

NATIONAL DIRECTORATE FOR ECONOMIC POLICY

QUARTERLY INFLATION REVIEW

JANUARY -MARCH 2022

N.40

KEY STATISTICS

- In March 2022 start the year (Year on Year, **YoY**) inflation in Timor-Leste rose to 6.0%. This is a large increase considering inflation at the same point last year was only 2.9%
- During the start quarter of 2022 (Quarter on Quarter, **QoQ**) inflation in the whole country was 2.7%.
- Between January and March (QoQ) inflation in Districts was slightly higher than in Dili (2.8% in Districts vs 2.7% in Dili).
- In March 2022, core inflation ie (inflation excluding) volatile categories such as food, was 4.5% when compared to the last year.
- The CPI category with biggest increase in the final quarter of the year was Alcohol and tobacco 15.0% (QoQ).
- Clothing and footwear and housing categories saw small decreases of 0.3% (QoQ).
- The World Bank (WB) food price index increased by 38% between March 2021 and March 2022 (YoY) and also saw an 27% increase over the last 3 months.
- Domestic food prices rose in March by 7.0% (YoY) and 2.4% (QoQ). This is thought to be due to the Covid-19 lockdown in 2021, which disrupted domestic food supply chains, as well as due increases in oil prices. The current rise in inflation in Timor-Leste is likely the result of a combination of international and domestic factors mentioned above. During Covid-19, food supply from districts to Dili was hampered due to lockdowns which caused prices to rise. To help the community the government provided subsidies such as providing basic commodities to lighten the burden on the community. The government also payed subsidies to civil servants. Domestic food prices rose 7.0% year on year between March 2021 and March 2022.
- Rice is a main staple in Timor and the world rice price fell 20% in March 2022, since December 2020 (YoY) but rose by 6% over the last 3 months (QoQ). There was a brief spike in prices in April 2020 but prices are now in line with 2019 prices. This is good for Timorese consumers.
- Coffee is one of Timor's most important non-oil exports. The world price of coffee (Arabica) has increased 55% over the last year (YoY) but decreased 4% over the last 3 months. This 86% of the peak price seen in April 2011, but a steady recovery from a 10 year low seen in May 2019. This should be good news for coffee farmers and exporters.
- The price of oil halved in the 1st quarter of 2020 year due to the fall in global demand during the height of the Covid-19 crisis, bottoming out at \$21.04 per barrel in April 2020, but prices have recovered since, increasing to \$112.40 per barrel in March 2022. This is a 76% increase from the same time last year. The price of oil is now higher than it was before the start of the Covid-19 crisis in Dec 2019. Oil is an important component of everyday

products and involved in the supply chain of nearly all goods, so the increase in oil prices over the last year is a key reason behind higher inflation in Timor-Leste.

- The Nominal Effective Exchange Rate (NEER) decreased -1.1% (YoY) while the Real Effective Exchange Rate (REER) decreased -0.7.% (YoY). This will have a negative effect on consumers and importers in Timor Leste as imports become more expensive but will have a positive effect on Timorese exporters whose products become cheaper overseas.
- Recurrent government expenditure decreased 49.0% between Q1 2022 with Q1 2021.
- Money Supply in March 2022 increased YoY by 21.4%.
- International supply chain issues, increased transportation costs and a rebound in oil prices in the aftermath of Covid has led to an increase in global price levels.
- As a small open economy, the current level of inflation witnessed in Timor-Leste is a result of international markets.

Inflation Outlook	2018	2019	2020	2021	2022*	2023*	2024*
Timor-Leste	2.3%	0.9%	0.5%	3.8%	6.7%	3.0%	3.0%

