

**TINKER, TAILOR, SOLDIER, ENERGY: GASSED EUROPEAN PENINSULA VIS-À-VIS FRONTLOADING THE AATMANIRBHAR BHARAT PITCH IN A SEEMINGLY (DE)GLOBALISED WORLD:WHAT INDIA THOUGHT YESTERDAY, WORLD IS YET TO THINK TODAY!**

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The galloping gas prices in Europe has made the world pause and catch a breath in mid-August, amidst a war seemingly entering a deceptively 'deadlocked zone' as benchmark TTF gas prices spiked close to EUR 340/MWH, five times their prices at the start of the year (and, almost 14 times their 10 years average prices!) with gas supply through Nord Stream1 drying up fast. The rising cost of living, and its impact on the people on the fringe in particular, as the Eurozone and UK are battling a run away inflation whose worst is yet to come could hardly be comprehended by a world where unprecedented tightening of policy rates is juxtaposed against slowing down economies, checkmated by gathering winds of recession in the offing. **That also makes in hindsight the benefits of Aatmanirbhar Bharat pitch pursued in earnest by our policy makers that is worth the cost in an otherwise globalised world where individual aspirations and interests of the nations can trump the well laid plans. It is always better to build our own capabilities rather than depending on others, that makes Europe so vulnerable now. Puritans cite the classic case of Germany not building a single LNG terminal all through 2006-22 and instead purely depending on gas supply from Russia.**

The military conflict between Russia and Ukraine has widened to include economic measure as weapon among the warring sides. Russian pipeline flows to Europe have been dropping since the second half of 2021 and following recent cuts in deliveries, Russian exports to the EU are now down roughly 60 percent compared to June 2021 and further downward escalation is a reality. The EU27 region is almost fully dependent on gas imports with more than 90% of the gas consumed in the euro area is imported. Unlike the petroleum products, gas is the primary energy source most consumed in the industrial sector and has high proportion in household final consumption. Significant increase in natural gas prices dampen economic activity through both the consumption channel and the intermediate goods channel. In respect of specific industrial segments, the shortage in gas supply is expected to impact the production of fertilizers, steel, aluminum and zinc. Fertilizer crunch is in fact deepening with more than two-thirds of production capacity halted by soaring gas costs as gas is both a key feedstock and a source of power for the sector. Thus EU may become a net importer of fertilizers in the current year.

**It is estimated by ECB that the direct and indirect impact of a hypothetical 10% gas rationing shock on the corporate sector is estimated to reduce euro area gross value added (GVA) by about 0.7%. Further a 10% reduction in consumer demand due to higher energy bills is expected to cascade to other sectors with loss of value added in the range 0.1% to 1%. Real estate services, public administration, health and education will be impacted the most.**

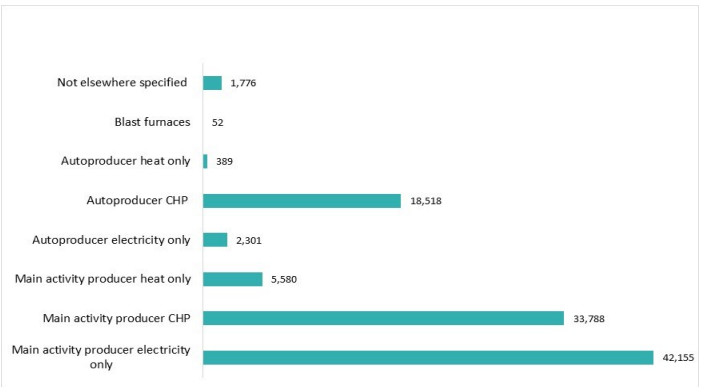
Through 2006 to 2009, there had been frequent skirmishes between Ukrainian *Naftogaz* and Russian *Gazprom* controlled entities on pricing and supply of gas flowing through Ukraine to other European countries, resulting in cut-offs and substantial reduction in supply in freezing winter. Russia thereafter formed an alliance with Germany to initiate works on Nord Stream1, a 1200 kms plus pipeline that passes under Baltic sea connecting *Vyborg* near Finland to *Lubmin* in Germany that ensured energy security to Germany, the European powerhouse that largely shouldered the beleaguered PIIGS nations during the heydays of Eurozone crisis, in succession to Financial crisis of 2007-09. Puritans cite the classic case of Germany not building a single LNG terminal all through 2006-22 as the force du jour behind the chaos prevailing in the nearly 'gassed' European peninsula which threatens to alter the social fabric of the variegated land as the heightened expenditure on energy and heating bills by households and heightened cost of living through a run away inflation are increasingly getting imprinted in growing public unease. It is in this backdrop that we need to understand the embedded theme of **Aatmanirbhar Bharat** being pursued by the policy makers here of late, as deep fissures appear in an otherwise seemingly perfect globalised world. **Aatmanirbhar Bharat Abhiyaan is the vision of new India envisaged by the Government.** The aim is to make the country and its citizens independent and self-reliant in all senses through five pillars outlined of Aatmanirbhar Bharat – Economy, Infrastructure, System, Vibrant Demography and Demand as bold reforms and enablers across sectors augment 'Make in India' in Strategic/Defence sectors to boost our ability to carve out a niche strong place in the changing demographics. Energy security and energy efficiency are the key themes under the self reliant India ambit as the country gears to make a shift towards transitioning to greener and cleaner sources of energy, also to meet its obligations under COP26.

