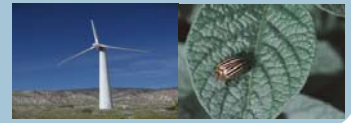




Australian emissions trading on hold



28 August 2009

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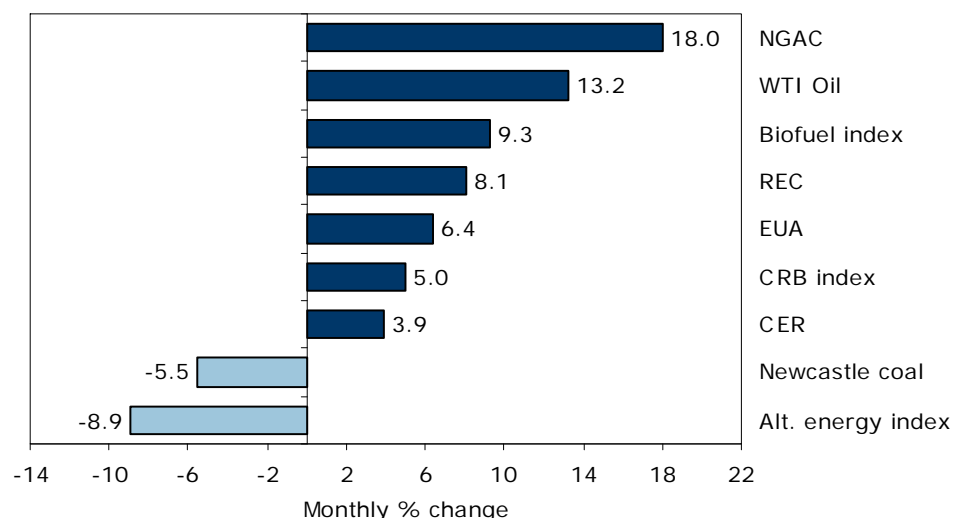
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Market Update

- **RECs have fallen from its peak** as passing of the expanded RET legislation faced uncertainty. Linkage to CPRS legislation around EITE assistance saw voting on the expanded scheme legislation, which was expected to pass by June, deferred until after Parliament returned from winter recess. Spot RECs reached a low of \$37.10, it's lowest since Sep 07. Legislation was eventually passed after some tinkering (*see Policy Update and Product Feature: RET*) and RECs have recovered to around \$40.
- **NGAC prices rallied** on the unexpected announcement in June that the NSW government was seeking to disallow NGAC creation from Category A generation from Jul 09. The spot price doubled reaching a high of \$7.60 before consolidating and is now close to \$6.
- **The AEU market came to a halt** following the May announcement of CPRS delay. With the uncertainty involved in the scheme, most players will likely wait for legislations to pass before firing up the market again.
- **EUA prices see-sawed but overall remained strong** despite bearish macroeconomic outlook. Prices were pressured by selling by industrials and in the lead up to the June UK auction but supported by power industry buying. The forward curve saw a contango of between 300–400 bps higher than Euribor.
- **CERs followed EUAs** in the Dec 09 contract. Unlike EUAs however, the CER forward curve has been in backwardation since June between Dec 09 to Dec 10 and Dec 11. This is suggested to be caused by the delays in CER issuance from CDM projects, causing a squeeze in near term supply.

Figure 1: % Price performance for the month ending 21 August 2009



Sources: Bloomberg, globalCOAL, ECX, ANZ Global Markets.

Policy Update: Australia's RET is now law ...

In their April meeting the Council of Australian Governments (COAG) agreed on the final design of the national Renewable Energy Target (RET), which expands on the existing MRET (see scheme details on p. 3). Enabling federal legislation was finally passed in August 2009, after the Government agreed to de-link the RET legislation from its doomed emissions trading scheme, the Carbon Pollution Reduction Scheme (CPRS). The RET intends to ensure that 20% of national electricity output comes from renewable sources (solar, wind, geothermal, wave and others).

This legislation gives the RET legal status, but it also provides strong positive encouragement to associated investment and development which can now generate valuable RET credits. The Government's 'Infrastructure Australia' development fund for example, will now be able to look at funding applications for renewable energy projects in the context of national energy supplies and the development of the national energy grid. And the NSW Government will now proceed with six new regional renewable energy projects.

