Economic environment and insurance industry

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SECULAR STAGNATION: LOW GROWTH, INFLATION AND INTEREST RATES

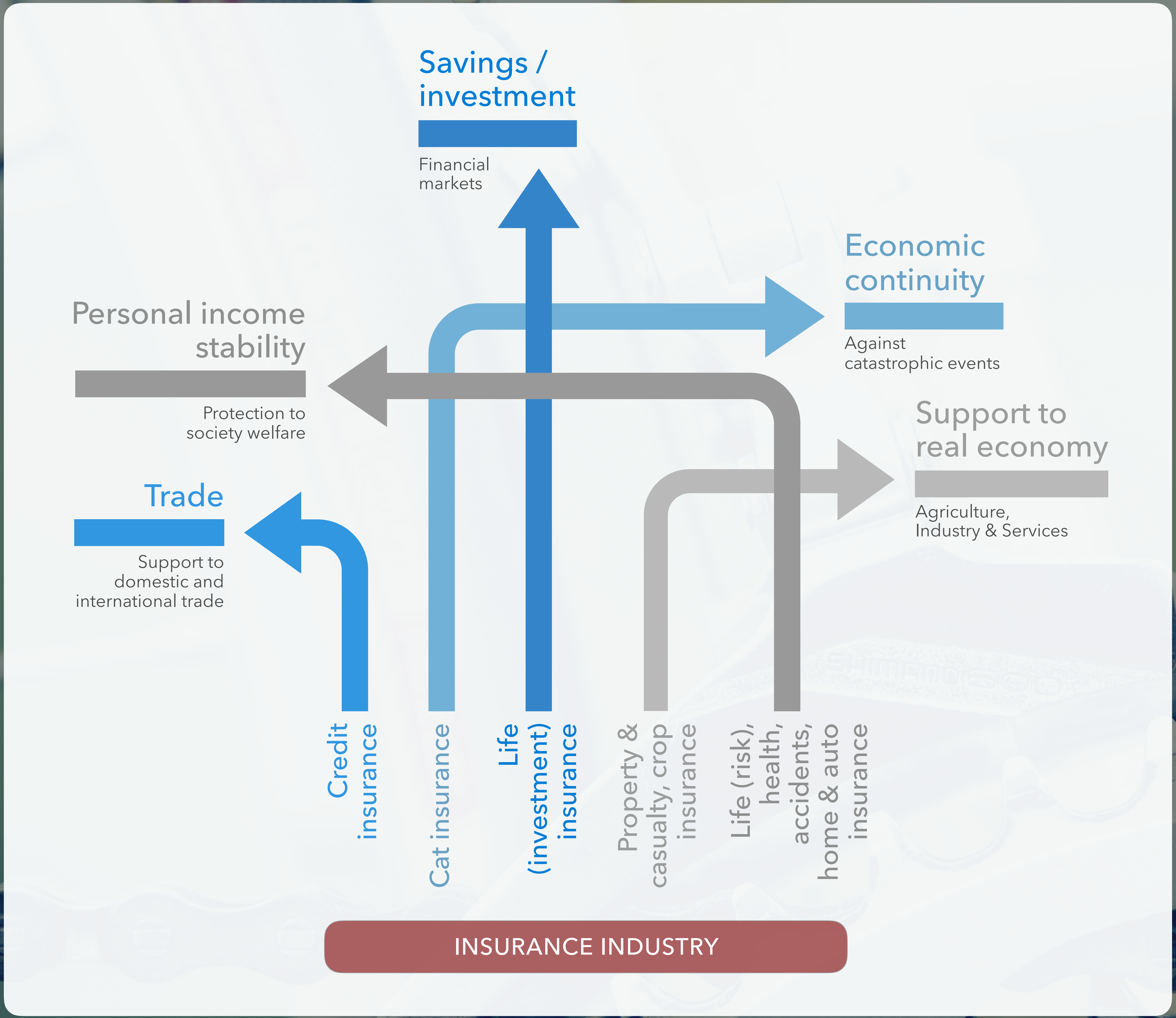
- 2016 was a year marked by **moderate, divergent and fragile** global economic growth.
- 2016 was the year in which the international community became aware of the structural effects that the **low growth, inflation and interest rate environment (secular stagnation)** can produce in terms of economic performance and financial stability.
- 2017 will be a year to generate a space of public policies in which **fiscal policy might have a central, but not exclusive, role.**
- The **fiscal impulse** will be relevant not so much by its intensity but by its effect in a coordinated and complementary environment with other economic policies.

- 2017-2018 will offer a better perspective of economic growth, but it will continue the trend of moderation, divergence and global fragility (on average, it will approach 3%, inflation will also accelerate to similar rates).

- There will be significant differences in the momentum of global activity, not only between emerging and developed markets, but also amongst developed economies (especially with respect to the performance of the US economy).

- The global monetary policy will be very heterogeneous, although in general a temporary rebound of long-term yields is expected.

- Expectations are biased downward (accentuate the negative factors), as there are latent vulnerabilities and risks that could develop (with different levels of probability and severity) over the next months: vulnerability of emerging markets, European vulnerabilities, US economic policy, real estate sovereign-financial crisis in China.



- The economy and the insurance sector.

- The insurance industry has close linkages with all areas of economic activity.

