During the past few months, the European market has experienced a substantial rise in the price of emission rights, a development that has brought tremendous change in the viability of conventional power producers. Marcus Ferdinand, Head of EU Power & Carbon Analytics at ICIS, a global carbon market intelligence provider, shared his views in an interview with energypress.

Where do you see CO2 prices at the end of 2018 and one year from now?

With our fundamental market model we see prices finishing 2018 at €21.60/t and 2019 at €25.00/t. We see the market stability reserve as the main driver behind prices at the moment, resulting in a tight market balance as of next year. At the moment, we see several market participants frontrunning the effect of the MSR by taking speculative positions in anticipation of the price rising.

Apparently, in places like Germany, the short term view is positive for coal plants because of favorable competition to natural gas. However, talking about the mid to long term and in light of the EU electricity market reform and capacity mechanisms, is there a path towards survival available to them? What CO2 strategy must they follow in order to stay afloat?

With the higher carbon price we see coal generation being squeezed more and more, leading to additional fuel switching from coal to gas generation across Europe. Some utilities with a large coal portfolio have started to hedge the risk of higher carbon prices by building additional financial hedges to virtually lower their exposure to a high carbon price environment. We foresee this behavior, which we also see as one driver behind higher carbon prices at the moment, to allow these participants to maintain running their plants for a bit longer than suggested by the market. However, we currently also see more and more investments in gas and renewable energy sources and traditional utilities to adapt their business model, a step that seems inevitable in a decarbonizing world.

Apart from the rise of CO2 prices, we have also witnessed a new volatility in the emission rights market. In recent days there were significant ups and downs with many analysts talking about greater numbers of speculators influencing volumes and prices. Does this mean that the market is maturing and starting to resemble more traditional commodities markets? What are the dangers from speculative activity and how can power producers prepare themselves for a more volatile CO2 market in terms of available tools, hedging etc?

The volatility in the recent days has in my view largely been caused by speculative positions. First, some market participants holding bullish speculative positions expecting additional price gains tried to squeeze the lemon until the last drop and pushed the price above the €25/t level. This has likely caused some market participants to realize profits and by unwinding positions and pushing these allowances to the market. In such a situation, the market showed some herd behavior with other market participants following in selling their positions. This resulted in additional volume being pushed to the market, increasing the traded volume and causing the carbon price to fall-off a cliff. With the sharp correction, the Dec-18 contract is back in the upward-pointing channel that guided the price development since January 2018. I believe that the past six trading sessions were an exceptional test of the market regarding its ability to absorb a larger volume of speculative, non-compliance positions.

I think that yesterday’s correction has largely neutralized the effect of the more aggressive positions seen affecting the market over the past week with the EUA Dec-18 contract falling back in its long-term upwards-pointing trend channel witnessed since the start of the year. Overall, I believe that the time until the start of the MSR as of 1 January 2019 could remain highly volatile.

The carbon market is still a compliance-driven market where compliance operators receive a signal for what it costs to abate one ton of emissions. This has not changed with additional non-compliance players being active. However, it has caused some of the compliance operators to re-think their approach to the market. Speculative activity per se is not harmful to the market as it increases liquidity which is required to find a fair price for carbon allowances. In order to assess the impact of such positions it depends on the time frame of these investors and when the allowances return to market.

Power producers are usually protected against these price swings as they tend to hedge their power production on the futures market, meaning they sell power up to four years in advance and buy carbon allowances and the required fuels (coal and gas) at the same time. By doing so, using financial contracts, power producers know exactly how much they earn with their power plants in the future and are not bound to day-to-day volatility. I think for the power sector it is more the long-term implications of a higher carbon price that could be of concern in the case where producers have a coal-dependent portfolio. In such a case, it will likely trigger more structural changes and strategic decisions on how to protect against higher carbon prices.

In case you have been following developments in the Greek market, especially the sale of the main power utility PPC’s plants, do you believe the tender is going to have a successful result or not and why?

I am not too familiar with the process and would prefer not to comment.

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