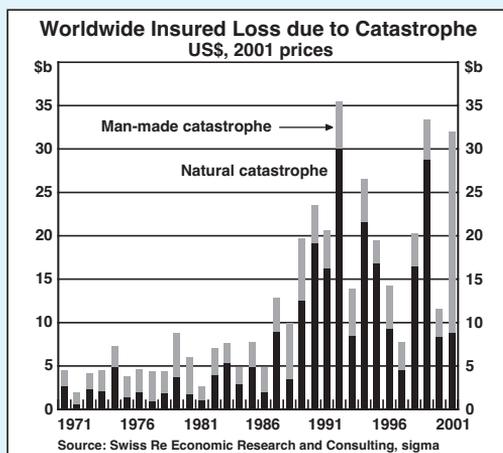


Box C: Insurance Prices

The price of insurance has risen markedly over the past year and further price rises are likely in the period ahead. This follows substantial losses in the global insurance industry in recent years, an escalating assessment of future insurance payouts, the collapse of HIH and lower returns on the assets held by insurance companies.

The rise in reinsurance premiums following large losses due to natural and man-made catastrophes is one of the main reasons for an increase in costs to the Australian insurance industry (Graph C1). In 1999, there were an unusual number of large natural catastrophes around the world, including the Sydney hailstorm that was the eighth largest insured loss in the world in that year. The insured loss from the events of 11 September is likely to exceed the largest preceding single-event loss, Hurricane Andrew in 1992, when the insurance industry paid claims of roughly US\$20 billion (in 2001 prices).

Graph C1



As a consequence of these large losses, reinsurers' capital reserves have declined, and this has led to a contraction in the supply of reinsurance. In combination with an increase in demand for reinsurance, this has resulted in a sharp increase in price. In addition to this, a more long-lasting effect on insurance premiums from recent events will depend upon the extent to which the risk of both natural and man-made catastrophes is reassessed. A further reason why costs faced by the Australian insurance industry have increased is that the Australian community is becoming more willing to claim for losses incurred. This has led to an increase in the actuarial assessment of expected payouts, particularly for products such as public liability insurance.

As well as changes in costs, insurance premiums are influenced by the degree of competition in the insurance market. In recent years the Australian general insurance industry has been characterised by strong competition which has held down direct insurance premiums despite the rising costs. An important factor behind this was HIH's policy of aggressively building market share by offering lower premiums. With this effect no longer operating, a return to more normal practices would see some rise in premiums.

Effects on the CPI

Insurance premiums affect the CPI directly through households' purchases of car, house and contents insurance which has a weight of 1.5 per cent in the CPI. The price of household insurance services in the CPI has increased by 6 per cent over the past year. However, there is also an indirect effect as rising commercial premiums for businesses are passed through to consumer prices.

Insurance industry surveys, such as the JP Morgan-Trowbridge Consulting-Deloitte survey, suggest that even prior to the events of September, industry observers were expecting some classes of commercial insurance premiums to rise by up to 20 per cent over the year to June 2002. The largest increases are expected for professional

indemnity, public liability and commercial property insurance, as these areas are most affected by the problem of higher numbers of claims and higher reinsurance costs. More recently, the cost of products such as airline liability insurance have increased and have been passed on quickly to consumers. ✕