October 2006
IMF Country Report No. 06/371

Bosnia and Herzegovina: 2006 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Bosnia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with Bosnia and Herzegovina, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 27, 2006, with the officials of Bosnia and Herzegovina on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 27, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October, 13, 2006 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Bosnia and Herzegovina.

The document listed below have been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Bosnia and Herzegovina

Approved by Juha Kähkönen and Scott Brown

September 27, 2006

The 2006 Article IV consultation discussions took place in Sarajevo and Banja Luka during June 13–27. The staff team, comprising Messrs. Demekas (head), Chelsky, Kanda (all EUR), Jahjah (PDR), and Maliszewski (FAD), and assisted by Messrs. Norregaard and Slack, Resident Representatives, and Mmes. Selimovic-Mehmedbasic and Milic at the Resident Representative's Office, met Mr. Paravac, Member of the State Presidency; Mr. Terzić, Chairman of the State Council of Ministers; Ms. Marić, State Finance Minister; Mr. Hadžipašić, Prime Minister, and Mr. Vrankić, Finance Minister of the Federation of Bosnia & Herzegovina (Federation); Mr. Čavić, President, Mr. Dodik, Prime Minister, and Mr. Džombić, Finance Minister of the Republika Srpska (RS); Mr. Kozarić, Governor of the Central Bank of Bosnia & Herzegovina (CBBH); Dr. Schwarz-Schilling, High Representative, and Mr. Butler, Principal Deputy High Representative; and other representatives of the international community, political parties, and the media. Mr. Klein (OED) attended some of the meetings. The mission's concluding statement is available at http://www.imf.org/external/np/ms/2006/062606b.htm.

Two **Financial Sector Assessment Program (FSAP)** missions took place during December 2005 and March 2006, and Mr. Craig (MCM) joined the Article IV mission to discuss its conclusions with the authorities. The main findings of the FSAP are summarized in this report, and the FSSA paper is circulated under a separate cover.

The governance structure created under the 1995 Dayton Peace Agreement is complex and expensive. The DPA created two largely autonomous Entities (the Republika Srpska (RS) and the Croat-Bosniac Federation of Bosnia & Herzegovina, itself divided into 10 cantons) and the tiny District of Brcko, which exercise most of the economic power, as well as a State government, with a limited—but increasing—mandate. This structure causes fragmentation and duplication of many domestic policy functions, aggravated by weak reporting and coordination and low administrative capacity. An internationally appointed High Representative has extensive powers to dismiss elected officials and impose or overrule legislation, but his office will be closed and replaced by an EU Special Representative in mid-2007. Elections for State and Entity governments will be held on October 1.

Negotiations on a Stabilization & Association Agreement (SAA) with the EU started earlier this year. The authorities intend to conclude SAA discussions by year-end, but slow progress in police, media, and other reforms and lack of progress in cooperation with the Hague Tribunal (ICTY) may delay the process.

Despite recent improvements in trade statistics, **poor data quality impedes effective surveillance**, especially in the areas of national accounts and balance of payments statistics.

Bosnia and Herzegovina has not accepted the obligations under Art. VIII, Sections 2, 3, and 4 but maintains restrictions arising from measures taken with respect to frozen foreign currency deposits, mainly on the transferability of balances and interest accrued for nonresidents. Staff does not recommend approval of these restrictions.

Contents | Page

Appendix Figures

Appendix Tables

EXECUTIVE SUMMARY

Bosnia & Herzegovina has enjoyed rapid growth and price stability in recent years, but stronger policy ownership, improved policy coordination, and meaningful progress in structural reform are needed to provide the basis for sustained, private sector-led growth. Postwar reconstruction and expansion of public consumption and investment, financed by international assistance, has supported living standards but has left the economy behind other countries in the region, with an oversized and inefficient government, a large external imbalance, and high unemployment. This year, the temporary gains from the VAT and the forthcoming elections are fueling spending pressures, whose full effect will become evident in 2007; and structural policies are drifting, particularly in the Federation.

The policy discussions focused on the following areas:

- ***Ensuring the sustainability of public finances in the face of emerging spending pressures and still uncertain domestic liabilities***. Staff felt that undoing the incipient loosening of fiscal policy this year and achieving and maintaining a small general government surplus in 2007 and the medium term would help counter domestic demand pressures and support the currency board by contributing to domestic savings. Moreover, notwithstanding recent progress in this area, it would provide a cushion to deal with continuing uncertainties about the cost of settling domestic claims against the government. The authorities agreed with the need for caution but felt that sustained surpluses were unjustified. Looking forward, the governments that will emerge after the October elections would need to accommodate new spending needs, particularly on infrastructure and state-building, while reducing the tax burden.

- ***Improving fiscal governance and coordination***. The recent agreement on a draft National Fiscal Council (NFC) law is welcome, but the political will to adopt and implement it has yet to be proven. Going beyond the NFC law, staff pointed out that effective fiscal governance requires deeper reforms in intergovernmental fiscal relations, and harmonization of the various social safety nets and pension systems in the country. The authorities felt that some of these reforms were premature.

- ***Reducing financial sector vulnerabilities***. The rapid credit growth in recent years has highlighted the need for reliable credit risk assessment by banks, as well as their effective supervision. The authorities and staff agreed on the desirability of unifying bank supervision, but the authorities remain divided on the prospective of the institutional setup. The regulation and oversight of leasing needs to be strengthened.

- ***Strengthening the private sector while improving competitiveness and the external position***. The authorities and staff agreed that the viability of the currency board had to be underpinned by increased domestic savings and stronger external competitiveness. Macro-critical reforms include implementing bankruptcy laws, accelerating corporate restructuring, improving the business environment, and liberalizing labor markets. The authorities did not have an overall strategy to tackle these issues—this task would fall to the governments that would emerge after the elections.

I. Background

1. **Growth has been strong and inflation low over the past several years, and there has been some progress in structural reforms**. Growth has averaged 5 percent annually, and inflation has remained low, underpinned by the currency board. Financial deepening has continued and the banking system has been largely privatized. International reserves are high and rising (Tables 1–2). Customs and indirect tax policy have been unified and a VAT successfully introduced in January 2006. Finally, the general government balance has strengthened by 4 percentage points of GDP during 2001–05 while, at 32 percent of GDP at end-2005, public debt is relatively low. At the same time, an uncertain but potentially large amount of outstanding war damage and other claims against the government continues to be a major threat to fiscal sustainability. Recent steps toward restructuring some of these claims are mitigating these concerns, but risks remain.

2. **These achievements, however, are hostage to fundamental political and economic imbalances**:

- ***Policy coordination is hampered by weak institutions and lack of political will***. Several incidents highlight the ineffectiveness of current coordination mechanisms and the resistance against centralizing key policy functions, notably the controversy over unifying bank supervision and the continuing dispute over the allocation of indirect tax revenue among the Entities and Brcko District, which froze the transfer of funds from the treasury to their budgets for several months this year. In addition, the first attempt at amending the constitution to strengthen core State institutions (notably the Council of Ministers and the House of Representatives) with a view to facilitating policy-making at the State level was narrowly rejected in April.

- ***The external imbalance***, ***while likely much smaller than official estimates indicate (Box 1), is large, reflecting insufficient private savings*** (Tables 3–4). Poor current account data introduce greater-than-usual uncertainties in any quantitative assessment of the level of the real exchange rate. The CPI-based REER has been stable and exports have recently been rising fast and are projected to continue rising, suggesting that there is no major misalignment. But the export base is narrow and vulnerable to commodity price movements, and unit labor costs and other competitiveness indicators are mixed (Figure 1 and Section II.D).

- ***Structural reforms lag behind neighbors' and sustained private sector-led growth has yet to take root***. Bosnia & Herzegovina ranks last among all European transition economies on the EBRD transition index, and the pace of reform is disappointing (Figure 2). In the World Bank's *Doing Business 2007* report, Bosnia & Herzegovina slipped from the 91st to the 95th position. The government is large, wide swathes of the corporate sector remain loss-making, and bankruptcy procedures are not effective. Unemployment is estimated by the World Bank at over 20 percent. Notwithstanding a few large foreign investments in metals and mining, FDI penetration, at less than US$600 per capita, is one of the lowest in the region.

Box 1. What is the True Current Account Deficit in Bosnia & Herzegovina?

Staff has explored, in consultation with the CBBH, two alternative approaches that provide more accurate estimates of the current account deficit than the official estimates (see accompanying Selected Issues paper). A range of plausible estimates is derived *first* by using alternative data for remittances—a key component of the current account—and *second* by estimating the current account from capital and financial account data.

The CBBH estimate of remittances underestimates receipts substantially. This estimate relies on a 2004 household survey. There are, however, indications that remittances are larger and have been increasing in recent years: the most tangible one is a substantial increase in remittances recorded through the banking system. Regional comparisons also suggest remittances in Bosnia & Herzegovina are underestimated. On this basis, staff estimates that remittances are likely to be 3–5 percent of GDP higher than reported by the CBBH. On account of this factor alone, the true current account deficit is lower than the CBBH estimate by at least this amount.

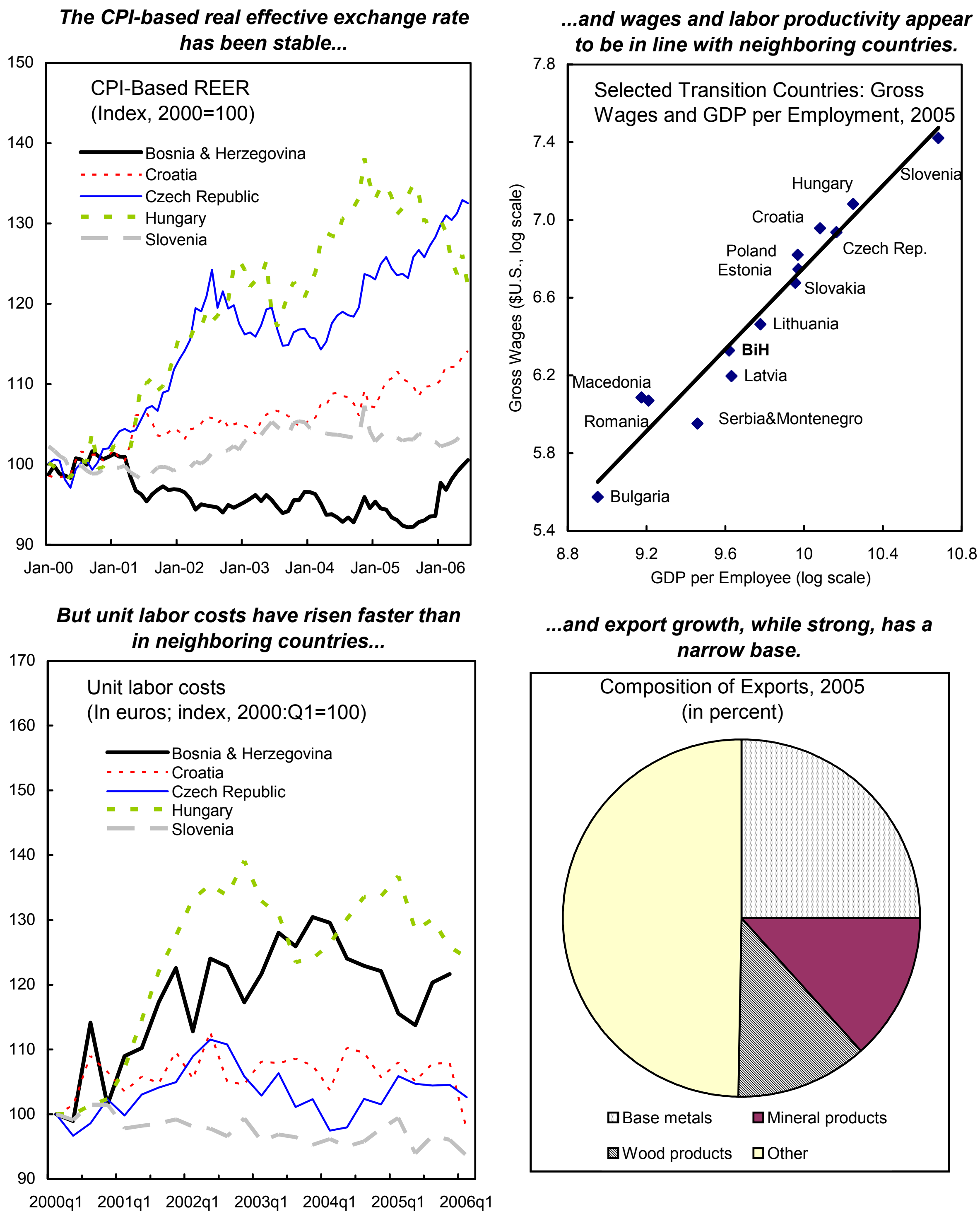
Capital and financial accounts statistics provide an alternative estimate of the current account deficit. Identified capital inflows in recent years amounted to 7–13 percent of GDP annually. This provides a lower-bound estimate of the current account deficit.

These two estimates suggest that the current account deficit is at the range of 7–18 percent of GDP. But the size of the current account deficit relative to the economy is exaggerated by the underestimation of GDP in the national accounts due to sizeable nonobserved activity. While this is a common problem in many economies, the evidence suggests that it is larger in Bosnia & Herzegovina, and may indeed have increased in recent years. Previous staff analysis (IMF Country Report No. 05/198) concluded that GDP in Bosnia & Herzegovina could be 30–50 percent higher than official national accounts suggest, although a recent upward revision in official GDP estimates (by about 10 percent) to capture imputed rent has shrunk this gap. Combining the range of current account estimates with an adjusted GDP suggests that the true current account deficit in Bosnia & Herzegovina has been in the range of 6–14 percent of GDP in recent years.

3. **Recent macroeconomic trends, correcting for the effects of the VAT, underscore these concerns** (Figure 3). Growth is projected to accelerate slightly in 2006 (to 5½ percent) on account of strong consumption, and the current account deficit to improve (from 21 percent of GDP in 2005 to 17 percent this year). The latter projection, however, reflects a large decline in imports in early 2006 following a surge late last year in anticipation of the VAT (Box 2). Correcting for this temporary shift, estimated at about 1¾ percentage points of GDP, as well as for the likely VAT-induced improvement in the statistical coverage of exports, which is harder to quantify, all but eliminates the current account improvement. Underlying inflation—excluding the impact of VAT and administrative price hikes—is estimated at 3–4 percent, slightly higher than last year.

4. **The persistently large current account deficit and the uptick in underlying inflation reflect strong domestic demand**. Demand pressures are fueled by wage growth (7.5 percent in the year to July) and continuing robust credit expansion: following a VAT-related surge in December 2005, private sector credit grew at an annualized rate of 19 percent through July.

Figure 1. Bosnia and Herzegovina: Competitiveness Indicators, 2000-06



Sources: Bosnian authorities; and IMF staff estimates.

Figure 2. Bosnia and Herzegovina: Progress in Structural Reforms, 2003-05

Bosnia & Herzegovina still lags behind neighboring countries...

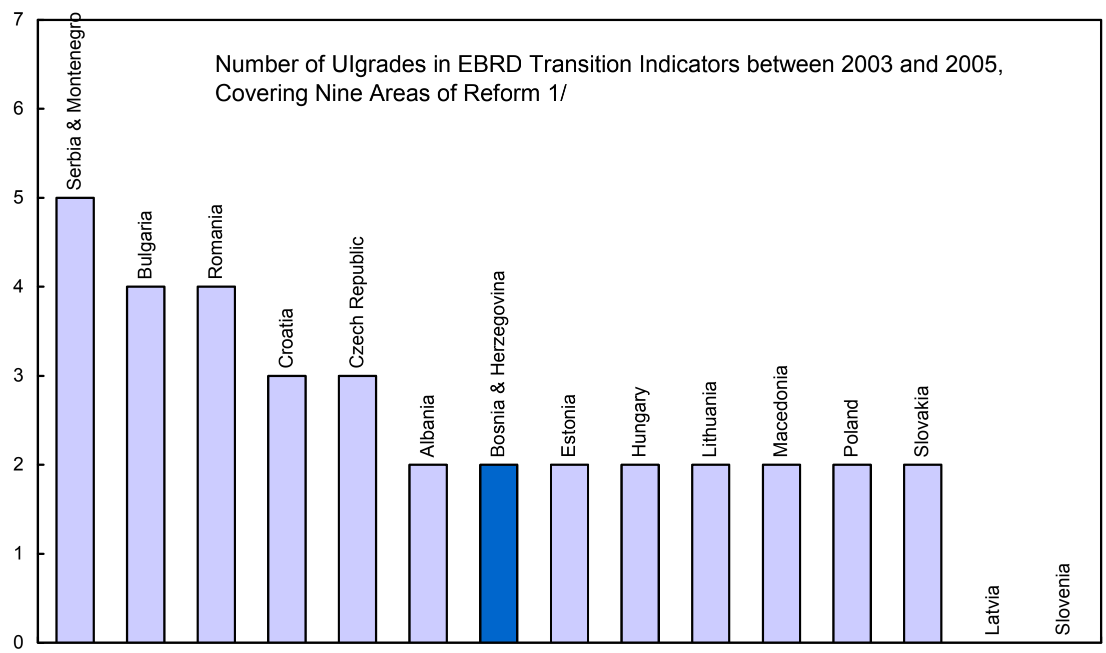
Bosnia & Herzegovina and Selected Countries: EBRD Transition Indicator Scores, 2005

		Enterprises			Markets and Trade			Financial Institutions		Infrastructure
	Private sector share of GDP EBRD midyear estimate (%)	Large-scale privatization	Small-scale privatization	Governance & enterprise restructuring	Price liberalization	Trade & foreign exchange system	Competition policy	Banking reform & interest rate liberalization	Securities markets & nonbank financial institutions	Infrastructure reform
BiH	55	2.7	3.0	2.0	4.0	3.7	1.0	2.7	1.7	2.3
CE/Baltic 1/	76	3.8	4.3	3.4	4.3	4.3	2.9	3.8	3.3	3.2
SE Europe 2/	67	3.3	3.8	2.4	4.2	4.2	2.1	3.1	2.1	2.6

Sources: *EBRD Transition Report* , 2005; and IMF staff calculations of (unweighted) regional averages.

