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To the point!

Cross-Asset- and Strategy-Research

A gas stop would create economic havoc

Stagflation would follow, while the war might go on regardless.

No question is currently occupying the minds of politicians, captains of industry, and citizens as much as the opportunities and pitfalls of a gas embargo against Russia. Or the consequences should the taps be closed by the Russian side.

Emotionally, many support such a gas embargo. It would help to overcome our paralyzing feeling of helplessness in the face of brutal mass murder. However, it is far from clear whether a gas embargo would really help to shorten the indescribable suffering of the population in Ukraine. All the less so since Europe has already transferred €40 billion to Putin for commodity supplies since the war began (see last week's edition). His war chest is anything but empty. Putin doesn't even need the sanctioned currency reserves of the central bank at the moment.

There are numerous examples of draconian sanctions (Iran, North Korea, Venezuela, Cuba) that have been sat out by dictatorial regimes, albeit at the expense of the population. But what does an cynical czar care about his own population!

Why gas is so critical for us

The loss of Russian gas would have a much more severe economic impact than the absence of coal or oil from Russia. There are two principal reasons for this:

- For one thing, gas from Russia can be compensated only marginally by imports from other countries. There are no alternative pipelines from other regions. The lack of terminals, tankers, and delivery capacity also makes the use of liquefied natural gas (LNG) unrealistic for the foreseeable future. We have made ourselves dependent on Russian pipelines. This cannot be undone in a hurry now.

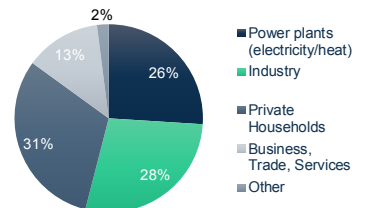


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Use of natural gas in Germany, 2021



Source: BDEW, LBBW Research

There is no realistic way to replace Russian gas in the short term

- What's more, gas is not only used as an energy source. A good quarter of consumption is used in specialized industrial processes, especially but not exclusively in the chemical industry. In most cases, there are no viable technological alternatives to gas in the short term.

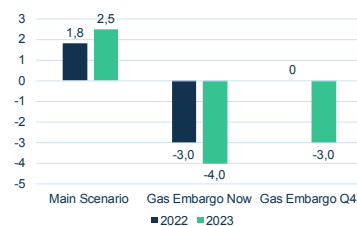
Stress along industrial supply chains

When natural gas supply bottlenecks occur, the legal situation is clear: households are to be supplied until the very end, while industry gets the tap turned off. If, for example, a plastic that requires natural gas to be produced can no longer be manufactured, then the companies that need such plastics as an intermediate product can also no longer continue to produce. These companies can then also no longer supply their downstream customers, and so on. The lined-up dominoes fall one after the other.

A recession would be virtually guaranteed

How extensive the economic costs will be if these supply chain problems eat through the economic system also depends on *when* the disruption occurs. If gas stops finding its way to Germany only at the beginning of the heating season, the "fallout" will not be as devastating as in a scenario that assumes a stop in the coming weeks (see chart). Either way, a severe downturn beckons. This may provoke a smirk in the Kremlin. Whether it will do anything to shorten the war is highly quite uncertain. The balance of costs and benefits of a gas embargo do not seem to be tilted in the favor of Europe.

Growth forecast with and without gas deliveries (%)



Source: LBBW Research

Many industrial processes could come to a standstill

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