# 2. Monetary Targets and Economic Policy

# Control of Monetary Aggregates

4/8/1978 – 7/9/1978

MR. BRIDGEMAN

TREASURY/BANK MONETARY CONTROL REVIEW

At our meeting last week with the Bank of England, I said that I thought we needed to make some attempt to explore the conceptual framework of official monetary policy. I promised to set out some of the points and questions which I would like to see covered. What follows will be a little rambling: I leave it to you whether it is worth passing on to others, or better kept as a note we could discuss together when the material already commissioned has been prepared.

2. We have drifted into an active monetary policy for reasons which have very little to do with any understanding about the relationship between monetary policy and other elements in the economy and its management. There seem at various times to have been two elements in official thinking (both here and in the Bank of England):

- In greater or lesser degree there is a belief that the available quantity of money or credit influences the level of demand or activity, investment decisions, the level of prices, the atmosphere of wage negotiations: but there is little if any explicit consensus about the extent, the routes, the general balance of these influences;

- a much stronger consensus has developed around the belief that, whatever the underlying realities, financial markets react to the stance of monetary policy, the behaviour of financial markets can itself affect the development of the economy in important ways, and monetary policy is therefore indirectly important (the most important feature of it being that it should be perceived to be successful).



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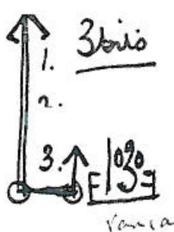
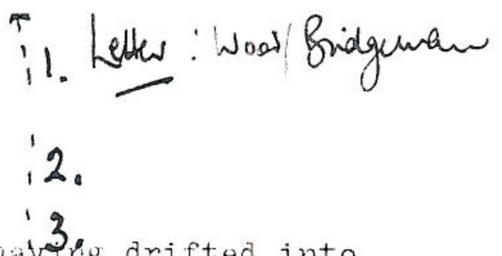

3. I do not feel at all apologetic over having drifted into monetary policy in this way. There is no generally accepted theory about relationships between money and other elements in the economy, and I do not for a moment suppose that we can, or should try, to develop one in our current exercise. But I would like to see whether we can develop a few provisional hypotheses about some elements in the problem. I would like to think that - even if wider agreement in the Treasury proved unattainable - we could at least make some progress within HF and the relevant part of the Bank of England, as a basis for our own future discussions and recommendations.

4. Let me therefore put down some propositions (which I think I hold) and some questions which I would like to see explored:-

(a) I believe that optimum economic management cannot be achieved - or indeed greatly helped - by appropriate monetary policy; but inappropriate monetary policy can do great damage.

(b) I suspect the damaging effects of inappropriate monetary policy are systematically asymmetrical: tight monetary policy will tend to have a larger effect on activity than on prices, whereas lax monetary policy will contribute more to inflation than expansion of activity. I think this is simply a function of elasticity of response.

(c) It follows that an appropriate generalised objective for monetary policy would be " a neutral stance", unless one deliberately sets an imbalance in the temporary relative importance of growth and counter-inflation targets.

(d) I think we are on solid ground (even if the quantification is not easy) in asserting that monetary policy can be driven off course if unrealistic demands are placed upon it: the most obvious illustration is that a PSBR which cannot

be financed by currently practicable methods or some appropriate development of them either calls the level of the PSBR into question or points to the necessity for some wider structural change in the economy.

(e) How far, then, can we get in defining "a neutral stance"? I think I would be content at this level of generalisation with a match between money supply and the predicted nominal GDP (or TFE?) which satisfies or reconciles objectives for activity, counter-inflation, etc. But -

(f) What definition of money or credit is the best reflection of nominal GDP (or TFE). I feel that this must be a wide definition. Note that at this point one is not pre-judging the right operational target.

5. So much for the most general macro-level. There follow two areas of closer discussion, of which I think the first is to look more closely at possible routes of influence. I think that what I would like to do is to consider a number of ways in which we think money may have real effects, and identify what kinds or locations of money might be most relevant. In some cases, one might find that one puts considerable weight on general confidence or atmosphere, and that would be worth noting.

