Swiss Re Institute

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Economic Insights
Central and Eastern Europe: the future's bright in life

Key takeaways

- CEE economies have remained resilient to slowdown in Europe's industrial sector, due to a more diversified economic structure.
- Domestic rather than export demand has become the main growth driver, due to very strong wage growth and public investment.
- A strong rise in purchasing power will help lift insurance penetration in the CEE region.
- We forecast 7% annual growth in life premiums over the next five years, four times higher than over the past decade and five times the growth pace in advanced markets.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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In a nutshell

Central and Eastern European economies have grown strongly as greater economic diversity made the region more resilient to the ongoing slowdown in western European economies. With rising purchasing power, we see significant potential for insurance penetration in the region to increase over the coming years.

Central and Eastern European (CEE) economies have grown strongly in 2019, demonstrating remarkable resilience to the slowdown of their main trading partners. Most notably in Germany, industrial production has fallen 7.5% since the beginning of 2018, almost twice the euro area aggregate. In the main CEE economies, industrial production has risen on average by 3% over the same period (see Figure 1). This is a surprise, given that most CEE countries are small, open economies, highly integrated with supply chains across Europe. For instance, exports of EU-members of CEE[1] countries comprise around 54% of GDP, with a quarter going to Germany alone.

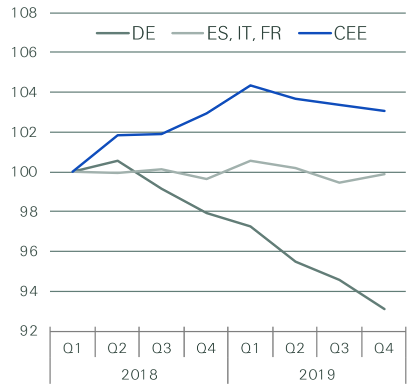
The reasons for the impressive resilience are mostly structural. Since the global financial crisis, CEE countries have rebalanced their economies and since 2014, domestic rather than export demand, has been the main growth driver. Developments in the labour market have supported consumption. Most of the region has experienced fast employment growth, resulting in record low unemployment and stellar wage growth. For instance, between 2008 and 2018, real earnings rose by 29% in Hungary and 27% in Poland, compared with 14% in Germany. This has led to a strong rise in purchasing power, fueling consumption. Consumption had additional support from remittance inflows. The World Bank estimates that CEE migrant workers sent about USD 27 billion home in 2017, with Poland alone having received close to USD 7 billion. Remittances constitute a relatively small share of GDP for larger countries (eg, 1.2% of GDP in Poland), but are significant for some of the smaller economies of the region (eg, Croatia 4.6% of GDP).

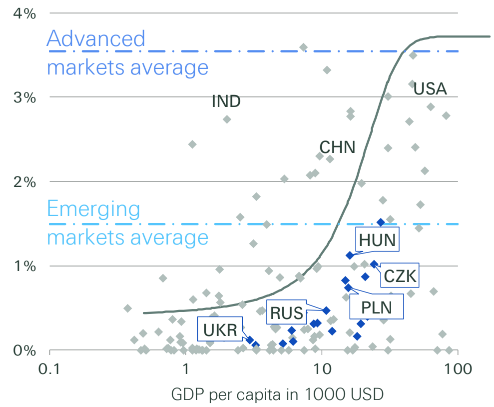
Government spending, low interest rates and an inflow of EU funds have also fueled growth. Over the past five years, public investment in CEE countries exceeded the euro area average by around 7-14% of GDP. Part of the investment boom has originated from inflows of EU structural funds. The IIF estimates[2] that over 2007-2018, these inflows contributed to average annual output growth by as much as 1.2 percentage points (ppt) in Poland and 0.7 ppt in Hungary. While the 2021-27 EU budget is likely to result in much smaller contributions for some of the CEE countries, strong investment growth should be sustained in the coming years as funds from the current budget period will continue to be disbursed well into 2023.

[1] Note: EU CEE countries are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia
[2] *Macro Notes: EU Structural Funds Boost Growth in CEE*, IIF, 4 December 2019

Figure 1 (LHS)
Industrial production index (Q1 2018=100), GDP weighted

Figure 2 (RHS)
Life insurance penetration 2018 (premiums as a % of GDP)





Source: Swiss Re Institute, Datastream; Note: CEE includes CZ, EE, LV, PL, RM, SK, SI, BG, HU

In the coming years, we expect domestic demand to continue to support economic growth in CEE economies, although GDP growth is set to slow given weakness in the European industrial sector. We believe economic resilience will also support demand for insurance in CEE, where significant protection gaps remain. For instance, non-life insurance premiums have grown strongly in the past decade but not as fast as GDP growth, resulting in a fall in insurance penetration to below pre-global financial crisis levels. This is in part due to too much focus on the auto sector, and little innovation in other lines. Over the next five years, we expect insurance penetration to rise gradually as real premiums grow at more than double the pace of the advanced markets average, at 3.6%[3].

Life insurance penetration in CEE is low and has fallen below the emerging market average as of 2018, as other emerging economies are closing the protection gap faster (see Figure 2). Low interest rates remain a challenge overall but the outlook for life insurers in the region looks promising, in our view. With the stark growth in purchasing power, we see significant potential for narrowing of the protection gap over the coming decade as insurance becomes relatively more affordable to households. Over 2020-2024 we expect annual average life premium growth of over 7%[4], four times higher than over the past decade, and five times stronger than in advanced markets. As a result, insurance penetration is set to increase.

[3] and [4] average real annual premium growth for the CEE-CIS region