

Europe's Energy Crisis

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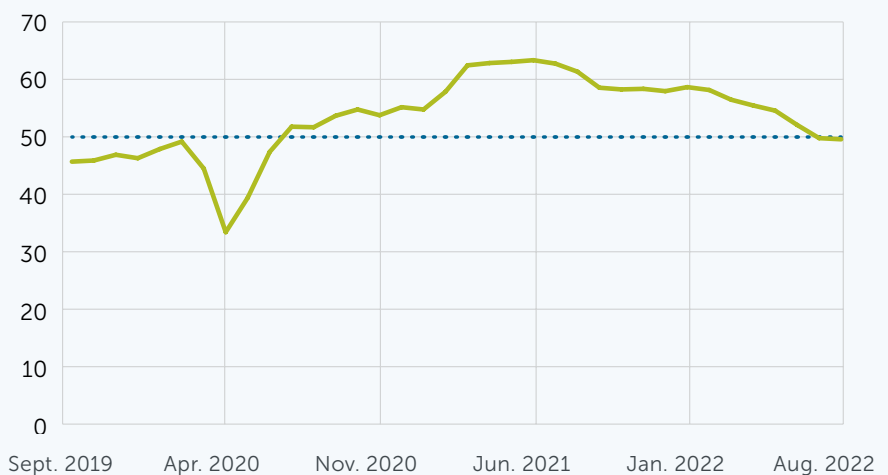
This piece is best read in conjunction with Sara Shahram's [natural gas note](#). The purpose of this is to focus in on the region that is facing the brunt of the impact, Europe.

Europe's recovery cut short by a looming energy crisis

Europe has barely had time to rebound from COVID and is now being faced with an energy crisis, which has serious implications to governments, corporations and consumers. We will address each of these individually but start by saying that the Eurozone, as judged by the Manufacturing PMI (Purchasing Manager Index), is likely in a manufacturing recession.

Anything below 50 signals contraction and the August reading was 49.6 (down from a high of 63 in June 2021). Concurrent with this, inflation is high and rising across Europe. In order to cope with this the European Central Bank has raised rates and maintains a hawkish stance.

Eurozone Manufacturing PMI



Source: Bloomberg September 30, 2019–August 31, 2022

Impact on European governments and their response

There are many ways European governments are being impacted by rising natural gas prices. Their key goal is to protect the consumer and certain industries. In Spain and Portugal, there are temporary subsidies being given to power generation companies to lower prices. The broader EU is yet to announce such formal measures but there are continuing talks of price caps and windfall taxes being put in place. We would expect such measures to be enacted. One area we are less certain of is targeted, more aggressive gas rationing. If rationing was put in place this would likely put more pressure on the overall economy. Hardly a bright spot, but the aforementioned manufacturing recession might be a self-balancing mechanism in that industrial demand might naturally decline, helping to reduce the necessity for rationing. In the medium term, the focus of Eurozone government's will likely be for an increase in renewable capacity.

Impact on European companies

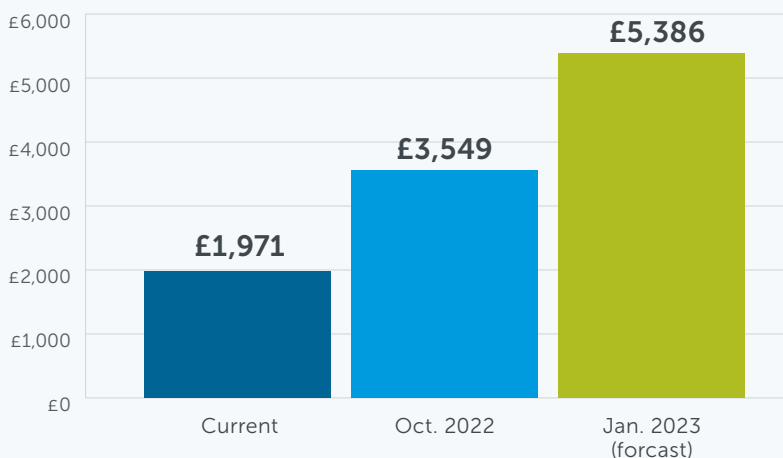
European corporates are being hit by rising costs and potentially uncertain gas supply. This is on top of a still broken, but improving supply chain. In some cases it is having catastrophic impact. For example, as a result of rising natural gas prices, a Norwegian fertilizer company Yara is temporarily curtailing ammonia production. CF Industries, another chemical company, has announced similar measures. These are the two most glaring examples but according to VCI, a German chemical industry association, there has also been reduced output of other products. I am often reminded by a colleague that in the 2000 tech bubble one of the issues that large technology companies faced was a rapid deterioration by some of their customers which ultimately impacted their operations. There is a strong parallel here. Capacity closures may not only impact sales of their suppliers, but also cause severe problems throughout the supply chain. A notable result of these shutdowns has been Carlsberg Polska, the third largest brewer in Poland halting beer production due to its inability to source CO2.

Impact on European consumers

It is with no surprise that the European consumer is being pressured. Higher rates impact borrowing costs but more importantly, rising electricity and gas prices are really hitting the consumer hard. The clearest example is in the U.K. where the existing price cap for household energy prices is GBP1,971 (this reflects the average annual household energy bill determined by regulators). In October this is set to rise to GBP3,549 (+80%). At recent levels it could rise to GBP5,386.

The hope is that there will be intervention but this is a fairly bleak picture. The median 2021 U.K. household disposable income was roughly GBP31,400. The consumer is trading down where possible and we expect purchases of large goods to moderate. We have just spoken to the U.K. but unfortunately this picture is true across Europe.

U.K. Household Energy Price Cap



Source: <https://www.bbc.com/news/business-58090533>, analyst estimates

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David Mann

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