FEDERAL RESERVE BANK OF BOSTON™

The President's Report *to the* Board *of* Directors

August 4, 2011

CURRENT ECONOMIC DEVELOPMENTS - August 4, 2011

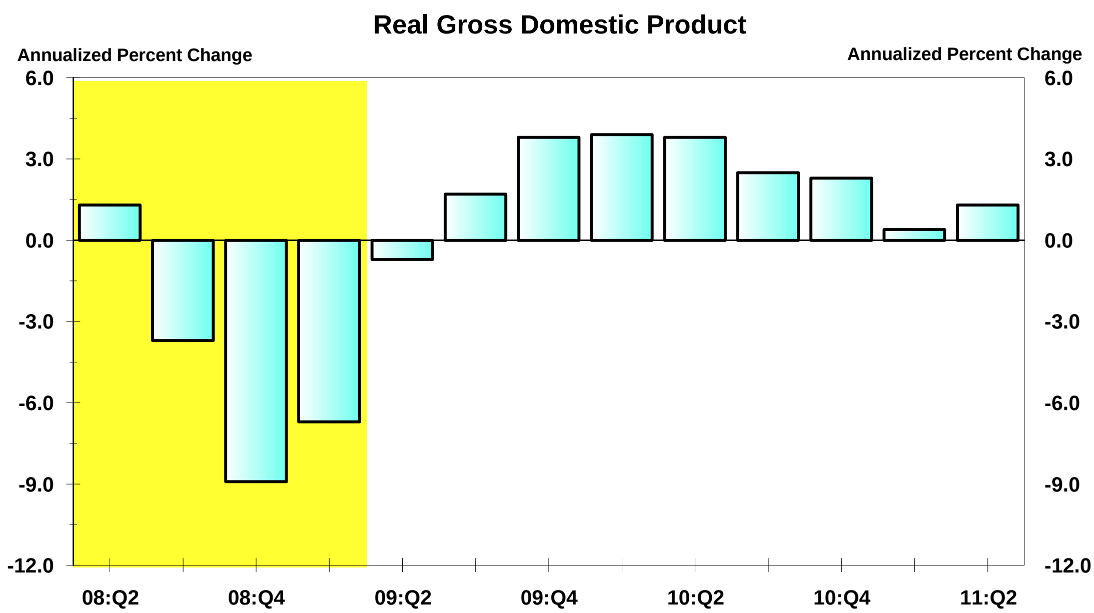
Data released since your last Directors' meeting show the economy grew at a slow pace in the second quarter, and that economic activity during both the recession and subsequent recovery was weaker than previously estimated. The weakness in the economy through the first half of the year was broad, with only business investment and inventory growth providing consistent support. More robust job creation in the coming months will be imperative to support a stronger recovery.

The increase in real GDP in the second quarter primarily reflected positive contributions from exports, nonresidential fixed investment, inventory investment and federal government spending. Those effects were partly offset by negative contributions from state and local government spending and imports. First quarter growth was revised sharply downward due mostly to downward adjustments to gross domestic private investment and net exports.

Initial claims for unemployment insurance eased a bit in July, but were little changed from their average over the first six months of the year. Consumer attitudes were mixes in July due to disparate short-term outlooks, but concerns about current job and income conditions were evident in both surveys. Data from the manufacturing sector continue to support growth in investment, although on a smaller scale. The ISM index fell further in July, but held above 50, and industrial production posted a small increase in the second quarter.

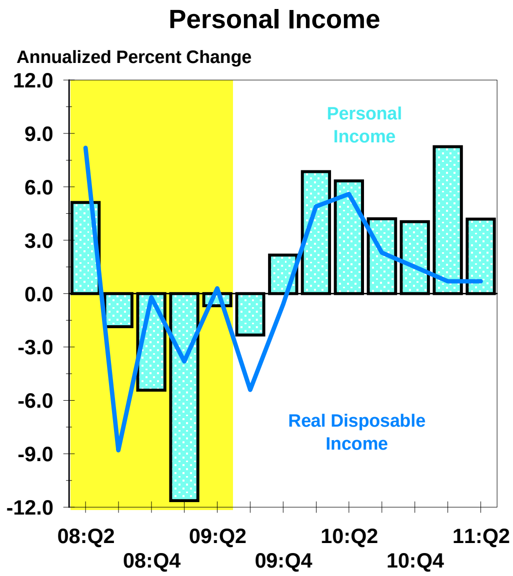
Headline inflation measures accelerated further in the second quarter, as did core indices. Compensation costs, as measured by the ECI, also picked up due to higher benefit costs. Oil prices were little changed in July after falling steadily in the latter part of the second quarter.

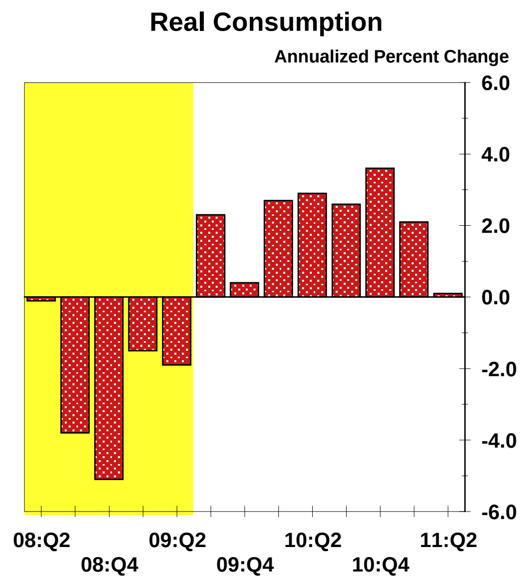
Real GDP growth accelerated in the second quarter, but only because first quarter growth was revised sharply lower. Growth through the first half of the year has averaged only 0.9%, and only 1.6% over the past four quarters. Revisions also showed that the recession was more severe than previously thought.



