DECLARATION OF BUDGETARY STRATEGY 2026

OPTIMISING RESULTS WITH REALISTIC EXPENDITURE

República Democrática de Timor-Leste
Ministry of Finance

Declaration of Budgetary Strategy 2026

Optimising Results with Realistic Expenditure

Contents

Technical Disclaimer

Pursuant to Article 23 of the Budget and Public Financial Management Framework Law (Law No. 3/2025, 23rd April 2025)[1], this document provides an overview of the latest macro-economic and fiscal projections, along with a declaration of the Government's fiscal strategy ahead of the budget proposal for 2026 General State Budget (hereafter Budget 2026).

This declaration of the government's intentions for Budget 2026 and the medium-term comes ahead of the Budget Review Committee, during which the government will have the opportunity to evaluate economic concerns, policy priorities and available financing in greater details. As such, the budget ceiling and macroeconomic projections outlined in this document are subject to alterations and revisions ahead of the budget proposal submission on the first of October.

All numbers are also subject to review ahead of the budget proposal as new data and information becomes available to the Ministry of Finance. Therefore, the numbers outlined in the document below should be treated as indicative and for the purpose of facilitating greater transparency and understanding of the country's economic and fiscal position ahead of the budget proposal and subsequent debates. The opportunity for further analysis and data availability during the budget setting process has the potential to change the Ministry of Finance's understanding of the outlook for economic growth and revenues in both 2025 and beyond.

In addition, this year is the first time that the Ministry of Finance has published a Budget Strategy Document in June. The Ministry will continue to strive for improvements in the detail and quality of analysis provided in future documents.

[1] https://www.mj.gov.tl/jornal/public/docs/2025/serie_1/SERIE_I_NO_17.pdf

Executive Summary

The IX Constitutional Government of Timor-Leste presents the Budget Strategy for 2026 that sets out a prudent fiscal path aimed at enhancing service delivery, promoting sustainable economic growth, and extending the lifespan of the Petroleum Fund. The strategy reflects a shift from growth driven by high government expenditure towards a more sustainable model facilitated by improved public sector efficiency and greater private sector participation.

Economic growth in 2025 is projected at 4.3%, driven by strong capital spending and improved execution. However, this growth remains heavily dependent on government spending, with over 90% of GDP accounted for by public expenditure. Fiscal sustainability analyses from Budget 2025 warn of the depletion of the Petroleum Fund by 2035 if excess withdrawals persist. To mitigate this, the Government proposes a 13% reduction in the 2026 consolidated budget ceiling to US$1.85 billion, with targeted cuts in recurrent spending and a redirection of resources toward high-impact investments.

The Budget Strategy for 2026 outlines a number of critical reforms. On the expenditure side, measures include the introduction of a civil service retirement age, off-budget financing for advisors, and consolidation of public transfers. These measures are complemented by strategic investments in infrastructure (e.g., Dili Airport rehabilitation, rural electrification, and digital connectivity), health and education, and enabling frameworks for agriculture, tourism, and private sector development.

On the revenue side, the Government plans to implement a Value Added Tax (VAT) from 2027. The VAT is expected to boost collections by up to 1.5% of GDP in the short-term and reduce reliance on petroleum revenues, aligning Timor-Leste with international fiscal standards.

The proposed strategy would extend the life of the Petroleum Fund to 2038, providing crucial fiscal space to implement the Strategic Development Plan 2011–2030 and provide time to secure new resources from the Greater Sunrise project. While GDP growth is expected to moderate to 2.7% in 2026 due to tighter expenditure, this is seen as a necessary correction toward sustainable and resilient growth.

This Budget Strategy is an indicative roadmap. Its success depends on effective implementation, public financial management reforms, and collective decisions of the Budget Review Committee and Parliament in the months ahead. An indicative fiscal and memorandum table is provided in Table 1.

Table 1: Indicative Fiscal and Memorandum Table – Central Administration and RAEOA, US$m

	Approved Budget 2025	Indicative Proposal 2026
Total Consolidated Expenditure Central Administration + RAEOA	**2,125**	**1,850**
Recurrent	1663	1467
Salaries & Wages	*490*	*415*
Goods and Services	*415*	*362*
Public Transfers	*758*	*690*
Capital	462	383
Minor Capital	*23*	*29*
Capital & Development	*440*	*354*
Revenues	**811**	**796**
Domestic Revenues	259	270
Estimated Sustainable Income (ESI)	552	525
Fiscal Balance	**-1,315**	**-1,054**
Financing Deficit	**1,315**	**1,054**
Excess Withdrawals	1,009	851
Use of Cash Balance	251	146
Loans	45	50
Direct Budget Support	9	8

**Note: All figures rounded to the nearest million as 2026 figures should be treated as preliminary Source: Approved OJE 2025 and calculations from the Directorate of National Economic Policy (DNPE), Ministry of Finance.*

1. Budgetary Strategy and Macro-Fiscal Outlook

Budgetary Strategy

1.1. The government's budgetary strategy for 2026 is outlined by the theme of this document "Optimising results with realistic expenditure". This recognises need to build upon recent achievements with efficient and sustainable budget allocations.

1.2. Building on from the 2025 budget, the Government's strategy is based on achieving the goals set out by the Strategic Development Plan. This document aims to lay out a plan for Budget 2026, that will continue to prioritise economic growth, job creation and poverty reduction, however with a renewed focus on efficiency and long-term sustainability.

1.3. As with previous years, close to 75% of the approved allocation for Budget 2025 was financed by Petroleum Fund withdrawals. These resources allowed the government to spend more than regional peers[2] on priority sectors such as health, education and social protection. In addition, with over 20% of the budget allocated to development capital investments, the government continued to economic growth and upgrading the country's infrastructure. As a result, the preliminary outlook for 2025 (based on government execution data up until May) suggests that higher government spending on infrastructure development, social protection and key programs will lead to increased economic growth in 2025.

1.4. Whilst positive, this economic growth continues to be fuelled by government expenditure[3], which in turn is financed by excess withdrawals that draw down from the lifespan of the Petroleum Fund. Fiscal sustainability projections outlined in Budget 2025, warned that if the trend of economic growth fuelled by higher government expenditure continued in the medium term, the Petroleum Fund would fully deplete by 2035.

1.5. Taking this into account, this document outlines a plan to create the conditions for sustainable economic growth. The consolidated ceiling proposal for the Central Administration and RAEOA (US$1.85bn) represents a 13% reduction in the approved ceiling for 2026. Furthermore, proposed measures for 2026 and the medium-term (2027-2030) seek to gradually transition the government's role in the economy from the main driver of economic growth, to a facilitator of growth and development.

1.6. The proposed measures in Budget 2026 outlined in this document lay the foundations for this through efficiency savings. This in turn sets a new approach to the state budget; one of optimising results with sustainable and realistic expenditure levels. The proposed allocations are in line with the government's execution capacity which in turn reduces the opportunities for wasteful and unproductive expenditure.

[2] Analysis from Jornada Orsamentu 2026 slides: https://www.mof.gov.tl/publicationdetails/material-jornada-orsamental-2026

[3] MoF estimates suggest government spending in 2024 exceeded 90% of GDP and that a similar trend is anticipated for 2025

1.7. Greater government efficiency can also create an enabling environment for economic growth. Better budget allocations can ensure greater effectiveness of programs that support economic diversification. More efficient expenditure on salaries and wages can reduce potential effects of crowding-out (i.e., where the government monopolises resources that could otherwise be available for the private sector).

1.8. Health and education continue to be priority sectors for Budget 2026, however budget allocations will aim to have a greater focus on improving outcomes in these sectors. Furthermore, the priority and measures section below outlines proposals for attracting private investment and facilitating economic diversification. These include the refurbishment and redevelopment of Dili Airport, setting up a National Development Bank, issuing land titles and improving internet connectivity through the installation of a fibre optic cable.

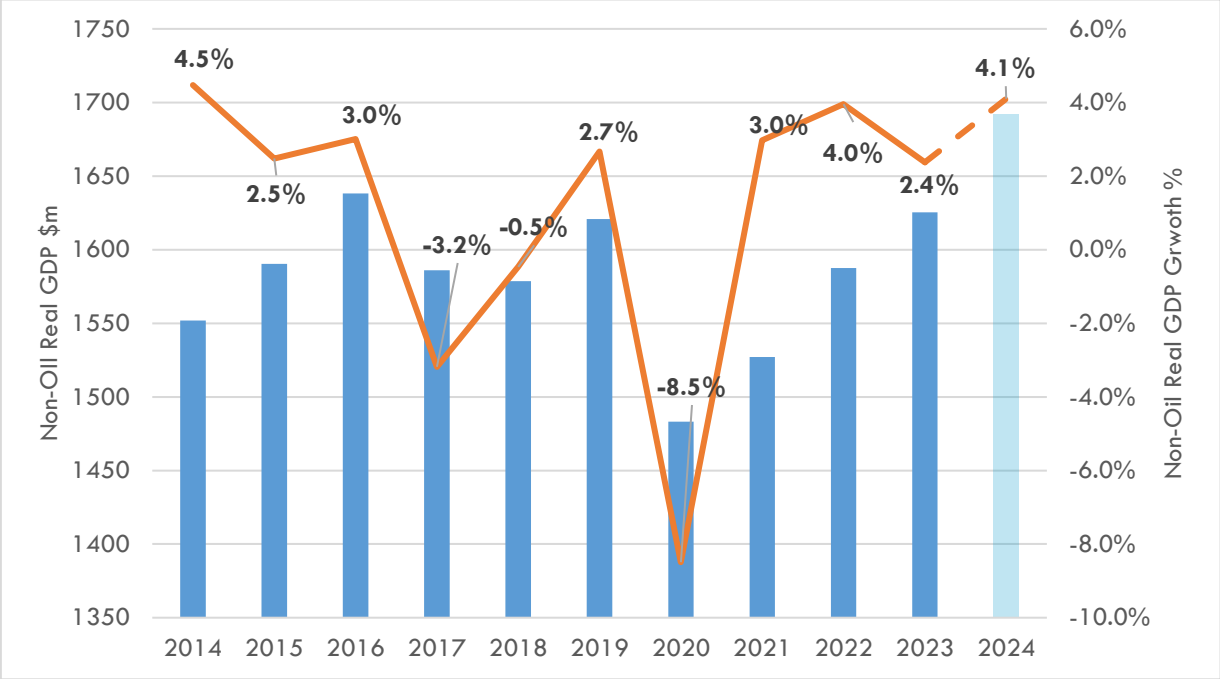
1.9. At the same time efforts will be made to consolidate and improve the efficacy of government expenditure through reforms to payroll and workforce as well as public transfers. Some of these reforms and their impacts are outlined in the measures and fiscal projections below. They include proposals to raise greater revenues through the implementation of a Value Added Tax in 2027.

1.10. The combined effect of these plans will be to extended the lifespan of the Petroleum Fund to 2038 (3 years later than outlined in Budget 2025). When combined with further reforms during the medium-term and the development of new petroleum resources through the Greater Sunrise pipeline, this strategy has the potential to secure the country's long term fiscal sustainability whilst also realising the objectives of the Strategic Development Plan.

1.11. The strategy outlined through the measures, proposed allocations and projections in this document represents and indicative proposal for 2026 and beyond. The stated impacts are subject to both further analysis over the coming months as well as subject to the decisions taken during the Budget Review Committee and subsequent Parliamentary debates.

Review of Recent Macroeconomic Developments

Figure 1: GDP growth actuals and Estimate 2024, LHS $US Million, RHS %



*Source: Statistics Institute, INETL, Ministry of Finance *2024 numbers are preliminary*

Historic Growth

1.12. As an oil producing nation, Timor-Leste's overall GDP is subject to a great deal of fluctuation as it is dependent on oil production numbers and international prices (both factors that are difficult to predict). However, since the oil sector provides minimal employment as it requires highly skilled and specialized workforce and operates largely offshore, focusing on non-oil GDP better reflects the economic conditions experienced by the population.

1.13. Timor-Leste experienced real GDP growth averaging 1.0% per year over 2014-2023 (past 10 years). These growth rates were higher in the early 2010s and were 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. Government investment enabled a significant upgrade to road and electricity coverage throughout Timor-Leste, which has helped to improve both living standards and the business environment.

1.14. However, negative economic growth rates in 2017, 2018 and 2020 have undermined the progress made. In 2020, GDP growth fell by 8.5% due to the combined effect of the delay in approving the General State Budget, political uncertainty, the COVID-19 pandemic and the application of the State of Emergency.

1.15. 2021 saw a large increase in government expenditure of around 29% as the Government looked to kick-start the economy following the impact of the pandemic. As a result, real non-oil GDP growth in 2021 bounced back to 3.0%.

1.16. In 2022, GDP grew at 4.0%, primarily due to an increase in public and private investment. Government transfers and a recovery from the COVID-19 pandemic also fuelled a large increase in private consumption (which rose by 14.6% in real terms). Government spending in 2022 reached the highest level in the history of the country at US$1.74 billion. At the same time, however, imports also increased by 23% in real terms, which was a result of increasing demand and global prices.

1.17. GDP growth fell to 2.4% in 2023. Whilst overall government expenditure on salaries and wages and goods and services increased by 4.6%, a high inflation rate saw government consumption fall by 0.8% in real terms. Despite this, overall growth remained positive as government capital spending and private investment rose.

1.18. Household consumption also saw an increase of 3.8%. This reflects an increase in overall economic activity as the economy recovered from lingering effects of the COVID-19 pandemic. Non-oil exports rose by 31.9% in real terms, however this was driven by an increase in service exports, particularly travel services, as exports of goods (excluding petroleum exports) saw a fall of 16%.

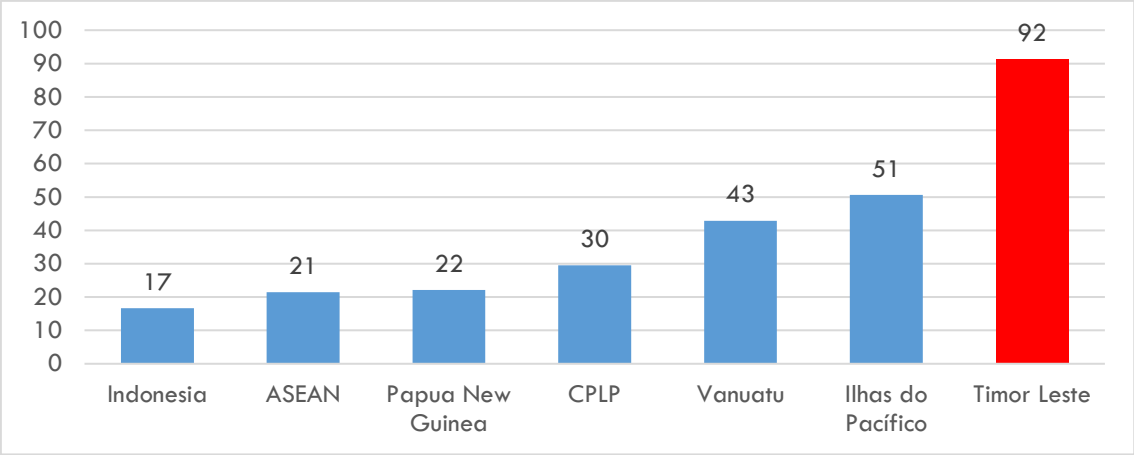
GDP 2024

1.19. Non-Oil GDP growth is estimated to have accelerated 4.1 % in 2024. The higher growth rate, following a reduction to 2.4% in 2023 was primarily driven by strong growth in investment (both private and public) as reforms to government procurement and investment management led to improvements in the execution of government spending, which subsequently supported the expansion of the private sector.

1.20. Overall GDP growth over the last decade is displayed in the Figure 1 above. The estimated performance in 2024 represents the strongest economic growth in the past decade, a reflection of a reinforced private sector, stable government and the effectiveness of budget allocations and reforms.

1.21. Government expenditure continued to be the main driver of economic growth in 2024, and was estimated to be 92% of GDP (levels that are far higher than other countries in the region as well as CPLP countries). A breakdown of government expenditure is provided in section 3 (recent expenditure developments) of this document.

Figure 2: Government expenditure as a percentage of GDP, %



Source: World Bank Development Indicators (WDI) and GRP, Ministry of Finance, May 2025

1.22. Below we outline the progression of each of the main components of GDP (Consumption – including government consumption, Investment, Exports and Imports).

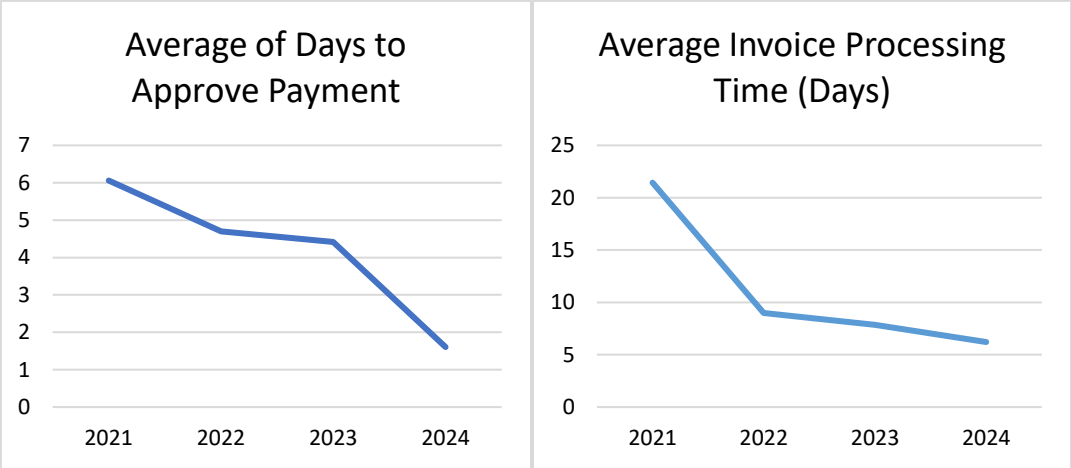
1.23. **Consumption** is made up of both private consumption and government expenditure on goods and services as well as salaries and wages (known as general government consumption).

1.24. **General government consumption** grew by 3% (in real terms) as a result of both increased purchases of Goods and Services and Salary and Wages (as covered by other sections of this document).

1.25. The final approved budget for Central Administration and RAEOA for 2024 may have only seen an increase of 10% compared to 2023, however overall expenditure (for the Central Administration and RAEOA) increased by 11%.

1.26. This was in part driven by improvements in invoice and payment processing times which led to an increase the government performance. As shown by Figure 3 , average processing times for payments and invoices reduced by two days in 2024.

