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Economics & INSURANCE

MAPFRE Economics

Posts

Introduction

For the new publication of **Economics and Insurance** magazine, we have selected five articles we believe provide our readers with a complete and up-to-date view of the most relevant topics in the economy and insurance. Below is a brief summary of each:

In the article "*Real estate markets and the insurance sector*" we analyze the relationship between real estate markets and the insurance industry. We explore how changes in home prices and trends in the real estate market could affect insurance companies, as well as the products and services offered in this context. We also highlight the synthetic indicator MAPFRE Economics uses to measure the potential of real estate activity for the insurance industry in 43 countries.

The second article, "*Monetary policy*" presents monetary policy on a global level and its influence on financial markets and the economy in general. It examines the decisions by the main central banks, interest rates, financial stability and the challenges facing those responsible for monetary policy in an economic environment of high inflation.

The "Global economic outlook (Q2 2023)" is summarized in the third article, analyzing economic perspectives for the second quarter of this year, evaluating factors like GDP growth, inflation, employment, and other key indicators. It also provides a general view of baseline and stressed scenarios of the expected trends in the world's main regions and economic sectors.

In the fourth article, "*Industry outlook for the insurance market (Q2 2023)*" we take a closer look at the specific outlook for the insurance industry in the second quarter of this year. We analyze the challenges and opportunities facing the industry and emerging changes that could impact insurance companies' financial and strategic results.

Finally, we have the collaboration of Juan Fernández Palacios, author of the article, "*The senior economy, an emerging reality*" where he shows a global outlook of the senior economy and the challenges facing this growing demographic. He discusses topics such as population aging, the economic and social impact of this phenomenon, and the measures necessary to guarantee senior citizens' financial security and well-being in the future.

We hope you enjoy this new edition of the magazine and find the information interesting.

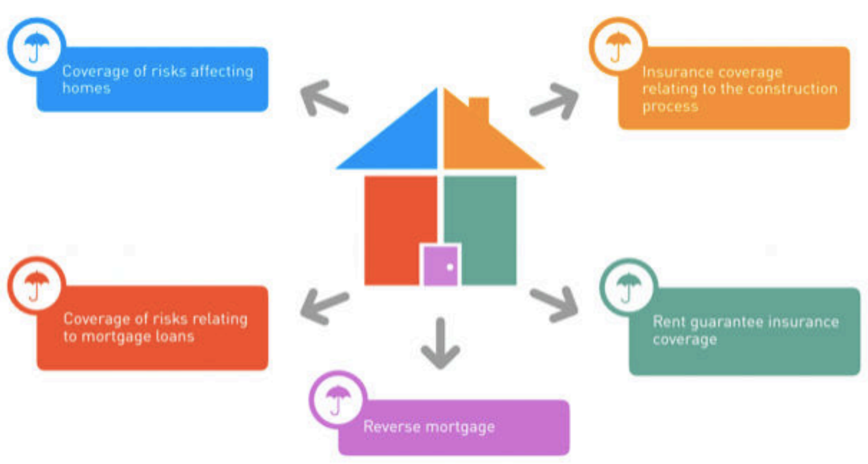
Real estate markets and the insurance sector

Author: MAPFRE Economics

Summary of the reportes conclusions:
MAPFRE Economics
Real estate markets and the insurance sector
Madrid, Fundación MAPFRE, April 2023

Real estate markets are among the most relevant activities in a country's economy and in the dynamics of the insurance sector, generating a wide variety of coverage needs. This is true both on the insurance demand side, with homeowners, businesses and other public and private institutions that own the properties or have a right to them, and on the supply side, with real estate developers, construction companies, financial entities and engineers, architects,

Chart 1
Link between the residential real estate market and insurance activity



Source: MAPFRE Economics

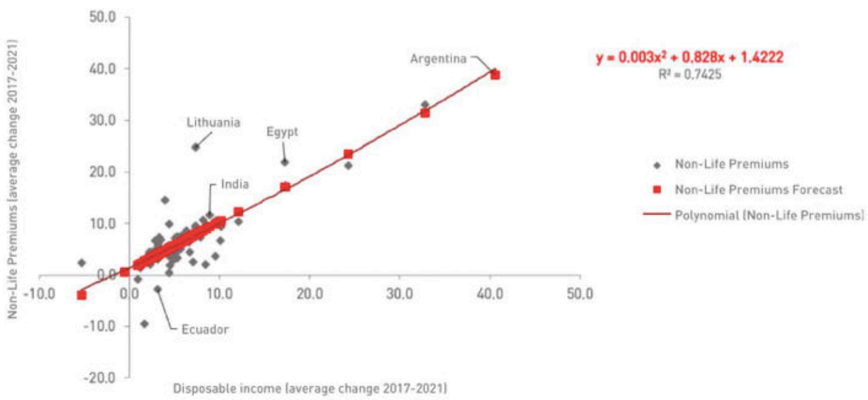
real estate agents, appraisers and many other professionals. Insurance, meanwhile, plays a key role, helping to protect assets, facilitating the granting of mortgages and their mobilization on the financial markets, and promoting economic stability among homeowners and businesses, contributing to the well-being of society at large (see Chart 1).

There are many indicators in developed countries related directly to the real estate market, while substantially less information is available on emerging markets. That leads to certain limitations regarding the pool of markets available for a comparative analysis of the base dynamics governing their real estate markets and their relationship with insurance activities.

Two especially significant indicators for the insurance sector are the housing stock and its growth (construction of new homes), which generate potential policies for the homeowner and HOA insurance, in addition to specific insurance related to the construction period and possible liabilities that may arise on completion of construction, related to its execution. Outstanding mortgage balances and newly granted mortgages are also significant indicators for insurance activity, as they are directly related to the insured capital in Life insurance covering the risk of death and disability of the mortgage debt holders.

In addition to housing stock and mortgages, demographics, gross capital formation for investment in housing, disposable personal income and others are also highly relevant indicators. The evolution of disposable personal income is essential, both for the development of the real estate market and for the insurance activity (see Chart 2).

Chart 2
Disposable income vs. Non-Life premiums: fitted regression curve

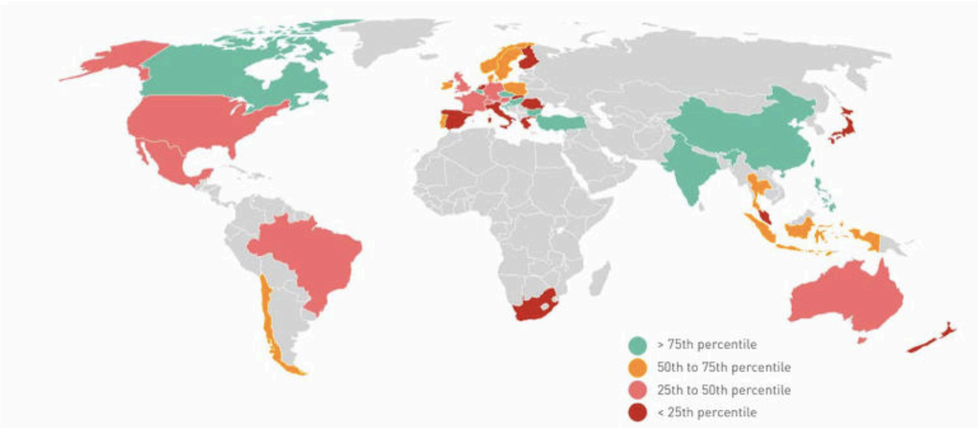


Source: MAPFRE Economics

It is clear that there is a notably high correlation between the Non-Life insurance segment and disposable personal income, which translates into a high coefficient of determination. Risk Life insurance, which together with property & casualty insurance related to the home and the housing construction process, are the most relevant for real estate market coverage and follow a pattern similar to that of Non-Life insurance at the aggregate level, which we have used as a proxy to assess the correlation. Thus, in the explanation of the evolution of premiums in the Non-Life insurance segment in the 2017-2021 period, the variation in disposable personal income would explain 74.2% of the variation in premiums, while the rest would be attributable to other factors.

