

EUROPEAN CARBON MARKET

TRENDS AND PERSPECTIVES

AUG'23

DEC'23



European Carbon Market. Trends and Perspective

Aug'23 -Dec'23

The analysis is a product of the staff of EMBA Power.

September 2023

The findings and interpretation are expressed based on data available at the time of the report. However, there is no guarantee that they will continue to remain correct in the future. The use of this information for any action undertaken should be done with competent professional assistance, based on the specific circumstances of certain legal entities and based on the state of affairs at that time.

AUGUST

August typically leads to an increase in EUA prices. The month is known for halving its auction supply as many traders are on vacation and activity is reduced accordingly. Financial speculators see this thin trading as an opportunity to enter the market and dictate an upward direction.

“This has happened every year since 2008 – with one exception – and is pretty much baked into trading strategy,” warned carbon reporter Allesandro Vittely in an article published a year ago.

Furthermore, persistent high temperatures across Europe as well as low wind and reduced hydropower usually boost demand for fossil fuel-fired electricity and therefore increase demand for allowances, adding further upward pressure on carbon prices.

In the past few years, several all-time highs have been reached during this month. On August 30, 2021, carbon prices passed €60 for the first time ever, more than doubling since the beginning of that year amid tougher climate goals and prospects of reduced gas supplies.

Another record was reached on 19 August 2022, when the EUAs rose above €99, up by 28% since the month had started. The main reason for the rise was the surge in gas prices following Russia's decision to reduce deliveries.

However, some market participants pointed the finger at short-term speculations, based on Commitment of Traders data published by the ICE platform. “This price rise is insane,” said Refinitiv analyst Yan Qin quoted by Montel at that time.



Data from the main ICE Endex exchange show that **since 2015, EU permits have risen by an average of 8% at the end of the month**, one of the strongest average monthly performances of the year and one of the most consistent as well.

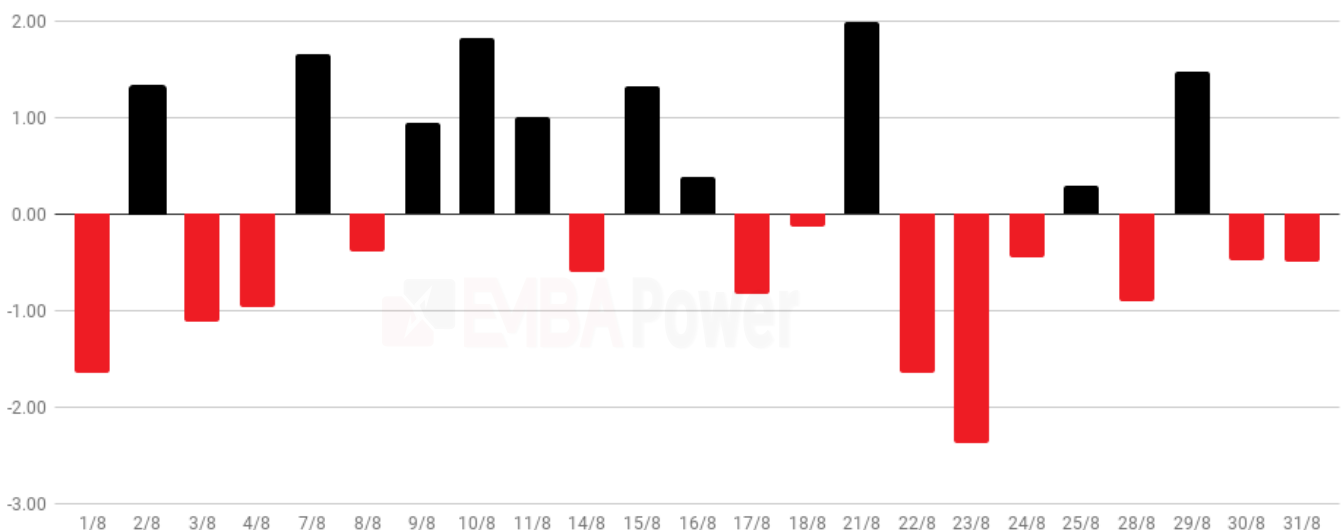
Climate Market Now
Weekly report, 31 August 2023

AUGUST'23

This year's August has been surprising as **carbon prices were fairly stable**, trading between €82,30 and €90,44. Compared to the previous years, there have been little price movements. The largest daily swing of €2,38 occurred on the 24th when prices dropped from the previous day's settlement.