Source: Bureau of Economic Analysis / Haver Analytics.

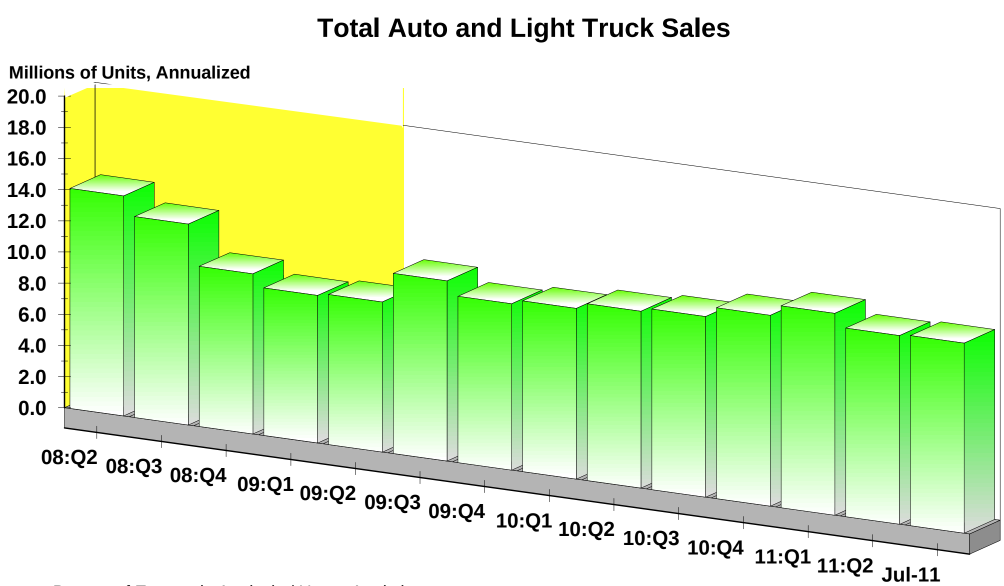
While nominal incomes continued to rise steadily in the second quarter, real disposable income managed only another small gain. The lack of income growth has taken a toll on consumption, which was essentially flat in the second quarter. Without more growth in either jobs or income, consumption is unlikely to improve much in the near term.





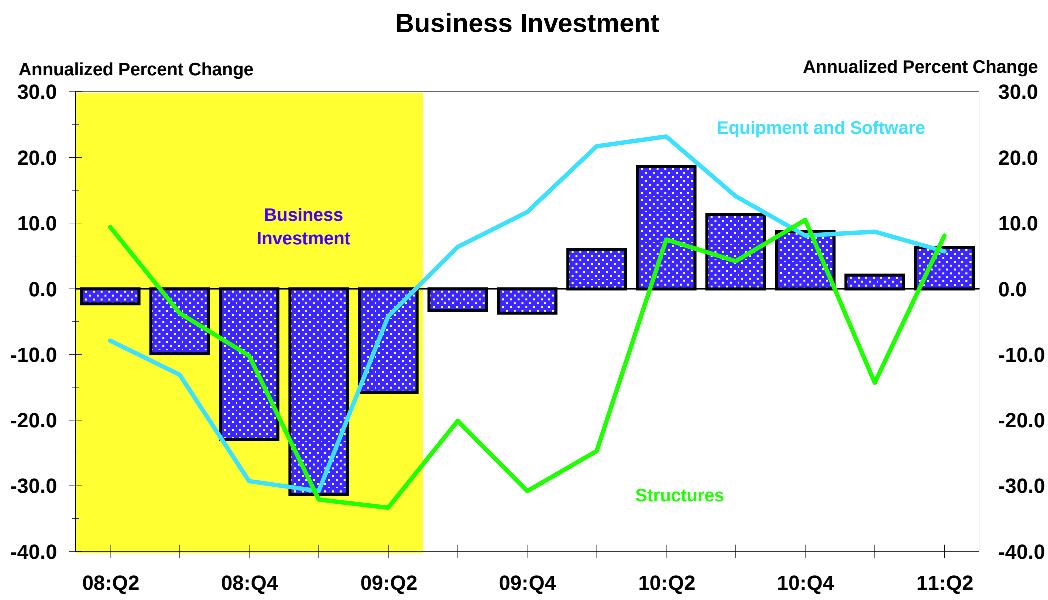
Source: Bureau of Economic Analysis / Haver Analytics.

Lightweight vehicle sales rose in July from June, essentially matching their second quarter average. The industry continued to be restricted by shortages of Japanese models, as both Toyota and Honda saw more than a 20% drop in sales compared to July 2010. Other manufacturers cited the ongoing job and income concerns of potential customers as significant hurdles to a robust recovery in sales going forward.



