

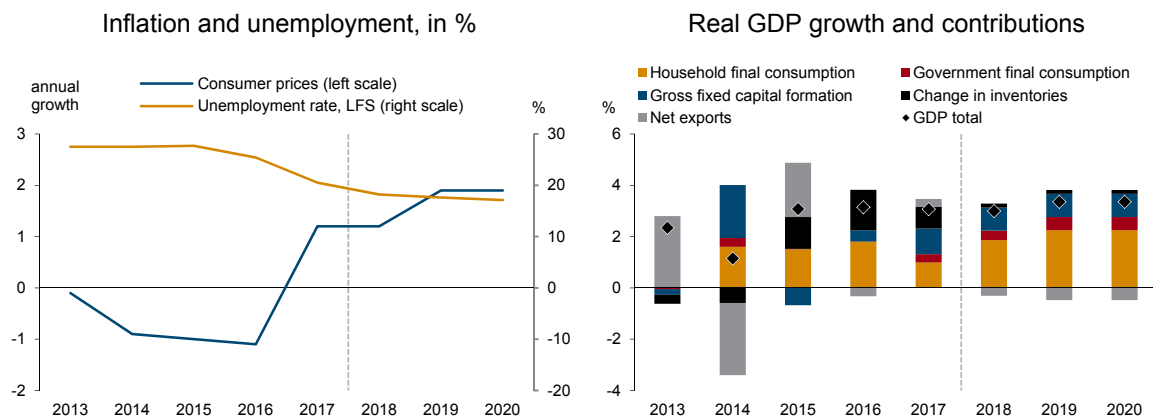


BOSNIA AND HERZEGOVINA: Elevated political risk unlikely to derail growth

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Political risk is unusually high following the recent election, and in particular the potential for a constitutional crisis in the Federation. This will have an impact on reforms and policy-making, but shouldn't impact growth too much. We think that growth will remain in the range of 3-3.5% during the forecast period, with external factors such as remittances, exports and tourism likely to remain important. Inflation will stay low, while the labour market will improve slowly.

Figure 38 / Bosnia and Herzegovina: Main macroeconomic indicators



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

The outcome of the election on 7 October was inconclusive, and as such is unlikely to ease the political crisis in Bosnia and Herzegovina (BiH). Voters went to the polls to elect a new parliament, assemblies in both entities, ten cantonal assemblies in the Federation, and the three-member national presidency. In total 518 positions were up for election. Milorad Dodik, the nationalist president of the Republika Srpska, looks to have won the Serb seat in the tripartite national presidency. He is likely to use his position to continue to push for the separation of Republika Srpska from the rest of BiH. Šefik Džaferović won the Bosniak seat, and Željko Komšić the Croat seat.

Political noise around elections is nothing new in BiH, but a particular issue this time is whether the results in the Federation will be accepted, and this could prolong political stasis for some time. As a result, we think that political risks in the country are even higher than is normally the case. Currently there is no legal basis for the election of the Federation's House of Peoples, meaning that a constitutional crisis is possible. Whatever happens, this will hamper efforts to form a new government at both the Federation and national level. In addition to this constitutional uncertainty, there were allegations of fraud and manipulation in the election. Heightened political risk in the region, related to discussions over a possible land swap between Serbia and Kosovo, could also have big implications for Bosnia and Herzegovina.

Broad financial and macroeconomic stability looks relatively secure for now. The major rating agencies have not changed their assessments of BiH, indicating that political noise is already baked into foreign investor expectations (despite some fiscal loosening ahead of the election). Most of the funding for the country's large current account deficit is concessional and long-term in nature, further reducing stability risks. The IMF postponed disbursements under the Extended Fund Facility (EFF) programme earlier this year, reflecting pre-election reform stasis. It is likely that it will take some time to restart the EFF programme, but this is not necessarily a big problem, at least from the perspective of fiscal sustainability. The bigger issue around the EFF is that it is an important stability and reform anchor, but we expect it to eventually resume.

