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FROM JEDDA 010822Z APR 85

TO ROUTINE FCO

TEL NO 187 OF 1ST APRIL 1985

INFO ROUTINE LAGOS, KUWAIT, DOHA, ABU DHABI, DUBAI, MUSCAT,
BIS TEHRAN, BAGHDAD, ALGIERS, WASHINGTON, TOKYO, BAHRAIN.
INFO SAVING JAKARTA, CARACAS, QUITO, MEXICO CITY, OSLO, RIYADH.

CALL ON SAUDI OIL MINISTER

SUMMARY

1. YAMANI MAINTAINS THAT OPEC MONITORING ARRANGEMENTS ARE WORKING AND THAT OPEC PRODUCTION IS CURRENTLY 15.5 MBD, IN SPITE OF HIS PUBLIC

OPTIMISM YAMANI SEES GROWING RISK OF AN UNCONTROLLED DROP IN PRICE. HE IS CONCERNED THAT UKCS EXPORTS MAY INCREASE AND ADVOCATES A BRITISH OIL TAX REFERENCE PRICE. THERE MAY BE AN ELEMENT OF BLUFF IN HIS WARNINGS THAT THERE ARE LIMITS TO SAUDI ARABIA'S WILLINGNESS TO GO ON SHORING UP THE PRICE.

DETAIL

2. HAVING FAILED TO SEE SHAIKH AHMED ZAKI YAMANI WHEN CARRYING OUT THE INSTRUCTIONS IN YOUR TELNOS 115 AND 116 OF 12 MARCH, HE WAS INVITED TO CALL ON HIM IN RIYADH ON 31 MARCH. IN ANSWER TO MY QUESTION YAMANI CONFIRMED THAT THE OPEC AGREEMENT OF 30 JANUARY HAD SO FAR HELD. HE HAD HIMSELF SEEN JANUARY OPEC PRODUCTION FIGURES: THOSE FOR FEBRUARY AND MARCH HAD GONE TO THE DUTCH ARBITERS. HE WAS SATISFIED THAT THEY WERE ACCURATE. CURRENT OPEC PRODUCTION WAS 15.5 TO 15.6 MBD.

3. OF THIS, SAUDI PRODUCTION WAS 3.9 MBD (400,000 MBD BELOW QUOTA). THIS FIGURE EXCLUDED CRUDE FOR IRAQ AND THAT PUT INTO STORAGE AND NOT SOLD. BUT IT INCLUDED CRUDE SOLD FROM STORAGE, WHICH MEANT THAT IN FEBRUARY IT HAD BEEN HIGHER THAN ACTUAL LIFTINGS. THE OIL IN STORAGE WAS NEARLY ALL AT SEA IN EUROPE, AMERICA AND THE FAR EAST: THE VOLUME WAS WELL BELOW THE PRESS ESTIMATE OF 60 M BBL.

4. KUWAIT PRODUCTION IN MARCH WAS ABOUT 100,000 BD BELOW THE QUOTA TO COMPENSATE FOR QUOTE ACCIDENTAL UNQUOTE OVER PRODUCTION IN JANUARY. THE NIGERIANS WERE 100,000 BD OVER THEIR QUOTA, ON WHICH THERE WAS SOME DISAGREEMENT. IRAN HAD BEEN UNDER QUOTA IN JANUARY, NEAR IT IN FEBRUARY AND UP TO IT IN EARLY MARCH. BUT IRANIAN EXPORTS HAD FALLEN MARKEDLY IN THE LAST 7 TO 8 DAYS: ACCORDING TO JAPANESE SOURCES AIR RAIDS ON KHARG ISLAND APPEARED TO HAVE DAMAGED THE TANK FARM: BECAUSE OF THIS OR PERHAPS BECAUSE THEY WERE SCARED OF MOVING FROM UNDER THE SURROUNDING AIR COVER SIX TANKERS WERE WAITING AT KHARJ. IRAQI ACTION APPEARED ALSO TO HAVE INTERRUPTED THE TANKER SHUTTLE TO THE SOUTH GULF (THE SAUDIS WERE MONITORING TANKER MOVEMENTS).