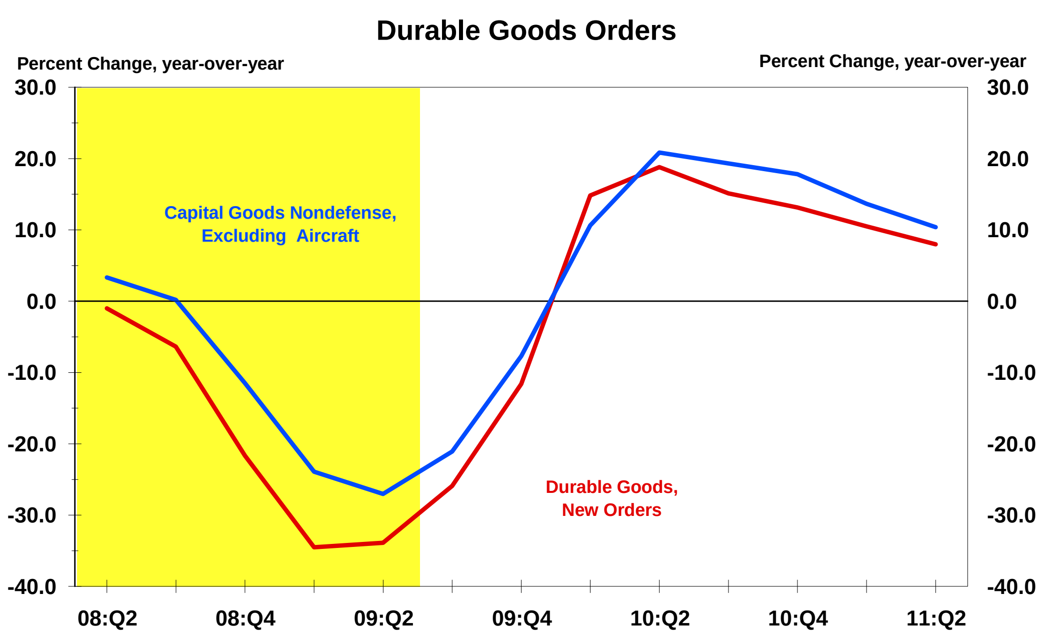
Source: Bureau of Economic Analysis / Haver Analytics.

Business investment accelerated in the second quarter, due largely to a rebound in investment in structures. Investment in equipment and software eased further in the second quarter, growing at its slowest pace since the recession.



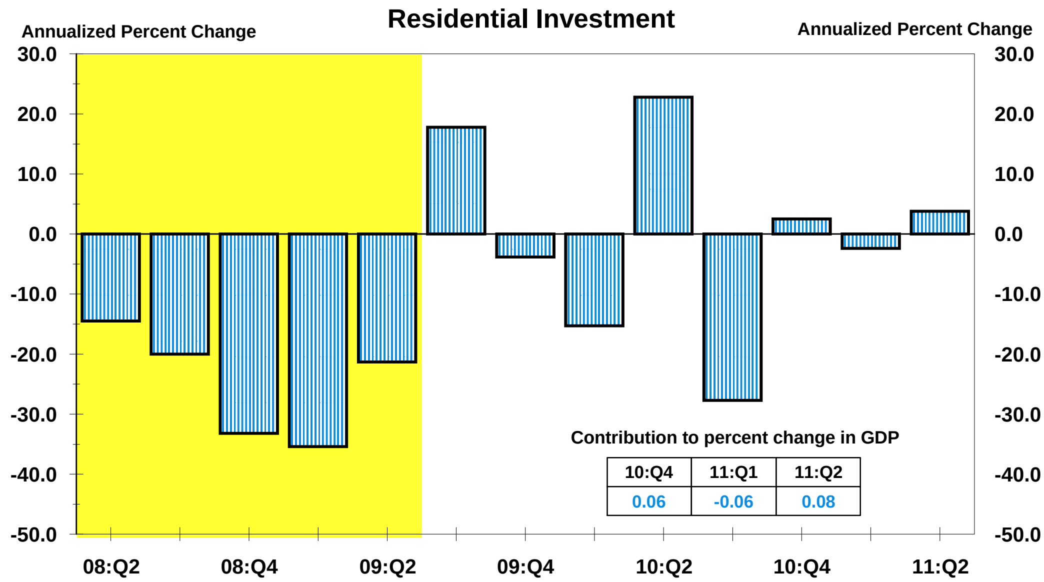
Source: Bureau of Economic Analysis / Haver Analytics.

Durable goods orders posted another solid year-over-year gain in the second quarter, as did orders for nondefense capital goods, excluding aircraft. However, those increases have been steadily declining over the past year.



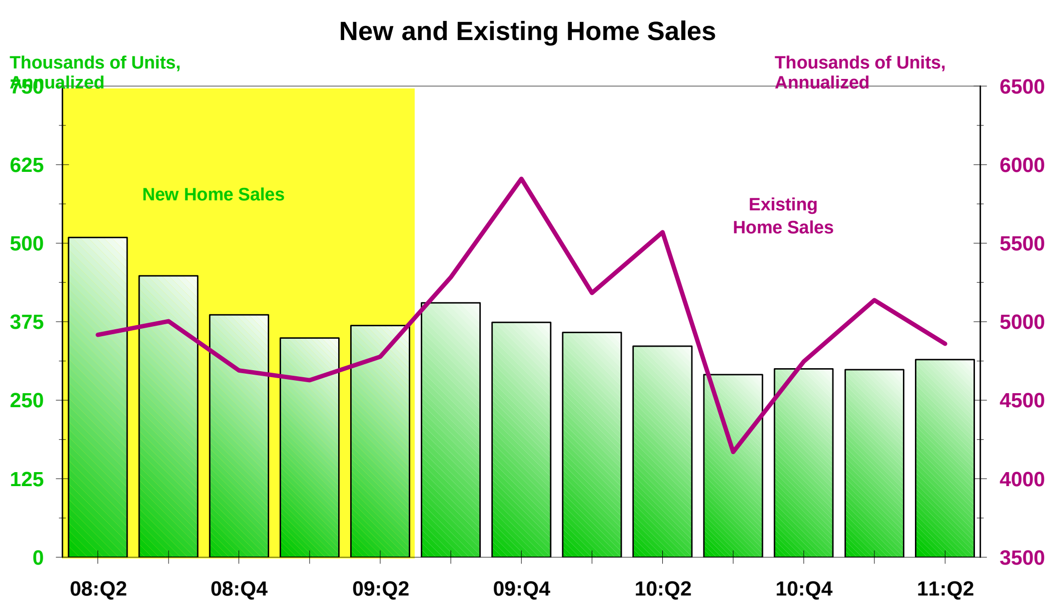
Source: U.S. Census Bureau / Haver Analytics.

