



Bosnia and Herzegovina

Highlights

- **Growth is moderating in 2023.** Following robust acceleration in 2022, output growth slowed significantly in the first half of 2023, due mainly to worsening net exports, as external demand has been continuously weakening.
- **Some missing parts of the legal framework for renewables have been completed.** The adoption of a set of energy laws in the Federation of Bosnia and Herzegovina (FBiH) streamlines administrative procedures for the construction and operation of renewable energy facilities and reforms the incentives system for renewable energy. Similar laws are already in place in the Republika Srpska (RS) entity.
- **The government has approved the draft National Energy and Climate Plan (NECP).** The draft NECP is aiming for a carbon emissions trading scheme by 2026, taking into account the European Union (EU)'s upcoming Carbon Border Adjustment Mechanism (CBAM), and sets the coal power plant shut-off date for 2030.

Key priorities for 2024

- **Long-term growth could be boosted by increasing public investment.** Given the availability of fiscal space and existing infrastructure gaps, the authorities should scale up investments that promote growth and the green economy, in addition to improving the capacity of the public administration to implement public investments.
- **More preparation is needed for the EU's CBAM.** Efforts should be intensified given the country's target to introduce a carbon emissions trading scheme by 2026, including aligning excise rates on fossil fuels with the EU acquis, redirecting fossil fuel subsidies to renewable energy sources, and continuing electricity tariff reforms.
- **Faster alignment of the country's legal framework with the EU acquis is necessary to advance the EU accession process.** Alignment of domestic legislation with the EU should follow the 14 priorities set out by the European Commission, leveraging the reform momentum brought on by the country's fresh candidacy status.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.8	-2.9	7.3	3.8	1.5
Inflation (average)	0.6	-1.1	2.0	14.0	5.5
Government balance/GDP	1.4	-4.6	0.6	0.9	-1.1
Current account balance/GDP	-2.5	-2.8	-1.7	-4.5	-4.3
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.0	-2.6	-3.0	-2.4
External debt/GDP	62.1	66.9	55.5	52.1	n.a.
Gross reserves/GDP	34.5	39.0	40.8	35.3	n.a.
Credit to private sector/GDP	57.2	57.7	53.3	48.1	n.a.

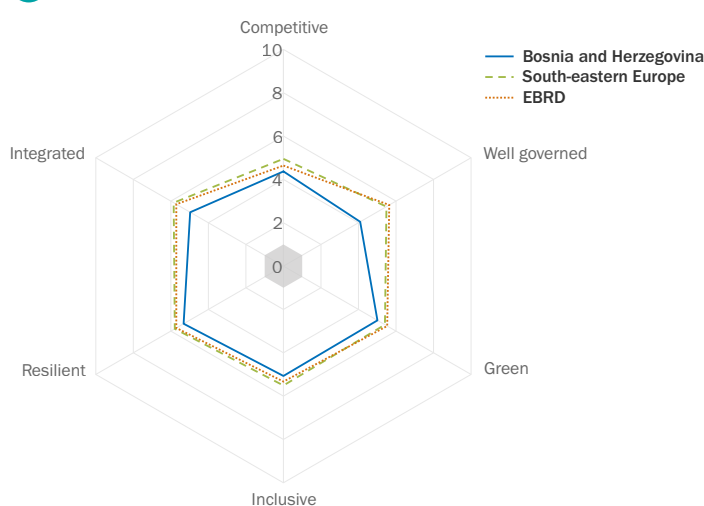
Macroeconomic developments and policy response

Economic growth is slowing. Following robust growth of 3.8 per cent in 2022, the economy expanded by just 1.4 per cent year on year in the first half of 2023, partly due to the slowdown in external demand. As the sizeable industrial sector contracted by 4 per cent in real terms and the net export position deteriorated in the first half of the year, growth was mainly supported by investment on the expenditure side and services (notably retail, tourism and information and communication) on the production side. Mildly negative import growth exceeded export growth (with exports contracting by 4 per cent year on year), and the current account deficit, which doubled in 2022, remained elevated in the first half of 2023. In the face of persistently high inflation, household consumption remained muted despite stable credit growth and consistently high remittance inflows of around 7 per cent of gross domestic product (GDP).

