



Carbon Content: Understanding the RePower EU Hangover and the Political Road Ahead

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*** Sales View Only ***

Summary:

EUAs have enjoyed a strong four-month rally with prices peaking at c€82. Investment funds now hold an estimated 97Mt in net long positions — the greatest length since 2021 — reflecting improved confidence in the structural tightness of the EU ETS. However, with speculative length elevated and liquidity thinner than usual, the market is more sensitive to policy headlines than fundamentals alone would suggest. A cluster of regulatory developments that are due shortly — draft CBAM rules, possible flexibility around the 2040 90% climate target, likely UK-EU ETS linkage, and the potential delay of ETS2 — may introduce short-term noise and sentiment-driven volatility, with price action periodically diverging from fundamentals.

Below we outline what is happening, what comes next and why we believe the fundamental picture for EUAs remains robust. If you prefer, you can skip directly to our sales view [here](#):

- Both the EU Council and the EU Parliament have adopted a 90% emission reduction target - with scope for some flexibilities including a 5% limit for carbon offsets to contribute to the goal. The next step is for both legislators to fully agree on a text in the coming weeks ([full details here](#))
- CBAM - draft proposals for the first compliance obligation in 2026 are expected to have a strong verification process introducing thresholds and on-site visits to ensure a reliable baseline and the long-term integrity of both CBAM and the ETS. ([full details here](#))
- A draft of the Benchmarks for regular free allocation in 2026-2030 was leaked from the European Commission. ([full details here](#))
- UK-EU ETS linkage talks are ongoing and are now in hands of the EU Commission. ([full details here](#))
- The EU (both Council and Parliament) have agreed to postpone ETS2's scheduled start from 2027 to 2028, but the final law is not yet adopted. The main concern is that higher costs of road transport and heating fuels would be politically unpalatable. ([full details here](#))

As Brussels re-enters full political mode, the biggest risk to EUA Prices is that the lingering RePowerEU front-loading hangover amplifies headline-driven moves, rather than an actual risk of structural changes to the core mechanics of the EU ETS.

We see a familiar pattern within the proposals:

- *Plenty of political headlines.*
- *A policy environment that continues to anchor the ETS as the primary decarbonisation tool in Europe.*

We expect noise and volatility, but we continue to view the regulatory developments as being neutral-to-constructive for the medium- to long-term EUA outlook. ([full details on opinion here](#))

Please read on for full details and do let us know if you'd like to discuss further.

FULL TEXT: Regulatory noise returns — but the impact on EUAs remains far more psychological than fundamental

The 90% emission reduction, but with flexibilities

The Council and Parliament reached conclusions supporting the 90% emission reduction target. What remains is the formal trilogue negotiation and the final publications of the amendments to the European Climate Law.

What is happening:

The final publication of the Law most likely will include:

- A binding 90% net reduction compared to 1990.
- Up to 5% of the 90% target may be met via high-quality international carbon credits subject to robust criteria and timing.
- Inclusion of CDR (Carbon Domestic Removals) in the EU ETS to compensate for residual emissions
- Enhanced flexibility within and across sectors and instruments for Member States.
- Biennial assessment of the progress in parallel with competitiveness.

What this means for the ETS:

- Currently, the EU ETS's cap is reduced annually with a linear reduction factor of 4.3% and 4.4% from 2028 to 2030. Assuming this annual reduction beyond 2030 would have meant a cap of c0 EUAs by 2040. The EU ETS cap will now have to be adjusted to the overall 2040 target with specific shares for ETS1, ETS2 and other emissions.
- While ETS1 will likely do the heavy lifting with respect to the 2040 target, there are discussions in Brussels to spread the cumulative ETS1 cap out for longer, meaning increasing the reduction in earlier years, while relaxing later years' reductions to still allow for some EUAs to come to market post-2040
- The allowance of up to 5% international credits may reduce some domestic abatement pressure, but only marginally — 85% of this still needs to be done internally. Furthermore, carbon credits will be introduced after 2036, so the major cuts still need to be domestic in the near term. It is yet to be seen how this 5% is split between different carbon reduction efforts. ETS1 is likely to be central to delivering a larger share of domestic cuts that credits cannot cover. Additionally, we would expect EUA supply to be reduced to allow for the number of carbon credits that would be allowed in the system.