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5. YAMANI SAID THAT THE NEW SAUDI BUDGET HAD BEEN BASED ON AN ASSUMPTION OF 4 MBD PRODUCTION. THIS WAS QUOTE A PROBLEM UNQUOTE (I.E., TO ASSUME INSUFFICIENT REVENUE TO BALANCE THE BUDGET WITHOUT FURTHER DRAWINGS FROM THE FINANCIAL RESERVES) BUT OTHER OPEC MEMBERS HAD MORE SERIOUS PROBLEMS. NIGERIA WAS NOW AT THE MINIMUM LEVEL OF PRODUCTION NEEDED TO FINANCE THE BUDGET. IRAQ WOULD BE PUTTING AN EXTRA 1 MBD ON THE WORLD MARKET WHEN THE RED SEA AND MEDITERRANEAN PIPELINES WERE COMPLETED IN LATE 1985 AND EARLY 1986. OPEC'S ABILITY TO CONTROL PRICES WAS WEAKENING AND THE RISK OF A PRICE WAR WAS INCREASING. YAMANI DID NOT SEE THERE BEING ANOTHER CONTROLLED DROP IN THE PRICE: IF A CUT CAME IT WOULD BE SHARP- TO BELOW DOLLARS 20 BBL. NIGERIA, FOR EXAMPLE, WOULD INCREASE PRODUCTION IF THE PRICE BEGAN TO SLIDE AND THAT WOULD DRIVE PRICES DOWN STILL FURTHER. YAMANI, WHO LOOKED AND SOUNDED WEARY SAID THAT HE WAS PRIVATELY LESS OPTIMISTIC ABOUT PRICES THAN IN PUBLIC AND ADDED POINTEDLY THAT HE WAS QUOTE GETTING TIRED OF FIGHTING TO CONTROL PRICES UNQUOTE.

6. HE ASKED ABOUT PRESS REPORTS, WHICH HAVE BEEN DENIED, OF FURTHER OIL BARTER DEALS. YAMANI SAID, WITH A SMILE, THAT HE WAS QUOTE NOT FOND OF BARTER UNQUOTE. IF SPENDING MINISTERS COULD NOT GET ALL THE MONEY THEY NEEDED FROM THE FINANCE MINISTER, THEY TRIED TO GET OIL FROM THE OIL MINISTER. THE IMPLICATION WAS THAT SUCH EFFORTS WOULD BE RESISTED, BUT THAT RESISTANCE MIGHT BE OVERRIDDEN.

7. YAMANI COMMENTED ON UK POLICIES AT SEVERAL POINTS IN OUR CONVERSATION: AT THE OUTSET HE REMARKED THAT QUOTE OUR BUSINESS IS IMPROVING, DON'T PUSH IT TOO FAR UNQUOTE. LATER HE ADDED THAT UKCS PRODUCTION WAS HIGH: HE HOPED THAT IT WOULD NOT INCREASE: UKCS EXPORTS, WHICH WERE GROWING IN THE AFTERMATH OF THE MINERS' STRIKE WERE HAVING A QUOTE NEGATIVE EFFECT UNQUOTE ON THE MARKET. HE POINTED OUT THAT THE UKCS WINTER FIGURES HAD BEEN, AS USUAL, SEASONALLY HIGH: THE AVERAGE FOR THE YEAR WOULD BE LOWER: HE DREW YAMANI'S ATTENTION TO OUR 1985 FORECAST RANGE. ON THE CHANGE IN BNOC'S FUNCTION, WHICH HE SAW AS A MOVE TO AVOID PARLIAMENTARY CRITICISM OF FINANCIAL SUPPORT FOR BNOC, YAMANI SAID HE ATTACHED PARTICULAR IMPORTANCE TO OUR IMPROVING ON THE NORWEGIAN SYSTEM OF SETTING A TAX REFERENCE PRICE AND TO HMG CONTINUING TO SELL EQUITY CRUDE IN THE MARKET: IN OTHER WORDS AN ARGUMENT FOR HMG CONTINUING TO INFLUENCE THE UKCS PRICE. HE EXPLAINED THAT BNOC'S TERM PRICES HAD BECOME A DESTABILISING FACTOR AND OUR CONVICTION THAT PRICES SHOULD BE SET BY THE MARKET.

8. COMMENT. YAMANI'S MESSAGE WAS UNDERSTATED BUT NONETHELESS CLEAR. THERE WAS NO FURTHER SCOPE FOR CUTS IN OPEC, AND PARTICULARLY SAUDI, PRODUCTION TO COMPENSATE FOR INCREASES IN NON OPEC
LX4 6. WE SHOULD NOT COUNT ON A REPEAT OF THE SAUDI ACTION IN JANUARY TO SHORE UP PRICES SHOULD THEY AGAIN COME UNDER PRESSURE.

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THERE IS AN ELEMENT OF BLUFF IN YAMANI'S REMARKS. BUT THE SAUDIS MAY BE IN THE COURSE OF PERSUADING THEMSELVES THAT A SHARP DROP IN PRICE WOULD FOR THEM BE MANAGEABLE IN THE SHORT TERM AND PERHAPS EVEN BENEFICIAL IN THE LONG TERM. THE FACT IS THAT ANY SUCH DROP WOULD MAKE IT EVEN MORE DIFFICULT FOR THE SAUDIS TO HOLD TO THEIR FORECASTS OF A BALANCED BUDGET IN THE NEW FINANCIAL YEAR.

FCO PSE PASS SAVING ADDRESSEES

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