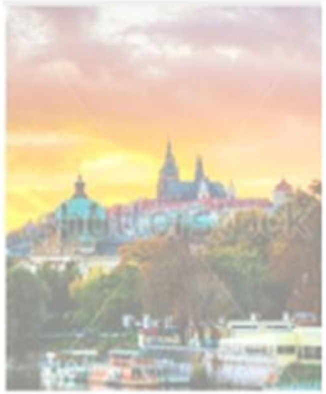
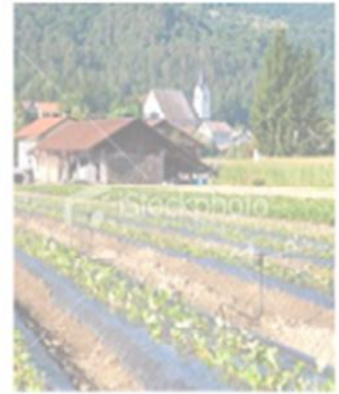
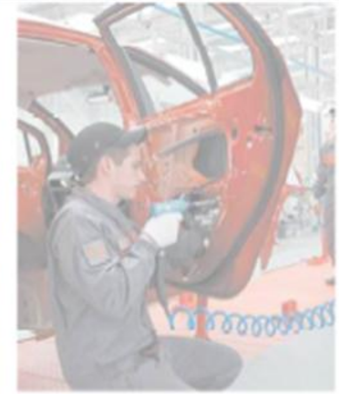


A new dawn: Reigniting growth in Central and Eastern Europe

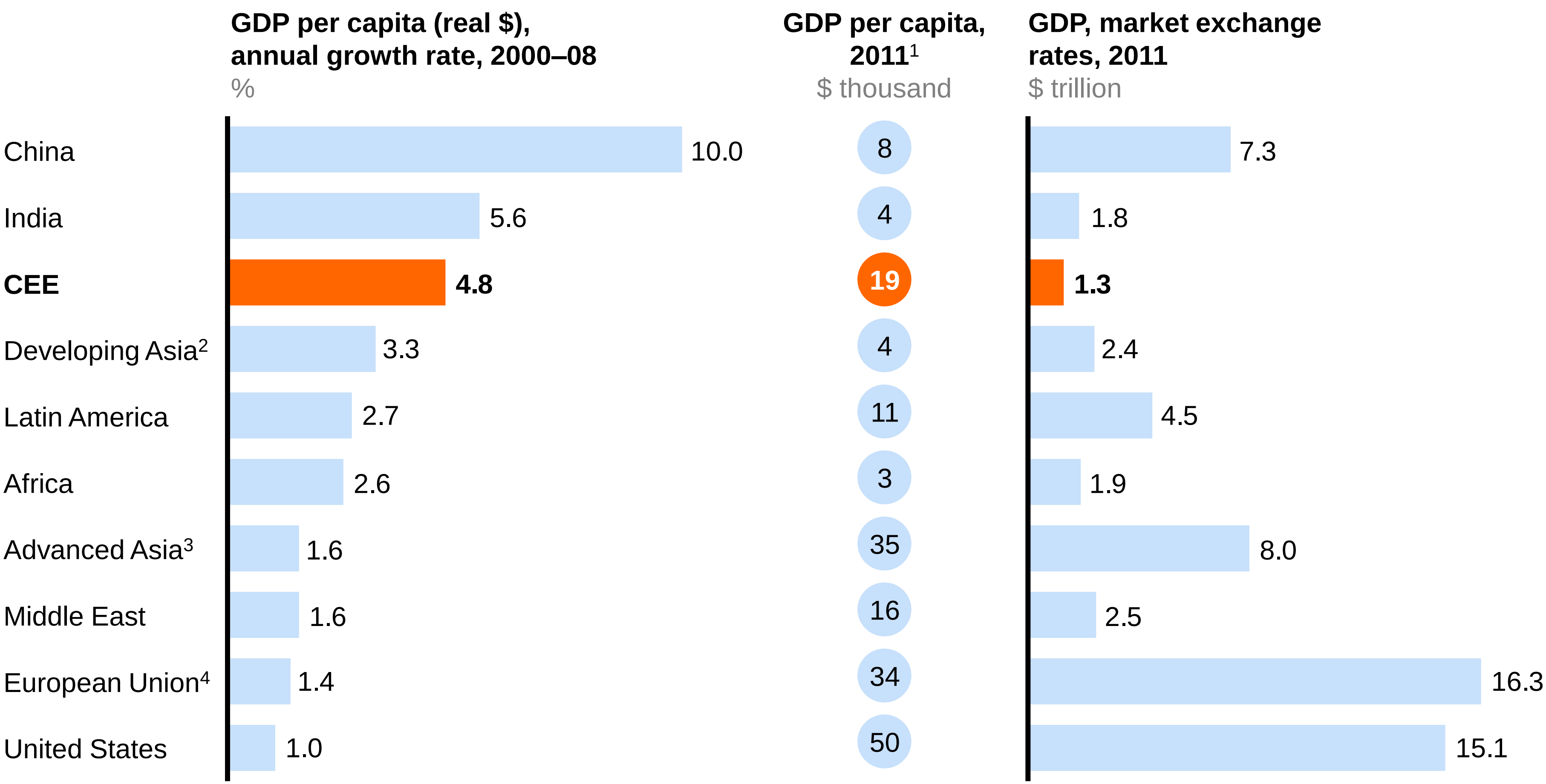
McKinsey Global Institute

Dr. Jan Mischke

December 2014

McKinsey&Company

Central and Eastern Europe was one of the fastest-growing regions in the world before 2008



1 In purchasing power parity terms.
2 Not including China and India.
3 Japan, Hong Kong, South Korea, Singapore, and Taiwan.
4 Not including CEE.

