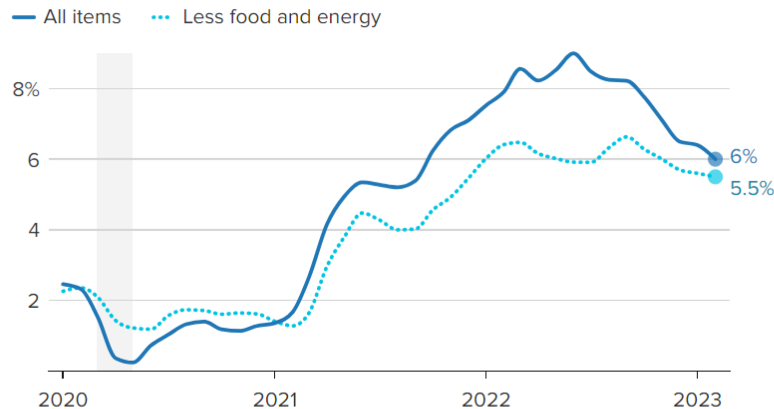
Citizens Market Update

March 28, 2023

- Inflation rose in February but was in-line with market estimates. The CPI increased 0.4% for the month and 6.0% for the 12 months ending February; this was the smallest 12-month increase since the period ending September 2021. The all items less food and energy index rose 0.5% for the month and 5.5% over the last 12 months, it is also the smallest 12-month increase since December 2021. The energy index increased 5.2% for the 12 months ending February, and the food index increased 9.5% over the last year



- Total nonfarm payroll employment rose by 311,000 in February and the unemployment increased slightly to 3.6% (5.9 million unemployed person), but still remains very low. The labor force participation rate has not yet returned to pre-pandemic levels – the labor force participation rate is at 62.5%, or 0.9% below its pre-COVID level of 63.4% in February 2020 – this translates into an additional 1.5 million persons missing from the payroll.

- The student loan forgiveness plan battle is still going on as it plans to forgive up to $20,000 in student loans for individuals making less than $125,000 is expected to translate into a 5% of additional spending, or $1,000 per individual, which will add further to inflation, but not to the same magnitude as prior stimulus measures, which added approximately 1.5% or 25% to the current core inflation

- Each individual bank that has been a victim of the banking crisis has different problems specific to the individual bank, but the crisis broadly reflects weaknesses by the rapid raising of interest rates by global central banks and fears of a worldwide economic slowdown. A rescue plan unveiled by the U.S. government on March 12th has seen banks borrow billions from the Fed, using government bonds as collateral. So far, banks borrowed $53.7 billion from the Fed's new program and another Fed program designed to help banks saw borrowings rise to $179.8 billion

- Depositors have been pulling billions out of regular checking and savings accounts and putting them in money market accounts at large banks and investment firms that pay much higher

interest rates. More than $100 billion came into money market accounts in the week immediately following the collapse of SVB, the highest inflow since 1992

- Last Wednesday, the Fed raised interest rates by a quarter point – less than had been expected – as it battles inflation that is still running at levels more than twice its annual average target of 2% while also eyeing the precarious position the economy is in due to the banking crisis. Currently the Fed Funds rate is at 4.75%-5.00% and the market expectation is for possibly one other quarter point increase before the Fed pauses its rate hikes to reassess due to the banking crisis

- Global markets are in similar position as Global Central Banks followed the Fed's monetary policy and US fiscal policy during the COVID lockdown and now the world is trying to play catch up to manage inflation – however, part of this inflation was initially due to the unanticipated Russian invasion of Ukraine which worsened the inflation and economic outlook.

- The fear in the banking sector has spilled over to the bond market, where yields on U.S. Treasuries have decreased recently as demand for them surged amid a flight to safety as well as probability of recession has also increased. Since the beginning of this year, the 1-year UST has decreased from 4.78% to 4.38%, the 2-year UST has decreased from 4.38% to 3.76%, the 5-year UST has decreased from 3.82% to 3.39% and the 10-year UST has decreased from 3.66% to 3.38%

U.S. Treasury Rates						
	1-Year	**2-Year**	**5-Year**	**7-Year**	**10-Year**	**2-10 Yr Spread**
Current (3/23)	**4.38**	**3.76**	**3.39**	**3.39**	**3.38**	**(0.38)**
Beginning of 2023 (1/2)	4.78	4.38	3.82	3.76	3.66	(0.72)
1-Yr Prior	1.55	2.13	2.37	2.39	2.34	0.21
2-Yrs Prior	0.08	0.15	0.83	1.29	1.63	1.48
3-Yrs Prior	0.17	0.28	0.38	0.63	0.76	0.48
5-Yrs Prior	2.09	2.27	2.56	2.68	2.74	0.47
5-Yr Average	1.65	1.72	1.87	2.01	2.10	0.38
10-Yr Average	1.11	1.27	1.74	1.99	2.19	0.92
Current as % Above / Below 5-Yr Average	165%	119%	81%	69%	61%	-199%
Current as % Above / Below 10-Yr Average	296%	195%	95%	70%	54%	-141%

- The result of higher interest rates, lower equity prices, significant mark to market losses, and global banking sector pressure will lead to higher unemployment and to economic slowdown and most likely will lead to recession over the next 6-9 months:
    - As almost all of the Fiscal stimuli in the total amount of $5.7 trillion are spent and is mostly already reflected in economic growth numbers

   - Economy is going to slow down with the increase in interest rates, banking crises, and with equity market declines leading to further tightening financial conditions.
   - Housing sector has slowed significantly mortgage rates have increased to levels not seen since 2007
   - Savings rate is down, credit card balances are up and that should reduce consumer demand and of course the increase in prices due to inflation

- While the recent decrease in interest rates has reduced the negative mark-to-market in our investment portfolio, the current MTM is negative $711 million, but these values are non-economic and non-cash as these negative values pull to par as they mature

- However, our income return is stable and rising interest rates are economically beneficial as they lead to higher interest income and we will get the benefit of increasing rates by investing remaining portion after Ian's claims of our maturing securities as well as additional premiums at higher rates

- Globally, weather disasters caused an estimated economic loss of $260 billion in 2022, surpassing the 10-year average of $207 billion. Insured losses in 2022 are estimated at $115 billion, again higher than the 10-year average of $81 billion. Hurricane Ian caused approximately $40 billion to $60 billion in insured damages, second only to Hurricane Katrina in 2005

- As expected, risk transfer pricing is up for the year with most Florida carriers experiencing rate increases of approximately 30%-50%, while pricing indications for non-Florida risk is up 10%-20%

- The risk transfer market is experiencing some positive momentum with capital inflows due to the attractive nature of risk transfer pricing and uncorrelated risk relative to other asset classes in the current market environment

- While there is a significant amount of demand for risk transfer capacity from cedants, from Florida carriers in particular, investor demand has been stable, resulting in a significantly higher spread levels than in prior years

- Capital markets transactions have been able to upsize and price at levels marginally below the initial price guidance, but overall spread levels are above what has been seen in prior years due to the increased scrutiny on credit and risk, increasing cost of capital, macro-level stress in the financial markets, and alternative investment opportunities