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Bosnia & Herzegovina: 2010 Article IV Consultation, Second and Third Reviews Under the Stand-By Arrangement, Request for Waiver of Nonobservance of a Performance Criterion, and Rephasing of Purchases

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on September 1, 2010, 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 21, 2010. 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.

- Supplementary Information and Supplementary Letter of Intent completed on October 14, 2010

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during October 15, 2010 discussion of the staff report that concluded the Article IV Consultation

- A Press Release summarizing the views of the Executive Board as expressed during its October 15, 2010 discussion of the staff report for Bosnia and Herzegovina

- A statement by the Executive Director for the Bosnia and Herzegovina

The document(s) listed below will be separately released

Selected Issues
Letter of Intent and Supplementary Letter of Intent sent to the IMF by the authorities of Bosnia and Herzegovina*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

Staff Report for the 2010 Article IV Consultation, Second and Third Reviews Under the Stand-By Arrangement, Request for Waiver of Nonobservance of a Performance Criterion, and Rephasing of Purchases

Prepared by the European Department
(In consultation with other departments)

Approved by Adam Bennett and Jan Kees Martijn

September 21, 2010

Discussions. Discussions were held in Sarajevo and Banja Luka during May 5–17 and August 17–September 1. The mission met with: (i) at the State level: the Chair of the Council of Ministers Špirić, the Minister of Finance and Treasury Vrankić, and Central Bank Governor Kozarić; (ii) in the Federation of Bosnia and Herzegovina: Prime Minister Mujezinović and Minister of Finance Bevanda; and (iii) in the Republika Srpska: Prime Minister Dodik and Minister of Finance Džombić. Staff also met with other senior officials, High Representative Inzko, ambassadors, trade unions, and representatives of the private sector. The mission team comprised Mr. Christou (head); Mr. Iossifov and Mr. Abdelkader (all EUR), Ms. Karpowicz (FAD), Mr. Darbar (MCM), and Ms. Khachatryan (SPR). Mr. Cuc (resident representative) assisted the mission. Mr. Tomić (OED) attended policy meetings. The mission coordinated closely with World Bank staff on structural issues.

Stand-By Arrangement (SBA). To date two purchases totaling SDR 304.38 million have been made under the 36-month, SDR 1,014.6 million (600 percent of quota) SBA approved on July 8, 2009. The authorities are requesting rephasing of purchases and completion of the second and third reviews, after which a purchase in the amount of SDR118.4 million will be made available. Of this amount, the authorities intend to draw SDR33.82 million for budget support, while given the strong reserve position they will not draw the remainder at this stage.

Program status. All end-March 2010 targets and end-June 2010 (the controlling test date for the reviews) performance criteria were met, except for the one on non-accumulation of domestic arrears. Progress was also made on the program's structural reform benchmarks, albeit with delays.

Context of past surveillance. Prior to 2009, Fund advice noted the rising external imbalances and pointed out that expansionary fiscal and public wage policies could threaten competitiveness and increase risks to external stability. The program supported by the SBA incorporates policies consistent with Fund advice, although implementation of structural reforms has been slow.

Exchange system. Currency Board pegged to the euro at a rate of KM1 = €0.5113. Bosnia and Herzegovina has not accepted the obligations of Article VIII, Sections 2, 3, and 4.

Statistics. Statistical data are broadly adequate for surveillance.

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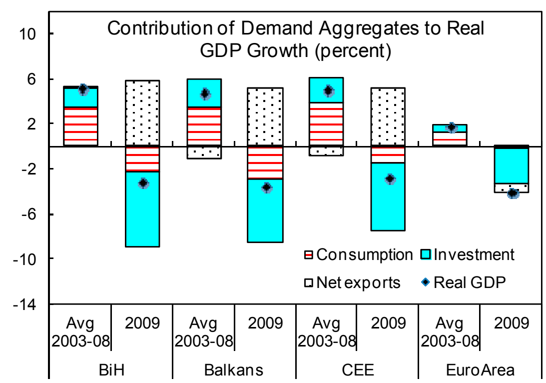
I. Context—Growing Imbalances, the Crisis, and the Program

1. **The global economic and financial crisis found the economy of Bosnia and Herzegovina (BiH) in a vulnerable position.** Prior to the crisis, like elsewhere in the region, with capital inflows driving a domestic demand boom, internal and external imbalances worsened. Loose fiscal and public wage policies also contributed to the overheating of the economy. The crisis triggered a collapse in the demand for BiH exports and severely curtailed cross-border financial inflows. The banking system came under strain, as the spate of negative news about foreign banks with subsidiaries in BiH triggered a mini-deposit run in late 2008.

2. **Faced with increasing financing pressures in early 2009, the authorities put together a comprehensive program supported by an IMF Stand-By Arrangement.** The program was designed to safeguard the currency board and cushion the effects of the deteriorating external environment, while adopting policies to redress fiscal imbalances and strengthen the financial sector. The authorities' approach included: (i) gradual fiscal consolidation accompanied by structural fiscal reforms to bring public finances on a sustainable path; (ii) steps to strengthen the resilience of the financial sector alongside commitments by foreign parent banks to maintain their external exposures to BiH and keep their subsidiaries capitalized; and (iii) substantial financing from the Fund along with funds from the World Bank and the EU.

II. Recent Economic Developments

3. **The program helped mitigate the impact of the crisis on the economy.** The economy fell into recession in 2009, with real GDP declining by 3.1 percent, but the output contraction was limited relative to other countries in the region. Private investment and spending on consumer durables collapsed, while private current consumption softened to a lesser extent, on the back of moderate growth of wages and social benefits. It now seems that the economy is emerging from the recession: high frequency indicators point to an export-led pick-up of economic activity, supported by a rebound of external commodity demand. The drop in domestic demand appears to be leveling off, aided by stabilizing credit conditions. Private investment, however, continues to lose ground amidst weak FDI inflows.



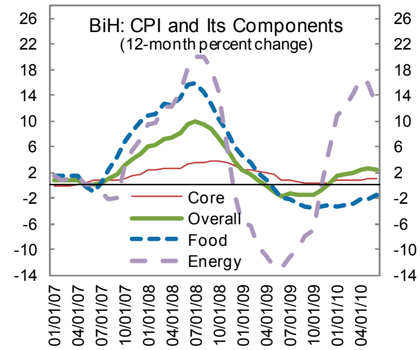
Source: IMF's WEO database and Fund staff estimates.

BIH: Leading Indicators, June 2010
(percent change year-to-date over corresponding period in previous year)

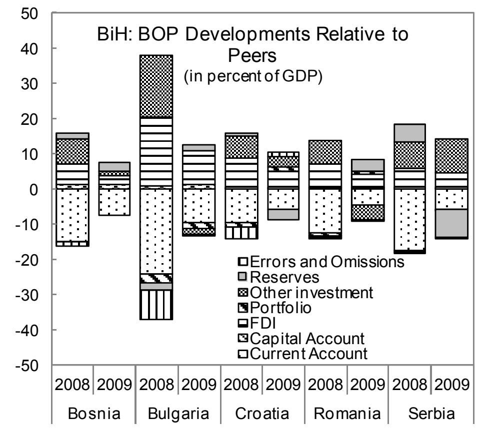
	Dec-09	Jun-10
Industrial production	-3.3	1.3
Gross wage, all sectors	8.3	0.5
Retail trade (Federation)	-12.4	3.6
Value-added tax revenues (net of refunds)	-9.3	3.2
Imports	-24.4	4.8
Capital goods	-39.0	-14.5
Durable consumer goods	-39.5	1.6
Non-durable consumer goods	-4.4	0.7
Exports	-17.9	32.7
Foreign direct investment	-50.3	-34.4
Credit to private sector (12-month growth)	-3.8	-1.3
Consumer price inflation	-0.4	2.1
Producer price inflation	-1.8	-0.6

4. **Inflation has decelerated.** Average inflation reached 7½ percent in 2008, on the back of rising food

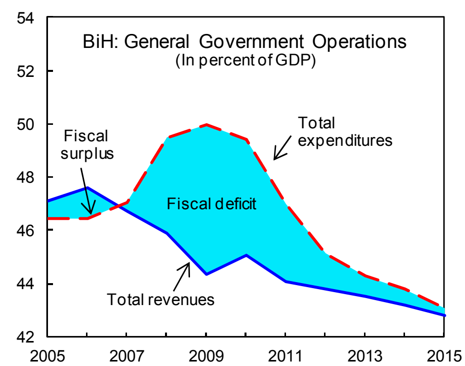
and fuel prices, and demand pressures. The reversal of these demand and supply-side factors in 2009 brought inflation into negative territory. The weakness of domestic demand is keeping core inflation in check.



5. **The persistently high current account deficit contracted sharply and financing pressures were alleviated**. The steep decline in domestic demand along with a slump in international prices of BiH imports led to a rapid narrowing of the current account deficit in 2009–10. At the same time, the multilateral financial support package and the commitment of parent banks to maintain their exposures to the country helped contain the impact of a drop in external balance-of-payments financing on international reserves. Current transfers declined sharply and remain depressed, due to the worsening economic situation in the EU, where most migrant and seasonal workers are located.

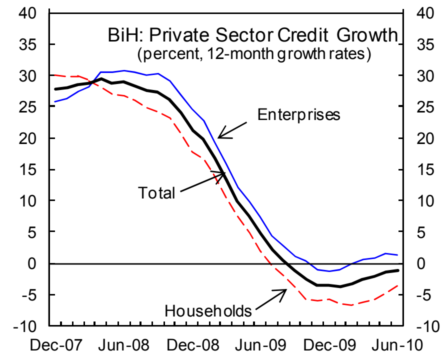


6. **Fiscal performance has posed risks to macroeconomic stability.** Following the procyclical fiscal expansion in 2008, the general government deficit widened to 5¾ percent of GDP in 2009 on account of a marked revenue shortfall.[1] Despite expenditure savings measures initiated under the SBA, the program's fiscal deficit target for 2009 was missed by 1 percentage point of GDP. Although the overall spending was in line with the program, its composition was not. The consolidated general government wage bill grew in 2009—on top of the unsustainable increases in 2008—despite programmed consolidation, and savings on cash transfers were less than planned. Despite the accumulation of a small amount of domestic arrears (less than 0.1 percent of GDP), which have since been cleared, fiscal performance so far this year has been in line with the revised fiscal adjustment strategy that accommodates a slightly higher deficit for 2010 (4.5 percent of GDP) compared with the original program.



7. **The global financial crisis tested the resilience of the domestic banking system, and signs of stress are emerging.** Banks weathered the October 2008 mini-deposit run with the help of liquidity injections from parent banks and the lowering of reserve requirements by the central bank. Confidence building steps, such as the negotiation of the 2009 SBA, BiH's

[1] See Selected Issues Paper "Cyclical Developments and Fiscal Policy Design".



participation in the European Bank Coordination Initiative, and the increase of deposit insurance, helped restore public calm. At the same time, the pre-crisis rapid credit growth came to a sudden stop. Faced with worsening financial health of enterprises and households, banks cut back their loan portfolios and raised interest rates to shore-up flagging profitability. With the slowdown in the economy, non-performing loans (NPLs) more than doubled to 8.7 percent by June 2010. The related increase in provisioning resulted in an overall loss for the sector thus far in 2010.

III. Policy Discussions on the Program

A. Outlook and Risks

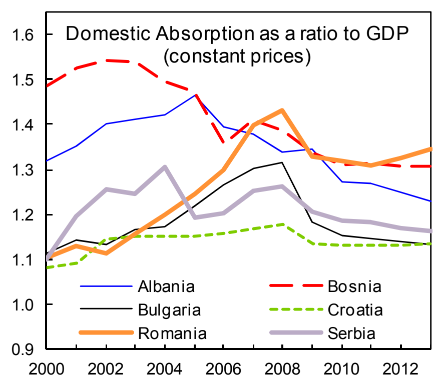
8. **Economic growth is set to resume.** The economy seems to have bottomed out in the first half of the year and staff projects a moderate recovery already under way leading to a rebound in 2011. Domestic demand will remain subdued, held in check by stagnant real wages and ongoing fiscal consolidation. Underlying inflation is projected to remain low. Private sector credit will pick-up slowly, as banks have yet to absorb the full losses due to non-performing loans in their portfolios (Tables 7 and 8). The authorities were in broad agreement with staff views.

9. **The adjustment of the current account is expected to continue, while the financial account will likely strengthen.** In 2010–11, the narrowing of the current account deficit will be driven in part by lower than pre-crisis domestic demand and an improved outlook for BiH's key export commodity prices. Net transfers are projected to stabilize at 12 percent of GDP, reflecting a recovery in the EU and higher labor mobility in the region. Capital inflows are expected to recover, mainly due to an increase in foreign direct investment—initially driven by privatization and later on by an improvement in the business environment. The resumption of consumption and investment growth will restore private sector foreign borrowing and the European Bank Coordination Initiative will facilitate further increase in bank foreign liabilities.

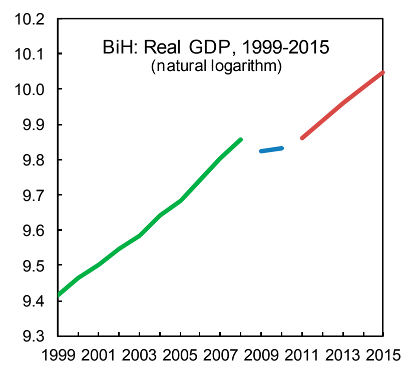
10. **Risks to the outlook appear balanced, but the political situation could complicate program implementation.** A further deterioration of credit quality could hamper the fragile recovery in bank lending, and thereby restrain the real economy. Moreover, the authorities may find it difficult to keep the momentum for structural reforms, as the general elections approach (presidential and parliamentary (entity and cantonal) elections will take place in early October 2010). Further complications may arise from delays in formation of new governments, and especially at the State level. Nevertheless, all policymakers the mission met with, including opposition politicians, recognize the need to adhere to the policies

envisaged under the program. On the upside, a faster economic recovery in BiH's trading partners may boost external demand and private capital inflows.

11. **Medium-term prospects depend critically on the implementation of structural reforms to improve the country's growth potential.** Reforms aimed at enhancing BiH's human capital and speeding-up the pace of technological change would boost productivity and export prospects, helping achieve medium-term growth of 4½ percent. Still, the post-crisis growth rate of the BiH economy is likely to be, on average, slightly below its pre-crisis value. Domestic demand is expected to remain below pre-crisis levels relative to domestic income, reflecting fiscal consolidation and the end of the credit boom funded from abroad. Inflation is projected to remain low in line with developments in the euro area. Maintaining a sustainable level of the current account over the medium-term requires further diversification of the economy, enhancement of capacity and productivity in export sectors, and improvement of the business and investment environment. If these reforms proceed slowly this could deter FDI and tighten the external financing constraint, which would adversely affect BiH's growth prospects. The authorities broadly agreed with the analysis and pointed to the need for ambitious structural reforms to help attract FDI and raise growth to pre-crisis levels.



Source: IMF's WEO database and Fund staff estimates.



Source: BiH Statistical Agency and Fund forecasts.

B. Preserving External Stability

12. **Under current assumptions, official foreign exchange reserves are adequate to guarantee the stability of the currency board.** The currency board continues to enjoy strong support and remains a key macroeconomic anchor. In the wake of the global recession the current account balance has moved closer to its sustainable path (Box 1). Foreign reserves are projected to remain strong

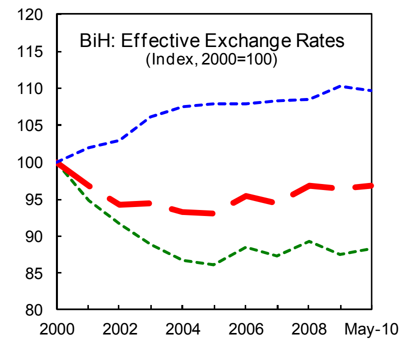
Bosnia and Herzegovina: Potential Foreign Exchange Liquidity Drains and Liquidity Buffers
(In percent of GDP)

Indicator	Dec-07	Dec-08	Dec-09	Jun-10	Dec-10
Potential Liquidity Drains (A+B+C+D)	55.2	50.9	53.2	55.0	54.9
A. Cash, excluding cash in vaults	10.0	9.3	8.4	8.2	8.3
B. Deposits by residents (nongovernment)	41.7	38.9	42.4	44.1	44.3
B.1. Domestic currency	20.8	18.9	20.3	20.4	21.0
B.2. Foreign currency	20.9	20.1	22.1	23.7	23.2
C. Commercial banks' short-term foreign liabilities	3.5	2.7	2.4	2.7	2.4
D. Nonbank short-term external debt	0.0	0.0	0.0	0.0	0.0
Potential Liquidity Buffers (E+F)	46.2	38.1	39.4	40.5	42.1
E. Central bank and central government liquid external assets	29.9	25.6	27.0	26.7	29.2
F. Commercial banks' liquid foreign currency assets	16.2	12.5	12.4	13.8	12.9
Potential buffers' coverage of potential drains, percent:					
including banks' short-term liabilities to nonresidents (E+F)/(A+B+C+D)	83.6	74.9	74.1	73.5	76.6
excluding banks' short-term liabilities to nonresidents (E+F)/(A+B+D)	89.2	79.0	77.6	77.4	80.2
Memorandum item: central bank FX reserves/household deposits	130.2	121.4	110.2	98.6	101.0

Sources: CBBH; and Fund staff calculations and estimates.

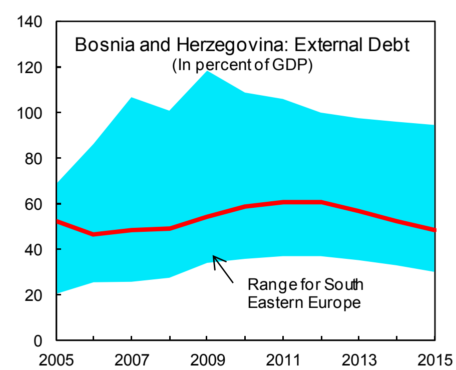
relative to imports and sufficient to accommodate moderate money demand growth in line with GDP. The analysis of potential liquidity drains and buffers indicate slow but steady recovery of potential buffers, bringing them closer to pre-crisis levels by end-2010.

13. **The current real effective exchange rate (REER) level does not raise significant external stability concerns.** CGER-type methods yield REER estimates ranging from 8 percent undervaluation to 18 percent overvaluation over the medium-term, although the estimates are subject to high degree of uncertainty (Box 1)[2]. In addition, the terms of trade are expected to improve slightly and export volumes to return to positive growth. While the currency board anchors macroeconomic and external stability, the absence of foreign exchange rate instrument for economic adjustment puts significant pressure on relative price adjustment and internal devaluation. Staff emphasized that preserving external competitiveness over the medium term would require fiscal consolidation and wage restraint, and structural reforms to overcome long-standing labor market rigidities and impediments to entrepreneurship. The authorities concurred noting their commitment to the SBA's medium-term fiscal adjustment path and the ongoing initiatives to further align the labor market and business environment regulatory framework with international best practice. Staff also discussed prerequisite actions needed for accepting the obligations under Article VIII Sections 2, 3, and 4, and urged the authorities to remove the existing restrictions on the transferability of balances and of interest accrued on frozen foreign-currency deposits. The authorities indicated that they have initiated procedures to deal with this over the coming period based on advice provided by IMF Legal Department



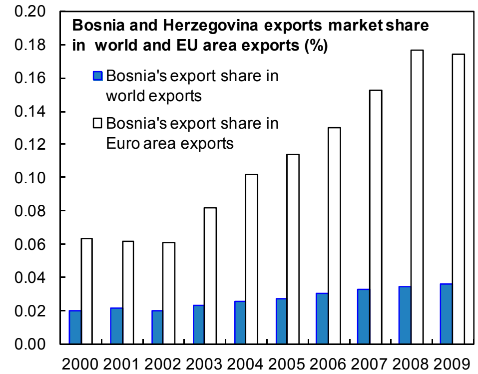
Source: IMF's INS and staff estimates.

14. **External debt is sustainable in the baseline medium-term scenario but is vulnerable to a number of shocks (Appendix I)**. The debt-to-GDP ratio is expected to increase from pre-crisis 48 percent to about 60 percent in 201–12, which is low relative to other countries in the region. Bound tests suggest that BiH's external position would be particularly vulnerable to a real depreciation shock, a noninterest current account shock, and a slowdown in GDP growth. Higher external debt service in 2013–15 related to SBA repurchases will limit governments' capacity to take on and service new debt. In light of this, staff argued that foreign-funded projects need to be carefully screened and prioritized. The authorities shared this assessment, but noted the country's large infrastructure needs.



[2] See also Selected Issues Paper "External Sector Stability and Competitiveness."

Box 1. BiH: External Stability Analysis



Real effective exchange rate (REER) developments indicate stable (based on relative consumer prices) external competitiveness of BiH that has underpinned its growing export market shares. BiH exports market share in world and Euro area regional markets improved in pre-crisis era. During the crisis, the market share in world exports stabilized, however, BiH lost some of its markets in the EU area.

BiH: External Stability Analysis

	Current account norm	REER mis-alignment [1]
Medium-term current account projection -5.0		
Balassa - Samuelson	…	-8.2
External Sustainabilty Approach	-4.4	3.0
CGER Macroeconomic Balance Approach		
Pooled	-1.7	18.1
ALM [2]	-4.1	4.9
Equilibrium REER Approach		
CPI-based REER	…	-4.2
Unit labor cost-based REER	…	8.8

[1] Undervaluation (-) and overvaluation (+).
[2] Based on Abiad, Leigh and Mody (2007).

External stability concepts for economies like BiH are particularly difficult to benchmark, partly due to the short historical time series for a transition economy that experienced a war. While staff analysis suggests that the current account deficit somewhat exceeds sustainable levels, with large uncertainties surrounding estimates, there is no strong evidence for real exchange rate overvaluation that could result in future external instability. According to a number of methodologies, equilibrium current account deficit estimates are between 1.7–4.4 percent of GDP compared to a medium-term current account projection of 5.0 percent. The CGER macroeconomic balance approach suggests an equilibrium deficit of 1.7 percent. However, taking into account financial integration and potential EU convergence, the equilibrium current account deficit is estimated at 4.1 percent of GDP. The external sustainability approach suggests that the equilibrium current account deficit, which would stabilize the net foreign liability position at around 8 percent of GDP (average of the previous 5 years), would be 4.4 percent of GDP. Based on the estimated alternative equilibrium current account norms, the REER misalignment ranges from a small undervaluation of 4.2 percent under the equilibrium CPI-based REER approach to about 18 percent overvaluation under the pooled estimate of the macrobalance approach.

Non-model analysis of competitiveness demonstrates the need for structural reforms to foster private sector-led growth in BiH. An IMF staff survey[1] of private sector reaffirmed the findings of the other studies which suggest that the key factors impeding FDI and access of companies to foreign markets are: (i) political instability; (ii) complicated and expensive bureaucracy; (iii) lack of clear vision for economic development; (iv) corruption and weak legislative framework; and (v) poor quality control (i.e., local certification and standardization). Substantial opportunities lie in enhanced productivity via bigger investment in R&D and human capital.

[1] The IMF team met five companies in each entity, the Chamber of Foreign Trade and Commerce, the Foreign investment Promotion Agency.

C. Maintaining Fiscal Discipline

15. **The authorities reiterated their commitment to fiscal consolidation through fiscal reform, while smoothing the pace of adjustment in line with their social objectives.** With monetary policy assigned to maintain the currency board arrangement, fiscal policy was the only available instrument to soften the economic downturn. However, given the starting unsustainable fiscal position, a discretionary fiscal stimulus was not a

policy option. As elsewhere in the region, the authorities chose to allow automatic stabilizers (primarily on the revenue side) to play out. The disbursements under the SBA and the new SDR allocations helped the authorities broadly maintain the provision of public services and initiate structural fiscal reforms aimed at putting public finances on a sustainable footing.

16. **Attaining the program's 2010 fiscal target requires efforts by all governments.** Revenue performance to date has been broadly in line with the program, with better-than-budgeted VAT and excise collections largely offsetting shortfalls in the other revenue sources. Total expenditures remained significantly below the program target, due in part to slow execution of the capital budget and delays in the adoption of the Federation's cantonal budgets. However, both entities have exceeded the half-yearly targets for war disability benefits, which are the largest rights-based transfer program, while the Federation cantons have failed to implement envisioned wage cuts. The authorities acknowledged the need for stronger efforts to contain the wage bill and reduce rights-based transfers to stay within the program's overall deficit target of 4½ percent of GDP.

- ***Federation.*** The size of the cantonal budgets and the delays in carrying out eligibility audits of war-related cash benefits could threaten the Federation's 2010 fiscal target. Eligibility audits commenced with a six-month delay and at their current pace will take more than five years to complete. At the same time, some cantons have approved expansionary budgets based on large expected transfers from the central government and unrealistic revenue projections. The central authorities concurred with the assessment and proposed a set of corrective measures to be included in a rebalanced budget (approval of which is prior action and has been met). Measures focus on containing the wage bill, expediting eligibility audits of beneficiaries and improving the audit process (prior action, LOI¶10—met), and making transfers to the cantons conditional on cantonal budget rebalances to reduce current expenditures (prior action, LOI¶10—met).

- ***RS.*** On current trends, the program's fiscal deficit target for the RS should be within reach. However, progress on the second stage of eligibility audits of war disability benefits recipients has proved challenging, and as a result only KM1.2 million of savings have been realized through June. The authorities have taken steps to expedite audits and expect to complete the second stage by end-2011 instead of three years. In addition, the mission cautioned the authorities about the financial situation of the Pension and Health Funds. The government has addressed liquidity problems through allowing increased transfers to the Pension Fund and commercial bank borrowing by the two funds, ahead of the planned pension system and health care reform(LOI¶12 and 13).

17. **There was agreement that the program's 2011 fiscal deficit target of 3 percent of GDP remains appropriate.** The authorities have made progress in preparing the medium-term budget framework elaborated by the Fiscal Council, which will underpin the 2011 budgets. However, no agreement has been reached on how the State's budget will be financed next year, resulting in delays in the budget preparation process at all levels of

government. With State and Entity budget approvals now envisaged after the formation of new governments following the October elections, staff and the authorities agreed that the details of the 2011 budgets will be discussed at the time of the next review. As revenues are projected to remain broadly unchanged relative to GDP, fiscal efforts will continue to focus on expenditure, aiming at increasing the gains from the reforms initiated this year. Public sector wage restraint will continue, and savings on transfers to individuals and other current spending will provide room to finance infrastructure projects.

18. **The authorities are committed to strengthen their efforts on structural fiscal reforms.** The Federation will improve the process of eligibility audits for war disability, pension, and other benefits (prior action—met). Since there have been delays in the reform of privileged pensions (end-March benchmark), the Federation authorities have agreed to refrain from the introduction of new privileged pensions (continuous benchmark) and to consider this reform in the context of the overall pension system reform. In addition, a new round of audits of civilian disability benefits will commence in 2011. In the RS, eligibility audits of war disability and pension benefits will be expedited, and a medical re-examination of all recipients of disability pensions granted in the last three years will begin immediately. The BiH authorities will also conduct an analysis of expenditures across all governments with the objective of identifying possible savings that would help reduce the total expenditure envelope (currently at 50 percent of GDP); the results of the analysis will be incorporated into the 2012–14 global fiscal framework.

19. **Staff and the authorities agreed on the need to protect vulnerable groups and safeguard public investment.** As part of the social sector reforms supported by the World Bank, social benefits and social assistance programs are being reformed to improve their efficiency through better targeting of the poor and most vulnerable. Also, the financial integrity of the pensions and employment funds will be preserved. The program envisaged increases in capital spending, but capacity constraints have led to underexecution of big infrastructure projects. Going forward, efforts will be made to improve implementation capacity.

