Comparing options for addressing EUETS oversupply

This document provides summary material and charts comparing options currently under discussion for correcting the supply demand balance in the EUETS.

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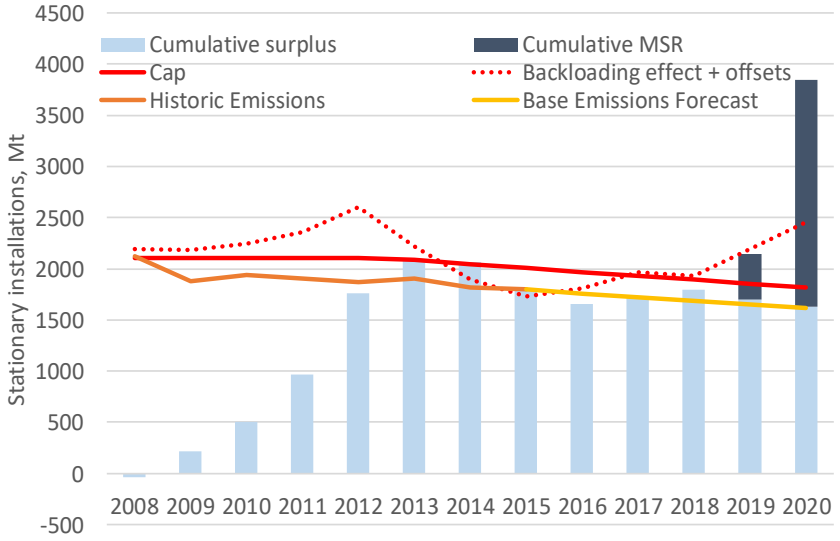
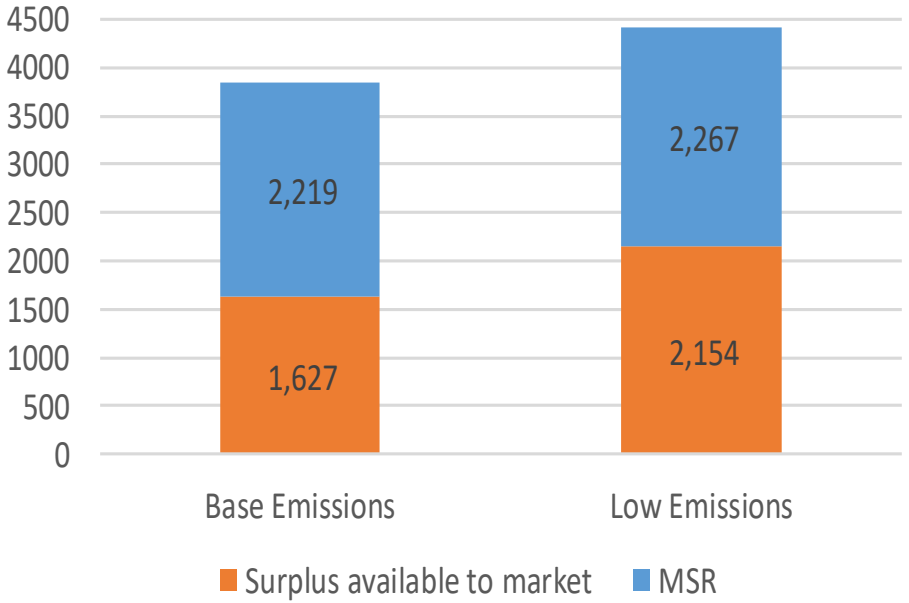
15 December 2016

There will be a large surplus by 2020, which will be largely unaffected by reform proposals, as none affect Phase 3.

- **Emissions continue to be below the cap during the rest of phase 3 …**



- **…so the total surplus will be 3.8-4.4 billion tonnes by 2020 …**



Note: emissions tracks are consistent with price projections shown on a later chart.

