

PRESIDENT'S REPORT TO THE BOARD OF DIRECTORS,
FEDERAL RESERVE BANK OF BOSTON
Current Economic Developments - August 4, 2005

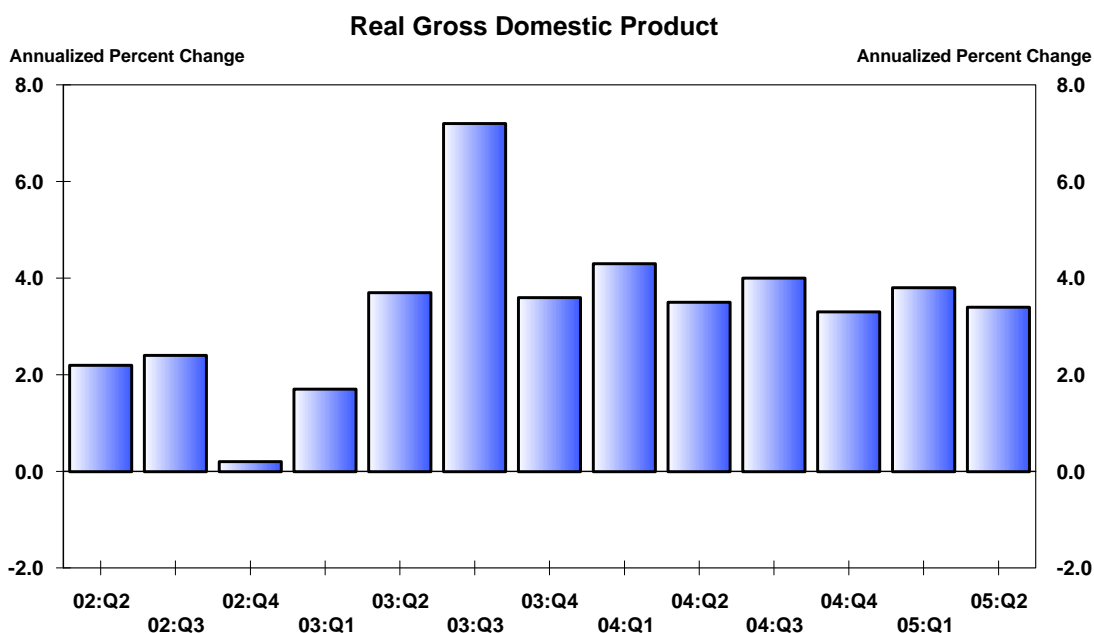
Data since your last Directors' meeting show the economy grew in the second quarter at a slower pace than seen in the first quarter. However domestic demand was much stronger as inventories were reduced.

The growth in real GDP during the second quarter was due primarily to personal consumption expenditures, exports, equipment and software, residential investment and government spending. The deceleration in real GDP from the first quarter primarily reflected a downturn in private inventory investment.

In July, consumer attitudes showed improvement after easing in the second quarter. Auto and light truck sales increased dramatically, boding well for third quarter consumption. Payrolls grew in July, the unemployment rate decreased, and initial claims for unemployment insurance fell. The ISM employment index returned to the positive side of 50 and its manufacturing index also increased.

Recent inflation data, aside from rising energy prices, has been benign. Core CPI was essentially flat in the second quarter and total compensation costs, as measured by the ECI, decreased slightly. Unit labor costs and total compensation also decelerated in the second quarter.

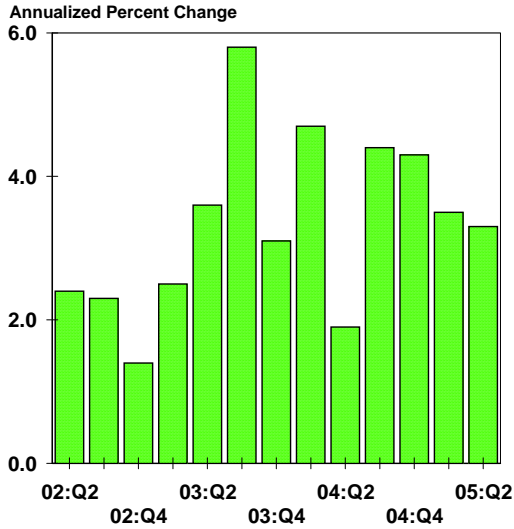
Real GDP growth decelerated in the second quarter, reflecting a downturn in private inventory investment that was partly offset by a downturn in imports and accelerations in exports and in equipment and software investment.



Source: Bureau of Economic Analysis.

