

PRESIDENT'S REPORT TO THE BOARD OF DIRECTORS,  
FEDERAL RESERVE BANK OF BOSTON

Current Economic Developments - October 14th, 2004

Data released since your last Directors' meeting indicate the economy is back on track following a second quarter dip. It appears third quarter GDP will be above 4%, improving upon the second quarter's upwardly revised 3.3%. September auto sales and August construction spending both indicate stronger activity.

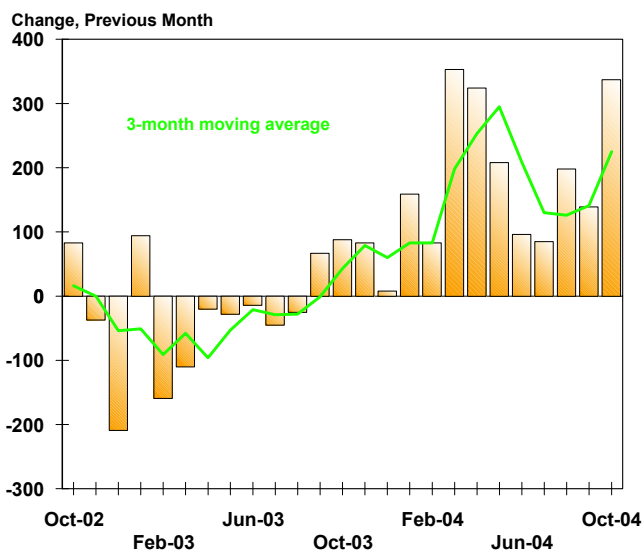
In September, payroll employment increased less than expected but the unemployment rate was unchanged. Initial claims edged up and consumer sentiment and confidence continued to ease somewhat. Personal income posted a solid increase in August while spending held steady.

In the business sector, industrial production rose marginally while capacity utilization was flat. The September ISM diffusion index, while lower than the January peak, remains consistent with strong activity.

While consumer and producer prices showed little change in August, escalating energy prices may be cause for concern. There is also a risk that higher gasoline and heating prices will undermine consumers' willingness to spend. Ultimately, the strength in household spending will be determined by the level of job and income growth, which makes September's employment data troublesome.

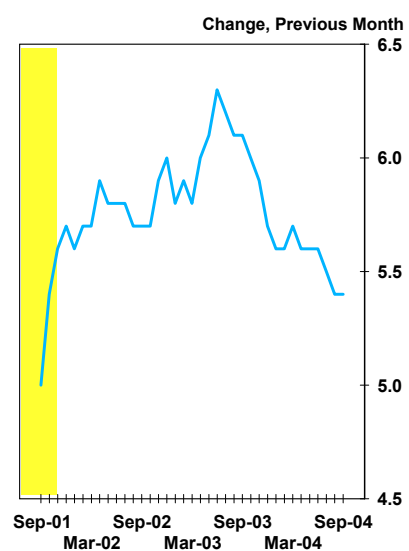
Nonfarm payroll employment rose in September and the unemployment rate was unchanged, holding at its nearly three year low.

Change in Nonfarm Payroll Employment



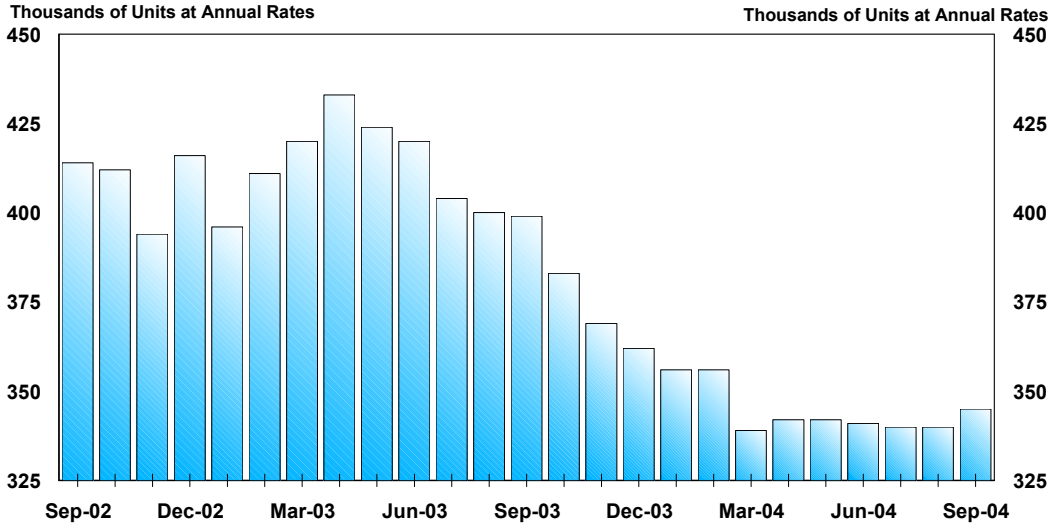
Source: Bureau of Labor Statistics.

