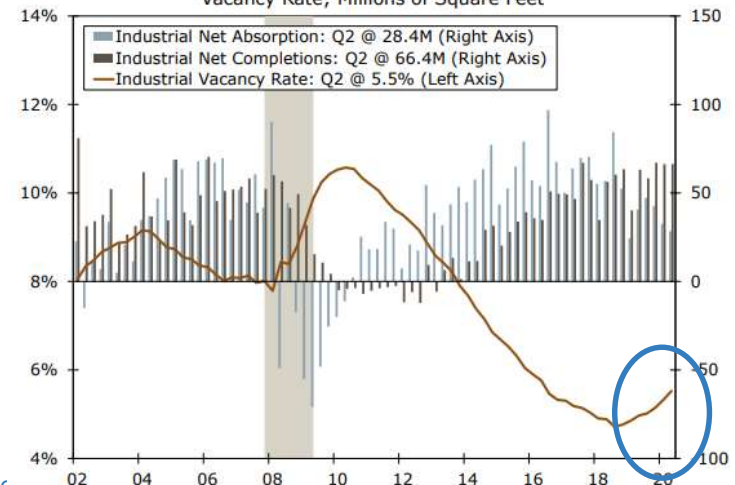
Office Supply & Demand
Vacancy Rate; Millions of Square Feet



Retail Supply & Demand
Vacancy Rate; Millions of Square Feet



Industrial Supply & Demand
Vacancy Rate; Millions of Square Feet



Rising vacancies mean potentially higher claim frequency and severity.

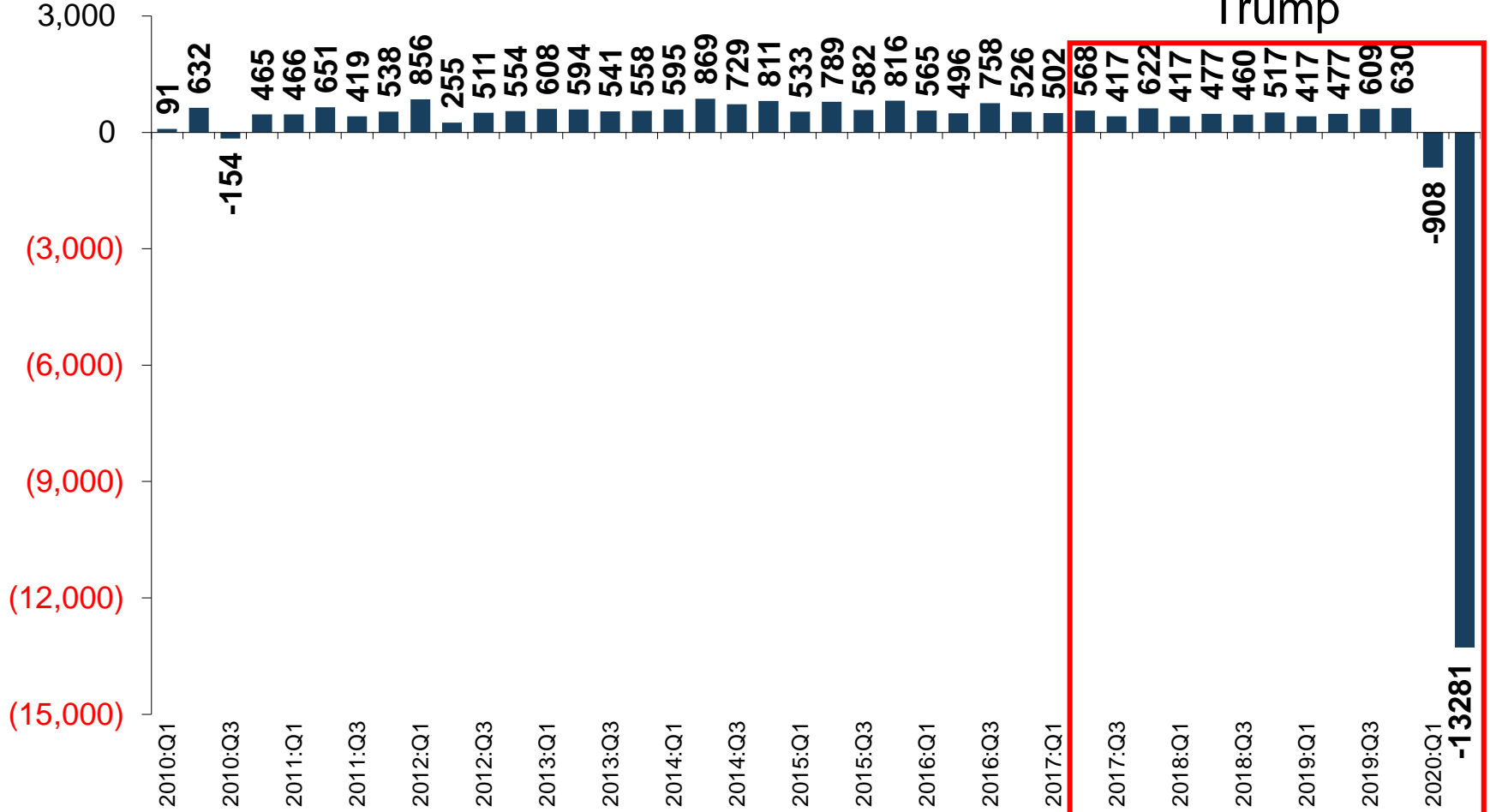


Labor Market Trends

Continuing Job Gains in the Private Sector

Nonfarm Employment, Quarterly Change*

Thousands



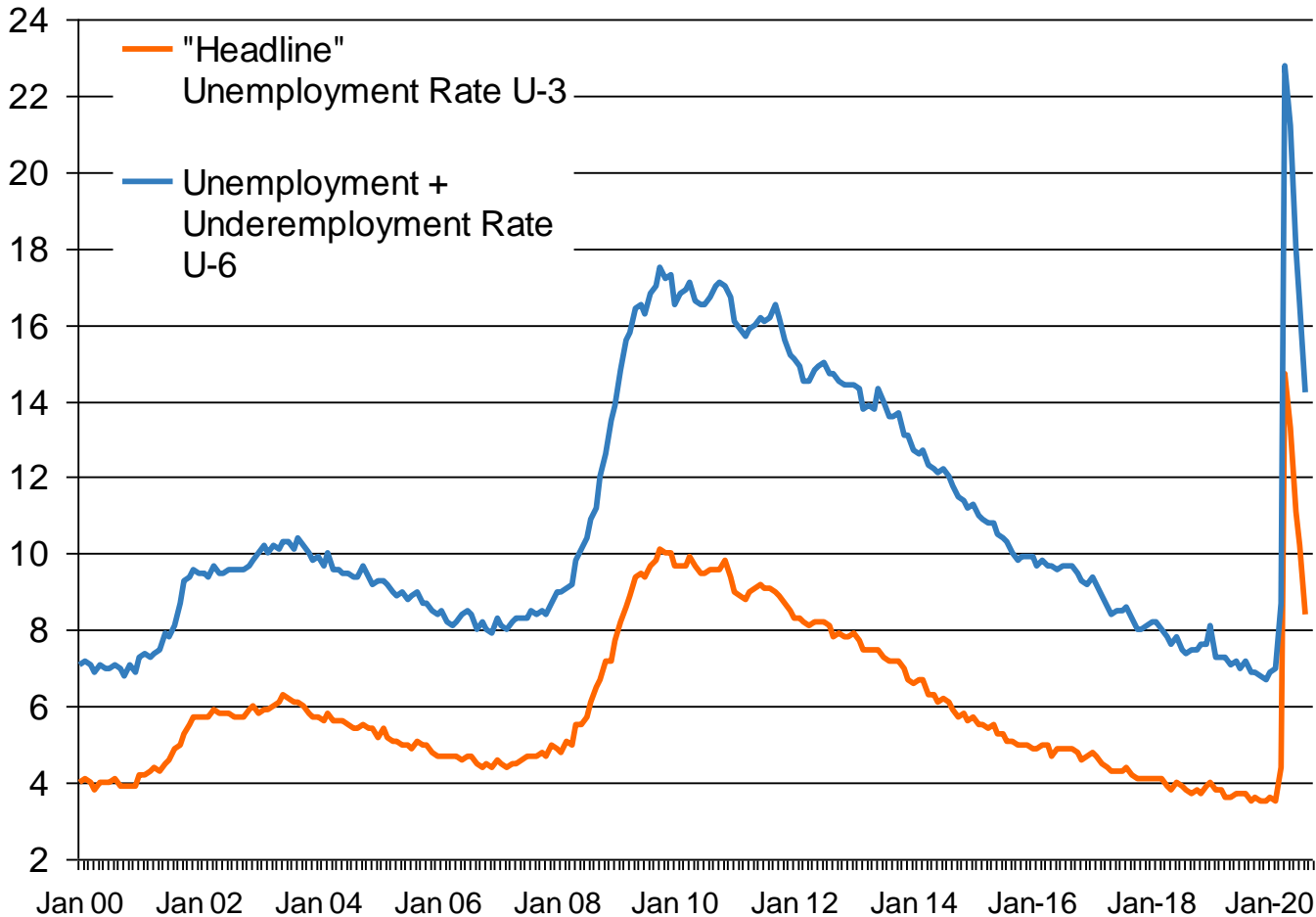
We have a steep employment hill to climb to get back to employment levels at the end of 2019.



*Seasonally adjusted; 2020:Q3 is estimated based on preliminary data
Sources: US Bureau of Labor Statistics; Insurance Information Institute

Unemployment and Underemployment Rates

January 2000 through latest month
Seasonally Adjusted (%)



U-6 was 14.2% in August 2020.