6. Some examples of the effects we should be looking for are:-

(a) Investment decisions: I think we believe that supply/price of money can be important, but is not always important. I guess that one element of this is that there is a range of supply/price within which that consideration does not matter, but that above some probably indeterminate point price becomes increasingly important. I am not looking for precise answers, but: for example, the industrial debenture market has been closed for years, which I take to be a function of price - is this a signpost? Can we say anything about the relative importance of real and nominal interest rates (my prejudice is that economists like real rates but businessmen pay more attention to nominal rates)?

(b) Wage negotiations: some members of the Conservative Party (and some ardent monetarists) believe that a tight monetary policy will affect wage negotiations. Do we share the belief (my personal view is that this is part of the asymmetry which I referred to earlier)? Might it in this connection be more important to see what is happening to corporate liquidity (or profits) than monetary policy generally?

(c) Consumer demand: can we say anything about the relationship between monetary policy (or aspects of it) and the savings ratio?

(d) Asset prices: perhaps the area in which there is most common ground of belief that monetary policy matters.

7. We should also look at these points from the direction: where are effects of changes in particular elements of money and credit likely to be most strongly felt?

(J.G.LITTLER)

4 August, 1978

cc Mr Middleton
Mr Shepherd
Mrs Lomax
Mr Hartley
Mr Grice

MR ODLING-SMEE

MONETARY POLICY

I attach a redraft of this section of Mr Atkinson's paper. It takes account of comments on the previous draft made at Mr Atkinson's meeting. I am copying this to Mr Grice who has just prepared a substantial piece of work on "Aspects of monetary policy and the real economy". Should any redrafting be needed before I return from leave on 18 September he would be able to undertake it.

2. I am also copying this note to Mr Shepherd in case he should wish to make early comments. I have tried to meet his criticism by trying to get rid of the black box aspect of monetarism but he may feel that I have not succeeded.

KENNETH KING
31 August 1978

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## 3. MONETARY POLICY

3.1 Monetary policy is now seen as having a greater impact on economic activity and inflation than would have been thought the case a few years ago. Monetary targets have made explicit the increased importance attached to it and their form - target growth rates for £M3 - reflects the shift in emphasis from controlling interest rates to controlling the money supply. The level chosen for the monetary target will depend on prevailing circumstances; over a period of one or two years a growth rate for money in line with ~~minimal~~ nominal income is generally thought of as an accommodating policy, with tight or lax policies defined as lower and higher rates of growth of money respectively. ~~Tight or lax monetary policy is seen as affecting both output and the level of inflation - it will act directly on prices through its effect on asset prices — most notably housing — and through its effect on interest rates; by acting on the level of output it will change prices through changes in demand pressures~~. Over the longer term this simple definition of monetary stance has to be made more complicated because of trend changes in money income relationships.

3.2 It is impossible to measure the behaviour of the money supply unequivocally: there are many possible definitions of money of which three - M1, £M3 and "wider liquidity", sometimes called M5 - are important. In the short run their behaviour can differ greatly and the interpretation of monetary stance becomes difficult; each offers some information not given by the other two and is subject to distortions which can make it perform in a misleading way. Further, each would cause monetary policy to act in a different way if it were chosen as the principal target variable. It is thus worthwhile to use all the information available from the behaviour of the various indicators of monetary stance in making assessments of the impact of monetary policy. The case for placing greater emphasis on "wider liquidity" - M5 - is strong. Its usefulness is somewhat limited because information is not available on all components on a monthly basis, information on some of the components is subject to delay and no seasonal adjustment mechanism has yet been developed. The authorities do in fact take account of movements in important components of M5, most notably building society deposits, when they assess the thrust of monetary policy. There is however the possibility that markets will not attribute the same importance to M5, given that it is not an explicit official target. There is a case for attaching some weight to the behaviour of M1 given that it defines money as a medium of exchange; the problem with placing too much reliance on this approach is that other assets, most notably a large proportion of building society deposits, are now treated by their owners as though they were bank deposits.

