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MINISTRY FOR FOREIGN AFFAIRS
AND TRADE PROMOTION

PARLIAMENTARY SECRETARIAT
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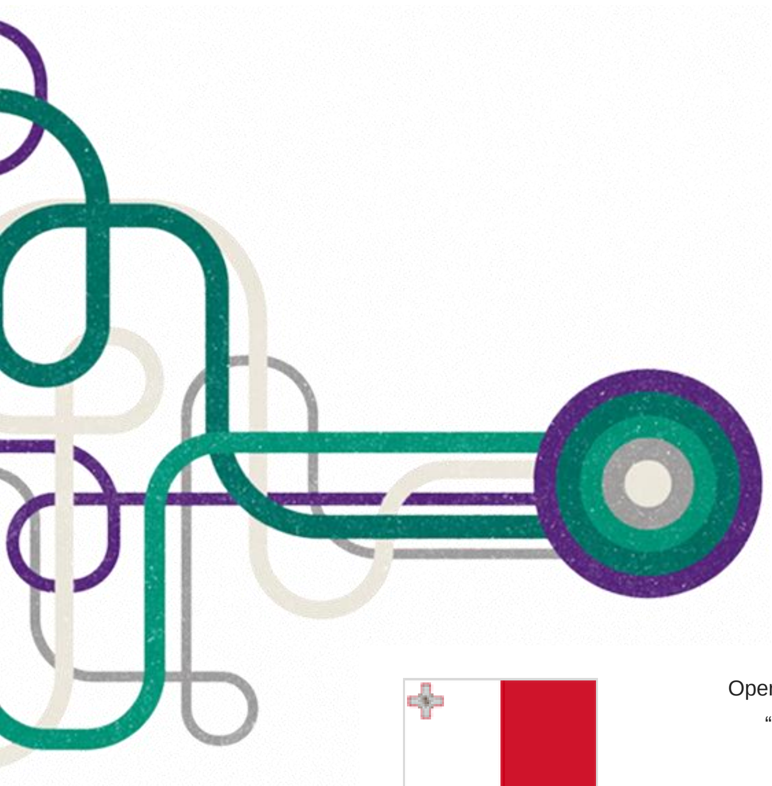

Europe's growth economies

An overview of sectoral performance and outlook

November 2018

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Overview of report

Executive summary

Title	Insights	Impact
Overall EU economic outlook	For the first time since 2007, in 2017 all Member States of the European Union (EU) experienced an expansion in their economy. This performance was supported by high levels of confidence, coordinated financial assistance, synchronised global expansion, low financing costs and favourable labour market conditions.	Short-term indicators suggest that the pace of growth has slowed down slightly in early 2018 as a result of a number of temporary factors. The European economy has the potential to continue growing above prospective rates, with unemployment continuing to fall and inflation increasing at a minimal rate.
Main economic activities within the EU	Industry (including manufacturing) remains the largest economic activity in the EU, followed closely by wholesale and retail trade (which includes transport, accommodation and food services). In recent years, the highest growth industries were the information and communication sector, professional, scientific and technical activities sector, and the construction sector.	Industry contributed 19.7% of EU total Gross Value Added (GVA), while economic activities relating to wholesale and retail trade contributed 19.1%. In 2017, the information and communication sector, the professional, scientific and technical activities sector, and the construction sector experienced the highest annual growth amongst all other industries at 4.7%, 4.2% and 4.1%, respectively.
Eastern Europe roars ahead	The highest economic growth rate among Eastern European countries is being registered in countries such as Poland, the Czech Republic and Hungary, well exceeding that of more advanced EU member states. This growth is mainly driven by low unemployment, increased consumer spending, as well as significant funds being provided by the EU for further development.	In spite of the extraordinary growth being experienced by these countries, Eastern European economies still contribute minimally to overall EU GDP. However, these economies are inherently more competitive, enabling labour productivity to potentially increase.
Czech Republic	The largest contributors to the Czech economy are industry (including manufacturing) and wholesale and retail trade (including transport and accommodation). Economic growth is expected to be driven by the automotive sector, the pharmaceutical industry, the wholesale and retail sector, as well as financial and real estate activities.	The latest economic forecasts show that the Czech economy is expected to continue growing; with forecast annual average real GDP growth for 2019-2020 estimated at 2.8%.
Poland	Industry (including manufacturing) and wholesale and retail trade (including transport and accommodation) are the largest contributors to the Polish economy. However, growth is expected to be driven by developments in the tourism sector, pharmaceuticals, as well as professional, scientific and technical activities.	As a result of positive developments in the various sectors of the Polish economy, it is expected that the country's average real GDP growth per annum will be circa 3.5% for the period 2019-2020.
Romania	The Romanian economy remains highly dependent on industry (including manufacturing), as well as wholesale and retail trade (including transport and accommodation). However, notable growth has been recorded by the information and communication sector and also in professional, scientific and technical activities.	According to the latest available economic forecasts, between 2019-2020, the Romanian economy is expected to grow by 3.7% per annum.