D. Strengthening the Financial Sector

20. **Although the banking system managed well the initial spillover from the global crisis, vigilance is needed for new signs of stress.** Staff commended the authorities for their swift and effective response to the crisis, noting the full recovery of household deposits to their pre-crisis level in 2010 (Box 2). The return to normalcy has allowed parent banks to withdraw their emergency liquidity support. However, there was agreement that credit risk remains a concern as NPLs are yet to peak. Higher provisions against NPLs and the slump in lending activity have stretched banks' capital. Supervisors have asked banks to retain profits to increase their capital buffers, but with 2009 profits being significantly lower, banks will have to look to their owners for any additional capital. The absence of local subsidiaries of Greek banks has shielded the domestic market from market anxiety about Greece's

creditworthiness. The authorities also noted that Hypo Alpe Adria Group's (HGAA) restructuring, which has two systemically important subsidiaries in BiH, is not likely to affect the local market because HGAA considers the BiH market as a core business.

21. **Staff encouraged the authorities to follow up with banks participating in the European Bank Coordination Initiative.** Stress tests results based on end-2009 data indicate that in the stress scenario, five banks face some shortfall in capital, including two systemically important banks. The authorities have discussed these results with the banks and noted the potential need for additional capital. Although, overall exposures of parent banks to BiH have declined only marginally through end-March 2010 compared with end-2008, individual parent bank exposure varies considerably from bank to bank, particularly vis-à-vis their subsidiaries. Given that the banks are liquid, demand for credit is still weak, and the overall balance of payments is stable, the decline in some individual bank exposures is not of immediate concern. Staff urged the authorities to continue to monitor developments in exposures and follow up with the banks as necessary. Furthermore, it was agreed that the stress tests would be updated using end June 2010 data and, following a second round of discussions with the banks, a meeting with the participating parent banks to review and renew their commitments would be convened later this year (LOI¶20).

BIH: Parent Banks Exposure to BiH

	KM millions	Percent change from Dec '08	
	Dec '08	Dec '09	Mar '10
Exposure to subsidiaries	5,370	-6.3	-9.2
All other exposures	1,134	31.9	34.6
Total	6,504	0.4	-1.5

22. **Progress is being made in strengthening the monitoring of financial stability, the crisis management framework, and banking supervision.** Staff welcomed the increased cooperation and data sharing among the members of the Standing Committee on Financial Stability. The Banking Agencies are receiving technical assistance from USAID as part of a multi-stage program to gradually adopt risk-based supervision and move to Basel II, which will help harmonize supervisory practices and regulations in the two entities. Ongoing Fund technical assistance has helped the CBBH and the Banking Agencies increase their capacity to conduct bank stress tests. Domestic bank supervisors regularly participate in supervisory colleges of foreign banks. In particular, there is close cooperation and regular exchange of information with the Austrian supervisors. At the same time, staff noted that despite progress, formal memoranda of understanding (MoUs) have not yet been signed with the Austrian and Italian supervisors. The authorities indicated that they aim to finalize shortly these bilateral MoUs (LOI¶19). Staff reiterated its earlier recommendation to unify the two Banking Agencies, but the authorities indicated that this would need a political resolution.

23. **The authorities have started to address the recommendations in the 2009 MONEYVAL anti-money laundering and combating the financing of terrorism (AML/CFT) mutual evaluation report.** The CBBH is coordinating work on amending the banking law and the law governing foreign currency operations was amended to bring it in line with the 2009 AML/CFT law. The Financial Intelligence Unit (FIU), housed in the State Protection and Investigation Agency (SIPA), increased its staff from 18 at the time of the

evaluation to 25 employees and targets a total of 30 staff. The authorities are preparing amendments to the SIPA law and the AML/CFT law that would enable them to establish a more independent FIU. Nevertheless, many areas, such as Customer Due Diligence, insurance sector supervision, the filing of Suspicious Transaction Reports and national coordination, still need to be addressed and staff encouraged the authorities to continue their efforts in strengthening the AML/CFT regime.

Box 2. BiH: Policy Response to the Global Financial Crisis

Bank reserve requirements were relaxed from 18 to 14 percent in October 2008 with a further reduction of the reserve requirement on long-term liabilities to 10 percent and 7 percent in 2009.

A Standing Committee for Financial Stability (SC) was formed comprising representatives of the Fiscal Council, the CBBH, the two banking agencies, and the Deposit Insurance Agency (DIA). Participants signed a Memorandum of Understanding that formalizes the cooperative arrangement for crisis management and crisis preparedness. The SC is expected to meet at least once every quarter to monitor vulnerabilities in the financial sector and to exchange views and information.

The deposit insurance coverage was increased in December, 2008 from KM 7,500 to KM 20,000 (€10,000). The authorities have signed an agreement with the EBRD to enable the DIA to access emergency credit (up to €50 million) in case its funds are insufficient to cover a payment event. This has enabled the DIA to increase insurance coverage to KM 35,000 in April, 2010. In addition the authorities have amended the regulation to allow all banks, regardless of ownership, membership in the deposit insurance scheme.

To support credit growth in a tightening credit environment the authorities relaxed temporarily the prudential rules on restructuring. Under certain conditions enterprises and households could apply and banks could restructure credit so that the borrower did not default.

Following meetings in Vienna in June 2009 and in Sarajevo in September 2009 nine parent banks committed to maintaining their exposure to BiH and ensuring that their subsidiaries are adequately capitalized under the European Bank Coordination Initiative (EBCI). The nine parent banks have 13 subsidiaries in BiH, which account for 85 percent of banking sector assets at end 2009. A status meeting was held in February 2010 and a follow up meeting is planned for later this year.

E. Improving Data Quality

24. **While data are adequate for surveillance purposes, staff analysis is being affected by certain shortcomings.** The timeliness, quality, and comprehensiveness of fiscal data need significant improvement. Budget execution data does not include transactions for projects financed by external loans or directly by foreign donors. There are delays in reporting by lower levels of government, particularly in the Federation. In addition, the BOP data has insufficient detail, including on foreign grants, workers' remittances, and changes in

foreign currency cash holdings. Discrepancies between the production and expenditure GDP measures are large.

25. **The authorities have made concerted efforts to improve the quality of statistics in recent years, leveraging on technical assistance provided by the Fund and the EU.** The authorities have established a coordinating group to provide data for monitoring of the SBA. With the help of a peripatetic PFM advisor, the State, Federation and RS are working to transition to GFS 2001 reporting standards and shorten reporting delays. Staff commended the authorities' progress, including their commitment to apply international accounting standards for the public sector and other international standards of financial reporting (LOI¶22). Staff emphasized the need for further improvement in the timeliness and coverage of consolidated general government accounts, which should incorporate foreign-financed investment projects and their funding and a complete accounting of financing operations. The authorities concurred and noted their plans to implement these recommendations starting with the 2012 budgets (LOI¶16). Finally, the mission urged the authorities to join GDDS.

IV. Program Issues

26. **The attached Letter of Intent summarizes the progress in implementing the economic program.**

- All quantitative performance criteria for end-June 2010 were met except the one on non-accumulation of domestic arrears. The nonobservance of this PC is based on the nonobservance of the sub-ceiling for arrears by the RS, as a small amount of arrears (less than 0.1 percent of GDP) was accumulated during the first quarter of 2010, mainly on account of liquidity difficulties in the Health Fund. All those arrears have now been cleared and the authorities are asking for a waiver of nonobservance. In the Federation, the collection of detailed information on arrears of lower levels of government has proved very difficult within the reporting deadline, owing to capacity constraints, the decentralized government structure, and the lack of enforcement powers on the part of the central government. Based on final information for the central government and preliminary information for lower government levels, the zero-ceiling on accumulation of domestic arrears by the Federation has not been exceeded. Staff discussed with the authorities steps to improve the data collection process and put together a detailed template to be adopted by the Ministry of Finance and transmitted to all lower levels of government for regular reporting. In addition, the authorities will increase the staff in the Ministry of Finance unit responsible for the collection of fiscal information from lower levels of government, in order to be able to meet the reporting deadlines in future program reviews.

- Progress on structural reforms has been uneven (LOI¶ 2). Fiscal reporting has improved and quarterly consolidated general government data are now regularly published on the government's website. The Federation government approved with a delay the pension reform strategy in June 2010, and parliament adopted the public wage legislation in July 2010 (both end-March structural benchmarks). Eligibility audits of war benefit recipients started only in July and are yet to produce any tangible results (continuous benchmark from start of year). The end-March structural benchmark on the reform of privileged pensions, which was missed by the Federation, was also redesigned (¶18 above). In Republika Srpska, all end-March 2010 benchmarks—related to eligibility audits, the reform of privileged pensions, and the pension reform—have been met.

27. **The Letter also sets out policy commitments for the remainder of 2010**. Quantitative performance criteria are proposed to be established for September and December 2010, including a ceiling on new guarantees and the assumption of enterprise debt to banks by government (to accommodate a Federation government guarantee to the Railway company, which is restructuring with financing from the EBRD). New structural conditionality will continue to focus on the fiscal area, and it is deemed necessary to address long-standing structural problems, ensure a return of public finances to a sustainable medium-term path, and improve fiscal reporting.

28. **Rephasing of purchases is requested.** The second review under the SBA (based on the observance of end-March 2010 performance criteria) was delayed to give the authorities more time to come up with corrective measures to address emerging fiscal pressures. Since the conditions prescribed by the SBA for the authorities to request the purchase of the tranche that becomes available on September 10, 2010 (based on the observance of end-June 2010 performance criteria and satisfactory progress under the program) have been met, the authorities would be eligible to purchase two tranches for a combined disbursement of SDR169.1 million (100 percent of quota), under the program's original phasing. However, in light of the stronger-than programmed reserve position, the authorities request rephasing of purchases making available a disbursement of SDR118.4 million (70 percent of quota). Of this available amount, the authorities intend to purchase SDR33.82 million (20 percent of quota) in support of the Entity budgets. Going forward, it is envisaged to stick to the program's exit strategy from temporary budget financing using Fund resources.

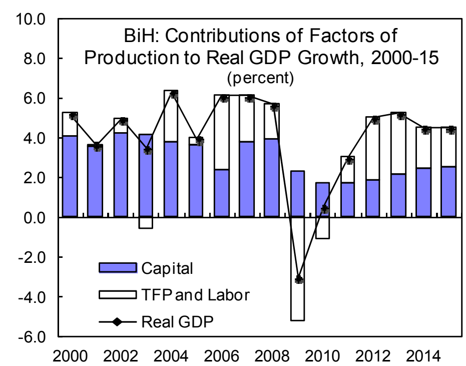
29. **BiH's capacity to repay the Fund remains good.** By the end of the SBA, the level of Fund credit outstanding is projected to reach 8.5 percent of GDP (29.2 percent of gross international reserves), and Fund repurchases and charges would peak at 63 percent of total debt service in 2014 (Table 10). The country's excellent record of meeting Fund financial obligations, the expectation that the program would lay the foundations for the return to a sustainable medium-term growth path, and a strong political commitment to the program provide assurances that BiH should be able to discharge its Fund obligations in a timely manner. Additional comfort stems from the fact that the public debt will remain below 43 percent of GDP even at its peak in 2011, reflecting the government's commitment to sound fiscal policy (Appendix II).

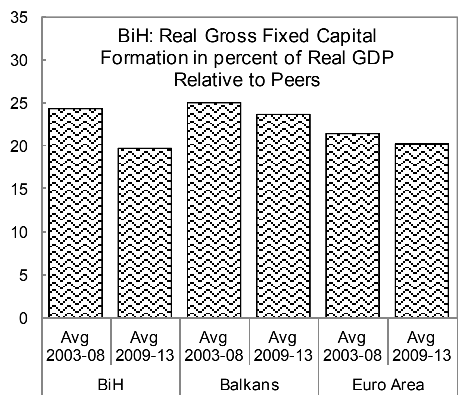
V. LOOKING BEYOND THE CRISIS

30. **Discussions focused on policies that could bring about sustainable growth.** Staff argued that a shift is needed to a growth model based on productivity increases supported by strong macroeconomic policies. The authorities broadly shared this view and a rich exchange of views with the authorities also came in a seminar organized jointly between the IMF and the central bank in May 2010.

A. Advancing Growth-Enhancing Structural Reforms[3]

31. **Post-crisis, the growth of the BiH economy will likely become more dependent on gains in human capital and technological change.** Staff analyzed the BiH economy's production process to quantify the contributions of physical and human capital and technological change to real GDP growth. Results show that the pre-crisis growth of output was mostly driven by rapid accumulation of factors of production. Post-crisis, the projected return to normalcy of credit growth—reflecting the switch of banks' funding from foreign borrowing to domestic deposits—suggests that, unless private and public savings increase significantly relative to the baseline projection, the pace of capital accumulation and its contribution to real GDP growth will be lower. Future growth will hence need to rely to a greater extent on gains in human capital and total factor productivity.





32. **There was agreement, however, that existing labor market rigidities and red tape handicap BiH's economic potential.** Among the main constraints holding back the development of the labor market are the low labor force participation rate; the sizable skill gaps; the market distortions created by the large informal sector; and the ineffectiveness of the labor mediation public services—which collectively keep the unemployment rate high. Corporate sector performance is hampered by limited progress in creating a single economic space within the country; excessive red tape; the stalled privatization of strategic enterprises in the Federation and of medium-size public companies in both entities; poor corporate governance and unfinished rationalization of staffing in many state-owned and voucher-privatized enterprises; and inadequate infrastructure.

[3] See Selected Issues Paper "Post-crisis Growth Prospects and Supporting Policies".

33. **Enhancing BiH's human capital and speeding-up the pace of technological change, hence, requires a renewed emphasis on structural reforms:**

- **Among labor market reform priorities**, staff highlighted the need for: better alignment of the systems of collective bargaining and wage determination with the principles of market economy; public sector hiring and benefits restraint; refocusing the work of Employment Funds to active job placement policies; and conditioning of all non-insurance cash benefits on recipients' income and ability to work and rigorous carrying-out of eligibility audits to weed out fraud. The authorities concurred with the brunt of the analysis and reiterated their commitment to reforming the system of social benefits with help from the World Bank. They noted the recent adoption by the Federation and RS governments of employment strategies that define the broad objectives of public policies in the labor market. The authorities also highlighted ongoing initiatives to improve the employment protection legislation in both the Federation and the RS.

- **To speed-up the pace of technological change,** staff reiterated the importance of increasing the efficiency of the regulatory system to allow quicker business startups, fewer authorizations for business operations, and a reduction in the number of different tax payments. Corporate sector performance can be boosted by speeding up the privatization of large strategic enterprises in the Federation and medium-size public companies in both entities, and restructuring of underperforming voucher-privatized companies. The authorities noted that the 2010 World Bank's Doing Business report showed progress in reducing the cost of starting a business and the time needed to register property. They also pointed to the liberalization of the trade regime with the EU, since the entry into force of the Stabilization and Association Agreement in July 2008. The European Commission's formal recommendation in May 2010 to lift the visa-regime for BiH citizens opens the prospect for further integration of the local economy in the larger European marketplace.

B. Achieving Medium-Term Fiscal Consolidation

34. **Credible medium-term fiscal consolidation will require ambitious structural fiscal reforms.** The initial low level of public sector indebtedness should allow financing of the projected modest medium-term deficits without jeopardizing the sustainability of public finances. Staff emphasized the need to reduce the tax burden (by focusing mainly on a reduction in social contributions) and the total expenditure envelope, while re-orienting expenditures towards capital spending; this will help boost growth through better infrastructure and less waste of public resources. Key elements of the medium-term fiscal strategy should include:

- ***Rights-based benefits reform.*** Much of the spending pressure affecting the fiscal accounts over the past few years stems from poorly targeted and inefficient rights-based benefits. There was agreement on the need to press ahead with the implementation of the reform of the system of rights-based benefits according to the action plan prepared in consultation with the World Bank.

- ***Pension reform (Box 3)[4].*** Faced with increasing demographic pressures, the authorities have initiated reforms of the pension systems. The Federation approved a pension reform strategy, which still needs to be fleshed out in greater detail and to incorporate an overhaul of privileged pensions. In the RS, with the pension reform strategy already approved by parliament, the authorities need to follow through with the preparation and adoption of pertinent legislation.

- ***Reforms to rein in the wage bill (Box 4).*** BiH's government payroll has grown substantially in recent years and is very high compared with other countries. Although the public wage reforms in the State and the RS during 2006–08, and the recent approval of the Federation Wage Law are welcome, there is still a need for comprehensive reform of public administration. Staff urged the authorities to look into this reform in the context of the comprehensive analysis of government expenditure to be launched in the coming months and to come up with concrete measures with the objective of reining in the wage bill.

- ***Fiscal coordination.*** Since its establishment in 2008, the role of the Fiscal Council in coordinating fiscal policy across the country has been limited. It is important that the authorities take steps to improve the Council's operational framework and involve it in the design of medium-term fiscal policy and fiscal targets.

[4] See Selected Issues Paper "The Case for Pension Systems Reform."

Box 3. BiH: Pension System—Case for Reform

The two entity pension funds, administered on a pay-as-you-go principle, have been under increasing financial pressure—mainly from demographic trends, but also from deterioration of the general fiscal situation and the design of the pension systems themselves. Expenditure on public pensions has been one of the fastest-growing components of public expenditure in the two entities. In the Federation, this spending rose from 7.7 percent of GDP in 2005 to 10.0 percent in 2009; and in the RS, from 7.8 percent of GDP to 9.0 percent over the same period.

One symptom of the weakness of the system are the high and rising system dependency ratios—too few paying contributors relative to the number of pensioners. In the last two years, these ratios rose by 10 percent in the Federation and 8 percent in the RS. Staff estimates that another increase of 10 percent would require additional budget funds equivalent to 0.8 percent of GDP in the Federation; and 2.6 percent of GDP in the RS.

In the Federation, the system of privileged pensions (with early retirement benefits for selected groups of beneficiaries) poses risks to the contributory pension system. The quadrupling in the number of beneficiaries in the last three years and the corresponding increase in budget co-financing requirements have strained the Entity budget and resulted in a run-up of arrears in payment obligations of the budget toward the pension fund in the amount of KM 180 million at end-2009.

Putting the public pension systems on a sound footing should encompass a number of complementary steps: tackling disincentives to formal sector employment and taking measures to raise contribution payment compliance; introducing further parametric changes, including an increase in the retirement age and in the length of required contributory service; and, reforming the system of privileged pensions.

Box 4. BiH: Government Employee Compensation

Over 2004–09, annual real growth of government employee compensation (the wage bill) averaged 6.3 percent. In 2007 alone, the real wage bill increased by 15 percent. By 2008, the share of the wage bill in total spending was almost a quarter, while more than a quarter of domestic revenues were spent on this category of outlays. The average general government wage bill in percent of GDP was higher than the average for Europe and other regions during 2000–08, and substantially higher than the average of middle-income countries.

Table 1. Government Compensation of Employees [1]

Country Groups	General Government			
	Sample Size	% of GDP	% of government expenditures	% of government revenues
Africa	9	9.8	33.4	30.7
Asia and Pacific	11	6.6	27.5	22.9
Europe	40	10.2	26.5	25.4
Bosnia and Herzegovina	**1**	**11.6**	**28.9**	**26.3**
Western Hemisphere	15	9.2	36.0	33.2
Middle East and Central Asia	11	8.3	32.8	26.4
Low-Income Countries	6	7.0	25.8	26.8
Middle-Income Countries	44	8.7	31.8	28.2
High-Income Countries	36	10.4	28.0	25.9

Sources: *Government Finance Statistics* database (IMF), and IMF staff estimates.
[1] General government, consolidated central government, or budgetary central government, annual averages for 2000-08 depending on availability.

The government wage bill has increased both because of hiring and because of wage increases. Partly due to competition among various parts of administration and to indexation practices that have linked wage increases to economy wide wages of two years before, wages increased substantially. These practices have created an inflationary spiral contributing to a large differential with private sector salaries of 50 percent in 2010. Indexation was suspended in 2009 when further adjustment became unsustainable.

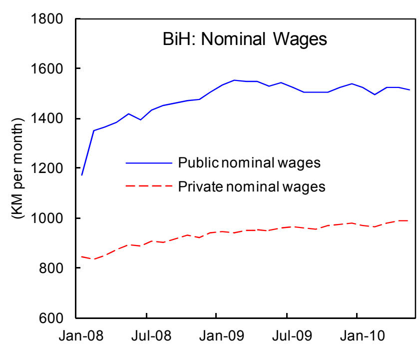


Table 2. Public Sector Employment [1]
(Percent of polulation)

	General Government	Education	Health
Africa	3.8	1.0	0.9
Asia and Pacific	4.2	1.1	0.7
Europe	7.7	2.4	2.5
Bosnia and Herzegovina[2]	**9.5**	**1.3**	**1.1**
Western Hemisphere	5.3	1.8	0.8
Middle East and Central Asia	4.6	2.0	0.8
Low-Income Countries	1.1	0.8	0.6
Middle-Income Countries	5.3	2.1	1.1
High-Income Countries	7.9	2.1	2.4

Sources: *LABORSTA* database (ILO).
[1]Annual averages for the 2000-08 period.
[2] Includes Entities and State

Employment is high partly due to the constitutional set up of the country. However, employment in the education sector which usually constitutes a large share of total employment is below comparators, suggesting that the core of "excess" employment is at the level of administration in the State and Entities.

VI. Staff Appraisal

35. **Bosnia and Herzegovina's stabilization program has helped mitigate the impact of the global financial crisis on the economy.** The crisis found BiH in a vulnerable position: external imbalances were rising, loose fiscal and incomes policies exacerbated the overheating of the economy, and the banking sector came under strain. The authorities' policy package—gradual fiscal consolidation, steps to strengthen the resilience of the financial sector, and structural fiscal reform—along with substantial Fund financial support

and commitments by foreign banks to support their subsidiaries, has limited the output loss and alleviated financing constraints. Performance under the program has been encouraging: fiscal restraint is addressing large imbalances of recent years and structural fiscal reforms have advanced, albeit at a slower pace than initially envisaged.

36. **Attaining the program's 2010 fiscal target should be the first step toward restoring fiscal sustainability.** Staff welcomes the authorities' commitment to expenditure restraint and the measures to ensure that the 2010 general government deficit objective will be met. This objective strikes an appropriate balance between fiscal policy's response to the cycle and medium-term consolidation, and is also supported by measures that would secure a permanent reduction in recurrent government spending. Staff welcomes that public investment is protected and the social safety net is being reformed to protect vulnerable groups.

37. **With the economy now emerging out of the recession, policy continuity is important in the period leading up to and immediately after the October elections.** Although the short-term economic and financial outlook has stabilized, continued efforts are needed to ensure fiscal and external sustainability. The current juncture presents a unique opportunity for the new governments that will come in power following the October elections to advance fiscal consolidation and tackle structural problem. However, successful implementation of bold structural reforms will require broad political support and societal consensus.

38. **Medium-term fiscal consolidation should be accompanied by reforms in current spending, while making room for capital expenditure.** Staff endorses the envisaged fiscal deficit of 3 percent of GDP for 2011, which is consistent with the country's medium-term consolidation objectives. With expenditure exceeding 50 percent of GDP, the focus of policies should be on reducing current expenditure by persevering with the systemic reforms of rights-based benefits and untargeted transfers, reining in the wage bill, and reforming pensions systems.

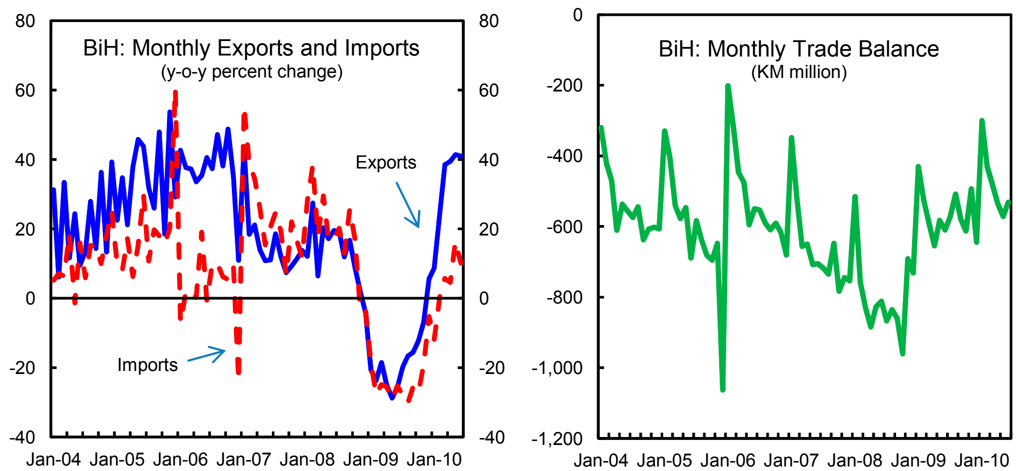
39. **The authorities' response in the financial sector to the global crisis has been appropriate.** The banking system withstood the initial impact of the crisis but is now facing some stress with rising NPLs and declining profitability. The authorities need to remain vigilant and monitor closely developments in credit quality and spillover risks from regional developments. Staff welcomes steps to enhance the monitoring of financial stability, and improve crisis preparedness and management, and urges the authorities to further increase cooperation between the central bank and banking agencies. The commitments by foreign parent banks to maintain their exposure vis-à-vis BiH and keep their subsidiaries well capitalized should help contain external financing gaps and support market confidence. The authorities should continue to further strengthen their cooperation with home supervisors, including by completing the MoUs with remaining home supervisors.

40. **BiH has not accepted the obligations under Article VIII, Sections 2, 3, and 4,** but maintains restrictions on the transferability of balances and interest accrued on foreign-currency deposits, subject to Fund jurisdiction under Article VIII. Staff does not recommend approval of these restrictions.

