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## **THE MANUFACTURING FIRMS' CONFIDENCE FALLS AGAIN IN MARCH**

- In March, the seasonally adjusted confidence index (base year 2000 = 100) decreases from 86.6 to 85, which is close to the smallest figures ever observed since July 2003. The contraction is mainly due to worsening expectations on production, which reach their trough since November 2001. Besides, inventories grow and assessments on the present order-book level slightly diminish
- With the present March Survey, ISAE starts providing the seasonally adjusted data concerning some financial variables relevant for firms, namely the current available liquidity to meet operational needs is diminishing, while its stabilisation is expected in the next few month, within a framework characterised by a stable cost of money
- Turning to single sectors, confidence is recovering in investment goods, where the balance increases from 83.3 to 84.6, while it falls in intermediate goods (from 84.9 to 83.6) and in consumer goods (from 91.8 to 88.3)
- The contraction is particularly evident in some leading sectors of the Italian specialisation model, namely confidence decreases by three percentage points - alongside with a strong fall in production expectations - in textile and clothing as well as in leather goods and shoes

## **EXPORT TURNOVER STRONGLY DECREASES IN Q1**

- In keeping with the expectations described in the past Survey, the export turnover strongly falls in Q1, while the ISAE respondents expect a substantial stability in the next few months
- Unfavourable indications also come from assessments on the export constraints, which are growing compared to the previous quarter, particularly because of the higher pressure coming from costs and from "other reasons", probably linked to the exchange rate appreciation. Similarly, according to the ISAE respondents, also the competitive pressure exerted both by European and by non-European countries (China in particular) is growing
- Alongside with the above mentioned confidence fall, a considerable export deterioration, as well as a rise in obstacles to exports and a remarkable growth in the competitive pressure from emerging countries in general, and from China in particular (which is a major competitor in those sectors according to almost half of respondents), is observed in the textile and clothing sector.

*Data referring to April shall be diffused on **April 28, 2005**.*

*Next ISAE surveys are scheduled as follows:*

**March 30, 2005:** *ISAE Monthly Survey on Traditional Retail Trade and Large Distribution (Reference month: February) and ISAE Monthly Business Service Survey (Reference month: March)*

**April 5, 2005:** *Comparative Business Surveys for Italy, Germany and France (Reference month: March)*

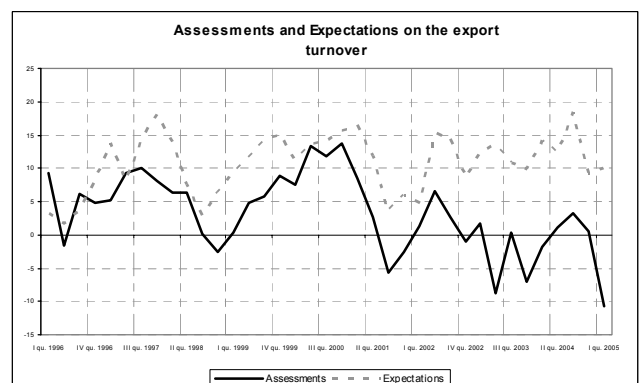
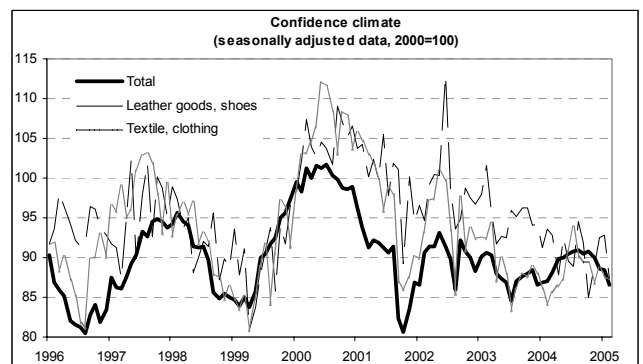
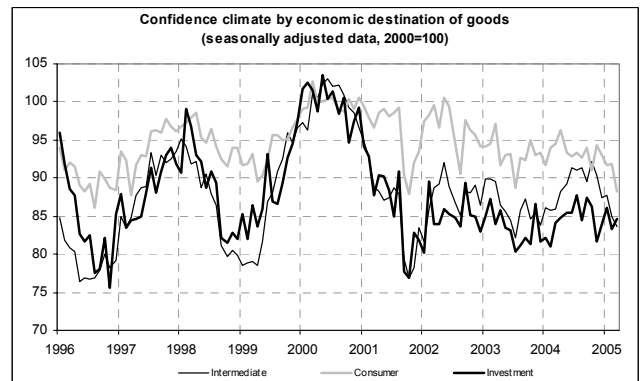
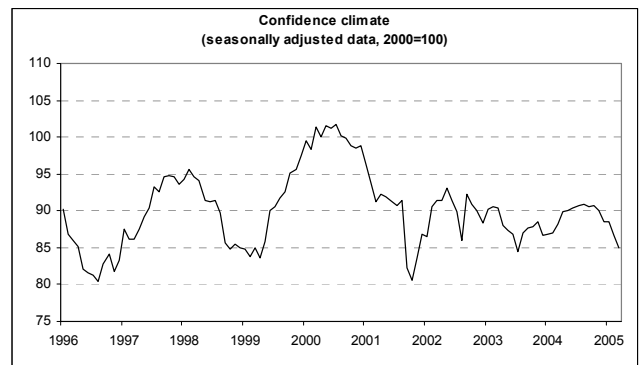
The full text of ISAE Surveys (either hardcopy or electronic) is available on sale (for further information see web site [www.isae.it](http://www.isae.it))