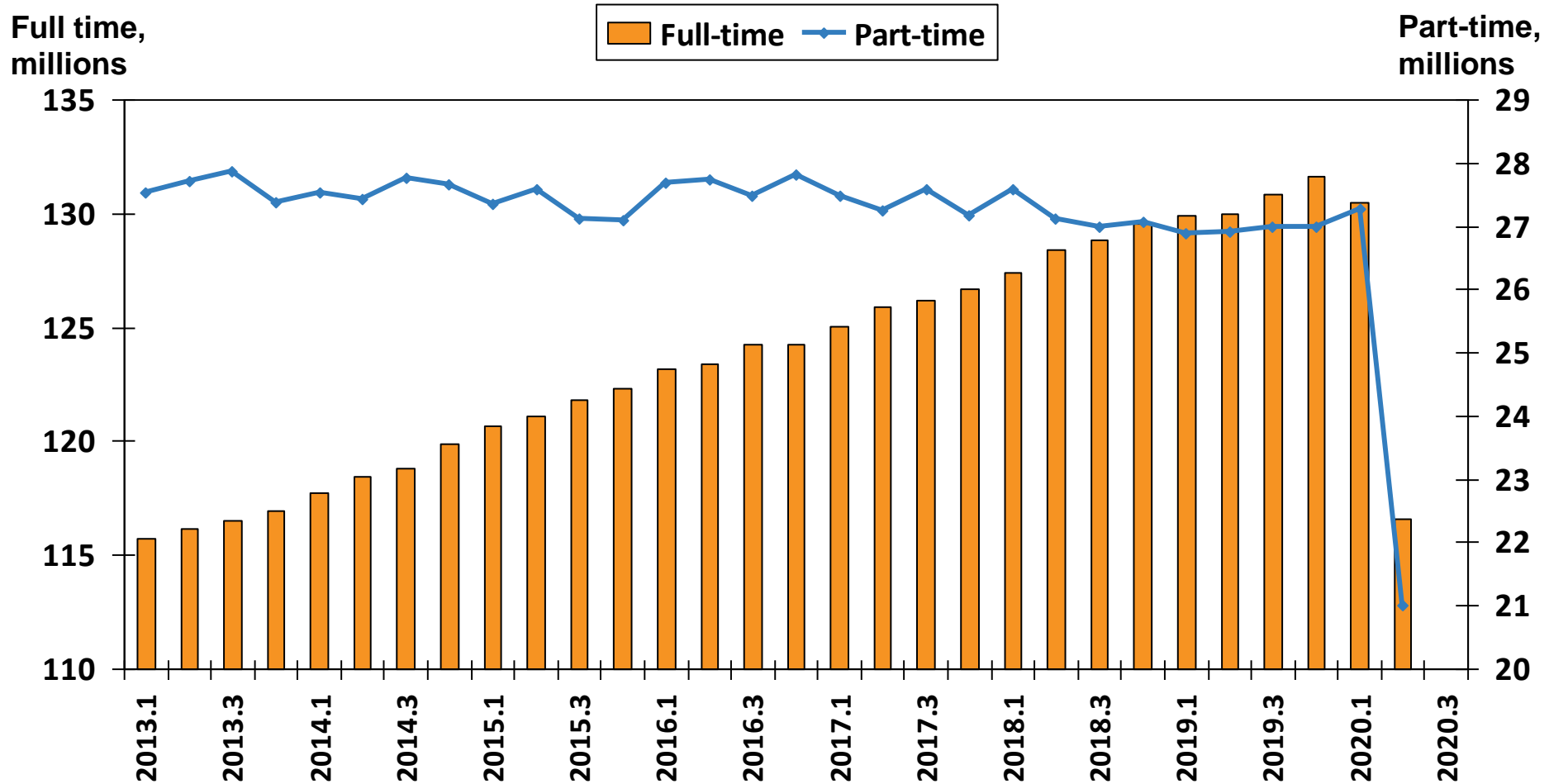
“Headline” unemployment was 8.4% in August 2020. 4% or so is generally considered to be “full employment.”

Based on the latest readings, the job market is getting better, but only slowly. Officially, 13 million are unemployed.



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

A Closer Look: Full-time vs. Part-time Employment, Quarterly, 2013:Q1-2020:Q2

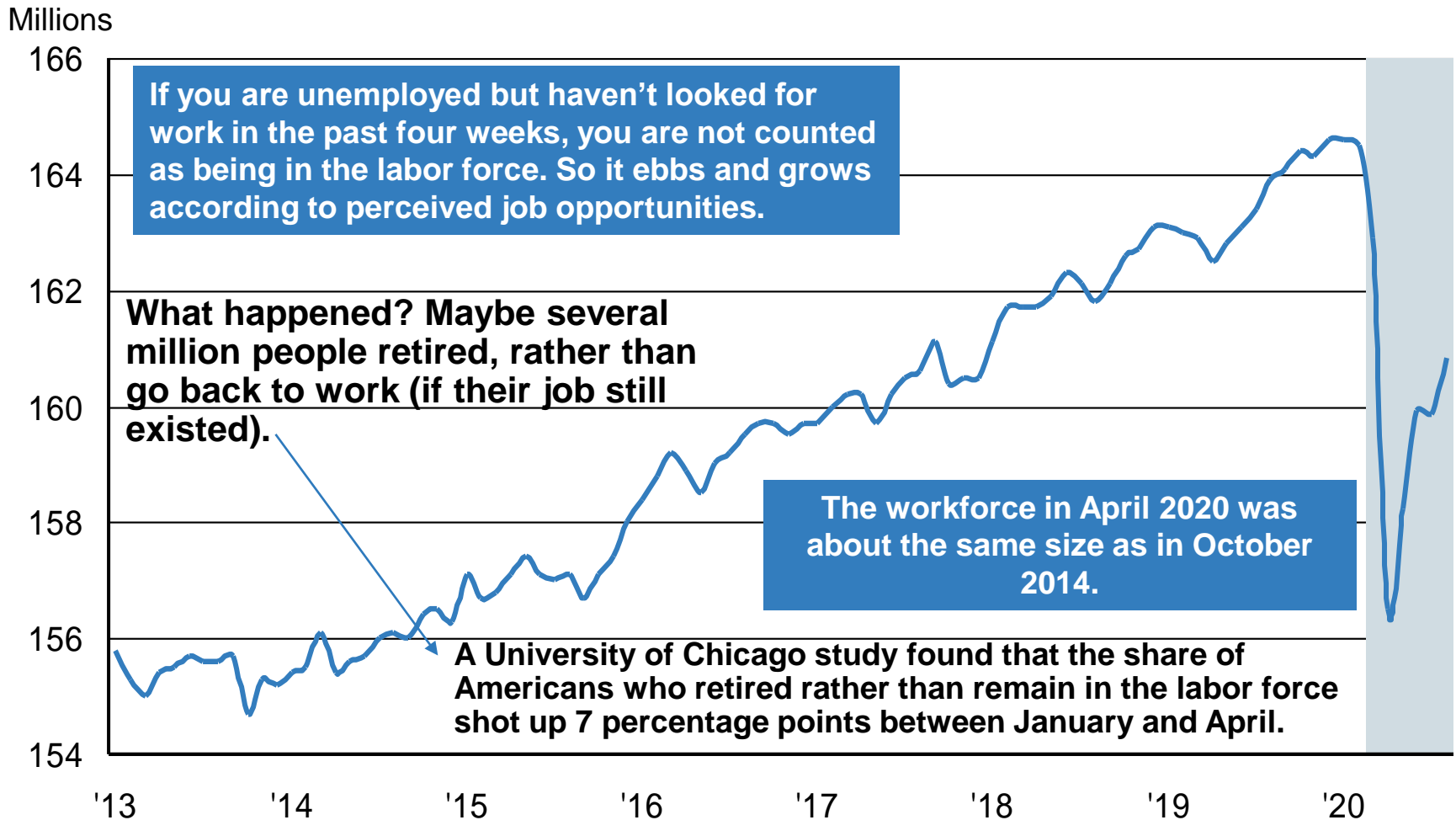


In one quarter, we went from 130 million employed full-time to 116 million.
We went from 27 million employed part-time to 21 million.



The Civilian Labor Force: A Closer Look

Jan. 2013 – August 2020



From February 2020 to April, the workforce shrank by 8.1 million, but it regained 4.3 million by August, for a net drop of 3.8 million.

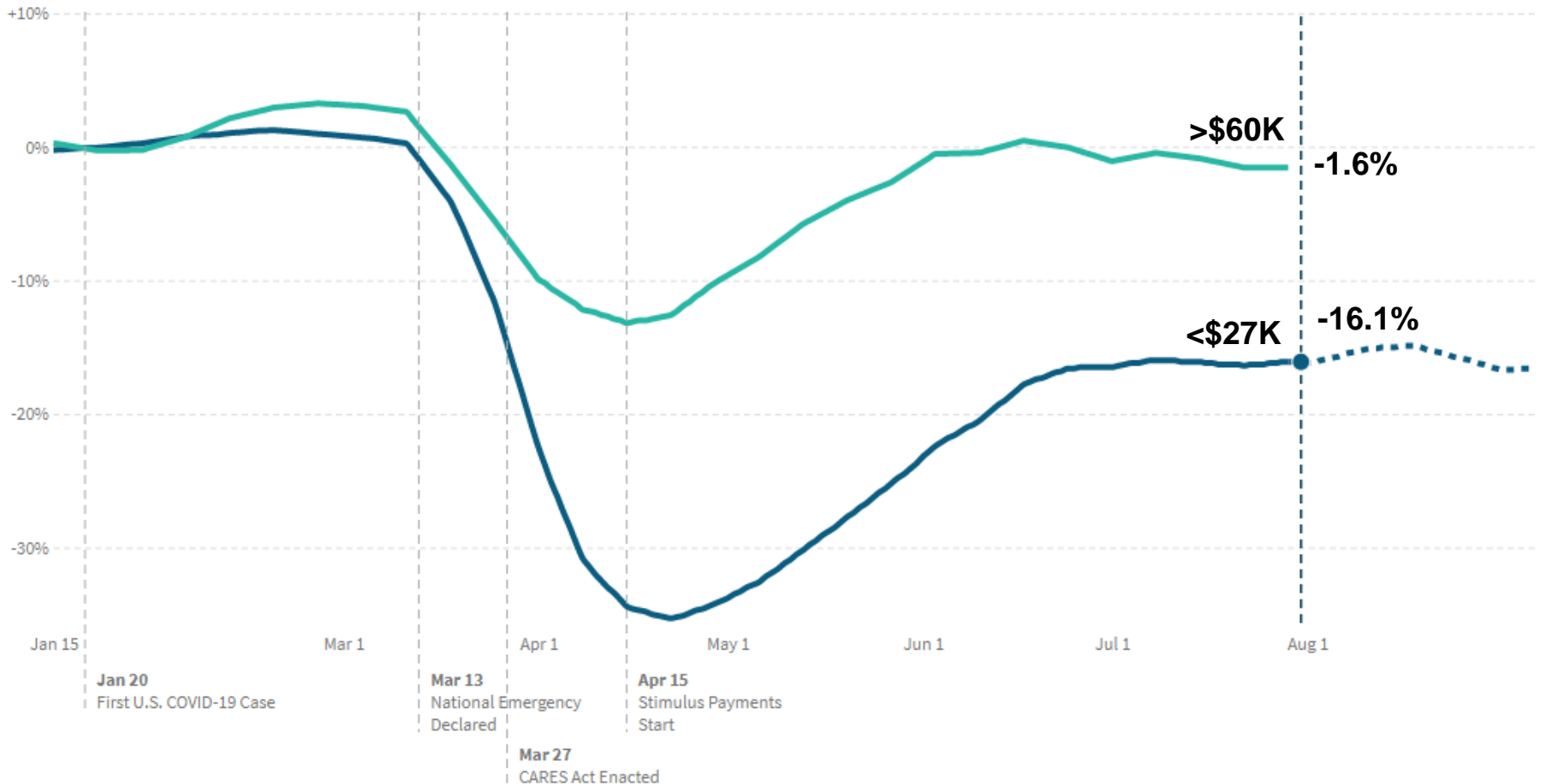


Notes: Recession indicated by gray shaded column. Data are seasonally adjusted.

