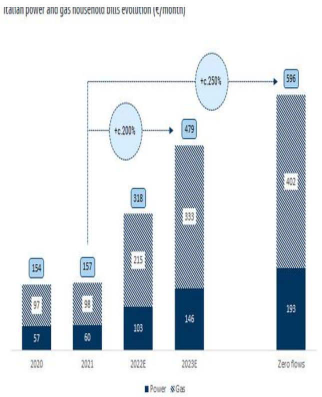


Europe’s Nightmare Scenario Comes True: Energy Bills To Rise By €2 Trillion, Will Reach 20% Of Disposable Income

Description

EU: What is the scale of the energy challenge?

We got a very shocking sense of the staggering numbers involved in the existential, crippling European crisis earlier today when Norwegian energy giant Equinor echoed what Zoltan Pozsar said in March, warning that “European energy trading risks grinding to a halt **unless governments extend liquidity to cover *margin calls of at least $1.5 trillion.*”** As Bloomberg put it, in its best non-Zoltan imitation, “aside from inflating bills and fanning inflation, the biggest energy crisis in decades is sucking up capital to guarantee trades amid wild price swings. That’s putting pressure on European Union officials to intervene to prevent energy markets from stalling.”

“Liquidity support is going to be needed,” Helge Haugane, Equinor’s senior vice president for gas and power, said in an interview. The issue is focused on derivatives trading, while the physical market is functioning, he said, adding that the company’s estimate for $1.5 trillion to prop up so-called paper trading is “conservative.””

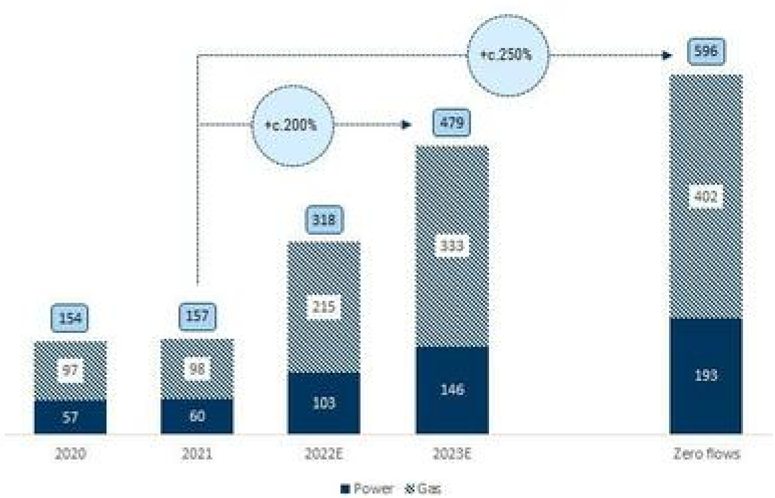
In other words, ***massive*** amounts of newly-printed funding (because with yields blowing up, Europe’s fiscal stimulus will be over before it started unless central banks step in and backstop the latest energy hyperinflation bailout plans) will be required to avert an energy disaster. Alas, the final number ***will be even more massive,*** because overnight Goldman’s research team published a must read note (available to pro subs), in which the bank looked at the scale of the energy bill challenge, potential European government responses and industry implications, and quantified the total damage. The numbers are staggering:

According to Goldman, **Italian household energy bills could rise from ~€150 to ~€600 in 2023.** Some more details:

> *“For most families and industrial customers, energy bills are renegotiated every twelve months; on our estimates, energy bills for most consumers will peak this winter. We estimate a c.€500/month cost for power and gas currently, implying a c.200% increase vs. 2021 when average bills were c.€160/month. Energy bills could approach €600/month in a*

> *zero flows (from Russia) scenario we believe (see here for more on this zero flows scenario). "*

Exhibit 1: Based on current forward curves, household energy bills in Italy could reach nearly €500/month
Italian power and gas household bills evolution (€/month)



Source: Eurostat, Goldman Sachs Global Investment Research

The trigger for this exponential surge in costs: since January 2020, 1-year forward gas and power prices – usually the reference when signing new energy supply contracts for families or industrial customers – have each increased by more than 13x. The following exhibit shows this evolution, rebased to 100.

