Growth to remain subdued in 2024

Economic activity slowed to 1.6% y/y in 2023 as domestic drivers of growth softened, while external ones tumbled. High-frequency indicators, except for retail, indicate still subdued performance at the start of the year. Labor market tighten last year, but is showing signs of slowing early in 2024, while wage growth, although moderating a bit, remains well above historical trend. Inflation decelerated faster than elsewhere in the region and continues to hover around 2% y/y since the end of last year. Upcoming local elections in October might bring some spending pressures, but likely also another round of polarizing statements.

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Economic forecasts

Economy	2024f	2025f
Real GDP growth (%)	1.8	3.1
Unemployment (%)	12.9	12.5
CPI (%), average	2.5	3.2
Budget balance (% GDP)	-1.7	-0.2
Public debt (% of GDP)	25.9	25.2
Current account (% GDP)	-3.0	-2.7

Source: Erste Group Research

Ratings	Current	Outlook
Moody's	B3	stable
S&P	B+	stable

Source: Erste Group Research

General	2024f
Population (in mn)	3.3
GDP/Capita EUR	8,284

Source: Erste Group Research

Note:
**Information on past performance is not a reliable indicator for future performance. Forecasts are not a reliable indicator for future performance.*

- Last year has seen modest growth of real economic activity as real GDP expanded 1.6% y/y. Slowdown in growth stems from a decline in foreign demand and the resulting significant decline of domestic exports, while on the other hand, investment and personal spending have had positive contributions to growth.
- This year we expect only a mild acceleration of activity. On the domestic side, we can still see strong retail activity maintaining double-digit growth rates, but industrial production remains in the red, with continuously weak manufacturing output. On the external side, export of goods remains deep in negative area (-8.2% y/y after 4M24), while imports accelerated (5.7% y/y after 4M24) creating a massive trade deficit. Bottom line, we have downgraded our FY24 GDP forecast by 0.4pp to 1.8% y/y. Growth expectations for 2025 have now been upgraded by 0.5pp to 3.1% y/y reflecting expected stronger recovery of external demand.
- Inflation decelerated from 14.7% y/y at the end of 2022 to just 2% y/y on average in 4M24, thus showing stronger deceleration pace than elsewhere in the region. Inflation in 2024 is expected to be 2.6% where core inflation and food prices will again have the largest contributions in the growth structure, followed by pressures from higher electricity prices. In line with projected acceleration of economic activity in 2025, inflation should rise to 3.2% y/y in 2025.
- In absolute terms, the C/A gap dropped 30.4% y/y in 2023 largely due to stagnating nominal trade gap. Relative to the GDP, C/A gap narrowed 1.6pp to 2.7% of the GDP. Adverse developments in foreign trade present in 2H23 continued, and even deepened in the first quarter of 2024 with declining exports and an increase of the value of imports. We expect the trade gap will widen by roughly 1.2pp of the GDP in 2024, which will push the C/A gap towards 3% of the GDP.
- According to data published in the Global Fiscal Framework from February 2024, general government revenues increased by 10.3% y/y in 2023, while expenditures rose 14% y/y thus leading to a general government gap of BAM 428mn or 0.8% of the GDP. According to the same document, the gap is expected to widen to BAM 900mn this year (1.7% of the GDP) before declining to just 0.2% of GDP in 2025.
- Despite Bosnia and Herzegovina's progress towards European Union accession, Bosnian Serb authorities continue to 'actively subvert' the state, peace overseer Christian Schmidt said in his latest update to the UN secretary general. As we move closer to local elections scheduled for October we can expect a continuation of confrontations between the High Representative Schmidt and the leader of Republika Srpska, Milorad Dodik.

