EXECUTIVE BOARD MEETING

SM/21/16

February 10, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Bosnia and Herzegovina—Staff Report for the 2020 Article IV Consultation**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Wednesday, February 24, 2021**
Publication:	Yes*
Questions:	Mr. Petri, EUR (ext. 30406) Mr. Ben Ltaifa, EUR (ext. 34045) Mr. Cipollone, EUR (ext. 38761)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	After Board Consideration—European Bank for Reconstruction and Development, World Trade Organization

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

February 8, 2021

EXECUTIVE SUMMARY

Context: Pre-pandemic, Bosnia and Herzegovina's (BiH) economy was growing, but at a pace below the more successful countries in Eastern Europe. The pandemic generated a substantial output contraction in 2020. Early in the pandemic, the authorities successfully implemented restrictions to prevent the spread of the virus and took measures to support firms and households. However, the ongoing second wave poses additional challenges. A gradual recovery is expected for the second half of 2021. Political disagreements about policy coordination at the BiH State level have hampered program implementation under the 2016 EFF arrangement and the deepening of the single economic space. The challenge is to deal with the pandemic and put the economy on a higher medium-term growth trajectory.

Key Policy Discussions: Staff supported the authorities' plans to accommodate pandemic-related fiscal measures, and to return to a less expansive fiscal policy once the economic recovery is well entrenched. While the authorities' efforts should center on addressing the continued fallout from the crisis, they should also implement long-delayed structural reforms to achieve faster convergence with EU per-capita incomes and slow emigration.

- **Mitigating the economic and social impact of the pandemic.** Fiscal policies should support a strong and sustainable economic recovery, minimize economic scarring, and mitigate social insecurity. Looking forward, the greater challenge is to improve the quality of budgets by controlling current spending and accelerating human and physical capital investments. Potential fiscal risks arising from the health sector and public enterprises liabilities and arrears need to be addressed.

- **Preserving financial stability and completing the bank resolution framework.** The Currency Board Arrangement has served BiH well and can be further strengthened by implementing IMF recommendations on reserve requirements. The banking sector has so far weathered the crisis, but bank supervision needs to be intensified, including through more frequent on- and off-site inspections and timely corrective measures, to preempt potential risks. The resolution framework should be strengthened, including by establishing a country-wide Financial Stability Fund.

- **Strengthening the single economic space and improving governance.** Passing State legislation on public procurement; electronic signatures; and electricity and natural gas would foster investment, achieve efficiencies, and reduce corruption opportunities. FBiH legislation on personal income tax; social security contributions; and insolvency would also strengthen the single economic space. A single account registry would help enforce anti-money laundering rules and strengthen credit growth through asset recovery.

Approved By
Jörg Decressin (EUR) and Bjorn Rother (SPR)

Discussions took place remotely October 19–30 and November 19 to December 18, 2020, which supplemented the previous ones held in Sarajevo and Banja Luka in late February-early March 2020. The mission comprised Messrs. Petri (head), Ben Ltaifa, Cipollone, Zhang (all EUR), Nakatani (FAD), Omoev (SPR), Suganuma (MCM), Jewell (Resident Representative), Ms. Cegar and Mr. Music (local economists). Ms. Teskeredzic and Mr. Fazlagic provided local support. Mses. Samuel and Zhang (both EUR) assisted with the preparation of this report. The mission met with Chairman of the BiH Council of Ministers Tegeltija, BiH Finance Minister Bevanda, Central Bank of BiH Governor Softic, Federation of BiH (FBiH) Prime Minister Novalic, Republika Srpska (RS) Prime Minister Viskovic, FBiH Finance Minister Milicevic, RS Finance Minister Vidovic, other government officials, members of the business and diplomatic communities, and civil society organizations. Mr. Manchev (OED) attended most mission meetings.

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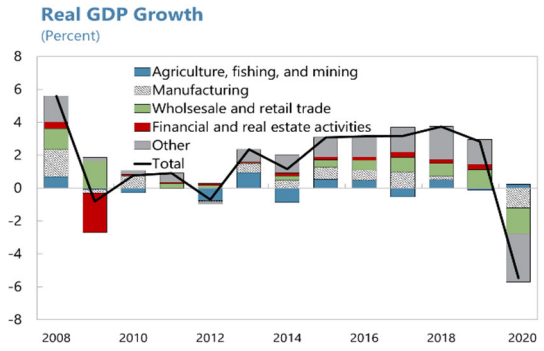
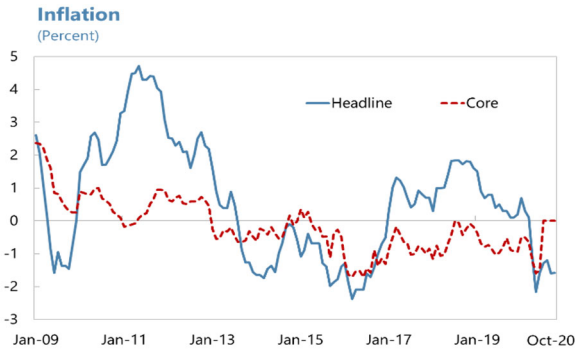
Figure 1. Bosnia and Herzegovina: Selected Economic Indicators

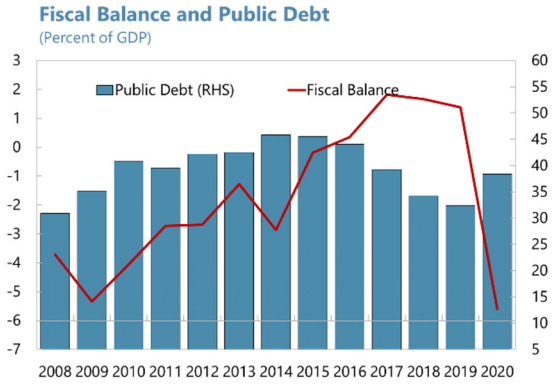
Economic recovery continued through 2019, but growth declined in 2020 in most sectors.



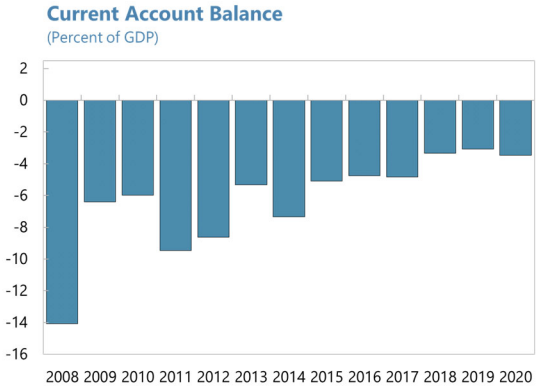
Inflation has turned negative recently



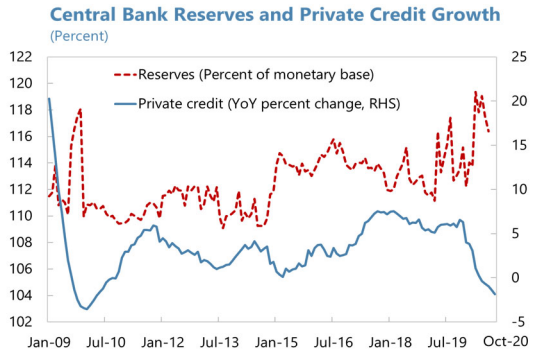
The fiscal position was in surplus until 2019 thanks to strong revenues, with debt on a strong downward trend...



...while the current account deficit has been stable. The external assessment suggests that the external position is broadly consistent with fundamentals.



Supported by the RFI, central bank international reserves have increased; credit growth declined.



The real effective exchange rate (REER) has depreciated somewhat, reflecting persistent low inflation/deflation.

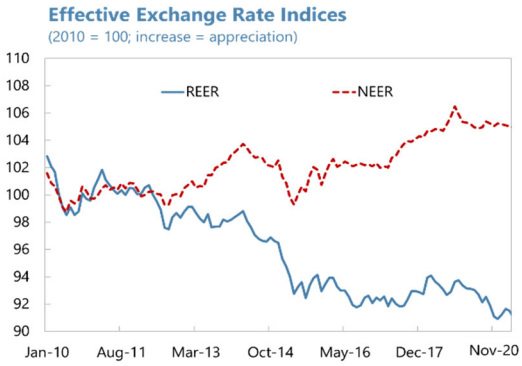
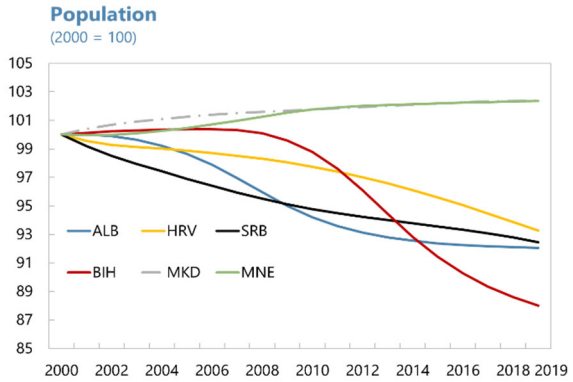
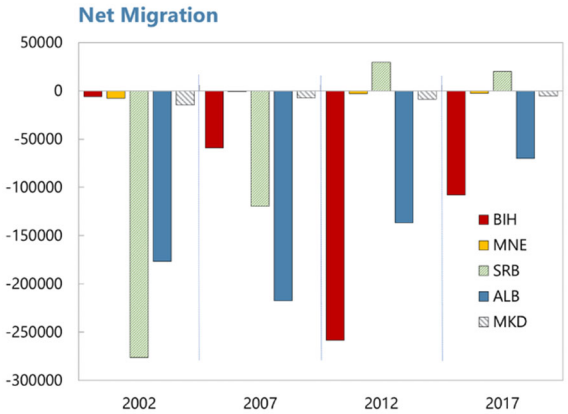


Figure 2. Bosnia and Herzegovina: Jobs and Growth

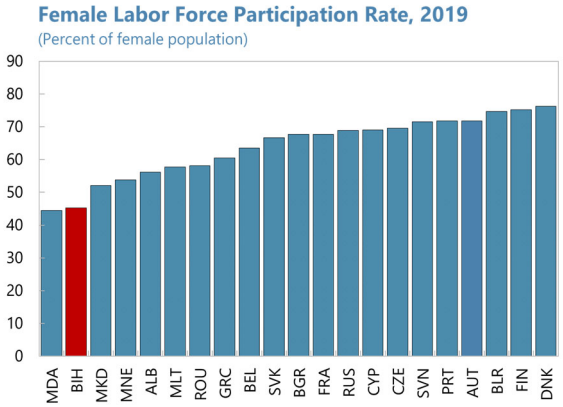
BiH has seen a large population decline …



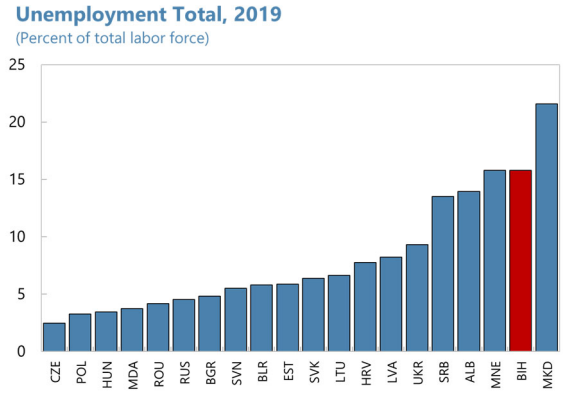
… in part reflecting emigration to Advanced Europe.



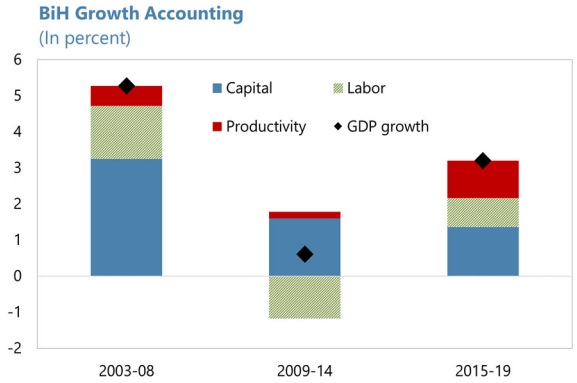
Female participation is among the lowest in Europe …



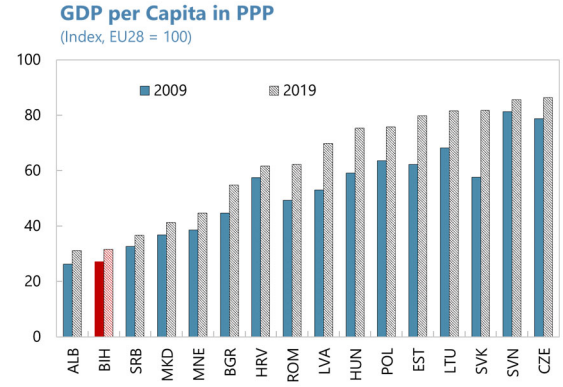
… while unemployment is one of the highest.



While TFP improved prior to the pandemic, growth was constrained by declining labor force and investment …



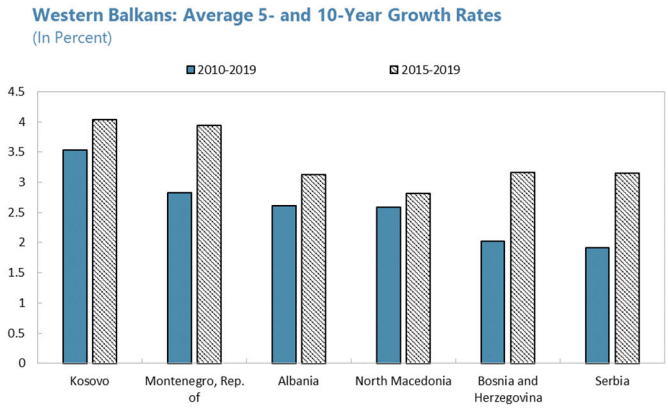
… convergence was slow compared to Advanced Europe with GDP per-capita below 40 percent of EU average.



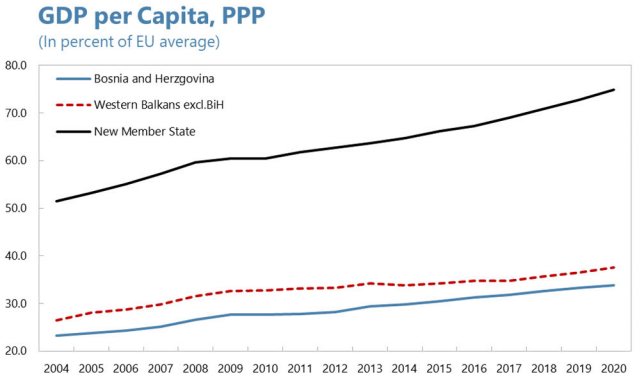
Sources: IMF WEO; World Population Prospects, 2019, United Nations, Eurostat, WB Development Indicators, ILO; and IMF staff calculations.

CONTEXT

1. Before the pandemic, the economy was stable, but growth was slower than most Western Balkan countries reflecting low investment, outmigration, and political deadlock that has prevented growth-supporting reforms. Macroeconomic stability was maintained before the crisis, but policy implementation since the previous Article IV consultation has been uneven (Annex IV). In the Federation of BiH (FBiH), government formation is still pending after the 2018 election. It took over a year to form the State-level government (Institutions of BiH, IBiH), whereas the Republika Srpska (RS) formed its government in December 2018. Ethnocentric ruling parties suffered losses in the two largest cities in the November 2020 local elections. Political tensions have been elevated for some time with limited consensus on policy coordination at the State level amidst some politicians questioning the future of the country.

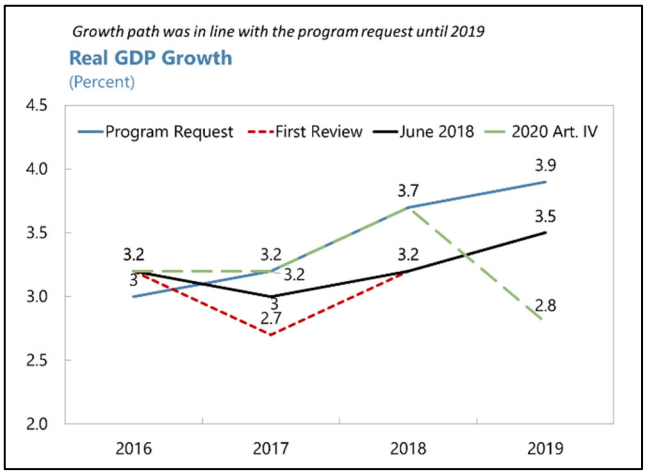


Sources: World Economic Outlook; and IMF Staff Calculations.



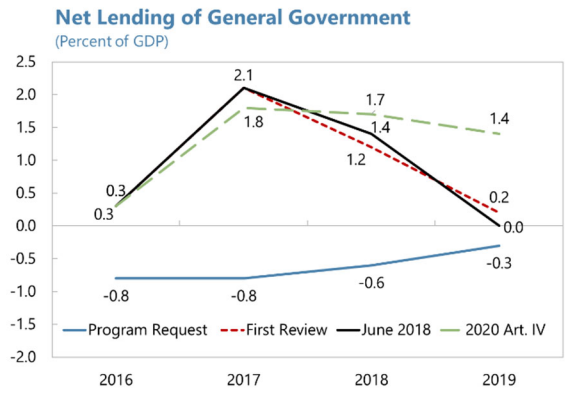
Sources: IMF World Economic Outlook; and IMF staff calculations.

2. The 2016 Extended Fund Facility (EFF) maintained macroeconomic stability and unlocked external support but the envisaged re-orientation of spending towards investment and structural reforms required for higher and more inclusive growth have not materialized. Performance under the EFF—canceled in April 2020—was mixed with only one review completed. While most macroeconomic targets were broadly met (current spending and initial growth), the fiscal deficit target was better than programmed by under-executing investment spending relative to program. The structural reform agenda did not advance as programmed amid internal political disagreements and lack of government formation (Annex V). However, the authorities raised excise taxes to support much-needed, externally-funded infrastructure investment, and they passed banking and deposit-insurance legislation.

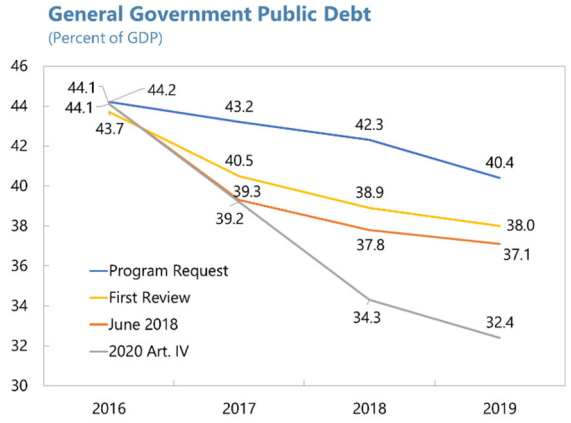


Strong Fiscal Performance Over 2016–19 But Little Capital Investment

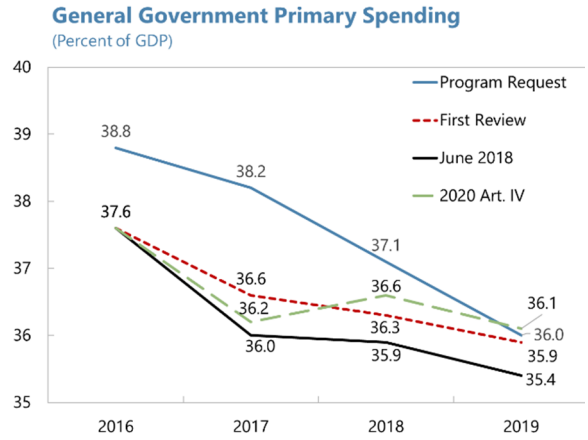
Net lending was less than programed throughout the period, and …



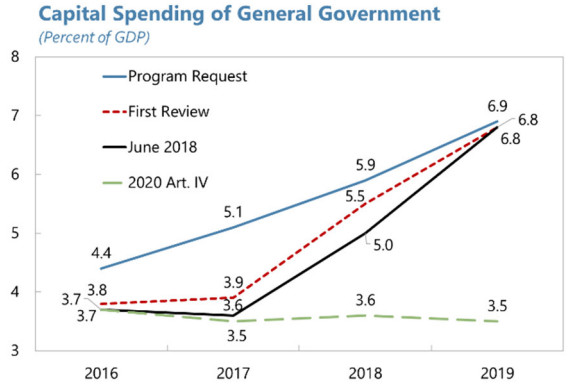
… public debt fell 8 percentage points more than programmed.



Primary spending was controlled in line with program, …



… but capital spending never reached program targets.



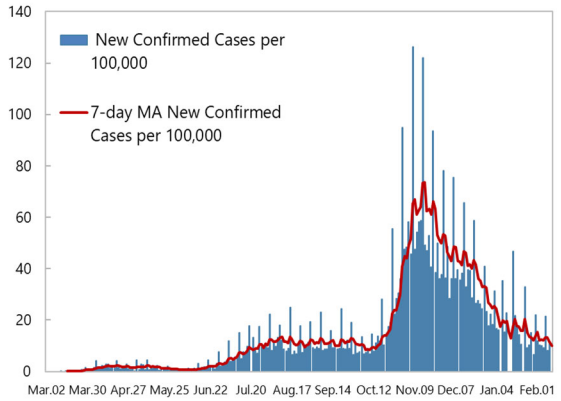
Sources: BiH authorities; and IMF staff calculations.

3. The pandemic has inflicted a heavy toll and is exacerbated by a migrant crisis. The first wave in March/April was mild compared to most EU countries in terms of cases, hospitalizations, and deaths. The authorities imposed effective lockdowns, border closures, and social distancing, which, however, led to a collapse of domestic demand, especially services (Figure 3). The entity governments imposed a state of emergency from mid-March to end-May and enforced stringent mobility restrictions. With the ongoing second wave, cases, hospitalizations, and fatality rates have increased markedly. While these numbers seem to be declining, BiH had one of the world's highest COVID deaths-per-capita in January 2021. Moreover, thousands of migrants have been stranded in BiH, many housed poorly during a harsh winter. The migrant crisis revealed severe institutional weaknesses and strained relations with the EU.

Figure 3. Bosnia and Herzegovina: COVID-19 High Frequency Indicators

Cases have declined since their November peak.

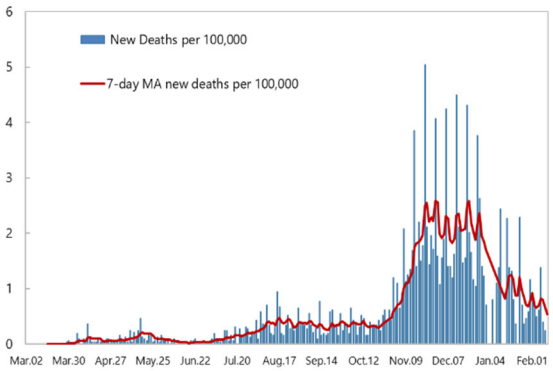
BiH: Daily Confirmed Cases per 100,000 Population
(Unit)



Sources: Johns Hopkins University

Deaths have declined with a lag.

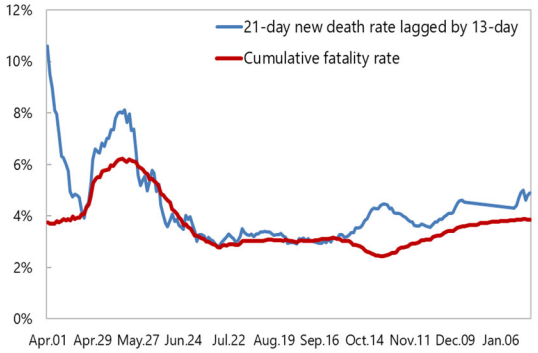
BiH: Daily New Deaths per 100,000 Population
(Unit)



Sources: Johns Hopkins University

Death rates have edged up since late 2020.

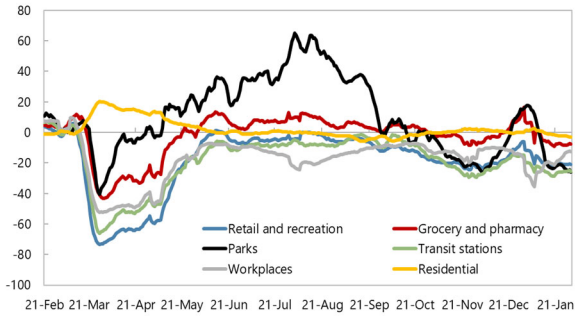
BiH: Cumulative and 21-day Death Rate
(Percentage of Total Infections)



Sources: Johns Hopkins University

Mobility has declined marginally in Q4-2020

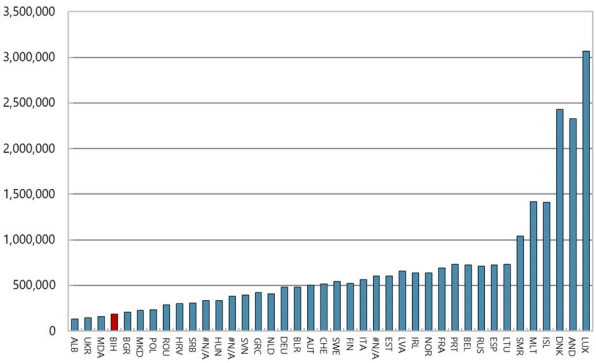
BiH: Google Mobility Index
(Percent deviation from baseline, 7-day moving average)



Sources: Google Mobility Report

BiH has comparatively low rates of testing.

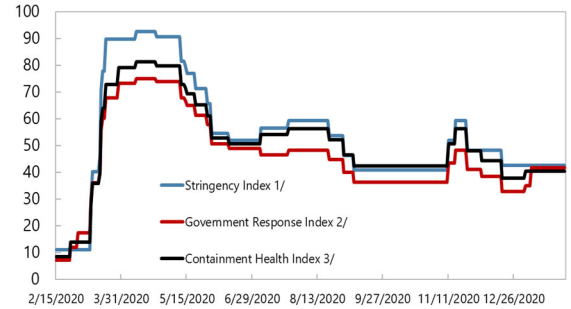
BiH: Total Covid-19 Tests, Latest
(Per 1 million population)



Sources: World Meters

COVID restrictions have been broadly stable in Q4-2020.