Given the relevance of real estate activity in economic performance, in general, and in the insurance sector, in particular, MAPFRE Economics proposes an indicator that aims to provide a relative measurement, initially, of the potential of real estate activity and, from there, of its relevance to the insurance sector for a group of 43 countries. Chart 3 shows the geography of this synthetic index known as the Indicator of Real Estate Potential for the Insurance Industry (IPIA).

Chart 3
Map of the indicator of Real Estate Potential for the Insurance Industry (IRPII)



Source: MAPFRE Economics

Meanwhile, Table 1 includes the list, sorted from most to least potential, of the 43 countries for which it was possible to obtain the information necessary to create the indicator. The information shows that the highest level of potential, measured using the IPIA, is found in India, followed by the Philippines and China. China and Turkey, whose positive elasticity in the insurance business when faced with variations in disposable personal income improves their score, are also above the 75th percentile in the indicator's, in fourth and fifth place, respectively. The rest of the markets above the 75th percentile in the IPIA distribution are Belgium, Bulgaria, Indonesia, Czech Republic, Taiwan and Singapore. Japan lies at the bottom of the ranking, below the 25th percentile, presenting indicators that are typical for a very mature market with a shrinking population. It showed weak scores in all the sub-indexes that influence the indicator. This distribution percentile is rounded out by Romania, Greece, Italy, Finland, South Africa, Slovakia, Malaysia, Spain, the Netherlands, and Switzerland.

Table 1
Indicator of Real Estate Potential for the Insurance Industry (IRPII)

	Country	Indexes used to construct the indicator		Indicator of Real Estate Potential for the Insurance Industry (IRPII = $\sqrt{IRPI * e}$)
		Indicator of Real Estate Potential (IRP)	Index of Non-Life insurance demand sensitivity to changes in disposable income (e)	
1	India	75.7	93.5	84.1
2	Philippines	89.5	72.6	80.6
3	China	75.0	78.0	76.5
4	Canada	54.8	83.0	67.5
5	Turkey	57.5	75.9	66.0
6	Belgium	42.7	100.0	65.4
8	Bulgaria	46.3	91.9	65.2
9	Indonesia	67.0	61.5	64.2
10	Czech Republic	49.7	81.4	63.6
11	Taiwan	50.2	80.5	63.5
12	Singapore	46.6	86.0	63.3
13	Hungary	51.4	77.9	63.3
14	Croatia	46.0	86.6	63.1
15	Thailand	49.2	80.7	63.0
16	Denmark	48.4	78.5	61.6
17	Sweden	55.0	68.1	61.2
18	Chile	52.0	71.8	61.1
19	Brazil	52.3	71.1	61.0
20	Norway	49.6	74.8	60.9
21	Ireland	49.9	73.5	60.5
22	Portugal	37.6	96.1	60.1
23	Australia	57.8	61.8	59.8
24	Poland	42.6	83.6	59.7
25	United Kingdom	49.9	69.4	58.8
26	United States	49.4	65.3	56.8
27	Germany	40.8	77.3	56.2
28	Hong Kong	42.2	72.5	55.3
29	Austria	42.7	70.8	55.0
30	France	40.6	71.7	54.0
31	Mexico	48.2	60.2	53.9
32	New Zealand	63.1	42.4	51.8
33	Switzerland	42.7	61.2	51.1
34	Netherlands	45.7	52.9	49.1
35	Spain	35.2	65.8	48.1
36	Malaysia	66.4	34.8	48.1
37	Slovakia	54.5	42.1	47.9
38	South Africa	48.7	43.1	45.8
39	Finland	37.6	55.4	45.6
40	Italy	30.9	58.2	42.4
41	Greece	27.1	65.1	42.0
42	Romania	44.1	34.3	38.9
43	Japan	27.4	38.3	32.4

Source: MAPFRE Economics

In-depth analysis of some of the real estate markets considered to be representative shows that in emerging economies such as Brazil and Mexico, mortgages are not very developed (so they have great potential), with public promotion institutions that facilitate access to loans for workers with formal employment contracts. Other markets such as South Korea are characterized by the existence of a long-standing regulatory framework that has had a deep impact on residential real estate prices, maintaining growth even below the general inflation rate until two years ago. In the United States and the United Kingdom, having the most developed capital markets in the world has made a deep mark on the evolution of their real estate markets, as seen in the analysis of the historical price series, mortgages, new housing construction, number of transactions and other indicators.

The MAPFRE Economics report entitled Real estate markets and the insurance sector contains a specific revision for a series of reference markets, including the United States, Mexico, Brazil, the United Kingdom, Spain, Germany, Japan and South Korea. With regard to these markets, the indicators selected for in-depth analysis have been classified based on their relevance to insurance markets, including the housing stock and new construction, real estate transactions, outstanding mortgages and new mortgages, reverse mortgages, real estate investment instruments in the investment portfolios of insurance companies, housing prices and mortgage rates (mortgage securitization and covered bonds), the household credit gap, residential rentals, affordability and home purchase assistance programs, as well as the evolution of home-related insurance, Risk Life insurance, engineering insurance and other coverages associated with the residential construction process.

The complete analysis of the real estate markets and the insurance sector in the United States, Mexico, Brazil, the United Kingdom, Spain, Germany, Japan and South Korea is available in the report Real estate markets and the insurance sector, provided by MAPFRE Economics

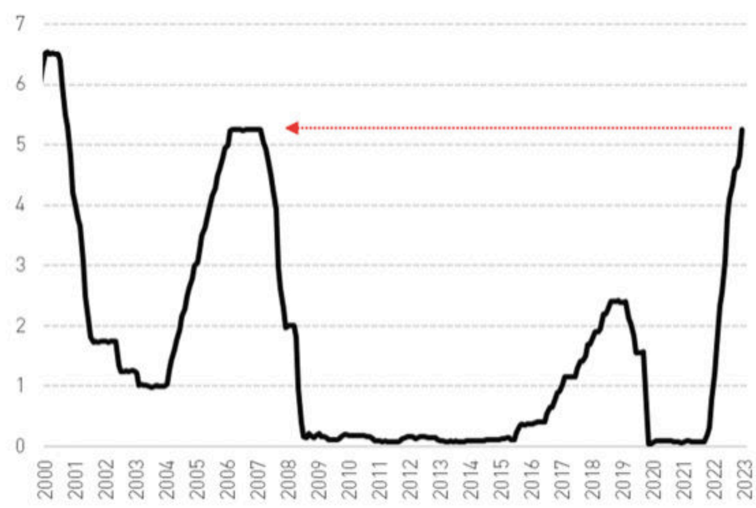
Monetary Policy Update

Author: MAPFRE Economics

Federal Reserve

In its May meeting, the United States Federal Reserve unanimously decided to once again increase benchmark interest rates by 25 basis points (bps), placing them in the official range of 5.00-5.25%. By doing so, it opened the door to putting the tightening cycle on hold (currently on par with that of 2006-2007), though in the future it will be subject to new incoming inflation and economic performance data, and it has not committed to a terminal rate (see Chart 1). It should be noted that this narrow margin for maneuvering is maintained in response to cumulative tightening of monetary policy in the United States, the monetary policy's delayed effects on economic activity and inflation, and recent economic and financial developments.

Chart 1
Benchmark interest rates



Source: MAPFRE Economics (based on Bloomberg data)

In terms of the balance sheet, the Federal Reserve made no changes to its asset holding reduction, with the monthly combined roll off of $60 billion in Treasury bonds and $35 billion in MBS (Mortgage-Backed Securities), without offering any additional future guidance.

