

Swiss Re



Global Economic, Market and Insurance Outlook



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IUMI

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Agenda

- Global economic outlook
- Outlook for major asset classes
- Global P&C outlook



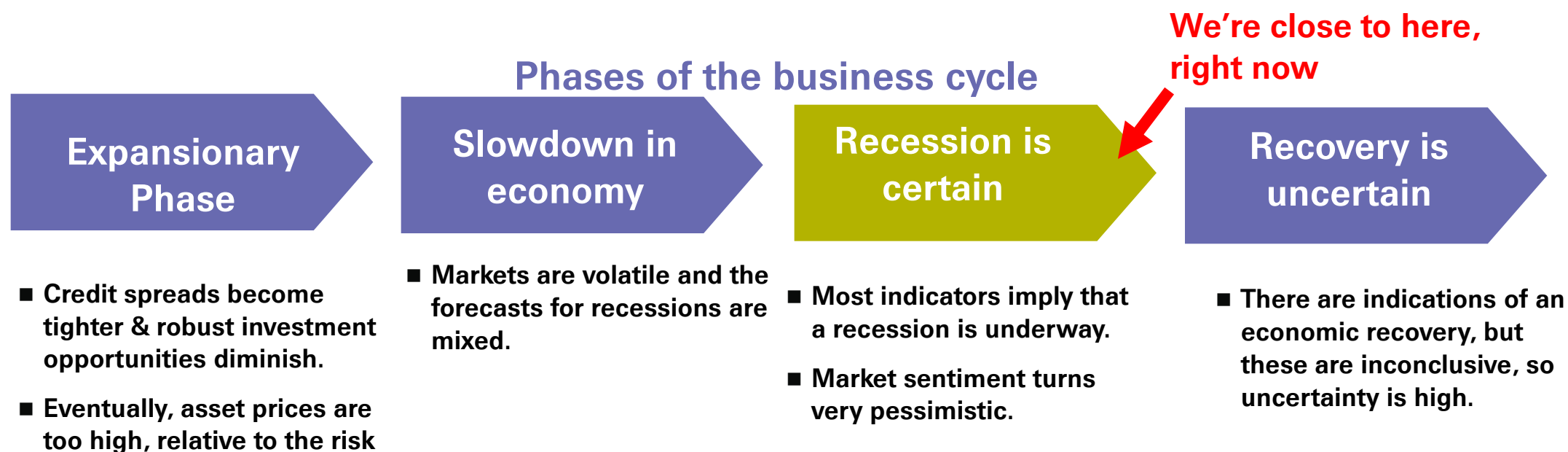
Overview

- A global growth slowdown is underway, with US basically in a recession.
- Inflation remains a problem for Central banks, so monetary easing will be cautious
- Market volatility likely to continue. Spreads will remain wide. Equity markets weak at least until end-2008.
- Despite impact on asset valuations, P&C market shows few signs of hardening.

What is a recession?

Definition of recession

- **Common definition:** Two quarters in a row of negative “real” GDP growth (real GDP = after-inflation Gross Domestic Product)
- Growth in output of goods and services becomes negative (real income falls), unemployment rises, manufacturing down, sales down



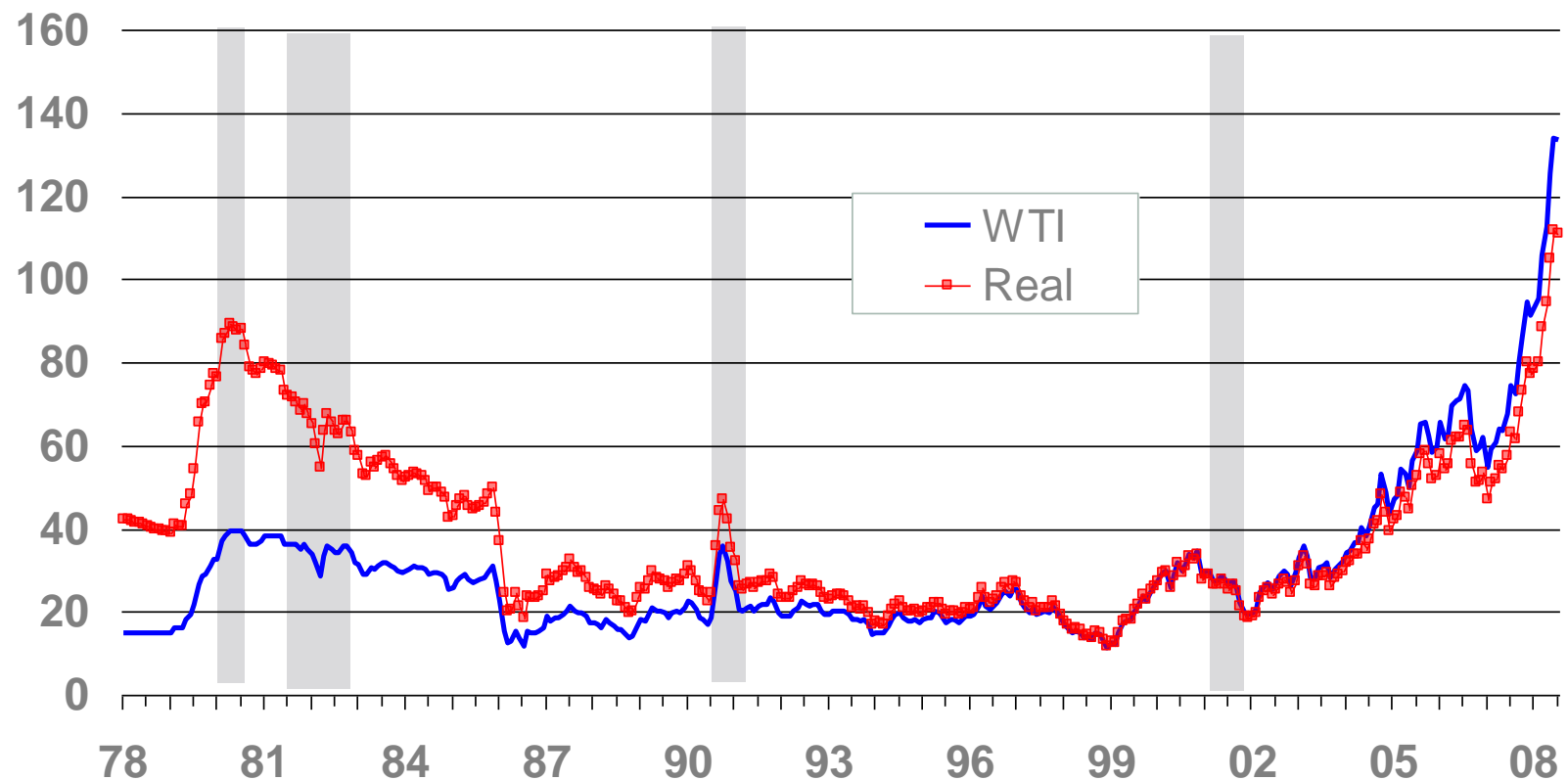
Sources: Swiss Re Economic Research & Consulting



Record high oil prices, even after-inflation

Recessions are shaded areas (US economy)