The European Central Bank has raised its key interest rates by an unprecedented 75 basis points in its 8th September meet and promised further hikes, prioritising the fight against inflation even as the bloc is likely heading towards a winter recession and gas rationing. **In the UK, the new political dispensation has frozen the gas and electricity bills for the average households at GBP2500 a year for next 2 years whose financial implications are surely going to reverberate through not only the UK but also the Eurozone fighting worsening climatic conditions as also rising political uncertainty. In select Baltic nations like Lithuania, Latvia, Estonia last inflation print is running well above 20%. Seems, the beleaguered Eurozone is the new axis of unpredictable uncertainty in a world rife with unknown unknowns.**

**EU GAS CRISIS REGIONAL AND GLOBAL IMPACT**

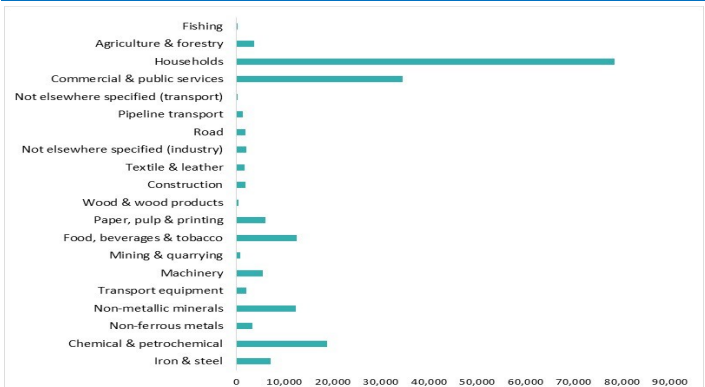
- ◆ The military conflict between Russia and Ukraine has widened to include economic measure as weapon among the warring sides. In this league the stoppage of natural gas to EU from Russia has become a major economic challenge for countries in this region. Russian pipeline flows to Europe have been dropping since the second half of 2021 and following recent cuts in deliveries, Russian exports to the EU are now down roughly 60 percent compared to June 2021 and further downward escalation is possible.
- ◆ The EU27 region is almost fully dependent on gas imports. More than 90% of the gas consumed in the euro area is imported, with Russia forming the bulk of the supplies.
- ◆ Unlike the petroleum products, gas is the primary energy source most consumed in the industrial sector and has high proportion in household final consumption. Significant increases in natural gas prices dampen economic activity through both the consumption channel and the intermediate goods channel.
- ◆ The latest energy balances sheet for 2020 for EU27 countries shows that use of natural gas transformational input is concentrated under the head Electricity & heat generation.
- ◆ In terms of final consumption of natural gas there is wide absorption of natural gas across sectors with household sector accounting for the bulk of final consumption. As a result, higher gas prices will reduce households’ real disposable income and purchasing power leading to sudden or prolonged shifts in consumption preferences.
- ◆ In respect of specific industrial segments, the shortage in gas supply is expected to impact the production of fertilizers, steel, aluminum and zinc. Fertilizer crunch is in fact deepening with more than two-thirds of production capacity halted by soaring gas costs. Fertilizer companies are being especially affected because gas is both a key feedstock and a source of power for the sector. Thus EU may become a net importer of fertilizers in the current year.
- ◆ It is estimated by ECB that the direct and indirect impact of a hypothetical 10% gas rationing shock on the corporate sector is estimated to reduce euro area gross value added (GVA) by about 0.7%. Further a 10% reduction in consumer demand due to higher energy bills is expected to cascade to other sectors with loss of value added in the range 0.1% to 1%. Real estate services, public administration, health and education will be impacted the most.