Real economy

Growth slowed in 2023

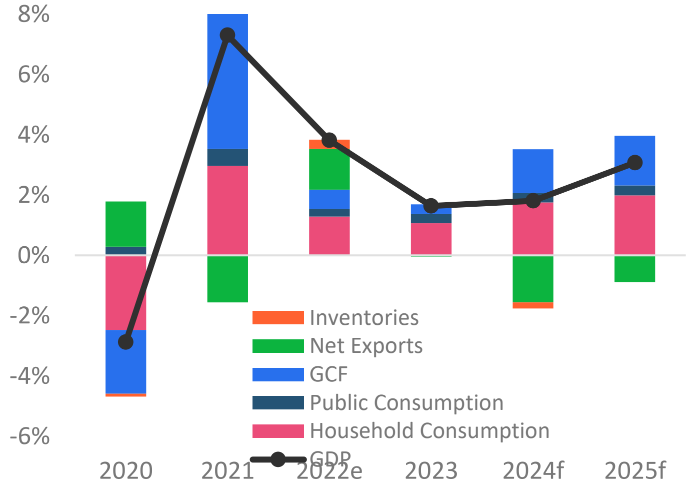
Economic growth slowed down from 3.8% in 2022 to just 1.6% y/y in 2023. Slowdown stems from observed external weaknesses, as exports of goods and service tumbled 3.2% y/y, but also weaker domestic demand. Total consumption kept relatively similar pace, as mild growth slowdown in household consumption was partially recouped through higher public spending, hence the contribution to growth from consumption landed at 1.6pp (vs 1.8pp in 2022). Investments and inventory performance, while still positive, halved on a yearly basis recording 1.2% y/y growth.

External pressures continued early in 2024

When assessing the outlook available high frequency indicators still paint a though economic environment. On the domestic side, industrial production contracted 4.4% y/y on average in 4M24. Meanwhile exports remain under pressure due to soft EU performance. Trade balance data shows another strong contraction on the exports side in 4M24 (-8.3% y/y) while imports accelerated (+5.6% y/y). The only positive impulse early in the year comes from the retail side as double-digit growth continues. During the forecast period, domestic demand, in particular private consumption, is projected to strengthen and to become the main driver of growth, benefitting from rising wages, already low and stable inflation and improving employment level. However, private investment could remain subdued, as a result of the frequent political stalemates, which are expected to persist, delaying structural reforms and impeding the business environment. Public investment, mostly related to infrastructure works, should benefit from upcoming local election cycle and deliver positive impetus to growth. The recovery in external demand is pushed back towards the end of the year, compared to previous expectations of stronger pickup already from the 2Q.

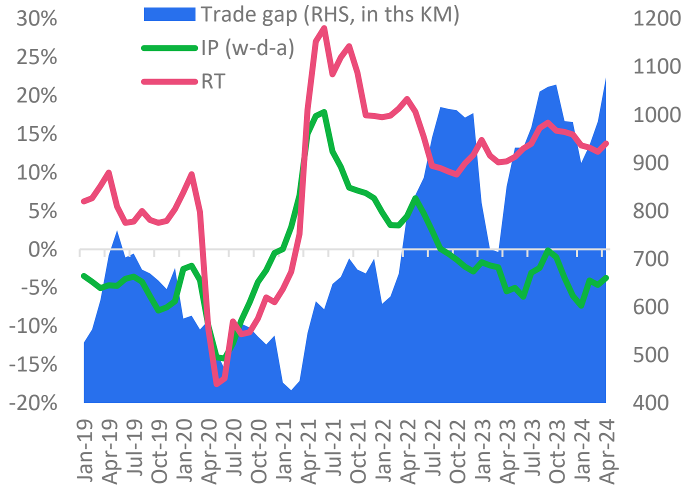
Bottom line, we have downgraded our FY24 GDP forecast by 0.4pp to 1.8% y/y. Growth expectations for 2025 have now been upgraded by 0.5pp to 3.1% y/y reflecting expected stronger recovery of external demand.

Growth under pressure due to external headwind
Real GDP, contributions (y/y)



Source: BHAS, Erste Group Research

Trade gap soars again
Retail trade, ind. production and trade balance (3mma, y/y)

