

# ESG Now Podcast

## “The First Ever Price Forecast for Airline's Carbon Credits”

Transcript, 06 December 2024

Mike Disabato (00:00):

What's up everyone? And welcome to the weekly edition of ESG Now, where we cover how the environment, our society and corporate governance effects and are affected by our economy. I'm your host Mike Disto, and this week we discussed the groundbreaking report we published on the cost of carbon credits to the global airline industry that are trying to lower their emissions. Thanks as always for joining us. Stay tuned. December, with all the holiday and family, fun is usually one of the busiest flight months of the year. There are vacation days to use family to see flights to take. This of course means a lot of carbon emissions are released into the atmosphere because air travel is emissions intense, but fear not. The aviation industry is aware of this and your concern, oh, environmentally conscious consumer and they are employing several tools to lower their emissions. These include new planes, hopefully more efficient routes and taxing and of course sustainable aviation fuel.

(01:04):

Now the problem is none of those options are really doing that much at the moment. Planes aren't being delivered quickly, efficiencies and route and taxing can only do so much, and SAF is expected to be around 0.5% of the aviation's fuel use in 2025. But the industry knew that this was the case and that's why they've established a bridging tool to get them through the slow technological progress in aviation until that changes. Of course, I'm talking about carbon credits, specifically carbon credits as part of the UN standard setting body called the International Civil Aviation Organization or ICAO for short. It's carbon credit program called the Carbon Offsetting and Reduction Scheme for International Aviation or CORSIA. So you got that, the ICAO CORSIA, the UN loves acronyms. Now CORSIA entered into a pivotal new phase in 2024, phase one to be exact phase one of its grand plan to lower the aviation industry's carbon emissions.

(02:04):

It shifted from its pilot phase, which went from 2021 to 2023 into this phase, which is going to go from 2024 to 2026. And then there are phases after that. So to mark this momentous year in aviation, my colleagues at MSCI Carbon markets published a report called CORSIA Costs and Implications for the Airline Industry. It's the world's first price forecast for CORSIA and I of course am going to link the report in the podcast episode. But luckily for you today, since reading is tiring, I call up one of the report's main authors, Ferris Plato, and asked him to take me through how the first year of CORSIA was for the airline industry and what he sees the future holds for the industry and CORSIA overall.

Faris Pleho (02:49):

So the pictures changed quite potentially from the pilot phase where we had zero demand and a lot of supply of these carbon credits that are eligible for COR in the phase one. Now we're seeing loads of demand, but actually supply has been really slow to kick in. IKEA has to approve each registry for its credits, part of the COI eligibility process. And really until a month ago, there were only two registries that were eligible. They were relatively small, but last month they approved some of the largest registries in the market and this includes Vera Gold Standard, the Global Carbon Council and CAR to supply eligible credits for cor. So that unlocks a lot of supplier. This was like the main constraint people were talking about this year when it came to corsea. Now Woody's registries are eligible, but it does ignore this key requirement in the phase one that's come in that wasn't applicable in pilot phase, which is this requirement for corresponding the adjusted credits and to keep it simple corresponding in the adjusted credits, just avoid double counting of emissions. So IKEA requires airlines to use credits that have a corresponding adjustment applied to avoid double counting between the airline's use under corsea and a country's use of that same carbon credit under its national targets under the Paris Climate Agreement. And there's a real lack of availability of these corresponding the adjusted credits in the market at the moment. There are just 4.6 million tons available from a project registered in Guyana and in phase one we expect demand to be somewhere between 106 and 137 million tons. That's quite a substantial shortfall,

Mike Disabato (04:33):

Which putting on my economics 101 hat, that gap between supply and demand is going to do something to the price of the available credits, isn't it?

Faris Pleho (04:43):

So currently the average price of a carbon credit is somewhere around the three to \$5 per ton range. That's where it's fluctuated throughout the year. But for example, with these Guyana credits, we already know that they're trading with a floor price around \$20 per ton, which is a substantial premium over this global average. And that's partly down to the fact that the project type they are, it's to do with reducing deforestation, but it's also accounts for this premium that host countries demanding for these correspondingly adjusted credits, which we know is somewhere in that five to \$10 range of the premium. So what this means, this shortage in phase one is going to lead to driving prices upwards. And our price forecast indicates that prices are going to be somewhere between 18 and \$51 per ton in the current phase. And that's based on a range of scenarios. We combine demand and supply scenarios and average depends on how much supply is going to come online since we have a fairly good understanding of what demand is going to be. So that's based on flying on traffic patterns, but supply is much less certain because it's based on this requirement for host countries of these projects to issue these correspondingly adjusted credits to the market.