SOURCE: International Monetary Fund; McKinsey Global Institute analysis

A new CEE growth model would increase investments, maintain balanced trade, and accelerate productivity growth

	CEE 2013	New growth model	CEE 2025
Demand	▪ Consumption-driven growth (80% of GDP) ▪ Exports concentrated in EU-15 and in a few industries	1. Expand exports and focus on higher value-added activities	▪ Balanced and diversified trade with increased capital contribution
Supply	▪ GDP growth driven by increasing hours worked and moderate productivity growth	2. Unleash growth and productivity in domestic sectors	▪ Investment rate increased to above pre-crisis level ▪ Increased labour force participation rates to compensate for ageing ▪ Accelerated productivity growth
Financing	▪ High foreign borrowing, collapse of FDI since the crisis, low domestic savings	3. Finance growth via renewed FDI and higher domestic savings	▪ Renewed FDI and domestic savings

Enablers
Infrastructure, competitive cities, regulation, education, innovation

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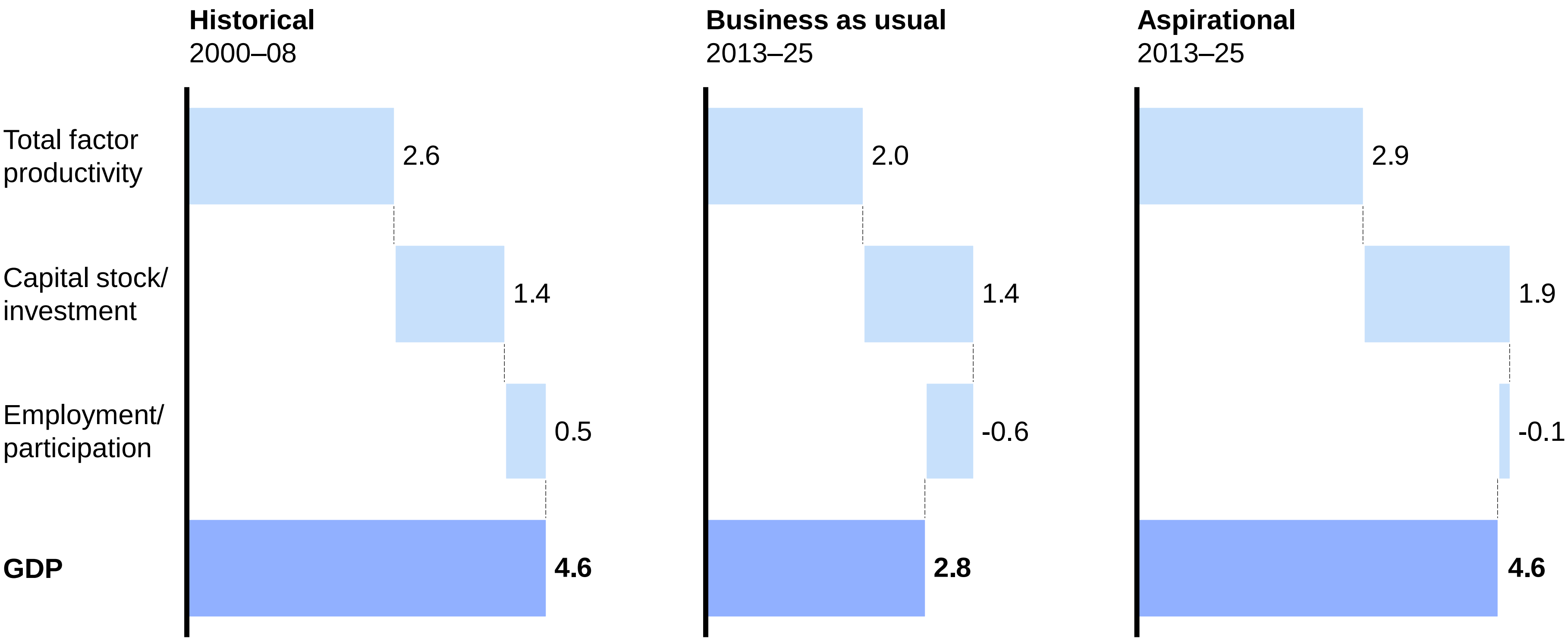
SOURCE: McKinsey Global Institute analysis

In an "aspirational" scenario, CEE economies can return to pre-crisis GDP growth

Growth rates

%



NOTE: Numbers may not sum due to rounding.

