

# MOODY'S

## RATINGS

### **Rating Action: Moody's Ratings assigns B3 issuer rating to the Federation of Bosnia and Herzegovina; stable outlook**

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14 May 2024

Frankfurt am Main, May 14, 2024 -- Moody's Ratings (Moody's) has today assigned B3 local and foreign currency long-term issuer ratings to the Federation of Bosnia and Herzegovina (FBiH), as well as a b3 Baseline Credit Assessment (BCA). The outlook is stable.

#### RATINGS RATIONALE

The B3 rating and b3 BCA reflect the complex institutional structure that shapes the intergovernmental relations between the Bosnia and Herzegovina's (BiH, B3 stable) constitutional entities and challenges stemming from weak coordination among governing bodies. The rating action also reflects the FBiH's limited economic strength partly related to migration and an ageing population as well as its indirect exposure to the FBiH-owned companies' debt.

The rating and BCA also take into account a number of credit strengths including the FBiH's fiscal autonomy, and its unique status and tax regime, protected by BiH's constitution. The FBiH's solid fiscal metrics, comfortable liquidity position and contained direct debt also underpin the ratings.

The complex institutional framework, while offering substantial fiscal independence, poses difficulties in achieving consistent policies and harmonized decision-making process across the country. The multiple layers of government and the absence of effective coordination between the FBiH and Republic of Srpska (B3 stable) remain a significant hurdle in adopting structural reforms, which are necessary prerequisites for BiH's successful integration into the European Union (EU, Aaa stable), as well as the effective implementation of BiH's Economic Reform Plan. Furthermore, the complex and divisive political environment and persistent political tensions weigh on policy effectiveness.

BiH's economy is relatively small, with low competitiveness internationally. The

country's economic framework, which encompasses the FBiH, heavily relies on low value-added industries, contributing to economic vulnerability.

The FBiH shows high unemployment rates, with a low rate of labor force participation which in turn heightens social risks and encourages migration outside the country over the years. The continuous outflow of workers, particularly the younger population, intensifies pressure on the labor market and exacerbates ageing trends which weighs on potential growth.

Over the past few years, FBiH has posted moderate debt levels with debt-to-operating revenue ratio at 58% in 2023 from 74% in 2022. The increase in operating revenue and decrease of the FBiH's nominal debt will drive the gradual fall of its debt levels (excluding self-supporting debt of government-owned entities) to 53% of operating revenue projected in 2024 and 40% in 2025. Moody's forecasts that the FBiH's debt affordability will remain strong, supported by the FBiH's low appetite for debt financing and underpinned by good market access, including the access to international financial institutions.

The FBiH's large investment needs are partly funded by the government-owned companies, cantons and municipalities, lifting their borrowing needs. When considering the debt of these entities, the total debt amounts to approximately 121% of operating revenue in 2023. However, Moody's considers the majority of the debt of FBiH's companies as self-supporting and therefore not posing significant risks to FBiH.

The BiH unique institutional framework allows for a large degree of fiscal autonomy, enabling each entity to tailor its fiscal policies. FBiH has a broader tax base than the central government, encompassing a wider variety of revenue sources with a power to set tax rates and define the tax base, except for the shared Value Added Tax (VAT) which is the sole responsibility of the central government.

Moody's expects that FBiH will sustain its solid operating performance in 2024-2025 driven by an increase in tax revenues, prudent budgetary management and control over the operating expenditure growth. Moody's forecasts BiH's real GDP growth to accelerate to 3% in 2024 up from 1.8% in 2023, driven by stronger private consumption, leading to a greater VAT proceeds, an important revenue source for the FBiH. This will drive the maintenance of solid gross operating balance of the FBiH at around 5% of projected operating revenue in 2024.

FBiH's cash and cash equivalents remain sound averaging BAM848 million throughout 2023, accounting for 15.5% of operating revenue and covering about 0.72x of debt servicing costs falling due over the next 12 months. Furthermore, FBiH has demonstrated access to external liquidity, securing funds from a diverse range of investors.

