

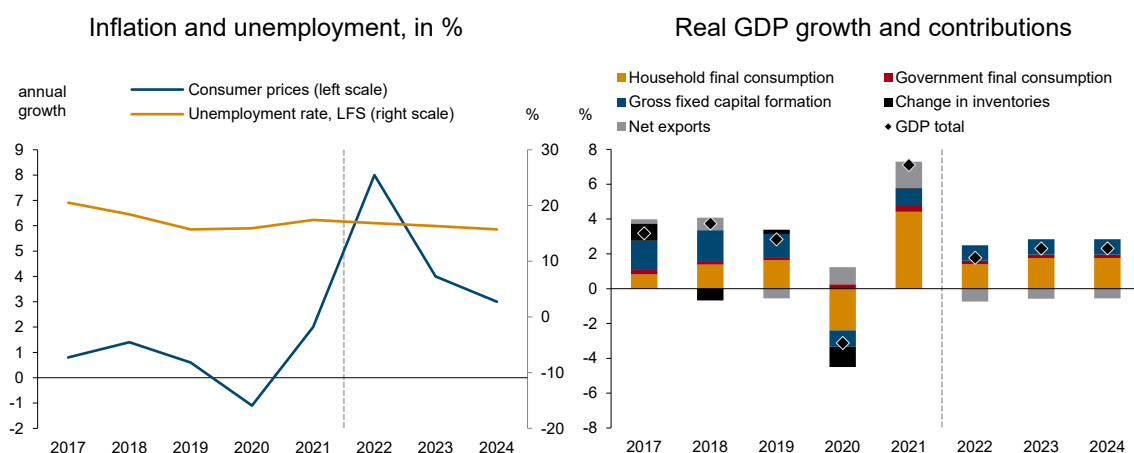


BOSNIA AND HERZEGOVINA: Local political tensions leave the country in limbo

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The economy grew more strongly than expected in 2021, due to a significant rise in industrial production, private consumption and exports. However, growth in 2022 is expected to be much weaker, given the threats of high inflation brought about by the war in Ukraine and the rise in local political tensions. The entity governments have failed to reach agreement on decisions that are important to the country's progress, and this is undermining its prospects for European integration, while also rendering it less attractive to both foreign investors and its own citizens, who are leaving the country in droves.

Figure 4.3 / Bosnia and Herzegovina: Main macroeconomic indicators



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

The economy grew by an estimated 7.1% in 2021, thereby significantly exceeding the level of pre-pandemic 2019. The high growth rate is a result of a significant increase in industrial production (10.7%), private consumption (6.1%) and exports (42.3%), as the COVID-related restrictions were fairly mild in 2021. Tourism recovered significantly, with total visitor nights increasing by 79.6% in 2021, compared to the previous year. Remittances, which make up around 8% of GDP, increased by 20% in 2021, exceeding the pre-pandemic level. Steeply rising food and energy bills meant that inflation surged towards the end of the year, reaching 6.3% in December; however, the annual figure was just 2%, thanks to a low rate in the first half of the year. Economic recovery on the one hand, and a reduction in pandemic-related fiscal support on the other have turned a fiscal deficit of 5.3% of GDP in 2020 into an estimated surplus of 3.5% in 2021, providing a welcome fiscal buffer in light of the increased uncertainty caused by the Russia-Ukraine war.

Although direct economic ties with Russia and Ukraine are limited, the effect of the war in Ukraine can already be felt in the financial sector and prices. There was a run on one Russian-owned bank that operated across Bosnia and Herzegovina and that had a market share of around 5%. The bank was then bought by a domestic finance company, which put a stop to the run; however, the memory of the Bosnian war and the fear of conflict locally have resulted in reduced confidence in the banking sector. The increased demand for food – partly a consequence of the fear of further price rises occasioned by the Russia-Ukraine war and partly the result of anxiety about local conflict and food shortages – has led to additional pressure on the already high supply-side-driven inflation. Thus, inflation in February reached 8.1%, its highest level since 2008.

