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CALIFORNIA CARBON TWICE AS EXPENSIVE AS EUROPEAN

The cost of carbon in California has risen sharply while the equivalent in the European Emissions Trading System has so far gained little from yesterday's long-awaited reform proposals

London, 26 July 2012 – A reduction in regulatory uncertainty in California, and concern about a nuclear power outage, have helped to push the price of a carbon allowance in the US' most populous state to more than double that in the much longer-established European Union Emissions Trading System.

The value of a California Carbon Allowance (CCA) for delivery in December 2012 closed at \$19.50 per metric ton of CO₂ equivalent (EUR16.04/tCO₂) on 24 July, the highest closing price of the year so far. The price for European Union Allowances (EUAs) for delivery in December 2012 closed at EUR7.20/tCO₂ on the same day.

The much higher price in California may be surprising to Europeans, given perceptions about American reluctance to take action on climate change. Ironically, the California scheme was almost derailed earlier this year by legal action taken by an environmental action group (the Association of Irrigated Residents) who insisted that the scheme was not strict enough.

The price of EUAs has remained low despite the European Commission's release yesterday of its proposal for changes to auctioning volumes in Phase III of the EU ETS, which begins in 2013. These changes, if approved by both Parliament and the Council, would delay some of the auctioning volume originally intended for the early years of Phase III, into the later years. The changes were proposed by the European Commission in response to widespread criticism that the price in the EU ETS is too low to promote the necessary investments in clean energy.

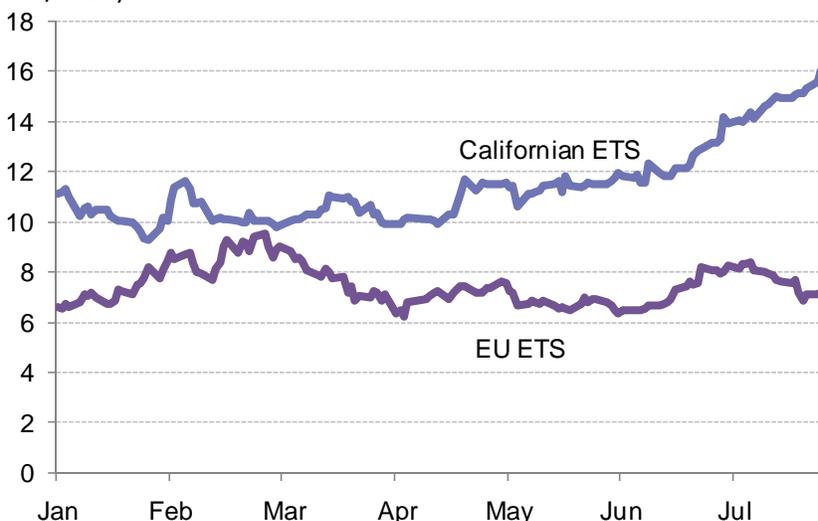
In the long term, Bloomberg New Energy Finance expects prices in both the Californian and EU ETS to rise significantly, since the emission reduction targets in both parts of the world for the period beyond 2020 are likely to continue to strengthen. At the moment the firm's base case forecast for the spot price of an allowance in 2020 in both markets is the same, at EUR45/tCO₂ (\$55/tCO₂). The fact that the forecasts are the same is purely coincidental and belies significant structural differences in the two markets; the EU ETS has access to the Kyoto market for international credits whereas California does not; and the largest sector in the EU ETS is the power sector while transportation is the largest emitter in the California market.

Matthew Cowie, head of carbon market research at Bloomberg New Energy Finance, commented, "While it appears that Europe has the political will to give the EU ETS more teeth in the long term, the process of fixing the problems continues to suffer delays. A month ago most market participants thought that changes to the Auctioning Regulation could be in place by the end of 2012, but most commentators

now expect that this will take well into 2013 to accomplish. This market needs both ambition and structural stability in order to regain its lost importance.”

Michel Di Capua, head of North American research at Bloomberg New Energy Finance, commented, "After several failed attempts to introduce cap-and-trade at the national level, there's a widespread belief that carbon markets are dead in North America. Not so. We are on the verge of seeing the emergence of a meaningful tradable market that over the long run will transform California's power, industrial, and transport sectors. The business community should take note; this market will impact some of the country's largest utilities and some of the world's biggest oil and gas players, among others."

Figure 1: California and European carbon prices since the start of 2012, December 2012 futures contract (EUR/tCO₂)



Source: ICE, Bloomberg

Futures contracts for the California market have been trading since 2011. Its underlying spot market is due to begin in 2013. The EU ETS saw the first futures trading in 2003, and the start of spot trading in 2005.

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