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

Two Economies: Employment Rates in 2020 Differ by Wage Levels

In the United States, as of July 31 2020, employment rates among workers in the bottom wage quartile decreased by **16.1%** compared to January 2020.



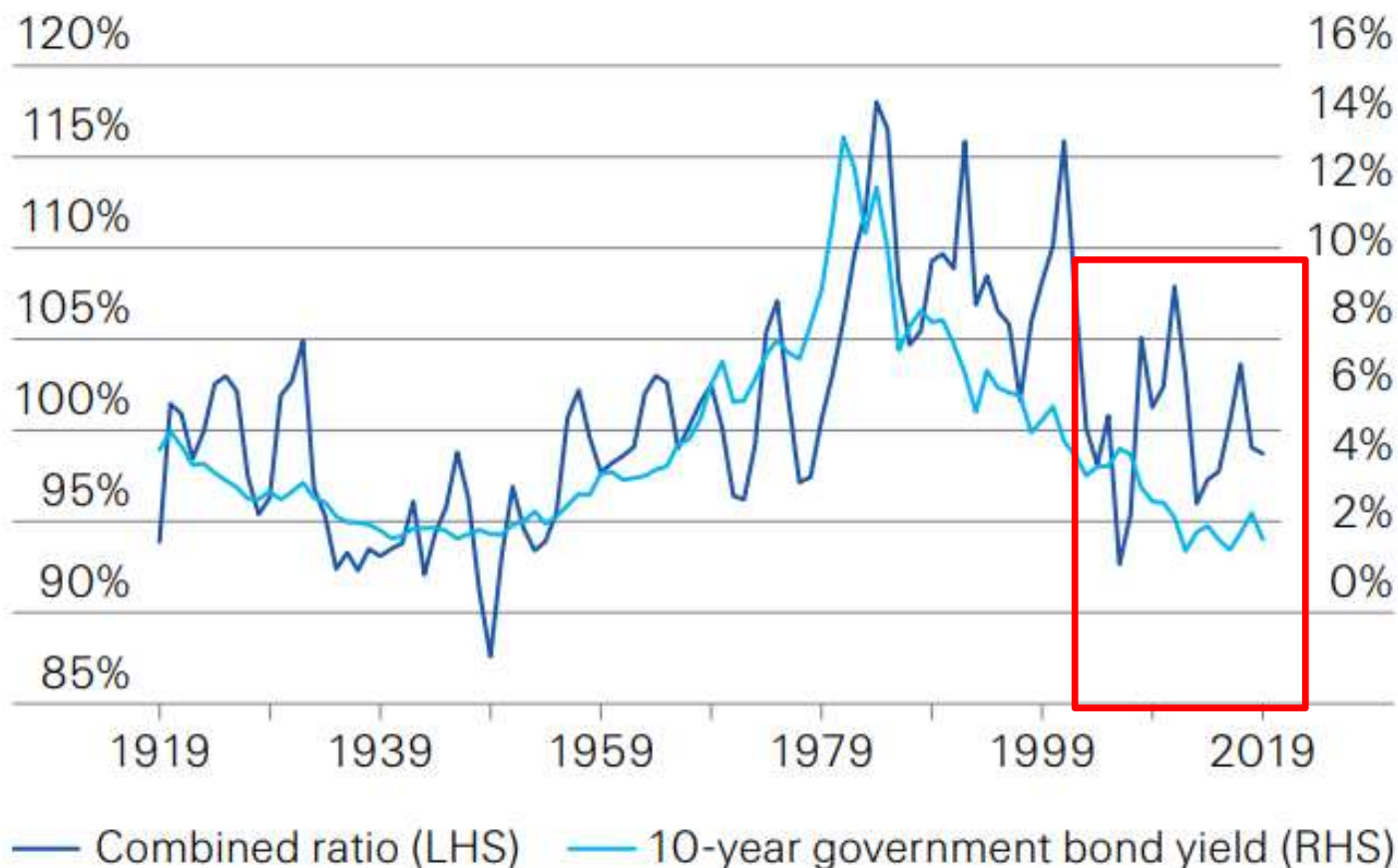
Source: <https://tracktherecovery.org/>

The Investment Story: Lower for Longer

*Depressed Yields Will Necessarily
Influence Underwriting & Pricing*

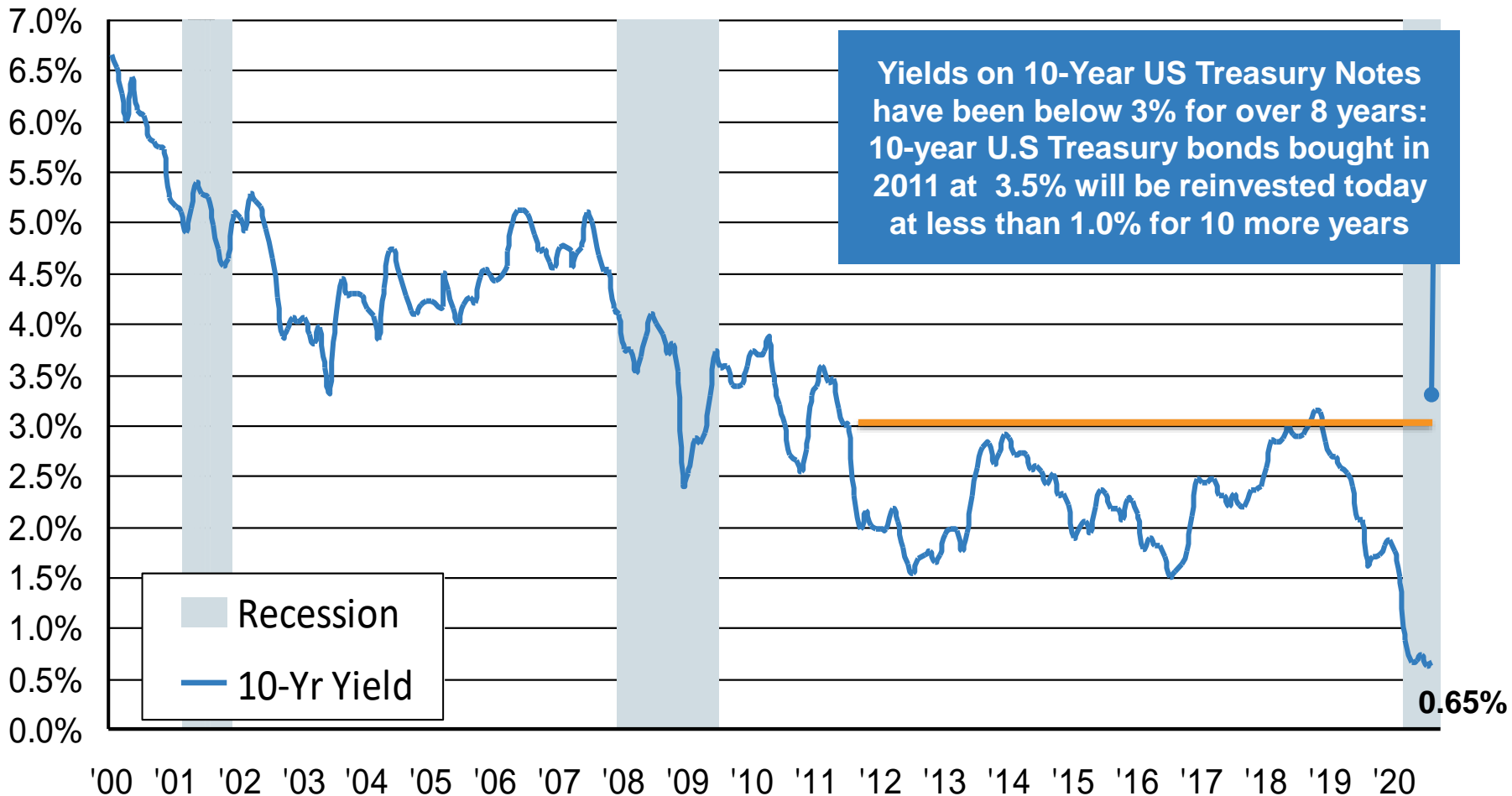
Why We Focus on Interest Rates

There is a strong long-term relationship between the non-life combined ratio and nominal interest rates. Investment returns tend to offset underwriting losses.



