How re/insurance industry support the economic recovery in post-crisis time

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Executive Summary

Deep global recession and protracted recovery

There will be global recession in 2020. The containment measures to restrict and slow the spread of the Covid-19 virus have shut down large parts of the economy. We see only partial and protracted recovery in the second half and forecast a 3.8% contraction in global gross domestic product (GDP) in the full year 2020, far more than the 1.8% slump seen at the time of the global financial crisis (GFC).

We believe the immediate output loss in the US and the euro area will be twice as large as during the GFC, and that it will happen more than twice as fast. We expect the recovery in 2021 to be stronger in the US than in the euro area, given its greater economic resilience even before the onset of the pandemic. All told, the risks remain to the downside. For instance, financial conditions have tightened significantly and, if the financial market reaction worsens further and feeds back into the real economy, there could be a full-blown credit crisis. Another risk stems from supply-chain disruptions, which could impact the many economies closely integrated into the global supply chain network. China's economy has been particularly hard hit, but will rebound strongly. The first quarter hit was strong and with a slow return to work and weaker global backdrop, we have revised our 2020 China growth forecast down to 3.2%. Longer-term, we remain positive on China and forecast a rebound to 7.0% growth in 2021.

Fiscal policy to do the heavy lifting

The global economy is less resilient than it was at the onset of the GFC. A main reason has been that in many advanced economies, the monetary policy options to deal with a crisis have been exhausted,

and scope for fiscal policy actions is also constrained. In response to the Covid-19 crisis, the major central banks have pushed monetary policy to the limits and in some cases, even beyond. However, there is not much that central banks alone can do and irrespective of also limited room for manoeuvre, this time fiscal policy will need to be the main tool to manage the crisis. Fiscal authorities are taking action, with an initial focus on ensuring sufficient funds for healthcare and to support liquidity- constrained companies and people who have lost their jobs as a result of the economic shut down. Beyond bridging liquidity gaps, we expect aggregate fiscal easing across the major markets of around 3.1% of global GDP in 2020, much higher than the 1.6% response seen during the GFC, yet not sufficient to avoid a sluggish recovery. As a means to facilitate the massive fiscal stimulus and through continued "financial repression", we expect central banks will cap yield increases if needed. And in the US, we believe the Fed is already implicitly adopting yield curve control by not allowing government bond yields and mortgage rates to increase substantially. In China, we also see massive investment on provincial and national level have been announced to boost economic growth through enhancing digitalization and infrastructure construction.

Re/insurance outlook

Overall, given sufficient capital we expect that the re/insurance industry will weather the shock from the Covid-19 pandemic. Relative to others, the industry is less exposed to dwindling revenue streams and supply chain disruptions. Also, while the current economic crisis exposes the complexities of the market system, the huge and necessary central bank and government fiscal intervention the shock has elicited will serve to heighten risk general awareness, and also accelerate the trend of digitalisation. Both will extend the boundaries of insurability into new areas.

On the Property and Casualty (P&C) side, we forecast that global premium growth in primary insurance will reduce by around 2 percentage points (ppt) in real terms to 0.9% in 2020, the biggest falls coming for commercial lines impacted by global lockdown. We expect the downturn to be less

extreme than during the GFC, and that premium growth will rebound to 2.4% in 2021 as macroeconomic conditions improve. Emerging markets will remain the main driver of global sector growth. While we forecast a slowdown in emerging market premium growth to 3.8% in 2020 from 4.8% in 2019, we see a rebound to 6% annual growth in 2021-23, mostly from emerging Asia.

In life and health (L&H), we estimate that the Covid-19 crisis will reduce global premium growth by 6 ppt in real terms in 2020. The main impact will stem from the current financial market turmoil that is straining savings-type business. Protection business has lower annual volatility and will be less affected. Overall, we forecast life premium growth worldwide to decline by 3%, with economic recovery driving a rebound to 3% premium growth in 2021. In the emerging markets, the premium growth outlook for 2020 is clouded by the pandemic, but we also expect rising support from rising health risk awareness. Overall, we forecast that emerging market L&H premiums will grow by around 7% this year.

Having affected by the outbreak of Covid-19, Chinese insurers have been reporting mixed performance by 1Q this year but overall have managed to remain resilient, with enough solvency across the industry. Against the backdrop of a steadily recovering economy, supportive government policies as well as steady growing insurance demand will support the development of insurance sector. Overall, China's dominance of emerging market insurance premium has increased, and the country will remain a predominant source of additional P&C and L&H premiums in the coming years. We maintain our expectation that China will become the world's largest insurance market in mid 2030s.

Role of re/insurance industry to support economic recovery

Overall, insurance is an integral part of a country's national economy and is indispensable in stabilising income growth and facilitating productive activities. Insurance also contributes directly to economic growth through its business services and employment. The degree of insurance cover is important for the speed and magnitude of recovery. To support recovery of real economy, we would

suggest the following implications to boost insurance development and recovery of real economy in China: 1) Private public partnerships (PPP); 2) Index insurance; 3) Inclusive insurance. We believe a main growth area in China is the green bond market. This can provide insurance solutions to support economic recovery and growth, including to SMEs: 1) Green or climate bonds ;2) Insuring small- and medium-sized enterprises opportunity.

The weakening global growth was further shadowed by Covid-19

Global growth had been weak going into 2020, even before the Covid-19 outbreak. The world economy expanded by just 2.5% in 2019, not far from the level that has historically constituted a global recession.[1] Italy's economy was already contracting before the virus shock, and Japan was tipping into recession after a hike in value-added tax in October. The German economy was fragile amidst auto sector weakness and a contraction in global trade. While there were some signs of stabilisation in global trade and manufacturing at the beginning of 2020, the virus outbreak has changed the outlook fundamentally: the global economy is in recession.

The measures actioned to contain the Covid-19 outbreak led to a sudden stop in global economic activity starting in this March, and we expect partial economic lockdown, especially for US and Europe, to last throughout the second quarter of this year. The GDP drop to the mid-year in the US and euro area will be twice as large as during the GFC and will happen more than twice as fast. Indeed, this recession seems to be quite atypical: it could be one of the deepest, but also one of the shortest on record, with the services sector also strongly hit. We estimate that the global output loss from the Covid-19 pandemic will amount to about USD 11 trillion by the end of 2021. We expect a global recession in 2020, with economic activity contracting by 3.8%, not far off the -1.8% drop in 2009 (Table 1). Since 1980, only 5% of all recessions have lasted six months or less. While the drop in economic activity will be more sudden than during the GFC, at this stage we expect a rebound in the second half, resulting in an overall contraction for 2020 fairly close to that seen during the GFC, and much worse than in the mild recessions of 1991 and 200.

[1] Global growth figures reported here are based on market exchange rates. Using purchasing power parities, global growth in 2019 was 2.9%. Global growth below 2.5% based on PPPs has typically constituted a global recession.

