INTERNATIONAL MONETARY FUND

PRESS RELEASE NO. 16/492

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IMF Concludes Staff Visit to Timor-Leste

November 7, 2016

End-of-Mission press releases include statements of IMF staff teams that convey preliminary findings after a visit to a country. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. This mission will not result in a Board discussion.

- Economy activity in Timor-Leste is expanding at a satisfactory pace, and is likely to maintain the momentum into next year
- The medium-term outlook depends critically on economic diversification as oil fields in operation are expected to be depleted by around 2020
- Medium-term risks also lie in whether the front-loading of public investment would generate sufficient social and economic returns, which would help achieve inclusive growth

An International Monetary Fund (IMF) team led by Ms. Yu Ching Wong visited Timor-Leste during October 24–28 to assess recent economic developments and discuss government policies. The team met with Finance Minister Ms. Santina Cardoso, Central Bank of Timor-Leste Deputy Governors Ms. Nur-Aini Djafar Alkatiri and Ms. Sara Lobo Brites, and other senior officials, and held discussions with private sector and civil society representatives as well as development partners.

At the conclusion of the mission, Ms. Wong made the following statement:

"Economic activity is expanding at a satisfactory pace and is likely to maintain the momentum into next year. Real non-oil GDP in 2016 is expected to grow at 5 percent, supported by government spending. Consumer prices are expected to decline by 0.6 percent year on year in 2016, due to lower global food and oil prices. The external current balance is expected to turn to a deficit of 9.9 percent of GDP in 2016 due in large part to a sharp increase in imports related to the increase in public investments. The supplementary budget approved in July 2016 doubled capital spending. Additional capital expenditures of 15.6 percent of GDP has been allocated to projects under the infrastructure fund that are expected to advance ahead of schedule in 2016. As a result, the overall fiscal deficit in 2016 is widened to 13.9 percent of GDP. The increase in capital spending is financed through excess withdrawals from the Petroleum Fund (PF).

"The near-term outlook remains generally favorable with a continuing non-oil growth recovery accompanied by low inflation. The medium-term outlook however depends critically on economic diversification as oil fields in operation are expected to be depleted by around 2020. While the impact of current low oil prices to the PF is limited, as projected withdrawals from the PF are above the estimated sustainable income levels, the PF balance is expected to decline over the medium-term. Moreover, the investment returns of the PF are exposed to the volatility of global financial markets. Also, medium-term risks lie in whether the front-loading of public investment would generate sufficient social and economic returns, which would help achieve inclusive growth. Moreover, that would in turn translate into higher tax returns and fiscal sustainability.

"The Fund's past advice on the need for bold fiscal consolidation measures to ensure long-term fiscal and debt sustainability remains valid. Recurrent spending can be further rationalized by containing the increase in current transfers. While recognizing the need to close the infrastructure gap, the front-loading of capital spending warrants moderation given resource and capacity constraints.

"Public investment should be better prioritized, focusing on projects with higher returns determined by rigorous investment appraisal. This would help to ensure more "bang for the buck" in tapping into the PF. To further streamline plans for capital spending, the authorities should consider creating a mechanism to enable multi-year capital commitments and ensure that updates to the Strategic Development Plan include indicative costing to enable prioritization and selection.

"Through closer consultation with multilateral and bilateral development partners, the authorities can better anticipate the level of available concessional financing. The authorities should also consider developing a set of clear criteria to help identify public investment projects that would benefit additionally from knowledge transfer from partnership with multilateral and bilateral creditors.

"We welcome the progress in customs and tax reforms to mobilize domestic revenues. On the introduction of a value-added tax (VAT), in addition to the broad consultation on the draft VAT Law with domestic stakeholders, an early start in strengthening the tax administration capacity would help pave the way for a smooth implementation of the VAT. The IMF stands ready to provide technical assistance, in coordination with other development partners, in the design and implementation of the VAT and other fiscal reform initiatives.

"The banking system remains sound. As private sector credit growth has continued to lag behind rapid deposit growth, excess deposits placed abroad by banks have increased. Financial soundness indicators have improved; notably, the banks' non-performing loan ratio declined to 15 percent in September 2016 from 23 percent at end-2015 due largely to the resolution of legacy bad loans. The IMF team welcomes the steady progress in implementing the Financial Sector Master Plan aimed at raising financial inclusion and safeguarding financial stability.

"We would like to thank the authorities and our counterparts for their warm hospitality and for the candid discussions."

IMF Communications Department

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