EU carbon price slides amid policy noise and fund selling

EU allowances have sold off aggressively over the last month with concerns about possible policy changes in the EU, and more noise around a rebalancing in EU climate ambitions and competitiveness. This noise is unlikely to disappear anytime soon

Headlines and policy noise have spooked the market recently

Policy noise spooks the market

EU allowances (EUAs) have seen a spectacular collapse in prices over the last month after the market broke above EUR92/t in mid-January. The December contract fell below EUR70/t at one stage this week as the market became increasingly concerned about potential policy changes, with the EU set to review the Emission Trading System (ETS) and proposed reforms due in the third quarter.

There has been growing noise that the EU will slow the phase-out of free allowances, while also easing the linear reduction factor (LRF) for the EU ETS cap. Currently, the LRF used is 4.3% per year, and this is set to increase to 4.4% from 2028. However, an EU official has suggested the LRF could be cut to 3.4% from as early as 2029.

These headlines have spooked the market. However, this is not entirely fresh news. In December 2025, when the European Commission provisionally agreed to cut emissions by 90% by 2040 from 1990 levels, it was stated that in the upcoming review of the ETS, the trajectory of the ETS should be revised to allow for a small amount of emissions after 2039. As it currently stands, the cap would reach zero by 2039. And secondly, the Commission should consider a slower phase-out of

free allowances from 2028 to support decarbonisation, investment and employment in Europe.

Adding further downward pressure on the market were comments from German Chancellor Friedrich Merz recently, where he said that the EU should be open to revisions or postponements in the ETS if it doesn't push companies towards carbon-free production and harms competitiveness.

Meanwhile, comments from French President Emmanuel Macron questioning competitiveness and high carbon prices only added to the pressure. The French President has blamed high carbon prices on speculation, suggesting that EUAs should be trading around EUR30-40/t.

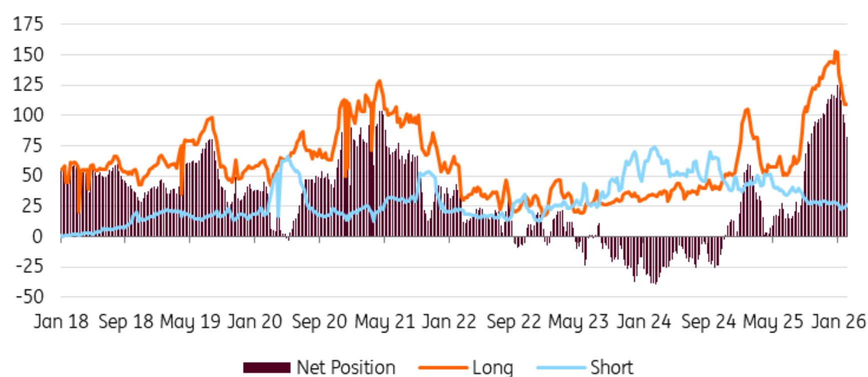
These are downside risks that we highlighted in our Commodities Outlook at the end of last year, where we suggested there may be a push to try to find a new balance between climate ambitions and competitiveness. And the large speculative long in the market entering this year only heightened this risk.

Aggressive speculative selling

The 25% sell-off in the market since mid-January has been aggressive, particularly in a year when the market is expected to tighten significantly with a large fall in supply. However, Greenland-related trade tensions, followed by potential policy changes in the ETS, have left the speculative community increasingly nervous. Investment funds had built up a record net long in EUAs in recent months, having bought more than 100k lots between August last year and January this year, and recent developments would have seen longs running for the exit, intensifying the sell-off in the market.

Given that funds still hold a relatively sizeable long, there is room for further weakness if sentiment sours further. The investment fund gross long in EUAs is around 109k contracts, well above an average of almost 60k contracts between 2018 and 2025. Meanwhile, the fund long as a percentage of total open interest is around 16%, down from almost 23% in January, but still well above the 2018-2025 average of a little more than 7%.

Investment funds start to cut large long position in EUAs (000 contracts)



Source: ICE, ING Research

EUA market still set to tighten in 2026

Policy reviews and the expectation for proposed reforms to the EU ETS in the third quarter mean that we are likely to continue to hear plenty of noise around potential changes to the ETS, and as a result, prices are likely to remain volatile.

However, fundamentally, the short-term outlook for EUAs remains supportive. The market is still expected to tighten this year, which should push prices higher from current levels. We are still forecasting that EUAs average EUR83/t in 2026.

Even with the sell-off seen in prices, we are still of the view that the Commission does not need to auction the full 93.3m allowances it has planned for this year to hit its REPowerEU revenue target of EUR20bn. So far this year, the Commission has auctioned a little over 17.1m allowances for REPowerEU and assuming a price of EUR70/t, we would only need to see 54.3m further allowances auctioned to hit the revenue target. This would necessitate almost 21.8m allowances less than planned.

Meanwhile, in the longer term, by function, supply will tighten in the market as the cap is reduced, which should continue to be supportive for prices. However, how supportive depends on the outcome of the reforms to the ETS. A slower phase-out of free allowances from 2028, which is reportedly being considered, would take some upward pressure off the market, while a lower LRF for the cap, possibly as early as 2029, would mean a more gradual pace of tightening in the market.

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