Table 1 Our latest key forecasts for 2020, compared to consensus, in %

	Real GDP growth		CPI		10 yield	
	SRI	Consensus	SRI	Consensus	SRI	Consensus
US	-6.4	-4.0	0.7	0.8	1.0	0.9
Euro Area	-7.5	-5.7	0.2	0.4	-0.6	-0.4
Japan	-4.0	-3.3	0.4	-0.1	0.0	0.0
China	3.2	1.8	3.0	3.1	2.6	2.4
World	-3.8					

Source: Swiss Re Institute, Bloomberg
Note: "Consensus" refers to surveys by Bloomberg.

The gates for fiscal stimulus are wide open, and this will help the real economy in the latter half of 2020, but a stimulus-induced economic recovery will not remedy the already weak economic environment that prevailed prior to the shock. Despite supportive fiscal and monetary policy action, the virus outbreak will cause business bankruptcies and layoffs to rise, leaving companies and consumers in a weaker position, even when the pandemic shock subsides. The Covid-19 outbreak exposes the fragility of the global economy. SRI – LSE Macroeconomic Resilience Index[2] outlines an economy's ability to absorb shocks and, as already stated, we believe the global economy is less resilient to shocks than it was before the GFC.[3] This is largely due to virtually exhausted monetary policy and often constrained fiscal space in advanced economies. That matters because countries with weaker balance sheets – like many euro area countries – experience recessions that are roughly twice as deep and long as is the case for countries with stronger balance sheets. Further, the recoveries in weaker balance sheet countries are about a third as strong than in the others.[4] We believe today's shock will prove particularly challenging for the euro area, and it will likely reignite some of the tensions that caused the region's debt crisis in 2012.

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[2] *sigma* 5/2019, op. cit.
[3] See also *sigma* 6/2019 – Sustaining resilience amid slowing growth: global economic and insurance outlook 2020/21, Swiss Re Institute.
[4] *Public Sector Balance Sheet Strength and the Macro Economy*, IMF Working Paper, 2019.

Despite forthcoming fiscal stimulus, risks remain to the downside. Given the exceptional degree of current uncertainty, the recession may well turn out to be even worse than the GFC. There's uncertainty around many aspects, such as when the virus outbreak may peak and how effective the measures to contain it will be. It seems likely that we will not return to normal in the second half of the year, but instead have to accept some kind of "semi-normality" until a vaccine is found.[5] This phase is likely to entail still-constrained economic activity and poses downside risks to growth. Risks also stem from inadequate fiscal and monetary policy actions. In addition, financial conditions have already tightened significantly (see Figure 1), and there is a risk that the financial market reaction will feed back negatively to the real economy, causing a full-blown credit crisis.

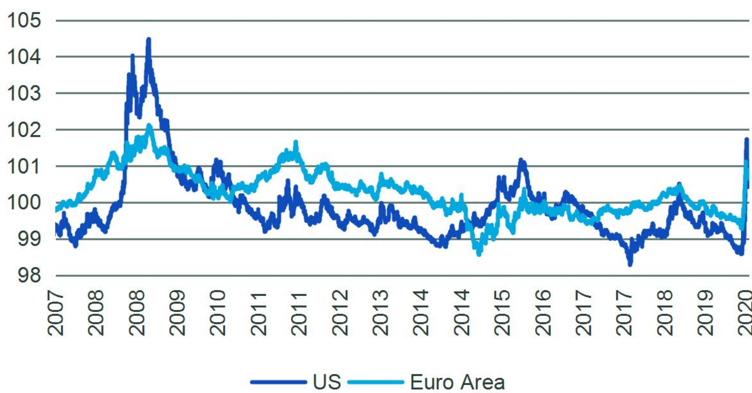


Figure 1 Goldman Sachs Financial Conditions Index

Source: Bloomberg, updated as of 6.4.2020

The lack of cooperation amongst the G7 and particularly within the EU is striking, and an improvement there would have a positive impact on the growth outlook. Policy coordination between fiscal and monetary authorities will also be key. Fiscal stimulus has been accelerating – we expect it to amount to a substantial 3% of global GDP this year – with some encouraging signs of coordination between governments and central banks. Stronger and more targeted global fiscal/monetary policy coordination could bolster market sentiment and lead to a more meaningful upswing in the second half.

[5] "The Road to Semi-Normal," *The New York Times*, 4 April 2020.

Could the pandemic shock trigger a systemic crisis?

Possible transmission mechanisms

The roots of today's crisis are different from those of the GFC where high leverage in the financial system was at the core. Nevertheless, it is possible that today's shock will *lead to* problems in the financial system and thus cause a broader systemic crisis. To assess this risk, we look at various transmission mechanisms that are key to gauge the length, depth and channels of a potential recession. The speed and impact of how shocks propagate through the economy can be amplified by various political, economic and financial factors, as shown in Table 2. Overall the risk to the global economy from these amplifiers has increased over the last decade. At the region/country level, we think the euro area is more fragile than the US and China, given less monetary and fiscal room, a weaker banking sector and more rigid labour markets.

Table 2 Stylised view of crisis amplifiers and buffers, current view by region (red: likely to amplify shocks, green: likely to act as buffer)

	Amplifiers/buffers	US	Eurozone	China
Policy space / buffer	Fiscal space	green	orange	green
	Monetary space	red	red	orange
Structural adjustment mechanisms/buffers	Economic diversification	green	green	orange
	Labour market efficiency	green	orange	orange
	Bank resilience	green	orange	red
	Portfolio concentration	red	red	red
	Private debt levels	orange	orange	red
	International cooperation	orange	orange	orange
	Funding market liquidity	red	red	green

Source: Swiss Re Institute

In the current situation, the following amplification channels are key:

- **Fiscal space:** Countries with weak balance sheets experience recessions roughly twice as deep and twice as long with recession recoveries only a third as strong than in countries with healthy balance sheets.[6] Since the GFC, government debt has increased considerably in many

[6] *Public Sector Balance Sheet Strength and the Macro Economy*, IMF Working Paper, 2019

advanced markets, reducing fiscal space. In our view, several euro area countries lack fiscal space, and their weak balance sheets will be a key challenge in dealing with the current crisis.

- **Private debt:** Corporate debt levels have reached all-time highs and the average investment grade (IG) credit market rating has deteriorated. This is a delicate situation as credit contagion is a real risk, also for insurers.. Outside of traditional bond markets, leveraged loans have grown substantially and have become riskier since the GFC. Household debt is also an issue in the US, where increasing amounts of student and auto loans, as well as credit card debt are experiencing growing or high rates of delinquencies. Suddenly falling incomes could amplify defaults of household debt.

- **Bank resilience:** The US banking system is in better shape than at the onset of the GFC and more resilient than in Europe where, despite solid capital ratios, banks continue to face a challenging operating environment. For example, Italy's banks remain relatively exposed to domestic government debt. Should investors lose faith in the solvency of the Italian government (eg, because of the further increase in its debt), that could threaten banks' health.