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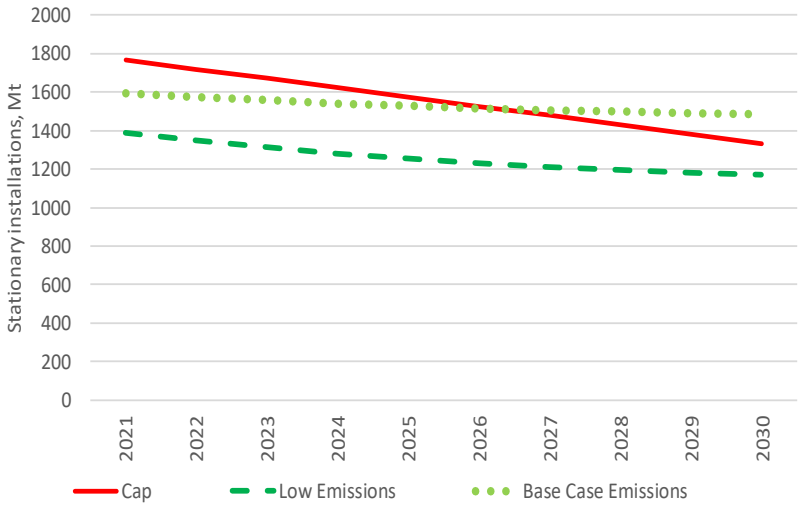
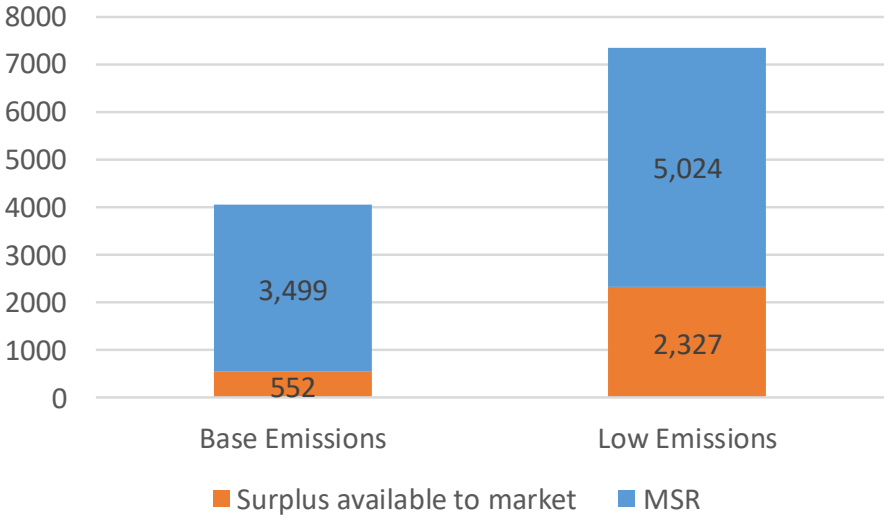
The surplus will grow further by 2030 under current proposals

- **With current proposals annual surpluses will be generated until late in Phase 4 and possibly throughout …**



- **By 2030 the MSR will contain 3-5 billion tonnes with some surplus still available to market**



- *Consequences of large MSR are to destabilize the market by creating uncertainty about what will happen to such large volumes –total is a quarter to half of cumulative Phase 4 cap*
- *Cancellation of 300 million allowances is welcome but affects total in MSR by less than 10%*
- *At current rates of release, all MSR volumes would only return to market around 2070*