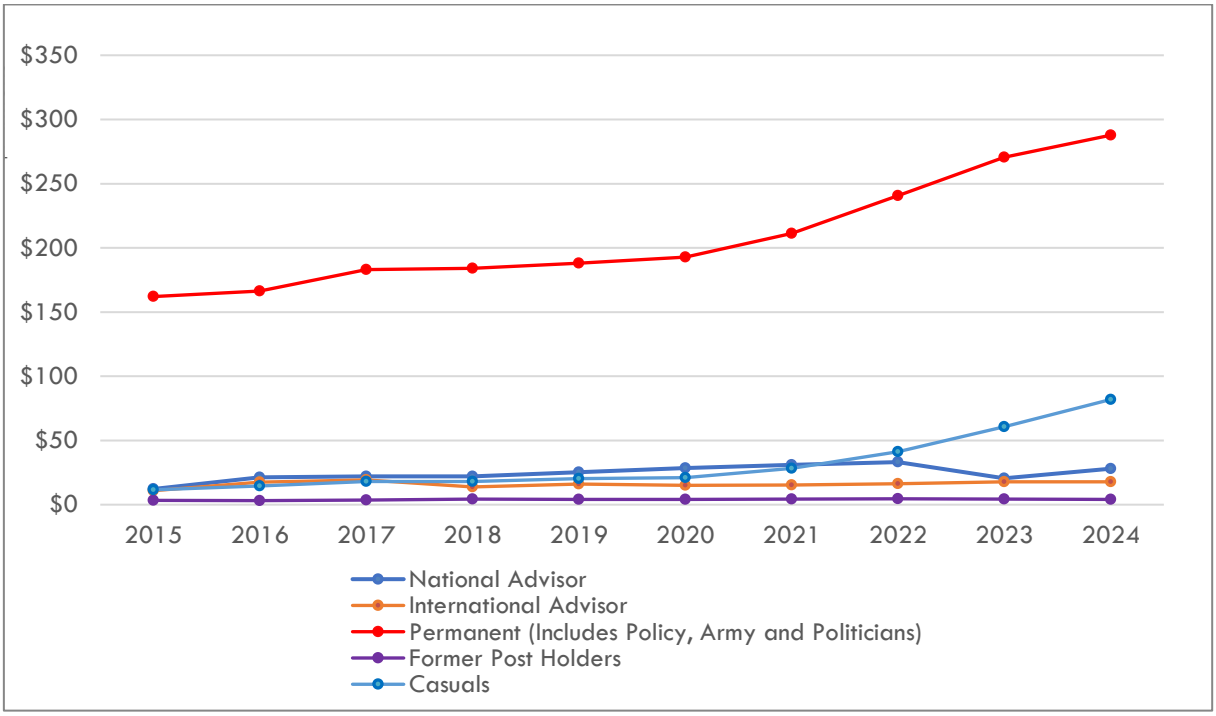
Figure 3: Invoice and Payment Approval Times



Source: GRP, Ministry of Finance, May 2025

1.27. Government expenditure on salary and wages also increased in 2024 with the total payroll reaching US$420 million. Figure 4 provides a breakdown by the categories of employees. These are Permanent staff (which includes politicians), Ex-Titulares, National and International Advisors and other staff on fixed-term or temporary contracts (i.e., Casuals).

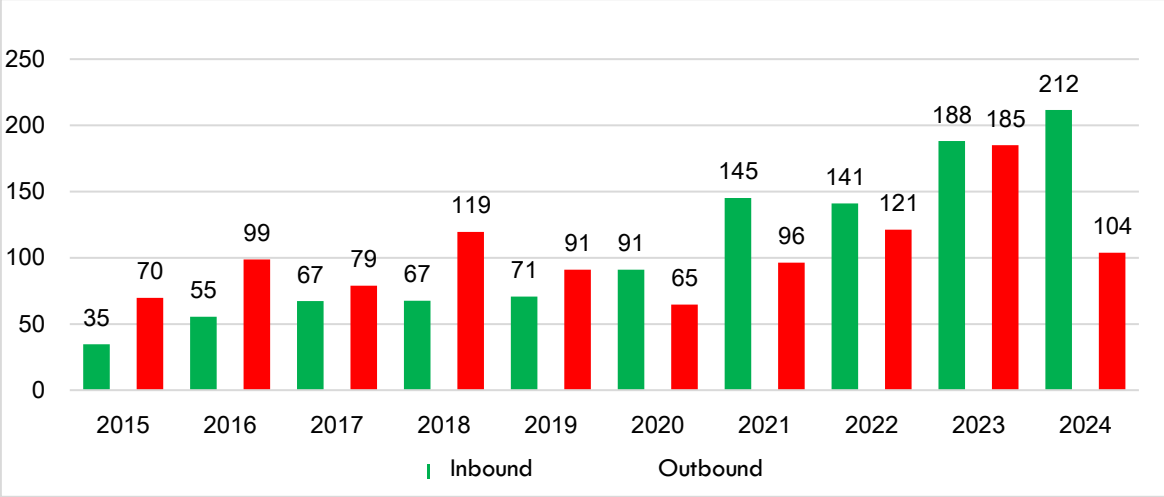
Figure 4: Breakdown of Government Payroll Data by employee type, $US Million



Source: Payroll Data, Ministry of Finance, April 2025

1.28. **Private Consumption** is estimated to have grown by 3.3%. This potentially reflects growth in the private sector. Remittances are also an important driver of consumption in Timor-Leste. Net remittances for households increased significantly with outward remittances falling by over US$80 million and inward remittances rising by US$24 million.

Figure 5: Inward and Outward Remittances to Households, $US Million



Source: Central Bank of Timor-Leste, BCTL, May 2025

1.29. **Investment** is estimated to have seen significant growth in 2024. This is largely driven by public investment (predicted to have grown 48.1% in real terms), however private investment is also estimated to have seen significant growth of 16.5% in real terms.

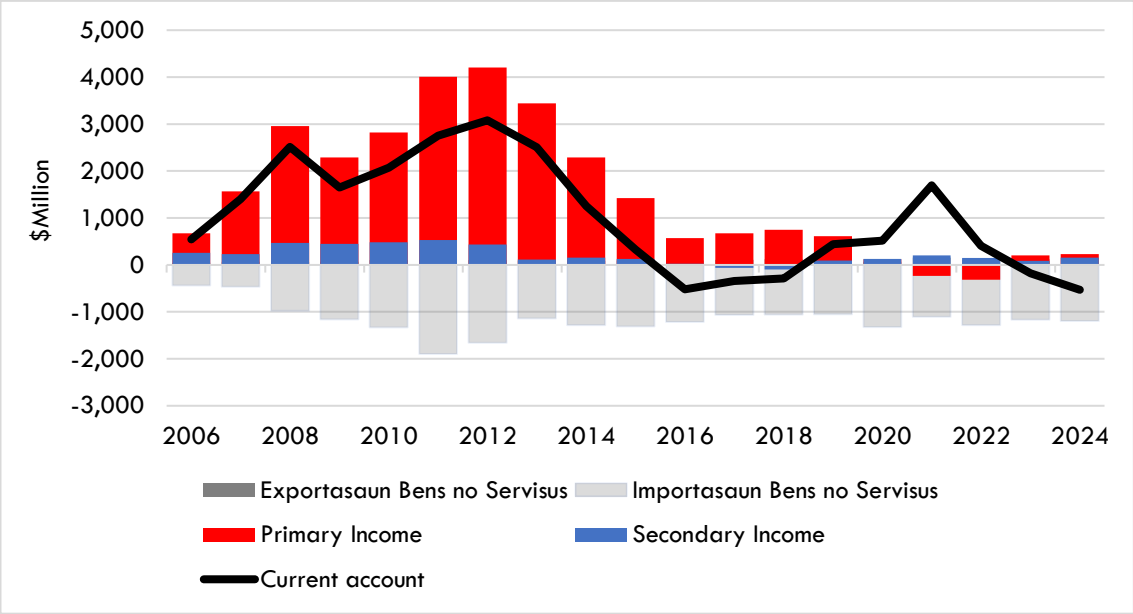
1.30. Capital and development expenditure for the Central Administration and RAEOA totalled US$301 million (an increase from US$192 million in 2023), reflecting a strong focus on long-term infrastructure development, including road rehabilitation, bridge construction and highway expansion. Additionally, preparations for a historic Papal visit in September 2024 led to a boost to government investment in public infrastructure.

1.31. Furthermore, 2024 has witnessed a significant increase in tourism. Immigration data indicates a 25% rise in tourist visa issuances over the year, a growth expected to positively impact private sector development and enhance the investment outlook for 2024.

Trade Balance

1.32. As shown in Figure 6, with the depletion of oil reserves from the Bayu-Undan oil field, Timor-Leste has run current account deficits over the last two years. This means that the country's imports from the rest of the world are higher than its exports.

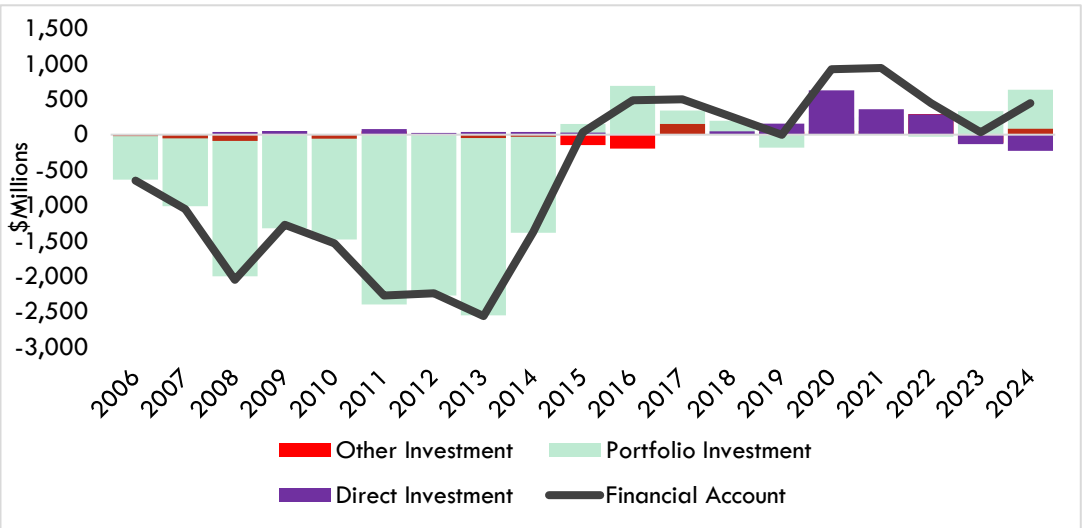
Figure 6: Current Account Balance, $US million



Source: Central Bank of Timor-Leste, BCTL, May 2025

1.33. The current account deficit of US$530 million in 2024 has been financed by withdrawals from the Petroleum Fund. This is shown by a positive capital and financial account whereby the green bar in Figure 7 (Portfolio Investments) represents net revenues into the Petroleum Fund when negative and net drawdowns from the Fund when positive.

Figure 7: Financial Account Balance, US$m



Source: Central Bank of Timor-Leste, BCTL, May 2025

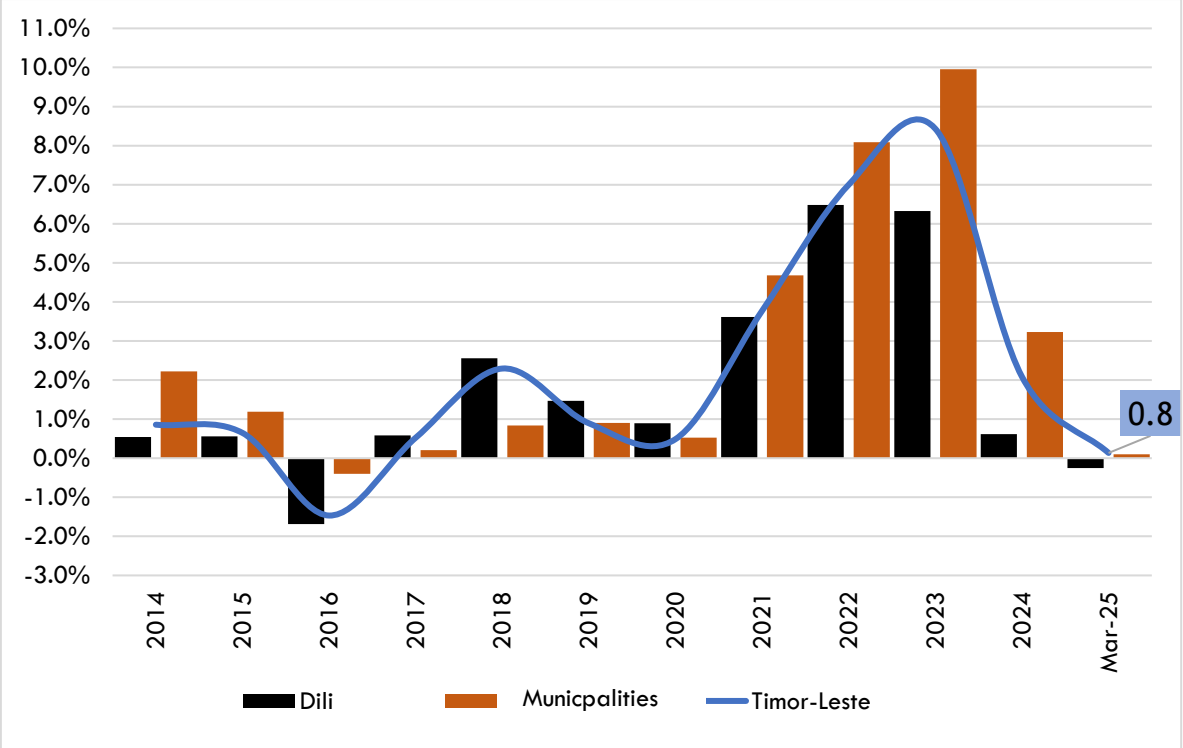
Inflation and Exchange Rates

1.34. Inflation has fallen significantly in 2024. Overall CPI inflation averaged 2.1% in 2024, a reduction of nearly 5 percentage points from average inflation rate in 2023. Average inflation is forecasted to be 1.8% in 2025. In March 2025 year on year inflation was at 0.8%. This means that a basket of goods and services that cost US$100 in March 2024 cost US$100.8 in March 2025.

1.35. The significant fall in inflation in 2024, can be attributed to the Government's efforts to reduce import duties from 5% to 2.5% (in Rectification Budget 2023) and eliminate the tax on sugar and confectionery products (previously $1 per kilo of sugar).

1.36. Further reasons for declining inflation include a reduction in shipping costs and a fall in the global food prices. 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.

Figure 8: Annual CPI inflation 2014-2025, %



Source: CPI data, National Statistics Institute (INETL) https://inetl-ip.gov.tl/, April 2025

1.37. As shown by Table 2, inflation is projected to fall further in the coming years. This is mainly due to an expected decline in shipping costs as well as commodity prices. Potential rises in oil prices due to conflict in the Middle East could lead to moderate increases in inflation. This situation will be observed over the coming months and updated during the budget report submission.

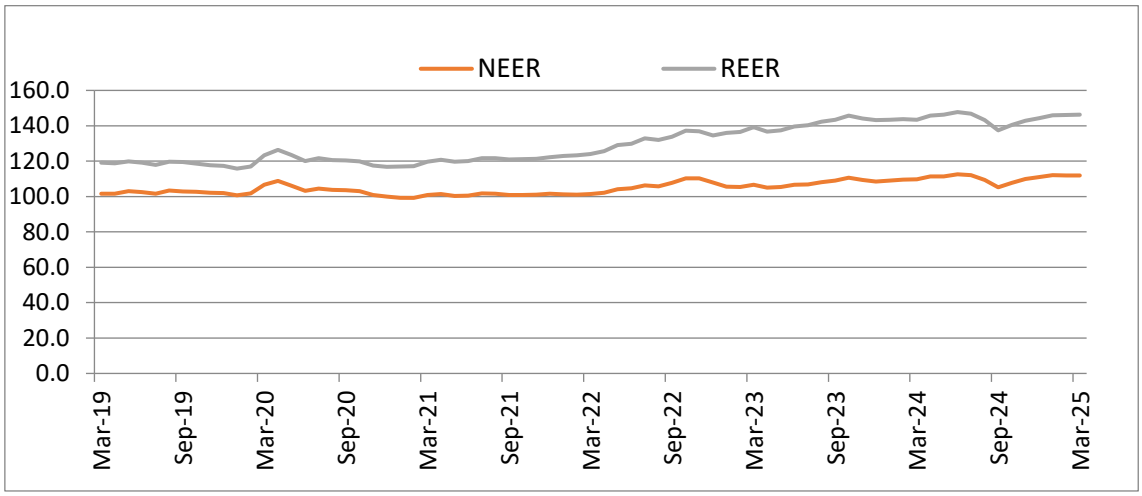
Table 2: Annual Inflation (average year on year) 2024 and forecast 2024-2030, %

Category	2024	2025	2026	2027	2028	2029	2030
Inflation Forecast (Average Consumer Prices)	2.1%	1.8%	2.0%	2.0%	2.0%	2.0%	2.0%

Source: Inflation for 2023 from the National Statistics Institute (INETL) https://inetl-ip.gov.tl/, Ministry of Finance. Inflation Forecasts for 2024 from the National Directorate of Economic Policy, Ministry of Finance. Forecasts 2026-2029 from the International Monetary Fund, April 2025

1.38. Figure 9 shows movements in the nominal and real (inflation adjusted) exchange rates. An appreciation in exchange rates make imports relatively cheaper and can drive down inflation rates. However, they also make exports less competitive. The exchange rate has remained relatively stable over the past five years. This stability is a key advantage of the US dollar above other currencies and allows business to plan more effectively.

