

NATIONAL DIRECTORATE FOR ECONOMIC POLICY

QUARTERLY INFLATION REVIEW

JULY -SEPTEMBER 2022

N.42

KEY STATISTICS

- In September 2022 (Year on Year, **YoY**) inflation in Timor-Leste rose to 7.9%. This is a large increase considering inflation at the same point last year was only 4.1%
- During the third quarter of 2022 (Quarter on Quarter, **QoQ**) inflation in the whole country was 0.3%. It was 0.4% the same time last year.
- Inflation in Dili (QoQ) was higher than in the municipalities outside of Dili(0.7% in Dili, while it was -0.1% outside of Dili).
- In September 2022, core inflation which excludes volatile categories such as food, was 7.2% when compared to the last year (YoY).
- The CPI category with biggest increase over the third quarter of the year was Transport 1.6% (QoQ).
- Clothing and footwear and communication categories saw small decreases of -0.1% (QoQ).
- The World Bank (WB) food price index increased by 15% between September 2021 and September 2022 (YoY) but a fall of -13% over the last 3 months.
- In Timor-Leste food prices rose in September by 8.2% (YoY) and 0.2% (QoQ). This is due to global increases in energy prices and supply chain disruptions driven by the Russian- Ukraine war.
- Rice is a main staple in Timor and the world rice price rose 10% in September 2022 (YoY) but fell by --1% 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 19% over the last year (YoY) but decreased-2% over the last 3 months. This is 90% of the peak price seen in April 2011 of \$6.62/kg, but a steady recovery from the 10 year low seen in May 2019 (\$2.73/kg). This should be good news for coffee farmers and exporters.
- The price of oil increased 21% from the same time last year, this due to disruption in global oil supply caused by the war Ukraine –Russian but over the last quarter prices have began to temper and fell by 25% over Q3. 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 government has responded by introducing fuel subsidies to transport operators.
- The Nominal Effective Exchange Rate (NEER) increased 7.4% (YoY) while the Real Effective Exchange Rate (REER) increased 7.8.% (YoY). This will have a positive effect on consumers and importers in Timor Leste as imports

become more cheaper but will have a negative effect on Timorese exporters whose products become expensive overseas. Strong US dollar can reduce the impact of increased global oil prices on the imports.

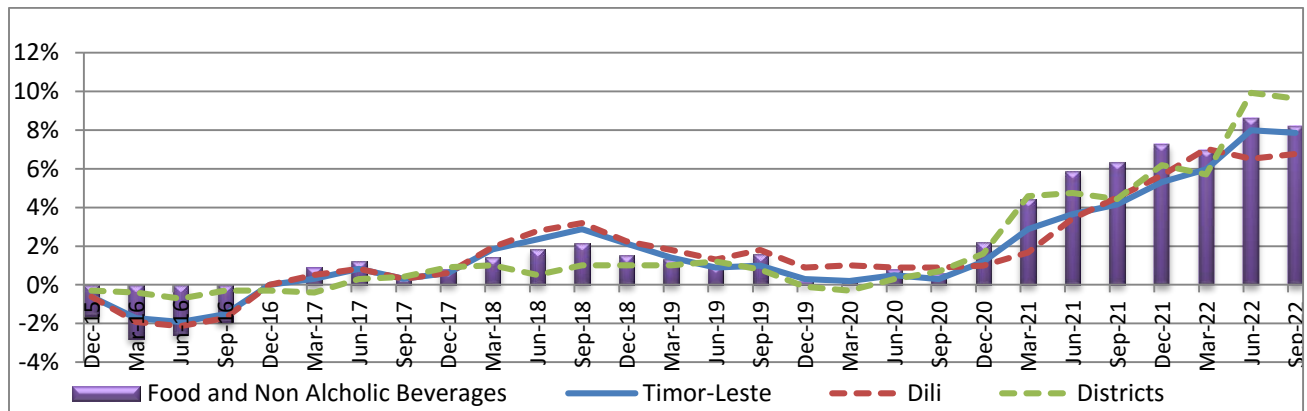
- Total government spending in Q3 2022 increased 17.3% compared to the same time last year. This is due to the fact that 2021 execution was hampered by covid lockdowns and flooding.
- Money Supply in September 2022 increased YoY by 19.9%. However is a small open economy such as Timor Leste, without local currency: money supply does not have any systematic and plausible effect over inflation in Timor Leste.
- As a small open economy, the current level of inflation witnessed in Timor-Leste is largely a result of international markets.