**Use of Natural Gas Transformation Input for EU27 for 2020 (in Ktoe)**



Source: SBI Research

**Final Consumption of Natural Gas by Major Sectors for EU27 (In Ktoe)**



Source: SBI Research

**THE GERMAN GAMBLE**

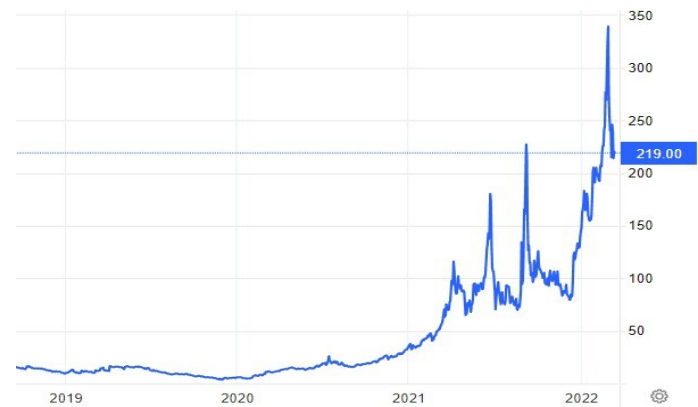
♦ Europe’s first wake up call towards gas imbroglio came on the very first day of 2006 when Russia momentarily stopped gas supply passing through Ukraine, alleging diversion and non payment of contractual prices. The uproar amidst freezing winter ensured bilateral talks were held early between Ukrainian *Naftogaz* and Russian *Gazprom* controlled entities and gas supply was restored on 4th January though frequent skirmishes continued till January 2009 when 18 EU nations reported substantial cut-off or complete supply cut as sparks flared up between the two sides and reached a zenith. Kremlin announced to completely move away from channeling gas through Ukraine and that was also the time when works on ~1200 kms long Nord Stream1, stretching all the way from *Vyborg* near Finland to *Lubmin* in Germany gained traction (though it was theoretically approved in the fag days of Gerhard Schroder’s chancellorship in 2005 itself). The first line of majority Gazprom owned (51%) Nord Stream1 started functioning from end 2011, running under Baltic Sea, complemented by another line in October 2012. Germany, the powerhouse of Europe that had shouldered the turmoil in PIIGS and other countries in Eurozone crisis during the material time almost went unilaterally in securing energy supply from Russia, notwithstanding the intense opposition from smaller Baltic nations *en route* as also USA who forewarned of Russia’s aggression and perils of sole dependency on a single, turbulent source. With the Russian intentions of cutting European gas supply citing maintenance of the Nord Stream1 pipeline becoming evident, benchmark Dutch TTF (Title Transfer Facility) futures galloped through the 2022, peaking to ~Eur340/MWH against ~Eur70/MWH but cooling off later as floating storage and regasification units (FSRU), designed to convert the super-chilled fuel transported on seagoing vessels into gas that can be pumped into onshore networks started getting put into action, starting from Eemshaven, the Dutch port. Puritans cite the classic case of Germany not building a single LNG terminal all through 2006-22 (coinciding largely with Angela Merkel’s 16 years chancellorship) as the force du jour behind the chaos prevailing in the nearly ‘gassed’ European peninsula which threatens to alter the social fabric of the variegated land as the heightened expenditure on energy and heating bills and heightened cost of living through a run away inflation are increasingly getting imprinted in growing public unease. It is in this backdrop that we need to appreciate and understand the embedded theme of *Aatmanirbhar Bharat* being pursued by the policy makers of late, as deep fissures appear in an otherwise perfectly globalised world.

**The Not Too Smooth Run of 1200 kms plus long Nord Stream 1**



Source: Wikimedia, SBI Research

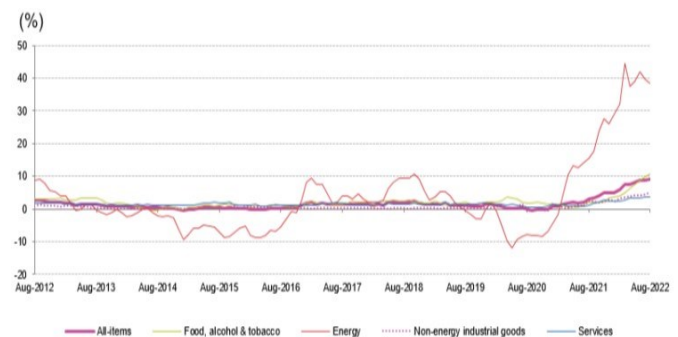
**European Benchmark Dutch TTF Natural Gas Prices (Eur/MWH)**