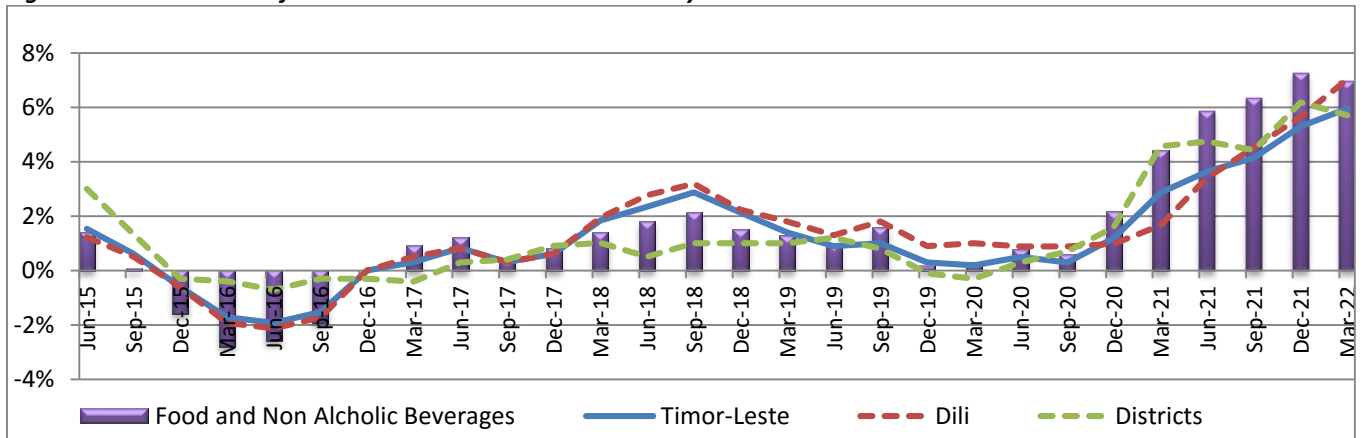
TRENDS IN INFLATION OVER TIME

In March 2022 YoY inflation in Timor-Leste was 6.0%; this means that a basket of goods and services that cost \$100.00 in March 2021 cost \$106.0 in March 2022– on average, prices are up compared to one year ago. The Government’s target range for inflation is 4%-6% as set out in the Government’s Strategic Development Plan. September 2021 is the first time quarterly inflation was in this range since December 2013 as the last few years in Timor has seen low inflation. YoY food and non-alcoholic beverage inflation in March 2022 was 7.0%, higher than the increase of 4.4% witnessed last March. Inflation in **Dili** was 7.0% (YoY) which is slightly more than inflation in **Districts** which rose by 5.7% over the same period. With year on year inflation in March 2022 of 6.0%, Timor-Leste’s level of inflation has seen a strong increase. 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 increased significantly between March 2021 and March 2022 increasing 38%. Domestic food prices have also been seeing an increase of 7.0% in the same time frame. It is expected that the current world food prices are projected to start stabilizing in 2023 into the short and medium term. Rice specifically is a staple part of the Timorese diet. The international benchmark for rice prices decreased -20% in march 2022, this will have a positive effect on poorer households where basic foods make up the majority of their spending and this will leave them with more disposable income. Coffee prices (both Arabica and Robusta) increased 55% in March 2022 year on year. This will positively affect those families who rely on coffee production in Timor-Leste.

Inflation in Dili was 7.0% (YoY) which is slightly more than inflation in Districts which rose by 5.7% over the same period. The CPI categories with the biggest increases were Alcohol and Tobacco which increase 18.4% and Transport which increased 8.0%, this is likely to be due to the recent increase in excise taxes and international oil prices respectively.

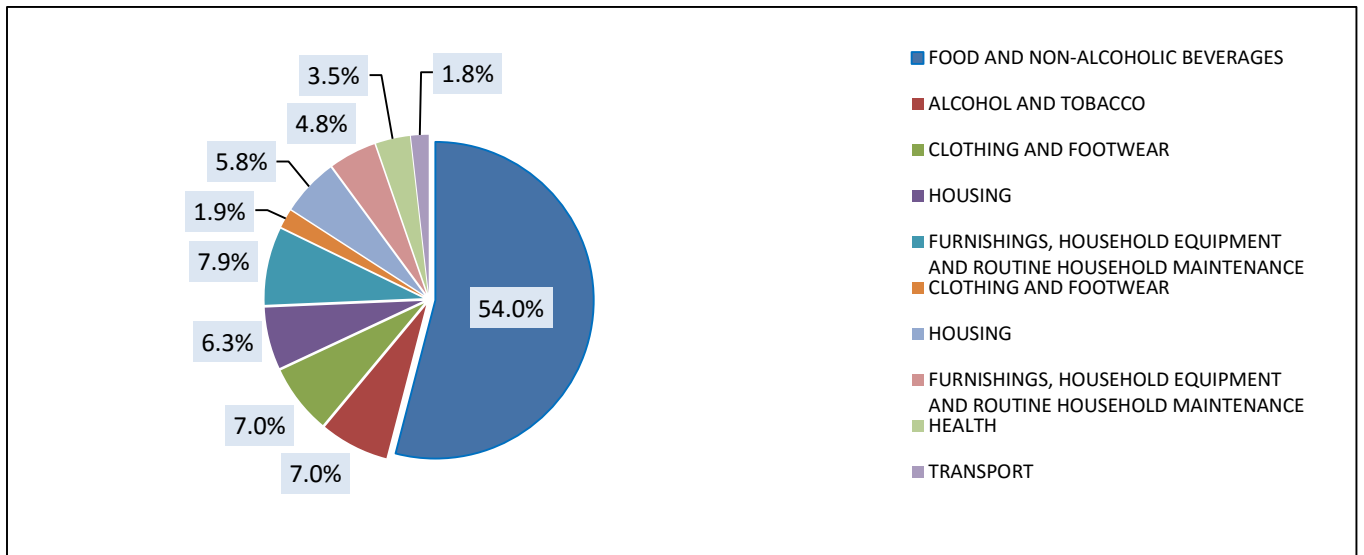
Figure 1: Year-on-Year Inflation in Timor-Leste over the last 5 years



