

Rising gas prices are a pressing problem for the EU

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Natural gas prices are breaking new records on EU gas hubs: they have risen by about 250-300% this year. This is due to the rapid economic recovery after the pandemic, the unusually cold winter of 2020-1, low levels in storages, the outflow of liquefied gas to Asian markets, which remain more attractive, as well as very limited increases in deliveries from traditional suppliers, primarily Russia. The high gas prices (along with the rising costs of CO₂ emission allowances) are affecting electricity prices, and have also resulted in significant reductions of production by firms in the gas- and energy-intensive sectors, in particular including those from the fertiliser and metal sectors. The rising costs of energy, fertilisers and metals are contributing to further price increases, including food and industrial production. Spain had already called on the European Commission to intervene back in the summer. Wholesale energy prices there have more than tripled since December 2020, so Madrid is now planning to introduce a gas price cap, cut electricity taxation, and redistribute some of the energy companies' revenues. The Spanish government is demanding that the European Commission take specific political steps and develop guidelines for the member states on how to react to price increases in a consistent manner, compliant with EU regulations. It has suggested taking action to curb speculation on the CO₂ emission allowances market, creating a centralised platform for joint European purchases of natural gas and strategic gas reserves, which would increase the EU's resilience to price fluctuations on world markets. The high prices are also being increasingly felt by other EU countries, and have almost caused a crisis on the British market.

The topic of the high gas & energy prices was discussed at an informal meeting of EU energy ministers in Ljubljana on 22 September. Greece's representative appealed for the development of an EU-funded mechanism (a hedging fund from the sales of carbon emissions allowances in the ETS system) to support households and companies suffering from the soaring energy prices; Romania also demanded that the EC take action. On the other hand, Spain requested that energy prices be discussed at the October European Council, in which it was supported by the representatives of Italy, Hungary, Romania, Portugal, Poland and Malta. During a press conference, the energy commissioner Kadri Simson rejected the suggestion that some of the price increases had been caused by the EU's electricity market design, arguing that the situation on the global markets was mainly responsible. She also said that the EC was ready to present a toolbox of short-term and temporary measures to help EU states cope with the effects of the global price rises and protect their most vulnerable consumers in a way which conformed with EU regulations; the EU would work in the longer term to limit its dependence on imports and stick to its climate goals.

Commentary

- The record rises in gas costs since summer – which is normally a time of lower demand and lower prices – together with the lowest levels in EU reservoirs for a decade (~72% on average) and the insufficient supplies to the European market herald a difficult winter and further price increases. The steep price rises are linked to the ever deeper liberalisation of the European market, where around 80% of gas supplies were sold in 2020 at prices based on gas-to-gas competition. The situation will be particularly severe in the event of long-term frost, and the persistent problems and uncertainty in the gas and energy market will additionally contribute to price rises on the gas hubs. It is unclear whether it will be possible, in the face of the challenges which have persisted for several months, to obtain additional supplies of gas in the case of the rising winter demand. A large part of the non-contracted LNG in long-term contracts flows to Asian markets, where, due to the boom in post-pandemic demand, prices remain higher than those in Europe. The traditional pipeline suppliers are not increasing their exports to Europe either. Exports from Algeria (an important source of gas for France, Italy and Spain) are not rising, and there are even reports of possible problems with supplies from Algeria to Spain via the GME gas pipeline related to the growing tensions between Algeria and Morocco. The only entity currently ready to increase supplies to the EU market is Norway's Equinor (which announced on 20 September that it would increase production and exports from the Oseberg and Troll fields by 2 bcm per year as of October). However, this growth will be spread over many months, and as such will have little impact on the market situation in Europe in the immediate future.
- Despite the rising prices, the volume of gas supplied from Russia, the EU's largest supplier, is not increasing; nor is there much indication that Gazprom intends to increase it in October. The company is meeting its obligations under long-term contracts, but its limited bookings of additional transmission capacities during a succession of recent auctions show that it is not planning any substantial additional deliveries. During the recent monthly auctions on 20 September, only about a third of the capacity offered at the Polish-German Mallnow border point on the Yamal pipeline (30.1 mcm out of 86.5 mcm per day) was reserved; and no capacity has been reserved at all at points on the Russian-Ukrainian and Serbian-Hungarian borders.
- The lack of increased supplies from Russia, together with the low levels of gas in storage sites (especially those whose co-owner or partner is Gazprom) is causing concern in Europe. There are ever more frequent suggestions that the Russian side is acting deliberately, in order to have the Nord Stream 2 gas pipeline launched as soon as possible. On 16 September, a group of 43 MEPs called on the European Commission to launch an investigation into the possible deliberate manipulation of the situation on the European market by Gazprom, undertaking actions potentially violating EU competition rules. On 21 September, the International Energy Agency (IEA) issued a statement on the record high gas prices in the EU; in its opinion, although Russia is meeting its long-term obligations, supplies to Europe are lower than in 2019. The IEA maintains that that Russia could do more to increase the availability of gas on the European market, and to ensure that storage facilities are adequately filled before the heating season. In turn, the US energy secretary, Jennifer Granholm, stated at a press conference during the P-TECC

(Partnership for Transatlantic Energy and Climate Cooperation) forum organised in Warsaw that the price increases raise concerns about the reliability and security of supplies in Europe. She said the US wanted to work with its European allies to ensure stable, secure gas supplies this winter and help diversify energy sources in the long run, especially as certain actors could manipulate supply levels for their own profit. However some experts (including from the Oxford Institute for Energy Studies) and industry media (such as Bloomberg) claim that Russia cannot at present significantly increase its exports because its output is already high, production capacities are limited in their flexibility in the short term, and also because domestic demand is high; moreover, Russia needs to fill its own gas reservoirs.

- The rising gas and energy prices are affecting entire economies and posing an increasingly serious challenge to the EU. Discussing action related to climate goals is falling into the background in the context of the intensifying energy crisis. Rising prices and the lack of adequate steps to eliminate the effects of this upward trend, especially for the most vulnerable groups of customers, may reduce support for the implementation of the ambitious (and costly) goals of the European Green Deal, which was directly suggested by both Spain in its September letter to the European Commission and the association of the non-ferrous metal industry Eurometaux. The effects of high price rises have already been impacting the EU energy mix in a disadvantageous way from the perspective of the energy transformation goals: the current market conditions mean that expensive gas is increasingly being replaced by cheaper – but dirtier – coal.
- It is all the more important to develop an adequate political response to the energy prices problem as there are many indications that a structural change in the natural gas market is underway, and there is no prospect of a return to the low rates that had been seen in 2019-20. So far, the high prices have encouraged investment in the upstream sector of new deposits and export infrastructure around the world, while the current widespread drive to decarbonise economies and move away from natural gas (or switch to 'green' gases) over the next few decades has deterred costly and long-term investments in this fossil fuel. Oil and gas companies are increasingly investing in new technologies instead, which will allow them to meet climate requirements.
- In the longer term, persistently high gas prices may become a problem in those EU countries where natural gas was supposed to play a key role in the energy transition and the shift away from coal. This situation will hinder investments in new infrastructure and the gas-fired generation of electricity, which has already been made more complex due to the increasingly difficult access to EU financing. It may also adversely affect the implementation of the new diversification projects in Central and South-Eastern Europe. The structurally higher gas prices could - as the European Commission hopes - mean that work on new technologies and decarbonisation activities accelerates, but also that the use of nuclear energy will become more attractive. However, it is possible that continued high gas & energy prices will have the reverse effect, and cast ever more doubt on the EU's current energy & climate policy.