



The Southern Surge

**prospects for insurance and financial services
in India and South East Asia**

A CII report by Vanessa Rossi, Senior Research Fellow, Chatham House

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foreword

Foreword

The Chartered Insurance Institute (CII) is pleased to publish this comprehensive report on the future prospects for the insurance and financial services markets in India and across South East Asia. With over 95,000 members in more than 150 countries, the CII is the world's largest professional body for practitioners in this field, embracing both the General and Life insurance sectors.

This report comes as countries like India and regions like South East Asia stand poised to surpass the old western economies in their international prominence. They already enjoy a well developed and diverse financial sector which has helped their economies weather the global downturn by learning from previous crises. Singapore now ranks number four in the World Economic Forum's 2009 index of financial market development, right behind the United States. Meanwhile the Indian market has grown faster than predicated a decade ago.

But our report predicts that the real "Southern Surge" of financial sector growth in Malaysia and India is yet to come, carrying significant benefit to the rest of South East Asia. We asked Chatham House to examine the insurance and financial services markets in these countries, and their findings highlight how important and varied these economies are. Their clear prediction is that Malaysia will increase about seven-fold over the next twenty years, reaching nearly \$70bn by 2030. However, in India, the period after 2020 will see an unprecedented financial market surge: even under a pessimistic scenario, the insurance market is likely to see annual growth rates greater than 10%. In the high growth case, the overall insurance market could grow up to twenty times to be worth over \$1.3 trillion by 2030.

So how can those markets prepare for this "Southern Surge" in a way that sustains public trust and confidence? Another finding from Chatham House is that enhanced investment in education, skills and professionalism are the essential ingredients for making the growth happen in the first place. Moreover, the vital networks and interactions that professionals create can help to foster a healthy and vibrant society as well as enhance partnerships across the region and beyond.

We have always believed that professionalism should be at the forefront of effective growth. The fast growing financial markets in Asia and the Middle East represent the largest increases in our membership, signalling a view that embedding increased standards of knowledge and conduct are a prerequisite for sustainable financial sector growth. This report confirms the thinking behind this approach. With growth in India due to accelerate in 2020, now would be the time to build the culture. This way, when "the Southern Surge" does occur, professionalism will already be a firmly embedded feature of the market.



A handwritten signature in black ink, appearing to read "Alexander Scott", with a long horizontal flourish extending to the right.

Dr Alexander Scott
Chief Executive Officer

The Chartered Insurance Institute
July 2010

executive summary

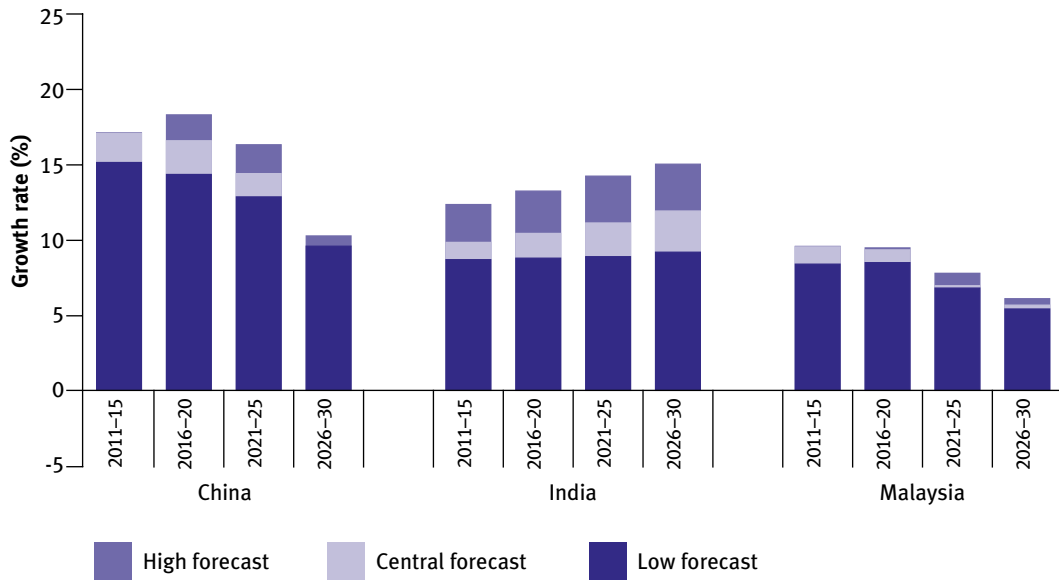
This report examines prospects for growth of the insurance markets in India and across South East Asia, particularly Malaysia and Singapore. Its main prediction is that especially India and Malaysia, having already grown significantly, could surge forward in the next few decades to become dominant regional and even global financial hubs.

The analysis looks at major drivers that could make this “Southern Surge” of growth happen, underscoring the importance of investment in education, skills and training. It also highlights the role of professionalism in creating and sustaining these markets locally, regionally and globally.

Executive summary

- Speeding up or slowing down? Growth in financial services is progressing at a fast pace across Asia but markets are nevertheless at quite different stages of development, some starting to mature while others are poised for a new phase of rapidly rising demand. According to the assessments presented in this report, the “Southern Surge” of economic growth in especially India is yet to come.
- Financial services have considerable scope to expand in India and across South East Asia not only due to the opportunities created by the region’s generally strong economic growth prospects but more particularly because India, the largest market in the region, has not yet fully developed in financial services and is unlikely to see the typically sharp take-off in demand for such services before 2020.
- Malaysia is already an important regional leader in the financial services market, especially for Islamic financial products, and is further advanced than India. However, the country could be on the verge of a fast growth phase for financial services as GDP per capita is just reaching what is estimated to be a key threshold for accelerating household demand. This means that demand for insurance could almost double over the next decade measured as a share (%) of GDP but growth would then start to slow as the Malaysian market reached maturity.
- In contrast, the developed city state of Singapore has less scope for expansion in its home market than developing Asia, although it still enjoys high growth in GDP per capita and has potential for insurance premiums to pick up to levels comparable to leading OECD countries. As a key regional hub, Singapore may also expand its influence as a supplier of capital and expertise in the Asia region.
- India shows the potential for the largest growth: 2020-2030 could see the most dramatic increases in demand for financial services, implying that the general insurance market might be worth between \$120 billion and \$340 billion by 2030, compared with less than \$10 billion today. Including the life market, total premiums could rise from around \$60 billion today to between \$550 billion and over a trillion (over 8% of GDP) by 2030.
- The differences between India’s growth scenarios depend heavily on two key factors. First is the extent to which the country invests in education and professional training to upgrade skills. Second is the extent to which it prioritises the development of international financial partnerships. This includes building more extensive city-to-city relationships with other centres both regionally and globally, and easing limitations to entry by foreign financial institutions.
- Despite its impressive growth under the various scenarios, India’s market will be on a different time scale to China’s. By 2025-2030, growth in the Chinese market will begin to slow down, just as India’s looks set for a period of rapid expansion (see Figure A overleaf).

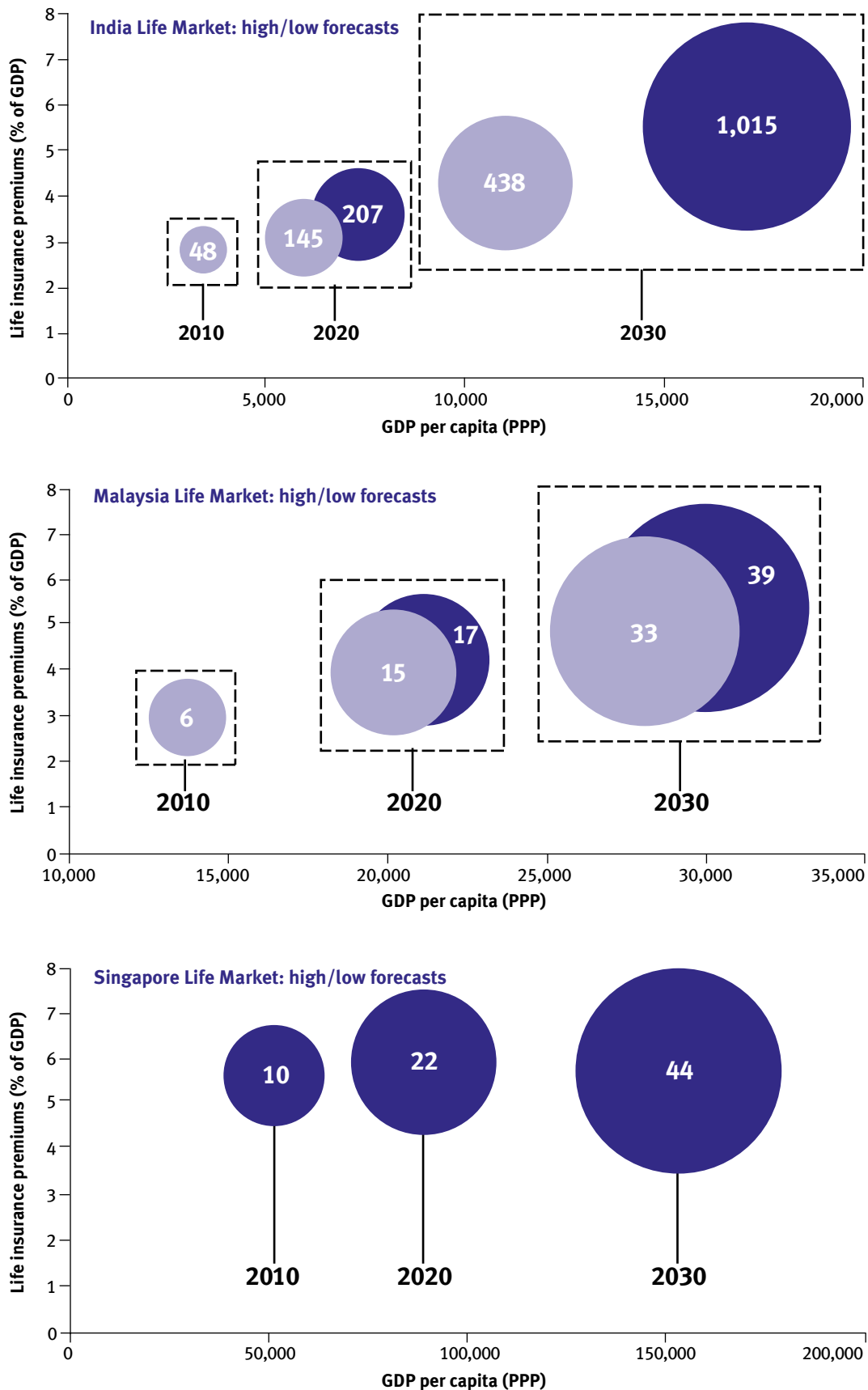
Figure A: Average annual real growth rate of the total insurance market shows growth slowing down in China and Malaysia in the 2020s, while India’s continues to accelerate



Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

- The Asian economy’s track record for strong and stable growth has fostered the development of a rapidly growing internal market. This has encouraged the steady rise of regional trade and financial connections and has strengthened the role of the key city hubs, most notably Hong Kong and Singapore. Improving the quality of business and professional skills also highlights the need to increase training capacity and the standing of professional bodies to oversee business practice. The major Asian cities are all targets for expansion in such activities.
- In all these economies, encouraging the development of professionalism within the financial sectors will also play a vital role in not only driving the “Southern Surge” of growth, but also ensuring this happens in a manner that instils market trust and confidence. First, professions create clusters and pools of skilled practitioners which encourage the growth of talent in the labour force. Second, they help to organise the labour force through national networks that also span across wider society. Third, they can help to foster wider partnerships both regionally and beyond, thereby enhancing connections between financial hubs.
- The alternative scenarios for growth in the insurance markets – including the life sectors – in India, Malaysia and Singapore are set out and described in this report, and are depicted in the charts in Figure B overleaf.

Figure B: Growth of the Life sectors by country, 2010–2030, showing estimated market size (in US\$ billion) under the proposed alternative scenarios



Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

overview

“ Improved and responsible access to financial markets, professional banking and insurance services can help stimulate and support stable growth. In the private sector, access to financial products can improve the security of household income, encourage home ownership and boost consumer spending as well as promoting profitable industry development and the expansion of new industries, especially in fast rising technology and professional services sectors. ”

Overview

The insurance and financial services markets in India and South East Asia are set to expand considerably over the next twenty to thirty years. In relatively developed Singapore and Malaysia, this growth will start out high but then decline slightly as markets mature. Yet for India, much of the acceleration in growth will occur after 2020, once the level of household incomes has reached the stage at which demand for insurance and financial products enters a rapid take-off phase for the bulk of consumers. The “Southern Surge” is yet to come.

In an effort to better understand the medium- to long-term prospects in the region for insurance and financial services professionals, the Chartered Insurance Institute asked Chatham House to undertake a research project to examine the potential drivers and prospects for the organic growth of markets in these sectors in this part of the world. Their focus is especially India, but also Malaysia and Singapore, as well as the regional implications of this growth and comparisons with other parts of Asia, notably China.

What are the fundamental drivers and scope for growth in financial services¹ across this region?² How are these trends tied to projections for the development of the economy as a whole? This study sheds some light on these issues by examining the relationship between scenarios for the economy and growth in the financial services market. We firstly review the economic backdrop and potential for further expansion across the services sector and then address the ways in which financial services, specifically the example of the insurance market, may be correlated with household income growth. Such growth would also offer more business opportunities for the city hubs of Mumbai, Singapore and Kuala Lumpur.³

Expansion of the broad services sector, including development of financial capabilities, will not only be promoted by, but also help in, fostering the region’s next decade of growth and investment: this is an important two-way relationship. Improved and responsible access to financial markets, professional banking and insurance services can help stimulate and support stable growth. In the private sector, access to financial products can improve the security of household income, encourage home ownership and boost consumer spending as well as promoting profitable industry development and the expansion of new industries, especially in fast rising technology and professional services sectors. Financial hubs are an essential part of this process as they offer the opportunity to rapidly and effectively improve the quality and scope of services offered. In addition, dynamic clusters encourage the growth of talent in the labour force, a significant bonus in view of the increasing global competition for skilled professionals.

To illustrate the importance of the key demand drivers for financial services, especially for India, we develop a range of scenarios for potential growth in the insurance market over the next twenty years. Important fundamental factors to watch in estimating organic market growth in developing countries are the rate of urbanisation (in its own right, as an indicator of urban demand, but also as a proxy for national productivity and income growth) and the scope for demand to enter a rapid take-off phase as incomes breach critical thresholds. This analysis reveals a very wide range of estimates for expansion in the Asian insurance market, all of which point to substantial business increases to come.

¹ By financial services, we refer to insurance, banking and wealth management in general. Later in this report, we also refer to retail financial services, namely those services aimed at individuals and small businesses.

² The scope of analysis of this report is India and South East Asia, the latter incorporating the Association of South East Asian Nations of Malaysia, Singapore, Indonesia, Thailand, Vietnam, the Philippines, Cambodia, Laos, Brunei and Burma. The analysis presented in this report also has implications for other important markets in South Asia such as Pakistan and Bangladesh, for which similar studies could be undertaken.

³ These three hubs are chosen on the basis of their leading role in the region, as illustrated in this report. Whether examined on the basis of macroeconomic statistics or microeconomic evidence, these stand out as the key centres for financial services in South Asia.

Part 1:

A favourable background for financial sector development: strong economic growth with rapid urbanisation and rising living standards

section highlights

- Asia has been an incubator for rapid economic development for many years. The region's relatively robust public sector finances and banking system, helped it weather the recent global crisis with little damage.
- Productivity gains in developing countries are typically associated with a rising urban population and successful migration of under-employed agricultural labour to more productive jobs. India has yet to enter a period of faster urban development, and whether it can successfully make this transition or not will define not only its own economic potential but the potential of the region.
- Creating an expanding urban middle class and a better-off rural population stimulates even faster growth in consumer demand and a take-off in domestic sales of key high ticket items which typically lead to rising demand for financial products, for example, consumer loans and insurance.
- To drive forward its economic growth and development, India must invest in infrastructure but also in education and skills, which are particularly important for capacity building in sectors such as financial and professional services.
- To augment domestic investment, India must also prioritise the fostering of closer financial partnerships with other financial hubs across the region. These include enhancing already growing foreign direct investment, and encouraging professionalism linkages.
- Singapore and Malaysia will also experience relatively rapid growth, though on a much smaller scale than India.

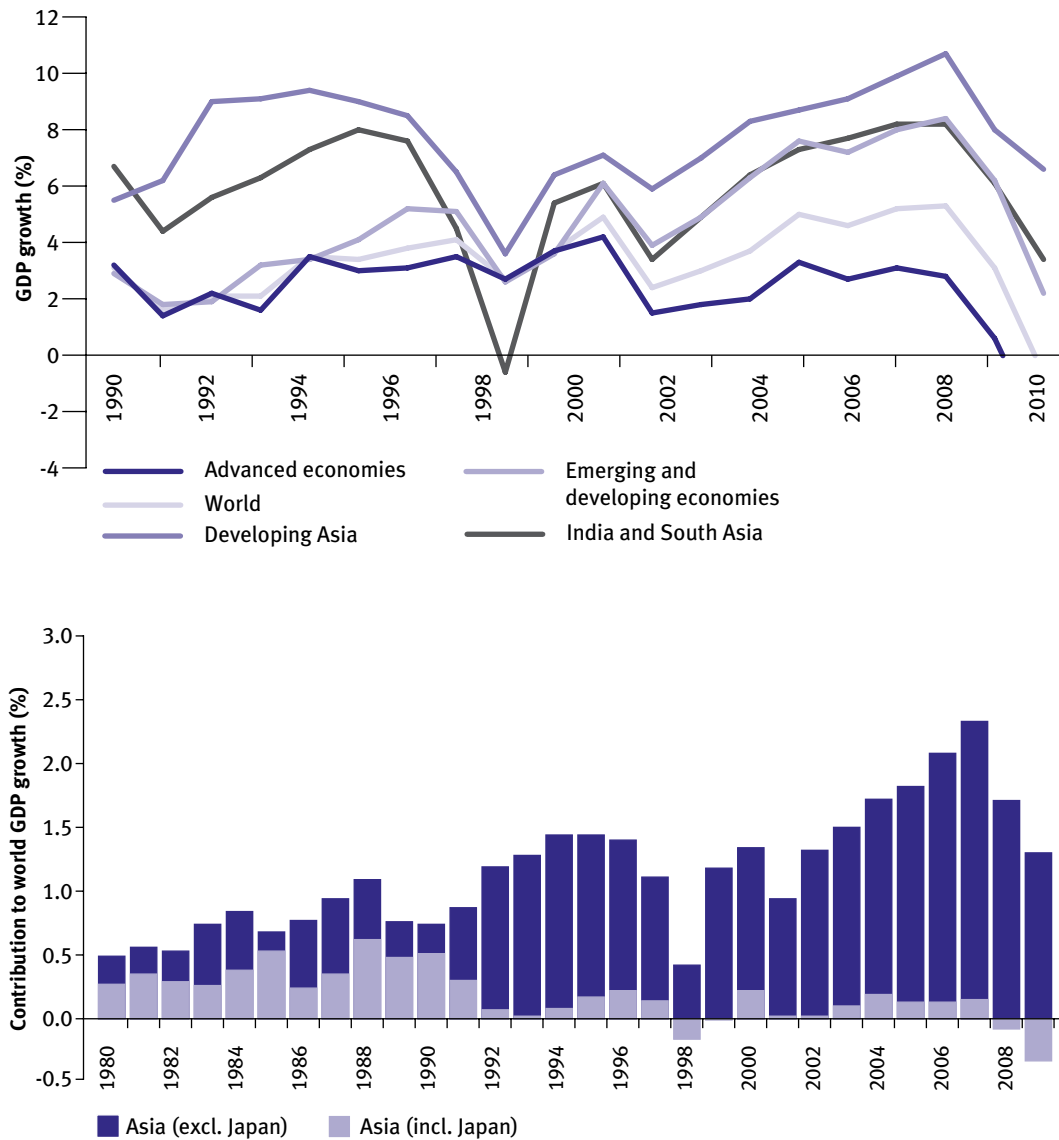
Part 1: A favourable background for financial sector development: strong economic growth with rapid urbanisation and rising living standards

It is well-known that Asia has been an incubator for rapid economic development for many years, starting in the 1950s and 1960s with Japan and the trading hubs of Hong Kong and Singapore, followed in the 1970s and 1980s by the strong industrial growth of South Korea, Malaysia and Taiwan and, to a lesser extent, Thailand and the Philippines. But Asia only started to achieve the necessary scale to act as the powerhouse of the global economy from the 1990s, based on the exceptional take-off of the Chinese economy along with a significantly improved growth performance in India from 2003.⁴ These recent waves of development have been associated with increasing urbanisation and rising living standards across the continent's emerging markets, which have led to a fast changing consumer market and demand for services, including financial products such as banking and insurance. Confidence has been boosted by this experience of strong growth over many years, although household savings rates typically remain high across the continent and there is still ample scope for further growth in financial services.