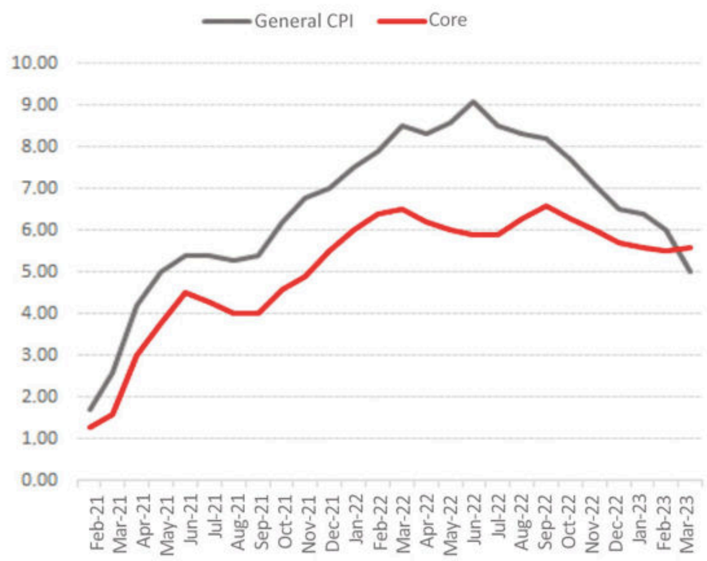
In summary, and despite not presenting new macroeconomic projections or an updated dot plot, the Federal Reserve continued to moderate its message and strike a balance between concerns over price stability and financial stability, offering a conditional pause so as to determine future decisions (based on a new projections table), but ruling out the possibility of an interest rate cut until 2024 at the earliest.

Assessment

The Federal Reserve's latest monetary policy decision was accompanied by few macroeconomic developments compared to its last meeting in March. In any case, notable highlights included that job growth is still strong (as confirmed by the ADP National Employment Report and payroll data), as is activity data, leading to more positive than expected figures (the latest PMIs indicated that the US manufacturing sector had once again contracted, while the service sector continues to expand, though at a more moderate pace).

As for how this is reflected in prices, the inflation slowdown continues to present a positive reading, although reversal is continuing at a slower than expected pace, with energy acting as the main driver of deflation in the general reading, which is partially canceled out by the rise in food prices and service inflation remaining at high levels. This is not the case, however, in core inflation, which once again logged a year-on-year increase, or in wage growth, which continues to struggle to recover from accumulated loss in real terms (see Chart 2).

Chart 2
General and core inflation

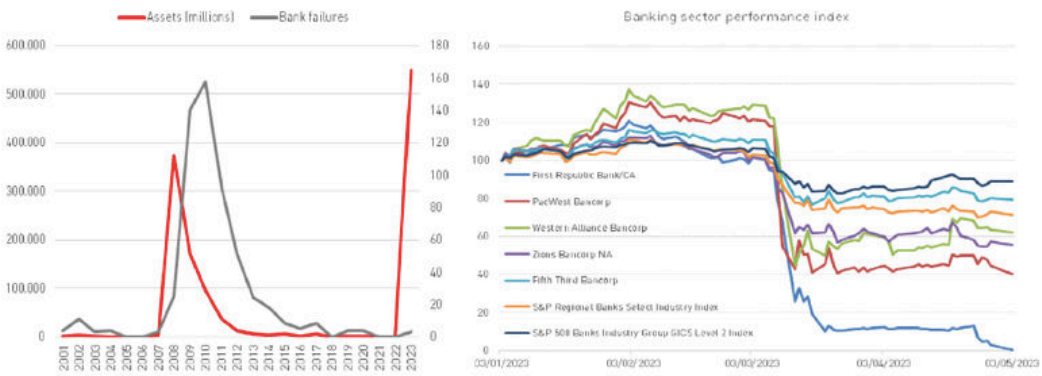


Source: MAPFRE Economics (with Haver data)

Meanwhile, various instances of financial instability continue to fuel fears over the health of the US's financial system. A noteworthy event in this regard was the recent collapse of the First Republic Bank, which was subsequently sold to JP Morgan with help from the Federal Deposit Insurance Corporation (FDIC) in the form of a $50 billion credit line. The effects of this collapse have raised the sum of banking failures so far in 2023 above the peak reached in 2008, with $548 billion (in terms of assets of the balance sheet).

At the same time, concerns over the US banking system, far from being quelled, continue to spread to the rest of the regional banking sector, with PacWest Bank leading in a new instance of this spread (see Charts 3 and 4).

Charts 3 and 4
Regional banks and FDIC banking interventions



Source: MAPFRE Economics (with Bloomberg and FDIC data)

The current disjunction between economic stability (skewed upwards) and financial stability (skewed downwards) are joined, on the one hand, by the cumulative effect of the monetary policy and the delayed effects still to come (the transmission rate of the monetary policy), against a backdrop in which, for the first time since 2019, real interest rates are in on slightly positive ground (see Chart 5), and on the other hand, by uncertainty over the state of credit, as its crunch may suffer an additional setback from the banking sector.

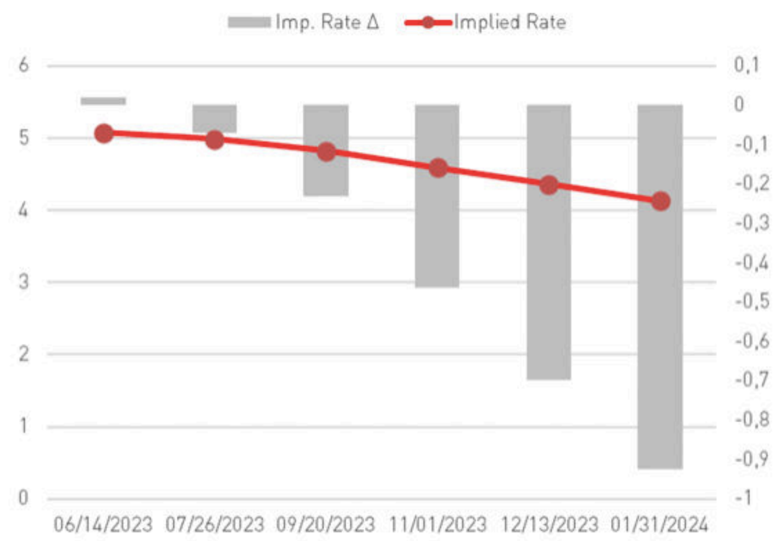
In summary, while the economic situation remains positive (the fact that inflation persists is, in a way, an indication of this strength), for now, the idea that it would be advisable to pause the tightening process is gaining traction. Nevertheless, this seems to be happening through a "proactive" approach, that is, by keeping real interest rate levels positive, and without ruling out the possibility of an additional interest rate hike in response to inflation potentially rising once again (as the risk scenario in our report, 2023 Economic and Industry Outlook: Second Quarter Perspectives, outlines).

Chart 5
Real interest rates to IPC

Source: MAPFRE Economics (based on Bloomberg data)

However, it is important to point out that this pause in the tightening process is part of a transition path that is already skewed towards giving more importance to the risk to financial stability, as the delayed effect of monetary policy puts pressure on both sides of the balance, and stricter financial conditions slow down demand, and thus, inflation. At the same time, the risk of non-linear events remains high, the catalyst for a lower implicit interest rate at the closing of 2023, in line with market forecasts and persistent signs of recession (see Chart 6).

Chart 6
Yield curve in the United States

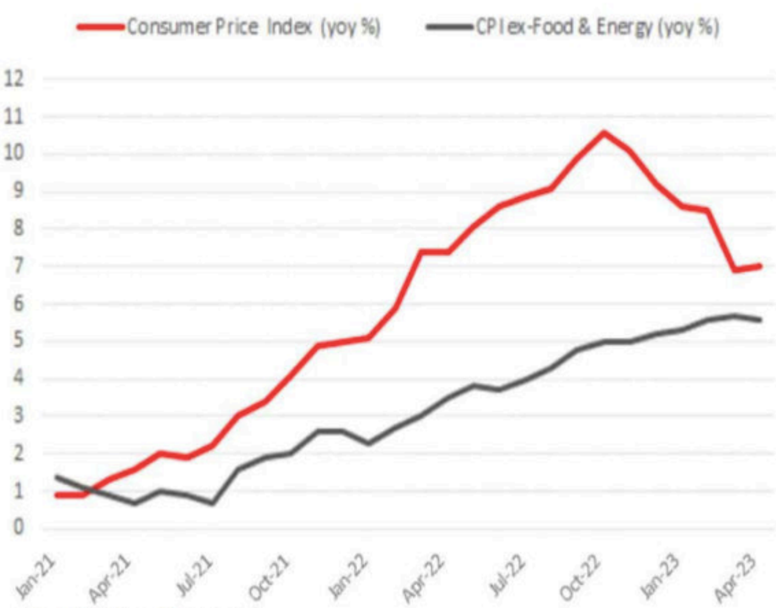


Source: MAPFRE Economics (based on Bloomberg data)

European Central Bank

In a meeting held on May 4, the European Central Bank (ECB) reaffirmed its commitment to monetary normalization by raising benchmark interest rates by 25 additional bps, a smaller increase than those of previous meetings. In doing so, it set the range of interest rates of main refinancing operations and the interest rates on the marginal lending facility and the deposit facility at 3.75%, 4.00%, and 3.25%, respectively.