TIMOR LESTE’S CPI BASKET²

The Consumer Price Index (CPI)¹ is used to measure consumer price inflation. To understand CPI think of a large basket containing the goods and services bought by households, the CPI estimates the change to the total cost of the basket on a monthly basis. Food and non-alcoholic beverages represent 54% of Timor-Leste’s CPI basket² as more than half of Timorese household expenditure is spent on this group. Thus price movements in this group will have a significant impact on the overall rate of inflation and the purchasing power of Timorese citizens.

Figure 2: Timor Leste’s CPI Weights



Over the 12 months from March 2021 to March 2022 there have been significant *price changes* in the following spending classes³ :

- Alcohol and Tobacco (+18.4%)- *biggest increase*

¹ The CPI is a weighted index meaning that the influence on the CPI index of a given item is dependent on the item’s share in total household consumption.

² Timor-Leste’s CPI basket is made up of the ten expenditure groupings seen in Figure Two.

³ Expenditure classes are the sub-categories within an expenditure group in a CPI index

- Transport (+8.0%)- second biggest increase

Despite these price changes for the groups mentioned above, contribution to overall inflation can be very different. **Contribution to inflation rate** measures the contribution to the overall rate of inflation of a grouping of goods and services, eg, the combination of its *price change and weight* within the series⁴. Therefore a small change in the growth rate of Food and Non Alcoholic Beverages can still have a big contribution to overall inflation due to it being the most important category as we can see below.

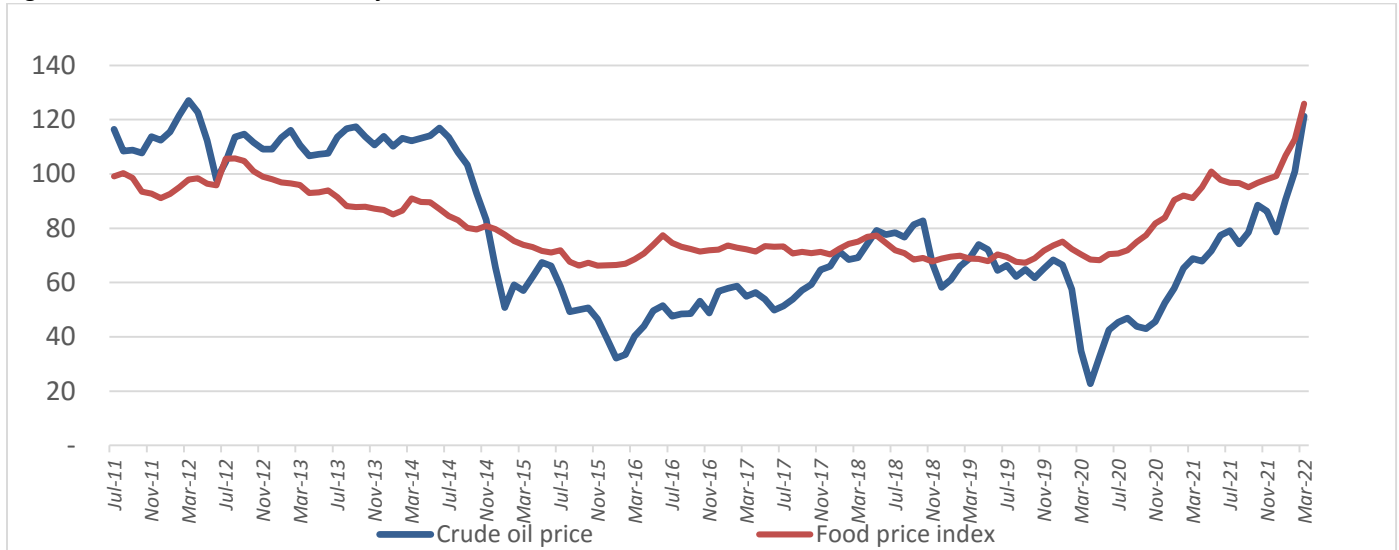
CAUSES OF INFLATION⁵

International Factors

Commodity Prices

International food prices have increased significantly over the last year with the World Bank (WB) food price index increasing 38% between March 2021 and March 2022. World rice prices (Thai benchmark) decreased -20% (YoY). Coffee Arabica Prices increased 76% (YoY). In March 2022, crude oil (Brent)⁶ increased 55% YoY in and has now surpassed pre-covid price levels.