Inflation Outlook	2018	2019	2020	2021	2022*	2023*	2024*
Timor-Leste	2.3%	0.9%	0.5%	3.8%	7.2%	3.6%	3.3%

TRENDS IN INFLATION OVER TIME

In September 2022 YoY inflation in Timor-Leste was 7.9%; this means that a basket of goods and services that cost \$100.00 in September 2021 cost \$107.9 in September 2022– on average, prices are up compared to one year ago. Over the last 5 years, Timor-Leste experienced deflation (average price level falling) during 2016 but then experience low stable inflation between 2017 and 2020. Since December 2020 there has seen a sustained increase in inflation due to a combination of Covid-19 and the war in Ukraine increasing world oil prices and disrupting supply chains. 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. Inflation outside of Dili was 9.6% (YoY) which is slightly more than inflation in Dili which rose by 6.8% over the same period.

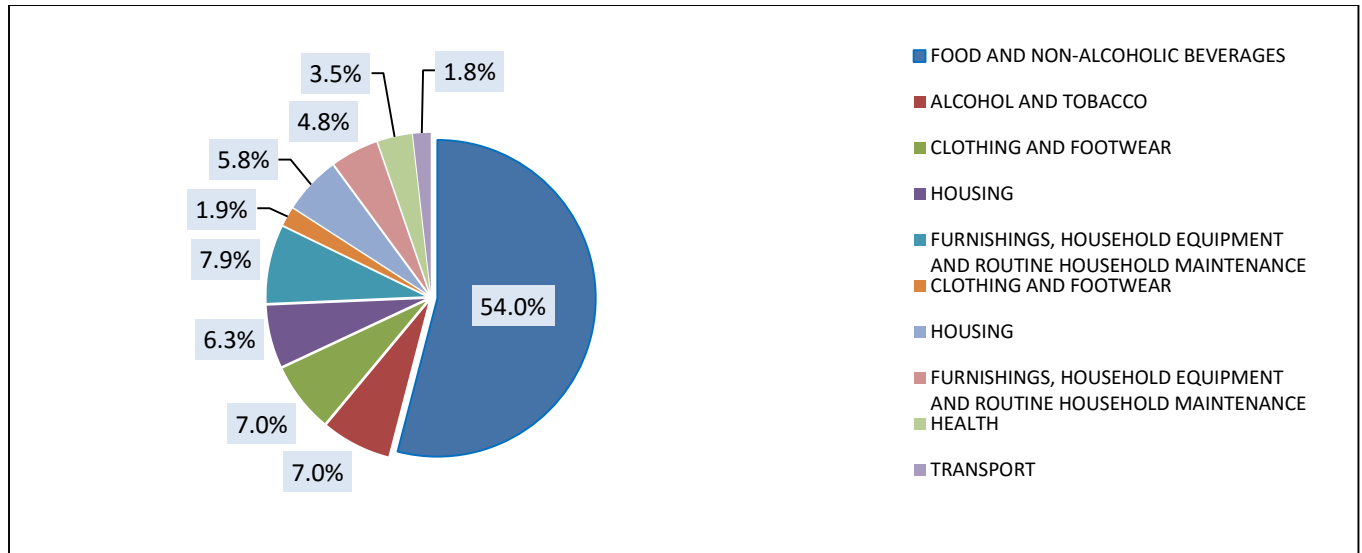
Figure 1: Year-on-Year Inflation in Timor-Leste over the last 5 years



TIMOR LESTE'S CPI BASKET

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 September 2021 to September 2022 there have been significant *price changes* in the following spending classes³:

- Alcohol and Tabacco (+26.6%)- *biggest increase*
- Transport (+14.6%)- *second biggest increase*
- Food and non-alcoholic beverages (+8.2%)- *third biggest increase*
- Clothing and Footwar was the only category to decrease -0.7%

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.

