BOSNIA AND HERZEGOVINA

Highlights

- **Progress on the country's reform agenda has stalled in 2017.** Key prior actions required under the existing programme with the International Monetary Fund (IMF) have been delayed for months, holding up the first review of the programme and jeopardising international funding for important infrastructure projects.
- **Macroeconomic performance has been resilient.** Growth has remained positive in recent years despite adverse shocks and a difficult investment climate, and short-term indicators in 2017 on industry and exports continue to move in a positive direction.
- **Major privatisations in the Federation remain stalled.** Although some sales have occurred in the past year, key assets remain in state hands and there appears to be little or no appetite to make substantive progress on privatisation for the two state-owned telecommunications companies.

Key priorities for 2018

- **The reform agenda needs to be kick-started again.** The main short-term priority is to get the IMF programme back on track and complete the long-delayed first review by implementing the necessary prior actions.
- **Key investment climate improvements should be targeted and implemented.** The authorities have shown a willingness to engage in reforms in this area. The challenge now is to improve the dialogue between the authorities and the private sector on investment-related issues and to deliver results in areas such as procurement reform, enhancing tax administration, and improving business registration.
- **Regional integration should be enhanced.** Bosnia and Herzegovina has belatedly agreed to join the Western Balkans Transport Community, but it will be vital to accelerate reforms in order to benefit from the international support for infrastructure projects that promote regional connectivity.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	2.4	1.1	3.1	3.2	2.5
Inflation (average)	-0.1	-0.9	-1.0	-1.1	1.8
Government balance/GDP	-1.9	-2.9	-0.2	0.4	-0.4
Current account balance/GDP	-5.3	-7.4	-5.5	-4.5	-4.3
Net FDI/GDP [neg. sign = inflows]	-1.3	-2.8	-1.5	-1.6	-1.6
External debt/GDP	61.7	63.7	63.7	62.8	n.a.
Gross reserves/GDP	27.6	26.3	29.7	31.1	n.a.
Credit to private sector/GDP	56.6	56.4	54.9	55.5	n.a.

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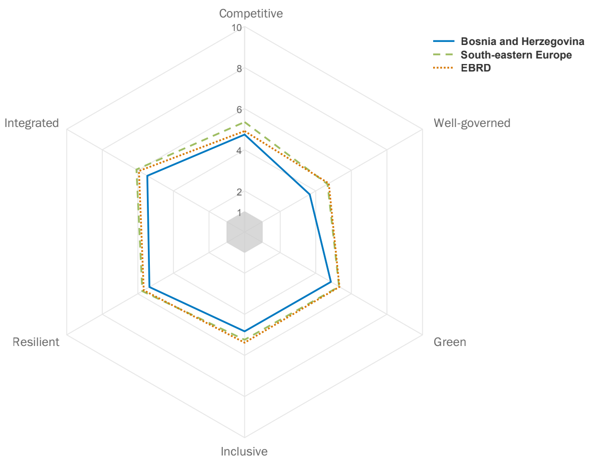
Macroeconomic performance

The economy has shown resilience in recent years. Growth in 2016 is estimated at 3.2 per cent, following a recent revision upwards, after 3.1 per cent in 2015. The economy continued to grow in the first half of 2017 albeit at a slower rate, estimated at 2.2 per cent year-on-year. The slow-down was driven by a weaker performance of the agricultural sector compared with the same period last year, as well as a levelling of the industry sector. In addition, the construction sector's performance was subdued as the implementation of some key infrastructure projects, including Corridor Vc, is delayed.

A reform slow-down in 2017 is threatening external financing. The completion of the first review of the three-year Extended Fund Facility signed with the IMF in September 2016 has been held up for many months. Staff-level agreement on the review had been reached in November 2016 but delays have occurred in implementing several prior actions (see below). As a result, further disbursements from the IMF are on hold and some financing from the European Commission and from international financial institutions (IFIs), including the EBRD and EIB, is on hold or jeopardised. However, the appropriate budgets for 2017 that fulfil IMF requirements were approved in both entities. Public debt is relatively low by regional standards at around 40 per cent of GDP, implying some room for a modest increase in borrowing in the short term.

