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Insurance markets in Asia – quality before growth

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Insurance markets in Asia – quality before growth

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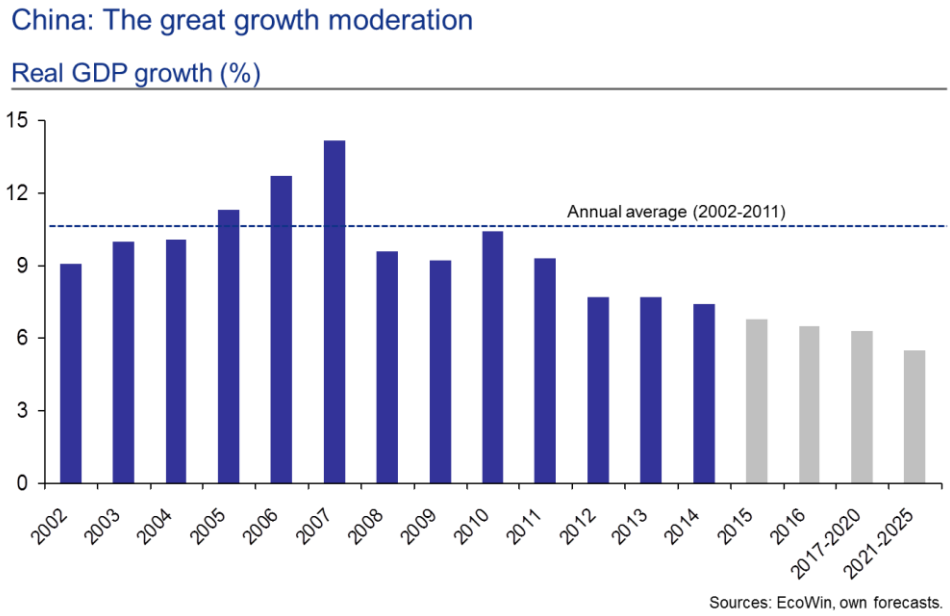
1. ASIA REMAINS THE WORLD'S ECONOMIC ENGINE – DESPITE LOSING GROWTH MOMENTUM

For many years, Asia's emerging markets – led by China – were able to sustain exceptionally strong growth momentum. In the period from 2002 to 2011, regional gross domestic product grew at an average rate of 8.2% a year, with China even achieving double-digit growth of +10.6%. The region is now fairly far removed from growth rates like these, reporting pretty constant growth in economic output of between 6% and 6½% a year over the last three years. In the long term, we can expect to see a further moderate decline in the pace of growth, with the growth rate in five to ten years' time likely to come in at "only" 5¼% at the most based on our estimates.

Regional heavyweight China sets the trend

The regional trend towards more subdued growth rates is dominated by developments in China. The world's second largest economy now accounts for more than 60% of the total economic output of all Asian emerging markets, compared with just over 40% ten years ago. The past few years have seen the pace of growth in the Chinese economy gradually slow, bringing it down, most recently, to 7.4% in 2014. China is currently locked in a very difficult process of transition. The country's "tried and tested" growth model, which focused primarily on exports and investment, is now increasingly hitting its economic, ecological and social limits and has been one of the major factors contributing to the macroeconomic imbalances that the country is now grappling with. These include, by way of example, excess capacity in industry, rampant lending, local property bubbles and exploding debt levels among provinces and municipalities.

In response to these macroeconomic aberrations, the Chinese leadership already set about revamping the Chinese growth model a few years ago. One of the aims is to strengthen private consumption to make economic development less reliant on investment and export demand. There are also plans to expand the country's service sector. China is looking to achieve sustainable and stable economic growth. The initiated structural change and the moves to rid the economy of existing imbalances pose enormous challenges for both Chinese policymakers and the economy. The risks associated with these moves are not to be taken lightly. With overall global economic growth only moderate, overcoming these challenges is rendered even more difficult. Given the room for maneuver available, however, we expect the Chinese government and the central bank to succeed in stabilizing economic development and preventing a hard landing for the Chinese economy. Nevertheless, we believe that a further slowdown in economic momentum is virtually inevitable. Looking five to ten years down the line, we predict that China will be reporting annual growth in economic output of around 5.5%.



India – permanently the new Number One in terms of growth momentum?

