Economics

Business Conditions at Firms Stable, Heading into New Period of Uncertainty

Liability insurance rates up 7% this year, more for smaller firms

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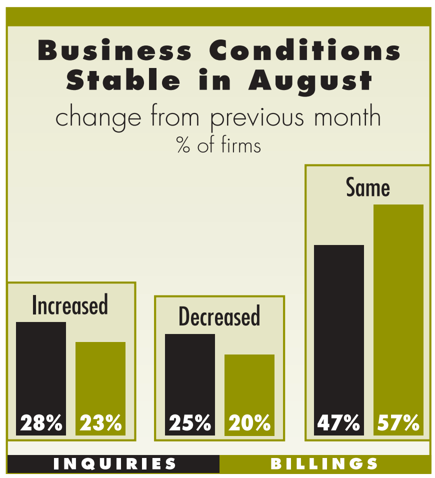
The economy is in for a major upheaval on the heels of the terrorist attacks. However, it is still too early to gauge the short-term impact on our economy, much less the longer-term implications. Some sectors undoubtedly will suffer more than others: the airline, lodging and hospitality, and insurance industries are three obvious areas of concern, assuming the federal government doesn't step in to mitigate these substantial losses.

There was reasonable chance that our economy would not be able to avoid a recession even before the events of the past week. Now, however, the odds have substantially increased. More important are the sources of the economic weakness. To date, the cooling of an overheated technology sector was the major vulnerability in our economy. The chances are that this sector will recover in the months ahead with the anticipated pickup in government defense spending.

You would have to think now that the major vulnerability is in the consumer sector, as consumer confidence has been shaken by these events. In fact, the preliminary consumer confidence numbers for September already show a dramatic decline. Even though most interviews occurred before the attacks, the University of Michigan's consumer sentiment index dropped 8.6% in September, and the counterpart for expectations declined 9.4%. A drop of that magnitude indicates an impending decline in consumer spending well beyond air travel. And already there are numerous reports of businesses suspending nonessential employee travel.



Firms had been recovering

It has been a rocky year for architecture firms, but the recent numbers were improving. August figures showed an increase in billings after two months of declines. Figures were particularly encouraging in the Midwest and South regions. However, inquiries for new projects were pointing to less growth in the months ahead. Beginning this past June, inquiries for new projects moved from strong growth to only modest gains. This trend was indicating continued but uneven growth in the months ahead. Now, however, even that scenario seems optimistic.

Liability insurance rates on the rise

For the past year, liability insurance companies have been warning of increases in rates charged to architecture firms. A slowing stock market was cutting into profitability, forcing carriers to offset some of the shortfall through rate hikes. However, given continued strong competition among insurers, architecture firms were finding that they had some leverage.

To date, even though firms have been able to exert some market leverage, rates appear to have risen. According to information from our panel, firms that have renewed or changed policies since the beginning of the year are paying an average of about 7% higher rates. (Firms were asked to provide only increases in the liability insurance rate per $1,000 of coverage at their last renewal. Many firms are seeing premiums rise substantially more because their volume of business has increased.) This compares to an average 4.2% increase for firms that last renewed in 2000 and a 3.8% increase for renewals in 1999 or before.

Smaller firms that have renewed this year are seeing greater increases in coverage. Firms with billings under $1 million per year report rate increases in excess of 9%, while firms with billings in excess of $1 million report only 5% increases in liability insurance rates.