

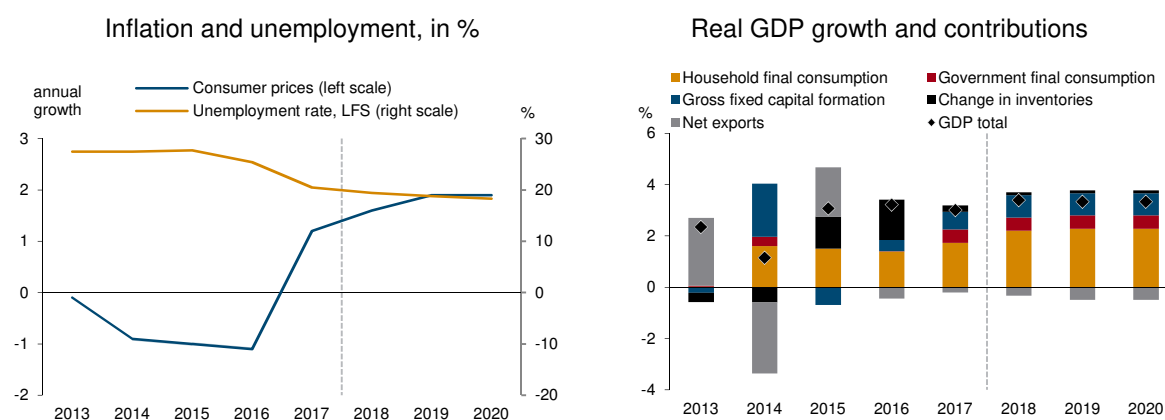


BOSNIA AND HERZEGOVINA: Positive external conditions driving growth

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The economy is benefiting from highly supportive external conditions, which are driving strong growth of remittances and exports. These trends should continue this year, and feed through to higher domestic employment and private consumption growth. The political situation remains problematic, and is unlikely to change before the upcoming election. During the forecast period, the economy should grow in the 3.5% per year range.

Figure 42 / Bosnia and Herzegovina: Main macroeconomic indicators



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

The economy performed well on the back of supportive external factors in 2017, and we expect these conditions to remain firmly in place this year. High frequency indicators suggest a strong end to 2017, with industrial output, merchandise exports, tourism arrivals and retail trade volumes all maintaining high growth rates. After estimated 3% growth in 2017, we expect the economy to expand by around 3.5% this year, and at a similar rate during the rest of the forecast period.

External developments have been crucial in supporting growth, and this will remain the case during 2018 at least. Economic activity was notably strong in the eurozone – a key market for Bosnia and Herzegovina (BiH) – last year, above all as a result of boom-like conditions in Germany. Sentiment indicators for the single currency area suggest a further firming of positive momentum in recent months. Bosnian nominal merchandise exports rose by an average 17.4% year on year in 2017, helping to drive

a 3.2% increase in industrial output. Export growth has been notably strong to nearby markets, especially Croatia and Slovenia, as well as others in the Western Balkans. This is a positive development, given that regional growth has generally been subdued in the period since the global financial crisis.

The tourism sector is booming, driving up services export values. Total tourism arrivals increased by an average 12.3% year on year in January-November 2017, including a 16.5% increase in visitors from abroad. The main sources of tourists remain nearby countries; the four most popular tourism sources in 2017 were Croatia, Serbia, Turkey and Italy. However, notably strong growth last year was recorded from non-European sources including China (+123% year on year in January-November) and Saudi Arabia (+37%).

Strong external trends have fed through to much better domestic employment conditions, and this trend looks set to continue during the forecast period. Although it continues to suffer from major structural deficiencies, the labour market is improving quite significantly, with the unemployment rate falling fast. BiH's registered unemployment rate stood at 38.7% in November 2017 according to the statistics agency, a 2.2 percentage point improvement compared with a year earlier. Employment growth is likely to have been over 3% in 2017. Manufacturing has accounted for around half of recent job growth. By contrast, construction activity – which tends to be labour intensive – was relatively subdued in 2017, and political bottlenecks remain a risk for construction activity during the forecast period (see below). Nevertheless, our core view is that further disbursements of external funding and rising economic activity should spur a gradual recovery in construction in the coming years.

Robust growth in the external sector has seen the economy's structure start to shift, with exports rising as a share of GDP. Moreover, the structure of goods exports is becoming more diversified, with industries including machinery and mechanical appliances and transport equipment accounting for a greater share of the total. However, private consumption will remain the main driver of growth during the forecast period, owing to positive employment and wage growth, and its large share of overall economic activity. Consumption has benefited from strong external conditions, including remittance inflows and better employment and earnings growth on the back of rising exports. Retail trade volumes rose by an average 5.1% year on year in 2017.