SOURCE: McKinsey Global Growth Model; McKinsey Global Institute analysis

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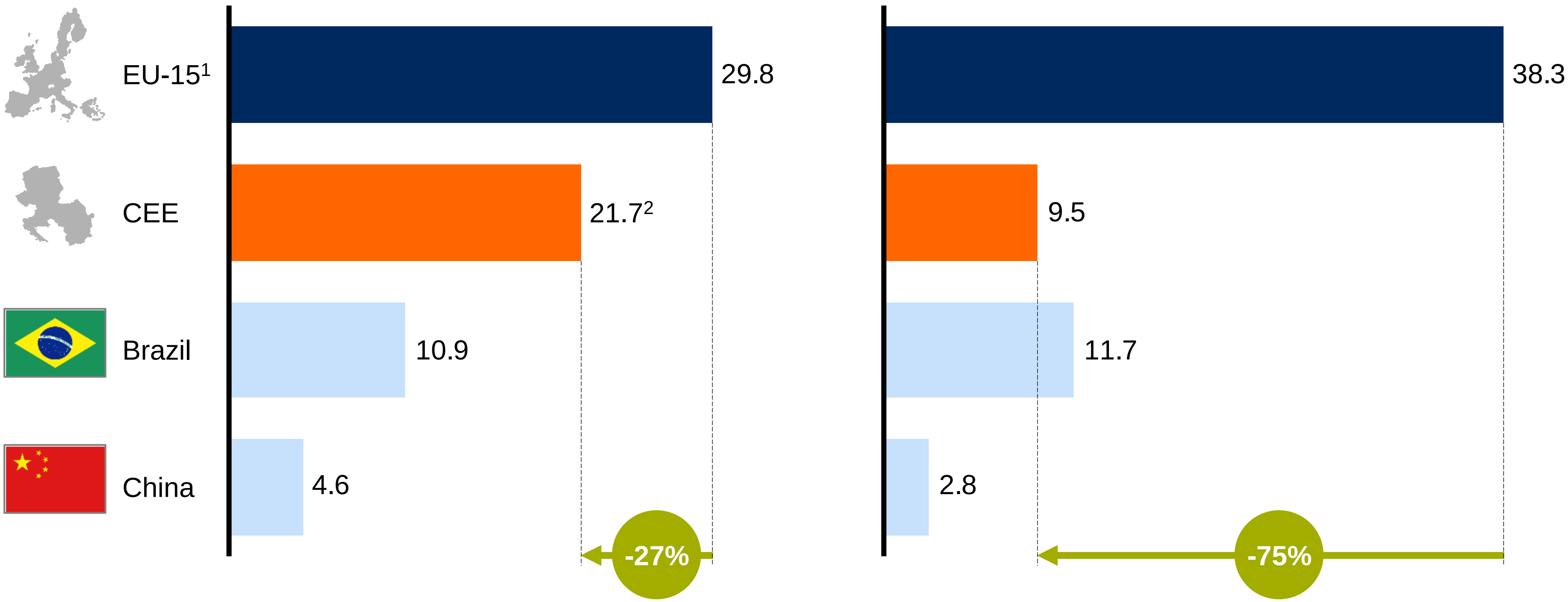
SOURCE: McKinsey Global Institute analysis

The CEE region offers an educated workforce and substantially lower labour costs than the EU-15

Share of labour force with tertiary education, 2010
%

Average labour cost per hour, 2011
$



1 Excluding Luxembourg.
2 Excluding Croatia.

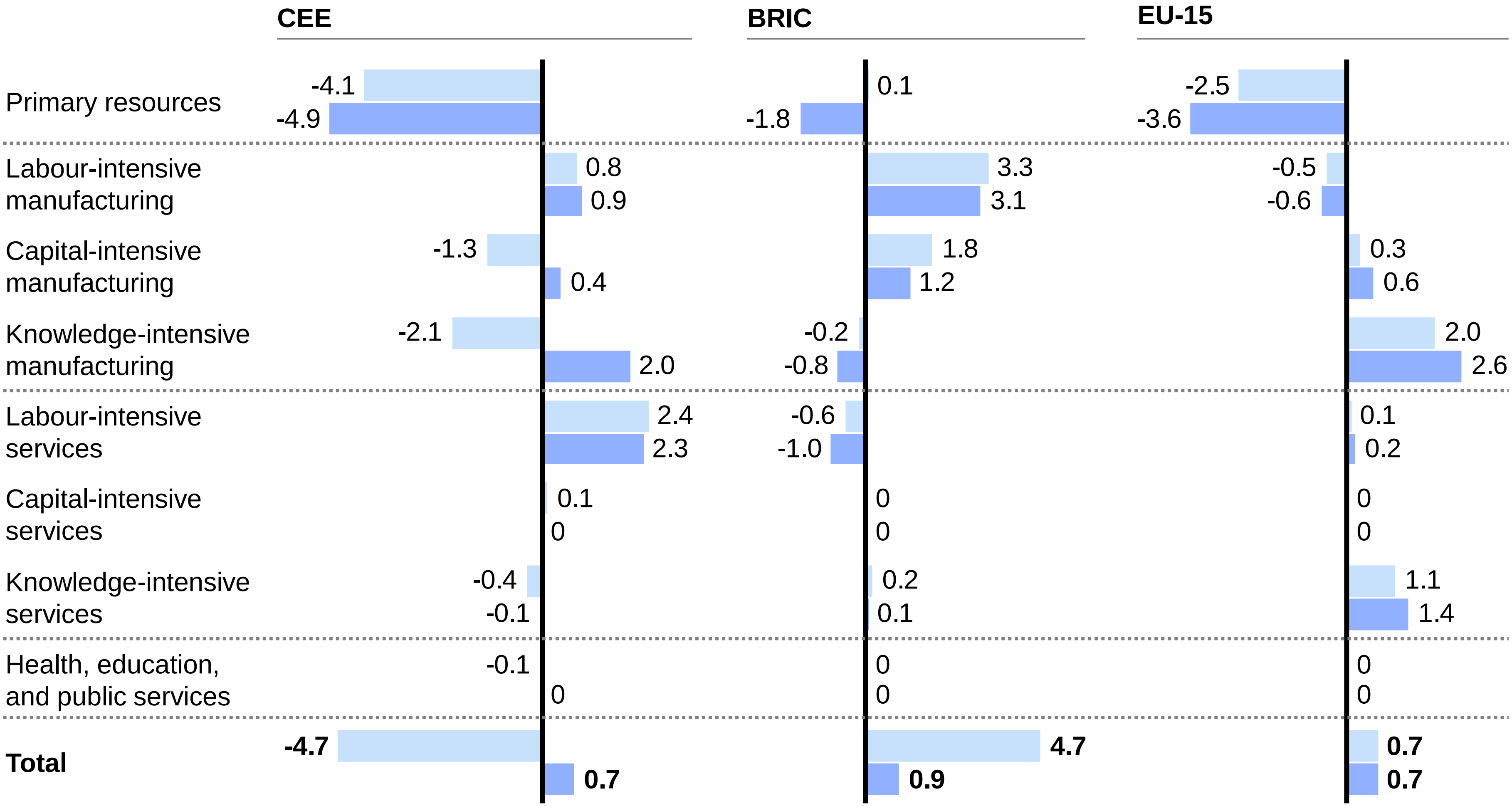
SOURCE: Organisation for Economic Co-operation and Development; United Nations; Eurostat; Economist Intelligence Unit; World Bank; McKinsey Global Institute analysis

