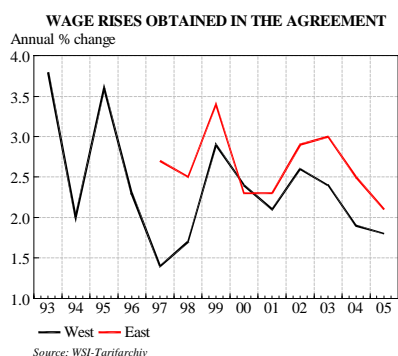


WAGE RESTRAINT CONTINUES

€# Whereas the ECB is putting more emphasis on the risks of price/salary bubbles appearing as a result of the fleeting explosion of inflation, for the time being there are no tangible signs of such a phenomenon in Germany. The wage restraint applying since 2003 is expected to continue.

€# Significant structural changes have appeared in how wages are set, with wage costs being adapted to the pace of activity: there is less widespread use of industry-wide pricing agreements ("Tarifautonomie"); a trade-off is developing among the factors of sustaining domestic employment, raising working time and restraining wages.

Wage rises contained for the moment



These annual average increases affect one million employees in the East and 6.9 million in the West. The 2005 figures concern 4.4 million people and do not take into account the results of the wage agreement of the public services that came into effect on 1 October.

On the basis of the agreements that came into effect in the first half of 2005 (affecting 2 million Germans in the West and 350,000 people in Eastern Germany), the average increase of wages negotiated is 1.8% for the whole of Germany (1.8% in the West, and 2.1% in the East). Wage restraint – logically – is most marked in industries experiencing difficulties (construction, textiles, printing), while large increases were given in the chemicals industry (an average annual increase of 1.6% for 2005, and 3% for 2006) and steel-making (3.4% in 2005, 2.3% in 2006).

Upcoming large rounds of wage negotiations

End date of the previous agreement	Sector	Union	Employees affected
28/02/2006	Electronics and metallurgy industry, East and West	IG Metall	3,240,800
	E. ON	IG BCE, Ver.di	76,100
31/03/2006	Accommodation and food service, Rhineland-North Westphalia, Thuringia	NGG	116,600
	Deutsche Telekom AG, East and West	Ver.di	70,000
30/04/2006	Deutsche Post AG, East and West	Ver.di	142,000
	Textile industry, West	IG Metall	74,700
31/05/2006	Banks, East and West	Ver.di	437,300
30/06/2006	NRW	IG BCE, Ver.di	15,800
31/08/2006	Steel-making, metallurgy, Bremen, Lower Saxony, Rhineland-North Westphalia, East	IG Metall	111,900
31/12/2006	Chemicals industry, Rhineland, Hessen, Rhineland-Pfalz	IG BCE	262,900
31/01/2007	Chemicals industry, Schleswig-Holstein, Hamburg, Lower Saxony, Bremen, Bad-Wurtemberg, Bavaria, Berlin	IG BCE	256,700
	Volkswagen AG	IG Metall	103,000
31/03/2007	Construction, East and West (not incl. Bavaria)	IG BAU	599,900
	Wholesale and Retail trade, Bade-Wurtemberg, Bavaria, Saxony	Ver.di	344,200
	Printing, East and West	Ver.di	185,900
	Textile industry, East	IG Metall	15,200
30/04/2007	Wholesale and Retail trade, all other Länder	Ver.di	723,700
30/06/2007	Deutsche Bahn AG, East and West	Transnet	140,000
31/12/2007	Public services, federal and local, Bundesagentur für Arbeit, Knappschaften, Ortskrankenkassen	Ver.di	1,553,100

Source: Tarifvertrag

The next decisive round will be that of metallurgy in Bade-Wurtemberg at the start of 2006; it involves a large number of employees directly and provides direction for many SMEs and a reference for other negotiations. It is highly unlikely, however, that IG Metall will ask for excessive increases, as in 2002, since its negotiating power has been reduced as a result of the high level of unemployment; recent examples (Bosch, Opel) show that it recognises the imperatives of improving competitiveness as an acceptable argument in a negotiation. As a reaction to the austerity plan of the Merckel government, IG Metall is aiming for a 5% increase for the mechanics and electronics industry: if the negotiations end in rises higher than 3%, there will be some legitimacy to talk of second-round effects in Europe (last year, the union was asking for 4%, and obtained a raise of a little more than 2%).

