December 2023

Summary and introductory remarks

With COVID-19 lockdowns ending as a catalyst, the international and local inflationary environment accelerated and continues to sustain elevated consumer price increases. Internationally, wars, disasters, stimulus, supply disruption, and locally, Eskom continues to impact. Current El Niño weather conditions also raise risk. As we have seen sudden decelerations and accelerations, the insurer, underwriter, and intermediary must stay abreast of environmental developments. Be mindful that insurance inflation is higher than CPI. Reinsurers also pass increases into this environment, which has hardened the direct market. Although inflation seems to be slowing, there remains significant local and international upward risk, as evidenced by recent upticks.

- Inflation is not our friend!
- COVID taught us that inflation tends to be contagious and spreads quickly across territories and countries.
- Internationally, the reduction in inflation has slowed, leading to a “higher for longer” outlook, driven by ongoing stimulus by international governments, supply disruptions, and natural catastrophes.
- The general inflationary environment in South Africa accelerated in 2022 and 2023, but it is tapering as we approach 2024. Yet we saw an increase in August, September and October, reminding us that much upside risk remains.

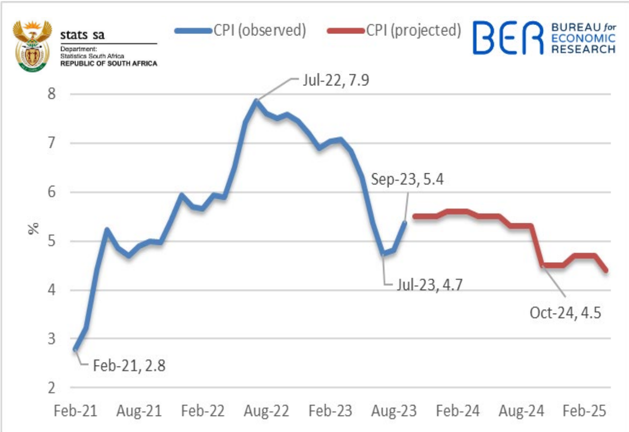
Headline inflation (CPI) – turning up?

In February of 2021, the CPI, as measured by Stats SA, reached a low of 2.8% year-on-year change.

Inflation accelerated and peaked in July 2022 at 7.9% and started to taper (slowly), reaching 6.8% in April 2023.

Over the next three months, it slowed rapidly to 4.7% in July 2023; in August and September, it increased to 5.4%. In October 2023, it increased again to 5.9%.

The Bureau for Economic Research (BER) expect CPI to revert to the mid-point of the target range in October 2024 and average 5.2% over 2024.



CPI A BAROMETER: CPI is useful as a barometer of the general level of the South African inflation environment. It's not perfect, though, as it comprises a broad basket of underlying commodities, services and other items that are not all immediately or at all related to insurance claims cost. Underwriters should limit it as a starting point for considering current and future claims cost escalation. Bryte expects it to average 5% in 2024.

Headline inflation (2024 Outlook)

The South African Reserve Bank (SRB) revised its 2023 headline inflation forecast to 5.8% in November (from 5.9%). SRB's inflation outlook assesses risks towards the upside and mentions fuel prices, food inflation, currency weakness, electricity prices and logistic problems.

The SRB's projections for 2024 were revised down to 5.0%; the downward revision was observed across all quarters. Headline inflation is only expected to reach the target range (3%-6%) mid-point of 4.5% by 2025.

SARB MPC Forecast CPI 2024

South African Reserve Bank	Q1	Q2	Q3	Q4	2024
Jan-23	5.1	4.9	4.6	4.5	4.8
Mar-23	5.1	5.0	4.7	4.6	4.9
May-23	5.4	5.3	4.9	4.7	5.1
Jul-23	5.1	5.2	4.9	4.7	5.0
Sep-23	5.3	5.2	5.3	4.7	5.1
Nov-23	5.2	5.1	5.0	4.6	5.0

