

# The perfect storm: The energy sector in crisis

Eduardo Peixoto Gomes reports on how the rocketing cost of energy is affecting the European energy market



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**U**nprecedented high energy costs are striking European energy markets since late 2021. Historically, EU Natural Gas reached an all time high of €345/MWh in March of 2022. According to Trading Economics' global macro models and analysts expectations, EU Natural Gas is expected to be traded at €91.39/MWh by the end of this quarter and at €124.37/MWh in 12 months time.

Futures markets are pricing European gas at three times their 2021 levels for (at least) the next three years. In sum, households

and industry are being punched full in the face.

This energy price surge is the outcome of several factors, notably the post Covid-19 rise in global demand, carbon pricing and, more recently and relevantly, the Russian invasion of Ukraine.

As newspapers keep reminding us daily, Russia has historically been the European Union's (EU) largest supplier of natural gas. In fact, in 2021, the EU imported an average of over 380 million cubic metres per day of gas by pipeline from Russia. This corresponds approximately to 45% of EU gas imports in 2021 and almost 40% of its total gas consumption.

Considering the dearth of Russian gas supplies, the EU Energy Commissioner has started to take measures to try to mitigate the impact of high energy prices, notably, by presenting a proposal to revise gas supply regulations to improve coordination among member states over gas storage and getting in touch with partners to try to replace Russian gas supplies from alternative sources and, consequently, boost EU gas supplies.

Nonetheless, will these measures be sufficient? What is the path Europe should take to get out of this crisis?

The soaring energy prices are causing a profound and adverse

impact on production costs and consequently, rising costs for consumers, with potentially dire effects on economic activity and on the banks' loan books.

Furthermore, the aforementioned higher costs for consumers, but also supply chain disruptions, may well affect consumers' behaviour and, therefore, reduce economic activity. Moreover, industries, specifically the most energy-intensive sectors, need urgent intervention as their business viability and sustainability are facing a massive survivability test.

The European Commission has reminded us that increasing pressures on prices might accelerate monetary policy normalization, i.e. will cause the European Central Bank (ECB) to start raising interest rates to curb the inflation peak. As per a post by Christine Lagarde, President of the ECB, dated 23 May 2022:

*“Based on the current outlook, we are likely to be in a position to exit negative interest rates by the end of the third quarter. The next stage of normalisation would need to be guided by the evolution of the medium-term inflation outlook. If we see inflation stabilising at 2% over the medium term, a progressive further normalisation of interest rates towards the neutral rate will be appropriate.”*

The most immediate consequence of the increase of the Euribor rate, which is the rate at which the majority of mortgages are indexed, is the exacerbation of the burden on families' through interest payments to banks on mortgage loans, which may deepen the economic slowdown.

My understanding is that this energy crisis is a test for the resilience of European companies. Today's crisis could be the trigger for action that protects their short-term profitability while helping them pull ahead in the race to a net-zero world. In sum and quoting John F. Kennedy:

*“The Chinese use two brush strokes to write the word ‘crisis.’ One brush stroke*

*stands for danger; the other for opportunity. In a crisis, be aware of the danger – but recognize the opportunity.”*

Therefore, in order to tackle the current energy crisis, measures need to be implemented to reduce Europe's reliance on fossil fuels, especially on Russian gas.

Experts view the only lasting solution to fossil fuels dependence to be to complete the green transition. As this seems to be an extremely bold objective to be fully achieved in a short period of time, the sooner companies adopt and implement decarbonization strategies, such as the deployment of new wind and solar projects, the sooner they will be able to mitigate their high energy costs.

It is important to highlight that the European Investment Bank (EIB) has financed energy infrastructure with around €60 billion between 2016 and 2020. This included over €53 billion for renewable energy, energy efficiency and electricity grid projects in Europe and around the world. In 2020 alone, the EIB provided €11.6 billion for energy related projects. Towards the end of 2019, the EIB adopted a new energy lending policy which calls for the following:<sup>1</sup>

#### **Unlocking energy efficiency investments**

The EIB will set up a European Initiative for Building Renovation to support new ways of financing building rehabilitation. During the coming decade, the EIB will double the volume of investment in energy efficiency, especially in residential buildings.

*“Given the pressing need to accelerate market uptake for energy efficiency measures, the EIB will consider financing up to 75% of a project's costs”.*<sup>2</sup>

#### **Decarbonising energy supply**

The EIB will support the market integration of renewable electricity projects and promote increased regional cooperation, as well as back other types of renewables, including renewable heating, the production and

integration of low-carbon gases, such as hydrogen, and low-carbon fuels, in order to try to more than double its renewable energy capacity to decarbonise its energy supply and meet its 2030 renewable targets.

#### **Supporting innovative low-carbon technologies**

The EIB also supports the early deployment of technologies to increase industrial learning and promote future cost reduction, as energy transformation is only possible with a wide portfolio of energy technologies and services, many of which are still at the developmental stage and come with relatively high costs. The EIB will also support initial commercial production lines related to breakthrough technologies and new types of energy infrastructure to stimulate their market uptake.

#### **Investing in a more secure enabling infrastructure**

Besides interconnections, investment in national electricity networks is likely to remain high for the next decade, both at transmission and distribution level. The EIB will continue to support the development of electricity networks, including the interconnection target agreed for 2030 as well as European Projects of Common Interest. The EIB will also look to prioritise investments that increase network flexibility.

Considering the abovementioned energy lending policy by the EIB, the commitment made by the Parties to the Paris Agreement to transforming their development trajectories towards sustainability, the urgent need to tackle the current energy crisis and the growing demand for energy and related services, there will be plenty of opportunities for new business and hope (still!) for a better and greener Europe. ■



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#### **Footnotes:**

<sup>1</sup> European Investment Bank Group – Energy Overview 2021, available at: <[www.eib.org/en/publications/energy-overview-2021](http://www.eib.org/en/publications/energy-overview-2021)>.

<sup>2</sup> *idem*