Tendances Carbone

The Monthly Bulletin on the European Carbon Market

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Editorial

Phase III of the EU ETS: finding a balance when the clock is ticking

By the end of 2010, the European Commission is supposed to have adopted decisions governing critical aspects of Phase III of the European Union Emissions Trading Scheme (EU ETS). These include the introduction and operation of the auctioning system as well as the amount and distribution of free allowances to sectors exposed to carbon leakage. Additionally, the Commission must produce two reports covering carbon leakage risk with respect to the international negotiations and another on carbon market regulation.

In this legislative session, the Commission must cope with two major challenges: firstly, it faces short deadlines that do not allow enough time to produce the number of documents required and, secondly, there is a need to reach a consensus among Member States on diverging objectives in a challenging economic and budgetary context. It will be more complicated to achieve a rapid resolution as the documents overlap, not only with each other but also with other European directives, including the directives in the Energy-Climate Package. For example, the regulation on the organisation of allowance auctions is linked to the 'registries' regulation and the directive on the financial instruments market (MIFID). These documents are all currently being revised.

The various drafts of regulations to be enforced during Phase III of the EU ETS are now at different stages in the process of adoption via 'comitology' involving the Commission, the Member States and the European Parliament:

- The official list of some fifty product benchmarks – which will determine the free allocation of allowances to 164 sectors and sub-sectors found to be exposed to carbon leakage risk – should be published soon by the Commission in time for submission in autumn to a vote by the Climate Change Committee which comprises the Member States. Formal adoption is planned for early 2011.
- On July 1st, 2010, the Commission sent its draft auctioning regulation to the Climate Change Committee, which is expected to announce its decision on July 14th. In it, the Commission defends in particular setting up a common auction platform while allowing the Member States to opt out and develop their own platforms under certain conditions. Germany, Poland, Spain and the United Kingdom, who consider the current document too restrictive and penalizing, could still form a minority to block its implementation. Nevertheless, there have been numerous calls to vote in favour of the regulation to avoid further delaying its adoption, initially planned for June 30th, 2010. The swift adoption of the regulation would give market actors some certainty and would launch the joint selection process of the common platform in the autumn, following the 3-month examination period granted to the Parliament.
- After the approval of the Climate Change Committee on February 17th, 2010, the European Council and Parliament are expected to validate the revised registries regulation by September.

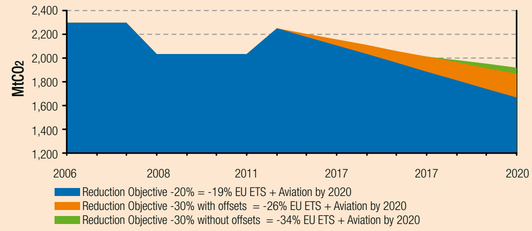
Beyond these technical decisions, which are crucial to ensure the smooth operation of the EU ETS, is the prospect of revising the European emission reduction objective upwards from -20% to -30% by 2020. The European Commission has devoted a communication to this topic, published on May 26th, explaining that this choice would cost 22 billion euros less than the amount estimated before the economic crisis. Such a decision would require further emission reductions within the EU ETS by 2020, which are especially important as the other objectives of the Energy-Climate Package might not be achieved. The Member States are still divided and they have agreed to come back to the discussion no later than October 2010 at the next European Environment Council meeting.

Faced with the challenges of short deadlines and the need to reach consensus on diverging interests, the European Commission will have to stabilise all the parameters of Phase III by the end of 2011. It is also seeking to combine a principled position of leadership with pragmatic realism – a difficult exercise indeed.

