

SEE ENERGY BRIEF

Monthly Analysis

Europe Caught Between Two Wars Struggles
to Meet Rising Costs



Introduction

Europe is once again confronting a serious energy security challenge as escalating hostilities between the United States and Iran coincide with the continuing war in Ukraine. Disruptions around the Strait of Hormuz, attacks on shipping in the Red Sea and repeated strikes on Russian energy infrastructure are placing additional pressure on an already strained global energy system. Oil and natural gas prices have risen sharply, while concerns over declining inventories, constrained shipping routes and insufficient gas storage are intensifying fears of a broader economic shock. At the same time, European government bond markets are coming under pressure as borrowing costs rise, raising concerns about the fiscal consequences of prolonged energy-driven inflation. (1)

For Europe, the timing is particularly difficult. The continent has spent the past several years reducing its dependence on Russian pipeline gas and attempting to strengthen its energy resilience through LNG imports, renewable generation, new interconnections and demand reduction. Yet the current crisis illustrates that replacing one source of vulnerability with a more diversified but highly interconnected global energy system does not eliminate risk. Europe remains exposed to developments far beyond its borders, from geopolitical tensions in the Middle East to disruptions in Russian refining and maritime trade. If these pressures persist into the winter, the consequences could extend well beyond energy markets, affecting inflation, industrial competitiveness, household finances, monetary policy and economic growth. (2)

A New Energy Shock

Europe is once again entering dangerous energy territory. The simultaneous escalation of US-Iran tensions and the continuing conflict in Ukraine are creating a combination of supply disruptions, rising prices and geopolitical uncertainty that European governments and markets may find increasingly difficult to contain. What initially appeared to be another temporary shock to international energy markets is beginning to resemble a more structural challenge to Europe's energy security.

Developments in the Middle East have been particularly damaging. Renewed hostilities between the United States and Iran around the Strait of Hormuz have heightened concerns that oil and LNG shipments from the Gulf could remain severely restricted. Brent crude has moved towards \$107 a barrel, roughly 58% higher on an annual basis, while European natural gas prices at the TTF hub have approached €73/MWh, more than twice their January level. (3)

The central problem, however, is not merely the price of energy but its physical availability. Although Washington has repeatedly maintained that the US Navy has established effective control over the Strait of

Hormuz, commercial shipping through the waterway remains severely constrained. Vessel-tracking data indicate that only a small number of ships are currently making the passage. On August 31, only four vessels were reported to have transited the Strait, compared with a ten-day average of approximately 13 and roughly 130–140 vessels a day before the conflict (4). Although at the end of September the situation had improved with 15-18 vessels passing through the Straits daily and transporting some 7.4 million barrels of oil per day.

Figure 1: Brent Crude Oil Price (\$/barrel) Over the Last 1 Year



Sources: ICE, Financial Times

Figure 2: Dutch TTF Natural Gas Futures (€/MWh) Over the Last 1 Year



Source: ICE

That decline illustrates the scale of the disruption. The Strait of Hormuz is one of the world's most important energy corridors, carrying a significant proportion of global oil and LNG shipments. Even when Gulf producers retain the ability to produce oil and gas, restrictions on shipping prevent them from restoring exports to normal levels.

The International Energy Agency (IEA) has warned that global oil supplies remain severely constrained. According to its August Oil Market Report, approximately 8.3 million barrels per day of Gulf production

remained shut in during July, while global oil supply remained 6.3 million barrels per day below the previous year's level. (5)

The Red Sea Adds Another Vulnerability

The energy crisis is being compounded by continuing attacks on commercial shipping in the Red Sea, disrupting one of the world's most important maritime corridors. The Bab el-Mandeb Strait connects the Red Sea with the Gulf of Aden and provides a critical gateway towards the Suez Canal, linking energy-producing regions in the Middle East and Asia with European markets. The security risks have encouraged many shipping companies to avoid the area and redirect vessels around the Cape of Good Hope. Although this reduces the risk of attacks, it adds thousands of nautical miles to some voyages, increasing fuel consumption, insurance premiums, crew costs and delivery times.

