Market Report

Consumer and Retail Market in Germany

March 2005

Content

1 Political Economy in Germany

An overview on various aspects of economical development, structures and consumers

1.1 Economical Development

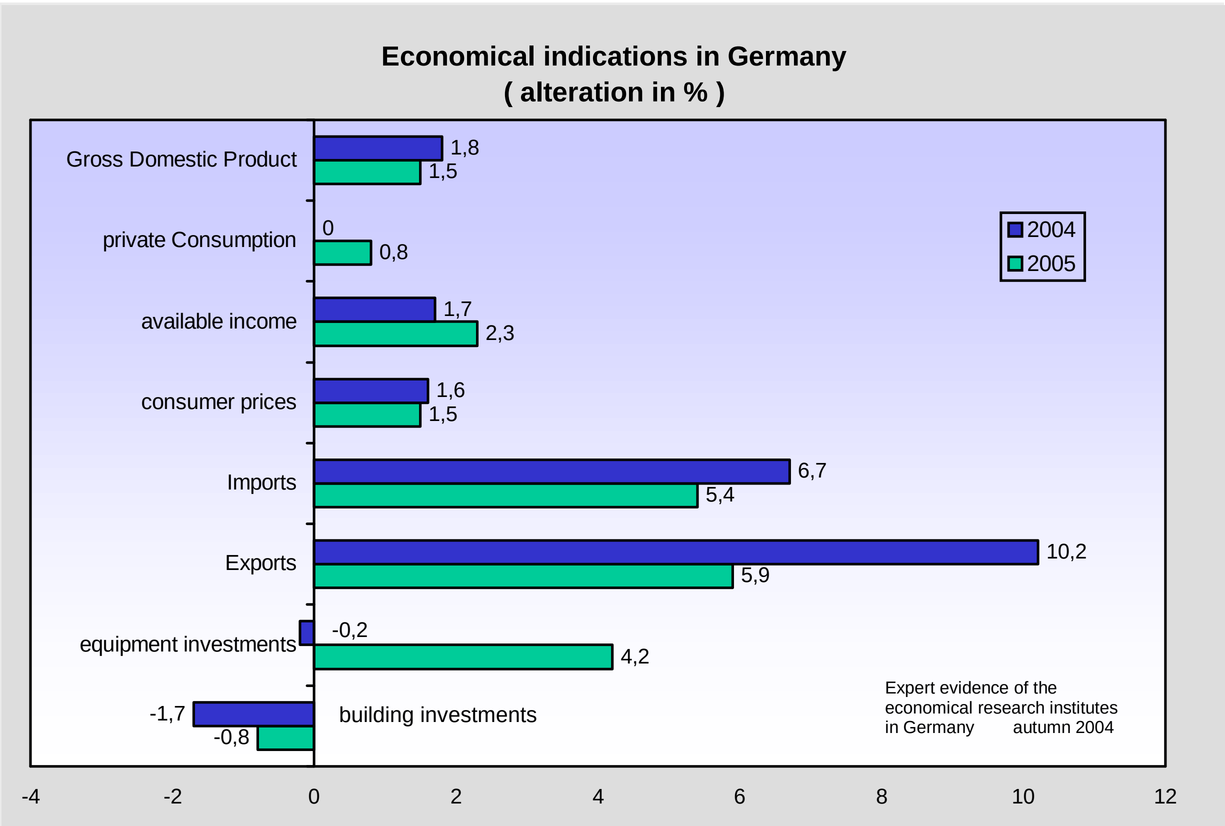
While in 2004 worlds economy had a growths rate of 3,9% and will still have an expected growths in 2005 of 3,2% in spite of high oil prices and a slower American economy; Germanys economical growths is far beyond.

There has been a slight recovering during the first half of 2004 but in comparison to former upswings the economical dynamic is rather small. Impulses for the economy solely came from abroad but even these impulses get weaker. So after an increase of the gross domestic product of 1,8% in 2004 there will just be a growths of 1,5% in 2005 or even less.

