

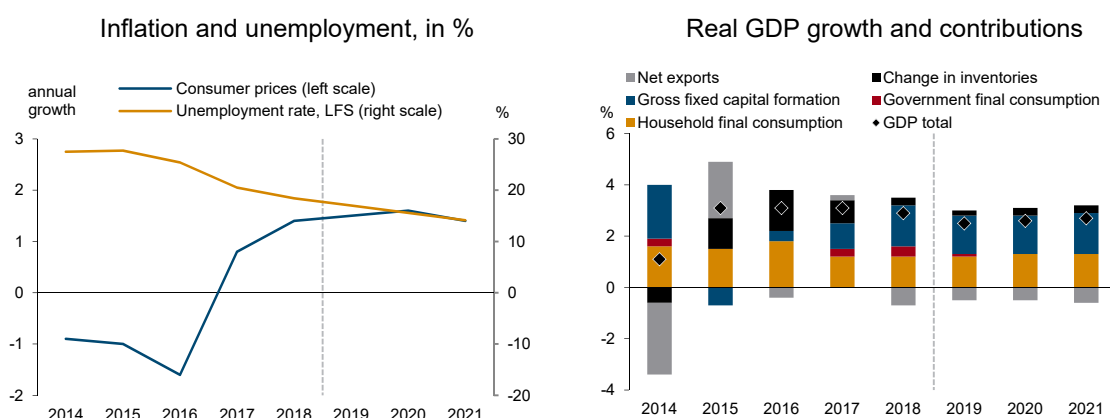


## BOSNIA AND HERZEGOVINA: Once again politics impede stronger growth

GORAN VUKŠIĆ

Following the general elections in October 2018, the process of government formation at the country level and in the Federation of Bosnia and Herzegovina is lengthy. Along with slightly deteriorating external conditions over the whole forecasting period, the political factors will negatively affect growth in 2019, with an estimated growth rate of 2.5%. Under the assumption that the political stalemate is resolved soon, we expect growth in 2020 and 2021 to mildly increase.

**Figure 6.3 / Bosnia and Herzegovina: Main macroeconomic indicators**



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**The real GDP growth rate in 2018 is estimated at 2.9% – slightly lower than previously expected,** due to a likely slowdown in the last quarter, as signalled by decelerating growth of exports and imports of goods, as well as industrial production. The largest contributors to growth were investment and household consumption – based on the available national accounts data for the first three quarters of 2018, which also contain a revision of 2017 quarterly data that was particularly significant for investment statistics.

**According to the first data for the whole year, real industrial output expanded by only 1.6% during 2018,** with the highest increase of 6.6% recorded in the energy sector. While the overall construction output rose by only 0.8%, there are signs of construction companies becoming more oriented towards foreign markets. Though this market segment is still comparatively small, exports of construction services rose at an estimated rate of 13%.

**The overall contribution of net exports of goods and services to growth turned out negative**

despite solid, although decelerating, real exports growth estimated at 6% for the year 2018. Exports of services were largely driven by the strengthening tourism sector with the number of foreign tourist arrivals and overnight stays in 2018 rising by 14% and 13% compared to 2017, respectively. At the same time, however, imports rose by 5.5% leading to an overall negative contribution from net exports (owing to a much bigger absolute size of imports versus exports). The current account deficit amounted to 4.5% of GDP, which is only a slight improvement from the previous two years. Strong remittances inflows continued financing a large part of the persistent deficit in trade in goods and services.

**Labour market developments were moderately positive, with employment rising by 0.8% and real gross wages by 1.7% for the full year 2018.**

Despite a significant decline of 2.1 percentage points, the unemployment rate still remains exceptionally high and amounts to 18.1% according to Labour Force Survey data 2018. In such an environment, the consumer price inflation remained low and amounted to 1.4%. The largest price increases were 8.9% for transport, following the international oil price increase, and 8.8% for tobacco products, which is related to tobacco excise hikes introduced at the beginning of 2018.