BiH: COVID-19 Government Response Stringency Index
(Index)



Sources: The Oxford COVID-19 Government Response Tracker
1/ The original stringency index, which records the strictness of 'lockdown style' policies that primarily restrict people's behaviour.
2/ The overall government response index records how the response of governments has varied overall.
3/ The containment and health index combines 'lockdown' restrictions and closures with measures such as testing policy and contact tracing, short term investment in healthcare, as well investments in vaccine.

4. The Rapid Financing Instrument (RFI) approved in April 2020 supported crisis efforts. The disbursement of €333 million helped BiH meet urgent BOP needs, arising from both external shocks and the needed fiscal policy response. The EU pledged Macro-Financial Assistance (€250 million), to be disbursed in two tranches in 2021-22. The World Bank also approved emergency assistance ($36.2 million), which has been partially disbursed.

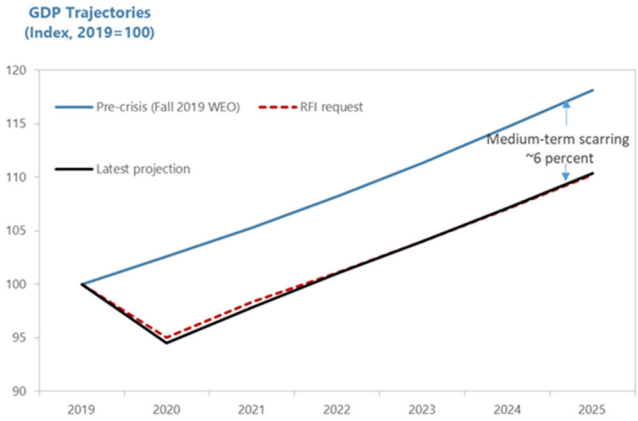
5. The EU membership process is advancing very slowly, which adds urgency to stronger domestic policy efforts aimed at addressing growth bottlenecks. In 2019, the EU Council endorsed the European Commission's (EC) opinion on BiH's request for EU candidacy. The opinion includes 14 prior actions (mainly on democracy/rule of law) for opening EU accession-candidate negotiations.

OUTLOOK, EXTERNAL STABILITY AND RISKS

6. The pandemic has had a large economic impact. Economic activity is estimated to have contracted by 5½ percent in 2020, versus a pre-crisis average growth of 3 percent. This sharp contraction was caused by a slump in domestic demand (depressing hospitality services) and a weak external environment where exports were hit hard by the EU recession. In line with the Euro Area, inflationary pressures have been contained, given the economic slack and will remain so for some time.

7. The pandemic is projected to have a protracted impact throughout the first half of 2021. With COVID cases and hospitalizations still elevated and vaccinations expected to become widely available only towards the middle of 2021, the economic recovery is projected for the second half of 2021. It is expected to be tempered by weakened balance sheets of households, businesses, and banks as well as depressed external demand, especially tourism. However, given exceptional uncertainty related to vaccinations, the recovery might be delayed or arrive sooner.

8. The medium-term prospects are less favorable than in the recent past, which will make it difficult to address high unemployment and outmigration. Following the sharp contraction in 2020, economic activity is expected to expand by 3½ percent in 2021 and 3¼ percent in 2022 (Figure 4). Over the medium term, the growth rate is projected at 3 percent, which is below the pace of many Eastern European economies when they were at similar per capita income levels. The medium-term potential is hampered by slower-than-previously projected investment growth and continued labor-market outflows, especially by disillusioned young and skilled people. Continued delays in implementing regional connectivity projects could curtail exports, including tourism. This medium-term outlook assumes that there is no significant



long-term economic damage from the pandemic, although there will be some permanent loss in the level of GDP.

9. External accounts are expected to weaken in 2021. The current account deficit (3½ percent of GDP) widened slightly in 2020 compared to 2019 and is projected to further deteriorate in 2021 (5 percent of GDP) amid a decline in exports (tourism) and remittances, which will be somewhat offset by import contraction. The financial accounts are projected to deteriorate, due to the reduction in foreign direct investments and other capital flows. Gross official reserves are projected to decline from 8.5 to 7.9 months of imports during 2021.

10. BiH's external position in 2020 was broadly consistent with fundamentals and desirable policy settings (Annex II). Both the current account and the Real Equilibrium Exchange Rate (REER) approaches point to a real exchange rate in line with fundamentals. However, subdued export performance may be related to short-comings in transportation and connectivity infrastructure and the business climate.

11. A protracted pandemic, delayed vaccine availability, and heightened political uncertainties pose significant downside risks (Annex I). A longer-lasting pandemic, including uncertainty about vaccine availability, would delay the recovery and impair banks' balance sheets. Social discontent and political instability could also complicate the recovery. Continued political disagreements regarding policy coordination at the State level could reduce international financial support with negative consequences for growth and pandemic support measures. Further delays in forming the FBiH government could undermine the implementation of reforms. Less likely, a quicker-than-envisaged recovery in the EU would help confidence and boost BiH exports.

MITIGATING THE IMPACTS OF THE PANDEMIC—POLICY DISCUSSIONS

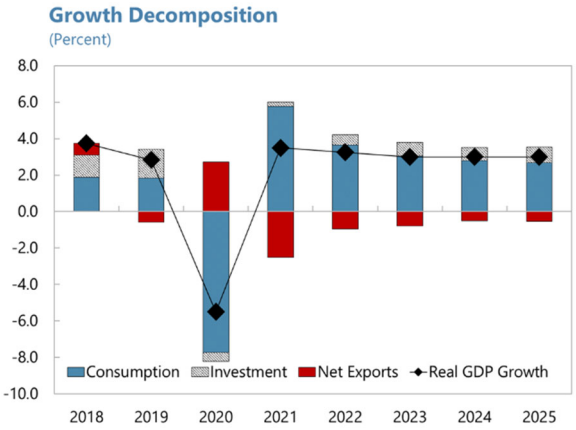
A. Fiscal Policy: *Providing Targeted and Sustainable Fiscal Support*

Policy discussions focused on immediate pandemic responses including (i) providing the health sector with sufficient resources, and (ii) allowing for a temporary fiscal expansion to support the economy and protect the most vulnerable.

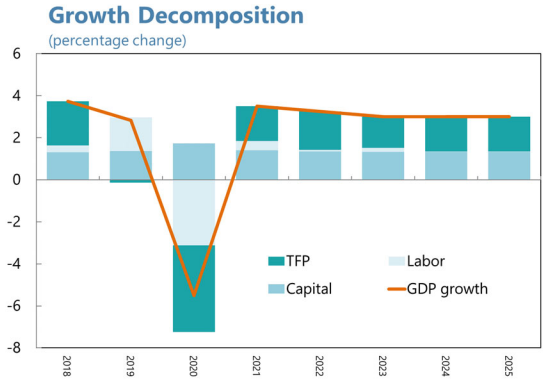
12. The expansionary fiscal stance in 2020 was appropriate to mitigate the pandemic. Fiscal buffers accumulated in previous years allowed the BiH authorities to quickly respond to the pandemic. Revised 2020 budgets reflected both lower revenues and higher spending measures, particularly for the health sector. Tax revenues declined by 7½ percent compared to 2019, driven mainly by lower indirect tax collections. Current expenditures increased by 7 percent due to higher health care and economic support spending. Externally-financed investments also increased. As a result, the 2020 fiscal deficit is estimated at 5½ percent of GDP after years of surpluses.

Figure 4. Bosnia and Herzegovina: Medium-Term Projections, 2018–25

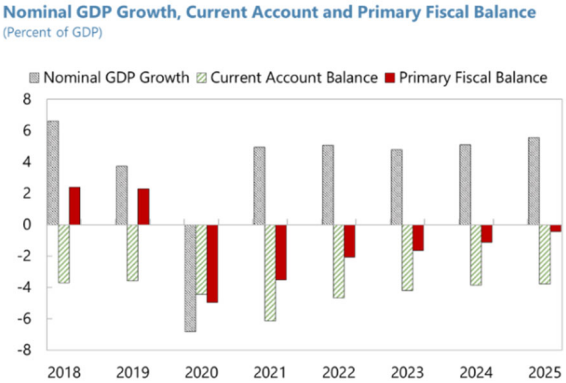
Growth will be driven largely by domestic demand.



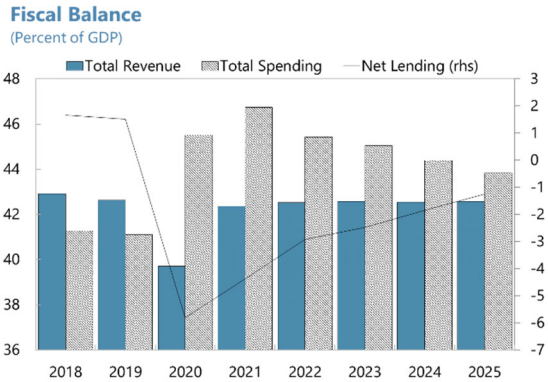
TFP and capital are expected to make the largest contributions to future growth



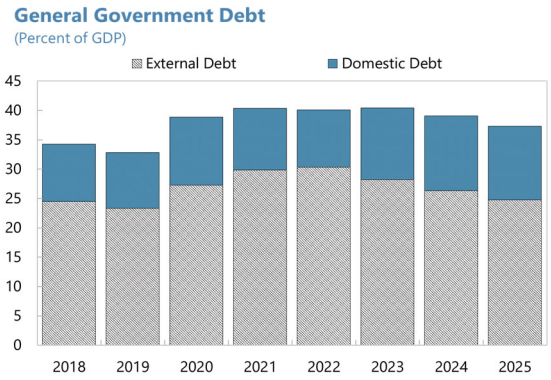
Both internal and external imbalances are expected to decline over the medium-term.



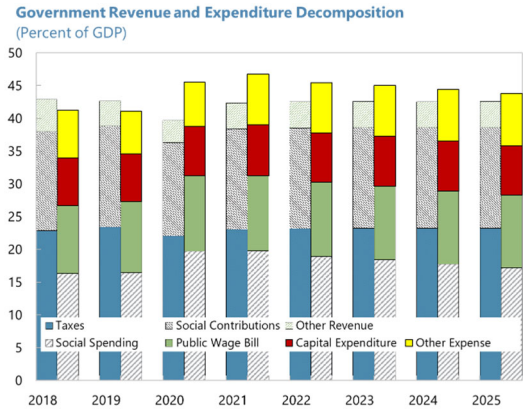
Improvements in fiscal balances are mainly due to the decline in spending after the pandemic's end.



Debt levels are projected to decline gradually.



Decline in pandemic-related social spending should lower fiscal expenditures over the medium term.



Sources: BiH authorities; and IMF staff projections.

13. The initial emergency fiscal response alleviated the pandemic impact. Governments implemented substantial health-sector support packages—funding for medical supplies and facilities, hiring professionals, and raising their wages (0.6 percent of GDP). Both entities established compensation/solidarity funds that helped firms subsidize Social Security Contributions (SSC) and provide minimum wages to workers in affected sectors (hospitality, catering, transport). They also provided financing to cantons and municipalities. COVID discretionary spending in 2020 was considerable (2.5 percent of GDP), but some delays in implementation occurred, including for off-budget loan guarantees, and the measures were not coordinated between entities, cantons and municipalities.

BIH: Fiscal Measures in Response to COVID-19

Measures	2020	
	Millions of KM	Percent of GDP
Discretionary measures	**826.2**	**2.5**
Health sector support	*222.5*	*0.6*
Support for households	*1.0*	*0.0*
Support for firms	*310.6*	*0.9*
Other support	*291.4*	*0.9*
Off-budget measures		
Guarantee funds	150.0	0.5

Sources: BiH authorities; and IMF Staff calculations.

14. Fiscal support should continue in 2021 but become more targeted. Tax revenues are expected to grow in line with GDP, while remaining below the pre-COVID levels due to the prolonged pandemic shock. Government spending increases by 2 percent relative to 2020 and should move towards well-targeted measures—affected sectors and households—aimed at mitigating the pandemic and supporting the recovery. The 2021 fiscal stance appears broadly appropriate as it avoids cliff effects as emergency measures expire. Continued large budget allocations for health and corporate support (wage subsidies) are welcome. However, unemployment-benefit schemes should be accompanied by more active labor-market programs, such as (re)training. The overall fiscal deficit is projected to reach 4½ percent of GDP in 2021, financed mainly domestically. The cost of such financing will likely increase despite good liquidity in the banking system, and the authorities have been reluctant historically to finance spending at higher interest costs. However, reductions in spending could have negative implications for growth and social inequality. The authorities are encouraged to execute their expenditure plans, improve debt management to minimize interest costs, and strengthen guarantee programs.

Text Table 1: BIH - General Government Finances, 2020-2021

(in percent of respective GDP)

	FBIH		RS		BIH	
Year	2020	2021	2020	2021	2020	2021
Revenue	**37.5**	**38.0**	**40.3**	**40.3**	**41.0**	**41.0**
Taxes	18.5	18.6	20.9	21.2	21.9	21.8
Social Security Contributions	16.6	16.6	15.4	15.3	15.9	15.7
Non-tax Revenue	2.4	2.8	4.0	3.7	3.3	3.4
Expenditure	**42.3**	**41.6**	**47.7**	**46.4**	**46.6**	**45.4**
Expense	38.6	37.9	41.2	40.2	41.8	40.8
Of which: Wages	9.5	9.6	10.3	10.3	11.8	11.8
Nonfinancial Assets	3.7	3.7	6.5	6.2	4.8	4.7
Net Lending	**-4.8**	**-3.6**	**-7.4**	**-6.2**	**-5.6**	**-4.5**
Primary Surplus	**-4.2**	**-3.0**	**-6.2**	**-4.8**	**-4.8**	**-3.6**

Sources: IMF staff projections.

15. Reforming the health sector and clearing public-sector arrears will help address fiscal risks. Staff agreed with the authorities to increase health-sector resources in 2021. This will help ensure adequate health care for the entire population regardless of health insurance status—a new practice during the pandemic. Entity governments are working with the World Bank to make the health sector more efficient and sustainable, including by introducing commitment controls and integrating health institutions into treasury systems. Health arrears have hampered the health-care performance. Staff strongly encouraged the governments to develop comprehensive plans to reduce liabilities of the health and PE sectors and accelerate arrears clearance. In the RS, total health sector liabilities are about KM1 billion (about half are intergovernmental arrears). In the FBiH, PE-related SSC and general government arrears are estimated at about KM1.1 billion.[1]

16. Social assistance should be expanded to support the most vulnerable during the pandemic. The authorities' continued focus on unemployment benefits is welcome. However, social assistance eligibility criteria and coverage periods should be expanded to support the vulnerable, including in the informal sector. Entity governments should work with the World Bank to expand assistance coverage, including by updating databases, and identifying and verifying beneficiaries.

17. Staff welcomed the authorities' commitment to strengthening Public Financial Management (PFM) and procurement. Both entities will continue to report on companies that received pandemic-related support on respective FBiH and RS websites.[2] The authorities are encouraged to also publish details of COVID-related contracts while naming the beneficial owners of the contract entities. The entity Auditor Generals will conduct and publish ex-post audits of COVID-related spending (including extrabudgetary funds) as part of the 2020 general government audits. Staff welcomed the State (IBiH), entity (FBiH and RS), and Brčko District (BD) governments' commitments to adopt a country-wide PFM strategy by mid-2021. Staff urged the authorities to adopt a State-law on public procurement in line with EU recommendations. The new legislation will help ensure a level playing field for suppliers, improve transparency, combat corruption, and generate budgetary savings.

18. The authorities should use the pandemic crisis to pursue more growth-friendly fiscal policies. A normative reform scenario suggests that growth could be increased without jeopardizing fiscal sustainability. FBiH tax reforms could lower labor taxes and stimulate formal employment (see below). Greater revenue administration efforts focusing on tax compliance, risk analysis, management of large taxpayers, and audit improvements could raise revenues efficiently. Exercising wage restraint by limiting real wage growth below economic growth and implementing public administration reform would lower the high wage bill. Greater pandemic social spending during 2021-23 period could help protect the vulnerable and increase female labor market participation (see below). More domestically-financed public investment could reduce infrastructure bottlenecks and help raise the economy's growth potential. Greater usage of government guarantees during

[1] Projections do not include arrears clearance.

[2] FBiH: http://www.pufbih.ba/v1/novosti/1879/lista-korisnika-subvencija-po-osnovu-doprinosa-za-obavezna-osiguranja; and RS: https://poreskaupravars.org/wp-content/uploads/2020/10/Pregled-poslovnih-subjekata-kojima-je-odobrena-pomoc-za-mjesec-april-2020..pdf.

2021 and 2020 could stimulate credit growth and alleviate financing constraints of local companies. Significant arrears clearance would improve suppliers' liquidity and result in lower costs.

Text Table 2: BIH - Adjustment Measures under Normative Scenario
(in percent of GDP, cumulative)

	Normative Scenario		
Year	2021	2023	2025
Revenues	**0.1**	**0.2**	**0.3**
Revenue administration	0.1	0.2	0.3
PIT/SSC reform for FBiH	0.0	0.0	0.0
Expenditure	**0.2**	**0.5**	**0.5**
Restrain wage growth	-0.2	-0.4	-0.6
Pandemic social spending	0.2	0.1	0.0
Increase capital spending	0.2	0.8	1.1
One-off fiscal measures	**1.5**	**4.0**	**n/a**
Fiscal cost of guarantees 1/	0.5	1.0	n/a
Arrears clearance 2/	1.0	3.0	n/a

Sources: IMF staff projections.
1/ One-time spending assumed to take place in 2021 and 2022.
2/ Takes place below the line over 2021-23, but affects the measured debt stock.

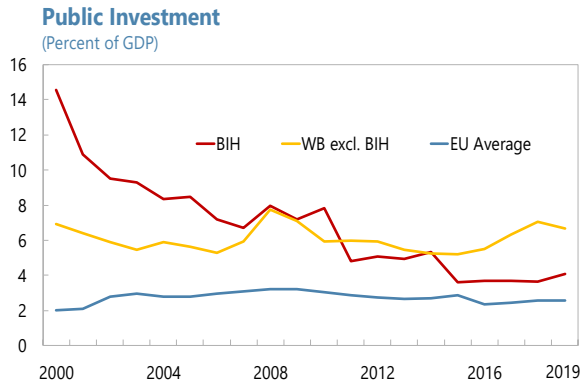
Text Table 3: BIH - Baseline Versus Normative Scenario
(in percent of GDP)

	Baseline Scenario			Normative Scenario		
Year	2021	2023	2025	2021	2023	2025
Real GDP growth rate	**3.5**	**3.0**	**3.0**	**4.0**	**3.3**	**3.3**
Revenue	**41.0**	**41.4**	**42.0**	**41.1**	**41.6**	**42.3**
Tax revenue	21.8	22.2	22.8	21.9	22.4	23.1
SSC & non-tax revenue	19.2	19.2	19.2	19.2	19.2	19.2
Expenditure	**45.4**	**43.5**	**42.7**	**46.1**	**44.0**	**43.2**
Expense 1/	40.8	39.1	38.3	41.3	38.8	37.7
Of which : wages	11.8	11.7	11.6	11.6	11.3	11.0
Nonfinancial assets	4.7	4.4	4.3	4.9	5.2	5.4
Net lending	**-4.5**	**-2.1**	**-0.7**	**-5.1**	**-2.4**	**-0.9**
Primary surplus	**-3.6**	**-1.1**	**0.3**	**-4.2**	**-1.4**	**0.1**
Government debt /2	**38.7**	**41.9**	**41.6**	**40.6**	**46.2**	**45.7**

Sources: IMF staff projections.
1/ Includes fiscal cost of guarantees in 2021 normative scenario.
2/ Includes arrears clearance, which is not recorded under expenditure.

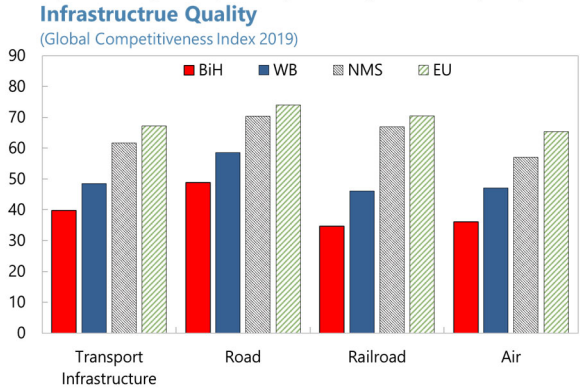
19. Fiscal policy should facilitate the reallocation of resources towards critical investments. This calls for reining in current spending—when pandemic spending is no longer needed—and boosting capital spending. Staff recommended bringing current spending back to pre-pandemic levels (in terms of GDP), largely by containing the wage bill (e.g., restricting hiring for non-critical functions and keeping the real wage bill constant). A substantial reallocation of resources towards critical physical and human capital investments would stimulate the economy post-pandemic. So far, progress in implementing public investment has been limited, mainly due to capacity constraints. To effectively scale up investment, staff urged the authorities to implement the IMF Public Investment Management Assessment (PIMA) recommendations to prioritize projects with identified financing and completed documentation. Staff encouraged the RS government to request a PIMA mission. FBiH should make larger efforts to raise domestically-financed investments.

Public investment has lagged behind in recent years



Sources: World Economic Outlook; and IMF staff calculations.

BiH infrastructure quality is poor compared to regional and European peers



Sources: World Economic Forum, Global Competitiveness Indicators.

20. Policy coordination at all levels is needed to improve BiH's economy and make the normative policy scenario feasible. There is no unified BiH fiscal policy, although this is BiH's main policy tool. The fiscal council has some role in coordinating fiscal policy, but in practice the entities do not coordinate budgets. State-level fiscal policy is non-existent because its budget is fixed and minuscule (3 percent of GDP). On the revenue side, revenue bases should be fully harmonized to reduce tax distortions. Revenue allocation coefficients should be formula-based. However, harmonization policies are blocked due to disagreements about competencies with little regard to economic efficiency or the common good. These problems are to some extent replicated at the FBiH level. During the pandemic the FBiH central government helped FBiH cantons provide public goods, such as healthcare and education. However, there are virtually no levers to incentivize cantonal or municipal governments to implement prudent fiscal policies, reduce nuisance para-fiscal fees, or clear arrears (or report on them). Even statistical data exchange and compilation is hampered by jurisdictional disputes. Staff recommended a bigger role for the fiscal council for economic policy coordination and urged the authorities to improve reform implementation. To strengthen revenue administration, staff encouraged the authorities to restore the bulk exchange of taxpayer information between all four tax agencies and the two entity business information agencies in line with the 2016 EFF.

21. Debt sustainability analysis shows that public debt remains sustainable under a normative scenario with higher capital spending, even though downside risks have increased (Annex III). Once the recovery is well underway, staff recommended that BiH return to a debt-stabilizing fiscal policy to rebuild fiscal buffers. This would imply a gradual reduction of the primary deficit to about 1 percent of GDP. Public debt remains vulnerable to contingent liability shocks, especially from PEs. A larger or more persistent pandemic impact than assumed could worsen debt dynamics. In such a case, the authorities should prolong and possibly increase pandemic support measures (especially loan guarantee and social support programs) while seeking additional financing from IFIs given limited domestic financing availability.

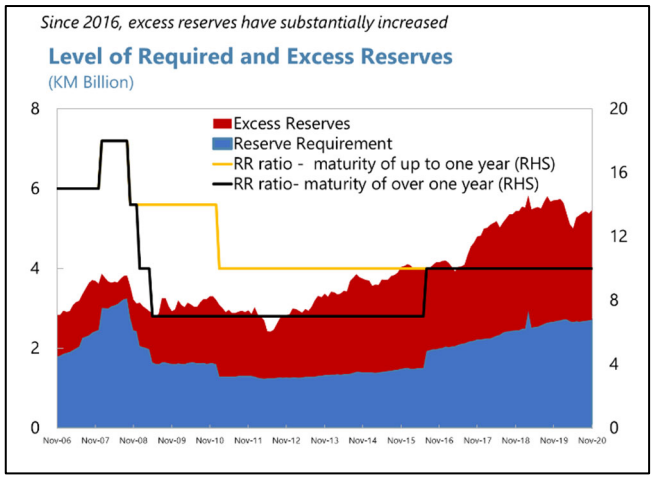
Authorities' Views

The authorities agreed with staff that a temporary fiscal expansion is the appropriate pandemic response. They committed to return to a debt-stabilizing fiscal policy once a sustained economic recovery is underway. They acknowledged the need to improve the quality of the budget by shifting resources from current to capital spending. However, they argued that arrears (health sector and PEs) could only be cleared with IFI support. The FBiH also pointed to data and coordination problems at the cantonal and municipal levels related to constitutional competencies. The RS argued that the fiscal council had no legal authority to conduct fiscal policy at the BiH level.

B. Financial Sector Policies: *Preserving Stability and Supporting the Economy*

Preserving the currency board arrangement (CBA), enhancing banking-sector resilience, completing the bank-resolution framework, and improving the loan-guarantee funds are key objectives.

22. The CBA and CBBH policies have played key roles in preserving macroeconomic and financial stability during the pandemic. The overall banking system has remained solid, with adequate average capital buffers, steady NPL ratios, and comfortable liquidity-coverage ratios. Banks' deposits and loans have continued broadly stable, showcasing the credibility of the CBA. The CBBH strongly resisted calls to use its international reserves for fiscal purposes—which would undermine the CBA—and provided currency as needed. Notwithstanding this achievement, the CBA should be further strengthened by modernizing the reserve-requirement framework (Annex VII). Staff encouraged the CBBH to fully align the remuneration of foreign-currency (FX) reserves with their opportunity cost, which is the ECB deposit-facility rate (currently -50 basis points) minus custody costs (some 10 basis points). FX and domestic-currency reserve remuneration would be differentiated through a risk premium paid on domestic-currency required reserves. The CBBH would thus gain a



powerful tool for defending the CBA by setting the risk premium, while reducing euroization over time. Staff supported the authorities' commitment to banning the use of CBBH international reserves for fiscal purposes.

Authorities' Views

The CBBH reiterated its strong commitment to the CBA and agreed to modernize its reserve framework by differentiating the remuneration of FX reserves and domestic-currency required reserves. Their objective is to remunerate FX reserves fully at the opportunity cost of euro placements abroad.

