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Bosnia and Herzegovina: landing in the fog

Assessment of current economic developments in Bosnia and Herzegovina (BiH) is hampered by the lack of whole-country indicators. To make matters worse, indicators available for the period starting from October 2008 do not necessarily match other sources of information pertaining to most recent developments. Despite the limited visibility, there is little doubt that the economy is heading for what might be termed 'a forced landing'.

Bosnia and Herzegovina's statisticians do not produce an industrial production index for the country as a whole; instead, they produce two such indices: one for each entity (Federation of BiH and Republika Srpska).¹ These indices have to be taken with a dose of salt; some components reflect nominal (instead of real) changes, thus making it difficult to use them for analysing real sector developments. The index for the Republika Srpska speaks of the entity's industrial production in December 2008 having doubled over December 2007. This has mainly one simple reason: After having been bought by the Russian state company Zarubezhneft, Republika Srpska's refinery company finally resumed production in late November. At the same time, however, most industry groupings recorded a decline (other intermediary goods and capital goods) or a more modest increase (consumer goods). The Federation's aggregate industrial output was, year on year, up by 9.4% in December 2008. Possibly, an index for the whole country, even if calculated at constant prices, would have shown slight annual growth in December 2008. Such a conclusion is, however, put in question by the frequent media reports on lay-offs or reduced working hours in different companies. Industrial output indices for January 2009 leave no doubt about strong decline.

The metal, automotive and wood processing sectors, all lynchpins of the country's industry, are in trouble. If a highly specialized company, such as Metalno Zenica, has full order books, it is deemed worthy of reporting in the media. The government of the Republika Srpska entity spares no effort in announcing its plans to support the business environment, be it funding construction work or supporting the textile sector and metal processing plants such as the alumina factory Birac. Implementing those plans, however, will be a difficult undertaking.

The reduction of activities can be clearly seen in the foreign trade data. In 2008, both exports and imports increased considerably up until July; they remained at a rather high level during the subsequent months, only to plummet in November and December. The foreign trade deficit was relatively low in those two months; this is mostly attributable to the decline in fuel and food prices.

¹ For years now, the EU and international financial institutions have been pushing for more data with country-wide coverage and they have launched several projects to foster improvements, so far with limited success.

Over the next few months, it may prove more difficult to fund the current account deficit. Matters could be exacerbated by a drop in the inflow of remittances, should relatives living abroad have to economize.

A glimpse at the price indices² confirms that developments in BiH do not deviate substantially from events elsewhere: The consumer price index went up until mid-2008, stopped rising in subsequent months only to fall from November onwards. In all likelihood, prices of tradable goods will remain stable or even drop over the next few months. Prices of non-tradable goods and services may not necessarily follow this trend, as prices of public utilities may well increase. Real estate prices have declined by some 30%. Our estimate of approximately zero annual inflation in 2009 differs considerably from others that reckon with an inflation rate of around 5%. We do not regard the latter as very realistic despite the inflationary expectations, which are visible, for example, in the mark-up ceilings introduced for certain products in the Republika Srpska.

Construction boomed throughout most of 2008; even the figures for November 2008 still confirm this. The boom most probably came to an end in December or January. Banks have become more reticent in their lending behaviour. They now take a closer look at the quality of collateral and charge higher risk premia. As in other countries, there was a brief episode in October when clients started withdrawing money from their bank accounts. The central bank responded swiftly and successfully. The announcement of higher deposit guarantees brought relief.

There is every reason to worry about the fiscal situation. A few months ago, the public sector indulged in a round of rewarding its senior executives with higher salaries. Protests from various quarters convinced the parliament of the need to introduce certain revisions in January 2009. Relatively high public sector wages will add to the problems of making ends meet. Economic stagnation in tandem with roughly constant price levels will lead to rather unfavourable developments in terms of government revenues. To some degree, this is already making itself felt, as the Indirect Tax Authority reports. At the same time, it will be difficult to restrict the growth of expenditures. For example, higher unemployment could place the social security system under severe strain. Some segments of it are in trouble already. The public sector may well face difficulties in financing its deficit. The removal of barriers to trade with the European Union has already affected the trade balance and fiscal revenues negatively. In January 2009, tariff revenues were below the level of January 2008. This was foreseeable and had been predicted in a study prepared for the BiH government³ as far back as 2006. At the time, it would have been easy to avoid most of the subsequent negative revenue effects. A display of firmer resolve to improve the business environment could have strengthened the competitiveness of producers of tradables. Exporters are complaining about increased non-tariff barriers in other CEFTA countries. At the same time, reintroducing tariffs on agro-food imports vis-à-vis CEFTA countries has become an issue.

