

State and Trends of the Carbon Market 2005

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Introduction: Two Major Regulatory Developments



- **October 2004: Russia decides** to ratify the Kyoto Protocol
- **January 2005: The EU Emissions Trading Scheme begins operation**

How is the market responding to these regulatory developments?



Methodology

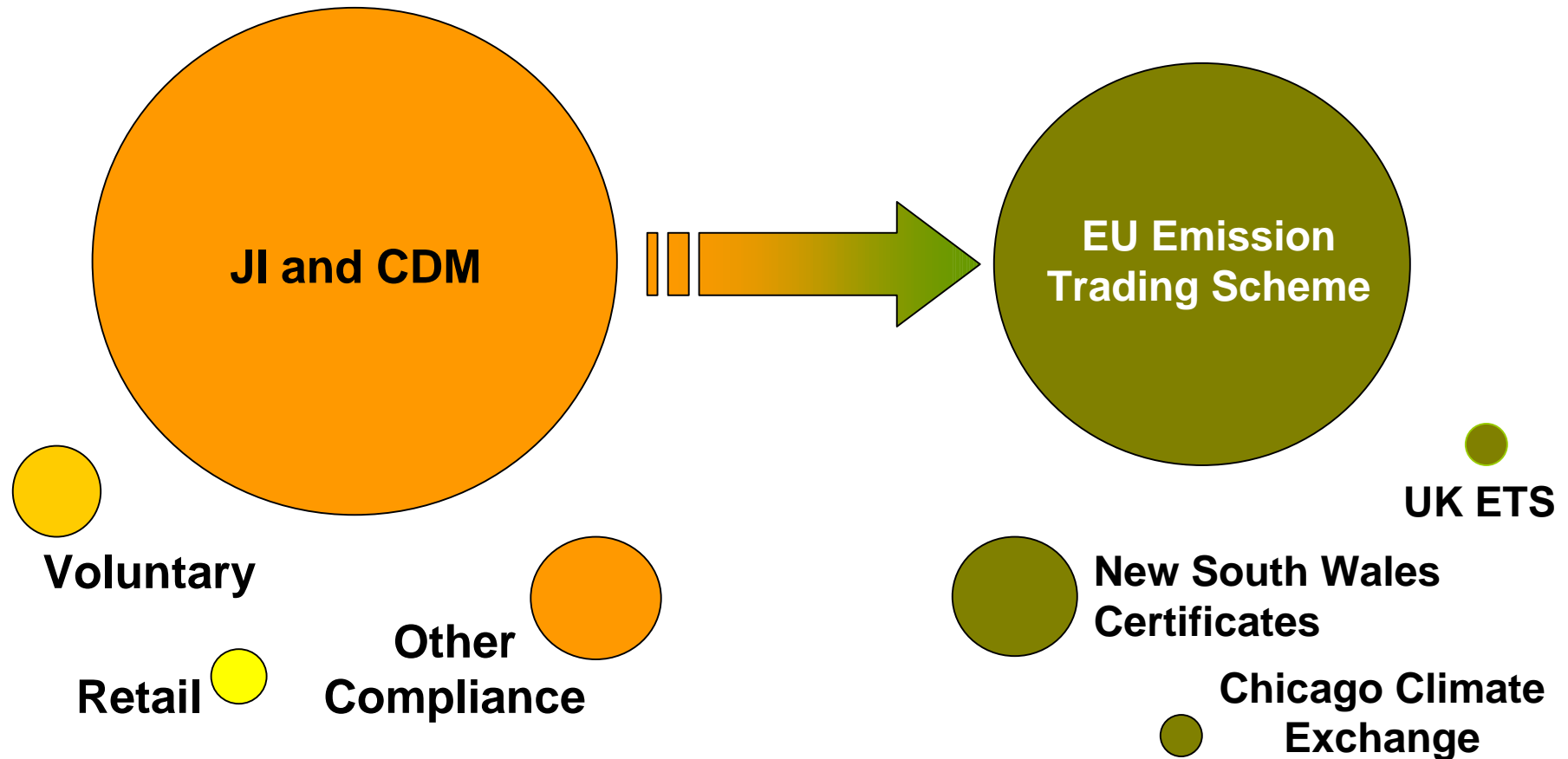
- Limited information on carbon transactions is publicly available
- This study is based on material provided by **Evolution Markets LLC, Natsource LLC**, and on interviews with many market players
- Database of **487** project-based transactions (signed or advanced stage of negotiation) + aggregated data on allowance markets