3.3 Monetary policy affects inflation and activity through many channels, some of which are readily traceable, others more diffuse. The direct linkages, though more easily understood, are probably less significant in their impact than the indirect. The rate of growth of the money supply plays a large part in determining the availability of credit and hence the timing as well as the scale of expenditure decisions subject to financing constraints. Investment in plant and machinery and in stockbuilding, expenditure on consumer durables and housing can all be restricted by tight monetary policy. ~~These direct mechanisms affect a limited part of expenditure decisions and are more likely to be effective as a constraint on spending plans than as an incentive to increase expenditure.~~ The indirect linkages between money, output and pricing are tenuous and depend for their existence on the strength and stability of relationships between money and income. Though these relationships are somewhat imprecise in the United Kingdom, changes in the money supply are generally accepted as having a strong though diffuse effect on demand through the portfolio mechanism as companies and persons change their expenditure patterns to shift their wealth between liquid and illiquid assets. Though at first sight improbable, an individual or company can have "excess" money balances in the sense that he or it will wish to move part of a portfolio into assets with a higher yield or, possibly, a greater capital certainty in real terms. A growth in the money supply~~, appropriately measured,~~ can thus lead to expenditure effects independently of the direct links through credit creation referred to above. An individual may choose to switch part of the increased wealth associated with the changed money supply to consumer durables, a company may seek to expand its stock of work in progress and so on through a multiplicity of ill-defined channels. An important difference between a policy designed to influence the supply of credit and a policy which varies the money supply is that the former can restrain demand but, in the absence of would-be borrowers, cannot expand it. The latter can, though with uncertain lags, act either to restrain or expand demand. These more diffuse money-income relationships are the result of companies and individuals changing the balance of liquid and non-liquid assets in their portfolios. Given that it is possible to change holdings of M1 or, though to a much lesser extent, £M3 balances, while leaving unchanged a person's overall liquidity, it seems desirable to emphasise the wider money supply measures when assessing the impact of monetary policy.

3.4 Monetery policy also affects the economy, especially on open economy like ours, through its effect on capital flows and the exchange rate. This works through the linkages formulated using the concept of domestic credit expansion which,

starting with the assumption that a stable money-income relationship exists, suggests that when the domestic money supply is smaller than the domestic demand for money, capital account inflows will occur, causing the exchange rate to appreciate and that this process will continue until supply and demand balance. UK experience suggests that two important qualifications are necessary in assessing the behaviour of DCE. The first is that since our demand for money function is imprecise, the relationship between the money stock at any period in time and the growth in it that will allow it to reach its equilibrium level is almost impossible to know. Secondly speculative capital flows into and out of the UK can depend on factors other than the growth of the money supply - especially in the short-run. Moreover, the timing of changes in market sentiment and the scale and direction of the associated flows are unpredictable. It is possible for the authorities to be following appropriate monetary policies and yet for market sentiment to cause capital account flows that leave DCE sharply above or below target levels - especially when these are expressed on a quarterly basis.

3.5 In principle an accommodating monetary stance should neither aggravate inflationary pressures nor act as a constraint on real growth. A tight monetary policy will offer the benefits of reduced inflationary pressures at the cost, at least in the short term and possibly in the medium term, of both a lower level of activity and a loss of competitiveness caused by capital inflows and an appreciating exchange rate. While a lax monetary stance may generate expansionary pressures in the short term these will probably be rapidly offset by the consequences of a loss of confidence. The path the authorities will wish to take in choosing the target rate of growth of the money supply is thus likely to be a narrow one and it would be natural to err on the side of caution - that is towards a tight monetary policy - given that too-rapid monetary growth may be expected to build up inflationary pressures that would take a long time to eliminate.