Source: A.M. Best, Datastream, Swiss Re Institute

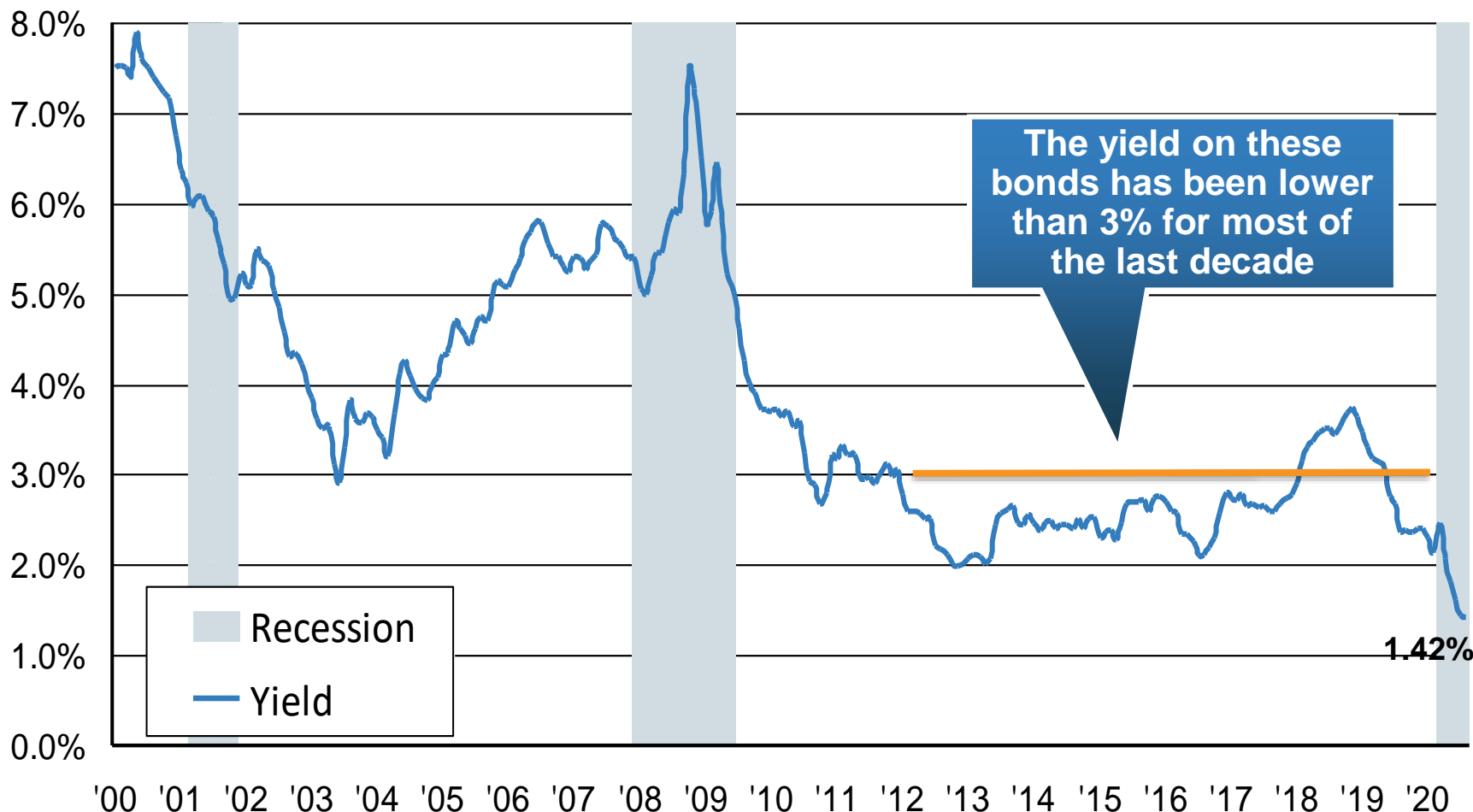
US Treasury Note 10-Year Yields*



Since nearly 50% of P/C bond/cash investments are in 5-year or longer maturities, most P/C insurer portfolios will have low-yielding bonds for years to come.

*Monthly, constant maturity, nominal rates, through August 2020.

BofA AA Corporate Index Effective Yields,* 2000–2020



Since the yield on these bonds has been lower than 3% for most of the past decade, many P/C insurer portfolios will have low-yielding bonds for years to come.

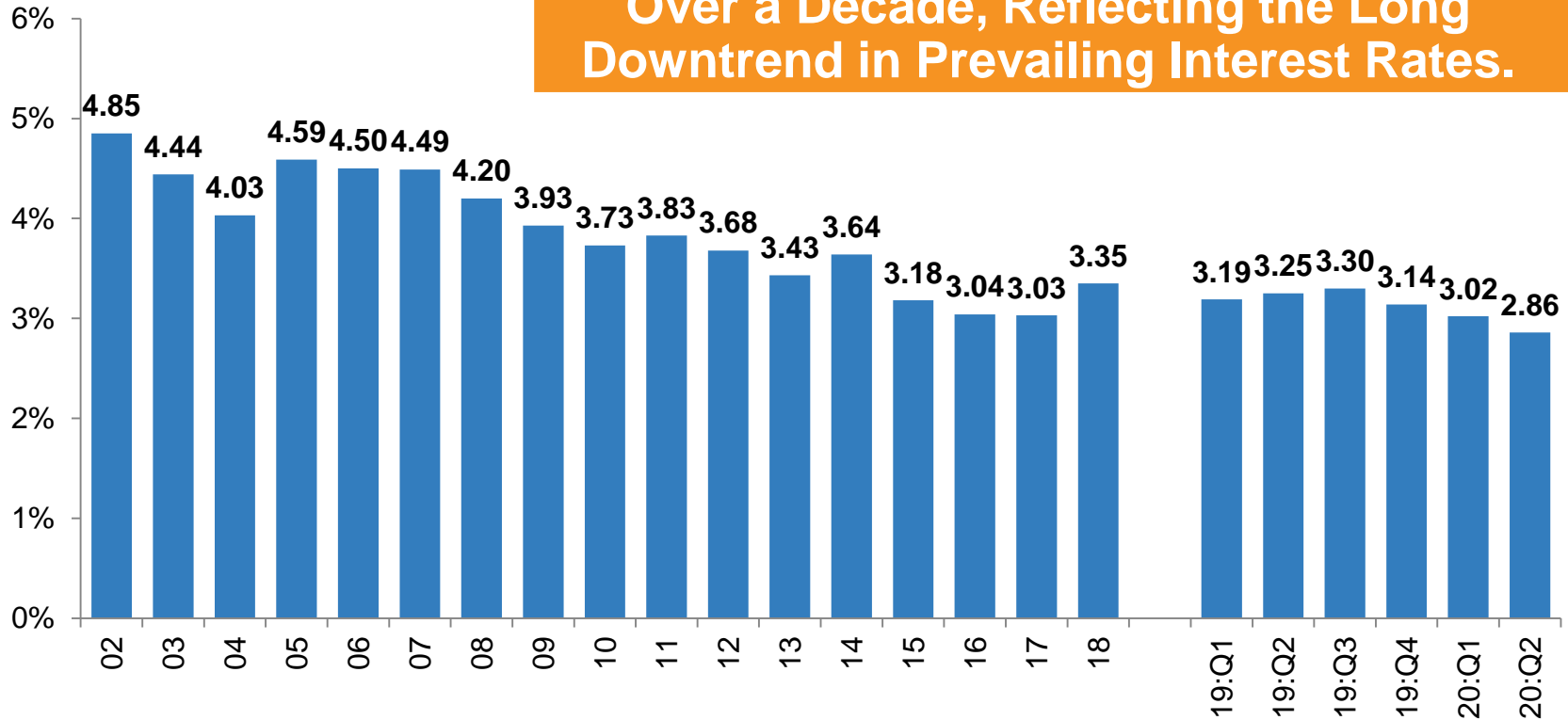
*Monthly, not seasonally adjusted, through August 2020.



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

P/C Insurer Portfolio Yields, 2002-2020:Q2

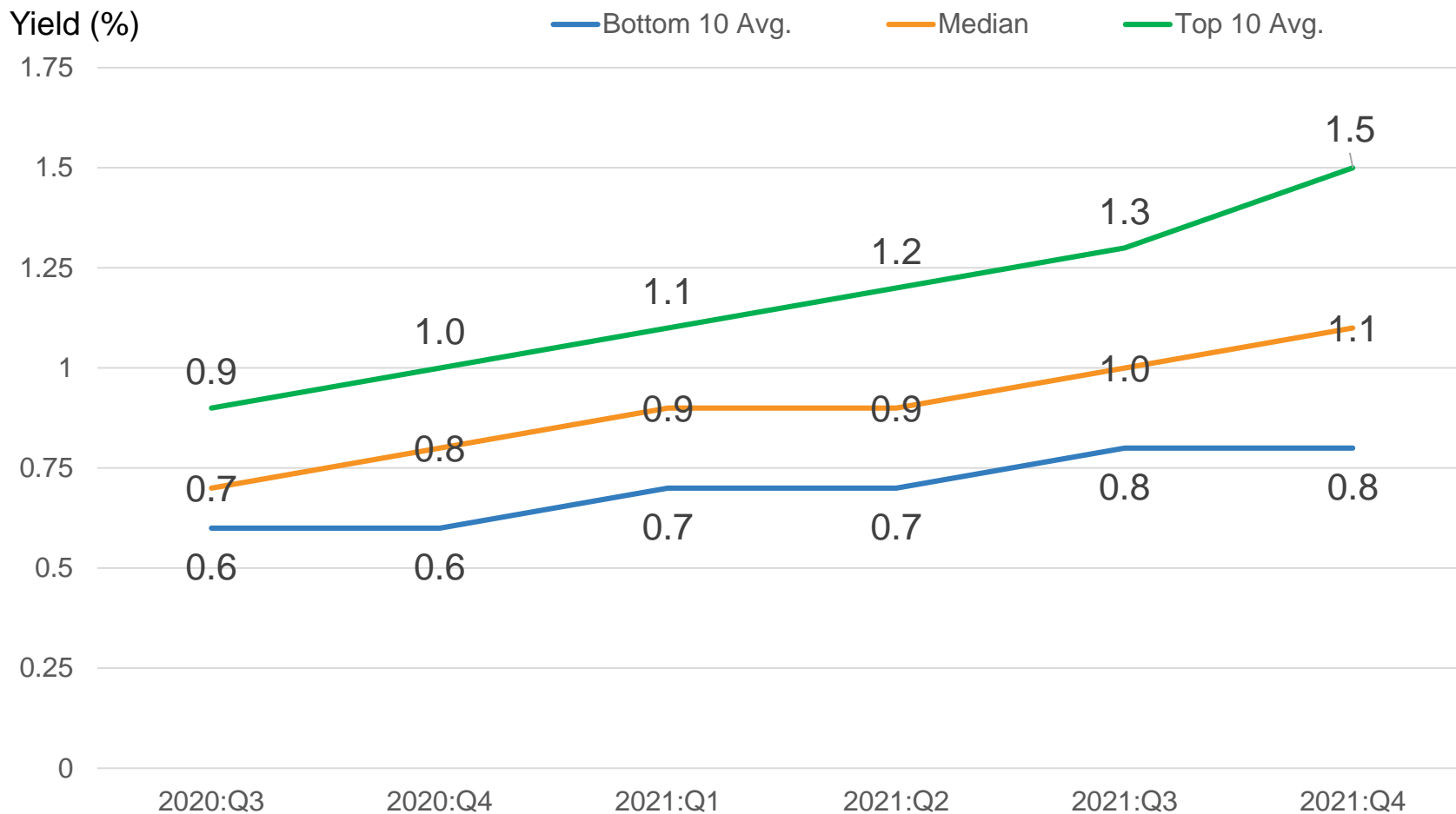
P/C Carrier Yields Have Been Falling for Over a Decade, Reflecting the Long Downtrend in Prevailing Interest Rates.



