

# US Economic Outlook

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Tampa, 10 March 2020

# Outline for today

Macro Environment

Economic and Political  
Risks



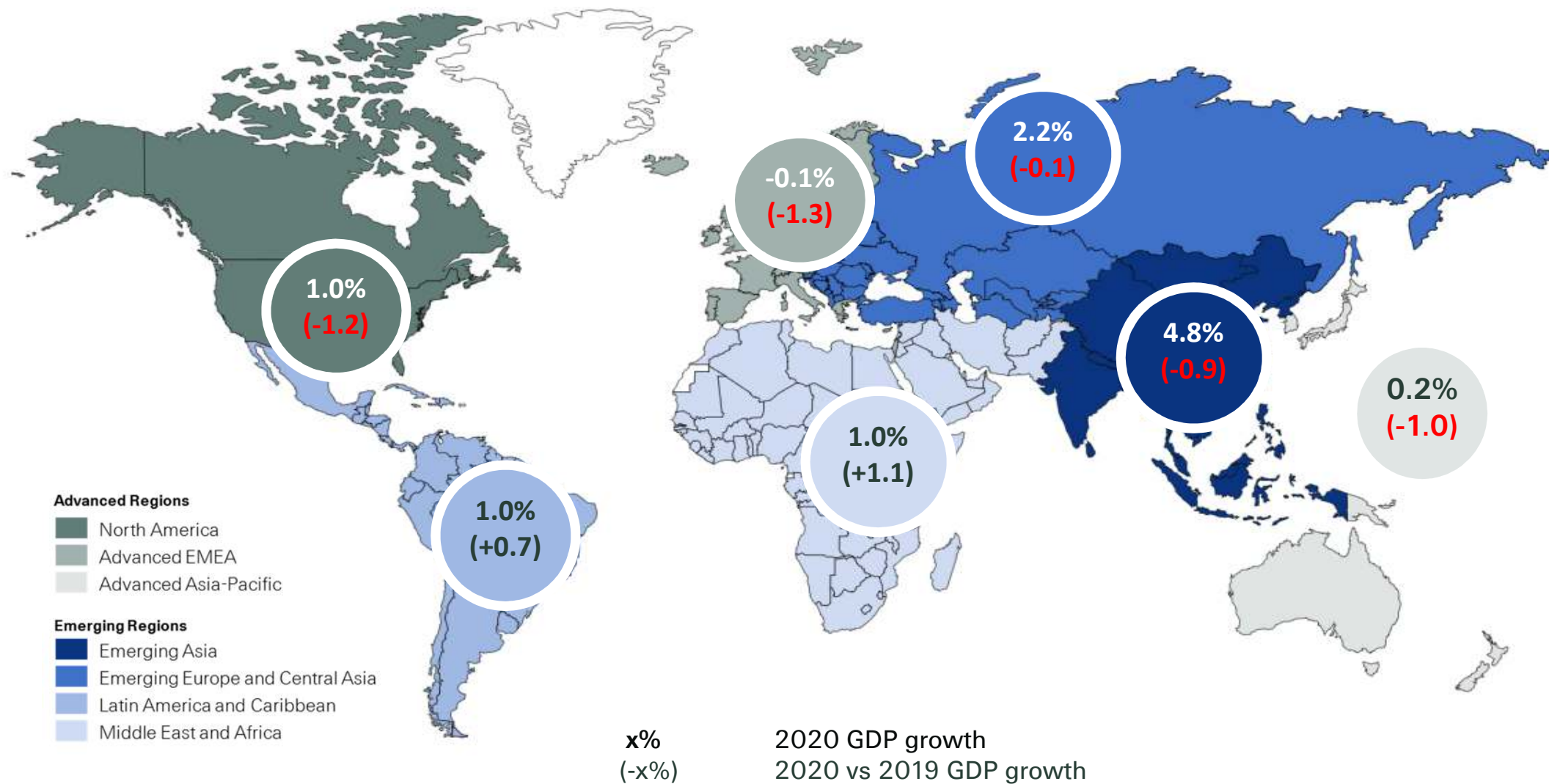
# Macro Environment

## Macroeconomic environment

# The spread of the coronavirus has turned from a "downside risk to watch" to a global recession scenario

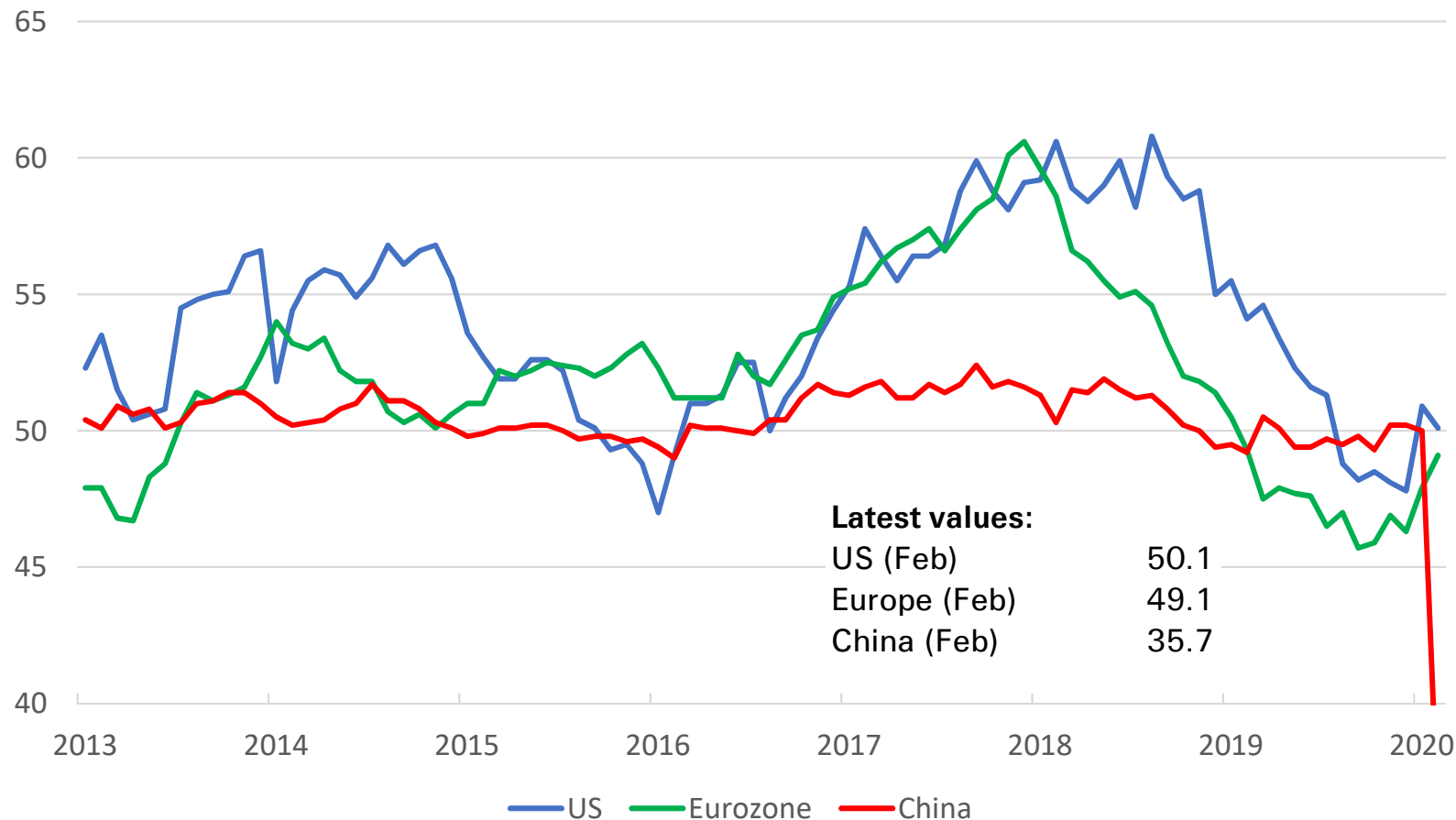
- The global recession is expected to still be mild in a historical recession context
- Global growth takes a hit in the second and third quarter
- The nascent manufacturing recovery gets derailed
- US recession risk surges to 40%

	Real GDP growth		Inflation		CB policy rate		10y yield	
	2020	2021	2020	2021	2020	2021	2020	2021
<b>US</b>	<b>1.1</b>	<b>1.8</b>	<b>1.5</b>	<b>1.7</b>	<b>0.1</b>	<b>0.1</b>	<b>1.0</b>	<b>1.0</b>
<b>Euro Area</b>	<b>-0.4</b>	<b>0.8</b>	<b>0.7</b>	<b>0.9</b>	<b>0.0</b>	<b>0.0</b>	<b>-0.6</b>	<b>-0.6</b>
<b>China</b>	<b>4.8</b>	<b>5.5</b>	<b>3.0</b>	<b>2.5</b>	<b>2.4</b>	<b>2.4</b>	<b>2.9</b>	<b>2.9</b>