West Texas Intermediate, \$bbl, and real 2000 dollars, bbl

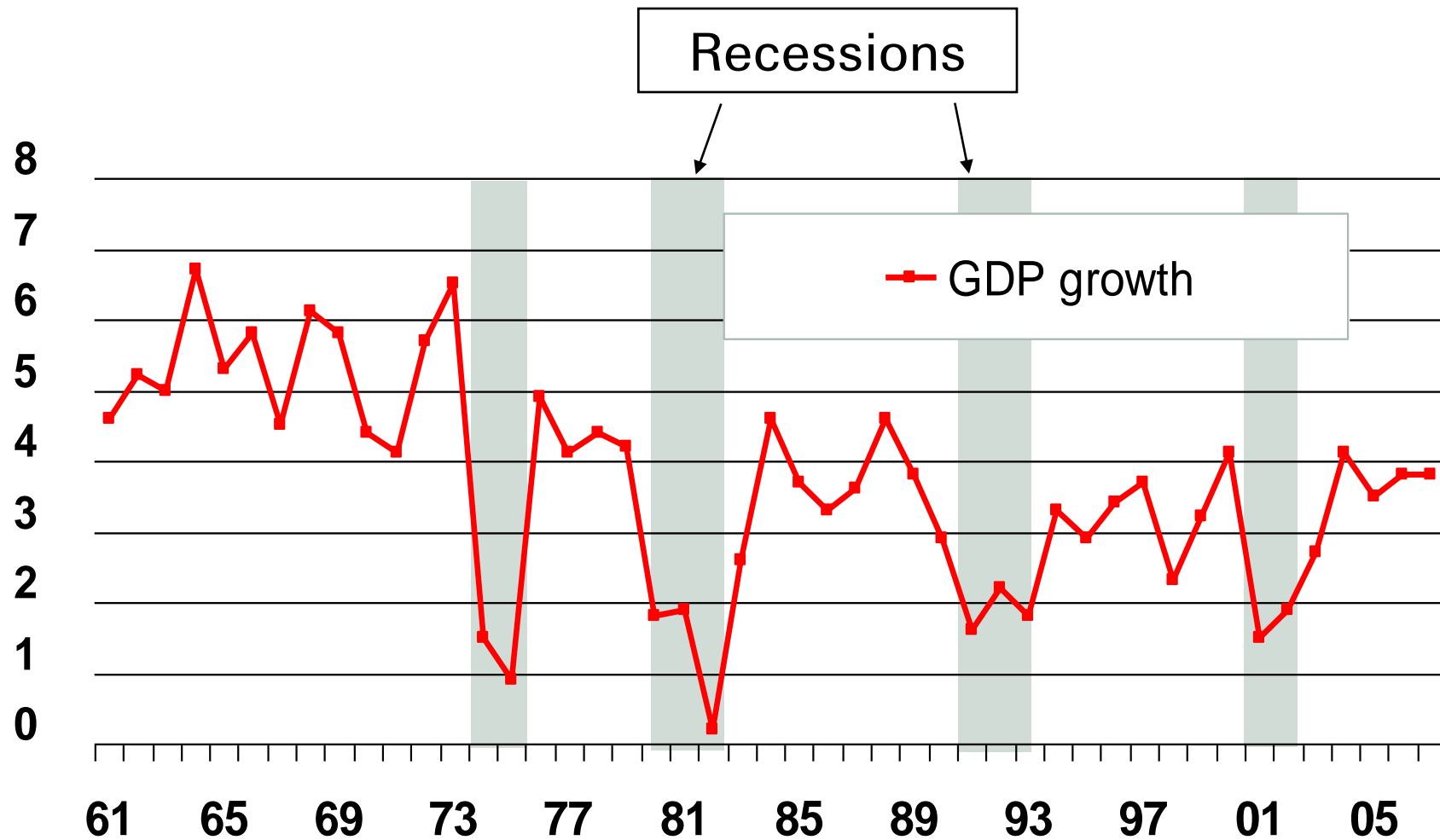


Source: Federal Reserve Bank of St. Louis, Bureau of Labor Statistics (BLS),
Note: WTI deflated by CPI index, excluding food and energy, to get real price



World GDP Growth

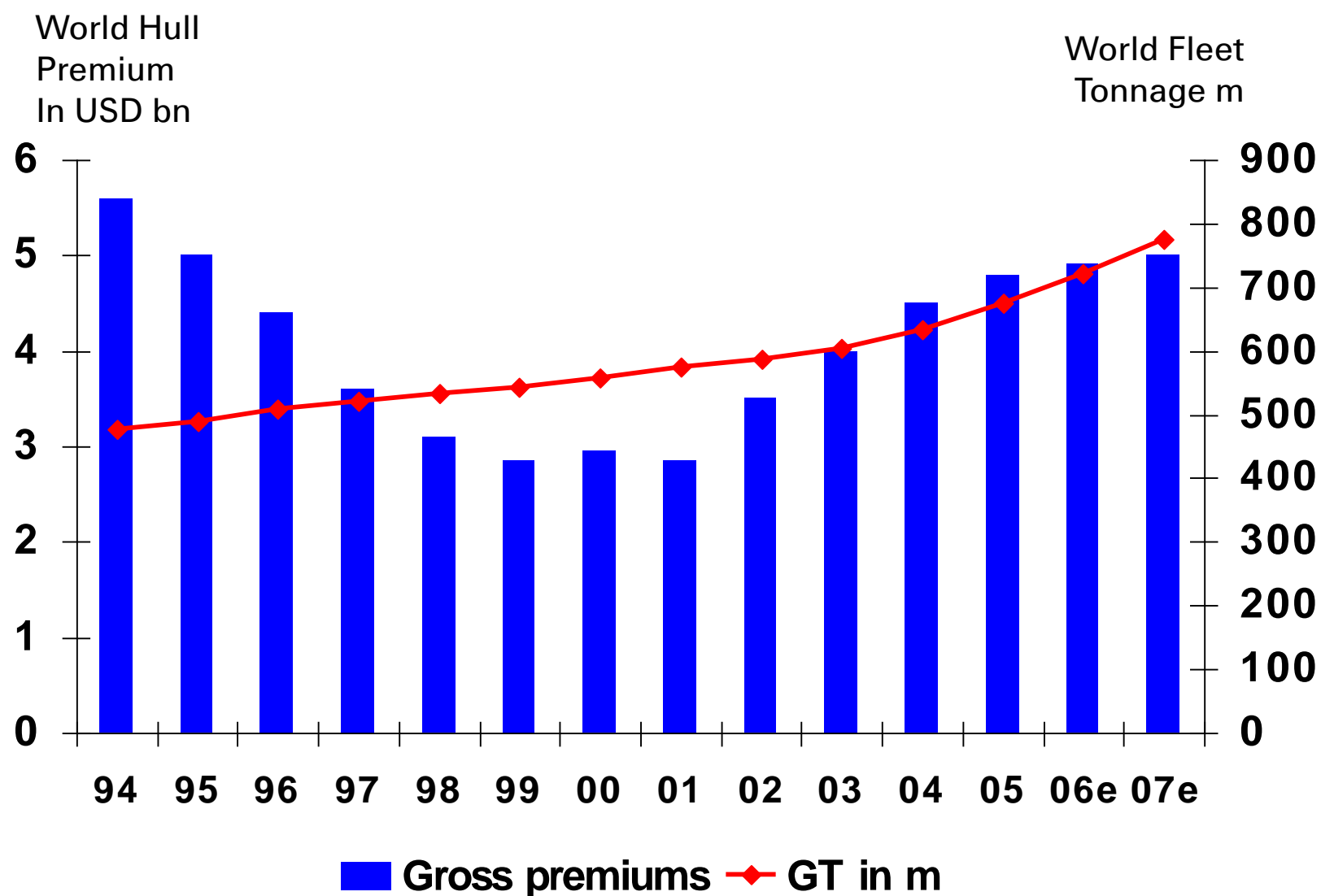
Recessions are
shaded areas
(Global economy)



Sources: World Bank, Swiss Re Economic Research & Consulting

Global Marine Insurance: Gross Premium Hull vs. World Gross Tonnage: Uncorrelated

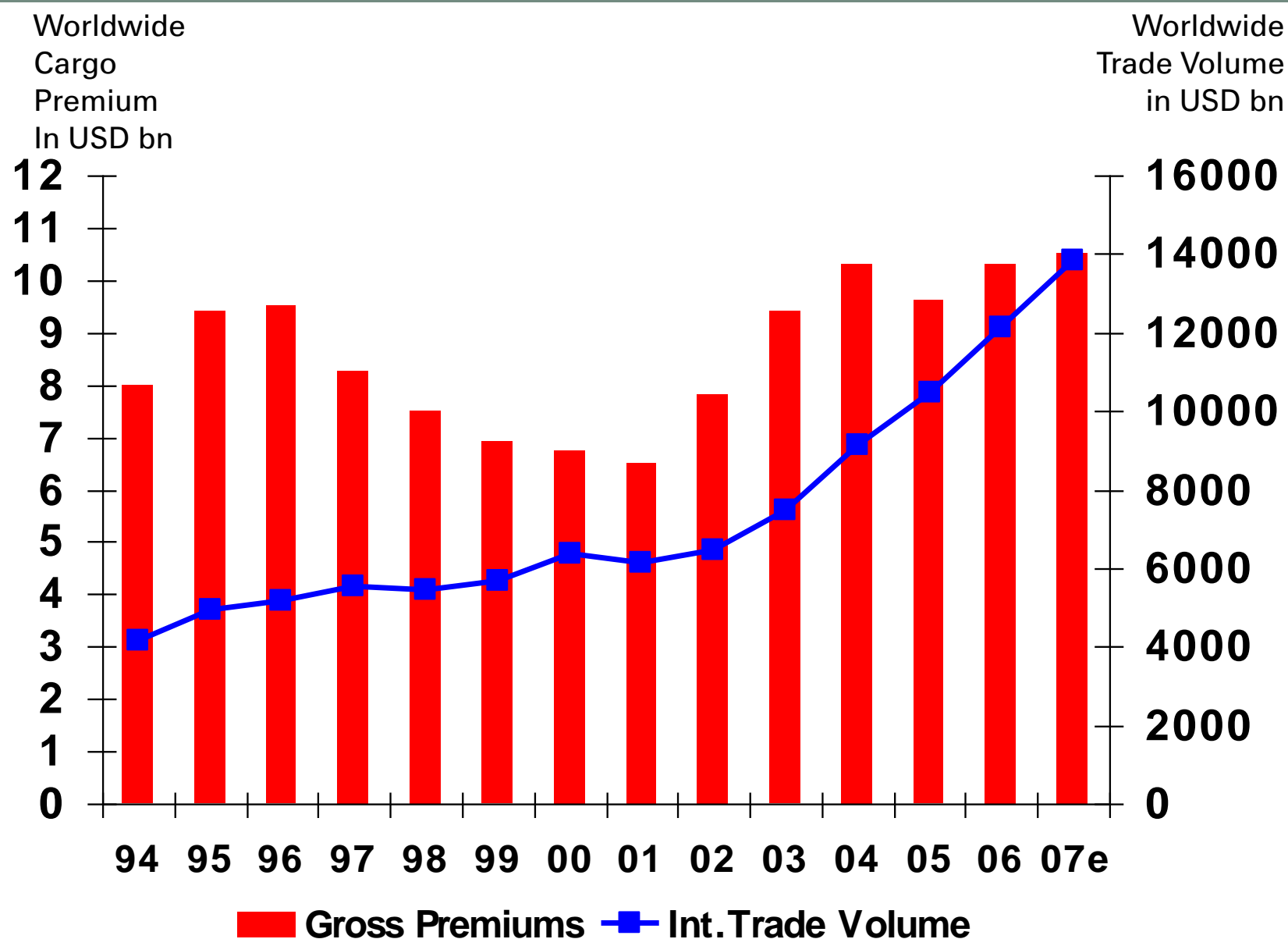
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Source: Lloyd's Register World Fleet Stats / IUMI / Cefor / Swiss Re estimate