1. Expanding exports: knowledge intense manufacturing

The CEE area has a more mature trade profile than BRIC economies

2007
2011

Net exports
% of GDP



NOTE: Noncategorised and confidential trade is not included in the analysis. Numbers may not sum due to rounding.

SOURCE: World Integrated Trade Solution; International Trade Center; McKinsey Global Institute analysis

1. Expanding exports: agribusiness/ food processing

Low labour and raw materials costs make processed food exports to Western Europe attractive

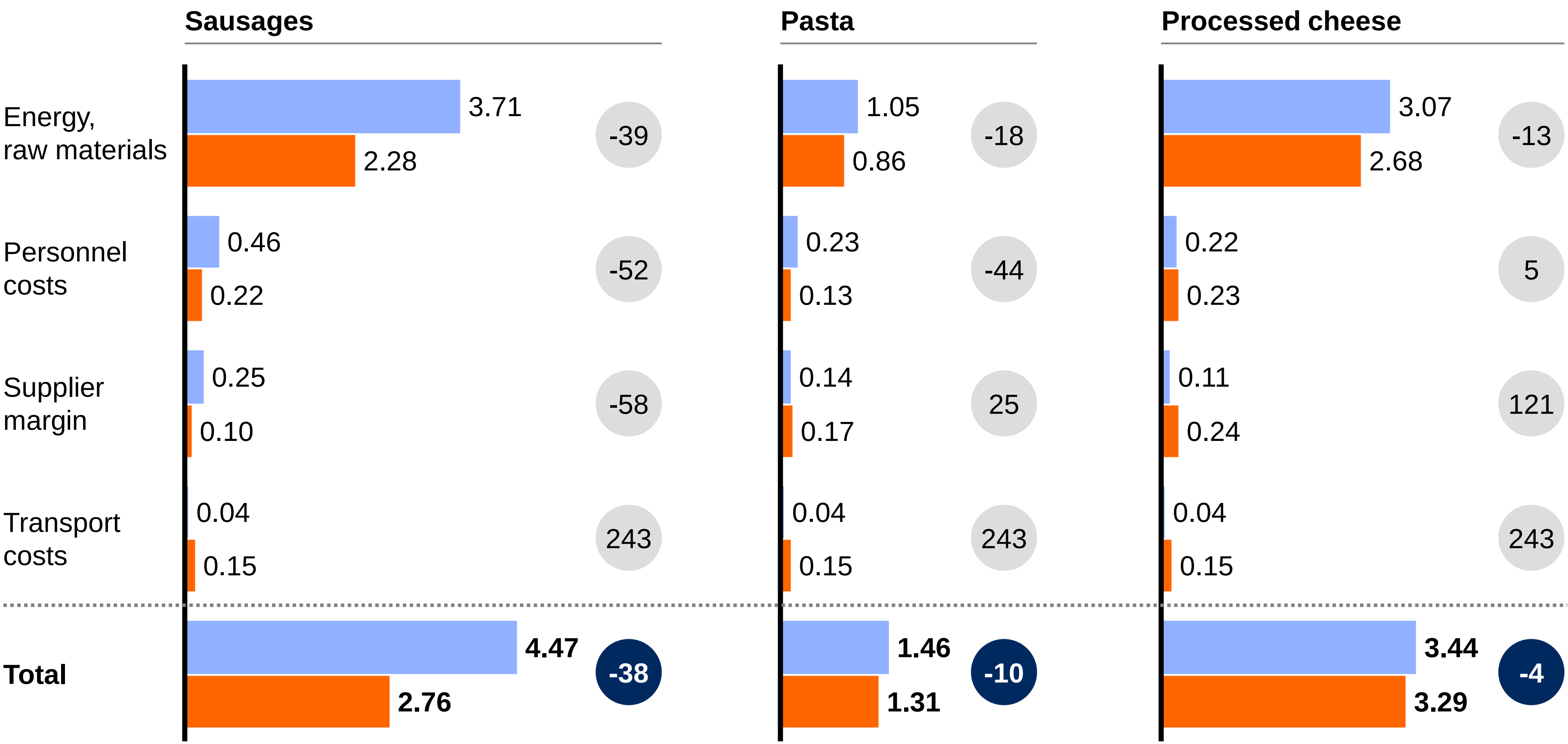
Production costs, 2011

€ per kilo

Germany

Poland

% Cost difference (Poland vs. Germany)



NOTE: Transport costs (by road) have been added on top of production costs. For Germany, data apply to the Hamburg–Berlin route; for Poland, Warsaw-Berlin. Weight of manufacturing cost components data is for 2010. Numbers may not sum due to rounding.