Residential investment posted a small increase in the second quarter, and overall has been little changed over the past three quarters. On a more positive note, residential investment is no longer a drag on GDP. From 2006 through the end of the recession, residential investment restricted GDP by an average of 1.0% per quarter. During the recovery, on average it has had no impact.



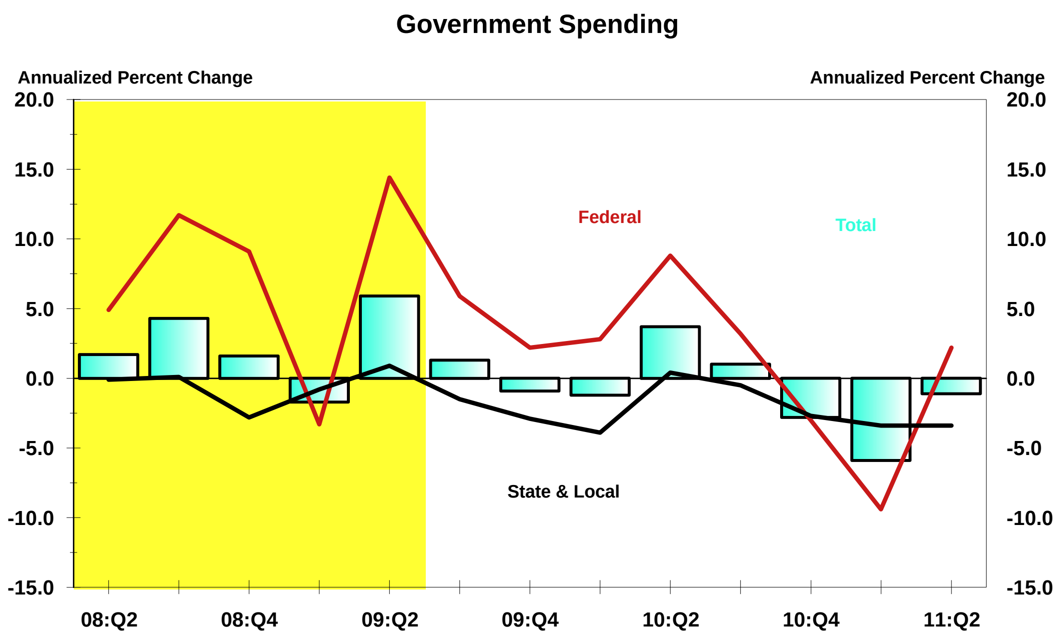
Source: U.S. Census Bureau / Haver Analytics.

Housing sales remained weak in the second quarter, culminating with lower-than-expected sales in June. New home sales were up overall in the second quarter, but remain close to the record lows seen over the previous three quarters. Sales of existing homes fell in the second quarter, erasing more than half of the previous quarter's gain.



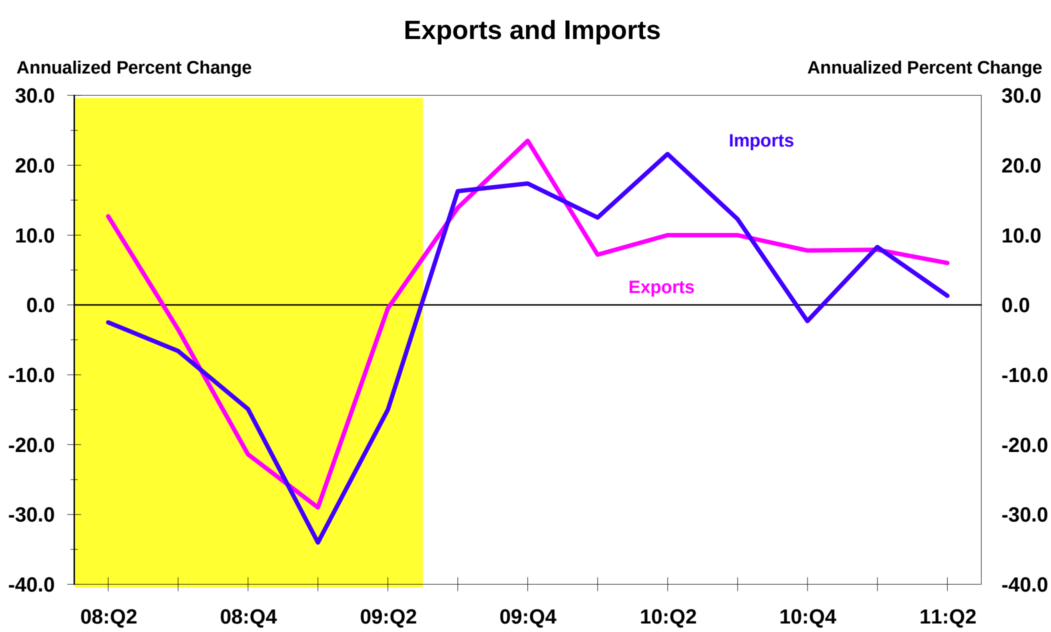
Source: U.S. Census Bureau / Haver Analytics.

Government spending fell further in the second quarter, as state and local governments continued to restrict their expenditures. Federal spending picked up a bit in the second quarter, due primarily to a rebound in defense spending.



