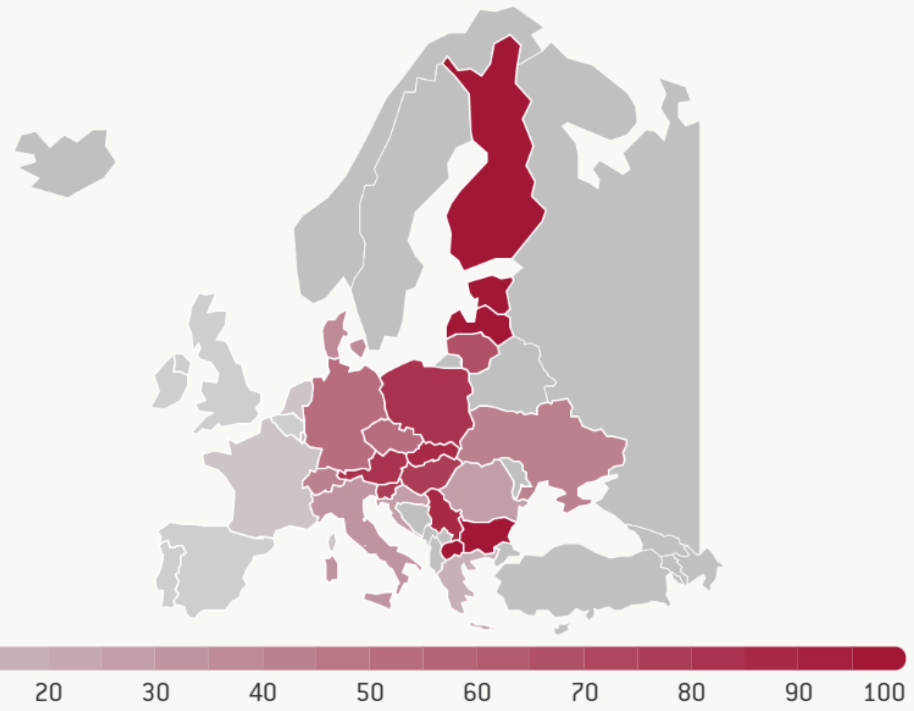
Don’t break the thermometer – fix the heating and the thermostat

Georg Zachmann, Senior Felow at Bruegel

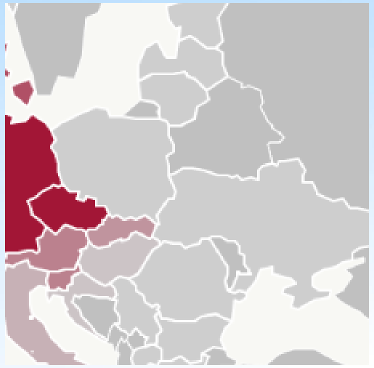
STOP IN GAS FLOWS

Figure 7: Share of Gas Imports from Country and Russian Pipeline in 2021

Russia (total)

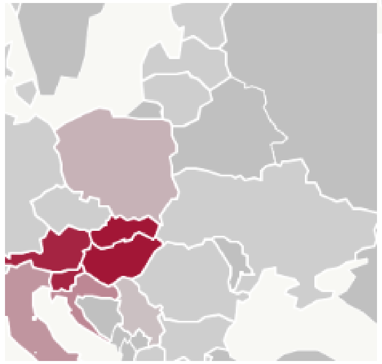


Source: Bruegel on ENTSO-G



Nordstream – closed since summer 2022

Yamal – closed since spring 2022



UGTS – at ~25% of last years

European Commission

EU PULLS A LOT OF “FREE” LNG

- EU+UK might get 85 bcm more from LNG than in the past years (160 bcm instead of 83 bcm)