23. While overall financial conditions have remained relatively stable, pockets of weaknesses and risks are growing, warranting intensified monitoring. Despite challenging macroeconomic and financial conditions, deposits have remained stable, including those denominated in Euro. Banks' capitalization and liquidity have remained adequate (Table 7). However, banks' asset quality is weakening, and NPLs have remained elevated—and in some domestically-owned banks, under-provisioned—raising capital-adequacy concerns. Staff encouraged supervisors to intensify already close monitoring through off- and on-site inspections, and require corrective measures, including credible recapitalization plans for banks under enhanced supervision. Looking forward, the recently introduced Supervisory Review and Evaluation Process (SREP) methodology will help to detect deficiencies and weaknesses, and better tailor corrective actions and implementation timelines. The authorities should resist any mandatory conversion of FX denominated loans into local currency. The FBiH authorities should move expeditiously to appoint qualified members to the Securities Commission, which is necessary to execute several decisions, including pending bank recapitalizations.

24. Loan moratoria have provided temporary relief to households and firms. In April, supervisors quickly introduced loan moratoria to be granted on a case-by-case basis with no changes in loan classification rules. Moratoria have been critical to prevent credit contraction and alleviate liquidity pressures. Both individuals and companies utilized moratoria, although the uptake was lower than expected. Staff supported the authorities' decision not to allow new loan moratoria requests after end-2020, since it could lead to loan under-provisioning.

25. Supervisors need to work with banks to prepare for the likely deterioration of bank assets. The combined effect of output contraction and loan-moratoria phaseout could translate into higher NPLs. Corrective measures to effectively deal with increased NPLs, including adequate provisioning, should be in place to ensure a well-functioning banking system. Staff encouraged the authorities to undertake, with IFI technical support, a comprehensive analysis of the obstacles to NPL resolution and design an NPL action plan, including an out-of-court framework. Also, the FBiH parliament should finalize adopting the insolvency law—aligned with RS and Brcko District legislation—as it could play a crucial role in the coming months when default rates are expected to increase.

26. Loan-guarantee funds should support the economy now. Guarantee funds are a powerful tool to provide firms, especially SMEs, with additional resources to withstand liquidity shocks and/or

finance working capital. The utilization of guarantee schemes has been low. To make them more effective, staff recommended increasing the government-risk coverage, streamlining administrative procedures, and adopting a portfolio approach (for loans below certain amounts). The RS guarantee fund already has a relatively high government-risk coverage (70 percent) and a portfolio approach. By contrast, the FBiH guarantee fund only provides a risk coverage of 50 percent and suffers from lengthy and redundant bureaucratic processes (loan-by-loan assessment duplicated by the FBiH development bank). Staff is concerned that the FBiH guarantee program might be too slow to have an impact during the pandemic. Both entities committed to providing additional resources to guarantee funds if needed.

27. Staff encouraged the authorities to enhance the bank-resolution framework. Reforms in this area have moved slowly because of policy disagreements on the roles of State-level and entity institutions. However, the adoption of the new Deposit Insurance Agency (DIA) legislation, allowing the use of DIA resources for resolution purposes, was an important step to completing the resolution framework.

- **The establishment of a Financial Stability Fund (FSF), in line with the 2015 FSAP recommendations would complete the bank-resolution framework.** Given the absence of a lender-of-last resort, an FSF would play an essential function in preserving financial stability if a failing bank needs to be resolved while minimizing costs to taxpayers. Given economies of scale in administration, potentially large capital needs, and the fact that most banks operate throughout BiH, staff strongly recommended creating a single FSF, which will require amending entity banking laws and the deposit-insurance law.

- **An effective Standing Committee for Financial Stability (SCFS) is essential.** The CBBH should present comprehensive assessments of the macroeconomic and credit cycles to the SCFS, which should meet at least quarterly. Regular CBBH macro and credit analysis will also help to operationalize counter-cyclical, systemic-risk, and domestic systemically-important bank (D-SIB) capital buffers—an important step in enhancing financial resilience. Moreover, the responsibilities for cooperation among agencies and governments should be defined in a comprehensive three-pillar Financial Stability MOU (FSMOU), as envisaged in the 2016 EFF.

- **Once the economy recovers, the DIA should move to charging risk-based premia**—an additional disciplining device for banks—and continue gradually increasing the coverage of insured deposits up to the DIA's target size. The BiH parliament should ratify the EBRD stand-by credit line (€30 million) to further strengthen DIA resources for bank-resolution and liquidation operations.

28. Development banks need to become financially viable and focus on alleviating financial market failures. Both entities have been working for years with the World Bank on modernizing the development banks. These banks engage in standard financial-sector activities and should be under banking agency supervision because they pose financial-sector risks. Both entity governments should adopt new strategic statements to align development banks' missions with

best international practices and make them financially sustainable. Also, new legislation to fully reflect the updated mission should be passed by entity parliaments.

29. The 2021 safeguards assessment update is substantially completed and found that the CBBH continues to maintain broadly robust safeguards. Most recommendations from the 2017 assessment have been implemented. Staff recommended that governance arrangements be reinforced by clarifying CBBH internal rules on the role of the Management Board and the Audit Committee.

Authorities' Views

While the overall financial sector has remained stable, the authorities recognized that vulnerabilities are growing, particularly in some banks. They shared staff's views that banks' asset quality could deteriorate when loan moratoria expire. They also concurred with staff that an effective NPL resolution strategy needs to be prepared. However, the RS authorities opposed a single, independent FSF because in their view it transfers entity competencies to the State level. They explained that the FSMOU also implies a transfer of competencies and that the methodology for determining D-SIBs has to be decided by the RS banking agency and should require RS instead of BiH data. In principle, they agreed that the loan guarantee schemes could be made more attractive by increasing the governments' risk coverage and reducing administrative burdens. However, the FBiH authorities were reluctant to move to a portfolio approach for loan guarantees because of potential fiscal risks and preferred to wait for first results before changing the scheme.

C. Structural Reforms: *Strengthening Governance, Improving Competitiveness, and Creating Job Opportunities*

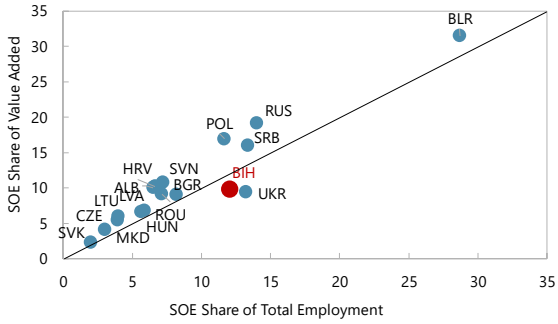
Poor governance and a weak business climate are serious obstacles to a more competitive economy. More efforts are needed to: (i) improve PE oversight and transparency; (ii) promote a green economy; (iii) support digitalization; (iv) improve governance and strengthen institutions to tackle corruption and (v) improve labor market policies.

30. Weak PE performance and governance have limited their contribution to economic growth (Annex VIII). The economic footprint of PEs is considerable. They account for 11 percent of total employment and own about 40 percent of fixed assets. However, many are barely profitable or loss-making and some are engaged in activities with no obvious public-policy objective. Others could benefit from some private-sector involvement (airports, utilities, forestry, etc.). The PE debt stock is roughly 26 percent of GDP, including large tax and SSC arrears, but this is not fully reflected in public-sector debt statistics because of aggregation difficulties. PE governance falls short of OECD guidelines and ranks low compared to regional comparators, increasing corruption vulnerabilities.

31. Enhancing oversight and transparency is a first step to modernize PEs. Staff recommended establishing a PE central-oversight unit in each entity's prime minister's office; and creating the capacity of monitoring, assessing, and managing fiscal risks within the ministries of finance. The rationale for public ownership should be clarified by a comprehensive public ownership policy document, which should outline the overarching financial, corporate and policy objectives of PEs. Moreover, entities should create or enhance searchable websites with a complete list of PEs operating within each entity, including individual and aggregated financial statements, external audit reports, and organizational information. Management and board members of PEs should be appointed solely based on strong technical qualifications while ensuring their political independence.

PE employees in BiH produce less value added than other countries in the region.

Value Added vs Employment, 2016

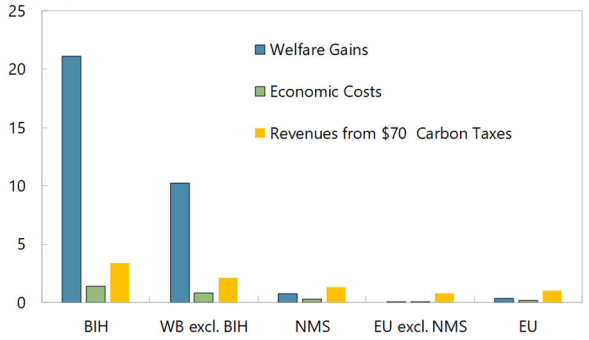


Source: Richmond, and others (2019).

32. More efforts are needed to move toward a low-carbon economy. Energy subsidies are estimated to be above 30 percent of GDP—mostly related to air pollution from burning coal, which has negative health effects. In this context, the European Energy Community recently suspended BiH's voting rights for noncompliance, including failure to adopt a State-level law on Electricity and Natural Gas in line with the "EU third energy package". This legislation would provide the legal framework to develop an effective single market for electricity and gas. This would enhance security and standard of supply, while keeping prices low through higher competition. Staff encouraged the authorities to increase and promote investments in green energy by seizing all available financing opportunities offered by IFIs. In the medium term, a carbon tax could generate revenues for financing green energy investments and create substantial welfare gains by reducing coal pollution.

Impact of US$70 Carbon Tax

(In percent of GDP)



Sources: IMF Policy Paper: "Fiscal Policies for implementing Paris Climate Strategies - From Principle To Practice"

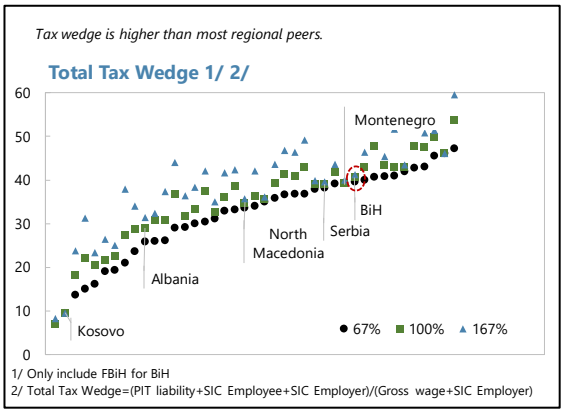
33. Digitalization is central to foster economic development and prevent corruption. Staff encouraged the authorities to engage with key development partners on digitalization. To raise competitiveness and attract more FDI, the authorities must digitalize, simplify, and modernize the economy. The adoption of new draft legislation on electronic identification and trust services for electronic transactions, including a country-wide supervisory body, would ensure further alignment with existing EU legislation, ensure international recognition, and help digitalize the banking system. Similarly, new public procurement legislation would encourage e-procurement platforms.

34. There has been very limited progress in improving governance and competitiveness. The 2019 EU Expert Report on the rule of law describes serious shortcomings that continue to hamper the business environment as investors face significant administrative and legislative obstacles. Large court backlogs, redundant procedures, and inconsistent regulations, at various levels of governments, encourage corruption while preventing substantial private investment, including FDI. Similarly, the 2020 Group of States against Corruption (GRECO) report on corruption prevention noted that BiH had not implemented fully any of the 15 recommendations from the 2015 Evaluation Report. Staff encouraged the authorities to request an IMF Governance Diagnostic Mission and publish its results. The Diagnostic would identify key priority areas and sequencing for reforms to address major shortcomings. Importantly, improving governance could slow the ongoing migration of young and skilled people towards EU countries.

35. The authorities are making some progress in strengthening the AML/CFT framework. Staff welcomed the authorities' efforts to strengthen various aspects of the AML/CFT framework, and BiH is no longer subject to FATF's follow-up review process. BiH authorities confirmed their commitment to improve the effectiveness of their AML/CFT framework by enhancing its supervisory and sanctioning regime. The objective is to make the preventive measures of the framework more robust—such as customer due diligence, including for politically exposed persons, and suspicious transaction reporting—along with more efforts to ensure transparency regarding beneficial ownership of legal persons. Staff recommended the establishment, at the CBBH, of a country-wide registry of bank accounts of private individuals as envisaged in the 2016 EFF. This could help law enforcement and tax authorities link the name of private individuals to their bank accounts when conducting financial investigations (e.g., money laundering, corruption). Staff recommended including the name(s) of beneficial owner(s) in the registry for legal persons. This would make debt enforcement more effective, including through account garnishments. The authorities confirmed that no changes have been introduced in the foreign exchange system since the 2017 Article IV consultation. They also confirmed their willingness to formally accept the Article VIII obligations.

36. Reducing the labor tax wedge, enhancing education, and expanding childcare could raise formal employment and reduce unemployment. Unemployment is particularly high among young people (40 percent), and female labor-force participation is very low. Both are primarily caused by limited private-sector job opportunities. Nonetheless, high labor taxes, skill mismatches, and rigid labor markets, together with high reservation wages, are key factors hampering the labor market. Staff encouraged the authorities to:

- **Adopt the draft SSC/PIT law to reduce SSC rates, broaden the tax base for SSC and PIT, and make PIT more progressive.** This would lower labor taxes for low-wage earners and could stimulate higher formal employment. Further revenue neutral



reductions of SSC rates could be considered as part of more comprehensive tax and revenue sharing reforms.

- **Enhance the quality of public education to lift labor force skills and tackle structural unemployment.** The mismatch of education and vocational training curricula with labor market needs is a key factor behind high unemployment.

- **Expand affordable childcare, early education programs, and flexible work arrangements to increase labor participation.** Strengthening childcare and early education programs would improve childhood education and boost female employment.

Authorities' Views

The authorities shared staff's views that structural reforms are urgently needed to accelerate economic growth and tackle high unemployment. They agreed that improving PE oversight, productivity, and governance; reducing the labor tax wedge; and increasing investment in education are essential for boosting private investment and formal employment. However, the RS strongly opposed the introduction of a new, single registry for bank accounts of individuals at the CBBH arguing that it implies a transfer or competencies. The authorities concurred with staff that a greener economy would generate welfare gains and new jobs. However, they believed that this transition should be gradual to safeguard existing investments and employment in brown energy. Also, the RS opposed the draft State-law for electricity and natural gas and creating a country-wide regulatory agency. The authorities supported the digitalization of the economy, but the RS objected to the draft State-law on digitalization and wanted to reduce the powers of the existing State-level regulator.

D. Capacity Development

37. BiH has been an active user of Capacity Development (CD). The implementation of CD recommendations has remained broadly satisfactory. Staff encouraged the authorities to enhance coordination with other CD providers to improve prioritization and minimize duplications. The BiH authorities should strengthen their administrative and institutional capacity to facilitate the EU candidate process. In this context, staff recommended subscribing to the IMF Special Data Dissemination Standard (SDDS) to improve availability and timeliness of public data. Also, the ongoing successful assistance for revenue administration, PFM (particularly for PEs), macroeconomic analysis, and macro-prudential buffers should continue.

STAFF APPRAISAL

38. The BiH economy is facing a sharp economic slowdown. The pandemic has affected BiH through both domestic containment measures and spillovers from its main EU trading partners, who also suffer strong downturns. Following a large output contraction in 2020, a gradual recovery is expected to take place in the second half of 2021, assuming vaccinations will control the pandemic.

39. The Currency Board Agreement (CBA) served BiH well in maintaining external and financial stability. Like in previous crises, the CBA has provided a credible anchor for the stability of the financial system and the overall economy. The external position in 2020 was in line with fundamentals and desirable policy settings. The CBBH should continue to resist using international reserves for fiscal purposes. However, the CBA should be strengthened by modernizing the reserve requirement framework. A differentiated remuneration for domestic- and foreign-denominated currency reserves would give the CBBH an additional tool to defend the CBA and effectively respond to economic shocks.

40. Staff supports the temporary fiscal expansion during 2020-21. BiH entered the pandemic with fiscal buffers, which have been used to support the economy. Fiscal policy should continue to accommodate the costs of pandemic-related health, job, business, and social support measures. These measures are essential for mitigating the pandemic's impact and supporting a strong recovery. Spending in 2021 could be better targeted to effectively mitigate the fallout of the crisis. In the absence of additional IFI financial support, mobilizing domestic financing could become challenging and hamper budget execution with potentially negative consequences for growth and social protection.

41. Existing social safety nets should be strengthened to better support vulnerable groups. The authorities' initial swift policy response to contain the virus and limit the economic fallout was effective. However, the coverage and duration of social spending and unemployment support could be expanded to support disadvantaged persons. Childcare and early education programs should be enhanced to ease employment constraints on households and support female labor market participation.

42. Stronger State-level policy coordination is needed for enhancing the single economic space. The lack of economic policy coordination has contributed to slow economic growth. BiH should empower the fiscal council to formulate country-wide fiscal policy as a policy tool. The revenue bases for taxes should be harmonized and revenue sharing mechanisms de-politicized. Similarly, revenue and expenditure assignments should be reviewed with a view to creating efficiency gains and incentives for fiscal responsibility at all levels of government. The exchange of taxpayer information between tax authorities and entity business information agencies should be resumed. Improving the single economic space should be the prime objective of economic policy making.

43. Looking beyond the near term, a more growth-friendly fiscal policy is needed. The fiscal deficit is expected to gradually decline as pandemic measures are phased out. Debt is projected to remain sustainable over the medium term. However, to support faster per-capita income convergence with the EU, resources should shift from current to capital spending, particularly by reducing the wage bill through public administration reform. Project selection, implementation, and monitoring should be improved in line with IMF PIMA recommendations. The RS would benefit from an IMF PIMA assessment. The FBiH should increase capital spending allocations to remove infrastructure bottlenecks. Adoption of a country-wide PFM strategy would also help achieve these objectives. Identifying and clearing public sector arrears (mainly health

sector in the RS and PEs in the FBiH) would reduce contingent fiscal liabilities and help improve health services and PE performance. On the revenue side, a reduction in labor taxes (particularly for low wages) could stimulate formal employment, and a reduction in para-fiscal fees could improve the business environment.

44. The authorities should intensify monitoring banking vulnerabilities, prepare for an increase in NPLs, and improve the effectiveness of loan guarantee funds. While the overall financial system has weathered the pandemic's early impact, elevated NPLs and insufficient loan provisioning in some banks underscore the importance of strong supervisory oversight and enforcement of prudential norms. Banking agencies should continue to conduct rigorous on- and off-site inspections and require prompt corrective actions if needed, including credible and timely recapitalization plans. Following the end of loan moratoria, NPLs are expected to rise and banks' timely recognition of deteriorated assets should be ensured. An effective NPL resolution strategy, including establishing an out-of-court restructuring mechanism, should be put into place soon. The authorities should increase the government's risk coverage for the loan guarantee programs and remove administrative bottlenecks for granting guarantees. The FBiH authorities should move expeditiously to appoint qualified members to the Securities Commission and pass modernized insolvency legislation.

45. Further work is needed to strengthen financial stability and modernize development banks. In the absence of a lender-of-last-resort, establishing a single, independent FSF is needed to complete the resolution framework. Signing the comprehensive three-pillar (FSMOU) would strengthen the role of the SCFS, cooperation among banking agencies and other stakeholders, and increase the resilience of the single financial space. New strategic statements and related legislation are needed to modernize the entity development banks.

46. PE reforms are key to improving productivity, encouraging competition and strengthening fiscal sustainability and governance. Better oversight and greater transparency are urgently needed to rationalize this sector. Key reforms include: establishing centralized oversight units to address poor financial performance; creating the capacity to manage fiscal risks by identifying and tackling contingent liabilities; publishing financial statements regularly; publishing a comprehensive ownership document explaining the rationale for state ownership of PEs; and basing PE board and management appointments on merit and experience. Divestiture of non-core PEs and private-sector management for suitable PEs should also be considered. Public-sector debt statistics should fully incorporate PE debts.

47. The transition to a low-carbon economy should be accelerated given BiH's large coal subsidies. Investments in renewable energy would generate substantial welfare gains and business/job opportunities. The adoption of a country-wide electricity and natural gas law in line with EU legislation including a country-wide regulator would lay the foundation for improving energy efficiency and supply security.

48. Fostering digitalization would raise productivity and reduce corruption opportunities. The adoption of EU-aligned State-level legislation on electronic identification and trust services for

electronic transactions, including a country-wide supervisory body, would lay the foundation for e-government and e-commerce. Revised State-level legislation on public procurement will enhance the overall framework, including the use of e-procurement platforms and enforcement mechanisms, which will help level the playing field for all suppliers and limit corruption opportunities.

49. More efforts are needed to improve governance and competitiveness. Governance and corruption vulnerabilities remain a serious concern, and a weak rule of law continues to stifle economic development. An IMF Governance Diagnostic Mission could help identify priority areas for improvements. Removing governance weaknesses could reduce outward migration, especially of skilled and young people. The implementation of a single account registry for individuals at the CBBH could improve AML/CFT practices and strengthen asset recovery and credit growth. The safeguards assessment recommended that CBBH reinforces its governance arrangements.

50. Staff recommends that the next Article IV Consultation be held on the regular 12-month cycle.

Table 1. Bosnia and Herzegovina: Selected Economic Indicators, 2017–25

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Proj.		
Nominal GDP (KM billion)	31.4	33.4	35.3	33.2	34.8	36.3	37.9	39.7	41.7
Gross national saving (in percent of GDP)	16.2	17.7	18.5	18.4	16.5	16.7	17.0	17.1	17.3
Gross investment (in percent of GDP)	21.1	21.1	21.6	21.9	21.5	21.0	20.9	20.9	20.9
				(Percent change)					
Real GDP	3.2	3.7	2.8	-5.5	3.5	3.3	3.0	3.0	3.0
GDP Deflator	1.7	2.7	2.6	-0.4	1.1	1.1	1.4	1.6	2.1
CPI (period average)	0.8	1.4	0.6	-0.6	1.2	1.0	1.3	1.6	2.0
Money and credit (end of period)									
Base Money	12.4	10.3	6.9	0.3	6.2	--	--	--	--
Broad Money	9.5	8.8	8.7	1.1	6.3	--	--	--	--
Credit to the private sector	7.3	5.6	6.3	-1.2	6.4	--	--	--	--
				(In percent of GDP)					
Operations of the general government									
Revenue, *of which* :	42.3	42.7	41.7	41.0	41.0	41.1	41.4	41.7	42.0
Taxes	22.3	22.9	23.0	21.9	21.8	21.9	22.2	22.6	22.8
Social security contributions	14.9	15.1	15.1	15.9	15.7	15.7	15.7	15.7	15.7
Expenditure	40.5	41.0	40.4	46.6	45.4	43.8	43.5	43.1	42.7
of which : Investment expenditure	3.5	3.6	3.5	4.8	4.7	4.4	4.4	4.4	4.3
Net lending	1.8	1.7	1.4	-5.6	-4.5	-2.7	-2.1	-1.3	-0.7
Net lending, excl. interest payment	2.6	2.4	2.1	-4.8	-3.6	-1.8	-1.1	-0.4	0.3
Total general government debt	39.2	34.3	32.4	38.3	38.6	40.2	41.7	41.6	41.4
Domestic general government debt 1/2/	13.3	9.8	9.4	12.2	13.6	16.1	21.0	22.5	23.6
External general government debt	26.0	24.5	22.9	26.2	25.0	24.1	20.7	19.1	17.8
Balance of payments				(In percent of GDP)					
Exports of goods and services	41.0	42.4	40.5	37.8	39.1	39.0	38.8	38.7	38.6
Imports of goods and services	57.3	57.2	55.2	50.5	53.5	53.6	53.6	53.7	53.5
Trade balance	-16.2	-14.7	-14.7	-12.7	-14.4	-14.6	-14.8	-14.9	-15.0
Current transfers, net	12.2	12.0	11.7	9.3	9.7	10.2	10.6	11.0	11.0
Current account balance	-4.8	-3.3	-3.1	-3.5	-4.9	-4.3	-4.0	-3.7	-3.6
Foreign direct investment (+=inflow)	3.4	2.9	1.9	1.4	1.3	1.5	1.7	1.8	1.9
Gross official reserves (Euro million)	5,411	5,956	6,455	6,730	6,530	6,465	6,491	6,571	6,685
(In months of imports)	6.6	7.2	9.0	8.5	7.9	7.5	7.2	6.9	6.7
(In percent of monetary base)	112.2	112.0	113.5	118.0	107.9	--	--	--	--
(In percent of IMF ARA metric)	101.8	102.8	107.2	118.1	110.7	--	--	--	--
External debt 3/	72.0	64.4	64.3	76.0	69.5	67.2	62.7	59.9	57.3
Memorandum Items:									
Unemployment rate (national definition)	20.5	18.4	15.7	--	--	--	--	--	--
GDP per capita (in euros)	4,784	5,146	5,467	5,181	5,445	5,708	5,980	6,291	6,640
Output gap (in percent of potential GDP)	0.0	0.5	0.4	-3.1	-2.9	-2.1	-1.3	-0.9	0.0
REER (Index 2000=100)	85.6	86.5	85.1	84.6	--	--	--	--	--
NEER (Index 2000=100)	110.8	113.0	112.9	114.8	--	--	--	--	--

Sources: BiH authorities; and IMF staff estimates and projections.

1/ On average, half of the domestic debt stock is indexed to the Euro.

2/ The stock of general government domestic debt does not include domestic arrears and those of public enterprises.

3/ Includes inter-company loans in private external debt.