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

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

CAUSES OF INFLATION⁵

International Factors

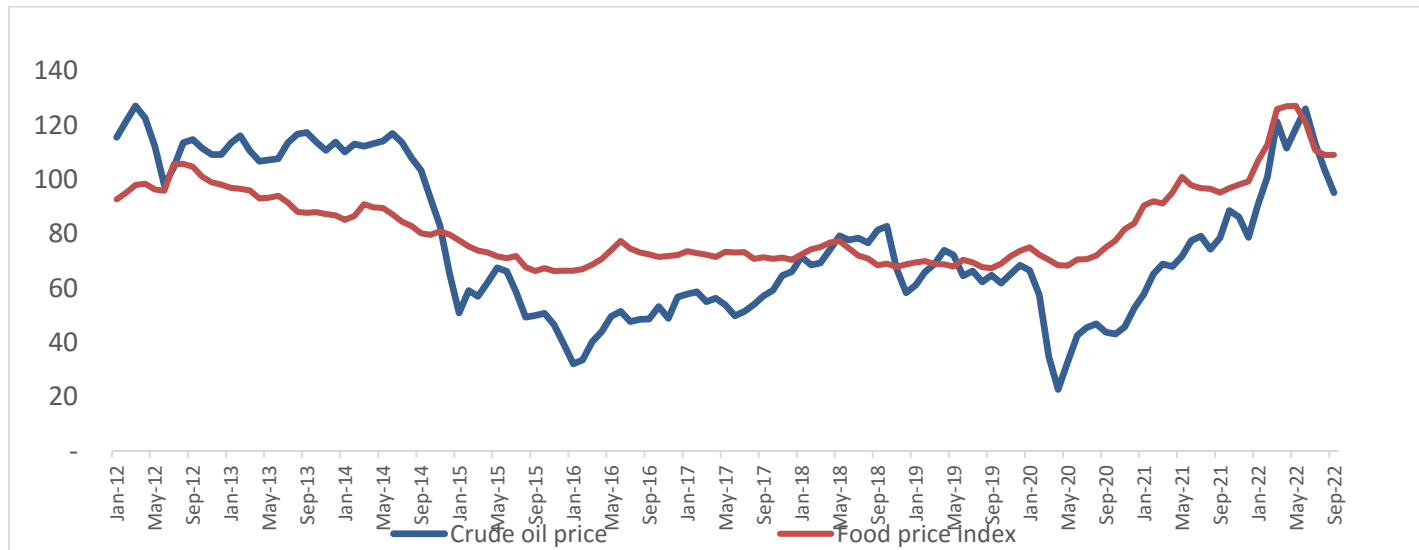
Commodity Prices

As mentioned, 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. International food prices have increased significantly over the last year with the World Bank (WB) food price index increasing 15% between September 2021 and September 2022. Domestic food prices have also been seeing an increase of 8.2% 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 increased 10% in September 2022 over the last year, 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 19% in September 2022 year on year. This will positively affect those families who rely on coffee production in Timor-Leste.

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 price of oil increased 21% from the same time last year, this due to disruption in global oil supply caused by the war Ukraine –Russian however, over the last quarter prices have began to temper and fell by 25% over Q3. The government has responded by introducing fuel subsidies tottransport operators.

