CONFIDENTIAL

BF Wednesday meeting folder

(2)

Prime Minister

An added complication is that Nigeria have deliberately set the price of its main crude at exactly the current BNOC price for Brent crude. Thus BNOC has no room for cutting prices without undercutting Nigeria. I will arrange another meeting on this before your lunch with Mr Walker on Wednesday.

AT 31/1

MR ~~TURNBULL~~ 31 January 1985

OIL PRICES IN THE AFTERMATH OF THE OPEC MEETING

The world's oil markets are the subject of much analysis. For all that, hard information is difficult to come by, even on basic elements such as production, demand and stocks. The latter is particularly obscure. For want of hard facts, sentiment and rumour play an important part in the behaviour of oil markets and the movement of prices. Hence, the importance of BNOC's next move on pricing - should we give OPEC a vote of confidence by leaving the official price unchanged, or not?

For weeks now oil company crude buyers have been holding back and buying no more than the bare minimum. With OPEC in disarray and spot oil prices falling, this made sense. Not surprisingly, the January liftings of oil from the OPEC producers have been unusually low; Shell would say around 15 million barrels per day (b/d); others, including Yamani, have quoted 14 million b/d. That means a shortfall against the world's demand in January of something like 1.5 - 2.5 million b/d. In other circumstances (such as those following the Iranian Revolution in 1979) this would have caused a panic. As it is, commercially-minded buyers have held back and dug ever deeper into their oil stocks.

The interesting thing is that as far as most experts can judge the world's operational oil stocks are now very low - even approaching the minimum. Some argue that this is not as crucial as it might appear, since there is a large cushion of compulsory emergency stock; some Governments are prepared to turn a blind eye to the use of such stock, thereby reducing the cost of oil imports.

CONFIDENTIAL

In any event, we now have a situation where:

- There are no uncommitted oil cargoes available for immediate delivery in Europe. (A reflection of this is the fact that the price of Brent crude for immediate delivery is nearly $28 per barrel - versus BNOC's official price of $28.65 per barrel).

- Significantly less cargoes than usual are on their way from the Middle East and Africa because of the recent stand-off by buyers.

- Yet in February and March there should be pent-up demand - perhaps 1 million b/d above the 16 million b/d limit which OPEC's new auditors will be policing.

- Action against tankers in the northern part of the Arabian Gulf is hotting up and the immediate signs are that little oil will be leaving Iran because the Iranians are not offering a large enough risk premium.

- In the United States, the most sensitive weathervane of the oil market, stocks have fallen sharply and product prices have perked up. This should underpin the price of the most widely-traded United States domestic crude, West Texas Intermediate, whose recent slide has played a large part in the bearish sentiment of the market.

- Yesterday's agreement by OPEC was as solid as anyone could realistically have expected. (At least the light crude producers in the Gulf do not need to cheat on price to sell their production entitlements).

On the face of it, these positive indications should be persuading oil buyers to uncross their fingers, get into the market and buy. Against that, spring is round the corner and with it fears that OPEC will again be in difficulty.

My instinct is that the market is at a potential turning point. If BNOC holds its price, buyers will be encouraged to move in and buy more than the bare minimum. Spot prices will harden - probably above the official price. The recovery may not be sustainable, but while it lasts it will be helpful to sterling and interest rates.

JOHN WYBREW