Figure 9: Nominal and Real Exchange rates March 2019-March 2025, Index

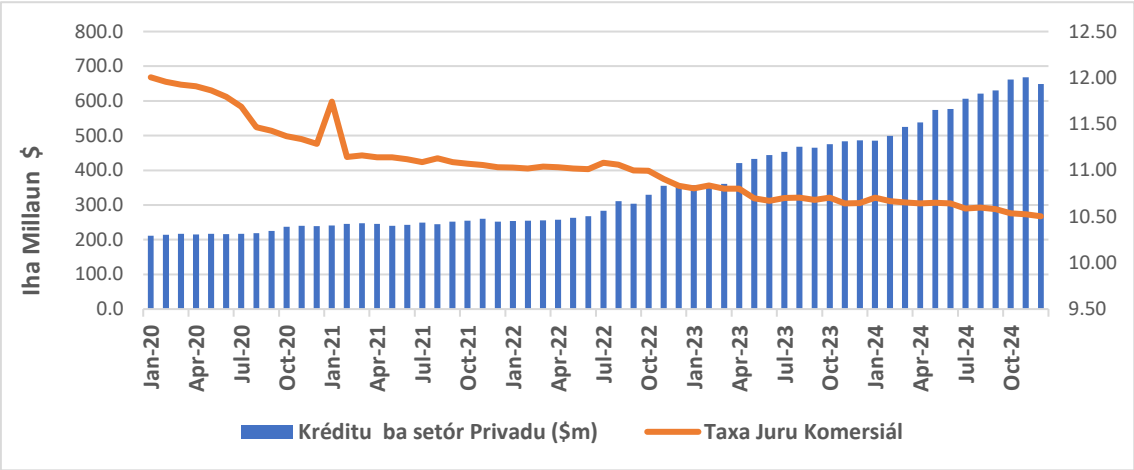


Source: Central Bank of Timor-Leste BCTL, May 2025

Financial Sector Trends

1.39. The year-on-year interest rate on loans to private businesses was 10.71% in January 2024, and fell to 10.5% by December 2024. The fall in interest rates has been accompanied by an increase in consistent rises in domestic credit throughout the year, this indicates that the private sector is showing signs of growth.

Figure 10: Commercial Interest Rates % (RHS) and Credit to Private Sector US$ Million (LHS)



Source Central Bank of Timor-Leste, April 2025. Interest Rate (RHS, %), Credit (LHS, $m), March 2025

Employment Overview

1.40. The latest available employment statistics in Timor-Leste are from the 2022 census publication. Census data shows that the labour force participation rate was 35.9% and unemployment rate was 2.9% in 2022. Table 3 shows the breakdown of the labour force as reported in the census.

Table 3: Main labour force status categories and indicators, by sex

a. Categories (in thousands)

Category	Total	Male	Female
Working-age population 15+	874.0	441.6	432.4
Labour Force	313.7	185	128.7
of whom employed	304.7	180	124.8
of whom unemployed	9.0	5.1	3.9
Outside the labour force	560.3	256.6	303.7

b. Categories (in percentage)

Indicator	Total	Male	Female
Labour Force participation rate	35.9	41.9	29.8
Employment-to-population ratio	34.9	40.8	28.9
Unemployment rate	2.9	2.7	3.0

Source: Census 2022, National Statistics Institute INETL

1.41. As with other ASEAN countries, Timor-Leste's labour market is characterized by high levels of informality. The latest estimation made by the Ministry of Finance, using the 2021 Timor-Leste Labour Force Survey, reveals that from the individuals employed above, 71.1% are in informal employment.

Macroeconomic and fiscal projections (2026-2030)

Expenditure allocations

1.42. Table 4 provides proposed expenditure allocations for Budget 2026 and the medium-term. Based on expenditure over the first five months of the year, total expenditure for RAEOA and the Central Administration in 2025 is anticipated to reach US$1.99bn. This includes a US$10m transfer from the Central Administration to RAEOA. Removing this would mean that out of consolidated budget of US$2.125 million for 2025, the Ministry of Finance expects an execution rate of close to $1.98bn or 93% on the consolidated number.

1.43. This projection is based on execution up until May 2025. A full breakdown of expenditure up until May is available in the section titled “Expenditure Review Budget 2025” under section 3 of this document. We assume that expenditure from June to December will rise in line with the trends observed in 2023 and 2024, whereby government expenditure, particularly expenditure on capital (minor capital and development capital) rose sharply in the last two quarters of the year.

1.44. The projection for 2025 is based on the evolution of government spending during the first 5 months of the year which, as shown in section 3, appears to have exceeded expenditure during the first 5 months of 2024. If expenditure, in particular expenditure on capital and goods and services, in the remaining months of the year does not follow the strong growth that was observed in the latter half of 2024, government execution could fall to as low as $1.9bn. This would lead us to downgrade our central and lower bound GDP projections shown below.

Table 4: Expenditure Forecast for 2025 and Proposed Allocations 2026-2030, $USm

Economic Classification	Approved OGE 2025 (Consolidated)	2025 Projection	2026	2027	2028	2029	2030
Salary & Wages	490	486	415	412	408	403	398
Goods & Services	415	362	362	376	392	407	423
Transfers (Does not include transfers to RAEOA)	758	756	690	717	717	716	716
Minor Capital	23	24	29	30	32	33	34
Capital & Development	440	350	354	388	453	482	510
Total (Central + RAEOA)	**2,125**	**1,979**	**1,850**	**1,924**	**2,001**	**2,041**	**2,082**

Source: National Directorate for Economic Policy, Ministry of Finance. *Note 2025 numbers are consolidated, i.e. they do not include the US$10m transfer from the Central Administration to RAEOA.

1.45. The proposed allocations in 2026 sees a 13% cut from the consolidated budget proposed the Central Administration and RAEOA. The rationale behind this is to bring the budget in line with the government's absorptive capacity (i.e., in line with values that the government can actually execute) and at the same time implement expenditure efficiencies.

1.46. The proposed allocation for Salaries and Wages in 2026 sees a fall of 15% from the US$490 million approved for Budget 2025. There are further reductions of US$3-5 million a year from 2027 to 2030.

1.47. The proposed reduction in 2026 is the result of three main factors. Firstly, the government's decision to introduce a compulsory retirement age for civil servants at 65 has the potential to save up to US$15 million during the first year of implementation and around US$3-5 million during each subsequent year.

1.48. Secondly, the government will seek to finance advisors (National and International) through development partners. This has the potential to not only reduce costs, but also to increase the transparency and accountability of advisor recruitment and performance. Advisors working at service-delivering entities, such as health, education and the military are to be ring-fenced from this reform to avoid any unintended disruption to key services (e.g., teaching, medical services etc). This measure has the potential to reduce the government wage bill by a further US$30 million. Further reductions will be sought by reducing the numbers of casual or temporary staff where they are found to be duplicating functions already delivered by the civil service.

1.49. It should be noted that there are also upwards pressures on salaries. For example, recruitment of Customs and Tax authority staff in order to implement a Value Added Tax and the recruitment of new police cadets. Proposed reductions and upward pressures will be debated during the Budget Review Committee (KRO) ahead of the formulation of the 2026 Budget Proposal.

1.50. The proposed allocation for Goods and Services in 2026 represents a 13% reduction from Budget 2025. This in line with the projected execution rate for 2025. In future years, this category is anticipated to grow in line with inflation and population growth.

1.51. Expenditure for transfers sees a suggested reduction to US$690 million in 2026. This is the result of the potential for one-off savings to the transfer to EDTL and Bee-TL (Electricity and Water SOEs) due to increasing tariff revenue and healthy cash balance positions. The fiscal risks statement in section 4 outlines the cash balances of these entities as of December 2023. The 2026 budget proposal will provide an update as of December 2024 for all State-Owned enterprises. However, financial information provided by EDTL shows an US$8 million increase electricity sales in 2025 and a cash balance estimate of US$89.9 million as of December 2024.

1.52. Transfer expenditure is shown to increase in 2027 after State Owned Enterprises draw down on their cash balances in 2026. Transfer expenditure to non-governmental and private sector organisations will be cut and replaced by loans and grants provided by a National Development Bank. The government will also seek opportunities for efficiency savings in household transfers through reducing duplicate payments. This will be facilitated by plans to roll-out a unique ID for all citizens; this would allow for greater tracking of social protection payments. As such suggested allocations to are frozen for 2028 to 2030.

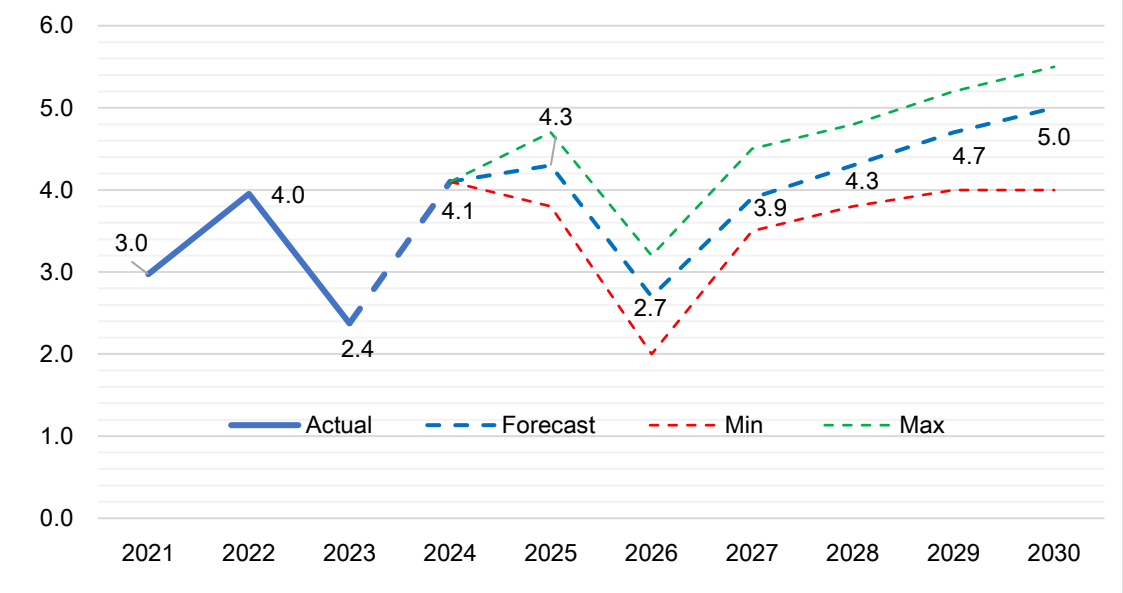
1.53. As shown in section 3 of this document, the largest expenditures on transfers are on social protection payments and on transfers to State Owned Enterprises. The largest transfer to State-Owned enterprises is to the electricity company EDTL. EDTL maintains relatively cheap electricity prices for businesses and households by financing over two-thirds of its expenditure through government subsidies[4]. The largest costs faced by EDTL are the imports of diesel which is used for electricity generation. If the government is able to accelerate the transition to renewable energy sources, for example through solar panels, it could see a reduction in the costs borne by EDTL. This could result in considerable reductions to transfer expenditure in the medium term.

1.54. The overall expenditure allocations are projected to increase in line with population growth and inflation in 2027 and 2028, and by inflation alone in the following years. Notably, allocations in 2027 and 2028 will see increases beyond inflation to support presidential and parliamentary elections, the implementation of a Value Added Tax (VAT) and the transition to the ASEAN trading bloc.

1.55. Expenditure allocations for capital are also assumed to increase each year in the medium term to maximise the opportunities for economic growth. GDP projections that arise from these expenditure allocations are provided below.

GDP Projections

Figure 11: GDP growth and Projections, %



Source: 2021-2023 actuals from National Accounts, INETL, September 2024; 2024 preliminary estimate from INETL; 2026-2030 projections, National Directorate for Economic Policy, Ministry of Finance

[4] EDTL financial reports. Key financial information is available in the Annex of the Budget Report for OGE 2025. https://assets.ctfassets.net/60pzqxyjaawg/4UcagSab7EBcUodkU7TCdk/031cd56cfa0643dfd7a31dc6b1fe3076/02.03.Format_Budget_Report_English_2025_Approved_250129__2_.pdf

1.56. Figure 11 provides GDP forecasts that are based on the previously mentioned expenditure forecasts for 2025 and budget allocations for 2026 to 2030. The chart provides central estimates that are stated in the numbers as well as lower and upper bounds to reflect forecast uncertainties.

1.57. Growth is anticipated to rise further in 2025 with the central estimate suggesting GDP growth of 4.3%. As stated above, if government expenditure fails to rise in the second half of the year in line with the pattern observed in 2023 and 2024, these central estimates will be revised down. The estimates will be refined in the proposal for Budget 2026 as more data will be available at that time.

1.58. The central estimate projects a decline in GDP growth to 2.7% in 2026, primarily due to a projected fall in the volume of government expenditure. However, this temporary slowdown in economic growth may not necessarily hinder improvement in living standards. The focus on more efficient spending and effective implementation of government programs, particularly those leading to improved outcomes in health and education can successfully facilitate private sector growth in key economic sectors such as agriculture and tourism. This may result in improvements to living standards and will build the foundations for stronger and more sustainable economic growth in future years.

1.59. Since GDP growth is currently driven by government expenditure, it is also highly sensitive to changes in volumes of government spending. This highlights the importance of measuring the success of government programs through a range of indicators, not just GDP growth.

1.60. Economic growth is anticipated to gradually rise in future years and eventually reach the government's targets. This is conditional on successful implementation of the programs and priorities outlined in section 2 of this document.

1.61. In the absence of external shocks, whether the GDP forecasts are in line with the central estimates or the upper and lower bounds depends on the success of government programs. If the programs and priorities mentioned in 2026 are successfully implemented and result in higher foreign direct investment and the expansion of the private sector, economic growth will be closer to the upper bound estimates in Figure 11 above.

1.62. On the other hand, inefficient spending and poor execution rates can mean that growth is closer to the lower bound estimates.

Revenue and ESI Projections

1.63. Table 5 provides forecasts for domestic revenues and the Estimated Sustainable Income (ESI). Initial collections for 2025 suggest that tax revenues could increase by 8% this year. Tax revenues are anticipated to see a boost of around 1.5% of GDP in 2027 with the introduction of a Value Added Tax. Details on revenue forecasts are provided in section 4 of this document.

1.64. Tax revenues for 2026 do not include potential revenue impacts from ASEAN accession which will require the immediate removal of some taxes on trade. This is subject to the

evolution of ongoing negotiations and preliminary estimates of the impact will be available in the Budget 2026 proposal submissions.

Table 5: Revenues Actuals 2021-2024 and projections 2025-2030, $USm

Revenue Category	2021	2022	2023	2024	2025 proj	2026 proj	2027 proj	2028 proj	2029 proj	2030 proj
Domestic Revenues*	218	218	251	249	258	270	317	337	356	376
Tax Revenues	*118*	*152*	*188*	*195*	*210*	*223*	*268*	*285*	*301*	*317*
Non-Tax Revenues	*100*	*66*	*63*	*54*	*48*	*47*	*49*	*52*	*55*	*59*
ESI**	548	554	490	522	552	525	511	485	455	424
Total	**766**	**772**	**741**	**771**	**810**	**796**	**828**	**822**	**812**	**800**

Notes: * domestic revenue figures (tax and non-tax) presented above are slightly higher than those on the Transparency Portal. This is due to the inclusion of values from suspended accounts and rebates from the previous year. ** ESI estimates from 2026 onwards are based on current projected PF balance. The final figure for 2026 will be provided in the Budget 2026 submission.

Deficit Financing

1.65. Additional resources to finance government spending include excess withdrawals from the Petroleum Fund, loan disbursements and grants. Table 6 provides a forecast for these financing items.

Table 6: Projection of deficit financing items, $USm

Financing Item	OGE 2025	2026 proj	2027 proj	2028 proj	2029 proj	2030 proj
Excess Withdrawals	1,009	851	1,066	1,146	1,191	1,254
Loan Disbursement	45	50	27	30	35	25
Direct Budget Support (DBS)*	9	8	3	3	3	3
Total	**1,063**	**908**	**1,096**	**1,179**	**1,229**	**1,282**

*DBS projections are not available beyond 2028, numbers for 2029 and 2030 assume that DBS will remain at the same level as 2028; Source: DGMRE and National Directorate for Economic Policy, Ministry of Finance; All numbers rounded to the nearest million as they are indicative.

1.66. Table 6 does not include potential financing from cash balances, however cash balance financing for Budget 2026 is reflected in a lower excess withdrawal figure above (compared to 2027-2030). Financing from cash balances was US$251 million in Budget 2025. As government execution increases, cash balance financing will reduce. This is reflected in the fiscal and memorandum table in the executive summary which shows estimated cash balance financing of US$146 million for Budget 2026[5].

1.67. However, in order to support core payment functions during the first few months of the year the treasury typically maintains cash balances of around US$200 million. In previous years, low rates of government execution have meant that the Treasury has maintained this amount or higher. In future years, if government execution is close to 100%, the Ministry of Finance will have to reevaluate its model of cash balance management and financing.

Fiscal Sustainability Analysis

1.68. Over the past decade, the Petroleum Fund has regularly financed over 70% of the budget. As such, a key element of any Fiscal Sustainability Analysis in Timor-Leste is centred on predicting the lifespan of the Petroleum Fund.

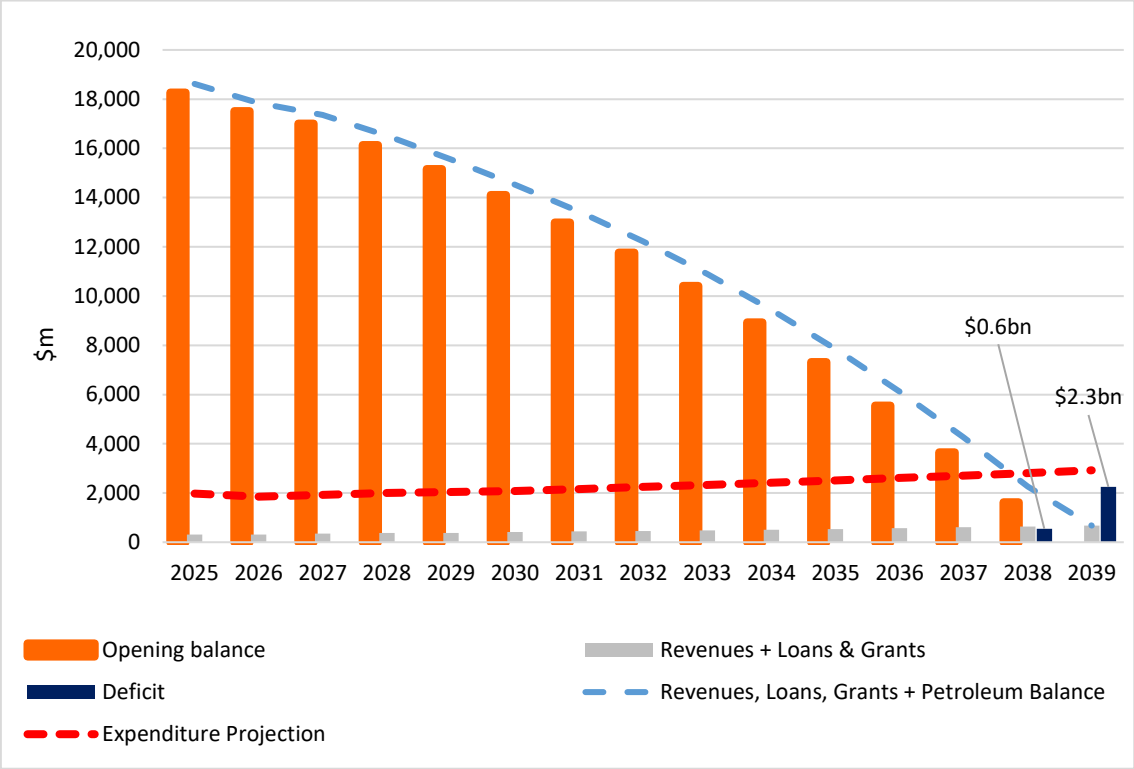
1.69. Figure 12 illustrates the current forecast for the Fund's lifespan. This estimation incorporates the proposed budget ceiling for Budget 2026 and the medium-term expenditure proposals shown above. Beyond 2030, expenditure is anticipated to increase in line with inflation and population growth.