The B3 rating of FBiH incorporates a BCA of b3 and a low extraordinary support

assumption from the Government of Bosnia and Herzegovina (B3 stable).

## RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects FBiH's capacity to preserve its solid financial position, which provides some degree of shock absorption capacity, benefiting from a supportive institutional framework that secures strong revenue flexibility. The outlook also reflects Moody's expectation that the FBiH will maintain its debt burden at similar levels over the next two years.

## ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

FBiH's CIS-4 indicates that ESG considerations have a high impact on the current credit rating. This reflects the entity's exposure to a number of environmental risks, including physical climate risks, high exposure to social risks and a moderate governance profile.

FBiH's exposure to environmental risks (E-3) stems from physical climate risks, water management and natural capital. FBiH's main environmental risk exposure is related to physical climate risk and weather-related events such as floods, heatwaves and weather changes that impact crop yields and result in mitigation expenses and economic losses. FBiH also has important forestry and mining sectors which has led to some environmental degradation.

The (S-4) score assigned to FBiH reflects its high exposure to social risks primarily mirroring ageing population, negative net migration and high unemployment rates, in particular among the young and female population, with limited job opportunities which have led to high emigration. In long terms, these demographic challenges will hinder economic growth and put pressure on public finances.

The (G-3) score assigned to FBiH is largely influenced by the entity's somewhat good financial management practices and prudent budgetary assumptions. Their policies and guidelines on debt and investment management are mostly followed, although the debt management poses some risks as evidenced by high exposure to foreign currency. However, the existence of Currency Board and the fact that BAM is pegged to EUR mitigates this risk.

The specific economic indicators, as required by EU regulation, are not available for Bosnia and Herzegovina, Federation of. The following national economic indicators are relevant to the sovereign rating, which was used as an input to this credit rating action.

Sovereign Issuer: Bosnia and Herzegovina, Government of

GDP per capita (PPP basis, US\$): 18,524 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 4.2% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 14.8% (2022)

Gen. Gov. Financial Balance/GDP: 0.9% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: -4.3% (2022) (also known as External Balance)

External debt/GDP: 52.5% (2022)

Economic resiliency: b2

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

## SUMMARY OF MINUTES FROM RATING COMMITTEE

On 09 May 2024, a rating committee was called to discuss the rating of the Bosnia and Herzegovina, Federation of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, the issuer's institutions and governance strength, the issuer's governance and/or management, the issuer's fiscal or financial strength, including its debt profile, and the systemic risk in which the issuer operates.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of Bosnia and Herzegovina's sovereign rating would result in upward pressure on the FBiH's rating provided that FBiH continues to post solid operating and financial performance along with moderate debt levels.

A downgrade of Bosnia and Herzegovina's sovereign rating would lead to a similar action on the FBiH's rating. A significant deterioration in FBiH's financial performance and an increase in debt may also exert downward rating pressure.

The principal methodology used in these ratings was Regional and Local Governments published in January 2018 and available at <https://ratings.moodys.com/rmc-documents/66129>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

This rating action concerns a new rating for an issuer not previously publicly rated by us at the time that the EU sovereign release calendar was published, and is therefore being released on a date not listed in that publication.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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At least one ESG consideration was material to the credit rating action(s) announced and described above.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at [https://ratings.moodys.com/documents/PBC\\_1355824](https://ratings.moodys.com/documents/PBC_1355824).

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Gjorgji Josifov  
Asst Vice President - Analyst  
Sub-Sovereign Group  
Moody's Deutschland GmbH, Czech branch  
Washingtonova 17  
110 00 Praha 1 (Prague 1)  
Prague,  
Czech Republic  
JOURNALISTS: 44 20 7772 5456  
Client Service: 44 20 7772 5454

Sebastien Hay  
Associate Managing Director  
Sub-Sovereign Group  
JOURNALISTS: 44 20 7772 5456  
Client Service: 44 20 7772 5454

Releasing Office:  
Moody's Deutschland GmbH  
An der Welle 5  
Frankfurt am Main, 60322  
Germany  
JOURNALISTS: 44 20 7772 5456  
Client Service: 44 20 7772 5454

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