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MONETARY TARGETS: NOTE OF A DISCUSSION IN THE CHANCELLOR'S OFFICE AT 2.45 P.M. ON 13 JANUARY 1984

Present:	Chancellor of the Exchequer	Governor	Mr Cassell
	Economic Secretary	Deputy Governor	Mr Battishill
	Sir P Middleton	Mr George	Mr Lankester
	Sir T Burns	Mr Goodhart	Mr Ridley
			Mrs Lomax

Papers: Treasury paper of 6 January;
Bank paper of 10 January

It was agreed at the outset that it would be necessary, in the 1984 MTFS, to move to two target ranges, one for broad and one for narrow money. The discussion then centred on the choice of narrow money target aggregate(s).

2. The Governor and Mr George argued that M2 was conceptually the best measure of transactions balances. But, because its track record was as yet very short, it would be rash to go for M2 as the single narrow money target aggregate. It would however be no less rash to choose M0 alone, for, just as it had proved useful to refer specifically to PSL2 as a cross check on £M3, so it would be useful to have two narrow money target aggregates. Sir T Burns thought that introducing M2 would invite questions which, given the short track record, would be very hard to handle; but it was noted that the Mansion House speech references to M0 had similarly raised a number of questions. Sir P Middleton pointed to the danger of differential movements in M0 and M2, and the Chancellor pointed out that the reasons for their recent similar movements were not fully understood. Targeting either carried risks, but they would not be reduced by targetting both.

3. The Deputy Governor however argued that the aim now should be to make a modification to the targets which should prove durable. To bring in M2 would be helpful in avoiding a risk of discontinuity if, as its track record lengthened, its primacy became obvious. Moreover M0 figures could virtually be derived on a weekly basis by outside observers: if M0 were the only narrow money target aggregate, we might face something similar to the weekly problems now faced by the Fed. And two target aggregates would be mutually reinforcing: if only one were adopted, the difficulty of defending inaction in the face of a couple of aberrant months would be considerable. The Chancellor thought that the converse was that the market might think that having two target aggregates represented a recipe for inaction. The authorities might be perceived to have moved still further away from the initial firm stress on £M3, with a plethora of target aggregates to ensure that at least one would be hit. This risk was however thought to be containable: Mr George thought that the market was in no doubt that the Government took the exercise seriously, and that it made sense to look at both broad and narrow aggregates. He saw a considerably greater risk of an adverse market reaction if M0 were singled out as the narrow money target aggregate, and the Governor thought it important to go for two broad and two narrow target aggregates.

4. It was agreed that option 3 in the Treasury paper of 6 January would be the appropriate solution for the 1984 MTFS. For broad money one would look at £M3 (and PSL2) and for narrow money M0 (and M2). Sir P Middleton presented a possible MTFS formula (attached) which was agreed to be satisfactory, subject to further discussion on the length of the target period (and possible consideration of a change of name for PSL2). The Governor expressed satisfaction with the decision taken: the new arrangement was in his view logical and workable, and would have the whole-hearted support of the Bank.

J O KERR
16 January 1984

Distribution

Those present
Chief Secretary
Financial Secretary
Minister of State
Mr Monck

DRAFT SECTION FOR MTFS

Money ranges

2.10 As announced in the Budget Speech, there will be two target ranges for monetary growth in 1984-85. The target for broad money is to be set [at the 6-10 per cent indicated in last year's Financial Statement]. The target for narrow money will be [X-Y per cent]. As usual these ranges apply to the annual rate of growth over the 14 months beginning in February 1984. Illustrative ranges for the next few years are shown in table 2.2. Precise targets for the later years will be decided nearer the time.

Table 2.2 Ranges for Monetary Growth

	Percentage change during year		
	1984-85	1985-86	1986-87
Broad money - £M3 (and PSL2)			
Narrow money - M0 (and M2)			

2.11 The main measure of broad money for target purposes will remain £M3; the authorities will continue to take account of other indicators of broad money, especially PSL2. The target for narrow money applies to M0; in judging the performance of M0 as an indicator of transactions balances, particular attention will also be paid to the behaviour of M2. The interpretation of monetary conditions will continue to take account of all the available evidence, including the exchange rate. The ranges shown in Table 2.2 have again been constructed on the assumption that there is no major change in the exchange rate from year to year.

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16 January 1984

Andrew Turnbull Esq
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LONDON SW1

Dear Andrew,

MONETARY TARGETS

The Prime Minister spoke to the Chancellor last week about the paper enclosed with my letter of 9 January to you. My letter mentioned that the Chancellor would be discussing with the Governor, on 13 January, the form of the monetary targets to be included in the MTFS in this year's Red Book. I now enclose my record of that meeting: as you will see, the outcome was, as the Chancellor hoped, agreement on the last option set out in the Treasury paper, for which the Bank in the end promised full support.

As before, a copy of this letter and enclosure goes to Alan Walters.

Yours ever,

J O KERR

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