

Josef Pöschl

Bosnia and Herzegovina: the need to sign on the dotted line

In all likelihood, economic growth in Bosnia and Herzegovina (BiH) will have slowed down in the second half of 2007 and significant acceleration is unlikely in 2008. Even after the post-war consolidation phase (1996-1999), annual GDP growth in most years exceeded 5%. With growth rates ranging between four and five percent, 2007 and 2008 will be exceptions to the rule. Nevertheless, BiH's catching-up process will continue compared to the EU, where economic growth will also decelerate.

In 2007, foreign trade stopped promoting GDP growth. Export growth was strong, but import growth was even stronger. The impact of higher world market prices for energy and agricultural products became clearly visible. In more recent years, import data have fluctuated markedly. In 2005, imports boomed; in 2006 they stagnated, only to soar upwards again in 2007. Whereas the downturn in the period 2005-2006 was attributable to the introduction of VAT on 1 January 2006, the upturn in 2007 stemmed from the rise in world market prices mentioned above.

Hit by the hikes

BiH is heavily dependent on imports of crude oil and agro-food (agriculture and food processing). Both commodities have become more expensive. The performance of the agro-food sector is disappointing, given that BiH is a country where a large proportion of the population is engaged in farming. In BiH food-processors often find it less trouble to rely on imports: they find it easier to obtain good quality inputs in the quantities they need. Farmers, on the other hand, are angered by the lack of competitiveness that stems from the poorly developed logistics and institutional settings. Their organizations are pressing for tariff and non-tariff barriers. In January, the government yielded and introduced tariffs on imports of livestock. Throughout 2007, continuing pressure from the farmers upset matters in relation to the country's accession to CEFTA; in the meantime, however, BiH has joined CEFTA. WTO membership should follow soon.

The pronounced rise in world market prices for both cereals and energy has had a major adverse impact on real household incomes – and hence on private consumption. Higher energy prices translated into higher prices for household heating as well as for private and public transport. As cereals serve as inputs into both animal husbandry and bakery products, the price hike pushed costs up across broad segments of the food-processing sector (e.g., dairy products, meat and bread). In low-income countries such as BiH, a surge in food and energy prices delivers a swingeing blow to consumers' real incomes, since food and energy account for an ever-increasing large share of total household expenditures. In 2007 gross monthly wages averaged EUR 480; however, in some

branches – especially those with a large female workforce – wages are far below average. For example, in December 2007 the union of textile workers in the Federation of BiH (FBiH) announced that it had reached an agreement on fixing the minimum wage at EUR 0.89 per hour: equivalent to a monthly wage slightly over EUR 150.

When the BiH bakeries increased their prices, it led to a public outcry and a wave of protests. In an attempt to soothe matters, the FBiH government set about restricting the increases in prices for bakery products and started purchasing grain to support the industry on the supply side and avoid bottlenecks.

Less consumption does not necessarily mean less investment

We cannot count on household consumption growing much in real terms in 2008. Higher prices for imported energy also mean higher costs for enterprises, all the more so given the energy-intensive production in the metallurgical sector, the country's largest industry. World market prices for some metals have increased and certain quarters in the BiH metallurgical industry have profited from that fact. Only in parts of the corporate sector might there be some slow-down in terms of investment growth. In recent years, construction activities have boomed in many parts of the country. Quite possibly, this trend will persist.

Troubles down at the rumour mill

Over the past few years, inflation has been very moderate. Up to mid-2005, the price index remained stable and even declined slightly over long periods of time. This was the outcome of the currency board regime and pegging to the euro. Even so, that regime has always been a bone of contention, albeit mainly academic in nature. Quite recently, the situation worsened: fears of devaluation were rife and people started hoarding euros. In mid-January, the governor of the central bank, Kemal Kozaric, hastened to assure the public that their devaluation fears were unfounded. The currency is legally bound to the euro, thus making surprise devaluations quite impossible. Central bank reserves are sound (EUR 3.4 billion or one third of the annual GDP at the end of 2007).

Weakness at the helm

Some good news would help assuage public dissatisfaction with the current state of affairs. A signature under the Stabilization and Association Agreement (SAA) with the EU and the positive expectations associated therewith could send a much needed signal. The process has reached the initialization stage and might reach finalization in March 2008 – at least that is what the Slovenian EU presidency is hoping. Unfortunately once again, BiH politicians are up to their usual games. They agreed on police reform in principle and committed themselves to elaborating on details, only to have it prove too difficult and thus possibly not materialize in due time. Police reform, at least a 'soft' version of the same, is the main ingredient in the reform package that the EU wishes to see resolved first.

The inordinate difficulties associated with resolving matters at the upper level contrasts sharply with the good performance to be observed extensively at the lower – and local – levels of public administration. This, together with the population's eagerness to achieve a good measure of economic success, has turned BiH into a country characterized by 'business as usual'. Were it to focus more on strategic solutions at the top, the country could be much more affluent than at present. The relative weakness of the central government is evident in its treatment of the budget for 2008 amounting to some EUR 1.19 billion as compared to the FBiH budget of EUR 1.76 billion. Another telling feature is that by end of January 2008 the FBiH budget proposal had already sailed through parliament, whereas the central government budget was still floundering in all the toing and froing between the Council of Ministers and the BiH Presidency.

In BiH, exposure to the developments in energy and food prices is greater than exposure to the turbulences on the financial markets. As slower global GDP growth is likely to allow energy and cereal markets to recede into calmer waters, we can count on less inflation and slower import growth. The corporate sector's positive development should continue; thus, under 'normal conditions' we can reckon with higher growth in the period 2009-2010. As for SAA requirements, a last-minute solution is feasible. BiH may thus gain access to greater financial support in the near future. In that context, the problem that arises is one of an almost complete lack of ideas on how to use the funds once they become available – not to mention the lack of preparations for implementing those ideas.

