Insights on the global economy and the implications for underwriting

Economic outlook and underwriting implications webinar summary

24 April, 2024

Global economies have for the most part proved their resilience through a pandemic, rising inflation and geopolitical uncertainties, providing hope that they are robust enough to withstand any further shocks, a panel of experts agreed.

There remain concerns over global economic issues, said **Ron Davis**, Global Head of Customer Management at Zurich Commercial Insurance. But despite such worries, “there is still cause for optimism,” he added.

Davis was the moderator of a discussion sponsored by Zurich that examined the state of global economies, some of the trends and challenges expected to shape them in coming years, and how insurers and risk managers might be affected. He was joined by **Guy Miller**, Zurich’s Chief Market Strategist and Economist, and **Penny Seach**, Group Chief Underwriting Officer at Zurich.

Global growth should track historical trends, but not without headwinds, according to Miller. Like fissures under a frozen pond, there are fractures underneath what appears to be a reasonably good worldwide economy, he said.

Conflict in the Middle East and the war Ukraine, elections in many countries, troublesome inflation and high interest rates are among the issues that could challenge growth, Miller said.

These factors are also associated with rapid changes in the risk landscape for both insurers and risk managers, which Seach pointed out. “The world continues to be complex and fast-moving,” she said, and it is vital for both Zurich and our customers to understand these changes in order to assess the potential impacts on both business and insurance.

Challenges make for uneven growth

The global economic environment remains heavily impacted by changes in behavior during the COVID-19 pandemic, Miller pointed out.

Pandemic lockdowns that kept people from moving around caused a surge in demand for manufactured goods and significant falloff in the need for services, Miller explained. During a time of booming global trade, economies such as Germany’s soared as consumers clamored for goods produced there.

But as the pandemic waned, so did demand for goods. “Economies like Germany that are heavily export-dependent have really been suffering over the last year or two,” Miller said.

Meanwhile, service-dependent economies have surged since lockdowns were lifted. Spain, for example, “is doing extremely well” as the world’s second-most-popular destination for travel, he added.

Worldwide, Miller said trend-like growth should continue in many parts of the world, with some countries lagging and others showing surprising strength.

“We’re in an environment today where the European economies continue to be somewhat stagnant,” Miller said. And the Chinese economy, plagued by a depressed property market, is “very lackluster,” he noted.

“The China situation is quite a challenging one,” Miller said. “There are not many investment opportunities for the population of China, so over the last 20-odd years they have been increasingly exposed to the housing market.”

The Chinese have invested large amounts into housing for lack of other investment options, Miller said. Massive overbuilding and sketchy financing arrangements contributed to an implosion in the market that forced housing values into freefall and some property companies into bankruptcy, Miller explained.

But the property crisis in China is unlikely to spill over into other parts of the world, Miller said, because there is little external investment in that country. “I think it’s a China-specific problem… I do think they have the capabilities to shore it up, but this is a multi-year story,” he added. “It’s not a quick fix and why the growth dynamic in China is likely to remain very lackluster for the next year or two.”

“The big surprise is the strength of the U.S. economy, which continues to surprise on the upside with consumption very robust,” Miller said. In fact, he added, the U.S. economy “is really running too hot right now” as the Federal Reserve Bank tries to manage interest rates and inflation.

Inflation stays sticky

While core inflation is expected to fall closer to targets set by central banks as interest rates make a "measured decline," the road towards a strong and healthy global economy will have some curves, Miller said. "It will not be a straight line."

While a decline in prices for goods, energy and food has caused inflation worldwide to fall appreciably, it has "moved sideways" for the past six months in some regions and actual price levels are still high, Miller said, and inflation remains well above the 2% target of central banks.

"We think it comes down to the targets," he added, but on a "bumpy trajectory."

Looming just under the surface, he warned, is the potential for geopolitics to create disruptions that could significantly disrupt world economies, Miller said.

But, so far, the war in Ukraine and conflict the Middle East have not led to major disruptions. Even as Iran and Israel fired on each other for the first time, oil prices fell, Miller said. "That may be complacency on the part of the markets, but it tells you this is seen as a dreadful but containable environment."

Insurers weather economic conditions

Economic inflation has a significant impact on the insurance market, particularly in claims costs, Seach pointed out. But there are other inflationary trends.

Litigation abuse, formerly known as "social inflation," puts significant pressure on insurers, as does "green inflation," which reflects the rising cost of environmentally friendly projects, Seach said.

Among the impacts of economic inflation is pressure on insurers to clearly understand the nature of claims, Seach said. That means knowing how much of claims severity is related to a service element and how much is related to components for example. "And making sure we model that properly so we can get correct trends on where we think that will land for us," she added.

In uncertain times, Zurich is putting increased emphasis on building resilience to prevent losses rather than trying to manage risks after claims occur.

"If we focus on resilience first everything else becomes a part of that," Seach pointed out, the result will be to create "distinct value" for the customer.

