Letter from the President

I am pleased to share this 2007 annual report with you and to provide some observations on the past year, my first as Bank president.

As you know, turmoil in U.S. and international financial markets emerged in late summer, making my first months as a Reserve Bank president very eventful.

Prior to July, the U.S. economy had appeared to be settling into a "sweet spot." Core inflation was edging down, and the U.S. unemployment rate remained near historic lows. To be sure, there were significant risks to this sweet spot, notably the weakening of the housing sector and rising energy prices.

Circumstances changed significantly in the middle of the year. Delinquency rates and foreclosures on subprime mortgages began to escalate, house prices in many parts of the country began to fall, and credit markets became turbulent and in some cases illiquid. As of mid-August, the combination of higher credit costs – and in some cases reduced availability of credit – threatened to weaken the U.S. economy.

I have spent the bulk of my career – first as a research economist and then a bank regulator – studying the ways that financial markets affect the real economy. Indeed, several of us who are current Federal Reserve monetary policy makers did extensive research on the credit crunch period of the early 1990s – work that has proven to be valuable preparation for dealing with today's financial problems.

To help ease the turmoil in financial markets and address the emerging risks to the real economy, the Federal Reserve has been proactive and decisive – mixing innovative new tactics with aggressive use of our traditional monetary tools. In the fall, the Federal Reserve opened a Term Auction Facility (TAF) for making collateralized loans to banks. The TAF allows banks to bid for reserves anonymously through an auction process and, thus, addresses banks' concerns that borrowing at the discount window may signal economic weakness. (Additional lending facilities were introduced in 2008.) These steps are designed to promote liquidity and smooth functioning in financial markets that have been under stress and to contain turmoil that could spread to many corners of the economy.

Here at the Federal Reserve Bank of Boston, we have been focusing intently on the problems stemming from subprime mortgages and on ways to mitigate the effects of rising delinquencies and foreclosures on borrowers and others. We have been actively sharing our research findings and participating in the national and regional policy debates. We also worked with five large New England banks to encourage their establishment of the Mortgage Relief Fund – designed to reach out to borrowers holding subprime loans and, where possible, to help them refinance into more affordable loans. A number of community banks will be joining this effort in 2008.

Other aspects of our work in 2007 are described in the Bank Highlights section of this annual report. Of particular note is our work helping the U.S. Treasury and federal agencies with a variety of financial applications. Also noteworthy is the work of our bank supervision staff in preparing for implementation of the new Basel II capital requirements; two Boston officers have taken on national Basel II leadership roles for the Federal Reserve System. Our economists made valuable contributions to economic research and policy making in 2007, and our three research centers – the New England Public Policy Center, the Behavioral Economics Center, and the Emerging Payments Research Group – continued to shed new light on topical economic policy issues. In payments and financial services, we made additional strides in our tradition of quality service and innovation.

In all of these activities – and the many others I do not have space to mention – we worked toward our vision of excellence in serving the public as the nation's central bank in New England. In our daily work, we are more than ever focused on the goal of making a difference.

I would like to thank the staff of the Bank, our directors, and the members of our advisory groups for their commitment and service. I also thank them, and many of you, for welcoming me to my new role as president and for offering support and counsel.

I want to conclude with words of appreciation for several individuals who completed their terms of service to the Bank in 2007. Two members of our Board of Directors, Ronald Logue, Chairman and CEO of State Street Corporation, and Dr. Samuel Thier, Professor of Medicine and Health Care Policy at Harvard Medical School and Massachusetts General Hospital, gave a wealth of wise counsel during their terms, and we thank them. We give special thanks to Dr. Thier for his service as chairman of the board in 2004 and 2005 and as deputy chair in 2003.

And on behalf of everyone here at the Bank, I want to thank my predecessor, Cathy Minehan, and congratulate her on nearly forty years of public service at the Federal Reserve, first in New York and then at our Bank, including her 13 years as President. Cathy instilled the highest standards of excellence in the Bank and in those of us who worked under her leadership. She worked tirelessly to advance the Bank's capabilities and public contributions in a distinguished term as President. We all wish Cathy the very best as she turns to new pursuits.

In 2007, the Bank's people worked together to make a difference and to advance the public interest. We look forward to continuing that work in 2008 and beyond.

Sincerely,

Eric Rosengren

Eric S. Rosengren
President and Chief Executive Officer