41. **On the basis of BiH's performance under the SBA and the corrective actions taken to address the causes of the non-observance of the performance criterion on non-accumulation of domestic arrears, staff supports the request for a waiver for nonobservance of the performance criterion and completion of the second and third reviews, establishing performance criteria, and rephasing of purchases as specified in the LOI¶23 and Table 13.**

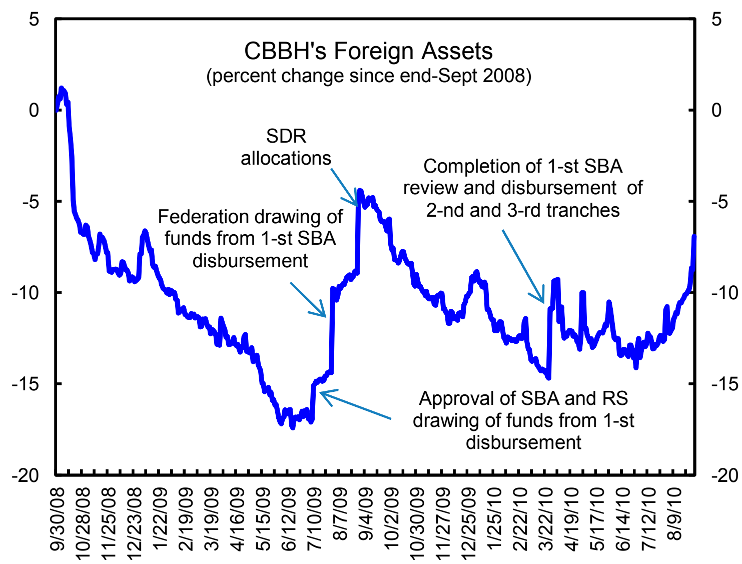
42. **It is proposed that the next Article IV consultation be held on the 24-month cycle, subject to the decision on consultation cycles in program countries.**

Figure 1. Bosnia and Herzegovina: External Trade, 2004–09



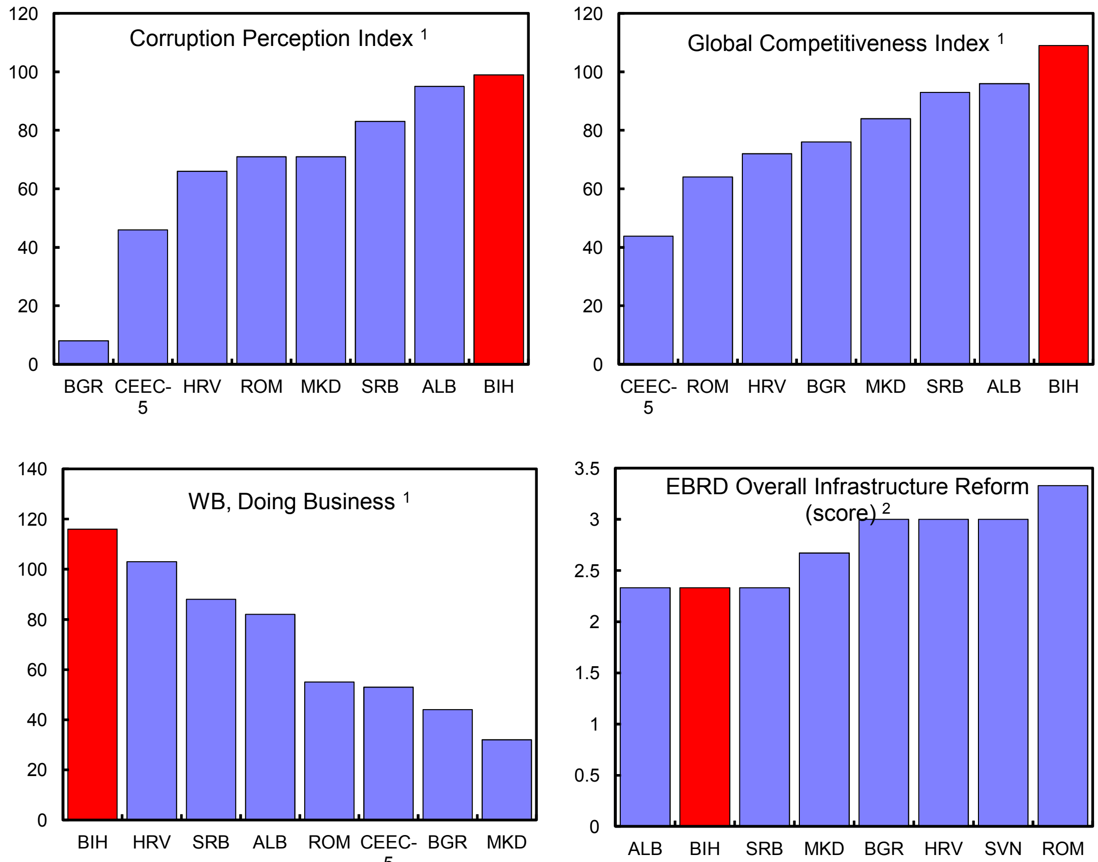
Source: CBBH and staff estimates.

Figure 2. BiH: Central Bank's Foreign Assets , 2008–10



Sources: CBBH and IMF staff calculations.

Figure 3. Indicators of Institutional Quality and Reform, 2009
(World rank, unless otherwise specified)



Sources: EBRD; Transparency International; World Bank, Doing Business Database; World Economic Forum.

[1] Lower ranking means better environment. The corruption perception index relates to perceptions of the degree of corruption as seen by business people and country analysts, it covers 180 countries. The global competitiveness index covers 125 countries. The World Bank indices cover 178 countries.

[2] The EBRD maximum score is 4.33, with maximum being best.

CEEC-5 include Czech Republic, Estonia, Hungary, Poland and Slovenia.

Table 1. Bosnia and Herzegovina: Selected Economic Indicators, 2008–15

	2008	2009	2010		2011	2012	2013	2014	2015
			EBS/10/39 Prog.	Proj.			Proj.		
Nominal GDP (KM million)	24,702	23,994	24,775	24,235	25,336	27,268	29,417	31,509	33,750
Gross national saving (in percent of GDP)	13.5	15.2	14.0	14.3	14.7	15.3	16.2	17.4	18.0
Gross investment (in percent of GDP)	28.0	22.1	21.3	19.8	20.2	20.5	21.5	22.5	23.0
				(Percent change)					
Real GDP	5.7	-3.1	0.5	0.5	3.0	5.0	5.2	4.5	4.5
CPI (period average)	7.4	-0.4	1.6	2.4	2.5	2.5	2.5	2.5	2.5
Money and credit (end of period)									
Broad money	3.7	2.4	0.3	3.6	4.5	7.6	7.9	7.1	7.1
Credit to the private sector	20.7	-3.8	-2.7	1.0	2.3	7.6	7.9	5.7	5.7
				(In percent of GDP)					
General government budget									
Revenue	45.9	44.6	44.3	45.9	45.8	45.8	45.6	45.4	45.1
Of which: grants	2.4	2.0	1.9	2.0	2.0	2.1	2.1	2.1	1.9
Expenditure (on a commitment basis)	49.5	50.2	48.8	50.4	48.8	47.2	46.3	46.0	45.4
Of which: investment expenditure	6.8	6.5	6.2	6.4	6.5	6.4	6.5	6.7	6.8
Primary balance	-3.1	-5.1	-3.9	-3.7	-2.1	-0.6	0.0	0.0	0.4
Overall balance	-3.6	-5.7	-4.5	-4.5	-3.0	-1.4	-0.7	-0.6	-0.3
External public debt	17.2	21.7	25.5	26.2	29.4	29.0	26.0	22.5	19.1
Total public debt	30.8	35.4	38.1	39.1	43.0	39.7	34.5	30.8	27.1
				(In millions of euros)					
Balance of payments									
Exports of goods and services	4,648	3,923	4,144	4,526	4,861	5,145	5,453	5,777	6,077
Imports of goods and services	8,827	6,780	7,194	7,222	7,610	8,008	8,506	8,985	9,413
Unrequited transfers, net	1,930	1,633	1,724	1,637	1,657	1,722	1,822	1,928	2,002
Current account balance	-1,819	-840	-930	-684	-707	-732	-792	-815	-863
(In percent of GDP)	-14.4	-6.8	-7.3	-5.5	-5.5	-5.2	-5.3	-5.1	-5.0
Foreign direct investment	627.1	183.5	350.0	200.0	378.0	728.0	728.0	728.0	728.0
(In percent of GDP)	5.0	1.5	2.8	1.6	2.9	5.2	4.8	4.5	4.2
Gross official reserves	3,219	3,176	3,421	3,219	3,733	4,052	4,045	4,040	3,979
(In months of imports)	5.7	5.3	5.4	5.1	5.6	5.7	5.4	5.2	4.9
External debt, percent of GDP	49.0	54.1	58.3	58.6	60.6	60.3	56.5	52.2	48.3
External debt service/GNFS exports (percent)	5.4	6.6	13.1	11.8	12.4	13.9	18.0	22.6	25.1

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

Table 2. Bosnia and Herzegovina: Real Sector Developments, 2008–15

	2008	2009 Est.	2010	2011	2012 Projections	2013	2014	2015
Real aggregates								
Growth rates				(Percent change)				
GDP at constant 1999 prices	5.7	-3.1	0.5	3.0	5.0	5.2	4.5	4.5
Domestic demand	3.7	-6.7	-1.4	3.5	4.7	5.2	4.4	4.0
Private	1.5	-8.0	-2.2	4.7	5.5	5.6	4.5	4.2
Public	12.7	-1.8	1.2	-0.6	1.7	3.5	4.3	3.3
Consumption	2.0	-2.2	0.5	3.2	4.1	4.0	3.2	3.2
Private	-0.8	-2.6	0.2	4.6	5.0	4.3	3.3	3.4
Public	14.3	-0.5	1.8	-1.8	0.7	2.5	2.5	2.5
Gross capital formation	10.2	-22.5	-9.8	4.5	7.2	10.9	10.0	7.4
Private	10.9	-27.9	-13.7	5.1	8.3	12.9	10.2	8.2
Public	8.0	-5.7	-0.6	3.2	5.0	6.4	9.6	5.5
Foreign demand	-1.7	-17.3	-7.9	5.2	3.4	4.8	4.1	2.3
Exports of goods and services	8.8	-4.0	4.2	3.3	3.8	4.3	4.6	4.2
Imports of goods and services	3.0	-11.0	-1.8	4.2	3.6	4.5	4.4	3.3
Contributions to real GDP growth	(Year-on-year change over real GDP in previous year, in percent)							
GDP at constant 1999 prices	5.7	-3.1	0.5	3.0	5.0	5.2	4.5	4.5
Domestic demand	5.1	-8.9	-1.8	4.4	5.9	6.5	5.6	5.1
Private	1.6	-8.4	-2.1	4.6	5.4	5.6	4.4	4.2
Public	3.4	-0.5	0.4	-0.2	0.5	1.0	1.2	0.9
Consumption	2.2	-2.3	0.5	3.4	4.4	4.2	3.3	3.3
Private	-0.7	-2.1	0.1	3.8	4.2	3.6	2.8	2.8
Public	2.9	-0.1	0.4	-0.4	0.1	0.5	0.5	0.5
Gross capital formation	2.9	-6.6	-2.3	1.0	1.6	2.4	2.3	1.8
Private	2.3	-6.2	-2.3	0.7	1.2	1.9	1.6	1.4
Public	0.6	-0.4	0.0	0.2	0.3	0.4	0.7	0.4
Foreign demand	0.6	5.8	2.3	-1.4	-0.9	-1.3	-1.1	-0.6
Exports of goods and services	2.6	-1.2	1.2	1.0	1.2	1.3	1.4	1.3
Imports of goods and services	2.0	-7.0	-1.0	2.4	2.1	2.6	2.5	1.9
Deflators				(Percent change)				
GDP	7.4	0.2	0.5	1.5	2.5	2.5	2.5	2.5
Domestic demand	10.9	-3.7	1.1	0.6	2.3	2.4	2.3	2.5
Consumption	6.4	-1.8	1.9	1.4	2.5	2.5	2.5	2.5
Investment	5.3	-1.0	0.4	1.8	2.0	2.0	1.9	1.9
Exports of goods and services	3.1	-14.5	10.5	4.0	2.0	1.6	1.3	0.9
Imports of goods and services	12.3	-13.9	8.1	1.2	1.6	1.6	1.2	1.4
Nominal aggregates								
Nominal GDP (KM million)	24,702	23,994	24,235	25,336	27,268	29,417	31,509	33,750
				(In percent of GDP)				
Consumption	105.3	101.3	101.9	101.1	100.0	98.8	97.4	96.3
Private	84.8	80.6	80.7	80.9	80.7	79.9	78.9	78.2
Public	20.5	20.6	21.2	20.2	19.4	18.9	18.5	18.1
Gross capital formation	28.0	22.1	19.8	20.2	20.5	21.5	22.5	23.0
Private	21.2	15.6	13.4	13.7	14.1	15.0	15.8	16.2
Public	6.8	6.5	6.4	6.5	6.4	6.5	6.7	6.8
National Savings	13.5	15.2	14.3	14.7	15.3	16.2	17.4	18.0
Private	11.3	15.2	13.2	12.1	11.0	11.3	12.1	12.2
Public	2.2	0.1	1.1	2.6	4.2	4.9	5.4	5.8
Saving-Investment balance	-14.5	-6.9	-5.5	-5.5	-5.2	-5.3	-5.1	-5.0
Current account balance	-14.5	-6.9	-5.5	-5.5	-5.2	-5.3	-5.1	-5.0

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

Table 3. Bosnia and Herzegovina: Balance of Payments, 2008–15
(In millions of euros, unless otherwise indicated)

	2008	2009		2010		2011	2012	2013	2014	2015
	Actual	EBS/09/94 Prog.	Est.	EBS/10/39 Prog.	Proj.			Proj.		
Current account	-1,819	-1,201	-840	-930	-684	-707	-732	-792	-815	-863
Trade balance	-4,180	-3,208	-2,857	-3,050	-2,696	-2,749	-2,864	-3,052	-3,208	-3,336
Goods	-4,823	-3,912	-3,406	-3,658	-3,240	-3,327	-3,480	-3,709	-3,911	-4,039
Export of goods (fob)	3,522	2,713	2,920	3,093	3,522	3,804	4,024	4,263	4,512	4,784
Import of goods (fob)	-8,345	-6,625	-6,327	-6,751	-6,762	-7,131	-7,504	-7,972	-8,423	-8,823
Services (net)	643	704	549	608	544	579	616	657	703	703
Exports	1,126	1,130	1,002	1,051	1,004	1,057	1,120	1,190	1,265	1,293
Imports	-483	-425	-453	-443	-460	-479	-504	-533	-562	-590
Income (net)	431	235	385	396	375	385	410	438	465	471
Total credit	795	535	558	718	512	540	582	633	677	713
Total debit	-365	-300	-173	-322	-137	-156	-172	-195	-212	-241
Of which, Interest payments	-190	-125	-183	-137	-105	-123	-138	-159	-175	-202
Current transfers (net)	1,930	1,771	1,633	1,724	1,637	1,657	1,722	1,822	1,928	2,002
Government (net)	186	180	147	146	146	151	171	193	214	214
Workers' remittances	1,254		995	…	998	1,009	1,042	1,077	1,115	1,196
Other (NGOs etc.)	490		491	…	493	496	508	552	599	592
Capital and Financial Accounts (excl. Reserves)	1,690	481	772	463	216	717	849	785	811	802
Capital account	201	218	174	195	176	190	196	202	209	216
Capital transfers (net)	201	218	174	195	176	190	196	202	209	216
General government	106	106	93	93	94	105	107	109	111	114
Other sectors	95	112	81	102	82	85	89	93	98	103
Financial account	1,488	263	598	269	40	528	653	583	602	585
Direct investment (net)	627	258	184	350	200	378	728	728	728	728
Abroad	-9	0	7	0	0	0	0	0	0	0
In BiH	636	258	177	350	200	378	728	728	728	728
Portfolio investment (net)	-6	0	-19	0	0	0	0	0	0	0
Other investment (net)	867	5	434	-81	-160	150	-75	-145	-126	-143
Assets (net)	-334	103	-134	-73	-120	-114	-294	-227	-69	-70
Short-term	-113	…	-231	…	-96	-95	-266	-203	-52	-53
Banks	232	…	66	…	-76	-80	-251	-193	-42	-43
Other sectors, excl. government and central bank	-344	…	-297	…	-20	-15	-15	-10	-10	-10
Medium and long-term	-221	…	97	…	-24	-19	-28	-25	-17	-17
Banks	-3	…	18	…	-4	-4	-13	-10	-2	-2
Other sectors, excl. government and central bank	-162	…	12	…	-20	-15	-15	-15	-15	-15
Liabilities (net)	1,201	-98	568	-8	-40	264	219	82	-57	-72
Short-term	226	…	97	…	9	43	42	46	51	55
General government	0	…	0	…	0	0	0	0	0	0
Banks	-51	…	-45	…	-35	6	6	7	7	7
Other sectors	276	…	142	…	44	37	36	40	44	48
Medium and long-term	976	…	471	…	-50	221	177	36	-107	-128
Monetary authority [1]	0	…	153	…	0	0	-17	-112	-218	-241
General government	66	…	340	…	75	65	38	-20	-70	-82
Disbursements of loans	128	…	417	…	193	191	189	200	237	253
Project	103	…	213	…	193	191	189	200	237	253
Budget	0	…	203	…	0	0	0	0	0	0
Amortization of loans	-62	…	-77	…	-117	-127	-151	-220	-307	-335
Banks	628	…	-143	…	-259	47	47	48	49	50
Other sectors	282	…	121	…	133	110	108	119	131	145
Errors and omissions	-76	…	22	…	0	0	0	0	0	0
Overall balance	-206	…	-46	…	-468	10	117	-7	-4	-61
Financing	206	…	46	…	468	-10	-117	7	4	61
Change in net international reserves	206	…	46	…	-43	-514	-319	7	4	61
External financing gap	0	…	…	…	511	503	201	0	0	0
IMF	0	…	…	…	376	400	201	0	0	0
World Bank	0	…	…	…	85	53	0	0	0	0
EU	0	…	…	…	50	50	0	0	0	0
Other	0	…	…	…	0	0	0	0	0	0
Memorandum items										
Current account balance (in percent of GDP)	-14.4	-9.7	-6.8	-7.3	-5.5	-5.5	-5.2	-5.3	-5.1	-5.0
Trade balance (in percent of GDP)	-38.2	-31.5	-27.8	-28.9	-26.1	-25.7	-25.0	-24.7	-24.3	-23.4
Import of goods (change, percent)	15.4	-19.7	-24.2	7.2	6.9	5.5	5.2	6.2	5.7	4.7
Export of goods (change, percent)	13.9	-21.4	-17.1	9.7	20.6	8.0	5.8	5.9	5.8	6.0
Transfers (in percent of GDP)	15.3	14.3	13.3	13.6	13.2	12.8	12.3	12.1	12.0	11.6
Net foreign direct investment (in percent of GDP)	5.0	2.1	1.5	2.8	1.6	2.9	5.2	4.8	4.5	4.2
External debt/GDP (in percent)	49.0	52.4	54.1	58.3	58.6	60.6	60.3	56.5	52.2	48.3
Private sector	31.8	30.8	32.4	32.8	32.4	31.1	31.3	30.5	29.7	29.2
Public sector	17.2	21.5	21.7	25.5	26.2	29.4	29.0	26.0	22.5	19.1
External debt service/GNFS exports (percent)	5.4	11.3	6.6	13.1	11.8	12.4	13.9	18.0	22.6	25.1
Gross official reserves (in millions of Euro)	3,219	2,932	3,176	3,421	3,219	3,733	4,052	4,045	4,040	3,979
(In months of prospective imports of goods and services)	5.7	4.7	5.3	5.4	5.1	5.6	5.7	5.4	5.2	4.9

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

[1] Positive entry in 2009 represents the general and special SDR allocations. The negative entries capture repayments of mulilateral loans to support gross international reserves accumulation.

Table 4. Bosnia and Herzegovina: General Government, 2009-15

(Percent of GDP)

	2009	2010							2011	2012	2013	2014	2015
	Dec	Mar		Jun		Sep	Dec		Dec	Dec	Dec	Dec	Dec
	Actual	EBS/10/39 Prog.	Act.	EBS/10/39 Prog.	Proj.	Prog.	EBS/10/39 Prog.	Prog.			Proj.		
Revenue	44.6	9.5	10.2	21.6	21.9	33.9	44.3	45.9	45.8	45.8	45.6	45.4	45.1
Tax	37.0	8.0	8.6	17.8	18.4	28.2	37.1	38.4	38.4	38.9	38.7	38.6	38.5
VAT / Sales tax	11.8	2.5	2.6	5.4	5.7	8.8	11.7	12.0	11.7	12.2	12.1	11.9	11.8
Excises	5.2	1.2	1.3	2.6	2.9	4.3	5.7	5.8	6.1	6.1	6.2	6.2	6.2
Trade taxes	1.4	0.3	0.3	0.6	0.6	1.0	1.3	1.4	1.2	0.9	0.7	0.7	0.7
Other indirect taxes	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Direct taxes	3.0	0.8	0.7	1.6	1.6	2.3	3.3	3.1	3.1	3.2	3.3	3.3	3.3
Social Security contributions	15.0	3.2	3.5	7.5	7.3	11.4	15.0	15.6	15.8	15.9	15.9	15.9	15.9
Other tax revenues	0.5	0.0	0.1	0.0	0.2	0.3	0.0	0.5	0.5	0.5	0.5	0.5	0.5
Non-tax	5.1	0.9	1.1	2.5	2.5	3.6	4.8	4.9	4.9	4.6	4.6	4.6	4.6
Dividends	0.5	0.1	0.0	0.2	0.0	0.6	0.5	0.6	0.5	0.3	0.2	0.1	0.1
Grants	2.0	0.5	0.5	0.9	1.0	1.5	1.9	2.0	2.0	2.1	2.1	2.1	1.9
For budget support	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0
Foreign investment projects	1.9	0.5	0.5	0.9	1.0	1.5	1.9	1.9	2.0	2.0	2.0	2.0	1.9
Expenditure and net lending	50.2	10.9	10.8	24.2	23.0	37.3	48.8	50.4	48.8	47.2	46.3	46.0	45.4
Wage bill	13.1	3.0	3.2	6.1	6.4	9.9	12.3	13.2	12.8	12.2	11.8	11.6	11.3
Goods and services	9.7	2.3	2.2	5.0	4.6	7.3	10.1	10.0	9.9	9.7	9.5	9.4	9.3
Subsidies and transfers	17.2	3.8	3.8	8.2	8.0	12.4	16.6	16.8	16.3	15.9	15.6	15.5	15.4
Social benefits	11.1	2.9	2.7	5.4	5.5	8.2	10.7	10.9	10.9	11.0	11.0	11.2	11.3
Other transfers to households	4.5	0.6	0.8	1.9	1.9	3.0	4.0	4.1	3.8	3.6	3.3	3.1	3.0
Subsidies to industry and agriculture	1.6	0.3	0.2	0.9	0.6	1.2	1.9	1.8	1.5	1.3	1.2	1.2	1.1
Interest payments	0.5	0.1	0.1	0.3	0.3	0.6	0.7	0.8	0.9	0.8	0.8	0.7	0.7
Other current spending	2.3	0.3	0.4	1.4	0.9	2.1	2.7	2.9	2.5	2.3	2.2	2.1	2.1
Investment expenditure	6.5	1.2	1.1	3.1	2.7	4.7	6.2	6.4	6.5	6.4	6.5	6.7	6.8
Foreign financed investment projects	3.4	0.8	0.7	1.7	1.6	2.6	3.3	3.5	3.5	3.4	3.3	3.5	3.4
Other investment expenditure	3.1	0.4	0.4	1.4	1.1	2.1	2.9	2.9	3.0	3.1	3.1	3.3	3.4
Unrecorded expenditure (off budget)	0.7	0.2	0.2	0.4	0.3	0.5	0.7	0.8	0.0	0.0	0.0	0.0	0.0
Net lending	-0.2	0.0	-0.1	-0.2	-0.2	-0.2	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0
Consolidation error / discrepancy [1]	0.3	0.0	0.0	0.0	0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance	-5.7	-1.4	-0.6	-2.6	-1.1	-3.4	-4.5	-4.5	-3.0	-1.4	-0.7	-0.6	-0.3
Structural balance	-4.8	…	…	…	…	…	…	-3.9	-1.4	-0.9	-0.7	-0.2	0.0
Financing	5.7	1.4	0.6	2.6	1.1	3.4	4.5	4.5	3.0	1.4	0.7	0.6	0.3
Domestic financing	2.8	-0.5	-0.6	0.2	-0.5	1.5	0.3	0.8	1.7	0.4	0.5	0.7	0.5
GSM proceeds	0.2	0.0	0.0	0.1	0.1	0.2	0.2	0.3	0.2	0.2	0.2	0.1	0.1
One-off operations [1]	2.0	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.3	2.0	1.7	0.1	0.1
Domestic claims	-0.2	0.0	-0.1	0.0	-0.2	-0.2	0.0	-0.2	-0.3	-0.4	-0.4	-0.3	-0.3
Domestic amortization	-0.4	-0.2	0.0	-0.3	0.0	-0.2	-1.0	-0.3	-0.3	-0.3	-0.2	-0.2	-0.1
Change in arrears and float	0.5	-1.5	-0.8	-1.5	-0.9	-0.8	-1.5	-0.8	-0.2	0.0	0.0	0.0	0.0
Other domestic financing	0.7	1.1	0.3	1.9	0.5	2.6	2.6	1.8	2.0	-1.2	-0.8	1.0	0.7
Bank financing	1.5	1.3	0.4	2.3	0.7	3.1	3.4	2.6	2.0	-1.2	-0.8	1.0	0.7
Development Bank	-0.8	-0.2	-0.1	-0.4	-0.2	-0.5	-0.8	-0.8	0.0	0.0	0.0	0.0	0.0
Foreign financing	2.6	0.2	0.1	0.3	0.2	0.5	0.5	0.6	0.5	0.3	-0.1	-0.4	-0.5
For budget support [2]	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
For investment projects	1.6	0.4	0.2	0.7	0.7	1.1	1.4	1.6	1.5	1.4	1.3	1.5	1.5
Amortization	-0.6	-0.1	-0.1	-0.5	-0.4	-0.7	-0.9	-1.0	-1.0	-1.1	-1.5	-1.9	-1.9
Financing gap/discrepancy	0.2	1.7	1.1	2.2	1.4	1.5	3.7	3.1	0.8	0.7	0.4	0.4	0.3
Identified financing [2]	0.0	1.7	1.1	2.2	1.1	1.5	3.7	3.1	0.8	0.0	0.0	0.0	0.0
Remaining gap / Errors and omissions	0.2	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.7	0.4	0.4	0.3
Memorandum item													
Primary balance	-5.1	-1.3	-0.5	-2.3	-0.9	-2.9	-3.9	-3.7	-2.1	-0.6	0.0	0.0	0.4

Sources: Ministry of Finance; and IMF staff estimates.

[1] Includes proceeds from privatization, succession funds, and the use of the 2009 SDR allocations.

[2] Disbursements of budget support loans and grants from multilateral creditors in the past are recorded under "Foreign financing for budget support" and "Grants for budget support", respectively, and under "Identified financing of financing gap" in the current year and in projections.

Table 5. Bosnia and Herzegovina: General Government, 2009-15

(Millions of KM)

	2009	2010				2010			2011	2012	2013	2014	2015
	Dec.	Mar		Jun		Sep	Dec		Dec				
	Actual	EBS/10/39 Prog.	Proj.	EBS/10/39 Prog.	Est.	Prog.	EBS/10/39 Prog.	Prog.	Proj.				
Revenue	10,697	2,349	2,477	5,340	5,296	8,206	10,973	11,130	11,606	12,502	13,411	14,292	15,236
Tax revenue	8,888	1,976	2,090	4,420	4,448	6,840	9,193	9,313	9,740	10,602	11,399	12,171	13,009
VAT / Sales tax	2,828	609	626	1,341	1,374	2,142	2,902	2,902	2,956	3,314	3,556	3,761	3,991
Excises	1,247	297	327	653	696	1,043	1,413	1,413	1,542	1,674	1,822	1,951	2,090
Trade taxes	341	69	63	151	138	242	328	328	295	240	205	217	227
Other indirect taxes	21	5	23	10	22	21	20	20	21	23	25	26	28
Direct taxes	714	203	172	406	385	547	812	747	790	871	957	1,038	1,127
Social Security contributions	3,607	792	848	1,857	1,774	2,762	3,715	3,781	4,007	4,342	4,684	5,017	5,374
Other tax revenues	130	1	32	1	58	83	2	123	129	138	149	160	171
Non- tax revenue	1,214	232	265	624	606	869	1,189	1,179	1,233	1,253	1,347	1,439	1,537
Dividends	117	24	0	60	0	135	120	157	117	88	59	30	33
Grants	477	118	122	235	242	362	471	481	516	559	606	652	656
Budget support	26	1	5	2	8	10	4	12	15	15	15	15	15
Foreign investment projects	451	117	117	233	235	352	467	469	501	544	591	636	641
Expenditure and net lending	12,054	2,700	2,628	5,992	5,573	9,036	12,100	12,224	12,363	12,881	13,631	14,489	15,335
Wage bill	3,154	734	772	1,514	1,542	2,406	3,058	3,207	3,238	3,315	3,484	3,645	3,802
Goods and services	2,335	564	526	1,243	1,114	1,766	2,491	2,426	2,506	2,641	2,803	2,964	3,142
Subsidies and transfers	4,121	942	912	2,020	1,940	3,014	4,109	4,083	4,129	4,322	4,584	4,885	5,183
Social benefits	2,668	725	664	1,328	1,332	1,989	2,656	2,649	2,769	2,999	3,236	3,532	3,807
Other transfers to households	1,078	142	194	469	451	731	979	1,005	975	977	983	983	1,000
Subsidies to industry and agriculture	375	75	54	223	157	294	475	429	385	346	365	370	376
Interest payments	127	27	23	75	61	134	162	187	221	223	226	213	232
Other current spending	548	83	85	341	221	511	678	694	637	631	636	663	694
Investment expenditure	1,559	304	274	767	654	1,134	1,533	1,558	1,636	1,753	1,903	2,125	2,286
Foreign financed investment projects	823	205	177	410	397	629	821	857	875	914	982	1,100	1,135
Other investment expenditure	736	99	97	356	257	505	712	700	761	839	922	1,025	1,151
Unrecorded expenditure	178	38	44	91	68	128	182	189	0	0	0	0	0
Net lending	-40	9	-17	-57	-43	-55	-113	-108	0	0	0	0	0
Consolidation error / discrepancy [1]	70	0	8	0	16	-2	0	-12	-5	-5	-5	-5	-5
Overall balance	-1,356	-351	-150	-653	-277	-830	-1,127	-1,094	-757	-379	-220	-198	-99
Financing on a commitment basis	1,356	351	150	653	277	830	1,127	1,094	757	379	220	198	99
Domestic financing	681	-125	-143	51	-121	364	78	198	426	98	133	215	168
GSM proceeds	39	12	1	25	13	37	50	61	51	51	51	33	33
One-off operations [1]	486	0	3	0	7	20	0	31	81	534	486	39	42
Domestic claims (flow, + = increase)	-54	0	-21	0	-37	-57	0	-58	-82	-101	-119	-110	-110
Domestic amortization	-89	-52	2	-85	7	-54	-248	-71	-85	-72	-60	-58	-33
Change in arrears and float	129	-368	-203	-368	-229	-203	-368	-195	-45	0	0	0	0
Other domestic financing	169	283	75	480	117	622	645	431	506	-314	-225	311	237
Bank financing	358	333	104	580	175	751	845	631	506	-314	-225	311	237
Transfer to the Development Bank (RS)	-189	-50	-29	-100	-58	-129	-200	-200	0	0	0	0	0
Foreign financing	616	55	34	63	55	112	120	148	129	78	-36	-135	-157
For budget support [2]	394	0	0	0	0	0	0	0	0	0	0	0	0
For investment projects	374	88	60	177	162	277	354	388	374	370	390	464	494
Amortization	-152	-33	-26	-114	-106	-165	-234	-240	-245	-293	-427	-598	-652
Financing gap/discrepancy	59	421	260	539	342	353	929	747	201	204	124	118	89
Identified financing [2]	0	421	271	539	271	353	929	747	201	0	0	0	0
IMF	…	265	276	265	276	353	464	483	0	0	0	0	0
WB	…	156	0	156	0	0	269	166	104	0	0	0	0
EU	…	0	0	118	0	0	196	98	98	0	0	0	0
Exchange rate discrepancy	…	0	-5	0	-5	0	0	0	0	0	0	0	0
Remaining gap / Errors and omissions	59	0	-10	0	72	0	0	0	0	204	124	118	89

Sources: Ministry of Finance; and IMF staff estimates.

