Novak Statement on Ukraine Gas Transit Agreement

If you are curious why are we paying attention to this unsolicited remark from the Russian Deputy Prime Minister, Alexander Novak, it is because we believe this to be a statement of far-reaching implications for EU gas and power markets. The reason is not just the results of the recent US election and its resulting impact on the energy and commodities world, but also to provide a first alert that this story will have long-lasting consequences for the energy transition in Britain as this development links with the Clean Power 2030 report, released two days ago by the newly minted National Energy System Operator.

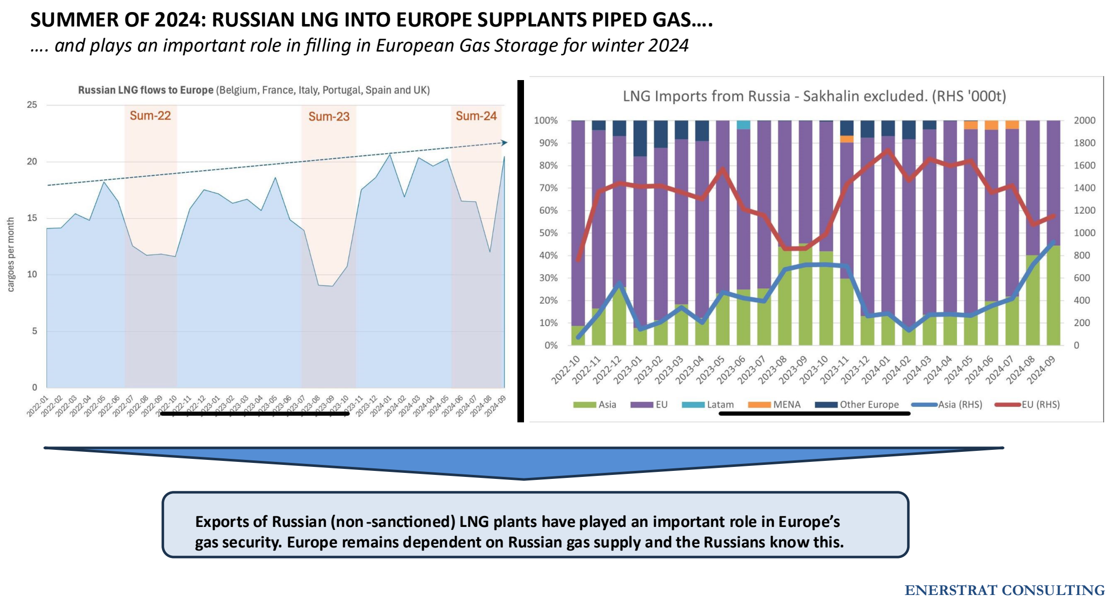
First, what is curious about the statement by Deputy Prime Minister Alexander Novak is not the content, but its timing.

Russia/Gazprom has a well-formed view about the inevitability of the role of Russian gas in the EU. The EU is Russia's biggest and most profitable market, and our own comment made on the 7th October exactly a month ago (and reproduced below) made this point. We also mentioned at the time how Russia is sending the gas it would have sent via pipeline as LNG with one eye on the strategic opportunity for rising LNG demand in Asia and how the marginal cargoes coming into the profitable EU gas market now also have an Asian premium embedded into it.

What we said on October 07th 2024: Russian LNG to the rescue for European winter gas demand

Our curated slide below says it all:

Russian LNG has played a critical role in the deliveries into European gas storages this year and the trend is an upward one, compared on a year-on-year basis. This has been a good summer for the non-sanctioned Russian LNG projects and lends credence to our view that the TTF gas price in Europe will have a significant "Asia factor" built in. The contest for Russian LNG really is between Europe and Asia. The centre of gravity of the global gas trade is has shifted east and we expect major Asian players to grow their presence on the TTF gas markets as the gas market globalisation continues apace.



