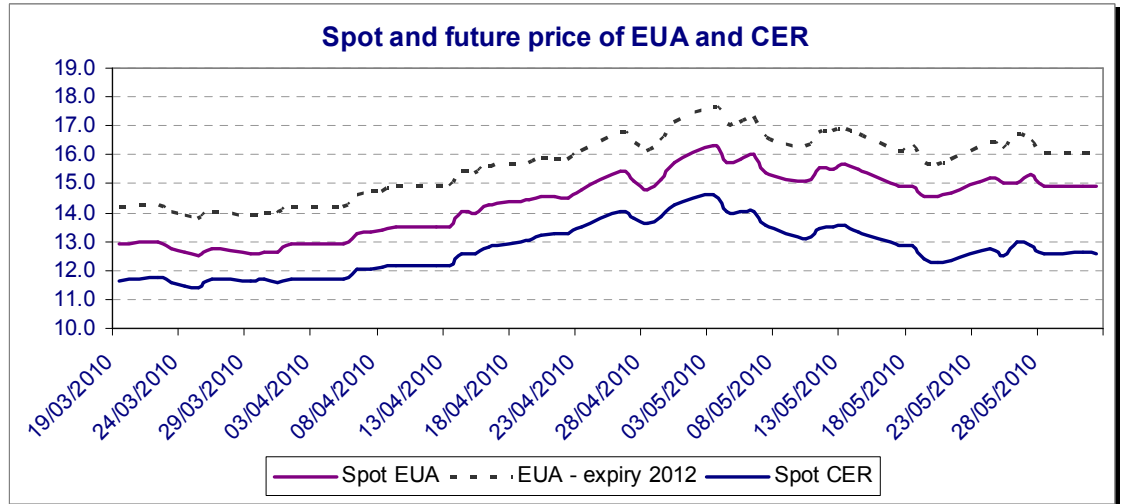


Carbon price summary

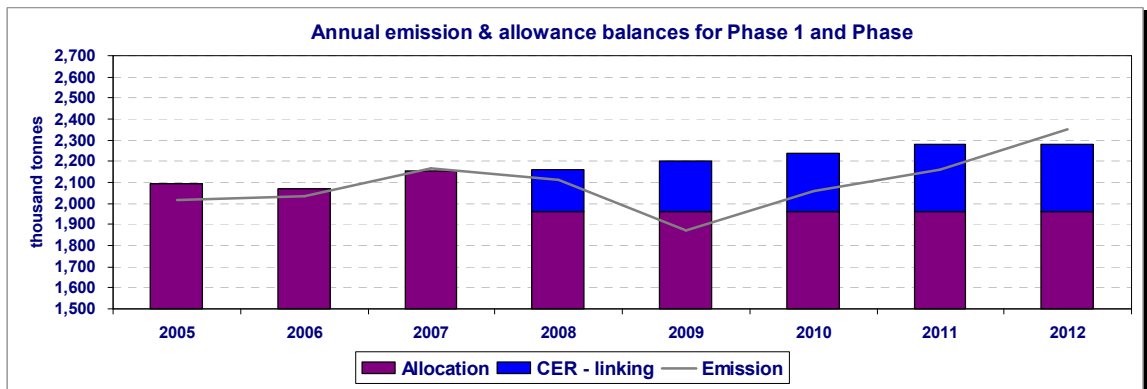
The past two weeks showed large falls in all commodity and financial markets. Carbon markets were no exceptions. The average 10% decrease in the carbon price can be considered as a decent performance in light with the general trends in the commodity and financial markets.



The prices in the next few days will be very much driven by international sentiment. Also as the compliance period is over and the summer is coming, liquidity is also expected to decrease. Overall we do not expect the prices to change much with a somewhat higher risk of prices falling than rising in the short term.

Net carbon balance

The recently published EU Emissions Trading Scheme (EU ETS) emission data is a good occasion to review the fundamentals of the carbon market. At the first sight, the fundamental outlook appears to be negative. Emissions have fallen below 2 billion tonnes for the first time in the history of EU ETS. The total surplus for Phase 2 is estimated to be 600 million units which is more than five times as much as the surplus of Phase 1 which had lead to near-zero carbon price.