SOURCE: Eurostat; GlobalShippingCosts.com; McKinsey Global Institute analysis

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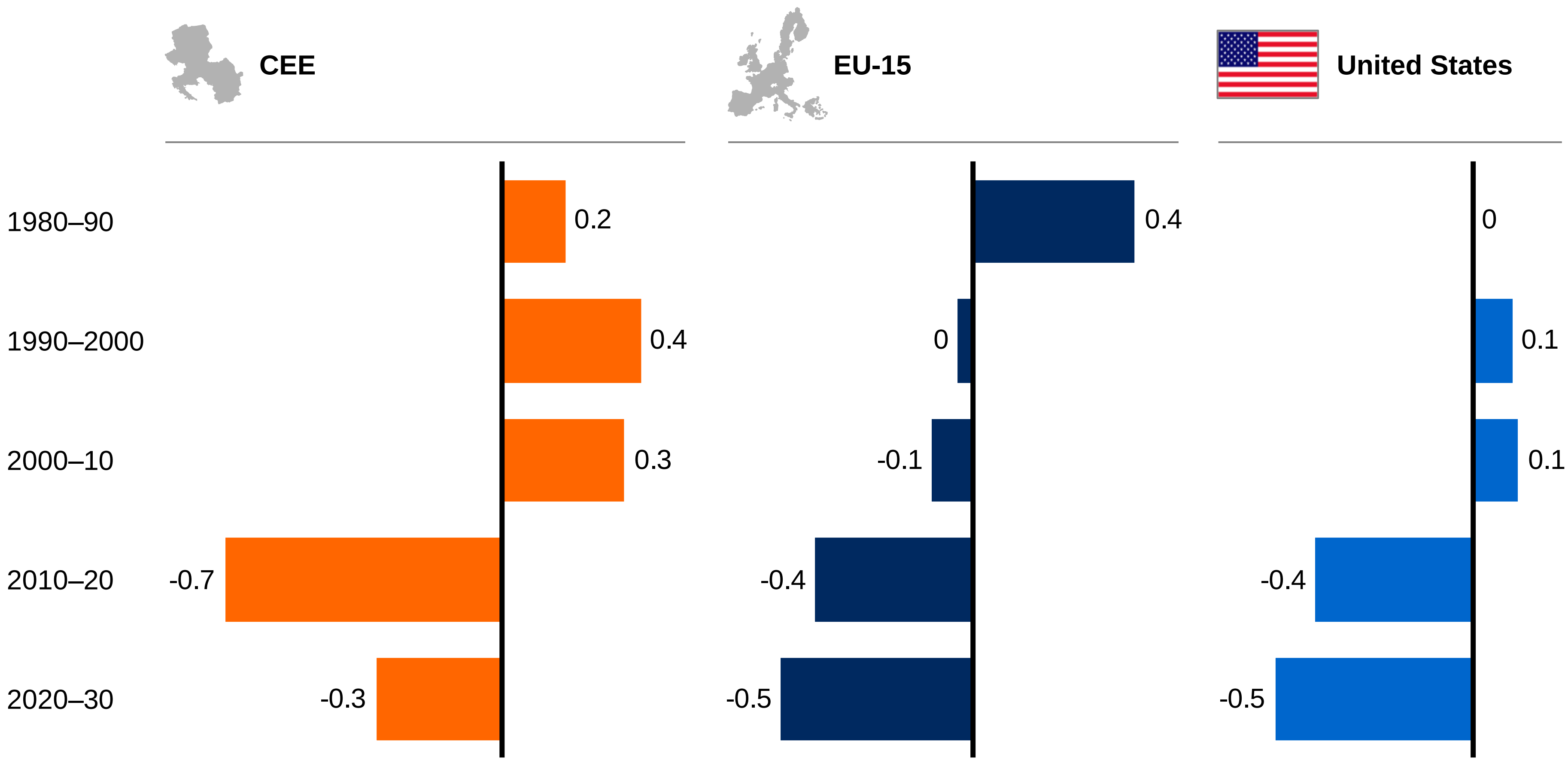
SOURCE: McKinsey Global Institute analysis

Ageing will have a larger impact on CEE labour forces than in the EU-15 or the United States in 2010–20

Contribution of share of working-age population growth to GDP per capita growth[1]