Section 1: EU economic performance and outlook

1. EU economic performance and outlook
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Economic Performance in the European Union

Overview of economic situation in the EU

The European economy consists of an internal market of mixed economies based on free market and advanced social models. The economies of the various Member States of the European Union (EU) together make up the second largest economy in the world. In fact, the EU's GDP for 2017 amounted to €15.3 trillion; which represents 22% of the world's GDP.

Since the onset of the international financial crisis that started in the United States (US) in 2007, very different economic situations emerged in the various EU Member States. Higher unemployment rates and public debt existed in Mediterranean countries, such as Greece and Italy (but not in Malta), with lower unemployment rates and higher GDP growth rates being recorded in Northern and Eastern EU Member States. Economies started to recover in 2013, with the EU economy becoming relatively stable in 2014.

Economic performance of EU Member States

In 2017, three Member States contributed to over 50% of the EU's GDP. Germany's contribution amounted to almost €3.3 trillion, thereby accounting for over one-fifth of the EU's GDP (as shown in the adjacent table) and reinforcing its position as the leading EU economy. The United Kingdom (UK) and France ranked second and third, contributing 15.2% and 14.9% to the EU's GDP, respectively.

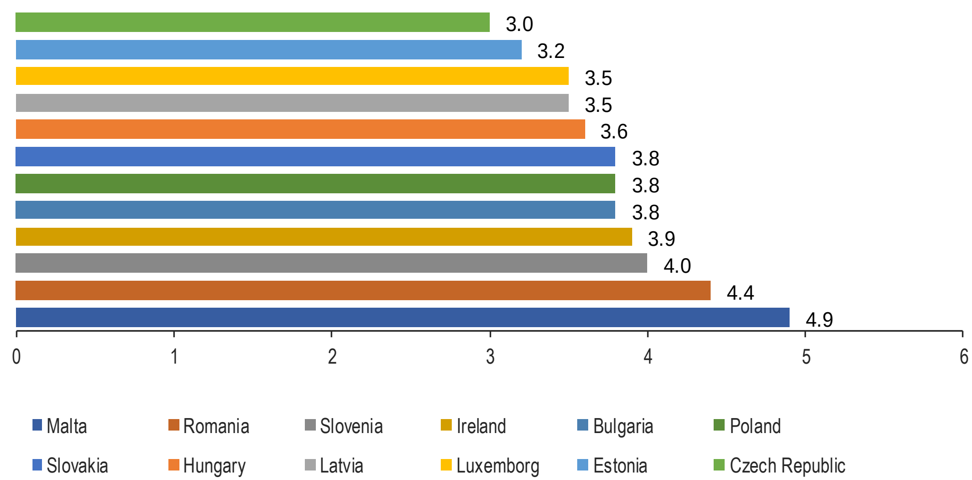
In contrast to the observed developments in the ten-year period to 2017, the economic growth rates recorded by the largest EU economies in 2017 have been lower than that of the EU-28. Instead, the growth rate of the European economy has been driven by developments in the smaller and less advanced economies of EU Member States. Specifically, in 2017, the GDP growth rates of the likes of Ireland (3.9%), the Netherlands (3.2%), Luxembourg (3.5%) and Malta (4.9%) were higher than that of the EU-28 (2.4%); as were those of less advanced Eastern European economies such as Romania (4.4%), Slovenia (4.0%), Bulgaria (3.8%), Poland (3.8%), Slovakia(3.8%), Hungary (3.6%), Latvia(3.5%), Estonia (3.2%) and the Czech Republic (3.0%).

