Allianz

ECONOMIC INSIGHTS

Inflationary issues March 2023

The levels of disruption that we saw at the end of 2022 (see our December Insights) look set to continue in 2023. Economic pressures, food shortages, the war in Ukraine and further strike action across a range of sectors are still affecting supply chains, and food and energy prices have risen further.

However, the Bank of England expects inflation to fall from the middle of this year and Prime Minister Rishi Sunak said halving inflation by the end of 2023 is a government priority.

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

Also take a look at our underinsurance hub, where you can find all of our insight articles, webinars, podcasts and guidance notes that can help address the risks of underinsurance.

Inflation and price indices

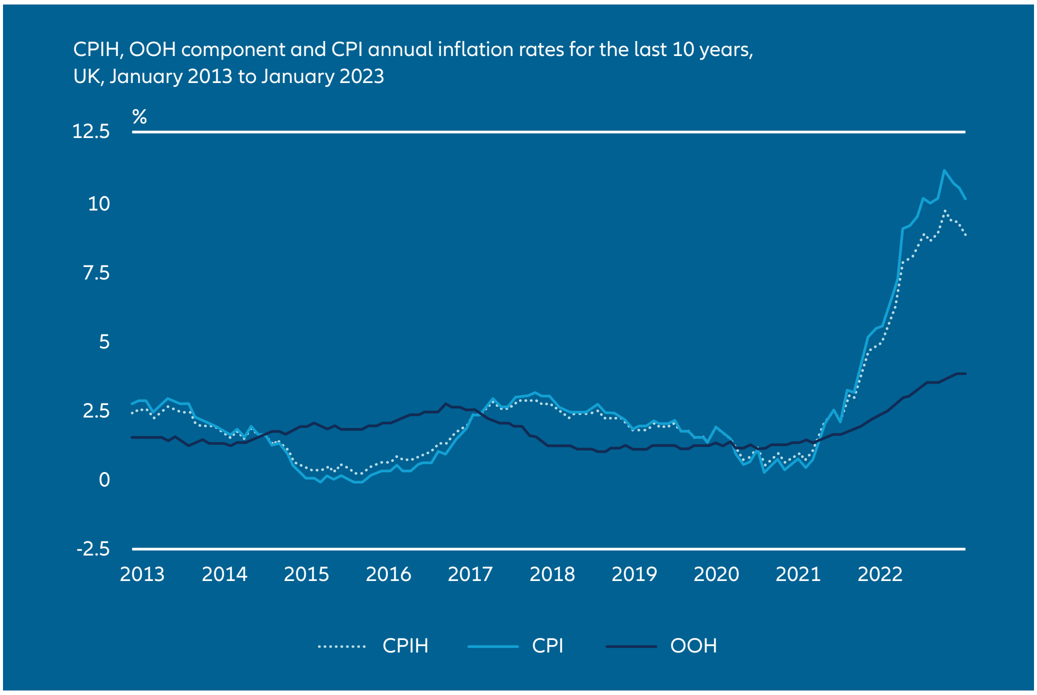
- On 2 February 2023, the Bank of England announced a 0.50% increase in its base rate from 3.50% to 4.00%. (Source: Bank of England). This means many people will face higher borrowing costs, and some businesses will face higher loan rates. Overall, people are expected to spend less on goods and services.
- We expect an update from the Bank of England on interest rates on 23 March 2023.
- The **rate of inflation has been declining**, with the annual inflation rate falling to 10.1% in January, down from 10.5% in December 2022. The Bank of England predicts that inflation will begin to fall quickly from the middle of this year and be around 4% by the end of the year. Inflation is expected to continue to fall towards the Bank of England's target of 2% after that. (Source: Bank of England)
- Prime Minister Rishi Sunak said halving inflation by the end of 2023 is a priority for the government, but as yet, no new policies have been announced to achieve this. (Source: BBC News)

For Intermediary Use

- Pay increases for many people aren't keeping up with rising prices, despite wages increasing by their fastest rate in more than 20 years. Once inflation is taken into account, average pay actually fell. Many workers across a range of sectors including rail, teaching and the NHS are **striking over pay**, saying that wages should reflect the increased costs of living. (Source: BBC News)

- 94% of adults in Great Britain reported an **increase in their cost of living** in January-February 2023. (Source: Office for National Statistics)

- 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 10.1% in the 12 months to January 2023, down from 10.5% in December 2022. The Consumer Prices Index including owner occupiers' housing costs (CPIH) rose by 8.8% in the 12 months to January 2023, down from 9.2% in December 2022. (Source: Office for National Statistics)



Insurance Impacts

- Record inflation and the cost of living crisis will be the greatest challenge faced by the insurance sector this year. (Source: Insurance Times)

