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REAL EFFECTS OF CARBON FINANCIALIZATION

The recent influx of financial traders into carbon allowance markets has raised concerns about its distortive effects on carbon allowance prices and its repercussions for firms that rely on these price signals to make emissions decisions. This paper studies how financial carbon trading affects the allocative efficiency of carbon allowance markets and highlights the importance of facilitating financial arbitrages rather than imposing restrictions. Exploiting allowance transaction data in the European carbon market and using carbon policy shocks as supply shifters, I identify a price-inelastic carbon demand by large financial traders. The lack of elastic arbitrage capital is associated with a decline in the carbon price informativeness and contributes to the carbon market crash during the Russia-Ukraine war. The decreased informativeness has real effects: I find that firms with inferior private information reduce their emissions less efficiently when the carbon price is less informative, and the cross-sectional dispersion of carbon intensity increases with the informational inefficiency. I develop a macro-finance model with managerial learning from carbon prices that rationalizes these novel empirical findings.

12 January 2024 (Friday)

9:30-11:00am

SEK205, 2/F, Simon & Eleanor Kwok Building

English

SPEAKER

MR. ZHIMIN CHEN
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Due date: 13 January 2024

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