



Democratic Republic of Timor-Leste
Ministry of Finance



Pre-Budget Statement

2021

Including the 2020 Mid-Year Report

Preface

The publication of Timor-Leste's first-ever Pre-Budget Statement, including the Mid-Year Report, represents a significant step forward by the Ministry of Finance in the area of public financial management reform.

This document reports on the government priorities for the next fiscal year and for the medium term, describing their alignment to the proposed General State Budget. It details the proposed budget strategy for 2020, highlighting allocations to the various institutions, new measures and fiscal sustainability implications. It also outlines the macroeconomic and fiscal context, their key developments, risks and forecasts over the medium term. The issue also covers trends and projections for other sources of financing i.e. Petroleum Fund's revenues and returns, loans and grants.

The Pre-Budget Statement aims, above all, to enhance transparency and disclosure in Timor-Leste's budget process. As such, this report hopes to stimulate positive and constructive discussions across and within Government, Private Sector, Civil Society Organizations, International Partners, the People of Timor-Leste and other interested parties, expanding participation to the budget journey to all its stakeholders.

I am convinced that the 2021 Pre-Budget Statement will increase awareness and understanding of the Government's financial management and help the People become good and informed citizens by providing them with relevant information on the 2021 Pre-Budget and Mid-Year analysis.

I wish to express my appreciation to the Directorates and Units of the Ministry of Finance that have contributed to the drafting and compilation of this report, whose work has been essential to its publication.

This documentation is available for consultation on the website of the Ministry of Finance, www.mof.gov.tl. Inquiries relating to this publication should be directed to the General Directorate of Planning and Budgeting on e-mail jgama@mof.gov.tl – tel. +670 77852000, svaquim@mof.gov.tl – tel. +670 77305809 and epmartins@mof.gov.tl – +670 77879183.



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1 Technical Disclaimer

Timor-Leste's 2021 Pre-Budget Statement, including the Mid-Year Report, is published prior to the 2021 General State Budget Book. For this reason, all economic projections contained in this statement are preliminary in nature and may be amended in the 2021 General State Budget Book publication. Both the aggregate budget ceiling and the proposed allocations to Line Ministries, Self-Funded Agencies (SFAs), Municipal Authorities and other relevant entities, as approved by the Council of Ministers, may be subject to change, following the Budget Review Committee revision, the Parliamentary discussions and Presidential assessment. Finally all 2020 actual figures for revenue and expenditure are preliminary, and might be amended at the closure of the 2020 financial year, once reconciliation of accounts by the DG Treasury of the Ministry of Finance has occurred.

2 Executive Summary

Government Policy

Timor-Leste's 2017-2023 Strategic Development Plan is organized around four pillars: Institutional Framework, Social Capital, Economic Development and Infrastructure Development, where the last three have been designed as priority in the VIII Constitutional Government's mandate. The proposed 2021 Budget allocates the largest share to the Social Capital Sector, followed by Infrastructure Development, Institutional Framework and Economic Development. The proposed budget ceiling is set at \$1.6bn and its split across appropriation categories as in the table below.

Table 1: Combined Sources Budget 2018-2021, \$ Millions

	2018 Actual	2019 Budget	2020 Budget	2021 Budget
Combined Source Budget	1,343.9	1,681.2	1,681.1	1,755.1
Government Expenditures by Fund	1,172.7	1,482.0	1,497.1	1,600.0
CFTL (excl. loans)	1,119.0	1,375.0	1,426.4	1,497.7
HCDF	14.5	20.0	10.7	13
Borrowing/Loans (disbursements)	39.2	87.0	60.0	80.2
European Union (Direct Budget Support) & ILO*	-	-	10.6	9.1
Development Partner Commitments	171.2	199.2	184.0	155.1

Source: National Directorate of Budget and Development Partnership Management Unit, Ministry of Finance, 2020. *ILO one-off support in 2020

COVID-19

Timor-Leste recorded its first COVID-19 case on 21st March 2020. There has since been a total of 26 recorded cases in the country, all of which have so far recovered with no deaths. There has been no evidence of community transmission and the last active case was announced on 20th August.

Following the first confirmed case, Parliament declared a State of Emergency to run from 28th March to 27th April 2020. This was subsequently extended twice, firstly to 27th May and the 27th June. The country's first new case since 15th May was recorded on 3rd August and a new State of Emergency was reinstated on 6th August to run for another 30 days. The State of Emergency aimed to limit public movement through the suspension of public transport and banned large group meet-ups (5 or more people) including religious services, festivals, sporting events, cultural activities and the running of schools/universities. Non-resident foreigners were banned from entry and all returning Timorese had to complete a mandatory 14-day quarantine upon arrival in a government funded quarantine centre. Anyone experiencing COVID symptoms had to self-isolate and submit for testing. On 13th April, it was announced that the borders would close to all citizens, including Timorese, until further notice. International commercial flights were suspended.

The National Parliament approved a total amount of 536.3 million extra-ordinary withdrawal from the Petroleum Fund, with \$219.5 million to be set aside for an autonomous COVID-19 Fund where its planning and allocation is coordinated by the Integrated Crisis Management Centre (CIGC), while the Inter-ministerial Committee approved the measures to prevent and combat

COVID-19 before it's proceed to final execution approval by the Council of Management for COVID-19. The bill set out broad spending programs and sub-programs level, including \$198.3 million for prevention and combating COVID-19. This was focused on the acquisition of essential medical equipment and goods, the creation and maintenance of isolation centres and training for key staff. \$4.95 million was used to improve sustainable production and productivity and \$17.0 million to provide access to food and non-food services. The remainder of the extraordinary withdrawal totalled \$316.6 million is used to reinforce the Treasury account during the duo-decimal.

On 17 April, the government announced a 19-measure economic stimulus and response package, including deferral tax payments; a universal cash transfer provided a monthly basic income of \$100 to households earning less than \$500/month for up to 2 months. So far, 298,495 families have been supported by the scheme; Private sector employees unable to work owing to the state of emergency still received 60% of their salary provided by the government; All electricity consumers (over 160,000 individuals) received a \$15 credit per month during the state of emergency; Payment of water bills; social security contributions (workers and employers) and rent of government properties was be suspended; over 4,200 Timorese students currently abroad, unable to return to the country, received a stipend and students unable to attend school in Timor received an internet subsidy to allow them to study online; a 3-month emergency supply of rice was be purchased; and movement of food supplies across the country was subsidized, especially to more remote areas. The package also included the creation of new credit opportunities and a reduction in interest payments. Businesses were provided access to emergency loans to prevent bankruptcy and those importing essential goods were given credit guarantees.

Impact on the Petroleum Fund

During the global economic downturn due to COVID-19 outbreak, the Petroleum Fund saw a significant fall in its valuation, with an estimated loss of \$844 million (-4.7%) in Q1. This was mainly due to the global developed market equities falling by over 21% and a decline in the global oil price of over 65%. However the losses were partly offset by the positive return posted by the fixed income portfolio (3.95%) as global investors moved from emerging markets and risky assets to safe-haven assets such as US Treasuries and other USD-denominated instruments. The yield of sovereign bonds fell across the globe as major Central Banks cut interest rates and reintroduced quantitative easing in response to global economic contraction. The Fund currently invests 35 % in equity and 55% in US government bonds, with the rest kept in cash and private debt placement in Timor GAP E.P. A fall in the Fund will lower the Estimated Sustainable Income – the amount that can be withdrawn from the Fund without lowering its asset value. This is a key component of total government revenue – usually double the size of domestic revenue. The Fund's year-to-date return as of August was +6.47% (equivalent to \$1,128.5 million), bringing the annualized since inception return to +4.7%. The global developed market equities bounced back as economic activity started to improve with the easing of coronavirus lockdown restrictions. Sovereign bond yields saw little change.

There is still a high degree of uncertainty due to fear of second wave of COVID-19 as countries relaxing the lockdown measures and a bleak global economic outlook. The rapid decline in oil prices in March 2020 impacted expected 2020 Petroleum Revenues which are revised down to \$268.7million from the previous estimate of \$595.0, a fall of 55%. The internal studies in the Ministry of Finance show the calculated ESI is sensitive to changes in the oil price. However

those impacts are minimal as it only affects to less than 2% of the Petroleum Wealth which is now mostly in the form of financial assets.

Petroleum Fund Revenue

The Petroleum Fund revenues remain the main source of funding for the state budget. They consist of petroleum revenue and investment income. The Petroleum Fund projections are updated once a year as part of the Budget process. The proposed 2020 Budget Book presented to the National Parliament in September 2020 included preliminary figures for 2021.

The total petroleum revenue for 2021 is estimated to be around \$68.0 million and expected investment return is \$650.5 million. The preliminary estimate for 2021 ESI is \$535.6 million. The new expenditures ceiling for 2021 is set at \$1.6 billion, which includes estimated withdrawal of \$1,140.2 million. This is about \$605 million higher than the ESI.

Macro-Fiscal Overview

Economic growth is expected to contract by -6.0% in 2020 due to COVID and the delayed budget, but is expected to return to positive growth of 2.8% in 2021. This return to growth is driven by an end to political uncertainty and return to strong government expenditure. Meanwhile, inflation is expected to remain low and stable at 0.7% 2020 and 2.1% in 2021.

Domestic revenue reached \$86.7m by the end of June 2020, a decline of \$10.4m on collections at the same time the year before. While total revenue collections in Q1 2020 were up 9.8% on those in Q1 2019, they declined significantly in Q2 due to the impact of the global COVID-19 pandemic and the associated state of emergency enacted in Timor-Leste. Collections were 26.2% lower than the same time period of the previous year. Preliminary forecasts see domestic revenue set to equal \$172.3m by the end of 2020 and \$183.5 by the end of 2021. Following a fall in 2020, non-oil receipts are set to be on a consistent growth trend for the next 5 years; nearing \$215m by 2025 provided that positive macro-economic conditions hold. Enacting key fiscal policy reforms would help to increase this growth even further.

Historical Expenditure Analysis

The State Budget for 2020 has not been passed at the time of the publication of this report. Timor-Leste has been under duo-decimal DOT regime for the majority of 2020 as the budget was not passed on a regular schedule. Only up to 1/12 of the previous year's original budget can be distributed per month. This system means that the core functions of government can continue although some policies outside of normal annual activity will not be able to take place (for example the Census) or restrict significant infrastructure projects.

Allocations to Minor Capital and Capital Development will increase by a small amount in the last few months of the non-DOT 2020 budget, after it is passed by Parliament.

Please note that execution is calculated not on the basis of allocation from January-June in DOT 2020 and not total final budget which is yet to be passed. The total budget allocation till June in DOT 2020 is \$865.5 million with total execution of \$451.8 million.

Fiscal Sustainability Analysis

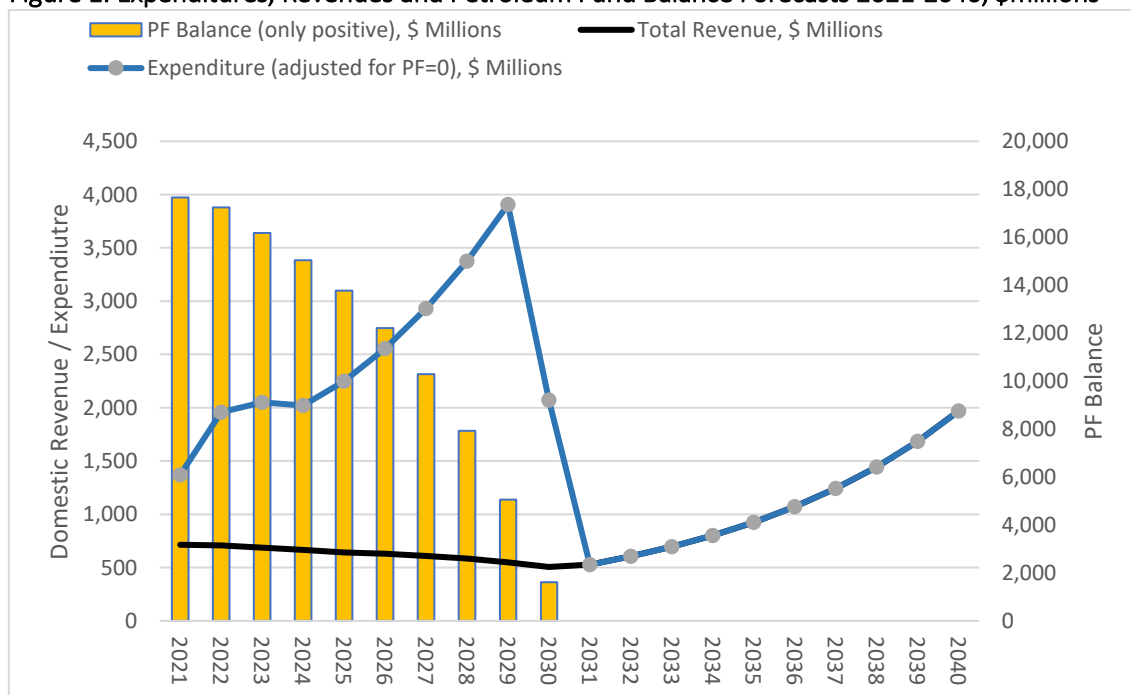
The economy of Timor-Leste is currently highly dependent on the Petroleum Fund for financing the fiscal deficit. The current government policy is one of front-loading expenditure, running high government budgets in the short run to finance capital spending for key infrastructure, with

the aim to encourage development of the private sector, increase diversification and grow the overall economy. A stronger non-government Timorese economy would require less funding from the Petroleum Fund in the future as the fiscal deficit would be smaller due to higher non-oil domestic revenues and a lower need for government spending to boost the economy in normal times.

The Ministry of Finance conducts a fiscal sustainability analysis for the budget ceiling chosen each budget cycle. Through the use of modelling, the impact of the selected budget ceiling on the long term sustainability of Timor-Leste can be estimated, specifically the overall balance of the Petroleum Fund. The model used mainly focuses on the impact of capital spending on longer-term GDP and domestic revenues and their bearing on the Petroleum Fund reserves. This is in line with the current front-loading policy.

Due to uncertainty of future variables in the model, e.g. the budget of future years, the model uses a number of assumptions. Firstly, it makes assumptions about the growth rates of the ceilings for all appropriation categories, based on historical data, while the growth of Capital and Development is estimated to follow the requested amounts set out by the Infrastructure Fund in the years 2021-2024 (including payments for Tasi Mane starting in 2022) and a long term growth rate based on past data after that. Short term GDP and inflation figures are based on forecasts by the National Directorate of Economic Policy in the Ministry of Finance. The long run growth rate of GDP, inflation and domestic revenue growth and the long term return on the Petroleum Fund are constructed using set base line levels. Changes to any of these assumptions would have significant changes on the forecasted end date of the Petroleum Fund. For example, if the rate of expenditure growth were to increase more than that assumed in the model, then the Petroleum Fund would finish quicker than forecasted. The ESI (Estimated Sustainable Amount) from the Petroleum Fund is set at 3% of the Petroleum Fund value and counted as part of Total Revenue. This means that as the amount of the Petroleum Fund falls, so does the amount of the ESI.

Figure 1: Expenditures, Revenues and Petroleum Fund Balance Forecasts 2021-2040, \$millions



Source: National Directorate of Economic Policy, Ministry of Finance, September 2020.

Under this fiscal ceiling, as well as the selected assumptions, the model estimates that the Petroleum Fund would run out in 2031, 11 years away.

As the Fund begins to get close to zero, expenditure would have to fall rapidly in order to match domestic revenues as that would be the only source of income (excluding external debt). ESI would no longer exist. The model estimates this would be mean an 87% fall in expenditure in two years (2029-2031), falling from \$3.9 billion to \$527 million (when expenditure must equal domestic revenue). If revenues do not rise as quickly as the model forecasts, the fall in expenditure would have to be even greater. Therefore it is vital that mobilisation of domestic revenues is a key focus of the government over the coming years.

It is important to state that the model does not factor in any effect to GDP when the Petroleum Fund balance hits zero, or close to it. This seems unlikely as the associated fall in expenditure would likely cause an economic downturn, with a fall in consumer and private sector spending and a decline in GDP. This downturn would also have an effect on domestic revenues, further decreasing possible expenditure.

Loans and Public Private Partnerships (PPPs)

Loans – At present, external loans are provided by international multilateral banks such as the Asian Development Bank and the World Bank, and one bilateral loan from JICA. These have a considerable degree of concessionality and compare favourably to the opportunity cost of withdrawing funds from the petroleum fund.

At the end of 2019, debt stock increased to \$192.20m. Considering the Covid-19 outbreak, fall in disbursement is expected in 2020 as construction projects may suffer delays.

There are currently 15 ongoing road projects funded by concessional loans of which 8 projects had already been completed. Other projects that most likely to be concluded by 2020/2021 bringing the total numbers of projects completed to nearly 70% by end the year.

Infrastructure development is expected to continue playing a key role in the country's economic development in the medium term. Strategic sectors such as water, education, telecommunication, and air transports should receive concessional financing. This would help unleash the growth potential of other key economic activities, leading to inclusive economic growth and poverty reduction. The Government is therefore proposing an estimated ceiling of \$465m for new concessional foreign loans to be negotiated in 2021.

PPPs – The PPPs projects are currently ongoing: the Tibar Bay Port PPP which is in the Implementation and Operation Stage, the Medical Diagnostic PPP, in the procurement and negotiation stage, the Affordable Housing PPP, Cristo Rei PPP and Presidente Nicolau Lobato International Airport, in Feasibility Stage.

Development Partners

Development Partners' support reached \$161.8m in 2019. It is forecast to rise to \$184.0m in 2020, a rise of 13.7%. This increase in development partner non-lending assistance is due to development partners' recognition of the importance of effectively tackling the effects of the coronavirus in Timor-Leste. The international community has been able to mobilize additional support in a short time frame in order to support the Government in properly responding to the global pandemic. 2021 is scheduled to experience a 15.7% decrease as compared to 2020

planned disbursements, with a forecast total of \$155.1m. This trend is due to continue into 2022.

3 Government Priorities and Budget Proposal

3.1 Government Priorities and New Measures

On August, 2020 the Council of Ministers approved the ceiling for the draft 2021 General State Budget (GSB), set at \$1.6bn, and its disaggregation to Line Ministries, SFAs, Municipal Authorities and other relevant institutions. Both the ceiling and its disaggregation are preliminary and may undergo amendments through the Budget Review Committee assessment, the Parliamentary debate and the Presidential evaluation.

The approved draft GSB aims to finance the VIII Constitutional Government's Program for the 2021 fiscal year. Six areas are defined as priorities for the 2021 Budget and of the remainder of the Government's mandate, 2021-2023:

Table 2: Priorities of the VIII Government, 2021

No.	Priority
1	Social Capital Development
2	Economic Development
3	Development of Key Infrastructure
4	Development and Protection of the Environment
5	Institutional Development
6	Reform to Key Pillars of Society

The proposed GSB allocations aim to reflect, therefore, such priorities. The aggregate allocation to each Pillar and their respective new measures are described below. **Please note all sectoral allocations described below are preliminary and do not include final budgets for new measures.**

Social Sector Development

- Create education and training opportunities which are of quality, inclusive and which respond to the needs of the economy.
- Continue to prepare the health sector in terms of quality and service delivery especially in response to the COVID-19 pandemic.
- Improve drinking water and sanitation infrastructure to ensure quality of life, health and prevention of disease.

Economic Development

- Focus on recovery of the economy following the economic downturn due to the impacts of COVID-19 in 2020.
- Facilitate investment in the private sector, prioritising small and medium size enterprises.
- Create employment options to increase national productivity and opportunity for all.
- Increase agricultural productivity and food security by improving and creating new infrastructure, distribution channels and storage of agricultural products.
- Diversify the economy and increase the growth rate in an inclusive and sustainable manner, following government priorities.

Development of Key Infrastructure

- Develop ports, airports, roads both urban and rural
- Development of logistical capacity both land, waterway and air

Development and Protection of the Environment

- Promote sustainable behavior and environment
- Emphasise the principle of reduce, reuse and recycle

Institutional Development

- Consolidate defence and foreign affairs institutions
- Consolidation of external relations

Reform to Key Pillars of Society

- Make improvements in the following sectors:
- Public Administration
- Economic Reform
- Judicial Reform
- Public Finance Management Reform.

3.2 Economic Recovery Package (ERP)

On 29th July, the Council of Ministers approved short term measures to be taken in 2020 to mitigate the impact of the economic crisis due to COVID-19. The principal objective of these measures were of aiding citizens to meet basic needs, assist those workings in the informal sector, secure jobs posts and income and assist businesses.

On the 12th August, the Council of Ministers approved a \$104.6m Economic Recovery Package of 71 measures with the objective of aiding the recuperation of the economy post COVID-19 between 2021 and 2023. The plan has 3 clear objectives:

- 1) Increasing employment: ensuring all jobs are both productive and dignified
- 2) Realisation and consolidation of public social investment programmes (Education, Health, Housing or Social Protection)
- 3) Review productive sectors and promote areas that contribute to economic growth

Nearly 90% of the 71 measures are included in the ongoing activities that integrated in the Dalan Ba Futuru Timor-Leste (DBFTL) system. These cost of these activities have already been included in the allocation given to converged LM/SFA/Ms. Some LM/SFAs will get additional economic recovery measures if they provide essential services/contribute to essential activities. The Ministry of Finance through DGMRE (Directorate-General for Resource Management and External Mobilization) will also map existing/new donor support received which will be detailed in Budget Book 5 2021.

Only the following 4 measures that are not in line with existing activities are:

1. Reinforcing support for projects such as “Quinta Portugal” or others of a similar nature, to increase technical assistance to coffee and other agricultural producers (measure number 9);
2. Create a state-owned company to boost the Tourism sector for the implementation of the tourism policy (measure number 10)
3. Construction of public fountains (measure number 23)
4. The acceleration of the entire process of installing optical fiber through the submarine cable that connects Timor-Leste with the rest of the world (measure number 70)

Table 3: Economic Recovery Package Measures 2021

LM/ IE	Number of Activites	Total Allocation of ERP	Description of New Measures (not including on going programmes)
MINISTRY OF COORDINATING ECONOMIC AFFAIRS	12	\$450,000	<ul style="list-style-type: none"> - Develop a normative framework linked to the importation of bags and plastic objects - Draft regulation relating to import and fees and charges reform - Encouraging sustainable livestock production - Direct microcredit support to each cooperative
SECRETARIAT OF THE PROFESSIONAL TRAINING EMPLOYMENT	10	\$1,354,000	<ul style="list-style-type: none"> - Identification phase of potential sites - Training for those working on the construction of roads, including via mobile training - Support the rehabilitation and construction of pre school, basic education school, primary and secondary and technic vocational, professional - Arrange career fairs for third year secondary/ technic vocational students across 12 districts and RAEOA - Draft regulations on compulsory registration of unemployed (contributory scheme) and conducted research and analysis on potential employment areas.
SECRETARIAT OF COOPERATIVE	2	\$3,500,000	<ul style="list-style-type: none"> - Consolidate and establish cooperatives to promote macro and small business and support integrated production
SECRETARIAT OF STATE OF ENVIRONMENT	3	\$540,000	<ul style="list-style-type: none"> - Reforestation and rehabilitation of degraded areas - Community Based Natural Resources Management programs - Conservation and management of crocodile habits - Develop sustainable water supply for use in Agriculture and ensure increased efficiency in water use to help combat climate change.
THE MINISTRY OF JUSTICE	4	\$2,067,000	<ul style="list-style-type: none"> - Approve and publish the “Land Law” and all other legislation associated with it

			<ul style="list-style-type: none"> - Prepare and approve the necessary regulatory framework for the operation of companies (such as bankruptcy, mergers, access to credit, etc.) - Improve the functioning of Courts giving them the ability to decide on civil / commercial and not just criminal cases in the universal implementation of the effective issuance of the “identity card” (with unique and lifetime identity number)
MINISTRY OF STATE ADMINISTRATION	3	\$14,324,000	<ul style="list-style-type: none"> - Invest in water and sanitation in rural and urban area - Decentralization administration - Conduct comparative study focused on South Korea - Study links between lines ministries to identify the necessary conditions for the establishment of the Citizenship store in a municipality as pilot/PDIM project.
MINISTRY OF EDUCATION, YOUTH AND SPORT	14	\$31,711,000	<ul style="list-style-type: none"> - Define a plan for the first phase of construction of 3 new CAFE and the second phase of 5 CAFÉ - Construct of 6 new buildings, 36 ESG classrooms, 5 new laboratory buildings, 8 new Library buildings, 8 ESG in 8 municipalities, 6 new computer rooms in 6 schools in 6 municipalities, 20 new school buildings and 3 new Ainaro CAFES - Rehabilitate 7 ESG school buildings across 7 municipalities - Create a new CAFE implementation plan defined by Liquica, Covalima and Baucau - Improve teacher training programs for the various teaching degrees (INFORDEPE)
MINISTRY OF HEALTH	6	\$12,651,000	<ul style="list-style-type: none"> - Construction of health posts and health services - Establish and construct specialized clinics in HNGV (Centre for Medical Treatment and Cardiologia Oncologia) with the expansion of a VIP room - Expansion and rehabilitation of hospital references - Construction of a pediatrics unit - Expansion of the Hospital Dr. Antonio Carvalho - Training and capacity building for health professionals - Ensure installation of the water supply to the health centers and health posts - Develop a the legal framework on the traditional medicine or treatment to integrate in the National Health system and promote community education about the use of traditional medicine and treatment and alignment traditional treatment
MINISTRY OF HIGHER EDUCATION,	4	\$1,935,000	<ul style="list-style-type: none"> - Create credit line to the universities allocated in DTG - Develop tourist and cultural infrastructure areas focusing on the preservation, conservation and promotion of Timor-Leste’s material and immaterial

SCIENCE AND CULTURE			cultural heritage - Form and manage the National Library in the management and licensing of Higher Education Institutions.
MINISTRY OF SOCIAL SOLIDARITY AND INCLUSION	6	Annual allocation continued and reallocated to new specialised secretariat	- All activities related is on annual alocation
MINISTRY OF PUBLIC WORKS	28	\$20,504,000	- Basic sanitation, bio-fuel and new storage methods
MINISTRY OF TRANSPORT AND COMMUNICATION	11	\$3,042,000	- Develop new web services, focusing on connectivity project NCB-VII
MINISTRY OF TOURISM, COMMERCE AND INDUSTRY	7	\$2,1 85,000	- Create a new tourism authority and tourism zone - Establiish a centre for industry to support and promote national industry to encourage import substitution
MINISTRY OF AGRICULTURE AND FISHERIES	32	\$5,178,000	- Improving access to market -Increasing production and diversification of agricultural products - Improving the management and preservation of natural resources - Develop the tourism sector through conservation and management of crocodiles
PUBLIC SERVICE COMMISSION	7	\$172,000	- Realise of the process of recruitment, promotion and placement - Provide the performance evaluation - Ensuring the payment of salaries and running disciplinary process - Coordinate and organize professional managers - Develop professional staff framework
BUSINESS REGISRATION AND VERIFICATION SERVICE (SERVICE AND AUTONOMOUS FUND)	2	\$438,000	- Prepare and approve the operation of the regulatory of the company framework (bankruptcy, mergers, access to credit) - Create a better communication mechanism between business registration and tax services to improve the efficiency

NATIONAL HOSPITAL GUIDO VALADARES (SERVICE AND AUTONOMOUS FUND)	3	\$1,739,000	<ul style="list-style-type: none"> - Strengthen public investment to expand hospital infrastructure - Develop, train and human resources awards accreditation to health - Promote constantly to improve and improve health personnel
NATIONAL HEALTH INSTITUTE	3	\$235,290	<ul style="list-style-type: none"> - Medical training for nurses, obstetricians, allies, managers and technical administrators.
NATIONAL CENTER FOR EMPLOYMENT AND VOCATIONAL TRAINING	17	\$41,000	<ul style="list-style-type: none"> - Operate “ Maubara residency nursery centers” - - Develop and manage key tourism infrastructure - Mobilise farmers to improve access to seeds and machinery
TIC TIMOR	4	\$2,493,000	<ul style="list-style-type: none"> - Accelerate the entire process of installing optical fiber through the submarine cable that connects Timor-Leste with the rest of the world
MINISTRY OF TOURISM, COMMERCE AND INDUSTRY	11	\$2,185,000	<ul style="list-style-type: none"> - Develop and promote of national to encourage import substitution - Establish a number of industrial centers - Reforms fees and charges - Develop, regulate and promote commercial activities - Control and regularization of commercial activities - Support to industry groups, artisanal producers and those in the food industry - Create the Timor-Leste Tourism Authority - Construct of a marketing and hospitality training center - Develop infrastructure and management of Tourist Sites - Create Integrated Tourism Development Zones, - - Support the development of community-based tourism

Source: General Directorate of State Finance, Ministry of Finance 2020.

