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Received-Date:20110905  
Received-Time:14:13:00  
Sent-Date:20110905  
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Subject: RE: [RESTRICTED] FW: DECC Carbon Price Assumptions

REDACTED

Thanks for your questions.

I've numbered the questions in your email (see below). Our answers are below, with help from our EU ETS analysts here in DECC.

I hope this is helpful.

Regards

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Answers

(1):

An increase in the number of EUAs surrendered in the current period implies lower abatement "effort" in the current period, followed by higher effort in future periods. This implies a lower EUA price in the current period, followed by a higher average EUA price over future periods.

(2):

One can see the implied market cost of carry from the forward curve – it is around 4-7% (nominal) depending on the vintage and the time at which you make the assessment.

It's probably reasonable to ignore the years in which the cost of carry is higher (2012-13) as this is driven by the lack of available allowances for Phase III. Such a premium should be corrected as a result of early auctioning. Thus the relevant market figures for cost of carry is probably around 4-6%.

You're right – we currently assume 1.5% real – which broadly equates to around 4.5% at current inflation rates.

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The development of carbon prices post-2020 is uncertain, so modelling investors' expectations of this introduces another layer of uncertainty. As you highlight, this creates difficulties when attempting to model the impacts now (in 2011) of the CPF up to 2030. REDACTED REDACTED REDACTED  
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Alternatively, given the inherent difficulty, we could simply choose not to attribute impacts between the CPF and the underlying "EUA" price. This is what we are doing in the price and bills analysis that will be published alongside the Annual Energy Statement.

Best

REDACTED

From: REDACTED

Sent: 26 August 2011 11:29

To: REDACTED REDACTED

Cc: REDACTED REDACTED REDACTED

Subject: [RESTRICTED] FW: DECC Carbon Price Assumptions

REDACTED, REDACTED,

I have a few questions from our infrastructure team that thought you may be able to help with.

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REST OF EMAIL CHAIN REDACTED AS OUT OF SCOPE