2022 Q3 Energy Market Update

# OPEC+ Sets the Floor for Oil Prices, but Supply Chains Hold Back Growth


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Shockwaves hit the energy market when OPEC+ met in early October and agreed to a 2 million barrel per day output cut. The effects of the decision are still being felt, and the U.S. and European countries are weighing retaliatory measures.

OPEC+ made this decision due to many factors, but one thing is clear. They're looking to prop up oil prices around $90 a barrel and are reluctant to let prices drop further than that, no matter the economic headwinds.

## WHAT'S ACTUALLY HAPPENING

It is important to note that we aren't going to actually see 2 million barrels coming offline; the real number is actually around 890,000 barrels. This is due to the fact the OPEC+ countries commit to a certain level of output, and since the pandemic many of the countries haven't been able to meet their assigned allocation of that output. In fact, the group as a whole has been short by almost 3.6 million barrels a day. Many members of OPEC+ feel the current price of oil isn't accurately reflecting how tight oil supplies are and this cut was meant to wake the world up to that fact.

To be fair, OPEC+ isn't wrong. Looking into 2023, there are many factors that will continue to weigh on prices. Russia is a member of OPEC+ and currently they are pumping right under 10 million BPD, but there are concerns around them maintaining this output. Many of their shale fields are very complicated and have required expertise from Western companies who are now pulling out of the country due to the conflict with Ukraine.

We know shale wells have shorter lives and need to be replaced quickly, so this will be an interesting development to monitor. It will also be interesting to watch and see what potential actions U.S. and European leaders take. Two potential options on the table that could bring additional production online are renewing the Iran nuclear deal and easing sanctions on Venezuela. Venezuela holds vast amounts of oil, but even if sanctions were lifted it would take years to see a positive effect on prices due to the country's aging oil infrastructure.

## EFFECTS ON U.S. ENERGY COMPANIES

So what does this mean for U.S. energy companies? Well, in the past we would've seen shale fields roar back to life and operations ramp up. There is certainly a case to be made for it.

Currently, crude oil stocks in the U.S. have hit a low, not seen since the 1980s. Oil stocks in the U.S. hit their peak in July of 2020 at 1.2 billion barrels. Today, we're down to 845,000 barrels and there doesn't seem to be an end in sight. The current administration has continued to draw down the strategic petroleum reserve in an effort to tamp down prices. The unfortunate part is this eventually has to be refilled.

Even with shortfalls looking likely in the short to midterm, most oil companies in the U.S. are continuing to be conservative with CAPEX and that's not going to change heading into Q4 and into 2023, especially with a recession on the horizon.

Commentary from multiple CEOs points to returning cash to shareholders who have been battered over the last decade, as well as continuing to pay down debt.

The news isn't all bad. As discussed in previous newsletters, we've seen growth from almost all insureds from a payroll, fleet count, and revenue standpoint. The energy companies who survived the COVID-19 induced downturn seem to have plenty of economic opportunity and are projecting growth into 2023.

There do seem to be two major issues, however, lack of labor and very tight supply chains are holding back growth and will likely continue into Q4 and into 2023. The pandemic saw a severe retraction in employment numbers, and since the recovery they haven't returned. In addition, there was a significant delay in the procurement of material that's required in the oil patch and the industry still hasn't been able to catch up.

## ENERGY INSURANCE INDUSTRY IMPACT

As of today, the energy insurance marketplace is continuing to provide competitive solutions for insureds. We saw appetite changes from carriers in late 2021 and early 2022 and for the most part the space has adjusted and found some consistency.

**Here's the rundown:**

- We're continuing to see carriers leverage lead umbrellas to win deals. Carriers are getting more and more comfortable with increasing their limits to stay on accounts. In fact, multiple carriers have deployed up to $20 million in limits. This indicates to us that they've been able to negotiate and find capacity in the reinsurance space to help support these activities.
- In addition to the umbrellas, we're also seeing carriers leverage the Workers' Compensation line of coverage. This line of business has been consistently profitable and carriers are increasingly putting pressure on agents to bundle this line in order to quote the umbrellas.
- We are continuing to see carriers reduce rate increases to retain accounts. In many cases we've been successful in achieving rate reductions. With the growth accounts are seeing, this is a very favorable option for all parties from an economies of scale perspective. If there is any loss activity, trucking issues, or significant changes in operations, however, this result has been much harder to achieve.
- Underwriters are continuing to diligently underwrite the AL and HNOA lines of business if they're sitting excess of a fleet. We're seeing more and more requests for AL supplementals to be completed, in addition to the GL supplementals.
- We've continued to monitor insurance companies being pressured to pull out of the oil and gas space. Munich Re announced on October 6, it will refuse to insure any contract or project exclusively covering the financing, planning, construction or operation of oil and gas fields, midstream infrastructure or oil-fired power plants, beginning in April 2023. Munich Re is one of the largest reinsurance companies, so it will be interesting to monitor the effects of this decision as time goes on and see if other companies will join them.

As we wait to see the effects of OPEC+'s decision on the U.S. energy industry and in turn, the energy insurance marketplace, we're keeping our eye on finding competitive solutions to help agents and insureds navigate the uncertainty.