Emilie Alberola – emilie.alberola@cdcclimat.com
Senior Research Fellow - CDC Climat Research

Graph of the month:

Estimated emissions cap for the EU ETS comparing the reduction objectives –20 and –30% by 2020 (includes aviation)

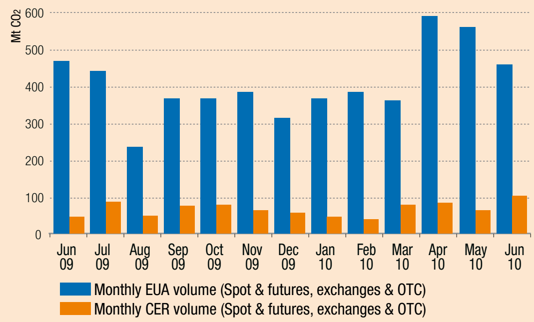


The emission cap under the EU ETS increases in 2012 with the inclusion of aviation and then declines steadily by a factor that depends on the chosen European target. From the European Commission Communication of May 26th 2010, we estimate that moving from a -20% to a -30% target in 2020 (compared to 1990) will require an additional reduction of between 50 Mt to 250 Mt of emissions annually by facilities and airlines in the EU ETS. *Source: CDC Climat research, from the analysis report of the European Commission's May 26, 2010.*

Monthly volumes:

Decreased by 20% for EUAs, increased by 36% for CERs

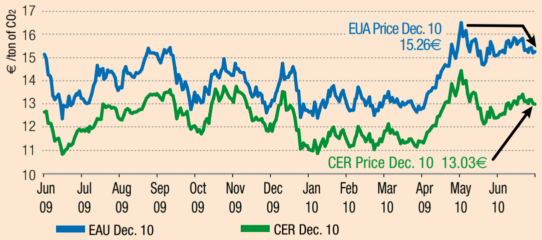
Source: ECX, LEBA, Noodpool, PointCarbon



Carbon prices:

Fluctuated in a narrow trading range for EUAs while advanced slightly for CERs.

Source: ECX



EUA – CER price spreads:

Narrowed, but still 40% above their 12-month average.

Source: ECX

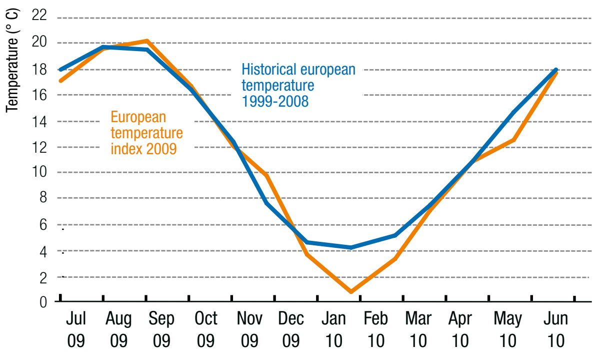
Weather

Temperatures (°C)

• Average of BlueNext Weather indices* – France, Germany, UK and Spain – weighted by the allowances allocated to each country.

	May	June
Monthly average (°C) - 2010	12.6	17.7
Monthly average (°C) - 2000-2009	14.8	18.0
Monthly minimum – 2010	8.9	13.8
Monthly maximum – 2010	18.3	22.0

Source: CDC Climat Research, based on data provided by Météo-France and BlueNext



Precipitation (mm)

• Average of precipitation indices for Lyon, Oslo, Turin**, Vienna and Madrid, weighted by the hydroelectric share in each country's electric power mix.

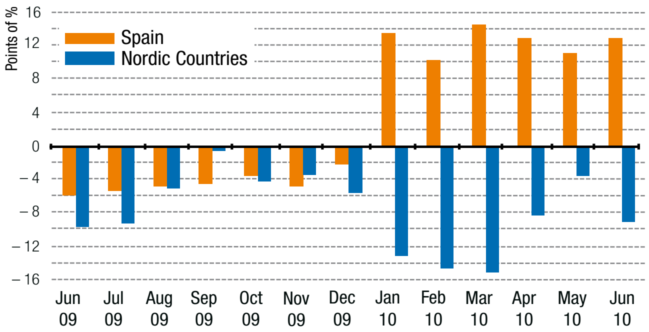
	May	June
Monthly precipitation – 2010	86.0	96.5
Monthly precipitation - 2000-2009**	73.1	63.7
Cumulative over 12 months	739.4	771.5
Cumulative over 12 months 2000-2009**	776.3	771.3

Source: CDC Climat Research based on data provided by Météo-France

*** Precipitation for Turin Bric della Croce, a new observation point for Turin, was not available prior to 2006.*

Reservoir Content for Electricity Production

• Spread between the monthly rate of reservoir levels (%) and the ten-year average rate (%).



