

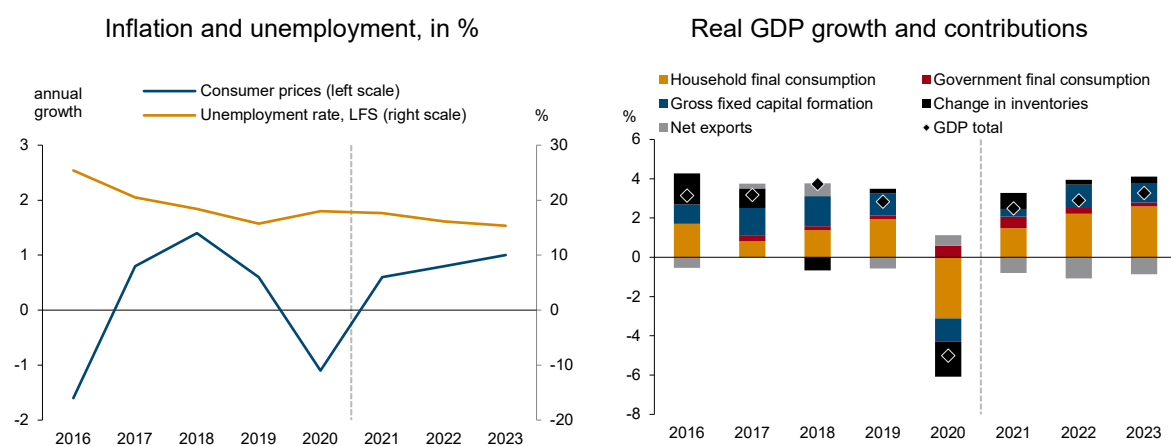


BOSNIA AND HERZEGOVINA: Vaccine delays and limited fiscal capacity slow down the recovery

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The COVID-19 pandemic caused the worst recession in Bosnia and Herzegovina since the Bosnian war, with an estimated GDP decline in 2020 of 5%. With the third wave of the pandemic, vaccine delays and the introduction of new restrictions, economic recovery will be delayed. Additional obstacles to growth include an inefficient fiscal structure and political disputes, which are preventing structural reform of the country and delaying its progress towards EU and NATO integration.

Figure 4.3 / Bosnia and Herzegovina: Main macroeconomic indicators



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

The third wave of the COVID-19 pandemic has struck, with both infections and virus-related deaths soaring; this has resulted in the introduction of new restrictions. In March 2021, the number of infections in Bosnia and Herzegovina (BiH) reached its highest level since the start of the pandemic, and there is now a shortage of hospital beds, equipment, medicines and medical personnel. BiH has one of the highest COVID-19 per capita death rates in the world (fourth place, as of the end of March). In order to try to reduce the spread of the virus, local authorities introduced new restrictions in March 2021. These include the closure of bars and restaurants, a curfew during the evening hours and the closure of schools (switching to online lessons), although the measures have not been synchronised either between the country's entities or even between cantons.

With the help of international funds, the governments have adopted a set of measures aimed at mitigating the adverse impact of the crisis on individuals and firms. According to the International Monetary Fund (IMF), COVID-19 discretionary spending in 2020 made up 2.5% of GDP and was

distributed with delays and with no coordination between the levels of government. The level of discretionary spending has been much lower than in neighbouring countries – due largely to limited fiscal capacity, which is a result of an inefficient fiscal structure and an inability to access international markets. Consequently, fiscal expenditure is limited by inadequate domestic public revenue, and the country relies heavily on international assistance, which has so far been provided mostly by the EU and the IMF.

The rigid and inefficient fiscal structure has restricted the capacity of fiscal policy to act effectively during the crisis. Rises in public-sector wages and in social benefits, as well as a high level of the grey economy, high unemployment rates and limited ability to borrow money, all severely restrict the capacity of fiscal policy. Furthermore, the rigid fiscal structure and political disputes have limited the governments' ability to redirect public expenditure to those sectors most in need. This has resulted in a slow and sluggish response to medical needs and vaccination agreements. Citizens, who do not trust the government to acquire the necessary vaccines, have been going to Serbia to be vaccinated – further proof of the government's inability to cope with the situation.