India is currently one of the few countries in the world where economic development is surprising on the upside. The ambitious program of reforms ushered in by Prime Minister Narendra Modi, coupled with gradual monetary policy easing, budget consolidation helped along by low oil prices, and substantial capital inflows from abroad, is expected to improve the foundation for sustainable growth. This year is likely to see India outstrip China in the growth stakes. The question as to whether it can overtake China in the longer term depends primarily on whether it manages to plug its infrastructural deficits, some of which can only be described as grave. The biggest bottlenecks affect India's energy and transport infrastructure, particularly – with regard to the latter – roads and railways. Estimates as to the amount the country actually needs to invest vary considerably, ranging from USD 420bn to USD 1,000bn over the next five years. Measures to improve the business climate, cut red tape and simplifiy land acquisition are also at the very top of the reform agenda. All in all, we are confident that the government led by Prime Minister Modi will push ahead with all of these reforms. The reform process, however, could prove to be very hard-going, as the current discussion on the amendment of the Indian Land Acquisition Act shows. The planned amendment to the Act, which came into force in early 2014, aims to make it easier to buy land and to reduce the associated costs but is facing strong opposition in the Indian upper house where the government lacks a majority. Assuming that a large chunk of the reform agenda described above can be implemented over the next few years, the Indian economy should be able to clock up growth averaging around 6½% a year over the next five to ten years, putting it just ahead of China.

Asia remains the world's economic engine despite the growth slowdown

The sustained economic slowdown in China is also bound to leave its mark on many other countries in the region. Over the past two decades, many Asian emerging markets have increasingly geared their foreign trade towards China. In 2014, for example, 25% of all South Korean exports were destined for China, compared with just below 11% 15 years ago. China accounts for a current total of 13.5% of Malaysia's total exports and still makes up a substantial 12% of Thailand's. This stronger focus on China within the context of

intra-Asian trade is due, on the one hand, to the fact that the country's domestic market has grown considerably. On the other, however, the shift reflects changes in the region's production processes. Whereas in the past, many countries exported directly to Europe or the US, it is now common for intermediate products to be delivered to China, where the end products are manufactured and then ultimately exported to the buyer countries. This means that weaker economic development in China and a much more moderate expansion in global goods trade will likely put a damper on export momentum in most of Asia's up-and-coming economies. But there is another reason why Asian growth momentum is expected to continue to taper off: as prosperity levels rise, economies find it increasingly difficult to maintain a high level of growth momentum. Put simply, it is easier for a country with annual per capita GDP of EUR 5,000 to generate real economic growth to the tune of 4% a year than it is for a country with annual per capita GDP of EUR 20,000. Taking South Korea, the region's third-largest economy, as an example, we expect to see real GDP growth of "only" 3% a year over the next five to ten years. With per capita GDP of around EUR 22,600 (2014), prosperity levels in South Korea are already well ahead of the regional average.

Growth rates in Emerging Asia
real GDP, % change over previous year

	2010	2011	2012	2013	2014	2015[1)]	2016[2)]	2017-2020[2)]	2021-2025[2)]
China	10.4	9.3	7.7	7.7	7.4	6.8	6.5	6.3	5.5
Hong Kong	6.8	4.8	1.7	3.1	2.5	2.5	2.8	3.0	3.0
India	9.3	7.7	4.8	6.4	7.2	7.5	7.7	7.5	6.5
Indonesia	6.2	6.2	6.0	5.6	5.0	5.0	5.5	5.5	5.0
Malaysia	7.4	5.2	5.6	4.7	6.0	5.2	5.5	5.0	4.5
Philippines	7.6	3.7	6.8	7.2	6.1	6.2	6.5	5.7	5.0
Singapore	15.2	6.2	3.4	4.4	2.9	3.0	3.8	4.5	4.0
South Korea	6.5	3.7	2.3	2.9	3.3	3.5	3.8	3.5	3.0
Taiwan	10.6	3.8	2.1	2.2	3.7	3.7	3.5	3.5	3.5
Thailand	7.8	0.1	6.5	2.9	0.7	3.0	3.5	4.0	4.0
Emerging Asia	**9.5**	**7.5**	**6.1**	**6.4**	**6.3**	**6.1**	**6.1**	**6.0**	**5.3**

1) Estimate. 2) Forecast.

Sources: EcoWin, own forecasts.

But even if growth in Asia continues to lose momentum as described above, the region will remain the fastest-growing in the world. Asia will continue to make a major growth contribution to global output, not least thanks to its growing slice of the global output cake. The following example provides a good illustration: in 2014, the Asian region achieved growth of 6.3% in real terms, with global output growing by 2.5%. Asia's share of global output came in at 22%, putting the region's growth contribution at 55%. For the period from 2021 to 2025, we expect to see average GDP growth of 5¼% in Asia and 3% worldwide. But given that Asia's share is likely to have risen to over 28% by then, its growth contribution will still come in at almost 50%.

