

PEAR's Electric Intelligence® Newsletter

(Released May 24, 2007)

Power & Energy Analytic Resources, Inc.

EXECUTIVE SUMMARY

The State of the SO₂ Market: The Closet Bulls Advance?

- Every auction tells a story; or if it does not, it has one told on its behalf. According to the market sages, **the real message of EPA's 2007 SO₂ auction lay in the supposedly bullish results for the advance market**, (see *NM-OS-07 v2.1, below.*) The key question remains **how long will the closet bulls wait to emerge?** A detailed review of the allowance transactions data tells us more about why prices may be range-bound in the \$400s than the 2007 Auction results do. After the unusual developments of late-2005 through mid-2006 **we are back to more typical market conditions.**
 - In particular, lower sulfur coal-fired companies are selling surplus allowances to meet the steady if unspectacular requirements of “the usual suspects”: the short companies who, despite their ongoing retrofit programs, remain short.

The State of the NO_x Market: What Will Annual Allowances Due to the Seasonal Market?

- After flirting with parity, **banked and current vintage NO_x allowances have begun to diverge again** (see *NM-OS-07 v2.8, below.*) Fortunately, to keep it interesting, the discount is nowhere near flow control levels, at about \$800 for banked vs. \$1,000 for 2007 vintage allowances.
 - Furthermore, the most recent pattern of NO_x trading has changed little from preceding quarters, with a strong role for industrials and little new interest from financials.
- In the absence of other new market information, it is worth speculating as to **whether the failure to hit a bid reported to be as high as \$3,000 for a 2009 annual allowance is having a chilling effect on seasonal allowances** as well.
 - It is hard to imagine a combined annual and seasonal price exceeding \$3,800 (the sum of the bid and current prices) so it is conceivable the market is in a “wait-and-see” mode.

**NM-OS-07 v.2-1: What CAIR Price Does the Auction Support?
Spot vs Advance Auction History 1993-2007 vs Implied Price 2005-2007**

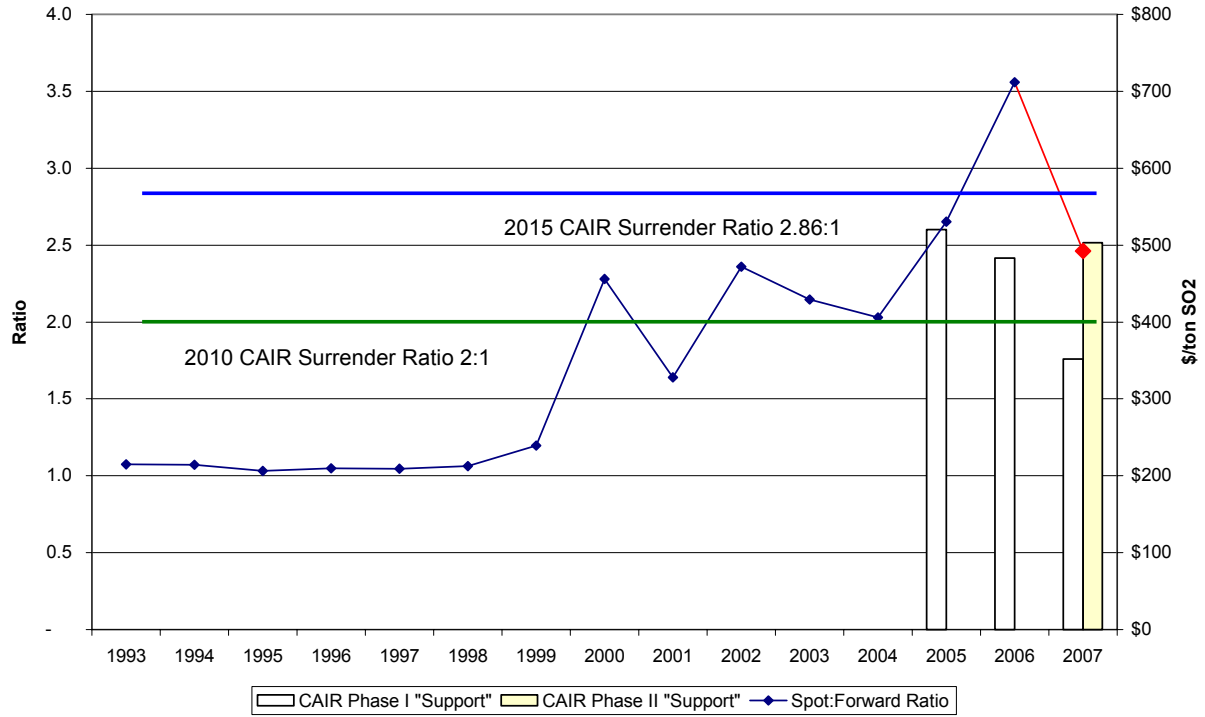


Fig NM OS-07 v.2- 8: NOx Volume vs Price Front Year Vintage
Typical NOx Trading Cycle Disrupted by Heavier Trading In 2006 Q4 -2007 Q1