The consequences extend beyond higher freight costs. Longer voyages reduce the effective capacity of the global tanker fleet because individual vessels spend more time transporting each cargo and therefore complete fewer journeys. This means that even if global oil and gas production remains relatively stable, the amount of energy that can be transported efficiently to consuming markets may decline. The distinction is critical for Europe: an energy shortage does not necessarily mean that the world lacks physical resources; it can also arise because available supplies cannot reach the right markets at the right time. A disruption to transportation infrastructure can therefore create regional scarcity, forcing buyers to compete more aggressively for alternative cargoes and pushing prices higher.

The Red Sea problem becomes considerably more serious when combined with disruption around the Strait of Hormuz. These two maritime chokepoints are strategically interconnected. Hormuz is essential for the export of Gulf oil and LNG, while the Red Sea–Suez route provides an important corridor for transporting energy and other commodities towards Europe. A disruption at Hormuz restricts the availability of Gulf energy at its source, whereas disruption in the Red Sea restricts the routes through which international trade can move. If both chokepoints remain impaired simultaneously, the global market loses much of its ability to redirect supplies quickly when disruptions occur. The resulting loss of logistical flexibility can amplify the original supply shock.

The impact could be particularly significant for Europe because the continent has become increasingly dependent on seaborne energy imports following the reduction of Russian pipeline supplies. Europe has diversified its suppliers, but diversification of suppliers does not automatically mean diversification of transport routes. LNG illustrates the problem particularly well. European buyers increasingly compete in a global market in which cargoes can be redirected towards Asia or other regions offering higher prices. If Middle Eastern LNG exports are disrupted while Asian demand remains strong, European importers may

have to compete for supplies from the United States and other producers, potentially driving European gas prices substantially higher. The same pressures can affect diesel, jet fuel and other refined products that Europe imports through complex international supply chains.

The deeper lesson is that energy security is not simply a question of production. It is also a question of logistics, infrastructure and geopolitical stability. Europe may now have a more diversified portfolio of energy suppliers than it did before the energy crisis triggered by the war in Ukraine, but its dependence on a limited number of maritime chokepoints leaves it vulnerable to external shocks. The Red Sea disruption can therefore generate a wider economic chain reaction: higher shipping and insurance costs raise energy prices; higher energy prices increase production and transportation costs; and these pressures feed into inflation and weaken the competitiveness of European industry. For Europe, the central question is no longer simply whether sufficient oil and gas exist on global markets, but whether those supplies can reach European consumers reliably, securely and at a price that households and industries can afford.

Inflation Meets Weak Economic Growth

The current energy shock is arriving at an especially difficult moment for Europe. The continent has already experienced an exceptionally challenging summer, while rising energy prices are feeding directly into consumer inflation. Eurostat's latest flash estimate shows that euro-area annual inflation rose to 3.3% in August 2026, from 2.9% in July, while energy inflation accelerated to 14.3%, compared with 10.3% in July (6). This combination of high energy costs and fragile economic growth could prove particularly damaging. European households remain highly sensitive to electricity, gas and transport prices, while energy-intensive industries are already facing intense international competition. The effects of higher energy prices extend far beyond household utility bills. Energy is an essential input into transportation, manufacturing, agriculture, chemicals, construction and services. A sustained increase in oil and gas prices therefore raises costs throughout the economy, creating both direct and indirect inflationary pressures.

