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Due to the floods, in the autumn round, the Central Bank of Bosnia and Herzegovina significantly revised projections on the medium term economic activity and inflation

Sarajevo, 20. 11. 2024. godine



Brza procjena BDP-a u drugom kvartalu 2024. godine i inflacije u kratkom roku

Key notes:

- The CBBH estimates annual growth of real economic activity in 2024 at 2.4%, which is 0.2 percentage points lower than the April projection, based on expectations of a slowdown in economic activity in the last quarter following the impact of the floods. We expect the effects of the floods to influence the potential GDP, and that the consequences will exceed the current financial losses in the directly affected areas. The projections will certainly be subject to revisions as official high-frequency statistical data arrive, which for October are expected only from the second half of December. At the time of the projections preparation, we had available only estimates of current material and financial damage in the directly affected areas, as well as part of the structural business statistics for 2023.*
- We expect moderate economic growth until the end of the projection horizon. The estimate of real GDP trends for 2025 is 2.6%, and 2.8% for 2026. Although personal consumption slows down significantly due to demographic changes, which significantly reduce the working-age population, and thus available income, it is the main driver of economic growth in the medium term. We expect that personal consumption will be additionally affected by the slowdown in economic activity due to the floods.*
- In 2024, we project inflation of 1.8%, which is 0.8 percentage points lower compared to the round of medium-term projections from April 2024. The correction was made in part due to the officially published data until September 2024, which indicate price stagnation in the utilities costs section, despite increases in electricity prices, and an annual drop in prices in the transportation section. As a result of the floods, we expect an increase in transport prices, which will also affect the prices of food products.*
- We expect the biggest contribution to price growth in the next two years from administrative costs, i.e., core inflation, primarily electricity and transportation prices. Further increases in the price of electricity and transportation may lead to chain increases in the price of services and consumer goods, which could lead to the upward revision of the inflation projections.*

The Central Bank of Bosnia and Herzegovina (CBBH) is publishing the second round of projections of key macroeconomic variables for the period 2024-2026. The previously published medium-term projections (April 2024) for 2024 were 2.6% for the real economic activity and 2.6% inflation. The medium-term projections have been revised, primarily due to the first preliminary assessments of the floods effects, which could lead to a decrease in economic activity, as well as official data published by the time the projections were made. The floods that struck a part of BH in early October caused the interruption of road and rail communication in some parts, which led to disruptions in the transport of raw materials and products. Passenger and cargo railway traffic on the Sarajevo-Čapljina section, which is connected to the port of Ploče, which is very important for BH's imports and exports, has been completely suspended. Also, the damage to the main road has caused disruption in the tourism sector, which is one of the key sectors in the southern part of BH. The narrow fiscal space decreases the possibility of strong fiscal support for economic activity, primarily through infrastructure and damage repair projects in local communities. On the other hand, private donations and international assistance could fill part of these needs, which will also be reflected in the country's current balance of payments position, primarily net inflows through the capital account.

At the time of preparing the projections, we did not have any official high-frequency data that would help us calibrate the effects of the floods. Data for October, such as industrial production, transport or trade, will be available at the earliest at the end of December. We calibrated our expectations of the effects based on information on the number of companies in the directly affected areas, their activity codes, the number of employees and the turnover of these companies in 2023, and information on companies using rail transport and the port of Ploče for the transport of raw materials and products. Based on the limited official information we have collected regarding the effects of the May 2014 floods, it is evident that, although relatively local in nature, the October floods have a significantly greater potential to cause damage to economic activity in the medium term, and that the effects exceed the expected costs of repairing damage on the local road infrastructure and production facilities. Given all of the above, as well as previous experiences with the effects of the 2014 floods on statistical data and their frequent revisions, we expect that the medium-term macroeconomic projections will be revised in the next few rounds.

Table 1 . Selected Macroeconomic Indicators

	Second round of projections in 2024; November						First round of projections in 2024; April				
	Official data in the time of			Projections			Official data in the		Projections		
	2021	2022	2023	2024	2025	2026	2022	2023	2024	2025	2026
	Changes at annual level, %										
Real GDP	7,6	3,7	1,9	2,4	2,6	2,8	3,8	1,6	2,6	2,9	3,3
Inflation (CPI)	2,0	14,0	6,1	1,8	1,9	2,0	14,0	6,1	2,6	2,0	1,7
Personal consumption	4,2	1,9	1,1	2,7	1,8	2,0	1,9	1,6	2,6	4,5	3,9
Government spending	2,9	1,3	2,1	1,8	1,4	0,8	1,3	1,7	1,5	1,0	0,7
Investments	22,7	2,4	2,1	9,0	0,6	4,3	2,4	1,2	0,6	1,5	3,2
Exports	25,4	11,8	-1,2	-0,4	4,3	4,5	12,0	-3,2	1,1	6,2	6,9
Imports	20,6	6,2	-1,3	3,3	1,5	3,3	6,2	-2,4	0,2	6,2	5,8
Average net wages	4,3	12,5	12,5	8,7	4,5	2,6	12,5	12,6	5,5	3,6	2,9
Employees	1,1	2,1	1,2	1,1	0,5	0,3	2,1	1,2	1,9	1,7	1,5
Real property prices	6,4	16,3	15,9	8,2	2,9	1,1	16,6	15,9	6,7	2,7	4,6
Household loans (period end)	5,5	5,2	7,4	8,4	5,8	5,4	5,2	7,6	6,4	4,9	3,9
Corporates loans (period end)	1,8	5,3	6,2	8,2	5,1	4,7	5,3	5,5	4,6	3,9	3,2
M2 (period end)	11,6	5,4	7,7	7,8	8,2	8,3	5,4	7,6	7,9	7,9	8,0
	u %										
Unemployment rate (implicit)	32,4	30,2	29,1	27,4	24,6	23,7	30,2	28,7	27,8	26,3	25,0
NPL (period end)	5,8	4,5	3,8	3,4	3,5	3,7	4,5	3,8	3,6	3,8	4,2
	u % BDP-a										
Personal consumption	67,2	65,9	65,1	65,3	64,7	64,2	67,5	67,5	67,9	68,9	69,3
Government spending	19,1	18,6	18,6	18,5	18,3	17,9	18,5	18,5	18,4	18,0	17,6
Investments	24,7	24,6	25,0	26,6	26,0	26,4	26,6	26,5	25,8	25,5	25,4
Net exports	-11,0	-9,0	-8,7	-10,3	-9,1	-8,6	-12,8	-12,6	-12,1	-12,4	-12,3

