PRESIDENT'S REPORT TO THE BOARD OF DIRECTORS,
FEDERAL RESERVE BANK OF BOSTON
Current Economic Developments - May 12, 2005

Data since your last Directors' meeting show the economy expanded in the first quarter of 2005 at its slowest pace in two years.

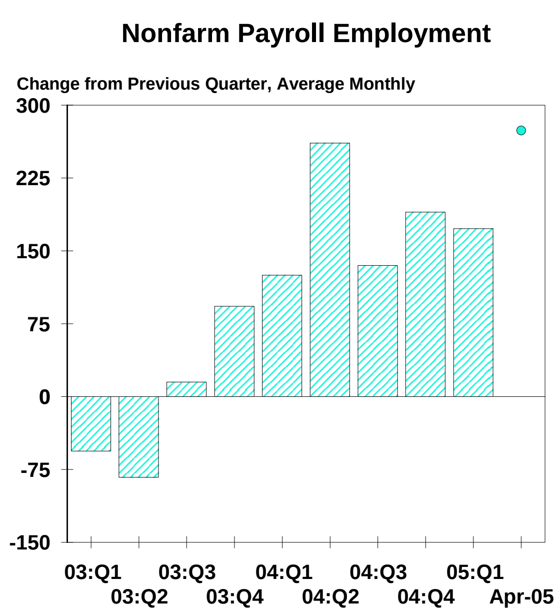
In April, consumer attitudes deteriorated as confidence, sentiment, and expectations all fell. But auto and light truck sales rose, continuing a trend seen throughout early 2005. Payroll employment increased, initial claims for unemployment decreased, and oil prices fell slightly from their previous record high. Yet the ISM index continues on its downward path, and its employment component fell to offest earlier gains.

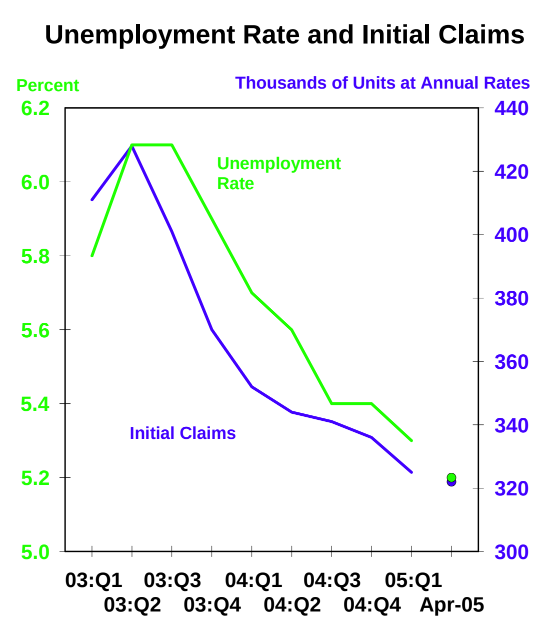
The slowdown in GDP growth om the first quarter was due primarily to a deceleration in equipment and software investment, increased imports and lower consumption. The losses in these areas were slightly offset by accelerations in exports, private inventory investment and residential investment. Some of the inventory investment may have been unintended due to weaker final sales, and recent data show the trade deficit to be smaller than originally estimated.

Consumption slowed as disposable income fell for the first time in over two years. A deceleration in equipment and software investment contributed to a slowdown in business investment. Residential investment remains strong, with new homes selling at a record pace.

Total compensation costs, as measured by the ECI, decreased slightly as benefit costs dropped and wage and salary inflation held steady. Productivity growth increased in the first quarter, as did unit labor and compensation costs.

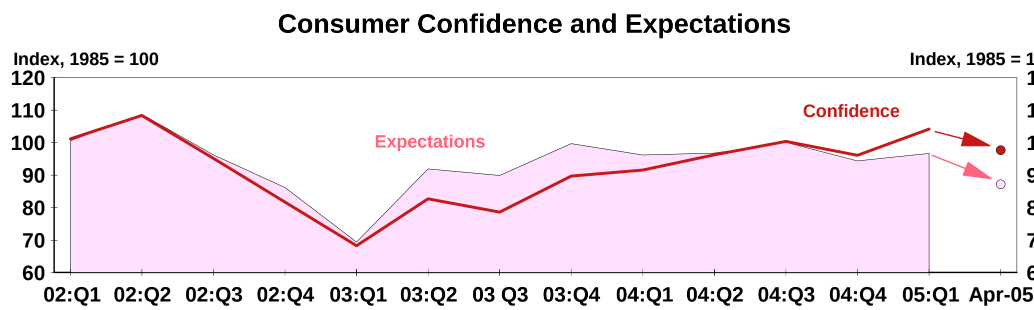
The labor market continues to show signs of strength. Payroll employment increased again in April while initial claims continue to decrease. The unemployment rate was one-tenth of a percent lower in April than in the first quarter.