Global Marine Insurance: Gross Premium Cargo vs. International Trade Volume

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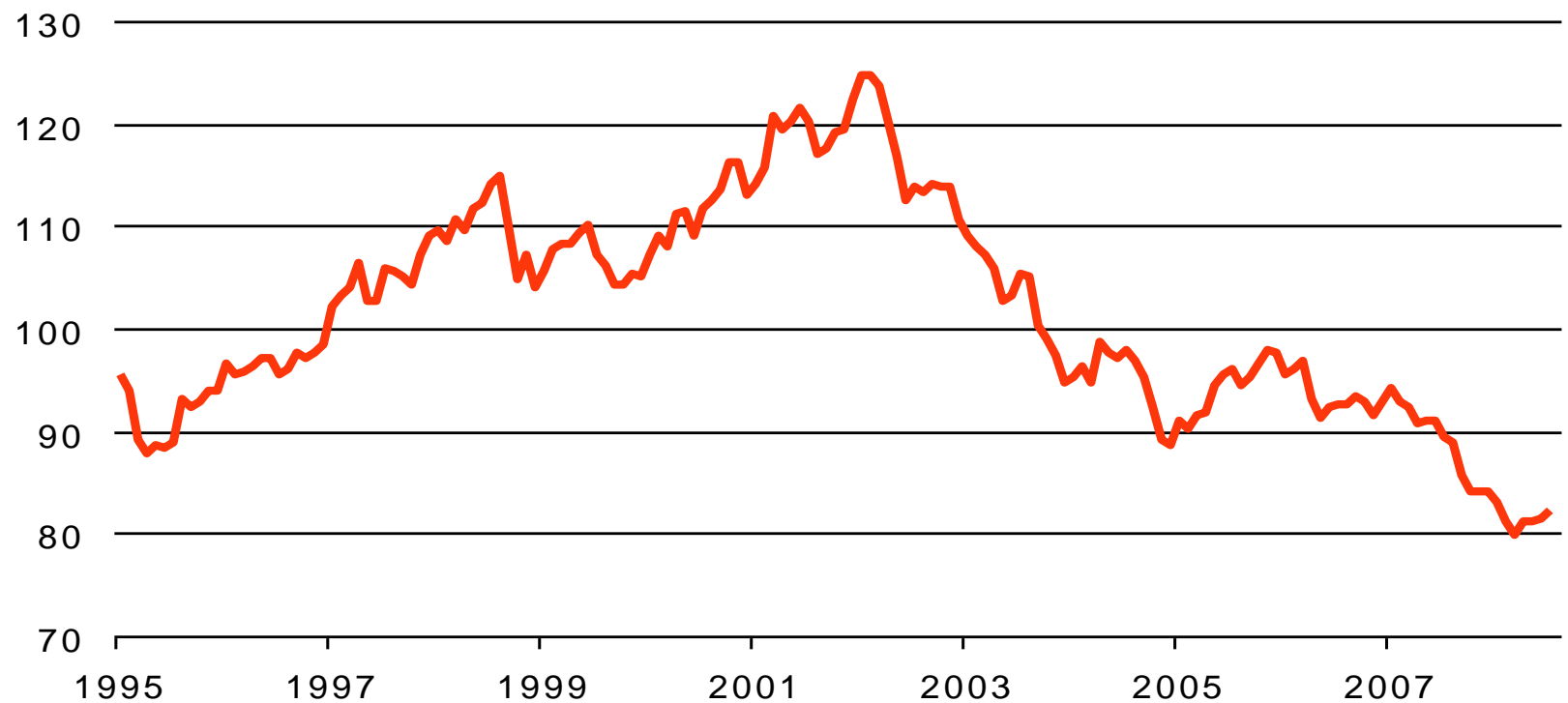


