Swiss Re Institute

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Economic Insights:
Global economy is inadequately prepared for the next crisis

Key takeaways

- The annual IMF/World Bank meetings confirmed our view that global economic growth remains robust, though with higher downside risks, especially for 2019/20.
- The global economy is inadequately prepared for the next crisis. Economic buffers (fiscal, monetary) and resilience have decreased over the past ten years.
- The next financial crisis will have more of the same: even lower rates and larger asset purchases. This will especially hurt the life insurance industry.
- In our view, the biggest risk to the global economy is a global trade war. A resulting stagflationary environment may not be accommodated this time, however, by monetary policy.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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In a nutshell

Alongside the 2018 IMF/World Bank Annual Meetings, policy makers highlighted that the global economy is inadequately prepared for the next financial crisis. We sense a lack of commitment to increase economic resilience. Looking ahead, we believe that central bank policies remain the "only game in town"; however, the room for manoeuvre in the next financial crisis will be much more limited.

Following the IMF/World Bank and G20 Annual Meetings, no news is not necessarily good news. Although the IMF's economic projections are still quite benign for now, the downside risks are increasing.[1] We broadly share this view. At the same time, the international community has not reached a consensus on a common vision for growth. The structure of the global economy is more multipolar now than a few decades ago. Economies are more interconnected and the Emerging Markets are more integrated, public debt levels have risen, income disparity is higher and the pace of technological change is faster. In short, the challenges are bigger than in the past. Yet economic decisions are more decentralised.

National policy makers from core countries were clear in their analysis that the global economy and financial system are inadequately prepared for the next crisis. We could not agree more. The G20 Eminent Persons Group report also highlighted the need to make economies more resilient to shocks.[2] Indeed, Singapore's Deputy Prime Minister Tharman called for "a little less conversation, a little more action please". We believe that the hurdles for private capital to flow into infrastructure financing should be lowered through concerted action and cooperation between the multilateral development banks and the private sector. In our view, lower hurdles for investments would increase the bankability of projects, benefiting the insurance sector on the asset and underwriting sides.

Potential policy responses for the next financial crisis were also highly debated. Looking ahead, we believe that central banks are not entirely "out of bullets", although this will not lift the real economy's trend growth rate. The next crisis will feature more of the same: even lower central bank policy rates and larger asset purchases, though not all central banks have the same degree of freedom.[3] Given the lack of concrete and sustainable economic solutions, kicking the can down the road is the only realistic option. The

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[1] IMF, 2018, "World Economic Outlook", Available at https://www.imf.org/en/Publications/WEO/Issues/2018/09/24/world-economic-outlook-october-2018

[2] G20, 2018, "Making the Global Financial System Work for All". Report of the G20 Eminent Persons Group on Global Financial Governance.

[3] The ECB, for example, is already very close to political constraints.

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insurance sector, and in particular the life insurance industry and policyholders, will again suffer in such a scenario. With very low yields, people may rely less on life insurance covers, which causes the protection gap, the difference between insured and uninsured losses, to rise.

Trade tensions were also featured prominently in policy discussions. The IMF's World Economic Outlook shows that a trade war[4] could shave 0.4% points off global GDP in the longer term. The Bank of France estimates that a global trade war could be much worse and lead to a lower global real GDP level of up to 3% after two years, due to other factors such as declining investment demand and rising financing costs, among others.[5] Crucially, as a trade war with tariffs leads to higher consumer prices, a stagflationary environment where inflation increases, but real GDP growth remains subdued, could ensue. The paradox is that central banks might even be blamed for the negative consequences of such an environment, as they might be unable to ease monetary policy.

Under an escalating trade war scenario, the re/insurance sector is affected in two ways. First, economic growth slows, which is associated with lower premium growth. Second, inflation is higher than expected, which adversely affects insurers on both the liability and asset sides.

As alluded to previously, a global trade war remains the number one risk for our economic forecasts. However, as we have mentioned in issue 1/2018 of the Economic Insights series, "Protectionism on the rise, and here to stay", trade tensions could ultimately lead to fairer global trade. Although this "silver lining" scenario is more remote, it was also acknowledged by the official G20 IMFC steering communiqué.[6]

[4] Key assumptions besides the already announced and largely expected tariffs include a 25% tariff by the US on all imported cars and car parts and similar retaliation by trading partners. In addition, confidence shocks and tightening financial conditions are also taken into account.

[5] Berthou et. al., 2018, "Quantifying the losses from a global trade war". Available at https://blocnotesdeleco.banque-france.fr/en/blog-entry/quantifying-losses-global-trade-war

[6] IMF, 2018. "Communiqué of the Thirty-Eighth Meeting of the IMFC". Available at https://www.imf.org/en/News/Articles/2018/10/10/communique-of-the-thirty-eighth-meeting-of-the-international-monetary-and-financial-committee