Prime Minister (2)

A meeting has been arranged for Wednesday 6 March to discuss BNOC's withdrawal from contracts. PW is expected to circulate a note beforehand.

CONFIDENTIAL

AT 1/3

I will keep next Sunday lunch free

MR TURNBULL

1 March 1985

THE OIL MARKET

BNOC's respite has been brief. Two weeks ago a cargo of North Sea oil sold on the spot market for immediate delivery would have made a modest profit. Now BNOC would lose at least \$0.5 per barrel, and oil for sale in the latter half of March would cost BNOC around \$1.0 per barrel.

There is no cause for panic. There is not the pent-up pressure for a downward slide of oil prices such as we saw in December and January.

Free world demand is still stagnant at around 46 million B/D. The net demand for OPEC oil in 1985 is likely to be around 0.5 million B/D less than in 1984, but OPEC discipline on production quotas is being maintained and deviations from official OPEC prices have become fewer. The other stabilising factor is the exceptionally low level of oil stocks held by the oil companies. Shell and Esso independently estimate that commercial oil stocks are very close to the minimum required for the world oil supply system to function smoothly. The trend is striking:

Years	Commercial oil stocks in days of average consumption
1982	99 days
1983	91 days
end 1984	79 days
mid 1985	69 days (continuing)

BNOC remains a problem. A reduction of BNOC's official price, either by a fixed amount or by moving to a new basis and tracking the spot market, still carries a high risk of upsetting OPEC members, although of course BNOC's forced spot sales are already putting downward pressure on prices. The Nigerians - so far continuing to sell their oil at what for them is a worryingly high price - would feel bound to respond. OPEC's fragile unity would be ruptured and bearish oil traders would begin another squeeze.

BNOC is exposed to financial risks on one-third of its total availability, ie 500,000 B/D. BNOC is now back in the red in having to sell this large volume through weak spot markets. The case for winding down BNOC's loss-making availability remains compelling. The security-of-supply argument has evaporated. Shell's latest 5-year forecast sees a continuing large surplus of supply potential.

Relying solely on BNOC's contractual arrangements, the loss-making availability could be reduced from the current 500,000 B/D to 210,000 B/D by 1.1.86. It should be possible to speed up the process by persuading the oil companies voluntarily to waive contractual arrangements already made - another challenge to Peter Walker's negotiating skills.

Peter Walker goes before the Energy Select Committee next Wednesday to defend his policy on BNOC. The parliamentary debate on the additional £25 million required for BNOC is likely to be around 15-20th March. Between those events would seem a good time to initiate the run-down of loss-making availability. We understand that nothing has been done so far.

JOHN WYBREW