The ECB's Difficult Policy Dilemma

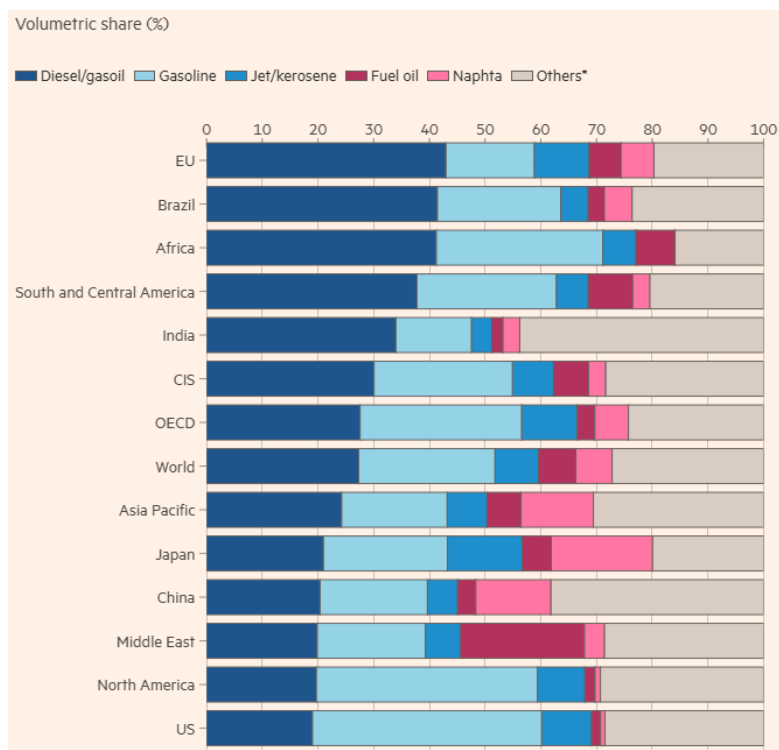
The European Central Bank (ECB) faces an increasingly complicated policy environment. Higher energy prices could keep inflation elevated for longer, potentially requiring monetary policy to remain restrictive at a time when European economies are already struggling to generate strong growth. This creates a difficult trade-off. Businesses would benefit from lower interest rates to support investment, while households and governments would also prefer lower borrowing costs. Yet an energy-driven inflation shock could make monetary easing more difficult. The danger is that Europe could find itself trapped between weak growth and persistent inflation—a combination that would leave policymakers with considerably less room to respond to either problem.

Ukraine and the Growing Refining Problem

The war in Ukraine is increasingly affecting global energy markets not only through disruptions to crude oil production and exports, but also through damage to Russia's refining infrastructure. Ukrainian drone and missile attacks have repeatedly targeted Russian refineries and oil-processing facilities, seeking to reduce Moscow's ability to generate revenue from energy exports and to disrupt supplies to the domestic market. The effects are becoming increasingly visible. Reuters reported that Russian seaborne oil-product exports fell by 33.3% in July compared with June and by 54.7% compared with July 2025, following attacks that forced several refineries into unplanned shutdowns. (7)

The importance of these attacks extends well beyond Russia's borders because refining capacity cannot be replaced as easily as crude-oil production. A refinery converts crude into products such as diesel, gasoline and jet fuel, which are essential to transportation, agriculture, aviation and industry. The IEA reported that global refinery crude throughput in July remained nearly 5 million barrels per day below the level of a year earlier, while attacks on Russian refineries and continuing disruptions in the Middle East led it to reduce its estimate for Q3 2026 refinery runs by a further 370,000 barrels per day. This creates an important distinction in the present crisis. The world may have access to crude oil, but insufficient refining capacity can still produce shortages of the fuels that consumers and businesses actually require.

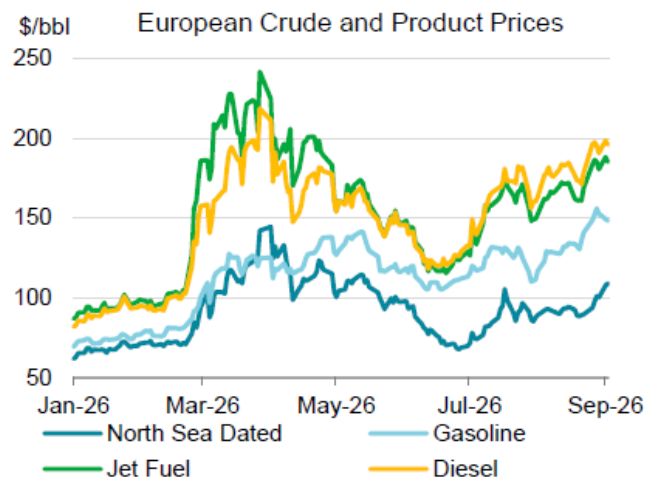
Figure 3: Diesel and Gasoil Dominate EU Petroleum Consumption