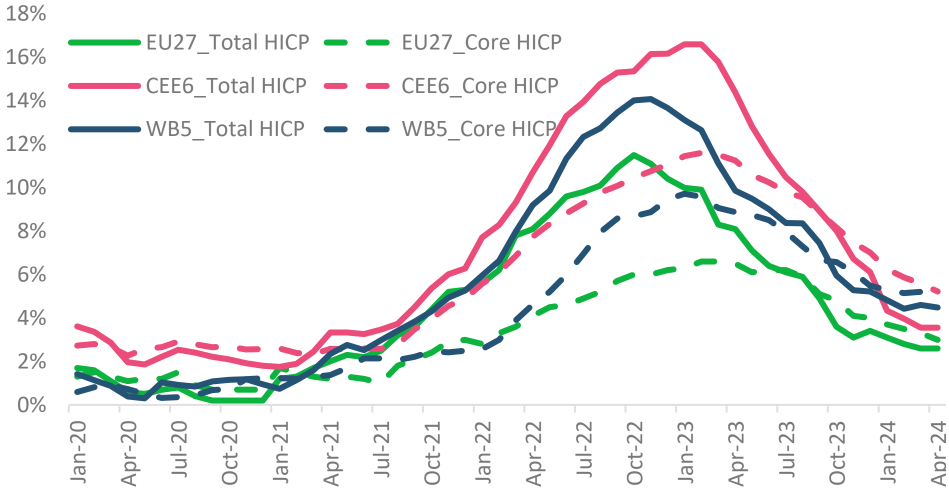


Source: BHAS, Erste Group Research

Inflation dynamics normalizing everywhere

After the 2022 exceptionally strong inflation shock, the growth of average consumer prices, the same as in the region, slowed down in 2023 to 6.3% y/y, while ending the year at 2.2% y/y. Food and non-alcoholic beverages was the key category which contributed to overall higher inflation, as it rose 10.9% y/y, although largely due to pressures in 1Q23. Core inflation and headline inflation in Bosnia and Herzegovina at the end of 2023 were thus slightly higher (5.9% and 6.3%, respectively) than in the euro area (5.0% and 5.5%), showing that inflationary pressure in 2023 is not only affected by exogenous pressure but also by increasing pressure from domestic prices.

Core inflation above headline in most countries
Headline and Core HICP (y/y)

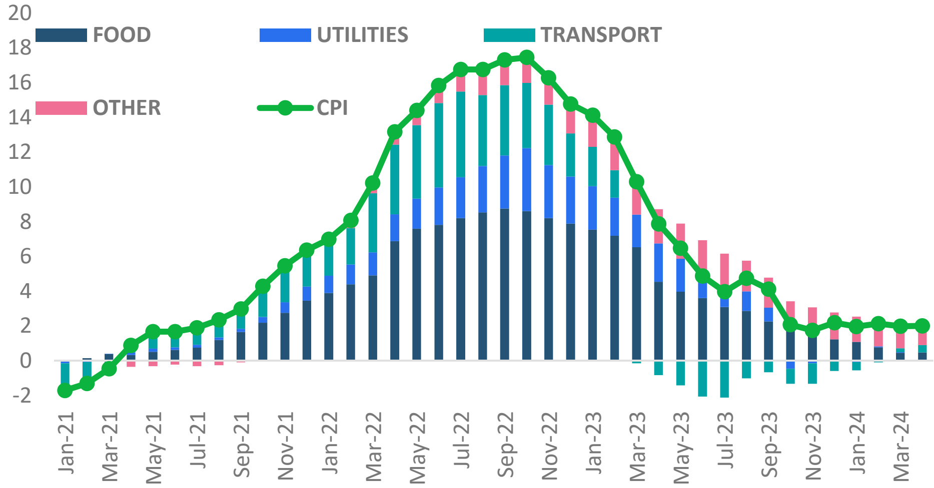


Source: Eurostat, Erste Group Research

Inflation could rise again in 2H24 as utility prices go up

The decreasing external shocks effect and the strengthening of domestic price pressures are likely to continue in 2024. According to announcements, electricity prices should rise 10% from mid-year. As a reminder, electricity prices, as the most important sub-category of the total utility costs, have made a large contribution to the inflation growth in 2023, with the recorded annual growth of 6.0%. The announced rise in price doesn't come as a surprise given that households in Bosnia and Herzegovina pay one of the cheapest electricity prices in Europe. Overall, we expect inflation to average 2.6% y/y in 2024 with higher prints towards the end of the year. In line with projected acceleration of economic activity in 2025, inflation should rise to 3.2% y/y in 2025.

Food price pressures eased
Contributions to overall CPI (%)