Different to former upward trends so far there is no recovery in the domestic consumption. The expectations in income are at a very low level because of the low economical growths expectations and high energy prices. Even the next step of the tax reform starting 2005 is not expected to increase domestic consumption more than just a hint.

While the number of working people has been increasing slowly during 2004, because of some instruments in employment politics (Mini Jobs, Ich-Ag's) the number of social insurance paying people is shrinking and the unemployment rate has been remarkably increasing. In January 2005 there are 5 Mio people unemployed - a rate of 12,1%. A fast and radical change of this situation in 2005 is not realistic.

Much stronger will be the increase of equipment investments. Besides positive sales perspectives abroad is the reason the better profit situation of enterprises because of low interest rates, consolidation success and little to no increase in salaries.



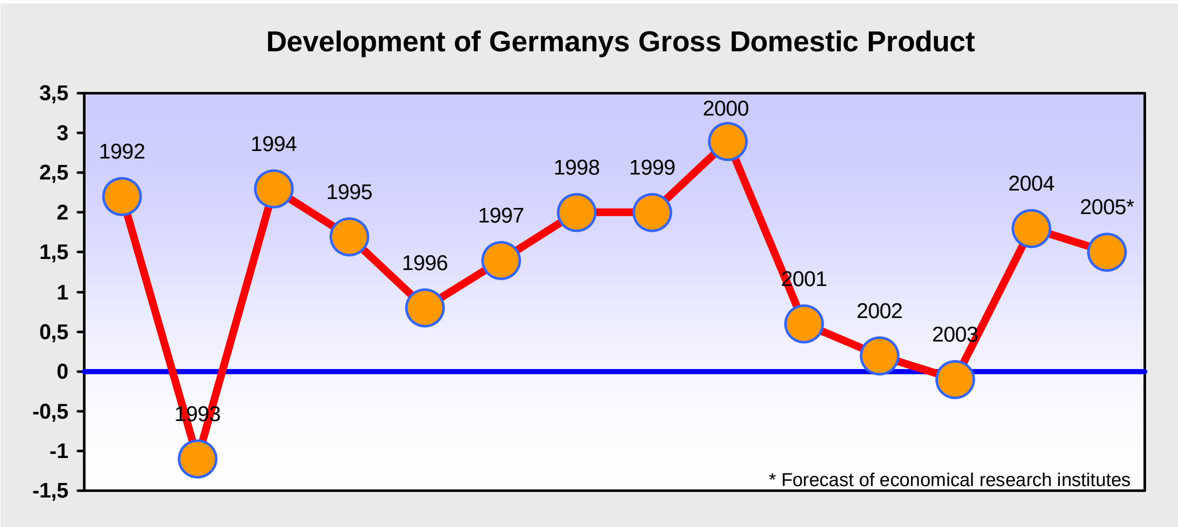
Some important facts:

		2003	2004	2005
Domestic people with income	Mio	36,27	38,34	38,55
Unemployed people	Mio	4,38	4,37*	4,33*
Unemployment rate	%	10,3	10,2	10,1
Savings rate	%	10,7	10,8	10,8

* Unemployment in Dec.04: 4,46 Mio (10,8%); in Jan. 05: 5,04 Mio (12,1%); in Feb. 05: 5,2 Mio (12,4%)

		Alteration in %	Alteration in %	Alteration in %
Consumption of private Households	nom.	1,2	1,7	2,3
	real	0,0	0,0	0,8
Investments	nom.	-3,1	-1,0	2,0
	real	-2,2	-1,0	1,5
Exports	nom.	1,0	10,4	7,7
	real	1,8	10,2	5,9
Imports	nom.	1,5	7,1	7,5
	real	4,0	6,7	5,4
Gross Domestic Product	nom.	1,0	2,3	2,4
	real	-0,1	1,8	1,5
Gross Salaries		-0,2	0,3	1,3
Enterprise - and Capital income		3,5	11,5	5,9
Available income		1,2	1,7	2,3
State Receipts		0,8	-0,2	1,2
State Expenses		1,1	0,0	0,6

* nominal: in current prices / real: in prices of 1995
Source: expert evidence of economical research institutes / autumn 2004 (DIW, Ifo etc.)