[1] Includes proceeds from privatization, succession funds, and the use of the 2009 SDR allocations.

[2] Disbursements of budget support loans and grants from multilateral creditors in the past are recorded under "Foreign financing for budget support" and "Grants for budget support", respectively, and under "Identified financing of financing gap" in the current year and in projections.

Table 5a. Bosnia and Herzegovina: State Government, 2009-10

(Millions of KM)

	2009	2010						
	Dec	Mar		Jun		Sep	Dec	
	Actual	EBS/10/39 Prog.	Est.	EBS/10/39 Prog.	Est.	Prog.	EBS/10/39 Prog.	Prog.
Revenue	964	197	193	452	451	655	849	858
Tax revenue and contributions	729	172	168	342	338	513	689	689
Indirect taxes	729	172	168	342	338	513	689	689
Non-tax	204	25	21	110	103	128	160	152
Grants	31	0	5	0	10	14	0	17
For budget support	24	0	5	0	8	10	0	12
For investment	0	0	0	0	0	0	0	0
Transfer from other levels	7	0	0	0	3	4	0	5
Expenditure on a commitment basis	952	237	194	505	435	786	1,043	1,031
Wage bill	636	152	150	320	320	515	671	668
Goods and services	183	50	31	115	76	150	235	200
Interest payments	0	0	1	0	0	1	1	1
Other current spending	62	15	10	30	30	60	57	83
Investment expenditure	71	20	2	40	8	60	79	79
Foreign financed investment projects	0	0	0	0	0	0	0	0
Other investment expenditure	71	20	2	40	8	60	79	79
Consolidation error / discrepancy	0	0	0	0	0	0	0	0
Overall balance	12	-40	0	-53	16	-131	-194	-173
Financing	-12	40	0	53	-16	131	194	173
Domestic financing	0	41	-3	15	-71	134	157	166
GSM proceeds	14	5	0	9	4	17	18	18
One-off operations [1]	1	17	17	17	17	17	17	17
Domestic claims, amortization	0	0	0	0	0	0	0	0
Change in arrears and float	13	0	-24	0	-22	-12	0	10
Other domestic financing	-28	20	3	-11	-71	112	122	121
Banking system, net	-28	20	3	-11	-71	112	122	121
Foreign financing	1	-1	-1	-1	-1	-3	-3	-3
For investment projects	0	0	0	0	0	0	0	0
For budget support [2]	0	0	0	0	0	0	0	0
Amortization	1	-1	-1	-1	-1	-3	-3	-3
Financing gap/discrepancy	-12	0	5	40	56	0	40	10
Identified financing [2]	…	0	0	40	0	0	40	10
IMF	…	0	0	0	0	0	0	0
WB	…	0	0	0	0	0	0	0
EU	…	0	0	40	0	0	40	10
Exchange rate discrepancy	…	0	0	0	0	0	0	0
Remaining gap / Errors and omissions	-12	0	5	0	56	0	0	0

Sources: Ministry of Finance; and IMF staff estimates.

[1] Includes proceeds from privatization, succession funds, and the use of the 2009 SDR allocations.

[2] Disbursements of budget support loans and grants from multilateral creditors in the past are recorded under "Foreign financing for budget support" and "Grants for budget support", respectively, and under "Identified financing of financing gap" in the current year and in projections.

Table 5b. Federation BiH Consolidated General Government, 2009-10

(Millions of KM)

	2009	2010						
	Dec.	Mar		Jun		Sep	Dec	
	Actual	EBS/10/39 Prog.	Est.	EBS/10/39 Prog.	Est.	Prog.	EBS/10/39 Prog.	Prog.
Revenue	6,321	1,396	1,483	3,227	3,178	4,967	6,678	6,724
Tax revenue and contributions	5,306	1,180	1,256	2,694	2,727	4,122	5,613	5,692
Indirect taxes	2,330	522	544	1,171	1,214	1,895	2,566	2,566
Direct taxes	508	118	99	235	236	309	470	526
Social Security contributions	2,468	541	613	1,288	1,277	1,918	2,577	2,600
Non-tax	583	114	149	317	294	474	634	570
Grants	315	78	78	156	156	235	311	313
For budget support	2	0	0	0	0	0	0	0
For investment	313	78	78	156	156	235	311	313
Dividends	117	24	0	60	0	135	120	149
Expenditure on a commitment basis	6,955	1,531	1,531	3,519	3,275	5,289	7,117	7,137
Wage bill	1,606	353	402	738	776	1,215	1,477	1,629
Goods and services	1,405	334	330	751	685	1,061	1,502	1,460
Subsidies and transfers	2,699	601	590	1,315	1,283	1,970	2,699	2,655
Social benefits	1,679	478	424	855	851	1,260	1,709	1,670
Other transfers to households	808	82	127	346	320	536	733	736
Subsidies to industry and agriculture	211	40	40	114	112	173	257	248
Interest payments	71	16	11	51	34	86	110	120
Other current spending	317	41	46	234	123	340	469	456
Investment expenditure	834	171	174	459	380	640	918	875
Foreign financed investment projects	537	137	120	273	264	406	546	548
Other investment expenditure	297	35	54	186	116	234	371	327
Unrecorded expenditures	0	0	0	0	0	0	0	0
Net lending	-9	15	-12	-29	-26	-22	-57	-57
Consolidation error / discrepancy	33	0	-10	0	20	0	0	0
Overall balance	-634	-135	-48	-293	-97	-322	-439	-414
Financing	634	135	48	293	97	322	439	414
Domestic	155	-186	-152	-88	-71	25	-230	-151
GSM	16	6	1	11	4	4	22	22
One-off operations [1]	322	-14	-10	-14	-6	7	-14	18
Domestic amortization	-44	-6	2	-16	7	-50	-97	-67
Domestic claims (flow, + = increase)	-5	0	0	0	0	0	0	0
Change in arrears	45	-232	-122	-232	-95	-95	-232	-115
Other domestic financing	-179	61	-23	164	19	159	91	-8
Banking system, net	-179	61	-23	164	19	159	91	-8
Foreign financing	390	41	26	48	40	62	94	84
Loan disbursement	487	59	42	118	107	171	235	235
For investment projects	224	59	42	118	107	171	235	235
For budget support [2]	263	0	0	0	0	0	0	0
Amortization	-97	-18	-15	-69	-67	-109	-141	-151
Financing gap/discrepancy	89	281	173	332	127	235	574	480
Identified financing [2]	…	281	180	332	180	235	574	480
IMF	…	177	184	177	184	235	309	322
WB	…	104	0	104	0	0	162	100
EU	…	0	0	52	0	0	104	59
Exchange rate discrepancy	…	0	-4	0	-4	0	0	0
Remaining gap / Errors and omission	89	0	-7	0	-53	0	0	0

Sources: Ministry of Finance; and IMF staff estimates.

[1] Includes proceeds from privatization, succession funds, and the use of the 2009 SDR allocations.

[2] Disbursements of budget support loans and grants from multilateral creditors in the past are recorded under "Foreign financing for budget support" and "Grants for budget support", respectively, and under "Identified financing of financing gap" in the current year and in projections.

Table 5c. Bosnia and Herzegovina: Republika Srpska Consolidated General Government, 2009-10

(Millions of KM)

	2009	2010						
	Dec	Mar		Jun		Sep	Dec	
	Actual	EBS/10/39 Prog.	Est.	EBS/10/39 Prog.	Est.	Prog.	EBS/10/39 Prog.	Prog.
Revenue	3,189	713	736	1,569	1,581	2,448	3,250	3,368
Tax	2,660	591	609	1,314	1,304	2,028	2,738	2,790
Indirect taxes	1,202	258	274	580	608	939	1,271	1,281
Direct taxes	319	83	78	165	157	245	329	329
Social Security contributions	1,140	250	257	569	538	844	1,138	1,180
Non-tax	391	82	88	176	199	303	352	413
Grants	138	40	39	80	78	117	160	156
For budget support	0	1	0	2	0	0	4	0
For investment	138	39	39	78	78	117	156	156
Expenditure on a commitment basis	3,914	884	851	1,872	1,780	2,837	3,749	3,871
Wage bill	839	208	200	413	407	617	826	826
Goods and services	705	167	160	352	339	526	704	716
Subsidies and transfers	1,384	332	319	687	646	1,022	1,373	1,392
Social benefits	988	247	241	473	482	729	946	979
Other transfers to households	242	53	64	111	121	181	221	245
Subsidies to industry and agriculture	154	32	14	103	44	112	206	169
Interest payments	56	10	11	23	27	46	50	66
Other current spending	163	26	28	74	61	105	147	149
Investment expenditure	621	109	95	261	249	427	523	583
Foreign financed investment projects	286	69	54	137	127	217	274	303
Other investment expenditure	335	41	41	124	122	209	248	281
Off-budget	178	38	44	91	68	128	182	189
Net lending (+/-)	-31	-7	-5	-28	-17	-34	-56	-50
Consolidation error / discrepancy	0	0	0	0	0	0	0	0
Overall balance	-725	-170	-115	-303	-199	-388	-500	-503
Financing	725	170	115	303	199	388	500	503
Domestic	524	14	10	121	33	224	157	185
GSM	10	2	0	5	6	16	10	21
One-off operations [1]	163	-8	-10	-8	-10	-10	-8	-10
Domestic claims, amortization	-90	-46	-21	-69	-37	-57	-147	-58
Change in arrears and float	72	-136	-57	-136	-112	-95	-136	-90
Other domestic financing	370	201	98	329	186	370	438	321
Banking system, net	558	251	127	429	243	499	638	521
Transfer to the Development Bank	-189	-50	-29	-100	-58	-129	-200	-200
Foreign financing	224	16	5	16	10	47	29	61
Loan disbursement	279	30	14	59	48	100	119	147
For investment projects	148	30	14	59	48	100	119	147
For budget support [2]	131	0	0	0	0	0	0	0
Amortization	-56	-14	-10	-44	-39	-53	-90	-85
Financing gap/discrepancy	-22	140	100	166	156	118	314	257
Identified financing [2]	…	140	90	166	90	118	314	257
IMF	…	88	92	88	92	118	155	161
WB	…	52	0	52	0	0	108	66
EU	…	0	0	26	0	0	52	29
Exchange rate discrepancy	…	0	-2	0	-2	0	0	0
Remaining gap / Errors and omissions	-22	0	10	0	66	0	0	0

Sources: Ministry of Finance; and IMF staff estimates.

[1] Includes proceeds from privatization, succession funds, and the use of the 2009 SDR allocations.

[2] Disbursements of budget support loans and grants from multilateral creditors in the past are recorded under "Foreign financing for budget support" and "Grants for budget support", respectively, and under "Identified financing of financing gap" in the current year and in projections.

Table 6. Bosnia and Herzegovina: Monetary Survey, 2008–15

	2008	2009	2010				2011	2012	2013	2014	2015
	Dec.	Dec.	Jun.		Dec.		Dec.				
	Actual	Actual	EBS/10/39 Prog.	Actual	EBS/10/39 Prog.	Proj.	Proj.				
	(Million KM, end of period)										
Net foreign assets	3,111	3,462	3,545	4,023	3,928	4,270	5,327	6,336	6,592	6,556	6,409
Foreign assets	9,422	9,210	9,322	9,323	9,733	9,443	10,604	11,719	12,081	12,156	12,121
Foreign liabilities	6,311	5,748	5,777	5,300	5,806	5,173	5,277	5,382	5,490	5,600	5,712
Net domestic assets	9,593	9,540	9,575	9,399	9,115	9,198	8,753	8,817	9,756	10,954	12,346
Domestic credit	12,991	12,844	13,165	13,063	12,745	13,202	13,126	13,567	14,731	16,271	17,836
Claims on general government (net)	-1,302	-907	-405	-804	-639	-687	-1,079	-1,721	-1,762	-1,160	-586
Claims on central (state and entity) government (net)	-1,462	-1,153	-652	-1,077	-886	-938	-1,330	-1,972	-2,013	-1,411	-838
Claims on public agencies (Social Security Funds)	14	53	39	58	39	49	49	49	49	49	49
Claims on local government	147	193	207	216	207	202	202	202	202	202	202
Claims on nongovernment	14,293	13,751	13,570	13,866	13,384	13,889	14,205	15,288	16,492	17,431	18,422
Other items (net)	-3,398	-3,304	-3,590	-3,664	-3,630	-4,005	-4,373	-4,750	-4,975	-5,317	-5,490
Broad money (M2)	12,704	13,003	13,120	13,422	13,042	13,467	14,079	15,153	16,347	17,510	18,755
Narrow money (M1)	5,995	5,888	5,858	5,861	5,629	6,011	6,227	6,617	7,034	7,446	7,879
Currency	2,301	2,009	2,105	1,990	2,000	2,001	2,005	2,028	2,027	2,036	2,033
Demand deposits	3,695	3,879	3,753	3,872	3,629	4,009	4,222	4,589	5,007	5,410	5,846
Quasi-money (M1)	6,708	7,115	7,263	7,560	7,414	7,457	7,853	8,536	9,314	10,064	10,877
Time and savings deposits	1,727	1,785	1,781	1,789	1,780	1,802	1,898	2,063	2,251	2,432	2,629
Foreign currency deposits	4,982	5,330	5,482	5,771	5,634	5,655	5,955	6,473	7,063	7,632	8,248
	(12-month change over broad money in same period last year, in percent)										
Net foreign assets	-16.6	2.8	7.4	11.2	3.6	6.2	7.8	7.2	1.7	-0.2	-0.8
Net domestic assets	20.3	-0.4	-1.4	-2.8	-3.2	-2.6	-3.3	0.5	6.2	7.3	8.0
Domestic credit	26.0	-1.2	0.3	-0.5	-0.8	2.8	-0.6	3.1	7.7	9.4	8.9
Claims on general government (net)	6.0	3.1	4.2	0.9	2.1	1.7	-2.9	-4.6	-0.3	3.7	3.3
Claims on nongovernment	20.0	-4.3	-3.9	-1.5	-2.9	1.1	2.3	7.7	8.0	5.7	5.7
Other items (net)	-5.7	0.7	-1.7	-2.3	-2.5	-5.4	-2.7	-2.7	-1.5	-2.1	-1.0
Broad money (M2)	3.7	2.4	6.0	8.4	0.3	3.6	4.5	7.6	7.9	7.1	7.1
Memorandum items:											
	(Annual percent change)										
Broad money (M2)	3.7	2.4	6.0	8.4	0.3	3.6	4.5	7.6	7.9	7.1	7.1
Reserve money (RM)	-8.4	-1.0	8.6	4.9	-0.1	-3.3	4.0	4.5	3.1	6.8	5.5
Credit to the private sector	20.7	-3.8	-3.4	-1.3	-2.7	1.0	2.3	7.6	7.9	5.7	5.7
	(Percent)										
Credit to the private sector (in percent of GDP)	57.9	57.3	…	…	54.0	57.3	56.1	56.1	56.1	55.3	54.6
Broad money (in percent of GDP)	51.4	54.2	…	…	52.6	55.6	55.6	55.6	55.6	55.6	55.6
Central bank net foreign assets (in percent of domestic currency outside banks)	274.8	310.5	296.5	300.6	335.9	315.9	365.5	392.0	391.6	389.5	384.2
	(Ratio)										
Velocity (GDP/end-of-period M2)	1.9	1.8	…	…	1.9	1.8	1.8	1.8	1.8	1.8	1.8
Reserve money multiplier (M2/RM)	2.2	2.3	…	…	2.3	2.5	2.5	2.6	2.7	2.7	2.7

Source: CBBH and IMF staff estimates and projections.

Table 7. Bosnia and Herzegovina: Central Bank and Commercial Banks, 2008–15
(Million KM, end of period)

	2008	2009	2010				2011	2012	2013	2014	2015
	Dec.	Dec.	Jun.		Dec.		Dec.				
	Actual	Actual	EBS/10/39 Prog.	Actual	EBS/10/39 Prog.	Proj.	Proj.				
Central bank											
Net foreign assets	6,323	6,239	6,241	5,980	6,718	6,323	7,328	7,951	7,938	7,929	7,809
Foreign assets	6,324	6,240	6,242	5,981	6,719	6,324	7,329	7,952	7,938	7,930	7,810
Foreign liabilities	1	1	1	1	1	1	1	1	1	1	1
Of which: Medium- and long-term	0	0	0	0	0	0	0	0	0	0	0
Net domestic assets	-619	-590	-677	-604	-1,073	-858	-1,645	-2,011	-1,814	-1,389	-909
Claims on general government (net)	-23	-57	-130	-84	-520	-337	-1,120	-1,482	-1,263	-837	-366
Claims on central (state and entity) government (net)	-23	-57	-130	-84	-520	-337	-1,120	-1,482	-1,263	-837	-366
Claims	0	0	0	0	0	0	0	0	0	0	0
Deposits	-23	-57	-130	-84	-520	-337	-1,120	-1,482	-1,263	-837	-366
Claims on public agencies (Social Security Funds)	0	0	0	0	0	0	0	0	0	0	0
Claims on commercial banks (net)	0	0	0	0	0	0	0	0	0	0	0
Claims on nongovernment	2	1	1	1	1	1	1	1	1	1	1
Other items (net)	-597	-535	-548	-522	-555	-523	-527	-531	-553	-554	-545
Reserve money	5,704	5,649	5,565	5,376	5,645	5,465	5,683	5,941	6,124	6,540	6,900
Currency outside banks	2,301	2,009	2,105	1,990	2,000	2,001	2,005	2,028	2,027	2,036	2,033
Bank reserves	3,396	3,633	3,454	3,379	3,639	3,459	3,673	3,908	4,092	4,500	4,863
Vault cash	252	258	258	297	288	273	290	308	323	355	384
Deposits	3,144	3,375	3,195	3,082	3,351	3,186	3,384	3,600	3,770	4,145	4,480
Nonbank deposits	7	6	6	7	6	4	4	4	4	4	4
Deposit money banks											
Net foreign assets	-3,212	-2,777	-2,696	-1,957	-2,790	-2,053	-2,001	-1,615	-1,346	-1,373	-1,400
Foreign assets	3,098	2,971	3,080	3,342	3,015	3,119	3,275	3,766	4,143	4,226	4,310
Foreign liabilities	6,310	5,747	5,776	5,299	5,805	5,172	5,276	5,381	5,489	5,599	5,711
Of which: Medium- and long-term	5,645	5,171	5,171	4,638	5,222	4,586	4,678	4,771	4,867	4,964	5,063
Net domestic assets	13,607	13,764	13,711	13,382	13,827	13,515	14,071	14,736	15,662	16,843	18,119
Reserves	3,395	3,632	3,454	3,378	3,639	3,459	3,673	3,908	4,092	4,500	4,863
Vault cash	252	258	258	297	288	273	290	308	323	355	384
Deposits with central bank	3,143	3,374	3,195	3,082	3,351	3,186	3,384	3,600	3,770	4,145	4,480
Domestic credit	13,013	12,899	13,294	13,145	13,264	13,538	14,244	15,047	15,992	17,106	18,200
Claims on government (net)	-1,278	-850	-275	-720	-119	-350	41	-239	-499	-323	-221
Claims on central (state and entity) government (net)	-1,438	-1,097	-521	-993	-365	-601	-210	-491	-750	-574	-472
Claims on public agencies (Social Security Funds)	14	53	39	58	39	49	49	49	49	49	49
Claims on local government	147	193	207	216	207	202	202	202	202	202	202
Claims on private sector	14,291	13,750	13,569	13,865	13,383	13,888	14,203	15,286	16,491	17,429	18,421
Other items (net)	-2,800	-2,767	-3,036	-3,142	-3,075	-3,482	-3,846	-4,219	-4,422	-4,763	-4,944
Liabilities to Central Bank	0	0	0	0	0	0	0	0	0	0	0
Deposit liabilities to nonbank residents	10,396	10,987	11,016	11,425	11,036	11,462	12,070	13,120	14,316	15,470	16,718
Of which: Local government	547	604	600	530	600	481	496	529	495	360	226
Public agencies (Social Security Funds)	230	211	211	206	211	309	309	309	309	309	309

Source: CBBH and IMF staff estimates and projections.

Table 8. Bosnia and Herzegovina: Financial Soundness Indicators, 2005–10
(Percent)

	2005	2006	2007	2008	2009	2010 Mar	2010 Jun
Capital							
Tier 1 capital to risk-weighted assets (RWA)	13.7	13.6	12.6	12.0	12.4	12.6	12.0
Net capital to RWA	17.8	17.7	17.1	16.3	16.1	15.7	15.1
Quality of assets							
Nonperforming loans to total loans	5.3	4.0	3.0	3.1	5.9	7.1	8.7
Nonperforming assets (NPAs) to total assets	3.3	2.5	1.8	2.2	3.9	4.8	5.9
NPAs net of provisions to tier 1 capital	20.4	15.2	12.9	14.3	25.9	31.7	38.5
Provision to NPAs	40.1	39.6	37.2	37.9	34.6	32.9	34.3
Profitability							
Return on assets	0.7	0.9	0.9	0.4	0.1	0.0	-0.3
Return on equity	6.2	8.5	8.9	4.3	1.1	-0.4	-3.0
Net interest income to gross income	54.1	54.3	59.9	60.6	61.5	63.8	62.9
Noninterest expenses to gross income	90.1	86.4	84.9	90.5	97.4	101.9	110.9
Liquidity							
Liquid assets to total assets	36.1	35.9	37.7	30.0	30.9	30.6	29.5
Liquid assets to short- term financial liabilities	61.9	60.8	61.3	51.8	52.9	50.6	49.3
Short- term financial liabilities to total financial liabilities	66.1	67.1	69.0	65.4	66.2	68.1	67.6
Foreign exchange risk							
Foreign currency and indexed loans to total loans	68.7	71.0	74.0	73.3	73.9	73.6	72.3
Foreign currency liabilities to total financial liabilities	64.4	62.8	65.0	69.5	69.2	68.5	68.9
Net open position	8.3	8.9	4.9	6.2	1.7	4.8	4.6

Source: CBBH.

Table 9a. Bosnia and Herzegovina: Gross Financing Requirements 2008–15
(In millions of euros)

	2008	2009	2010	2011	2012	2013	2014	2015
Financing requirements	-1,881	-917	-1,113	-1,186	-1,307	-1,617	-1,948	-2,187
Current account deficit	-1,819	-840	-684	-707	-732	-792	-815	-863
Amortization	-62	-77	-428	-479	-575	-825	-1,132	-1,324
Government [1]	-62	-77	-117	-127	-166	-330	-524	-574
Other	0	0	-311	-352	-409	-495	-609	-750
Financing	1,881	917	1,113	1,186	1,307	1,617	1,948	2,187
Capital transfers	201	174	176	190	196	202	209	216
FDI	627	184	200	378	728	728	728	728
Net bank financing	807	-104	-374	-31	-210	-147	12	12
Foreign loans	629	900	371	337	333	358	412	446
Government	71	484	193	191	189	200	237	253
Other	558	416	178	146	144	159	175	193
Gross international reserves (– = increase)	206	46	-43	-514	-319	7	4	61
Other	-589	-283	271	322	377	468	582	723
Financing gap [2]	0	0	511	503	201	0	0	0
Fiscal	0	0	382	103	0	0	0	0
Augmentation of reserves	0	0	129	400	201	0	0	0
IMF	0	0	376	400	201	0	0	0
of which, for budget support	0	0	247	0	0	0	0	0
World Bank	0	0	85	53	0	0	0	0
EU	0	0	50	50	0	0	0	0
Other	0	0	0	0	0	0	0	0

Table 9b. Bosnia and Herzegovina: Gross Financing Requirements 2008–15
(In percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015
Financing requirements	-14.9	-7.5	-9.0	-9.2	-9.4	-10.8	-12.1	-12.7
Current account deficit	-14.4	-6.8	-5.5	-5.5	-5.2	-5.3	-5.1	-5.0
Amortization	-0.5	-0.6	-3.5	-3.7	-4.1	-5.5	-7.0	-7.7
Government [1]	-0.5	-0.6	-0.9	-1.0	-1.2	-2.2	-3.3	-3.3
Other	0.0	0.0	-2.5	-2.7	-2.9	-3.3	-3.8	-4.3
Financing	14.9	7.5	9.0	9.2	9.4	10.8	12.1	12.7
Capital transfers	1.6	1.4	1.4	1.5	1.4	1.3	1.3	1.3
FDI	5.0	1.5	1.6	2.9	5.2	4.8	4.5	4.2
Net bank financing	6.4	-0.8	-3.0	-0.2	-1.5	-1.0	0.1	0.1
Foreign loans	5.0	7.3	3.0	2.6	2.4	2.4	2.6	2.6
Government	0.6	3.9	1.6	1.5	1.4	1.3	1.5	1.5
Other	4.4	3.4	1.4	1.1	1.0	1.1	1.1	1.1
Gross international reserves (– = increase)	1.6	0.4	-0.3	-4.0	-2.3	0.0	0.0	0.4
Financing gap [2]	0.0	0.0	4.1	3.9	1.4	0.0	0.0	0.0
Fiscal	0.0	0.0	3.1	0.8	0.0	0.0	0.0	0.0
Augmentation of reserves	0.0	0.0	1.0	3.1	1.4	0.0	0.0	0.0
IMF	0.0	0.0	3.0	3.1	1.4	0.0	0.0	0.0
World Bank	0.0	0.0	0.7	0.4	0.0	0.0	0.0	0.0
EU	0.0	0.0	0.4	0.4	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: IMF staff projections and calculations.

