Monthly Economic Overview Bosnia & Herzegovina

No.3

Credit rating of B&H

Credit rating	S&P		Moody's	
	Rating	Outlook	Rating	Outlook
LT	B	Stable	B3	Stable
Date of last change	March-18		February-18	
Activity	Confirmed		Confirmed	

Source: Central Bank of B&H, Raiffeisen BANK dd BiH

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Highlights

- ✓ The Central Bank of B&H (CBBH) has successfully operated the Currency Board Arrangement (CBA) since 1998 which proved to be very efficient in maintaining the stability of the local currency. The ultimate goal of the monetary authorities as well as political players is to maintain the CBA as long as possible, as it has proved to be one of the anchors of macroeconomic stability and has enhanced the economic recovery in previous period. Therefore, the CB system will remain intact for the foreseeable future.

- ✓ Construction sector provides around 4.0% of GDP and around 4.5% of employment in B&H. It remains the sector with the highest potential for growth in the mid-term period, while utilization of such a potential is highly coherent with the political stability of the country.

- ✓ Several important macroeconomic indicators available for Jan-18 envisage to continuation of economic upturn: Export of goods expanded at an annual rate of 25.4% which represented a strong acceleration from 10.7% yoy growth registered in Dec-17.

- ✓ Banking sector has maintained its growth momentum in first month of 2018, with strong performance on both sides of the balance sheet (loans and deposits). It should be highlighted that the corporate sector was the main driver of loans and deposits figures in Jan-18.

- ✓ After Moody's had confirmed the B3 credit rating for B&H (with stable outlook) in Feb-18, S&P also affirmed its B/B long and short-term foreign and local currency sovereign credit ratings on B&H. As for 2018 outlook, we still expect slight acceleration of real GDP growth close to 3.0% yoy

Key macroeconomic figures of Bosnia and Herzegovina

	2012	2013	2014	2015	2016	2017e	2018f	2019f	2020f
Nominal GDP (EUR bn)	13.4	13.7	14.0	14.6	15.3	16.1	**17.0**	18.0	19.0
Real GDP (% yoy)	-0.8	2.3	1.2	3.1	3.1	2.5	**2.8**	3.0	2.8
GDP per capita (EUR)	3,452	3,531	3,614	3,784	3,967	4,179	**4,421**	4,698	4,967
GDP per capita (EUR at PPP)	6,900	7,200	7,300	7,500	7,900	8,300	**8,800**	9,400	9,700
Household consumption (real, % yoy)	-0.7	0.0	1.9	1.8	1.7	1.9	**1.7**	1.7	1.9
Gross fixed capital formation (real, % yoy)	4.0	-3.0	8.2	2.9	10.8	5.8	**8.0**	9.5	8.9
Industrial output (% yoy)	-5.2	6.7	0.1	2.6	4.3	3.1	**4.8**	5.0	4.5
Producer prices (avg, % yoy)	1.3	-2.2	-0.2	0.6	-2.3	3.0	**2.5**	2.3	2.3
Consumer prices (avg, % yoy)	2.1	-0.1	-0.9	-1.0	-1.1	1.3	**1.8**	2.0	2.0
Average gross industrial wages (% yoy)	2.2	-0.5	0.3	0.0	0.9	1.4	**5.1**	6.1	4.0
Unemployment rate (avg, %)	28.0	27.5	27.5	27.7	25.4	20.5	**18.0**	16.0	15.0
General budget balance (% of GDP)	-2.0	-2.2	-2.0	0.7	1.2	1.0	**-0.5**	0.5	0.5
Public debt (% of GDP)	39.9	38.9	42.1	41.8	40.4	37.5	**37.0**	38.5	39.0
Trade balance (EUR bn)	-3.8	-3.5	-3.8	-3.5	-3.4	-3.6	**-3.9**	-4.2	-4.3
Current account balance (% of GDP)	-8.6	-5.3	-7.4	-5.7	-5.1	-5.0	**-5.9**	-6.4	-6.3
Net foreign direct investment (% of GDP)	1.9	1.3	2.9	1.7	1.6	2.2	**2.7**	3.3	3.9
Official FX reserves (EUR bn)	3.3	3.6	4.0	4.4	4.9	5.4	**5.5**	5.8	6.1
Gross foreign debt (% of GDP)	52.1	52.1	51.7	53.4	54.4	54.2	**54.1**	54.0	55.0
EUR/BAM (avg)	1.96	1.96	1.96	1.96	1.96	1.96	**1.96**	1.96	1.96
USD/BAM (avg)	1.52	1.47	1.47	1.76	1.77	1.73	**1.55**	1.47	1.44