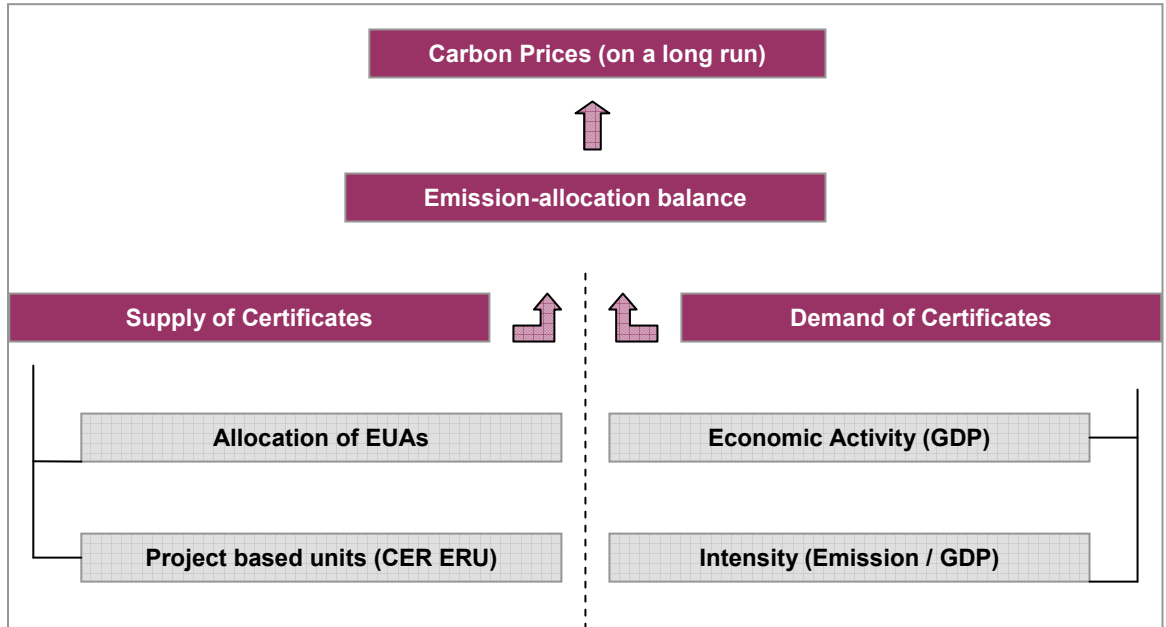


The approximate financial value of this surplus is near € 10 billion. Is there a market for such a huge surplus? At the first sight the fundamental outlook appears to be weak. However by looking behind the surface, one can reveal that the situation is by far not as bad as it appears to be.

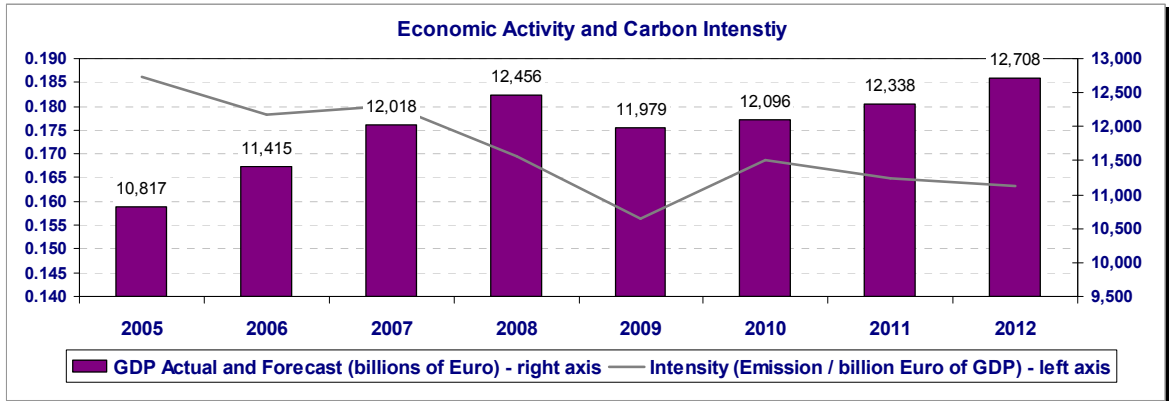
For more information on Carbon markets feel free to contact us at:

+36 1 489 1900
trading@vertisfinance.com

Although the carbon market is complex as it is related to the economic activity as a whole, it is possible to capture most of the insights by using the following very simple top-down framework. Using this framework; one can follow the carbon market by focusing only on 4 key ingredients or even one can build a simple model for the carbon market and optimize compliance strategy accordingly:



- Allocations of EUAs represent the main supply of certificates. It is available from the Community Independent Transaction Log (CITL) database in MS Excel format. Normally it is fixed at the beginning of the period; some minor uncertainty may arise because of the New Entrants' Reserve (NER).
- Project based units represent the main uncertainties for the supply of emission certificates. This is enough to mention that according to the current estimates; less than 50% of the originally planned 2.9 billion units will hit the market. CER supply forecasts are made regularly by UN and other for profit and non-profit organizations. ERU forecast is available, for example from Vertis Environmental Finance.
- Economic activity can be measured by GDP; again many estimates and forecasts are available. The current analysis uses the official data of the European Union.
- Emissions intensity is a ratio of the annual emissions of the EU ETS's installations divided by the GDP of the European Union. It expresses how many emissions are needed per unit of GDP in the European Union. It encompasses all structural factors that are specifically related with the carbon market; fuel switching, energy intensity etc; just to mention a few of them. Indeed the ultimate goal of the European Union is to reduce carbon intensity in the economy.



By looking at the diagram above it is clear that the exceptionally low emission figure was primarily driven by the drop in carbon intensity. However there was no structural change behind this drop. Therefore the carbon intensity is expected to return to the (increasing) trend that was observed before the recession.

By multiplying the projected carbon intensity with the estimated GDP figures, one can make simple demand estimation for the emission certificates. Then the total balance can be calculated by comparing this estimated demand of emission certificates with the total supply of emission certificates. This method is extremely useful to carry out simple “back of the envelope” calculations to judge how certain much discussed factors will influence the carbon prices. An interesting and insightful example would be to calculate what happens with the Phase 2 balance if Phase 3 auctioning for the power market is delayed by 6 or 12 months. Also important to keep in mind that between Phase 2 and Phase 3 banking opportunity presents itself which was not the case between the Phase 1 and Phase 2 of the EU ETS. Please follow our analysis as in the upcoming weeks we will follow up on these issues.