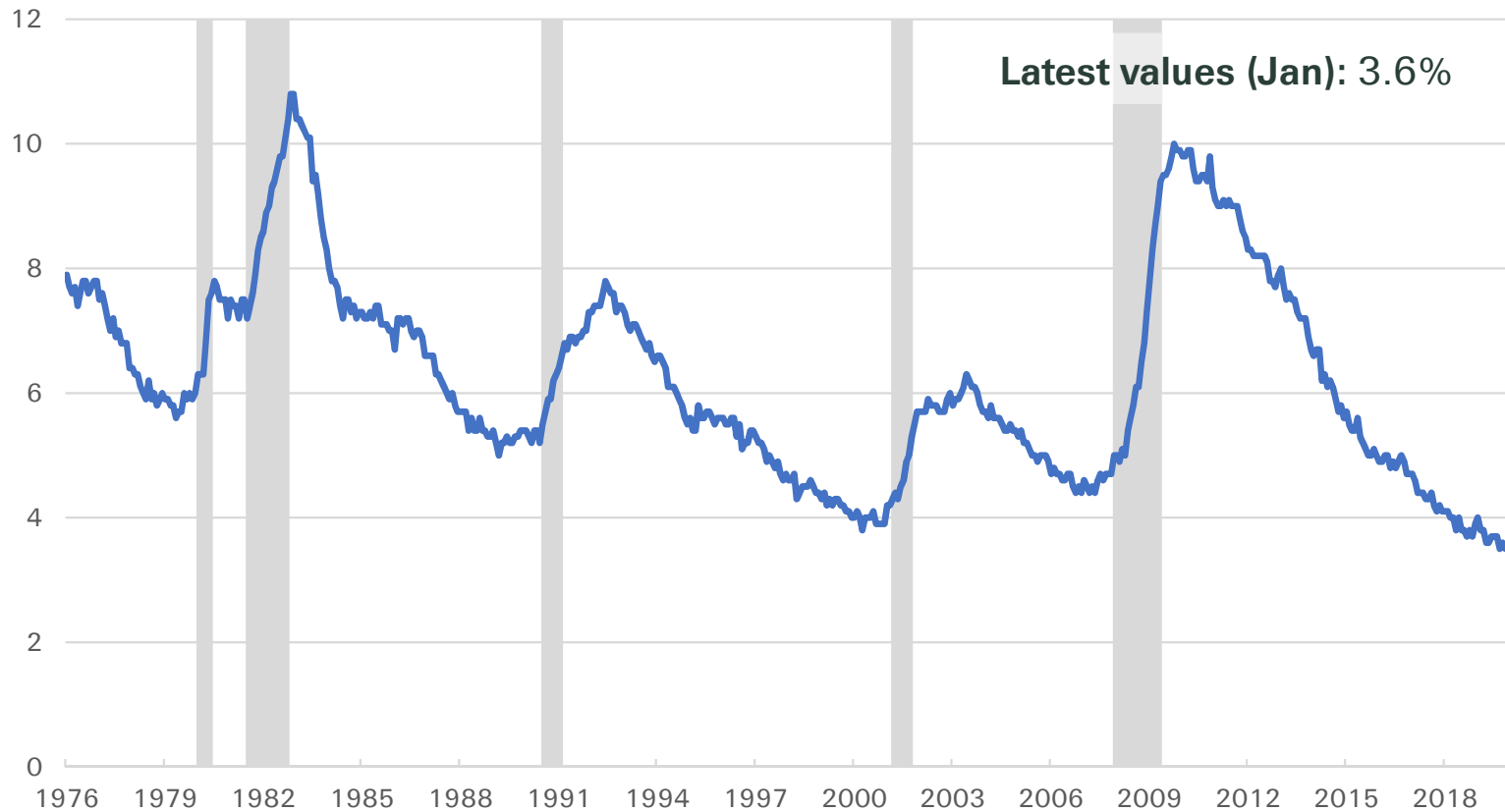
## Macroeconomic environment

# Trade tensions were weighing on the manufacturing segment in North America – giving way to COVID-19



## Macroeconomic environment

# The unemployment rate is near historical lows



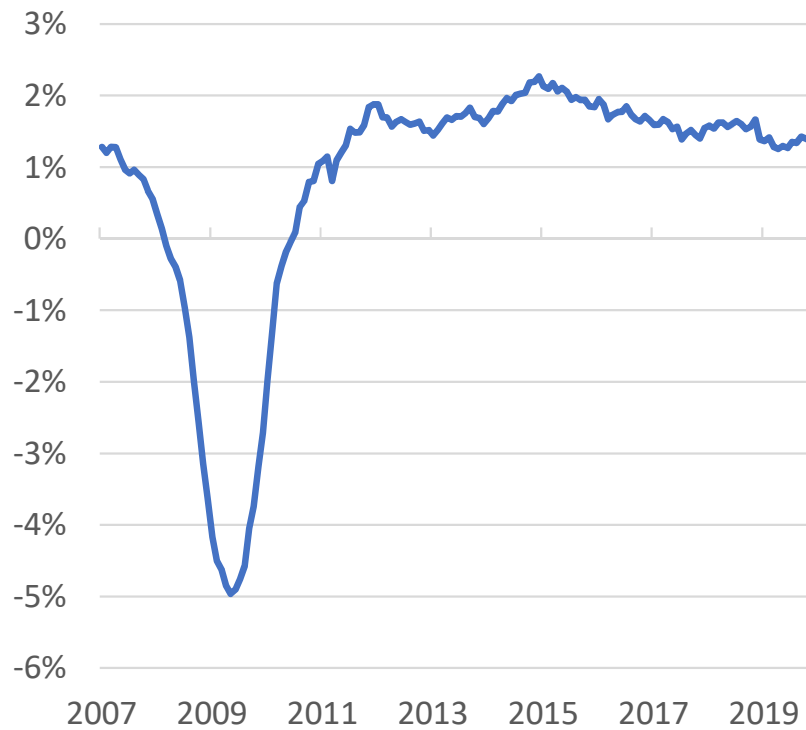
Source: Datastream, U.S. Bureau of Labor Statistics

# Macroeconomic environment

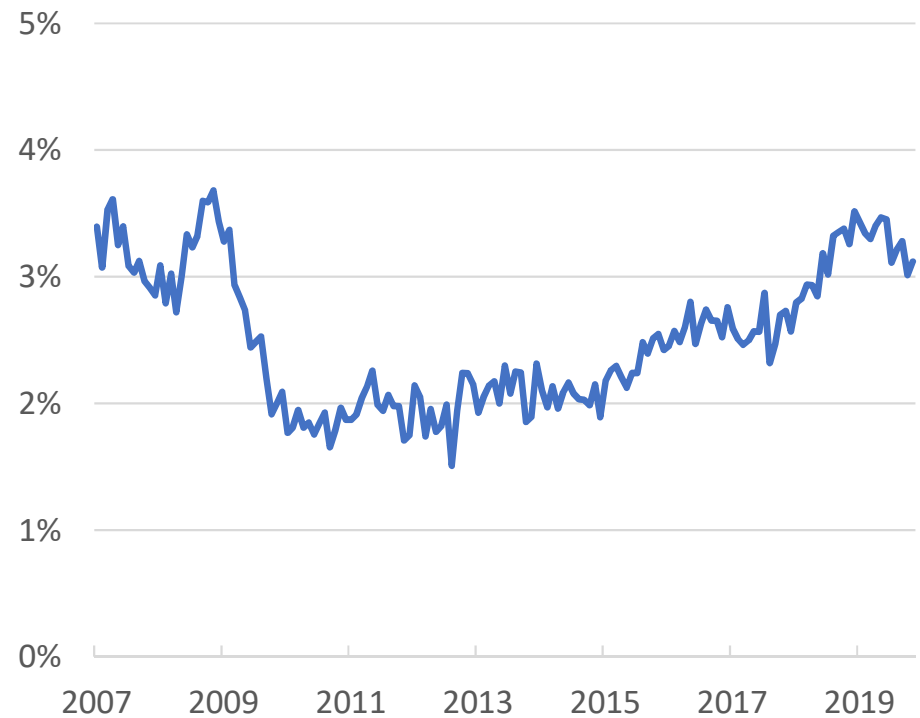
## Employment growth and wage growth are slowing