Exhibit 13: Since early 2020, 1-year forward gas and power prices have increased by more than 13x
Germany power and TTF 1-year forward price evolution (rebased to 100)

As of August 31, 2022
Source: Bloomberg, Goldman Sachs Global Investment Research

For Europe as a whole, **this would be equivalent to a near €2 TRILLION increase in gas and power spending (equivalent to c.15% of GDP).**

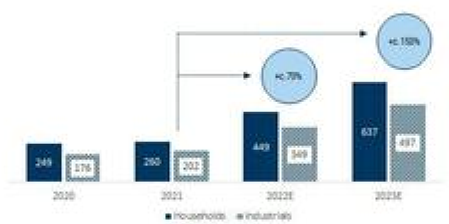
Exhibit 2: For Europe as a whole, the increase in energy costs between 2021 and 2023 could approach €2 tn
Europe's increase in energy costs calculation (TWh, €/MWh and € bn)

	Power	Gas	Energy
Consumption *TWh*	3,300	5,500	-
Consumption adj for CCGTs *TWh*	3,300	4,125	-
Energy price in 2021 *€/MWh*	75	27	-
Current energy price *€/MWh*	450	200	-
Energy bills increase 2021-now *€ bn*	1,238	714	**1,951**

Source: Goldman Sachs Global Investment Research

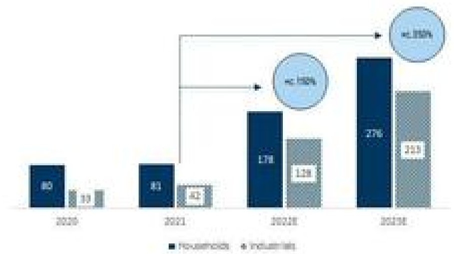
Goldman next calculates that if current 1-year forward prices remain unchanged for the coming six months, **supply contract renegotiations would lift the EU's power and gas unitary bills by c.200%, vs. 2021.** As a reference, the exhibits below show (using Italy as an example) the unitary cost of energy (€/MWh) evolution of gas and electricity, for both industrial users and households.

Exhibit 21 : EU power bills could increase by c.70% in 2022, and by c.150% in 2023, vs. 2021
Italian household and industrial electricity bills; evolution (€/MWh)



Source: Eurostat, Goldman Sachs Global Investment Research

Exhibit 22 : EU gas bills could increase by c.150% in 2022, and by c.350% in 2023, vs.2021
Italian household and industrial gas bills; evolution (€/MWh)

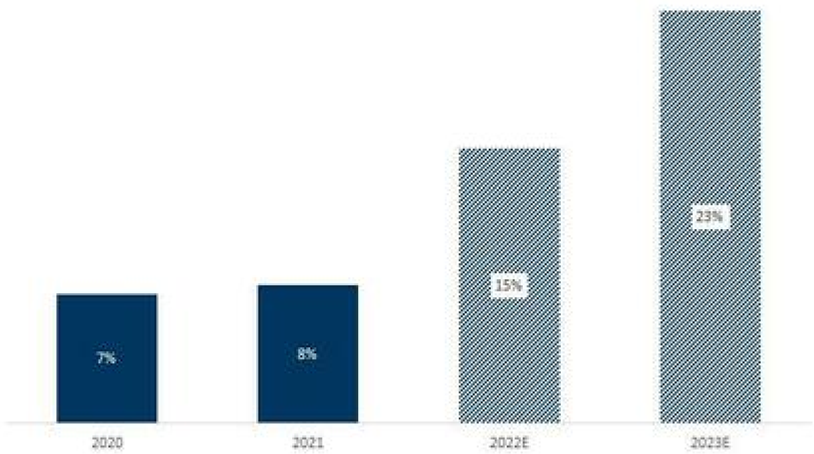


Source: Eurostat, Goldman Sachs Global Investment Research

In this nightmare scenario, Energy bills would constitute over 20% of EU household gross disposable income.

