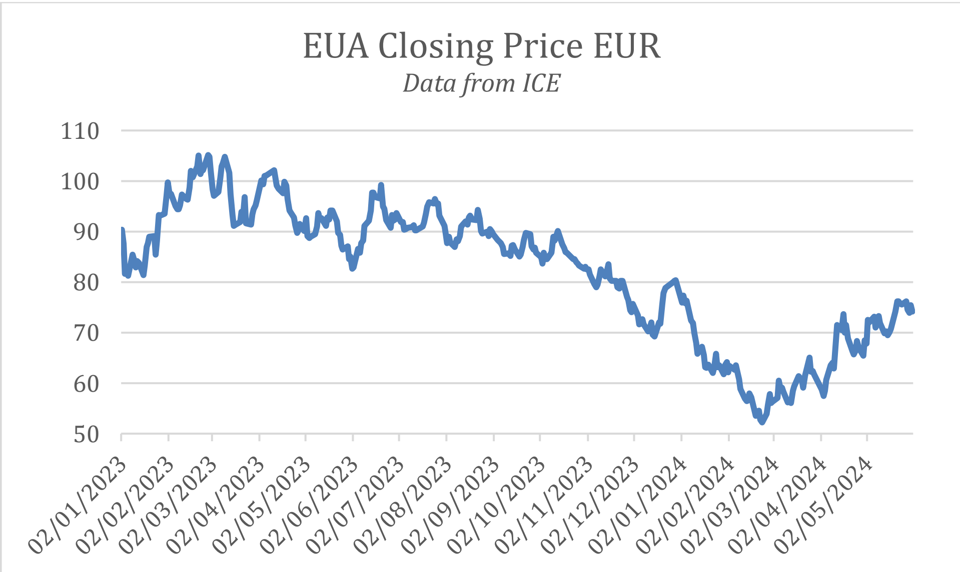
FIS Consultancy for Shipping in the EU Emissions Trading System (EU ETS)

EUA WEEKLY REPORT 03/06/24

In brief: Funds halve net short in quieter week

December EUAs closed the week down 2% at 74.10. It was a week of lower trading activity and volatility than the week prior (traded volume came in at roughly half) after the expiry of the June options contract the week ending 24 May. Strong correlation with Dutch gas (TTF) continued to dominate the picture. The Commitment of Trader's (CoT) Report revealed funds halved their net short position to the lowest level in seven months. Traders noted the development has reduced the chances of short squeezes that dominated much of last year. EUAs seem comfortable for now between EUR70 and EUR75 levels. Failing spikes in TTF prices, we expect EUAs to trade sideways through the week. Outlook: neutral.



What happened? (Price movements)

- Monday opened to firm prices across German power and EU gas which ultimately injected strength into the EUA market throughout the day. The Dec24 contract settled 1.3% higher at EUR 76.65

