Insurance in a Fragmented World Economy

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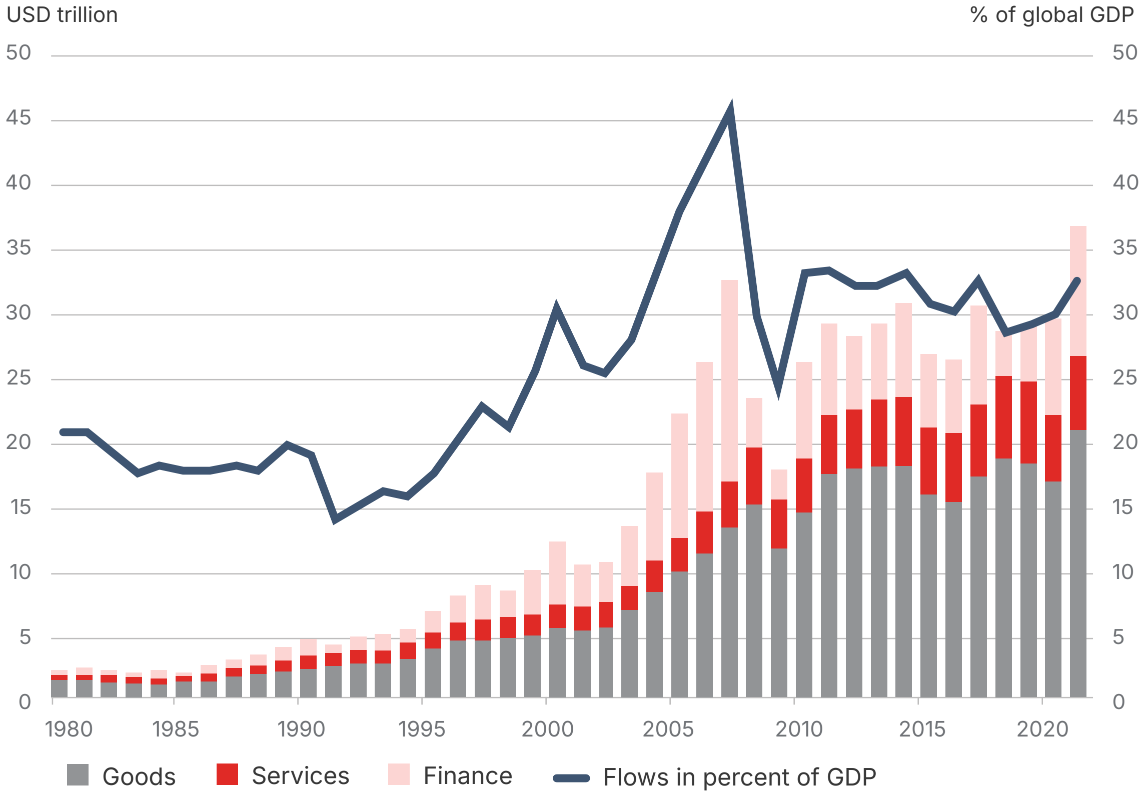
The 2008 Financial Crisis marked a significant turning point in global economic liberalisation. It prompted the rise of anti-globalisation and populist movements and significantly slowed down the steady growth of cross-border trade and foreign direct investment flows that had gained momentum since the 1980s. The world has since entered an era of 'slowbalisation', characterised by stagnation in global integration (see Figure 1).

FIGURE 1: GLOBAL TRADE FLOWS (IN USD TRILLION AND PERCENT OF GLOBAL GDP)



Source: International Monetary Fund (IMF)[1]

Recent geopolitical upheavals – including the US-China trade conflict, the COVID-19 pandemic, and the Russia-Ukraine war – have further fragmented trade and supply chains, steering the global economy towards 'geoeconomic fragmentation'. This reflects nations' increasing prioritisation of security and resilience over efficiency – as

1 IMF 2023.

exemplified by free trade and globally integrated supply chains – though the global economy remains deeply interconnected, making large-scale 'deglobalisation' unlikely.

Current trends towards protectionism have reversed some of the gains from trade liberalisation made in the post-war era, which fostered global economic growth and brought down inflation. Foreign direct investment, vital for growth and technology transfer, has also suffered – since the Financial Crisis, foreign direct investment flows have declined as a share of global GDP, worsened by geopolitical tensions. Capital increasingly gravitates within geopolitical blocs, prompting a restructuring of global supply chains via reshoring or 'friend-shoring'. While these strategies may reduce geopolitical risks, they come at the cost of efficiency, ultimately raising production costs and consumer prices.