Chart 7
General and core inflation



Source: MAPFRE Economics (with Haver data)

As for the balance sheet, the ECB is continuing to reduce its security holdings through the Asset Purchase Programme (APP), at an average pace of €15 billion until June 2023, unlike reinvestments under APP, which will be discontinued as of July. Elsewhere, it will maintain its intention to reinvest the principal payments from securities purchased under PEPP (Pandemic Emergency Purchase Programme) until at least the end of 2024, as well as the direction of the Targeted Longer-term Refinancing Operations (TLTROs), with no new developments.

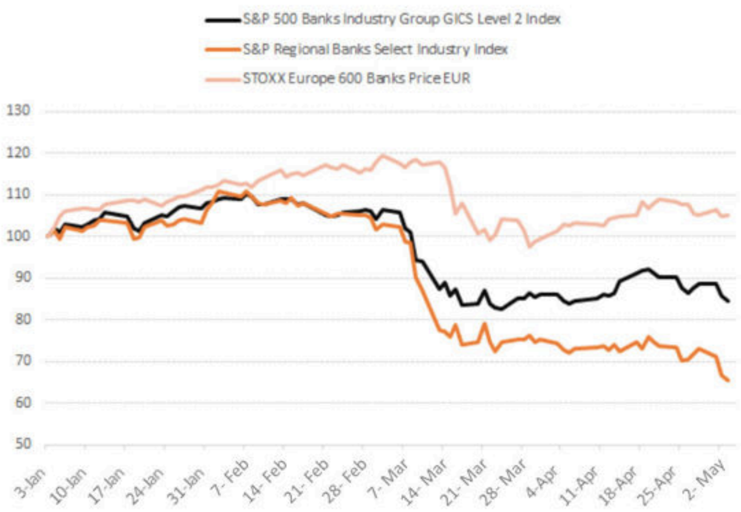
Assessment

As in the case of the United States, economic development that was less punitive than expected has confirmed that perspectives on inflation remain that it has been “too high for too long”, and thus an additional effort in terms of monetary policy is needed.

Despite the steady decline in the general price index over the past few months (the preliminary estimate for April is 7% year-on-year, compared to 6.9% in March, far from double-digit figures), as well as in core inflation (5.6% year- on-year in April, one decimal point less than March and the first decrease since June 2022), the unpredictability demonstrated by the latest Eurostat flash estimates (the year-end trend was curbed and even reversed), inflation figures still far above the 2% target, the effects of the strong fiscal policy shield, very negative real rates, and the gathering momentum of labor market pressures all seem to indicate that the tightening cycle still needs to continue.

At the same time, as Chart 8 shows, the latest strain on the US banking system, under shared causes (facing heavy unrealized losses due to interest rate risk and certain bank runs to monetary funds in search of risk-free remuneration), was not replicated in the Eurozone, demonstrating that the latter is somewhat resilient, and reinforcing the basis for a strict banking regulation precedent, though it is still incomplete (a banking union still has yet to be finalized).

Chart 8
European banking sector and US banking sector

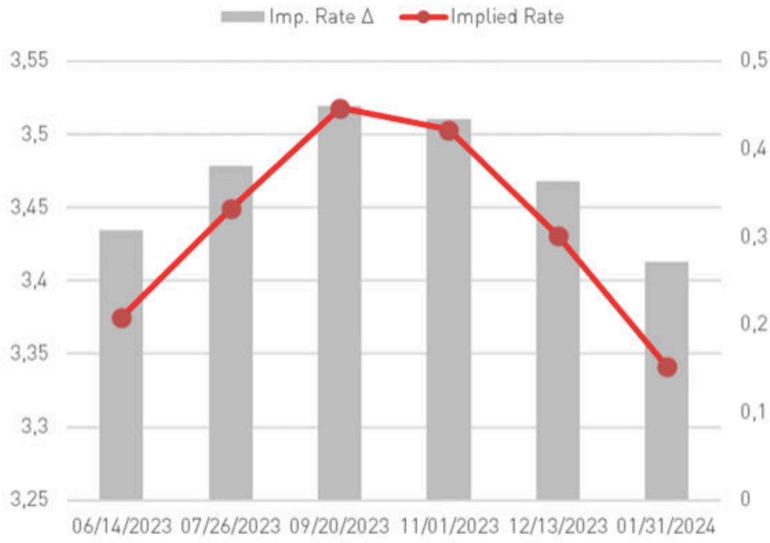


Source: MAPFRE Economics (based on Bloomberg data)

All this, together with the US Federal Reserve's slight delay in activating the tightening cycle, leads to the expectation that the ECB is still far from reconsidering a pause, based on the combination of price stability (still premature) and financial stability (still unbalanced), and given that the monetary policy transmission protection instrument (TPI) has still not been activated.

Thus, the baseline scenario of the Eurozone's future monetary stance continues to be maintaining the pace of the interest rate increase at the current 25 bps, at the expense of reducing the balance sheet at a faster rate (see Chart 9). This is considered most likely to happen in the ECB's next meeting in June, setting

Chart 9
European Union yield curves



Source: MAPFRE Economics (based on Bloomberg data)

September's meeting up to be the possible turning point for reaching a terminal rate, at which point it will be possible to assess the delayed effects of the monetary policy with enough policy space to sustain positive real interest rates for some time.

Global economic outlook

Author: MAPFRE Economics

Summary of the reports conclusions:
MAPFRE Economics
2023 Economic and industry second quarter perspectives
Madrid, Fundación MAPFRE, April 2023

Despite the current environment, in which the world has lost the capacity for long-term growth, it can be seen how, thanks to improved performance and a greater contribution from all the economic regions of the world, at the beginning of 2023 the global economy has improved growth prospects for 2023 and 2024, compared to what was anticipated in our previous 2023 Economic and Industry Outlook report (see Chart 1).

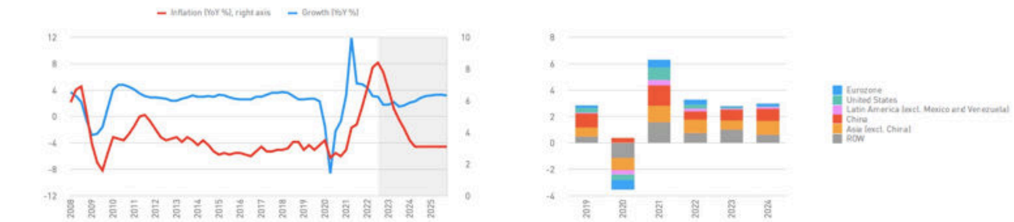
Thus, the risk of recession emanating from a large part of the developed economies (mainly the Eurozone) has eased and, thanks to the acceleration of the economy in the short term, the foundations have been strengthened for growth that, in general terms, is expected to be more benign. However, this moderate optimism remains insufficient to avoid the risks of the "hard landing" contemplated during 2022, compounded by recent signs of financial instability coming from the banking sector on both sides of the Atlantic.

In this sense, the cyclical momentum is expected to remain in the stagflationary phase, with a fragile pace of activity and below potential, together with a visibly more punitive monetary policy on the demand side, while inflation is expected to remain above the targets set by the main central banks, although under a downward dynamic that could show some volatility compared to the previous year in some components such as energy or food.

In response to the positive supply catalysts, the supply chains have continued on the path of normalization supported by the moderation in the prices of raw materials, the dynamism of the services sector and the gain in traction of

China with its reopening process. On the other hand, geopolitical tensions have continued to frustrate the full fluidity of global trade, crystallizing the protectionist current and multipolar fragmentation, mainly around strategic sectors such as semiconductors or certain scarce basic commodities.

