



TIMOR-LESTE

	2019
Population, million	1.4
GDP, current US\$ billion	1.7
GDP per capita, current US\$	1,238
School enrollment, primary (% gross) ^b	119.8
Life expectancy at birth, years ^b	69.0

Sources: WDI, Macro Poverty Outlook, and official data.
 Note: (a) Most recent WDI value (2017).

Despite a return to economic growth in 2019, failure to approve a state budget and the global COVID-19 outbreak have considerably weighed down prospects for 2020. The ongoing political uncertainty may compound these effects. Improved preparedness and response to global health emergencies and climatic shocks will be key to sustain achievements in human development. Meanwhile, a stable political environment and a strong policy commitment to support the private sector are crucial to avert a significant economic contraction.

Recent Developments

Gross domestic product (GDP) is thought to have recovered by over 3 percent in 2019, in a rebound from the 2017–2018 recession. Improved economic activity was supported by both public and private consumption, although investment likely faltered. Despite a relatively low budget execution rate (at 83 percent), total public spending still increased by 5 percent when compared to 2018. Expenditures on goods and services and public transfers were its key drivers, while capital spending declined by 7 percent. Private consumption was boosted by

strong credit demand from households and low inflation. Notwithstanding this economic upturn, GDP per capita remains considerably below the level observed in 2016.

The late approval of the 2019 state budget contributed to a slow start, but public spending picked up throughout the year. Government revenues remained low, even when considering the Estimated Sustainable Income (ESI)—which is the amount that can be withdrawn from the Petroleum Fund without depleting its asset value. Tax revenues declined for a third consecutive year, underscoring the need to develop an effective tax policy and strengthen tax administration. The fiscal deficit worsened to 31 percent of GDP, reversing the positive trend recorded in recent years—largely enabled by a constrained spending environment in 2017 and 2018. The deficit was mostly financed by excess withdrawals from the Petroleum Fund, which are the amounts above the ESI that are transferred to the state budget. The Petroleum Fund balance reached a record high of \$17.7 billion in December, albeit due to a \$1.7 billion asset revaluation accounted by the strong performance of international equity markets in 2019. Petroleum revenues (excluding investment returns) have been consistently outpaced by total withdrawals in the past five years.

Consumer price inflation slowed to 0.9 percent in 2019, even though prices for education, and alcohol and tobacco increased by 9.0 percent and 3.5 percent, respectively. This deceleration contributed to a depreciation of the real exchange rate, which was reinforced by the weakening of the U.S. dollar—the country's currency—against the currencies of its main trading partners. Commercial bank credit grew by 5 percent in 2019, owing to strong demand from households that compensated declines in the productive sectors. Meanwhile, average lending rates increased by nearly 2 percentage points to reach 16.3 percent in December—the highest level since 2007. Credit to the private sector remains low at 14 percent of GDP, despite a robust level of deposits (nearly five times higher as a share of GDP).

The current account turned a surplus for the first time since 2015, partly owing to a significant increase in primary income—which predominantly comprises petroleum-related revenues such as taxes and royalties. The trade

deficit is thought to have remained broadly stable. With the ratification of the Maritime Boundary Treaty in August 2019, oil and gas fields previously shared between Australia and Timor-Leste in the Joint Petroleum Development Area (JPDA) transitioned to Timor-Leste's exclusive jurisdiction. With this change, offshore petroleum production is now considered to be part of Timor-Leste's national accounts, and therefore trade statistics. However, given the limited data available and the need to compare economic performance across time, estimates for 2019 and forecasts for 2020–2022 do not (yet) reflect this change.

Outlook

The government failed to get its 2020 state budget proposal approved by Parliament, triggering significant political uncertainty. Members of the National Congress for the Reconstruction of Timor-Leste (CNRT), the senior partner in the government coalition, abstained in the parliamentary vote. The President subsequently asked all political parties to attempt to form a new coalition in order to avoid early elections. While there is still no clear political solution to the impasse, the next government will have to prepare two state budgets until the end of the year, a situation reminiscent of 2018. Public spending will be relatively constrained until a 2020 state budget is approved by Parliament.

The global outbreak of the novel coronavirus (COVID-19) will also affect domestic economic activity, especially through stringent travel restrictions and public health measures to contain its spread. Given the renewed political uncertainty and likely COVID-19 impacts, the GDP growth forecast for 2020 has been lowered from the previous 4.6 percent (October 2019) to –2.8 percent. However, it should be noted that this projection is still subject to much uncertainty.

