

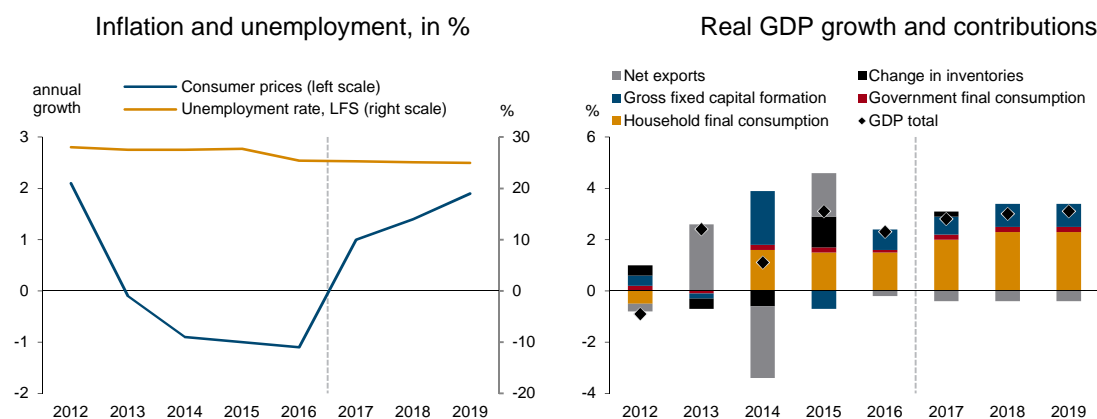


## BOSNIA AND HERZEGOVINA: Growth momentum robust amid political risks

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Growth momentum improved in the second half of 2016, and this should continue in 2017, as a strengthening labour market and rising wages boost private consumption. Industrial output should also post fairly strong growth, helping to underpin an improvement in exports, although this will continue to be held back somewhat by poor infrastructure. The IMF programme will face delays related to political infighting, but should continue to ensure relative fiscal discipline.

**Figure 35 / Bosnia and Herzegovina: Main macroeconomic indicators**



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

**The political situation remains unstable and uncondusive to growth.** Recent elections, including the municipal polls in October 2016, have seen parties with more strongly ethnic, religious and nationalistic agendas gain ground. In January 2017, the Republika Srpska held celebrations for its National Day (which had previously been ruled unconstitutional by the federal constitutional court). The president of the entity, Milorad Dodik, used the opportunity again to discuss openly the prospect of the Republika Srpska's secession from Bosnia and Herzegovina. He said that he would hold a referendum on the issue by the end of 2018. Parts of the national armed forces took part in the celebrations, increasing doubts about the cohesion of the country.

**Mr Dodik has become more assertive in his demands for secession.** In January, he was sanctioned by the previous US administration for defying the constitutional court. Americans now cannot do business with him and any assets he has in the US are frozen (the new US administration may undo the measure, but that is unclear at present). The potential for less EU and US focus on the Western Balkans could mean that Bosnia is at increased risk of instability.

**Growth slowed in 2016, but should pick up again in 2017 as household consumption and investment rise.** After rising by 1.5% in the first half of 2016, growth picked up to 2.4% in the third quarter of the year. It was driven primarily by mining and manufacturing, although in the third quarter agriculture made a significant positive contribution. We estimate full-year growth of 2.3% in 2016, down from 3.1% in the previous year. Growth should rise to 2.8% this year, and around 3% during the rest of the forecast period, primarily driven by household consumption and (to a lesser extent) investment.

**The outlook for private consumption appears relatively positive, and this should be the main driver of growth in 2017-2019.** After dipping during the first half of 2016, retail trade strengthened, reaching an average of 7.3% year on year in the third quarter and 8.2% in the fourth. The labour market looks strong, with total employment rising by 2.7% year on year in November, the fastest growth since 2014. Average net wages increased by 2.5% year on year in November, the most rapid rise since 2011.

**The industrial sector also looks to have good momentum heading into 2017.** Industrial output rose by 4.3% in 2016 as a whole, the strongest growth since 2013. Output gains were led in particular by production of durable consumer goods, which increased by an average of 12.7% in working-day adjusted terms. Energy (+7.5%) and capital goods (+4.6%) also grew strongly. Output was much stronger in the Republika Srpska (+8%) than in the Federation (+2.6%) last year. However, infrastructure deficiencies will continue to hold back a more rapid development of the industrial sector and, consequently, export capacity.

**The Extended Fund Facility (EFF) with the IMF, approved in September 2016 and due to last for three years, includes an ambitious reform programme.** Among the programme's aims are an improvement in the business environment, a shift in the tax burden away from labour, the restructuring and privatisation of state-owned enterprises, an increase in excise taxes on fuel, a reduction in public sector employment and wages, and the construction of the Bosnian section of the Corridor Vc motorway (which will also pass through Hungary and Croatia). Progress on meeting the targets set by the programme is likely to be slow, although incremental improvements can be expected.