1/ Eight new EU member states: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.
2/ Southeastern Europe (excluding Bosnia and Herzegovina): Albania, Bulgaria, Croatia, Romania, FYR Macedonia, and Serbia and Montenegro.

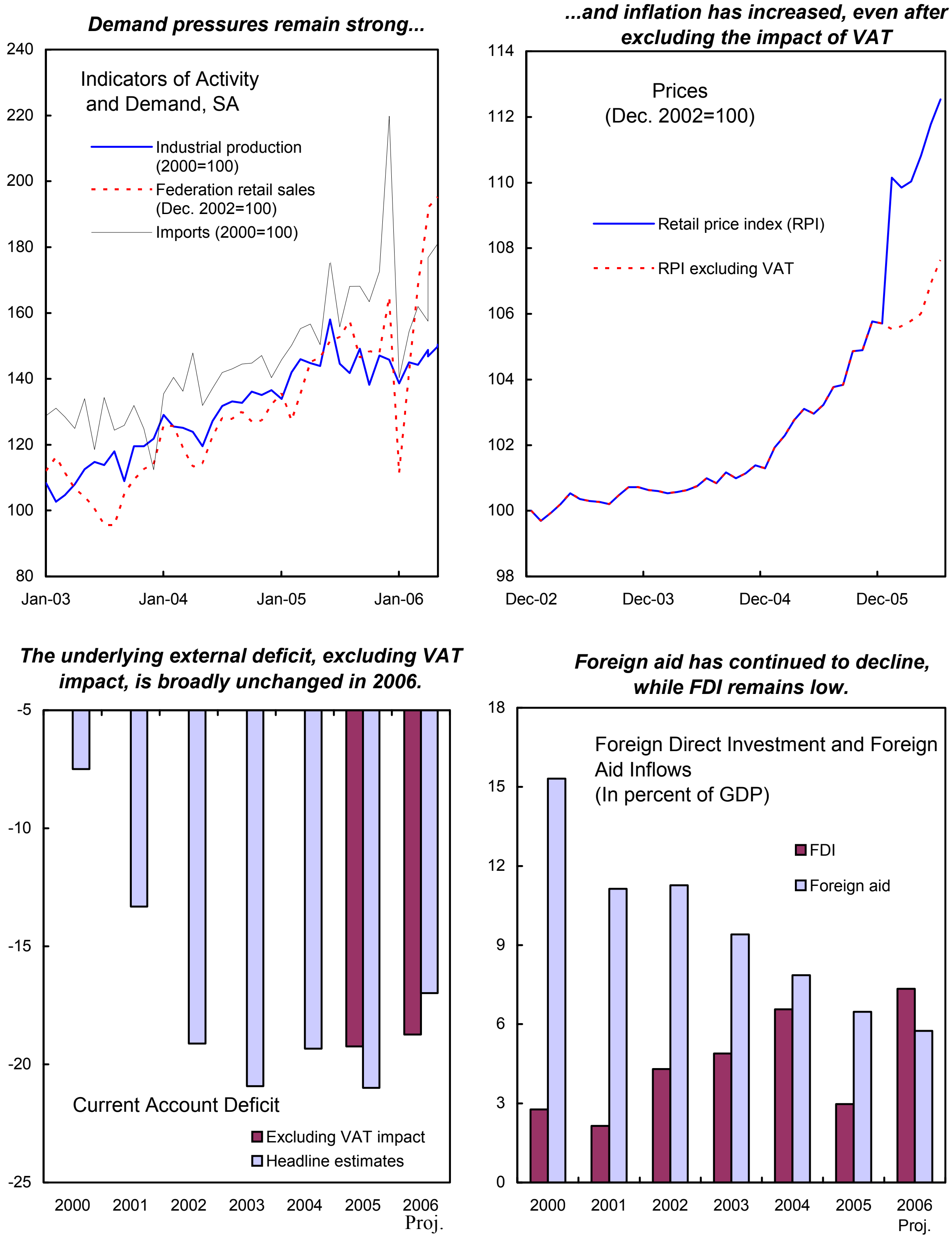
... and the pace of structural reform has been slow...



Sources: *EBRD Transition Reports* , 2003 and 2005; and IMF staff estimates of unweighted regional and category averages. Indicators range from 1 (no reform) to 4+ (standards of an industrialized market economy).

1/ The nine areas are large-scale privatization; small-scale privatization; governance & enterprise restructuring; price liberalization; trade & foreign exchange system; competition policy; banking reform & interest rate liberalization; securities markets & nonbank financial institutions; and infrastructure reform.

Figure 3. Bosnia and Herzegovina: Selected Indicators, 2000-06



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

Box. 2 The Impact of the VAT

On January 1, 2006 the sales tax was replaced by a VAT at a standard 17 percent rate with very limited exemptions. VAT revenue accrues to the Indirect Tax Authority (ITA). The successful introduction of the VAT had manifold effects on the economy.

Consumer prices in July were 8.5 percent higher than their level a year earlier. Staff estimates that the VAT accounts for 3–3½ percentage points of the increase, and the rest reflects underlying inflation and the impact of administrative price increases in late 2005 and 2006.

Imports spiked in December 2005 in anticipation of the VAT and fell drastically in January. This shift in imports, which raised the external current account deficit in 2005 and reduced it in 2006, is estimated at 1¾ percent of GDP.

Exports increased strongly in early 2006 (43 percent in the first seven months relative to the same period last year). Some of this increase probably reflects stronger incentives for accurate reporting by exporters due to the VAT, but the precise extent of this factor is hard to estimate.

VAT collection through July amounted to 9½ percent of GDP compared with 6 percent for the sales tax in the same period last year. However, collection of delayed sales tax from December 2005 was 1 percent of GDP, which will not be repeated next year; and outstanding 2006 VAT refunds and credits another 0.5 percent of GDP, which will be refunded in 2007. The permanent gain from the VAT is thus estimated at about 1 percent of GDP.

5. **After years of successful consolidation, the underlying fiscal stance weakened this year and spending pressures are rising**. After achieving a general government surplus for the first time in 2005, the adopted 2006 budgets—the first to be prepared without intervention by the Office of the High Representative (HR)—targeted a deficit of ½ percentage point of GDP, despite the concerns about fiscal sustainability arising from the outstanding domestic claims against the government (also flagged at the conclusion of the last Article IV consultation). In the event, given the substantial unexpected temporary VAT windfall (Box 2)—and assuming the Entities will not revise their budgets to raise spending—staff estimates that the consolidated general government will again register a surplus in 2006, overperforming the budget targets by a substantial margin. Adjusted for the transitory gains from VAT, however, the outcome would be a small deficit, implying an easing of 1 percentage point of GDP from 2005 (Tables 5–6). Moreover, the VAT windfall and the pre-election environment are generating spending pressures at all levels of government, the impact of which will be felt mostly next year (Section II.A).

Consolidated General Government
(in percent of GDP)

	2005	2006	
	Actual	Budget	Staff est.
Balance	0.9	-0.5	0.7
adjusted for VAT			-0.2
Primary balance	1.5	0.2	1.4
adjusted for VAT			0.4

6. **The financial sector is dominated by foreign banks that, while resilient to a variety of shocks, have contributed to demand pressures by aggressively expanding credit** (Figure 4 and Tables 7–9). The recent FSAP found that foreign banks may be underestimating credit risk and relying on low-cost foreign funding from their parent institutions, and identified weaknesses in supervision and corporate governance (Box 3).

Box 3. FSAP Key Findings

The financial sector is dominated by banks, with total assets at 75 percent of GDP. Foreign-owned banks are the main players, with the six largest holding 65 percent of bank assets.

The dominance of foreign banks minimizes solvency risk and—as stress tests show—enhances the system's resilience to shocks, but raises other concerns. These include possible underestimation of credit risk, as these subsidiaries strive to meet high return on equity targets set by their parents, and reliance on low-cost foreign funding, which diminishes the incentive to mobilize long-term local deposits and raises the risk of contagion from adverse developments in other countries

Supervision is fragmented and has important gaps. The two Entity-based supervisory agencies are weak and subject to political interference. Strengthening is needed in consolidated supervision, loan evaluation, provisioning, and cooperation with foreign supervisors to enhance oversight of foreign-owned banks.

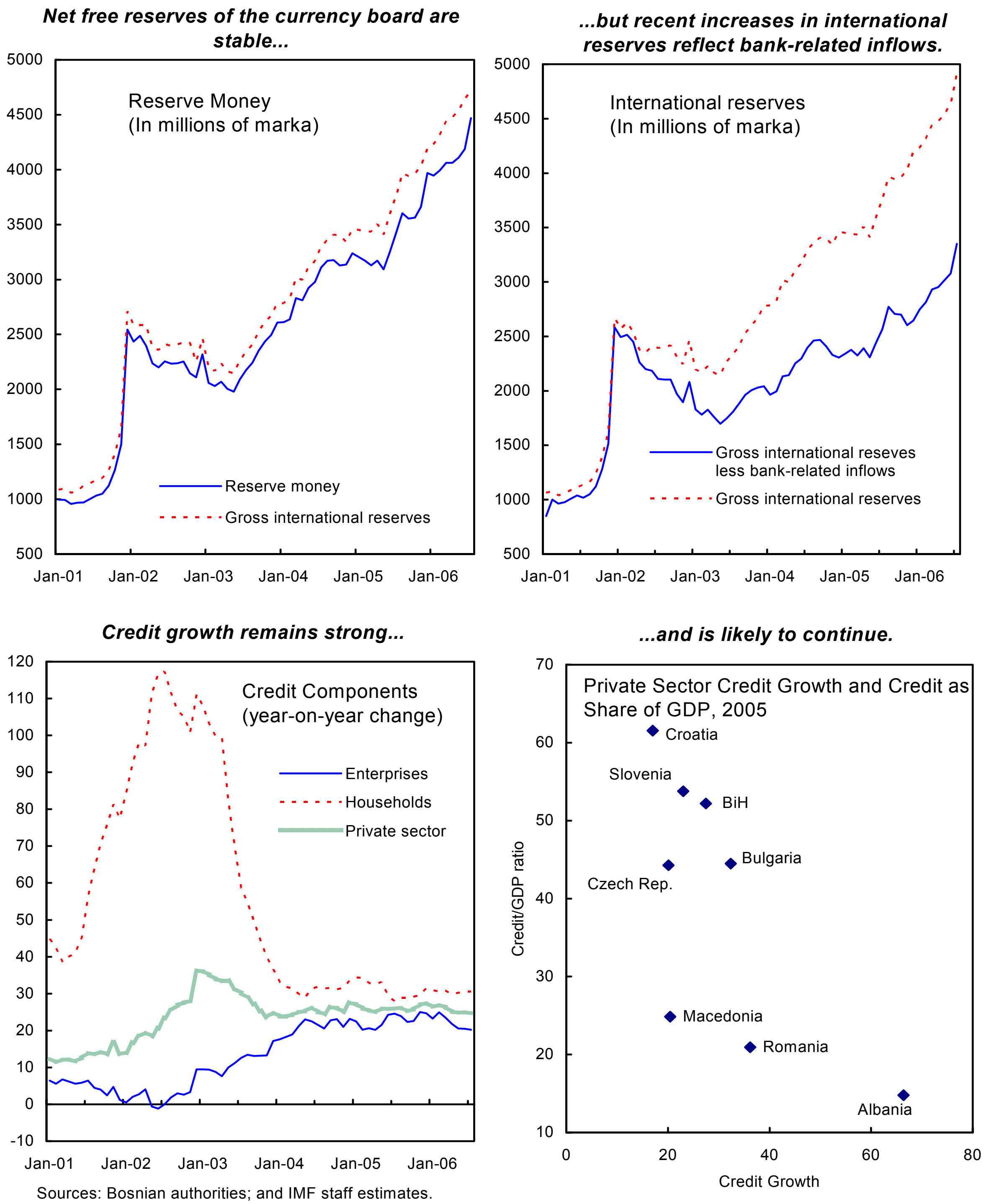
Institutional capacity and corporate governance are poor, even in comparison to neighboring countries. Despite progress in establishing the legal framework for insolvency, contract enforcement, and creditors' rights, implementation is weak. Corporate governance suffers from opaque ownership, lack of accountability of boards and managers, and poor financial reporting and, according to the EBRD, is the least effective in the region. This is evident in the Privatization Investment Funds, which control a substantial share of corporate sector assets.

II. Report on the Discussions

7. **Discussions focused on the need to create the basis for sustainable and dynamic private sector development and broad-based growth**. Bosnia & Herzegovina's growth so far has come mostly from postwar reconstruction and expansion of public consumption and investment financed by international assistance; public enterprise restructuring and private sector development have been neglected. While this approach has supported living standards and spurred much-needed institutional development during the last decade, it has left the economy well behind other countries in the region, with an overweight and inefficient government, chronically loss-making state enterprises, distorted factor markets, high unemployment, and a weak private sector—except in a few pockets, that have been successfully transformed by foreign investment.

8. **Staff's medium-term scenario highlights the risks of continuing on present trends** (Table 10). The main driving force in the baseline (no policy change) scenario is the projected increase of exports, driven by a near doubling of output and exports of aluminum and steel as a result of a few large foreign investments in these sectors during 2003–04. High world prices of metals projected in the near term reinforce the impact on the current account. Hence, with unchanged policies, growth could accelerate to 5½–6 percent annually and the

Figure 4. Bosnia and Herzegovina: Money and Financial Sector Developments, 2001-06



Sources: Bosnian authorities; and IMF staff estimates.

current account deficit decline by some 3 percentage points of GDP by 2009. This outlook seems reassuring: without major additional policy effort, the external imbalance would decline and, toward the end of the decade, the true current account deficit would be in the single digits. Staff, however, pointed out four important downside risks. *First*, this improvement in the baseline current account would be temporary and hostage to world steel and commodity prices: indeed in the outer years, when metal prices decline according to the latest WEO projections, exports would fall, the current account deficit start increasing, and reserves decline. *Second*, absent reforms to improve the business climate, private investment would remain low and income and consumption growth could not be sustained if exports slowed or in the event of other shocks. *Third*, vulnerabilities in the financial sector, which is now underwriting the growth in private consumption, could, if left unaddressed, amplify the impact of possible shocks. *Fourth*, without expenditure adjustment, the fiscal deficit would slowly rise and public debt would remain stuck at relatively high levels. Far from reassuring, the baseline scenario underscored, in staff's view, the fragility of the gains achieved so far and the vulnerability of the economy.

9. **The authorities felt the staff's baseline was too pessimistic**. They pointed out that non-metal export performance had been strengthening and expected this to continue. They argued that the pace of reform would accelerate after the elections, stimulating higher private investment and more broad-based and sustainable growth. And they remained committed to maintaining a prudent fiscal position over the medium term.

10. **Nevertheless, they agreed with staff on the main medium-term policy priorities**:

- ***ensuring the sustainability of public finances*** in the face of emerging spending pressures and still uncertain domestic liabilities;
- ***improving fiscal governance and coordination***;
- ***reducing financial sector vulnerabilities*** that reflected weaknesses in supervision and underestimation of credit risk in an environment of rapid credit growth; and
- ***strengthening the private sector and improving competitiveness and the external position*** through structural reforms.

11. **But a strategy to tackle these priorities has yet to emerge**. The authorities reiterated their commitment to the currency board, which they saw as the cornerstone of the economic stability achieved in recent years, and were aware of the exigencies this posed for policies. But the response to the recommendations of past Article IV consultations has been limited (Box 4) due to poor political cooperation, fragmented institutions, weak administrative capacity and—this year—absorption with the forthcoming elections. These factors have also prevented the development of a comprehensive medium-term strategy. The SAA currently under discussion with the EU and the prospect of eventual membership, though unanimously supported, have so far failed to act as a focal point for policies.

Box 4. Implementation of Past Fund Policy Advice

The last Fund arrangement expired in February 2004. Since then, there have been two Article IV consultations (http://www.imf.org/external/pubs/scr/2004/cr0467.pdf, http://www.imf.org/external/pubs/scr/2005/cr05199.pdf) with broadly similar conclusions.