Wage determination undergoing significant structural changes

€# The terms of wage agreements made are constantly getting longer: the average has risen from 14 months in 1994 in West Germany, to 22 months in 2004.

€# Industry-wide agreements are less common

An increasing number of companies are pulling out of industry-wide wage negotiations, or leaving or not joining the professional associations, either by entering into company-wide agreements or using *Öffnungsklauseln* which allow a company to leave industry-wide agreements and to set lower wages so as to ensure the company's survival, as long as the employer and the employees both approve. More and more companies are going this way. While the process is presently voluntary, the CDU/CSU wanted to provide this type of agreement with legal status (if approved by the works committee and two thirds of employees), to which the SPD is firmly opposed. In total, in 2004, 32% of employees in the West (and 48% in the East) were not covered by a wage agreement, even though in this percentage, half of the companies were following the direction set by the industry-wide agreements.

Furthermore, the extension of an agreement to the entire industry (*Allgemeinverbindlichkeit* resolved by the labour ministry with the agreement of the employer, unions and employees) is used more and more rarely: Two per cent of agreements in 2004, as against more than 5% at the start of the 1990s, are extended; what is more, they increasingly affect working conditions, rather than wages.

Coverage of industry-wide wage agreements

As a % of the number of employees in West (East) Germany	Industry-wide agreements		Company-wide agreements		No agreement	
	1995	2004	1995	2004	1995	2004
Capital goods ¹	82	65 (26)	9	7 (14)	9	28 (60)
Consumer goods ²	73	65 (29)	7	5 (10)	20	30 (61)
Construction	93	76 (40)	2	3 (8)	5	22 (52)
Sale, maintenance & repair	71	60 (31)	10	5 (12)	20	36 (58)
Transport and communication	54	49 (25)	35	19 (27)	11	32 (48)
Public service bodies and insurance	78	85 (86)	19	1 (10)	3	5 (4)
Total	72	61 (41)	11	7 (12)	17	32 (48)

Source: Institut für Arbeitsmarktforschung, IAB Betriebspanel

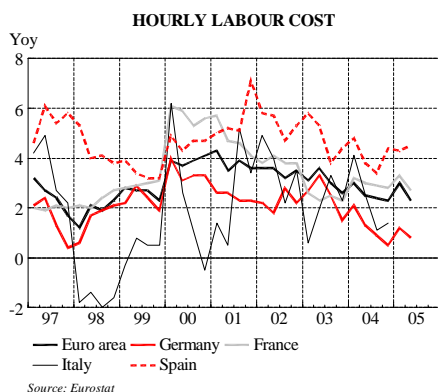
¹ in 1995, only the machine construction industry; ² in 1995, only the textile and clothing industry

Two factors continue to maintain the rises in wages. **Wages in Eastern Germany catching up to those in Western Germany**, still promoted by the unions, leading to wage rises in the East between 2.5% and 3%. Wages in the East under agreements now come to 94% of those in the West, up from only 60% in 1991. The most recent agreements show that the large rises in the East will continue until parity is reached (the difference is still quite large in the public services, construction and the chemicals industry). **The lack of differentiation in wage rises according to level of qualifications and size of one-off payments** tend to induce greater wage inflation for lower qualified jobs that are already handicapped by the high level of payroll costs.

Wage agreements take full account of the issues of working time. This has always been the case in Germany: since 1984 in the metallurgy industry, collective bargaining agreements have regularly been signed that "exchange" a reduction in working time in return for wage restraint and greater flexibility in the organisation of work; the agreement entered into in March 1994 for this industry included the Volkswagen model, i.e., the possibility of using a greater reduction in working time (up to 30 hours) with partial or no wage compensation so as to avoid layoffs. What is new is that now it is rises in working hours that are negotiated in exchange for continuation of employment. This phenomenon occurred for the first time in the statistics in 2004, when the average number of hours worked increased to 36 hours after a continual decline from 38.5 hours in 1991 to 35.8 hours in 2003. This movement was initiated at Daimler-Chrysler, Porsche, BMW, Bosch and Siemens in 2004, and extended by the "Pforzheimer" agreement (signed in February 2004 in metallurgy in Baden-Wurtemberg and then extended to the whole of Germany, it specifies that, in certain conditions, up to 50% of the employees of a company may work up to 40 hours a week, which is a waiver of the 35 hours set down in the industry-wide agreement).