- CDRs have been scheduled to play a part in the EU ETS for a long time. This is not new and intended to compensate for hard-to-abate emissions (e.g. long-haul aviation) in the scheme.

SALES OPINION:

Markets often react to these discussions as though “flexibility” or “offset allowances” would dilute the ETS today. This policy noise generates short-term volatility. As always, the timing of changes need to be considered when assessing the impact on EUA prices. As the flexibility elements (and the potential extension of the cap) all take effect post-2035, the announcement can have a sentiment effect, but the near- to mid-term fundamentals (demand vs supply) will not change if these amendments are finally adopted.

The use of these credits (whether offsets or CDRs) will deliver flexibility at the point where the ETS is approaching its end game. The market will anyway be under immense pressure post-2035 and the new flexibility will likely deliver some welcome breathing space.

The biennial assessments also add to the political noise but leave the ETS cap untouched. Member States gain some flexibility in how they meet the 2040 trajectory, yet none of this affects EUA supply. For the market, it means more headline swings but no change to the underlying structural tightness of the EU ETS in the near- to mid-term. ([back to summary](#))

CBAM: Implementation: efficiency and competitiveness

2026 will be the first compliance year for CBAM. Policymakers have released an updated draft implementing rules aimed at clarifying methodology, verification requirements, and interactions with free allocation.

What is happening:

- The draft rules are tightening MRV (monitoring, reporting, verification) — including stricter default values, verification flexibility only for low-risk cases, on-site monitoring during the first year, etc.
- EU producers that export their goods will receive focused support to ensure a levelled playing field outside of the EU. This might come in the form of allowances or as a share of CBAM revenue; details are yet to be released. Equally there will be a system to recognise any carbon costs already paid in third countries.
- Earlier this year, the EU proposed raising the thresholds for CBAM compliance. Only 10% of the initial number of importers will be in-scope but will still account for 99% of emissions.
- The final draft will include extending the mechanism's scope to cover **downstream goods** — especially steel- and aluminium-intensive components and fabricated metal items that currently evade the base-material list. The draft leaks suggest the selection criteria will hinge on tradability, the level of embedded emissions, and carbon-leakage risk.

What this means for the ETS:

Tighter MRV, an EUA rebate to exporters as well as a more overall focused CBAM system can increase the confidence of EU industry into the effectiveness of the CBAM system overall which would strengthen the system in the mid- to long-term:

- CBAM strengthens the political feasibility of maintaining a tight cap by reducing carbon leakage. It creates a levelled playing field for EU producers not only inside but outside the EU. EU producers will be incentivised to increase output as the currently cheaper import options start to fade. Higher output from intra-bloc producers will translate to higher emissions within the EU. More emissions naturally translate into more demand for EUAs, except this time, demand might come with more (cost-efficient) willingness to pay for allowances and ultimately decarbonise.
- CBAM is also paving the way for more carbon-cost discipline globally. With EU CBAM's implementation, a spillover effect of new ETS systems worldwide is happening. Currently 24.3% of emissions are covered by ETSs worldwide; in five years, this will be 31%, an increase of c25%. By 2030, Carbon compliance costs will be c16% of global corporate tax receipts. This

expansion strengthens the convergence of a Carbon price and the use of the mechanisms worldwide.

SALES OPINION:

CBAM is happening. After a year of whispers and rumours around delay, this is the clear message that the EU is sending.

It will adapt to be more efficient and robust in the long term.

MRV tightening will ensure credibility and reliable metrics throughout the mechanism.

The support to EU exporters through extra allocation or “EUA rebates” might put limited short-term pressure on EUAs. However, this early support of EU’s industry makes the ETS stronger in the medium term by providing timely tools for local industry to decarbonise and reduce risk to the ETS functioning. ([back to summary](#))

Allocation Benchmarks:

What is happening:

Last week, preliminary Allocation Benchmarks were leaked. Benchmarks are one key factor – alongside activity levels and CBAM phase-in – in determining the free allocation at an installation level. Benchmark developments are a continuation of the previous adjustment in the 2021-25, with some benchmarks reducing at the minimum possible (hot steel, aluminium, cement, ammonia) and some at the maximum possible (other steel benchmarks, pulp & paper, some chemicals, some construction materials, heat and fuel).