1.2 Demographic Structure

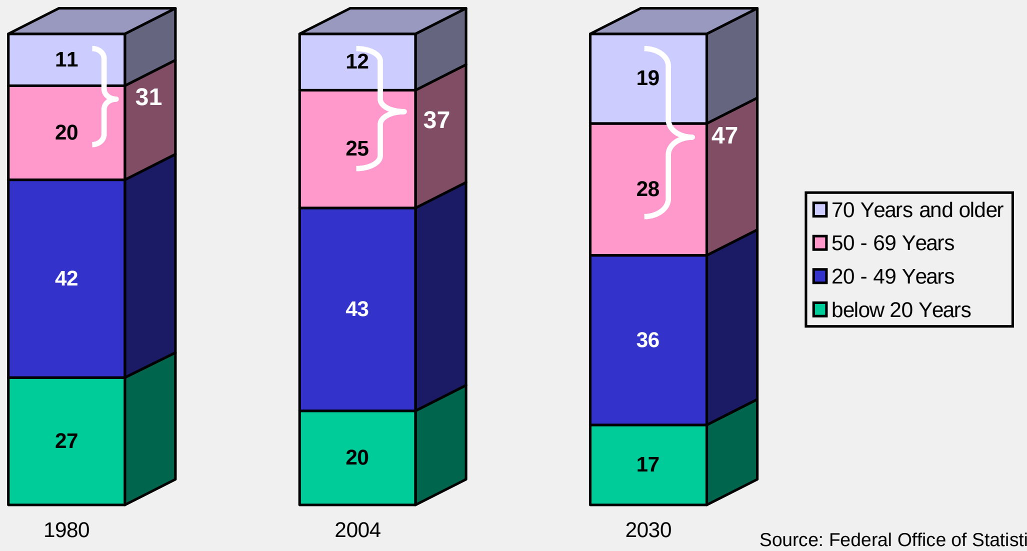
There are massive changes within the demographic structure of the German population during the next 15 years.

Population after age - groups 2004 - 2020

	2004 Mio.	2020 Mio.	Alteration Mio.
Below 20 Years	16,8	14,6	-2,2
20 - 49 Years	35,4	30,5	-4,9
50 - 69 Years	20,5	24,5	+4,0
70 Years and older	10,1	13,2	+3,1
Total	82,8	82,8	±0,0

The age structures in East- and West Germany are nearly the same - in East Germany there is a tendency to even older age groups cause the birth rate is nearly 30% lower than in the West. Today the rate of children under 6 years is in West Germany 5,9% while in East Germany the rate is only 4,2%.

Changes in the age – structure 1980 - 2030
in %

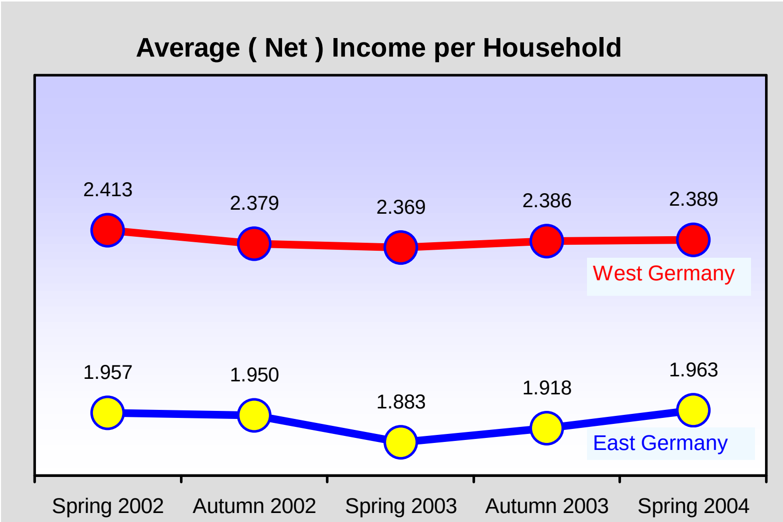


Source: Federal Office of Statistics

Considering the population in total will not be shrinking, there will be a drastic increase in the older population groups. Within the next 25 years nearly half of the population will be 50 years and older. This will have a large impact on the political and economical structure in Germany.
The working population will become older with a lot less innovation and creativity within the industry. Less young people will have even lesser money to spend because of the larger burdens of social insurance structures.
A large part of available income will flow into medical and health care, fitness and wellness products and their industry. Retirement programs and health care instead of education and research will eat up state expenses.
Marketing and trade will focus strongly on the older population groups and their values, cause this will be consumer group with the largest impact on demand.

