The background of the slide is a photograph of the Statue of Liberty on Liberty Island, with the New York City skyline visible in the distance under a blue sky with light clouds.

NORTH AMERICA INSURANCE MARKET COST OUTLOOK Q2/2022



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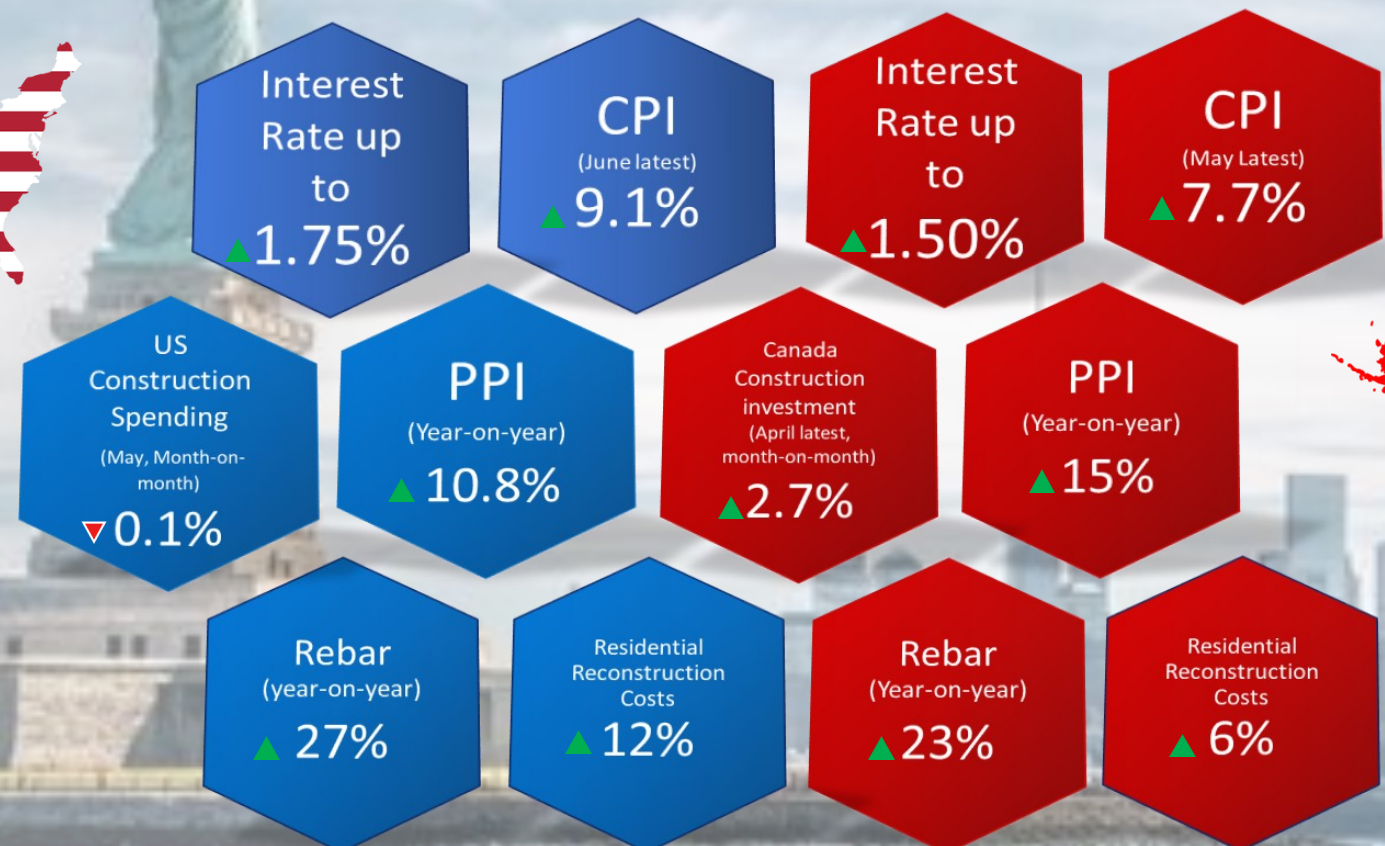
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2022 has seen inflationary pressures on a global scale. In North America rising inflation has been influenced by surging oil and gas prices, sharp increases in critical construction materials, and labour skills shortages. The Ukraine conflict has added further uncertainty.