Source: BHAS, Erste Group Research

External sector

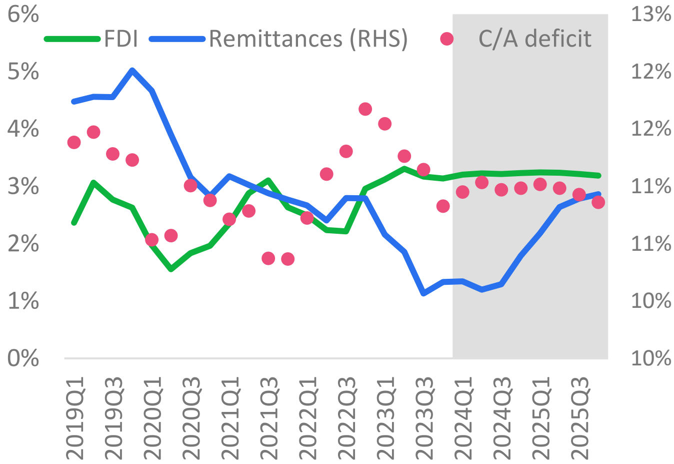
External imbalances improved

External imbalances narrowed last year, as the current account gap fell from 4.3% of the GDP in 2022, to 2.7% of GDP at the end of last year. Improvement mostly owes to smaller trade gap, as the trade deficit fell 2.7pp of GDP to 19.7% of GDP. Remittance inflows remained solid, despite the deteriorating macroeconomic outlook, standing at 10.2% of GDP. On the financing side, net FDI inflow improved by 21% y/y, reaching 3.1% of GDP and thus covering the entire C/A gap, compared to just 68% at the end of 2022.

Foreign reserves remain adequate

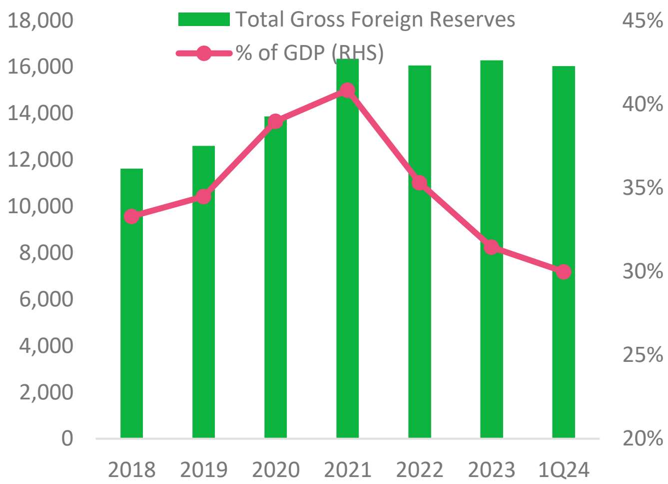
We believe that the C/A gap will remain largely stable over the forecasted period. Expected worsening of the goods trade balance should be partly offset by steady tourism flow. As previously, debt financing will likely account for only a small portion of current account funding, with most financing representing net foreign direct investment inflows, a capital account surplus (including European pre-accession funds) and positive net errors and omissions likely reflecting unrecorded transfers from Bosnian citizens working abroad. The Currency Board Arrangement continues to serve the country well amid heightened domestic and external pressures. The latest available data for March indicates that total gross foreign reserves remain adequate at around KM 16bn or 30% of expected nominal GDP.

C/A gap narrowed in 2023
C/A deficit, net FDI, remittances (% of GDP)



Source: CBBH, Erste Group Research

Stock of foreign reserves stable
Total gross foreign reserves (in KM mn)



Source: CBBH, Erste Group Research

Monetary and fiscal developments

Solid loan dynamics

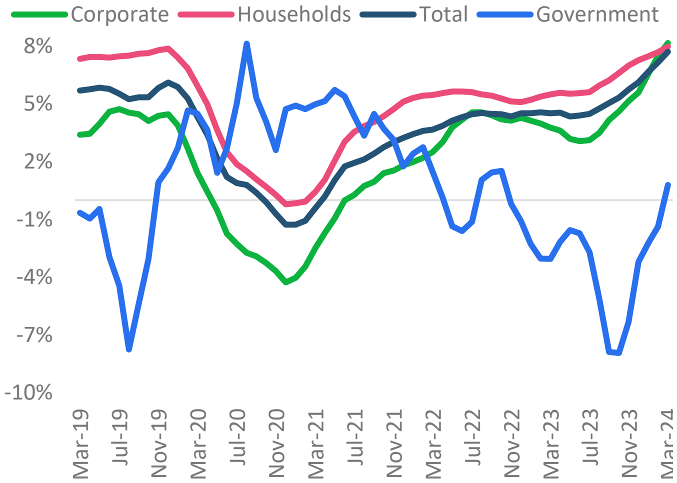
Despite tightening of bank lending standards, and despite the expected rise in the costs of financing sources, credit growth in BH exceeded the expectations. Credit activity accelerated in 2023, rising 6.6% y/y, compared to 4.7% y/y in 2022. Looking at the sectoral structure, we can see similar positive developments on both the retail and corporate side as stock of credit rose 7.4% y/y and 6.7% y/y respectively. Meanwhile, loans to government again contracted (-2.1% y/y) although less than a year ago.