The concentration of systemic risk keeps Seach awake at night, she said. "In a connected, complex world, there are a lot of intersections of risk", she said, and Zurich is working to incorporate those complexities into modeling that will help the insurer better understand and manage these threats.

The complexity of such risks as those that threaten supply chains is illustrated by the collapse of the Francis Scott Key Bridge in Baltimore earlier this year when it was hit by a container ship, Seach said. When the accident snarled the busiest port in the U.S. for the transport of automobile, farm and construction equipment, major disruptions were felt along the east coast as buyers' goods were delayed.

"The east coast has a good road and rail network, so there is some form of resilience there," Seach said. But nonetheless the accident caused delays – and resulting losses – in transporting cargo to owners.

Supply chain risks have spurred new thinking at Zurich.

"We are thinking about loss-value determination in a different way," Seach said. For example, a loss of raw materials at the beginning of the supply chain has an impact on the other end as well. It could mean the finished product is unable to be completed, which would create a loss of profits, Seach said. "We think about the real value that will be lost."

Planning for natural catastrophes

Recent flooding in Dubai highlights the unpredictability of hazard events, but it doesn't dampen insurers' appetite for catastrophe risks, according to Seach.

Insurance capacity will continue to be available in Dubai and other parts of the world where natural hazards could unexpectedly occur, she said. "This was an extraordinary event, with the heaviest rainfall recorded in 75 years."

While risk modeling helps highlight natural catastrophe risks, models aren't perfect, Seach said. Zurich uses multiple models, both internal and external, to help understand and plan for extraordinary events, irrespective of where they may be within the insurer's global portfolio, she added.

Green economy opportunities

There are plenty of insurance opportunities within the green economy, according to Seach, along with some downsides.

A downside is lack of historical data that insurers can use to underwrite green risks, she said. But there is "big opportunity because this is where investment and growth are going," Seach added. And it is incumbent upon insurers to ramp up quickly, invest in capabilities to insure and help manage the risk and make sure its products are fit for purpose.

Like those related to supply chains, green risks also call for a re-think, Seach said.

Insurers need to consider how they can bring insight at the design stage of energy efficient buildings rather than simply insuring the building after it is built, Seach said. "Our mindset should be that design ensures insurability", she added. "Build in resilience and insurability from the get-go instead of trying to retrofit an insurance solution," Seach said.

She also challenged the often-repeated notion that insurers won't cover solar power risks. "This is frustrating because there is a fair amount of insurance capacity that is available for solar installations. This dampens depending on exposure to extreme weather, but this is where resilience as a focus matters."

And from the perspective of risk mitigation, Seach said, being clear on measures taken to protect installations from extreme weather such as hail is critical. "There are preventative measures that can help build a level of protection against these events," she said, but they are often not pursued because of cost.

"This is the wrong way of thinking," Seach said. "We should be thinking at the stage of design about how we build resilience into the infrastructure so that we don't put strain on any one part of the economy," whether it is the energy sector, insurers or lenders, she said.

Understanding the Circular Economy, which keeps products and materials in circulation as long as possible to avoid environmental impacts, has its own risk challenges, according to Seach.

Directives and regulations such as the Right to Repair Directive in the European Union is changing the nature of risk, Seach said. Manufacturers have to carry more component parts for longer, increasing possible storage and accumulation risk. "Adequacy of Insured Values are impacted. And fundamentally, the product liability exposure is changing due to longer lifespan of products."

Keeping current with AI

Artificial intelligence (AI) has been around for decades, but its use has soared in recent years specifically now with advances in Generative AI, Seach said.

New and changing technologies are often viewed as threats or create concern about the risks they introduce, Seach said. “But there’s a huge amount of opportunity for us to think through as well.”

The Global Cybersecurity Outlook 2024 report (WEF) revealed that over 56% of participants felt that Generative AI gave cyber criminals an advantage. However, less than 9% thought it would improve an organization’s ability to predict, detect or respond to a cyberattack. This speaks strongly to our bias to pessimism, but can be overcome. The ability, agility and speed of AI will identify patterns and possible threats far quicker that what the human eye would likely be able to do.

While AI provides a number of benefits, it also poses some challenges from an underwriting perspective, according to Seach.

“How do we understand the implications of AI as it integrates, for example, into a product or a process we are insuring?” she asked. “Understanding this and how we underwrite these new exposures requires different thinking.”

Insurers are considering the intersection and concentration of risk created by AI, Seach said. Regulatory changes will have a big part in driving outcomes and potentially creating liabilities.

“These are exposures that we have today, especially from a Product Liability perspective. So looking closely at how AI is integrated into a product, and what this application then does, remains a core part of the risk assessment process. We are having different conversations with Risk Managers now and often bring in our own internal AI experts to help us understand recent developments in Generative AI.”

“We think the EU Artificial Intelligence Act framework is great,” Seach said, and we use this within Underwriting to help structure our thinking and ensure the questions that we ask are proportionate to the possible level of exposure.

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