



BOSNIA AND HERZEGOVINA

Highlights

- **The economy has once again proved to be resilient to reform slow-down and political uncertainty.** GDP grew by 3.0 per cent in 2017, following similar growth rates in the previous two years.
- **Reforms have slowed down in 2018 in advance of elections.** Some progress occurred in late 2017 when the law on an increase of the fuel excise duties was adopted, paving the way for a resumption of infrastructure financing. Since then, reforms have slowed markedly and the latest review of the IMF programme has been delayed.
- **Privatisation in the Federation remains stalled, despite having announced plans.** Major assets remain in state hands and there appears to be little appetite to make substantive progress.

Key priorities for 2019

- **New growth momentum is needed.** Once new governments are in place following the October 2018 elections, it is vital that a firm commitment is made to a new reform agenda, with a concrete, measureable set of deliverables on improving the investment climate and standards of governance, and advancing the country's EU approximation agenda.
- **The Federation's telecommunications companies should be privatised.** Progress in this area would not only improve the financial viability of the companies but also demonstrate a genuine commitment to attracting investment in key sectors.
- **Further efforts are needed to resolve non-performing loans (NPLs).** While the situation has improved in recent years, banks still face difficulties in writing off NPLs or selling them to non-bank entities.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.1	3.1	3.1	3.0	3.0
Inflation (average)	-0.9	-1.0	-1.1	1.2	1.4
Government balance/GDP	-2.9	-0.2	0.3	2.1	1.5
Current account balance/GDP	-7.4	-5.4	-4.9	-4.8	-6.0
Net FDI/GDP [neg. sign = inflows]	-2.9	-1.7	-1.6	-2.1	-2.1
External debt/GDP	61.6	62.3	62.4	61.0	n.a.
Gross reserves/GDP	26.3	29.6	30.5	35.7	n.a.
Credit to private sector/GDP	56.4	55.0	54.4	55.8	n.a.

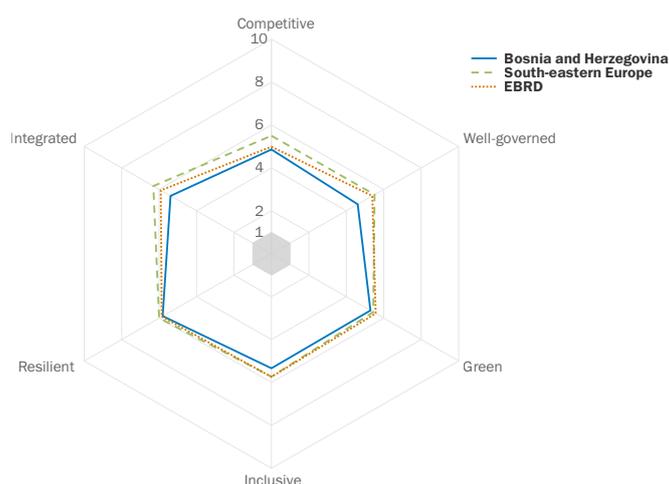
Macroeconomic performance

Moderate growth has continued. The economy grew by an estimated 3.0 per cent in 2017, following similar growth rates in the previous two years, and has once again proved to be resilient to reform slow-downs and political uncertainty. Services, and particularly domestic trade, were the main growth drivers, supported by private consumption. Industry also performed well last year, whereas the agriculture sector had a slight drag on growth. At the same time, there was a significant slow-down in investments, partly due to the significant delays in implementing reforms needed to unlock major infrastructure projects. Remittance inflows to Bosnia and Herzegovina rose by 7.2 per cent in 2017 to €1.3 billion, about 8.0 per cent of GDP, helped by the economic recovery in the eurozone. However, the overall current account remains in deficit at almost 5.0 per cent of GDP. GDP growth continued into the first half of 2018 at a similar pace, of 2.9 per cent year-on-year. Investment levels recovered after a slow-down in 2017, as adoption of the law on an increase of fuel excise duties in late 2017 paved the way for a resumption of infrastructure financing.

