

A sluggish year ahead for carbon demand

We expect a modest recovery in EUAs over 2025 with the removal of further free allowances. However, there are demand risks, while supply will remain strong with auction volumes brought forward for REPowerEU



We see EUA prices trending higher next year, though the move is likely to be more modest than initially expected

Weak demand and strong supply

EU Allowances (EUAs) have been under pressure for much of the year. Weak industrial production and strong renewables output have weighed on demand for EUAs over the year. This saw prices trading down to EUR52/t in February, the lowest levels since 2021. However, it has not just been the demand side of the equation which has put pressure on prices. The front loading of auction allowances for REPowerEU has increased supply, only adding to the downward pressure.

Speculators have been bearish on EUAs for much of the year, holding a net short. However, more recently speculators have flipped back to a net long, possibly suggesting a shift in sentiment. But there are plenty of risks from the trade front as we move into 2025, and a recovery in renewables generation (following a decline in November) could potentially see speculators head for the exit.

We see prices trending higher next year, though the move is likely to be more modest than initially expected. Offering support to the market is the further removal of free allowances for the aviation sector, further shipping sector emissions covered, and the market preparing itself for the start of

the removal of free allowances for Carbon Border Adjustment Mechanism (CBAM) sectors from 2026.

EUA demand remains sluggish

In 2023, EU verified emissions fell to their lowest level since the implementation of the EU Emissions Trading Scheme (EU ETS) in 2005 as well as seeing their largest year-on-year decline. This was largely driven by the electricity sector, with emissions falling significantly due to a strong switch from fossil fuels to renewables, as well as lower overall power generation. For 2024, it is looking as though emissions will see another YoY decline. Live tracking of EU emissions show that they have been largely trending below 2023 levels. Once again, the electricity generation sector will have played a key role in this, with strong renewables generation yet again.

Industrial activity in Europe remains sluggish; production in the eurozone has fallen YoY every month so far this year. A combination of high energy prices and subdued demand continues to weigh on output. And there is downside risk to industrial activity in 2025 with the potential for an escalation in trade tensions next year.

However, next year the aviation sector loses further free allowances, which is part of the gradual phasing out of free allowances for the industry. Free allowances were reduced by 25% this year and will be reduced by 50% in 2025 (from the initial free allocation). For 2026, there will be no more free allowances for the EU aviation sector. This should provide some support to demand. Looking further ahead, there is also the potential that the Commission includes emissions for flights departing EU airports to non-EU destinations, rather than just intra-EU flights as is currently the case.

Furthermore, 2025 will see more of the shipping sector's emissions covered. 2024 was the first year of inclusion of the shipping sector in the ETS and as part of a gradual phase in, only 40% of the sector's emissions were covered in 2024. For 2025, this rises to 70% and from 2026, 100% of emissions will be covered. Again, this is broadly supportive for demand dynamics.

In addition, we are currently in the transitional phase of CBAM but from 2026 it will be fully implemented, which will see CBAM sectors starting to gradually lose their free allowances.

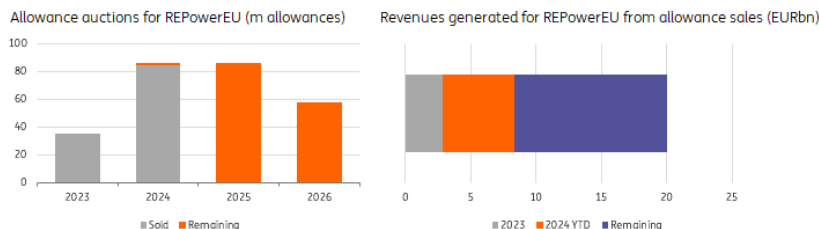
Allowance supply adds to the pressure

The selling of allowances to fund REPowerEU has added to the pressure on EUA prices. The European Commission is wanting to raise EUR20bn from allowance sales in order to partly fund REPowerEU. This supply has come from the Commission bringing forward volumes which were set to be auctioned later in the decade. In total, the plan is to bring forward 266.7m allowances for auction between 2023 and 2026.

In 2023, 35.2m allowances were sold. So far this year, 84.86m allowances have been sold. This has raised a total of EUR8.3bn for REPowerEU. The Commission still has almost 147m allowances to auction between now and the end of 2026, and given the target to raise EUR20bn in total, this means that it would need to achieve an average price of close to EUR80/t – far above current levels. This suggests that the EU will either have to sell even more allowances to achieve its EUR20bn target for REPowerEU or lower its target. If it is the former, that would only provide further headwinds to EUA prices.

While the bringing forward of this supply has been a bearish factor for the market, the fact that supply from 2027 has been reduced by a similar amount should prove supportive for EUA prices in the longer term.

Allowance sales for REPowerEU adds to the pressure for EUAs



Source: EEX, EC, ING Research

ING forecasts

	1Q25	2Q25	3Q25	4Q25	FY25
EUA (EUR/tonne)	70	73	75	78	74

Source: ING Research

Author

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.