The Unemployment Rate



Initial claims for unemployment rose in September. The increase, however, appears to be related to hurricane disruptions in the Southeast. The most recent data are very close to the level that has prevailed since March.

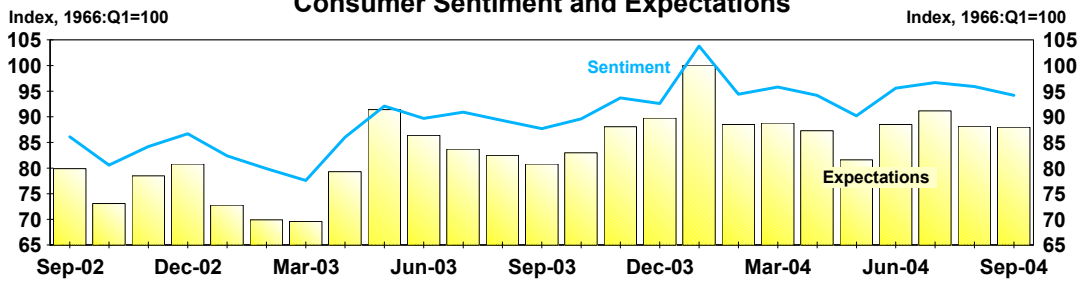
### Initial Claims



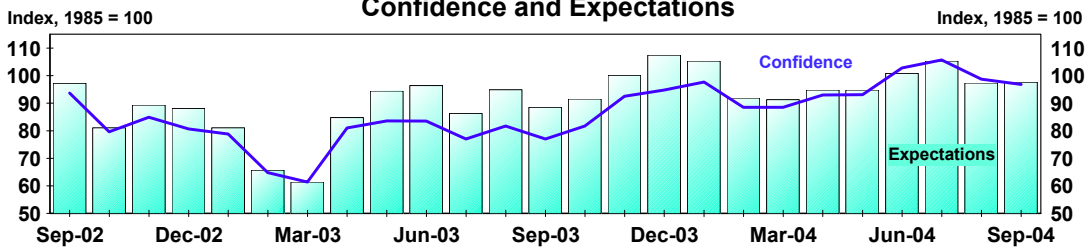
Source: Department of Labor, Employment and Training Administration.

Consumer confidence and sentiment deteriorated slightly in September, but future expectations were basically flat.

### Consumer Sentiment and Expectations

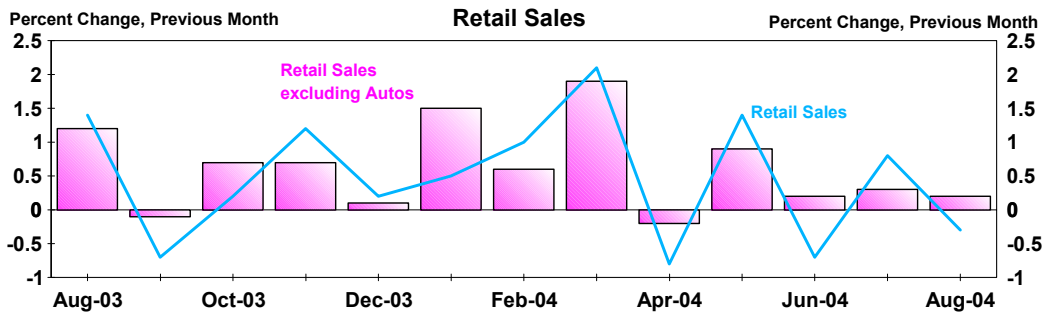
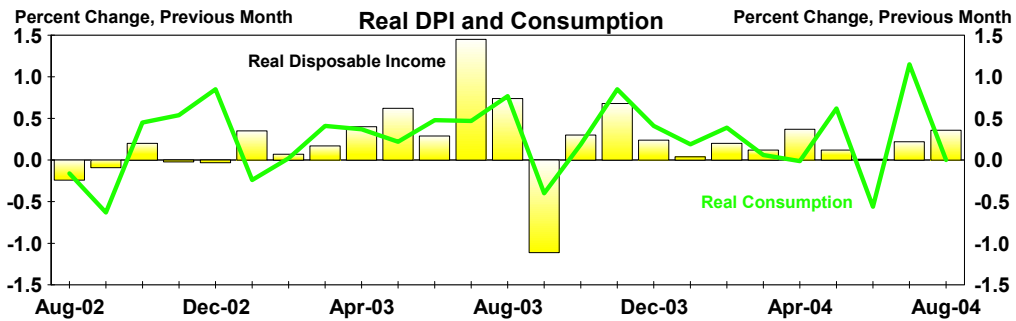


