Swiss Re AG Chief Economist Media Briefing Call

Company Participants

- Alexa Winnik, Media Relations & Corporate Reporting Manager
- Jerome Jean Haegeli, Group Chief Economist
- Thomas Holzheu, Chief Economist of Americas

Other Participants

- Barbara Schurer, Founder and Editor
- Unidentified Participant, Analyst

Presentation

Alexa Winnik

I think we can begin. So everyone's ready. All right. So good morning, everybody. Welcome to this year's global insurance outlook. As some of you already know, I'm Alexa Winnik from the Media Relations department at Swiss Re. There's some familiar faces here and some new ones. But certainly, welcome to everybody that came this year.

Today, our group Chief Economist, Jerome Haegeli; as well as our Chief Economist, Americas, Thomas Holzheu, will be discussing both a review of the major trends in the sector as well as the macroeconomy for 2019. But also importantly, the outlook for the next couple of years. There will also be a publication of the sigma report as well as the press release and the presentation, all of which will be available online at noon today GMT and 1 p.m. Central Eastern Time.

Following the presentation, we'll have time for Q&A both in the room and also on the line. But if there any follow-up questions certainly after -- and you've been reviewing the materials, please don't hesitate to contact either me or the Media Relations department. And we'll certainly get back to you.

So I don't want to take up too much time now that we had the fire drill. Jerome, would you like to begin?

Jerome Jean Haegeli {BIO 15760032 <GO>}

Absolutely. So first of all, also a very, very warm welcome from my side. And I'm Jerome and (also) from Thomas, it's great that you found your way here today. And also about the topic that we have, 2020, 2021, there's a lot of very exciting things going on, both on the macro and insurance market front. And we would like to take maybe half an hour to walk you through the key highlights of our latest analysis and the outlook. I will go through the macro part, hand over then to the insurance perspective to Thomas. Then we also have a few key themes, really important themes for the insurance sector as well as potential market stability and architecture, which we're going to go with you at the end. And these are all covered also in the sigma reports, which, as Alexa just mentioned, will be released at 12 o'clock.

If I shift maybe to what is the magic number for 2020 and 2021, what is the magic number? Do remember, it's 2. And likely, unfortunately, below 2. What do we mean with that? We mean is that we expect below 2percentage growth in the U.S. for 2020 and 2021. As you will see shortly, this is below market consensus. And we have good reasons to believe that the growth will not increase as many people expect yet again. But that growth, again, will rather disappoint. One reason being trade war, for us, trade war is the #1 risk. And will remain the #1 risk. And it has had already major repercussions. We'll talk about that shortly.

2% is also very important for an insurance company because 2% also relates to how much you can earn on the interest rate front. If 10-year rates are going to be below 2% yet again, challenging for the savings industry, they're definitely challenging for the pension industry. I think challenging for financial markets. We are not saying that the global bull market has -- in rates is coming to an end. We have -- yes, we have lower interest rates. But we are close to the end. But we do not expect interest rates to increase. We do not forecast mean reversion yet again. And also on the interest rate front, as we see shortly, we are below consensus.

Two, I think if you also think about 2, where have we been two years ago? Well two years ago, if you looked at the IMF forecast, fact was global growth was accelerating in 2/3 of the economies that we track globally, that the IMF also tracks globally. Fact is, today, if you look at our forecast, if you look at other forecasts and the incoming data shows you 90% of the economies are decelerating. So risk are definitely upside rather than to the downside. Low for longer, that's our topic. And for the sigma outlook and in a low-for-longer environment, the key question also is how can we sustain resilience? And there, we are very positive on the insurance part -- that the insurance part has a lot to offer in supporting resilience.

Let's first talk about the global outlook into more depth. Global growth continues to slow, interest rates remain low for longer. Top #1 risk is the trade war and yes, 35% likelihood of a U.S. recession. Now 35%, that's 1 in 3. That also means, to be clear, it's not on our baseline that we have a U.S. recession. However, we see the risk also as being elevated. If you were to look at 35%, how does that compare historically? It's maybe about double the historic rate of recession. So definitely, we are late cycle. 35% is also nothing new. We have been expecting this figure is unchanged. We have had this expectation of 35% now since a while.

What do we monitor in order to coach how the 35% and how the recession likely is evolving? I think it's really important to look at both the global CapEx picture, the global capital expenditure picture. And you see that on the left-hand side, with traditional indicators, actual figures in blue and now costs, which are higher frequency, more big data-like capital expenditure data with orange. You see a sharp decline in capital expenditure, which has started in 2018. But you also see a somewhat stabilization, which is good news, which also means that we shouldn't be alarmed. And we shouldn't expect a recession. Nevertheless, there's higher risk.