Growth is expected to continue in the short term. In light of the delays in implementing major infrastructure projects, GDP growth is likely to be just 2.5 per cent in 2017, rising to 3.0 per cent in 2018. The economy has proven to be resilient in the past to reform slow-downs and political upheavals, but the downside risks to this forecast are still significant. The weak investment climate deters investment and the country's complex institutional structure continues to impede the implementation of reforms and holds back growth. In the medium term, however, growth prospects could be enhanced if governments at all levels step up implementation of the ambitious reform agenda and if the EU approximation process advances further.

Assessment of transition qualities (1-10)



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Major structural reform developments

Important reforms are on hold. The IMF programme signed in September 2016 was intended to be a complement to the country's Reform Agenda adopted in July 2015 and a strong anchor for fiscal, financial and structural reforms. The first review of the programme has been on hold since late 2016 as a result of the failure to implement a number of prior actions. These include amendments to the law on deposit insurance to strengthen oversight of the system, and amendments to the law on excise duties to raise fuel taxes to help ensure the sustainability of financing for the road sector. A further set-back occurred in July 2017 at the Western Balkans Summit in Trieste, where Bosnia and Herzegovina was the only country not to sign the Treaty on the establishment of the Western Balkans Transport Community. However, this decision was reversed by the Bosnian authorities in September 2017 and the Treaty has now been signed.

Bosnia and Herzegovina is completing the European Union's questionnaire, received in December 2016. In September 2016, the EU General Affairs Council decided to recommend to the European Commission (EC) to launch the procedure for granting Bosnia and Herzegovina candidate status. This follows the submission of an application for membership in February 2016, and the entry into force of the country's Stabilisation and Association Agreement (SAA) on 1 June 2015. The government expects to submit answers to the EC's questionnaire in the last quarter of 2017. A Stabilisation and Association Council (SA Council) between Bosnia and Herzegovina and the EU has been established and held its second meeting in July 2017. The country is also in the final stages of accession to the World Trade Organization.

Major privatisations in the Federation continue to be stalled. In March 2017, the Federation government launched a tender for the sale of its stake in the insurance company Sarajevo Osiguranje. This is the sixth attempt to sell the stake after the previous five have failed due to lack of interest. However, resistance to this privatisation and others within the Federation remains strong. There are no plans yet to commit to privatising the telecommunications companies BH Telekom and HT Mostar, and the launch of due diligence for both companies – another prior action for the IMF programme – has not started.

The Energy Community has re-introduced sanctions against Bosnia and Herzegovina. On 1 April 2017, the Energy Community re-introduced sanctions because of the country's failure to adopt necessary legislation regarding the transmission of electricity and gas at state level. Bosnia and Herzegovina has also been accused of breaking Energy Community rules over thermal power plants under construction. The Energy Community secretariat has launched a case on the environmental impact assessment of the planned Ugljevik III thermal power plant (TPP), saying that the plant's environmental impact assessment procedure was not carried out in compliance with Energy Community rules. Also, in February 2017, the Energy Community secretariat ordered Bosnia and Herzegovina to revise the permit for Banovici TPP to take account of air pollution limits, thus accepting a complaint by the Sarajevo-based environmental watchdog Ekotim against Bosnia and Herzegovina's decision to grant permission for the construction of the 350 MW Banovici TPP.

The Banja Luka bourse has joined the SEE Link. One of the country's two bourses — the Banja Luka Stock Exchange (BLSE) – has become an active member of the SEE Link network. So far, the SEE Link network has included the exchanges of Bulgaria, FYR Macedonia and Croatia, which founded the network, as well as those of Slovenia and Serbia, which became official members in December 2016. SEE Link is a project, launched in February 2016, aiming to create a regional infrastructure for the trading of securities listed on the regional markets.

The Federation has adopted a new banking system law. In January 2017, the government of Federation of Bosnia and Herzegovina adopted a new law on the banking system, aiming to improve the stability of the banking sector. In March 2017, the law was approved by the parliament. The law is aligned to EU directives, which include stronger supervision of banks, a risk management system, restructuring of banks and other provisions related to the corporate governance in banks. It is harmonised with the Republika Srpska, where the respective banking laws have already been adopted.