

Under Pressure: The Global Implications of a European Gas Crisis

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Russia's weaponization of natural gas supply to Europe has, in our view, ignited a supply shock that will exacerbate a global competition for scarce resources.

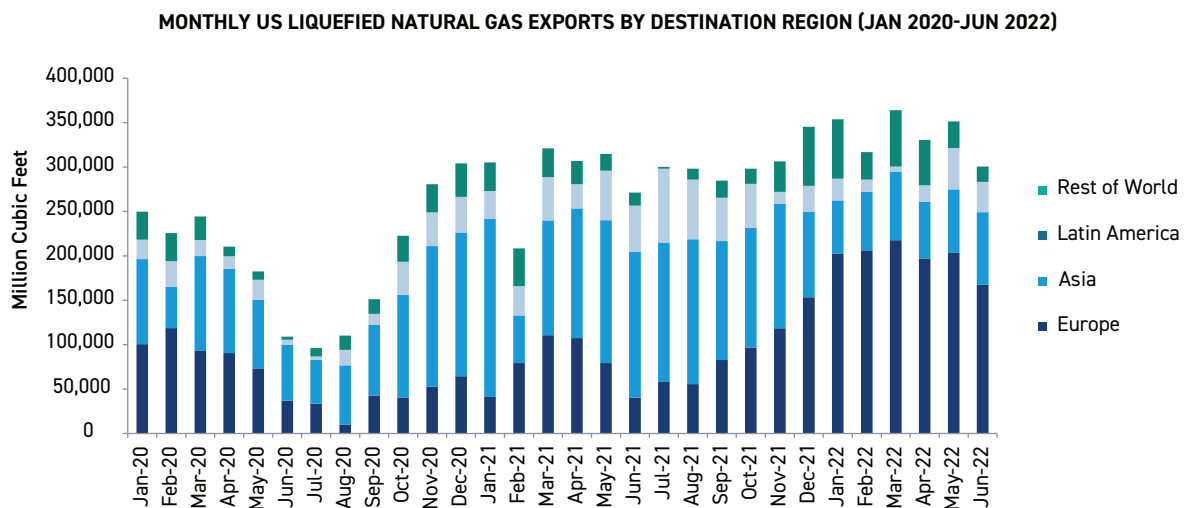
Markets seem to appreciate the potentially serious consequences of a shutoff—gas prices have climbed sharply in recent weeks—but we believe markets are currently underpricing the possibility of prolonged economic disruption and structural change in the world's trade and energy relationships. There are multiple points of interaction and overlap with efforts to reduce greenhouse gas emissions. In this paper we will explain how this shock could ripple throughout the globe.

A Global Competition for Limited Gas Supply

We believe markets may be taking comfort—perhaps too much comfort—from the fact that Europe has built up its storage stocks to normal seasonal levels. However, we think the challenge for Europe is more than filling storage tanks or reducing consumption during this difficult transition. Our view, one shared by many, is that Europe needs considerable changes in its energy supplies—both in terms of diversifying its gas suppliers and the mix of energy it uses. We see this as a serious shock for Europe and the challenge of finding new energy supplies will likely take years to address.

In the scramble for gas supply, we expect the competition to favor the highest bidder. Buyers are at the mercy of the marketplace because most gas is typically purchased on the spot market. Even where there are contracts in place, producers can choose to break them, sell at a higher price and still profit after paying the penalties. Recently, Europe has outbid other countries and upped its share of global liquid natural gas imports at the expense of Asia and the developing markets.

