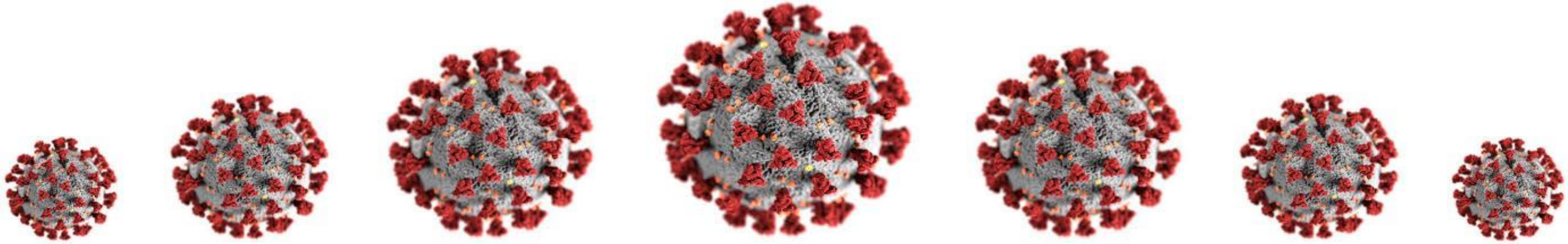
2020

THE CEE INDUSTRIAL UPSIDE

CEE REAL ESTATE COVID-19

Special Insights Series – Opportunities and Challenges in Extraordinary Times



COVID-19 & CEE's Industrial Upside

Europe's Near Shore Powerhouse

Tectonic plates are shifting in the global economy, with geopolitics playing a very important role in shaping future patterns of global trade growth. The CEE region - one of the fastest growing regions in the world over the last two decades - is well positioned to benefit from the changes impacting global trade. In this short piece, we focus on why we are quite bullish about the industrial and logistics prospects in the CEE region as a whole during the next growth cycle and beyond, as near-(on-)shoring is becoming a hot topic.

Labour markets

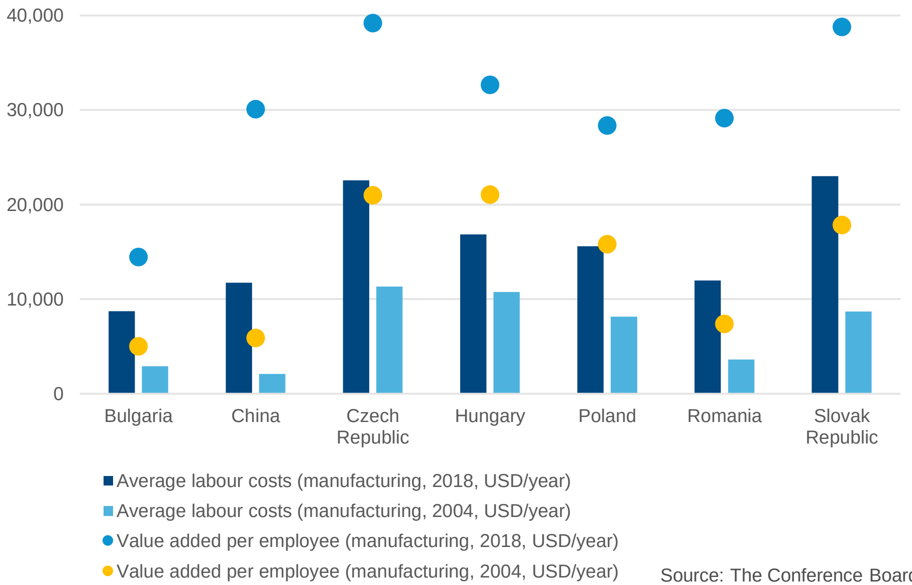
Probably the biggest advantage that CEE countries have, despite their smaller size, are their labour markets. Salaries are several times smaller than in Western Europe and, as of recent years, surprisingly comparable to markets such as China.

In fact, Bulgaria remains well below China's level of labour costs for manufacturing operations, with Romania comparable to China and Poland and Hungary not significantly higher. This is not to say that these markets compare in terms of critical mass, diversity of products and peak output complexity but from a cost and geographical (near-shoring) perspective, there is certainly some upside to be found in the CEE region.

The current situation is a far cry from a decade and a half ago, when the CEE countries were either joining the EU (2004) or were set to become members (2007). Between 2004 and 2018, average manufacturing labour costs have increased by more than 5 times in China, whereas in the CEE region, growth has been much more subdued. Czech Republic, Hungary, Poland and Slovakia all saw their manufacturing labour costs increase by 1.6 to 2.6 times in the same period, whereas Bulgaria and Romania, which were at the lower end of the spectrum (and still are) saw increases of just over 3 times.

