

Inflationary Issues

December 2022

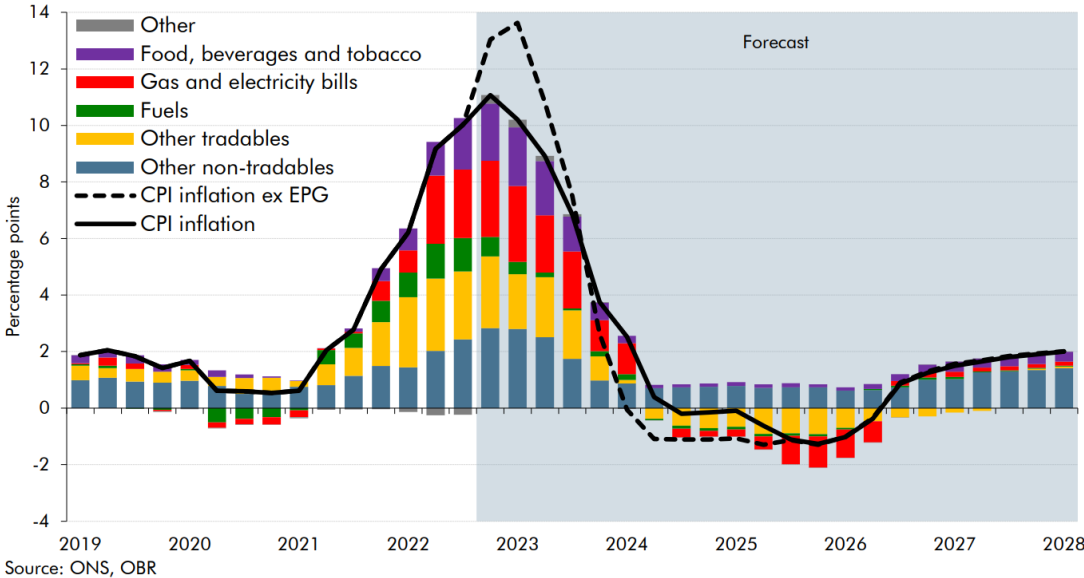
Since publishing our [July Insights](#) we've seen some major political and economic developments in the UK, including the resignations of two Prime Ministers in quick succession, a disastrous mini-budget predicted to have cost the UK £30bn, further strike action and a recession. Climate change continues to impact households across the UK with many areas now experiencing extreme flooding and, in addition, the energy crisis and the rising cost of living are significantly impacting manufacturers, suppliers and consumers.

Here we summarise the key issues, along with the relevant insurance implications that are likely to be affecting some customers.

Inflation and price indices

- In November, The Bank of England (BoE) lifted interest rates to 3% from 2.25%, the biggest jump since 1989. (Source: [BoE](#))
- UK inflation hit a 41-year high of 11.1% in October due to soaring food and energy prices. Gas prices have leaped 130% higher over the past year, while electricity has risen 66%. Food price inflation rose from 14.6% in September to 16.4% in October - its highest level since 1977. UK inflation is expected to remain high into next year, averaging 7.4-8.8% in 2023, higher than in any other G7 economy. Based on market expectations of higher interest rates and a sharp fall in gas prices, inflation would then fall with consumer prices falling for a full two years from mid-2024. (Source: [Economic and Fiscal Outlook - November 2022 – obr.uk](#))
- Britain has entered a recession that could potentially last two years - longer than during the 2008-09 financial crisis, (Source: [Reuters](#)) and despite wages increasing by their fastest rate in more than 20 years, once inflation is taken into account, average pay has fallen by 2.7%. In response, many unions have balloted their members for strike action over pay, saying that wages should reflect the increased costs of living. (Source: [BBC News](#))
- In its November Monetary Policy Report, the BoE laid out 2 possible scenarios, in which interest rates either remain constant at 3% for some time or rise to 5.2% by Q4 2023. However, even if interest rates stay on hold at 3%, the BoE still forecast a recession throughout 2023 and 2024 H1. The next announcement on interest rates will be on December 15. (Source: [November Monetary Policy Report](#))

