ANALYSIS: EU ETS intervention prospects seen as limited amid shock price spike

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Policymakers and industry have been caught off-guard by the rapid surge in EU carbon prices, and according to experts, the prospects to intervene may be limited and the idea generally unwelcome by many due to the painstakingly-constructed market reforms that triggered the year-long rally.

EU ETS prices have tripled so far this year and have rocketed more than 25% in the past three sessions to 10-year highs near €26 on Monday as traders and investors look to front-run anticipated gains from the Jan. 2019 introduction of the supply-curbing Market Stability Reserve (MSR).

The staggering increase follows years of rock-bottom carbon prices below €5 and several efforts to reform the market, which culminated in the comprehensive post-2020 ETS reforms agreed last year and finalised early this year.

Carbon is also partly responsible for pushing European power, gas, and coal prices to decade highs, which have yet to fully reverberate throughout the EU economy.

Observers have warned that the quick, steep rise in energy prices could have a dragging effect on a recovering EU economy that is now contending with US GDP growth in excess of 4% per annum, and as a result, cries from consumers, industry groups, and subsequently lawmakers could get very loud, very quickly if energy costs get out of hand.

But despite the sharp rise in EUAs, some experts see little chance that a short-term supply intervention under Article 29a of the ETS Directive will be sought, while others believe the hard-fought reforms are sufficiently robust to withstand political shifts unless prices get far higher.

“There were a lot of politicians that have been calling for higher prices for years, but they wouldn’t have expected to see them so soon,” said one carbon trader, who asked not to be named because they are not authorised to speak to the media.

“So now we are here, it will be difficult for them to reverse course unless we go way above €30 very quickly,” the trader added.

Milan Elkerbout of Brussels-based think-tank CEPS agreed.

“It is easy to make the argument that the price rise is the result of the legislative measures for which a lot of political capital has been spent over,” he told Carbon Pulse.

“Some could argue that such a sudden move wasn’t intended, but there is a credibility issue with that.”

Other observers noted that the recovery in EUAs to levels not seen since 2008 – before the global recession – have come following a series of market interventions, including the 2014 Backloading programme that saw 900 mln allowances temporarily withdrawn from the market over three years in a bid to lift prices.

Some EU lawmakers were reluctant to tinker with the ETS at the time, citing the European Commission’s free-market ethos and its general disinterest in introducing price floors, leading some observers to expect that they will likely be even more reluctant to intervene in the market this time around, especially as the latest rally appears primarily speculator-driven, meaning it could in theory unwind as quickly as it accelerated.

BRUSSELS RADAR

Lobbyists and policymakers alike have returned from the August political recess with carbon prices some €7 higher than when they left.

But so far the change has not drawn much attention even from the industry groups that have long feared that the cost of higher carbon prices could cripple their global competitiveness.

“Industry isn’t really lobbying against it,” said one Brussels-based lobbyist, adding that many trade associations remain more focused on influencing EU electricity market reforms due by year-end.

“[The carbon price] hasn’t been on top of our agenda the past weeks,” admitted one climate policy specialist at an industry group.

The issue wasn’t raised during a meeting of member state officials on energy issues last Friday, where electricity market reforms were top of the agenda.

After steering the ETS reforms to agreement over the previous three years, even Europe’s Climate Commissioner Miguel Arias Canete seems comfortable with the swift rise in carbon.

“Now we have a system that is much better than the one we had in the past,” he told the Financial Times last week.

ROBUST REFORMS

The reforms were finalised in early 2018 after a painstaking three-year legislative process involving multiple trade-offs designed to win over lawmakers from all 28 EU member states representing vastly different wealth profiles, energy mixes, and degrees of public concern for climate change.

“These Phase 4 reforms were widely supported by stakeholders, including industry,” said CEPS’ Elkerbout.

He pointed out that the new rules included maintaining the extensive free allocation of EUAs to industry through 2030, which will help cushion the blow of higher carbon prices over the next decade.

Industry lobbyists had also successfully campaigned both to lower the rate at which the free allocation will taper off and to boost the size of the Innovation Fund that disburses billions of euros to fund projects designed to cut emissions from factories.

One veteran market participant suggested those hard-fought concessions won’t quickly be forgotten and could therefore discount any pleas for sympathy from manufacturers over dearer carbon.

Elkerbout noted that the reforms were also designed to mitigate the impact on energy bills in poorer, coal-reliant states and to generate significant government income from selling allowances at auction.

“[The higher carbon prices] will show up in electricity bills at some point and there may be some degree of protest about it. Though in some of the places where this might be felt the most, there is a transitional free allocation to the power sector to limit at lot of that impact,” he said.

“Politicians might start to raise concerns, but this also might be limited because the ETS is raising a lot of revenue for national treasuries and that is very important for governments.”

EU member states are on track to raise a record of more than €10 billion through EUA auctions this year – roughly double the amount deposited into government coffers in 2017.

Dave Jones of climate campaigners Sandbag urged EU lawmakers to let the ETS run its course now that it was fulfilling its purpose of driving emission reductions in the electricity sector by encouraging utilities to switch fuels from coal to cleaner gas.

“It may seem painful now because much of the rise to €25 has happened over three months and not over three years, and also because it is accompanied by record coal and gas prices,” he said.

“This isn’t cause for concern as yet. We are in the carbon pricing sweet-spot needed to move investment out of coal into wind and solar, while keeping it affordable,” he added.

*****Article 29a and skyrocketing EUA prices will be a central topic at our Carbon Forward 2018 conference in London on Oct. 16-18. Click here for more info or to order tickets. Limited quantities remain.*****

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