Source: Agency for Statistics of B&H, Central Bank of B&H, Raiffeisen BANK dd BiH

Raiffeisen BANK dd
Bosna i Hercegovina

Key macroeconomic and banking sector indicators of Bosnia and Herzegovina

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017e	2018f
GDP and real economy											
Nominal GDP (EUR bn)	13.0	12.7	13.0	13.4	13.4	13.7	14.0	14.6	15.3	16.1	17.0
Real GDP (% yoy)	5.4	-3.0	0.9	1.0	-0.8	2.3	1.2	3.1	3.1	2.5	2.8
Nominal GDP per capita (EUR)	3,336	3,248	3,328	3,448	3,452	3,531	3,614	3,784	3,967	4,179	4,421
Industrial output (real, % yoy)	7.3	-3.3	1.6	5.6	-5.2	6.7	0.1	2.6	4.3	3.1	4.8
Retail trade index (real, % yoy)	n.a.	n.a.	n.a.	n.a.	n.a.	4.5	1.8	7.8	7.0	5.1	6.1
Household consumption (real, % yoy)	5.3	-4.5	0.1	-0.2	-0.7	0.0	1.9	1.8	1.7	1.9	1.7
Gross fixed capital formation (real, % yoy)	14.9	-28.3	-15.6	14.1	4.0	-3.0	8.2	2.9	10.8	5.8	8.0
Exports of goods and services (real, % yoy)	1.2	-3.2	13.9	4.6	0.1	7.8	4.2	6.8	9.5	10.1	8.0
Imports of goods and services (real, % yoy)	10.1	-14.3	2.5	2.9	0.7	-0.2	7.7	0.7	7.0	7.2	6.0
Balance of Payments											
C/A balance (EUR bn)	-1.8	-0.8	-0.8	-1.3	-1.2	-0.7	-1.0	-0.8	-0.8	-0.8	-1.0
C/A balance (in % of GDP)	-13.8	-6.4	-6.0	-9.5	-8.6	-5.3	-7.4	-5.7	-5.1	-5.0	-5.9
Secondary income (EUR bn)	2.0	1.7	1.8	1.8	1.9	1.9	2.0	1.8	1.8	1.8	1.9
Secondary income (in % of GDP)	15.0	13.5	13.9	13.5	14.0	13.8	14.5	12.5	11.9	11.2	11.9
Net inflow of FDI (EUR bn)	0.7	0.2	0.3	0.3	0.3	0.2	0.4	0.2	0.2	0.4	0.5
Net inflow of FDI (in % of GDP)	5.2	1.4	2.1	2.6	1.9	1.3	2.9	1.7	1.6	2.2	2.7
Export of goods (EUR bn)	3.4	2.8	3.6	4.2	4.0	4.3	4.4	4.6	4.8	5.7	6.1
Import of goods (EUR bn)	8.3	6.3	7.0	7.9	7.8	7.8	8.3	8.1	8.3	9.3	10.0
Trade balance (EUR bn)	-4.9	-3.5	-3.3	-3.7	-3.8	-3.5	-3.8	-3.5	-3.4	-3.6	-3.9
Trade balance (in % of GDP)	-37.5	-27.5	-25.7	-27.8	-28.2	-25.4	-27.5	-24.0	-22.6	-22.5	-22.8
Foreign reserves (EUR bn)	3.2	3.2	3.3	3.3	3.3	3.6	4.0	4.4	4.9	5.4	5.5
Prices, wages, unemplyoment											
Consumer prices (avg, % yoy)	7.4	-0.4	2.1	3.7	2.1	-0.1	-0.9	-1.0	-1.1	1.3	1.8
Producer prices (avg, % yoy)	8.6	-3.2	0.9	3.8	1.3	-2.2	-0.2	0.6	-2.3	3.0	2.5
Unemployment rate (avg, %)	23.4	24.1	27.2	27.6	28.0	27.5	27.5	27.7	25.4	20.5	18.0
Average monthly gross wages (EUR)	569.2	615.3	622.0	649.7	659.7	660.2	659.3	659.2	665.0	673.9	708.1
Average gross wages (LCY, % yoy)	16.7	8.1	1.1	4.4	1.5	0.1	-0.1	0.0	0.9	1.3	5.1
Fiscal position											
General budget balance (% of GDP)	-2.2	-4.4	-2.5	-1.3	-2.0	-2.2	-2.0	0.7	1.2	1.0	-0.5
Public debt (% of GDP)	29.0	33.4	37.4	38.0	39.9	38.9	42.1	41.8	40.4	37.5	37.0
Public debt (EUR bn)	3.8	4.2	4.9	5.1	5.3	5.3	5.9	6.1	6.2	6.0	6.3
External debt (EUR bn)	2.2	2.7	3.2	3.4	3.6	3.8	4.2	4.3	4.4	4.2	4.4
Internal debt (EUR bn)	1.6	1.6	1.6	1.7	1.7	1.5	1.7	1.8	1.8	1.9	1.9
Banking sector indicators											
Total Assets (EUR mn)	10.6	10.6	10.6	11.0	11.2	11.8	12.3	12.8	13.3	14.3	15.3
Total Assets (in % of GDP)	81.3	83.2	81.9	81.9	83.6	86.1	87.9	87.3	87.3	89.2	90.4
Total loans (EUR mn)	7.2	7.0	7.2	7.6	8.0	8.2	8.4	8.6	8.8	9.3	9.9
Total deposits (EUR mn)	6.1	6.2	6.4	6.6	6.8	7.3	7.9	8.5	9.1	10.1	10.9
Non-performing Loans (%) - NPL	3.1	5.9	11.4	11.8	13.5	15.1	14.2	13.7	11.8	10.8	9.8
Return on Assets (%) - ROA	0.4	0.1	-0.6	0.7	0.7	-0.1	0.8	0.3	1.1	1.7	1.5
Return on Equity (%) - ROE	4.2	0.8	-5.5	5.8	5.1	-0.5	5.4	2.0	7.3	11.7	10.6