As expected, activity on the secondary was relatively reduced due to the summer vacation season. In August, the **trading represented a volume of 16,86 million allowances, around 15% below this year's daily average**. However, the activity was almost the same as in August'22 when the volume totaled around 16,83 million allowances.

August Daily Swing



Daily trading average volume



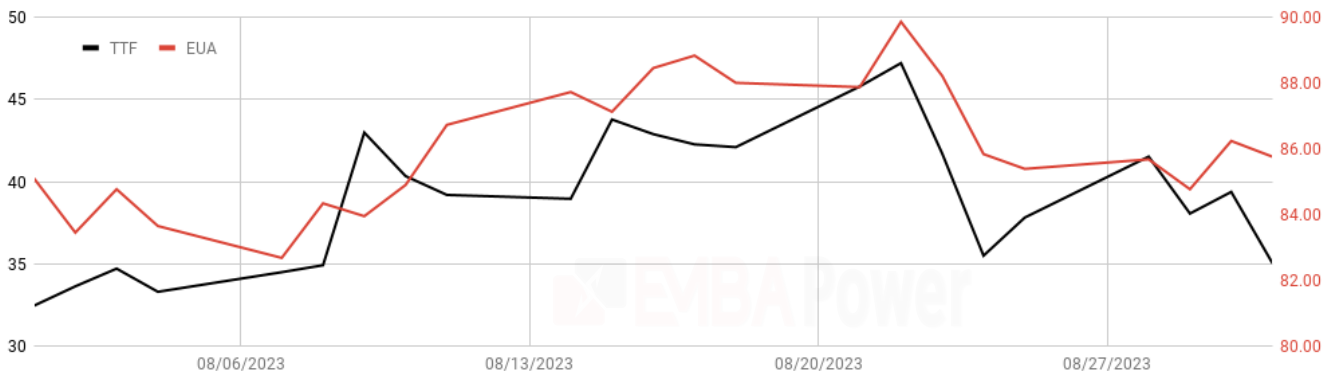
AUGUST '23

Despite closing in July at a higher level, most likely in anticipation of the reduced auctions, **when August concluded, the EUAs were recorded trading at €85,76**. This value was slightly below the previous month's settlement which was at €86,67. This decline may seem insignificant, however, it **suggests a potential shift in market sentiment**.

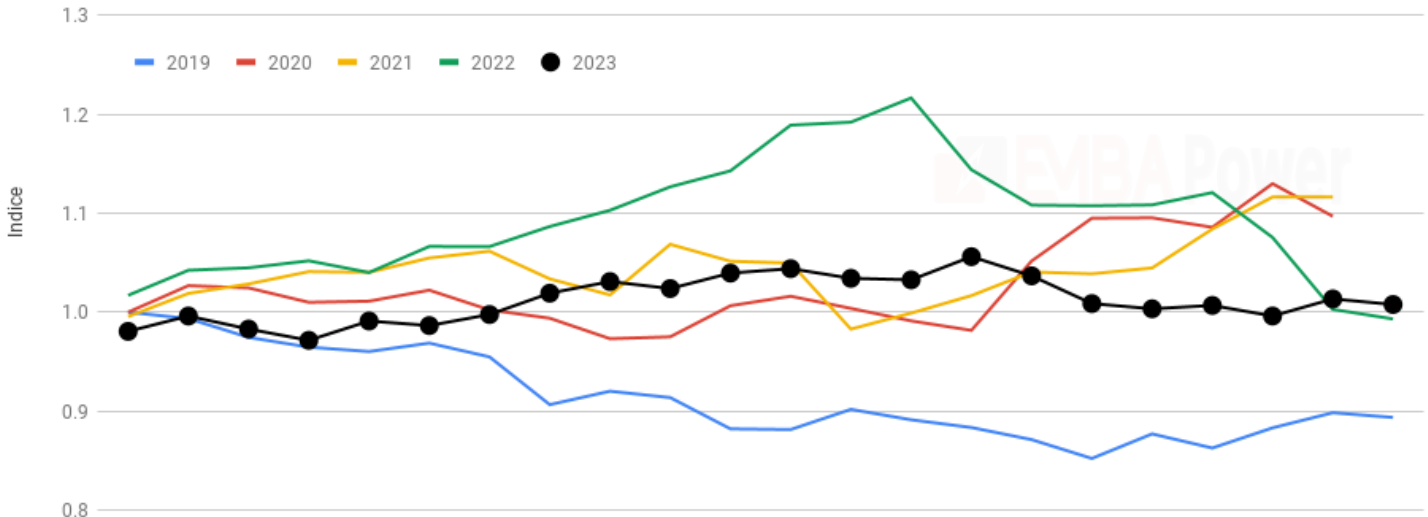
The month's highest level of €90,44 was hit on the 22nd tracking massive gains in gas prices. TTF front month responded promptly to the news that key Australian LNG plants could face strike action, risking losing around 6% of the global supply. The EUAs rose as much as 3% that day as gas prices hit their highest level since April.