“ The case of the insurance market in India demonstrates the potential benefits for reform to financial services. Since liberalisation in 1999 and the later abolition of tariffs, new entrants have proved very dynamic, rapidly gaining market share through a wider variety/higher quality of products than the state insurers could offer. Compared with forecasts made a decade ago, the growth performance of the Indian insurance market has actually been stronger than expected, particularly in life insurance. ”

⁴ Japan contributed significantly to world GDP growth in the 1960s and 1970s, yet could not be considered an economic powerhouse. Moreover, this development was not associated with rapid urbanisation.

Figure 1: Global growth – Asia powers ahead and contributes more to world GDP



Source: IMF (WEO) data and forecasts (2010-14)

The region’s relatively robust public sector finances and banking system, in part a legacy of the efforts made to reduce risk after the Asian crisis, helped it weather the recent global crisis with little damage. Although the Asian economies were shaken by the sharp drop in world trade and financial market turbulence in late 2008 and 2009, they were able to rebound quickly and strongly to growth rates well above those of other regions. Looking ahead beyond the post-crisis recovery, Asia is widely expected to continue performing strongly, with China destined to become the world’s largest economy in around fifteen years time, and India the third largest.

Economic growth is forecast to remain high primarily because the region’s developing economies have successfully demonstrated their ability to achieve rapid progress and they all have ample scope for further catch up in productivity rates compared with the leading developed countries (as shown by GDP per capita figures, with India’s productivity currently less than 5% of the leading developed countries’ rate and Malaysia’s less than 20%). Even high productivity economies such as Singapore are expected

⁵ In PPP terms, the gap is smaller, with India around 10% and Malaysia about 30% of developed country productivity, but it is still substantial, offering ample scope for further catch up growth.

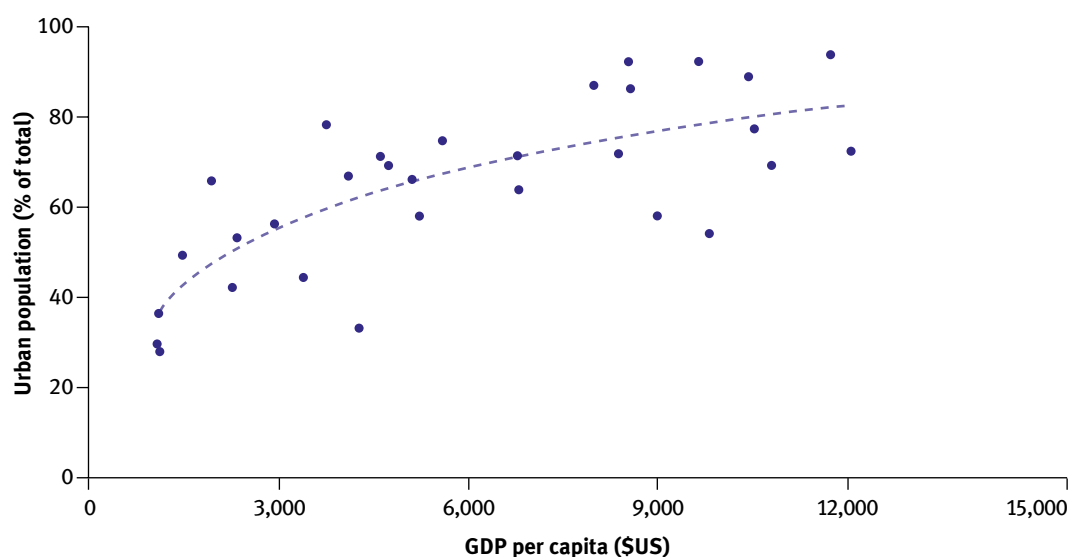
to benefit from the fast growth in the surrounding region, with its own growth rate possibly staying in the 4-5% range rather than falling to a more sedate OECD rate of 1-3%.

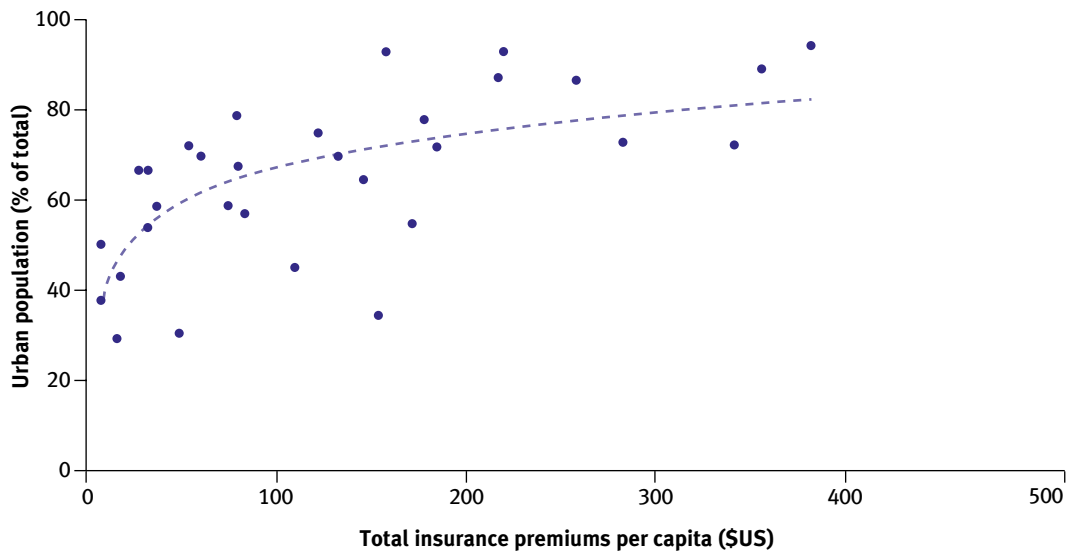
However, such productivity gains in developing countries are typically associated with a rising urban population and successful migration of under-employed agricultural labour to more productive jobs. Rapid and well-planned urbanisation acts as a key catalyst (both a symptom and a driver) of change, offering more workers the chance to raise skill levels and secure jobs in higher value-added industries. This boosts household incomes and living standards as well as national economic development: Figure 2 illustrates this general relationship between urbanisation and income growth (Figure 4 also shows the varying productivity rates observed for rural and urban workers in India). Creating an expanding urban middle class and a better-off rural population stimulates even faster growth in consumer demand and a take-off in domestic sales of key high ticket items such as household appliances, cars and homes, all of which typically lead to demand for financial products, for example, consumer loans and insurance (the relationship between rising urbanisation and the insurance market is also depicted in Figure 2). Thus the service sector not only benefits from growth in consumption but also helps drive this growth by creating yet more jobs and consumer demand.

Clearly, it is essential to examine economic prospects and projections for income growth when analysing the fundamental drivers of consumer market growth in developing countries (especially in less mature regions). This provides the underpinning for demand analysis. The insurance market scenarios developed in this report are linked to the potential for urbanisation as this provides an explanatory driver and narrative for attaining commensurate gains in productivity and incomes (GDP per capita), which in turn underpin forecasts for insurance demand.

In fact, the rate of urbanisation and the level of GDP per capita vary widely across the countries we focus on in this report, providing contrasting projections for the development of the financial services market. Most significantly, India still has a very low rate of urbanisation, reported to be around 30% of the population, which offers massive leeway for substantial increases to occur over the coming ten to twenty years. Given the scale of India's economy and its future financial services market, this has important implications not only the country's growth potential and the development of its financial services sector, but also for the region as a whole.

Figure 2: Increasing urbanisation is associated with higher income levels and a larger insurance market

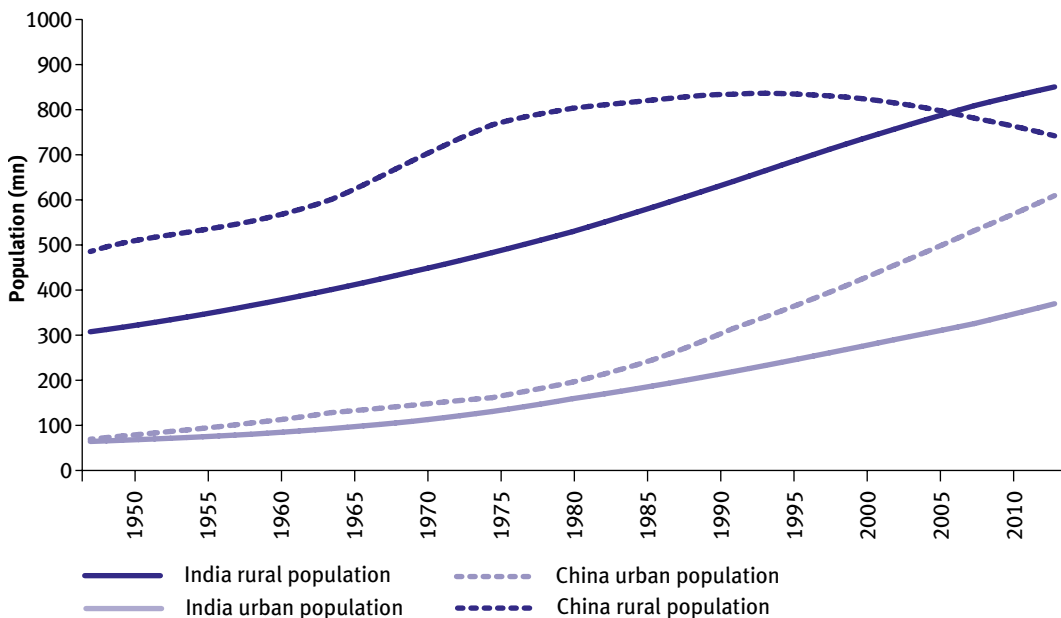


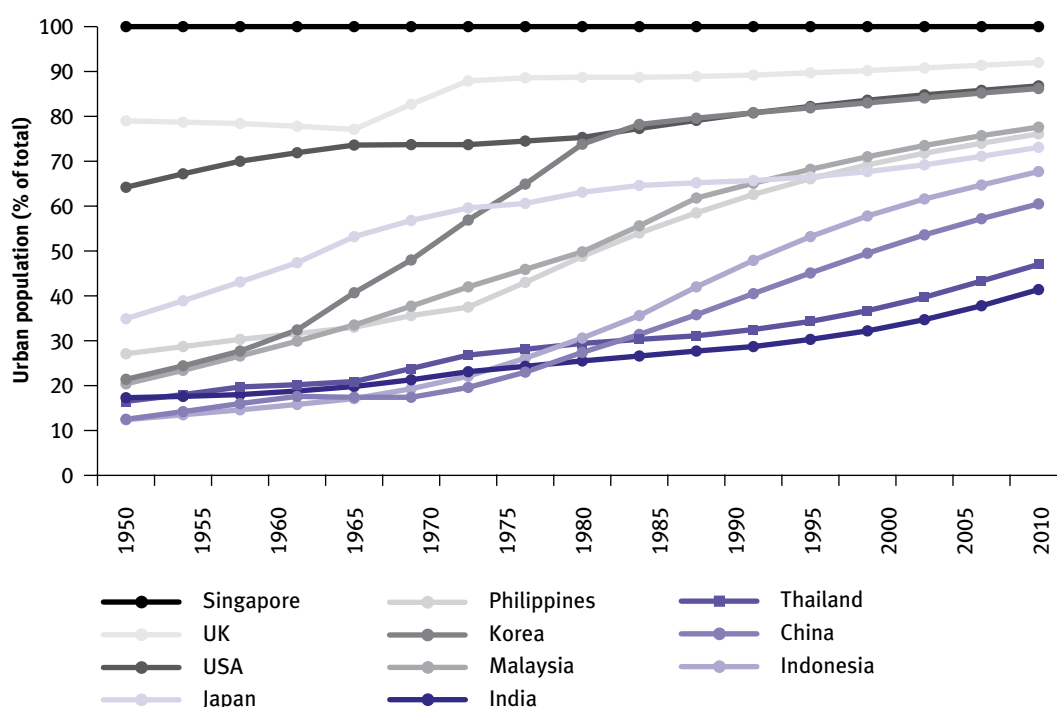


Source: Swiss Re (Sigma World Insurance Data), IMF (WEO) and UN population data. Note: data for 2008 from 31 emerging and developing economies

In contrast to the low urbanisation rate and slow pace of change in India, urbanisation has progressed rapidly in Malaysia, from close to 20% (similar to India), in 1950 to a mature economy rate of around 60% by 2000 and 65% in 2010 (well above India’s 30% rate). Further increases are anticipated but at a slower pace. However, past development is still being absorbed, with newly urbanised workers upgrading skills by improving training. At the other extreme to India is Singapore, which started out as an urbanised city state and has little potential to achieve a boost to productivity through transforming low skilled rural workers, although it can and does import workers to expand its talent pool and it also promotes continued training and improvement in skills for residents.

Figure 3: India’s rural and urban population based on UN data and the urbanisation rate compared with other countries





Source: UN population data

Forecasts for India are key to the region’s scope for fast growth

Clearly India, unlike China, has yet to enter a period of faster urban development⁶ – whether it can successfully make this transition or not will define not only its own economic potential but the potential of the region. This will be critical for the financial services outlook. We will therefore look in more detail at alternative scenarios for India’s growth prospects.

At one extreme, India’s urbanisation rate could remain low, well behind China and even further behind Malaysia and advanced Asian economies such as Japan. In fact, the UN’s demographic forecasts for India, based on annual growth rates of 1–1.5% for the overall population and a trend rise in the urbanisation rate, suggest only a moderate transition from a rural to urban society, with continued growth in the rural population. However, given the potential for urbanisation to suddenly accelerate as development takes off (as it did in China), the UN estimate should be considered a very conservative extrapolation.

In order to assess India’s economic prospects, we therefore examine three contrasting scenarios for urban development, a key driver of future productivity and economic growth:

- 1) the “consensus” baseline scenario in which population and urbanisation follow UN central forecasts;
- 2) a ‘High’ urbanisation scenario⁷ in which the urban population grows at a rate greater than the UN forecast (‘High’) and successfully raises productivity;
- 3) a ‘Low’ urbanisation scenario in which the urban proportion of the population is frozen at the 2010 level, reducing national productivity growth.

⁶ India’s rural population is only expected to plateau in the 2020s according to the UN. For comparison, China’s rural population actually entered a phase of decline in the mid-1990s (the Appendix includes further comparisons with China).

⁷ For the ‘High’ scenarios, the urbanisation rate is assumed to reach 60% in India and 85% in Malaysia by 2030. This is based on historical examples from Asia: for example, the urban share of the population doubled in Korea between 1965 and 1985, and almost doubled in China and Indonesia in the period 1980-2000.

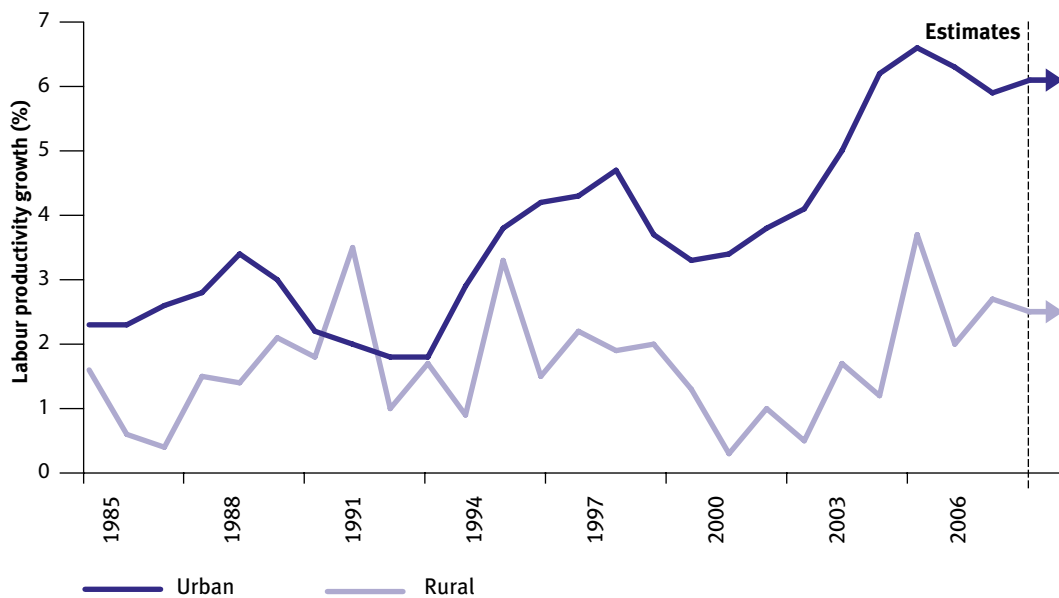
These “high”, “low” and “consensus” scenarios for the urban population are depicted in the charts below along with the associated estimates for GDP.⁸

As the population migrates from low productivity under-employment in rural areas to more productive urban employment, the average productivity of the national workforce (and thus GDP growth) increases. This is due to three factors:

- Former rural workers take up more productive occupations in existing urban areas;
- there is development of small conurbations (previously classified as rural) into newly urbanised areas, thus boosting the definition of the urban population;
- rural productivity increases as the number of households employed in agriculture drops but more or less the same output is still produced.

