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THE LANGUAGE OF CLAUSE (b), 1957-60

A Critical Review

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The nominal purpose of the Open Market Committee's policy directives, formally adopted at each meeting, is to instruct the Trading Desk concerning the objectives that are to govern the transactions conducted on the Committee's behalf over the period until the next meeting. The directive, and particularly clause (b) relating to the current posture of monetary policy, is better described as an attempt at succinct summary than as a self-contained and definitive statement of instructions. Since the Account Manager is present at the Committee's meeting his understanding of Committee instructions is based more on the discussion that has taken place and on the Chairman's statement of the Committee consensus at the conclusion of deliberations than on the directive. Between meetings of the Committee, the Account Manager has daily opportunities to consult with the Committee or its staff members on how current operations accord with Committee intentions.

As required by law the Board publishes a Record of Policy Actions for the preceding calendar year in its Annual Report. This Record summarizes the deliberations of the Committee, states the consensus reached at each meeting and quotes the policy directive adopted. The directive is thus part of the body of materials available to the public for information on the Committee's past intentions and actions.

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The first purpose of this memorandum is to evaluate the probable effectiveness of the kinds of language used in clause (b) in the recent past (1957-60) in promoting public understanding of the policy intentions of the Committee.<sup>1/</sup> A second purpose is to suggest possible lines of improvement in the formulation of clause (b). The memorandum is based entirely on an examination of the published record to enable the author to avoid any possible tendency to read into that record information derived from sources not available publicly.

The memorandum does not consider the usefulness of clause (b) for the purpose of instructing the Desk. This is because the clause is so heavily supplemented by other kinds of communication in transmitting instructions; because a different and deeper set of issues is involved in the question of formulating instructions, concerning the variables to be used in expressing proximate policy targets and the appropriate degree of specificity in the instructions; and finally, because evidently a main role of the clause is to summarize in the public record the Committee's policy intentions or objectives at successive dates.

#### Evaluation of past directives

Review of the Policy Records for the period 1957-60 leads to the conclusion that the language of clause (b) usually has not been very informative with respect to policy intentions, and at times may have served to encourage (after the fact) misinterpretation. In general, the explanatory material in Record, including the summary

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<sup>1/</sup> The successive versions of clause (b) adopted in this period are cited in the appendix.

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of the consensus reached at each meeting, carries the bulk of the information provided on policy intentions. The quotation of clause (b) as approved is reiterative at best and confusing at worst. At times the Record explains that a language change (nominally a change in instructions to the Desk) did not signify a policy change, or did not signify a particular policy change that might be read into it; or explains that some policy change was made despite the fact that the previous language was renewed.

It seems possible, indeed, that a reader provided with a version of the 1957-60 Policy Records from which all references to clause (b) had been deleted would be as well or better informed than if given an opportunity to peruse full texts. On the other hand, a reader given only the successive directives, without the commentary, would have substantial difficulty in discovering what policy was at particular times, and when and how it changed.

The text of clause (b) is formally adopted in the course of a meeting whereas the associated text of the Record, though based on the Committee's minutes, is prepared some time afterward. Both, however, constitute official Federal Reserve statements, and both reach the public together in the Annual Reports. It is natural, of course, for the explanatory material to be longer than the clause. But the reader might well wonder why the explanatory material can be characterized (as it has been increasingly in recent years) by such simple, straightforward statements as "The consensus favored a policy of moderately less restraint," while the associated directive called vaguely for "fostering sustainable growth." A

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summary of policy intentions that does not summarize but serves simply as a focal point for an explanation of what was really intended does not seem to be an efficient way of communicating.

The appendix to this paper includes a rather detailed discussion of the interpretative problems associated with each of the directives of 1957-60, and only a few general points will be made here. First, there is a tendency to use phrases, in varying combinations and orders, that express broad goals of monetary policy that might reasonably be considered to be Committee goals at all times; for example, "guarding against (or restraining) excessive credit expansion," and fostering "sustainable economic growth," "stability," and "expanding employment opportunities." The Committee evidently believes that the particular objectives it cites at any time, and the order in which it cites them, convey a sense of the relative importance of its main concerns at that time, and hence, an indication of its policy intentions then. In effect, the Committee's message is often coded into the directive in the form of a particular selection and order of building-block phrases. But unless the reader is initiated into the code the message is apt to be lost on him.