There's a higher risk because of the -- what you see on the right-hand side. You see global purchasing manager indices for the manufacturing sector. And this is, again, global. It holds true very much for you, unfortunately, as we know. But it also holds true for the U.S. and to some extent, also to China. Purchase manager indices have come down really considerably. And you -- we can think about manufacturing sector globally to be in recession or at least in big parts of the world.

Key question is, is the service sector or sentiment in the service sector, is it catching the flu from the manufacturing side? You see part of it, it is also trending down, the orange line. Nevertheless, there's quite a big delta, big difference. So we are putting -- we are placing a lot of emphasis and watch very closely whether the troubles that we are seeing in the manufacturing sector is being spilled over to the service sector. We see some signs of it. But it's definitely premature to expect the service sector also to go into recessionary territory.

Where are we today? U.S. expansion -- U.S. expansion is 124 months old. That's a lot, 124. Now when I relate this to my children, 12 and 14, 124 months, it's longer than Instagram, right? Instagram didn't even exist when the expansion started. Now the expansion doesn't die out of old age, it doesn't. But our analysis also clearly shows, analysis that we have done previously, it's really important to have enough buffers, fiscal buffers and monetary buffers, to withstand the shock. And by definition, most of the time, shocks are unanticipated. And what we see is that on the monetary side, this was true not just for the U.S. but for the Europe and also for most economy. The monetary policy options are largely exhausted. And there's more options on the fiscal front, I will talk about that clearly shortly.

What is -- why business cycle doesn't die out of old age? Definitely, the uncertainty is the enemy of the business cycle and uncertainty, we don't know how Phase 1 of the trade war will look like. As the name says, Phase 1, there's likely to be a Phase 2, maybe Phase 3, maybe a Phase 4. The big question is enforcement rules. The big question is what's going to be next in terms of the U.S. and China trade war. And the elephant in the room remains knowledge transfer and intellectual property rights. And that's our own result. That's why we don't see an easy resolution of the trade war at all. And it remains hanging over in terms of the effect of -- on the global economy.

It's really interesting. If you look at the effect so far of the trade war, U.S., China, it has taken about a 1percentage hit globally for global growth and the direct effects are maybe 1/4 of it. And the rest, the indirect effect, is the effect of the uncertainty on the sentiment. And that means for us that as long as it's not resolved. And you don't know the end game, it's unresolved and uncertain. And the hit will remain in place.

But we also think, besides monitoring what's happening on the hard and soft macro fund with the global CapEx and sentiment in this, it's also really important to track the level of negative yields and also have an assessment, where are we going in terms of the extent of negative yield environments? Unfortunately, we have become used. This is a chart I don't like at all. We have been really used to see the upward revisions in terms of the amount of negative-yielding debt. Now at least we have seen new records at about $15 trillion, $16 trillion, even $17 trillion. Now it has come down to around $13 trillion. This is for the global amount of negative-yielding debt outstanding. And tax is at about 25% of all outstanding bond. We think that's very negative. 25% of all outstanding bonds have negative yields. That's negative for a number of reasons, we speak more about that shortly.

If you think about the amount of negative-yielding debt, it's not just the -- it's not just that it leads to asset price inflation on the equity market front. But it also leads to lower earnings on household savings. And it's not that EU households or pensioners need to save less because of asset price inflation on the equity market front. No, a lot on the contrary. And that's what we also see in the figures, we see in the figures that actually, the savings rate in the EU has gone up. So all that we are saying is the negative rates are negative, full stop. And it is back-firing, especially in Europe because in Europe we have a bank -- banking finance system. 80% of our loans are financed by the banking system. And the banking sector is under strain also because of negative-yield environment.

I think it's also interesting, if you look at the latest OECD studies, which shows that low-income groups have still not recovered fully off the financial crisis. And maybe the level of negative debt and the level of -- the low level of interest rates in Europe is making the situation much more difficult for low-income groups to recover from the financial market shock of 2008.

Last but not least, also interesting to note that I think even though we have this record level of interest rates globally, if you look at the interest rates that credit card companies in the U.S. charge. And the Federal Reserve is tracking these data (since) about 25 years, this year, the interest rate of credit card companies, on average, are at an all-time high: 17%. So again, this low interest rate environment that you would think should be seen all across the economy is not really feeding through the economy. And it's really difficult to get out of it. Monetary policy definitely is in a black hole and getting out of it will be a major, major challenge. We will speak about that shortly.

