



ISTITUTO DI STUDI E ANALISI ECONOMICA

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Date: December 16, 2004

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MANUFACTURING FIRMS INTEND TO REDUCE INVESTMENTS BOTH IN THE 2004 FINAL BALANCE AND IN THE 2005 BUDGET

- The Bi-Annual ISAE Investment Survey carried out between October and November 2004 and limited to firms which made or planned investments in the three years 2002-2004 signals a contraction in investments of manufacturing and extractive firms equalling a nominal 5.9% in the final balance for 2004. Forecasts in the 2005 budget are less negative compared to 2004, with an estimated 2.1% cut in investments for equipment and machinery
- Qualitative forecasts for 2006 are moderately favourable. Most respondents (68%) expect an expenditure stability or even a rise compared to the previous year. Expectations for stability prevail in the sample (54%), while a considerable share of firms (32%) expect a further contraction in 2006
- However, most firms declare they increased their investment plans during the year, particularly because of administrative reasons. According to ISAE respondents, among the major investment-influencing factors in plans for 2004 and 2005 a considerable role is played by demand and - particularly with reference to plan reductions - by financing difficulties probably connected to the euro appreciation and to its impact on firm profitability
- With regard to investment destinations, most expenditure was aimed at productive capacity enlargement (33% in 2004 and 31% in 2005), followed by obsolete plant renewal (29 and 30% respectively in the two years), rationalisation (22 and 24%), environmental protection (10 and 9%) and sundry targets (6% in both years)
- A more thorough analysis of expenditure destinations shows that, both in 2004 and in 2005, most firms allocate funds for rationalisation and enlargement in order to improve the existing production processes. More specifically, with reference to environmental protection, investments in both years are mainly aimed at soil, air and water protection (24 and 34% of replies in the two years respectively), followed by waste disposal (15 and 23%), noise reduction (13 and 21%) and nature and landscape protection (2 and 8%)

Next Bi-Annual Investment Survey will be published in May 2005.

Next ISAE Surveys are scheduled as follows:

December 21, 2004: *ISAE Monthly Consumer Survey (Reference month: December)*

December 28, 2004: *ISAE Monthly Business Survey on Manufacturing and Extractive Firms (Reference month: Mal)*

December 29, 2004: *ISAE Monthly Business Service Survey (Reference month: December) and ISAE Monthly Survey on Traditional Retail Trade and Large Distribution (reference month: November)*

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

Between October and November 2004, ISAE carried out its traditional Bi-Annual Investment Survey on Manufacturing and Extractive Firms (representing about 27% of the overall expenditure for investments). The Survey – comprising only firms which invested in the three-year period 2002-2004 – gathers about 800 of the 4,000 firms composing the ISAE monthly sample.

According to the Bi-Annual ISAE Investment Survey, investments of manufacturing and extractive firms should decrease by about 5.9% in nominal terms. In 2005, firms foresee a further 2% contraction. Conversely, qualitative forecasts for 2006 are moderately favourable. Most respondents (68%) expect a stability (54%) or even a rise (14%) compared to the previous year, while 32% of the sample expect a further investment contraction.

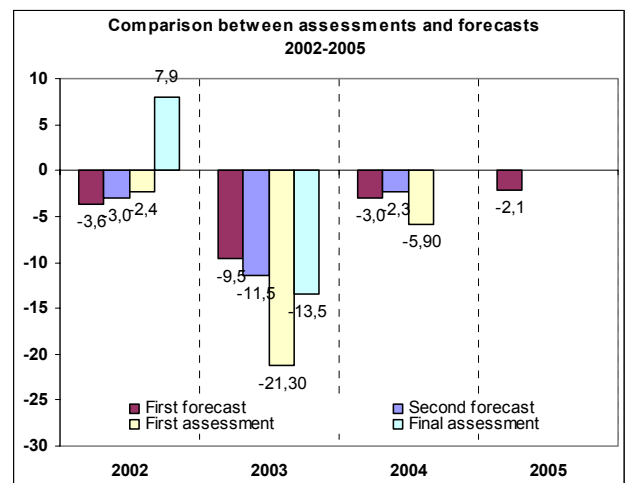
With regard to investment destinations, most expenditure is aimed at productive capacity enlargement (33% in 2004 and 31% in 2005), followed by expenditure for obsolete plant renewal (29 and 30% respectively in the two years), rationalisation (22 and 24%), investments for environmental protection (10 and 9%) and sundry (unspecified) targets (6% in both years).