² For BiH as a whole, only a consumer price index is available.

³ Author of the study was Mario Holzner, member of the wiiw staff; he prepared it in the context of a EuropeAid project.

The likely GDP development in terms of expenditure categories may be described as follows: over the next few months, private consumption will decline (or stagnate at best), as employment and the inflow of remittances will decline. Private investment will decline. The government sector will not be able to pursue an anti-cyclical fiscal policy. It is difficult to predict the net impact of foreign trade. In real terms, both exports and imports of goods and services will decline. It is difficult to see strong internal forces pushing for an economic recovery. For 2009, we expect a decline in real GDP, contrary to more optimistic forecasts, viz. that of the EBRD (1.5%). In 2010 and 2011, the economy may reach approximately the same level of output as in 2008. Recession is not likely to mean instability as well. In December, the country's stability was duly respected when Standard and Poor's gave BiH a B+ credit rating along and described the country's future prospects as stable.

A large proportion of the GDP is attributable to the public sector in a broader sense, in that it includes public utilities. The public sector will retain its stability compared to the production of tradables, both in real and nominal terms. EU money and projects funded by international financial institutions will also contribute to stabilizing the economy.

Some of the country's politicians are trying to woo the electorate with populist rhetoric. However, in January 2009 the three top leaders, one from each of the 'constituent peoples', baffled the public with what has since been called the 'Banja Luka agreement'. In essence, it is a territorial restructuring of the country. This sounds like a potential step in the right direction. However, the proof of the pudding is in the eating, and in BiH discussions tend to delay reforms endlessly. Pressure for change comes from the other Balkan countries' rapid rapprochement with the EU. Those citizens who do not have a second passport (from Croatia or Serbia) do not cherish the thought of ending up as the only people still requiring a Schengen visa. Should the constitutional arrangement remain as it is, BiH will hardly qualify for EU candidate status. In addition, the economy will not develop its potential to the full. Initiatives have to come from within BiH; this is the only way to secure close cooperation with the international community, especially the EU. In this context, the new High Representative/Special Representative – Valentin Inzko, possibly – and the new lead persons in the EU delegation will play a key role. The former head of the Directorate of European Integration has moved to Brussels to represent his country vis-à-vis the EU institutions. This will improve the country's standing there, but has created problems at home, as heading up this key institution calls for extensive experience and exceptional skills.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2003	2004	2005	2006	2007	2008 ¹⁾	2009	2010	2011
	Forecast								
Population, th pers., average	3832	3842	3843	3843	3843	3843	.	.	.
Gross domestic product, BAM mn, nom. ²⁾	13442.6	15786.0	16927.9	19121.1	21640.6	24400	24000	23800	24000
annual change in % (real) ²⁾	3.0	6.3	3.9	6.9	6.8	5.0	-1	-1	0