[1] Includes repayments of mulilateral support for both budget financing and official international reserves accummulation. In the BOP accounts, the latter are recorded under medium and long-term liabilities of monetary authority.

[2] Disbursements of budget support loans and grants from multilateral creditors (incl. IMF) are recorded under "Foreign loans" and "Current transfers", respectively, in the year they are drawn, and under "Identified financing of financing gap" in projections.

Table 10. Bosnia and Herzegovina: Indicators of Capacity to Repay the Fund, 2009–15

	2009	2010	2011	2012	2013	2014	2015
	Actual	Projections					
Fund repurchases and charges							
In millions of SDRs	1.3	3.5	12.1	44.7	173.5	310.7	330.9
In millions of U.S. dollars	2.1	5.2	18.4	68.0	264.3	474.1	512.8
In percent of exports of goods and NFS	0.04	0.1	0.3	1.0	3.8	6.5	6.7
In percent of external public debt service	1.2	2.3	6.9	21.5	50.7	62.8	62.1
In percent of quota	0.8	2.0	7.2	26.4	102.7	184.0	198.8
In percent of gross official reserves	0.0	0.1	0.4	1.3	5.2	9.3	10.3
Fund credit outstanding							
In millions of SDRs	182.6	507.2	845.3	991.6	839.8	545.7	222.0
In millions of U.S. dollars	281.7	768.9	1,284.9	1,508.9	1,279.6	832.5	344.1
In percent of quota	108.0	299.9	499.9	586.4	496.6	322.7	131.3
In percent of GDP	1.7	4.7	7.7	8.5	6.7	4.1	1.6
In percent of gross official reserves	6.1	18.6	26.9	29.2	25.0	16.3	6.9
Memorandum items:							
Exports of goods and services (millions of US$)	5,463	5,918	6,241	6,572	6,930	7,306	7,649
External public debt service (millions of US$)	175	231	266	316	521	754	825
Quota (millions of SDRs)	169	169	169	169	169	169	169
Quota (millions of US$)	261	256	257	257	258	258	262
Gross official reserves (millions of US$)	4,637	4,144	4,781	5,163	5,128	5,099	4,997
GDP (millions of US$)	17,043	16,202	16,631	17,808	19,114	20,375	21,720

Source: Fund staff estimates.

Based on what-if analysis as of August 28,2010.

Table 11. Bosnia and Herzegovina: Performance Criteria Under the 2009–12 Stand-By Arrangement, 2010

(In millions of KM)

	Cumulative flow since December 31, 2009							
	2010							
	March			June			September	December
	Program	Adj. Program [2]	Actual	Program	Adj. Program [2]	Actual	Program	Program
Ceiling on accumulation of net credit of the banking system to: [1, 2]								
General government	333	292	104	580	604	175	751	631
of which:								
State government	20	20	3	-11	-11	-71	112	121
RS government	251	237	127	429	480	243	499	521
Federation government	61	34	-23	164	137	19	159	-8
Ceiling on the increase in total value of guarantees by the State, Federation and RS governments of private and public sector enterprises' debts to domestic banks plus the value of enterprise debts to domestic banks assumed by these governments [3]	0		0	0		0	100	100
Ceiling on accumulation of external debt service arrears by the State, Federation and RS governments and CBBH [3]	0		0	0		0	0	0
Ceiling on contracting or guaranteeing of new short-term external nonconcessional debt by the State, Federation and RS governments and CBBH [3]	0		0	0		0	0	0
Ceiling on accumulation of domestic expenditure arrears by: [3]								
State government	0		0	0		0	0	0
RS government	0		15	0		-1	0	0
Federation government	0		-6 [4]	0		-17 [4]	0	0

[1] Equal to the sum of the three listed sub-ceilings plus the net bank credit to the District of Brčko, which is not monitored individually due to its small size.

[2] The targets on banking system net claims the general government will be adjusted upward (downward) by the full amount of any shortfall (surplus) in programmed disbursements of budget support loans and grants; and will also be adjusted upward (downward) by the amount by which reported chang float is arithmetically smaller (greater) than its targets in the fiscal program. The upward adjustment is limited to 10 percent of the absolute value of the respective change-in-float target (see Technical Memorandum of Understanding on Definitions and Reporting Under the 2009–12 Economic Program).

[3] Continuous.

[4] Based on preliminary information for lower levels of Federation government (cantons, municipalities, and cantonal extrabudgetary funds).

Table 12. Bosnia and Herzegovina: Structural Measures under the Stand-By Arrangement, 2010

Test date	Actions	Objective	Status	Type
		Continuous		
Continuous	Continued adherence of the Currency Board Arrangement as constituted under the law	Anchor for macroeconomic policy; Contribute to economic and political stability.	Met	Structural Benchmark
Continuous	Publish on the State government's web site quarterly consolidated general government accounts with a 5 week lag	Enhance fiscal transparency and program ownership.	Met (for March and June)	Structural Benchmark
Continuous	Carry out eligibility audits for civil and war benefit recipients; publish results (quarterly within 4 weeks after the end of each quarter) of audits, including expected savings from disqualifications (Federation, RS)	Reduce recurrent spending through better targeting of transfer programs.	RS (Met for March, and June (with delay in publication); Federation (not met)	Structural Benchmark
Continuous	No new privileged or special rights for retirement will be introduced prior to the pension system reform (Federation).	Contain the cost to central government of financing the pension system.		Structural Benchmark (New)
		Second and Third Reviews		
end-March 2010	Adopt by Parliament wage legislation consistent with the 2010 fiscal policy objectives (Federation)	Harmonization of remuneration policies across levels of government with the view of containing the public wage bill.	Met with delay in July	Structural Benchmark
end-March 2010	Reform privileged pensions by entity governments (Federation, RS)	Steps toward containing the cost to central governments of financing the pension systems.	RS (Met); Federation (Not met)	Structural Benchmark
end-March 2010	Prepare a strategy for pension reform by entity governments (Federation, RS)		RS (Met); Federation (Met with delay in June)	Structural Benchmark
	Approval by Federation Parliament of a 2010 revised Federation central government budget consistent with the authorities' commitments in Paragraph 10 of this LoI (Federation).	Reflect measures to contain the wage bill and transfers, ensure full funding of central government obligations on current-year transfers	Met	Prior Action
	Adoption of a government decision on measures to improve the audit process consistent with the authorities' commitments in Paragraph 10 of this LoI (Federation).	Reduce recurrent spending through better targeting of transfer programs.	Met	Prior Action
	Adoption of a government decision to condition the transfers to the cantons on cantonal budget rebalances to reduce current expenditures (Federation).	Reduce recurrent spending by cantons.	Met	Prior Action
		Fourth Review		
end-December 2010	Adoption by government of the Law on Pension and Disability Insurance in accordance with the Strategy of the Pension System Reform (RS)	Step toward containing the cost to central government of financing the pension system.		Structural Benchmark
end-December 2010	Establish a working group under the Fiscal Council to propose by December 31, 2010 recommendations, guidelines and a timetable for application of international accounting standards for the public sector and other international standards of financial reporting, including a harmonized fiscal reporting template, at all levels of government in BiH.	Enhance medium-term budget planning, fiscal transparency, and program ownership.		Structural Benchmark

Table 13. Bosnia and Herzegovina: Schedule of Purchases
Under the Stand-By Arrangement, 2009–12

	Available on or after	Amount of Purchase: In millions of SDRs	Amount of Purchase: In percent of quota [1]	Conditions
	Realized			
1	July 8, 2009	182.63	108	Board approval of the arrangement.
2	December 10, 2009	87.93	52	Observance of end-September 2009 performance criteria and completion of the first program review. [2]
3	March 10, 2010	33.82	20	Observance of end-December 2009 performance criteria, and completion of the quarterly program review. [2]
	Planned			
4	June 10, 2010	33.82	20	Observance of end-March 2010 performance criteria and completion of the second program review.
5	September 10, 2010	84.55	50	Observance of end-June 2010 performance criteria and completion of the third program review.
6	December 10, 2010	84.55	50	Observance of end-September 2010 performance criteria and completion of the forth program review.
7	March 10, 2011	84.55	50	Observance of end-December 2010 performance criteria and completion of the fifth program review.
8	June 10, 2011	84.55	50	Observance of end-March 2011 performance criteria and completion of the sixth program review.
9	September 10, 2011	84.55	50	Observance of end-June 2011 performance criteria and completion of the seventh program review.
10	December 10, 2011	84.55	50	Observance of end-September 2011 performance criteria and completion of the eighth program review.
11	March 10, 2012	84.55	50	Observance of end-December 2011 performance criteria and completion of the ninth program review.
12	June 10, 2012	84.55	50	Observance of end-March 2012 performance criteria and completion of the tenth program review.
	Total	**1,014.60**	**600**	

[1] The quota is SDR 169.1 million.

[2] The purchases of the December 2009 and March 2010 tranches were made following the concusion of the first program review on March 24, 2010.

APPENDIX I. BOSNIA AND HERZEGOVINA: EXTERNAL DEBT SUSTAINABILITY

43. **BiH's external debt continues to remain manageable, notwithstanding the increasing external financing needs of government and limited borrowing opportunities of the private sector due to global crisis. The debt-to-GDP ratio is expected to increase from pre-crisis 48 percent to about 60 percent in 2011–12.** The main contributor of the increase is the public sector, including the loans from IFIs and other multilateral and bilateral creditors aimed at supporting financing of the fiscal gap and implementation of essential investment projects. The crisis has prevented the increase of private sector borrowing opportunities: while non-bank sector borrowing increased at a modest pace, the banking sector borrowing abroad has declined substantially.

44. **In the baseline scenario, the dynamics of external debt indicators remain manageable and consistent with the macroeconomic framework under the SBA**. The baseline scenario assumes gradual improvement of public sector debt indicators driven by fiscal adjustment, expected inflows from privatization of public companies (in FBiH). Nevertheless government borrowing will remain at higher level compared to pre-crisis indicators, driven by the investment needs of government. The borrowing of the private sector (including bank and non-bank) will stabilize at around 30.5 percent of GDP during 2011–2015.

45. **Bound tests reveal that BiH's external debt remains vulnerable to a number of shocks.** The tests suggest that BiH's external position is particularly vulnerable to a real depreciation shock, a noninterest current account shock, and a slowdown in GDP growth. An interest rate shock seems to have a relatively moderate impact. For instance, a depreciation of the exchange rate by 30 percent would push external debt to above 85 percent of GDP, though debt would eventually return to a declining path in subsequent years reaching about 68 percent in 2015. A negative shock on the current account balance would also lead to an unsustainable debt path, with the external debt ratio reaching 59 percent of GDP through 2015.[5]

46. **Managing debt sustainability and reducing the risks of rapid debt accumulation will depend on maintaining macroeconomic policies conducive to sustainable growth, continuous fiscal consolidation and maintenance of external stability consistent with the currency board arrangement.** The dynamics of external debt will be influenced substantially by the pace of economic recovery throughout the next few years, the quality of current account adjustment and reforms conducive to increase in FDI, including the promotion of healthy business and investment environment.

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[5] The CAB shock assumes that noninterest current account is at baseline minus one-half standard deviations.

Appendix Table 1. Bosnia and Herzegovina: External Debt Sustainability Framework, 2005-2015

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt 1/**	52.0	46.9	48.4	50.5	53.9	**57.3**	**60.8**	**59.5**	**55.7**	**51.7**	**47.8**	**-6.1**
2 Change in external debt	2.9	-5.2	1.6	2.0	3.5	3.4	3.4	-1.3	-3.8	-4.0	-3.8	
3 Identified external debt-creating flows (4+8+9)	7.6	-4.4	-11.6	0.9	9.7	3.6	0.9	-2.8	-2.5	-1.8	-1.4	
4 Current account deficit, excluding interest payments	16.2	6.7	9.4	13.0	5.4	4.7	4.5	4.3	4.2	4.0	3.8	
5 Deficit in balance of goods and services	40.2	29.2	31.5	33.2	23.4	21.8	21.2	20.5	20.3	19.9	19.3	
6 Exports	32.7	36.5	37.4	37.0	32.1	36.5	37.5	36.9	36.3	35.9	35.2	
7 Imports	72.9	65.7	68.9	70.2	55.4	58.3	58.7	57.4	56.6	55.8	54.6	
8 Net non-debt creating capital inflows (negative)	-5.6	-6.2	-13.5	-5.0	-1.5	-1.6	-2.9	-5.2	-4.8	-4.5	-4.2	
9 Automatic debt dynamics 2/	-3.0	-4.9	-7.5	-7.1	5.8	0.6	-0.7	-1.8	-1.9	-1.3	-1.0	
10 Contribution from nominal interest rate	1.0	1.2	1.4	1.5	1.5	0.9	0.9	1.0	1.1	1.1	1.2	
11 Contribution from real GDP growth	-1.8	-2.8	-2.3	-2.3	1.7	-0.3	-1.7	-2.8	-2.9	-2.4	-2.2	
12 Contribution from price and exchange rate changes 3/	-2.1	-3.3	-6.5	-6.3	2.6	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 4/	-4.7	-0.8	13.2	1.1	-6.2	-0.2	2.6	1.5	-1.3	-2.2	-2.4	
External debt-to-exports ratio (in percent)	159.1	128.3	129.6	136.5	168.2	157.0	161.9	161.2	153.6	144.1	135.8	
Gross external financing need (in billions of US dollars) 5/	2.3	1.5	2.2	3.2	2.1	2.3	2.4	2.5	3.0	3.4	3.8	
in percent of GDP	21.5	12.0	14.2	17.4	12.6	14.0	14.3	14.2	15.5	16.9	17.4	
Scenario with key variables at their historical averages 6/						**57.3**	**61.6**	**65.7**	**67.0**	**67.4**	**67.5**	**-10.5**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.0	6.1	6.1	5.7	-3.1	0.5	3.0	5.0	5.2	4.5	4.5	
GDP deflator in US dollars (change in percent)	4.5	6.8	16.2	15.0	-5.0	-5.4	-0.3	2.0	2.0	2.0	2.0	
Nominal external interest rate (in percent)	2.1	2.7	3.6	3.8	2.7	1.5	1.7	1.7	1.9	2.1	2.4	
Growth of exports (US dollar terms, in percent)	20.7	26.7	26.2	20.2	-20.1	8.3	5.5	5.3	5.5	5.4	4.7	
Growth of imports (US dollar terms, in percent)	12.0	2.2	29.3	23.8	-27.3	0.0	3.5	4.7	5.7	5.1	4.3	
Current account balance, excluding interest payments	-16.2	-6.7	-9.4	-13.0	-5.4	-4.7	-4.5	-4.3	-4.2	-4.0	-3.8	
Net non-debt creating capital inflows	5.6	6.2	13.5	5.0	1.5	1.6	2.9	5.2	4.8	4.5	4.2	

1/ Slight differences in external debt to GDP estimates presented in this and other staff report tables are due to different methods of conversion of the various aggregates into common units.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, γ = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

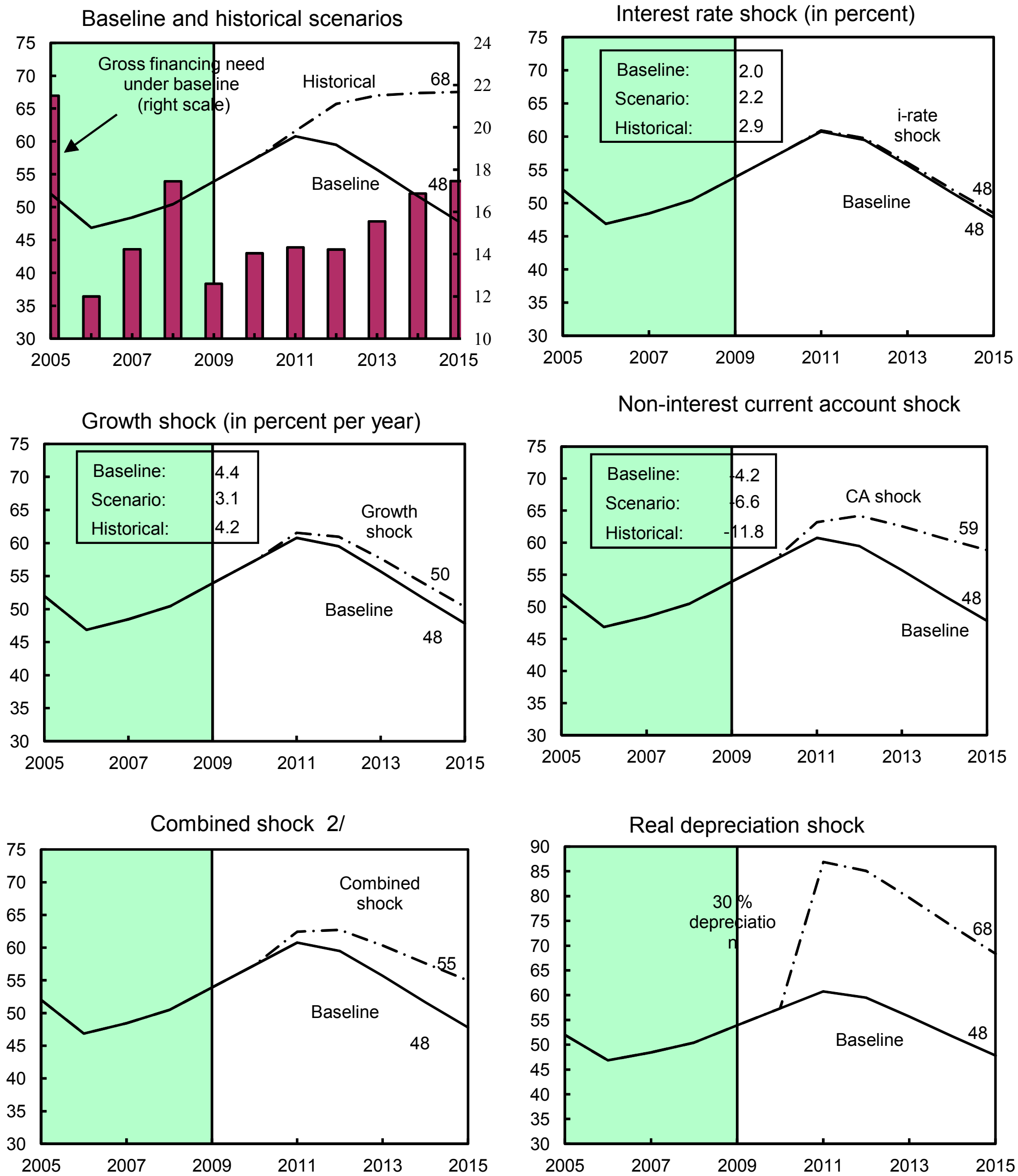
4/ For projection, line includes the impact of price and exchange rate changes.

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

6/ 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.

7/ 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.

Appendix Figure 1. Bosnia and Herzegovina: External Debt Sustainability: Bound Tests 1/ (External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and 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 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

APPENDIX II. BOSNIA AND HERZEGOVINA: PUBLIC DEBT SUSTAINABILITY

47. **The financial pressures on government finances resulting from the global crisis have increased substantially Bosnia and Herzegovina's public borrowing needs.** Public debt is expected to increase to 39 percent of GDP by end-2010 driven by external borrowing from IFIs and bilateral government financing for financing both current and capital expenditures. The external borrowing of 3.4 percent of GDP in 2009 was split almost equally between budget support and investment projects. In the medium-term, debt service is projected to increase from 1.7 percent of GDP in 2008 to about 4.4 percent by 2015.

48. **Under the baseline scenario, BiH public debt appears sustainable**. The program's medium-term scenario envisages fiscal consolidation; and BiH's debt level is projected to decline in nominal terms to 27 percent of GDP, close to its 2005 level. In line with declining primary deficits, gross financing needs are expected to decline as well, despite larger resources dedicated to debt servicing.

49. **BiH's public debt is susceptible to shocks.** Standardized shocks indicate that lower growth, exchange rate depreciation and higher primary deficits would substantially worsen debt sustainability, with debt-to GDP ratios increasing between 5 and 11 percentage points by 2015. In addition, a contingent liability shock is calibrated to reflect a potential cost to government of bank restructuring amounting to 10 percent of GDP in 2011. The probability of occurrence of such a shock is very low, as nine foreign banks, which subsidiaries account for 85 percent of BiH's banking sector assets, have committed to maintaining their exposure to BiH and ensuring that their subsidiaries are adequately capitalized under the European Bank Coordination Initiative. In this scenario public debt to GDP increase by over 8 percent of GDP by 2015.

50. **An alternative country-specific scenario points to sharply-increasing debt levels in the case of a complete lack of adjustment.** In this hypothetical no-adjustment scenario, overall balances are kept over the medium term at the level projected for 2010 (4.5 percent of GDP). The gross financing need in 2015 would increase from the currently projected 4 percent to 10 percent of GDP by 2015 with a corresponding worsening of the public debt burden.

51. **Debt sustainability depends heavily on a sustained growth recovery, in 2011 and beyond, as well as on sound macroeconomic management, including continuous fiscal consolidation.** Dynamics also crucially depends on current account adjustment and increase in FDI (including privatization in the Federation).

Appendix Table 2. Bosnia and Herzegovina: Public Sector Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing primary balance 9/**
1	**Baseline: Public sector debt 1/**	25.6	22.0	32.9	30.8	35.4	**39.1**	**43.0**	**39.7**	**34.5**	**30.8**	**27.1**	**-1.2**
	o/w foreign-currency denominated	25.6	21.2	17.5	17.2	21.7	26.2	29.4	29.0	26.0	22.5	19.1	
2	Change in public sector debt	0.1	-3.7	10.9	-2.1	4.5	3.7	4.0	-3.3	-5.2	-3.7	-3.7	
3	Identified debt-creating flows (4+7+12)	0.4	-7.7	-12.3	-0.3	7.8	4.0	1.0	-3.6	-3.8	-1.8	-1.9	
4	Primary deficit	-1.4	-2.9	-0.5	3.1	5.1	3.7	2.1	0.6	0.0	0.0	-0.4	
5	Revenue and grants	45.5	47.4	47.2	45.9	44.6	45.9	45.8	45.8	45.6	45.4	45.1	
6	Primary (noninterest) expenditure	44.2	44.5	46.6	49.0	49.7	49.7	47.9	46.4	45.6	45.3	44.7	
7	Automatic debt dynamics 2/	2.1	-4.6	-4.1	-2.8	2.7	0.4	-0.8	-2.2	-2.1	-1.6	-1.4	
8	Contribution from interest rate/growth differential 3/	-1.1	-2.2	-2.3	-3.0	1.4	0.4	-0.8	-2.2	-2.1	-1.6	-1.4	
9	Of which contribution from real interest rate	-0.2	-0.7	-1.0	-1.8	0.5	0.6	0.3	-0.2	-0.2	-0.2	-0.1	
10	Of which contribution from real GDP growth	-0.9	-1.6	-1.3	-1.3	1.0	-0.2	-1.1	-2.0	-1.9	-1.4	-1.3	
11	Contribution from exchange rate depreciation 4/	3.2	-2.4	-1.8	0.2	1.3	...	...	...	...	...	...	
12	Other identified debt-creating flows	-0.3	-0.1	-7.7	-0.6	-0.1	-0.1	-0.3	-2.0	-1.7	-0.1	-0.1	
13	Privatization receipts (negative)	-0.3	-0.1	-7.7	-0.6	-0.1	-0.1	-0.3	-2.0	-1.7	-0.1	-0.1	
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15	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	0.0	
16	Residual, including asset changes (2-3) 5/	-0.3	4.0	23.3	-1.8	-3.3	-0.3	3.0	0.3	-1.4	-1.9	-1.8	
	Public sector debt-to-revenue ratio 1/	56.3	46.3	69.8	67.2	79.3	85.1	93.9	86.7	75.7	67.9	60.0	
	Gross financing need 6/	0.1	-1.2	0.9	5.1	7.8	7.0	5.4	5.6	4.0	3.5	3.9	
	in billions of U.S. dollars	0.0	-0.1	0.1	0.9	1.3	1.1	0.9	1.0	0.8	0.7	0.9	
	Scenario with key variables at their historical averages 7/						**39.1**	**41.2**	**39.0**	**35.4**	**33.1**	**31.0**	**-1.7**
	Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
	Real GDP growth (in percent)	3.9	6.9	6.8	4.3	-3.1	0.5	3.0	5.0	5.2	4.5	4.5	
	Average nominal interest rate on public debt (in percent) 8/	2.5	3.1	3.2	1.7	1.7	2.2	2.3	2.0	2.1	2.1	2.4	
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-0.7	-2.6	-4.7	-5.7	1.5	1.7	0.8	-0.5	-0.4	-0.4	-0.1	
	Nominal appreciation (increase in US dollar value of local currency, in percent)	-11.6	11.4	10.3	-1.5	-6.7	...	...	...	...	...	...	
	Inflation rate (GDP deflator, in percent)	3.2	5.7	7.9	7.4	0.2	0.5	1.5	2.5	2.5	2.5	2.5	
	Growth of real primary spending (deflated by GDP deflator, in percent)	4.1	7.8	10.4	11.0	-1.7	0.4	-0.6	1.7	3.3	3.9	3.2	
	Primary deficit	-1.4	-2.9	-0.5	3.1	5.1	3.7	2.1	0.6	0.0	0.0	-0.4	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = 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 $r - \pi(1+g)$ and the real growth contribution as -g.

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

5/ For projections, this line includes exchange rate changes.

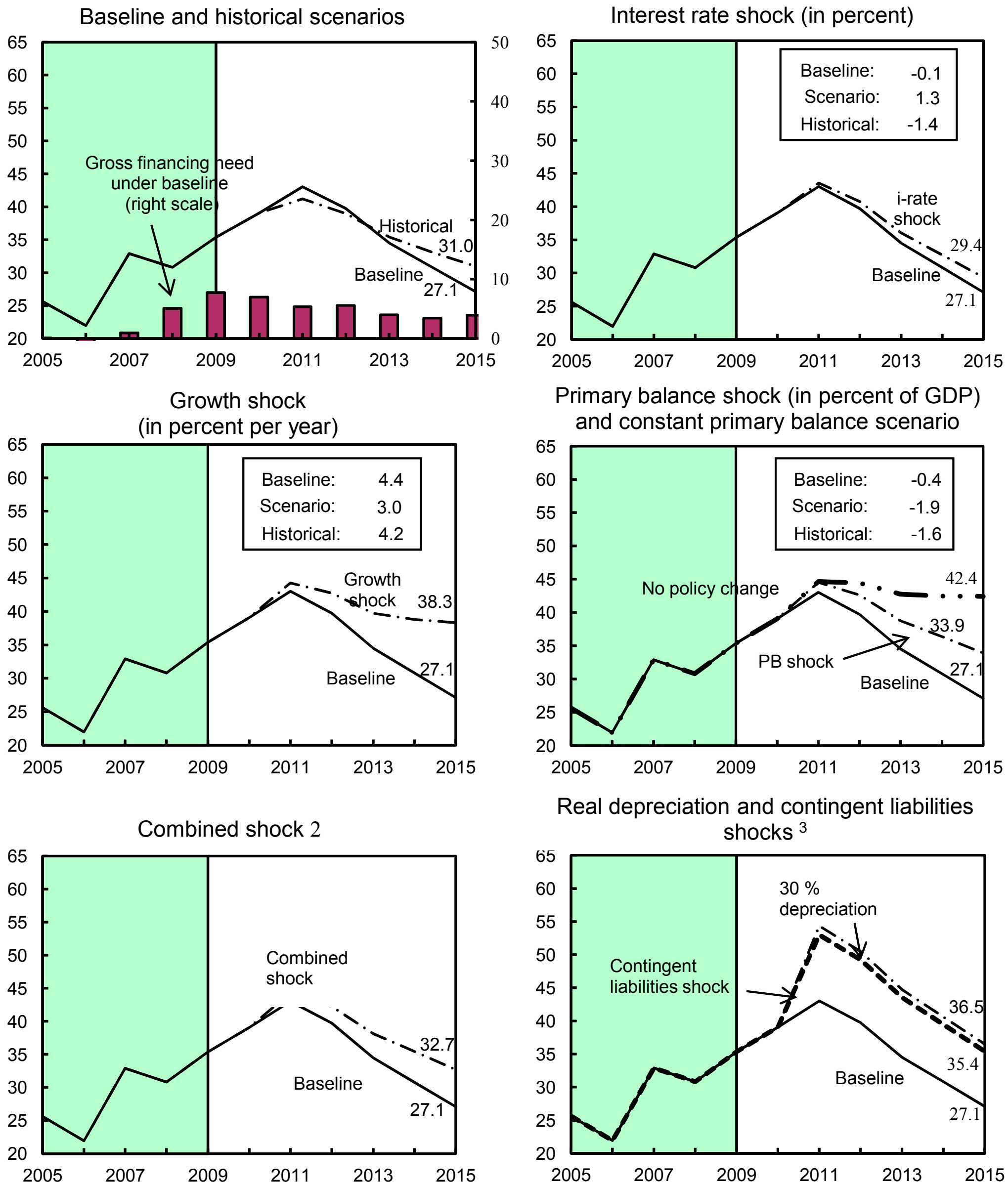
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

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

Appendix Figure 2. Bosnia and Herzegovina: Public Debt Sustainability: Bound Tests[1] (Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and 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 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

[3] One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

ATTACHMENT I. BOSNIA AND HERZEGOVINA: LETTER OF INTENT

Sarajevo and Banja Luka, Bosnia and Herzegovina
September 17, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. Despite the challenging external environment, the strengthening of our policies and the substantial financial support provided by the IMF since the approval of the Stand-By Arrangement (SBA) in July 2009 have helped stabilize the economy of Bosnia and Herzegovina (BiH) and set the stage for sustainable growth over the medium term. Macro-financial vulnerabilities have been reduced, as public confidence in banks has returned following the 2008 mini-deposit run, the decline in the foreign exchange reserves of the Central Bank of Bosnia and Herzegovina (CBBH) has been contained, and foreign banks have maintained their overall exposure to our country.