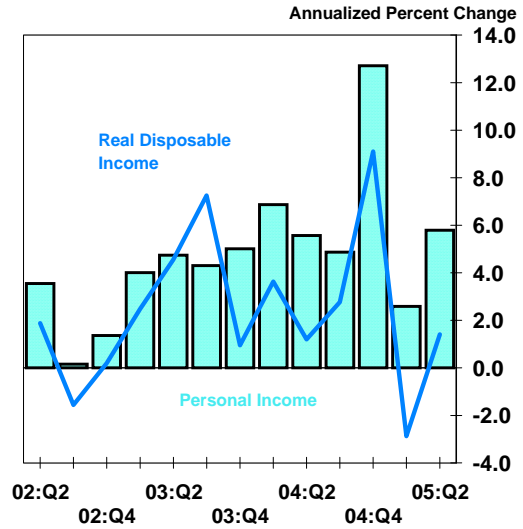
Real consumption continued to grow in the second quarter, albeit at a slightly slower pace, as personal income accelerated and Real DPI increased.

Real Consumption



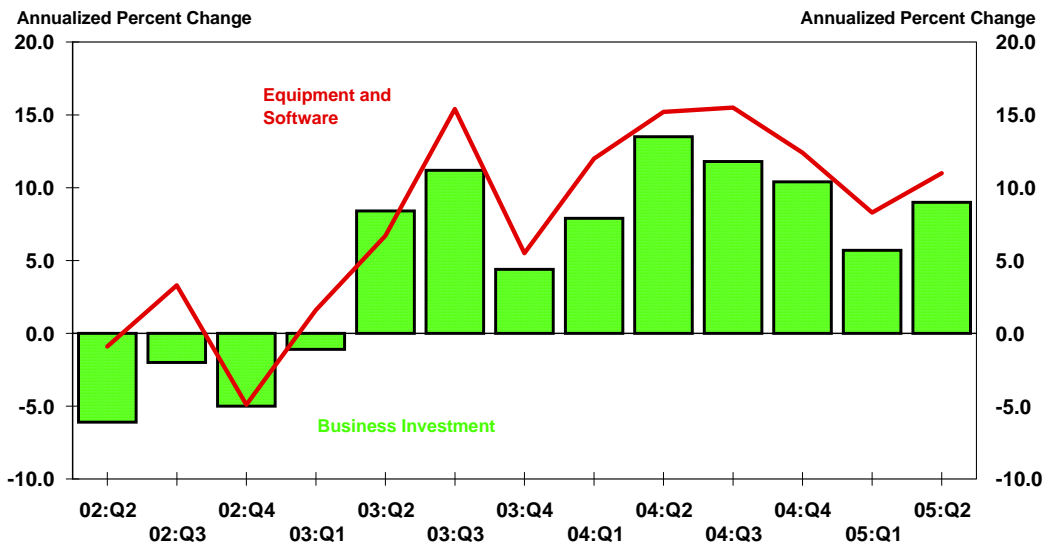
Source: Bureau of Economic Analysis.

Personal Income



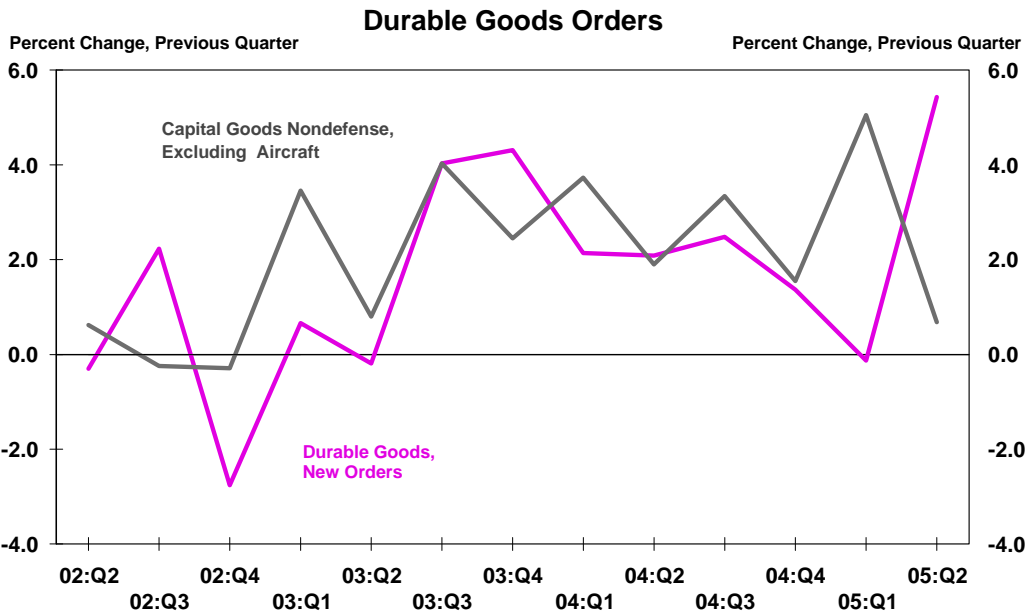
Growth in business investment increased in the second quarter, due primarily to an acceleration in equipment and software investment.

