The Stock Exchange during 2004

For the second consecutive year almost all the equity markets grew. In both the United States and Europe, the good results came during the final part of 2004, after several months without a clear course. The gradual improvement in company profits, the strengthening of the economic cycle, a US monetary policy capable of controlling long-term interest rates and the clarification of the United States election situation were background factors that together contributed towards sustaining share prices.

In local currency, the S&P500 index rose by 9.0% with respect to 2003 year-end, the Nasdaq Composite was up by 8.6%, the Nikkei225 by 7.6%, the EuroSTOXX by 9.9% and the MIB by 17.5%. The Italian market therefore surpassed the trends of the United States and the main European stock exchanges, on the strength of its sectoral composition more heavily concentrated on sectors favoured by the macroeconomic conditions (utilities and energy) and the presence of listed company business histories particularly appreciated by investors. The capitalisation/GDP ratio has started to grow again, reaching 43.1% at year-end compared to 37.5% in 2003, and positive signs were also recorded in terms of the number of IPOs and the demand for shares.

The Stock Exchanges gave positive performances in 2004 also due to particularly encouraging trends in company profits

2004 confirmed the growth trend in world product, supported above all by the good performances of the United States and the Asian economies. During the year, the United States GDP increased by 4.4% (3.0% in 2003), due in particular to the investment component; in addition to the confirmed positive trend in the real estate segment, there was a strong demand for non residential investments which rose by 10% year on year. Private consumption showed no sign of weakness and grew by 3.8%.
The Federal Reserve's management of monetary policy was particularly effective: in order to make it more neutral, there was a turnaround which, during the second half of the year, gradually took the Fed Funds from 1% at the end of 2003 to 2.25% at the end of 2004. Moreover, the stabilisation of medium-long term rates continued; despite the positive signs coming from the real economy, the long section of the curve did not steepen (the ten-year rates closed 2004 at approximately 4.2%), thus avoiding a sharp rise in the actual cost of money, with negative impacts on consumption and real estate investments in view of the high indebtedness of American families.
This was all possible due to the role performed by the Asian economies on the international capital market. In order to stabilise the exchange rate of their currencies against the dollar, the Chinese and Japanese Central Banks purchased huge quantities of US assets, thereby financing the growing public deficit and the balance of payments deficit. The already

substantial foreign deficit continued to expand again during 2004, exceeding 5% of GDP. Towards the end of 2004 the growth rate eased off and in 2005 there should be, at least according to the Fed's intentions, a soft landing management of the real estate cycle and a start to the gradual recovery of the twin deficits, in other words the federal deficit and, over a longer period, the foreign deficit.

2004 saw a growth in the United States economy owing to a favourable investment cycle, while Europe was able to benefit from an export lead recovery

Europe, and to a large extent Italy, have found it difficult to keep up with world growth, confirming structurally more limited potentialities. Figures for the Euro zone indicated a rise in GDP of 1.8%, an improvement with respect to 2003, but more contained by international comparison. The acceleration in international trade helped to boost the overseas channel (exports +5.6%), whilst internal demand, despite a slight upturn, appeared unable to generate an autonomous contribution to growth. Weighing heavily on the trend in the European economy were the sharp rise in the price of raw materials and oil and the substantial appreciation of the euro. These factors penetrated a production fabric already weakened by the growing international competition and did not allow the export lead recovery to explicate all its benefits.
The European Central Bank left the reference interest rate (Refi) unchanged at 2% throughout 2004. Due to the scarcely favourable trends in GDP, more than one Country failed to comply with the Stability Pact and this fact led to a reopening of the debate within the European institutions as regards revising the parameters established by same. The need is to reconcile a more flexible fiscal policy, insofar as it has to support growth, with fiscal rigour; the latter is particularly necessary in the case of Countries with a high debt stock and within a perspective of further enlargement of the Union to include new member States, ten of which already joined as from May 2004.

Against this background, the Italian economy was able to benefit from the international recovery and the gross domestic product grew on a yearly basis by 1.1% (+0.4% in 2003). The negative growth differential with respect to the main European partners is mostly due to the lower trend in exports (+3.7% year on year), the result of a sectoral composition of Italian industry which is more subject to forms of price competition originating from the new emerging Countries and heavily dependent on a particularly weak German demand. There was a positive domestic trend as regards investments in plants and machineries.

Despite Europe's unfavourable growth differential, the main continental stock exchanges nevertheless achieved positive results comparable to those of Wall Street, owing to the high correlation between the international Stock Exchanges and, in some specific cases, to the sectoral composition of the official list, an aspect which has become significant in a capital market which tends to privilege investment by sector rather than by Country. Considering the exchange rate dynamics, a European investor would have derived most benefit from an investment on the domestic markets. Expressed in euro, the S&P500 index grew by 1.2%, the Nikkei by 4.4%, the London FTSE by 8.7%, compared to the 9.5% growth of the EuroSTOXX. At European level, Italy and Spain recorded the best performances (17.5%), followed by France (7.4%), Germany (7.3%), Switzerland (3.7%) and Holland (3.5%). In terms of size categories, the small caps indices generally outperformed the higher-capitalised shares; on the

United States market the S&P Small cap index was up by +21.6% and the Mid cap by +15.2%, against 9.0% of the Composite 500.

As regards the breakdown of movements in the Italian stock indices, the MIB recorded one of the best performances at European level, with a rise of +17.5% compared to 2003 year-end and +35.0% compared to 2002 year-end (chart 1). The year's high was achieved during the end-of-year session, taking the index to 22,881. The continuous indices showed a uniform trend: the S&P/MIB reached +14.9%, the MIDEX +12.6% and the MIBSTAR +24.6%, as further indication of the good performance of the small & mid caps asset class also in Italy. The NUMTEL was down by 17.5%.

The MIB closed the year at +17.5%, one of the best performances in Europe

The sectors represented in the Italian market contributed differently to the positive results achieved. At macro-sector level, Services (+27.8%) went relatively well, followed by Industrials (19.0%) and Financials (13.2%). Among the sectors of significant size (equal to at least 1% of capitalisation), particularly positive performances were recorded by Transportation (+33.3%) and Public Utilities (+31.5%); the latter, together with industrials energy (+23.2%), made a significant contribution to the overall result of the Italian market, also due to the high weight on overall capitalisation (respectively 28.5% and 13.7% at 2004 year-end).

CHART 1 - PERFORMANCE OF THE EQUITY MARKET - MONTHLY DATA