2. Implementation of the IMF-supported program has been in line with our commitments (Tables 1 and 2):

- *Quantitative performance criteria.* All end-March targets and end-June 2010 quantitative criteria were observed, except the one on the accumulation of domestic arrears.

- *Structural benchmarks.* We have met the structural benchmark for the publication on the State government's website of quarterly consolidated general government data for end-March and end-June 2010. In the Federation, the implementation of end-March 2010 structural benchmarks fell behind schedule, but the authorities have now advanced the program's reform agenda. Specifically, parliament adopted public wage legislation in July, the government approved a pension reform strategy in June, and eligibility audits for war benefit recipients began in early-July. The reform of privileged pensions and the latest round of eligibility audits of civilian disability benefit recipients will now take place in 2011. In Republika Srpska (RS), all end-March 2010 benchmarks—related to eligibility audits, the reform of privileged pensions, and the pension reform—have been met; and the end-June 2010 benchmark related to publication of results from eligibility audits was met with a few days' delay.

3. Overall budget implementation by the Institutions of BiH (State), Federation, and the RS has been in line with the program. At the same time, in the Federation, there are worrying signs that the reforms of rights-based cash transfer programs are not delivering the expected savings. In the RS, the finances of the pension and health insurance systems continue to be under pressure. In response, Entity governments have identified additional revenue sources and measures to contain expenditures, elaborated in this Letter.

4. In view of this performance and our continued commitment to the program, we request completion of the second and third reviews under the Stand-By Arrangement. On the basis of the corrective measures being taken, we request a waiver of non-observance of the performance criterion on non-accumulation of domestic arrears. In the RS, the zero sub-ceiling on accumulation of domestic arrears was exceeded during the first quarter of 2010, mainly on account of liquidity difficulties in the Health Fund, but since then outstanding arrears have been eliminated. In 2011, we will address this issue in the context of the planned reform of the health insurance system. In the Federation, the collection of detailed information on arrears of lower levels of government has proved very difficult within the reporting deadline, owing to capacity constraints, the decentralized government structure, and the lack of enforcement powers on the part of the central government. Available final information shows a reduction in the existing stock of domestic arrears for the central government and the cantons during January–June 2010, and preliminary information indicates that the zero ceiling on arrears accumulation was not exceeded by municipalities and cantonal extrabudgetary funds. To deal with these difficulties, we have prepared a template which will be introduced for reporting of arrears of all levels and we will increase the staff in the Ministry of Finance unit responsible for the collection of fiscal information from lower levels of government, in order to be able to meet the reporting deadline in future program reviews.

5. The policies set forth in this Letter and our previous letters (of June 16, 2009 and March 5, 2010) are adequate to achieve the objectives of our economic program, and we stand ready to take additional measures as appropriate to ensure the attainment of these objectives. We will consult with the IMF before modifying measures contained in this letter or adopting new measures that would deviate from the goals of the program, and provide the IMF with the necessary information for program monitoring.

A. Macroeconomic Framework

6. Our macroeconomic framework has retained cautious assumptions. We continue to believe in a gradual return to positive growth, with real GDP gaining about 0.5 percent in 2010 and 3 percent in 2011, aided by the recovery in the euro area. Inflation is expected to pick up to 2½ percent this year. Weak domestic demand in 2010 will keep the current account deficit considerably below pre-crisis levels. We expect the external financing situation to remain favorable. Foreign parent banks are expected to broadly maintain their total exposure to BiH, taking into account residents' direct borrowing from parent banks.

Other private flows, along with financing from the IMF, the World Bank, and the EU, should be sufficient to meet all external financing needs in 2010.

B. Fiscal Policy

7. In support of our commitment to the currency board, continued fiscal consolidation and structural fiscal reforms will remain the cornerstones of our policymaking. When the crisis hit, our fiscal position was threatened. The disbursements under the Stand-By Arrangement and the SDR allocations allowed us to maintain continuity of public services and gave us time to elaborate ambitious fiscal reforms aimed at putting public finances on a sustainable path. Our adjustment efforts focus on controlling current expenditure, while protecting transfers to vulnerable population groups and spending on much-needed infrastructure. In particular, public sector wages, which have grown very rapidly over the past few years, are being kept in check, while the system of social transfers is being reformed to improve its efficiency through better targeting.

8. The program's overall consolidated fiscal deficit objective of 4½ percent of GDP for 2010 remains appropriate. Although performance during the first half of the year is in line with the program, continued efforts will be needed to stay within the program targets.

9. The State has exercised prudence since the beginning of the program. In 2009, we accomplished an overall reduction in expenditures of KM 100 million compared to budget, and recorded a KM 12 million surplus. We implemented restrictive measures this year, and are targeting a deficit of KM 173 million, which will be financed from surpluses from earlier years, succession receipts, and funds from the budgetary support loan by the EU.

10. The Federation resisted expenditure pressures. Benefiting from better-than-budgeted revenue, it recorded a consolidated deficit of KM 97 million compared with the program's objective of KM 293 million in the first half of the year. However, due to delays in the implementation of the reforms of benefits, without additional efforts, expenditure pressures will continue to threaten the sustainability of our finances. We are thus determined to deal with these pressures with strong and concrete measures, which have been incorporated in a rebalanced 2010 budget (adoption by Parliament is a prior action and was met on September 14). Specifically:

- *Wages.* The Federation parliament adopted the Law on Wages in July (end-March structural benchmark) aimed at harmonizing and making more transparent the remuneration policies across levels of government. This Law along with a hiring restraint in the remainder of the year will ensure that the Federation central government's wage bill will not exceed the 2010 budgetary allocation; in fact, we expect to generate at least KM 3 million savings.

- *War-related cash benefits.* After some delay, we have started eligibility audits of beneficiaries (continuous structural benchmark). During July–August 2010, we audited 2,185 beneficiaries and referred 469 cases for further verification of documentation in military records. We will immediately suspend payments in cases of confirmed lack of adequate documentation. Owing to the delay in initiating the audit process and its complexity, we expect that savings will begin to materialize only toward the end of this year, but under current procedures the generated savings will be insufficient to allow us to stay within the budgeted allocation for war disability benefits. We will improve the audit process by giving priority to certain groups of beneficiaries (e.g., those who became eligible by proving their status and membership in the armed forces through administrative procedures, beneficiaries who exercised their rights without providing payroll certificates from the armed forces, the most recent beneficiaries, and those entitled on the basis of mental illness). We will also amend the Rulebook on the establishment and work of audit teams to allow the possibility for establishing up to 20 audit teams (instead of the current 15). The government will issue a decision to incorporate the aforementioned changes in the audit process by September 10, 2010 (prior action) and the Federation Ministry of Veterans' Affairs will issue the amended Rulebooks by end-September 2010. In addition, in October 2010 the FBiH government will evaluate the budget implementation and, if necessary, will apply an appropriate rationing coefficient in the last quarter of 2010 for all budget users. Finally, we will publish on a government website detailed results from the eligibility audits performed through August and will continue to publish these results quarterly.

    - *Medal holders' benefits.* We have introduced income tests for war medal holders effective May 1, 2010. Payments of benefits were suspended pending the outcome of eligibility audits and means-testing. We have removed from the beneficiary list 196 individuals who have failed to re-apply for benefits as of May 1, 2010, and following the income tests we will also remove from the beneficiary list by end-2010 the 20 percent of beneficiaries with the highest income. All these measures will result in savings of at least KM 1 million relative to the 2010 budget allocation.

    - *Demobilized soldiers' benefits.* The repeal of the Law on Demobilized Soldiers effective May 1, 2010 has resulted in cessation of all cash transfers to demobilized soldiers. Realized savings of KM 4.1 million relative to the budget allocation on this expenditure item have been used to settle arrears on unemployment benefits of demobilized soldiers accumulated in 2009. In the future, the social needs of demobilized soldiers will be addressed through existing programs of the social safety net.

    - *Privileged pensions.* We will overhaul the system of privileged pensions in the context of the implementation of the pension system reform in 2011. In the meantime, no new privileged or special rights for retirement will be introduced (continuous structural benchmark). We will tighten eligibility criteria and expedite audits of beneficiaries, and publish results quarterly. No one will be eligible to retire and use privileged or special provisions for retirement without the completion of an audit. Benefits will cease immediately in cases of fraud. To control the overall fiscal cost and improve equity of the public pension system, we will aim at aligning the average level of privileged pensions to that of pensions earned through full contributions.

- *Regularization of outstanding obligations.* We will resolve problems arising from weaknesses in budgeting, fiscal reporting and cash management, which have given rise to ad hoc treatment of outstanding obligations to final beneficiaries and those arising between various levels of government. We have already established and will publish an inventory of all outstanding obligations by level of government as of end-June 2010 toward beneficiaries under main transfer programs. As a next step, we will regularize and clear all outstanding obligations by planning funds for these purposes in the budgets of the FBiH starting from 2011, including by submitting to parliament a draft law for settlement of outstanding obligations to non-war invalids with the view of full payment in the course of the next two years, and by exploring different options for settlement of the FBiH Central Government debt to the Pension Fund, debt to demobilized soldiers, and other beneficiaries under main transfer programs.

- *Cantons*. Reflecting large expected transfers from the Federation government and unrealistic revenue projections, some cantons have approved expansionary budgets, and increased current spending compared with 2009. We will urge cantons to rebalance their budgets in line with the objectives of the Law on Savings. To this end, the Federation government will issue a decision to condition the transfers for deficit financing of cantons on cantonal budget rebalances to reduce current expenditures (prior action—met on September 8).

11. The RS exercised prudence in the first half of the year, recording a consolidated general government deficit of KM 199 million compared with the program's objective of KM 303 million. The government is committed to making strong efforts to limit the 2010 consolidated general government deficit to KM 503 million in line with the program. With better-than-projected revenue performance, our efforts will concentrate on keeping expenditure in check.

12. Ahead of the implementation of our comprehensive pension reform strategy, the RS government has begun addressing the liquidity challenges of the Pension Fund in the current year through increased transfers and borrowing from commercial banks. Parametric reforms have been initiated and the third pillar has been introduced during the past several years. The transition to the second pillar has been ruled out as too costly and difficult in the near term.

Future envisaged steps include: further increase in the effective retirement age of men and women; transition to the system of points similar to the German model; and indexation in line with the Swiss model (50 percent to CPI and 50 percent to wage growth). To this end, the RS government will, by end-2010, adopt the draft Law on Pension and Disability Insurance and forward it for adoption to the RS National Assembly in accordance with the adopted Strategy of the Pension System Reform (structural benchmark). Eligibility audits of veterans' and social benefits will continue.

13. The RS Government will initiate a reform of the health insurance system in accordance with the Strategy of Primary Health Care and the Strategy of Secondary and Tertiary Health Care in the RS. The reform will entail cost rationalization, introduction of a new payments model to health care institutions, and upgrades in information technology.

14. We have taken steps to strengthen the revenue side. We have amended the Law on Income Tax to: (i) make the costs of hot meals prepared by the employer and those delivered to the employer by a company registered for catering services tax free in the maximum amount of KM 3.5 a day per employee, or the maximum amount of KM 77 monthly per employee; (ii) reduce the amount of tax-exempt personal income from KM 3,600 to KM 3,000 annually; (iii) tax capital gains from the sale of property that was used for personal use; and (iv) tax pensions paid out from voluntary pension insurance plans up to KM 1,200. In tax administration, efforts to improve collection of revenues will focus on amending legislation and regulation with the view to improve control and broaden the coverage of taxpayers.

15. By end-2010, we will pass a new rulebook on financial reporting for budget users of the republic, municipalities, cities and funds; and, by end-September 2010 we will publish a new rulebook on the chart of accounts for budget users of the republic, municipalities, cities and funds, with application starting on January 1, 2011.

16. All governments are committed to maintaining fiscal discipline over the medium term. We therefore intend to reduce the general government deficit to 3 percent of GDP in 2011. Fiscal efforts will continue to focus on the expenditure side, which will benefit from the impact of the reforms undertaken this year.

- The Fiscal Council (FC) will adopt the Global Framework of Fiscal Balance and Policies in BiH consistent with the SBA to ensure that the 2011 State budget expenditures will remain at the 2010 level. This Framework will provide the basis for the preparation of the budgets of the State and the Entities for 2011.

- To improve the transparency of government operations, the 2012 budgets of the State, Federation, and RS will include foreign-financed investment projects financed from external loan drawings and grants, excluding technical assistance, that pass through the Treasury, as well as complete accounting of financing operations.

- Medium-term fiscal planning in the Federation will have to address substantial needs for capital investments in infrastructure. The consolidation of the wage bill, transfers and other current expenditures will continue. Restructuring and privatization of state-owned enterprises will be one of the important sources of financing.

- In the RS, the main challenges ahead will be containing pressure on social benefits arising from unfavourable demographic trends, transitioning to lower financing available for capital projects, and building up savings to service foreign debt obligations. This will imply strict control over the wage bill and other current spending. The RS government will adopt a Development Strategy (by end-May 2011) aimed at correcting the unfavourable economic structure inherited from the past and underutilization of the economy's comparative advantages and natural resources. The objective of the Strategy is to ensure competitiveness of the economy, increased employment, increased standard of living and improved social security of citizens.

17. We recognize the important role of the Fiscal Council in coordinating fiscal policy across BiH. We will establish common methodology according to which the State and the Entities will undertake a comprehensive analysis of expenditures. The results of the analysis will be presented to the FC in the context of the preparation of the 2012–14 Global Framework. We will continue to strengthen the Council's operational framework, including by improving fiscal methodology and multi-annual planning for the Global Framework, drafting proposals for short-term and long-term macroeconomic projections, and implementing established goals and criteria when adopting and executing the budget.

18. The unfavorable economic situation may have an impact on the vulnerable groups of our population. Thus, the envisaged reforms by the Entities are critical to ensuring that financial public support for households is better targeted toward the most vulnerable groups of the society, and that financial integrity of public pension and unemployment insurance schemes does not become jeopardized.

C. Financial Sector Policies

19. The banking system withstood the immediate impact of the global financial crisis well. However, nonperforming loans increased to 5.8 percent at end 2009 and continued to rise in the first half of 2010 reaching 8.7 percent at end June; and profitability has declined over the same period. The two Banking Agencies (BAs) are closely monitoring banking sector developments and are taking steps to ensure that banks continue to have adequate capital. To this end, banks were encouraged to retain profits, and use them to strengthen their capital buffers. In addition, the Banking Agencies will ensure that banks have forward-looking capital plans that will show how any potential deterioration in capital levels will be addressed. The BAs and the banks will review and, if necessary, revise such plans periodically, to account for changing macroeconomic environment. The BAs have strengthened their cooperation with foreign home supervisors including through their

participation in colleges of supervisors, and they hope to soon finalize bilateral Memoranda of Understanding with Austria's and Italy's banking supervisors.

20. We will follow up with parent banks on their pledge to continue to support their subsidiaries in BiH by keeping them adequately capitalized and maintaining their exposure to our country. As per the Bank Coordination Initiative, the CBBH along with the BAs prepared stress tests based on end-2009 data and discussed the results on a bilateral basis with each participating bank. We plan to update the stress tests using end June 2010 data and review with banks the need for additional capital based on the updated results. We will continue to monitor the exposure of parent banks vis-à-vis BiH, both directly to their subsidiaries and to the economy in general based on data provided to us on a regular basis by the parent banks. On an aggregate level, the parent banks' overall exposure at end-March 2010 was 1½ percent lower compared with end-2008. Following the second round of bilateral discussions with banks regarding the adequacy of their capital base and developments in the parent banks' exposure, we plan to convene another meeting of the parent banks to review and renew their commitments to BiH.

21. We have strengthened our framework for crisis preparedness and management. To this end we have established a Standing Committee for Financial Stability (SCFS), which consists of members of the Fiscal Council, the CBBH, the two Banking Agencies, and the Deposit Insurance Agency. A Memorandum of Understanding that establishes the formal framework of cooperation among the various parties has already been signed. The first meeting of the SCFS was held in May 2010, and we plan to meet at least once every quarter to discuss and exchange information related to financial stability. Prior to the meeting the CBBH and the Banking Agencies will prepare brief reports on the conditions in the financial sector. The reports will provide the basis of our discussion which will focus on identifying risks to the system and the appropriate response. Moreover the CBBH plans to increase the resources available for its Financial Stability Unit to enhance its capacity to monitor and analyze financial sector developments, and the BAs will continue to upgrade their information systems so that banking sector data can be readily processed and analyzed.

D. Data Issues

22. We have continued to make important progress in improving the quality of statistics. This has allowed us to meet the structural benchmark on the publication of preliminary consolidated general government fiscal data for the first and second quarters of 2010. At the same time, we are mindful of the significant gaps in the quality of published data, due among other things to the fact that budget execution data do not include transactions related to foreign-financed projects, accrual accounting has not yet been fully introduced in all government institutions; and the long delays in reporting by lower levels of government, particularly in the Federation. To address these serious problems, we are working with the help of TA from the regional TA advisor to transition to GFS 2001 reporting standards and shorten reporting delays. To this end, the Fiscal Council will establish a working group that,

by December 31, 2010 will make recommendations, and propose guidelines and a timetable for application of international accounting standards for the public sector and other international standards of financial reporting, including a harmonized fiscal reporting template, at all levels of government in BiH (structural benchmark).We will make progress towards improving data collection and reconciliation of external grants and loan disbursements at the level of donors, state, and Entities. At this stage we will improve statistics of project-tied grants that are extended through central governments and take steps to measure foreign in-kind grants.

E. Program Issues

23. The program will continue to be monitored through quarterly reviews, prior actions, quantitative performance criteria, and structural benchmarks. Revised quantitative targets for 2010 are set out in Table 1; and prior actions and structural benchmarks are set out in Table 2. We request that the end-September, and end-December 2010 targets be established as performance criteria. The understandings between the authorities of BiH and IMF staff regarding the quantitative performance criteria discussed in this Letter are further specified in the attached Technical Memorandum of Understanding. In light of our stronger-than-programmed reserve position, we also request rephasing of purchases envisaged for the second year of the arrangement to a smoother disbursement schedule (50 percent of quota at the completion of each quarterly program review). As a result, the amount of purchases that can be made upon successful completion of this review will be SDR 118.4 million (70 percent of quota). Of this amount, we plan to draw SDR 33.82 million to support the Entity budgets; and, given our strong reserve position, we will not draw the remaining amount at this stage and will consult with Fund staff should a need for further purchases arises.

24. IMF resources under the arrangement will be disbursed to the central bank, which acts as the fiscal agent for BiH, and credited to an account of the State. Resources earmarked for the budget will be allocated to the two Entity budgets on the customary 2/3:1/3 split.

/s/

Nikola Špirić
Chair
of the Council of Ministers
Bosnia and Herzegovina

/s/

Mustafa Mujezinović
Prime Minister
Federation of Bosnia
and Herzegovina

/s/

Milorad Dodik
Prime Minister
Republika Srpska

/s/

Dragan Vrankić
Minister of Finance
and Treasury of
Bosnia and Herzegovina

/s/

Vjekoslav Bevanda
Minister of Finance
Federation of Bosnia
and Herzegovina

/s/

Aleksandar Džombić
Minister of Finance
Republika Srpska

/s/
Kemal Kozarić
Governor
Central Bank of Bosnia and Herzegovina

Attachment

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

BOSNIA AND HERZEGOVINA

Technical Memorandum of Understanding on Definitions and Reporting Under the 2009–12 Economic Program

September 17, 2010

This memorandum supplements the Letter of Intent dated September 17, 2010. The memorandum updates and replaces the technical memorandum of understanding included in the IMF Board document for the 1-st SBA Review (Country Report 10/101). It sets out the understanding between the government of Bosnia and Herzegovina and the IMF mission regarding the definitions of quantitative performance criteria and targets and structural benchmarks for the stand-by arrangement (Tables 1–2) as well as data reporting requirements for program monitoring (Table 4).

I. DEFINITIONS

In the following definitions, the end-quarter test dates apply to the last working day of each quarter for both banking and budgetary statistics.

A. Ceiling on the Cumulative Change in Net Credit from the Banking System to the General Government

Definitions

- ***The general government*** is defined to include the governments of the State, the Republika Srpska Entity (RS), the Federation of Bosnia and Herzegovina Entity (Federation) and the District Brcko. The Federation government is defined to include the central government, the cantonal governments, the municipal governments, the extrabudgetary funds and the road fund. The RS government is defined to include the central government, the municipal governments, the extrabudgetary funds and the road fund. Extrabudgetary funds include, but are not limited to, the pension funds, health funds, unemployment funds, and children's fund in the two Entities. Any new budgetary and extra budgetary funds, created during the program period will also be included in the definition of the general government consistent with the definitions of the IMF *Manual on Government Finance Statistics 2001*. The BIH authorities will inform IMF staff of the creation of any such new funds.

- ***The banking system consists*** of the Central Bank of Bosnia and Herzegovina (CBBH) and the commercial banks in both Entities and the District of Brcko.

- ***Net credit of the banking system to the general government*** (net bank claims on general government) is defined as all banking system claims on general government (e.g., loans, securities, bills, and other claims in both convertible marka and foreign currencies) minus general government claims on the banking system (deposits, loans and other claims, including deposits in entities' escrow accounts) as defined in the Table 3 below.[1] For program purposes, those components of claims that are denominated in foreign currencies will be converted into convertible marka at current exchange rates.

Application of performance criteria

- The value of net bank claims on general government will be monitored from the accounts of the banking system, as compiled by the CBBH, and supplemented by information provided by the Ministries of Finance of each Entity and the State. Table 3 shows the banking system net claims on the general government as of end-December 2009.

- The ceilings on the cumulative change in net bank claims on general government will be defined, for each test date, as the cumulative change from the level existing on December 31 of the previous year.

- The ceilings on the cumulative change in net bank claims on general government will be defined in terms of three sub-ceilings that, together with the net bank claims on the District of Brčko,[2] sum to the ceiling for the general government. These sub-ceilings will be on the cumulative change in net bank claims on the government of the State, the governments of the Federation of Bosnia and Herzegovina and of the Republika Srpska. For the purposes of program monitoring, compliance with the ceiling on net bank claims on general government will require that each of these three sub-ceilings be observed independently.

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[1] Excluded from the definition of the general government claims on the central bank will be government deposits at CBBH counterpart to any future SDR purchases under the Stand-By Arrangement used for increase of the foreign reserves of the central bank.

[2] The net bank credit to the District of Brčko is not monitored individually because of its small size.

Adjustors to performance criteria

- The targets on net bank claims on general government will be adjusted upward (downward)[3] by the full amount of any shortfall (surplus) in programmed disbursements of budget support loans and grants. Program budget support disbursements are defined as external disbursements from official creditors (e.g., World Bank, IMF, and European Commission) used for financing of general government budget deficits.

- The targets on net bank claims on general government will be adjusted upward (downward)[4] by the amount by which reported change in float is arithmetically smaller (greater) than its targets in the fiscal program. Float is defined as accrued but unpaid purchases of goods and services, wages and salaries, pensions, social benefits, and investments that are not in arrears (as defined in the text below). The upward adjustment is limited to 10 percent of the absolute value of the respective change-in-float target.

BiH: General Government Change in Float, 2009
(In millions of KM)

	2009 Dec
Change in float ((1)-(2)-(3))	180
State government	0
FBiH government	113
RS government	67
District Brcko	0
(1) Change in arrears and float	180
State government	0
FBiH government	113
RS government	67
District Brcko	0
(2) External debt service arrears	0
State government	0
FBiH government	0
RS government	0
District Brcko	0
(3) Domestic arrears	0
State government	0
FBiH government	0
RS government	0
District Brcko	0

Sources: Ministries of Finance; and IMF staff estimates.

B. Operation of the Central Bank of Bosnia and Herzegovina

Under the Central Banking Law and the program, the CBBH is required to ensure that the value of its domestic liabilities does not exceed the convertible marka counter-value of its net foreign exchange reserves. Furthermore, the CBBH will pay a dividend only if its initial capital and general reserves exceed 5 percent of its monetary liabilities.

Definitions

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[3] In the case of both positive and negative targets on net bank claims on general government, upward means resetting of the target to an arithmetically bigger number, whereas downward means resetting of the target to an arithmetically smaller number.

[4] In the case of both positive and negative targets on net bank claims on general government, upward means resetting of the target to an arithmetically bigger number, whereas downward means resetting of the target to an arithmetically smaller number.

- ***Net foreign exchange reserves of CBBH*** are defined as the value of foreign assets less the value of foreign liabilities, including short-term liabilities denominated in convertible currencies or convertible marka.

- ***Foreign assets*** are defined to include: (i) any gold, other precious metal and stones held by or for the account of the Central Bank; (ii) any banknotes and coins in freely convertible foreign currency held by or for the account of the Central Bank; (iii) convertible foreign exchange notes; (iv) credit balances in convertible foreign exchange—including SDRs—on the books of foreign central banks or other financial institutions; (v) liquid debt securities issued by the government and the central bank of the country on whose currency the securities are denominated; and (vi) officially guaranteed forward and repurchase contracts of different types providing for future payments in convertible foreign exchange by nonresidents. Excluded are (i) assets in nonconvertible currencies; (ii) any assets that are pledged, collateralized, or otherwise encumbered; (iii) claims on residents; and (iv) foreign exchange claims arising from derivatives in foreign currencies vis-à-vis domestic currency.

- ***Foreign liabilities*** are defined to include: (i) foreign exchange and convertible marka balances on the books of the CBBH due to nonresidents, including foreign central banks and international financial institutions; (ii) credit balances due to foreign central banks, governments, international organizations, and foreign financial institutions; (iii) forward and repurchase contracts of different types providing for future payments in foreign exchange by the CBBH to nonresidents; and (iv) any other liabilities due to nonresidents.

- ***Monetary liabilities*** are defined as the sum of (a) currency in circulation, (b) credit balances of resident banks at the CBBH, and (c) credit balances of other residents at the CBBH.

- ***Capital and reserves*** are defined as (a) initial capital, (b) accumulated profits of the CBBH since the beginning of its operation on August 11, 1997, (c) shares, (d) other reserves.

