Europe's economic miracle lies in the east

Image source: iStock/FrankRamspott

At the turn of the century, Eastern Europe was often still regarded as a region emerging from its days of communism, with economies that lagged significantly behind its Western European counterparts. Yet, in just two decades, countries like Poland, the Czech Republic, and Slovakia have transformed into some of the fastest-growing economies in the European Union. This remarkable economic transformation is both proof of the adaptability of these nations, but also to the profound impact of EU integration.

Charles-Henry Monchau
Chief Investment Officer

Oliver Ramos
Junior Investment Analyst

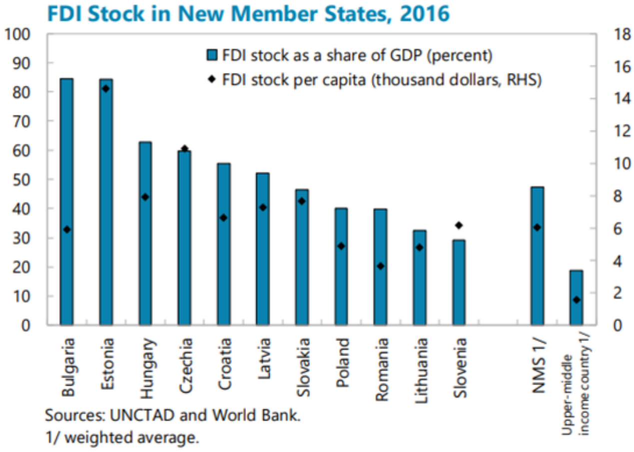
PRIVATE BANKING

The Impact of EU Membership on Economic Growth

One of the most significant drivers of economic development in Eastern Europe since joining the EU has been the infusion of structural and cohesion funds. These funds are aimed at reducing economic disparities within the EU, and have been pivotal in modernizing infrastructure and supporting long-term growth in these countries. Between 2004 and 2020, Eastern European countries received hundreds of billions of euros from these funds, which were channeled into projects ranging from transportation networks to education systems. Poland, the largest recipient of EU structural funds since 2004, has received nearly 250 billion euro sand effectively utilized them to expand its expressways and highways by over 550%, significantly enhancing its logistics and transportation sector. Similarly, Hungary and Romania have used part of their funds to upgrade their energy infrastructures, investing in renewable energy sources and smart energy systems, making their economies more competitive and less reliant on external energy sources.

The accession of Eastern European countries to the EU has not only given them access to the world's largest single market area, but also allowed them to integrate seamlessly into the EU's economic framework by eliminating trade barriers and adopting common regulations.. This integration has been particularly beneficial for export-driven economies like Czechia and Slovakia, where access to the EU market has led to a substantial increase in trade volumes. The Czech Republic serves as an exemplary case, with its trade with other EU member states accounting for over 80% of the country's total trade, highlighting the importance of this EU single market to its economy. Naturally, the ease of doing business within the EU has also facilitated the development of complex supply chains spanning multiple countries. This phenomenon has allowed Eastern European countries to specialize in specific sectors, such as automotive manufacturing in Slovakia or electronics in Hungary.

FDI Stock in New Member States, 2016



Sources: UNCTAD and World Bank.
1/ weighted average.

The elimination of trade barriers has also attracted significant foreign investment into this region, with many multinational companies seeking to leverage the competitive advantages of these economies, such as the lower labor costs and skilled workforce, while benefiting from this unrestricted access to the broader EU market. Foreign Direct Investment (FDI) has also been a cornerstone of Eastern Europe's economic success since joining the EU. Countries like Poland, Estonia, Hungary, and Slovakia have been highly effective at attracting investments, with many companies establishing production facilities in these countries, thereby aiding in transforming their economies into key players in global supply chains. The so-called "New Member States", comprised of eleven countries that joined in 2004, had already attracted a cumulative total gross FDI of almost 700 billion as of end-2016. FDI has been particularly significant in sectors such as automotive manufacturing, electronics, and information technology. These investments have directly led to the creation of thousands of jobs and as a result, help to foster the development of a highly skilled workforce, further increasing their competitiveness on the global stage.