Chart 1
Global: growth and inflation outlook and contribution by region



Source: MAPFRE Economics

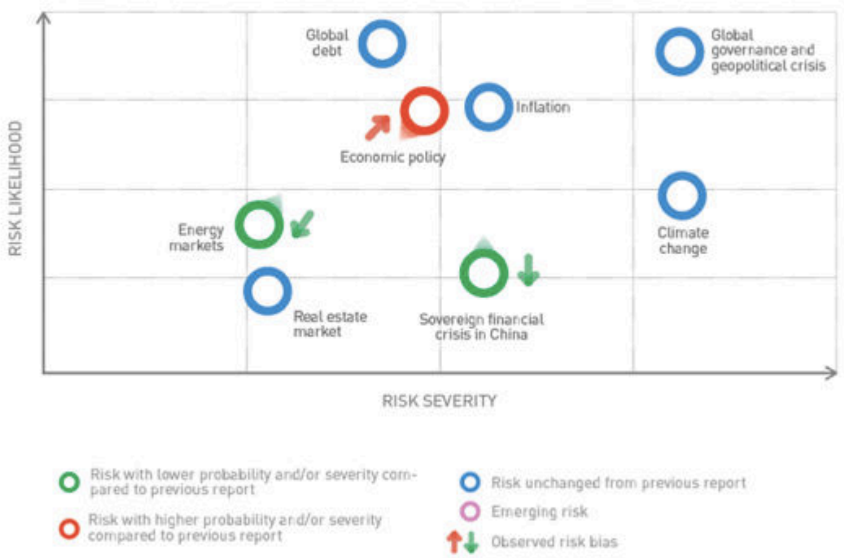
With regard to demand factors, optimism is due both to the savings generated during the pandemic that have not yet been consumed, and to the evolution of employment, whose dynamism continues surprisingly on an upward trend, with unemployment rates below the NAIRU (natural rate) and the ratio of vacancies to be filled in permanent imbalance. The job market situation observed at the limit (in the context of frictional unemployment) reveals two relevant dynamics: (i) there is professional mobility between vacancies, probably to take advantage of improved salary income (which explains why the number of vacancies is not significantly reduced) and (ii) during periods of high inflation such as the current one, it responds to changes in activity (as reflected in the sloping Phillips curve), which did not occur in periods with very low inflation.

As a result, this greater dynamism in terms of activity has been leading to a slower inflationary process, with the broad reading reflecting the positive effect of the oxygenation of supply, but with the underlying reading still reflecting the effects of the positive evolution of demand and its lagging momentum from the rotation towards the service sector.

The turbulence in the finance sector has recently been added to this situation, increasing the prospects of additional tightening of loan conditions, already strained per se by the cyclical momentum of monetary policy, given the extension of a more cautious vision regarding the assumption of risks (see Chart 2).

As regards monetary policy, the main central banks have continued advancing in the process of restriction and subsequent normalization, both on the balance sheet side and through interest rates, in an effort to slow down the credit cycle that is channeled towards lower demand, through stricter access standards, thus controlling inflation. To date, that effort has driven interest rates into restrictive territory at a record high rate. However, further developments are expected to be more marginal, allowing for an eventual acceleration in activity and for concerns over price stability shifting towards a focus on financial stability.

Chart 2
Short-term risk balance: vulnerabilities and global risks



Source: MAPFRE Economics

In short, the global outlook receives a moderately positive boost thanks to a calmer than anticipated start to the year, as well as uncertainties (such as the tail risks for 2022) that are clearing up, at least partially. This occurs, however, in a context in which it is recognized that global potential growth has fallen below 3%. At the same time, new fragilities are emerging in the financial system that remind us that perhaps the effects of the monetary overreaction are yet to come. Likewise, despite the fact that up to now it seems that the worst is now behind us, inflation has seen the downward pressure reduced and, with it its, rate of decline, leaving the main central banks faced with the complex dilemma between the search for price stability and financial stability. This is a dichotomy that can transition from a relatively benign baseline scenario to a risky one with relative fluidity, and where the effects of monetary policy lead to a harder landing.

Full analysis of the economic and industry perspectives with additional information and interactive charts on the Eurozone, Germany, Italy, Spain, the United Kingdom, the United States, Brazil, Mexico, Argentina, Turkey, Japan, China and the Philippines can be found in the report entitled 2023 Economic and Industry Outlook: Second Quarter Perspectives, compiled by MAPFRE Economics.

Industry outlook for the insurance market

Author: MAPFRE Economics

Summary of the reports conclusions:
MAPFRE Economics
2023 Economic and industry outlook: second quarter perspectives
Madrid, Fundación MAPFRE, April 2023

Revisions of the growth estimates for 2023 point to a downturn in the global economy that is less pronounced than initially expected due to various factors, including the reopening of China, the normalization of supply chains and a moderation in energy prices, with global growth that could be around 2.8% (3.4% in 2022), which, consequently, points to a more benign outlook for the insurance business. However, the profitability of insurance companies will remain under pressure from the rising cost of claims and other operating expenses, due to inflation that is beginning to show signs of improvement, but has not fully yielded and remains at high levels.

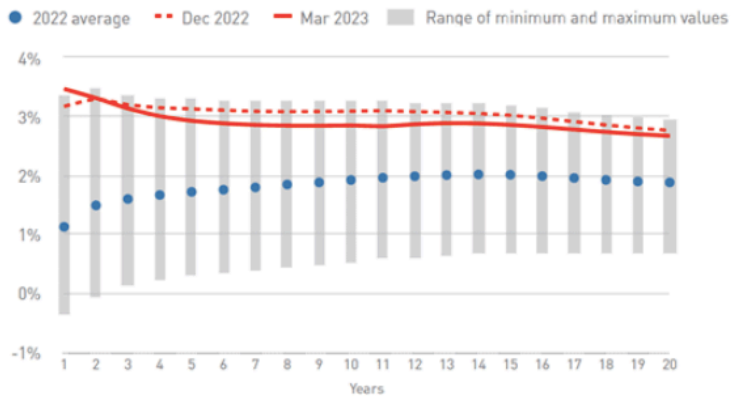
The normalization of supply chains and energy prices has boosted production in the automotive sector, increasing new vehicle registrations, with the positive effect that this entails for the auto insurance segment, although the tightening of conditions for financing the acquisition of new vehicles may weigh on the business in the coming months. Meanwhile, the rise in interest rates has revived traditional life savings and annuity insurance which, after a decade of low interest rates, had practically disappeared from the market. On the other hand, improved financial profitability for investment portfolios, the foreseeable moderation of inflation and the revision of rates applied in 2023 to offset the increase in claims costs and other operating expenses may help improve the insurance industry's profitability throughout the year.

Estimated economic growth in 2023 for the Eurozone stands at around 0.6% (3.5% in 2022), once again surpassing the forecasts made throughout the previous year, which indicated a slight recession. Moderation in energy prices and the quick end to the confinements of the Chinese economy have improved the economic outlook for this year. However, this scenario assumes that economic activity in the Eurozone remains modest, as the effects of tightening financing conditions and credit restrictions are transferred to the real economy, which could complicate the outlook for the insurance industry as it materializes and as long as the European Central Bank (ECB) decides to maintain a restrictive monetary policy in its fight against inflation.

The ECB has continued to tighten its monetary policy with a new rate hike of 25 basis points in May, following the two rate hikes of 50 bp each in February and March, leaving interest rates at 3.75% for the main financing operations and 3.25% for the deposit facility, without ruling out the possibility of some additional increase for the next meetings, depending on the inflation data that, although beginning to moderate, remain at high levels for the Eurozone as a whole, standing at 7% in April (6.9% in March), compared to an average inflation of 8.4% for 2022. On the other hand, the ECB's quantitative contraction program began in March, reducing bond holdings at a rate of €15 billion per month for four months, without altering its roadmap despite the turbulence suffered by the banking sector, but making it clear that if necessary it will use the means at its disposal to stabilize the financial system. This message helped reduce the tension in sovereign bond risk premiums in peripheral countries, which had begun to pick up significantly.