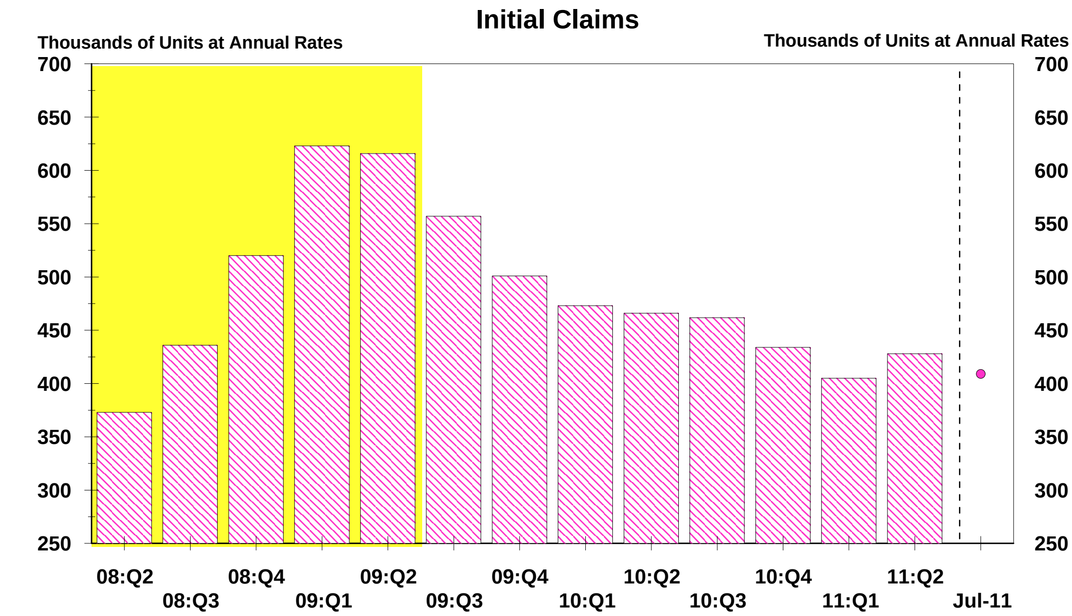
Source: Bureau of Economic Analysis / Haver Analytics.

Import growth slowed significantly in the second quarter, more than offsetting a smaller decline in export growth, allowing net exports to provide a small boost to real GDP.



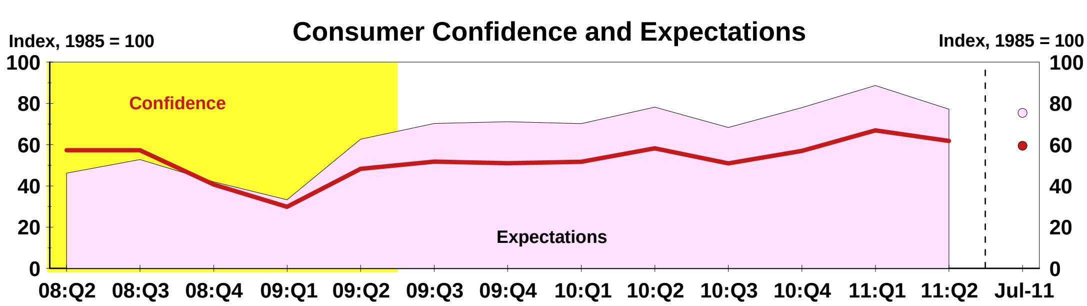
Source: Bureau of Economic Analysis / Haver Analytics.

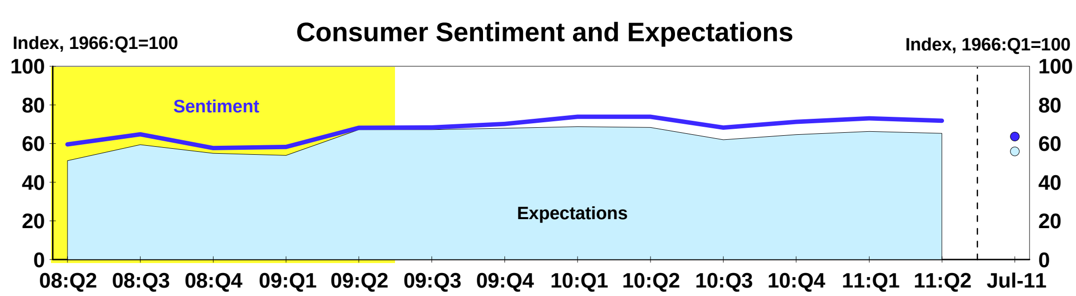
Initial claims for unemployment insurance fell a bit in July, but remain elevated well above pre-recession levels.



Source: Department of Labor, Employment and Training Administration / Haver Analytics.

Measures of consumer attitudes were mixes in July, as confidence improved while sentiment worsened. The difference was based in expectations, as respondents to both surveys felt worse about current economic conditions. Some improvement could be expected following the debt limit resolution, but concerns about the job market and stagnant incomes will likely persist into the coming months.

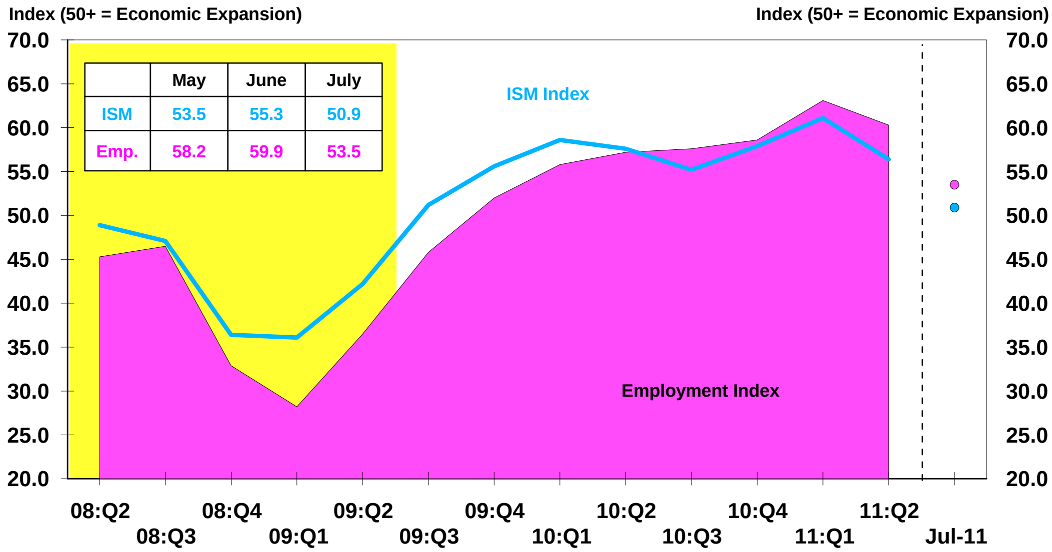




Source: The Conference Board (confidence) and University of Michigan (sentiment) / Haver Analytics.

