



Westpac carbon update

The market for NZUs

NZUs have been trading in a band between NZD17.50 and NZD18.50. Activity has increased significantly in recent weeks as we approach 1 July. We expect demand and activity to increase further over the next month or so as more liable entities enter the market. Whilst most of the transactions in the market have occurred on a spot basis, we have been seeing more interest and activity in forward transactions through to May 11, May 12 and May 13.

In recent weeks, the demand/supply balance has shifted with more liable entities coming to market in preparation for the scheme start on 1 July. The availability of supply, which is being driven by the price at which foresters are willing to sell at, is currently driving the market price. We expect this to continue in the short term, thereby placing more pressure on the price of NZUs.

Directly linked to the increasing NZU price is the availability of supply. Below is an outline of the facts with regard the supply and issuance of NZUs:

- the Ministry for Agriculture and Forestry has announced that a total of 4.4 million post-1989 forestry NZUs have been allocated in 2010 (which brings the total NZUs allocated to approximately 5 million to date); and
- the exact timing of fisheries (approximately 700 thousand NZUs) and pre-1990 forestry (approximately 17 million NZUs) allocations have yet to be confirmed.

The combination of 1) low actual issuance level; and 2) uncertainty associated with future issuance, is currently affecting the price of NZUs. Whilst we do expect the supply pressure to be alleviated in the future, without further guidance from the MAF it is difficult to form a view on how the additional supply will affect the price of NZUs in the medium term.

The market for CERS

With CER prices falling and the rising NZD rising (relative to the EUR), we have seen a fall in the local CER price to

approximately NZD22.60. At this level, NZUs remain the most cost effective option for a liable entity. Importantly, the falling CER price does place a ceiling on the NZU price as either unit maybe surrendered against a NZ liability.

International developments

When buying or selling NZUs it is important to understand the details and costs associated with the transaction. The issues for buyers and sellers to consider include:

Australia

Status: Introduction of the Carbon Pollution Reduction Scheme (CPRS) has been deferred until after the federal election. The Government cited the twin "practical realities" of delays in finalising an international agreement and lack of agreement with other parties (Coalition and the Greens) as the cause.

- As the drama of the Labor leadership spill began to unfold, the Senate passed legislation splitting the Renewable Energy Target (RET) into two schemes (Large and Small). The amendments allow the Government to alter the size of systems covered by the 'solar multiplier' regime and introduce a quality control regime for certificates created by small-scale technologies. The changes are designed to reduce the risk that an excess of certificates will undermine incentive for early investment in large scale projects.
- On June 23, Senator Penny Wong restated that, "the CPRS is the only credible mechanism that can deliver the full range of targets in a low-cost way, calibrated to international progress".
- At a recent Deakins Lecture, Malcolm Turnbull lambasted the Rudd Government over lack of leadership on dealing with climate change. Turnbull said "we are in the absurd position of having a national Government which has set an unconditional cut (to emissions) of 5% of 2000 levels by 2020 but does not have the means to achieve it".
- A recommendation from a recent Asia Pacific Economic Cooperation (APEC) energy ministers meeting in Japan was that the region should implement a tougher energy

efficiency goal. At the 2007 APEC summit in Sydney, leaders agreed to reduce the ratio of energy use to economic output to at least 25% below 2005 levels by 2030. This goal is likely to be far surpassed.

Europe

Status: Phase II of the European Union Emissions Trading Scheme (EU ETS) will end in December 2012. Participants are currently preparing for Phase III which will run from 2013 to 2020. Uncertainties associated with Phase III include 1) the EU target (20% or 30% reduction against 1990 levels); 2) the acceptability of certain emission allowances (CERs and ERUs); and 3) the role of auctioning.

- The EUA premium over CERs has fallen from EUR4.20 to EUR3.20 in recent days on fears of a shortfall of post-2012 CER supply. A United Nations (UN) working group will rule shortly on a revision to methodology that governs how many credits certain refrigerant gas plants can earn under the Clean Development Mechanism (CDM).
- Germany, the biggest emitter in Europe's cap-and-trade scheme, is unwilling to back the latest European Commission (EC) proposal governing auctioning of carbon allowances in the trading period 2103-2020 (Phase III) due to disagreement about rules allowing member states to hold their own auctions.
- Barclays has announced that it has made a recommended cash offer for Tricorona AB. The total consideration is approximately GBP98m. Tricorona is a Stockholm listed carbon developer that specialises in sourcing, development and trading of Certified Emission Reductions (CERs).

USA

Status: John Kerry and Joe Lieberman recently unveiled the Kerry Lieberman Climate Bill. The bill has been lauded as the best chance the US has had of passing climate change legislation. The bill provides for emission reductions of 17% by 2020 and 80% by 2050 based on 2005 levels by a cap and trade system.

- Support for the Kerry Lieberman Bill has been negatively affected by the BP oil spill. The Bill includes provisions to expand offshore drilling.
- In a White House address on June 16, President Obama said BP will pay and America will shift to clean energy. Obama said "the tragedy unfolding on our coast is the most painful and powerful reminder yet that the time to embrace a clean energy future is now".
- The eighth successful auction of carbon dioxide allowances was recently completed in the Regional Greenhouse Gas Initiative (RGGI). 40m allowances were sold for the 2009-2011 control period and just over 2m allowances for the 2012-2014 control period. Proceeds from all auctions to date now total USD660m, with the US States investing the vast majority of proceeds in energy efficiency and accelerating the deployment of renewable energy technologies.