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Ukraine: gas challenges ahead of the heating season

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On 29 July, the Verkhovna Rada adopted a law providing for a ban on heating price increases for the population and on gas price increases for individual consumers. The moratorium will last for the period of martial law and will continue six months after it ends. In addition, budget expenditures were increased by ₴264.3 billion (approximately $7.2 billion) which is to be transferred to the state-owned Naftogaz for the purchase of gas. Earlier, on 19 July, the government imposed an obligation on the company to supply it at a lower price to thermal power producers until the end of March 2023. This will allow the existing tariffs for residents of ₴7,420 (about $200) per 1,000 m³ to be maintained. At the same time, Naftogaz itself is in an increasingly difficult situation. On 26 July, it defaulted on the repayment of $335 million worth of Eurobonds, which entails a declaration of insolvency.

In 2021 Ukraine consumed 26.8 billion m³ of gas, of which 8.6 billion m³ was used by individual consumers, 6.3 billion m³ by heating companies and 11.9 billion m³ by industry and budgetary entities. As a result of the Russian aggression, its consumption fell significantly – by 24% in March compared to last year, and by 46% in May – due to a reduction in industrial production. The war also negatively affected domestic production, which decreased by around 7% (in 2021 amounted to 19.8 billion m³).

Commentary

- As of the end of July, Ukraine had 11.7 billion m³ of gas in underground storages. The government has obliged Naftogaz to accumulate 19 billion m³ of gas before the heating season (which usually starts in mid-October), while the head of the company, Yuriy Vitrenko, has claimed that 15 billion m³ would be sufficient. At present, around 35 million m³ of mainly domestically produced fuel is pumped per day, which is not enough to build up stocks to the level indicated by Vitrenko in two and a half months. At this point it is difficult to provide a clear forecast but, taking into account a possible reduction in gas consumption (the government is considering, among other things, lowering the minimum temperature in households from 20 to 16 degrees), even just under 15 billion m³ may be enough to successfully pass the heating season (in the 2021/2022 season, the country consumed 9.8 billion m³ from storage). The government's plans to stockpile 19 billion m³, on the other hand, seem unrealistic – both due to the very high gas prices on the EU market and its limited availability, caused by Russia's reduction in exports.

- No less of a problem than the potential fuel deficit is the damage to heat-generating installations and plants. As of 27 July, 343 boiler plants and eight heat-generating plants had been destroyed or damaged. The authorities are trying to carry out repairs on an ongoing basis, but in many cases this cannot be done due to the time-consuming nature and the ongoing hostilities. The government has earmarked ₴287 million ($7.8 million) for the renovation of three heat-generating plants (in Chernihiv, Kremenchuk and Okhtyrka) and ₴1.4 billion ($38.3 million) for the purchase of mobile boiler plants, generators, water purification systems and other equipment for use in emergency situations. According to local authorities, these funds are insufficient.

- There is a high risk that in the autumn, Russia will start deliberately destroying heat generation facilities across Ukraine, especially in major cities, in order to escalate the refugee crisis inside and outside the country. In addition, they may try to damage transport infrastructure. So far, this has only happened close to the front line, but on 25 July Gazprom increased the pressure on a transit pipeline near the Russian border without warning, which – without a quick response from the Ukrainians – could have led to a breakdown. It cannot be ruled out that missile attacks on gas infrastructure (e.g. compressor stations) could occur in the future in order to paralyse the national gas transmission system.
- Naftogaz's failure to repay the Eurobonds means that it will not be able to obtain external loans, primarily from the EBRD, and will shift the responsibility for its operation to the government. The Verkhovna Rada's adoption of a multibillion-dollar subsidy for the purchase of gas demonstrates how difficult Naftogaz's financial situation is. The necessity to sell gas to individual consumers and heat producers for the population at a price sometimes more than ten times lower than the market price creates a huge deficit, which will be an increasing burden on the Ukrainian budget.