Table 2. Bosnia and Herzegovina: Real Sector Developments, 2017–25

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Proj.		
Real growth rates				(Percent change)					
GDP at constant 2010 prices	3.2	3.7	2.8	-5.5	3.5	3.3	3.0	3.0	3.0
Domestic demand	2.6	2.6	2.9	-7.1	5.2	3.6	3.2	3.0	3.0
Private	2.7	2.8	3.5	-11.2	6.0	4.1	3.5	3.1	3.1
Public	2.2	2.1	1.0	9.2	2.8	2.0	2.5	2.6	2.6
Consumption	-0.1	2.0	1.9	-8.3	6.4	3.9	3.3	3.0	2.9
Private	-0.6	2.3	2.2	-11.9	7.3	4.3	3.5	3.1	3.0
Public	1.4	1.0	0.9	4.9	3.5	2.8	2.4	2.5	2.5
Gross capital formation	16.4	5.5	7.1	-2.1	1.0	2.4	3.2	3.1	3.7
Private	18.6	4.9	8.3	-8.8	1.3	3.4	3.2	3.1	3.8
Public	6.6	8.2	1.4	32.5	-0.2	-1.1	3.2	3.1	3.2
Net Exports									
Exports of goods and services	12.4	6.3	0.5	-8.7	6.6	5.8	3.8	4.7	4.4
Imports of goods and services	8.2	3.3	1.3	-10.9	9.4	5.8	4.1	4.2	4.1
Contributions to real GDP growth				(Year-on-year change over real GDP in previous year, in percent)					
GDP at constant 2010 prices	3.2	3.7	2.8	-5.5	3.5	3.3	3.0	3.0	3.0
Domestic demand	3.0	3.1	3.4	-8.2	6.0	4.2	3.8	3.5	3.5
Private	2.5	2.6	3.2	-10.4	5.2	3.7	3.1	2.8	2.8
Public	0.5	0.5	0.2	2.2	0.8	0.6	0.7	0.7	0.7
Consumption	-0.1	1.9	1.8	-7.7	5.8	3.7	3.1	2.8	2.7
Private	-0.4	1.7	1.7	-8.7	5.0	3.0	2.5	2.2	2.1
Public	0.3	0.2	0.2	1.0	0.8	0.6	0.5	0.6	0.5
Gross capital formation	3.2	1.2	1.6	-0.5	0.2	0.6	0.7	0.7	0.9
Private	2.9	0.9	1.5	-1.7	0.3	0.6	0.6	0.6	0.7
Public	0.2	0.3	0.1	1.2	0.0	-0.1	0.2	0.2	0.2
Net Exports	0.1	0.7	-0.6	2.7	-2.5	-1.0	-0.8	-0.5	-0.5
Exports of goods and services	4.7	2.6	0.2	-3.6	2.6	2.4	1.6	2.0	1.9
Imports of goods and services	4.6	1.9	0.8	-6.3	5.1	3.3	2.4	2.5	2.4
Deflators				(Percent Change)					
GDP	1.7	2.7	2.6	-0.4	1.1	1.1	1.4	1.6	2.1
Domestic demand	2.0	2.5	2.5	-0.5	0.8	0.9	1.4	1.8	2.1
Consumption	2.4	2.8	2.9	0.1	0.6	1.1	1.5	1.9	2.2
Investment	0.3	1.1	0.9	-2.4	1.4	-0.1	0.8	1.1	1.4
Exports of goods and services	5.5	3.6	0.0	-3.8	1.7	-1.6	-0.1	-0.2	0.3
Imports of goods and services	5.0	2.9	0.4	-3.3	1.2	-1.2	0.3	0.6	0.8
				(In percent of GDP)					
Consumption	95.2	93.6	93.1	90.8	92.9	93.5	93.8	94.1	94.1
Private	74.9	73.9	73.7	69.3	71.3	72.1	72.5	72.9	73.0
Public	20.3	19.8	19.4	21.5	21.6	21.5	21.3	21.2	21.1
Gross capital formation	21.1	21.1	21.6	21.9	21.5	21.0	20.9	20.9	20.9
Private	17.6	17.5	18.1	17.1	16.8	16.6	16.6	16.5	16.5
Public	3.5	3.6	3.5	4.8	4.7	4.4	4.4	4.4	4.3
National Savings	16.2	17.7	18.5	18.4	16.5	16.7	17.0	17.1	17.3
Private	10.6	12.6	13.9	19.4	16.7	15.4	15.0	14.4	13.9
Public	5.6	5.2	4.6	-0.9	-0.2	1.4	2.0	2.7	3.3
Saving-Investment balance	-4.8	-3.3	-3.1	-3.5	-4.9	-4.3	-4.0	-3.7	-3.6
Memorandum items:				(In percent)					
Unemployment rate (national definition) 1/	20.5	18.4	15.7	--	--	--	--	--	--
Nominal GDP (KM million)	31,376	33,444	35,296	33,226	34,753	36,284	37,894	39,669	41,702

Source: BiH, FBiH and RS Statistical Agencies, and Fund staff estimates.

1/ Based on the BiH Labor Survey. The unemployment rate based on unemployed persons registered in Unemployment Offices is significantly higher.

Table 3. Bosnia and Herzegovina: Balance of Payments, 2017–25 1/

(In millions of euros, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Proj.		
A. Current account	-776	-573	-557	-590	-878	-797	-772	-755	-765
Trade balance	-2,604	-2,519	-2,657	-2,165	-2,555	-2,701	-2,865	-3,029	-3,190
Goods	-3,800	-3,839	-4,072	-3,398	-3,829	-4,154	-4,426	-4,708	-5,011
Export of goods (fob)	4,791	5,320	5,204	4,580	5,032	5,137	5,317	5,552	5,794
Import of goods (fob)	-8,591	-9,159	-9,275	-7,978	-8,861	-9,291	-9,743	-10,260	-10,806
Services (net)	1,196	1,320	1,415	1,233	1,273	1,453	1,561	1,679	1,821
Exports	1,791	1,937	2,098	1,836	1,920	2,105	2,198	2,301	2,429
Imports	-595	-617	-683	-603	-647	-652	-637	-622	-608
Primary income (net):	-134	-102	-11	-13	-53	14	38	45	70
Total credit	496	524	579	580	613	659	712	769	831
Total debit	-630	-626	-590	-592	-666	-645	-674	-724	-761
Of which : interest payments	-84	-81	-77	-104	-105	-113	-120	-148	-162
Secondary income (net), *of which* :	1,962	2,048	2,110	1,587	1,730	1,889	2,056	2,230	2,355
Government (net)	36	15	-5	-5	-6	-6	-6	-7	-8
Workers' remittances	1,304	1,393	1,442	1,128	1,251	1,406	1,568	1,731	1,840
Other (NGOs etc.)	598	610	634	663	692	706	720	742	772
B. Capital account	175	159	152	154	177	179	182	185	190
Capital transfers (net)	175	159	152	154	177	179	182	185	190
General government	134	117	105	107	129	132	135	137	141
Other sectors	41	42	47	47	47	47	47	48	48
C. Financial account	-1,116	-1,187	-872	-711	-501	-553	-616	-650	-690
Direct investment (net)	-362	-509	-357	-245	-230	-278	-325	-360	-399
Assets	89	-6	-9	-18	-24	-7	-11	-16	-15
Liabilities	451	503	349	226	206	271	314	344	383
Portfolio investment (net)	-2	-29	20	-4	-7	-4	-4	-24	-24
Assets (net)	3	126	178	-14	-17	-14	-14	-14	-14
Liabilities (net)	5	155	158	-10	-10	-10	-10	10	10
Other investment (net)	-752	-649	-534	-462	-265	-271	-287	-266	-267
Assets (net)	-353	150	1	109	254	33	77	368	375
Short-term	-217	102	36	156	302	81	131	425	434
Banks	54	433	222	239	358	268	291	345	341
Other sectors, excl. government and central bank	-275	-333	-175	-73	-46	-177	-150	90	103
Medium and long-term	-135	48	-35	-47	-48	-48	-54	-56	-59
Banks	6	4	27	12	13	16	13	13	14
Other sectors, excl. government and central bank	-35	44	-62	-59	-61	-64	-67	-70	-74
Liabilities (net)	399	799	535	571	519	305	364	634	642
Short-term	581	766	342	135	132	210	347	452	431
General government	6	9	-14	0	0	0	0	0	1
Banks	73	275	-42	80	84	88	92	97	102
Other sectors	502	482	399	55	48	122	255	355	328
Medium and long-term	-182	34	193	436	386	95	16	183	211
Monetary authority	0	0	0	0	0	0	0	0	0
General government	-138	-25	-24	314	209	109	-198	51	32
Disbursements of loans	266	381	297	657	547	438	392	410	432
Project	266	305	297	291	339	356	367	380	401
Budget	0	76	0	356	188	62	0	0	0
Amortization of loans	405	406	321	343	338	329	590	359	400
Banks	-13	-45	81	66	-21	-12	92	77	102
Other sectors	-31	103	136	55	198	-3	122	55	77
D. Errors and omissions	144	-44	101	0	0	0	0	0	0
Overall balance (A+B-C+D)	658	730	568	275	-200	-64	26	80	114
Financing	-658	-730	-568	-275	200	64	-26	-80	-114
Change in net international reserves ("-"=increase)	-658	-730	-568	-275	200	64	-26	-80	-114
Memorandum items:									
Current account balance (in percent of GDP)	-4.8	-3.3	-3.1	-3.5	-4.9	-4.3	-4.0	-3.7	-3.6
Trade balance-Goods (in percent of GDP)	-23.7	-22.5	-22.6	-20.0	-21.5	-22.4	-22.8	-23.2	-23.5
Import of goods (change, percent)	13.6	6.6	1.3	-14.0	11.1	4.9	4.9	5.3	5.3
Export of goods (change, percent)	21.8	11.0	-2.2	-12.0	9.9	2.1	3.5	4.4	4.4
Transfers (in percent of GDP)	12.2	12.0	11.7	9.3	9.7	10.2	10.6	11.0	11.0
Net foreign direct investment (in percent of GDP)	-2.3	-3.0	-2.0	-1.4	-1.3	-1.5	-1.7	-1.8	-1.9
External debt/GDP (in percent)	72.0	64.4	64.3	76.0	69.5	67.2	62.7	59.9	57.3
Private sector	44.4	40.6	41.4	48.1	44.3	43.1	42.0	40.8	39.5
Public sector	27.6	23.8	22.9	27.9	25.2	24.1	20.7	19.1	17.8
External debt service/GNFS exports (percent)	19.3	17.7	17.1	19.5	18.1	17.5	21.6	19.2	18.1
Gross official reserves (in millions of Euro)	5,411	5,956	6,455	6,730	6,530	6,465	6,491	6,571	6,685
(In months of prospective imports of goods and services)	6.6	7.2	9.0	8.5	7.9	7.5	7.2	6.9	6.7
Reserves/IMF ARA metric (percent)	101.8	102.8	107.2	118.1	110.7	...	...	...	...

Sources: BiH authorities; and IMF staff estimates and projections.

1/ Based on BPM6.

Table 4a. Bosnia and Herzegovina: Government Statement of Operations, 2017–25

(Percent of GDP)

	2017	2018 GFSM 2001	2018 GFSM 2014	2019	2020 Est.	2021 Proj.	2022	2023	2024	2025
Revenue	**42.3**	**42.7**	**42.5**	**41.7**	**41.0**	**41.0**	**41.1**	**41.4**	**41.7**	**42.0**
Taxes	22.3	22.9	23.3	23.0	21.9	21.8	21.9	22.2	22.6	22.8
Direct taxes	4.0	4.2	4.0	3.8	3.7	3.7	3.7	3.8	3.9	3.9
Individual income tax	1.8	1.8	1.8	1.7	1.8	1.8	1.8	1.8	1.8	1.8
Corporate income tax	1.8	1.9	1.9	1.8	1.7	1.7	1.7	1.8	1.9	1.9
Indirect taxes	18.2	18.6	19.3	19.1	18.1	18.0	18.2	18.4	18.6	18.8
Other taxes	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social security contributions	14.9	15.1	15.1	15.1	15.9	15.7	15.7	15.7	15.7	15.7
Grants	0.4	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Other revenue	4.7	4.4	3.8	3.2	3.0	3.1	3.2	3.1	3.1	3.2
Expenditure	**40.5**	**41.0**	**41.0**	**40.4**	**46.6**	**45.4**	**43.8**	**43.5**	**43.1**	**42.7**
Expense	**37.0**	**37.4**	**37.4**	**36.9**	**41.8**	**40.8**	**39.4**	**39.1**	**38.7**	**38.3**
Compensation of employees	10.6	10.4	10.3	10.6	11.8	11.8	11.8	11.7	11.7	11.6
Use of goods and services	7.2	7.3	7.2	7.2	7.9	7.9	7.9	7.8	7.8	7.7
Social benefits	15.1	14.9	15.0	14.8	16.9	15.8	15.6	15.3	15.1	14.8
Interest	0.8	0.7	0.8	0.8	0.8	0.9	0.9	1.0	0.9	1.0
Subsidies	1.4	1.4	1.4	1.4	1.9	2.2	1.3	1.3	1.3	1.3
Other expense	1.9	2.7	2.8	2.1	2.2	2.1	2.0	2.0	2.0	2.0
Net acquisition of nonfinancial assets	**3.5**	**3.6**	**3.6**	**3.5**	**4.8**	**4.7**	**4.4**	**4.4**	**4.4**	**4.3**
Acquisition of nonfinancial assets	3.7	3.7	3.7	3.7	4.9	4.8	4.5	4.5	4.5	4.5
Foreign financed capital spending	1.8	1.3	1.3	1.5	2.1	2.1	2.1	2.1	2.0	2.0
Domestically financed capital spending	1.8	2.4	2.4	2.2	2.8	2.6	2.4	2.4	2.4	2.4
Disposal of nonfinancial assets	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Gross/net operating balance (revenue - expense)	**5.3**	**5.3**	**5.1**	**4.9**	**-0.8**	**0.2**	**1.7**	**2.3**	**3.0**	**3.6**
Net lending/borrowing (revenue - expenditure)	**1.8**	**1.7**	**1.5**	**1.4**	**-5.6**	**-4.5**	**-2.7**	**-2.1**	**-1.3**	**-0.7**
Net acquisition of financial assets	**-0.5**	**-0.2**	**-0.4**	**0.4**	**-1.9**	**-1.6**	**0.6**	**1.1**	**0.7**	**1.2**
Domestic assets	0.2	-0.2	-0.4	0.4	-1.9	-1.6	0.6	1.1	0.7	1.2
Currency and deposits	0.6	0.1	0.1	0.4	-2.1	-1.8	0.5	1.0	0.8	1.2
Loans	-0.1	0.3	0.1	-0.2	0.0	0.2	0.1	0.1	0.0	0.0
Equity and investment fund shares	0.0	-0.5	-0.5	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Foreign assets	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**-1.6**	**-0.4**	**-0.7**	**-0.1**	**3.7**	**2.9**	**3.3**	**3.1**	**2.1**	**1.9**
Domestic liabilities	-0.4	-1.1	-1.3	0.1	2.0	1.9	3.0	5.7	2.9	2.4
Debt securities	0.1	-0.9	-1.0	0.5	1.8	1.9	2.9	4.4	1.6	0.8
Other government obligations	-0.3	-0.4	-0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1
Loans	0.4	0.4	0.3	0.0	0.7	0.2	0.3	1.4	1.5	1.7
Other accounts payable	-0.5	-0.2	-0.2	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0
Foreign liabilities	-1.3	0.6	0.6	-0.2	1.7	0.9	0.3	-2.5	-0.8	-0.5
Debt securities	-0.1	0.9	0.9	0.0	0.0	0.0	0.0	-0.9	0.0	0.0
Loans	-1.2	-0.3	-0.3	-0.2	1.7	0.9	0.3	-1.7	-0.8	-0.5
Drawings	1.6	2.2	2.2	1.8	3.7	2.8	2.1	1.7	1.7	1.7
Amortization	2.8	2.6	2.6	2.0	2.0	1.9	1.7	3.4	2.5	2.2
Statistical discrepancy	**-0.6**	**-1.4**	**-1.2**	**-0.9**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items										
Net lending exc externally-financed operations	3.3	2.7	2.6	2.5	-3.7	-2.6	-0.8	-0.2	0.5	1.1
Structural balance (% of potential GDP)	1.8	1.4	1.2	1.2	-4.0	-3.0	-1.7	-1.4	-0.9	-0.7

Sources: BiH authorities; and IMF staff estimates and projections.

Table 4b. Bosnia and Herzegovina: Government Statement of Operations, 2017–25

(KM million)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.	Proj.				
Revenue	**13,284**	**14,276**	**14,735**	**13,628**	**14,239**	**14,914**	**15,687**	**16,546**	**17,497**
Taxes	6,987	7,653	8,127	7,263	7,569	7,959	8,427	8,951	9,502
Direct taxes	1,264	1,396	1,337	1,225	1,280	1,338	1,431	1,552	1,632
Indirect taxes	5,711	6,232	6,757	6,009	6,259	6,589	6,963	7,364	7,834
Other taxes	13	25	34	30	31	32	34	35	37
Social security contributions	4,680	5,047	5,345	5,272	5,471	5,712	5,966	6,245	6,565
Grants	129	108	146	109	111	99	101	103	106
For budget support	24	28	24	28	24	25	26	27	29
For investment projects	105	80	121	78	87	74	75	76	78
Other revenue	1,488	1,467	1,117	983	1,088	1,144	1,193	1,247	1,323
Expenditure	**12,715**	**13,722**	**14,246**	**15,491**	**15,790**	**15,896**	**16,471**	**17,081**	**17,799**
Expense	**11,612**	**12,515**	**13,010**	**13,894**	**14,174**	**14,300**	**14,811**	**15,350**	**15,988**
Compensation of employees	3,341	3,486	3,741	3,935	4,118	4,279	4,435	4,626	4,839
Use of goods and services	2,255	2,426	2,543	2,620	2,751	2,849	2,958	3,078	3,214
Social benefits	4,728	4,994	5,224	5,614	5,496	5,643	5,808	5,981	6,159
Interest	260	250	269	266	298	330	368	363	421
Interest payments to nonresidents	128	140	171	175	194	205	208	190	240
Interest payments to residents	131	110	98	90	104	126	159	173	181
Subsidies	429	464	502	620	772	464	484	507	533
Grants	16	16	1	0	0	0	0	0	0
Other expense	600	895	730	740	740	735	758	794	821
Net acquisition of nonfinancial assets	**1,104**	**1,208**	**1,236**	**1,597**	**1,616**	**1,597**	**1,661**	**1,732**	**1,811**
Acquisition of nonfinancial assets	1,148	1,248	1,293	1,634	1,655	1,637	1,702	1,775	1,856
Foreign financed capital spending	574	445	521	707	743	761	783	809	852
Domestically financed capital spending	575	803	772	927	912	875	919	965	1,004
Disposal of nonfinancial assets	45	41	57	37	39	40	41	43	45
Gross/net operating balance (revenue - expense)	**1,673**	**1,761**	**1,725**	**-266**	**65**	**614**	**876**	**1,196**	**1,509**
Net lending/borrowing (revenue - expenditure)	**569**	**554**	**489**	**-1,864**	**-1,551**	**-983**	**-785**	**-535**	**-303**
Net acquisition of financial assets	**-142**	**-51**	**130**	**-643**	**-557**	**231**	**398**	**295**	**485**
Domestic assets	63	-51	130	-643	-557	231	398	295	485
Currency and deposits	180	20	153	-686	-631	198	362	309	489
Loans	-42	106	-65	15	74	33	36	-14	-4
Equity and investment fund shares	1	-164	-5	35	0	0	0	0	0
Foreign assets	-204	0	0	0	0	0	0	0	0
Net incurrence of liabilities	**-511**	**-150**	**-29**	**1,219**	**995**	**1,214**	**1,183**	**831**	**788**
Domestic liabilities	-118	-358	50	662	676	1,095	2,147	1,158	1,000
Debt securities	31	-300	172	586	673	1,038	1,661	635	348
Issuance	627	220	522	1,009	1,242	2,137	3,433	2,965	3,433
Short-term T-Bills	352	40	20	379	432	607	709	715	882
Long-term government bonds	257	137	502	630	810	1,530	2,724	2,250	2,551
Amortization	596	519	348	423	570	1,099	1,772	2,330	3,085
Short-term T-Bills	368	182	40	260	140	294	709	715	882
Long-term government bonds	228	338	309	163	430	805	1,063	1,615	2,203
Other government obligations	-105	-132	-59	-60	-60	-61	-61	-61	-61
Loans	111	144	-16	221	64	118	547	584	713
Other accounts payable	-155	-70	-47	-85	0	0	0	0	0
Foreign liabilities	-393	207	-79	557	318	119	-964	-327	-212
Debt securities	-25	316	-13	0	0	0	-329	0	0
Loans	-368	-108	-66	557	318	119	-635	-327	-212
Drawings	515	751	629	1,217	968	753	649	672	710
Amortization	883	859	696	660	650	634	1,284	1,000	922
Statistical discrepancy	**-200**	**-454**	**-330**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items									
Indirect revenues	5,711	6,232	6,757	6,009	6,259	6,589	6,963	7,364	7,834
Net lending exc externally-financed operations	1,037	919	889	-1,234	-896	-295	-77	198	472

Sources: BiH authorities; and IMF staff estimates and projections.

Table 4c. Bosnia and Herzegovina: Entity Governments Statement of Operations, 2019–21

(Percent of respective GDP)

	Federation			Republika Srpska			Federation			Republika Srpska		
	Central Government			Central Government			General Government			General Government		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Revenue	**8.1**	**17.0**	**16.9**	**26.3**	**25.7**	**25.5**	**38.5**	**37.5**	**38.0**	**40.9**	**40.3**	**40.3**
Taxes	7.3	7.0	6.9	16.2	15.2	15.5	19.9	18.5	18.6	22.5	20.9	21.2
Direct taxes	0.4	0.3	0.3	3.4	3.3	3.3	3.7	3.6	3.6	4.1	4.0	4.0
Indirect taxes	6.8	6.6	6.6	12.6	11.8	12.0	16.2	14.9	15.0	18.1	16.7	16.9
Social security contributions	0.0	9.0	9.0	7.9	8.6	8.5	15.9	16.6	16.6	14.3	15.4	15.3
Grants	0.2	0.2	0.2	0.7	0.4	0.4	0.2	0.2	0.3	0.7	0.4	0.4
Other revenue	0.7	0.8	0.8	1.5	1.4	1.2	2.4	2.1	2.5	3.4	3.6	3.4
Expenditure	**7.1**	**20.0**	**19.7**	**26.7**	**31.5**	**31.3**	**37.3**	**42.3**	**41.6**	**40.2**	**47.7**	**46.4**
Expense	**6.5**	**18.9**	**18.7**	**24.9**	**29.7**	**29.3**	**34.3**	**38.6**	**37.9**	**35.6**	**41.2**	**40.2**
Compensation of employees	1.0	1.2	1.2	6.7	7.7	7.7	8.6	9.5	9.6	8.9	10.3	10.3
Use of goods and services	0.3	0.4	0.5	1.4	1.4	1.4	8.4	9.2	9.2	3.3	3.7	3.7
Social benefits	2.0	13.3	12.5	12.1	13.1	13.0	13.2	15.6	14.3	18.9	20.4	20.2
Interest	0.5	0.6	0.6	1.0	0.9	1.1	0.6	0.6	0.7	1.2	1.2	1.4
Subsidies	0.5	0.7	0.9	1.0	2.0	2.2	1.4	1.6	2.1	1.4	2.4	2.6
Other expense	0.4	0.8	0.9	1.1	1.5	1.3	2.1	2.1	2.1	1.9	2.3	2.1
Net acquisition of nonfinancial assets	**0.6**	**1.1**	**1.0**	**1.8**	**1.8**	**1.9**	**2.9**	**3.7**	**3.7**	**4.7**	**6.5**	**6.2**
Acquisition of nonfinancial assets	0.6	1.1	1.0	1.8	1.8	2.0	3.0	3.8	3.8	4.8	6.7	6.4
Foreign financed capital spending	0.4	0.8	0.8	0.4	0.7	0.8	1.5	1.8	1.7	1.5	3.0	3.2
Domestically financed capital spending	0.2	0.2	0.2	1.5	1.2	1.2	1.5	2.1	2.1	3.3	3.7	3.2
Disposal of nonfinancial assets	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Gross/net operating balance (revenue - expense)	**1.6**	**-2.0**	**-1.7**	**1.4**	**-4.1**	**-3.8**	**4.1**	**-1.1**	**0.1**	**5.4**	**-0.8**	**0.1**
Net lending/borrowing (revenue - expenditure)	**1.1**	**-3.0**	**-2.8**	**-0.3**	**-5.8**	**-5.8**	**1.2**	**-4.8**	**-3.6**	**0.7**	**-7.4**	**-6.2**
Net acquisition of financial assets	**-0.7**	**-1.3**	**-2.6**	**1.0**	**-0.8**	**-0.7**	**-0.3**	**-2.1**	**-2.0**	**1.7**	**-1.6**	**-0.5**
Domestic assets	-0.7	-1.3	-2.6	1.0	-0.8	-0.7	-0.3	-2.1	-2.0	1.7	-1.6	-0.5
Currency and deposits	0.0	-0.2	-2.3	0.2	-1.3	-2.0	0.0	-2.2	-2.0	1.2	-1.8	-1.2
Loans	-0.7	-1.2	-0.2	0.8	0.4	1.3	-0.3	0.1	0.0	0.2	0.0	0.7
Net incurrence of liabilities	**-1.5**	**1.7**	**0.2**	**1.4**	**5.0**	**5.0**	**-0.5**	**2.7**	**1.6**	**0.9**	**5.8**	**5.6**
Domestic liabilities	0.0	1.1	0.9	1.1	3.0	3.8	-0.1	1.3	1.1	0.6	3.6	3.8
Debt securities	0.0	1.1	0.8	1.3	3.1	4.3	0.1	1.1	0.8	1.4	3.1	4.3
Other government obligations	0.0	0.0	0.0	-0.5	-0.5	-0.5	0.0	0.0	0.0	-0.5	-0.6	-0.5
Loans	0.0	0.0	0.1	0.3	0.4	0.0	-0.1	0.1	0.3	0.1	1.8	0.0
Foreign liabilities	-1.5	0.5	-0.7	0.2	2.0	1.2	-0.4	1.5	0.5	0.3	2.2	1.8
Loans	-1.5	0.5	-0.7	0.4	2.0	1.2	-0.4	1.5	0.5	0.4	2.2	1.8
Drawings	0.3	2.6	1.3	2.3	3.9	3.1	1.4	3.6	2.5	2.6	4.1	3.7
Amortization	1.8	2.1	2.0	1.9	1.9	1.8	1.9	2.1	2.0	2.2	1.9	1.8
Statistical discrepancy	**-0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-1.1**	**0.0**	**0.0**	**0.1**	**0.0**	**0.0**
Memorandum items												
Net lending exc externally-financed operations	1.3	-2.4	-2.2	-0.7	-5.5	-5.3	2.6	-3.2	-2.1	2.2	-4.4	-3.0
Primary balance (% of GDP)	1.5	-2.5	-2.2	0.6	-4.9	-4.7	1.8	-4.2	-3.0	1.9	-6.2	-4.8

Sources: BiH authorities; and IMF staff estimates and projections.

Note: Federation central government included pension fund in 2020.

