

Editorial

(By: Luis Felipe Neira, Executive – Carbon Trading)

In Commodity Markets

Even though there has been a remarkable progress in the carbon market, it still remains quite small compared with any other well established markets. However, the carbon credits that constitute the assets traded in the market have been considered for a while as a new asset class. Hence, some market theories and behaviours are expected to be similar to those seen in the commodity markets, especially due to the existing correlation of the carbon with energy markets.

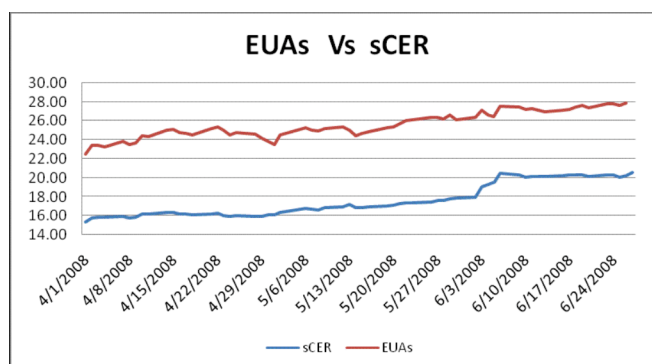
Under some common assumptions (no transaction costs, trading on continuous time and no-arbitrage opportunities), spot prices for carbon credits (namely EUAs and/or CERs) of different vintages should be equal. However, the market is characterized by uncertainty and positive transaction cost (higher than in other markets), some abatement costs can be different than expected, cost of compliance and emissions of GHGs are stochastic (hence uncertain); due to these uncertainties, holding carbon credits can be seen a way by firms to hedge against unexpected high prices, this benefit that it is accrued from holding the carbon credits is called convenience yield (or cost of carry), which can be understood as a premium that is paid to the holder of the commodity in spot market rather than having a future position, keeping the spot prices relative higher than futures prices. This prices structure is known as *backwardation*, which is a common element amongst some commodities.

However, the carbon market has showed an opposite behaviour, a *contango* price structure, where future prices are greater than spot prices, in particular for the prices of EUAs. *Contango* term structure works particular well in markets with large available stocks, easily stored and most importantly with stable supply and demand flow. This is not the case in the carbon markets, where supply is quite complex, and demand depends on the levels of GHGs which have high uncertainty.

As for the prices of CERs, with the recently launch of CERs Futures (around Feb 2008), a backwardation was observed in the price terms structure (On May 30th @ Dec08: €17.87; Dec09: €17.49). However, in recent weeks, there has been a change of this term structure to a contango one (On July 27th- Dec08: €20.58; Dec09: €21.05), even though there has been a perception in the market that the number of projects underperforming has increased, with some analyst revising downwards their forecasted volume of CERs to be delivered by 0.36 bn tonnes with in a period of six months, hence the demand and supply flows are not stable. The fact that the Swiss Registry has allowed not Swiss-based firms to hold accounts in the registry, it could have been perceived by the market as a stable source of CERs into the EU ETS, mitigating the delivery issue of the ITL and CITL connectivity. _

Market Price Updates

The last fortnight started with the an increased of the price of carbon, busted by the increase of oil prices, closing on Monday the 16th at €20.28 for sec-CERs, €0.12 higher than the closing price from the previous week. During the same week, there was a slightly decline of the oil prices, which didn't affect the carbon prices, particularly, as Germany electricity prices increased during the midweek, stimulating the trade of EUAs. The end of the 16 – 20 June week, closed with a decline of €0.17/CER (closing at €20.17) and a decline of €0.23/EUAs (closing at €27.41), in part attributed to a profit-taking from traders, and a weaken oil and electricity prices, although there were small volumes traded on Friday.