### Employment growth yoy



### Average hourly earnings yoy





## Macroeconomic environment

# Consumer confidence is moving sideways, but remains at historically high levels

### Conference Board confidence consumer sentiment

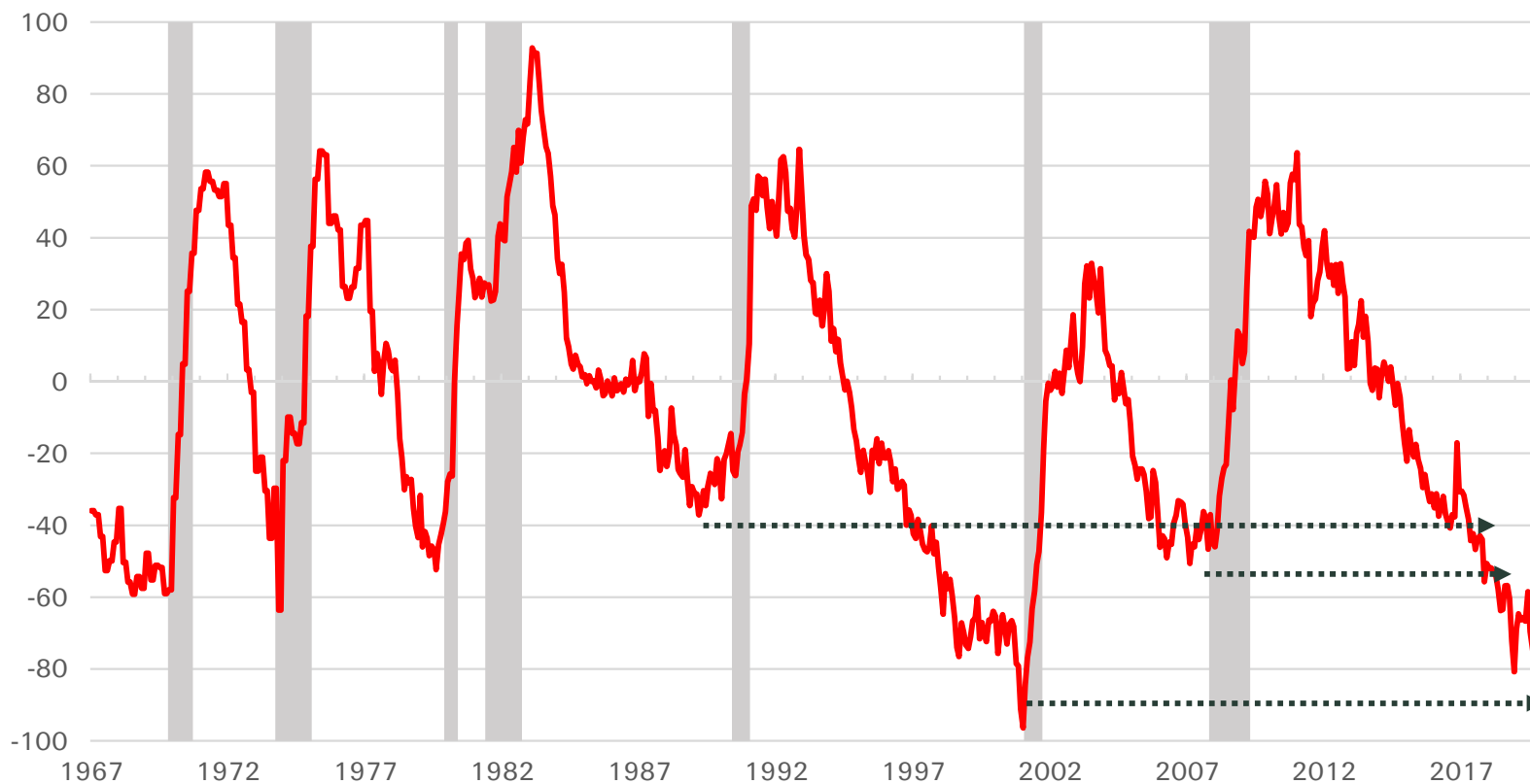


Source: Conference Board

## Macroeconomic environment

Consumers are much more optimistic about today than about the future; this is normally a sign for a late cycle

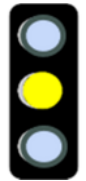
Conference Board: consumer expectation minus present situation



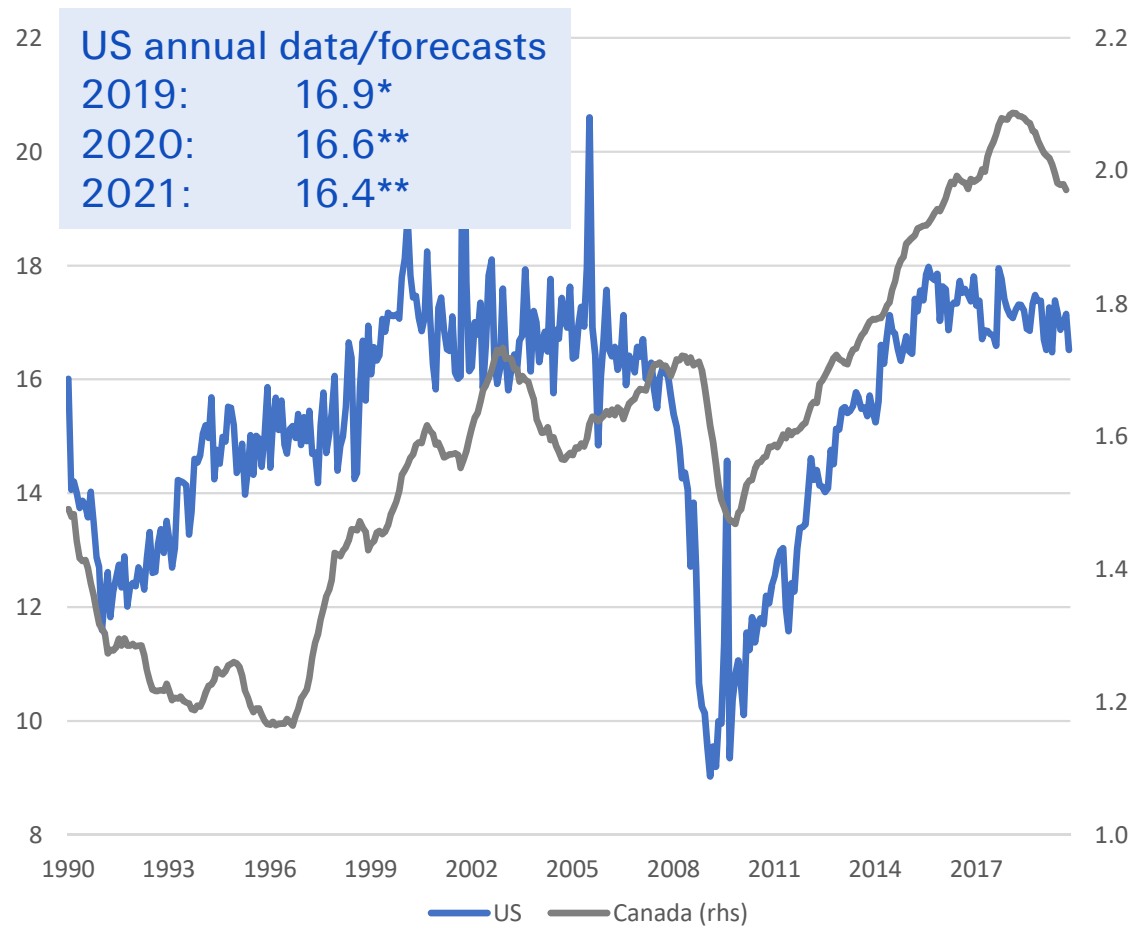
Source: Conference Board

# Macroeconomic environment

## Light vehicle sales – beyond the peak



Millions, annualized\*



- US auto demand has been slowing since 2016
- US consumer outlook remains broadly positive
- Declining affordability with rising auto interest rates
- Pent-up demand satisfied by 2015/16

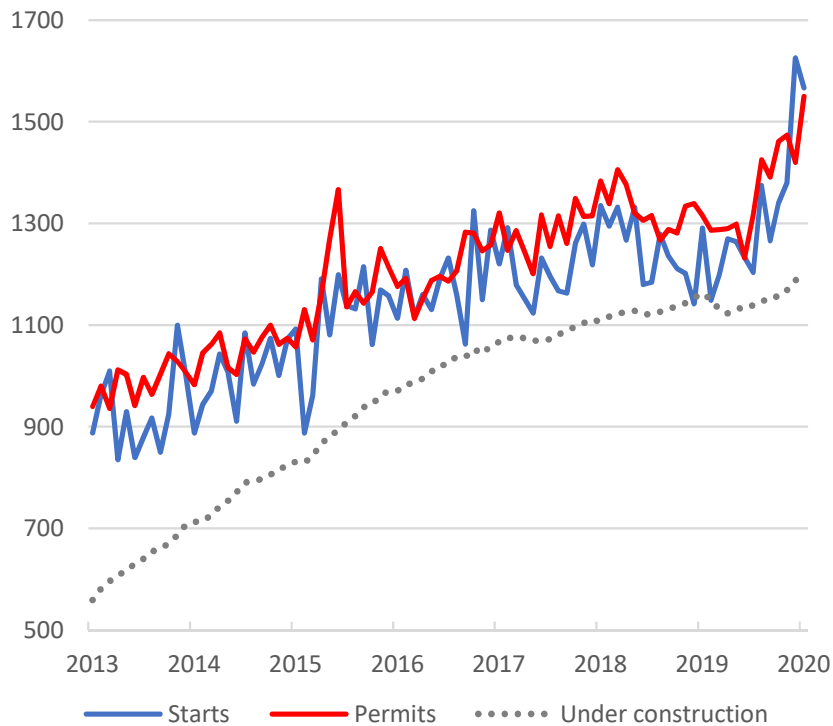
Sources: \*Datastream, \*\*Blue Chip Economic Indicators, Feb 2020

## Macroeconomic environment

# Housing market indicators have taken off strongly - affordability gets boost from lower rates, though impact is waning



### Housing starts, permits, construction



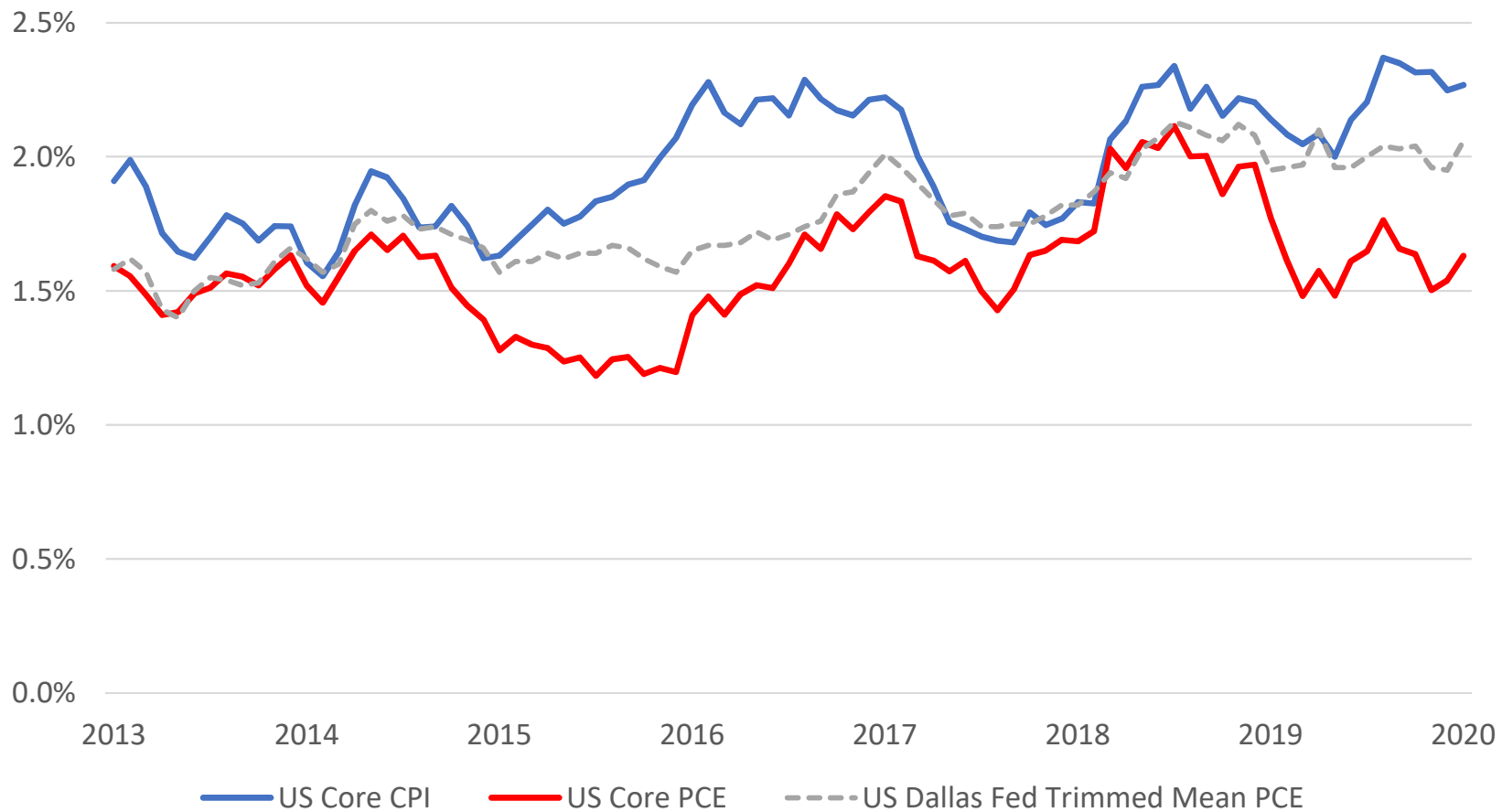
### Average weekly mortgage rates 30-year fixed