Fiscal policy. The general government maintained a small primary surplus in 2005 and 2006, but the underlying policy easing in 2006–07 is inappropriate. There has been some progress toward settling domestic debt this year, but major risks remain (Section II.A). There has been no progress toward identifying expenditure savings to reduce the tax burden and accommodate future spending needs.

Fiscal governance. In recent months, the authorities reached agreement on a draft National Fiscal Council law—a key Fund recommendation. Despite some shortcomings (Section II.B), the draft is an important step forward. But the timetable for its adoption has drifted, raising questions about the political will to implement it.

Structural reform. Corporate restructuring and privatization have been slow: they have moved forward in the RS but have ground to a halt in the Federation. Indeed a recent Federation law on debt write-offs is a step backwards. Consistent with Fund advice, the Federation government abolished minimum wage indexation; however, there has been little progress toward rationalizing labor market regulations to facilitate worker mobility. The business climate remains inimical to investment.

12. **Against this background, discussions focused on (i) identifying immediate steps that could stop the policy drift this year, and (ii) outlining the policies that could start addressing the medium-term priorities**. The latter could be of use to the governments that will take office after the October elections. With the closure of the Office of the HR next year, these will for the first time have full responsibility for governing the country.

A. Fiscal Policy

13. **The authorities saw the budget targets for 2006 as appropriate and, despite election pressures, feasible**. The governments in both Entities and the State acknowledged that pressures were mounting, as indicated by recent legislative initiatives to expand social benefits, proposals to introduce exemptions to the VAT, and wage increases granted at lower levels of government, particularly in the Federation (which the Entity government could do little to stop in the highly decentralized Federation setup). Both Entity governments, however, stressed that they would not revise their own budgets before the elections. On this assumption—as also suggested by staff projections—the consolidated outcome for the year as a whole would be a small surplus.

14. **In staff's view, more ambitious fiscal targets were needed**. Staff pointed out that the projected outcome this year reflected mostly the temporary VAT windfall; without it, the general government balance would show a sizeable deterioration from 2005. Looking ahead, the payment in 2007 of delayed VAT refunds, the continuing erosion of trade tax revenue as a result of ongoing liberalization, and the permanent effect of any spending increases granted this year would put significant pressures on the budget. Staff estimated that, if left unchecked, these factors would generate a consolidated general government deficit of 1½–1¾ percent of GDP in 2007, a cumulative deterioration of some 2½ percentage points

since 2005. Although this deficit was still low by international standards, in staff's view a fiscal correction was needed for two reasons:

- ***Fiscal policy is the only macroeconomic instrument that can counter domestic demand pressures and redress the large external imbalance***, given the currency board and open capital account. Indeed staff econometric analysis (see accompanying Selected Issues Paper) suggests a strong impact of fiscal expenditure on the current account deficit.

- Despite recent progress, ***significant uncertainties remain about the future burden of settling domestic claims against the government*** (Box 5), arguing for a cautious policy stance, at least until the situation is clarified.

Box 5. Domestic Claims Against the Government

Following Constitutional Court decisions in December 2004 and April 2005 that invalidated laws restructuring domestic claims against the governments (IMF Country Report No. 05/199), the authorities have taken a number of steps.

- In April 2006, a State law was approved settling some KM 1.9 billion of claims arising from **frozen foreign currency deposits** with a combination of cash payments in 2006 and 2007 and bonds of up to 13 years' maturity to be issued in 2007–08 at an interest rate of 2.5 percent

- The RS has passed legislation to settle **war damage claims** capped at KM 0.6 billion, by issuing bonds of up to 35 years' maturity by 2008 with a 25-year grace period at an interest rate of 1.5 percent. The Federation recently passed a similar law, setting the limit at KM 0.9 billion (although actual claims are estimated at about half that) and issuing bonds with slightly longer maturity, a 13-year grace period, and an interest rate of 2.5 percent

- **General liabilities** of KM 0.2 billion in the RS, including wage and other arrears, would be settled through 25-years bonds issued by mid-2007, with a 15-year grace period at an interest rate of 1.5 percent. These liabilities are negligible in the Federation, and the government is settling them in cash.

- The terms of settling **restitution** claims are still unclear and their size is potentially very large. In a draft law under preparation, the authorities have indicated that they intend to maximize restitution in kind and cap monetary compensation at KM 3 billion. But the preparation of the law has been very slow.

Under plausible assumptions, domestic claims under the first three categories would increase government debt by about 25 percent of 2005 GDP and generate average annual debt service (principal and interest) of about 1 percent of GDP over the medium term. However, there are pressures for more favorable terms, as illustrated by amendments to the frozen foreign currency deposit law recently approved by the House of Representatives, and now awaiting approval by the upper house; while the size of restitution payments remains uncertain.

15. **Staff argued in favor of a small general government surplus over the medium term**. From the point of view of short-term macroeconomic management, the priority was to

withdraw as soon as possible the fiscal stimulus generated by the policy drift this year. From a medium-term perspective, as the staff's debt sustainability analysis indicates (Appendix I), a small surplus (¼–½ percentage point of GDP) would steadily reduce the public debt ratio after taking into account the estimated impact of settling domestic claims. Staff pointed out that (i) reducing, rather than just stabilizing public debt would insure against the considerable uncertainties still surrounding the size and settlement terms of domestic claims; and (ii) a longer-term debt sustainability analysis (see accompanying Selected Issues paper) reveals that the concessionality of existing government obligations will lapse over time, requiring a larger debt-stabilizing primary balance than during the initial five years.

16. **Maintaining small fiscal surpluses would involve tough political choices**. This year, it would require keeping spending in line with the budgets, especially on wages, maintaining spending discipline across all levels of government, and rejecting proposals for exemptions from the VAT. In 2007 and the medium term, it would require identifying sizeable savings. These would be necessary not only to bring the fiscal balance to the required level but, more important, to lower total spending—matched on the revenue side by lower labor taxes—and, within this shrinking envelope, accommodate emerging spending needs. Plans to expand the State administration, prepare for eventual EU membership, and raise public investment will lay increasing claim on government resources, totaling—according to the World Bank's Public Expenditure and Investment Review—some 2–3 percentage points of GDP annually by 2010. In staff's view, savings of this magnitude could be found by rationalizing the wage bill, better targeting subsidies and transfers (one-third and one-quarter of total spending, respectively), and reducing inefficiencies and duplication of government functions.

17. **The authorities, however, were noncommittal**. They agreed that the uncertainty about domestic claims was the biggest threat to fiscal sustainability, and therefore justified a more cautious approach to fiscal policy; but they considered chronic fiscal surpluses economically unjustified and politically unsustainable. They stressed the need to raise public investment on infrastructure, especially roads, but were not in a position to discuss offsetting expenditure cuts, preferring to defer this debate to the governments that would emerge after the elections.

B. Fiscal Governance

18. **The recent intergovernmental agreement on a draft National Fiscal Council (NFC) law was a major step toward improved fiscal policy coordination**. According to the draft law agreed by the governments at end-June, the NFC comprises the three Prime Ministers and three Finance Ministers of the State and Entities, with the CBBH Governor, Mayor of Brcko District, and ITA Chairman as observers. It is tasked with adopting annually a rolling three-year fiscal framework with aggregate targets for the consolidated budget, as well as for the budgets of the State and Entities, including indirect revenue projections. Decisions require the support of five of the six voting members, including at least one representative of each ethnic group (Bosniac, Croat, Serb). If agreement cannot be reached on a budget target, the governments are obliged to continue using last year's budget allocations. If a government violates the agreed framework, it would be obliged after 60 days

to place an amount equal to one-tenth of the deviation in escrow, to be used exclusively for paying domestic debt.

19. **Staff welcomed the draft law despite its shortcomings, but noted that the timetable for its implementation was unclear**. Compared to international experience (Box 6 and accompanying Selected Issues paper), the draft law seems to provide a strong institutional mechanism for coordination, with clear—though perhaps too demanding—voting and deadlock-breaking rules. But the penalties that are envisaged to enforce compliance are weak, and the definition of the consolidated budget balance excludes most capital spending. More importantly, the timetable for its implementation was unclear, and recent statements raised questions about the political commitment to adopt it.

Box 6. International Experience with Fiscal Coordination Mechanisms

Research drawing on the experience of Austria, Australia, Belgium, Brazil, South Africa, Switzerland, and the EU shows that there are different approaches to fiscal coordination; all involve **fiscal rules** or **independent fiscal institutions** or a combination of the two:

- **Countries with fixed exchange rates** require stricter rules and stronger institutions than those with flexible exchange rates.

- Successful coordination requires a unified budget calendar, consistent accounting rules, and regular fiscal reporting across all levels of government.

- The effectiveness and credibility of any coordination mechanism depends on the existence of **penalties**, as well as the **ability and willingness to enforce them**. The strongest mechanisms impose penalties automatically on those governments violating the agreed policies. Such penalties can be waived only by a majority vote.

- In most cases, the total level of public spending and the aggregate balance are decided at the national level and the responsibility for enforcement of penalties rests with the national government. The distribution of revenue, spending, and the aggregate balance is negotiated between national and subnational governments.

- Fiscal rules and independent fiscal institutions are necessary but not sufficient to guarantee good fiscal policies; **political will to coordinate is a central requirement**.

20. **Staff considered that improving governance and promoting efficient and accountable fiscal structures required fundamental reforms going well beyond the NFC; the authorities, however, felt these were premature**. Staff pointed out the need to reform and coordinate direct taxes to reduce distortions and improve tax compliance and labor market participation; harmonize the provisions of the multitude of social safety nets and pension systems to ensure their viability and develop a single labor market; and rationalize intergovernmental fiscal relations, both between the State and the Entities and between the Entities and local governments, to strengthen incentives for cooperation and align taxing authority with spending responsibility. The authorities were not prepared to contemplate these reforms at this juncture: they felt such action would open fundamental

issues of distribution of competencies between Entities and State that go to the heart of the current constitutional arrangements.

C. Financial Stability

21. **In the context of the currency board, the CBBH can do very little to affect macroeconomic conditions**. As the CBBH does not set interest rates or have lender-of-last-resort functions, the only tool at its disposal to influence overall liquidity conditions is the reserve requirement. Credit has grown rapidly in recent years, but the starting point was low and the pace is in line with that elsewhere in the region. Given the recent deceleration of credit growth (from 27½ percent last year to 19 percent on a seasonally adjusted annualized basis in the year to July), the CBBH saw the current level of the reserve requirement (15 percent) as appropriate but stood ready to adjust it if necessary. Staff agreed: the reserve requirement had limited effectiveness as a macroeconomic policy instrument and could not be adjusted frequently. Nevertheless, staff supported the removal of the statutory 20 percent ceiling, if only as a signal of the CBBH's readiness to use this instrument if necessary.

22. **The CBBH's main role instead is to help safeguard the stability of the financial system**. The principal sources of vulnerability are underestimation of credit risk and reliance—especially by foreign banks—on low-cost foreign funding. On the former, the CBBH explained that the credit registry for corporate loans that started operating in April, which it planned to extend to household loans by year-end, would help improve risk assessment by banks. Staff agreed, but pointed out that the use by banks of the information in the registry should be encouraged and integrated into the regulations and the work of the supervisors. As regards the latter source of vulnerability, staff and the CBBH discussed several options but agreed that all entailed significant risks. Relaxing the current maturity-matching requirements of the CBBH for assets and liabilities would allow banks to use low-cost domestic short-term deposits, rather than foreign borrowing, to fund credit, thus reducing reliance on potentially volatile capital flows; but this option risks exacerbating credit growth if not implemented gradually. Introducing higher reserve requirements for foreign liabilities would reduce their cost advantage; but, as the experience of other countries in the region shows, it can also stimulate disintermediation.

23. **Although there was agreement in principle, staff's advice to unify bank supervision was controversial**. All concurred that a single supervisor was needed for what was increasingly becoming a unified banking system. But there was no agreement on the coverage (banks or the entire financial sector), institutional setup (the CBBH or an independent agency), or location (Sarajevo or Banja Luka) of the supervisor. While some of these open issues are genuine, they also have a political angle: unifying supervision was seen, especially by the RS, as one more step toward centralizing institutions at the State level. Leaving that aside, staff argued that a unified supervisor should start by covering banks and leasing, an activity that was increasingly used as a substitute for bank lending. Staff was agnostic about the institutional setup; it pointed out, however, that establishing a separate agency would demand effort to ensure its independence and protection from political interference, while in the case of the CBBH, this was already established.

24. **Leasing and insurance activities are growing fast but supervision is weak or nonexistent**. Staff pointed out the risks this created for these sectors and, ultimately, for the public. It urged the authorities to set up the legal framework for leasing, give supervisory authority to the unified supervisor, and build up technical regulations and capacity in insurance supervision.

D. Competitiveness and External Sustainability

25. **The large external imbalance, narrow export base, mixed competitiveness indicators, and recent policy inaction raised concerns about external sustainability and the viability of the currency board**. Staff noted that even after correcting for the known data shortcomings, the current account deficit was still large and, although projected to improve, would remain large over the medium term. Given the relatively high level of external debt, this situation increased external vulnerability (Appendix I). How did the authorities assess the external position and prospects? What would be the risks for the currency board if the external imbalance did not improve? And how could domestic savings rise to ensure sustainability?

26. **The authorities did not share staff's concerns about external sustainability**. They agreed that the current account deficit was a source of vulnerability, but pointed out that its true ratio to GDP was probably comparable to other countries in the region, including some with currency boards. They noted that the external debt had highly concessional terms, the debt service burden was light, and short-term portfolio flows were negligible, lessening the risk of a capital account crisis. And they argued that staff's medium-term baseline underestimated the strength of non-metal exports.

27. **The authorities reiterated their commitment to the currency board, which they saw as a viable arrangement until EU membership and euro adoption**. They argued that the currency board had ensured monetary stability during the difficult post-conflict period and, despite the exacting requirements it placed on other policies, particularly fiscal, it—as well as the level of the peg—was still appropriate for Bosnia & Herzegovina. Although the currency board was occasionally criticized by economic commentators, including during outreach activities of the mission, the authorities felt that there is no serious alternative. Their exit strategy remains euro adoption, as in some Baltic countries and Bulgaria.

28. **The authorities concurred that for this exit strategy to be successful, domestic savings had to increase and competitiveness to strengthen through structural reforms**. Their exit strategy implied that the currency board would have to be maintained for a long time. To reduce the risks during this period, structural reforms are needed to strengthen private sector activity and boost exports. The authorities acknowledged that recent progress in structural reforms had been disappointing, but they were not in a position to outline an overall strategy going forward; this task would fall to the governments after the elections.

29. **Staff agreed that structural reforms were the most important instrument to improve the external position, and expressed concern with policy drift in this area**. Staff noted that macroeconomic policies—essentially fiscal—could not by themselves generate the incremental domestic savings required to reduce the current account deficit to sustainable

levels: reforms to boost private profitability and savings were needed. From this angle, staff saw two priorities:

- ***Corporate restructuring and private sector development***. Privatization, bankruptcy, and liquidation should be accelerated, particularly in the Federation, and tax enforcement stepped up. To improve the business environment, enforcement of property rights should be strengthened, business registration and inspection streamlined, and regulations reduced.

- ***Labor market flexibility***. To facilitate corporate restructuring and new business creation, labor and other laws should be amended to stop the accumulation of wage arrears when the workers are not effectively employed by the firm and to allow worker mobility without first having to clear existing arrears. The current rigid collective agreements should be replaced by a firm-level system of wage bargaining. Labor market flexibility, alongside public sector wage moderation, is particularly important for maintaining competitiveness in a currency board setting.

Staff noted that although there were signs of movement in some of these areas, the lack of a comprehensive strategy was worrisome, as indicated *inter alia* by the lapsing in August of the World Bank's Privatization Technical Assistance Credit due to the authorities' lack of interest in drawing on it.

III. STAFF APPRAISAL

30. **Bosnia & Herzegovina has enjoyed a period of rapid growth and price stability**. This has been largely underwritten by the extensive support provided by the international community during the last decade. But it has also reflected key policy choices, notably the currency board and the fiscal consolidation of the last several years, including the successful introduction of the VAT in 2006. That macroeconomic stability has been maintained in the face of a large external imbalance—even after correcting for statistical shortcomings that overstate its size—bears testimony to the validity of these choices.

31. **This good performance has contributed to complacency and the recent policy drift, which the country can ill afford**. The current macroeconomic stability is fragile, as highlighted by staff's analysis of the medium-term outlook and the financial sector vulnerabilities documented in the FSAP. Even if it is maintained, stability alone cannot guarantee sustainable growth and job creation. As international assistance declines, a robust and competitive domestic private sector must become the engine of growth. The authorities are aware of the need for a comprehensive policy agenda to achieve this, but there is little sense of ownership and commitment to translate this agenda into action.

32. **The governments that will be formed after the elections should make sound macroeconomic policies and structural reforms a key priority**. For Bosnia & Herzegovina to have a chance of achieving its ultimate goal of European integration, these governments must fill the gap that will be left by the closure of the HR's Office and the transformation of this position into an EU Special Representative. In the economic policy area, this means safeguarding macroeconomic stability and promoting a healthy private

sector. This will entail difficult political choices but has to be weighed against the risks that continued inaction would pose for growth, macroeconomic stability, and the currency board.

