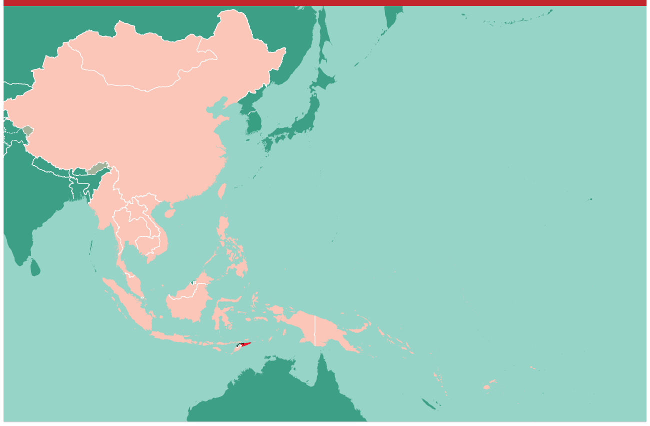
TIMOR-LESTE



	2017
Population, million	1.3
GDP, current US$ billion	1.7
GDP per capita, current US$	1,302
International poverty rate ($1.9)[a]	30.3
Gini coefficient[a]	28.7
School enrolment, primary (% gross)[b]	136.8
Life expectancy at birth, years[b]	68.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes: (a) Most recent value (2014), 2011 PPPs. (b) Most recent WDI value (2015).

Summary

GDP growth is expected to have fallen sharply in 2017 to -1.8 percent, driven by a decline in public spending as the government has not been able to secure a legislative mandate. To resolve the ongoing political impasse, new elections will be held in May 2018 and, following the formation of a new government, public spending is expected to moderate upwards again later in 2018. The budget continues to consume more resources that can be sustainably drawn from the Petroleum Fund, with the risk of a damaging fiscal cliff in the medium-term when state resources are depleted.

Recent Developments

GDP growth is expected to have fallen sharply in 2017 to a projected -1.8 percent from 5.3 percent the year before.[1] This contraction has been driven by lower government spending, and is sharper than predicted six months ago, as Parliament did not pass a proposed rectification budget, leading to especially large falls in expenditure year-on-year in the last quarter. Overall public spending fell by 24 percent. The public sector accounts for 75 percent of GDP, so it can drive overall GDP growth trends. Private consumption is expected to be more resilient in 2017 as civil service salaries were the only area of spending to increase. GFCF is expected to have fallen sharply in 2017 with the fall in public investment accompanied by declining inward foreign investment. By Q3 2017, air passenger arrivals were 12 percent higher year-on-year, suggesting that service exports due to the international visitor market continued to grow. Total aircraft movements stood at 856 in the third quarter of 2017, the highest quarterly level recorded to date. However, exports of coffee, Timor-Leste's main non-petroleum merchandize export, have fallen sharply in 2017 compared to 2016. Petroleum production fell by 14 percent in 2017. An alternative measure of GDP, which includes both onshore economic activity and a pro-rated amount of activity from the offshore oilfields is expected to have contracted by approximately 10 percent in 2017 in real terms.

2017 was a strong year for government receipts overall, with petroleum receipts and investment returns from the Petroleum Fund (PF) both rising. Yet, non-oil revenue mobilization declined to US$180m, or 10.8 percent of GDP. Balances in the PF grew from US$15.8bn at end 2016 to US$16.8bn at end 2017. Government expenditure, which reached an unprecedented level of US$1.77bn in 2016, has fallen back in 2017 by 24 percent to US$1.35bn with a tighter budget, especially compared in the final quarter, when in previous years large amounts of capital budget were expended. Capital expenditure more than halved (or, excluding a one-off payment to an escrow account in 2016, fell by 30 percent), most of which was spent on road construction. Current expenditure also contracted,

1 Unless specified, GDP refers to the domestic economy excluding production activity in areas of joint-sovereignty, such as the Joint Petroleum Development Area (JPDA). This is sometimes also referred to as 'non-oil GDP' to distinguish it from measures of GDP that include some proportion of activity from joint-sovereignty areas (or 'total GDP').

by 8 percent to US$940m in 2017. 2017 was the first year amortization payments fell due on public sector debt. The government budget balance is volatile, and the "ESI-adjusted budget balance",[2] calculated as domestic revenue plus ESI less total expenditure, has been steadily deteriorating in recent years, although in 2017, the fiscal consolidation led it to recover from -51 percent of GDP in 2016 to -32 percent of GDP in 2017.

Annual average CPI inflation increased moderately over 2017 to 0.6, from -1.3 percent in 2016, largely driven by prices movements in tradable sector, and depreciation of its currency, the US dollar, in the last year. Credit to the private sector has been stagnant for some time but in 2017, private sector credit began to grow rapidly again, increasing by 25 percent over 2017.

Estimates from the latest living standard survey show the poverty rate in Timor-Leste, based on the national poverty line, declined from 50.4 percent in 2007 to 41.8 percent in 2014. Progress with poverty reduction was uneven across the country: poverty in rural areas, which account for about 80 percent of the poor, fell at a slower rate than in urban areas. Across regions, poverty incidence remains the highest in the Western region (55.5 percent). Despite having the lowest poverty rate, poverty in the Eastern region increased slightly from 31.6 percent to 33.8 percent during 2007–2014, while by contrast the Central region experienced the greatest decline during this period, from 54.3 percent to 40 percent.

