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Bosnia and Herzegovina: Downers and uppers in moderation

Bosnia and Herzegovina (BiH) generates a high proportion of its GDP in sectors producing goods and services that are not exposed to international competition. It shares this characteristic with other economies in Southeast Europe; BiH is far from being an extreme case. Total manufacturing generates slightly over 10% of the GDP, whereas public administration in a broader sense¹ and trade (wholesale and retail) contribute significantly more: close to 25% and 16%, respectively. The value-added of financial intermediation and real estate together is almost equal to that of manufacturing. At the same time, the share of manufacturing in total registered employment is over 20% – and thus disproportionately high.

In more recent years prior to the crisis, the export to GDP ratio was below 30%: an extremely low figure for a small open economy. Whereas SMEs developed nicely after 1995, the number of large successful exporters has remained low. The country has failed to develop fully into a single economic space – owing to shortcomings in both the physical and institutional infrastructure. Moreover, BiH hardly offers companies easy access to large markets. Efforts to coordinate the use of existing capacities have been lacking. The leading political forces have never made it their first joint priority to remove such obstacles, so that the huge sums, which international organizations and donor countries earmarked to support BiH in the years after 1995, have yielded suboptimal results. Some major exporters from earlier times never fully recovered, while the involvement of foreign direct investors has remained low; investment in export capacities, such as those of Mittal in Zenica, remained the exception rather than the rule. The country suffers from major shortcomings, which will be difficult to overcome.

In the period January to April 2010, BiH exports amounted to EUR 1.1 billion – up by 28% year-on-year. They covered 55% of imports (EUR 2 billion). The change in the volume of imports was negligible. Quite possibly, financing imports from sources other than export revenues has become more difficult than in the past. Between 2008 and 2009, imports

¹ Including defence, social security, education, health and social work as well as other community, social and personal services.

contracted by 25%, while the current account deficit dropped from EUR 1.9 billion to 0.9 billion. As for covering that deficit, the inflow of foreign direct investment (FDI) fell from EUR 0.73 to 0.36 billion, while the currency reserves diminished somewhat. By the end of March 2010, however, they had almost fully recovered – despite a 25% decrease in FDI compared to the first quarter of 2009.

A large proportion of the population in BiH lives in rural areas and is engaged in farming (frequently at a subsistence level). Nevertheless, the trade balance in terms of food is markedly negative. In the period January-April 2010, exports of unprocessed agricultural products and processed food covered less than one quarter of imports. Customs and excise authorities lack the efficiency required to control the volumes and prices declared. Trade policy makes only limited use of the instruments available, such as import tariffs for livestock, meat and meat products or seasonal tariffs for certain products, as well as such mechanisms as in-country inspection. At the same time, food exports suffer from inadequate services provided by laboratories authorized to issue certificates valid for exports into the EU. Basic metals contributed most to total exports (20%) in the period January-April 2010, but wood and wood products (including furniture) generated a higher surplus over the same period (EUR 102 million compared to 95 million). The third major surplus-generating export good is electricity (EUR 75 million).

Industrial data offer a mixed picture. The Statistics Office in Republika Srpska keeps publishing positive growth figures – over 7% increase in output year-on-year for the first four months of 2010, whereas employment fell at nearly the same rate. This discrepancy follows from the fact that the increase in output is attributable to but a few industries (in particular, mining of metal ores), whereas most other industries are struggling for want of demand. The Statistics Office of the Federation of BiH reports a 2.2% increase in output and a 1% decline in employment for the same period. Producer prices for the first four months of 2010 were slightly down compared to the same period in the previous year: a drop of 0.4%, Wages, however, remained practically unchanged. In the context of the currency board regime, this is not a bad development, as it does not support fears of deteriorating competitiveness.

In contrast to a slight increase in industrial output, construction activities continued to be depressed. In April 2010, compared to April 2009, they were down by 29% in the Federation of BiH and by 19% in Republika Srpska. This was due to both low private demand and tight public budgets. Projects financed by the EU and IFIs continue to have a stabilizing effect without, however, incurring an expansionary element. Empty order books are causing trouble; one major construction company, Sarajevo Hidrogradnja, has declared its inability to pay salaries.

