

Economic Insights

Longer-term implications of COVID-19: paradigm shifts

Key takeaways

- We expect COVID-19 to accelerate paradigm shifts that were already in the making.
- Such changes include a larger role of government, accelerated digital transformation and a restructuring of supply chains.
- Taken together, this could lead to a stagflationary and/or financial repression environment over the next two to three years, both very challenging for re/insurers.
- Evolving supply chains and accelerated digitalisation will create new re/insurance opportunities.

About Economic Insights

Analysis of key economic developments and their implications for the global re/insurance industry.

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In a nutshell

The COVID-19 experience will likely accelerate paradigm shifts already in the making before the crisis started: a larger role of government, accelerated digital transformation and de-risking of global supply chains. Higher inflation risk coupled with financial repression present challenges to re/insurers. At the same time, there will be great opportunities from evolving supply chains.

Every major crisis marks an inflection point. We believe the global economic shock from the current COVID-19 pandemic could trigger several paradigm shifts. For re/insurers, the following shifts are particularly important:

- **Fiscal/monetary coordination and outright debt monetization.** The 2008 playbook of central banks has been rolled out again, and in some cases policymakers have even been going beyond previous limits.¹ Looking ahead, policy measures previously considered unorthodox (eg, more extreme forms of fiscal/monetary coordination like monetization of government debt through "helicopter money"²), may well become the norm. Moves to this end are already underway with central banks buying public debt in large and even unlimited quantities. Central banks could also cap yields resulting in a prolonged period of financial repression, a challenging environment for long-term investors such as re/insurers.
- **Bigger role for government.** In response to the COVID-19 crisis, governments have emerged as spenders and lenders of last resort, taking a much more active role in the economy. They are unlikely to retreat hastily when the pandemic is over. There have already been public injections of capital into and nationalisations of private firms, and we expect more as loans turn into equity stakes and guarantees into bailouts. In addition, the crisis has accentuated the rise in economic inequality and we are likely to see more policy taboos being broken. For example, the idea of universal basic income is gaining traction³, and higher taxation is becoming increasingly likely.
- **Peak of globalisation and emergence of parallel supply chains.** Besides the US-China trade war, the disruptions across the global supply chains due to the containment measures against COVID-19 will likely translate into companies restructuring their supply chains to make them more robust. Changes are likely to include relocation of production to cut concentration risk, shortening of supply chains

¹ For example, the ECB has dropped previous limit to buy no more than a third any country's eligible bonds for its EUR 750bn Pandemic Emergency Purchase Programme.

² For more information on "Helicopter money", please see *Sustaining resilience amid slowing growth: global economic and insurance outlook 2020/21*, Swiss Re Institute, *sigma* 6/2019

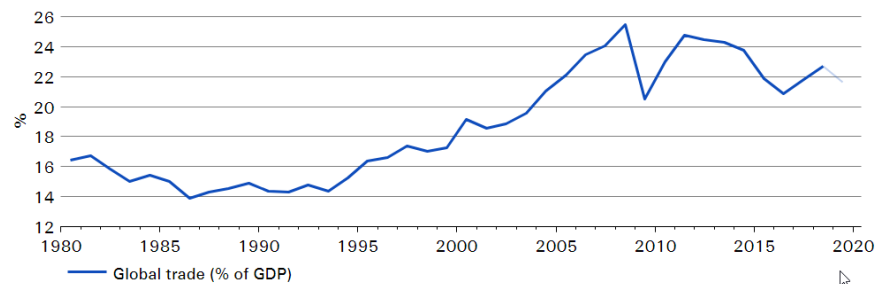
³ Spain, for example, has recently introduced a basic income for the poor.

and/or building of parallel ones. Such changes will involve construction of new production units and associated infrastructure facilities, presenting new opportunities for property, engineering and business interruption insurance.⁴

- **Accelerated digital transformation.** We expect the digitalisation trend to intensify as a result of COVID-19 lockdown measures. For example, many desk-job employees have been working remotely and e-commerce companies and platforms become even more important. We believe the COVID-19 experience will only perpetuate these trends. There will be associated insurance opportunities, including in cyber, personal and commercial lines.
- **Bringing it all together: is the era of low inflation coming to an end?** After more than two decades of low inflation, the COVID-19 shock could trigger a turnaround. The current crisis could result in sharp declines of production capacities and persistent supply chain disruptions. Coupled with massive fiscal stimulus, this may result in stagflation – high inflation amid economic stagnation. A trend towards de-globalisation and monetary financing of government debt could add to inflation risks. We are not concerned about inflation in the near term. However, we attach a likelihood of around 10-15% to emerging stagflation over the next two to three years.

Extrapolating from experiences of the past few decades may not be a winning strategy going forward. For re/insurers, impending paradigm shifts will bring new challenges and opportunities. While a stagflationary environment⁵ is not our base case, it would be a toxic scenario, coupling low real investment returns with high claims inflation. At the same time, parallel supply chains and accelerated digitalisation will create new opportunities for the industry.

Figure 1: Peak of globalisation?
Global trade, % of GDP



Source: IMF, Refinitiv, Swiss Re Institute

⁴ *Trade war and pandemic to accelerate global supply chain restructuring*, Swiss Re Institute, Economic Insights, Issue 10/2020

⁵ This is an environment of low economic growth, coupled with relatively high inflation.

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