3.6 It follows that a clear view of the appropriate monetary stance and close control over the behaviour of the monetary aggregates are important. They are also difficult to achieve. There are long and uncertain lags between changes in interest rates and changes in the supply of and demand for financial assets and notwithstanding the authorities' greater willingness to allow large movements in interest rates over the past few years, periods of slow monetary growth have been interspersed with periods of rapid increase. There is every likelihood that this will continue. The use of direct controls to restrain too-rapid growth, most notably the supplementary special deposits scheme (which in effect places a ceiling on interest-bearing deposits taken by the banks) has proven effective. The continuing use of such controls, however, would tend to make them less effective, since financial institutions are finding ways of - partially - circumventing them.

3.7 The need to resort to direct controls on monetary growth reflects notonly the lags between interest rate shifts and the growth of the money supply already referred to, but also the problem posed by markets anticipating movements in long-term interest rates. If the money supply is growing too rapidly under a regime of monetary targets, it is obvious that interest rates will soon rise, depressing gilt prices and inflicting capital losses on purchasers. Under such conditions the institutions that are the chief buyers of gilts postpone purchases until it is clear that interest rates have reached levels where they are much more likely to fall than rise. The authorities find themselves obliged to raise interest rates ~~rapidly~~ because this "buyers' strike" causes the monetary aggregates to grow still more rapidly. It is also possible for market expectations to operate in the reverse direction: buyers anticipate a fall in long interest rates and consequent capital gains on gilts - and buy them in whatever quantities are available until the authorities permit long interest rates to fall. The lesson to be drawn from this is not necessarily that money market are always right - it would be difficult to give a rational explanation for some recent movements in long interest rates - but that market pressures can be irrestible. The parallel with exchange rate intervention is obvious: the authorities may be able to stop some unwarranted fluctuations but they will find it impossible to stop them all.

3.8 Direct controls act as an upper limit on monetary growth but cannot be used to stimulate it when the monetary aggregates are growing too slowly. Despite the present concern over the rapid growth of the money supply, periods of slow growth (slow that is in relation to the growth of nominal income) have predominated since 1975. Initially this could be viewed as a desirable reaction to earlier periods of excessive monetary growth, as the velocity of circulation returned to more normal levels. Subsequently, the continued slow growth of the money supply raised velocity to levels which, in historical terms, were high and which suggested that monetary stance was restrictive. The recent rapid growth of the money supply was not sufficient to restore velocity to normal levels, and it is possible to argue that monetary policy is still tight. The lengthy periods of slow monetary growth did not, however give rise to high interest rates or other direct evidence that a shortage of credit was acting as a constraint on activity, and they did not trouble the authorities: we tended to welcome the semblance of virtue while being grateful that we were not paying its costs.

3.9 When the income-velocity of circulation of money is high it should, in principle, be possible for the authorities to tolerate a long period of rapid monetary growth as the relationship returns to more normal levels. Monetary theory is, after all,

cast in terms of a relationship between the stock of money and the flow of nominal income. In practice if the money supply grows more rapidly than nominal GDP for a period as long as a year then pressure on the authorities to take restrictive action develop. This suggests that markets tend to view the change in the money supply as being more important than its absolute level. It is possible to explain such an attitude in three ways: markets tend to be short-sighted and the best indication they have of the future policies of the authorities is their present behaviour so that too-rapid monetary growth which may be justifiable now (in terms of returning velocity to more normal levels) will be taken to suggest that the authorities may continue to tolerate rapid growth until it does generate fresh inflationary pressures: secondly markets may continue to attach importance to flow aspects of monetary growth and view, for example, the large PSBR that may be associated with rapid monetary growth with disfavour; thirdly markets' emphasis on the growth rather than the level of the money supply may be the result of the fact that for presentational purposes, monetary targets have been cast in a simplistic way in terms of growth rates and that markets have come to place too much weight on this formulation. There is an asymmetry in the response of markets to monetary growth at rates they see as being too high or too low. They are unhappy to see periods of low growth compensated by periods of rapid growth; the authorities have to take account of their views by acting promptly to restrict rapid growth and there is a danger that velocity will tend to rise over time and monetary stance continue to tighten. It could be argued, however, that market preference is explicitly for a tight monetary policy because of its counter-inflationary effects and that rates of money supply growth that only occasionally reach an accommodating level is the most that will be acceptable.