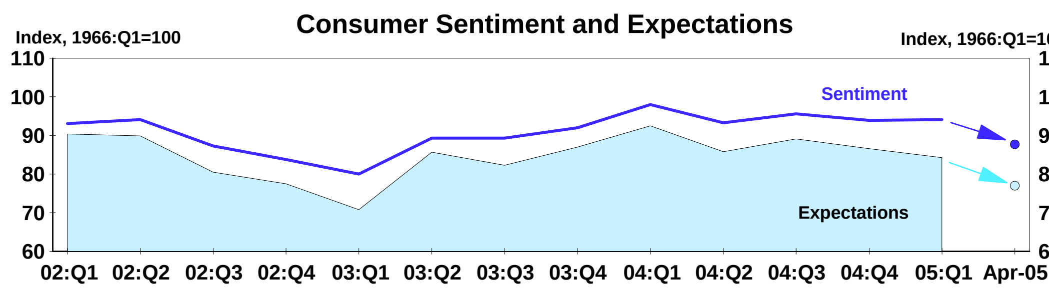




Source: Bureau of Labor Statistics (employment) Department of Labor, Employment and Training Administration (claims).

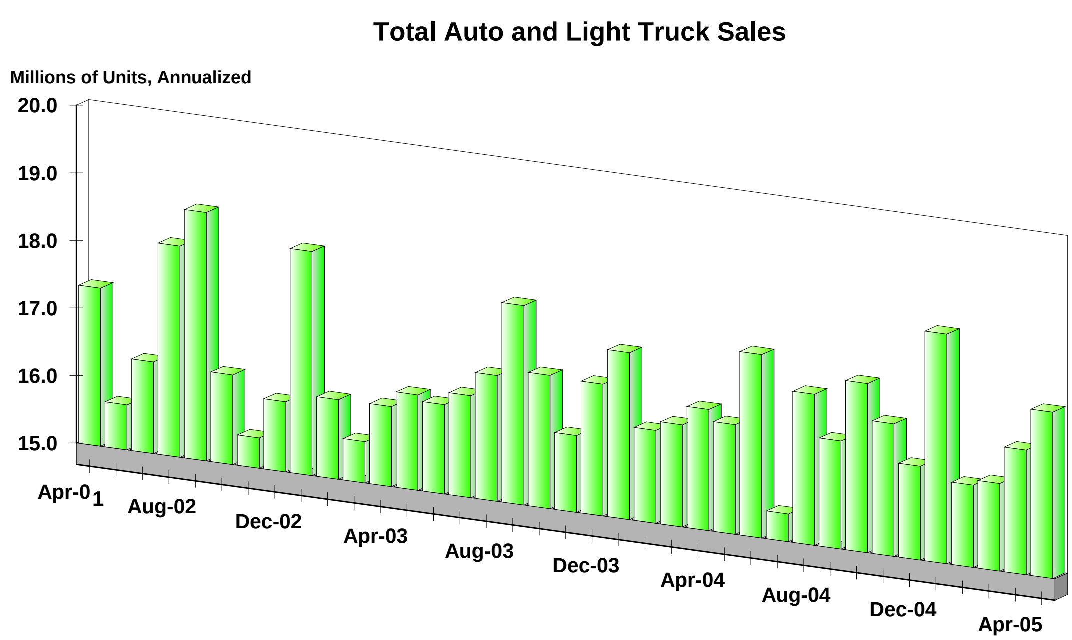
Consumer attitudes weakend in April as confidence, sentiment, and expectations all experienced declines.





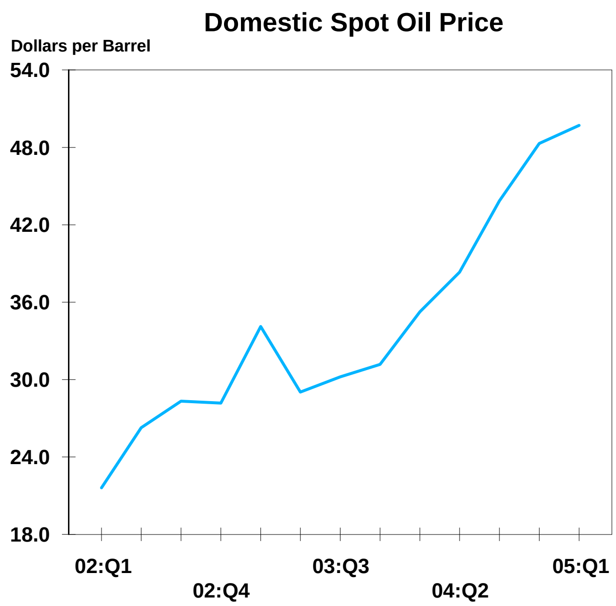
Source: The Conference Board (confidence) and University of Michigan (sentiment).