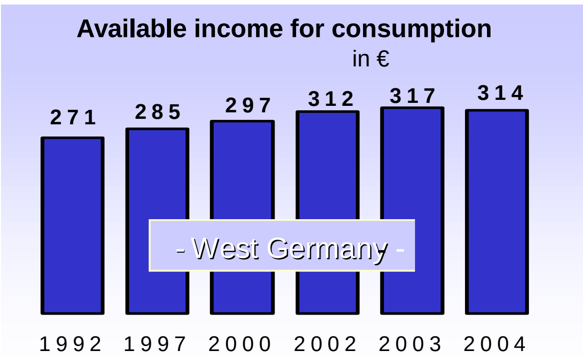
1.3 Consumption Climate 2004

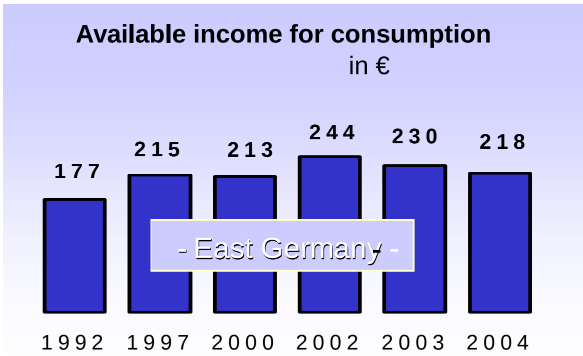
One of the most important indications for Trade and all sorts of retail is the consumption climate. It clearly shows all factors that influence the willingness and the potential of the population to spend money. It also shows -statistically- trends, opportunities, threads and weaknesses that will influence consumption.



Basis: Federal Republic Germany; Population from 14 Years Source: AWA

- Households in East Germany have still about 20% less income compared to the West.
- After a decrease in the income of 2 / 4% in 2003 following the recession in the German economy there is a slight continuous increase ‘til then, which might be slightly positive effected by the tax-reform in 2005
- The household income in the West is still lower than in 2002





Basis: Federal Republic Germany; Population from 14 Years Source: AWA

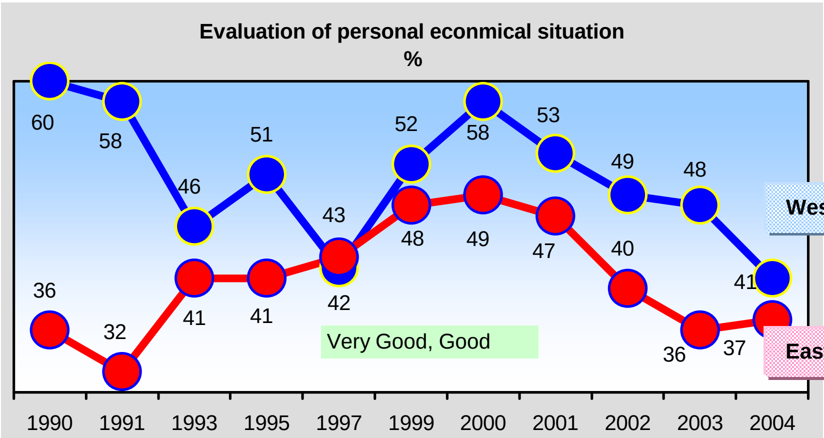
Considering the income that is available in German households after covering all necessary costs for living, the difference between East and West is even more remarkable. Concerning the potential for consumption eastern Germans have about 30% less money to spend. While there has been a constant growth in both parts of Germany since 1992, the available income in the East fluctuates much stronger than in the West.