Business Investment



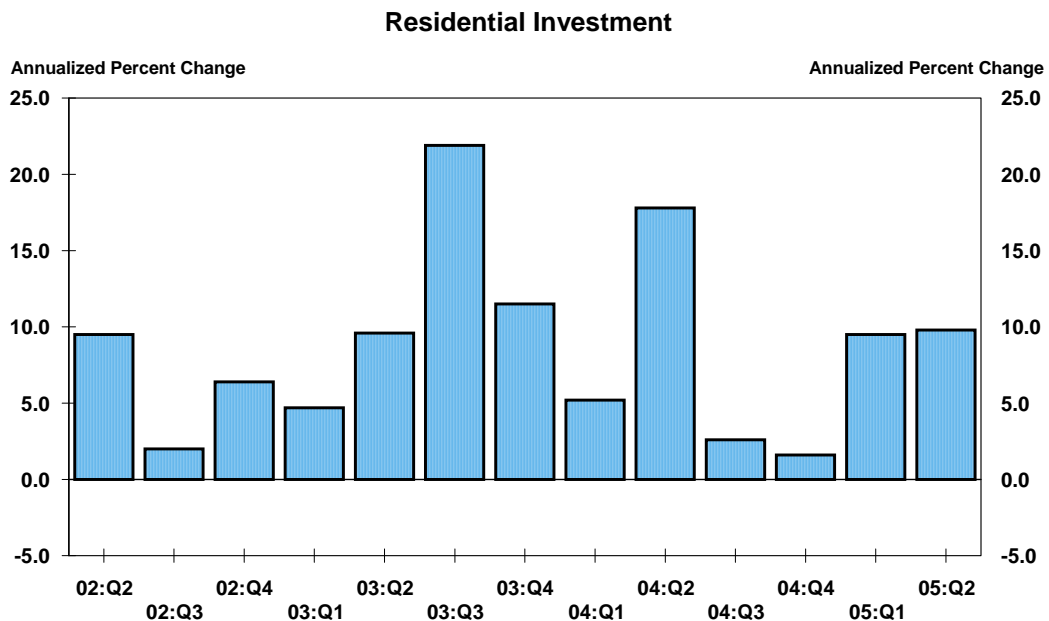
Source: Bureau of Economic Analysis.

New orders for durable goods rebounded in the second quarter, growing at their fastest quarterly pace on record. Orders of nondefense capital goods, excluding aircraft, slowed.



Source: U.S. Census Bureau.

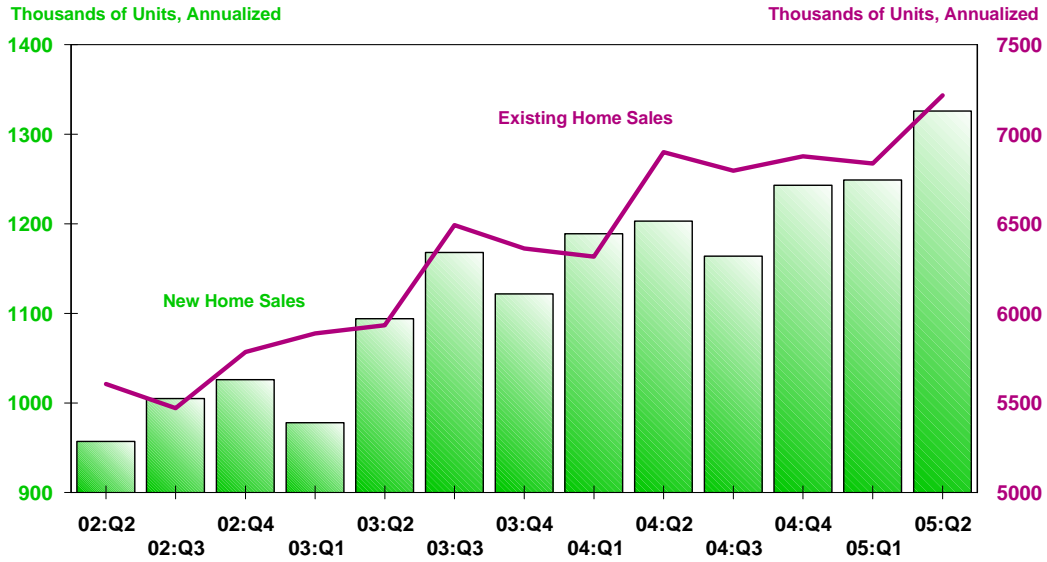
Residential investment was basically flat in the second quarter, and remains strong.



Source: U.S. Census Bureau.

In the second quarter, sales of both new and existing homes increased to establish new record paces.