Further delays are occurring to the IMF programme amid fiscal concerns. Economic reforms are currently anchored by a €533 million, three-year IMF Extended Fund Facility signed in September 2016. However, progress under the programme has been far from smooth. The first review was eventually completed in February 2018 after an approximately one-year delay. The passage through parliament, after several failed attempts, of the law on an increase of the fuel excise tax in December 2017 enabled the completion of the review. However, the second review is currently on hold because of concerns over new spending proposals in both entities: in the Federation, the government adopted a law expanding benefits for veterans, while the government in Republika Srpska decided to increase the minimum wage and pensions as of 1 July 2018.

Further growth is expected in the short term, but downside risks are significant. The economy is projected to grow by 3.0 per cent in 2018 and 3.5 per cent in 2019. The resumption of infrastructure financing in the roads sector, including for Corridor Vc, and investment should therefore play a more growth-supportive role in the coming period. Nevertheless, uncertainty associated with the aftermath of the general elections in October 2018 and the stalling, or even possible reversal, of reforms remain important downside risks.

Assessment of transition qualities (1-10)



Major structural reform developments

Progress in reforms remains slow. In February 2018 Bosnia and Herzegovina submitted answers to the EU's questionnaire, received in December 2016. The lengthy time it took to complete the questionnaire reflected the country's complicated, multi-layered administrative structure and internal disagreements. Having received the questionnaire, the European Commission is preparing an opinion on the country's EU membership application. In April 2018 the European Commission noted in its progress report that, although the state-level government had made some progress in implementing legislation changes agreed under the Reform Agenda in place since 2015, delivery on a number of reforms was delayed by lack of agreement within the ruling coalition members. The report urged the authorities of Bosnia and Herzegovina to adopt countrywide strategies in areas such as energy, employment and public financial management, and to step up reforms of public administration and the judicial system.

The business environment remains difficult. Bosnia and Herzegovina was ranked 89th overall (out of 190 countries) in the World Bank *Doing Business 2019* report, the lowest ranking among the Western Balkans countries. Nevertheless, the country has experienced a small improvement in its absolute score, on a scale from 0 to 100 (where the latter represents the best performance), and it now scores 63.55. The most problematic areas remain in dealing with construction permits, protecting minority investors, starting a business and enforcing contracts.

Privatisation in the Federation remains stalled, despite announced plans. In February 2018 the government of the Federation approved the privatisation plan for 2018, which foresees the sale of government equity in four major companies: the engineering company Energoinvest, fuel retailer Energopetrol, aluminium smelter Aluminij and insurer Sarajevo Osiguranje. However, resistance to the privatisation process within the Federation remains strong and prospects for successful sales are limited. There has also been no progress in the past year in privatising the telecommunications companies BH Telekom and HT Mostar, and the related due diligence – a prior action for the IMF programme – has not taken place yet.

Road construction is moving ahead. China's Shandong is close to securing a concession contract for the Banja Luka-Prijedor highway. The Chinese company and the Republika Srpska road company signed a deal to cooperate on the construction of the Banja Luka-Prijedor-Novi Grad highway in November 2017. The arrangement is worth US\$ 320 million. The 42 km-long Banja Luka-Prijedor section is the first phase of this deal. The concession is expected to be given for a period of 25 to 30 years and the Chinese company is supposed to secure funds for construction without sovereign guarantees from either the Bosnia and Herzegovina or Republika Srpska governments.

Renewable energy projects are advancing. Bosnia and Herzegovina aims to increase the share of electricity produced from renewable sources to 40 per cent by 2020 from the current 34 per cent. After being delayed for years due to legal issues, the construction of the 49.5 MW Trusina wind park in Republika Srpska is scheduled to start in the last quarter of 2018. The wind park, which is estimated to cost around €72 million, should be operational by the end of 2019. In July 2018 the authorities in Republika Srpska launched a tender for the construction of a 65 MW solar power plant near Ljubinje, which would be the country's largest so far.

Key banking legislation has advanced but has not yet been adopted. The government of Bosnia and Herzegovina has adopted the law on insurance of bank deposits, required by the IMF as part of the set of reforms aimed at stabilising the banking sector. The new legislation secures better protection of depositors and is part of an overall modernisation of the banking sector. Under the new law, banks that obtain permits to operate from the entities' banking agencies automatically enter into the deposit insurance process. The law is one of five to be adopted to reform the banking sector, and needs approval by the state-level parliament, which is still pending.