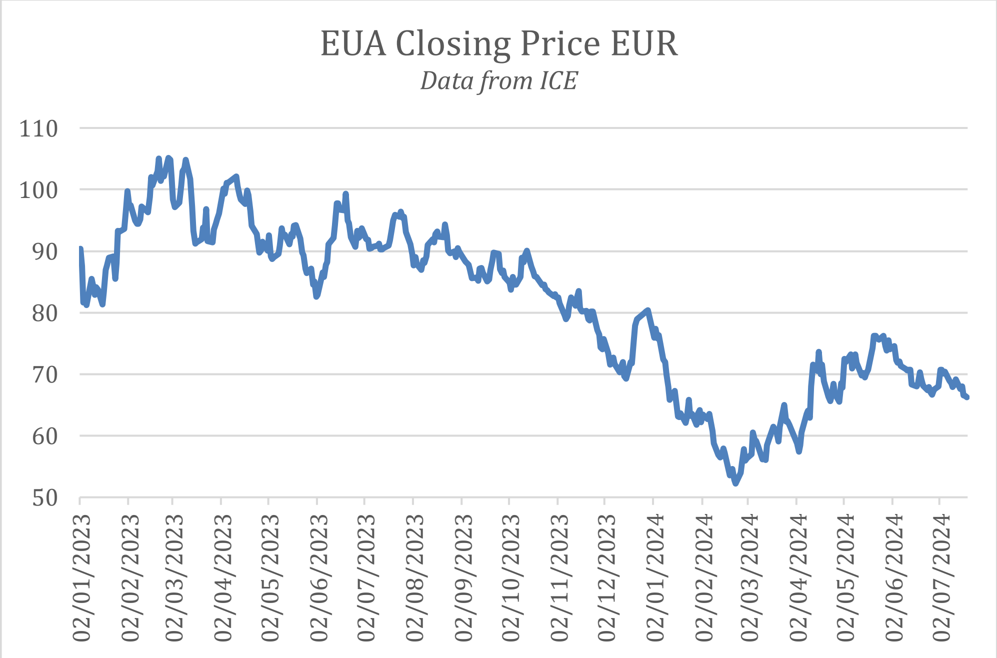
FIS Consultancy for Shipping in the EU Emissions Trading System (EU ETS)

EUA WEEKLY REPORT 22/07/24

In brief: EUAs Slide Amid Lackluster Trading

The benchmark contract settled at EUR 66.30 last Friday, marking a EUR 2.89 (4.2%) weekly loss. EUAs traded in a narrow EUR 3.86 range over the week with volume falling 28.3% on the week prior. Total open interest near a yearly high. The Commitment of Traders (CoT) data revealed a 1% increase in net short positions, a marginal change that is representative of the quiet mid-holiday market at present. EUAs continue to broadly follow TTF in direction, with the 10-day correlation between the two markets standing at 0.71 as of last week. EUA auctions take place four days this week, with no auction on Wednesday. With this year being the first with a full August auction schedule, analysts are predicting EUAs are likely to be pushed further down as the summer progresses. With stability in European gas and low demand for EUAs amid low activity, EUAs likely face further downward pressure this week failing TTF supply spikes (more below). Outlook: bearish.



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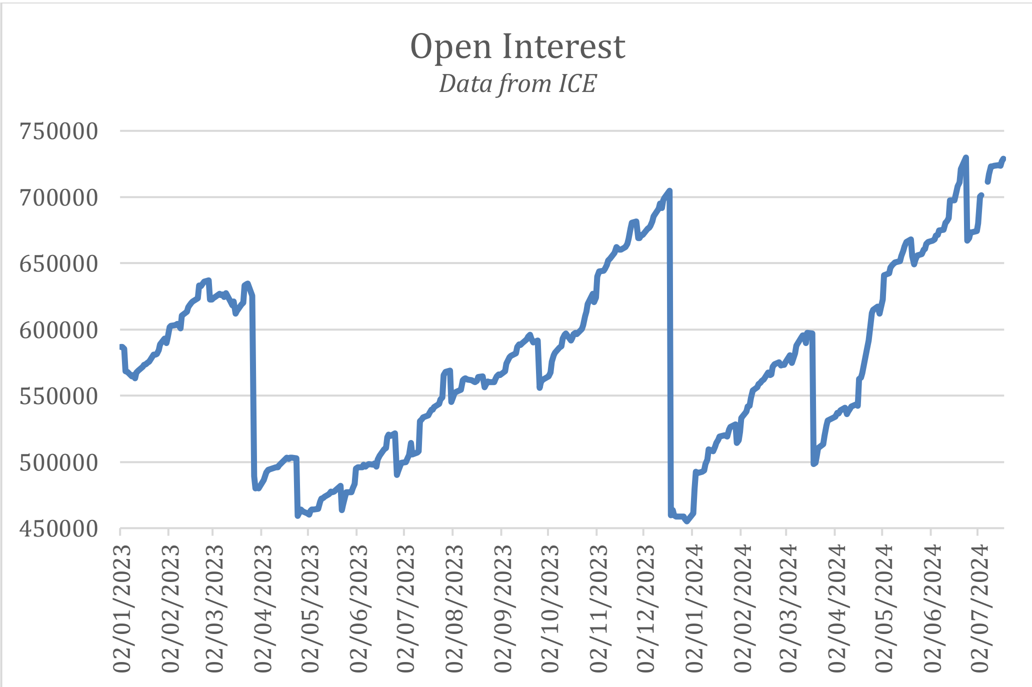
What happened? (Price movements)