On the deposit side, we can see similar developments as far as the overall performance goes. Total deposits rose 6.5% y/y in 2023, although largely due to base effects given short lasting but strong withdrawal of deposits from two banks which were exposed to reputational risk in 2022. Sector-wise, strongest growth of deposits was recorded in the corporate sector (15.4% y/y), followed by 10.2% y/y growth on the retail side. Government deposits have declined 7.1% y/y. The L/D ratio remained relatively unchanged at 75.6%.

Banking sector stable

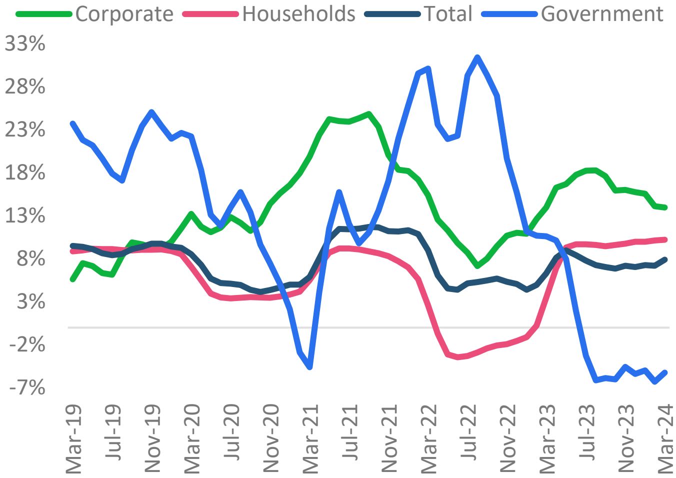
The banking sector is well-capitalized, with Tier 1 capital ratio steady at 18.7% at the end of 2023. Overall profitability further improved with rising ROA and ROE ratios, alongside improved asset quality as NPLs declining to 3.8%, down from 4.5%. BiH's financial sector remains largely conventional in nature, predominantly deposit-funded, and with a limited amount of external debt outstanding. We expect that domestic credit will continue to expand this year as well.

Loan activity accelerating
Loans to corporate, household and government (y/y)



Source: CBBH, Erste Group Research

Retail deposits stabilized
Corporate, household and government deposits (y/y)



Source: CBBH, Erste Group Research

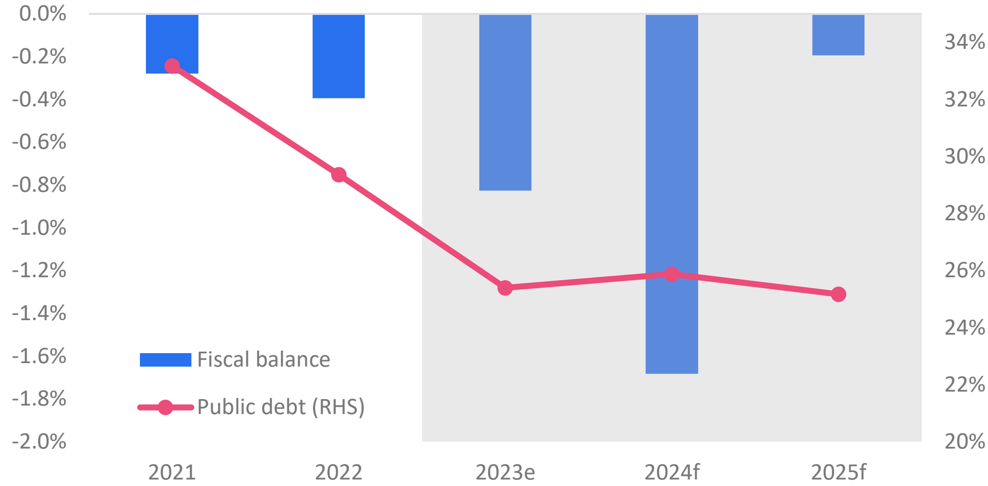
Small budget gap(s); public debt remain lowest in the region

We are still waiting for the official fiscal data for 2023 but according to estimates published in the Global Fiscal Framework from February 2024, general government revenues increased by 10.3% y/y in 2023, while expenditures rose 14% y/y thus leading to a general government gap of BAM 428mn or 0.8% of the GDP. In 2023, there was no significant borrowing by the Entity governments from international financial institutions, while borrowing in the domestic capital market was somewhat more intensive. Despite record high revenues, a deficit in the 2023 Entity budgets was planned, due to a significant growth of expenditures due to inflationary pressures and the implementation of government measures to help vulnerable groups. The governments of both BH Entities revised the 2023 budget over the course of 2023.