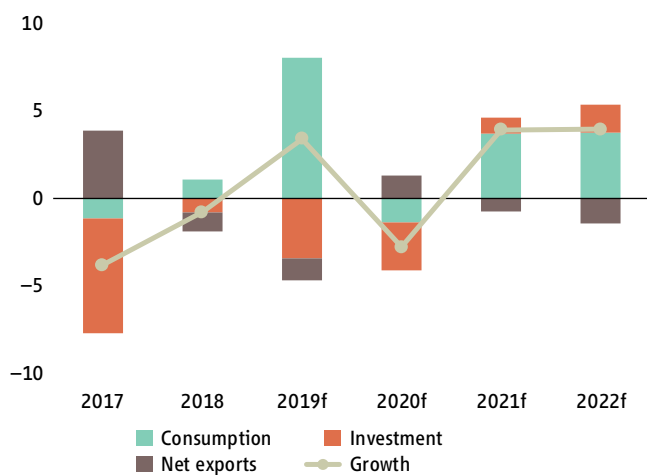
Risks and Challenges

The economic impact of the global COVID-19 outbreak will be felt through constraints to the movement of persons (namely workers, tourists, and business people),

disruptions in international trade, and deteriorating global equity markets. Recent travel restrictions will affect the implementation of public investment projects (many of which are reliant on Chinese workers) and the nascent tourism sector. Trade disruptions could affect imports, which are key to satisfy domestic demand—given limited productive capacities. The collapse of international stock markets (and, to a lesser extent, the sharp fall in oil prices) will negatively impact the value of the Petroleum Fund, although its link to the real economy mainly operates through withdrawals to fund the state budget. Public health measures to contain the spread of COVID-19 within the population—especially 'social distancing'—will also weigh down on economic activity, although their time frame is unclear. Moreover, recent heavy rains caused floods that affected thousands of people, particularly in Dili, where much of the economic activity takes place. Overall, a lack of preparedness for global health emergencies and climatic shocks could undermine human development achievements. In an interconnected world, failure to prepare for (and tackle) the spread of communicable diseases could lead to significant human and economic costs. Extreme weather events, such as droughts and heavy rains, can have a significant impact on agricultural yields (and thus living standards) as well as on connective infrastructure (especially roads).

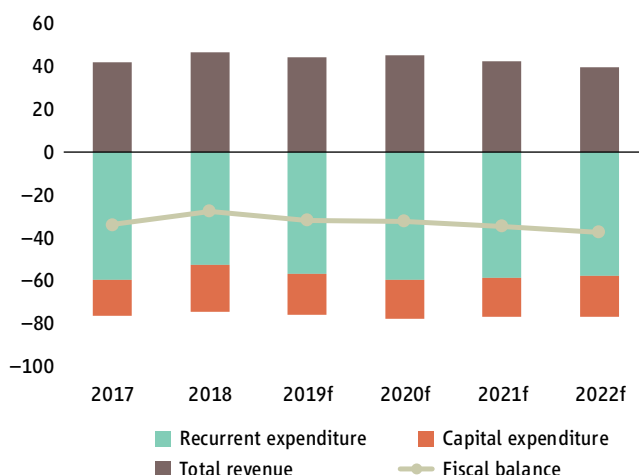
The intermittent political uncertainty observed since 2017 has contributed to a volatile pattern in public spending. It is likely that the quality of public spending has suffered during this period because of inadequate planning, delayed budget decisions, and spending restrictions. While a political solution might be eventually found to avoid a third parliamentary election since 2017, political tensions remain elevated. Moreover, fiscal sustainability remains a critical medium-term concern. Protecting the Petroleum Fund from large withdrawals ought to be a key priority, especially when considering the financing options for the development of the Greater Sunrise oil and gas fields. Efforts to mobilize additional domestic resources—through a comprehensive fiscal reform—would also contribute to ease the pressure on the Petroleum Fund.

Figure 1. Real GDP growth, contribution to real growth



Sources: Ministry of Finance & World Bank staff estimates.

Figure 2. Fiscal aggregates (percentage of GDP)



Sources: Ministry of Finance & World Bank staff estimates.
Note: Total revenue includes the ESI but not excess withdrawals.

	2017	2018	2019e	2020f	2021f	2022f
Real GDP growth, at constant market prices	-3.8	-0.8	3.4	-2.8	3.9	4.0
Private consumption	3.6	2.6	3.2	-1.7	3.1	3.9
Government consumption	-5.8	-1.0	10.9	-0.4	2.8	2.1
Gross fixed capital investment	-16.7	-1.8	-10.1	-9.3	3.4	5.9
Exports, goods, and services	-39.1	8.4	1.5	0.2	4.5	6.4
Imports, goods, and services	-8.7	2.3	2.2	-2.3	1.4	2.8
Real GDP growth, at constant factor prices	-3.6	-0.2	3.0	-2.8	3.9	4.0
Agriculture	-3.3	4.4	2.4	2.1	2.6	2.9
Industry	-26.5	5.3	3.2	-1.8	1.1	2.4
Services	3.1	-2.4	3.2	-4.3	5.0	4.6
Inflation (consumer price index)	0.6	2.2	0.9	1.4	1.8	2.2
Fiscal balance (% of GDP)	-33.4	-27.5	-30.8	-30.8	-32.4	-34.1
Current account balance (% of GDP)	-17.6	-12.2	3.5	1.9	-10.3	-28.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Note: e = estimate, f = forecast.
(a) The ESI is part of total revenue, while excess withdrawals from the PF is a financing term.