The decentralised fiscal system has resulted in complex, delayed and uncoordinated responses to the pandemic and vaccine procurement. An IMF loan worth EUR 333m (approximately 2% of BiH's GDP) was approved in April 2020, but remained tied up in the Central Bank of BiH for two months, as the politicians could not agree on its disbursement. After that, the state-level government requested another loan from the IMF of EUR 750m for the recovery; but the talks were suspended in December 2020, as the politicians from both entities could not agree to IMF requirements. All this emphasises the extent and depth of the political disfunction and the difficulty of acquiring and adequately allocating the necessary funds. With the state failing to reach any agreement on vaccine procurement, and now that it is clear that the procurement of vaccines through the COVAX scheme will be delayed, local authorities are announcing their own arrangements, with no coordination by the state: Republika Srpska started procuring vaccines in March 2021, but very slowly and in relatively small quantities, while the Federation of BiH has still had no deliveries of vaccines (except a token number of donations from Serbia). In the Federation of BiH, the funds allocated are not being used on account of political disputes and unclear jurisdictions, which are additionally delaying the whole process.

The growth rate reached its lowest level since the war. Economic activity was adversely impacted in 2020 by the COVID-19 containment measures taken by the country and its main trading and investment partners. The estimated decline in GDP in 2020 was 5%, the result of a decrease in household spending and investment, and a significant fall in the current account balance due to a big drop in the export of goods, as well as in tourism and remittances. Remittances, which made up around 8% of GDP in 2019, fell by 40% in 2020. Tourism, which accounted for around 9% of GDP in 2019, fell by 70% in 2020. Inflation turned negative once again in 2020 (as in 2013-2016), with consumer prices falling by 1.1% year on year, as a result of a decline in transport, clothing and footwear prices, and government price controls on certain products during the emergency. In January 2021, the inflation rate dipped even further into negative territory (-1.7% year on year), but the projections are that the rate will eventually increase, as economic activity starts to pick up. It is nevertheless likely to remain low in 2021 and 2022, forecast at 0.6% and 0.8%, respectively, due to the slow pace of recovery and low personal consumption.

The banking sector is sufficiently capitalised and liquid, but loans to households and enterprises are decreasing, and at 6.7% in 2020, the share of non-performing loans (NPLs) is still high. There was a drop in loans approved for enterprises and households in 2020. On the other hand, excess reserves are steadily accruing, due to the lack of safe investments and strict requirements for deposit and loan maturity matching. A moratorium on the repayment of loans has been introduced by the banks to ease liquidity constraints during the COVID-19 crisis, but this is a palliative measure that does not ease the burden of debt repayment – and indeed will even increase that burden once the moratorium ends. The share of NPLs decreased by 1.3 percentage points in 2020, compared to 2019; but the figure is likely to rise again in 2021, due to the increased number of unemployed people and business closures.

Recovery has been delayed by the rising number of infections in the first quarter of 2021, new restrictions, the uncertainty regarding the availability of vaccines and political disagreements.

GDP is projected to grow by 2.5% in 2021, but the pre-crisis level is unlikely to be reached before late 2022, on account of the new restrictions introduced in 2021 following the rise in the number of infections and the delays in the delivery of vaccines. Exports of goods and services, as well as remittances, will likely recover during 2021, as trading partner countries are projected to recover at a faster pace. Investments are also likely to pick up, as there are some big public investments that have been announced (e.g. the Sarajevo-Belgrade highway, financed by Turkey). Fiscal policy will continue to be expansionary in 2021, but not too much, on account of the limited borrowing capacity. GDP growth is forecast to be low due to the small projected increase in personal consumption – a result of the high unemployment rate, which is forecast to be 17.6% in 2021. A further decline in economic activity, investments and employment is also possible, if significant previously announced public investments and international financial assistance are not continued.

Long-term growth trends are potentially threatened by political instability, a high level of emigration and the country's ageing population. Although the nationalistic ruling parties suffered losses in the two largest cities in the local elections of November 2020, political tensions are still running high as those nationalistic parties are obstructing the formation of local governments. Constant political disagreements at all levels of government and an inability to implement adequate structural reforms towards creating a single economic space could reduce investment and international financial support, with negative consequences for growth. Long-term recession or stagnation could further result in greater power for the nationalistic parties and increased traction for their ideas involving the country's disintegration. Furthermore, the country's population is ageing rapidly: BiH has the lowest fertility rate in the world and a very high emigration rate (especially among young people). Young, educated people are leaving the country due to difficulties in finding a job and on account of social discontent, which is amplified by the focus in the media – which are heavily controlled by the political parties – on divisions between the entities and political disagreements.