Source: Agency for Statistics of B&H, Central Bank of B&H, Raiffeisen BANK dd BiH

No threats for the Currency Board Arrangement (CBA) in the foreseeable future

The Central Bank of B&H (CBBH) has successfully operated the Currency Board Arrangement (CBA) since 1998, according to which the local currency BAM is pegged to EUR at a rate of BAM 1.95583 to EUR. The main goal of the Currency Board Arrangement is to maintain the stability of the local currency which is prerequisite for the overall macroeconomic stability.

At the disposal of the CBBH there is only one monetary policy tool – the required reserve ratio. In accordance with the Law on the Central Bank of BiH, the Bank is not allowed to pursue the lender of last resort function, and it is prevented from conducting open market operations. Therefore, the Bank is completely insulated from the possibility of influencing interest rates and the money supply. This also implied that inflationary developments were largely reflecting global price movements of imported commodities and domestic policies affecting wages and social benefits.

Since global financial crisis back in 2008, the Central Bank of B&H loosens its monetary policy stance by reducing the required reserves ratio two times. First in 2009, the CBBH reduced the required reserves ratio from 10% to 7%, on all deposits with maturity of 12 months and above. Later in 2011 the CBBH decided to further loosen its monetary policy stance by reducing required reserves ratio from 14% to 10% on deposits with maturity of less than 12 months. Since then, the CBBH did not change its monetary stance recognizing the need for a continuation of the relaxing monetary policy.