33. **Fiscal policy should aim at sustained small surpluses over the medium term**. Staff believes that a sustained surplus of ¼–½ percentage point of GDP would help generate the increase in domestic savings needed to address the external imbalance; ensure that public debt is on a declining path, taking into account the burden of domestic claims against the government; and insure against the uncertainties still surrounding these claims. This goal should be re-assessed once the size and settlement terms of these claims have been finalized.

34. **The bigger challenge is to find the expenditure cuts that are needed not only to improve the overall balance but also to reduce the size of the government and make room for new spending**. The size of the government is large for an economy like Bosnia & Herzegovina's. This is partly because the state-building agenda of the last decade paid little attention to the efficiency of public spending. As a result, unless large savings are found in other areas, there will be no room to reduce the burden of taxation, especially on labor, while satisfying demands to create new state institutions, meeting the exigencies of preparing the country for EU accession, and making the much-needed investment in infrastructure. These savings are likely to be found mainly in the public wage bill and social spending, where public resources are wasted on inefficiency and duplication of functions.

35. **The agreement on a National Fiscal Council law is welcome, but the challenge of creating efficient and accountable fiscal structures goes well beyond the coordination of budgetary policies**. The draft law has shortcomings, especially in the area of enforcement. Still, it is a major step toward better fiscal policy coordination. It should now be approved and implemented as soon as possible. But political will to cooperate and abide by the spirit of the law will be the key to securing fiscal policy coordination, and coordination by itself is not sufficient to deliver good policies—this requires formulating, setting, and achieving the right targets. Moreover, improving fiscal efficiency and accountability requires far-reaching reforms in harmonizing the provisions of the multitude of social safety nets and pension systems, as well as rationalizing revenue-sharing and intergovernmental fiscal relations.

36. **Maintaining financial stability requires taking steps to improve credit risk management by banks, unifying bank supervision, and closing gaps in the oversight of the nonbank financial sector**. Within the constraints of the currency board and an open capital account, the CBBH's only—and inefficient—instrument to influence bank liquidity is the reserve requirement. Although its present level is appropriate, staff supports the removal of the statutory ceiling on the reserve requirement. Staff welcomes the operation of the credit registry and the plans to extend it to households by year-end. Other options to reduce the excessive reliance of banks on low-cost foreign borrowing, such as differentiated reserve requirements on foreign liabilities, are possible, but their benefits should be carefully weighed against the potential pitfalls. Bank supervision should be unified as soon as possible, preferably at the CBBH, which is already well established, or at a new independent agency, and the legal and regulatory framework for leasing and insurance should be strengthened.

37. **Structural reforms are critical for strengthening competitiveness, creating an enabling environment for private sector activity, and ultimately ensuring external sustainability**. Although the recent strength of exports does not indicate a major real exchange rate misalignment at this point, an accurate overall assessment is impeded by data weaknesses while other indirect competitiveness indicators are mixed. But given the large external imbalance, reforms that boost private sector profitability and savings are macro-critical and, in any event, necessary if Bosnia & Herzegovina is to catch up with its neighbors—much less with the advanced economies in the EU, which it aspires to join. Staff urges the authorities, particularly in the Federation, to start corporate restructuring and privatization in earnest; improve the business environment; step up bankruptcy proceedings, including through tax enforcement; amend labor laws to stop the accumulation of wage arrears when workers are not effectively employed by the firm; and replace the current collective agreements by a firm-level bargaining system. Improvements in the quality of statistical data, especially in the national accounts and balance of payments, are urgently needed to enable accurate economic analysis and effective surveillance.

38. **Bold structural reforms and a sustained prudent fiscal position are also key to the viability of the currency board**. The currency board continues to serve Bosnia & Herzegovina well. However, given that the authorities envisage maintaining it until EU membership and euro adoption, it is imperative to start on the path of the reforms outlined above that will boost domestic savings, both public and private, and mitigate financial sector vulnerabilities. These reforms will take time to bear fruit. But unless they are implemented now, the risks to the currency board will increase with time.

39. It is proposed that the next consultation with Bosnia & Herzegovina take place on the standard 12-month cycle.

Table 1. Bosnia and Herzegovina: Selected Economic Indicators, 2002–06

	2002	2003	2004	2005	2006
				Est.	Proj.
Nominal GDP (millions of marka)	12,806	13,492	14,534	15,605	17,533
Gross national saving (in percent of GDP)	1.0	-0.6	-0.6	-2.0	3.6
Gross investment (in percent of GDP)	20.1	20.4	18.8	19.2	20.5
	(Percent change)				
Real GDP	5.0	4.1	5.8	5.0	5.5
Index of industrial production (period average) 1/	11.6	3.0	13.6	11.0	7.4
Gross wages (period average) 1/	6.9	8.1	3.4	3.4	8.7
CPI (period average) 1/	0.3	0.6	0.2	2.8	6.5
Money and credit (end of period)					
Broad money 2/	7.0	10.0	24.3	18.2	22.4
Total credit	37.4	25.4	31.1	27.7	19.3
Of which : credit to the private sector	36.2	24.8	27.5	27.5	23.0
	(In percent of GDP)				
General government budget					
Revenue	46.0	50.3	50.0	51.1	51.3
Of which: grants	7.2	6.3	5.5	4.8	4.3
Expenditure (on a commitment basis)	49.3	52.4	50.4	50.2	50.6
Of which: investment expenditure	9.8	11.1	10.2	9.8	9.6
Primary balance	-2.1	-1.2	0.2	1.5	1.4
Overall balance	-3.3	-2.0	-0.4	0.9	0.7
External public debt	34.3	30.2	27.8	30.0	29.4
NPV of external public debt	26.2	23.1	21.2	22.9	22.5
Total public debt	34.8	30.6	28.1	31.7	48.2 3/
	(In millions of euros, unless otherwise indicated)				
Balance of payments					
Exports of goods and services	1,721	1,935	2,398	2,897	3,316
Imports of goods and services	5,012	5,313	5,704	6,455	6,742
Unrequited transfers, net	1,500	1,462	1,502	1,484	1,527
Current account balance	-1,252	-1,444	-1,437	-1,695	-1,523
(In percent of GDP)	-19.1	-20.9	-19.3	-21.3	-17.0
Foreign direct investment	281.8	337.6	487.7	239.7	658.7
(In percent of GDP)	4.3	4.9	6.6	3.0	7.3
Gross official reserves	1,272	1,436	1,782	2,160	2,512 4/
(In months of imports)	3.3	3.5	4.0	3.8	4.6
Net international reserves (in percent of private sector deposits)	70.3	69.7	68.3	69.0	...
External debt service	132	131	116	119	144
(In percent of exports of goods and services)	7.7	6.8	4.8	4.1	4.3

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

1/ Based on weighted averages for the Federation and Republika Srpska.

2/ Broad money includes currency, demand deposits, time and savings deposits, bonds, and money market instruments.

3/ Assuming 17 percent of GDP of debt to settle domestic claims against the government.

4/ End-July.

Table 2. Bosnia and Herzegovina: Selected Economic Indicators for the Entities, 2002–06

	2002	2003	2004	2005	2006
				Est.	Proj.
Federation					
Nominal GDP (millions of marka)	8,705	8,953	9,494	9,946	11,176
(percent of BiH GDP)	68.0	66.4	65.3	63.7	63.7
Real GDP (percent change)	5.0	3.0	4.5	2.9	5.5
Index of industrial production (percent change; period average)	14.2	2.0	13.6	8.7	7.1
Gross wages (percent change; period average)	7.8	8.2	1.8	2.1	...
CPI (percent change; period average)	-0.2	0.2	-0.3	2.7	6.5
	(In percent of Federation GDP)				
Central government budget					
Revenue	12.0	11.5	11.3	11.5	10.1
Expenditure	12.8	11.1	10.4	9.6	9.5
Of which: change in stock of arrears	-0.4	0.6	-0.4	-0.7	0.0
Overall balance	-0.8	0.3	1.0	1.9	0.6
Overall balance (percent of BiH GDP)	-0.5	0.2	0.6	1.2	0.4
Budget for cantonal governments and extrabudgetary funds					
Revenue	26.0	33.1	34.0	34.7	34.9
Expenditure	26.2	32.8	33.1	34.6	34.3
Of which : change in stock of arrears	-0.5	0.0	0.0	0.0	0.0
Overall balance	-0.2	0.3	0.9	0.1	0.6
Overall balance (percent of BiH GDP)	-0.1	0.2	0.6	0.1	0.4
Republika Srpska					
Nominal GDP (millions of marka)	3,706	4,097	4,487	5,068	5,694
(percent of BiH GDP)	28.9	30.4	30.9	32.5	32.5
Real GDP (percent change)	3.5	6.5	7.1	10.9	5.5
Index of industrial production (percent change; period average)	4.5	5.7	13.8	17.7	8.2
Gross wages (percent change; period average)	2.4	9.2	11.5	10.1	...
CPI (percent change; period average)	1.7	1.8	1.8	3.0	6.5
	(In percent of Republika Srpska GDP)				
Budget for central government and municipalities					
Revenue	32.7	31.1	30.0	29.5	29.2
Expenditure	33.3	29.9	30.4	27.6	26.8
Of which : change in stock of arrears	0.0	-0.8	-0.4	-0.1	0.0
Overall balance	-0.6	1.2	-0.4	1.9	2.4
Overall balance (percent of BiH GDP)	-0.2	0.4	-0.1	0.6	0.8
Extrabudgetary funds					
Revenue	10.7	13.4	14.7	14.7	14.6
Expenditure	10.7	13.4	14.5	14.1	14.4
Of which : change in stock of arrears	0.0	-0.1	-0.1	-0.1	0.0
Overall balance	0.0	0.0	0.2	0.6	0.2
Overall balance (percent of BiH GDP)	0.0	0.0	0.1	0.2	0.1

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

Table 3. Bosnia and Herzegovina: Balance of Payments, 2003–07

(In millions of euros, unless otherwise indicated)

	2003	2004	2005	2006	2007
				Projections	
Merchandise trade balance (based on country-partner data)	-3,671	-3,678	-4,005	-3,928	-4,186
Exports, f.o.b.	1,303	1,677	2,080	2,422	2,706
Imports, f.o.b.	-4,974	-5,355	-6,085	-6,350	-6,893
Reconstruction	-351	-281	-242	-235	-273
Other	-4,623	-5,074	-5,843	-6,116	-6,620
Services, net	293	372	447	503	544
Exports	632	721	817	895	962
Imports	-339	-349	-370	-392	-418
Income, net	472	367	379	376	381
Earnings	574	460	475	470	473
Debit	-102	-93	-96	-94	-92
Of which: interest payments	-49	-41	-45	-52	-51
Current transfers, net	1,462	1,502	1,484	1,527	1,561
Receipts	1,571	1,641	1,633	1,675	1,710
Of which: official grants	*25*	*5*	*19*	22	16
private	1,009	1,054	1,063	1,103	1,144
Outflows	-109	-139	-149	-149	-149
Current account balance	-1,444	-1,437	-1,695	-1,523	-1,701
Direct investment (net)	338	488	240	659	877
Capital transfers	411	393	360	369	379
Private transfers	241	256	244	254	263
Official transfers	170	137	116	116	116
Foreign loans (net)	414	185	679	345	544
Disbursements	181	162	136	128	202
Project loans	181	144	126	119	157
Program loans (Incl. from World Bank and EU)	0	18	10	10	45
Amortization	-37	-37	-41	-55	-75
Commercial banks+private sector nonbank borrowing	226	5	484	168	304
Trade credits	44	55	99	104	113
Capital account balance	1,163	1,066	1,279	1,374	1,800
Errors and omissions 1/	711	896	587	657	657
Overall balance	430	526	170	508	756
Financing	-430	-526	-170	-508	-756
Change in net international reserves (increase, -)	-179	-370	-411	-508	-756
Gross official reserves	-164	-346	-378	-471	-741
Net use of Fund resources	-15	-24	-33	-37	-14
Purchases	30	14	0	0	0
Repurchases (Projections are on expectations basis)	-45	-38	-33	-37	-14
Memorandum items:					
Current account balance (percent of GDP)	-20.9	-19.3	-21.3	-17.0	-17.5
Trade balance (percent of GDP)	-53.2	-49.5	-50.2	-43.8	-43.0
Import of goods (change, percent, in euros)	6.0	7.6	13.6	4.4	8.5
Export of goods (change, percent, in euros)	11.5	28.7	24.0	16.4	11.8
Transfers (percent of GDP)	21.2	20.2	18.6	17.0	16.0
Net foreign investment (percent of GDP)	4.9	6.6	3.0	7.3	9.0
External debt/GDP (percent)	55.3	53.5	57.9	54.7	54.2
Of which: public	30.2	27.8	30.0	29.4	28.6
External public debt service/GNFS (percent)	6.8	4.8	4.1	4.3	3.8
Gross official reserves	1,436	1,782	2,160	2,631	3,372
(Months of imports of goods and services)	3.5	4.0	3.8	4.7	5.5
Nominal GDP	6,898	7,431	7,978	8,964	9,740

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

1/ Errors and omissions are explicitly projected to capture unrecorded capital inflows.

Table 4. Bosnia and Herzegovina: Vulnerability Indicators, 2003–06

	2003	2004	2005 Est.	2006 Proj.
Import of goods (change, percent, in euros)	11.5	28.7	24.0	16.4
Export of goods (change, percent, in euros)	6.0	7.6	13.6	4.4
Current account balance (percent of GDP)	-20.9	-19.3	-21.3	-17.0
Capital and financial account (percent of GDP)	16.9	14.3	16.0	15.2
Gross official reserves (end of period, millions of euros)	1,436	1,782	2,160	2,631
In months of imports of goods and nonfactor services (GNFS)	3.5	4.0	3.8	4.7
Broad money/NFA (end of period)	2.8	2.5	2.9	2.8
Foreign exchange deposits/reserves (percent, end of period)	68.4	74.4	74.6	75.4
Total external public debt (percent of GDP)	30.2	27.8	30.0	29.4
External public debt service/exports of GNFS (percent) 1/	6.8	4.8	4.1	4.3
External debt service to multilateral creditors/exports of GNFS (percent)	5.2	3.7	3.2	3.4
External debt service to multilateral creditors (percent of total debt service)	76.9	76.4	77.2	77.2
External debt service to the IMF (percent of total debt service)	36.8	35.2	29.7	26.8
Exchange rate (per U.S. dollar, period average)	1.73	1.57	1.57	…
REER (annual average percentage change; depreciation =-)	-16.1	-2.3	1.0	…

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

1/ Includes repayment of IMF loans.

Table 5. Bosnia and Herzegovina: General Government, 2003–07

(In percent of GDP)

	2003	2004	2005	2006	2006	2007
			Est.	Budget	Projections	
Revenue	50.3	50.0	51.1	48.6	51.3	49.1
Tax	37.0	37.2	38.8	37.5	40.1	38.2
VAT / sales tax	10.5	11.2	11.8	12.3	14.7	12.8
Excises	5.7	5.7	6.3	5.9	5.6	5.6
Trade taxes	4.8	3.8	4.0	3.3	3.0	3.0
Direct taxes	2.8	2.9	2.9	2.8	2.9	2.9
Social security contributions	13.4	13.8	13.8	13.2	13.8	13.8
Nontax	7.0	7.3	7.5	6.8	7.0	6.9
Grants	6.3	5.5	4.8	4.3	4.3	4.0
For budget support	0.4	0.2	0.3	0.2	0.2	0.2
For investment	6.0	5.3	4.5	4.1	4.1	3.9
Consolidated expenditure on a commitment basis	52.4	50.4	50.2	49.1	50.6	50.8
Wage bill	13.7	13.0	12.4	12.0	12.2	12.2
Of which: severance package	0.0	0.1	0.0	0.0	0.0	0.1
Goods and services	11.1	10.6	10.6	9.7	9.7	9.7
Subsidies and transfers to nonpublic agents	14.1	13.9	14.3	14.9	15.4	15.5
Transfers to households	12.7	12.5	12.9	13.1	13.5	13.7
Subsidies to industry and agriculture	1.4	1.4	1.4	1.9	1.9	1.9
Interest payments	0.8	0.6	0.6	0.7	0.7	0.7
Other current spending	1.6	2.1	2.6	3.0	3.0	3.0
Investment expenditure	11.1	10.2	9.8	8.8	9.6	9.7
Foreign-financed investment projects	8.6	7.2	6.0	5.4	5.4	5.5
Other investment expenditure	2.5	3.0	3.8	3.4	4.2	4.2
Balance	-2.0	-0.4	0.9	-0.5	0.7	-1.7
Financing	2.0	0.4	-0.9	0.5	-0.7	1.7
Domestic financing	0.2	-1.0	-1.6	0.1	-1.1	0.6
GSM proceeds	0.0	0.0	0.4	0.2	0.2	0.2
Privatization proceeds	0.0	0.0	0.3	0.0	2.0	1.8
Repayment of domestic claims	0.0	-0.4	-0.6	-0.6	-0.8	-0.1
Repayment of other arrears and float	0.1	-0.4	-0.5	0.0	0.0	0.0
Other domestic financing	0.1	-0.3	-1.1	0.5	-2.4	-1.3
Foreign financing	1.8	1.4	0.7	0.4	0.3	1.1
For budget support	0.4	0.4	0.1	0.2	0.1	0.4
For investment	2.6	1.9	1.6	1.3	1.3	1.6
Amortization	-1.2	-1.0	-0.9	-1.1	-1.0	-0.9
Memorandum items:						
Underlying balance 1/	-2.0	-0.4	0.9	-0.5	-0.2	-1.3
Primary balance	-1.2	0.2	1.5	0.2	1.4	-1.0

Sources: Ministries of Finance; and IMF staff estimates and projections.