Sources: EUAs-ECX; sCER-Reuters

On the week of the 23-27 June, the prices of EUAs and CERs closed on Monday 23rd at a higher price, boosted by the increase of oil and electricity prices, recovering lost ground at the end of the previous week. After the release of U.S weekly stock data, the price on Wednesday 25th of June, the price of oil dropped, driving the prices of carbon credits down, to price levels experienced three weeks ago, however, carbon prices quickly recovered lost ground, experiencing a strong rally, due to rising commodity energy prices, high oil prices and Germany electricity prices. CER closed the week at €20.58 / CER and EUAs at €27.69 /EUAs; with a narrowing EUAs-CERs spread of €7.10._

Carbon Market Updates

- A new classified assessment carried out by The National Intelligence Council (NIC) explores how climate change could be a threat to the national security of the U.S in the next 20 years. This threat could arise from political instability, massive migration, terrorism and conflicts over natural resources. This report could change the future of carbon markets, sources suggested.
- The allocation of allowances is being debated amongst utilities in the US, although most utilities have agreed that there should be some sort of Cap-and-Trade programme to curtail GHG emissions.
- The US ambassador to Japan has expressed concerns that the G8 summit could not lead to any conclusions since the deal for Climate Change could not be achieved without the participation of developing nations.
- Shipping and Aviation industry could come under the CDM according to a proposal by UK's Tyndall centre for Climate Change. According to the centre Aviation and shipping Industry could be the most emitters by 2020 as the trade between countries increase.
- Lufthansa, Germany's air fleet has disclosed aims to cut CO2 emissions by 25% of each kilometre travelled by 2020, since 2006 levels.
- A new Cap-and-Trade bill is set to be introduced by the House of Representatives in the US proposing 80% cuts by 2050 since 1990 levels.
- UK plans new renewable energy plan and considers investments to the tune of \$1Billion for the same .
- Scientists at a conference in Sweden warn that the world is calculating CO2 emissions wrongly. According to them, the amount of CO2 in the atmosphere needs to be measured rather than the amount of CO2 which is not being emitted.
- Australia moves into introduction of mandatory reporting guidelines to all companies from July 1st 2008.
- The EU parliament is keen on setting up of an ETS for aviation and the funds so collected, will be used for financing green energy projects.
- Barclays Bank launches a new financial product which let investors to buy debt securities, whose performance are tied to global carbon prices and could be traded on the New York Stock Exchange (NYSE).
- Sir Nicholas Stern announces that 20% of GDP will be sued to fight climate change by 2050 if actions are not taken by the US government as of now.
- US commodity regulators say that the US futures market may hot \$2 Trillion by 2020. _

CDM Market Updates

- IDEACarbon launches CDM project risk rating services. The Carbon Rating Agency –an IDEACarbon company- will use traditional credit rating nomenclature, to indicate the probability of project-based credits being physically delivered. It will do so on a systematic assessment on risk-by-risk and project-by-project basis. The delivery expectations have dropped in the past year from 1,95 bn tonnes in September 2007 to 1,59 bn tonnes in March 2008, according with IDEACarbon. It also says that, the issuance rate is only 70% for most of the CDM projects.
- A Greenpeace's analysis suggests that Germany would be able to cut only half of its emissions by the end of Kyoto period.
- UNFCCC brings in focus on CDM project potential for transport sector considering it is the most underexposed category in the emission reduction arena.
- Lawmakers in the US amend the Cap-and-Trade scheme to allow CER's(to a max of 5%) into the market.
- A REDD-Carbon deal was set in the island of Papua of Indonesia to protect up to one million-hectares of rainforest. The MoU was signed between the company New Forests and the Government of Papua New Guinea.
- Phase II and III of EU-ETS focusing on Gold Standard CERs may be detrimental to Primary CERs and other Secondary CERs, which will also reduce the CERs quota in the EU-ETS.
- DOEs to get fixed timelines for each phase said Mr R.K.Sethi at a conference held in Mumbai, India.
- UK has become the leader in purchasing 59% of the CER's in 2007.
- Construction started on India's largest (2MW) Solar-CDM Project at Burdwan District, West Bengal, India
- Since 2002, the global cumulative growth in the carbon market is 92,000% says USCFTC.
- **CDM FACTS:**
 - *Registered Projects: 1105*
 - *Issued CERs: 159,119,210*
 - *Expected CERs: 1,280,000,000 (From registered projects until the end of 2012)._*

Source: UNFCCC

ASIA CARBON'S ACTIVITIES IN THE MARKET.