In its analysis of risk-free interest rate curves for March compared to December of last year, the European Insurance and Occupational Pensions Authority (EIOPA) observes a rise in interest rates on the short segment of the curve and a fall in all segments with maturities over two years (which are

Chart 1
Eurozone: risk-free yield curve
(%)



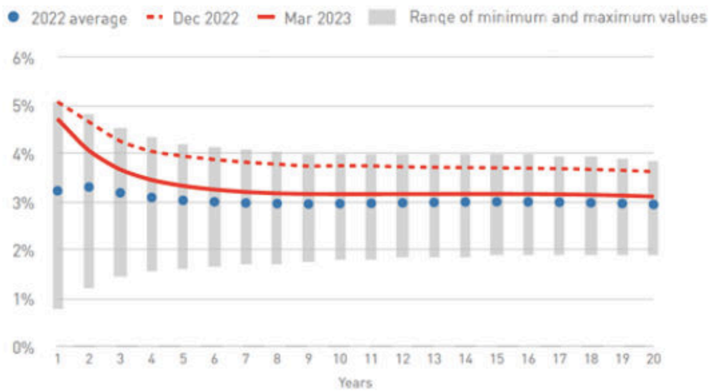
Source: MAPFRE Economics (based on EIOPA data)

Click here to access the interactive version of this information below the rates for December), which has led to a significant inversion of the risk-free yield curves that affects practically all of its segments, especially maturities of up to five years (see Chart 1).

The rises in risk-free interest rates continue to offering a favorable outlook for the Life Savings business, although the inversion of the interest rate curve has complicated the management of this business, which must adapt to a new environment in which the term premium is negative, more appropriate for products with shorter durations and periodic renewals and more complex for longer-term products such as traditional life annuities. On the other hand, the Euro Stoxx 50 index has gained 11.9% so far this year, through the end of March. In the US market the S&P 500 has gained 7.5%, and, to a greater extent, the Nasdaq Composite, at 17.7%. This improved performance of the indexes (after the drops experienced the previous year), can help the development of life insurance products in which the policyholder assumes the investment risk, which can also take advantage of the higher profitability offered by fixed income in the combination of products launched on the market.

On the other hand, the United States Federal Reserve has once again raised interest rates, with three additional increases in 2023 of 25 basis points each at the February, March and April meetings, remaining in a range of between 5% and 5.25%. Although additional hikes have not been ruled out if inflation does not subside, the probability of this happening has been reduced due to the problems arising in some small- and medium-sized banks in this country. In any case, the Federal Reserve has maintained its position that it will continue to apply a restrictive monetary policy as long as there are no solid indications that inflation is controlled at levels close to its 2% target, with data that continue to improve, but remain far from that goal.

Chart 2
United States: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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Despite these increases in the monetary policy interest rates, the risk-free yield curve for the US market for March produced by EIOPA (see Chart 2) shows a relaxation in the interest rates in all segments of the curve, moving away from the maximum values set in 2022.

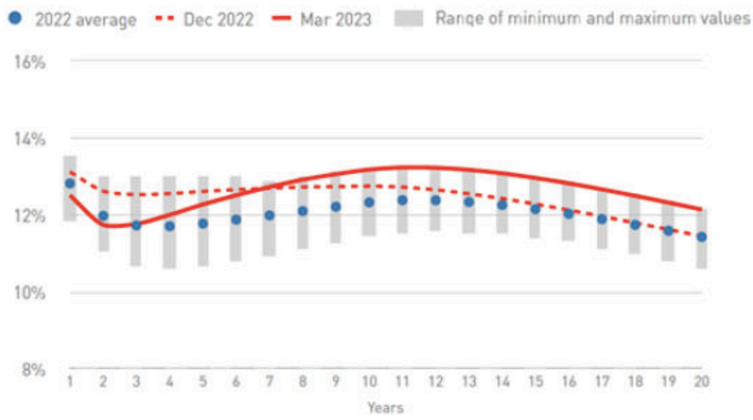
In any case, the high levels of risk-free interest rates continue to offer a favorable outlook for the Life Savings business, but the inversion of the interest rate curve has complicated the management of this business, which must adapt to a new environment in which the short-term rates are higher than the long-term rates (negative term premium), which could benefit products with shorter durations and periodic renewals, although more complex for longer-term products, as well as for traditional life annuities.

On the other hand, the S&P 500 index had gained 7.5% through the end of March and the Nasdaq Composite 17.7%. This partial recovery of equity indexes can help the development of life insurance products in which the policyholder assumes the investment risk, which is very common in the US market. This can also take advantage of the higher profitability offered by fixed income in the combination of products launched on the market.

Among the emerging markets, in Brazil, the tightening of financial conditions due to the restrictive monetary policy implemented by the central bank is being transferred to the real economy, which is slowing down, with inflation continuing to moderate. This may lead to a downturn in the insurance market, mainly in the Non-Life segment, although the normalization of supply chains and energy prices has boosted the automotive sector, increasing production and new vehicle registrations, with the positive effect that this entails for the auto insurance segment. Regarding the interest rate environment, which is highly relevant for the insurance business due to the extensive development of Life Savings insurance in the Brazilian market, it is worth noting that the central bank once again decided to keep interest rates at 13.75% in their meetings in February, March and April (the sixth consecutive time) with inflation that continues to decline, entering the upper part of its target range in March (for the first time in two years). This positive real interest rate environment is still favorable for conducting the life savings and annuities business, with interest rates offering returns significantly higher than the latest inflation data.

In the EIOPA risk-free yield curves corresponding to the end of March (see Chart 3), a drop is observed in the short and medium segments of the curve up to maturities of less than seven years. There is a small negative slope in its initial segments, which continues to favor the development of products backed with short-maturity sovereign bonds, very common in this market (VGBL and PGBL). The option of entering into bonds with longer durations is even more attractive, taking advantage of the increase in the level of interest

Chart 3
Brazil: risk-free yield curve
[%]



Source: MAPFRE Economics (based on EIOPA data)

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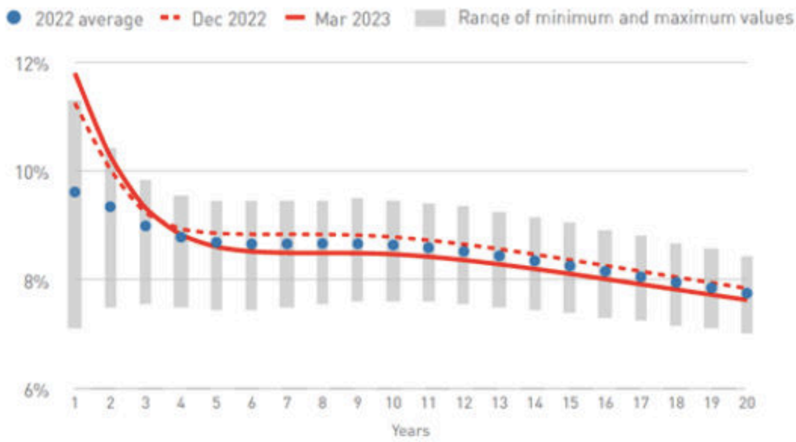
rates in the longest segments, which remain above the short rates (positive term premium in the long segments).

In the case of Mexico, while still in a situation of weak economic dynamics, GDP growth expectations for 2023 improve slightly, estimated at around 1.2% (3.1% in 2022). Even in a fragile economic environment, the activity levels could improve by 2024 when GDP growth could be around 1.5%. The Mexican economy continues to feel the effect of the high interest rates raised again in the last meetings of the Bank of Mexico, maintaining a restrictive monetary policy as long as inflation does not show clear signs of returning to its target range. This may lead to a downturn in the insurance market, mainly in the Non-Life segment, although (as has happened in other countries) the normalization of supply chains and energy prices has boosted production in the automotive sector, improving exports and new vehicle registrations, with the positive effect that this entails for the auto insurance segment. Meanwhile, the moderation of inflation (6.85% in March, compared to 7.9% average inflation in 2022) and the higher profitability of investment portfolios could help improve the profitability of the insurance industry this year.