Therefore, the higher the rate of urbanisation, the quicker the pace at which productivity tends to rise. As a consequence, in the “high” urbanisation scenario, household income levels increase at a faster rate than in the slow urbanisation scenarios. In reality many complementary changes have to occur: for example, even if workers do move to urban areas, urban output may not increase immediately as it takes time for migrants to find employment, improve skills and move up the income ladder. In this context, the opportunity for learning-by-doing and upgrading skills is an important first step to improving livelihoods.

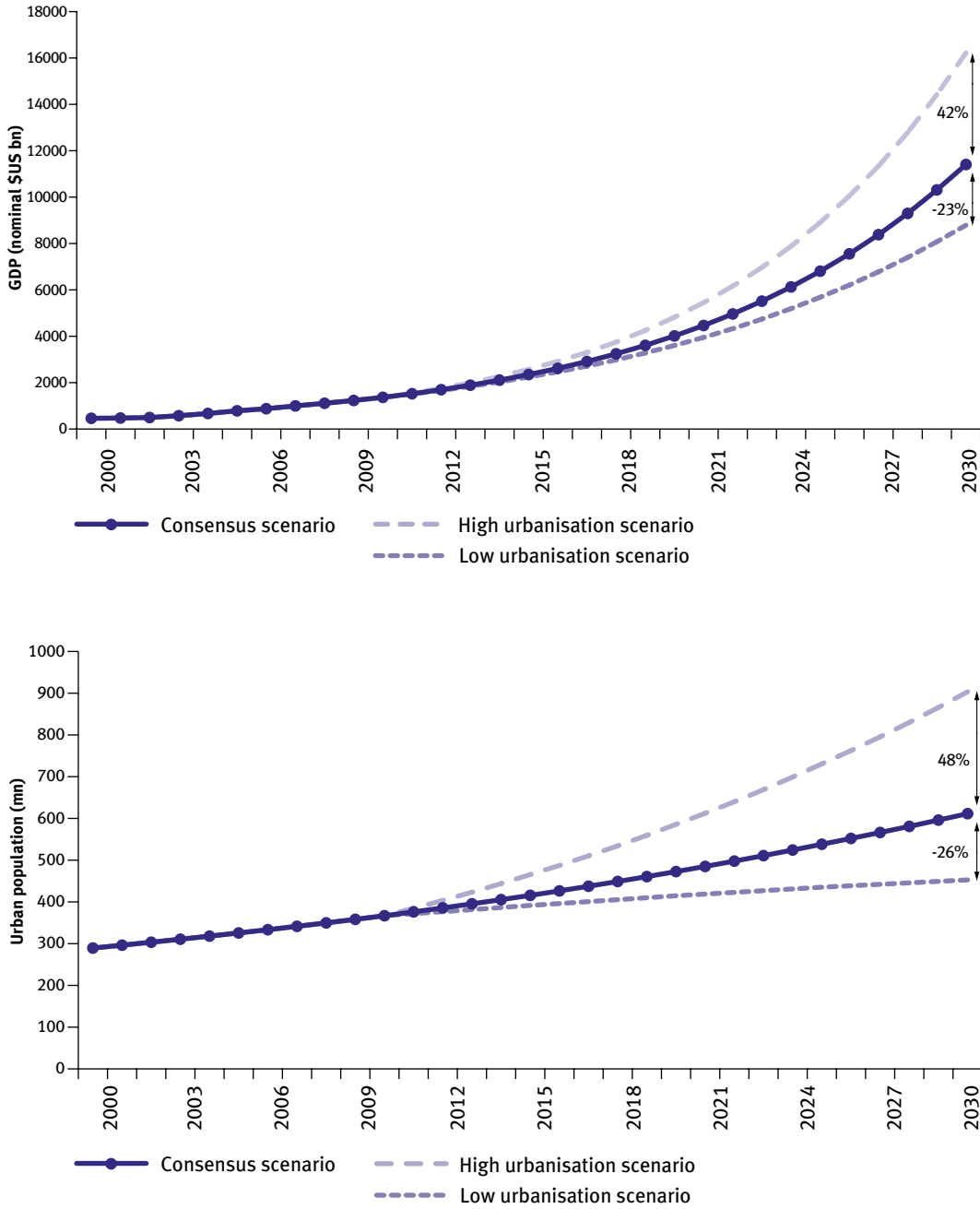
Figure 4: Labour productivity growth in India is higher in urban areas (5-year rolling averages and indicative estimates used in the scenarios)



Source: World Bank (WDI) data and own calculations

⁸ These are compiled by calculating the different productivity rates of the rural and urban labour force multiplied by the respective rural and urban population numbers, which also change. This implies that a shift from rural into urban work successfully raises productivity and boosts overall economic growth compared with the case in which there is no further migration to urban areas (the low forecast). Essentially, loss of one rural worker has little impact on total output in the agricultural economy but this extra worker can add considerably to output in the urban context, raising national production and productivity. Projections for urban and rural labour productivity in the period 2010-30 have been calculated using past trends as well as information from trends in other countries in the region.

Figure 5: Alternative demographic and economic growth scenarios for India

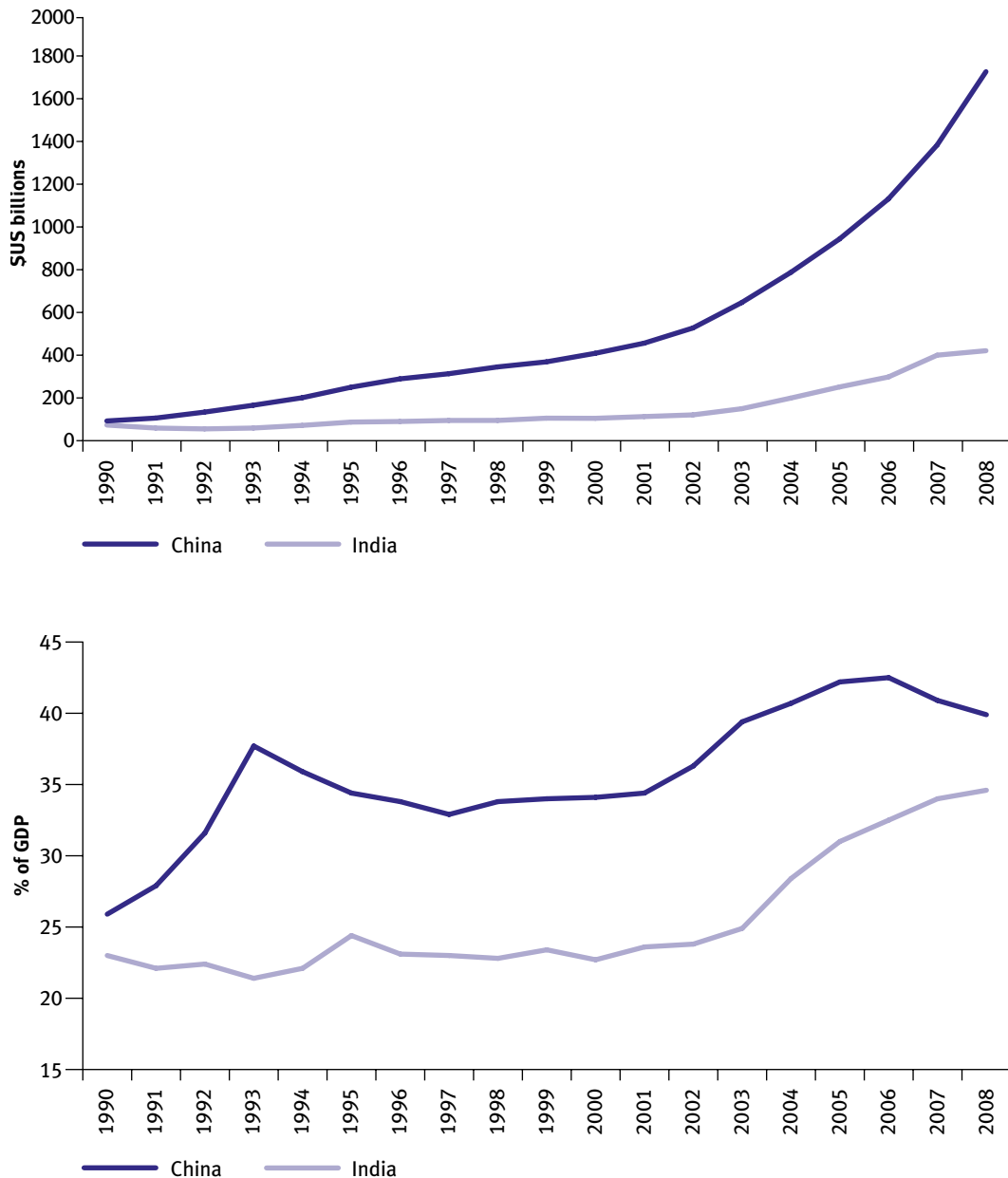


Source: Own projections based on IMF (WEO) and UN population data

In the rapid urbanisation scenario, India’s urban development is assumed to take off as it already has in China and Malaysia and, in this case, the urban population, which encompasses most of the middle income households, could reach 900 million by 2030, almost 50% above the UN estimate.

Estimated levels of GDP across the scenarios similarly vary, with significant implications for GDP per capita. This impacts on potential growth in retail financial services including insurance as the latter is strongly correlated with a rising middle income population, largely composed of urban households. The estimated impact on financial services and insurance is addressed later in Part 3.

Figure 6: Investment rates in India and China



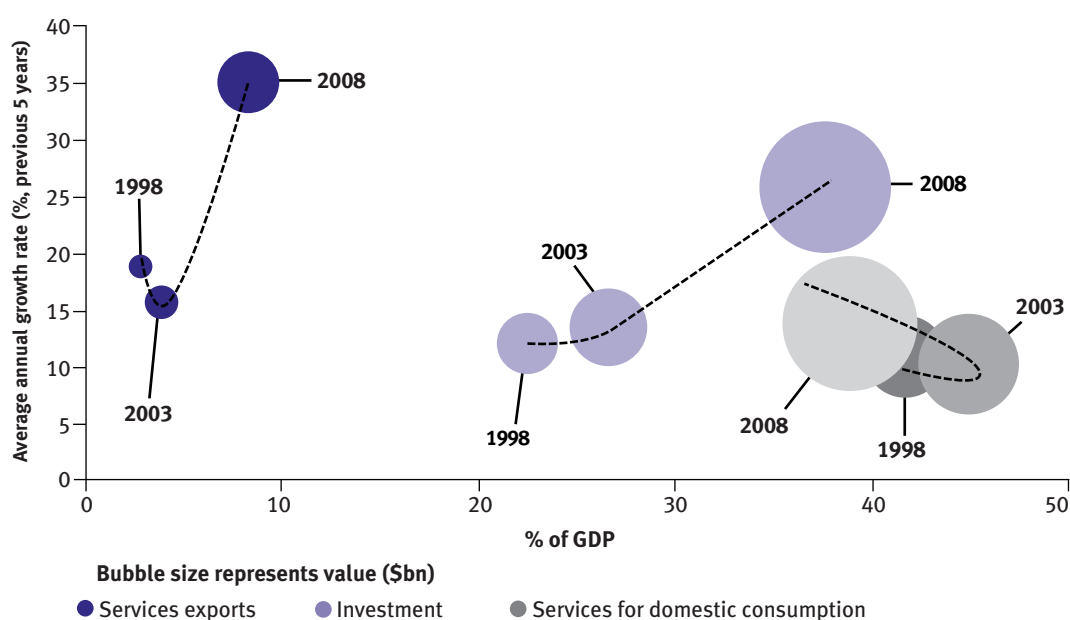
Source: World Bank data

However, to achieve the high growth scenario, with a substantial and successful rise in the urban population and sustained economic expansion of 8–10% per annum (the same magnitude that China has enjoyed during the last decade), annual investment spending must also rise sharply in order to support businesses and infrastructure. Most of this funding must come from private sources. China has succeeded in both urbanising rapidly and investing at a massive rate: annual investment was not far off \$2 trillion in 2008 and will probably reach around \$2.5 trillion this year, about five times the investment spend in India (which is similar to the level of China about a decade ago). China has thus developed the necessary capacity and infrastructure to rapidly expand its economy. Although investment has accelerated markedly since 2004, India has yet to prove that it can meet this challenge – currently India spends 5% of GDP on maintaining infrastructure, while China spends 10%.⁹

⁹ NMCC (2009).

So far, India's dynamic service industries have continued to find creative ways of sustaining their high rates of growth. However, they will be increasingly challenged, even constrained, if their growth is not complemented by a broad range of infrastructure and social developments. In the rapid early development phase of new service sectors, private entrepreneurs in India succeeded regardless of the infrastructure. Growth of important new services, which made a substantial contribution to export revenues, also pressured the government into agreeing to improvements in infrastructure, some of which were privately funded (e.g. toll roads). As Figure 7 shows, growth in investment has accompanied growth in the services sector (particularly services exports). Notable recent infrastructure improvements include the building of 3,600 miles of highway for the 'golden quadrilateral', linking the main cities of Mumbai, Delhi, Kolkata and Chennai, and the upgrading of Delhi's metro system.¹⁰ However, maintaining and improving upon this level of investment will require more policy initiatives. A recent report by McKinsey (2010) identified the potential for local government to increase infrastructure investment, following examples elsewhere (particularly in China). This may involve central government distribution of loans and grants, or permission for local governments to raise money through asset sales issuance of debt and/or revenue raising, e.g. through value added taxes.

Figure 7: Investment and services in India both show a marked take-off from around 2003–04



Source: World Bank data

The next decade will see considerable pressure for change from leading entrepreneurs and the rising middle classes, which will affect many areas of activity including the outlook for financial services. There is already a greater private sector response to the supply of services and goods, from health care and insurance to electric power, housing and utilities.¹¹ If this successful trend continues, it will expand urban job opportunities at all levels, leading to many more low paid workers moving up the skills ladder and improving living standards. But the urbanisation rate must advance from its relatively low rate, absorbing more people from the agricultural sector and other low productivity occupations. This is not as difficult a process as it may seem as many entry-level urban jobs require little by way of formal training, for example, in retail services, domestic help and basic construction work, where on-the-job training is typical. Favourable economic trends and the successful absorption of labour into urban jobs not only boosts construction and services activity, but increasingly involves the use of more formal financial services for households and for the burgeoning number of small- to medium- sized enterprises (SMEs).

¹⁰ Financial Times (2008).

¹¹ See, for example, Times of India (2009a, 2009b) and analyses of India's insurance market by P. Gupta (2006, 2010).

Nevertheless, the challenges posed in absorbing India's urbanising population are substantial. To facilitate rapid urbanisation and the incorporation of millions of former rural households into the urban environment, solutions must be found for the provision of public goods such as energy, water and housing, all of which are still under strain.

Can India manage all these demands? Apart from doubts about organisational capacity and decision-making in India, there are also important differences in terms of the cost of infrastructure that impact on potential solutions to urban bottlenecks. For example, the cost of building materials is notably higher in India than for competitors such as China. A report by the National Manufacturing Competitiveness Council (NMCC, 2009), a body established in 2004 by the Indian government, points to the high cost of raw materials in India. China has an advantage over India as production of these materials is largely local (and subsidised, e.g. energy inputs are cheaper). Logistical bottlenecks are also a hindrance in India and transport costs are high.¹² In addition, power generation requires substantial investment – based on consensus growth forecasts, it is estimated that India may need to triple its power output over the next decade.¹³

If no means of resolving these multiple development problems is found, the concept of rapid urbanisation and a sustained period of Chinese-style economic growth of 8–10% for India will fail¹⁴ – the “high growth” scenario will never happen, India will not come close to matching China. Given the difficulty in meeting these challenges, the trend towards urbanisation may plausibly reach a binding limit. If the urbanisation rate stalls (say at 30%, the 2010 level), then by 2030 the urban population might be some 26% (150 million) lower than the consensus forecast. This is the “low growth” scenario depicted here.

If India fails to make a pronounced transition to a more skilled urban economy and is faced instead with a still increasing population of low skilled (largely under-employed agricultural) workers, then economic growth will be choked off by a lack of suitable labour (and rising inflationary pressure) while the rural economy will suffer from very low productivity growth (and rising underemployment) given the inability to increase agricultural output at more than 2–3% per annum. Overall GDP growth prospects could be held back in the 5–7% range rather than rising to the “high growth” scenario range of 8–10%.

In fact, some areas of skilled labour are already noted as being in short supply, particularly engineering, software design and middle management.¹⁵ Average annual wage growth for senior management positions has been of the order of 30–40% because of supply shortages. Furthermore, a joint World Bank and Federation of Indian Chambers of Commerce and Industry (FICCI) survey, published in November 2009, reported that two-thirds of Indian employers are not satisfied with the engineering skills of recent graduates.¹⁶

There has been significant progress at the lower end of the education system. For example, in April 2010, a law guaranteeing the right of children to enjoy a free education was enacted. This obliges schools to provide a certain minimum quality of education, as well as obliging private schools to reserve 25% of places for students from less well off sectors of society.¹⁷ Yet access to higher education and therefore training for the type of skills necessary in the high value-added services sector remains more limited – only around 12% of students enrol in higher education, which is concentrated in just a few states.¹⁸

¹² The NMCC estimate the cost of the average freight tonne-kilometre in India as \$0.2 (\$US) while in China it is only \$0.013.

¹³ Financial Times (2008).

¹⁴ Other studies have noted this such as McKinsey (2010).

¹⁵ McKinsey (2007).

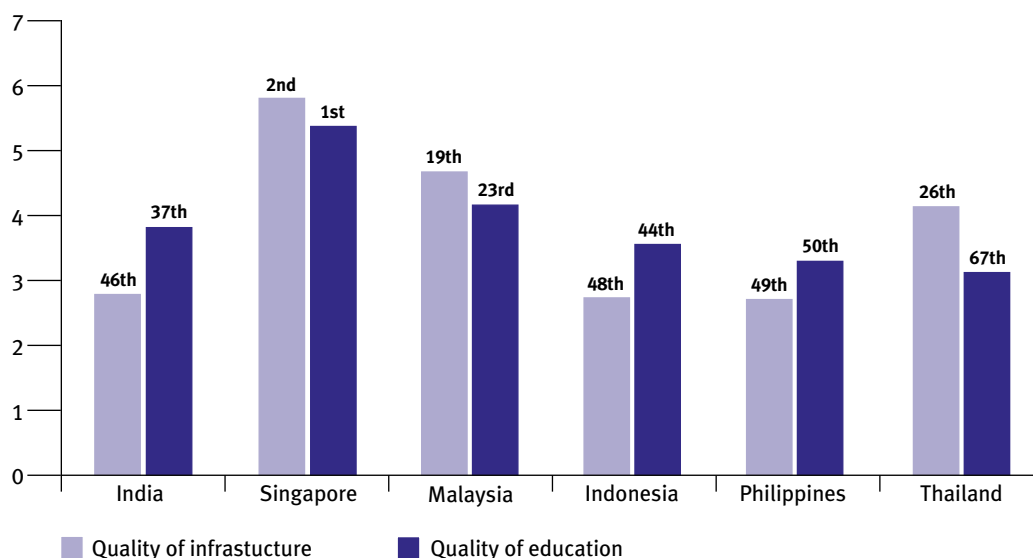
¹⁶ Financial Times (2009).