Note: The official data used at the time of the projections preparation were as of November 10, 2024, while for the previous spring round the data were as of April 5, 2024. The shares of components in GDP were calculated based on model estimates.

We assess that potential GDP growth has slowed, so that expected economic activity in the medium term is moderate.

The CBBH estimates that the expected growth trend of economic activity will slow down as early as from the fourth quarter of 2024 due to the impact of the floods on the economic activity. Our first preliminary estimate is that the effect of the October natural disaster on capital components could be half of the effects in 2014, their impact on potential GDP being negative.

We assume that economic growth will slow down as early as from the fourth quarter of this year, the real annual growth of economic activity being projected at 2.4% in 2024. The dynamics of moderate economic growth could continue in the period ahead, while below-average growth is

expected compared to the previous decade (3.0%). With regard to convergence towards the average levels of consumption in the EU member countries, this is an unfavourable trend, which can be reversed, primarily, by structural reforms. In the next two years, real annual GDP growth is projected at the rates of 2.6% in 2025 and 2.8% in 2026, which is a significant downward revision, especially for the last year and the projection horizon. Personal consumption, which is the largest macroeconomic aggregate in the GDP structure is estimated to be the main generator of economic growth. Its share in the total GDP in 2024 is estimated at 65.3%, with a slow downward trend in the projection horizon due to a higher contribution of investments, impacted by the record high growth rates in the first half of the current year, but also demographic changes, and expected changes in real disposable income of households. In the previous round of projections, real investments were projected at much lower values. However, with the publication of official data for the first half of the year, real growth of gross investments was 20.4% and this component, based on expert estimates, has been significantly revised in our projections, based on earlier revision practices with the publication of official statistics on national accounts from the third quarter. In previous periods, our estimates of the total investments in the GDP structure, having been revised downwards, appeared to be too optimistic, when the final, official statistical data for the entire year were published. We believe that the revisions come, mainly, from changes in stocks for which the detailed data of lower frequencies are not even published yet.

Inflation for 2024 has been revised downwards to the level of 1.8% and is projected to go further to 2% in the projection horizon.

Inflation measured by the consumer price index, after reaching 6.1% in the last year, slowed down and we estimate that it could be around 1.8% in 2024. We expect inflation rate to continue to move towards 2.0% by the end of the projection horizon. Such inflation growth rates are significantly higher than the average for the period since the official collection of data on consumer prices in BH has started. Compared to the spring round of projections, the annual inflation rate has been revised downwards, by 0.8 percentage points, mainly due to the officially published data until September of this year. The average price growth in the Entities diverges significantly, with consumer price inflation in BH being close to the arithmetic average of inflation by the Entities, regardless of the significantly higher weight of the FBH in total consumption at the state level. According to the data of the Entity Statistics Agencies for September, the annual inflation of 1.3%

was recorded in the Federation of BH and 0.4% in Republika Srpska. In September, the annual inflation rate was 0.8% at BH level.

Official data showed an unexpected stagnation in the category of utility costs, and an annual decline of prices in the transport category. The increase of the electric energy price for households in the FBH and the expected impact of the base effect, mainly in the categories of utility costs and transport, are not clearly expressed in the official data. In the third quarter alone, the utility costs category at the level of BH recorded a very modest annual price increase of 0.8%, while the transport category recorded an annual price decrease of 1.8%. It has been announced that the provisional measures of locking the prices of the basic supplies will be extended by the end of the year, however, the CBBH analyses of the effects of the measures taken so far have not indicated a decrease of headline inflation.

We expect that the increase of the nominal labour price, due to frictions related to the labour supply, the increase of transport prices, and the increase of electric energy prices, will have a slightly stronger impact on the consumer price index trend in the coming period. Additionally, at the end of the projection horizon, a significant effect is expected to result from the growth of prices of the fossil energy based products following the introduction of the CBAM mechanism, according to the regulation of carbon emissions in international trade, which will have a particular effect on major industries such as the production of base metals.

The results of the next round of medium-term macroeconomic projections, with a possible revision of the annual projections of the key macroeconomic variables for the period 2025-2027, is planned for April 2025. Nowcast of economic activity and inflation, which may indicate the direction and intensity of changes of the medium-term projections of real GDP and inflation, will be published at the end of each quarter. The next planned publication of nowcast is scheduled for December 2024.