Structure of the Carbon Market

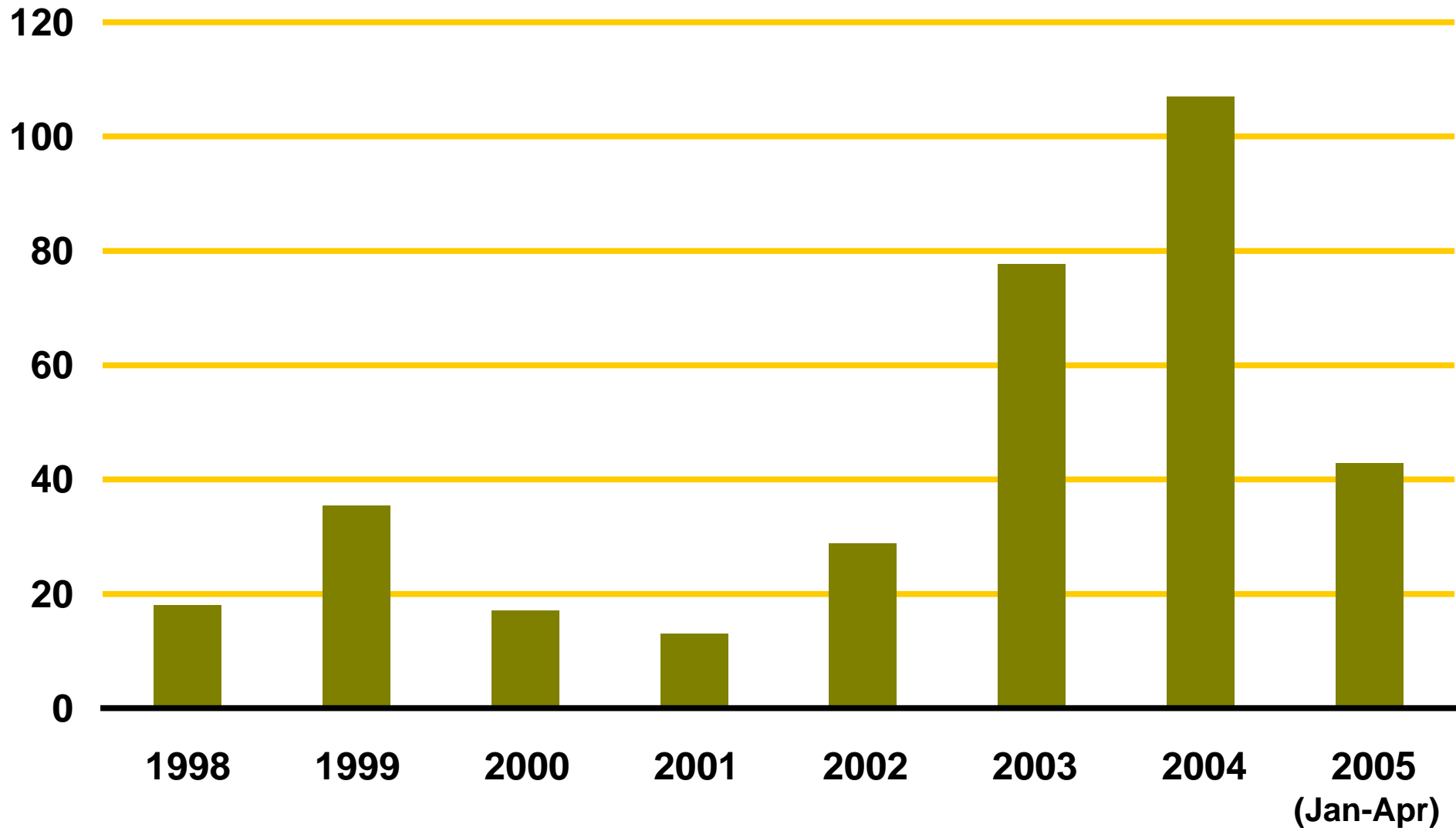


Project-Based Transactions