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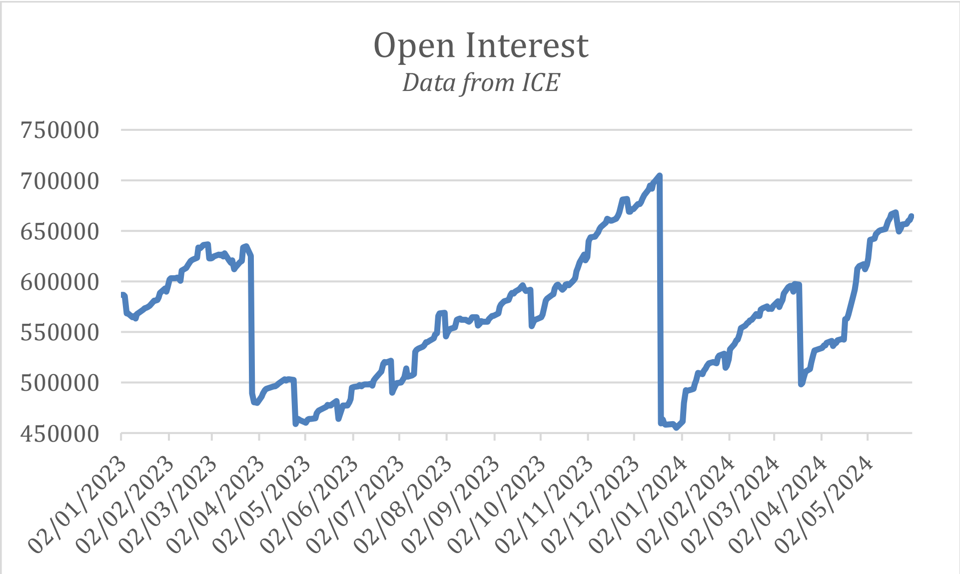
- Tuesday saw the gains from the day prior reversed as weakness in the energy complex resulted in EUAs dropping off from an opening high of EUR 76.25. The benchmark contract closed the day down 2.2% at EUR 74.58
- Wednesday saw the downward move continue as Commitment of Trader's (CoT) data showed investment funds reduced their net short positions to the lowest in seven months. The Dec24 contract settled at EUR 73.86, a 1% drop on the day
- Thursday marked a return for the bulls as a late spike in the TTF June contract helped spark a strong finish for carbon. The benchmark contract settled 2.2% higher to settle at EUR 75.48
- Despite a strong auction result boosting prices, with EUAs rising by 1.3% after the auction, TTF gas remained the ultimate price driver and its weakness caused EUAs to drop off throughout the day. The benchmark contract settled at EUR 74.10, down 1.8% on the day and 2% on the week.



Why? (Market drivers)

- Commitment of Trader's (CoT) Report: CoT data last Wednesday revealed investment funds reduced their net short positions to 6.7 Mt, down 7.3 Mt (52.3%) from the week ending 17 May. This is the smallest net short position held by funds since October last year

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    - Total longs increased by 3.9 Mt to 44.4 Mt and total shorts decreased by 3.4 Mt to 51.1 Mt. For context, in 2023, funds held 27.8 Mt in long and 36 Mt in short positions on average on a weekly basis
    - The reduction in net short position by half last week encapsulated the bullish mood in the market at present. Additionally, now that funds short positions are ebbing, it has been noted there is less risk of a short squeeze
- Dutch TTF continued to direct the price of carbon last week, with both markets closely linked and certainly less volatile than the week prior after the expiry of the June options contract the week ending 24 May.
    - The role of TTF in the direction of EUAs can be briefly summarised as follows: Gas dictates the price of power which in turn determines fossil profit margins, hedging, and finally EUA prices
    - Although European gas storage is at a healthy level, one risk factor worth noting is the supply side of LNG, which Europe is now reliant on. As such, any threat of supply of this resource can result in spikes in the energy market.

What's coming up? (Trends and key developments)

- Macro: European industry activity showed signs of uptick in output in May. Confidence in the economy is also improving. ECB is anticipated to cut rates in June
- Power sector emissions: could increase this summer should the EU have a warmer than expected summer and cooling demand is required. This will also depend on wind output. Less wind would mean more fossil fuel output
- Politics: The UK election is on the 4 July. This, along with the European Parliament (EP) elections on 6-9 June, could also influence outcomes of carbon market reviews. The EP could push for less ambitious climate action if a smaller left-wing majority comes in
    - Reuters reports polls suggest the main pro-EU groups around the political centre—the centre-right, centre-left, Greens and liberals—will have a smaller majority than presently, while the far-right will make gains

Further Reading

- ETS Market Stability Reserve (MSR) to reduce auction volume by around 267 million allowances between September 2024 and August 2025 https://climate.ec.europa.eu/news-your-voice/news/ets-market-stability-reserve-reduce-auction-volume-around-267-million-allowances-between-september-2024-06-01_en

- Climate think tank Ember reported EU wind and solar power generation increased by 46% from 2019, when the current European Commission took office, to 2023, displacing a fifth of the bloc's fossil fuel generation: https://ember-climate.org/insights/in-brief/wind-and-solar-displace-a-fifth-of-eu-fossil-generation-since-2019/

Sources

All pricing data taken from Intercontinental Exchange (ICE) and European Energy Exchange (EEX)

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