

Bosnia-Herzegovina Business Forecast Report Q1 2015

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Abstracts

Core Views

The results of the October 12 election provide little optimism for a change in Bosnia's dysfunctional political system, especially as hard line parties representing each of the three constituent peoples made strong gains. With few signs that radical improvements are forthcoming, we expect the country to muddle through in the coming years, with frustrating delays to badly-needed reforms.

The economic recovery that began with earnest in 2013 faces an important, albeit temporary, setback after historic flooding in May caused massive damage to property and infrastructure. The domestic problem will be compounded by a regional slowdown, especially among Bosnia's key trading partners.

Budget policy will continue to be guided by the government's Stand-By Agreement with the IMF – which we expect to be extended beyond June 2015 – though budget execution will still be affected by political disputes.

Major Forecast Changes

We have adjusted our target for GDP growth in 2015 to 1.6%, from a previous 2.5%, as political uncertainty following the election weighs on investment activity and regional headwinds restrict export growth. We have lowered our target for annual average inflation in 2014 to -0.8%, from a previous 0.3%, as the deflationary trend persisted throughout the first three quarters of the year. We have also lowered our inflation target for 2015 to 1.5%, from a previous 1.8%. After coming in at a revised 5.9% of GDP in 2013, we have increased our target for the current account deficit to 7.9% of GDP in

2014 on account of reduced export growth in the aftermath of flooding. We have also raised our 2015 forecast to 8.2% of GDP, from a previous 7.3%.

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Election Results Point To More Of The Same

The October 12 election results suggest little in the way of change for Bosnia-Herzegovina's convoluted political system, especially as more hard line nationalist parties made the strongest gains overall. We expect structural deficiencies and ethnic divisions to continue to hamper policy making at a crucial period for the economy, while also weighing on political stability going forward.

Table: Political Overview

Long-Term Political Outlook

Unity To Prove Elusive Over Next Decade

Tensions between ethnic groups will continue to undermine Bosnia's EU accession prospects, development potential and risk profile through the next decade, with a number of issues having the potential to result in a further deterioration in the political situation. That said, we expect the international community to remain firmly committed to Bosnia, which should prevent a relapse into large-scale armed conflict.

CHAPTER 2: ECONOMIC OUTLOOK

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GDP growth in Bosnia-Herzegovina contracted by 1.2% y-o-y in Q214 due to the cost of massive flooding in May. We retain our growth target for full-year 2014 at 0.2% but have lowered our forecast for 2015 to 1.6% on account of political instability and an increasingly bleak outlook among the country's major trading partners.

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Unemployment To Remain High

Latest data from the labour market show that Bosnia-Herzegovina continues to suffer from chronic unemployment, with a rate of 27.5 % and few signs of structural reforms required to boost job creation. As a result, low wage growth, a large grey economy, and a brain drain problem are likely to remain features of the local economy over the medium-term forecast period.

Balance Of Payments

Wider Deficits On Weaker Regional Demand

A worsening short-term outlook for exports will lead to wider current account deficits in the coming years. We forecast a deficit of 7.9 % in 2014, rising to 8.2% in 2015, as reduced economic activity following summer floods, combined with weakening demand in key trading partners, will subdue export growth. With the current account set to remain in deficit over the ten-year forecast period, drawing in more foreign direct investment will be crucial to boost long-term productivity and export growth.

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Price Pressures To Remain Subdued in 2015

There are finally signs of returning price pressures after a prolonged period of deflation in Bosnia. Nevertheless, we have lowered our average inflation targets for 2015 and 2016 in line with our more cautious view on the short-term economic recovery and our forecast for softer international commodity prices ahead.

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