Source: MAPFRE Economic Research

TRANSMISSION MECHANISMS FROM THE REAL ECONOMY TO THE INSURANCE INDUSTRY

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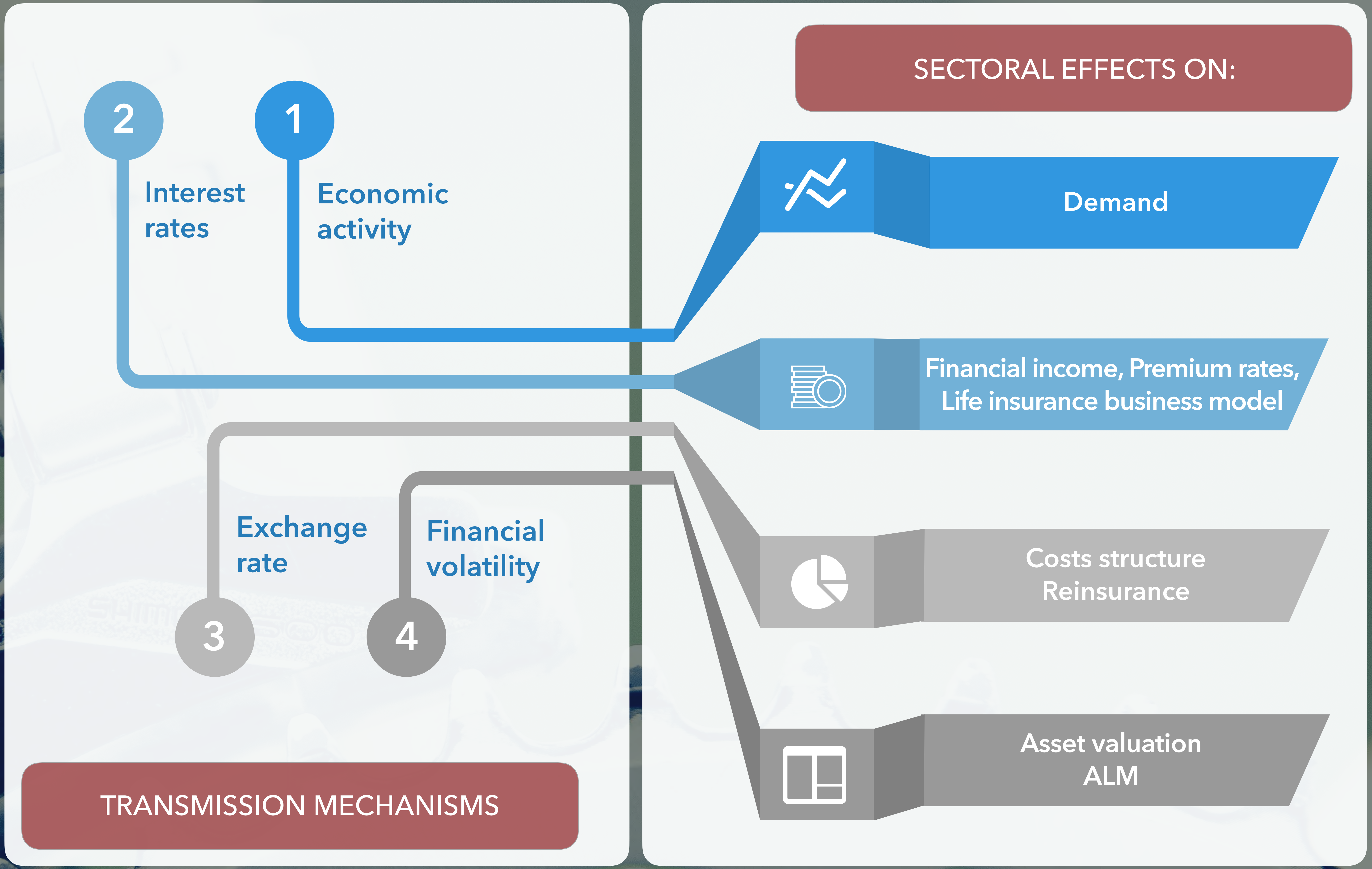
- Likewise, the insurance industry general performance depends on several **macroeconomic factors.**



