

BOSNIA AND HERZEGOVINA

Key conditions and challenges

Table 1 2021

Population, million	3.3
GDP, current US\$ billion	21.3
GDP per capita, current US\$	6513.1
Life expectancy at birth, years ^a	77.4
Total GHG Emissions (mtCO ₂ e)	28.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2019).

Real GDP growth is expected to decelerate to 2.9 percent in 2022 after rebounding to 6.5 percent in 2021. Meanwhile, inflation surged to 7 percent in January 2022 (yoy) compared to the annual rate of 2 percent last year. Delayed structural reforms impede EU accession and potential output growth. The war in Ukraine will likely aggravate price pressures resulting in an inflation rate of 4.8 percent in 2022.

BiH has been a potential EU candidate since 2016. Yet, little progress has been made in competitiveness-enhancing product market reforms and in improving the business environment. The internal market and the state institutional set-up are still highly fragmented, while country-wide supervisory and regulatory institutions remain weak.

Macroeconomic stability was maintained over the last decade largely facilitated by the currency board peg to the euro, which, together with the EU membership prospects remain a critical economic anchor. Despite real income growing roughly over 3 percent per annum since 2015, per capita GDP continues to hover around one-third of the EU27 average. A more pronounced convergence toward the EU27 average will be difficult to achieve with low investment rates and a growth model that relies on private consumption.

The pandemic has inflicted a significant cost on BiH's economy, yet a full recovery to the 2019 real income level has been achieved in 2021. That said, BiH is unlikely to catch up with the pre-pandemic growth trajectory, unless political bottlenecks are resolved.

BiH built fiscal buffers prior to the pandemic by running fiscal surpluses between 1 and 3 percent of GDP from 2015 to 2019. These surpluses helped rein in the current

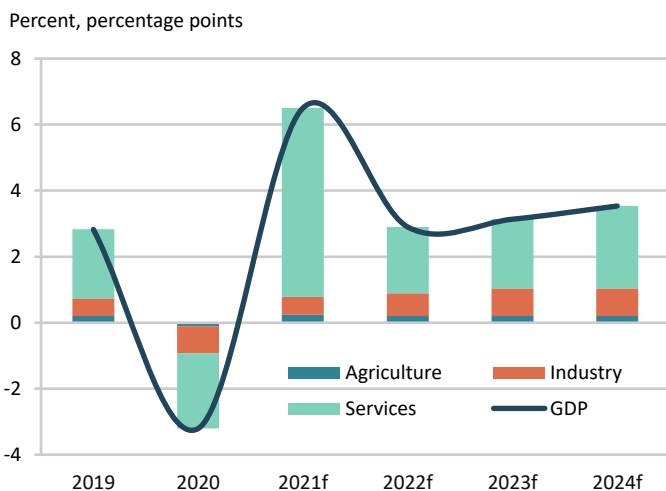
account deficits, financed largely by net FDI inflows.

Steady, albeit low, economic growth has not translated into more and better jobs, with a large share of the workforce active in the informal sector and stalled poverty reduction according to the latest official data from 2015. Implementation of much needed structural reforms remains sluggish due to political frictions, pressures from frequent elections, corruption that pervades all levels of society, and fragmentation of responsibilities between the two entities and Cantons. As a result of the political impasse and welfare prospects, BiH exhibits the highest stock of emigration across the Balkans.

Recent developments

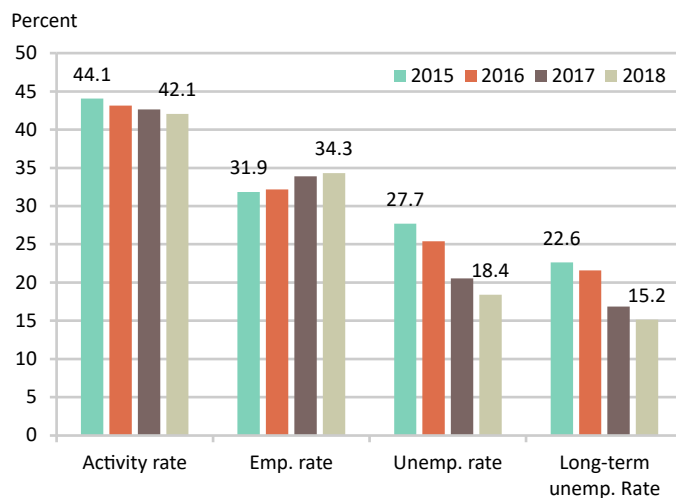
The rebound in economic growth estimated at 6.5 percent in 2021 was an exceptional performance, which helped real GDP exceed the pre-crisis level. Real growth was driven by a surge in exports, and robust growth in private consumption. Meanwhile, inflation accelerated to 7 percent in January 2022 (yoy) and totaled 2 percent in 2021 compared to a 1.1 percent deflation in 2020. The sharply rising prices during the last quarter of 2021 and in January 2022 were caused by stronger consumer demand, continuing supply chain problems, and a high passthrough effect given the currency board arrangement. Food and transport prices accelerated to 12 percent and 13.6

