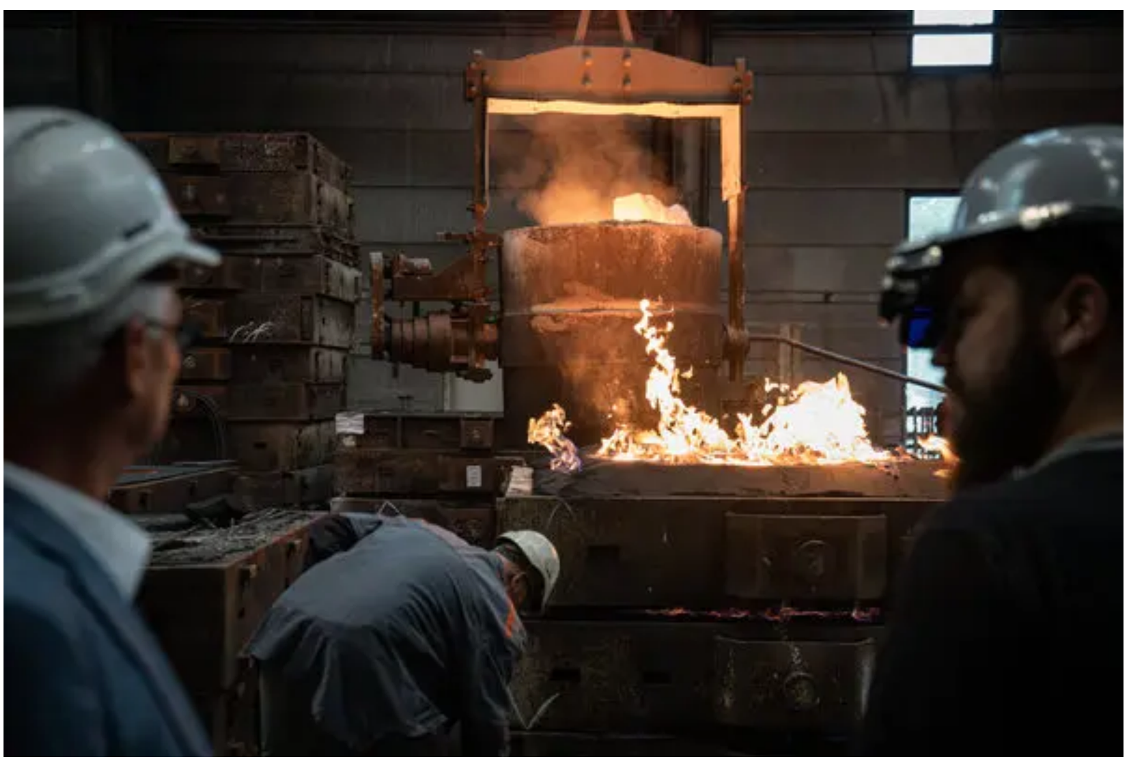
nytimes.com

Germany Hopes to Outrace a Russian Gas Cutoff and Bone Cold Winter

By

10-13 minutes



Credit...Lena Mucha for The New York Times

Europe's largest economy and key energy hub still depends on gas supplies now ensnared in conflict. Here's how Germany is preparing and what is at stake.

A furnace casting stainless steel at the Schmees factory in Pirna, Germany.Credit...Lena Mucha for The New York Times

Patricia Cohen and Melissa Eddy

Patricia Cohen is a global economics correspondent based in London. Melissa Eddy, based in Berlin, reported this article from Pirna in eastern Germany.

- July 15, 2022

Russian natural gas has fired the furnaces that create molten stainless steel at Clemens Schmees's family foundry since 1961, when his father set up shop in a garage in the western part of Germany.