Even if Rates Rise in the Next Few Years, Portfolio Yields Are Unlikely to Rise Quickly Since Low Yields of Recent Years Are “Baked In” to Future Returns.



August 2020: Quarterly Yield Forecasts for 10-Year US Treasury Bonds in 2020-21



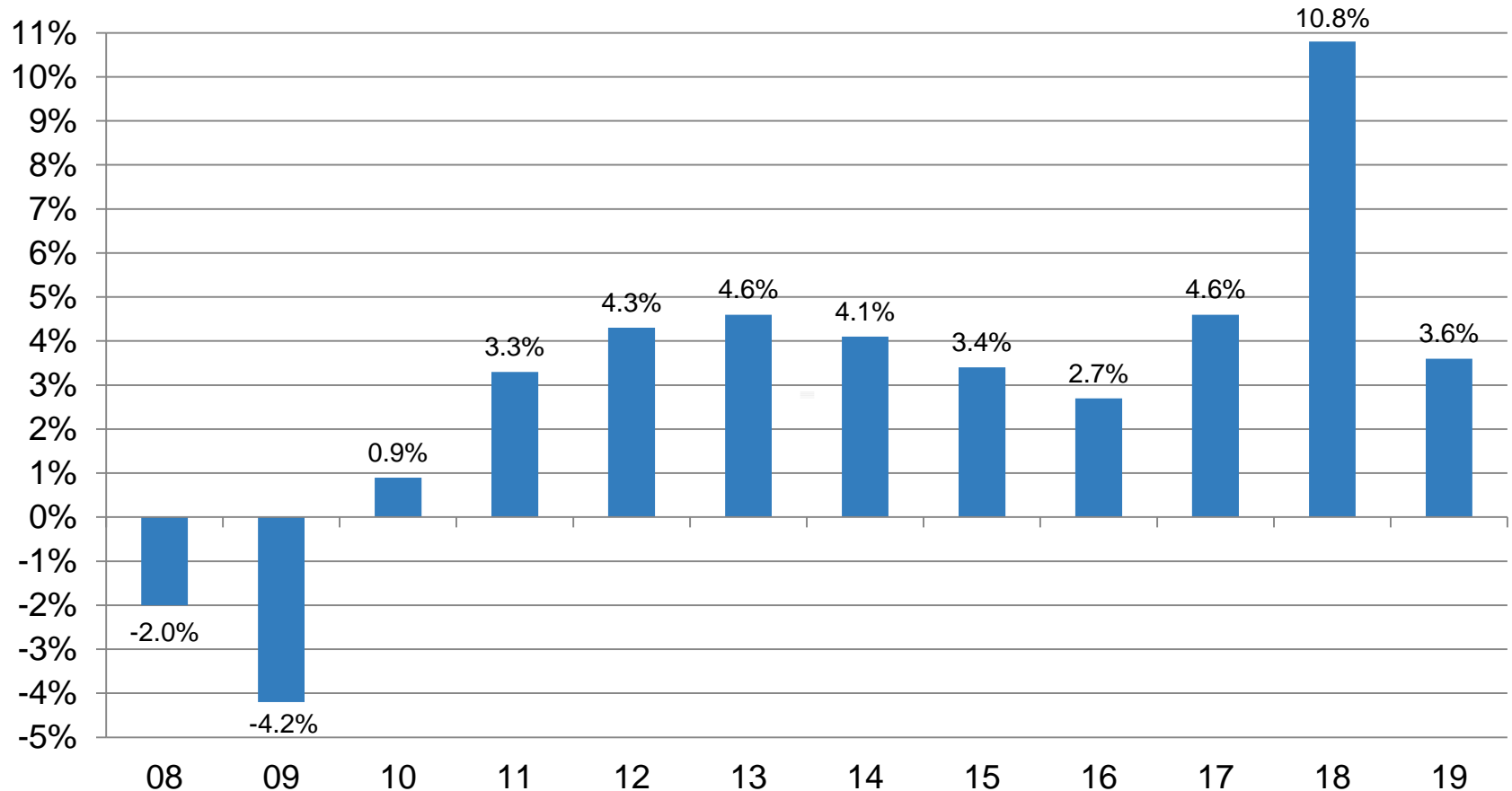
The forecasts in the Blue Chip survey see a common direction for the yield of 10-year T-bonds in 2021 but not much relief.



P/C Insurance Industry: *Financial Update*

*It's Hard to Know Where We Stand
or Where We're Going*

Net Written Premium Growth (All P/C Lines): Annual Change, 2008-2019

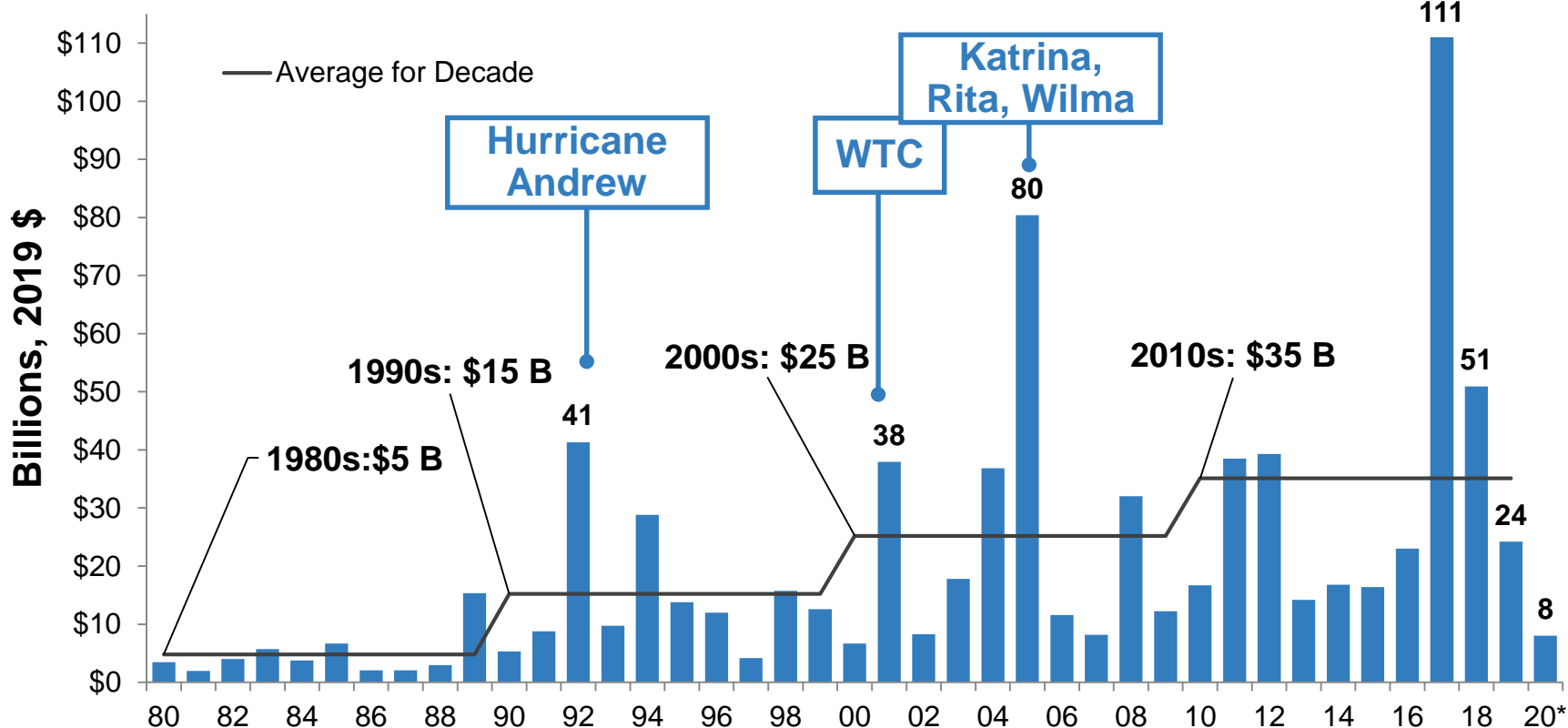


**Net Written Premiums rose more in 2018 than in any year in the prior decade.
The spike was due largely to reinsurance changes driven by tax reform.**



Sources: A.M. Best (2007-2013), ISO (2014-19).

U.S. Inflation-Adjusted Insured Cat Losses



2019 – 11th worst year for U.S. Insured Catastrophe Losses. Average Insured Loss per Year for 1980-2019 is \$20.1B.

