Will Europe's energy crisis trigger the next crash?

By Elisa Barwick

While a drastically reduced flow of Russian gas is a major factor in the European energy crisis and explosion of inflation, the existential crisis the continent is facing can hardly be attributed to that factor alone. Commodity inflation had already taken off in 2020, escalating in 2021: More than a decade of expansionary monetary policy, funnelled into speculation, combined with a reduction of investment in industry and infrastructure development, has swept Europe and the world to the point of a new, global depression and interlinked world war danger.

Speculation is now being acknowledged as a factor in driving up energy prices, including by the German Finance Minister Christian Lindner who criticised the Leipzig-based European Energy Exchange. Konstantinos Xifaras, CEO of the Greek national gas company DEPA, blamed speculation in financial derivatives (high risk speculative contracts) conducted on the far more important Dutch TTF (Title Transfer Facility) virtual gas trading hub, for high gas prices. "The volume of gas traded on the TTF is 100 times greater than the volume of [physical] gas traded on the Dutch market. The imbalance started even before Russia's invasion of Ukraine and this indicator is no longer credible", he said in a LinkedIn post, calling for a new market index based on real supply and demand.

Ignoring the actual problem, in a 7 September statement European Union (EU) President Ursula von der Leyen announced that the EU would instead "propose a mandatory target for reducing electricity use at peak hours". She even urged that futures (a type of derivatives) markets be secured, saying that the current instability of energy utilities "threatens their capacity not only to trade, *but also the stability of the futures markets*"! (Emphasis added.) Not all are on board, however. While 70,000 people protested energy prices in the streets of Prague (pictured), the Czech government, which holds the rotating chair of the EU Council, included the suspension of energy derivatives trading in the list of proposals to be discussed at the EU extraordinary energy summit held 9 September. The EU rejected any proposal to regulate the futures market at that forum (unsurprising as it would require unanimous support), agreeing instead to a levy on excess energy profits; a reduction of energy consumption during peak hours; and a cap on profits by non-gas energy producers. The plan is yet to be approved by EU members states.

Ahead of such a decision the situation is already dire. After a meeting with the German government, German Industrial Association head Siegfried Russwurm warned that "the substance of industry is threatened" by rising prices. Gas consumption by industry in July was 21 per cent lower than last year, signifying "a dramatic plunge in production". German Economy Minister Robert Habeck called the situation "alarming", noting that some firms "have completely ceased to produce". In addition to Habeck's warning in July of an "energy Lehman", the Finnish Economic Affairs Minister Mika Lintila on 4 September said the crisis has all the makings of "a kind of Lehman Brothers of energy industry". Hungarian Foreign Minister Peter Szijjarto warned 29 August that Western Europe is headed for an "energy collapse".

The treasuries of numerous European governments are bailing out energy providers with loans or credit guarantees, and measures to assist industry and households: Sweden €33 billion, Finland up to €10 billion, Austria €2 billion, Switzerland €4 billion, and Germany some €80 billion. British banks are considering an extension of credit lines to energy operators. While incoming British PM Liz Truss is promising £150 billion in aid for business, household and local government bills (over several years), much of the overall expenditure is not going to people, industry, or purchase of actual power, but to fund the insurance racket overseeing the liquidity of power companies on the hook for price hedging.

'Derivatives time bomb'

Among others, an article in London's 9 September *Financial Times*, by British author Gillian Tett, calls out a "€1.5tn derivatives time bomb". As Tett explains, "European utilities have fallen into the habit of using derivatives to lock in the price of their future electricity sales … in order to protect themselves against possible price falls." But since prices have surged instead and the contracts cannot be cancelled, "massive paper losses" have been recorded. "The exchanges are now trying to protect themselves against the risks by demanding that the utilities post collateral, which would normally come in the form of cash." This is otherwise known as a "margin call". The 2008 liquidity crunch was set off when the derivatives holdings of Lehman Brothers began to unwind, triggering increased margin calls and cash hoarding.

For example, the Finnish state-owned energy company Fortum Corporation, which reported in August that its collateral requirements increased by €1 billion in one week, has received bridge financing from the government to increase its margin holdings with the Nordic commodities exchange NASDAQ.

As per the opaque nature of derivatives markets, nobody knows the total value of the margin calls demanded of already-squeezed European utilities by the clearing houses. Norwegian energy group, Equinor, suggests (conservatively) that it could amount to US$1.5 trillion (€1.5tr)—over 5 per cent of the value of Europe's entire GDP—reports Tett.

As Tett states, it is difficult to defuse this time bomb, because clearing houses must demand this collateral or "risk imploding themselves, which [in turn] poses new systemic risks". *AAS* has long argued that clearing houses *themselves* are systemic risks. Rather than addressing the risk of derivatives by outlawing them after the 2008 crash, the Bank for International Settlements (BIS) created an additional layer of risk by introducing a new middleman—central counterparties (CCPs). The BIS itself, by 2018, had acknowledged that a failure of CCPs could have "systemic consequences". ("CCP scheme can crash the entire banking system", *AAS*, 27 May 2020.)

Don't blame Russia

Russian President Vladimir Putin can't be blamed for high prices: He is on the record opposing the abandonment of long-term contracts in favour of "gas exchange trading". ("Leaders demand end to speculation driving energy crisis", *AAS*, 20 Oct. 2021). Furthermore, working with other nations, Russia is proposing to fix stable commodity prices for trade, including by the exclusion of speculation. ("Days are numbered for US dollar order", *AAS*, 7 Sept.)

Regarding Russian gas delivery: Kremlin spokesman Dmitry Peskov announced that the cessation of gas deliveries through the Nord Stream 1 pipeline was due to an inability to service infrastructure and equipment because of the sanctions regime. Russia had made this clear at the commencement of sanctions; and an oil leak in the last functioning turbine, detected 2 September in a compressor station near St. Petersburg, Russia, has put the pipeline out of action. Gazprom has increased flows of gas transiting through Ukraine via the Sudzha pumping stations, but its proposal to do the same for the Sokhranovka pumping station was rejected by Ukraine. Other pipelines still operating include the Turkish Stream pipeline, which supplies Greece, the Balkans and Italy. The Yamal pipeline, which delivers gas to Germany through Belarus and Poland, was cut off in response to Polish sanctions. Nord Stream 2, which is ready for use, has been denied certification due to sanctions. It parallels Nord Stream 1 and could make up for maintenance supply issues. Speaking at the Eastern Economic Forum in Vladivostok on 7 September, Putin said Moscow is ready to "switch on" the new pipeline to deliver gas to Europe, and to restore flows in Nord Stream 1 if a new turbine is provided.