

The EU gas savings plan ahead of a long winter*



By Marco Protopapa, J.P. Morgan

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- *EU managed to quickly broker a deal on a gas savings plan ahead of winter despite diverging views*
- *Plan entails 10-15% gas savings target over Aug-Mar, calibrated to make up for a halt to Russian supply*
- *Final deal allows for country specific targets and likely a total cut close to 10% on aggregate*
- *As gas storage reaches the 80% target, coordinated savings and redistribution across the region mitigate rationing risk and size of economic impact*
- *Exposure to economic shock, while mitigated, remains asymmetric and proportional to Russian dependence*

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After Gazprom's decision to cut flows of natural gas via NordStream 1 to 20% of normal capacity, prices in Europe have hovered near 200€/Mwh, reflecting ongoing concerns about further weaponization of Russian gas supply as a reaction to sanctions.

Anticipating a worst case scenario of a complete halt to Russian supply of gas, the EU Council has adopted a gas savings plan; the aim is to immediately, albeit gradually, reduce gas demand to minimize the risk of shortages next winter. These preventive gas savings are calibrated to withstand a shutdown of Russian supply from an EU-wide perspective, allowing gas to be redistributed within the region from countries in (relative) surplus to countries in deficit.

The initial plan, according to an earlier EC proposal, was a compulsory 15% cut to gas consumption (measured over the last 5 years) uniformly across countries, over August– March. This plan was subject to predictable criticism from several countries, as it was perceived as too harsh towards countries which either: (i) have less dependence on Russian gas or are not connected to the EU grid, (ii) have made more progress towards diversifying supply sources away from Russia, and (iii) have made more progress on replenishing their storage levels. Bluntly put, the EC plan was perceived as biased in favour of Germany, who remain by far the most exposed large economy, after Italy has nearly halved its dependence on Russian gas in the last 6 months. Not surprisingly, vocal opposition came from Italy and Spain, among others, while Hungary continued to remain an isolated contrarian, given PM Orbán's pro-Russian stance.

Despite these misgivings, a compromise agreement has been found. The agreement is on a voluntary basis in the first instance, which may become compulsory in the case of a region-wide emergency. And it includes a set of exemptions/exceptions which allow tailor made gas savings targets to country specific situations, while safeguarding the principle of intra-EU solidarity.

The final plan will see both country specific targets and a less ambitious overall total cut (arguably closer to 10%). But, in our view, the ability to reach agreement in the space of a week shows that so far Europe maintains a united front against Russia– with the usual exception of Hungary. Of course, there are question marks about the future, with politically weakened leaders like Macron and with a departing leader like Draghi. The loss of the latter is potentially a big issue but at this stage we don't see a concrete risk of Italy turning pro-Russian, given the solid pro-NATO stance professed by the BoI leader Meloni, who is in the driving seat of a potential right wing government.

This said, preparedness ahead of the winter is crucial, and it will be important to monitor how the gas reduction plan proceeds. There is an open question as to how the general population will react to the gas savings message at the same time that the economy is set to weaken sharply, as per [our forecast](#). The further spike in gas prices (and hence electricity prices) since mid-June may already be enough to elicit more significant behavioral responses in the next few months, and the latest consumer confidence data suggest significant retrenchment in consumption after the surge in services spending in 2Q22.

Rationing risk: asymmetric and sometimes considerable

The EU Council plan has been heralded with satisfaction in the main European capitals, as a tangible show of solidarity within constraints. The practical implication is that, pending effective implementation, the risk of rationing during the winter and its economic impact would be materially smaller. But it would certainly remain and could arguably be large in certain cases given differences in exposure to Russian gas. Hence, there will be a clear pecking order among countries in terms of the potential economic shock, in turn proportional to the degree of Russian dependence. We have flagged that gas rationing is a major source of downside risk for our Euro area outlook.