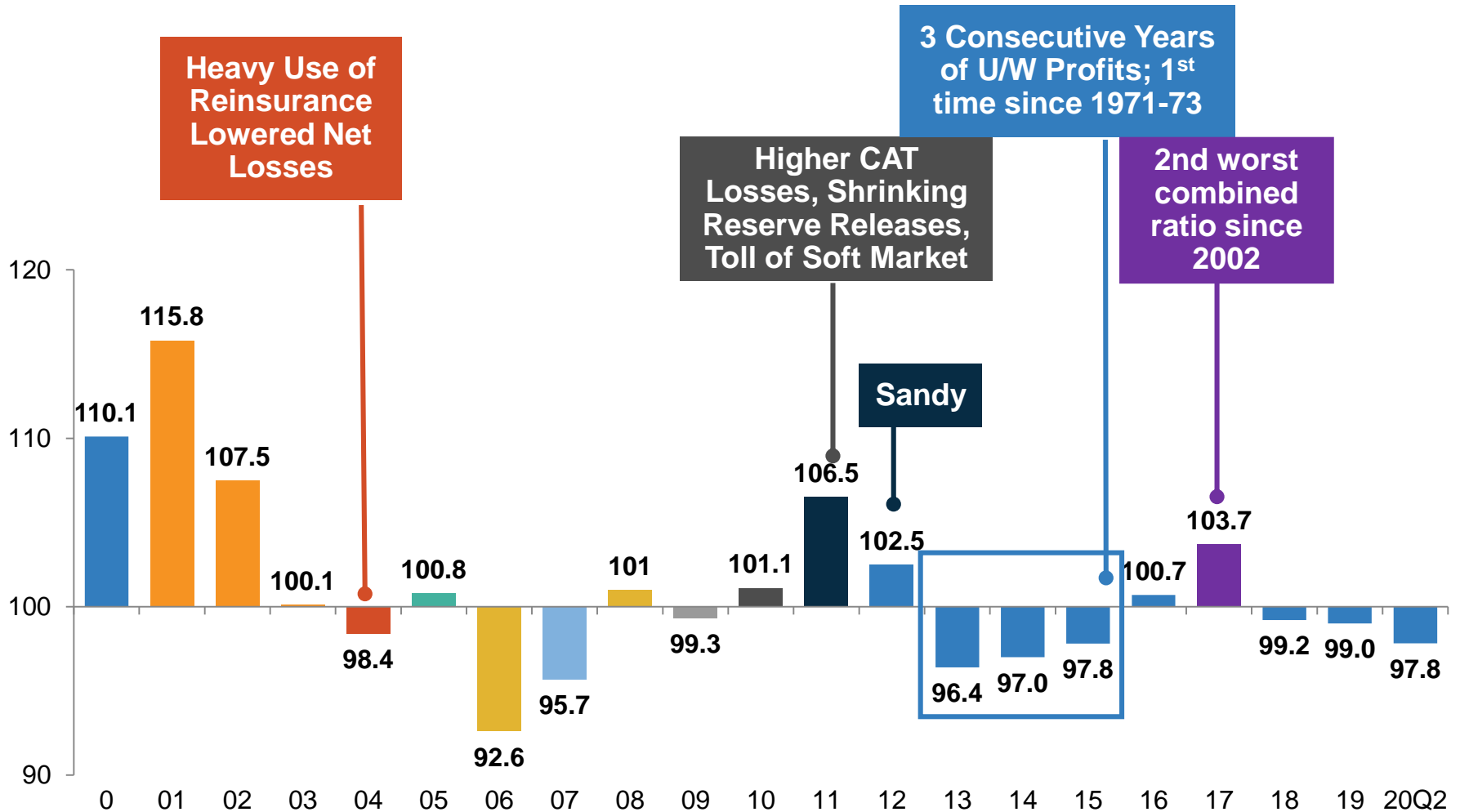
*2020: Aon estimate through April.

2010s is average of 2010 to 2019. All losses are Direct.

Sources: Property Claims Service, a Verisk Analytics business; Aon; Insurance Information Institute.



P/C Insurance Industry Combined Ratio, 2000-2018*



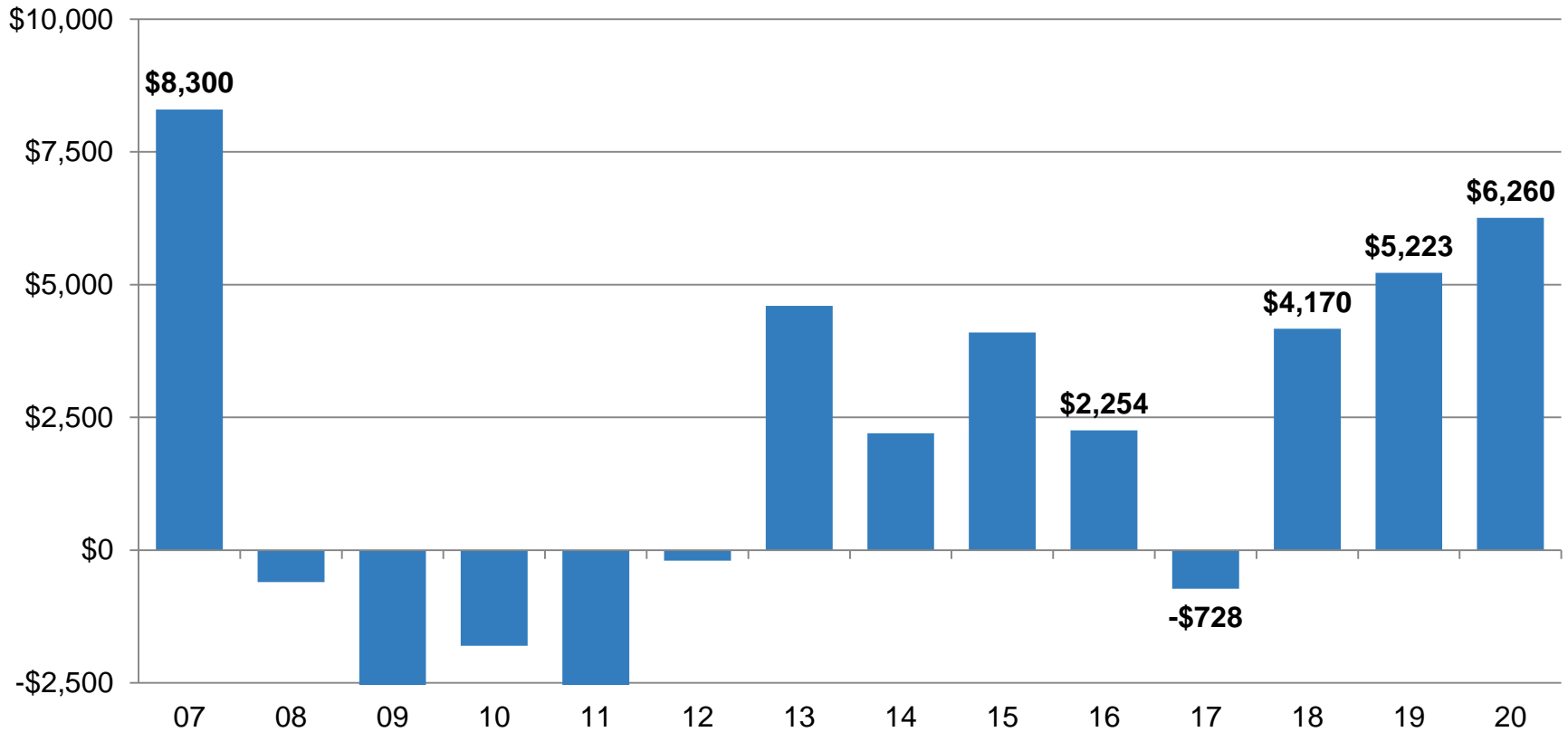
*Excludes Mortgage & Financial Guaranty insurers 2008-2014.

Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.1; 2012:=103.2; 2013: = 96.1; 2014: = 97.0.

Sources: A.M. Best; ISO, a Verisk Analytics® business; NAIC data from S&P Global Intelligence; I.I.I.



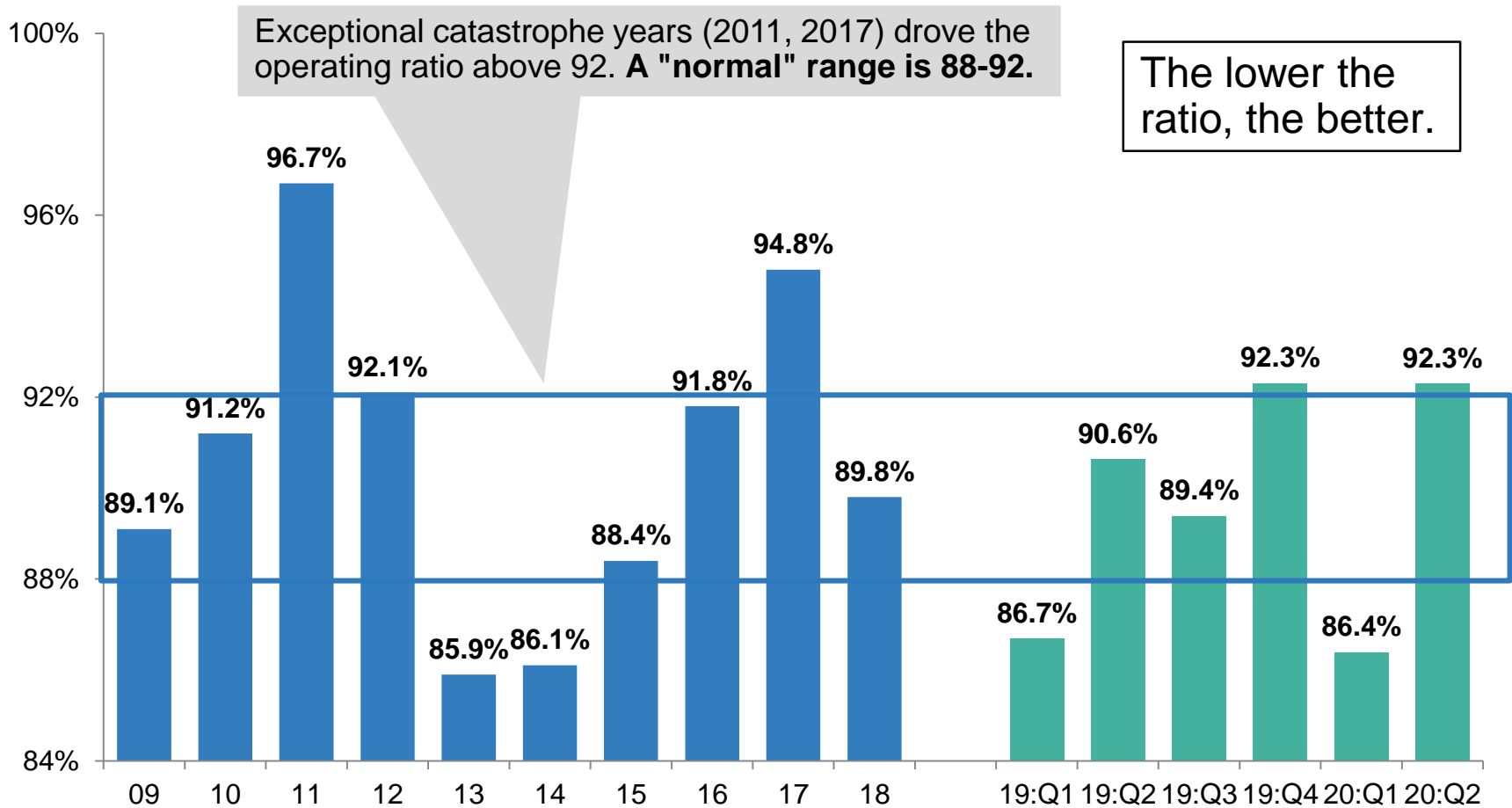
Net Underwriting Gains and Losses, 1st Quarters