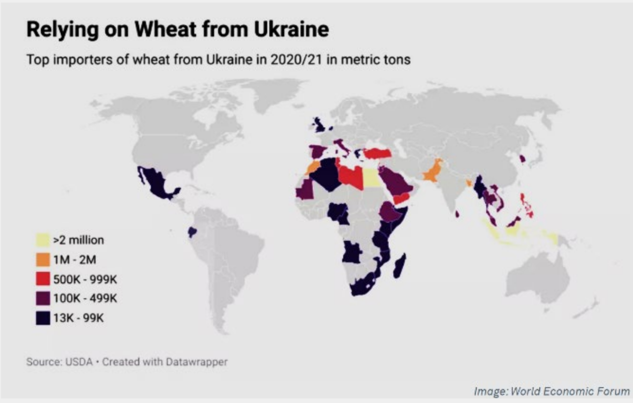
INSURANCE INFLATION: Insurance inflation (the tempo at which claims costs escalate), like medical inflation, historically, runs at a margin above headline inflation (CPI). Bryte expects it to average 3% in 2024.

War

In 2022, the Ukraine-Russia war drove up international inflation. The crisis increased the cost of related items throughout the region due to its disruption to Ukraine's supply of food, commodities, and manufactured components, and with embargoes on Russian gas and oil supply to Europe. Like the rest of the world, South Africa imported much of this inflation.

War disrupts world economy

Russia invaded Ukraine on 24 February 2022. Ukraine, at the time, was a large contributor to global production, including food (46% of global sunflower oil), iron ore and steel (a major supplier to China), fertilisers (a basic input in food production), and components (e.g., microchips for vehicle manufacturing).



Disasters

- Major local disasters have played a significant role in accelerating inflation on building costs. In the case of disasters, be they manmade or natural, if large enough in scale, they can create demand and simultaneously disrupt supply, which combine to cause temporary surges in inflation.
  - The July 2021 KZN unrest required billions in property repairs. The unrest damaged supply lines as well.
  - The April 2022 KZN floods were severe enough to cause a demand surge, with repair and replacement costs increasing.
- REINSURANCE RATE CHANGE: International disasters have resulted in insurance of property lines being re-rated globally, impacting the property and business interruption lines in policies. The global cost of reinsurance against weather perils has increased. The average rate increases for the 2022/23 renewal cycle exceeded 30%. In the 2023/24 cycle, we anticipate increases tapering to 15% only, but a recent large industry fire could force rates up beyond this figure.

The ongoing electricity crisis, with ever-present blackouts and grid failure risks, was only declared a national disaster for a short period between 9 February and 5 April 2023. For the last decade, the average annual increase in the cost of electricity for ratepayers has been 9.8% per annum. This problem permeates throughout the economy.

Stimulus

The government's stimulus drives demand, which fuels inflation. Lockdowns associated with COVID-19 impacted the global economy simultaneously. In turn, governments devised economic stimulus initiatives (all with large infrastructure spend components) and announced these (in quick succession) from 2021 to 2023. These have caused and are causing global shortages and an escalation in demand for construction materials like steel, cement, timber, and gypsum.

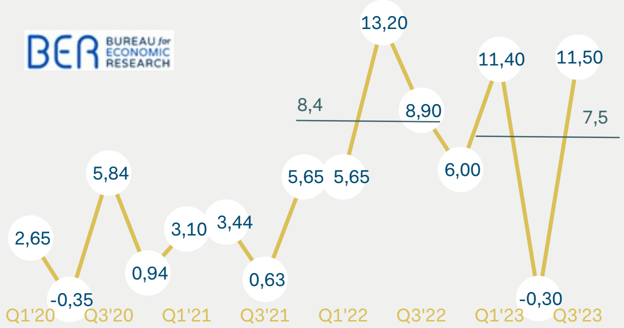
Governments are spending money and implementing measures to protect their local supplies, like export tariff increases and restrictions. Timing of announcements by prominent countries:

- 2021 SA R50 billion, also US, China, India, UK
- 2022 SA R17 billion, also EU, Japan, Canada, Australia
- 2023 SA R1.3 trillion over five years, also Germany, France, Italy, Brazil

Building cost index

The index reached 13.2% (year-on-year) in the second quarter of 2022. It receded over the next two quarters but bounced back to 11.4% in the first quarter of 2023.