Source: Aon Ren Rep / IUMI / Cefor / SR est./World Bank



The US-dollar has depreciated, but appears to be stabilizing

USD nominal effective exchange rate

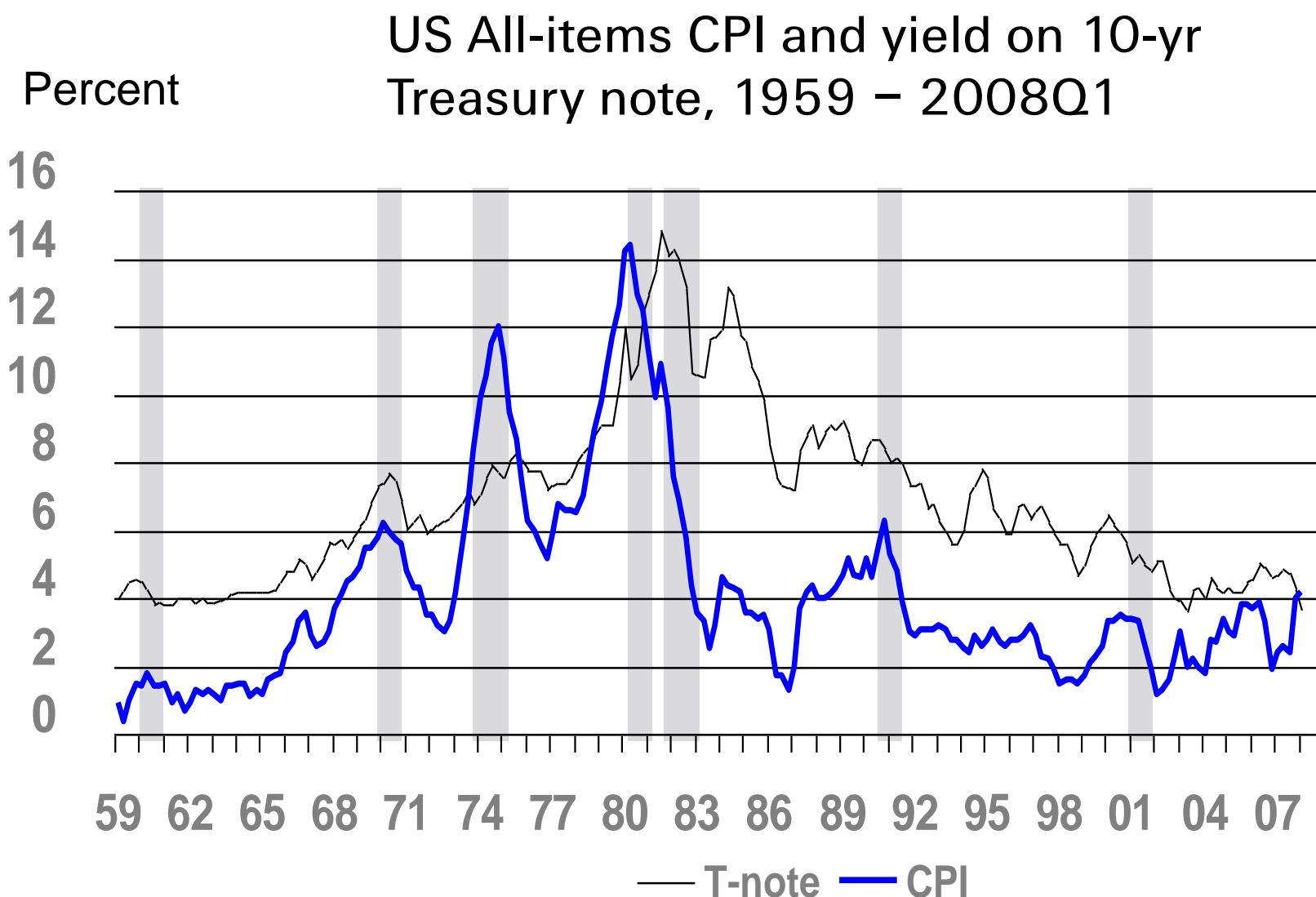


Source: Bloomberg



Inflation rises into a recession, then falls

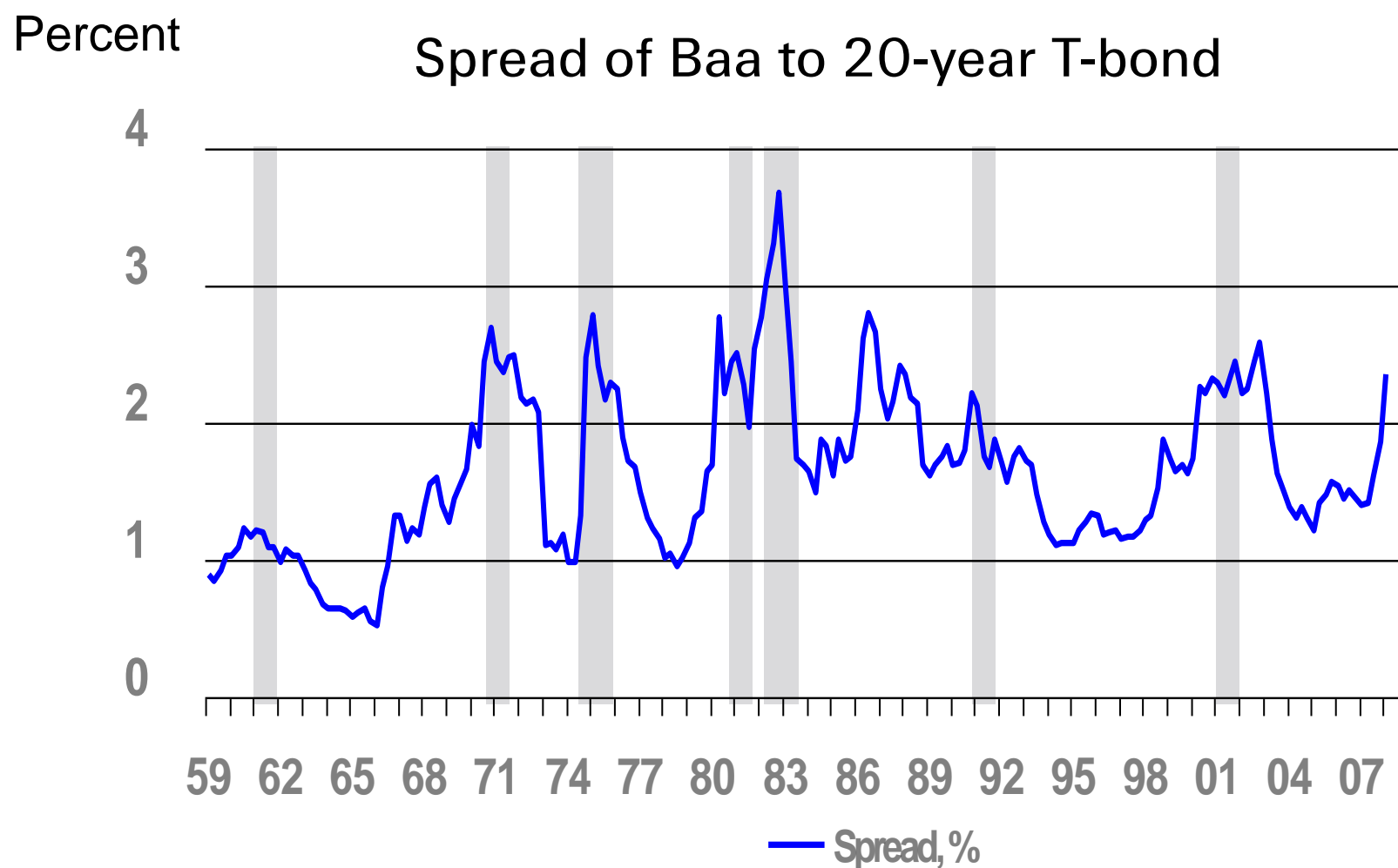
Inflation is
year-over-year
rate



Source: Bureau of Labor Statistics, NBER, SR Economic Research & Consulting



Credit spreads rise into, then fall after a recession



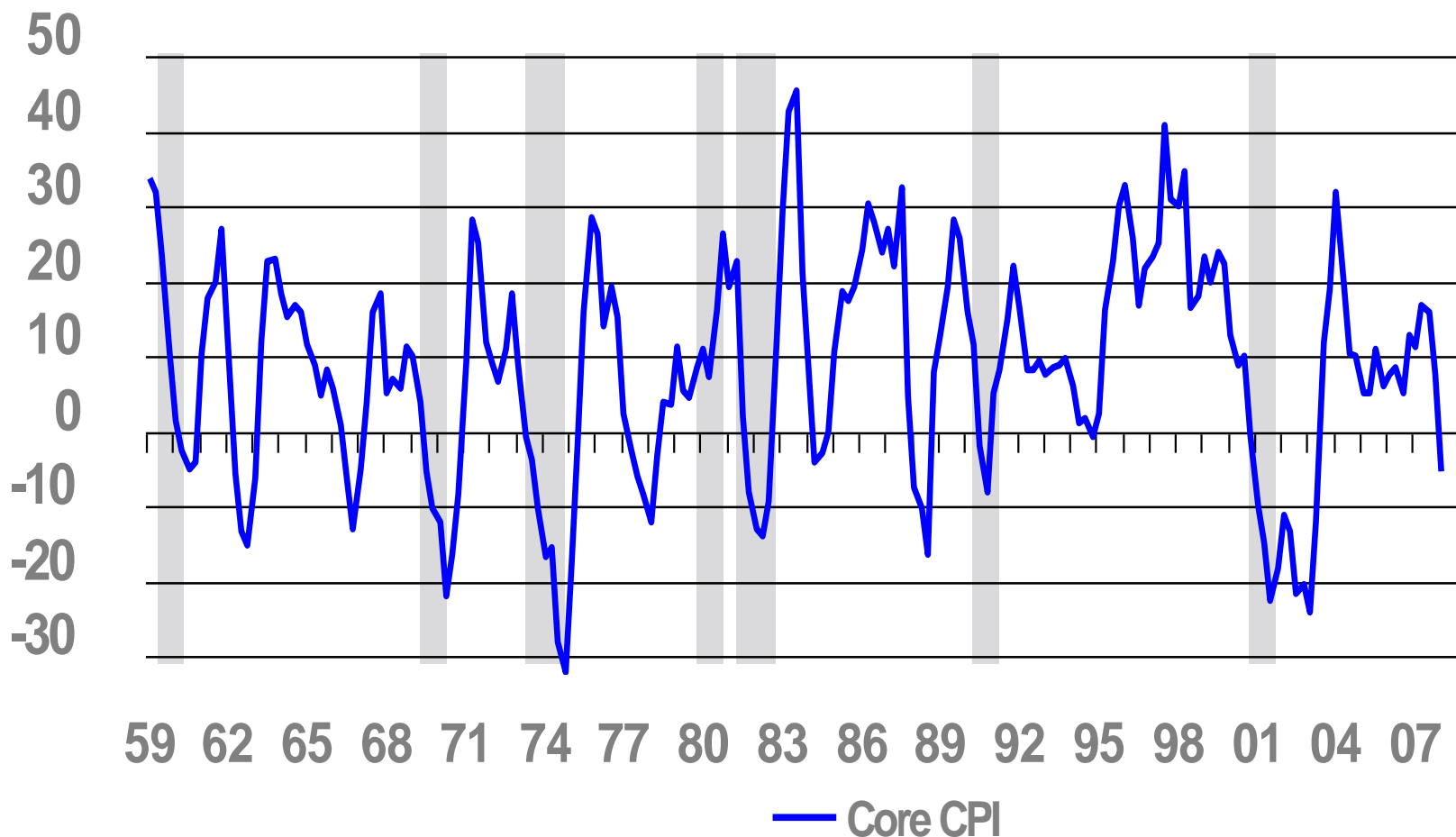
Source: Moody's, Federal Reserve Board, NBER, SR Economic Research & Consulting