## General Results

According to the ISAE Monthly Survey carried out between March 1 and 18 on a panel of about 4,000 firms, the manufacturing and extractive firms' confidence indicator (seasonally adjusted data) decreases from 86.6 to 85, close to the smallest figures ever observed since July 2003. The contraction is mainly due to worsening expectations on production, which reach their trough since November 2001. Besides, inventories grow and assessments on the present order-book level slightly diminish.

Turning to single sectors, confidence is recovering in investment goods, where the balance increases from 83.3 to 84.6, while it falls in intermediate goods (from 84.9 to 83.6) and in consumer goods (from 91.8 to 88.3). Indeed, the contraction is particularly evident in some leading sectors of the Italian specialisation model (included in intermediate and consumer goods), namely textile and clothing as well as leather goods and shoes.

According to the results of the traditional quarterly Survey on export firms, the export turnover strongly falls in Q1 2005, while a substantial stability is expected in the next three months. Unfavourable indications also come from assessments on the export constraints, which are growing compared to the previous quarter, particularly because of the higher pressure coming from costs and from "other reasons", probably linked to the exchange rate appreciation. Similarly, according to the ISAE respondents, also the competitive pressure exerted both by European and by non-European countries (China in particular) is growing. Alongside with that confidence fall, a considerable export deterioration, as well as a rise in obstacles to exports and a remarkable growth in the competitive pressure from emerging countries in general, and from China in particular (which is a major competitor in those sectors according to almost half of respondents), is observed in the textile and clothing sector.