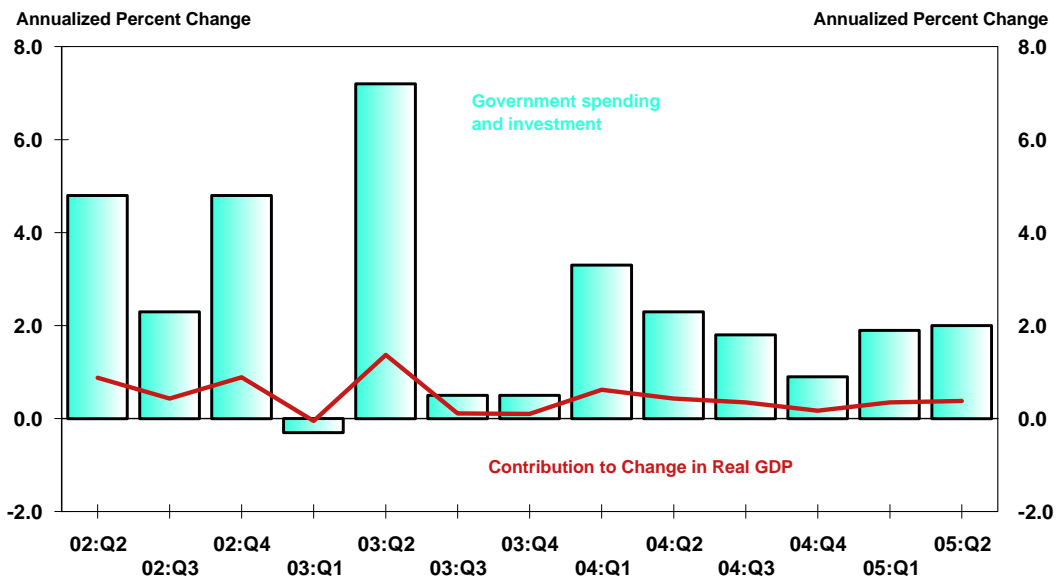
New and Existing Home Sales



Source: U.S. Census Bureau.

Government spending edged up slightly in the second quarter, yet still contributed less than half of a percentage point to the change in GDP.

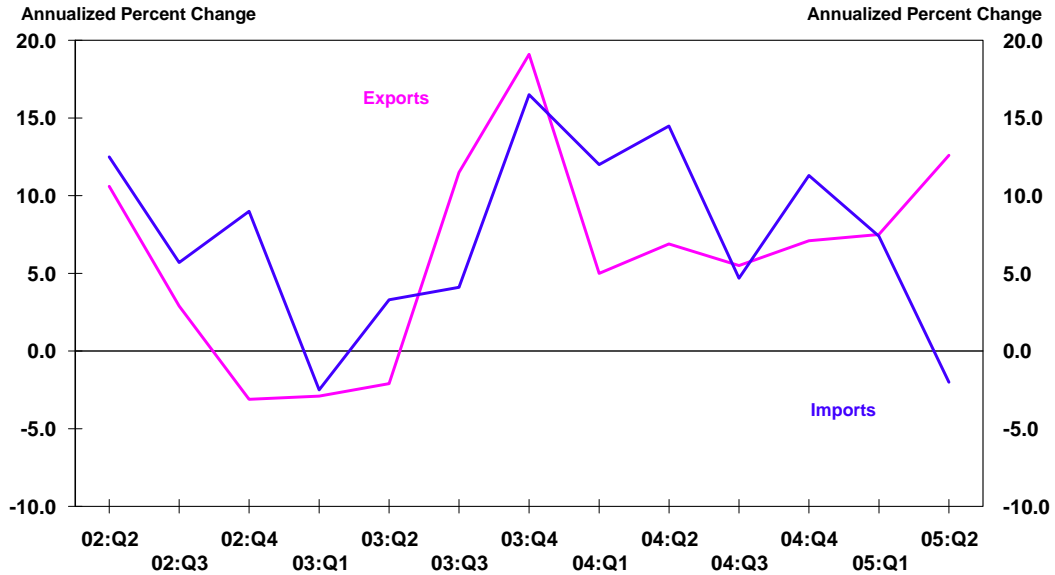
Government Spending



Source: Bureau of Economic Analysis.

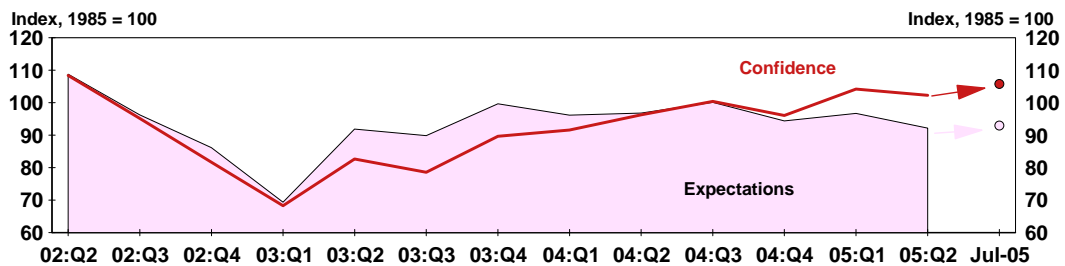
Export growth continued to accelerate in the second quarter, and imports fell for the first time in over two years.