Despite rising employment and wages, economic confidence remains fairly weak, which could limit consumer spending during the forecast period. According to the 2017 Balkan Barometer, only 19% of Bosnians thought that their financial situation would improve in the next 12 months, and only 15% were optimistic about the state of the economy over the same period (both were the lowest levels in the region). 73% of Bosnian respondents felt that unemployment was one of the two most important issues facing the economy (the highest in the region).

Major slack in the labour market will continue to contribute to historically low inflation rates during the forecast period. Price growth in BiH averaged 1.4% in 2017, reflecting the lack of upward pressure on prices across the eurozone. Some further short-term upward pressure on prices could come from energy costs, but this will not be long-lasting; behind that, core inflation is likely to remain subdued. While the labour market is improving, it is far from tight, indicating that demand-pull pressure on prices will remain very muted.

Growth in 2017 was negatively impacted by a delay to the disbursement of the next tranche of IMF funding, and further delays are fairly likely during the forecast period. BiH signed a three-year programme with the IMF in September 2016. However, the IMF delayed the release of the second tranche in May 2017, owing to a failure of the Bosnian authorities to meet the necessary conditions. In December 2017, the IMF announced that it had reached a staff-level agreement with BiH to release the next tranche (subject to fulfilment of outstanding conditions). We expect the IMF programme to remain in place, although future disbursements may also be subject to delays.

Beyond 2018, we expect growth to remain in the 3-3.5% per year range. This will be driven primarily by private consumption, which accounts for the majority of overall GDP. Foreign demand will also contribute, although 2017-18 is likely to mark the peak of the economic cycle in the eurozone. Investment growth will be positive, although the contribution of investment to overall GDP growth will rely on disbursements of official funding from external sources, which could be delayed owing to political developments. The potential for further delays represents the biggest downside risk to our growth forecasts. On the flipside, better-than-expected progress on reforms to unlock official funding represent the best chance of increasing BiH's growth rate to 4% or above.

Rising exports will not significantly change current account dynamics, with the external deficit set to remain large during the forecast period. Strong growth of exports and remittances has provided important support for the external accounts, although the large absolute size of imports will keep the deficit elevated. Moreover, imports should pick up on the back of rising private consumption growth this year, and higher investment during the forecast period. The deficit should continue to be largely covered by concessional funding and FDI, reducing stability risks.

Politically, conditions remain generally unsupportive of economic growth, and there is a potential for additional volatility in the run-up to the general election in October. Although officially the campaign has not yet started, in practice it is already underway. This on its own is unlikely to significantly derail growth; economic agents in BiH are well used to political noise and should ride it out. More of an issue is that in the Republika Srpska, long-standing President Milorad Dodik has to step down having served two terms, and the battle over who will succeed him could be destabilising (it is not yet clear whether Mr Dodik will run for the Serb position in BiH's tripartite presidency).

The most significant political issue is the current stalemate over proposed changes to the Federation's electoral law. Bosnian Croats in the Federation are demanding a new electoral law to prevent the possibility of Bosniaks electing Croat representatives. In practice, this would mean dividing the whole Federation into ethnically-based electoral units, which is resisted by most Bosniaks. Without a new law, however, it may not be possible to form the House of Peoples (the upper chamber) either in the Federation or at the state level after the election. The possibility that the elections could be postponed, prolonging political deadlock and potentially further delaying the release of tranches of IMF funding, cannot be ruled out.

