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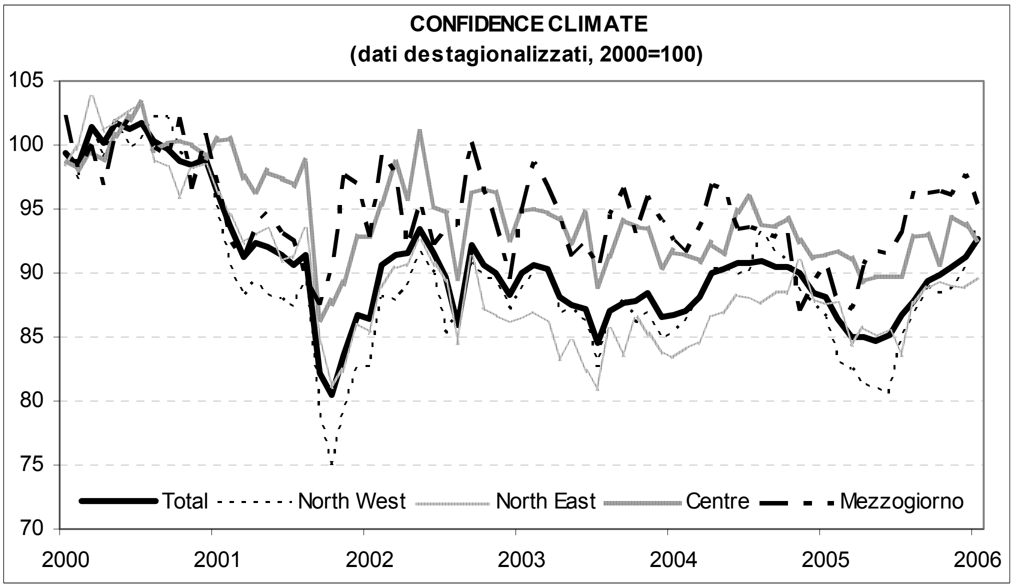
MANUFACTURING FIRMS' CONFIDENCE IMPROVES IN JANUARY

- **In January, the seasonally adjusted index (2000=100) climbed to 92.7 from 91.2, thanks to the recovery in production expectations and the cutback in stocks of finished products. Confidence rose to the highest level since May 2002, but remained still far from the previous cyclical peak recorded in summer 2000**
- **The business climate markedly improved in the capital goods (from 91.8 to 95.7) and intermediate goods sectors (from 89.6 to 90.7). Whereas it suffered a setback in consumer goods, moving from 93.3 to 92.3, in line with the stalling signals reported by the latest ISAE surveys on Italian consumers**
- **Confidence developments were not homogeneous across regions: optimism increased for firms in the North West and the North East (from 90.5 to 93.5 and from 88.8 to 89.5, respectively), while it weakened in the Centre (from 93,7 to 92.7) and in the *Mezzogiorno* (from 97.7 to 95.3)**

PLANT UTILIZATION AND EMPLOYMENT INCREASE, AND CONSTRAINTS TO BUSINESS ACTIVITY DIMINISH

- **The traditional ISAE quarterly survey recorded positive developments for current and future demand and production. Surveyed firms posted a rise in new orders, work hours, capacity utilization rate and insured production**
- **On a regional basis, the rate of capacity utilization markedly increased in the North West and remained unchanged in the North East, while it barely edged up in the Centre and down in the *Mezzogiorno***
- **The proportion of firms that reported obstacles to business activity decreased, owing mainly to diminished demand constraints. Firms strongly improved their competitive position both on domestic and foreign markets, and, accordingly, enhanced significantly their short-term expectations on the volume of exports**



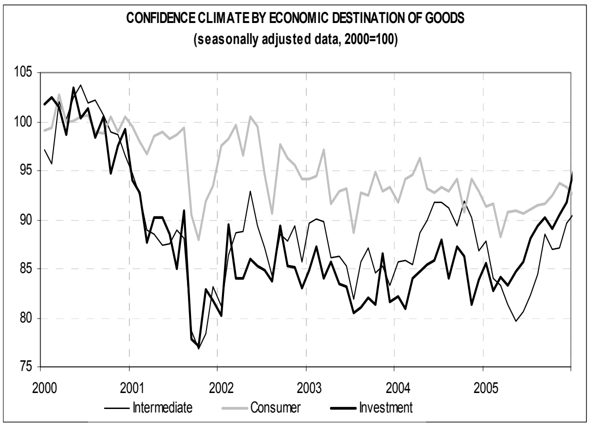
Data on February shall be diffused on February 24, 2006.
The next ISAE surveys are scheduled as follows:
January 31, 2006: *ISAE Monthly Survey on Traditional Retail Trade and Large Distribution (reference period: December 2005) and ISAE Monthly Business Services Survey (reference period: January 2006)*
February 6, 2006: ISAE International Comparative Business and Consumer Surveys *(reference period: January 2006)*
The full text of ISAE Surveys (either hardcopy or electronic format) is available on sale (for further information see the web site www.isae.it)