EU's largest economies

Countries	GDP average growth (2007-2017)	GDP annual growth (2017)	% of EU GDP (2017)
EU-28	0.8%	2.4%	-
Sweden	1.6%	2.3%	3.1%
Germany	1.2%	2.2%	21.3%
United Kingdom	1.1%	1.8%	15.2%
Belgium	0.9%	1.7%	2.9%
France	0.8%	1.8%	14.9%
Italy	-0.3%	1.6%	11.3%

Sources: Eurostat

Fastest EU growing economies in 2017 (%)



Source: European Commission

Sectoral outlook in the European Union

Economic growth projected to continue, albeit at a slower rate

GDP growth in 2018 is exceeding expectations, but is expected to slow down to 1.9% in 2019. Austria, Germany and the Netherlands are expected to outperform other EU Member States in 2019; but their growth rates are expected to moderate thereafter.

Output of economic activities in EU member states

In 2017, industry was still the largest economic activity in the EU in terms of output generated. It accounted for 19.7% of EU total Gross Value Added (GVA), higher than the share of economic activities relating to wholesale and retail trade, transport, accommodation and food services (19.1%). Public administration, defence, education, human health and social work activities (18.5%) and real estate activities (11.2%) also accounted for a significant share of the EU's total GVA.

Share of economic activities in EU total GVA, 1997 and 2017 (%)

Source: Eurostat

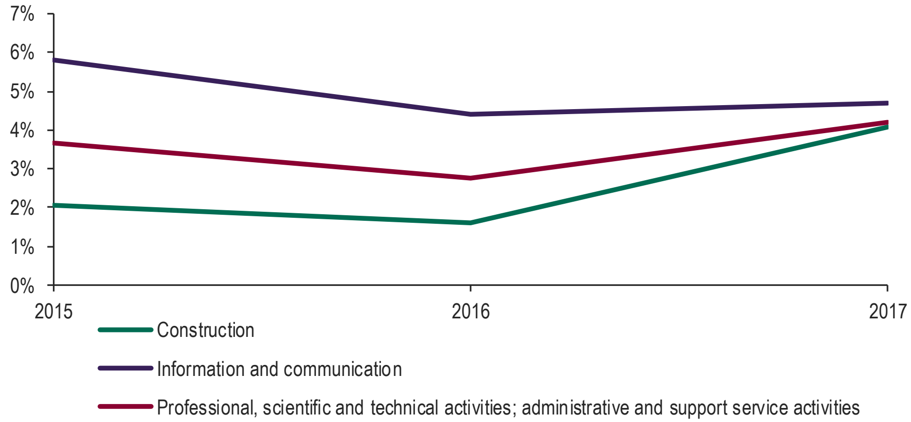
Highest growth industries in the EU

In 2017, the information and communication sector, the professional, scientific and technical activities sector, and the construction sector experienced the highest annual growth amongst all other industries at 4.7%, 4.2% and 4.1%, respectively, as shown in the table on the following page.

Information and communication. In 2017, computer programming, consultancy and related activities generated almost half (42.6%) of the sector's value added, and employed 51.7% of the workforce. The UK made the largest contribution among EU member states to value added and employment within the information and communication services sector.

Sectoral outlook in the European Union

Highest annual growth of EU sectors



Source: Eurostat

*Construction***.** This sector is one of the smallest within the EU's non-financial business economy, and it traditionally displays strong cyclical development. In fact, activity related to construction contracted sharply during the financial and economic crisis, but these effects are now minimal in the majority of EU member states.

Professional, scientific and technical activities. This sector's contribution to the non-financial business economy was 10.2% of total value added. Belgium, Greece, Cyprus and UK were the most specialised EU member states in employment terms in this sector, as each employed more than 10% of their non-financial business economy workforce in these activities.

