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Bosnia and Herzegovina: The choice between take-off and slow growth

In previous forecasts, we predicted that in the case of Bosnia and Herzegovina (BiH) the international financial and economic crisis would trigger a relatively modest GDP decline. In fact, the GDP fell by 2.9% in 2009 and stabilized on that lower level in 2010 (our estimate is 0.8% growth). Regarding resumption of growth, we took a rather cautious stance – and still keep doing so (by predicting 2.8% growth in 2011 and 3% in the two subsequent years). The key question is which forces could initiate the return to a path of high growth.

The banking sector's focus switched from credit expansion to the collection of receivables. The sector is stable, whereas the micro credits industry is in deep trouble. Remittances from abroad have stabilized on a lower level; all levels of government as well as enterprises in the public utilities sphere were confronted with unexpectedly low revenues and had to economize on the expenditure side. Private investment dropped. As a result, employment has declined and unemployment rose. The number of poor has increased considerably. All this started in 2009 and became fully visible in 2010.

In 2010, signs of recovery became visible too, namely in that relatively small segment of the BiH economy which produces tradable goods. On international markets, the demand for metals and metal products and some other materials went up, something that provoked a boom in the country's exports. They rose by 25%. Imports rose too, but merely by somewhat less than 10%, while domestic income remained almost stagnant – the value-added creation of the export sector is too small to provoke a larger immediate move of the whole economy.

There are some burdens the country will have to live with for long time. One is the ratio between the number of persons with regular employment, which is low, and the number of retired persons, which is huge. An imbalance between the number of persons of working age and the availability of workplaces provokes high unemployment. The crisis has led to deterioration. Other burdens would be removable in the case of good-will of the main players. A new constitution could make the public sector less complicated, less costly and

much more efficient and transparent. Ample space for reforms would also be in the field of business environment. A good example is the agrifood sector. Currently, net imports of agricultural products and processed food are high. Because institutional backstopping is lacking, the products of BiH farmers and food processors have very limited access to foreign markets. They do not have enough power to enforce a change, so they are scared about the recent removal of tariffs for EU food in the context of the Stability and Association Agreement. Repeatedly, international comparisons have confirmed that the business environment in BiH is less favourable than in many other countries. It is not supportive to business start-ups by domestic persons, and the country could be made more attractive to foreign investors in the manufacturing sector.

A good example for inertia, which is a common feature of West Balkan countries, has become visible in the CEFTA context. Under pressure from outside – especially the EU – the countries signed a free-trade agreement several years ago. To be able to continue with the protection of domestic interests, the governments kept non-tariff barriers untouched or made even stronger use of them than previously. A key barrier is non-recognition of the partner countries' certificates. Recently, BiH and Serbia have decided to take a pioneer role. They plan to introduce mutual recognition through a bilateral agreement.

In the elections of last October, a considerable part of the electorate expressed a wish for change. It was clear from the beginning that forming a new government on the state level would be difficult and time-consuming. In early March 2011, the old government was still running the show. From the very beginning, the social democrats, backed by many more votes than previously, have insisted on a joint programme as precondition for forming a coalition. The potential partners kept rejecting this approach, which for BiH would be a novelty. Soon, politicians and political parties got involved in power struggles, which they try to sell to the public as a fight for justice in ethnicity terms. This has led to a deadlock. The international community is concerned, and interventions are manifold, high-ranking German and US government representatives included. The influence of central government bodies is at stake: it was extremely limited from the very beginning, and it took a lot of efforts to pep it up, to some degree at least, over the last 15 years. The situation has invited the two entities, the Federation of BiH and Republika Srpska, to dominate the scene and expand their influence. Republika Srpska has managed to make use of this opportunity, whereas in the Federation, forming a government has proved as similarly difficult as on the central level. For the time being, those BiH citizens who have not disposed of their Croat or Serb passport feel relief after having got the right of visa-free travel to Schengen countries.