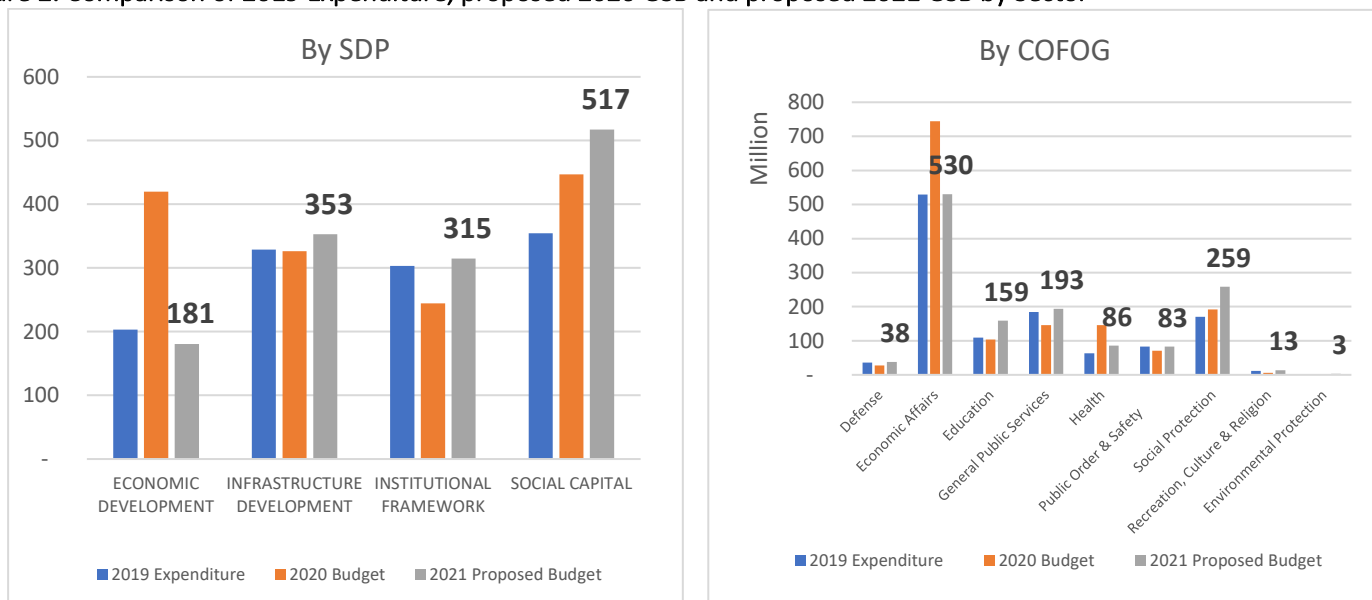
Analysis of the 2021 Proposed General State Budget by Sector

Timor-Leste’s 2017-2023 Strategic Development Plan is organized around four pillars: Institutional Framework, Social Capital, Economic Development and Infrastructure Development, where the last three have been designed as priority in the VIII Constitutional Government’s mandate. The proposed 2021 Budget allocates the largest share to the Social Capital Sector, followed by Infrastructure Development, Institutional Framework and Economic Development, and, excluding however loan disbursements and the transfer to ZEESM-RAEOA (see Figure 2, left-hand graph).

Following instead the international sectorial and more detailed classification COFOG (see Figure 1, right-hand graph), it can be observed that the Economic Affairs sector remains the largest, in line with previous year, followed by Social Protection, Social Protections, General Public

Services, Education and Health. It should be noted that Health and Economic Affairs sectors have a lower GSB compared to 2020, as they received a \$220 million economic recovery package in the previous GSB 2020.

Figure 2: Comparison of 2019 Expenditure, proposed 2020 GSB and proposed 2021 GSB by Sector*



Source: General Directorate of State Finance, Ministry of Finance 2020. *This does not include loans, minor capital, new capital measures of \$10 million and allocation to RAEOA-ZEESM that are currently under discussion. Please note that all 2021 Infrastructure Fund allocations are preliminary and may change.

3.3 2021 General State Budget (GSB) Proposal

The VIII Constitutional Government has approved a Budget ceiling of \$1.6bn, whose disaggregation according to spending categories is reported in the table below.

Table 4: Proposed 2021 Budget by Appropriation Category, \$ Millions

Appropriation Category	Proposed 2021 Budget
Salary and Wages	216.2
Goods and Services	438.0
Public Transfers	480.7
HCDF	13.0
Public Transfers- RAEOA	127.0
Total Recurrent Expenditure	1,274.9
Minor Capital	6.0
Capital and Development (IF)	198.8
Capital and Development (LM, PDIM)	30.9
Total Capital Expenditure	235.8
Loan Disbursements	80.2
Support from EU-DBS	9.1
Total New Measures (included in appcat above)	104.6
Total Budget Ceiling	1,600.0

Source: General Directorate of State Finance, Ministry of Finance 2020.

Recurrent expenditure amounts to \$1.27bn. This budget includes \$104.6 million economic recuperation package that has been allocated to various ministries and agencies that align with

government priorities (see section 3.1). Salaries and Wages have increased nearly 5% in comparison to Proposed GSB 2020 while Goods and Services have decreased (9.4%). The overall recurrent package however remains in line with proposed GSB 2020. RAEOA is set to receive \$127.0 million in 2021 in comparison to \$76.0 million in proposed GSB 2020.

The Capital and Development fiscal ceiling is preliminarily set at \$309.9 million, including loan disbursements. This amount is to be allocated according to Table 5, where 64.1% falls under the Infrastructure Fund management and includes the budget for loan disbursements, and the rest is allocated to Line Ministries, SFAs and Municipalities. New capital measures will be discussed and presented in the expedited Budget Review Committee.

Table 5: Proposed Allocation of the Capital and Development 2021 Budget by Institution, \$ Millions

Institution	Proposed 2021 Budget
Infrastructure Fund (New and Ongoing Measures)	198.8
Infrastructure Fund (Loans)	80.2
Line Ministries, Autonomous Agencies (New and Ongoing Measures)	25.0
Integrated Municipal Development Plan	5.9
Total	309.9

Source: General Directorate of State Finance, Ministry of Finance 2020.

The sources of financing of the proposed GSB are highlighted in Table 6. 41.1% of the proposed fiscal ceiling will be financed through *sustainable* domestic sources i.e. non-oil domestic revenue and the Estimated Sustainable Income of the Petroleum Fund; 58.9% oil and external sources, specifically loan disbursements (4.6%) and withdrawals in excess of the ESI (45.2%). Direct Budget Support from the EU (0.5%) and other development partners (8.6%) make up the remaining amount.

This shows how Timor-Leste's remains highly dependent on both oil-derived (ESI and Excess Withdrawals) and external (loan disbursements) financing streams. Fiscal Sustainability analysis on the proposed ceiling predicts that the Petroleum Fund will be depleted by the year 2031, at historic baseline assumptions of medium- and long-term revenue, expenditure and GDP growth, and excluding the costs or benefits from the Greater Sunrise development.

Expanding the sustainable, domestic and non-oil revenue base remains key to ensure the country's long-term sustainability and development.

Table 6: Revenue and Financing Source of the Proposed 2021 General State Budget*, \$ Millions

Revenue	Proposed 2021 Budget
Domestic Revenue	183.5
Estimated Sustainable Income	535.6
Financing	
Excess Withdrawals from the Petroleum Fund	791.6
Loan Disbursements	80.2
Cash Balance	0.0
European Union (Direct Budget Support)	9.1
Development Partner Commitments	155.1

Source: General Directorate of State Finance, Ministry of Finance 2020. *Please note that all figures will be recalculated before the final budget proposal.

Disaggregation of the proposed 2021 General State Budget by receiving Public Entity

The tables below present the proposed 2021 GSB divided by Line Ministries and SFAs and Municipal Authorities' allocation, comparing it with the 2019 actual and proposed 2020 GSB.

Table 7: Proposed Allocation to Line Ministries, \$

Sector	Name	Actual 2019	Proposed GSB 2020	Proposed GSB 2021	Change from 2019 Actual	Change from prop. 2020 GSB
SOCIAL CAPITAL	Secretariat of State for Equality and Inclusion	1,383,608	959,910	1,457,822	5%	52%
	Ministry of Health	40,290,927	42,716,222	58,715,975	46%	37%
	Ministry of Education, Youth and Sports Including SEJD	78,280,614	68,048,920	111,896,846	43%	64%
	Secretariat of State for Youth and Sport	7,164,796	2,431,878	7,747,871	8%	219%
	Ministry of Higher Education, Science and Culture Including SEAC	5,051,116	5,429,323	9,330,499	85%	72%
	Ministry of Social Solidarity and Inclusion	54,756,235	59,286,030	59,303,355	8%	0%
	Ministry of National Liberation Combatants Affairs	95,991,047	97,683,732	100,520,098	5%	3%
INSTITUTIONAL FRAMEWORK	Prime-Minister	8,667,795	6,928,645	7,905,135	-9%	14%
	Minister of State for the Presidency of the Council of Ministers	4,424,551	4,016,496	4,509,789	2%	12%
	Ministry of Legislative Reform and Parliamentary Affairs Including SECS	6,000,059	4,729,787	6,616,027	10%	40%
	Ministry of Finance	16,407,806	16,491,152	16,883,650	3%	2%
	Appropriations for all of Government	142,895,623	163,447,294	170,507,511	19%	4%
	Ministry of Foreign Affairs and Cooperation	22,428,528	20,644,239	22,914,129	2%	11%
	Ministry of Justice	18,067,118	11,072,492	20,575,510	14%	86%
	Ministry of State Administration	18,343,991	14,704,411	32,702,844	78%	122%
	Ministry of Defense	25,766,404	21,493,521	33,259,924	29%	55%
	Ministry of Interior	44,715,253	45,749,819	46,270,601	3%	1%
	Ombudsman for Human Rights	1,420,842	1,155,894	1,458,612	3%	26%
INFRA. DEVELOPMENT	Ministry of Planning and Strategic Investment	4,767,444	3,536,341	6,739,176	41%	91%
	Ministry of Public Works	109,434,817	187,899,600	176,741,600	62%	-6%
	Ministry of Transport and Communications	5,379,529	6,029,857	8,841,135	64%	47%
ECONOMIC DEVELOPMENT	Ministry of State, Coordinator of Economic Affairs	715,425	113,738,902	1,490,535	108%	-99%
	Secretariat of State for Vocational Training Policy and Employment	4,814,197	3,570,006	6,886,729	43%	93%
	Secretariat of State for Cooperative Sector	2,936,166	2,481,151	7,718,370	163%	211%

Secretariat for State for Environment	1,158,786	957,841	1,785,394	54%	86%
Ministry of Tourism, Commerce and Industry	5,323,584	4,290,192	10,352,730	94%	141%
Ministry of Agriculture & Fisheries	11,908,236	7,038,645	19,892,578	67%	183%
Ministry of Mineral Resources and oil	24,827,701	27,651,475	36,193,849	46%	31%

Source: General Directorate of State Finance, Ministry of Finance 2020.

Ministries belonging to priority sectors have received budget increase compared to the proposed GSB 2020. These include Ministry of Agriculture (+31%), Ministry of Tourism, Commerce and Industry (+141%), Secretariat of State for Cooperative Sector (+211%), Secretariat of State for Vocational Training Policy and Employment (+93%), Ministry of Planning and Strategic Investment (+91%), Ministry of Justice (+86%), Ombudsman for Human Rights (+26%), Ministry of State Administration (+122%), Ministry of Education, Youth and Sports Including SEJD(+64%), Ministry of Higher Education, Science and Culture Including SEAC (+72%), and Ministry of Social Solidarity and Inclusion (+1%). Please note that the Ministry of State, Coordinator of Economic Affairs appears to have received a massive reduction because it received the economic recovery package in proposed GSB 2020 as a one-off transfer.

Table 8: Proposed Allocation to SFAs in GSB 2021, \$

SDP Sector	SFA	2021 Proposed Budget	% change from proposed GSB 2020
Economic Development	Institute of Support for Enterprise Development (Self-Financed Autonomous with Own Revenues)	1,070,917	24%
	Specialized Agency for Investment (Self-Financed Autonomous with Own Revenues)	1,238,219	-52%
	Registry and Business Verification Services (Self-Financed Autonomous with Own Revenues)	1,537,500	-32%
	Bambu (Self-Financed Autonomous with Own Revenues)	517,134	-25%
	Training Center SENAI (Self-Financed Autonomous with Own Revenues)	353,238	-94%
	Centro de Logístico Nacional	1,936,521	115%
	Autoridade de Inspeção Alimentar e Fiscalização da Atividade Económica, Sanitária e Alimentar (Serviço e Fundo Autónomo)	718,445	-94%
	Centro Nacional de Emprego e Formação Profissional - Tibar	1,403,814	22%
	Instituto Nacional do Desenvolvimento de Mão-de-Obra	545,991	-10%
	Commission for Administration of the Infrastructure Fund (FI)	731,695	98%
Infrastructure Development	Institute for Equipment Management (Self-Funded and Autonomous with Own Revenues)	3,025,576	118%
	Administration of Ports of Timor-Leste (Self-Funded and Autonomous Service with Own Revenues)	3,957,510	296%

	National Communications Authority (Self-Funded and Autonomous Service with Own Revenues)	842,132	-20%
Institutional Framework	Presidency of the Republic	6,384,386	848%
	National Parliament	13,009,984	1869%
	Courts	6,382,540	588%
	Prosecutor-General of the Republic	3,637,488	1109%
	Anti-corruption Commission	1,159,473	318%
	Public Service Commission	2,351,348	114%
	Forensic Police of Criminal Investigation (Self-Financed Autonomous with Own Revenues)	1,601,284	-87%
	National Defense Institute (Self-Funded and Autonomous with Own Revenues)	1,249,583	129%
	National Intelligence Service (SNI)	1,507,779	-79%
	State Inspectorate General	832,049	-88%
	National Institute of Public Administration	946,512	68%
	National Electoral Commission	8,488,887	1330%
	Council for Definitive Delimitation of Maritime Boundaries (Administrative and Financial Autonomy without Own Revenues)	1,145,861	475%
Social Capital	National University Timor Lorosae (Self-Financed Services with own revenues)	14,771,072	1911%
	Archive and Museum Resistência Timorese	2,062,359	292%
	Press Council (Self-Financed Autonomous with Own Revenues)	754,166	206%
	National Hospital Guido Valadares (Self-Financed Autonomous with Own Revenues)	11,569,590	135%
	SAMES (Self-Financed and Autonomous with Own Revenues)	6,008,433	71%
	National Laboratory (Self-Funded and Autonomous with Own Revenues)	624,682	-42%
	National Center for Rehabilitation (Self-Funded and Autonomous with Own Revenues)	873,125	-74%
	Agência Nacional para Avaliação e Acreditação Académica (Autonomia Administrativa e Financeira com Receitas Próprias)	455,021	2%
	Institute of Health Sciences (Autonomia Administrativa e Financeira com Receitas Próprias)	1,222,500	-83%
	Commission for Administration of the Human Capital Fund (FDCH)	13,000,000	21%

Source: General Directorate of State Finance, Ministry of Finance 2020.

Table 9: Proposed Allocation to Municipal Authorities, \$

Municipal Authority	Proposed Budget 2021
Administração Municipal de Aileu	2,157,027
Administração Municipal de Ainaro	2,551,413
Administração Municipal de Covalima	2,773,358
Administração Municipal de Lautém	2,837,133
Administração Municipal de Liquiçá	2,264,186
Administração Municipal de Manatuto	2,655,918
Administração Municipal de Manufahi	2,686,998
Administração Municipal de Viqueque	2,719,847
Autoridade Municipal de Baucau	3,431,315
Autoridade Municipal de Bobonaro	3,628,392
Autoridade Municipal de Dili	5,856,767
Autoridade Municipal de Ermera	2,737,402

Source: General Directorate of State Finance, Ministry of Finance 2020.

4 Macro-Fiscal Overview

4.1 Summary

Table 10: Economic Indicators, 2020-2022, %

Summary	Forecast		
	2020	2021	2022
Real GDP (non-oil)	-6.0%	2.8%	2.0%
Inflation CPI	0.7%	2.1%	2.7%

Source: Ministry of Finance, National Directorate of Economic Policy, 2020.

- Real non-oil GDP growth is expected to contract by 6% in 2020 due the combined effect of the Budget being delayed, political uncertainty, COVID -19 and the State of Emergency.
- 2021 is due to see GDP return to positive growth of 2.8% as a result of a rebound in private investment and household consumption, assuming the Budget is passed.
- Inflation is expected to remain low and stable at 0.7% in 2020 and 2.1% in 2021. This will positively contribute to increasing Timor-Leste's competitiveness, with inflation expected to be lower than the regional average.
- Between May 2019 and May 2020 the US dollar appreciated by 4.6% against a weighted basket of currencies of Timor-Leste's trading partners (the nominal effective exchange rate, NEER). There has been a small overall appreciation in the last few years which has reduced the price of imports, placing downward pressure on domestic inflation, benefiting Timorese consumers. However, this appreciation also makes Timorese non-oil exports more expensive in international markets constraining the development of the country's exports.
- The exchange rate forecast suggests a small depreciation with Timor-Leste's trading partners in the medium term, 2021 to 2024, which should provide a boost to competitiveness.

4.2 Macroeconomic Trends

4.2.1 Growth

Timor-Leste

Given the relatively small level of employment in the oil sector, total GDP is not the best measure of economic performance for Timor-Leste. Instead, it is more useful to monitor economic performance using non-oil GDP together with a wide variety of other indicators relating to the non-oil economy. This approach provides a more accurate indication of the real impact of changes in the economy on the people of Timor-Leste.

In 2018, non oil real GDP in Timor-Leste decreased by -3.8% to \$1,578.1m. National Accounts data exist up to 2018, which is the latest year of GDP data available without forecasting.

Timor-Leste experienced GDP growth, averaging 3.3% per year over 2010-2018. These growth rates have been driven by increases in government expenditure associated with the government's economic strategy to ensure that Timor-Leste has the necessary infrastructure to

allow the private sector to flourish in the long-run. The Government’s economic strategy uses loan financing and excess withdrawals¹ from the Petroleum Fund to finance high quality investment in infrastructure and human capital development. As outlined in Timor-Leste’s Strategic Development Plan, the Government’s high return investments will provide the necessary foundations for long-term sustainable private sector led development. Government investment has enabled a significant upgrade to road and electricity coverage throughout Timor-Leste, which has helped to improve both living standards and the business environment.

Non-oil GDP growth in 2019 shows signs of recovery from the recent episodes of negative growth (-3.8% in 2017 and -0.8% in 2018). The contraction was a consequence of declines in government expenditure, private sector investment, and lower exports. Political uncertainty also led to lower development partner spending and reduced business activity. The coffee harvest, the main source of exports, was affected by a poor season. The preliminary forecast for 2019 indicates a return to growth of around 2.7%. This is largely due to political stability, boosting business activity and household consumption.

International

Table 11: Growth Indicators, 2018-2021, %

Country	Actual		Forecast	
	2018	2019	2020	2021
World	3.6%	2.9%	-3.0%	5.8%
Advanced Economies	2.2%	1.7%	-6.1%	4.5%
Emerging and Developing Economies	4.5%	3.7%	-1.1%	6.6%
Emerging and Developing Asia	6.3%	5.5%	1.0%	8.5%
China	6.8%	6.1%	1.2%	9.2%

Source: IMF World Economic Outlook April 2020.

Global growth outlook is projected to contract by –3.0% in 2020. Advanced economies are forecast to shrink the most by -6.1%, while growth for emerging markets and developing economies is forecast to fall -1.1%. The fall in global growth was driven mostly by the outbreak of COVID-19. The U.S. economy is projected to contract this year by -5.9%. However, China will maintain positive growth of 1.2% in 2020.

Global growth is expected to rebound to 5.8% in 2021, the advanced economy group is forecast to grow at 4.5%, while growth for the emerging market and developing economy group is forecast at 6.6%. However, the rebound in 2021 is uncertain and depends on how fast the pandemic will fade. A lot of effort have been done in accommodating the public health requirements around the world to prevent the spread of the virus, nonetheless this policy limited the economic activity and the financial system which is contributed to the decline in growth in 2020. Nevertheless high levels of growth, especially in Asia, still provides a solid foundation for Timorese exporters and economic development. The international environment provides favourable conditions for Timor-Leste to take advantage of in 2020 and beyond.

¹Withdrawals from the Petroleum Fund in excess of the ESI.

4.2.2 Prices and Inflation

Table 12: Global and Regional Inflation Rates (%)

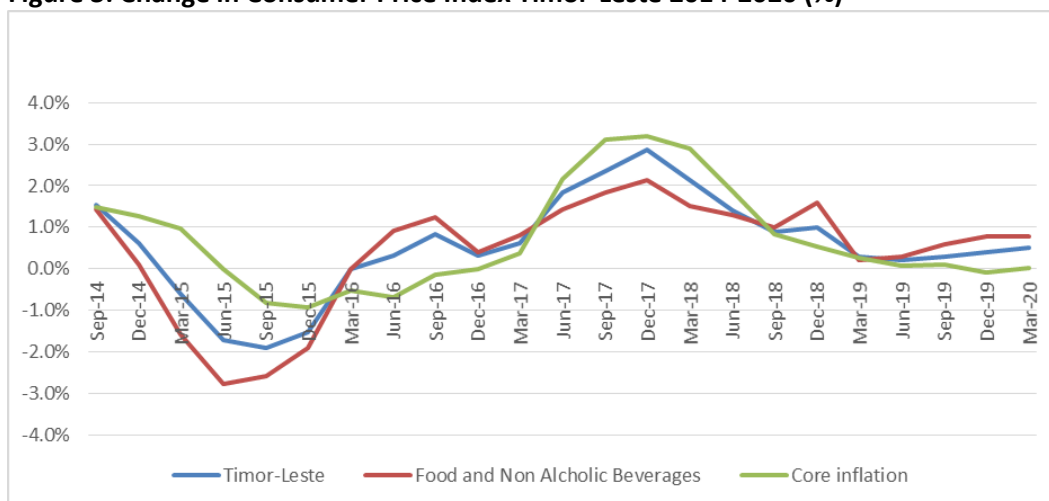
Country	Actual		Forecast	
	2018	2019	2020	2021
World	3.6%	3.6%	3.0%	3.3%
Advanced Economies	2.0%	1.4%	0.5%	1.5%
Emerging and Developing Economies	4.8%	5.0%	4.6%	4.5%
Emerging and Developing Asia	2.6%	3.2%	3.0%	2.9%
Timor-Leste*	2.3%	0.9%	0.7%	2.1%

Source: IMF World Economic Outlook April 2020. *Ministry of Finance forecast.

Timor-Leste

With year on year inflation in June 2020 of 0.5%, Timor-Leste still enjoys a low level of inflation. Due to the significant weight of food and non-alcoholic beverages in the CPI basket and the high proportion of food imported into Timor-Leste every year, international food prices remain one of the key drivers of the overall CPI rate, and the MoF continues to monitor price levels. The World Bank (WB) food price index has remained stable between May 2019 and May 2020 increasing just 0.5%. Domestic food prices have also been muted seeing a small increase of just 0.8% in the same timeframe. It is expected that the current world food prices will fall slightly in 2020 and then experience a small uptick in 2021 but remain stable. Rice specifically is a staple part of the Timorese diet. The benchmark Thai 5% rice is expected to increase 8% in between 2019 and 2020, this will have a negative effect on poorer households where basic foods make up the majority of their spending and this will leave them with less disposable income. Coffee prices (both Arabica and Robusta) are expected to decrease 3% and 7% respectively in 2020. This will negatively affect those families who rely on coffee production in Timor-Leste.

Figure 3: Change in Consumer Price Index Timor-Leste 2014-2020 (%)



Source: Ministry of Finance, National Directorate of Economic Policy and General Directorate of Statistics, 2020.

International

Global inflation forecast at 3.0% by the IMF in 2020. The decline in the commodity prices especially lower oil prices have contributed to the sharp falls in consumer price inflation in the advanced economies. However, the inflation is projected to soften in the coming years. For the emerging market economies, inflation has been rising reflecting the impact of currency depreciation and higher commodity prices, but it is projected to moderate as the impact of tighter monetary policy and recent declines in oil prices. Low inflation in Timor-Leste in this context will tend to help improve competitiveness.