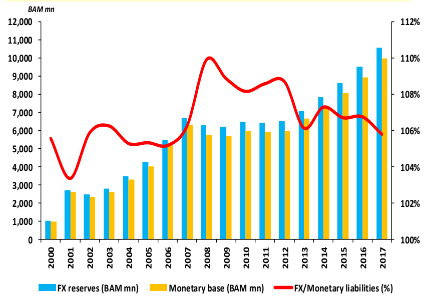
Monetary liabilities of the CBBH have to be fully covered with foreign assets, i.e. the Law on the Central Bank of Bosnia and Herzegovina requires that the total amount of its monetary liabilities should never exceed its net foreign exchange reserves. Monetary liabilities of the CBBH, according to the Law on the Central Bank of Bosnia and Herzegovina, include the cash in circulation and local deposits of banks and other residents. Coverage of the local currency in foreign currency in relation to the needed minimum of 100% is used to act in case of unexpected events in foreign financial markets. According to last data from the Central bank of B&H, the coverage ratio of monetary liabilities stands at 105.8% as of Dec- 17.

The Currency Board Arrangement proved to be very efficient in maintaining the stability of the local currency and one of the key anchors of the macroeconomic policy and environment. The possible threat to the stability of the local currency could come from unexpected instability of the banking sector, uncontrolled increase of the State external debt or from the unsustainable current account deficit. However, these threats have from this perspective quite balanced risk prospect in the medium-term (5 years) and therefore we do not question the stability of the local currency under the CB arrangement. The ultimate goal of the monetary authorities as well as the key political players is to maintain the CBA as long as possible, as it has proved to be one of the anchors of macroeconomic stability and has enhanced the economic recovery in previous period. The only possible exit strategy from the CBA for now is the joining the EMU at some point.

BAM anchored to EUR

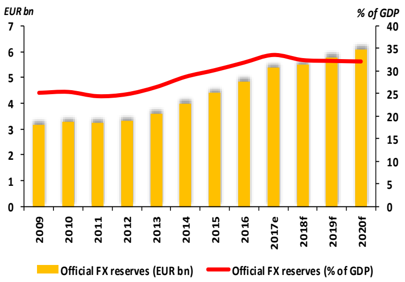
Source: Raiffeisen BANK dd BiH

FX coverage of m. liabilities



Source: Central Bank of B&H, Raiffeisen BANK dd BiH

FX reserves (forecast)

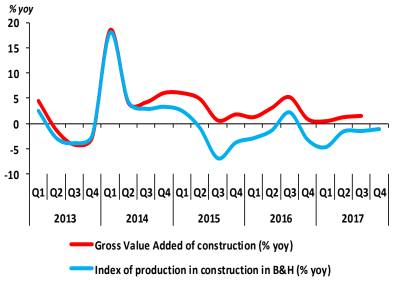


Source: Central Bank of B&H, Raiffeisen BANK dd BiH

Construction growth chained by unsupportive political landscape

Construction sector provides around 4.0% of GDP and around 4.5% of employment in B&H. It is one of the economic sectors which strongly suffered from the effect of the global economic crisis back in 2008-2009. More precisely, global recession in 2008 lead to five years of negative GVA (gross value added) performance of the construction sector (period from 2009 until 2013), with average negative growth rate of 5.5% yoy. In period 2014-2016, construction sector recovered mostly on the back of the low statistics base, contributing to around 0.1 pp to economic growth. According to the last available data, in first three quarters of 2017 the construction sector has posted increase of 1.1% yoy, the weakest print in four years. Even though, this will be the fourth straight year in which construction sector has positive contribution to real GDP, its importance to overall economy (GDP) is rather trivial. To analyse dynamics of the construction sector we primarily follow the indices of production in construction published by the State Agency for Statistic on quarterly level dynamics (consistent with GVA for construction sector please see chart Construction figures). Since 2015 seasonally adjusted production in construction is in negative area: decline of 1.9% yoy on average in period 2015-2017. Breaking down the components of the production in construction index clearly point to subsection of the construction sector which is the main drag to the overall performance. By types of construction in the same period (2015-2017), the respectable index increased by 5.7% yoy (on average) in the building constructions and decreased by 7.2% on the civil engineering works. Therefore, the weak performance of the civil engineering is still main drag to the overall performance of the construction sector while positive dynamics in building construction is not strong enough to mitigate negative effect reported in civil engineering.