However, following that run-up, gas prices have retreated to levels recorded before the strike rumors with market participants realizing that Europe is more than prepared for winter demand. In fact, as of August 31, gas reserves stood at 92,81%, almost 12% above the five-year average. The European carbon market also edged down, following the movements in gas prices and "continued to keep an eye on that topic" as stated by Energi Danmark.

TTF vs EUA



August Price Index 2019-2023

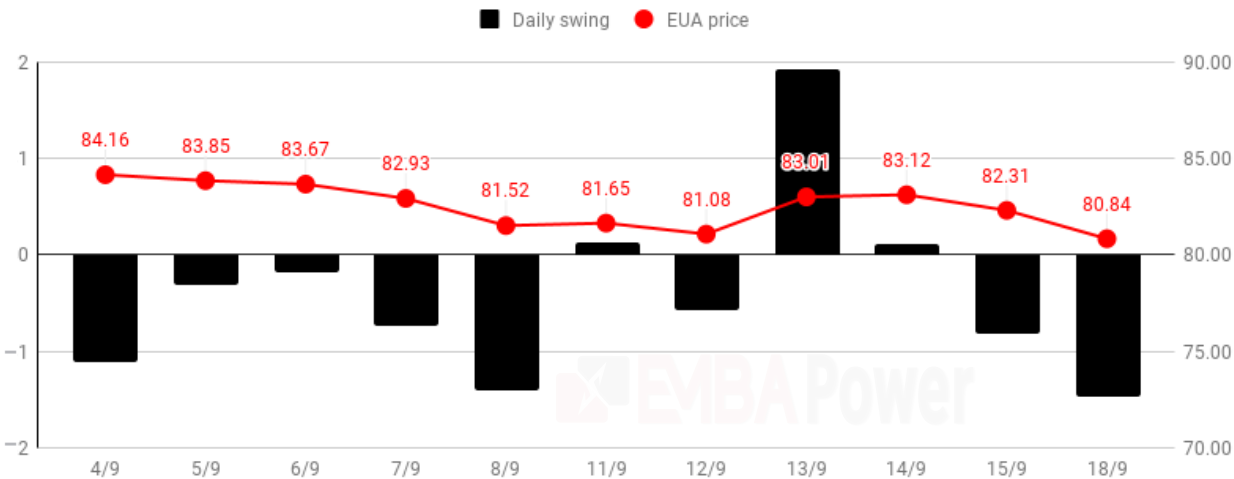


THE FIRST HALF OF SEPTEMBER '23

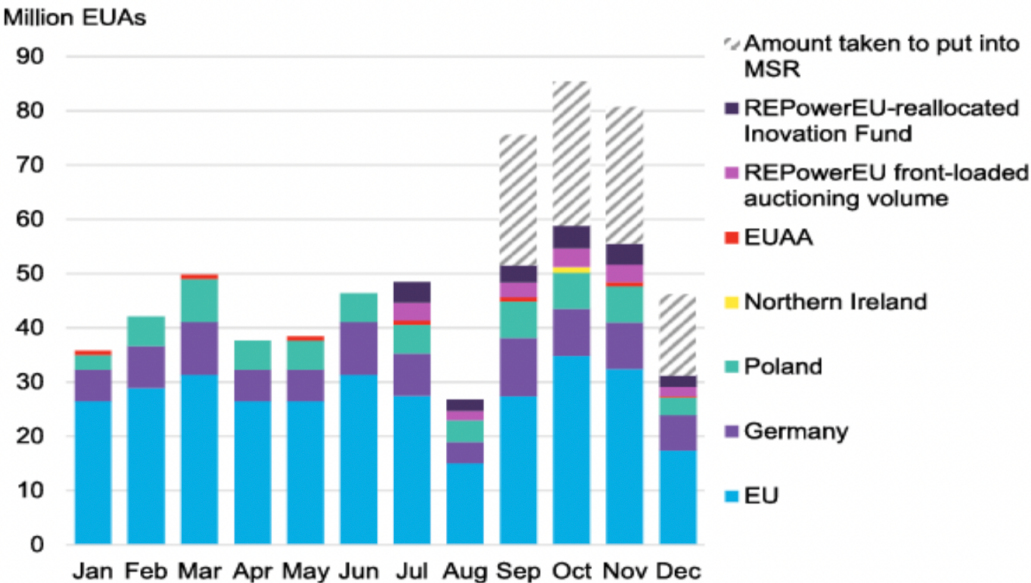
The European carbon market started the month on a downward trajectory as prices have posted losses nearly every day. The main reasons for the decline could be the increased auction supply and falling gas and coal prices.

However, by far, the biggest day-to-day fluctuation of €1,93 was recorded on the 13th when prices traded upwards, amid bullish signals from gas and coal markets. Except for that day, so far this month, carbon allowances have been relatively stable with no sudden movements. Also, trading activity has increased by almost 13% compared to August, which was expected as September marks the end of the summer season.

