Gazprom halts gas supplies to Poland and Bulgaria

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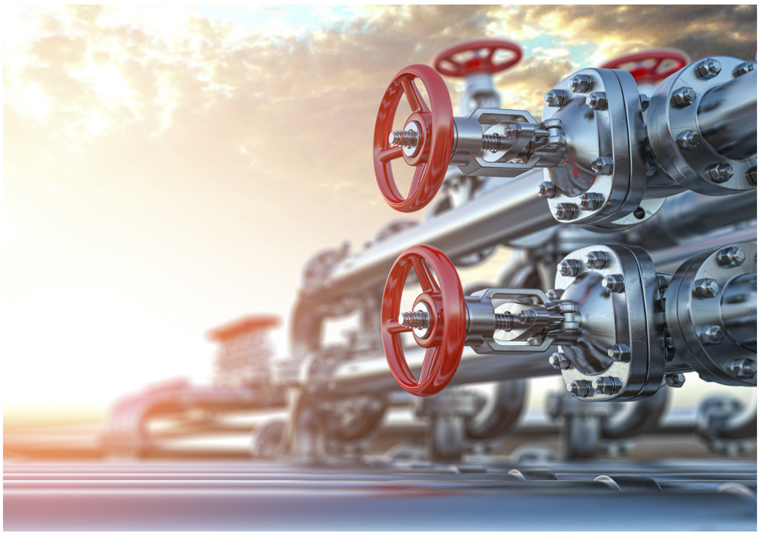

ANALYSIS
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PRIVATE BANKING

The facts

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Poland confirmed that supplies had been cut, while Bulgaria said it would find out soon. Both accused Gazprom of breaching longstanding supply contracts.

In early April, Russian President Vladimir Putin demanded that buyers from "unfriendly" countries pay for their gas imports in rubles or be cut off, starting with payments due in April. The European Union has rejected this demand as rewriting contracts that called for payment in euros.

Poland is among Russian's least friendly neighbors, both from a historical perspective but also due to their current support to Ukraine: they host US troops, have supplied tanks and is home to the largest number of Ukrainian refugees.

Supplies from Gazprom cover about 50% of Poland's consumption and about 90% of Bulgaria's. Poland said it did not need to draw on reserves and its gas storage was 76% full. Bulgaria has said it is in talks to try to import liquefied natural gas through Turkey and Greece.

Should other EU natural Gas buyers refuse the Kremlin's requirement, further cutoffs are likely in the second half of May, when the next payments are due.

Poland and Bulgaria are also transit states for Russian natural gas pipelines. The Kremlin said yesterday that any illegal withdrawal will result in an equivalent cut in supply.

To the surprise of many, Bloomberg reported this morning that four European gas buyers have already paid for supplies in rubles as Russia demanded, citing a person close to the Russian gas giant. According to Reuters, Germany's Uniper and Austrian OMV are among the companies that have folded to the Kremlin's demands and thus potentially violated EU directives. The consequences of such violations remain to be seen.

Meanwhile, Hungary has struck a deal to pay into a euro-denominated account with Gazprombank in (name of country or city), which in turn will deposit the funds in rubles to Gazprom Export. Its next payment is due on May 22, he said. Slovakia seems to have reached a similar agreement.

Analysis

Russia wants to be paid in rubles as the sanctions make the EUR and the USD of little use. They also need a strong ruble to pay for the war and keep their economy afloat amid all the sanctions. Natural gas exports bring in around one billion dollars a day for Russia. It is also an economic and geopolitical weapon for Russia and the Kremlin is using it to secure as many rubles as possible.

In the short to medium-term, the EU will keep buying Russia natural gas since there is no effective alternative as 40% of EU natural gas comes from Russia. With the winter being behind us, there is less need for natural gas by EU households but a large need for the significant manufacturing sectors. "If gas supplies were to be cut off, the German economy would undergo a sharp recession," said Stefan Kooths, research director for business cycles and growth at the Kiel Institute. Meanwhile, the CEO of German chemical giant BASF has gone on record saying that replacing Russian gas would take 4-5 years and that a reduction of gas volumes by more than half could lead to shutdowns at Ludwigshafen, the world's biggest chemicals plant.

While the EU needs Russian gas, they don't want to pay in rubles. As such, the scheme currently used by some EU companies (described above) could be the best way for the EU to save face and not fall afoul of the law. But this solution also has some shortcomings: 1/ They remain reliant on Russian energy; 2/ It keeps the Russian economy in decent shape with its current account surplus at a record high and the ruble trading at a 2-year high against the euro, etc.) and thus enabling them to finance the war; 3/ The euro paid by EU companies is not reinjected into the EU economy. The Kremlin does not want to keep euros and are thus not buying EU sovereigns as they used to do; 4/ There is a risk of split among EU members as some companies are ready to pay in rubles while other countries refuse any compromise – at least for now.

Opinion

There is no easy fix or perfect solution from a European perspective. It is in the interest of both the EU and Russia to find a solution that keeps gas payments in compliance with the EU's legal requirements, consistent with recent comments from Brussels, and long-term contracts being respected.

Imposing a full embargo on Russian oil import on which the EU is less reliant than gas would be a face saving measure and allowing gas imports, in euros, to continue. Such a decision will nevertheless keep energy prices volatile and increase the risk of a deep recession in the EU in the near future.

From an asset allocation perspective, we remain cautious on risk assets. Indeed, we have a "disinclination" positioning on both equities and credit. We have a "strong disinclination" view on European equities as the eurozone is the most exposed to the current energy crisis and Russia's war in Ukraine. We also maintain a "disinclination" view on the euro against dollar.

Finally, we are keeping exposure to broad commodities as a portfolio hedge.

For further information

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