Regarding the interest rate environment, the Bank of Mexico decided to apply two additional increases in the reference monetary policy interest rate in February and March of 50 and 25 basis points, respectively, leaving it at 11.25%. Thus, in the risk-free yield curves produced by EIOPA (see Chart 4), a slight rise is observed in the shortest segments of the curve with maturities of up to four years, significantly inverted in these segments, as well as a slight drop and a flatter curve in the longer segments. Therefore, this interest rate environment continues to be appropriate for the development of Life Savings insurance, which can offer significantly higher remuneration than the latest inflation data. The inversion in the interest rate curve remains favorable for launching savings products with shorter-term rate guarantees and periodic reviews of guaranteed rates.

Chart 4
Mexico: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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In Spain, economic growth expectations for 2023 are estimated at 1.7% (5.5% in 2022), which would lead to exceeding the pre-pandemic production level this year. The recovery of tourism, moderation of energy prices and normalization of supply chain problems are helping this improvement, particularly in certain sectors of activity, such as the automobile industry, improving exports and new vehicle registrations, favoring the recovery of the auto insurance business.

However, it is still an environment of weak economic activity, as a result of the tightening of financial conditions for households and companies, which will continue as long as inflation shows no clear signs of easing throughout the Eurozone economy. This environment points to more moderate growth for the insurance business and better prospects for its profitability throughout the year if inflation continues to moderate. The forecast for 2024 is that the Spanish economy will continue to slow down, with estimated growth of 1.4%, as the effects of the tightening of financing conditions are transferred to the real economy, which may also weigh on the growth of the insurance industry.

Full analysis of the economic and industry perspectives with additional information and interactive charts on the Eurozone, Germany, Italy, Spain, the United Kingdom, the United States, Brazil, Mexico, Argentina, Turkey, Japan, China and the Philippines can be found in the report entitled 2023 Economic and Industry Outlook: Second Quarter Perspectives, compiled by MAPFRE Economics.

The senior economy, an emerging reality

Author: Juan Fernández Palacios
Director of the Ageingnomics Research Center of Fundación Mapfre

Pioneering neural network and deep learning researcher Geoffrey Hinton, considered (on a journalistic scale) the godfather of AI at Google, told the BBC on his departure from the company that "AI-based chatbots do not currently surpass us in intelligence, but they may soon do so"… "we expect things to get better quite quickly. So, we need to be concerned about that."

At age 75, GH has decided to retire. This is yet another example of a member of the senior generation excelling in tasks that, until now, have been considered the province of young minds.

THE GREAT CHALLENGES OF THE 21ST CENTURY

As we near the end of the first quarter of the 21st century, we can already consider the three main challenges currently threatening our way of life to be consolidated: population aging, the digital revolution and climate change. These are three society-wide phenomena that, to a greater or lesser extent, originate in human action and that, on a single planet, are unlikely to evolve independently of each other.

The interaction between the digital revolution and climate generates positive outcomes: technological advances enable the implementation of more efficient processes, for example, in the production and use of renewable energies or in the reduction of industrial and urban pollution.

In turn, digital media contribute to increased life expectancy, which is one of the foundations on which population aging is based, especially due to advances in the health field involving new means of diagnosis, curative therapies or surgical treatments; not to mention digital platforms or even the application of artificial intelligence, which help to combat unwanted loneliness.

Finally, the most direct path from global warming to aging and vice versa is also through health, mainly due to the impact of temperature increases on the most vulnerable population groups. The extent to which the climate crisis can break the trend of increasing life expectancy could be explored.

But the interconnection between these three vectors of change does not prevent us from adopting a different attitude towards each of them: the urgent adoption of measures to contain the climate emergency, the adaptation and channeling of the digital revolution for the benefit of all, and the promotion and exploitation of opportunities associated with increased life expectancy, particularly health-related life expectancy.

Because, focusing on this last vector, the truth is that until recently the focus has only been on the threats inherent to population aging. For example, in the field of pensions, where the imbalance in public systems based on the pay-as-you-go system which compromises their sustainability, has been emphasized, coupled with the inadequacy of private savings in supplementary systems. Or in health systems, where the main concern is the increase in age-related illnesses (Alzheimer's, Parkinson's, bone fractures, etc.) and the costs associated with the introduction of new technologies. Related to the foregoing, there is an important challenge posed by the growing need for long-term care services, in a context of a shortage of professionals and the relative failure of the nursing home model and centers for dependent seniors. And all this in a scenario of scarcity of labor resources in an increasing number of productive sectors; in fact, in the last decade, year after year the active population in the European Union has been shrinking.

POPULATION AGING: A POSITIVE OUTLOOK

These negative effects are real and we must pay attention to them. However, a positive outlook is also possible.

Thus, in the area of pensions, a wide range of solutions have been proposed by various bodies, some of which are supported by the practice of some countries: formulas based on a better combination of public and private systems, generally pay-as-you-go in the former (first pillar) and funded in the latter (second and third pillars); alternatives such as the Swedish notional accounts system, or automatic enrollment in a company plan (autoenrollment) in the United Kingdom and other countries; additional resources could also be expected to reach the public systems, beyond incremental measures of the cost of the labor factor, through improvements in productivity associated with technological development and progress in workers' education and health levels; or, as a last resort, delaying the retirement age, something that various governments are already applying or trying to apply as a measure to contain the growth of the dependency ratio (retired persons/population between 20 and 64 years of age) which, according to Eurostat, in the EU and in 2040 will only remain at the 2020 level if working life is extended to 70 years of age, with variations by country (1).

On the other hand, when projecting future public spending on health and long-term care for dependent persons, it is advisable not to simply extrapolate present trends linearly; firstly, because the development and expansion of the use of new technologies normally entail economies of scale and cost reductions; secondly, although the European Commission assumes a progressive increase in the number of people in need of long-term care within the Union (from 19.5 million in 2016 to 23.6 million in 2030 and 30.5 million in 2050), it is undeniable that the increase in life expectancy is accompanied by an improvement in the physical and mental conditions of citizens because, among other reasons, the guidelines for healthy aging are being widely adopted by our societies. In fact, some experts argue, not without reason, that the negative economic impact on health and care is linked not so much to old age as to the end of life, so that a delay in the latter would also lead to postponing such additional costs (2).

Finally, the lever of immigration may permit the immediate arrival of resources to compensate for the decrease in the active population; it would be a matter of favoring legal and recurrent entry of foreign workers and professionals, without ruling out agreements with the immigrants' countries of origin. Of course, policies to promote the birth rate should not be neglected as a solution with long-term effects for those regions or countries that are highly aged; on a global scale, an eventual reactivation of demographic expansion will have to adhere to the limits already imposed by the depletion of the planet's basic resources.

These measures are not easy to adopt or do not guarantee a complete solution to the problems. But beyond these, a tangible reality must be considered in this positive approach: the potential of the senior generation and the growing weight of the senior economy in the global economy.

THE SENIOR GENERATION AND ITS IMPACT ON THE ECONOMY

If we think about the possible strengths of this generation, the first thing that comes to mind is its relative weight in the population as a whole, which is naturally increasing as life expectancy increases and the influx of younger generations decreases due to the reduction in fertility rates. Both elements are taking shape on a global scale; life expectancy will continue to increase in most countries, even without disruptive medical changes or advances, with a fairly homogeneous life expectancy to 65 years of age by country, between 20 and 25 years; and the number of children per woman, which has been reduced by half in the last 70 years, would now stand at 2.5, 1.64 in the more developed regions and 2.60 in the less developed ones (3).

In Spain, this strength is measured in the 16 million people who today are already over 55 years of age, a third of the population, which will rise to 42.5% in 2050 according to the central scenario of the INE's projections. However, according to the latest available estimate from the same organization, life expectancy in good health (free of functional limitations or disability) would already be 66 years, that is, with the capacity to maintain varied levels of activity.

We can therefore speak of a reserve army of labor that will generate a demographic dividend that emulates that produced by the demographic explosion of the mid-20th century; a population group in good physical and mental condition, experienced, well-trained and with a proven capacity to adapt, as well as a willingness to continue contributing to society and the economy, given the right conditions.