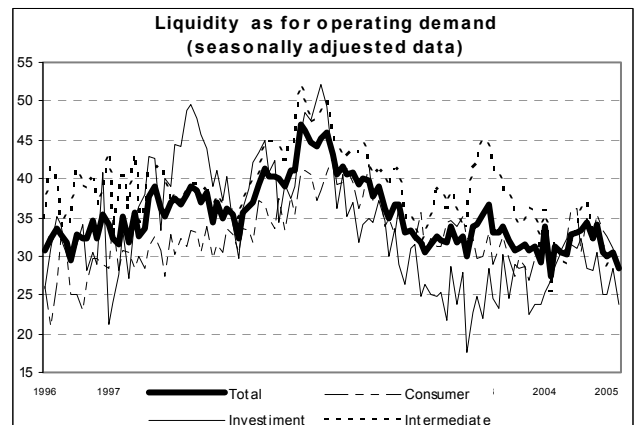
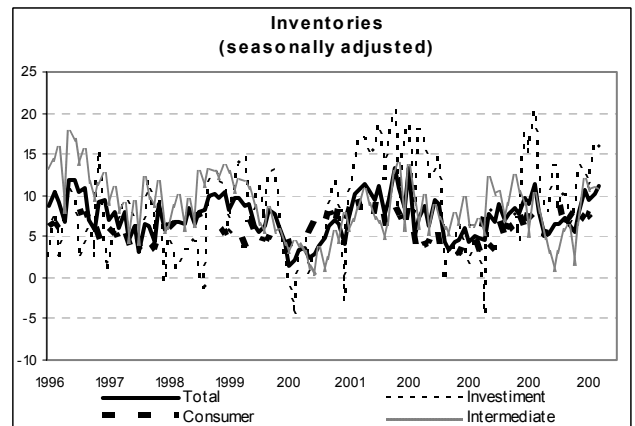
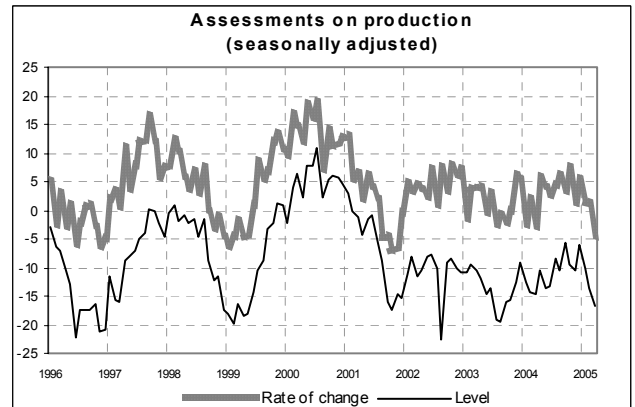
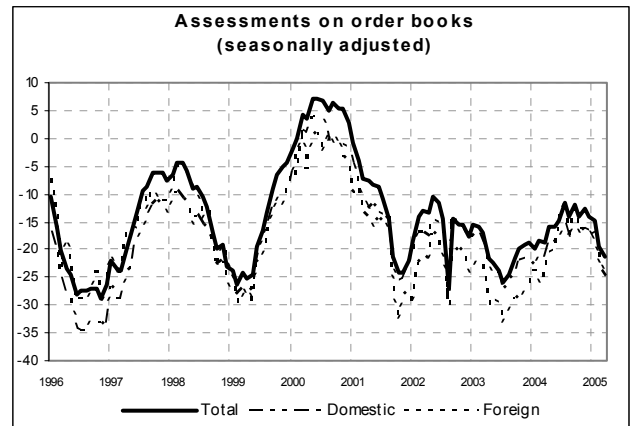


### Situation in the reference month (March 2005)

In March, the ISAE respondents provide negative indications on order books, production and inventories; even the available liquidity to meet operational needs is diminishing.

The seasonally adjusted order-book balance falls both on the domestic markets and, in particular, on the foreign ones (from -21 to -25). Balances referring to production are also decreasing, whether production levels (passing from -14 to -17, close to the smallest figures since August 2003) or the current production variations (falling from 1 to -5, thus becoming negative for the first time since March 2004) are considered. Inventories continue to grow and their balance rises from 10 to 11, thus getting near the maximum peak reached since December 2004. Finally, firms show that the available liquidity to meet operational needs is decreasing compared to February (the balance equalling 29 from 31, which is one of the lowest troughs of the past few years).