- **Lower liquidity:** Funding markets have structurally lower liquidity today than in 2008. While the size of the USD investment grade credit market has nearly tripled since the GFC, primary dealer[7] balance sheets have halved on the back of Basel III regulations.[8] Further and since the outbreak of the pandemic, lower liquidity has led to dislocations even in traditionally high-liquid markets like US Treasuries (see Comparing the financial market reaction to date to past crises). While the Fed and other central banks are providing a backstop through large liquidity

[7] Firms buying government or corporate debt and acting as market makers. These include for example some of the big US banks.
[8] For example, higher capital charges for risks have led to lower dealer inventories.

support, continued severe strain in key global funding markets can propagate financial market stress.

A main uncertainty is the duration of the current situation. An upside relative to 2008 is that central banks are providing swift support to each layer of financial stress. The downside is that volatility and uncertainty are often mutually reinforcing. The longer market conditions remain stressed, the higher the risk of a broader systemic crisis. The inherent uncertainty will not disappear unless: 1) strong medical advances help contain the virus outbreak and shorten the duration of the crisis; and/or 2) international policy cooperation ensures establishment of an economic and financial market backstop to mitigate liquidity and funding stress.

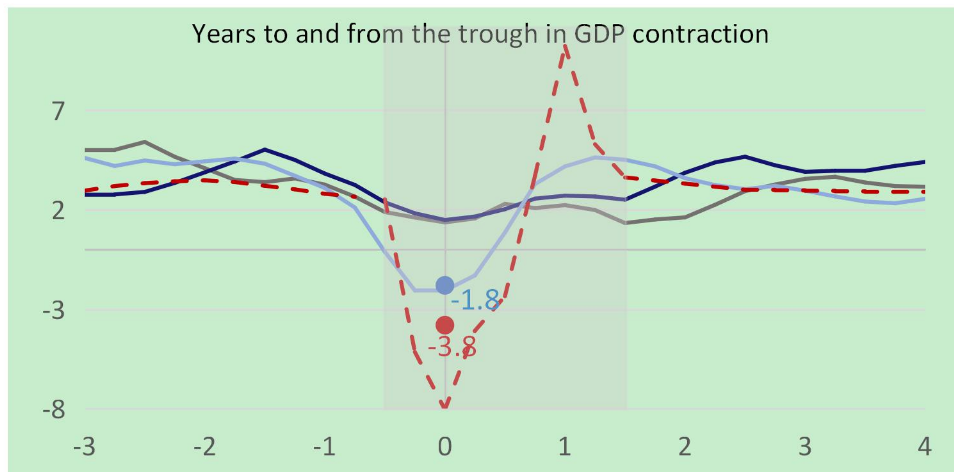
Effects of historical recessions

Each global recession seen since the start of the 1990s happened when global economic growth was strong, in the order of 4% to 5%. The severity of each downturn, however, depends on a number of factors such as the state of the economy going into the recession, the catalyst for the drop-in activity, and the reach of impact. The output loss of the GFC was the largest experienced since the 1990s, with global GDP contracting by roughly 1.8% in 2009 – 3.6 percentage points (ppt) below 2008 growth. The world economy recovered swiftly post-GFC, in part due to central bank action. Since the initial recovery phase, however, growth has remained muted, largely because the euro area economy plunged back into recession during the sovereign debt crisis of 2011/12.

While this year's drop in economic activity will be much more sudden than during the GFC, we expect the massive fiscal stimulus to support a rebound in the second half of the year. This will result in an overall 2020 contraction close to that seen in the GFC. However, the Covid-19 induced recession will be much worse than the milder recessions of 1991 and 2001, and the recovery will not take economic activity back to its previous expansion path. We estimate that the global output loss by the end of 2021 will amount to roughly USD 11trillion. For the US, the output loss accumulates to

just above USD 2 trillion, and above USD 1trillion for the euro area. In addition, we expect structural issues to hamper growth in the longer-term. Much of the stimulus is aimed at buffering the negative impact of the virus outbreak on the economy, with little thought about increasing future productivity. Given the weak economic resilience of many countries at the beginning of 2020, we believe growth rates will return to subdued levels only. Longer-term growth will face headwinds from impaired supply chains and production capacities, higher unemployment and business bankruptcies, as well as the need to repay debts built up during the crisis.

Figure 2 GDP growth evolution of historical recessions



t = 0 represents the trough in GDP growth contraction for each crisis period
Shadow box represents the time frame when global yoy GDP growth was computed from the US, Eurozone and China quarterly data for the recession induced by the Covid-19 outbreak. This approximation holds for 2020 and 2021 quarterly data.
Source: Thomson Reuters Datastream (Oxford Economics), Swiss Re Institute

Impact of Covid-19 on economy and financial market

The Covid-19 pandemic is a simultaneous shock to economic supply and demand, amplified by the negative financial market reaction feeding back to the economy. Some studies[9] suggest supply shocks are the biggest economic costs, and others[10] that demand effects dominate.[11] We think demand effects

[9] W.J McKibbon, A.A. Sidorenko, *The Global Macroeconomic Consequences of Pandemic Influenza*, Brookings, 2006.
[10] G. Verikios, M. Sullivan, P. Stojanovski, J.Giesecke, G. Woo, *The Global Economic Effects of Pandemic Influenza*, 2011.

likely outweigh the impact from supply disruptions in the shorter term, not least because much of the consumption lost on vacation and other leisure activities, for example, may not be recovered later. In contrast, manufacturing output can be recouped, provided demand does not falter in a sustained way. A recent UBS study estimates that supply disruption accounts for about 28% of the hit to global GDP in a pandemic scenario, vs 57% for consumption weakness and 15% for tourism.[12]

Beyond the human tragedy of death and illness, it is the measures to contain spread of a pandemic that cause the bulk of economic damage. According to a World Bank study, efforts to contain the outbreak of Avian Flu in 2006 were responsible for 60% of the economic impact. Illness and absence from work for other reasons (eg, to care for family members) caused about 30% of the impact, and mortality the remaining 10%.[13] In light of the broad lockdown currently in place, containment efforts are likely to cause the bulk of economic damage resulting from the Covid-19 pandemic.

Estimates of the size of a pandemic shock on overall economic output usually begin with assumptions on the share of population who become sick, and the share of people who die. Those numbers (along with assumptions on family care, school closings, etc) can form the basis of the labour force shock. The shock to the labour force in today's outbreak is exacerbated by the measures to contain the spread of infections, which also affect perfectly healthy people working in, for example, the leisure industry. Gauging the additional impact from disruptions to supply chains is more challenging. The degree to which an economy is integrated into the global supply chain can give indication about its vulnerability. Judging by the size of intermediate goods trade (Figure 3), South Korea and several European economies seem most exposed across the largest 20 economies, and the US economy least. However, this measure may not adequately capture a country's true vulnerability as one lacking input (even if of small value) can lead to disproportionate damage in production lines.

