30. 1.80

MR. McMAHON

Copies to: Mr. Fforde
Mr. Dow
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TOWARDS A VIEW ON MONETARY POLICY

1. The following points on your draft of 25. 1.80 owe something to my having had the advantage of seeing some of the comments of other recipients.

2. I would gladly see the first sentence slightly weakened. The thrust of monetary policy is tight or loose as the growth of money supply is less than or greater than the growth of demand for money at a given real interest rate. At best nominal interest rates and the relative growth of some nominal aggregate are alternative indicators of the threat of policy - as between which the growth of some nominal monetary aggregate relative to some nominal output level is to be preferred. 'Measure' suggests the feasibility of a degree of certainty about the threat which may not be attainable.

3. There seems to be an ambiguity in paragraph 7. When monetary policy is said to 'work through' interest rates, is the reference to its effects on aggregate demand, inflation expectations, the exchange rate, etc., or (as I suspect) to the notion that money and credit markets clear so that, *ceteris paribus*, tighter money always means higher interest rates?

4. I have serious reservations about automaticity not only because it commits one not to use other available and relevant information but also because I am not satisfied that the 'formulae' concerned would not have more damaging expectational consequences than present procedures. Annex D reflects an awareness of these issues but remains imprecise.

5. As a proponent of at least keeping the door open for a switch of emphasis from monetary quantities towards the exchange rate I would certainly not want this to be seen as relaxing the intended discipline of the former. Could this be achieved by adding to paragraph 13 some such phrase as "by reference to the level anticipated when the monetary target was set"?

30th January 1980.

J.S. Flemming.

JF