3.10 Monetary targets will remain an important feature of policy-making over the foreseeable future: market pressures will oblige us to accord their effective operation considerable weight. Targets will impose a necessary constraint on the amount of expansion that is feasible, but a policy of minimizing the growth of the money supply at all times would be inappropriate. Monetary targets may affect businessmen's and even union leaders' price expectations and so have some effect on wage bargaining. Tight monetary policy has played a part in raising the exchange rate and hence reducing imported inflation. The increased price stability that should follow ought to restore business confidence and foster investment but the timescale over which these benefits accrue is likely to be long. Over the same period there will be costs in terms of output foregone and deterioration in competitiveness. More emphasis should be placed on the relationship between the money supply and income. It would follow that care should be taken to avoid long periods when the money supply grows at below target rates because of the difficulty of offsetting them by periods of faster growth.

MR LITTLER

cc attached for:-
Mr Middleton
Mr Wiggins

MONETARY CONTROL REVIEW

This minute is a response to your minute of 4 August which you left with me before you went on leave. It is intended as a basis for discussion between us: if you agree I would suggest that Mr Middleton and Mr Wiggins might join us. At this stage it is intended as an "in-house" piece of thinking - we could consider after our discussion whether, and if so how, the points in your minute and this could be put to the Littler/Fforde group or otherwise fed into that exercise.

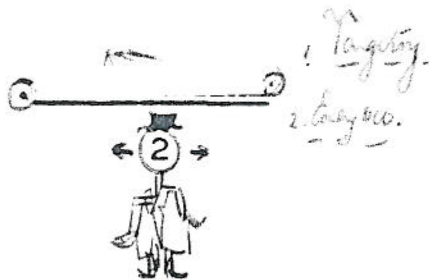
Terminology

2. It may first be useful to clear out of the way a potential ambiguity which may be involved in the words "monetary policy". There are two potential meanings:-

i. policy directed to influencing monetary conditions domestic and external - eg domestically, the monetary aggregates, interest rates, the availability of liquidity and credit, the financial position of different sectors of the economy, and externally the exchange rate, the pattern of capital flows;

and ii. policy about the use of the monetary instruments, interest rates, open-market operations in gilts and Treasury Bills, the SSD scheme etc.

The distinction between the two is essentially that the first goes considerably wider than the second since a wide range of other factors, some within the Government's influence or control, others not, influence monetary conditions besides the authorities' use of



monetary instruments - the rate of inflation and expectations about its future, the PSBR, and expectations about other currencies in relation to sterling are major examples of these.

3. While the responsibility for advice from time to time on the use of the instruments of monetary policy rests with the Bank and this side of the Treasury, (and for giving effect to it to the Bank), the underlying criterion must surely be how can monetary conditions best be influenced - whether by the use of monetary instruments or by other means - to contribute to the Government's overall economic aims. I therefore see our concern being as much with the wider definition as the narrower.

The Evolution of the Approach to Monetary Policy

4. I am not sure that I would characterise what has happened as a "drift into a more active monetary policy", or that the reasons have had "very little to do with any understanding about the relationship between monetary policy and other elements in the economy and its management". I think that I would characterise it as first increasing realisation that monetary conditions can have a significant effect on the real economy and so must be allowed for in economic policy making, and second, within the first, increasing emphasis on the control of the monetary aggregates to the extent that adherence to a target range for one aggregate has now become a major intermediate objective of economic policy.