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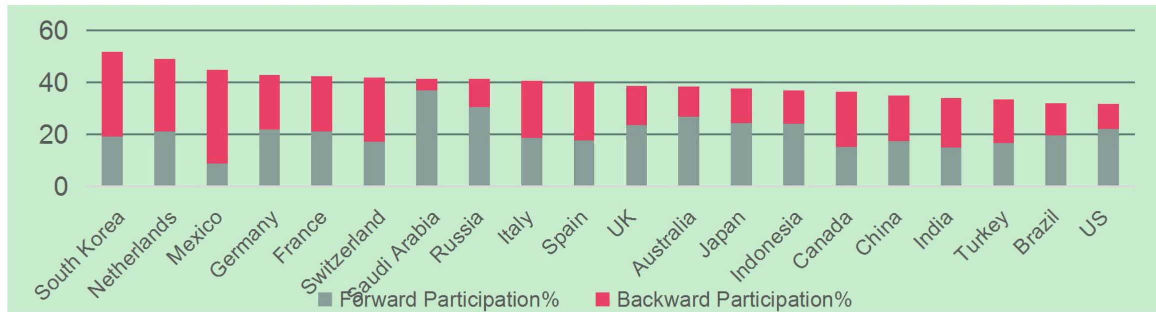
[11] It can be difficult to disentangle demand and supply effects (eg, lower leisure activities may be driven by a combination of lower demand, as people prefer to go out less, and lower supply, as establishments are mandated to shut down).
[12] *Pandemic Scenarios for Global Markets – How Bad Could It get?* UBS Global Research,
11 March 2020.
[13] A. Burns, D. van der Mensbrugghe, H. Timmer, *Evaluating the Economic Consequences of Avian Influenza*, World Bank, 2008 (originally published in a slightly different form in the World Bank's June 2006 edition of *Global Development Finance*).

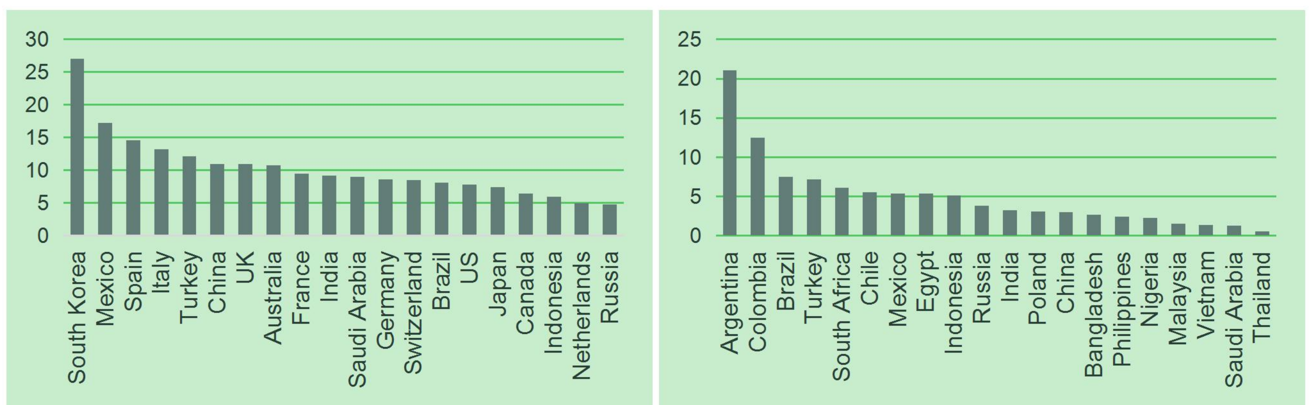
Figure 3 Markets' participation in the global supply chain (20 largest economies by GDP, % of total exports 2015)



Note: Forward participation is defined as a country's domestic value-added (DVA) content embodied in intermediate exports that are further re-exported to third countries as a percentage of total exports. Backward participation is foreign value-added (FVA) content embodied in a country's exports as a percentage of total exports.
Source: OECD

To gauge the demand shock, indicators such as the share of transportation, tourism and other recreational services in the economy, which tend to suffer most from a pandemic, are used. Again, the severe lockdown measures implemented in the current pandemic amplify the demand impact. Among the 20 largest economies, South Korea, Spain and Italy are the most, and the Netherlands and Russia the least exposed to a drop in tourism, judging by the tourism share of their GDP (Figure 4, lhs). Finally, economies with large external debts and interest payments are likely to be among the most vulnerable to tightening financial conditions (Figure 4, rhs). On this basis, next to some Latin American markets, Turkey and South Africa stand out as highly exposed to a sharp tightening in financial conditions.

Figure 4 Travel and tourism % of GDP 2018 (lhs), interest payments on external debt in % of exports 2018 (20 largest emerging markets by GDP, rhs)



Source: World Travel & Tourism Council, OE, Haver Analytics

While there is too little hard data available to gauge the impact of the Covid-19 outbreak on the different industries, stock market performance across different sectors provide indication. Sectors closely linked to leisure (equipment & products), travel (airlines and auto sectors) and energy companies (oil & gas, electricity) have recorded above-average losses on stock indices. Sectors catering to basic needs like water utilities, food & staples retail and household products, have fared best in the current situation. Biotech and pharma companies have also fared comparably well.[14]

We expect all G7 countries to be in recession in 2020. Countries with close supply-chain links to China (eg, Germany) have been hard hit by the supply chain disruptions originating from China in the first quarter already. In China, activity seems to be normalising gradually,[15] but it will suffer from the slump in global demand. In the major advanced markets, the second quarter will record a massive downturn in economic activity, and we expect disruptions to last well into the third quarter. How quickly economic activity will pick up once the lockdown period is over will depend on the effectiveness of the policy response in containing lasting damage, and on bond markets' tolerance of higher debt burdens. The fewer initially solvent companies go out of business and the fewer people lose their jobs during the lockdown, the brighter the prospect for economic recovery thereafter. Heavily indebted euro area economies, including Italy, are more likely to experience lasting damage than fiscally healthy countries like Germany. While government debt burdens are elevated in the US, we expect the central bank to ensure that the additional financing costs remain bearable by keeping interest rates low. We expect the shock in the US to be less pronounced and the recovery in 2021 to

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[14] S&P 500 data from Bloomberg, comparing the peak on 19 February with 16 March 2020.

[15] By 28 March 2020, 98.6% (and 89.9% of all employees) of large and medium-sized enterprises above designated size and 76% of SMEs have resumed working, according to data reported by Ministry of Industry and Information Technology of the PRC, *Phoenix Finance*, 30 March 2020, https://finance.ifeng.com/c/7vG1h9tl7bJ; By 24 March 2020, according to Baidu work resumption index, an average of 74.82% of national workers (excluding Hong Kong, Macau and Taiwan) have resumed working. Source: *Jinrongjie,* 27 March 2020, http://finance.jrj.com.cn/2020/03/27151229127222.shtml;
By 27 March 2020, the resumption rates of catering, accommodation, home service and other enterprises related to the tertiary industry reached 80%, 60% and 40% respectively, according to information released by Ministry of Commerce of PRC, *Xinhua net*, 30 March 2020, http://www.xinhuanet.com/2020-03/30/c_1125785471.htm.

be stronger than in the euro area next year, given its greater economic resilience before the onset of the Covid-19 pandemic.

Table 3 compares Covid-19 to the GFC and the euro area sovereign debt crisis (H2 2011). In terms of financial impact, the current situation already exceeds the sell-off intensity seen during the sovereign debt crisis (second last column). If current developments continue down the same path, the sell-off will even become comparable to the GFC, or greater. In our view, this year will go down in textbooks as a time of market panic alongside 1929, 1987, and 2008.