Consumer prices continue to show a declining trend. That holds true, at least, for products sold under competitive conditions. The 2.4% year-on-year increase in consumer prices, as reported in April 2010, is largely attributable to: (i) levies on alcohol and tobacco products (+ 30.6%) following an increase in excise tax as of 1 January 2010; and (ii) higher prices for transport (+11.5%), communications (+8.3%), education (+5.8%) and housing (+5.4%).

Privatization came close to a standstill a long time back. One of the rare exceptions is Bosnalijek, a pharmaceutical company, shares of which are held by IFC and the government of the Federation of BiH. A US investor is interested, but the case has become rather controversial. A recent attempt to privatize shares in Aluminij Mostar failed and a new tender process will follow.

Most of the micro-loan organizations operating in BiH suffered losses in 2009. According to the central bank, commercial banks are meeting the statutory level of capitalization, but some of them could well need additional capital, should the situation get any worse. Their overall loan volume has remained more or less stable in recent months, hinting at a marginally positive trend. Money supply has also increased slightly.

In May 2010, revenues of the Indirect Taxation Office, including customs duties, increased by 12% year-on-year despite a drop in revenues from value-added tax. Nevertheless, making ends meet will be difficult in 2010; discussions on the allocation of budget revenues have intensified. In the context of the current stand-by agreement, the IMF has entered a plea for granting the central government a higher share in tax revenues. It has also urged the Federation of BiH to reduce its budget deficit, at least part of which is structural in nature. The Federation has failed to: (i) adopt a law pertaining to civil service salaries; (ii) report on the effects of having revised certain budget expenditures; (iii) launch a reform of the pension system; and (iv) redefine the system of privileged pensions. In the run-up to the general election scheduled for 3 October, politicians are afraid of disappointing some of the electorate through painful reforms. The delay in meeting previously agreed goals has led to a temporary suspension of talks on maintaining the stand-by arrangement. This will postpone the disbursement of the fourth tranche of IMF funds (about EUR 40 million). If the delay persists, problems associated with financing the public deficits will gradually intensify.

Several years ago BiH citizens with Croatian passports acquired the right to visa-free travel throughout the Schengen countries. Those with Serb passports followed suit a few months ago. As confirmed at the EU Balkan Summit on 2 June 2010, the EU will expand its visa liberalization programme later this year so as to include all BiH citizens. In order to meet the prerequisites, the country needs to build up capacities still more and strengthen the

legal framework for fighting organized crime and corruption. This will involve implementing an action plan for the introduction of an electronic system for the exchange of police records and the harmonization of criminal legislation at the state level.

In their meeting on 23 April in Tallinn, the NATO foreign ministers agreed to accept the BiH application for a Membership Action Plan (MAP). In order to start the process, BiH will have to transfer ownership of all defence-related property to the central state: a controversial issue within the country. As for EU membership, Valentin Inzko, High Representative and EU Special Representative, recently mentioned that 2018 might be a possible accession date for several Balkan countries. It remains to be seen whether BiH manages to organize its first post-war census in 2011.