### Confidence and Expectations



Source: University of Michigan (sentiment) and The Conference Board (confidence).

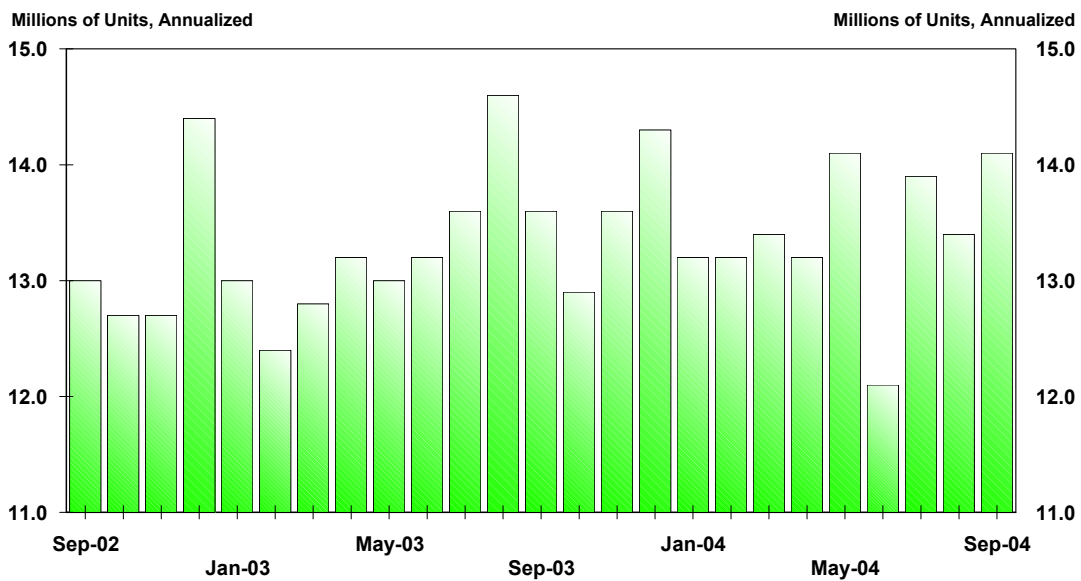
In August, real disposable income posted its largest gain since April. Real consumption was flat following an (upwardly revised) surge in July. Retail sales fell slightly in August, while retail sales excluding autos rose marginally.



Sources: Bureau of Economic Analysis (DPI) and U.S. Census Bureau (retail sales)

In September, domestic auto and light truck sales rose to hit their highest level since May.