In Q3, pricing volatility and rising inflation is likely to continue, with a potential easing in Q4.

In Q2 supply-chain disruption has eased but is likely to continue to be a key driver of insurers' rising claims costs due to the uncertainty around Ukraine conflict and China's Covid response, as many products are manufactured in China. This is impacting the insurance industry with repair costs increasing and supply chain pressures prolonging lead-in time for replacement equipment and materials.

MARKET SNAPSHOT



GDP - Gross Domestic Product
CPI - Consumer Price Index
TPI - Tender Price Index
PPI—Producer Price Index

Introduction

GRS' North America Market Outlook Q2, 2022 considers the impact of inflation, and increased material and labour pricing pressures on:

- insurance claims,
- values at risk, and
- the overall insurance market.

The Federal Reserve has raised interest rates from **1%** in Q1 to **1.75%** (the third increase this year and largest since 1994) in Q2 to counter rising inflation.¹

The impact of the Russian-Ukraine conflict has affected the cost of imported materials. Steel is one example: the US has heavily relied on pig-iron supplies from Russia and Ukraine; these represented almost **60%** of imports between 2018/21. In Q1/Q2 we observe the US relying on South American suppliers: imports from Brazil represented **27%** in Q2.²

Construction Output

USA: In Q2, US construction spending was up **2%** compared with Q1. However, there was a minor reduction in May by **0.1%**.³

According to ENR's Construction Industry Confidence Index (CICI), construction executives were pessimistic about the US economy. The Economic Confidence Index fell from **46** in Q1, to **23** in Q2: that is the lowest economic index rating since the CICI Started in Q1 2009.⁴

On a positive note, at least for public sector construction, we note the approval in 2021 of the *Investment Infrastructure Jobs Acts* (IIJA), which is likely to green light around **USD 550 billion** in new federal Infrastructure spending over the next five years.⁵

According to ENR's 20 City Construction Cost Index, construction costs were up **0.8%** month-on-month (m-on-m) in May with an average **3%** increase from Q1 to Q2. The Building Cost index was also up **1.4%** m-on-m in May, with a average **4%** increase from Q1 to Q2.⁶

Canada: Investment in construction increased by **2.7%** in April with increases in both the residential **(+3.2%)** and the non-residential sectors **(+1.4%)**.⁷

The Canadian Construction Price index for both residential and non-residential construction recorded increases in building costs through Q1 to Q2, and from H1 2021 to H1 2022 per Figure 1.

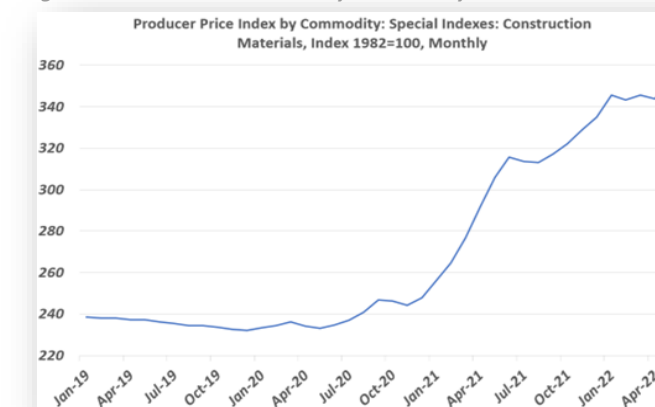
Figure 1: Canadian Building Construction Price Index.⁸

	Residential	Non - residential
Q1 to Q2 2022	▲5.6%	▲2.6%
Q2 2021 to Q2 2022	▲20%	▲12%

Material Prices

In Q1, US material prices stabilised. However, in Q2 we have seen material costs regain their upward momentum due to on-going supply chain pressures and the Ukraine conflict.