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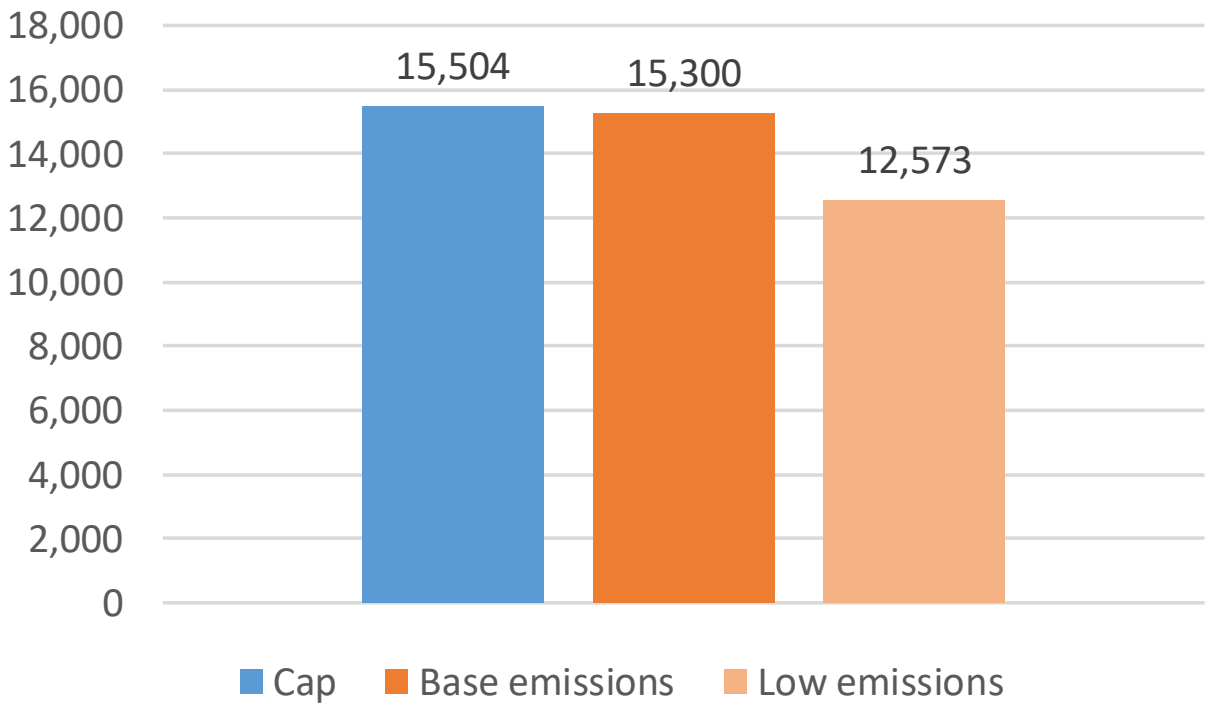
Emissions in Phase 4 are likely to be below the cumulative cap (without the existing surplus) even if the EUETS itself leads to little abatement

- **The cumulative cap over Phase 4 is at least as high as forecast emissions even without the accumulated surplus …**