Looking at single sectors, assessments are by no means homogeneous: indeed, evaluations on production of investment goods recover (the balance passing from -21 to -15), showing a stability on the domestic markets (at -26) and a rise (from -20 to -16) on the foreign ones. In this sector, also production levels and current variations improve (from -12 and 0 to -8 and 1 respectively), while the balance of inventories stabilises (at 16). Consumer goods producers signal an order-book worsening (the balance decreasing from -19 to -21 and from -20 to -29 on foreign markets) and a slight rise in inventories (from 7 to 8), alongside with a remarkable fall in their production levels (from -14 to -19) and their current variation (from -1 to -3). Within a framework characterised by stable inventories at high levels (the balance equalling 11 for the third month in a row), also the intermediate goods situation is unfavourable. The order-book balance is decreasing (from -21 to -24: namely passing from -25 to -27 on the domestic market and from -21 to -22 on the foreign one), as indeed is the one referring to production (the production level balance passing from -15 to -20, while the one referring to production variation falling from 2 to -9).

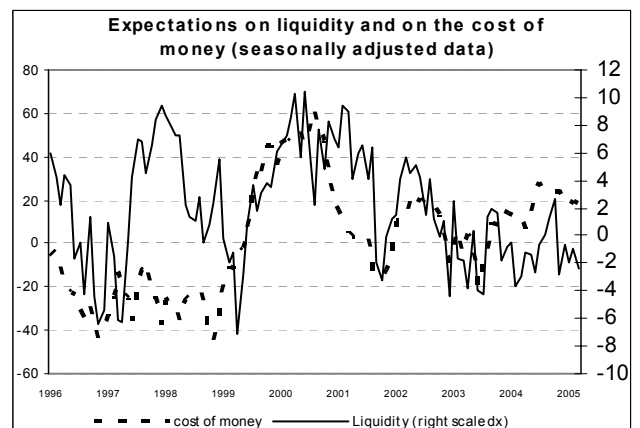
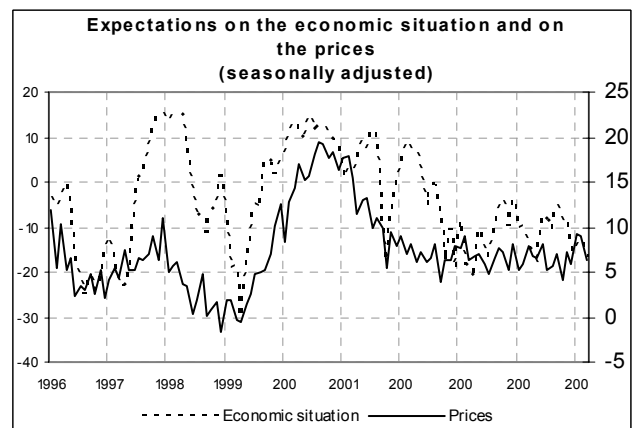
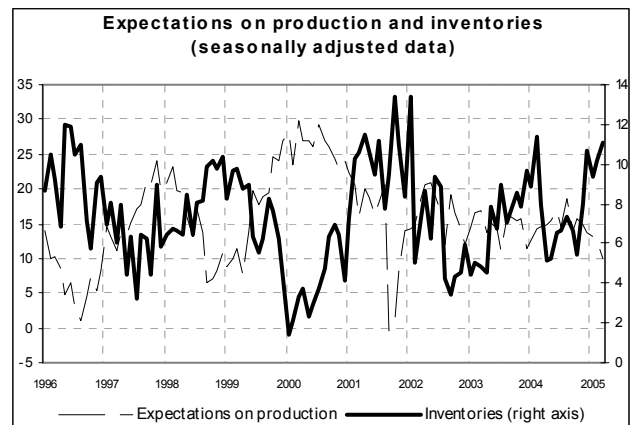


## Forecasts for next quarter

In March, the ISAE respondents are definitively more pessimistic with respect to the previous month, with reference both to the main firm variables and to the general economic trend. On the financial side, a fall is expected in the available liquidity and in the cost of money.

The balances of order-book and production expectations decrease from 13 to 10, which marks the lowest expectations since November 2001. Entrepreneurs also take for granted an employment fall for the next few months (the raw balance passing from -1 to -2) alongside with a selling price contractions (the balance decreasing from 10 to 6). The economic expectations on the Italian economy turn out to be particularly negative, the balance deteriorates from -12 to -16, which is close to the lowest figures since May 2004. Expectations on firms' liquidity fall from -1 to -2, but those referring to a rise in the cost of money slightly decrease (from 20 to 18, though remaining on high levels compared to the data of the past few years).