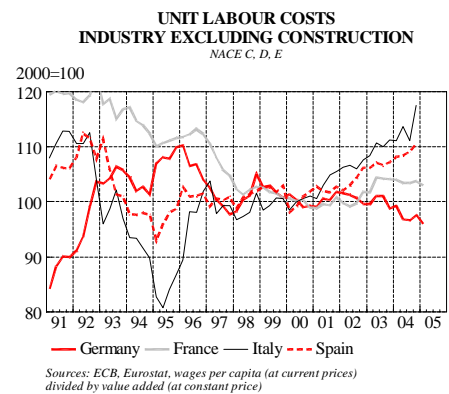
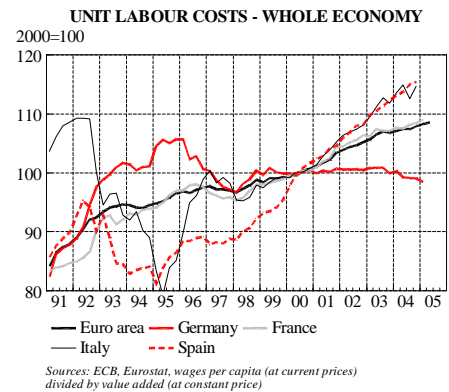
Since then, this movement has spread to include employees of public service agencies. The agreement signed in 2005 by Ver.di specifies: a rise from 38.5 hours to 39 hours in weekly working time for federal government employees in the West and to 40 hours for those of local bodies; the possibilities of the increasing in working hours to 45 hours per week with no payment of overtime; in addition, in 2007, a variable share based on performance will be introduced for federal and local body employees (initially 1% of wages, and due to reach 8% in stages). In total, the average rise in wages of the 1.5 million employees affected comes to less than one per cent in 2005.

Overall, unit wage costs are declining

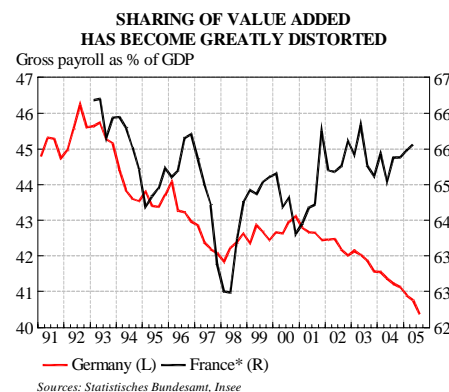


The hourly cost of labour in Germany, therefore, has been growing much more slowly than in the other eurozone countries since 2000. However, it is still high due to the proportion of payroll costs (social security charges, etc.) on which it is much more difficult to put pressure than on the hourly wage. This is precisely the aspect that recent reforms have targeted, since the grand coalition between

CDU/CSU and SPD wants to reduce them further by lowering unemployment insurance contributions by 2 points, financed by a part of the scheduled increase in VAT. Especially in industry, wage restraint has led to a considerable reduction in unit wage costs. The magnitude of their reduction is, however, not as great as in 1997, but it is quite likely that it will be more long-lasting (and more gradual), than that former one, due to the structural changes leading it.



This rebound in competitiveness has clearly enabled Germany to gain market share in intra-eurozone trade, to profit from the new vitality of emerging countries (Central and Eastern European countries, China), and from the recycling of the oil bill by oil-exporting countries (gains of market share for OPEC countries) and to restrict the negative impact of the rising value of the euro on its exports. However, in the short term, these efforts in favour of competitiveness involving strong pressure being put on wages and jobs have resulted in a large distortion in the sharing of value added to the detriment of households, in turn leading to weak domestic consumption lasting an unheard-of time. However, households are expected to benefit from German industry's solid performance and the return of profits, but not before 2007, by most counts.



* Wage compensation paid by non-financial companies as a % of the value-added of non-financial companies

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