1/ Corrected for temporary effects of VAT refunds by replacing *actual* refunds and tax credits with *requests* for refunds and tax credits.

Table 6. Bosnia and Herzegovina: Elements of General Government, 2003–07

(In percent of GDP)

	2003	2004	2005 Est.	2006 Budget	2006 Projections	2007 Projections
Federation budget						
Revenue and grants	7.4	7.2	7.1	6.0	6.3	6.1
Expenditure	7.2	6.6	5.7	5.1	5.1	5.1
Of which: transfers to other levels of government	0.5	0.7	0.2	0.2	0.2	0.2
Balance	0.2	0.6	1.3	0.8	1.2	1.1
Federation Road Fund						
Revenue and grants	0.6	0.6	0.7	0.6	0.6	0.6
Of which: transfers from the Federation budget	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	0.6	0.6	0.8	0.7	1.0	1.0
Balance	0.0	0.0	-0.1	-0.1	-0.4	-0.4
Cantonal and municipal budgets						
Revenue and grants	11.5	11.7	11.4	11.0	11.6	11.0
Of which: transfers from the Federation budget	0.1	0.1	0.1	0.1	0.1	0.1
Expenditure	11.4	11.4	11.6	11.1	11.7	11.7
Balance	0.1	0.3	-0.1	-0.1	-0.1	-0.7
Federation extrabudgetary funds						
Revenue and grants	10.1	10.2	10.2	9.8	10.2	10.2
Of which: transfers from the Federation budget	0.0	0.0	0.1	0.1	0.1	0.1
Expenditure	10.0	9.8	10.0	9.8	9.8	9.8
Balance	0.1	0.4	0.2	0.0	0.4	0.4
RS budget and municipalities						
Revenue and grants	9.4	8.8	9.2	8.5	9.1	8.6
Expenditure	9.1	8.9	8.5	8.0	8.4	8.5
Of which: transfers to other levels of government	0.9	1.1	1.0	0.9	0.9	0.9
Balance	0.4	-0.1	0.7	0.4	0.7	0.0
RS Road Fund						
Revenue and grants	0.0	0.4	0.5	0.4	0.4	0.4
Of which: transfers from the RS budget	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	0.0	0.5	0.5	0.5	0.5	0.5
Balance	0.0	0.0	-0.1	-0.1	-0.1	-0.1
RS extrabudgetary funds						
Revenue and grants	4.1	4.5	4.8	4.5	4.7	4.7
Of which: transfers from the RS budget	0.7	0.8	1.0	0.9	0.9	0.9
Expenditure	4.1	4.5	4.6	4.5	4.7	4.7
Balance	0.0	0.1	0.2	0.0	0.0	0.0
State						
Revenue and grants	1.3	1.6	2.4	3.7	3.7	3.7
Of which: transfers from other levels of government	0.6	0.8	0.0	0.0	0.0	0.0
Expenditure	1.4	1.6	2.2	3.8	3.8	3.9
Balance	-0.1	0.1	0.3	-0.1	-0.1	-0.1
ITA						
Balance	...	...	0.4	...	0.6	...
Brcko District						
Revenue and grants	1.4	1.4	1.2	1.1	1.1	1.1
Expenditure	1.5	1.1	1.5	1.2	1.2	1.2
Of which: transfers to other levels of government	0.0	0.0	0.0	0.0	0.0	0.0
Balance	-0.1	0.3	-0.2	-0.1	-0.1	-0.1
Foreign-financed investment projects						
Grants	6.0	5.3	4.5	4.2	4.1	3.9
Expenditure	8.6	7.2	6.0	5.2	5.4	5.5
Balance	-2.6	-1.9	-1.6	-1.0	-1.3	-1.6

Sources: Ministries of Finance; and IMF staff estimates and projections.

Table 7. Bosnia and Herzegovina: Monetary Survey, 2002–06 1/
(In millions of marka, unles otherwise indicated)

	2002	2003	2004	2005	2006	
					July	December Proj.
Net foreign assets	2,144	1,932	2,739	2,755	3,716	3,547
Foreign assets	3,940	4,370	5,391	6,314	7,348	7,503
Foreign liabilities	1,796	2,438	2,652	3,559	3,632	3,956
Domestic credit	3,787	4,630	5,465	6,977	7,501	8,323
Claims on central government (net)	-400	-468	-443	-553	-987	-935
Claims on noncentral government	29	22	25	32	37	37
Claims on private sector	4,158	5,076	5,883	7,498	8,451	9,220
Nonfinancial enterprises and cooperatives	2,643	3,017	3,146	3,924	4,335	4,747
Households	1,440	1,966	2,629	3,457	4,009	4,354
Other	75	92	108	117	107	118
Broad money	4,997	5,496	6,832	8,077	9,174	9,886
Narrow money	2,969	3,113	3,535	4,108	4,577	5,217
Currency outside banks	1,737	1,601	1,671	1,729	1,811	1,867
Demand deposits of noncentral government	155	220	343	410	568	571
Demand deposits of the private sector	1,076	1,293	1,521	1,970	2,197	2,779
Nonfinancial enterprises and cooperatives	706	820	877	1,139	1,199	1,858
Households	301	389	564	717	884	800
Other	70	83	81	114	114	121
Quasi-money	2,028	2,383	3,296	3,969	4,597	4,668
Time and savings deposits in domestic currency	261	462	703	818	980	727
Foreign currency deposits	1,767	1,921	2,593	3,150	3,618	3,941
Other items (net)	-933	-1,066	-1,372	-1,655	-2,042	-1,984
Memorandum items:						
Broad money growth (year-on-year) 2/	7.0	10.0	24.3	18.2	22.5	22.4
NDA growth (year-on-year)	25.6	22.3	18.0	27.7	21.1	19.1
NFA growth (year-on-year)	-15.7	-9.9	41.8	0.6	29.5	28.7
Domestic credit contribution to broad money growth (year-on-yea	16.5	16.9	15.2	22.1	17.4	16.7
NFA contribution to broad money growth (year-on-year)	-8.5	-4.2	14.7	0.2	11.3	9.8
Broad money (percent of GDP)	39.0	40.7	47.0	51.8	54.8	56.4
Domestic credit (percent of GDP)	29.6	34.3	37.6	44.7	44.8	47.5
Private sector credit (percent of GDP)	32.5	37.6	40.5	48.0	50.5	52.6
Credit to household sector (percent of GDP)	11.2	14.6	18.1	22.2	24.0	24.8
Nominal GDP	12,806	13,492	14,534	15,605	16,729	17,533
Velocity of broad money	2.6	2.5	2.1	1.9	1.8	1.8
Broad money multiplier	2.2	2.1	2.1	2.0	2.1	2.1

Sources: Central Bank of Bosnia and Herzegovina; and IMF staff estimates and projections.

1/ Because data for March 2005 onward are based on the upgraded classification of general government, there is a structural break in March 2005.
2/ The jump in broad money growth in 2004 reflects banks' efforts to mobilize foreign currency deposits, following a tightening of end-month forex exposure limits. Further regulatory changes in late 2004 dampened these efforts.

Table 8. Bosnia and Herzegovina: Monetary Authorities' Balance Sheet 2002–06
(In millions of marka, unless otherwise indicated)

	2002	2003	2004	2005	2006	
					July	December Proj.
Reserve money	2,318	2,608	3,239	3,970	4,469	4,804
Currency outside monetary authorities	1,869	1,722	1,817	1,907	2,022	2,081
Currency outside banks	1,737	1,601	1,671	1,729	1,811	1,867
Commercial bank cash in vaults	131	121	147	178	211	214
Commercial bank deposits with CBBH	447	884	1,420	2,060	2,443	2,718
Other demand deposits with CBBH	3	2	2	3	4	4
Net foreign assets	2,487	2,807	3,484	4,223	5,132	5,224
Domestic credit (net)	-27	-18	-43	-36	-248	-179
Claims on general government (net)	-27	-19	-45	-38	-250	-181
Claims on the private sector	0.2	0.2	1.8	1.9	2.3	2.2
Other items (net)	-142	-181	-203	-217	-415	-241
12-month growth rates (percent)						
Reserve money	-8.9	12.5	24.2	22.6	30.4	21.0
Net foreign assets	-8.1	12.9	24.1	21.2	35.4	23.7
Net claims on general government	-45.2	-30.4	139.6	-15.4	51.3	380.3
Memorandum items:						
NFA in percent of currency outside the banks	143.2	175.3	208.6	244.2	283.4	279.8
NFA in percent of broad money	49.7	51.1	51.0	52.3	55.9	52.8
Net free reserves	122.7	153.3	173.0	187.1	192.8	205.8

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

Table 9. Bosnia and Herzegovina: Survey of Domestic Money Banks, 2002–06 1/
(In millions of marka, unless otherwise indicated)

	2002	2003	2004	2005	2006	
					July	December Proj.
Net foreign assets	-343	-875	-745	-1,467	-1,416	-1,677
Assets	1,452	1,562	1,906	2,090	2,215	2,278
Liabilities	1,795	2,437	2,651	3,558	3,631	3,955
Net domestic assets	3,601	4,768	5,904	7,812	8,775	9,691
Net claims on central government	-373	-449	-398	-515	-737	-753
Credits	32	24	21	19	17	20
Deposits	406	473	419	533	754	773
Claims on noncentral government	29	22	25	32	37	37
Claims on private sector	4,158	5,076	5,882	7,496	8,449	9,220
Households	1,440	1,966	2,628	3,456	4,007	4,354
Nonfinancial enterprises and cooperatives	2,643	3,017	3,146	3,924	4,335	4,747
Other	75	92	108	117	107	118
Reserves 2/	578	884	1,420	2,060	2,443	2,718
Required reserves	175	271	758	1,435	1,632	1,795
Excess reserves 2/	403	613	661	625	812	923
Of which : cash in vaults 2/	131	...	...	...	...	...
Cash in vaults, not included in reserves 2/	...	121	147	178	211	214
Other items (net)	-791	-885	-1,170	-1,439	-1,628	-1,745
Deposits (excl. central government)	3,257	3,893	5,159	6,345	7,359	8,014
Demand deposits	2,038	2,329	2,851	3,528	4,105	4,446
Time and savings deposits	1,219	1,564	2,308	2,816	3,254	3,568
Deposits in foreign currency	1,767	1,921	2,593	3,150	3,618	3,941
Deposits in domestic currency	1,490	1,972	2,566	3,195	3,741	4,073
Memorandum items:						
Nominal GDP	12,806	13,492	14,534	15,605	16,729	17,533
Adjusted credit to the private sector 3/	3,695	4,613	5,882	7,496	8,449	9,220
12-month growth (percent)	36.2	24.8	27.5	27.5	24.7	23.0
Adjusted credit to enterprises 3/	2,180	2,554	3,146	3,924	4,335	4,747
12-month growth (percent)	9.5	17.2	23.2	24.7	20.2	21.0
Credit to households (12-month growth, percent)	111.2	36.6	33.6	31.5	30.5	26.0
Year-to-date growth of deposits (percent)	8.8	19.5	32.5	23.0	16.0	26.3
Year-to-date increase in credit to private sector	849	918	806	1,615	953	1,724
Adjusted credit to the private sector (percent of GDP) 3/	28.9	34.2	40.5	48.0	50.5	52.6
Base for reserves	1,750	5,413	7,584	9,902	10,990	11,969
Excess reserves/deposits (in percent)	12.4	15.8	12.8	9.8	11.0	11.5
Velocity of deposits	3.9	3.5	2.8	2.5	2.3	2.2

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

1/ Because data for March 2005 onward are based on an upgraded classification of general government, there is a structural break in March 2005
2/ Starting in June 2003, cash in vaults are excluded from assets eligible to meet reserve requirements.
3/ 2002-03 data are adjusted to correct for the structural break due to the RS govt. takeover of KM 463 million of old bank claims on RS enterprises in June 2004.

Table 10. Bosnia and Herzegovina: Staff Illustrative Medium-Term Framework, 2003–11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
			Est.	Projections					
Real sector									
Real GDP growth (percent)	4.1	5.8	5.0	5.5	6.0	6.0	5.4	4.5	4.0
CPI, period average percent change	0.6	0.2	2.8	6.5	2.5	1.9	1.8	1.8	1.8
Savings and investment	(In percent of GDP)								
Consumption 1/	128.6	125.7	125.4	117.7	116.6	116.1	115.0	116.5	116.4
Public	26.3	26.1	26.1	25.3	25.4	25.4	25.4	25.4	25.4
Private 1/	102.4	99.6	99.3	92.4	91.3	90.7	89.6	91.1	91.1
Investment	20.4	18.8	19.2	20.5	20.8	17.7	17.0	16.8	16.4
Public	11.1	10.2	9.8	9.6	9.7	9.1	8.3	8.1	7.7
Private	9.3	8.5	9.4	10.9	11.1	8.7	8.7	8.7	8.7
National savings	-0.6	-0.6	-2.0	3.6	3.3	2.9	2.9	0.7	0.3
Public	4.0	4.6	6.2	6.9	4.8	4.5	4.1	3.7	3.3
Private	-4.5	-5.2	-8.2	-3.4	-1.5	-1.5	-1.1	-3.0	-3.0
Foreign savings	20.9	19.3	21.3	17.0	17.5	14.8	14.1	16.1	16.0
General government	(In percent of GDP, unless otherwise indicated)								
Total revenue and grants	50.3	50.0	51.1	51.3	49.1	48.6	47.8	47.3	46.6
o/w Grants	6.3	5.5	4.8	4.3	4.0	3.8	3.4	3.2	2.9
Total expenditure	52.4	50.4	50.2	50.6	50.8	50.5	49.9	49.8	49.6
Current	41.3	40.2	40.4	41.0	41.1	41.5	41.6	41.7	41.9
Capital	11.1	10.2	9.8	9.6	9.7	9.1	8.3	8.1	7.7
Overall balance	-2.0	-0.4	0.9	0.7	-1.7	-2.0	-2.1	-2.5	-3.0
Overall balance excl. grants	-8.4	-5.9	-3.9	-3.6	-5.7	-5.7	-5.5	-5.7	-5.9
Public debt (percent of GDP)2/	30.6	28.1	31.7	48.2	54.8	58.0	56.3	55.9	56.1
Foreign assistance (in percent of GDP) 3/	9.4	7.9	6.5	5.7	6.1	5.0	4.3	4.0	3.6
(In millions of dollars)	733	726	643	646	767	682	623	623	596
Balance of payments									
Current account balance (percent of GDP)	-20.9	-19.3	-21.3	-17.0	-17.5	-14.8	-14.1	-16.1	-16.0
Export growth rate (percent)		29	24	16	12	22	11	-2	3
Import growth rate (percent)		8	14	4	9	8	6	5	4
Gross reserves (months of imports of GNFS	3.5	4.0	3.8	4.7	5.5	5.6	5.6	5.2	4.8
	(In percent of exports of GNFS)								
Total external debt service	6.8	4.8	4.1	4.3	3.8	3.2	3.2	3.3	3.2

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

1/ Reflects a structural break in 2006 due to a change in statistical coverage.
2/ Data from 2006 onwards include an estimate of debt assumptions to settle domestic claims on government.
3/ Grants and disbursements of foreign loans.

APPENDIX I—BOSNIA & HERZEGOVINA: DEBT SUSTAINABILITY ANALYSIS

1. **Bosnia & Herzegovina's current and projected government indebtedness is comfortable, although bound tests show significant risks.** In the staff's baseline scenario (Table 10), the effect of the projected growth rate would offset the deterioration of the fiscal position and broadly stabilize the debt-to-GDP ratio. But assumptions to cover domestic claims against the government are a risk to debt dynamics. In the main scenario, in which debt assumptions to cover domestic claims are conservatively assumed to total slightly over 30 percentage points of GDP over 2006–08—see details in Box—the debt ratio broadly stabilizes over the medium term and gross financing needs, though increasing as a share of GDP, remain manageable. This is also the case in the "contingent liabilities shock" stress test, in which debt assumptions to cover domestic claims are higher than in the main scenario by 10 percentage points of GDP. But a significant growth slowdown could lead to explosive debt dynamics: the "growth shock" scenario (growth lower by 2 standard deviations, averaging 3.4 percent annually starting in 2007), combining the growth slowdown with an unchanged nominal expenditure path, demonstrates the risks of continued slow structural reform combined with ambitious expenditure plans. With the policy adjustment suggested by staff, however (Scenario A3), the debt-to-GDP ratio declines rapidly over the projection period.