Sources: Datastream, Federal Reserve

## Macroeconomic environment

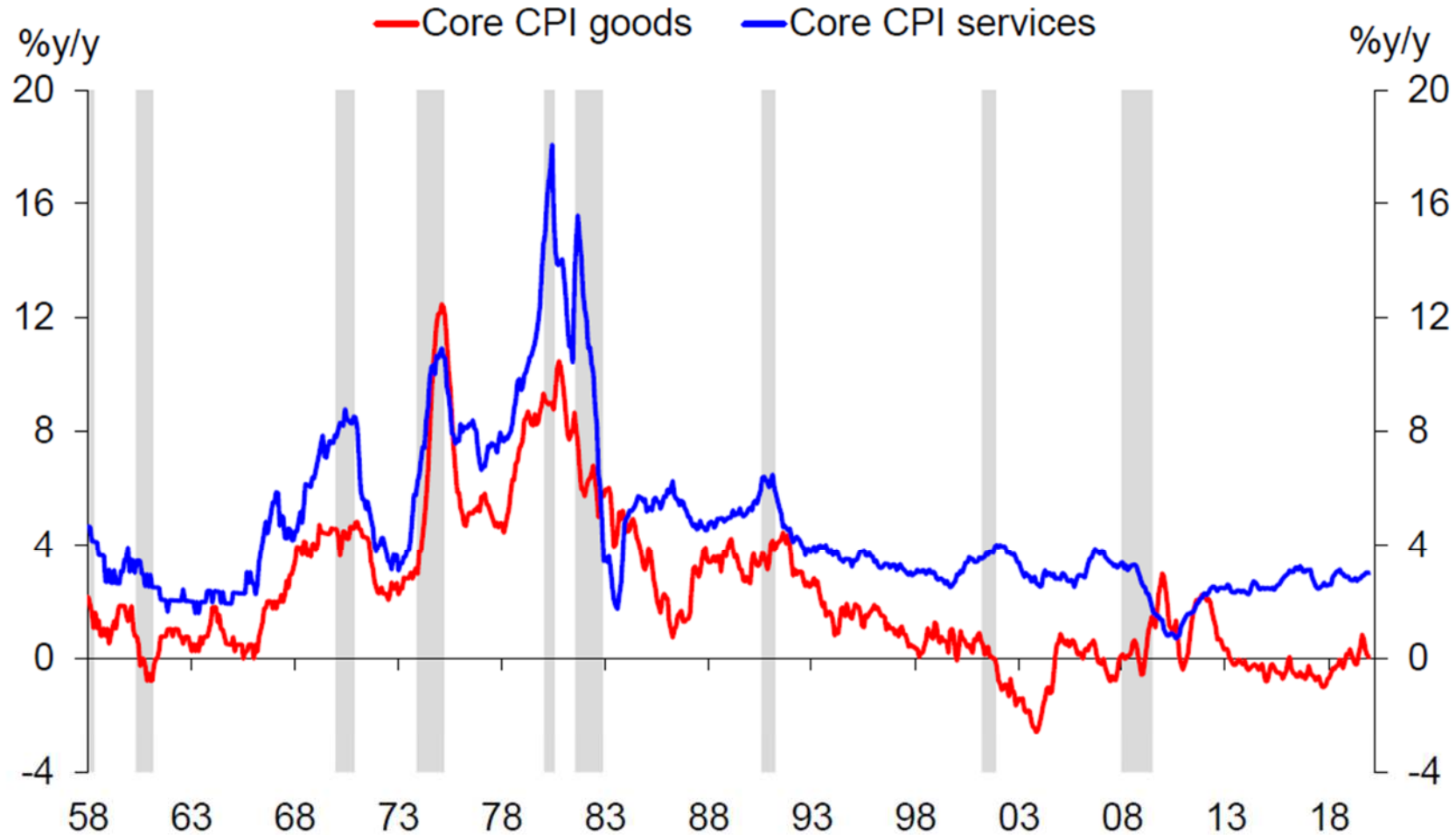
# Inflation expectations remain well anchored



Source: Datastream, U.S. Bureau of Labor Statistics

## Macroeconomic environment

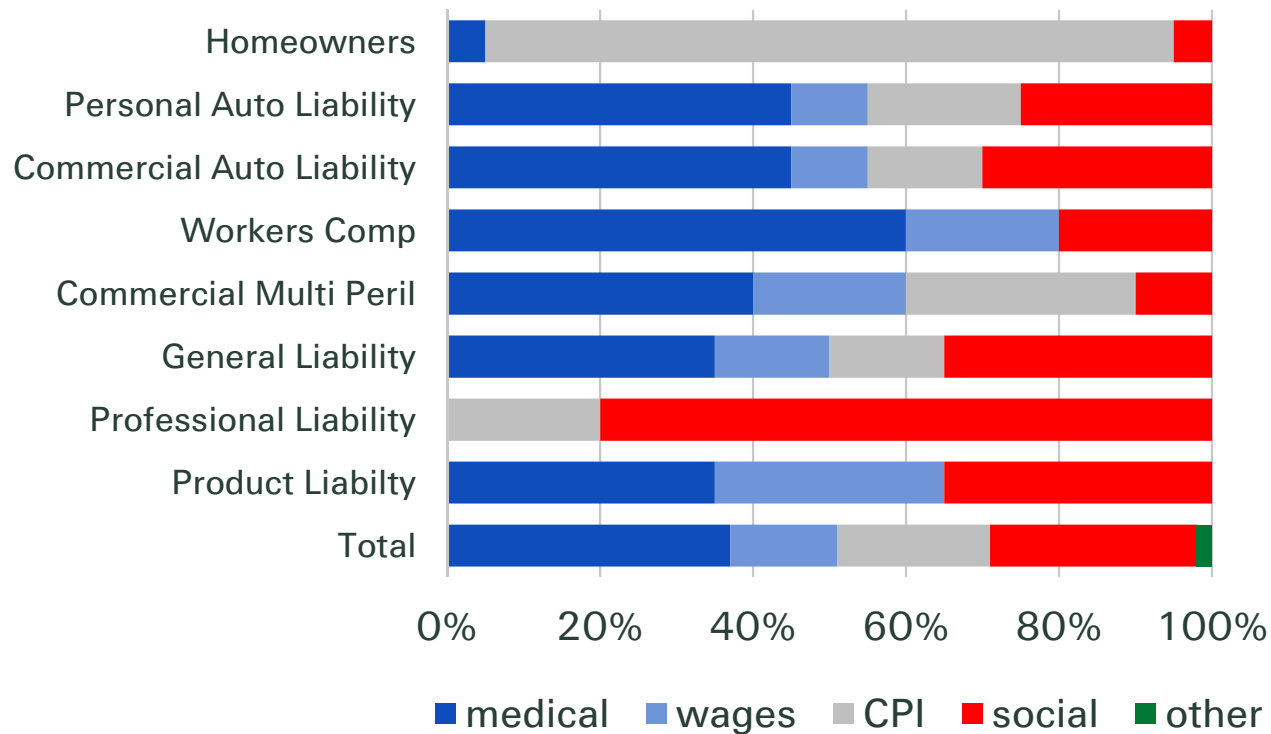
Inflation for goods is flat for the last two decades – more pronounced for services



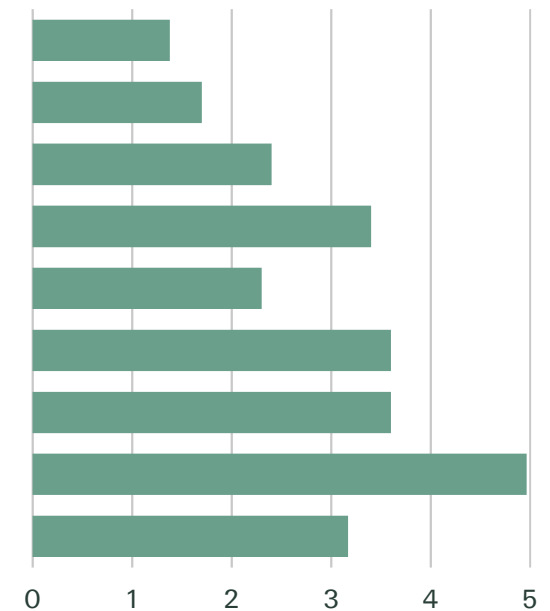
Source: BLS, Haver Analytics, DB Global Research

