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MONTHLY ISAE BUSINESS SURVEY ON MANUFACTURING AND EXTRACTIVE FIRMS

Reference period: April 2003

- According to the ISAE Monthly Survey carried out between April 1 and 17, the manufacturing and extractive firms' confidence indicator (seasonally adjusted data), after the contraction registered in March (92.5), experiences a further fall, going down to 90.2, which is the lowest level since January 2002
- The negative trend of confidence witnessed over the past two months both in Italy and in the euro area, had probably been influenced by international tensions connected to the war in Iraq; also in similar past occasions, confidence has almost always registered marked and long-lasting deteriorations. Indeed, in March, the Italian entrepreneurs' confidence fall was smaller than in France and Germany
- Expectations on the short-term evolution of production worsen, as do assessments on order books; negative signals also come from inventories which show some signals of recovery, though remaining below "Normal" levels for the tenth month in a row
- Respondents are slightly more pessimist on order-book and employment prospects as well. Conversely, expectations on the Italian economic trend show a slight recovery, within a general situation where price tensions are expected
- The confidence deterioration is in keeping with the average figures for the intermediate goods (the index of which fall from 92.9 to 90.2) and it is particularly harsh in investment goods (where the indicator diminishes by about four points, from 82.8 to 86.4). In consumer goods, the indicator remains substantially stable compared to the previous month (from 94.6 to 94.5)

QUARTERLY QUESTIONS

Reference period: I quarter 2003

- On a quarterly basis, ISAE poses to its sample specific questions concerning the degree of plant utilisation, the new order-book flow and others
- In the Ist quarter 2003, new signals of demand deterioration emerge, particularly on the foreign market
- The demand contraction brings about a strong deterioration of capacity utilization, which falls down to 75.7%, that is on its lowest levels since the IV quarter 1996
- The share of firms deeming that, at present, there are considerable constraints to production growth rises from 32 to 36%. The percentage of those stating that those constraints are mainly linked to the demand scarcity prevails, while the number of respondents identifying the main cause for obstacles to production in "other reasons" - probably linked to the political-military tensions on the international scene - is growing

Confidence climate
(seasonally adjusted data), 1995=100



Data referring to May shall be diffused on **May 27, 2003**.

Next ISAE surveys are scheduled as follows:

April 30, 2003: ISAE Monthly Business Service Survey (Reference period: April) and ISAE Monthly Survey on Traditional Retail Trade and Large Distribution (Reference month: March)

May 2, 2003: Comparative Business Surveys for Italy, Germany and France (Reference month: April)

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

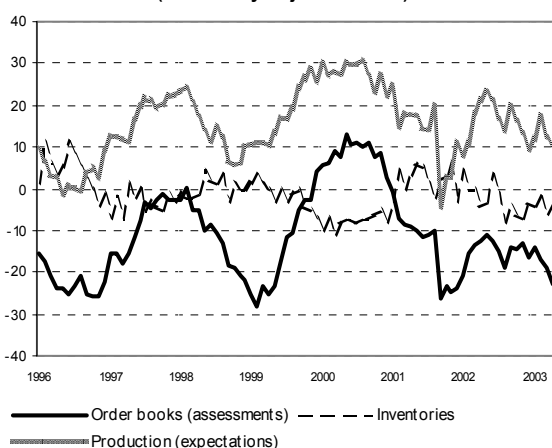
General Results

According to the ISAE Monthly Survey carried out between April 1 and 17 on a panel of about 4,000 manufacturing and extractive firms, the manufacturing and extractive firms' confidence indicator (seasonally adjusted data) falls in April, from 92.5 to 90.2, thus reaching the lowest levels since January 2002. Expectations on the short-term evolution of production are diminishing, while assessments on order books are worsening. Negative signals come from inventories too, which - through remaining below normal levels for the tenth month in a row - show signals of recovery. Even the pessimistic approach on prospects of order books and employment is increasing, while expectations on the Italian economic trend shows a modest recovery, within a framework where price tensions are expected.

The confidence deterioration is in keeping with the average figures for intermediate goods (the index of which fall from 92.9 to 90.2) and is particularly harsh in investment goods (where the indicator diminishes by about four points, from 82.8 to 78.4). In consumer goods, the indicator remains substantially stable compared to the previous month (from 94.6 to 94.5).

The negative confidence trend witnessed over the past two months has probably been influenced by international tensions connected to the War in Iraq; also in similar past occasions, confidence had almost always registered marked and long-lasting deteriorations. Indeed, in March, the Italian entrepreneurs' confidence fall was smaller than that of France and Germany.