Success Stories

A shining example of a success story has been Poland, which since joining the EU in 2004 has more than doubled its GDP, representing one of the most impressive economic turnarounds in modern European history. In the decade leading up to 2022, Poland's economy experienced an average growth rate of 3.7%, significantly above the 2.5% average for Eastern Europe, and noticeably outpacing the EU average. This growth stems from a combination of factors such as the effective utilization of EU funds, strong domestic demand, and a resilient export sector. Poland has also seen a substantial reduction in unemployment, which dropped from 18.6% in 2004, the highest in the Eurozone at the time, to around 3% in 2024, representing the second lowest unemployment in the EU. Poland was also Central and Eastern Europe's leading FDI destination in 2019, 2020, and 2021, attracting 424 FDI projects in 2021 alone. Some of the key sectors for investment in the country include software and IT services, logistics, and construction.

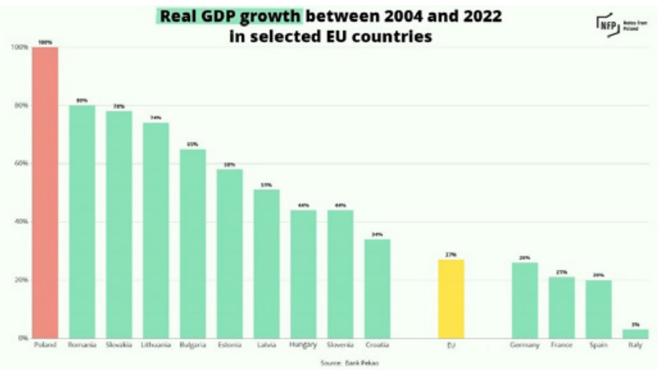
FDI in central and eastern Europe

Top ten CEE countries by number of inbound FDI projects, 2021

Russia and Belarus not included
Click for: FDI FDI per capita
Source: GlobalData's FDI Projects Database

Moreover, countries like Czechia and Slovakia have done a great job at leveraging their strategic location and strong industrial bases to become key players in the European automotive sector. This sector has been a critical driver of their economic growth, as both countries are now major manufacturing hubs for global automotive companies. In The Czech Republic, the automotive industry accounts for over a quarter of the country's manufacturing output, and directly employs over 180,000 people, making it the biggest industrial sector in the country. Czechia now produces approximately 1.4 million vehicles annually, with companies such as Škoda Auto playing pivotal roles in their success. These accomplishments on the industrial front have contributed to Czechia's robust economic performance, resulting in an average real GDP growth of around 2.2% in the decade to 2022. Additionally, since joining the EU, Czechia has seen its GDP per capita grow threefold, which in SPA (Standard Purchasing Power) puts it above that of Spain and Italy. Furthermore, thanks to investments from major automotive firms like Volkswagen, Kia, and Jaguar Land Rover, Slovakia has become the world's largest car manufacturer per capita, producing 184 cars per 1,000 inhabitants in 2022. The automotive sector alone accounts for 46.5% of Slovakia's industrial output and 41.4% of its exports.