1.70. It is important to note that this modelling assumes no additional petroleum resources will be discovered and extracted before the Fund fully depletes, and that no new taxes will be introduced. However, the Government is actively advancing negotiations related to the Greater Sunrise field as well as other potential oil and mining opportunities, which will unlock new petroleum and mineral resources for Timor-Leste. Concurrently, the Ministry of Finance is carefully exploring the costs and benefits of introducing taxation reforms. These proactive measures have the potential to delay the depletion of the Petroleum Fund and secure the country's long-term future.

1.71. Further details of the modelling are provided in section 4.

[5] Based on projections for 2025 revenues, loan disbursement and expenditure.

Figure 12: Petroleum Fund Lifespan under current trajectory



Source: Estimates from the Directorate of National Economic Policy DNPE, Ministry of Finance

1.72. If the Petroleum Fund is depleted before new petroleum revenues are discovered and extracted, significant consequences for government expenditure and the broader economy will arise. In such a scenario, upon the Fund's exhaustion, the government will not have sufficient revenues to carry out its most basic functions such as paying salaries to public sector workers, providing social security payments to the elderly, continuing payments to veterans and paying back loans.

1.73. Depleting the Petroleum Fund will also require large spending cuts that would result in a large shock to GDP. This would lead to large increases in unemployment and significant declines in incomes, the provision of public services, and ultimately, living standards.

1.74. This eventuality also carries implications for the country's ability to continue importing to the same scale and circulate currency internally. The country is able to sustain a dollarized economy since petroleum revenues saved in the Petroleum Fund guarantee a regular supply of US dollars. A large non-oil trade deficit is only manageable within a dollarized economy because US dollars drawn from the Petroleum Fund can replace the large outflow of dollars that are spent on imports.

1.75. If a currency alternative is not in place well in advance of the point that the Petroleum Fund depletes, persistent trade deficits could spark a liquidity crisis. Without the use of the Petroleum Fund savings to finance the outflow of US Dollars from expenditure on imports, individuals and businesses could find themselves without the currency needed for daily transactions.

1.76. In the absence of new petroleum revenues, the government has three main options for extending the life-span of the Petroleum Fund:

- Reforms to increase domestic revenues;
- Measures to reduce government expenditure;
- Increasing alternative revenue sources such as loans and grants.

2. Government Priorities and Reforms

Citizen Consultation – Key Results

Overview Citizens Consultation

2.1. As part of the Budget 2026 preparation, the Government conducted a nationwide citizen consultation covering all 13 municipalities and the RAEOA. The consultation provided communities the opportunity to directly voice their priorities and challenges. Structured around four development pillars: Social Capital, Economic Development, Infrastructure Development, and Institutional Framework, the process generated strong evidence to guide planning and budgeting decisions.

2.2. While the consultation used both surveys and focus group discussions, not all subsectors under each pillar were covered in depth. For example, seaports and airports (Infrastructure), rural development, petroleum, and private sector investment (Economic Development), and security, defence, foreign affairs, and decentralization (Institutional Framework) were not explored. The findings presented below reflect only the areas actively discussed during the consultation.

Social capital

2.3. **Health**: Widespread concern was expressed over persistent shortages of healthcare staff and essential medical supplies including basic medical equipment. Survey results showed that 62% of respondents identified the lack of doctors and nurses as a major barrier to service delivery, while 60% cited frequent stockouts of medicines. Communities strongly supported the expansion of mobile health outreach and emphasized the need for more localized planning and budgeting mechanisms at the Community Health Centre (CHC) level to improve responsiveness and resource use.

2.4. **Education**: Citizens across all municipalities highlighted significant challenges in education, particularly the shortage of qualified teachers and poor school infrastructure in rural areas. A majority (55.8%) prioritized enhanced teacher training, with nearly half calling for the expansion of school access closer to communities. Focus group discussions further revealed the urgent need for disability-inclusive facilities and stronger monitoring of school grants and school feeding programs to ensure transparency and impact.

2.5. **Social Inclusion**: While nearly 85% of respondents considered existing government efforts on social inclusion to be effective, many emphasized that implementation remains uneven at the suco level. Focus groups identified key barriers such as complex administrative processes and limited outreach, particularly for vulnerable populations. Citizens advocated for the expansion of One-Stop Shops (*Balkaun Úniku*) and mobile registration services to facilitate easier access to social protection programs for women, persons with disabilities, and the elderly.

2.6. **Environment**: Environmental concerns featured prominently in citizen feedback, with 53.1% of respondents identifying deforestation as the most urgent issue. Other critical challenges included the impacts of climate change and inadequate waste management systems.

Participants called for stronger investment in local conservation initiatives, eco-friendly practices, and the integration of environmental education in schools to build long-term awareness and community stewardship.

2.7. **Culture and Heritage:** Cultural preservation emerged as a national priority, with 94.6% of respondents agreeing that cultural heritage should be a major focus of government investment. Citizens emphasized the importance of safeguarding traditional knowledge, local languages, and historic sites. Youth engagement through arts, cultural festivals, and community programs was widely recommended as a means to strengthen identity and intergenerational connection.

Economic Development

2.8. **Agriculture**: Agriculture remains a vital sector for local livelihoods, with 59.7% of respondents identifying it as the top priority for job creation. Citizens across municipalities called for greater access to irrigation, modern farming equipment, and stronger market linkages. Particular emphasis was placed on rehabilitating small-scale irrigation systems and cold storage infrastructure in productive areas and municipalities such as Ainaro and Viqueque, to enhance agricultural output and reduce post-harvest losses.

2.9. **Tourism**: Local communities strongly supported the development of inclusive tourism models that generate income and preserve cultural assets. Key recommendations included capacity-building programs for community-run enterprises, infrastructure upgrades in high-potential areas such as Atauro Island and Mount Ramelau, and targeted support for cultural tourism. Youth and women's groups, in particular, highlighted the importance of hospitality training and entrepreneurship opportunities in this growing sector.

Infrastructure Development

2.10. **Roads and Bridges**: Transport infrastructure was identified as one of the most urgent priorities. Over 62% of citizens rated road conditions as poor, particularly in upland sucos where seasonal rains frequently isolate communities. Citizens called for the rehabilitation of rural and municipal roads, investment in climate-resilient bridge construction, and the establishment of regular maintenance systems to ensure year-round mobility and access to essential services.

2.11. **Water and Sanitation**: Concerns over limited access to clean water and adequate sanitation were raised by 35.1% of respondents. Communities urged for urgent improvements in water infrastructure and called for better coordination between central and municipal authorities under the decentralization framework. The need for sustainable operations and maintenance (O&M) systems was also highlighted to ensure the long-term functionality of public water services.

2.12. **Electricity**: Electricity access remains a persistent challenge, with more than half of citizens reporting daily power outages that disrupt both daily life and local economic activity. Community members emphasized the need for expanded rural electrification, especially through renewable energy solutions such as solar mini-grids. These were seen as essential for improving household welfare, supporting local enterprises, and enabling public services such as schools and clinics to function effectively.

2.13. **Telecommunications**: While not a core focus of the consultation framework, citizens especially in remote and upland municipalities identified poor mobile and internet connectivity as a persistent barrier affecting education, access to information, and public service delivery. Communities reported that weak signals and limited coverage disrupted online learning, hindered communication with government institutions, and restricted access to digital platforms for registration, banking, and emergency alerts. Citizens called for expanded mobile network coverage, public Wi-Fi hubs, and affordable internet for schools, clinics, and suco offices. They emphasized the need for stronger coordination with telecommunication providers to ensure inclusive digital access, highlighting that reliable connectivity is essential for improving service delivery, supporting livelihoods, and strengthening community engagement in local governance.

Institutional Framework

2.14. **Justice**: Citizens across municipalities reported limited access to the justice system, citing high costs, lengthy delays, and inadequate legal support services. They recommended expanding mobile court circuits, implementing legal literacy campaigns, and strengthening the Public Defender's Office. These measures were seen as essential to promote equity and ensure that justice is accessible to all, especially in remote and underserved areas.

2.15. **Governance and public services**:
Trust in public institutions remains uneven across municipalities. Only one-third of respondents rated public service delivery as "very efficient," while many expressed concerns over delays, lack of transparency, and limited responsiveness at the local level. Citizens called for the institutionalization of participatory budgeting, the establishment of accessible grievance and feedback mechanisms at the suco and municipal levels, and the regular publication of budget allocations, expenditures, and performance results. These measures were seen as critical for strengthening transparency, accountability, and citizen oversight in public administration.

Government Priorities and Measures

2.16. In 2026, the Government will continue to align its priorities and measures with the long-term vision of the Strategic Development Plan (SDP) 2011–2030 and the policy commitments outlined in the IX Constitutional Government Programme. These guiding frameworks reinforce the national commitment to inclusive and sustainable development, aiming to improve service delivery, strengthen economic competitiveness, and enhance citizen well-being. Grounded in principles of equity and resilience, the Government's agenda emphasizes accelerating job creation, diversifying the economy, expanding quality infrastructure, and modernizing public institutions. These priorities are further informed by nationwide citizen consultations and sector performance data, ensuring that the Budget 2026 responds directly to community needs and national policy goals.

2.17. To maximize development impact and ensure transparent and results-driven public spending, the Government is adopting programme-based budgeting as a central planning and financing tool. This approach links resources to measurable outcomes and organizes interventions into four strategic pillars: Social Capital Development, Economic Development, Infrastructure Development, and Institutional Framework. Through this structure, the Government will channel investments into critical programs such as improved access to health and education, agricultural transformation, rural infrastructure, digital connectivity, public administration reform, and enhanced justice and security services. Each category

reflects an integrated strategy to address structural challenges, unlock economic potential, and build resilient institutions, thereby aligning budgetary allocations with national priorities for long-term progress.

2.18. The priorities and measures outlined below are indicative and will be subject to further review by the Budget Review Committee. This process will ensure their alignment with broader macro-fiscal objectives and the strategic priorities of the IX Constitutional Government Programme.

Social capital development

2.19. **Health - Strengthening Local Health Systems and Expanding Community-Based Service Delivery**: In 2026, the Government will prioritize investments in critical health system reforms to expand equitable access to quality health services, particularly in rural and underserved areas. Aligned with the IX Constitutional Government Program and the National Primary Health Care Policy, the National Health Outreach Program will be scaled up to deliver essential services, including maternal and child health care, immunizations, and non-communicable disease screening across all *sucos*. Community health centers will receive support to effectively coordinate these activities, with local managers receiving targeted training in planning, budgeting, and expenditure tracking. The deployment and retention of health workers in rural areas will be enhanced through non-financial incentives such as relocation support and in-service training. All health facilities will prepare standardized annual implementation plans linked to national priorities and budget ceilings, ensuring a consistent and accountable approach to decentralized health delivery.

2.20. **Investing in Inclusive Health Infrastructure and Reliable Medical Supply Chains:** To enhance health service access, the Government will implement a national program to upgrade health facilities to universal design standards. This will include installing ramps, signage, accessible toilets, and safe waiting areas, with disability inclusion indicators embedded in annual planning and monitoring frameworks. Investments will prioritize facilities in underserved areas to reduce infrastructure-related service disparities. Complementing these efforts, the Government will modernize the national medical supply and logistics system to ensure the continuous availability of essential medicines and diagnostic supplies. Real-time stock tracking will be introduced at municipal and facility levels, aligned with the national essential medicines list. Additional investments will be made in municipal warehousing and last-mile delivery logistics to reduce stockouts and strengthen the reliability of service delivery. Together, these reforms will contribute to a more resilient, inclusive, and accountable health system, delivering long-term health and economic benefits to the people of Timor-Leste.

2.21. **Education - Improving Teacher Quality, Deployment, and Training to Raise Learning Outcomes:** In 2026, the Government will allocate significant resources to address structural challenges in the education workforce as part of its commitment to improving learning outcomes at the pre-school and basic education levels. To address urgent staffing gaps, especially in remote and extremely remote areas, the Government will prioritize the redistribution of existing teachers across the national territory. This equity-focused deployment will be guided by teacher mapping, student–teacher ratios, and regional disparities. Logistics and coordination with municipal authorities will be strengthened to support effective placement. In parallel, the Government will scale up targeted teacher training in science, mathematics, IT, and inclusive education, ensuring alignment with the national curriculum and providing follow-up support through school-based coaching and

monitoring. These measures represent core pillars of the national effort to professionalize the teaching workforce and deliver more equitable, high-quality education for all.

2.22. **Enhancing Learning Environments and Advancing Curriculum Reform for Greater Relevance and Inclusion**: In parallel with human resource improvements, the Budget 2026 will support key infrastructure and curricular reforms to strengthen the foundations of student learning. Investments will target the construction and rehabilitation of classrooms, water and sanitation facilities, and inclusive spaces, particularly in rural and peri-urban areas. Gender-sensitive facilities will be built to reduce dropout rates among girls, while accessibility improvements will enable greater participation of children with disabilities. The Government will ensure the nationwide distribution of curriculum-aligned textbooks, learning aids, and early-grade reading materials, as well as standardized furniture and improved library access. Simultaneously, 2026 will mark the launch of a phased Curriculum Reform for Cycle 3 (Grades 7–9), starting with the national rollout of the revised Grade 7 curriculum. This reform will modernize content, promote bilingual instruction, and introduce learner-centred approaches in alignment with the Strategic Development Plan and the IX Constitutional Government Program. By focusing on both foundational learning and systemic reforms, these critical programs will deliver measurable improvements in access, equity, and learning quality across Timor-Leste's education system.

2.23. **Social inclusion - Modernizing Social Protection Systems for Efficient and Equitable Delivery:** In 2026, the Government will invest in the modernization of its social protection systems to enhance targeting, efficiency, and results-based delivery of services to vulnerable populations. A central pillar of this effort is the reform and digitalization of the *Bolsa da Mãe* Program, which will include the development of a centralized, secure beneficiary database, the rollout of personalized Tutor Cards, and strengthened monitoring and evaluation mechanisms. These reforms aim to reduce inclusion and exclusion errors, improve transparency, and enable more responsive delivery of support to women and children in need. At the systems level, the Government will initiate a broader transformation of the Social Services Information Management System (IMS) by digitizing existing manual records and building an integrated platform for data sharing and real-time planning. These strategic investments will allow for smarter resource allocation, reduce administrative inefficiencies, and ensure that social programs are more aligned with actual household needs and vulnerabilities.

2.24. **Institutionalizing Humanitarian Response Standards to Promote Dignity and Social Equity:** To improve the consistency, coordination, and dignity of emergency support, the Government will institutionalize national operational standards for humanitarian assistance in 2026. These will include standardized procedures for food distribution, protocols for funeral support, and the regulation of vehicles and materials used in emergency interventions. By formalizing these processes, the Government aims to reduce disparities in service delivery, reinforce public trust in state-supported social assistance, and promote a more equitable and respectful approach to supporting families in crisis. These reforms will also strengthen the resilience of the social inclusion system in responding to natural disasters, public health emergencies, and other shocks. Together, these initiatives reflect the Government's strategic shift from fragmented welfare responses to a coherent, rights-based social protection framework that delivers sustainable and inclusive outcomes.

2.25. **Culture and Heritage - Investing in Cultural Access, Artistic Production, and Youth Engagement:** In 2026, the Government will scale up its commitment to the cultural sector through the National Culture and Heritage Development Program, aligned with the IX

Constitutional Government's vision of strengthening national identity, fostering social inclusion, and supporting creative expression. Public resources will be directed toward expanding access to cultural spaces, supporting Timorese artists, and engaging young people in artistic activities. Key initiatives include the rehabilitation of cultural centers, promotion of local art festivals, and institutional support for creative production across municipalities. Special focus will be placed on ensuring equitable participation for youth and communities in rural areas, allowing broader access to cultural expression and learning opportunities. These efforts aim to empower local talent, boost creative industries, and reinforce cultural participation as a pillar of civic life.

2.26. **Preserving Cultural Heritage and Strengthening Sector Sustainability:** To ensure the long-term sustainability of the cultural sector, the Government will continue to strengthen the Cultural Heritage Preservation and Transmission Strategy, with a focus on safeguarding both the tangible and intangible heritage of Timor-Leste. This includes the documentation of oral histories, traditional knowledge systems, and historical assets, as well as investments in heritage sites, museums, and public archives. Public awareness campaigns and school-based cultural education will be expanded to foster a greater appreciation of cultural heritage among younger generations. At the institutional level, capacity-building programs will be implemented to improve governance, coordination, and professional standards across the sector. These investments reflect the Government's strategic objective to protect collective memory, promote creativity, and ensure that Timor-Leste's cultural legacy is preserved, celebrated, and passed on to future generations.

Economic Development

2.27. **Environment - Advancing Environmental Sustainability and the Blue Economy for Climate-Resilient Development:** In 2026, the Government will strengthen its commitment to environmental protection and climate resilience by advancing policies that safeguard natural resources, protect biodiversity, and promote sustainable development practices. Public investments will prioritize climate adaptation measures such as integrated watershed management, reforestation, and coastal defense, while also reinforcing institutional capacities for environmental regulation and enforcement. As part of its strategic vision, the Government will expand its focus on the blue economy, recognizing the ocean as a vital resource for national development. Initiatives will include the sustainable management of marine and coastal ecosystems, support for community-based fisheries, and investments in marine ecotourism. These efforts will be implemented in line with Timor-Leste's commitments to the Paris Agreement and the Sustainable Development Goals (SDGs), ensuring that environmental sustainability and ocean-based economic potential are fully integrated into the country's development pathway.