Assessments on order books, expectations on production and inventories (seasonally adjusted data)

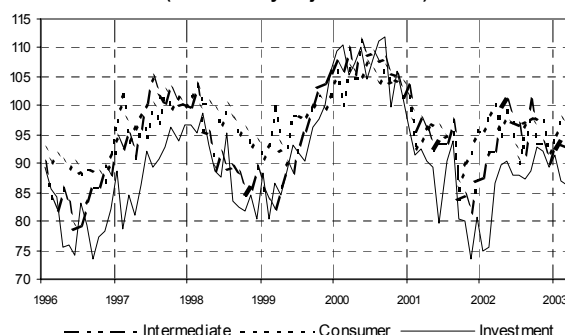


Situation in the reference period (April 2003)

In April, ISAE respondents express negative opinions on order books and production, signalling at the same time a slight recovery of inventories. With regard to orders, the seasonally adjusted balance reaches its lowest level since December 2001 (from -19 to -13); the contraction is more intense on domestic markets (where the seasonally adjusted balance falls from -18 to -21, thus reaching the lowest figure since January 2002) than on foreign markets (where the seasonally adjusted balance falls from -23 to -25, which is the lowest figure since November 2001). With regard to inventories, the seasonally adjusted balance goes up from -6 to -4, remaining below what are considered "Normal" levels for the tenth month in a row, and thus confirming the firms' trend to face the existing demand by resorting to inventories. Similarly, most respondents consider productive levels still "Low", even though their balance slightly recovers compared to March (from -15 to -14).

The worsening of assessments on order books has been spreading to all sectors: the overall balance markedly decreases in intermediate goods (from -20 to -26), as well as in final goods (from -16 to -19 in consumer goods and from -18 to -21 in investment goods). On the domestic market, producers of machinery and equipment signal a recovery (the balance goes from -22 to -20); on foreign markets, particularly unfavourable signals come from intermediate goods (where the balance contraction hits all sectors: with reference to order books, the overall balance decreases in consumer goods (from -14 to -16) and in intermediate goods (from -17 to -20), while it remains constant in investment goods (-17). On the domestic

Confidence climate by economic destination of goods (seasonally adjusted data)



market, the deterioration is equally distributed in all sectors, while on foreign markets there are signals of recovery in consumer goods (the balance passing from -26 to -25). Inventories remain below "Normal" levels in all sectors; however, signals of inventories' recovery emerge both in investment goods (the seasonally adjusted balance going from -10 to -5) and in intermediate goods (the seasonally adjusted balance passing from -5 to -1). However, those sectors signal a slight rise in assessments on production levels: the balances go from -17 to -15 and from -21 to -15 in investment goods and in intermediate goods respectively.

Forecasts for the next quarter

Still negative assessments on the present situation of demand and order books go alongside with a less optimistic approach to short-term prospects at firm level. Conversely, expectations on the overall Italian economic situation - which remains on particularly depressed levels - slightly recover. Finally, selling price tensions are emerging again.

Expectations on production remain positive, though their seasonally adjusted balance falls for the second month in a row (from 12 to 10). Expectations on the order-book trend in the next quarter are slightly less rosy (the balance goes from 17 to 16). Most ISAE respondents (75%) continue to expect a substantial employment stability for the next quarter (raw data only, given the short monthly historical series). The number of those forecasting an employment reduction goes up (from 14% to 15% of respondents) and the balance goes from -4 to -5. Less favourable expectations on order books, production and employment are accompanied by price tensions: the share of firms expecting order-book rises in the next quarter continues to exceed the number of those forecasting a reduction, and the seasonally adjusted balance grows from 7 to 8. Expectations on the general economic situation show some signals of recovery: the seasonally adjusted balance passes from -21 to -17, though remaining close to the lowest levels of the year, probably influenced by the international tensions stemming from the war in Iraq.

Turning to single sectors, expectations on production are stable in intermediate goods (the balance equalling 15), while final goods are worsening (the seasonally adjusted

balances of investment goods and consumer goods going from 13 to 9 and from 22 to 20 respectively). Expectations on production exclusively diminish in investment goods (the seasonally adjusted balance passing from 6 to 1), while they remain stable in intermediate goods (14) and slightly recover in consumer goods (from 11 to 12). The indication of a relatively higher short-term optimism of consumer goods producers is also confirmed by data on employment. Indeed, consumer goods producers recover from -9 to -7 (raw data), while investment goods producers (with a negative balance passing from 3 to -1) and intermediate goods producers (from -4 to -6) show worsening data. For consumer goods producers, the slight improvement in expectations on production and employment go alongside with a rise in expectations on selling prices (the balance going from 15 to 19, which is close to the peaks of 2002). Inflationary tensions slightly increase also in intermediate goods (from 5 to 6), while they diminish in investment goods, where the share of those expecting a price fall exceeds again the number of those expecting their rise, with a balance going from 2 to -2.