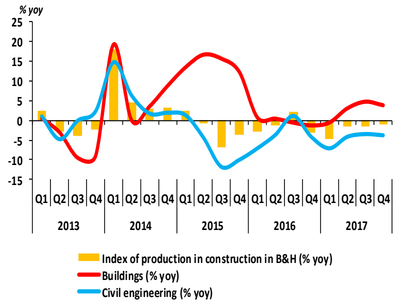
Construction figures



Source: Agency for Statistics of B&H, Raiffeisen BANK dd BiH

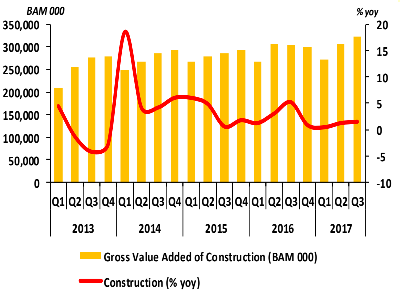
Negative figure within the civil engineering sector is reflection of the elusive political stability within the country. Since the last General Elections (Oct-14) we evidenced total lack of new construction sights on largest infrastructural project in the country – Corridor VC. The main political parties, up until Dec- 17, could not agree on Law on Excise duties as key precondition to withdraw the funds from the international financial institutions (EBRD and EIB) for the infrastructure projects. Consequently, since 2015 the civil engineering hovers within negative territory, bringing down the total construction sector to very low levels. Nevertheless, construction remains the sector with the highest potential for growth in the mid-term period, while utilization of such a potential is highly coherent with the political stability of the country. Announced investments in energy sector along with accelerated construction works in infrastructure, could push the construction sector indices into the positive double-digit area. From current political and economic perspective we see high probability for such scenario to be materialized. More precisely, the EBRD has signed a Memorandum of Understanding with B&H in Feb-18 to disburse a three - year EUR 700 mn loan to finance highway construction in both entities. Also we have to bear in mind the approaching General Elections, which are usually followed by numerous infrastructure projects (mostly in reginal roads) while we also expect several energy projects to be constructed in mid-term period (HPP Vranduk, WM Podvelezje etc). All in all we see a good chance for the construction sector to be the key engine of the economic growth in mid-term period if we see supportive political landscape for such scenario.

Prod. in construction index



Source: Agency for Statistics of B&H Raiffeisen BANK dd BiH

GVA of Construction



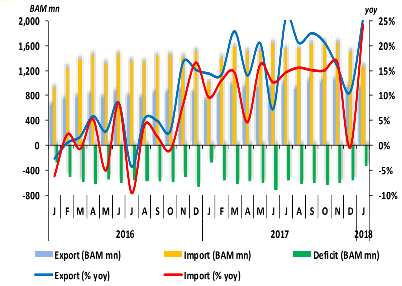
Source: Agency for Statistics of B&H, Raiffeisen BANK dd BiH

Only few macroeconomic data available for first month of 2018

As the Agency for Statistics of B&H is in the process of the methodological changes for key heavy weight indicators, only several indicators are available as of Jan-18.

Trade balance: B&H exports jumped in Jan-18, mainly due to stronger demand for mineral products (43.5% yoy) and base metals (50.0% yoy), which contributed to 1/2 of total growth. Explicitly, export of goods expanded at an annual rate of 25.4% (amounting to BAM 906 mn), which represented a strong acceleration from 10.7% yoy growth registered in Dec-17. In same month, import of goods soared by 24.2% yoy in turnover to reach BAM 1.25 bn, thus marking the strongest gain in seven years. Thus, the trade deficit totalled BAM 348.8 mn which is increase by 21.1% yoy while the export to import ratio reached a new all-time high of 72.2%. Export turnover to the EU market hit BAM 686.5 mn, up 25.1% yoy, accounting for 75% of the total export of B&H. Import from EU reached BAM 773.5 mn (or 61% of total import), soaring 19.8% yoy. It is too early to say that this year's trade turnover will surpass our target rates, but with such favourable starting point in 2018, the upward revision could be occurred in period ahead. However, we should wait at least until end of Q1 before changing our target rates for 2018.

