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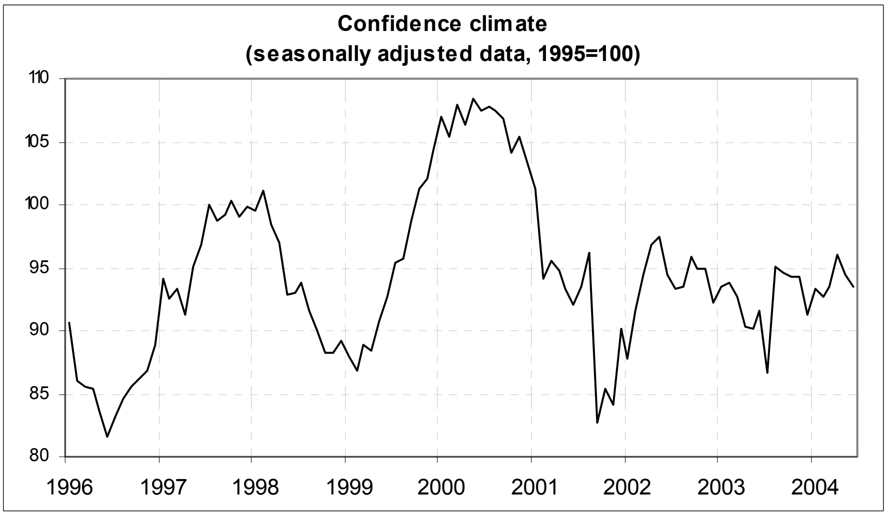
THE CONFIDENCE CLIMATE OF MANUFACTURING AND EXTRACTIVE FIRMS FALLS IN JUNE OWING TO AN INVENTORIES' ACCUMULATION

- **In June, the seasonally adjusted confidence climate of manufacturing and extractive firms falls from 94.5 to 93.6. Given an improvement in assessments on the present demand and stable production expectations, the contraction is exclusively due to an inventories' accumulation**
- **The inventories' growth may be an undesired consequence of a demand trend less favourable than expected or, alternatively, a precaution in view of a possible future order-book acceleration. Some indications corroborating this latter hypothesis come from the improved demand expectations**
- **Looking at single sectors, a contraction is observed in the confidence indicator of intermediate goods producers, passing from 92.1 in May to 89.5 in June. Conversely, the index remains rather stable in consumer goods (from 98.5 to 98.4) and considerably grows in investment goods (jumping from 92.1 to 95, which is close to the maximum figures ever reached since January 2001)**
- **Italian firms report a recovery in both domestic and foreign order books. Among non confidence-building variables, short-term expectations on the general economic situation of Italy improve, while those on the price trend diminish**

EXPORT TURNOVER GROWS IN THE IIQ 2004

- **According to the questions ISAE poses to exporting firms on a quarterly basis, export constraints diminish, particularly those referring to delivery and to bureaucratic-administrative difficulties**
- **Short-term forecasts on turnover are however less favourable than in the previous Survey**
- **With the present Survey, ISAE modifies its replies concerning the main competing countries on the international markets: in particular, countries which joined the EU in the latest enlargement are now part of the Union and the role of China is clearly mentioned among the rest of the world**
- **The share of respondents considering European countries other than France, Germany and the United Kingdom as important competitors equals 29%, those indicating China as a significant competitor on the international markets account for 25% of the sample. Besides, a 10-point rise is signalled in the number of those indicating France as the main international competitor of Italian exporting firms**



Data referring to July shall be diffused on **July 27, 2004**
Next ISAE surveys are scheduled as follows:
June 28, 2004: *ISAE Monthly Survey on Traditional Retail Trade and Large Distribution (Reference month: May)* and *ISAE Monthly Business Service Survey (Reference period: June)*
June 30, 2004: *Comparative Business Surveys for Italy, Germany and France (Reference month: June)*

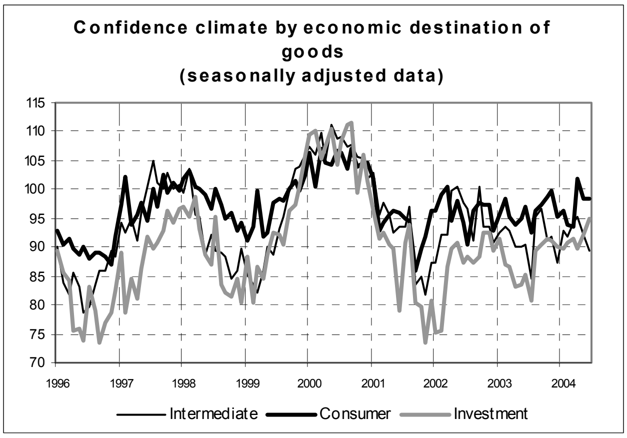
The full text of ISAE Surveys (either hardcopy or electronic) is available on sale (for further information see web site www.isae.it)