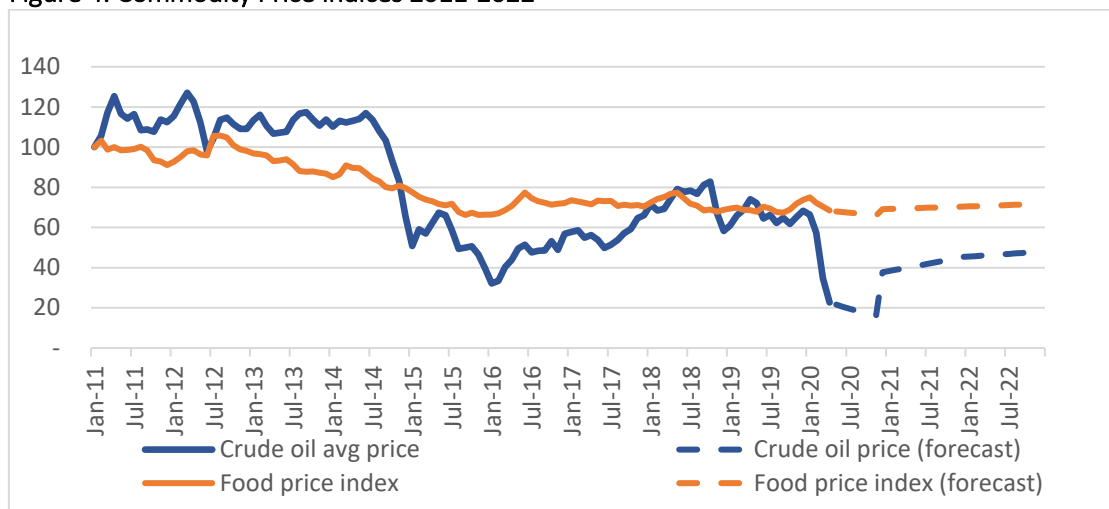
Oil prices

Oil prices are important to Timor-Leste both for consumers, through consumer prices, and as an oil exporting country. The average international price of crude oil has witnessed dramatic declines since June 2014 from highs of \$108.4 per barrel to lows of \$29.8 per barrel in January 2016. The decline in oil prices was driven by the increased global supply during a period of low global demand. Following this prices had started to recover with oil prices for 2019 averaging at \$64 per barrel. However, global demand for oil has drastically declined since the onset of the COVID-19 pandemic. Since the beginning of January 2020, many governments' around the world imposed restrictions on travel and temporary business closures to stem outbreak. Oil prices fell to \$21/barrel in April 2020, however, the average is expected to be slightly above \$40/barrel for 2020, down 33% from 2019. Prices are expected to rise to \$50/b in 2021.

Agricultural Commodity Prices

A significant portion of the food consumed in Timor-Leste is imported and thus changes in international food prices can have a significant impact on both the rate of inflation and standard of living. According to the World Bank Commodities Price Index (2011=100), international food prices have continued to decline from a high of 105.8 in August 2012, though prices had been stable averaging at 73 and 70 in 2018 and 2019 respectively. The World Bank is forecasting that food prices will fall marginally in 2020 and then recover in 2021 and 2022, however the increase is small, and overall food prices are expected to remain stable. Rice specifically is a staple part of the Timorese diet. The benchmark Thai 5% rice is expected to increase 8% in between 2019 and 2020, this will have a negative effect on poorer households where basic foods make up the majority of their spending and this will leave them with less disposable income. Coffee prices (both Arabica and Robusta) are expected to decrease 3% and 7% respectively in 2020. This will negatively affect those families who rely on coffee production in Timor-Leste.

Figure 4: Commodity Price Indices 2011-2022



Source: Ministry of Finance, National Directorate of Economic Policy and General Directorate of Statistics, 2020.

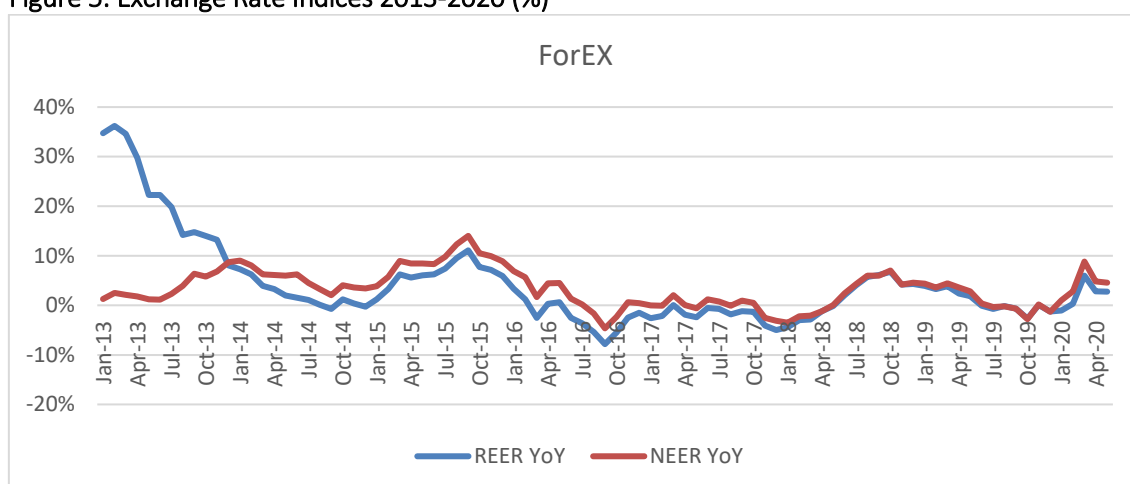
4.2.3 Exchange Rates and Competitiveness

Between June 2019 and June 2020 the US dollar appreciated by 3.0% against a weighted basket of currencies of Timor-Leste’s trading partners (the nominal effective exchange rate, NEER). There has been a small overall appreciation in the last few years which has reduced the price of imports, placing downward pressure on domestic inflation, benefiting Timorese consumers. However, this appreciation makes Timorese non-oil exports more expensive in international markets constraining the development of the country’s exports sector.

An inflation-adjusted measure of the exchange rate, the real effective exchange rate (REER), is a better measure of competitiveness. If inflation in Timor-Leste is lower than in other countries, this can help mitigate exchange rate appreciation. The REER has appreciated by 1.3% between June 2019 and June 2020, driven by the exchange rate changes captured in the NEER and lower inflation in Timor-Leste compared to its neighbours over the last year.

The inflation rate in Timor-Leste is expected to be lower than its neighbours in the near future, and so Timor-Leste can expect an improvement in competitiveness. This will help the Timorese export market be well-placed in the international market. While this is to be welcomed, the government is not complacent about the issue of competitiveness. A key priority is improving the business environment to encourage improved competitiveness, and the inflation target policy is a part of meeting the priority.

Figure 5: Exchange Rate Indices 2013-2020 (%)



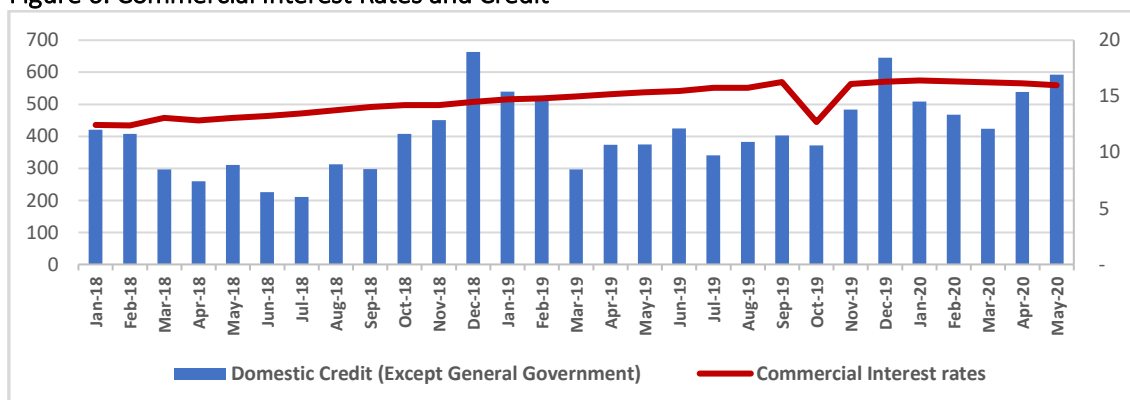
Source: Ministry of Finance, National Directorate of Economic Policy and General Directorate of Statistics, 2020.

4.2.4 Financial Sector Trends

Commercial Interest Rates and Credit

The amount and cost of credit to the private sector is an important indicator for private sector development. Loans to the private sector were at an average interest rate of 15.99% in May 2020, these have been stable with a slight increase over the last year (15.36% in May 2019). Total domestic credit, excluding general government, was \$592 million in May 2020, with an average of \$458 million over the prior 12 months.

Figure 6: Commercial Interest Rates and Credit



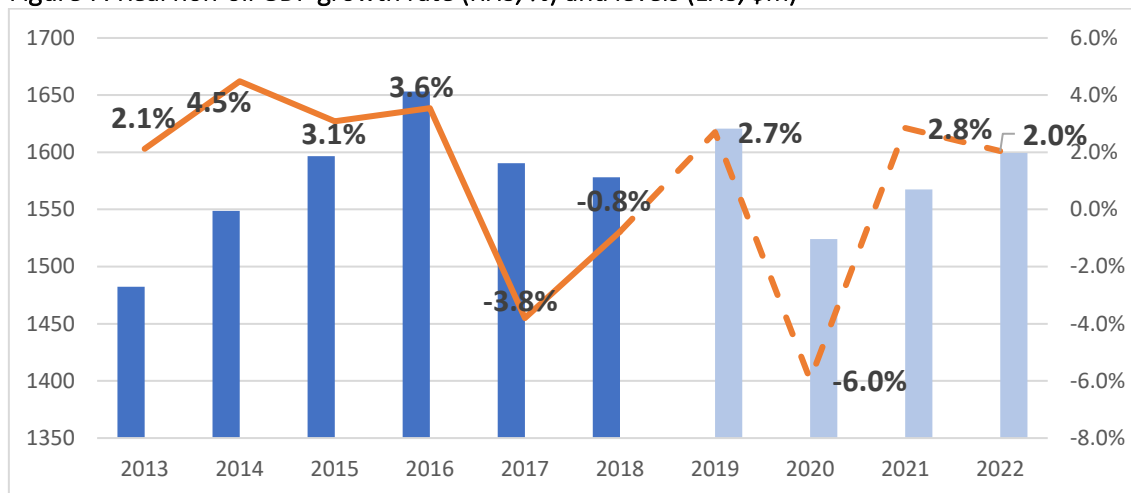
Source: Banco Central Timor-Leste, 2020. Interest Rate (RHS, %), Credit (LHS, \$m).

4.3 Economic Outlook

The Ministry of Finance is forecasting non-oil GDP growth to be -6.0% for 2020. This is due to the delayed Budget approval which restrains public spending and political uncertainty which has a negative impact on the private sector along with the impact of the COVID crisis and associated state of emergency. 2021 is due to see GDP return to positive growth of 2.8% as a result of a rebound in private investment and household consumption, assuming the Budget is passed.

Over the medium term, Ministry of Finance expects return to positive sustainable growth based on political stability and private sector investment.

Figure 7: Real non-oil GDP growth rate (RHS, %) and levels (LHS, \$m)



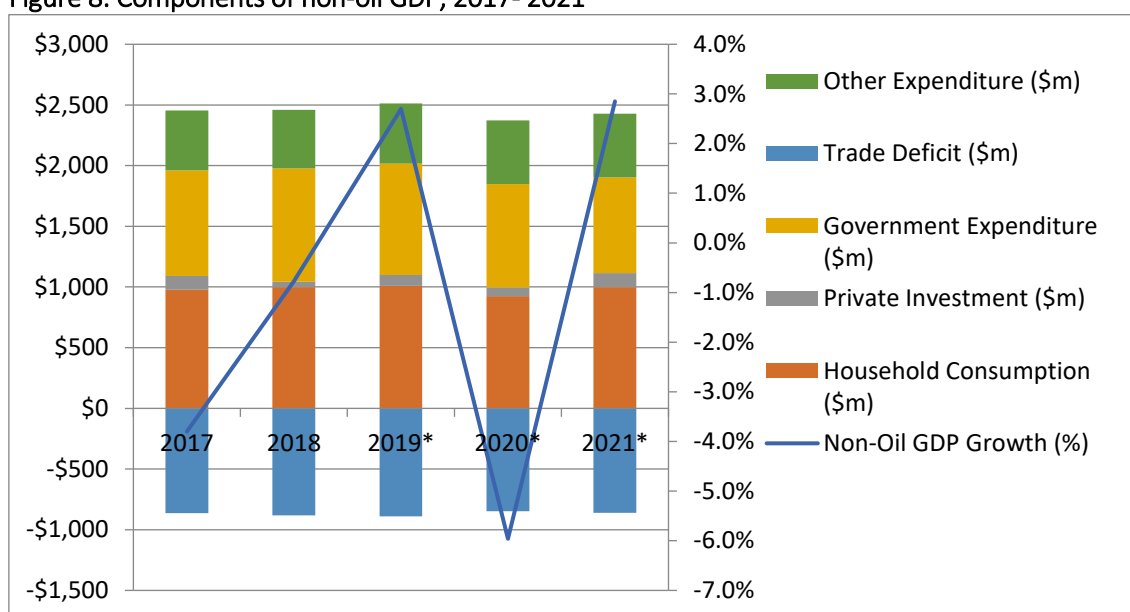
Source: Timor-Leste National Accounts 2000-2018, General Directorate of Statistics; 2019-2022 Economic Forecasts, National Directorate of Economic Policy, Ministry of Finance, 2020.

The negative impact of COVID and the state of emergency on living standards will be lessened due to the various government policies aimed at assisting the most vulnerable during the crisis including the payment of 60% for the employment salary and stabilising credit line to maintain the purchase power and capacity of the private sector. Consumption is likely to fall during 2020 particularly during the months of the State of Emergency. A low inflationary environment due to the fall in world oil prices will ease consumption to some extent, but the increase in the cost of rice and fall in the price of coffee will hit the poorest and rural households the most.

Public sector investment in 2020 was somewhat constrained by the duo-decimal system. However, the new coalition should provide the political stability for the Budget to be approved for 2021 providing greater momentum for public infrastructure projects, especially in education, health, and water and sanitation. These projects will also provide jobs for Timorese people. The infrastructure assets resulting from this public investment as well as legal reform will create an environment conducive to strong growth in the private sector, boosting growth into the future.

In the short and medium term one will see continued construction on the Tibar Bay Port, and the expansion of existing and new commercial projects throughout the country. Such investments are consistent with the Government’s economic strategy, alongside continued investments in human capital and education, to attract investors and consequently creating jobs domestically.

Figure 8: Components of non-oil GDP, 2017- 2021



Source: Timor-Leste National Accounts 2000-2018, General Directorate of Statistics; 2019-2021 Economic Forecasts, National Directorate of Economic Policy, Ministry of Finance, 2020.

Risks and Uncertainty

Economic forecasts or projections aim to predict annual GDP growth rates and high level macroeconomic figures. Making forecasts about what macroeconomic variables may be in the future is important to help governments and businesses make decisions with regard to policies, planning and investment. However, it is important to understand that in order to make these predictions we have to make some assumptions about future conditions. Therefore all projections always include an element of uncertainty. The main uncertainties in the forecast come from imports and government budget execution. If government spending is particularly import-dependent, meaning that much of the new spending goes to goods and services from outside Timor-Leste, the GDP forecasts for future years may be reduced downwards as imports have a negative effect on final GDP.

In addition, if there is a large change in execution rates this may have a noticeable impact on the economy, especially given that the state budget makes up a large portion of Timor's GDP. Execution rates differ each year for different reasons and also depend on the absorptive capacity of the Timor-Leste economy. Absorptive capacity means how much money line ministries are actually able to spend despite how much money they have. For example even if the budget was increased a large amount, line ministries may find it impossible to spend all of that money. As with all forecasting, the more time and accurate data one has, the less assumptions we have to make and the closer we move to the true value.

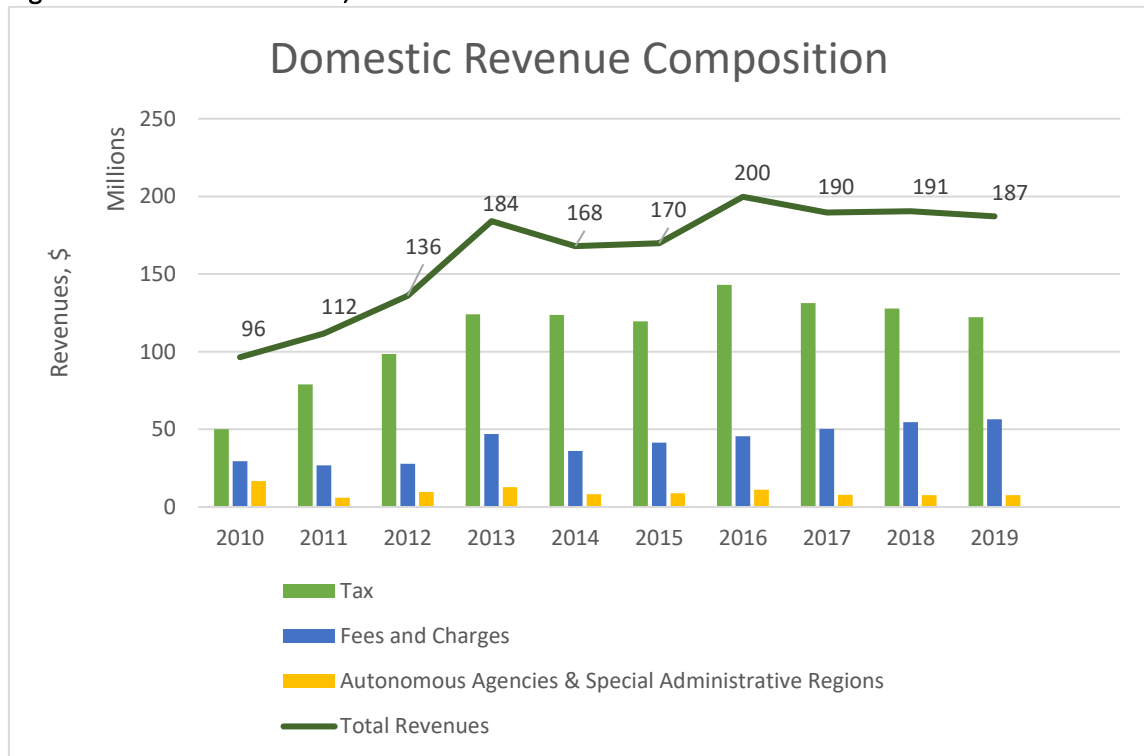
4.4 Domestic Revenue

4.4.1 Historical Trends

Over the past 10 years, domestic revenues have not followed a consistent growth pattern. During the period from 2010 to 2014, revenues increased at an average rate of 24% per year.

They then saw a decline in 2014, followed by another rise to a peak in 2016 of \$199.7 million. The political instability of 2017 caused a subsequent fall in overall revenues, largely due to a fall in tax receipts. This decline continued into 2018 and 2019 as tax receipts and total revenues continued to fall.

Figure 9: Domestic Revenues, 2010-2019

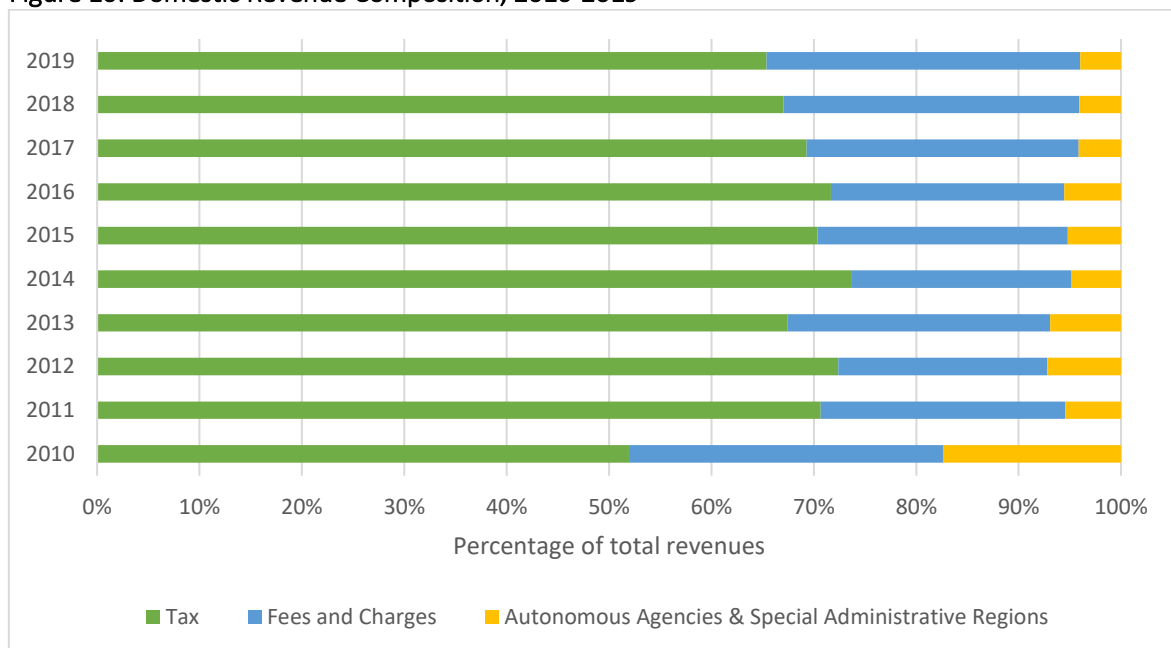


Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Comparing the composition of different year’s revenues, it is clear that taxes are consistently the largest contributor, making up nearly 2/3 of the total revenue collection (an average of 68% of the total across the last 10 years). This is in comparison to 26% for Fees and Charges and 6% for Autonomous Agencies & Special Administrative Regions. There does not seem to be a strong link between the total revenue amount and the composition of the total. However the past 4 years have seen a fall in the total percentage contributed to tax, alongside a fall in overall collections. 2019 had one of the lowest years for tax contribution to total revenues, making up 65%. This was compensated by a rise in Fees and Charges to 31% and Autonomous Agencies making up the final 4%. While interest receipts have been increasing over recent years, they still make up less than 1% of overall collections.

It is important to note that the total for 2019 is the only year that does not include ZEESM revenue collections as those figures have not yet been made available. Therefore for comparison reasons, none of the following sections will include either ZEEM taxes or fees and charges in their analysis, these will be discussed in their own separate section at the end.

Figure 10: Domestic Revenue Composition, 2010-2019



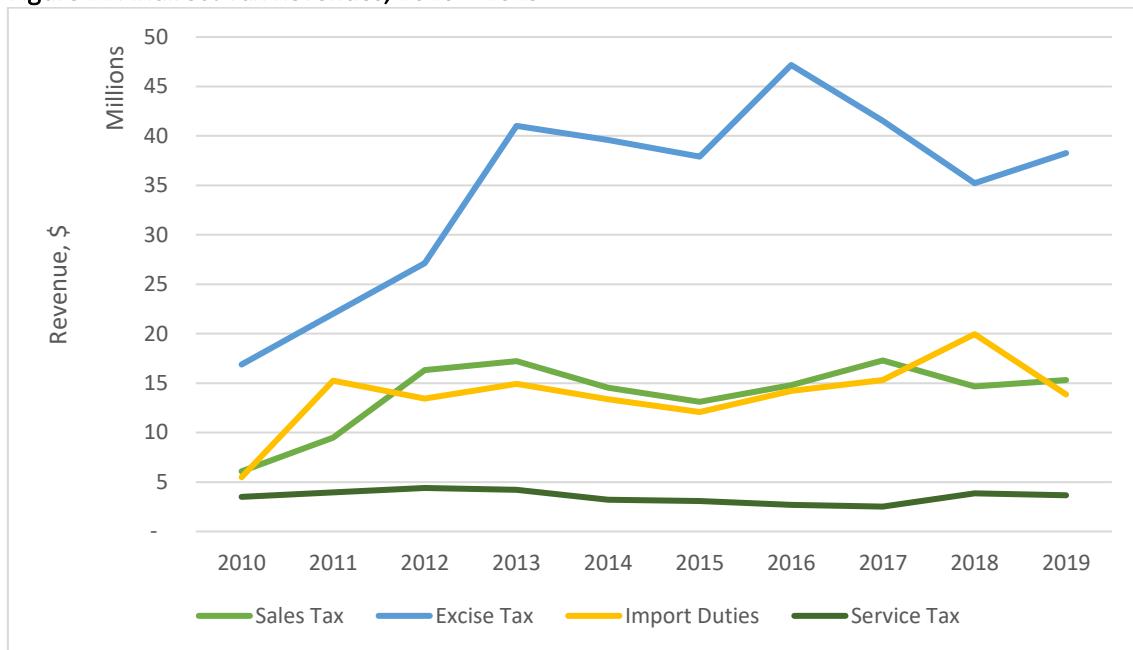
Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Focusing in on tax revenues in more detail; like total domestic revenues, after a rise at the start of the period, the past few years have seen significant fluctuations with 2019 seeing a continued fall in total tax receipts to \$122.3 million from a total on \$124.7 million in 2018, excluding ZEEMS taxes.

Excise tax, the largest contributor to tax receipts and overall domestic revenues, saw a rise in collections. This suggests a boost to consumer spending. Both types of individual income taxes also rose. The rise in public sector income taxes was largely due to an increase in casual worker employment across government, as casual workers are more likely than permanent to eligible for income tax by earning over the \$500/month threshold.

