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Prime Minister (4)
To note
AT 7/10

MR TURNBULL

7 October 1983

cc Mr Mount

Thanks for a very helpful note
MT

OIL PRICES

UKCS spot crude prices are currently about 50-75 ¢ / barrel below term prices. The weakening of the spot market has occurred during the last week and reflects a general realisation that the market in the 4th quarter is likely to be slacker than expected.

Three main factors have contributed:

1) demand expectations are being revised downwards after earlier optimistic assessments, particularly by the US companies, of the impact on oil demand of economic recovery;

2) supply has increased as all OPEC members with the exceptions of Iraq and Kuwait have edged above their production quotas. OPEC are currently producing oil at about 1 million barrels per day (mbd) above the agreed OPEC ceiling of 17.5 mbd;

3) as a consequence of the above factors, planned stock levels now look too high and some stock reductions are expected during the 4th quarter.

The expectation, therefore, is that the spot market will remain weak although it seems unlikely that BNOC term prices will come under serious pressure during the remainder of this year. BNOC are experiencing some difficulties in reaching agreement on their proposals for the 4th quarter but they are confident that these can be overcome. A cold winter or increased fears about the Gulf of Hormuz could change the situation and the OPEC Monitoring Committee meeting on 27 October may restrain current OPEC production. Nevertheless the position is fragile.

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The prospects for next year look potentially more serious and there is a possibility that the events of early 1983 may be repeated. OPEC demand is likely to fall back towards 17.5 mbd in the second quarter and it will be a test of OPEC's unity whether production will be trimmed back.

In such a situation BNOC will need to ensure that UK CS prices remain competitive with Nigerian prices in order to reduce their vulnerability in a deteriorating market. The UK should continue to resist any OPEC proposals for co-ordination on production levels. This is unlikely to have any effect in stabilising the market in the future, would reverse earlier assurances and run counter to our policy of relying on market forces for the optimal development of the North Sea.

Although 1984 will be a difficult time in the oil market, and the outlook remains uncertain, there is a reasonable chance that a major destabilising crisis can be avoided.

DLP.

DAVID PASCALL