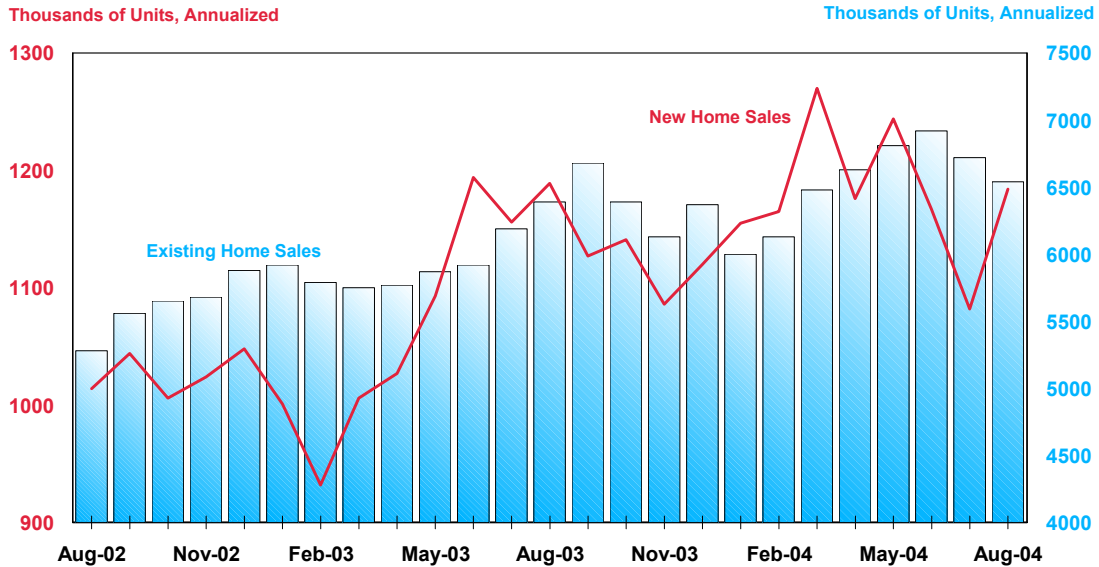
**Domestic Auto and Light Truck Sales**



Source: Bureau of Economic Analysis.

The housing market continues to be strong. New home sales rose in August and existing home sales remain at high levels.

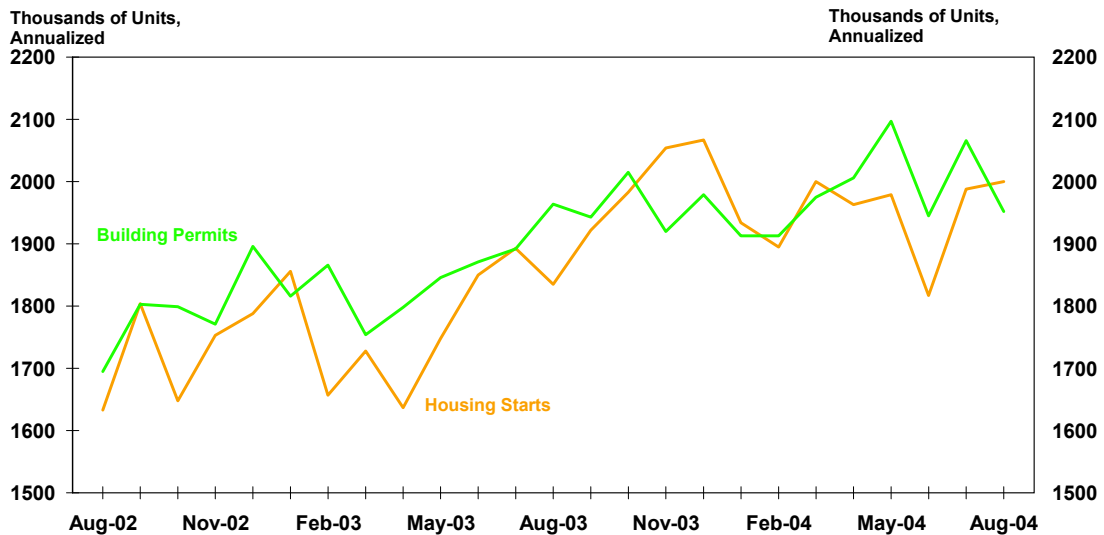
### New and Existing Home Sales



Source: U.S. Census Bureau.