Table 4.3 / Bosnia and Herzegovina: Selected economic indicators

	2017	2018	2019	2020 ¹⁾	2021	2022	2023
					Forecast		
Population, th pers., average	3,504	3,496	3,485	3,478	3,470	3,446	3,434
Gross domestic product, BAM m, nom. ²⁾	31,376	33,444	35,296	33,200	34,200	35,500	37,000
annual change in % (real)	3.2	3.7	2.8	-5.0	2.5	2.9	3.3
GDP/capita (EUR at PPP) ²⁾	9,030	9,620	10,080	9,740	.	.	.
Consumption of households, BAM m, nom. ²⁾	24,200	25,042	26,158	24,780	.	.	.
annual change in % (real)	1.0	1.8	2.6	-4.2	2.0	3.0	3.5
Gross fixed capital form., BAM m, nom. ²⁾	5,926	6,550	6,994	6,500	.	.	.
annual change in % (real)	7.8	8.1	5.8	-6.0	2.0	6.0	5.0
Gross industrial production							
annual change in % (real)	3.2	1.6	-5.3	-6.0	3.0	4.0	3.0
Gross agricultural production ³⁾							
annual change in % (real)	-15.5	21.5	2.0	-1.0	.	.	.
Construction output total							
annual change in % (real)	-1.1	0.4	-2.0	0.2	.	.	.
Employed persons, LFS, th, April	815.7	822.4	802.9	780.0	770	780	800
annual change in %	1.8	0.8	-2.4	-2.8	-1.0	1.0	2.0
Unemployed persons, LFS, th, April	210.7	185.5	149.4	171.0	165	150	145
Unemployment rate, LFS, in %, April	20.5	18.4	15.7	18.0	17.6	16.1	15.3
Reg. unemployment rate, in %, eop	38.7	34.7	32.8	33.7	.	.	.
Average monthly gross wages, BAM	1,321	1,363	1,421	1,476	1,510	1,540	1,570
annual change in % (real, gross)	0.8	1.7	3.7	5.0	1.5	1.0	1.0
Average monthly net wages, BAM	851	879	921	956	970	990	1,010
annual change in % (real, net)	0.7	1.9	4.2	4.9	1.3	1.1	1.0
Consumer prices, % p.a.	0.8	1.4	0.6	-1.1	0.6	0.8	1.0
Producer prices in industry, % p.a.	3.0	3.5	0.1	-1.2	1.0	1.4	1.5
General governm.budget, nat.def., % of GDP							
Revenues	43.1	43.0	42.6	39.0	40.0	40.5	41.0
Expenditures	40.5	40.8	40.7	43.0	42.0	41.0	40.8
Deficit (-) / surplus (+)	2.6	2.2	1.9	-4.0	-2.0	-0.5	0.2
General gov.gross debt, nat.def., % of GDP	36.1	34.2	32.8	38.5	39.0	39.0	38.0
Stock of loans of non-fin.private sector, % p.a.	7.3	5.5	6.7	-2.5	.	.	.
Non-performing loans (NPL), in %, eop	10.0	8.8	7.4	6.1	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾
Current account, EUR m ⁵⁾	-777	-572	-556	-557	-780	-840	-880
Current account, % of GDP	-4.8	-3.3	-3.1	-3.3	-4.5	-4.6	-4.6
Exports of goods, BOP, EUR m ⁵⁾	4,776	5,327	5,205	4,808	5,020	5,320	5,480
annual change in %	21.3	11.5	-2.3	-7.6	4.5	6.0	3.0
Imports of goods, BOP, EUR m ⁵⁾	8,568	9,172	9,277	8,044	8,470	9,060	9,420
annual change in %	13.3	7.1	1.1	-13.3	5.3	7.0	4.0
Exports of services, BOP, EUR m ⁵⁾	1,781	1,944	2,100	1,146	1,320	1,480	1,570
annual change in %	10.0	9.1	8.0	-45.4	15.0	12.0	6.0
Imports of services, BOP, EUR m ⁵⁾	590	618	684	452	540	590	630
annual change in %	9.9	4.8	10.6	-33.9	20.0	10.0	6.0
FDI liabilities, EUR m ⁵⁾	455	501	346	320	.	.	.
FDI assets, EUR m ⁵⁾	88	-6	-9	-10	.	.	.
Gross reserves of CB excl. gold, EUR m ⁵⁾	5,293	5,835	6,311	6,942	.	.	.
Gross external debt, EUR m	10,712	11,284	11,486	11,364	11,750	11,650	11,550
Gross external debt, % of GDP	66.8	66.0	63.6	66.9	67.2	64.2	61.1
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary and wiiw estimates. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate from 2019. - 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.

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