Exports and Imports

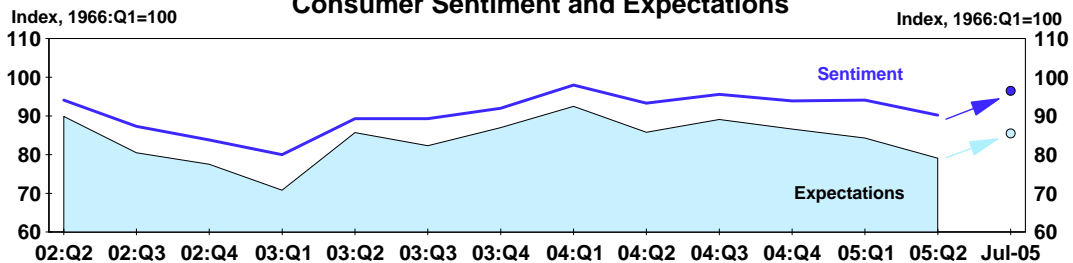


Consumer attitudes weakened in the second quarter, but showed signs of improvement in July.

Consumer Confidence and Expectations



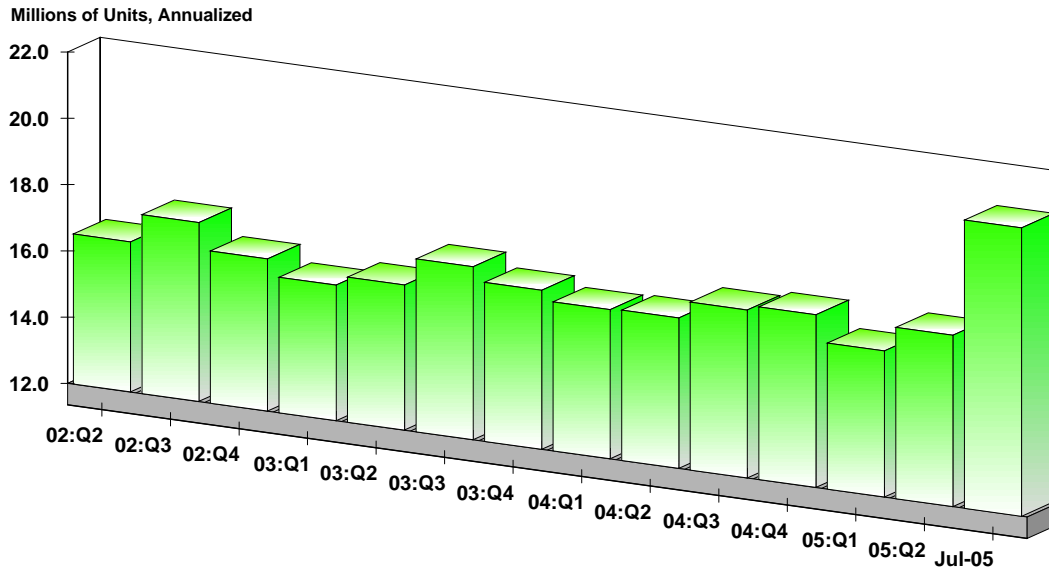
Consumer Sentiment and Expectations



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

Total auto and light truck sales surged in July as consumers responded to generous discount programs offered by manufacturers.