- ***Free reserves of the CBBH*** are defined as foreign exchange reserves not utilized as backing for the currency. They therefore consist of the stock of CBBH net foreign exchange reserves less the stock of CBBH monetary liabilities.

- Foreign currency holdings will be converted into convertible marka at the exchange rates of April 30, 2009, as published in the IMF *International Financial Statistics*.

Valuation changes will therefore be monitored from the accounts of the CBBH, with information on net foreign assets provided monthly by the CBBH.[5]

C. Ceiling on External Payment Arrears

Definitions

- ***External payment arrears*** are defined as overdue debt service arising in respect of debt obligations incurred directly or guaranteed by the the State, Republika Srpska, and the Federation governments or CBBH, except on debt subject to rescheduling or restructuring.

- ***Debt obligations*** are defined as all current liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the State, Republika Srpska, and the Federation governments or CBBH to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits and leases) will be included in the definition and be subject to the ceiling.

Application of performance criterion

- The ceiling on the change in external payments arrears applies to the change in the stock of overdue payments on medium- and long-term debt contracted or guaranteed by the the State, Republika Srpska, and the Federation governments or by the CBBH. This criterion will apply continuously.

- The limit on the change in external payments arrears also applies to the change in the stock of overdue payments on short term debt in convertible currencies with an original maturity of up to and including one year.

- Accumulation of new external arrears is prohibited under the program.

[5] At end-April 2009, one SDR unit was equal to 1.1283 euro, or to 1.4978 U.S. dollars.

D. Ceiling on Domestic Expenditure Arrears

Definition

The performance criterion established on the stock of domestic payments arrears contemplates a zero ceiling on the increase in the stock of arrears compared with the stock as of December 31 of the previous year. The stock of arrears is defined as the sum of payments obligations (accounts payable) past the due date stipulated by the contractual or legal payment period for each expenditure item and are nondisputed. They can arise on any expenditure item, including transfers to individuals, debt service, wages, pensions, energy payments and goods and services. Past-due payments obligations on inter-governmental transfers (i.e., transfers between Entity central governments and local governments, and extrabudgetary funds) are not included in the stock of arrears.

Application of performance criterion

The zero ceiling on the increase in the stock of arrears applies to the State, the Federation, and the Republika Srpska governments. This criterion applies continuously. Thus, if, in any given day any of the three governments exceeds the zero ceiling on the change in the stock of its arrears compared with the stock of the same government's arrears as of December 31 of the previous year, the performance criterion will be missed.

E. Contracting or Guaranteeing of New Nonconcessional Short-Term External Debt

Governments will consult with the IMF before contracting or guaranteeing any new external debt.

Definitions

- ***The term "debt"*** is defined to include all current liabilities to non-residents, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the State, Republika Srpska, and the Federation governments or CBBH to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract (No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, Decision No. 6230–(79/140), August 3, 1979, as amended by Decision Nos. 11096–(95/100), October 25, 1995, 12274-(00/85), August 24, 2000, and 14416-(09/91), August 31, 2009, effective December 1, 2009). In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits and leases) will be included in the definition.

- ***New nonconcessional external debt*** is defined as including all debt (as defined above) contracted or guaranteed by the State, Republika Srpska, and the Federation governments or the CBBH during the program period that is not on concessional terms.

- ***Concessional loans*** are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest rates reported by the OECD (CIRRS). For short-term loans, the average CIRRs of the proceeding six-month period (plus a margin of 0.75 percent) will be used.

- ***Short-term external debt*** is defined as debt contracted or guaranteed with an original maturity of up to and including one year.

Application of performance criteria

The ceiling on contracting new short-term external nonconcessional debt applies to obligations of the State State, Republika Srpska, and the Federation governments, and CBBH. This criterion will apply continuously.

F. Ceiling on the Increase in the Total Value of Outstanding Commitments by the State, Republika Srpska, and the Federation of Bosnia and Herzegovina under Guarantees of Private and Public Sector Enterprises' Debts to Domestic Banks plus the Value of Enterprise Debts to Domestic Banks Assumed by these Governments

The authorities will consult with the IMF before guaranteeing to domestic banks the repayment of loans by private and public enterprises and before assuming enterprise debt to domestic banks.

Definition

The increase in the total value of outstanding commitments of the State, Republika Srpska, and the Federation of Bosnia and Herzegovina under guarantees for the repayment by private and public sector enterprises of debts to domestic banks plus the value of enterprises debts to domestic banks assumed by these governments will be limited during the program period.

Application of performance criteria

This criterion will apply continuously. This ceiling on the increase in the total value of outstanding commitments under the above-referred guarantees by the State, Republika Srpska, and the Federation of Bosnia and Herzegovina plus the value of enterprise debts to domestic banks assumed by these governments will apply relative to the total value of such commitments and assumed debts existing as of December 31 of the previous year.

II. Data Reporting

The Bosnia and Herzegovina authorities will report the following data to the Fund within the time limits listed below. The authorities will also provide, no later than the first week of each month, a summary of key macroeconomic policy decisions taken during the previous month; a summary of regulatory changes in the area of banking and financial sector, report any revisions to monthly and annual fiscal reports as well as any amendments to the Entity and state budget and local government budgets within a week after their approval.

Any revisions to past data previously reported to the Fund will be reported to the Fund promptly, together with a detailed explanation. The data will be provided in an electronic form.

All magnitudes subject to performance criteria or indicative targets will be reported in millions of convertible marka where the corresponding target is in convertible marka, or in millions of euro where the target is in euro.

The Bosnia and Herzegovina authorities will supply the Fund with any additional information that the Fund requests in connection with monitoring performance under the program on a timely basis.

Table 1. Bosnia and Herzegovina: Performance Criteria Under the 2009–12 Stand-By Arrangement, 2010

(In millions of KM)

	Cumulative flow since December 31, 2009							
	2010							
	March			June			September	December
	Program	Adj. Program [2]	Actual	Program	Adj. Program [2]	Actual	Program	Program
Ceiling on accumulation of net credit of the banking system to: [1, 2]								
General government	333	292	104	580	604	175	751	631
of which:								
State government	20	20	3	-11	-11	-71	112	121
RS government	251	237	127	429	480	243	499	521
Federation government	61	34	-23	164	137	19	159	-8
Ceiling on the increase in total value of guarantees by the State, Federation and RS governments of private and public sector enterprises' debts to domestic banks plus the value of enterprise debts to domestic banks assumed by these governments [3]	0		0	0		0	100	100
Ceiling on accumulation of external debt service arrears by the State, Federation and RS governments and CBBH [3]	0		0	0		0	0	0
Ceiling on contracting or guaranteeing of new short-term external nonconcessional debt by the State, Federation and RS governments and CBBH [3]	0		0	0		0	0	0
Ceiling on accumulation of domestic expenditure arrears by: [3]								
State government	0		0	0		0	0	0
RS government	0		15	0		-1	0	0
Federation government	0		-6 [4]	0		-17 [4]	0	0

[1] Equal to the sum of the three listed sub-ceilings plus the net bank credit to the District of Brčko, which is not monitored individually due to its small size.

[2] The targets on banking system net claims the general government will be adjusted upward (downward) by the full amount of any shortfall (surplus) in programmed disbursements of budget support loans and grants; and will also be adjusted upward (downward) by the amount by which reported chang float is arithmetically smaller (greater) than its targets in the fiscal program. The upward adjustment is limited to 10 percent of the absolute value of the respective change-in-float target (see Technical Memorandum of Understanding on Definitions and Reporting Under the 2009–12 Economic Program).

[3] Continuous.

[4] Based on preliminary information for lower levels of Federation government (cantons, municipalities, and cantonal extrabudgetary funds).

Table 2. Bosnia and Herzegovina: Structural Measures under the Stand-By Arrangement, 2010

Test date	Actions	Objective	Status	Type
	Continuous			
Continuous	Continued adherence of the Currency Board Arrangement as constituted under the law	Anchor for macroeconomic policy; Contribute to economic and political stability.	Met	Structural Benchmark
Continuous	Publish on the State government's web site quarterly consolidated general government accounts with a 5 week lag	Enhance fiscal transparency and program ownership.	Met (for March and June)	Structural Benchmark
Continuous	Carry out eligibility audits for civil and war benefit recipients; publish results (quarterly within 4 weeks after the end of each quarter) of audits, including expected savings from disqualifications (Federation, RS)	Reduce recurrent spending through better targeting of transfer programs.	RS (Met for March, and June (with delay in publication); Federation (not met)	Structural Benchmark
Continuous	No new privileged or special rights for retirement will be introduced prior to the pension system reform (Federation).	Contain the cost to central government of financing the pension system.		Structural Benchmark (New)
	Second and Third Reviews			
end-March 2010	Adopt by Parliament wage legislation consistent with the 2010 fiscal policy objectives (Federation)	Harmonization of remuneration policies across levels of government with the view of containing the public wage bill.	Met with delay in July	Structural Benchmark
end-March 2010	Reform privileged pensions by entity governments (Federation, RS)	Steps toward containing the cost to central governments of financing the pension systems.	RS (Met); Federation (Not met)	Structural Benchmark
end-March 2010	Prepare a strategy for pension reform by entity governments (Federation, RS)		RS (Met); Federation (Met with delay in June)	Structural Benchmark
	Approval by Federation Parliament of a 2010 revised Federation central government budget consistent with the authorities' commitments in Paragraph 10 of this LoI (Federation).	Reflect measures to contain the wage bill and transfers, ensure full funding of central government obligations on current-year transfers	Met	Prior Action
	Adoption of a government decision on measures to improve the audit process consistent with the authorities' commitments in Paragraph 10 of this LoI (Federation).	Reduce recurrent spending through better targeting of transfer programs.		Prior Action
	Adoption of a government decision to condition the transfers to the cantons on cantonal budget rebalances to reduce current expenditures (Federation).	Reduce recurrent spending by cantons.	Met	Prior Action
	Fourth Review			
end-December 2010	Adoption by government of the Law on Pension and Disability Insurance in accordance with the Strategy of the Pension System Reform (RS)	Step toward containing the cost to central government of financing the pension system.		Structural Benchmark
end-December 2010	Establish a working group under the Fiscal Council to propose by December 31, 2010 recommendations, guidelines and a timetable for application of international accounting standards for the public sector and other international standards of financial reporting, including a harmonized fiscal reporting template, at all levels of government in BiH.	Enhance medium-term budget planning, fiscal transparency, and program ownership.		Structural Benchmark

Table 3. Bosnia and Herzegovina: Net Claims of the Banking System on the General Government, as of December 31, 2009

(In millions of KM)

	Stock
Total net bank claims on the general government ((1) + (2))	**-2,025**
(1) Central bank claims on general government (net)	-398
Claims	0
State government	0
FBiH government [1]	0
RS government [2]	0
District Brcko	0
Deposits	398
On-balance sheet deposits in KM [3]	50
State government [4]	48
FBiH government [1]	2
RS government [2]	0
District Brcko	0
Off-balance sheet deposits in foreign currency	347
State government [5]	347
FBiH government	0
District Brcko	0
(2) Commercial bank claims on general government (net)	-1,627
Claims	350
State government	1
FBiH government [1]	40
RS government [2]	303
District Brcko	6
Deposits	1,977
State government	46
FBiH government [1]	963
RS government [2, 6]	890
District Brcko	78

Source: CBBH.

[1] Includes FBiH central government, cantons, municipalities, road fund, and social funds.

[2] Includes RS central government, municipalities, road fund, and social funds.

[3] Excludes on-balance sheet accounts at CBBH used for safekeeping on behalf of State and Entity governments of the proceeds from sale of general and special SDR allocations.

[4] The deposits of the State government, as reported by CBBH, are adjusted to exclude the deposits of the Indirect Tax Administration (KM 33.65 million at end-September, 2009).

[5] Excludes the off-balance sheet account at CBBH used as a pass-through account for external debt servicing on behalf of Entity governments; and the off-balance sheet account at CBBH used for safekeeping on behalf of State and Entity governments of succession funds from the distribution of rights, obligations, assets and liabilities of the former Socialist Federal Republic of Yugoslavia among successor states.

[6] The deposits of the RS government are adjusted to exclude the deposits of investment funds managed by the RS Development Bank. Whereas the latter is not included in the definition of general government, some banks report the deposits of these investment funds as part of net bank credit to government. At end-September 2009, the amount of excluded deposits stood at KM 33.78 million.

Table 4. Bosnia and Herzegovina: Data Reporting Requirements under the 2009 SBA

	Data series	Data frequency	Periodicity of data reporting	Timeliness of data reporting
I.	**Daily data reporting**	**Daily**	**Weekly**	**Up to 14 working days after the end of each week, unless noted otherwise**
1	Gross international reserves			
2	CBBH foreign exchange purchases and sales			
II.	**Monthly data reporting**	**Monthly**	**Monthly**	**Up to 4 weeks after the end of each month, unless noted otherwise**
Financial sector				
1	The balance sheet of the CBBH.			
2	The commercial bank survey and monetary survey			
3	Weighted average interest rates by bank and by type of loans			
4	Banking sector credit to the general government (by level of government)			
5	Government deposits in the banking sector			
Government finances				
6	Revenues, expenditures and financing data for central governments (the State, and the Entity governments). Expenditures will include those financed from deposits in the escrow accounts.			
7	ITA revenues.			
9	Report on inflows into and outflows from escrow accounts (FBiH, RS).			
10	Transfers to the Entity Development Banks from the Entity central governments.			
Debt service				
8	New external loans contracted or guaranteed by governments.			
III.	**Quarterly data reporting**	**Quarterly**	**Quarterly**	**Up to five weeks after the end of each quarter, unless noted otherwise**
Financial sector				
1	Banking supervision: financial soundness indicators			
2	Banking supervision: bank-by-bank commercial banks' summary balance sheets and income statements and prudential data on loan quality, liquidity, and exposures[1]			
14	Net exposure to BiH of foreign bank groups participating in the European Bank Coordination Initiative for BiH[2]			
Government finances				
3	Revenues, expenditures and financing data for municipalities (in both entities), and cantons (in the Federation), and Brcko District			
4	Revenues, expenditures and financing data for the road funds in both entities			
5	Revenues, expenditures and financing data for the extrabudgetary funds (pension funds, health funds, unemployment funds and (in the RS) the children's fund)			
6	Revenues, expenditures and financing data for consolidated BiH, consolidated FBIH, and consolidated RS general governments			
16	End-period stock of outstanding arrears and float during the reference period by creditor and type of expenditure (wages, social benefits, pension, goods and services, etc.)			
7	Financial statements of the RS Investment and Development Bank			
17	Number of demobilized soldiers receiving unemployment benefits (by canton), and amounts paid			
Debt service				
8	External debt service projections for current year; total, by creditor, by level of government, and in original currency			
9	Newly issued government guarantees on external and domestic loans contracted by public and private entities			
10	Newly contracted government external loans and degree of concessionality (grant element); total, by creditor, by purpose (project/budget support), original currency, and maturity			
11	External debt service payments (interest, amortization) by level of government			
12	External loan and grants disbursements; by creditor, by level of government, by purpose (project/budget support) and original currency			
13	Stock of external debt for public sector, private nonbank sector, and banking sector			
15	Stock of domestic government debt outstanding (by level of government, type of obligation, and holder (bank and non-bank sectors)); projected domestic government debt interest and amortization payments (by level of government, type of obligation, and holder)			

[1] Up to six weeks after the end of each quarter
[2] Upon request within eight weeks

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

2010 Article IV Consultation, Second and Third Reviews under the Stand-By Arrangement, Request for Waiver of Nonobservance of a Performance Criterion, and Rephasing of Purchases—Informational Annex

Prepared by the European Department

September 21, 2010

- **Relations with the Fund:** Bosnia and Herzegovina (BiH) has been a member of the International Monetary Fund since 1992. BiH has not accepted the obligations under Article VIII Sections 2, 3, and 4 and, therefore, avails itself of the transitional arrangements under Article XIV. A three-year, SDR 1,014.6 million (about US$1.6 billion, 600 percent of quota) Stand-By Arrangement with the IMF, was approved on July 8, 2009. The Executive Board completed the first review under the SBA in March 2010.
- **Bank-Fund Collaboration:** The Fund and World Bank BiH teams meet regularly to consult on and coordinate the two institutions' activities and plans. They have identified seven areas of structural reform as macrocritical in light of their importance for fiscal sustainability and financial sector stability. These include social safety nets and rights-based benefits, public sector pay and wage bill management, labor taxation, budget planning, fiscal reporting, tax administration, and financial sector supervision and contingency planning.
- **Exchange rate regime**: 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 changed 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.
- **Statistical Issues:** While data are broadly adequate for surveillance purposes, staff analysis is being affected by shortcomings in certain areas. The timeliness, quality, and comprehensiveness of fiscal data need significant improvement. The BOP data has insufficient details. The discrepancies between the production and expenditure measures of GDP are relatively high. Nonetheless, BiH authorities have made concerted efforts to improve the quality of statistics in recent years, leveraging on TA provided by the EU and the IMF.

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APPENDIX I. FUND RELATIONS
(As of August 31, 2010)

I. Membership Status: Joined: December 14, 1992; Article XIV

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	169.10	100.00
Fund holdings of currency	473.45	279.98
Reserve Tranche Position	0.05	0.03

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	160.89	100.00
Holdings	0.10	0.06

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
Stand-by Arrangements	304.38	180.00

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jul 08, 2009	Jun 30, 2012	1,014.60	304.38
Stand-By	Aug 02, 2002	Feb 29, 2004	67.60	67.60
Stand-By	May 29, 1998	May 29, 2001	94.42	94.42

VI. Projected Payments to Fund (SDR Million; based on Existing and Prospective Drawings):

	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Principal	0	0	22.83	151.77	294.23	323.83	190.24	31.71
Charges/Interest	2.35	11.88	21.54	21.41	16.34	7.03	2.56	0.69
Total	**2.35**	**11.88**	**44.37**	**173.17**	**310.58**	**330.86**	**192.80**	**32.40**

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, Central Bank of Bosnia and Herzegovina (CBBH) was subject to an assessment in the context of a potential successor for the 2002 arrangement. The assessment was completed on January 24, 2005 and recommendations were made to address weaknesses identified in the Bank's safeguards. Based on the information received from the authorities, all the recommendations have been implemented.

An update of safeguards assessment of the Central Bank of Bosnia and Herzegovina (CBBH) was conducted in connection with the Stand-By Arrangement (SBA) approved on July 8, 2009. The update found that the CBBH has further improved its safeguards framework since the 2005 assessment. Developments include the adoption of a bank wide risk assessment methodology, strengthening of the internal audit function, and amending the Audit Committee's (AC) by-laws to limit the number of its members and assure their independence from executive activities at the bank. The CBBH has also adopted a formal policy for the appointment and rotation of external auditors. This update assessment found that the Central Bank of Bosnia and Herzegovina's (CBBH) financial reporting, control and audit practices generally comply with international standards and best practices. However, some aspects of the audit oversight mechanism should be strengthened.

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 (BiH) has not accepted the obligations under Article VIII Sections 2, 3, and 4 and therefore avails itself of the transitional arrangements under Article XIV. BiH no longer maintains restrictions under the transitional provisions of Art XIV. It maintains restrictions on the transferability of balances and interest accrued on frozen foreign-currency deposits, subject to Fund jurisdiction under Article VIII.

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 considers 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 was presented to the Board along with the 2006 Article IV consultation (SM/06/335).

X. Last Article IV Consultation

The last Article IV consultation was concluded on September 17, 2008 (IMF Country Report No. 08/327).

XI. Resident Representative

The IMF currently has a resident representative office in Sarajevo. Mr. Milan Cuc assumed his position as a resident representative in October 2009.

XII. Technical Assistance 2000–10

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
	November 2009, March 2010, July 2010, (ongoing)	Public Financial Management with regional peripatetic advisor
FIN	January 2005	Safeguard Assessment of the Central Bank of Bosnia and Herzegovina
	October 2009	Safeguard Assessment of the Central Bank of Bosnia and Herzegovina
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)
	October – November 2006	Banking supervision and reserve management
	June 2006	Research and Policy
	April 2007	Research and Policy
	January 2009	Crisis Management/Contingency Planning/ Bank Supervision
	April 2009, November 2009, March – April 2010, June 2010	Stress Testing

STA	May 1999–June 2004	Resident statistical advisor
	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 2005–07	Real sector statistics advisor
	March 2007	Data ROSC
	January 2008	Balance of Payments and International Investment Position

APPENDIX II. BANK-FUND COLLABORATION

1. The Fund BiH team meets on a regular basis with the representatives of the World Bank BiH team to consult on and coordinate the two institutions' activities and plans.

2. The Fund and Bank BiH teams share the view that economic recovery has started in BiH, but the country faces substantial internal and external macroeconomic challenges. While the crisis has reversed a long lasting trend of slow economic growth, it has caused no major disturbances. The currency board arrangement and the whole banking sector have weathered the crisis well. In 2010, exports have resumed growth, but access to foreign private capital (both FDI and credit) has been very limited and investment growth has not resumed yet. National savings are inadequate to finance pre-crisis investment levels. The reforms to improve the efficiency of the public sector and restore fiscal sustainability (which are expected to increase public saving) have been launched, but have yet to be implemented.

3. Based on this shared assessment, the teams identified seven areas of structural reform as macrocritical in light of their importance for fiscal sustainability and financial sector stability.

- **Social safety nets and rights-based benefits.** The social safety net is complex, with a large number of overlapping programs that are not well-targeted and fail to reach some of the most vulnerable groups in society. This is especially the case for the panoply of transfers directed at war veterans and demobilized soldiers. The authorities have launched an ambitious reform agenda to overhaul the benefits system.

- **Public sector pay and wage bill management.** In 2009, BiH spent around 13.1 percent of GDP on public sector wages. The wage bill has grown significantly since 2006 (about 2 percentage points) and has been one of the main contributors to a widening fiscal deficit. Furthermore, while significant improvements have been made to reform very compressed salary scales in public administration, reduce the number of non-wage benefits and increase transparency in line with good international practice, there is still significant scope for improvement in this area.

- **Labor taxation.** Social contribution rates levied on formal employment, particularly in the Federation, are high (41.5% of gross wage). Social contribution payments, which are higher than in the majority of OECD countries, increase the cost of labor, hinder competitiveness, and contribute to informality. Reducing the rates of social contribution through a combination of efficiency improvements in the health and pension systems and substituting a share of financing with less distorting revenue sources is needed to improve the competitiveness of the BiH economy, while reducing informality.

- **Budget planning.** Accurate revenue and expenditure forecasts are needed to ensure realistic budgets and avoid supplementary budgets and under-execution of the budget that result from revenue underperformance or underestimation of expenditure. Moreover, a medium-term fiscal framework would help to anchor fiscal policy around the goal of public debt sustainability. There is an urgent need to strengthen medium-term budgeting and improve the effectiveness of the Fiscal Council including via ensuring accurate and timely fiscal reporting by all levels of government (see below).

- **Fiscal reporting.** Progress in this area should help improve fiscal policy coordination, fiscal planning, and performance monitoring. The multi-layer system of government and lack of common reporting standards have hampered efforts to present a consolidated picture of government finances to date. The Fund program and provision of technical assistance are expected to provide sufficient leverage for renewed efforts on this front.

- **Tax administration.** Improvements in tax administration should aim at better control and a broadening of the tax base. As a first step, an overall diagnostic mission could assist the authorities to identify priority areas for follow-up.

- **Financial sector**. Stronger financial sector supervision and contingency planning should help ensure that the authorities are able to monitor the health of the system and respond appropriately to any emerging problems. Following substantial support for strengthening the stress-testing capacity of the Central Bank of Bosnia and Herzegovina (CBBH), further efforts are needed to strengthen the capacity of the Banking Agencies. A framework for cooperation between the CBBH, the Finance Ministries, and other agencies, along the lines recommended by the February 2009 IMF technical assistance mission, has already been put in place and the Standing Committee for Financial Stability has been established. It is essential that the Committee meets on a regular basis for a discussion and exchange of information on financial stability issues.

4. **The teams agreed on the following division of labor:**

- **Social safety net and rights-based benefits.** The Bank will continue to advise the authorities and provide implementation support for measures to consolidate various programs and improve targeting. The Social Safety Net and Employment Project, approved by the World Bank Executive Board in February 2010, is financing technical assistance and capacity building services related to the reforms of the social protection system. The project will also continue to support active labor market programs for active job seekers among vulnerable categories. In addition, the Public Expenditure Development Policy Loan (DPL), approved by the World Bank Executive Board in April 2010, supports increased assistance to the poor while reducing the fiscal deficit via more effective, efficient and equitable social protection policies. Future priorities include introducing a registry of programs and beneficiaries, implementing recently-introduced legislation, introducing means testing and other targeting mechanisms for a number of social and veterans' benefits, conducting eligibility audits, reviewing new programs to ensure proper targeting and affordability, and supporting the design of pension reform strategy.

- **Public sector wages.** The Bank will continue to provide assistance to the authorities in improving the wage bill management and public sector pay practices with the aim of increasing transparency, improving the link between pay levels, job complexity, and performance, and contributing to fiscal sustainability. The DPL aims to reform public expenditures that have been the main driver of pro-cyclical fiscal policies, notably the high wage bill and excessive and regressive social transfers.

- **Labor taxation.** The Bank will support the authorities in efforts to reduce the burden of social contributions on formal employment and harmonizing the bases for payment of income tax and social contributions between the two BiH Entities with the aim of increasing competitiveness in the formal sector and strengthening the single economic space across the BiH. To this end, the DPL will aim at lowering social contribution rates to encourage formal sector employment and enhance competitiveness and private sector development.

- **Budget planning.** Both the Fund and the Bank will encourage the authorities to implement realistic, predictable, and transparent budget procedures. The Fund and the Bank will also continue advising the authorities to improve the medium-term budget planning. To this end, the Fund and the Bank will continue urging the authorities to strengthen the Fiscal Council's operational framework by improving fiscal methodology and multi-annual planning for the Global Framework, drafting proposals for short-term and long-term macroeconomic projections, and implementing established goals and criteria when adopting and executing the budget, and incorporating foreign-financed projects. Medium-term fiscal planning in the Federation will have to address substantial needs for capital investments in infrastructure.

- **Fiscal Reporting.** The Fund will continue to advise the authorities and provide technical assistance to improve fiscal reporting. The priority for the coming year is putting in place a coherent system of fiscal reporting for all levels of government which will permit quick and flexible consolidation. For FY 2011, technical assistance will continue to be provided by the Center in Ljubljana through visits by a peripatetic PFM advisor. The objective would be to set up processes for timely data reports by lower levels of governments and for consolidation of source data into general government accounts.

- **Tax Administration.** In response to the authorities' request, the Fund will provide technical assistance in the area of tax administration. As a first step, a diagnostic mission to take place in early-2011 will help the authorities identify priorities going forward.

- **Financial sector.** The Fund will continue to provide technical assistance in the area of stress testing of bank balance sheets. To this end, an MCM mission on stress testing has already visited the country in June 2010 and provided assistance to the two Banking Agencies, and follow-up missions could be scheduled for 2011. Finally, a joint MCM/LEG TA could help put in place recommendations for strengthening the framework of bank resolution.

APPENDIX III. STATISTICAL ISSUES

1. While data are broadly adequate for surveillance purposes, staff analysis is being affected by shortcomings in certain areas. The timeliness, quality, and comprehensiveness of fiscal data need significant improvement. Budget execution data does not include transactions related to projects financed by external loans or directly by international donors. Accrual accounting has not yet been fully introduced in all government institutions, so transactions are recorded on a mixed accrual/cash basis. There are also significant delays in reporting by lower levels of government, particularly in the Federation. As a result, the published quarterly consolidated general government accounts are beset by delays and spotty coverage, particularly of financial operations. In addition, the BOP data has insufficient detail on foreign grants, workers' remittances, income received by residents working for international organizations in the country, spending by their nonresident staff, trade credit by suppliers, informal trade, and changes in foreign currency cash holdings. The discrepancies between the production and expenditure measures of GDP are relatively high. At the same time, BiH authorities have made concerted efforts to improve the quality of statistics in recent years, leveraging on TA provided by the EU and IMF.