Figure 2: Producer Price Index by Commodity⁹



According to ENR US Materials Cost Index, materials in May increased **3%** month-on-month and 9% from Q1 to Q2. In the 12 months H1 2021 to H1 2022 costs increased **34.3%**.¹⁰

According to U.S. Bureau of Labour Statistics Producer Price Index, construction input prices for residential and non-residential rose month-on-month and year-on-year.¹¹

Figure 3: US Bureau of Labour Statistics shows PPI Construction Input

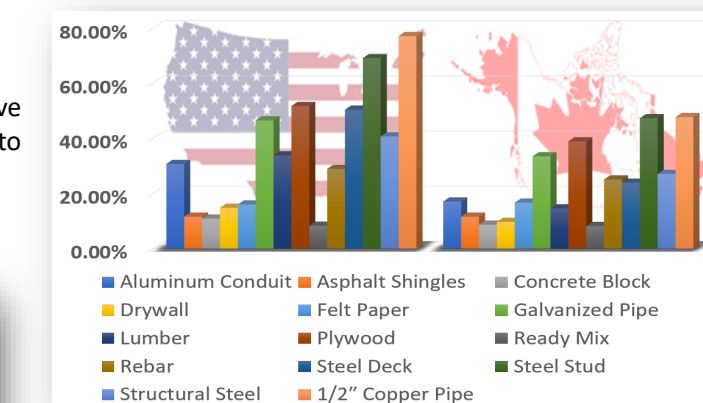
Construction Input	Residential	Non-residential
Month-on-Month (Apr'22-May'22)	▲2.3%	▲2.3%
Year-on-year (May'21 - May'22)	▲21.4%	▲21.9%

Input prices rose in 10 of 11 sub-categories in May with the largest increases in:

- natural gas **(+39.7%)**; and
- unprocessed energy materials **(+16.3%)**.¹²

Residential material costs in the US and Canada are significantly higher than before the pandemic. From Q1 to Q2 copper pipe and lumber costs increased **7% and 22% respectively** in US. In Canada the increases were **8%** and **16%**.¹³

Figure 4: US / Canada % change in Material May 2021 vs 2022



According to Associated Builders and Contractors, increased demand is adding to backlogs and supply pressures. Alongside this, the U.S. economy's post-pandemic recovery is holding building material costs at high levels.



The Royal Institution of Chartered Surveyors' (RICS) Global Construction Monitor in both the US and Canada, shown in **Fig. 5**, identifies the biggest factors affecting construction pricing. These were: the cost of materials; availability of materials; and, labour shortages.¹⁴

Figure 5: RICS Global Construction Monitor Q1/22



In both the US and Canada, increasing material costs have resulted in rising residential reconstruction costs. The national average increased cost from Q1 to Q2 are shown in **Figure 6**, along with the range across the regions.¹⁵

Figure 6: Residential reconstruction cost % increase

		% Increase
	% Range	1.8% - 5.2%
	% Q-on-Q	3.9%
	% Y-on-Y	12%
		% Increase
	% Range	2% - 4.7%
	% Q-on-Q	2.5%
	% Y-on-Y	6%

Labour

In June 2022 construction industry unemployment in the U.S. is at a record low. The number of unemployed Construction workers fell by **345,000** or **47%**.¹⁶ U.S. jobseekers with construction experience fell from:

- **7.5% in** June 2021; to
- **3.7%** in June 2022.

The June 2022 figure is the lowest in the 23-year data history, which highlights a potential shortage of skilled labour.¹⁷

This trend could continue in the US as a result of the IIJA but, despite infrastructure remaining strong, building construction could struggle with further interest rate rises that might slow economic activity and housing investment.

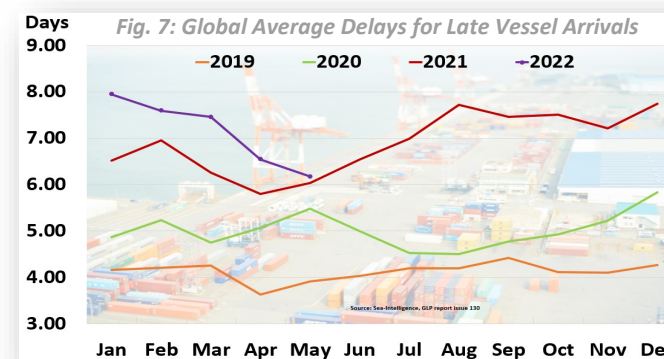
Canadian Construction industry employment was trending upward from November 2021 through Q1, and was up **5.3%** on a year-over-year basis in May. In the early part of Q2 we observed a downward trend. However, this reversed in June when the number of people working in construction grew by **23,000 (+1.5%)**, and recouped losses observed over the previous two months. On a year-over-year basis, employment in construction grew at a faster pace **(+8.0%)** than most other industries.¹⁸