¹⁷ Times of India (2010).

¹⁸ Economic Times (2010).

Thus education and infrastructure levels may already be posing a constraint on the pace of growth. Evidently, new solutions have to be implemented urgently, to assure a stronger economic growth scenario through this decade.¹⁹

Figure 8: The quality of education and of infrastructure (7=high, 0= low) and ranking out of 133 countries. Singapore followed by Malaysia show a clear lead



Source: WEF – Global Competitiveness Report 2009–10

In addition, financial capacity may already be acting as a brake on India’s economic growth. Although the savings rate in India has increased over the last decade, it remains much lower than China’s rate and, moreover, savings have tended to be channelled unproductively. Obligations on banks and financial institutions to hold government bonds (a form of direct crowding out effect) have typically constrained the scope for private credit growth in India²⁰ and there have been restrictions in the form of the proportion of loans earmarked for ‘priority’ sectors. Banks’ profits are therefore made through high margins between lending and deposit rates. Pension funds and insurers are also mandated to hold a high proportion of government bonds, weakening the demand for corporate bonds and private equity. These constraints have been recognised, with Prime Minister Singh putting forward proposals for financial sector reform in November 2009, including the development of corporate bond markets and cutting back state ownership.

The case of the insurance market demonstrates the potential benefits for reform to financial services. Since the liberalisation of the market in 1999 and the later abolition of tariffs, new entrants to the market have proved very dynamic, rapidly gaining market share through a wider variety/higher quality of products than the state insurers could offer.²¹ Compared with forecasts made a decade ago,²² the growth performance of the Indian insurance market has actually been stronger than expected, particularly in the life sector. As a result, the development of India’s insurance market is advanced for the level of income (this is explored in more detail in sections 3 and 4).

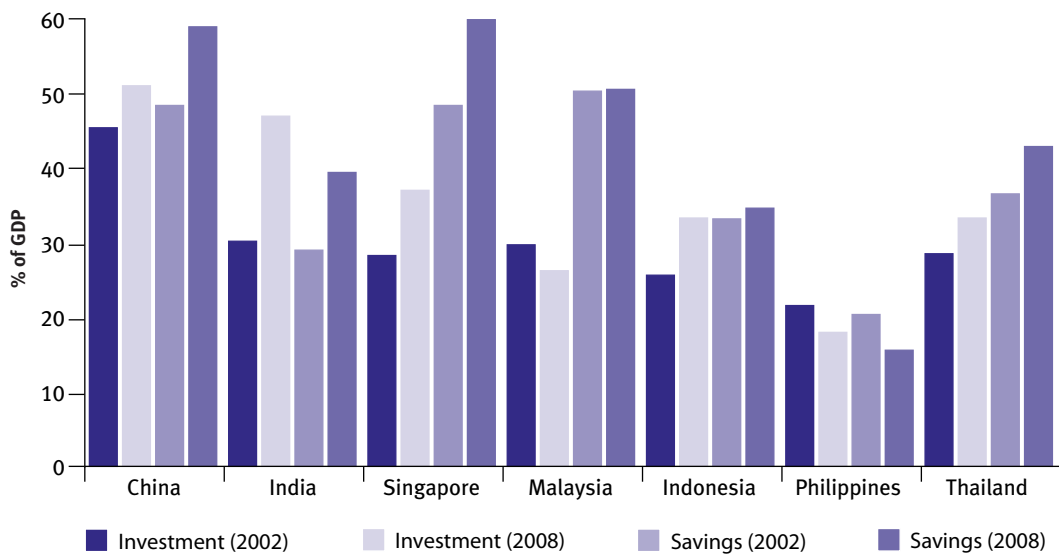
¹⁹ Some solutions proposed at the annual FICCI Education Summit in November 2009 include industry sponsored scholarships and encouragement of foreign university entry into India (see Singhania, 2009). Currently, while foreign investment into the education sector is permitted, stand alone campuses cannot be established (Financial Times, 2010).

²⁰ Other studies have noted this, including McKinsey (2006) and Oxford Analytica (2004).

²¹ Gupta (2006, 2010). Prior to this, there had been one state life insurance company and four state general insurance companies.

²² Gupta (2000).

Figure 9: Savings and investment rates (% of GDP) show high growth in India, Malaysia and Singapore, yet India still lags behind China



Source: World Bank (WDI) data

However, it remains to be seen what new changes will be politically feasible as these could well create deep divisions within the ruling Congress Party. Apart from this, household savings are also used to support companies in the informal sector in rural areas, and this is unlikely to shift rapidly as rural consumption will continue to play a significant part in the economy over the next 10–20 years.

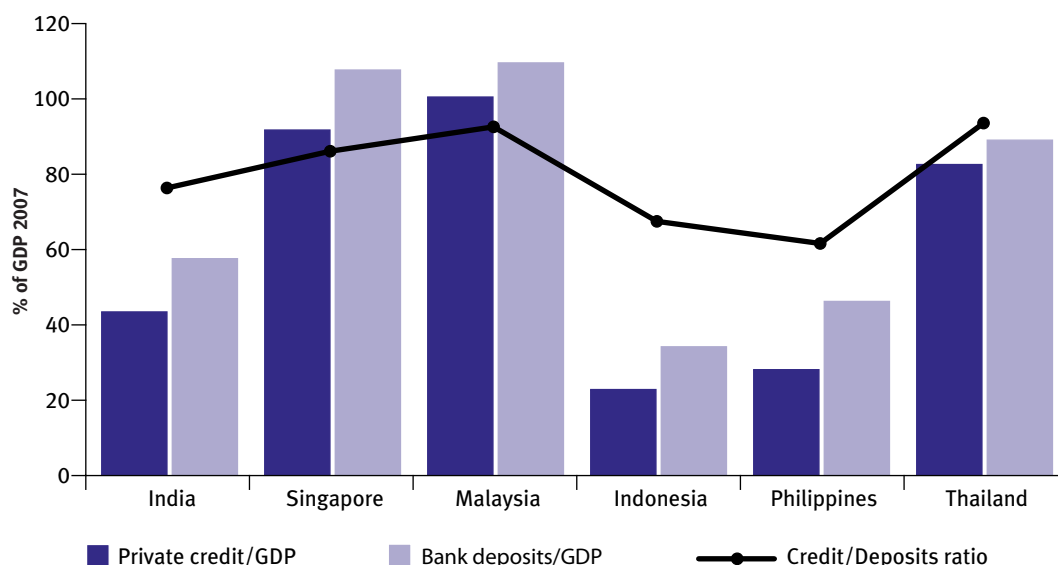
The overall implication is that, in spite of recent improvements, domestic savings will almost certainly continue to be too low compared with India’s need for capital and investment. Thus India probably needs to develop international financial partnerships even more urgently than trade relations. And it should not neglect the potential gains from fostering relations in services trade, especially as this may offer opportunities to develop the overall regional market through access to expertise and capital. As an indicator of India’s existing financial connections, FDI inflows into India are currently rather small, standing at about \$42 billion in 2008,²³ yet the flow has expanded rapidly over the last five years – FDI inflows were only \$5.8 billion in 2004. According to bilateral FDI data from the Indian Ministry of Commerce and Industry,²⁴ Singapore has been the largest source of FDI into India over the period 2000–10, while Malaysia provided only a small proportion of FDI. Other well established financial connections with India include the USA and UK (second and third largest sources for FDI into India respectively). The implication is that India has already begun to develop partnerships with well established financial markets, yet more could be done. For example, limitations to entry for foreign banks have meant that foreign banks only hold 8.5% of the banking sector’s assets²⁵ – this also limits the ability to support higher investment growth in India.

²³ Or 3.3% of GDP (UNCTAD data). FDI into India compares unfavourably with other countries such as Brazil (\$45 billion), Russia (\$70 billion) and China (\$108 billion).

²⁴ Singapore accounts for 16% of India’s FDI, the USA 13.3%, the UK 9.3% and Malaysia just 0.4% (FDI inflows from Mauritius, which are reported to account for about half of India’s FDI, have been excluded from calculations as this operates as an offshore centre dealing largely in financial investments).

²⁵ Reserve Bank of India data for 2009.

Figure 10: India has relatively low bank deposits and private credit (% of GDP, 2007), as well as a low ratio of credit to deposits



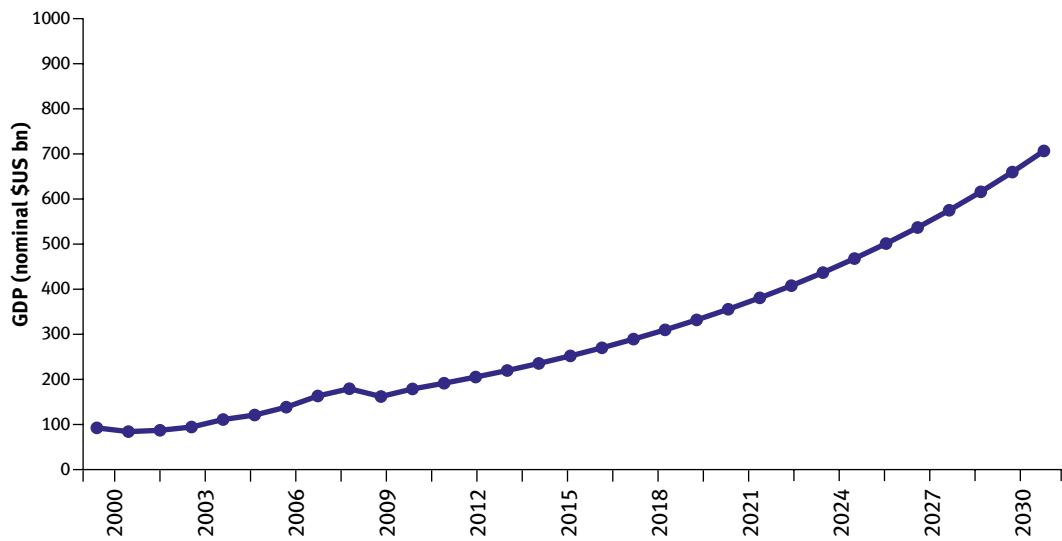
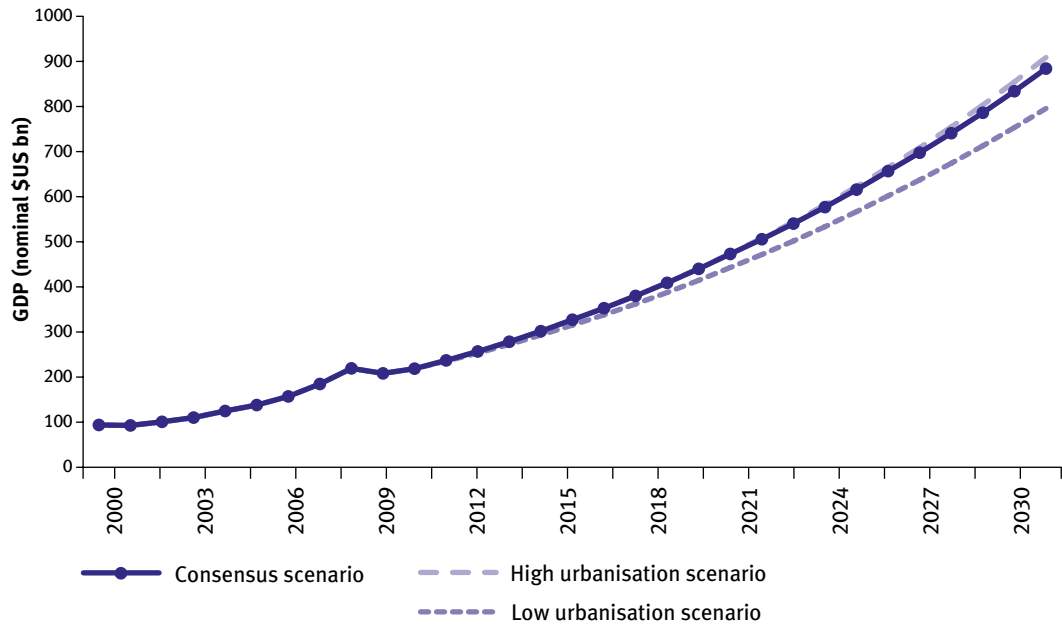
Source: WEF – Financial Development Report 2009

Scenarios for Malaysia and Singapore

Alternative growth scenarios for Malaysia have been calculated applying the same method as that used for India, based on a range of urbanisation assumptions. However, because of the reduced scope for urbanisation compared with India, the potential range of GDP growth forecasts is much narrower for Malaysia (in the range of 4–5%).

For Singapore, only a central (consensus) forecast of 4.5% growth has been used, reflecting estimates from the IMF and Singapore’s Ministry of Finance. The reason for this is that Singapore is a highly urbanised society, so urbanisation cannot be a driver of alternative growth forecasts as it is in India and Malaysia – comparable sensitivity tests are therefore not available. In addition, as will be demonstrated later, alternative economic growth forecasts are estimated to have only a limited impact in the relatively static insurance market of Singapore.

Figure 11: Economic growth scenarios for Malaysia and Singapore



Source: Own projections based on IMF (WEO) and UN population data

Table 1 presents a summary of estimates for urbanisation and economic growth in India, Malaysia and Singapore under the three scenarios. We return to these in Part 3 when examining the development of financial services in these countries.

Table 1: Summary of economic growth scenarios

	2010	2020			2030		
		Consensus	High	Low	Consensus	High	Low
India							
GDP (nominal \$US, bn)	1,366	4,015	4,820	3,605	11,405	16,220	8,790
GDP per capita (nominal \$US)	1,119	2,910	3,495	2,615	7,575	10,775	5,835
GDP per capita (PPP)	3,077	6,575	7,565	6,050	13,405	17,115	11,105
Urban population (mn)	366.9	472.6	585.8	414.7	611.4	903.4	452.7
		Consensus	High	Low	2000–08 average		
Average real GDP growth (2010–30)		8.0	9.8	6.6	7.2		
Malaysia							
GDP (nominal \$US, bn)	219	473	475	445	885	910	795
GDP per capita (nominal \$US)	7,832	14,775	14,810	13,830	25,065	25,765	22,560
GDP per capita (PPP)	13,750	21,140	21,170	20,265	29,080	29,530	27,390
Urban population (mn)	20.2	25.1	25.2	23.1	29.0	30.0	25.5
		Consensus	High	Low	2000–08 average		
Average real GDP growth (2010–30)		4.5	4.7	4.0	5.5		
Singapore							
GDP (nominal \$US, bn)	179	355			707		
GDP per capita (nominal \$US)	36,968	68,110			129,400		
GDP per capita (PPP)	51,350	87,935			155,305		
Population (mn)	4.8	5.2			5.5		
		Consensus	2000–08 average				
Average real GDP growth (2010–30)	4.5	5.5					

Source: Own projections based on IMF (WEO) and UN population data

Part 2:

Key markets and hubs for financial services in India and South East Asia

section highlights

- India, Malaysia and Singapore are the most important markets in South and South East Asia not just because of the size and growth of their economies but due to the relative strength of their financial sectors.
- Data for the insurance market also show the same pattern of development and importance, with India clearly the largest market because of its population size, but Malaysia and Singapore the most important regional markets in terms of development of insurance, as illustrated by the value of premiums on a dollars per capita basis.
- Meeting the multiple needs of the region will also require access to expertise, capital and well-functioning financial markets. These attributes could be supplied through the further development of regional linkages, for example between India and the more mature markets of Singapore and Malaysia.
- The Asian economy's track record for strong and stable growth has fostered the development of a rapidly growing internal market. This has encouraged the steady rise of regional trade and financial connections and has strengthened the role of the key city hubs, most notably Hong Kong and Singapore.
- Improving the quality of business and professional skills also highlights the need to increase training capacity and the standing of professional bodies to oversee business practice. The major Asian cities are all targets for expansion in such activities.

Part 2: Key markets and hubs for financial services in India and South East Asia

India, Malaysia and Singapore are the most important markets in South and South East Asia not just because of the size and growth of their economies but due to the relative strength of their financial sectors. The scale of the overall financial sector is an important indicator of both the development of the financial system and the potential of the retail financial market. These three, markedly different, countries also offer a contrasting picture of the state of the region's economic and financial development: from the still low income (but large) economy of India, to the more developed Malaysia and the high income (but very small city state) economy of Singapore.

While the dominance of India's economy is fairly obvious in financial sector statistics, Singapore and Malaysia are also strongly represented and well ahead of other important regional economies such as Indonesia, Thailand and the Philippines. Along with the role of their key cities, the relative size and maturity of the financial sectors in India, Malaysia and Singapore indicates that they play an important part in the current functioning and future growth prospects of the financial services sector in the region. This is true not only for national financial statistics (Table 2) but also for the general development of retail markets (Table 3).

“ Industry clusters and large pools of skilled professionals create networks and complementary service opportunities. There are not just company specific economies of scale to be gained from operating within a hub but also economies of scale across the range of businesses involved in finance, accounting and legal advisory work. ”

Table 2: National financial sector comparisons show dominance of India followed by Singapore and Malaysia

\$ bn	India	Singapore	Malaysia	Indonesia	Philippines	Thailand
Public bonds	696.7	160.7	77.6	146.5	80.4	92.7
Private bonds	79.5	80.0	144.0	22.2	11.2	52.4
Bank deposits	761.5	194.9	225.1	156.3	75.3	233.2
Equity	1,819.1	353.5	325.7	211.7	103.2	196.0
Total	3,356.8	789.1	772.4	536.7	270.1	574.3

Source: World Federation of Exchanges (WFE)

Table 3: General retail market indicators point to dominance of India, Singapore and Malaysia as key consumer centres in South and South East Asia

	India	Singapore	Malaysia	Indonesia	Philippines	Thailand
GDP (\$US bn)	1,206.7	181.9	221.6	511.8	166.7	273.3
Population (mn)	1,203.28	4.75	27.76	231.55	92.23	67.06
GDP p/capita (\$)	1,031	37,293	6,897	2,329	1,746	3,940
Household consumption (% of GDP)	56.0	39.3	45.6	62.6	76.9	51.1
Credit cards (mn)	24.0	6.7	11.0	10.0	8.0	14.0
Credit cards (per 100 people)	2.0	141.1	39.6	4.3	8.7	20.9
Personal computers (per 100 people)	3.3	74.3	23.1	2.0	7.2	6.7
Internet users (per 100 people)	7.2	67.7	62.6	11.1	6.0	20.0
Motor vehicles in use (per 1,000 people)	17.7	139.7	21.2	42.5	34.0	153.6
Assets/GDP (%)	304.5	472.7	413.7	124.2	187.5	233.4

Source: UN, IMF (WEO), World Bank (WDI), Euromonitor, National Statistical Authorities²⁶

Detailed figures for the insurance market also show the same pattern of development and importance, with India clearly the largest market because of its population size but Malaysia and Singapore the most important regional markets in terms of development of insurance, as illustrated by the value of premiums on a dollars per capita basis. This means that both Singapore and Malaysia, in spite of relatively low populations, are larger overall markets for insurance than other major regional economies, such as populous Indonesia.