Exhibit 18: At current gas/power prices, energy bills could represent >20% of households' disposable income by 2023, we estimate

EU households' energy bills over gross disposable income evolution (percentage)



EU average calculated as an average of Germany, Spain, France and Italy

Source: Eurostat, Goldman Sachs Global Investment Research

The next table shows a sensitivity analysis in the surge in energy bills for Europe, depending on the development of gas and power prices.

Exhibit 3: Europe's energy bills could surge by c.€1-4 trillion vs 2021, depending on the evolution of gas/power prices

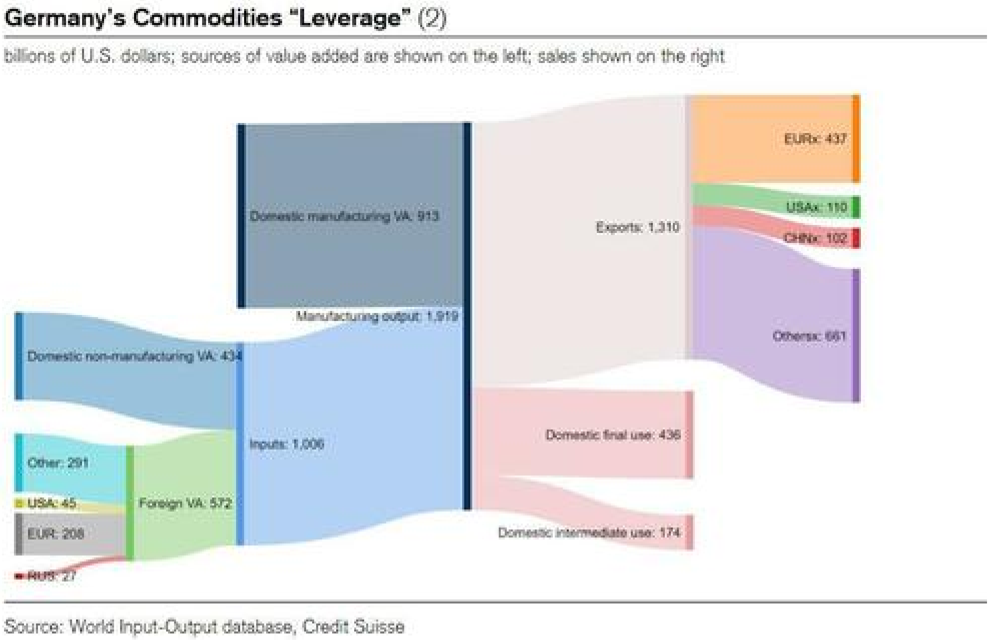
Surge in Europe's gas/power bills vs 2021 (power at €75/MWh, gas at €27/MWh)

	EU Energy bills increase vs 2021 (€ bn)		
	Power	Gas	Energy
Gas €100/MWh, Power €250/MWh	578	301	**879**
Gas €150/MWh, Power €350/MWh	908	507	**1,415**
Gas €200/MWh, Power €450/MWh	1,238	714	**1,951**
Gas €250/MWh, Power €550/MWh	1,568	920	**2,487**
Gas €300/MWh, Power €650/MWh	1,898	1,126	**3,024**
Gas €350/MWh, Power €750/MWh	2,228	1,332	**3,560**
Gas €400/MWh, Power€ 850/MWh	2,558	1,539	**4,096**

Source: Goldman Sachs Global Investment Research

And while Goldman does not say it, the biggest winner from this historic transfer of wealth – one which sees Europe's standard of living implode as disposable income evaporates going instead into staples like power and heat… is none other than Vladimir Putin.

