WHAT'S HOT: FIT FOR 55 ON THE CUSP OF BECOMING LAW

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On Tuesday 18th April 2023, the European Union Parliament approved key components of the 'Fit for 55' legislative package designed to reduce greenhouse gas emissions by 55% by 2030 relative to 1990 levels. The deal now just needs formal ratification by the Council of the EU and is close to becoming law.

We are closing in on two years of fraught negotiations between Parliament, the Council and Commission in a deal that is ultimately more ambitious than the original proposal put forward by the Commission in 2021. For example, a tighter Linear Reduction Factor (the pace at which emission caps are reduced) and a wider scope for the Carbon Border Adjustment Mechanism (which will help the phasing out of free-allowances) are all in the near-final law. The Ukraine war slowed the discussion process as REPower EU occupied a lot of the legislative bandwidth, but with overlapping goals, the war has ultimately accelerated the desire for a green transition as it goes hand-in-hand with energy independence from Russia.

Significant consensus reached in December 2022

As the tripartite (Parliament, the Council and Commission) had largely come to an agreement in December 2022, the approval of the deal by Parliament without amendments means that there was little price action on European Union Allowances on the back of the news last week. In December 2022, Members of the European Parliament and EU governments were negotiating well into the night of Saturday 18th December to thrash out an 11th hour deal before heading on vacation. The deal is seen to have significant consensus across the tripartite and unlikely to face resistance from the Council.

Meeting 2030 goals

The provisional agreements we detailed in [What's Hot: A Golden Cross for EUA Futures]() are now closer to becoming law. Next, the focus will be on implementation. What's clear is that the protracted negotiation timeframe has eaten into the window of time taking us to 2030 (one of the key milestones for the Green Deal Law). While the phase-in of several components reflects the later-than-anticipated start date, it still means the Emissions Trading System (ETS) needs to deliver on strong results. The financial incentive for companies to implement decarbonising technology largely depends on European Union Allowance prices remaining high.

Implementation will start soon

The Carbon Border Adjustment Mechanism (CBAM) is scheduled to start a transitional period from as early as 1st October 2023, where data will be collected, and methodology developed. Starting from 2026, free allocations to sectors covered by CBAM will begin to be tapered and fully phased out by 2034 (two years earlier than the Commissions original proposal).

The inclusion of the Maritime sector into the ETS could happen as early as 2024, once again with phased compliance[1].

The Aviation sector will also stop receiving free allowances altogether by 2026, with tapering starting in 2024[2].

In short, implementation is just around the corner, and we expect a lot of details to be ironed out in coming months.

Price bullish for European Union Allowances

We have long-held that the ‘Fit for 55’ legislative package will be positive to EUA prices. The fact that we are final stages of getting it into law without it being watered down significantly, and in many ways being more ambitious than originally planned, should help drive prices higher.

The interaction between Fit for 55 and REPowerEU does cloud the analysis a little. Front-loading sales of EUAs will help fund REPowerEU, increasing supply initially. However, there will be tightness in EUA markets at the backend as the aggregate number of EUA auctions will not change over the current phase (that lasts until 2030). Price weakness from front-loading may prove to be temporary as a result.

Sources

[1] Vessels will have to surrender EUAs equivalent to 40% of emissions in 2024, 70% in 2025 and 100% in 2026.

[2] They will still receive 75% free allowances in 2024, 50% in in 2025 before falling to 0 in 2026.

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