7. Monetary Base Control

20/3/81 – 2/4/81

MR TURNBULL

cc Mr Middleton
Mr Britton
Mrs Lomax
Mr Pirie
Mr H Davies

TIMETABLE FOR NEXT STEPS ON MONETARY CONTROL

Mr George has described to me the following, largely institutional, steps:

a. Mr Somerset, in his role as the clearers' "bank manager", will see them individually about the average voluntary level of balances they will hold with the Bank. This will determine the level of the mandatory "lock-up" of non-operational balances by all banks necessary to give the Bank the equivalent of the income they used to get from the 1½% cash requirement on the clearers only;

b. the Bank have to decide internally how the new requirement should be denominated. They are inclined to stick to eligible liabilities. I think we can leave this to the Bank;

c. after a. and b. the Bank will see the separate banking associations in the week beginning 30 March for formal discussion of the monetary control document which has already been discussed informally;

d. individual banks who want to get the status of having eligible bills will apply bilaterally to the Bank;

e. the RAR will cease to be a minimum at the end of these talks, perhaps by the end of May. This timing is uncertain but it is intended to allow for a lot of detail eg about the new statistical list defining the "banking sector", effective dates and decisions about individual eligible acceptors etc. I have asked the Bank why the RAR could not cease to be a minimum before all the other details are sorted out;

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f. the supervisors will open talks through the British Banking Association. They will be aiming to settle with individual classes of banks with particular liquidity norms to replace the general norm equivalent to the RAR. The supervisors would like this replacement to take place as soon as specific normas are settled. But it may be that there will be objections on competitiveness grounds if some banks are released from the RAR norm before others. Mr George is reminding Mr Page that he still owes us a paper on the prudential timetable.

N MONCK
20 March 1981

Bf for Britton/Monck

MR MIDDLETON

cc Mr Burns
Mr Britton
Mr Monck
Mr Riley
Mr Turnbull
Mr Grice
Mr Shields

MONETARY STATISTICS

Peter Stibbard (CSO) rang me about the new figures for the monetary base. The Bank have already approached him about including monthly figures in Financial Statistics (they will not for the time being at least appear in the Bank's own press notice). The new table will probably appear for the first time in the May edition. Unless we tell them different, CSO will simply reproduce what the Bank give them - "total 1-3" and all. I had previously warned Peter Stibbard that we might want to have an Mo series; do we want to press the point, or shall we abide by our temporary truce with the Bank?

2. You will be interested to hear that Peter Stibbard has booked space in either the May or the June Economic Trends for an article on (non-bank) private sector gross and net financial wealth. I hope we can keep to this timetable.

RL

RACHEL LOMAX
25 March 1981

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cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Sir D Wass
Mr Ryrie
Mr Burns
Mr Unwin
Mr Monck
Mr Britton
Mr Turnbull
Mrs Lomax

10 DOWNING STREET

MR. BURNS
MR. MIDDLETON

MONETARY BASE CONTROL

I have received the enclosed memorandum annotated by the Prime Minister. I thought you ought to see it so you know what our remit is.

Pl attach to Mr Middleton's min of today's date Monetary Control
10/4/81

25 March 1981 ALAN WALTERS

1585/3

Mr Lankester

PRIME MINISTER

MONETARY BASE CONTROL

1. I propose that, now the budget is over, we try again to introduce MBC. In my view it is of considerable urgency.

2. At present there is no ostensible monetary control. We are not moving interest rates according to some rule about the excess of monetary ($£M_3$) growth over target values. We need to control the base of the banking system and at present we have very inadequate means to do this.

3. There is a lot of liquidity in the system mainly in the form of interest bearing financial assets. In order to prevent an explosion in the means of payment, we ought to prevent these financial assets being converted into money. MBC would enable us to avoid such a monetisation.

4. Some problems of adaptation remain but they are minor. My contacts with discount houses have shown that these firms could very quickly adapt to MBC. Indeed in many respects such adaptation has already occurred. The other objections raised by the Chancellor - the behaviour of the building societies and the fate of the two gilt jobbers - need to be examined again, but I doubt if they should constitute a lasting barrier to MBC.

5. If you agree, I shall pursue this further with Middleton and Burns and then the Chancellor.

Agreed - but we stick to £M3 for our MTFS target not.

AAW

12 March 1981

cc Mr. Lankester
Mr. Wolfson
Mr. Hoskyns
Mr. Duguid
Mr. Strauss

TELEPHONE
01-601 4444

BANK OF ENGLAND
LONDON EC2R 8AH.