Maybe a little bit less abstract, let's see the forecast, point forecast. What are our point forecasts for growth and yields, bottom line and key message, they are below market consensus. Already, if you look back at our -- to ones who have been here in this room last year. And if you looked at our focus relative to consensus, already last year we were below consensus. And during 2019, right, consensus also came down considerably. And I think that our forecast beginning of the year has become more or less the kind of consensus.

It's a healthy economic backdrop for the U.S. at about 2.3% for this year. A number of factors, especially in the first half, helped this. Second half, much more difficult in the U.S. And more importantly, much more importantly, 2020, they expect the cooling off in the U.S. but also for the very difficult challenging environment in Europe. We have 1.6% for U.S. growth rate in our books. That compares to the consensus of 1.8% for next year and to the forecast of the IMF of 2.1%. For the Euro area, we are also a little bit below consensus at 0.9%, consensus being at 1.1%. And for China, more or less close to 6% at around 5.9%. You see it also with the charts where our forecasts are relative to consensus.

If you look at interest rate front, I think it's maybe even more interesting what's happening on the interest rates front. Who would have thought, year-to-date, we tried to track the number of interest rate cuts year-to-date. Year-to-date, we had 58 interest rate cuts. And beginning of the year, including us, we wouldn't have expected that the central banks make this policy U-turn. They have made a policy U-turn, a very significant one from quantitative tightening to quantitative easening. And they are staying on that course, even though we are close to the end. So 58 interest rate cuts. And there's a little bit more to come. We have still one more in our book from the Feds in Q1 2020.

How does it translate into the 10-year interest rate forecast, which is the forecast, which is more important, together with the activity forecast for insurance companies? We have 1.4% as our forecast for 10-year interest rates. And for -- in the U.S. and for the EU area minus 0.6%. Consensus is about 1.9% for 10-year interest rate in the U.S. and minus 0.4% for German bonds. So definitely, a very subdued and fragile environment which we are projecting.

Last words on Europe, then I talk about the risks. On Europe, if you look at globally, as you -- I mean at the aggregate euro area, fact is, half of Europe is stagnating or in a recession. You're going to get soon the latest newer area GDP growth figure. In our view, we see Germany being in a recession and the first country within the G7 context being in recession. So when you are saying 35% likelihood for a U.S. recession, we should also bear in mind that the U.S. is still a much more resilient economy than many other economies in a G7 context and especially relative to Europe, U.S. still looks much, much better.

I think key global theme is, if you look at our forecast then on macro and then on the insurance market front is that the pivot from the west to the east will continue. Again, we expect China to be the largest insurance market in 15 years' time or less. And we also expect that China's market within emerging market Asia for the insurance market front to be by far the most important marketplace. 60% of premiums in Asia is likely going to come from Asia. And you also see it at a more global level if you look at overall contribution, China already today, at least in GDP terms, in purchasing power terms, is much more important than the U.S. in terms of adding for growth. So these are pockets of growth, which we are also at Swiss Re looking for there in Asia and also more specifically in China.

Now point forecast is only interesting when you also relate them to what is the distribution around them and what is the risk. How does the risk landscape look like? U.S./Global recession, 35%. Mentioned that already. Why? Trade war. Trade war for us, #1 risk global economy. We attach a life of the brand, 30%. That is, again, escalate to such an extent that it becomes global. And global for us would be that the European auto sector, for example, is also going to be included. And already today, if you look at the effect of the U.S.-China trade war, it's much larger than what economies at large have expected. That's why we are pretty confident that, unfortunately, the soft patch that we have seen over the last few quarters is likely going to be a theme again for 2020.

Another downside risk factor definitely is also Central Bank policy error, not small at 20%. I think the risk of a Central Bank policy error is something we shouldn't forget. The question there is also if inflation may be returning -- is -- one thing is inflation on the asset prices, asset price inflation. The other thing is inflation on consumer prices. Are we underestimating? Is the Phillips curve suddenly nonlinear? It's not impossible. Then if inflation would be just a little bit more than expected, I'm definitely a big believer in the fact also the form of Central Bank group, that the central banks would adapt and change the course. And that would have major, major repercussions on assets and market prices.

