Collective Intelligence

An Unprecedented Energy Crisis for Europe

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BRUNSWICK

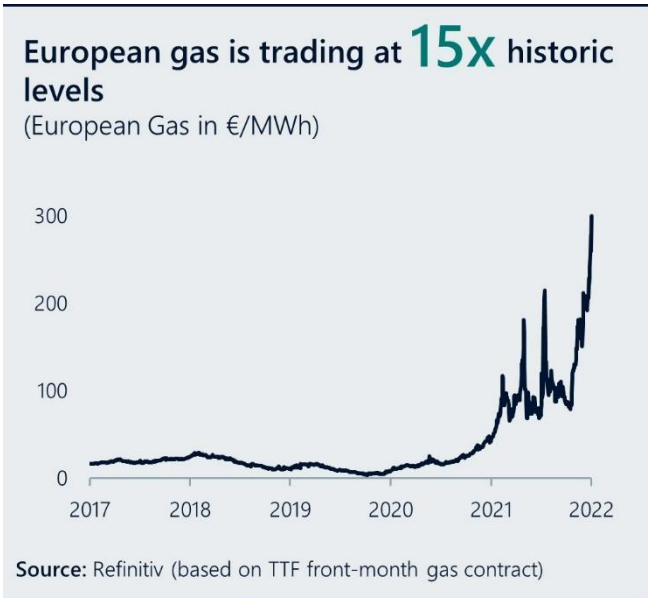
An Unprecedented Energy Crisis for Europe

High gas and power prices in Europe are likely to persist for some years to come. We are already seeing many households fall into fuel poverty and energy intensive industries beginning to close, with significant ramifications for European living standards, jobs, supply chains and sovereign debt. In this note, we highlight the range of potential risks posed to companies by the energy crisis, and what they need to consider to weather Europe's coming winter of discontent.

Fluctuating demand, war and underinvestment

Europe is facing its worst energy price shock in decades, bringing to an end a long period of relatively secure, affordable and increasingly low-carbon supplies of energy. The reasons are varied and multi-faceted. On the demand side, we saw economic activity and associated energy demand decrease dramatically during the COVID-19 pandemic, and rapidly rebound as the world reopened from lockdowns.

On the supply side, the outbreak of war in Ukraine exacerbated an already tight energy market given Europe's dependence on imported natural gas. Globally, we have seen years of structural underinvestment in upstream oil and gas capacity – by as much as US $1 trillion according to Shell CEO Ben van Beurden – as commodity prices stayed low for much of the past decade.



As pipeline flows of natural gas between Russia and Europe have declined, Europe has turned to global gas markets, bidding high prices to attract liquefied natural gas cargoes, often redirected from the Pacific Basin. The need to urgently refill gas storage capacity ahead of colder winter months and the shut down of major gas pipelines from Russia has increased both demand and price of future gas contracts. **This has left Europe chronically short of gas molecules**, leading to extreme energy prices with European natural gas trading at 15 times historic levels at the beginning of September.

A new era of extreme energy prices

This has led to a parallel crisis for European power markets where gas-fired power plants largely set the price of electricity. Unplanned outages of French nuclear reactors and a drought, which has depleted hydro levels and constrained the transit of coal cargoes on European waterways, have exacerbated an already tight power market. For the first time in recent history, it is more economic to burn oil than gas for electricity generation.

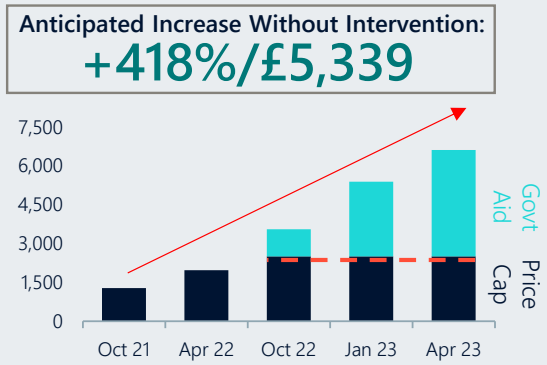
While energy prices have come off recent highs, commodity markets continue to price in scarcity beyond this winter. Since July, European gas prices for delivery in 2023 and 2024 have more than doubled as prices continue to search for levels which induce demand to balance the market.