2. INSURANCE MARKET – SUSTAINED MOMENTUM DUE TO A SHIFT IN COUNTRY WEIGHTINGS

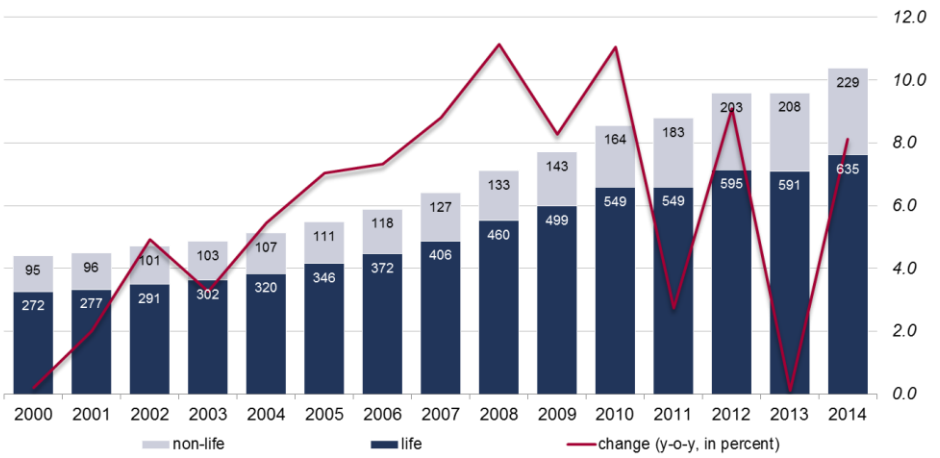
Thanks to the economic upswing in the emerging markets, the Asian market also ranks among the fastest-growing insurance markets in the world. In the period between 2002 and 2014, total gross written premiums[1] in the fourteen countries included in our analysis, namely China, Hong Kong, India, Indonesia, Japan, Laos, Malaysia, the Philippines, Singapore, Sri Lanka, South Korea, Taiwan, Thailand and Vietnam, grew at an average rate of 6.6% a year.[2] In 2014 alone, gross written premiums climbed by 8.1% to reach a new record high of around EUR 865bn. This has allowed the region to up its share of total global premium income from 20.5% to 28.4% since 2002.

2.1 Financial crisis as turning point in insurance market development

Nevertheless, a few cracks have started to appear in the hitherto flawless success story since the financial crisis: whereas between 2003 and 2008, growth rates for the region climbed to new record highs year after year, the trend witnessed over the past five years has been more of a rollercoaster ride. This is, however, due less to a collective slump during this period, and more to isolated developments affecting individual countries.

Watershed financial crisis

Gross written premiums*, by line of business
(in bn EUR, 2014 exchange rates, in percent)



* Ex health insurance.

Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

The growth rate stumbled to its absolute low to date back in 2013, when the Asian insurance market virtually stagnated with premium growth of only 0.1%. This was largely due to the slump on the South Korean insurance market triggered by reforms to the way in which products featuring savings components are taxed. Two years previously, developments had been hindered by the absolute drop in premium income in China and Taiwan, whereas in 2009, the overall picture had been clouded by a combination of a marked growth slowdown in China and an absolute drop in premium income in the city states of Hong Kong and Singapore.

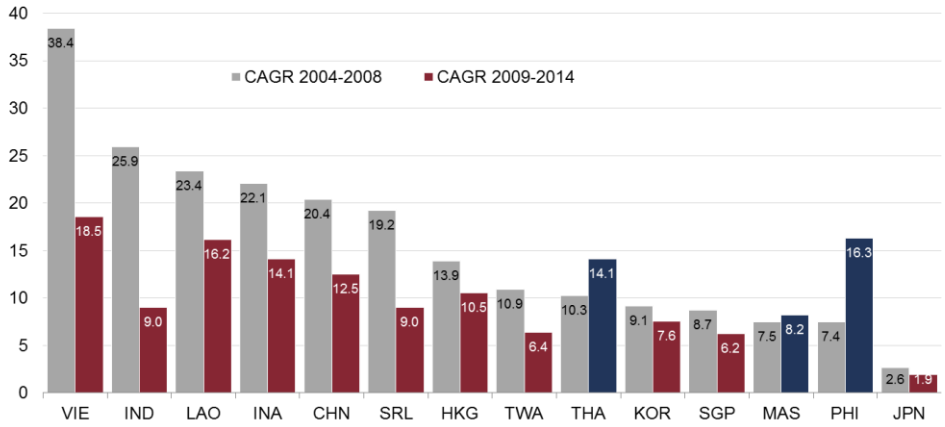
[1] Excl. health insurance.
[2] Growth rates in nominal terms, based on fixed exchange rates from 2014.

