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The interconnectedness of the economy and geopolitics and their impact on the insurance sector

While inflation slowly moves towards target levels, interest rates remain elevated, and the global economy remains relatively resilient insofar as we have managed to avoid a general recession. Fears that prolonged elevated interest rates could lead to banking failures, due to increases in loan defaults as debt servicing became costlier, did not materialise. Furthermore, emerging market economies with their relatively frail fiscal conditions following elevated spending levels brought on by the COVID-19 pandemic, have continued to grow and the spike in inflation has generally not led to the wage-price spiral feared towards the end of 2022.

Global economic growth reached a low of 2.3% at the end of 2022 and has been improving since, with the International Monetary Fund (IMF) predicting steady growth of around 3.2% for both 2024 and 2025[1] supported by the predicted reductions in interest rates and the stimulating impact thereof on consumption and investment expenditure.

Median inflation has also slowed from a global peak of 9.4% at the end of 2022 and is expected to reach 2.8% by the end of 2024 and 2.4% in 2025, following the moderation in prices of fuel and food as well as the improvements in efficiency of global supply channels.

Therefore, by most indicators, it appears that the global economy will experience a gradual recovery following the disruptions caused by the global COVID-19 pandemic and the ongoing geopolitical conflicts[2] currently disrupting the global market.

The more positive expectations for the performance of the global economy in 2024 and beyond are centred around the predicted action of central banks to reduce interest rates in line with the moderation of inflation. This expectation has generally provided support for global equity and bond markets from the start of 2024, with new record levels being reached by the United States S&P 500 composite index as well as the Indian Nifty 50 index. This has been the case even as the expectations of the number and size of interest rate reductions have reduced and shifted later into 2024 in line with more modest reductions in inflation, implying that interest rates will remain higher for longer. Much of the reduction in inflation rates from the 2022 highs can be attributed to the moderation of energy prices and the price of goods as supply chains adjusted and adapted to the post pandemic and geopolitical disruptions. In contrast, services inflation has remained higher and has prevented more rapid deceleration of inflation.

1 International Monetary Fund (IMF), World Economic Outlook - Steady but Slow: Resilience amid Divergence. April 2024: https://www.imf.org/en/Publications/WEO/Issues/2024/04/16/world-economic-outlook-april-2024

2 Most notably the wars in Ukraine and in the Middle East

However, given the many different economic structures and strategies around the world, there is also much divergence between regional and country growth paths. According to the World Economic Outlook, the United States has experienced good economic growth and strong demand, while growth in Europe has been anaemic but is expected to improve from this year onwards based on loosening monetary policy and reduced energy costs. China's economy continues to be impacted by the problems experienced in its property sector triggered by a liquidity crunch, with weaker domestic demand and pressure on public debt. This may lead to trade surpluses and further impacts on existing trade tensions. The reconfiguration of global supply chains may lead to more geopolitics. This is expected to shift global trade and power to other large emerging markets that can accommodate these changes.

The IMF has stated that many low income emerging and developing countries have fared the worst and have to date been unable to emerge from the effects of the pandemic and the cost-of-living crises. To make progress, these countries and economies will have to focus on making the structural reforms that will lead to higher economic growth and at the same time attract investment while focusing on developmental goals and improving the quality of their human capital. These countries, especially those that are more indebted, are experiencing increased fiscal pressure as well as losses of total factor productivity[3] due to misallocation of capital and labour within sectors and countries.

The World Economic Outlook also emphasises that harnessing the expected positive productivity impacts from the growing integration of artificial intelligence (AI) through all aspects of the economy and for all citizens will require countries to improve their digital infrastructure and increase investment in human capital. Failure to do so will only increase the divergence of economic paths and development benefits when compared to those countries that implement these measures successfully.

While investment in the green economy has grown strongly in advanced economies and China[4], more needs to be done in emerging and developing economies where the negative effects of climate change will be experienced. This will require not only large-scale technology transfer, but also a significant increase in sustainability finance driven by the private sector. In addition to the global trends listed above there are a number of domestic factors that may negate or even reverse any positive impacts expected. The ongoing cost pressures imposed by the insufficient and inconsistent supply of electricity, along with the deteriorating logistics infrastructure throughout South Africa, will continue to contribute to higher output costs and keep prices higher for longer, further delaying the reduction of the inflation rate back to target levels. This impact is augmented by efficiency losses and reduced productivity due to widespread government malversation and governance failures, including incongruent policy and the overly centrist approach to governance.

South Africa conducted a general election at the end of May 2024, the result of which may have a range of possible outcomes on the economy and the insurance industry. The impact of the election will depend on how the result is perceived by local and international stakeholders in terms of political and economic risk, with an increase in perceived risk leading to generally higher domestic costs and economic pressures, while the opposite would be true for an improvement in South Africa's risk profile.

The impact of the macroeconomic environment, natural disasters and the ongoing geopolitical conflicts on the insurance industry are many and varied. These factors have resulted in changes to the demand for insurance products, cost of insuring risks and the viability of insurance as catastrophic risks increase in frequency and size in line with climate change impacts.

The global and local expectation is for a reduction in inflation through 2024, leading to a lowering of interest rates and consequent increase in economic growth. This would provide a tailwind to the insurance sector by simultaneously reducing the cost pressures underlying the insurance market while increasing the ability of both businesses and individuals to purchase insurance products. As mentioned above, this trend could however be reversed in South Africa where several structural problems have resulted in increased upward pressures on insurance costs as the economy faces a challenging logistic and policy environment, slow growth, high unemployment, a weakening currency, growing public debt, a shrinking tax base and bad governance.

[3] https://en.wikipedia.org/wiki/Total_factor_productivity

[4] International Monetary Fund (IMF), World Economic Outlook - Steady but Slow: Resilience amid Divergence. April 2024: https://www.imf.org/en/Publications/WEO/Issues/2024/04/16/world-economic-outlook-april-2024

In addition, climate change related insurance claims are rising both internationally and in South Africa, with ongoing global warming likely to worsen the situation in future. Apart from being the hottest year on record, South Africa in 2023 experienced a total of around ten weather-related claim events. Many of these events could be classified as significant, including the storms and flooding in the Western Cape, Eastern Cape and KwaZulu-Natal, and the hailstorms experienced in Gauteng and Mpumalanga. The result is that the insurance landscape is changing, with insurers and reinsurers adapting their strategies and loss models in step with the increased frequency and severity of these events and resulting in reduced coverage or even the exclusion of certain events. This may also result in reinsurers taking less risk from these types of events leaving insurers unable to smooth out losses over time, and significant increases in the cost of insurance.

The outcome of the 2024 general elections on the South African economy is critical in understanding the impacts on the local economy. With many other countries also going through general elections, the impact on the global and local economies will become even more critical to monitor and understand in the next few months.