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Bosnia and Herzegovina:
relative stability

Bosnia and Herzegovina (BiH) managed to negotiate a stand-by agreement with the IMF. This was no easy undertaking for two main reasons. First, the IMF team relied on the traditional conditionality approach, thus there was no escaping cuts in fiscal expenditures. Secondly, the country's constitutional setting is aimed more at forestalling decisions than facilitating the decision-making process – all agreements require that positive feedback be obtained from simply too many BiH governments (BiH government, entity governments). The stand-by agreement constitutes support for and consolidation of the currency board arrangement, which since 1995 has stood firm as the central pillar of economic stability.

Stability is also the characteristic feature of the price level. Not only did consumer prices not rise during the second half of 2008 and the first five months in 2009, but they even declined slightly over most of that period. In May 2009, the price index was by 2.8% lower compared to October 2008. Real estate prices also dropped. Like everywhere else, stock markets registered a steep decline. The banking sector is predominantly foreign-owned. In the context of the Vienna Initiative, in June the parent banks agreed to abstain from withdrawing major amounts of capital under the condition that the stand-by arrangement with the IMF comes into operation. The latter could take time, as the envisaged cuts in disability allowances to veterans triggered fierce protests.

The increase in industrial output ended abruptly by January 2009, and in the first three months the output was by 3% lower than in the first quarter 2008. The decline was relatively modest given a 13% year-on-year (first quarter 2009) rise in industrial production in the Republika Srpska (RS). In that entity, the re-launch of production in the refinery sector raised the output index in December 2008. On reviewing other segments of the industry, a decline similar to that in the other entity (FBiH, Federation of BiH) is to be observed. It is thus not surprising that RS entrepreneurs have expressed deep discontent with the situation they face. In BiH as a whole, the manufacturing sector has re-aligned much of its pre-war specialization: metals and wood processing, and the metal industry in particular, have had to reduce output drastically. For example, exports of the aluminum producer Aluminij dropped by 60% year-on-year (Q1 2009). Food production, which tends to be affected less by a recession, is weak in BiH; the country's food imports far outstrip exports. Agrifood producers point to the low levels of subsidization compared to neighbouring countries which, they claim, undermine their competitiveness. They maintain, furthermore, that free trade under the CEFTA rules has stripped them of protection. As for agrifood and fishery products (livestock, fresh fish, meat, milk, poultry), in May a trade conflict erupted between BiH and Croatia, with food security arguments being used on both sides to justify import bans. On 18 June, the House of Peoples adopted the

Protection of Domestic Production Act, introducing import tariffs on a number of items from Croatia and Serbia including meat, milk and dairy products. Protests from CEFTA partner countries and the WTO were not successful. Ploys aimed at obstructing trade have become increasingly frequent in the West Balkan region: At a meeting in May, representatives of chambers of commerce from BiH, Croatia and Serbia identified non-tariff barriers of an administrative and technical nature as the largest obstacle to the implementation of CEFTA. The main reason for the poor export performance of BiH, however, is the low proportion of companies that meet internationally certified quality standards. The situation would be better, had the manufacturing sector attracted more foreign investment.

Export figures testify that the country's industry was hard hit by the global economic crisis. Exports declined by 21% in the first quarter of 2009. Imports fell even more, by 24%, so that the trade deficit was unusually low: EUR 780 million compared to EUR 1,050 million one year ago. The value of construction work completed abroad in the first quarter of 2009 was also 32% lower than in the same period of the previous year. The current account deficit, which amounted to EUR 1.9billion in 2008, may come down to about EUR 1.1 billion in 2009. Tourism revenues in the first quarter of 2009 also declined; the trend is likely to continue throughout the current year. The inflow of remittances may also decrease. With regard to capital flows, too, conditions have worsened. The inflow of FDI will remain meagre despite an 8% year-on-year increase in the period January-April 2009. Funds needed for debt servicing purposes are scarce, as a result of which the country's currency reserves on 31 March 2009 were lower than one year previous (EUR 3.1 billion compared to 3.4 billion). Ideally, the current account deficit should fall significantly below one billion euro, as larger gaps might gobble up currency reserves within a few years. BiH will have to find ways and means of securing better balanced current accounts.

Our projection of a 3% decline in GDP in 2009 may create the impression that we consider the recession in BiH to be moderate compared to many other European countries. This is true. However, were it to materialize, that modest decline in GDP would certainly not be attributable to the competitive strength of local producers. It simply means that the contribution of producers of tradables to the GDP is low. Producers of non-tradables, including public utilities and government services, generate a large part of the country's GDP and their output does not fluctuate that much. An engine that would bring the economy back to the growth path is not yet visible – either outside the country or inside it – so that GDP is likely to stagnate, more or less, in 2010 and 2011.

In December 2008, the Government of BiH and the employers' federation agreed on an anti-crisis package. However, implementation is still lacking. In the period October 2008 to April 2009, over 40,000 persons lost their jobs. A further 50,000 persons might be laid off by the end of 2009. Even now, more than one million citizens are considered poor, according to the Coordinating Committee of Charity Organizations.