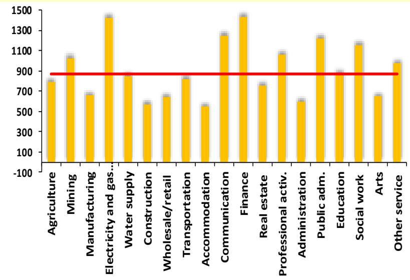
Trade balance of B&H



Source: Agency for Statistics of B&H , Raiffeisen BANK dd BiH

Labour market: Average net wages posted an increase of 2.7% yoy up to BAM 870 as of Jan-17: the highest average net salary is still earned in the financial and insurance sector (BAM 1,423) and the lowest in accommodation and food service activities (BAM 541). In same month, total number of persons in paid employment in B&H amounted to 790.943, which are up by 3.1% compared to Jan-17. The highest number of employees is still registered in area of manufacturing (20.7% of total employees) and wholesale/retail trade (18.6% of total employees). Unemployment rate has continued to decline in Jan-18 but the level of the official unemployment is still very high. In terms of registered unemployment, the rate decreased to 37.5% in Jan-18, thus marking the lowest unemployment rate since data are available. As a reminder, the results from the annual labour force survey (using ILO methodology, which accounts for undeclared work) point to a decline in unemployment rate to 20.5% in 2017. Total number of unemployed persons in Jan-18 amounted 475,541 out of which 8.3% refers to persons with university qualification, 28.0% to secondary school qualification, 33.2% to unskilled workers. All in all, we expect that the official labour market statistics will continue to post signs of strength in 2018, along with LFS figures which we use as more relevant data for the economy of B&H. In that sense, LFS unemployment rate is expected to decline further down to 18% in 2018, but mostly as a result of shrinking labour force and "brain drain" phenomena visible in past two years, rather than more distinct economic dynamics.

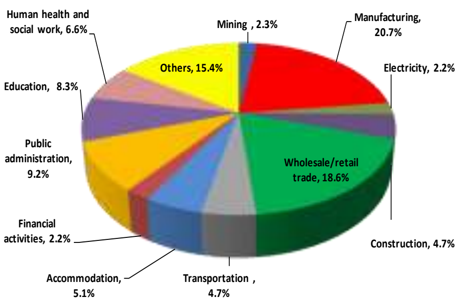
Avg. net wages (by sectors)



Source: Agency for Statistics of B&H, Raiffeisen BANK dd BiH

Tourism sector: After B&H B&H registered its best tourist season in post war period in 2017 (with 1,317 thds arrivals and 2,677 thds nights 12.3% yoy), positive trend in tourist sector has continued in 2018. In Jan-18 tourists in B&H realized 63.8K visits and 147.5K nights which is increase by 15.3% yoy and by 18.5% yoy. Concerning the structure of foreign tourist nights in Jan-18, most of them were realized by tourists from Croatia (34.0%), Serbia (15.2%), Slovenia (6.3%), Turkey (6.1%) and Italy (3.6%). Tourism is rising contributor the B&H economy and its upward momentum is expected to be continued in this year as we expect new peaks in tourism sector during 2018.

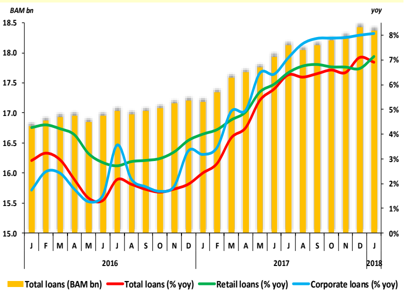
Employment (% structure)



Source: Agency for Statistics of B&H Raiffeisen BANK dd BiH

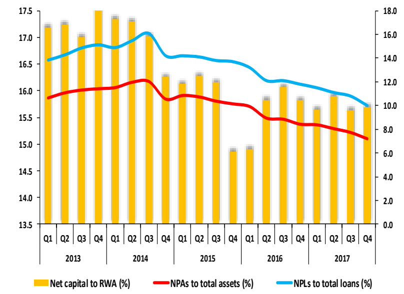
Corporate sector remained main driver of loans and deposits growth in Jan-18

Loans performance



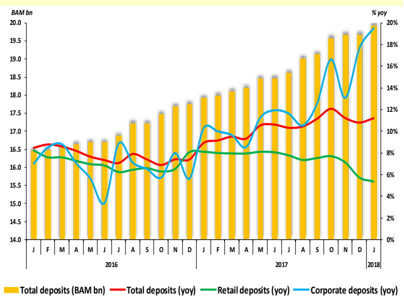
Source: Central Bank of B&H, Raiffeisen BANK dd BiH