Due to the anticipated increase in international food and energy prices and weak domestic stocks and alternative sources, we expect inflation to grow significantly in 2022. Inflation is expected to climb to 8% in 2022 and to stand at 4% in 2023 – up 7 percentage points (pp) and 2.8 pp, respectively, on the previous forecast. These forecasts assume that there are no new shocks, as inflation in February (i.e. before the war), when oil and gas were still not that expensive, was above 8%. Since wages and pensions are not aligned with rising market prices, citizens are currently facing a lower standard of living. Since the central bank of Bosnia and Herzegovina operates a currency board, it does not have the tools necessary to combat rising inflation. The only instrument available is the bank reserve requirement; but banks already hold high levels of excess reserves, despite the negative rates on those that were introduced in 2016. Fiscal policy has so far failed to temper the inflation shock, as a lack of political consensus has meant that all proposals to temporarily abolish excise duties on oil and petroleum products and to introduce a lower value added tax on essential products have been rejected. No other measures (such as price controls) related to the new inflation threats in 2022 have been announced.

Political tensions have been growing since the end of 2021, threatening the country's internal security and stability and slowing the EU accession process. One part of the country, Republika Srpska, has been disrupting the work of state institutions since late 2021, and has started to take steps to create its own army, tax authority and judiciary, which could lead to its secession. The US, the UK and some EU countries have announced economic and financial sanctions on anyone who violates the constitutional order in Bosnia and Herzegovina, should the secession activities continue. Meanwhile, the entity governments have failed to reach agreements and take decisions that are important for the country's future. A law on the prevention of conflicts, which was stipulated as a condition by the European Commission for progress in the EU accession process, was rejected. Even the country's position on the subject of Russian aggression against Ukraine is not unified: two members of the presidency condemn the actions, while the member from Republika Srpska wants to maintain a neutral stance and even advocates a further strengthening of energy cooperation with Russia. Moreover, one part of the other entity, the Federation of Bosnia and Herzegovina, is insisting on changing the Election Law, but no agreement can be reached; this has resulted in heightened tension within this entity as well, and increased uncertainty about the October elections. Although all of these tensions might simply be a way for ruling politicians to boost their popularity ahead of the elections, they are jeopardising the country's political stability, its economic progress and the support of the EU, and are potentially opening up the possibility of renewed inter-ethnic violence.

Due to the rising inflation rates and the increase in political domestic and foreign risks, our forecasts for GDP growth have been revised downwards. We expect GDP to grow by 1.8% in 2022 and by 2.3% in 2023 – a downward revision of 1.3 and 1.2 pp, respectively. This is mostly a reflection of the increased political risks, which are likely to lead to postponement of the implementation of public infrastructure projects and private sector investment; reduced purchasing power due to inflation, which will slow consumer spending; and weaker exports, due to lower EU demand caused by the war in Ukraine. Exports of goods and services and private consumption will continue to increase (albeit at a slower pace), which will contribute to GDP growth, provided the political tensions do not escalate.

A further consequence of the increased tension and the fear of violent new conflicts is an upsurge in the number of people leaving the country, which only serves to damage the country's long-term prospects. In surveys across the country, citizens are voicing their dissatisfaction with their life in Bosnia and Herzegovina and their feeling of a lack of security and progress. As a result, the number of people leaving the country has been rapidly increasing. Governance weaknesses and inefficiencies are damaging the economic and business environment, as the country fails to implement the reforms needed to strengthen the single economic space and draw it towards further integration with the European Union. As a consequence, investment is less attractive, more people are leaving the country and employers have already started reporting a lack of quality workforce. This will weigh heavily on economic growth in years to come, reducing the country's long-term economic prospects.

