Global economic developments hit Timor-Leste hard

By La’o Hamutuk, 13 March 2020 (revised 13 March)

Since 2015, Timor-Leste’s state revenues have depended on income earned from investing the money saved in the Petroleum Fund, rather than on royalties and taxes from extracting and exporting oil and gas.

In this investment-dependent condition, La’o Hamutuk decided to look into how global economic and financial market changes will affect the financial capacity and stability of Timor-Leste’s government operations. Although we cannot influence these events, we need to understand them.

This article is a preliminary analysis of how recent changes – from 12 February to 12 March 2020 – are impacting our Petroleum Fund (PF).

Falling equity prices

Equity (stock) markets in the U.S. and other countries dropped about 26% during the last 30 days. The PF owned about $6.6 billion in equities at the end of 2019.¹ Therefore, we have lost about $1.7 billion in the market value of our stocks. However, the market is very volatile, and we do not need to sell our stocks right now. If the market bounces back (as it did in 2019), we will lose less money, but if it continues to fall (as it did in 2008), we could lose a lot more.

Timor-Leste’s Petroleum Fund was the only one in the world which didn’t lose money during the 2008 global economic crisis, because we were not invested in stocks. (Norway lost about $90 billion.) In 2010, when the Petroleum Fund Law was being revised to allow more of the Fund to be used to buy stocks, La’o Hamutuk asked “How will Timor-Leste’s Government respond to opposition and public concern when the principal of the Petroleum Fund loses value due to market forces outside their control, or because of a poor decision by an external manager? How can we make sure that we don’t buy when prices are high and sell when they are low?”²

Even if we don’t sell the stocks, the balance in the PF is used to calculate the Estimated Sustainable Income (ESI) guideline for how much can be withdrawn sustainably from the Petroleum Fund. A fall of $1.7 billion

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in the Fund’s balance reduces ESI by $51 million – about twice as much as the State spends on agriculture every year.

**Falling interest rates**

Most of the Petroleum Fund is invested in government bonds, including $7.9 billion (as of the end of 2019) in those issued by the United States Treasury, and $1.6 billion in other countries. Yield rates of medium-term U.S. bonds have dropped to less than half of their previous levels. Last year, the Petroleum Fund received $420 million in interest and dividends, and this could drop to $200 million if rates stay where they are. If they fall further, Timor-Leste will receive even less in interest and dividends.

![Yield rates on U.S. Treasury bonds: down 53%](chart)

**Falling oil prices**

Although oil and gas exports are no longer Timor-Leste’s main source of income (and may end entirely in about three years), the Fund still receives some revenue from them. Last year, the Ministry of Finance projected that oil and gas revenues in 2020 would be $595 million, based on an expected Brent oil price of $62 per barrel. However, on 13 March the price was $33. If prices stabilize at around $35, petroleum revenues in 2020 will be less than half of what the Ministry projected, and the ESI would drop by about $12 million. If they fall further, the impact will be even more severe.

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$259 million of this was interest from bonds, and the rest was dividends from stocks. Both will be affected by changing interest rates (and dividends by reductions in corporate profits); the impacts will probably be similar.
Low oil prices will restrict petroleum development across the globe, including in Timor-Leste. If they stay low, projects will be less profitable for companies, and Bayu-Undan could stop production even earlier than 2022, as is currently planned. (This happened with Kitan in 2015.)

Companies and investors will reassess the economics of every future project – including on-shore exploration, Buffalo, Chuditch, Greater Sunrise and Tasi Mane – possibly leading to delays or cancellations. The bidding round that ANPM is currently conducting may attract less interest, because companies hesitate to embark on or invest in new projects when they are uncertain that they will make money.
Conclusion

If the prices and interest rates discussed above don’t get any worse (or better) during the rest of this year, by the end of 2020 Timor-Leste’s Petroleum Fund’s investments will have a net loss of about $1.5 billion, more than two billion lower than the $640 million gain the Ministry of Finance estimated in the proposed 2020 budget. In addition, oil and gas royalties and taxes will be $300 million less than the Government ‘prudently’ projected. The losses could continue in future years.

Last year, La’o Hamutuk projected that the Petroleum Fund could be empty by 2028, even if it is not used to pay capital costs of the Tasi Mane project. If current global trends persist, this will happen several years sooner.

The outgoing VIII Government intends to withdraw $250 million from the Petroleum Fund because the machinery of the state cannot continue to function without it. Since January (as in 2018), slower state spending has weakened Timor-Leste’s entire economy, making poor people even poorer. This reduced economic activity underscores how much our population depends on the state spending money from the Petroleum Fund – and how weak the rest of our economy is.

The recent threats to the Fund’s medium-term survival are not new, and could become even worse due to climate change and the reduced balance in the Fund. They remind us that Timor-Leste urgently needs to diversify its economy away from petroleum and investments. It is long past time to invest in our children’s health and education so that our productive, sustainable and equitable economy – agriculture, light industry and eco-tourism – can enable our people to survive and thrive. That is the only way to achieve the Petroleum Fund’s promise to benefit future generations.

Update, 14 March:

The above article was written on 13 March 2020, based on prices and yield rates at the close of business on Thursday 12 March. The following day, all three indices used in these calculations improved, and the drop in expected 2020 Petroleum Fund revenues if nothing changes is now $1.8 billion, a smaller loss than the $2.3 billion we calculated the day before. These numbers will change every day, and could get better or worse. The data is available at:

- S&P 500 Stock Market Index (2.71 on 13 March):
  https://www.marketwatch.com/investing/index/spx/charts

- U.S. Treasury Bond Yields (0.74% on 13 March):

- Brent oil price ($34.69 on 13 March):
  https://www.exchangerates.org.uk/commodities/live-oil-prices/BRT-USD.html