Finally, with regard to the short-term evolution of the Italian economy, expectations remain negative, even though there are wide-spread signals of recovery in all sectors: the balance goes from -16 to -11 in investment goods, it passes from -23 to -17 in consumer goods and from -20 to -13 in intermediate goods.

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

	Confidence climate	Order-book level	Finished goods inventories	Expectations on production
Jan. 2003	93.4	-14	-4	11
Feb. 2003	93.6	-17	-2	17
Mar. 2003	92.5	-19	-6	12
Apr. 2003	90.2	-23	-4	10

The war impact on the manufacturing firms' confidence

Unlike what happened for the consumers' confidence climate (see the ISAE Consumer Survey of April 22), the outbreak of the war in Iraq seems to have had a remarkable

negative impact on the confidence climate of manufacturing and extractive firms in April. Indeed, also in similar past occasions (the 1991 Gulf war, the 1999 Kosovo war, the terrorist attack of September 11, 2001), the manufacturing firms' confidence had almost always been influenced by international tensions, registering marked and long-lasting deteriorations.

To better identify effects of those shocks on the cyclical behaviour of confidence, a choice was made to adopt the indicators adjusted for the cyclical and irregular components as well as for longer-term trends, the latter identified through the estimation of a simple local deterministic trend. More precisely, the cyclical component was approximated by the residual of a regression of the confidence climate on a "local" trend component of linear and quadratic type, made on an interval of 49 months (that is, between the two years preceding and following the shock). Then the series were observed in a period comprised between one year before and one year after the military-political shock.

During the first Gulf war (January-February 1991), in the twelve months preceding the war, the cyclical component of the confidence climate of Italian manufacturing and extractive firms showed a strong contraction, which became harsher upon the war outbreak. The rapid conclusion of the military crisis favoured an indicator growth already since February, though the indicator remained on levels close to the depressed one of January 1991.

The Kosovo war had less relevant effects: the cyclical component of confidence in the twelve months preceding the war got through a negative phase, reaching a minimum level in February 1999. The growth was gradual between March and June, partially slowed down by the uncertainty connected to military operations, and then markedly accelerated in the following months. In March 2000 - twelve months since the war outbreak - it reached much higher levels than those of March 1999.

The unfavourable impact was particularly important and persistent after the terrorist attacks of Sept. 11, 2001. The cyclical component of confidence - which in August had started to show signals of recovery after difficult months -

brusquely fell in September and remained below the figures of the previous Summer for more than six months.

Looking at the recent trends, the cyclical component of the manufacturing firms' confidence registered - in the twelve months preceding the war in Iraq, namely between April 2002 and April 2003 - a trend similar to the one observed before the Gulf and the Kosovo wars. Signals of recovery had emerged between December and February, but the uncertainty observed in March and the final war outbreak in April had favoured a new cyclical contraction of the indicator, which seems less marked compared to the one registered after the Sept. 11 attacks, but similar to the one caused by the Gulf war. Should the confidence cyclical trend of Italian manufacturing firms prove to be similar to the one immediately following the Gulf war also in the next few months, then the war conclusion is likely to bring about a gradual confidence recovery, which should however still remain for some time below the average levels of the I quarter 2003.

The main quarterly results (I quarter 2003)

According to the results of the usual quarterly answers, further signals of demand deterioration emerge both in general and on foreign markets in particular. The ensured production length on the basis of the present order-book level goes down from 4.5 months of the previous Survey to 3.8 months, and the balance of new order books falls from -4 to -9 compared to IV quarter 2002. In both cases those are the lowest levels since the IV quarter 2001. Firms expect an export fall also in the next quarter (the balance should decrease from 19 to 13 and then go back to the values of the III quarter 2002). In keeping with those indications, also inventories of raw materials and semi-finished products recover and their balance passes from -3 to -1.

The demand contraction implies also a strong reduction in capacity utilization, which goes down by 1.5 percentage points, passing from 77.2 to 75.7% in a quarter. That is the lowest level ever reached since the IV quarter 1996. From this point of view, also short-term prospects seem not to be favourable, as the share of those considering their productive capacity "More than sufficient" compared to their needs rises from 29 to 32%, while the number of those

deeming it "Sufficient" falls from 68 to 63%. The reduction in the degree of plant utilisation is not accompanied by a similar cut in the working hours, the balance of which remains substantially stable compared to the IV quarter 2002 (from -2 to -1).

In keeping with those indications, there is also a rise in the percentage of those feeling that the productive activity is negatively influenced by demand (which are relevant for 63% of respondents) and supply constraints. Indeed, the number of those considering that insufficient plants obstacle the production growth falls from 4 to 3%, while the share of those identifying their problems in "lack of manpower" remains stable at 8%. Conversely, the role of "other reasons" increases, probably connected to the ongoing political-military tensions and to the uncertainty characterising the cyclical phase.

