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TO IMMEDIATE F.C.O.
TELEGRAM NUMBER 030 OF 14TH JANUARY 1985.

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INFO PRIORITY RIYADH.

YOUR TELNO 11 : OIL : SAUDI POLICY

1. I HAVE NO DIRECT EVIDENCE OF WHAT WAS IN YAMANI'S MIND AT HIS PRESS CONFERENCE ON 29 DECEMBER WHEN HE SPOKE OF SAUDI ARABIA STARTING A PRICE WAR (FULL TEXT IN MEES OF 7 JANUARY). HIS REMARKS CONTRASTED WITH HIS EARLIER STATEMENT (MY TELNO 604) THAT THE SAUDIS DID NOT FAVOUR ANY KIND OF PRICE WAR. BUT I NOTE THAT HIS REMARKS WERE IN REPLY TO QUESTIONS ABOUT NORTH SEA PRODUCTION RESTRAINT. YAMANI STILL APPEARS UNABLE TO ACCEPT THAT HMG COULD NOT REDUCE UKCS PRODUCTION IF THEY REALLY WANTED TO. HE MAY FEEL THAT SUCH THREATS WILL IN THEMSELVES, PARTICULARLY AT A TIME WHEN THE POUND IS ALREADY WEAK, LEAD US TO RE-CONSIDER OUR PRODUCTION POLICY, AND TO DEFER ANY MOVE ON BNOG PRICING.

2. MY REPLIES TO THE SPECIFIC QUESTIONS IN YOUR TUR ARE:

- A. I DOUBT WHETHER YAMANI HAD THE KING'S AUTHORITY FOR THESE REMARKS. IT IS NOT THE SAUDI WAY, OR THE KING'S STYLE, TO CONTEMPLATE A MOVE WITH SUCH UNPREDICTABLE CONSEQUENCES FOR SAUDI INCOME PLUS, AS YAMANI ACKNOWLEDGES, SERIOUS EFFECTS ON OTHER PRODUCERS AND THUS ON THE INTERNATIONAL FINANCIAL SITUATION. I DO NOT THINK THE SAUDIS WOULD LIGHTLY GIVE UP THE ROLE THEY HAVE BUILT UP FOR THEMSELVES AS GUARDIANS OF MARKET STABILITY. THE KING'S INCLINATION WILL BE TO SEEK A CONSENSUS WITH OTHER OPEC MEMBERS, POSSIBLY AT A SLIGHTLY LOWER PRICE (WHICH WOULD THEN BE DEFENDED) AND TO TRY TO PERSUADE OTHER PRODUCERS THAT THEIR INTEREST LIES IN ALIGNING THEIR PRICING AND PRODUCTION POLICY WITH OPEC'S. I DO NOT SEE YAMANI INITIATING A PRICE WAR WITHOUT THE KING'S PRIOR APPROVAL.
- B. WERE THE SAUDIS NEVERTHELESS TO ACT, IT COULD BE THROUGH A CUT IN THE SAUDI OFFICIAL SELLING PRICE, POSSIBLY BACK DATED TO THE BEGINNING OF THE QUARTER, AND THROUGH THE RELEASE OF A GREATER QUANTITY OF SAUDI OIL ON THE SPOT MARKET.
- C. THE SAUDIS WOULD NOT WANT TO ALIENATE OTHER MEMBERS OF OPEC: THE FACT THAT A PRICE WAR WOULD DO THIS IS A FURTHER RESTRAINT (COMPARE (A) ABOVE). THEY WOULD PROBABLY SEEK TO ARGUE THAT OTHERS HAD STARTED THE ROT BEFORE THEY. THEY WOULD TRY TO CARRY THE OTHER GCC PRODUCERS AND IRAQ WITH THEM.

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D. SAUDI ARABIA'S FOREIGN EXCHANGE RESERVES ARE ALREADY BEING BADLY DEPLETED AS A RESULT OF FALLING OIL INCOME. THE DRAW-DOWN IN THE PRESENT BUDGET YEAR (ENDING 21 MARCH) IS LIKELY TO BE AT LEAST US DOLLARS 20 BILLION. THIS WILL STILL LEAVE RESERVES AT AROUND US DOLLARS 90 BILLION, AND CAPABLE, FOR A SHORT WHILE AT LEAST, OF ACCOMMODATING MUCH HEAVIER DRAWINGS, TO SUPPORT A PRICE WAR. IN THEORY, THERE IS NO CERTAINTY THAT SAUDI ARABIA WOULD BE SUBSTANTIALLY WORSE OFF, IF A LARGE PRICE CUT RESULTED IN HIGHER OIL DEMAND (EXPORTS OF 3.8 MBD AT DOLLARS 15 PER BARREL WOULD GENERATE THE SAME REVENUE AS 2 MBD AT EXISTING PRICES). BUT IN PRACTICE, YAMANI HIMSELF CANNOT BE CONFIDENT THAT WORLD OIL DEMAND, WHATEVER THE SHORT TIME PRICE, WOULD BE SUFFICIENT TO ABSORB SIGNIFICANTLY HIGHER PRODUCTION LEVELS.

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