Source: MAPFRE Economic Research

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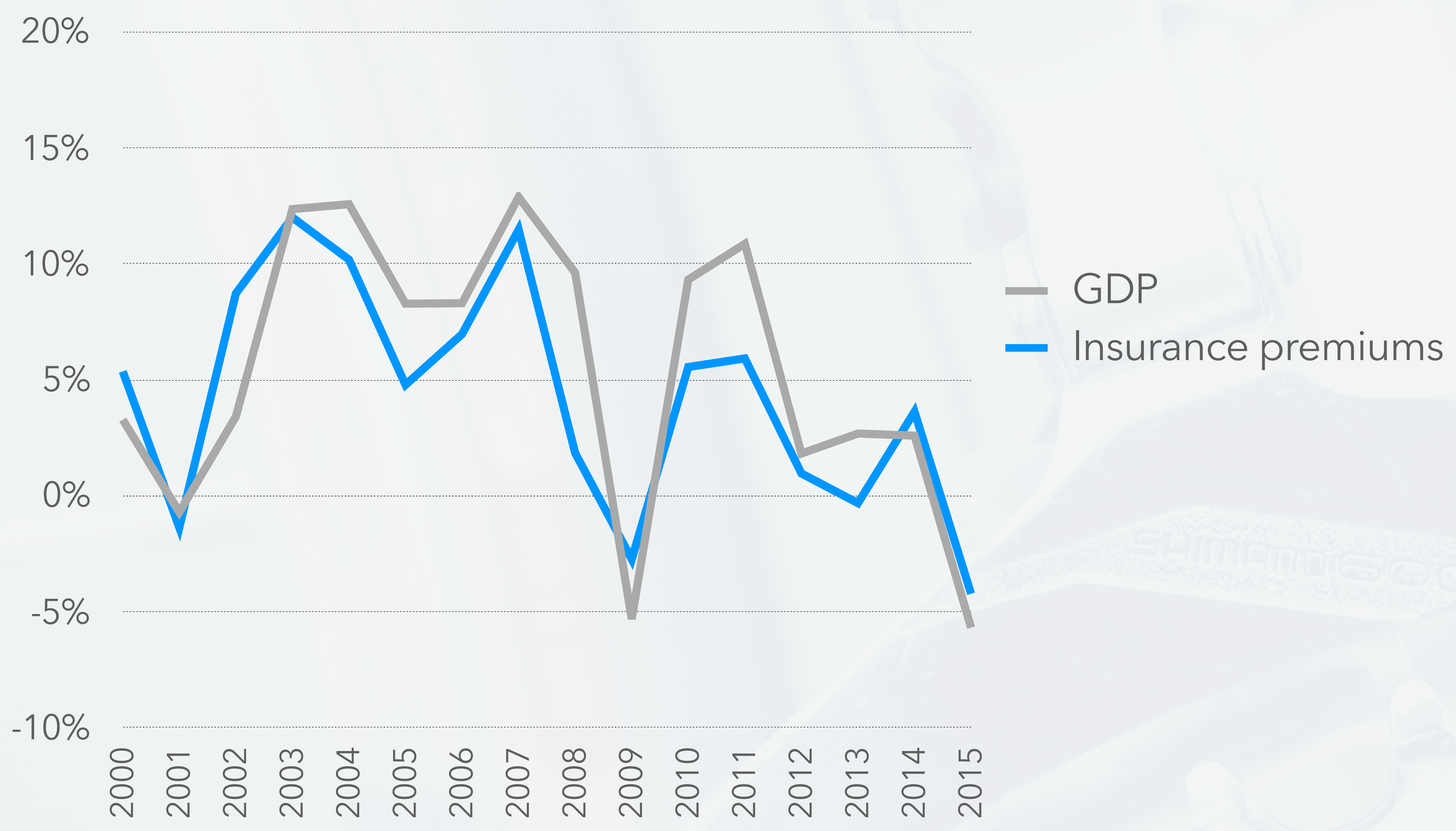
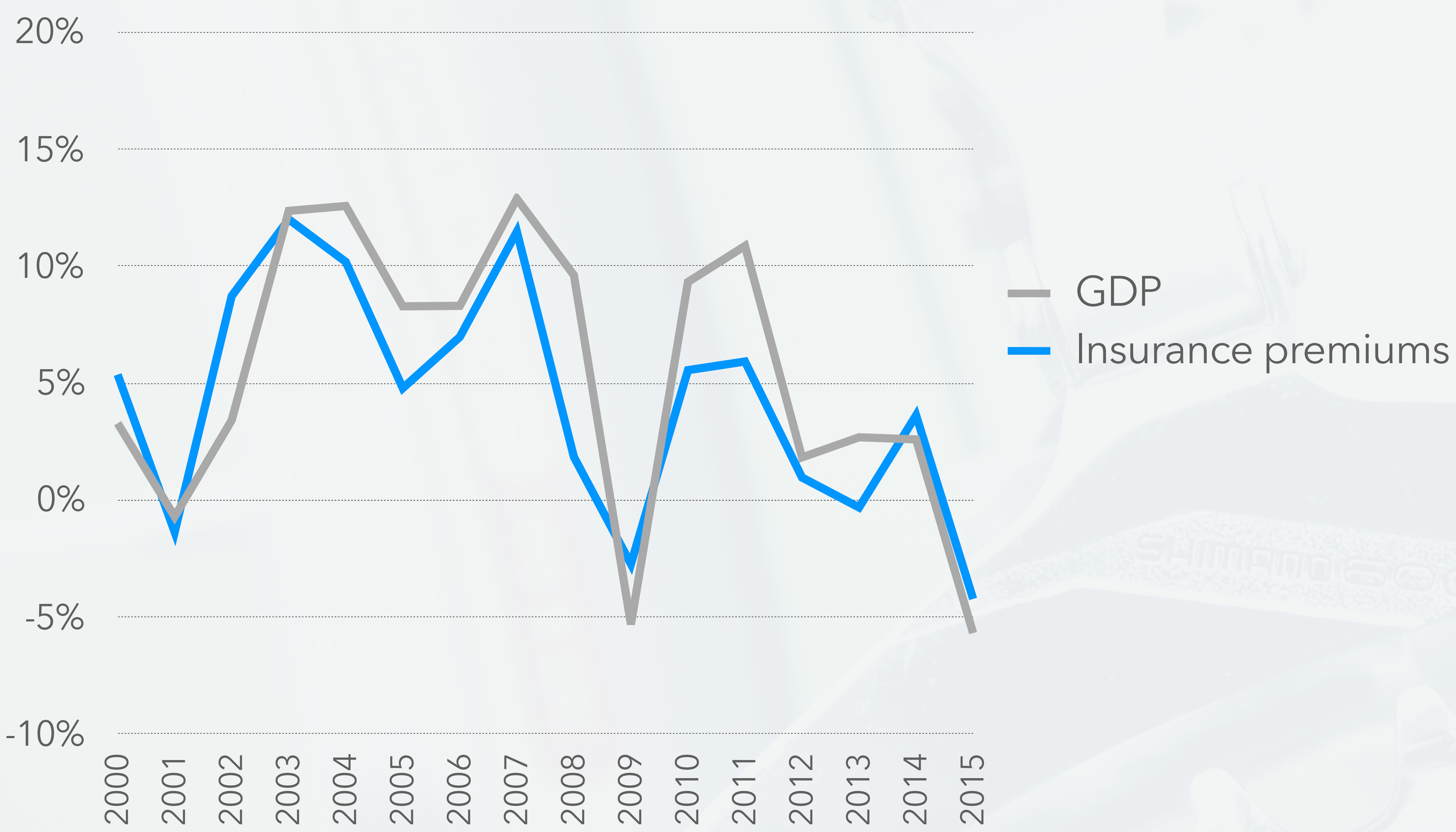
Global GDP vs global insurance premiums growth, 2000-2015
(annual growth rates, nominal USD)



- Therefore, one of the main features of the insurance sector is its **pro-cyclical behaviour.**
- Its growth rate is highly **sensitive and synchronic** to changes in the overall economic activity.

Source: MAPFRE Economic Research (IMF and Swiss Re data)

Global GDP vs global insurance premiums growth, 2000-2015
(annual growth rates, nominal USD)



- **Role of insurance in the economy.** Insurance products compensate for and disperse risks arising from economic activity. As it expands, so does insurance demand.
- **Main features of insurance business model.** In order to avoid an adverse selection process, the technical rigor of the underwriting process increases during periods of crisis, and tends to relax during periods of economic expansion.
- **Effect of risk-senstitve regulations.** Capital charges based on risk level tends to increase in the lower part of the economic cycle, contracting the growth capacity of insurance undertakings.

