Europe's Electricity Crisis
Energy, Inflation, and the Transition

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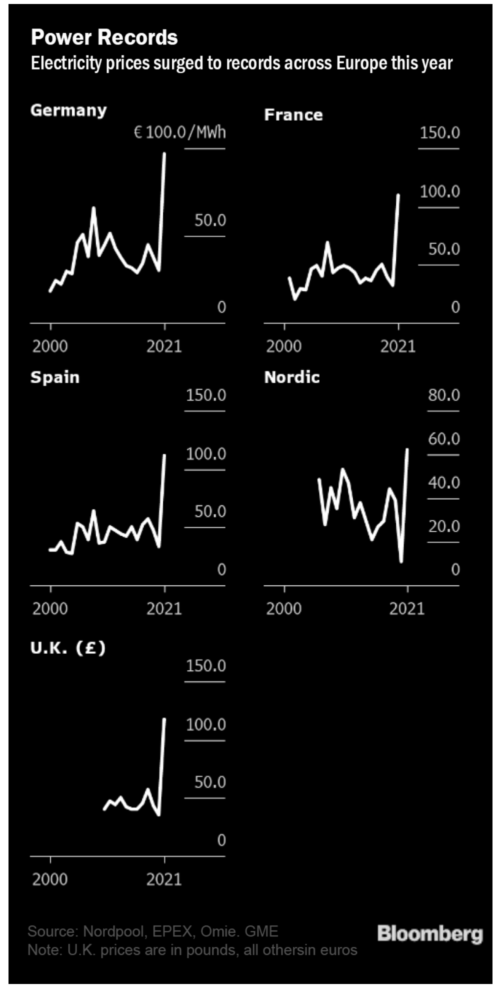
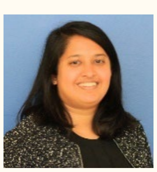
Europe is facing its worst energy crisis in decades, with record high gas prices and record high power prices. The immediate cause for the spikes was an unexpected shutdown in some of the French nuclear fleet, and lower output from wind in Germany and Northern UK. The trend is likely to fuel further inflation and hamper growth in the region. To date, over 20 power retailers in the UK filed for bankruptcy. European governments rolled out a slew of policy measures aimed at lowering household electricity bills such as price caps, vouchers, suspension of VAT/taxes, subsidies, and clawing back power generation profits. Still, Italians are expected to face a 55% increase in household electricity bills in 1Q 2022,[1] even after taking into account the EUR 8 billion spent since July by the government to curb price hikes.



The European electricity crisis originated as a gas crisis. Growth in global gas demand, low European gas storage (less than 80% full vs 96% last year),[2] and supply disruptions led to a 250% year-to-date rise in European gas prices with prices peaking at over 800% last month.[3] As global gas markets became further integrated, Europe succumbed to the effects of China's spike in demand, South America's drought-induced demand for imported natural gas, production outages in Norway, and Russia's fluctuating levels of supplies. Coal also saw surging prices thanks to its own supply disruptions and emergency gas to coal switching. To make matters worse, European renewable output was lower than usual. France unexpectedly shut down 10% of its grid in December and plans to shut another 20% in January for nuclear plant maintenance.[4] As a result, France, a major regional exporter of electricity, will be forced to purchase power in the market alongside its neighbors at elevated prices. Finally, Germany is pushing ahead with its well telegraphed but poorly timed shut down of half its nuclear fleet this year.[5] European power prices surged over the last few months, peaking at over EUR 400/MWh compared to a 3-year average of 60 EUR/MWh. Last week, gas prices and power prices came down from these unprecedented highs as LNG shipments were diverted to Europe. However, prices remain elevated, and fears of supply risk and volatility persist as Europe heads into the coldest part of the year.

The crisis is playing out against the backdrop of Europe's longer term energy transition plan. Ironically, the crisis increased Europe's use of coal and oil generators. Fossil fuels will continue to play a critical role in the energy transition despite potentially slowing demand and investment, especially because fossil fuels, unlike electricity, can be easily stored. Power prices are likely to remain volatile as Europe relies more on intermittent sources of renewable energy while also pushing towards greater electrification. Away from the near-term confluence of destabilizing factors, over time, we expect investment in storage solutions and long-distance transmission lines to integrate electricity markets will help increase reliability.

1) https://www.reuters.com/business/energy/italy-retail-power-bills-rise-55-next-quarter-regulator-2021-12-30/
2) https://agsi.gie.eu/#/historical/eu
3) https://www.theice.com/products/27996665/Dutch-TTF-Gas-Futures/data?marketId=5336900&span=2
4) https://blinks.bloomberg.com/news/stories/R47LCSDWX2PU
5) https://www.france24.com/en/live-news/20211231-germany-to-close-nuclear-reactors-despite-energy-crisis
Chart) Bloomberg, https://blinks.bloomberg.com/news/stories/R4XIBADWX2PX



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