- Both businesses and consumers are feeling the impact, which is subsequently influencing their insurance purchasing decisions. Customers will be looking for products that offer better terms and pricing to reduce their overall cost. Insurers should be aware of this expected shift and proactively try to keep clients on board. (Source: Silverline)

- Insurers are focussing on rate strength, inevitably leading to increased premiums for customers. (Source: Allianz news)

- Claims severity has increased while inflation will further challenge costs. Updating valuations of assets is key for companies and insurers. (Source: Allianz press release)

- 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)

Supply chain disruption

- **Disruptions to supply chain operations are set to continue** in 2023. (Source: KPMG)

- The recent macro-economic turmoil and the war in Ukraine has increased vulnerability, triggering shortages and price increases in energy, food and certain raw materials. **The conflict has added further pressure** to supply chains already struggling with post-pandemic disruption, such as shortages in semiconductors, which have yet to fully recover. (Source: Allianz Risk Barometer)

- In the year ahead, **organisations may experience limited access to critical inputs for manufacturing**, or even spare parts and critical maintenance items. Building resilient supply chains will be a key focus for businesses in 2023. (Source: KPMG)

- The **construction industry is one of the hardest hit** in the UK, facing material and labour shortages with 75% of contractors having issues recruiting, according to a survey from the Civil Engineering Contractors Association. (Source: Construction News)

- **Shipping costs are plunging as consumer spending declines**. The price of shipping goods on global trade routes fell 85% below its peak, as the cost of living crisis hits consumer spending and Covid-related supply chain disruption eases. The widespread delays and queues which hit ports at the height of the pandemic, have also dissipated. (Source: Financial Times)

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.

- Supply chain disruption intensifies demand for business interruption insurance coverage and so businesses need to ensure they have the proper insurance coverage to protect against supply chain failure.

Energy crisis

- Oil and gas continue to be in great demand but the continuing war in Ukraine means that less is available from Russia, further exacerbating the energy crisis. (Source: BBC News)

- On 1 January 2023, the **Office of Gas and Electricity Markets (Ofgem) increased its energy cap on prices**, this led to price rises for gas and electricity. (Source: Office for National Statistics)

- **Wholesale gas prices have been showing signs of declining** and stabilising, which is positive news. (Source: Tradingeconomics.com)

- **Electricity, gas and other fuels were the main contributing factor to higher inflation rates** from April 2022. The contribution from this class increased from 2.53 percentage points to 2.56 percentage points in January 2023. (Source: Office for National Statistics)

- Currently, the most important financial issue for the public is energy costs. (Source: BBC News)

Insurance Impacts

- 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)

- Some businesses have been reducing gas consumption by switching to LPG (liquefied petroleum gas) or oil, or reactivating or upgrading redundancy systems that have long been unused. This has the potential to increase the risk of technical failure and change a company's risk profile. (Source: Allianz News)

- Any business interruption loss could potentially be much higher as electricity prices have soared. It's therefore more important than ever to assess and mitigate operational risks with a professional underwriting and risk consulting dialogue. (Source: Allianz News)

The cost and shortages of food and supplies

- The **war in Ukraine has reduced the amount of grain available**, pushing up food prices.

- **Annual food inflation hit 16.7% in January 2023**. Basics such as milk, olive oil, cheese and eggs saw the largest increases but costs for sugar, jam, honey, syrups, chocolate and soft drinks and juices also jumped. (Source: BBC News)

- **Grocery prices in the four weeks to 19 February rose 17.1%** from a year ago, the highest rate since its records began in 2008. (Source: BBC News)

Insurance Impacts

- In the last 3 months, 7% of people have cut back to make savings, with 46% of those cancelling insurance cover and 59% changing to a cheaper policy. 15% of 18-24 year olds have cut down on their insurance costs this winter. (Source: Consumer Intelligence)

- 29% of consumers say they're more likely to purchase a lower cover insurance product in the future, and 28% say they're more likely to pay in instalments in the future. (Source: Consumer Intelligence)

- 41% of motor customers and 43% of home customers are now deemed to be vulnerable due to the cost of living crisis. This is nearly half an insurer's customer base. (Source: Consumer Intelligence)

The cost of materials

- There are **signs that the price of building materials may be starting to settle** after a sharp 25% rise in 2022, but the outlook is still uncertain. (Source: Homebuilding and Renovating)
- **The price and availability of commodities may fluctuate in 2023** – whether that be fuel/diesel, construction items like timber, steel and resin, or plastic for packaging. (Source: KPMG)
- The increased prices of raw materials, supply chain delays and shortage of available tradespeople means that **property owners are spending more on projects** than previously. (Source: Checkatrade)
- The material price index for 'All Work' increased by 11.2% in December 2022 compared to the same month the previous year. This followed an increase of 12.7% in November 2022 compared to November 2021. (Source: Gov.UK)