In 2023, the index has been very volatile. The 2023 YTD average is 7.5%, 0.9% lower than the 8.4% average for 2022. Therefore, over the two years, building costs increased by 16.6%.

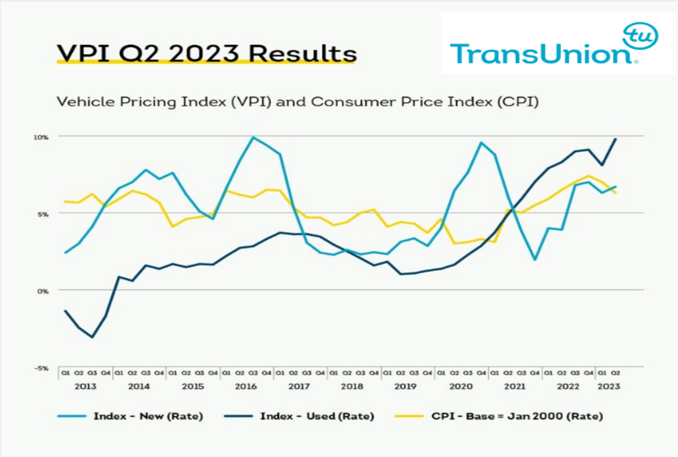


Supply chain

Supply chain disruptions and their aftermath continue to reverberate through the economy. A clear example is the South African vehicle market, with depreciation rates at record lows and second-hand vehicle price increases outstripping new vehicle prices.

Vehicle price escalation

The rate at which used vehicle prices increase continues to outstrip that of new vehicles. Consumer demand is displaced to used vehicles due to shortages in new vehicles. The gap has been narrowing since 2021, but we noted an increase in Q2 2023. The lingering favouring of used vehicles could also be attributed to raised interest rates and the consumer's strained financial position.

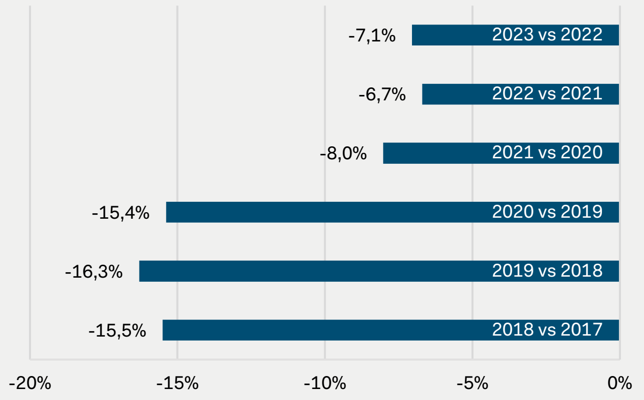


When working on motor renewals, claims cost escalation (on partial damage) and depreciation (on total losses) must be balanced using the claims weight between repairing damaged vehicles and replacing stolen or written vehicles. The cost of replacement claims is offset by salvages and recoveries, reducing its weight in the renewal consideration.

Weighted vehicle depreciation (retail value)

The depreciation rate has accelerated to minus 7.1%. This is too small a change to conclude early indications of increasing supply.

The rule of thumb weighting on repair/write-offs is 85/15. Repair escalates at renewal, while write-offs follow the depreciating retail value of the vehicle.



Brokers and underwriters in our market are expected to put all this complexity together when approaching renewals. Considering the time pressure typically associated with renewals, premium increases must be decided with limited calculation time. The below matchbox serves as a quick reference in these circumstances. Note these adjustments are aimed at maintaining loss ratios.

Underwriter's matchbox at renewal

Expected in 2024:

- Headline inflation: 5% (CPI), expected in 2024, but adjusted if this changes.
- Insurance inflation: CPI + 3% = 8% (property and non-motor lines)
- Motor renewal inflation: Insurance inflation less depreciation = 8% - 2% = 6%
- Liability renewal inflation: Insurance inflation = 8% + 3% = 11%
- Reinsurance rate change: 6% on property lines, in addition to insurance inflation
- Property renewal inflation: Insurance inflation plus reinsurance rate change = 8% + 6% = 14%