Bosnia and Herzegovina

Highlights

- **Growth is accelerating in 2024.** Following a subdued performance in 2023 (1.7 per cent real growth), real economic growth picked up to 2.4 per cent year on year in the first half of 2024, mainly due to a recovery in domestic demand and investment.
- **The European Council agreed to open European Union (EU) accession negotiations with Bosnia and Herzegovina.** However, no date has been set and the negotiating framework has not yet been put in place, pending the completion of required reforms.
- **The Council of Ministers of Bosnia and Herzegovina adopted, in June 2024, a Strategy for the Fight against Corruption for 2024-28, along with an action plan for its implementation.** The adoption of these strategic documents is one of the 14 key priorities the country needs to fulfil to advance on the path to EU membership.

Key priorities for 2025

- **Fiscal reform is needed to rebuild the country's financial reserves and enhance potential growth by shifting resources from current expenditure to capital investment.** This can be accomplished by reviewing employment and wage policies and better targeting of social spending.
- **Electricity pricing remains a significant fiscal risk, requiring urgent reform.** Measures are needed to address a situation in which household electricity prices are largely set below cost recovery levels, with domestic prices subsidised by export revenues. In addition, the authorities in the country's two entities either capped (Federation of Bosnia and Herzegovina) or froze (Republika Srpska) price increases for 2024. In the Federation of Bosnia and Herzegovina, the publicly owned energy utility proposed a block-tariff structure, which would have increased average household prices by 10 per cent, but the proposal was rejected by the regulator.
- **Top priorities should be stronger measures to prevent and combat corruption, enhanced transparency and accountability, and the safeguarding of financial integrity.** Poor governance and the weak rule of law continue to hinder sustained and inclusive growth. The new Law on Anti-Money Laundering and Counter-Terrorism Financing aligns the country's framework with Financial Action Task Force standards, but further efforts are required to ensure its effectiveness.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.0	7.4	4.2	1.7	2.8
Inflation (average)	-1.1	2.0	14.0	6.1	2.0
Government balance/GDP	-4.6	0.6	0.9	-1.2	-2.4
Current account balance/GDP	-2.8	-1.8	-4.3	-2.7	-5.0
Net FDI/GDP [neg. sign = inflows]	-2.4	-3.2	-3.3	-3.5	-4.0
External debt/GDP	63.9	57.4	51.7	49.5	na
Gross reserves/GDP	39.8	41.7	35.1	33.2	na
Credit to private sector/GDP	57.7	53.3	48.1	48.3	na

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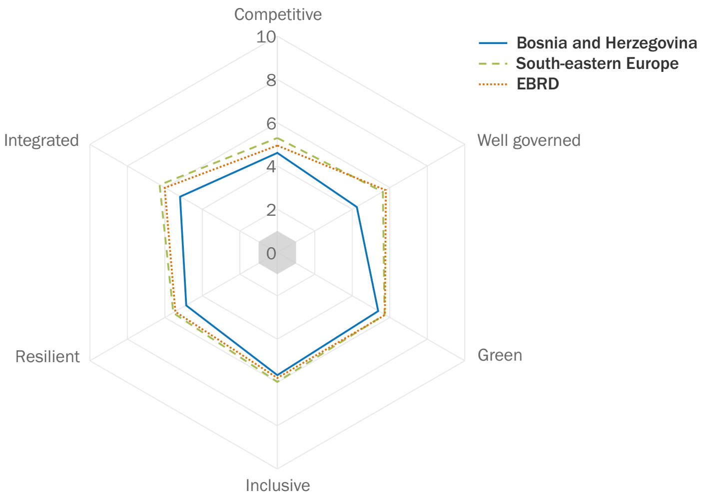
Macroeconomic developments and policy response

Economic growth is accelerating. Following a slowdown to 1.7 per cent in 2023, real gross domestic product (GDP) growth picked up to 2.4 per cent year on year in the first half of 2024. This was on the back of a strong rise in fixed investment and robust growth in private consumption due to easing inflation and growing remittance inflows. The contribution of net exports was negative due to simultaneous growth in goods imports and a decline in goods exports, the latter driven by subdued external demand. The current account deficit almost doubled from the first half of 2023 to around €720 million, or 6.0 per cent of GDP, in the first half of 2024. Foreign direct investment inflows stood at around €500 million in the first half of 2024, which is an 11.0 per cent decline compared with the first half of 2023. On the production side, growth in the first half was driven by services and construction, while industrial production declined.