Day to day changes



Scheduled EU ETS auction volumes in 2023



Source: Bloomberg, August 2023, from <https://climatemarketnow.com/>

MARKET OUTLOOK FOR THE REST OF '23



The European carbon market is looking at the rest of 2023 with many challenges, some new and some old. All combined, those challenges could result in different scenarios.

The general sentiment is that the short-term trend is downward, driven primarily by the slowdown in economic activity. Economists are increasingly recognizing that the outlook for growth in the euro area is far from ideal. Germany, Europe's largest economy has already fallen into technical recession.

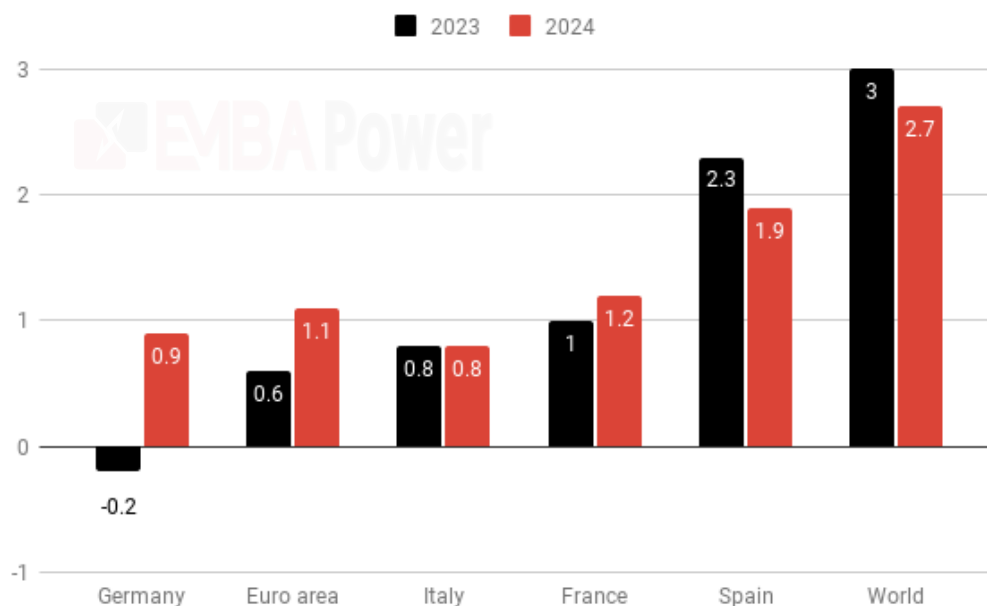
Other major economies in the eurozone are also experiencing weaknesses. Growth rates in France and Italy, the second and the third largest economies in the EU, are slightly above zero. However, Germany is expected "to experience the heaviest blow from a slowdown in the world economy" as stated by the Organisation for Economic Co-operation and Development.