Table 5a. Institutions of BiH: Statement of Government Operations, 2017–25

(KM million)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.	Proj.				
Revenue	**926**	**924**	**926**	**937**	**942**	**949**	**956**	**964**	**973**
Taxes	750	750	750	780	780	780	780	780	780
Direct taxes	0	0	0	0	0	0	0	0	0
Indirect taxes	750	750	750	780	780	780	780	780	780
Other taxes	0	0	0	0	0	0	0	0	0
Social security contributions	0	0	0	0	0	0	0	0	0
Grants	14	18	14	14	12	13	13	14	15
Other revenue	162	156	162	143	150	156	163	170	178
Expenditure	**946**	**957**	**876**	**1,003**	**1,046**	**1,050**	**1,048**	**1,056**	**1,064**
Expense	**848**	**872**	**855**	**941**	**982**	**987**	**983**	**987**	**992**
Compensation of employees	641	653	667	696	741	754	756	758	759
Use of goods and services	161	173	159	173	187	190	192	193	194
Social benefits	1	3	4	8	6	6	6	6	6
Interest	1	1	1	1	1	1	1	1	1
Transfers to other general government units	8	10	6	26	17	8	8	8	9
Other expense	34	32	19	39	30	29	21	22	23
Net acquisition of nonfinancial assets	**97**	**85**	**20**	**62**	**65**	**63**	**65**	**68**	**72**
Acquisition of nonfinancial assets	100	89	26	62	65	63	65	68	72
Foreign financed capital spending	6	3	3	3	3	3	3	4	4
Domestically financed capital spending	94	85	23	59	62	59	62	65	68
Disposal of nonfinancial assets	3	3	6	0	0	0	0	0	0
Gross/net operating balance (revenue - expense)	**77**	**52**	**71**	**-4**	**-40**	**-38**	**-27**	**-23**	**-19**
Net lending/borrowing (revenue - expenditure)	**-20**	**-33**	**50**	**-66**	**-104**	**-101**	**-92**	**-92**	**-91**
Net acquisition of financial assets	**-1**	**-32**	**25**	**-66**	**-104**	**-101**	**-92**	**-92**	**-91**
Domestic assets	20	-32	25	-66	-104	-101	-92	-92	-91
Foreign assets	-21	0	0	0	0	0	0	0	0
Net incurrence of liabilities	**21**	**2**	**-25**	**0**	**0**	**0**	**0**	**0**	**0**
Domestic liabilities	0	3	-22	0	0	0	0	0	0
Foreign liabilities	21	-1	-3	0	0	0	0	0	0
Debt securities	0	0	0	0	0	0	0	0	0
Loans	21	-1	-3	0	0	0	0	0	0
Drawings	21	0	0	0	0	0	0	0	0
Amortization	0	1	3	0	0	0	0	0	0
Other accounts payable	0	0	0	0	0	0	0	0	0
Statistical discrepancy	**-1**	**-1**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items									
Net lending exc externally-financed operations	-14	-30	54	-63	-101	-98	-89	-88	-87

Sources: BiH authorities; and IMF staff estimates and projections.

Table 5b. Federation of BiH: Statement of General Government Operations, 2017–25

(KM million)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Proj.		
Revenue	**8,017**	**8,609**	**8,898**	**8,079**	**8,526**	**8,958**	**9,447**	**9,990**	**10,597**
Taxes	3,928	4,374	4,597	3,987	4,171	4,414	4,705	5,029	5,370
Direct taxes	772	813	849	772	803	842	902	978	1,028
Indirect taxes	3,153	3,560	3,746	3,213	3,368	3,571	3,802	4,050	4,340
Other taxes	2	1	1	1	1	1	1	1	1
Social security contributions	3,204	3,457	3,689	3,579	3,728	3,893	4,065	4,256	4,474
Grants	74	57	50	53	58	60	61	62	64
Other revenue	811	722	562	460	568	592	616	643	690
Expenditure	**7,528**	**8,085**	**8,617**	**9,122**	**9,345**	**9,448**	**9,806**	**10,187**	**10,636**
Expense	**6,932**	**7,520**	**7,945**	**8,315**	**8,515**	**8,625**	**8,958**	**9,309**	**9,715**
Compensation of employees	1,667	1,760	1,996	2,043	2,152	2,257	2,352	2,472	2,599
Use of goods and services	1,681	1,785	1,943	1,976	2,075	2,165	2,259	2,363	2,482
Social benefits	2,748	2,895	3,063	3,371	3,211	3,296	3,394	3,495	3,593
Interest	127	125	131	139	146	161	174	164	196
Subsidies	268	287	329	340	465	286	299	313	329
Other expense	442	666	483	444	465	460	481	503	516
Net acquisition of nonfinancial assets	**596**	**566**	**671**	**807**	**830**	**823**	**848**	**878**	**921**
Acquisition of nonfinancial assets	617	579	703	826	850	844	869	901	945
Foreign financed capital spending	344	262	349	384	387	406	413	423	446
Domestically financed capital spending	273	316	354	443	463	437	457	478	499
Disposal of nonfinancial assets	21	13	32	19	20	21	22	23	24
Gross/net operating balance (revenue - expense)	**1,084**	**1,090**	**952**	**-235**	**11**	**333**	**489**	**681**	**882**
Net lending/borrowing (revenue - expenditure)	**488**	**524**	**281**	**-1,042**	**-819**	**-490**	**-358**	**-197**	**-39**
Net acquisition of financial assets	**-22**	**-153**	**-78**	**-455**	**-455**	**47**	**116**	**123**	**243**
Domestic assets	98	-153	-78	-455	-455	47	116	123	243
Of which , Currency and deposits	104	-12	0	-471	-451	50	119	126	246
Net incurrence of liabilities	**-361**	**-344**	**-116**	**588**	**364**	**537**	**474**	**320**	**282**
Domestic liabilities	-73	-211	-13	274	253	538	759	618	471
Of which , Debt securities	-92	-161	19	248	190	425	304	244	44
Foreign liabilities	-287	-133	-103	314	111	-1	-285	-298	-189
Loans	-287	-133	-103	314	111	-1	-285	-298	-189
Drawings	281	409	331	772	557	424	357	366	389
Amortization	568	542	434	458	446	425	642	664	578
Other accounts payable	0	0	0	0	0	0	0	0	0
Statistical discrepancy / financing gap	**-149**	**-332**	**-243**	**0**	**0**	**0**	**0**	**0**	**0**

Sources: BiH authorities; and IMF staff estimates and projections.

Table 5c. Federation of BiH: Statement of Central Government Operations, 2017–25

(KM million)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Proj.		
Revenue	**1,908**	**1,871**	**1,879**	**3,658**	**3,803**	**3,968**	**4,299**	**4,512**	**4,726**
Taxes	1,600	1,669	1,681	1,503	1,555	1,623	1,853	1,956	2,027
Direct taxes	76	85	99	72	73	80	88	99	104
Indirect taxes	1,524	1,584	1,582	1,431	1,482	1,543	1,766	1,856	1,922
Other taxes	0	0	0	0	0	0	0	0	0
Social security contributions	0	0	0	1,948	2,029	2,118	2,212	2,316	2,434
Grants	65	51	39	42	47	48	48	49	50
For budget support	0	0	0	3	0	0	0	0	0
For investment projects	65	51	39	39	47	48	48	49	50
Other revenue	242	151	159	165	173	179	185	192	215
Expenditure	**1,658**	**1,718**	**1,631**	**4,307**	**4,423**	**4,341**	**4,484**	**4,611**	**4,777**
Expense	**1,372**	**1,558**	**1,498**	**4,080**	**4,190**	**4,097**	**4,235**	**4,355**	**4,508**
Compensation of employees	219	218	234	259	270	282	294	308	324
Use of goods and services	70	62	63	94	117	120	124	128	133
Social benefits	458	471	465	2,868	2,815	2,884	2,966	3,048	3,127
Interest	104	104	110	120	126	140	152	141	172
Subsidies	132	121	121	145	211	70	73	77	81
Transfers to other general government units	326	377	412	423	448	414	431	449	471
Other expense	63	205	92	171	203	187	195	204	202
Net acquisition of nonfinancial assets	**286**	**160**	**134**	**227**	**233**	**244**	**249**	**256**	**269**
Acquisition of nonfinancial assets	286	160	134	227	233	244	249	256	269
Foreign financed capital spending	271	127	96	177	181	189	192	196	206
Domestically financed capital spending	15	33	37	50	52	55	57	60	63
Disposal of nonfinancial assets	0	0	0	0	0	0	0	0	0
Gross/net operating balance (revenue - expense)	**535**	**313**	**381**	**-421**	**-387**	**-130**	**64**	**157**	**218**
Net lending/borrowing (revenue - expenditure)	**249**	**153**	**247**	**-649**	**-620**	**-373**	**-185**	**-99**	**-51**
Net acquisition of financial assets	**-291**	**-322**	**-168**	**-288**	**-576**	**-221**	**-32**	**-119**	**-130**
Domestic assets	-171	-322	-168	-288	-576	-221	-32	-119	-130
Of which: Currency and deposits	104	0	0	-34	-521	-123	33	15	7
Foreign assets	-120	0	0	0	0	0	0	0	0
Net incurrence of liabilities	**-525**	**-484**	**-345**	**361**	**44**	**152**	**153**	**-20**	**-79**
Domestic liabilities	-170	-217	10	247	205	436	651	497	342
Of which: Debt securities	-111	-217	10	248	190	425	304	244	44
Foreign liabilities	-355	-267	-355	114	-161	-284	-498	-517	-421
Loans	-355	-267	-355	114	-161	-284	-498	-517	-421
Drawings	206	271	73	566	284	141	144	147	156
For budget support	0	195	15	427	150	0	0	0	0
For investment projects	206	76	58	139	134	141	144	147	156
Amortization	561	537	428	452	446	425	642	664	578
Other accounts payable	0	0	0	0	0	0	0	0	0
Statistical discrepancy	**-15**	**8**	**-70**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items									
Net lending exc externally-financed operations	455	229	305	-510	-486	-232	-42	48	105

Sources: BiH authorities; and IMF staff estimates and projections.

Note: Central government includes pension fund since 2020.

Table 5d. Republika Srpska: Statement of General Government Operations, 2017–25

(KM million)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Proj.		
Revenue	**4,080**	**4,378**	**4,606**	**4,354**	**4,480**	**4,690**	**4,949**	**5,239**	**5,551**
Taxes	2,094	2,435	2,526	2,257	2,363	2,496	2,658	2,841	3,033
Direct taxes	467	482	460	431	450	467	500	544	571
Indirect taxes	1,619	1,927	2,035	1,799	1,885	1,999	2,127	2,265	2,427
Other taxes	9	26	31	27	28	29	31	32	34
Social security contributions	1,436	1,543	1,612	1,661	1,701	1,776	1,855	1,942	2,041
Grants	40	27	83	44	40	26	26	27	27
Other revenue	511	373	385	392	376	392	410	429	450
Expenditure	**4,030**	**4,434**	**4,526**	**5,152**	**5,167**	**5,143**	**5,351**	**5,559**	**5,804**
Expense	**3,631**	**3,897**	**4,001**	**4,446**	**4,474**	**4,464**	**4,637**	**4,809**	**5,022**
Compensation of employees	966	948	1,000	1,117	1,143	1,181	1,237	1,302	1,378
Use of goods and services	348	368	369	398	412	415	425	436	446
Social benefits	1,944	2,076	2,128	2,206	2,249	2,311	2,376	2,447	2,525
Interest	132	136	137	126	151	168	193	199	225
Subsidies	133	149	155	257	288	159	166	174	182
Other expense	107	219	212	243	230	231	241	252	265
Net acquisition of nonfinancial assets	**399**	**538**	**524**	**706**	**694**	**679**	**714**	**750**	**782**
Acquisition of nonfinancial assets	420	559	544	724	712	698	734	770	802
Foreign financed capital spending	224	178	169	321	352	352	367	383	402
Domestically financed capital spending	196	381	375	403	360	346	367	387	400
Disposal of nonfinancial assets	22	21	19	18	19	19	20	20	21
Gross/net operating balance (revenue - expense)	**450**	**482**	**605**	**-92**	**7**	**226**	**312**	**430**	**529**
Net lending/borrowing (revenue - expenditure)	**51**	**-56**	**80**	**-798**	**-687**	**-453**	**-401**	**-320**	**-252**
Net acquisition of financial assets	**-118**	**61**	**189**	**-171**	**-59**	**224**	**308**	**190**	**254**
Domestic assets	-54	61	189	-171	-59	224	308	190	254
Of which: Currency and deposits	54	65	137	-198	-137	188	268	201	254
Net incurrence of liabilities	**-167**	**120**	**99**	**626**	**628**	**677**	**709**	**511**	**506**
Domestic liabilities, *of which:*	-44	-226	64	389	424	557	1,388	540	529
Debt securities	123	-182	153	339	483	613	1,357	391	304
Loans	33	73	17	196	2	5	92	210	286
Foreign liabilities	-123	346	35	237	204	120	-679	-29	-23
Loans	-97	30	48	237	204	120	-351	-29	-23
Drawings	213	339	297	439	409	329	292	306	322
Amortization	310	309	250	202	204	209	643	335	345
Other accounts payable	0	0	0	0	0	0	0	0	0
Statistical discrepancy / financing gap	**-2**	**-3**	**10**	**0**	**0**	**0**	**0**	**0**	**0**

Sources: BiH authorities; and IMF staff estimates and projections.

Table 5e. Republika Srpska: Statement of Central Government Operations, 2017–25

(KM million)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Proj.		
Revenue	**2,705**	**2,849**	**2,962**	**2,772**	**2,837**	**2,968**	**3,258**	**3,363**	**3,573**
Taxes	1,607	1,775	1,820	1,647	1,722	1,820	2,060	2,110	2,255
Direct taxes	383	394	384	355	366	382	410	450	473
Indirect taxes	1,216	1,361	1,414	1,273	1,336	1,418	1,628	1,637	1,759
Other taxes	8	21	22	19	20	20	21	22	23
Social security contributions	804	861	892	925	943	985	1,028	1,076	1,132
Grants	34	24	81	41	40	26	26	27	27
For budget support	0	0	0	2	0	0	0	0	0
For investment projects	34	24	81	41	40	26	26	27	27
Other revenue	256	186	166	156	128	134	140	147	154
Expenditure	**2,638**	**2,934**	**3,001**	**3,401**	**3,479**	**3,438**	**3,586**	**3,722**	**3,899**
Expense	**2,497**	**2,726**	**2,804**	**3,210**	**3,265**	**3,235**	**3,370**	**3,498**	**3,664**
Compensation of employees	736	716	755	835	852	877	908	944	987
Use of goods and services	149	156	160	157	161	168	176	184	194
Social benefits	1,236	1,326	1,363	1,415	1,450	1,493	1,542	1,594	1,651
Interest	97	108	107	100	124	140	163	168	193
Subsidies	108	121	115	219	249	118	123	129	135
Transfers to other general government units	123	161	181	327	289	302	315	330	347
Other expense	47	138	122	157	140	136	142	149	157
Net acquisition of nonfinancial assets	**141**	**208**	**197**	**191**	**214**	**203**	**216**	**224**	**235**
Acquisition of nonfinancial assets	146	214	204	198	220	209	223	230	241
Foreign financed capital spending	88	84	40	72	92	80	83	86	89
Domestically financed capital spending	58	130	163	126	129	129	140	145	152
Disposal of nonfinancial assets	6	6	7	6	6	6	6	6	6
Gross/net operating balance (revenue - expense)	**208**	**122**	**159**	**-438**	**-428**	**-267**	**-111**	**-134**	**-91**
Net lending/borrowing (revenue - expenditure)	**67**	**-86**	**-38**	**-629**	**-642**	**-470**	**-328**	**-358**	**-327**
Net acquisition of financial assets	**-22**	**-73**	**113**	**-86**	**-81**	**140**	**270**	**103**	**150**
Domestic assets, *of which* :	42	-73	113	-86	-81	140	270	103	150
Currency and deposits	73	31	22	-144	-224	-11	110	-15	15
Loans	8	-63	86	48	143	152	161	118	135
Equity and investment fund shares	0	-11	-8	31	0	0	0	0	0
Net incurrence of liabilities	**-89**	**10**	**152**	**543**	**561**	**610**	**598**	**461**	**477**
Domestic liabilities, *of which* :	19	-347	126	326	426	560	1,300	513	524
Debt securities	129	-193	150	339	483	613	1,357	391	304
Loans	23	-88	38	45	2	5	1	180	278
Foreign liabilities	-109	357	27	217	135	50	-701	-52	-47
Loans	-83	41	39	217	135	50	-373	-52	-47
Drawings	196	319	257	419	339	259	270	283	297
For budget support	0	107	35	263	92	0	0	0	0
For investment projects	196	213	222	157	248	259	270	283	297
Amortization	280	278	217	202	204	209	643	335	345
Other accounts payable	0	0	0	0	0	0	0	0	0
Statistical discrepancy	**0**	**3**	**-1**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items									
Net lending exc externally-financed operations	121	-26	-79	-598	-591	-416	-272	-300	-265

Sources: BiH authorities; and IMF staff estimates and projections.

Table 6. Bosnia and Herzegovina: Monetary Survey, 2017–21

	2017 Dec	2018 Dec	2019 Dec	2020 Est.	2021 Proj.
	(Million KM, end of period)				
Net foreign assets	10,782	12,464	13,951	14,400	13,844
Foreign assets	13,371	15,504	17,070	17,675	17,283
Foreign liabilities	2,589	3,040	3,119	3,275	3,439
Net domestic assets	11,471	11,626	11,052	12,192	15,553
Domestic credit	17,909	18,570	19,585	20,837	23,334
Claims on general government (net)	363	35	-172	1,264	2,512
Claims on public nonfinancial corporations	406	428	509	550	576
Claims on private sector	17,140	18,107	19,248	19,022	20,246
Other items (net)	-6,438	-6,944	-8,532	-8,646	-7,782
Broad money (M2)	22,116	24,064	26,156	26,437	28,099
Narrow money (M1)	10,572	12,018	13,075	13,488	12,998
Currency	3,648	3,977	4,330	5,410	5,732
Demand deposits	6,924	8,041	8,744	8,078	7,266
Quasi-money	11,544	12,046	13,081	12,950	15,101
Time and savings deposits	4,092	4,302	2,998	3,271	4,582
Foreign currency deposits	7,452	7,744	10,083	9,679	10,519
	(Annual percent change in terms of broad money)				
Net foreign assets	5.2	7.6	6.2	1.7	-2.1
Net domestic assets	4.9	0.7	-2.4	4.4	12.7
Domestic credit	4.7	3.0	4.2	4.8	9.4
Claims on general government (net)	-1.3	-1.5	-0.9	5.5	4.7
Claims on public nonfinancial corporations	0.2	0.1	0.3	0.2	0.1
Claims on private sector	5.8	4.4	4.7	-0.9	4.6
Other items (net)	0.2	-2.3	-6.6	-0.4	3.3
Memorandum items:					
	(Annual percent change)				
Broad money (M2)	9.5	8.8	8.7	1.1	6.3
Reserve money (RM)	12.4	10.3	6.9	0.3	6.2
Credit to the private sector	7.3	5.6	6.3	-1.2	6.4
	(Percent)				
Credit to the private sector (in percent of GDP)	54.6	54.1	54.5	57.3	58.3
Broad money (in percent of GDP)	70.5	72.0	74.1	79.6	80.9
Central bank net foreign assets (in percent of reserve	112.2	112.0	113.5	118.0	107.9
	(Ratio)				
Velocity (GDP/end-of-period M2)	1.4	1.4	1.3	1.3	1.2
Reserve money multiplier (M2/RM)	2.3	2.3	2.4	2.4	2.4

Source: CBBH; and IMF staff estimates and projections.

Table 7. Bosnia and Herzegovina: Financial Soundness Indicators, 2015–20
(In percent)

	2015	2016	2017	2018	2019	2020 Q3
Capital						
Tier 1 capital to risk-weighted assets (RWA)	13.8	15.0	14.8	16.5	17.5	17.3
Net capital to RWA	14.9	15.8	15.7	17.5	18.0	18.3
Quality of assets [1]						
Nonperforming loans to total loans	13.7	11.8	10.0	8.8	7.4	6.6
Nonperforming assets (NPAs) to total assets	10.1	8.4	7.2	12.1	9.9	4.4
NPAs net of provisions to tier 1 capital	27.1	18.6	14.7	12.4	10.3	7.9
Provision to NPAs	72.8	75.8	77.9	79.1	78.5	80.5
Profitability						
Return on assets [2]	0.1	0.9	1.3	13.0	1.4	0.9
Return on equity [2]	1.1	6.2	9.3	9.6	10.4	7.0
Net interest income to gross income	62.0	60.4	58.3	60.1	56.8	56.4
Noninterest expenses to gross income	94.5	80.7	72.9	74.8	71.0	80.1
Liquidity						
Liquid assets to total assets	26.5	27.2	28.4	29.7	29.6	28.0
Liquid assets to short- term financial liabilities	44.0	44.1	44.3	44.7	45.5	41.3
Short- term financial liabilities to total financial liabilities	70.7	72.8	75.2	77.3	75.3	78.4
Foreign exchange risk						
Foreign currency and indexed loans to total loans	60.8	62.6	60.1	56.7	53.9	51.6
Foreign currency liabilities to total financial liabilities	60.3	57.4	55.2	53.3	50.7	48.9
Net open position	9.0	1.7	-0.2	22.4	3.5	2.3

Source: CBBH.

[1] Prior to 2010, assets classified as loss, alongside the provisions made against them, were held off-balance sheet by banks in BiH. This lowered the reported NPL ratios and coverage of nonperforming loans by provisions. Starting with the December 2010 data in the RS, and the December 2011 data in the Federation, banks record on-balance sheet the "loss" loans and related accrued interest and provisions, resulting in a structural break in the series.

[2] Interyear values obtained by summing up the quarterly net income in the current and the preceding three quarters.

Annex I. Risk Assessment Matrix[1]

	Source of Risks	Relative Likelihood	Expected Impact	Recommended Policy Response
	External Risks			
Downside Risks	**Unexpected shift in the Covid-19 pandemic.** **Downside.** The disease proves harder to eradicate (e.g., due to difficulties in finding/distributing a vaccine), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources). Monetary and fiscal policy response is insufficient amid dwindling policy space and concerns about debt sustainability. Financial markets reassess real economy risks leading to a repricing of risk assets, unmasking of debt-related vulnerabilities, and weakening banks and nonbank financial intermediaries–forcing them to reduce credit (further weighing on growth). Financing difficulties extend to vulnerable sovereigns, leading to cascading debt defaults, capital outflows, depreciation pressures, and in some cases inflation. Pandemic-prompted protectionist actions (e.g., export controls) reemerge, disrupting trade and global value chains.	High	High	The authorities should be prepared to prioritize the response to the unexpected shift in the Covid-19 pandemic and allocate more resources to higher health expenditures. Automatic stabilizers should be allowed to fully operate. In case of prolonged disruption of economic activity, consider targeted measures to support vulnerable households and the most affected companies. Risks to the financial sector should be monitored closely.
	Intensified geopolitical tensions and security risks (e.g., in response to pandemic) cause socio-economic and political disruption, disorderly migration, higher commodity prices (if supply is disrupted), and lower confidence.	High	**Low** .	The authorities should remain vigilant to closely monitor the situation and be ready to collaborate with the EU and neighbor countries to better design/implement any response. Additional fiscal spending would likely be warranted to address the challenges.
	Weaker-than-expected growth in Europe. Protracted impact of the pandemic results in delayed investments, reduces private consumption, and strains banks. With limited policy space, the region enters a prolonged period of anemic growth and low inflation.	High	**Medium**	A permanently weaker than projected growth in the EU, in particular Germany and Austria, where the largest share of the diaspora community resides could reduce growth in BiH. Lower remittances would lower domestic demand given the large amounts of remittance inflows. Lower exports would slow activity. Temporarily softer activity could be buffered by letting automatic stabilizers play and boosting public investment and improving its efficiency. Sustained lower growth warrants adoption of structural reforms.
	Continued domestic political stalemate. The inability to implement meaningful structural reforms at all levels, but especially with respect to the single economic space could reduce investment confidence and lead to further outmigration. International financial support could decline significantly in such a scenario.	High	**High**	Maintain macroeconomic stability and work towards finding consensus on critical reforms. Continue implementing the domestically-financed capital projects. Improve debt management to minimize interest rate increases on domestic financing.

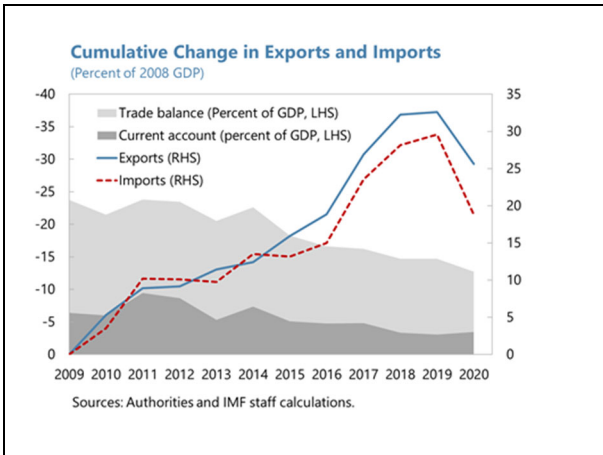
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

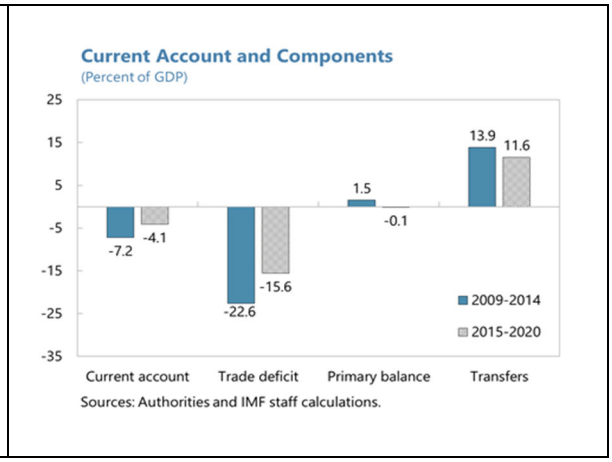
Annex II. External Sector Assessment

The external position of BiH in 2020 was broadly in line with fundamentals and desirable policy settings based on estimated data. The two EBA-lite methodologies, as well as broader competitiveness indicators suggest that the real exchange rate is fairly valued. International reserve coverage is broadly adequate, buttressed by the RFI provided in Q2 2020. That said, metrics tailored to BiH's Currency Board Arrangement (CBA) suggest that increasing reserves over time could help in responding to more severe shocks, reduce external vulnerabilities, and strengthen the stability of CBA (Section E). Investing in transport infrastructure and connectivity would lift supply-side constraints and would enhance competitiveness. Similarly, structural reforms and improved governance would improve the business and investment climate, particularly for export-oriented activities that require stability and the rule of law.