Nevertheless, this developmental turning point can be witnessed in all of the countries included in our study to some degree. If we compare growth rates in the five years before and after the financial crisis, i.e. 2004 to 2008 and then 2009 to 2014, the continuing effect of the financial crisis hit India the hardest, with average annual growth dipping by almost two-thirds, from 25.9% to 9.0%. The ongoing economic slump left its mark on the Indian life insurance business in particular. In Sri Lanka and Vietnam, which had by far the highest average rate of growth in the region (namely 38.4%) before the crisis hit, the average annual growth rate was more than halved, and Taiwan and China reported rates that were down by more than one-third. Exceptions to this rule include Malaysia, where life insurers reaped the benefits of the speedy recovery on the capital market and in the demand for unit-linked life insurance, as well as Thailand and the Philippines, where a number of factors including, notably, increasing financial literacy among the population at large – boosted by state-run programs – helped to further diversify existing savings and lift the demand for private provision. All in all, the Asian insurance market grew at an average rate of 7.9% a year in the five years prior to the outbreak of the financial crisis, compared with average growth of "only" 6.5% in the period stretching from 2009 to 2014.

Most countries report damped growth since outbreak of financial crisis

Development of gross written premiums*, by country

(CAGR, in percent)



* Ex health insurance.

Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

Provided that the region does not encounter any major social or political unrest, we expect to see average annual growth to the tune of around 8% over the next ten years. The fact that, based on this forecast, the Asian insurance market looks set to outstrip the rate of growth seen over the past twelve years despite the slowdown in economic growth is not, however, due to the prospect of higher growth on individual markets, but rather to a shift in the weighting of markets within the region.

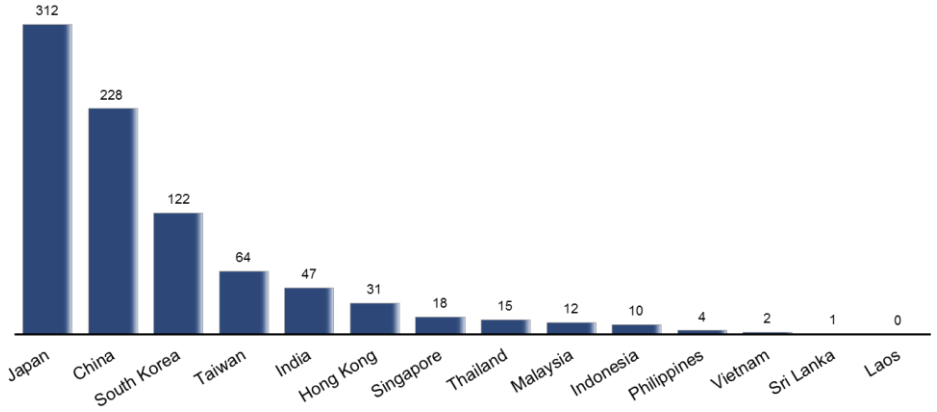
Japan's dominance is fading away

To date, the growth in total premium income in Asia has been influenced largely by the development of the Japanese insurance market. With gross written premiums equivalent to EUR 312bn, Japan was the largest Asian insurance market in 2014, ahead of China, with EUR 228bn and South Korea, where premium income came to EUR 122bn. Life and P&C insurance premiums in the other eleven countries in our analysis totaled EUR 202bn, with Taiwan alone accounting for EUR 64bn and India, the second most populous country in the world after China, contributing EUR 47bn. In those countries at

the bottom end of the scale, on the other hand, premium income was still well below the EUR 1bn mark; in Sri Lanka, the equivalent of EUR 560m in total was spent on insurance cover, while in Laos, the smallest market in the region to date, the amount spent on insurance came in at around EUR 46m.

Japan still biggest insurance market in Asia

Insurance markets, by premium income* (2014, in bn EUR)



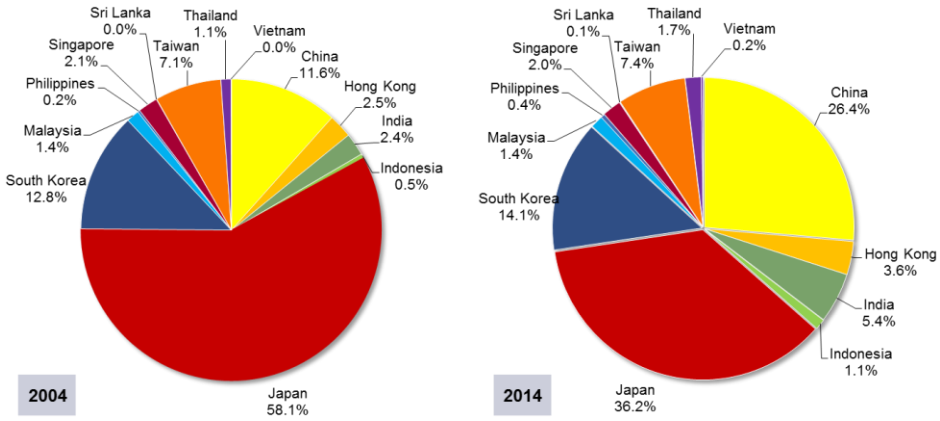
* Ex health insurance.

Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

Whereas in 2014, Japan still had the highest market share in the region, at 36.2%, a comparison with market shares ten years ago illustrates that Japan is losing its dominant role and that the weightings are starting to shift. In 2004, Japan still made up 58.1% of the Asian insurance market, followed by South Korea in second place, with premium income accounting for 12.8% of the regional total, and then by China, which had a share of only 11.6%. China, in particular, has come on in leaps and bounds as far as its market position is concerned: with a share of 26.4%, China has overtaken South Korea, where gross written premiums amounted to 14.1% of the regional total in 2014, by a wide margin. Taiwan remained the fourth-largest market, increasing its slice of the regional market cake from 7.1% to 7.4%. India's market share has doubled over the past ten years, albeit at a low level from 2.4% to 5.4%, with the result that this very populous country nudged the city state of Hong Kong out of the top 5.

Japan's dominance in the region is fading away

Gross written premiums*, by country (in percent)



* Ex health insurance.

Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

Japan putting a damper on regional growth

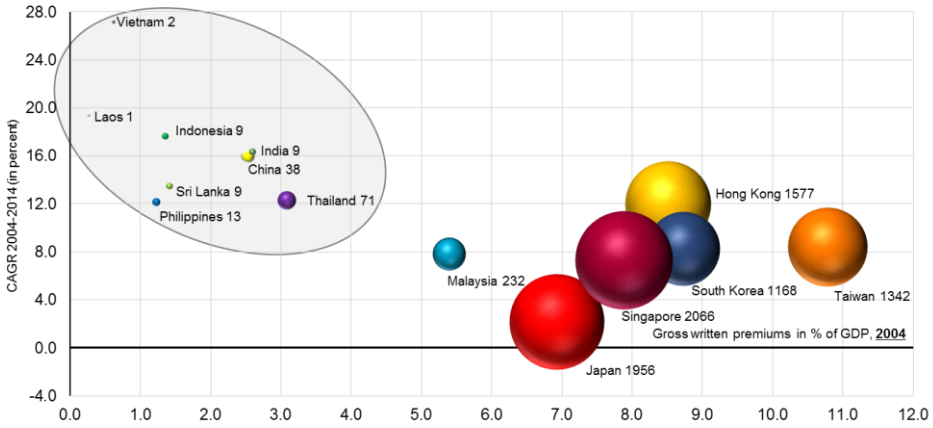
This shift in market shares witnessed over the past ten years can be explained by the varying pace of growth in the individual countries. Growth was driven first by economic development and second by the level of maturity of the individual insurance markets, i.e. the backlog demand in the various countries. The lower the insurance density and insurance penetration rate were back in 2004, the higher the average growth rate tended to be.

In countries where the insurance market reported double-digit growth rates ranging from 12.3% (Thailand) to 27.2% (Laos)[3], for example, the insurance penetration rate came in at between 0.3% (Laos) and 3.1% (Thailand) of GDP, with average annual per capita spending[4] stretching from the equivalent of EUR 1 in Laos to EUR 71 in Thailand. Overall, premiums in these countries grew by 15.9% a year on average. The highest rate of growth was seen in Vietnam, where the insurance market swelled by an annual average of 27.2%, although it is worth bearing in mind that, in 2004, gross written premiums came in at a mere 0.7% of GDP, corresponding to average per capita spending of only EUR 2 a year. Insurance premiums in the more mature markets, where the insurance penetration rate in 2004 ranged from 5.4% (Malaysia) to 10.8% (Taiwan) and per capita spending came in between the equivalent of EUR 232 in Malaysia and EUR 2,066 in Singapore, grew at a far more leisurely pace of 4.5% per annum. The majority of the markets achieved annual growth rates of between 7.4% (Singapore) and 8.4% (Taiwan). Two countries proved to be exceptions to the rule: Hong Kong and Japan. Whereas gross written premiums in Hong Kong grew by 12.0% on average, the annual growth rate in Japan averaged only 2.2% and left the country languishing at the bottom of the league table, not least due to a marked slowdown in economic development. Leaving Japan out of the equation, growth in this group of countries comes in at 8.6%.

[3] In order of average annual growth, these countries include Vietnam, Laos, Indonesia, India, China, Sri Lanka, Thailand and the Philippines.
[4] Converted based on EUR exchange rates in 2014.