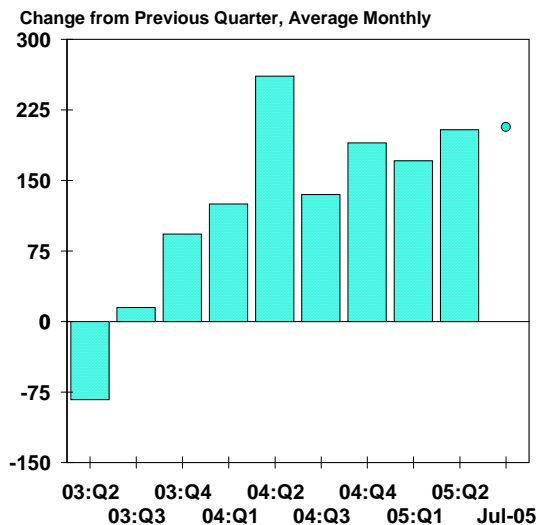
Total Auto and Light Truck Sales



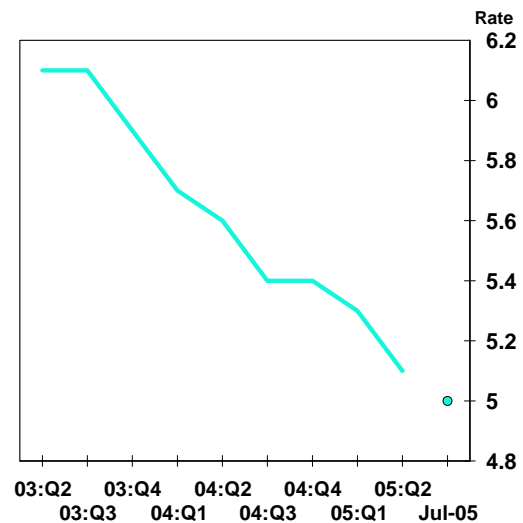
Source: Bureau of Economic Analysis

The labor market continues to show signs of strength. Payroll employment increased further in July while the unemployment rate was one-tenth of a percentage point lower in July than its second quarter average.

Nonfarm Payroll Employment

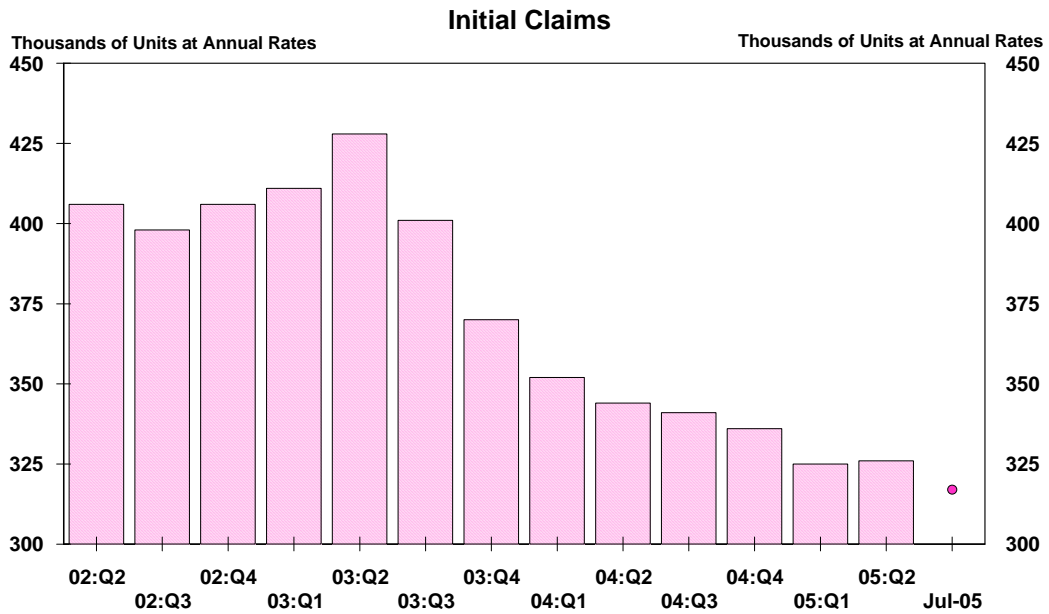


Unemployment Rate



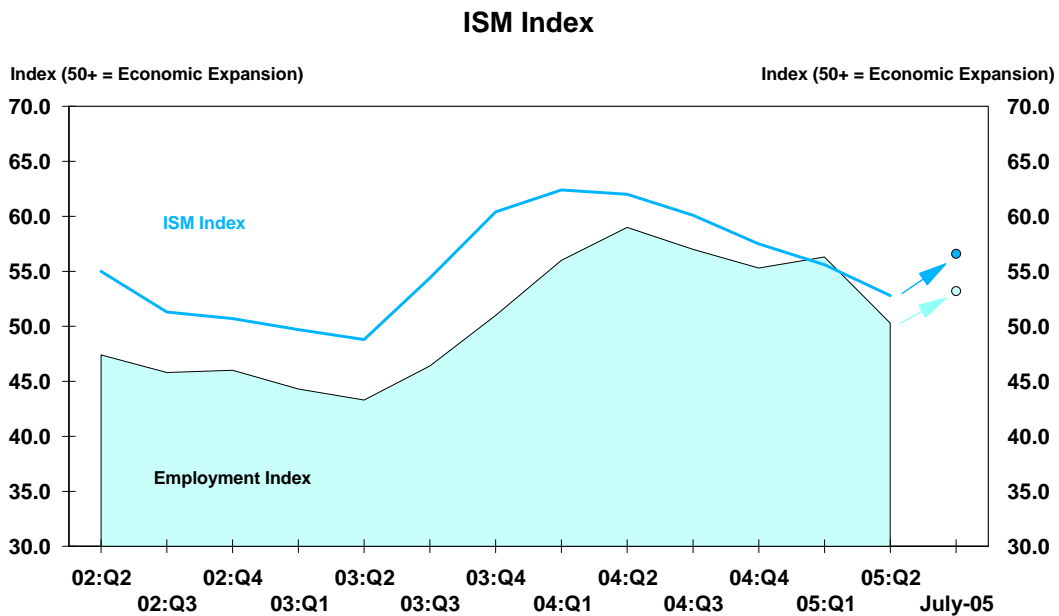
Source: Bureau of Labor Statistics (employment) Department of Labor, Employment and Training Administration (claims).