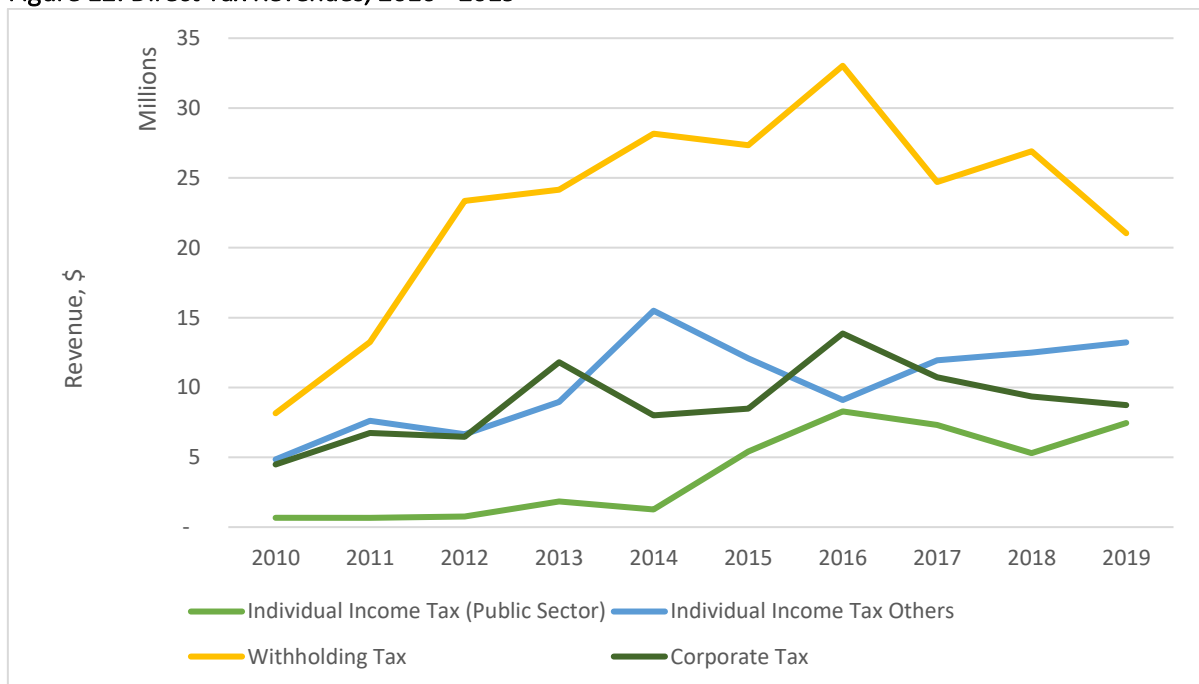
Withholding tax, the second largest contribution to tax revenues, fell significantly due to a decline in capital expenditure. However, it is important to note that there are often delays in the receipt of such taxes. As a large number of capital projects were commissioned in Q4 2019, the withholding tax revenues were not collected before the close of the financial year in December and spilled over into Q1 2020 where unusually high levels of withholding tax were seen. Corporate taxes also fell, suggesting a drop in private sector activity during the year. This was emphasized by a small fall in service duties. Import duties also fell substantially in comparison with the previous year.

Figure 11: Indirect Tax Revenues, 2010 – 2019



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Figure 12: Direct Tax Revenues, 2010 - 2019

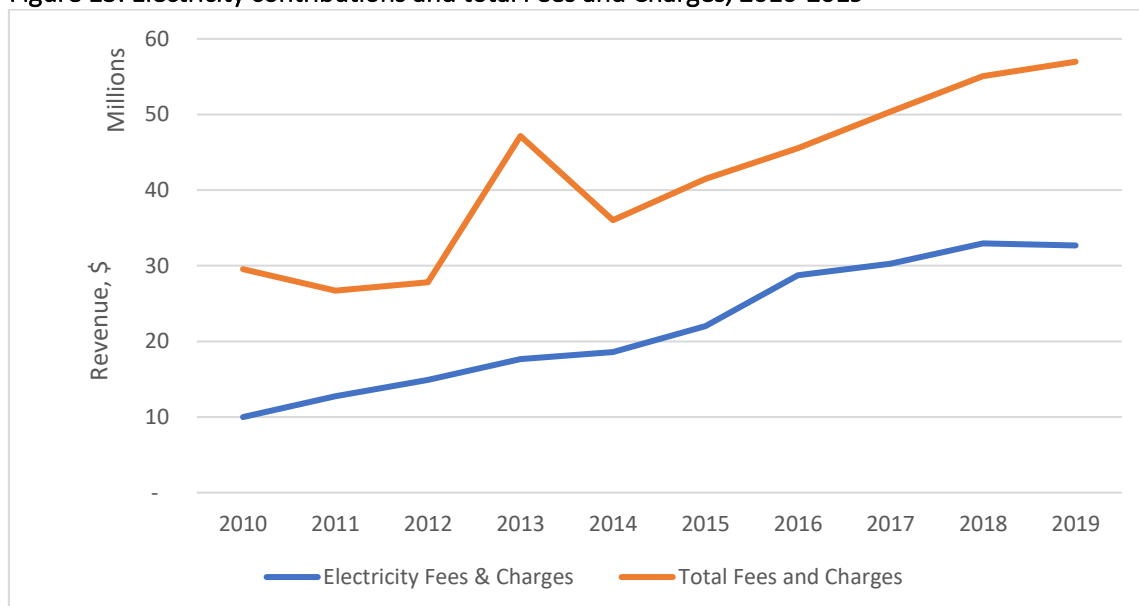


Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Looking at Fees and Charges, they have seen consistent growth over the past 6 years. 2013 was a significantly high year due to an exceptionally large contribution of other non-tax revenues which grew from just below \$1 million in 2012 to over \$15 million in 2013 and fell back to \$4.7 million in 2014. Excluding 2013 from the trend line, due to its exceptionally high levels, revenues from Fees and Charges have grown since 2011. This continued in 2019, increasing to \$57 million in 2019 compared to \$55 million in 2018. However the rate of growth was slower than in previous years, as seen by the graph below.

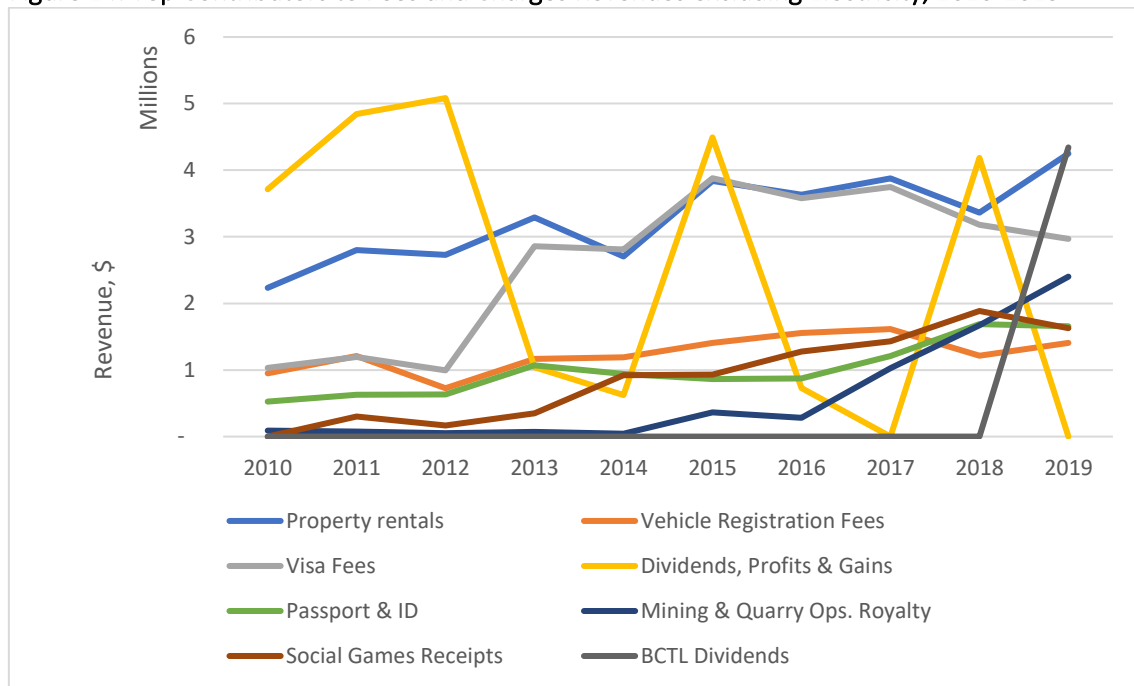
Electricity still dominated the total, comprising just over 55% of the total fees and charges revenue from fees and charges. This is a slightly decline from the 60% it made up in 2018 but still above the 53% average for the past 10 years. The total revenues from electricity saw a slight decline in collections in 2019. However there were significant increases in the incomes generated by property rentals and mining & quarry royalties. Revenues from fines and penalties from tribunals and TL Internet Domain Revenue also increased relative to 2018. Dividends from BCTL saw a significant rise, becoming the third highest contributor in the category after electricity and property rentals.

Figure 13: Electricity contributions and total Fees and Charges, 2010-2019



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Figure 14: Top Contributors to Fees and Charges Revenues excluding Electricity, 2010-2019

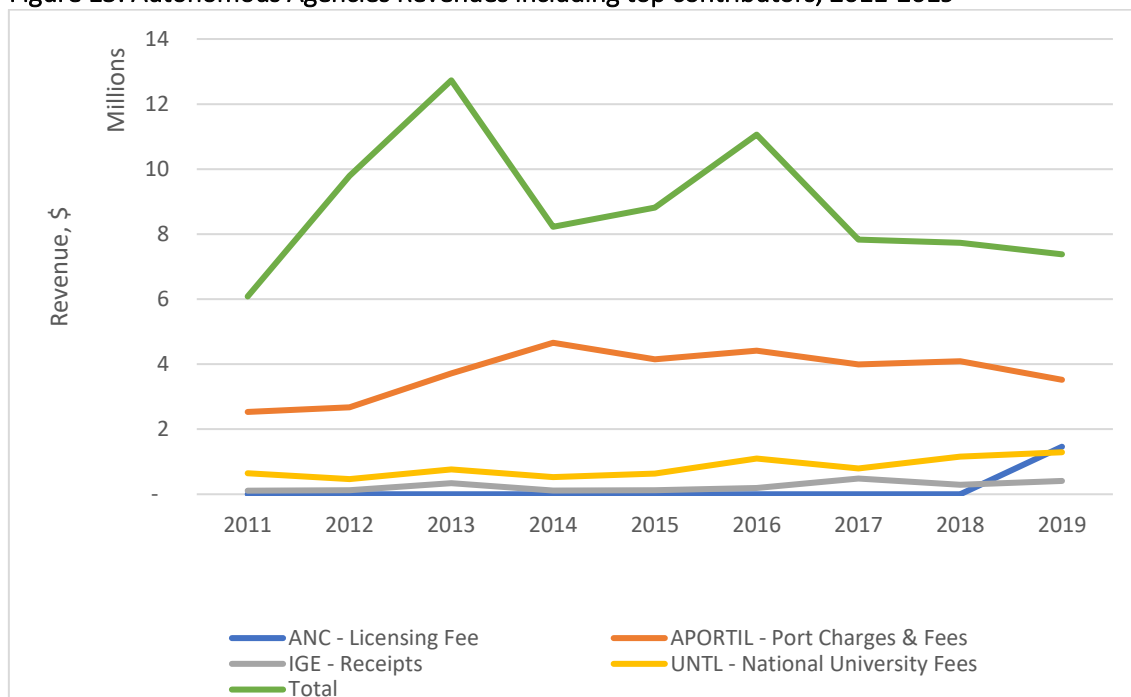


Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Autonomous Agencies do not seem to follow any historic trend. However the large spikes in 2013 and 2016 do coincide with rises in the overall revenue collection. The Autonomous Agencies total for 2019 was slightly higher than those in 2017 and 2018. APORTIL has consistently been the largest contributor to the total, averaging around 40%.

2019 saw the introduction of a new revenue stream from the introduction of the ANC (Autoridade Nacional de Comunicações) Licensing Fee, which became the second highest revenue stream. There were also increases in collections from IGE Receipts and UNTL University Fees. However there were falls in a number of other line items including the APORTIL Port Charges & Fees, the CLN Sale of Rice and Institute for the Support of Enterprise Development Service Fees. As mentioned before, Special Administrative Regions are not included in this analysis, unlike previous years, due to the delay in data collection.

Figure 15: Autonomous Agencies Revenues including top contributors, 2011-2019



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

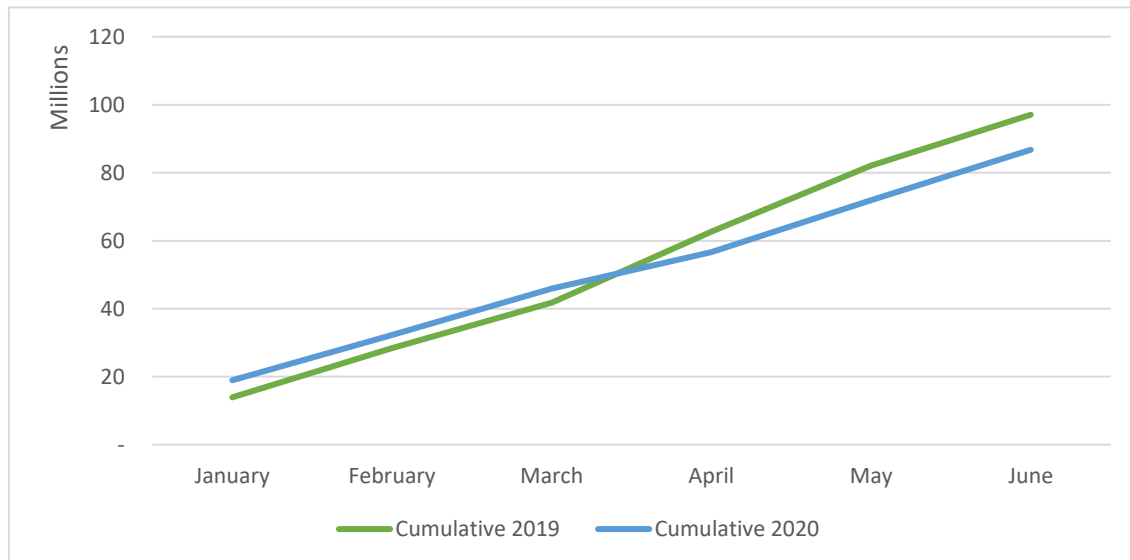
4.4.2 Mid-Year Analysis

2020 had a strong start to the year, outperforming 2019 across the first Quarter. This was largely due to delayed payments of some key taxes at the end of 2019, in particular withholding taxes. Other key revenue contributors such as excise tax and electricity fees and charges also saw a year on year rise. At the end of Q1, total domestic revenues in 2020 were \$45.9 million, an increase of the Q1 2019 total of \$41.8 million. This growth was largely unanticipated, especially given the political uncertainty surrounding the delayed passing of the national budget at the end of 2019 which was expected to reduce private sector confidence in the economy, further reducing overall spending and subsequently domestic revenues.

However the impact of COVID-19, mainly due to the introduction of the State of Emergency at the end of March and extended till the end of June, was significant. The State of Emergency aimed to limit the movement of people within the country and across borders to prevent the spread of the disease. This has a significant knock-on effect on consumer and private sector spending. A number of government revenue streams were suspended, including all social security contributions for both employers and employees, rent on government buildings and the payment of water fees. All electricity consumers in the country received a \$15 per month electricity credit during the State of Emergency. Electricity is often the second largest contributor to total revenues, making up nearly a fifth of total domestic revenues (17%) in 2019.

Domestic revenues in April saw a substantial impact, with overall revenues increasing by only \$10.8 million in 2020; nearly half the total in 2019 of \$20.9 million. The effect is clearly seen in the cumulative collection graph below, where 2020 collections surpass 2019's until April, after which they lag behind. By the end of Q2 2020, total revenues were \$86.7 million. The total for Q2 2019 was over 10% higher at \$97.1 million.

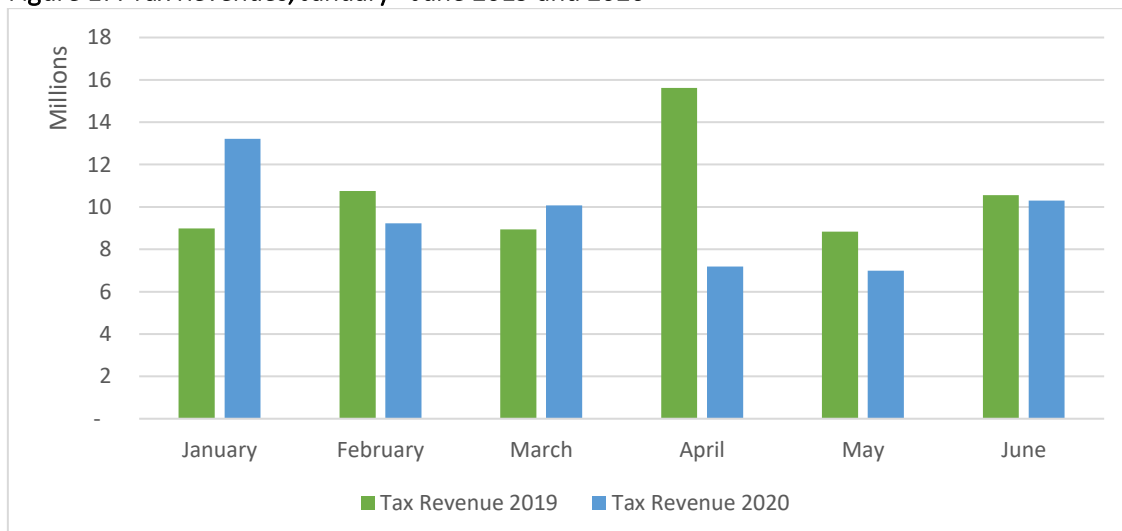
Figure 16: Cumulative Domestic Revenue Collections, January - June 2019 and 2020



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Tax revenues follow a similar pattern to overall revenue collections, superseding collections in 2019 for January and March, and only a slight decline in February. However, they saw a significant fall in April, decreasing more than half of that of the previous year (-54% fall to \$7.2 million from \$15.6 million). There was a quick bounce back though with May and June collections only slightly down on those of the same months in 2019 (\$7.0 million v \$8.3 million and \$10.3 million v \$10.6 million respectively).

Figure 17: Tax Revenues, January - June 2019 and 2020

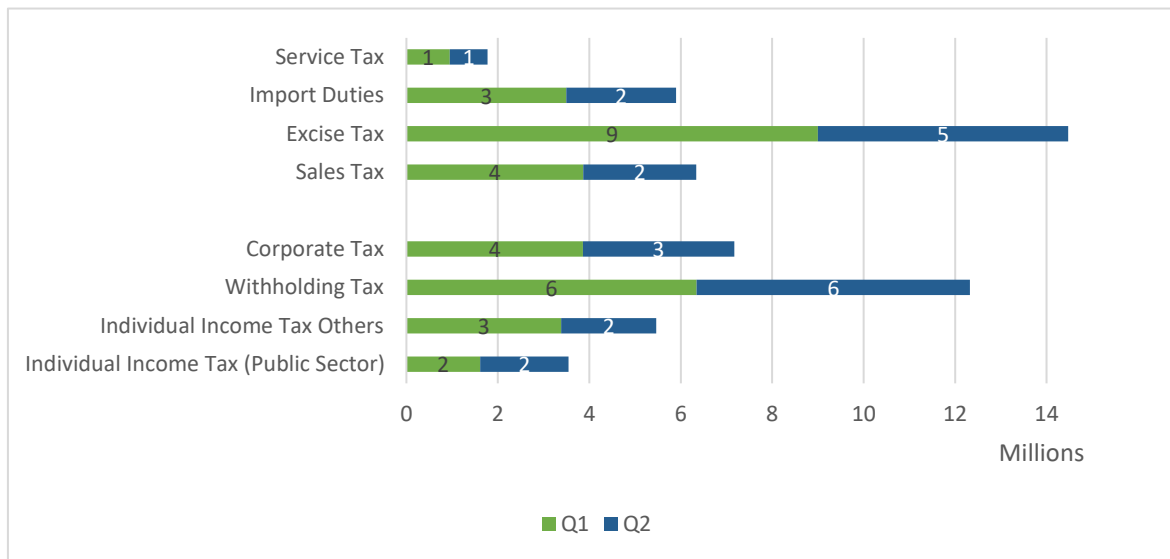


Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Focusing on the 2020 data only, there does not seem to be a vast difference between the first two quarters of the year. This is because while there was a large decline in overall tax revenues in April, May and June saw a near return to 2019 levels.

However nearly all taxes did fall during Q2 in comparison to the previous quarter. All indirect taxes, which are those more closely linked to consumer spending and signs of consumer confidence, fell during the State of Emergency. For direct taxes, the majority also fell during Q2, with only Individual Income Taxes for the Public Sector rising slightly.

Figure 18: Tax Revenues, Q1 and Q2 2020

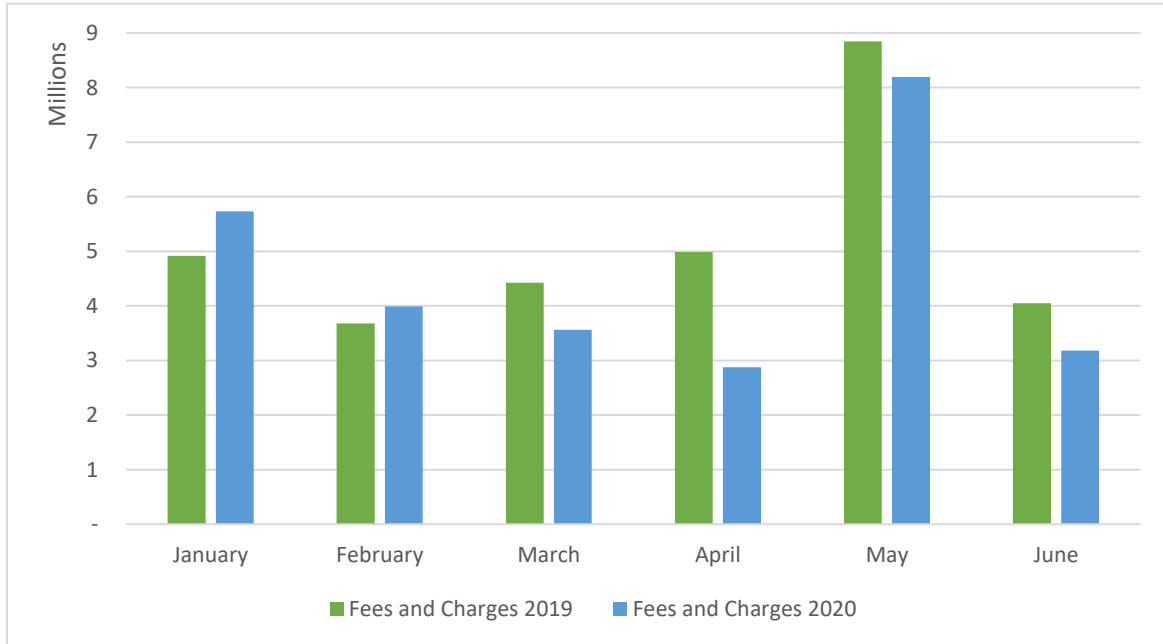


Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

The situation is similar for Fees and Charges collections. They also saw a strong start to the fiscal year, with higher collections in both January and February than the same time in 2019. 2020 saw a slight fall in comparison for March, though the majority of the decline is again focused on April

where collections for 2020 were 42% lower than 2019. There was some recovery in May and June, but lower than that the bounce back for taxes.

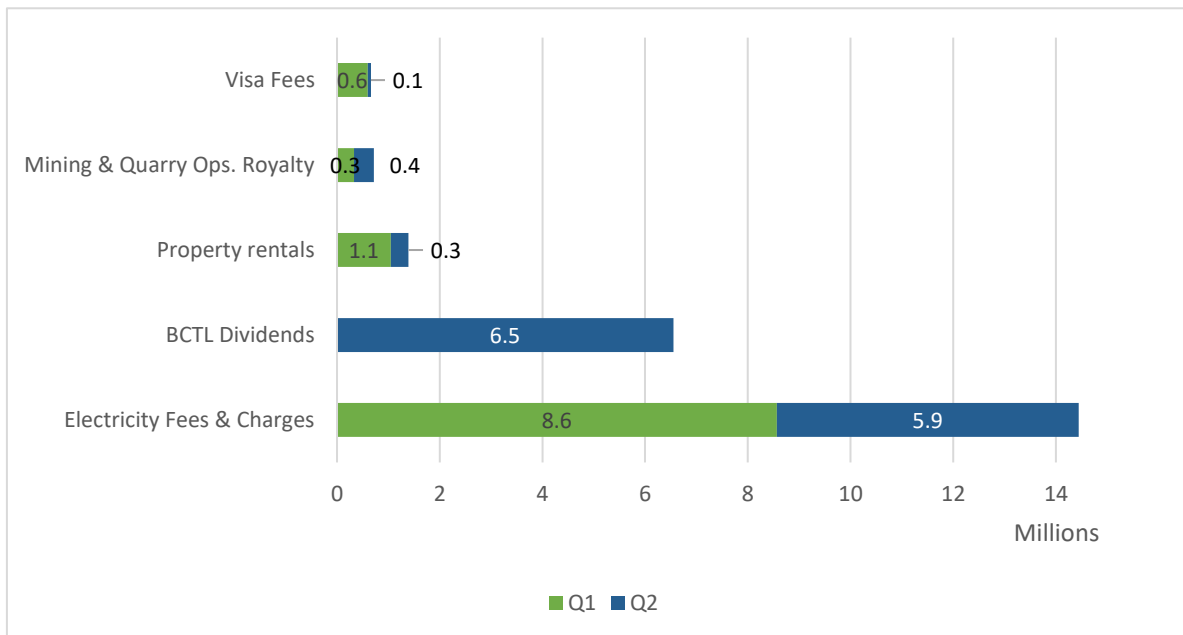
Figure 19: Fees and Charges Revenues, January - June 2019 and 2020



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

The comparison quarter on quarter is similar, with all the highest contributors having higher collections in Q1 compared to Q2. The one exception is BCTL Dividends coming from the Central Bank. These are only released once a year, in May, and therefore would only appear in one quarter regardless.