Key FSI



Source: Central Bank of B&H , Raiffeisen BANK dd BiH

Deposits dynamics



Source: Central Bank of B&H , Raiffeisen BANK dd BiH

The banking sector figures for 2017 continued to flow in, one by one, confirming that last year was the best period for the banking sector performance since the global financial crisis in 2008. Preliminary profitability figures have shown that B&H banks ended the previous year with net profit of BAM 385.8 mn which is by 50.6% higher bottom-line result compared to 2016. In 12 months of 2017, B&H banks collected revenues in total amount BAM 1.42 bn (7.1% yoy), thus being at the all-time high level. Amount of net interest revenues also reached its peak in 2017 of BAM 830.3 mn (3.3% yoy) while non-interest costs totalled BAM 1.04 bn (-3.3% yoy). Consequently, the key profitability ratios were as follows: ROAA = 1.5% and ROAE =10.3%. For the time being, these are the only available profitability figures for 2017, while more comprehensive overview of the banking sector performance in 2017 in next report (scheduled to be published by the end of Apr-18).

Banking sector has maintained its growth momentum in first month of 2018, with strong performance on both sides of the balance sheet (loans and deposits). It also should be highlighted that the corporate sector was the main driver of loans and deposits figures in Jan-18. In particular, total loans granted by B&H banks in Jan-18, increased by 6.9% yoy (7.1% yoy) thus reaching value of BAM 18.36 bn. As already mentioned, the corporate sector was at the forefront of loans dynamics in Jan-18, growing by 8.1% yoy (strongest gain since Nov-11) up to BAM 8.68 bn or 47.3% of total loans. Retail loans growth was also robust although with slightly slower pace than corporate amounting (7.1% yoy - highest since Apr-09) to BAM 8.64 bn (47.0% of total loans). On the negative note, the lending towards the public sector declined by 6.6% yoy to BAM 936 mn or 5.1% of total loans.

In same month, total deposits of B&H banking sector reported growth of 11.2% (10.8% yoy in Dec-18), which is 9th consecutive month of double-digit deposits expansion and 59th straight month in which growth of total deposits exceed the growth of total loans. Corporate sector was also the main driving force behind deposits dynamics, growing by 19.5% yoy (highest since Nov-07) up to BAM 4.9 bn or 24.6% of total deposits. Citizens savings went up by 5.4% yoy (lowest since Sep-09), still holding the largest share in deposits structure (BAM 11.3 bn or 56.7% of total deposits). Finally, public sector deposits totalled BAM 2.25 bn (33.6% yoy) which accounts to 11.3% of total deposits. Accordingly, total deposits in Jan-18 reached value of BAM 19.92 bn (all time high) while the L/D ratio went down further to 92.2% - 18th straight month in which L/D ratio is below 100%.

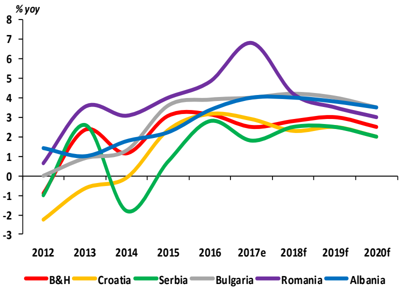
In this year we expect continuation of a more healthy level of credit growth in range of 5-7% yoy fuelled by export driven corporate segment and planned infrastructural investments expected in Election 2018. Retail segment should remain in focus of banks due to its solid risk profile and stable growth of private consumption. Deposits in the Bosnian banking sector should remain robust, growing at an "accustomed" range of 5-7% yoy, driven by LCY demand deposits and short-term FCY deposits. Although B&H banking sector proved to be quite resilient to political turmoil and crisis in the past, the political uncertainty is clearly one of the key obstacles for a more prominent revival of banking sector dynamics, as well as for the market's general risk perception by investors.