Source: MAPFRE Economic Research (IMF and Swiss Re data)

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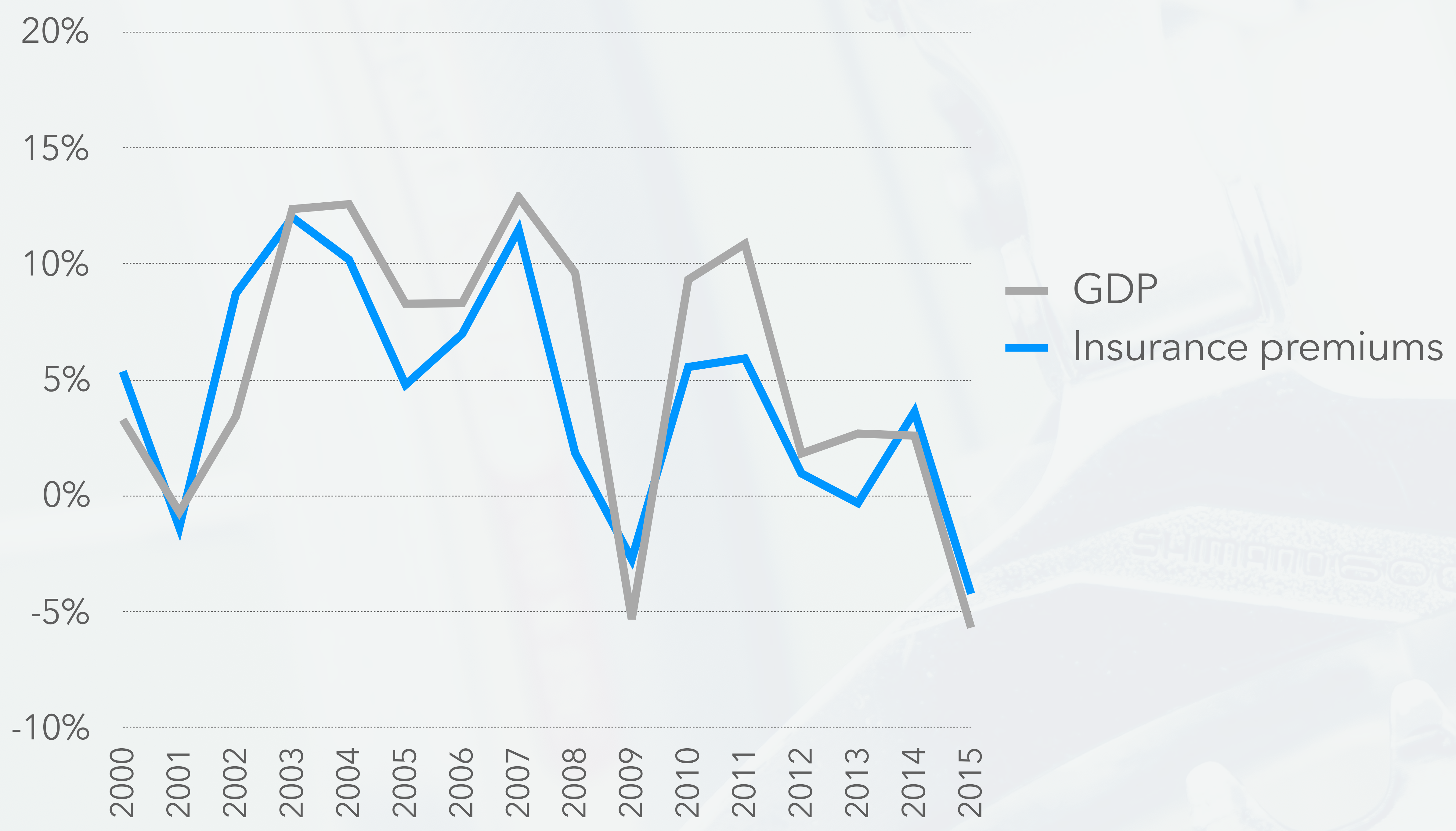


Developed markets:

- High synchronisation of Non-Life insurance.
- High level of Life insurance penetration.

Emerging markets:

- Amplification of the pro-cyclical effect due to the size of the Insurance Protection Gap (insufficient insurance coverage).
- Low level of Life insurance penetration.

Source: MAPFRE Economic Research (IMF and Swiss Re data)

- GDP growth expectations for 2017 are a key element in the outlook for the life and non-life insurance market segments, strongly linked to the economic performance.
- Overall growth outlook is favorable, although the low level of growth forecast for some developed economies would provide an equally weak scenario for the insurance sector in those markets.
- The higher elasticity of demand for insurance in emerging economies (with low penetration levels) in the face of GDP growth, should imply a growth that will be higher than that of developed economies.
- In 2017, the insurance sector is expected to accelerate in developed and emerging markets, with the latter leading the growth of the industry.