Table 12 / Bosnia and Herzegovina: Selected economic indicators

	2013	2014	2015	2016	2017 ¹⁾	2018	2019	2020
						Forecast		
Population, th pers., mid-year ²⁾	3,531	3,526	3,518	3,511	3,510	3,506	3,503	3,499
Gross domestic product, BAM mn, nom. ³⁾	26,779	27,359	28,586	29,900	31,200	32,800	34,500	36,300
annual change in % (real)	2.3	1.1	3.1	3.1	3.0	3.4	3.3	3.3
GDP/capita (EUR at PPP) ³⁾	8,100	8,300	8,700	9,000	9,300	.	.	.
Consumption of households, BAM mn, nom. ³⁾	22,521	22,830	23,157	23,538	24,350	.	.	.
annual change in % (real)	0.0	1.9	1.8	1.7	2.2	2.8	2.9	2.9
Gross fixed capital form., BAM mn, nom. ³⁾	4,808	5,330	5,097	5,189	5,460	.	.	.
annual change in % (real)	-1.2	11.5	-3.5	2.5	4.0	5.0	5.0	5.0
Gross industrial production								
annual change in % (real)	5.2	0.2	3.1	4.4	3.1	3.3	3.0	2.8
Gross agricultural production ⁴⁾								
annual change in % (real)	15.2	-14.2	5.0	2.0	3.0	.	.	.
Construction output total								
annual change in % (real)	-2.4	6.8	-3.2	-1.0	-2.1	.	.	.
Employed persons, LFS, th, April	821.6	812.0	822.0	801.0	815.7	830	840	850
annual change in %	1.0	-1.2	1.2	-2.6	1.8	1.8	1.5	1.3
Unemployed persons, LFS, th, April	311.5	308.0	315.0	273.0	210.7	200	195	190
Unemployment rate, LFS, in %, April	27.5	27.5	27.7	25.4	20.5	19.4	18.8	18.3
Reg. unemployment rate, in %, eop	44.5	43.6	42.9	40.9	38.8	.	.	.
Average monthly gross wages, BAM	1,291	1,290	1,289	1,301	1,320	1,360	1,400	1,440
annual change in % (real, gross)	0.2	0.8	1.0	2.0	0.3	1.1	0.9	0.8
Average monthly net wages, BAM	827	831	830	838	850	870	900	930
annual change in % (real, net)	0.2	1.3	1.0	2.0	0.2	1.0	1.0	0.9
Consumer prices, % p.a.	-0.1	-0.9	-1.0	-1.1	1.2	1.6	1.9	1.9
Producer prices in industry, % p.a.	-1.8	-0.5	0.6	-2.1	3.0	1.8	2.1	2.1
General governm. budget, nat. def., % of GDP								
Revenues	42.6	43.7	43.2	42.7	42.5	42.7	42.9	43.2
Expenditures	44.8	45.8	42.5	41.5	41.5	41.7	42.5	42.9
Deficit (-) / surplus (+)	-2.2	-2.0	0.7	1.2	1.0	1.0	0.4	0.3
General gov. gross debt, nat. def., % of GDP ⁵⁾	37.6	41.6	41.9	40.5	40.8	39.9	39.6	39.7
Stock of loans of non-fin. private sector, % p.a.	2.9	1.7	2.0	3.5	7.4	.	.	.
Non-performing loans (NPL), in %, eop	15.1	14.2	13.7	11.8	10.7	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾
Current account, EUR mn ⁷⁾	-728	-1,033	-826	-776	-740	-773	-804	-844
Current account, % of GDP ⁷⁾	-5.3	-7.4	-5.7	-5.1	-4.6	-4.6	-4.6	-4.5
Exports of goods, BOP, EUR mn ⁷⁾	3,397	3,501	3,678	3,935	4,350	4,590	4,870	5,170
annual change in %	9.5	3.0	5.1	7.0	10.5	5.5	6.1	6.1
Imports of goods, BOP, EUR mn ⁷⁾	7,027	7,527	7,355	7,535	8,060	8,450	8,890	9,350
annual change in %	-0.7	7.1	-2.3	2.4	7.0	4.8	5.2	5.2
Exports of services, BOP, EUR mn ⁷⁾	1,223	1,253	1,378	1,436	1,540	1,630	1,730	1,830
annual change in %	-1.0	2.5	9.9	4.3	7.2	6.1	5.9	5.9
Imports of services, BOP, EUR mn ⁷⁾	392	401	445	457	470	500	530	570
annual change in %	-2.2	2.1	11.2	2.7	2.7	6.0	6.0	7.0
FDI liabilities, EUR mn ⁷⁾	239	408	334	247	320	.	.	.
FDI assets, EUR mn ⁷⁾	64	7	85	6	30	.	.	.
Gross reserves of NB excl. gold, EUR mn	3,530	3,908	4,307	4,768	5,293	.	.	.
Gross external debt, EUR mn ⁵⁾	7,092	7,470	7,936	8,378	8,645	9,077	9,622	10,199
Gross external debt, % of GDP ⁵⁾	51.8	53.4	54.3	54.8	54.2	54.1	54.5	55.0
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 census October 2013. - 3) According to ESA'10 (FISIM not yet reallocated to industries). - 4) Based on UN-FAO data, from 2015 wiiw estimate. - 5) Public debt, 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.