The government of Republika Srpska is bent on projecting an image of the emphasis it places on business stimulation; it is difficult, however, to distinguish between words and deeds. The Federation (FBiH) government finds it difficult to fund its expenditures (government salaries, social security expenditures etc.). The entity agreed with the IMF to cut its budget by just over EUR 200 million. The uppermost formal level of administration, the BiH government, is too weak to develop firm initiatives. A clear demonstration of that weakness is the government's inability to agree on a candidate to head up the Directorate for European Integration, a position that has been vacant since January 2009. Poor governance also explains the country's low degree of absorption of EU and IFI funds. The political stalemate continues to impinge on the success of the private sector's economic activities, which tend to be strong. Although this makes for stability, it slows down any dynamic. In this way, much of the country's potential remains unexploited. Given that a major violent uproar or outbreak of hostilities is unlikely, BiH will attract but little international attention over the next few years in spite of continuous political quarrels. The High Representative, with his Bonn powers, who at the same time is currently also the EU Special Representative without Bonn powers, will have no easy life. The job may become even more troublesome after the shutdown of the High Representative's Office. Within the country, nationalistic rhetoric serves the ruling elites in masking efforts to protect the sinecures they acquired in the course of the nineties. Outside the country, views regarding an adequate response are split.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	3843	3843	3843	3843	.	.	.	.	.
Gross domestic product, BAM mn, nom.	16927.9	19121.1	21640.6	24400	.	.	23500	23300	23800
annual change in % (real)	3.9	6.9	6.8	5.0	.	.	-3	-1	1
GDP/capita (EUR at exchange rate)	2300	2500	2900	3200	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5100	5700	6300	6700	.	.	.	.	.
GDP by expend. approach, BAM mn, nom.	18177.6	21151.3	24161.2	.	.	.	.	.	.
Consumption of households, BAM mn, nom.	16513.9	18064.3	19802.3	.	.	.	.	.	.
annual change in % (real)	6.2	4.5	8.3	5	.	.	0	-1	0
Gross fixed capital form., BAM mn, nom.	4889.5	4756.8	6382.5	.	.	.	.	.	.
annual change in % (real)	18.5	-9.4	27.5	5	.	.	-9	0	4
Gross industrial production									
annual change in % (real) [2]	10.8	11.5	6.4	11.0	5.3	-2.5	-11	0	3
Gross agricultural production, total									
annual change in % (real)	-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	642.8	653.3	686.1	705.6	699.8	703.8	.	.	.
annual change in %	0.9	1.6	5.0	2.9	3.5	0.6	.	.	.
Unemployed persons - LFS, th, April	.	366.8	346.7	272.0	.	.	.	.	.
Unemployment rate - LFS, in %, April	.	31.1	29.0	23.4	.	.	27	28	27
Reg. unemployment rate, in %, end of period	44.1	44.1	42.5	40.6	42.1	41.2	.	.	.
Average gross monthly wages, BAM [3]	798	869	939	1070	1045	1200	.	.	.
annual change in % (real, net) [3][4]	3.4	2.3	8.5	6.1	7.2	13.1	.	.	.
Consumer prices, % p.a. [5]	3.0	6.2	1.5	7.5	6.4	1.6	-0.5	0	1
Producer prices in industry, % p.a.	.	.	.	.	.	.	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	42.1	44.9	45.4	45	.	.	.	.	.
Expenditures	39.6	42.0	44.1	43	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	2.4	2.9	1.3	2	.	.	-2	-3	-1
Public debt in % of GDP [6]	25.6	22.0	30.5	34.3	.	.	.	.	.
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn [7]	-1500.1	-769.6	-1152.0	-1879.1	-375.6	-156.9	-1100	-900	-1000
Current account in % of GDP	-17.3	-7.9	-10.4	-15.1	.	.	-9	-8	-8
Exports of goods, BOP, EUR mn [7]	2059.7	2687.3	3091.6	3522.0	823.2	652.9	3000	3100	3260
annual growth rate in %	22.8	30.5	15.0	13.9	16.6	-20.7	-15	3	5
Imports of goods, BOP, EUR mn [7]	6021.6	6093.0	7233.6	8341.3	1880.7	1433.9	6500	6400	6500
annual growth rate in %	12.5	1.2	18.7	15.3	26.6	-23.8	-22	-2	2
Exports of services, BOP, EUR mn [7]	798.6	903.9	1062.0	1126.1	231.2	207.9	1000	1030	1080
annual growth rate in %	14.7	13.2	17.5	6.0	13.7	-10.0	-11	3	5
Imports of services, BOP, EUR mn [7]	352.6	375.0	442.7	438.6	78.3	76.9	400	400	410
annual growth rate in %	1.0	6.3	18.0	-0.9	3.3	-1.8	-9	0	2
FDI inflow, EUR mn [7]	493.1	572.3	1546.2	689.5	78.9	27.6	.	.	.
FDI outflow, EUR mn [7]	0.4	3.2	17.2	.	.	.	.	.	.
Gross reserves of NB excl. gold, EUR mn [8]	2160.0	2787.4	3424.9	3218.9	3376.3	3095.8	.	.	.
Gross external debt, EUR mn	2222.6	2085.6	2029.3	2143.8	2002.7	.	.	.	.
Gross external debt in % of GDP	25.7	21.3	18.3	17.2	16.1	.	.	.	.
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 [9]	0.857	0.878	0.889	0.952	.	.	.	.	.

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

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