Sources: NAIC data, sourced from S&P Global Market Intelligence, ISO/PCI. 2019

P/C industry operating ratios

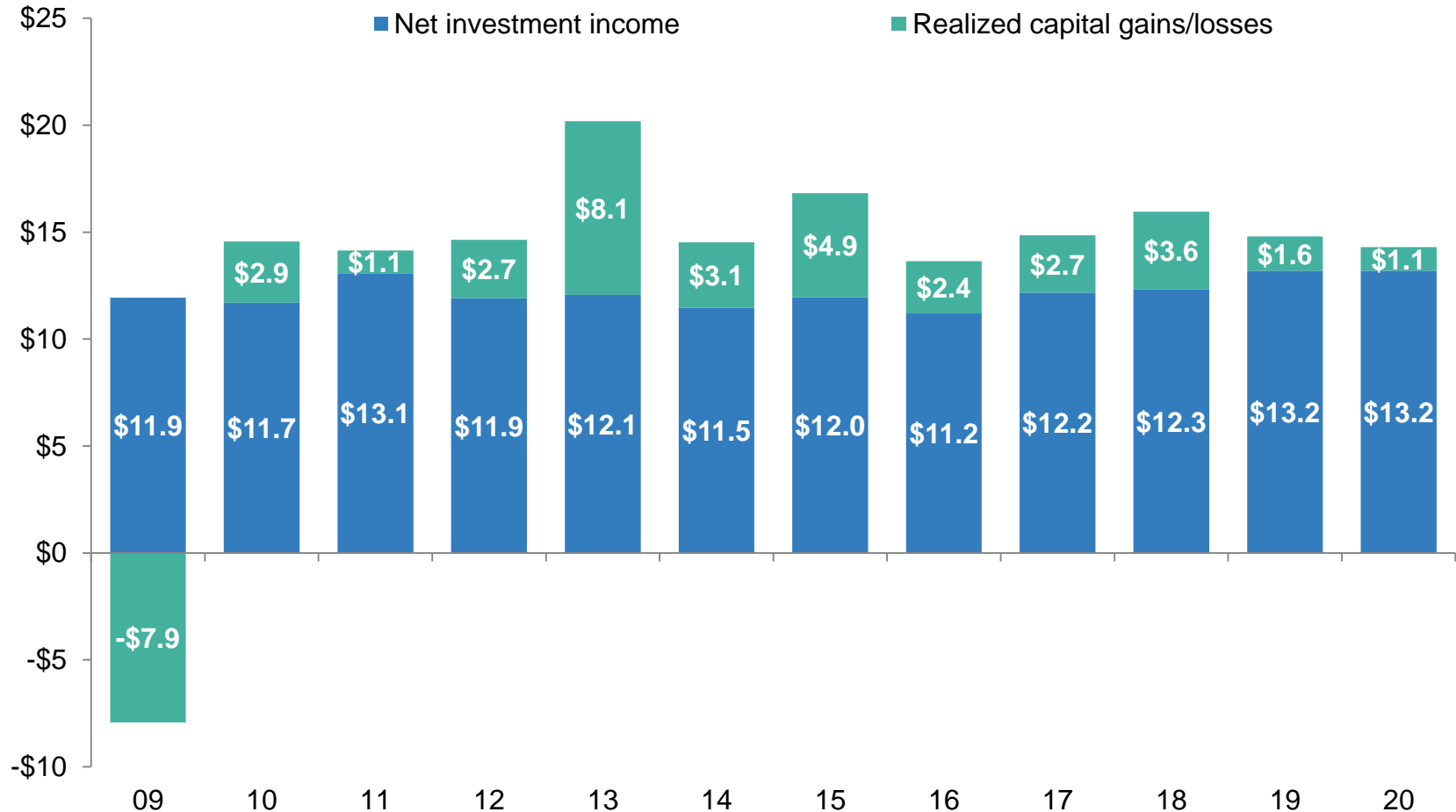
- Operating ratio = combined ratio (losses plus expenses as a percent of earned premiums) minus net investment income as a percent of earned premiums.
- Operating ratio includes all insurance and investment operations except taxes and capital gains and losses.



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

Sources of investment gains

\$ Billions

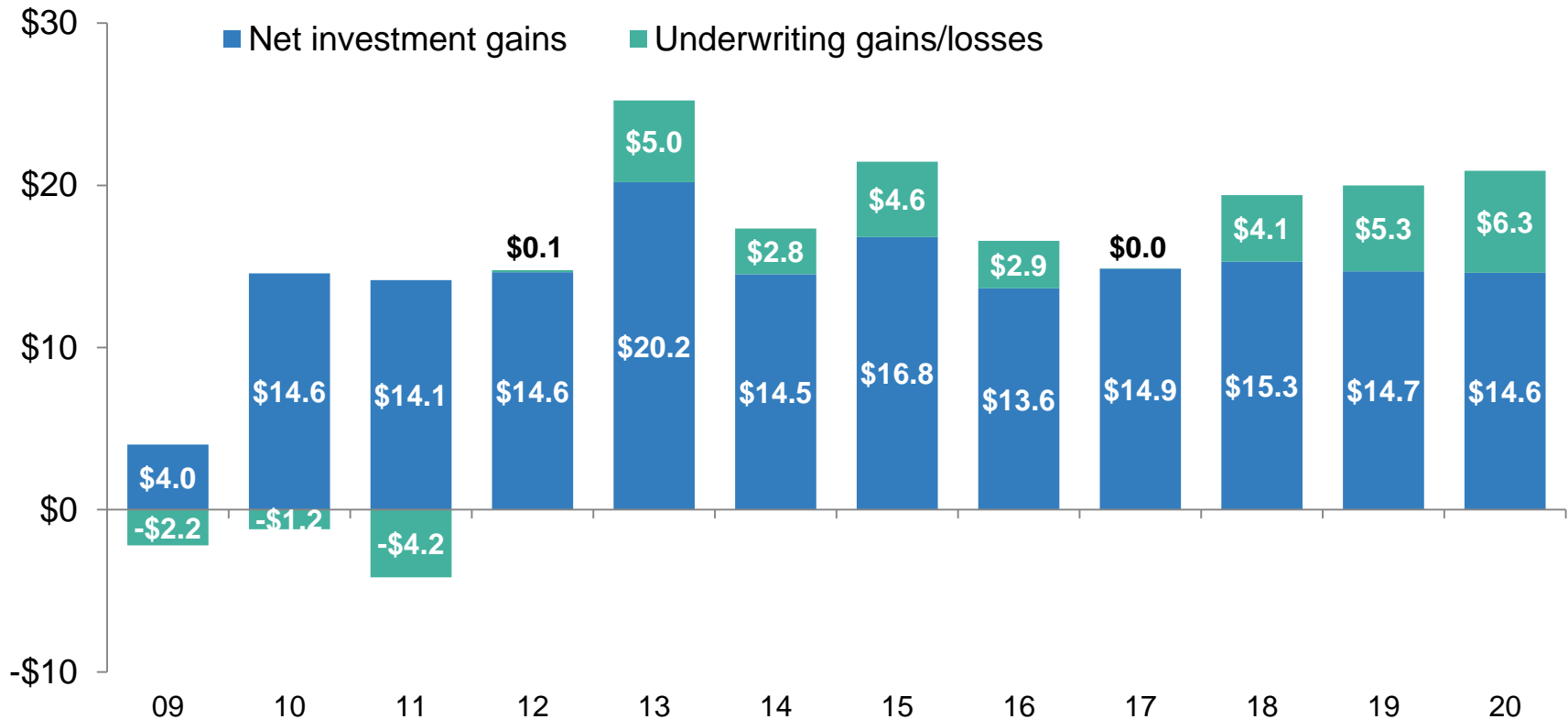


**Steady Investment Income
but smaller realized capital gains in 2020:Q1.**



Key sources of P/C insurer profits

\$ Billions



**Steady Investment Gains,
Good Underwriting Results Lifted Profits.**

Through first quarter.

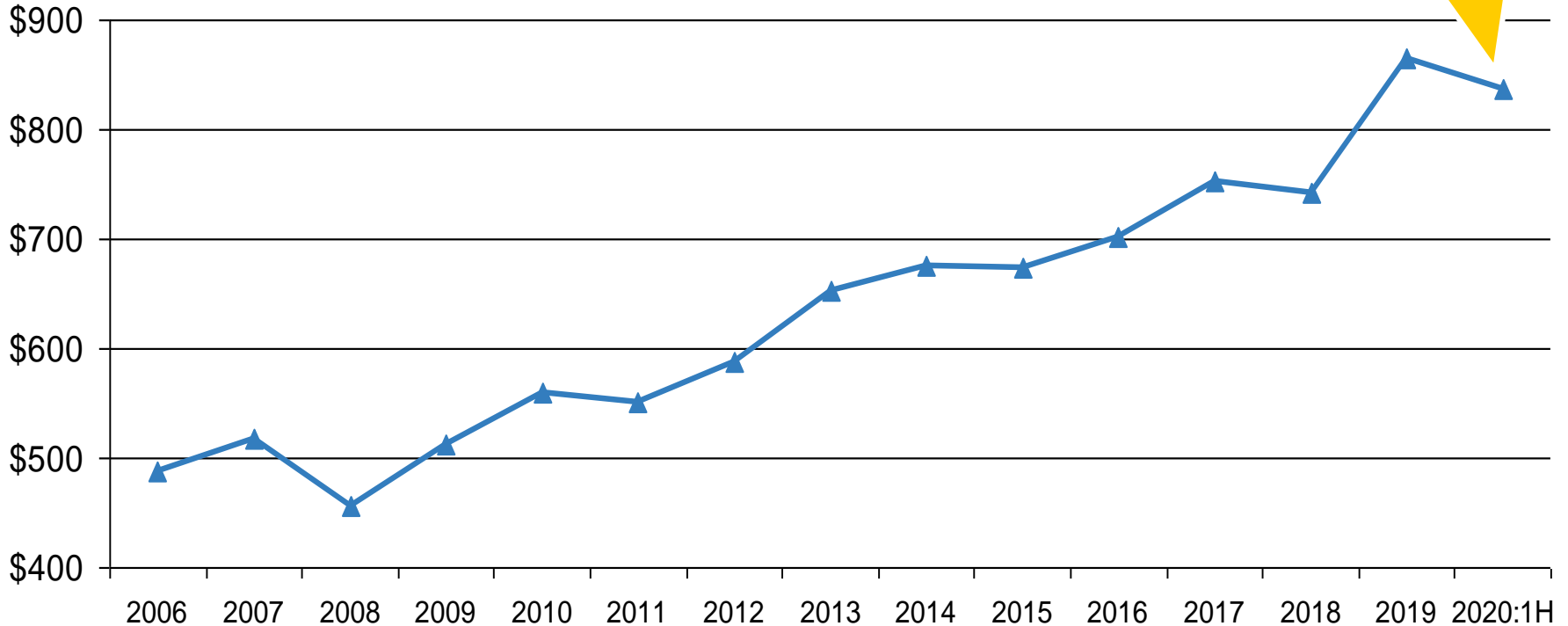
Data are before taxes and exclude extraordinary items.

