

Appendix I: Kevin Parker, Perspective on Carbon Prices



Kevin Parker

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The Financial Times printed an article by Kevin Parker, Global Head of Deutsche Asset Management, on July 16th, 2008. In the article, titled “Carbon emitters’ free ride is about to end”¹, Parker argued that most companies in the EU were short carbon, and that the price of carbon is set to rise dramatically going forward.

“The astonishing truth about the carbon market is that nearly everyone is short carbon: companies will breach their emissions limits and do not own allowances to make up the difference. When I ask market participants: “who has surplus allowances to sell? I get back blank stares. It cannot be long before the market recognizes this fundamental supply/demand imbalance.

The carbon market, in addition to allowing offsets, should also encourage the switching away from pollution-intensive fossil fuels such as coal to less carbon-intensive gas and renewables. Carbon pricing should be correlated with oil and natural gas prices, which are soaring. A recent report by my colleague Mark Lewis at Deutsche Bank (“It takes CO₂ to contango”, May 30, 2008) argues that carbon’s market clearing price with oil at \$85 (55) a barrel and coal at \$90 (58) a tonne is about 40 a tonne. However, with the actual oil price at about \$135 (87) and coal at \$200 (127), the market clearing price for carbon is 75 to 80 a tonne – nearly three times its current level.

The markets have an uncanny ability to find the weak hand. Those emitters with too few allowances to cover their carbon output are going to get squeezed by the lack of supply, and a rise to at least 100 looks inevitable....

The effects of a repricing of carbon will be profound. Carbon will take its place alongside oil, coal and gas as one of the most closely followed commodities in the world. This will mark the beginning of externalities at last being priced into the cost of production. It will signal that carbon emitters have had a free ride for long enough. Governments – the US’s in particular – will have to join Europe to create a global market for pricing carbon and businesses around the world will have to accept the price the market sets.

A higher carbon price will force companies to make radical changes to their business models (this has already begun in the European utility sector). Early movers are likely to be winners. It will be an economic imperative for corporate boards and managements to take into account carbon pricing in their business and strategic planning....

The rising cost of carbon will also drive the need for, and the viability of, alternative technologies. Capital will start to flow to new areas of investment: existing technologies to conserve power and mitigate carbon emissions, developing technologies for carbon capture and alternative energy. Like many turning points, the carbon price rise will be fraught with risk. However, that is worth the enormous opportunities and benefits it will create....”

¹Carbon emitters’ free ride is about to end, Financial Times, July 16, 2008