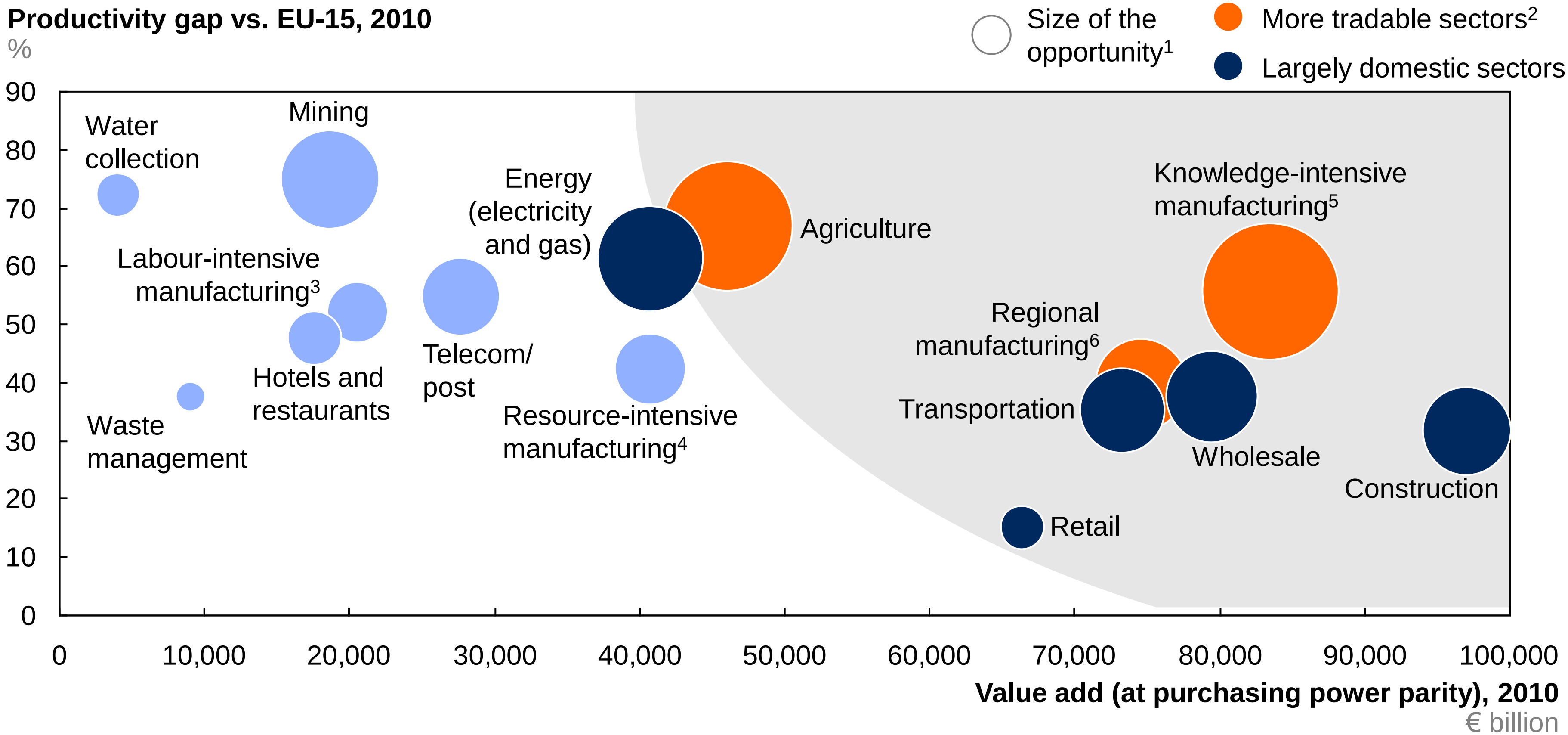
%



1 Assuming stable labour utilisation and labour productivity growth.

SOURCE: United Nations Population Division; McKinsey Global Institute analysis

The largest productivity opportunities are in some manufacturing sectors, agriculture, construction, transportation, energy, retail, and wholesale



1 Calculated as multiple of size of the gap and value add.
2 Agriculture and regional processing are traded within short distances; in this report, we group them as exports due to the opportunities we discuss.
3 Textiles, apparel, leather, furniture, jewellery, toys, and other.
4 Wood products, refined petroleum, coke, nuclear, pulp and paper, and mineral-based products.
5 Chemicals; motor vehicles, trailers, and parts; transport equipment; electrical machinery; computers and office machinery; semiconductors and electronics; and medical, precision, and optical.
6 Rubber and plastics; fabricated metal products; and food and beverage.
NOTE: Excludes Bulgaria and Croatia.