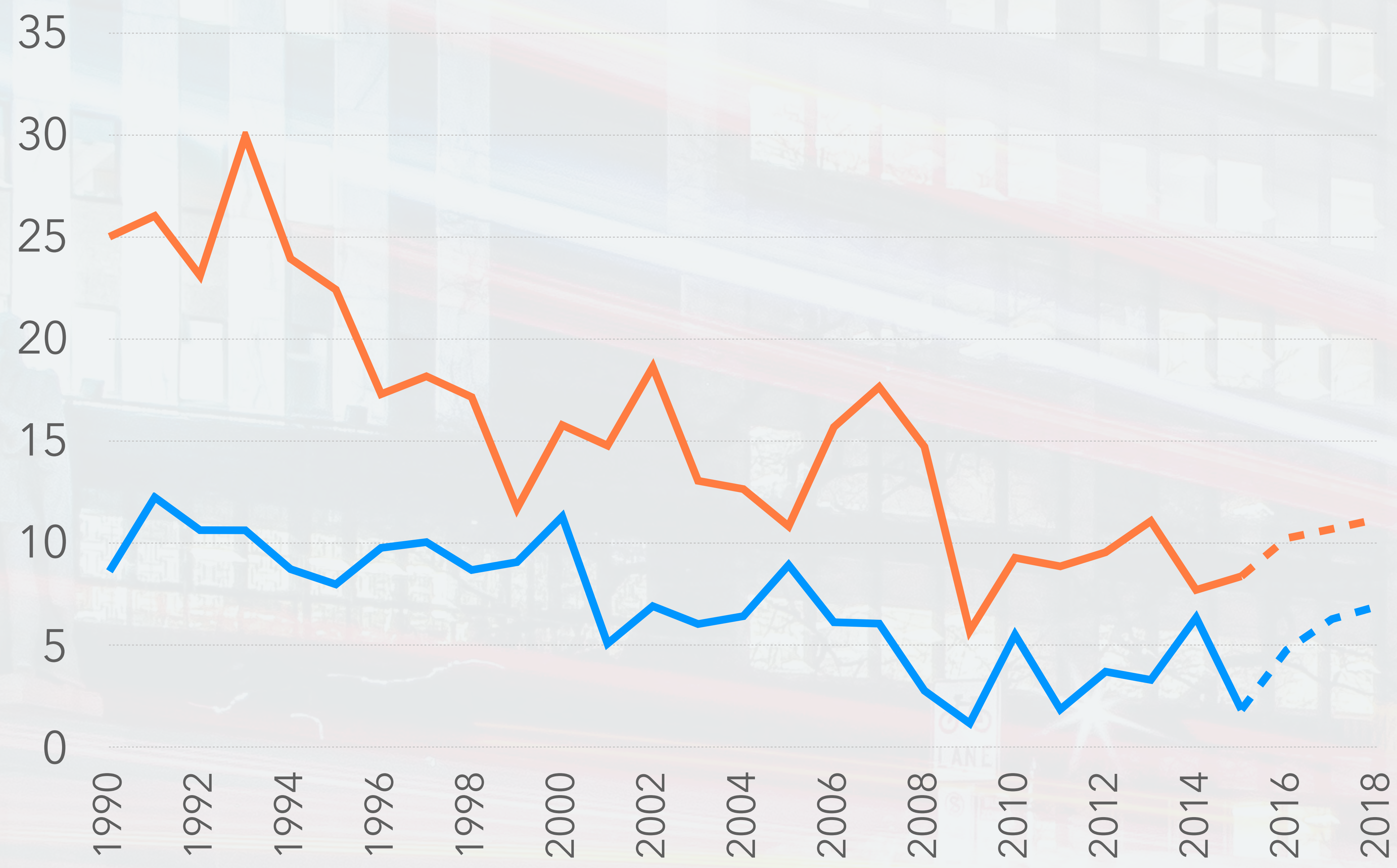
Median growth of insurance premiums by line of business and region

(nominal growth, %)

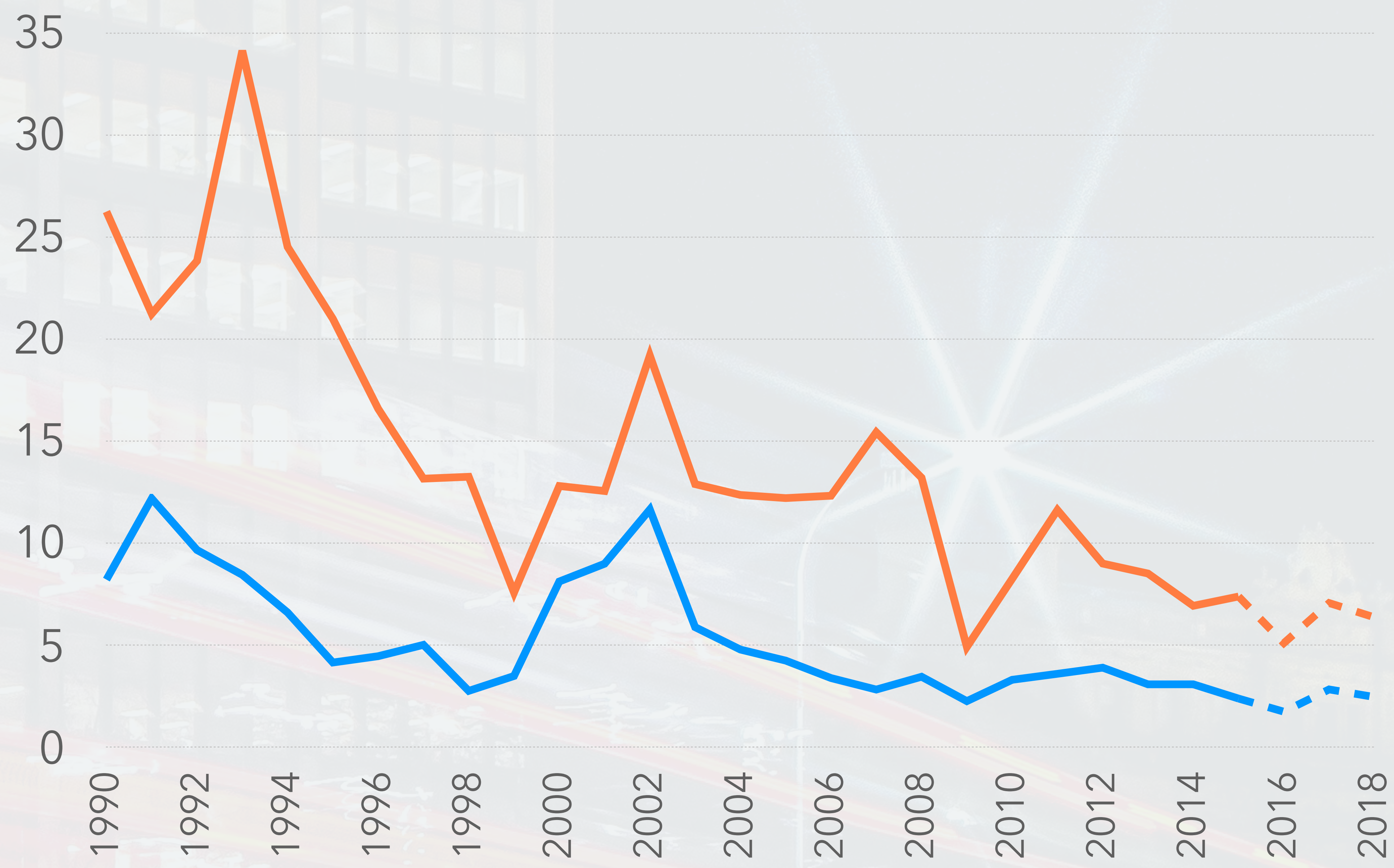
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Overall insurance market														
Total	9,8	11,3	13,8	9,5	3,3	8,2	5,5	8,1	7,9	7,2	5,6	6,9	8,1	8,6
Non Life	12,3	13,4	14,7	7,9	3,9	8,8	4,2	6,8	8,6	8,3	5,9	4,2	6,0	5,7
Emerging markets														
Total	10,8	15,7	17,7	14,7	5,7	9,3	8,9	9,6	11,1	7,7	8,4	10,3	10,7	11,2
Non Life	12,2	12,3	15,4	13,2	4,9	8,3	11,6	9,0	8,5	6,9	7,4	5,1	7,1	6,4
Developed markets														
Total	8,9	6,1	6,1	2,8	1,2	5,5	1,9	3,7	3,3	6,4	1,9	4,8	6,3	6,9
Non Life	4,3	3,4	2,9	3,5	2,3	3,3	3,6	3,9	3,1	3,1	2,4	1,8	2,9	2,5