But we already knew that: last weekend Credit Suisse repo guru Zoltan Poszar published what may have been the most insightful snippet of the entire European energy crisis (to date) when he extended the infamous "Minsky Moment" framework to Europe, and specifically Germany, which he said "can't cover its payments without Russian gas and the government is asking citizens to conserve energy to leave more for industry." He then elaborated that "Minsky moments are triggered by excessive financial leverage, **and in the context of supply chains, leverage means excessive operating leverage: in Germany, $2 trillion of value added depends on $20 billion of gas from Russia… …that's 100-times leverage – much more than Lehman's."**



Guess what: Russian gas will never cost $20 billion again, and meanwhile the margin call on that 100x leverage is now due.

So what solutions could governments use to cushion the consumer hit in Europe? According to Goldman, two come to mind:

Windfall tax on European utilities would have very little impact (only €30bn of income per year).

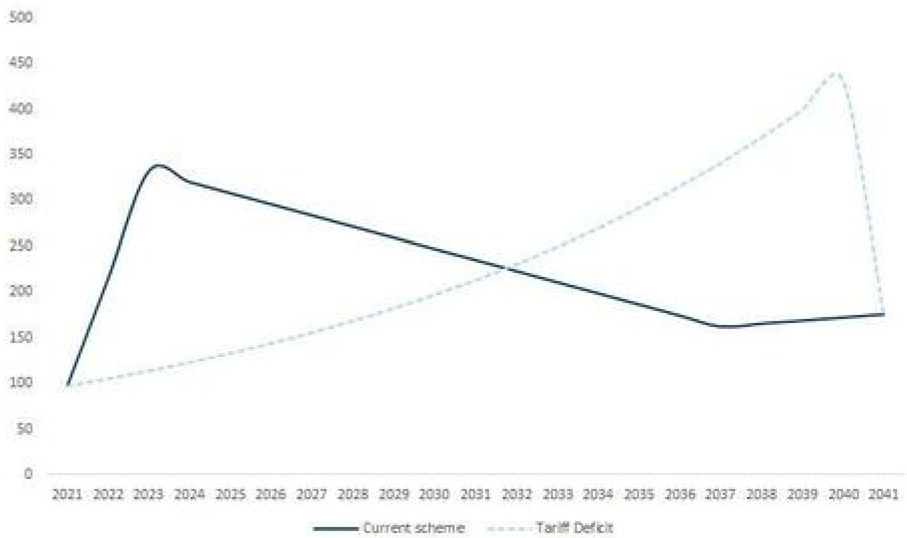
Price caps in power generation would be more effective and could save €650bn p/a. This is based on fact that a large part of power generation costs less than the marginal source of energy. These could follow the example set in Spain, where there are two co-existing caps:

1. a cap on gas prices that CCGTs are permitted to translate to the electricity price (c.€70/MWhg, which compares with current TTF levels of c.€200/MWhg); and
2. a cap on the level of remuneration fixed-cost technologies (hydro, nuclear, wind, solar) are allowed to receive (c.€75/MWh).

But price caps would not fully solve the affordability issue, as **the increase in gas and power bills would still be +€1.3 tn, or c.10% of GDP on the team's estimates.**

This is why Goldman believes that the introduction of a “tariff deficit” might eventually be needed, to spread the recent spike in bills over 10-20 years, and allowing the Utilities to securitize promptly these future payments. Although this scheme would limit demand destruction, it would smooth the increase in tariffs, limit the near-term decline in industrial production, and largely defuse regulatory risk.

Exhibit 9: Tariff deficit would spread the same cost for gas bills, over a much longer period, as seen in this example for Italy
Italy monthly gas bills per household evolution, average per month (€/month)



Source: Goldman Sachs Global Investment Research, Eurostat

Whatever the band aid solution that is applied, however, the reality is grim. And while we wait for the latest Zoltan note to quanity it in a way only he can, the math is simple: Europe can’t print more nat gas, oil, coal, etc, so one way or another, it will have to offset the surge in costs, first in commodities and then in all downstream chains, which in the very near future will mean governments will soon be subsidizing Europe’s cost of living as the alternative is a violent revolution. In short: we are about to see the printers go brrrr like never before, if only to prevent Europeans from going brrrr this winter…

by Tyler Durden

Category

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