The ISM manufacturing index continued to fall dramatically in July, reaching its lowest level in two years. The index held above 50, however, a signal that the manufacturing sector is still slowly expanding. The employment index also fell sharply in July, displaying the largest single-month drop since late 2008.

ISM Index

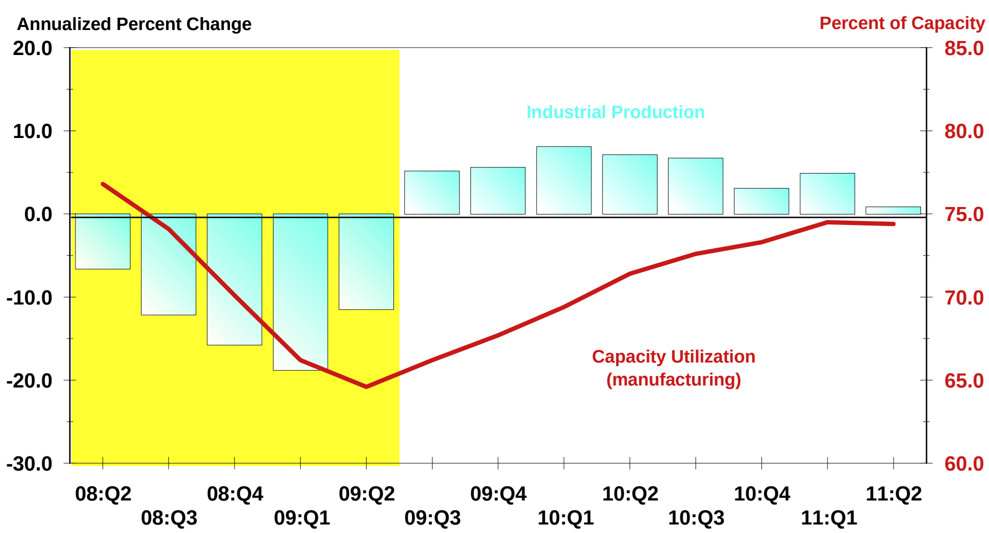


	May	June	July
ISM	53.5	55.3	50.9
Emp.	58.2	59.9	53.5

Source: Institute for Supply Management / Haver Analytics.

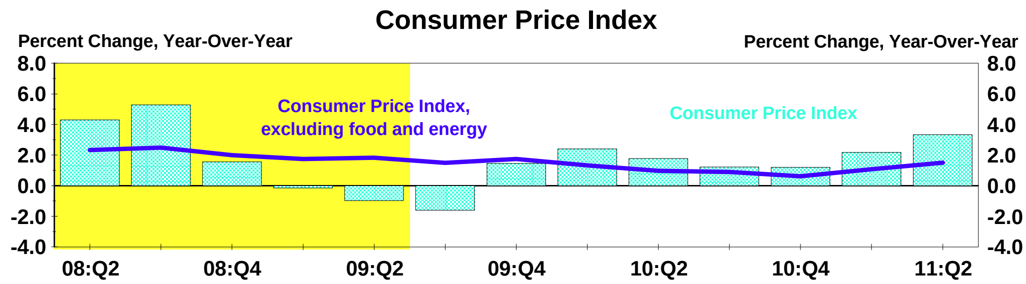
Growth in industrial production slowed in the second quarter, due primarily to decreases in the production of consumer goods and untilities. Capacity utilization declined slightly in the second quarter, the first decline since the end of the recession.

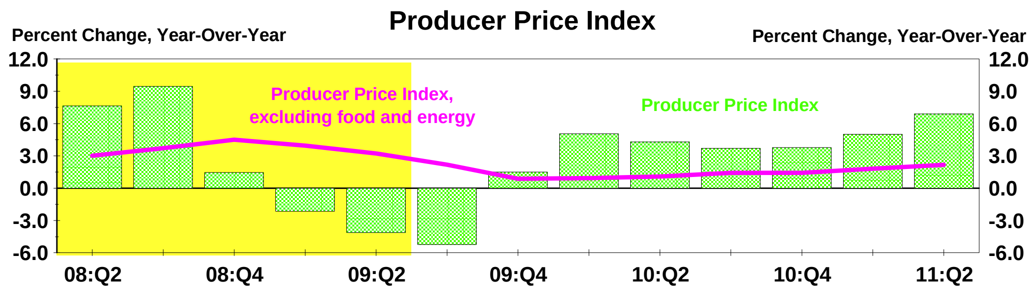
Industrial Production and Capacity Utilization



Source: Federal Reserve Board of Governors / Haver Analytics.