The authorities have used fiscal policy measures to mitigate the effects of inflation. Annual inflation peaked at 17.4 per cent in October 2022 but dropped to 4.1 per cent by September 2023, reflecting global disinflation trends and slowing domestic demand. The authorities continued to employ expansionary fiscal policy in 2023 to protect the population's disposable incomes, including minimum wage increases from the beginning of the year and pension adjustments in both entities, alongside one-off aid to veterans and a cut in wholesale gas prices in the FBiH. Most price control measures have expired, as did the export ban on firewood and pellets in January 2023 and that on logs in July 2023. The central bank increased remuneration rates on required reserves of banks from July 2023, in line with International Monetary Fund (IMF) recommendations and with the goal of narrowing the interest rate gap with the eurozone. A measure limiting retailers' profit margins on essential food and household items was put in place in the FBiH in August 2023, and in the RS in October 2023.

Economic growth is expected to be subdued in the short term, as risks tilt towards the downside. GDP growth is forecast at 1.5 per cent in 2023 and 3 per cent in 2024. The worsening outlook stems from the persistently high inflation rate eroding disposable incomes, the expected further deterioration of net exports due to the ongoing slowdown in the eurozone and other export markets, as well as tighter financing conditions. Domestic political issues are also a risk to the outlook, as witnessed by recent delays to foreign-funded infrastructure projects in the RS. On the positive side, the country's EU candidacy status and relatively quick state- and entity-level government formation may accelerate reforms.

Assessment of transition qualities (1-10)



Structural reform developments

A set of energy laws has been adopted. The FBiH adopted three new laws in July 2023 on: (i) electricity, (ii) energy and the regulation of energy activities, and (iii) the use of renewable energy sources and efficient cogeneration. The laws are set to streamline administrative procedures for the construction and operation of renewable energy facilities, and reform the incentives system for renewable energy so that feed-in tariffs for small plants and feed-in premiums for large plants are determined through auctions. The legislation introduces new categories of participants in the electricity market, such as the “energy community”, the “storage operator”, and the “prosumer” (an entity producing electricity mainly for self-consumption). A similar piece of legislation, the Law on Renewable Energy Sources, is already in place in the RS, but that law allows bidding procedures to determine incentives for larger renewable capacities only. From January 2023 electricity prices in the RS have been pegged to consumption through block tariffs. From June 2023 issuing bodies in the RS can also issue guarantees of origin for electricity, enabling trading in line with EU rules.

The draft NECP has been approved by the government and has undergone public consultation.

The draft NECP takes into account the EU's upcoming CBAM and plans for the introduction of a carbon emissions trading scheme by 2026, while setting the shut-off date for coal power plants at 2030. While the draft plan states there will be no new fossil fuel plants, Tuzla 4 and Kakanj 5, two highly polluting thermal power plants, are set to continue operating beyond their allowed lifetime under the opt-out regime of the EU's Large Combustion Plant Directive, thus breaching the country's obligations under the Energy Community Treaty. Nonetheless, the draft NECP sets an ambitious target for 70 per cent of gross final consumption of electricity to come from renewable sources in 2030 (compared with some 50 per cent in 2022). Public consultation for the document was open until the end of July 2023.

A set of laws related to EU accession has been adopted. The parliament of Bosnia and Herzegovina adopted in August 2023 the Law on the Ombudsman, the Law on Access to Information, the Law on Foreigners and the Law on Wines, while another important piece of legislation, the Law on High Judicial and Prosecutorial Council, was adopted in September. These laws are in line with some of the 14 priorities set out in 2019 by the European Commission in the Opinion on Bosnia and Herzegovina's application for EU membership.

Public enterprise oversight units have been established in both entities. This is an important step for the broader reform of public enterprises, as it should help improve transparency regarding their operations. The RS unit has been up and running since March 2023 but the FBiH unit is yet to be staffed. A registry of public enterprises in the FBiH is available online, now with complete financial reporting, while the RS is working on a roadmap for a comprehensive fiscal risk assessment of public enterprises, according to the IMF.