CONFIDENTIAL

cc DP
CC NO

NBPM
AT 17/12

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 December 1983

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

Dear Peter

BNOC: 1984 FIRST QUARTER PRICES

Thank you for your letter of 14 December. I agree that BNOC's approach offers the best prospect of avoiding instability in the oil market, and, as my office reported to yours earlier today, I was entirely content that you should proceed as you suggested.

Copies of this letter go to the other recipients of yours.

Yours ever
Nigel

NIGEL LAWSON

CONFIDENTIAL

Energy BNOC

16 DEC 1983

010

Prime Minister

With Treasury agreement BNOC announced unchanged prices, thereby staying in line with OPEC who also held prices. The aim was to scotch rumours of a cut by BNOC. Customers have yet to agree.

AT 14/12

01 211 6402

CONFIDENTIAL

The Rt Hon NIgel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

December 1983

BNOC: 1984 FIRST QUARTER PRICES

BNOC's contracts with its customers require it to propose prices for the first quarter of 1984 by 15 December (although these provisions have frequently been breached without ill consequences). I discussed the way ahead with Douglas Croham and Ian Goskirk of BNOC this morning.

The oil market is weak. World production significantly exceeded consumption in the third quarter thus causing a build up of stocks higher than intended. The winter in the main consuming countries has so far been mild. There remain ambiguities about Saudi intentions in respect of their role as swing producer. As a consequence, spot prices for UKCS crudes have been around $1.50 below term, US spot prices have declined and Russia has twice cut the official prices for its exports. The immediate market by itself would justify a reduction of perhaps 50c to $1 a barrel in the price of UKCS crude. However our slightly longer term assessment is that, given a normal winter and observance by OPEC of their production ceiling, there is no underlying reason for a reduction of prices. That perception is shared by Shell, Esso and BP as well as by BNOC.

Earlier this year, in consultation with you, BNOC tackled the problems created by the market weakness by postponing proposals on prices, undertaking to backdate them when they had eventually been agreed. But that was against a background of patent disunity within OPEC when it was known that Saudi Arabia wished to see a cut in official prices. Now OPEC has just concluded a conference at which all Member States reaffirmed their commitment to the production levels and prices agreed last March in their "London agreement". Any delay by BNOC in current circumstances would signal a lack of belief in these OPEC commitments and increase the instability in the market.

BNOC's choice is, therefore, to propose that either its current term prices continue or that they are reduced to bring them more in line with spot prices. Yamani indicated to me yesterday that OPEC will maintain and indeed improve discipline. He warned me in confidence that any reduction in BNOC's prices would be followed by reductions at least as great in the official prices of Nigeria, the North African producers and the UAE. It may well be that Nigeria and perhaps other producers would also expand production in order to maintain revenue. In that case, a price reduction by BNOC would not enable it to retain its term customers; it would merely drive spot prices down in front of it and pose a major threat to the stability of the oil market.

We have to take Yamani's warnings seriously. BNOC has concluded, and I agree, that it has no option but to propose that existing prices be maintained. It is likely as a consequence to lose some term customers and therefore be forced to sell spot. However, a proposal now to maintain prices would not preclude later acceptance, after negotiation, of a reduction if that loss of custom became so great as to pose as much of a threat to market stability as a proposal to reduce prices.

The Daily Mail and other papers have published today a report that BNOC is about to reduce prices by $1 a barrel or more. We need now to show all the confidence we can in current prices. That is best done by very swift rebuttal through BNOC going out today to its customers and suppliers proposing no change. Unless I hear from you, I shall let BNOC know at 3.00 pm that I see no objections to such a move.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe and Norman Tebbit.

PETER WALKER