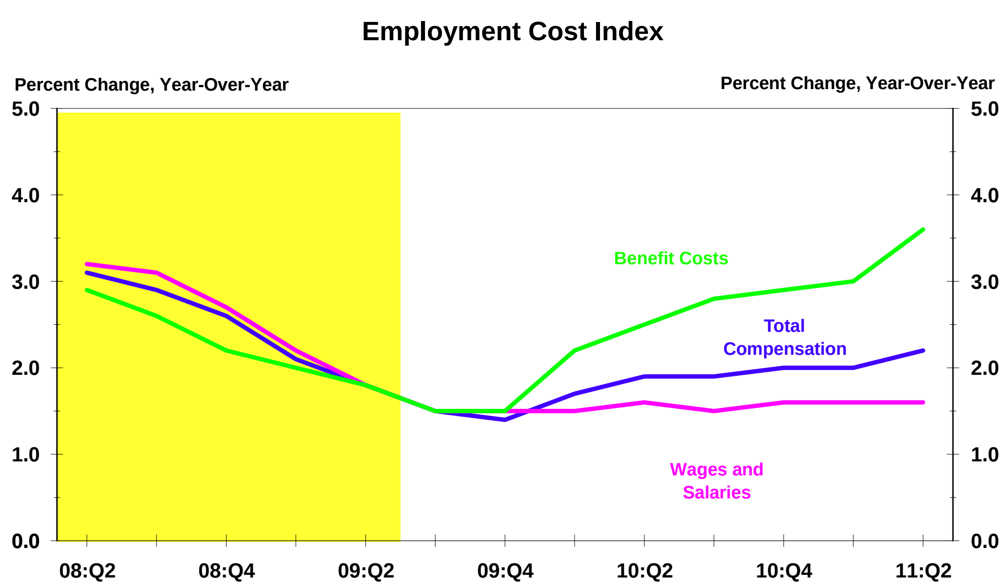
Total consumer prices continued to accelerate in the second quarter, growing at their fastest pace in nearly three years. The recent gains were due primarily to higher food and energy prices, although the core index also continued to rise due to higher apparel and vehicle prices. Both total and core measures for producers also picked up in the second quarter.





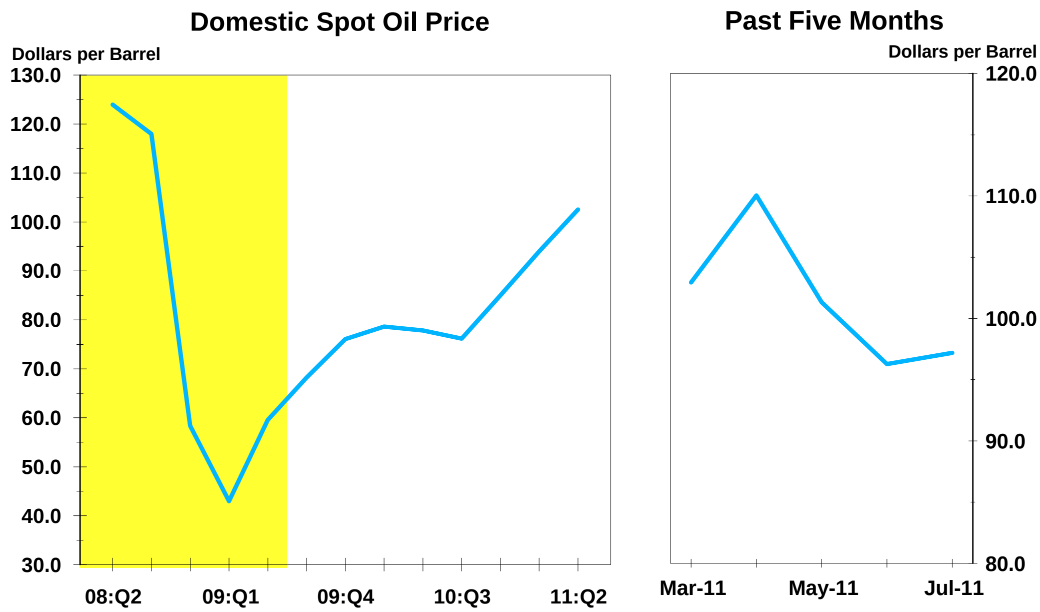
Source: Bureau of Labor Statistics / Haver Analytics.

Growth in wages and salaries has held mostly steady over the past two years, but total compensation costs have continued to rise as benefit costs have taken off. The increase in benefit costs in the second quarter was the biggest in almost five years.



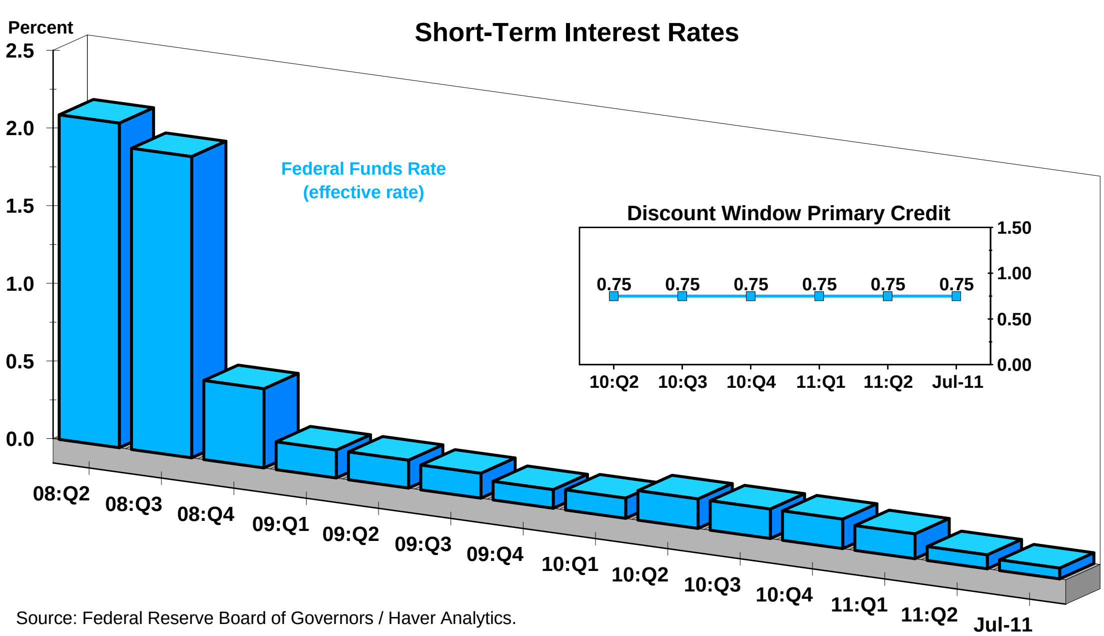
Source: Bureau of Labor Statistics / Haver Analytics.