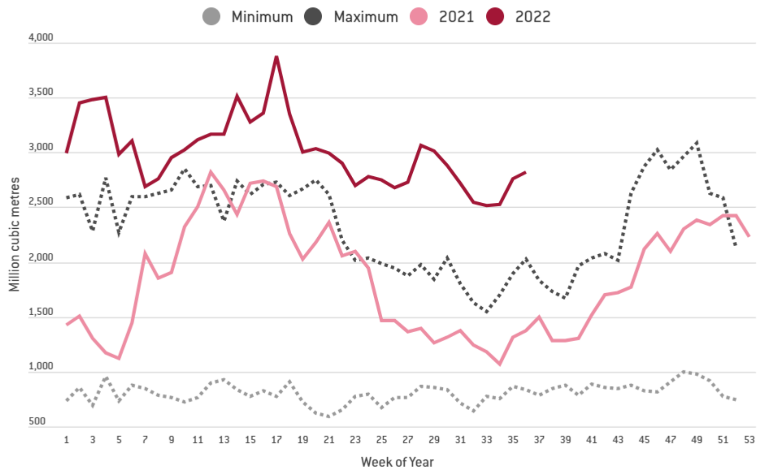
Average **weekly** EU+UK imports in bcm

	avgerage 2019-2021	2022	difference
RU	3.1	1.6	- 1.5
LNG	1.4	3.0	1.6

Source: Bruegel based on Entso-G data
Note: based on the first 36 weeks of the year

- Of a global LNG market of ~550 bcm
  - The shift represents about 15%
  - EU+UK total about 30%
  - And assuming half the mkt is long-term, this is ~60% of “free” LNG

Weekly LNG Imports into the EU+UK



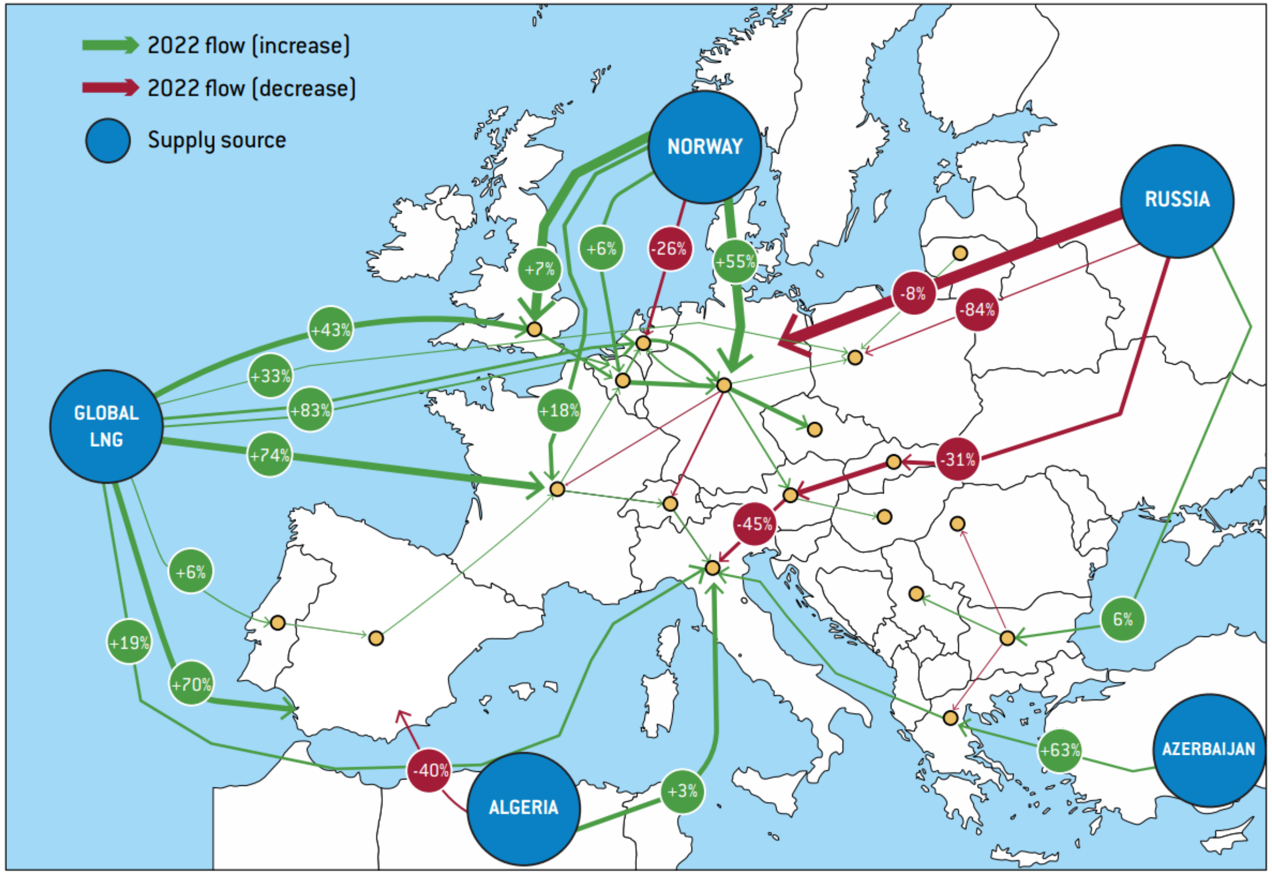
Source: ENTSO-G, https://transparency.entsog.eu/#/map
Note: Minimum and Maximum values are calculated from the period 2015-2020.
Data for the last week may be changed following updates to ENTSO-G points. As of 25/12/21, Norway imports at Emden were updated and Krk Croatian LNG was included resulting in changes to underlying data. On 01/04/2022, weeks 10,11,12 LNG data were revised downward due to a double-counting of Spanish LNG imports which arose as a result of changes to the reporting at the ENTSO-G transparency platform.

