BOSNIA AND HERZEGOVINA

Table 1	**2022**
Population, million	3.2
GDP, current US$ billion	23.0
GDP per capita, current US$	7118.9
Life expectancy at birth, years[a]	75.3
Total GHG emissions (mtCO2e)	27.2

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2021).

After decelerating to 3.9 percent in 2022, real GDP growth is expected to further slow to 2.2 percent in 2023 as private consumption weakens. Annual inflation will remain elevated at 6 percent in 2023 driven by food, housing, and energy prices, weakening disposable income, and creating risks for poverty reduction. Upcoming municipal elections will likely make the 2022 fiscal surplus short-lived. Public debt is expected at about 36 percent of GDP. Structural reforms remain delayed mainly due to ongoing political frictions.

Key conditions and challenges

To become an EU candidate, BiH needs to address 14 reform priorities in the areas of democracy, the rule of law, human rights, and public administration. In parallel, economic criteria for EU accession require BiH to reduce internal market fragmentation by strengthening country-wide regulatory and supervisory institutions, enhancing transparency and efficiency of the oversized public sector, and reducing political involvement in the management of the public sector, including state-owned enterprises. EU accession will also require an improved business environment in part based on (i) simplified business registration and licensing procedures and (ii) harmonized and mutually recognized licenses and certificates between the entities.

BiH has shown macroeconomic stability and resilience over the past decade, including during the COVID-19 and post-COVID periods. These have been largely facilitated by three economic anchors: the currency board (which ties the BiH mark to the euro), the state-wide collection of indirect taxes through ITA, and EU membership prospects.

Nevertheless, with real income growth averaging around 1.6 percent from 2009 to 2019, living standards are stagnant as real per capita consumption is around 40 percent of the EU27 average. Faster convergence toward the EU27 average will be difficult to achieve due to low investment rates, a growth model that relies on private consumption, and absent structural reforms.

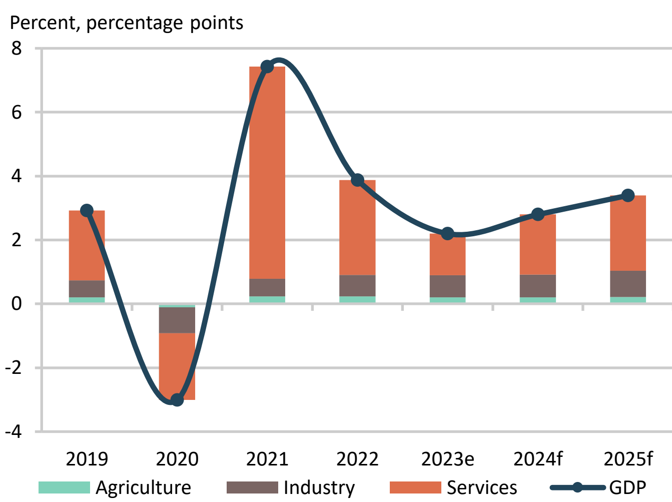
The implementation of structural reforms remains sluggish due to political frictions, pressures from frequent elections, widespread corruption, and fragmentation of responsibilities between the two entities and cantons. Because of the resulting poor welfare prospects, BiH exhibits one of the highest labor out-emigration rates in the Western Balkans.

Recent developments

In 2022, real GDP grew 3.9 percent compared to 7.4 percent the year before as the rebound from the post-pandemic period subsided. Economic activity slowed from 5.9 percent in Q1 2022 (yoy) to 1.7 percent in Q4 2022 (yoy) mainly due to output deceleration in manufacturing. This trend persisted into Q1 2023, with real output rising a mere 1.1 percent (yoy). The latter is primarily owed to the fall in private consumption, which contracted 0.4 percent (yoy) due to the weakening of real disposable income caused by high inflation.

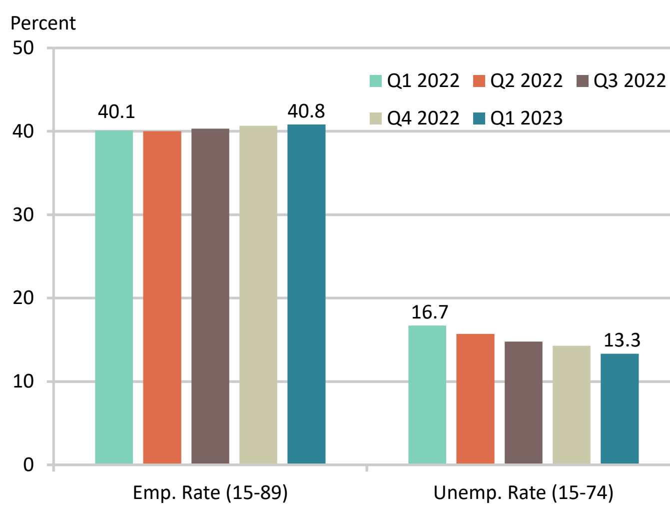
Inflation slowed to 4.9 percent in June (yoy), which translates into an inflation rate of 9.3 percent during January-June of 2023, a 2.2 percentage point contraction vis-à-vis the same period last year. Inflation dynamics were driven by higher food, housing, and transport prices, putting disproportionate stress on lower income groups, and generating risks for poverty reduction.