**The sizeable government balance surplus from 2017 is estimated to have further slightly expanded in 2018,**

largely due to solid increases in revenues, which outpaced the estimated expenditure growth. The likely under-execution of public investment over the first eight months of 2018 may have contributed to such developments. At the current stage, however, there is no definitive information on the government-spending dynamics in the last quarter. The share of public debt in GDP declined to below 32%, which opens up some fiscal space for increasing the much needed public investment over the years to come.

**For the forecasting period, we expect a deceleration of growth in 2019 to 2.5%, and mild improvements in the following two years.**

These developments will mostly reflect the increased political uncertainty in 2019, and the slight deterioration of external economic conditions. As in 2018, the largest contributions to growth in the following three years are expected to come from investment and household consumption. Real government consumption will grow at rates just above zero, while the contribution from net exports is to remain slightly negative as exports are expected to further decelerate after recording exceptionally high growth rates during the 2015-2017 period.

**The largest (internal) downward risk to our forecasts is related to the political situation,** after the general elections held on 7 October last year. Currently, it appears that the government formation process, particularly in the Federation of Bosnia and Herzegovina, may be prolonged. Obstacles for government formation appear mostly related to diverging views of potential coalition partners with respect to the country's path towards NATO accession, at the country level, and with respect to the Electoral Law at the level of the Federation. Bosnia and Herzegovina has been rather slow in the implementation of reforms, not only in the fiscal area, even with a government in place. This is likely due to the complex organisational structure of the state and, correspondingly, fragmented and inefficient decision-making. Therefore, at least in the short term with more pronounced political challenges than usual, an even less-active policy-making can be expected. The recent example of the belated 2019 budget of the Federation, which was finally adopted on 20 February, shows that policy-making has been considerably slowed, but that even in the current political constellation at least the most crucial decisions for the functioning of the state are still met. Thus, we base our forecasts on the assumption that the

political stalemate will be largely resolved during the first half of 2019, i.e. that the political factors, although still a burden, will be less of a drag on the economy in the second half of 2019 and the rest of the forecasting period.

**The investment in Bosnia and Herzegovina, as a share in GDP, has been the lowest when compared to other Western Balkan countries**, and by far the lowest when expressed in per cent of final expenditures. Despite a rather unsupportive regulatory and business environment, which is not likely to change quickly, the country has experienced a significant (private) investment surge over the last three years. We expect this recent investment momentum to be maintained to some extent. In addition, the share of government investment in aggregate gross fixed capital formation in recent years amounted to below 15%, with a gradual increase projected in last year's government medium-term plans. Our growth projections are based on the assumption that public investment will increase, but with a likely delay at least in 2019, caused by political factors. Although we do not expect the government to fully absorb the investment potential, we do find it likely that public investment will pick up towards the end of the forecasting period, lending support to the overall investment dynamics and possibly creating some spillovers to the private sector. Correspondingly, the government balance is projected to stay in positive territory in the following years as well, but diminishing to zero by 2021.

**Consumer price inflation is likely to remain low, at levels around 1.5%**, in line with eurozone trends. Stable, although modest growth will bring about small employment gains, moderate real wage increases, and further reductions in the unemployment rate, which, however, will still remain high. Such developments will lend support to real increases in household consumption.

**The current account deficit shall remain at levels comparable to the previous two years**, i.e. around 4.5% of GDP, with small gradual improvements towards the end of forecast period. Remittances flows will remain a significant and slightly increasing source of finance.

**In summary, our growth estimates of 2.5% in 2019, 2.6% in 2020, and 2.7% in 2021, are mildly revised downwards from our previous forecast.** The reasons are the deteriorating external conditions affecting the export performance, as well as the increased political uncertainty (especially in 2019), which endangers government fiscal and reform plans. The negative political factors, unless they escalate, represent more of an obstacle in accelerating longer-term growth by implementing planned reforms and executing growth-enhancing public investment, rather than an immediate risk to current, positive but modest, economic performance.