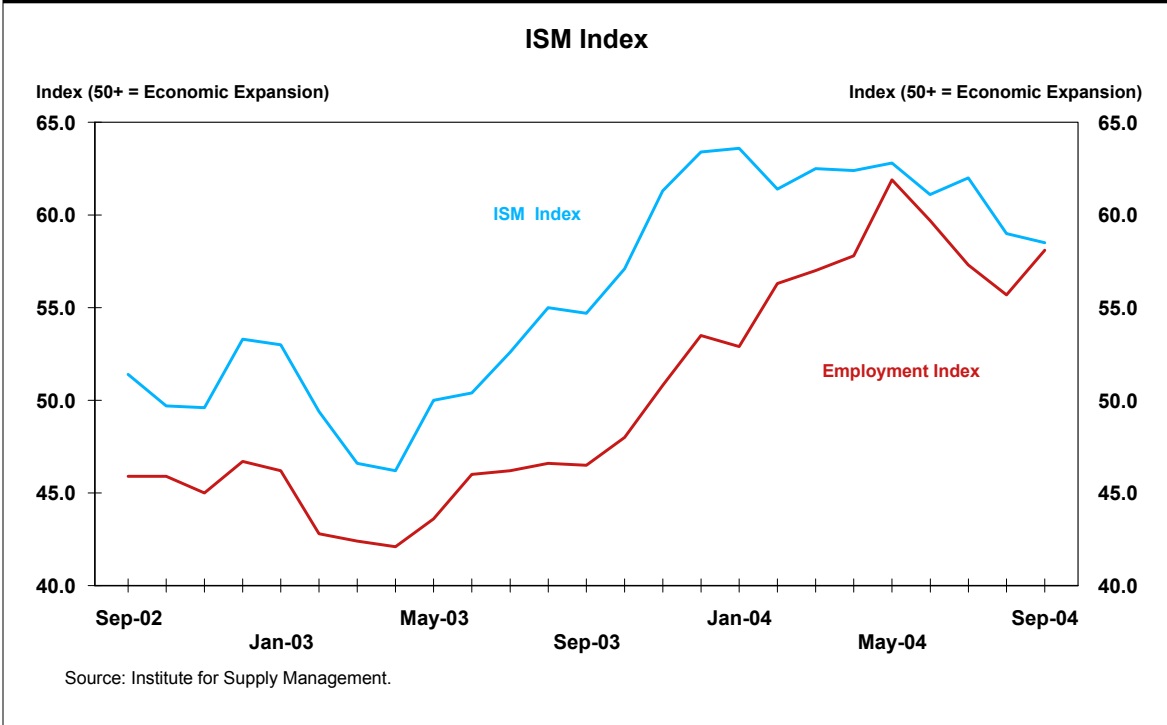
Similarly, building activity remains brisk.

### Housing Starts and Building Permits

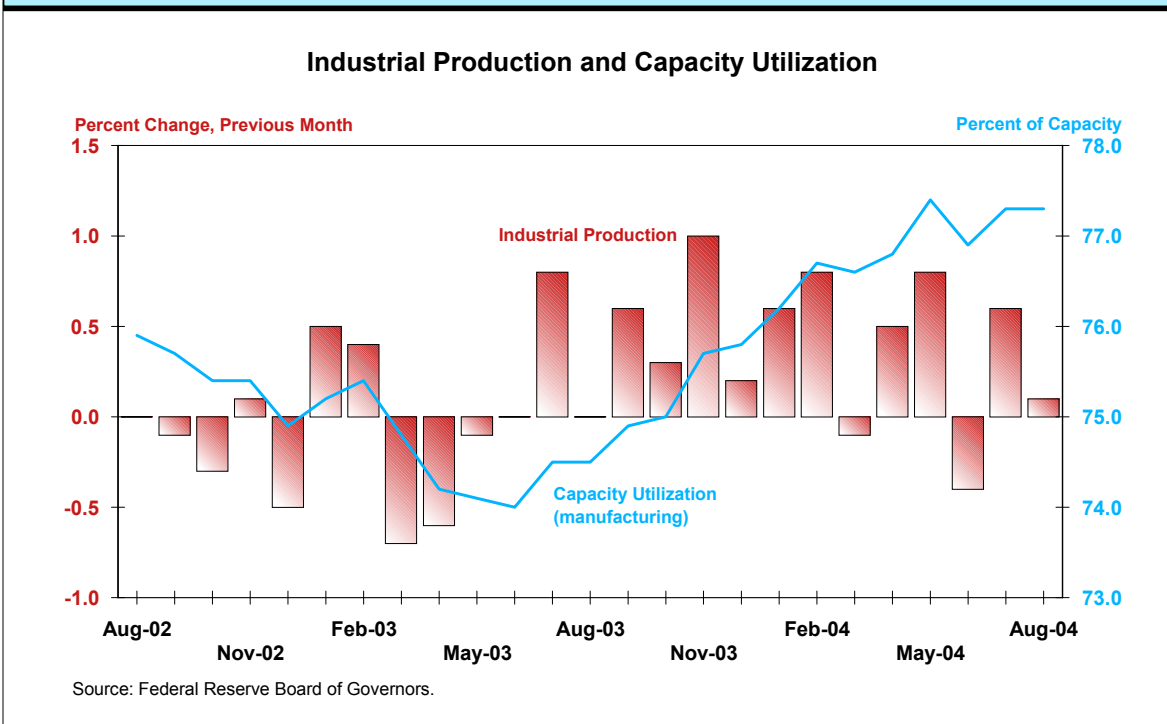


Source: U.S. Census Bureau.