SOURCE: Eurostat; McKinsey Global Institute analysis

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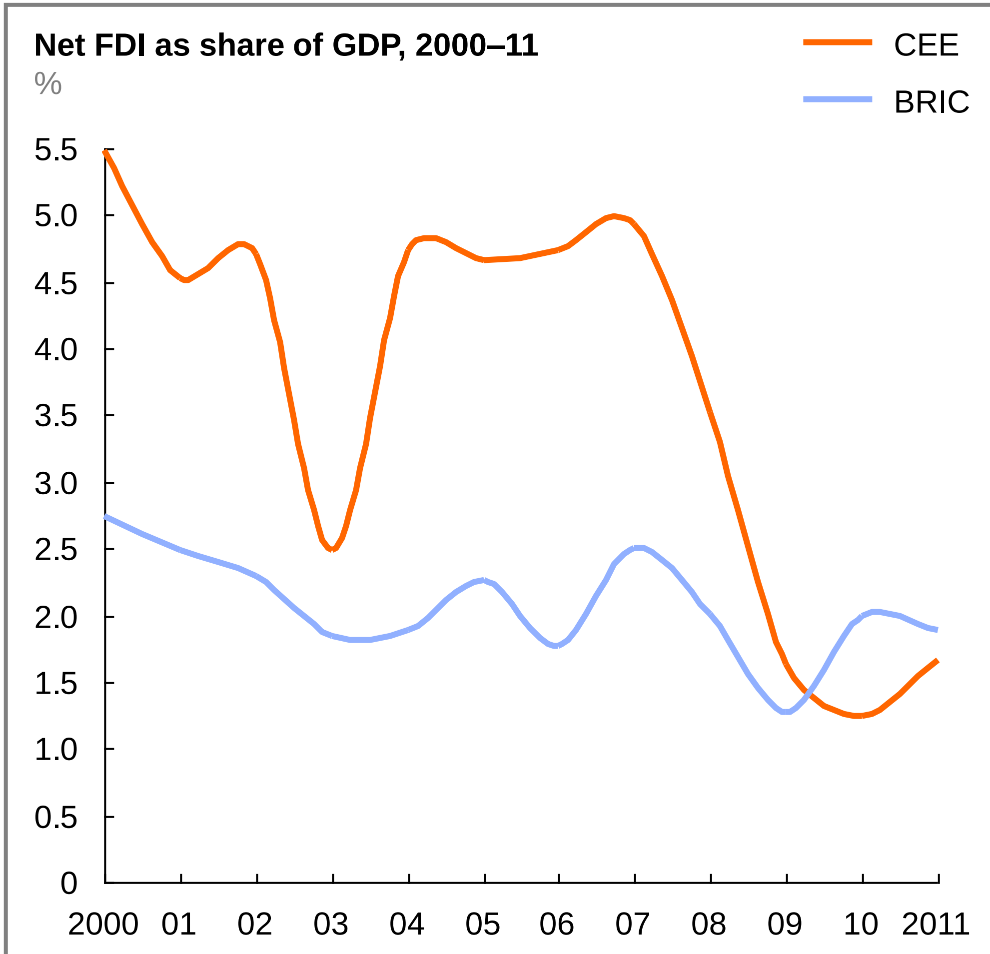
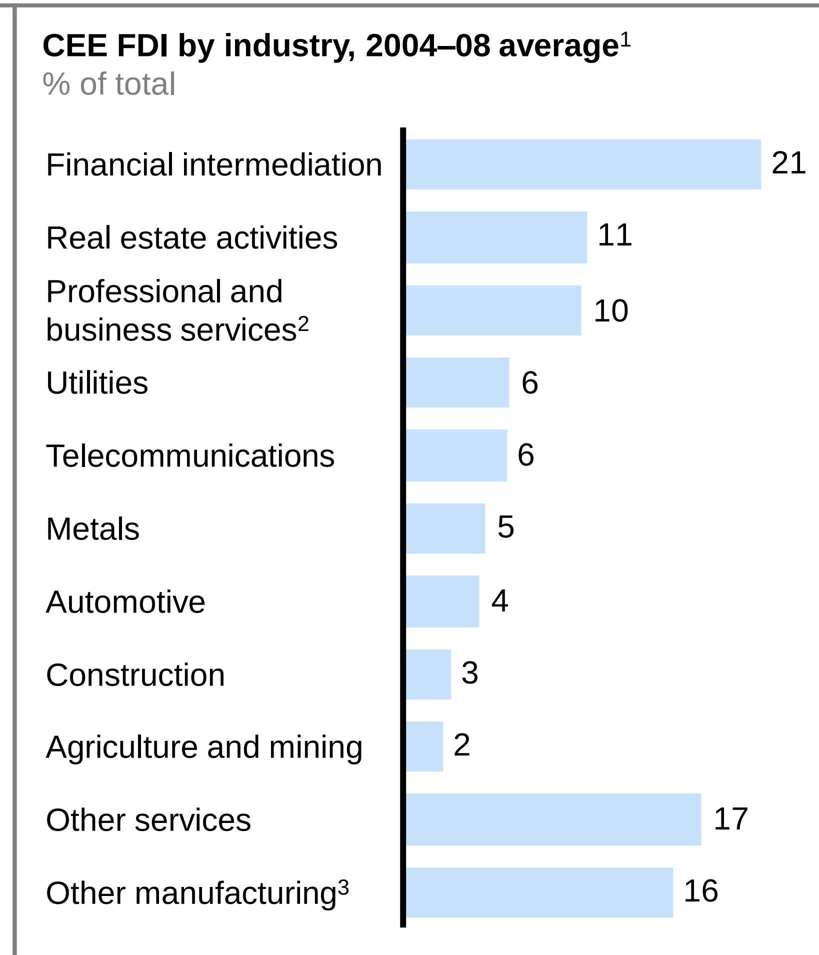
SOURCE: McKinsey Global Institute analysis

CEE economies attracted more FDI as a share of GDP than other developing economies; six industries captured almost half of FDI inflows