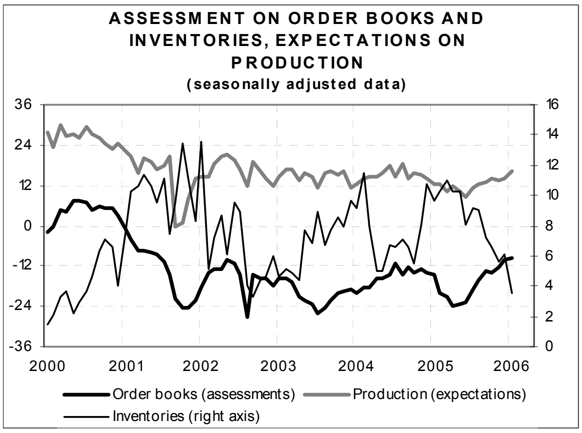
General results

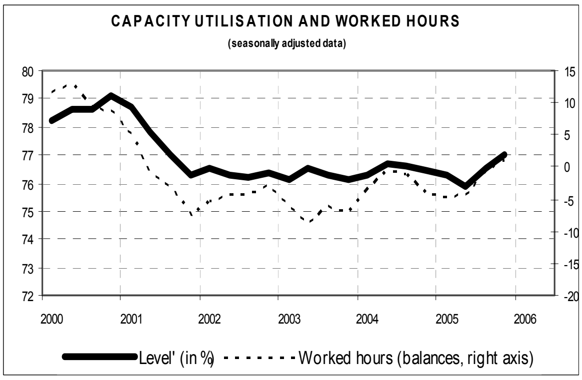
The ISAE Survey, carried out on a panel of about 4,000 respondents between January 1 and January 20, 2006, reported an increase in the seasonally adjusted confidence of manufacturing and mining firms. In January, the index rose to 92.7 from 91.2 in the previous month. The business climate climbed to its highest level since May 2002, though remaining faraway from the cyclical peak posted during the summer of 2000 (101.7 in July). The good performance was backed by the recovery of production expectations and by the de-stocking of finished products. With regard to the variables excluded from the definition of confidence, firms predicted an improvement in demand and a rise in selling prices.

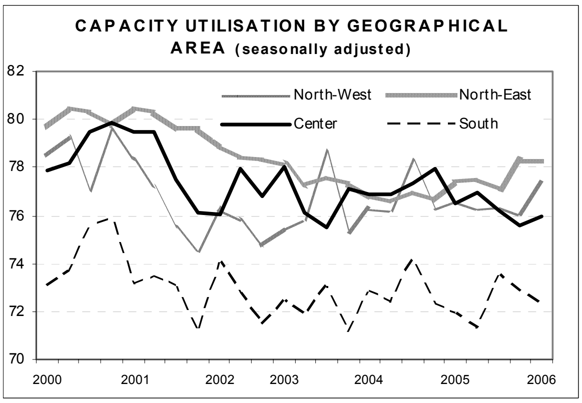
Confidence developments were not homogeneous across sectors and regions. The index soared (from 91.8 to 95.7) for capital goods firms, increased more moderately for the intermediate goods sector (from 89.6 to 90.7), whereas it lowered by one point for consumer goods firms (from 93.3 to 92.3). On a regional basis, optimism rose for firms in the North West and the North East (from 90.5 to 93.5 and from 88.8 to 89.5, respectively), while it fell for those in the Centre (from 93.7 to 92.7) and in the *Mezzogiorno* (from 97.7 to 95.3).

Positive indications came from the traditional quarterly survey on current and expected production and demand conditions. Firms, surveyed by ISAE, recorded an increase in new orders, work hours, rate of plant utilization and insured production. The proportion of those that considered the current rate of capacity utilization "more than sufficient" lowered. Firms' competitive position improved in both domestic and foreign markets. Whereas the fraction of those that reported constraints to production decreased. Ultimately, firms predicted a sharp increase in the volume of exports in the following months.