#EUSEW2022

European Commission

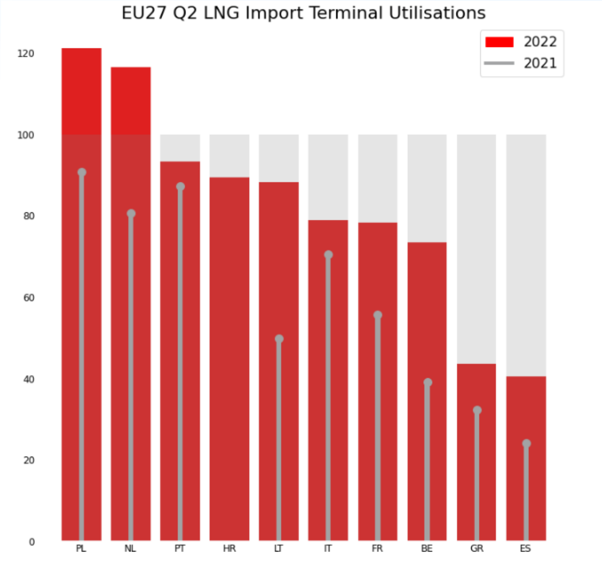
MARKETS DID A GREAT JOB IN ADJUSTING TO NEW SITUATION

Figure 1: Natural gas flows in the European market, first half 2022 vs first half 2021



Source: Arrows on the map show the largest flows of natural gas around the European market and selected smaller flows. Arrowheads indicate direction, while arrow width indicates size of 2022 flow. Natural gas flows in the European market, first half 2022 vs first half 2021