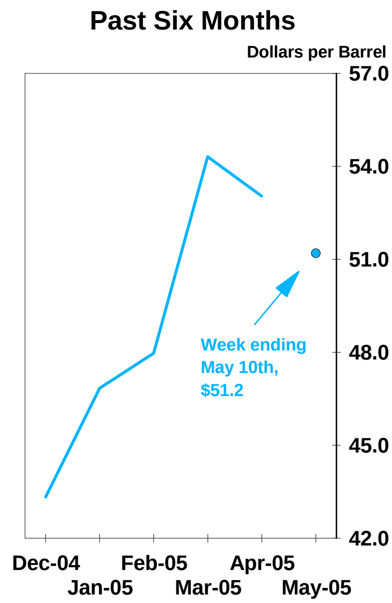
Despite decreases in consumer attitudes, auto and light truck sales rose in April.



Source: Federal Reserve, Board of Governors.

Oil prices rose in the first quarter, continuing to set record highs. However, recent data show prices easing slightly.





Source: Wall Street Journal (oil prices).

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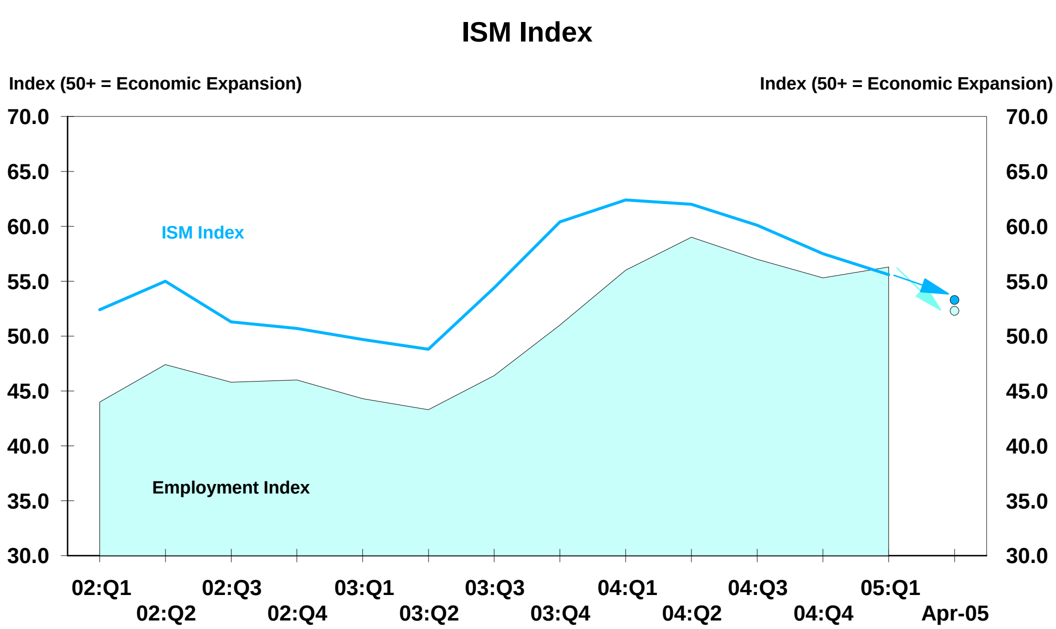
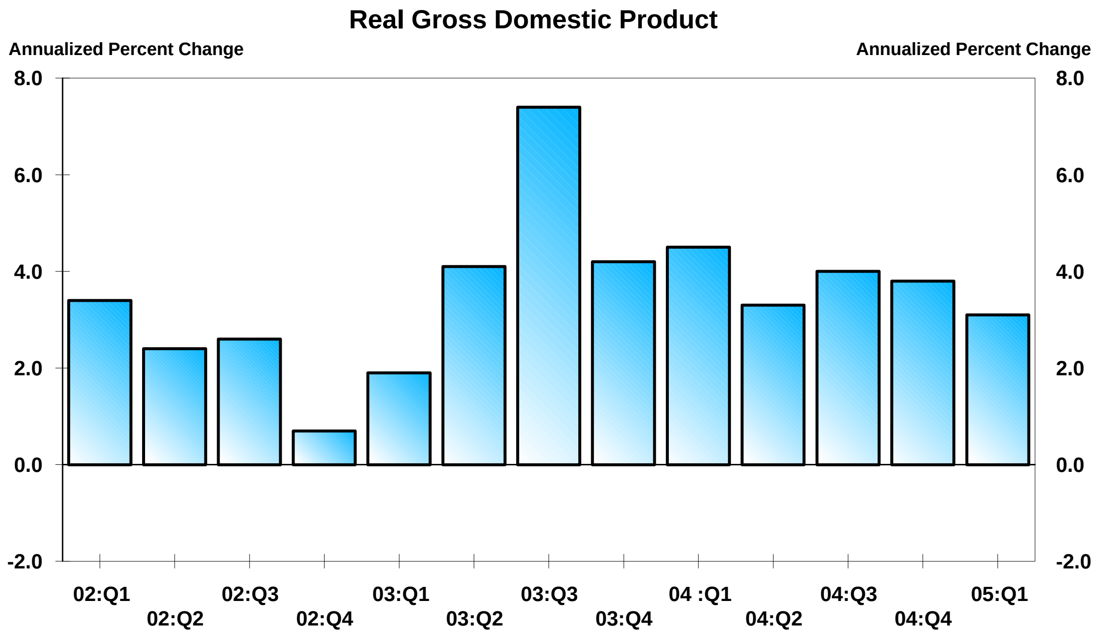
The ISM index dropped in April, following the trend seen over the past year. The employment index also fell in April, offsetting first quarter gains. However, both indices remain above 50.