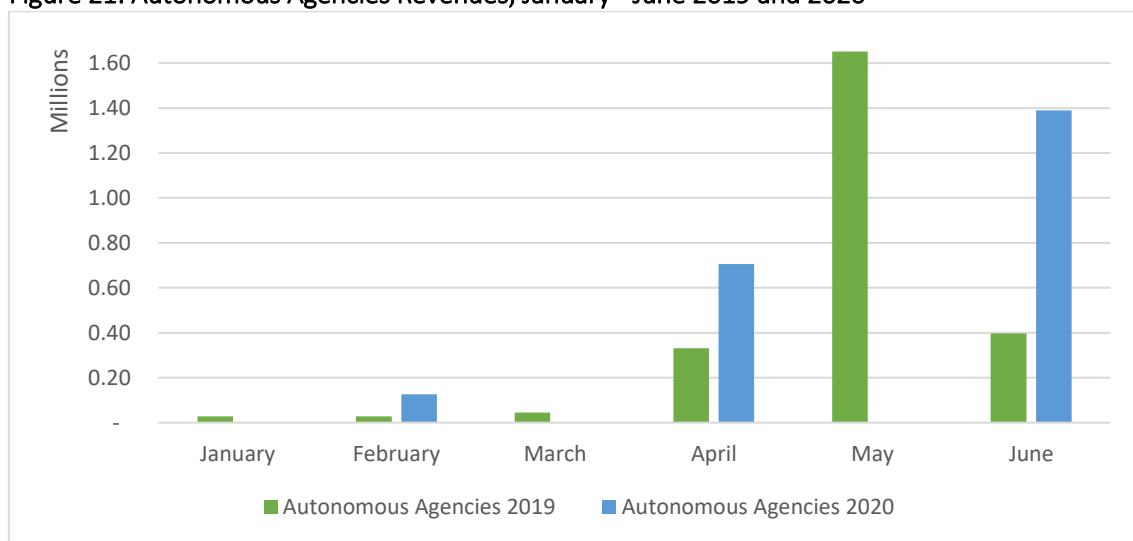
Figure 20: Fees and Charges Revenues, Q1 and Q2 2020



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

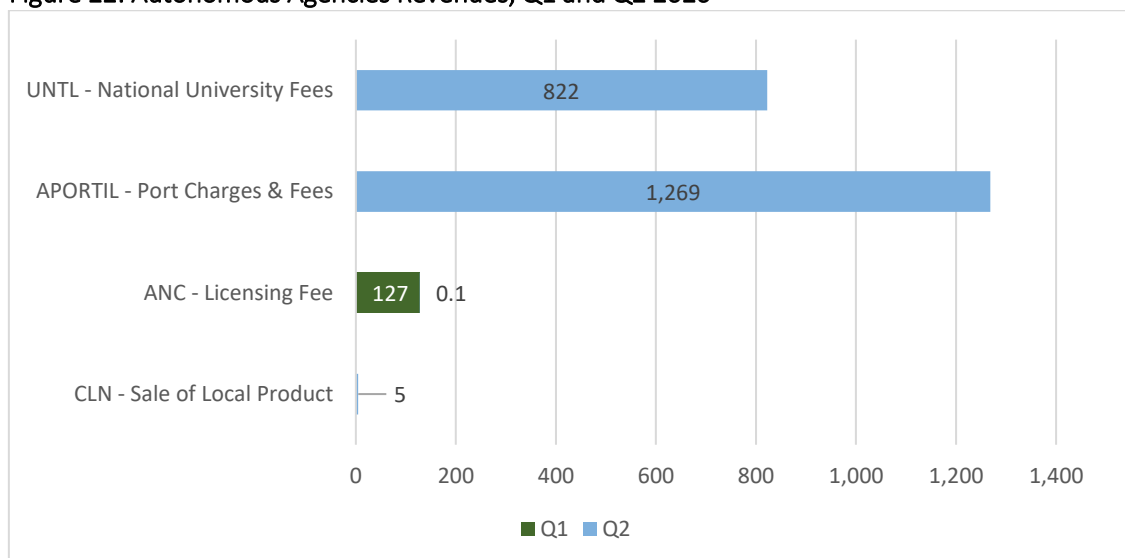
Autonomous Agencies often see the majority of their collections take place in the final quarter of the fiscal year. Comparing Q1 for 2019 and 2020, there is a little difference. April surprising saw a rise on 2019, countering the trends seen for Taxes and Fees and Charges. The only payment was \$705,942 from UNTL, more than double its contribution in the same month in 2019. This is probably backdated university fees and therefore would be unaffected by the State of Emergency introduction. May 2020 was an exceptionally low month for 2020, with no revenue collections compared to \$1.7 million in 2019. However there was a bounce back in June, where collections in 2020 were around 4 times those in 2019. So far in 2020, only 4 Agencies have reported positive revenues. These are shown on the quarterly comparison graph below. The figures shows that the majority of collections occurred in Q2 as that was when the payments from the two largest contributors took place.

Figure 21: Autonomous Agencies Revenues, January - June 2019 and 2020



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

Figure 22: Autonomous Agencies Revenues, Q1 and Q2 2020



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

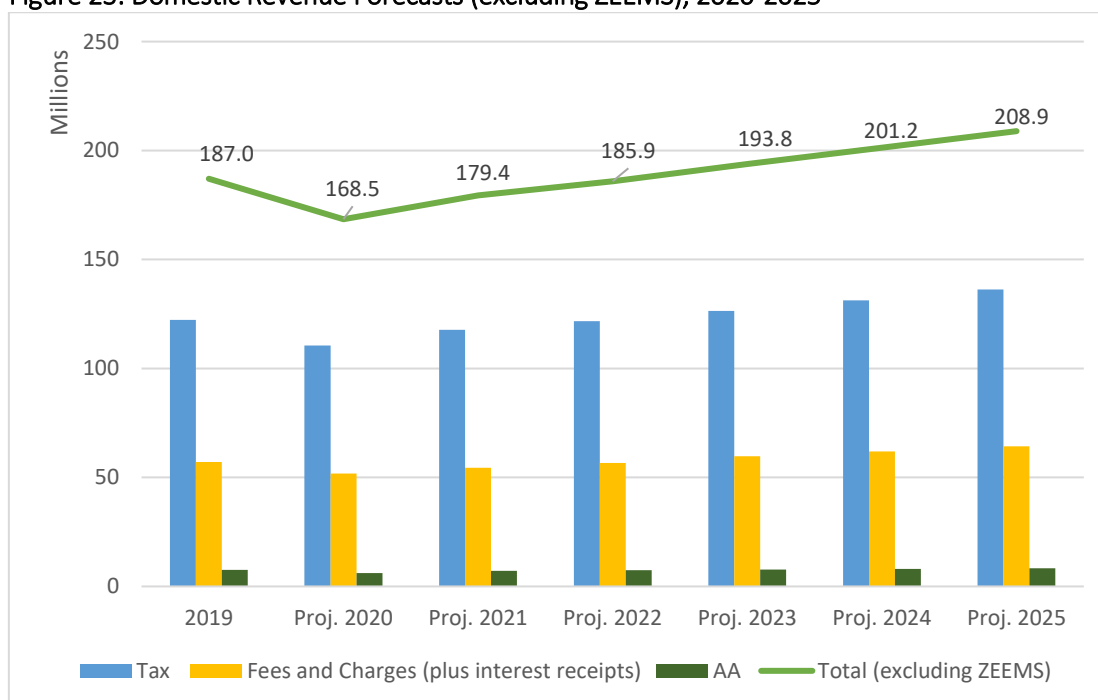
4.4.3 Revenue Projections

Forecasts for 2020 see a significant fall in many revenue streams, largely due to the State of Emergency to prevent the spread to COVID-19. The majority of the impact is expected to fall in Q2, when the State of Emergency was enacted, with a bounce back is likely to occur in the latter half of the year due to the continuing poor economic outlook both nationally and internationally. The delay in the passing of the 2020 budget may also mean that, like 2019, a number of tax payments are not made in the 2020 financial year and will spill over to 2021 collections. This is especially likely for Withholding Taxes as they are closely linked to capital projects that can take longer to process than other payments.

However future years are expected to see a rise in revenues, driven by a stable macroeconomic and political environment and an expected economic bounce back from the GDP decline of 2020. Tax revenues are expected to be boosted by reforms in the tax collection systems, in particular the shift to SIGTAS (Standard Integrated Government Tax Administration System) 3.0, which aims to increase the Tax Authority’s capacity to enforce greater tax compliance. The move to increased decentralization of government activity has also seen the introduction of a number of new revenue streams through local advertising and parking services. Further decentralization, improvements and reinforcement of collection mechanisms in line ministries and the introduction of new non-tax instruments are expected to boost collections of Fees and Charges. Autonomous Agency collections, while they have no planned policy changes or reforms, are expected to rise with the improved economic conditions.

Note, these forecast continue to include EDTL revenues (fees and charges and new installations) as part of the Fees and Charges total. This is likely to be changed in the 2021 Budget as EDTL is due to become a public enterprise in 2021.

Figure 23: Domestic Revenue Forecasts (excluding ZEEMS), 2020-2025

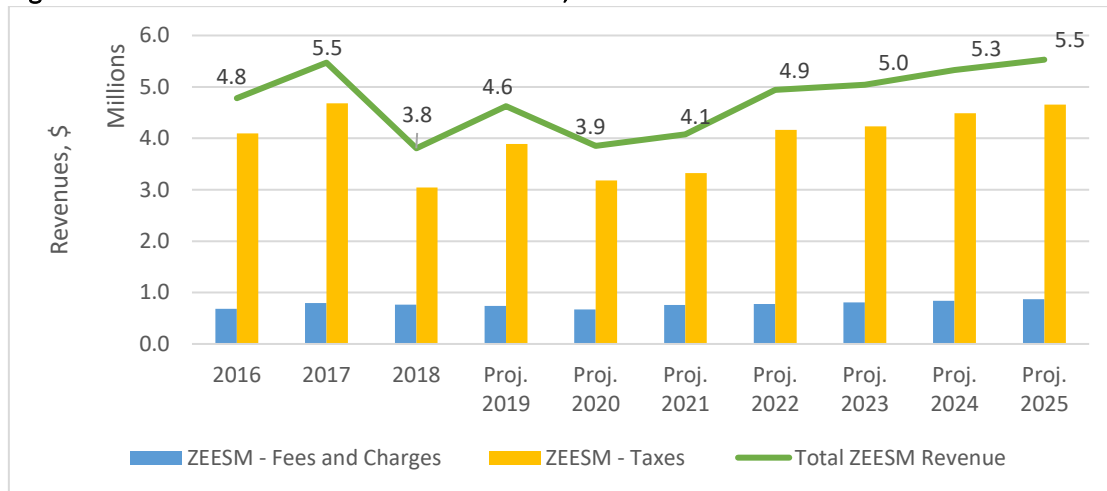


Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

4.4.4 ZEEMS Revenues

The Special Administrative Region of ZEEMS has two forms of revenue; taxes and fees and charges. As mentioned earlier, there are still no figures for the 2019 fiscal year. This means that the figures given below are still an estimate and not the final figures. This also means that the future projections are also likely to be less accurate than the other line items as they have one fewer data point to aid in the estimation.

Figure 24: ZEEMS Revenues Actual and Forecast, 2016-2025

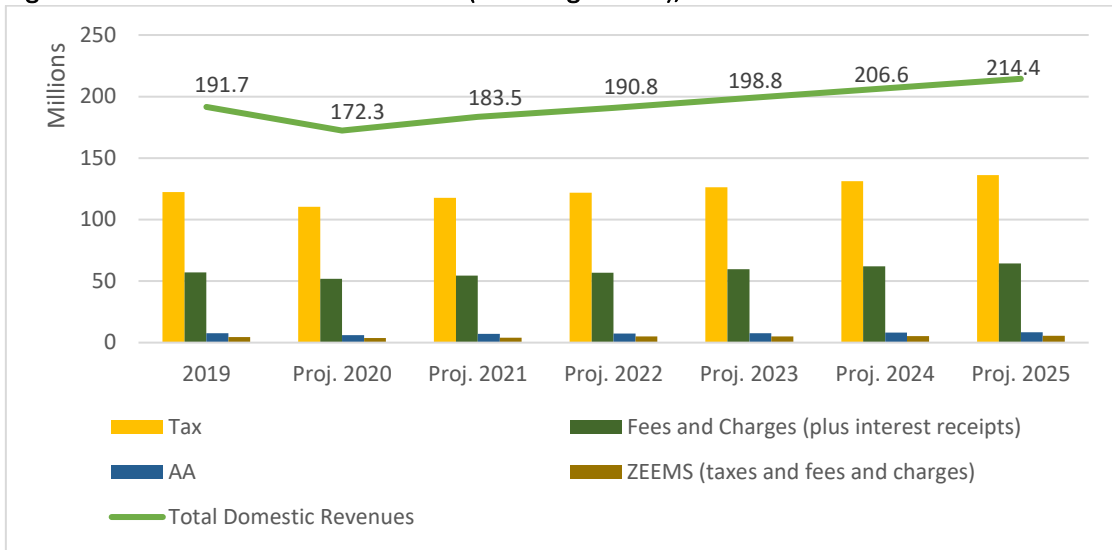


Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

As seen from the graph above, it is clear to see that while revenues were high and rising in 2016 and 2017, ZEEMS saw a large fall in revenues in 2018. This was largely due to a sharp fall in tax receipts during that period.

Revenues are predicted to largely bounce back in 2019, though the impact of the State of Emergency is expected to cause another fall in 2020. Following that, revenues are expected to climb steadily, based on the current assumption of steady economic growth in the country. Including the ZEEMS estimates into the total domestic revenues gives a total forecast for 2020 of \$172.3 million and 2021 of \$183.5 million. The other years can be seen on the graph below. The trend is similar to the domestic revenue forecast without ZEEMS as they are both based on the same assumptions for future economic conditions.

Figure 25: Domestic Revenue Forecasts (including ZEEMS), 2020-2025



Source: National Directorate of Economic Policy, Ministry of Finance, August 2020.

4.5 Petroleum Fund Revenue

The Petroleum Fund revenues remain the main source of funding for the state budget, consisting of petroleum revenue and investment income. The recent settlement of the maritime boundaries between Timor-Leste and Australia with the signing of the Maritime Boundaries Treaty (MBT) results in most of the Former Joint Petroleum Development Area (Former JPDA) now falling within Timor-Leste's jurisdiction. As of September 2019, all of the revenues originating from the Former JPDA will be fully paid to Timor-Leste, with certain adjustments made under the requirement for 'conditions equivalent' during the transitional arrangement.

There are effectively 11 active Productions Sharing Contracts: 2 on-shore, 8 offshore and 1 related to the Greater Sunrise Special Regime. However, the current petroleum revenues originate from one major project, the Bayu-Undan field. Despite its natural declining production profile, the BU field is expected to continue to generate revenues to Timor-Leste until its Production Sharing Contracts (PSCs) expire in 2021/22. Production beyond 2022 will depend on contract negotiations and whether the remaining reserve is economically profitable.

As at August 2020, the Fund's balance was \$18,671.0 million, an increase of \$979.1 million from the start of year. The balance of the Fund is determined by inflows from petroleum revenues, investment returns and outflows from government withdrawals.

The petroleum revenue is driven by three major factors: oil price, production and costs. The revised projections in the State Budget 2020 were based on the EIA's projected Brent price in January 2020. The production and costs information were provided by the Operator in August 2020. The new information were incorporated in calculating the ESI for Budget 2020-2021 and projecting future revenues.

The monthly average of the Brent oil price was \$40.9/b from January to August 2020. Oil prices fell sharply in the first quarter with the shutdown of economic activities during the Coronavirus (Covid-19) outbreak, which was worsened by a price war between Saudi Arabia and Russia. Inventories were high and there was a massive oversupply. The oil price rose in June as countries started to lift the lockdown measures and as global supply decreased due to production cuts agreed to by the Organization of the Petroleum Exporting Countries (OPEC) and partner countries, including Russia (OPEC +). In the second half of 2020, the EIA now expects monthly Brent spot prices will average \$42/b and rise to an average of \$50/b in 2021.² The oil price used in the revised Budget 2020 is \$41.2/b, 33.1% lower than the price previously estimated of \$61.6/b.

The actual production in 2019 was 38 million barrels of oil equivalent, which is around 10 per cent higher than estimated in Budget 2020. The higher production was mostly driven by the positive outcome of the Bayu-Undan Infill Well project in the second half of 2018. Despite the lower oil price and production, more condensate and LPG cargoes were sold in 2019, which pushed the actual total petroleum revenue (net revenue) collected in 2019 up to \$756.3 million, compared to \$510.1m in 2018. The revenue in 2018 was \$446.7 million after deducting the \$63.3m tax refund. There was no Tax Refund during the fiscal year of 2019.

² EIA's Short-Term Energy Outlook, released on September 9, 2020. www.eai.gov

Table 13: Petroleum Fund Revenues 2019-2021 (\$m)

	2019 Projection	2019 Actual	2020 Projection	2020 Actual Aug 2020	2021 Projection
Total Petroleum Fund Revenue	2,460.6	2,857.2	927.8	1,398.6	718.5
PF Investment return, net	1,724.3	2,100.9	651.9	1,128.5	650.5
Petroleum Revenue	736.3	756.3	268.7	270.2	68.0
Petroleum Taxes	265.1	327.4	91.9	105.2	11.3
Royalties and Profit oil	434.5	428.9	169.3	157.4	37.9
Other Taxes payment *	36.7	-	7.6	7.6	18.8

Source: Petroleum Fund Policy and Management Office, MoF.

*Other taxes payment includes Non BU taxes and pipeline minus tax refund (if any).

As of August 2020, receipts from the sale of oil and gas amounting to \$270.2m have been paid into the PF account, which is 1% higher compared to the estimates in Budget 2020 of \$268.7 million. The revenue in 2020 is expected to be lower compared to previous years due to lower oil price, declining production profile and the implication of Covid-19 to the petroleum activities.

The Petroleum Fund's investment returned \$2,100.9 million (\$2.1 billion) in 2019, which is equivalent to a return of 13.3 per cent. The equity allocation (35% of the Fund) returned 27.7%, Bonds (60%) returned 5.2% and the Alternatives instrument (5%) posted a return of 1.1%. The record annual return in 2019 was driven by equity's strong performance, while bonds also delivered healthy returns. The stock market rally was despite uncertainty over global economic growth, the US-China trade disputes and the UK's departure from the European Union.

As of August 2020, the Fund's Year-to-Date return is +6.47%, which translates to net income of \$1,128.5 million. The equity portfolio has posted a return of +3.56%, while the fixed income allocation posted a return of +4.89%. Stock markets fell sharply in the first quarter as economic activity slumped with the coronavirus shutdowns. The mark to market loss in equities was partly offset by capital gains in the government bond portfolio, which rose in value because yields declined. Equity markets rebounded in the second quarter. Investor sentiment was boosted by the monetary and fiscal policy stimulus to offset the slowdown, as well as early signs of a recovery in activity as covid-19 restrictions were eased. The private debt allocation accrued 3.00% interest during the period. The final return for 2020 will depend on market movements over the coming months; another downturn in equity markets will erode the return. Returns vary significantly over short horizons and for long-term investors such as the Petroleum Fund, it is better to assess returns over long horizons.

Table 14: Petroleum Fund Investment Return 2018 – August 2020 (in %)

	2018	2019	2020		
			Q1	Q2	FYTD
Total Fund	-2.63	13.25	-4.70	7.27	6.47
Bonds	0.78	5.16	3.95	0.84	4.23
Equity	-8.33	27.67	-21.64	18.66	3.56
Private Debt		3.28	1.15	1.09	3.00

The government has withdrawn \$12,004.1 million from the Fund since its inception up until August 2020. This exceeds the cumulative ESI over that period by \$4,472.5 million. Since 2009, annual withdrawals have averaged about 5 per cent of Petroleum Wealth, compared to the 3

percent ESI. The excess reflects the Government's policy to front-load expenditure to enable economic development.

The proposed withdrawal for the FY 2020 in the Budget 2020 is now \$963.9 million, down from \$996.5 million in the previous submission. The proposed withdrawal is \$419.5 million above the calculated ESI of \$544.4 million for 2020. By the end of the August, the government has withdrawn \$419.5 million out of \$536.3 million extra-ordinary withdrawal approved by the Parliament in April and June to finance the Covid-19 fund (\$219.5 million) and to support the Treasury balance the duo decimal regime. The Petroleum Fund balances are shown in Table 15 which also take into account the actual result in 2019 and 2020 discussed above.

Table 15: Petroleum Fund Savings 2019-2020(\$m)

	2019 Projection	2019 Actual	2020 Projection	2020 Actual Aug 2020	2021 Projection
Opening PF Balance	15,803.6	15,803.6	17,691.8	17,691.8	17,655.7
Petroleum Revenue (excluding PF Interest)	736.3	756.3	268.7	270.2	68.0
PF Interest, Net	1,724.3	2,100.9	659.1	1,128.5	650.5
Total Withdrawals	-1,196.4	-969.0	-963.9	-419.5	-1,140.2
Closing PF Balance	17,067.9	17,691.8	17,655.7	18,670.9	17,234.1
Net inflows*	1,264.2	1,888.2	-36.1	979.1	-421.7

Source: Petroleum Fund Policy and Management Office, Ministry of Finance, 2020.

* Net inflows = Petroleum revenues + net PF interest – total withdrawal.

4.6 Petroleum Wealth and ESI calculation

According to the Petroleum Fund Law, the Estimated Sustainable Income (ESI) is the maximum amount that can be appropriated from the Petroleum Fund in a fiscal year and leave sufficient resources in the Petroleum Fund for an amount of the equal real value to be appropriated in all later years. The ESI is set to be 3 percent of the Petroleum Wealth. However, the Government can withdraw an amount from the Petroleum Fund in excess of the ESI given an explanation that it is in the long-term interest of Timor-Leste and that is approved by the National Parliament.

The ESI is only updated once a year as part of the main budget process. Table 16 shows the estimated Petroleum Wealth and the ESI 2020-2021.

Table 16: Petroleum Wealth and the Estimated Sustainable Income (ESI) 2020-2021 (\$m)

	ESI 2020	ESI 2021 pre.
Estimated Sustainable Income (PWx3%)	544.4	535.6
Total Petroleum Wealth (PW)	18,145.1	17,852.4
Opening PF Balance	17,691.8	17,655.7
Net Present Value of Future Revenues	453.2	196.7

Source: Petroleum Fund Policy and Management Office, Ministry of Finance, 2020.

The Total Petroleum Wealth on a Net Present Value basis is estimated to be \$18,145.1 million on 1 January 2020. This is \$253.3 million or about 1.4% higher than the figure calculated in September 2019. Therefore, sustainable income has risen correspondingly from \$536.8 million per annum to \$544.4 million for 2020. The current preliminary estimates for ESI 2021 is \$535.6 million.

5 Expenditure Analysis

5.1 Historical Trends

5.1.1.1 Total level of expenditure

The General State Budget (GSB) for 2019 was \$1.482 billion including loans. Out of this, 70.0% of the allocation was to recurrent categories. The materiality directive³ of Timor-Leste states that the government must spend 100% of the budget by the fourth quarter (Q4). The total government execution by Q4, 2019 (by current budget which includes transfers, virements and contingency transfer) was 83.8%. The Infrastructure Fund including loans (IF) and Human Capital development Fund (HCDF) execution for Q4, 2019 stood at 75.3% and 88.3% respectively.

The highest government expenditure in the last five year period was in 2016 at \$1.64 billion a year with a rectification budget. While 2017 was a duo-decimal year, the government's execution of CFTL (85.8%) was comparable to previous years. Hence, overall execution did not decrease but the issues that line ministries/autonomous agencies (LM/AAs) faced were due to the piece-meal execution of the budget which delayed procurement, contracting etc.

Table 17: Government execution of the final budget (2015-19)

AppCat	2015 Execution	2016 Execution	2017 Execution	2018 Execution	2019 Execution
Capital & Development	69.1%	69.8%	71.2%	85.4%	71.5%
Goods & Services	87.0%	89.7%	86.0%	90.3%	82.7%
Minor Capital	82.5%	84.3%	66.3%	42.7%	74.0%
Salary & Wages	94.5%	94.5%	91.8%	96.0%	93.5%
Transfers	96.0%	98.6%	95.7%	95.6%	93.3%

Sources: Ministry of Finance, IFMISU, July 2020

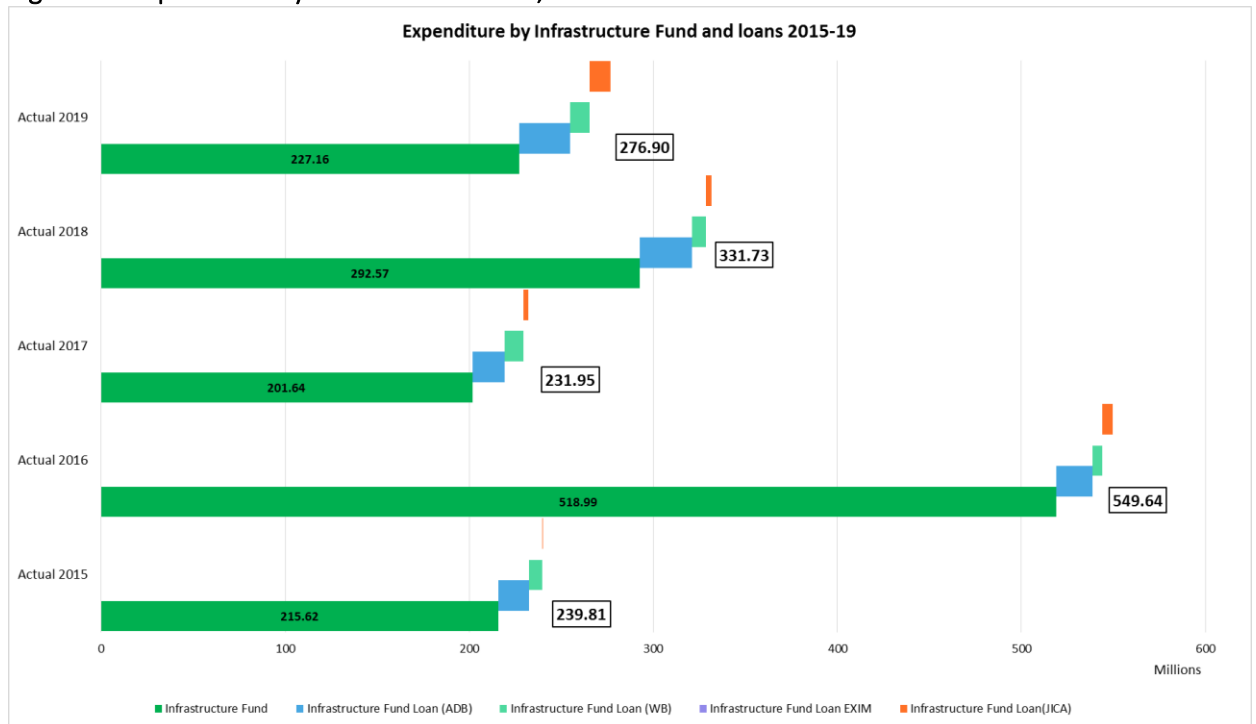
5.1.1.2 Expenditure by Funds

The Infrastructure Fund (IF) and the Human Capital Development Fund (HCDF) are two independent funds which deal with big infrastructure projects, and skill building respectively. IF has received above \$368.0 million on average (original allocation) in 2015-2019. It executed between 70.0-75.0% of its budget in 2015-2019. In 2018 and 2019, its execution was 85.9% and 73.5% respectively, driven down by its Japan International Cooperation Agency (JICA) loan and Asian Development Bank (ADB) loan execution.

HCDF received an increasing budget allocation each year in 2015-2019, with an increase in GSB 2019 at \$20.0 million (original allocation). HCDF executed 84.0-88.0% of its allocation from 2015-2019, with a slightly lower execution of 77.5% in 2015. All of its budget is allocated to trainings, workshops and scholarships.