Source: MAPFRE Economic Research

Overall market: growth forecast for developed and emerging markets
(median growth of insurance premiums, %)



Non Life market: growth forecast for developed and emerging markets
(median growth of insurance premiums, %)



Emerging markets: actual growth
Developed markets: actual growth
Emerging markets: forecast
Developed markets: forecast

Source: MAPFRE Economic Research

1 Big Data

2 New non-traditional participants

3 Expanding distribution channels

4 Use of technology in the automobile business and the internet of things

5 Usage-Based Insurance

6 App-Based Management

7 Adapting to change in demographic patterns

8 Effects of climate change

9 Cyber risks

10 Regulatory convergence

- Most of **the main macro-business trends observed in the insurance industry** in 2016 will continue to deepen throughout 2017.

Source: MAPFRE Economic Research

1 Big Data

- Big Data for **customer analysis and segmentation** (creating individualised client profiles), as well as for **service management.**

Source: MAPFRE Economic Research

2 New non-traditional participants

- New financial firms that offer insurance services at lower costs based on the reformulation of the principle of the mutualisation of risks and the **intensive use of information technologies and collaborative economy schemes** (FinTech, InsurTech).

3 Expanding distribution channels

- Insurance undertakings will continue **to emphasise the expansion of their distribution channels** as a way to be successful in a more competitive market, particularly the development of **digital channels** in which the process of customer segmentation will prevail.

Source: MAPFRE Economic Research

4 Use of technology in the automobile business and the internet of things

- Insurers will continue to adapt their operation and business models to the new reality of the automobile business (semi-autonomous driving) by **identifying the reduction of certain risks and the emergence of others that will need adequate coverage.**
- Likewise, insurance companies will continue to **incorporate the so-called internet of things** as part of their business model.

Source: MAPFRE Economic Research

5 Usage-Based Insurance

- The trend towards the Usage-Based Insurance will continue by designing and offering more competitive products in which the **insurance premium will be linked to the use** (PAYD, Pay-As-You-Drive) **or driver behaviour** (PHYD, Pay-How-You-Drive).

6 App-Based Management

- The use of technological applications (apps) to carry out the management of different **business processes and the monitoring of the risk conditions of clients.**

Source: MAPFRE Economic Research

7 Adapting to change in demographic patterns

- Primarily determined not only by the **population ageing** (that will affect the design of pension and life products), but also by variations in **migration patterns** that will affect customer segmentation and product design.

Source: MAPFRE Economic Research

8 Effects of climate change

- A trend that has dominated the concerns in the field of non-life insurance with regard to **protection against risks of nature**, especially in the face of the **effects of climate change associated with changes in urbanisation patterns.**

Source: MAPFRE Economic Research

9 Cyber risks

- The need, on one hand, for **protection against cyber attacks** and, on the other, for accurately determining the degree of insurability of those risks through traditional idiosyncratic compensation mechanisms.

- **Other emerging risks** associated with the use of new electronic devices (eg. drones) will generate a growing demand for third party liability insurance.