Besides the pure statistical figures domestic consumption is just as much influenced by psychological feelings. A survey from April 2004 among German people older than 16 years shows very dramatic how people feel about their financial potential for consuming. The question was to compare the financial situation from today with previous year and whether they would have *more*, *less*, or *more or less* the same amount of money to spend.

	Total %	West %	East %
More money	5	5	5
Rather less money	60	58	69
More or less the same	31	33	23
Indecisive, no answer	4	4	3

⅔ of the people find they have less money, which slows down domestic demand.

Under the circumstance that the focus is on selling jewellery and Germany is one of the major target markets we have to realise that the attitude to such kind of luxury goods is very important and closely linked to the evaluation by potential consumers of their own economical and financial situation.

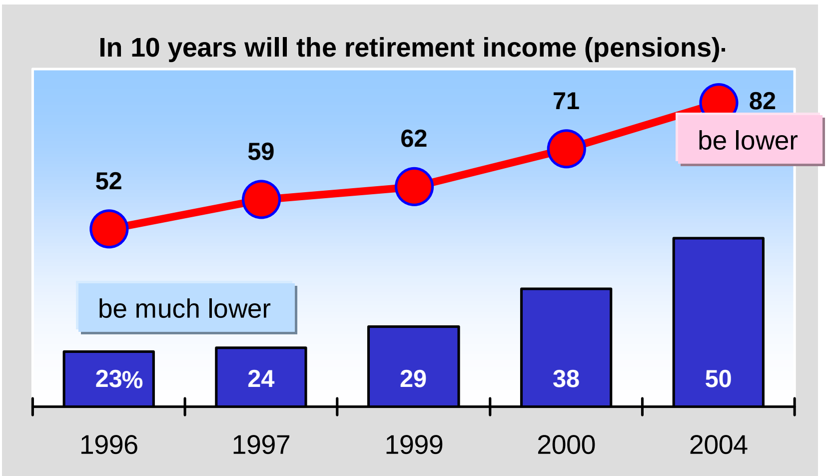


Basis: Federal Republic Germany; Population from 14 Years Source: AWA, IfD Allensbach

Within 4 years the percentage of people in West and east that would consider their own financial situation as good or very good dropped dramatically. So if more than half of the West German- and nearly 2/3 of the East-German population consider their situation as not good or poor, chances for consumption are not likely.

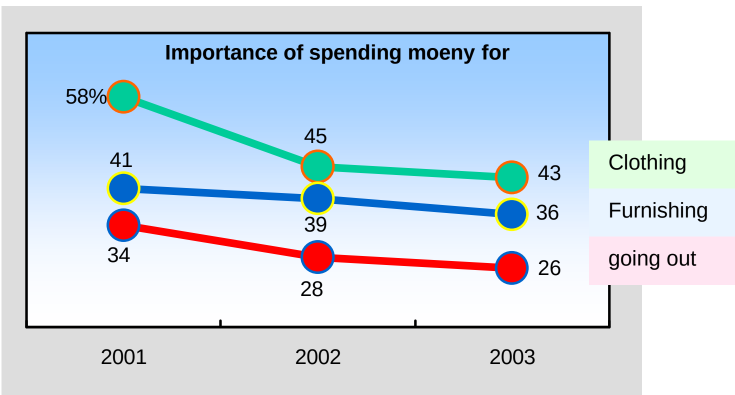
Taking into consideration that the German population will age dramatically and these older age groups will become the largest part of the consumers within the next years it is worth to have a look at the proposed income situation of this target group.

In answer to the question what people expect how the retirement income / pensions will have developed within 10 years, 82% believe that they will be lower and even 50% believe that they will be much lower. This will not only have an effect on consumption but also on price-consciousness and price-quality relations.



Basis: Federal Republic Germany; Population from 16 Years Source: AWA

In all this statistics one can see that the consumption climate in Germany today is very much influenced by personal insecurity when looking at the future. This is not age related but there is still a huge gap between the West and the East where, as well the realistic financial potential to spend is far lower, but also the insecurity concerning the future is much higher. In a very tight and insecure economical surrounding it is obvious that people will start saving and reduce the expenses on lifestyle or consumption.



