

## Offset Supply a Key Driver for California Carbon

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The price of carbon in California will average \$40/t between 2012 and 2020, analysts predict. California's upcoming carbon market will be the largest in North America and the second largest in the world when it begins in 2012. Access to offsets will be a key price driver in the market due to few low-cost internal abatement options for the scheme's participants, analysts from Point Carbon, a Thomson Reuters company, predicted in a report released Thursday. "Because California's economy is already quite efficient, however, low-cost abatement opportunities are very limited and reducing emissions quickly becomes costly," the analysts wrote. California emitters can use offsets to meet up to 8 per cent of their compliance obligations, but while regulators have so far identified four project types eligible for compliance, there is uncertainty surrounding what other offsets they will allow in the programme.

### Short to long

The analysts predict that carbon prices in the first year of trading will emerge at \$13 per tonne of CO<sub>2</sub>, slightly higher than the \$10 price floor set by regulators. Prices will grow steadily as the market progresses, rising to \$38 in 2017, the last year of the second compliance period, and \$75 in 2020, the last year of the programme, according to the report. The market is expected to be under supplied during its first phase (2012-2014), when trading is limited to the electric sector and large industrial facilities, the analysts said. But they predict there will be an ample supply of early action offsets in those first years, enabling emitters to bank some 30 million allowances. In phase two, from 2015 to 2017, the market will expand to cover transportation, residential and commercial fuels, increasing the annual size of the market from around 160 million tonnes to around 400 million.

### Tight supply

The analysts said the supply of available offsets will not come to market fast enough to meet demand in that phase, which is set to grow as allowance supply gradually decreases. The amount of available allowances will drop as the emissions cap tightens and the amount of allowances that must be set aside for a cost-contain fund rises from 1 per cent annually in phase one to 4 per cent in 2015-2018. In their assessment the analysts also factored in some delays and limitations in offset project development credit issuance and made "conservative assumptions" as to what other offset types regulators may allow. "This means the second compliance period is the turning point at which the market transitions from a situation where participants have more offsets than they need for compliance, to a short market where further abatement may be required," the report said.

### Price ceiling

The tightness of the market that starts in phase two will in turn drive up prices in the third compliance period, according to the report. "The third compliance period will see the largest EtC (emissions to cap, the difference between expected emissions and the cap set by regulators), and limited access to offsets, which will likely drive emitters to buy price containment reserve allowances, and push prices up to the \$69-\$78/t range," it said. To underscore the importance of offsets on California carbon prices, the analysts modelled a scenario, in which they assumed the full use and availability of offsets. Under that scenario, California carbon prices reach only \$59 in 2020 compared to forecasts in the \$70s.

### Similar projections

Earlier this month, London-based analysts at Barclays forecast a similar range of prices for the Californian CO<sub>2</sub> market. The bank estimated that carbon prices would average \$16 in the first trading phase; \$40 in phase two and \$73 in the final compliance period. Like Point Carbon, Barclays said offset availability and the impact of other state policies to reduce greenhouse gas emissions, such as a renewable energy mandate and clean vehicle regulations, would drive prices. Last week, traders said California carbon allowances (CCAs) for 2012 delivery were bid at \$14.00 in nascent pre-compliance over-the-counter trading. Spot market climate reserve tonnes (CRTs), offsets expected to be eligible in California's future cap-and-trade system, were bid at \$8.75 and offered at \$9.50, last week.

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