General Results

According to the ISAE Monthly Survey carried out between June 3 and 18 on a panel of about 4,000 firms, the manufacturing and extractive firms' confidence indicator (seasonally adjusted data) falls in June from 94.5 to 93.6. Given the improved assessments on the present demand and given the stable production expectations, the contraction is exclusively due to an inventories' accumulation. The inventories' growth may be an undesired consequence of a demand trend less favourable than expected or, alternatively, a precaution in view of a possible future order-book acceleration. Some indications corroborating this latter hypothesis come from rosier demand expectations.

The demand improvement concerns both domestic and, in particular, foreign markets. Among non confidence-building variables, short-term expectations on the general economic situation of Italy improve, while those on the price trend diminish.

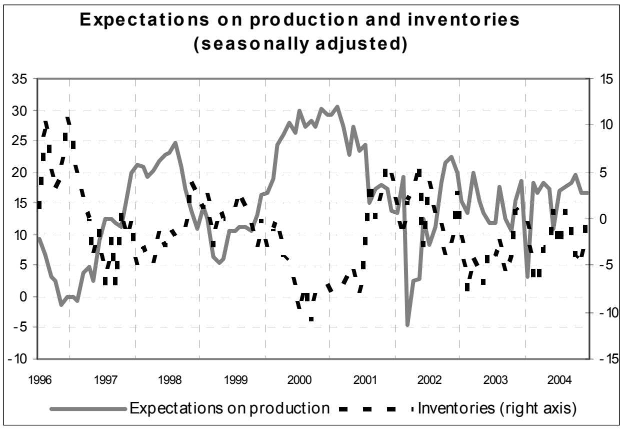
Looking at single sectors, a contraction is observed in the confidence indicator of intermediate goods producers, passing from 92.1 in May to 89.5 in June. Conversely, the index remains rather stable in consumer goods (from 98.5 to 98.4) and considerably grows in investment goods (jumping from 92.1 to 95, which is close to the maximum figures ever reached since January 2001).

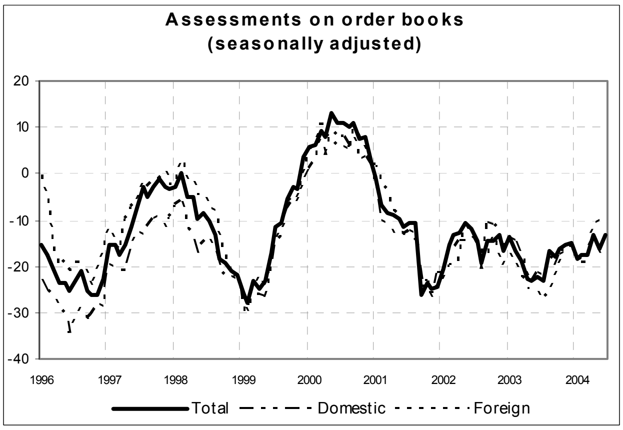


Situation in the reference period (June 2004)

In June, the seasonally adjusted balance of assessments on order books recovers from –16 to –13, thus getting close to the April figures after the May contraction. The domestic demand balance rises from –17 to –16, while the one on foreign order books registers a larger improvement, passing from –10 to –6, which is near the highest values ever reached since March 2001. Operators signal a substantial stability in assessments on the production level and on the current production variation, the balances passing from –14 and 4 in May to –13 and 2 in June. However, inventories are above what are considered as "Normal" levels for the first time since February (the balance growing from –5 to 1).

Looking at single sectors, the picture is improving in investment goods, while consumer and intermediate goods producers are more cautious. In investment goods, assessments on order books definitely recover, passing from –6 to –2 in terms of balance. The improvement is particularly evident in evaluations on foreign markets, the balance of which rises from –3 to 2, which means registering a positive figure for the first time since March 2001. The cyclical improvement of this sector is confirmed by the strong acceleration in the current production variation (the balance passing from 6 to 12, which is close to the peaks ever reached since August 2003). The current production levels are however below what are considered as "Normal" levels (though the figures are improving in terms of balance, passing from –3 to –1). Finally, with regard to inventories of machinery and equipment, the balance rises from –2 in May to 0 in June. In consumer goods, the overall assessments on order books jump from –17 to –10 in terms of balance, particularly thanks to rosier evaluations on foreign markets (the balance growing from –16 to –10, while evaluations on domestic demand remain stable at –13). In this sector, the production growth and the current production level are slightly worsening (from 3 and –14 to 1 and –15 respectively) and finished products' inventories are again on "equilibrium" levels (being 0 the balance; it was -10 in May).