Technology diffusion has been impeded by geoeconomic fragmentation as countries enforce export restrictions to safeguard national interests. This deceleration in innovation and productivity could lead to significant long-term GDP losses, particularly in technology-driven economies like the US and China. Estimates suggest that the trend toward technological decoupling in itself could slash certain countries' GDP by as much as 5%, compared to the 10-year forecast.

Combined with restrictions on cross-border flows of goods, services, and capital, geoeconomic fragmentation could lower GDP growth in some countries by up to 12%. Declines in cross-border trade and investment, compounded by technological decoupling, risk creating a stagflation environment characterised by higher inflation and lower economic growth.

Implications for insurers

Geoeconomic fragmentation presents notable challenges and potential opportunities for insurers (see Table 1). It complicates global risk management, hampering international cooperation on pressing issues such as climate change, pandemic preparedness, and cybersecurity that require coordinated action. Insurers may also face increased risk exposure and insurability challenges related to these threats.

TABLE 1: ECONOMIC MANIFESTATIONS OF GEOECONOMIC FRAGMENTATION

Cross-border trade	Cross-border capital flows and supply chains	Technology diffusion	Provision of global public goods	Economic growth	Inflation
• Higher consumer and producer prices due to tariffs • Stagnant or lower trade volumes (driven by trade in intermediate goods)	• Deceleration in flows due to restrictions and supply chain reconfigurations • Higher concentration of flows • Impact of governments' strategic manufacturing initiatives	• Export restrictions (e.g. on semi-conductors) • Negative long-term impact on innovation and technological progress	Eroding multilateralism with negative effects on: • Climate risk mitigation • Pandemic preparedness • Cybersecurity	• Long-term GDP losses due to stagnant or lower cross-border trade, capital, knowledge and technology flows	• Higher inflation due to increasing import prices, domestic firms' growing pricing power and governments' strategic manufacturing initiatives • Exposure to oil price shocks • Surging military spending

Source: Geneva Association

Geographical risk spreading, a hallmark of effective insurance, is increasingly constrained by barriers to cross-border activities. This heightens the volatility of claims and investment returns, potentially necessitating higher premiums for policyholders. Fragmentation also increases operational complexity for international insurers, as diverging or even discriminatory legal and regulatory frameworks impose significant compliance costs, particularly in geopolitically distant regions. This may compel some insurers to refocus on home and geopolitically closer markets, potentially spurring consolidation within the insurance industry.

The commercial and specialty insurance sectors face immediate and direct issues. Unlike retail insurance, which is affected indirectly by changes in economic growth and inflation, these sectors grapple with heightened risks tied to political instability and supply chain interruptions, for example. However, opportunities also arise from increased government investment in essential infrastructure, for example in semiconductor production and clean energy.

Recent industrial policies, such as the US CHIPS and Science Act, have positively influenced the outlook for commercial property insurance, which protects assets against risks like fire and natural disasters. New investments and construction projects necessitate comprehensive property coverage, particularly as the emphasis on strengthening critical supply chains and technological infrastructure elevates the risk profile of high-value assets.

Engineering insurance, which addresses risks associated with the construction, installation, and operational activities of projects, is also poised for growth in a geopolitically influenced industrial policy environment. The push for energy independence is likely to spur investments in renewable energy and localised manufacturing, increasing demand for specialised engineering insurance products for complex machinery and renewable installations like wind turbines and solar farms.

Marine insurance, crucial for covering losses related to ships, cargo, and infrastructure, faces challenges from geoeconomic fragmentation. A shift from global toward localised supply chains is expected, which will affect established shipping routes. This could, in the short term, lead to an uptick in insurance claims due to rerouting, ultimately heightening marine insurers' risk exposure.

Geoeconomic fragmentation also introduces complexities for trade credit insurance, which protects businesses against non-payment risks arising from trading partners' insolvencies or defaults. Increased trade barriers could strain firms reliant on international commerce, raising the likelihood of insolvencies – particularly among small and medium-sized enterprises.

Political risk insurance, which offers coverage against losses from political events such as expropriation, has gained prominence. The tense geopolitical climate amplifies demand for this coverage, particularly among multinational companies which are now more vulnerable to actions jeopardising their foreign assets.