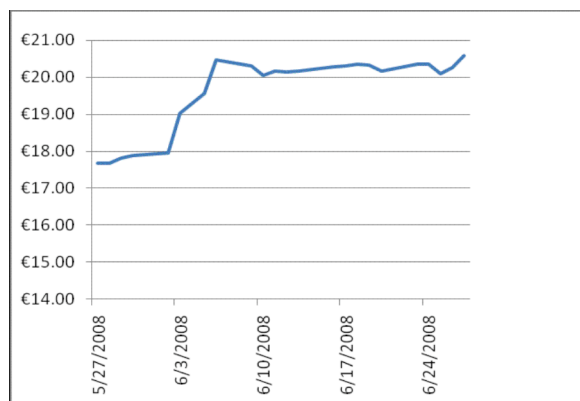
- Asia Carbon Global's First Singapore CDM Project.** A Singaporean project obtained the Letter of Approval for a 10MW Food Waste Grid Connected Power Project. Singapore signed the Kyoto Protocol in April 2006, and by granting this letter of approval, this project is considered to contribute to the sustainable development of Singapore.
- Asia Carbon Emissions Management India** has recently uploaded one of its projects developed in the United Arab Emirates (UAE) for global stakeholder comments until the 10th of July 2008. The project title is: "Energy Efficient Natural Gas Fired Thermal Fluid Heating System at JBF RAK FZLLC, Ras Al Khaimah, UAE." The web link is the following: <http://cdm.unfccc.int/Projects/Validation/DB/XW/YWXJ5TYKNSRPH1R15ZR4FUWQBC7F/view.html>.
- Asia Carbon Exchange signs MoU with JBIC** to host the Nikkei-JBIC Carbon Quotation Index within the Asia Carbon Global website.
- ACX-Change secures European buyer to purchase South Korean CERs.** These CERs, in excess of 76,000, were sourced from a small-scale hydroelectric power plant project in South Korea, the transaction was executed in last week's auction held on the 26th of July.
- Asia Carbon Emission Management India P Ltd** has uploaded two projects for global stakeholder consultation,
 - Energy Efficient Acid Absorption Crystallizer Project, at Birla Cellulosic, Kharach, link: <http://cdm.unfccc.int/Projects/Validation/DB/OJ/U1JZBZ42AY2YL1NDXNQH2LN71UQN/view.html>
 - Biogas based steam generation project by Union Paper Mills, link: <http://cdm.unfccc.int/Projects/Validation/DB/N7/8PY1VK7L7AZRF6AWQEBZNCGDD31E/view.html>.

Price Index Table

Source	Reuters	Platts	LEBA	ECX	CCX (USD \$)
Date	CERs	CERs	CER Index	EUAs	
16-Jun	€20.28	€20.10	€20.28	€27.13	
17-Jun	€20.29	€ 20.30	€20.22	€27.24	
18-Jun	€20.34	€ 20.40	€20.38	€27.50	
19-Jun	€20.34	€20.40	€20.61	€27.64	
20-Jun	€20.17	€20.15	€20.17	€27.41	\$ 5,85
23-Jun	€20.35	€20.38	€20.33	€27.77	
24-Jun	€20.35	€20.35	€20.45	€27.78	
25-Jun	€20.10	€20.20	€20.34	€27.59	
26-Jun	€20.27	€20.35	€20.28	€27.88	
27-Jun	€20.58			€27.69	

For
2008
Vintages

Reuters' CER Price Index: 27May – 27 June /08



For more information please contact:

ashish@asiacarbon.com
luis@asiacarbon.com

Asia Carbon Exchange International B.V.
Kingsfordweg 151 #12-08
1043 GR Amsterdam
The Netherlands

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