²⁶ Notes: Household consumption expenditure is 2008 data except for Malaysia and Thailand which are 2007. Population data is for 2009. GDP and GDP per capita data are for 2009 (in current \$US). Credit card numbers are estimated 2009 figures. Personal Computers are 2006 figures, except for Singapore and India (which are 2007) and Thailand (2005). Internet users are 2007 figures except for Malaysia (which is 2008). Cars per population are 2006 figures.

Table 4: Insurance market indicators also confirm the three leading financial hubs

		India	Singapore	Malaysia	Indonesia	Philippines	Thailand
Insurance market (2008, direct premiums written)							
\$US mn	Total	55,438	14,948	9,040	6,904	2,348	9,895
	Life	48,313	10,121	5,867	4,705	1,490	5,618
	General	7,125	4,827	3,173	2,199	858	4,277
\$US per capita	Total	47	3,200	331	31	27	149
	Life	41	2,167	215	21	17	85
	General	6	1,033	116	10	10	64
% of GDP	Total	4.6	8.3	4.0	1.3	1.4	3.7
	Life	4.0	5.6	2.6	0.9	0.9	2.1
	General	0.6	2.7	1.4	0.4	0.5	1.6

Source: Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

The variance in the per capita figures for the insurance market also demonstrates that there is substantial scope for progress in providing a full range of financial services to the rising business class and middle-income consumers of Asia.

This is especially true in India if the recent rapid pace of growth is maintained, increasing urbanisation and creating more opportunities for formal employment, better pay and conditions. The latter trends would imply faster demand growth for insurance and banking services, even for lower income urban workers.

However, meeting the multiple needs of the region will also require access to expertise, capital and well-functioning financial markets. These attributes could be supplied through the development of regional linkages, for example, between India and the more mature markets of Singapore and Malaysia. Mumbai has already built up a dominant position as the key financial hub for India, with strong international associations, but the scope for growth in India's burgeoning market remains very substantial and it might benefit from additional expertise and capacity supplied from other regional hubs.

Singapore is already highly developed, skilled and urbanised but, with little scope for population growth, it has to focus on business opportunities in the developing Asian region. While the local general insurance market remains underdeveloped, in part due to the specificities of the city state, many other financial services are well developed. Insurance products may also become more closely geared to the demands of an ageing population, a specialism that will become increasingly important in other parts of Asia as well (as shown in demographic trends, Table 5).

Singapore already plays a key role in regional and global markets for trade and finance as well as in specialist hi-tech niches such as biotechnology, other R&D functions, education and training. It has sought to increase investment in the region and in opportunities in India in particular. If legislation permits, this could lead to closer mutual development in retail financial services, with capital and expertise from Singapore backing development on the India continent.

Table 5: Demographic indicators

	India	Singapore	Malaysia	Indonesia	Philippines	Thailand
Life expectancy (2010-15)	65.2	81.0	75.2	72.2	72.9	69.9
Population aged 65 or over (% of total)						
2010	4.9	10.2	4.8	6.1	4.3	7.7
2020	6.3	17.9	7.1	7.5	5.7	10.6

Source: UN population data

In addition, Malaysia has developed rapidly and Kuala Lumpur is an important hub for finance and services. Although it is a much smaller financial centre than Singapore or Mumbai, according to some measures, it has a well developed private sector and asset to GDP ratio (as shown in Table 2) and it scores well in surveys of financial markets (discussed below). The financial sector as well as industries such as energy, petrochemicals and IT may have further scope to develop across the region and in conjunction with India.

Regional linkages and city hubs: India and South East Asia lags behind North East Asia

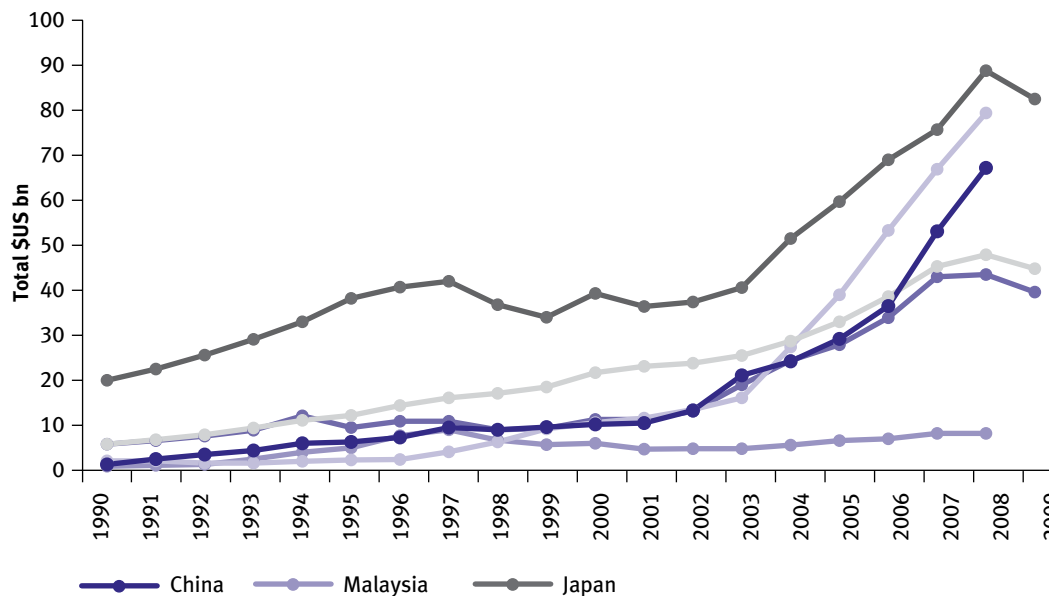
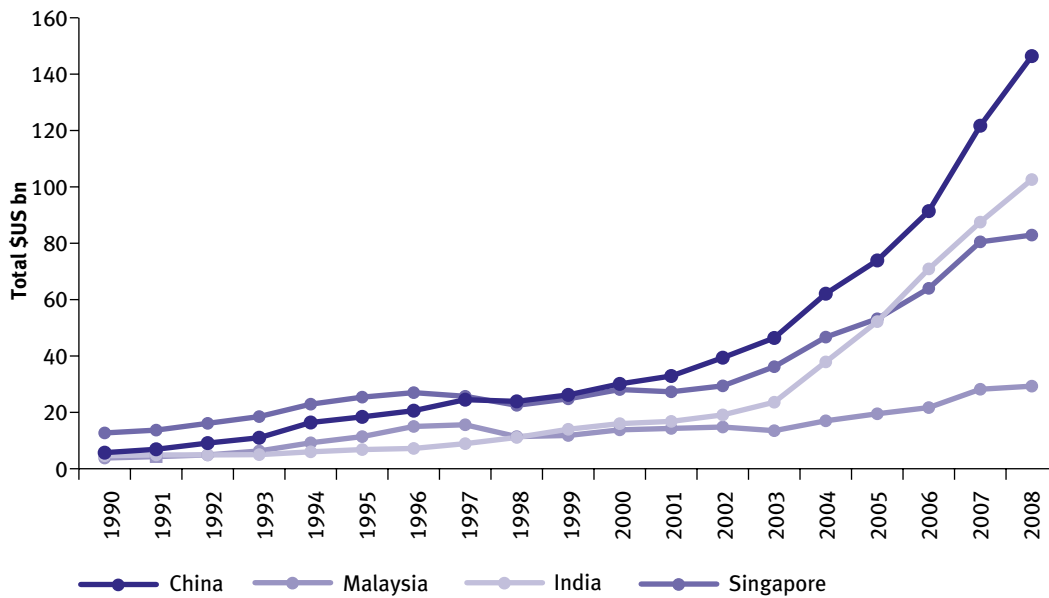
The Asian economy's track record for strong and stable growth has fostered the development of a rapidly growing internal market. This has encouraged the steady rise of regional trade and financial linkages and has strengthened the role of the key city hubs, most notably Hong Kong and Singapore. However, inter-regional ties in India and South East Asia are lagging behind those of North East Asia, suggesting that significant potential exists within the region to develop trade, financial and knowledge linkages, particularly between relatively developed economies such as Singapore and Malaysia and fast emerging India.

Part of the reason for the variance in interconnectedness is the distinct difference in the patterns of exchange between India and South East Asia on the one hand and North East Asia on the other. Two factors are critical: the strength of trade relations across the region and the difference in savings rates, and thus patterns of capital flows. Trade and financial ties across North East Asia are generally far stronger than those across India and South East Asia and have been built on the region's broadly based manufacturing trade, which has encouraged cross border relationships for sourcing inputs and finance as well as for final export sales. This is illustrated by the fact that within the Asia region, Korea, China, and Japan have the strongest regional trading links (Hong Kong and Singapore play a role but clearly due to their status as trading hubs) – notably India is not featured. A large part of these variations reflects key differences between China and India as well as the greater degree of industrialisation in North East Asia.

For example, many inputs for China's booming export industries and domestic economy are sourced from within Asia, whether these are computer components from Taiwan, food products from Thailand or timber from Indonesia. And, even though China's final export sales have been primarily targeted at the US, Europe and Japan, sales to other countries have also increased. In addition, China's strong regional ties are not only due to import requirements on one side and export market growth on the other but also extend to financial exchanges: there have long been substantial inward investment to China and now there are also rising flows of capital from China into other parts of Asia. This has fostered deeper business relations, especially but not solely in North East Asia, and has encouraged the development of regional hubs to provide related services, including insurance and financial services: Hong Kong is the prime example but Taiwan is also an important partner for the mainland in both component supplies and investment. In addition, China's relations with both Japan and Korea incorporate financial elements as well as goods trade.

In contrast, India's trade focuses on developed markets and the Middle East with only weak ties within the Asian region. Data for regional trade also illustrate that other countries tend to have stronger trade relations with Singapore, Japan and China than with India (or indeed with each other). Among these countries, Singapore, Malaysia and Indonesia show the strongest bilateral trade relationships, aided by their geographical proximity. For India, these trends are largely explained by its focus on the development of service industries, in particular business services trade with the developed countries of Europe and the US: this does not build intra-Asia relationships.

Figure 12: Services exports (total, \$US bn): India shows rapid growth and is now the second largest exporter of business and financial services in Asia



Source: WTO data

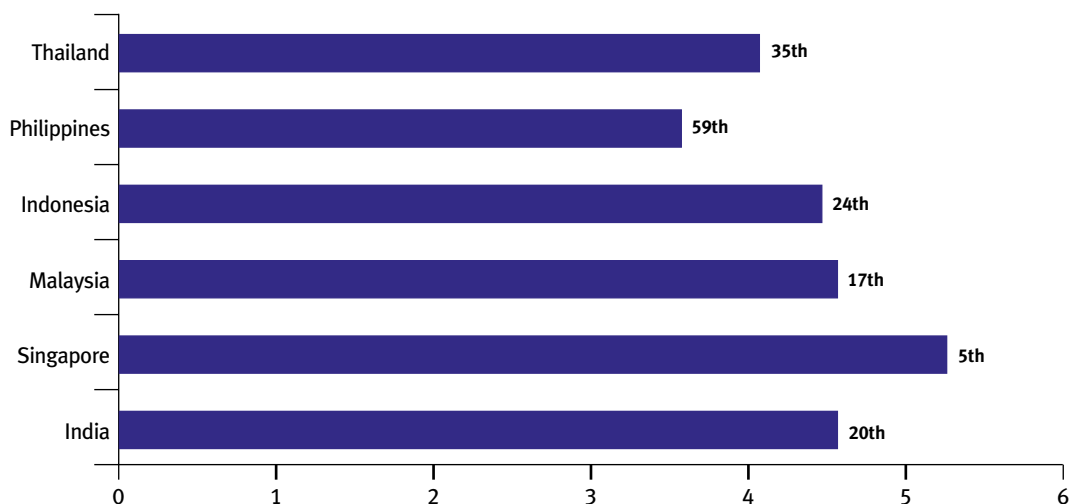
The financing requirements of the two countries are also very different. China’s savings rate has been exceptionally high, generating an excess of national savings that has resulted in both remarkably strong rates of investment in domestic development and, latterly, capital flows abroad. But India has a dearth of domestic savings and needs to import capital – even the excess savings of more developed parts of South East Asia would be insufficient to fund the annual investment that India needs if it is to compete with China’s speed of development.

We therefore argue that India needs to develop financial partnerships more urgently than trade relations, whereas China is seeking to broaden the base of its global import-export network. However, India should not neglect the potential gains from fostering relations in services trade, especially as this may offer opportunities to develop the overall Indian and South East Asian markets through access to both expertise and capital.

This suggests developing more intensive city-to-city relationships for India, especially in high-level professional and financial services, where businesses tend to cluster in key city hubs. Indeed, financial hubs are essential as they offer the opportunity to rapidly and effectively improve the quality and scope of services offered and the ability to cater for a wider range of clients and requirements. Industry clusters and large pools of skilled professionals create networks and complementary service opportunities. There are not just company specific economies of scale to be gained from operating within a hub but also economies of scale across the range of businesses involved in finance, accounting and legal advisory work. In addition, dynamic clusters encourage the growth of talent in the labour force, a significant bonus in view of the increasing global competition for skilled professionals. Nevertheless, to develop this talent, it will be necessary to increase the availability of both formal and non-formal education (the latter including training and accreditation) so that a full range of professional and financial services can be offered to the population.

The growth in income levels in India and the expected rapid uptake in financial products will therefore create a valuable opportunity for more developed financial markets both in the region – Singapore and Malaysia – and elsewhere. Countries with strong international linkages – such as the UK and USA – would be able to export their expertise and facilitate India’s transition to an urban based economy.

Figure 13: Extent of cluster development (score 7=high, 0=low; ranking out of 133 countries)



Source: WEF Global Competitiveness Report 2009-10

Asia is already quite highly rated for cluster development, as reported in the World Economic Forum’s Global Competitiveness Report (2009–2010). And the rising competitiveness of Asia’s foremost cities in the financial services sector is also noted in other recent reports, such as the City of London’s Global Financial Centres Index (GFCI-7) which evaluates the competitiveness of financial centres (including the opinions of those working in the financial markets), and the World Economic Forum’s (WEF) Financial Development Index (in their Financial Development Report, 2009), which assesses the effectiveness of financial markets and the breadth and depth of access to financial services. In these reports, it is notable that Singapore, Malaysia and India generally outperformed other countries in the region.

GFCI-7 (March 2010) – Global Financial Centres Indicators	
1=	London
1=	New York
3	Hong Kong
4	Singapore
5	Tokyo
9=	Shenzhen
9=	Sydney
11	Shanghai
15	Beijing
28	Seoul
51	Kuala Lumpur
58	Mumbai
61	Bangkok
63	Jakarta
66	Manila

WEF 2009 – Financial Development Index	
1	United Kingdom
2	Australia
3	United States
4	Singapore
5	Hong Kong
9	Japan
22	Malaysia
23	Korea
26	China
35	Thailand
38	India
45	Vietnam
48	Indonesia
50	Philippines

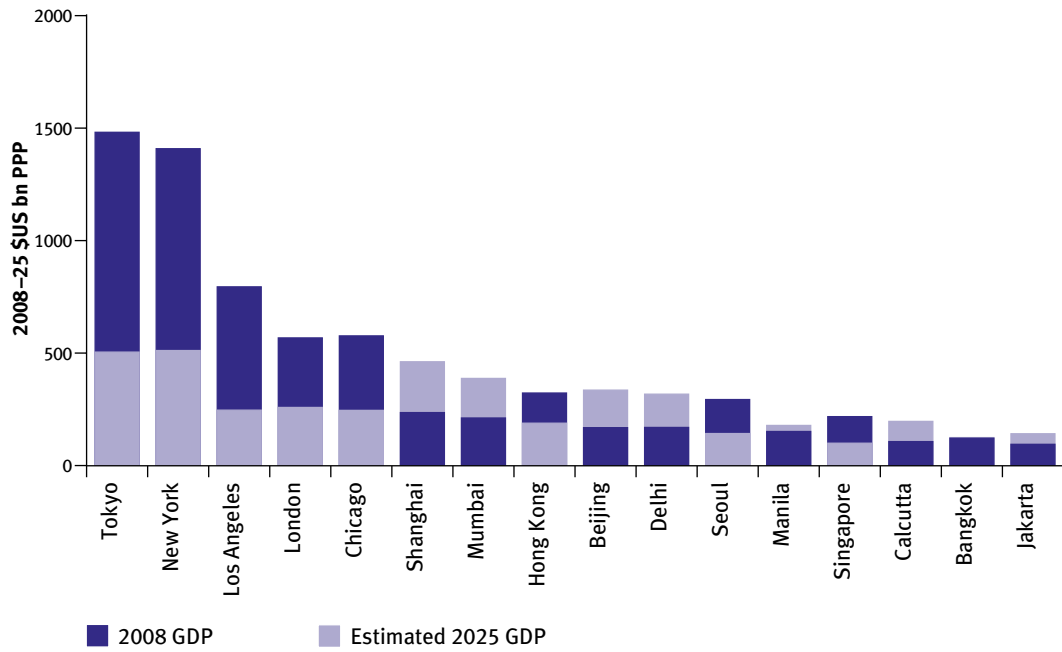
In the most recent GFCI, Singapore continued performing strongly at the global level, narrowing the gap versus the leaders, Hong Kong, New York and London. Although Kuala Lumpur and Mumbai fell slightly in the rankings from the September 2009 report, due to the faster growth of some non-Asian centres, they still rate highly among the South and South East Asian centres.

The WEF’s Financial Development Report (2009) also places Singapore very highly, scoring exceptionally for the development of its financial markets, although scoring relatively poorly in terms of the development of non-banking financial services (in part reflecting an underdeveloped domestic insurance market). Malaysia and India lie further down the rankings. However, India is noted for the strength of its judiciary, the size of its financial markets, and the strength of non-banking financial services, while Malaysia scores well for banking financial services. In both the Indian and Malaysian case, commercial enterprises have good access to financial services, yet retail access is seen as relatively weak.

The potential for continued high growth across the leading Asian cities is indicated in the positive projections for the future. According to expert estimates, the big winners over the coming 15 years will be the leading Chinese and Indian cities, with Beijing, Shanghai, Mumbai, Delhi and Kolkata all forecast to see GDP approximately triple (in constant price, PPP terms – the increase will be even larger in current prices). Mumbai will likely become the third key city in Asia – overtaking established cities such as Hong Kong, Seoul and Singapore, but lying behind Tokyo and Shanghai. Despite its decline in the city rankings, Singapore’s growth is forecast to remain at the high end of projections for developed cities (with an estimated increase in GDP of around 45% over the 15 year period according to these city forecasts).

However, the sustained success of city economies will depend not just on growing the population but doing so successfully – that means alleviating potential bottlenecks such as congested transport infrastructure, housing shortages, pollution and crime, otherwise mobile talent and businesses will migrate. Improving the quality of business and professional skills also highlights the need to increase training capacity and the standing of professional bodies to oversee business practice. The major Asian cities are all targets for expansion in such activities.