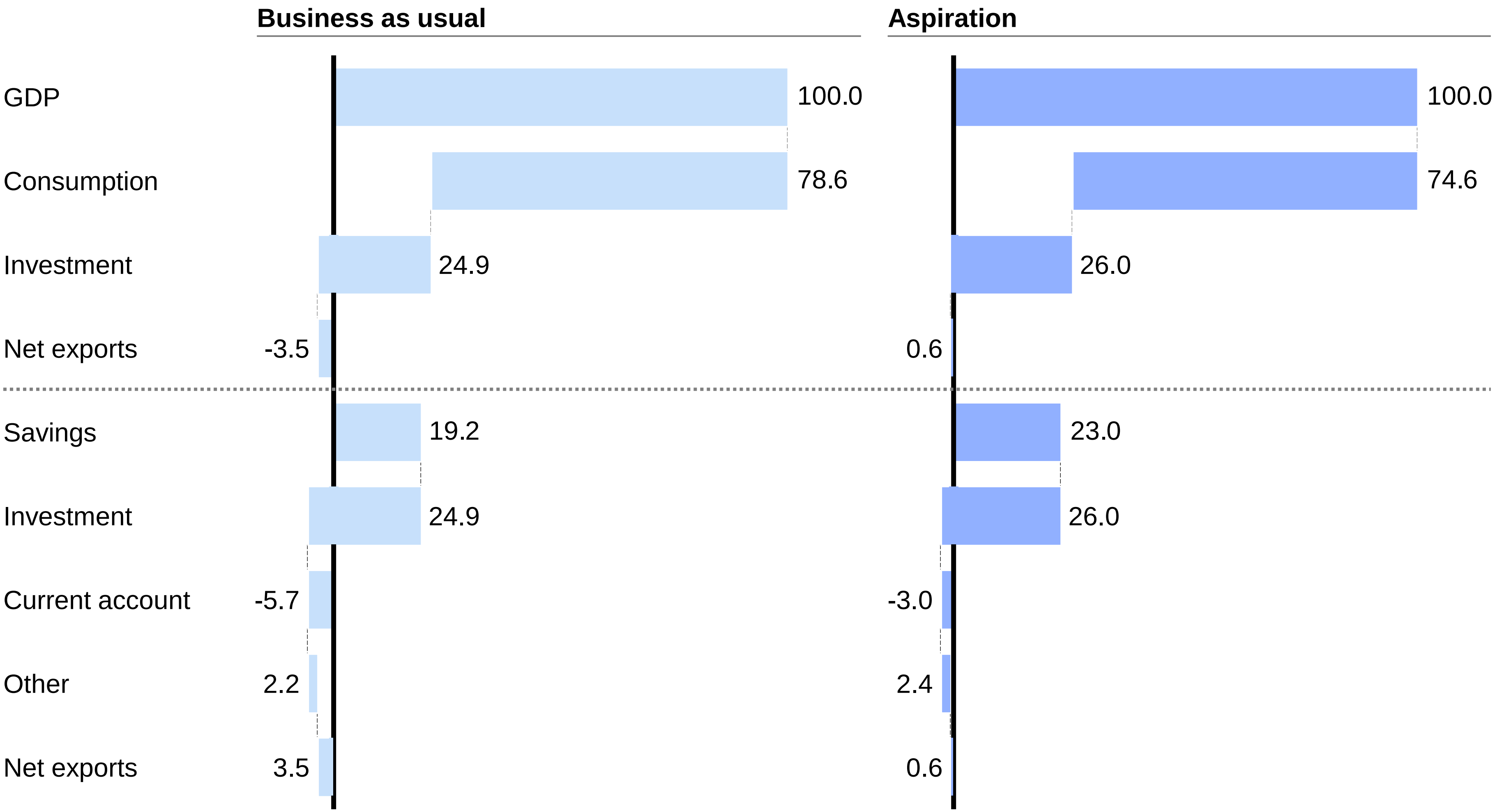


1 Calculated as delta in FDI stock; excludes Croatia.
2 Includes advertising, accounting, architecture, audit, business consultancy, legal, and market research.
3 Largest subcategories are chemicals (4.3%), food (2.1%), and textiles/apparel (2.1%).

SOURCE: UNCTADstat; Economist Intelligence Unit; Eurostat; McKinsey Global Institute analysis

The new growth model requires a significant shift towards investment, exports, and domestic savings and a shift away from consumption

% of GDP, 2013–25



NOTE: Numbers may not sum due to rounding.

SOURCE: McKinsey Global Growth Model; McKinsey Global Institute analysis

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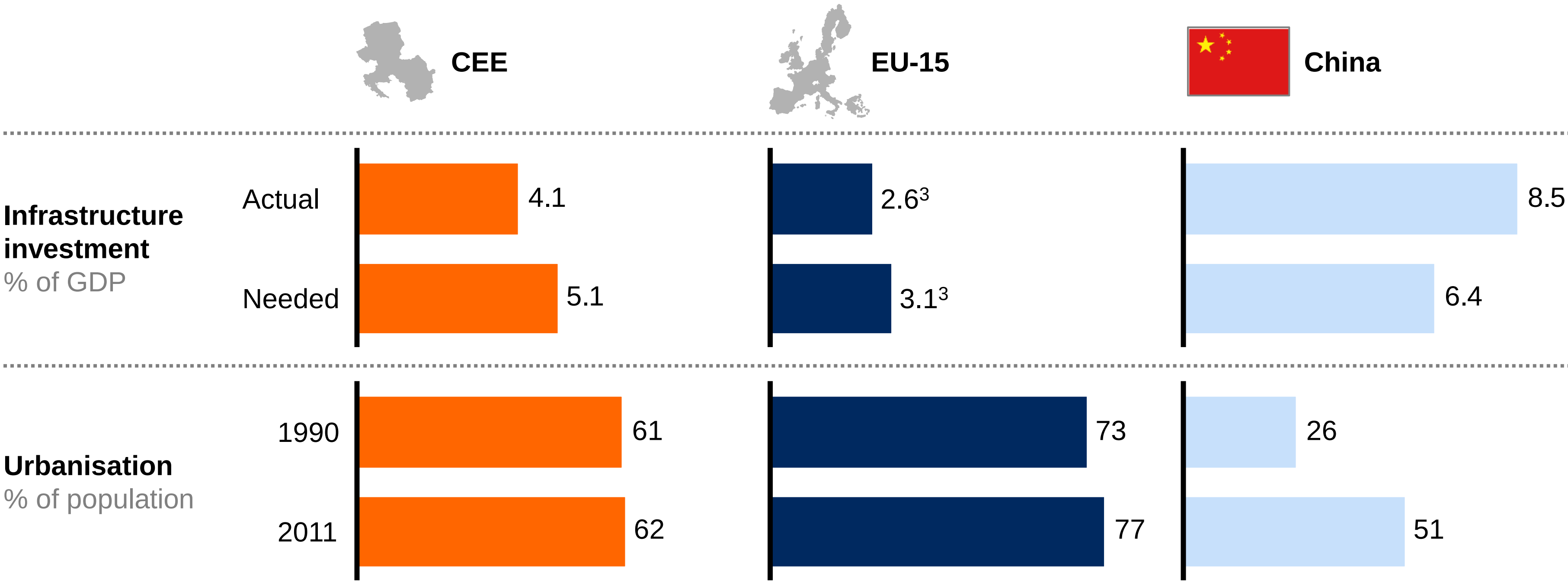
SOURCE: McKinsey Global Institute analysis

CEE economies need to build a strong foundation for further growth



	CEE	EU-15	China
Regulation (ease of doing business rank)[1]	33–89	5–72	96
Education PISA[2]	424–500	470–536	556[4]
R&D % of GDP, 2010	0.9	2.1	1.7[5]

1 Best and worst performers for CEE and EU-15.
2 OECD Programme for International Student Assessment, best and worst performers for CEE and EU-15.
3 EU-27.
4 China score is for Shanghai.
5 2009 data.

SOURCE: World Bank; Organisation for Economic Co-operation and Development; McKinsey Global Institute analysis

Thank you

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