1 April 1980

Mr Lankester [illegible] cc Mr Middleton
Mr Hine [illegible] [illegible]

Out of the blue with no hint of this exchange in my correspondence with [illegible] Kensfield. However probably no harm done in the event.

[illegible] 1 April

Leonard Williams Esq DFC FCA
Chief General Manager
Nationwide Building Society
New Oxford House
High Holborn
London WC1V 6PW

Dear Leonard

You will recall that when we met on 18 March, I promised to let you have some details of what we were proposing to ask from the banks in respect of retail deposits.

The fact of the matter is that for some time we have felt a need for a measure of money which might more accurately represent transactions balances than our present aggregates. M1, as you know, consists only of notes and coin and sight deposits, whereas in practice payments may often be made from other types of deposit. On the other hand, sterling M3, being the total of non-bank resident sterling deposits, obviously includes a good deal of portfolio or wholesale balances.

What we are therefore seeking from the banks is something in between. In the light of some recent discussion with them, what we now have in mind is that the new series should comprise

(i) all non-interest-bearing sight deposits;

(ii) all other accounts on which cheques can be drawn or from which standing orders or other direct payments can be made;

(iii) all other deposits below £100,000 in size and withdrawable either by law or by common practice within one month - such maturity to be defined in residual rather than original terms.

Obviously, quite a few of the details of the proposed series remain to be settled and it will be some time yet before we get any actual figures. When we do, and when we are satisfied

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that teething problems have been solved, then we shall aim to publish them in our Bulletin. It is likely that when we do so, we will also show alongside them for purposes of comparison figures of shares and deposits with building societies, probably on a similar basis to those already included in the published PSL 2 series (ie excluding SAYE accounts and term shares).

Yours Sincerely

John [illegible]

MR MONCK

cc Mr Middleton (for info)
Mr Britton
Mr Turnbull
Mr Grice
Mr Shields
Mr H Davies

MONETARY BASE CONTROL; WHERE NOW?

I attach a draft of the paper on MBC: it is very much a first shot and rather long and rambling as a result. But you may like a chance to see it before I go on leave (3-15 April inclusive). I am not sure when we can have a meeting on all this, as others will be going on leave as I return. It may be best, therefore, if people let me have their comments in writing, for my return.

RACHEL LOMAX
2 April 1981

Encl.

DRAFT

FURTHER THOUGHTS ON MONETARY BASE CONTROL

Introduction

The papers prepared for the PM's Seminar last autumn identified a number of problems with the system of monetary control, as it then was. Since then, a number of innovations have been made which have been publicly justified both as "desirable in their own right" and as contributing to a possible eventual move to some system of monetary base control. Mr Turnbull's paper explains what the recent changes might be expected to contribute to monetary control, when they are fully implemented, and discusses what further improvements might in their own terms be worth making. This paper looks at where we now stand on the question of MBC. What, precisely, might we hope for from a further move to MBC that we will not get from the system of monetary control as now conceived? Can we narrow down the serious options on MBC any further, following the internal debates over the last six months? What can we learn from the operation of the new system, about the merits and feasibility of one or other forms of MBC? What further changes would be needed to get to one of these options, from where we are now? And have the changes we have made up till now all been in the right direction, from this point of view?

Monetary base control: as a technique of control

2. The debate that followed the publication of the Green Paper was dominated by the value of monetary base control as a technique of control. In the absence of direct controls on credit, the main way in which the Bank has sought to influence monetary conditions is through its operations in short term

money markets* - ie. "by supplying cash to or withdrawing cash from the banking system through open market operations, with a safety valve, which may be used to a greater or lesser extent, in the form of discount window lending" (E George 4 February). Traditionally, money market operations have been directed towards securing the Bank's objectives for short term interest rates. Monetary base control was seen, above all, as providing an alternative quantitative basis for these operations, according to which the Bank would focus on the amount of cash supplied rather than on its price.

5. The technical case for MBC is that it would provide a more appropriate and reliable means of controlling the targeted monetary aggregate than the alternative technique of manipulating interest rates to influence the demand (and supply) of money. Discretionary control of interest rates was said to have the following disadvantages:

(i) the authorities can only directly influence short rates, but broad money depends on relative interest rates. The link between the level of short rates and broad money (and possibly other aggregates) is tenuous and poorly understood;

(ii) if the authorities fix interest rates, errors and unexpected shocks will show up in the target variable - money. There is a risk of giving misleading signals to the market. Policy may, unwittingly, be given an inflationary bias, as inflationary shocks are accommodated and prove hard to reverse;

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*It also operates in other financial markets, notably the foreign exchange market and the gilt edged market. While it now uses a quantitative rule to determine its operations in foreign exchange (ie no net intervention) it has traditionally acted as a price taker in the gilt edged market.