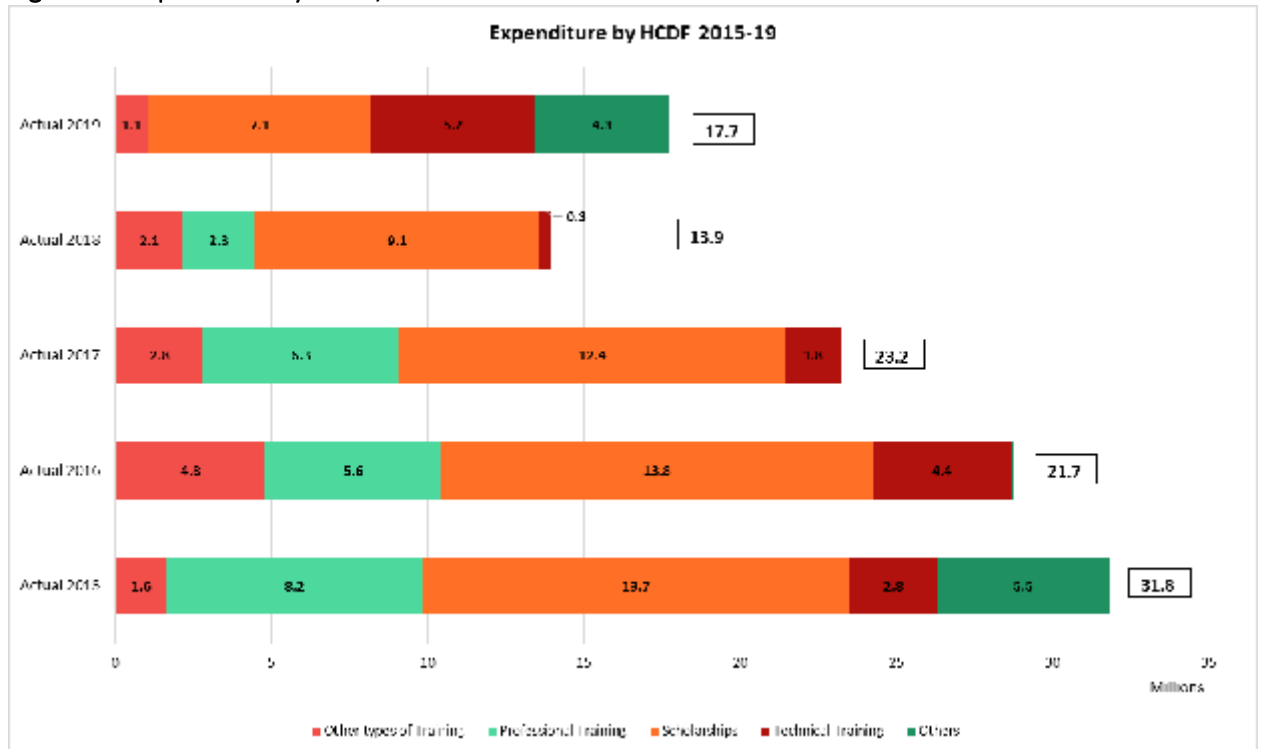
³ Ref no: 44/DGT/III/2016 Ministerial Directive on Materiality in Budget execution analysis and conduct of financial reviews

Figure 26: Expenditure by Infrastructure Fund, 2015-19



Sources: Ministry of Finance, IFMISU, July 2020

Figure 27: Expenditure by HCDF, 2015-19



Sources: Ministry of Finance, IFMISU, July 2020

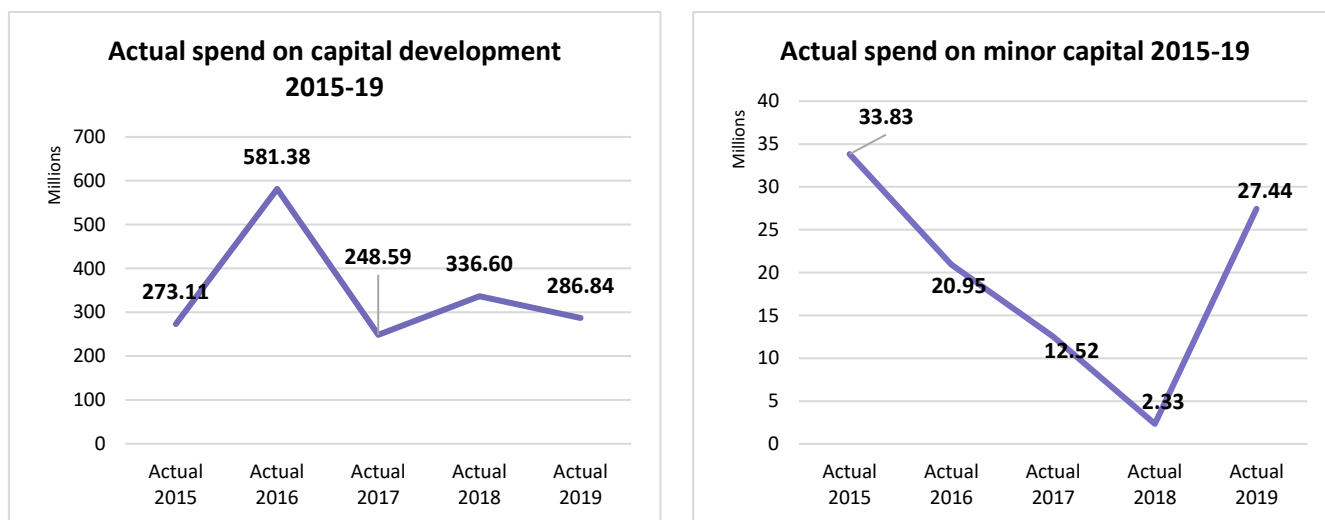
5.1.1.3 Expenditure by economic classification

Capital

Capital development (CD) has been a stated policy objective in Timor-Leste. Trends from 2015-2019 show that it receives the highest allocation in Timor-Leste. On average, it receives just under 30.0% of the total budget allocation of the government. There was a budget increase in 2016 was due to a rectification budget which allocated an additional \$390k to the Infrastructure Fund for important infrastructure projects. In State Budget 2019, it received \$400.9 million final budget, out of which \$287.0 million were spent. The 2019 decrease was because of a reduction in the programmes for Tasi Mane, Urban and Rural development, Public Edifices and Information Technology.

The total expenditure on CD follows the trend of IF which is the main implementer of all big infrastructure projects. Its execution follows the same trends. It was under 70.0% (2015-17) and 85.4% in 2018, and regressed to 71.5% in 2019. From 2015, minor capital has received an overall decreasing budget allocation (1-4%) which increased dramatically in 2019. However, the execution was low because of a delays in spending on electricity, water, sanitation etc.

Figure 28: Capital expenditure, 2015-19



Sources: Ministry of Finance, IFMISU, July 2020

Recurrent

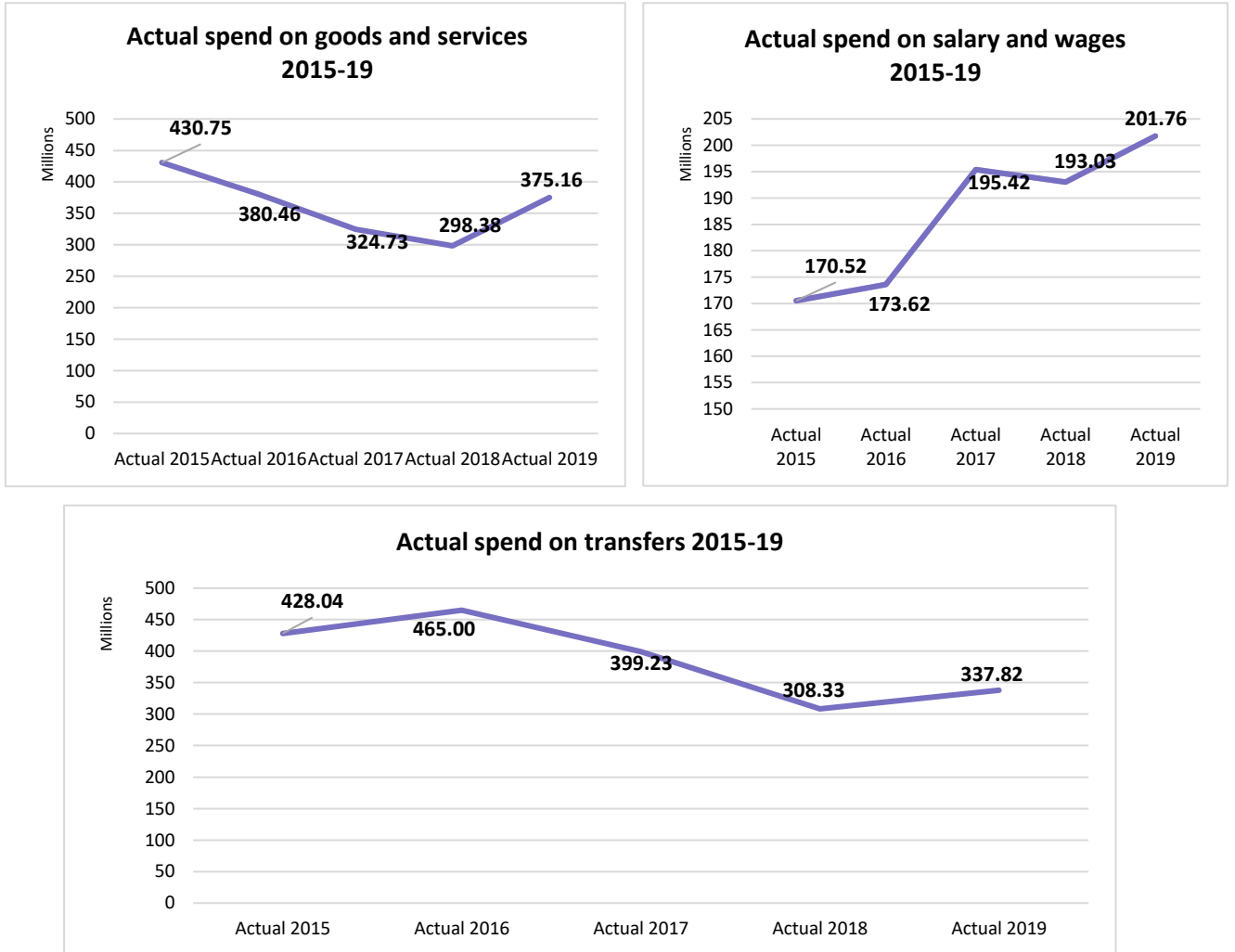
Recurrent budget (salary and wages, goods and services, and transfers) final allocation has remained between 65.0-73.0% from 2015-2019 (with 2016 as an exception with only 56.0% allocation). In 2019, recurrent budget was 71.0% of the total original allocation.

Goods and services receive 22.0-32.0% of the total allocation and it shows a declining trend year on year as the government tries to identify and mitigate superfluous spending. However the increase in 2019 was due to payment of combustibles and maintenance for the Hera and Betano generators, including the master plan for water and roads.

9-16% of the total fiscal envelope is allocated to Salary and Wages (SW) on average. There was an increase in the 2017 SW expenditure due to retroactive payments of teachers from 2011-2016 and recruitment of health professionals. The 2015 and 2016 spike in Transfers expenditure was driven by allocation to ZEESM project development. In general Transfers are driven by the

contributory regime, veteran payments, Bolsa da Mae scheme, disaster management, social investments and others.

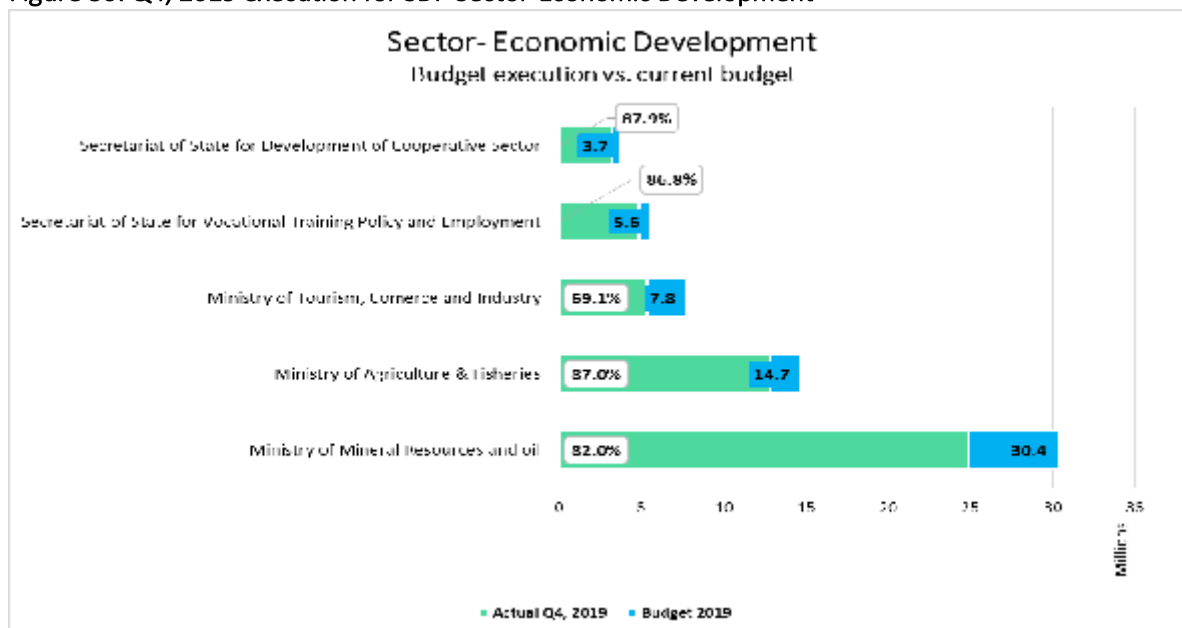
Figure 29: Recurrent expenditure, 2015-19



Sources: Ministry of Finance, IFMISU, July 2020

5.1.1.4 Expenditure by functional classification

Figure 30: Q4, 2019 execution for SDP Sector-Economic Development



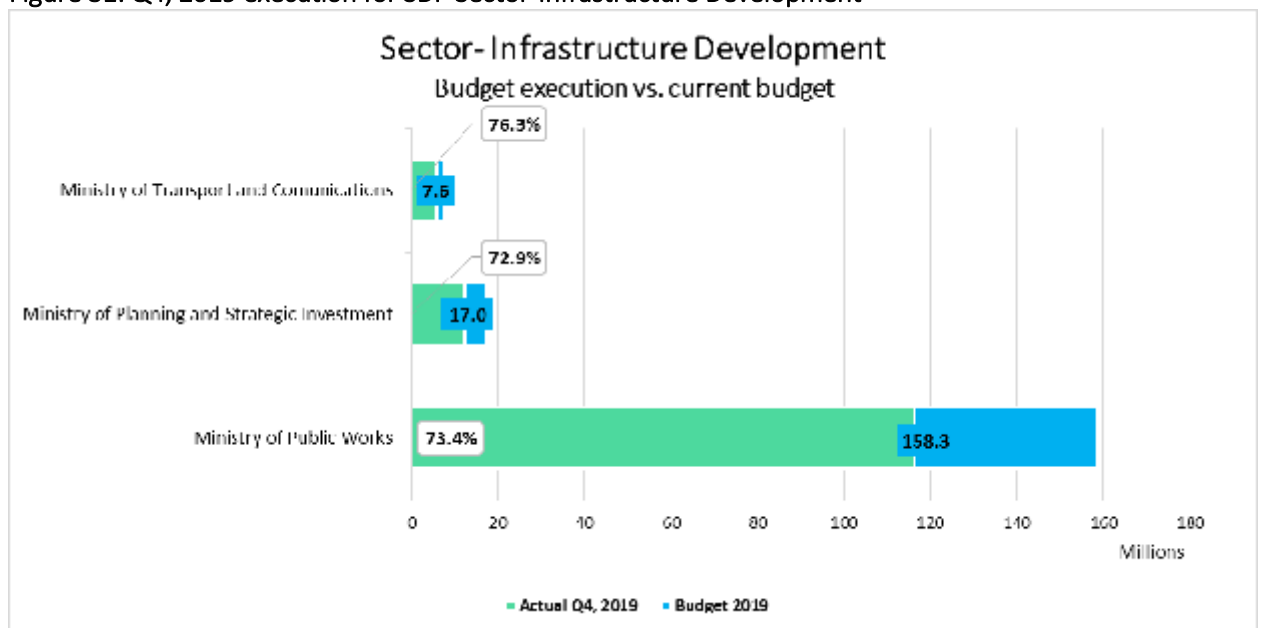
Sources: Ministry of Finance, IFMISU, January 2020

This sector saw decreasing budget allocation from 2015-2018 but received a boost in the 2019 budget again. Ministry of Agriculture and Fisheries (MAF) showed an improvement in overall execution in 2018, in comparison with its 2016 and 2017 execution, which stood at 90.8%. However, 2019 execution for MAF showed a small decrease, driven down by its Capital Development (CD) execution. SEFOPE executed 87.9 % of its budget in 2019 and has steadily decreased its use of virements from 2016.

Ministry of Resources and Oil (106.0%) over-executed in 2018 because of a contingency transfer of \$1 million but reached only 81.9% execution in 2019. This was driven by an 83.2% execution of its Transfers budget (transferred to ANPM (Autoridade Nacional do Petroleo e Minerai), Timor Gap and IPG (Institute of Petroleum and Geology)). The National Company for Mining was allocated \$450,000 but did not receive approval from the President of the Republic on time before the end of the financial year 2019. ANPM received funds from the joint development area between Timor-Leste and Australia which were to be deducted from its GSB 2019 allocation—which may exaggerate its poor execution as the final allocation has not been adjusted. SW execution was low because of delayed recruitment and non-completion of its organic structure.

Ministry of Tourism, Commerce and Industry only executed two-thirds of its total Goods and Services (GS) allocation in 2019, driving its overall execution down. Till Q2, it had low GS execution driven by issues in procurement for i) plans to install system for games, ii) park industry and (iii) social business, and creation of laws for the tourism sector.

Figure 31: Q4, 2019 execution for SDP Sector-Infrastructure Development



Sources: Ministry of Finance, IFMISU, January 2020

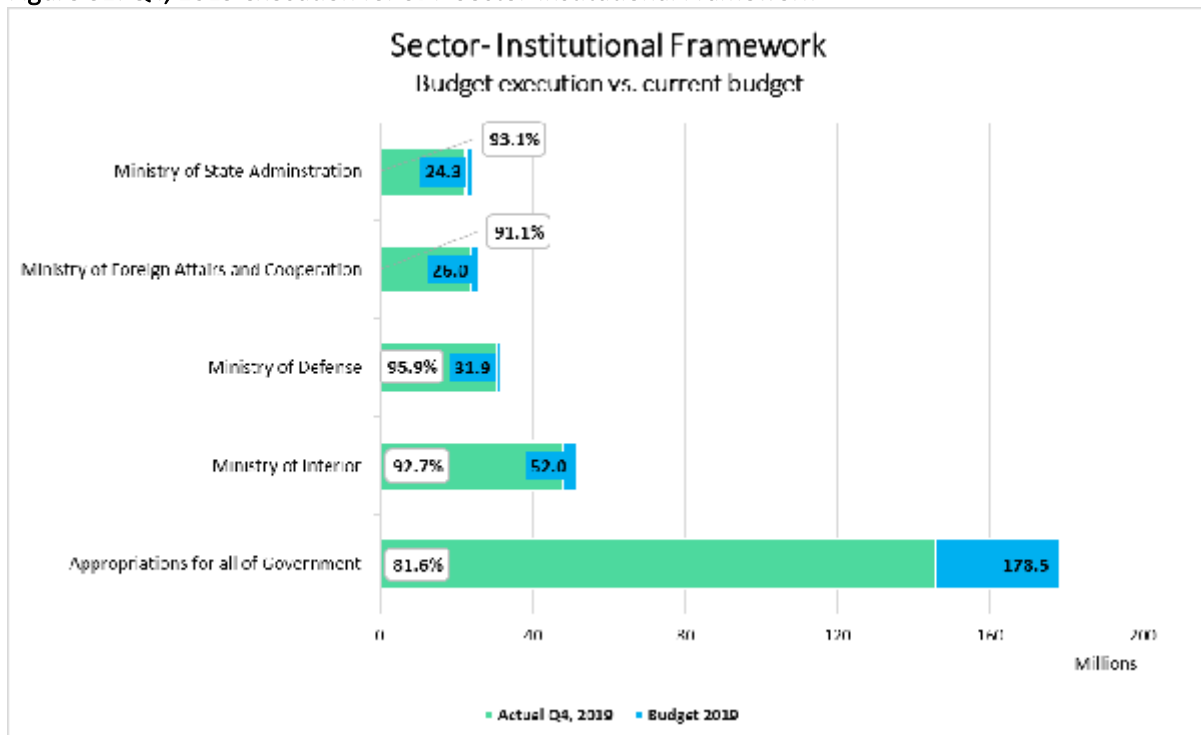
Infrastructure Development sector received a decrease in budget allocation in 2017 but has increased 2018 onwards. The Ministry of Public Works (MoP), along with the IF, consistently gets the highest allocations in Infrastructure development. MoP’s execution performance as a whole has improved over time however, large differences exist across Directorates, some of which have been showing consistently deteriorating trends. In 2018, a large virement was made to settle outstanding debt to electricity contractors, financed by the Contingency Fund.

In 2019, MOP executed only 11.9% of its \$16.8m CD budget by the end of Q4 stating that the payment process request was slow from National Development Agency’s (AND) side and that companies also did not raise their payment request on time. MC execution was also under 30% as some projects were still in contract stage by the end of the year. It also used \$3.5m in contingency measures. GS executions reached 81.1% as payment for debt in rubric in fuel generators, maintenance for generators and maintenance line transmission was needed.

Ministry of Planning and Strategic Investment’s (MPIE) overall execution was 72.4% in 2019. MPIE reported that SW (41.1%) was low as the Cabinet of the Minister had not been able to recruit. Its CD execution (63.9%) was not approved by the National Directorate of Administration and Finance in time.

Ministry of Transport and Communications’ (MTC) overall execution was just 75.8% in 2019. Its CD and SW execution were under 75.0%. MTC had budgeted for Directors of the newly created directorates under its organic law. However, a merit based selection process delayed the execution of the SW budget for these new positions. It transferred funds to ANATL during the year based on its proposal submitted to MTC.

Figure 32: Q4, 2019 execution for SDP Sector-Institutional Framework



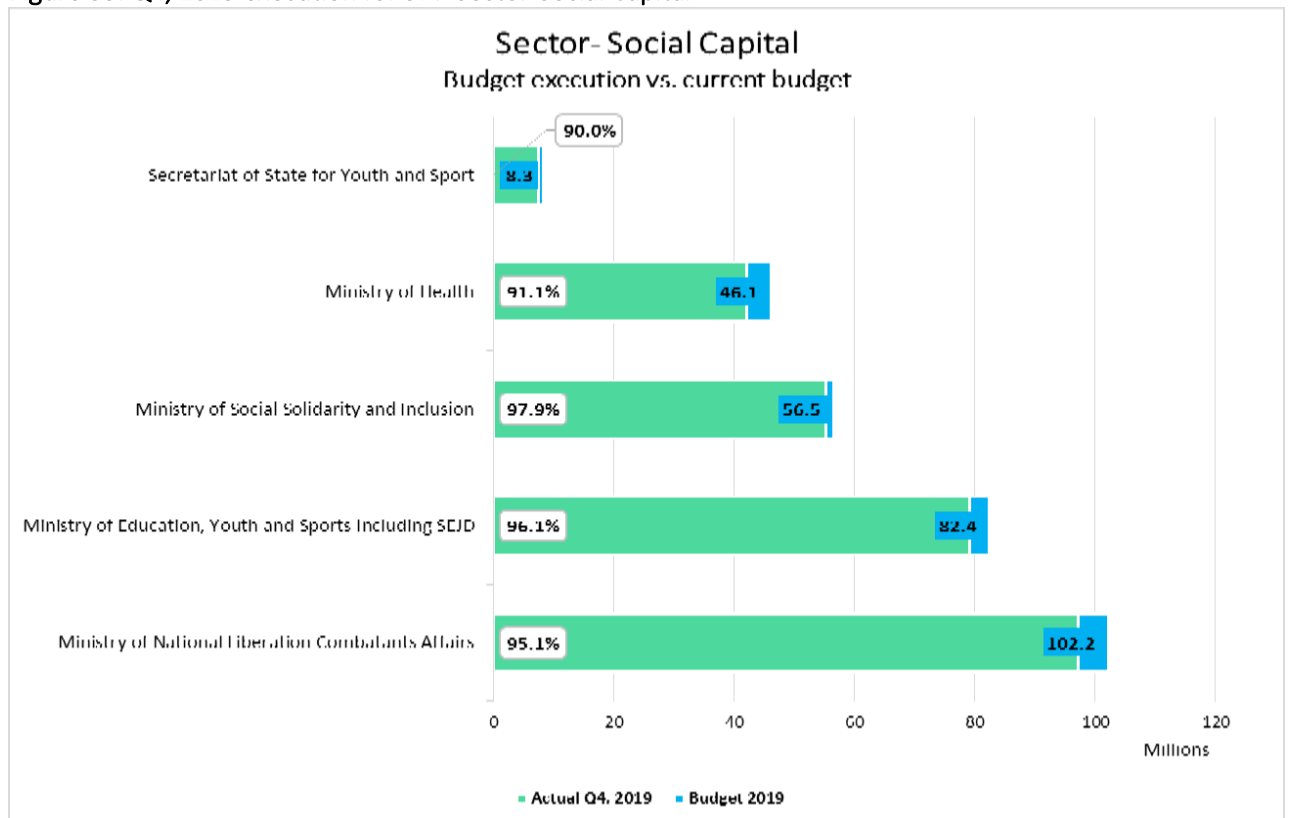
Sources: Ministry of Finance, IFMISU, January 2020

The Institutional Framework sector received an increasing budget allocation till 2016, after which there was a decreasing trend till 2019. In 2019, the budget allocation for this sector again increased. Appropriations for all of Government which also falls under the Institutional Framework sector had a final budget of \$178.5 million in 2019 executing 81.6% of the same.

In 2019, Ministry of Foreign Affairs execution was 88.7% as the transfers to the embassy and other payments had not been reported as completed by them. Ministry of State Administration received a contingency transfer of \$1.7m for the celebration of the 20th anniversary of referendum and Chegeda day for INTERFET in 2019.

In 2019, Ministry of Interior (MI) SW execution did not reach 100% because its public recruitment was slow, the promotion degree was not implemented as the new organic structure of MI was approved late. It generated savings in payments related to the tenderization of uniform sewing of security guards and the Bomber Corpus.

Figure 33: Q4, 2019 execution for SDP Sector-Social Capital



Sources: Ministry of Finance, IFMISU, January 2020

Social Capital sector received over a 10.0% increase in budget allocation in 2019 compared to 2018 final budget. Important social sector ministries for education, health and social solidarity have consistently high execution across years.