While this procedure seems to be unnecessarily oblique and complicated, the successive directives might still communicate something to the trained reader if the Committee was consistent in the way it coded its message. But it has been less than consistent, using a variety of devices (noted in the appendix) to signal its policy intentions, and varying the intended meaning of similar signals.

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This has placed a rather heavy burden of interpretation on the reader of the Record. So also has the occasional use of certain phrases that can only be described as mysterious, such as those of 1957 instructing the Desk to "recognize" varying lists of factors.

Finally, the Committee evidently feels that the directive should be changed less frequently than the consensus calls for a change in instructions. This is indicated by the several references in the Record to policy changes to be made "within the scope of the present directive" and by two debates in 1960 on whether a policy change decided on was sufficiently "basic" to require a change in the directive. The implication is that the directive is viewed as a statement of the general posture of policy, and is intended to reflect only major and not modest or gradual shifts in posture. The problem with this approach is that major shifts can occur through the cumulation of small changes, so that there may never be a "right" time to change the language of the clause. Either unchanged language must be allowed to get hopelessly out of date or a change must be made when there has been no basic shift. Over the period reviewed most policy changes were gradual, and the Committee was not successful in confining revisions of the clause to dates of basic shifts in policy.

Since the nominal purpose of the directive is to transmit instructions for a three-week period, there is no obvious reason why its language should be insensitive to the kinds of policy changes that are in fact often made at such intervals. It is true that the changes may represent only a slight "leaning" one way or the other,

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and may be viewed as temporary, tentative, or probing. But if the nature of the consensus can be succinctly summarized in the Record it is not clear why it cannot also be reflected in the directive. Admittedly, a difficult practical problem exists of obtaining agreement among 12 (or 19) persons on specific language at a particular meeting, for there may be as many shadings of opinion as there are participants at the table. But if it could be done, the problem of having to make clause (b) "catch up" periodically with policy would be avoided. Also avoided would be the need for the Record to interpret the clause to the reader and to reconcile the described consensus on policy with the nominal statement of policy in the clause.

Proposals for future directives

It is clear that a policy statement compressed to a length of 20 or 30 words cannot give more than an indication of the Committee's current intentions. It should be possible, however, to give both an absolute and relative description of current policy; that is, to indicate whether it is one of ease or restraint, and whether and how it differs from that adopted at the preceding meeting. A general form that might be found adequate is illustrated by the following:

"The Committee directs that open market operations be undertaken, until otherwise directed, to maintain a degree of ease about the same as that prevailing since the last meeting."

This general form could be modified readily to allow for a great variety of circumstances. At different times the degree of ease (or restraint) called for might be specified as very slightly (or slightly, moderately, substantially, etc.) greater (or less)

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than that previously prevailing. To handle circumstances where the actual situation differed from that intended, the instruction might call for "a degree of ease about the same as that intended at the time of the last meeting, but somewhat less than that actually prevailing." To meet special problems, such as gold outflows or disorderly markets, the basic language might be supplemented or supplanted by other language, and other modifications could be made as the occasion warranted. The explanatory material of the Record could be relied on, as it is now, to elaborate on the Committee's intentions when necessary and to describe the basis for its decisions.

This kind of directive probably would avoid many of the problems of interpretation that have characterized those used in the recent past. It is true, however, that it is a relatively "bare bones" statement. In particular, the only indication provided of the general posture of policy would be in the choice between the words ease and restraint, and this in itself may lead to misinterpretation. It may be desirable, therefore, to precede this simple type of statement with another describing the broad kind of policy the Committee believes is required by current economic circumstances. A full instruction, for example, might read:

"The Committee directs that open market operations be undertaken to encourage the forces of recovery now evident in the economy. Until the Committee otherwise directs, operations should be designed to maintain a degree of ease about the same as that prevailing since the last meeting."

Presumably the first sentence of such an instruction would be subject to change less often than the second. If changes in the first sentence are read as indications of "basic" shifts, there may



be a problem with respect to their timing over an interval in which policy changed cumulatively, similar to that described earlier for the present kind of directive. The problem would be less serious than at present, however, since the progression of gradual changes would have been accurately reflected in the language of the successive second sentences.