With a global average temperature of 14.8°C, May 2010 was the warmest since records began in 1880 (+ 0.7°C above the global average for the 20th century), according to the U.S. National Oceanic and Atmospheric Administration. Though warm temperatures were present over most of the globe, anomalously cool conditions were present across Western North America, interior Asia and Western Europe. In June, our indicator of European average temperature rose to almost its ten-year average (17.7°C vs. 18.0°C). Germany and the UK reported near-normal temperatures while temperatures in France and Spain were slightly below normal (by - 0.2°C and - 1.2°C, respectively). Overall precipitation has been above its ten-year average (97 mm vs. 64mm), bringing the cumulative annual total to a level similar to that observed over the previous ten years.

** The BlueNext Weather indices are defined on the basis of average temperatures, weighted by the population of the representative regions making up each country.*

Economic Activity

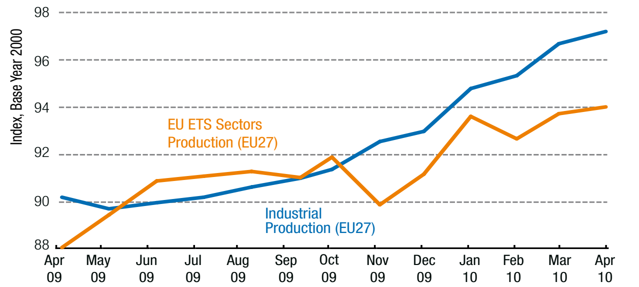
Production Indices

EU27 (base year 2000)	April 10	Change over last month (%)	Change over 12-month average (%)
Indust. prod. (excl. construction)	97.2	0.5%	5.6%
EU ETS sectors production*	94.0	0.3%	3.5%
Electricity, gas and heating	97.4	-0.2%	2.5%
Cement	72.1	4.6%	0.3%
Metallurgy	93.2	2.5%	20.1%
Oil refinery	89.5	-0.7%	-2.5%
Paper and cardboard	98.4	-0.7%	9.8%
Glass	90.3	2.0%	8.7%
Ceramics	86.9	0.5%	10.3%
Metal ore	98.4	-0.7%	9.8%

** Index weighted by EU ETS sectors' weight in average total allocation over 2005-2007.*

Source: Eurostat

Total Production and Production by EU ETS Sectors



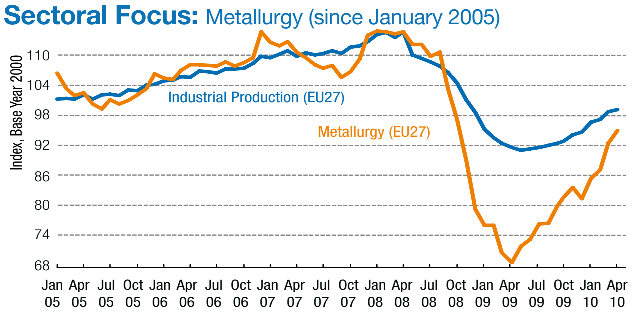
Note: Data reflect a new classification of economic activities that was implemented in May 2010.

Opinion of Business Leaders

EU 27	April	May	June
Industrial Sentiment Indicator	-7	-5	-6

Source: European Commission

Sectoral Focus: Metallurgy (since January 2005)



Source: Eurostat

The European industrial production index continued to improve (+0.5% in April) while the index for sectors covered by the EU ETS increased by 0.3%. Production in all EU ETS sectors rose above its twelve-month average, with the exception of oil refining which reported a 2.5% decline. In June, the confidence indicator for the industrial sector declined by 1 point on concerns over the robustness of economic recovery. While the indicator for services improved by 2 points, it remained unchanged for consumers and retailers and declined by 2 points for the construction sector.