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



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

FIGURE 2 Bosnia and Herzegovina / Labor market indicators, 2020-2021



Sources: LFS 2020 - 2021 report, World Bank staff calculations.

percent in January 2022 (yoy), likely disproportionately affecting the less well-off. Despite a renewed acceleration in Covid-19 cases toward the end of 2021 and in January-February 2022, improvements in the labor market participation and employment rate continued through the end of 2021 (Figure 2).

A surge in tax revenues was not fully offset by higher spending, which resulted in a return to fiscal surpluses estimated at 0.5 percent of GDP in 2021, after a deficit of 1.8 percent of GDP in 2020. Higher public wages, and additional spending on goods and services as well as higher social benefits were aimed at softening the effects of the pandemic.

The sharp rise in exports narrowed the traditionally large merchandise deficit and helped narrow the current account shortfall to 3.2 percent of GDP in 2021 compared to 3.9 percent in 2020. External financing largely entailed net FDI inflows, mainly into the foreign-owned banking sector, which remained stable during the pandemic.

Without access to international markets, the authorities continue relying on support

from IFIs. The extent of this financial support will depend on the de-escalation of political tensions, which have risen significantly over the past ten months.

Outlook

Real GDP is projected to decelerate to 2.9 percent in 2022 and stabilize below 3.5 percent over the medium term. Growth is expected to be driven by a further pick up in private consumption fueled by remittances, tightening labor market, and domestic lending in the short term. Investment in energy and infrastructure will add to the growth stimulus over the medium term. Higher exports are likely to be offset by higher imports mainly for infrastructure projects. As the impact of the pandemic subsides, and the political paralysis is overcome, the Socio-Economic Program, fulfilling priorities for EU accession, is expected to gain attention.

The fiscal deficit in 2022 is likely to be driven by pre-election spending activities. A return to surplus may occur in 2023,

barring the implementation of changes to the VAT law.

With the global energy market disrupted due to the war in Ukraine, inflationary pressures are assumed to last longer than initially expected, leaving inflation at around 4.8 percent.

Several risks tilt the outlook to the downside. First, protracted effects of the war in Ukraine would have a negative impact on aggregate demand in BiH through lower business and consumer confidence. Second, war-related uncertainties and sanctions will dampen the recovery in the EU, adversely impacting demand for BiH exports. However, price and volume effects for BiH's exports of iron and steel products and aluminium could in part offset the negative effects of a slowdown in EU growth. Third, slower growth in the EU could also limit remittances, on which the country is dependent (close to 8 percent of GDP). Finally, these risks would be further aggravated, if geopolitical tensions shift to BiH and exacerbate already significant political frictions.

TABLE 2 Bosnia and Herzegovina / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	2.7	-3.1	6.5	2.9	3.1	3.5
Private Consumption	2.8	-4.5	4.0	2.7	3.1	3.5
Government Consumption	2.6	0.5	6.1	2.8	3.0	3.0
Gross Fixed Capital Investment	1.9	-20.2	2.5	-2.3	4.4	3.9
Exports, Goods and Services	-0.3	-8.5	28.0	9.0	7.0	8.0
Imports, Goods and Services	0.2	-13.4	17.0	6.0	6.5	7.0
Real GDP growth, at constant factor prices	2.8	-3.1	6.5	2.9	3.1	3.5
Agriculture	2.9	-1.5	3.4	3.0	2.9	2.9
Industry	1.9	-3.0	2.0	2.6	3.2	3.2
Services	3.2	-3.3	8.7	3.0	3.1	3.7
Inflation (Consumer Price Index)	1.2	2.0	2.0	4.8	0.9	0.2
Current Account Balance (% of GDP)	-2.9	-3.9	-3.2	-2.4	-3.2	-4.0
Net Foreign Direct Investment (% of GDP)	3.5	2.0	3.3	3.5	3.3	3.2
Fiscal Balance (% of GDP)	1.9	-1.8	0.5	-0.8	0.3	1.1
Debt (% of GDP)	34.3	39.9	37.8	37.4	36.9	36.3
Primary Balance (% of GDP)	2.8	-0.5	1.8	0.1	1.2	1.9
GHG emissions growth (mtCO2e)	-2.4	-5.6	4.8	2.3	3.1	3.9
Energy related GHG emissions (% of total)	89.0	88.7	89.1	89.2	89.4	89.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.