

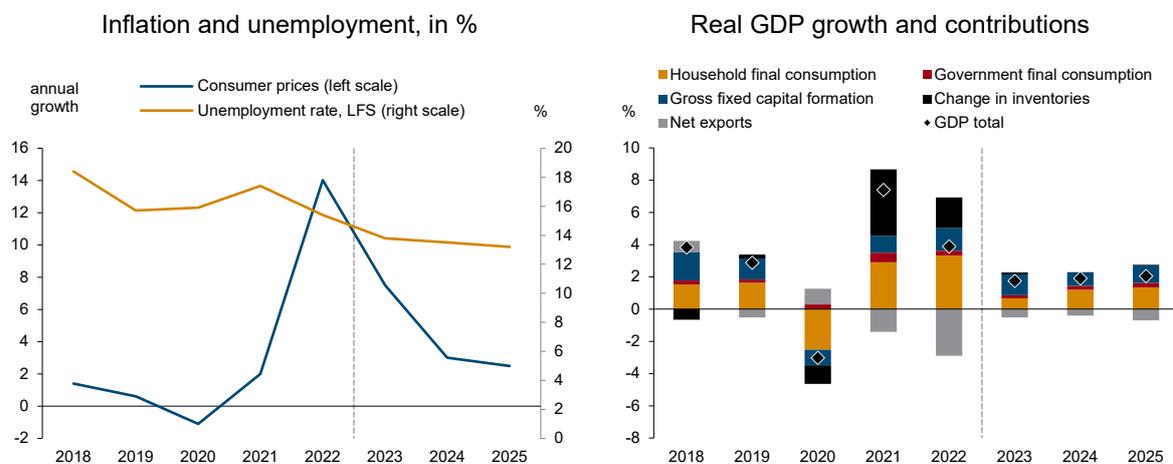


## BOSNIA AND HERZEGOVINA: Economy stagnating, as political tensions come to the fore

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The year started with rather slow economic growth, as a result of a decline in household consumption and net exports. Inflation has been falling, despite the inability of the central bank to influence interest rates under the currency board arrangement. Political tensions are again on the rise, as one part of the country, Republika Srpska, has ceased to heed the decisions of the international official who oversees peace in the country. On a positive note, the country's new government has been making some progress in meeting the conditions set by the EU for progress towards EU accession, and the country's S&P sovereign rating was upgraded in August 2023 in recognition of its economic resilience.

**Figure 6.3 / Bosnia and Herzegovina: Main macroeconomic indicators**



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

**The data for Q1 2023 suggest slow economic growth, and only a minor improvement is expected for the rest of the year.** The GDP growth rate has declined steadily since 2021, reaching 1.1% in Q1 2023. Compared with the same period last year, real increases were recorded in government consumption (+2%) and gross capital formation (+12.4%); meanwhile, real decreases were posted in household final consumption (-0.4%) and net exports (-3%) – consequences of the high rate of inflation at the beginning of the year and weaker demand from EU markets, respectively. However, inflation fell in Q2 and real wages increased in the first six months (by 4.9% on average, compared to the same period last year); thus we can expect to see some improvement in household consumption from Q2 onwards.

**On balance, we have left our growth forecasts for 2023 and 2024 unchanged, at 1.7% and 1.9%, respectively.** Industrial production fell by 3.9% in the first seven months of 2023, compared to the same period last year, while retail trade turnover increased by 13.1% in real terms for the same period, supported by increased consumer borrowing, tourism and remittances. Remittances rose by 7% in Q1 year on year, and tourist visits in the first seven months were 20.7% up on the same period last year. Although foreign direct investment increased by more than 80% in nominal euro terms in Q1 2023, compared to Q1 2022, it did not reach the level of Q1 2021 and accounted for only around 3% of GDP. We expect a slow increase in the coming period in both household and government consumption, as well as in gross capital formation; however, we also anticipate deteriorating net exports. Accordingly, we have made no revision to the spring forecast for GDP growth for 2023 and 2024 – 1.7% and 1.9%, respectively.