Stock markets tend to decline in recessions

Year-over-year
growth, %

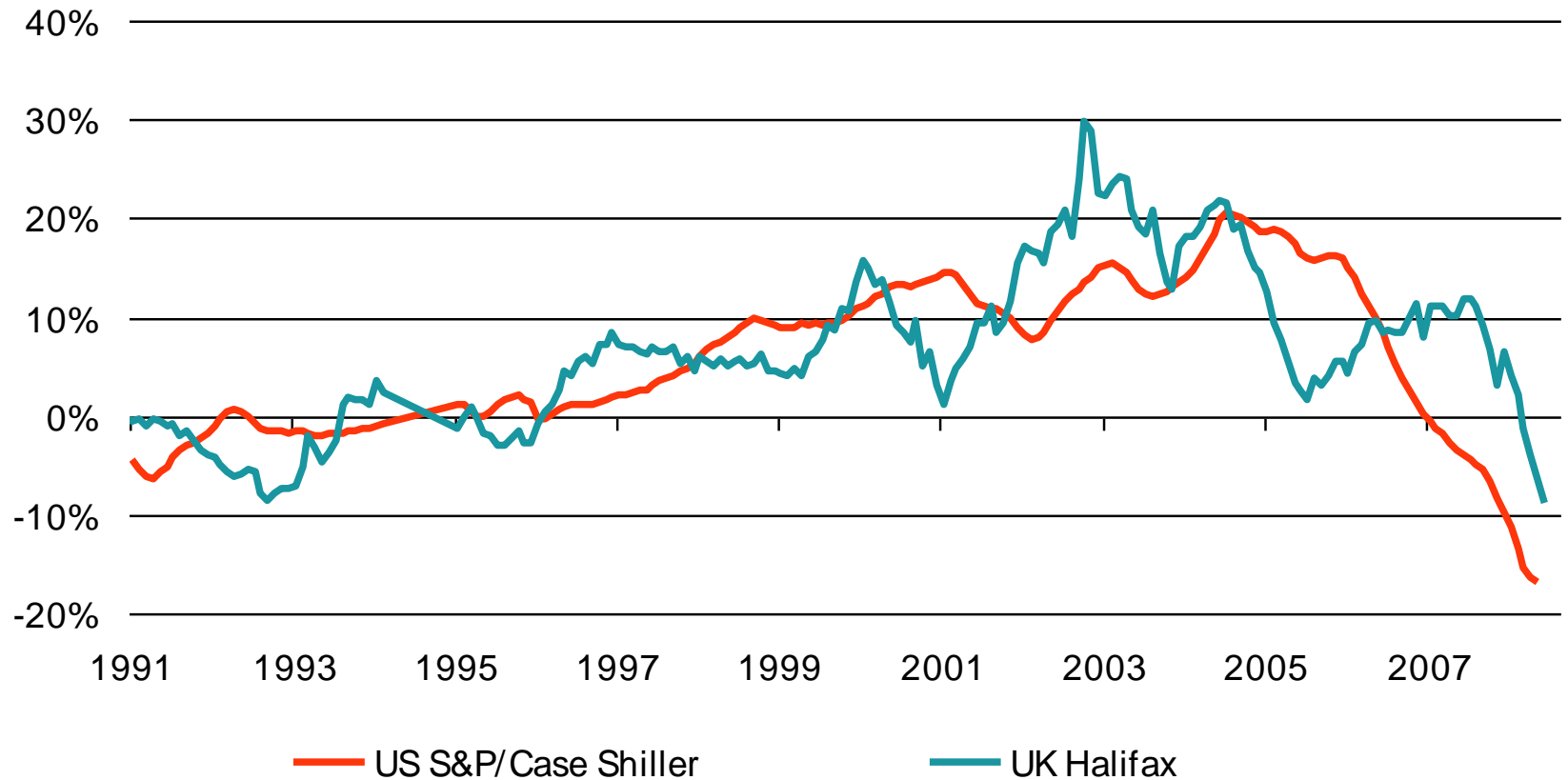
S&P 500 index



Source: Standard & Poor's, NBER, SR Economic Research & Consulting

US house prices are down around 5% year-on-year, UK house price inflation is falling

House prices, %-change year-on-year



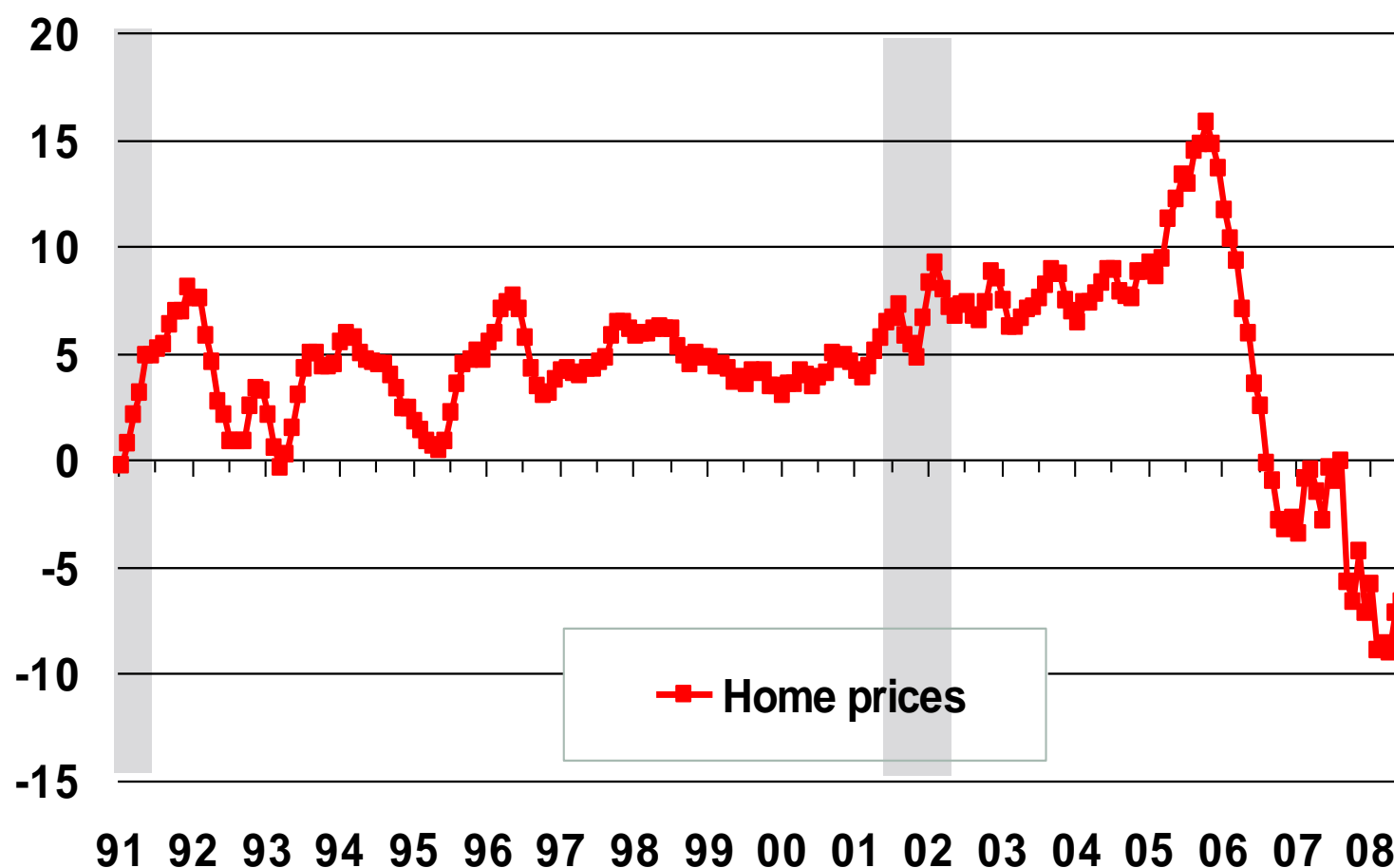
Source: Bloomberg



Housing prices: signs of a floor?

% change year ago,
3-month mov. avg.

Single-Family
Existing
homes sold,
median price



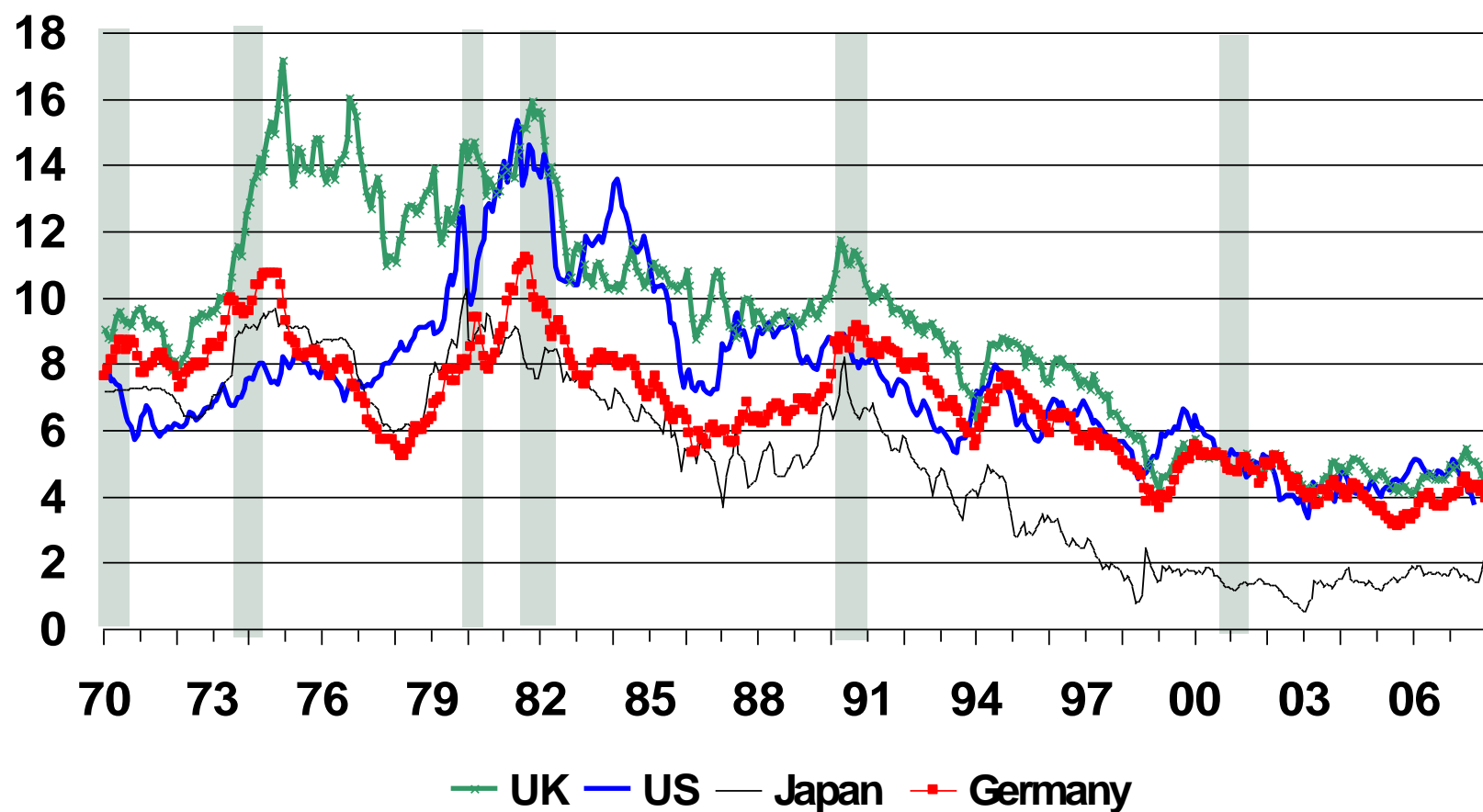
Source: National Association of Realtors