- ***We consider it unlikely that emissions will be above our base case***

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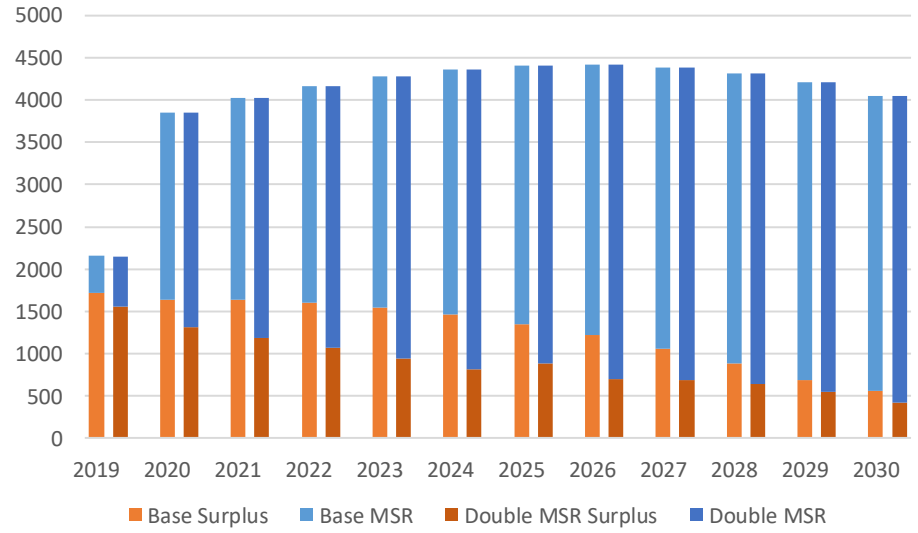
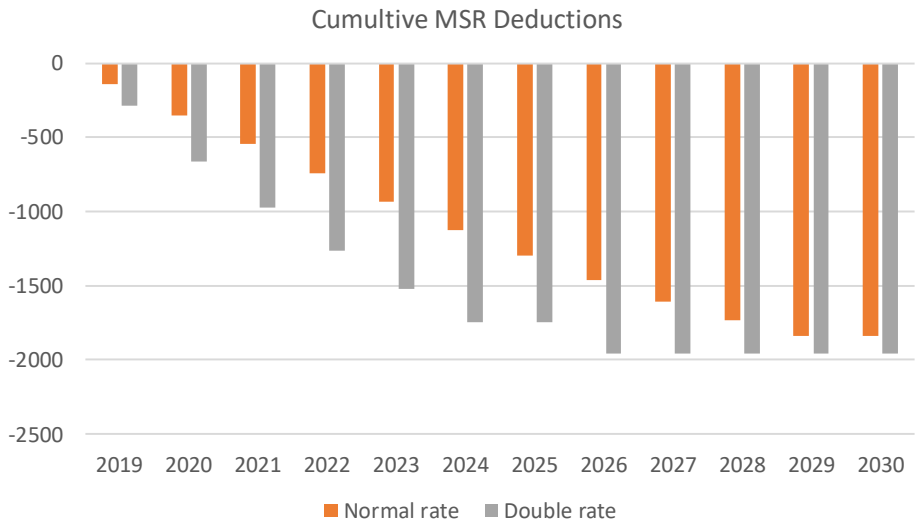
Doubling MSR deduction rate for three years has little effect by 2030 because the surplus persists through Phase 4

- **Increasing the rate at which allowances are placed in the MSR does not change the fundamental supply-demand balance by the end of the period …**





- *Price effect may increase surplus slightly by lowering demand, but this effect is likely small (see later chart)*

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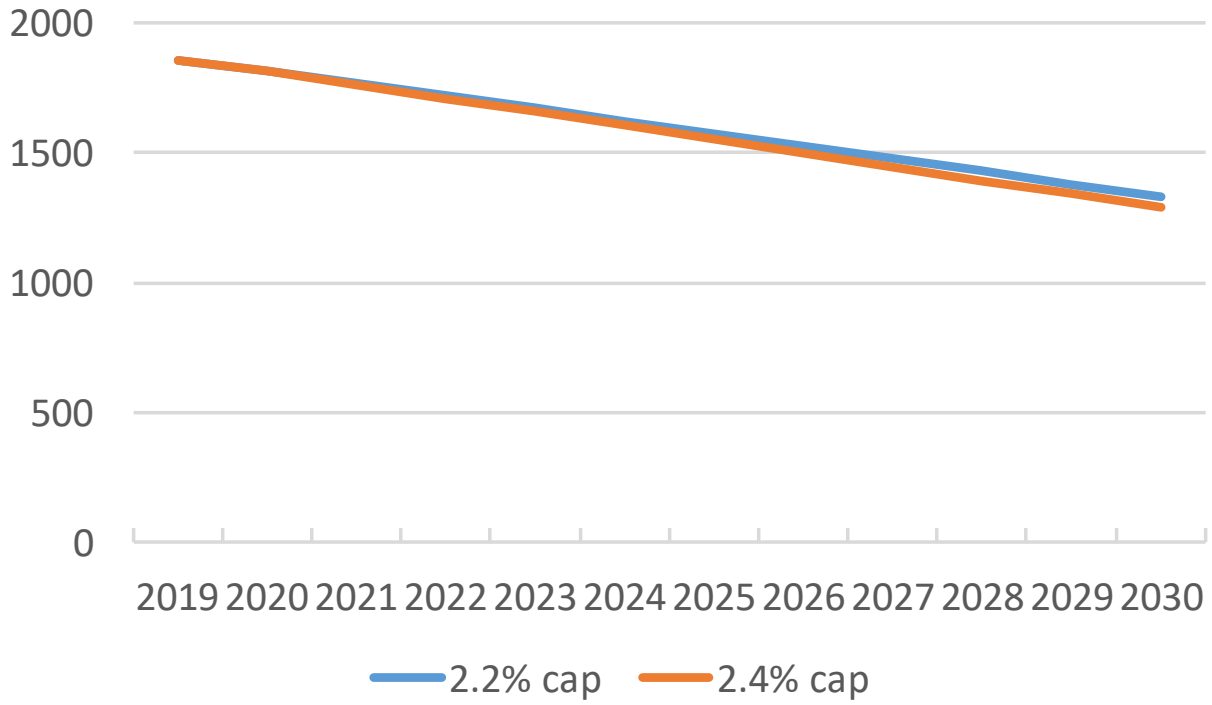
Increasing the LRF to 2.4% has only a minor impact on the market before 2030