In 2019 as well, ministries with the highest allocation in the Social Capital sector performed above the average yet again by the end of Q4, with the exception of Secretariat for Youth and Sport (SEJD) which reached 90.0%.

The Ministry of National Liberation Combatant Affairs (MACLAN) had the highest budget allocation in Social Capital, spending 95.1% of its budget. While its Public Transfers (PT) execution was high, all the other appropriation categories were low, especially CD (19.1%) and SW (62.3%). SW and CD execution was low as the Cabinet of the Minister was not established and its plan to recruit 21 civil servants in 2019 could not be realised. The scholarship for CLN martyrs and children of the deceased had planned to help up to 720 individuals at a cost of \$499,000 but instead the scheme only supported 393 beneficiaries at a total cost of \$322,000.

Ministry of Health's execution slipped from 2018 execution of 95.5% to its 2014-2017 trends of 91-92% in 2019. MSSSI continued to have the highest execution across all LMs, same as 2018. Ministries like MS and MEJD also make high virements each year using the contingency fund options.

Municipalities

In 2019, municipality budget execution stood in the 80.0-92.0% range, Dili having the highest execution at 92%. This is a big improvement from 2017 when they were first granted autonomous status and execution stood in the 65.0-75.0% range.

SW execution was between 77.0-88.0% for all municipalities, while MC execution was nearly 100.0% with the exception of Manatuto at 74.5%. Liquica and Manufahi had the lowest PT execution between 63.0-64.0%, making Liquiça the lowest executing municipality overall. Liquica stated that the funds could not be executed as it was waiting its mandate to make payments to Council members at the suco level. This was true for many other municipalities like Baucau and Bobonaro. Execution for Merenda Escolar (School feeding programme) did not reach its desired level in private schools.

5.2 Mid-year analysis

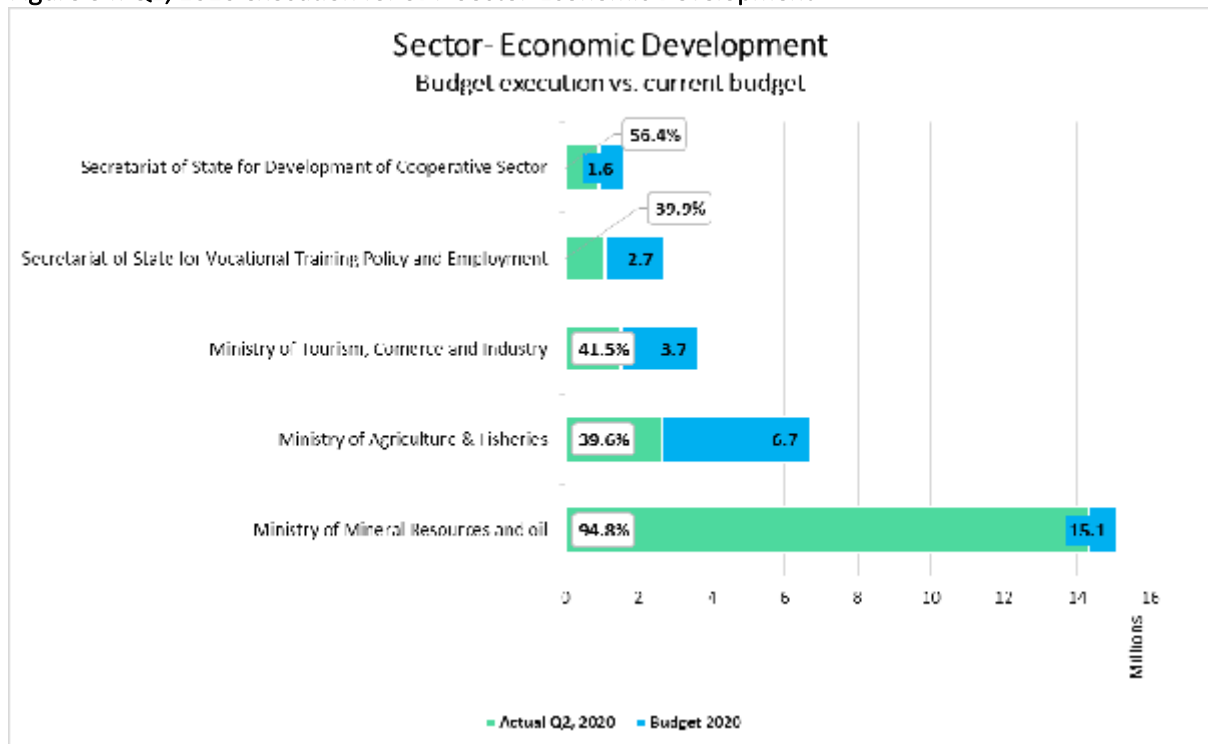
The State Budget for 2020 has not been passed at the time of the publication of this report. Timor-Leste has been under duo-decimal DOT regime for the majority of 2020 as the budget was not passed on a regular schedule. Only up to 1/12 of the previous year's original budget can be distributed per month. This system means that the core functions of government can continue although some policies outside of normal annual activity will not be able to take place (for example the Census) or restrict significant infrastructure projects.

Allocations to Minor Capital and Capital Development will increase by a small amount in the last few months of the non-DOT 2020 budget, after it is passed by Parliament.

This section describes budget execution using the Strategic Development Plan (SDP) classification of Timor-Leste. Five ministries in each sector, with the highest budget allocation in 2020 DOT system, are displayed in the following graphs.

Please note that execution is calculated not on the basis of allocation from January-June in DOT 2020 and not total final budget which is yet to be passed. The total budget allocation till June in DOT 2020 is \$865.5 million with total execution of \$451.8 million.

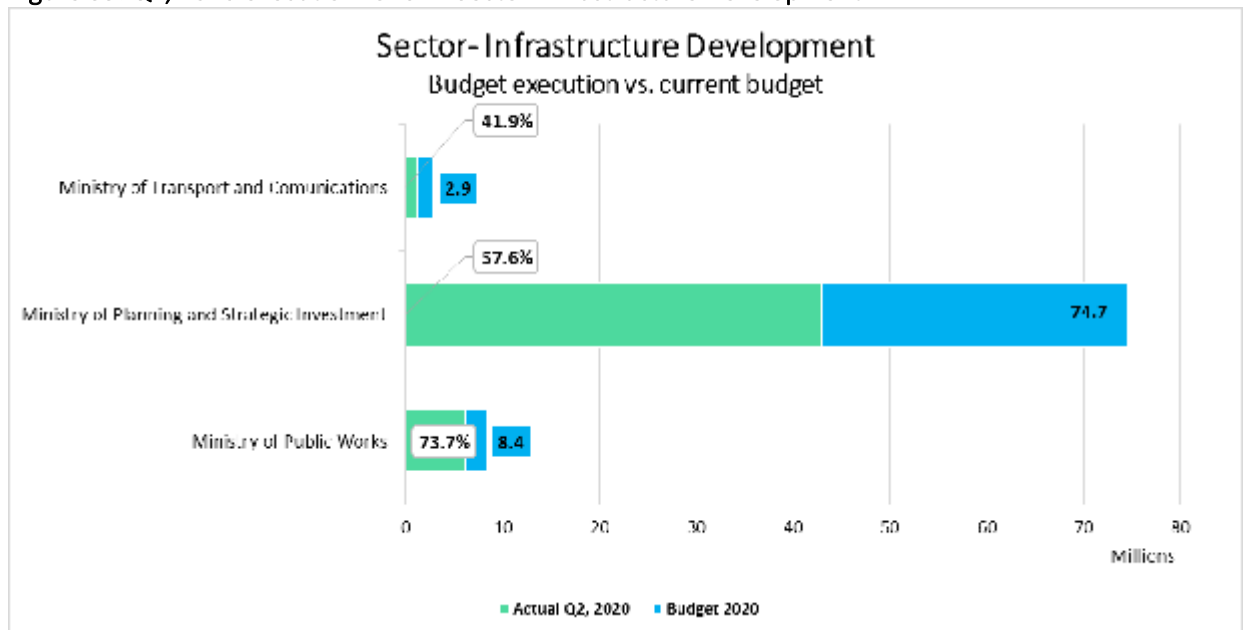
Figure 34: Q2, 2020 execution for SDP Sector-Economic Development



Sources: Ministry of Finance, IFMISU, July 2020

Ministry of Mineral Resources and Oil had the highest budget in the Economic Development SDP sector in DOT 2020 and has also the highest execution. Other Ministries and Secretariats have struggled to reach even 50.0% execution, with the exception of Secretariat of State for the Development of the Cooperative Sector (SEC) which has reached 56.4%.

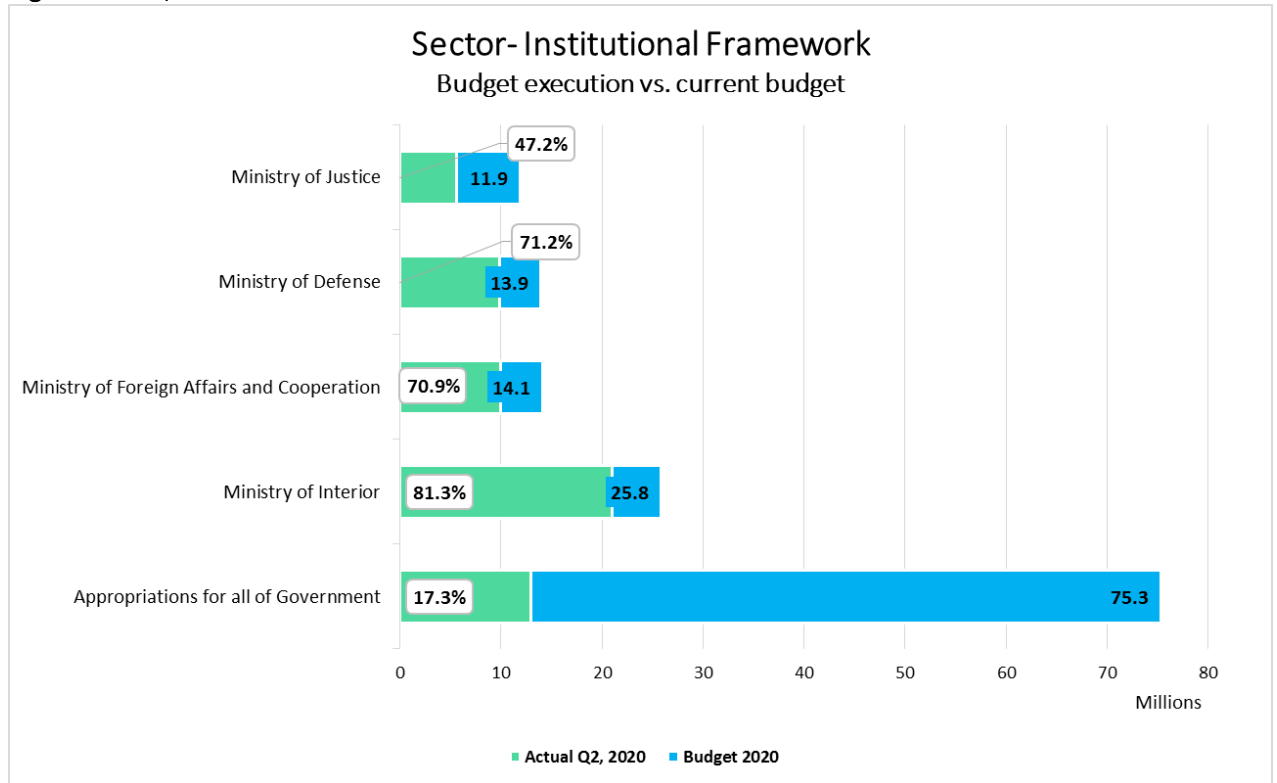
Figure 35: Q2, 2020 execution for SDP Sector-Infrastructure Development



Sources: Ministry of Finance, IFMISU, July 2020

Ministry of Public Works usually has the highest budget allocated to it in the Infrastructure Development (excluding Infrastructure Fund) sector. In DOT 2020, it has only received a total allocation of \$8.4 million as there is a limit on capital projects. Ministry of Planning and Strategic Investment's (MPIE) and Transport and Communications (MTC) execution stood at 57.6% and 41.9% respectively.

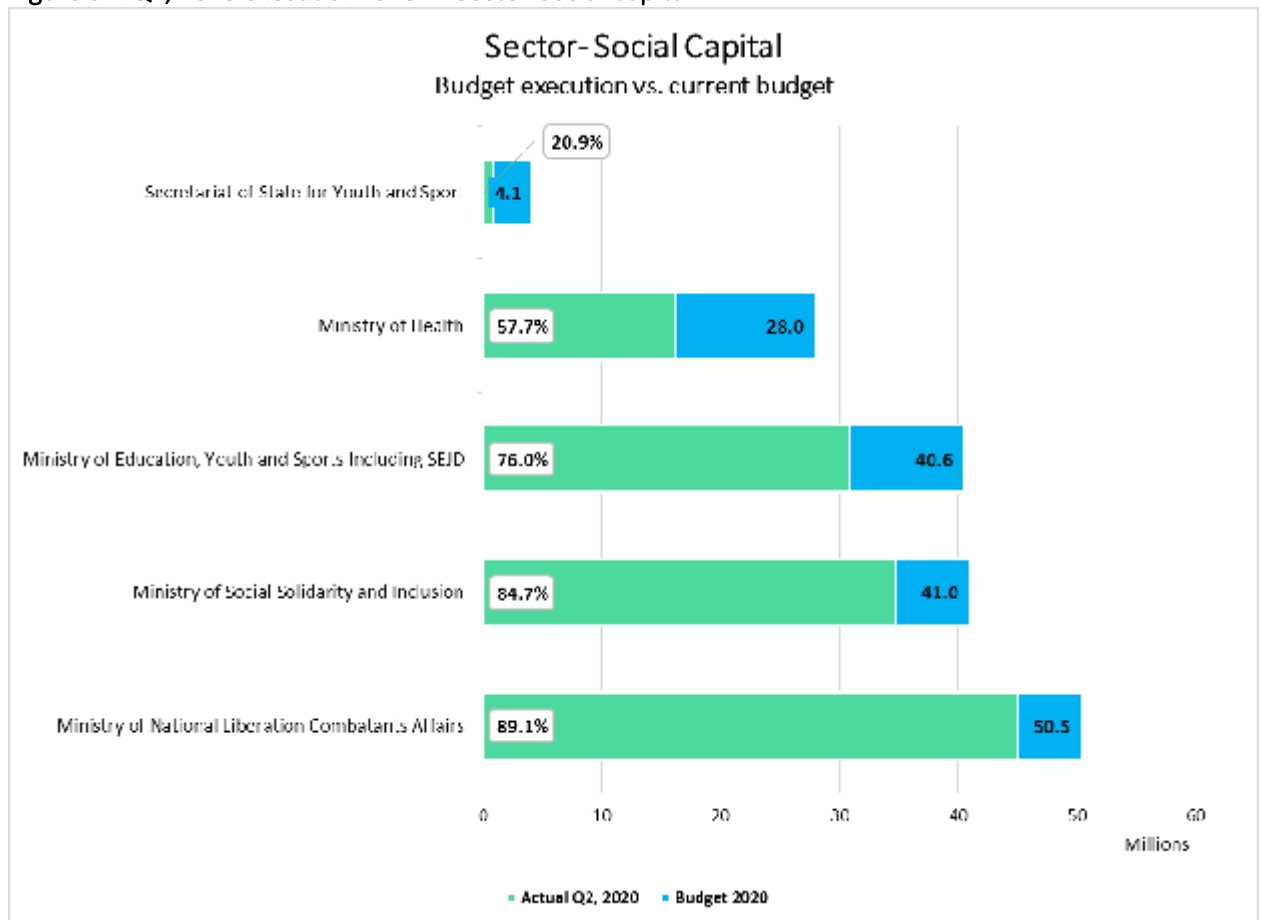
Figure 36: Q2, 2020 execution for SDP Sector-Institutional Framework



Sources: Ministry of Finance, IFMISU, July 2020

Appropriations for all of Government has the highest Institutional Framework allocation in DOT 2020 but has only executed 17.3% of it. Other ministries in this sector have executed 70.0% of their budget with the exception of Ministry of Justice that stands at 47.2%.

Figure 37: Q2, 2020 execution for SDP Sector-Social Capital



Sources: Ministry of Finance, IFMISU, July 2020

The Ministry of National Liberation Combatant Affairs (MACLAN) continues to have the highest allocation in DOT 2020 as most of its budget is public transfer pension payments which cannot be delayed. Secretariat of Youth and Sport only executed 20.9%, driven down by its Transfers execution which stood at 8.2% by the end of Q2, 2020.

Covid-19 Fund

In light of the 2020 Covid-19 pandemic, Timor-Leste instituted a Covid-19 fund (\$220 million) for the health response as well as for economic recovery. Till end of Q2, 2020 \$24.9 million were spent on GS and \$71.3 million were spent on PT, a total of \$96.2 million. Some of the measures spent on include i) state of emergency, ii) social distancing, iii) labour productivity, iv) change in supply chains, v) market performance, and vi) social transfers (electricity subsidy, microbusiness loans, worker wage subsidy).

6 Loans and Public Private Partnerships

6.1 Loans

The Government currently still depends on foreign loan to meet its borrowing needs for concessional loans. As established in the Strategic Development Plan 2011-2030 and regulated by public debt regime law No.13/2011, the primary objective of taking concessional loans should be related to the construction of strategic infrastructure for the development of the country.

6.1.1 Terms of Loans

At present, external loans are mainly provided by international multilateral banks such as Asian Development Bank and World Bank including one bilateral loan from JICA. By creditor category, ADB is currently the major lender to TL and its loans accounts for nearly 70% of the total loan amount followed by WB and JICA. Below are the terms of the loans:

Table 18: Terms of Loans

Creditor	Currency	Approved loan (million USD)	Grace Period (year)	Initial Amortization (year)	Year Complete	Interest rate FY 2019
ADB	USD, SDR	271.65	5.1	20	2044	2.51%
WB	USD, SDR	134.20	7.5	20	2059	2.65%
JICA	JPY	68.72	10	20	2042	0.70%
Total		474.57				

Source: Ministry of Finance, PMLU, June 2020.

These are loans that have a considerable degree of concessionality and compare favourably to the opportunity cost of withdrawing funds from the petroleum fund. A key advantage is that the financial cost of concessional borrowing (2.34%) is currently lower than the return on the Petroleum Fund (4.5%) ensuring that the future debt repayments remain well within the country's capacity to pay.

Table 19: Cost of borrowing vs PF return

Description	2012	2013	2014	2015	2016	2017	2018	2019
Cost of borrowing (effective rate)				1.02%	1.42%	1.68%	2.06%	2.34%
PF historical return	4.1%	4.4%	4.2%	3.8%	3.8%	4.4%	3.8%	4.5%

Source: Ministry of Finance, PMLU, June 2020.

6.1.2 Portfolio Management

The management of public debt plays a critical role in determining the sustainability of fiscal policy. Due to change in methodology⁴, TL's debt carrying capacity is now rated higher than

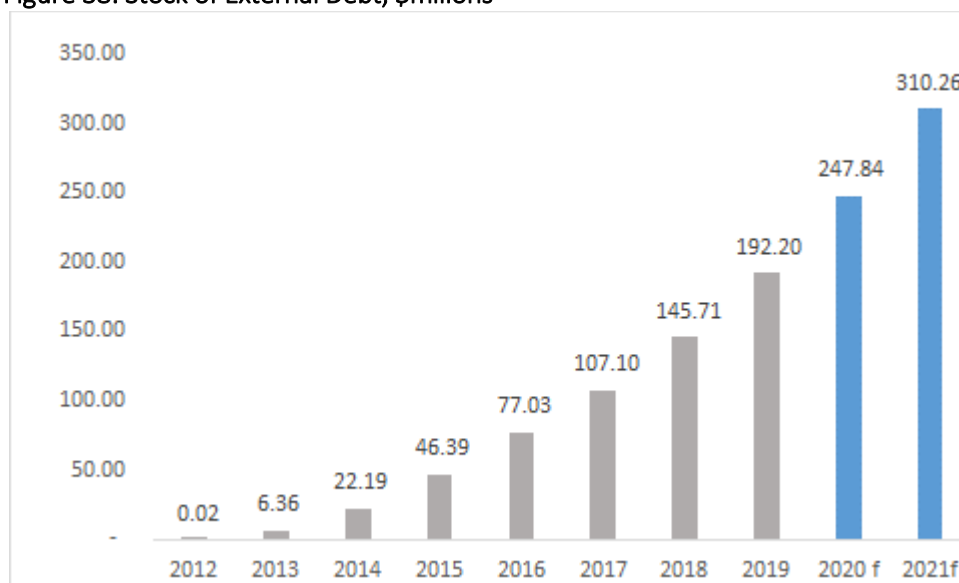
⁴ In evaluating debt sustainability, Ministry of Finance is utilising a method jointly developed by the World Bank and International Monetary Fund, known as Low Income Country Debt Sustainability Analysis (LIC-DSA). As set under the new guidelines, a country's debt carrying capacity is classified into one of the three categories: weak, medium and strong based on its composite indicator score (CI).

previous by the IMF article IV assessment held in 2019 increased from weak to medium; thus, risk of external debt distress was also lowered from medium to low.

Changes in External Debt Stock

As end of the fiscal year, the stock of external debt increased to USD 192.20m in 2019 from \$145.71 at the end of 2018. The 32% increase is attributable to the total new disbursement of \$45.75m from multilateral and bilateral institutions including ADB, WB and JICA for ongoing and new projects. Interest and other fee related payments for the period increased from \$2.58m in 2018 to \$3.93m as at end of 2019. This amount is relatively small compared to the amount currently the Government owes to these lenders.

Figure 38: Stock of External Debt, \$millions



Source: Ministry of Finance, PMLU, June 2020.

Considering the impact of Covid-19 outbreak, particularly delaying a number of key capital projects, a fall in disbursements is expected in 2020. Disbursements in 2020 are expected to fall 31% compared to those in 2019. However a recovery is expected in 2021, with loan disbursements forecast to reach \$70.7 million, making the total debt stock estimated to be \$310.26 million by the end of 2021.

Debt Indicators

TL's debt ratios increased over the years, marginally. Despite this, total public debt remained sustainable over the year reflecting the Government's prudent management of the debt.

Table 20: External Debt Indicators for the period 2012-2019, % of GDP and Revenue

External Debt Indicators for the period 2012-2019 (in percentage of GDP and Revenue)								
	2012	2013	2014	2015	2016	2017	2018	2019 p
Total Debt to GDP								
External Debt to GDP	0.00	0.43	1.43	2.9	4.66	6.73	9.23	11.71
Total Debt Service to Revenue								
External Debt Service to Revenue	0.00	0.01	0.04	0.04	0.12	0.27	0.42	0.98
External Debt Service to DGP	0.00	0.01	0.02	0.02	0.05	0.11	0.20	0.44

Source: Ministry of Finance, PMLU, June 2020.

External Debt to GDP - The size of external debt to GDP during the period was relatively small when compared to the debt burden threshold and benchmarks as established under the debt sustainability frameworks for low income countries⁵. While the ratio constantly increased marginally from 0.43 percent in 2013 to 9.2 percent in 2018, the values are far below 40%. This marginal increase was due to an increase in disbursement and external downward growth trend in GDP. While there was a slight recover during 2017-2018, the percentage increase in external debt was still higher than GDP growth, hence, higher external debt to GDP ratio.

Debt Service to Revenue – The debt service to revenue ratio started to increase more than two times in 2015. This increase was primarily due to an increase in debt service payments while revenue declined from 2017-2018. Repayment of principal started in September 2017 for ADB loan 2857. Despite the increase from 0.12 in 2017 to 0.27 percent in 2018, this percentage of debt service to revenue is still well-under the threshold 18 percent.

Debt Service Forecast – Annual debt service is calculated on each loan to cover the repayment of principal, interest and other miscellaneous charges on a debt for a particular period.

Table 21: Debt Service Forecasts, \$m

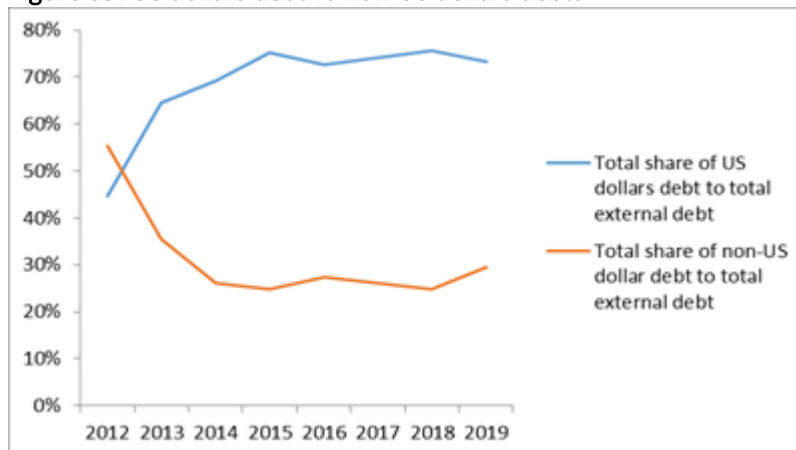
Year	2020	2021	2022	2023	2024
Debt Service	9.55	15.61	24.34	27.05	26.77

Risk Indicators

Foreign Exchange Risk – Complying with the loan policy note, the US dollar has remained the dominant currency in the Government’s external debt portfolio. Given the country’s highly dollarized economy, the large share of US dollar currency debt in the portfolio 75 percent in 2018 cushioned the Government from extreme exchange rate movements. The policy to retain a larger share of US dollars debt continues at least in the short to medium term.

⁵ Further reference on this subject: “Guidance Note the Bank-Fund Debt Sustainability Framework for Low Income Countries”, February 2018.

Figure 39: US dollars debt vs non-US dollars debts

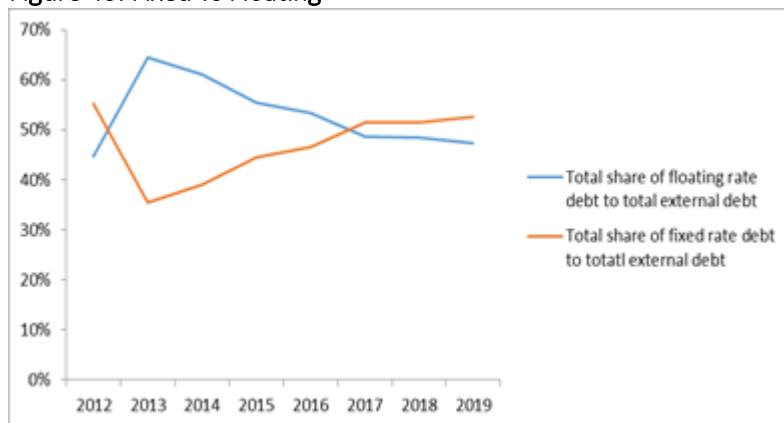


Source: Ministry of Finance, , PMLU, June 2020

Interest rate risk – From 2013, the total share of fixed rate debt started to increase until it comprised the majority share of the debt portfolio, in 2017 and 2018 consecutively. The change occurred as a result of the ability of the Government in managing interest rate risk independently by converting the priority for disbursement from variable rate to fixed rate taken into account market interest rate fluctuation.

