

The already high prices continue to rise on the European gas market

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The prices of natural gas on European gas hubs are once again record high. On 16 December 2021, the price of gas on the Dutch TTF reached 142.7 euros/MWh (i.e. the equivalent of more than US\$ 1,575 per 1 tcm of gas). The price increases are associated with falling temperatures, lower renewable energy production, growing demand for natural gas, continued insufficient supply of gas and persistent market uncertainty. The volume of intra-EU gas production has been on the wane and earthquakes recorded in the Netherlands (most recently in November) are preventing even a temporary increase in production at the Groningen gas field. LNG is delivered predominantly to Asia, where prices on gas hubs are usually higher than in Europe (the recent price increases have been exceptional in that they reversed this relationship, which, in turn, may attract additional uncontracted cargos to Europe). Finally, despite the fact that Gazprom has increased its supplies to the EU, compared with the average volumes supplied in November, it continues to supply less gas than in previous years. According to the company's figures, on 1–15 December 2021 the flows of gas to Europe were more than 20% lower than in the corresponding period in 2020 and more than 33% lower than back in 2019. In addition, there continues to be a high level of uncertainty regarding the volume of Russian gas flows – Gazprom has not booked any capacity in the Yamal pipeline for longer terms (neither annual, nor quarterly and monthly) and in December 2021 it started to book capacities on a daily basis. Although last month the company started to pump gas to its European storage facilities, from most of them gas is being concurrently withdrawn due to rising demand recorded in the heating season. Moreover, at present the level of gas in EU storage facilities is the lowest in at least a decade. According to data published by the association of European gas infrastructure operators on the AGSI+ platform, on 15 December 2021 these facilities were filled in 61% which is more than 17 percentage points less than the 10-year average for this period. Usually, such a low ratio is not recorded earlier than in mid-January.

Commentary

- The record high natural gas prices in Europe are contributing to a further increase in the price of electricity – on 15 December 2021 in most EU member states the day-ahead electricity price was more than 300 euros/MWh. Combined with the related increase in coal-based electricity generation, this also results in an increase in the price of emission allowances. In addition, they constitute an increasing burden to individual customers (especially in regions where gas heating is predominant) and to gas-intensive industrial

customers. Due to the currently limited options for fuel switching, this is resulting in demand destruction, which is (and will continue to be) particularly evident in the chemical industry, including the fertiliser sector. This, in turn, will contribute to continued increase in food prices.

- At present, there are no indications that the gas prices could fall and stabilise in the nearest future. Europe is facing several months of winter and potentially frosty weather and there are no clear prospects for any increase in gas supplies. Russia should have the greatest potential for increasing the supplies, however, despite the fact that gas flows have become stable now, there are no indications that supplies could return to the levels recorded in previous years. Contradictory messages from the Russian side and the lack of transparency regarding the actual current production and export capabilities make impossible a clear assessment of the extent to which the presently reduced supplies are also a result of internal production limitations and or just a manifestation of Moscow's game in pursuit of its own interests. At the same time although Russian politicians claim that Russia's gas export to the EU could increase considerably as soon as Nord Stream 2 is launched, everything (including statements by the German gas market regulator) indicates that this pipeline will become operational no sooner than in the second half of 2022.
- Due to the situation on the EU gas market and the exceptionally low filling level of storage facilities, there are concerns regarding possible gas shortages, especially at the end of the heating season. On 3 December 2021, the CEO of the Italian company Snam, the EU's largest operator of underground gas storage facilities, warned that in case of an exceptionally cold winter and the resulting increase in demand for gas Europe will be in "real trouble" when it comes to securing a sufficient volume of gas. As a consequence, the Italian government has warned of the risk of blackouts in a situation of prolonged gas shortages, and Snam has announced that a reduction in industrial gas consumption may be necessary. It cannot be ruled out that in such situation the most affected states will invoke the solidarity mechanism envisaged in the Security of Gas Supply Regulation. It has been evident for some time now that preparations for this type of situation are ongoing, e.g. in Germany which on 2 December 2021 signed an agreement with Austria on mutual support in case of a gas crisis.
- Gas and electricity prices were among the most important issues discussed during the meeting of the European Council held on 16 December 2021. Due to major differences among the member states (regarding their assessment of the situation on the carbon market and the proposed actions, as well as the role of nuclear energy and gas in the EU's green taxonomy), no joint conclusions on energy were agreed. The situation on the gas market has also impacted on the shape of the gas package announced by the European Commission on 15 December 2021. Although the main purpose of this package is to facilitate the implementation of climate-related goals defined in the EU Green Deal by fostering decarbonisation of the gas sector, creating a hydrogen market and reducing methane emissions, it also relates to EU's security of supply and resilience to price shocks. In particular as amendments to the Security of Gas Supply Regulation proposals have been made to boost regional cooperation in risk assessment and solidarity arrangements should problems with gas supplies emerge. They also stipulate

to make access to infrastructure, including to gas storage facilities (in the EU and in the Energy Community member states), part of risk assessment and preventive actions plans at both national and regional level. Finally – as part of these preventive actions – plans have been made for the operators to establish a voluntary mechanism for joint purchase of gas for the needs of strategic reserves. These proposals will be the subject of an intra-EU debate. Despite the fact that there are voices (e.g. Luxembourg's energy minister) urging the member states to adopt them in a fast-track procedure so that the regulation is ready ahead of the next winter, they will not have a major impact on the present situation. This is consistent with the previous statements issued by the EC, which indicated that short-term measures related to the crisis on the gas and electricity markets remain mainly within the competence of the member states. In addition, there are no indications that the EU is ready to launch political actions regarding the prices, including for example starting a dialogue with Russia on the reasons behind the reduction in gas supplies and the prospects for increasing them.

- Gas prices are expected to fall in March/April 2022, i.e. when the wintertime and the heating season are over. In the context of the ongoing energy transition and the efforts to increase the share of intermittent renewable energy sources on the one hand, and climate change, greater weather unpredictability and more frequent emergence of extreme weather phenomena on the other, demand for gas will continue to be volatile. Moreover – due to increased global competition on the gas market, which is strongly affecting the LNG market, and to unpredictable behaviour on the part of the EU's largest supplier (which may, but does not have to decrease once Nord Stream 2 is launched) – it is unclear whether the supply of gas on the European market will increase in the next few years. Finally, the climate policy pursued both in the EU and globally (which for example envisages abandoning financial support to new gas infrastructure) as well as forecasts spelling a decrease in the consumption of natural gas in a long-term perspective reduce the attractiveness of investments in gas upstream. This, in turn, undermines the prospects for an increase in the availability of natural gas over the next decade or so. All this will contribute to the prices of gas remaining in the higher range and more volatile than in previous years.