

CARBON TRADING

CER-EUA SPREADS

“A closer look at the current spread between CER (credits generated by emission reduction projects in developing countries and which can be used in the European Scheme for compliance) and EUA (the European CO2 currency). The lack of the ITL (the registry necessary to transfer CER globally) is causing some headaches, but can't explain the spread to the full extent (it's 7,5 EUR/t). There have to be other reasons...”



CER-EUA spread
Source: 3CGroup

3C Group Carbon Investment Advisory: Clemens Huettner

The CO₂ market has seen considerable erosion in the value of European Emission Allowances (“EUA”) over the last couple of weeks. While EUA were traded at levels far above of 22 EUR/t (with a peak at 26.00 EUR/t on 30/05/2007), they did not seem to find any support, whilst they fell over the last couple of days. Weaker European power prices and some profit taking activities of financial players for sure have contributed to this drop, but increasingly traders pointed to Certified Emission Reductions (“CER”), quoting them as one of the main reasons for weakening EUA prices. CERs are generated by so called Flexible Mechanism Projects under the Kyoto Protocol, which are mainly realised in China, India and Brazil. To an extent, CERs can be used for compliance in the European Emission Trading Scheme (“EU ETS”). Price-wise, CERs have for quite some time now played a minor role. They have always been priced at a discount to EUA, the main reasons being: the lack of an International Transaction Log (“ITL”), a register, which is needed to transfer CER physically and, owing to their comparatively low “production costs” of < 10 EUR/t. However, the market is aware, that the purely technical ITL problem will be solved in the near future.

Over the last couple of days, activity on the CER side picked up rapidly and more and more natural players in the EU Emission Trading Scheme are now getting interested. Obviously the spread between EUA and CER and the consecutive swap possibility seems now to be widely regarded as a risk free arbitrage possibility, which is certainly correct. It took a number of players some time to take a trading decisions and to make use of this simple operation (CER purchase against EUA sale), which allows for cashing in on the current price difference between CER and EUA.

As a result of these activities and a new wave of freshly imported CERs into the EU, European Emission Allowances have lost value. Moreover the spread between EUA and CERs is tightening. Two weeks ago, CER were traded at a level of 65% of EUA, now they stand at a 27 % discount to the corresponding EUA contract. This development will continue and is likely to accelerate over the next couple of weeks as a number of players, in lieu of shrinking margins, will try to get swap deals done, at the earliest possible. It remains to be seen, how many CERs will enter the market if the demand side continues to grow. Long CER players could artificially hold back their credits and let the spread tighten even further, which would accelerate this development even more. The signals are quite clear: continued CER / EUA swaps will lead to a tighter spread.