Concluding note

It is believed that directives along either of the lines proposed, preferably the second, would go a long way toward improving the public's understanding of the Committee's policy intentions. Except when it is necessary to deal with special problems, the alternatives facing the Committee at most meetings would be relatively limited; they might often be confined to a choice between say, the phrases "slightly tighter (or easier)" or "moderately tighter (or easier)." In many cases the Committee would, in effect, be composing the policy directive in the process of arriving at its consensus. Thus, in addition to clarifying the Committee's intentions, the proposed procedure may have the incidental advantage of saving time at meetings.

It might be added that language of the type suggested would retain the not inconsiderable ambiguity inherent in the words "ease" and "restraint," and with respect to the quantitative implications of such adjectives as "slight" and "moderate." The issues here are precisely those involved in communications between the Committee and the Desk, relating to target variables and the nature of the specific full instructions given the Desk. As noted earlier, such questions are not considered in the present memorandum.

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Finally, the whole process of formulating an appropriate directive would be facilitated if the Committee were to break down its directive into a standing authority directive to be adopted once a year, with interim changes as circumstances may require, and a current policy directive that would be adopted at each meeting. The Committee's staff might be instructed to prepare in advance of individual meetings alternative formulations of a current policy directive for the Committee's consideration and discussion. These could be made available to the Chairman for his use in getting agreement among Committee members as to the policy directive wording.

Appendix

These notes cite the language of clause (b) of the Open Market Committee's directive on each date of change in the calendar years 1957-60, inclusive, and discuss the relationship of the language changes to changes in the Committee's policy intentions at and between those dates. The source is the Record of Policy Actions published in the Annual Reports for the years covered.

The directive in effect at the opening of 1957 had originally been adopted in November 1956. Clause (b) provided for open market operations with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth, while recognizing additional pressures in the money, credit, and capital markets resulting from seasonal factors and international conditions." Subsequent language changes were as follows:

January 8, 1957: "to restraining inflationary developments in the interest of sustainable economic growth while recognizing unsettled conditions in the money, credit, and capital markets and in the international situation."

The significance of this language change, taken by itself, is obscure. The reference to seasonal factors was deleted, and what the Desk was to recognize was changed from "additional pressures" to "unsettled conditions." The discussion in the Record implies that the Committee felt that restrictive

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pressure had been unduly relaxed in the preceding weeks in an effort to meet seasonal credit needs, and wanted some tightening. If the deletion of the reference to seasonal factors was meant to carry this message, it would hardly seem adequate to the task. The Committee may have reasoned that the initial instruction for "recognizing...pressures...resulting from seasonal factors..." implied some easing, and therefore to strike this reference would imply the reverse. But to the outside reader an instruction to "recognize" a circumstance does not necessarily indicate what course of action is to be followed regarding it.

The Record also notes that "At the same time, the revised wording registered an awareness by the Committee of the possibility of unduly severe restraint inherent in the current low level of corporate liquidity and in the financing program ahead." It is hard to see where in the new language this particular awareness is registered, unless it is in the words "unsettled conditions." Again, the connection between the Committee's intent and the language in which it is expressed is tenuous at best.

The directive was unchanged at the two following meetings (late January, and February 1957). At the first of these the renewal was associated with a finding that the "current relative ease was unintended," and with a call for "restoring the approximate degree of restraint of the late November-early December period... ." At the second the Committee favored a continuation of the "status quo."

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March 5, 1957: "to restraining inflationary developments in the interest of sustainable economic growth while recognizing uncertainties in the business outlook, the financial markets, and the international situation."

Once more the language change, per se, is of obscure significance. What is now to be recognized is "uncertainties" rather than "unsettled conditions"; and the business outlook is included in the list of things viewed as uncertain. The second of these changes might be taken to imply a move toward less restraint, but the Record appears to disclaim this. It first comments that "This change in wording ... was not an indication of a shift in direction of policy but was designed to emphasize the factor of uncertainty in the current business outlook." This explanation is not very helpful, since policy shifts may involve changes in degree without changes in direction, and the act of emphasizing, like that of recognizing, has no clear-cut implication for action. A statement in the next paragraph is more specific: "Thus, the Committee sought to continue about the same pressure on credit expansion that had been intended by the actions taken at the last several meetings, and in modifying the wording ... it was simply bringing into the picture a specific reference to the business outlook that had not been mentioned in the previous wording." Evidently, then, the change was devoid of policy significance, at least for the immediate future.