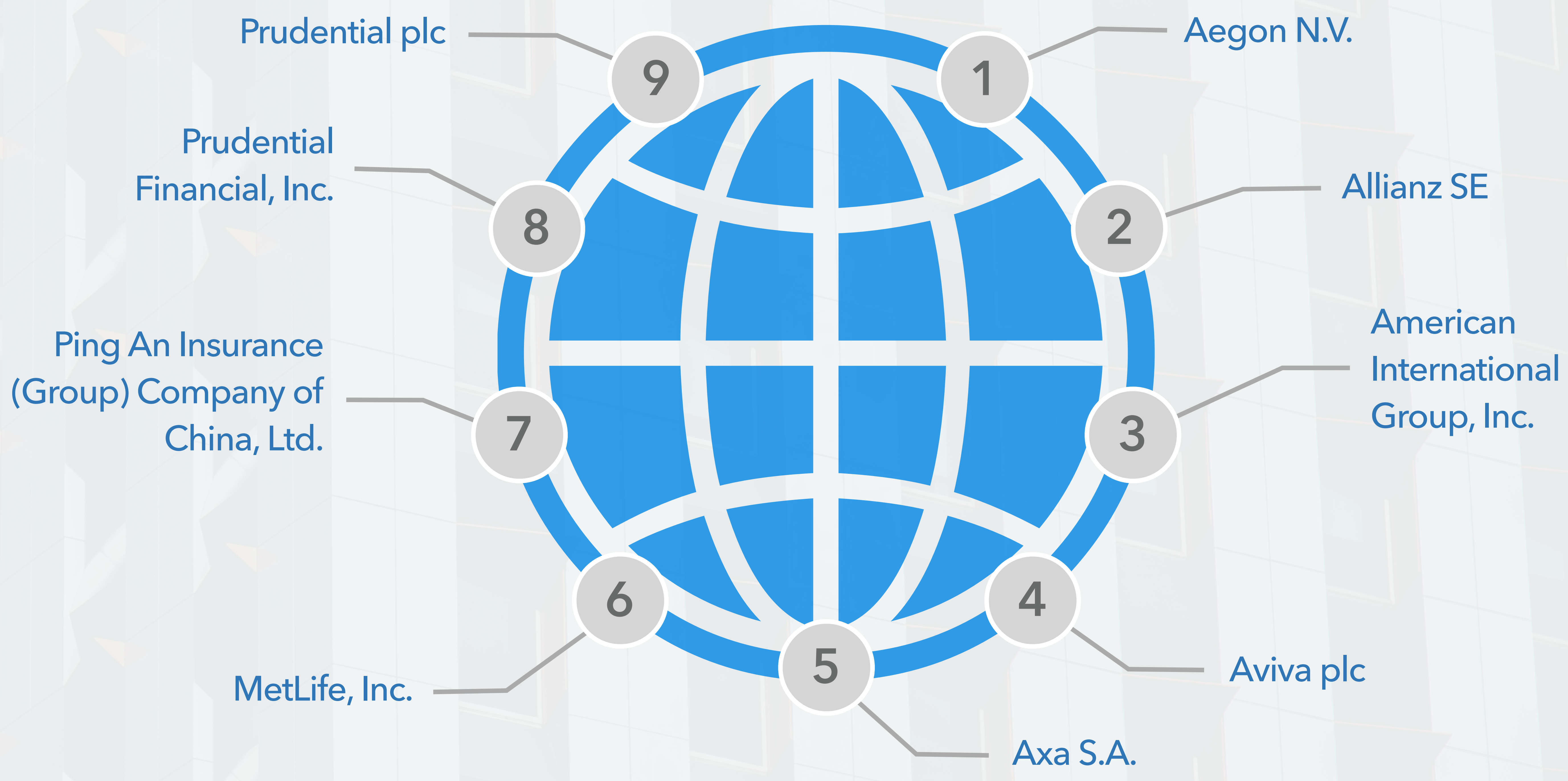
Source: MAPFRE Economic Research

10 Regulatory convergence

- Process of regulatory convergence in the insurance field towards **prudential models based on risk** (Solvency II-type).
- Implementation of regulatory measures linked to **systemic risk and financial stability** (at both global and domestic levels).

Source: MAPFRE Economic Research

- FSB designation of **Global Systemically Important Insurers (G-SIIs).**



Source: MAPFRE Economic Research (with information from the FSB)

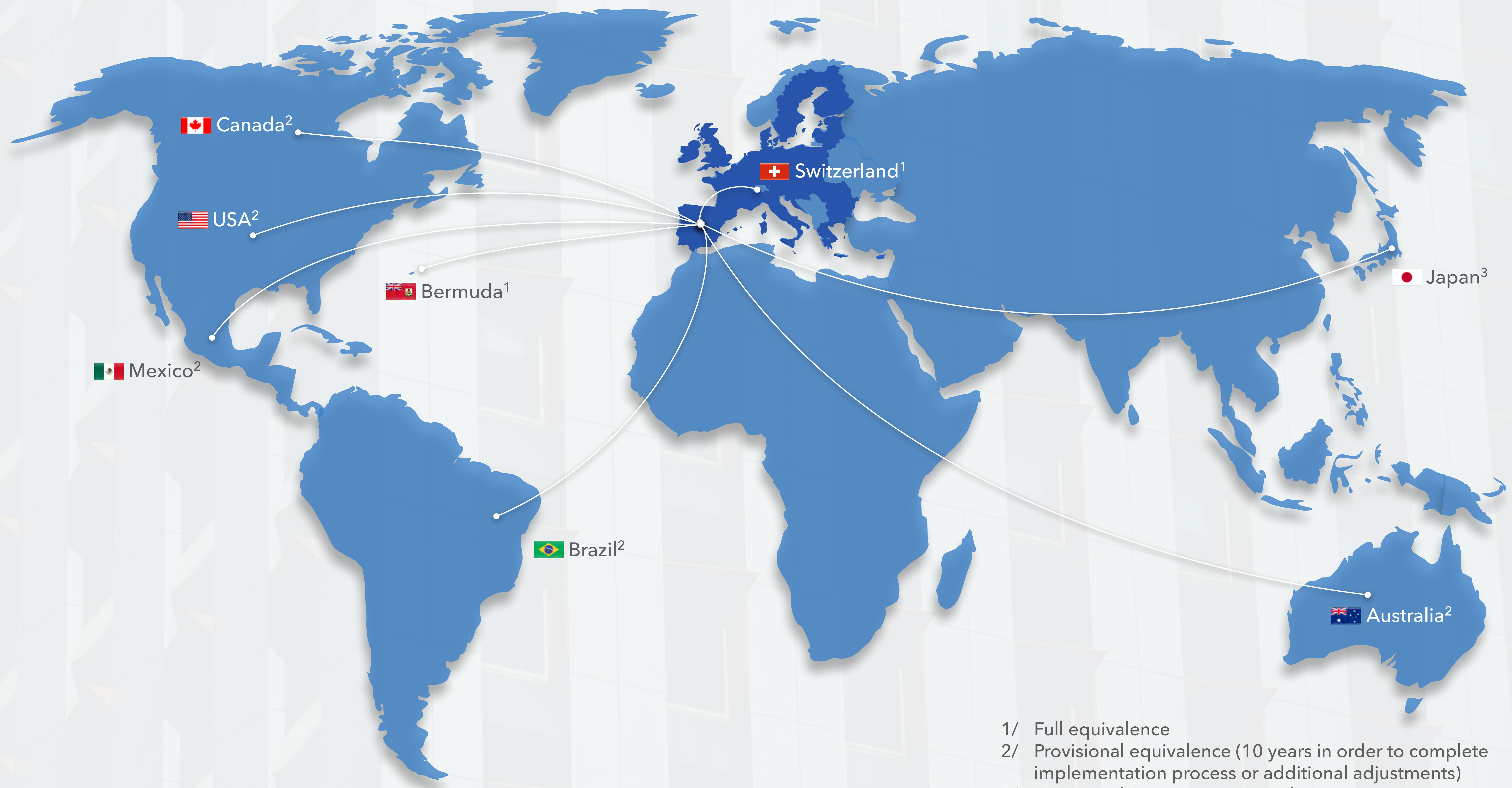
- IAIS project for an **international capital standard (ICS).**