Figure 14: Cities' GDP projections (2008–25, \$US bn PPP)



Source: PwC (2009). Kuala Lumpur is not included

Part 3:

Demand for insurance services in India and across South East Asia

section highlights

- Demand analysis for emerging market economies typically uses so-called “S curves” to estimate future growth potential, identifying the level of income at which product demand takes-off into a fast growth phase and the level at which demand matures. This analysis is applied to the insurance sector.
- India remains in the low income bracket but has been steadily moving up towards the take-off point and could be set to become the world’s fifth largest consumer market with a middle class of over half a billion people by 2025.
- Malaysia appears poised to enter the steep part of the S curve over the coming decade, and Singapore stands out as an outlier for the retail insurance market, with very low premiums compared with its high levels of per capita GDP.
- Using a scenario approach to explore the scope for high/low estimates of future demand, this report highlights both the likely scale and time profile of future growth in the market and the possible range of variations in forecasts to 2030.
- The Malaysian insurance market is forecast to expand significantly as a percent of GDP over the next decade before tailing off by the mid-2020s. However, it is only at this point that India’s insurance market is likely to embark on a phase of accelerated growth, expanding far more rapidly than GDP (itself growing at a relatively fast clip).
- As India is the largest market in the region, its demand profile will dominate overall trends, suggesting scope for a “Southern Surge” scenario around 2020.

Part 3: Demand for insurance services in India and across South East Asia

In this section, we analyse the potential demand for insurance services in India and across South East Asia. We use so-called “S curves” to correlate product demand with the rising incomes (GDP per capita) using time series and cross sectional (cross-country) data.²⁷ It allows for the observation that demand tends to grow slowly at low income levels and then suddenly rises, taking-off at a certain threshold level of income, until demand matures and growth flattens off again at a higher plateau (effectively forming a forward sloping ‘S’). For example, India’s recent surge in GDP per capita, supported by rising urbanisation, has led many forecasters to predict an accelerating consumer boom over the coming ten to twenty years. Such projections suggest that India is set to become the world’s fifth largest consumer market with a middle class of over half a billion people by around 2025.²⁸ Urbanisation is also expected to dominate consumption trends, shifting the weight away from rural areas that currently account for just over half of consumption (and around 70% of the population). By 2030, the urban population could rise to 50–60% of the total under the high growth scenario, and thus to 70–80% of consumption.

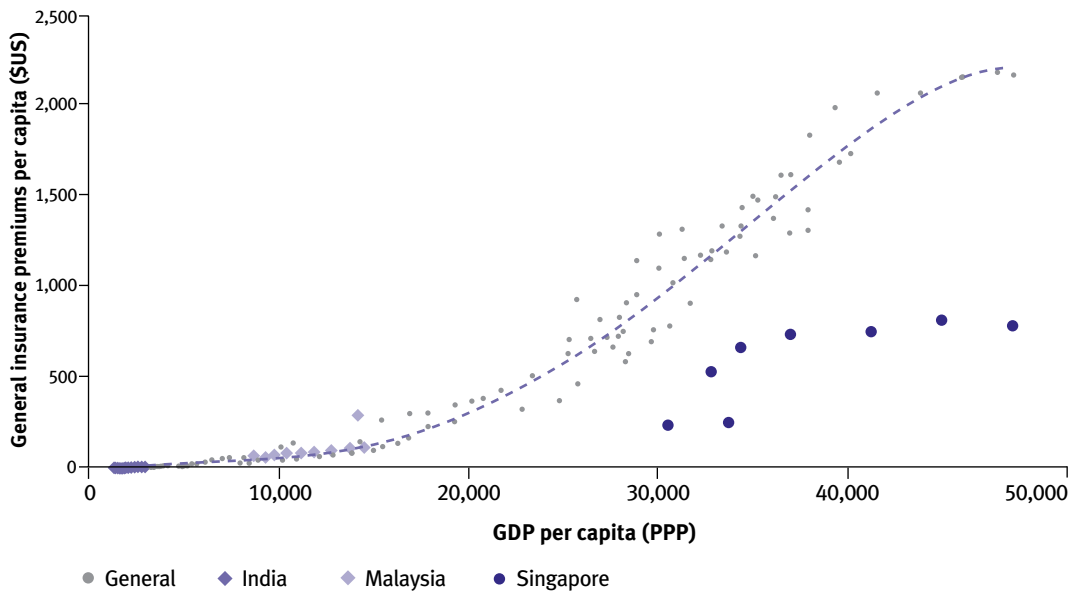
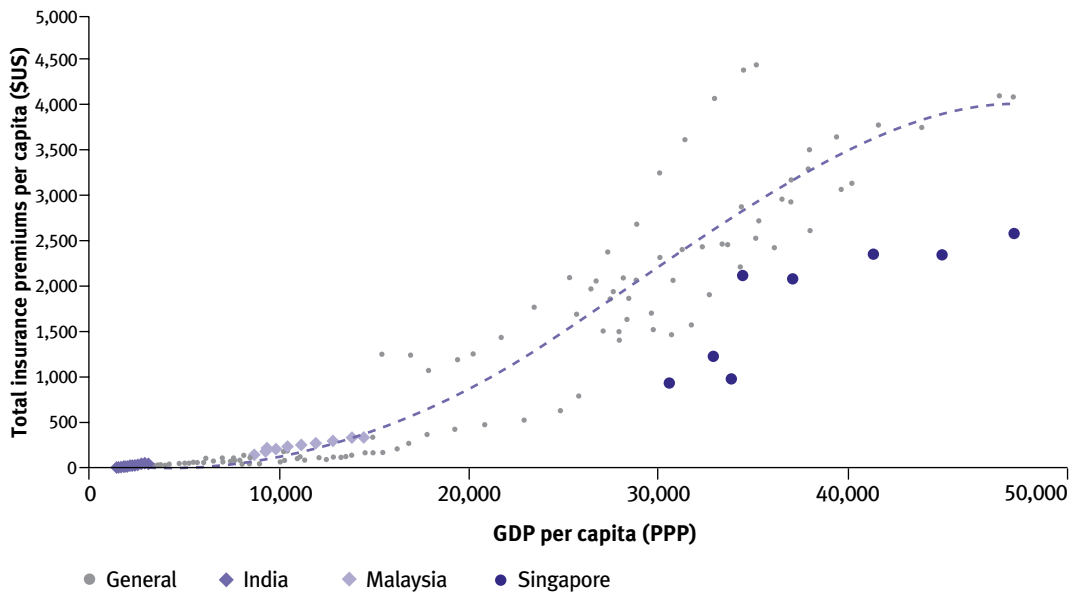
While other studies have pointed to Asia’s potential as a consumer market, where are the Asian economies in relation to the estimated S curve for financial services? The historic and current situation is depicted in the international context in Figure 15, with the picture for India and Singapore blown up in more detail in Figure 16.

“ If the high urbanisation/GDP growth scenario materialises in India, the effect on the insurance industry will be particularly marked. For an estimated 42% difference in GDP between the high urbanisation and baseline scenarios in 2030, the growth of the general insurance market could be almost double this figure. ”

²⁷ For relatively small changes in GDP (and for slow moving, mature economies), projected growth in product sales may be approximated by using a simple linear model (e.g. a 1% rise in GDP implies a 1% rise in product sales). However, this can lead to excessively low estimates for sales growth in fast changing emerging economies, where there are clearly identified phases when demand for some products tends to accelerate far faster than predicted by the simple linear model. Effectively, there is a take off into growth that is not captured by a linear extrapolation but is better modelled by assuming a non-linear relationship that looks like an S. This analysis is now widely adopted to examine growth potential in developing countries’ markets for goods such as high ticket durables (cars, household appliances) and also for financial services, from bank accounts to insurance products.

²⁸ McKinsey (2007).

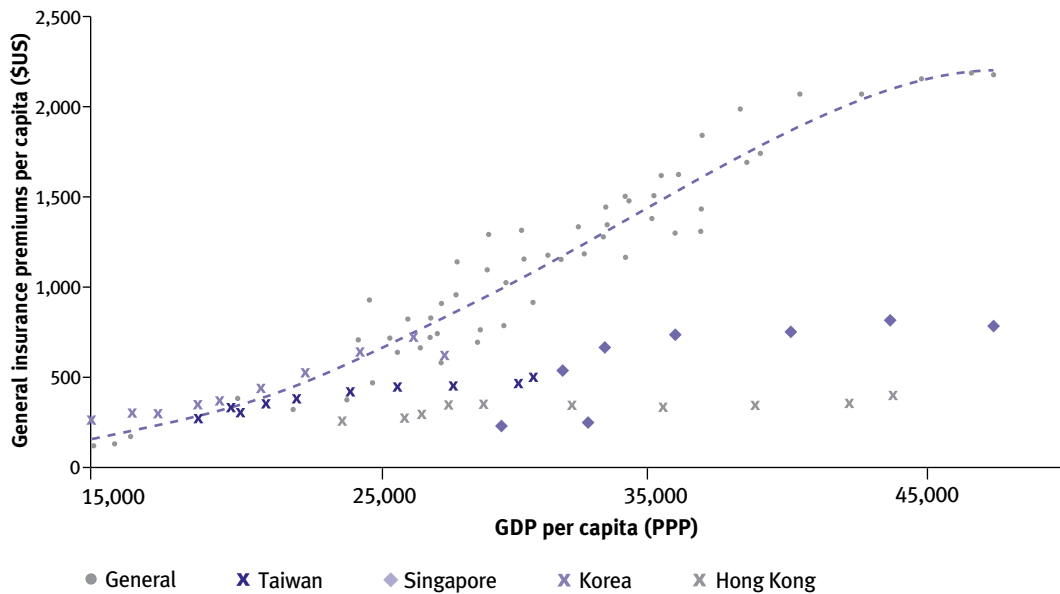
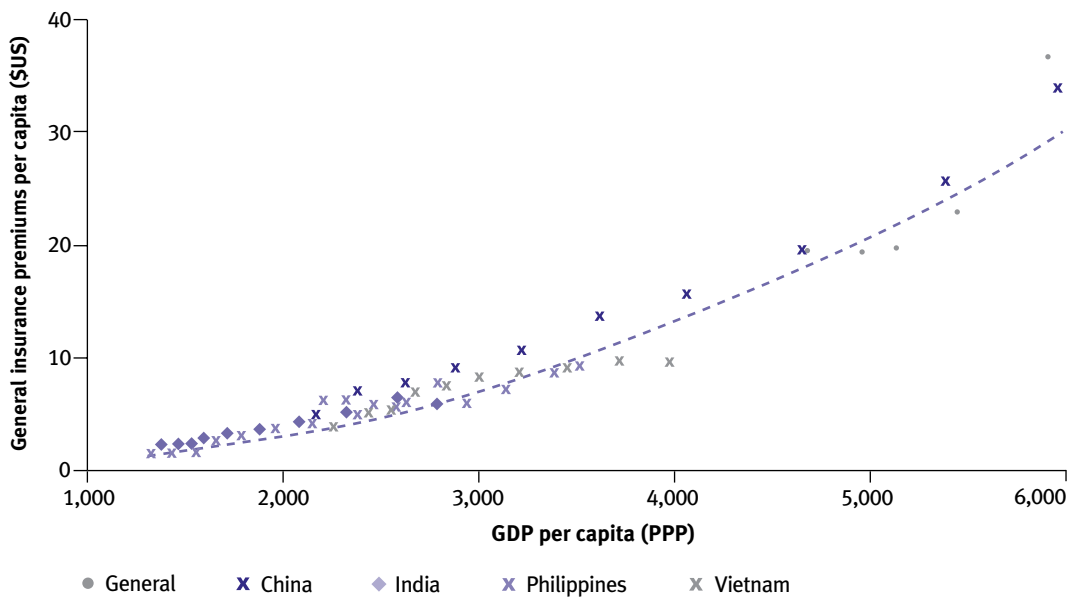
Figure 15: Historic data for insurance premiums written (\$US) against GDP per capita show an 'S' curve of accelerating demand followed by a plateau (total market on LHS and general market on RHS)²⁹



Source: Swiss Re (Sigma World Insurance Data) and IMF (WEO) data. Data for 1999-2008

²⁹ The trend line is calculated from observed data (for the years 1999–2008) for the following countries: Australia, Brazil, Canada, Chile, China, Czech Republic, France, Germany, Indonesia, Korea, Philippines, Thailand, Turkey, the USA and Vietnam.

Figure 16: A focus on India and Singapore in general insurance (data 1999–2008)



Source: Swiss Re (Sigma World Insurance Data) and IMF (WEO) data (“General” denotes other countries included in the cross-country data set used to fit the S curve)

India clearly remains in the low income bracket but has been steadily moving up the first (fairly flat) part of the S curve as GDP per capita has risen (here depicted in terms of GDP at PPP, which puts the current rate of per capita GDP about three times higher than it is in current dollar terms). It is still a long way from entering the faster growth phase, where the S curve becomes steeper, suggesting that there could be a period of particularly high growth in the demand for financial services to come in the future, probably from around 2020.

In fact, Malaysia appears poised to enter the steep part of the S curve over the coming decade – its income level is already advanced compared with India. In addition, Malaysia is fast developing as an Islamic finance hub: it is the strongest competitor in the region in this rapidly expanding market. The value of takaful (Sharia compliant insurance) in Malaysia has grown at around 17% annually between 1998 and 2007, aided by tax incentives, low capital requirements (one-tenth of that for normal insurance) and advanced regulation, and potential premiums in this market are forecast to rise to around \$7bn by 2015.³⁰ Furthermore, growth opportunities could lie in developing ties with India and Indonesia, which have 155 million and 207 million Muslim citizens respectively.

In contrast, Singapore stands out as an outlier in terms of the general cross-country S curve estimated for the retail insurance market, with very low premiums compared with its high levels of per capita GDP. However, as a small city state (similar to Hong Kong), it may have less scope for insurance services, for example, car ownership is much lower (around 14 vehicles per 100 people in Singapore and 7 per 100 people in Hong Kong, compared with around 25–30 in Korea and Japan and nearly 50 in the US) and there may be greater state provisioning for housing and other social benefits that also reduces insurance demand. These factors may go some way to explaining the lack of growth in personal lines of general insurance.

In principle, this analysis can be used to produce market forecasts. However, there are a number of risks in estimating and interpreting such forecasts, chiefly due to uncertainty over the key drivers of these estimates. Most importantly, as discussed already, population and urbanisation projections may vary widely. For India, for which this is a key factor driving both the economy and the insurance market, a more rapid increase in the urbanisation rate looks likely but has yet to be realised – so the fast development scenario cannot be taken for granted. Secondly, even under a high growth scenario for India, GDP per capita starts from an extremely low base and projections suggest it may remain as low as \$5,000–\$10,000 in 2030 (similar to where Malaysia is today). This does not reflect a particularly affluent consumer society, partly because a significant part of the population could remain in very low income occupations even under the more favourable transition assumptions. Thus the take-off into fast growth in retail financial services for India might come later rather than sooner, disappointing those expecting an early boom in India's consumer markets in the 2010–2020 period.

In order to address the complexity of the market outlook, we therefore adopt a scenario approach to exploring the scope for high/low estimates of future demand, highlighting both the likely scale and time profile of future growth in the market and the possible range of variations in forecasts to 2030.

Scenarios for the general insurance market

Based on the “high-low” and consensus range of projections for urbanisation and economic growth presented in Section 1, and the historic S curves depicted above, a range of scenarios can be estimated for the future outlook for the insurance market (a similar analysis could be applied to other financial service markets). We firstly focus on scenarios for the general insurance market³¹ for Malaysia and India, along with a consensus forecast for Singapore, before looking at the scope for growth in the total market.

³⁰ Swiss Re (2008).

³¹ The general insurance market is depicted here because demand for general insurance has a very strong correlation to the level of GDP per capita, whereas demand in the life insurance market shows distinct cross-country variations.

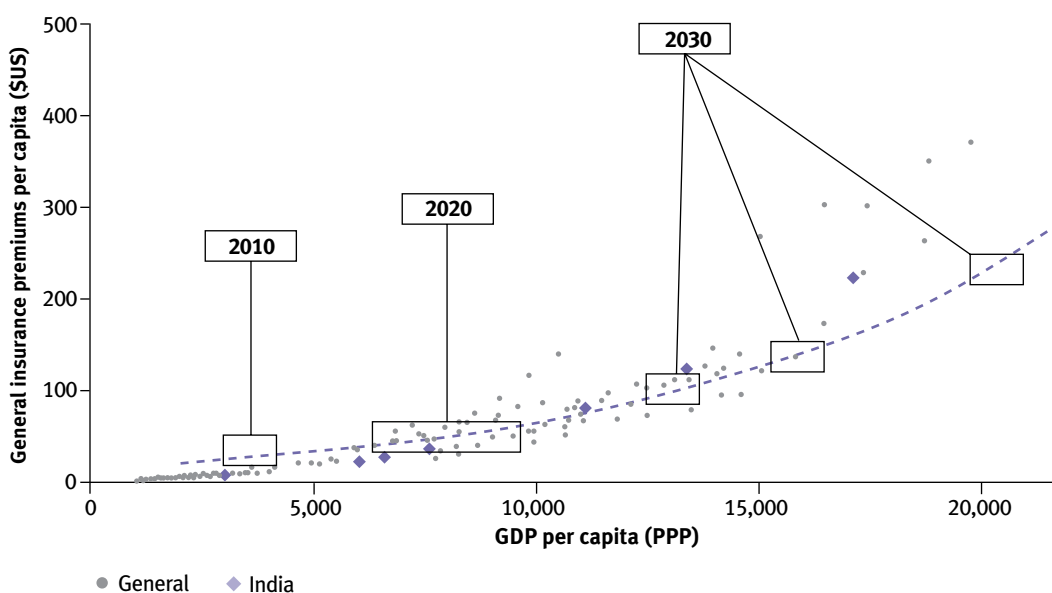
Table 6: General insurance market growth scenarios

