Citizens Market Update

December 4, 2023

- Inflation was unchanged in October at 0.4% and over the last 12 months, the all items index increased by 3.2% before seasonal adjustment – a smaller increase than the 3.7% increase for the 12 months ending September. The index for shelter continued to rise in October, offsetting a decline in the gasoline index and resulting in the seasonally adjusted index being unchanged over the month. The all items less food and energy index rose 4.0% over the last 12 months – its smallest 12-month change since the period ending in September 2021. The inflation is coming down but still away from Fed's target rate of 2%,
- Total nonfarm payroll employment increased by 150,000 in October and the unemployment rate was unchanged at 3.9% with 6.5 million unemployed persons. This employment increase is below the average monthly gain of 258,000 over the prior 12 months. However, since their recent lows in April, the unemployment rate and number of unemployed persons are up by 0.5% and 849,000, respectively. All of this reflects that labor market is slowing down.
- Since March 2022, the Fed has raised its benchmark borrowing rate 11 times to the current range of 5.25%-5.50%. The market does not expect the Fed to raise rates at its December meeting and is now projecting two to three cuts in the second half of 2024, which would put the Fed Funds rate at approximately 4.50%-4.75% by the end of 2024. However, we expect Fed to cut rates three to four times in 2024 as the inflation is coming down and economic conditions continues to slow down.
- In addition to holding rates at relatively elevated levels, the Fed is continuing to reduce its bond holdings with the Fed balance sheet decreasing by approximately $1 trillion since June 2022. The Fed is also allowing up approximately $100 billion in proceeds from maturing Treasury bonds to roll off each month, rather than reinvesting them. And at the same time, the Treasury is issuing significantly higher amounts of debt to fund fiscal deficits, both of these factors are leading to rates to remain higher than the current economic conditions would necessitate.
- The Fed is projecting inflation to steadily cool, while the labor market remains historically strong, personal consumption remains high, and energy prices have recently increased. We expect GDP to increase 2.4% this year but to slowdown in 2024 and to only increase by less than 1% before recovering to approximately 2% or similar to pre-covid levels in 2025.
- Consumers, who make up about two-thirds of all economic activity, have slowed spending but continue to remain engaged in the economy with no signs of stopping anytime soon as real disposable income is outpacing personal consumption expenditures by 3.9% and 2.2%, on a year-over-year basis respectively and they continue to borrow on credit card.
- One of the reasons we have been able to avoid recession, so far is continuous large government spending, and its multiplier effect, through various programs even beyond 2020

programs - 2021 American Rescue Plan, 2021 Infrastructure and Jobs Act, 2022 Inflation Reduction Act, and 2022 Chips Act. However, this at the same time has added to the sticky inflation.

- As we know, the monetary policy works with significant and variable lag, we still haven't seen the full impact of the interest rate increases. Nonetheless, most of the cash infusion from fiscal stimulus is gone and student loan repayments ae starting, we expect economic conditions to slow down and lead to at least mild recession in early 2024.
- Based on the projection of maintaining current Fed rate levels through the first half of 2024 with no additional rate increases, rates have decreased significantly in the past month, but the yield curve remains inverted with the spread between the 3-month and 10-year Treasury at 1.14% and the spread between the 2-year and 10-year Treasury at 0.36%. Since the beginning of the year, the 1-year and 2-year treasuries are basically unchanged while the 5-year and 10-year treasuries has increased by 15 and 25 basis points, respectively.
- While the recent decrease in interest rates has increased the negative mark-to-market in our investment portfolio, the current MTM is negative $783 million, these values are non-economic and non-cash as these negative values pull to par as the securities mature. Our portfolio duration is much shorter today than it was a year ago and therefore the evaporation pace has accelerated.
- Lastly, our income return is stable and historically high interest rates are economically beneficial as they lead to higher interest income and we have now started to realize the benefit of higher rates in our portfolio by investing the remaining portion of our maturing securities, after Ian's claims, as well as additional premiums at higher interest rates. We have over $4 billion maturing over the next 12 months, which will give us sufficient liquidity for 2024 season as well as allow us to earn significantly higher interest income.
- Global reinsurance markets are heading into 2024 with a positive outlook and expectations of an orderly market with marginal rate increases that will depend on the cedent as supply is expected to exceed demand. We expect rate increases to be approximately 5%.