The language of clause (b) was unchanged at the next 11 meetings -- through that of October 1957. At the first of these, in late March, the language was renewed with the understanding that

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"doubts should be resolved on the side of greater rather than less restraint than had existed in recent months." For the five subsequent meetings, however, the consensus called for maintenance of the existing degree of restraint. In late July there was an expressed desire to "regain the degree of pressure that existed before the Treasury refunding operation... ." In August the directive was renewed "with the understanding that the System Account would have latitude for flexibility ..."; in September, "that doubts would be resolved on the side of less rather than greater restraint"; and in late October, that "although general policy was not to be changed appreciably, it should tend on the easier side from where it had been in recent weeks."

November 12, 1957: "to fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves."

According to the Record, "The Committee's decision at this meeting ... did not signify a shift that would entirely eliminate restraint on credit expansion, but it did reflect a decision that there should be a moderate relaxation of the degree of restrictive pressure." The new language differed from the old in three respects. First, the wording of the leading phrase was inverted; instead of restraining inflation in the interest of growth, the Desk was to foster growth without inflation. This is one of three instances in 1957-60 when a language inversion was used to signal a policy change, and in this case the signal probably is clearer than in the two later cases. Second, the direction of the policy shift (if not the magnitude) was specified by the concluding phrase. The only other

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occasions in 1957-60 when a specific statement about direction was incorporated within the directive itself was in May 1960 and the months following. Third, the Desk was no longer enjoined to "recognize" uncertainties or anything else.

At the next meeting (December 1957), ". . . the general view of the Committee was that there should be further moderating of the restrictive pressures on credit expansion and, for this reason, the (November) directive was renewed. . . ." The implication is that if the November directive had been left in effect for a long period the Desk would have been required to moderate pressures continuously.

December 17, 1957: "to cushioning adjustments and mitigating recessionary tendencies in the economy."

With this change reference to inflation is abandoned, but so also is the instruction to moderate pressures. The first deletion might be taken to imply a step-up in the lessening of restraint, if not a shift to ease, but the second might be read to signify the opposite. The new language, on the whole and particularly in the instruction to mitigate "recessionary tendencies," seems to suggest the former interpretation. The Record appears to deny this, however: "The recession was still of moderate intensity, and inasmuch as the Committee actions taken since mid-November to lessen pressures on reserves, together with the reduction in . . . discount rates, had signaled an effective change in policy toward less severe credit restraint, it did not appear to the Committee that additional major actions were necessary at the moment. The change in . . . wording . . . was adopted with the understanding that reserves would continue to be

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made somewhat more available, but the particular reason for this change was to recognize that the economy had encountered a recession and that the ... Committee's policies were being molded accordingly."

This directive was renewed at the three following meetings. At the first of these it was agreed that "a slight easing in the reserve positions of banks would be desirable"; at the second, that "approximately the same condition in the money market that had existed immediately prior to this meeting" should be maintained; and at the third, that "the Committee should continue to follow an 'even keel policy tipped on the side of ease'."

March 4, 1958: "to contributing further by monetary ease to resumption of stable growth of the economy."

According to the Record, this change resulted from a "feeling that the directive should reflect a more positive approach to recovery than was embodied in the (previous wording)." A "more positive approach" presumably implies stronger policy actions. The Committee may have intended to suggest this, first, by using the word "further," and second, by including the phrase "monetary ease." Neither signal is wholly clear. "Contributing further" could be read as further in time as well as further in degree; that is, it might simply be taken as a continuation of the previous policy of "mitigating recessionary tendencies." The new reference to ease would have been more significant had the previous directive included the word "restraint"; since it did not, the reader might



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have reasoned that a posture of ease was consistent with the previous intent to mitigate recession, and therefore that no change was implied by the use of the new word.