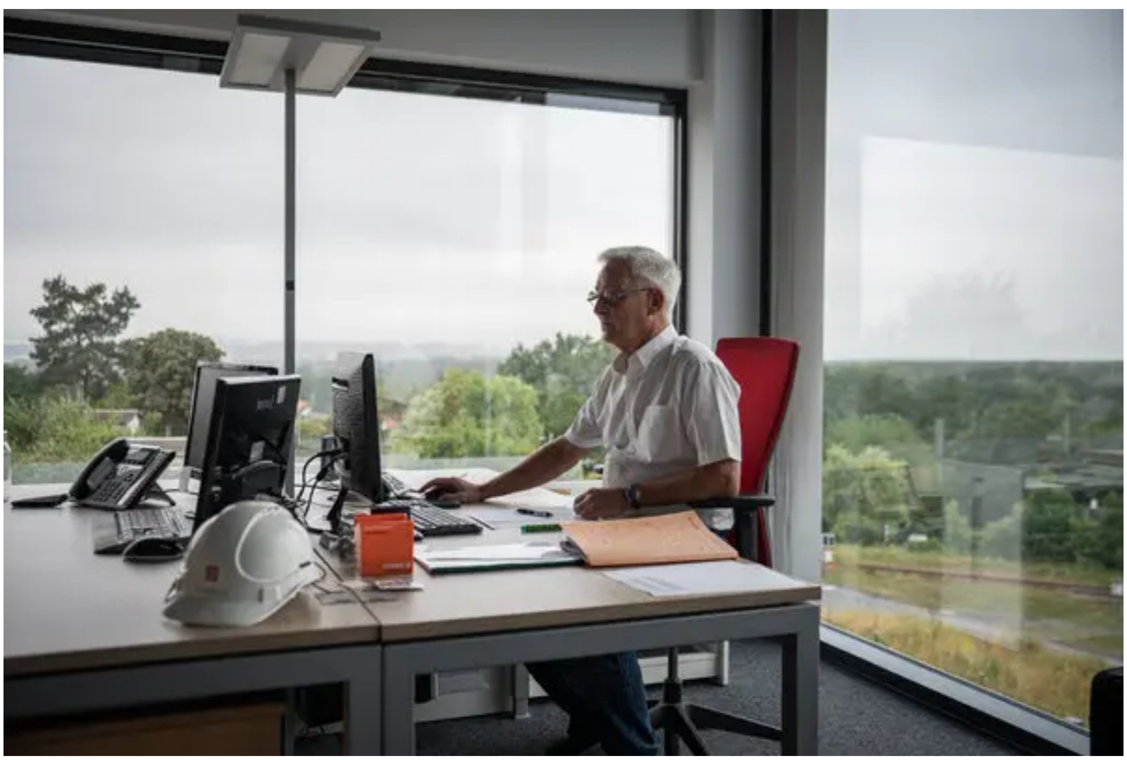
It never crossed Clemens's mind that this energy flow could one day become unaffordable or cease altogether. Now Mr. Schmees, like thousands of other chieftains at companies across Germany, is scrambling to prepare for the possibility that his operations could face stringent rationing this winter if Russia turns off the gas.

"We've had many crises," he said, sitting in the company's branch office in the eastern city of Pirna, overlooking the Elbe River valley. "But we have never before had such instability and uncertainty, all at once."

Such sentiments are reverberating this week in executive suites, at kitchen tables and in government offices as Nord Stream 1, the direct gas pipeline between Russia and Europe, was shut down for 10 days of scheduled maintenance.

Germany, the pipeline's terminus and a gas transit hub for the rest of Europe, is the largest and most important economy on the continent. And anxiety that President Vladimir V. Putin may not switch the gas back on — as a display of brinkmanship with countries that oppose Russia's invasion of Ukraine — is particularly sharp.

Image



Credit...Lena Mucha for The New York Times

In Berlin, officials have declared a "gas crisis" and triggered an emergency energy plan. Already landlords, schools and municipalities have begun to lower thermostats, ration hot water, close swimming pools, turn off air-conditioners, dim streetlights and exhort the benefits of cold showers. Analysts predict that a recession in Germany is "imminent." Government officials are racing to bail out the largest importer of Russian gas, a company called Uniper. And political leaders warn that Germany's "social peace" could unravel.

The crisis has not only set off a frantic clamber to manage a potentially painful crunch this winter. It has also prompted a reassessment of the economic model that turned Germany into a global powerhouse and produced enormous wealth for decades.

Nearly every country on the continent is facing potentially profound energy shortages, soaring prices and slower growth. On Thursday, the European Commission cut its growth forecast for this year to 2.7 percent. In another sign of recession anxiety, the value of the euro dipped below the dollar this week.

Still, “Germany is worse off than the eurozone as a whole,” said Jacob Kirkegaard, a senior fellow at the German Marshall Fund in Brussels.

The Russia-Ukraine War and the Global Economy

Card 1 of 7

A far-reaching conflict. Russia’s invasion on Ukraine has had a ripple effect across the globe, adding to the stock market’s woes. The conflict has caused dizzying spikes in gas prices and product shortages, and has pushed Europe to reconsider its reliance on Russian energy sources.

More than any other economy in the region, Germany's is built on industrial giants — mighty chemical, auto, glass and steel producers — that consume enormous amounts of fuel, two-thirds of it imported. The chemical and pharmaceutical industries alone use 27 percent of the country's gas supply.

Most of it came from Russia. Before Mr. Putin invaded Ukraine five months ago and set off retaliatory sanctions from Europe, the United States and their allies, Russia delivered 40 percent of Germany's imported oil and more than 55 percent of its imported gas.

Gazprom, Russia's gas monopoly, cut deliveries in June, and if they are reduced further, German industries may soon confront fuel shortages that will compel them to scale back production, Mr. Kirkegaard said. “I don’t think there are that many other European countries that have to do that,” he said.

Over the next five to eight years, until more of an ongoing transition to renewable energy is completed, the country will be “under acute pressure,” he added. “That is the time period when Germany’s economy is still basically going to be fueled by fossil fuels.”

High oil and gas prices and a difficult energy transition are not the only challenges.