Where are the forces that could trigger a strong business upswing? Private consumption is not likely to become the engine of growth in the near future, as unemployment will remain high, wage growth will remain low and remittances from abroad are not likely to rise. We can count with a continuation of export growth, as we can see from favourable January 2011 data, but its GDP impact will remain moderate due to reasons mentioned above. The various governments (central, entity/canton levels) will hardly be in a position to expand their expenditures largely. The remaining potential engine of growth resumption is private investment. To activate it, the governments on the different state levels would need to join forces to improve the business environment substantially. This should create better conditions for exports of goods and services with high value-added content and be supportive to the establishment of a regime of barrier-free intra-CEFTA trade. The fact that something, but not very much, will happen in this direction is the background for our forecast of 2.8% GDP growth in 2011 and 3% thereafter. Inflation will remain low and unemployment high. The current account in percent of GDP will not return to previous high levels.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2005	2006	2007	2008	2009	2010 ¹⁾	2011	2012	2013
								Forecast	
Population, th pers., average	3843	3843	3843	3842	3843	3843	3843	3843	3842
Gross domestic product, BAM mn, nom. ²⁾	17127.4	19252.5	21760.2	24702.5	23994.1	24690	25500	26500	27600
annual change in % (real) ²⁾	3.9	6.1	6.2	5.7	-2.9	0.8	2.2	3	3
GDP/capita (EUR at exchange rate)	2300	2500	2900	3300	3200	3300	3400	3500	3700
GDP/capita (EUR at PPP - wiiw)	5200	5700	6300	6600	6300	6400	.	.	.
GDP by expend. approach, BAM mn, nom. ²⁾	18338.2	21366.1	24689.1	28106.1	27427.5	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	16513.9	18064.3	19911.3	22451.3	21528.4	21980	.	.	.
annual change in % (real) ²⁾	6.2	4.5	5.9	5.9	-4.2	0	1	2	2
Gross fixed capital form, BAM mn, nom. ²⁾	4889.5	4756.8	6446.4	7521.0	5638.0	5760	.	.	.
annual change in % (real) ²⁾	18.5	-9.4	28.8	10.9	-24.0	0	2	5	5
Gross industrial production ³⁾									
annual change in % (real)	10.8	11.5	6.4	11.0	-3.3	1.6	7	10	10
Gross agricultural production									
annual change in % (real)	0.0	3.2	-1.6	.	.	.	.	.	.
Employed persons - LFS, th, April	.	811.0	849.6	890.2	859.2	842.8	840	845	850
annual change in %	.	.	4.8	4.8	-3.5	-1.9	-0.3	0.6	0.6
Employees total - reg., th, average	642.8	653.3	686.1	705.6	697.6	685	685	690	700
annual change in %	0.9	1.6	5.0	2.9	-1.1	-1.8	0.0	0.7	1.4
Unemployed persons - LFS, th, April	.	366.8	346.7	272.0	272.3	315.1	315	310	300
Unemployment rate - LFS, in %, April	.	31.1	29.0	23.4	24.1	27.2	27	27	26
Reg. unemployment rate, in %, end of period	44.1	44.1	42.5	40.6	42.4	43	43	42	42
Average gross monthly wages, BAM	796	869	954	1113	1204	1215	1250	1300	1400
annual change in % (real, net)	3.4	2.3	8.4	8.4	5.6	-0.9	.	.	.
Consumer prices, % p.a.	3.0	6.2	1.5	7.5	-0.4	2.1	1	1	1
Producer prices in industry, % p.a.	.	.	.	.	.	.	.	.	.
General government budget, nat. def., % GDP									
Revenues	41.6	44.6	45.2	44.1	43.1	42.5	43.0	44.0	44.0
Expenditures	39.2	41.7	44.0	46.3	47.6	47.0	46.5	46.5	46.0
Deficit (-) / surplus (+)	2.4	2.9	1.2	-2.2	-4.5	-4.5	-3.5	-2.5	-2.0
Public debt, nat. def., in % of GDP ⁴⁾	25.6	22.0	29.8	30.8	33.4	36	38	39	40
Central bank policy rate, % p.a., end of period ⁵⁾
Current account, EUR mn ⁶⁾	-1499.6	-783.5	-1190.6	-1819.0	-840.0	-900	-900	-800	-800
Current account in % of GDP	-17.1	-8.0	-10.7	-14.4	-6.8	-7.1	-7	-6	-6
Exports of goods, BOP, EUR mn ⁶⁾	2059.7	2687.2	3091.5	3522.0	2920.2	3650	4000	4400	4850
annual growth rate in %	22.8	30.5	15.0	13.9	-17.1	25	10	10	10
Imports of goods, BOP, EUR mn ⁶⁾	6021.5	6092.9	7233.6	8344.6	6326.6	6900	7250	7600	7950
annual growth rate in %	12.5	1.2	18.7	15.4	-24.2	9	5	5	5
Exports of services, BOP, EUR mn ⁶⁾	798.5	904.3	1061.7	1125.6	1002.3	950	1050	1150	1260
annual growth rate in %	14.7	13.2	17.4	6.0	-11.0	-5	11	10	10
Imports of services, BOP, EUR mn ⁶⁾	352.4	369.9	422.3	482.7	453.3	420	440	460	490
annual growth rate in %	1.0	4.9	14.2	14.3	-6.1	-7	5	5	7
FDI inflow, EUR mn ⁶⁾	493.1	610.9	1519.8	636.3	176.8	200	220	300	400
FDI outflow, EUR mn ⁶⁾	0.4	3.2	20.5	9.2	-6.7	0	0	0	0
Gross reserves of NB excl. gold, EUR mn ⁷⁾	2160.0	2787.4	3424.9	3218.9	3143.8	3267.6	.	.	.
Gross external debt, EUR mn ⁸⁾	2217.9	2081.5	2025.4	2168.0	2676.2	3195.2	.	.	.
Gross external debt in % of GDP	25.3	21.1	18.2	17.2	21.8	25.3	.	.	.
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR ⁹⁾	0.8576	0.8751	0.9007	0.9698	0.9897	1.0003	0.95	0.95	0.95

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices). - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) Based on IMF data. - 5) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 6) Converted from national currency with the average exchange rate. - 7) Including investment in foreign securities. - 8) Gross external public debt. - 9) Benchmark results 2005 from Eurostat and wiiw estimates.

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