Key Assumptions for the Fiscal Sustainability Analysis

- Continued strong growth and low inflation, and no policy change from the current stance over the medium term, in line with the staff's baseline medium-term projections (Table 10).
- Continued access to concessional external borrowing, with an average grant element of 35 percent and disbursements gradually declining from a peak of 2.1 percent of GDP in 2007 to 0.7 percent in 2011.
- Domestic borrowing on commercial terms (average projected LIBOR at 5 percent + 200 basis points) to cover additional financing needs, gradually increasing from deposit accumulation in 2007 to 2 percent of GDP in 2011.
- Increase in the face value of debt by 17 percent of GDP in 2006 associated with the settlement of frozen foreign currency deposits (FFCD), war claims, and general government obligations. The average grant element of these settlements is expected to exceed 25 percent (see Box 5).
- Increase in the face value of debt equivalent to 10 percent of GDP in 2007, and to 5 percent of GDP in 2008 from the possible recognition of additional domestic claims (losses of state enterprises, restitution claims, and other potential claims) on terms similar to those for the settlement of FFCDs.
- Privatization receipts of 2 percent of GDP in 2006 and in 2007 from the sale of the RS Telecom.

2. **Bosnia & Herzegovina's external debt relative to GDP is relatively high.** External sustainability indicators (external debt-to-export and GDP ratio) improve over the medium term. Bound tests show limited risks except for shocks on the current account. This reflects the assumption that economic growth is projected to remain well above the real effective interest rate on external debt. Gross external financing needs as a percentage of GDP remain constant after peaking in 2007 due to a jump in the demand for imports. The highest risk to external sustainability stems from a current account shock. Effective interest rates on external debt are low, largely the result of concessional borrowing from the World Bank. A change in the borrowing structure (from public to private or from concessional to nonconcessional) would also weaken the sustainability of Bosnia and Herzegovina's external debt position. Finally, an additional risk is that of a liquidity, rather than solvency, crisis. Although the dynamics in the baseline appear reassuring, current account financing will continue to depend heavily on largely unidentified and potentially volatile inflows. Reversal of these inflows could constrain liquidity and either compress imports or force short-term borrowing at much less favorable terms.

Key Assumptions for the External Debt Sustainability Analysis

- Continued strong growth and low inflation, and unchanged policies in line with the staff's baseline medium term projections (Table 10).
- Decelerating growth rate of exports and imports (in value), with the exports growth rate higher than imports.
- Continued access to concessional external borrowing, with an average grant element of 35 percent and disbursements gradually declining from a peak of 2.1 percent of GDP in 2007 to 0.7 percent in 2011.
- Sustained but declining, inflows of remittances, cross-border and seasonal workers' income.

Table 11. Bosnia and Herzegovina: Public Sector Debt Sustainability Framework, 2002–11

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	
							I. Baseline Projections						**Debt-stabilizing primary balance 10/**
Public sector debt 1/	34.8	30.6	28.1	31.7			**50.1**	**57.5**	**57.7**	**55.4**	**54.7**	**54.7**	**-1.7**
o/w foreign-currency denominated	34.3	30.2	27.8	30.0			29.4	28.6	27.1	25.3	24.0	22.8	
Change in public sector debt	-1.5	-4.2	-2.5	3.6			18.5	7.4	0.2	-2.3	-0.7	0.0	
Identified debt-creating flows (4+7+12)	-3.1	-5.5	-4.2	2.3			15.7	5.2	-2.5	-2.0	-0.9	-0.2	
Primary deficit	2.1	1.2	-0.2	-1.5			-1.4	1.0	1.0	0.9	1.3	1.6	
Revenue and grants	48.5	50.3	50.0	51.1			51.3	49.1	48.6	47.8	47.3	46.6	
Primary (noninterest) expenditure	50.7	51.6	49.9	49.6			49.9	50.2	49.5	48.8	48.6	48.2	
Automatic debt dynamics 2/	-5.1	-6.7	-4.0	2.1			-2.7	-4.0	-3.4	-2.9	-2.2	-1.7	
Contribution from interest rate/growth differential 3/	-0.8	-1.0	-1.6	-1.4			-2.8	-3.3	-3.3	-2.8	-2.1	-1.6	
Of which contribution from real interest rate	0.9	0.4	0.0	-0.1			-1.2	-0.6	-0.1	0.1	0.3	0.4	
Of which contribution from real GDP growth	-1.7	-1.4	-1.6	-1.3			-1.5	-2.8	-3.2	-2.9	-2.3	-2.1	
Contribution from exchange rate depreciation 4/	-4.4	-5.7	-2.4	3.5			0.1	-0.7	-0.1	-0.1	-0.1	-0.1	
Other identified debt-creating flows	-0.1	0.0	0.0	1.7			19.8	8.2	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.1	0.0	0.0	-0.3			-2.0	-1.8	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	2.0			21.8	10.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3)	1.6	1.3	1.7	1.3			2.7	2.2	2.6	-0.3	0.2	0.1	
Public sector debt-to-revenue ratio 1/	71.6	60.8	56.1	62.0			97.6	117.1	118.8	115.7	115.7	117.4	
Gross financing need 5/	4.2	3.2	1.4	0.7			1.7	2.7	4.0	4.1	5.0	6.0	
in billions of U.S. dollars	0.3	0.3	0.1	0.1			0.2	0.3	0.5	0.6	0.8	1.0	
Key Macroeconomic and Fiscal Assumptions					10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	5.0	4.1	5.8	5.0	4.8	0.8	5.5	6.0	6.0	5.4	4.5	4.0	5.2
Average nominal interest rate on public debt (in percent) 6/	3.3	2.4	2.1	2.2	2.5	0.5	2.4	1.4	1.9	2.1	2.4	2.7	2.1
Average real interest rate (nominal rate minus change in GDP deflator, in percei	2.8	1.2	0.2	-0.1	-0.2	2.3	-4.1	-1.1	0.0	0.3	0.6	0.9	0.1
Nominal appreciation (increase in US dollar value of local currency, in percent)	14.1	20.7	9.1	-11.6	3.5	13.3	-0.4	2.4	0.5	0.4	0.4	0.4	0.8
Inflation rate (GDP deflator, in percent)	0.5	1.2	1.9	2.3	2.7	2.1	6.5	2.5	1.9	1.8	1.8	1.8	2.0
Growth of real primary spending (deflated by GDP deflator, in percent)	1.7	6.0	2.2	4.5	1.0	6.5	6.2	6.5	4.6	3.9	4.0	3.1	4.4
Primary deficit	2.1	1.2	-0.2	-1.5	2.1	3.0	-1.4	1.0	1.0	0.9	1.3	1.6	1.2
							II. Stress Tests for Public Debt Ratio						**Debt-stabilizing primary balance 10/**
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2006–11 7/							**50.1**	**59.6**	**61.3**	**59.9**	**59.2**	**58.5**	**-2.9**
A2. No policy change (constant primary balance) in 2006–11							**50.1**	**55.1**	**53.1**	**48.6**	**45.5**	**42.8**	**-1.4**
A3. Balance consistent with staff advice (of 1/4 percentage point of GDP) in 2006–11							**50.1**	**57.5**	**57.7**	**51.0**	**47.8**	**45.0**	**-1.7**
B. Bound Tests													
B1. Real interest rate is at baseline plus one standard deviations							**50.1**	**58.1**	**58.8**	**57.0**	**56.9**	**57.4**	**-1.2**
B2. Real GDP growth is at baseline minus 2 standard deviations							**50.1**	**59.2**	**61.9**	**62.6**	**65.8**	**70.4**	**-1.1**
B3. Primary balance is at baseline minus one-half standard deviation							**50.1**	**59.1**	**60.6**	**59.7**	**60.3**	**61.7**	**-2.0**
B4. Combination of B1-B3 using one-quarter standard deviation shocks							**50.1**	**58.7**	**59.9**	**58.7**	**59.1**	**60.1**	**-1.5**
B5. One time 30 percent real depreciation in 2006 9/							**50.1**	**71.5**	**70.8**	**67.8**	**66.6**	**66.2**	**-2.1**
B6. 10 percent of GDP increase in other debt-creating flows in 2006							**50.1**	**67.5**	**67.1**	**64.3**	**63.3**	**63.0**	**-2.0**

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

1/ General government.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

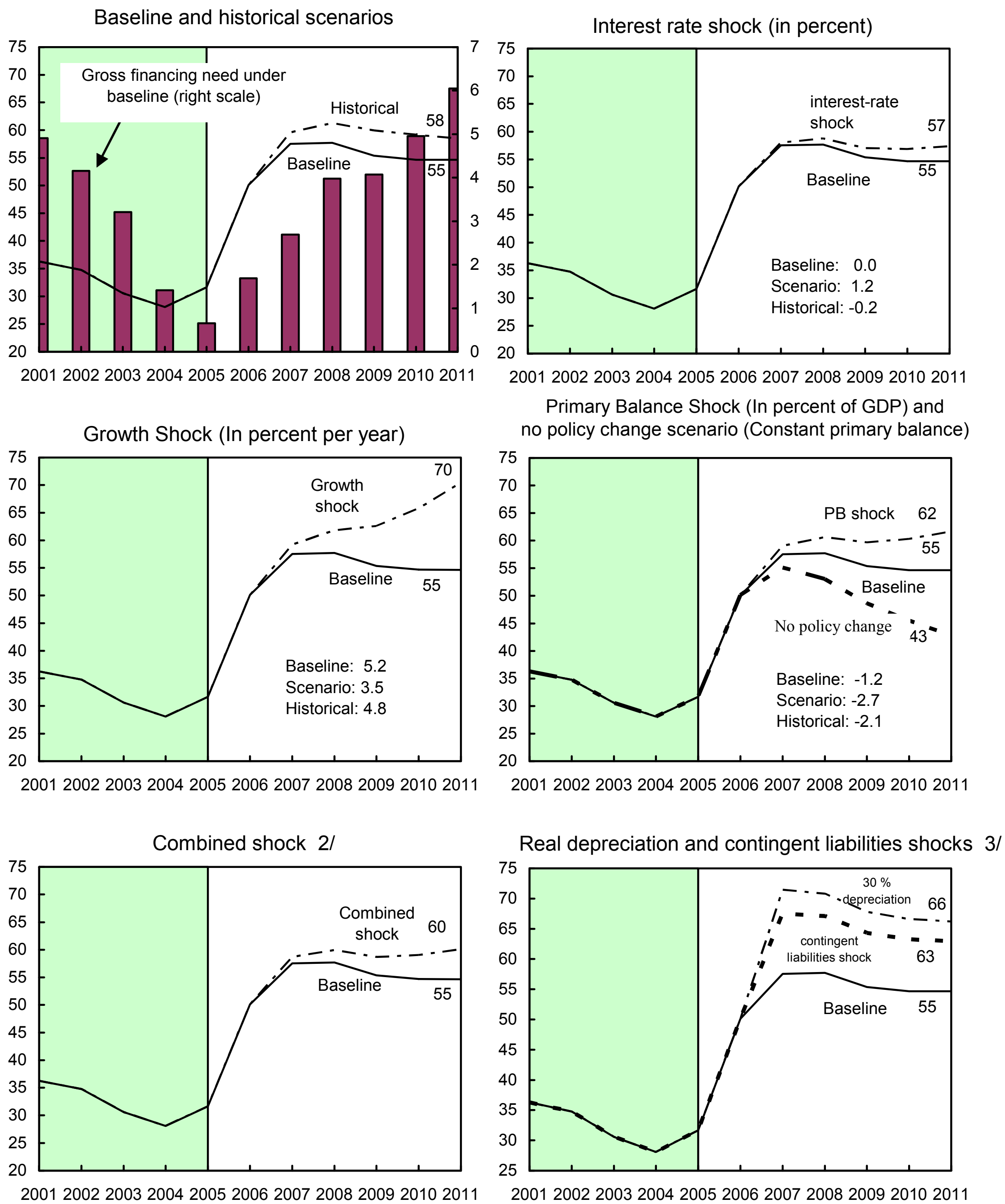
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ The implied change in other key variables under this scenario is discussed in the text.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

10/ 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.

Figure 5. Bosnia and Herzegovina: Public Debt Sustainability: Bound Tests, 2001-11 1/
(Public debt in percent of GDP)



Sources: Bosnia's data; and IMF staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent one-fourth standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ Onetime real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2007, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 12. Bosnia and Herzegovina: External Debt Sustainability Framework, 2002–11
(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	
							I. Baseline Projections						**Debt-stabilizing non-interest current account 6/**
External debt	56.5	55.3	53.5	57.9			**54.7**	**54.2**	**53.5**	**52.5**	**52.2**	**52.1**	**-4.7**
Change in external debt	5.6	-1.2	-1.8	4.4			-3.2	-0.5	-0.6	-1.0	-0.3	0.0	
Identified external debt-creating flows (4+8+9)	9.7	4.3	4.2	14.7			2.9	2.9	7.7	7.6	10.3	10.6	
Current account deficit, excluding interest payments	17.6	19.4	18.1	20.0			15.9	16.5	13.9	13.2	15.3	15.3	
Deficit in balance of goods and services	50.3	49.0	44.5	44.6			38.2	37.4	33.8	32.0	33.3	32.8	
Exports	26.3	28.1	32.3	36.3			37.0	37.7	41.0	41.7	39.0	38.3	
Imports	76.6	77.0	76.8	80.9			75.2	75.1	74.7	73.7	72.3	71.1	
Net non-debt creating capital inflows (negative)	-4.3	-4.9	-6.6	-3.0			-7.3	-9.0	-2.8	-2.6	-2.5	-2.3	
Automatic debt dynamics 1/	-3.6	-10.2	-7.4	-2.3			-5.7	-4.6	-3.4	-3.0	-2.5	-2.3	
Contribution from nominal interest rate	1.5	1.5	1.2	1.2			1.0	0.9	0.9	0.9	0.8	0.8	
Contribution from real GDP growth	-2.3	-1.8	-2.7	-2.5			-2.8	-2.9	-3.0	-2.7	-2.2	-2.0	
Contribution from price and exchange rate changes 2/	-2.9	-9.9	-5.9	-1.0			-4.0	-2.6	-1.3	-1.2	-1.1	-1.1	
Residual, incl. change in gross foreign assets (2-3)	-4.0	-5.5	-6.0	-10.3			-6.0	-3.4	-8.3	-8.6	-10.6	-10.6	
External debt-to-exports ratio (in percent)	214.9	197.1	165.7	159.4			147.8	143.9	130.7	125.8	133.7	136.3	
Gross external financing need (in billions of US dollars) 3/	2.1	3.1	3.8	4.6			4.8	5.2	5.3	5.8	6.6	7.2	
in percent of GDP	33.3	39.7	41.5	46.1			42.6	41.1	39.2	39.5	42.3	43.3	
Key Macroeconomic Assumptions					7-Year Historical Average	7-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	5.0	4.1	5.8	5.0	7.2	4.8	5.5	6.0	6.0	5.4	4.5	4.0	5.2
Exchange rate appreciation (US dollar value of local currency, change in perc	5.4	19.7	9.9	0.2	2.1	10.7	0.8	2.4	0.5	0.4	0.4	0.4	0.8
GDP deflator in US dollars (change in percent)	6.0	21.2	12.0	2.0	4.9	9.4	7.4	5.0	2.4	2.3	2.2	2.2	2.8
Nominal external interest rate (in percent)	3.3	3.3	2.7	2.4	2.8	0.4	2.0	1.9	1.8	1.8	1.7	1.6	1.8
Growth of exports (US dollar terms, in percent)	-0.5	34.7	36.2	21.0	16.4	15.5	15.4	13.3	18.1	9.8	-0.1	4.2	9.0
Growth of imports (US dollar terms, in percent)	8.4	26.9	18.0	13.4	16.3	17.5	5.3	11.1	8.1	6.3	4.7	4.4	6.9
Current account balance, excluding interest payments	-17.6	-19.4	-18.1	-20.0	-14.4	5.8	-15.9	-16.5	-13.9	-13.2	-15.3	-15.3	-14.8
Net non-debt creating capital inflows	4.3	4.9	6.6	3.0	3.6	1.7	7.3	9.0	2.8	2.6	2.5	2.3	3.9
							II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2006–11 4/							**54.7**	**57.4**	**55.3**	**53.4**	**50.4**	**48.1**	**-7.8**
A2. Adjustement policy scenario							**54.7**	**54.2**	**52.7**	**51.4**	**49.0**	**47.4**	**-7.7**
B. Bound Tests													
B1. Nominal interest rate is at baseline plus one-half standard deviation							**54.7**	**54.3**	**53.7**	**52.8**	**52.5**	**52.6**	**-4.6**
B2. Real GDP growth is at baseline minus one-half standard deviation							**54.7**	**55.1**	**55.0**	**54.3**	**53.9**	**53.4**	**-3.8**
B3. Non-interest current account is at baseline minus one-half standard deviation							**54.7**	**57.1**	**59.2**	**60.7**	**62.9**	**65.3**	**-5.2**
B4. Combination of B1-B3 using 1/4 standard deviation shocks							**54.7**	**56.1**	**57.2**	**57.7**	**58.6**	**59.7**	**-4.4**
B5. One time 30 percent real depreciation in 2007							**54.7**	**73.4**	**65.8**	**58.3**	**50.9**	**44.2**	**-5.5**