(iii) interest rates are too political an instrument to use flexibly (there will be a "bias to delay" at least in the case of upward movements).

4. Is MBC really the answer the these problems? An alternative approach to (i) is to target one of the narrow aggregates, which has a better defined relationship with short term interest rates. Even if this is not possible, the case for MBC depends not on the empirical weakness of the link between interest rates and the demand for money but on the demonstrable superiority of the money multiplier relationship (between base money and the target money supply). In practice however institutional arrangements have made it impossible to judge this point in the UK.

5. On (iii) it can be argued that the mere fact that interest rates are so highly political makes it impractical to relinquish control over them, as implied by MBC. On the other hand, similar arguments apply to exchange rates and the Government has managed to convince an important section of opinion that there is little it can do to reverse a highly unpopular movement in the rate over the past two years.

6. Whether (ii) is a serious problem or not depends on the nature of the shocks to which the demand for money is most frequently subject. In some cases it may be desirable to allow the money supply to respond to unforeseen events. Failure to accommodate unexpected changes in the demand for money, relative to nominal incomes, will involve unnecessary changes in interest rates which will destabilise the real economy. On the other hand, the appropriate response to unforeseen movements in nominal incomes will typically be an offsetting movement in interest rates.

7. Whether interest rates or the monetary base provide a better operating guide is therefore an empirical issue. But note that precisely the same question arises in choosing between the monetary aggregates and interest rates as intermediate targets. The implication of taking some measure of the money supply as the intermediate goal of monetary policy is that unpredictable shifts in velocity are less of a problem than unforeseen movements in nominal incomes. Choice of a money supply target thus establishes some presumption in favour of the base as a useful operating guide.

8. Before leaving techniques of control, it is worth noting another group of problems which we identified last autumn which have an indirect bearing on the case for MBC - the shortage of effective monetary policy instruments. The authorities have no direct control over long term interest rates - though whether this is self-imposed or an inevitable corollary of the Government's domination of UK long term capital markets has been hotly debated. The range of available debt instruments is limited (though it is now being widened). The RAR, never very useful, has now effectively been abolished; special deposits have been zero since the middle of last year. The scope for directly influencing banking sector liquidity (other than through open market operations) is correspondingly limited. The scale of the distortions revealed by the removal of the SSD scheme has, for the time being, seriously discredited direct controls while the abolition of exchange controls has severely limited their potential usefulness in the future.

9. There are a number of implications for the MBC debate. First the lack of alternatives underlines the need to conduct money market operations as effectively as possible. Second, if MBC could increase the range of monetary policy that would be an important advantage. It is sometimes argued, for example, that MBC would be a way of putting pressure on the banks to modify

their behaviour in ways that would be helpful to monetary control rather than as at present, responding passively to the demands of their customers. (This was the Mervyn Lewis argument). Attractive as this argument is, however, it has been treated with considerable scepticism by almost everyone who has ever had anything to do with practical banking - and while that is scarcely conclusive, there is no evidence on the other side either.

10. Thirdly, the objections to direct controls extend to some forms of MBC as well. We concluded last autumn that the abolition of exchange controls made it impractical to attempt to control £M3 (or any other broad money aggregate) by mandatory MBC* The reasons were spelt out at length in the TSCS Report on Monetary Policy. While in principle it might be possible to use MBC to control a narrower aggregate, like M2, there would still be scope for domestic disintermediation and distortions, especially if building society deposits were excluded from the definition of M2. The value of so doing, despite these problems, also depends, of course, on whether the narrower aggregate was thought to be sufficiently well related to final objectives to be suitable as a target.

Monetary base: as an intermediate target

11. The debate about control techniques took it for granted that the intermediate objectives of monetary policy would be defined by a target for the money supply. But internal discussions have ranged more widely. The unexpectedly rapid growth of £M3 at a time when other indicators were suggesting that policy was very tight, raised fundamental questions about the way in which monetary policy objectives were defined. Was

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*Or by a negotiable entitlements scheme.