We would now also draw your attention to not only the overall rise in the LNG cargoes coming into Europe but also to note the “seasonality” in these cargoes: the Russian LNG supply into Europe rising from early spring into the summer is directed into the European gas storage, and as gas storages fill up in the autumn (October 01 is the start of the “gas year” in Europe) the LNG buying tapers off. *This means the European customers now view Russian gas only as a backup security of supply option and the reduction in pipeline gas flows suggest that Russian market share in Europe is now in terminal decline. This recognition is reflected in the timing of this statement from Alexander Novak- the pointsman for Russian energy strategy.*

Now see the next slide below:

OUT TURN OF RUSSIAN PIPED GAS SUPPLY THROUGH UKRAINE HAS BEEN LESS THAN THE AGREED TRANSIT SUNSET AGREEMENT

The Russia-Ukraine transit contract signed on 31st Dec 2019 was agreed for a taper to 40bcm per annum; at the time of signing the war clouds were not apparent.

Russia then sought to supplant pipeline deliveries with LNG; however with one eye on rising Asian demand.

LNG imports largely went into EU gas storage which get filled in the summer- for security of gas supply as Europe continued with supply diversification away from Russia.

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When the Ukraine-Russia gas transit agreement was signed, with tremendous pressure from Russia at the time on 31st December 2019, the volume commitment was curtailed from around 120 BCM annually to 40 BCM annually for the next 5 years. The contract, as we have been writing about for some time, expires on 31st December 2024. Actual volume flows now stand significantly curtailed and taken together with the insight that European consumer appetite for Russian gas is now only limited to ensuring security of supply by using it to fill the gas storages for winter demand, this statement becomes quite significant.

Considering the outcome of the US elections, the timing of this statement suggests that Russia (and indeed the global gas market participants) believe that the so called “LNG Pause” initiated by the Biden administration will be reversed.

US LNG will flow into Europe and the current price levels as suggested in the article €40.23/MWh ($12/MMBtU) (*more pricing details appear in the link appended at the end of this piece*) against the US Henry Hub price of $2.73/MMBtU makes US LNG supply into Europe very attractive.

The newly-built LNG receiving terminal at Gdansk in Poland is an ideal location for the landing point for this gas that can seamlessly flow into the European gas grid as well as into the around 35BCM gas storage capacity in western Ukraine. This way the gas storage and pipeline system of Ukraine (operated by GTSOU) can and will ensure that these assets will command a more attractive tariff than then expired Russian gas transit contract. Therefore, we do not see the Ukrainian government/GTSOU to be in any hurry or panic about the expiring Russian gas transit contract.

The loss of European gas market revenues is a body blow to Gazprom and the Russian government treasury - advantage US LNG. Watch out for US LNG suppliers signing term LNG contracts with European gas buyers.

The opportunity for US LNG to secure markets in Britain and Europe does not appear palpable with the farrago of green subsidies and state aid to green projects; the noise and disinformation emanating from the green echo chambers of European energy policy makers. However, we believe the EU policy makers have seen the writing on the wall. The vote of confidence for the Scholz government in Germany, now called for January 2025 with possible elections in Germany by March 2025, reflects the disquiet generated by the deindustrialisation underway in Germany. The dominoes will begin to fall if the vote of no-confidence motion is upheld in the Bundesrat in January. The results of the US election perhaps, will have put in place some unprecedented challenges for the newly minted European Commission.

Finally, why does this development matter in Britain?

Dear reader, you only have to look at the gas and electricity wholesale market prices in the UK and read the National Energy System Operator published its Clean Power 2030 plan. For all its lofty statements on low-carbon-powered Britain, the insight we draw is that Britain needs additional gas-fired power generation capacity of at least 20 GW over the next 10 years, new interconnection capacity (which adds to the energy import dependence) of 4GW notwithstanding.

The mid 1990s was a period of "dash for gas" in Britain and the winners then were the American utilities (yes, and a certain company called Enron too). This time it will be a wave of new US LNG suppliers.

We are looking at the next wave of dash for gas, not only in Britain but also the EU. Watch out for the already well-established British players in the US: National Grid and Centrica.

Watch out for European gas majors securing not just contracts but also possibly equity in the LNG projects in the US as the history of 1986 repeats in the European gas markets with Russian market share decimated.

Link to the S&P Global article referenced above can be found here.