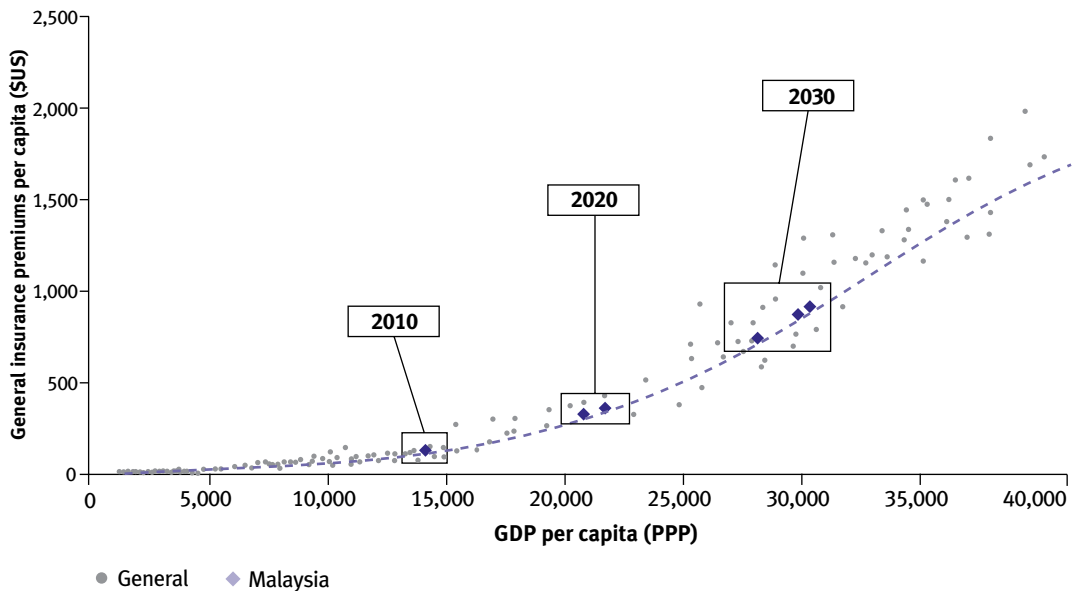
General insurance market	2010	2020			2030		
		Consensus	High	Low	Consensus	High	Low
India							
Premiums per capita (\$US)	6.9	27	35	23	123	222	80
Market size (\$US bn)	8.4	37	49	31	186	334	121
Market size (% of GDP)	0.6	0.9	1.0	0.9	1.6	2.1	1.4
Malaysia							
Premiums per capita (\$US)	130.3	375	378	337	867	903	739
Market size (\$US bn)	3.6	12	12	11	31	32	26
Market size (% of GDP)	1.7	2.5	2.5	2.4	3.5	3.5	3.3

General insurance market	2010	2010–20			2020–30		
		Consensus	High	Low	Consensus	High	Low
Average annual real growth rate (%)							
India	12.5	15.7	10.7	14.2	17.7	11.1	
Malaysia	9.4	9.5	8.2	6.6	7.0	6.0	

Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

Figure 17: Forecasts for the general insurance market in India and Malaysia

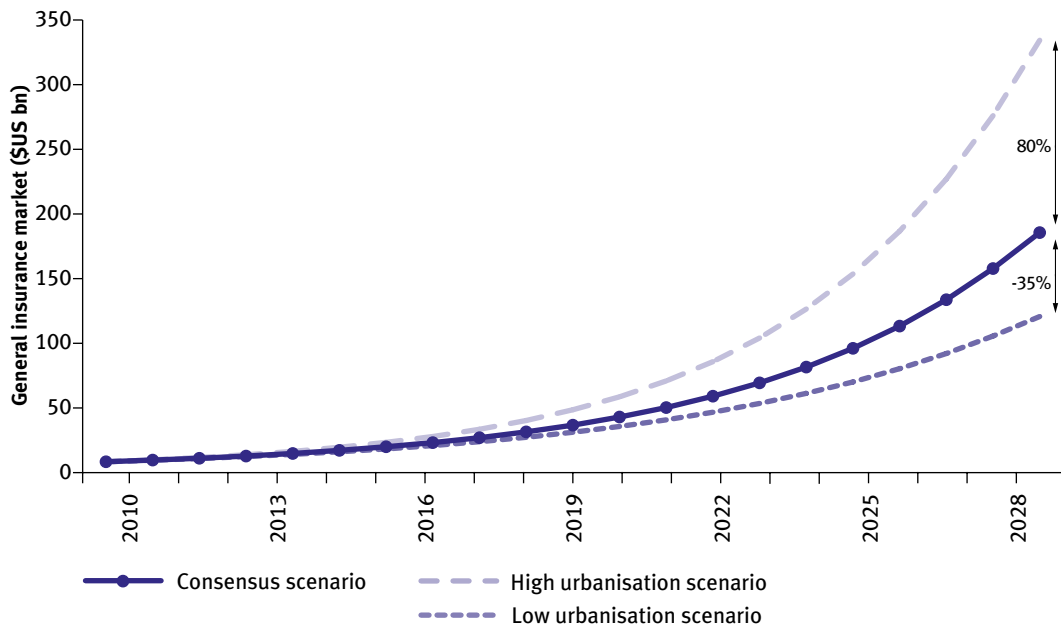


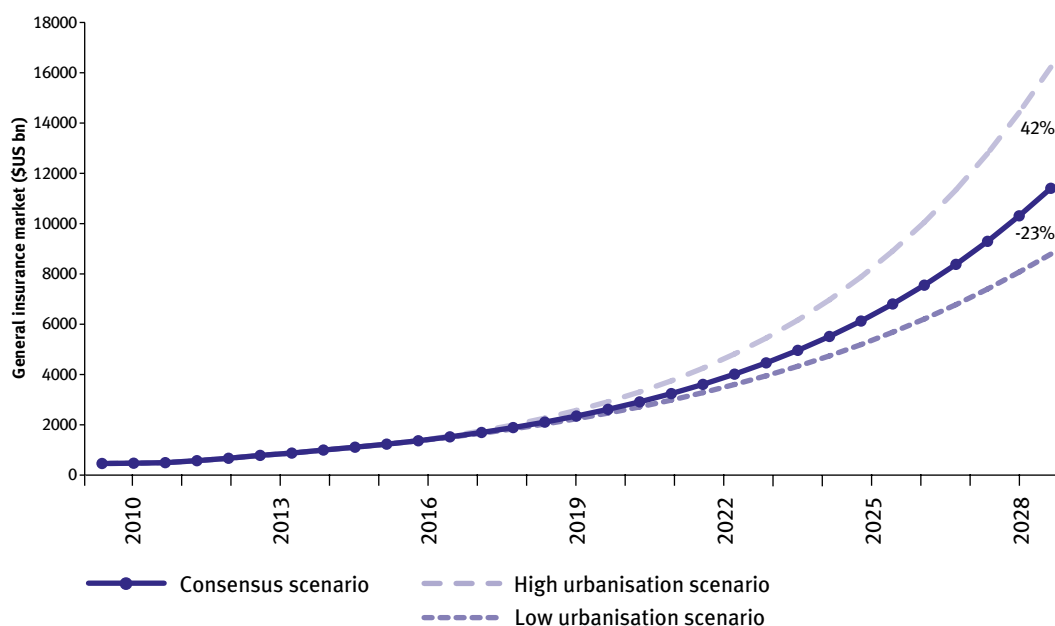


Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

Rapid urbanisation clearly has a strong impact on the development of a country’s insurance market by promoting much higher growth rates and putting the market on the steep upward slope of the S curve. In India, given the low starting point for GDP per capita, the take-off threshold is unlikely to be reached until some time between 2020 and 2030 (indeed, under the low urbanisation/GDP growth scenario, this point would occur even later). As the predicted annual growth rates for the insurance market demonstrate, opportunities in the Indian insurance market will probably increase sharply in the 2020s. In contrast, in Malaysia, high growth opportunities will be concentrated in the coming decade (while it is on the accelerating part of the S curve) and will subsequently flatten off (even if GDP continues to rise robustly).

Figure 18: Growth of India’s general insurance market and GDP under alternative scenarios





Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

If the high urbanisation/GDP growth scenario materialises in India, the effect on the insurance industry will be particularly marked. For an estimated 42% difference in GDP between the high urbanisation and baseline scenarios in 2030, the growth of the general insurance market could be almost double this figure. In the Malaysian case, because the high urbanisation scenario does not differ significantly from the baseline scenario (particularly in the period 2010–20), there is not such a large difference in the alternative forecasts for GDP and the insurance market. However, the low urbanisation scenario points out the risks to market development. If Malaysia’s GDP turned out to be 10% lower than the baseline estimate, as estimated in the low urbanisation scenario, the value of the insurance market could fall behind the consensus forecast by almost 20%.

While urbanisation will not be a driver of growth and the insurance market in Singapore, and the country is an outlier in the general insurance market (with very low premiums), tentative forecasts for the development of the general insurance market can be made based on historical trends for economic growth and the demand for general insurance. However, in spite of this analysis pointing to robust expansion relative to mature western markets, the Singapore insurance market clearly demonstrates much lower growth potential than India and Malaysia.

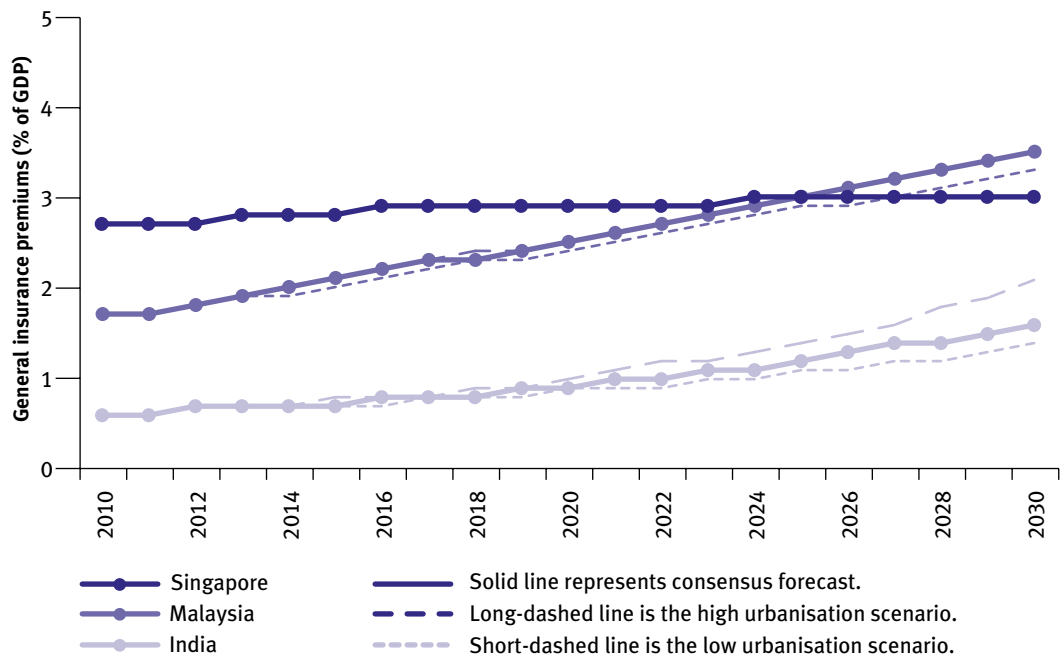
Table 7: Singapore general insurance market forecast

General insurance market	2010	2020	2030
Premiums per capita (\$US)	989.7	1,989	3,828
Market size (\$US bn)	4.8	10	21
Market size (% of GDP)	2.7	2.9	3.0
	2010–20	2020–30	
Average annual real growth rate (%)	4.9	4.1	

Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

In summary, the size of the general insurance market relative to GDP in Singapore is likely to remain more or less flat over the coming two decades (see Figure 19), only expanding in absolute value in line with GDP. In contrast, the Malaysian insurance market is forecast to expand significantly as a percent of GDP over the next decade before tailing off by the mid-2020s. However, it is only at this point that India's insurance market is likely to embark on a phase of accelerated growth, expanding far more rapidly than GDP (itself growing at a relatively fast clip). As this is the largest market in the region, India's profile will dominate overall trends, suggesting scope for a "Southern Surge" scenario around 2020.

Figure 19: Estimates for the general insurance market (as % of GDP) show Malaysia tailing off by mid-2020s while India begins its rapid growth phase



Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

Part 4:

Scenarios and Conclusions for the Overall Insurance Market

“ India presents a potentially massive opportunity for expansion of Asia’s market for financial services – estimates for the future size of the insurance market alone indicate both the scope for rapid growth and the very wide spread of scenarios that must be taken into account in assessing the outlook. Even under a pessimistic scenario, the insurance market is likely to see annual growth rates greater than 10%. In the high growth case, the overall insurance market could be worth well over \$1 trillion by 2030. ”

Part 4: Scenarios and Conclusions for the Overall Insurance Market

S curve analysis for the total insurance market appears somewhat less reliable than for general insurance largely because of the influence of the life insurance market, which exhibits a wider spread of observations and is more idiosyncratic by country. For example, in 2008 the life insurance market in Taiwan was valued at 13.5% of GDP, yet in Germany it was only 3% of GDP, despite Germany’s higher GDP per capita (probably reflecting varying social policies). To some extent, this reduces confidence in the estimates derived using a fitted S curve. However, with this caveat, it is still possible to estimate a range of outcomes for the market on a similar basis to the scenarios presented above for the general insurance market. Estimates for the life market can then be combined with the general insurance estimates to produce an overall market analysis and projections.

The resulting “high-low” and consensus scenarios for the total insurance market are shown in the table and charts below.

Table 8: Forecasts for the life insurance market

Life insurance market	2010	2020			2030		
		Consensus	High	Low	Consensus	High	Low
India							
Premiums per capita (\$US)	39.6	120	150	105	414	674	291
Market size (\$US bn)	48.3	165	207	145	623	1,015	438
Market size (% of GDP)	3.5	4.1	4.3	4.0	5.5	6.3	5.0
Malaysia							
Premiums per capita (\$US)	216.5	525	527	479	1,073	1,111	937
Market size (\$US bn)	6.0	17	17	15	38	39	33
Market size (% of GDP)	2.8	3.6	3.6	3.5	4.3	4.3	4.2
Singapore							
Premiums per capita (\$US)	2,103.2	4,226			8,134		
Total market size (\$US bn)	10.2	22			44		
Total market size (% of GDP)	5.7	6.2			6.3		

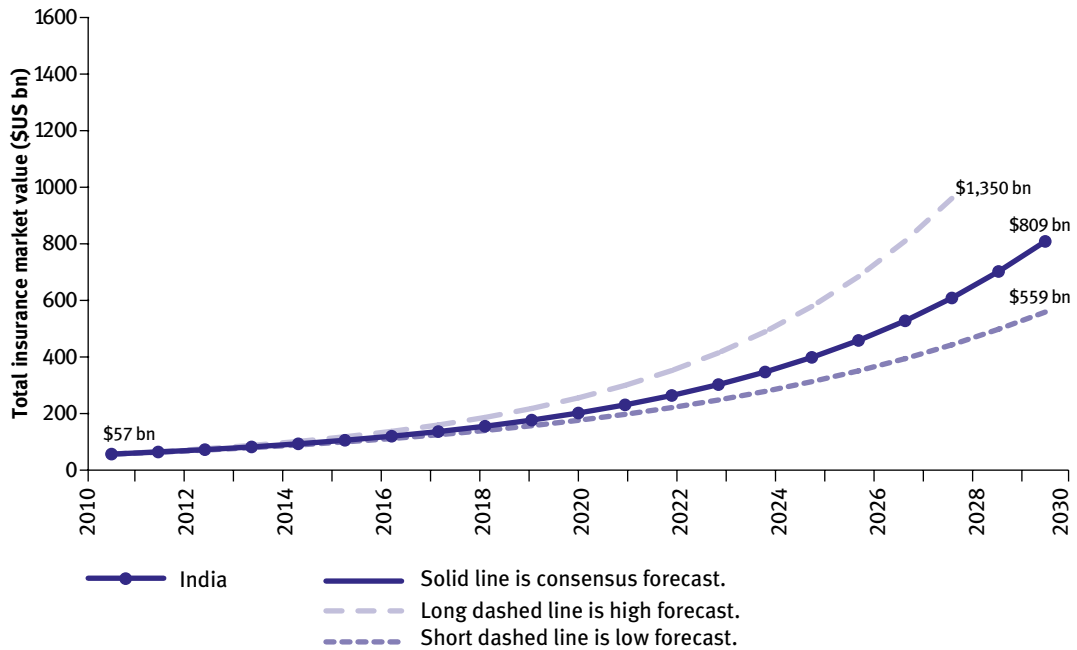
Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

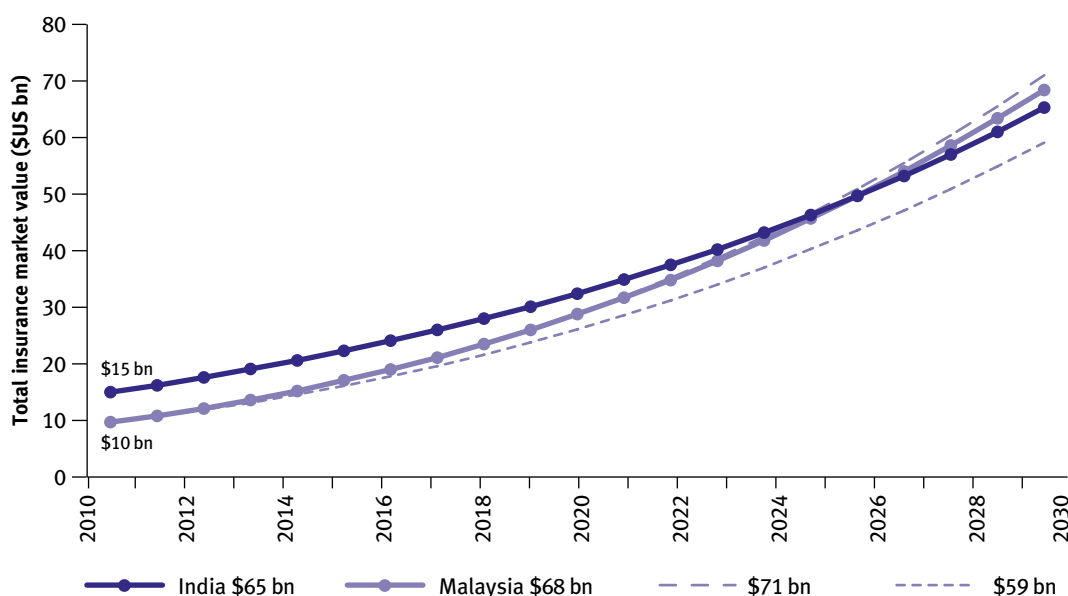
Table 9: Forecasts for the total insurance market

Total insurance market	2010			2020			2030		
		Consensus	High	Low	Consensus	High	Low		
India									
Premiums per capita (\$US)	46.5	146	185	128	537	896	371		
Market size (\$US bn)	56.7	202	256	176	809	1,350	559		
Market size (% of GDP)	4.2	5.0	5.3	4.9	7.1	8.3	6.4		
Malaysia									
Premiums per capita (\$US)	346.8	901	904	816	1,940	2,014	1,676		
Market size (\$US bn)	9.7	29	29	26	68	71	59		
Market size (% of GDP)	4.4	6.1	6.1	5.9	7.7	7.8	7.4		
Singapore									
Premiums per capita (\$US)	3,092.9	6,214			11,962				
Total market size (\$US bn)	15.0	32			65				
Total market size (% of GDP)	8.4	9.1			9.2				

Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

Figure 20: Forecasts for the total insurance market (\$US bn)





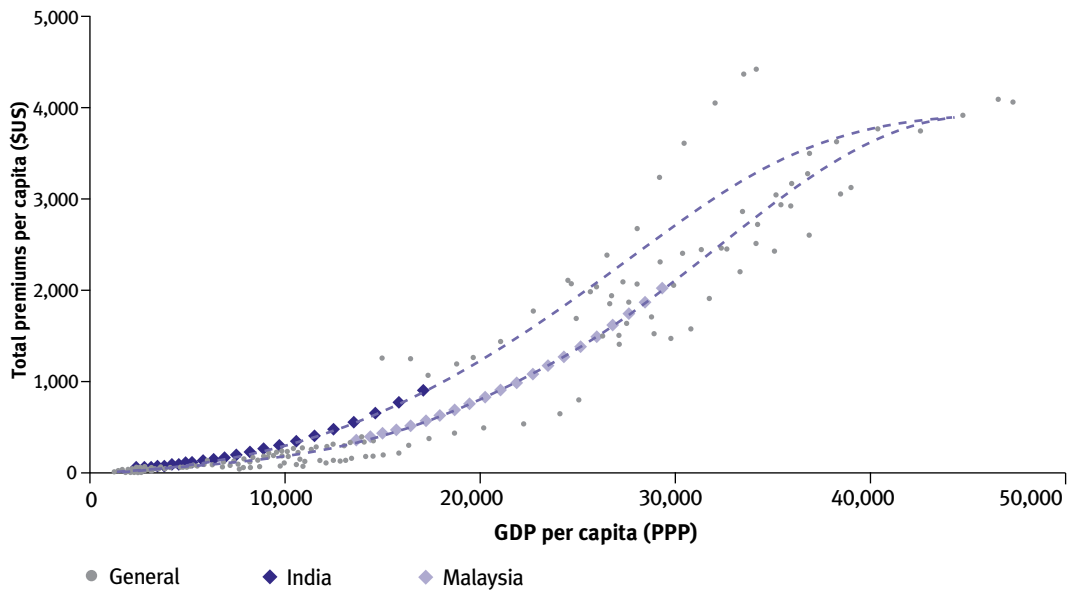
Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

The forecast scenarios for India highlight both the massive potential for growth as well as the hazards of forecasting. As of 2008, the life insurance market in India was approximately seven times larger than the general insurance market, reflecting exceptionally high growth between 2004 and 2007 when the life insurance market as a percent of GDP almost doubled. Demand for life insurance may therefore appear to have commenced its ascent of the S curve at an earlier income level than the international trend would predict (and earlier than general insurance). However, this might also represent a one-off pick up due to other factors such as deregulation and changes in market structure over this period. For example, the high private expenditure on healthcare will have incentivised many to purchase health insurance.³²

Forecasts for India's life insurance market have taken this early development into account and tend to assume that high growth will now continue. Consequently, India's total insurance market also shows a higher level of development than the international trend for any given income level. The corollary is that we would expect insurance market growth to begin decelerating at a relatively lower income level, as shown in the modified (higher) S curve for India included in Figure 21. In the case that India's insurance market settles down to a more typical trend, 2030 forecasts for the value of the India insurance market could be of the order of 2–3% of GDP less (worth between \$150 and \$480 billion in premiums).