Cyber insurance, which primarily addresses losses stemming from cyberattacks and data breaches, is increasingly vital in today's geopolitical environment. State-sponsored cyber threats may escalate due to geopolitical tensions, exacerbating risks for businesses and adding to attribution challenges in the context of insurability.

Corporate executives and non-executives use directors & officers (D&O) insurance to protect against claims stemming from their decisions. Geoeconomic fragmentation increases the potential for arbitrary regulatory investigations, which amplifies claims exposure for D&O insurers. Reputational risks tied to political controversies further underscore the importance of D&O coverage.

Insurance industry responses

Insurers must proactively adapt to geoeconomic fragmentation to maintain resilience and relevance as a stabilising force in a rapidly changing world economy. Effective scenario planning is key. This methodology equips insurers to anticipate various potential futures and assess both immediate and long-term impacts on operations. Each scenario must consider implications for critical areas such as claims frequency, severity, and investment returns, as well as impact assessments encompassing growth, profitability, and solvency (see Table 2).

TABLE 2: STRATEGIC INSURANCE INDUSTRY RESPONSES TO GEOECONOMIC FRAGMENTATION

Gradual and controlled intensification of geoeconomic fragmentation with no reversal of globalisation	Exacerbation of geoeconomic fragmentation due to escalating tit-for-tat measures	Bifurcation into two antagonistic blocs
• Adjust product offering (e.g. supply chain and trade credit insurance • Incorporate real-time geopolitical intelligence and predictive analytics in underwriting approaches • Integrate scenario analysis and stress testing in risk management frameworks • Reconsider international footprint • Capture opportunities in capital and asset management (e.g. reglobalisation and industrial policies)	• Cater to specific needs of domestic industries benefiting from geoeconomic fragmentation • Adopt a dynamic approach to underwriting in the face of increased unpredictability • Reduce exposure to fragile global supply chains • Develop contingency plans for operations abroad • Focus capital management on liquidity and adaptability • Adopt more defensive investment strategy	• Double down on product offerings for infrastructure, green energy, and advanced manufacturing within the bloc • Adopt a more granular approach to underwriting to account for heightened risk concentration and correlation • Recalibrate capital and asset management towards government-supported initiatives (e.g. critical infrastructure, key technologies)

Source: Geneva Association

We put forward three geoeconomic fragmentation scenarios and possible responses from insurers. Scenario 1 envisions a gradual and controlled intensification of geoeconomic fragmentation, marked by regionalisation of trade, a further geopolitically inspired increase in tariffs and government subsidies for specific domestic sectors, and selective decoupling, but not a full-scale reversal of globalisation. In this environment, insurers must develop products that address specific new risks emerging from more fragmented global markets. Political risk insurance should deal with shifting trade policies, and supply chain insurance will need to adapt to more regionalised supply chains. A more granular approach to underwriting will be essential, incorporating real-time geopolitical intelligence to assess region-specific risks. Capital management must be highly flexible, adjusting to varying geopolitical risks across regions. Insurers will also need to diversify asset portfolios across countries and sectors benefiting from this scenario, such as non-aligned countries and renewable energy and advanced technology companies.

Scenario 2 foresees an exacerbation of geoeconomic fragmentation due to trade-war-like tit-for-tat measures, where escalating protectionism leads to more volatile global cross-border flows and supply chains. Insurers will need to address heightened risks related to trade disruptions, with increased demand for products covering trade conflicts and retaliatory measures. Underwriting must adapt to the unpredictable nature of escalating trade barriers, requiring dynamic risk assessments and stress tests. Capital management will emphasise liquidity and flexibility, enabling quick redeployment of funds to less exposed regions. In asset management, defensive strategies will dominate, with increased allocation toward markets insulated from geopolitical conflicts, such as non-aligned nations

Scenario 3 is the most extreme outcome: a bifurcation into two antagonistic blocs, prompted by a major geopolitical conflict and large-scale economic sanctions. This radical fragmentation forces insurers to align with one bloc, severely limiting global diversification opportunities. Insurers will need to focus on bloc-specific products, particularly in sectors like infrastructure and manufacturing, driven by government policy. Underwriting as well as capital and asset management will have to address heightened concentration risks within each bloc.

Scenario 2 is considered the most likely outcome, given the results of the 2024 US presidential election. Scenario 1 also has significant likelihood, as key trading partners may adopt a transactional approach to avoid an outright global trade war. Scenario 3 is expected to remain a remote possibility.

References

IMF. 2023. Geoeconomic Fragmentation and the Future of Multilateralism.