2.28. **Rural Development - Expanding Access to Decent Housing and Basic Services in Rural Areas**: A key component of the rural development agenda is the expansion of Decent Rural Housing and Infrastructure, focused on improving living conditions and dignity for vulnerable families. In 2026, the Government will implement targeted initiatives to build and rehabilitate housing infrastructure in rural communities, guided by typologies adapted to the social and economic realities of Timorese households. Minimum hygiene standards will be ensured in all supported housing units, particularly for low-income and remote populations. These investments will be accompanied by policies to attract investment and improve service access in rural areas, reinforcing the broader goal of equitable territorial development. Together, these programs reflect the Government's strategic aim to make rural communities

more productive, resilient, and inclusive, while preserving their cultural and environmental assets.

2.29. **Agriculture - Transforming Agriculture into a Driver of Productivity, Investment, and Food Security**: In 2026, the Government will prioritize transformative investments in agriculture as a foundation for inclusive economic growth, rural employment, and national food security. Public resources under the General State Budget and the Infrastructure Fund will support the rehabilitation and expansion of strategic irrigation systems, targeting high-potential areas where improved water management can significantly boost cropping intensity and staple yields, including rice and maize. Through the National Irrigation Rehabilitation Program, the Ministry of Agriculture will shift from a service provider to an enabler of farmer productivity and private sector engagement. Simultaneously, the Government will launch a series of measures to catalyze private investment in agriculture, including community-based land registration, cooperative formation, and the simplification of licensing for agribusinesses. Blended finance and public–private partnerships will be used to attract investment in mechanization hubs and cold storage infrastructure, helping to modernize supply chains and create off-farm rural employment.

2.30. **Enhancing Food Self-Sufficiency, Nutrition, and Rural Livelihoods**: To reduce dependency on food imports and address persistent undernutrition, the Government will intensify support for domestic production of cereals, vegetables, and fish, aligned with national priorities for food sovereignty and improved nutrition outcomes. Priority will also be given to import substitution for food that Timor-Leste can produce domestically, reducing reliance on external markets and strengthening local value chains. This will include expanded access to quality seeds and inputs, localized extension services, and targeted investment in applied agricultural research. These interventions are part of a broader effort to improve food self-sufficiency and nutritional resilience in vulnerable populations, particularly in rural and peri-urban areas. The strategy is closely linked with cross-sector goals to reduce stunting, improve children's health, and promote local economic development. These investments reflect the Government's commitment under the IX Constitutional Government Program and Strategic Development Plan to build a productive, climate-resilient, and inclusive agri-food system by 2030.

2.31. **Petroleum & Minerals – Greater Sunrise Negotiation and Development**: The development of the Greater Sunrise gas field under the Greater Sunrise Special Regime, within the framework of the Maritime Boundary Treaty, remains a top priority for the Government in this sector. The Government will continue to intensify negotiations with Greater Sunrise upstream stakeholders, such as the Government of Australia and the Sunrise Joint Venture Partners (including TIMOR GAP, E.P., Woodside, and Osaka Gas) with the objective of commencing field development by 2027/2028 and achieving first gas production by 2032.

2.32. Following the planned closure of the Bayu Undan field, the Government has launched a comprehensive strategy to ensure energy sector sustainability and economic resilience. Recognizing petroleum and mineral resources as critical drivers of future development, the Government is engaging with stakeholders including TIMOR GAP, Santos, and others to repurpose Bayu Undan facilities as a processing hub for nearby gas fields such as Chuditch and Kelp Deep, while continuing production of the remaining hydrocarbons in the Bayu Undan reservoir. In parallel, the Government also plans to collaborate with interested parties to convert the depleted Bayu Undan reservoir into a regional Carbon Capture and Storage (CCS) facility with a potential capacity of 10 million tons per year. This transformation aims

to extend the life of existing infrastructure, attract international investment, and generate new state revenue. Furthermore, offshore and onshore exploration of petroleum and mineral blocks will be intensified throughout 2026.

2.33. **Strategic Infrastructure and Regional Development for Energy Sovereignty**: In parallel, strategic infrastructure projects such as the Tasi Mane Project and downstream petroleum development in Natarbora are being advanced to reinforce national energy sovereignty and support industrial growth. The Tasi Mane initiative envisions the creation of a southern development corridor, incorporating key infrastructure such as a logistics base, LNG plant, refinery, and petrochemical complex. These efforts aim to establish a national energy value chain, create jobs, and stimulate regional development by building a downstream petroleum industry in Timor-Leste. Collectively, these measures reflect the Government's long-term commitment to transform the petroleum, gas, and mineral sectors from primarily extractive activities into more diversified, integrated, and modern industries. This transformation is intended to build a more sustainable energy economy and ensure that the benefits are secured for both current and future generations.

2.34. **Tourism - Boosting Visitor Arrivals Through Strategic Destination Marketing:** In 2026, the Government will prioritize the implementation of a National Destination Marketing Program to significantly increase international visitor arrivals and raise the country's global tourism profile. The program will focus on high-potential markets such as Australia, Indonesia, and Singapore through targeted digital campaigns highlighting Timor-Leste's niche offerings in marine and diving tourism, cultural heritage, and eco-adventure travel. The Ministry of Tourism, in coordination with the Tourism Authority of Timor-Leste (AATL), will reinforce its presence at major global tourism trade events, standardize branding, and revamp the official tourism portal (timorleste.tl). To enhance visibility and conversion, multilingual content, influencer partnerships, and analytics-driven promotion will be deployed. These efforts are aligned with the IX Constitutional Government Program and contribute to national goals for economic diversification, job creation, and SME development particularly in coastal and rural communities.

2.35. **Reforming Sector Governance to Enable Investment and Coordination:** To unlock the economic potential of the tourism sector, the Government will implement a Tourism Governance Reform Package focused on institutional clarity, legal coherence, and professionalization. In 2026, the mandates of the Ministry of Tourism and the AATL will be formally delineated, and existing tourism legislation will be reviewed to eliminate fragmentation and streamline decision-making. The reactivation of inter-ministerial and technical coordination mechanisms will improve alignment across transport, infrastructure, and immigration sectors, critical enablers of visitor mobility and experience. The Ministry will also implement a capacity-building strategy to elevate tourism sector management and support the development of national tourism service standards and business licensing protocols. These reforms aim to attract private investment, enhance the quality of services, and ensure that tourism contributes sustainably to national income and employment.

2.36. **Private Sector Investment – Facilitating Private Sector Growth through Trade Enablement and Financial Access:** In 2026, the Government will strengthen its commitment to private sector development by implementing targeted measures to improve the business environment and support domestic enterprise growth. Priority actions will include the acceleration of certificate of origin issuance to facilitate export competitiveness, alongside expanded access to credit and financial services for micro, small, and medium enterprises (MSMEs). Complementary investments in financial literacy and business training

programs will equip entrepreneurs with the skills needed to scale their operations and enter new markets. These initiatives form part of a broader strategy to promote private investment, stimulate job creation, and diversify the economy, advancing the Government's agenda for inclusive and sustainable growth.

2.37. **Investing in Skills and Labor Mobility to Drive Economic Diversification:** In 2026, the Government will prioritize strategic investments in human capital development as a foundation for economic diversification and job creation, in line with the IX Constitutional Government's commitment to inclusive growth. Within this framework, public resources will support the expansion of technical and vocational education and training (TVET) systems, the strengthening of labor market linkages, and the rollout of labor mobility programs in coordination with bilateral and regional partners. In line with agricultural policy, one of the major job creation strategies is to strengthen the agriculture sector by maximizing training opportunities through agricultural training centers. These efforts aim to equip young Timorese with the skills demanded by priority sectors including agriculture, construction, tourism, and digital services, while promoting overseas employment opportunities through targeted partnerships. By aligning workforce development with investment priorities, these programs will generate employment, reduce youth underemployment, and support Timor-Leste's transition toward a more productive and diversified economy.

2.38. **Driving Trade, Industrial Growth, and Economic Diversification:** In 2026, the Government will advance its strategic vision for Trade and Industry by investing in critical programs aimed at strengthening the private sector, promoting exports, and fostering economic diversification. Public resources will support the development of logistics infrastructure, the digitization of industrial processes, and the implementation of policies that encourage foreign investment and industrial sustainability. Key initiatives will focus on creating a more attractive and competitive business environment for Timorese entrepreneurs, supporting cooperatives and the social economy, and delivering targeted workforce training to meet evolving market demands. These efforts are designed to stimulate inclusive growth, enhance national production capacity, and reinforce a resilient economic model centered on job creation and long-term sustainability, core objectives under the IX Constitutional Government's economic agenda.

Infrastructure Development and Multi-Year Investments

2.39. As of January 2025, the Infrastructure Fund had a balance of US$1.7 billion worth on unexecuted projects. This includes US$1.2 billion worth of projects that do yet have contracts. The largest infrastructure projects are mentioned below.

2.40. **Strengthening Infrastructure Project Selection through Investment Readiness and Strategic Alignment:** In 2026, the Government of Timor-Leste will strengthen the project selection process under the Infrastructure Fund by applying a more rigorous readiness assessment and prioritizing strategic investments that drive economic growth and service delivery. Aligned with the principles of the Public Investment Management System (PIMS), resource allocation will focus on infrastructure projects that demonstrate strong economic viability, contribute directly to national development priorities, and show clear readiness for implementation. This includes the development and application of robust investment criteria to ensure that only well-prepared, high-impact projects such as those enhancing connectivity, resilience, and access to essential public services are funded. These reforms aim to improve the efficiency, transparency, and effectiveness of capital spending in line with the Strategic Development Plan and the goals of the 2026 Declaration of Budgetary Strategy.

2.41. **Roads and Bridges - Accelerating National Connectivity through Strategic Roads and Bridge Investments**: In 2026, the Government of Timor-Leste will advance a set of critical infrastructure programs under the National Roads and Bridge Development Initiative, aimed at driving inclusive economic growth, improving rural mobility, and strengthening climate resilience. These investments are aligned with the Strategic Development Plan 2011–2030 and the IX Constitutional Government's commitment to modernize transport systems and reduce territorial disparities. Priority will be placed on completing ongoing national, municipal, and rural road projects. Additional focus areas for 2026 include the completion of six strategically important bridges and the development of climate-resilient protection works along 13 rivers, spanning a combined length of 9,200 meters to ensure year-round access and mitigate flood risks. Together, these programs form part of an integrated national strategy to strengthen regional connectivity, stimulate rural productivity, and safeguard infrastructure against climate-related hazards.

2.42. **Institutional Reforms and Rural Connectivity to Maximize Development Impact:** To ensure infrastructure investments yield sustainable returns, the Government will implement the Private Sector Performance and Accountability Reform Package in 2026. This includes the launch of a contractor classification system tied to performance, financial incentives for high-performing firms, and strict penalties for delays, creating a more competitive and accountable construction environment. Priority will be given to expanding rural road networks, which are vital for linking farmers to markets, enabling access to schools and clinics, and reducing social and economic isolation. These measures directly respond to the needs identified in the 2025 national citizen consultation process and support the Government's broader objective to deliver services more equitably across the territory. Through these strategic investments and reforms, the 2026 State Budget aims to stimulate local economies, reduce regional disparities, and promote sustainable infrastructure development as a foundation for inclusive national progress.

2.43. **Water and Sanitation** - **Expanding Access to Clean Water and Strengthening Public Health Outcomes:** In 2026, the Government will intensify investment in the Water Infrastructure Expansion Program to ensure equitable and sustainable access to clean water, particularly in municipal and administrative post capitals. This effort is guided by the Business Plan of BeTL,E.P 2022–2026, which is aligned with the Strategic Development Plan and national commitments to the Sustainable Development Goals. With infrastructure already implemented in 30 administrative post capitals, 2026 will focus on scaling up water connections in remaining areas (excluding RAEOA) and improving service reliability. These investments are expected to reduce the incidence of waterborne diseases, enhance household well-being, and contribute to inclusive public health outcomes, especially in peri-urban and underserved communities.

2.44. **Promoting Financial Sustainability and Responsible Water Use:** To ensure long-term sustainability of water services, the Government will implement a Water Service Financial Sustainability Reform, focusing on improved revenue collection and professional service delivery. In 2026, the nationwide installation of billing meters will be expanded to improve cost recovery, reinforce consumer accountability, and cover operation and maintenance expenses. Technical personnel will be deployed to manage service delivery efficiently and ensure compliance with performance standards. These reforms will strengthen the institutional capacity of BTL,E.P, promote more responsible water use, and reduce reliance on public subsidies over time. Together, these efforts will support the Government's dual objectives of expanding access and ensuring the financial sustainability of critical utility services.

2.45. **Electricity** - **Modernizing Electricity Infrastructure and Expanding National Access.** In 2026, the Government will prioritize critical investments under the National Electricity Infrastructure and Access Program to enhance network reliability, digital operations, and equitable service delivery across the country. Key infrastructure projects will include the completion of the Kuluhun–Becora underground cable in Dili and continued development of substations and transmission lines in Aileu. Network resilience will be improved through interconnection of major substations (e.g., Comoro–Camea), while digitization efforts will expand in Dili with electronic platforms for energy sales and advanced metering systems. Medium- and low-voltage extensions will continue nationwide to close service gaps in remote areas. These upgrades will be supported by standardized technical operations and materials procurement to reduce maintenance costs and improve service quality. Together, these investments will contribute to more reliable and inclusive electricity access, supporting household welfare and economic productivity.

2.46. **Accelerating the Renewable Energy Transition and Financial Reform:** Aligned with national goals for energy sustainability and climate resilience, the Government will implement a Renewable Energy and Financial Sustainability Reform Package. This includes the construction of a 72 MW solar photovoltaic plant in Laleia, Manatuto, and a 1–2 MW facility in Atauro, alongside feasibility studies for wind energy in Bobonaro and Ossu. These initiatives support the Government's target of achieving 100% suco-level electrification by 2025, bolstered by the scale-up of the Timor Naroman rural electrification program across 130 *aldeias*. To ensure the long-term financial viability of EDTL, priority will be given to installing functional meters for all customers, enhancing billing and collection systems, introducing facility rental taxes, and enforcing compliance through structured penalties. These reforms aim to reduce system losses, improve revenue collection and cost recovery, and position the electricity sector for long-term sustainability, while contributing to green energy transition goals and economic diversification.

2.47. **Airports - Rehabilitating Timor-Leste's International Gateway for Connectivity and Regional Integration**: In 2026, the Government will launch the Dili International Airport Rehabilitation Project as a flagship infrastructure investment to modernize the country's air transport sector. As the principal international entry point, Presidente Nicolau Lobato International Airport plays a vital role in enabling trade, tourism, diplomatic engagement, and Timor-Leste's preparation for ASEAN membership. Rehabilitation works will include upgrades to the runway, terminal facilities, and aviation safety systems to bring the airport into compliance with international standards. These improvements aim to increase passenger handling capacity, improve service quality, and reduce operational inefficiencies. As a critical economic enabler, the project will strengthen national logistics infrastructure, enhance investor confidence, and improve connectivity with key regional partners, reinforcing Timor-Leste's integration into the global economy.

2.48. **Enhancing Urban Mobility for Inclusive and Sustainable Transport Access**: To complement national air transport upgrades, the Government will also implement an Urban Mobility Reform Program focused on modernizing public transport systems, starting with Dili. In 2026, reforms will include improvements in service scheduling, introduction of structured driver training programs, and stronger enforcement of road safety regulations. These measures aim to make everyday transport safer, more reliable, and more inclusive, particularly for low-income households, women, and youth. By improving the urban mobility system, the Government seeks to reduce congestion, improve access to jobs and services, and foster more livable urban environments. These efforts directly support national goals for productivity, social cohesion, and climate-resilient development, in line with the Strategic

Development Plan and the IX Constitutional Government's infrastructure modernization agenda.

2.49. **Telecommunications - Operationalizing the National Digital Backbone for Inclusive Connectivity and Economic Growth**: In 2026, the Government will operationalize the Timor-Leste South Submarine Cable System (TLSSC) under the National Digital Backbone Operationalization Program, marking a transformative milestone in the country's digital infrastructure agenda. Following the successful landing of the fiber optic cable in 2024 and system testing in early 2025, the 2026 focus will be on delivering high-capacity, secure, and affordable internet access across the national territory. Public investment will support the institutional development and technical activation of *Cabos de Timor-Leste, E.P*. (CTL, E.P.), the newly established state-owned enterprise responsible for managing both the TLSSC and the terrestrial fiber optic network. CTL, E.P. will function as the national digital infrastructure authority, ensuring compliance with performance and regulatory standards while offering open and competitive wholesale access to licensed telecommunications providers. These efforts will reduce internet costs, expand service coverage, and improve the quality of digital connectivity for households, businesses, and public institutions. The fiber optic network will also enable e-learning, enhance the education system, improve digital services and systems in the health sector, and strengthen other service delivery such as justice, while reinforcing e-government systems and platforms.

2.50. **Expanding Universal Digital Access to Support Social Inclusion and Service Delivery:** To ensure no community is left behind in the digital transformation, the Government will complement terrestrial fiber deployment with the Universal Digital Access Initiative, leveraging Starlink satellite technology to serve extremely remote and mountainous areas where fiber infrastructure is not yet viable. This hybrid approach will ensure that schools, health centers, and administrative posts across the country gain reliable access to fast internet, facilitating e-education, e-health, and access to digital public services. These investments will unlock new opportunities for private sector innovation, support the digitalization of public administration, and promote equitable access to technology. By activating the digital backbone and expanding last-mile connectivity, the 2026 State Budget will contribute directly to national competitiveness, human capital development, and inclusive growth, laying the foundation for Timor-Leste's emergence as a digitally connected and economically diversified nation.

Institutional Frameworks

2.51. **Foreign Affairs - Advancing ASEAN Accession as a Strategic Foreign Policy and Development Priority**: In 2026, the Government will accelerate the implementation of the ASEAN Accession and Integration Program as a critical national priority for regional integration and foreign policy advancement. Public resources will support the completion of procedural and institutional requirements outlined in the ASEAN Roadmap for Full Membership, including legal harmonization, policy alignment, and interministerial coordination. Timor-Leste will strengthen national focal points across ASEAN's sectoral bodies, finalize negotiations on key economic and trade-related agreements, and improve the institutional readiness of public agencies to engage fully in ASEAN mechanisms. Capacity-building programs will target civil servants, diplomats, and technical experts, while nationwide public awareness campaigns will prepare citizens and businesses to understand and benefit from ASEAN membership. These investments will enable Timor-Leste to meet the obligations of ASEAN membership and strengthen its diplomatic, economic, and regional engagement capabilities.