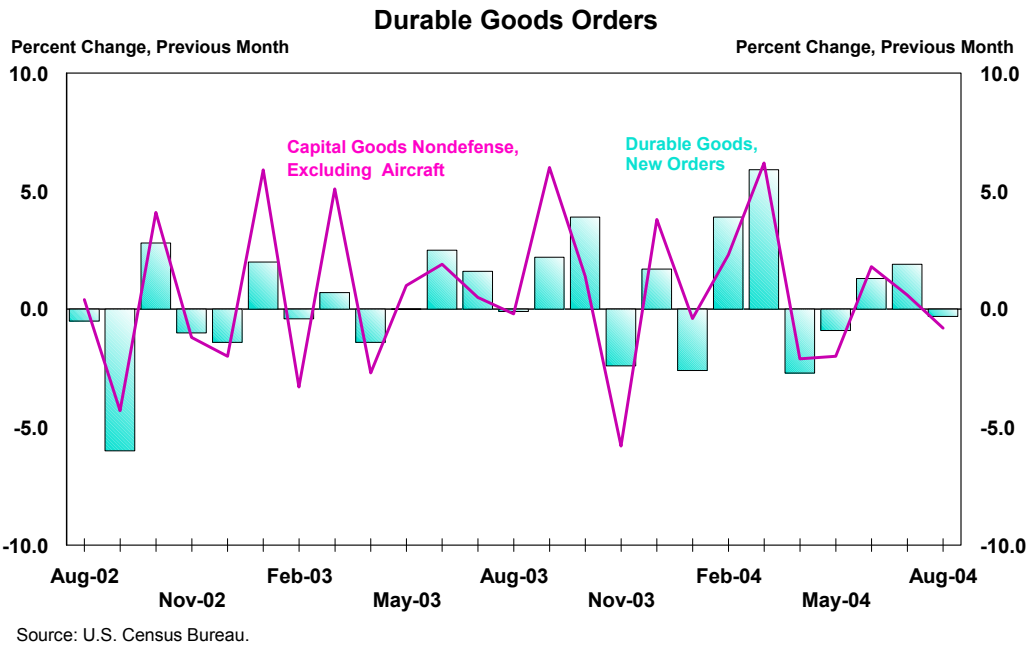
In the business sector, the ISM diffusion index fell in September. The employment component of the index recouped the losses seen in August. The current level of the diffusion index remains strong from a long-term perspective.



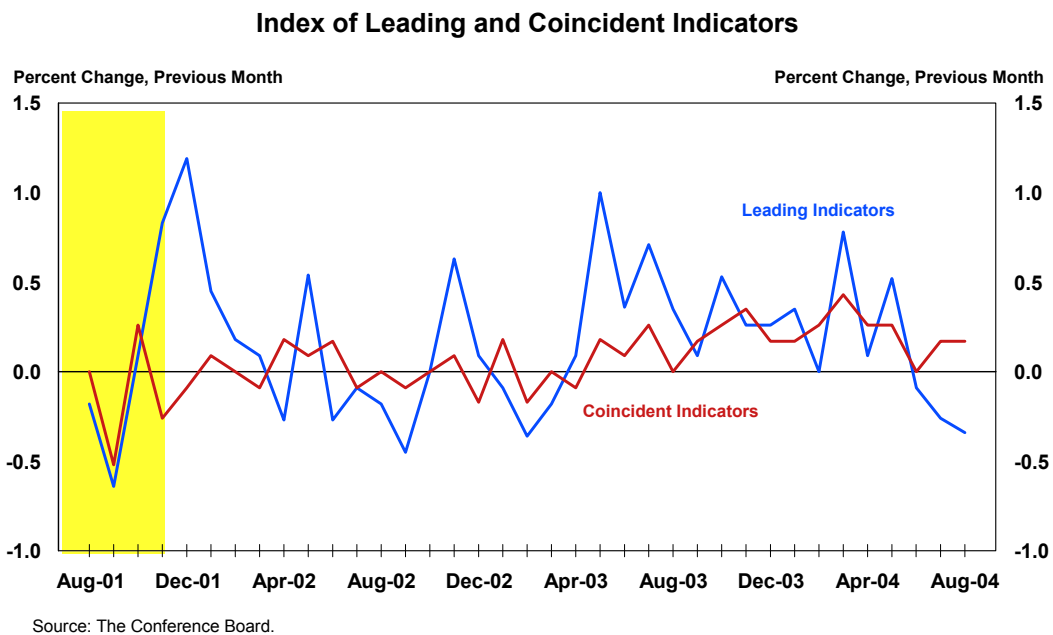
In August, industrial production posted a small gain, while capacity utilization was flat.