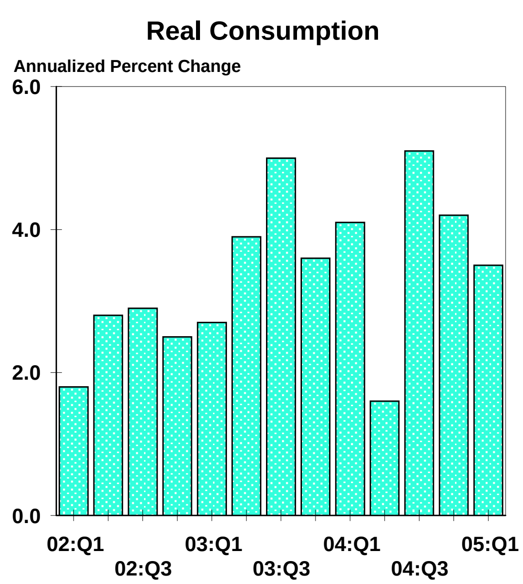
Source: National Association of Purchasing Management.

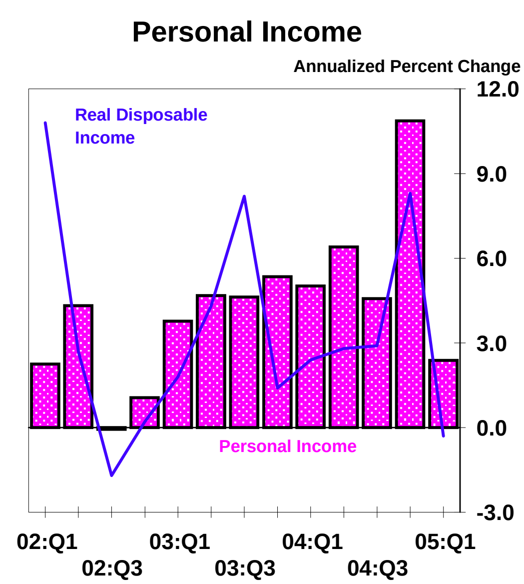
During the first quarter, real GDP growth decelerated due primarily to a downturn in equipment and software, an acceleration in imports and a deceleration in consumption. While the GDP figures portray an expanding economy, it is the slowest growth rate in two years.



Source: Bureau of Economic Analysis.