- GDP & Labour Market:** GDP is set to contract by 1.4% in 2023. Annual GDP growth picks up to 1.3% in 2024. Stronger growth is forecast in 2025 (2.6%) and 2026 (2.7%). Output is set to recover to pre-pandemic levels only in Q4 2024. Unemployment is forecast to rise from current 3.6% rate to 4.1% in 2023 and then peak at 4.9% in Q4 2024. By late 2027, unemployment returns to its estimated structural rate of 4.1%. (Source: [Economic and Fiscal Outlook - November 2022 – obr.uk](#))
- Living Standards:** The monthly rate of the Consumer Prices Index (CPI), which measures the average change in price of a typical basket of consumer goods, rose by 2% in October 2022 compared with 1.1% in October 2021. This means that, between September and October 2022, the prices of goods and services bought or consumed by UK households have increased by 2.0%. (Source: [Office for National Statistics](#)). The real household disposable income (RHDl) per person is set to fall by 4.3% in 2022-23 due to inflation eroding real wages – the largest since ONS records began in 1956-57. That is followed by the second largest RHDl per person fall in 2023-24 at 2.8%. Overall, UK households are set to witness a cumulative 7.1% fall in living standards over the next two years to 2023-24. (Source: [Economic and Fiscal Outlook – November 2022 – obr.uk](#))
- Business Investment:** Business investment is still 8% below its pre-pandemic level – lower than previous forecasts of a strong business investment recovery. As the economy enters recession, business investment is expected to fall further in 2023 by more than GDP; recovery starts from 2024. Key reasons include rising interest rates, high energy prices, 6% rise in corporation tax from April 2023, uncertainty over the UK tax regime. (Source: [Economic and Fiscal Outlook – November 2022 – obr.uk](#))
- Key contributors to consumer price index (CPI) inflation and forecasts** (Source: [Economic and Fiscal Outlook – November 2022 – obr.uk](#)):



Insurance impacts

- Both businesses and consumers are feeling the impact on their coffers, which is subsequently influencing their insurance purchasing decisions.
 - Claims severity has increased while inflation will further challenge costs. Updating valuations of assets is key for companies and insurers. (Source: [Allianz press release](#))
 - Insurers are focussing on rate strength, inevitably leading to increased premiums for customers. (Source: [Allianz news](#))
 - Corporate risk has risen again, but higher fiscal support should prevent a large wave of business insolvencies and an acceleration in severity rates. (Source: [Allianz economic research](#))
 - After two years of declines, we expect a broad-based acceleration in business insolvencies globally: +10% in 2022 and +19% in 2023. (Source: [Allianz economic research](#))
 - Reductions in real income could see deferment of non-essential insurance purchases. (Source: [Reinsurance News](#))
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Supply chain disruption

- The Climate Change Committee's evidence shows that we are already experiencing disruption to domestic supply chains from floods, droughts, high temperatures and other extreme weather in the UK. (Source: [Climate Change Committee](#))
- Recent events, such as Covid and the Russian invasion of Ukraine have significantly impacted on people and the economy, causing rises in food and energy prices and disruption to the production and transportation of a wide range of goods. (Source: [Climate Change Committee](#))
- Whilst the construction industry continues to face issues with materials shortages, labour shortages continue to present the biggest challenge, with 244,000 fewer workers in the construction sector compared to 2019. (Source: [Homebuilding & Renovating](#))
- Executives at food associations warned food supply chain disruption had been escalating in recent months, but progress has been "lacking" when it came to protecting food supply and ensuring food safety. (Source: [Chartered Institute of Procurement and Supply](#))

Insurance impacts

- Supply chain disruptions can reduce revenue, cut into market share, threaten production and distribution, inflate costs and ultimately affect a company's bottom line.
 - Purchasing specialty insurance policies can limit exposure to loss.
 - Businesses need to ensure they have the relevant insurance coverage to protect against supply chain failure.
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Energy crisis