EUROPE HAS SIGNIFICANTLY INCREASED ITS SHARE OF US LIQUEFIED NATURAL GAS SUPPLY

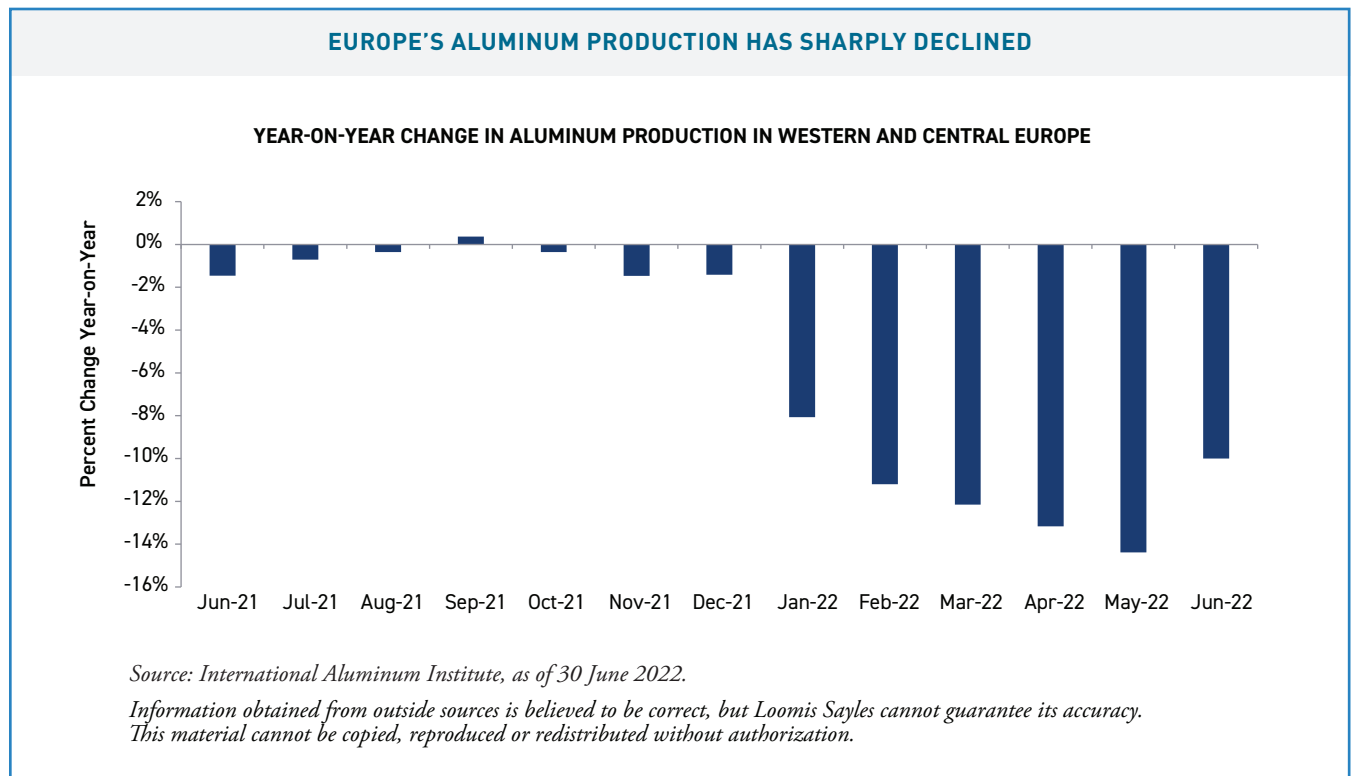


Source: US Energy Information Administration (EIA), as of 30 June 2022. Note: Europe includes Turkey.

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The Impact of Industrial Cutbacks

If buyers are unable to get gas, a likely possibility, it could force cutbacks in demand, whether voluntary or mandated. A number of Europe’s big producers of ammonia, a key ingredient in fertilizer, have already scaled back output in response to high gas prices. This is a highly visible example, given the central role of gas in the ammonia production process and the attention given to some of the first corporate announcements. Much of the impact of the shortage could be more opaque, becoming apparent at points further along the supply or production line. And many of these lines are highly globalized, and within Europe often have complex, cross-border linkages.



As we saw during the pandemic, reduced production in one location can gum up the works everywhere. When it comes to the global supply chains and production processes, there are few islands of self-sufficiency. We believe that industrial cutbacks in Europe and elsewhere could cause widespread and unpredictable supply chain disruptions that ripple across the globe.

PRICE PAIN

As businesses look for ways to reduce their dependence on natural gas, we expect them to bid up prices for oil, diesel fuel, coal and electricity, which could potentially turn a gas crisis into a larger energy crisis.

There's also potential for inflation stemming from supply chain bottlenecks, as we witnessed in the aftermath of the COVID-19 shutdowns. For countries already dealing with elevated global food prices, the effects could be devastating. For more on possible food supply risks, watch our video: [Ukraine and Food Scarcity Fears: Myths vs. Reality](#).

THE PATH FORWARD

While much attention has been focused on the short-term problem—getting enough gas to last through the winter—we anticipate long-lasting repercussions from Russia's war with Ukraine.

In our view, the conflict has precipitated a long, multi-year effort to reorder the world's energy and trade relationships. The global energy market was already tight, experiencing significant secular changes due to climate change, but Russia's actions appear to have accelerated the process. This shift is widely considered to be an expensive, difficult prospect. Europe in particular faces a significant transformation that would likely take years, with a profound economic impact.

The emergence of less-integrated economic spheres recalls in some ways the Cold War. But economies in the current-day environment tend to be linked in far more complex ways—both in terms of production processes and financial activities. We believe this shift in the economic order is not likely to manifest itself in market pricing in a matter of days or weeks, but instead could shape asset prices in a dynamic manner—both in Europe and globally.

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