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MR NORGROVE

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THE OIL MARKET

The oil market is buzzing with speculation and rumours that Saudi Arabia is concluding new "netback deals". Under these, they would sell upwards of 1 million b/d of additional crude oil at a price netted back from the prevailing spot market prices for oil products. Such deals are attractive to the oil companies and the Saudis would have no difficulty in finding ready customers.

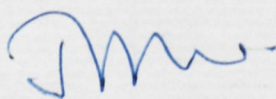
Does this mean that Saudi Arabia has abandoned its role as OPEC's swing producer - the means by which supply is kept closely in line with demand and oil prices are held artificially high? My information - especially from Petroleum Economics Ltd, a reputable firm of analysts who have high-level contacts in the oil companies and OPEC - tends to confirm such a policy change.

The Saudis have had a fundamental rethink and concluded that their fast shrinking share of OPEC production - at times below 2 million b/d - is unacceptably low. They aim to re-establish and then defend a production level of at least 3½ million b/d. They see netback deals to integrated oil companies as the least disruptive way of achieving this. They will argue that in theory, provided the other OPEC members share the burden of balancing supply against demand, netback deals need not entail a discount off official prices.

Some experts still see this as a threat rather than an accomplished fact - the Saudis putting pressure on other OPEC members before the OPEC meeting early in October. But this hope is belied by the fact that Exxon has already chartered five large tankers and Mobil and Texaco are rapidly withdrawing from alternative crude oil sources.

Exceptionally low oil industry stocks and a seasonal pick-up of oil demand may allow sufficient room for the higher Saudi production to be accommodated in the fourth quarter without undermining oil prices. But unless the other OPEC members genuinely achieve a greater measure of self-discipline than hitherto, the Spring of next year will see world oil production significantly in excess of demand and prices sliding fast.

The Saudis do mean to test the collective will and nerve of their fellow OPEC members.



JOHN WYBREW