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Bubble Risk Bulletin

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The Society Of Actuaries (SOA) has brought together several leading enterprise risk management (ERM) actuaries to identify the top 11 concentrated areas of risk of 2011 and provide insight on how ERM programs can be used to hedge against those systemic risks. With rigorous training in identifying, managing and mitigating risk, actuaries are well-equipped to discuss the areas of risk that need attention as we work to rebuild the financial system post-crisis.

The Perfect Storm: Falling U.S. Dollar, Rising Oil Prices And The End Of QE2

When asked what are the emerging risks that will have the greatest impact over the next few years, almost half (49 percent) of corporate risk managers say the fall in value of the U.S. dollar is the top emerging risk (Society of Actuaries Emerging Risk Survey, 2010). This is a growing concern because of the brewing economic storms that could collide to have a big impact on the value of the U.S. dollar.

Two major economic events, the end of quantitative easing (QE2) and drastic increases in oil prices, may be set to collide with the fall of the U.S. dollar's value, which could send waves through the global marketplace.
As oil price shocks impact economic growth, injecting additional liquidity into the financial system to keep interest rates low is needed to cushion the economic blow brought by higher oil prices. Industry leaders are well aware the Fed's quantitative easing program drove the dollar's decline in 2010. With oil prices approaching record highs because of events in the Middle East, further devaluation of the U.S. dollar will impact consumer purchasing patterns and weigh on global growth, especially in Asia and other developed economies. The low level of the Federal Reserve's discount rate and related Treasury yields have driven investors looking for higher returns into riskier markets such as equities, high risk loans and emerging market debt. With quantitative easing slated to end in June, many are wondering what will happen to the value of the U.S. dollar and if Treasury yields will rise high enough to unwind some of the flow of money into the riskier asset classes.

Actuary Marc Altschull, who is the Chief of Staff to the Chief Investment Officer of ING's Fixed Income and Proprietary Advisory Services and has a background in enterprise risk management, emphasizes the impact of the value of the U.S. dollar and how an unwinding of its depreciation could result in a dramatic and sizeable move that may catch corporate executives off guard. It is important for executives and corporate risk managers alike to understand how the risk of these simultaneous events will impact corporations' bottom line.

QUESTIONS FOR CONSIDERATION

- Will slow economic growth or low interest rates/quantitative easing have the biggest impact on the value of the dollar?
- How will the end of quantitative easing impact oil prices?
- Historically, every spike in oil prices has lead to another recession. Since we are seeing a spike in oil prices, are we headed into a double dip?

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