Among the largest Euro area economies, Germany is by far the most exposed and its savings effort will presumably exceed the 15% target, give the exemptions granted to other countries (including Italy, France and Spain). Italy has already made substantive progress leading to only modest rationing risk. However, we have noted that this assessment is conditional on Italy staying the course on moderate gas savings (7%) and further planned progress on strengthening LNG facilities. The Draghi administration will continue to deliver on that front in the interim, but it's clear that soon this matter will be in the hands of the next government. France and Spain, instead are not dependent on Russian gas but remain exposed, like every other country, to international gas prices. To the best of our knowledge, government plans where planned gas savings are well below the 10% mark are considered feasible and not likely to elicit a material impact on activity.

According to the EU plan, France and Spain and, to some extent Italy (at least as a transit for LNG) will be crucial in assisting North West Europe ensure its energy supplies through the winter. Below we discuss the key features of the EU Council deal.

The 15% target

Before the war, Russia supplied roughly 40% of the EU gas consumption, which in turn is close to 9% of total energy consumption (Table 1). However, there are major differences across countries, as regards both the share of gas over total energy consumption and the dependence on Russian imports.

In Germany, Russian gas imports accounted for nearly 16% of total energy consumption before the war, and several other countries in Northern Europe are also significantly dependent on Russian gas. Italy was also heavily dependent (12.5% of total energy), but a major diversification effort has nearly halved that figures in the last months.

The EC has calculated that a complete stop to Russian gas flows ahead of the winter would involve a net supply loss for the EU worth 45 billion cubic meters (bcm) of gas (or 30% of total Russian supply on an annual basis), in the case of a harsh winter. In the case of an average winter the loss would fall to 30bcm. The EC calculates that the 45bcm loss could be made up by reducing gas consumption by 15% in the aggregate over August-March, or 10% in the case of a 30bcm loss. Under these assumptions, and considering that the EU gas storage target of 80% are set to be surpassed (current EU storage levels are already at 71%, thanks to offsetting increase in LNG supply, Table 2), the EC estimates that it would be possible to minimize the risk of rationing (and hence the economic shock), provided that countries are willing to share their supply.

Table 1: EA dependence on Russian gas imports (% share, 2019-20 data)

	Gas share % total energy	Russian imports % of gas	Russian imports % of total energy
EU	23.7	38.0	9.0
Belgium	29.3	7.9	2.3
Bulgaria	12.4	72.8	9.0
Czechia	21.7	86.0	18.7
Denmark	11.5	52.4	6.0
Germany	26.8	58.9	15.8
Estonia	9.0	86.5	7.8
Ireland	18.0	0.0	0.0
Greece	7.6	38.9	3.0
Spain	19.1	10.5	2.0
France	20.6	20.0	4.1
Croatia	17.1	55.0	9.4
Italy	30.9	40.4	12.5
Latvia	8.5	100.1	8.5
Lithuania	11.0	50.5	5.6
Luxembourg	17.3	27.2	4.7
Hungary	32.3	110.4	35.7
Netherlands	37.6	35.8	13.5
Austria	18.7	58.6	11.0
Poland	13.1	45.5	6.0
Portugal	11.4	9.6	1.1
Romania	24.9	15.5	3.9
Slovenia	13.1	81.0	10.6
Slovakia	25.3	75.2	19.0
Finland	3.0	92.4	2.8
Sweden	1.5	13.9	0.2
Norway	2.1	0.2	0.0