An inevitable policy response

Absent intervention or price controls, this extreme pricing in the wholesale energy markets will be passed through to consumers **with no household or company in Europe unaffected.** Some companies will be able to substitute fuels and pass costs onto their customers, whereas others will need to curtail production or even consider relocation outside of Europe. **This has made intervention from policymakers inevitable.**

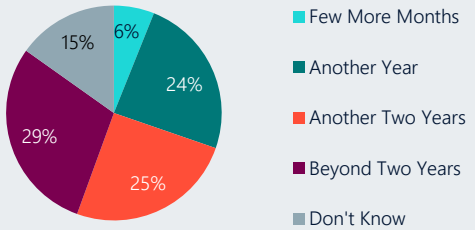
To illustrate this, energy bills in April 2023 were expected to exceed £6,000 for the average UK household, an increase of over 400% since October 2021. To put this into context, the share of disposable income which would be spent on gas and electricity for the median UK household would grow from 6% to 21% by next spring.[1] It is therefore no surprise that the new UK Prime Minister, Liz Truss, announced an "energy price guarantee" during her first week in office. This will cap energy unit costs such that the average household will pay no more than £2,500 on energy bills for two years, essentially shifting wholesale energy price risk onto the government balance sheet.

The Energy Crisis is the 'Cost of Living' crisis...
(Average Household Energy Bill in GBP)



Source: Brunswick, Cornwall Energy

...And more than 50% believe the energy crisis will last two or more years



Q. For how long do you expect the energy crisis to last?
Methodology: Brunswick Insight Survey of 2,070 British Adults, August 2022

As with COVID-19, the responses to the crisis have the potential to create second- and third-order impacts for corporates with implications across industries for strategy, reputation and social license. As one example, companies trading in wholesale energy markets are experiencing significant collateral and working capital requirements as exposure across their trading books has increased. The resulting liquidity constraints have increased risk of defaults across the energy value chain, raising concerns over the reliability of counterparties and potential contagion into wider markets. Higher corporate tax rates or more targeted "windfall" taxes are a likely response to the inevitable government intervention in such a scenario.

We are already seeing this play out on the Continent with several countries across Europe implementing emergency loan and guarantee programmes. On September 14th, the European Commission announced it was considering measures to provide liquidity relief to energy companies, and unveiled emergency measures involving electricity rationing, temporary price caps on generator profits, as well as "solidarity contributions" on profits for the oil, gas, coal and refinery sectors.

In **Appendix A**, we illustrate potential ways responses to the crisis can cascade through to corporate reputation and strategy.

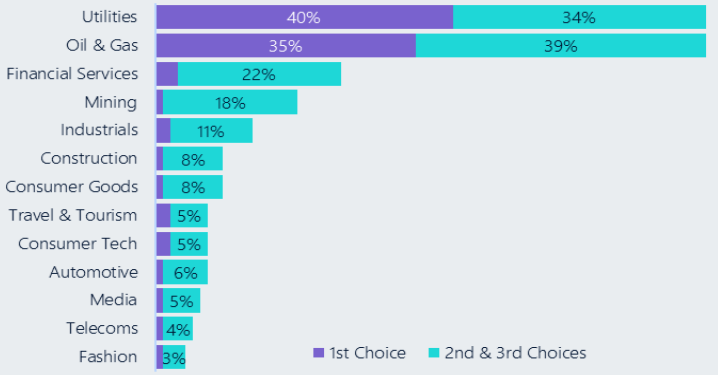
[1] Source: UK Office for National Statistics. Note: Based on median disposable income of £31,400 in FY2021.

The public expect corporates to act

The likelihood of a prolonged energy crisis is filtering through to the wider public. A recent survey by Brunswick Group of 2,070 UK adults found that more than half believed that the energy crisis would last at least two or more years, while 24% believed it would last another year. Consumers will expect to see not just near-term help to minimize the impact of higher energy prices from governments and corporates, but also longer-term solutions.

The challenges posed by the energy crisis suggest that no one company, sector or government can resolve it. But it is clear that while the vast sums required to prevent the poorest in Europe from choosing between eating and heating this winter will come from governments, there is a clear expectation from the general public that corporates will do their bit. In our polling, we found that expectations for who is responsible for resolving the energy crisis is almost equally split between business (49%) and government (51%).

Energy sector leads expectations of action, but every sector has a role to play



Q. Which THREE of the following sectors can do the most to reduce the impact of the energy crisis?
Methodology: Brunswick Insight Survey of 2,070 British Adults, August 2022

The same research indicated that these expectations are not limited to energy companies. Financial services, mining and the industrial sector are all also expected to play a part in supporting consumers through the energy crisis. **It is clear that in addition to managing the direct impacts of the energy crisis on their business, customers and employees will also expect businesses themselves to step up.**

Five questions companies should consider

As boards, management teams, investor relations and corporate affairs teams consider the implications and uncertainties of the energy crisis, we highlight five key questions to consider:

1. What steps are we taking to better understand the potential direct and indirect impacts of the energy crisis on our business, including potential developments in financial markets, geopolitics, politics and society?

2. How has the crisis changed the make-up, requirements and expectations of our priority stakeholders across different time horizons?

3. What are the potential implications for delivery of the company strategy and financial framework/objectives? How should we be adapting our strategy, investor relations, communications and policy advocacy to reflect the external reality?

4. Do we understand how the crisis is impacting our own employees? What do we need to do differently and how should leadership engage with them?