£M3 a suitable target? Was it sensible to rely only on one measure of the money supply? Was it even right to define monetary policy exclusively in terms of a money supply target and ignore other indicators of monetary stance like real interest rates and the exchange rate? Monetary base control as defined above (a rule for determining the basis on which open market operations are conducted) has a place in this wider debate, since what should be controlled turns, at least in part, on what can be controlled. But the monetary base was also considered not as a short term operating target, but as a longer term intermediate target - a proposal which does not necessarily involve radical changes in techniques of control (though it might).

12. The case for the monetary base as an intermediate target is that it is at least as well related to final objectives as other monetary aggregates and that it has the advantage of being more directly controllable. The internal papers prepared earlier this year cast doubt on both these propositions. It is only the currency component of the base that appears to be systematically related to GNP or prices: but since currency has been entirely demand determined it is difficult to see this as evidence of a causal link from the base to nominal incomes. In the short term at least, it would be surprising if the relationship between the base and nominal incomes were as good as that between broader measures of money and GNP, since the base/GNP relationship will be disturbed by shifts in the money multiplier as well as by the shifts in velocity which upset the link between broad money and GNP.

13. We concluded that the wide base might even be more difficult to control than M1. True, there is daily information about the base. But 85% of the base consists of the public's holdings of notes and coin. The enormous

disparity between the banks holding of cash and the public's means that a simple policy of offsetting movements in one against the other would not be practical. Control of the wide base would not be different in principle from control of M1 or £M3, whether the Bank's operating rules were formulated in terms of prices or quantities. A surge in the public's demand for notes and coin would require the Bank either to squeeze the supply of cash to the banks (or equivalently, to drive up interest rates), until the banks bid notes and coin away from the non-bank (or, what amounts to the same thing, the public's demand for notes and coins is reduced to the required extent). The problem is that the relationship between the wide base and interest rates seems to be considerably weaker, less stable and more poorly determined than that between M1 and interest rates. Control of the base would probably be less certain, and require wider swings in short term interest rates, than control of M1.

Narrowing the options on MBC

14. Recent discussions have probably put us in a position to rule out some options altogether viz:-

(i) MBC as a technique for controlling broad money (£M3 and the PSL's);

(ii) targeting the monetary base as an alternative to the money supply proper (M1 or £M3)

That leaves mandatory MBC as a means of controlling narrow measures of money; and non-mandatory control of bank holdings of cash (ie. bankers'balances and, possibly till money). Memories of the corset make all forms of mandatory MBC fairly unattractive. But the main problem is the lack of a suitable target aggregate. Disintermediation would almost certainly be a severe problem with M1. Even if figures for M2 are available later this year, it will be a number of years before we can tell whether it will be a suitable target aggregate. It will take three years merely to determine its seasonality. For practical purposes, therefore, we can rule out an early move to <u>any</u> form of mandatory monetary base control.

15. The main problem with non-mandatory control of banks' holdingsof cash is that there is no guarantee that it would lead to improved monetary control. That would depend on the stability of the money multiplier*. While we can infer something about the money multiplier by observing the stability of the relationship between the public's holdings of notes and coins and total deposits, present institutional arrangements mean that the banks do not have a well determined demand for bankers' balances: their demand for cash is dominated by their precautionary holdings of till money. There is every reason to expect changes in the terms on which cash is supplied to produce a radical change in the nature of the bank's total demand for cash. In our present state of knowledge we are in no position to judge whether or not the money multiplier is likely to be more stable than the relationship between short term interest rates and the relevant measure of the money supply.

16. Non-mandatory MBC might also raise the question of the appropriate monetary target. The narrow base might turn out to be well related to M1 or M2, but not to £M3. But the value of such a link with narrow money would depend on the significance attached to targeting these aggregates.

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*Defined as $m = \dfrac{1}{1 - (1 - r)(1 - c)}$ where r is the ratio of bank holdings of cash to total deposits, and c is the ratio of public holdings of currency to deposits.

17. The fundamental issue is, however, the continued definition of monetary policy in terms of money supply targets. It clearly makes no sense to evolve in the direction of any form of MBC if the commitment to using targets for the monetary aggregates as the basis for setting interest rates is wavering. The Budget marked a re-affirmation of broad money targets as a basis for setting <u>fiscal</u> policy instruments: but the decision to "take a wider range of factors into account in determining interest rates" seemed to imply a move away from money supply targets as the basis for determining <u>monetary</u> policy instruments. There is an obvious tension between making interest rate decisions more discretionary (as is involved in widening the range of relevant criteria) and making them more endogenous to decisions about quantities (as implied by MBC). Until this conflict is resolved, we cannot judge whether there is a case for moving any further in the direction of MBC, in any form.