After hitting their most recent peak in April, oil prices fell steadily through the remainder of the second quarter. Prices held mostly steady in the mid-$90's during July, before approaching $100 again late in the month.



Source: Wall Street Journal / Haver Analytics.

Overall, data since your last Directors' meeting show the economy grew at a slow pace in the second quarter, and that economic activity during both the recession and subsequent recovery was weaker than previously estimated. The weakness in the economy through the first half of the year was broad, with only business investment and inventory growth providing consistent support. More robust job creation in the coming months will be imperative to support a stronger recovery.



Source: Federal Reserve Board of Governors / Haver Analytics.

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

August 11, 2011

Current Economic Developments - Addendum: Data released in the past week

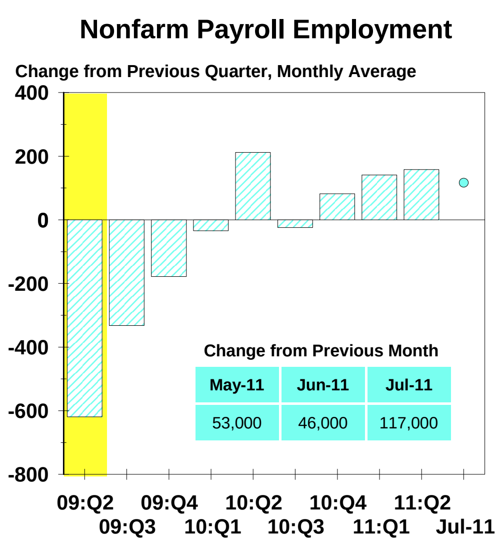
The employment situation report for July was better than anticipated. More jobs were added than expected, and gains for the previous two months were revised higher. The unemployment rate also dipped slightly in July, though that was due primarily to a sizable decrease in the labor force. Also of positive note in the report were increases in average hourly earnings and hours worked. Despite the employment report being better than expected, the data did little to ease concerns about the economic outlook.

Productivity fell 0.3% in the second quarter, its second consecutive decline. Unit labor costs and compensation per hour both slowed significantly in the second quarter, growing at less than half the pace seen in the first quarter.

Through the first week of August, Redbook sales were up 0.7% compared to July, and up 4.8% compared to the same period last year. Oil prices fell dramatically over the past week, averaging $85.2 per barrel as opposed to the previous week's average of $95.8.

There are many data releases due out Thursday and Friday, and the data is expected to come in mostly on the positive side. Improvements are expected in retail sales, business inventories and foreign trade, but consumer sentiment is expected to fall further.

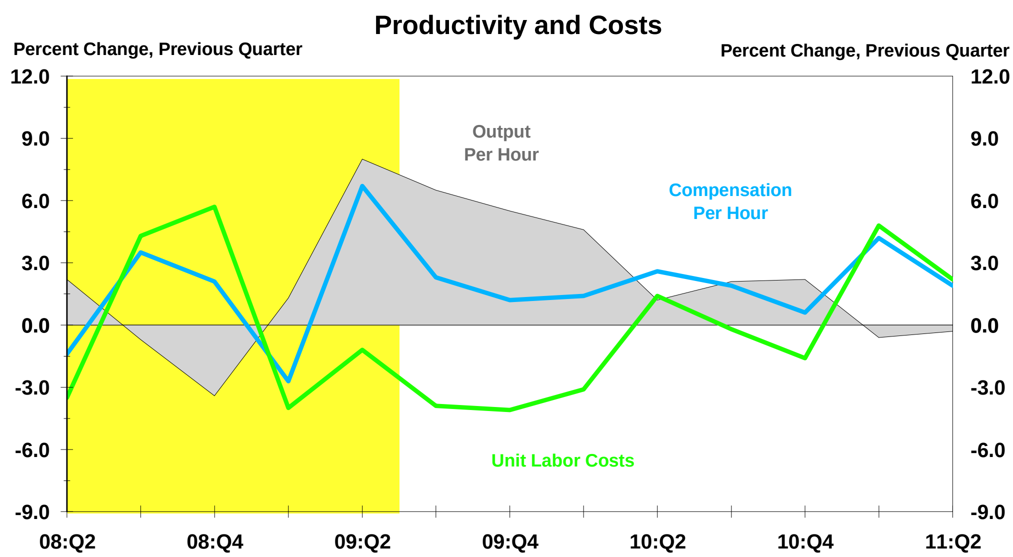
Nonfarm payrolls added 117,000 jobs in July, and job gains for the previous two months were revised larger by 56,000. Private employment increased by 154,000 jobs in July, and has increased by an average 164,000 per month so far this year. The unemployment rate was unchanged in July from the second quarter average, but down one-tenth from its June level.



May-11	Jun-11	Jul-11
53,000	46,000	117,000

Source: Bureau of Labor Statistics / Haver Analytcis.

Productivity decreased again in the second quarter, the result of hours worked increasing faster than output. Growth in unit labor costs and hourly compensation both slowed during the quarter. In the first quarter, productivity was revised sharply downward, from the previously estimated 1.8% increase to a 0.6% decline. The change was due almost entirely to lower output, as hours worked were mostly unrevised.



Source: Bureau of Labor Statistics / Haver Analytics.