LNG terminals still have sparse capacity



GAS DEMAND REDUCTION IN THE REGION

Industry	Y-t-d	August
HU	-14%	-35%
PL	-25%	-48%
RO	-24%	-38%

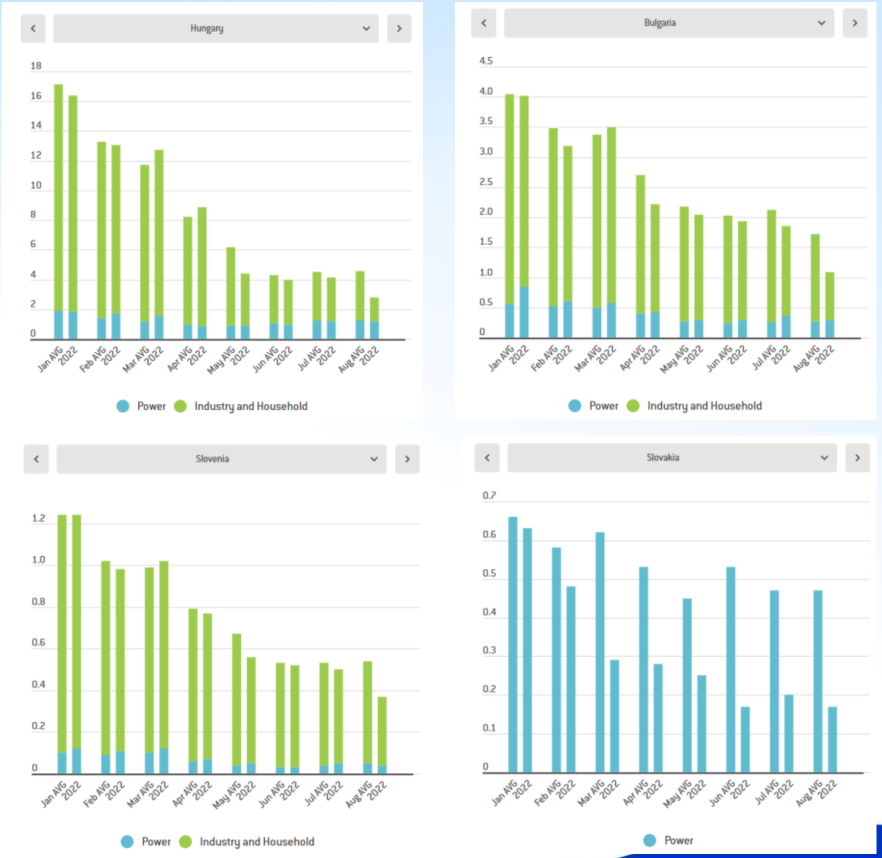
Strong decline in **industrial** gas consumption

Household	Y-t-d	August
HU	-1%	-9%
PL	-4%	-17%
RO	-4%	-5%

For **household** gas consumption we do not know – wait for heating season

Power	BG	CZ	HR	HU	PL	RO	SI	SK
Y-t-d	21%	-1%	40%	4%	-18%	9%	16%	-43%
August	7%	13%	43%	-6%	-49%	13%	-20%	-64%

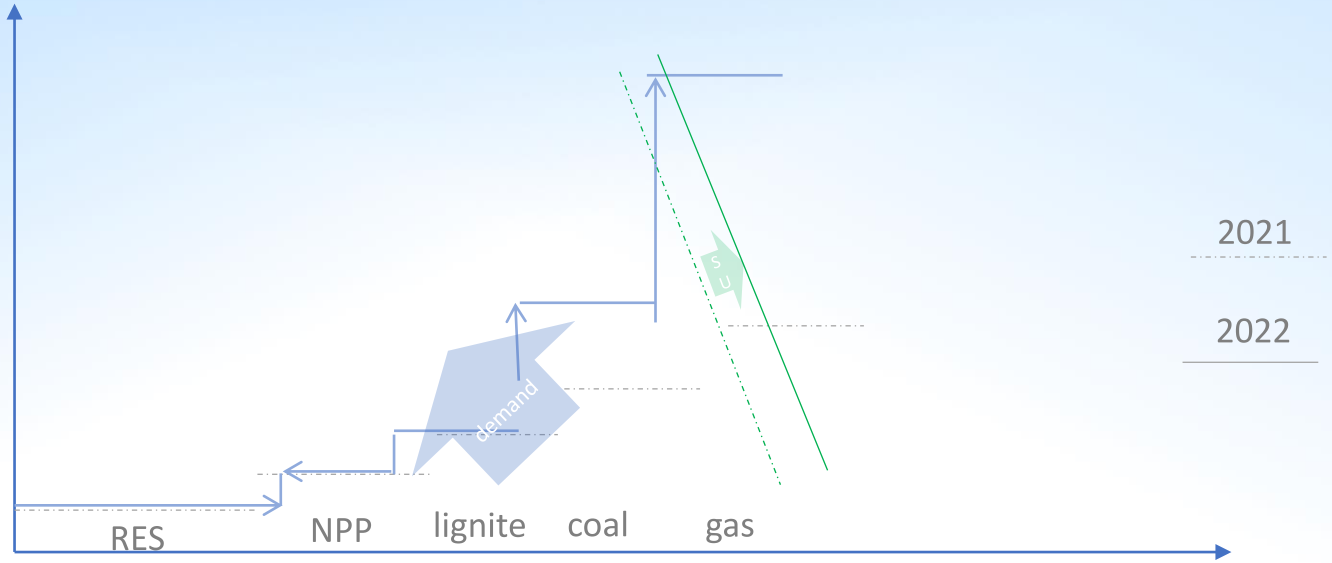
Very mixed picture in the **power** sector



