

EDITORIAL

A 2006 LED BY FOODSTUFFS AND ENERGY PRODUCTS

A DOWNHILL PATH FOR INFLATION IN 2007

The last months of the year are traditionally those in which the first the assessments of the full year are made. The year 2006 has been a transitory period for inflation with the rate firmly anchored a little above 2% for a long time until it fell sharply to 1.8% in October, a level not seen since way back in 1999.

The fall is hardly a surprise since net of the more volatile elements of fresh fruit and vegetables and energy, inflation has remained at these levels since the start of the year,

An "unnatural" fall which is attributable entirely to the strong downturn in oil prices, which fell by almost 20 dollars per barrel from the peak at the end of August. While the increases in energy product prices prevented inflation from falling naturally below 2% with oil prices rising constantly in the first half of the year, the fall in the price of Brent has brought inflation down to the core levels at which it has been for around two years. Although core inflation has remained stable, it is the result of opposing forces: the indirect effects of past increases in oil and other raw materials has been offset by the benefits of globalisation which are manifesting with localisation/delocalisation in emerging countries of the more labour intensive stages of production processes and with subsequent price competition from imported goods on domestic markets. These trends are summarised by the course of inflation on non foodstuff goods markets, where prices accelerated year-on-year from an average of 0.9% in 2005 to an expected average of 1.2% for 2006.

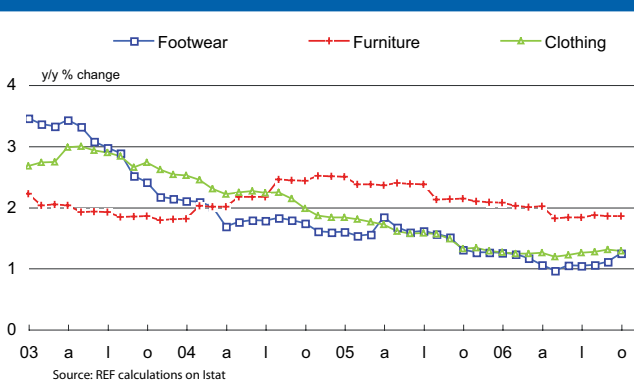
At the same time signs of recovery have started to be seen even in the foodstuff sector which has remained free from price pressure in recent years. While it has been confined to specific supply chains such as oils and meat, it has generated a jump in inflation from an average of 0.1% in 2005 to an expected average of 1.7% for 2006.

Another phenomenon which has affected inflation is the fall in private sector services prices, where a role has been played by both greater openness towards competition in some sectors such as the financial and insurance sectors and demand feedback from the price increases in 2002-2004 such as hotels, restaurants and bars.

The forecast for the year to come is based on oil prices settling at below 60 dollars per barrel and the continuation of some recently emerging trends. Steady

consumer demand is opening up the path to an acceleration in foodstuff and non foodstuff goods: the former affected by the spread of recoveries in supply chains which have not so far benefited from increases such as milk and its derivatives, preserves and other packaged foodstuffs as well as beverages, the latter affected by a slight recovery of margins eroded by price competition. The picture for public sector tariffs is one of recovery after the price compression of the last two years and the acceleration of private sector services prices completes the picture: average inflation will slow to 1.9% in 2007.

GOODS INFLATION: SOME SUB-COMPONENTS



SOURCE: REF CALCULATIONS ON ISTAT DATA



DOMESTIC PRICES

INFLATION TEMPORARILY UNDER 2%

Inflation decelerated sharply in October falling by three tenths of a percentage point from 2.1% in September to 1.8% in October. The fall in prices was due largely to the energy component of the index which reflected oil prices coming down again. Energy products, which adjusted almost immediately to the change in oil prices, fell by 5% in October. Despite falling below 2%, the scenario for inflation contains hidden sources of pressure on prices. The core component of inflation has remained stable at 1.8% and this confirms that prices have started to recover at least in some sectors.