2.52. **Strengthening Regional Connectivity and Participation in ASEAN Pillars:** Aligned with the ASEAN Community Vision 2045 and the IX Constitutional Government Program, Timor-Leste will focus on advancing ASEAN's three core pillars: political-security, economic, and socio-cultural integration. In 2026, strategic efforts will be made to promote regional peace and dialogue, boost economic resilience through trade and investment frameworks, support digital integration, and advance sustainable development goals. Dedicated budget allocations will support Timor-Leste's participation in regional meetings, institutional representation, and logistical coordination for ASEAN events and summits. Improved coordination with international partners and ASEAN dialogue institutions will also be pursued to mobilize technical support and development financing. These efforts will consolidate Timor-Leste's status as the 11th ASEAN Member State and enable it to contribute meaningfully to the region's long-term peace, prosperity, and people-centered development agenda.

2.53. **Justice - Strengthening Legal Identity, Land Rights, and Access to Justice for All:** In 2026, the Government will prioritize the development of a modern, accessible, and gender-responsive justice system, with a strategic focus on expanding legal identity and land rights as foundations for equity and rule of law. In 2026, the government will focus on accelerating the nationwide issuance of Unique Identification (ID) cards to ensure that all citizens, especially those in rural and vulnerable communities, can access justice, public services, and economic opportunities. With regard to Land Rights, the Government's focus for 2026 will be to enhance and simplify the process of land tittle registration as part of its strategic objective to strengthen land rights. Access to justice will also be enhanced in 2026 through the provision of an accessible and gender responsive justice system for all citizens, especially those in rural and vulnerable communities. These efforts will be integrated with broader justice reforms, including the decentralization of judicial services, expansion of the judicial map, and simplification of legal procedures to improve legal access and reduce institutional bottlenecks.

As part of its integrity agenda, the Government will implement a comprehensive anti-corruption strategy to uphold judicial independence and public accountability. The justice sector will also advance gender-sensitive reforms, including training for legal professionals and the establishment of mechanisms to prevent and respond to gender-based violence. These initiatives reflect the Government's long-term vision to strengthen democratic institutions and ensure equal access to justice for all.

2.54. **Public Administration Reform - Modernizing Human Resource Management for a Professional and Accountable Civil Service:** As part of the broader Public Administration Reform Plan 2023–2028, the Government of Timor-Leste will prioritize the modernization of human resource management as a foundational pillar of institutional performance and service delivery. In 2026, critical investments will be directed toward the rollout of merit-based, standardized HR practices across at least 60% of public institutions, supported by a new legal framework for strategic workforce planning. The integration of the SIGAP-FOUN system with the GRP-FMIS in three priority sectors will enable alignment between human resources and public finance. Strategic workforce diagnostics will be scaled up, with at least 40% of institutions expected to complete workforce plans in 2026, increasing to 80% by 2028. These reforms will promote rational staffing, reduce redundancy, and ensure the public workforce is fit-for-purpose across all sectors.

2.55. **Digital Transformation, Retirement Reform, and Institutional Accountability:** The Budget 2026 will also support full digitalization of HR records, targeting 100% integration of

eligible civil servants into SIGAP-FOUN to enable real-time personnel monitoring and evidence-based decision-making. To ensure a transparent and efficient retirement process, a new digital retirement module integrated with the National Institute of Social Security (INSS) will be deployed, alongside institutionalized pre-retirement training and annual data validation exercises. Legal and ethical compliance will be strengthened across the civil service, with a target of 60% of institutions operating functional compliance programs by the end of 2026 and 90% of disciplinary cases addressed in a timely manner. The modernization and full digitization of the Civil Service Commission's systems will reinforce oversight and coordination across institutions. Together, these strategic reforms will help build a fair, accountable, and performance-driven public administration.

2.56. **Financial Sector - Establishing the National Development Bank to Finance Inclusive Growth and Fund Stability:** In 2026, the Government will prioritize the establishment of the National Development Bank (BDN) as a key instrument to support economic transformation and strengthen the country's financial architecture. The BDN will be designed to provide accessible credit facilities to national businesses, particularly in priority sectors such as agriculture, fisheries, tourism, and industry, to stimulate private sector growth and job creation. As a state-backed financial institution, the BDN will also serve as a platform to attract foreign investment and promote strategic partnerships for development. This initiative reflects the Government's commitment to building a robust, nationally owned development finance institution capable of driving inclusive growth and supporting the structural transformation of Timor-Leste's economy.

2.57. **Decentralisation - Expanding One-Stop Shops to Improve Local Access to Public Services**: In 2026, the Government will scale up implementation of the One-Stop Shop Expansion Program (Balkaun Úniku) as a flagship reform to bring essential public services closer to citizens, particularly in rural and underserved areas. These service centers will provide streamlined access to civil registration, identity documentation, notary services, and legal certifications through a single point of contact, enhancing efficiency, transparency, and citizen satisfaction. With planned coverage in all municipalities, this initiative will form a cornerstone of the national decentralization agenda and directly contribute to improved public trust in State institutions. Budget allocations will support the establishment, rehabilitation, and operational readiness of Balkaun Úniku facilities, including essential equipment, IT systems, utilities, and service delivery tools. These investments align with the IX Constitutional Government's commitment to decentralization and inclusive governance.

2.58. **Strengthening Municipal Capacity for Decentralized and Integrated Service Delivery:** A critical success factor for the effective operation of Balkaun Úniku is the availability of qualified civil servants at the municipal level. In 2026, the Government will prioritize the deployment and retention of trained personnel through structured human resource planning and targeted capacity-building programs led by the Ministry of State Administration (MSA) and line ministries. Front-line service staff will receive continuous training and mentoring to ensure professionalism, responsiveness, and compliance with national service standards. In parallel, technical coordination between MSA and relevant institutions will be strengthened to support integrated service delivery and digital systems interoperability. Together, these efforts represent a critical reform in local governance and public administration, advancing the decentralization process and enabling more accessible, efficient, and citizen-oriented service delivery across the country.

Key Developments in PFM

2.59. The Government is implementing an ambitious programme of Public Financial Management (PFM) reform to improve fiscal discipline, enhance transparency, and support effective service delivery. These efforts are guided by the Ministry of Finance's Five-Year Strategic Plan and the updated PFM Reform Roadmap. Reform actions span legal and institutional frameworks, budgetary and accounting systems, revenue mobilisation, oversight mechanisms, and digital modernisation.

2.60. The foundation of PFM reform in Timor-Leste has been significantly strengthened through the enactment of the new Budget Framework Law (LEO, Law No. 3/2025), which replaces the 2022 law and introduces a comprehensive set of fiscal rules that govern the entire budget cycle, from strategic planning through to execution, reporting, and audit. The law aims to embed fiscal discipline, predictability, and transparency into the functioning of the state. To operationalise the LEO, a suite of implementing regulations is in the final stages of preparation. These will codify the rules and responsibilities related to planning, budget execution, treasury operations, internal control, and fiscal oversight, ensuring consistent and accountable application of the law across ministries and agencies.

2.61. In tandem with the LEO, the Government has modernised the legal basis for public procurement through Decree-Law No. 1/2025. This new Procurement Law introduces standard competitive procedures and integrates features aligned with the WTO Government Procurement Agreement (GPA), such as non-discrimination and transparency, while preserving a 10% preference margin for local suppliers to stimulate domestic enterprise. The Ministry of Finance has also commenced the development of standardised procurement templates and is rolling out a national training programme for procurement officers. Additionally, efforts are underway to strengthen institutional architecture through the drafting of a revised Organic Law for the Ministry and the establishment of a Professional Accountancy Organisation (PAO), which will introduce a recognised certification framework for accountants and elevate national accounting and auditing standards.

2.62. Timor-Leste has initiated a transition to programme-based budgeting to better link public expenditure to results. This approach ensures that budget allocations are tied not merely to inputs but also to outputs and performance indicators, enabling ministries to demonstrate how resources contribute to tangible outcomes. Ministries are receiving technical support to align their budget submissions with performance frameworks, and efforts are ongoing to embed monitoring and evaluation (M&E) principles into annual planning cycles. This is a major shift from the traditional line-item approach and marks a move towards more strategic and accountable public spending.

2.63. Concurrently, the Government has launched the gradual adoption of accrual accounting aligned with International Public Sector Accounting Standards (IPSAS). This reform enhances transparency by recognising assets, liabilities, and expenses in a manner that more accurately reflects the financial position of the public sector.

2.64. The rollout of analytical tools, such as Power BI dashboards, is further improving the Government's ability to monitor budget execution and expenditure patterns in real time, allowing for more informed and timely decision-making.

2.65. As part of its medium-term fiscal strategy, the Government of Timor-Leste has finalised a draft Value Added Tax (VAT) Act. This is a pivotal reform that aims to broaden the domestic

revenue base and reduce reliance on oil revenues. The introduction of VAT is also strategically aligned with the requirements of ASEAN and WTO membership, ensuring that Timor-Leste's tax system meets international norms. In preparation, legal frameworks are being reviewed and system upgrades are being designed to accommodate VAT-specific processes such as registration, filing, and refund mechanisms. Stakeholder consultations and taxpayer education campaigns are planned as part of the implementation process.

2.66. IT systems supporting revenue administration are also undergoing significant transformation. The Integrated Tax Administration System (ITAS) and the Government Resource Planning (GRP) platform are being upgraded to support improved taxpayer services, automation of compliance processes, and enhanced data accuracy. These changes are central to building a more responsive and efficient tax administration. Furthermore, the Government has taken decisive steps to maintain fiscal sustainability by restructuring or cancelling a number of International Financial Institution (IFI) loans that no longer align with the updated macro-fiscal framework. This approach ensures that borrowing is aligned with development priorities and sustainable debt thresholds.

2.67. Robust data is essential for sound policy and fiscal planning, and significant progress has been made on this front. The National Institute of Statistics (INETL) has completed two critical datasets, the Timor-Leste Survey of Living Standards (TLSLS) 2024 (to be published in the coming months) and the 2022 Population and Housing Census. These provide an updated statistical foundation for government decision-making. The TLSLS will provide detailed insights into consumption patterns, income sources, and poverty levels, while the Census provides comprehensive demographic data. Together, they form the empirical backbone for poverty reduction strategies, targeted social transfers, and regional development initiatives.

2.68. The Government will continue to strengthen outcome data and improve accounting standards to support evidence-based decision-making. Enhancing the frequency and scope of key economic and social indicators will be essential for tracking the progress of public policies and development measures. At the same time, institutional and legislative reforms will be pursued to align both public and private sector accounting practices with international standards. This will not only improve fiscal transparency but also contribute to a better business environment and facilitate private sector development in Timor-Leste.

2.69. To improve institutional performance and accountability, the Ministry of Finance has launched a Performance Assessment Framework that tracks staff and unit performance against key performance indicators (KPIs). The system also links training and professional development to performance outcomes, providing incentives for continuous improvement. Initial implementation has shown promise in reinforcing a culture of results-oriented management within the Ministry.

2.70. Institutional reforms have also included a restructuring of the Ministry's internal operations to improve coordination and delivery. This includes the introduction of clearer reporting lines, and the appointment of senior managers with strong performance mandates. These changes aim to improve responsiveness, reduce bureaucratic delays, and ensure that policy decisions are executed efficiently. Strengthened leadership and clearer internal accountability have also improved coordination with other ministries, contributing to smoother inter-agency collaboration on cross-cutting reforms.

2.71. Digital transformation is a cornerstone of the current PFM reform agenda. In 2025, the Government launched a broad ICT upgrade programme, beginning with the expansion and modernisation of the national data centre. This investment ensures that government data is stored securely and made available through reliable and resilient infrastructure. The upgraded data centre also serves as the backbone for hosting critical financial management systems, including IFMIS and ITAS. These enhancements will reduce system downtime, improve cybersecurity, and provide a platform for future cloud-based services.

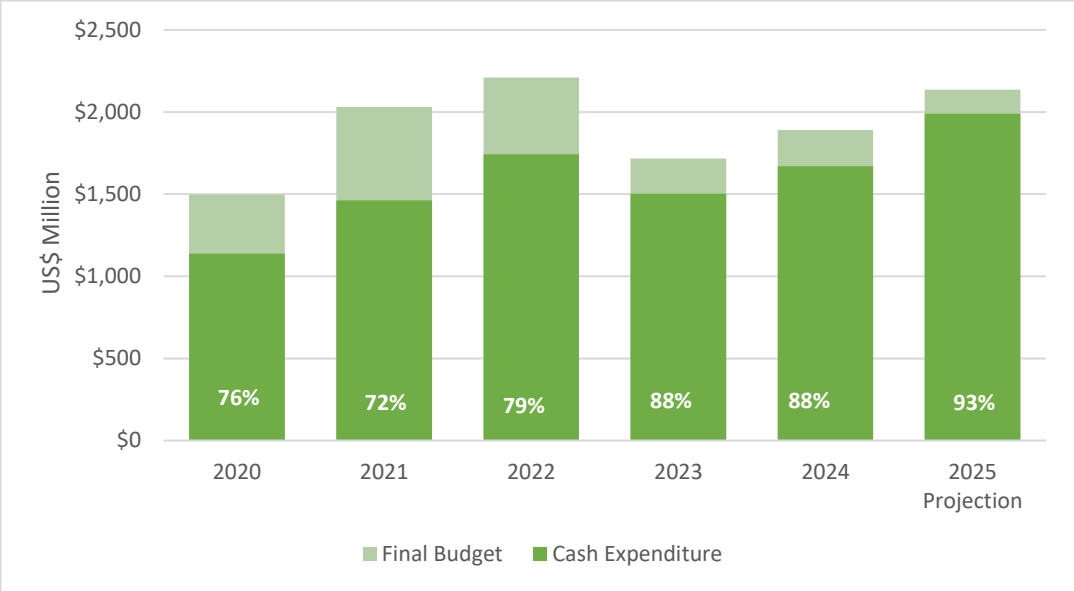
2.72. Significant progress has also been made on system interoperability. A new central integration platform is being developed to enable different public finance systems—such as IFMIS, ITAS, procurement platforms, and human resources databases—to communicate seamlessly. This interoperability will eliminate data duplication, reduce manual reconciliation efforts, and allow for unified dashboards that provide real-time oversight of government finances. The next-generation IFMIS upgrade focuses on improving budget reliability, automating reporting functions, and integrating treasury operations. These efforts are essential to achieving end-to-end digitalisation of public financial processes and enhancing overall governance efficiency.

3. Expenditure Outcomes and Ceilings

Recent Expenditure Developments

3.1. This section provides and overview of budget execution for the period 2020 to 2025. The review looks at the budget and execution numbers for the Central Administration and RAEOA, which include the transfer from the state to the social security fund. The final annual budget increased by 43%, rising from US$1.5 billion to US$2.1 billion. Following the Rectification Budget in 2023, the approved budget was reduced to US$1.7 billion, but it increased again by 10% in 2024 and a further 13% in 2025. In addition, the government substantially improved its budget execution rate, from the lowest rate of 72% in 2021 to 88% in 2023 and 2024. A further improvement is expected for 2025 with an initial projection to reach 93%,

Figure 13: Final Budget and Spending 2020-2025 (Central Administration and RAEOA), US$ Million



Source: GRP, Ministry of Finance, June 2025 *Note – figures are unconsolidated amounts and include transfers from the Central Administration to RAEOA e.g., in 2025 the Central Administration transferred $10m to RAEOA meaning the consolidated budget was $10m lower than stated above. 2025 budget numbers include adjustments from January to May 2025

3.2. Table 7 provides headline numbers for budgets from 2020 to 2024 such as original and final allocations, cash expenditure and pending obligations and commitments. Between 2020-2024 pending commitments averaged US$38.6 million, similarly, the average end-of-year pending obligations equalled US$76.8 million.

Table 7: Headline Budget Numbers 2020-2024, US$ Million

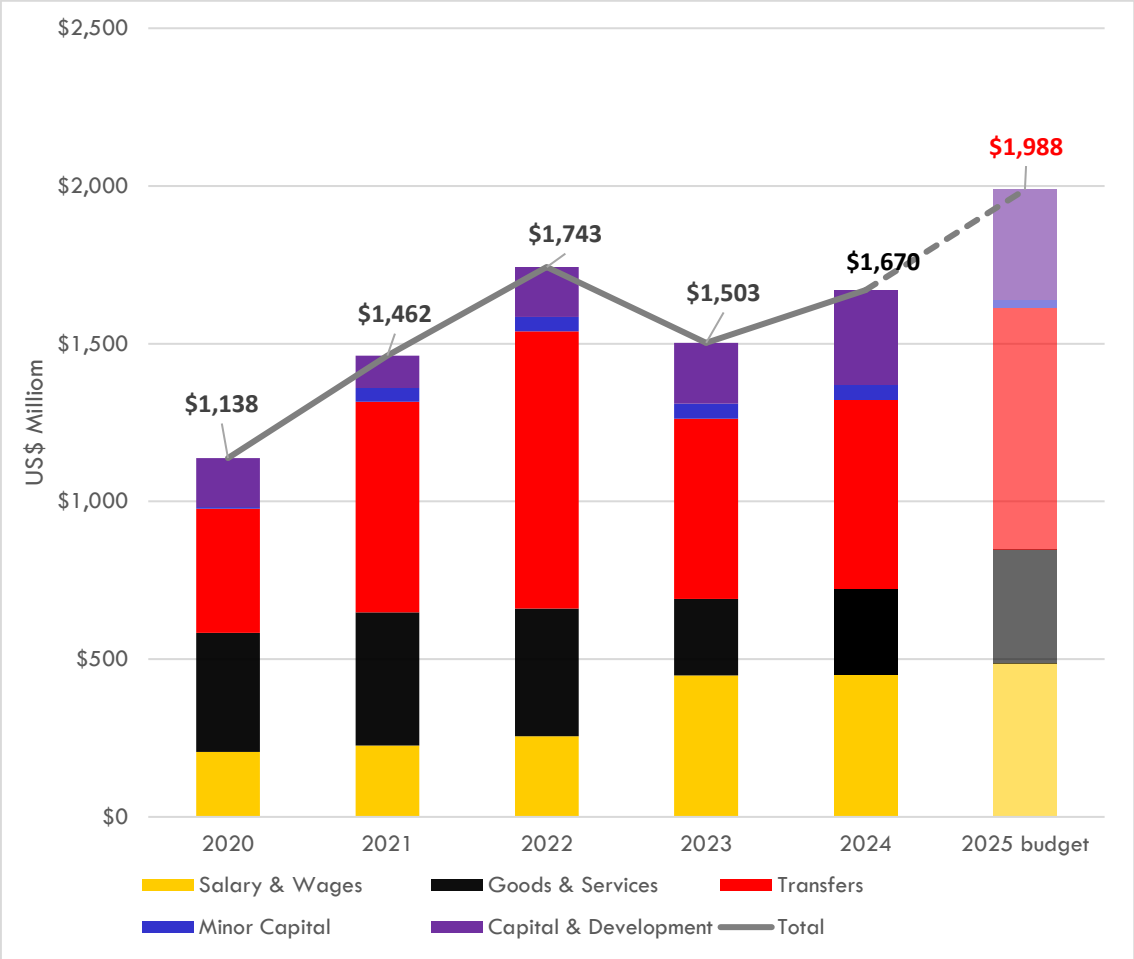
Category	2020	2021	2022	2023	2024
Original	1,497	1,895	1,885	1,920	1,890
Current	1,497	2,030	2,211	1,717	1,890
Cash expenditure	1,138	1,462	1,743	1,503	1,670
Pending commitment	34	54	45	34	26
Pending obligation	114	84	90	46	50
Execution Rate%	76%	72%	79%	88%	88%
Unexecuted Contracts	2.6%	3.4%	2.4%	2.1%	1.5%
Pending Payment Rate	9.1%	5.4%	4.9%	3.0%	2.9%

Source: GRP, Ministry of Finance, June 2025

3.3. Annual government cash expenditure has increased by 47% between 2020 and 2024. Following low execution in 2020 due to the onset of the COVID-19 pandemic, expenditure saw substantial increases of 29% and 19% in 2021 and 2022, respectively. This was primarily driven by increases in transfer spending. The highest government expenditure in the last five-year period was in 2022 at US$1.74 billion. Expenditure declined in 2023 following expenditure rationalisation efforts by the new government but increased again by over 11% in 2024 and is projected to increase by almost 19% in 2025, which is above the combined rates of inflation and population growth, and is expected to be higher than the 2022 level (see chart below).