Figure 3: International Commodity Price Indices



Exchange Rate

An appreciation (depreciation) of the US dollar against the currencies of Timor-Leste’s major trading partners will put downward (upward) pressure on the price of imports in Timor-Leste. However, the effects of exchange rate and international commodity price movements on prices in Timor-Leste are likely to be felt some time after they occur, as it

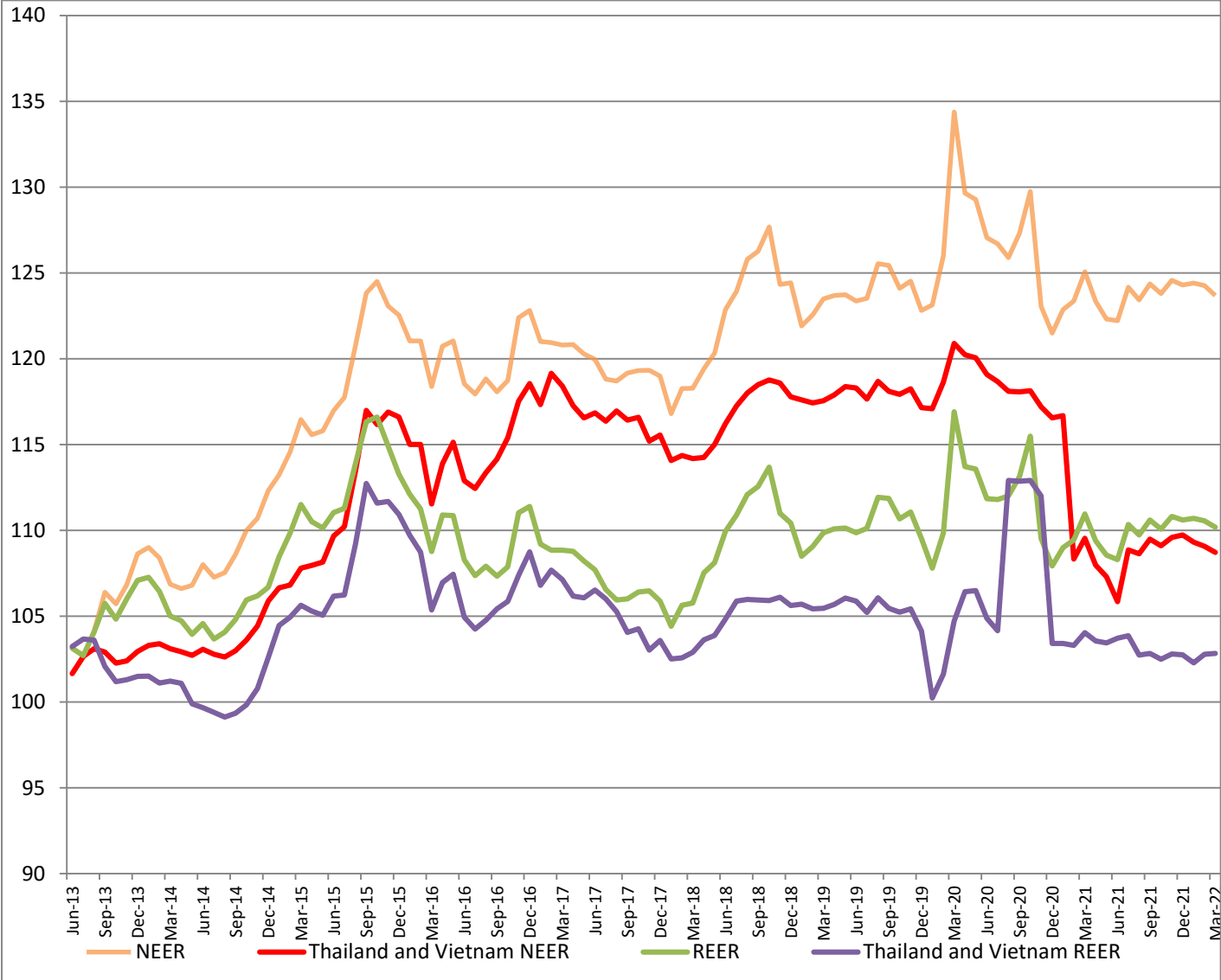
⁴ The contributions of each grouping will sum to give the overall rate of inflation

