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Inflation worries businesses – and their insurers

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The war in Ukraine has rapidly disrupted global trade in key commodities like grain, oil and gas, ,exacerbating an existing background of energy shortages and rising costs. It is therefore not surprising that our latest Risk and Resilience survey shows inflation, in particular, is one of the key factors worrying business leaders, nor that they expect economic uncertainty to remain high through to the end of this year.

High inflation impacts multiple aspects of corporate decision making, from the changing value of stock to rising employee wages and the cost of borrowing. At the same time, business leaders must also show human empathy for the suffering and hardships that employees and customers may be experiencing. And unlike the previous generation, which endured the double-digit inflation of the 70s and early 80s, the majority of today's senior business leaders are having to address a challenge that their career to date has not prepared them for.

Our latest Risk & resilience Geopolitical Risk Report reveals that concerns about inflation differ internationally. In the US, 42% of companies rated it their biggest concern – a much higher number than in the UK, where only 33% of business leaders rated it their biggest concern. Even more striking is the lack of resilience that business believes it has to inflationary pressure, with fully 65% of US business leaders (55% globally) feeling unprepared to meet the challenge.

The view from the UK with Oli Wheeler, Focus Group Lead, International Management Liability

UK business leaders appear to be less concerned about both economic uncertainty and inflation than their US counterparts. Perhaps years of Brexit and COVID-19 uncertainty have bred a weariness about doom and gloom, and this would be justified.

Supply chain bottlenecks may be a short-term problem which businesses are becoming practiced at working through, but the costs involved in transforming to a zero-carbon economy ("greenflation") and rising labour costs that stem from Brexit and COVID-19 are long-term issues that won't disappear any time soon. In recent weeks it has become clear, in the short term at least, that Sterling is facing considerable pressure that will exacerbate inflation, most notably as oil is priced in dollars[1]. All of this will likely drive a period of price increases and with these seemingly intractable underlying problems. Improving productivity is key to keeping inflation down, both for the country and for individual firms[2].

Compounding issues in the UK include supply cost pressures, Brexit and the EU trade agreement now back on the agenda, increased regulation and audit bodies being established in the UK (ARGA), and ESG and climate risks. These are all increasing exposures and uncertainty. Assessing these risks is making the landscape even more difficult for insurers, particularly in the D&O market. If this uncertain path continues with macroeconomic pressures and claims inflation, we may start seeing a reverse in the current market terms and conditions. As a market we need stability, and that's certainly what clients are telling us too.

The view from the US with Patrick Whalen, Underwriter, Management Liability

In contrast to the UK, US business leaders are keenly aware of the impending impacts of inflation. Their concern is justified as financial market volatility and losses are currently driving the greatest run-up in prices that the US has seen in four decades. The S&P 500 has officially entered a bear market and is down more than 20% since the beginning of the year, and the prevailing sentiment in the US is an expectation that inflation is only going to get worse[3].

US retail sales fell in May as supply chain challenges drove a decrease in major purchases like vehicles and record high gas prices pulled spending away from other goods. The Federal Reserve has since raised interest rates to try to reduce inflation, but US businesses face a long road ahead as rising prices for everything from groceries to housing influence American consumers' buying power and economic confidence for the foreseeable future[4].

In the US, there is clearly cause for concern for inflationary risks the Directors and Officers (D&O) market now faces. Inflation and supply chain constraints, including raw material costs and pressures on the transportation costs, are leading to higher costs of goods sold. Companies are now faced with the dilemma of passing these costs onto their end consumer. During this same period of increased pricing, companies, especially those in the Retail and Hospitality sector, may face a market with significantly less discretionary spending. All this can lead to lower sales volume, or lower sales overall. Finally, wage and labor inflation remain a challenge in a tight, though softening, labor market. Companies are spending more to attract and retain their talent. Whether it's due to a single reason or a combination of the above, companies' margins are being impacted, leading to weaker financial results.

Amidst these challenges is another looming around the corner. Economic signs and pundits point to a potential global recession. Despite the improvement in unemployment rates from the all-time highs during the peak of the Covid-19 pandemic, analysts are warning of signs of future mass layoffs. Between the potential for high unemployment rates and higher costs, the risk to Employment Practice Liability (EPL) insurers is also increasing. Workers may look to recover lost wages through whatever means available, including lawsuits against their former employer. A strong relationship between company, broker, and insurance carrier can help during a period where unemployment rates are uncertain.

Insurance buying will be complex

The conflict in Ukraine was already proving an inflection point for the insurance markets, with hardening rates and capacity changes anticipated in some specific classes as a result. Now, the wider impact of inflationary pressure is likely to push costs (and potentially therefore premiums) higher across all classes. This is bad news for insurers, and ultimately even worse news for the business owners who are our customers.

Equally, inflation brings uncertainty, and this also makes the case for insurance in certain key areas becoming ever more critical. For those trading internationally, trade credit insurance becomes absolutely critical. With rising business pressure, D&O risk also rises; and business interruption also becomes more likely in a world where energy supply and supply chains are both less certain. As pricing goes up, whether due to supply chain constraints or wage increases, this cannot help but impact companies' overall performance, leaving them open to potential litigation from shareholders. In a land of rising costs and rising risks, many business owners may consider protecting their business operations as a continued priority, no matter what happens to cost.

Find out more on the latest geopolitical risks in our latest Risk & Resilience report.

Percentage ranking Inflation and Economic Uncertainty as their top risks

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1 Britain's political risks, economic fears keep sterling under pressure | Reuters
2 Low economic growth is a slow-burning crisis for Britain | The Economist
3 How Long Might The Bear Market Last? (forbes.com)
4 Why Is Inflation Rising Right Now? – Forbes Advisor