Financial crisis in European energy markets

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The continued escalation of the US-led NATO war against Russia in Ukraine is threatening to spark a financial crisis in European energy markets that could spread more broadly to hit banks and other areas of the financial system.

Over the weekend the Swedish and Finnish governments announced they were providing emergency assistance, running into the tens of billions of dollars, for energy companies hit by liquidity problems as they confront a 10-fold escalation in gas prices and violent swings in the market which are making it increasingly difficult to finance their trading operations.

The immediate origins of the move, in which the Swedish government said it would provide up to $23 billion in credit for utility companies, lie in the decision by major powers to step up sanctions against Russia.

Last Friday, finance ministers from the G7, comprising the US, Canada, France, Germany Italy, Japan and the UK, agreed they would press ahead with efforts to impose a cap on Russian oil prices in order to reduce the revenue to the Russian government and "build on and amplify the reach of existing sanctions."

In response, Russia said it was cutting off gas supplies through the Nordstream 1 pipeline, claiming sanctions had impeded maintenance work.

There was an immediate outcry against the Russian response amid claims that the gas market was being "weaponised," and Moscow's move was proof of Russian "cynicism."

Comments by Swedish and Finnish government ministers as well as from industry representatives point to the extent and depth of the financial problems confronting energy companies arising from the way they trade in the gas market.

This involves the use of derivatives in which they try to cover large movements in prices for which they must obtain credit from banks and other financial institutions. But prices have become so high and the movements so violent that the money which they need to place with their creditors as collateral has reached a point where once "normal" operations have broken down.

According to one European trader, cited by the *Financial Times* (FT): "The amount of cash you need to participate in these markets is getting to impossible levels."

Announcing the move in the wake of the decision to shut down Nordstream 1, Swedish Prime Minister Magdalena Anderrson said the government would provide hundreds of billions of kroner to fund the collateral energy producers need to post to finance their deals.

Standing beside the Swedish financial regulator, the central bank governor, and the finance minister, as she made the announcement, Anderrson said Russia's decision "not only risks leading to a 'war winter' but also threatens our financial stability."

The Swedish move was followed by a tweet from Finnish Finance Minister Annika Saarikko that similar action was underway. "The concern is shared. Similar preparations are well under way in Finland," she said.

This was followed by a press conference conducted by Finnish Economy Minister Mika Lintilä in which he outlined the seriousness of the problem which has seen the government announce a €10 billion loan and guarantee package.

"The nervousness in the market is strong," he said. "Here are all the ingredients for the energy sector's version of Lehman Brothers." The collapse of the US investment bank in September was the trigger for the global financial crisis.

Remarks by those involved in energy markets underscore the extent of the financial dangers.

Jean Francois Lambert, the founder of a commodities trading company and a former head of commodity trade finance at HSBC, told the FT other countries were likely to intervene in energy markets.

"The crisis is moving into the next stage. If one of the large energy companies collapses there are fears there could be a domino effect," he said. "The call for liquidity is so enormous that maybe one day we have a problem that could harm the whole market."

Speaking in support of the Swedish government's measures, Stefan Ingvfes, governor of the country's central bank, the Riksbank, said: "We need to isolate this in one market so it doesn't infect the financial sector."

The crisis is not confined to the Nordic countries but extends across the European continent and to the UK.

Lambert said the situation was not yet a financial crisis but indicated that it could become one.

"The large banks in Germany, France, Italy and Spain should be able to stomach this. But if one of their large customers traps them in a liquidity squeeze then you could see all the banks pulling back," he said.

The effects of the gas price escalation have already been felt. In July the German government announced a €15 billion rescue package for Uniper, the largest European buyer of Russian gas which has been losing tens of millions of euros a day, and the company last month asked for a further €4 billion.

Speaking to the FT about Sweden's move, the country's finance minister Max Elger said: "This is a problem that is Europe-wide… liquidity is an issue in many countries. It may be the case that other countries will have to follow suit."

The crisis is also heavily impacting Britain. The deputy director at Energy UK, a trade organisation which advocates for around 100 energy companies, told the FT that electricity producers in Britain were "really concerned about the situation this winter in relation to liquidity."

Urging the British government to investigate and understand the scale of the problems confronting companies, he said: "Fundamentally the energy markets is not designed to deal with the scale of market volatility that we have seen over recent months."

But as the war against Russia intensifies and further economic sanctions are employed the crisis is set to worsen.

The top Russian energy official Alexander Novak said the EU was responsible for the cuts in gas supplies and if it did not roll back sanctions the situation could worsen as prices continued to rise.

"The whole problem is at their end," he said. "This nearsighted policy is leading to the collapse we see on European energy markets. This is not even the end, because we are still in the warm part of the year. Winter is coming, and many things are hard to predict."

It has been reported that European energy ministers will meet on Friday in an emergency meeting to consider their response to the crisis under conditions where one electricity executive has warned it would only take "matter of days for not only small but large generators" to collapse because of liquidity problems.