Source: Financial Times

Diesel is particularly vulnerable. Russia has historically been a major exporter of refined petroleum products, while European markets remain heavily dependent on international trade in diesel and other middle distillates. The IEA estimates that diesel exports from Russia, the Middle East and Asia were 1.3 million barrels per day lower year-on-year, equivalent to around 1/5 of global seaborne diesel trade. Jet-fuel exports from the same regions were also approximately 670,000 barrels per day lower than a year earlier. The consequences are already visible in global markets. Reuters reported in early September that diesel supplies are expected to remain tight through the winter, with limited refining capacity and geopolitical disruptions placing sustained pressure on inventories and prices. (8)

Figure 4: European Crude and Product Prices



Source: IEA

Russia itself is also increasingly affected by the disruption. Repeated attacks have reduced domestic fuel production sufficiently to generate shortages and force Moscow to restrict exports. By late August, Russian gasoline production had fallen to roughly 70% of domestic demand, according to Reuters, following attacks and emergency shutdowns at several refineries (9). Russia subsequently extended restrictions on diesel exports through September 30, while broader restrictions on gasoline and other petroleum products were also maintained (10). The resulting situation illustrates the paradox of the current energy crisis. Russia remains one of the world's largest oil producers, but damage to its refining system is limiting its ability to transform crude into usable fuels and to supply both domestic and international markets.

For Europe, the implications are particularly serious because Russian refinery disruptions are occurring simultaneously with the loss of Middle Eastern refining and export capacity. In its August Oil Market Report (5), the IEA has warned that increasingly tight product markets have pushed refining margins sharply higher, with diesel, jet fuel and gasoline particularly affected. Europe must therefore compete more aggressively for refined products from alternative suppliers precisely when global refining capacity is already under pressure. This could translate into higher diesel and transport costs, more expensive agricultural production, rising

logistics costs and renewed inflationary pressure. The Ukrainian attacks may therefore be strategically effective in weakening Russia's energy infrastructure, but they also contribute to a broader global shortage of refined fuels. For Europe, the central concern is that the energy crisis is no longer simply about securing crude oil and natural gas. It is increasingly about securing the refining capacity and refined products needed to keep the European economy functioning.

Europe's Gas Storage Problem

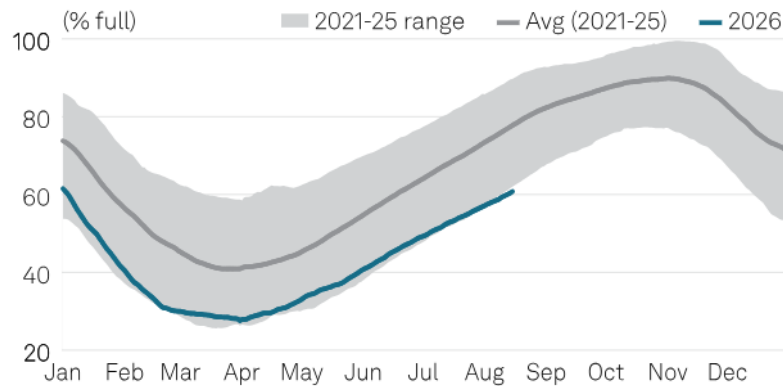
Europe is approaching the 2026-2027 winter heating season with an unusually weak gas storage position, creating a new source of vulnerability at precisely the moment when international gas markets are under severe geopolitical pressure. According to Gas Infrastructure Europe (GIE) (11), EU gas storage facilities were only 66.9% full on September 7, equivalent to about 757 TWh of stored gas. This is exceptionally low for the time of year and leaves Europe with considerably less of the traditional winter buffer than it would normally have. The problem is particularly acute in Germany, where storage was only 54.5% full, while the Netherlands was around 50% and Austria approximately 67%. These figures matter because underground storage is one of Europe's principal mechanisms for balancing fluctuations between supply and winter demand.