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Investments for 2004 and forecasts for 2005

According to the pre-final balance for 2004 provided by ISAE respondents, investments in the manufacturing and extractive sector should fall by 5.9% in 2004. Those same firms forecast a further expenditure contraction by 2.1% in 2005. Looking at data by firm dimension, the 2004 deterioration is particularly marked for medium-sized firms (whose expenditure should diminish by 11.8% on average), while small firms should register a 4.2% contraction and large firms expect an average annual fall by 1.4%.

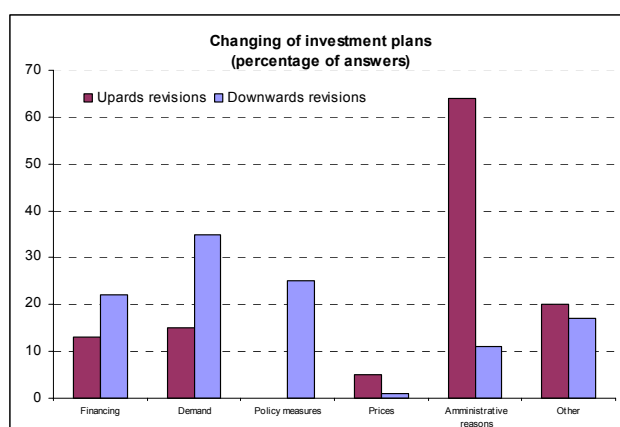
For 2005, medium-sized firms expect an expenditure rise by 4.6%, while large firms foresee an investment cut by 2.1%. Finally, forecasts for small firms are particularly pessimistic, with an estimated average fall equalling 22.2% in 2005.



Forecasts for 2006

Moderately rosier indications come from qualitative forecasts on investments for 2006. Most respondents (68%) expect they will rise their investment expenditure compared to the previous year (14% of the sample) or at least maintain the 2004 level (54%), while 32% of the sample foresee a further investment reduction. Data by firm size show that the optimistic approach prevails in large firms (66% of the sample expect an unchanged investment expenditure, 12% expect an investment rise and 22% foresee a contraction), while a considerable share of firms with less than 50 employees expect an investment fall in 2006 (49% of the sample as against 36% expecting an unchanged expenditure level and 15% forecasting an investment rise). Also medium-sized firms' evaluations are cautious: indeed, 47% of the sample expect a substantial investment stability, while 24% foresee a fall and 19% of firms declare they wish to invest more than in the previous year.

Turning to single sectors, favourable signals come from chemicals, rubber and plastics, where the relative majority of firms (namely 44%) reckon they will increase investments (22% of respondents expect stability and 34% expect a contraction), while pessimism prevails in foodstuff (where 69% of respondents declare they wish to reduce their expenditure) and in textile, clothing, shoes and leather products (where that share equals 47%).



Investment plan variations in 2004

According to the ISAE Survey, 61% of firms reviewed their investment plans during the year, with a majority of upward variations (44%) compared to downward changes (17%). 64% of entrepreneurs who raised their original forecasts mention administrative problems as the main cause (with a growing importance compared to the past), probably linked to the ongoing review of the firm accounting methodology. 20% of firms quote other unspecified reasons for their upwards plan variations, while 15% mention changes in the demand structure (which is however decreasing compared to the past Survey) and 13% indicate greater financial possibilities. Indeed, the demand trend is the main cause for downward changes of original plans (which is important for 35% of the sample), but a major role is also played by economic policy provisions (according to 25% of respondents). Finally, the share of firms (22% as against 13% in the previous Survey) mentioning their smaller financing opportunities as a major negative factor is considerably growing, probably because of the strong euro appreciation which had a negative impact on the firm profitability.

However, replies are still heterogeneous both in terms of firm size and looking at single sectors. Indeed, most respondents operating in small and medium-sized firms declare they did not review their investment plans during the year. Conversely, among those who did change their plans, the shares of those who did so because of variations in the demand structure and for other unspecified reasons prevails (32 and 42% in small and medium-sized firms respectively). Conversely, most large firms (74%: 51% with an upward variation and 23% with a downward variation) enlarged their plans for administrative reasons and reduced them because of changes in the demand structure. Finally, looking at single sectors, most (downward) variations took place in chemicals, rubber and plastics and most (upward) changes concerned foodstuff.