Initial claims for unemployment insurance were essentially flat in the second quarter, and fell slightly in July.



Source: Department of Labor, Employment and Training Administration.

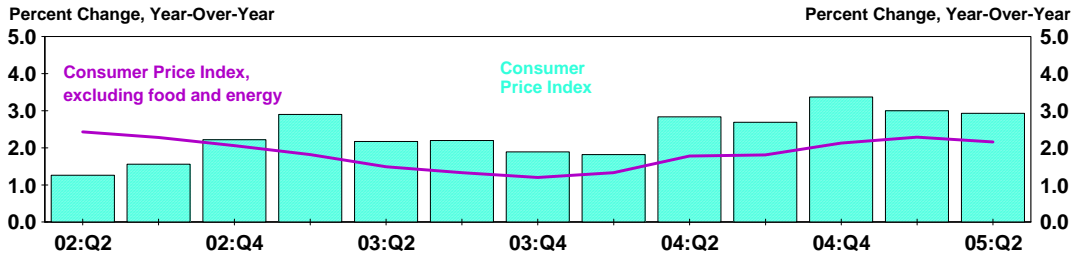
After falling further in the second quarter, the ISM index rebounded in July. The employment index also rose in July, climbing back over 50.



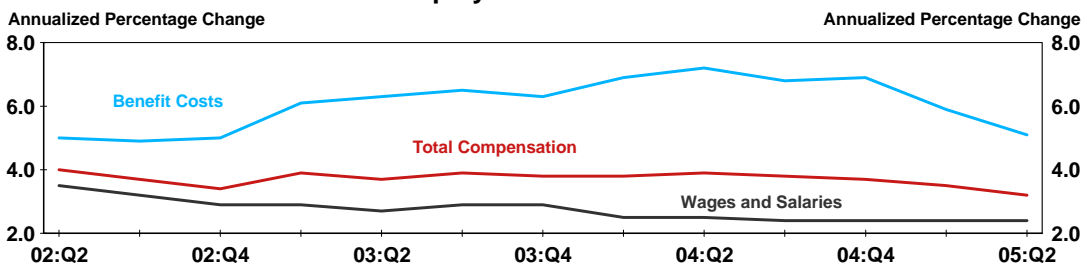
Source: National Association of Purchasing Management.

Consumer price inflation, both overall and when excluding food and energy, was a bit slower in the second quarter. Employment costs decelerated for a fourth consecutive quarter, as benefit costs decreased and wages remained steady.

Consumer Price Index



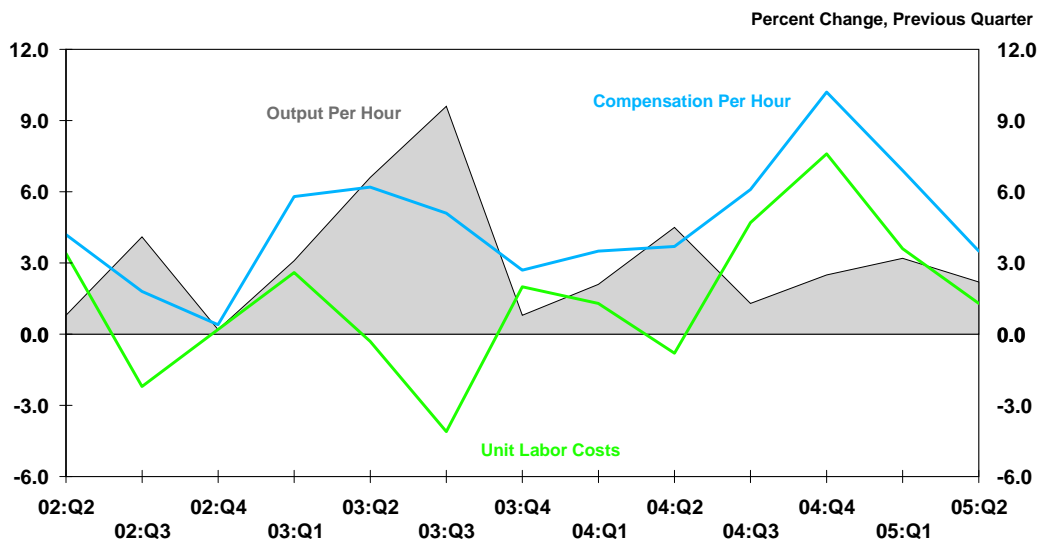
Employment Cost Index



Source: Bureau of Labor Statistics.