Also worrying, global market stress measures have shown signals like those seen during the GFC. In particular, liquidity in traditionally highly liquid markets such as US Treasuries, has been exceptionally poor.

Table 3 Comparison of Covid-19 to GFC and euro area sovereign debt crisis

Region		Indicator	Latest	Since outbreak	YTD	YE 2019	Past market sell-offs H2 2011	Past market sell-offs Q4 2007	Current sell-off as % of prior sell-offs H2 2011	Current sell-off as % of prior sell-offs Q4 2007
USA $	Indicators	PMI	52.50	-3.00	-2.40	54.90	-1.90	-11.00	158%	27%
		CPI	1.82	0.12	0.26	1.57	0.31	-0.95	40%	-13%
		Fin Con	100.67	2.08	1.88	98.79	1.21	5.46	172%	38%
		Consumer conf	89.10	-10.70	-10.20	99.30	-12.00	-27.10	89%	39%
	Rates	2y	0.25	-1.17	-1.32	1.57	-0.14	-3.18	864%	37%
		10y	0.65	-0.92	-1.27	1.92	-1.14	-1.78	80%	52%
	Risk assets	Equities	2'489	-27%	-23%	3'231	-16%	-56%	161%	47%
		IG spread	283	187	190	93	100	395	187%	47%
		HY spread	1'050	612	623	427	328	1'229	187%	50%
Eurozone €	Indicators	PMI	29.70	-21.60	-21.20	50.90			-	-
		CPI	0.70	-0.70	-0.60	1.30	0.30	-0.90	-233%	78%
		Fin Con	100.71	1.44	1.13	99.58	0.43	2.17	335%	66%
		Consumer conf	-11.60	-3.50	-3.50	-8.10	-5.10	-14.90	69%	23%
	Rates	2y - DE	-0.65	-0.01	-0.05	-0.60	-0.93	-2.87	1%	0%
		10y - DE	-0.42	-0.00	-0.24	-0.19	-1.10	-1.39	0%	0%
		2y - IT	0.47	0.66	0.52	-0.05	0.58	-2.11	113%	-31%
		10y - IT	1.54	0.58	0.13	1.41	0.09	-0.08	664%	-695%
	Risk assets	Equities	2'767	-28%	-26%	3'745	-25%	-59%	116%	48%
		Equities - DE	9'947	-28%	-25%	13'249	-29%	-54%	97%	52%
		Equities - IT	16'876	-34%	-28%	23'506	-27%	-69%	126%	49%
		IG spread	239	150	146	93	172	371	87%	40%
		HY spread	895	531	538	357	457	1'720	116%	31%
China ¥	Indicators	PMI	46.70	-5.20	-5.90	52.60	0.00	0.00	0%	0%
		CPI	5.20	-0.20	0.70	4.50	-0.30	-7.80	67%	3%
		Fin Con	102.15	-0.14	0.04	102.11	2.04	4.90	-7%	-3%
		Consumer conf	118.90	-7.50	-7.70	126.60	-4.70	-12.10	160%	62%
	Risk assets	Shanghai comp	2'764	-7%	-9%	3'050	-15%	-62%	48%	12%
		Hang Seng	23'749	-14%	-16%	28'190	-28%	-58%	51%	24%
		Corp credit sprea	482	142	150	332	497	791	29%	18%
Global	Market Stress	VIX	44.34	29.96	30.56	13.78	23.30	33.21	129%	90%
		Libor-OIS	1.38	1.25	1.03	0.35	0.14	0.43	894%	291%
		Ted spread	1.36	1.24	1.00	0.36	0.16	-0.14	784%	-883%
		MOVE Index	65.01	-3.03	6.73	58.28	24.70	67.80	-12%	-4%
	Commodities	Brent crude oil	32.96	-25.62	-31.12	64.08				
		Gold spot	1'636.22	28.52	113.39	1'522.83	20.70	201.46	138%	14%

Updated: 06.04.2020 13:15 CET
Peaks and troughs defined by S&P highs/lows

Source: Swiss Re Institute, Bloomberg

Suggestions on fiscal and monetary policies and implications for China

The root of the shock from the pandemic outbreak lies in the real economy, while the shock imparted by the GFC originated in the financial sector. Likewise, the tools that worked well to fight the GFC will be less effective in fighting the Covid-19 shock. This time around, fiscal authorities rather than central banks need to do the heavy lifting. We have argued before that in a next downturn, central banks would first resort to "more of the same", then adopt more innovative measures by overcoming political constraints previously considered sacrosanct, before eventually moving to various forms of "helicopter money".[16] In our view, the Covid-19 pandemic is already accelerating this journey.

In the realm of "more of the same", the major central banks have swiftly slashed interest rates to close to zero (where they were not already there), and have reactivated or stepped up asset purchases. In the US, the Fed is already implicitly adopting yield curve control by not allowing government bond yields and mortgage rates to increase substantially. Meanwhile, some central banks have already put aside previously imposed constraints. For example, the self-imposed limit to buy no more than a third of any country's eligible bonds will not apply to the extra EUR 750 billion of bonds the ECB has committed to buy. Even the highly contentious joint bond issuance is up for debate again. The negative equity market reaction to major central bank announcements, however, confirms our view that monetary policy alone will not be able to tackle this crisis. Instead, a forceful and coordinated monetary and fiscal policy response is needed.

There is mounting evidence that fiscal authorities are picking up the baton. During the current phase of the crisis with large parts of the global economy in lockdown, the immediate focus for government action is on ensuring sufficient funds for healthcare and on preventing healthy companies from laying off staff and going bankrupt. A group of European economists estimate the cost of exceptional support measures (including health and economic relief measures) and automatic stabilisers, will be

[16] *sigma* 6/2019, op. cit.

2% of GDP for a one-month period.[17] As automatic stabilizers kick in and additional fiscal stimulus is implemented, government deficits will rise substantially. Based on currently-announced fiscal measures, budget balances in developed economies may be hit in a range from 4% to 8% of GDP, taking fiscal deficits above 10% in some places.[18] This will be manageable for most countries given the low debt servicing cost, but more problematic for others (eg, Italy).

Governments have announced a wide range of measures in these areas, ranging from loans and guarantees to subsidised short working hours. In addition, financial regulations have been loosened. For example, Chinese regulators have let banks run up more non-performing loans and in Europe, a planned increase in the capital that banks must hold has been cancelled. In an encouraging effort for coordinated action between fiscal and monetary authorities, the Bank of England (BoE) and UK Treasury have launched the "Covid Corporate Financing Facility" (CCFF), which will provide funding to businesses by purchasing commercial paper (CP) of up to 1-year maturity. This will help companies bridge illiquidity issues.[19] Similarly, in the US the Fed has launched Primary and Secondary Market Corporate Credit Facilities (PMCCF and SMCCF), which will buy corporate bonds with a maturity of up to 4 years (including in the primary market), with the Treasury making an initial USD 30 billion equity investment to cover any losses from the programmes.[20]

If the phase of acute disruption is short-lived, economic activity will likely rebound swiftly with little need for additional fiscal stimulus to prop up demand. However, since we expect disruptions in Europe and the US to last for several months, large stimulus packages will be needed to make up for lost income once the pandemic outbreak subsides. Some countries have announced such packages. For instance, in the US a relief package worth USD 2 trillion (9.3% of 2019 GDP) has been passed, significantly higher than the USD 787 billion (5.4% of 2008 GDP) fiscal stimulus during the GFC.