All eyes are already on October's General Elections

After Moody's had confirmed the B3 credit rating for B&H (with stable outlook) in Feb-18, S&P also affirmed its B/B long and short-term foreign and local currency sovereign credit ratings on B&H. S&P underlined that the rating could be revised upwards if the political setting recovered its reform agility, resulting in maintained, solid growth momentum by supporting investments and markedly lifting income levels. On the other hand, S&P could lower the ratings if political developments in 2018 create a bottleneck that revers progress made under the reform agenda so far and notably reduces the growth momentum. In our view, it is not reasonable to expect any changes, upward or downward revision, of the B&H credit rating in the mid-term period. Both Moody's and S&P underline the political landscape as the main risk/opportunity for the economic dynamics in 2018. With General Elections just seven months away, we see low probability of ongoing positive political developments, but instead intensified national rhetoric and political manoeuvring which will, consequently, result in absence of any fundamental reforms. Therefore, we remain firm on stand that political developments ahead will create a bottleneck for the continuation of the reforms related to the EFF with the IMF or EU membership path. As for the fiscal stability even without the IMF 2018 Budgets should be viable and stable as the ministries will most probably again turn more to the local debt market. Moreover, due to satisfactory level of liquidity in 2018, need for financial funds was reduced, so all planned auctions in FB&H for H1 2018 were cancelled while RS entity also cancelled 2 T-bills auctions In Q1 2018. However, in 2019, after the Elections we believe the IMF is the only viable alternative for financing.

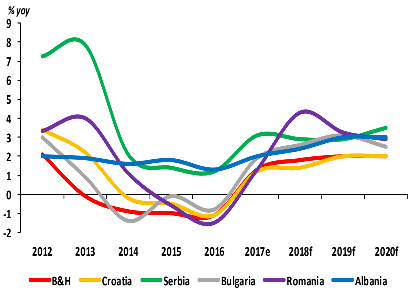
As for 2018 outlook, we still expect slight acceleration of real GDP growth close to 3.0% yoy. Other major financial institutions also recon on similar growth momentum in this year: Moody's predicts real GDP expansion of 3.7% yoy in 2018 (which is the most optimistic scenario from all major international financial institutions: EBRD and S&P forecasts real GDP growth of 3.0%, the IMF and the World Bank of 3.2% yoy. Several important macroeconomic indicators available for Jan-18 envisage to continuation in acceleration upturn (export of goods expanded by 25.4% yoy, net salaries grew by 2.7% yoy, while total loans jumped by 6.9% yoy). It is also important to underline that in Feb-18 the EBRD signed the Memorandum of Understanding with B&H to disburse a three-year EUR 700 mn loan to finance highways construction in both entities. Therefore, for the time being we stick to our projections that the business cycle in 2018 will be borne by more robust revival of gross investments (8.0% yoy), followed by exports of goods and services (8.0% yoy) and private consumption (1.7%). Declining unemployment rate (down to 18% in 2018 by LFS methodology) is assumed to remain reflection of a fall in the activity rate and a reduction of the labour force. Inflation is expected to be boosted again to more healthy levels being at the level of 1.8% yoy on average, mostly thanks to supply side factors such are higher imported prices of oil, food and beverages and transport prices. IMF and S&P are also predicting rising price pressure in 2018 but at slightly slower pace being at 1.6% yoy respectively. Improved private consumption should push the imports of goods and services up to 6.0% yoy while we also expect the C/A deficit to widen up to 5.9% of GDP in 2018. We also reckon on the gradual improvement of the FDI print, up to 2.7% in 2018 but which is still well below the pre-crisis levels (before 2009). All in all, in years ahead we expect improved economic performance while the main risk but also the main opportunity for our baseline scenario emerges from the political stability and outcome of the General elections in Oct-18.

Real GDP - % yoy (f)



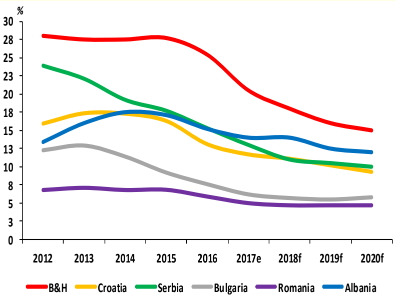
Source: Agency for Statistics of B&H, RBI/Raiffeisen RESEARCH

Inflation - % yoy (f)



Source: Agency for Statistics of B&H, RBI/Raiffeisen RESEARCH

Unemployment rate (f)



Source: Agency for Statistics of B&H, RBI/Raiffeisen RESEARCH

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