5. Do we need to update our risk register and crisis/issues management plans?

How we can help

Brunswick is supporting a range of clients on the European energy and cost of living crises with strategic communications advice spanning public affairs and advocacy, geopolitics, investor engagement, employee engagement and industrial relations topics.

We also work with clients to think through medium- to long-term sector and company-specific risks and scenarios, including potential developments across financial markets, geopolitics, politics and society. This helps companies identify potential risks and how they could compound to impact delivery of their strategy, investment case, brand, reputation or social license. In turn, this helps companies identify strategic options and opportunities, anticipate likely stakeholder and competitor responses and inform recommendations across business strategy, policy advocacy, internal and external communications.

To continue the conversation:

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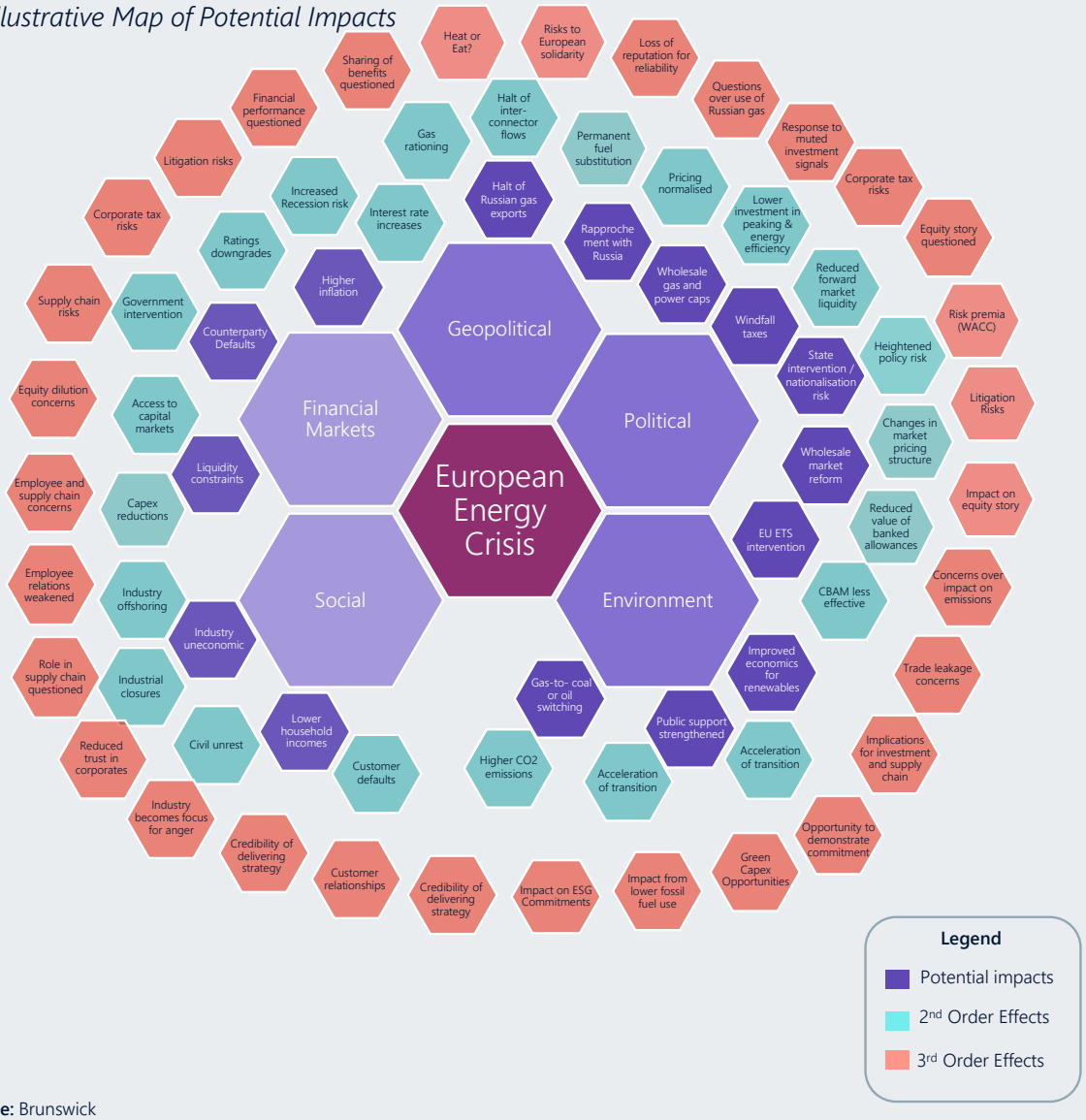
Appendix A:

The European Energy Crisis Will Have Long-Lasting and Far-Reaching Repercussions

Illustrative Map of Potential Impacts



Source: Brunswick