Image

Credit...Lena Mucha for The New York Times

Image

Credit...Lena Mucha for The New York Times

Much of Germany’s wealth derives from

exports of manufactured goods. Yet even before the war, its output and exports had slowed. And now China, Germany's biggest trading partner, is expected to see substantially slower growth than in the previous decade, reporting on Friday that the economy expanded just 0.4 percent in the second quarter. That slowdown is likely to ripple through other emerging nations in Asia, dragging down their growth as well.

At the same time, Beijing has been developing its own industrial producers, turning onetime consumers and business partners of German companies into potential competitors.

The shifting landscape raises pointed questions: Is an economy built on energy-hungry industries sustainable when fuel is very expensive? Can an export-driven strategy succeed when major trading partners are vulnerable to sanctions, and when countries are more keenly attuned to the security risks of globalized trade?

Some economists have argued that the German business models were partly based on an erroneous assumption and that cheap Russian gas wasn't as cheap as it looked.

The economist Joseph Stiglitz, a Nobel laureate, said the market failed to accurately price in the risk — however unlikely it may have seemed at the time — that Russia could decide to reduce or withhold gas to apply political pressure.

It would be like figuring the costs of building a ship without including the cost of lifeboats.

"They didn't take into account what could happen," Mr. Stiglitz said.

In any case, the latest series of disruptions has created political problems for Chancellor

Olaf Scholz's coalition government. Energy prices are expected to climb further. Inflation last month was 7.6 percent. Investor confidence in Germany has dropped to its lowest point in a decade.

Mr. Scholz gathered the leaders of big German companies in Berlin this week to discuss how the Ukraine war and economic sanctions against Russia are affecting their businesses.

Industry has long had an outsize voice in Germany's policymaking, enjoying a relationship that has come under criticism from some quarters.

Image

Credit...Lena Mucha for The New York Times

Image

Credit...Lena Mucha for The New York Times

"It is this lobby that is brutal and keeps trying to set the course," said Norbert Röttgen, a conservative lawmaker, a former environment minister and an opponent of the decision to build a second Nord Stream pipeline to Germany. (The opening of the $11 billion pipeline was suspended in February.)

Households, hospitals and essential services will be considered priorities if gas rationing becomes unavoidable, but industrial representatives have been pleading their cases in Berlin.

"Industry will pretty much have a big role in dictating how things are going and which measures will be taken and which won't," said Matthias Breuer, an associate professor at Columbia University's Graduate School of Business. Influential business and political figures will argue that it will be more important to "keep people employed than keep them warm."

Whatever the policy choices, he added, "everyone understands that this war really means a big loss of wealth for everyone in the West as well as in Russia."

Much of the economic debate in Germany now revolves around just how big those losses may be, particularly if the supply of energy from Russia is suddenly halted. Conclusions have ranged from mild to disastrous.

Tom Krebs, an economist at the University of Mannheim and adviser to the finance ministry, estimated in May that Germany's national output could drop as much as 12 percent once ripple effects on industries beyond energy and consumers were taken into account.

Looking ahead to the winter, Mr. Krebs said much depended on the temperature and Russian gas delivery levels.

Image

Credit...Lena Mucha for The New York Times

Image

Credit...Lena Mucha for The New York Times

“The best case is stagnation with high inflation,” he said. But over the longer term, he argued, Germany could come out more competitive if it manages the energy transition well and provides speedy and significant public investment to create the requisite infrastructure.

Marcel Fratzscher, president of the German Institute for Economic Research, agreed. Germany’s industrial success is based on added value more than cheap energy, he said. Most German exports, he said, are “highly specialized products — that gives them an advantage and makes them competitive.”

Labor policy, too, will have an impact.

Wage negotiations for the industrial sector are scheduled to begin in September. The powerful I.G. Metall union will seek an 8 percent wage increase for its 3.9 million members. And starting Oct. 1, a new minimum wage law will establish for the first time a single national rate — 12 euros an hour.

For now, supply chain breakdowns are still causing headaches, and businesses that were only beginning to recover from the Covid-19 pandemic are busy devising contingency plans for gas shortages.

Beiersdorf, maker of skin care products including Nivea, has had a crisis team in place since May to draw up backup plans — including readying diesel generators — to ensure production keeps running.

At Schmees, high costs have already forced the shutdown of one furnace, cutting into the foundry's ability to meet deadlines. Customers waiting for deliveries of stainless steel include companies that run massive turbines used in icebreaker ships and artists who use it in their sculptures.

Mr. Schmees, an energetic man who prides himself on having nurtured a strong company culture, is planning to ask his employees to work a six-day week through the end of the year, to ensure that he can fill all of the firm's orders by December. That is how long he's betting that Germany's natural gas supplies will hold if Russia cuts off the flow entirely.

"The tragedy," Mr. Schmees said, "is that we have only now realized what we've gambled away with this cheap gas from Russia."

Image

Credit...Lena Mucha for The New York Times

Katrin Bennhold contributed reporting from Berlin.