Some sectors face significant reductions from the benchmark adjustment including fallback benchmarks such as heat and fuel.

However, four benchmarks that are only reducing at the minimum rates account for about 45% of total free allocation. This reduction might not seem substantial but, these sectors will face an additional decrease of free allocation via phasing-out due to CBAM. Their allocation will be reduced nearly 50% by 2030.

According to the current rules, free allocation will significantly reduce for all sectors covered by the EU ETS. Some sectors will be more affected by benchmark reductions, while others will be more affected by the phase-in of CBAM.

SALES OPINION:

The leaked benchmarks should not be a surprise for market participants as the benchmarks are a continuation of the previous adjustment period. Although, some benchmarks reduce at the minimum possible, overall free allocation will reduce for all market participants towards 2030.

It will be interesting to see how the discussion in Brussels changes in the next week; voices from Germany (government, but also chemical companies) and elsewhere are getting louder regarding delaying the phase-out of free allocation. While we believe that an overall delay of the free allocation phase-out (meaning at the same time a delay in CBAM phase-in) is unlikely, we do see an increased likelihood of conditional free allocation for those industrial companies who invest in decarbonisation measures.

From a price perspective it will be key to see where potential additional allocation volumes are taken from – it is very likely that the cap will be untouched and hence planned auction volume will have to be reduced to allow for any additional free allocation. This means that overall supply will likely not change, but the timing of supply could potentially alter . [\(back to summary\)](#)

UK-EU ETS Linkage: Convergence upwards.

The EU Council has unanimously agreed to grant the Commission a mandate to begin formal negotiation with the UK on market linkage.

What is happening:

- The EU Commission will start negotiations to achieve mutual recognition of allowances (fungibility) similar to the one existing with the Swiss ETS.
- The UK ETS will have to align in key areas such as the function of the MSR MRV rules, free allocation, Leakage protection (CBAM), auctioning rules, CDRs, and a joint governance committee and safeguard clauses.
- Negotiations are proceeding slowly but steadily; a full linkage agreement is likely but not before 2027 or 2028

What this means for the ETS:

The UK ETS has a mathematically steeper Linear Reduction Factor than the EU. But, the UK's emissions have fallen rapidly: there is no more coal-powered generation, there is high renewable production, lower industrial output post-Brexit, all leading to lower UKA prices. The EU overall has a lower decarbonisation process but a stricter regulatory framework (MSR, CBAM, etc.) so the market is tighter and prices are higher. It seems that price convergence does not seem to be dragging EUAs down, rather tightening UKAs upwards.

The caps will remain separate, but this linkage will have a positive sentiment effect and a slightly positive fundamental impact on the EUA market. By tightening the UKA market and making allowances fungible, a tighter UKA cap would additionally tighten the EU ETS

SALES OPINION:

Historically, linkage discussions have caused knee-jerk bearish reactions — but the fundamentals point to neutral-to-slightly-bullish as price convergence is happening upwards.

A classic mutual-recognition model would deepen liquidity without altering the EU ETS cap, while regulatory alignment means the UK system will effectively tighten toward EU standards rather than the other way around. Price convergence gravitates toward the larger market, suggesting UKAs rise toward EUA levels. Overall, linkage adds some headline noise but does not weaken the structural case for EUAs — if anything, it reinforces it. . [\(back to summary\)](#)

ETS2 Delay: Headline risk > actual market impact

What is happening:

On 5 November, EU Ministers agreed to **request** a one-year postponement of ETS2 (from 2027 to 2028) as part of the 2040 climate package. The scope of ETS2 is road transport and buildings. This scope would have more direct impact on consumers. Direct household energy bills would go up if domestic fuel suppliers pass on carbon cost and/or road fuel prices rise in line with additional ETS2 taxation.

