

BOSNIA AND HERZEGOVINA

Recent developments

Table 1 **2018**

Population, million	3.5
GDP, current US\$ billion	19.2
GDP per capita, current US\$	5476
Life expectancy at birth, years ^a	76.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2016).

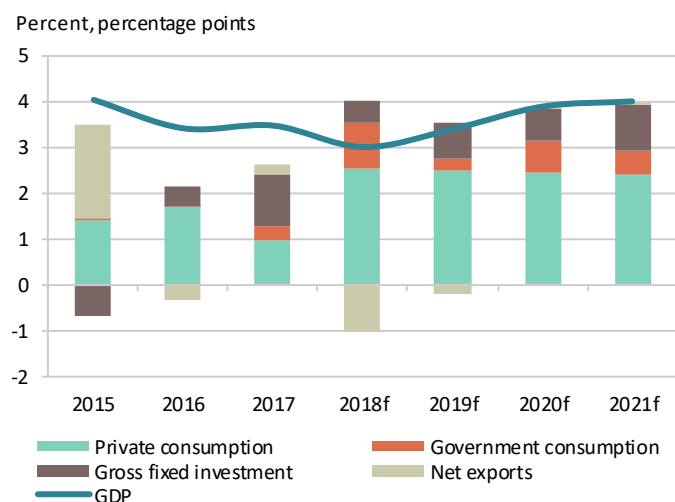
Economic growth in Bosnia and Herzegovina (BiH) remained stable at 3 percent in 2018 and is expected to pick-up starting in 2019 with the implementation of infrastructure investment. Translating this growth into improvements in labor markets will be important for continuing reducing poverty, which was last recorded at 16 percent in 2015 and is expected to have declined in more recent years on account of the decline in unemployment. Delays in Governments formation after the general elections is a downside risk to the growth outlook.

Growth reached an estimated 3 percent in 2018. Domestic demand remains the dominant driver of growth, with consumption adding 3.5pp, investment 0.5 pp and net exports subtracting 1pp. Improved external demand has supported exports growth, but higher growth of imports in 2018 is offsetting this momentum. Unemployment remains high, although some improvements are observed in the labor market. The unemployment rate fell from 20.5 percent in 2017 to 18.4 in 2018, driven by a reduction in activity rate and a slight rise in employment (mainly in manufacturing and construction). The 15-24 years-old benefited particularly from this increase in employment in industry sectors, which drove a substantial decline in youth unemployment, from 46 to 39 percent. Long-term unemployment, however, remains stubbornly high, as 4 of every 5 unemployed workers have been looking for employment for more than a year. Prices continued to rise in 2018. The consumer price index increased by 1.8 percent year-on-year (y-o-y) in December 2018. The biggest driver of the increase were transport, tobacco and rental housing. Given that growth in nominal salaries was 4.9 percent y-o-y, the effect on real incomes was positive. In 2018, fiscal deficit is expected to be at a 0.5 percent of GDP, down from a surplus of 2.6 percent in 2017. In 2018, revenues rose mainly due to stronger collection of indirect taxes, while expenditures rose

mainly as a result of higher spending on public wages and social benefits. At the same time, while sluggish capital spending in 2017 reflected implementation delays, a pick-up of 2.5 pp is estimated in 2018 mainly due to investments in construction and roads infrastructure. The current account deficit (CAD) is forecast to rise slightly in 2018 as imports experience higher growth rate than exports. FDI remained at low levels covering 2 percent of GDP. Total public debt in 2018 is estimated at 37.1 percent of GDP, consisting largely of concessional borrowing from international financial institutions, while the total external debt is estimated at 70.5 percent of GDP.

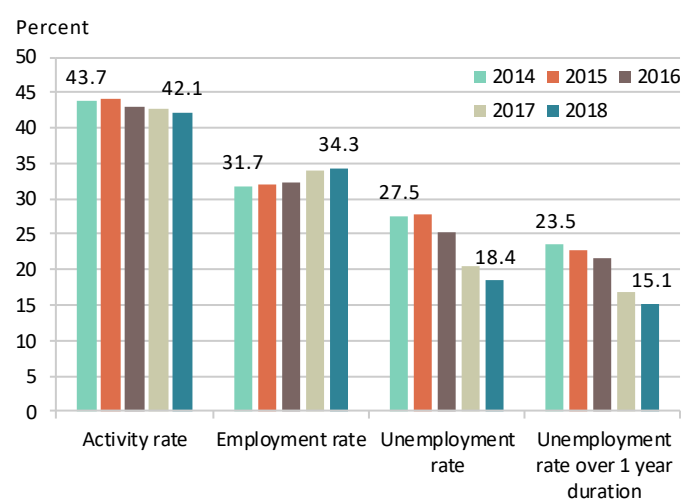
The latest available poverty data using the national poverty line is for 2015 and was estimated at 16 percent, very close to the 15 percent poverty rate estimated for 2011. Rural poverty (19 percent) was higher than urban poverty (12 percent). The implementation of new labor laws in both BiH entities, and continuation of support schemes for first-time job seekers are expected to improve labor market outcomes in the coming years, hence also supporting poverty reduction. The improvement in labor market indicators recorded between 2015 and 2018 (after the most recent microdata was collected) suggest that poverty may have receded more recently. Simulations that replicate the fall in unemployment captured by the Labor Force Survey show that this impact could account for a decrease of two percentage points in poverty. Inequality has remained constant in BiH between 2011 and 2015, with a Gini ratio of 33.

