2016 Article IV Consultation Outreach Seminar

IMF Timor-Leste Team
Dili, Timor-Leste
February 11, 2016

Outline

- World Economic Outlook
- Key Recommendations of 2016 Article IV Consultation
- Cross-cutting Issues
  ➢ Financial Inclusion
  ➢ Economic Diversification
Su d ed de and, diminis ed prospects

World Economic Outlook

Subdued demand, diminished prospects

Continuing uneven recovery, with a more gradual pick-up in activity in 2016
- AEs asynchronous monetary policy (U.S. tightening; EA and Japan loosening)
- Continuing weaker prospects in EMs (rebalancing in China; low commodity prices)

Risks
- Increasing financial market volatility (capital flows reversals; liquidity shortages)
- Sharper slowdown in China
- Secular stagnation risks still present
- Geopolitical risks remain very relevant

A difficult challenge. Short and medium term policy action needed!
- More aggregate demand needed despite limited policy space
- Infrastructure investment
- Structural reforms
Growth 2015

Future growth downgraded
### Projections and Country Evolution 1

**Advanced Economies Real GDP Growth Projections**
(percent change from a year earlier)

<table>
<thead>
<tr>
<th></th>
<th>World</th>
<th>AEs.</th>
<th>U.S.</th>
<th>EA</th>
<th>Japan</th>
<th>U.K.</th>
<th>Germany</th>
<th>France</th>
<th>Italy</th>
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<td>(Jan 2016)</td>
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Source: IMF, World Economic Outlook.

### Projections and Country Evolution 2

**Emerging Market and Developing Economies Real GDP Growth Projections**
(percent change from a year earlier)

<table>
<thead>
<tr>
<th></th>
<th>EMDEs</th>
<th>China</th>
<th>India</th>
<th>Russia</th>
<th>LAC</th>
<th>Brazil</th>
<th>Mexico</th>
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<td>(Oct 2015)</td>
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<tr>
<td>(Jan 2016)</td>
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<td>(Oct 2015)</td>
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<td>3.1</td>
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</tbody>
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Source: IMF, World Economic Outlook.
Global Risks and Spillovers

➢ Sharp growth slowdown in China:
  ▪ Insufficient progress with reforms leads to a continued buildup of vulnerabilities
  ▪ Sharp slowdown in 2016-17
➢ Sharper-than-expected global growth slowdown:
  ▪ Significant slowdown in other large EMs/frontier economies
  ▪ Structurally weak growth in key advanced and emerging economies
➢ Tighter or more volatile global financial conditions:
  ▪ Sharp asset price decline and decompression of credit spreads
  ▪ Surge in the US dollar
➢ A sudden rise in global risk aversion could generate a broader contagion effects
➢ An escalation of ongoing geopolitical tensions affecting confidence and disrupting global trade, financial, and tourism flows

Policy Recommendations

Advanced economies
- Deal with legacies
- Continue with monetary accommodation where output gaps are negative and inflation too low (Euro area, Japan); smooth normalization (US)
- Absorb and integrate refugees
- Utilize fiscal space (Euro area)

Emerging market and developing economies
- Improve business climate/diversify export base
- Continue to use exchange rates as shock absorber as much as possible
- Evaluate tradeoffs before loosening monetary and/or fiscal policies
- Output gaps might be small despite growth slowdown
- Strengthens supervision and macroprudential frameworks

All countries
- Increase potential output – How?
- The case for infrastructure investment
- Which structural reforms to choose?
# Role of the IMF

Support members facing a changing world

| Ensure quick delivery of financial assistance | Agility | Improve provision of capacity building |
| Better integrate policy advice across sectors | Integration | Synergies between surveillance and capacity building |
| Deepen engagement with members | Member-Focused | Strengthen knowledge management and timely feedback |

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**Key Recommendations of Timor-Leste 2016 Article IV Consultation**
Recent Developments and Outlook

- Stable non-oil GDP growth
- Low inflationary pressure
- Fiscal and external balances deteriorated due to falling oil prices
- Petroleum Fund balance: first decline in value
- Oil prices remain low in the medium term
Policy Recommendations