# Not all inflation is created equal: medical, wage and social inflation exceed general CPI trends

US Primary Insurers' Estimated exposure to inflation

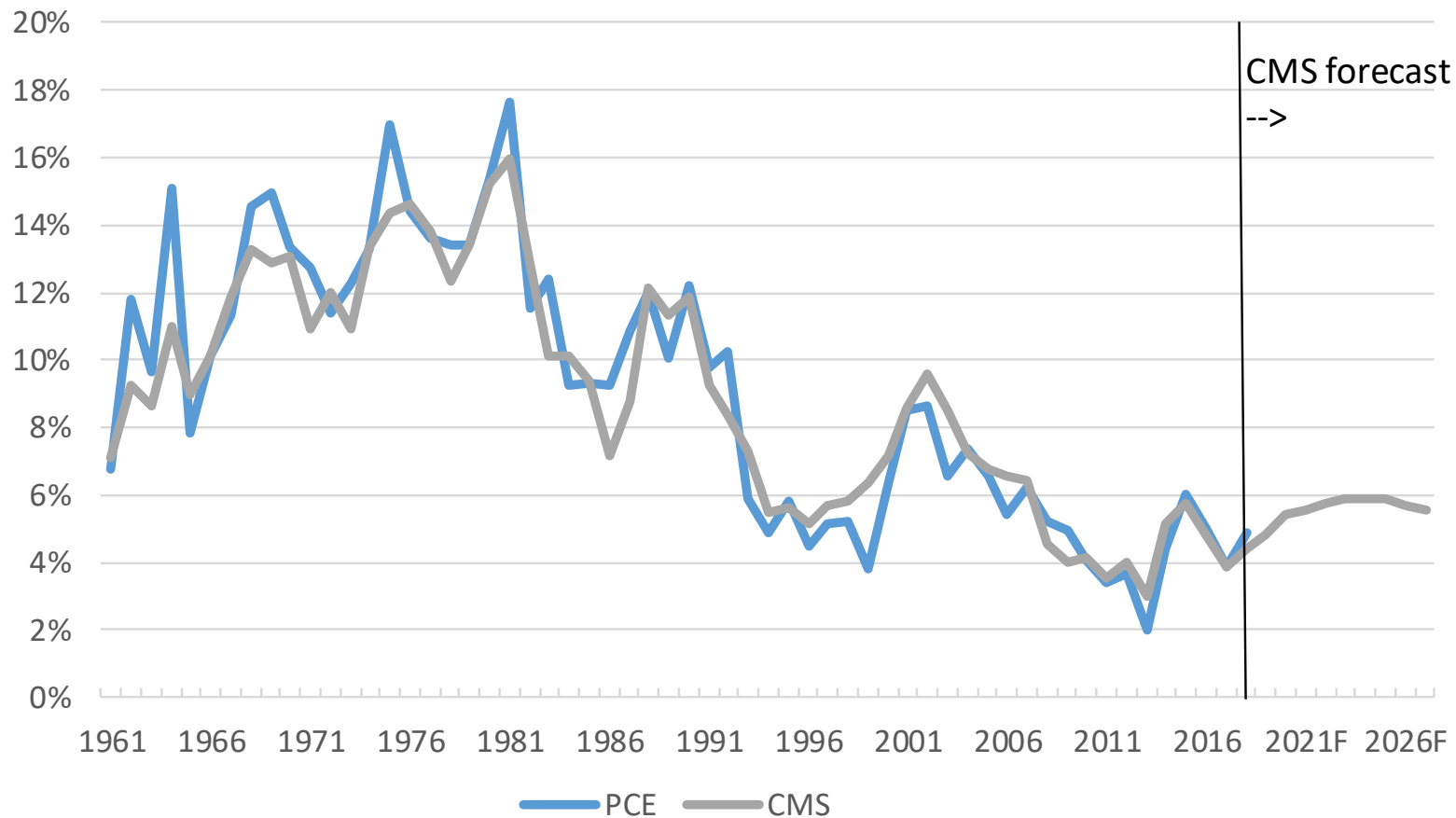


Claims duration, years



## Macroeconomic environment

# Healthcare expenditure growth remains modest by historical standards, but well above headline inflation



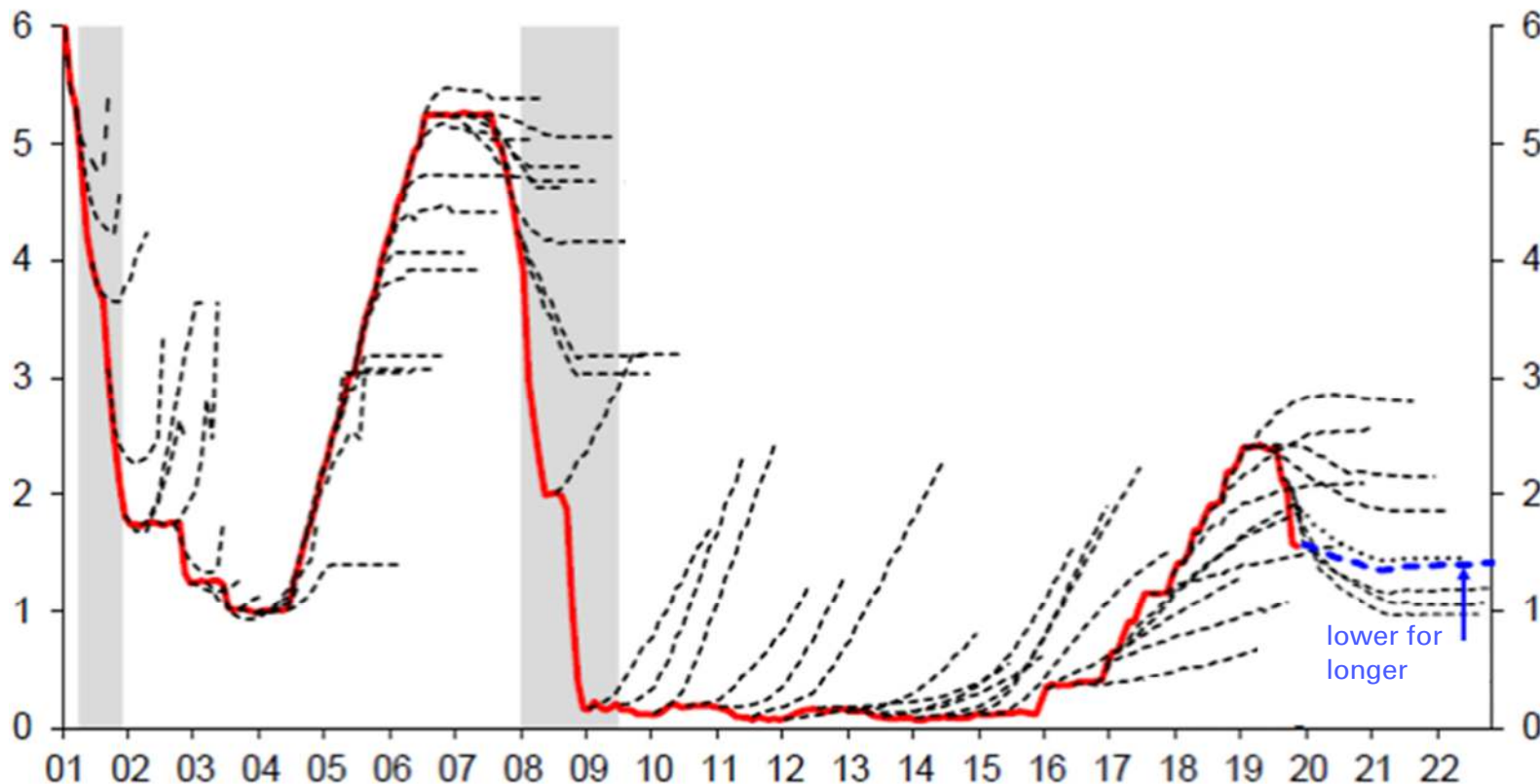


## Macroeconomic environment

# Lower and slower for longer is starting to sink in

- Markets have systematically overestimated rate increases while the IMF has continuously revised lower its global growth forecasts
- Over recent years, reality appears to have sunk in. The rates market now also expects a low for longer scenario

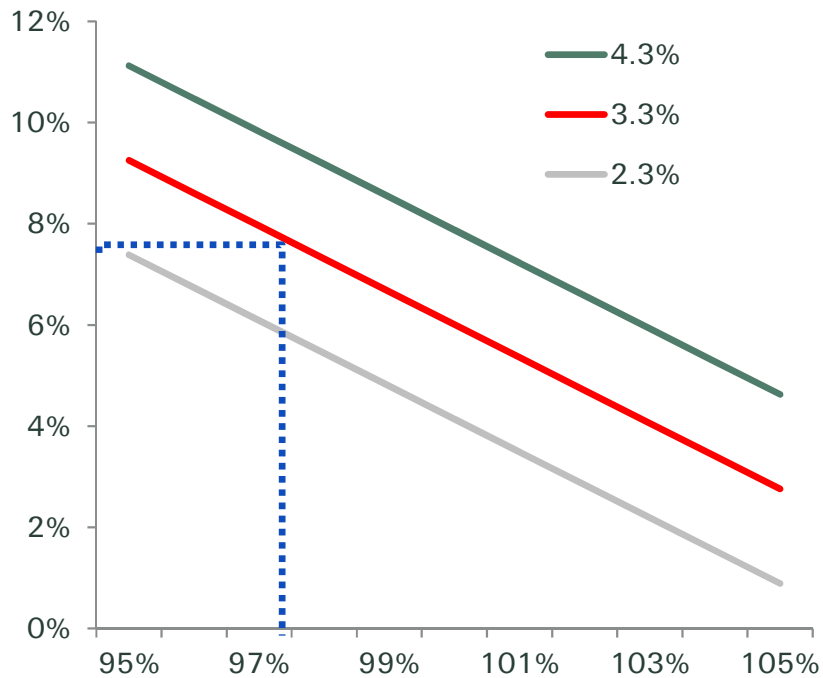
Fed funds futures at different points in time, in %