2. The Dayton peace treaty, which ended the civil war, implicitly gave responsibility for statistical functions to the two Entities (The Federation of Bosnia and Herzegovina and Republika Srpska (RS)). 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 has been provided in recent years, mainly by the European Union. An IFS country page has been in existence since July 2001. A Fund resident statistical advisor was assigned to the Central Bank of Bosnia & Herzegovina (CBBH) during May 1999–June 2004 to provide technical assistance in the development of all areas of macroeconomic statistics. An STA resident real sector statistical advisor was appointed in the period November 2005–November 2007. A mission to prepare the ROSC Data Module took place in March 2007 and the report was published in February 2008.

A. Real Sector Statistics

3. Efforts have been made in both Entities to improve real sector statistics. The Federation and RS have both published nominal GDP estimates using the production approach consistent with the 1993 SNA, since 1998 and 1999, respectively. Compilation of the GDP by production approach for both entities and the country as a whole at constant prices (at prices of previous year) started in 2006, with technical assistance from the IMF. Expenditure-based GDP data at current and constant prices have been published for the

period 2004-2008. However, discrepancies between the production and expenditure measures of GDP are relatively high and more work is needed to reconcile these estimates.

4. A consumer price index (CPI), based on internationally- recommended practices, has been implemented with the technical and financial support of the Italian government. This CPI was released in 2007, and consistent series are available monthly countrywide and for each entity, with the series starting in January 2005. The CPI weights are derived from the household budget survey, which has been conducted since 2004. Also, producer price indices (PPI) are now available for both Entities. Industrial production indices are prepared in each Entity. The Industrial Production index at the country level has been made available in 2009 with historical time series going back till 2006. Whereas the statistical institutes of both Entities compile data on employment, unemployment, and wages based on questionable methodologies, the annual Labor Force Survey follows international methodological standards and provides data on employment, unemployment, population and labor force for the country and the entities since 2006.

B. External Sector Statistics

5. Despite resource constraints, continuing improvements have been made to the quality of the balance of payments data, particularly in terms of services and financial transactions. Concepts and definitions follow international standards, as stated in the fifth edition of the Balance of Payments Manual (BPM5), including the residence concept. Nevertheless, many shortcomings remain. Some of these shortcomings arise from intrinsic measurement difficulties, such as the frequent small transactions and workers' remittances. As a result, a degree of uncertainty remains about several important components of the balance of payments, where source data are inadequate due to the lack of comprehensive surveys on services and remittances and to the difficulty of recording the large number of small cash transactions.

6. Trade data are published by the BHAS and balance of payments statistics by the CBBH. Merchandise trade is recorded using the Automated System for Customs Data processing system. The customs administration for the whole country has been reorganized, and a trade classification system introduced. BHAS now produces export and import data from customs records, but needs to produce the data on a general trade basis and not on a special trade basis. Trade data may also be subject to incomplete coverage and under-invoicing. The data coverage remains poor in areas of foreign grants, workers' remittances, income received by residents working for international organizations in the country, spending by their nonresident staff, informal trade, and changes in foreign currency cash holdings. All foreign grants, loans, loan repayments, and interest payments for which the state government has assumed responsibility, are consistent with the balance of payments data, as the same source data are used for the compilation of GFS and the balance of payments. However, the balance of payments data also include an estimate of foreign-financed projects which are currently excluded from GFS. Data are consistent with monetary statistics.

C. Government Finance Statistics

7. The CBBH compiles government finance statistics (GFS) in accordance with the definitions and concepts of the *Government Finance Statistics Manual 2001*. The periodicity and timeliness of data on government operations and quarterly consolidated central government operations meet or exceed GDDS recommendations. While the institutional coverage of the GFS is broadly consistent with international guidelines, its scope does not cover all economic stocks (balance sheet data) and flows (cash flow data). In addition, the GFS does not include transactions related to projects directly financed by international donors, and quarterly statistics exclude all transactions in financial assets and liabilities due to incomplete quarterly source data. Because accrual accounting has not yet been fully introduced in all government institutions, transactions are recorded on a mixed accrual/cash basis.[1] External government debt data are published quarterly, and data on domestic debt were published for the first time in the annual Global Fiscal Framework document in 2009. GFS data are broadly consistent with the balance of payments, but can not be reconciled with monetary statistics, due to differences in sectorization and data gaps, and are not reconciled with national accounts data.

8. Authorities are making concerted effort to improve the quality of the GFS. They have established a coordinating group, including representatives of the central bank and ministries of finance of the two Entities and the state institutions, to provide data for monitoring of the stand-by arrangement. With the help of a peripatetic PFM advisor, the State, Federation and Republika Srpska are implementing bridging tables from the existing chart of accounts to formats compatible with GFS 2001 and ESA 95 to improve the quality of consolidated general government data.

D. Monetary and Financial Statistics

9. The CBBH reports monetary accounts to the Fund on a countrywide and Entity basis. The CBBH is in the process of switching its reporting of monetary data to the Fund to the Standardized Report Forms developed by STA that embody the methodology of the *Monetary and Financial Statistics Manual*. The CBBH already collects data using the standardized report forms 1SR (Central bank), 2SR (commercial banks), and 4SR (Other financial institutions) and is in the process of validating the received data against the information collected by the existing reporting system for the period January 2006 – March 2010. Furthermore, the CBBH expanded the coverage of the weighted average interest rates from 4 indicators to 26 indicators (14 active interest rates and 12 passive interest rates with breakdown by maturity, currency, and sectors). Finally, the CBBH extended the coverage of

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[1] At the State level, some earmarked revenues are not recorded until the corresponding expenditure takes place. In the Federation, expenditures are not entered into the Treasury payment system if there are no available funds to pay them out or if obligations exceed the budgeted amounts.

its annual financial sector statistics to encompass approximately 120 financial institutions (investment funds, insurance companies, microcredit institutions, leasing companies, brokerage houses, and stock exchanges).

Appendix Table 1. Bosnia and Herzegovina: Table of Common Indicators Required for Surveillance

(As of September 3, 2010)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	08/27/10	08/31/10	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	07/2010	08/2010	M	M	M		
Reserve/Base Money	07/2010	08/2010	M	M	M	O, O, LO, O	O, O, O, O, O
Broad Money	07/2010	08/2010	M	M	M		
Central Bank Balance Sheet	07/2010	08/2010	M	M	M		
Consolidated Balance Sheet of the Banking System	07/2010	08/2010	M	M	M		
Interest Rates[2]	07/2010	08/2010	M	M	M		
Consumer Price Index	07/2010	08/2010	M	M	M	LNO, NO, LNO, LO	LNO, LO, LNO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2009	03/2010	A	A	A	O, LNO, LO, LO	LNO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	07/2009	08/2010	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2009	03/2010	A	A	A		
External Current Account Balance	Q2 2010	08/2010	Q	Q	Q	O, O, LO, LO	LNO, O, LO, O, LO
Exports and Imports of Goods and Services	07/2010	08/2010	M	M	M		
GDP/GNP	2009	07/2010	A	A	A	O, LNO, LO, LO	LNO, LNO, LO, LO, LO
Gross External Debt	2009	03/2010	A	A	A		
International Investment Position	N/A	N/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); and not available (NA). [7] Reflects the assessment provided in the data ROSC or the Substantive Update (published on February 2008 and based on the findings of the mission that took place during March 13–28, 2007) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA). [8] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

Staff Report for the 2010 Article IV Consultation, Second and Third Reviews Under the Stand-By Arrangement, Request for Waivers of Nonobservance and Applicability of Performance Criteria, and Rephasing of Purchases—Supplementary Information and Supplementary Letter of Intent

Prepared by the European Department
(In consultation with other departments)

Approved by Adam Bennett and Jan Kees Martijn

October 14, 2010

This supplement provides information on developments and performance since the issuance of the staff report for the 2010 Article IV Consultation, Second and Third Reviews Under the Stand-By Arrangement, Request for Waiver of Nonobservance of a Performance Criterion, and Rephasing of Purchases (EBS/10/183). The information contained in this supplement does not change the thrust of the staff appraisal, and supports the authorities' request for a waiver of applicability of the end-September 2010 performance criterion on net bank credit to government, which has become controlling in view of the October 15, 2010 date for Board consideration of the second and third SBA reviews.

I. Recent Developments

1. **Recent indicators reaffirm the slow pace of the recovery (text table).** Domestic demand remains subdued amidst stagnant real wages, weak remittances, and stalled bank lending. As a result, the sharp correction of the current account deficit continues. Indirect tax revenues through September were stronger than budgeted and, if the trend continues, will exceed the program projection. At end-June 2010, foreign parent banks' exposure to Bosnia and Herzegovina (BiH) was about 8 percentage points lower than at end 2008. This has had a limited impact on the economy, as banks continue to hold excess liquidity and the overall balance of payments remains stable.

BIH: High-Frequency Economic Indicators
(percent change year-to-date over corresponding period in previous year)

	Jun-10	Aug-10
Industrial production (real)	1.3	1.1
Capital goods	-41.8	-38.5
Consumer durables	3.4	11.9
Consumer non-durables	3.5	2.4
Imports (nominal)	4.8	8.1
Capital goods	-14.5	-10.0
Consumer durables	1.6	3.1
Consumer non-durables	0.7	2.0
Exports (nominal)	32.7	31.0
Gross wage, all sectors (nominal)	0.5	0.7
Value-added tax revenues (net of refunds)	3.9	5.5
Credit to private sector (12-month growth)	-1.3	-0.3
Consumer price inflation	2.1	2.0
Producer price inflation	-0.6	-0.1

Source: BiH authorities; and IMF staff estimates.

II. Program Performance and Modalities

2. **The performance criteria relating to short-term external debt, external debt service arrears, and debt guarantees were met.** In particular, there has not been any accumulation of external debt service arrears and no new short-term non-concessional external debt was contracted or guaranteed by the central bank, State, Federation, or RS governments. Furthermore, the State, Federation, and RS governments did not extend any guarantees of enterprise debt to domestic banks and no debt under such guarantees was assumed by these governments. The margin by which the performance criterion on domestic expenditure arrears was breached (in the first quarter of 2010)—for which the authorities request a waiver of nonobservance—remains unchanged (Table 1 of the Supplementary Letter of Intent).

3. **Although there is no information on the quantitative performance criterion on net bank credit to government for end-September 2010, the authorities are confident that it has been met.** As of end-August, the separate sub-ceilings on net bank credit to the BiH general government, State, Federation, and RS governments were all less than two-thirds of their respective programmed values for end-September 2010. Based on this fact and the continued strength of indirect tax revenues, the authorities are confident that the end-September performance criterion has been met.

4. **Further progress was made on structural reforms of war-related transfers.** In the Federation, following the adoption by government of measures to improve the efficiency of eligibility audits (which was a prior action and was met), the government approved related changes in the Rulebook on the establishment and work of audit teams. In addition, the first quarterly report on eligibility audits of war-related cash benefits was published on October 8, 2010. In the RS, the eligibility audits of war-related benefits are proceeding as planned.

5. **Staff supports the authorities' request for a waiver of applicability of the end-September 2010 performance criterion on net bank credit to government, for which data is not available.** A revised proposed decision, granting the requested waiver of applicability, is attached.

BOSNIA AND HERZEGOVINA: SUPPLEMENTARY LETTER OF INTENT

Sarajevo and Banja Luka, Bosnia and Herzegovina
October 13, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

Further to our letter of September 17, 2010, which reiterates our commitment to the economic program supported by the Stand-By Arrangement (SBA) with the Fund, we hereby request a waiver of applicability for the end-September 2010 performance criterion on net bank credit to the government, which has become controlling in view of the October 15, 2010 date for Board consideration of the second and third SBA reviews. While we do not have the full information to assess the performance under this criterion, we are confident that it was observed. The continuous quantitative performance criteria on external public debt service arrears, short-term non-concessional external public debt, and public guarantees and assumption of enterprise debt to domestic banks have been observed. The margin by which the performance criterion on domestic expenditure arrears was breached (in the first quarter of 2010)—for which we had requested a waiver of nonobservance in our September 17, 2010 letter—remains unchanged (Table 1).

/s/	/s/	/s/
Dragan Vrankić Minister of Finance and Treasury of Bosnia and Herzegovina	Vjekoslav Bevanda Minister of Finance Federation of Bosnia and Herzegovina	Aleksandar Džombić Minister of Finance Republika Srpska

Table 1. Bosnia and Herzegovina: Performance Criteria Under the 2009–12 Stand-By Arrangement, 2010

(In millions of KM)

	Cumulative flow since December 31, 2009									
	2010									
	March			June			September			December
	Program	Adj. Program [2]	Actual	Program	Adj. Program [2]	Actual	Program	Adj. Program [2]	Actual	Program
Ceiling on accumulation of net credit of the banking system to: [1]										
General government	333	292	104	580	604	175	751	N/A	N/A	631
of which:										
State government	20	20	3	-11	-11	-71	112	N/A	N/A	121
RS government	251	237	127	429	480	243	499	N/A	N/A	521
Federation government	61	34	-23	164	137	19	159	N/A	N/A	-8
Ceiling on the increase in the total value of outstanding commitments by the State, Federation and RS governments under guarantees of private and public sector enterprises' debts to domestic banks plus the value of enterprise debts to domestic banks assumed by these governments [3]	0		0	0		0	100		0	100
Ceiling on accumulation of new external debt service arrears by the State, Federation and RS governments and CBBH [3]	0		0	0		0	0		0	0
Ceiling on contracting or guaranteeing of new nonconcessional short-term external debt by the State, Federation and RS governments and CBBH [3]	0		0	0		0	0		0	0
Ceiling on the increase in the stock of domestic expenditure arrears by: [3]										
State government	0		0	0		0	0		0	0
RS government	0		15	0		-1	0		-1	0
Federation government	0		-6	0		-17	0		-30	0

[1] Equal to the sum of the three listed sub-ceilings plus the net bank credit to the District of Brčko, which is not monitored individually due to its small size.
[2] The targets on banking system net claims the general government will be adjusted upward (downward) by the full amount of any shortfall (surplus) in programmed disbursements of budget support loans and grants; and will also be adjusted upward (downward) by the amount by which reported change in float is arithmetically smaller (greater) than its targets in the fiscal program. The upward adjustment is limited to 10 percent of the absolute value of the respective change-in-float target (see Technical Memorandum of Understanding on Definitions and Reporting Under the 2009–12 Economic Program).
[3] Continuous.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/154
FOR IMMEDIATE RELEASE
December 3, 2010

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

IMF Executive Board Concludes 2010 Article IV Consultation with Bosnia and Herzegovina

On October 15, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bosnia and Herzegovina.[1]

Background

After several years of strong growth, increasingly accompanied by external and internal imbalances, the economy of Bosnia and Herzegovina fell into recession in 2009. Like elsewhere in the region, Bosnia and Herzegovina's pre-crisis growth relied on booming domestic demand financed from abroad. Sharp increases in government spending on wages and social transfers in 2008 added to demand pressures, which manifested in widening current account deficits and a spike in inflation. The global economic and financial crisis triggered a collapse in the demand for Bosnia and Herzegovina's exports and severely curtailed cross-border financial inflows. Private investment and spending on consumer durables collapsed, while private consumption softened to a lesser extent, on the back of moderate growth of wages and social benefits. The pre-crisis credit boom came to a sudden stop.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Faced with increasing financing pressures in early 2009, the authorities put together a comprehensive program supported by an IMF Stand-By Arrangement. The program was designed to safeguard the currency board and cushion the effects of the deteriorating external environment, while adopting policies to redress fiscal imbalances and strengthen the financial sector. The authorities' approach included: (i) gradual fiscal consolidation accompanied by structural fiscal reforms to bring public finances on a sustainable path; (ii) steps to strengthen the resilience of the financial sector alongside commitments from foreign parent banks to maintain their exposures to BiH and keep their subsidiaries capitalized; and (iii) substantial financing from the IMF along with funds from the World Bank and the European Union (EU).

Bosnia and Herzegovina's stabilization program has helped mitigate the impact of the global financial crisis on the economy. The IMF's financial support package has helped minimize the impact of revenue shortfalls on government spending, thus limiting output losses. It has also helped stem the loss of foreign reserves by the central bank and shore up investor confidence. Confidence building steps, including Bosnia and Herzegovina's participation in the European Bank Coordination Initiative, and the increase of the scope and limit of deposit insurance coverage helped restore depositors' confidence in the banking system. Performance under the program has been encouraging: fiscal restraint is addressing large imbalances of recent years and structural fiscal reforms have advanced, albeit at a slower pace than initially envisaged.

The economy appears to have bottomed out and is projected to stage a modest recovery in 2010, paving the way for a rebound in 2011. Domestic demand will remain subdued, held in check by stagnant real wages and ongoing fiscal consolidation. This will contribute to a further narrowing of the current account deficit. Underlying inflation is projected to remain low. Private sector credit will pick-up slowly, as banks have yet to absorb the full losses due to non-performing loans in their portfolios. The program targets a general government deficit of 4.5 percent of Gross Domestic Product (GDP) in 2010.

Executive Board Assessment

Executive Directors welcomed Bosnia and Herzegovina's satisfactory performance under the program amidst a challenging economic and political environment. Fiscal restraint is addressing large imbalances of recent years and structural fiscal reforms have advanced, albeit at a slower pace than initially envisaged. Directors emphasized that important challenges remain in ensuring that the economic and policy adjustments are sustainable. They encouraged the newly-elected governments to accelerate structural reforms to ensure fiscal and external sustainability, and to provide the basis for robust, sustainable growth.

Directors noted that attaining the program's 2010 and 2011 fiscal targets will pave the way to restoring fiscal sustainability. Directors encouraged the expenditure restraint demonstrated to be maintained, stressing that meeting the 2010 fiscal target hinges on steadfast implementation of reforms of war-related benefits and a reduction of current expenditures by the Federation's cantons. Directors welcomed the authorities' confirmation of the program's overall fiscal deficit target for next year, and encouraged them to finalize discussions on the 2011 budgets in the Fiscal Council expeditiously.

Directors underscored that medium-term fiscal consolidation needs to be accompanied by a shift from recurrent to capital expenditures. This will require perseverance with the reforms of rights-based benefits to improve their efficiency through better targeting of the poor and the most vulnerable, reining in the public wage bill, and putting the pensions systems on a sustainable footing. Directors welcomed the authorities' commitment to carry out comprehensive expenditure reviews at the State and Entity levels. They noted that the resources freed-up by these reforms would help finance much-needed infrastructure investments.

Directors commended the authorities for vigilant financial sector policies which helped the financial system weather well the spillovers from the global financial crisis. They also welcomed the commitments by foreign parent banks to maintain their exposure vis-à-vis Bosnia and Herzegovina and keep their subsidiaries well capitalized. Directors noted that rising nonperforming loans and declining profitability in the banking sector require continued vigilance and close monitoring of developments in credit quality and spillover risks from regional developments.

Directors underscored that medium-term prospects depend critically on the implementation of structural reforms to improve the country's growth potential. Reforms aimed at addressing labor market rigidities, speeding up the pace of technological change, and improving the business environment would set the stage for robust, sustainable growth.

Directors called on the authorities to take the necessary steps to accept the obligations under Article VIII. They also encouraged further efforts to address data quality issues.

Bosnia and Herzegovina: Selected Economic Indicators, 2006–11

	2006	2007	2008	2009	2010 Proj.	2011 Proj.
	(Percent change)					
Output and prices						
Real GDP	6.1	6.1	5.7	-3.1	0.5	3.0
CPI (period average) [1]	6.1	1.5	7.4	-0.4	2.4	2.5
Money and credit (end of period)						
Broad money	24.7	21.6	3.7	2.4	3.6	4.5
Credit to the private sector	23.3	28.1	20.7	-3.8	1.0	2.3
	(In percent of GDP)					
General government budget						
Revenue	47.2	46.7	45.9	44.6	45.9	45.8
Expenditure (on a commitment basis)	46.1	47.1	49.5	50.2	50.4	48.8
Overall balance	1.1	-0.3	-3.6	-5.7	-4.5	-3.0
External public debt	21.1	18.2	17.2	21.7	26.2	29.4
Total public debt	21.4	32.9	30.8	35.4	39.1	43.0
	(In millions of euros)					
Balance of payments						
Exports of goods and services	3,592	4,153	4,648	3,923	4,526	4,861
Imports of goods and services	6,463	7,656	8,827	6,780	7,222	7,610
Current account balance	-783	-1,191	-1,819	-840	-684	-707
(In percent of GDP)	-8.0	-10.7	-14.4	-6.8	-5.5	-5.5
Gross official reserves	2,761	3,425	3,219	3,176	3,219	3,733
(In months of imports)	4.3	4.7	5.7	5.3	5.1	5.6
External debt service (In percent of exports of goods and services)	5.8	5.3	5.4	6.6	11.8	12.4
Exchange rate regime	Currency board since August 1997					
Exchange rate (KM/Euro)	0.51	0.51	0.51	0.51	...	...
Real effective exchange rate (2000=100, increase=appreciation) [2]	90.8	89.2	91.2	91.4	...	...

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

[1] In 2006, affected by the VAT introduction.

[2] Adjusted for VAT effect.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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October 15, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second and Third Reviews under Stand-By Arrangement with Bosnia and Herzegovina, Approves €132.8 million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second and third reviews of Bosnia and Herzegovina's economic performance under a program supported by a 36-month Stand-By Arrangement (SBA). The completion of the reviews enables the immediate disbursement of an amount equivalent to SDR 118.37 million (about €132.8 million or US$187.1 million), of which the authorities intend to draw SDR 33.82 million, bringing total disbursements under the program to an amount equivalent to SDR 338.2 million (about €379.4 million or US$534.6 million). In completing the review, the Executive Board approved request for waiver of nonobservance of continuous performance criterion on the accumulation of domestic payment arrears and waiver of applicability of the end-September 2010 performance criterion on net bank credit to the government.

The SBA was approved on July 8, 2009 (see Press Release No.09/258). Following the Executive Board's discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

“Bosnia and Herzegovina’s satisfactory implementation of policies supported by the Stand-By Arrangement is proceeding amidst a challenging economic and political environment. Fiscal restraint is addressing large imbalances of recent years and structural fiscal reforms have advanced. Strong implementation by the newly-elected governments of the structural reform agenda is needed to ensure fiscal and external sustainability and provide the basis for robust, sustainable growth.

“Attaining the program’s 2010 fiscal target is the first step towards restoring fiscal sustainability. The authorities have demonstrated expenditure restraint and have adopted measures to ensure that the 2010 general government deficit objective will be met. Implementation of reforms of war-related benefits and the reduction of current expenditures by the Federation’s cantons will be essential in this regard.

“The 2011 fiscal deficit target of 3 percent of GDP strikes an appropriate balance between the need for fiscal tightening and promoting the incipient economic recovery. Medium-term fiscal consolidation will need to be accompanied by a shift from recurrent to capital expenditures. With government expenditure now in excess of 50 percent of GDP, policies should focus on reducing current expenditure by intensifying reforms of rights-based benefits to improve their efficiency through better targeting of the poor and most vulnerable, reining in the public wage bill, and putting the pensions systems on a sustainable footing. Freed-up resources will help finance badly needed infrastructure investments, which alongside reforms to tackle labor market rigidities and improve the business environment, will set the stage for a robust, sustainable growth.

“The authorities’ financial sector policies have been appropriate, helping preserve financial stability in the face of the global financial crisis. Foreign parent banks’ commitment to maintain their exposure vis-à-vis Bosnia and Herzegovina and keep their subsidiaries well capitalized further strengthened market confidence. Rising non-performing loans and declining bank profitability call for continued vigilance and close monitoring of developments in credit quality and spillover risks from regional developments”.

Statement by Mr. Yakusha and Mr. Tomic on Bosnia and Herzegovina
October 15, 2010

The authorities of Bosnia and Herzegovina (BiH) would like to thank staff for a constructive policy dialogue and an excellent set of papers which correctly describe the recent economic developments and major policy challenges ahead. Two staff visits were necessary to conclude the discussions on the program reviews, and with hindsight, staff's consistent and strict insistence on adhering to the program's strategy and tackling politically sensitive spots (such as the high public sector wage bill, non-targeted benefits, pension and health system), were beneficial for maintaining credibility. Program performance remains satisfactory, despite some delays on the structural reform front. There was a breach of one performance criteria, namely non-accumulation of domestic arrears that occurred in the Health Fund of the Republika Srpska (RS) as a consequence of liquidity constraints during the first quarter of 2010, for which a waiver is requested based on corrective action already taken.

The program helped to limit the impact of the crisis on the economy, and contributed to a return to positive growth territory, as signaled by the leading indicators already in 2010. Most notably, the program, while providing short-term financing at favorable terms that helped dampen the fall in GDP, also raised the awareness of policy makers to structural issues, a key for medium-term developments. Unemployment has remained the biggest economic problem. Despite an expected revival of growth in 2011, the solution for unemployment, the growth model that will create jobs, is still to be found.

Developments since the last Article IV Consultations held in September 2008 provided ample opportunity for testing the strengths of the financial system. Faced with a decrease in deposits in late 2008, the Central bank of BiH (CBBH) reduced reserve requirements in several instances, while domestic, mainly foreign-owned banks, received liquidity injections from parent banks. Apart from a sudden stop in credit activity during 2009, which negatively reflected on banks' profitability, a substantial increase in non-performing loans' (NPLs) share in total loans from 3.1 percent in 2008 to 8.7 percent currently, is the most discernible deterioration. However, it is not expected that this figure will further increase significantly, signaling that, in comparison to regional peers, the banking system preserved soundness.

The Fund program contributed significantly to the stabilization of the banking system by securing commitment to the exposure under the European Bank Coordination Initiative (Vienna Initiative), requiring establishment of the Standing Committee on Financial Stability, and improved surveillance through stress testing introduced under technical assistance provided. Similarly, entity banking agencies benefited from the USAID technical assistance that will help introduce Basel II standards. With a strengthened institutional framework, the monetary authorities carefully monitor developments in the banking system, currently characterized by surplus liquidity, and stand ready to act should there be any need.

Reinforced credibility in the financial system served as a strong support also for the currency board, which remains widely perceived as the best nominal anchor. With inflation pressure kept in check, partly also due to subdued domestic demand, the authorities remain fully committed to the current arrangement. Finally, there is no evidence of currency over/undervaluation. Improvements observed in the current account so far, and stronger revival of exports compared to imports, bode well for further reduction in external imbalances. The external debt position, despite some increase, scores favorably compared to regional peers.

The prospects for reaching a deficit of 4.5 percent of GDP target in 2010 are good. Further adjustment of at least 1.5 percent of GDP is expected in 2011, and this objective serves as a major input for budget planning at the different levels of government. Since the expenditure to GDP ratio remains high, the authorities are determined to thoroughly review expenditures across the different levels of government with the objective of identifying possible savings, already for the period 2012–14.

Important legislation that should help contain current expenditures (such as the wage bill law in the Federation BiH, the government's decision to speed up the audit process of beneficiaries, or pension reform strategies adopted by the entity parliaments) was enacted under the program and its contribution to the return to a more appropriate fiscal stance is expected in the medium term. More importantly, the sheer process of the laws' adoption and the public debate initiated, have prepared the stage for fiscal adjustment envisaged in the near term. Although public debt sustainability analyses reveal a still relatively comfortable position, the authorities are aware of the projected increase in debt servicing in the medium term and increase in borrowing needs in the absence of continued fiscal adjustment.

Securing sustained recovery will depend on the success in further improving the labor market, including a collective bargaining mechanism, enhancing technological change and amelioration of the business environment. Staff has contributed to internal discussion on growth promoting possibilities that will be useful for the governments that assume office after the recent elections.

Irrespective of the fact that it may take some time before the new cabinets are formed, the immediate task on budget 2011 preparation is going according to schedule. Finally, in light of the limited balance of payments needs, the authorities intend to purchase only part of the available tranches at this stage.