Section 2: Eastern European Economies

1. Economic performance and outlook
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Eastern European economies

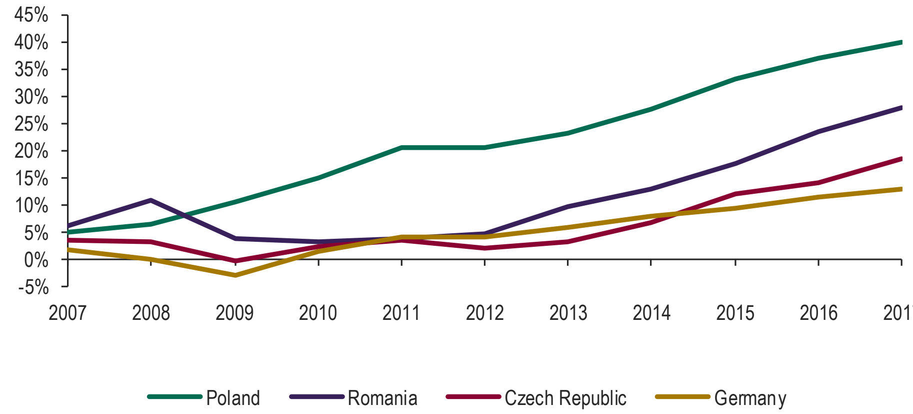
Overview of Eastern European economies

Romania was the fastest growing Eastern European economy in 2017, with an estimated GDP growth rate of 4.4%. Other Eastern European countries, such as Poland and the Czech Republic, are also growing faster than other major economies in Western Europe. Such countries benefited from a steady stream of income from EU cohesion funds and from low levels of unemployment, which, in turn, boosted consumer confidence and domestic demand. In other countries, such as Hungary, high demand for staff and the migration of many workers to Western Europe is creating operational challenges for local companies. Poland, the region's largest economy, has managed to avoid a shortage of workers by importing labour primarily from Ukraine.

All of these economies are still heavily reliant on manufacturing (see adjacent figure), whereby they export the majority of their production to the rest of the EU. The Czech Republic has the lowest unemployment rate in the EU, with approximately 35% of the labour force being employed in manufacturing; this being the highest proportion of all EU member states. This sector also heavily relies on automakers such as Toyota, Volkswagen and Peugeot which all have factories in the Czech Republic. Moreover, Romania's largest exporter is Dacia, a French subsidiary of Renault.

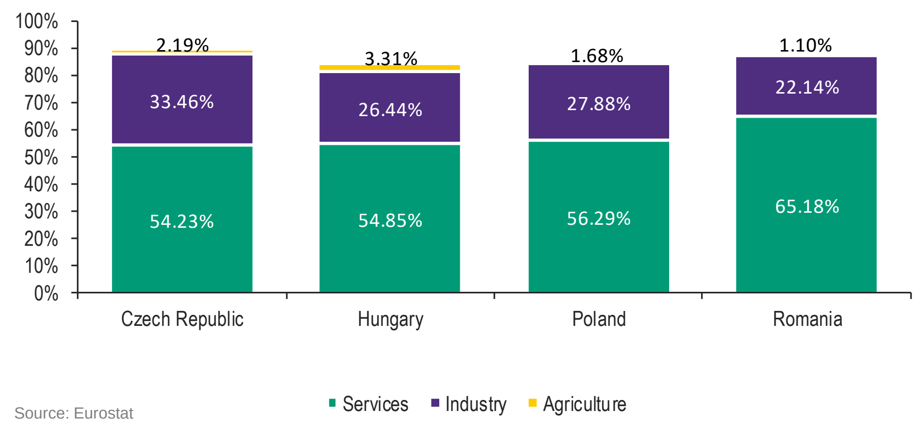
Despite the significant growth being experienced by these countries, Eastern European economies still represent a small share of the EU's overall GDP. However, policymakers believe the EU economy's strength has had a substantial impact on the role of Eastern European countries. Much of the boom that has kept these governments popular has come on the back of a recovery inside the eurozone, particularly Germany. This recovery has boosted demand for exports from Central and Eastern Europe which has led to the creation of new jobs in the region, where many major Western European companies have set up factories to take advantage of the relatively low labour costs.