Source: Eurostat, J.P. Morgan

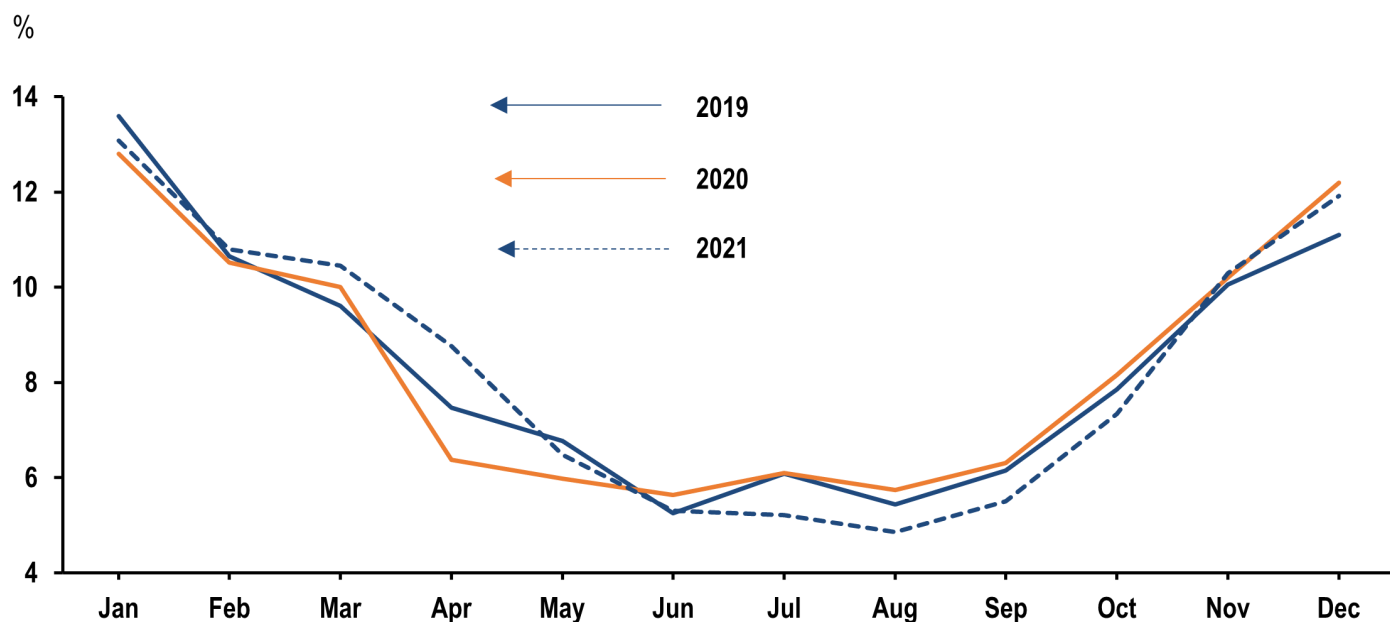
Table 2: EU Gas storage (% of total, as of 2 August)

	Stock/capacity	Stock/cons
EU	70.2	18.7
Austria	58.0	52.2
Belgium	77.2	3.4
Bulgaria	48.3	8.3
Croatia	53.6	7.7
Czech Republic	79.2	37.7
Denmark	88.4	30.5
France	80.0	22.5
Germany	69.4	17.0
Hungary	52.1	30.1
Italy	73.4	18.2
Latvia	53.4	94.4
Netherlands	66.3	22.3
Poland	98.9	14.5
Portugal	100.0	5.6
Romania	59.2	15.8
Slovakia	68.8	43.3
Spain	78.0	7.4
Sweden	90.8	0.8

Source: AGIE, J.P. Morgan

Even if storage levels were to reach 100% , that alone wouldn't be sufficient to avoid rationing without advanced and coordinated gas savings. The reason is that gas consumption is very seasonal (Figure 3), with 55% of the total consumed in the cold season (Nov-Mar). In fact, the full storage capacity corresponds only to 27% of EU gas consumption, which essentially means that gas storage levels would be depleted at some point in Jan-Feb depending on country heterogeneity.

Figure 3: EU natural gas consumption - monthly pattern



Source: Eurostat, J.P. Morgan

A mechanism for compulsion

The EU Council agreement is on a voluntary basis, but, as discussed, the current price levels are already providing strong incentives, as the fiscal space for more domestic supports shrinks. The voluntary mechanism would become compulsory in the case of a crisis, defined as a “substantial risk of a severe gas shortage or an exceptionally high gas demand” –a definition that clearly applies to a stop of Russian flows. Such an alert would be triggered when at least 5 member states make a request, pending a qualified majority vote in the EU Council (55% of member states representing 65% of the EU population).