Looking at single sectors, forecasts are rather homogeneous: indeed, when investment goods are considered, balances referring to order books and production expectations fall from 15 and 17 to 11 and 15 respectively, while the price balance decreases from 11 to 9 and the one concerning the general economic situation goes down from -9 to -11. Entrepreneurs also expect an employment contraction (the raw balance going from 4 to 0), together with a fall of the available liquidity (the seasonally adjusted balance goes to -6 from -2). A rise in the cost of money is also expected by the firms operating in this sector. Expectations in consumer goods worsen more, as the balance of order books goes from 18 to 9, than the one on production (from 15 to 7) and the one referring to the general economic situation (from -14 to -24). Conversely, when in intermediate goods are considered, expectations on order books, production and employment remain substantially stable. Those on the general economic situation worsen from -12 to -16, as do those on the firms' liquidity (from 3 to 1). Finally, the expectations for a rise of the selling prices slow down and the balance goes down to 4, which is close to the minimum figures reached over the past 13 months.

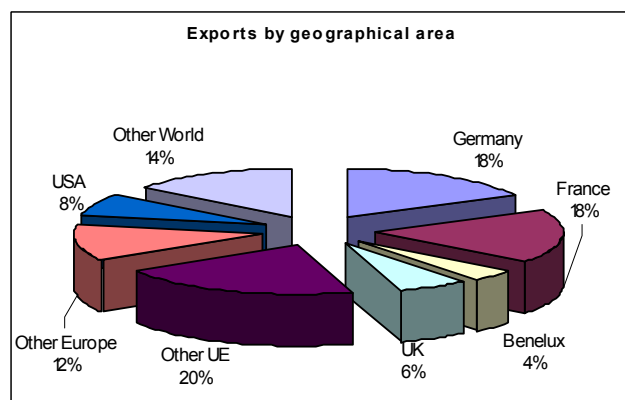
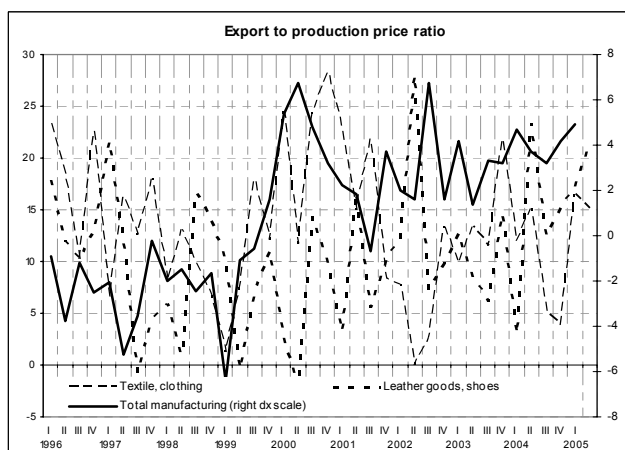
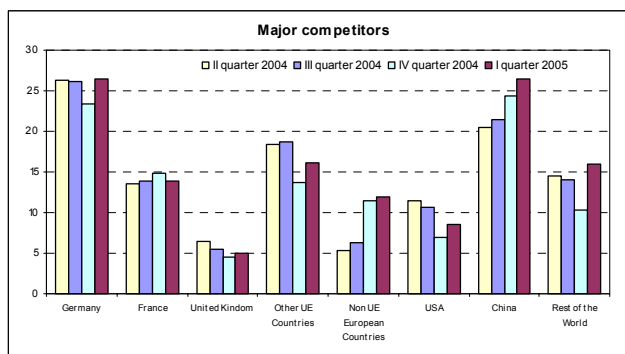
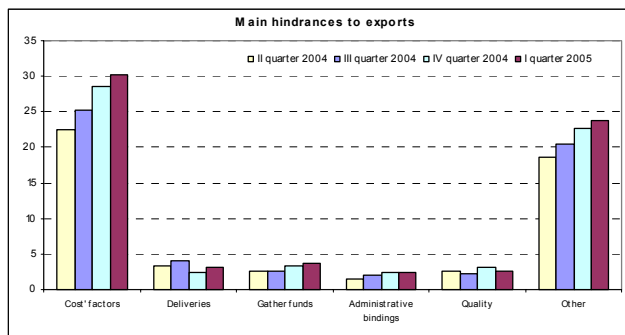