Cumulative GDP growth in European economies



Source: Eurostat

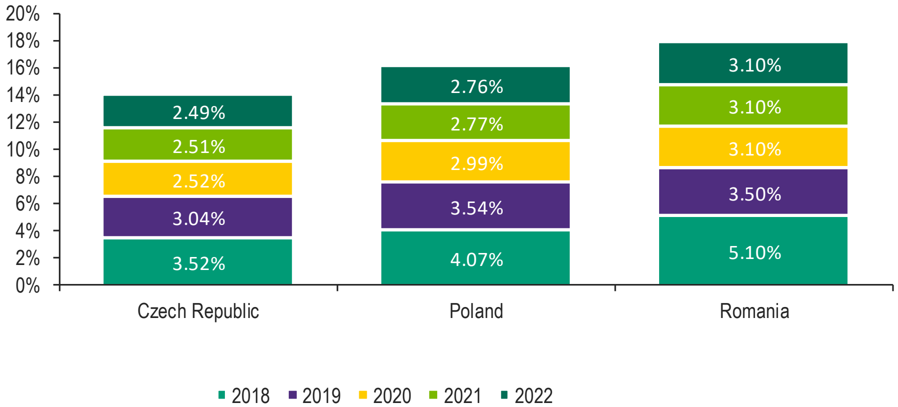
Share of economic sectors in GDP in 2017



Source: Eurostat

High performing industries in Eastern Europe

Eastern Europe projected GDP growth rates (2018 -2022)



Source: Statista

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These economies are typically more competitive, and have a higher potential for increases in labour productivity. As a result of higher employment, consumers in the region have larger purchasing power, a phenomenon supported by domestic government spending. In fact, in recent years, the main driver of economic growth was private consumption resulting from a constant increase in wages, high consumer trust and employment.

Eastern Europe economic outlook

The rapid growth in these countries' economies may come at a cost. For example, in Romania, fears exist that this economic success is being spurred by unsustainable consumer spending driven by the government increasing public wages. Wages are outpacing productivity growth and tax cuts have increased the budget deficit. Even further into the future, these economies will need to shift jobs from manufacturing to services if they wish to avoid the inevitable disruption to factory jobs from technological developments including automation. However, for the time being, the benefits of these economic models seem to outweigh the risks, so these Eastern European economies are projected to keep growing (see adjacent figure).

In the remainder of this section, we focus on the economic performance and potential of three of the fastest emerging Eastern European economies, namely, the Czech Republic, Poland and Romania.

Economic outlook: Czech Republic

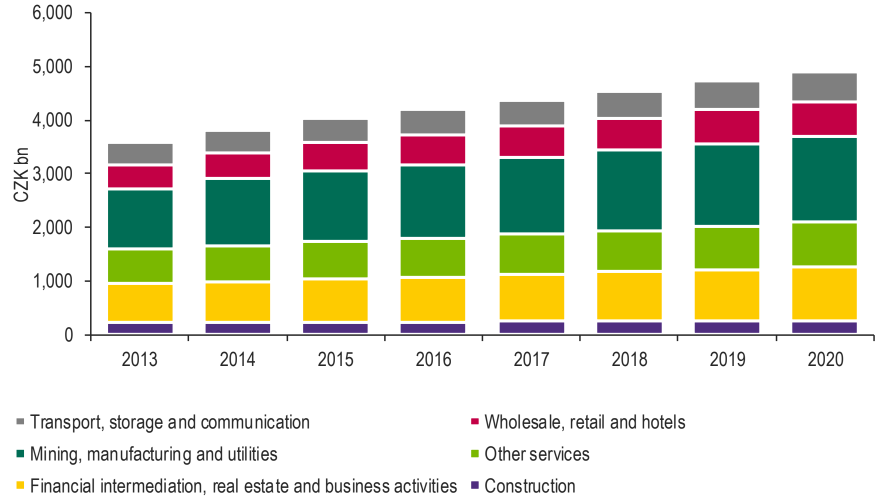
Consistent economic growth

- In 2017, the Czech economy recorded a growth rate of 4.4% due to strong exports and public investment. Moreover, real GDP is forecasted to grow at an annual average rate of 2.8% during the period 2018-2020. Consumer sentiment is expected to remain positive in 2019, as a result of the improving economic activity due to the stable political environment.