Allowance Markets



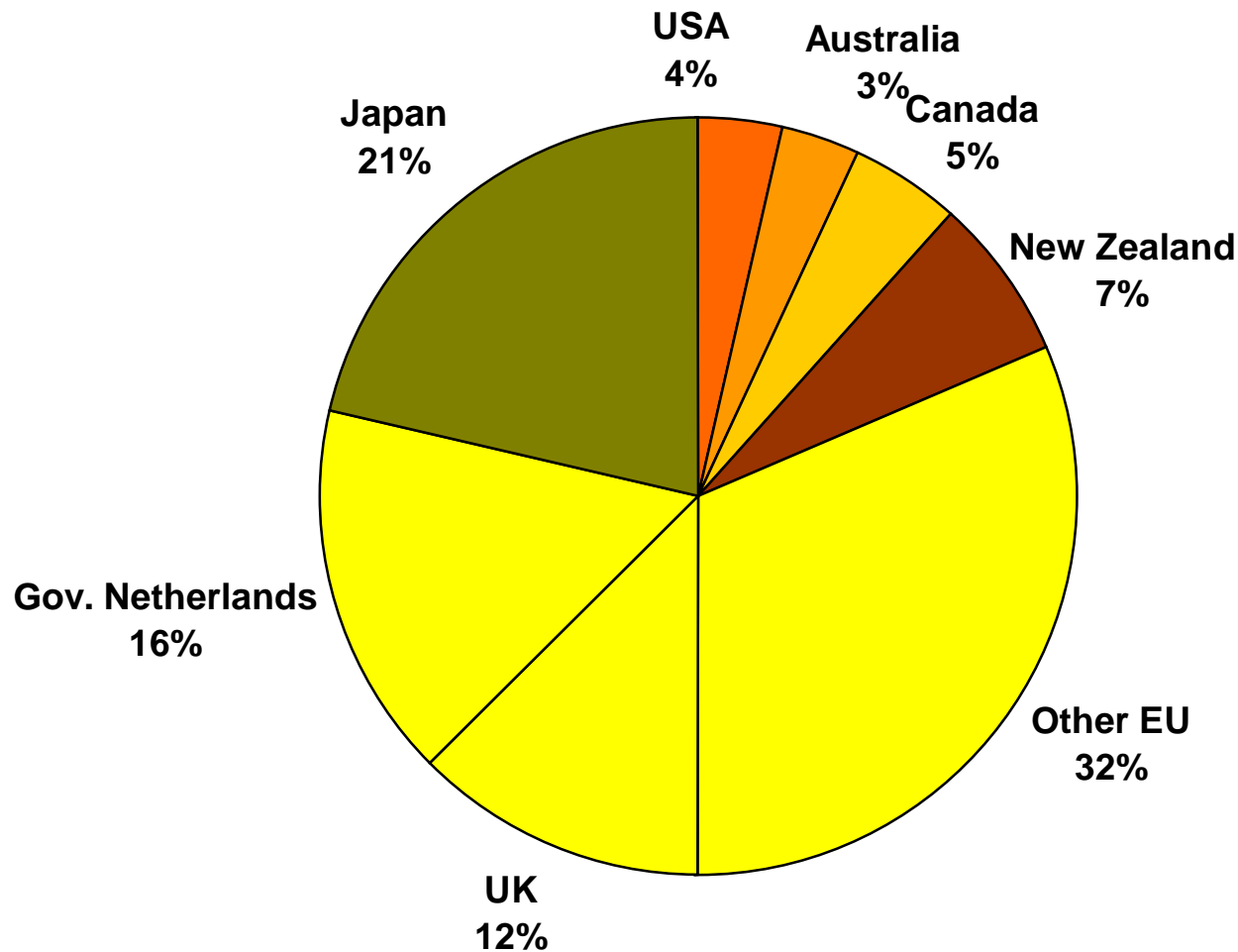
Volume Traded Through Projects: Growing (in million tCO₂e)