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

g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

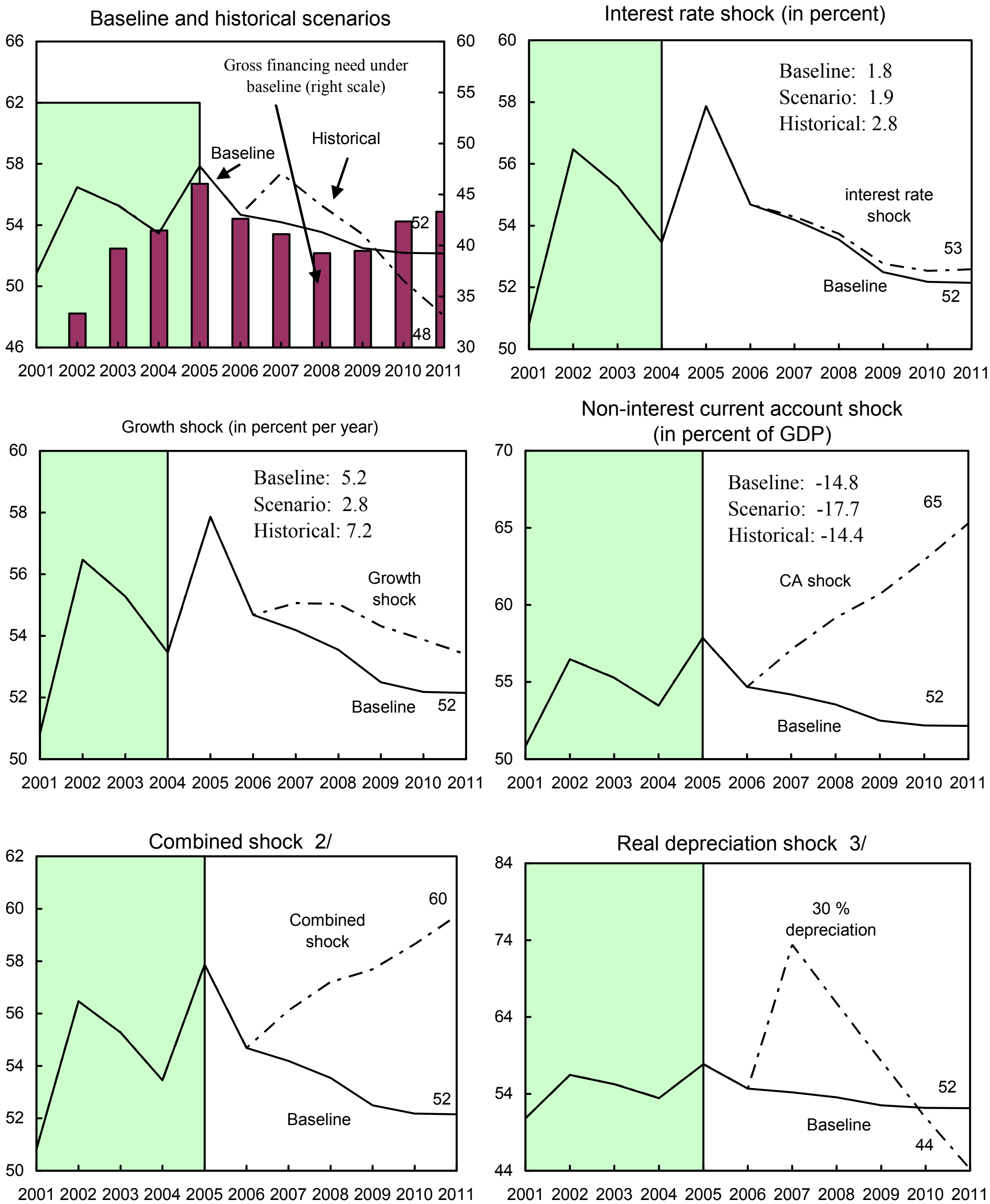
3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

5/ The implied change in other key variables under this scenario is discussed in the text.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 6. Bosnia and Herzegovina: External Debt Sustainability: Bound Tests, 2001-11 1/
(External debt in percent of GDP)



Sources: Bosnia's data; and IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent one-fourth standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ Onetime real depreciation of 30 percent occurs in 2006.

APPENDIX II—BOSNIA & HERZEGOVINA: FUND RELATIONS

As of August 31, 2006

I. Membership Status: Member since 12/14/1992; Article XIV

II. General Resources Account:

	SDR Million	%Quota
Quota	169.10	100.00
Fund Holdings of Currency	193.10	114.20

III. SDR Department:

	SDR Million	%Allocation
Net cumulative allocation	20.48	100.00
Holdings	0.25	1.20

IV. Outstanding Purchases and Loans:

	SDR Million	%Quota
Stand-by-Arrangements	24.00	14.19

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	8/02/2002	2/29/2004	67.60	67.60
Stand-by	5/29/1998	5/29/2001	94.42	94.42

VI. Projected Payments to Fund on Expectations Basis:(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	10.50	12.00	1.50	0.00	0.00
Charges/Interest	0.49	1.27	0.82	0.79	0.79
Total	10.99	13.27	2.32	0.79	0.79

VII. **Safeguards Assessment**

Under the Fund’s safeguards assessments policy, the Central Bank of Bosnia and Herzegovina (CBBH) is subject to a full safeguards assessment with respect to any new Stand-By Arrangement. The assessment was completed on January 24, 2005 and concluded that safeguards in place at the CBBH were generally adequate. However, weaknesses were identified in the internal audit and control system, and the safeguards assessment recommended measures to address them.

VIII. **Exchange Rate Arrangements**

The currency of Bosnia and Herzegovina is the convertible marka (KM), introduced on August 11, 1997. On September 5, 2002, the State parliament approved an amendment to the CBBH law that changes the peg of the KM from the DM to the Euro under a currency board arrangement. The KM is pegged to the euro at KM 1 = 0.5113 euro.

Bosnia and Herzegovina maintains restrictions on payments and transfers for current international transactions resulting from measures taken with respect to frozen foreign currency deposits as identified in IMF Country Report No. 02/52.

IX. **FSAP**

Two FSAP missions took place in December 2005 and March 2006, and an *Aide Mémoire* was presented to the authorities. The FSAP assessed risks to financial stability and weaknesses in banking supervision using a Basel Core Principles assessment. It also consider financial sector development needs in the areas of insurance, access to finance, the insolvency regime and corporate governance, drawing on a detailed assessment of the OECD Principles of Good Corporate Governance. The FSSA is being presented to the Board along with the 2006 Article IV consultation.

X. **Last Article IV Consultation**

Bosnia and Herzegovina is on the twelve month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The last Article IV consultation was concluded on May 27, 2005.

XI. **Resident Representative**

Mr. John Norregaard and Mr. Graham Slack have been the Fund's resident representatives in Bosnia and Herzegovina since August 2004. Mr. Norregaard completed his assignment in June 2006.

XII. **Technical Assistance 2000–2006**

Department	**Timing**	**Purpose**
FAD	August 2000	Treasury systems
	September–October 2000	Value-added tax
	July 2001	Treasury Systems
	April 2002	Value-added Tax
	April 2002	Treasury systems
	February 2003	Treasury systems
	May 2003	Public expenditure management
	June 2004	VAT policy and implementation
	March 2005	Poverty and social impact analysis (VAT)
	March 2005-2006	Macro-Fiscal advisor
MCM	September 2000	Advisor on payments system.

	March–April 2001	Payments system, currency management, accounting and research
	January–February 2002	Payment system
	October–November 2002	Strengthening Banking Supervision
	August–September 2003	Banking supervision
	September 2003	International reserve management
	April 2004	AML/CFT Supervision
	January 2005	Advisor to CBBH Governor
	January 2005	Banking supervision
	April 2005	Credit Risk and Rapid Credit Growth
	September 2005	Financial soundness indicators
	November–December 2005	FSAP (primary mission)
	March 2006	FSAP (second mission)
STA	October 2000	Money and banking statistics
	December 2001	Money and banking statistics
	April–May 2004	Money and banking statistics
	May 2004	Government finance statistics
	March 2005	Workers' remittances
	November 2005–2006	Real sector statistics advisor

APPENDIX III—BOSNIA & HERZEGOVINA: STATISTICAL ISSUES

1. Data provision is inadequate for surveillance purposes. The Dayton peace treaty, which ended the civil war, implicitly gave responsibility for statistical functions to the two Entities (The Federation of Bosnia & Herzegovina and Republika Srpska). In August 1998, the State created its own statistical institute, the Bosnia & Herzegovina Agency for Statistics (BHAS) with a view to compiling country-wide statistics in accordance with internationally accepted methodologies, consolidating data produced by the Entities Statistical Institutes, and acting as the primary coordinating agency for contacts with international agencies. Significant technical assistance was provided in recent years, mainly by the European Union. A Fund resident statistical advisor was assigned to the Central Bank of Bosnia & Herzegovina (CBBH) in May 1999, to provide technical assistance in the development of all areas of macroeconomic statistics on the basis of the comprehensive review conducted in early 1998 by the Fund's Multisector Statistics mission and the recommendations of Fund missions in the areas of monetary and balance of payments statistics. A country page for Bosnia & Herzegovina in International Finance Statistics (IFS) was introduced in July 2001. A STA resident real sector statistical adviser was appointed to Bosnia & Herzegovina in November 2005.

A. Real Sector

2. In recent years, efforts have been made in both Entities to improve real sector statistics, but results have been mixed. The Federation and RS both have published nominal GDP estimates using the production approach based on international standards recommended by the *1993 SNA*, since 1998 and 1999, respectively. However, in both cases, production estimates at constant prices and GDP by expenditure are still unavailable and informal sector activities are under-recorded. A household budget survey, which will serve as the basis for revising price indices and facilitate the compilation of GDP by the expenditure approach, has been completed. There are still no meaningful short-term business and consumer surveys. Both statistical offices compile price indices using outdated methodologies, and consistent time series are not available. Industrial production indices are prepared in each Entity, but there is no index at the country level and consistent time series are not available. Labor statistics are the weakest area for both Institutes, and data on employment, unemployment, and wage rates are based on deficient methodologies.

B. Balance of Payments

3. Trade data are published by the BHAS and balance of payments statistics by the Central Bank of Bosnia & Herzegovina (CBBH). There is however a high degree of uncertainty about the true values of balance of payments aggregates. Shortcomings in the data limit their usefulness. The quality of the balance of payments data is generally poor, in particular with regard to the coverage of foreign grants, workers' remittances, income residents receive from working for international organizations in Bosnia & Herzegovina and the spending of by their nonresident staff, and trade credit by suppliers. Significant progress has been made in improving merchandise trade data as a result of the introduction of the

ASYCUDA processing system; moving to an integrated customs administration for the whole country; reorganization of customs; and the introduction of a trade classification system. BHAS now produces export and import data from customs records, but needs to produce these data on a general trade basis and not just on a special trade basis.

C. Government Finance

4. The CBBH has recently agreed, in accord with the finance ministers of the State and two entity governments, to take the lead in compiling Government Finance Statistics (GFS) on a countrywide basis, and assigned a team of three staff to work on the GFS. At its request, STA fielded a GFS technical assistance mission in September 2003. The mission examined the structure of the relations between governments and advised on sector classification for international comparison purposes. It developed a system to allow budget data to be classified, aggregated, and consolidated into summary GFS aggregates for all governments, except for municipalities. This exercise also demonstrated that currently available data do not provide a satisfactory basis for compilation of GFS. The mission suggested enlisting the help of USAID to develop reporting systems that can electronically link GFS codes with ORACLE accounting systems used in the Treasuries. Reporting systems are still being developed.

5. The mission developed a medium term development plan for fiscal statistics in Bosnia & Herzegovina, taking account of the problems posed by the complexity of the Bosnia & Herzegovina government structure and the difficulties faced by the CBBH in collecting and processing data. The mission recommended a conservative approach, with the essential first step utilizing simple systems and processes which allow summary GFS reports to be produced on a timely and regular basis. Progress requires commitments by all parties to cooperate, as well as additional computer resources and, in the long run, more staff, at the CBBH.

6. In 2005, Bosnia reported GFS to STA for the first time for publication in the *Government Finance Statistics Yearbook* covering central government operations for 2003 and 2004.

D. Monetary Accounts

The CBBH reports monetary accounts to the Fund on both a countrywide and Entity basis. It also began, in early 2003, reporting weighted average interest rate data for bank deposits and loans with data from January 2002 onward for publication in the IFS. Over the period 1996–2001, several Fund technical assistance missions have assisted the authorities in establishing an integrated system for compiling countrywide monetary statistics meeting Fund standards. The latest mission, in April/May 2004, reviewed in particular the recent institutional changes and accounting developments that have important implications for monetary statistics and assisted in revising and updating the current monetary data compilation procedures. The mission recommended improvements in, among other areas, the treatment of “passive accounts” on banks’ balance sheets, banks’ claims arising from “credit card debts,” “euro-linked” loans in national currency, and government accounts.

APPENDIX III: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF AUGUST 31, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	8/31/06	8/31/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	July 2006	August 2006	M	M	M
Reserve/Base Money	July 2006	August 2006	M	M	M
Broad Money	July 2006	August 2006	M	M	M
Central Bank Balance Sheet	July 2006	August 2006	M	M	M
Consolidated Balance Sheet of the Banking System	July 2006	August 2006	M	M	M
Interest Rates[2]	July 2006	August 2006	M	M	M
Consumer Price Index	July 2006	August 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2005	July 2006	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	June 2006	August 2006	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2005	March 2006	A	A	A
External Current Account Balance	Q1 2006	July 2006	Q	Q	Q
Exports and Imports of Goods and Services	Q1 2006	July 2006	Q	Q	Q
GDP/GNP	2005 (p)	July 2005	A	A	A
Gross External Debt	2005	March 2006	A	A	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A);Irregular (I); Not Available (NA).

APPENDIX IV—BOSNIA & HERZEGOVINA: WORLD BANK RELATIONS

A. Bosnia and Herzegovina's Poverty Reduction Strategy

1. The World Bank has taken the lead in supporting the structural and institutional reforms underpinning progress from post-conflict recovery as well as in the finalization of the Medium-Term Development Strategy/Poverty Reduction Strategy Paper (PRSP). The PRSP, drawing on the EC's 2003 feasibility study of the stabilization and association process, was agreed by entity and state governments in February 2004 for the period through 2007. It commits the authorities to sustainable and balanced economic development, poverty reduction, and accelerated EU integration.

2. After one year, a large number of the proposed measures have been implemented. But hesitant cooperation between entity governments has delayed implementation of some of the most important measures including adoption of a framework law on higher education, a legal framework to establish minimum social entitlements for all citizens, introduction of targeted safety nets, and definition of reform to the pension system.

B. World Bank Projects

3. A Country Assistance Strategy (CAS) covering FY05–07 was approved in August 2004. It is anchored in the PRSP and structured along three pillars: (i) improving public finance and strengthening institutions; (ii) promoting sustainable private-sector led growth; and (iii) investing in key social and economic infrastructure. The base case sets IDA allocations at US$152 million and is conditional on satisfactory macroeconomic and reform performance. The CAS is designed to help improve creditworthiness, which should ultimately enable BiH to access a substantially larger pool of IBRD resources.

4. While no longer receiving the levels of financing following the 1995 Dayton Accord, BiH still enjoys exceptional access to concessional IDA financing despite income per capita well-above the IDA threshold. The active IDA portfolio includes 13 investment and three adjustment projects with a total commitment of US$361 million, of which US$230 million remain to be disbursed. Negotiations have recently been completed on the US$290 million **"Power 4"** electricity sector modernization project. The Bank will provide US$36 million, with other multilateral and bilateral donors providing the rest.

5. The investment side of the portfolio has performed well, with only a few problem projects. However, there have been significant challenges on the adjustment side. The **Second Social Sector Structural Adjustment Credit (SOSAC II)**, with an undisbursed amount of US$51 million, lapsed at the end of June 2006, with the 2006 budgets still not in line with the authorities' commitments under the credit despite repeated extensions of the deadline for declaring the credit effective.

6. Reforming government spending and higher education finance is the key objective of the **Economic Management Structural Adjustment Credit (EMSAC)**, the first tranche of which was released in December 2004. A second tranche of about

US$25 million is scheduled to be disbursed by end 2006 provided the credit's conditions are met, including submission to the state parliament of a draft higher education law, enactment of state and RS salary laws, and enactment of internal and supreme audit laws. Progress on most of these conditions is moderate to slow. The Bank delivered the **Public Expenditure and Institutional Review (PEIR)** to the authorities in June 2006.

7. Improving the business environment with support from **Bank's Business Environment Adjustment Credit (BAC)** will be critical to strengthening growth and employment and encouraging investment. Although delayed, supporting legislation has now been passed in both entities but needs to be implemented to permit disbursement of the final US$24 million tranche in early 2007. The World Bank has been discussing with the authorities the importance of accelerating corporate restructuring, including via privatization and bankruptcy. A **Programmatic Development Policy Credit** could be offered to support this reform.

