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Rumblings of a German Revival

By MARK LANDLER

HEIDELBERG, Germany, Jan. 12 - Germany, after four years of stagnation, is showing signs of reclaiming its role as the economic engine of Europe. And much of the credit goes to old-line German companies like the printing press manufacturer named for this ancient university town.

Heidelberger Druckmaschinen, the world's largest maker of printing presses, was flat on its back two years ago, the victim of a downturn in the media industry and of Japanese rivals that undercut its prices. Now, after painful therapy that included 3,500 layoffs, the company is humming again.

The rest of the country may soon join it. A variety of recent statistics suggests that Germany, the world's third-largest economy, is on the mend, with quickening growth, surging investor confidence, signs of a rebirth in consumer spending and even a modest decline in unemployment.

A reinvigorated Germany would have far-reaching implications for Europe and even the global economy. It accounts for a fifth of the economic activity of the European Union, and is the world's largest exporter, a title it has managed to retain even during these lean years.

"The rumors of Germany's death have been exaggerated," said Norbert Walter, the chief economist at Deutsche Bank. "We've really made lots of progress, and we've gotten off to a good start in 2006."

Germany has seen false dawns before, of course. There was a burst of enthusiasm here last winter before the economy relapsed and an unpopular German government felt forced to call early elections. Germany grew barely 1 percent in 2005, and even the most bullish projections for this year put growth at just 2 percent - a pace that would qualify as a lull in the United States.

For the first time since the tech bubble burst in late 2000, however, there is a real sense that Germany is on the move.

For one, the Germans voted in a new government, under its first woman leader, which has helped lift the mood in this often-pessimistic country. [Chancellor Angela Merkel, who met with President Bush in Washington on Jan. 13, has gotten off to a sure-footed start, political analysts say, raising hopes that she can push through overdue economic changes.]

For another, German industry has whipped itself into shape. By taking unpopular steps, like cutting jobs, extending work hours without extra pay and moving production to lower-cost countries, companies have pruned their costs and regained their competitive edge in global markets.

Back in fighting trim, German industry has begun flexing its muscles overseas. The chemical giant BASF recently made a $4.9 billion hostile takeover bid for the Engelhard Corporation of New Jersey, while the steel maker ThyssenKrupp is locked in a battle for a Canadian steel giant.

"The strength of German companies has been hidden by a productivity and cost disadvantage," said Alexander C. Dibelius, a partner at Goldman Sachs who runs its German office. "When they increase their productivity, their products are pretty much unbeatable."

The reversal in fortunes is evident in a visit here to Heidelberg, where its namesake company looms large, with a shimmering glass tower opposite the train station and a sprawling factory outside town.

Earlier in the decade, Heidelberger Druckmaschinen reflected Germany's industrial decline. Its sales tumbled 17 percent in 2003, as customers put off big-ticket purchases. The rise of the euro against the dollar and the Japanese yen had the effect of making Heidelberger's printing presses 30 percent more expensive than those of Japanese competitors.

The company's unionized work force and rigorous apprenticeships seemed hopelessly ill suited to the realities of a global economy. In fiscal 2004, it lost $840 million, on sales of $4.5 billion.

With Heidelberger's survival in question, it took drastic action, selling two divisions - Web presses, which print newspapers, and digital printing. It cut 3,500 jobs and extracted a deal from its union, IG Metall, to extend the workweek to 36.75 hours a week, from 35 hours, for the same pay.

"We went to the workers and said, 'Look guys, we've got to get more flexible,' " Bernhard Schreier, the chief executive of Heidelberger, said. "The times were very tough for the unions over the last two to three years, so they had to make a lot of concessions in company negotiations."

The same pattern was repeated throughout Germany: Siemens, Volkswagen and DaimlerChrysler forced their unions to accept wage freezes or modest raises, often under the threat of moving jobs abroad.

Despite its reputation as a workers' paradise, wage increases in Germany have lagged those in other euro countries by an aggregate 10 percent since 1996, according to a report by Bank of America. That said, hourly wages in western Germany are still among the highest in Europe.

"Germany had priced itself out of the market by the late 1990's," said Daniel Gros, the director of the Center for European Policy Studies in Brussels. "It is basically pricing itself back into the market."