The cost of borrowing is expected to continue to rise as TL is now classified as a blend country⁶ and is slowly being phased out from concessional financing by its external creditors. To limit the exposure to interest rate shocks, there needs to expand the use of more concessional financing from bilateral loan providers.

Figure 40: Fixed vs Floating



Source: Ministry of Finance, , PMLU, June 2020.

6.1.3 Current Project Status

There are currently 15 ongoing road projects funded by concessional loans of which 6 projects had already been completed. These include roads connecting Tibar-Liquica/Tibar-Gleno, Manatuto-Laclubar junction and Solerema-Ainaro corridor. Other projects that most likely to be

⁶ Being a blend country, TL has a limited access to concessional lending with a fixed interest rate.

concluded by 2019/2020 are roads from Laclubar junct.-Natarbora, Manatuto-Baucau, and Dili-Manatuto bringing the total numbers of projects completion to over 60% by end the year.

Total capital contribution made by this investment is \$429.85m which is by a ratio of total investment, concessional loans accounted for approximately 62%. Of this, \$157.07 m has been disbursed leaving a balance of \$109.33 m to be spent for next 1-2 years in accordance with project construction periods. On the other hand, state contribution to the overall budget of Civil Works contract was \$163.45m with an estimated remaining \$43.77m for further disbursement.

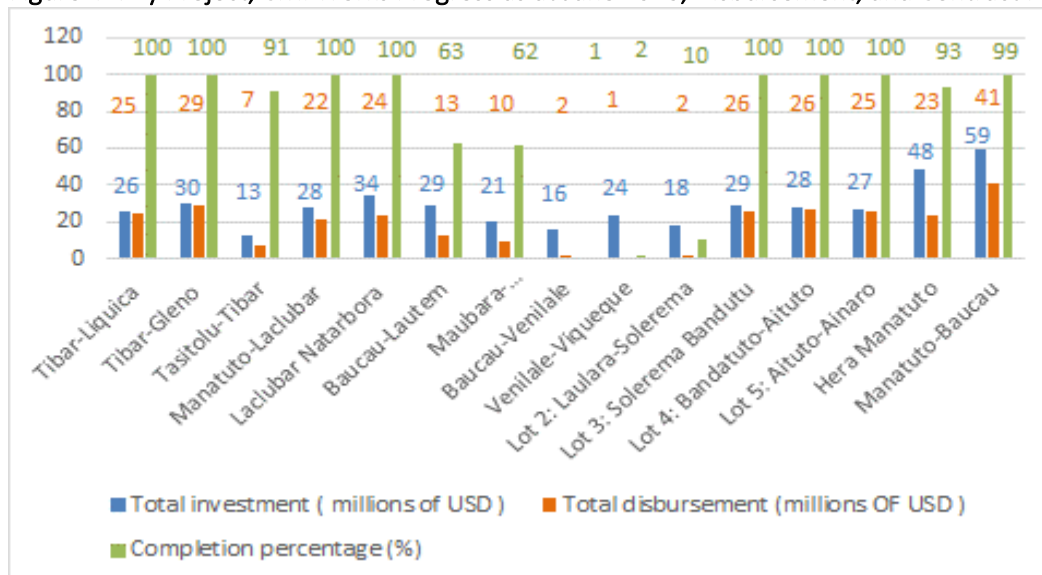
New projects included road section from Baucau-Venilale/Venilale-Viqueque and Laulara-Solerema. The key challenges in project implementation were mainly relating to the release of social safeguard documents by relevant line ministries including delay in environmental licensing and resettlements and payment delays. As for the latter, it explained the trends illustrated in the graph below for road section Dili-Manatuto and Manatuto-Baucau. While projects progress was relatively high disbursements were significantly low relative to the contract amounts.

Table 22: Total investment in Civil Works

Source of Fund	Total Investment in Civil Works (USD million)	Disbursement as at 30 June 2020(USD million)	Contract Balance (USD million)
Loan Fund	266.40	157.07	109.33
State Contribution	163.45	119.68	43.77
Total	429.85	276.75	153.10

Source: Ministry of Finance, PMLU, June 2020.

Figure 41: By Project, Civil Works Progress as at June 2020, Disbursement, and Contract Price



Source: Ministry of Finance, PMLU, June 2020.

There is about \$40m loan saving from ADB ongoing loan -funded projects. The cost reduction increases year by year as a result of the number of participating bidders also increases in public procurement; hence, bringing down the prices by approximately 40% . This includes surplus in civil works, consulting services and unallocated loan contingencies. By projects, Baucau-Lautem/Maub-Karim/Atab-Motain contributed over \$25m in saving while other projects such

as Manatuto-Natabora, Baucau-Viqueque, Manatuto- Baucau, and Tacitolu-Tibar accounted for the remaining balance.

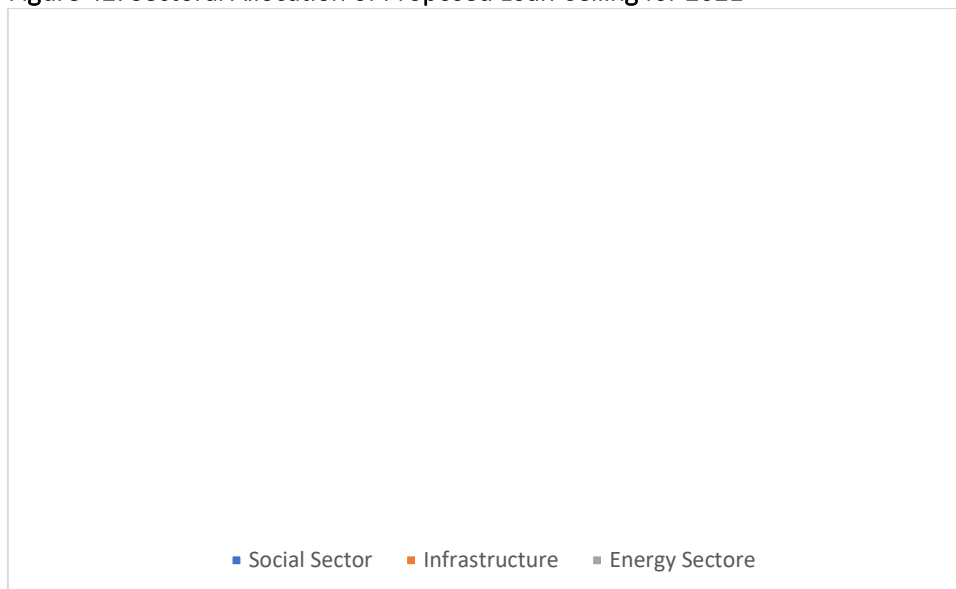
As a borrower, the Government can decide whether to fully utilise the saving or simply cancel the amount by complying with public debt law No.13/2011 and other relevant laws. For this purpose, the Government has already requested ADB to maximise the use of some of this saving to fund for the construction of three (3) bridges: Seical Bridge, Borouai causeway and Malailada causeway with a total estimated cost at \$14m a long Baucau-Lautem road section and mitigate the pressure on the state budget.

6.1.4 Future Loans

Infrastructure development would remain to play a key role in the country’s economic development success in the medium term. New strategic sectors such as water, education, telecommunication, and air transports should receive concessional financing. This would help unleash the growth potential of other key economic activities; hence, inclusive economic growth and poverty reduction.

In this respect, annual loan ceiling is required for parliamentary approval, in the context of the State Budget Law, prior to implementing all these programs. The amount is set according to project cost estimates and debt sustainability analysis. On the DSA, based on the MOF internal analysis, the country’s external debt stock to GDP remained relatively low in 2018 which is 9.2%. IMF staff completed the country’s 2019 article IV consultation by stressing the need for making effective use of concessional borrowing for continued investment in infrastructure. In light of all the above, the Government is therefore, proposing a ceiling of \$400m for new concessional foreign loans to be negotiated in 2021.

Figure 42: Sectoral Allocation of Proposed Loan Ceiling for 2021



Source: Ministry of Finance, PMLU, June 2020.

6.2 Public Private Partnerships

6.2.1 Overview of Public Private Partnerships in Timor-Leste

In general terms, the Public Private Partnership (PPP) refers to arrangements in which the private sector build infrastructure assets and provides services that traditionally have been provided by the State.

DL 8/2014 stipulates the formation of PPPLU, a PPP facilitation agency under the Ministry of Finance to take on the tasks of managing and implementing the PPP Project Cycle in coordination with line ministries and Council for Administration of Infrastructure Fund (CAFI). An important role of the PPPLU is to promote and create environment for attracting foreign direct investment (FDI) through PPP modality, while at the same time looking for ways of encouraging local private sector involvement in PPP projects by pursuing policies that will allow for development of small to medium scale PPPs. One Sector that have high potential for this is the Tourism Sector.

Tourism is thought to be one of several strategic sectors with potential to further diversify Timor-Leste's economy. Due to its close linkages to other sectors, improvement to the tourism sector requires wide range of intervention, e.g. in transport infrastructure, water and sanitation, agriculture, health infrastructure and education and training.

6.2.2 Existing PPPs Projects

Currently, one PPP project is in **Implementation and Operation Stage** (Tibar Bay Port PPP), one in **Procurement and Negotiation Stage** (Medical Diagnostics) while others in **Feasibility Stage** (Affordable Housing, Cristo Rei and Presidente Nicolau Lobato International Airport).

Tibar Bay Port PPP Project

The PPP modality chosen for Tibar Bay Port was a 30-year concession, including the design, partial financing, construction, operation and maintenance of the port infrastructure. The project was awarded to a consortium comprised by Bolloré Africa Logistics and SDV East Timor through an international competitive bidding which formed Timor Port SA (Concessionaire) to implement it.

The concession agreement was signed on 3rd June 2016 between the GoTL and the TPSA and the concession was awarded for 30 (thirty) years including a construction period which started on 30 August 2018 and expected to be completed by May 2022. The construction progress until end of August 2020 was 31.67%.

The Environmental License was awarded on 15 March 2018 and currently extended until 15 March 2022. So far there is record of environmental impacts resulting from the construction of Tibar Port.

The capital expenditure of the Phase-I is around USD 300 million. The Concessionaire will fund the majority of the amount by means of equity and debt and the GoTL has allocated an amount of USD 129, 45 million as Viability Gap Funding (VGF) to the Concessionaire. Until end of August 2020, the total amount disbursed from VGF was USD 45.31 million.

Medical Diagnostics PPP

Medical diagnostics PPP is currently in preparation of tender documents and other necessary structures (e.g. accessible data room) which are the early steps in the **Procurement and Negotiation Stage**. Previously, the Feasibility Study and Transaction Structuring Report (TSR) have been approved by CAFI on 11 July 2019 after clearance from the Ministry of Health in June 2019. The TSR recommended that the project upgrade imaging and laboratory diagnostic services in the National Hospital, all referral hospitals and 8 Community Health Centers (CHCs) to achieve a demand coverage of 98.2% of the total population. Concession period is recommended at 11 years to consist of 1 year of upgrading and construction of selected facilities and 10 years operation period. Potential bid parameter and bid evaluation criteria have also been recommended. The estimated Government contribution will be about \$12 million per year for operation and maintenance of health diagnostic services. It is estimated that the contribution of private sector will be around \$11 million for the upgrading or construction of facilities, operate and maintain Laboratory and Imaging centers and provide quality diagnostic services to patients in Timor-Leste. In addition, private sector also will employ and train diagnostic services staff, comply with local regulation and international best practices in health care service delivery. Signing the extension of Financial Advisory Service Agreement between GoTL and IFC finalized and the proposed work program and timetable will be adjusted and resumed accordingly.

Affordable Housing

The pre-feasibility study for Affordable Housing PPP project has been completed, submitted and approved by CAFI to proceed with feasibility study. Currently in the proses of finalizing the Financial Advisory Service Agreement (FASA) document between GoTL and IFC (*International Finance Cooperation*). The study made an assessment of the housing ecosystem in Timor Leste including existing housing market, the housing value chain which considers the demand and supply sides of the housing provision in Dili and make recommendations for the creation of a vibrant housing market in the capital. Among the recommendations are – facilitating access to construction finance products and incentivize developers to provide market-based solutions for affordable housing (supply side) and facilitate access to home loans/mortgages for households with effective purchase power (demand side) and make available subsidy program to increase access to housing for qualified low income groups. Subsequent step for the project is to proceed with Feasibility Study phase where deeper analysis of the technical, legal, commercial as well as social and environmental terms are conducted.

Cristo Rei PPP

Cristo Rei is a well-known icon of capital Dili. The site is a religious as well as a recreational facility with open air chapel, green space and parking areas. Cristo Rei is well visited either by international or domestic visitors alike which also make regular maintenance a necessity for the site. A Pre-Feasibility Study has been conducted and found a PPP – Concession Model for a pre-determined duration - with 100 percent CAPEX from the private sector with progressive royalty paid to the Government to be highly possible.

Presidente Nicolau Lobato International Airport Development

Pursuant to the decision of the Council of Ministers to develop the International Airport of Presidente Nicolau Lobato (“Airport”) through PPP Hybrid modality, this modality entails the combination of investment from private and public. The implementation of the project involves

public investment through Engineering, Procurement and Construction (EPC) contract with possibility of involvement of private sector for construction, operation and maintenance of the entire airport. The Feasibility study for runway development along with other airport subcomponents is underway and construction of these components will be financed through ADB loan while the preparatory studies for other key components (e. g. Terminal) will be initiated in 2021 and financed through public and potential private investment. One important element of preparatory study includes resettlement of affected communities who reside in the surrounded area of the runway expansion. This includes the preparation of Resettlement Action Plan (RAP) which will be established by the Government with the support of airport stakeholders. Meanwhile, the implementation of phase 1 of Financial Advisory Service Agreement (FASA) with IFC is progressing well, and it is expected to conclude before end of 2020. The phase 1 consists of technical, financial, environmental and social (E&S) and legal due diligence and structuring. Phase 2 of FASA comprises of tender and award, and it will be started once the phase 1 is completed. The Airport project also receives plethora of interest from some international agencies whose commitment still subject to final confirmation.

6.2.3 Budget Estimate

Tibar Bay Port PPP project involved the provision of Viability Gap Funding (VGF) of \$129.5m in 2016 (recorded as 2016 expenditure) for earthwork, construction and equipment purchase. Private sector contribution to this project is around \$153.87m meaning that the Government's VGF contribution stood at about 45% of total project cost.

To hold the VGF until disbursement, the Government was contractually required to deposit the full amount in an Escrow Account. For this purpose, a three party Escrow Agreement was reached between the Government, Timor Port SA and the United Overseas Bank (UoB) of Singapore in November 2016. First disbursement from the Escrow Account occurred in the third quarter of 2019.

The Escrow Account is earning interests. As of June, 2020, interest earned amounted to **\$8.23m**, deposited in the Escrow Interest Account. The Escrow Agreement stipulated that the interest earned can only be transferred to the Government after the closing of the account and/or termination of the Escrow Agreement.

Actual expenditure for 2017, 2018 and 2019 for PPP projects consisted of budget for the PPPLU and Tibar Bay Port Project Management Unit (TBP PMU), payment of Financial Advisory Service Agreement for TBP PPP, medical diagnostics and Dili water supply PPPs, as well as payment for Independent Engineer service. The 2020 budget contains similar provisions with addition of studies for the development of roundabout for Port access and EDTL substation for electricity connection to TBP.

Estimated budget for 2021 will contain a rapid increase due to the capital expenditure from the construction of roundabout, EDTL substation and Medical Diagnostic service payment. In addition, due to the promulgation of Ministry of Finance organic law, the PPP and Loan programs are now structurally separate divisions. Therefore, 2021 budget for the PPP and Loan has been separated. For the PPP, in the near future, more increase in the budget is projected for 2022 and 2023 if affordable housing PPP materialize. New initiatives in tourism sectors are likely to require allocation of budgets from 2021 onward.

Table 23: Actual, 2019 Budget and Estimated Budget for 2020 – 2025, \$ Millions

	2017 Act	2018 Act	2019 Act	2020 Est	2021 Est	2022 Est	2023 Est	2024 Est	2025 Est
Combined Sources Budget	1.21	1.28	1.55	2.81	25.65	59.82	34.97	27.94	41.50
MoF Budget									
PPPU	0.51	0.46	0.40	0.60	0.61	0.57	0.63	0.69	0.76
PMU TBP Project	0.45	0.36	0.63	0.60	0.60	0.41	0.30	0.27	0.24
SUB TOTAL	0.96	0.82	1.03	1.20	1.21	0.98	0.92	0.96	1.00
Dotação Todo Governo									
PMU Cristo Rei Project					0.06	0.03	0.03	0.03	0
PMU Dili Airport Project					0.75	0.82	0.90	0.0	0
Medical Diag. PPP - Service Payment					2.00	12.00	12.00	12.00	12.00
SUB TOTAL	0.00	0.00	0.00	0.00	2.81	12.85	12.93	12.03	12.00
Infrastructure Fund									
TBP PPP									
PT FASA*	0.15	0.15	0.0						
IE* payment	0	0.31	0.32	0.32	0.40	0.31	0.07		
Roundabout				0.25	2.20				
EDTL substation				0.32	4.50				
SUB TOTAL	0.15	0.46	0.32	0.89	7.10	0.31	0.07	0.00	0.00
Medical Diag. PPP									
FS FASA*	0.10		0.20						
PT FASA*					0.51	0.18			
IM* payment						0.50	0.50	0.50	0.50
SUB TOTAL	0.10	0.00	0.20	0.00	0.51	0.68	0.50	0.50	0.50
Affordable Housing PPP									
FS & TSR FASA				0.12	0.40				
Resettlement – Site Clearance					0.10				
Construction (VGF)					2.50	25.00	1.00	1.50	22.50
PT FASA*					0.00	0.15	0.15		
SUB TOTAL	0.00	0.00	0.00	0.12	3.00	25.15	1.15	1.50	22.50
Tourism PPP									
FS & TSR*, Resettlement					0.25	0.35	0.40	0.45	0.50
Construction						2.00	3.00	5.00	5.00
SUB TOTAL	0.00	0.00	0.00	0.00	0.25	2.35	3.40	5.45	5.50
President Nicolau Lobato International Airport Hybrid PPP									
FS & TSR*				0.60	0.50				
Demolition of existing Airport infrastructures					0.50	0.5			

Studies & Construction – VIP Building					0.50	3.00	3.00	3.50	
Studies & Construction- Cargo Terminal					0.20	2.00	1.00		
Studies & Construction- Power Supply System					0.20	2.00	1.00		
Studies & Construction - Access Road, GSE Service Road, Perimeter Road & Fire Road					0.00	0.50	2.50	2.00	
Studies & Construction- Car Parking/drop off zones					0.20	1.00	3.00		
Studies & Construction- Boundary fences, Security fences & Gates					0.50	2.00	2.00		
Studies & Installations- Lightings/Aeronautical Ground Lights							0.50	2.00	
Studies & Construction- Fire Fighting Infrastructures					0.50	1.00	1.50		
Others Support Infrastructure					2.00	1.70	2.00	2.00	
Resettlement					5.00	2.00			
SUB TOTAL	0.00	0.00	0.00	0.6	10.1	15.7	16.50	9.5	0

Source: Ministry of Finance, PPPU, July 2020. PPPU = Public Private Partnership Unit, PMU TBP = Project Management Unit Tibar Bay Port, *PT FASA = Post Transaction Financial Advisory and Service Agreement; IE = Independent Engineer; FS FASA = Feasibility Study FASA; IM=Independent Monitoring; TSR = Transaction Structuring Report.

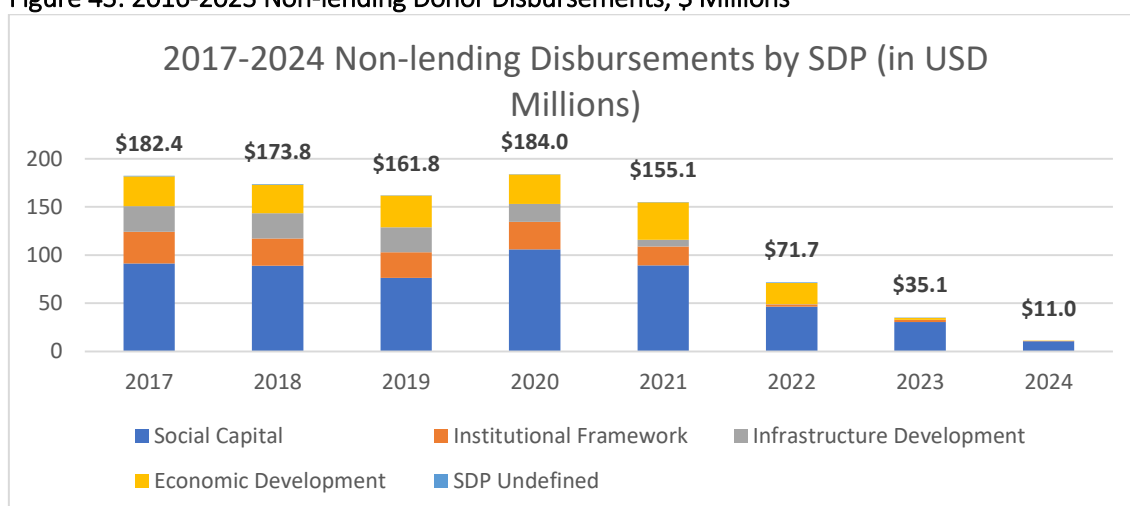
7 Development Partners

7.1 Grant Forecasts

2021 is scheduled to experience a contraction of \$28.9 million as compared to 2020 planned disbursements. 2020 saw a significant increase in development partner non-lending assistance as a result of additional funding mobilized for Coronavirus response efforts. Although 2021 will see a decrease, it is expected that the actual disbursements will surpass \$155.1, typically development partners under report their projected assistance.

The data generated for the PBS was produced on the 25 September from the Aid Transparency Portal. This number will change as we approach the budget submission date. Please note that the European Union's Direct Budget Support programs are not included in these figures.

Figure 43: 2016-2023 Non-lending Donor Disbursements, \$ Millions



Source: Aid Transparency Portal, report generated on September 25, 2020.

Table 24: Planned Disbursements by SDP Sub-pillar and Pillar for 2020-2021, \$ Millions

SDP	SDP Sub-pillar	2021	2022	2 year total
Social Capital	Education and Training	39.1	25.7	64.8
	Health	34.3	18.8	53.1
	Social Inclusion	14	0.9	14.9
	Environment	1.8	1.0	2.8
	Culture and Heritage	0.2	0.2	0.4
Subtotal		89.4	46.5	136.0
Economic Development	Agriculture	25.8	18.6	44.4
	Rural Development	7.9	0.6	8.5
	Private Sector Investment	1.5	1.5	3.0
	Tourism	3.6	1.2	4.8
Subtotal		38.7	21.9	60.8

SDP	SDP Sub-pillar	2021	2022	2 year total
Institutional Development	Public Sector Management and Good Governance	11.0	0.8	11.8
	Security	7.0	0.9	7.9
	Justice	0.9	-	0.9
	Foreign Affairs	0.6	0.6	1.2
Subtotal		19.4	2.2	21.6
Infrastructure Development	Roads and Bridges	3.6	0.3	3.9
	Water and Sanitation	2.0	-	2.0
	Sea Ports	1.2		1.2
	Electricity	0.3		0.3
Subtotal		7.1	0.3	7.4
SDP Undefined		0.4	0.8	1.2
Total		155.1	71.7	226.8

Source: Ministry of Finance, DGGMRE, September 2020.

Table 25: Top 10 Projects 2020-2021, \$ Millions

Project Title	Development Partner	SDP Sub-pillars	2019 & 2020 Total
Ai ba Futuru - Partnership for Sustainable Agroforestry Project (PSAF)	EU and Germany	Agriculture	16.8
Timor-Leste: Sustainable Agriculture Productivity Improvement Project	World Bank	Agriculture	14.5
Escolas de Referência de Timor-Leste - Centros de Formação	Portugal	Education and Training	12.1
5530-Escola Portuguesa Ruy Cinatti – Centro de Ensino e Língua Portuguesa	Portugal	Education and Training	11.3
Australia - Timor-Leste Partnership for Human Development - Health Sector	Australia	Health	8.1
HATUTAN Education and Nutrition Program (Beneficiary is Ministry of Education)	US Embassy	Education and Training	7.9
Australian NGO Cooperation Program (ANCP)	Australia	<ul style="list-style-type: none"> • Agriculture • Health • Social Inclusion • Justice • Water and Sanitation • Public Sector Management and Good Governance • Education and Training 	6.9
Australian Award Timor-Leste Program	Australia	Education and Training	6.8
National TB Programme (NTP) and Resilient and Sustainable Systems for Health (RSSH)	Global Fund	Health	6.1

Timor Leste Police Development Program (TLPDP)	Australia	Security	5.9
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Source: Ministry of Finance, DGGMRE, September 2020.

7.2 Direct Budget Support

Timor-Leste has been receiving Direct Budget Support (DBS) from the European Union since 2014. The latest agreement was signed in 2016 under the 11th European Development Fund.

EU DBS is considered as a financing for 2021 State Budget because it uses Government system (the money is in a Treasury sub-account) and on-budget, where the money is used directly by the beneficiary ministries for the public financial management program (Ministry of Finance), Malnutrition (Ministry of Health) and decentralization (Ministry of State Administration).

Total amount of DBS for 2021 State Budget is \$9.1m

In this context, the funds are directly given to the country's government without prior earmarking. However, a variable tranche depends on specific Key Performance Indicators (KPIs) agreed upon by the Ministry of Finance and the EU. While the funds are not separate or additional to the Ministry's core business, they must support clearly stated priorities and the Ministry's own planning framework.

In 2019, it received a first tranche of \$3.1 million. The second tranche of \$6.7 million was received on 19 September 2019. Out of this, \$3.8 million was distributed to the Ministry of Finance, \$2.2 million to the Ministry of Health and \$559,951 to the Ministry of State Administration.

7.3 Policy Developments

The DGGMRE has been instrumental in providing timely support to development partners who have mobilized funds for the country. We have facilitated support from the ADB, Australia, Japan, and the United Nations, to name a few. The unit will continue to work to support the Government and development partners in their efforts to produce a harmonized approach towards addressing the Covid-19 pandemic.