Main Buyers: European Governments and Firms



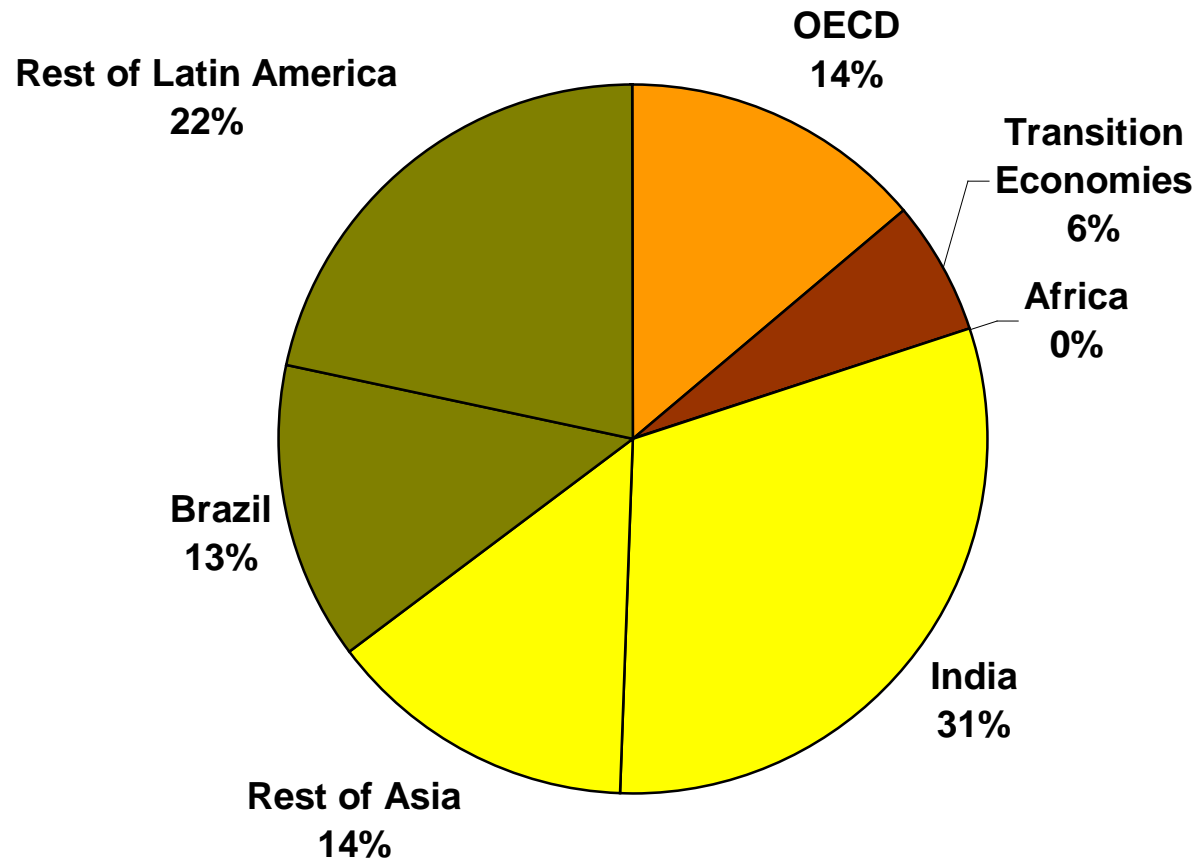
In percent of volume purchased From Jan.04 to Apr.05