This directive was renewed at the next five meetings, although at the one immediately following, in late March, the Committee "concluded that operations ... should be directed toward maintaining a slightly larger volume of free reserves and money market conditions slightly easier...." At the April meeting it was agreed that "this general level (of free reserves) should be maintained"; in early May, that "the prevailing policy of ease should be continued"; in late May, that an "even keel" should be maintained; and in June, that "the Committee should make no change in Federal Reserve credit policy." A series of short-term directive changes were made in July and early August in connection with the special problem of a disorderly government securities market.

August 19, 1958: "to fostering conditions in the money market conducive to balanced economic recovery."

The Record notes that a "vigorous revival" in activity was taking place at the time, and that "... the data presented indicated that the rate of expansion in the money supply in the immediate future should be tempered and that operations ... should move in the direction of lower free reserves...." It then goes on to say that "the objectives sought ... were encompassed in the amended wording of clause (b)...." It is hard to find a basis for this last assertion in a literal reading of the new language. Conditions "conducive to balanced recovery" presumably were an objective of the

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Committee's before as well as after the turn in business, and the August directive might have served equally well in March as the one that was in effect then. Alternatively, in August the Committee might as readily have called for operations "contributing further ... to resumption of stable growth...." It perhaps might even have included the March reference to "monetary ease," since it is not clear from the Record that the policy intention had shifted so far by August as to be called "restraint." In short, it is mainly the fact that the language was changed, rather than the specific change made, that might have been expected to convey the signal of a policy shift. But such an implication was denied in other cases -- for example, March 1957 and December 1957.

The consensus at the next four meetings favored no policy change (expressed variously in the Record as a decision in favor of "substantially the same tone in the money market," "an even keel in the market," maintenance of "conditions in the market about as they were at present" and, in one instance, against aiming toward a greater degree of restraint.) Accordingly, the August directive was renewed without change. However, it was again renewed at the next meeting, in early December, when "The policy discussion by the Committee pointed to some increase in the degree of restraint that should be exerted...."

December 16, 1958: "to fostering conditions in the money market conducive to sustainable economic growth and stability."

Here the phrase "sustainable economic growth and stability" was substituted for "balanced recovery." This change, according to

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the Record, represented a shift in emphasis toward "preventing expansion at an unsustainable rate" as well as a feeling that the word "recovery" was outdated. It is moot whether the substitution of the word "sustainable" for "balanced" would be taken by most readers to imply greater restraint, but the replacement of "recovery" with "growth" might well have carried this implication. In any case, the intent was to make only a "very moderate" move toward greater restraint. A substantially similar intent had been expressed at the preceding meeting, with no change in language.

Incidentally, the language of this particular directive might be deemed an appropriate instruction to the Desk at all times and under all circumstances.

The December directive was renewed at each of the first seven meetings of 1959, with the consensus favoring no change in the degree of restraint. At the last of these meetings, however, (May 5, 1959), "... the majority of the Committee agreed that it would be desirable to move towards greater restraint on credit expansion as soon as feasible after the current Treasury financing was completed...."

May 26, 1959: "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities."

This change was associated with a conclusion that "an intensification of restraint was required," and the new language, with the first reference to "restraining inflationary expansion" since October 1957, was less ambiguous than at other times. The May directive was renewed at the next 13 meetings, at all but the last of

which (February 1960) the consensus favored a continuation of the prevailing degree of restraint. In early July 1959, however, the Record indicates that the instruction to the Account Manager "was tempered with the proviso that ... doubts should be resolved on the side of ease during the period of Treasury financing." Again, in late September, the qualification was made "that any deviations preferably should be on the side of less restraint."

At the meeting in February 1960, "There was unanimity of opinion that any tightening ... should be avoided. On the contrary, while a majority favored watchful waiting during the period immediately ahead, there were several ... who leaned toward slightly less restraint.... It was felt rather generally that a moderate increase in the money supply would be desirable .... ...consideration was given to ... modification of the policy directive ... so as to place emphasis ... upon the fostering of sustainable growth ... rather than upon restraint of inflationary credit expansion.... The consensus, however, did not favor a change at this time, on the grounds that it would indicate a basic shift in ... policy and that such a shift was not called for at present." The decision on these grounds to make no change in language (as distinct from a decision against the particular language change described) suggests that Committee was taking a different view of the directive than it had earlier. As noted above, on several occasions in the period reviewed the Record indicates that a language change was not intended to imply a policy change, and on one occasion, that it was intended to signal a "very moderate" change.