In the private sector, the RET will help support the market for domestic and industrial-scale renewable energy equipment that is manufactured locally or imported. Europe has a well-established renewable equipment manufacturing sector (producing mainly solar cells and wind turbines) and output is growing rapidly from China and other Asian source countries. Manufacturing and installation costs for renewable energy equipment — and particularly solar cell products from China — are falling steadily. Householders can further reduce their net costs with government rebates and credits under the RET scheme.

... but emissions trading is delayed indefinitely

In August the Government made another attempt to have the legislation for its CPRS passed by Parliament. Opposition to the scheme in the Senate from both the Opposition and the Greens has made enactment impossible in its current form. The National Party within the Opposition Coalition and the independent Senator Fielding (a self-proclaimed climate-change sceptic) oppose emissions trading outright, even though support for emissions trading in some form is still part of the Opposition's official policy platform.

The passing of the CPRS legislation has now become a political football, as well as a contentious policy issue in its own right. The government is widely expected to reintroduce the CPRS Bill to Parliament in November, in an effort to get it passed before the UN's climate change conference in Copenhagen commences in December, even though the Opposition insists it will not vote on the Bill until after Copenhagen. A second rebuff by the Senate however, could result in the double dissolution of Parliament and an early federal election.

Delays to the CPRS are also having material effects on industry, particularly in the energy generation sector, where continuing uncertainty about future liabilities and requirements is causing delays to much-needed plant maintenance and upgrading. There are also reports of contracts for wholesale energy supplies being delayed as a result of the continuing uncertainty, since state government-imposed retail pricing caps (in all states) mean that energy retailers cannot be assured that they will be able to pass on any increased costs to their customers.

Product Feature: RET

Expanded RET legislations passed on 20 August 2009

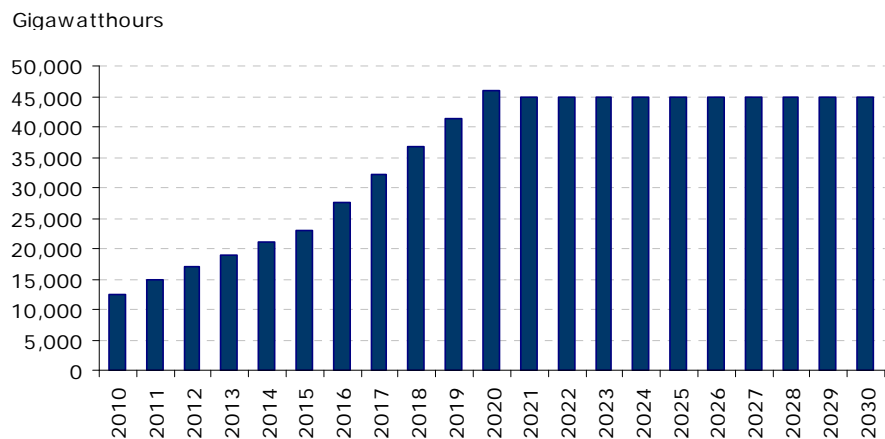
Mandatory Renewable Energy Target

The Mandatory Renewable Energy Target (MRET) was implemented in 2001 to increase generation and use of renewable energy in Australia. The scheme imposes a legal liability on wholesale purchaser of electricity to source increasing amounts of power from renewable sources through the purchase and surrender of RECs. The original target was to achieve 9,500 gigawatt hours of renewable energy by 2010.

What is the Expanded RET?

In 2007 the Australian Government committed to ensuring that renewable energy would represent 20% of Australia's electricity supply by 2020. To realise this commitment, the Government introduced an expanded national Renewable Energy Target (RET), which aims to achieve 45,000 gigawatt hours of renewable energy by 2020, over four times the original MRET target (refer to chart). COAG approved final designs of the expanded RET at their April 2009 meeting and following some further amendments (see below), enabling legislations were passed on 20 August 2009.