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



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

FIGURE 2 Bosnia and Herzegovina / Labor market indicators, 2014-2018



Sources: LFS 2014-2018 report, World Bank staff calculations. LFS 2018 preliminary results.

Outlook

Supported primarily by consumption and to some extent by public investment, economic growth is projected to gradually strengthen to about 4 percent by 2021. As the reform agenda deepens, a moderate rise in exports is expected, but strong demand for imported goods implies that consumption will continue to drive growth. Remittances are likely to remain high and stable at 8.3 percent of GDP, and, together with progress on reforms, will underpin a gradual pickup in consumption. Investments in energy, infrastructure, and tourism will also support job creation in those sectors. A stronger push on the capital investment program and streamlining of current spending, including better targeting of social assistance programs, remains a high priority for the authorities' medium-term economic programs.

As poverty is strongly associated with unemployment and inactivity, economic growth and improvements in labor market participation and employment will remain key, especially in sectors that employ the low-skilled. Much of the unemployed have secondary education or less.

With high unemployment and expectations of flat real wages, poverty is projected to decline slowly over the next several years. Improvements in agricultural productivity will also be critical, as close to 16 percent of employment depends on this sector.

In the medium run, with improved progress on ongoing structural reforms and higher demand for foreign goods, the CAD is expected to widen further from 5.6 percent of GDP in 2018 to 6.4 percent of GDP by 2021. Overall, in the medium term both fiscal and external deficits are expected to persist.

Risks and challenges

Addressing persistent unemployment and boosting growth while maintaining macro-fiscal stability, remain central to the BiH reform agenda. To this end, promoting private sector employment creation and improving job-preparedness among new entrants to the labor force and the currently unemployed will be necessary. Otherwise, poverty will see only modest improvement, continuing the trend in recent years.

Pressures on current spending from frequent elections and slow implementation

of the reform agenda weigh heavily on the government's ability to speed-up future growth. Although external deficits continue to be moderate, on the fiscal side the tax burden is high, and public spending is inefficient, as evidenced by poorly-targeted benefits. Planned fiscal reforms aim to strengthen the social contribution system and introduce a progressive income tax system. These reforms are a step forward and, in combination with other reforms, will help build a fairer and more growth-enhancing tax system. Provision of an effective safety net will not be effective if structural rigidities in spending are not addressed—especially the high public wage bill. However, support from the international partners can help the authorities to deliver on the challenging reform agenda.

There are notable risks, both domestic and external. The main domestic risk is the challenging political environment, which makes structural reforms difficult especially in such areas as infrastructure, telecommunications, energy, and transport. It also raises risks to the economic outlook. The main external risk for BiH remains slow growth in the EU and rising in developed countries interest rates.

TABLE 2 Bosnia and Herzegovina / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.4	3.5	3.0	3.4	3.9	4.0
Private Consumption	2.2	1.2	3.4	3.3	3.3	3.2
Government Consumption	0.0	1.5	5.0	1.5	3.6	2.6
Gross Fixed Capital Investment	2.5	6.3	2.7	4.3	3.7	5.5
Exports, Goods and Services	9.3	10.1	4.5	4.6	3.5	3.5
Imports, Goods and Services	6.7	6.3	5.0	3.5	2.4	2.4
Real GDP growth, at constant factor prices	3.1	3.2	3.0	3.4	3.9	4.0
Agriculture	7.6	-4.4	0.5	2.9	2.9	2.9
Industry	4.7	3.0	1.5	1.9	2.5	2.5
Services	2.0	4.2	3.9	4.0	4.5	4.7
Inflation (Consumer Price Index)	-1.1	1.2	2.5	3.4	4.2	2.0
Current Account Balance (% of GDP)	-4.5	-4.6	-5.6	-5.8	-6.3	-6.4
Net Foreign Direct Investment (% of GDP)	-1.6	-2.0	2.3	2.7	2.9	2.7
Fiscal Balance (% of GDP)	1.2	0.9	-0.5	0.3	1.2	1.1
Debt (% of GDP)	39.1	38.4	37.1	34.8	36.2	35.9
Primary Balance (% of GDP)	2.0	2.2	0.9	1.2	2.4	2.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.