Statement by Jeroen Kremers, Executive Director for Bosnia and Herzegovina and Nir Klein, Senior Advisor to Executive Director October 13, 2006

General remarks

Not withstanding extreme complexities, stemming from its unique political and economic structure, Bosnia & Herzegovina (BiH) has made considerable progress in recent years. With assistance from the international community, including the Fund, the authorities have succeeded in restoring macroeconomic and financial stability, rebuilding policy-making institutions and reconstructing the infrastructure severely damaged from the three-year war. These policies have had a significant and positive impact on economic activity and stability. Over the past decade, GDP – although from a very low level - tripled; the high fiscal deficits turned into surpluses; inflation significantly declined and structural and state-building reforms were launched. These achievements paved the way to talks with the EU representatives toward the Stabilization and Association Agreement (SAA) at the end of 2005.

Having said that, the authorities acknowledge that much remains to be done and there are many risks up the road. The unemployment and poverty levels are still high, the current account deficit is large, the private sector continues to be weak and the financial system and business climate need to be enhanced. Additionally, the high internal debt threatens fiscal sustainability. Indeed, the economy is lagging behind other countries in the region in several transition indicators. Sharing the staff's observations and concurring with the main recommendations for policy priorities, the authorities stress that lack of political support exacerbated by fragmented institutions have prevented them from more forcefully moving forward with important reforms.

It is therefore regrettable that after two successful SBAs, the authorities and staff failed to agree on the third SBA, particularly in an election year, when budgetary pressures mount. The authorities hope that cooperation with the Fund will continue soon after the new government is formed. This would be highly important for the Bosnian authorities, to agree on a prudent consolidated budget for 2007 and to formulate an explicit reform agenda for strengthening the private sector and competitiveness. Moreover, close cooperation with the Fund would also be beneficial to facilitate public consensus on the required structural reforms as well as to improve the country's image for investors.

Macroeconomic developments

Supported by favorable external conditions along with the growing interest of foreign investors, economic activity continues to record strong growth, making the country one of the fastest growing economies in the region. In 2005, GDP grew by 5 percent, and with the ongoing surge in exports and investment, the authorities project that the growth rate will accelerate to 6 percent in 2006 and further to around 7 percent in 2007-09. The current account balance has improved in the past year and together with high capital inflows, contributed to the economy's external resilience. In this context, international reserves this year have reached the highest level in the post-war era, both nominally and in terms of months of import, and the external debt-to-GDP ratio is projected to slightly decline to below 30 percent. Following a moderate decline in 2005, Foreign Direct Investments (FDI) renewed their upward path and reached, in 2006, a record-high level.[1]

The authorities welcome the staff's selected issues paper on BiH's current account deficit, which shows that the "true" current account deficit is much lower than the official figure suggests. This estimation supports the authorities' position in past discussions and shows that the external vulnerability of BiH is equivalent to that of other countries in transition, including some with a currency board arrangement. Going forward, the authorities concur with staff that the large current account deficit is still a matter of concern and requires sound policies to support its reduction. In this context, the authorities stress the importance of a combined policy action of fiscal and monetary instruments to improve the external position. They also believe that the growing external demand for Bosnian products with sustained strong growth will stimulate a continuous decline in the current account-to-GDP ratio.

Structural reforms

The authorities fully concur with staff that strengthening the private sector, widening the export base and improving competitiveness are beneficial to further reduce external vulnerabilities. The authorities also agree that the implementation of reforms is somewhat protracted; however, they stress that this is not a result of a lack of clear strategy. In this context, the private sector and the labor market reforms are properly addressed within the Mid-Term Development Strategy for 2004-07 (PRSP), which has been supported by the World Bank's and the IMF's Executive Boards. The current Mid-Term Development Strategy ends next year and the elected governments will have to prepare the new one by the end of 2007. The authorities believe that this will be an opportunity for the new governments to commit to speeding up structural reforms. Despite some delays, the authorities have continued to enhance private sector activity by moving forward with companies' restructuring this year. However, following the amendment to the Republika Srpska (RS) privatization law, which allows greater flexibility in the privatization process, it gained greater momentum in RS than in the Federation. A development worth noting in that respect is the RS government's decision to call for an international tender for the sale of the publicly held telecommunications

[1] According to the data, which was published by the CBBH early October, the total FDI for 2005 was KM 823 mln.

provider, Telecom Srpska, which is the second largest telecom company in BiH. The authorities hope to conclude the sale by the end of the year. Preparations for the sale of the oil refineries at Brod and Modrica together with a fuel retailer, Petrol, are taking place as well. As for the Federation, the government sold 67 percent of Bosnia's biggest fuel retailer Energopetrol (September), but its plan to sell 24 sizable companies in 2006 is somewhat lagging behind. The authorities expect that the adoption of the law that allows privatization of firms via the stock exchange (July) will speed up the process.
Bosnia & Herzegovina remains committed to trade liberalization. Despite its high trade deficit, the authorities fully liberalized the trade of agricultural goods and reduced the average custom protection to the lowest in the region. The authorities also take active part in the current CEFTA discussions, aimed at establishing a free trade zone in Southeast Europe to replace the existing bilateral free trade agreements. The last round of CEFTA negotiations are supposed to be held by the end of October.

Fiscal issues

With the successful implementation of the VAT and the fiscal discipline kept throughout 2006, the authorities are pleased to note that the country will record a fiscal surplus in 2006 following the surplus recorded in 2005. The authorities do not share the staff's view that the growing spending pressures in 2006 have not been resisted. To the contrary, they underscore that neither the state nor any of the entities rebalanced their budgets despite the elections and the strong growth in VAT revenues. They are aware that some deterioration occurred at the canton level and by approval of the new war-veteran legislation in the Federation; however, given the strong VAT revenues, they project that fiscal consolidation will be even stronger in 2006 than over the previous year. The authorities are pleased to note that this outcome will occur in the absence of the IMF's SBA – an evidence of the authorities' continued commitment to strong and prudent fiscal policies.

The BiH state government has recently approved the Budget Framework Paper (BFP) for the next three years (2007-2009). The BFP adheres to the principle that the demand for increased spending on priority projects should be covered by savings in low priority areas, and it envisages explicit recommendations for a higher level of fiscal sustainability through fiscal consolidation and fiscal reforms, particularly in the areas of revenue collection, social services systems, public investment and public expenditure management. The BFP needs to be approved by the National Fiscal Council (NFC), and should be seen, at this point, as the authorities' commitment to prudent fiscal policy.
In view of rising spending pressures, including from diminishing donor assistance, the settlement of domestic claims and the EU integration process, which requires building new state institutions, the authorities are not convinced that the staff's proposed fiscal targets are appropriate. According to their view, fiscal targets should remain close to balance to ensure fiscal sustainability, and at the same time provide sufficient resources to overcome increasing needs.

The authorities note with satisfaction that the introduction of the VAT went smoothly, and attempts to adopt VAT exemptions were successfully blocked by the parliament. So far, VAT revenues are significantly higher than previously expected and the authorities project that further improvement of tax collection will boost revenues even more. The authorities plan to spend a share of total VAT revenues to decrease direct taxes, particularly labor taxes, which will promote creation of new jobs in the private sector, and reduce the currently large informal sector of the economy. Accordingly, in 2006 the authorities continue with preparations of direct taxation system reform, including taxes on capital, labor and property.

The authorities agree with staff that inadequate fiscal co-ordination remains a serious weakness. To enhance coordination of budget design and execution among various levels of government, the authorities have agreed on a draft of the NFC law, which is consistent with the staff's key recommendations. The draft contains clear and well-designed mechanisms for fiscal coordination and envisages the maximum enforcement possible under the current constitution of BiH. Many political parties have expressed commitment to continue discussion on constitutional changes after the elections and are of the view that any constitutional changes should address positioning the NFC within the Constitution in order to strengthen the enforcement mechanism under the existing draft law.

Like staff, the authorities perceive the domestic claim settlement a priority. The plans for settling the war-related claims have been approved by the both entities and the work on settlement of restitution and frozen deposits claims is underway. Indeed, these claims envisage large fiscal pressures; however, the authorities reiterated their commitment to approve the new legislation prudently and in a fiscally sustainable manner.

Monetary issues

The high credibility of the currency board has served the economy well in keeping inflation under control and maintaining financial stability. In 2006 inflation has somewhat accelerated due to the VAT introduction, the increase in oil price and the continuous reform in the energy sector, however, from 2007 onwards the authorities project that inflation will revert to low levels. The Central Bank of BiH (CBBH) intervened several times in the past by raising the required reserves (RR) rate in order to slow down credit growth. To that end, in December of 2005 the CBBH raised the RR to 15 percent and succeeded to somewhat suppress the rapid credit growth.[2] At this juncture, the current level of RR is seen by the CBBH as appropriate, yet it is closely monitoring

[2] Although in nominal terms the credit growth rate is still high, in real terms, in view of the relatively high inflation this year, credit growth is significantly lower than in 2005.

credit developments and is prepared to adjust its policy if needed. The CBBH confirm that, in line with the staff's advice, the statutory 20 percent cap on RR has been removed (as of early October).

Financial stability and supervision

The authorities are committed to thoroughly analyze the FSAP recommendations and to address the identified shortcomings. In this context, the CBBH is developing its own capacities to better assess potential risks and weaknesses within the financial sector. The Fund's continued help in this regard is of great importance and the authorities hope to be able to rely on it in the future as well.

The authorities are well aware that the current organization of banking supervision is not adequate and it hinders further development. In this regard, a unified supervision system at the state level seems to be more effective in safeguarding financial stability and will be in line with the general approach of building a single economic space in BiH. However, since this issue is politically charged, further discussions on the supervision's coverage, institutional setup and location are expected to take place after the newly elected governments are formed.

The authorities agree that the leasing sector needs better supervision; however they do not share the staff's view that this should be done under the umbrella of banking supervision, particularly given that the leasing companies are not deposit taking institutions and do not affect the functioning of the banking sector in a material way. The authorities stress that, in view of the multiple assignments together with the limited resources, the banking supervision agencies should focus, at this point, on improving their risk assessments and bank oversight.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 06/117
FOR IMMEDIATE RELEASE
October 19, 2006

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Bosnia and Herzegovina

On October 13, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bosnia and Herzegovina.[3]

Background

Economic activity has remained robust and inflation low over the past several years. Growth has averaged 5 percent annually, and inflation—underpinned by the currency board—has remained low. Financial deepening has continued, the banking system is largely privatized, and international reserves are high and rising. Customs and indirect tax policy have been unified and a value-added tax (VAT) successfully introduced in January 2006. The general government balance has strengthened by 4 percentage points of GDP during 2001–05, while public debt at 32 percent of GDP at end–2005 is relatively low.

But these achievements continue to be hostage to fundamental political and economic imbalances: policy coordination hampered by weak institutions and lack of political will, lagging structural reforms, and a large current account deficit. While the recent intergovernmental agreement on a draft National Fiscal Council law represents a major step toward improved fiscal policy coordination, it has yet to be implemented.

---

[3] 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. 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.

The fragmented fiscal system and the continuing dispute over the allocation of indirect tax revenue highlight the ineffectiveness of current coordination mechanisms and the resistance against centralizing key policy functions.

The approach of the October elections has led to fiscal policy slippages this year. Although the general government is likely to record a small surplus in 2006, this reflects temporary gains from the introduction of the VAT. If these lapse in 2007, the government deficit could—in the absence of corrective action—deteriorate by over 2 percentage points of GDP. Moreover, an uncertain but potentially large amount of outstanding claims against the government continues to be a major threat to fiscal sustainability over the medium term. Recent steps toward restructuring some of these claims are mitigating these concerns, but risks remain.

The current account deficit of the balance of payments, while likely much smaller than official estimates indicate, is large, reflecting insufficient private savings. Export growth has accelerated in 2004 and 2005, but the export base remains narrow and vulnerable to commodity price movements. Competitiveness indicators are mixed.

The rapid growth of credit to the private sector has drawn attention to the financial sector's vulnerabilities. The recent Financial Sector Assessment Program has found that, while the large presence of foreign banks may help enhance the system's resilience to shocks, they may underestimate credit risk and their reliance on low-cost foreign funding diminishes the incentive to mobilize long-term local deposits. The fragmentation of bank supervision among different agencies, the absence of consolidated supervision, and severe weaknesses in corporate governance are also sources of vulnerability for the financial sector.

Structural reforms lag behind those in neighboring countries and sustained private sector-led growth has yet to take root. At 50 percent of GDP, the government dominates the economy, while large segments of the corporate sector remain loss-making and unemployment is widespread. Notwithstanding a few large investments in metals and mining, foreign direct investment penetration, at less than $600 per capita, is one of the lowest in the region.

Executive Board Assessment

Executive Directors welcomed the strong economic growth and price stability achieved in recent years. They noted, however, that while postwar reconstruction and expansion of public consumption and investment had improved living standards, it had left the economy with inefficiencies in the structure of government, a large external imbalance, and high unemployment. While achievements in fiscal consolidation and in fostering price stability were recognized, Directors voiced concern over fragmented economic policy making and called for stronger policy ownership, improved coordination, and meaningful progress in structural reforms to strengthen the basis for sustained, private sector-led growth.

Directors noted that the fiscal situation remains fragile, given the intensifying spending pressures along with the transitory windfall from the VAT introduction, and the potentially large, unresolved domestic claims against the government. In this context, they cautioned that unrealistically generous terms for settling outstanding domestic claims would jeopardize long-term fiscal sustainability. Directors advised that a fiscal policy that aims at sustaining small surpluses over the medium term will help generate the increased domestic savings needed to address the external imbalance and keep public debt on a declining path. Reducing the duplication of government functions, prioritizing expenditures, and rationalizing social transfers and the wage bill will create room for additional priority spending, as well as for reducing the high burden of taxation.

Directors welcomed the agreement on a draft National Fiscal Council law, and urged that it be implemented without delay. They noted that, while the law is indispensable for better fiscal coordination, securing better fiscal policies and more efficient intergovernmental fiscal relations will also depend on strengthening the political cooperation. Over the medium term, it will be necessary to harmonize the provisions of the multitude of social safety nets and pension systems, as well as to rationalize revenue-sharing arrangements. These reforms will contribute to reducing the size of government and the tax burden.

Directors considered that the currency board has served Bosnia and Herzegovina well by providing an anchor for macroeconomic policies and contributing to business and investor confidence. They emphasized that, in addition to a prudent fiscal policy, structural reforms will be critical for maintaining the viability of the currency board, and expressed concern at their slow pace this year. Directors urged action on measures to make labor markets more flexible, amending labor laws to stop the accumulation of wage arrears, and accelerating corporate restructuring through bankruptcy and privatization. As the authorities intend to maintain the currency board until EU membership and adoption of the euro, the early launching of these reforms is imperative.

Directors noted that financial sector stability indicators are largely positive, and urged the authorities to address remaining vulnerabilities. The rapid credit growth of recent years highlights the need to improve credit risk management by banks. In this context, Directors urged the authorities to unify bank supervision as soon as possible. Directors welcomed the operation of the credit registry and the plans to extend it to cover households by end-2006.

Directors noted that, despite recent improvements in trade statistics, poor data quality hampers policy making and impedes effective surveillance. They urged the authorities to make data quality a priority and take all necessary steps, including by taking advantage of the donor technical support, to improve transparency, timeliness, and comprehensiveness of economic and financial data, particularly in the areas of the national accounts and balance of payments.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Bosnia and Herzegovina: Selected Economic Indicators, 2002–06

	2002	2003	2004	2005 Est.	2006 Proj.	
			(Percent change)			
Real GDP	5.0	4.1	5.8	5.0	5.5	
CPI (period average) 1/	0.3	0.6	0.2	2.8	6.5	
Money and credit (end of period)						
Broad money 2/	7.0	10.0	24.3	18.2	22.4	
Domestic credit	37.4	25.4	31.1	27.7	19.3	
Of which: credit to the private sector	36.2	24.8	27.5	27.5	23.0	
			(In percent of GDP)			
General government budget						
Revenue	46.0	50.3	50.0	51.1	51.3	
Expenditure (on a commitment basis)	49.3	52.4	50.4	50.2	50.6	
Overall balance	-3.3	-2.0	-0.4	0.9	0.7	
External public debt	34.3	30.2	27.8	30.0	29.4	
NPV of external public debt	26.2	23.1	21.2	22.9	22.5	
Total public debt	34.8	30.6	28.1	31.7	48.2	3/
			(In millions of euros)			
Balance of payments						
Exports of goods and services	1,721	1,935	2,398	2,897	3,316	
Imports of goods and services	5,012	5,313	5,704	6,455	6,742	
Current account balance	-1,252	-1,444	-1,437	-1,695	-1,523	
(In percent of GDP)	-19.1	-20.9	-19.3	-21.3	-17.0	
Gross official reserves	1,272	1,436	1,782	2,160	2,512	4/
(In months of imports)	3.3	3.5	4.0	3.8	4.6	
External debt service	132	131	116	119	144	
(In percent of exports of goods and services)	7.7	6.8	4.8	4.1	4.3	
Exchange rate regime			Currency board since August 1997			
Exchange rate, October 13, 2006			1KM = Euro 0.5113			
Real effective exchange rate (2000=100, increase=appreciation)	95.1	95.4	94.4	93.4	...	

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

1/ Based on weighted averages for the Federation and Republika Srpska.
2/ Broad money includes currency, demand deposits, time and savings deposits, bonds, and money market instruments.
3/ Assuming 17 percent of GDP of debt to settle domestic claims against the government.
4/ End-July.