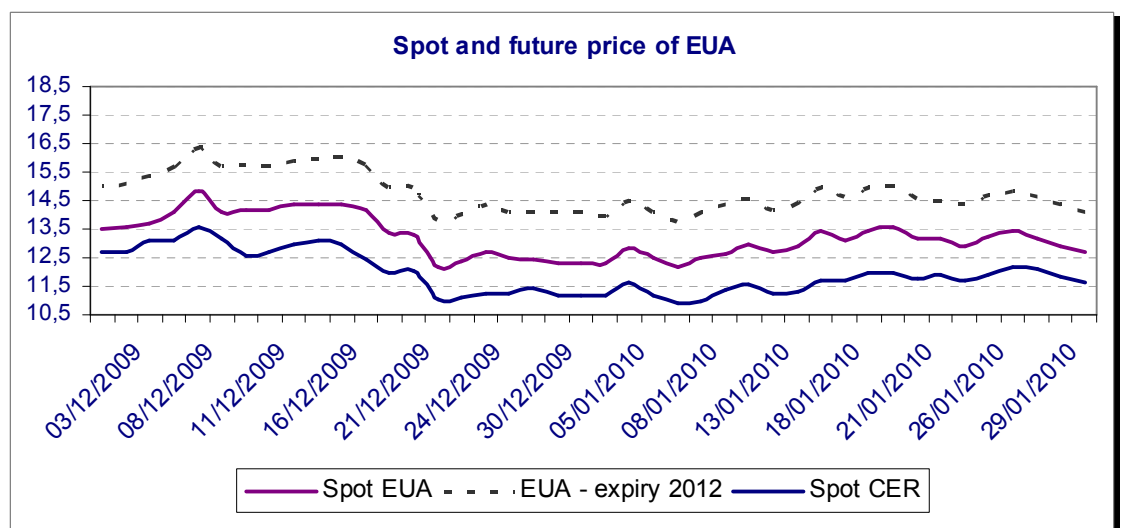


Carbon price summary – January

Lack of direction and prices moving sideways are the most suitable expressions to describe the carbon prices in the first month of 2010. Nor the decreasing uncertainty over the European Union's commitment, neither the particularly cold winter had serious effect on the price of EUA and CER in January. Increasing volumes and slightly decreasing EUA-CER spread during the month may indicate an upgrading activity from compliance players.

The price of the EUA closed January below 13 EUR/unit, despite that EUAs were traded highest at 14 EUR/unit just a couple of weeks before. The CER was traded between 10.5 and 12.5 EUR/unit in January and closed the month around 11.5 EUR/unit. Recently more and more compliance players have decided to do spot swap transactions in order to take advantage of the price difference between the EUA and CER, the two types of units which can be used for compliance in the EU Emissions Trading Scheme (EU ETS).



The short term outlook for carbon prices – similarly to any other commodities – is influenced by US president Barack Obama's announcement to tighten bank regulations, which would prevent banks or financial institutions from investing in, owning or sponsoring a hedge fund or private equity fund. The direct consequence of such plan to the carbon market appears to be limited: in one hand it is hard to imagine any carbon market without major non-compliance players providing the required liquidity, and in the other hand major players in the carbon market are European institutions. The negative sentiment is complemented by weak fundamentals - the expected surplus in the second trading period (2008-2012) of the EU ETS is over 160 million EUA. The political insecurities, the negative sentiments and the weak carbon fundamentals reduce the probability of any significant price increase in the short run.

Climate policy insights after Copenhagen

Governments were meant to tell the United Nations by 31 January if they want to sign up for the Copenhagen Accord and submit plans for curbing greenhouse gas emissions by 2020. The United Nations said the deadline is flexible. It is worth to remember that the deal was not adopted by the UN summit on 19 December 2009 after objections by a few developing nations, which triggered a demand for all to take sides by 31 January 2010. After all 55 countries submitted voluntary targets to the UN until 2 February, but no major country has come forward with a reduction target that matches the conditional EU offer to cut emissions by 30% below 1990 levels. (Only Norway is committed to beat this target.)

For the future of the EU ETS the most important thing is the continuous commitment from the European Union which decided to stick to its lower offer (20%) of cutting carbon emissions under a UN climate accord, but it maintains a conditional pledge to do more if other polluting nations – notably China and the United States – do likewise. Some EU countries such as Poland, Italy, Cyprus and Malta had opposed making the more ambitious conditional target because of concerns that it would be too costly for their industry. *"Italy and Poland said at the meeting that they were concerned but they wouldn't stand in the way,"* an EU envoy said. Other countries Britain, Denmark and the Netherlands were much more in favour of a 30 percent offer. *"The UK remains committed to the conditional offer of 30 percent to stay on the table to ensure that we do not lose the momentum that has been generated over the last few months,"* said an official from Britain's Department of Energy and Climate Change.

Overall a 30 percent commitment could have a significant positive price impact. The biggest issue is that with the current technological setup it is unclear how could the EU meet such targets. Adding up all remission reduction capacities of the power generating sector as it exists right now and even using the linking capacity does not seem to be sufficient enough to meet the targets. A 30% target could foster innovation and economic growth as well as could lead to companies missing the target and paying an expensive penalty to do so.