Insurance Impacts

- The fluctuations in material costs may impact the profitability of small, local builders, which could see an increase in insolvencies and a decline in SME new business and renewals. (Source: fmb.org.uk)
- Shortages in construction materials and labour may mean that insurers face delays when attempting to resolve claims. (Source: PropertyCasualty360)

Construction

- **The Construction sector continues to struggle** due to economic uncertainties, labour and material shortages and rising costs, planning delays, costs associated with energy efficiency upgrades, rising PI insurance costs and IR35 tax charges and the removal of the red diesel rebate.
- **Insolvencies in the sector continue to soar**, construction firms in the UK went out of business at the highest rate in a decade in 2022.
- **Two thirds of builders are putting their prices up**, with a third also saying they are still struggling with labour shortages of carpenters, bricklayers and general labourers. (Source: Homebuilding).
- In December 2022, an almost record number of **concrete, cement and brick suppliers said they were planning to increase their sales prices further**. (Source: Think)
- It's predicted that **construction output across the UK will fall by 3.9% in 2023** following a rise of 2.0% in 2022. (Source: The Construction Index)
- UK housebuilder Persimmon warned that its **new home sales could fall by up to 40%** this year if demand stays as it is now, meaning that sales could fall to 8,000 vs 14,000 last year.

- UK housebuilders have already **cut back on land purchases and building new property** as the market has slowed. Housing supply is estimated to hit its lowest levels since the second world war in the coming years due to higher mortgage rates and environmental and planning regulations. (Source: Financial Times)

- In more reassuring news, the latest Construction Purchasing Managers Index shows an increase from 48.4 in January to 54.6 in February, showing **the construction industry is expanding**. (Source: Investing.com)

Insurance Impacts

- Companies going under, general interest rate rises, supply chain pressures and demand for labour are the highest risk for construction sector insurers in 2023. Delays or cessation of projects due to these factors could see a rise in disputes and losses. (Source: RPC)

- In addition to concerns about rising building material costs, labour shortages and increasing insolvencies, there are now concerns relating to increased responsibilities imposed by the Building Safety Act 2022. (Source: Lexology)

- 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)

Motor

- The **annual inflation rate for transport was 3.4% in January 2023, down for a seventh consecutive month** from a peak of 15.2% in June 2022, and the lowest rate since February 2021. Source: Office of National Statistics)

- The main drivers behind the easing in the inflation rate between December 2022 and January 2023 came from passenger transport services and motor fuels. (Source: Office of National Statistics)

- **Average petrol prices fell 5.9 pence per litre (ppl) between December 2022 and January 2023** compared with a smaller monthly fall of 0.7ppl a year earlier. (Source: Office of National Statistics). The price difference between diesel and unleaded has shrunk to 22.3 p/litre. (Source: AA)

Insurance Impacts

- Motor claims inflation is continuing to increase at a substantial rate, with an average claim now costing £5,349. (Source: WTW). Please read our guide on Allianz news - what's driving motor claims inflation?

- Due to the rising costs of comprehensive motor insurance plans, it's predicted that the car insurance market will grow at a compound annual growth rate (CAGR) of 2.3% from £18.4 billion in 2021 to £20.6 billion in 2026. (Source: U Switch)

- The considerable losses anticipated across the motor insurance industry are likely to have been a key factor in the sharp rise in insurance premiums predicted for many drivers in the coming year. (Source: U Switch)

Commercial Property

- **The UK housing market is expected to slow in 2023 and 2024** due to higher mortgage rates and cost of living crisis delaying property purchase, particularly first time buyers.
- **Annual private rental prices increased by 4.3% in England, 3.9% in Wales, and 4.5% in Scotland** in the 12 months to January 2023. (Source: Office for National Statistics)
- **Lack of supply of rental stock continues to drive demand and prices up** due to suppressed investor activity during the pandemic and more landlords opting in for selling their properties. Smaller landlords are leaving the market due to increased costs of building work, higher rates, proposed new legislations and recent tax changes.
- **Approvals for house purchases decreased** to 39,600 in January 2023, the fifth consecutive monthly decrease and lowest since January 2009 (32,400).
- **House prices are forecast to fall by 9%** between the fourth quarter of 2022 and the third quarter of 2024, largely driven by significantly higher mortgage rates, as well as the wider economic downturn. (Source OBR)

Insurance Impacts

- It's predicted that inflation will hit property casualty insurers the hardest because the claim costs for things like collision repair services are going up. (Source: Silverline)
- Insurance claim costs will put pressure on insurance companies because they will be taking a lot of costs and expenses out of the industry, which will reduce the ability to have as much capacity. (Source: Silverline)

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 Group's Chief Economist, publishes a weekly update on Allianz markets, macro, sector and insurance.