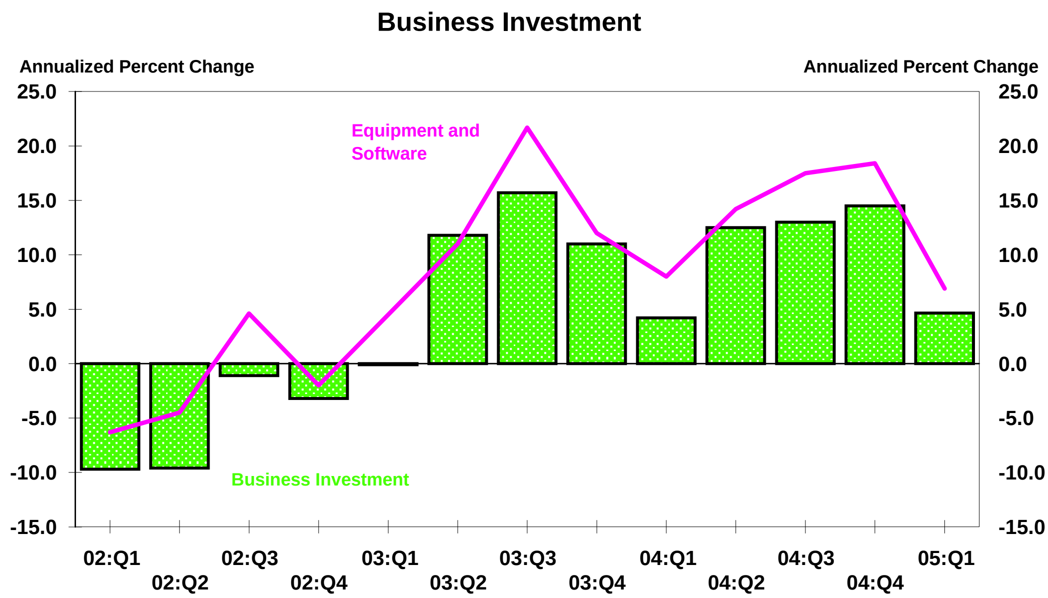
Growth in real consumption slowed for the second consecutive quarter, aided by a deceleration in personal income and a drop in real disposable income. Real DPI fell as monthly increases late in the quarter were not strong enough to overcome a drop in January; following a special Microsoft dividend paid to shareholders in December.





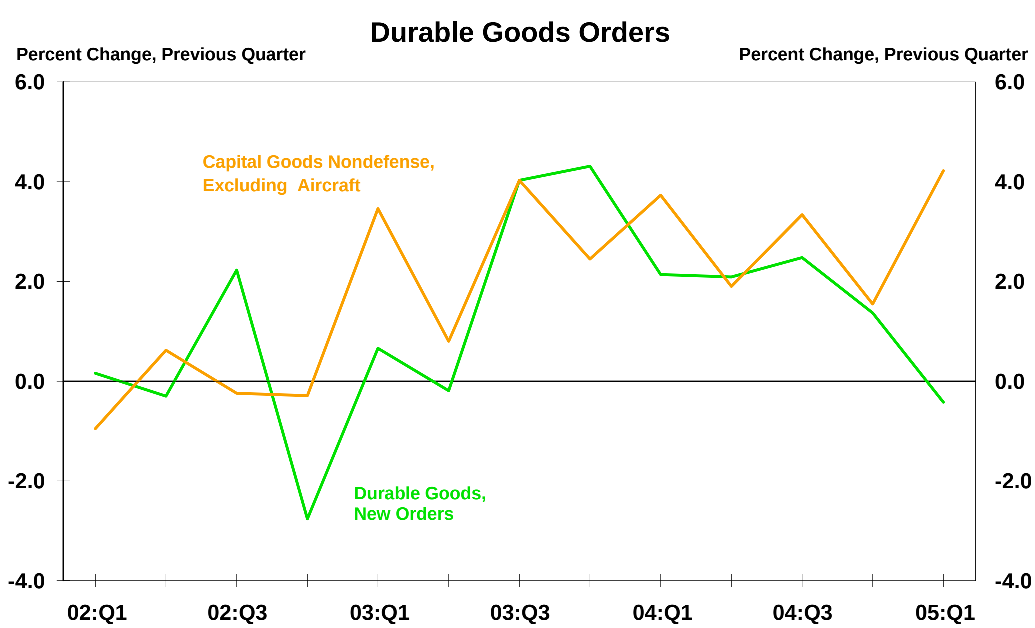
Source: Bureau of Economic Analysis.

Growth in business investment slowed considerably in the first quarter, due primarily to a deceleration in equipment and software investment.



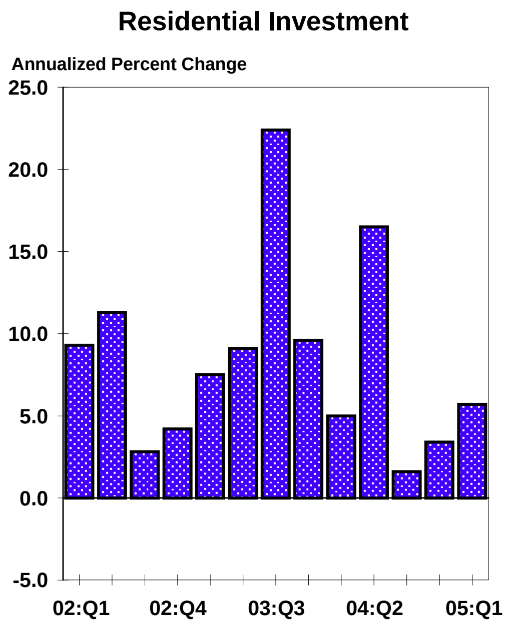
Source: Bureau of Economic Analysis.

