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cc MASTER

10 DOWNING STREET

From the Private Secretary

30 January 1985

Dear Michael

BNOC AND OIL PRICES

The Prime Minister held a meeting yesterday morning to discuss developments in the oil market. Present were the Secretary of State for Energy and the Chancellor of the Exchequer.

There was a brief discussion of the Secretary of State for Energy's meeting with the Nigerian Oil Minister. This concluded that even though it was difficult to do business with the Nigerians it was necessary to keep in touch with them. The Secretary of State for Energy said he had received a report from Shaikh Yamani at the conclusion of the first day of the OPEC meeting. Yamani was confident that the meeting would produce a good settlement on prices and that production would be cut to 14 mbd for the next quarter, a figure which would be monitored by the new audit group. The Secretary of State for Energy said Esso believed that if production were held at this level it would, in the short term at least, have a significant effect on prices as it would require a stock draw down of 5 mbd as opposed to the 3 nbd which most oil companies were expecting. There were, however, two adverse factors. In the short term, there was the prospect of a scaling down of oil burn by the UK which would reduce demand for heavy fuel oil by 500,000 mbd. In the longer term there were doubts about OPEC's ability to restrain production as on previous occasions it had responded to any easing in the immediate pressure by breaching agreed production levels.

The Secretary of State for Energy said Shaikh Yamani believed that there was a change of view about oil prices in the US Treasury, partly reflecting a change of officials. The US Treasury were no longer pressing so hard for a reduction in oil prices to $25 per barrel, but was now giving greater weight to the implications for the US banking system of a fall in oil prices.

The Chancellor of the Exchequer hoped the current uncertainty would be resolved quickly as this was particularly damaging for sterling. He hoped also that the settlement would include a reduction in the price of Arab

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Light as without this the package was unlikely to be credible. In discussion, it was agreed that BNOC could not settle its January prices until the outcome of the OPEC meeting was known. It would be necessary to inform Yamani before any announcement was made. This could be done by delaying an announcement until after 6 February when he would be in London on his way to Washington where King Fahd would be meeting President Reagan. This would give the Government an opportunity to explain its position fully. Yamani would, of course, press for production cutbacks by the UK though he was well aware of the Government's position on this issue.

The Secretary of State for Energy said BNOC had made a little progress in scaling down its participation contracts but it could proceed only cautiously as any major and overt move would incur OPEC hostility.

Summing up the discussion, the Prime Minister said no decision on BNOC's prices could be made at present. If possible, this should be delayed until after 6 February when Ministers would be able to explain the Government's position fully to Shaikh Yamani. Meanwhile BNOC should continue, as far as possible, to wind down its participation contracts. The eventual aim should be to take BNOC out of the pricing arena.

I am copying this letter to Rachel Lomax (HM Treasury) and Peter Ricketts (Foreign and Commonwealth Office). As with earlier correspondence on this subject, I should be grateful if it were shown only to those who strictly need to know of its contents.

Yours sincerely
Andrew Turnbull

Andrew Turnbull

Michael Reidy, Esq.,
Department of Energy.

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UK's ENERGY RESOURCES STRONG ACROSS ALL FUELS NOT JUST OIL

In 1982, the latest year for which figures are available, the UK was more than self sufficient in coal and we produced three quarters of our own gas consumption. By contrast Japan, France, Italy and Germany needed to import most of their gas requirements. Japan and Italy also needed to import the bulk of their coal requirements.

Percentage Self Sufficiency in Coal, Gas and Total Energy*

	Japan	Italy	France	Germany	USA	UK
Coal	19	8	52	99	107	106
Gas	8	48	26	34	92	78
Total Energy	18	20	40	48	88	119

* See annex for details.

2. Even if North Sea oil production stopped completely our coal and gas supplies and our nuclear and hydro generating capacity would be enough to meet more than 60% of our total energy requirements. Germany and France can produce less than half their requirements. Japan and Italy produce less than a fifth of their energy needs.

AJM/EcS
29/1/85

UK's Relative Fuel Self Sufficiency in 1983

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		Coal	Oil	Gas	Nuclear	Hydro	Total
UK	Production	71	118	34	13	2	239
	Consumption	67	74	44	13	2	200
	Net imports etc	-4	-44	10	-	-	-39
	Self Sufficiency %	106	159	78	100	100	119
USA	Production	480	485	389	80	87	1521
	Consumption	448	695	420	80	87	1734
	Net Imports	-32	210	31	-	-	213
	Self Sufficiency %	107	70	92	100	100	88
Japan	Production	12	-	2	27	23	63
	Consumption	62	214	25	27	23	351
	Net Imports etc	50	214	23	-	-	288
	Self Sufficiency %	19	0	8	100	100	18
West Germany -	Production	84	4	14	16	5	123
	Consumption	85	109	41	16	5	256
	Net Imports	1	105	27	-	-	133
	Self Sufficiency %	99	4	34	100	100	48
France -	Production	14	2	6	36	18	77
	Consumption	27	88	23	36	18	192
	Net Imports	13	86	17	-	-	115
	Self Sufficiency %	52	3	26	100	100	40
Italy	Production	1	2	11	1	10	26
	Consumption	12	82	23	1	10	130
	Net Imports	11	80	12	-	-	104
	Self Sufficiency %	8	2	48	100	100	20

Source: IEA provisional energy balances for 1983 (April 1984)

Sterling and Oil Market Weakness

1. The prospect of collapsing oil prices is thought to affect sterling's relative parity in two ways. First, the currencies of the major net oil importers are boosted - this is a question of the Yen, Lira, Mark, Dollar rising rather than sterling falling. Second, the market believes that a falling oil price is likely to make it harder for the Government to keep to responsible money and fiscal policies. The apparent but misleading tendency for a falling £ to boost North Sea tax revenue in Sterling is part of this. It is misleading because the real effect of the falling £ is to boost inflation, boost public expenditure, while raising exports and reducing imports. It therefore reduces the scope and the need for a fiscal injection.

2. In any defence of sterling it would be counter productive to stress the UK's degree of energy self sufficiency; that would only reinforce the degree of gain that oil importers stand to gain from falling oil prices, boosting their currencies and as a counterpart weakening sterling. It would equally be counter productive to stress the extra oil tax revenue the Chancellor would receive from the falling £. That in a sense is what the market most fears

3. A better combination of arguments would be

a) Oil prices still stand at record levels in terms of the basket of manufactured goods that can be bought - this is largely because of the sharp rise in the Dollar.

b) UK non-oil exports (more than 85% of our total exports of goods and services) are rising sharply, up [11%] in volume over latest year, and would be boosted by a fall in oil prices.

c) UK non energy industry and services (90% of the economy) would have its costs lowered by falling oil prices.

d) Oil countries might not benefit so much from oil price falls because the result coul

well be for a period of energy supply an price turbulence. In such turbulenc insecurity, countries like the UK relatively secure in their er would be better placed to wea

e) Determination to continue to rec to increase the scope for initiat the reward for enterprise.

f) Adjustment to exchange rates since 198 removed the "petrocurrency" gains made b 1980 and 1982. In real terms sterling is now highly competitive. Any further fall w not only be an unnecessary incentive, but wou needlessly damage our economic trading partner.