New orders for durable goods decreased, after four consecutive months of improvement. And capital goods excluding aircraft fell for the second straight month.

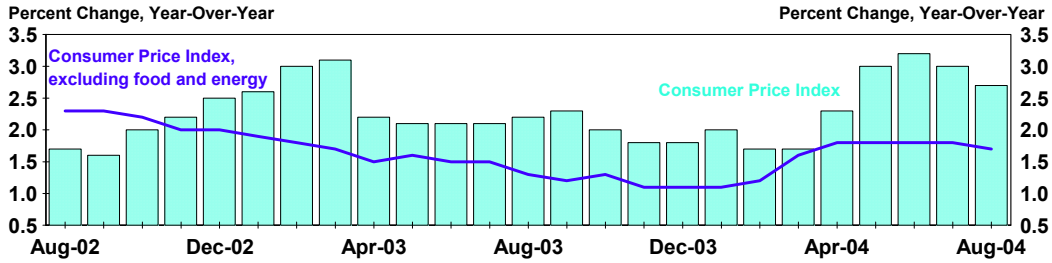


The index of leading indicators dropped in August for the third consecutive month, falling to an 18-month low.

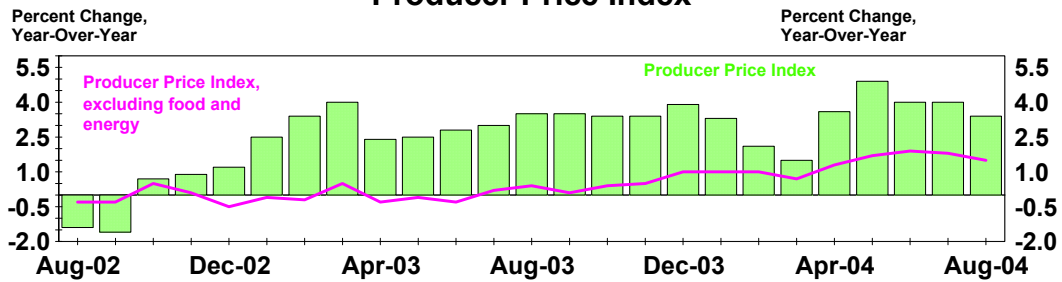


Inflation concerns are subsiding, as growth in total CPI and PPI continue to abate. Core prices continue to signal low inflation risks.