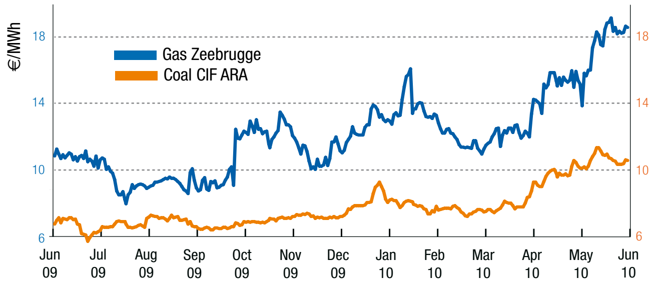
This month's focus is on the metallurgy sector, which comprises 254 installations and accounts for nearly 10% of annual allocation under the EU ETS. The EU-27 iron and steel production index has regained 24 points since its trough in April 2009. All the EU countries showed a rise in production in April. For the first four months of the year 2010, production increased by 35% in the EU-27: the high mark was achieved by Germany (+62%), the low mark by Greece (-15%).

Energy Prices

		May 2010	June 2010
		Average closing price	
Brent, in $/barrel		77.00 $/bbl	75.66 $/bbl
Natural gas Zeebrugge month ahead		4.45 €/MMBTU	5.26 €/MMBTU
Amsterdam coal CIF ARA month ahead		71.20 €/t	77.00 €/t
Powernext Futures™ month ahead	Base	46.62 €/MWh	47.26 €/MWh
	Peak	57.95 €/MWh	60.32 €/MWh
BlueNext spot price		15.30 €/t	15.32 €/t
Clean spark spread		13.27 €/MWh	9.13 €/MWh
Clean dark spread		11.67 €/MWh	10.52 €/MWh
CO_2 switch price coal/gas		11.85 €/t	17.81 €/t

Source: Reuters, BlueNext, PowerNext, CDC Climat Research

• Primary energy prices



• Price of electricity and price difference between electricity and primary energy prices

Having suffered a steep decline the previous month, oil prices stabilised in June. Brent crude oil traded at a narrow range of $72 - $79 per barrel, for a monthly decline of 1.7% (or an increase of 1% in €, due to the decline in € vs. $). Total oil supply fell by an estimated 0.7% in May while global oil demand was revised slightly upwards (0.07%) by the International Energy Agency. Macroeconomic data, especially from the non-OECD countries which account almost single-handedly for the growth in oil demand, will remain the primary factor for oil price developments over the coming months. The natural gas price continued to recover, rising another 17% in June after an impressive 21% gain in May. It has risen more than 120% since it hit bottom on 20 July 2009. The coal price, having risen 20% in May, rose a modest 8% in June. It has risen 62% since its trough on 23 June 2009. With prices of gas outpacing those of coal and electricity, the clean spark spread rose above the clean dark spread, providing power generators with an incentive to ramp up the coal burners for the first time in nearly 18 months.

Availability of Kyoto credits and allocation of allowances in the EU ETS

CDM credits	As of June 2010	As of July 2010	Change
Number of projects in the pipeline	5,955	6,184	229
Of which: - number of projects registered	2,171	2,262	91
- number of projects with CER issued	709	743	34
Cumulative volume of CER issued (Mt)	407	421	14
CER available 2008-2012 – UNEP Risoe estimate	992	1,012	20
CER available until April 2013 – CDC Climat Research estimate	1,200	1,200	0

European Union allowances	Jan. – June 2010	Jan. – Dec. 2009	Phase II til June 2010
Allowances auctioned/sold (Mt)	45	72	161
Total revenues of the allowances auctioned/sold (M€)	622	909	2,855

Source: CDC Climat Research, UNEP-Risoe CDM Pipeline and European Commission

In June, Bulgaria was suspended from trading on June 30th for violating GHG reporting rules set under the Kyoto Protocol. UN representatives will review its accreditation in September and October. It also has withdrawn its suit against the EC over its NAP for Phase II of the EU ETS.