Key sectors

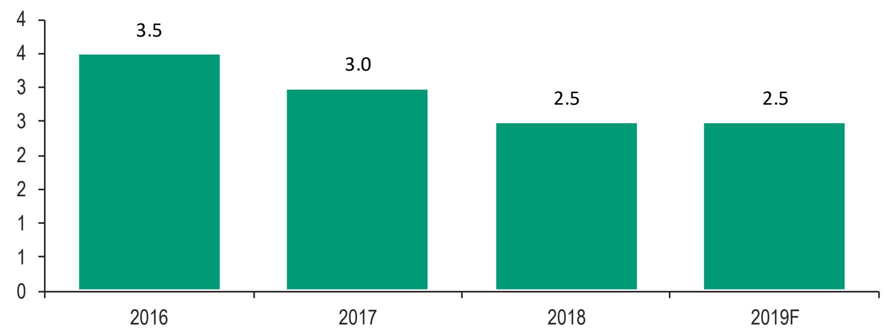
- With a share of 24.6% of total GVA, industry (inclusive of manufacturing activities) remains the largest contributor to the Czech economy. This is followed by wholesale and retail trade (including transport and accommodation); which account for 14.7% of total GVA. Other key activities relate to real estate, and professional, administration and support services. This is shown in the adjacent figure.
- Looking into the near future, the construction sector is expected to be a key stimulant of the economy, due to high public spending on infrastructure projects. Moreover, international and domestic demand for Czech services will stimulate growth for financial services and real estate activities.
- Turning to the country's manufacturing sector, which includes the country's world-class automotive industry, as well as the steel and the pharmaceutical industries, we note that it is expected to continue growing over the coming years. The sector relies on export demand, which is expected to be buoyant.
- Finally, we note that the country's large wholesale and retail sector is also expected to continue growing, boosted by low levels of unemployment, increasing wages and improved consumer confidence.

Key sectors' contribution to the economy



Source: Eurostat

GDP growth (Year-on-year)



Source: Eurostat

Economic outlook: Poland

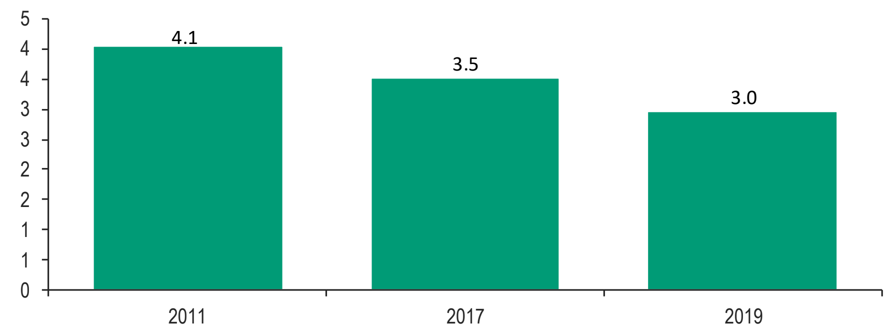
Economy expected to gather momentum

- While the majority of European economies are still recovering from the international economic crisis, the Polish economy has reinforced itself as one of the most stable economies in Eastern Europe.
- Poland's real GDP growth increased by 4.8% in 2017, compared to 3.1% recorded in 2016. This is attributable to an increase in real household consumption expenditure and boosts in investment. The country's economic growth is projected to continue growing in the coming years as a result of growing business confidence, sustained investments and further increases in domestic demand.

Key sectors

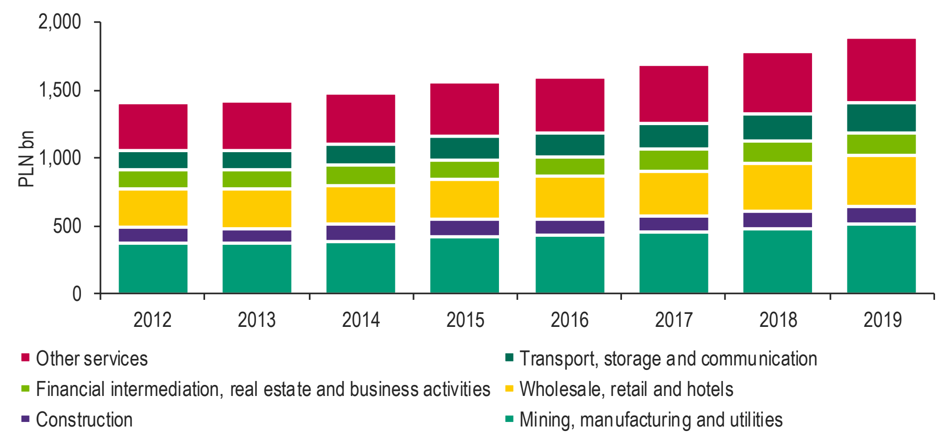
- With a share of 26.0% of total GVA, industry (including manufacturing) remains the largest sector in the Polish economy, mainly driven by metals and fuels. This is followed closely by the wholesale and retail trade sector (which also includes transport and accommodation) which accounts for 25.2% of total GVA. The fastest growing sector of the economy is that related to professional, scientific and technical activities; which in 2017 grew by 14.2% when compared to 2016.
- The hospitality industry is also expected to grow significantly as a result of increasing tourism demand and related services within the country. Poland's pharmaceutical sector is also projected to grow in the coming years, as the country is considered as an attractive market for the pharma industry, bolstered by the fact that Poland is a member of the EU thereby benefiting from a stable regulatory environment.

