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27 Feb 2008 08:48 GMT =DJ CHINA ENERGY WATCH:

## Asian Exchanges Target Carbon Trading

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Of DOW JONES NEWSWIRES

HONG KONG (Dow Jones)--The carbon market in Asia may soon hit the big time: trading on exchanges.

Demand for carbon credits has already spawned sophisticated markets for their trade in Europe. Now Asian exchanges are looking to get in on the US\$60 billion dollar market, which is forecast to double each year for the next few years. But while Asia has plenty of sellers, it's unclear where the buyers will come from.

"How do you tell a European government or European company it's better to buy (carbon credits) in Asia?" asked Emmanuelle Fages, a carbon analyst at Societe Generale in Paris.

The Hong Kong Exchanges & Clearing Ltd. (0388.HK) last month became the latest Asian exchange to express interest in carbon credits, which allow companies to comply with emissions-reduction requirements without actually cutting their own output of greenhouse gases.

The Multi Commodity Exchange of India, the nation's largest commodities exchange by volume, launched futures trading in carbon credits in January.

Other plans in the works include the China Beijing Equity Exchange's carbon trading proposal, which reportedly could get regulatory approval this year. South Korea's stock exchange is looking into launching carbon credit trading as early as this year, while the Tokyo Stock Exchange is considering a similar project.

The new Asian carbon exchanges will have the advantage of proximity to the world's largest carbon credit sellers, China and India, but that alone won't make for a liquid market.

The drawback is that, unlike in Europe, most key economies in Asia such as India and China don't have regulations requiring companies to buy carbon credits. Japan is the only Asian country buying carbon credits, but Japanese companies don't buy them on exchanges.

"It's a pipe dream," one industry insider at an international bank said of the Asian exchanges. "It's

a fad, everyone wants to have a carbon exchange because it's the thing to do this year."

Following Europe

The carbon market appeals to Asian exchanges for one simple reason: carbon trading promises to be big business.

According to Point Carbon, an Oslo-based data provider, the volume of credits traded this year will rise an estimated 56% to 4.2 billion tons, worth about US\$92 billion at current prices.

The industry grew from the Kyoto Protocol, which requires companies in signatory countries to cut down on carbon emissions and to fund "Clean Development Mechanism," or CDM, projects in developing nations. Companies can buy carbon "credits" - representing one ton of carbon saved from emission - to help them meet emissions goals.

To date, the carbon market has been dominated by so-called "compliance buyers" from Europe but increasingly, financial institutions such as Deutsche Bank and Goldman Sachs as well as hedge funds are joining the market - looking to profit from carbon futures the same way they do with crude oil or gold.

In Asia, the Kyoto Protocol has sparked a seller's market. China is the world's largest seller of carbon credits and numerous Chinese companies see the carbon business as a moneymaking side venture.

Chinese steelmaker Anshan Iron & Steel Group Corp., for example, said it had agreed to sell 13 million tons of carbon dioxide emission credits from its CDM project to the European Carbon Fund and Camco International for roughly US\$219 million.

For an Asian exchange "the big advantage is suppliers. For many people from China and India, it will be easier to be active as sellers of carbon credits. They might have an easier way to register to become members of exchanges in Asia than in Europe," said Societe Generale's Fages.

If They Build It, Who Will Come?

Asia is following in the footsteps of Europe, where carbon credits are traded on the Oslo-based Nord Pool and the European Climate Exchange. Buyers on these exchanges are numerous, and the Asian challengers will be looking to draw some of them away.

That won't be easy. A cautionary tale came in September when the Asia Carbon Exchange in Singapore proposed auctions that "weren't much of a success because they had many sellers but the buyers who came were mostly opportunistic and looking for low prices," Fages said. Sellers were looking for higher prices, the parties couldn't agree and few sales resulted.

"There has to be something unique and compelling for European participants to want to trade in Asia," said Oral Dawe, Goldman Sachs' co-head of Asia commodity sales and trading.

With the pool of buyers diversifying, exchanges will need to offer futures and options, as well as physical contracts backed by actual carbon credits.

To entice buyers, "exchanges really have to bring some value-added products, so buyers can participate," said Dinesh Babu, Asia Carbon Exchange's director of carbon trading.

The Hong Kong Exchange has already said it wants to work with another exchange, possibly on listing emissions-related structured products and exchange traded funds as well as derivatives linked to emissions.

However, luring existing buyers from Europe with new products won't be enough on its own to ensure the success of the new exchanges. Asian governments also need to create local demand for carbon credits.

"China has got a lot of supply (of credits), but no demand. All the demand is coming from outside. So that's part of the thing that makes the exchange a little bit tougher," said Roger Raufer, an independent consultant. "Ultimately, the bigger game will be (whether) Asia can create its own demand," he continued.

Thus far, developing nations haven't shown any interest in mandating carbon emission cutbacks. Chinese regulators, for instance, have laid out some plans to fight pollution but not to create emissions targets.

Without regulations requiring companies to buy credits, there is little reason for them to do so. Similarly, power plants are encouraged to cut emissions, but aren't yet penalized if they do nothing.

Another risk to Asian exchanges is simply the unknown: the Kyoto Protocol expires in 2012 and it's unclear what will replace it. Market watchers expect rapid growth in the current cap-and-trade system until 2012, but other systems, such as a carbon tax, could be favored afterwards.

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February 27, 2008 03:48 ET (08:48 GMT)

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