In June, Germany sold 1.5 million spot EUAs at an average price of €15.27 and 2.85 million futures EUAs at an average price of €15.42 at weekly auctions. In the UK, 4.4 million CO_2 allowances were auctioned at €15.60.

Regarding Phase III of the EU ETS, according to a Communication of the European Commission on July 1st, the Climate Change Committee is scheduled to vote on the proposed auctioning regulation on July 14th. Easing the conditions for Member States to opt out of the centralised EU-wide auction platform and auction their EUAs via their own national platform remains a subject of intense debate. If and when the proposal is adopted by the Committee, the plans will then face a three-month scrutiny period by the European Parliament and Council. The Commission also adopted a decision on the Phase III emissions cap on July 9th which will set it at 1.927 billion allowances in 2013, with an annual reduction of 1.74%.

Our forecast for CER supply until April 2013 remained unchanged at 1.200 billion in June, despite the slower pace of recent issuance.

Dashboard

European Union Emissions Trading Scheme

		Jun-09	Jul-09	Aug-09	Sept-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Spot Market (BlueNext)	Phase II Average closing price in €	13.25	13.75	14.61	14.17	14.05	13.54	13.48	12.98	12.87	12.87	14.25	15.30	15.32
	Total monthly volume in kt	85,982	90,411	27,557	34,664	34,149	48,765	33,587	30,949	30,129	40,500	44,527	24,671	23,344
Futures Market (ECX)	Dec. 2008/Dec. 2009 Average closing price in €	13.49	13.91	14.72	14.24	14.08	13.54	13.78	13.70	13.04	13.05	14.41	15.50	15.48
	Dec. 2012 Average closing price in €	15.66	16.23	16.89	16.03	15.83	15.10	15.14	15.48	14.13	14.16	15.59	16.55	16.42
	Total monthly volume in kt	339,388	317,834	203,685	302,872	304,328	325,490	270,710	320,398	337,559	295,072	508,756	515,409	400,298
Total European market volume in kt (PointCarbon)		469,291	441,631	236,398	367,693	366,468	386,471	314,143	365,799	385,017	361,136	590,210	558,401	447,613

Source: BlueNext, ECX, Point Carbon

International Kyoto Credit Market

		Jun-09	Jul-09	Aug-09	Sept-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Spot Market (BlueNext)	Average Closing Price in €	11.61	12.45	12.99	12.81	13.17	12.71	12.24	11.68	11.64	11.74	12.91	13.16	12.98
	Total monthly volume in kt	1,881	3,164	1,870	2,403	3,384	3,051	2,385	2,860	4,210	6,901	4,308	2,455	4,750
Futures Market (ECX)	Average Closing Price in €	11.61	12.43	12.99	12.73	12.98	12.57	12.24	11.51	11.47	11.52	12.73	13.10	12.98
	Total monthly volume in kt	43,633	81,959	45,097	72,162	74,115	60,698	54,807	42,244	35,847	71,310	80,412	64,473	86,498

Source: Reuters, LEBA, NordPool, Nymex

Weather

Temperatures (°C)	Jun-09	Jul-09	Aug-09	Sept-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Germany - difference monthly and decennial average	-1.3	0.5	0.9	1.0	-1.0	3.0	-0.8	-4.4	-2.4	0.1	-0.1	-2.9	0.0
Spain - difference monthly and decennial average	0.7	0.7	1.1	0.1	1.1	2.0	0.2	-0.5	-0.7	-1.2	0.7	-0.7	-1.2
France - difference monthly and decennial average	-0.6	0.3	1.0	0.6	-0.2	2.6	-0.3	-2.8	-1.5	-0.8	0.4	-2.0	-0.2
UK - difference monthly and decennial average	-0.4	-0.9	-0.5	-0.7	0.5	1.3	-1.6	-3.5	-2.4	-0.4	0.2	-1.1	0.8

