Central and Eastern Europe: long-term growth driver for the entire EU area

In the 2000s, Eastern Europe was a successful region of Emerging Markets. A kind of gold rush attracted many investors to these markets. The region was hit hard by the financial crisis of 2008, but the investment story was not yet written off. It was only political changes, such as the Caucasus war of 2008, the annexation of Crimea in 2014 and, ultimately, the war in Ukraine in 2022, that made this region almost uninvestable for many investors.

Region falls from the radar of investors

While Central Europe as part of the EU remained investable, the investment region of Central and Eastern Europe (CEE) has been significantly reduced in size due to the loss of Russia. Valuations are down 30 to 40 per cent compared to ten years ago due to the risk associated with the war in Ukraine and the lack of liquidity. But high energy prices – which affect all of Europe – are also weighing on economic development and the region's attractiveness. Whether the situation will improve in the near future depends on many factors, including the outcome of the war in Ukraine.

Global conflicts and their impact

Global conflicts, such as the trade dispute between the US and China, are also affecting the region. Even before Donald Trump took office as US president, there were discussions in Europe about moving the production of goods closer to their own markets again and not having everything manufactured in Asia, especially China. The Eastern European markets could benefit from a shift in production from Asia to Europe, as these countries produce more cheaply than Western Europe. However, the region is heavily dependent on the West, particularly Germany. If Germany's economy falters, Eastern Europe will suffer too. Therefore, the actions of the new German government could potentially improve the economic situation again.

Nevertheless, it is still unclear how Trump's tariff policy, particularly regarding China and possibly also Europe, will affect the region. If China is no longer able to export its goods to the US, they could be diverted to Europe, which would intensify competition. It is also possible that production will migrate from China to the region, which in turn would be positive for the region. However, it is currently completely up in the air as to what will happen – other consequences are also possible.

Silver linings and challenges

Despite the negative assessments, there are individual bright spots in the region. Poland, the largest country within the European Emerging Markets, has become more attractive again after the opposition's victory in the 2023 election. Croatia and Slovenia also offer new opportunities for investors. These two small countries have seen strong economic growth, particularly Croatia, which has introduced the euro and is benefiting from relatively new and substantial EU funding. Both local stock markets were among the best stock markets in the world in 2024, and we continue to see strong prospects for 2025.

"In the long term, the region could become a growth driver for the entire area of the European Union. The potential for recovery is there, though the timing is uncertain, but probably drawing closer."

András Szálkai,
Senior Fund Manager Equities CEE at Raiffeisen Capital Management.

End of the war in Ukraine?

In recent weeks, we have seen a lot of news suggesting that negotiations have begun to end the war in the Ukraine. The markets in Central Europe have reacted strongly to this, especially the Polish equity market, which has already risen by more than 20% by mid-February. The Austrian stock market, which is actually part of the Western European portfolio but mostly operates in Central Europe, has also reacted more strongly to the hoped-for negotiations, along with Poland. The valuation level of this region continues to include a discount of around 20 to 30%, which could disappear in the near future if there are positive developments.

Conclusion: a look into the future

The region is currently not the first choice for investors due to geopolitical uncertainties, economic weakness, and the unforeseeable consequences of changes in (tariff) policy. However, a ceasefire in the Ukraine and the economic recovery of Western Europe would significantly improve the situation. This region could be a long-term growth driver for the entire EU area. The price-earnings ratio (P/E) for 2025 is 7.8, which is low compared to other markets. The discount compared to developed markets has grown over the years. While the timing remains uncertain, the potential for a recovery is there, and probably getting closer. Until then, capital markets in CEE will probably remain on hold for international investors.

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