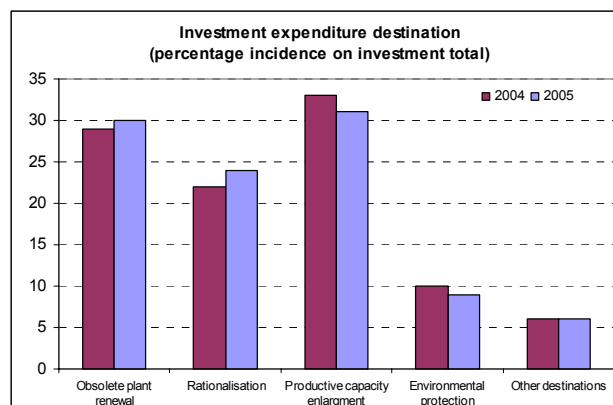
Main investment-influencing factors

The Bi-Annual ISAE Investment Survey also investigates the main investment-influencing factors determining the investment decisions. Among those factors, the current and expected demand evolution plays an important role both in determining the 2004 results and in influencing the 2005 forecasts. In 2004, 53% of respondents consider the demand evolution to be very important and 32% deem it is stimulating; in 2005, 53% of the sample consider it very important and 35% stimulating. Those factors are followed by technical reasons due to the technological development, by manpower availability and by the firm's adaptability to new technologies. 32% of firms consider those factors to be of major importance both in 2004 and in 2005, while they are "stimulating" for 48% of respondents in 2004 and for 46% in 2005. The availability of financial means is very important for 36% of firms and stimulating for 44% of them in 2004, while 41% of the sample find it both important and stimulating in 2005.

Main investment destinations

While analysing the different investment destinations, most expenditure is aimed at productive capacity enlargement both in 2004 (33% of the whole sample) and in 2005 (31%). That item is followed by expenditure for obsolete plant renewal (mentioned by 30% of respondents in 2005 and 29% in 2004), for plant rationalisation (24 and 22% respectively), for environmental protection (9 and 10% respectively, which marks a growing trend as against the previous Survey) and for sundry items (6%). Data analysis by firm dimension shows that investments aimed at obsolete plant substitution and renewal prevail in small and medium-sized firms (33 and 34% of expenditure respectively in 2004 and 30 and 36% in 2005), while expenditure for enlargement takes up a particular importance in large firms (41 and 33% in 2004 and 2005 respectively). Looking at different sectors, investments for productive capacity enlargement prevail in mechanics (including means of transportation) and foodstuff (both in 2004 and in 2005) and in chemicals (in 2005 only). Finally, expenditure for environmental protection is preferred by large firms both in 2004 and in 2005,

particularly by firms operating in mechanics and in chemicals, rubber and plastics.



Expenditure for productive capacity rationalisation and enlargement and for environmental protection

Compared to the previous Survey, the share of expenditure aimed at automation within the existing production processes is growing to the detriment of expenditure for process and product innovation. Indeed, firms spending for rationalisation signal their intentions to invest in the automation of the existing productive processes (67 and 65% of replies in 2004 and 2005 respectively, as against 47% for 2004 in the previous Survey). That destination is followed by investments in new productive techniques (which are important for 46 and 43% of respondents in both years, compared to a share of 57% in the previous Survey) and in energy saving (28 and 25% of the sample in the two years, that share equalling 36% last Spring).

Data are homogenous both in terms of firm dimension and in terms of sectors: the only exceptions are textiles, clothing, shoes and leather products and paper, printing and press, where expenditure to introduce new production technologies prevail.

In 2004 and in 2005, 66 and 63% of firms respectively invest in plant enlargement within the existing productive plans, 48 and 58% do so in view of the introduction of new products. Breaking down data by firm dimension, the introduction of new products absorbs investments mainly in large firms (74% of them allocate investments to that target, while only 57% of large firms do so) and, looking

at single sectors, a major role is played by mechanics and means of transportation and by chemicals, rubber and plastics.

Finally, looking at investment destinations by category of environmental expenditure, both in 2004 and in 2005 most investments were aimed at soil, air and water protection (24 and 34% of replies respectively), followed by waste disposal (15 and 23% of respondents in the two years) and noise reduction (13 and 21%). Nature and landscape protection (2 and 8%), are however less important.