⁵ Within this section inflation refers to YoY inflation

⁶ World Bank Pink Sheet, updated February 2022

takes time for the change in the price of imported goods to feed through to a change in the price of consumer goods. The **effective exchange rate** is the exchange rate of a country’s currency, measured as the weighted sum of the exchange rates with its commercial partners. The **nominal effective exchange rate (NEER)** is an unadjusted weighted average rate at which one country's currency exchanges for a basket of multiple foreign currencies. The **real effective exchange rate (REER)** is adjusted for the effects of inflation.

Figure 4: Exchange Rates



Between March 2021 and March 2022 Timor-Leste’s NEER depreciated by 1.1% while the REER depreciated 0.7%. Over this period the NEER also depreciated -0.8% against a weighted Thai Baht and Vietnamese Dong basket and, the REER depreciated by -1.2% against the same basket. This real depreciation places upwards pressure on rice prices and inflation in Timor-Leste (as Thailand and Vietnam export large quantities of rice to Timor-Leste).

Domestic Factors

Government Spending

Year on year recurrent government expenditure decreased in Q1 2022 by -49.0% compared with Q1 2021. A rise in government expenditure, particularly recurrent expenditures such as transfers and salaries & wages, can have an inflationary impact on the economy, however this is currently not the case in Timor-Leste which is a small open economy. The current rise in big inflation in Timor-Leste is likely the result of a combination of international factors mentioned above. As a result the war in Ukraine, oil prices have increased and these have spread to all sectors. Food prices have increased further due to supply issues Districts were less able to supply food to Dili during the COVID-19 lockdown.

Money Supply

The average change in money supply across the year to March 2022⁷, was a 57.8% increase. However is a small open economy such as Timor Leste, without local currency: money supply does not have any systematic and plausible effect over inflation in Timor Leste.

Tradable vs Non-tradable (International vs Domestic pressures)

Tradable goods and services refer to those whose prices are largely determined on the world market, and all other goods and services are non-tradable. This enables splitting out the inflationary (or deflationary) pressures coming from international or domestic sources. In March 2022 non-tradeable (domestic) prices have been lower than the tradeable (international) prices, with non-tradeable prices growing at 2.1% vs tradeable prices growing 7.7% (YoY) in March 2022. This suggests that the current level of inflation in Timor-Leste is largely determined by international markets.

CONSEQUENCES OF INFLATION

Inflation can cause households' purchasing power to fall. **Purchasing power** measures the quantity of goods and services which can be purchased with a unit of currency. Therefore inflation decreases the amount of goods and services a consumer is able to purchase with their monthly salary which can reduce living standards and may increase poverty. The current low inflation level should benefit households on lower incomes.

INFLATION OUTLOOK

Commodity Outlook- both oil and food are forecast to increase slightly in 2023 and then reduce and stabilise in the medium term.

Exchange Rate Outlook- both NEER and REER are both set to remain stable.

The inflation rate in Timor-Leste is expected to be lower than its neighbours in the near future as emerging and developing asia is forecast to have an inflation rate of 3.0% in 2023.

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ANNEX 1: CONCEPTS AND TERMINOLOGY

Year-on-year (YoY) inflation is the most commonly used measure and is calculated by comparing the price index from a given period with the same month in the previous year. For example, the year-on-year inflation in December 2021 measures the percentage change in prices between Marchr 2021 and March 2022.

⁷ Taking the average change in money supply for the last 12 months compared to the previous 12 months.

Quarter-on-quarter inflation (QoQ) is calculated by comparing the price index from the last month of a given quarter (March, June, September or December) with the last month of the previous quarter. Eg QoQ inflation in September 2021 measures the percentage change in prices between June 2020 and September 2021.

Month-on-month inflation (MoM) is calculated by comparing the price index from the latest month to the previous month. Eg, MoM inflation in December 2021 measures the percentage change in prices between February 2022 and March 2022. Timor-Leste's Consumer Price Index is published monthly by General Directorate of Statistics (MPF)⁸.

ANNEX 2: NOTES

This bulletin is produced by the National Directorate for Economic Policy, Ministry of Finance, on a quarterly basis. Please refer any queries to the below contacts:

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⁸ See for latest CPI data from the General Directorate of Statistics (<http://www.statistics.gov.tl/category/survey-indicators/consumer-price-index/?lang=en>)