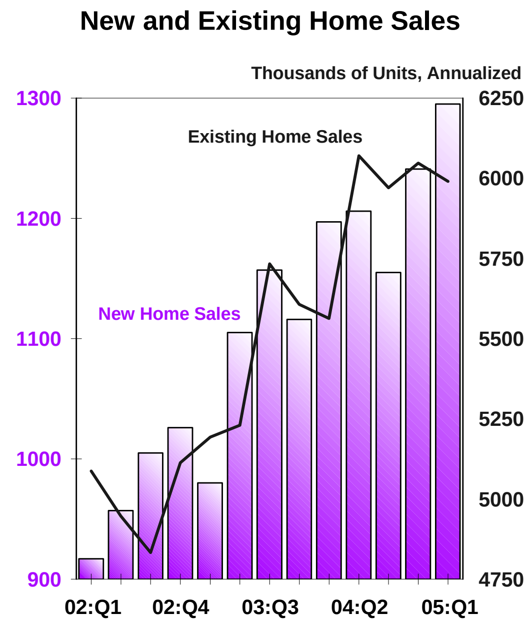
New orders for durable goods fell in the first quarter, following six consecutive quarters of growth. Orders of nondefense capital goods, excluding aircraft, increased overall in the first quarter, but were negative over the past two months.



Source: U.S. Census Bureau.

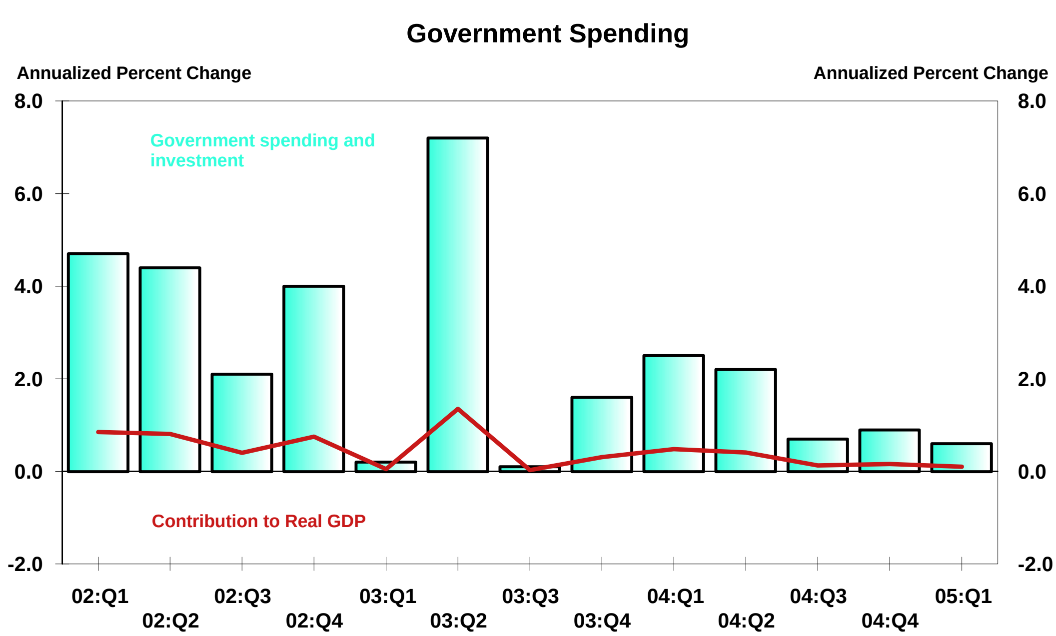
The housing market remained strong in the first quarter. Residential investment accelerated while new home sales set a record pace. Existing homes also continue to sell at an historically high rate.