The Entity budgets for 2024 are adopted reflecting larger financing of current and less financing of capital spending. The Budget of the Federation of BH for 2024 was adopted in January in the amount of KM 7.5bn, which is the highest amount so far having been increased by more than half a billion KM compared to 2023. On the other hand, the National Assembly of Republika Srpska adopted the Budget of RS for 2024 in December 2023, in the amount of KM 5.7bn, which represents an increase 3.8% y/y.

The financing needs for RS in 2024 amount to KM 955mn. According to the RS Budget for 2024, a debt of KM 810mn is planned on a foreign market and 145mn in the local market. On the other hand, the Federation planned a budget deficit in 2024 in the amount of KM 470mn. The financing needs for the Federation of BH in 2024 amount to KM 1.3bn. Borrowing is planned in the form of bonds (KM 540mn), T-bills (KM 360mn) and on a foreign market and from foreign creditors in the amount of up to KM 395mn. Despite expected mild rise of overall public debt to GDP, the ratio will remain stable and still the lowest in the region.

Budget gaps remain manageable
Fiscal balance, public debt (% of GDP)



Source: CBBH, Global Fiscal Framework, Erste Group Research

Politics

Relations between High Representative Schmidt and Milorad Dodik remain tense

Things are heating up on the local political scene as we move closer towards local elections scheduled in October. Earlier decision by the High Representative to impose changes to Bosnia's electoral law, aimed at fortifying the integrity of the electoral process, has unleashed reactions from political elites, notably from the Serbian entity. Republika Srpska drafted and adopted its own Electoral Law. The law gives the Serb entity control over elections and envisages the creation of a Republic Election Commision, which would make the current state-level one invalid.

Despite Bosnia and Herzegovina's progress towards European Union accession, Bosnian Serb authorities continue to 'actively subvert' the state, peace overseer Christian Schmidt said in his latest update to the UN secretary general, citing in particular 'unprecedented pressure' on the judiciary. On the other hand, in a fight over the date of Republika Srpska statehood day, Bosnia Serb leader Dodik has changed the day that Republika Srpska marks its statehood day, effectively consenting to the authority of the Bosnia courts and the effect of US sanctions. We expect more polarizing statements and moves as we move closer to the date of local elections.

Forecasts

Annual	2017	2018	2019	2020	2021	2022	2023	2024f	2025f
Nominal GDP (BAM mn)	33,096	34,921	36,538	35,584	40,031	45,518	51,804	53,466	56,864
Population (mn)	3.5	3.5	3.5	3.5	3.5	3.4	3.4	3.3	3.3
GDP per capita (EUR)	4,829	5,107	5,351	5,236	5,933	6,815	7,864	8,284	8,946
Real GDP (growth y/y %)	3.8	3.3	3.5	-2.9	7.3	3.8	1.6	1.8	3.1
Nominal gross wages (EUR)	676	708	726	756	788	880	995	1082	1153
Gross wages growth (%)	1.6	4.8	2.5	4.1	4.3	11.7	13.0	8.8	6.6
CPI (y/y, average %)	0.8	1.4	0.6	-1.1	2.0	14.0	6.3	2.5	3.2
CPI (y/y, year end %)	0.7	1.6	0.3	-1.6	6.3	14.7	2.2	3.6	2.9
Unemployment (%)	20.5	18.4	15.7	15.9	17.4	15.4	13.2	12.9	12.5
Trade balance (% of GDP)	-22.4	-21.5	-21.8	-17.6	-17.9	-22.4	-19.7	-20.8	-20.7
Current account balance (% of GDP)	-4.6	-3.1	-2.5	-2.8	-1.7	-4.3	-2.7	-3.0	-2.7
FDI inflow (% of GDP)	2.2	2.7	2.0	2.0	2.6	3.0	3.1	3.2	3.2
General government budget balance (	2.4	2.1	1.9	-5.1	-0.3	-0.4	-0.8	-1.7	-0.2
Public debt (% of GDP)	34.2	32.7	31.6	35.2	33.2	29.4	25.4	25.9	25.2
EUR/BAM	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
USD/BAM	1.74	1.66	1.75	1.72	1.65	1.86	1.81	1.80	1.78

Source: Erste Group Research

Note:
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