Basis: Federal Republic Germany; Population from 16 Years Source: AWA

In 2004 this tendency surely continued since the available income for consumption did shrink in comparison to 2003. While the willingness to spend money on clothing has decreased by 25% this is also a good indication for the willingness to spend money on jewellery.

2 The German Consumer

An excursion in the world of the consumer today - pretensions, expectations, behaviour and lifestyle

2.1 Consumption Trends

Having a closer look at various consumer segments in 2004, one can see that there are remarkable differences within certain segments. This is a good indication for priorities in certain areas and on special product lines.

Consumption Trends	Mio. EUR	Alteration to previous year Mio EUR	%
Food; Drinks	1.324,20	105,2	8,6
Textiles, Clothing	148,5	-8,4	-5,3
Body care	651,4	22,0	3,5
House- and Garden	166,6	-14,5	-8,0
Audio, Video; Photo	74,4	-17,3	-18,9
Office, Computer, Communication	507,7	81,2	19,0
Travel, Tourism	237,5	21,5	10,0
Trade and Mail order	1.146,60	137,5	13,6
Personal Needs	58,4	6,0	11,4
Watches and Jewellery	24,6	-3,8	-13,4

Economic Segments 1st half 2004; Source: Nielsen Media Research

- People continue to spend money on food and drinks.
- Holidays and travel are always important.
- Photo has been loosing a lot because of a more or less satisfied market and decreasing sales prices, but mobile phones, notebooks and games carry the computer section. These are also the most important merchandise groups for the trade.
- Body care becomes more important- 'beauty trend', while the consumers start saving on furnishing, clothing and jewellery.

In general consumption trends differ little between East and West Germany. In the West people spend more money on housing and rents, health- and body care and going out, people in the East rather spend their money for food, cars and entertainment. Price is in any case more important than brands, which is mentioned in the latest Market Research Reports (VuMA) for East Germany - once they buy brands, eastern Germans rather prefer their regional brands, which are hardly known in the West.

Household Income is used for..	East %	West %
Housing, Energy	31,2	32,7
Food, Drinks	15,1	13,8
Traffic, Cars	15,1	14,2
Entertainment, Hobby	13,1	11,5
Furniture, Household	5,6	5,7
Clothing, Shoes	5	5
Hotels, Going out	3,7	4,4
News, Information	3,3	3,1
Health-/ Body Care	2,5	3,9
Education	0,8	0,9

Source: Federal Office of Statistics

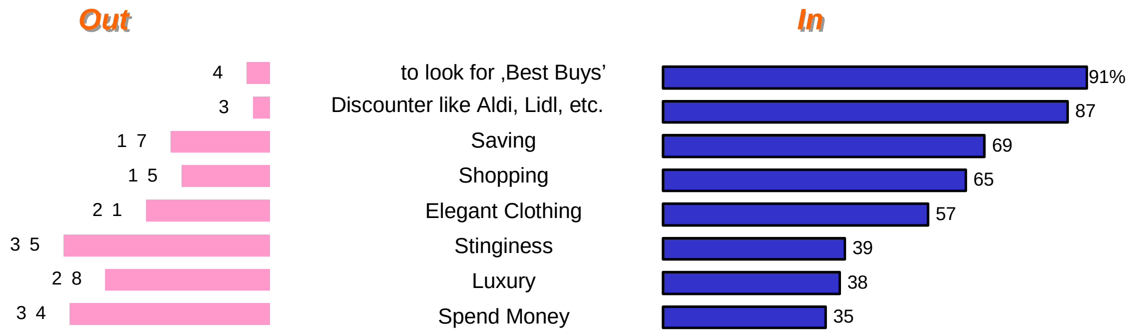
But there is also a larger loyalty to brands, once they are accepted. More than western Germans the eastern Germans can be seduced at the points of sale and they end up spending more money than they wanted.
People in East Germany tend more to a nice home, a harmonious family life and a secure workplace than in the West. They are more open to new technologies and have a much stronger evaluation of product efficiency in relation to its price. Quality expectations are very much the same for West and East.