Long-term bond yields remain low

Government
bonds

10-year government bond yields, percent

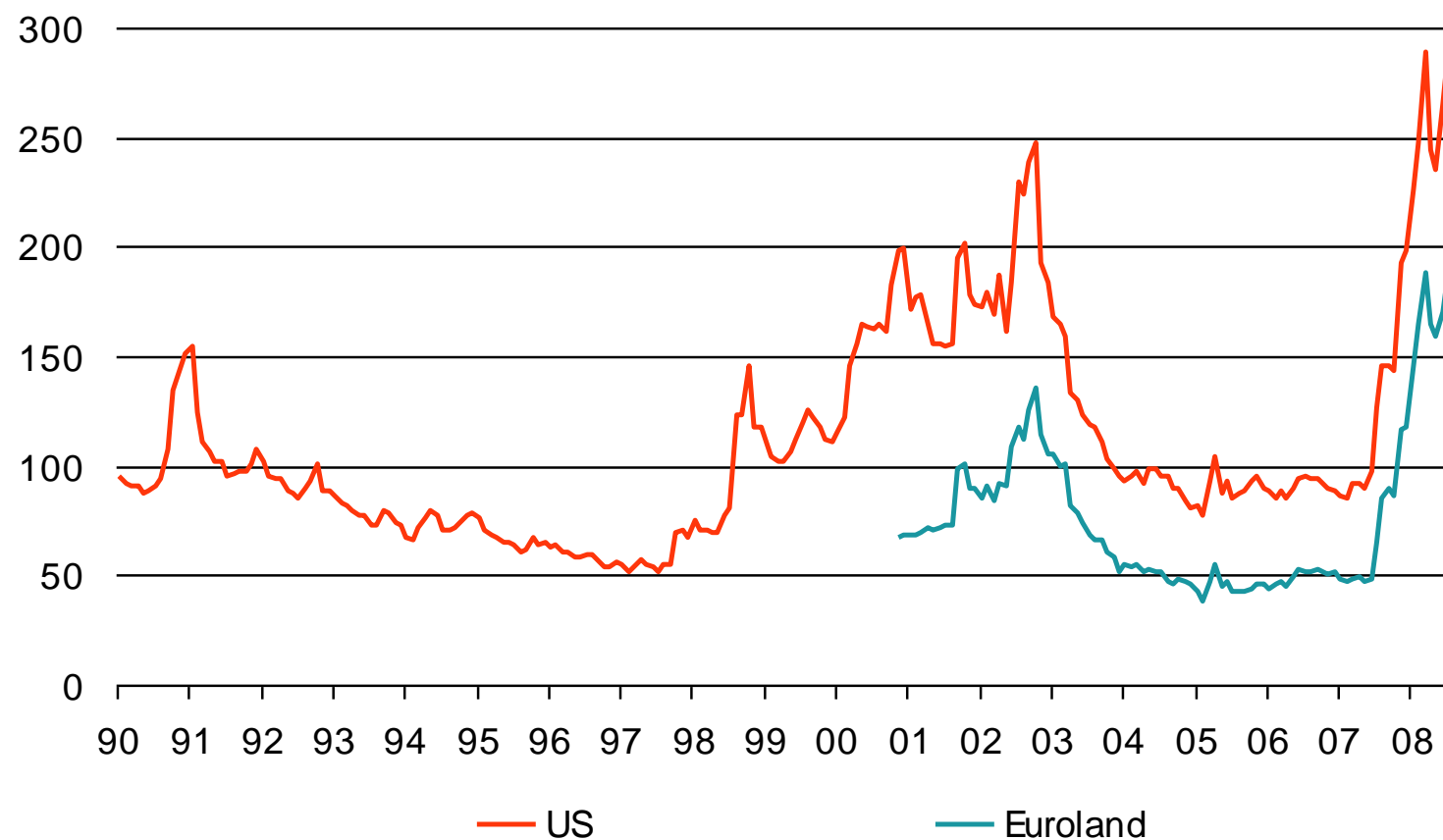


Source: Reuters EcoWin



Corporate bond credit spreads have surged

Corporate bond spreads (Investment grade, basis points, since 1989)