**Inflation has plummeted – to 4% in July – while interest rates remain low.** The central bank of Bosnia and Herzegovina cannot influence commercial banks' interest rates, as it operates as a currency board. Since banks in Bosnia and Herzegovina currently rely almost entirely on local funding sources that are unconnected to benchmark interest rates on the international market, interest-rate increases have been much lower than in the case of commercial banks in the euro area. Although interest rates have remained quite low, inflation has been falling rapidly – from 14.1% in January to 4% in July, the lowest level for two years, mostly on account of a fall in the cost of transport and electricity. We expect inflation to stay at a similar level until the end of the year, so our inflation forecast for 2023 has been downgraded by 1.5 percentage points (to 7.5% on an average annual basis). We expect a further decline to 3% next year.

**Unemployment is falling significantly, but mostly because of high emigration.** According to the Labour Force Survey (LFS), the unemployment rate declined significantly in Q1 and Q2 2023 – to 13.3% and 13.1%, respectively, as against 15.5% in 2022. This is largely a result of a high rate of emigration from the country (according to the LFS, the active population continued to fall in the first two quarters) and partly a consequence of increased employment in the service sector (primarily tourism) and the IT sector. The increased emigration of the workforce and skilled people means that the labour shortage is increasing, especially in construction, transportation, catering and tourism. Work permits for foreign workers have been increasing in number – and would probably have increased even more had the application process not been so lengthy. Other persistent problems on the labour market include high long-term unemployment (60.3% of those unemployed have had no work for more than two years) and high youth unemployment (33.5%).

**Political tensions are increasing again, with one part of the country – Republika Srpska – ignoring the decisions of the high representative, the international official who oversees implementation of the Dayton Agreement.** Republika Srpska has passed two laws, the first preventing the high representative's decisions from being published in Republika Srpska's Official Gazette (so that it does not have to heed them), and the second allowing the constitutional court's rulings to be ignored on the entity's territory. In consequence, the president of Republika Srpska, Milorad Dodik, has been charged by the prosecutor's office in Bosnia and Herzegovina with disobeying the decisions of the high representative and the constitutional court. All of this undermines the country's constitution and the functioning of state institutions. It may also place the economic progress of the country 'on hold', as political issues are again being put before economic growth, while at the same time it projects to the international community and potential investors the image of an unstable country.

**On the positive side, the new government is making some progress with the adoption of new laws required by the EU, and S&P has improved Bosnia and Herzegovina's credit rating.** The new government is making some progress towards fulfilling the conditions required for EU accession negotiations to commence, by passing new laws (e.g. on freedom of access to information, a human rights ombudsman, etc.) required within the 'European package'. Furthermore, in August 2023, S&P upgraded Bosnia and Herzegovina's credit rating from 'B' to 'B+', with a stable outlook. This reflects the country's economic resilience, in spite of such recent impacts as the Covid-19 pandemic, several instances of political unrest, and weaker external demand. However, the move came before the fresh political tensions, and so S&P may reconsider its decision if those tensions increase.