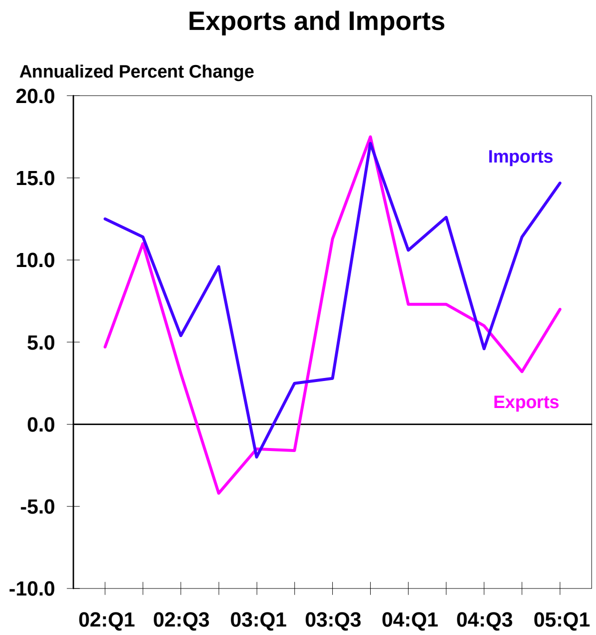
Source: U.S. Census Bureau.

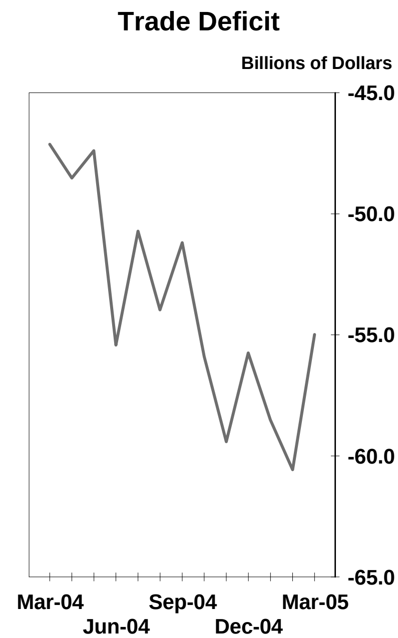
Government spending slowed slightly in the first quarter, contributing only one-tenth of a percentage point to GDP.



Source: Bureau of Economic Analysis.

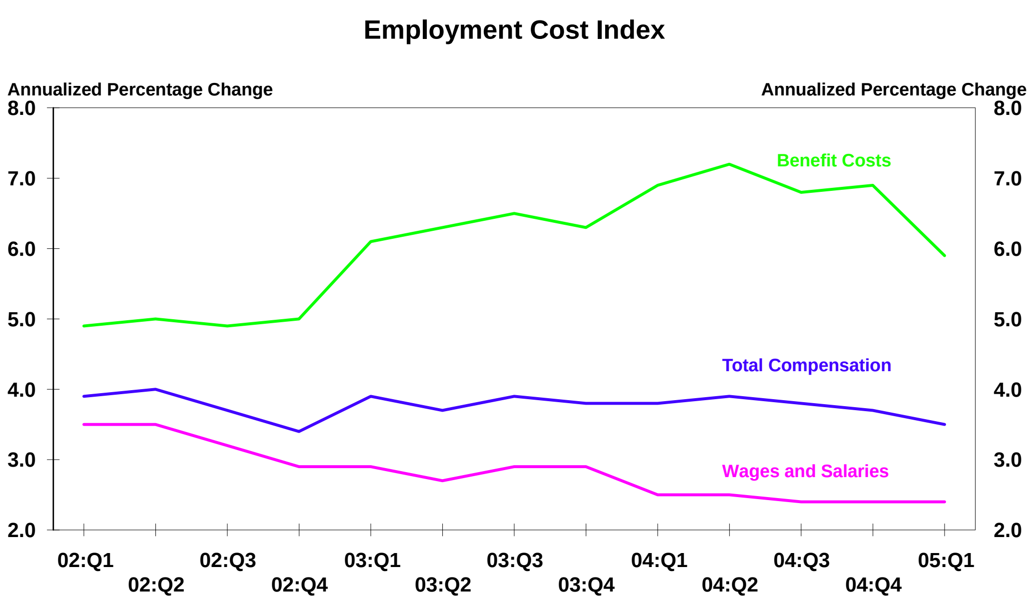
Export growth accelerated in the first quarter for the first time in over a year, but imports are growing at a rate more than twice as fast. Still, the trade gap narrowed in March to its lowest point in six months.