So with this, maybe very quickly, a quick summary of our core macro views. Our core macro views, we think they are our loyal companions for the common years. What are they? Number one, that the lower negative rates are here to stay and they do more harm than good in Europe. More harm than good. It punishes the savers, it incentivize zombification. It makes it more difficult for companies to get the rate of bad debt because it makes it too easy to keep on bad debt on the books. And third -- and also -- that's also part of the research that we have done with London School of Economics, low rates doesn't incentivize structural reforms as data shows. And last but not least, I think it's really problematic having negative rates in Europe, given Europe is a banking -- is a banking base origination of credit. And it hurts the banking transmission channel.

Number two. Yes. If you look at our macro picture, it's not a super rosy one. Definitely, it isn't more fragile than the weak one. However, we shouldn't forget, bad macro doesn't mean bad markets. And we put it here in cursive. This is the case as long as inflation remains moderate. Our expectation is inflation will remain moderate. Nevertheless, there are pockets of increase in inflation pressure, wage inflation being one, medical inflation in the U.S. being the other.

Number three. Global economy, we see them -- we see the global economy as being less resilient than 2007 and 2008. And I think that's a very important assessment. Three factors: debt has increased, EUR 70 trillion; second, productivity -- productivity or economic trend growth is today lower by about 2percentage points; and number three, we have used a lot of monetary policy. And the very fact that we have such amount of negative-yielding debt. That's the fact that we have such amount of negative-yielding debt, we have used fiscal expansion. And we don't have economic trend growth back to its previous trajectory based on the global economy is less resilient.

You will see later on as a key theme, we also believe Europe is more at risk of (Japanification) than the U.S. And last but not least, U.S. yield curve is probably one depreciation away from negative territory. And what is next? We have to watch out also for helicopter money. But it will come at different form. And we'll talk about that later on.

With that, happy to pass over to Thomas. Thank you.

Thomas Holzheu {BIO 6899683 <GO>}

Yes. So thank you for setting the scene. And one of the goals of the annual outlook sigma is to show how the economic backdrop is shaping the outlook for the insurance industry. And so we have seen this increased macro risk and a picture of a slowing global economy. Against this backdrop, the insurance outlook is actually -- it's stable. So this is good news, adding to resilience. And that relates to growth, to profitability of the insurance. And we'll go into detail here.

So it's a busy slide, at first glance. And to make it easy, we've put up these -- the candy dots so instead of throwing numbers at you. Let's look at the imagery and the colors. So we expect growth to be steady somewhere around trend. And that applies to life and to non-life. And if we go through this chart here with the numbers, the data for non-life on the top. So we do expect that premium growth is somewhere around 3% looking forward. That is where it is right now, estimates for 2019. And that is also where we have been for the last couple of years. But it's -- the competition is a bit different. So where we have -- what we see right now, the trend is that in mature economies and in the U.S., we actually see some additional growth impetus from hardening commercial rates. And so there's a bit of a tailwind there. On the other hand, there are headwinds from -- on -- with regards to profitability from rising claims inflation.

So if we look at the sideways outlook for premium growth, you see a green dot here for the -- in terms of underwriting profitability. And this is relative to the past couple of years. And 2 reasons there. As I mentioned, some rate improvement on the commercial side. And -- but then also, we had severe cat losses in prior years. And we don't expect this going forward. So the first half of 2019, the cat loss burden for property for nat cat was about average. We did see, though, in the second half, a couple of tropical cyclones in Asia and also the wildfire losses will probably push the claims burden up a little bit for the remainder of the year. But going forward, we would expect a more -- obviously, an average cat loss burden. We cannot predict catastrophes beyond that. And we had a heavy burden in 2017 and 2016 as a benchmark, for example.

On the investment side, we see the outlook. There's obviously, as Jerome mentioned, the impact of low interest rates, which are the key driver of investment returns for insurance companies, mostly invested in fixed income instruments. We had so far a relative good year on -- year-to-date in 2019 if we look at GAAP returns because there were capital gains that show up there and boosted the reported, at least in GAAP accounting reported returns.

Going forward, low interest rates are a challenge. And that's non-life. Then also, of course, for life industry, insurers invest their own money, they invest -- life insurers invest money for their policyholders and returns are tied into that. So a bit of a mix of competition, the green for underwriting results. We see a yellow-orange for -- on the investment side. So the mix is at sideways on the profitability against this backdrop of the slowdown in the global economy. Then on the life side, we see premium growth to pick up compared to past years and move more towards trend growth. And that will be somewhere closer to 3% on a global basis.