A. Current Account Assessment

1. The current account deficit is estimated to have widened moderately in 2020, reflecting countervailing effects of the COVID-19 pandemic. Despite a narrower goods trade deficit,[1] caused by the contracting domestic demand and compressed imports, staff estimates that the current account deficit increased to 3½ percent of GDP compared to 3 percent of GDP in 2019, reflecting a partial recovery in the second half of 2020 and declines in net remittances by 0.7 percent of GDP and net services exports by 0.6 percent of GDP.



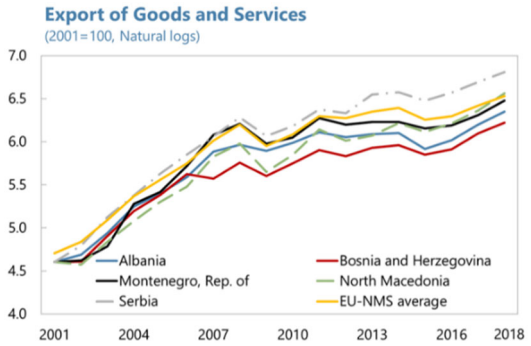


2. However, the current account and trade deficits in 2020 are estimated to be well below recent historical averages. Post GFC, the improvement in the external position came both as a result of higher exports growth and initially import contraction, reflecting better external demand, tighter fiscal policy, restrained private consumption, and increasing trade integration with the EU and the neighboring countries. For the period 2009-14, the current account and trade deficits averaged around 7 and 23 percent of GDP, respectively. These deficits improved on average by

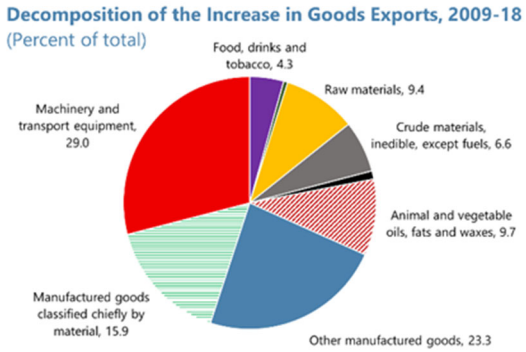
[1] Goods trade deficit declined by around 3 percent of GDP over the first 8 months of 2020.

more than 3 and 7 percent of GDP, respectively, during the 2015-20 period. Staff expects the increased participation in the EU supply chains to continue over the projection period, albeit at a slower pace slowed by the pandemic disruptions.

3. Starting in 2015, the growth of goods exports outpaced the increase in imports and more than compensated the reduction in transfers. The improvement in exports of goods over the last decade was primarily driven by exports of manufacturing goods, machinery and transport equipment, which account for more than 68 percent of the cumulative €3.2 billion increase since 2009. That said, Bosnia is still lagging most peer countries and the new EU member states in trade and supply chain integration owing to the weaknesses in investor protection, contract enforcement, and property rights. Transfers were stable as a share of GDP—except for 2020 when they declined by 2½ percent of GDP). The stability of transfers is largely explained by the relative stabilization in emigration trends and the steady growth of donor economies. Transfers are projected to return close to their pre-pandemic level over the medium term.



Sources: IMF, World Economic Outlook; and IMF staff calcualtions.



Sources: Eurostat and IMF staff calculations.

B. Capital and Financial Accounts

4. Net private capital inflows continued in 2020, albeit at a lower pace. These inflows were mostly supported by FDI and other non-bank sectors net inflows totaling 2.8 percent of GDP. At the same time, the domestic banking sector continued accumulating net claims vis-à-vis the rest of the world in the form of currency and deposits holding with parent bank groups, while the government has received net inflows totaling 2 percent of GDP (partly explained by RFI disbursements). In 2021, staff expects net private capital inflows to slow on the back of depressed FDI and lower other non-bank private financial borrowing, while net bank outflows should ease given the crisis-induced relaxation of the liquidity regulations aimed at inducing domestic credit. Staff projects that capital transfers to the economy to stay around one percent of GDP.

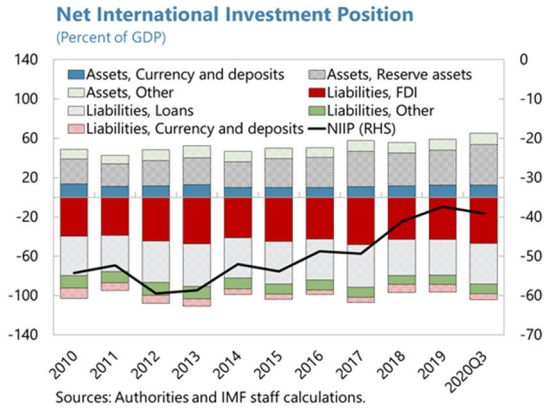
C. Foreign Asset and Liability Trajectory

5. The improvements in the current account have also helped stabilized the Net International Investment Position (NIIP). The improvement in NIIP over the 2013-2020-Q3 period by almost 20 percent of GDP came mainly from the increase in the reserve assets, and reduction in

banks' liabilities, which have declined by about 6 percent of GDP. The decrease in the banks' external loans drove the reduction in bank's liabilities to a large extent, with the banks external financing relying almost exclusively on deposit borrowings. The liability side is largely dominated by FDI and loans, while the main component of assets is reserve assets and banks' claims on parents. That said, in 2020 the NIIP is expected to deteriorate mainly as a result of government external borrowing.

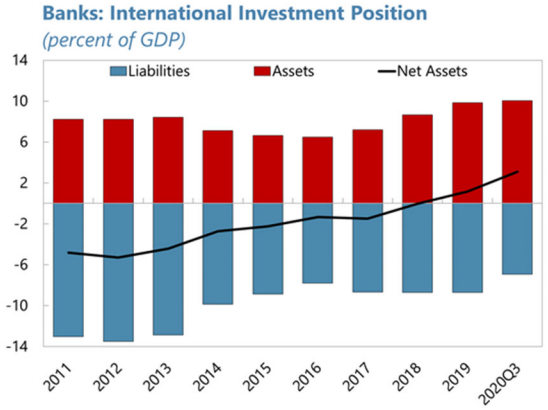
BiH: International Investment Position, 2011-20

The NIIP has improved gradually since 2012 ...



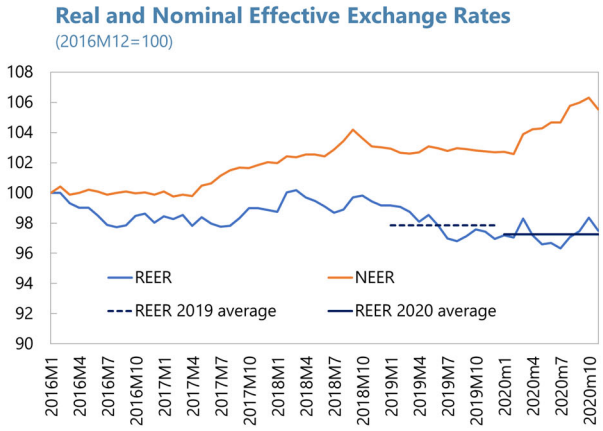
Sources: Authorities and IMF staff calculations.

... in line with the NIIP trend of banks.

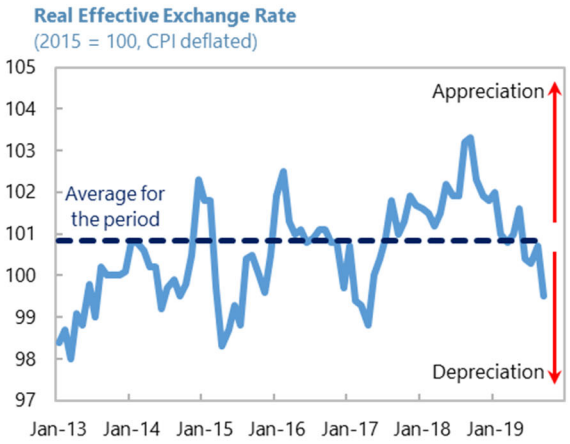


D. Real Exchange Rate (EBA-lite Assessment)

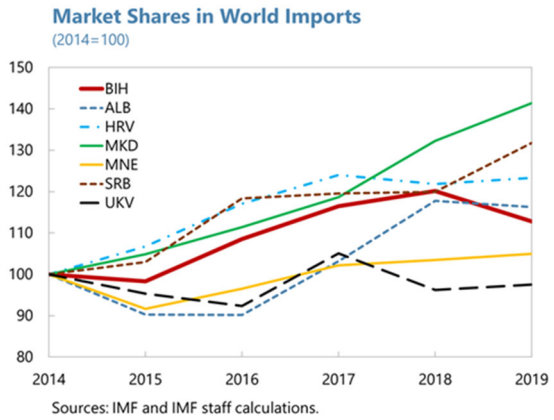
6. In 2020, the Real Effective Exchange Rate (REER) is estimated to have depreciated slightly relative to 2019, while the NEER appreciated by around 2 percent. Following the onset of the pandemic, the REER depreciated marginally in 2020, owing mostly to the negative inflation differential vis-à-vis the EU trading partners, with a share in total exports of more than 80 percent.



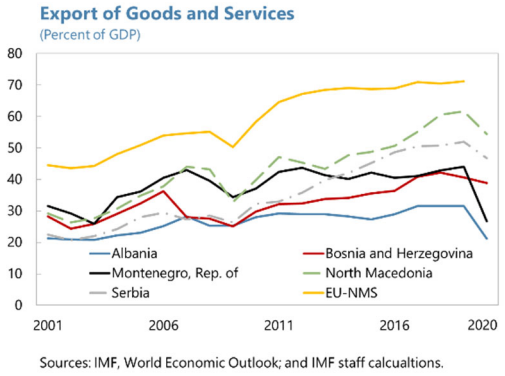
Sources: IMF and IMF staff calculations.



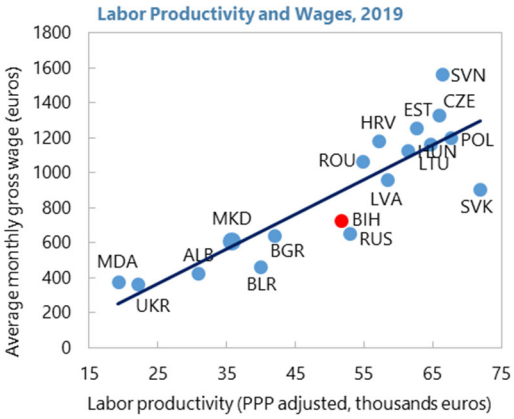
7. Broader measures of competitiveness, such as market share and cost, show moderate concerns. BiH exports gained some market share in the world since 2014, owing to the export-oriented FDI inflows and integration into the EU supply chains, but exports are relatively low as a share of GDP compared to competitors. BiH's wages are aligned with productivity, although recent increases in the minimum wage may have weakened this relationship. Overall, export performance seems to be hampered more by structural shortcomings in transportation and communications infrastructure then by price issues (exchange rate and labor productivity).



BiH has seen relatively modest export gains, which were partly reversed during the crisis.



Labor productivity is ahead of wages by international comparison.



8. Based on two EBA-lite methodologies the real effective exchange rate is broadly in line with fundamentals and desirable policies.

- **Current account (CA) model:** The multilaterally consistent cyclically-adjusted CA norm is -5.0 percent of GDP, in which the norm incorporates a policy gap of 0.1. percent of GDP resulting among others from fiscal policy (2.1 percent), change in reserves (-3.1 percent), public health expenditure (0.1 percent), private sector credit (0.2 percent) and relative labor productivity (-0.8 percent) vis-à-vis medium-term objectives. This implies a CA gap of 1.0 percent of GDP, or a small REER undervaluation of less than 3 percent.

- **REER model:** The model estimates a REER gap of 1.1 percent—a minimal overvaluation. This includes an adjustment for desired policies to the estimated REER norm of around 0.3 percent. Thus, absent policy gaps visa-a-vis the desired levels and the rest of the world, the REER norm would have been 0.3 percent higher and imply smaller overvaluation. The policy gap is defined as a sum of the product of the differences between the actual and policy desired values of policy variables and corresponding model coefficients. For example, the main components of the policy gap include the private credit policy gap estimated at 0.2 percent, calculated as a product of the difference between the actual credit level of 58.6 percent and the policy desired level of credit at 60 percent of GDP and a model suggested coefficient of 0.135. The other main components are private credit growth policy gap (0.36 percent) and interaction between the level of capital controls and relative workers' productivity (-0.5 percent).

Bosnia and Herzegovina: Results from EBA-lite models, 2020
(in percent of GDP, unless otherwise indicated)

	CA model	REER model
CA-Actual	**-3.5**	
Cyclical contributions (from model)	0.7	
Natural disasters and conflicts	-0.1	
Adjusted CA	**-4.0**	
CA Norm (from model) 1/	**-5.0**	
Adjusted CA Norm	**-5.0**	
CA Gap	**1.0**	**-0.4**
o/w Policy gap	0.1	
Elasticity	-0.33	
REER Gap (in percent)	**-2.8**	**1.1**

1/ Cyclically adjusted, including multilateral consistency adjustments.

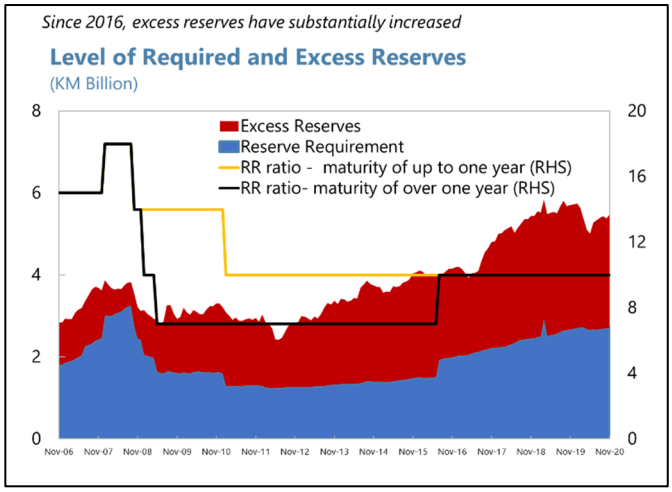
E. Assessing Reserve Adequacy in a Currency Board Arrangement (CBA)[2]

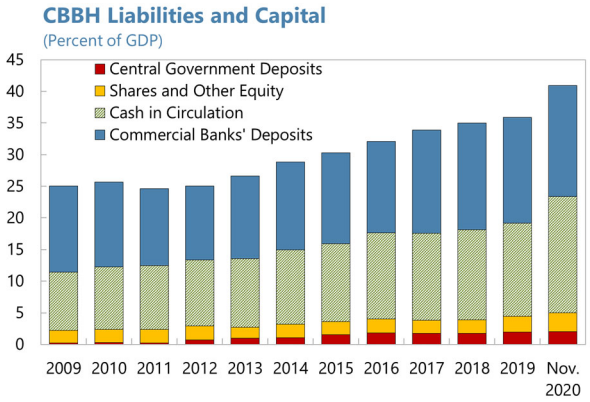
9. In a currency board arrangement, **international reserves play a key role**. The central bank of BiH (CBBH) has no role in managing the exchange rate since its value against the adopted foreign currency (the Euro) is legally defined. The CBBH can only issue base money (currency and CBBH deposits) in exchange for euro. However, not being part of the European System of Central Banks (ESCB), the CBBH does not have access to any ESCB credit lines to mitigate liquidity needs.[3]

[2] Prepared by Giuseppe Cipollone.

[3] Currently the Deposit Insurance Agency (DIA) has no stand-by credit line with the EBRD. The last one (€50 million) expired end-2017, but a renewal is currently underway and should be finalized soon.

10. BiH international reserves are largely driven by banks' deposits (required and excess reserves). By end-November 2020, gross international reserves have been close to 40 percent of GDP and are largely held in Euro-denominated securities and deposits. On the CBBH's liability side, banks' reserves have been growing on average at 5.5 percent per year over the last 10 years and currently represent almost 50 percent of total amount. Banks' excess reserves are substantial (more than 50 percent of total banks' reserves) and have been growing at a faster rate (13 percent) than required reserves (3 percent) over the same period. Since 2016, the higher-than-ECB remuneration rate for banks' excess reserves has been a main driver of excess reserve accumulation, which reached record levels.[4] This has caused a deterioration of CBBH's income position and encouraged a more aggressive reserve asset management with investment in Euro-denominated government bonds with longer maturity and/or lower ratings.[5]





11. The traditional Reserve Adequacy (RA) metric tries to assess the capacities to prevent and mitigate external shocks. Therefore, RA metrics usually encompass risks resulting from shocks to the current and capital accounts. The former consists of shocks to external demand or terms of trade while the latter include external liabilities shocks or capital flight. The following parts of the balance of payments might be considered as sources of these risks:

(i) *Export revenues* are usually a good approximation of potential losses that could arise from a negative external demand or terms-of-trade shock. Other external financing inflows, such as remittance, foreign aid or FDI might also reflect potential drains resulting from deterioration in the external environment.

[4] IMF Technical Assistance (TA) report on implementation of a new reserve requirement framework. IMF Country Report N. 19/316, October 2019.

[5] On May 1, 2019, the CBBH brought the remuneration of banks' excess reserves in line with the ECB deposit facility rate. The abovementioned IMF TA encouraged the CBBH to differentiate remuneration rates between banks' Euro and local currency reserves.

(ii) *Short-term debt* and *other external liabilities on a remaining-maturity basis* indicate potential losses associated with the ability of foreigners to liquidate their positions during periods of financial and economic distress.

(iii) Similarly, *liquid domestic assets* –measured, for instance, by M2[6]—capture potential losses that could arise from domestic capital outflows. M2 tends to capture this risk of capital flight and it may also be seen as a measure of potential need for bank support during or after a crisis, particularly when banks have very large external exposures.

The traditional IMF Reserve Adequacy (RA) metric is the following:[7]

$$RA = 10\%X + 30\%STD + 20\%OL + 10\%M2 \qquad (1), \text{ where:}$$

(iv) Export revenue (X).

(v) Short-term debt (STD).

(vi) Other (debt and equity) liabilities (OL).

(vii) Broad money (M2).

12. Currency board arrangements and Euroized economies might be more impacted by pressures stemming from financial obligations and external shocks. While currency risks are quite limited, both CBAs and euroized economies need to deal with pressures resulting from private and public financial obligations. Shocks might require liquidity buffers that cannot be domestically generated. Traditionally, CBAs do not play a lender of last resort (LOLR) role given that it cannot print money to address lack of liquidity. This is the CBBH's case. Therefore, larger liquidity buffers, in the adopted foreign currency, are needed to mitigate externally or domestically driven shocks on financial institutions.

13. Assessing reserve adequacy for Bosnia and Herzegovina benefits from some country-specific adjustments.

(viii) *Export revenue (X).* Export losses could be substantial even for a country with a currency board arrangement.[8] The BiH's reliance on remittances for FX earnings (on average 8 percent of GDP) called for an adjustment of the RA metric to address this source of risks. Remittances are subject to disruptions because they are also concentrated in a few countries (mostly Germany), which exposes them to

[6] Cash and checking deposits (M1) plus savings and time deposits, money market funds, and other liquid assets such as T-bills.

[7] The metrics is a simple sum of potential losses based on countries with fixed exchange rate regime experiences during the past stress episodes. Weights correspond to the value of an extreme (10th percentile) drain during the stress events. IMF, *Assessing Reserve Adequacy – Supplementary Information*, Supplement 1, SM/11/31.

[8] IMF, 2013, *Assessing Reserve Adequacy – Further Considerations*, IMF Policy Paper, SM/13/301.

slowdowns in these economies. In 2020, a significant drop is expected. Therefore, adding remittance inflows (R) to total exports (X) could help better assess reserves adequacy.[9]

(ix) *Short-term debt (STD).* Losses resulting from short-term foreign debt liabilities (short-term financial obligations) is an important source of risks in CBAs similar to other countries, with no change in the weight.

(x) *Other (debt and equity) liabilities (OL)*. Despite the limited amount (stock is 35 percent of GDP in 2017), they could also generate substantial distress in capital account crisis episodes. Therefore, a 20-percent weight could be retained for this (future) source of risk.

(xi) Finally, to account for a risk resulting from *domestic* capital outflows, *broad money* (M2)—with a higher 15-percent weight—should be included in the RA metric. In CBAs, base money has a statutory role for reserve holdings with a coverage ratio above 100 percent. However, modern CBA arrangements hold reserves well in excess of the monetary base, presumably reflecting a view that covering base money alone may not be enough to respond to potential balance of payment flows.[10] In BiH base money is approximately half of M2, so an increase in the coverage ratio of 10 percent would justify an increase in the M2 weight by 5 percentage points.

The adjusted RA metric is the following:

$$RA = 10\% (X+R) + 30\%STD + 20\%OL + 15\%M2 \qquad (2),$$

14. BiH's reserve adequacy is within the traditional ARA metric band. Gross reserves are above the more traditional thresholds of the 3-month import coverage, 100 percent of short-term external debt and within the traditional ARA metric band.

15. While gross international reserves, excluding the IMF RFI disbursement, at end-October 2020 are above traditional ARA metrics, they are slightly below the adjusted ARA metric. If bank's excess reserves are excluded, gross international reserves fall below the traditional and adjusted RA metric. High levels of excess reserves are a relatively recent phenomenon and might not persist in the future. If excess reserves are excluded (which is plausible in a crisis scenario), the adjusted RA metric falls to 73 percent, which is below the recommended band of 100-150 percent.

[9] While a 10-percent weight might seem excessive given the relative stability of remittance inflow. It would allow, however, capturing additional risks stemming from informal remittance inflows.

[10] IMF (2011) Assessing Reserve Adequacy.

16. The above analysis suggests that increasing CBBH international reserves over time could be beneficial for prudential purposes. Based on the adjusted ARA metric, gross international reserves have fallen to 96 percent of the 100-150 percent adequacy range at end-November 2020. Building higher reserve buffers over time might be useful to address more severe shocks and strengthen the stability of BiH's CBA. As other countries with CBAs, the authorities may want to target a higher reserve coverage ratio than the CBBH's implicit 105 percent target over time.[11]

BIH: Reserve Adequacy Metrics

(based on end-Nov 2020 reserve levels, excluding RFI disbursement)

	Minimum threshold	Gross reserves	Gross Reserves excluding excess reserves
Months of import coverage	3	8.1	7.6
Traditional RA metric (%)	100-150	105	85
Adjusted RA metric (%)	100-150	96	73

Sources: BIH authorities and IMF calculations

F. Conclusion

17. Reserves coverage is broadly adequate per various reserve adequacy metrics, supported by the RFI disbursement. Gross international reserves, estimated at 6.7 billion euros at end-2020, covered 8.5 months of prospective imports of goods and services and 50 percent of broad money. Reserves stood at some 118 percent of the IMF's ARA metric, within the suggested range, and a little over short-term debt (at remaining maturity). That said, the reduction in private capital inflows is expected to put pressure on reserves in the coming months and ratios are expected to deteriorate in 2021 based on current policies.

Reserve Adequacy Ratios for Bosnia and Herzegovina, 2020

Reserve/STD (percent)1/	179.0
Reserve/Months of prospective import goods and services 2/	8.5
Reserve/Broad money (percent) 3/	49.8
Expanded 'Greenspan-Guidotti' metric: Reserves/(STD + CA deficit)	156.1
Reserves/ARA metric (percent) 4/	118.1

1/ Suggested threshold for adequacy: 100 percent.
2/ Suggested range for adequacy: 3-6 months;
3/ Suggested threshold for adequacy: 20 percent
4/ Suggested range for adequacy: 100-150 percent.

18. In conclusion, external position in 2020 was broadly consistent with fundamental and desirable policy settings. This conclusion is derived from the IMF's multilaterally consistent estimates based on the analysis of the current and capital account, NIIP, real effective exchange rate, and net international reserves.

[11] The coverage ratios for Bulgaria and the Hong Kong Special Administrative Region, People's Republic of China were, respectively, 113 and 206 percent in 2019.

Annex III. Debt Sustainability Analysis

Results from an updated Debt Sustainability Analysis (DSA) using staff's baseline projections indicate that Bosnia and Herzegovina's public debt remains sustainable in the medium term, even after the impact of the pandemic. Following a deterioration over 2020-23, the debt-to-GDP ratio is projected to stabilize. IFIs and bilateral officials are assumed to provide external financing through long-maturity and low-interest loans. Alternative scenarios suggest that debt is sustainable under most adverse scenarios, except for a scenario based on a constant primary deficit at 2020 levels, which is unrealistic given the severe and temporary impact of the pandemic on public finances. The higher capital spending scenario shows that there is room for more absorption of IFIs' financing for growth-enhancing projects with limited impact on debt dynamics and government financing needs.

1. For data availability reasons, this analysis covers general government debt with incomplete public enterprise (PE) coverage and partial inclusion of arrears. PEs hold significant amounts of debt (around a quarter of GDP). A part of this debt, which is related to on-lending or debt that has been guaranteed is included in the analysis, but there is no data on how much of the PE debt is already included in the general government debt. Including the gross PE debt would imply double counting and would not be accurate. The authorities are working on producing consolidated public debt numbers, but this effort could take a few years.[1] The dynamics of the DSA for the entire public sector should be similar because fiscal primary deficits would be unchanged even though debt levels would be somewhat higher. Regarding arrears, in 2018, total liabilities of the RS health sector were around KM1 billion (8 percent of RS-GDP), of which arrears might be KM0.5 billion.[2] In FBiH, total unpaid social contributions are estimated at KM1.1 billion (4 percent of FBiH-GDP)—mostly from PEs.[3] Thus, including arrears should raise measured debt levels only somewhat but should not materially affect the underlying primary fiscal deficits.

2. The assumptions are in line with the macroeconomic framework baseline. The primary fiscal balance is expected to deteriorate significantly in 2020 and gradually return close to a debt-stabilizing position in 2023.

Debt profiles and vulnerabilities. A very large share of the debt has a maturity higher than one year and more than two-thirds denominated in foreign currency (mostly euro). The share of foreign-denominated debt has increased overtime, stemming from EBRD and EIB financing for Corridor VC (the highway corridor connecting BiH to Croatia and Serbia). IFI financing reflects favorable long-term financial terms currently provided by the EBRD, EIB, IMF and WB. A gradual increase in the average maturity of outstanding domestic debt is also assumed. Gross fiscal financing needs will increase to 10 percent of GDP in 2024 reflecting large pandemic-related primary deficits and

[1] FAD is providing technical assistance on PEs and STA on government finance statistics.