ITALY: BREAKDOWN OF INFLATION

	ANNUAL % CHANGE			
	Avg. 2004	Avg. 2005	Aug.06/ Aug.05	Oct.06/ Oct.05
Food	2,2	0,1	2,2	2,6
Processed food	2,3	0,8	2,4	2,7
Fish and seafood	1,6	1,2	4,3	4,9
Fruit and vegetables	2,0	-3,8	0,2	1,5
Industrial goods	0,8	0,9	1,0	1,3
Medical products	1,7	1,3	0,2	0,1
Clothing	2,2	1,5	1,3	1,3
Footwear	1,8	1,5	1,1	1,2
Furniture and furnishings	2,2	2,3	1,9	1,8
Household appliances	-0,3	-0,9	-1,0	-1,1
Radio, TV, etc.	-13,3	-11,6	-10,3	-8,2
Photog. equip., optical instr.	1,4	0,7	1,3	1,3
Household goods	1,7	1,0	1,7	1,9
Tools and equip. for house	2,6	2,3	2,2	2,3
Products for personal care	1,8	0,5	0,8	1,0
Newspapers, books	2,0	1,5	0,9	2,0
CD, magnetic tape	0,6	0,1	0,5	0,5
Games, toys, sport equip.	1,0	0,7	0,2	0,5
Miscellaneous goods	2,6	2,6	9,9	10,1
Motor cars and access.	-0,1	2,2	1,4	1,8
Energy	2,4	8,9	10,4	1,5
Heating oil and fuels	5,8	10,8	8,7	-5,0
Electricity and gas	-1,7	6,4	12,8	10,5
Services	3,3	2,9	2,1	2,4
Personal care, recreation	2,2	1,8	1,4	1,5
Housing	2,7	2,6	2,3	2,3
Transport	4,9	4,7	2,4	2,7
Health	2,9	2,0	2,4	2,4
Financial and n.e.c.	2,9	3,9	1,7	1,6
Restaurants and hotels	3,4	2,6	2,4	2,8
Regulated prices	1,5	0,0	0,2	-0,5
Nationally	0,6	-1,4	-1,2	-2,5
Locally	3,1	2,4	2,6	2,7
Rents	2,8	2,4	2,4	2,7
Tobacco	9,8	8,9	6,4	6,4
All-items	2,2	1,9	2,2	1,8

SOURCE: REF CALCULATIONS ON ISTAT DATA (NIC)

FORECASTS

NEW YEAR: INFLATION AT 1.9%

A fall in oil prices to 58 dollars per barrel is bringing total inflation into line with core inflation. Steady consumer demand is opening up the path to an acceleration in foodstuff and non foodstuff goods: the former affected by the spread of recoveries in supply chains which have not so far benefited from increases such as milk and its derivatives, preserves and other packaged foodstuffs as well as beverages, the latter affected by a slight recovery of margins eroded by price competition.

INFLATION IN ITALY: HISTORICAL DATA AND FORECASTS

ANNUAL % CHANGE					
	2004	2005	2006	2006	2007
	Avg	Avg	Oct.	Avg (*)	Avg (*)
Consumer prices (NIC)					
Food	2,2	0,1	2,6	1,7	2,3
- ex fresh food	2,3	0,8	2,7	2,0	1,7
Non-energy industrial	0,9	0,9	1,3	1,2	1,6
Energy ⁽¹⁾	2,4	8,9	1,5	8,1	-1,0
Services	3,3	2,9	2,4	2,3	2,8
Admistrd prices ⁽²⁾	1,5	0,0	-0,5	0,3	1,7
Rents	2,7	2,4	2,7	2,5	2,4
All-items	2,2	1,9	1,8	2,1	1,9

(*) FORECASTS

(1) INCLUDING REGULATED ENERGY PRICES (ELECTRICITY, GAS, ETC.)

(2) EXCLUDING ENERGY (ELECTRICITY, GAS, ETC.)