Figure 2: Expanded National Renewable Energy Targets



Scheme Amendments

A number of amendments were made to the final design of the scheme:

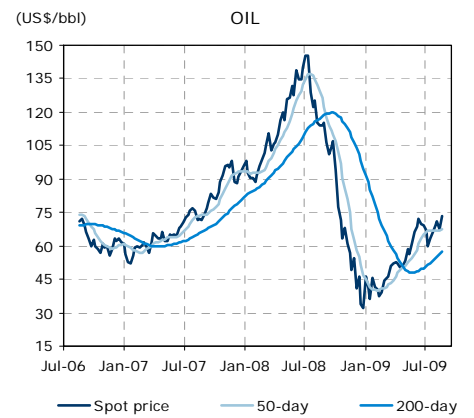
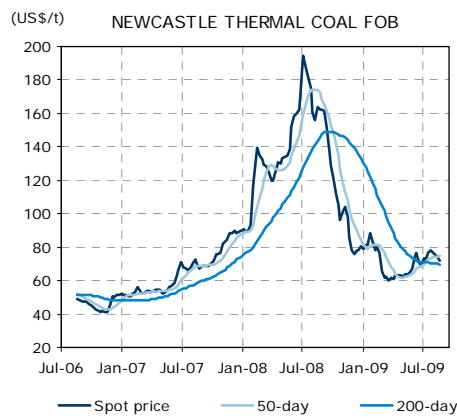
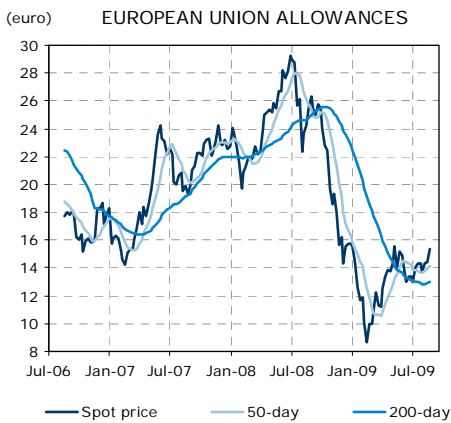
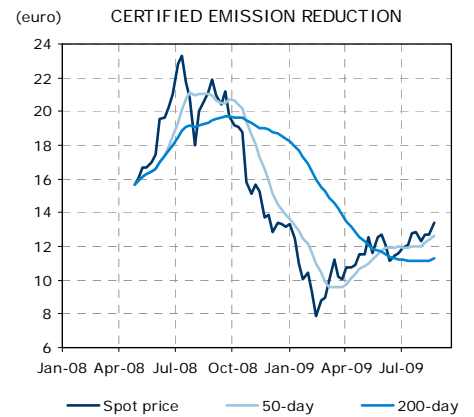
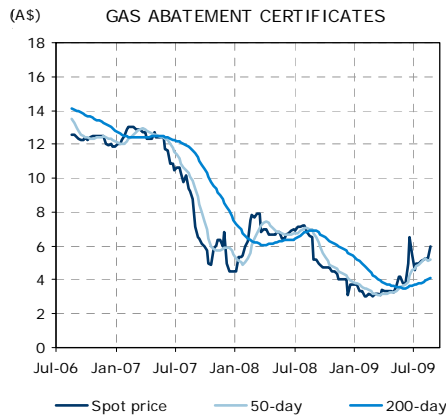
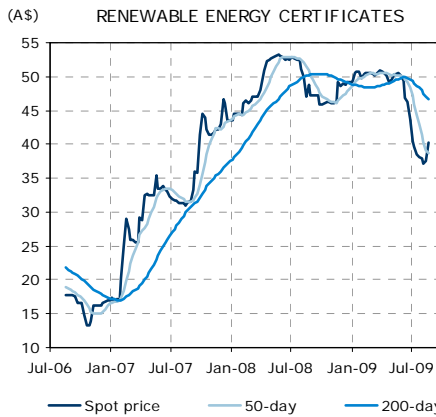
- Waste Coal Mine Gas (WCMG) has been added as an eligible source of energy and will be allowed to create RECs within certain limits. This applies to existing WCMG projects and for generation from 1 July 2011 until 31 December 2020. Applications for eligibility must be made by 30 Jun 10. The annual renewable energy targets have been further increased from 2011 to 2020 to account for the addition of WCMG.
- To support household investment in small renewable generation units, the credit multiplier remains for the first 1.5 kW of installed capacity. The multiplier will now apply for installations starting from 9 June 2009, being the date when applications for solar panel rebates were stopped.
- Assistance to EITE industries is reinstated after de-linking this part of the RET from CPRS legislation. Eligible EITE activities will receive partial exemption from liability under the RET.