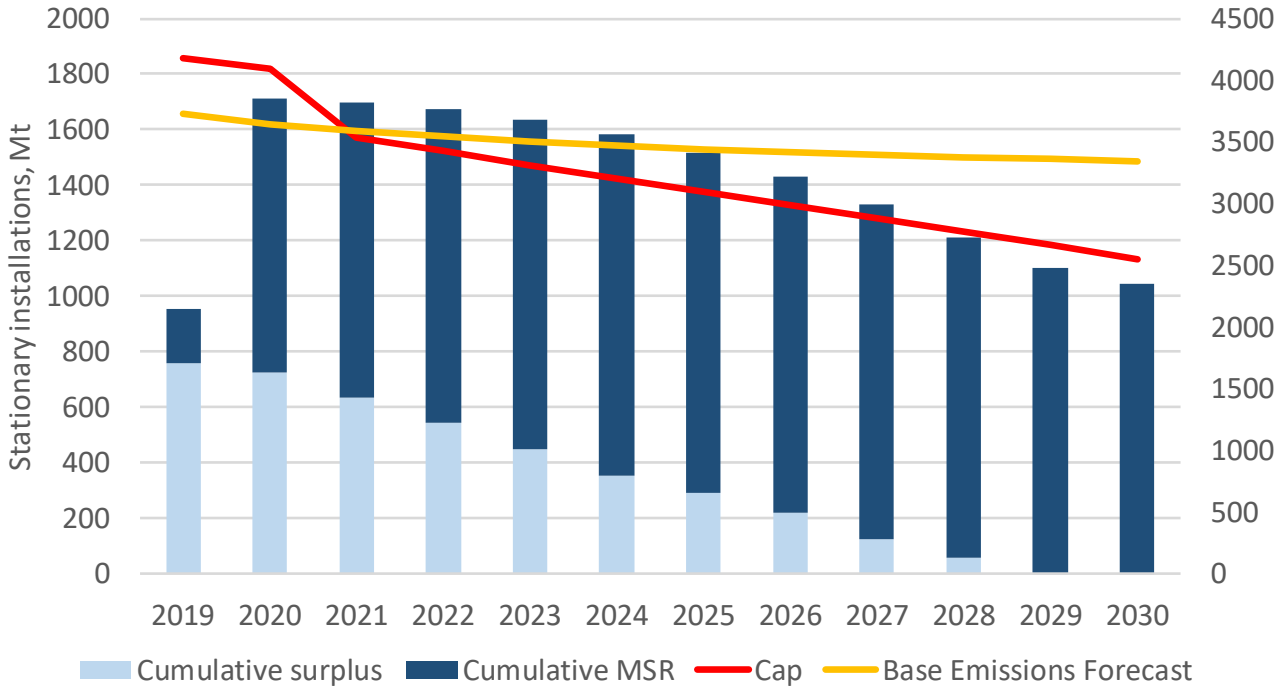
- **Increasing the LRF to 2.4% only decreases the cumulative surplus in 2030 by 242Mt during Phase 4 (3-5% of cumulative surplus in 2020, 1.6% of cumulative cap for Phase 4)**