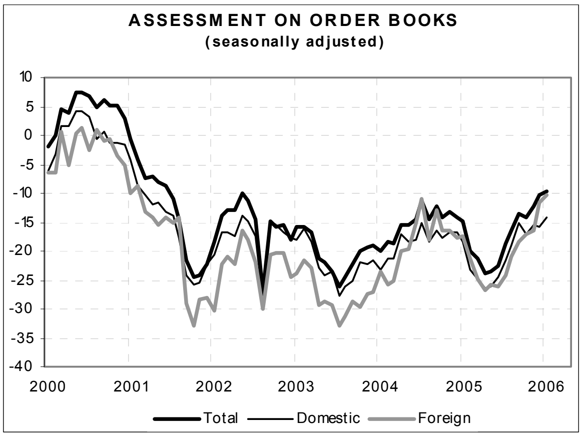
Situation in the reference period (January 2006)

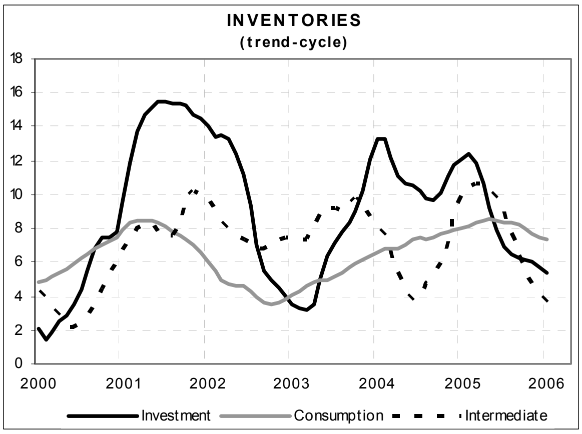
Notwithstanding a moderate increase in domestic demand, in January overall demand remained unchanged (at -10 on balance), reflecting virtual standstill for foreign demand. Production levels also remained stable (at -6 on balance), whereas inventories decreased (from 6 to 4), and liquidity for operational requirements rose (from 36 to 38).

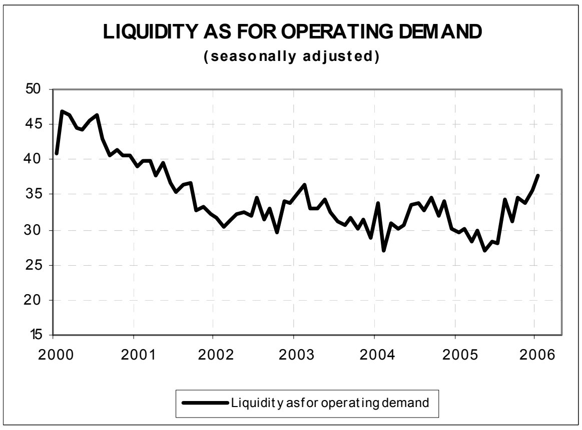
The situation for the capital goods sector markedly improved. Positive developments with respect to the previous quarter were supported by the rise in total demand from -5 to -1 (from -14 to -10 for the domestic component, and from -5 to -1 for the foreign one), in the level of production (from -3 to 0) and in the ratio of liquidity to operational requirements (from 41 to 43), coupled with a fall in inventories (from 6 to 4). Progress also portrayed the intermediate goods sector, for which the balance for demand moved from -11 to -10 (from -16 to -13 for domestic demand, and from -16 to -9 for external demand), the level of production recovered from -6 to -4, the ratio of liquidity to operational requirements increased from 33 to 35, and stocks declined from 5 to 2. In contrast, a negative performance characterized the consumer goods sector: demand diminished, on balance, from -12 to -19 (from -16 to -21 for the domestic component, and from -16 to -23 for the external one), the production level fell from -10 to -14, and the ratio of liquidity to operational requirements moved from 34 to 31. De-stocking was the only positive development for the sector (from 8 to 7, on balance).

Outlook for the following three months

In January, firms were more optimistic regarding the main business variables, but maintained their forecasts unchanged for the overall economy. As for financial conditions, firms kept their interest rates forecasts constant, while they worsened their outlook for liquidity. The balances for orders and production increased from 14 to 18 and from 14 to 16, respectively. For the following months, firms predicted an increase in employment (the raw index rose from -3 to 3) and in selling prices. For the latter, the balance moved from 12 to 13, reaching the highest level over the last year, probably because of the continuous rise in energy prices. Expectations on the level of firms' liquidity decreased from -7 to -2, while those on interest rates remained stable (at 46). Finally, also general expectations on Italian economic prospects remained unchanged (at -10).