5. In significant part the change over the last decade or so in the attitude to financial conditions has been influenced by two factors:-

i. the fact that in conditions of high and variable rates of inflation and, more recently, floating exchange rates, conditions in financial markets both are more unstable and variable, and any change in them can have a greater and more immediate effect on other parts of the economy;

ii. the Milton Friedman school of economists who have argued that on the one hand control of the money supply matters,

and on the other that attempts to stimulate the economy by fiscal means are likely to be counter productive, leading to higher prices rather than higher activity.

That is not to say that the monetarists arguments have been accepted "in toto": indeed there are few, if any, in either the Treasury or the Bank who would so accept them.

6. Over-simplifying, I think that it is possible to trace the following main phases in the development of "official" thinking:-

i. 1971: Competition and Credit Control - recognised the need to control monetary aggregates (without specifying how closely), and proposed relying on interest rates to achieve this;

ii. the 1972-73 Money Supply "explosion": interest rates proved an inadequate method of control - birth of the SSD scheme. In retrospect, most people I think accept that high rate of growth of money supply in those years contributed to the inflationary pressures in 1974;

iii. 1974: new Chancellor arrived committed, both publicly and intellectually, to controlling money supply and, initially at least, to keeping down the PSBR;

iv. 1974-75: low rates of growth of M3 (10% pa or less) achieved virtually costlessly. Debate about how tightly it needed to be controlled remained academic (eg Douglas Wass argued that he would not be worried by 15% pa but would by 20% pa);

v. early 1976: ill-fated Bridgeman report, the Hopkin/Cassell paper and Couzens paper sought at different levels to distil consensus of view in a situation of growing awareness that keeping monetary aggregates "under control" could lead to

painful policy choices in the future: the 1976 Budget speech for the first time gave greater meaning to the commitment to the control of the money supply by referring to a growth consistent with the intended growth of money gdp;

vi. spring/summer 1976: the vicious circle of interaction between domestic and external financial markets. The Chancellor decided to quantify the intended growth of M3 (12%) as part of July measures, judging that advantage of published target for confidence would outweigh risks of it being a "destabilising factor".

vii. December 1976: letter of intent to IMF involved DCE limits, and cuts in PSBR to make those limits feasible. DCE limits were accepted at two levels:-

a. pragmatic: for the IMF, DCE is a good way of encapsulating both domestic monetary conditions and balance of payments performance and so of ensuring a debtor country's ability to repay - as a debtor we had to accept our creditor's view;

b. theoretical: there are respectable arguments that at a time of balance of payments deficit DCE is a more relevant indicator of domestic monetary conditions than £M3. (This is another aspect of the assymetry to which you refer.)

viii. 1977-78: shift of emphasis to £M3, partly as a result of "City" (ie both Bank and market) preferences for "M's", partly because of return to current account surplus. Main points were:-

a. events demonstrated again links between domestic and external monetary conditions - links which are now reflected in the monetary models;

b. work on economic effects of policy measures, and development of main NIF model, took increasing account of effects of financial factors: in particular "ready reckoners" allow for monetary effects offsetting fiscal measures (but not fully, after a short lag, as strict monetarists would argue);

c. in practice, achievement of reduced PSBR and DCE has helped in financial markets, but has not generated an upsurge in industrial confidence, and so activity - particularly investment - which the IMF team argued in 1976 would follow from their proposals;

d. experience of monetary targets has shown not only that they can help general climate in financial markets, but that they can also lead to instability in markets (the vicious and virtuous circle), just as some of us (including the Chief Cashier) had warned that they might.

History.