To put things into a different context, labour costs in Germany for manufacturing are between 3 times higher than in Czech Republic and Slovakia, around 4 times above Hungary's and Poland's, nearly 6 times above Romania's and almost 8 times above Bulgaria's.

Manufacturing Labour Costs (2004 vs. 2018)



Source: The Conference Board

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Meanwhile, productivity has more than kept up with this increase in salaries. In all CEE countries, the gap between value added per employee and labour costs has actually widened significantly between 2004 and 2018. It is worth noting that Romania's spread between value added per employee and labour costs is just a fraction below China's, with the other CEE markets trailing not too far behind.

CEE's Established Track Record

Since 2004, the year that Czech Republic, Hungary, Poland and Slovakia all joined the EU (Romania and Bulgaria joined in 2007), the CEE-6's share in EU manufacturing output has more than doubled from a 6.4% share of the total to 11% last year. Altogether, the region has overtaken Spain and the UK as measured by the output of its factories and is closing in on France. While the region's factories were initially focused on churning out goods involving low-complexity manufacturing processes, this has also changed gradually over time: the medium-high and high technology value added goods now make up a much higher share throughout the CEE than a decade ago.

Manufacturing Value Added (2004 vs. 2019)

	Manufacturing value added (2004, EUR Bn)
Germany	453
Italy	231
France	216
United Kingdom	216
Spain	122
CEE	**95**

	Manufacturing value added (2019, EUR Bn)
Germany	668
Italy	267
France	238
CEE	**229**
United Kingdom	217
Spain	138

Source: Eurostat

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Reforms

Though uneven, CEE countries have generally been good reformers over the last decade, with EU rules and funds continuously pushing things forward; this suggests even more potential upside that could be unearthed by further improvements.

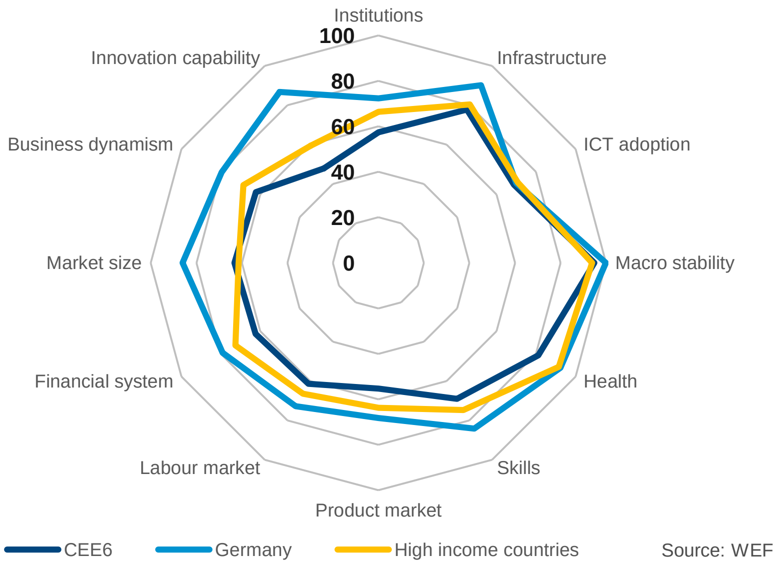
We looked at the World Economic Forum's competitiveness indicators for 2010 and 2019. A decade ago, the CEE's average score for their infrastructure stood at 63% of Germany's, though after constant improvements and massive investments by CEE states, it reached 86% last year. Likewise, the institutional strength score improved from 68% of Germany's level in 2010 to 79% last year. And catching up on one of the world's most competitive economies is no mean feat. Looking at the average for high income countries (which the CEE region as a whole is quite far apart from), its competitiveness indicators look even better.

Still, there are some negative aspects worth pointing out: relative to Germany, the competitiveness of the labour market score has deteriorated quite a bit during the same period, potentially amid methodological changes in the rankings, but also likely due to labour supply being not as bountiful as in the past, with wages also increasing steadily. Also, despite many great things coming out of the region, according to the WEF, innovation remains the CEE's Achilles heel, scoring almost half of Germany, which is nevertheless, one of the world's top innovators.

Summary

The fact that the CEE region has enabled manufacturers to generate higher levels of economic output at disproportionately lower operating costs is a compelling case for continued FDI into the region.

Competitiveness Indicators



Source: WEF

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