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BNOC'S OIL PRICING POLICY

Before Christmas, one of the big oil traders on the New York Mercantile Exchange gave its staff T-shirts bearing the slogan "25 in 85". When West Texas Intermediate, the most widely traded US crude oil, fell below $25 per barrel, the traders re-appeared with the T-shirts saying "~~2~~5 in 85".

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Oil industry analysts are not that bearish. With oil buyers holding back in anticipation of falling prices, current world oil production is close to, and quite possibly below, demand. This cannot be sustained for long, since world oil stocks are already very low, particularly in Europe. Longer term, the discouraging oil price outlook is putting a damper on investment in exploration and new development. Over time the structural imbalance between supply and demand will be corrected even if demand remains depressed.

In OPEC mythology it is the North Sea producers, particularly the British, who have let the side down by steadily increasing production, and by fostering a European spot market which has put downward pressure on oil prices. Today it is the animal commercial spirits of traders in North America that is probably the most potent factor in pushing prices down.

Unlike Governments and most consumers, traders relish instability and price movement. Once they sense that they have a commodity price on the run, be it oil or sterling, the instincts of the chase are powerfully reinforcing. The signs are that OPEC will fail to do enough at their Geneva meeting to shake off the psychological challenge of the "$25 in 85" bears.

BNOC now has to set a price for oil purchased in January. Psychology is all important. For BNOC to cut its losses by switching to spot-market-related pricing will be a serious psychological blow to a despondent OPEC. Worse, it would be a stimulus to speculative traders relishing the downward slide of oil prices. (As we know, there are other traders in New York with "$1 = £1" on their T-shirts.)

Both Energy and Treasury want to avoid changing BNOC's official pricing policy at this critical juncture. They are right, especially in the light of today's news of a $2 or more price reduction by the Mexicans who are the fourth largest producer. At what point are the Saudi's provoked into radical measures like a sharp price drop? That would concentrate minds greatly, including the minds of those planning the next wave of production investment in the North Sea and other high-cost areas.

At your meeting on 16 January, it was agreed that BNOC should seek, as far as possible, to disengage from participation contracts. Peter Walker should be pressed to pursue this with urgency. For BNOC to be a heavy forced seller on a weak spot market does nothing but depress prices.

JM

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