MarketStance Version 11.2 Forecast Release Notes

Underwriting, private sector growth key commercial lines factors in our slowly growing economy

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Eric Price-Glynn

Economist & Assistant Vice-President

Property and Casualty Research and Development

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Who to contact for more information

Please contact Katie Haberlandt in our Client Services department at ms@marketstance.com (860) 704-6381 / 888-777-2587 or your Regional Relationship Director if you have any questions or service needs. We value your business, and thank you for your continued support!

Summary

Despite slow growth, the national commercial lines outlook continues improving as of mid-year, primarily due to a hardening market across most if not all lines of business.

Echoing our Commercial Insight 11.1 (CI 11.1) forecast note, pricing, not the economy undergirds premium growth in commercial lines. Following last year's catastrophe losses and the lack of profitability in workers' compensation and other casualty lines for many major carriers, pricing discipline has returned.

In this economic environment the promise of near zero asset returns adds pressure on underwriting performance as a source of profit growth. As a consequence, underwriters face a surgeon's task of picking the right risks if they want to achieve a competitive advantage.

A risk picker's market

In that spirit, Commercial Insight and Growth Advisor clients can turn their attention to pockets of opportunity emerging in the 2013-14 forecast, particularly in metro areas stressed by housing's collapse in the second half of the 2000s and in the perennial growth leadership state of Texas. Some fast-growth examples are shown in Table I:

Table I. Small Commercial Employment Growth and Rankings, Larger MSAs

	2011-12		2013-14	
Metro Area	**Employment Growth (ann.)**	**Rank**	**Employment Growth (ann.)**	**Rank**
Tucson, AZ	1.7%	27	4.6%	1
Austin-Round Rock-San Marcos, TX	4.0%	1	3.4%	2
Salt Lake City, UT	3.0%	5	3.2%	3
Dallas-Fort Worth-Arlington, TX	2.8%	8	2.9%	4
San Antonio-New Braunfels, TX	1.6%	28	2.9%	5
Atlanta-Sandy Springs-Marietta, GA	1.5%	33	2.8%	6
Houston-Sugar Land-Baytown, TX	3.6%	3	2.6%	7
Raleigh-Cary, NC	3.4%	4	2.5%	8
Las Vegas-Paradise, NV	0.2%	59	2.5%	9
Phoenix-Mesa-Glendale, AZ	2.0%	20	2.4%	10

Source: MarketStance Commercial Insight 11.2 Headquarters Data (August 2012)

Looking at the small commercial (1-49 EE) segment, Tucson (**#1**), Las Vegas (**#9**), and Phoenix (**#10**) have broken in to our Top-10 fastest forecast growth areas in terms of 2013-14 employment growth, despite the fact that these three metros ranked #27, #59, and #20, respectively, in 2011-12, among larger metro areas in the segment.

At the industry level, sectors such as residential lessors' risks will continue seeing positive growth. The return to more normal credit underwriting standards, limited job and income growth, and heavy student loan indebtedness, will continue turning many would-have-been owners into renters.

As the renting propensity grows the rental vacancy rate falls. In less than three years, this vacancy rate has fallen from 11.1 percent to 8.6 percent – a remarkable 22 percent decline from the record highs reached during the 2000s housing bubble.

Nationally, growth in multi-family construction (SIC 1522) provides a noteworthy bright-spot in our largely uninspired economy. Thanks to building catching up with demand, this industry has vaulted from the bottom third of all four-digit SICs, in terms 2011-12 employment growth, to the top-third, with a respectable 2.4 percent forecast annual growth in 2013-14, 0.7 percent above the national average for all industries for the same period.

Economic risks – near and longer term

Turning to our slowly growing national economy, two themes figure prominently in the medium-term economic forecast horizon.

First, the election cycle closes the door on any further federal government efforts to speed the recovery, despite the current sub-par 1.5 percent economic growth rate, 15 percent "U-6" unemployment rate (including involuntary part-time), and record low federal borrowing costs.

Whatever one's personal political position, the implications of slow growth over the medium and longer terms are fairly straight-forward – and negative – for the potential rate of commercial lines exposure growth.

While much political battle here and internationally occurs around "the debt" of governments at all levels – and for good reasons, because the question of who will face the burdens of future spending cuts, tax increases and debt repayments looms large – there is little question either theoretically or empirically about how we collectively got here.

The collapse of housing sales and prices, and disappearance of all of the spending reliant on both created a $1.5 trillion hole, beginning in 2009. The federal government mustered little more than half that in all forms of spending projects and tax cuts – leaving an approximately $600-700 billion hole behind. The weak private sector has barely filled this hole, and state and local governments have actually dug it ever deeper since 2009, under mandates to balance their budgets.

On an employment and income basis, although GDP has "recovered" its 2007, pre-recession level, the post-recession period has generated too little spending and jobs to really be spoken of as a "recovery" in any meaningful sense.

Now that layoffs of teachers, professors, and public safety staffs have leveled-off in some areas and government fiscal and monetary policy are both at election year stand-still, the full weight of any true near-term recovery is on the private sector, not on governments.

Governments, as requested by both political parties for election purposes, are "out of the way" – at least in policy terms, for the time being – and this has been true for at least a year.

The private sector will likely continue carrying all (or nearly all) of the growth burden well through the inauguration in March, 2013. To the extent that private firms both large and small see profitable expansion opportunities, accelerate their real investments, employ the unemployed – and purchase more commercial insurance and insurance services – the general commercial lines outlook will brighten, reinforcing the positive underwriting cycle well underway.

To the extent this fails to happen – and our forecast suggests a more nuanced picture – the national economy today will largely be the economy we have twelve months from now. Overhanging this minimal growth economy will be the omnipresent worry in the background about the impacts of trade and financial linkages to Europe, should Europe do nothing about slow growth in Germany, France, Italy, and elsewhere.

Thus, a second theme of the national forecast emerges as increasingly likely over the longer term. The collapse of the residential asset markets will in all likelihood combine with ill-advised policy responses both here and abroad, restraining growth in commercial lines premiums for some time to come.

The considerable distortions of electioneering aside, the long-run economic performance of the U.S. provides few prospects for organic growth of commercial lines exposures at the national level.

The seeming good times in commercial lines of the middle 2000s, a perception amped-up by the premium-rich construction sector and other factors, masks the longer term trend that neither the Bush nor Obama administrations presided over a rapidly growing economy. The periods spanning Bush I, Bush II, and Obama had notably modest economic performance.

All told, as Professor Menzie Chin at the University of Wisconsin La Follette School points out, when you strip out the war-driven defense spending, the economic and employment growth during the last three presidential administrations was basically indistinguishable, averaging less than 1 percent per year on a GDP per capita basis – far below a healthy growth rate, even for a mature economy. In other words ours is an economy growing only modestly faster the population.

One can pick sides in terms of which administration or brief period was slightly better on a given growth metric and extrapolate a national economic story, political view, or forecast from there.

But the underlying message for commercial lines for the foreseeable future continues to be that brokers, carriers and the industry generally will have to know a lot more about the parts of the economy – what we like to call pockets of opportunity – business classes, size segments, and specific territories – than can ever be indicated by the rate of growth in gross domestic product or employment. These pockets are what will provide both hope and help, when it comes to planning and acting intelligently, that is, profitably.

This is a surgeon's economy – and carriers will have to leverage expertise, tools and techniques that enable surgical behavior to gain any growth much less competitive advantage. **This is where MarketStance can help!**

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