[2] Currently, the accounting systems generally record government liabilities but do not record the payment due date. Therefore, it is difficult to know the overdue payment amounts (arrears). The authorities are working with World Bank and IMF staff on formulating a strategy for clearing arrears in the health sectors of both entities.

[3] FBiH data are less reliable because of cantonal reporting difficulties.

increasing debt services from previous IFI loans. However, a sizable share of financing will be covered by IFI financing, including the EBRD, EIB and WB. No external commercial loans are envisaged given the lack of BiH access to international markets. Domestic financing remains available but will likely become more expensive.

A. Baseline and Alternative Scenarios

3. Following a sharp deterioration in 2020, debt dynamics are expected to improve over the medium term. Public debt is estimated to rapidly increase in 2020 by reaching 39 percent, reflecting a sharp recession and large increase in COVID-related spending. Following this sharp surge, the debt-to-GDP ratio will gradually increase to 42 percent in 2023 and remain at this level with a slight downward trend in 2025 (baseline). IFIs and bilateral officials are projected to continue to provide external financing through project loans. Commercial banks operating in BiH are expected to continue to absorb treasury bills and bonds. The authorities should further extend the average debt maturities if modernized debt strategies are adopted and implemented. With the extension of the average maturity, the share of euro-denominated debt will likely increase. Banks and pension funds are willing to buy domestic bonds with longer maturity, but most have a strong preference for a euro-clause.

B. Scenarios and Shocks

4. Baseline projections are consistent with the recent developments, but subject to significant uncertainty due to the EU outlook. After the output contraction in 2020, a rebound is expected in 2021. From 2022 onwards, GDP growth is expected to remain close to potential (3 percent) throughout the projection period. The fiscal primary deficit will follow a smoother path with a gradual improvement until approaching a balanced position by end-2025. These policies will lead to a stabilization of the debt at around 42 percent of GDP by end-2025. Of course, a more protracted-than-expected slow recovery in key trading partners in the EU and/or BiH economies would lead to lower GDP growth and higher primary deficits in earlier years.

5. Under the historical scenario, the debt-to-GDP ratio would largely remain unchanged. The paths of public debt and gross financing needs would deviate from the baseline, largely due to protracted primary deficits. The debt ratio would remain close to the end-2020 level of close to 39 percent, with a gradual decline over the projection period.

6. The constant primary surplus scenario seems unrealistic, given that the COVID-19 shock is likely of a temporary nature. Assuming a constant primary deficit at 2020 levels (5 percent of GDP) throughout the projection period, the debt-to-GDP ratio would increase steadily to 57 percent in 2025. Such large primary deficits in the coming years seem unlikely but would also be unsustainable. The gross financing needs would follow a similar upward trend. Available resources would be limited due to the small investor basis, largely banks, and underdeveloped secondary bond market.

7. The real exchange rate shock has limited impact. After a spike in the first year (2021), the debt-to-GDP ratio is projected to stabilize as in the baseline scenario while remaining slightly above it.

8. The higher capital-spending scenario underscores that debt remains sustainable when IFI financing is used to address infrastructure gaps. Assuming larger capital spending (additional 0.5 percent of GDP compared to the baseline financed mainly by EBRD/EIB) after some marginal increases in early years, the debt ratio to GDP is expected to decline while remaining just above the baseline by the end of the projection period.[4]

9. BiH's debt is sustainable under the baseline scenario and active policies could address further shocks or risks. Under the baseline, pandemic-related spending would decline, and revenues would recover with fiscal policy converging to the debt-stabilizing primary balance of 0.7 percent of GDP in 2025. If temporary fiscal shocks were to arise during the projection period, the authorities could respond with a combination of shock-related spending and revenue-raising measures. Under most reasonable shock scenarios debt would remain sustainable. Including PE debt or arrears explicitly in the DSA would not materially change the analysis.

[4] A multiplier of 1 is assumed for the increased capital spending.

Bosnia and Herzegovina: Public Sector Debt Sustainability Analysis - Baseline Scenario

(in percent of GDP unless otherwise indicated)

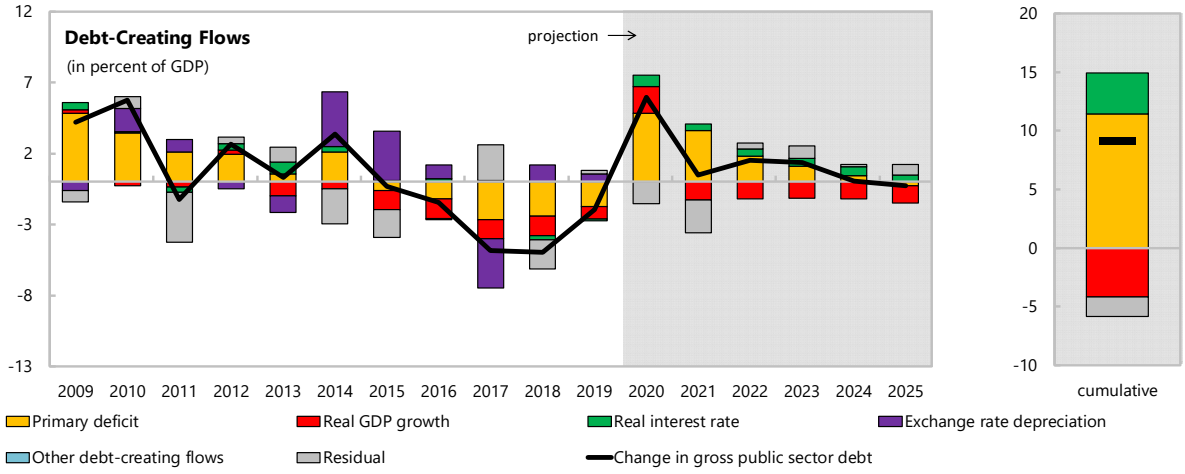
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2011-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	42.7	34.3	32.4	38.3	38.8	40.3	41.7	41.7	41.5
Public gross financing needs	4.2	2.7	1.4	8.9	7.6	6.6	9.0	10.5	10.4
Real GDP growth (in percent)	1.9	3.7	2.8	-5.5	3.5	3.3	3.0	3.0	3.0
Inflation (GDP deflator, in percent)	1.2	2.7	2.6	-0.4	1.1	1.1	1.4	1.6	2.1
Nominal GDP growth (in percent)	3.1	6.6	5.5	-5.9	4.6	4.4	4.4	4.7	5.1
Effective interest rate (in percent) [4/]	1.8	2.0	2.3	1.9	2.3	2.6	2.9	3.3	3.4

As of December 31, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		N/A
5Y CDS (bp)		N/A
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	B	B
Fitch	B	B

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.2	-5.0	-1.9	5.9	0.5	1.5	1.4	0.0	-0.3	9.1	
Identified debt-creating flows	0.3	-2.9	-2.2	7.5	2.8	1.1	0.5	-0.1	-1.0	10.8	
Primary deficit	0.3	-2.4	-1.7	4.8	3.6	1.8	1.1	0.4	-0.3	11.5	-0.7
Primary (noninterest) revenue and grants	43.2	42.7	41.7	41.0	41.0	41.1	41.4	41.7	42.0	248.2	
Primary (noninterest) expenditure	43.5	40.3	40.0	45.8	44.6	42.9	42.5	42.1	41.7	259.6	
Automatic debt dynamics [5/]	0.0	-0.5	-0.5	2.7	-0.8	-0.7	-0.6	-0.6	-0.7	-0.7	
Interest rate/growth differential [6/]	-0.5	-1.7	-1.0	2.7	-0.8	-0.7	-0.6	-0.6	-0.7	-0.7	
Of which: real interest rate	0.3	-0.3	-0.1	0.8	0.5	0.5	0.6	0.6	0.5	3.5	
Of which: real GDP growth	-0.8	-1.4	-0.9	1.9	-1.3	-1.2	-1.2	-1.2	-1.2	-4.1	
Exchange rate depreciation [7/]	0.6	1.2	0.6	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General Govt - Financing - Privatization (	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.6	-2.0	0.3	-1.5	-2.3	0.4	0.9	0.2	0.7	-1.7	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

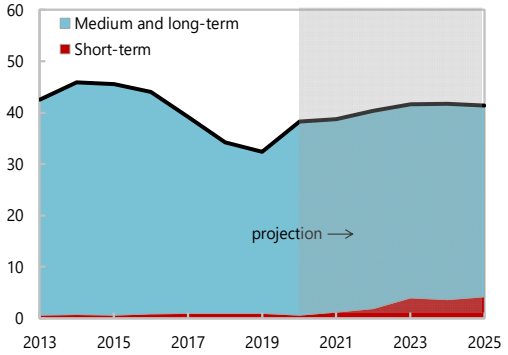
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Bosnia and Herzegovina: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

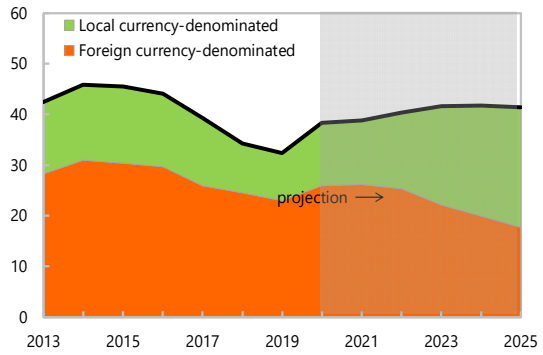
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

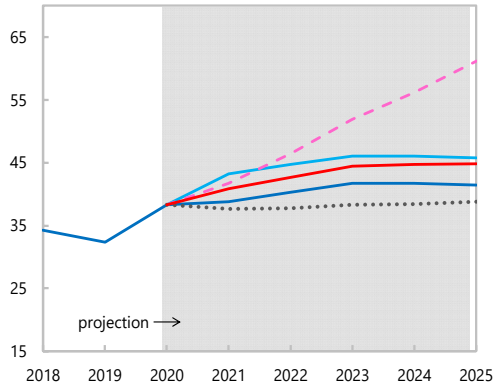


Alternative Scenarios

Baseline
Historical
Constant Primary Balance
Higher capital spending/GDP growth rate
Real Exchange Rate Shock

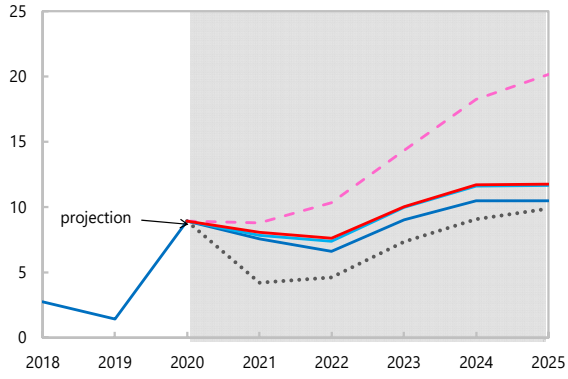
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-5.5	3.5	3.3	3.0	3.0	3.0
Inflation	-0.4	1.1	1.1	1.4	1.6	2.1
Primary Balance	-4.8	-3.6	-1.8	-1.1	-0.4	0.3
Effective interest rate	1.9	2.3	2.6	2.9	3.3	3.4
Constant Primary Balance Scenario						
Real GDP growth	-5.5	3.5	3.3	3.0	3.0	3.0
Inflation	-0.4	1.1	1.1	1.4	1.6	2.1
Primary Balance	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8
Effective interest rate	1.9	2.3	2.5	2.7	3.0	2.9
Higher capital spending/GDP growth rate						
Real GDP growth	-5.5	4.0	3.8	3.5	3.5	3.5
Inflation	-0.4	1.1	1.1	1.4	1.6	2.1
Primary Balance	-4.8	-4.1	-2.3	-1.6	-0.9	-0.2
Effective interest rate	1.9	2.3	2.6	2.9	3.3	3.4

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-5.5	2.0	2.0	2.0	2.0	2.0
Inflation	-0.4	1.1	1.1	1.4	1.6	2.1
Primary Balance	-4.8	-0.2	-0.2	-0.2	-0.2	-0.2
Effective interest rate	1.9	2.3	2.5	2.7	3.0	3.0
Real Exchange Rate Shock						
Real GDP growth	-5.5	3.5	3.3	3.0	3.0	3.0
Inflation	-0.4	5.6	1.1	1.4	1.6	2.1
Primary Balance	-4.8	-3.6	-1.8	-1.1	-0.4	0.3
Effective interest rate	1.9	2.6	2.6	2.8	3.2	3.3

Source: IMF staff.

Bosnia and Herzegovina: Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

Annex IV. Implementation of Article IV Recommendations

	2018 Art. IV Advice	Actions since 2018 Art. IV
Macroeconomic Stabilization	Prudent fiscal policy	**Progress** - Budgetary position has improved and remains prudent.
	Scaling-up implementation of key infrastructure projects.	**Some progress** – Capital spending has increased somewhat but is well below the 2016 EFF-supported program objectives, largely due to limited capacity (e.g., PIMA). Substantial progress is needed in improving preparation, selection and execution of large investments.
	Containing current spending	**Progress** - Current spending has remained under control. Public wages have been increased somewhat in 2019 and 2020, but the wage bill has declined as a share of GDP
Business environment and labor market	Reduction of labor tax wedge	**Limited progress** – PIT/SSC legislation has been submitted to the FBiH parliament, but not been approved yet.
	Reduction of para-fiscal fees	**Minimal progress** in cutting/rationalizing para-fiscal fees, but more transparency has been achieved.
	Harmonization of tax laws	**Some progress.** Corporate Income tax legislation was aligned.
	Improving PE governance	**Limited progress.** The WB is working with the RS railway company. Recently, the IMF technical assistance identified measures to address significant gaps. Governments confirmed interest in implementing key recommendations, although the timeline is unclear.
Banking sector	Improving coordination and cooperation among supervisors.	**Some progress** – The cooperation between entity's supervisor agencies is gradually improving. They are also conducting joint on-site supervision for large banks operating in both entities.
	Alignment to the EU regulation	**Some progress** - European Banking Agency (EBA) conducted the first assessment of regulatory equivalence, but the results are still unavailable.
	Strengthening prudential regulations	**Some progress** – With the support of USAID (FINRA), World Bank and IMF Technical Assistance, a number of projects to strengthen the regulatory framework are ongoing.

Annex V. Implementation of EFF Structural Conditionality

A. Met Structural Conditionality

Prior Actions	Status
1. Combine all taxpayer information from all four tax agencies and comprehensive company information from the entity business information agencies into a database that is available and fully searchable in each of the four tax agencies.	Met
2. Federation government to adopt a strategic plan to restrain wages and reduce overall employment in public sector.	Met
3. RS government to adopt a strategic plan to restrain wages and reduce overall employment in public sector.	Met
4. Council of Ministers of BiH to adopt a strategic plan to restrain wages and reduce overall employment in public sector.	Met
5. Hire internationally reputable auditors to conduct a detailed AQR for banks that were under enhanced supervision in 2015 or that experienced a rapid credit expansion in relation to the market in 2012-14 (i.e., with an average annual credit growth rate of greater than 10 percent of that period), and that haven't already undergone an AQR.	Met
Structural Benchmarks	
6. Continue to adhere to the Currency Board Arrangement as constituted under the law.	Met
7. Refrain from increasing public sector wages including refraining from increases in the wage base, the wage coefficients, and allowances.	Partially Met. Not met by IBiH only.
8. Refrain from imposing mandatory conversion of any foreign currency-denominated loans into local currency.	Met
9. FBA to make final assessment of recapitalization plans for banks that reveal capital shortfalls based on their AQR results.	Met
10. Federation government, in consultation with the World Bank Group and/or EBRD, will complete the financial and operational due diligence for BH Telecom and HT Mostar.	Met
11. Federation parliament to adopt a new draft Law on Banks and amendments to Banking Agency Law in line with IMF staff recommendations.	Met
12. RS parliament to adopt a new draft Law on Banks and amendments to Banking Agency Law in line with IMF staff recommendations.	Met
13. RSBA to make final assessment of recapitalization plans for banks that reveal capital shortfalls based on their AQR results.	Met
14. Federation government to submit to parliament amendments to the Law on Debt, Borrowing, and Guarantees to strengthen controls over lower level governments.	Met
15. RS government to adopt a restructuring plan for railways, developed with the assistance of the World Bank.	Met
16. RS parliament to amend its corporate income tax law to foster consistency, avoid double taxation between the entities and reduce tax incentives, in line with IMF staff recommendations.	Met

Structural Benchmarks	
17. FBiH government to submit a draft PIT/SSC law to the FBiH parliament for second reading, in line with IMF staff recommendations.	Met
18. State parliament to adopt amendments to the Law on Deposit Insurance in Banks in BiH in line with IMF staff recommendations.	Met with delay
19. FBiH to expand the treasury system to budget management systems in cantons.	Essentially met with delay. One canton does not use the treasury system.

B. Outstanding Structural Benchmarks Under the EFF

Structural benchmark	Date	Comments
1. Continue to adhere to the Currency Board Arrangement as constituted under the law.	Continuous	Always met.
2. Refrain from increasing public sector wages including refraining from increases in the wage base, the wage coefficients, and allowances.	Continuous	Met through 2nd Review. In 2019, salaries were increased in the BiH State Institutions, FBiH and RS. However, the increase has been either modest and/or for selected professions (e.g. police).
3. Refrain from imposing mandatory conversion of any foreign currency-denominated loans into local currency.	Continuous	Always met.
4. Adjust the allocation coefficient for indirect tax revenue on a quarterly basis and settle indirect tax claims semi-annually.	Quarterly	Not met, but current coefficients are close to the value they would have if updated quarterly. The coefficients were updated in mid-2020 and a settlement for most past cross-debts was concluded.
5. RSBA, FBA, CBBH, and DIA to adopt the identical methodology for determining domestic systemically important banks, in consultation with IMF staff.	End-March 2018	Entities have adopted methodologies that are very similar and result in the same identification. There is strong political resistance from RS authorities to officially align because of apparent legal obstacles to using country-wide data.
6. CBBH, DIA, FBA, RSBA, and other relevant parties to sign a Financial Stability MoU, in line with IMF staff recommendations.	End-June 2018	Serious political obstacles and technically too ambitious. RS authorities' resistance to transfer (or give the impression to transfer) power to a state level authority (namely the CBBH).
7. RS parliament to amend the law on IDBRS in line with IMF staff recommendations.	End-June 2018	The strategic statement is under discussion with the WB team. Key obstacle is the merger of various Funds with the Development Bank. Some progress has been made recently.

Structural benchmark	Date	Comments
8. FBiH parliament to amend the law on Federation Development Bank in line with IMF staff recommendations.	End-June 2018	The strategic statement is being discussed with the WB. No substantial issues are at stake. It could be adopted when a new Government is in place.
9. FBiH, to collect data on arrears at all the levels of government in FBiH, in line with IMF and World Bank advice.	End-June 2018	Some progress, but data availability at cantonal and municipal levels is very poor. Fund TA team is working together with the WB.
10. FBiH government to adopt a time bound action plan to address the arrears situation in the Federation, in line with IMF staff recommendation.	End-April 2019	As above.
11. RS government to require health centers to prepare budgets with hard budget constraints to prevent new arrear accumulations.	End-September 2018	RS government has intention to deal with this issue, particularly in a Fund-supported program. WB is working with the RS authorities.
12. RS cabinet to adopt a plan to restore financial sustainability of health institutions, in line with IMF and World Bank advice.	End-December 2018	See above.
13. FBiH government to adopt an operational plan to reduce overall employment in public sector based on the employment registry developed with the assistance of the World Bank.	End-December 2018	Very limited progress.
14. RS government to adopt an operational plan to reduce overall employment in public sector based on the employment registry developed with the assistance of the World Bank.	End-December 2018	Very limited progress.
15. Council of Ministers of BiH to adopt an operational plan to reduce overall employment in public sector based on the employment registry developed with the assistance of the World Bank.	End-December 2018	Very limited progress.
16. RS government to expand the treasury system to health centers.	End-March 2019	Pilot project launched in 2018. Only a few minor health institutions have been integrated, but this is still on the authorities' agenda.

Annex VI. Implementation of 2015 FSAP Recommendations

Recommendations and Authority Responsible for Implementation	#	Authorities' Comments
Banking Oversight		
Develop a remedial action program focusing on new tools, earlier step-up enforcement and heavier fines to expedite corrective action (FBA, BARS, relevant Ministries of Finance and Justice).	40	Implemented/FINRA involvement
Strengthen provisioning under IAS by issuing standards to encourage conservative assumptions on impairments by banks (FBA, BARS).	42	Partially implemented/FINRA involvement
Enact new Laws on Banks and amend relevant legislation addressing deficiencies in supervisory powers, consolidated supervision, and identification of ultimate beneficiary owners (FBA, BARS, CBBH, Ministries).	36	Implemented
Conduct additional AQRs in banks with weak solvency and liquidity indicators (FBA, BARS).	16	Implemented/Ongoing
Assure that banks continue implementing IFRS and external auditor implement IAS (FBA, BARS).	41	Implemented/FINRA involvement
Insurance Oversight		
The appointment of the FBiH-ISA director should be based on the relevant law (Government).	45	Implemented
The new insurance law in the FBiH should be approved if it shows improved convergence towards the EU insurance directives (FBiH-ISA).	44	Implemented
Introduce a formal channel of information sharing with banking agencies (FBiH-ISA).	46	Implemented
Update solvency regime by a gradual incorporation of risk elements, develop an early warning system, including prompt corrective actions. Capacity building is required (ISAs).	44	Implemented for Solvency 1. Ongoing for Solvency 2
Financial Safety Net, Resolution of NPLs, and Systemic Liquidity Management		
Revise the reserve requirements, maturity mismatch, and the liquidity ratio (CBBH, FBA, BARS).	55	Implemented/FINRA involvement
Design and implement the LCR, adapted to the BiH (FBA, BARS).	55	Implemented
Revise the consequences to banks for not complying with reserve requirement (CBBH).	54	Implemented

Recommendations and Authority Responsible for Implementation	#	Authorities' Comments
Enable prompt depositor pay-out (DIA).	60	Implemented (amended DIA law, but still pending the approval)
Provide resolution powers to the FBA and BARS for banks in their respective jurisdictions on the new Laws on Banks, following the FSB Key Attributes and EU BRRD (FBA, BARS, DIA, relevant Ministries)	65	Implemented
Broaden the scope to draw on the existing DIA for funding bank resolution using least-cost solution (DIA)	66	Implemented (FBiH and RS) through the FBiH Law on Banks. However, the adoption of the DI law is still pending.
Establish a Financial Stability Fund (FSF)—under the DIA—to provide for open bank resolution and limited and temporary liquidity support in systemic crisis (DIA, CBBH, FBA, BARS, Governments).	67	Not implemented yet.
Strengthen, regularly review, and test bank contingency plans of SCFS members (SCFS).	62	MoU under discussion
Strengthen the cooperation between DIA and financial safety net players (DIA, CBBH, FBA, BARS).	60	MoU has been drafted
Add macroprudential analysis and policy to the coordination MoU. Define and collect additional information for the assessment of vulnerabilities and macroprudential tools (CBBH, FBA and BARS).	52	MoU under discussion
Streamline collateral execution procedures by allowing a final auction at no reserve price if previous rounds of auctions failed and specify realistic criteria for asset market values (RS/FBiH Ministry of Justice).	34	Not implemented yet. The MoJ is working on that.
Consider tools and incentives to facilitate restructurings and debt resolution as well as adoption of out- of-court restructuring guidelines. (RS/FBiH/BiH MoF, FBA, BARS).	31	Not implemented
Revise the insolvency framework by introducing incentives to initiate proceedings early and expand the insolvency framework to cover businesses run by individuals. (RS/FBiH MoJ).	35	Not implemented
Financial Market Infrastructure		
Strengthen the legal framework to designate payment systems, and to protect settlement finality and netting in line with international standards (CBBH).	48	Implemented

Recommendations and Authority Responsible for Implementation	#	Authorities' Comments
Develop a comprehensive risk management framework for the RTGS system (CBBH).	47	Not implemented. In organizational terms, the CBBH could implement this recommendation through the establishment of the Oversight Unit.
Stress test the RTGS system, including the default of the largest participant and affiliates (CBBH).	47	Implemented. Stress tests were conducted for 2017. In 2018 the stress testing will be on semi-annual basis (two stress testing, combining larger number of banks).
Establish a recovery time objective for the RTGS system following disruptive events (CBBH).	47	Implemented
Establish a new oversight unit in Payment Systems Department, which is staffed with sufficient resources to carry out oversight responsibilities (CBBH).	48	Implemented. The re-organization of the Payment System Department has been concluded in July 2018.

Annex VII. Modernizing the CBBH's Reserve Requirement Framework[1]

The CBBH operates under a currency board arrangement (CBA) with the RRF as its only monetary instrument. Historically, the CBBH has successfully used the RRF to achieve its monetary and macroprudential goals. Nevertheless, some refinements to the framework could be considered, most importantly introducing different rates of remuneration of KM and foreign currency (FX) reserves to boost the resilience of the CBA.

1. The current RRF does not differentiate between currencies. Although the CBBH law allows for differentiation, both KM and FX required reserves are remunerated at the identical rate of 0 percent. The same is true for excess reserves (ER), which are remunerated at -0.50 percent (equal to the ECB deposit facility rate) and not differentiated between currencies. The reserve requirement ratio is set at 10 percent of the reserve base, regardless of the currency, and all reserves (both required and excess) are fulfilled in local currency.

2. Although the RRF has served the CBBH well, it has some drawbacks. By not differentiating between currencies, the CBBH cannot influence the attractiveness of holding KM over FX. FX required reserves (RR) are currently remunerated above CBBH's opportunity costs, which incentivizes FX (mostly euro) intermediation at the expense of domestic intermediation (thus perpetuating euroization). Moreover, the current framework does not allow the CBBH to defend the KM in a moment of crisis.

