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THE OIL MARKET

There is a striking contrast between the current buoyant state of the oil market and the gloomy prognosis for next Spring. Today, North Sea oil is nudging $30 per barrel, yet some bets would have it below $20 per barrel by the Spring. It may be helpful to separate the facts from speculation about how the poker game between the producers is played out.

The Facts

World oil demand is stagnant, and likely to remain so next year. Oil stocks continue at minimum operational levels, because no-one wants to hold a commodity in an over-supplied, falling market. Saudi Arabia has abandoned its role as OPEC's swing producer, changed its pricing policy and has boosted production from 2 to 4 million barrels per day - close to its nominal share of OPEC's official production ceiling of 16 million barrels per day.

The timing of Saudi Arabia's move was shrewd. The additional oil will hit the market just as the hand-to-mouth demand from oil buyers approaches its Winter peak. Meanwhile, buyers who have held back until the last moment are scrambling to meet early Winter demand. Heating oil stocks are particularly low in North America. Hence, the recent hardening of spot oil prices.

Forecasts of how long the market will remain firm range from December to next March, partly depending on the severity of the Winter. Thereafter, something will have to give. Assuming no growth of OPEC's production between 1985 and 1986, there is still likely to be a production surplus exceeding 1 million barrels per day.

The Speculation

Some OPEC producers, such as Iraq, Nigeria and Ecuador, are apparently intent on raising production. Even if Saudi Arabia is prepared to throttle back after this Winter, supply and demand cannot be balanced. Before long, oil prices will start falling rapidly. When the OPEC producers meet, it will take more than good intentions to arrest the slide; the price floor created by normal physical and economic factors is much lower than anyone dare contemplate. The poker game will be at its most intense. Non-OPEC producers will be urged to join in.

However, the players recognise that this is a game which none of them can win. Their oft-displayed survival instincts may yet result in the players throwing in their hands and finding a compromise solution. That would still be my bet.

JW

JOHN WYBREW