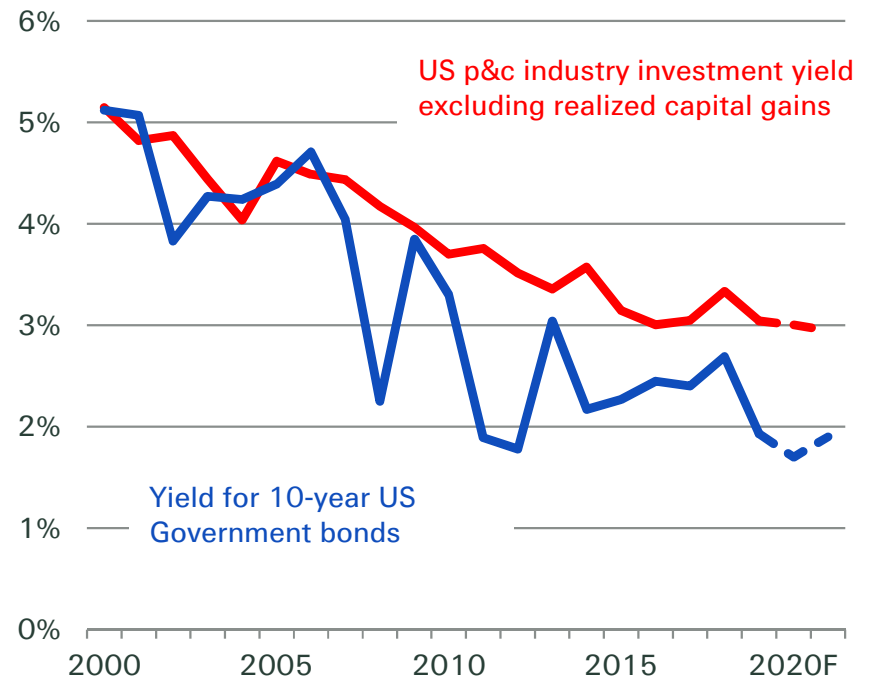
# Trade-off between investment yield and underwriting

