Russia’s war against Ukraine alters Europe’s energy landscape for good

- European countries rethink dependence on Russian gas, coal and oil
- Political support for renewable energy and nuclear boosted; even coal looking at a revival
- War sparks new interest in shelved and doubtful pipeline projects including Midcat
- Russian gas operations will not collapse but slow; supply cut to Europe unlikely for now

The war in Ukraine has had a significant impact on the European energy sector and, regardless of the outcome, the repercussions of Russia’s invasion will stay for many years to come. At the time of writing, gas, oil and coal prices are extremely volatile as no scenario, not even a full disruption to Russian energy supply, can be ruled out. Nord Stream 2 now looks like a stranded asset as Western partners pull out of the project [1] and Germany has halted the regulatory certification process which is necessary for the pipeline to start flowing gas.

Last night, Gas for Europe, the German subsidiary recently set up to operate the pipeline, said in a short note posted on its website that it would likely be wound up.

Even the IEA – of which Russia is not a member – has begun helping the EU draft a permanent [2] exit plan for Russian gas.

European companies are also reducing their exposure to the Russian energy sector - BP, Shell and Equinor are planning a full exit - which could deal a blow to Russia’s ambitious expansion plans for gas and LNG projects.

Around 40% of the gas consumed in the EU 27 is imported from Russia, according to research by Brussels-based think tank Bruegel, although some estimates have this figure closer to a third. Russia is also a significant supplier of coal and oil to the EU; about 70% of Europe’s thermal coal imports and 25% of crude oil imports come from Russia, according to the European Commission.

So far, Western sanctions have not targeted Russian energy exports directly although the sanctions on Russian banks appear to disrupted some trade with Russian counterparties.

At present, sanctions on Russian energy exports seems like a last resort as it would hit the European economy very hard and seriously jeopardise energy security.

“Targeting Russia’s oil exports might be next, but would have little impact since Russia can sell its oil, at a discount, elsewhere, provided it can find the tankers,” Daniel Gros, a Member of the Board and Distinguished Fellow at the Centre for European Policy Studies (CEPS) tells Gas Matters. “Gas exports would come in response to further atrocities, but only once the winter has ended.”

Russia, now facing an economic collapse, sorely needs the revenues from energy exports and is not expected to cut exports as things stand.

“When it comes to gas exports, at this stage it seems unlikely that Russia would cut them off or heavily tighten them, given the fact that it would basically be impossible to mitigate the loss of revenues generated by its exports to the European market," independent analyst Madalina Sisu Vicari tells Gas Matters.

However, a reduction of Russian gas supplies, similar to those that occurred around the turn of the year, could occur again, if Gazprom sees this as a tool to control the market and cash in on higher gas prices, Vicari says.

"Conversely, for the European buyers it will be impossible to replace all the Russian gas volumes in the short run," she adds.

Maximilian Hess, head of political risk at Hawthorn says short-term disruptions to Russian energy supply looked unlikely for now.

"In the short-term energy from Russia will flow although there will be disruptions to trade owing to the sanctions on Russian banks and in particular the Central Bank," he says. "In the medium-term, Russia will weaponise its energy exports and threaten the West with cut-offs to supply."

Enough LNG?

The war will increase Europe's dependence on LNG, with the US and Qatar among the key suppliers. The US is currently the main LNG exporter to Europe, with around three quarters [3] of its cargoes heading for Europe in January.

"Europe will be more dependent on US and Qatari LNG," says Hess. "Qatar is a swing producer, however QIA has a stake in Rosneft which complicates things further though it may be prepared to join BP in abandoning this given its recent new US alliance agreement."

Justin Dargin, a MENA energy expert at the University of Oxford, notes that the majority of Qatari gas is tied up in long-term commitments elsewhere.

"Europe is seeking to obtain additional LNG cargoes from major Middle East suppliers, such as Qatar, to make up for any potential Russian gas disruption," says Dargin. "However, in the short term, Qatari gas will not be about to make an appreciable impact on EU energy needs as the majority of Qatari gas is tied up in long-term contracts."

"Europe also needs to significantly invest much more in LNG import infrastructure, which is more of a long-term project," he adds.

Analysts have warned that there is not enough LNG regasification capacity to replace all of Europe's Russian pipeline imports alone. There are bottlenecks to worry about too. According to a recent report by an Oxford-based consultancy, the border capacity of LNG travelling between Spain, which has six LNG terminals, to France is only 7.7 Bcm/y. To this end, Spanish President Pedro Sánchez recently signalled that the country will support a relaunch of the shelved Midcat pipeline with France.