In this respect, Spain has some unresolved issues, among which the most important is to make progress in the compatibility between the status of worker and retiree. Our legislation is based on the principle of incompatibility (Article 213 of the General Social Security Law), which incorporates certain exceptions (active retirement, partial retirement, flexible retirement, etc.), although the regulations are excessively restrictive and provide little incentive. According to leading experts, full compatibility is a win-win situation for all parties involved: working people, who with flexibility and on a voluntary basis will be able to compensate for an eventual decrease in income associated with retirement; companies, by expanding their opportunities for filling vacancies with experience and talent; Social Security, which improves its income through solidarity contributions, without any sacrifice because workers will still receive their pensions if they are unable to work; the State, by increasing tax revenues and reducing health and dependency costs due to the benefits of active aging; and, ultimately, the Economy, since the generalization of compatibility will result in an increase in GDP (4).

As a result, Spain has one of the lowest work-pension combination ratios in the OECD in the 65-69 age segment: 0.5% for men and 1.8% for women. The conclusion is similar if we look at the labor market participation rate of the over-65s, which is 15% globally and which, at the level of each country, logically, is inversely proportional to the "generosity" of the public pension systems; in Europe the ratio is 9%, more than double that of Spain (4%). A final figure that illustrates the lower flexibility of the transition between activity and retirement in the Spanish system is the percentage of part-time work between 55 and 74 years of age, which reaches 12% in Spain, compared to, for example, 55% in Germany or 32% in Sweden (5).

Therefore, our country has an opportunity here, which will be realized if we are able to increase the senior generation's participation in the economy. It has been estimated that Spanish GDP could increase by approximately 10% if the level of employment of people over 65 reached that of Sweden, an increase that would exceed 15% if we take New Zealand as a reference; both countries have leading positions in the employment rate of people over 55 years of age in the OECD (6).

Spain must join the European trend in the development of the Senior Economy. Europe has huge potential there too; the employment level in the 55-64 age segment stood at 59.1% in 2019 in the EU, compared to 73.1% in the 20-64 age group. The European Commission estimates that this sector of the economy will have grown by approximately 5% per year in the decade 2015-2025 (7). We are talking not only about the health and care sector, where we envision the possibility of creating 8 million jobs in the EU over a period of 10 years, but also about a broader concept that looks more to the idea of healthy aging and includes tourism and leisure, housing, cosmetics and fashion, security, culture, mobility, banking and insurance.

A basic requirement for the growth of the Senior Economy and, therefore, of the economy in general, is maintaining the demand or spending capacity of the senior generation, which can be achieved by appealing to the various sources of income: those that constitute public pensions, those that come from personal property or real estate savings, from private pension systems, or those that are the result of the work or entrepreneurship of the members of that generation. This is not only a potential for future growth, but our country is already starting from a very consistent base: 60% of total spending in the Spanish economy in 2019 corresponded to the 50 and over population, with a total impact (direct and induced) equivalent to 26% of GDP that year (8).

AN HOLISTIC VIEW OF THE SENIOR ECONOMY

Faced with these prospects, public administrations must configure the framework that facilitates the best use of senior talent, whether at the national, regional or European level, in all those with regulatory capacity. Legislators must foster conditions that favor keeping those people in the labor market who are willing and able to do so, facilitating entrepreneurship as an alternative for those workers who end an employment relationship; and, of course, they must ensure the sustainability and sufficiency of a pension system that combines the strengths of the public and private sectors and makes it viable for citizens to flexibly choose the time and pace of their exit from the active phase of their lives.

Companies, meanwhile, must improve the management of senior talent within their organizations, and it would be in their interest to activate specific plans for older workers, without ruling out special employment conditions or designing suitable positions for them, and trying to increase their participation in training programs (an aspect in which Spain is among the lowest in the OECD).

In other words, the impetus for change cannot come only from the public sector; in fact, initiatives with a similar objective are emerging from the private sector. This is the case of Fundación Mapfre, which in 2020 decided to launch the Ageingnomics Research Center (ARC) (9) to contribute to the development of the silver economy.

The purpose of the ARC is to analyze, measure and monitor the evolution of the Senior Economy, which is considered the set of activities and resources originated by and/or for the senior generation; flexibly, senior citizens are understood to be those who have reached the age of 55, the age at which, according to the EU statistical office and on average, the transition between work and retirement usually begins (10). Its approach is comprehensive and, therefore, the Center regularly analyzes, first, what the citizens of this generation demand and consume, as well as what companies offer them, and second, the level of senior citizens' participation in productive activity.

For the first of these areas, demand, the ARC publishes the annual Senior Consumer Barometer, which analyzes the consumption patterns and spending priorities of the over-55s, as well as their evolution. The second, supply, is reflected in the Senior Economy Companies Monitor, which seeks an approach to the strategies and policies of the main companies in our country with respect to the aforementioned segment of the population, either through a specific range of products or the establishment of exclusive channels, prices or other special conditions.

Undoubtedly, the center of the Senior Economy's target is the labor market integration of the 55- to 70-year-old segment or even older; their level of participation in productive activity is the key factor in assessing their current situation and opportunities. The successive editions (I and II) of the Senior Talent Map published by the ARC confirm that our country has a long way to go towards achieving international best practices in this area, which first requires avoiding the feeling among mature workers that being over 55 means having no future in the labor market; in short, putting an end to the age discrimination that is deeply rooted in our system.

In a highly decentralized country such as ours, the appeal to best practices should also be made in the different geographical areas within our borders. The ARC pays attention to this with the annual publication of the Ranking of Territories for the Senior Economy, which compares the situation of this area of the economy in the 17 Autonomous Communities and, soon, in the largest cities of our country, based on a series of indicators; specifically 6 dimensions (demographics, employment, social participation, pensions, public space and infrastructure and social and health services) and four vectors for each one, with information obtained in all cases from publicly available, reliable and verifiable sources.

The ARC's commitment to research seeks to generate synergies with university institutions and other specialized centers, which are materialized in the annual call for an Academic Seminar in which researchers and experts present their proposals and projects on the topic chosen each year related to the senior generation and its economic and social impact.

Along with the research activity, the ARC promotes a series of informative activities that help citizens become aware of the new reality and the opportunities it offers; the publication of thematic guides is one of them: on entrepreneurship, healthy aging, style or solutions for generating income from real estate savings, etc. The events of the Ageingnomics Cycle, on the other hand, allow experts to discuss how the Senior Economy is impacting the different sectors.

And no less important is the Center's support for social entrepreneurship, through the Social Innovation Awards organized annually by Fundación Mapfre, in which the Senior Economy is one of the three verticals (together with Mobility and Digital Health); or, also, through the Tales for Senior Entrepreneurship Program, which is completely non-profit and in collaboration with a growing number of public universities, offers training and guidance to entrepreneurs over 55 years of age.

In short, despite demographic inertia, which will make the Senior Economy grow naturally, there is no reason to sit back and let things move forward on their own. We must activate the levers necessary for the optimal use of the potential of the senior generation. The displacement of people's life cycle requires an institutional positioning in favor of the so-called "Silver Economy", but it also requires a change of attitude in companies and in the citizens themselves. In short, a cultural change is required in the way middle age is considered.

(1) Eurostat projections, included in the Green Paper on Aging, European Commission, January 2021.
(2) Zweifel P, Felder S, Meiers M. Ageing of population and health care expenditure: a red herring? Health Econ 1999. Cited by Andrew Scott (The Lancet Healthy Longevity; December 2021).
(3) Mapfre Economics: a global perspective on pension systems, 04.2021.
(4) FEDEA, 1.2023, "Flexible and compatible retirement"- J.I. Conde Ruiz/Jesús Lahera.
(5) II Senior Talent Map of the Ageingnomics Research Center, Fundación Mapfre. Source: EU – Eurostat
(6) Golden Age Index, June 2018, PWC
(7) Green Book on Aging, European Commission, January 2021.
(8) Oxford Economics. Study of the Economy of Longevity in Spain (report for CENIE). September 2021.
(9) ageingnomics.fundacionmapfre.org
(10) Ageing Europe Report 2020, Eurostat.

NOTICE