Growth driver backlog demand

Growth rates, insurance density and penetration,*, ** (in percent, in EUR)



* Ex health insurance.
** The size of the bubble represents insurance premiums per capita in 2004 (in EUR, 2014 exchange rates).

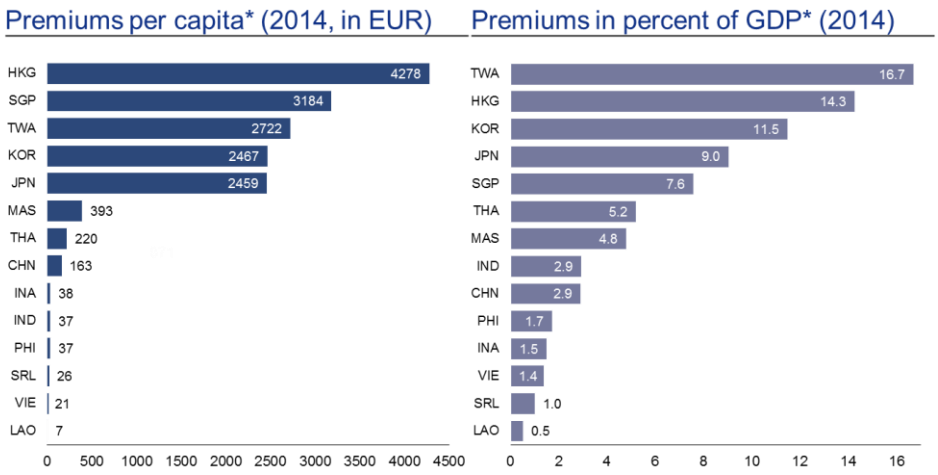
Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

Market maturity still varies considerably

Despite this development, market maturity in the region still varies considerably: the insurance density and insurance penetration rate remain the highest in Hong Kong, Japan, Singapore, South Korea and Taiwan, whereas Vietnam, Sri Lanka and Laos still have a lot of ground to make up. From this angle, China occupies a position in the middle of the rankings, behind Thailand and Malaysia.

Average per capita premium spending has almost trebled in Hong Kong over the past ten years, rising from EUR 1,580 to around EUR 4,280. In Singapore, it has climbed by more than 50% to around EUR 3,180. In Taiwan and Korea, it has more than doubled, and even Japan has seen its per capita premium spending rise by a far from insignificant 25% to around EUR 2,460. This means that last year, the average Japanese citizen was still spending more than 15 times as much on insurance cover than his Chinese counterpart – although average per capita insurance spending in China has increased more than fourfold during the same period. In Laos and Vietnam, spending has increased more than sixfold and tenfold respectively. In 2014, however, insurance density in Vietnam came in at only EUR 21, while the average citizen of Laos spent no more than EUR 7 on insurance policies.

Still marked differences in market maturity



* Ex health insurance.

Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

In terms of gross domestic product, Taiwan led the field – as it did back in 2004: last year, spending on insurance cover came in at just under 17% of GDP, followed by Hong Kong at 14.3% and South Korea with 11.5%. As was the case back in 2004, China and India were almost neck-and-neck in terms of the insurance penetration rate: in China, the rate rose from 2.5% to 2.9%, whereas in India, it climbed from 2.6% to 3.0%. - The fact that insurance density in China, at EUR 163, remains more than four times as high as in India, where average per capita spending stood at only EUR 37 last year, reflects the differences in the economic power of these two countries, the most populous on earth. - The bottom of the scale is occupied by Sri Lanka, where premium income growth has lagged behind GDP growth in recent years and the insurance penetration rate is only 1.0%, and Laos, with a rate of 0.5%.

2.2 Backlog demand remains growth driver

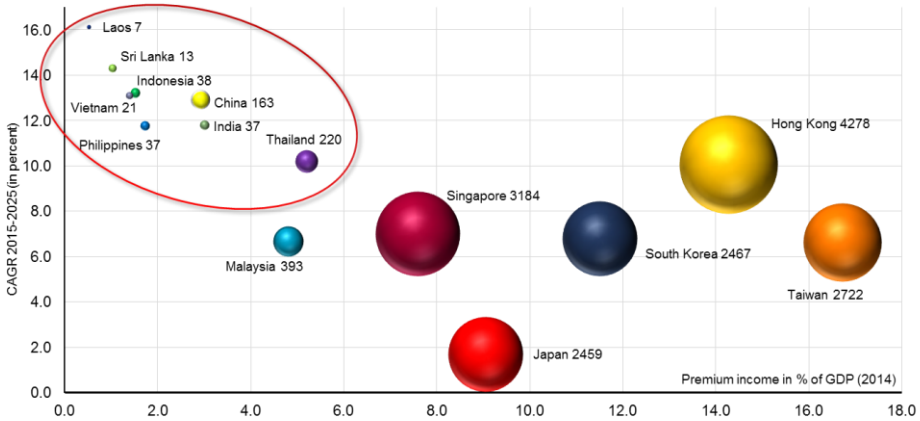
Compared with the situation in 2004, the group of more mature markets has certainly become slightly more heterogeneous, but the momentum on which the future growth outlook is based remains unchanged. Against the background of the still existing disparities, we expect the need for countries to catch-up to continue to be the driving force behind developments in the region in the future, and the countries with comparatively low insurance penetration and density to continue to grow faster than their more mature counterparts.