And I will go a little bit more into detail for our 2 sectors: non-life and life, how this adds up and how this shapes up on a -- in a regional view globally. So if we -- if you look at the left side of this chart here, which shows growth rates for non-life. The outlook, these are the solid bars, about 3%, which is pretty much close to where we have been or where the estimates of 2019 to be but then also close to the average of the past couple of years. If you look at the composition, the storyline of tuning into what Jerome outlined before, is very much a story of continued very strong growth in Asia. And we see this here, these are the -- in this chart, the bars on the right side, strong growth, expect somewhere around 9% here. And in terms of future growth. And China and India are very strong contributors to this growth story.

In mature economies, we expect lower growth. We have -- and so this is slightly below 2%. And this is all real terms so inflation-adjusted. And so we have a positive impact, as I mentioned, from stronger rates in commercial lines. But this is only part of the markets, it's not happening in personal lines. And it's very much focused, or a strong push comes here out of the U.S. and doesn't translate in the same way in all other regions. So we have the story of stronger growth for the -- for Asian -- for emerging markets but particularly coming out of Asia and China being the main contributor of additional growth.

And if you look at the right side of this chart, this story very much holds through also for the life side. And so while we have a little bit of a stronger forecast here in the overall numbers, we have, at the moment, the mature economies in 2019 are expected to almost stall, just 0.5% of real growth. And we expect very slow, below 2% growth going forward and a very solid, on the other hand, 8% to 9% growth coming out of the emerging markets. And China, much, much higher than that, over 11% going forward. So we have particularly a strong demand there coming out of critical illness types of products. But then also in the non-life pockets, we have private health insurance in China is a big pocket of demand. And this is also what some -- next topic that we write up or that chat on that -- in that segment.

And that -- we're getting to the special topics. And I'm handing back to Jerome to cover the first one.

Jerome Jean Haegeli {BIO 15760032 <GO>}

So very, very quickly. But maybe most importantly, key themes, what are the key themes that we think are important for the insurance industry and for the environment we operate in? We talked about them a little bit already, negative interest rates, number one. Number two, what about Japanification? Is it what we see in Japan happening more globally? If yes, where? And where should be more concerned about? And what does it mean for the insurance industry? Then also, how would it -- how would the recession -- what are the recession dynamics for the insurance company? And (there) conventional wisdom is not the good guidance. Thomas will speak about that.

Well on the first theme, negative rates are negative and here to stay. We mentioned it already. Just wanted to maybe highlight 2 points. Number one, if you look at the graph on the left-hand side, this shows you the life -- this shows you the life insurance situation in one axis. The Y-axis shows the duration mismatch. Duration mismatch, how much long liabilities than asset from a duration perspective. And the X-axis shows the spread between the guaranteed rate of return and investments. And the red circle, that's not a nice circle. These are where -- these are the jurisdictions and the marketplace where it's more problematic. Very fact is Germany definitely stands out with a duration gap of about 13 years, meaning their liabilities on average 13 years longer than the asset space and also has a quite large spread between what is being guaranteed policy holds and what they earn on an investment front.

This has been happening now for a while, for quite a long while. And if you look at our forecast, the interest rate front doesn't -- we don't have the expectation that this goes away anytime soon. This may be the situation in some places of -- in Europe, which is more of a concern. But it's not just in Europe, there's also some places in Asia. On the other hand. And this is the graph on the right-hand side, if you look at the overall duration from benchmark indices, be it the U.S. Treasury Benchmark index, or the Euro-area dominated the sovereign benchmark, the very fact is that these instruments that are out there in the marketplace, it's not just being held by insurance company or pension funds, it's also being held by mutual funds, they have become much, much, much longer in terms of duration.

Now average duration is about almost nine years of a euro sovereign bond. And that has increased from about six years in 2008, 2009. What does it mean? It means that if it were suddenly to have a sharp rise, a sudden sharp rise, increase interest rates, let's say, of around 100 basis points according to our calculations for total return investors and the marketplace at large, it would lead to very significant mark-to-market losses, at least accounting losses in the order of around $1.2 trillion. And that -- if you compare that in stock prime prices, it definitely is a large and direct cost of U.S. stock prime prices. And it means it's big. It also means, in case it would have a sharp increase in interest rates, probably it was something more temporary, which leads us support in our thinking that low interest rates is also a theme to stay with us for longer.

Helicopter money likely come in different shapes and likely a next recession. We think a fiscal expansion can be positive. It doesn't have to be all negative, it can be positive if it's used for increasing sustainable infrastructure or also green investment. The whole idea of expanding on the fiscal front, it is important that it leads to an increase in productivity growth. So far, we have missed seeing spending in the right place. That's why we are engaged in policy discussion and also engaged in how actually our framework we operate it where it could -- would best look like we would want to see more infrastructure investment, sustained infrastructure investment and also green finance or green sustainable investments.