The main exemptions

The Council agreement includes a list of exemptions. These exemptions are not automatic but require a green light from the EC. The spirit is that exceptions are granted to allow for country specific targets, but that is conditional on a demonstrable commitment from countries in likely surplus (like France and Spain) to help countries in deficits. Of course, this mechanism raises the question of how countries may react under duress.

Eventually, the end result of the exemptions is that gas savings will fall below 10% in large economies such as France, Italy and Spain, so that their gas savings target will align with the already existing domestic plans (i.e. for instance 7% in Italy). As a result of these exemptions, and with some uncertainty linked to the voluntary nature of the plan, it is likely that total gas savings will be closer to 10% of total gas consumption, i.e. the target calibrated versus an average winter. Examples of exemptions allowing below 15% gas savings include:

- Ireland Malta and Cyprus are automatically excluded from the deal because they are not connected to the EU network and couldn't provide relief to other countries.
- Spain and Portugal as well as France are effectively disconnected to the EU network and do not depend on Russian supply. They will simply need to demonstrate that they are exporting LNG to the “fullest” capacity.
- Countries which have exceeded the 80% gas storage target by end October, as a reward for their efforts. As of today, it seems that all countries will be able to achieve the 80% mark.

Sectors affected

The EU Council agreement explains that “member states agreed they should prioritise measures that do not affect protected customers such as households and essential services for the functioning of society like critical entities, healthcare and defence. Possible measures include reducing gas consumed in the electricity sector, measures to encourage fuel switch in industry, national awareness raising campaigns, targeted obligations to reduce heating and cooling and market-based measures such as auctioning between companies.”

Essentially, the deal gives member states the freedom to choose how they pursue their gas-reduction objectives. Although minimizing the impact on the households sector (which on average accounts for 36% of total gas usage, Table 4) and strategic industries will be sought, everybody will be involved. Tools will include (i) temperature limits on heating and air conditioning both in public sector buildings, residential building where enforceable, and services establishment, (ii) switching and optimizing fuels in the industrial sector, including whereby electricity savings (as gas is also used in electricity production), (iii) surcharges and incentive schemes, likely in the industrial sector. Specific provisions will apply to industries where capacity cannot fall for technical reasons below certain levels (damage to machinery, etc.). ■

Table 4: EA gas usage by country and sector (2019, % of total energy consumption)

	Households	Transport	Services	Industry	Energy/Heat	Non Energy	Other
EA19	36.3	1.6	16.7	34.3	6.2	2.1	2.9
Germany	40.1	1.4	17.0	34.9	6.1	0.2	0.2
France	37.2	0.5	19.6	34.4	3.9	2.1	2.3
Italy	48.1	3.4	21.1	25.5	1.9	0.0	0.0
Spain	8.7	0.6	4.9	21.8	1.2	18.2	44.6
Netherlands	31.2	0.3	13.2	23.3	12.5	10.9	8.6
Belgium	29.1	0.5	17.0	35.4	9.1	7.3	1.6

Source: Eurostat, J.P. Morgan

About the author

Marco Protopapa is a Senior Economist at J.P. Morgan within the Western Europe Economic Research team. He is responsible for the economic and political analysis of Italy and Southern Europe, and, in the Euro area space, for fiscal policy, debt sustainability and institutional developments. He also contributes his expertise in monetary policy and the business cycle and his deep institutional knowledge of the European Union to shape J.P. Morgan views.

Prior to joining J.P. Morgan in 2013, Marco spent a decade in Central banking, working for the European Central Bank and the Bank of Italy, in key positions in the research, monetary policy and financial stability departments. Marco holds advanced degrees in economics and finance from the London School of Economics (MSc, MPhil) and the Pompeu Fabra University (MSc).

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SUERF Secretariat
c/o OeNB
Otto-Wagner-Platz 3
A-1090 Vienna, Austria
Phone: +43-1-40420-7206
www.suerf.org • suerf@oenb.at