**Table 6.3 / Bosnia and Herzegovina: Selected economic indicators**

|   | 2014   | 2015   | 2016   | 2017   | 2018 <sup>1)</sup> | 2019     | 2020   | 2021   |
|---|--------|--------|--------|--------|--------------------|----------|--------|--------|
|   |        |        |        |        |                    | Forecast |        |        |
| Population, th pers., average                         | 3,526  | 3,518  | 3,511  | 3,505  | 3,500              | 3,495    | 3,490  | 3,485  |
| Gross domestic product, BAM mn, nom. <sup>2)</sup>    | 27,359 | 28,589 | 29,904 | 31,376 | 32,700             | 34,000   | 35,500 | 37,000 |
| annual change in % (real)                             | 1.1    | 3.1    | 3.1    | 3.2    | 2.9                | 2.5      | 2.6    | 2.7    |
| GDP/capita (EUR at PPP) <sup>2)</sup>                 | 8,300  | 8,800  | 9,000  | 9,300  | 9,700              | .        | .      | .      |
| Consumption of households, BAM mn, nom. <sup>2)</sup> | 22,830 | 23,157 | 23,653 | 24,416 | 25,150             | .        | .      | .      |
| annual change in % (real)                             | 1.9    | 1.8    | 2.2    | 1.5    | 1.6                | 1.6      | 1.7    | 1.7    |
| Gross fixed capital form., BAM mn, nom. <sup>2)</sup> | 5,330  | 5,097  | 5,189  | 5,653  | 6,250              | .        | .      | .      |
| annual change in % (real)                             | 11.5   | -3.5   | 2.5    | 5.8    | 9.0                | 8.2      | 8.5    | 9.0    |
| Gross industrial production                           |        |        |        |        |                    |          |        |        |
| annual change in % (real)                             | 0.2    | 3.1    | 4.4    | 3.2    | 1.6                | 2.5      | 2.3    | 2.0    |
| Gross agricultural production <sup>3)</sup>           |        |        |        |        |                    |          |        |        |
| annual change in % (real)                             | -16.8  | 12.6   | 12.0   | 4.1    | 2.3                | .        | .      | .      |
| Construction output total                             |        |        |        |        |                    |          |        |        |
| annual change in % (real)                             | 6.3    | 1.7    | -2.2   | -1.3   | 0.5                | .        | .      | .      |
| Employed persons, LFS, th, April                      | 812.0  | 822.0  | 801.0  | 815.7  | 822.4              | 830      | 840    | 850    |
| annual change in %                                    | -1.2   | 1.2    | -2.6   | 1.8    | 0.8                | 0.8      | 0.7    | 0.7    |
| Unemployed persons, LFS, th, April                    | 308.0  | 315.0  | 273.0  | 210.7  | 185.5              | 170      | 155    | 140    |
| Unemployment rate, LFS, in %, April                   | 27.5   | 27.7   | 25.4   | 20.5   | 18.4               | 17.0     | 15.6   | 14.1   |
| Reg. unemployment rate, in %, eop                     | 43.6   | 42.9   | 40.9   | 38.7   | 34.7               | .        | .      | .      |
| Average monthly gross wages, BAM                      | 1,290  | 1,289  | 1,301  | 1,321  | 1,363              | 1,410    | 1,450  | 1,490  |
| annual change in % (real, gross)                      | 0.8    | 1.0    | 2.5    | 0.8    | 1.7                | 1.7      | 1.3    | 1.3    |
| Average monthly net wages, BAM                        | 831    | 830    | 838    | 851    | 879                | 910      | 940    | 970    |
| annual change in % (real, net)                        | 1.3    | 1.0    | 2.6    | 0.7    | 1.9                | 1.7      | 1.3    | 1.3    |
| Consumer prices, % p.a.                               | -0.9   | -1.0   | -1.6   | 0.8    | 1.4                | 1.5      | 1.6    | 1.4    |