The economy is doing reasonably well, and this should continue into 2019, with growth set to remain in the 3-3.5% range during the forecast period. Private consumption will be the main driver, helped by rising wages and its particularly large share in overall GDP. High-frequency indicators suggest good underlying momentum, with industrial production, retail sales and construction output all growing at healthy rates. Meanwhile inflation remains low, and this is likely to remain the case (in line with eurozone trends), providing further support for real income growth.

External factors have been particularly supportive in driving growth in recent years, which has been important given generally subdued trends in domestic consumption and investment. As a result of this, the economy has become more open, with exports of goods and services now accounting for around 40% of GDP, from 25% in 2009. Latest data indicate that this is continuing: nominal euro-denominated merchandise exports increased by an average 13% year on year in the 12 months to August, with total tourist nights up 14.2% over the same period. Remittances have also risen strongly.

The importance of external factors for driving growth insulates the economy somewhat from domestic political noise. However, it also makes the country more exposed to an external slowdown than would otherwise have been the case. Momentum has already slowed in the EU, BiH's main export market, and the threat of a global trade war could exacerbate this. Notably, tourism sources are becoming more diversified. The latest data show that, while Croatia, Serbia, Turkey and Italy remain the main sources, inflows from countries such as China and Saudi Arabia are also growing quickly.

Although the economy has become much more open, the export structure remains quite dominated by low value goods. So far, BiH has had limited success in attempts to move up the value chain. Political factors may be dissuading bigger investors from committing long-term capital in the same way as has been seen in some regional peers. The strong performance of the external sector (trade, remittances and tourism) has kept the current account deficit roughly steady over the past year

(measured as the four quarters to Q2 2018 versus the same period a year earlier). A wider goods deficit (owing to the much bigger absolute size of imports versus exports) was largely offset by stronger surpluses on the services and secondary income accounts, helped by tourism and remittances, respectively.

Decent growth trends have done little to alleviate the major structural issues in the labour market. The unemployment rate has reached a historically low level, but still stood at 36% in July (registration data basis). Female unemployment on the same basis was 42.3%. However, while BiH is not suffering labour shortages in the same way as many other CESEE countries, skills shortages have been reported in certain sectors. The weakness of the labour market is likely to be one factor contributing to continued pessimism about the future among Bosnians. The 2018 Balkan Barometer, produced by the Regional Cooperation Council, again showed Bosnians as the region's least hopeful citizens about their economic future.

Conditions in the banking sector should continue to improve, with decent economic growth helping to drive a further improvement in asset quality. The ratio of non-performing loans (NPLs) to total loans fell to 9.3% in June 2018, its lowest level since 2010. Meanwhile credit growth is continuing to rise. Loans to the non-private financial sector rose by around 8% in the year to August 2018.

In summary our forecasts are largely unchanged from our previous forecast. We still think that a growth rate of around 3.5% during the medium term is achievable, with external factors more important than during the historical period, and very little inflation (in line with eurozone trends). The main risk to our forecast comes from political factors, with risks more elevated than usual (owing to both domestic and regional developments).