The low storage levels are not simply the result of weak preparation by individual countries. They reflect a much broader change in the economics of the European gas market. High gas prices during the summer have made it considerably more expensive for energy companies to purchase gas for injection, reducing the commercial incentive to rebuild inventories rapidly. At the same time, Europe's ability to replenish storage has been constrained by exceptionally strong competition for LNG. The disruption of Middle Eastern LNG supplies, particularly from Qatar, combined with strong Asian demand during the summer, has diverted cargoes away from Europe and pushed the continent into a much more competitive global market. Reuters reports that European benchmark gas prices recently reached their highest level since January 2023, while Germany's storage position has fallen to its lowest level in 15 years. The result is a vicious circle: high prices discourage storage injections, low storage increases market anxiety, and that anxiety contributes to further price volatility. (12)

Germany illustrates the strategic problem particularly clearly. As Europe's largest economy and one of its largest gas consumers, Germany's storage position has important consequences for the wider European market. Its facilities were only about 53%-55% full in early September, substantially below normal seasonal levels (13). German storage operators have warned that reaching the required winter preparedness levels will be difficult, while the German Economy Ministry has argued that an immediate physical supply crisis is not currently expected because the country has diversified its sources of supply since 2022. Germany can

now draw on Norwegian pipeline gas, LNG terminals and imports through neighbouring countries—options that were far more limited during the 2022 crisis. This distinction is important. Low storage does not automatically mean that Europe will run out of gas. The immediate danger is more likely to be a combination of high prices, reduced flexibility and greater exposure to sudden supply disruptions.

Figure 5: EU Gas Storage Fill Trails Recent Years



Source: Gas Infrastructure Europe

The European Commission has similarly concluded that there is no immediate EU-wide security-of-supply risk, emphasizing that Europe is better prepared than it was before the 2022 energy crisis. The Commission points to greater diversification of suppliers, expanded LNG import capacity and permanently lower gas demand as important sources of resilience (14). European gas consumption has indeed fallen substantially since the pre-2022 period, while renewable electricity generation has reduced the amount of gas required for power production in many periods. Nevertheless, this improved resilience should not be confused with immunity. A prolonged disruption of LNG supplies, an exceptionally cold winter or a period of weak wind and solar generation could rapidly increase gas demand and accelerate withdrawals from storage. In such circumstances, the lower starting inventory would leave European countries with a smaller margin for error.

The real significance of Europe’s gas storage problem, therefore, lies in the loss of flexibility rather than an imminent physical shortage. Storage acts as an insurance mechanism. It allows Europe to absorb temporary disruptions, respond to cold-weather demand and avoid having to purchase all additional gas on the spot market at whatever price happens to prevail. Entering winter with inventories around 67% full means that this insurance cushion is weaker than usual. If geopolitical tensions continue to restrict LNG supplies and Asian buyers remain aggressive competitors, Europe could face sustained pressure on gas prices even without a formal supply emergency. For European households and industry, that could be almost as damaging as a physical shortage, because persistently expensive gas would feed into electricity prices, industrial production, fertilizers, chemicals, transport and inflation. The central challenge for Europe is consequently not simply to fill its storage facilities before winter, but to build an energy system in which

storage, LNG infrastructure, pipeline diversification, renewable generation, nuclear and other reliable forms of electricity generation work together to provide resilience against prolonged geopolitical shocks.

The Alienation of EU Energy Policy From the Real Problem

The central weakness in the EU's current energy-policy debate is the growing distance between policy priorities and the structure of the economy that those policies are meant to serve. Europe continues to place strong emphasis on renewables, electrification, batteries, and the expansion of clean-energy technologies, while the immediate problem is broader: the cost, availability, and security of the energy that actually powers European industry, transport, heating, agriculture, and logistics.

Oil and gas remain deeply embedded in these sectors, directly as fuels and indirectly through petrochemicals, fertilizers, manufacturing, shipping, aviation, and the wider supply chain. Treating the energy transition primarily as a question of installing more renewable capacity risks overlooking the reality that Europe cannot simply substitute hydrocarbons with electricity on the timetable implied by policy targets.

But for renewables to be truly effective, Europe needs a fully or nearly complete electrified energy system, which currently lacks. And it will take several decades to develop that and at very high cost. The key question therefore is if European consumers are really willing to sustain such a cost which undoubtedly will translate in even higher electricity and gas bills?