What this means for ETS1:

- This delay will potentially ease political pressure on other climate legislation. In other words, compromising to this delay to ETS2 might be leverage for the Commission in upcoming reviews for the ETS1
- ETS2 does not affect ETS1's supply-demand balance.

SALES OPINION:

The delay has no impact on EUA market mechanics. Despite the potential set-back with respect to Climate Law, Brussels appears to be focusing upon ETS1 as the core mechanism to lead in reaching EU Climate Law targets .

[\(back to summary\)](#)

So what could matter for EUAs in the near term?

In our view:

RePowerEU left a meaningful overhang that still shapes trader psychology. The programme front-loaded more than 250 million EUAs into the auction schedule, flushing the market with liquidity at a time when fundamentals were tight. While the MSR has absorbed part of this surplus, the earlier front-loading also reduces auction volumes in subsequent years, creating a delayed tightening effect. This offsetting mechanism helps rebalance supply, but it also reinforces the lingering fear of “one more policy surprise.” This is the real hangover: traders remember how quickly auction supply can be reshuffled by political decisions, so even minor headlines now punch above their weight in sentiment terms. Fundamentals remain broadly supportive:

- Industrial output in the EU is steady rather than collapsing.*
- Power sector hedging is likely to rebuild*
- According to Bloomberg, after two years of double-digit growth renewable output is expected to be only 3%.*
- The MSR continues to remove meaningful volumes of EUAs from auctions.*
- The cap trajectory through 2030 is tight and unchanged.*
- Speculative positions are at 97mT net long.*

Regulatory headlines will continue to generate noise around the ETS, and political pressure can of course dampen sentiment. Headline risk is amplified at this time of year: late-Q4 and early-Q1 liquidity is thin, positioning is one-sided, and even modest policy headlines can trigger disproportionately large moves. Overall, the legislative ambition we have seen from Brussels in recent years is now balanced by questions around competitiveness and industry support – a return to a more historically typical equilibrium. While we do not expect immediate action that fundamentally undermines ETS1, the political environment has become more volatile, and headline risk has increased.

Our final view remains medium-term constructive, but the short-term path is clearly more volatile than the structural story implies. The cap trajectory is unchanged, MSR withdrawals remain substantial, CBAM is tightening global carbon discipline, UK linkage is incrementally bullish, and industrial demand is far from collapsing — all of which support a steady-state. But positioning and liquidity matter: specs are heavily long, political and regulatory headlines are imminent, and the market is prone to 10–15% sentiment-driven air-pockets even without a shift in fundamentals.

In practice, this means:

We expect higher realised volatility and temporary retracements even though structural supply–demand remains bullish.

Or in trader language: “Structurally bullish, tactically volatile.”

For longer-term holders, we believe that this environment presents opportunity rather than threat.

A final challenge for policymakers is striking the right balance between safeguarding industrial competitiveness and preserving the integrity of the ETS — and the Commission is clearly aware of how costly mis-calibrated interventions can be, as demonstrated by the RePowerEU front-loading episode. Recent communications suggest a deliberate shift: avoiding supply-side surprises, reinforcing predictability, and ensuring that decarbonisation remains the primary driver of competitiveness rather than a burden. The Commission increasingly frames climate policy and industrial strategy as mutually reinforcing — with CBAM, innovation funding, and clearer long-term targets designed to help EU manufacturers compete globally through lower-carbon production rather than temporary protections. Many of the measures now under discussion aim to provide industry with the tools and confidence needed to invest, not to dilute ambition, and are intended to strengthen the long-term sustainability of the ETS itself. The challenge now is to sustain this balance: offering industry the visibility required for capital planning while continuing to rebuild market credibility by avoiding unexpected supply-side interventions and reinforcing the ETS as a predictable, rules-based system, so that the market remains trusted, stable, and capable of driving genuine transformation. A well-governed ETS remains central to delivering both decarbonisation and competitiveness — and Brussels appears intent on protecting that dual objective.

Do let us know if you would like to discuss any of the above topics in more depth. Please note that all information provided is based on current public sources and leaked drafts from the EU Council, Parliament, and Commission, and may change prior to official publication. ([back to summary](#))

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