ELECTRICITY SUPPLY CURVE MOVED LEFT AND UP – AND MAYBE DEMAND MOVED RIGHT

- Nuclear in August was 6% of EU consumption lower than in 2021
- Hydro another 3%

-> Higher gas and coal consumption despit higher fuel prices

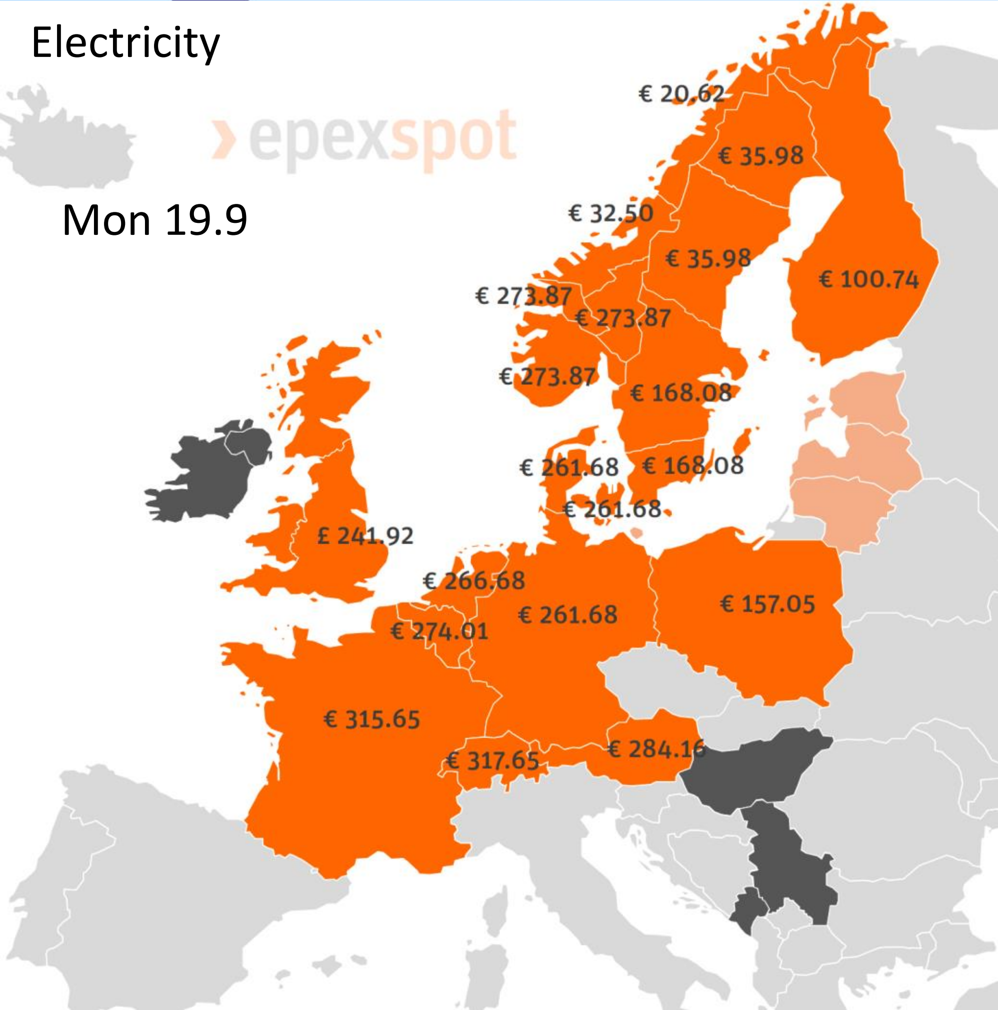


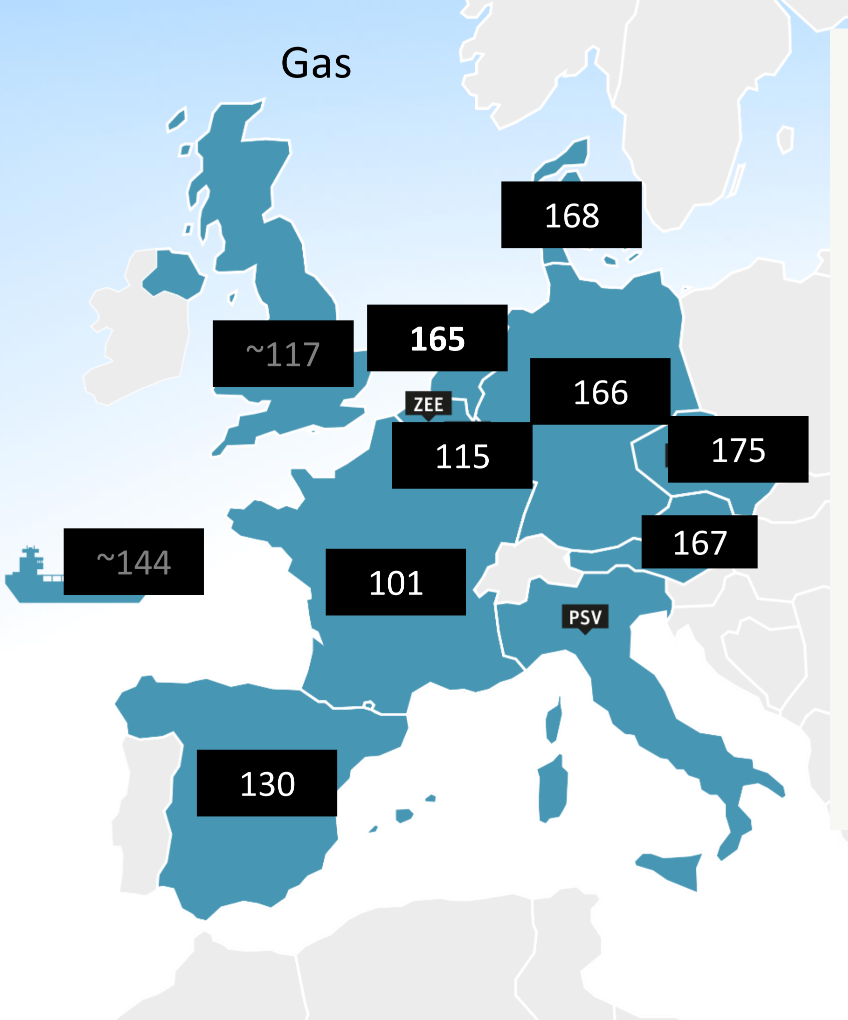
- Elec demand did not react
    - Y-t-d: **EU** elec demand decreased by 2% (superpeak by 1%)
    - Y-t-d: **DE** elec demand decreased by <1% (superpeak increased by 1%)

-> possibly, demand curve shifted right

#EUSEW2022

PRICES ALREADY SOMEWHAT "NORMALISED"





-> Can we relax?

- Prices are gradually trickling down to retail: Even an "only" five-fold increase will have drastic social/fiscal consequences
- Liquidity and stability risk in the energy-finance-nexus?