Figure 3: International Commodity Price Indice

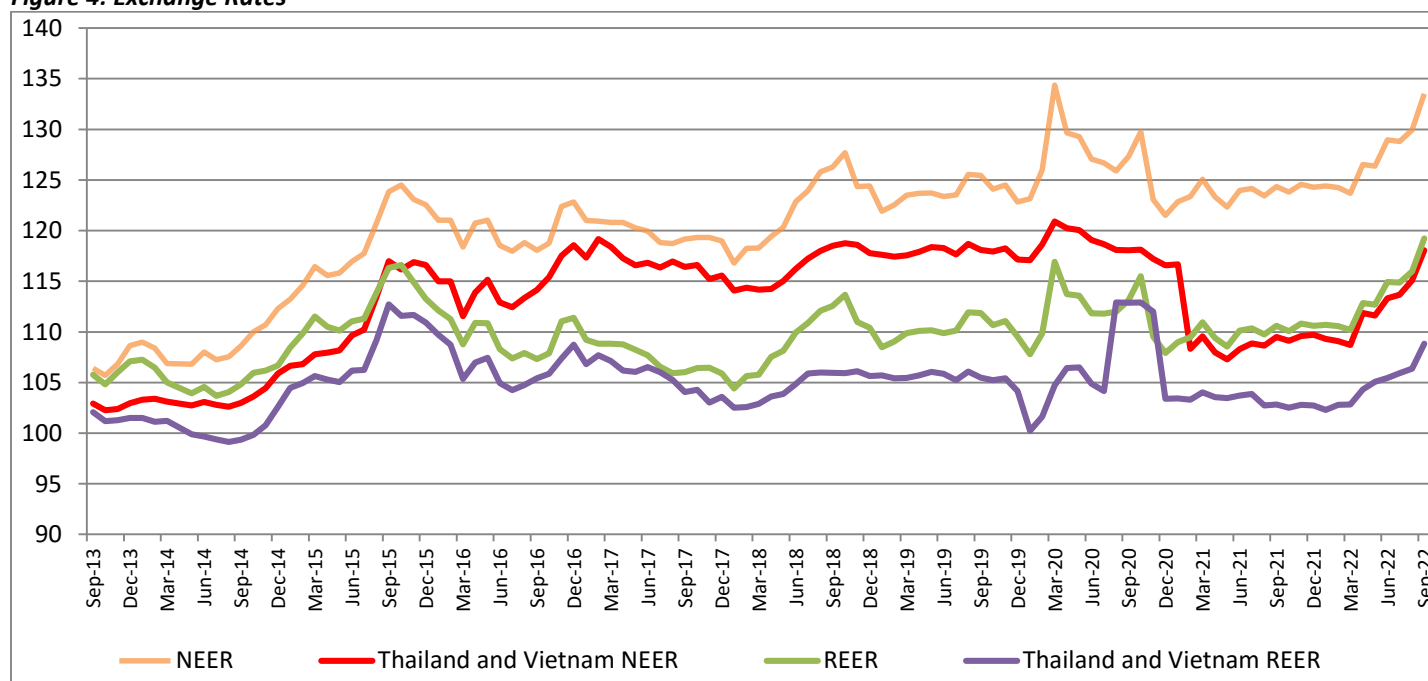


⁵ Within this section inflation refers to YoY inflation

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 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 September 2021 and September 2022 Timor-Leste's NEER appreciated by 7.4% while the REER appreciated 7.8%. Over this period the NEER also appreciated 7.8% against a weighted Thai Baht and Vietnamese Dong basket and, the REER appreciated by 5.8% against the same basket. This real appreciation places downwards 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 total government expenditure increased in Q3 2022 by 17.3%. In 2021 there was low execution of government expenditure due to the covid lock down and floods. However, the current rise in big inflation in Timor-Leste is likely the result of a combination of international factors for example, as a result the war in Ukraine, oil prices have increased and these have spread to all sectors.

Money Supply

The average change in money supply across the year to September 2022⁶, was a 19.9% 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 September 2022 non-tradeable (domestic) prices have been lower than the tradeable (international) prices, with non-tradeable prices growing at 1.0% vs tradeable prices growing 10.9% (YoY) in September 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.

INFLATION OUTLOOK

Inflation Outlook	2018	2019	2020	2021	2022*	2023*	2024*
Timor-Leste	2.3%	0.9%	0.5%	3.8%	7.2%	5.5%	3.3%

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 September 2021 and September 2022.

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 2022 measures the percentage change in prices between June 2022 and September 2022.

Month-on-month inflation (MoM) is calculated by comparing the price index from the latest month to the previous month. Eg, MoM inflation in September 2022 measures the percentage change in prices between August 2022 and September 2022. Timor-Leste's Consumer Price Index is published monthly by General Directorate of Statistics (MPF)⁷.

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:

1. Epifanio Martins, *Director of NDEP*
Email: epmartins@mof.gov.tl

⁶ Taking the average change in money supply for the last 12 months compared to the previous 12 months.

⁷ See for latest CPI data from the General Directorate of Statistics (<http://www.statistics.gov.tl/category/survey-indicators/consumer-price-index/?lang=en>)

2. Nelio Francisco B.S. Mesquita, *Analyst*
Email: nmesquita@mof.gov.tl
3. Georgina Conway, *Advisor*
Email: gconway@mof.gov.tl