Provided that the region is spared any major political and social unrest, we expect Laos, Sri Lanka, Indonesia, Vietnam, China, the Philippines, India and Thailand to achieve double-digit growth rates of between 10% and 16%, meaning that premium growth in this group of countries should come in at 12.7% in total, compared with 15.9% in the period between 2004 and 2014. In Malaysia, Singapore, South Korea and Taiwan, we expect to see gross written premiums climb by an average of 6.8% a year. Growth in Japan is likely to be much lower, averaging 1.7%. By contrast, we are slightly more optimistic for Hong Kong, which we expect to be able to maintain a high growth rate of around 10% a year. All in all, this should put premium income growth in the more mature markets at 4.5% on

average, on a par with the pace of growth seen over the past ten years. Excluding Japan, the rate of growth comes in at 7.3%, down slightly on the growth of 8.6% witnessed between 2004 and 2014.

Backlog demand remains most important growth driver

Growth potential* (annual average growth rate, in percent)



* Ex health insurance.
** The size of the bubble represents insurance premiums per capita in 2014 (in EUR, 2014 exchange rates).

Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

This means that we expect the growth momentum for the Asian markets to taper off somewhat. The increase in the average pace of growth in the region from 7.1% to 8.1% is attributable solely to the fact that Japan will continue to lose market share. Setting Japan aside, average growth in the region stood at 11.9% between 2004 and 2014, a rate that is expected to drop back to 10.6% in the ten years that lie ahead. After all, in addition to weaker economic development, we expect the markets to become more professional as they continue to bring their regulatory systems closer into line with international standards. We also forecast increased competitive pressure, which is likely to put a damper on price development, particularly in the P&C insurance business. In addition, demographic change in the region is also likely to have more of a bearing on the demand for insurance in the future.

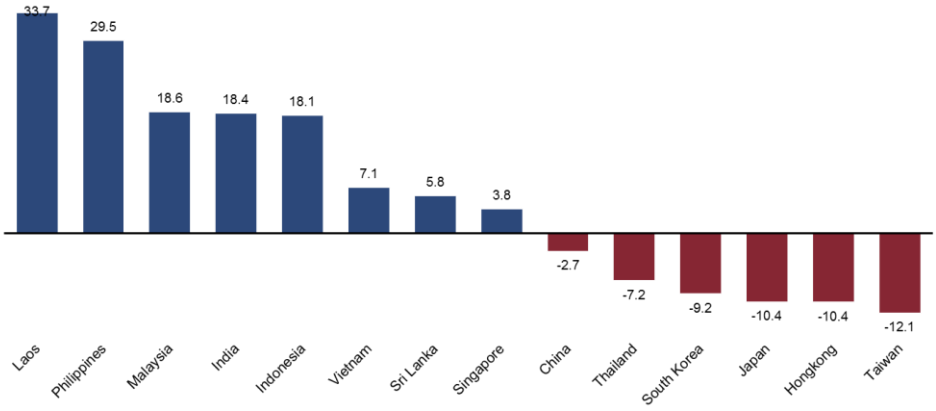
Demographic development will have more of an impact in the future

In most of the major Asian economies the population inworking age, for example, is goingto shrink – in some cases considerably –within the space of the next 15 years.[5] Even if the retirement age is lifted to 65, China is expected to see the number of people aged between 15 and 64 drop by 2.7%. The economically productive population is expected to contract by 7.2% in Thailand, 9.2% in South Korea, 10.4% in both Japan and Hong Kong and 12.1% in Taiwan.

[5] Cf. UN Population Division (2013): World Population Prospects, 2012 Revision.