- Gas prices have leaped 130% higher over the past year, while electricity has risen 66% (Source: [The Guardian](#))
- In October, UK households began receiving the first tranche of a £400 energy subsidy and the lower £2,500 energy price cap came into effect. (Source: [BBC News](#))
- As a result of the energy subsidy schemes, government borrowing increased to £13.5bn in November (Source: [BBC News](#))
- Oil and gas prices increased because energy was in greater demand as life got back to normal after Covid. At the same time, the war in Ukraine meant less was available from Russia, putting further pressure on prices. (Source: [BBC News](#))
- In November, energy regulator Ofgem announced in its quarterly update that the energy price cap was set to rise to an annual level of £4,279 in January 2023, however bill-payers remain protected under the government's Energy Price Guarantee (EPG). (Source: [Ofgem](#))
- Petrol prices are climbing again for the first time in three months, after October's controversial decision by the oil cartel and its allies to cut oil production, putting more pressure on drivers during the cost-of-living crisis. (Source: [The Guardian](#))
- Eurozone growth is likely to plunge to -0.8% in 2023 due to soaring energy prices and negative confidence effects. (Source: [Allianz Economic Research](#))

Insurance impacts

- The energy crisis means a massive profitability shock for European firms, which governments can only partially offset. It's estimated that the number of firms at risk of going belly up in case of a blackout scenario to be 42,000 (or 17% of the total) in the UK. (Source: [Allianz Economic Research](#))
- Prolonged economic weakness resulting from the energy crisis will impact overall demand for insurance and drive claims costs higher, according to analysts at the Swiss Re Institute. (Source: [Reinsurance News](#))

- It's predicted that there will be a greater push on green transition, providing long-term opportunities for insurers. (Source: [Reinsurance News](#))
 - Accelerated investments in renewable energy could further boost premium growth and insurance product innovation in this area. (Source: [Reinsurance News](#))
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The cost and shortages of food and supplies

- The monthly rate of the Consumer Prices Index (CPI), which measures the average change in price of a typical basket of consumer goods, rose by 2% in October 2022 compared with 1.1% in October 2021. This means that, between September and October 2022, the prices of goods and services bought or consumed by UK households have increased by 2.0%. (Source: [Office for National Statistics](#))
- Despite the three-point rise in confidence to -44 in November, consumer confidence index remains at near historic low. The slight uplift in confidence is likely to be caused by new government and new fiscal statement after the mini-budget shock. Household budgets remain constrained by fresh jumps in food prices, high energy bills, the prospect of new interest rate rises pressurising mortgage and rent payments, potential future hikes in council tax and squeezed real pay. Consumer spending is forecast to fall by 1.0% in 2023 (Source: [BoE](#))
- Food and energy prices have jumped, in part because of the Ukraine war, which has left many households facing hardship. (Source: [ONS](#))
- The price of food and non-alcoholic drinks rose by 16.2% in the year to October, up from 14.5% in September. (Source: [BBC News](#))
- In September food inflation reached 12.4%, the highest rate since research began in 2008. (Source: [Chartered Institute of Procurement and Supply](#))
- Raising interest rates will make it more expensive to borrow and encourage people not to spend money, easing the pressure on prices in the process. (Source: [BBC News](#))

Insurance impacts

- 70% of UK citizens have reduced their spending because of rising living costs. (Source: [Consumer Intelligence](#))
- It is likely that people will cut back on their insurance costs this quarter, with pet insurance predicted to be the most cancelled policy. (Source: [Consumer Intelligence](#))
- Of those who had looked to save on insurance in the last three months, 66% had swapped to a cheaper policy, and 43% had cancelled a policy. (Source: [Consumer Intelligence](#))

- 59% of the people who've cut back on their insurance costs have switched car insurance to cheaper cover. (Source: [Consumer Intelligence](#))
 - 30% of the people who've cut back on their insurance costs have swapped their buildings and contents insurance to a cheaper policy. (Source: [Consumer Intelligence](#))
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The cost of materials

