

ENERGY SECTOR SHAKE-OFF FOLLOWING THE RUSSIAN INVASION OF UKRAINE



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Measures by Western countries to decrease their dependence on Russian energy

The invasion of Ukraine by Russia has disrupted production in many different industries and sectors, rippling through supply chains and exerting great upward pressure on prices while increasing supply/demand imbalances. The energy sector is one of the most emblematic sectors affected by this disruption, with potentially medium- to long-term consequences.

With Russia supplying around 16% of the world's natural gas and 11% of its oil, the global energy supply is being disrupted by international sanctions on Russian oil and gas and voluntary shifts in demand away from them. While the USA and the UK were the first to progressively ban oil and gas imports from Russia, the EU decided last month to phase out seaborne deliveries of Russian oil and petroleum products, amounting (with the inclusion of the commitment by Germany and Poland to renounce Russian deliveries via pipeline) to about 90% of total oil imports from Russia. The EU should eliminate Russian oil imports by sea by the end of the year. In addition, the UK and the EU have agreed a co-ordinated ban on insuring ships carrying Russian oil. In the case of gas, other major developments include the decision by Russia to stop deliveries to certain EU countries that have decided not to comply with Russia's request for gas payments to be made in roubles.

Medium- to long-term reorientation of trade flows expected

Besides putting more upward pressure on oil and gas prices in a deficit market, in a sector lacking recent investment (especially for oil), fossil fuel markets will be shaken and the crisis could lead to a large-scale reorientation of trade flows in the medium to long term.

In the case of oil, Russia has up to now managed to find buyers in China, India and Turkey to compensate, and Russian crude oil exports have even increased in comparison to the pre-war period. The trend of volumes swinging from west to east should be reinforced, since more than half of Russian crude oil, condensate and refined fuel exports go to the EU. However, in practice, the move is not straightforward. For example, many of the refineries in emerging markets in Asia lack the complexity to handle Russia's sour Urals grade. EU imports from Russia would be replaced by additional imports from other regions, mainly from the Middle East, with the same kind of technical difficulties.

In the case of gas, Russian gas availability is at risk in Europe if Russia decides to suspend all exports (further bans in the RUB-denominated gas payment dispute or as a retaliation against sanctions) or the EU places an embargo on Russian gas. An immediate and complete shut-off of Russian gas would be a new major shock for Europe, and for Germany in particular. The IMF World Economic Outlook for April suggests, for example, that the GDP loss in 2023 of a downside scenario – including a halt in Russian oil and gas exports – would be about 3% for the EU as a whole. In such an event, the impact per country would likely depend on each country's gas intensity and the importance of Russian gas imports in its domestic gas supply. Indirectly, since Germany is the industrial engine of the eurozone economy, a slowdown would occur in other countries in the region. In addition to finding alternative sources of gas or replacement energy, a significant cut in demand would be required next winter to

Even the European Commission's 'REPower EU' plan to progressively cut reliance on Russian gas would impact the region's economic activity. This plan indeed should allow for a decrease in imports of Russian gas (which are at about 155 billion cubic metres) by two thirds

by the end of the year, by boosting supplies from other sources and reducing the demand for gas from various sectors of the economy. Actually, the single largest replacement source of energy in the EU's plan would come from increased imports of LNG, which the EU hopes could replace a third of Russian imports (50 billion cubic metres). It predicts that demand for gas – mainly from households – would also be reduced.

An increase in LNG imports would mainly benefit Australia, the USA and Qatar. Yet, in order to reach the objectives of the EU plan in terms of increasing LNG imports – the core of the EU plan – many hurdles must be overcome, ranging from the robustness of the gas infrastructure to the misplaced geographical distribution of LNG terminals and pipelines and to whether it can actually obtain spare LNG supplies. As a result, it seems quite unlikely that the EU would receive the expected 50 billion cubic metres of LNG and energy experts warn that painful consequences – i.e. energy rationing and blackouts this winter – are almost inevitable if Europe wants to stick to its plan.

From the Russian point of view, finding alternative markets for gas would be more difficult than for oil, as the gas market is more regional (transit of natural gas through pipelines is not flexible, and Russia's LNG production capacity still lags far behind its rivals). While a switch away from Europe to Asia, and China in particular (in February, Beijing and Moscow announced a 30-year contract for Russia to supply China with gas via a new pipeline), is expected in some measure, it would be difficult to completely offset the potential loss of the EU market as the projects to adapt would require massive financing, which will be lacking.

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