Waste Coal Mine Gas has been added as an eligible energy source

What About Other State Renewable Schemes?

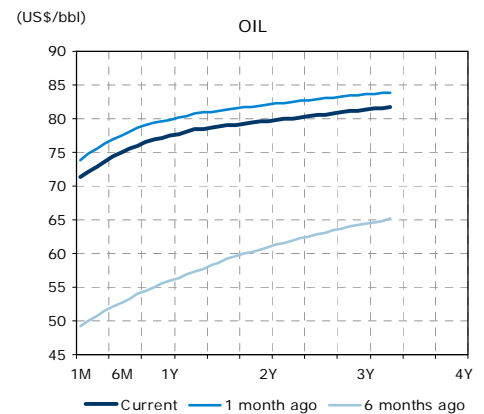
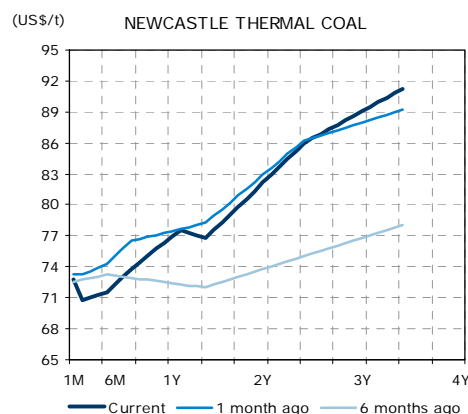
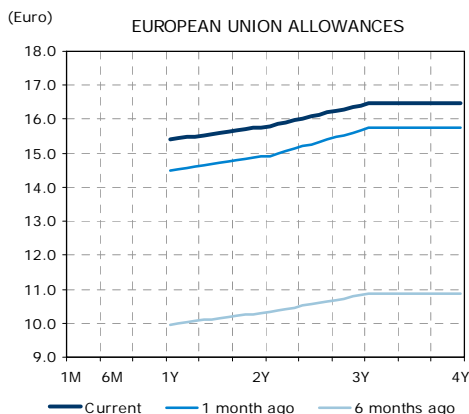
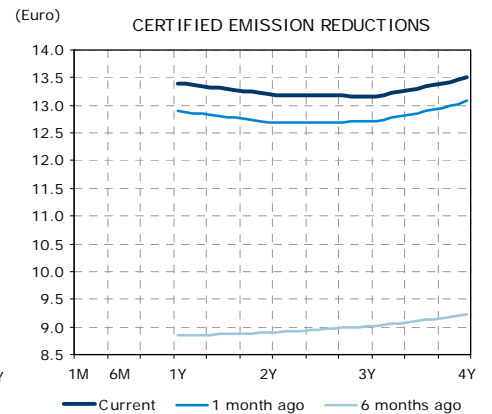
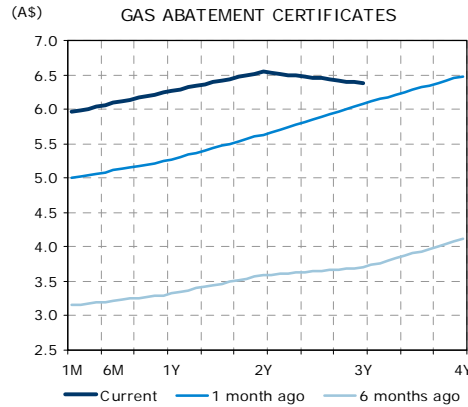
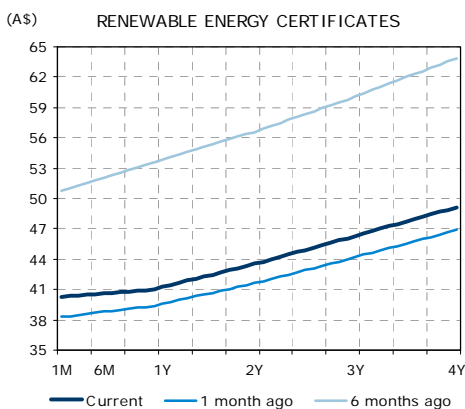
The Victorian Renewable Energy Target (VRET) is the only other operating renewable scheme and will be transitioned into the expanded RET. VRECs can be exchanged for RECs so long as the VRECs are surrendered between 1 April 2010 and 2 November 2010. Power station accredited under VRET will also be transferred into the RET scheme.