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[17] This is assuming there would be a 50% drop in private-sector activity and the government would cover one-third of the income fallout of the reduced economic activity and that the other two-thirds are borne by companies and, to a lesser extent, households. Source: A. Bénassy-Quéré, R. Marimon, J. Pisani-Ferry, L. Reichlin, D. Schoenmaker, B. Weder di Mauro, *COVID-19: Europe needs a catastrophe relief plan*, 11 March 2020.
[18] *The cost of the fiscal stimulus*, Capital Economics, 26 March 2020.
[19] In this scheme, the BoE operates as the Treasury's agent. The credit risk is with Treasury.
[20] *Primary Market Corporate Credit Facility*, Federal Reserve, 23 March 2020.

Among other measures, it encompasses four extra months of unemployment insurance to alleviate the pain on households. Overall, we expect the aggregate volume of fiscal easing across the major markets to be roughly 3.1% of global GDP in 2020 (see Table 4). In a historical context, the fiscal stimulus we expect to see this year is by far the largest seen in recent times. By way of comparison, the fiscal stimulus response to the GFC was much smaller at 1.6% of global GDP. However, given the large economic fallout from the lockdown measures, which will mean a near 100% loss in activity in several sectors (eg, travel, hospitality) over several months, much higher stimulus still will likely be required. Citi Research estimates that a stimulus of around 5% of global GDP would be needed to avoid a sluggish post-pandemic crisis recovery.[21]

The measures to alleviate the short-term economic pain and also the demand-boosting stimulus packages will translate into higher levels of public sector debt. At the very least, we expect central banks to ensure that borrowing costs will remain low for the foreseeable future to render the high debt levels more sustainable. We think it's likely that coordination between fiscal and monetary authorities will go beyond that. For example, the Fed could adopt some form of an explicit yield curve control (YCC) by committing to keeping the level of bond yields at a pre-defined level. We do not rule out more extreme forms of helicopter money, such as central bank-financed government spending or transfers, should the economic outlook become even bleaker.

Table 4 Overview of fiscal stimulus measures

Country	Size - % GDP[22]	Fiscal package - key elements
US	**8.3%**	• Medical and healthcare response (USD 8bn) • Support for work-leaves related to the virus (USD 100bn) • Unlocking of USD 50bn in emergency funds to States in various forms • Checks to families (USD 250bn), unemployment insurance (USD 483bn) • Direct lending and loan guarantees (USD 1.4tn)
China	**1.2%**	• Reduction of corporate social insurance; lowering corporate power tariff (RMB 650bn) • Targeted waiver of tax & fees (RMB 350bn) • Rental cut from SOE landlords and related tax cut (RMB 50bn) • Control and treatment for the coronavirus (RMB 110bn as of Mar 4)

[21] Coronavirus' Global Impact: Fiscal Actions – Where, When, How?, Citi Research, 24 March 2020
[22] Fiscal stimulus package sizes exclude guarantees and other liability-style stimulus. These are also based on announced packages

UK	5.5%	• NHS response fund (GBP 5bn) • Business support, subsidies for sick pay, coverage of portion of citizens' wages for jobs at risk • Cash grants and tax cuts for businesses worth 0.9% of GDP • Expanded hardship fund for households, 3-month mortgage payment holiday • Guarantees for SME loans; and GBP 330bn of government backed loans on offer (15% of GDP)
Germany	**5.1%**	• Easier access to short-time work and social benefits; tax deferrals/ adapted prepayments • Support to the Ministry of Health (EUR 60bn/ 1.8% of GDP) • Support for self-employed/ small businesses (EUR 50bn/1.5% of GDP) • Increase in public investment over 2021 - 2024 (EUR 12bn/0.4% of GDP) • New economic stabilisation fund (EUR 100bn) • Expansion of the credit and guarantees (EUR 400bn) to companies with no fixed upper limit
Japan	**7.0%**	• Disease control/ medical provisions; supporting quarantine system • Low- or no-interest loans to SMEs and freelancers • Compensation for parents burdened by school closures • Providing support to other Asian countries (1.8bn yen) • Stimulus package worth nearly USD 1tn • Off-budget lending scheme of 1.6tn yen for extending lines of credit and unsecured loans

Source: Swiss Re Institute, based on various sources, updated as of 7.4.2020

Impact of Covid-19 on insurance market

Relative to others, the insurance industry is less exposed to dwindling revenue streams and supply chain disruptions. Also, while the current economic crisis exposes the complexities of the market system, the huge and necessary central bank and government fiscal intervention the shock has elicited will serve to heighten risk general awareness, and also accelerate the trend of digitalization. Both will extend the boundaries of insurability into new areas.

Global primary P&C insurance market

The overall impact of Covid-19 on the non-life insurance industry will be mixed. Premium income and claims growth will likely fall as a result of the shutdown of social life in many countries to contain the virus spread, and as a follow-up effect of the closing of manufacturing sites due to disrupted supply chains and/or lack of demand. Underwriting results are likely to improve in personal and deteriorate in commercial lines.

There will be a significant impact on asset values, which will trigger solvency issues for weaker-capitalised insurers. On average, however, non-life insurers will be less affected than life insurers because of their lower asset gearing than those of life insurers. Further, lower interest rates will pressure profitability in the future. It will be difficult for insurers to offset the negative impacts on the asset side with a better pricing of underwriting risks as the global economy goes into a deep recession, even if the latter is short-lived.

We expect just a moderate reduction of global non-life premium growth due to the Covid-19 crisis of around 2 percentage points (ppt) globally. We forecast that global P&C premiums will grow by 0.9% in real terms 2020, and by 2.4% in 2021. This after an estimated 3.3% gain in global premiums in 2019. On the one hand, premium growth will be negatively impacted by declines in lines linked to business activity; on the other, prices in commercial insurance in particular have been hardening, and this will provide a tailwind to premium growth in the current year.