Despite this growth and, according to Bank of Canada estimates, **40%** of companies are currently experiencing labour skilled shortages.¹⁹

SUPPLY

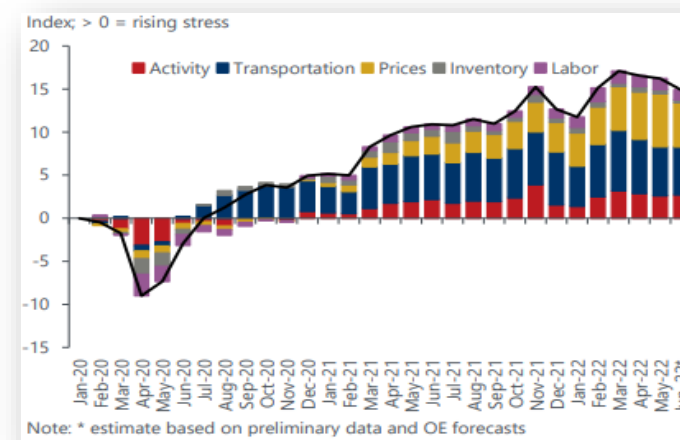
Shipping delays at the largest seaports in the U.S. combined with a backlog of domestic freight operations caused a shortage of goods and materials. This increased the inflationary impact on freight services in Q1 and Q2.²⁰

Freight backlogs declined in June, having reached an all-time high of nearly eight days in January 2022,. In May '22 the average had dropped to **6.17** days. But it is still high across each month compared with historical averages.²¹



Despite still being at all time highs in the U.S. we have observed supply chain pressures easing from Q1 into Q2 with reduced pressure for third straight month in June.²²

Figure 8: Shows US Supply Chain Pressure tracker



In Canada supply chain constraints have caused high energy, food, and housing costs. Inflation is likely to remain high throughout 2022, with the latest CPI at **7.7%**.²³

Impact on Insurers

For insurers in North America the impact and volatility of inflation on construction costs, material and skilled labour shortages and longer lead times makes assessing values at risk and potential loss scenarios challenging: what was accurate just three (3) months ago, may no longer be. Keeping abreast of market rates is imperative when assessing risk and claims exposures.

With supply chain pressure easing but backlogs and skilled labour shortages apparent, the impacts are affecting the reinstatement costs in the aftermath of a loss.

There is also a certain inevitability that, in line with inflation, claims values are likely to increase. But what may not be fully appreciated is that longer reinstatement periods may have a greater financial impact for Insurers than rising labour or material unit prices. Longer periods affect physical damage claims and time-element exposures such as business interruption or delay in start-up. Insured parties may be pressing for more frequent interim payments, and Insurers could be asked to fund acceleration costs to avoid costly delays.

With increased uncertainty on project pricing, there is increased in use of fluctuation clauses and amendments in contracts. There is a risk that projects may be under insured. With so many variables and volatility affecting Insurers' reserving and reinstatement exposures, a proactive and expert-led approach to claims' assessment is vital.

A LOOK AHEAD ... The next 12 months

The US and Canadian economies and construction sectors are likely to be impacted by the ongoing conflict in Ukraine with increases in construction material costs into Q3. Despite a fall in commodity prices in June, the lagged impact is unlikely to offer a swift decline and we expect further increases due to the backlog.

Inflation is likely to continue its upward trend in Q3: with the US at **9.1%** and Canada at an 18-year high of **7.7%** there is no immediate remedy. A more positive outlook is that the US has pledged 15bn cubic metres of LNG this year to EU-based consumers, which should provide a boost to the US LNG industry in addition to the IIJA infrastructure Investment.

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Country specific sources:

Canada Central Bank, US Bureau of Labor Statistics, US Federal Bank, Statistics Canada, Royal institution of Chartered Surveyors (RICS)
Construction Consultants TPI reports and industry specific associations and publications.



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