Mike Disabato (05:57):

Alright, so how does that translate into real world impacts for airlines, its customers, its investors and all that. Ferris and our colleagues at MSCI cover markets have forecasted the price for course eligible credits to be around 20 to \$50 US per credit, which is equivalent to one ton of CO2 equivalents reduced or removed. And the airline industry is going to demand as far as noted more

than a hundred million credits. So let's do on the conservative side, if we do the math there, of course that's 2 billion that the airline needs on the higher end, that's \$5 billion. Now, there's a lot that goes into how an airline makes money, but all its money making franchises are in the end based on selling tickets and flying planes, even though some airlines really are just loyalty programs with planes because many of them actually lose money on their literal flights.

(06:49):

You might know the adage, how do you make a million dollars running an airline start with a billion? So their margins are pretty thin. Spirit airlines in the US just filed chapter 11 bankruptcy proceedings because its business couldn't handle the increase in general economic labor costs that they then tried to pass onto its customers by raising ticket prices. So many airlines, especially low cost airlines, really cannot afford to raise ticket prices by that much. But as I noted, this could be two to 5 billion expenditure for airlines on just carbon credits alone. So how are they going to deal with those costs? To understand this, Ferris looked at two diametrically different airlines, EasyJet and Emirates.

Faris Pleho (07:30):

So we look to EasyJet, which is a UK based low cost carrier, someone similar to Southwest Airlines or Spirit Airlines in the US and then Emirates, you may know as the Middle East based luxury carrier with its large fleet of quite extravagant planes. They're known for their onboard showers, they're onboard bars, they're very opulent first class and business class accommodations on board. And they're very two very different business models and two different passenger demographics. With EasyJet, you are looking at someone who's spending around a hundred dollars on a flight, that's the average spend for an EasyJet flight and they're just going for a short flight, very commodified air transport. On Emirates, it's more about luxury opulence experience. Actually the average revenue per passenger at Emirates is close to \$600 per passenger, and that varies quite substantially. If you look at an economy passenger that might be paying \$500 and a first class passenger that's going to be paying \$10,000 per flight, for example.

(08:32):

Now with Corsea, each of these passengers, we assume that airlines are going to split the cost based on each passenger's emissions. Where we see that already it's happening in the market. We know that both Lufthansa, which is a German airline and Virgin Atlantic have started to introduce these environmental surcharges. Ultimately, airlines have two options. They can absorb the cost of decarbonization and course into their operating profit or they could pass it onto their passengers. And we're starting to see that airlines are already trying to pass it onto their passengers with these environmental surcharges. So during phase one, the average ticket price of an easy jet flight, according to their annual report is around \$116. And for course phase one, with these price projections that we're talking about, we're looking at somewhere between 12 and 84 cents per passenger depending on the number of, as you know, sorry, 12 to 42 cents per passenger.

(09:29):

So it's a relatively small increase to talking about less than a cup of coffee. With Emirates, that average revenue per passenger is 624 bucks, so much higher. And there we're looking at

somewhere between 80 cents and \$3 per passenger on average. And this is an average at each airline. Like I said, at Emirates you have passengers in different classes of travel, so someone in economy might pay somewhere between 80 cents and \$3, but someone in first class who's accountable for about four times the emissions might be looking at somewhere closer to 12 \$15 as a surcharge. But again, on a \$10,000 ticket, that's quite inconsequential for the passenger.

Mike Disabato (10:07):

Those are both inconsequential numbers and that's a good thing because if they weren't, if EasyJet and Emirates couldn't pass on those coia costs to customers, they would hit the airlines operating profit for EasyJet, that would be around two to 6%. And for Emirates it would be around one to 3% according to Ferris's research. Now Emirates with their planes that have showers on them, they could probably handle that. But easy jet, a low cost airline likely would have more trouble keeping passengers that want the lowest fare possible, which is a majority of a low cost airline customers. And to be honest, passengers for some airlines would even pay more than that. I know that kind of complicates what I said, but for low cost airlines, the economics are a bit different than your legacy airlines like Delta Lu Tanza, Emirates, planes like that versus the Spirit Frontier allergen EasyJet.

