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IENE Comment

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*By Irina Slav**

Winter is coming to Europe and this time, forecasts say, it may not be as mild as it was the last two years. This means demand for natural gas will increase more strongly than in 2022 and 2023. For two years, Europe lucked out on the weather. Not this year, it seems. And the continent is about to lose its last conduit to Russian pipeline gas. But it won't lose its dependence on gas.

The gas transit contract between Gazprom and Naftogas expires at the end of this year. The government in Kiyv has stated it has no interest in renewing it. While Russian pipeline gas flows have dropped precipitously in the last two years, the Ukrainian pipelines supplied significant volumes to Hungary, Slovakia, and Austria. Now, these countries will need to find alternatives—and the rest of Europe will need to ramp up LNG imports to ensure supply, even with fuller than usual storage.

The reason for this, although politicians are reluctant to admit it, is that wind and solar perform worse during the winter months. Solar installations commonly see a 50% or more declines in output during this season and wind droughts are not uncommon when the thermometer dips below zero. But demand for electricity increases in winter, for heating purposes, meaning demand for gas in Europe will increase—at the same time as demand for gas in Asia also jumps for the same seasonal reasons. Gas prices are about to climb higher. Possibly much higher. That's not good news for Europe and options are very limited.

Norway has replaced Russia as the top single supplier of natural gas to the European Union. But Norway cannot ramp up its production fast enough or strongly enough to absorb the seasonal increase in European demand. Nor would it want to, in light of Brussels' medium- to long-term plans to reduce its reliance on gas for power generation. Regardless of the feasibility of these plans, Norwegian producers are not going to invest in production expansion when they are on the table.

LNG has replaced much of the Russian gas flows but LNG is tricky as Europeans discovered as early as winter 2022. LNG is traded internationally on the spot market, where prices are dictated by immediate demand. That made the LNG that Europe rushed to import in 2022 eye-wateringly expensive, prompting some politicians to lash out at American LNG exporters calling them greedy. Sometimes running into market realities can be a painful experience.

LNG will continue to be the main accompaniment to Norwegian gas for Europe in the

observable future. Discussions about replacing Russian gas with gas from Azerbaijan are ongoing but there is a certain awkwardness about this deal, because Azerbaijan simply doesn't produce enough gas to replace all Russian flows. So, some Russian gas would need to keep coming into Europe, which Europe does not want on general principles. Europe would rather pay for expensive LNG than Russian pipeline gas—including Russian LNG, by the way, which is another thing politicians don't like to talk honestly about because it highlights the continent's gas dependence even more starkly.

So, European gas prices are once again set for a surge if weather forecasts for this winter turn out to be right. Prices, however, would affect demand, just as they did in the past two years, mild winters and all. This price-driven demand destruction would deepen the economic deterioration of Europe, and this is not something political elites are looking forward to eagerly.

That's exactly why Russian LNG imports are going strong even as leaders in Brussels and national capitals scrunch their noses and call for sanctions on the superchilled fuel. For all the talk about degrowth from the European Commission and selected climate NGOs, deterioration does not look good on an economy.

So, how does Europe solve its gas problem? For starters, acknowledging the problem would be a good idea. An even better idea would be to stop pretending that natural gas can be entirely replaced by even more wind and solar, so we can have even more useless panels and turbines for the cloudy, still winter weeks. Then it might be an excellent idea to start thinking about some more long-term gas contracts with U.S. exporters, Qatar, and, yes, Russia.

In the past two years, the European Union took the moral high ground without thinking, only to make a fool of itself by slamming Russia for retaliating against the barrage of sanctions by turning off the gas taps. Then it continued making a fool of itself by importing growing volumes of Russian LNG while boasting a reduced reliance on Russian gas. In some circles, this would be called hypocrisy. It would also be called unwise and unproductive.

Europe has a gas problem. There is much demand, especially in winter, and little local supply. This necessitates some long-term planning on the part of politicians as well as the admissions of some tough truths, chief among them the fact that prioritising emissions over economic health is a recipe for an expensive disaster.

** Energy Journalist and Contributing Editor, IENE Newsletters*

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3, Alex. Soutsou Str. 106 71 Athens, Greece, T: +30-210 3628457, 3640278, F: +30 210 3646144, marketing@iene.gr, www.iene.eu

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