**Table 6.3 / Bosnia and Herzegovina: Selected economic indicators**

	2020	2021	2022 <sup>1)</sup>	2022 January-June	2023	2023 Forecast	2024 Forecast	2025
Population, th pers., average	3,475	3,453	3,431	.	.	3,385	3,355	3,350
Gross domestic product, BAM m, nom. <sup>2)</sup>	34,728	39,107	45,605	.	.	49,900	52,400	54,800
annual change in % (real)	-3.0	7.4	3.9	.	.	1.7	1.9	2.1
GDP/capita (EUR at PPP) <sup>2)</sup>	9,920	11,120	12,490	.	.	.	.	.
Consumption of households, BAM m, nom. <sup>2)</sup>	24,659	26,300	30,586	.	.	.	.	.
annual change in % (real)	-3.5	4.1	4.9	.	.	1.0	1.8	2.0
Gross fixed capital form., BAM m, nom. <sup>2)</sup>	7,679	8,367	9,826	.	.	.	.	.
annual change in % (real)	-4.2	4.8	6.6	.	.	6.0	4.0	5.0
Gross industrial production								
annual change in % (real)	-6.4	9.7	0.9	4.0	-4.5	-1.0	2.0	4.0
Gross agricultural production <sup>3)</sup>								
annual change in % (real)	9.2	-16.9	0.3	.	.	.	.	.
Construction output total								
annual change in % (real)	0.2	2.5	-0.5	-0.6	-0.1	.	.	.
Employed persons, LFS, th, average <sup>4)</sup>	1,173.1	1,151.0	1,162.0	1,156	1,180	1,180	1,190	1,200
annual change in %	.	.	1.0	2.6	2.1	1.5	1.0	1.0
Unemployed persons, LFS, th, average <sup>4)</sup>	221.0	241.8	211.3	223	180	207	203	200
Unemployment rate, LFS, in %, average <sup>4)</sup>	15.9	17.4	15.4	16.2	13.2	13.8	13.5	13.2
Reg. unemployment rate, in %, eop	33.7	31.2	29.7	29.9	29.0	.	.	.
Average monthly gross wages, BAM	1,476	1,542	1,723	1,664	1,916	1,910	1,980	2,050
annual change in % (real, gross)	5.0	2.4	-2.0	-1.8	5.4	3.0	0.5	1.0
Average monthly net wages, BAM	956	998	1,122	1,085	1,244	1,240	1,290	1,340
annual change in % (real, net)	4.9	2.4	-1.4	-0.7	4.9	3.0	1.0	1.5
Consumer prices, % p.a.	-1.1	2.0	14.0	11.5	9.3	7.5	3.0	2.5
Producer prices in industry, % p.a.	-1.2	5.6	19.8	18.5	8.8	8.0	4.0	3.0
General governm. budget, nat. def., % of GDP								
Revenues	41.6	41.1	39.9	.	.	39.5	40.0	42.3
Expenditures	46.8	41.3	40.3	.	.	40.0	39.5	42.0
Deficit (-) / surplus (+)	-5.2	-0.3	-0.4	.	.	-0.5	0.5	0.3
General gov. gross debt, nat. def., % of GDP	36.1	34.0	29.3	.	.	27.3	25.5	24.1
Stock of loans of non-fin. private sector, % p.a.	-2.5	3.7	5.3	4.8	5.0	.	.	.
Non-performing loans (NPL), in %, eop	6.1	5.8	4.5	5.2	4.1	.	.	.
Central bank policy rate, % p.a., eop <sup>5)</sup>	.	.	.	.	.	.	.	.
Current account, EUR m <sup>6)</sup>	-575	-472	-1,045	.	.	-990	-960	-1,120
Current account, % of GDP	-3.2	-2.4	-4.5	.	.	-3.9	-3.6	-4.0
Exports of goods, BOP, EUR m <sup>6)</sup>	4,818	6,499	8,249	.	.	8,910	9,890	10,680
annual change in %	-7.4	34.9	26.9	.	.	8.0	11.0	8.0
Imports of goods, BOP, EUR m <sup>6)</sup>	8,023	10,165	13,410	.	.	14,620	16,080	17,210
annual change in %	-13.5	26.7	31.9	.	.	9.0	10.0	7.0
Exports of services, BOP, EUR m <sup>6)</sup>	1,251	1,930	2,719	.	.	3,070	3,610	3,830
annual change in %	-41.0	54.2	40.9	.	.	13.0	17.5	6.0
Imports of services, BOP, EUR m <sup>6)</sup>	488	615	866	.	.	990	1,120	1,210
annual change in %	-29.4	26.2	40.7	.	.	14.0	13.0	8.0
FDI liabilities, EUR m <sup>6)</sup>	384	529	615	.	.	680	.	.
FDI assets, EUR m <sup>6)</sup>	62	69	27	.	.	70	.	.
Gross reserves of CB excl. gold, EUR m <sup>6)</sup>	6,942	8,204	8,133	7,977	7,747	.	.	.
Gross external debt, EUR m	11,339	11,654	11,994	.	.	12,550	12,960	13,100
Gross external debt, % of GDP	63.9	58.3	51.4	.	.	49.2	48.4	46.8
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 2) According to ESA'10 (FISIM reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate in 2022. - 4) From 2021 new methodology in line with the Integrated European Social Statistics Regulation (IESS). - 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.

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