- Preserve fiscal sustainability
  - Scale back ambitious plan to front-load public investment
  - Rationalize recurrent spending
  - Strengthen non-oil revenues
  - Commit to a medium-term fiscal consolidation plan
- Maintain an appropriate balance between promoting financial inclusion and safeguarding financial stability
- Facilitate economic diversification
  - Catalyzing private sector development

Cross-cutting Issues
Financial Inclusion
Financial inclusion: "Access to and use of formal financial services"

Financial institution access index
- ATMs and commercial bank branches per 100,000 adults

Users of financial services
- Accounts, including savings & mobile (adults, firms, women)
- Credit through financial institutions (by purpose, firms, adults, women)
- Wage & transfers through accounts (adults, women, income)
- Insurance

Date: Sahay et al. (2015); Index based on Financial Access Survey (IMF) time series

Date: Financial Access Survey 2004-13 (IMF); Survey data on users for 2011 and 2014, FinInx (World Bank); Enterprise Survey (World Bank) for firms for various years
Financial Inclusion → Growth?

Channels Similar to Financial Development

- Expands Investable Funds
- Provides Household & Firms Risk-Mitigating Tools
- Eases Transactions
Financial Inclusion: Positive but Effect on Growth Falls at High Levels of Financial Depth

**Marginal Effects on Growth**

Financial Inclusion (FI) = ATMs per 100,000 adults

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Financial Inclusion: Positive but Effect on Growth Falls at High Levels of Financial Depth

**Marginal Effects on Growth**

Financial Inclusion (FI) = Percentage of firms not identifying access to finance as a major constraint
Inequality in Access to Banks and in Income Go Hand-in-Hand

Gender Gap in Bank Accounts Coexists with Income Inequality

Note: Data on Gin coefficients are for the latest available year; higher values mean more inequality. Source: World Bank 2016. IMF staff calculations.
Financial Inclusion → Stability?

Trade-Offs and Synergies

- Systemic Risk
- Deposits as Stable Funding Base during Crisis
- Risk Mitigation Tools

Financial Stability: Risks with Broadening Credit Access Rise as Supervisory Quality Falls

![Graph showing the relationship between bank stability and the number of borrowers from commercial banks per 1,000 adults under different levels of Basel Core Principles.]

Source: IMF staff calculations.

Note: Bank stability is approximated by bank z-score, which captures banks’ distance-to-distress (the amount of buffers banks have against shocks to earnings).
Output Stability: Risks with Broadening Credit Access Rise as Supervisory Quality Falls

Source: IMF staff calculations.
Note: Growth volatility is approximated by the 3-year rolling standard deviation of GDP growth.

Cross-cutting Issues Diversification
International experience suggests:

Diversification depends on country circumstances

There is no one-fits-all answer

Diversifying away from oil is very difficult

Success or failure appears to depend on the implementation of appropriate policies ahead of the decline in oil revenues


The case of Mauritius:
Focus on comparative advantage areas...


Source: The Observatory of Economic Complexity, MIT.
...and move up the product ladder
Mauritius: Export Product Space (2013)

Note: Network shows the relatedness between products (See Hidalgo, Hausmann et al. (2007)).
Source: The Observatory of Economic Complexity, MIT.

Policies to support diversification

1. Growth with low inflation
2. Legal and regulatory framework
3. Promote trade and FDI
4. SME's access to finance
5. Enhance infrastructure efficiency

Landscape of Timor-Leste’s export products

Timor-Leste: Export Products (2013)

Source: The Observatory of Economic Complexity, MIT.

What are the comparative advantages of Timor-Leste?

Young labor force has potential

• Invest in education and vocational training
• Exploit opportunity to work abroad and bring capital, skill and know-how

Agriculture & tourism with branding and marketing

• Coffee, spices, candlenuts...
• Access to market, product innovation

Google Search Volume "Timor & Tourism"
Role of the Government?

✓ Enabling business environment
✓ Serve as a facilitator
✓ Establish an effective dialogue with the private sector for better partnership

  e.g. legal frameworks, regulatory rules, labor training services, market access, access to finance, and infrastructure