Working age population in major Asian economies is going to shrink

Working age population* (percentage change between 2015 and 2030)



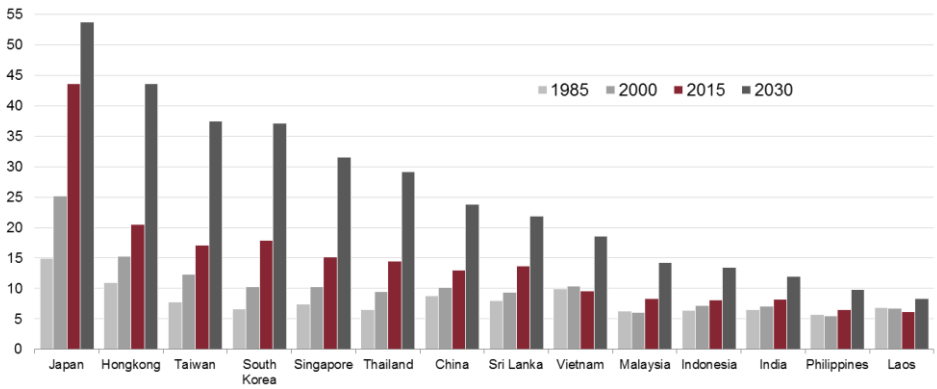
* Population aged between 15 and 64.

Sources: UN Population Division, World Population Prospects, 2012 Revision, Allianz Economic Research.

At the same time, the rate at which all of these societies are aging will pick up considerable speed as life expectancy rises. The old age dependency ratio, i.e. the ratio of the number of (potential) pensioners to people of working age, will double in most countries in the region. In Hong Kong, it will rise from the current level of 20% to around 43% over the next 15 years, with the ratio set to rise from 17% to 37% in Taiwan and South Korea, and from just under 15% to around 30% in Singapore and Thailand. At the same time, pension systems in many Asian countries are either just being set up, or only guarantee basic provision.

Demographic ageing to accelerate

Old-age dependency ratio* (in percent)



* Population aged 65 and older as percentage of population aged between 15 and 64.

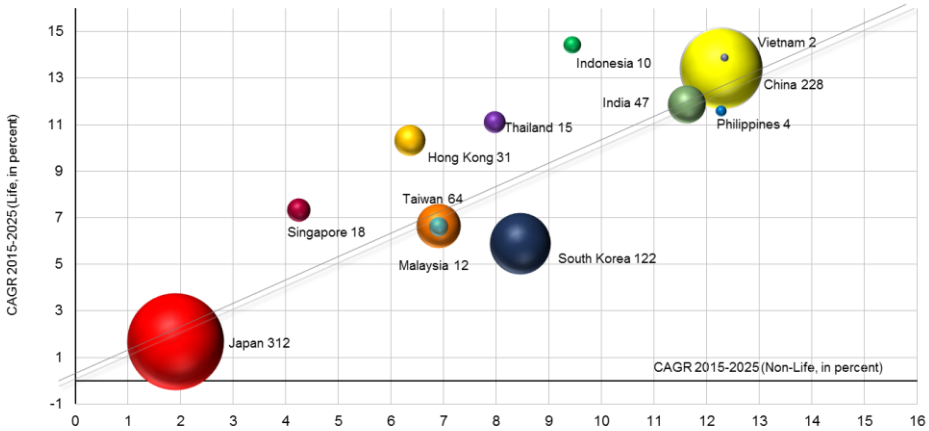
Sources: UN Population Division, World Population Prospects, 2012 Revision, Allianz Economic Research.

This is a development that is likely to favor life insurance, in particular, as private retirement provision becomes increasingly important, especially in the fast-growing economies. As a result, we expect the life insurance segment to see only a slight slowdown in growth, namely from 14.5% to 13.0%, in these countries; by contrast, we

predict growth on the P&C insurance market to slip back from 18.9% to 12.0%. On the more mature markets, growth on the life insurance market is likely to slacken from 5.5% to an average of 4.4% – leaving Japan out of the equation, we expect to see growth of 7.0% as against 8.8% over the past ten years – while growth on the P&C insurance market is expected to move up a gear from 2.8% to 5.0%. This is due, for one thing, to the success of "long-term general insurance", which adds a savings component to a P&C insurance policy, in Korea and, for another, to Japan's loss of market share. If we exclude Japan's premium income, this produces a marginal increase in the growth rate from 7.9% to 8.0%. While Japan is lurking at the lower end of the growth scale, China ranks among the fastest-growing countries in Asia. Taking exchange rate effects into account, our estimates predict that China will replace Japan as the region's largest market as early as next year, despite a less rosy growth outlook.

Demographic change in favor of life insurance demand

Growth potential*,**, by lines of business (in percent)



* Ex health insurance.
** The size of the bubble represents total insurance premium income in 2014 (in bn EUR, 2014 exchange rates).

Sources: National financial supervisory offices, national insurance associations, Axco, Allianz Economic Research.

These assessments are, as always, subject to the disclaimer provided below.

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Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the euro/US-dollar exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.