Considering the consumption index in Germany being 100 then the consumption potential in the '*old*' federal states is much higher (Hamburg 112; Hessen 109,3; Bavaria 106,4; Baden-Württemberg and Nordrhein-Westfalen 105,5). Berlin is a mixture of both sides and lies exactly on the index while the '*new*' federal states only have consumption indexes between 78,6 and 74,8. Nevertheless there is a very large potential for the future, with a lot of investment- and job development programs and a far larger rate of new-found businesses.

Objectively seen is the economical situation of households in Germany much more stable than the mood - but economy is at a high rate psychological. Accordingly..

- the insecurity moves the preferences between saving and consumption
- ...and changes the perspective from short-term consumption happiness to long term pre-care
- ...and leads to a shifting in purchases
- ...and turns the consumer to be more price sensitive

- Price-orientation is growing - and retail supports this as much as it can
- Stinginess is in *("Geiz ist geil")*
- Triumphal procession of discounters
- Shopping is in - but just as 'Smart-Shopping'
- Hunting for "*Schnäppchen"* => 'Best Buys' right through all classes of population
- The wish for more alternation underlines the price-orientation



Base: Federal Republic Germany, population from 16 years Source: Allensbach, IfD

On one hand the wish to alternate grows and is supported from producers as well as from retail through Innovations, shorter production cycles and interesting 'special offers'-
on the other hand commitments of consumers decrease - commitments to shopping places, brands, styles even hobbies.
The shopping behaviour becomes much more spontaneous.

2.2 Consumption Styles

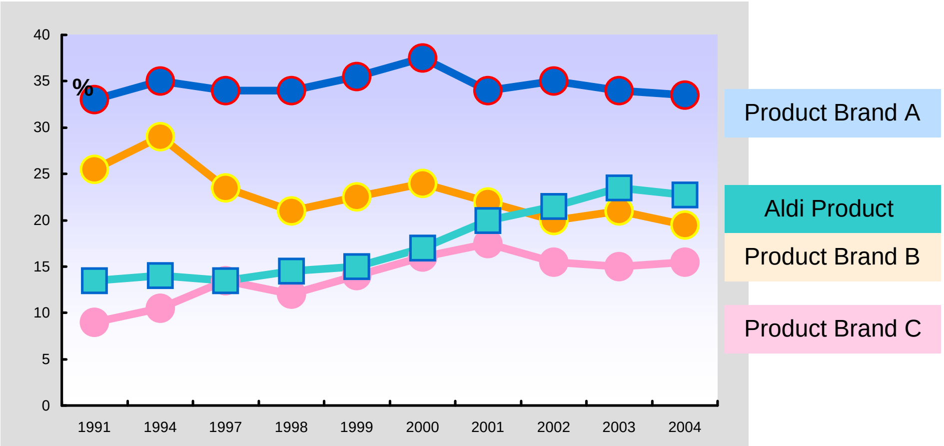
There are three major consumption styles to be found among the German population

	14 - 49 Years %	**50 - 69 years %**	**70 years and older %**
Price-orientation "I buy where prices are especially low"	58	60	56
Quality-orientation "I'm willing to pay more for good quality"	59	65	61
Regional-orientation "I rather buy regional products"	31	52	54

Basis: Federal Republic Germany; Population from 14 Years Source: AWA, IFD Allensbach

A broad majority of German consumers are very focussed on prices of products, however the product quality has to meet the expectations even more. This actually is the great advantage such retailers as *Aldi*, *Lidl* or *Tchibo* have - they are widely known to offer good quality products at comparably low prices. *Lidl* and *DM* drugstores for instance present right next to the premium brand products their own 'no name' products at a far lower price; *Aldi* and *Tchibo* have proven within their long history to put a special focus on product quality while offering the articles at lower prices than the other retail.
The willingness to buy regional products rather than others grows with age.