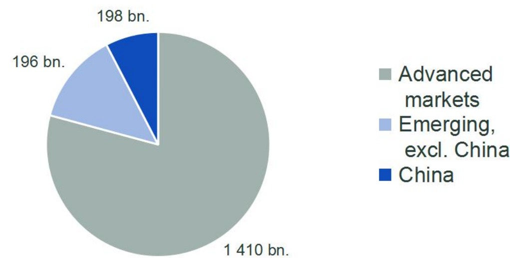


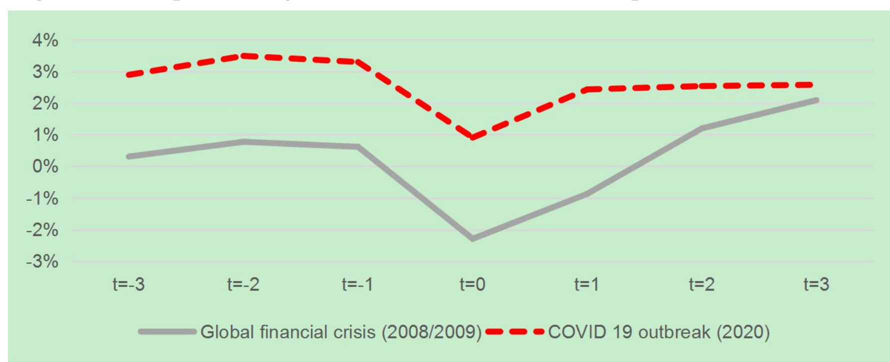
Figure 5 **Estimated primary market premiums in 2020 (in USD billion)**

Source: Swiss Re Institute

For the advanced markets, we forecast real premium growth of around 0.5% in 2020 and 1.5% in 2021. Premiums in emerging markets will grow by 2.2% this year and by 5.8% in 2021. China will be again the main driver, with 3.8% and 8% growth, respectively. Premiums in other emerging markets will rise by 1.1% in 2020 and accelerate to 3.6% in 2021. We estimate the average impact of the

Covid-19 crisis on the real premium growth at -2.2 ppt globally compared to our prior forecasts. We expect a less steep downturn than during the GFC (premium growth remains positive at 0.9% in 2020), because in 2008-09, the industry was in a soft phase of the underwriting cycle which further depressed premium growth. Today the market is in a more hardening environment. We expect a rebound in premium growth, alongside improving macro-economic backdrop to 2.4% in 2021, before gradually reverting to trend (see Figures 6).

Figure 6 Real premium growth: estimated Covid-19 impacts versus GFC recession



Note: t = 0 represents the outbreak of each crisis period

Source: Swiss Re Institute

The impact of the Covid-19 outbreak on the underwriting side of the non-life insurance sector will be comparably moderate, in our view. In addition to our reduced premium growth forecast for 2020, overall claims frequency is expected to fall. We expect the claims ratio to decline slightly for markets where personal lines are the larger segment.

Global primary L&H insurance market

We anticipate Covid-19 to impact the L&H insurance sector in three main areas, although it is too early to quantify the exact impact of the crisis:

1. *New business*: we see negative premium impact on new savings business on the back of lower sales, with primary distribution channels affected by reduced in-person interaction. Significant

constraints in daily life in many countries are likely to have a material negative effect on new business development, at least over the near term.

2. *Claims and benefits*: liability exposure to a spike in mortality risk, the severity of which at this point is highly uncertain. Also higher-than-expected claims in private medical expense (medex) insurance.

3. *Earnings, reserves and capital*: we expect the deterioration in equity markets and decline in interest rates will add pressure to life insurers' earnings, reserves and capital in 2020. A potential sustained disruption in the broader economy will cause deterioration in credit markets, leading to increased bond and loan defaults, and further pressure on regulatory solvency and capital levels.

Table 5 provides an overview of how we assess the implications of Covid-19 for the L&H sector. We believe the crisis will last for around three to six months, but a scenario of it dragging on 12-18 months (eg, until a vaccine becomes available) is also not unrealistic.

Table 5 How we expect Covid-19 to impact L&H business lines in 2020/21

Business lines		New business	Claims & benefits
All lines		Lower demand due to reduced in-person sales interactions	
Protection business	Mortality	Lower demand due to income effect (economic downturn) and reduced in-person sales; increased demand in medium term through rise in public awareness of protection need	Increase in mortality rate, but less than in general population (different age distribution and initial health status)
	Disability	Lower demand due to income effect (economic downturn)	Potential fraudulent claims: sick leave instead of business interruption
	Critical illness	Lower demand due to income effect (economic downturn)	Covid-19 is not directly defined as a covered condition in policies
	Long-term care	Lower demand due to income effect (economic downturn)	No significant impact expected
	Medical expense	Lower demand due to income effect (economic downturn) and reduced in-person sales; increased demand in medium term through rise in public awareness of protection need	Increased claims from Covid-19 testing and costly stationary care treatments (eg intensive care)

Savings business	Traditional w/ guarantees	Lower demand due to income effect (economic downturn), high stock market volatility and low interest rates. Some demand from people willing to invest when stock prices are low (up-side potential)	Increased stress to earn guarantees in force due to low investment returns
	Unit-linked		Low investment returns borne by policyholders

Covid-19 impact: positive, neutral, negative.
Source: Swiss Re Institute

Socio-economic differences are known to drive gaps in people's health and mortality experience. For instance, life expectancy between rich and poor countries is estimated to be 18 years. But there are also large gaps within countries and cities. The burden of non-communicable diseases (eg, cancer, chronic respiratory disease and diabetes) is disproportionately large in low and middle-income countries and can quickly eat up financial resources of poorer households.[23]

It is therefore important that countries improve child and maternal care, nutrition, gender equality, mental health, and access to adequate water and sanitation. An important factor is the reduction in inequality in healthcare, for example by improving governance and management of public and private health services. The insurance sector may play an important role in reducing inequalities through pre-paid private medical insurance to finance primary healthcare, which addresses the majority of a person's health needs. The WHO calls for all countries to allocate at least 1% of GDP to primary healthcare to give people access to essential services they need. Hence, the existing healthcare protection gap bears huge potential for health insurers to increase their risk pools, especially in emerging markets.

China as growth engine for emerging insurance market

Despite the sharp economic slowdown in 2020, China is expected to remain a key driver of global economic growth, including insurance sector. Having affected by the outbreak of Covid-19, Chinese insurers have been reporting mixed performance by February this year but overall have managed to

[23] WHO, January 2020, op. cit.

remain resilient, with solvency ratio of 247% across the industry. [24]Against the backdrop of a steadily recovering economy, supportive government policies as well as steady growing insurance demand, we now project P&C premiums in China will grow by 3.8% in 2020, and L&H premiums by 5.1% in real terms. Overall, China's dominance of emerging market insurance premium has increased, and the country will remain a predominant source of additional P&C and L&H premiums in the coming years. We maintain our expectation that China will become the world's largest insurance market in mid 2030s.

In P&C insurance, our forecasts imply the share of emerging market in global P&C insurance premiums will increase by around 8 ppts to 30% by 2030. This will be driven mostly by China (+6.5 ppts) while the rest of emerging markets will add another 1.5 ppts. Accordingly, the dominance of China in emerging market P&C premiums is projected to strengthen from 48% in 2019 to 50% in 2020, and further to 56% in 2030. China is expected to contribute 69% of additional emerging market P&C premiums to 2024, compared 58% (2019-2023) as projected in last year's report.

China's dominance in emerging market L&H premiums is also expected to increase. Its share is now projected to increase to 64% in 2020 from 59% in 2019, and further to around 70% by 2030. A key assumption is rising risk awareness and supportive government policies will act as important drivers to generate additional demand. The proliferation of digital ecosystem in China is also conducive to increasing penetration despite limitation to face-to-face sales through agents or bancassurers. In absolute terms, China is expected to generate the bulk (79%) of additional emerging market L&H premiums in the next five years to 2024. This is higher than the projection in last year's report of additional premiums to 2023, at 69%.