GDP growth (% year-on-year)



Source: Eurostat

Key sectors contribution to the economy



Source: Eurostat

Economic outlook: Romania

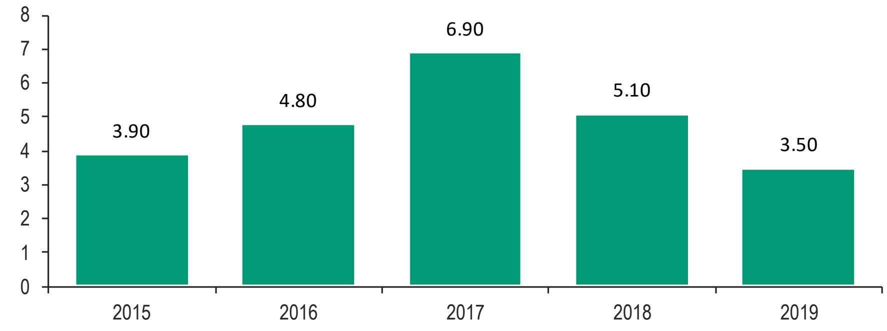
Economic highlights

- As previously mentioned, Romania was one of the fastest growing economies in the EU. It has managed to overcome increasing economic tensions such that during the third quarter of 2017, the Romanian economy recorded an annual growth rate of 8.6%, compared to the EU-28 average of 2.5%. This positive development was the result of tax cuts, lower inflation and significant increases in wages; all leading to higher consumer spending.

Key economic sectors

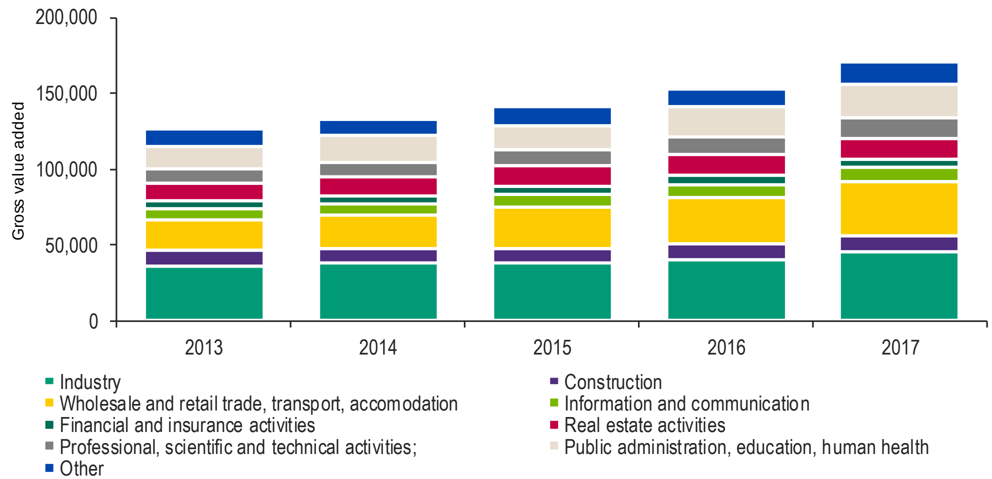
- The Romanian economy remains highly dependent on industry (including manufacturing), as well as wholesale and retail trade (including transport and accommodation). The former sector accounts for 26.7% of the country's total GVA, while the latter accounts for 20.5%. The adjacent figure also shows that Romania has a sizeable public sector that incudes public administration, education and health.
- However, in recent years, notable growth has been recorded by the information and communication sector and also in professional, scientific and technical activities. In part, these developments have been driven be government incentives to encourage younger participants in the labour market to work in these high value added sectors.