In Heidelberger's case, the agreement will cut its labor costs by $121 million, or 10 percent, a year by 2008. This, and a weaker-than-expected euro in 2005, helped close the price gap between Heidelberger and the Japanese. And a stronger global economy revived orders from the United States and Asia.

The turnaround necessitated a painful dose of humility. Heidelberg opted to get out of the newspaper printing business. And while it once viewed digital printing as the future, it had to accept that it could not compete with giants like Kodak, to which it sold its digital operation.

These days, Heidelberger is a smaller but fitter company, with a pretax profit margin of 5 percent to 10 percent. Its stock has risen 31 percent in the last 12 months, about the same as the broader German market, which was one of the world's top performers in 2005.

"I'm very confident we will continue to thrive from a German base," said Mr. Schreier, a 51-year-old mechanical engineer and career employee, whose father and grandfather both worked for the company. "The technology we are using today is a very lasting technology."

Printing presses involve the kind of precision engineering at which Germany has historically excelled, and on which it built its post-World War II economy. The question is whether Germany can hold on to these industries, at a time when China and India are joining other Asian exporters in moving up the industrial curve into more advanced technologies.

The exodus of German companies is a perennial theme, with corporate icons like Volkswagen building plants in Slovakia. Dirk Schumacher, an economist at Goldman Sachs, argues that, measured by the net outflow of foreign direct investment, it is more a trickle than a flood.

Mr. Schreier is cautiously optimistic, at least as far as his franchise is concerned. Unlike the automotive industry, which is relatively easy to transplant to lower-cost countries, printing presses are a low-volume, high-technology business, which requires skilled workers.

For all that, Heidelberger is putting the finishing touches on a factory outside Shanghai, which will start building a rudimentary printing machine by the end of this year. It will employ 200 to 300 workers.

Back home, Mr. Schreier's message to employees is that life will never be as comfortable as it once was. "There will be now a permanent cost discipline," he said, "because it is clear that if you let all the ropes loose, it will develop in the same direction where we were before."

That means Heidelberg will hire only sparingly; its payroll was flat in 2005, after the earlier layoffs.

The willingness of companies to hire is critical to solving one of Germany's other chronic problems, unemployment. The government reported in December that the number of jobless people declined by 110,000, on a seasonally adjusted basis. That was better than expected, but there are still 4.6 million people out of work, close to a record in the postwar period.

"What we still need is for the great success of German companies to translate into employment," said Klaus L. Wübbenhorst, the chief executive of GfK, a market research firm in Nuremburg.

Even so, the confidence of German consumers appears to be rebounding. GfK, which tracks the consumer climate, found that Germans were readier to make big purchases than at any time since late 2001. Their parsimony has been the biggest single drag on the country's growth.

The German government is doing its part to encourage shoppers. It announced an increase in the value-added tax on just about all purchases, to 19 percent from 16 percent, but deferred it until 2007. Germany's merchants are pinning their hopes on a rush of people buying cars and refrigerators. The go-go atmosphere may be helped by the soccer World Cup here next summer.

Once the tax increase takes effect, though, some experts fret that the economy will cool in 2007. The United States economy is another potential brake, since any slowdown there would hurt German exporters.

The European Central Bank is confident enough in the growth of Germany and Europe that it lifted interest rates last month for the first time in five years, and signaled on Thursday that it might do so again.

The German government has been among the most enthusiastic cheerleaders for a revival. It plans to revise its growth forecast for 2006 up from its original forecast of 1.2 percent. Chancellor Merkel has benefited from the good omens, winning high approval ratings.

But the government's actions so far have been small-bore: a few fiscal initiatives like the higher value-added tax, and a $30 billion public stimulus package to help small and medium-size businesses.

Mrs. Merkel, experts say, will have to be bolder in opening up the German labor market, as well as overhauling how Germany finances health care and pension funds. That will not be easy, given that she leads a balky coalition of Christian Democrats and Social Democrats.

Analysts have been impressed with the early show of solidarity in Berlin. But as Mrs. Merkel's predecessor, Gerhard Schröder, can attest, there are risks to being tied too closely to Germany's economic fortunes.

"This talk of a Merkel factor is very dangerous," said Elga Bartsch, an economist at Morgan Stanley. "If you get credit for the recovery, there's no doubt that people will turn on you when things go bad again."