The HOT SPOT

U.S. Insurance Industry Investment Exposure to the Energy Sector and Oil-Exporting Countries is Modest as Oil Price Plunge Continues (12/17/14)

Bloomberg News reported on Dec. 16 that the global price of crude oil plunged through $60 a barrel for the first time in five years. New York-traded West Texas Intermediate, the world's most liquid forum for crude oil trading, dipped below $55 on Dec. 16 for the first time in five years. From its mid-June peak, crude oil has slumped nearly 50% through mid-December this year. The stocks and debt securities of oil-producing companies are coming under pressure—high-yield exploration and production and oil-service companies in particular—while oil-exporting countries such as Russia (where the ruble has declined precipitously to record lows), Nigeria, Iran and Venezuela have also been hard-hit.

Figure 1: Price of Crude Oil (WTI), Last 30 Years

Energy stocks have come under pressure: The S&P 500 Energy Index is down about 10% over the past 12 months, despite the broad index's 14% positive 12-month return. Energy sector high-yield corporate bonds have also sold off. As of Dec. 16, the Energy component of the Markit CDX HY CDS Index had widened to 676 basis points (bps) after ranging from 250 bps to 300 bps for most of the year, while the overall CDX HY index widened to 404 bps after trading between 300 bps and 350 bps for most of 2014. Due to investor fear of "contagion," ripples have spread, causing emerging markets around the world to sell off. Through mid-December, stock markets in Colombia, Brazil, Mexico and Chile are down 13% to 30% in the past 12 months on a currency-adjusted basis, and Russia's MICEX Index is down 52%. Emerging market debt has followed suit, as the emerging market CDX Index widened to 419 bps on Dec. 16 after trading between 250 bps and 350 bps for most of the year.

At present, the global demand for oil is low because of weak economic activity, as well as increased energy efficiency, and a steady shift away from oil to alternative energy sources. Despite ongoing economic recovery in the U.S., economic activity in Europe remains sluggish. In addition, Asian economic growth remains under pressure, with Japan stagnant and China's

growth continuing to decelerate. On the supply front, geopolitical tensions have not disrupted oil, and the market seems relatively unconcerned about geopolitical risk. At the same time, the shale oil boom in the U.S. has enabled it to become the world's largest oil producer. This has allowed the U.S. to sharply reduce its dependence on imports, thereby freeing up global supply. OPEC, led by Saudi Arabia and other Gulf countries, has maintained production levels to preserve market share. According to The Economist magazine, Saudi Arabia can easily handle lower oil prices, given its $900 billion of reserves and its ultra-low production cost ($5 to $6 per barrel).

The fallout from the oil price plunge is worst for the players in the industry who have high cost structures (i.e., deep-water or Arctic drilling) that make them the most vulnerable to lower prices. The hardest hit countries are those dependent on a high oil price to fund their fiscal imbalances. The two most prominent countries are Russia (already suffering due to Western sanctions following its annexation of Crimea and continued interference in Ukraine) and Iran (which is supporting the Assad regime in Syria). The Russian ruble has plummeted more than 50% through mid-December despite massive efforts by the Russian central bank (an 11.5 percentage-point increase in rates and more than $80 billion of intervention), igniting market fears that capital controls may be imminent. The latest 6.5 percentage-point rate hike was the largest since the 1998 Russian sovereign default.

As of year-end 2013, the U.S. insurance industry had modest exposure to the key oil-exporting countries around the world, with a combined $169 billion of debt and equity exposure, or 3.0% of total cash and invested assets. Drilling down to specific country exposures, the majority, or 78%, was to Canada, whereas exposure to Russia and Venezuela was $882 million and $1.6 billion, respectively. There was minimal to no exposure to Iran or Nigeria. The U.S. insurance industry's worldwide oil-and-gas-related bond and stock exposure totaled $226 billion, or 4.1% of total cash and invested assets. Note that the country exposures and the energy sector exposure are not mutually exclusive.

The NAIC Capital Markets Bureau will continue to monitor events within the energy sector and the regions affected and will report as deemed appropriate regarding any potential impacts to the U.S. insurance industry's investments.

© 1990 – 2018 National Association of Insurance Commissioners. All rights reserved.