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PRIME MINISTER

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OIL PRICES

Many of the world's top oil traders will be in London later this week, not least to hear your speech at the Institute of Petroleum Dinner. They will have left their monitor screens secure in the belief that, if only briefly, the oil markets are relatively tranquil.

Since the OPEC meeting last week the downward slide of oil prices has been arrested. North Sea oil for immediate delivery is trading close to official BNOC prices. Around the cocktail circuit there will be much speculation as to whether this is a brief respite before a further slide - perhaps collapse - or the onset of a period of fragile stability. The American traders are the most bearish. The Europeans, including the analysts in BP and Shell, are more open-minded:

They concede that world oil demand is weak. US economic recovery seems to be slowing. Oil demand in Europe is still easing down. Overall demand in 1985 now looks like being only marginally higher than it was in 1984. On the other hand, OPEC production, at less than 16 million b/d, is probably below the current requirement for OPEC oil. Oil stocks are very low and should continue falling unless February and March are unseasonally mild. This Spring there could be an interesting coincidence between stocks reaching minimum levels around 4 billion barrels, just at the time when OPEC is normally under greater strain.

The sceptics doubt OPEC's ability to operate within their self-imposed production ceiling of 16 million b/d, even with a competent auditor around to blow the whistle. Others believe that the new OPEC price differentials are less liable to induce cheating on price and, with it, cheating on volumes. All accept that Nigeria is a weak link since it is exposed to the strong market forces around the Atlantic Basin.

Amidst this speculation, there are a few points of widespread agreement - particularly on events that would trigger a further downward spiral of oil prices. One such is any reduction of BNOC's official price. This would be contrary to expectations and would be seen as putting irresistible pressure on the Nigerians to move down, and thereby destroy OPEC's fragile defences.

Action Items

Treasury will be supporting Energy in not wanting to risk a reduction of BNOC's official price for oil purchases made in February and March. However, they would like to retrieve BNOC's £20 million losses in January by paying producers the average price realised in the market - essentially the average spot price, $1.50 below official. Provided the presentation is well handled, this is a good ploy. The risk of Nigerian retaliation should be confined to current and future BNOC pricing.

That ploy is probably a one-off, so Peter Walker's lack of progress in reducing BNOC's availability is a pressing concern. He may mention some success with BP, but we understand that this related to December; by January BNOC had taken the oil back into their trading portfolio.

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JOHN WYBREW