EU energy planners must at last face the hard facts of Europe's exceedingly high dependence on oil and gas imports (they cover more than 60% of energy demand). The only realistic response is to fast track exploration and production of indigenous hydrocarbon reserves so that in few years Europe can at least cover a small but significant share of oil and gas needs from domestic production. [\(15\)](#)

This creates a disconnect between the transition narrative and the economic pressures experienced by households and businesses. More wind and solar capacity can reduce dependence on fossil generation over time, but it does not by itself resolve Europe's exposure to oil and gas prices, nor does it automatically provide the firm energy, storage, grids, fuels, and industrial inputs required by a modern economy. Batteries can help balance an increasingly electrified power system, but they cannot substitute for oil in aviation, shipping and much of heavy transport, nor can they replace natural gas and petroleum-derived products across industrial processes. The result is a policy framework that can appear highly focused on the technologies of the future while paying insufficient attention to the energy system Europe actually operates today.

The issue, therefore, is not whether Europe should develop renewables or storage technologies, but whether energy policy is sufficiently grounded in the full scale of the problem. A credible strategy has to address affordability, security of supply, industrial competitiveness and decarbonisation simultaneously, rather than assuming that rapid deployment of renewables and batteries will resolve all four. Europe's dependence on oil and gas will not disappear simply because policy documents give greater prominence to renewables; it will decline only as viable alternatives become available across the sectors that currently depend on hydrocarbons. Until that distinction is reflected more clearly in policy, the EU risks treating the energy transition as primarily a technology-deployment exercise while businesses and consumers continue to confront the much more immediate problem of expensive and insecure energy.

Rising Costs to Consumers

The rising cost of energy is increasingly being felt directly by European consumers, through higher electricity and heating bills as well as more expensive transport, food and everyday goods. For households already facing pressure on their purchasing power, energy costs have become a broader cost-of-living issue. The EU's response has largely focused on helping Member States cushion the immediate impact, including encouraging targeted support for vulnerable consumers, subsidies and reductions in energy-related taxation. These measures can provide short-term relief, but they also raise a fundamental question: are they addressing the underlying causes of high energy costs, or primarily compensating consumers for them?

There is a particular contradiction when subsidies and tax reductions lower the effective price of fossil-fuel consumption. By making petrol, diesel, natural gas or other energy products cheaper for consumers, governments may reduce the immediate burden of high prices, but they can also weaken the incentive to consume less. In effect, public money and foregone tax revenue can help sustain demand for oil and gas precisely when Europe is seeking to reduce its dependence on them. This creates a difficult policy cycle: high prices generate political pressure for subsidies and tax relief; subsidies and lower taxation support continued consumption; and continued dependence on imported hydrocarbons leaves consumers exposed to future price and supply shocks.

A more durable response would place energy conservation and energy efficiency much closer to the centre of the policy agenda. Instead of concentrating primarily on making expensive energy cheaper, Europe could give greater priority to reducing the amount of energy households and businesses need in the first place—through building renovation, efficient heating and cooling, better industrial processes, smarter transport and reduced energy waste. Such measures can lower bills without creating the same incentive to consume more fossil fuels. The challenge for the EU, therefore, is to reconcile short-term protection of consumers with long-term reduction of energy demand: relief is necessary when costs surge, but policies that simply subsidise

consumption risk postponing rather than solving the underlying problem.

Discussion

The current crisis represents one of the most serious tests of Europe's energy strategy in years. The lesson should not be that the energy transition must be abandoned. Rather, it is that the transition must be accompanied by a much stronger emphasis on energy security, affordability and physical resilience. Europe needs greater diversification of oil and gas supplies, sufficient strategic storage, stronger electricity and gas interconnections, additional LNG infrastructure and better protection of critical energy infrastructure. It also needs reliable electricity generation capable of supporting the system during periods when renewable output is insufficient.

The debate over Europe's own conventional energy resources should also be reconsidered in the context of energy security. Europe possesses domestic hydrocarbon resources that, although insufficient to eliminate dependence on imports, could potentially contribute to supply resilience if developed under appropriate economic and environmental conditions. Together with renewables the EU needs to develop its own hydrocarbon resources so as to lessen its dependence on oil and gas imports and thus help balance out consumer prices. At the same time, relaxing some environmental rules, particularly those relating to CO₂ costs and taxes, could help moderate steep increases in electricity and gas prices and maintain much-needed competitiveness at the enterprise level.

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IENE SEE ENERGY BRIEF MONTHLY ANALYSIS - Issue No. 470 – ISSN:179-9163

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Monthly Analysis is published by the INSTITUTE OF ENERGY FOR SOUTH-EAST EUROPE (IENE)

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