### Consumer Price Index



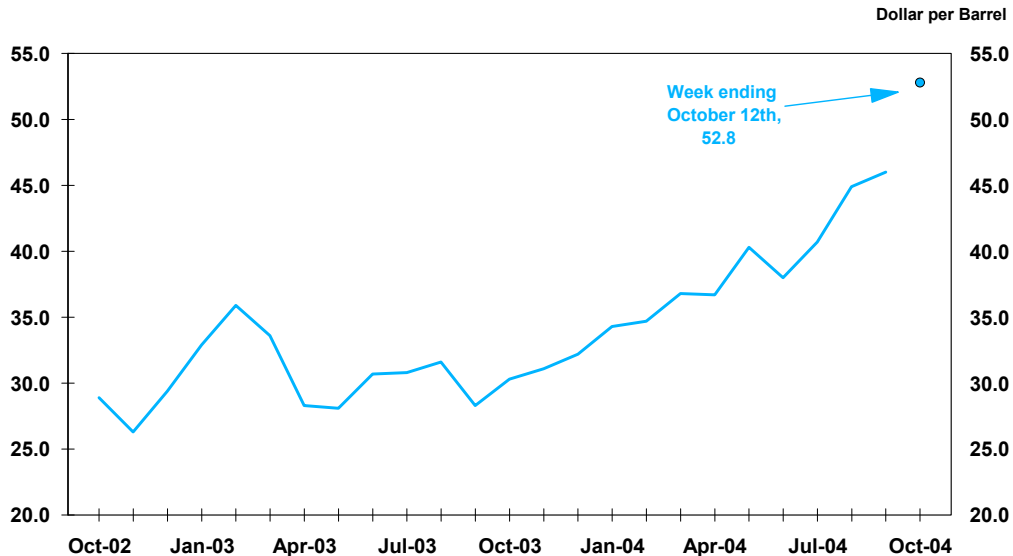
### Producer Price Index



Source: Bureau of Labor Statistics.

Still, escalating energy prices are cause for concern.

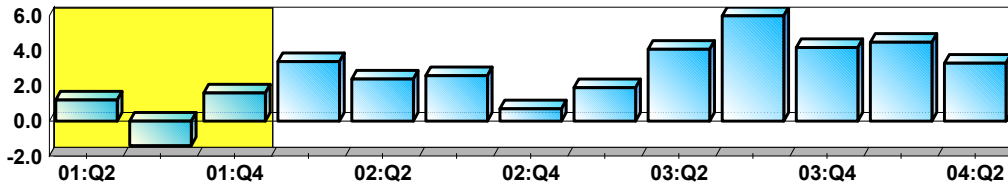
### Domestic Spot Oil Price



Source: West Texas Intermediate, Wall Street Journal.

Real GDP was revised upward in the second quarter, led by greater business investment, residential construction and exports.

### Real GDP

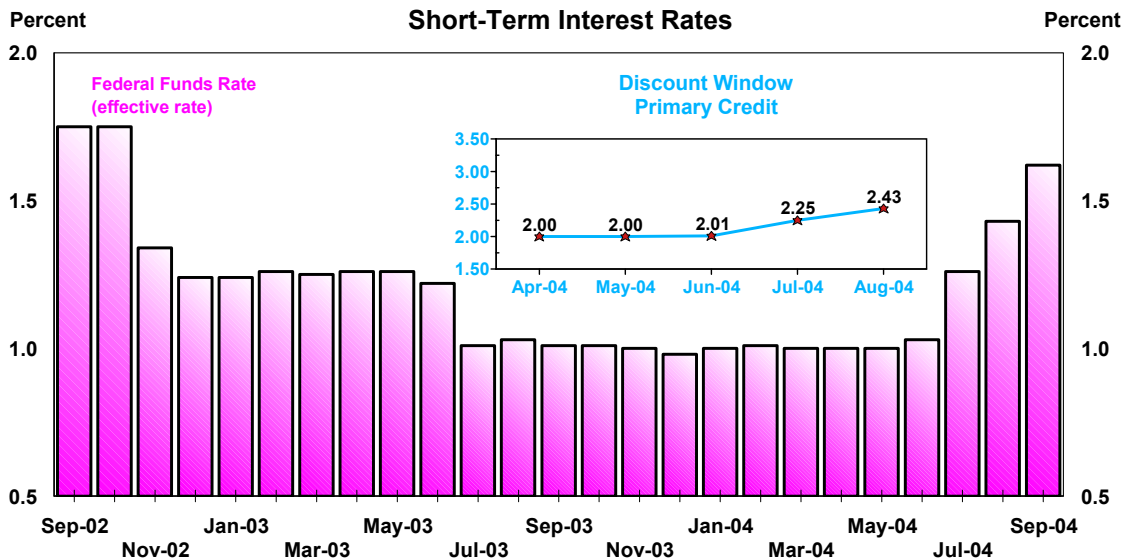


### Revisions to Second Quarter Real GDP

Description	Preliminary	Revised
Real GDP	2.8	3.3
Business Investment	12.1	12.5
Equipment & Software	13.6	14.2
Residential Investment	14.7	16.5
Government	2.4	2.2
Exports	6.1	7.3
Imports	14.1	12.6
Final Sales	2.1	2.5

Source: Bureau of Economic Analysis.

Overall, the data have been consistent with an acceleration of activity in the third quarter. As concerns the outlook, real GDP growth in the 3-4 percent range is the most likely outcome. But for such an outcome to materialize, there needs to be a substitution from policy-induced growth to private growth. In this regard, employment growth remains central.



Source: Federal Reserve Board of Governors.