Other projects that until recently looked doubtful may also get a new boost. This includes a second 10 Bcm/y string of the Trans Adriatic Pipeline, or TAP 2, which the European Commission recently said it will support politically and perhaps also financially despite leaving the project out of its updated list of Projects of Common Interest (PCI) late last year.

Even the proposed 10 Bcm/y East Med Pipeline, which sponsors say could link Israel, Cyprus and Greece by 2025, could now get stronger political backing from the West.

“The East Med pipeline project has run into many obstacles since its inception,” says Dargin.

“There are several economic, environmental and geopolitical tensions that may obstruct it coming on-line smoothly. However, most certainly, in the wake of the Ukrainian invasion, we can expect to see Europe greenlight, and move more aggressively to approve such projects to promote its energy supply diversification.”

Uninterrupted

It is clear that Ukraine wants to defend its reputation as a reliable transit country for Russian gas to reach Europe. At the time of writing, Russian gas appears to be flowing uninterrupted through the 146 Bcm/y Ukrainian pipeline network. There is, however, a risk of damage to the pipeline network as the war intensifies. The Ukrainian gas TSO GTSOU said on 2 March that a local pipeline near Kharkiv was damaged by shelling and that 40,000 citizens lost access to gas.

GTSOU said it is preparing an appeal to law enforcement agencies.

“According to preliminary information, there are no victims of the explosion among the employees. Gas transportation will be resumed after appropriate repairs as soon as possible,” the TSO said.

At the same time, Russian gas flows through the Ukrainian transmission system seem to be increasing.

“Flows into Ve?ké Kapušany [one of the border points between the Slovak Republic and Ukraine] moved to approx 80-85 Mcm/d last week and stayed there since,” one trading source tells Gas Matters. The lowest flows in January and February was around 25 Mcm/d at Ve?ké the source notes, citing figures from Slovakian TSO Eustream.

“The Ukrainian gas TSO workers are absolute heroes,” he says. “They manage to keep flows going despite all the hostilities.”

Coal and nuclear

Concerns over Russian gas supplies may force some EU nations to rethink their phase-out of nuclear and coal-fired power. Germany, for example, which has pushed forward its target for a coal phase out by eight years to 2030 and which is scheduled to switch off its last nuclear reactors this year, has signaled that it may review the timeline. At a press conference on Thursday, Fatih Birol, Executive Director of the International Energy Agency (IEA), urged EU member states to “take another look at the schedule” for nuclear phase outs.

“Russia’s aggression will further boost investments in renewables [in Europe],” says Hess. “But the war will also have ramifications for coal and nuclear phase outs, for example in Germany.”

Coal burn in Europe's power sector has increased in recent months on the back of higher gas prices. However, one point which is sometimes overlooked is that much of Europe's coal imports also come from Russia. Moreover, high energy coal from Russia is not easy to replace in a tight market with some power plants unable to switch coal types, analysts say.

Russian coal is cost competitive as the shipping route is shorter compared with other suppliers such as Colombia. Nevertheless, Russia's war against Ukraine has led to spikes in European coal prices in recent days.

Russian coal exports to Europe will probably be affected by geopolitical risks, not only Europe's aim to achieve a zero-carbon economy, says Vicari.

"The loss of coal exports toward European markets might not be mitigated as much as in the case of oil through eventual future exports toward China," she adds.

"There are reports that at least two of China's largest state-owned banks are limiting financing for Russian commodities, and in the absence of clarification from central authorities, the traders and purchasers would likely be reluctant to buy Russian coal."

Reduced exposure

In addition, a number of Western energy companies have announced plans to reduce their exposure to the Russian energy sector and Russian energy firms in recent days. Several companies have announced an end to financing of new projects in the country, while BP, Shell and Equinor have announced a full withdrawal from the country with BP aiming to sell its near 20% Rosneft stake [4].

Russia's oil sector is already subject to US and EU sanctions which were imposed after the Crimea invasion in 2014. These sanctions have hampered the development of oil projects in the Arctic, according to analysts.

With international oil companies also reducing or terminating exposure to Russia's gas projects, the planned expansion of the country's LNG sector is also in jeopardy, at least over time.

"The short-term impact will be limited since Russia has the skilled personnel to manage existing operations," says Gros. "However, it will become increasingly costly to maintain production and/or explore new fields in technically challenging areas such as the polar circle. Production will not collapse but be lower than without the sanctions." - AW