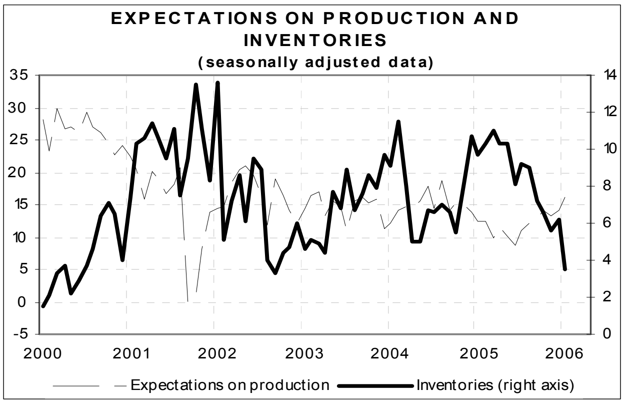
In the capital goods sector, forecasts improved markedly: expectations rose for orders and production (from 11 to 20 and from 19 to 26, respectively), as well as for employment (from 1 to 4) and the overall economic performance (from -8 to -4). Expectations for an increase in interest rates and in liquidity rose (from 46 to 49 and from 2 to 5, respectively), while those for a rise in selling prices remained unchanged. For the consumer goods sector, respondents worsened their predictions on orders (from 19 to 18) and on the overall economy (from -7 to -12), whereas they increased those on production (from 14 to 17) and on employment (from -5 to 0). Forecasts deteriorated for the interest rate trend (from 44 to 37), while they improved for liquidity (form 2 to 5). Furthermore, firms predicted a fall in selling prices (from 11 to 10, on balance). With regard to the intermediate products sector, firms improved their expectations for orders (from 11 to 15), the country's general economic situation (from -13 to -6) and employment (from -5 to 4), while they reduced those on production (from 12 to 11) and on interest rates (from 47 to 34). On the other hand, entrepreneurs increased expectations of higher selling prices (from 12 to 15) and improved those regarding the trend for liquidity (from -5 to 0).

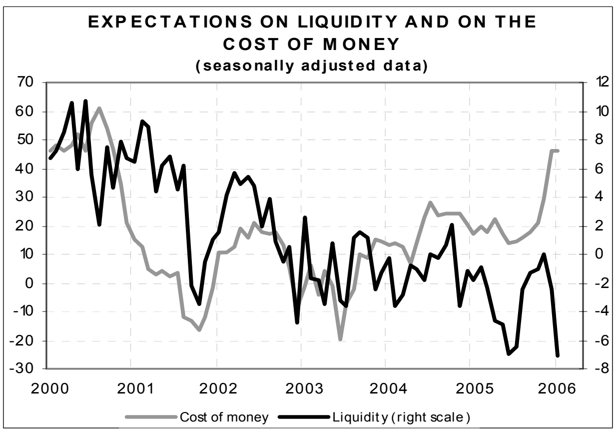
Main quarterly survey results (IVQ 2005)

The traditional quarterly ISAE survey, for the fourth quarter of 2005, pointed to rather favourable developments for current and future production and demand. The respondents signalled an increase in new orders (from 1 to 5), in work hours (from -1 to 1), in the rate of capacity utilization (from 76.5 to 77) and in production ensured on the basis of the current order books (3.4 to 3.7 months). The proportion of firms that considered the current level of productive capacity "more than sufficient" fell, on balance, from 30 to 28. The respondents that judged considerable the obstacles to production amounted to 34.9%, fewer than in the third quarter.

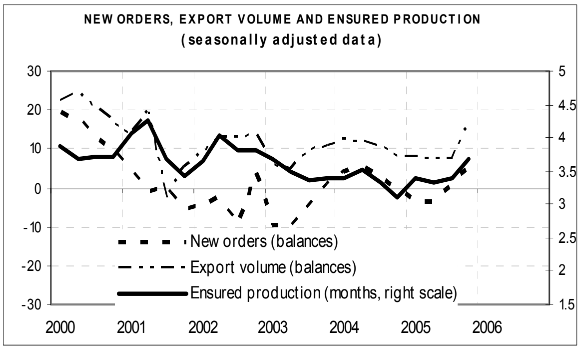
Manufacturing firms' confidence climate and balances of indicator-building series