Table 4.3 / Bosnia and Herzegovina: Selected economic indicators

	2018	2019	2020	2021 ¹⁾	2022	2023	2024
					Forecast		
Population, th pers., average	3,496	3,491	3,475	3,445	3,415	3,385	3,355
Gross domestic product, BAM m, nom. ²⁾	33,444	35,296	34,255	37,324	41,000	43,600	45,900
annual change in % (real)	3.7	2.8	-3.1	7.1	1.8	2.3	2.3
GDP/capita (EUR at PPP) ²⁾	9,620	10,110	9,840	10,890	.	.	.
Consumption of households, BAM m, nom. ²⁾	24,639	25,633	24,756	26,225	.	.	.
annual change in % (real)	1.8	2.2	-3.3	6.1	2.0	2.5	2.5
Gross fixed capital form., BAM m, nom. ²⁾	7,610	8,129	7,690	8,164	.	.	.
annual change in % (real)	8.1	5.8	-4.1	4.4	4.0	4.0	4.0
Gross industrial production							
annual change in % (real)	1.6	-5.3	-6.4	10.7	3.0	2.0	2.0
Gross agricultural production ³⁾							
annual change in % (real)	21.5	-8.4	-1.0	0.3	.	.	.
Construction output total							
annual change in % (real)	0.4	-2.0	0.2	2.4	.	.	.
Employed persons, LFS, th, average ⁴⁾	822.4	802.9	1,173.1	1,151.0	1,160	1,170	1,180
annual change in %	0.8	-2.4	.	.	0.5	0.5	0.5
Unemployed persons, LFS, th, average ⁴⁾	185.5	149.4	221.0	241.8	235	228	220
Unemployment rate, LFS, in %, average ⁴⁾	18.4	15.7	15.9	17.4	16.8	16.3	15.7
Reg. unemployment rate, in %, eop	34.7	32.8	33.6	31.0	.	.	.
Average monthly gross wages, BAM	1,363	1,421	1,476	1,542	1,670	1,750	1,820
annual change in % (real, gross)	1.7	3.7	5.0	2.4	0.0	0.5	1.0
Average monthly net wages, BAM	879	921	956	998	1,080	1,130	1,180
annual change in % (real, net)	1.9	4.2	4.9	2.4	0.0	0.5	1.0
Consumer prices, % p.a.	1.4	0.6	-1.1	2.0	8.0	4.0	3.0
Producer prices in industry, % p.a.	3.5	0.1	-1.2	5.6	12.0	6.0	4.0
General governm. budget, nat. def., % of GDP							
Revenues	43.0	42.5	42.1	38.5	39.0	39.5	40.0
Expenditures	40.8	40.6	47.4	35.0	39.0	39.0	39.0
Deficit (-) / surplus (+)	2.2	1.9	-5.3	3.5	0.0	0.5	1.0
General gov. gross debt, nat. def., % of GDP	34.2	32.8	36.6	35.2	35.0	35.0	35.0
Stock of loans of non-fin. private sector, % p.a.	5.5	6.7	-2.5	3.7	.	.	.
Non-performing loans (NPL), in %, eop	8.8	7.4	6.1	5.3	.	.	.
Central bank policy rate, % p.a., eop ⁵⁾
Current account, EUR m ⁶⁾	-559	-504	-657	-410	-780	-870	-960
Current account, % of GDP	-3.3	-2.8	-3.8	-2.1	-3.7	-3.9	-4.1
Exports of goods, BOP, EUR m ⁶⁾	5,327	5,205	4,818	6,500	7,770	8,660	9,400
annual change in %	11.5	-2.3	-7.4	34.9	19.5	11.5	8.5
Imports of goods, BOP, EUR m ⁶⁾	9,172	9,277	8,034	10,179	12,320	13,820	15,060
annual change in %	7.1	1.1	-13.4	26.7	21.0	12.2	9.0
Exports of services, BOP, EUR m ⁶⁾	1,959	2,117	1,229	1,910	2,310	2,660	2,950
annual change in %	10.0	8.0	-42.0	55.4	21.0	15.0	11.0
Imports of services, BOP, EUR m ⁶⁾	624	689	457	587	690	770	850
annual change in %	5.7	10.4	-33.7	28.6	18.0	12.0	10.0
FDI liabilities, EUR m ⁶⁾	507	388	364	445	.	.	.
FDI assets, EUR m ⁶⁾	16	111	68	38	.	.	.
Gross reserves of CB excl. gold, EUR m ⁶⁾	5,835	6,311	6,942	8,204	.	.	.
Gross external debt, EUR m	11,211	11,395	11,264	11,470	13,000	14,000	15,000
Gross external debt, % of GDP	65.6	63.1	64.3	60.1	62.0	62.8	63.9
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 2020. - 4) Until 2019 survey once a year and according to census 1991. From 2020 continuous quarterly survey based on census 2013 and according to EU + ILO definition. 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.