FIGURE 1 Bosnia and Herzegovina / Real GDP growth and contributions to real GDP growth



Sources: BiH Agency for Statistics (BHAS) and World Bank staff calculations.

FIGURE 2 Bosnia and Herzegovina / Labor market indicators



Sources: LFS 2021-2022 report and World Bank staff calculations.

Meanwhile, key labor market indicators remain static. The overall employment rate increased marginally to 40.8 percent in Q1 of 2023 compared to 40.1 percent in Q1 of 2022, while the unemployment rate shrunk to 13.3 percent, a 3.4 percentage points decline vis-à-vis Q1 2022. However, the decline in the unemployment rate was driven by people moving from employment to inactivity, and, thus, the overall activity rate declined by 1 percentage point during this period.

Stronger nominal tax revenues supported by high inflation generated a fiscal surplus of 0.4 percent of GDP in 2022. This compares to a deficit of 0.3 percent the year before, and 5.3 percent of GDP in 2020. Higher nominal expenditures in 2022 were driven by social measures aimed at softening the inflationary impact on households, and pre-election spending, including wage hikes and a hike in capital expenditures. Nevertheless, public debt remains low at 36 percent of GDP.

Adverse terms of trade caused a widening of the merchandise trade deficit during 2022 and the first half of 2023. The current account deficit therefore broadened to 4.5 percent in 2022 and is set to further widen to 4.7 percent of GDP in 2023. External financing largely entails net FDI inflows, mainly into the foreign-owned banking sector, which remained stable during the first half of 2023.

Outlook

Real GDP growth is set to decelerate to 2.2 percent in 2023, and 2.8 percent in 2024 as private consumption weakens due to the softening of real disposable income, and as exports adjust to much lower growth in the EU. By 2025, real output growth is expected to rebound to 3.4 percent as both exports and private consumption strengthen based on improving conditions in the EU and tightening labor markets. Stronger exports in 2024 and 2025 are likely to be offset by higher imports of consumer goods, resulting in a further widening of the current account deficit from 4.7 percent of GDP in 2023 to 5.1 percent by 2025. With general elections completed, and governments formed, the attention of policy makers could turn to the structural reform agenda and the fulfillment of legislative priorities for EU accession.

The return to fiscal surplus in 2022 is likely to be short-lived due to the upcoming municipal elections in 2024. Nevertheless, by 2024-25 the fiscal stance should be balanced again.

Given the ongoing supply shocks causing market disruptions and higher input costs for firms, inflationary pressures are projected to remain for some time. Hence, the inflation rate is expected to remain elevated at around 6 percent in 2023 and stabilize in 2024-25 at around 2 percent, in line with rates prior to the pandemic.

Downside risks dominate the outlook. Protracted market disruptions and uncertainty fanned by the war in Ukraine could have a negative impact on aggregate demand through depressed consumer and business confidence. Furthermore, the gradual recovery in the EU remains fragile, adversely impacting demand for BiH exports, except for energy. Adverse labor market developments across the EU could also limit remittance inflows, which support private consumption. Finally, geopolitical risks could further aggravate domestic political frictions with adverse consequences for the much-needed structural reform push.

TABLE 2 Bosnia and Herzegovina / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-3.3	7.1	4.0	2.2	2.8	3.4
Private consumption	-4.5	4.0	3.0	2.2	2.5	3.2
Government consumption	0.5	6.1	2.7	4.1	2.3	3.7
Gross fixed capital investment	-22.0	33.3	19.7	6.9	2.9	-0.4
Exports, goods and services	-8.5	5.0	9.9	4.0	5.5	6.0
Imports, goods and services	-13.4	8.0	12.0	6.0	4.0	3.4
Real GDP growth, at constant factor prices	-3.0	7.4	3.9	2.2	2.8	3.4
Agriculture	-1.5	3.4	3.5	3.1	3.0	3.2
Industry	-3.0	2.0	2.6	2.7	2.8	3.2
Services	-3.2	10.1	4.4	1.9	2.8	3.5
Inflation (consumer price index)	-1.1	2.0	14.0	6.0	2.5	1.0
Current account balance (% of GDP)	-4.0	-2.3	-4.5	-4.7	-4.8	-5.1
Net foreign direct investment inflow (% of GDP)	2.0	3.3	3.0	3.3	3.5	4.0
Fiscal balance (% of GDP)	-5.3	-0.3	0.4	-0.8	0.1	0.1
Revenues (% of GDP)	41.6	43.5	40.0	39.6	40.0	40.0
Debt (% of GDP)	40.3	38.0	35.9	36.2	36.1	35.8
Primary balance (% of GDP)	-4.0	1.0	1.2	0.0	0.9	0.9
GHG emissions growth (mtCO2e)	-2.5	7.7	5.5	3.7	3.6	4.1
Energy related GHG emissions (% of total)	86.6	87.2	87.7	87.7	87.6	87.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.