Inflation is falling but fiscal policy remains expansionary. Inflation has fallen steadily in the past two years, from 14.0 per cent on average in 2022 to 1.7 per cent on average in the first nine months of 2024, in line with global trends. However, the authorities in both entities have followed an expansionary fiscal policy in 2024, with increases in the minimum wage and pension adjustments in both entities and higher public-sector wages in certain cantons of the Federation of Bosnia and Herzegovina. The consolidated state-wide fiscal balance shifted from a surplus of 0.9 per cent of GDP in 2022 to a deficit of 1.7 per cent of GDP in 2023, due to the cumulative effect of multiple permanent increases in public wages and social benefits. The rising deficits, coupled with substantial debt repayments, have resulted in significant depletion of the country's financial buffers.

Economic growth is expected to pick up in the short term. Real GDP growth is forecast to reach 2.8 per cent in 2024, mainly on the back of recovering domestic demand and improving capital investment execution. A further increase to 3.0 per cent is expected in 2025 as external demand recovers, resulting in a rise in net exports. The main downside risks to the outlook are domestic political issues, which often delay or hinder important reforms or infrastructure projects. On the positive side, the country's EU candidacy status could give a much-needed boost to reforms.

Assessment of transition qualities (1-10)



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Structural reform developments

The reform agenda is facing delays, jeopardising external disbursements. The EU's Growth Plan and Reform and Growth Facility for the Western Balkans are designed to accelerate reforms in several areas in Bosnia and Herzegovina. The most important areas are: fundamental rights and democratic institutions; judicial reforms and the fight against corruption; the green and digital transition; improvements to the business environment; and education and labour-market reform. Planned allocations for Bosnia and Herzegovina are close to €1 billion, with one-third of that in grants and the rest in concessional loans. However, disbursement of the funding is conditional on the country adopting the reform agenda (which has not yet been done) and then implementing it.

Parliament passed a new Law on Anti-Money Laundering and Counter-Terrorism Financing. The new law, adopted in February 2024, seeks to harmonise Bosnia and Herzegovina's legal and regulatory landscape with key EU standards. It introduces a comprehensive legal framework that recognises and regulates previously unregulated financial services and products, such as crypto assets and e-money.

The Council of Ministers has adopted a Strategy for Fighting Corruption for 2024-28, as well as an action plan for its implementation. The strategy and action plan adopted in June 2024 include five interconnected components: general principles, a vision, strategic goals, programmes, and specific activities aimed at achieving the vision and goals. The three primary strategic objectives are to enhance the system of prevention and coordination mechanisms, improve the mechanisms for detecting, proving and prosecuting corrupt criminal acts, and strengthening inter-institutional, regional and international cooperation.

The electronic certificate for digital representation is finally being implemented. From 1 June 2024 the Agency for Identification Documents, Records and Data Exchange of Bosnia and Herzegovina started entering electronic certificates for digital representation into citizens' identity cards. The legislation prescribing the registration of electronic certificates in ID cards has existed since 2012, but for the past 12 years, citizens have had cards with a chip, but no registered electronic certificates. Registration of electronic certificates enables citizens to comply with EU standards in the field of digital identification.

The government of the Federation of Bosnia and Herzegovina is working on three major reforms in parallel. The reforms are to the fiscal system, income tax policy and the minimum wage. A set of laws designed to relieve the burden on the economy and enable wage growth will be presented to parliament in the coming months. The minimum wage is expected to be raised to BAM 1,000 (€510) per month, which will also serve as the threshold for non-taxable income. Income above that amount will be taxed at a single rate. The proposal reportedly foresees lowering the income-tax rate from 41.5 per cent to 28.0 per cent. Changes are also planned with regard to tax on profits; the rate will remain at 10 per cent, but reinvested profits will be exempt from taxation and a dividend tax of 10 per cent will be introduced.