Analysts have lowered average price forecasts for EU carbon permits for the next three years on expectations of lower demand from the power sector as the amount of renewable generation increases and the outlook for European industry is weak.

Reuters
July 2023

GDP projected growth rates for 2023 and 2024



Source: [OECD Economic Outlook, Interim Report September 2023](#).

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The economy is likely to remain subdued in the coming months. It broadly stagnated over the first half of the year, and recent indicators suggest it has also been weak in the third quarter.



Christine Lagarde

The president of the European Central Bank
4 September 2023

MARKET OUTLOOK FOR THE REST OF '23

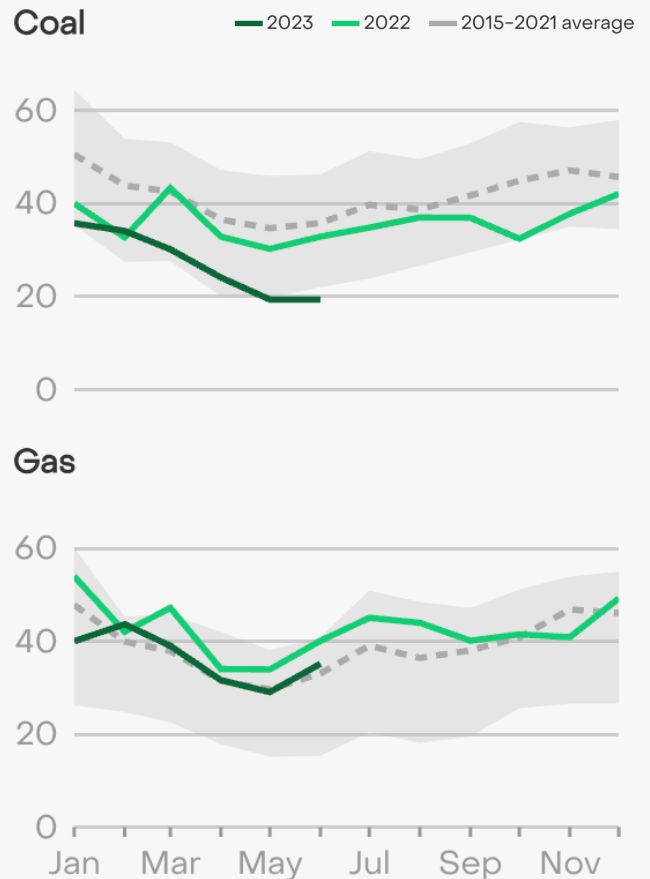
Also on the bearish side, **“wind and solar continue growing while hydro and nuclear recover from historic lows”**, as stated by Ember. As a result, renewables are replacing fossil fuels for power generation which naturally translates into lower demand for allowances.

The renewable power expansion also coincides with a significant drop in energy demand amid economic weakness. The most recent data on power generation in Europe show that **the total amount of energy dropped around 8% in the first half of 2023 compared to the same value recorded in 2022.**

Analysts translate the first-half decline in electricity generation this year to **a full-year decline in carbon emissions of around 125 million tonnes, or nearly 10% of total EU ETS emissions in 2022,**” writes Allesandro Vitelli



EU generation (TWh) by month



Source: [Ember monthly data](#)



EU fossil generation collapsed in the first half of 2023, falling by 17% compared to the same period in 2022. Fossil generation from January to June was the lowest since at least 2000

EMBER
30 August 2023

MARKET OUTLOOK

FOR THE REST OF '23

Gas price and availability as well as weather conditions are three important factors that can strongly influence carbon prices. TTF front month posted noticeable increases lately due to supply concerns triggered by strike actions in Australia and outages at the Troll gas field, the largest in Western Europe.



