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.

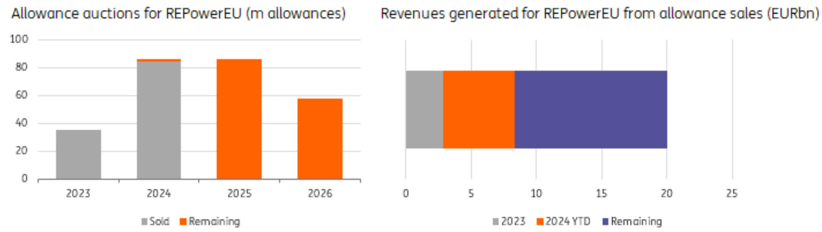
Allowance supply adds to the pressure

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

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