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Mr Monck

CHANGES IN THE BANK'S MONEY MARKET OPERATIONS AND POLICY FOR SHORT-TERM INTEREST RATES

1. Mr Monck has done this note very quickly so that we can narrow down the options before we write them up for the follow up to last night's meeting with the Prime Minister. I hope we can fit in a discussion tomorrow sometime.

2. There are two really crucial issues:

a. If you want a policy which will guarantee lower interest rates you have to relax the stance of domestic monetary policy next year. Even then it will be difficult to set operating rules for a medium term £M3 and a short term narrow aggregate which would guarantee lower interest rates.

b. If you wish to bring the exchange rate in to the reckoning for interest rate decisions, we need to consider very carefully how this could be done. With the current high rate, policy instruments might have to move a long way, in the shape of changes in interest rates and intervention, before the exchange rate moves. Then the move could be difficult to control. If we try to limit the exchange rate subject to M1 growing at not more than say 10% - quite high in relation to the MTFS figure for £M3, you might not manage much of a change in interest rates. On the other hand, if there is an open ended attempt to get the exchange rate down by expanding the money supply, you have effectively put monetary targeting into suspense for a time. There is not a lot of ground in between and it is

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difficult to define precisely. This is perhaps the area on which we should concentrate and direct what further analysis we can do before the middle of next week.

E. K. Clarke

pp P E MIDDLETON
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