Source: BlueNext

Precipitations (°C)	Jun-09	Jul-09	Aug-09	Sept-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Vienna - difference monthly and decennial precipitation	118.5	35.5	-15.3	-38.3	-7.4	-3.1	-7.4	-2.2	-12.4	-38.8	47.3	55.8	3.5
Madrid - difference monthly and decennial precipitation	-3.3	-4.5	-3.5	-8.3	-44.0	-35.4	58.0	15.5	64.1	16.7	-5.0	-24.1	12.6
Lyon - difference monthly and decennial precipitation	11.1	-21.7	-51.7	-30.1	-21.5	8.5	15.4	15.3	31.0	8.0	-36.9	54.0	31.8
Oslo - difference monthly and decennial precipitation	-42.6	76.9	34.4	-46.5	-37.9	31.7	-7.8	-64.0	-16.6	-3.7	-22.3	-26.7	17.3
Turin - difference monthly and decennial precipitation	-33.3	0.3	22.0	-35.7	18.9	-0.5	-45.0	5.5	47.2	20.1	-68.0	40.2	110.6
Hydraulic Reservoirs – Spread between the monthly rate of reservoir capacity and the decennial average rate													
Spain	-5.9	-5.3	-4.8	-4.5	-3.6	-4.8	-2.2	13.5	10.3	14.5	12.9	11.2	12.9
Nordic countries	-9.7	-9.3	-5.0	-0.6	-4.2	-3.5	-5.6	-13.1	-14.6	-15.1	-8.3	-3.6	-9.1

Source: Météo-France, NordPool, www.mamr.es

Economic activity

	Jun-09	Jul-09	Aug-09	Sept-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Total industry production index (excluding construction and seasonally adjusted), base year 2000 = 100													
Europe 27	89.89	90.12	90.55	90.92	91.31	92.49	92.92	94.74	95.31	96.67	97.18	-	-

Source: Eurostat

Energy prices

		Jun-09	Jul-09	Aug-09	Sept-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Brent crude oil, 1st maturity, in $/baril		69.29	65.75	73.06	68.15	73.93	77.58	75.21	77.01	74.79	79.93	85.84	77.00	75.66
Natural gas Zeebrugge, 1st maturity date, in €/MMBTU		3.15	2.71	2.69	2.73	3.58	3.39	3.41	4.05	3.85	3.41	3.71	4.45	5.26
Coal CIF ARA, 1st maturity date, in €/tonne		47.64	48.03	51.21	47.10	49.71	51.99	53.62	60.18	55.50	54.36	59.37	71.20	77.00
Powernext FuturesTM month ahead, in €/MWh	Base	39.07	31.68	40.14	46.90	66.60	61.06	53.50	49.78	39.22	37.97	37.97	46.62	47.26
	Peak	52.24	43.18	52.08	63.47	94.46	82.05	74.37	63.64	48.09	46.14	46.97	57.95	60.32
Difference in prices of electricity and of natural gas, corrected for the price of CO_2: Clean Spark spread in €/MWh		14.47	10.13	17.72	24.58	38.10	36.42	27.38	19.94	14.14	12.34	9.57	13.27	9.13
Difference in prices of electricity and of coal, corrected for the price of CO_2: Clean Dark spread in €/MWh		12.92	5.18	11.92	20.36	39.30	33.52	25.30	20.20	13.93	10.27	7.56	11.67	10.52
CO_2 switch price coal/gas in €/tonne		9.92	4.12	1.98	4.91	14.06	10.01	9.40	13.39	13.80	9.02	9.69	11.85	17.81

Source: Reuters, Powernext, CDC Climat Research

CDC Climat Research is the research department of CDC Climat, a subsidiary of the Caisse des Dépôts dedicated to the fight against climate change. CDC Climat Research provides public research on the economics of climate change.
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CDC Climat Research
Publication manager: Benoît Leguet
Contact: May Armstrong, Tel.: + 33 1 58 50 76 27
may.armstrong@cdcclimat.com
16, rue Berthollet – 94110 Arcueil

BlueNext SA
Contact: Boubékeur Ouaglal,
Tel.: +33 1 73 03 73 46
b.ouaglal@bluenext.eu
5, boulevard Montmartre – 75002 Paris