Helicopter money could have different shapes, probably, at some point, haircuts in Central Bank-held debt is not unimaginable and is probably even more likely, we think, number one. Number three (sic) (Number two) is coordinated QE and fiscal expansion as well as haircuts in Central Bank-held debt could come at some point, especially in Europe, not today, not tomorrow but at the next crisis. Why? Because monetary policy buffer is exhausted. We have gone beyond the limit, especially in Europe and Dutch front.

I won't spend too much on that slide. It's very packed and colorful, it's 30 years of economic history in one slide. So I'll leave it up to you. We can probably chat later on. I just wanted to highlight 2 things. What we highlight in bold as the key macro parameters is often overlooked: labor productivity, real GDP per capital (sic) (capita). These are important macro pictures and often overlooked. Japan doesn't do badly. Actually, it does quite well on the labor productivity front. It also does quite well on real GDP per capital (sic) (capita) in the G3 -- in the context compared to the U.S. and to the Eurozone if you look at the various time horizons.

If you look at GDP growth, per se, yes, GP growth, per se, is much lower. And we have the economic construction. And we have deflation here. We believe, however, it's much more important, again, to track productivity and to have policy outcomes, which is -- has improved labor productivity and has improved real GDP per capita income growth levels. Our -- in our assessment also, Europe is much more at risk to face Japanification. Towards the downside, Japanification is probably not even the worst case for Europe, right? Because Europe could dream of having the labor productivity and the real GDP per capita income that Japan has.

So yes, we think Japanification are important lessons to be drawn. Also important lessons to be drawn, if you think about what insurance markets have been doing over the last 20, 30 years, what have they done very shortly? Asset allocation funds increased illiquid instruments. They also increased much their exposure to foreign assets, you see it 25% in foreign security, 2018. 1990, it was about half, 13%. And this is also trends that we expect we're going to see more European insurance landscape.

Second, the product mix switched to unit-linked products reduced insurers' investment risk. If you looked again at the negative spreads in Germany and other places, all something which I would expect to continue happening, especially in Europe. And industry structure, the consolidation, M&A activity, I think we can also expect more on that front. And last but not the least, expansion to overseas markets. Fact is Japan is the second-largest insurance market in terms of M&A activity. They have good reasons because they need to look for growth somewhere else. I think global companies, they are going to increasingly look for growth in emerging markets, like us looking for growth also in Asia.

With this most important topic at the end is Thomas, recession scenario. Thank you.

Thomas Holzheu {BIO 6899683 <GO>}

All right. Thanks. So Jerome mentioned before, we have a probability of 35% for a U.S. or a global recession within the next year. And so the question is what does it mean for insurance industry? And there's a couple of transmission mechanisms how insurance industry is affected. So first, on the investment side, all insurance companies would lose from investments -- on the investment side and from lower interest rates going forward. Then there is an impact on demand, demand would be (no more) growth. Premium growth would be more moderate due to slower exposure growth, lower incomes due to weak labor markets and so on. And there are certain lines of business that are more affected like trade-credit, or marine transports types of lines that are more tied into the economy. And particularly if you have a trade war scenario that triggers this recession, then this marine-related or export-related lines of business would be affected even more.

But then there are also -- for non-life insurers, there are impacts on the claims cost side. And that's quite interesting. So there is an impact on frequency. And we showed it here on the right side in the graph. Credit and surety will be affected. And for example, through more insolvency during a recession, you will have more claims on that side. And the (D&O) lines might actually also be affected through more securities fraud class actions that relates to stock market meltdowns.

But the other that we showed that on the left-side chart, is a very interesting story. And that relates to the claims severity. And we see that for a lot of lines of business, particularly casualty lines, recessions will actually result in an easing of claims escalation. And so there is disinflation that follows -- or it is a result of slack in an economy during recession will actually benefit these lines of business through a lower claims severity going forward. So this is an important counter-effect benefit that will also play out through a couple of years. And this is what this chart on the left side shows, this is the combined ratio. And we see the dotted line is the beginning of a recession. And so we see these are 2 relevant U.S. recessions from the past. And we saw a run-up of claims inflation or combined ratios before the recession and then for a couple of years, a disinflationary benefit on the claims side.

And how would this translate to the current picture of profitability? So last year, we did an exercise where we looked at (other) estimates. What is the profitability level of the non-life industry worldwide if we iron out some of one-off items? And we had this -- if you look at these bars here, this is the profitability gap. We see that 6% to 9% of premium are missing just to achieve a 10% target ROE in most of these markets, largest insurance markets, North America, Europe and Japan. That's if we -- so if we take out unusual cat losses and reserve releases and so on. And so this is the -- shows the weak situation of profitability at this point.