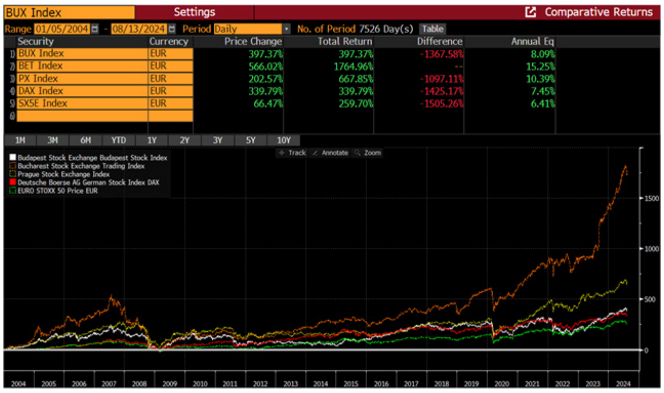
The Baltic States of Estonia, Latvia, and Lithuania have also undergone noteworthy economic transformations since joining the EU. These countries have successfully transitioned from post-soviet economies to dynamic markets with a particular focus on digital innovation. Estonia in particular has gained global recognition as a leader in innovation, and is quickly becoming the digital economy star of the EU. This small Baltic state is among the global leaders in key next-gen technologies such as cybersecurity, 6G, AI, cryptocurrencies and blockchain. The country is also primed to become the first to fully embrace Web3 technology, which is widely regarded as the future of the internet. With the help of leading Nordic corporations, such as Ericsson and Nokia, Estonia was able to build a state-of-the-art communications infrastructure. Estonia's economy clocked in an average growth rate of 2.9% in the decade leading up to 2022, which is more than double the Euro Area's average of 1.4%. Latvia and Lithuania have also followed the path of embracing digital transformation and have focused on building robust IT sectors. As a result, Latvia is now recognized as a growing Information and Communication Technology (ICT) superpower, having the sixth-fastest broadband connection in the world and the third largest fintech cluster in Europe. These States, and particularly Estonia, have also maintained strong fiscal discipline, with low public debt levels and balanced budgets which has helped them maintain stable growth. At the end of 2023, out of all EU Member states Estonia had the lowest debt to GDP ratio at 19.6%, and Lithuania significantly below some of its western counterparts, at 38.3%.



In the case of Romania, which joined the EU slightly later than some of its neighbors in 2007 with a GDP of 74 billion euros at the time, now has a figure over 4 times higher, resting above 300 billion. The country has even earned itself the nickname "The Switzerland of the East". Since joining the EU, Romania has made considerable progress across several other key areas. For instance, life expectancy in the country has increased by nearly four years, rising from 72.76 years in 2007 to 76.64 years in 2021. Although Romania still lags behind more developed economies like Germany in this regard, the country has seen a profound improvement since becoming an EU member. Another indicator of Romania's economic maturity is the significant reduction in its GINI index, which has dropped from 37.5 in 2007 to 33.9 by 2021, signaling progress in reducing income inequality. Additionally, Romania has made substantial strides in lowering unemployment, reducing the rate from around 6.5% in early 2007 to below 5% by 2019. Despite a slight increase in unemployment following the pandemic, Romania's jobless rate remains notably lower than that of more established economies like France, Italy, and Belgium.

Stock Market Performance

In addition, the stock markets of Eastern European countries like Romania, the Czech Republic, and Hungary have experienced significant growth since joining the EU. The main stock market index in Prague, called the PX index, is a great example of this. Over the past two decades, the PX index has generally outperformed many Western European markets. However, this performance has also been accompanied by greater volatility, particularly during the GFC of 2008 and the Eurozone crisis, during which the index suffered substantial losses. Moreover, Romania's BET index has also shown strong performance since Romania joined the EU in 2007, experiencing even more volatility over the past two decades, but also recording notably higher returns. It's a similar story for Hungary's main index, the BUX, which has also experienced significant growth since the country joined the EU in 2004. Overall, Eastern European indices have generally offered higher long-term returns than their Western European counterparts, though with greater risk and volatility. This reflects the rapid economic growth of these countries and their ongoing efforts to catch up to more developed economies.



For further information

Banque Syz SA
Quai des Bergues 1
CH-1201 Geneva
Tel +41 58 799 10 00
syzgroup.com

Charles-Henry Monchau, Chief Investment Officer
charles-henry.monchau@syzgroup.com

Oliver Ramos, Junior Investment Analyst
oliver.ramos@syzgroup.com