Economics Briefs

Effects Felt as Russia Begins To Cut Natural Gas Supplies to Europe

In a move coinciding with the triple visit to Kiev of France's President Macron, German Chancellor Scholz, and Italian Prime Minister Draghi, Russia began to cut gas supplies to Europe, June 16. First, Gazprom cut gas supplies flowing through the Nord Stream 1 pipeline to Germany to 100 million cubic meters per day, and then reduced it to 67 million cubic meters. Gazprom said the action was due to Canada not sending spare parts needed to repair compressors in Germany, because of the anti-Russian sanctions.

Almost simultaneously, Gazprom cut gas deliveries to Italy by 15%, without explanation. The cuts pushed gas future contract prices to over €140 per megawatt-hour at the Dutch exchange June 17—a *wholesale* price to distribution companies equivalent to about 15 cents per kilowatt-hour of electricity.

The Russian move is a clear warning. Russia's Ambassador to the European Union, Vladimir Chizhov, said June 16 that persistent problems with repairs to compressor stations could lead to Russia shutting down the Nord Stream 1 pipeline altogether. He suggested that in that case, Nord Stream 2 could be used. If Russia further reduces supplies, Germany and Italy will suffer severely and be forced to ration gas for industry and households. There is no way these countries can substitute for those imports in the short term. Even the relatively small amounts of liquefied natural gas (LNG) promised from the United States won't come in time. After the explosion that destroyed the Freeport, Texas, LNG hub from which tankers to Europe depart, the company has communicated that the hub won't be operative until late this year.

Italian economist Michele Geraci's team has calculated that a total Russian gas embargo would drop Italy's GDP 7% below the already decreased level of its current forecast.

U.S. Federal Reserve Starts Making Up Its 'Facts'

In its Annual Policy Statement to be submitted to congressional committees June 21 and 22 by Chairman Jerome Powell, the Federal Reserve appeared to be imitating the "whatever it takes" phrase of then European Central Bank head Mario Draghi in 2014, which is regarded in the financial world as showing the ultimate in policy firmness. The statement said, "The Federal Open Market Committee's [FOMC] commitment to restoring price stability—which is necessary for sustaining a strong labor market—is unconditional." The Fed's rate hikes to date have already generated interest-rate increases throughout the world, caused currency depreciation and capital flight in developing countries, and deepened an oncoming recession.

But the FOMC's desire to cast the American economy as ready easily to weather a "war on inflation," led it to use a clear falsehood in its June 15 announcement of the 0.75% rate increase, to be followed by another at its July meeting. The statement began: "Overall economic activity [in the U.S. economy —ed.] appears to have picked up after edging down in the first quarter." *On the same day,* the Atlanta Federal Reserve Bank reduced its running estimate of second-quarter U.S. economic growth from 0.9% most recently, to zero, explaining: "The nowcasts of second-quarter real personal consumption expenditures growth, real gross private domestic investment growth, and real government spending growth decreased from 3.7% to 2.6%, from –8.5% to –9.2%, and [from] 1.3% to 0.9%, respectively." Note in particular the second factor: Business capital investment, already strongly negative and dragging the GDP track down as well as holding back productivity, is becoming more negative as the Atlanta Fed staff tracks it. The FOMC's rate increases will decrease it further. It said it aims to have the Fed Funds rate at 4% by 2023.

Other reports from May supported the Atlanta Fed economists' reading. Retail sales fell by 0.3% even before inflation; factory production dropped by 0.2%; new home sales fell 16%; existing home sales dropped 29%, and housing permits fell by 10%; the Philadelphia Federal Reserve Bank's Manufacturing Index was reported negative, at –3; industrial capacity utilization fell by 0.1%. Industrial production rose by 0.2%, but only because of a big surge in utilities output.

The FOMC statement followed its opening falsehood with two more, still in the opening two short paragraphs, when it blamed the runaway inflation first on "Russia's invasion of Ukraine," and then on "China's COVID lockdowns."

'More U.S. Refining' Won't Work as an Anti-Inflation Strategy

The fact that U.S. oil refineries are now running collectively at 95% of capacity, is just one reason why President Biden's threats that he's "ready to use

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emergency authorities" to compel more production from them, won't work. His June 15 speech on the subject followed his demands that Exxon "invest" and "drill" at his press conference ending the Summit of the Americas in Los Angeles; that speech even contradicted Biden's own earlier executive orders seeking to suppress investment in fossil fuels.

