

# MARKET UPDATE

August 25, 2017

## Regional Greenhouse Gas Initiative (RGGI)

### Market Status

RGGI announced on August 23<sup>rd</sup> proposed changes to the Program for the period from 2021 to 2030. The announcement is the conclusion of a program review that has lasted more than a year. The market immediately reacted by trading from \$3.35 to \$4.50 in the afternoon. Prices had been trending down from a recent high of \$3.95 to \$3.30 in anticipation of the RGGI Auction scheduled for September 6<sup>th</sup>. The timing of the announcement took market participants by surprise. Many believed it would occur in the fourth quarter of this year.

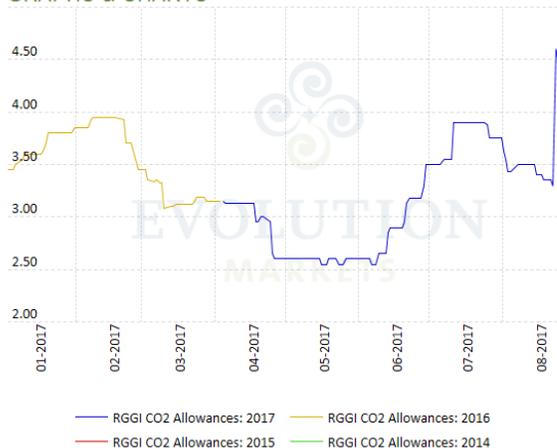
Term	Bid	Offer
Spot	\$4.45	\$4.60
Dec 16 Cleared	\$4.50	\$4.65

### Proposed Program Review Summary

RGGI's Program Review proposes the following changes:

- Cap of 75.15 million tons of CO<sub>2</sub>, declining by 2.275 million tons per year until 2030.
- Full adjustment of the allowance bank over five years from 2021 to 2025.
- A Cost Containment Reserve (CCR) and an Emission Containment Reserve (ECR), the size each being 10% of the regional cap.
- The ECR Trigger price will be \$6.00 in 2021 and rise 7% per year.
- The CCR trigger price will be \$13.00 in 2021 and also rise 7% per year.

### GRAPHS & CHARTS



RGGI is seeking stakeholder comments on the program changes. It will then issue a revised Model Rule, followed by implementation of the Rule by each participating state.

### Fundamentals and Future Outlook

Based on the Proposed Model Rule, prices jumped just over 30% to \$4.50 in one afternoon. This happened despite many of the program revisions having been discussed for quite some time. In fact, many of the proposed elements, such as a 30% allocation cut, full bank adjustment, and creation of the ECR (albeit without the specifics of size and price), were somewhat anticipated by market participants.

One factor in the price jump may be the details surrounding the ECR, which is designed to support allowances prices. The proposed Rule sets a trigger price of \$6.00 a ton, which rises 7% per year. And at 10% of the total allocation, the size of the ECR equates to roughly 7 million tons. I believe this trigger price was higher than anticipated, and based on current fundamentals, it would be hard to say that the RGGI price will not drift to \$6.00 by the beginning of 2021.

Based on historic and estimated emissions (2016: around 80 million tons; 2017: estimated between 70-75 million tons) and the program design of a full bank adjustment over five years, it seems the RGGI market will go flat by 2025. The five-year average adjusted allocation for 2021 – 2025 is approximately 70 million tons. If actual emissions average 70 million tons per year, the bank will be depleted by 2025. If actual emissions are greater than 70 million tons, then it is reasonable to assume that the bank will be depleted prior to 2025.

For example, if actual emissions are 63 million, then theoretically the lower demand would prompt lower prices and the ECR would kick in to remove up to approximately 7 million allowances. If actual emissions are lower than 63 million, then the bank will not be depleted until later than 2025.

In summary, it's reasonable to assume the RGGI price will trend to the ECR trigger price of \$6.00 in late 2020. Actual emissions year-to-year will be the ultimate determining factor, and the price could move higher than the ECR trigger price and toward the CCR price if higher emission rates cause the bank to be depleted earlier than expected, putting more demand into the market.

#### GRAPHS & CHARTS