Average Prices



Note: Spot prices and moving averages to 21 August 2009. **Sources:** Bloomberg, TFS Energy, ECX, ANZ Global Markets.

Forward Curves



Note: Forward curves to 21 August 2009. **Sources:** Bloomberg, globalCOAL, AFMA, ECX.

Commodity Prices and Currencies

Product	Current Price (21 Aug 09)	1mth ago		3 mths ago		6 mths ago		12 mths ago	
		price	% Δ	price	% Δ	price	% Δ	price	% Δ
Emissions									
REC (A\$ spot)	41.4	38.3	8.1	50.5	(17.9)	50.5	(18.0)	49.2	(15.8)
NGAC (A\$ spot)	5.9	5.0	18.0	4.5	32.6	3.1	90.3	6.5	(9.2)
AEU (A\$ contract 2011-12)	10.0	10.0	0.0	10.0	0.0	22.3	(55.1)	21.5	(53.5)
EUA (€ Dec '09)	15.4	14.5	6.4	15.0	2.7	10.0	54.5	25.8	(40.3)
CER (€ Dec '09)	13.4	12.9	3.9	12.3	8.9	8.8	51.6	21.3	(36.9)
Other energy									
WTI Cushing Oil (US\$)	73.3	64.7	13.2	60.6	21.0	39.4	85.8	120.9	(39.4)
Tapis Oil (US\$)	76.8	69.8	10.1	60.7	26.6	46.3	65.9	121.0	(36.5)
Newcastle Coal (US\$)	72.0	76.2	(5.5)	63.3	13.7	76.3	(5.7)	163.9	(56.1)
Richards Bay Coal (US\$)	63.5	64.1	(1.0)	56.4	12.6	67.8	(6.5)	156.2	(59.4)
Key Indices									
ASX 200 Index	4,291	4,051	5.9	3,814	12.5	3,402	26.1	4,875	(12.0)
CRB Index	259	247	5.0	242	7.0	202	28.0	406	(36.1)
S&P Alternative Energy Index	2,039	2,238	(8.9)	1,900	7.3	1,309	55.7	2,229	(8.5)
Bunge Biofuel Index	454	416	9.3	431	5.3	334	35.9	733	(38.1)
Currencies									
AUD/USD – Aussie	0.835	0.818	2.0	0.778	7.3	0.645	29.3	0.881	(5.2)
USD/JPY – Yen	94.38	93.74	0.7	94.41	(0.0)	93.35	1.1	108.43	(13.0)
EUR/USD – Euro	1.433	1.423	0.7	1.389	3.1	1.283	11.7	1.490	(3.8)
USD trade weighted	78.04	78.93	(1.1)	80.56	(3.1)	86.49	(9.8)	76.20	2.4
AUD trade weighted	65.30	64.50	1.2	62.20	5.0	54.00	20.9	68.20	(4.3)

Sources: Bloomberg, Point Carbon, ECX, globalCOAL, ANZ Global Markets.

Australian CPRS Development Timetable

Date	Development
15 Dec 2008	Government White Paper released
Early 2009	Draft legislation (the CPRS Bill) released for debate
1 Jul 2009	Second stage of GHG mandatory reporting commences
Aug 2009	CPRS Bill rejected by the Senate, another date to present Bill to be set
Dec 2009	UN Climate Change Conference in Copenhagen, Denmark
Late 2009	Consultation and drafting of CPRS technical regulations
Subject to the CPRS Bill being enacted by Parliament in 2009:	
Late 2009	CPRS Act, regulations and statutory regulatory agency commences
1 Jul 2010	Third stage of GHG mandatory reporting commences
Mid 2011	\$10 fixed price period commences
Mid 2012	Market commences trading

Sources: Department of Climate Change; Garnaut Review; Office of Senator Penny Wong.