Europe is set for a **mild autumn and start to winter**, which should lower gas demand for heating..

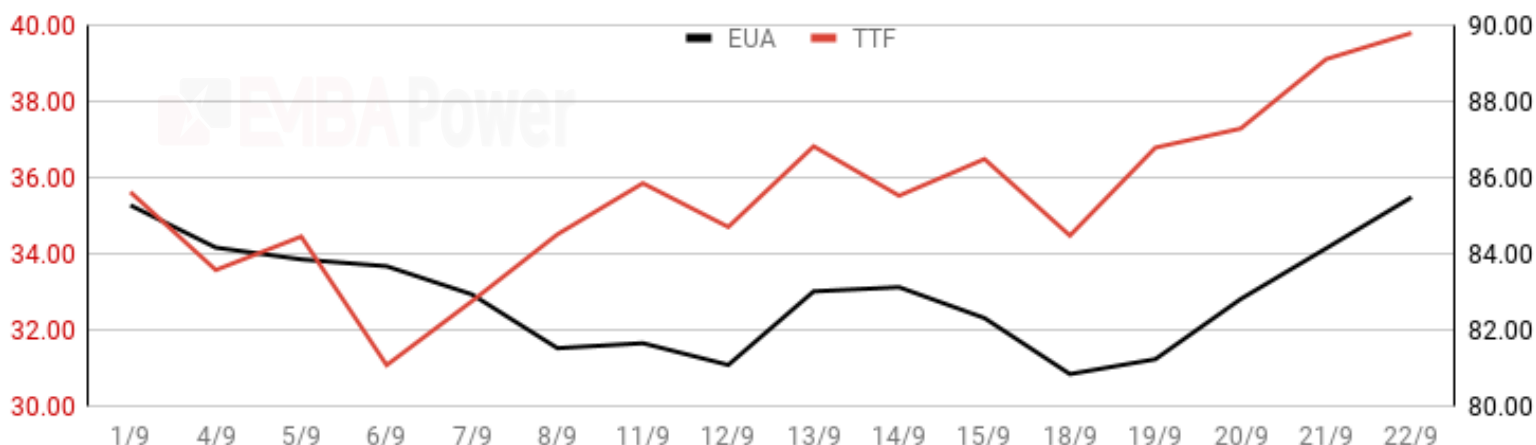
Montel News
19 September 2023

Unsurprisingly, carbon prices rebounded from a three-month low reached on 20 September, tracking massive gains posted by TTF. However, **gas prices should drop in the near future as supply concerns ease** amid "increased pipeline flows from Norway and the end of Australian LNG strike action," as reported by Montel News on 22 September.

Another key factor for carbon prices is gas storage. Unlike last year, the situation is much better and looks more stable. According to the latest data from Gas Infrastructure Europe for 23 September, **gas storage was 94,74% full, sufficiently high to enter the heating season.** Furthermore, the gas market is receiving once again a helping hand from the weather.

"Forecasts of an El-Nino year suggest **there is now a higher chance of a warmer-than-average winter across Asia and Europe**, which risks putting further downward pressure on prices," according to consultancy firm Wood Mackenzie.

EUA Dec'23 vs. TTF front month



MARKET OUTLOOK

FOR THE REST OF '23

Still, the carbon prices are holding up relatively well considering the picture detailed above. There are several factors that could offset the negative effects of the bearish trend such as the recent ambitious reform of the EU ETS and the behaviour of speculative players.

The new climate policies imply fewer new allowances into the market as well as higher demand for EUAs therefore contributing to higher carbon prices. Nonetheless the new reforms will take a while before showing any substantial changes and therefore, we expect to have rather a long-term impact on carbon prices.