GDP/capita (EUR at exchange rate)	1800	2100	2300	2500	2900	3200	.	.	.
GDP/capita (EUR at PPP - wiiw)	4100	4800	5100	5700	6300	6800	.	.	.
GDP by expend. approach, BAM mn, nom. ²⁾	.	16680.2	18177.6	21151.3	24161.2	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	.	15017.5	16513.9	18064.3	19802.3	.	.	.	.
annual change in % (real) ²⁾	.	.	6.2	4.5	8.3	5	0	-1	0
Gross fixed capital form., BAM mn, nom. ²⁾	.	4044.4	4889.5	4756.8	6382.5	.	.	.	.
annual change in % (real) ²⁾	.	.	18.5	-9.4	27.5	5	-9	0	4
Gross industrial production	.	.	.	.	.	.	.	.	.
annual change in % (real) ³⁾	5.1	12.1	10.8	11.5	6.4	7.5	-5	0	3
Gross agricultural production, total	.	.	.	.	.	.	.	.	.
annual change in % (real)	-8.4	27.7	-0.5	2.3	.	.	.	.	.
Employed persons - LFS, th, April	.	.	.	811.0	849.6	890.2	.	.	.
annual change in %	.	.	.	.	4.8	4.8	.	.	.
Employees total - reg., th, average	635.1	637.2	642.8	653.3	686.1	717.7	.	.	.
annual change in %	0.2	0.3	0.9	1.6	5.0	4.6	.	.	.
Unemployed persons - LFS, th, April	.	.	.	366.8	346.7	272.0	.	.	.
Unemployment rate - LFS, in %, April	.	.	.	31.1	29.0	23.4	27	27	26
Reg. unemployment rate, in %, end of period	41.9	43.2	44.1	44.1	42.5	40.5	.	.	.
Average gross monthly wages, BAM ⁴⁾	717	748	798	869	939	1070	.	.	.
annual change in % (real, net) ⁴⁾⁵⁾	7.3	3.5	3.4	2.3	8.5	6.1	.	.	.
Consumer prices, % p.a. ⁶⁾	1.1	0.8	3.0	6.2	1.5	7.5	-0.5	0	1
Producer prices in industry, % p.a.	.	.	.	.	.	.	.	.	.
General governm.budget, nat.def., % GDP	.	.	.	.	.	.	.	.	.
Revenues	44.8	40.4	42.1	44.9	45.4	45	.	.	.
Expenditures	44.0	38.8	39.6	42.0	44.1	43	.	.	.
Deficit (-) / surplus (+), % GDP	0.8	1.6	2.4	2.9	1.3	2	-1	-1	0
Public debt in % of GDP ⁷⁾	30.2	27.5	27.5	22.9	20.5	20	.	.	.
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn ⁸⁾	-1438.6	-1318.4	-1500.1	-763.5	-1396.5	-1600	-1300	-1100	-1000
Current account in % of GDP	-20.9	-16.3	-17.3	-7.8	-12.6	-12.8	-11	-9	-8
Exports of goods, BOP, EUR mn ⁸⁾	1303.0	1676.9	2059.7	2687.3	3091.6	3450	3000	3100	3260
annual growth rate in %	11.5	28.7	22.8	30.5	15.0	11.6	-13	3	5
Imports of goods, BOP, EUR mn ⁸⁾	4974.1	5354.5	6021.6	6093.0	7233.9	8250	6500	6400	6500
annual growth rate in %	6.0	7.6	12.5	1.2	18.7	14.0	-21	-2	2
Exports of services, BOP, EUR mn ⁸⁾	636.2	696.1	798.6	921.5	994.1	1100	1000	1030	1080
annual growth rate in %	15.2	9.4	14.7	15.4	7.9	10.7	-9	3	5
Imports of services, BOP, EUR mn ⁸⁾	339.2	349.2	352.6	386.6	413.5	450	400	400	410
annual growth rate in %	5.9	3.0	1.0	9.6	7.0	8.8	-11	0	2
FDI inflow, EUR mn ⁸⁾	337.7	566.9	493.1	572.3	1546.2	700	.	.	.
FDI outflow, EUR mn ⁸⁾	.	1.3	0.4	3.2	17.2	0.5	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁹⁾	1428.0	1778.8	2160.0	2787.4	3424.9	3000	.	.	.
Gross external public debt, EUR mn	2052.3	2061.4	2217.9	2081.5	2025.2	2025	.	.	.
Gross external public debt in % of GDP	29.9	25.5	25.6	21.3	18.3	16.2	.	.	.
Average exchange rate BAM/EUR	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/EUR ¹⁰⁾	0.850	0.850	0.857	0.878	0.889	0.928	.	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) From 2004 GDP figures include the Non-Observed Economy (NOE). - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) From 2005 District Brcko included. - 5) wiiw calculation. - 6) Until 2005 costs of living, from 2006 harmonized CPI. - 7) Based on IMF data. - 8) Converted from national currency. - 9) From 2006 including investment in foreign securities. - 10) Benchmark results 2005 from Eurostat and wiiw estimates.

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