- The material price index for 'All Work' increased by 15.5% in October 2022 compared to the same month in 2021. (Source: [Gov.uk](#))
- The current global raw materials shortage has had a profound impact on the UK trade and construction industry. Soaring demand, the impact of Brexit, continued pandemic recovery and shock factors like forest fire threats in North America are all reasons behind the shortages. (Source: [Checkatrade](#))
- A range of building materials have increased in price, such as: timber, cement, insulation, plywood and roof tiles (Source: [Checkatrade](#))

Insurance impacts

- The fluctuations in material costs may impact the profitability of small, local builders, which could see an increase insolvencies and a decline in SME new business and renewals. (Source: [fmb.org.uk](#))
 - Delays or cancellation of building projects could result in an increase in business interruption claims.
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Construction

- Construction PMI fell to a three-month low in November from 53.2 in October to 50.4. (Source: [S&P Global](#))
- UK construction firms signalled a slowdown in business activity growth due to subdued demand and reduced appetite among clients. (Source: [S&P Global](#))
- House building activity stalled due to higher mortgage rates and falling consumer confidence. (Source: [S&P Global](#))
- The rate of job creation eased to its slowest since Feb 2021 due to concerns about rising costs. (Source: [S&P Global](#))

Insurance impacts

- The switch to sustainable energy and the adoption of modern building methods, as well as the associated changes in design, materials and construction processes, will radically transform the risk landscape. (Source: [Allianz](#))
 - Project delays have the potential to drive up business interruption claims. (Source: [Allianz news](#))
 - Rebuild costs are escalating due to increased fuel prices, supply chain issues, climbing energy costs used in the production of wood and steel and higher wages for construction workers against a backdrop of a shortage of labour. (Source: [Allianz news](#))
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Motor

- Please read our separate motor claims inflation guide – '[what's driving motor claims inflation?](#)'
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Commercial property

- The MSCI UK property index that tracks shops, offices and warehouses worth tens of billions of pounds fell by a record 6.5%. (Source: [FT](#))
- The five-year Sonia swap rate, used by UK lenders to price loans, has risen fourfold in the past 12 months to 3.8%. (Source: [FT](#))
- Offices are among most affected: the cost of debt to fund a new office development project had risen from 8% to 14% in the past two months. (Source: [FT](#))
- Higher mortgage rates and the wider impact of a slowdown in the economy, such as rising unemployment, will unite to push down house prices, the OBR said. It forecast that there will still be an average increase in property prices this year of 10.7% despite the recent slowdown. (Source: [BBC News](#))
- Tenants renting social housing in England will face higher rental bills. (Source: [BBC News](#))
- Capital values decreased -6.8% across all UK commercial property in October 2022. Over the month, rental value growth was 0.3%. Total returns were -6.4%. (Source: [CBRE](#))
- In October, retail capital values decreased -4.8%, representing the smallest decline of all sectors. Retail capital value decreases were driven by standard shops (-5.5%) and retail warehouses (-4.7%). (Source: [CBRE](#))

- The property and construction sector is suffering from rising construction material prices and supply chain disruption. The greatest price increases seen in the 12 months leading up to August 2022 were for gravel, sand, kaolin and insulating materials. (Source: [Allianz news](#))

Insurance impacts

- The BCIS house rebuilding cost index, which is used for updating sums insured, grew by 9.4% between October 2021 and October 2022. (Source: [Allianz news](#))
- Global commercial insurance prices increased 9% in the second quarter of 2022 (down from an 11% increase in Q1), continuing a trend of moderating rate increases that began in Q1 2021. (Source: [Insurance Journal](#))

Further reading

[Allianz Economic Research](#) - Allianz global research analysing economic and industrial developments .

[Underinsurance](#) - Resources, information and guidance to help customers understand the issue of underinsurance.

[Ludonomics](#) - Ludovic Subran, Allianz's Chief Economist publishes a weekly update on Allianz markets, macro, sector, and insurance.