Now if we have a recession scenario. And we assume that interest rates drop further. And we assume here a 50 basis point drop across these markets, realistic at the current low interest rate environment, we will see that another 1% to 1.5% of premium profitability gap would widen -- would open up more as a result of this. Then there would be some offsetting benefit from what I mentioned in the prior slide, the story of the -- of disinflation, which is -- would be a slow-moving benefit that will play out a little bit over time.

So this is additional stress from the investment side. We don't think that this would be a moderate recession, it would pressure profitability. We don't think this would be a capital event in that respect. There are benefits on the claims side. But then there's also -- and that's something we have -- there are worries or concerns about what we call social inflation and noneconomic rises of claims through the changes in the legal system. And that's something that's playing out in the U.S., particularly in the moment. And we also mentioned this separately in the sigma. And there is also a slide in the appendix to cover this.

With that, let's do the wrap-up and hand back to Jerome.

Jerome Jean Haegeli {BIO 15760032 <GO>}

Thank you. We'll wrap up very briefly. And we have a good 10 minutes for Q&A. Number one, global growth low for longer. Below consensus growth forecast. Interest rate forecast, likewise, below 2%, 1.4% ten-year rate in the U.S. and 2020 economic growth, about 1.6%. Second, insurance market premium remains at trench growth, thanks also to Asia on the power of the economies and the strength of Jones market in Asia. So it is a good story for insurance markets looking ahead. And point number three, if you think about the key themes that have been with us over the last few years, they will remain also next few years as well.

Just an indication, (it's) important to watch and watch and also get the right lessons. It will mean for insurance companies more overseas investments, more growth overseas, especially for a European investor. And in terms of negative rates, negative rates are going to stay with us and probably the level of negative-yielding debt is the lower amount that we can expect going forward. And last but not least, if you think about our U.S. recession likelihood, 35%, what does it mean for insurance company? As Thomas just explained, at least for the non-life sector P&C side, it doesn't have to be as negative as one might think. It might actually even have some upside at least from a profitability point of view.

That's it from our side. In terms of the outlook, I know we took a little bit, maybe longer than we usually take. But we had a lot to say, a lot is happening. And yes, more than happy to open up for Q&A.

Alexa Winnik

And just a quick -- just a quick note. For those in the room, we'll start with those in the room and you, in particular. Just make sure the mic is on because we want to make sure that those on the line can hear your question. And of course, the response to the question, first.

Jerome Jean Haegeli {BIO 15760032 <GO>}

Alexa, in terms of time, we still have 10 minutes? Is that...

Alexa Winnik

Yes. We still have 10 minutes. So make sure to press the button before you go. Okay.

Questions And Answers

Q - Unidentified Participant

I haven't heard the B word at all. Why is that? Brexit.

A - Jerome Jean Haegeli {BIO 15760032 <GO>}

(inaudible) (Your question was)?

Q - Unidentified Participant

I haven't heard the word Brexit mentioned at all. Why is that? Is that not a concern at all?

A - Jerome Jean Haegeli {BIO 15760032 <GO>}

Well it -- for me and for us from an economic point of view, the way we look at U.K. and the Brexit, less of a concern, why? Because they have dragged on for a long time, meaning you see negative effects already on the U.K. economy of the tracked-on process. That's number one also. Number two, if you think about the timeline, it (all) went flat, Brexit, in terms of -- and it's all drawn out as a process, that you see Swiss Re but also many other insurance companies having taken actions already. So if you look at how Swiss Re is positioned in terms of Brexit, we have taken actions to be well positioned for a worst-case scenario. Why? Because U.K. is a super important and strategically important (new) market for us. And there's no luxury for inaction on that front.

Now, is Brexit a global systemic risk? I think much less so than I would have judged it would be one year ago because it's drawing out. And it allows policymakers to make preparations, even for a worst case. So not having mentioned Brexit doesn't mean that the likelihood of a hard Brexit is nil or is very low. It doesn't mean -- but it rather means that it wouldn't be a top 3 from our front in terms of the global markets and global financial market stability because it's so well drawn out.

Q - Barbara Schurer

Barbara Schurer, Lime Street Publications. But I'm as well member of Lloyd's, still one of the few names left. My question is on interest rates. And that is, what do you think is the new normal? Is the present one new normal? And if you said we get back to 5% as an average, when -- when and how would that be achieved?