**Inflation will turn positive in 2017, rising by 1% for the year as a whole, after falling by 1.1% in 2016.** Inflationary pressures are generally imported from the eurozone due to Bosnia's currency board arrangement with the single currency. Consumer price inflation remains negative, but moderated to -0.3% year on year in November and December 2016. The transport component of the consumer price basket, which largely reflects local energy prices, rose by 0.6% in December, the first positive outturn since early 2014.

**After a surplus in 2015, we expect the budget to fall back into deficit in 2016.** The consolidated budget surplus fell to BAM 278 million in the first half of 2016, compared with BAM 296 million in the same period of 2015. Revenue rose by 2.8%, while expenditure was up 2.4% compared to the same period of the previous year. The budget typically posts a large deficit in the fourth quarter of the year.

According to the IMF, fiscal numbers were largely in line with targets up to the end of the third quarter. Over the forecast period, we expect budget shortfalls slightly narrower than 1% of GDP. IMF funding could free up greater resources for capital spending.

**The IMF programme is likely to face delays and setbacks.** A failure to raise excise taxes on fuel in line with the timeframe stipulated by the IMF EFF caused a delay to the disbursement of the second IMF tranche (worth around EUR 80 million) which had been due in January (and also a delay to a European Bank for Reconstruction and Development loan for Corridor Vc). Press reports in February indicated that a further delay was likely. IMF payments under previous programmes have often been delayed because of a failure to meet stipulated targets.

**The banking sector continues to struggle, with non-performing loans (NPLs) still high and credit demand weak.** Central bank data show the level of credit to domestic non-financial corporations growing by 2.7% year on year in January-November 2016, while credit to other residents (mainly households) increased by 3.3%. Asset quality has improved somewhat, with NPLs at 8.8% of total gross loans in the third quarter of 2016, down from 10.4% a year earlier.

**Bosnia's external shortfall contracted by 22% in the first three quarters of 2016.** This was driven in particular by a BAM 245 million reduction in the merchandise goods deficit on the back of lower energy prices. The reduction in the current account deficit was mirrored by a fall in external financing, particularly net foreign direct investment (FDI) inflows, which dropped by BAM 155 million over the period. The current account deficit is a function of the large goods shortfall, which is partly offset by surpluses on the services and secondary income (remittances) accounts. Net FDI inflows covered just 25% of the current account deficit in January-September 2016, the lowest at this stage of the year since 2012. Other investment, chiefly loans, covered 102% of the current account shortfall.

**We estimate that the current account deficit narrowed to 4.5% of GDP in 2016, from 6% in the previous year.** The external shortfall is expected to widen again to 5.8% in 2017 as oil prices pick up, and to remain at a similar level in 2018-2019. Poor infrastructure will prevent a significant narrowing of the merchandise goods shortfall during the forecast period.

**Bosnia will continue to rely primarily on loans to fund the deficit, although risks associated with this are mitigated by the fact that most lending is concessional and of a long-term maturity.** Government external debt reached BAM 8.8 billion in the third quarter of 2016 (just over 30% of estimated full-year GDP). We estimate total external debt equivalent to 54.8% of GDP in 2016. Net foreign reserves reached an average of BAM 9.2 billion in the third quarter of 2016, equivalent to over five months of import cover, supporting the stability of the currency board arrangement.

**In summary, we expect the recent pick-up in growth momentum to be sustained during the forecast period.** We forecast real GDP growth of 2.8% this year, rising to 3% in 2018 and 3.1% in 2019. Growth will still be primarily supported by private consumption, underpinned by rising wages and a strengthening labour market. Investment will also contribute positively. With export capacity likely to be held back by infrastructure weakness, the current account deficit will remain large.