- *Assuming the same rates, the cumulative cap difference is over 2Bt by 2050*

Rebasing the cap has immediate impact from 2021, because it addresses the surplus at source

- **A surplus is no longer being generated in Phase 4 and the existing surplus will immediately start decreasing**

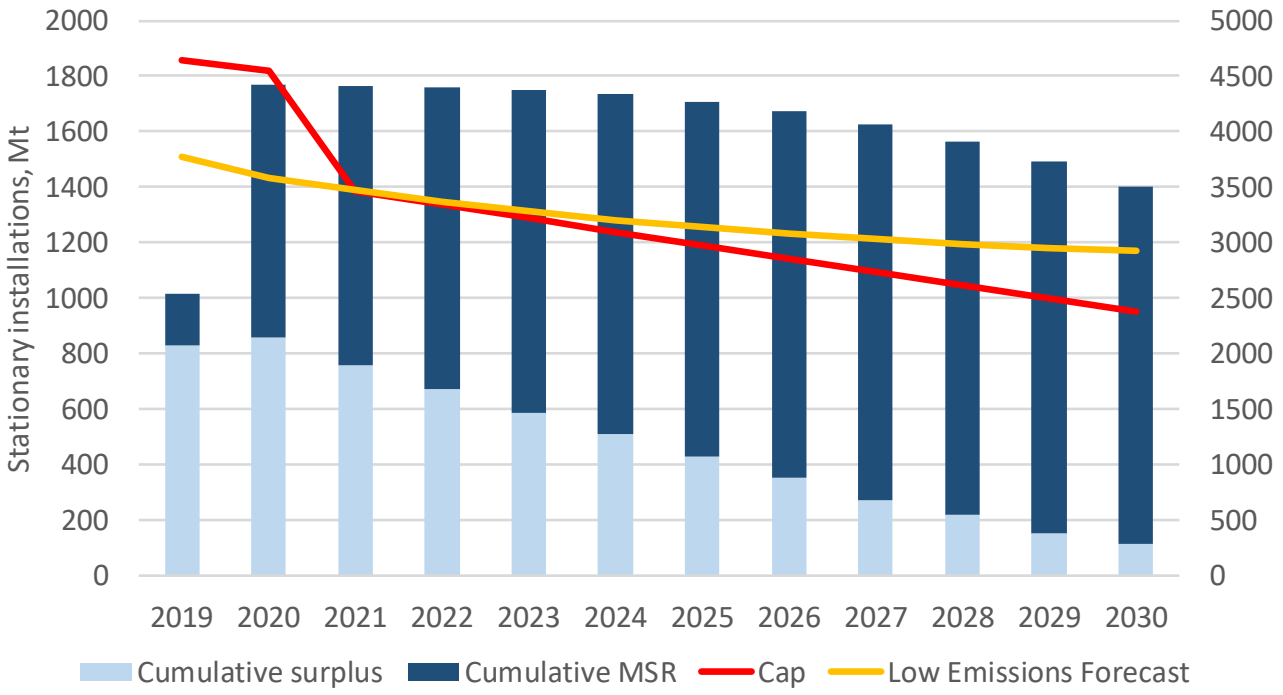


*Forecast 2020 emissions used as the new cap starting point

- *Increasing the LRF in addition to rebasing further increased stringency.*

Because rebasing aligns to actual emissions it is robust to different outcomes over the remainder of Phase 3