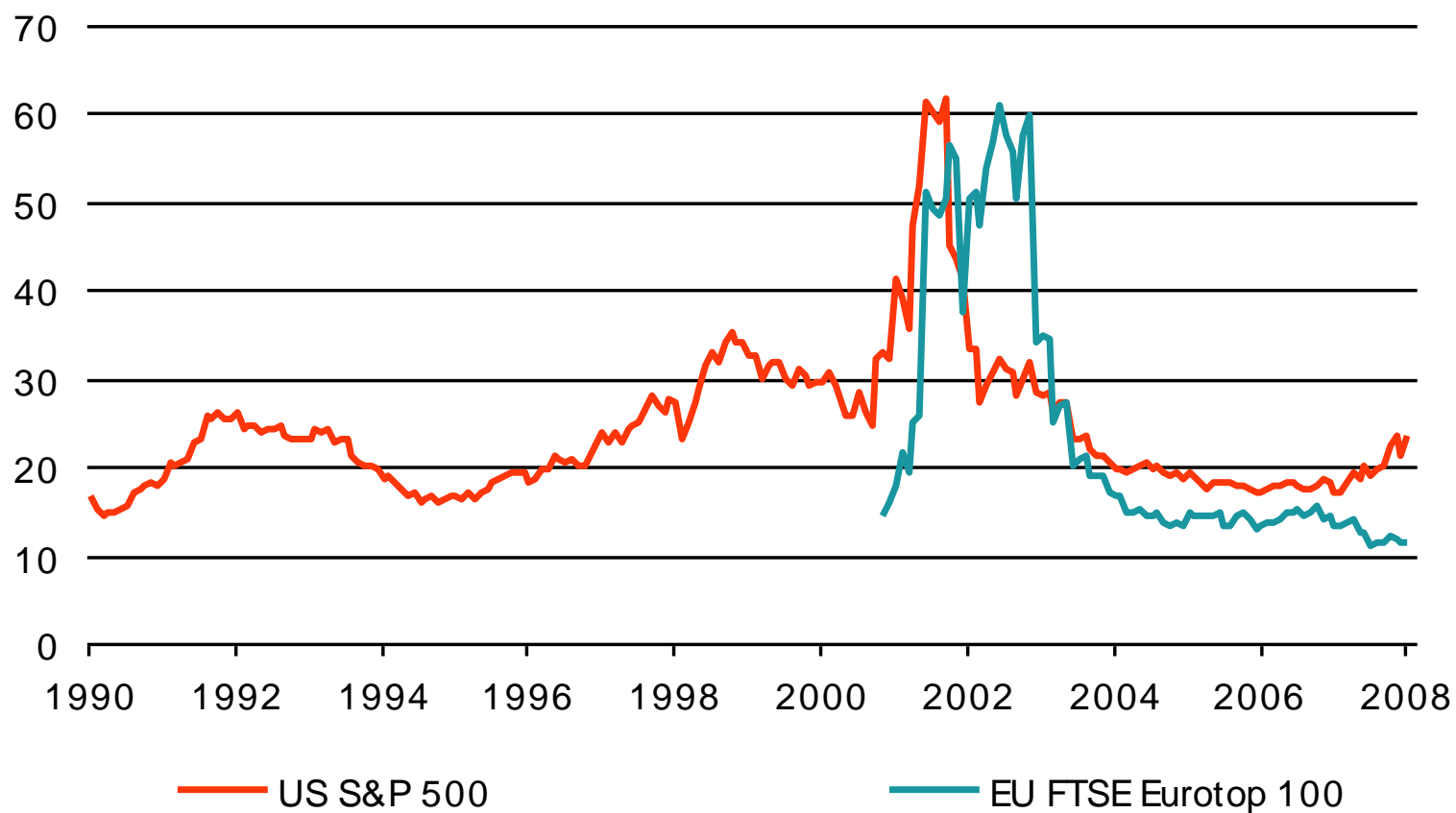
Source: Lehman Brothers



P/E Ratios remain relatively low

Equity
market
valuation

P/E Ratios



Source: Bloomberg



The P&C insurance industry posted solid results again in 2007

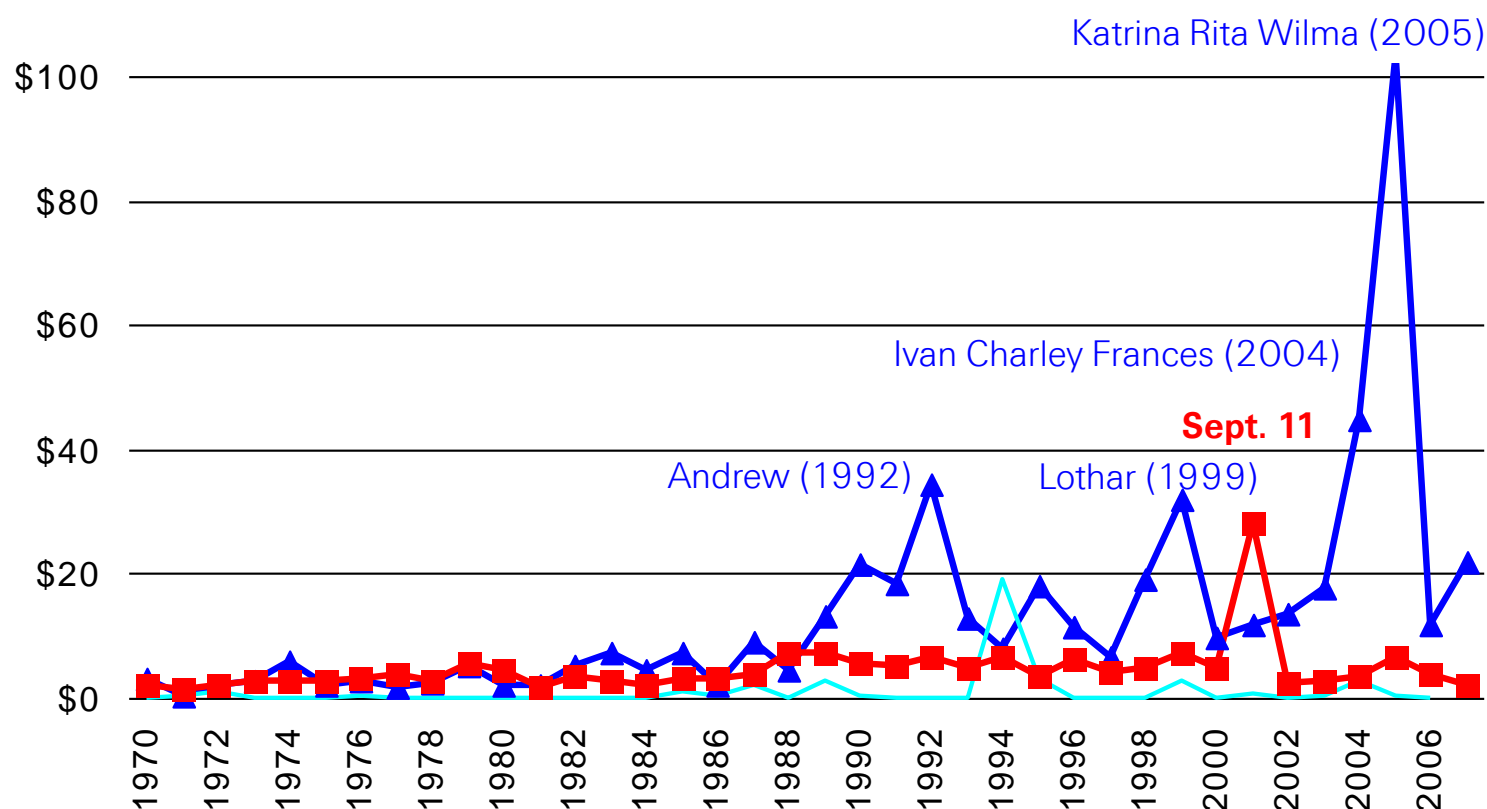
- Low cat years 2006 and 2007; strong earnings
- Rapid surplus growth, creating overcapacity
- Weak pricing across all lines
- Declining profitability; underwriting and investment results
- Reserves releases support earnings; when is the inflexion point?
- Negative premium growth
- Investment volatility, subprime crisis
- Active regulatory environment in Europe (Solvency II), and in US (election year)



Cat losses were relatively low in 2007/06, but long-term trend is up

Property and business interruption losses (USD billion, at 2006 prices)

▲ Weather-related Nat Cats ■ Man-made disasters — Earthquake/tsunami



Note: NFIP flood losses in US included (since 1970). Source: Swiss Re, *sigma* No 1/2008



Global P&C industry profitability peaked in 2006

Key performance indicators for major non-life insurance markets^[1]

	2004	2005	2006	2007E
Combined ratio	98%	98%	95%	97%
Investment yield ^[2]	4.2%	4.6%	4.1%	3.7%
ROE	11%	11%	12%	10%

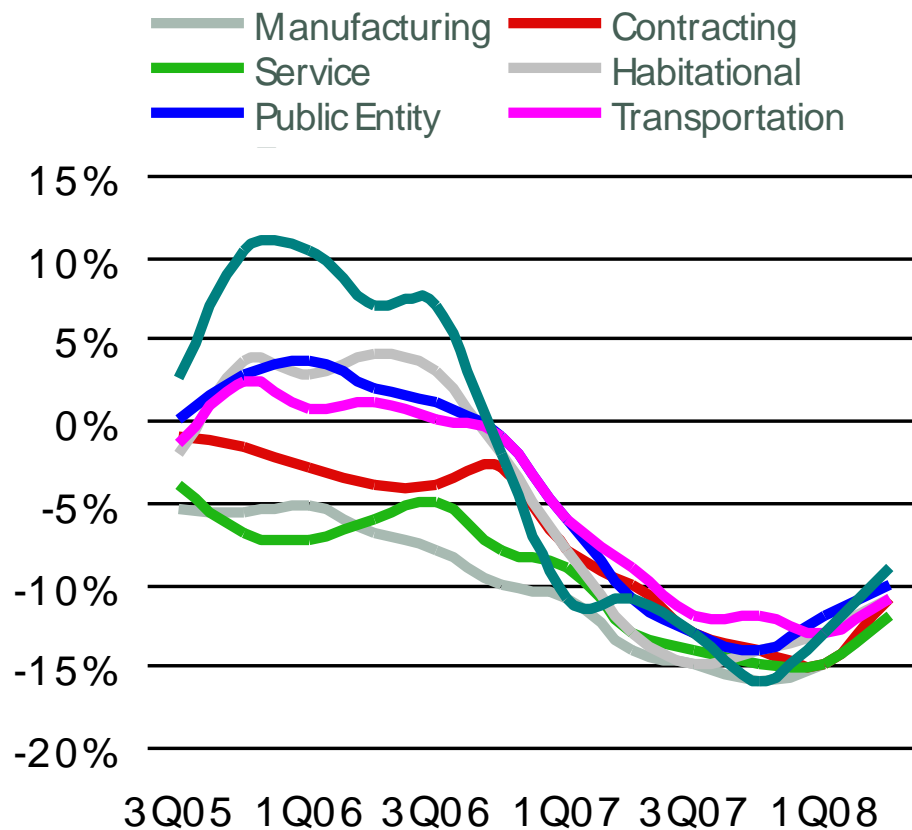
[1] Sample of major non-life insurance markets consists of Canada, Germany, France, UK, USA, and Japan