Source: Trading Economics, SBI Research

**Inflation is yet to see its worst in Eurozone member countries**

**Euro area annual inflation and its main components, August 2012 - August 2022 (estimated)**



Source: Eurostat, SBI Research

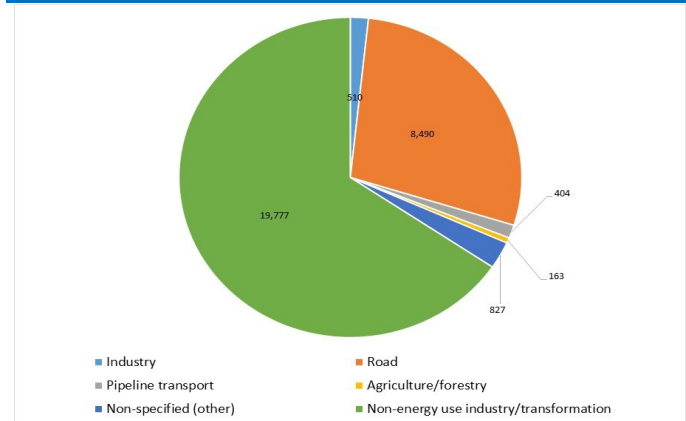
## AATMANIRBHAR BHARAT

- ◆ Aatmanirbhar Bharat Abhiyaan or Self-reliant India campaign is the vision of new India envisaged by the Government. The aim is to make the country and its citizens independent and self-reliant in all senses through five pillars outlined of Aatma Nirbhar Bharat – Economy, Infrastructure, System, Vibrant Demography and Demand as Government reforms and enablers across seven sectors power the Aatmanirbhar Bharat Abhiyaan. The Government has taken several bold reforms such as Supply Chain Reforms for Agriculture, Rational Tax Systems, Simple & Clear Laws, Capable Human Resource and Strong Financial System while augmenting 'Make in India' in Strategic/Defence sectors to boost our ability to carve out a niche strong place in the changing demographics. Energy security and energy efficiency are the key themes under the self-reliant India ambit as the country gears to make a shift towards transitioning to greener and cleaner sources of energy, also to meet its obligations under COP26 .

## EU GAS CRISIS AND INDIA

- ◆ Sudden shortage of gas in EU27 has impacted the price of natural gas and concomitantly disrupting the supply in other regions. In South Asia India, Pakistan, Sri Lanka, and Bangladesh are experiencing difficulty in sourcing gas.
- ◆ In case of India the current gas crisis will impact at various levels. First the loss of purchasing power in EU27 will impact the exports which are in nature of final consumption. Further disruption in production will impact exports of intermediate goods. Even intermediate good imports from EU to India may be disrupted if the production is impacted significantly.
- ◆ With EU turning importer of fertilizer as own production unable to meet the demand, international price of fertilizers will see rise impacting the food subsidy bill and hence the fiscal calculation.
- ◆ Unlike in Europe the consumption of gas is not that widespread locally. The absorption of natural gas as per energy balance sheet 2020-21 is highest in non-energy use which includes production of fertilizers and chemical followed by road and pipelines.
- ◆ Thus, current high prices will impact the cost of transports using CNG as fuel such as three wheelers. Further city gas distribution companies will see high cost of sourcing which will impact urban demand.

## Absorption of Natural Gas Among Sectors in India 2020-21( in Ktoe)



Source: SBI Research

## WAY FORWARD

- ◆ The current round of gas crisis in Europe will create a fresh round of inflationary pressures in food and transport prices. The prices of fertilizers and its raw material are expected to remain elevated during FY23.
- ◆ The European Central Bank raised its key interest rates by an unprecedented 75 basis points in its 8th September meet and promising further hikes, prioritising the fight against inflation even as the bloc is likely heading towards a winter recession and gas rationing. In the UK, the new political dispensation has frozen the gas and electricity bills for the average households at GBP2500 a year for next 2 years whose financial implications are surely going to reverberate through not only the UK but also the Eurozone fighting worsening climatic conditions as also rising political uncertainty. In select Baltic nations like Lithuania, Latvia, Estonia last inflation print is running well above 20%. Seems, the beleaguered Eurozone is the new axis of unpredictable uncertainty in a world rife with unknown unknowns.
- ◆ In the current situation, the interest rates will continue the rising trend with pace of hardening depending upon the domestic situation across countries. Sacrificing growth in these tough times will especially be harder for those at the fringe as the war, apparently in a 'deadlock zone' ravages and claims multiple resources.

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