**Table 6 / Bosnia and Herzegovina: Selected economic indicators**

	2012	2013	2014	2015	2016 <sup>1)</sup>	2017 Forecast	2018 Forecast	2019
Population, th pers., mid-year <sup>2)</sup>	3,836	3,832	3,827	3,819	3,816	3,820	3,818	3,815
Gross domestic product, BAM mn, nom. <sup>3)</sup>	26,193	26,743	27,304	28,659	29,000	30,100	31,400	33,000
annual change in % (real)	-0.9	2.4	1.1	3.1	2.3	2.8	3.0	3.1
GDP/capita (EUR at PPP) <sup>3)</sup>	7,300	7,500	7,700	8,100	8,300	.	.	.
Consumption of households, BAM mn, nom. <sup>3)</sup>	22,334	22,521	22,830	23,143	23,300	.	.	.
annual change in % (real)	-0.7	0.0	1.9	1.7	1.9	2.5	2.8	2.9
Gross fixed capital form., BAM mn, nom. <sup>3)</sup>	4,783	4,714	5,234	5,024	5,200	.	.	.
annual change in % (real)	2.2	-1.0	11.7	-3.5	4.5	4.0	5.0	5.0
Gross industrial production								
annual change in % (real)	-3.9	5.2	0.2	3.1	4.4	5.0	5.3	5.1
Gross agricultural production <sup>4)</sup>								
annual change in % (real)	-10.0	15.3	0.0	5.0	2.0	.	.	.
Construction output total								
annual change in % (real)	-3.1	-2.4	6.8	-3.2	-0.3	.	.	.
Employed persons, LFS, th, April	813.7	821.6	812.0	822.0	801.0	810	820	830
annual change in %	-0.3	1.0	-1.2	1.2	-2.6	0.8	1.1	1.1
Unemployed persons, LFS, th, April	316.6	311.5	308.0	315.0	273.0	274	275	276
Unemployment rate, LFS, in %, April	28.0	27.5	27.5	27.7	25.4	25.3	25.1	25.0
Reg. unemployment rate, in %, end of period	44.6	44.5	43.6	42.9	41.0	.	.	.
Average monthly gross wages, BAM	1,290	1,291	1,290	1,289	1,301	1,320	1,350	1,390
annual change in % (real, gross)	-0.5	0.2	0.8	1.0	2.0	0.8	1.1	1.1
Average monthly net wages, BAM	826	827	831	830	838	850	870	900
annual change in % (real, net)	-0.8	0.2	1.3	1.0	2.0	1.0	1.0	1.0
Consumer prices, % p.a.	2.1	-0.1	-0.9	-1.0	-1.1	1.0	1.4	1.9
Producer prices in industry, % p.a.	0.3	-1.8	-0.5	0.6	-2.3	1.8	1.9	2.1
General governm. budget, nat. def., % of GDP								
Revenues	43.8	42.7	43.8	43.2	43.5	45.2	45.4	45.4
Expenditures	45.8	44.8	45.8	42.6	44.5	46.0	46.2	46.3
Deficit (-) / surplus (+)	-2.0	-2.2	-2.0	0.7	-1.0	-0.8	-0.8	-0.9
Public debt, nat. def., % of GDP <sup>5)</sup>	44.3	43.5	44.0	45.0	45.2	44.9	44.7	44.5
Stock of loans of non-fin. private sector, % p.a.	3.1	2.9	1.7	2.0	2.6	.	.	.
Non-performing loans (NPL), in %, Dec	13.5	15.1	14.2	13.7	12.0	.	.	.
Central bank policy rate, % p.a., end of period <sup>6)</sup>	.	.	.	.	.	.	.	.
Current account, EUR mn <sup>7)</sup>	-1,160	-723	-1,029	-833	-890	-890	-915	-960
Current account, % of GDP <sup>7)</sup>	-8.7	-5.3	-7.4	-5.7	-6.0	-5.8	-5.7	-5.7
Exports of goods, BOP, EUR mn <sup>7)</sup>	2,988	3,286	3,385	3,562	3,550	3,720	3,920	4,160
annual change in %	1.2	10.0	3.0	5.3	-0.3	4.9	5.5	6.1
Imports of goods, BOP, EUR mn <sup>7)</sup>	7,079	7,027	7,527	7,355	7,400	7,700	8,050	8,470
annual change in %	-0.1	-0.7	7.1	-2.3	0.6	4.0	4.6	5.2
Exports of services, BOP, EUR mn <sup>7)</sup>	1,349	1,334	1,365	1,484	1,480	1,560	1,660	1,760
annual change in %	0.4	-1.1	2.3	8.8	-0.3	5.6	6.1	5.9
Imports of services, BOP, EUR mn <sup>7)</sup>	404	385	385	423	425	450	480	510
annual change in %	1.2	-4.7	0.1	9.9	0.4	5.0	6.0	6.0
FDI liabilities, EUR mn <sup>7)</sup>	305	239	392	264	250	.	.	.
FDI assets, EUR mn <sup>7)</sup>	46	64	6	43	50	.	.	.
Gross reserves of NB excl. gold, EUR mn	3,246	3,530	3,908	4,307	4,768	.	.	.
Gross external debt, EUR mn <sup>5)</sup>	6,991	7,138	7,245	7,825	8,125	8,250	8,400	8,550
Gross external debt, % of GDP <sup>5)</sup>	52.2	52.2	51.9	53.4	54.8	53.6	52.3	50.7
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96

1) Preliminary and wiiw estimates. - 2) According to census 1991. - 3) According to ESA'95 (FISIM not yet reallocated to industries). - 4) Based on UN-FAO data, from 2014 wiiw estimate. - 5) Based on IMF estimates. - 6) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 7) Converted from national currency.

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