Recent Changes in monetary control techniques

18. In this critical respect, developments since the autumn have not been favourable to the eventual introduction of MBC. On a more technical plane, however, some of the changes announced in November would be helpful if we decided to adopt MBC (in the sense of a quantity based approach to money market operations). The abolition of the reserve asset ratio is the most important; a primary liquidity requirement of this sort is quite incompatible with any form of MBC as it involves treating certain short term liquid assets as effectively as good as cash. The steps the Bank are taking to broaden the bill markets, by widening the range of eligible bills, are designed to improve the flexibility of their open market operations. In an MBC regime this should make it technically easier for them to regulate the supply of base money in the face of large and often unpredictable swings in the CGBR. The

Bank's reduced reliance on discount window lending is also a necessary step if interest rates are to be fully market determined, (given the authorities target for the base); as long as discount window operations are a regular feature, the rate at which the Bank are prepared to lend to the market will tend to put a ceiling on short term rates.

19. Of the changes still in the pipeline the proposal to let interest rates fluctuate within a 2% band should represent a modest further step towards MBC. It will familiarise market operators with more day to day volatility in short term interest rates and could cause them to differentiate more sharply between cash and other liquid assets. If the position of the band is changed relatively more frequently, the changes may prompt the private sector to make more far-reaching changes eg. to the terms on which loans are extended. These changes would be more likely to take place if there were a clear declaration of intent to move to MBC on an announced timetable. Moreover unless interest rate bands are somehow related to quantitative targets eg. for the base they will mark a very partial move in the direction of MBC.

20. The original intention was not to publish the bands. Abolishing MLR is the necessary corollary, always assuming that it continues to be a rate which has some operational significance (if only as a signal to the market). This proposal has been criticised as creating uncertainty for its own sake. Uncertainty about interest rates is certainly a likely consequence of introducing MBC, but it is not the purpose of doing so. On the other hand greater uncertainty about the terms on which cash will be available may be required to give cash the special status vis-a-vis other liquid assets which is implicit in the MBC approach to monetary control. In logic it was the failure to couple the announcement about unpublished interest rate bands with some statement about the new (quantity based) rules by which the authorities would be operating in future that laid the Government open to the charge of gratuitously increasing uncertainty.

21. The Banks are also planning to ask institutions whose bills will, under the new arrangements, now class as eligible to place an average agreed level of funds with the discount houses. The objective is to ensure that the ending of the RAR does not cause a sharp decline in call money, which would undermine the discount houses ability to discharge their present role as market makers in bills. A well functioning bill market would make it easier to move to MBC. However, viewed as an attempt to shore up the discount market, these proposals are not obviously consistent with an eventual move in that direction.

22. We have always argued that MBC (as a control technique) would almost certainly mean the end of the discount market in its present form. The special position of the discount houses stems from their priviledged access to cash. If discount window facilities are granted less freely, and on less predictable and favourable terms, while the terms on which other assets can be turned into cash become more uncertain, as the by-product of operating an MBC system, the discount houses may find it impossible to make a profit from accepting money at call. This was the view that the Discount Houses themselves took in their contribution to the monetary control consultations last summer. We cannot be certain that the discount houses would fail to adapt to the changed circumstances under MBC. But it is not obviously helpful to shore up existing arrangements which would almost certainly require major modification under a different system of control.

New evidence on MBC

23. We cannot expect to deduce from the operation of the new system how well a fully fledged system of MBC would work. We will only learn that by making the switch. But, on a less ambitious plane, there are a number of things we may hope to learn in the next few years. First, we shall start collecting

figures for M2. That will tell us whether there is a narrow aggregate which is suitable as the denominator of a compulsory cash ratio in a mandatory MBC system. Second, we should be able to see how responsive the banks demand for cash is to changes in the way the Bank conducts its money market operations. At present we do not know if there is likely to be a stable money multiplier at all. Even though the value of the multiplier would certainly shift as we moved closer to MBC observation of the behaviour of the base under the new system may help us to decide whether there is likely to be a reasonable behavioural link between bank cash and deposits. The existence of such a link is important information, even if the parameters cannot be determined in advance of a full move to MBC.

24. We may also learn something about how the system responds to more flexible, and possibly more volatile, short term interest rates. That includes the effect on financial institutions - discount houses, banks, building societies, and possibly on companies. It could also include the Government - it is for example, quite possible that the authorities will be unwilling to distance themselves from interest rate movements, in practice - at least when the direction of change happens to be acceptable. We may also be able to observe the effect on other economic variables - notably the exchange rate. Even if there is no visible response to a 2% interest band, that will be information of a sort - at present we have very little idea what degree of interest rate volatility would provoke significant changes in economic behaviour.