(10:59):

But still, there is this survey that was done by the airline industry body IDA that found that passengers would pay up to 11% more on their ticket to offset their emissions. But of course IKO knew this, this is sort of by design. They wanted to ensure that the cost of the phase one of COR was relatively minimal to airlines so they could pass on their costs through their customers and the industry would balk at these prices and air traffic could continue to grow. And so what the IKO did was they set its baseline requirement for the industry to lower its emissions at an achievable level, the 85% 2019 emissions, and we expect that baseline requirement to dip lower as the years progressed to better align corcio with the Paris Climate trajectory. But that means that airlines are going to need even more carbon credits to achieve their corcio requirements year after year. And if we take for granted at the moment that carbon credits actually are going to be used as they're purported to be used, they reduce or remove emissions, there's still the fact that airlines need enough of them to meet course requirements that get stricter and stricter year by year. And as Ferris noted, there isn't a hundred million credit gap that we are dealing with here. So what is he going to be looking at out there in the coming years to signal to him that the supply gap is being shored up?

Faris Pleho (12:21):

I mean, we expect the supply picture to change quite substantially over the next few years, right? So as I mentioned, I tell recently unlocked those major registries, so that brings a lot of eligible credits into the market, but it still require that corresponding adjustment. Now at COP 29, we finally got an agreement between countries on how to manage Article 6.2, which drives this corresponding adjustments mechanism for corsea. So that should really unlock substantial progress over the next few years. We see a lot more countries issues. At the moment there's only a handful of countries that have done so, but for a host country to correspond, to adjust a credit, it has to issue a letter of authorization to developers of these carbon credit projects that are out there. So what we're going to be keeping an eye on is an increased rate of these letters of authorization being issued and whether, so the number of projects that are getting these letters issued, but also the number of

credits that are coming to the market that are tagged as either course eligible or coming with this corresponding adjustment approval already. That's something we're going to be keeping a really close eye on, but to date there's been so little movement that we can't really use any historic data to project it forward. So it's something we're going to be keeping a very close eye on to see how it develops.

Mike Disabato ([13:39](#)):

Now I need to give you a bit more context here because what Faris just said is quite important. The purpose of a corresponding adjustment is to ensure that the same ton of CO2 is not counted towards two different greenhouse gas emission reduction targets the airlines and the country that sold the credit. So if that did happen, it would be called double claiming and you don't want that to happen. And carbon credits used within phase one or even phase two of coursea must have a corresponding adjustment applied to it. That means the carbon selling country must authorize a project to sell credits to an airline to use it against their coursea targets by issuing a letter of authorization. And then in theory, this will ensure that the host country is not going to use that credit toward achieving their own emissions goals. They're going to say, we transferred to the airline and this reduction removal is not our thing, it's the respective airlines. And a further complication of this is the UN's got no army for course to work. Countries have to enforce these requirements via their own networks and markets and all that. The UN's not going to step in and do anything about it. And right now there are 126 countries currently participating in phase one, but those countries need to enforce their own rules, which isn't always a certainty when it comes to the climate unfortunately. So because of all this I ask Ferris, are you confident? How do you feel?

Faris Pleho ([15:06](#)):

I lie, I'm quietly optimistic that we will get there. Like I said, we have that the major registries are now unlocked. We're talking around 230 million tons of credits are out there that meet the course requirements but don't have that letter of authorization for corresponding adjustments yet. So the credits are kind of out there. They just need to get these letters. And then we also have two, three more years for more credits to be issued. And finally that big at COP 29, the agreement with Article 6.2. Really all the ingredients are now there for course to function as it should.

Mike Disabato ([15:46](#)):

And if it does function as it should, we're probably going to see more than just the 61 airlines that have retired Any credits to date that's well shy over the 400 airlines that would be required to do so if as Faris notes course is functioning as it should. But in conclusion, remember here airlines have to offset between 106 and 137 million tons of CO2 during phase one of COR with an additional offsetting requirement of between 502 and 1,299 million tons of CO2 during phase two. Now so far, according to Ferris and his report authors airlines have reportedly engaged well with course on the monitoring, reporting and verification of emissions. But as I said, only 61 out of the 400 airlines that need to purchase credits have done so. And the retirement deadline for phase one might seem far off that it's in January of 2028. They have a little bit of a buffer year after the end of phase one, but it's going to come quickly. And what you don't want to have happen is have a credit crunch where everyone is trying to purchase credits at the deadline. That would increase costs and that isn't what

any company or investor wants anyway. It's something we're going to have to pay attention to. Happy holidays, safe traveling, and remember to be kind to your flight attendants.

(17:10):

And that's it for the week. I wanted to thank Farris for talking to me about the news with the sustainability twist. I wanted to thank you so much for listening. If you like what you heard, don't forget to rate and review us. That always helps and subscribe wherever you get your podcast. You can hear myself or any of the other ESG now hosts each week. Thanks again and talk to you soon.

Speaker 3 (17:45):

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