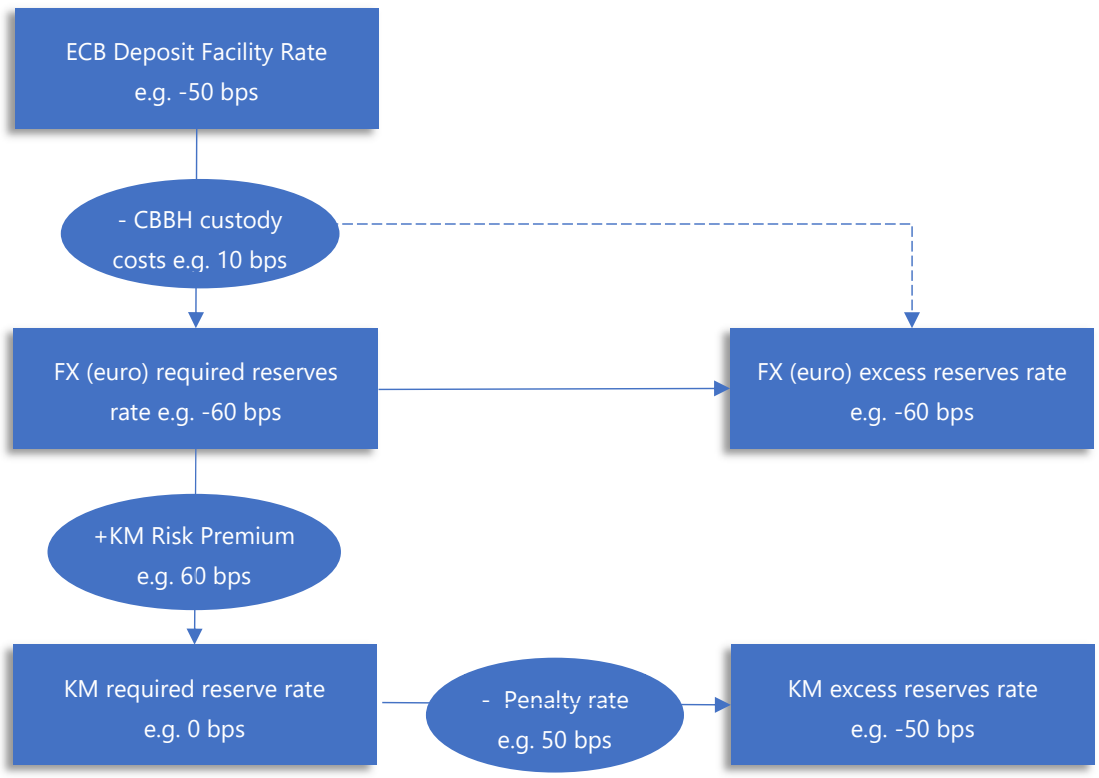
3. As a starting point, the CBBH should base remuneration decisions on the ECB deposit facility rate. The CBBH's opportunity cost is equal to the ECB deposit facility rate (-0.50) minus a small, fixed spread reflecting the CBBH's custody costs (around -0.10). Currently, this implies a remuneration rate of around -0.60 percent, to be applied to FX RR and ER. This would improve the CBBH's financial sustainability and eliminate arbitrage opportunities for banks.

4. The remuneration on KM RR would become the CBBH's main policy instrument to induce the public to hold KM-denominated assets. The remuneration rate on KM RR should approximate a market neutral rate consisting of the FX reserve remuneration plus a risk premium for holding KM assets. The KM risk premium is difficult to estimate, but to facilitate a transition to a rate structure resembling the current one, one could initially set it at 60 basis points (bps). Thus, the remuneration rate on KM RR would be 0 (as now). The KM risk premium would allow the CBBH to influence capital flows. A higher KM rate would encourage capital flows and encourage the holding of KM (both RR and ER).

[1] Prepared by Adrian Music based on MCM technical assistance report: https://www.imf.org/en/Publications/CR/Issues/2019/10/23/Bosnia-and-Herzegovina-Technical-Assistance-Report-Implementation-of-a-New-Reserve-48746?cid=em-COM-456-39618.

5. The rate on KM ER should be set at a penalty discount to KM RR but at or above the FX reserves. Initially, one could set the ER penalty at 50 bps. The KM ER rate would influence credit conditions: lowering the rate would encourage banks to lend out their excess reserves. Finally, in the new RRF, banks would eventually fulfill FX RR in FX to further discourage euroization.

Figure 1. Structure of Remuneration Rates in the New Framework



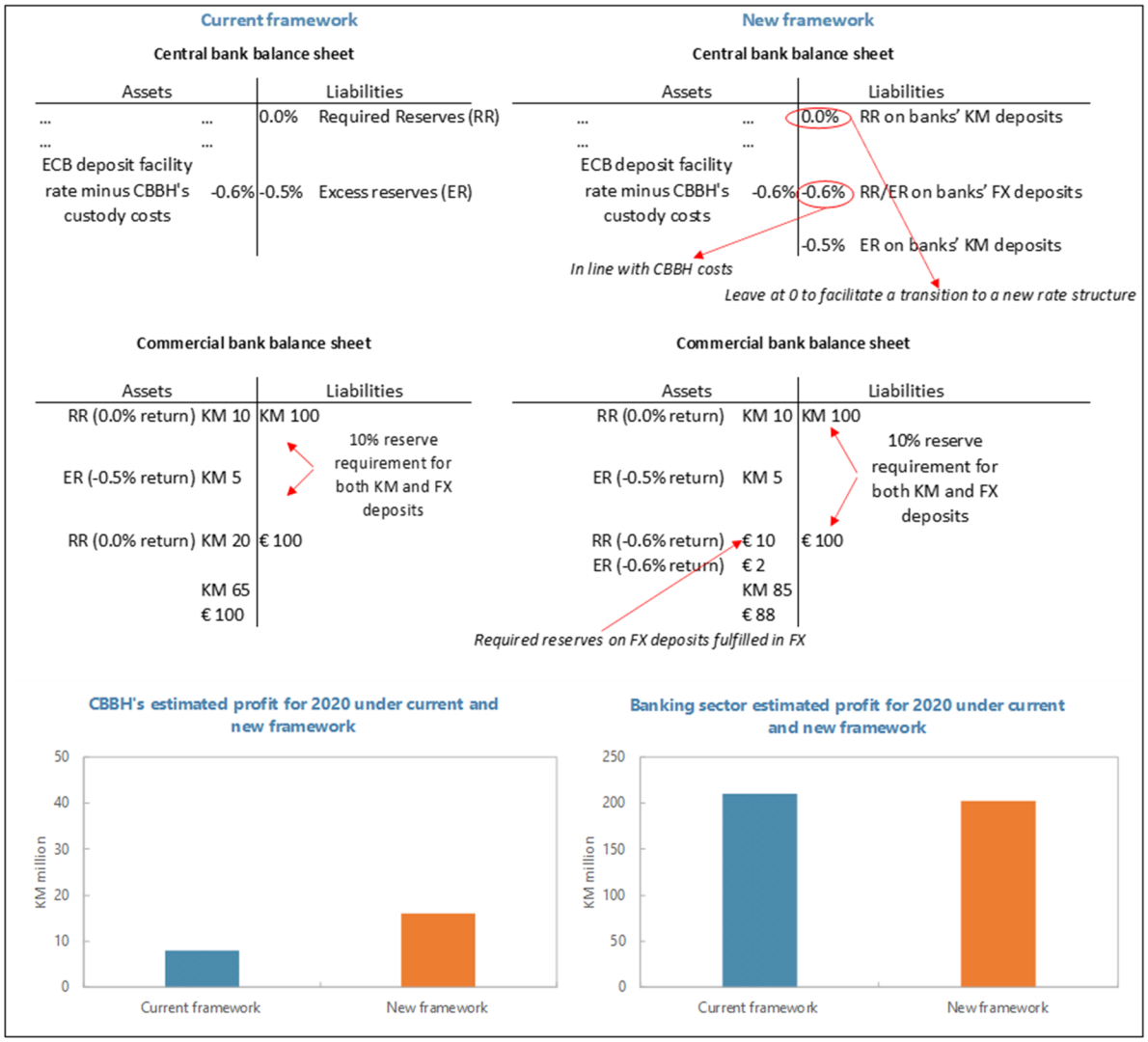
6. The new framework would enable the CBBH to better fulfill its objectives. The CBBH conduct monetary policy more effectively within the restrictions of the CBA by applying differentiated policy levers. Over time the new RRF would encourage a substitution of funding in foreign currency with funding in KM—especially if the KM risk premium were raised over time. This would contribute to the overall stability of the financial system.

7. The transition to the new RR framework is not expected to have adverse implications for the financial system. Banks' capitalization would not be affected, while the impact on banking sector profitability is likely to be minimal, depending on how the KM risk premium and the ER penalty are set. Under the proposal, the CBBH would gain marginally (KM8 million) because it would stop remunerating banks for FX reserves above its own opportunity cost.[2] This would also improve the coverage ratio of the CBA over time. To the extent that there were capital outflows, they would

[2] MCM also recommended that the CBBH charge banks at cost for the conversion into FX and vice versa.

likely be limited and manageable. Modernization of the RR framework is not likely to have major impact on credit growth. A gradual approach to fulfilling FX reserves in FX would give banks time to adjust their FX positions.

Figure 2. Stylized Central Bank and Commercial Bank Balance Sheets and Profit under the Current and New Reserve Requirement Frameworks



Annex VIII. Reforming Public Enterprises[1]

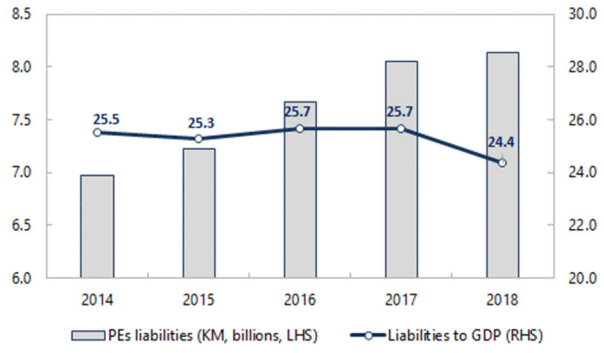
1. PEs are a large drain on the BiH's economy, impacting negatively fiscal sustainability, labor markets, and competitiveness. There are no accurate, up-to-date, and publicly available datasets on the PE sector, however, it is estimated that some 550 companies exist with majority public ownership. Staff analysis covering 414 PEs with data shows that PEs employ about 80 thousand workers (11 percent of employment), own about 40 percent of country-wide fixed assets, account for 10 percent of turnover, and hold 17 percent of total liabilities and 35 percent of tax arrears (2018 data). More importantly, the return on assets and equity of PEs is close to zero meaning that they do not contribute significantly to the economic growth.[2]

2. PEs control assets representing 91 percent of GDP. Fixed assets (property, plant, and equipment) comprising 62 percent of PE assets. PEs are not properly classified (some should be part of general government), and thus some infrastructure assets are attributed to PEs (highways, roads, railway infrastructure, etc.), which has resulted in the highest ratio of PE assets to GDP in the region (Richmond, 2019). In addition, the Supreme Audit Institution (SAI) stated that these assets are likely overvalued and issued qualified audits whereas external auditors surprisingly issued unqualified audits.

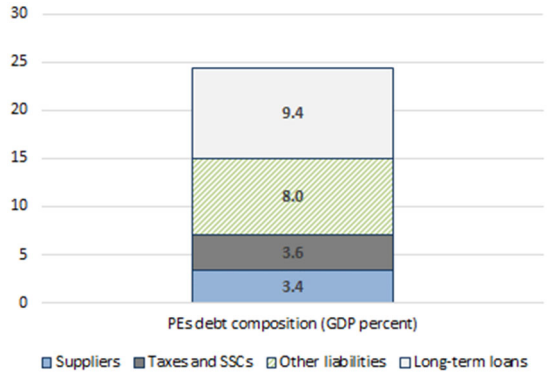
3. The liabilities of PEs have been growing steadily. At end-2018, unconsolidated PE debt totaled roughly a quarter of GDP. About half is held by transport PEs (highways and railways), with electricity and mining companies holding more than 20 percent. In addition to liabilities for taxes and contributions, there is a significant share of liabilities towards suppliers (about 4 percent of GDP). Due to data limitations, arrears data is not available, but most of the tax and some of the suppliers' liabilities are likely arrears that impact the economy negatively.

Figure 1. PE Liabilities, 2014-18

Although liabilities are falling relative to GDP, they have been growing steadily in nominal terms and exceed KM8 billion.



Governments at various levels provide implicit support in the form of tax and social security contribution arrears.



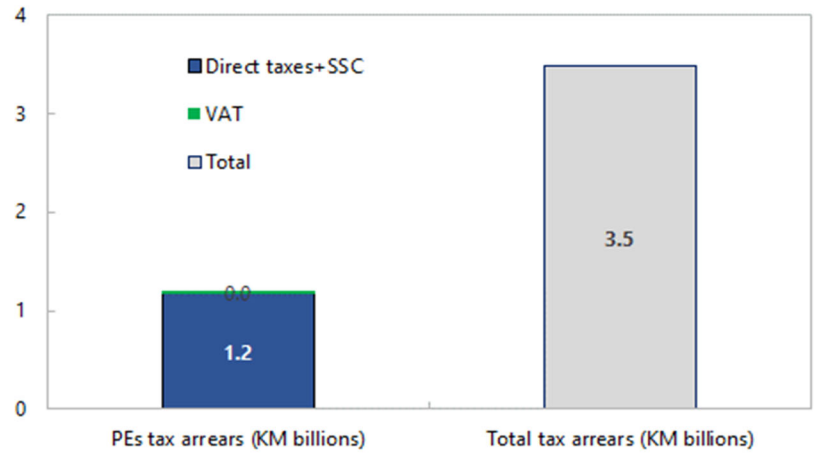
[1] Prepared by Bobana Cegar based on Cegar and Parodi, IMF WP/19/201 (source of charts) and FAD TA.

[2] In the set of companies, there are few natural monopolies for which it might be justified to run losses.

4. PEs have accumulated significant tax arrears. PEs are among the largest tax debtors, accounting for a third of tax arrears. Most are "missing contributions" to the health and pension funds, which impact their sustainability. These arrears accumulated over years, because the government tolerated this type of "financing".

Figure 2. PE Tax and SSC Arrears, 2018

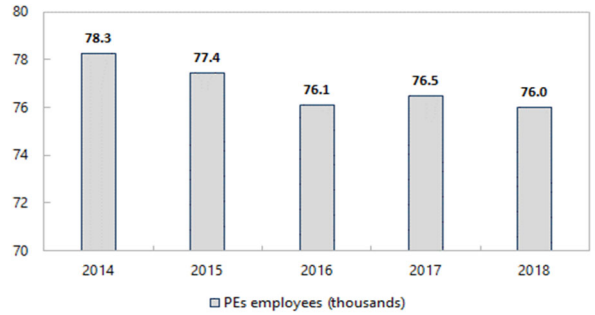
Governments at various levels provide implicit support in the form of tax and social security contribution arrears.



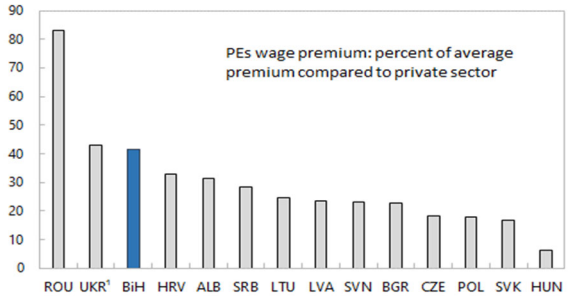
5. PEs distort labor markets. Employment in PEs is around a quarter of public-sector employment and 11 percent of total employment. A few large PEs, such as railways and mines, have significantly reduced their workers, but this was mostly off-set by other PEs that increased employment. Most PEs are believed to have excess employment and some staff without adequate qualifications; often with political connections. The average salary in PEs is 40 percent higher than in the private sector, despite lower worker productivity and profitability (Richmond, 2019).

Figure 3. PE Employment, 2014-18

Railways and mines reduced the number of employees in 2018. Most other companies are increasing their number of workers.



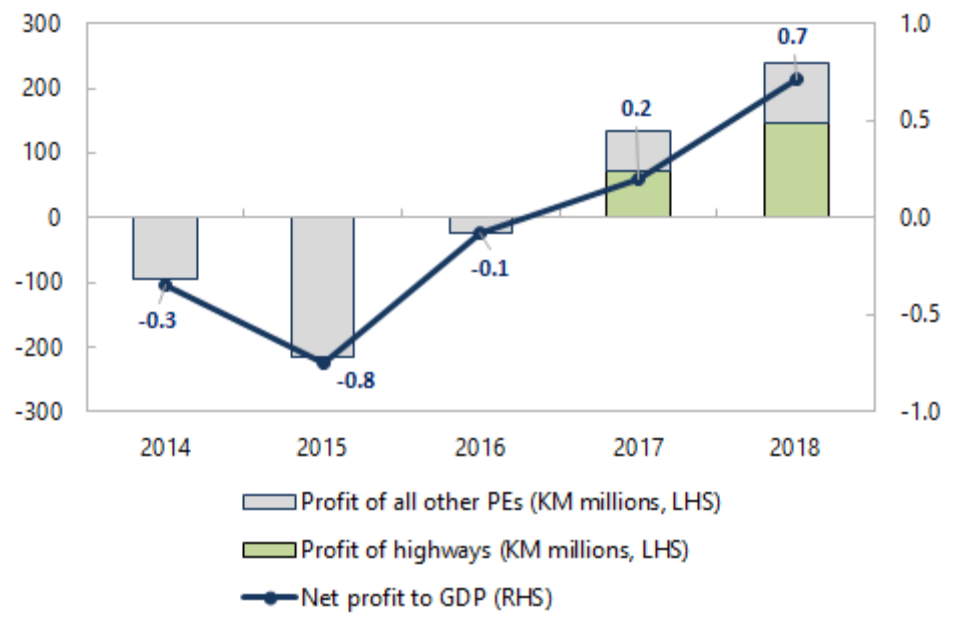
The high wage premium in the PE sector does not reflect higher worker productivity.



6. Although the PE sector recorded a marginal profit in 2017-18, this result is misleading. The result is over-reported because earmarked budget transfers are counted as revenues. For example, the highway companies are mostly financed by earmarked excise taxes, which doubled in 2018, resulting in high profit. On average, true profits for PEs were negative over the past 5 years, though with some improvement in recent years.

Figure 4. PE Profits After Taxes, 2014-18

Earmarked fuel taxes were the main source of profit in the PE sector in 2018. Without earmarks, the sector would have lost money on average over the past 5 years.



7. Total dividends paid by PEs are less than budget support. In 2018, 23 PEs paid dividends totaling KM226.3 million, or 0.7 percent of GDP. by Three PEs paid 93 percent following the government's decision to use PE funds for road infrastructure.[3] By contrast, PEs received direct budget support, in the form of subsidies and capital transfers (including earmarks), totaling 1.5 percent of GDP.

8. Illiquid, indebted, and unprofitable PEs do not contribute to economic growth and represent large fiscal risks. Almost half of PEs have a liquidity ratio below 1, signaling difficulties in meeting short-term liabilities. It is unlikely that PEs can reduce high debts without government support. During 2016-2018, PEs' over-estimated return on equity (ROE) averaged just 0.5 percent: a negligible return. If PEs averaged just 4 percent ROE (as Swedish PEs do, which is considered moderate risk), GDP would be almost 3 percent higher.

[3] Most likely, these payments should be considered super-dividends and be recorded as financing.

Figure 5. PEs Risk Analysis, 2016-18

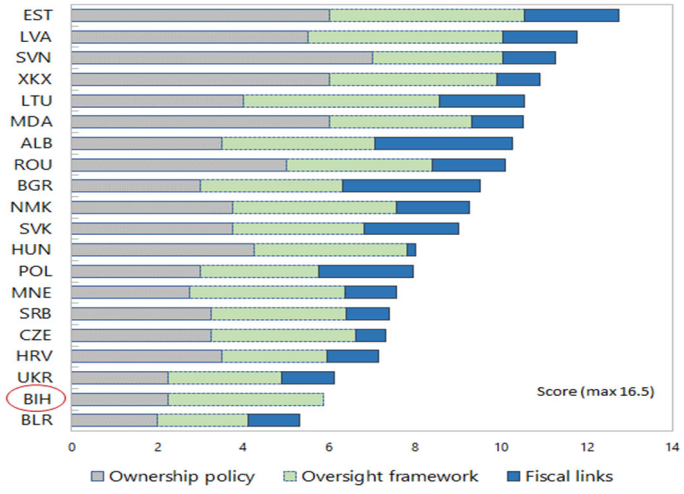
The PE sector is not contributing enough to the economy. Financial indicators mostly show very high risk or indicate low levels of efficiency.

Indicator	Sound	Low risk	Moderate	High risk	Very high risk	BiH SOEs 2016	2017	2018	Average
Liquidity = Current assets / Current liabilities	> 2	1.5 - 2	1.2 - 1.5	1 - 1.2	< 1	0.8	0.8	0.9	0.8
Leverage = Liabilities / EBITDA	< 1.5	1.5 - 2	2 - 3	3 - 5	< 5	7.8	7.7	6.1	7.2
ROE = Net profit / Average equity * 100	> 15%	8% - 15%	0% - 8%	-10% - 0%	< -10%	-0.1	0.3	1.2	0.5

9. PE governance falls short of WB and OECD guidelines and ranks low in the region. There are no ownership policy documents that outline the rationale for government ownership, or operational and financial objectives. Financial and operational performance evaluations should be conducted by dedicated units at the entity level. Audited financial statements are not published regularly, and the entity governments do not produce aggregate PE reports for submission to parliament. There are no formal policies defining how sizeable government support to PEs should be conditioned. Direct subsidies and loan guarantees to PEs are granted without any explicit requirements to improve performance. Furthermore, there are no formal dividend policies. The appointment of managers and oversight boards should occur on staggered scheduled and be disconnected from political criteria. Audit quality and frequency should be improved. These reforms would help to improve governance and reduce corruption vulnerabilities.

Figure 6. Composite PEs Governance Index, 2018

While the index cannot be used to evaluate actual implementation of policies, it can be used to assess gaps in legislation and policies underpinning the PE governance framework.



PRESS RELEASE

PR[YY/XX]

Appendix I. Draft Press Release

IMF Executive Board 2020 Article IV Consultation with Bosnia and Herzegovina

FOR IMMEDIATE RELEASE

Washington, DC – [February 24, 2021]: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Bosnia and Herzegovina.

Before the start of the COVID-19 pandemic, the macroeconomic situation was stable, and the outlook was favorable. The BiH was able to achieve macroeconomic stabilization and improve internal and external imbalances. Some important structural reforms were implemented under the government program supported by the 2016 EFF. Growth in economic activity was nearing its potential, supported by rising public infrastructure investments and external demand. But economic growth was below the pace needed to speed up convergence with the European Union. The unemployment rate, while declining, remained high among youth and women.

The pandemic has had severe adverse effects on the economy and the population. Following stabilization of daily cases during pervious summer, daily infections have been at high levels since the onset of the second wave, and the death rate has been particularly high. Economic activity has been severely impacted by the health restrictions put into place to contain the pandemic, which led to a substantial contraction in demand. Tourism has been brought to standstill and remittances from abroad plummeted.

Fiscal buffers accumulated in recent years enabled a rapid and strong fiscal response to the pandemic and its aftermath. Related measures included substantial support to the health sector, sizable financial support to severely affected firms, and increased unemployment spending. In addition, loan moratoria were introduced to ease liquidity constraints and credit guarantees have been put in place to help reduce borrowing costs and ensure continued flow of bank credit to hard-hit sectors.

The authorities have made some progress in improving the business environment and enhancing the functioning of labor market. However, institutional weaknesses particularly at the State level, a weak rule of law, poor, public infrastructure quality, and delays in implementing key regional connectivity projects remain the key factors undermining the country's attractiveness to private sector development and foreign investments.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Bosnia and Herzegovina: Selected Economic Indicators

	2017	2018	2019	2020 Est.	2021 Proj.
Nominal GDP (KM billion)	31.4	33.4	35.3	33.2	34.8
Gross national saving (in percent of GDP)	16.2	17.7	18.5	18.4	16.5
Gross investment (in percent of GDP)	21.1	21.1	21.6	21.9	21.5
			(Percent change)		
Real GDP	3.2	3.7	2.8	-5.5	3.5
GDP Deflator	1.7	2.7	2.6	-0.4	1.1
CPI (period average)	0.8	1.4	0.6	-0.6	1.2
Money and credit (end of period)					
Base Money	12.4	10.3	6.9	0.3	6.2
Broad Money	9.5	8.8	8.7	1.1	6.3
Credit to the private sector	7.3	5.6	6.3	-1.2	6.4
			(In percent of GDP)		
Operations of the general government					
Revenue, *of which* :	42.3	42.7	41.7	41.0	41.0
Taxes	22.3	22.9	23.0	21.9	21.8
Social security contributions	14.9	15.1	15.1	15.9	15.7
Expenditure	40.5	41.0	40.4	46.6	45.4
of which : Investment expenditure	3.5	3.6	3.5	4.8	4.7
Net lending	1.8	1.7	1.4	-5.6	-4.5
Net lending, excl. interest payment	2.6	2.4	2.1	-4.8	-3.6
Total general government debt	39.2	34.3	32.4	38.3	38.6
Domestic general government debt 1/2/	13.3	9.8	9.4	12.2	13.6
External general government debt	26.0	24.5	22.9	26.2	25.0
Balance of payments			(In percent of GDP)		
Exports of goods and services	41.0	42.4	40.5	37.8	39.1
Imports of goods and services	57.3	57.2	55.2	50.5	53.5
Trade balance	-16.2	-14.7	-14.7	-12.7	-14.4
Current transfers, net	12.2	12.0	11.7	9.3	9.7
Current account balance	-4.8	-3.3	-3.1	-3.5	-4.9
Foreign direct investment (+=inflow)	3.4	2.9	1.9	1.4	1.3
Gross official reserves (Euro million)	5,411	5,956	6,455	6,730	6,530
(In months of imports)	6.6	7.2	9.0	8.5	7.9
(In percent of monetary base)	112.2	112.0	113.5	118.0	107.9
(In percent of IMF ARA metric)	101.8	102.8	107.2	118.1	110.7
External debt 3/	72.0	64.4	64.3	76.0	69.5
Memorandum Items:					
Unemployment rate (national definition)	20.5	18.4	15.7	--	--
GDP per capita (in euros)	4,784	5,146	5,467	5,181	5,445
Output gap (in percent of potential GDP)	0.0	0.5	0.4	-3.1	-2.9
REER (Index 2000=100)	85.6	86.5	85.1	84.6	--
NEER (Index 2000=100)	110.8	113.0	112.9	114.8	--

Sources: BiH authorities; and IMF staff estimates and projections.

1/ On average, half of the domestic debt stock is indexed to the Euro.

2/ The stock of general government domestic debt does not include domestic arrears and

3/ Includes inter-company loans in private external debt.