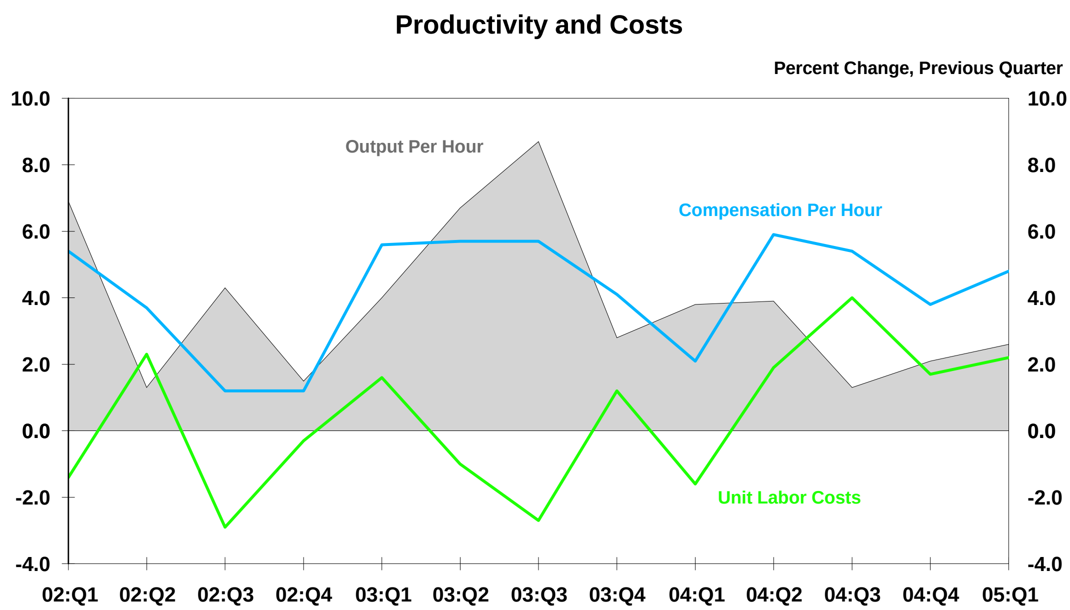
Source: Bureau of Economic Analysis.

Employment costs decelerated for a third consecutive quarter, as benefit costs decreased and wages remained steady.



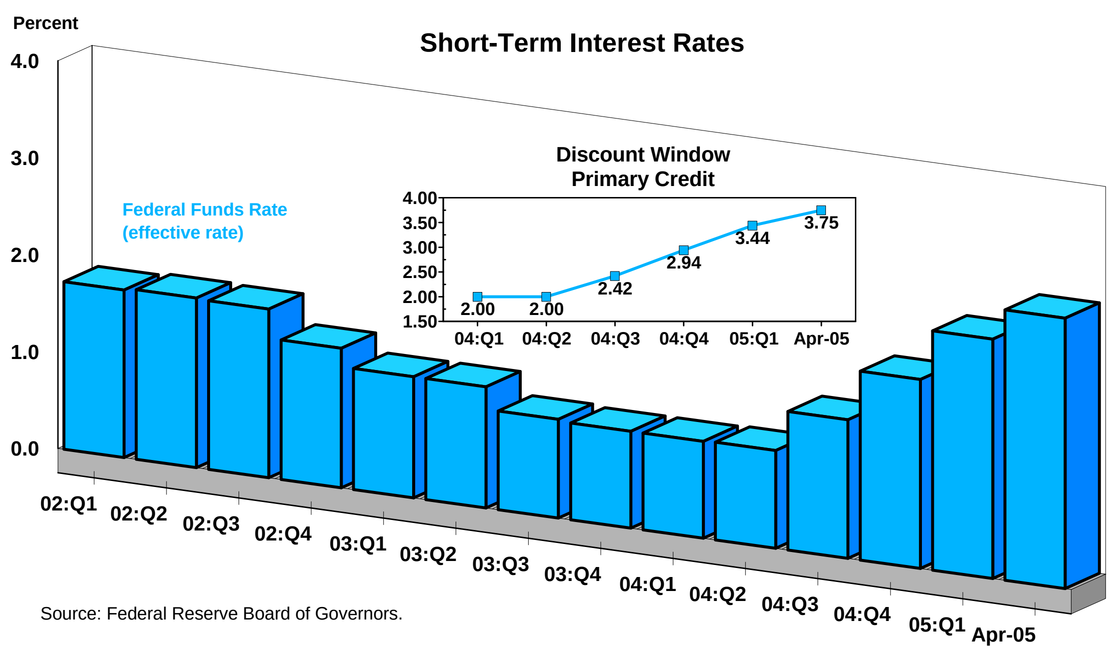
Source: Bureau of Labor Statistics.

Productivity growth increased slightly in the first quarter, but strong compensation led to rising unit labor costs.



Source: Bureau of Labor Statistics.

Overall, the economy grew in the first quarter at its slowest pace in two years. Consumption has slowed amid deteriorating consumer confidence and lower disposable income. In this regard, a stronger employment situation is key to achieveing faster growth.



Source: Federal Reserve Board of Governors.