EXPLORING LINK BETWEEN REGULATED AND VOLUNTARY CARBON MARKETS

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ABSTRACT

This paper makes an attempt to assess the relationship between the returns in the regulated and the voluntary carbon market. Daily spot prices data from the European Climate Exchange and the Chicago Climate Exchange is used for the analysis. While European Union Allowance (EUA) spot price is used as indicative variable of regulated market, the voluntary market spot prices are captured through the prices of various carbon vintages (such as Vintage-2005, Vintage-2006 etc). An unrestricted VAR model is applied to study the short run dynamics in the two markets with the help of impulse response function, variance decomposition and granger causality analysis. Both impulse response and variance decomposition suggest that there is information flow from one market to the other. Bi-directional causality is found between EUA returns and Vintages-2005 and 2007.

Key Words: Carbon Prices; VAR; Granger Causality