Table BA

Bosnia and Herzegovina: Selected economic indicators

	2002	2003	2004	2005	2006	2007 ¹⁾	2008	2009	2010
	Forecast								
Population, th pers., mid-year	3,828	3,832	3,842	3,843	3,845	3,846	.	.	.
Gross domestic product, BAM mn, nom. ²⁾	12,829	13,443	15,786	16,928	19,106	20,400	22,500	24,100	26,100
annual change in % (real)	5.5	3.0	6.3	4.3	6.2	5	4.5	5	6
GDP/capita (EUR at exchange rate)	1,714	1,794	2,101	2,252	2,541	2,712	.	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	3,980	4,100	4,810	5,130	5,580	6,010	.	.	.
Gross industrial production									
annual change in % (real) ³⁾	5.7	5.1	12.0	11.0	11.7	7	5.5	9	10
Net agricultural production, total									
annual change in % (real)	7.9	-7.5	20.3	-3.1	.	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	.	.	15,018	16,514	18,064	19,400	.	.	.
annual change in % (real)	.	.	.	6.2	4.5	6	3	5	5
Gross fixed capital form., BAM mn, nom. ²⁾	.	.	4,044	4,889	4,480	5,000	.	.	.
annual change in % (real)	.	.	.	18.5	-13.2	10	8	8	10
LFS - employed persons, th, avg. ⁴⁾	811.0	849.6	.	.	.
annual change in %	.	.	.	.	.	4.8	.	.	.
Reg employees total, th pers., end of period	637.7	634.0	638.4	642.4	652.8	679.2 ^{I-X}	.	.	.
annual change in %	1.9	-0.6	0.7	0.6	1.6	4.2 ^{I-X}	.	.	.
LFS - unemployed, th pers., average ⁴⁾	366.8	346.7	.	.	.
LFS - unemployment rate in %, average ⁴⁾	31.1	29.0	29	28	27
Reg. unemployment rate in %, end of period	40.9	42.0	43.2	44.2	44.8	43.4 ^X	.	.	.
Average gross monthly wages, BAM	660	717	748	798	869	939	.	.	.
annual change in % (real, net) ⁵⁾	-0.6	7.3	3.6	3.5	1.4	6.4	.	.	.
Consumer prices, % p.a. ⁶⁾	1.3	1.1	0.8	3.0	6.2	1.5	5.5	2	2
General governm. budget, nat. def., % GDP									
Revenues	40.0	44.8	40.4	41.1	44.8	44	45	44	43
Expenditures	40.1	44.0	38.8	38.7	41.9	42	43	42	41
Deficit (-) / surplus (+), % GDP	-0.1	0.8	1.6	2.4	2.9	2	2	2	2
Public debt in % of GDP	34.8	30.6	27.5	27.5	23.4	.	.	.	.
Current account, EUR mn ⁷⁾	-1,252	-1,439	-1,318	-1,605	-971	-1,400	-1,350	-1,300	-1,300
Current account in % of GDP	-19.1	-20.9	-16.3	-18.5	-9.9	-13.4	-11.7	-10.6	-9.8
Gross reserves of CB excl. gold, EUR mn ⁸⁾	1,270	1,428	1,779	2,160	2,787	3,273 ^{IX}	.	.	.
Gross external public debt, EUR mn	2,193	2,052	2,061	2,218	2,082	2,009 ^{IX}	.	.	.
Gross external public debt in % of GDP	33.4	29.9	25.5	25.6	21.3	.	.	.	.
FDI inflow, EUR mn	281.8	337.7	566.9	478.3	564.2	1,630	600	.	.
FDI outflow, EUR mn	.	.	1.3	1.0	1.8	.	.	.	.
Exports of goods, BOP, EUR mn ⁷⁾	1,169	1,303	1,677	2,087	2,687	3,100	3,650	4,350	5,250
annual growth rate in %	-7.8	11.5	28.7	24.5	28.7	15	18	19	21
Imports of goods, BOP, EUR mn ⁷⁾	4,692	4,974	5,355	6,091	6,093	7,400	8,000	8,750	9,700
annual growth rate in %	2.5	6.0	7.6	13.8	0.0	21	8	9	11
Exports of services, BOP, EUR mn ⁷⁾	552	636	696	767	885	1,000	1,150	1,300	1,450
annual growth rate in %	-0.7	15.2	9.4	10.2	15.3	13	15	13	12
Imports of services, BOP, EUR mn ⁷⁾	320	339	349	372	402	430	460	490	525
annual growth rate in %	6.2	5.9	3.0	6.5	8.2	7	7	7	7
Average exchange rate BAM/USD	2.077	1.734	1.576	1.573	1.559	1.438 ^{I-XI}	.	.	.
Average exchange rate BAM/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/USD, wiiw ⁹⁾	0.720	0.722	0.719	0.727	0.748	0.722	.	.	.
Purchasing power parity BAM/EUR, wiiw ⁹⁾	0.843	0.855	0.855	0.859	0.890	0.883	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2004 GDP figures include the Non-Observed Economy (NOE). - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) Data based on LFS April 2006 and April 2007. - 5) wiiw calculation. - 6) Until 2005 costs of living, from 2006 harmonized CPI. - 7) Converted from the national currency. - 8) From 2006 including investment in foreign securities. - 9) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics, IMF; wiiw forecasts.