INTERVENTIONS IN THE PRICE MECHANISM - ISSUES TO BE AVOIDED

1) **Drive up demand** -> not lower prices for price-responsive consumers too much
2) **Reduce supply/imports** -> not lower prices in the range where suppliers are price-responsive
3) **Mute signals for cross-border exchange** -> not iron over justified regional price differences
4) **Mute signals for inter-temporal optimisation** -> not iron over justified intertemporal price differences
5) **Mute long-term investment signals** -> not increase risk/capital cost for future investors
6) **Ignoring the complexity of legacy contracts**
7) **Ignoring differences between member states** -> improve situation for everyone, avoid massive transfers

DILEMA IN THE INTERNAL MARKET

- **Benefits** of *bringing in supplies/reducing demand* **dilute in the common market**
- **Cost** of *bringing in supplies / reducing demand* are **felt strongly nationally**

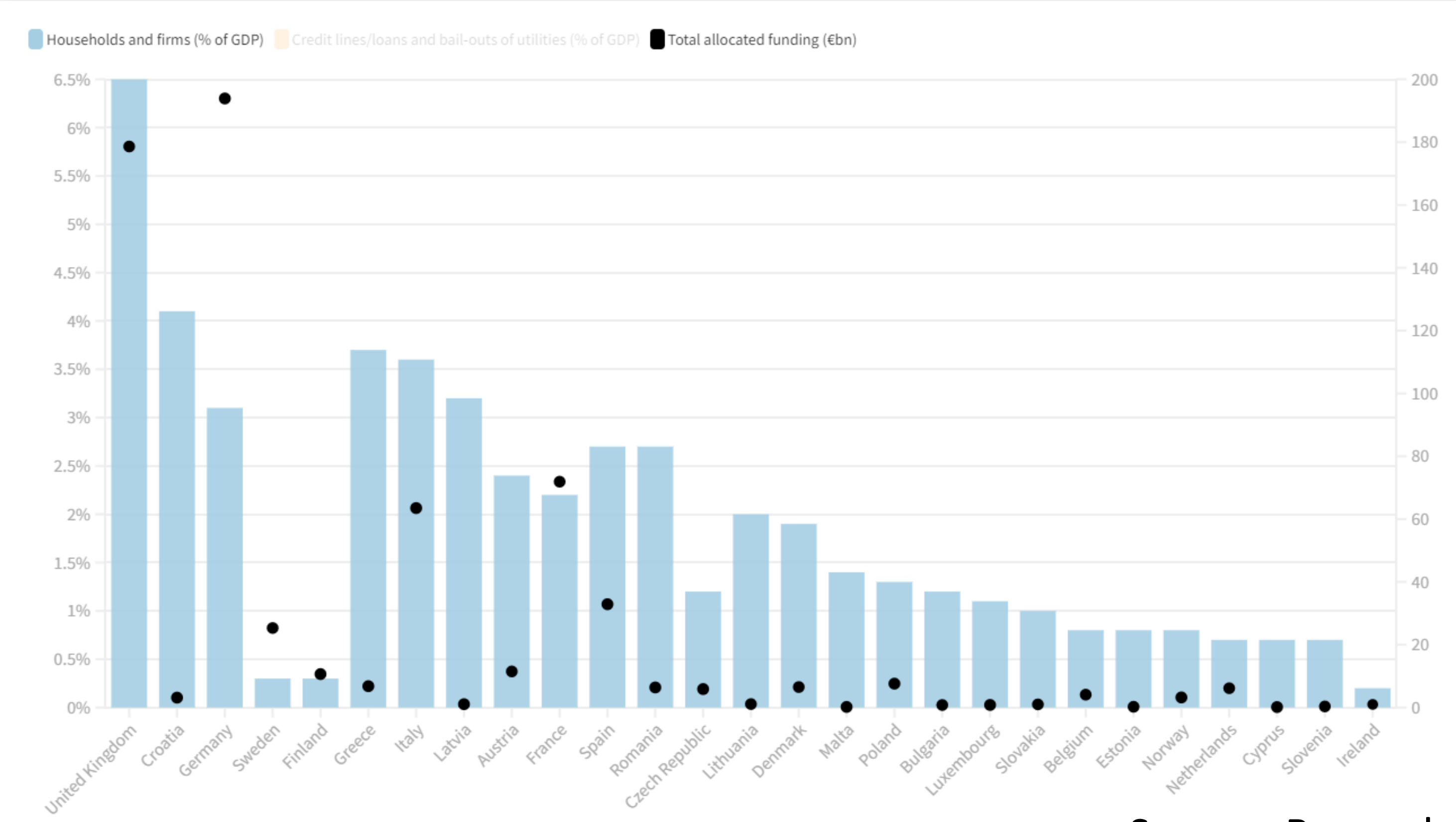
- **Subsidies** allow domestic consumers to outbid foreign consumers