SOURCE: REF CALCULATIONS ON ISTAT DATA

SPECIAL FOCUS

INFLATION AND THE COST OF LIVING

The ISTAT (Italian national statistics office) has just recently published information on price levels relating mostly to foodstuffs. The availability of this information is important because it makes it possible to establish whether there are significant differences between the amount citizens residing in different towns and cities must pay to purchase the same basket of goods and also to understand the relationship between two different statistics: cost of living and inflation.

COST OF LIVING IN ITALIAN CITIES

PERCENT DIFFERENCE RELATIVE TO ITALIAN MEAN	
Cities	Delta %
Torino	3,4
Aosta	13,2
Milano	6,6
Trento	0,2
Venezia	13,8
Trieste	10,6
Genova	11,9
Bologna	4,4
Firenze	-5,1
Perugia	-7,8
Ancona	2,3
Roma	-0,6
L'Aquila	-2,7
Campobasso	-
Napoli	-12,8
Bari	-14,0
Potenza	-12,4
Reggio Calabria	-2,9
Palermo	-4,1
Cagliari	-4,2

SOURCE: REF CALCULATIONS ON ISTAT DATA



FOODSTUFFS FOODSTUFFS MOVE TOWARDS 3%

The year 2006 has been the year of the recovery of foodstuff inflation, after the moderate inflation it experienced between 2004 and 2005. The current period is characterised by widespread and not negligible increases for many supply chains. Fruit is the fresh foodstuff that is driving the recovery, while there has been room for further reductions in vegetable prices. Fish has now reached a rate of growth of 5% per year. Supply chains for packaged foodstuffs have recorded increases in recent months which have not yet started to stabilise as expected from price performance at the top of the chain as seen in the basket monitored by Unioncamere.

FOODSTUFFS: BREAKDOWN OF INFLATION

ANNUAL % CHANGE

Department	Avg. 2004	Avg. 2005	Aug.06/ Aug.05	Oct.06/ Oct.05
Processed food	2,3	0,8	2,4	2,7
Beverages	2,3	0,7	1,2	1,1
Packaged	2,6	0,8	3,4	3,5
Fresh food	1,8	0,5	0,8	1,0
Frozen food	1,5	0,4	1,0	1,1
Pets food	2,0	1,2	1,5	1,5
Meat	2,4	0,9	3,5	4,3
Fish and seafood	1,6	1,2	4,3	4,9
Fruit and vegetables	2,0	-3,8	0,2	1,5
Food and beverages	2,2	0,1	2,2	2,6

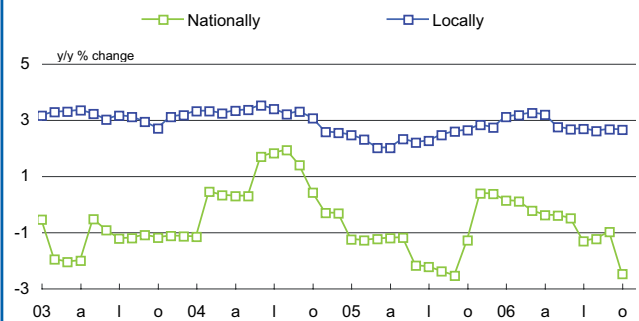
SOURCE: REF CALCULATIONS ON ISTAT DATA (NIC)

TARIFFS MEDICINES ARE DRIVING THE FALL IN TARIFFS

Tariff inflation worsened in 2006. The rate of growth in prices had more than doubled compared to the beginning of the year, driven by the energy sector.

There has been important news on the both the energy tariff front and for nationally controlled tariffs in recent months. The fall in oil prices will certainly favour a deceleration in electricity and gas tariffs, while measures to contain total spending on pharmaceuticals is putting a brake on these prices.

REGULATED PRICES (1)



(1) EXCLUDING ENERGY TARIFFS

SOURCE: REF CALCULATIONS ON ISTAT DATA (NIC)