➔ one point yield translates into ~ three points of combined ratio

Sensitivity of profitability (ROE) to investment yield and combined ratio



P&C insurers portfolio yields and US government bond market rates

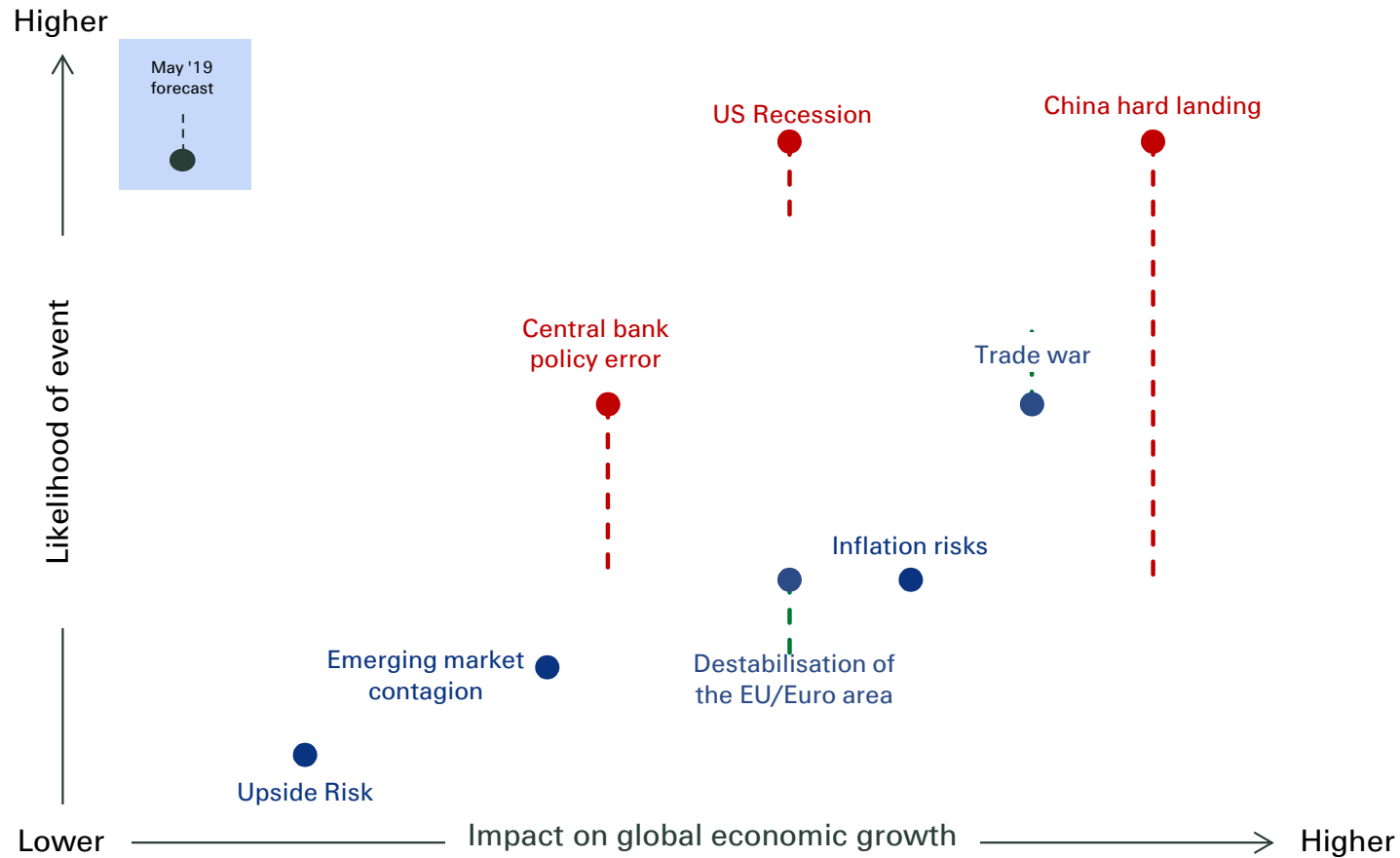


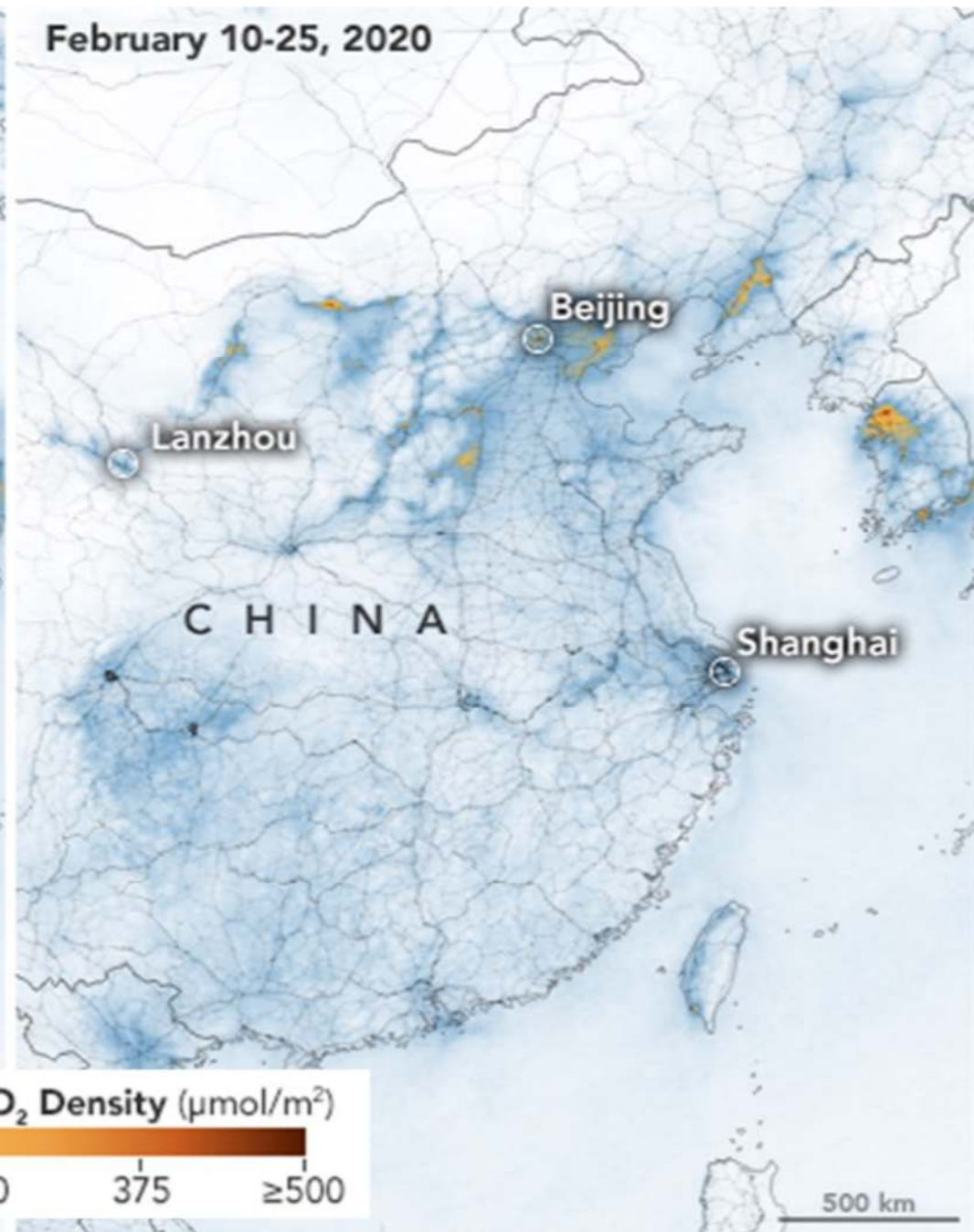
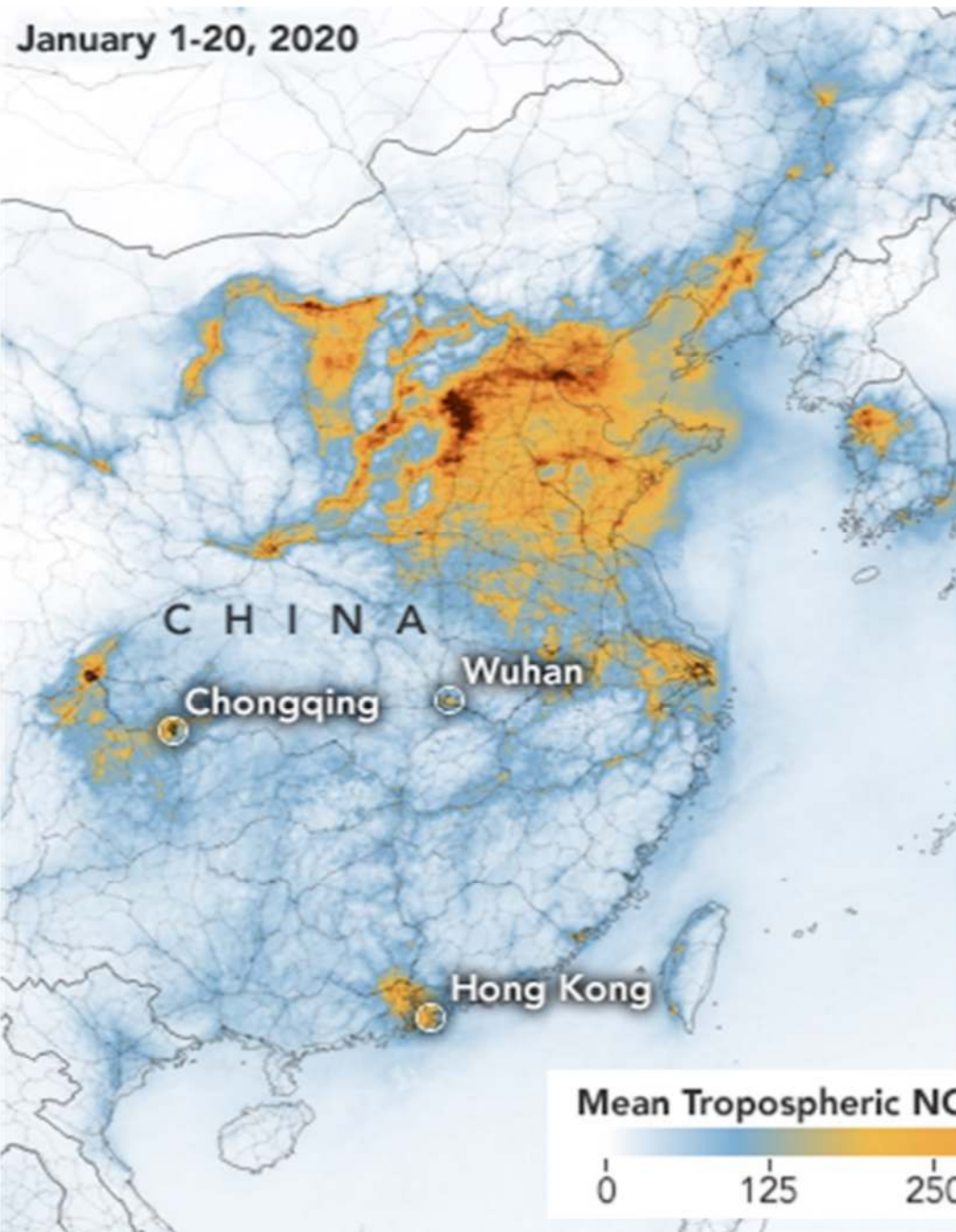


# Economic and Political Risks

# Macro risks

## Risk landscape: COVID-19 related risks have increased



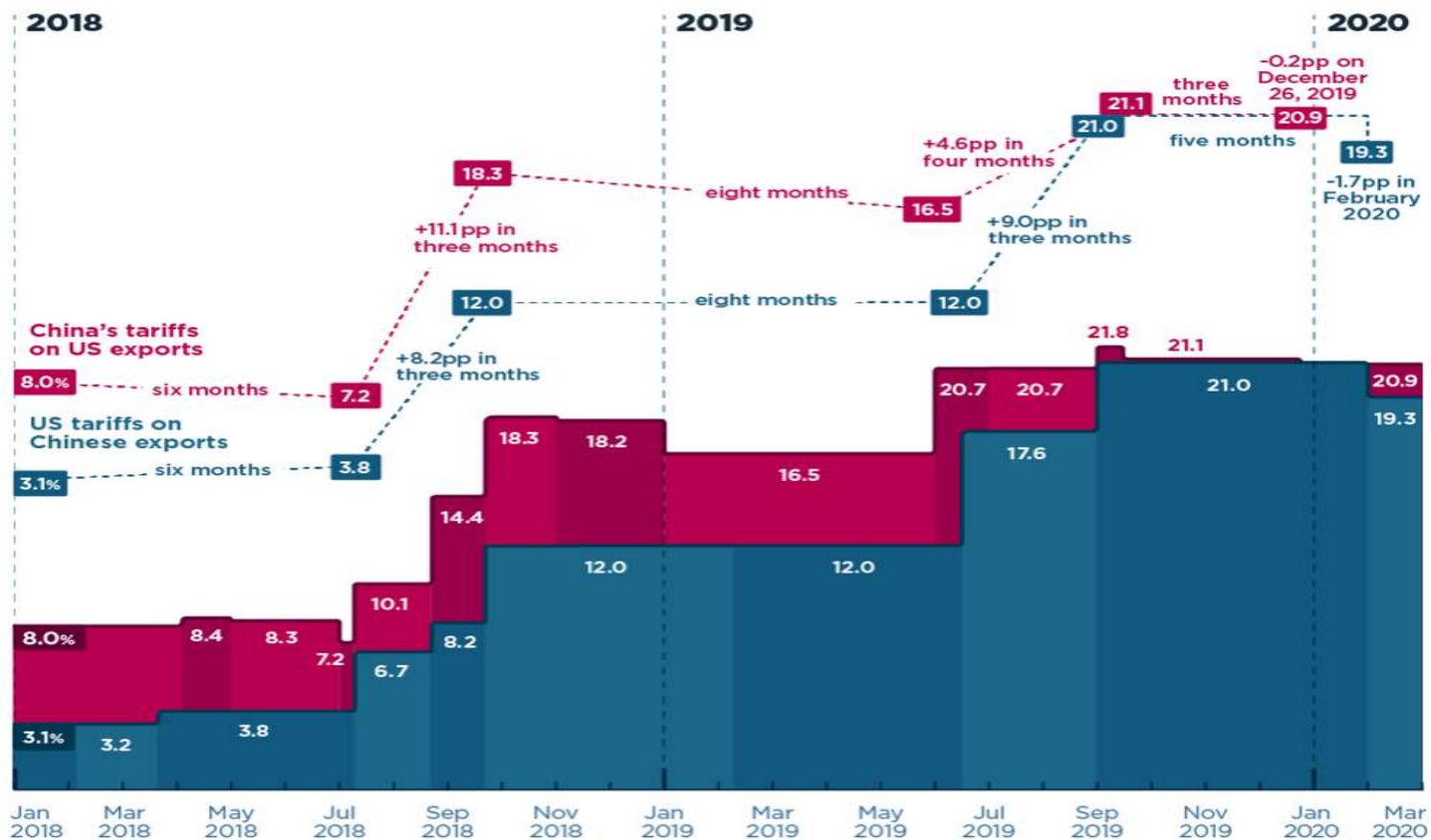


## Macro risks

# US-China Phase One deal does not resolve the conflict

- Avg. US tariff on Chinese goods will only fall by 1.7pp - up six-fold from pre-trade war
- Total US imports from China impacted by tariffs will still amount to roughly USD 375 bn

Average tariff rate, percent

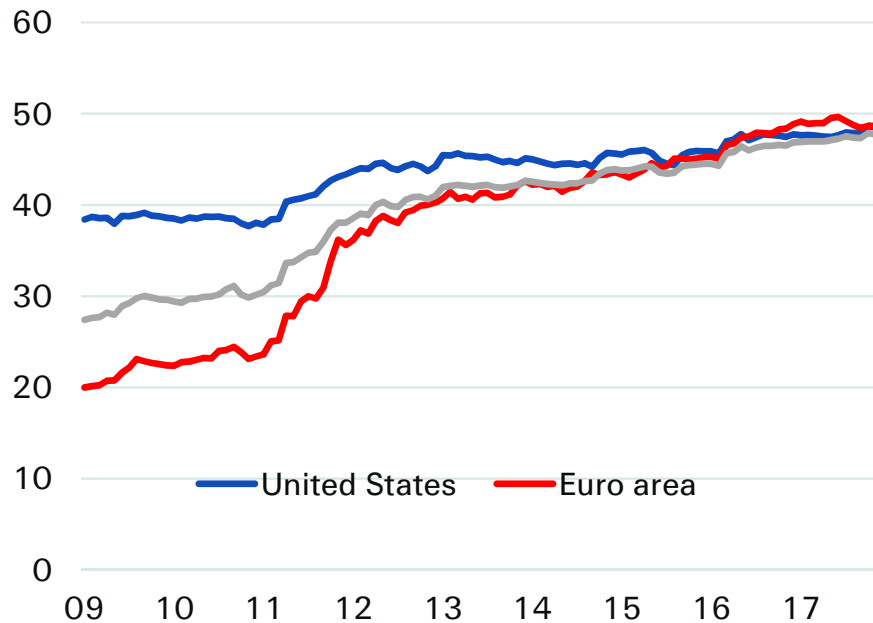


## Macro risks

# Vulnerabilities in the credit space

- More risk in IG market portfolio → more exposure to downward migration
- Recent surge in spreads reflects higher recession risks but levels remain low