- **If emissions fall faster or slower than anticipated to 2020, rebasing would still ensure that the surplus does not continue to grow throughout Phase 4**



*Forecast 2020 emissions used as the new cap starting point

- *In the highly unlikely case of emissions above the cap in 2020 the existing cap would be an upper limit.*

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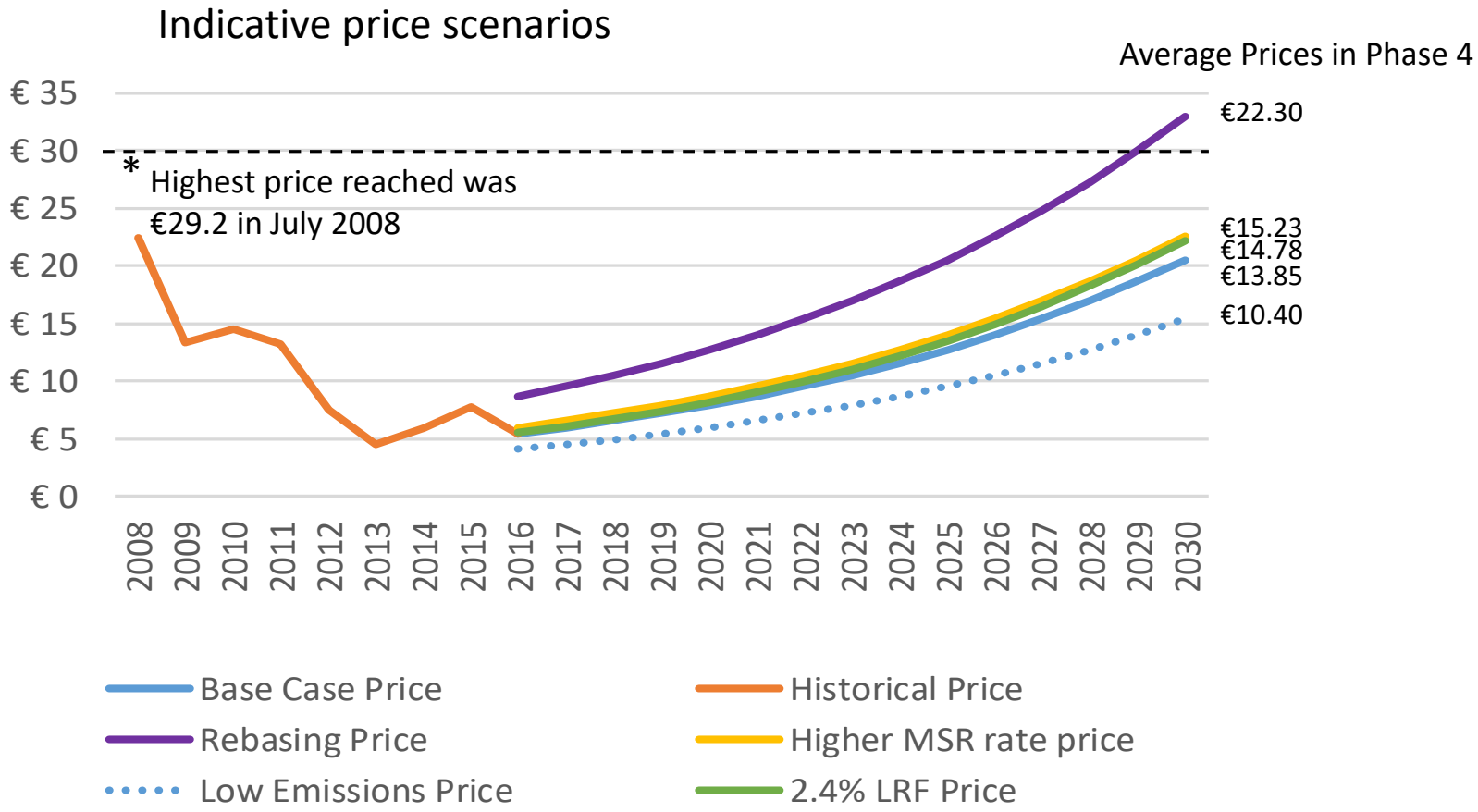
Price impact is moderate, in part because the existing surplus provides a large cushion. Even rebasing has only a moderate impact with prices reaching the expected Phase 3 level of €30/t only around 2030.