³² See Gupta (2000).

Figure 21: Forecasts for total insurance premiums per capita under the high urbanisation scenario show the early development of the Indian market

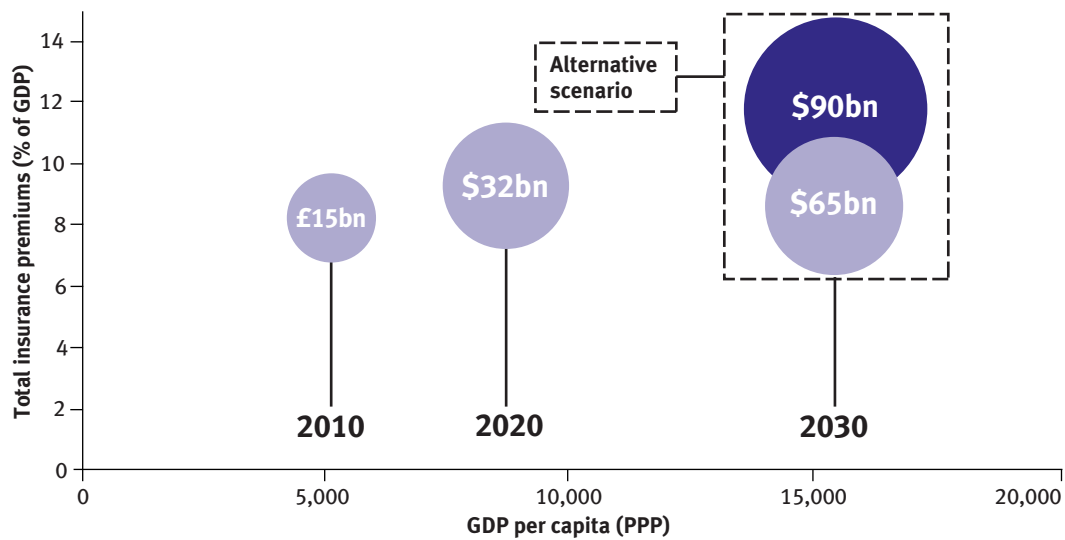
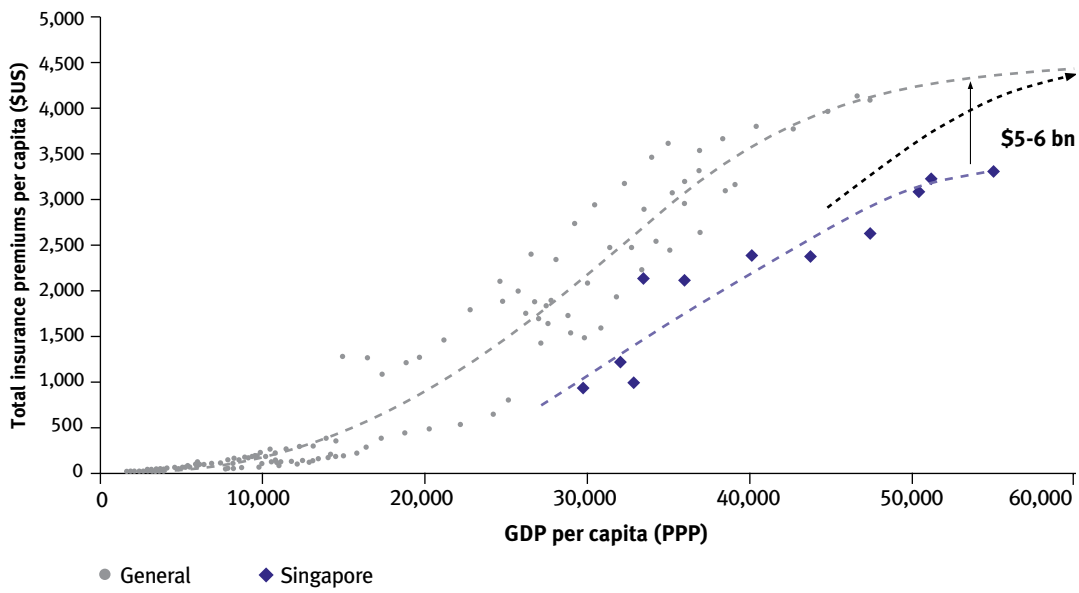


Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

Singapore's status as an outlier compared with international insurance market trends also contributes a degree of uncertainty to the forecasts. In this case, premiums are currently some \$1,000 per capita lower than they would normally be based on the high level of GDP per capita (amounting to some \$5–\$6 billion overall): if market characteristics change and Singapore's total insurance market actually moves up towards the international trend, then the market might increase in value by as much as \$25–\$ 30 billion by 2030. Such market changes are definitely possible and are highlighted in other studies. For example, Singaporeans are estimated to be under-insured in life insurance by approximately 67%.³³ Furthermore, as a prosperous regional hub, Singapore will continue to attract high net worth individuals who can be targeted by insurance policies geared towards their particular characteristics.

³³ Asia Insurance Review (2010).

Figure 22: Singapore's total insurance market could accelerate on the basis of a one-off adjustment to the international trend



Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

Overall Conclusions:

- Scenario analysis is essential in examining demand trends for fast growing emerging market economies in view of the wide range of forecasts for the underlying drivers of growth, including progress in development and urbanisation. This is particularly the case for India, which will be the key determinant of the regional economy and consumer demand in coming years.
- India presents a potentially massive opportunity for expansion of the region's market for financial services – estimates for the future size of the insurance market alone indicate both the scope for rapid growth and the very wide spread of scenarios that must be taken into account in assessing the outlook. This spread reflects major uncertainties especially about the scope for funding and speeding up urban development and economic progress, the key drivers of income growth and thus demand for financial services. However, even under a pessimistic scenario, the insurance market is likely to see annual growth rates greater than 10%. In the high growth case, the overall insurance market could be worth well over \$1 trillion by 2030.
- However, notably, market growth in India may not be as strong in 2010–2020 as it will be from 2020 onwards as India is still some way off reaching the critical point for GDP per capita at which general insurance demand experiences a very rapid take-off.
- Malaysia should develop rapidly over the next decade but forecasts could be more susceptible to downside risks than upside adjustments. By 2030, Malaysia will be reaching the higher end of the S curve and insurance market growth is likely to be decelerating. Nevertheless, the insurance market could be worth some \$60–\$70 billion by 2030 compared with under \$10 billion today.
- Singapore will see a relatively static development unless there are major changes in how the market functions – if the commitment to insurance picks up, in line with leading developed countries with commensurate GDP per capita, there could be a one-off burst of growth in premiums, as depicted in Figure 22 on previous page. This would significantly raise the forecast for market size.

Putting together all these features of the regional analysis, we would conclude that they point to a “Southern Surge” in Asian financial services markets around 2020, largely but not solely driven by the continued strong development of India's economy that should result in the bulk of the population reaching the critical income threshold for a rapid take-off in demand.

Appendix:

Market growth in China and India

“ While the growth of the Chinese insurance market will be far greater than in India, this will last until about 2025, at which time India will be just entering a period of accelerated growth. Hence, relative to China, over the next 10–15 years, growth prospects in 20–30 years’ time will be much greater. ”

Appendix: Market growth in China and India

Forecasts for growth in the Indian economy and the insurance market over the next two decades show very strong dynamics. Yet how will the Indian market compare to other large markets in 2030? In particular, where does India lie in relation to China, the outstanding leader of the emerging BRICs? Applying the same analysis and scenario methodology to China, the estimates for GDP and the insurance market are shown below in Tables A1 and A2.

Table A1: The world's largest economies by GDP, in current US dollars 1990–2030

Source: Own projections based on IMF (WEO) and UN population data, broadly matched by other estimates (allowing for variations largely due to the units used: for example, PwC use GDP at PPP, Goldman Sachs real 2003 dollars).

GDP estimates (current \$US trillion)						GDP per capita		
Rank	Region	1990	2000	2010	2020	2030	2010*	2030
1	US	6	10	15	24	35–40	47,000	99,000
2	China	< 0.5	1	5.5	18	55–60	4,000	39,000
3	Japan	3	4.5	5	6	7–8	39,000	64,000
4	Germany	2	2	3.5	4	5–5.5	43,000	78,000
5	France	1.5	1.5	3	4	5–5.5	48,000	82,000
6	UK	1	1.5	2.5	4	5–5.5	41,000	81,000
7	Italy	1	1	2.5	3.5	4.5–5	42,000	75,000
8	India	< 0.5	< 0.5	1.5	4	10–12	1,200	7,500
9–10	Brazil, Russia	< 0.5	< 1	1–1.5	3–4	6–7	7,000	37,000
	World total	23	32	65–70	120–130	210–230	9,800	26,500

(*) Several other countries rank highly in GDP per capita terms (\$40,000–\$100,000), notably Australia and Canada, but also smaller countries such as Hong Kong, Singapore, Switzerland, Norway, Ireland, Qatar and Luxembourg. Malaysia is a \$200–\$250 billion economy with a population of about 27 million and GDP per capita just under \$10,000.

While India's economic growth looks set to remain robust, possible averaging more than 9% per annum in the rapid urbanisation scenario, it is only in the period from 2020 to 2030 that India will start to move up the global league table of economies (measured by GDP) – even by 2020, India's GDP is only likely to reach a similar level to the major European economies, not more. And although India may be the third largest economy in the world by 2030, it will only be around a quarter of the size of the US's and a fifth of China's. In the insurance market, its profile and ranking will be similar.

Table A2: Insurance market forecasts for China

	2010	2020			2030		
		Consensus	High	Low	Consensus	High	Low
GDP (nominal \$US, bn)	4,752	18,300	19,180	16,175	55,550	66,475	44,075
GDP per capita (nominal \$US)	3,516	12,875	13,495	11,380	38,090	45,580	30,220
GDP per capita (PPP)	7,691	19,695	20,320	18,120	39,215	46,035	33,150
		Consensus	High	Low	2000–08 average		
Average GDP growth (2010–30)	7.9	8.8	6.7	10.1			1,676

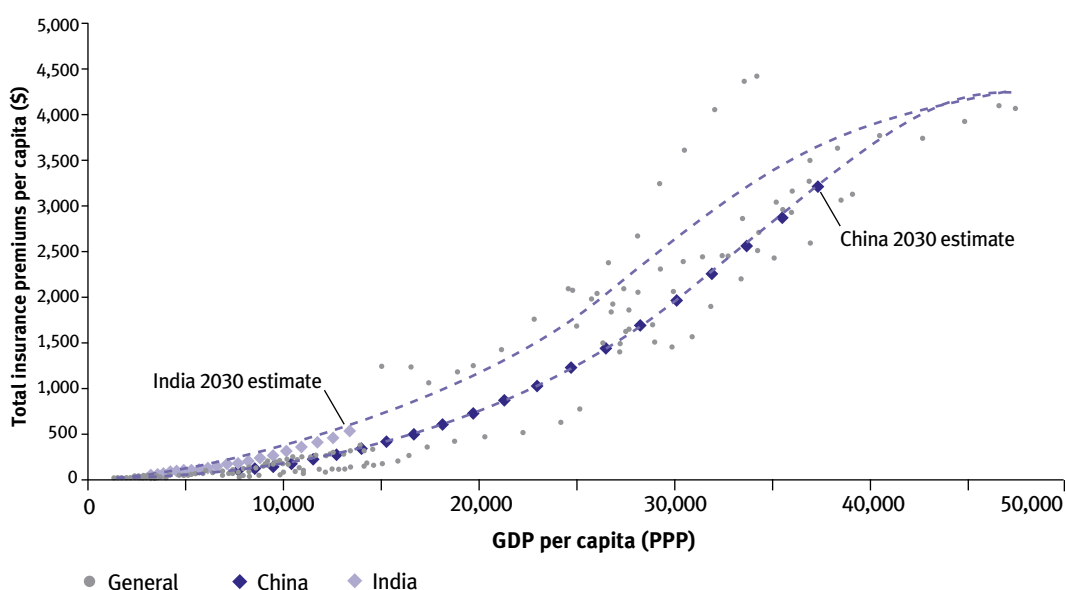
Total insurance

Premiums per capita (\$)	111	732	786	608	3,216	3,852	2,476
Market size (\$bn)	150	1,041	1,117	863	4,691	5,618	3,611
Market size (% of GDP)	3.2	5.7	5.8	5.3	8.4	8.5	8.2

Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

According to these estimates, between 2010 and 2030, the Chinese insurance market (which is already much larger than India’s) will actually grow at a quicker rate than the Indian market: the total value of China’s insurance market could go from being two and a half times that of the Indian market in 2010 to around four to six times greater in 2030. This reflects China’s headstart in terms of income growth and rapid urbanisation, so the average income level is about to reach the pivotal point for accelerated demand for insurance (much earlier than India). Also, for the next decade at least, China’s insurance market will reap the benefits of the same demographic dividend as in India – under the consensus forecast based on UN population estimates, the urban population in both countries will increase at an annual rate of around 2.5% until 2020, helping accelerate financial services development. However, by 2020, China’s urban population growth rate is likely to drop to 1–1.5% or less (as overall population growth is low and rural migration will be close to exhausted), while India’s should be able to maintain a fast pace as urbanisation would still be progressing, adding to the overall urban population growth.

Figure A1: Comparison of demand for insurance in China and India under the consensus urbanisation scenario

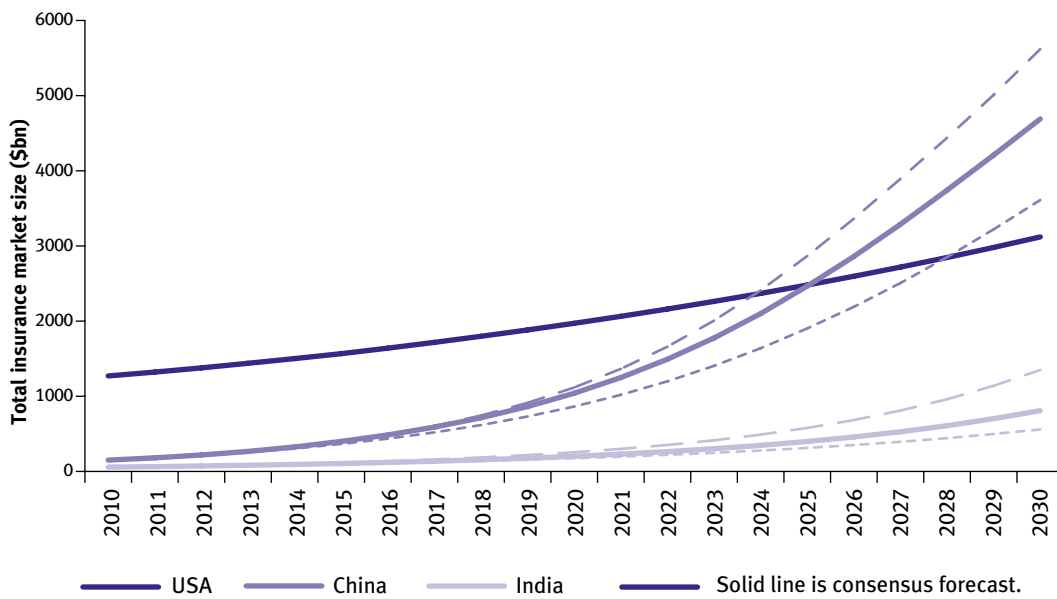


Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

With the Chinese total insurance market growing at an average rate of 11–18% per annum over the next two decades, it is likely to overtake the US as the world’s largest insurance market (the transition probably occurring between 2024 and 2029).³⁴ However, what is also important to note is that by this period, growth in the Chinese insurance market will begin to decelerate – income levels will have reached the higher part of the S-curve where demand flattens off.

In addition, the overall Chinese population is estimated to plateau between 2030 and 2035, leading to the conclusion that while the growth of the insurance market in China will be far greater than in India up until about 2025, at this point the Indian insurance market will be just entering a period of accelerated growth. Hence, relative to China, over the next 10–15 years, the performance of the Indian insurance market may seem disappointing, yet its growth prospects in 20–30 years’ time will be much greater.

Figure A2: Value of the total insurance market (\$bn) in the US, China and India



Source: Own projections based on Swiss Re (Sigma World Insurance Data) and IMF (WEO) data

³⁴ Estimates for the size of the insurance market in the US have been calculated using a similar methodology to that for Singapore. A consensus GDP growth forecast has been made and, reflecting the market’s mature nature, demand for insurance is expected to rise in a linear relationship to GDP.

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