The ______________________ monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the INDEX.

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For EM countries, aggregate [economic] growth stabilized in the first half of 2018, according to the IMF World Economic Outlook (WEO) dated as of October 2018. In particular, EM countries in Asia demonstrated stronger growth due in part to a pickup in the Indian economy, while fuel-exporters in the Middle East and Sub-Saharan Africa benefitted from higher oil prices; this trend has since reversed as oil prices have been trending lower, entering a bear market, for a variety of reasons. Economic recovery in Latin America continues albeit at a subdued pace; trade issues between Mexico and the U.S. have made some progress but are still uncertain relative to the North America Free Trade Agreement (NAFTA).

As shown in Table 1, as of October 2018, the IMF has forecasted growth in 2018 for all EM countries to be 4.7% — consistent with the 2017 growth rate — but a slight downward revision from its April 2018 forecast. EM ex.42 562.(h)3( )-77(t)-12(h)3(e)] TJ( )-34(p)31 0 0 1 212.33 547.06 Tfob1 0833( )-m -0.108 Tc[(EM)] TJETBT

In terms of financial conditions, the October 2018 published by the IMF, stated that significant differences have emerged between advanced and EM economies, where some countries are facing “weaker macroeconomic fundamentals and greater political uncertainty.” In China, for example, nonfinancial corporate sector leverage has been increasing and is above historical benchmarks. Credit quality is an ongoing concern in other EM economies as well.[2] In general, EM economies are susceptible to impacts from monetary policy in advanced economies. The financial condition of some EM economies have tightened since earlier this year due in part to country-specific factors, worsening external financing conditions and trade tensions, according to the IMF. Going forward, continued trade tensions, along with geopolitical uncertainty, could result in a change in risk sentiment and further tightening of global financial conditions.

S&P Global Ratings (S&P) research cites that “…foreign capital flows to emerging markets (excluding China) slowed markedly over the second and third quarters of 2018…”[3] due in part to “rising U.S. interest rates, a strong U.S. dollar and global trade tensions.” S&P also expects this trend to continue as advanced economics continue to tighten their respective monetary policies.

As of year-end 2017, the U.S. insurance industry had a total of $44.2 billion in BACV in EM investments (including bonds and common and preferred stocks), which was a 6% decrease from $46.8 billion at year-end 2016. Historically, total U.S. insurer EM investments have been relatively small, at less than 1% of total cash and invested assets. Life companies accounted for the majority of exposure at 90% of the total, followed by 14% with property/casualty (P/C) companies at year-end 2017.

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Chile, a leading producer of copper, as it is home to the world's largest copper mine, is expected to reach 4.0% GDP in 2018 according to the IMF — an increase from 1.5% in 2017. Chile's economy has benefited from a stable macroeconomic framework, according to the Organization for Economic Co-operation and Development (OECD)[4]. Growth in Chile had been slowing since 2014 because of weaker global trade and a decrease in copper prices; however, growth is expected to gain momentum in the short-term, as the exports market is expected to grow at a more solid pace, and copper prices are expected to rebound. In addition, Chile has a stable financial sector. Moody's lowered Chile's long-term sovereign debt rating to A1 in July 2018 (from Aa3) with a Stable Outlook, citing "broad based deterioration" in the company's debt profile.

In terms of EM regions, Latin America has historically accounted for the largest proportion of U.S. insurer EM bond investments (See Table 5) –

Argentina

NAIC designations for the industry's EM bond exposure suggest investment grade credit quality for almost 90% of the bonds as shown in Chart 2. About 12 % were considered below investment grade based on their NAIC 3 and NAIC 4 designations (there were no bonds with NAIC 5 or NAIC 6 designations).

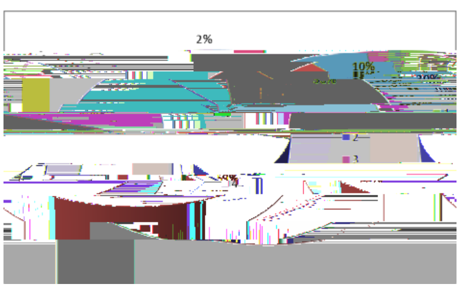
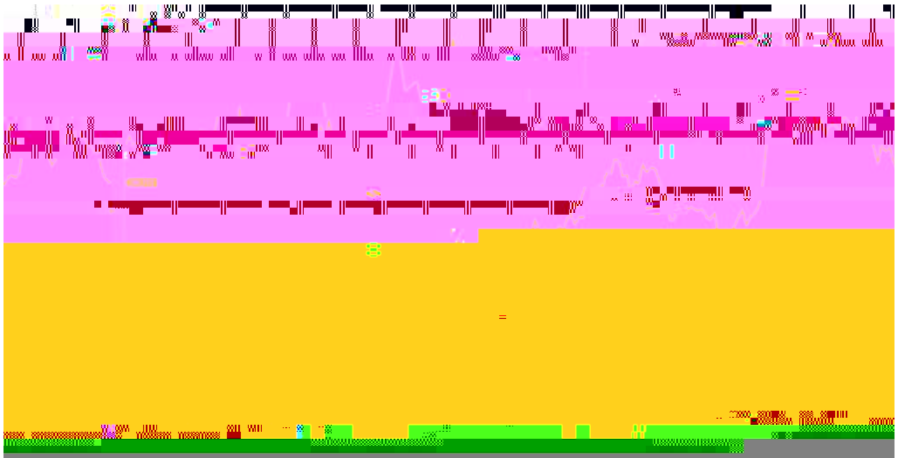


Chart 3 shows the trend in EM credit spreads based on the Markit CDX Emerging Markets Index (CDX EM) YTD as of Nov. 6, 2018. The CDX EM consists of fourteen sovereign issuers domiciled in Latin America, Eastern Europe, the Middle East and Africa that trade in the credit default swap market. Spreads have been widening since the beginning of the year, and in September 2018, they were near their widest levels since 2016 due in part to investors being risk-averse for a variety of reasons including geopolitical and trade-related tensions.



Source: Bloomberg

As of year-end 2017, U.S. insurer common and preferred unaffiliated stock investments totaled $1.3 billion, which was slightly more than the $1.2 billion at year-end 2016. The largest exposure was with China, at more than half of total EM stock exposure ($816 million, or 60% of total EM stock exposure), compared to $752 million at year-end 2016. Consistent with the year prior, the second largest EM stock exposure at year-end 2017 was with Greece ($172 million, up from $150 million at year-end 2016). The top three investments to EM stocks accounted for almost 80% of the U.S. insurance industry's total EM stock exposure at year-end 2017 (See Table 5). And the same five countries comprised the top five exposures for both year-end 2017 and year-end 2016. P/C companies accounted for the majority of U.S. insurers' EM stock exposure at year-end 2017, at 80% of the total (compared to 73% at year-end 2016).

China	816	60%
Greece	173	13%
Brazil	78	6%
Taiwan	64	5%
India	49	4%
Others	169	13%

China is the world's second largest economy, and real GDP growth is expected to be 6.6% in 2018, down from 6.9% in 2017, according to the IMF. GDP growth in China has been on a declining trend over the last few years. China's central bank has eased monetary policy to offset external pressures and the impact of financial regulation, according to the IMF's Global Financial Stability Report. In addition, China's equity markets have weakened due to rising trade tensions, particularly those between China and the U.S. The long-term sovereign debt of China is rated A1 with a Stable Outlook by Moody's, and A+ with a Stable Outlook by both S&P and Fitch.

Questions and comments are always welcome. Please contact the Capital Markets Bureau at CapitalMarkets@naic.org.