Note: Price scenarios are indicative only, based on analysis of the supply demand balance and abatement costs. They are for the purposes of comparing reform options only.

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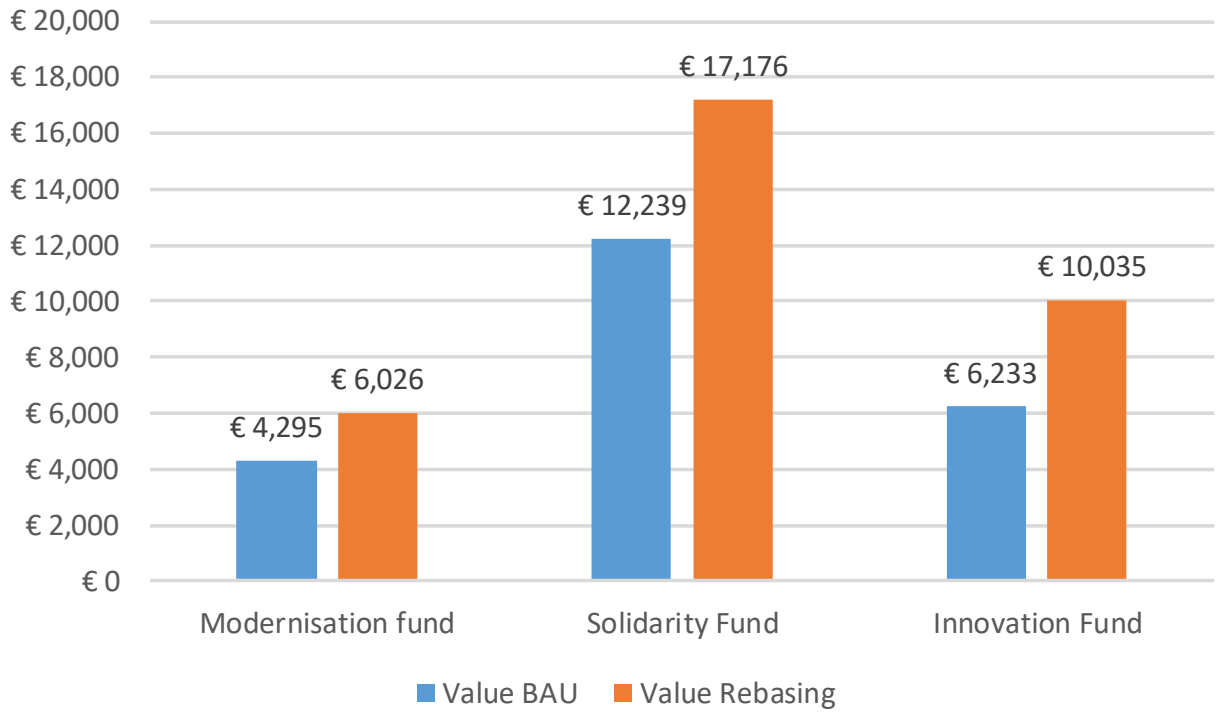
Rebasing will increase the value of funds by up to 50% as price increases outweigh the effect of reductions in the number of allowances.

- The expected increase in the carbon price, will grow the value of funds, despite volume reduction (and there is no volume reduction from the innovation fund).
- Average price over Phase 4 still averages below €30/t



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