### Manufacturing firms' confidence climate and balances of indicator-building series

	Confidence climate	Order-book level	Finished goods inventories	Expectations on production
Dec. 2004	88.5	-14	11	14
Jan 2005	88.5	-15	9	13
Feb. 2005	86.6	-20	10	13
March 2005	85.0	-21	11	10

## The main results of the Survey on exports

In keeping with the expectations of the past Survey, the export turnover clearly falls in Q1 2005. Indeed, the seasonally adjusted balance decreases from 1 in Q4 2004 to -11 in Q1 2005. Entrepreneurs expect a substantial stabilisation of their export turnover for the next three months (the balance passing from 9 to 10). Similarly, a rise is signalled in export constraints: indeed, the share of those reporting significant export constraints goes up from 48 to 49%, which is one of the highest figures of the past decade. According to the ISAE respondents, the role of costs (which are relevant for 30% of the sample as against 29 in Q4) further grows, as does that of “other reasons” (according to 23% of the sample, compared to 20% in the previous Survey) probably linked to the strong euro appreciation against the dollar and to the harshening international competition, particularly in some sectors. Conversely, financing costs, delivery delays and, more generally, problems connected with goods quality are not perceived as relevant (even though their importance is growing). Among the major competitors, the role of China (which is an important competitor for 26 of respondents, as against 24 in the previous Survey) is growing, as are the roles of non-European countries other than the USA (which are major competitors for 16% of respondents, compared to 10%). Also the competition from Germany and from other EU countries (other than France, Germany and the United Kingdom) is clearly rising. With regard to exports by geographical area, a fundamental role is played by France and Germany, while the remaining EU countries receive about 30% of exports, 8% go to the USA and 14% to the rest of the world. According to the ISAE sample, the ratio between export and producer prices grows for the second quarter in a row, in keeping with what recently emerged on the basis of the ISTAT data on the Average Unitary Values of Exporting Countries.



## Confidence and the export activity in different sectors

The confidence crisis emerged over the past few months is due to the negative trend observed in some important sectors of the Italian specialisation model, such as textile and clothing (ATECO classification DB; 650 firms surveyed by ISAE on a monthly basis) and leather goods and shoes (ATECO classification DC; 220 surveyed firms). Confidence suddenly fell in those sectors in Q1 2005 compared to Q4 2004. In leather goods and shoes, the index passes from 92.5 in December to 83.9 in March, while in textile and clothing the indicator falls from 88.7 (December) to 84.8 (March). A strong fall of production expectations is observed in both sectors: indeed, between December and March, they decrease from 7 to -6 in leather goods and from 8 to 1 in textile and clothing (close to the minimum figures of the past few years).

Looking at data on exports, in Q1 2005 assessments on the export turnover trend suddenly deteriorate and obstacles to exports grow in both sectors, mainly because of costs and of “other reasons”, which are considered much more relevant than on average in the whole manufacturing sector. Furthermore, the Survey points to a great competitive pressure coming from emerging countries: 46% of textile operators and more than 51% of leather firms name China as their major competitor (the average equals 25% of replies) and about 21% of operators in both sectors indicate “other countries” (other than Europe and the United States) as their main rivals. Finally, similarly with what has been observed for the whole manufacturing sector, one has to add up a rise in the ratio between export-domestic prices, which might be due to the market abandoning of weaker firms offering a poorer quality of products.

