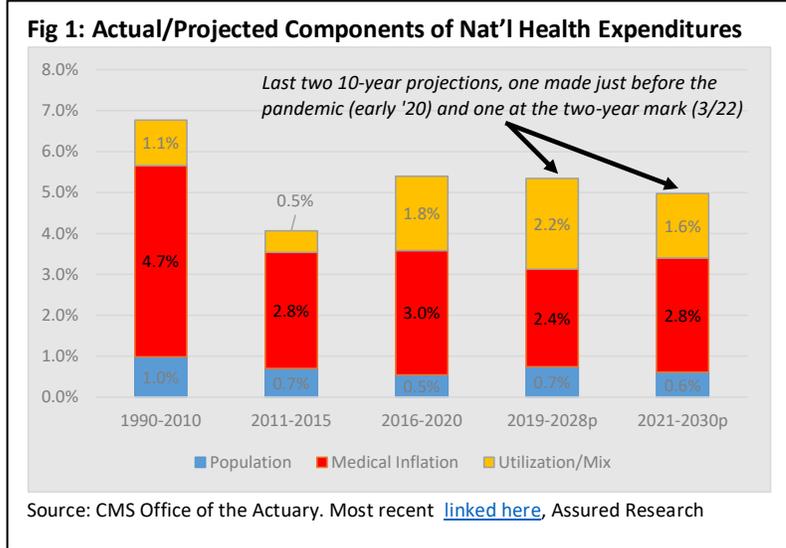


Assured Comment: Medical Inflation Forecasted to Stabilize After Brief Rise

But as we look ahead there seems a real risk that demand for healthcare will exceed the supply; recipe for inflation

The actuaries at the Centers for Medicare & Medicaid Services (CMS) took 2021 off...we understand why. Well, they didn't really take the year off, but they did delay their annual 10-year forecast of national health expenditures (NHE)



in light of the disrupted diagonals caused by COVID and the federal response to the healthcare crisis.

NHE's share of nominal GDP jumped to 19.7% in 2020; that's the highest level recorded since 1960.

The good news: CMS' actuaries think NHE and nominal GDP will grow at about the same rate over their latest 10-year forecast period (2021-2030) which means NHE%GDP will remain largely unchanged. (See Figure 2, bottom.)

That's both interesting and somewhat encouraging if it materializes, but **it's the components of NHE that interest us.** Figure 1 shows the actual historical components of NHE and the CMS' projections made

in early 2020 alongside their just released, 'post' pandemic projections. We'll remind that **growth in aggregate health expenditures are a function of changes in 1) the population; 2) medical inflation; and 3) utilization and mix changes** as the intensity of medical services evolves with the changes in population (e.g., retiring Baby Boomers using more medical care), new technologies, longer lives, etc.

Broad stability in the forecasted growth of NHE is good for P/C insurers, but a look under the hood reveals some interesting dynamics worth considering. CMS actuaries expect the disruption from the pandemic (e.g., the boost in supplemental federal spending and medical utilization patterns) to normalize by 2024. But in '22 the CMS forecasts

an acceleration in medical inflation – to 3.6% with deceleration thereafter. We're inclined to attribute the spike to rising wage/labor and materials costs (although the CMS' report did not explain their thinking).

But here is where our outlook strays from the CMS: **Over the next decade the population growth in people aged >65 years is forecasted at some 4x the overall population growth.** NHE growth is understandably forecasted to exceed GDP growth from 2025-2030 (older people use more medical

Fig 2: History of 10-Year Projections in Components of National Health Expenditures

From To	2016	2017	2018	2019	2021	Comments
Health Spending	5.8%	5.6%	5.7%	5.4%	5.1%	<i>Slight deceleration</i>
Nominal GDP	4.7%	4.6%	4.6%	4.3%	5.2%	<i>Influenced by pandemic</i>
Health Inflation	2.5%	2.6%	2.6%	2.4%	2.8%	<i>Modest acceleration</i>
U.S. Population	0.9%	0.9%	0.8%	0.7%	0.6%	<i>Decleration</i>
Per Capita Health Spending	4.8%	4.7%	4.8%	4.7%	4.4%	<i>Surprising with Baby...</i>
Per Capita GDP	3.7%	3.7%	3.8%	3.6%	4.5%	<i>...Boom generation?</i>

	2025	2026	2027	2028	2030
Health Spending % GDP	19.9%	19.7%	19.4%	19.7%	19.6%

Source: CMS Office of the Actuary. Most recent [linked here](#), Assured Research

services), but **we have to wonder if that increased utilization could drive inflation higher than the CMS forecasts?** Quite simply (to us) **it seems a real risk that demand for healthcare will grow faster than the supply** (a recipe for accelerating inflation). We're admittedly outside of our area of practice, but if a WC insurer, for instance, said they were going to hold their inflation assumption at 3.5-4.0% and wait to be proven conservative...we wouldn't argue.