- **Speeding-up investment** in alternative supplies **is very expensive** and **overinvesting** might even **reduce the future cash-flow**

- Massive incentives to *free-ride*, *beggar-thy-neighbour* and *wait-and-see*

SUBSIDIES FOR ENERGY CONSUMPTION IN MANY EU COUNTRIES

National support schemes for households and firms



Source: Bruegel

European Commission

Proposal: A “soft” Price Cap

HoSG agree that gas/elec price should stay below a certain level (eg on a quarterly basis not exceed 100/200€/MWh)

Akin to inflation-guidance of central banks!

They commit to coordinate to …

- enable politically locked **supplies** (joint purchasing of gas, NPP, …)
- reducing **demand** (moratorium on consumption subsidies)

… to achieve these values.

This allows keeping markets properly functioning,

and reduces import cost.

Policy Contribution
Issue n°10/22 | June 2022

How to make the EU Energy Platform an effective emergency tool

Walter Boltz
Klaus-Dieter Borchardt
Thierry Deschuyteneer
Jean Pisani-Ferry
Leigh Hancher
François Lévêque
Ben McWilliams
Axel Ockenfels
Simone Tagliapietra
Georg Zachmann

Executive summary

UNCERTAINTY ABOUT THE supply of Russian natural gas is causing extremely high and volatile European gas and electricity prices. European Union countries may struggle to import sufficient volumes of natural gas at reasonable prices. During the summer, the imperatives are to fill storage sites sufficiently in a coordinated manner and to organise sufficient import volumes to replace a substantial share of gas that might no longer come from Russia. Coordination is essential to ensure that disruptions during difficult winter months do not lead to a break-up of the EU internal gas market with potentially serious political repercussions.

PART OF THE EU response is establishment of an EU Energy Platform for the purchase of gas, LNG and hydrogen. This aims to pool demand to leverage the bloc's economic clout, international outreach to reliable partners and efficient use of existing infrastructure. EU leaders have backed the plan but it has not yet been translated into a feasible scheme.

THE PLATFORM SHOULD be developed into an effective emergency tool to safeguard gas supply in case Russian flows stop. We detail two complementary proposals to achieve this. First, there should be EU-wide auctioning of remuneration for filling storage sites in specific regions. Companies would remain responsible for all stages of the value chain, benefitting from remuneration and in return offering the market operator some control over how this gas is released during winter months. Second, EU demand for additional LNG quantities, and the sourcing of this on international markets, should be coordinated through a platform, creating a transparent market for these volumes.

THESE MECHANISMS WOULD resolve the prevention paradox and prevent free-riding. If EU countries buy gas jointly, they will find it much easier to let markets allocate scarce volumes across borders in case of a complete stop to Russian supplies. This would reduce the risk of energy market fragmentation, as well as the subsequent energy security, economic and political impacts of a shock that would hit member states very differently.

Walter Boltz is a Senior European Energy Adviser; Klaus-Dieter Borchardt is a Senior Visiting Research Fellow, Oxford Institute for Energy Studies; Thierry Deschuyteneer is an independent consultant; Jean Pisani-Ferry is a Senior Fellow at Bruegel; Leigh Hancher is a professor at the University of Tilburg; François Lévêque is a professor at Mines Paris-PSL; Ben McWilliams is a Research Analyst at Bruegel; Axel Ockenfels is a professor at the University of Cologne; Simone Tagliapietra is a Senior Fellow at Bruegel; Georg Zachmann is a Senior Fellow at Bruegel.

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