Source: MAPFRE Economic Research (with information from the IAIS)

- In 2017, **regulatory convergence will continue** towards risk-based prudential models (Solvency II-type) seeking:

(i) To adopt solvency systems based on risk measurement and risk management schemes, and

(ii) To create a local regulatory environment that harmonises with the operation of the main global insurance groups.



1/ Full equivalence
2/ Provisional equivalence (10 years in order to complete implementation process or additional adjustments)
3/ Provisional / temporary equivalence

Source: MAPFRE Economic Research (with information from EIOPA)

MAIN MACRO-BUSINESS TRENDS IN THE INSURANCE SECTOR: REGULATORY CONVERGENCE

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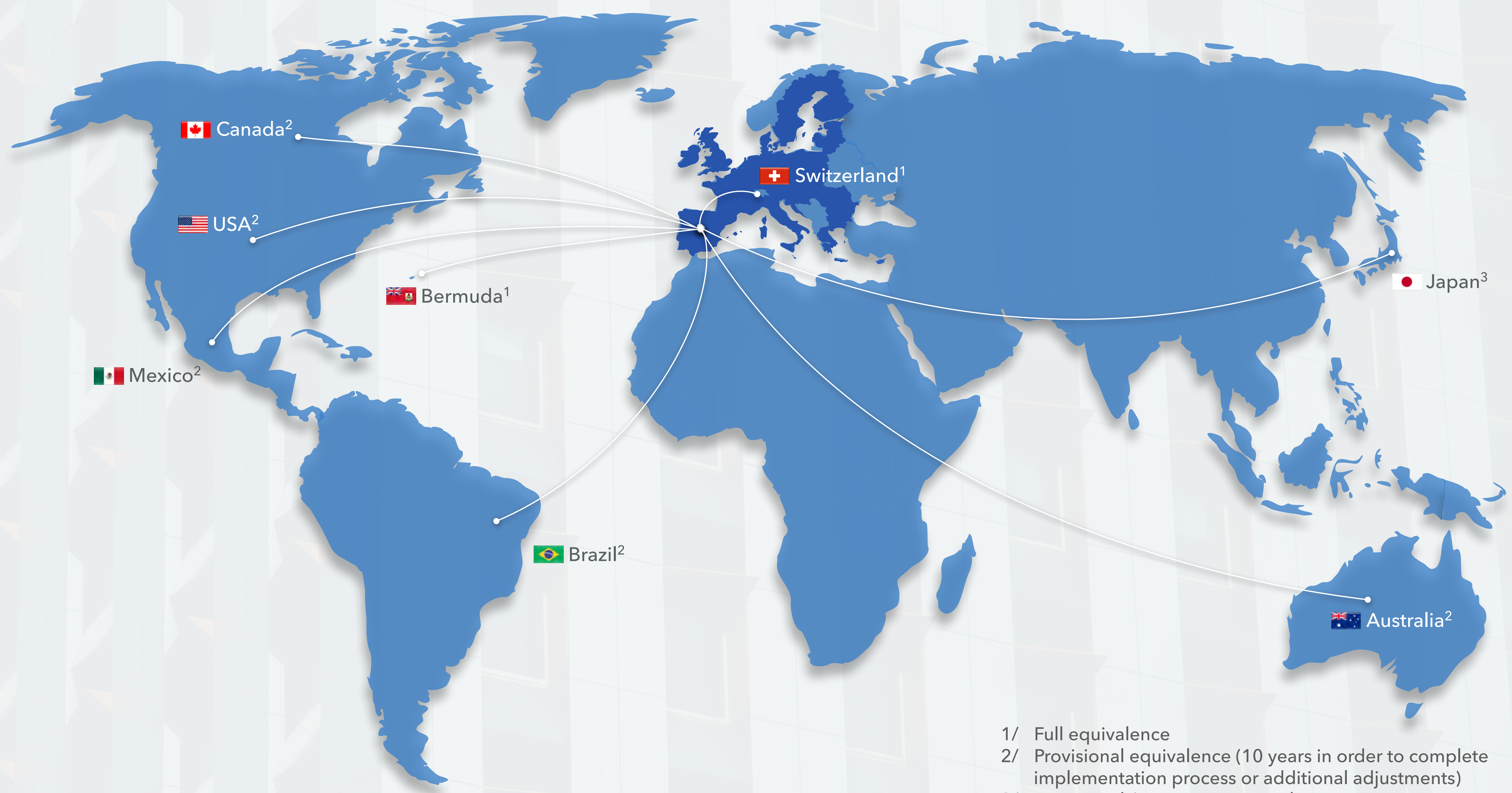
- Markets subject to Solvency II-type regulatory standards would account in 2017 for almost **76% of worldwide insurance premiums.**



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