GDP growth rates (2015-2020)



Source: Eurostat

Key sector contribution to the economy



Source: Eurostat

Foreign direct investment

Country	Insights
Czech Republic	Czech Republic ranks first amongst central and eastern European countries in terms of FDI inflows and stock. This is attributable to the establishment of various investment incentives, including the availability of skilled and cheap labour and its geographical advantages. A shift has occurred in the scope of FDI from manufacturing to strategic service centres. Moreover, the country was the biggest recipient of FDI inflows in Central Europe, ahead of Poland. Companies with foreign capital participation recorded high shares of exports and imports mainly in the processing industry. This includes branches of engineering and the electrical industry with a number of companies such as Bosh Diesel, Mitsubishi Electric Automotive and Toyota-Peugeot-Citroen Automobile being key contributors.
Poland	In 2018, Poland has become home to Europe's largest lithium-ion battery factory, with the ultimate goal of fulfilling increasing demand for electric vehicle components. Poland has built a stable reputation as a regional production hub for automotive parts and accessories, including GM/Opel, Volkswagen and Fiat being key investors. Moreover, German automotive manufacturer Daimler has commenced with the construction of its first Mercedes Benz factory in Poland, built specifically for engine production. Poland has also managed to make significant improvements in obtaining worldwide investments in a variety of sectors including aviation, food processing, and business software research and development.
Romania	Romania has numerous advantages for FDI including its well established industrial traditions, together with cost of labour being amongst the cheapest in the EU. The distribution of FDI by sector reflects the lead of the industrial sector, particularly the metallurgy industry. Other sectors have also generated investment, including banking and insurance, wholesale and retail and energy, construction and telecommunications. General Motors will commence investments in the near future to construct a production centre in Romania, and snowmobile and motorcycle producer Polaris investing €50 million in a snowmobile plant in Romania.

Section 3: Conclusion

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Conclusion

Expansion to continue amid new risks

The European economy has continued to move forward with what has become a more broad-based and stronger economic expansion. In 2017, the euro area economy has recorded the highest annual growth rate in 10 years, at 2.4%. However, the external downside risks have increased markedly, and the vulnerability of economic growth to foreign trade or financial shocks may have increased due to a stronger reliance on net exports and investment.

Long term perspective

Viewed over a longer time perspective, the European economy is making progress in shaking off much of the experience of the economic and financial crisis. Furthermore, the anticipation of improving future prospects has strengthened the growth momentum. The European economy is currently growing at a rate above its potential growth rate and unemployment continues to fall. Although recent short-term indicators point to somewhat slower growth, this is likely to result from temporary factors. Strong employment growth has absorbed large parts of the labour force and reduced potential untapped potential.

Current perspective

Viewed from a more recent perspective, the precise position of the economy in the business cycle is difficult to assess as indicators suggest room for further GDP growth to continue at above potential rates. Some of the main determinants of Europe's economic expansion, mainly, an improved demand outlook benefitting from strong global trade and elevated confidence, could suffer from tighter global financial conditions.

Through the analysis conducted, it is clear that numerous Eastern European countries rely heavily on the manufacturing sector to drive their economy, specifically the automotive sector including the production of various automotive parts and components. As such, the automotive sector is currently the largest contributor to nationwide imports and exports within Eastern Europe.

Moreover, this industry is projected to continue to have a significant impact on all analysed economies in the near future. Other areas for potential growth include the information and communication sector, and scientific and technical activities.

Poland's pharmaceutical sector also serves as a prime area for further development, which can bolster the production and import of pharmaceutical products and components to such countries, further enhancing the already growing economy.

List of abbreviations

Compound Annual Growth Rate	CAGR
European Union	EU
Foreign Direct Investment	FDI
Gross Domestic Product	GDP
Gross Value Added	GVA
Research and Development	R&D
United Kingdom	UK
United States	US

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