Share of IG-Grade Index with BBB rating  
(percent of total IG bonds in market portfolio)



Source: Federal Reserve, IMF, Swiss Re Institute

Corporate credit spreads, BBB  
(percentage points)



# Planned increases in asset allocations - all insurers

*Search for yield in liquidity, credit and equity risk*

## American top 5

- Private equity
- Commercial mortgage loans
- Infrastructure debt
- Middle market corporate loans
- Collateralized loan obligations

## EMEA top 5

- Infrastructure debt
- European investment grade corporates
- Private equity
- Middle market corporate loans
- Infrastructure Equity

## Asia Pacific top 5

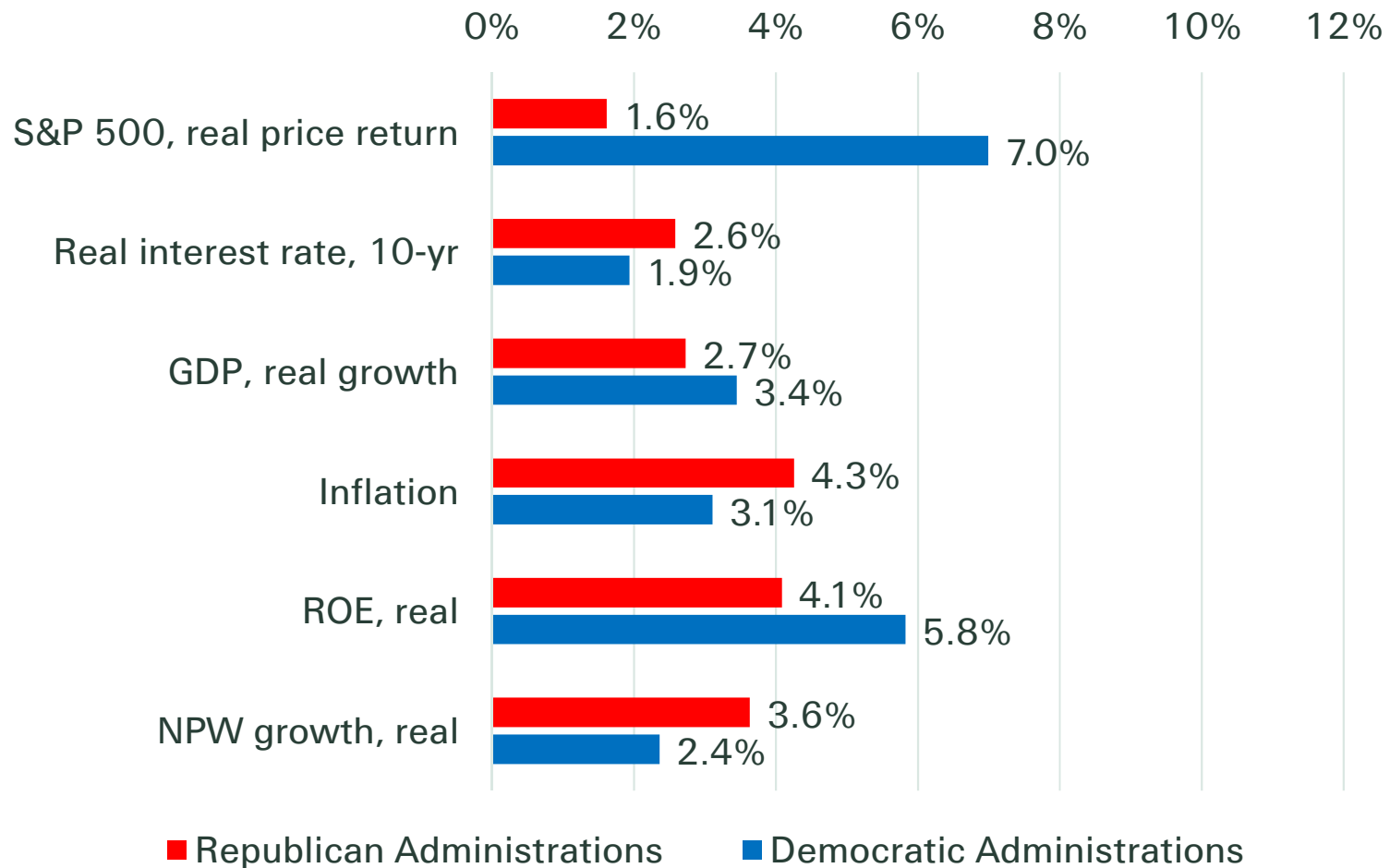
- Private equity
- Infrastructure debt
- Infrastructure equity
- US investment grade corporates
- Middle market corporate loans

Source: Goldman Sachs Asset Management – 2019 Insurance Survey

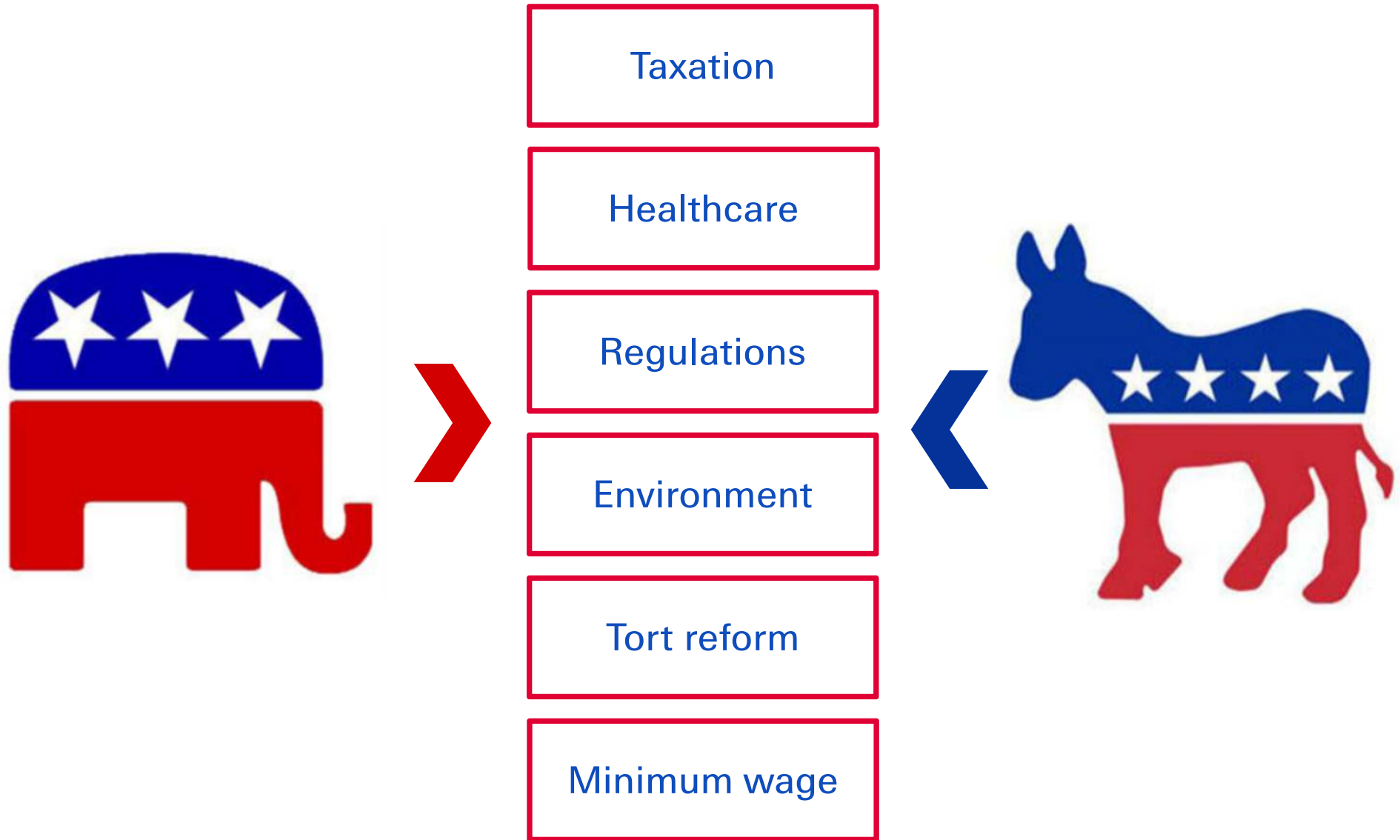


# Do politics matter for P&C insurance?

60-year annual averages 1959-2019



# Elections add uncertainty for the insurance industry





# Conclusions

# Conclusions

- Global recession
  - US recession risk is elevated at 40% in 2020
  - Fed cutting 100 bps, downside risks still dominate
- Interest rates are lower for longer
  - The ECB and the Fed are forcing investors to take risk
  - lower yields erode earnings potential
- Inflation risks remain
  - Wage and health care inflation drive costs for services (and claims)
  - Social inflation driven by non-economic factors in society
- COVID-19 is dominant risk

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