[2] including realized capital gains,

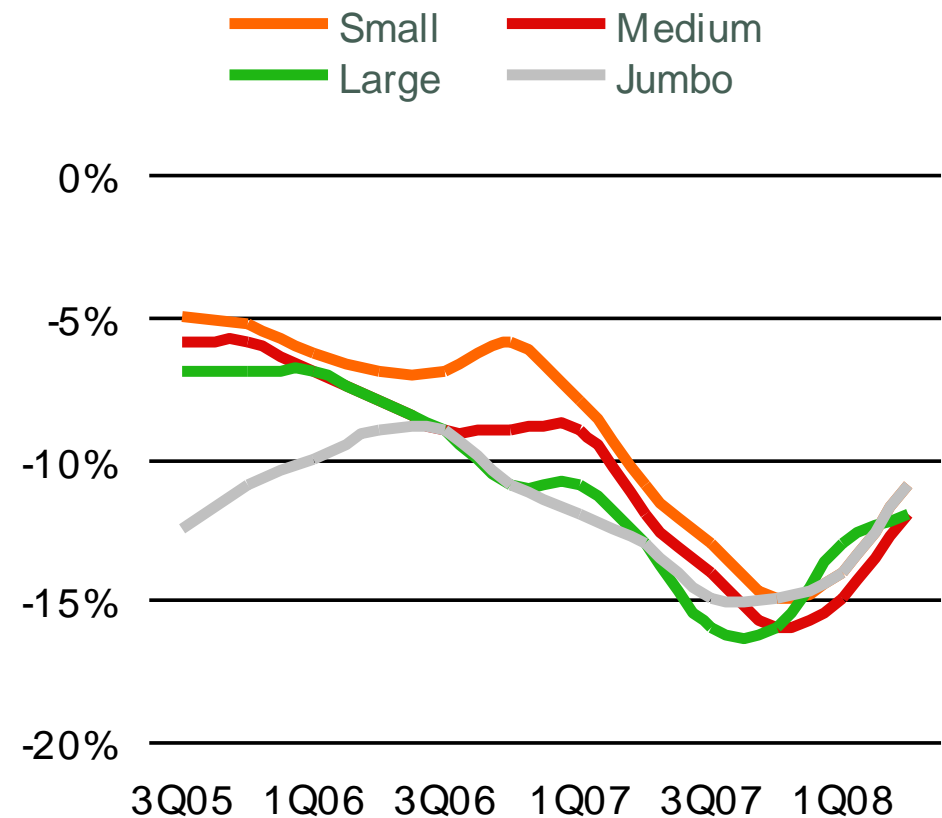
Sources: A.M. Best, forecasts by Swiss Re Economic Research & Consulting

US price trends are down and have converged between businesses, similar globally

Commercial rate trends by industry group



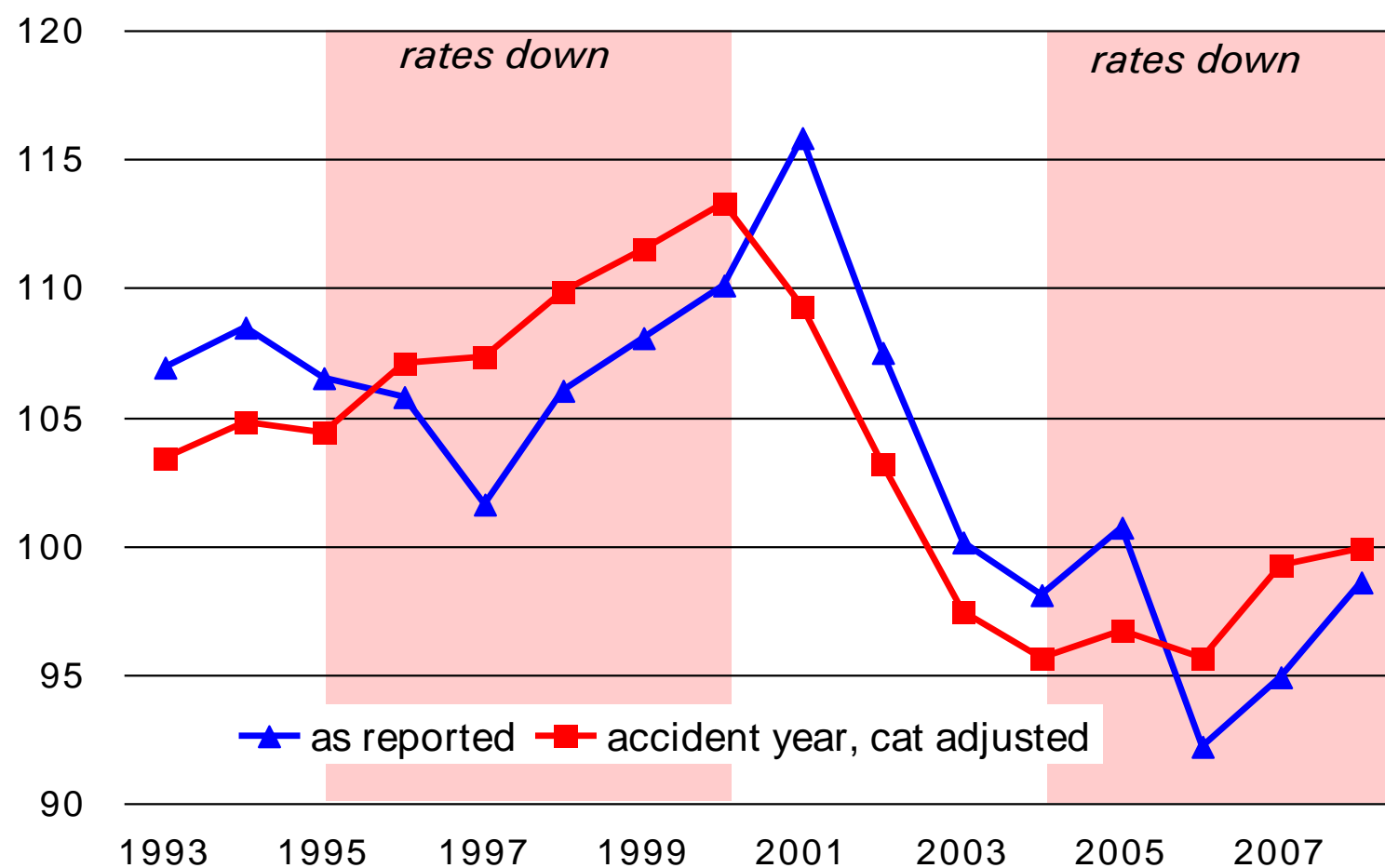
Commercial rate trends by client size





The late nineties faced the dire consequences of cumulative rate declines

US P&C industry combined ratios



Sources: A.M. Best, Economic Research & Consulting



Effects of the credit crisis on insurers

- Effects on insurance companies as investors
 - Subprime exposure, but this is manageable
 - Equity market volatility, spreads widen
 - Government bond yields remain low
- Effects on insurance companies as providers of insurance coverage
 - D&O/E&O insurance policies
 - Mortgage guaranty / Monoline financial guarantors
- Insurers face higher costs of capital
 - Prices for equity and hybrid capital have declined
 - Credit spreads widened
 - Leveraged capital is withdrawing from the insurance space



Inflation risks and insurers

- Inflation rising globally
- Risk
 - ▶ Oil, food and commodity prices rising
 - ▶ Steel prices up 200% since 2001
 - ▶ Weak USD boosts inflation in US and EMs with dollar-pegs
- Expectation: Inflation will moderate with global growth
 - ▶ Insurers long-tail lines could fare well under this scenario
- Risk: Severe recession scenario: elevated inflation, substantially higher short term rates (even Fed needs to raise rates), higher long-term rates and substantially lower stock markets and more defaults
 - ▶ Insurers' long-tail lines – not so well!
 - ▶ Insurers' assets – not so well either!
- Risk: Severe recession from worsening credit crisis



Industry trends require maintaining underwriting discipline

- Slow growth environment ahead
- Rates will be falling through 2008-09 resulting in deteriorating accident year loss ratios
- Frequency and severity of weather catastrophes will likely increase, compared to 2006 and 2007
- Favorable loss reserve contributions from prior years will shrink
- High volatility, low expected investment returns in all asset classes in the medium-term
- M&A can be expected to continue and possibly accelerate in 2008-09
- Disciplined underwriting, protecting earnings, and capital management are crucial, particularly with the low investment yields



Appendix: Global overview

		2006	2007	2008F	2009F
Real GDP growth					
	Euroland	2.9	2.6	1.3	0.6
	UK	2.9	3.1	1.3	0.4
	Japan	2.4	2.0	1.2	1.2
Inflation					
	Euroland	2.2	2.1	3.7	2.6
	UK	2.3	2.3	3.6	2.7
	Japan	0.2	0.1	1.2	1.0
Policy rates (eop)					
	Euroland	3.50	4.00	4.25	3.75
	UK	5.25	5.50	5.00	4.25
	Japan	0.28	0.46	0.50	1.25
Yields 10-yr govt bond					
	Euroland	3.9	4.3	4.2	4.1
	UK	4.7	4.5	4.5	4.4
	Japan	1.7	1.5	1.6	1.8

Sources: Swiss Re Economic Research & Consulting, mid-August forecast



Appendix: U.S. economic outlook

	2005	2006	2007	2008F	2009F
Annual Averages:					
Real GDP	3.1	2.9	2.2	1.3	1.0
CPI	3.4	3.2	2.9	4.7	2.4
End-of-Period:					
Fed Funds	4.25	5.25	4.25	2.00	3.5
10-yr T-note	4.4	4.7	4.0	3.8	4.2

Sources: Federal Reserve Board, Swiss Re Economic Research & Consulting



Questions?

To be put on the e-mail distribution list for Swiss Re's *US Economic Outlook*, or other country outlooks contact:

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