A Reuters senior markets analyst reported June 17 that U.S. refinery capacity has fallen by about 1 million barrels per day (bpd) in 30 months, according to the U.S. Energy Information Administration's May *Monthly Refinery Report*. About two-thirds of the loss can be attributed to the shutdown of three refineries: Philadelphia Energy Solutions in Pennsylvania, which closed its refinery (335,000 bpd) after an explosion and operating bankruptcy; Marathon in California, which is converting its Martinez refinery (161,000 bpd) to a biofuels facility per California policy; and Shell, which tried unsuccessfully to sell, and then closed its Convent, Louisiana refinery (240,000 bpd) under its strategy of transitioning to a low-carbon future.

Capacity reductions were accelerated by pandemic-driven reductions in fuel consumption. The industry struggles to manage these long-term pressures on the refining system, especially pressures from the projected increase in alternative-powered vehicles. Moreover, decisions regarding refining can't be easily reversed given the large amounts of capital involved in refinery upgrades and reconfigurations, the long lead times for planning and construction, and lengthy payback periods.

St. Petersburg Forum Shows China-Russia Cooperation Is Growing

Trade between China and Russia in the first five months of 2022 was up nearly 30% over the same period in 2021, totaling $65.81 billion, according to Chinese government data. At the plenary session of the annual St. Petersburg International Economic Forum (SPIEF) June 17, China's President, Xi Jinping, emphasized rising collaboration with Russia. "Trade over the first half of this year has been [in the tens of billions] and we can expect new records in upcoming months, which is a testament to the great cooperation between our two nations," Xi said, as reported by RT.

In the Russia-China Business Dialogue at the SPIEF June 16, some 40 Chinese companies participated from sectors such as machinery, auto parts and industrial equipment manufacturing. *Global Times* quoted the bold statements there by Xu Poling of the Chinese Academy of Social Sciences, who said China can "fill the vacancy" in logistics and trade for Russia, as Western nations seek to decouple. Chinese firms can take the place of Western firms that used to sell to Russia, Xu said, and Chinese firms will quickly expand their investment in Russia, providing technology and infrastructure.

Xu predicted that as Russian gas pipelines linking Europe are gradually restricted, Russia will "surely expand toward the South and the East, which will be a focus of China-Russia future cooperation." In fact, reports indicate that Russian energy exports now flow 50% to Asia, whereas until this year 75% of these exports went to Europe.

It was otherwise notable at SPIEF that the head of the American Chamber of Commerce in Asia, Robert Agee, declared that 85% of American firms in Russia are continuing business there, with another 5% still thinking over the problem.

Putin Describes State of Russian Economy in SPIEF Keynote

At the June 17 plenary of the St. Petersburg International Economic Forum, Russian President Vladimir Putin gave a detailed and systematic discussion of the Russian economy, assessing its problems, priorities, and accomplishments, especially under the onslaught of the "sanctions blitzkrieg" which NATO nations believed would suddenly crush the Russian economy, industry, and people's living standards.

"This did not work," Putin said, characterizing the propaganda about the dollar at 200 rubles and a complete Russian economic collapse as information warfare:

"Real life belied these predictions," [but] "we must be explicitly honest and realistic in assessing the situation, be independent in reaching conclusions, and of course have a can-do spirit. We are a strong people and can deal with any challenge…. The entire thousand-year history of our country bears this out."

Putin described the objectives: building up production, increasing supply in the domestic market, and restoring demand. There has been success in gradually lowering interest rates and inflation. However, he said, great efforts would be necessary to improve people's living conditions, to provide housing, transportation and new infrastructure, restore bank financing, and protect the most vulnerable citizens. The Russian president called for going beyond import substitution, to produce high-quality goods employing advanced state-of-the-art technology.

Putin's other point was that it is European countries who are suffering the brunt of the monster "Russia" sanctions. "Sanctions as a weapon have proved to be a double-edged sword, damaging their advocates and architects just as much." He estimated that the EU's direct calculable losses from the "sanctions fever" could exceed $400 billion this year, eating up the savings of the people of Europe.