

## A New Zealand carbon broker's perspective

By Nigel Brunel, Broker, OM Financial

The New Zealand ETS and carbon market has effectively begun with several trades having been transacted in the last couple of weeks totalling close to 1 million tonnes. It's been a long time coming given it's been over a year since the original ETS was passed by the previous Labour government in October 2008 and revised by the National government late 2009.

The ETS officially came into effect in January with large emitters required to report emissions from 1 January 2010 and having to offset 50 per cent of their emissions from July 2010. This delayed start to the first year means emitters will only have to pay for a quarter of their first years emissions.

A carbon tax option has been put in place for the first commitment period (CP1) of NZ\$25 per tonne. Emitters can either pay the government a NZ\$25 carbon tax per tonne or buy cheaper credits elsewhere.

The unit of carbon used in our emissions trading scheme is a New Zealand Unit (NZU), backed by a New Zealand AAU. Only NZUs can trade domestically, while they trade as AAUs offshore.

The allowable units in the scheme are NZUs, New Zealand AAUs, most CERs, and ERUs. Nuclear CERs are not allowed, nor are foreign AAUs. Whilst the legislation says greened AAUs would be allowed, the rules defining what a greened AAU is have not been written.

NZ carbon credits come from four sources: post-1989 forests registered in the ETS, pre-1990 allocations, post-1989 forests registered in the Permanent Forests Sink Initiative (PFSI, a separate scheme) and NZUs issued to trade-exposed emissions-intensive (EITE) industries. Only forestry credits can be sold overseas, EITE credits can be banked for future years but not sold abroad.

NZ carbon has been trading at about NZ\$20, approximately half-way between the euro price of greened AAUs and secondary CERs.

The rationale being that NZ AAUs represent actual sequestered carbon and is seen as higher-quality than greened AAUs. But New Zealand credits are not seen

to be worth as much as sCERs because sCERs are considered a liquid transparent global unit of carbon, a liquidity lacking in NZ.

The cap price of NZ\$25 has effectively created a floor for NZUs and to some extent shut sCERs out of the market at this point. Given the cap tax option of NZ\$25 is payable on 31 May 2011, 2012 and 2013, NZUs need to be discounted to take into account an emitter's holding costs. There also has to be some discount applied to the perceived credit risk in entering into contracts and holding credits versus simply paying a risk-free carbon tax.

The government has estimated it may have to issue a total of 80 million NZUs between 2008 and 2012, depending on how many forest owners actually opt in to the ETS. There is a perception in the market that there will be an overhang of credits throughout CP1 that will depress the price. Part of this overhang comes from NZUs issued to EITEs that cannot be exported and will most likely be banked or sold through the energy companies or on the spot and forward markets. It is unknown at this time exactly how many credits will be issued to EITEs, but it is expected to be close to 20 million.

The other part of the perceived overhang is from credits being issued to pre-1990 forest (land) owners as compensation for their stored carbon - also expected to be close to 20 million. The domestic price depends on how much of these volumes make its way to market.

The global carbon price will also dictate where the prices of NZUs travel. A sCER price below the cap will put pressure on NZUs. A rise in global carbon well above NZ\$25 will see millions of NZUs head offshore as AAUs, and up to 30 million could actually leave the registry before it closes to exports. Even at current sCER prices - our credits are heading offshore.

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