- Monday saw EUAs start the week on a bearish note as the prospect of higher renewable output across Europe halted the two-day rally in the energy complex. The Dec24 settled at EUR 67.75, a 2.2% loss on the day
- Tuesday brought about a small gain in EUAs as carbon tracked a firmer gas market throughout the day. The benchmark contract settled up 0.6% at EUR 68.02
- EUAs fell to their lowest in over two weeks on Wednesday (EUR 66.41) as the market resumed its recent downward trend. The Dec24 contract closed the day at EUR 66.54, down 2.2%
- On Thursday the carbon drop off continued as EUAs settled at their lowest point in 12 weeks. The benchmark contract settled at EUR 66.44, 0.2% down on the day
- Friday saw EUAs record their second consecutive weekly loss as the Dec24 contract fell by 4.2% over the five days to settle at EUR 66.30.



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Why? (Market drivers)

- As of last week, the 10-day correlation between carbon and TTF stood at 0.71, indicating the price direction of EUAs is still heavily influenced by gas and the fundamentals that impact this market.
    - With extreme heat hitting parts of Europe last week, renewable capacity (particularly solar) increased, putting some downward pressure on TTF. However, these hot conditions have primarily lent themselves to increased TTF prices over the past couple of weeks due to the rising demand for cooling facilities
    - Concern surrounding gas supply has also created mixed price signals in the market recently, with an outage at Freeport LNG in the US Gulf causing questions over global LNG supply. Despite this, US LNG supply remains stable (Hurricane Beryl having had little impact on liquefaction capacities), alleviating most worries
    - Certain headlines throughout the week did send bullish signals throughout the TTF market, with news on Wednesday that Gas flows from Ukraine to Slovakia were to be cut by 50% leading to a spike in TTF (up 5% at one point). However, this news was short lived and proven to be less severe, with both markets soon retracting (August TTF down 2.8% and carbon down 2.2% on the day).
- This time of year is usually characterised by a lack of demand from compliance entities as traders go on maintenance and reduce their regular purchasing behaviour, this trend has held for this year
    - Despite the new surrendering date being September 30 this year (as opposed to the previous 30 April date), analysts have suggested that last minute compliance buying in August will not reach high levels given these entities have now had 17 months to accumulate their EUAs for the 2023 period.
- Commitment of Traders (CoT) Report: Data from last week showed funds had increased their net short positions marginally, up 670,000 tonnes (1%) to 18.1 Mt the week ending July 12. This is now 50th consecutive net short position reported

- Analysts noted how this small change in short positions is reflective of the narrow trading range that has characterised the market in recent weeks
- Total longs decreased by 767,000 Mt to 36.5 Mt, while total shorts dropped by 140,000 Mt to 54.6 Mt
- In 2024, the average long position has been 35.7 Mt and 58.7 Mt in short positions.

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

Macro Outlook for the Week Ahead

The Eurozone's macroeconomic environment continues to evolve amid easing inflation, robust labour markets, and ongoing economic uncertainties. Inflation has been decreasing faster than expected, prompting the ECB to revise its forecasts downward. However, core inflation remains high due to strong wage growth in the services sector, challenging the ECB's price stabilization efforts. The ECB is expected to take a cautious approach, likely delaying rate cuts until inflation trends more sustainably toward the 2% target. Economic activity shows gradual recovery, with GDP growth projected at 0.8% for 2024, up from 0.5% in 2023. Consumer spending remains subdued as households prioritize savings amidst high interest rates and economic uncertainties. Investment activity is also lagging due to high financing costs and uncertainty. Recent political developments in the UK and France continue to influence economic policies and investor sentiment in the Eurozone.

EU Gas Market

European natural gas prices have been volatile recently, influenced by several key factors. Over the past week, prices experienced fluctuations, with the Dutch TTF front-month contract seeing significant movements. On Monday, prices fell as much as 3.2% after the partial restart of the Freeport LNG plant in Texas. This restart helped alleviate some supply concerns that had been heightened by Hurricane Beryl, which had led to the plant's temporary shutdown. Despite the plant's gradual ramp-up and multiple cancelled shipments, the resumption of operations has reduced some of the market's supply fears. As of today, Dutch front-month futures are trading around €31.23 per megawatt-hour. Current European gas storage levels are robust at 83%, significantly above the five-year average of 70%, contributing to a bearish outlook for the market. This high level of storage is expected to continue putting downward pressure on prices, potentially pushing them towards EUR 25/MWh.

Weather Forecast

Northern Europe: Northern Europe is set to experience cooler-than-usual temperatures this week, with forecasts predicting a drop of 4 degrees Celsius below the seasonal average. This is expected to increase heating demand, thereby impacting overall energy consumption in regions such as Germany, the UK, and Scandinavia.

Southern Europe: Southern Europe is currently enduring a heatwave, with significantly above-average temperatures expected to persist. Regions including Spain, Italy, and the Balkans are facing extreme heat, which is driving up cooling demand and overall energy consumption. This hot weather is likely to sustain or increase natural gas demand for electricity generation.

Overall, the interplay of a resilient Eurozone economy, slightly bearish gas market fundamentals due to high storage levels and easing supply risks, and varying weather conditions between Northern and Southern Europe suggests a dynamic and somewhat unpredictable outlook for EU allowances in the coming week.

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

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