3.4. As seen in the chart below, expenditure over the last five years has been dominated by recurrent spending, namely, expenditure on Salaries and Wages, Goods and Services and Transfers. Recurrent expenditure represented 86% of total expenditure in 2020 and increased to 90% in 2021, where only 10% of total expenditure was on capital. The share of capital expenditure increased to 16% in 2023 and 21% in 2024 (from 12% in 2022) as the 9th constitutional government attempted to prioritise economic development and growth.

Figure 14: Overall Government Expenditure 2020-2025, $US Million



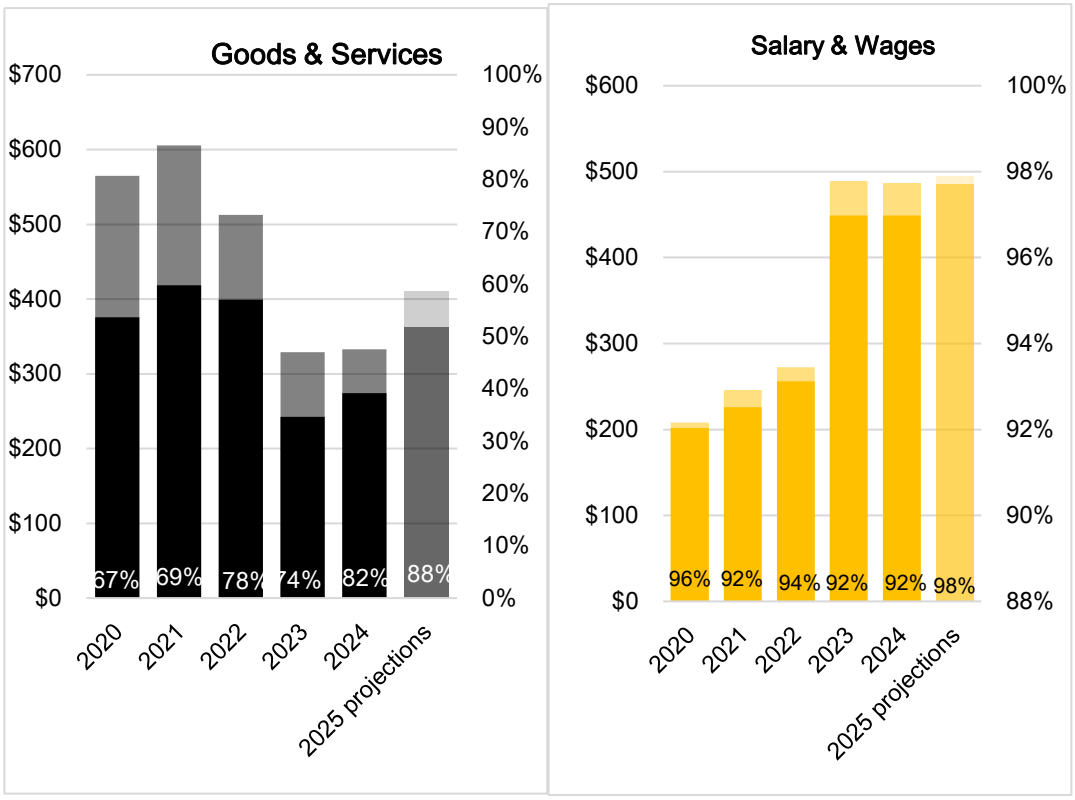
Source: GRP, Ministry of Finance, June 2025 *Note – figures are unconsolidated amounts and include transfers from the Central Administration to RAEOA e.g., in 2025 the Central Administration transferred $10m to RAEOA meaning the consolidated budget was $10m lower than stated above. 2025 budget numbers include adjustments from January to May 2025

3.5. Analysing recurrent expenditure in more detail, the charts below show a relatively high and stable execution rate for Salaries and Wages. On the other hand, execution rates for Goods and Services have seen significant variation over the past five years. The charts also show a large decline in Goods & Services expenditure in 2023, while salary and wages expenditures rise from US$256 million to US$449 million.

3.6. This is partially due to new hiring under the new government while Goods and Services expenditure was reduced under fiscal consolidation efforts under the new government. However, the main driver of this is the reclassification of economic categories that resulted in several items from Goods and Services and Transfers being reclassified to the Salary and Wages Category. Prior to 2023, expenditure on National and International Advisors appeared under the Goods and Services Category. From 2023 onward this expenditure moved to the Salary and Wages Category. Several items related to employee travel and allowances were also moved to the Salary and Wages Category from Goods and Services in 2023. Finally, prior to 2023, the State's contribution as an employer to the Social Security Fund was listed under the transfer category. This moved to the Salary and Wages category

in 2023. Therefore, spending on salary and wages stabilised after 2023. However, spending on good and services increased further by 23% in 2025 budget (see chart below)

Figure 15: Budget and Execution Figures for Salary & Wages and Goods & Services, US$ Million

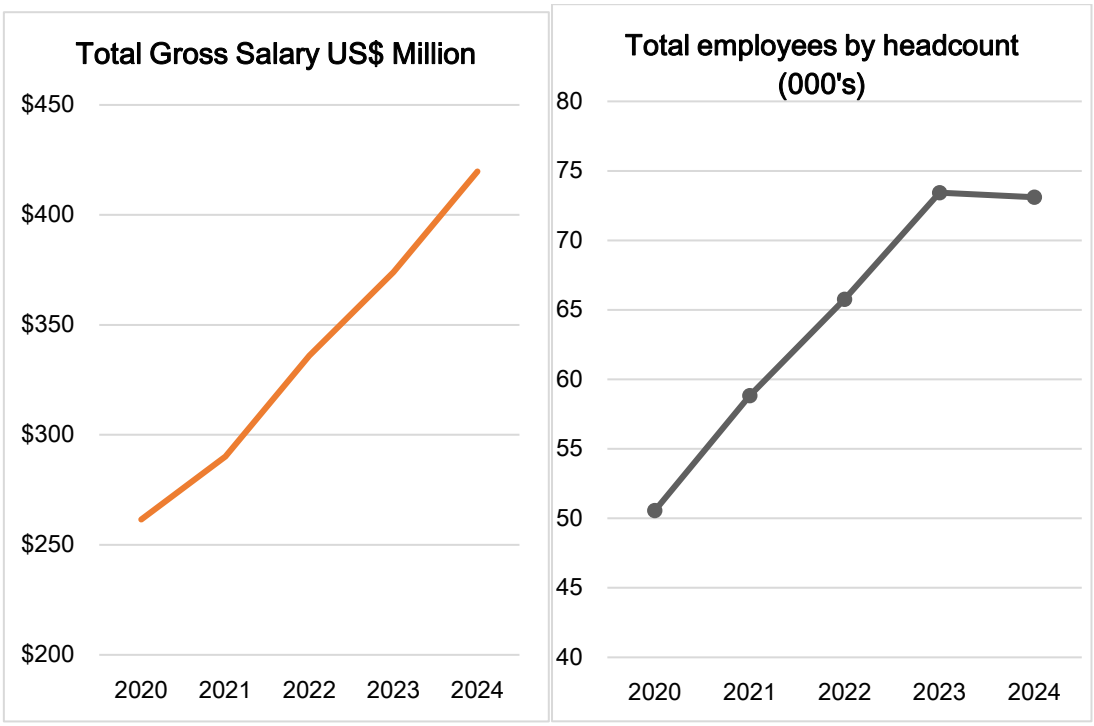


Source: GRP, Ministry of Finance, June 2025 *2025 budget numbers include adjustments from January to May 2025

3.7. Due to the fact that there is no clear mapping at item and line-item level from old to new categories, it is not possible to analyse historic data prior to 2022 under the new classification. Therefore, in order to properly analyse the drivers behind salary expenditure it is important to assess payroll data. Payroll data give a count of the total number of employees that work for the Central Administration and RAEOA and their total gross wages excluding variable allowances such as flight tickets and per diems. This excludes employees for extra budgetary entities such as public enterprises. The charts below give the total expenditure on salaries and the total number of government employees according to payroll data from 2020-2024.

3.8. The first chart shows that salary expenditure saw a 60% rise from 2020 to 2024. The largest rise was in 2022, where expenditure rose by 16%. The chart on the right shows that the rise in salary has been in part driven by hiring, with employee headcount according to the payroll data rising by 45% between 2020 and 2024. The largest period of hiring took place in 2021 where headcount increased by 16%.

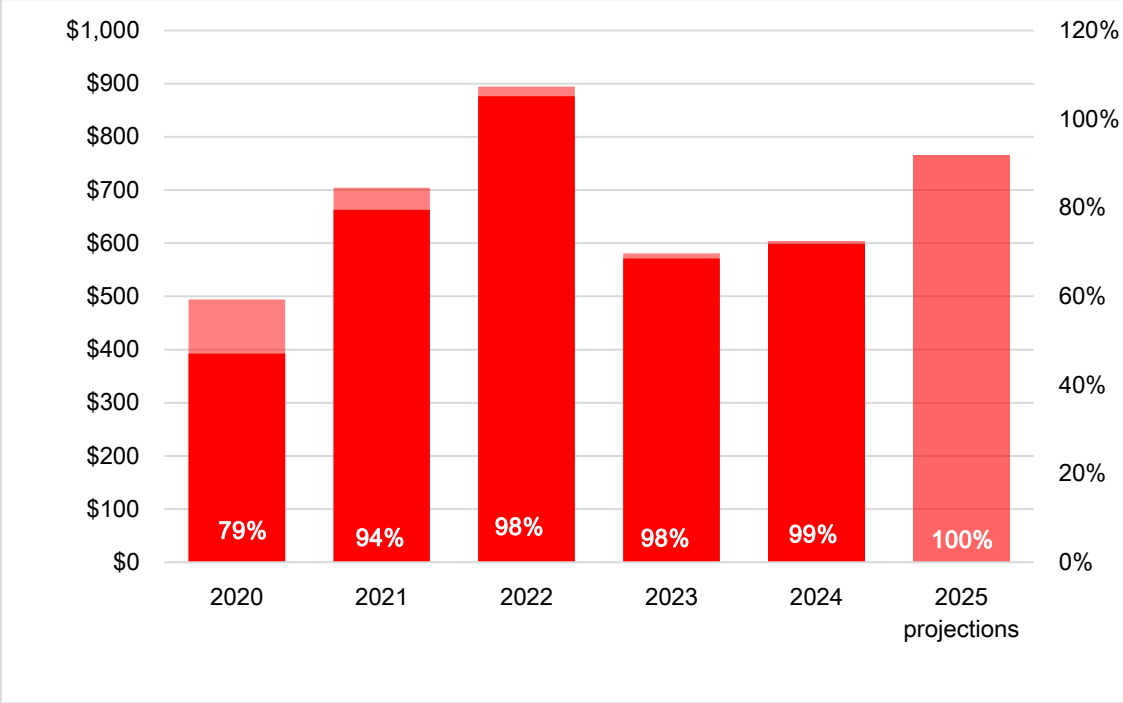
Figure 16: Payroll Data on Expenditure and Employee Count



**Note headcount numbers reflect total hiring throughout the year, as some contractors are only hired for a part of the year, these figures are higher than the snapshot of employees at the end of the year; Source: GRP, Ministry of Finance, June 2025*

3.9. Generally, expenditures on transfers saw an upward trend, indicating a 123% increase over the 2020-2023 period. This increase was primarily due to welfare programs during the pandemic and transfers to public entities (as a result of the creation of EDTL and BTL in 2020). The rectification budget in 2023 saw a large fall in transfers, which remained relatively low in 2024 but are set to rise again in 2025, mostly due to a large increase in transfers to the veteran fund. In terms of execution transfers have generally seen high execution over the past five years, except for 2020 where execution was impacted by the onset of the COVID-19 pandemic.

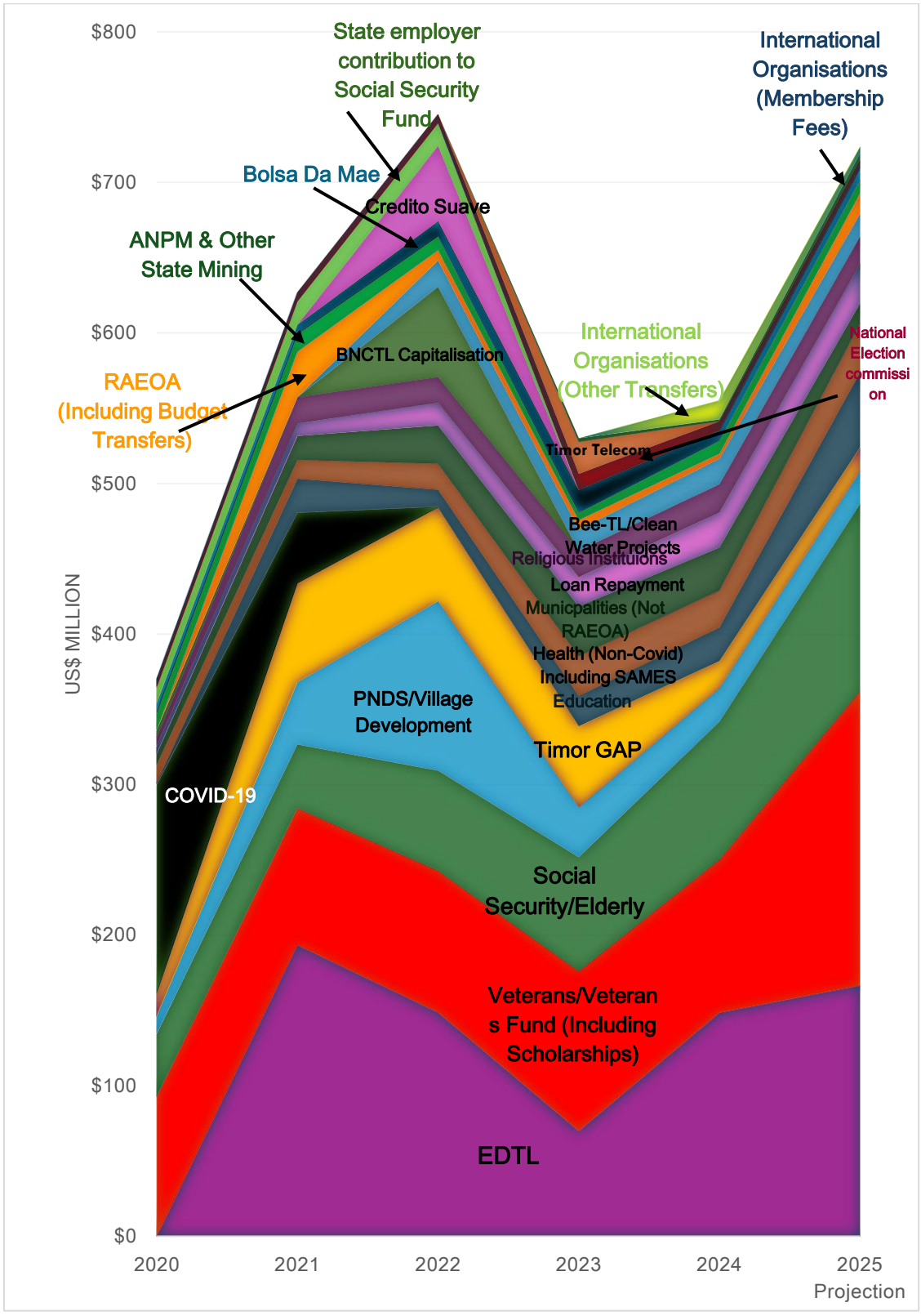
Figure 17: Transfer Budgeted and Execution, US$ Million



Source: GRP, Ministry of Finance, June 2025 *Note – figures are unconsolidated amounts and include transfers from the Central Administration to RAEOA e.g., in 2025 the Central Administration transferred $10m to RAEOA meaning the consolidated budget was $10m lower than stated above. 2025 budget numbers include adjustments from January to May 2025

3.10. Figure 18 helps to explain the main drivers of transfer expenditure. The chart shows the top transfers from 2020 to 2025, representing around 90% of transfer expenditure each year.

Figure 18: Top 90% of Transfer Expenditure 2020-2025, US$m



Source: Analysis from the National Directorate of Economic Policy based on GRP data, Ministry of Finance, June 2025

3.11. Expenditure and execution on Capital and Development and Minor Capital showed an overall increase in budget allocation and improvement in execution over the 2020- 2024 period. Development Capital had the weakest and most variable execution rates of all the categories, with an average of 56% between 2020-2024. This suggests weaknesses in project planning and procurement processes. Execution is nevertheless expected to increase in 2025 for both type of capital due to improvement procurement process.