| Producer prices in industry, % p.a.                   | -0.5   | 0.6    | -2.1   | 3.0    | 3.5                | 2.1      | 2.1    | 2.1    |
| General governm.budget, nat.def., % of GDP            |        |        |        |        |                    |          |        |        |
| Revenues  | 43.7   | 43.2   | 42.7   | 43.0   | 43.9               | 43.0     | 42.5   | 42.0   |
| Expenditures  | 45.8   | 42.5   | 41.5   | 40.4   | 41.1               | 42.5     | 42.0   | 42.0   |
| Deficit (-) / surplus (+)                             | -2.0   | 0.7    | 1.2    | 2.6    | 2.8                | 0.5      | 0.5    | 0.0    |
| General gov.gross debt, nat.def., % of GDP            | 41.6   | 41.9   | 40.4   | 36.1   | 31.7               | 30.0     | 28.0   | 27.0   |
| Stock of loans of non-fin.private sector, % p.a.      | 1.7    | 2.0    | 3.5    | 7.3    | 5.5                | .        | .      | .      |
| Non-performing loans (NPL), in %, eop                 | 14.2   | 13.7   | 11.8   | 10.0   | 9.4                | .        | .      | .      |
| Central bank policy rate, % p.a., eop <sup>4)</sup>   | .      | .      | .      | .      | .                  | .        | .      | .      |
| Current account, EUR mn <sup>5)</sup>                 | -1,025 | -774   | -711   | -754   | -757               | -794     | -786   | -757   |
| Current account, % of GDP                             | -7.3   | -5.3   | -4.7   | -4.7   | -4.5               | -4.6     | -4.3   | -4.0   |
| Exports of goods, BOP, EUR mn <sup>5)</sup>           | 3,501  | 3,678  | 3,936  | 4,775  | 5,140              | 5,490    | 5,850  | 6,220  |
| annual change in %                                    | 3.0    | 5.1    | 7.0    | 21.3   | 7.6                | 6.8      | 6.5    | 6.4    |
| Imports of goods, BOP, EUR mn <sup>5)</sup>           | 7,527  | 7,355  | 7,546  | 8,551  | 9,060              | 9,520    | 9,990  | 10,460 |
| annual change in %                                    | 7.1    | -2.3   | 2.6    | 13.3   | 6.0                | 5.1      | 4.9    | 4.7    |
| Exports of services, BOP, EUR mn <sup>5)</sup>        | 1,252  | 1,419  | 1,514  | 1,654  | 1,770              | 1,870    | 1,960  | 2,050  |
| annual change in %                                    | 2.4    | 13.3   | 6.7    | 9.2    | 7.0                | 5.5      | 5.0    | 4.6    |
| Imports of services, BOP, EUR mn <sup>5)</sup>        | 395    | 440    | 450    | 500    | 530                | 560      | 590    | 610    |
| annual change in %                                    | 0.8    | 11.2   | 2.3    | 11.0   | 6.1                | 5.0      | 4.6    | 4.0    |
| FDI liabilities, EUR mn <sup>5)</sup>                 | 408    | 345    | 256    | 413    | 450                | .        | .      | .      |
| FDI assets, EUR mn <sup>5)</sup>                      | 7      | 85     | -1     | 83     | 26                 | .        | .      | .      |
| Gross reserves of NB excl. gold, EUR mn <sup>5)</sup> | 3,908  | 4,307  | 4,768  | 5,293  | 5,835              | .        | .      | .      |
| Gross external debt, EUR mn <sup>6)</sup>             | 7,470  | 7,936  | 8,378  | 8,683  | 9,030              | 9,670    | 10,300 | 11,000 |
| Gross external debt, % of GDP <sup>6)</sup>           | 53.4   | 54.3   | 54.8   | 54.1   | 54.0               | 55.6     | 56.7   | 58.1   |
| Average exchange rate BAM/EUR                         | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558             | 1.9558   | 1.9558 | 1.9558 |

1) Preliminary and wiiw estimates. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate from 2017. - 4) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 5) Converted from national currency. - 6) Based on IMF estimates.

Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.