Source: NAIC data, sourced from S&P Global Market Intelligence.



Policyholder Surplus, 2006–2019

(\$ Billions)



The industry now has \$1 of surplus for every \$0.79 of NPW, near the strongest claims-paying status in its history.

The P/C insurance industry is in very strong financial condition.



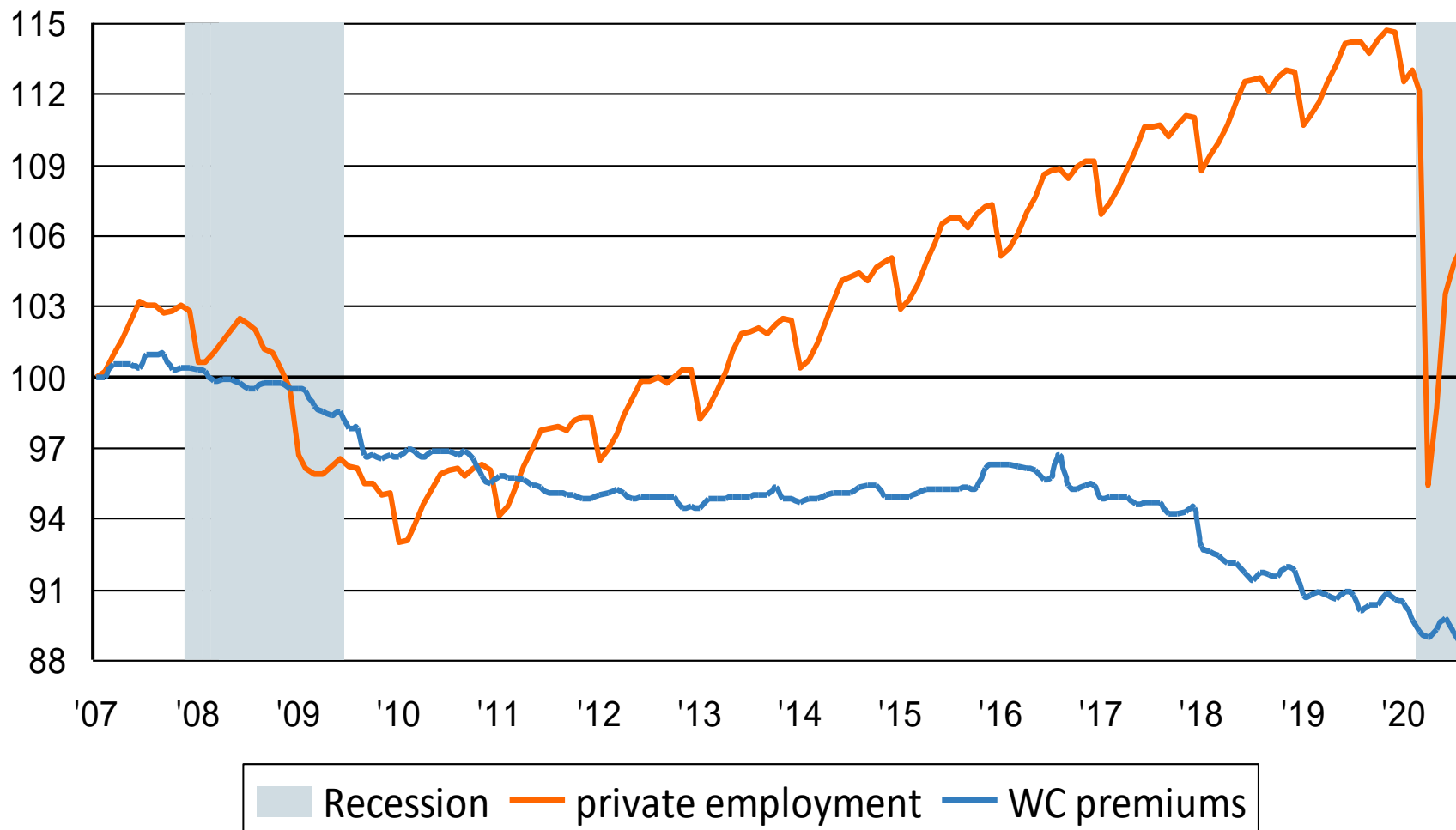
Sources: ISO, A.M. Best.

Commercial Insurance Premiums

Workers Comp Premiums, 2007–2020

Remarkably, total Workers Comp premiums have declined almost continually since 2007. From January 2007 to August 2020, -11.4%. This is even more remarkable given that total private employment rose by 14.7 million through February 2020 (+6.4 million through August 2020).

Index:
Jan 2007=100



Monthly, not seasonally adjusted, through August 2020.

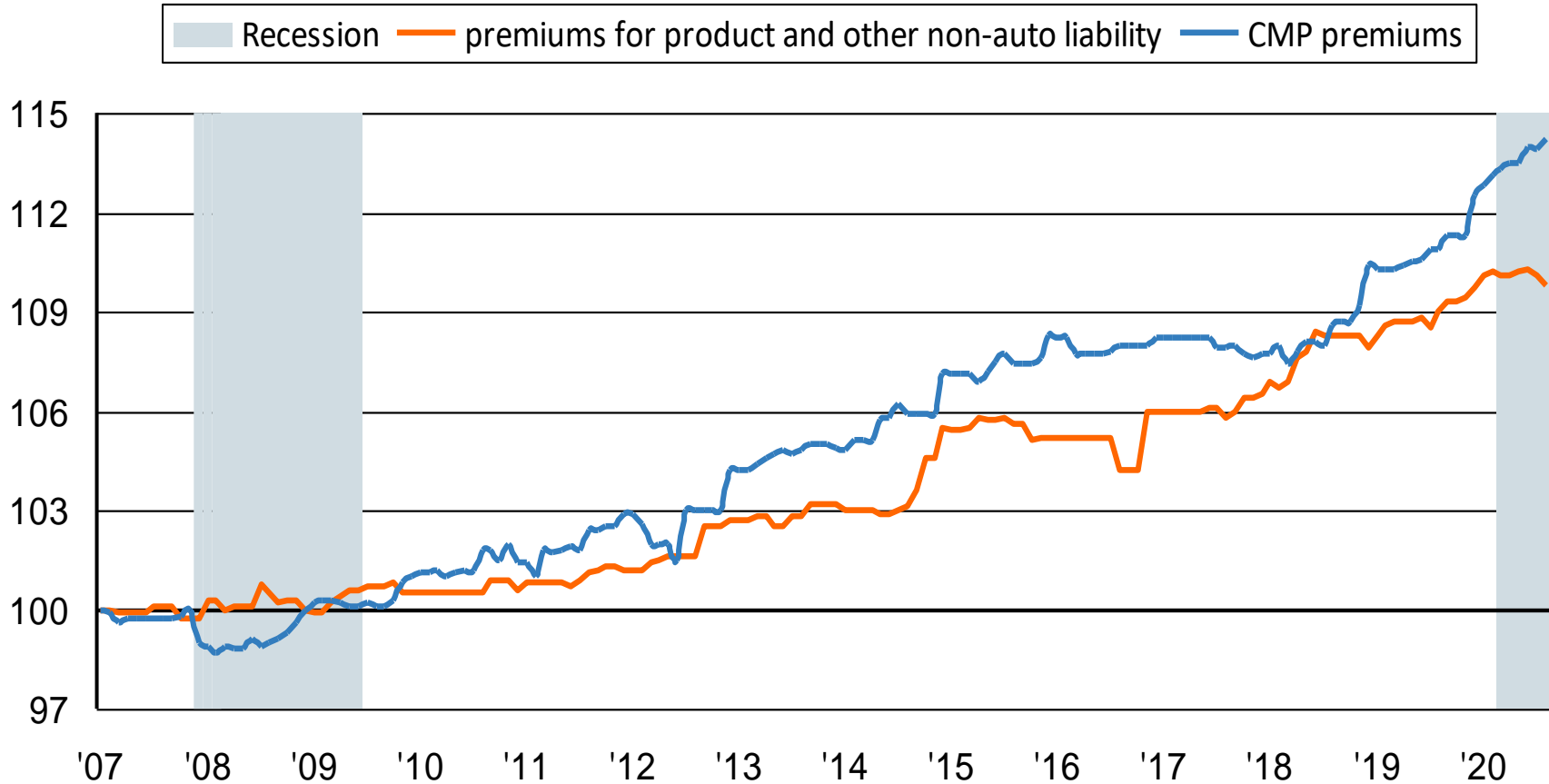


Sources: U.S. Bureau of Labor Statistics, Producer Price Index (WC premiums Index) and private employment; National Bureau of Economic Research (recession dates); Insurance Information Institute.

CMP and Liability Premiums, 2007–2020

Since 2007, total CMP premiums have risen about 14%. The “Great Recession” slowed this increase but not the current recession. Premium increases for liability insurance were slowed by both recessions but rose by about 10% overall.

Index:
Jan 2007=100



Monthly, not seasonally adjusted, through August 2020.



Sources: U.S. Bureau of Labor Statistics, Producer Price Index (CMP premiums Index) and private employment; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Questions?

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*Thank you for your time
and your attention!*