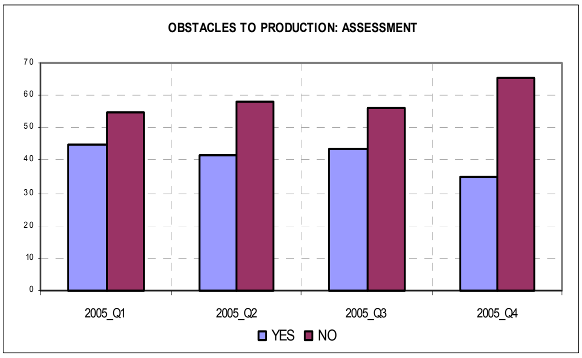
	Confidence climate	Order-book level	Finished goods inventories	Expectations on production
Oct. 2005	89.8	-14	7	14
Nov. 2005	90.4	-12	6	13
Dec. 2005	91.2	-10	6	14
Jan. 2006	92.7	-10	4	16





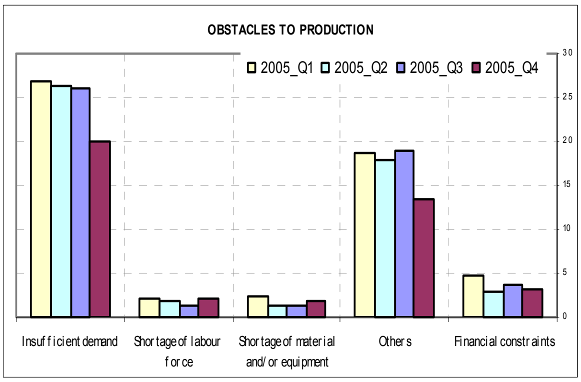
Firms considered that the scarcity of labour and the shortage of equipment were the main factors that hindered production with respect to the previous quarter. There was instead a fall in the proportion of those that placed at the top of the list of the obstacles to production the shortfall in demand, the financial constraints and other factors. As for the firms' competitive position, the raw balance improved at the national level (from 0 to 4), within the European Union (from -4 to -2) and with respect to non-European Union countries (from -7 to -2). Respondents forecast for the following three months a marked improvement in the volume of exports (from 7 to 17 on balance), and a decrease (from -9 to -8, on balance) in inventories of raw materials and semi-finished products, probably related to growing price trends.





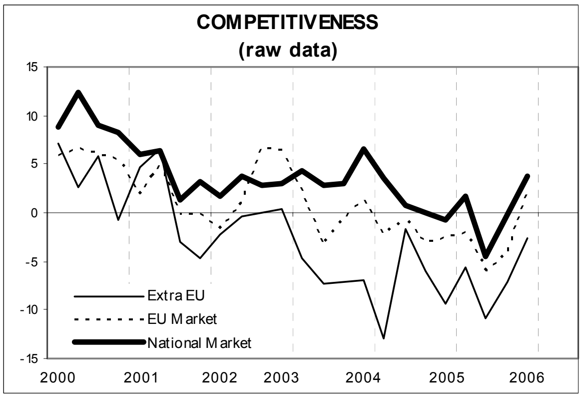
Regional breakdown of ISAE survey results

On a regional basis, the recovery recorded by the overall index of business climate reflected a marked improvement in the North: the seasonally adjusted index increased from 90.5 to 93.5 in the North West, and from 88.8 to 89.5 in the North East. Whereas the index fell both in the Centre and in the *Mezzogiorno*, from 93.7 to 92.7 and from 97.7 to 95.3, respectively. With regard to the various components of the business climate, the North and the Centre reported a general improvement in production expectations, while mixed signals characterized the views on orders and inventories.



<u>North West</u>

In this region, the rebound in the index mirrored both the substantial improvement in the assessment on the level of demand (both for domestic and foreign markets) and the recovery in production expectations, for which the balance increased for three consecutive months. Furthermore, the number of firms that considered inventories "above normal levels" diminished.



North East

The recovery in the confidence index was mainly due to the rise in production expectations (the seasonally adjusted balance increased again, after the fall registered in the previous month) and to the decrease in the balance of inventories. Entrepreneurs worsened, instead, their assessment on the level of total orders, in contrast with their view on both domestic and foreign demand.

Centre

In this region, the reduction in the overall confidence index was the result of a decrease in the balance of the assessments on the level of orders (in this case, the deterioration was due to a fall in expectations for both domestic and external demand), and of an increase in the balance for inventories. The trend in production, instead, moderately improved.

Mezzogiorno

The marked worsening in the confidence of entrepreneurs in the *Mezzogiorno* was driven both by a deterioration in the evaluation of the level of orders (due to widespread pessimism concerning the domestic market, along with stability in the assessment on foreign markets) and by a fall in the balance of production expectations. On the other hand, de-stocking was considered to be taking place, as the number of entrepreneurs that judged inventories to be “above normal levels” decreased.