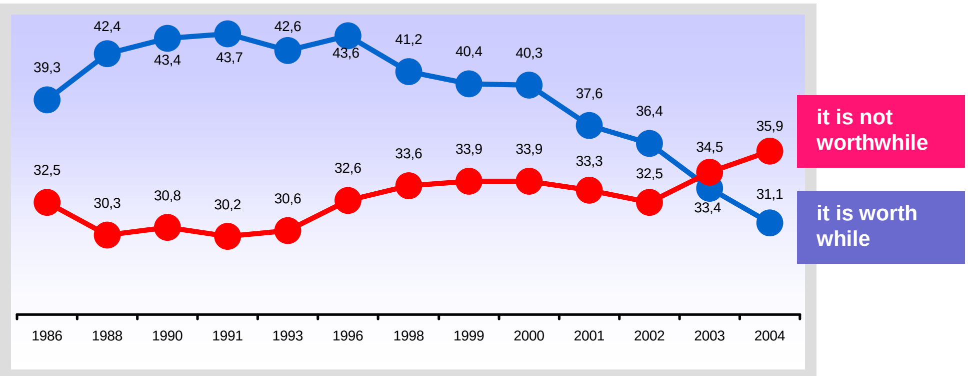
The market share of private labels from retailers like *Aldi* or *Tchibo* grows continuously. Housewives, being questioned: *'which kind of brands/labels of a certain consumption good they have in their household'* stated the following results:



Base: Federal Republic Germany. Housewives between 16 and 65 years. Source: AWA, IfD

While the premium brands/labels maintain more or less the high level they have reached within consumption - the *Aldi* 'private label' products more and more push away other brands. *Aldi* succeeds with good quality at low prices where other brands need a huge marketing effort (also financially) to survive.

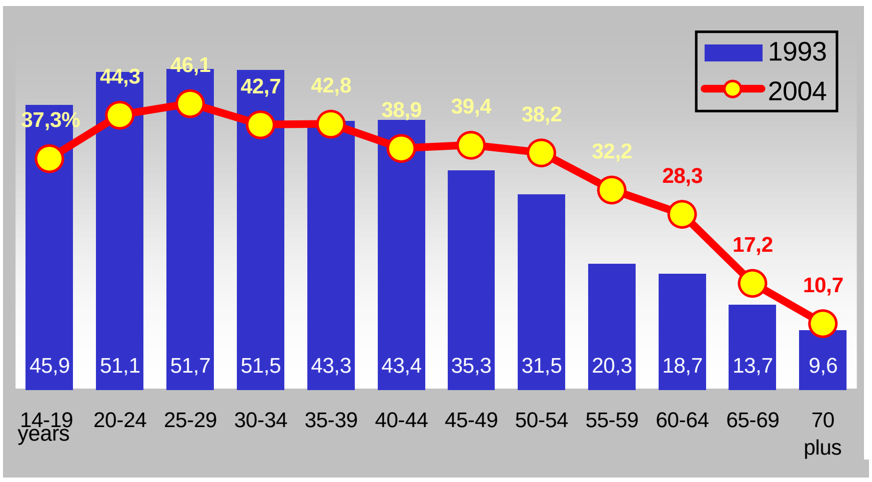
With consumers becoming more and more aware about the price/quality relations of products it is worth to have a look at their attitude towards brand products as such. A research over a very long period of time (at first just in West Germany, since 1992 in the whole country) shows that there is erosion in brand-commitment among German consumers.



Basis: Federal Republic Germany; Population from 14 Years Source: AWA, IfD Allensbach

Being questioned whether it is worthwhile to spend more money on brand products, the opinion of consumers has reversed within the past 5 years.

Next to the two major dimensions of price and quality orientation within the consumption styles there is another dimension evident, which describes consumers behaviour as *'Multi Dimensional Consumption-Style'*.
People that often wear jeans and just as well elegant clothes, that often eat simple but frequently also dine fine, that sometimes save money and sometimes lavish.



Base: Federal Republic Germany. Population from 14 years Source: Allensbach, AWA '93, '04

Nearly all age groups today show a similar behaviour within this 'multi-dimensional consumption-style'. What is remarkable is that the young people tend to become more one-sided while the older generations swap their behaviour far more often. People with 45 or older don't want to be pressed in one pattern anymore.