25. More ambitiously, we might discover more about the significance to be attached to different monetary aggregates. The divergent behaviour of the broad and narrow aggregates

in 1979 and 1980 is not entirely unprecedented, but it was very striking. It will be interesting to see whether the apparent lessons of 1972/75 receive any confirmation. If they do, then our relative neglect of the narrow aggregates in setting monetary policy instruments will be vindicated. Since the case for MBC (in both mandatory or non-mandatory forms) depends in large part on the relevance of the narrow aggregates to monetary control, that is in many ways the most important issue to be decided before passing a final verdict on MBC.

Further Steps

26. The most important single development needed to transform the new system of control into a proper MBC regime would be for the authorities to formulate objectives for some measure of the monetary base and to allow interest rates to respond more closely to divergences of the base from the target. That would mean both widening the bands and setting them with movements in the base in mind. Ultimately operating instructions might be couched entirely in terms of quantities (targets for the supply of cash to the banks) - rather than prices (short term interest rates). These changes would not require institutional changes in the system of monetary control, though they might provoke institutional changes in the private sector.

27. There are two possible changes to the existing framework that might in some circumstances be needed. The first is a change in the cash ratio, which would need replacing if it were decided to adopt a mandatory system. The second concerns the way in which the Bank organises its interventions in the money markets. If changes in the terms on which cash is supplied do cause a sharp contraction in the discount market, the Bank will have to deal directly with the banking system. At present they see real difficulties with this,

because the interbank market is dominated by the clearers, who (like the Bank) are net suppliers of cash to the rest of the system. With such a market structure, the Bank have argued, it is unrealistic to look for interest rates which are, in any meaningful sense, market determined.

28. It is not clear what the answer to this problem is, or even if it is a real problem since the discount houses might survive a move to MBC, against the odds . One possible solution would be for the Bank to influence the base by operating in a short term asset market which is less dominated by the oligopolistic clearers. The obvious candidate is the foreign exchange market, since the base can be influenced by sales and purchases of foreign exchange, as well as by open market operations in bills. One immediate objection to this course is the effect on the exchange rate which, unless domestic and foreign assets are perfect substitutes, would be more affected by operations in the foreign exchange market than in the domestic short term money markets. No doubt there are other problems. But the idea may be worth exploring further, if the problems of operating in the interbank market look like posing a major obstacle to to further movement towards MBC.

Conclusions

29. A move to MBC is sometimes presented as the logical operational consequence of adopting money supply targets. The corollary certainly holds - the case for MBC presupposes a strong commitment to formulating monetary objectives in terms of monetary aggregates rather than prices - interest rates or exchange rates. Monetary base control has little to offer a Government which, as a matter of principle, wants a wide range of factors to have a bearing on movements on short term interest rates. There is room for discretion in operating an MBC system of course but/if a move in that direction is to mean anything at all, it must mean a switch of emphasis away from interest rates, as important economic indicators, towards quantities (some measure of the base).

30. The analogy with the foreign exchange market is illuminating. Between the extremes of pure floating and totally fixed exchange rate regimes there is a wide range of "dirty floating" options. The opposite ends of the spectrum are however clearly defined. Similarly, MBC is, in principle, at the opposite end of the specturum from a purely discretionary interest rate regime. It is far from clear which direction along this spectrum the authorities currently wish to move.

31. Nor is it obvious what MBC could offer, as long as the authorities continue to define their monetary objectives primarily in terms of £M3. It is fairly clear that MBC is unlikely to be an effective instrument for controlling broad money. Moving to MBC would involve adopting a target for a narrow aggregate, possibly one for which we do not yet have figures. The merits of such a target would need examining in its own terms.

32. In the light of our previous discussions we can narrow down the options on MBC, purely on intellectual merits. Targeting the wide base has no clear advantage over targeting M1, and some disadvantages. Mandatory MBC in any form is not an immediate option, because there is no suitable aggregate against which reserve requirements might be set. Even if there were, the risk of creating unnecessary distortions make it fairly unattractive. That leaves (non-mandatory) control over the narrow base. The only serious objection is that we cannot tell whether moving in this direction would improve monetary control or not.

33. Compared with these issues, the technical questions raised by a further move to MBC are relatively minor. As far as we can tell a move to non-mandatory MBC would not require further major change to the framework of monetary control. The main practical question is how rapidly it is sensible to move along the spectrum - from thinking in terms