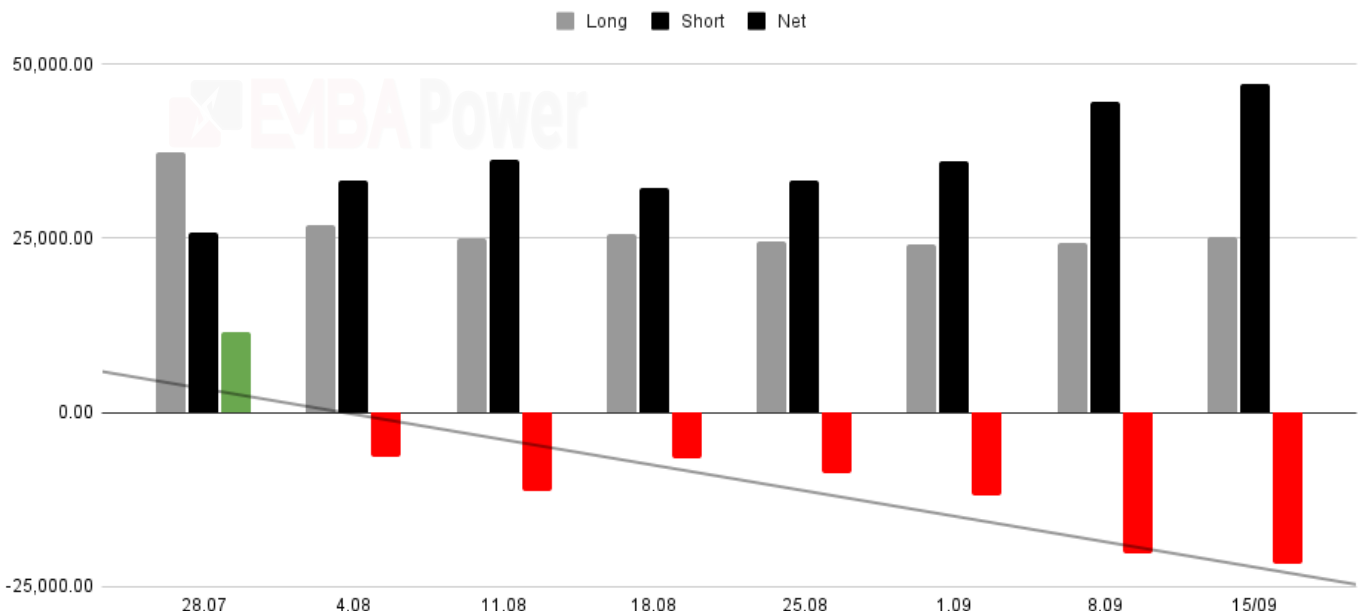
In anticipation of a future scarcity of allowances, speculative traders could exploit the prospect of rising prices in the future, a behavior to which we are by now so accustomed to. Still, the Commitment of Traders (CoT) issued by the ICE, shows that the investment fund category has flipped from net long to net short exposure.



While the overall picture... **looks unremittingly bearish for carbon demand**, experts are careful to point out that 2023 should not be considered in isolation. Evolving climate policy and future carbon demand play a key role in the market's pricing.

Alessandro Vitelli
Carbon reporter
8 August 2023

Commitment of traders data on investment funds' positions



MARKET OUTLOOK

FOR THE REST OF '23

The CoT report published for the week ending on 28 July showed investors holding net long positions of 11,6 million EUAs. However, they flipped to net short exposure at the start of August. Over the six weekly reports, **the net short positions increased significantly to 21,8 million as of 15 September.**



The bearish signals on the market are still visible despite the recent uptrend.

Morning Report
Energi Danmark
26 September 2023

Investors take advantage of a combination of long and short positions in order to lower their risks. From a trading perspective, when players think that the value of a commodity will fall in the future, they would choose to short the contract.

However, **when such net short positions are built, the additional demand created leads to higher prices, a phenomenon known in financial markets as a short squeeze.** It is very likely that, besides higher gas prices, this higher demand was one of the reasons behind the carbon price surge observed in the second half of this month.

Nonetheless, we expect this short squeeze potential that has dominated the market recently to end, resulting in falling prices with the weak economic outlook and warmer winter due to El Nino to add to the downside at least until the end of this year.