Outlook

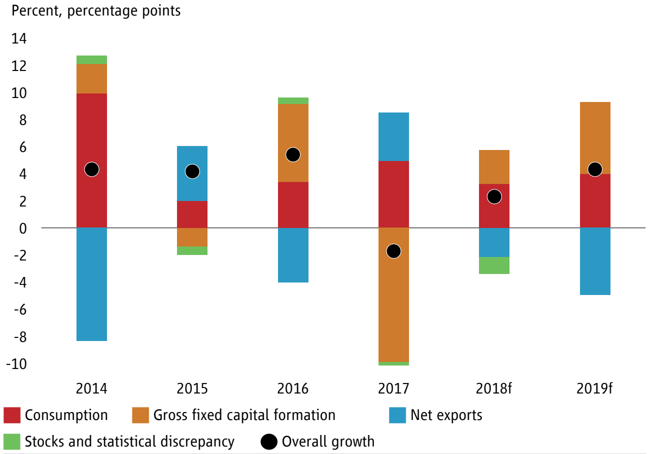
Growth is expected at 2.2 percent in 2018, lower than the 4 percent forecast six months ago due to continued slow government spending in the first half of the year while the current government lacks a legislative mandate for new spending programs. The return to growth would be driven by a moderate rebound in government spending in latter part of the year. While the outlook further ahead will be strongly affected by the program of the incoming government, a gradual continuation of historical government policy and recovery in private sector confidence is expected to see growth of 4.2 percent in 2019. The outlook for the private sector is now more uncertain than it was six months ago, and reestablishing regular government operations would be important to strengthen confidence in the positive future trajectory of the economy. FDI stands at its lowest levels than any time in the last 10 years. Some projects which have been delayed should start in earnest in 2018, while other going projects, such as the new Hilton hotel, will continue. A number of relatively large projects are currently under discussion in the tourism and light manufacturing sectors which are not explicitly included in the forecast, and should these projects become confirmed, the private investment outlook may strengthen further. Over the longer term, the outlook for new oil and gas development has improved, with Australia and Timor-Leste agreeing a clear legal framework in early 2018, although development of new capacity, should it occur, is still expected to be some years away.

Risks and Challenges

The outlook for growth depends on how the political situation evolves over 2018, as this will affect both the capacity of the public sector to deliver public services as well as the program of the government. A continuation of the political impasse which has seen the current government unable to pass budget legislation is likely to have adverse impacts on government service delivery, as well as business confidence. While 2017 saw a fiscal consolidation, the government budget remains deeply unsustainable, and a strengthening of pillars of a sustainable financing strategy—enabling private sector growth and developing an efficient domestic revenue mobilization framework—will be needed to avoid a fiscal cliff in the future.

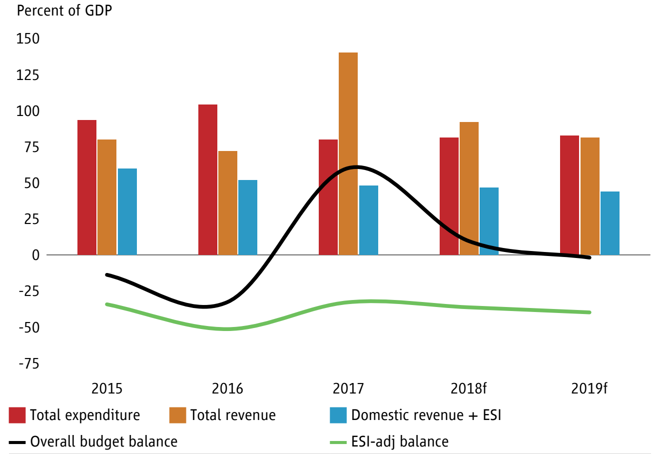
2 Notes: The Estimated Sustainable Income (ESI) is a legally-determined amount that can be sustainable withdrawn each year from the PF for budget financing.

Figure 1. Contributions to real GDP growth



Sources: General Directorate of Statistic, MoF GoTL & World Bank staff estimates.

Figure 2. Fiscal aggregates



Sources: Ministry of Finance, GoTL.

TIMOR-LESTE Selected Indicators	*2015*	*2016e*	*2017e*	*2018f*	*2019f*	*2020f*
Real GDP growth, at constant market prices	4.0	5.3	-1.8	2.2	4.2	4.0
Private Consumption	0.2	6.0	13.0	8.0	9.1	7.0
Government Consumption	3.2	-22.1	-15.8	14.0	-3.2	-3.4
Gross Fixed Capital Investment	-3.5	15.9	-15.4	8.6	8.6	5.9
Exports, Goods and Services	-29.2	15.2	3.8	11.3	18.8	18.4
Imports, Goods and Services	-8.4	8.1	-27.2	26.8	8.7	4.4
Real GDP growth, at constant factor prices	5.8	4.9	-2.9	3.1	4.2	4.0
Agriculture	-4.3	3.0	-0.5	1.1	1.2	1.4
Industry	22.2	7.6	-3.4	9.8	5.9	4.5
Services	4.8	4.7	-3.4	1.8	4.4	4.5
Inflation (Consumer Price Index)	0.6	-1.3	0.6	1.5	2.5	2.3
Current Account Balance (% of GDP)	20.8	-37.3	-1.0	-9.1	-9.6	-8.1
Financial and Capital Account (% of GDP)	3.6	34.3	64.1	52.4	32.4	17.2
Net Foreign Direct Investment (% of GDP)	1.9	-0.4	0.2	1.0	1.9	2.2
Fiscal Balance (% of GDP)[a]	-13.2	-32.8	60.5	10.1	-1.3	-11.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast. (a) 2016 expenditure excludes unspent balances held in an escrow account. (b) Calculations based on EAPPOV harmonization, using 2014-TLSLS. Nowcast: 2015–2017. Forecast are from 2018 to 2020. (c) Projection using neutral distribution (2014) with pass-through = 1 based on GDP per capita in constant LCU.