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March 1, 1960: "to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion."

This change reflected a consensus favoring "a policy of moderately less restraint." The signal evidently was intended to be incorporated in a reversal of phrases and the substitution of "guarding against" for "restraining" an undesired degree of credit expansion. (The substitution of the adjective "excessive" for "inflationary" in qualifying credit expansion may or may not have been intended to convey part of the signal.) The phrase reversal amounts to this: If "A" is taken as a symbol for sustainable growth, and "B" for an undesirable rate of credit expansion, the previous statement, "to prevent B in order to foster A" is replaced by the statement, "to foster A while preventing B." To many readers this might appear to be six of one and a half-dozen of the other. The use of the words "guarding against," with their suggestion of a passively protective posture, in place of the more active verb "restraining" might have helped to make the Committee's intent clearer to some readers, but the distinction would probably have been lost on many.

This directive was renewed at the three following meetings, at only the first of which, in late March, the Committee favored a maintenance of the existing situation. In April, the consensus "favored easing further the reserve positions of member banks, and thus encouraging an increase in the money supply, this to be done, however, in a modest way;" and the renewal of the directive was

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subject to this understanding. In early May the consensus was that "current conditions justified moving modestly in the direction of increasing the supply of reserves...." The Record adds that "The Committee concluded that this further relaxation of restraint could be accomplished within the scope of the existing policy directive...."

May 24, 1960: "to fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion."

The consensus at this time "favored a further supplying of reserves ... with a view to permitting a moderate expansion of bank credit and encouraging an increase in the money supply...." The signal was conveyed by deleting the instruction to guard against excessive credit expansion and adding an instruction to provide reserves for moderate expansion. So specific an instruction as that contained in the new language had not been used since November and December of 1957. As on the earlier occasion, with each renewal this language would seem to call for further additions to reserves. Whether or not the Committee so interpreted it at the first renewal, in June, is not clear; the consensus called for "waiting watchfully ... with the understanding that any deviations ... should be on the side of ease...." The suggested interpretation is evident in the two July renewals, however, when the consensuses were to "continue to provide reserves at approximately the present rate" (July 6), and to "continue to make reserves for bank deposit expansion readily available" (July 26).

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August 16, 1960: "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment."

The consensus at the time of this change, according to the Record, was that the objective of the preceding several months of providing reserves for moderate bank credit expansion should be "emphasized" -- presumably meaning that the rate at which reserves were being supplied should be stepped up. A minority, while agreeing with this consensus, opposed the language change on grounds that a majority had found persuasive in February 1960: "that the consensus did not contemplate a sufficient modification in the course and objectives of ... operations to necessitate a change in the directive." The new language was approved by a majority "After consideration of several suggestions for revision ... that would more strongly suggest a positive attitude toward increasing the availability of reserves...." In the new directive the order of phrases was reversed, as had been done twice before; the reference to expansion now came before rather than after the phrase beginning "fostering sustainable growth." Among other changes, the word "moderate" as a qualifier of the kind of expansion sought was dropped.

Here, as in other cases, it is doubtful that the message the Committee intended to convey would get through to most readers. The revised order of phrases might again have been taken as a distinction signifying no difference; and the deletion of the word "moderate" is ambiguous since no other adjective was put in its place. (A move away from "moderate" expansion might as readily have been in the direction of "slight" as "substantial.")

This directive was renewed at the two following meetings, at which the consensus was for continuing to "supply needed reserves readily." The last modification of the directive in the period covered was made at the October 25 meeting and involved the addition to the previous directive of the phrase, "while taking into consideration current international developments." The consensus on that date included the conclusion that "Insofar as it described the objectives of domestic monetary policy, the existing directive ... was regarded as continuing to be appropriate," but that in view of the increasing import of international developments it was desirable to refer to them specifically. No policy changes were called for at the remaining two meetings in 1960.