An official GDP growth figure for 2009 is still not available; we reckon with a relatively modest decline in GDP. We expect the economy to stagnate in 2010, followed by relatively modest GDP growth in 2011 and 2012. The main reason for this comparatively smooth performance is that most of the GDP stems from low-volatility sectors. The agents in those sectors are likely to find themselves compelled to economize on expenditures, which will have a dampening effect on aggregate demand. Hardly any of the main demand components of GDP are likely to experience a major boost over the next few years; exports, however, might prove the exception, should the global metals market enjoy a boom.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2006	2007	2008	2009 ¹⁾	2009 1st quarter	2010	2010	2011	2012
							Forecast		
Population, th pers., average	3843	3843	3842	3843	.	.	3843	3843	3843
Gross domestic product, BAM mn, nom. ²⁾	19252.5	21760.2	24702.5	23950.0	.	.	24100	24600	25600
annual change in % (real) ²⁾	6.1	6.2	5.7	-3.2	.	.	0	1	3
GDP/capita (EUR at exchange rate)	2500	2900	3300	3200	.	.	3200	3300	3400
GDP/capita (EUR at PPP - wiiw)	5700	6300	7000	6600	.	.	.	.	.
GDP by expend. approach, BAM mn, nom. ²⁾	21366.1	24708.6	28092.6	.	.	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	18064.3	19930.8	22437.4	21390	.	.	.	.	.
annual change in % (real) ²⁾	4.5	6.0	5.8	-4.0	.	.	-1	0	1
Gross fixed capital form., BAM mn, nom. ²⁾	4756.8	6446.4	7521.0	5920	.	.	.	.	.
annual change in % (real)	-9.4	28.8	10.9	-20.0	.	.	0	5	8
Gross industrial production ³⁾									
annual change in % (real)	11.5	6.4	11.0	-3.3	-2.5	1.3	0	3	7
Gross agricultural production, total									
annual change in % (real)	3.2	-1.6	.	.	.	.	.	.	.
Employed persons - LFS, th, April	811.0	849.6	890.2	859.2	859.2	.	820	820	820
annual change in %	.	4.8	4.8	-3.5	-3.5	.	-5	0	0
Employees total - reg., th, average	653.3	686.1	705.6	697.6	702.4	691.5	650	650	650
annual change in %	1.6	5.0	2.9	-1.1	0.4	-1.6	-7	0	0
Unemployed persons - LFS, th, April	366.8	346.7	272.0	272.3	272.3	.	.	.	.
Unemployment rate - LFS, in %, April	31.1	29.0	23.4	24.0	24.0	.	27	27	27
Reg. unemployment rate, in %, end of period	44.1	42.5	40.6	42.4	41.4	42.9	44	44	44
Average gross monthly wages, BAM	869	954	1112	1204	1200	1203	.	.	.
annual change in % (real, net)	2.3	8.4	8.4	5.6	9.8	-1.5	.	.	.
Consumer prices, % p.a.	6.2	1.5	7.5	-0.4	1.6	1.7	0.5	1	1
Producer prices in industry, % p.a.	.	.	.	.	.	.	.	.	.
General government budget, nat. def., % GDP									
Revenues	44.6	45.2	44.1	42.0	.	.	42	43	43
Expenditures	41.7	43.9	46.1	45.0	.	.	46	45	45
Deficit (-) / surplus (+)	2.9	1.3	-2.0	-3.0	.	.	-4	-2	-2
Public debt, nat. def., in % of GDP ⁴⁾	22.0	29.8	30.8	33.4	.	.	30	30	30
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn ⁵⁾	-769.7	-1156.2	-1909.0	-924.0	-174.0	-68.6	-1000	-1000	-1000
Current account in % of GDP	-7.8	-10.4	-15.1	-7.5	.	.	-8	-8	-8
Exports of goods, BOP, EUR mn ⁵⁾	2687.3	3091.5	3522.0	2920.2	655.4	811.3	3000	3200	3500
annual growth rate in %	30.5	15.0	13.9	-17.1	-20.4	23.8	3	7	9
Imports of goods, BOP, EUR mn ⁵⁾	6093.0	7233.6	8344.6	6326.6	1433.8	1408.9	6400	6700	7100
annual growth rate in %	1.2	18.7	15.4	-24.2	-23.9	-1.7	1	5	6
Exports of services, BOP, EUR mn ⁵⁾	903.7	1061.7	1125.6	991.7	205.4	175.5	1030	1080	1150
annual growth rate in %	13.2	17.5	6.0	-11.9	-11.6	-14.6	4	5	6
Imports of services, BOP, EUR mn ⁵⁾	374.9	421.2	485.4	455.4	77.1	67.4	400	410	420
annual growth rate in %	6.4	12.3	15.2	-6.2	-1.5	-12.6	-12	2	2
FDI inflow, EUR mn ⁵⁾	572.4	1517.3	726.0	360.8	32.0	17.3	300	400	700
FDI outflow, EUR mn ⁵⁾	3.2	20.5	9.2	3.3	1.1	0.5	5	5	5
Gross reserves of NB excl. gold, EUR mn ⁶⁾	2787.4	3424.9	3218.9	3143.8	3066.3	3131.7	3050	3050	4000
Gross external debt, EUR mn ⁷⁾	2081.5	2025.4	2168.0	2677.0	2242.0	2891.4	2700	2700	2500
Gross external debt in % of GDP	21.1	18.2	17.2	21.7	.	.	.	.	.
Average exchange rate BAM/EUR	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/EUR ⁸⁾	0.875	0.898	0.923	0.938	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (including shadow 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) Converted from national currency with the average exchange rate. - 6) Including investment in foreign securities. - 7) Gross external public debt. - 8) Benchmark results 2005 from Eurostat and wiiw estimates.

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