

growth rate, such a case could be indicated. The same applies *mutatis mutandis* to cyclical contractions. Balance of payments constraints, which usually find expression in interest rates, of course at times may predominate over considerations of domestic stability.

The implicit rule for target choice "when in doubt, use money" is not equally applicable, however, to short- and long-run target conflicts. It is hard to believe that an economy could remain stable if its policy makers maintained the wrong money growth rate for two years. There is no reason why an economy should not be able to live with the wrong money growth rate for three months. Monetary forces are neither immediate nor pervasive nor irreversible enough to push an economy off its equilibrium path in so short a time.

Adherence to a rigid money supply target in the very short run, on the other hand, whether stated as an absolute amount or as a rate of growth, is likely to generate a great deal of instability in short-term interest rates. The amount of money demanded on any day is subject to stochastic as well as seasonal influences. The seasonal factor can be eliminated after a fashion—the Federal Reserve operates with "seasonals" ranging from a year to very short periods. But there remains enough instability of demand from day to day to make interest rates jump about badly if supply does not accommodate.

In the short run therefore the central bank cannot have both stable money supply and stable interest rates. A choice must be made. Most central banks probably make the choice without even asking themselves the question; they stabilize interest rates, in a very short-run sense, at the expense of monetary instability. Most central banks do it by discounting and, in some cases, open market operations. The Federal Reserve's "money market conditions" and "free reserves" techniques leave interest rates a little more flexible, but essentially they imply preference for control over interest rates rather than money supply in the very short run.

Central banks probably overestimate the importance of interest rate stability. The financial markets are not the economy. Unstable interest rates may hurt operators in the market and certainly bring down criticism on the money manager. They are unlikely to have farther reaching repercussions of great gravity. Even so, instability of any sort is a cost. Risk premia must be charged to cover against it, in the form of permanently higher rates. Interest rate fluctuations, unlike those of the money supply, are very visible; large numbers of