Sales of new L&H policies in February/March were likely down significantly. Agents (58.8% of total L&H premiums) and banks/postal agencies (30.6%) are the main distribution channels, and both were

[24] Record of the press conference hosted by China Banking and Insurance Regulatory Commission, at https://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=894647&itemId=915.

almost shut down. We expect the sales to rebound in the second quarter of 2020 as face-to-face interactions resume. Increasing insurance awareness due to the Covid-19 experience should boost health premium growth in particular, mirroring what happened after the SARS outbreak in 2003. From May to July 2003, the monthly year-on-year growth rates of health insurance premiums averaged 150%, 151% and 149%.[25] The equivalents for life premiums were 37%, 35% and 34%.[26]

Support insurance development to enable macro recovery

There is a strong positive correlation between insurance and economic growth but direction of causality is ambiguous. Researchers and academics have recently stepped up efforts to better understand the functional relationship between insurance and economic growth. The results also vary depending on country, time period and specific line of business, highlighting the importance of a robust institutional and regulatory framework for a well-functioning insurance market.

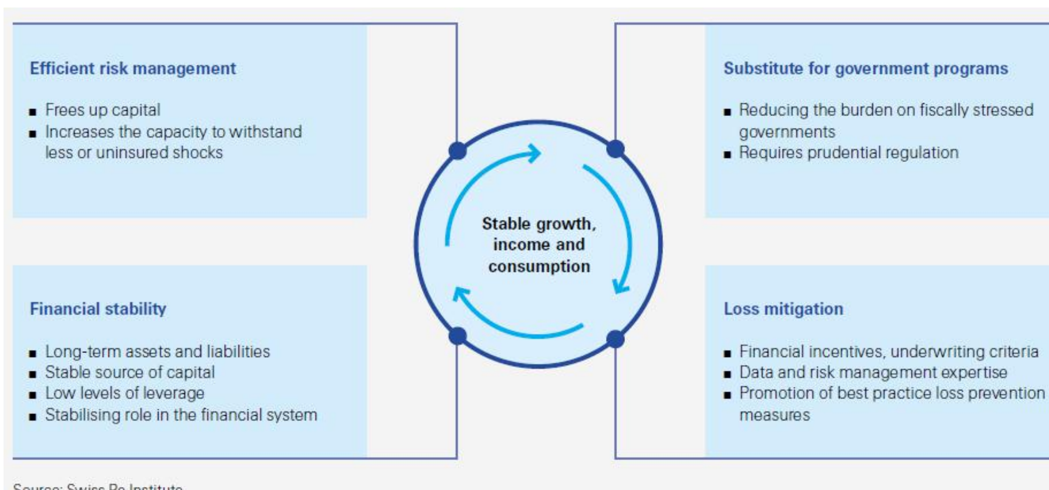
Overall, insurance is an integral part of a country's national economy and is indispensable in stabilising income growth and facilitating productive activities. Insurance also contributes directly to economic growth through its business services and employment. The degree of insurance cover is important for the speed and magnitude of recovery. Returning to production and restoring businesses is depending on funding. Insurance provides a permanent transfer of resources into a recovering industry/sector, for example, as a consequence of the recent governmental travel advisories/restrictions and increasing public fear over contraction of coronavirus, businesses located in areas where human contraction of coronavirus has been concentrated may experience significant disruptions. Coverage of business interruption insurance (BI) would protect business against income losses sustained as a result of disruptions to their operations, and contingent business insurance (CBI) similarly provides insurance for financial losses resulting from disruptions to a business's customers

[25] Data from CEIC
[26] Data from CEIC

or suppliers, usually requiring that the underlying cause of damage to the customer or supplier be of a type covered with respect to the business's own property.

According to SRI research, higher insurance penetration is correlated with lower macroeconomic volatility as measured by the standard deviation of GDP. In our econometric modelling, we find a statistically significant negative relationship between nonlife insurance penetration and GDP volatility in a panel data set of more than 100 countries. Secondly, insurance industry promotes financial stability by providing a stable source of long-term capital. Life insurers in particular are long-term institutional investors, a role that is important in stabilizing financial markets and improving macro resilience. Insurers are in better position than other industries because of their illiquid liabilities and low capital leverage. Third, private insurance can complement or even substitute for government programs, reducing the burden on tax payers. The relief offered by insurers is of particular relevance to fiscally-stressed governments, provided prudential regulation ensures the performance of the insurance sector during times of external shock. Lastly, re/insurance provide economic incentives to facilitate loss mitigation, benefiting policyholders and society at large. Insurance can provide financial incentives and risk management expertise that promote best practice loss prevention measures, such as building standards and fire protection (Figure 7).

Figure 7 How insurance benefits macro resilience of societies



To support recovery of real economy, we would suggest the following implications to boost insurance development and recovery of real economy in China:

- **Private public partnerships (PPP).** Governments and regulators set rules that enable the insurance market to develop and expand the availability of risk transfer solutions, and channels that insurance asset can invest. Many countries have beneficial tax rules for life and health insurance. Ideally, the regulatory system will also foster innovation through, for example, supporting the use of new technologies in insurance products and distribution. A number of re/insurers have collaborated with the World Band and regional NGOs in setting up climate risk-pooling schemes such as the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI) and others.[27]
- **Index insurance,** which is mainly used against climate risks including hail, drought, and floods. In East Africa, ACRE Africa provides farmers with weather index insurance, covering both drought and excessive rainfall through smart phones. In China, the Guangdong provincial government signed a parametric insurance solution in 2016 to cover losses from tropical cyclone and heavy rainfall.
- **Inclusive insurance** is also important, to widen insurance penetration to reach the lower part of the population pyramid. The insurance industry is responding to this market opportunity in a significant way – Allianz estimates that inclusive insurance has the potential to cover up to 3.8 billion people.[28]

We believe a main growth area in China is the green bond market. This can provide insurance solutions to support economic recovery and growth, including to SMEs:

[27] *Climate Change and the Insurance Industry: Taking Action as Risk Managers and Investors*, The Geneva Association, January 2018.
[28] Martin Hintz, *"Emerging Consumers 2016 Full Year Report",* Berlin: Allianz SE, April 3, 2017

- **Green or climate bonds** are specifically designed to encourage sustainable and climate resilience investment. Their use in emerging markets is still at an infant stage, accounting to around 3% of all regional bond issuance in 2018. [29] Recent sovereign issues of green bonds such as in Chile, is encouraging.
- **Insuring small- and medium-sized enterprises** in emerging markets has received less attention, even though formal SMEs contribute up to 60% of total employment and up to 40% of the GDP. This sector is under-served, providing a new insurance opportunity.

[29] "Emerging markets Green Bonds: Raising the profile", *International Finance*, 23 September 2019, https://internationalfinance.com/emerging-markets-green-bonds-raising-the-profile/.