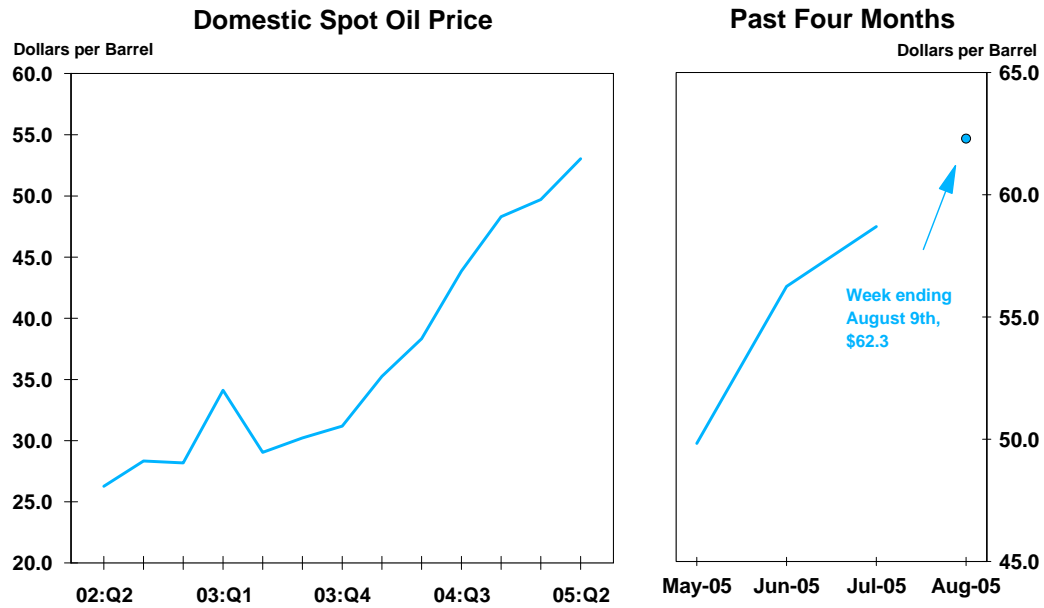
Productivity growth decreased in the second quarter, as did compensation and unit labor costs.

Productivity and Costs



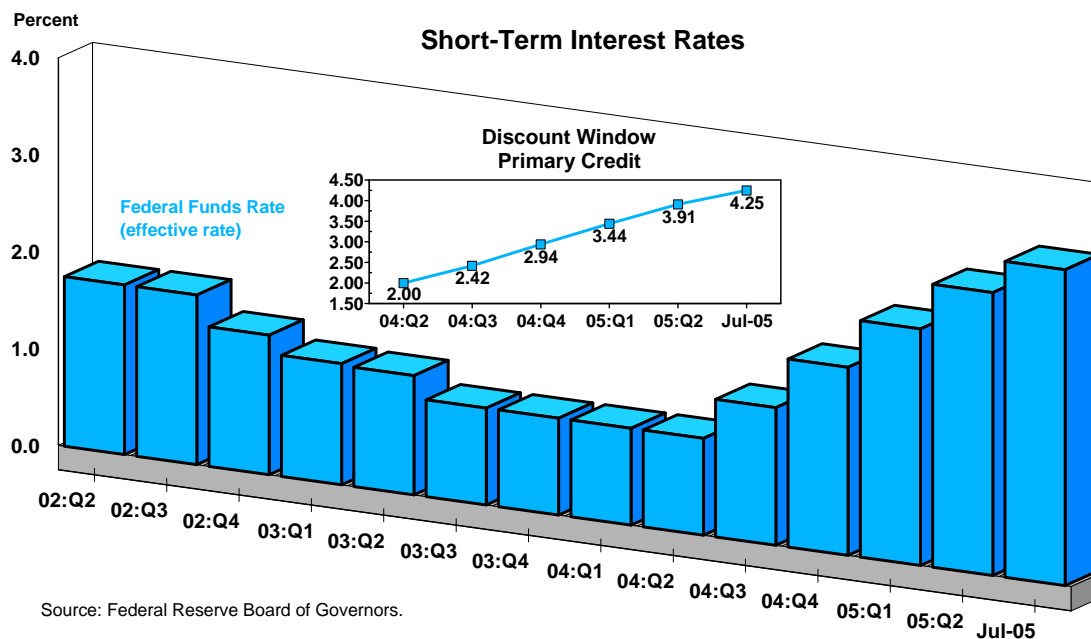
Source: Bureau of Labor Statistics.

Oil prices rose in the second quarter, setting another record high. Recent data show the trend continuing.



Source: Wall Street Journal (oil prices).

Overall, the economy grew in the second quarter at a slower pace than in the first quarter. However, domestic demand was much stronger as inventories were reduced. Consumption is strong, the housing market remains vibrant, and despite high energy prices consumer attitudes are solid.



Source: Federal Reserve Board of Governors.