

Letter from the President



Transition and transformation are themes running through this Annual Report from the Federal Reserve Bank of Boston. The report's essay reflects on transformations in New England's economy over the last 35 years, from the viewpoint of my colleague Lynn Browne, who followed the economy's every move over that time and has just recently retired from the Bank. And page 7 offers a tribute to Paul Connolly, the Bank's First Vice President and Chief Operating Officer, whose retirement at the end of 2010 ushered in a transition in the Bank's senior leadership. We welcome Kenneth C. Montgomery as the Bank's new First Vice President and Chief Operating Officer. The Highlights section of this report notes some areas where the Bank's work is evolving and, most importantly, having an impact that is positive and transformative for New Englanders and the nation.

Transitioning from the after-effects of the financial crisis and an acute recession is obviously a major concern for all of us today. Nationally, the economy grew during 2010, but not enough to make much progress in reducing unemployment, which continues unacceptably high. For 2011, I have forecast GDP growth of 3.0 to 4.0 percent. This is certainly an improvement, but — soberingly — would still leave unemployment at year's end far above anyone's estimate of full employment.

Housing has traditionally been a key generator of growth during the early stages of a recovery, but housing has not provided any lift to the economy thus far, and, looking ahead, it seems likely that residential investment, consumer durables, and services related to housing will be much less robust than usual. Other sectors, including business fixed investment, which has been relatively strong, will need to pick up the slack. It is important not to lose sight of how much excess capacity remains in the economy. It will likely take several years to return to full employment. It is also likely that measures of core inflation will remain well

below 2 percent over that period. Given this substantial excess capacity and low core inflation rate, it is appropriate that monetary policy has been deployed so as to encourage a more vigorous recovery.

I know that some observers are concerned about a flare-up in inflation. I believe that core inflation will remain low in the short run, and that in the longer term the Federal Reserve has the tools and the steadfast commitment to address inflationary pressures. Indeed, while monetary policy works with lags, it has been more than two years since the Fed's balance sheet expanded dramatically. Since that time, core inflation has remained quite low. As the economy makes further significant improvement, policy must become less accommodative. Getting this balance right will be one of the main policy challenges over the next several years. I am confident that the Federal Open Market Committee can meet this challenge.

New England, I would note, is recovering from the financial crisis and subsequent recession somewhat more quickly than the rest of the country. On the whole, our region enjoys relatively healthier residential and commercial real estate markets and better-capitalized financial institutions. We are fortunate in this regard, and it is likely that our quicker recovery will continue. As I talk to business people around the region, I hear growing confidence in the recovery. But I believe it is critical to our region's success that we New Englanders continue to find ways to do what we have done so well in the past: to collaborate, leverage our regional advantages, and promote the best ideas generated by our colleges and universities, medical and scientific facilities, technology entrepreneurs, and others. Taking these exceptional resources to the next level can lead to another of the transformations that have fuelled New England's growth over the decades.

Turning to the Bank itself, I am pleased to report that our work in 2010 was noteworthy on many fronts. In the monetary policy realm, we made significant contributions to the challenge of policymaking in a slow, post-crisis recovery, placing a balanced emphasis on both elements of the Federal Reserve's mandate — price stability and maximum sustainable employment. We not only produced excellent research and analysis, but we also worked hard to make sure that policymakers were aware of our findings. I am particularly pleased about the work we have done to help Massachusetts lawmakers see new possibilities for addressing the thorny issue of state-aid distribution. And we believe that we have played a positive role in helping public, private, and civic leaders in Springfield, Massachusetts, work more collaboratively to revitalize their community.

Our bank supervision staff had a demanding and productive year. They provided important policy contributions regarding supervisory oversight of systemically significant financial organizations, capital regulation, and supervisory engagement with non-depository financial institutions. As a result of the Dodd-Frank Act, staff have new supervisory responsibilities, additional opportunities to contribute to financial stability, and an expanded role in diversity and inclusion efforts. Apart from Dodd-Frank, the Bank's work for the U.S. Treasury and our activities on behalf of the entire Federal Reserve System grew as well. We expanded and enhanced the services we provide to the



U.S. Treasury with the goal of providing the most economic value to U.S. taxpayers. Our national responsibilities within the Federal Reserve System include financial management and Internet security. We fulfilled key objectives in both of these areas. These and other initiatives are described in more detail in the Bank Highlights section of this report.

We have a dedicated staff at the Bank, and I am grateful for their engagement and expertise. I am also most appreciative of the valuable service of our board of directors and our various advisory councils. The insights they share with us from all corners of New England truly make a difference in the work we do. In this regard, I especially want to thank two directors. James Smith, President and CEO of Webster Bank, N.A., completed his service on our board in 2010. During his term, Jim was an early supporter of our mortgage-relief and foreclosure-prevention efforts, and he brought a wealth of knowledge and perspective to board deliberations. Michael Wedge, former President and CEO of BJ's Wholesale Club, completed five years on our board in early 2011. Mike provided valued input and counsel, and his insights were always very helpful.

Sincerely,

Eric Rosengren