A - Jerome Jean Haegeli {BIO 15760032 <GO>}

I do think, from my perspective, yes, what we see today is a new normal, which it doesn't mean it's a good normal. It's not. The interest rates globally are depressed. They have been artificially depressed. And we at Swiss Re, in our research, we have been quite outspoken on that in the past and on the record. I don't believe we're going to go back anytime soon to 5% interest rate levels. It will take decades to get back to 5% interest rate levels. I don't think it's likely because we cannot digest 5% interest rates. If you would have, if we were -- if you were to know that 5% is possible as an interest rate environment next year, just think about the amount of debt which is outstanding, $70 trillion increase in global debt since 2008.

Now if the interest rates you were to pay maybe 5% and not 2% or lower, just think about, in terms of mathematics, it would lead to major insolvencies and bankruptcies. I don't think we are -- we can digest it. That's maybe the financial market explanation. The economic explanation is if you were to return to 5% interest rate level, that also were to mean that the level of natural interest rates or the level of productivity were to be much higher. And we don't see it in the numbers either. So I don't -- bottom line, I don't think that we are going to go out any time soon from the low -- from the lower interest rate environment. Now if end year is going to be 1.4% or 1.6%, I think difference there is not so important but likely going to be below 2%. That's our key outlook and (our -- look, our -- that's our) core view. Thank you.

Q - Unidentified Participant

(Mark Kagan). Don't have a publication at the moment. But (inaudible) space. You mentioned social inflation at the end. Obviously, big story for all of us at the moment is there was an event at Insurance Insider last week that Stephen Catlins (sic) (Stephen Catlin) mentioned a potential $100 billion to $200 billion casualty reserving deficiency. So I wonder what is your view on that potential claim or that as a potential shock to industry profitability going forward?

A - Thomas Holzheu {BIO 6899683 <GO>}

Yes. I mean I don't want to second-guess or comment directly on this specific number. We -- it's clear that social inflation, we see a higher frequency of large claims of this nuclear verdicts and the -- this will have a potential impact on some of the -- of prior-year business claims.

It is not widespread through all lines of business. So I think it's important, it's not all casualty lines are equally affected from that. So this is large commercial, large corporations that are particularly under stress here on this focus. So it is a worry. There's -- reserves might be deficient coming from that. But there are other factors that play a role as well as these economic factors. So we don't have our own quantification for that. It's -- I think it's the uncertainty around these trends are so large that it's probably not prudent to do this at this point and come up with a specific number. But it's a risk to watch out for.

A - Alexa Winnik

I think we have time for one more question in the room. You were raising your hand?

Q - Unidentified Participant

(Arthur Macey), Swiss publication in (inaudible). When I look at your economic projection for the U.K.. So you have slightly different view than the consensus and the IMF. So in 2019, you have -- you predict a stronger growth and from 2020 and beyond, slower growth. Why is that?

A - Jerome Jean Haegeli {BIO 15760032 <GO>}

So we have in U.K., right, you have 1.3% in terms of growth, consensus 1.2%, 1.2%. I wouldn't make much for 2019 and then for 2020, a little bit low. In terms of our difference with 2020, it's a little bit relating also how we view the U.S.-China trade war in terms of global growth. The very part that we don't have certainty what's going to happen on Brexit. And thanks for having asked before, right? Don't know when it's going to happen, which form it's going to happen.

These indirect effects are often even larger than the direct effect, Brexit and on top of global trade war, that's why we have a U.K. growth being lower than consensus and especially also lower than the IMF. The very fact that the global growth is being impacted 4 or 5x more by the indirect effects than the direct effects of the trade war tariffs, I think, is telling. And it's something which aren't going to go away 2020. Yes. Thank you.

A - Alexa Winnik

Okay. So if anyone has a question to follow-up, as I mentioned, please feel free to e-mail me. I mean many of you have my email address. But if you don't, also you can e-mail media relations, we'll make sure to get those answers to you as soon as possible. It seems we don't have any questions on the webcast, which is a blessing because it is actually noon right now. Or -- yes, it's 11, noon. (See, my computer's still on, very nice). So it hasn't gone on 2 hours. So many thanks to everybody for coming. And for those that are doing some interviews afterwards, let's go out there. And then I'll slowly bring you to the room to do the interview with Jerome. Thank you.

A - Jerome Jean Haegeli {BIO 15760032 <GO>}

Many thanks. (And thank you to you all).

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call. And thank you for participating in the conference. You may now disconnect your lines. Goodbye.