Finally, the overall assessments on demand in intermediate goods show a slight improvement (the balance going from –21 to-20), in the presence of a domestic market stability (the balance equalling –22) and of a foreign demand recovery (from –11 to –8). In this sector, the balance of the production variation passes from 0 to 2, the one of the current production level from –18 to –16. Inventories grow again and their balance goes from –2 to 2.

Forecasts for next quarter

In June, short-term expectations on production stabilise at 17 in terms of balance, those on order books and employment rise to 23 (from 21) and to –5 (from –8; raw data owing to the short historical series), while expectations on the economic trend recover from –9 in May to –4. The overall picture is still characterised by price tensions which slightly decrease compared to the recent past (the balance passing from 10 to 8 with an average figure of 9 in the IQ).

Also short-term expectations confirm that optimism comes from investment goods producers: the balance of order books jumps from 16 to 34, the one of production from 22 to 29, thus reaching the maximum figures ever reached since January 2001 in both cases. Expectations on employment become even rosier, passing from 1 to 4 in terms of raw balance, while those on the general economic framework are positive again for the first time since January (from –5 to 4) and those on prices witness a slight reduction in concerns for new inflationary tensions (though the concern remains and the balance passes from 12 to 9).

In consumer goods, expectations on order books and production rise from 25 and 19 to 26 and 20 respectively (seasonally adjusted balances), those on employment offset the strong May contraction (from –12 to –3). The rosier picture in this sector is completed by the inflationary tension easing (the balance passing from 14 to 6) and by the improvement in forecasts on the general economic situation of the country (from –11 to –6 in terms of balance).

In intermediate goods, forecasts on order books and production are worst in June than in May, which runs counter the general trend. The balance of order books falls from 21 to 17, the one of production goes from 15 to 10, which is the lowest figure over the past few months. Also the raw balance of labour market expectations slightly worsens from –9 to –10. Firms operating in this sector expect further selling price rises (from 10 to 12), though they are relatively less pessimistic than in the previous month on the prospects on the general economic situation (the balance passing from –5 to –1).

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

	Confidence climate	Order-book level	Finished goods inventories	Expectations on production
March 2004	93.4	-17	-1	18
April 2004	96.1	-13	-4	20
May 2004	94.5	-16	-5	17
June 2004	93.6	-13	1	17

The quarterly Survey on exporting firms

The quarterly Survey on exporting firms (about half of the ISAE monthly sample) shows signals of recovery in the Italian export trend during the IIQ 2004. However, favourable expectations for the next few months decrease. The balances referring to the export turnover pass from 4 to 18 with reference to current assessments, but they fall from 27 to 13 (thus coming back to the figures of IVQ 2003) in short-term expectations. The share of the export turnover of Italian firms – computed on the basis of the ISAE respondents' replies - decreases from 37 to 35% in the IIQ.

Furthermore, the number of firms considering their exports to be affected by negative factors – among which the high costs and prices, while the impact of financial factors and concerns for delivery delays decreases - falls from 39 to 36%.

The Survey also provides information on the main competitors of Italian firms on the international markets. Indeed, with the present Survey, ISAE modifies its replies by including in the Union the countries which joined the EU in the latest enlargement and by clearly mentioning the role of China among the rest of the world.

In the IIQ 2004, the share of countries signalling French firms as strong competitors strongly increases (36% of respondents, as against 26% in the previous Survey). 29% of ISAE respondents attach great importance to the competing role of EU countries other than France, Germany and the United Kingdom, and 25% considers China a significant competitor.

Finally, with reference to the outlet markets by geographical area, the weight of EU countries falls from 66 to 60%, with a contraction of Germany from 19 to 15% and of France from 16 to 14%. Conversely, the role of other EU countries rises from 18 to 19% and that of extra-EU European countries from 6 to 9, while the share of the United States grows from 8 to 10%. Firms' assessments on the ratio between domestic and export prices slightly decreases and the balance falls from 3 to 2.

Major competing countries