Glossary

Instrument	Definition
AAU	Assigned Amount Units are tradeable emission units allocated to Annex I Parties under the Kyoto Protocol each commitment period. Countries are allowed to emit GHGs equivalent to their assigned amount. (one AAU unit equals one tCO ₂ -e)
Additionality	The positive difference between the emissions that occur in a baseline scenario and the reduction of emissions that occur in the proposed project. Under the Kyoto Protocol gas emission reductions generated by CDM and JI project activities must be additional to those that otherwise would occur.
AEU	Australian Emissions Unit is the basic unit of compliance and trade in the forthcoming CPRS (from 2010).
Annex B Countries	Annex B (also known as Annex I) Countries are the developed signatory countries within the Kyoto Protocol that have committed to emission reduction targets.
CCS	Carbon Capture and Storage of CO ₂ within a carbon sink, which includes the absorption of atmospheric CO ₂ by biomass and/or the geological capture and storage of CO ₂ in oil/gas wells.
CDM	Clean Development Mechanism in Article 12 of the Kyoto Protocol allows Annex I Parties to invest in carbon projects aimed at reducing GHGs in developing countries to assist them with sustainable development. The investor receives tradeable carbon credits (CERs) in return.
CER	Certified Emission Reduction is a tradable credit generated by projects in developing countries that are registered as a CDM under Kyoto Protocol. (One CER represents a reduction in GHGs of one tCO ₂ -e)
CO ₂ -e	Carbon Dioxide Equivalent is the universal measure that indicates the global warming potential of each of the six GHGs targeted by the Kyoto Protocol, in terms of the corresponding impact on atmospheric CO ₂ . CO ₂ -e's is calculated by multiplying the Global Warming Potential (GWP) of a gas by its emitted weight.
CPRS	Carbon Pollution Reduction Scheme due to commence in Australia in 2010.
ERU	Emission Reduction Units is a unit of emission reduction issued pursuant to JI. When ERUs are issued, an equivalent number of AAUs are cancelled. (One ERU equals one metric ton of CO ₂ equivalent)
EUA	European Union Allowances is an exchange traded credit arising from the EU-ETS. EUA phase 2 commenced from 1 January 2008 and is valid to 31 December 2012. (One EUA equals one tonne unit of CO ₂ -e)
EU-ETS	The European Union Greenhouse Gas Emissions Trading Scheme commenced operation as the largest multi-country, multi-sector scheme globally in January 2005.
GHG	Greenhouse Gases are the gases emitted by human activities that are responsible for climate change. Annex I of the Kyoto Protocol targets 6 GHGs include - carbon dioxide (CO ₂), methane (CH ₄), nitrous oxide (N ₂ O) as well as hydrofluorocarbons (HFC-23), perfluorocarbons (PFCs) and sulfur hexafluoride (SF ₆).
ITL	The International Transaction Log provides the link between national registries and the CDM registry and is in charge of verifying the validity of transactions (including issuance, transfers, cancellations, etc).
JI	Joint Implementation allows an Annex I Party to implement an emission-reducing project in the territory of another Annex I Party and count the resulting ERUs towards its own Kyoto target.
Kyoto Protocol	Adopted at the Third Conference of the parties to the UN Framework Convention on Climate Change held in Kyoto, Japan in December 1997. It commits industrialised country signatories to reduce GHGs by an average of 5.2% compared with 1990 emissions by 2008-2012.
MRET	Mandatory Renewable Energy Target , which is the Australian government scheme to increase renewable energy generation and consumption.
NGAC	NSW Gas Abatement Certificates are created under the GHG Abatement scheme in NSW and ACT. (One GAC equals one tonne of CO ₂ -e)
REC	Renewable Energy Certificates were created under the Australian Government's national Mandatory Renewable Energy Target (MRET) scheme enforceable nationwide. (One REC equals one MWh of electricity generated from an eligible renewable source).
REDD	Reducing Emissions from Deforestation and Degradation is a set of UN programs to assist developing countries with technical assistance, training, demonstrations, research and financial incentives.
UNFCCC	United Nations Framework Convention on Climate Change
VER	Verified Emission Reductions are emission abatement units that are not part of mandatory schemes. Instead, they are verified by an independent auditor. VERs are used to voluntarily offset carbon emissions.
VREC	Victoria Renewable Energy Certificates are created under the Victoria State scheme in Australia and are similar to that of MRET.

Sources: ANZ, World Bank, UNFCCC.

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