Supply Concentrated in Middle-Income Countries

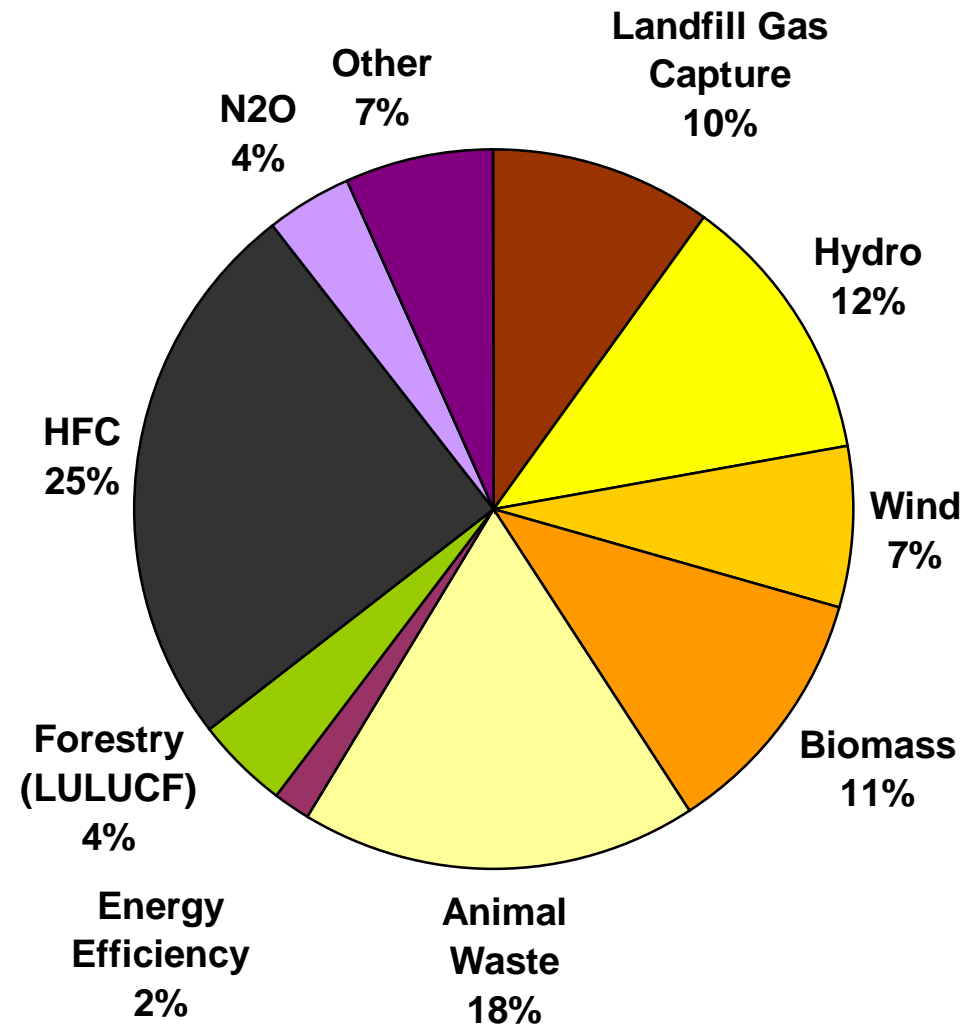


In percent of volume sold from January 2004 to April 2005



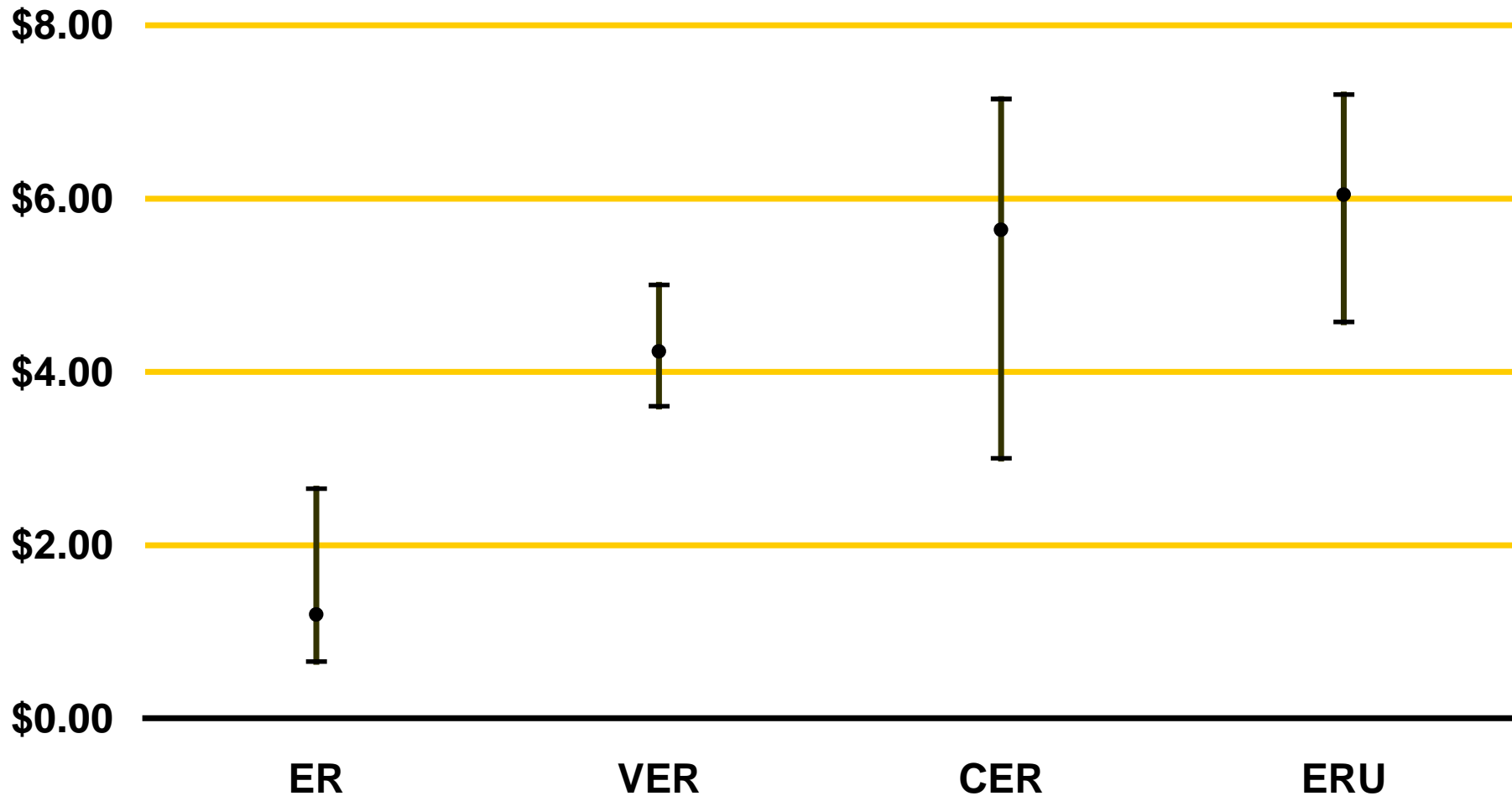
Non-CO₂ Gases Dominate

In percent of volume purchased from Jan.04 to Apr.05

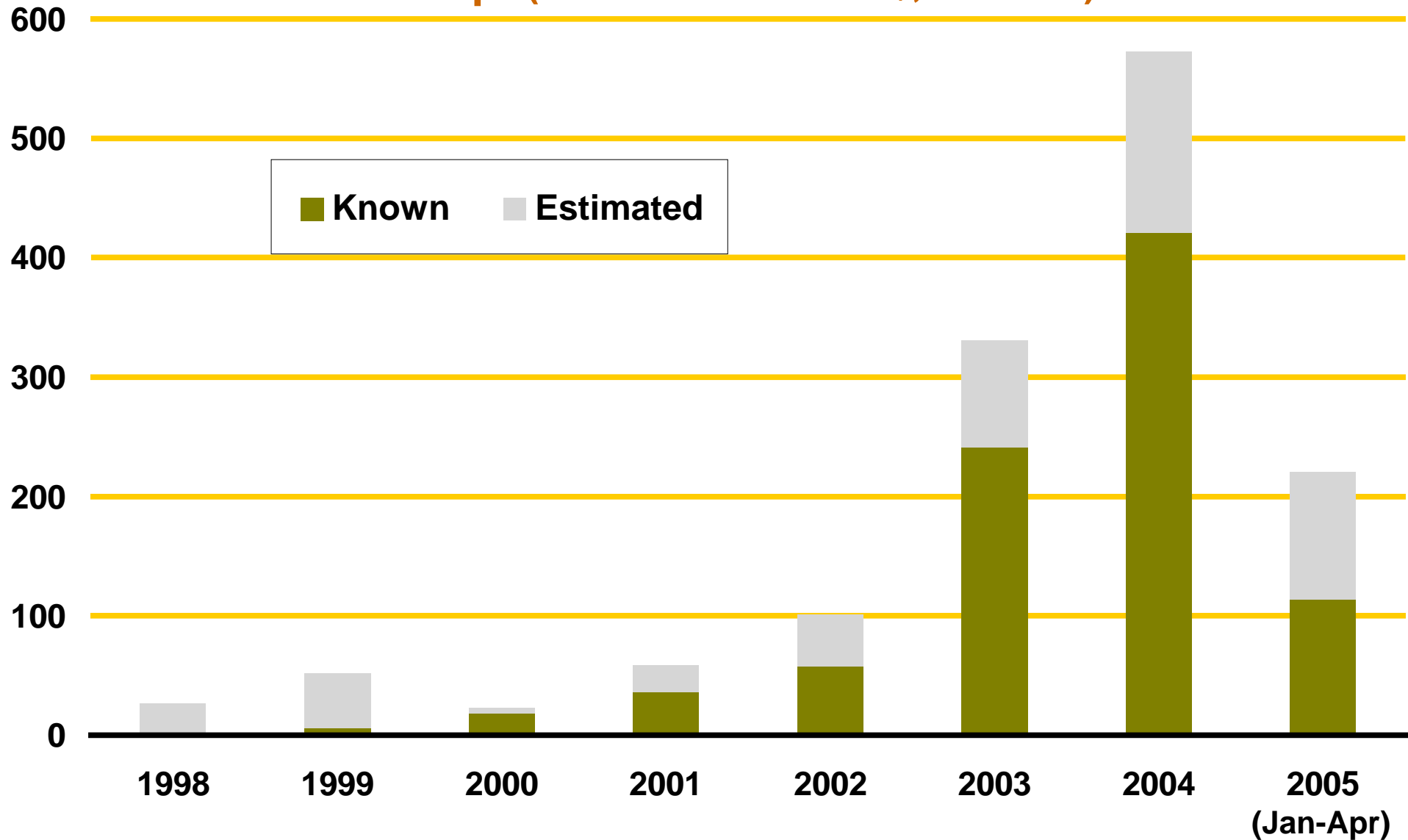


Prices Depend on Risks

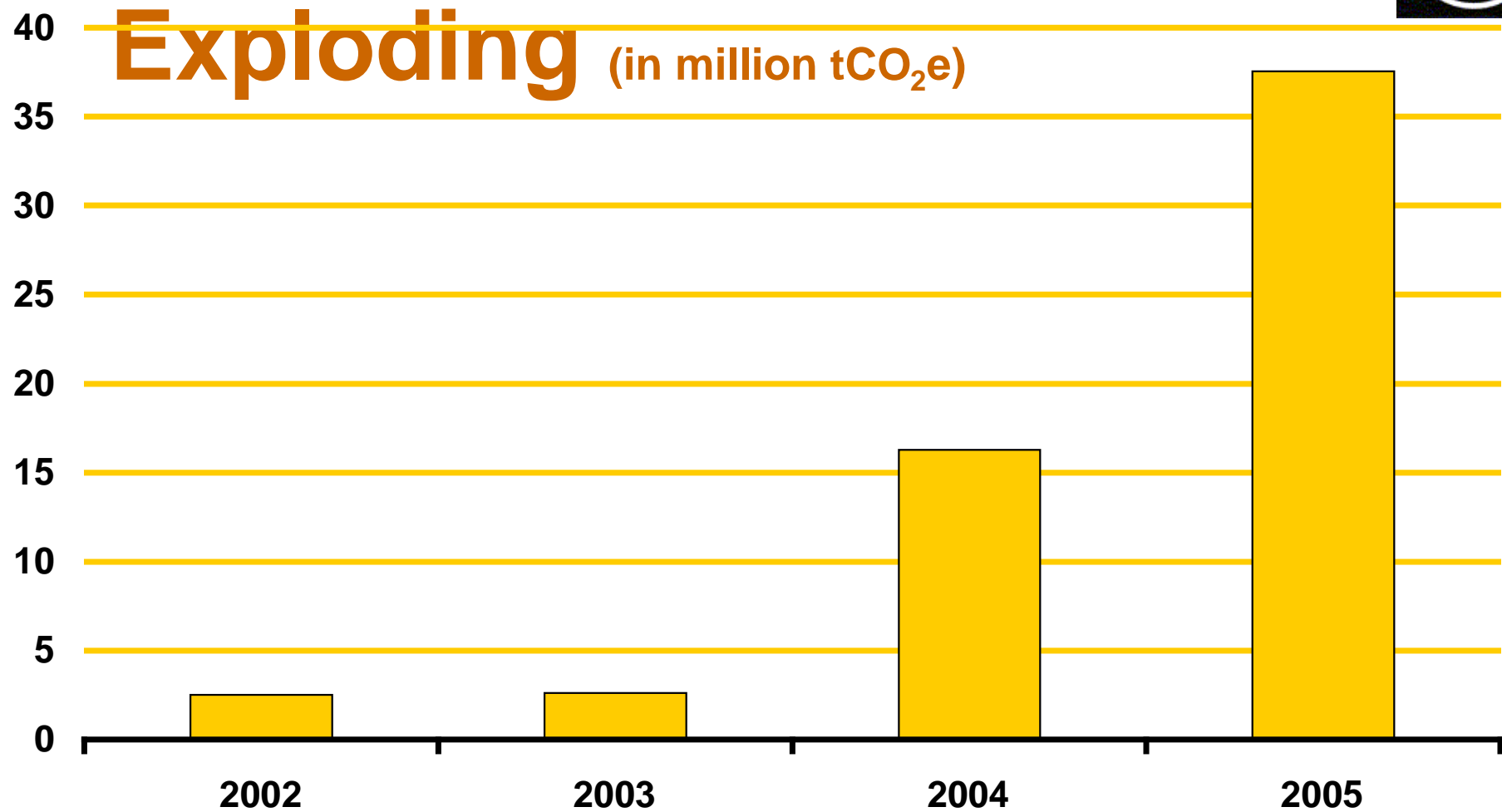
(weighted average prices from Jan. 2004 to April 2005 in U.S.\$ per metric tonne of CO₂e)



Total Value of Contracts over 1 b\$ (data in million U.S.\$, nominal)



Allowance Markets



(Jan.-March)

Insights on Price Differential



- Large price differential:
 - EU Allowances: 7 up to 17 euros / tCO₂e (spot and forward contracts)
 - Project-based: 3 to 7+ dollars / tCO₂e (forward contracts on expected CERs)
- Allowances and project-based contracts have **very different risk profiles**:
 - **Project and country risks**: high in CDM, none in allowances
 - **Compliance/regulatory risks**: high in CDM, none in allowance
 - **Delivery risks**: higher in CDM



Outlook

- **The market has responded to the regulatory signals and is now a real compliance market**
- Volumes should increase rapidly for both project and allowance segments.....
- ... although important uncertainties still need to be addressed
- Overall supply / demand picture (e.g. under Kyoto Protocol) is still unclear:
 - How much volume will JI/CDM deliver? Issue of **projects lead-time**
 - How many allowances will Russia and Ukraine bring to market?



Full report available at

www.carbonfinance.org

www.ieta.org