Table 13 / Bosnia and Herzegovina: Selected economic indicators

	2014	2015	2016	2017 ¹⁾	2017 January-June	2018	2018 Forecast	2019 Forecast	2020
Population, th pers., mid-year	3,526	3,518	3,511	3,505	.	.	3,506	3,503	3,499
Gross domestic product, BAM mn, nom. ²⁾	27,359	28,586	29,900	31,332	14,892	15,600	32,700	34,400	36,200
annual change in % (real)	1.1	3.1	3.1	3.1	3.4	2.7	3.0	3.4	3.4
GDP/capita (EUR at PPP) ²⁾	8,300	8,700	9,000	9,300	.	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	22,830	23,157	23,653	24,347	.	.	.	.	.
annual change in % (real)	1.9	1.8	2.2	1.2	.	.	2.4	2.9	2.9
Gross fixed capital form., BAM mn, nom. ²⁾	5,330	5,097	5,189	5,653	.	.	.	.	.
annual change in % (real)	11.5	-3.5	2.5	5.8	.	.	5.0	5.0	5.0
Gross industrial production									
annual change in % (real)	0.2	3.1	4.4	3.2	2.2	3.1	3.3	3.0	2.8
Gross agricultural production ³⁾									
annual change in % (real)	-16.8	12.6	12.0	4.1	.	.	.	.	.
Construction output total									
annual change in % (real)	6.3	1.7	-2.2	-1.3	-2.3	1.2	.	.	.
Employed persons, LFS, th, April	812.0	822.0	801.0	815.7	815.7	822.4	830	840	850
annual change in %	-1.2	1.2	-2.6	1.8	1.8	0.8	1.8	1.5	1.3
Unemployed persons, LFS, th, April	308.0	315.0	273.0	210.7	210.7	185.5	185	180	175
Unemployment rate, LFS, in %, April	27.5	27.7	25.4	20.5	20.5	18.4	18.2	17.6	17.1
Reg. unemployment rate, in %, eop	43.6	42.9	40.9	38.7	39.3	35.7	.	.	.
Average monthly gross wages, BAM	1,290	1,289	1,301	1,321	1,316	1,348	1,350	1,390	1,430
annual change in % (real, gross)	0.8	1.0	2.0	0.4	0.5	1.3	1.1	0.9	0.8
Average monthly net wages, BAM	831	830	838	851	848	867	870	900	930
annual change in % (real, net)	1.3	1.0	2.0	0.4	0.5	1.2	1.0	1.0	0.9
Consumer prices, % p.a.	-0.9	-1.0	-1.1	1.2	1.1	1.1	1.2	1.9	1.9
Producer prices in industry, % p.a.	-0.5	0.6	-2.1	3.0	2.6	3.6	1.8	2.1	2.1
General government budget, nat.def., % of GDP									
Revenues	43.7	43.2	42.7	43.0	.	.	42.7	42.9	43.2
Expenditures	45.8	42.5	41.5	40.4	.	.	41.7	42.5	42.9
Deficit (-) / surplus (+)	-2.0	0.7	1.2	2.6	.	.	1.0	0.4	0.3
General gov.gross debt, nat.def., % of GDP	41.6	41.9	40.5	36.2	.	.	39.9	39.6	39.7
Stock of loans of non-fin.private sector, % p.a.	1.7	2.0	3.5	7.3	6.2	7.0	.	.	.
Non-performing loans (NPL), in %, eop	14.2	13.7	11.8	10.0	11.1	9.3	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾
Current account, EUR mn ⁵⁾	-1,025	-774	-711	-754	-404	-392	-777	-809	-840
Current account, % of GDP	-7.3	-5.3	-4.7	-4.7	-5.3	-4.9	-4.6	-4.6	-4.5
Exports of goods, BOP, EUR mn ⁵⁾	3,501	3,678	3,936	4,775	2,221	2,496	5,040	5,350	5,680
annual change in %	3.0	5.1	7.0	21.3	20.5	12.4	5.5	6.1	6.1
Imports of goods, BOP, EUR mn ⁵⁾	7,527	7,355	7,546	8,551	4,052	4,332	8,960	9,430	9,920
annual change in %	7.1	-2.3	2.6	13.3	13.2	6.9	4.8	5.2	5.2
Exports of services, BOP, EUR mn ⁵⁾	1,252	1,419	1,514	1,654	736	771	1,750	1,850	1,960
annual change in %	2.4	13.3	6.7	9.2	9.8	4.7	6.1	5.9	5.9
Imports of services, BOP, EUR mn ⁵⁾	395	440	450	500	196	223	530	560	600
annual change in %	0.8	11.2	2.3	11.0	7.6	13.7	6.0	6.0	7.0
FDI liabilities, EUR mn ⁵⁾	408	345	256	413	229	231	420	.	.
FDI assets, EUR mn ⁵⁾	7	85	-1	83	33	13	34	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	3,908	4,307	4,768	5,293	4,735	5,572	.	.	.
Gross external debt, EUR mn ⁶⁾	7,470	7,936	8,378	8,683	.	.	9,080	9,620	10,199
Gross external debt, % of GDP ⁶⁾	53.4	54.3	54.8	54.2	.	.	54.3	54.7	55.1
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate in 2017. -

4) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 5) Converted from national currency. - 6) Based on IMF estimates.

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