The impact of banking crises on non-life insurance consumption

Insurance consumption is primarily determined by individual income levels or aggregate national output. Therefore, banking crises that adversely affect individual income and national output also reduce insurance consumption. **Dr Shinichi Kamiya** of the **Nanyang Business School** (NTU) explores.

An interesting and unappreciated consequence of banking crises is the significant retardation in the development of the non-life insurance market.

For instance, after the 1997 Asian financial crisis, the region's economies, as measured by per capita GDP, recovered relatively quickly. However, the recovery of non-life insurance consumption lagged significantly, and the industry has failed to return to its pre-crisis standing in these markets even after a decade has passed.

Reduction of non-life insurance on per capita basis

Unlike banking, for which aggregate deposits experience little change, even in the short to intermediate term, non-life insurance premiums, on a per capita basis, experience long term reduction after banking crises, particularly in high-income and upper-middle-income countries.

This post-crisis effect is long lasting, and the magnitude of premium loss is significant. The impact is strongest in high-income countries, where the marginal premium loss, which cannot be explained by a decline of GDP per capita, remains significant for 16 years from two years after the crisis (see Figure 1). The aggregate negative effect reaches approximately 176% of the average annual premium.

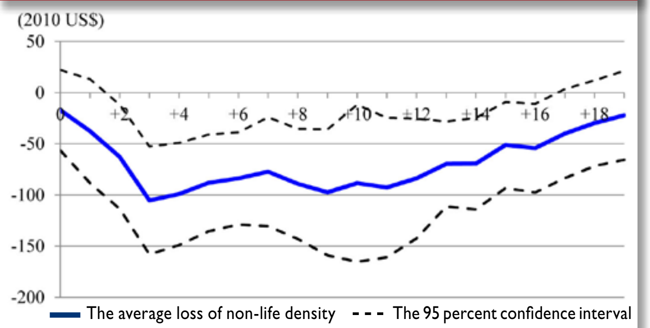
In high-income countries, motor insurance, property insurance and liability insurance premiums all experience adverse post-crisis effects for years, each suffering about a 20% premium loss. However, the downturn patterns of the post-crisis effect vary considerably across the lines of business. In contrast to motor insurance, which suffers a sharp decline in consumption immediately after a crisis, the marginal premium loss of property insurance tends to increase gradually for more than a decade, and hence its recovery takes longer than that of motor insurance.

Motor Insurance

The largest adverse effect on motor insurance consumption in high-income countries reaches US$60 per capita (19% of the average motor premium) in the three years after a crisis.

After that, the negative effect gradually decreases over time but remains statistically significant for 14 years. The aggregate loss of motor insurance consumption reaches 155% of the average motor premium. A similar negative effect can be observed in upper-middle-income counties but this lasts for only seven years. In low-income countries, motor insurance premiums decline less than GDP in the eight years after a crisis, as observed for non-life insurance in general.

Figure 1: Post-crisis effect on non-life density – High income countries



Source: Kamiya, Zanjani, and Li (2013)

Property Insurance

In high-income countries, the downturn phase for property insurance is quite different from that for motor insurance. After a sharp decline in the immediate aftermath of the crisis, the negative effect tends to increase steadily over time and the largest effect (US$35 per capita, or 18% of average property density) occurs 11 years after the crisis. Hence, recovery takes longer than for motor insurance. Lower-middle-income and low-income countries exhibit positive effects during the post-crisis period.

Liability Insurance

The post-crisis effect for liability insurance consumption in high-income countries lasts 17 years from the onset of the crisis. The marginal loss in the three years after the crisis reaches about 23% of the average liability insurance density, which is the largest across all types of non-life insurance.

Factors that explain the post-crisis loss of non-life premium

Broadly speaking, non-life insurance is used by businesses and households to protect investments, and the decline in non-life insurance premiums relative to GDP may suggest a shift away from higher-risk, higher-return investments toward safer activities. This shift mirrors the banking system's shift away from private credit toward safer investments after a financial crisis.

For high-income countries, the post-crisis premium loss of property and liability insurance is largely explained by a decline in credit availability to the private sector, which has slightly greater explanatory power than credit by the banking sector. Thus, long-lasting stagnation of externally funded investments in the private sector may be the cause of the drag on property and liability insurance consumption.

Trends of motor insurance consumption are, however, intriguing. The volume of risk exposure, that is, the use of motor vehicles, fails to explain the post-crisis premium loss in high-income countries, even as it does account adequately for the post-crisis decline in upper–middle-income countries. Further investigation is needed to determine the reason why post-crisis motor insurance consumption is excessively low in high-income countries.

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