<u>The Concepted Framework</u> (1975)

7. I think that decision makers - Ministers and those advising them - are now faced with a situation in which we cannot look for a single generally accepted conceptual model of how the main elements of the economy inter-relate and perform, as there probably was in the mid-1960s. There always has been, of course, uncertainties in forecasts and the analysis of policy options, but in the 60s these were mainly thought to arise from the estimation of the parameters of the relationship and from the fact that the relationships were themselves not deterministic but stochastic (ie including random elements, whose variances however were broadly known). Now we are faced with a situation in which there are acute differences between leading economists about the underlying "model" and about the relative importance of different key elements, especially the monetary factors. The uncertainty is as much about the structure of the economy as about estimating the relationships. As

administrators and government economists we cannot ourselves hope to resolve that debate. Our task is rather to advise on what policy gives the government the best prospect of achieving its economic objectives, notwithstanding those uncertainties. This involves taking account both of how far the alternative theories are supported by the evidence, and also of how inherently plausible they may be. Ideally we should be looking for policies which are both "robust" - in the sense that they give a tolerable outcome in a fairly wide range of possible outcomes of the various uncertainties - and "flexible" in the sense that they can be modified (rather than completely overturned) as time passes and actual events remove some of the uncertainties.

8. I recall that in early 1976 Sir Douglas Wass was critical of the monetarist approach, and of those of us who, without espousing that approach completely, argued that more account should be taken of financial factors, by saying that we were not offering a conceptually complete and consistent theoretical framework on which we could base our policy advice. But I think that it is illusory to expect to have such a complete framework at this juncture, unless you are prepared to ignore important elements of the evidence. We have to reconcile ourselves to a situation in which there is uncertainty about that framework and we have somehow to take account of the alternative approaches.

The Treasury Models

9. Against this background, I would take as the starting point the family of Treasury models, as representing the best consistent set of relationships, which the collectivity of Treasury economists can devise on the basis of existing evidence. FEU and HF3 has been preparing a paper under Mr Middleton's guidance which seeks to draw together what the economists have been able to estimate about effects of financial factors on the real economy, and which deals with most of the transmission elements referred to in your note. We will also need to take note of

the current"best views" in the Treasury and Bank of the financial elements - presumably the monetary model and the various "demand for any relationships".

10. That done we could then go onto ask in what areas there is the greatest area of uncertainty which may be because:-

i. the structure of the model cannot readily take account, at least at this stage, of other factors or effects which may be important;

ii. the relationships may be assymetrical (I would agree with those assymetries which you point to), but this is not reflected in the modeal;

iii. the relationships may be changing with time: in particular I suspect that there is a "learning" process in a significant number of parts of the economy, so that the reaction to identical events on two successive occasions would not be the same, even if all the other elements in the situation were also identical - this phenomenon probably applies to many of the policy measures in the monetary and incomes fields.

11. I would hope that this process - which I regard as one of stock-taking and assessment - would bring about the better common understanding (but not necessarily complete agreement), which you referred to in paragraph 3. (At this stage, I would say that I would agree with propositions a, b, and d (subject to what I said above about the meaning of "monetary policy") but would have doubts about c, e, and f in your paragraph 4).

"The Market View"

12. I would like to make two other short comments at this stage. First while the dichotomy between "the underlying realities" and "the

reaction of financial markets", which you refer to in paragraph 2, is sometimes useful, it is also dangerous. It may be politically and intellectually tempting to think of the financial markets as being a group of dealers and fund managers who have perverse and illogical reactions, and who are distinct from the real world of people taking decisions in manufacturing industry about levels of investments, output etc. But the financial markets are part of the underlying realities, and the people involved are frequently the same. The finance director of ICI is not in one category when he takes a decision about how he manages "leading and lagging" across the exchanges and the other when he takes a view on a "real" investment proposal - indeed the two decisions may be related.

The Role of Monetary Targets

13. The other is that I think the discussions in the Littler/Fforde group ought to clarify how far we see monetary targets fulfilling the following distinct, and sometimes conflicting, roles:-

i. as a long/medium term element of counter-inflation policy;

ii. as a means of reassuring financial markets and helping stability in such markets;

iii. as a short term operating rule for day-to-day and month-to-month decisions on monetary policy in between the 2 or 3 yearly reassessments of macro-economic policy as a whole.

S. Wilkes
P.P. J M BRIDGEMAN
7 September 1978