Figure 19: Budget and Execution for Capital Expenditure, $US Million

*Source: GRP, Ministry of Finance, June 2025; *2025 budget numbers include adjustments from January to May 2025*

Expenditure Review Budget 2025

3.12. The review provides an overview of budget performance in 2025 as of June 2025, compared with the same period in the previous year. The comparison shows that the 2025 overall execution rate, at 27%, is higher than last year despite a budget allocation being nearly 13% higher. This is mostly on account of a higher execution rate in salaries and wages, at 37% instead of 32%, and a higher execution of goods and services at 19% instead of 16%. Capital development maintains a similar execution rate to last year but with a higher allocation, which indicates that actual cash expenditure has increased by US$6 million compared to last year. However, this remains relatively low when contrasted with the US$440 million allocated (see table 3).

Table 8: Comparison between execution rate of OGE 2025 and OGE 2024 at the same period last year, US$m

Economic Category	Original OGE 2024	Current OGE 2024 as of 1st June	Actual Cash Expenditure OGE 2024 as of 1st June	Execution rate OGE 2024 as of 1st June %	Original OGE 2025	Current OGE 2025 as of 1st June	Actual Cash Expenditure OGE 2025 as of 1st June	Execution rate OGE 2025 as of 1st June %
Capital & Development	411	413	23	*6%*	440	440	29	*6%*
Goods & Services	384	333	54	*16%*	415	410	79	*19%*
Minor Capital	35	53	1	*2%*	23	24	1	*4%*
Salary & Wages	470	487	158	*32%*	490	494	184	*37%*
Transfers	590	604	229	*38%*	768	766	282	*37%*
Total	**1890**	**1890**	**464**	***25%***	**2,135**	**2,135**	**574**	***27%***

Source: Ministry of Finance, 1st June 2025 *Note – figures are unconsolidated amounts and include transfers from the Central Administration to RAEOA e.g., in 2025 the Central Administration transferred $10m to RAEOA meaning the consolidated budget was $10m lower than stated above. 2025 budget numbers include adjustments from January to May 2025

3.13. Table 9 shows the current execution rate of all programs with an allocation exceeding US$1 million in the 2025 budget. The execution rate varies significantly between programs. Among the larger programs, those with allocations above US$100 million, the Roads and Bridges programs have the lowest execution rate. As of 01 June, the Government has spent only 10% of its allocation for Roads and Bridges, compared to over 30% for other major programs. This reflects the fact that Roads and Bridges are primarily capital development investments, which are more complex to execute. This is also on account of the reduced activities by contractors working on the roads due to wet weather condition in the first half of the year. Other programs which depend more on transfers (such as electricity) or salaries and wages (such as basic education) have much higher execution rates.

3.14. For programs with allocations between US$10 million and US$100 million, the execution rate is particularly low for some programs, such as the Tasi Mane, Economic Diversification, and Airport programs. This is partially because they rely heavily on capital development, but it also reflects the fact that these programs are relatively new and may still be undergoing through procurement processes. On the other hand, well-established programs like Foreign Policy and National Security have relatively good execution rates of 50% and 29%, respectively. In contrast, agriculture, which, despite being a well-established priority program and only partially dependent on capital development, displays a particularly poor execution rate of less than 10%. The same can be said for related smaller programs like aquaculture and livestock, which have execution rates of 16% and 11%, respectively. For other smaller programs with allocations of less than US$10 million, a similar pattern is observed for Tourism, which, despite being a priority sector, has a notably poor execution rate of 18% (see Table below).

Table 9 execution rate of program with allocation over US$1m by June 1st (in US$m)

Program	Rev. budget	Execution (June 1st)	Execution rate (June 1st)
Social Inclusion	402	118	29%
Functioning and Institutional Development	375	110	29%
Roads and Bridges	227	22	10%
Electricity	184	87	47%
Basic Education	101	41	40%
Public Financial Management	84	16	19%
National Security	66	23	35%
Primary Health Care	54	12	22%
Secondary and tertiary health care	46	16	36%
Tasi Mane Project	44	0	0%
Contingency	43	0	0%
Economic Diversification	41	7	18%
Administrative Decentralization and Local Authority	39	13	32%
Timor-Leste Foreign Policy	38	19	50%
Agriculture, Horticulture and Coffee	35	3	9%
Airport	33	1	4%
Developing policies and best practices	27	13	47%
Water and Sanitation	26	7	26%
National Defence	24	7	29%
Response to the Structures Damaged by Calamity	24	0	1%
Secondary Education	18	6	35%
Areas with Special Administrative and Economic Treatment	18	2	9%
Access to Justice	18	5	28%
Constitutional functions of the parliament	15	5	30%
Scholarship	15	4	27%
Higher Education	15	4	29%
Greater Sunrise	12	4	34%
Preschool Education	11	4	33%
Rural and Urban Development	11	0.9	9%
Transports	7.4	1.2	16%
Information and Communications Technology	7.3	3.1	43%
Tourism	6.7	1.2	18%
Revitalização Comunitaria	6.5	0.6	9%
Services of the Population Courts	6.3	1.6	25%
Politica Estratégica Nacional	4.7	3.2	68%
Desenvovimento do Setor da Comunicação Social	4.5	1.4	31%
Culture and Heritage	4.5	0.4	9%
Controlar a qualidade de projetos públicos	3.9	1.3	34%
Implementação da Habitação comunitária digna	3.8	0.3	8%
Petroleum exploration	3.3	0.0	1%
Sustainable Management of Forest Resources	2.1	0.7	30%
Technical Training	2.1	0.7	35%
Territorial Ordering	2.1	0.3	14%
Fisheries, Aquaculture and Aquatic Resources	2.1	0.3	16%
Infrastructure connectivity	1.9	0.0	0%
Livestock, Veterinary and Technology	1.9	0.2	11%
Environment	1.8	0.4	22%
International Relations and Cooperation of the Parliament	1.8	0.3	19%
Professional Qualification	1.5	0.6	40%

Program	Rev. budget	Execution (June 1st)	Execution rate (June 1st)
Institutional Communication	1.4	0.4	27%
Iniciativas de Desenvolvimento do Presidente da República	1.4	0.5	40%

*Source: GRP, Ministry of Finance, June 2025; *2025 budget numbers include adjustments from January to May 2025*

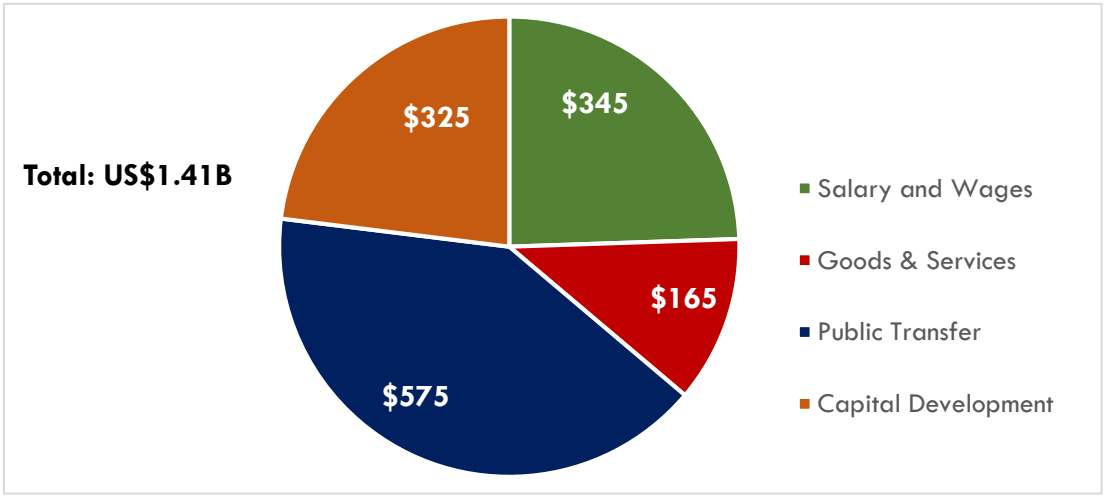
Obligatory Expenditure 2026

3.15. Obligatory spending for Budget 2026 amounts to a total pf US$1.41 billion. This category encompasses public expenditures that must be incurred according to law, binding agreements, or a degree of critical importance. It includes various commitment such as legal requirements, contractual obligations, memoranda of understanding, and certain current and essential spending.

3.16. The largest portion corresponds to US$575 million in transfers, comprising US$375 million for social inclusion, in large part related to the veterans transfer, which has almost doubled compared to last year. The rest of the transfers mostly go to repayment of loans and interest, as well as around US$130 million transferred to public enterprises, mostly EDTL.

3.17. The government also has the obligation to pay the salaries and wages for civil servants under permanent and special regimes and politicians, which represent around US$345 million for 2026. For capital and development, the current projects of the Infrastructure Fund as well as all the infrastructure projects of other entities are considered obligatory, representing US$352 million. Finally, essential goods and services such as fuel, public goods, and important equipment represent around US$165 million.

Figure 20 Obligatory Expenditure by categories (US$ million)



Source: Analysis from the General Directorate for Budget and Planning (DGPO) from GRP data, Ministry of Finance, June 2025

Expenditure Ceilings for the Administrative Public Sector

3.18. Table 10 provides proposed ceilings for different elements of the public administrative sector. A breakdown and explanation of total expenditure ceilings and RAEOA and the Central Administration is provided above in the macro-fiscal projections section of the document. The table below provides an indicative split of this ceiling between RAEOA and the Central Administration. The final decisions on this will be made during the budget review committee.

3.19. The ceilings for the Social Security Fund are include the National Institute for Social Security (INSS) and the Social Security Reserve Fund (FRSS). Social Security numbers are as provided in Budget 2025. Revised estimates will be provided in the Budget Proposal for budget 2026 once new information from the Social Security Fund is analysed over the coming months.

Table 10: Consolidated Expenditure Ceilings for Public Administrative Sector (Includes Social Security Fund - INSS)

Public Administrative Sector	Budget 2025	2026	2027	2028	2029	2030
Central Administration subtract Transfers to RAEOA	2,063	1,800	1,872	1,947	1,986	2,026
RAEOA	62	50	52	54	55	56
Total Central + RAEOA Consolidated	2,125	1,850	1,924	2,001	2,041	2,082
Social Security Fund (INSS)	174	200	201	199	200	208
Total Public Administrative Sector	**2,299**	**2,050**	**2,125**	**2,200**	**2,241**	**2,290**

**Note totals for the Central Administration and RAEOA are consolidated, ie they do not include transfers from the Central Administration to RAEOA; Source: Ministry of Finance, June 2025*

4. Fiscal Risks and Methodology

External Resources and Debt Limits

Loans

4.1. The Government utilises foreign loans to meet its borrowing requirements. In accordance with the Strategic Development Plan 2011-2030 and Public Debt Regime Law No. 13/2011, concessional loans are principally designated for the construction of strategic infrastructure essential for national development to support economic diversification. The terms of the loans are described below:

Table 11: Terms of Loans

Lender	Currency	Approved loan US$m	Grace Period (years)	Original Amortization Period (years)	Year Complete	Interest rate FY 2025
ADB	US, SDR	615.65	5	20	2048	4.6%
WB	US, SDR	134.20	7	24	2059	2.5%
JICA	JPY	68.72	10	20	2042	0.60%
AIFFP	US	45	5	20	2048	N/A
Total		**863.55**				
Note: The AIFFP fund for the Airport project is currently under review and has not yet entered the implementation phase. Therefe has no applicable interest charges.						

Source: Ministry of Finance, June 2025

4.2. On 11 December 2024, the Council of Ministers decided to cancel several agreements with the World Bank, reducing the total loans by $161 million to $864 million.

4.3. Given the substantial weight and high global interest rates, the ADB loan rate is set to rise to 4.6%, with the portfolio interest rate hitting 3.72% in 2025. While this is still lower than the petroleum fund's return of 4.40%, it requires the Government to focus on securing more fixed-rate loans to keep future debt payments manageable.

Table 12: Cost of borrowing vs PF return

Description	2019	2020	2021	2022	2023	2024	2025f
Cost of borrowing (effective rate)	2.34%	2.03%	1.50%	1.56%	3.25%	3.6%	3.72%
PF historical return (annual since inception)	4.45%	4.81%	4.90%	3.95%	4.27%	4.40%	4.40%

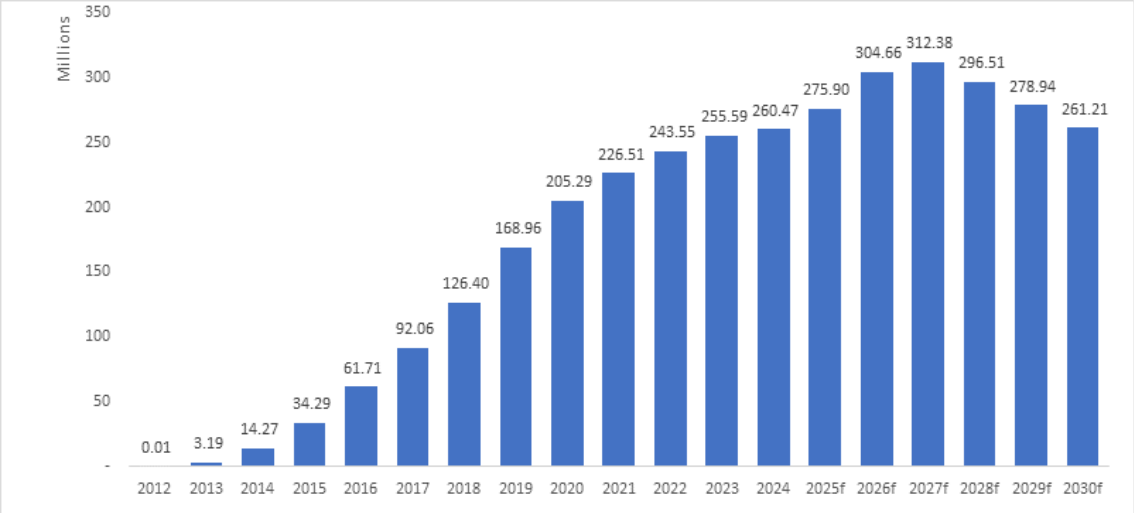
Source: Ministry of Finance, June 2025

4.4. Negotiations with international lending institutions indicate that some loan agreements may be amended, potentially delaying disbursement. Current forecasts suggest that external debt

will peak in 2027 before decreasing. The Government is also considering early repayment, which could further reduce debt.

4.5. By the end of fiscal year 2025, external debt is expected to reach around US$276 million. Interest and fees are likely to decrease from US$9.4 million in 2024 to US$8.6 million by the end of 2025 as ongoing projects reach completion. This debt is relatively small compared to the Government's total debt.

Figure 21: Stock of External Debt, US$m



Source: Ministry of Finance, June 2025

4.6. In 2026, disbursement is anticipated to remain relatively stable due to the completion of most projects. A moderate loan disbursement of $50 million is projected for that year, bringing the estimated total debt stock to $304.66 million by the end of 2026. During the year 2025, the government is authorized to contract or issue public debt up to a maximum amount of US$850 million, with a maximum term of 40 years. The government proposes a continuation of this maximum debt limit (US$850 million) for 2026, this is forecasted to represent 42% of GDP.

4.7. The country's debt ratios experienced a marginal increase over the last four years. However, starting in 2023, there has been a slight decrease in these ratios reflecting a fall in loan disbursement.

Table 13: External Debt Indicators for the period 2021-2030, % of GDP and Revenue

	2021	2022	2023	2024	2025f	2026f	2027f	2028f	2029f	2030f
Total External Debt to GDP	14.5%	14.5%	14.2%	14.3%	14.1%	15.0%	14.5%	12.9%	11.5%	10.3%
Total Debt Service to Revenue	1.3%	2.1%	3.1%	3.1%	3.2%	3.4%	4.4%	4.8%	4.9%	4.7%
Total external debt	226.5	243.6	255.6	260.5	275.9	304.7	312.4	296.5	278.9	261.2

	2021	2022	2023	2024	2025f	2026f	2027f	2028f	2029f	2030f
Debt Service	9.8	16.4	22.9	23.7	26.3	26.9	36.2	39.5	39.8	37.4
Revenue (ESI + domestic revenue)	766	772	741	771	810	796	828	822	812	800

Source: Ministry of Finance, June 2025.

4.8. External Debt to GDP - The size of external debt to GDP remains under the 30% threshold set by the debt sustainability frameworks for low-income countries with a moderate risk of default. In 2025, the debt-to-GDP ratio is expected to be 14.1%.

4.9. Debt Service to Revenue (ESI + Domestic Revenue)– Total debt service to revenue ratio is expected to increase from 1.3% in 2021 to 4.7% in 2030, with the highest value expected in 2029. Despite the upward trajectory, the values remain below the 14%.

Table 14: Debt Service Forecasts, US$m

Lender	Debt Service	2024	2025f	2026f	2027f	2028f	2029f	2030f
ADB	Principal	11.02	13.48	14.76	24.78	28.75	28.90	27.80
	Interest	7.55	6.89	6.30	5.71	5.11	3.83	3.52
	Charges	0.32	-	-	-	-	-	-
WB	Principal	2.5	2.73	2.73	2.73	2.73	3.58	4.31
	Interest	1.35	1.56	1.54	1.46	1.39	1.28	1.33
	Charges	-	-	-	-	-		-
JICA	Principal	0.76	1.39	1.39	1.39	1.39	3.58	3.42
	Interest	0.15	0.21	0.20	0.19	0.18	1.28	1.15
	Charges	-	-	-	-	-		-

Source: Ministry of Finance, June 2025.

Project Status

4.10. The costs of projects funded by concessional loans are mainly taken from three different sources: Loan, Infrastructure Fund, and Grant. Table 15 indicates that the total investment cost of the total loan-funded projects from 2012-2024 is estimated at US$596,427,690.19 of which US$436,549,931.29 is financed by loans, US$156,945,354.43 by the infrastructure fund, and US$2,932,404.47 by grants.

4.11. Table 15 also shows that the largest component of the investment cost is civil works, which accounts for US$522,483,282.48 or 87.6% of the total. Civil works are mainly financed by loans (71.1%) and the infrastructure fund (28.4%), with a small contribution from grants (0.6%). The second largest component is supervision, which costs US$51,676,661.14 or 8.7% of the total. Supervision is entirely financed by loans. The third component is other, which includes expenses such as resettlement and capitalisation. This component costs US$22,267,746.57 or 3.7% of the total and is financed by loans (61.8%) and the infrastructure fund (38.2%).

4.12. Government is currently in negotiations with lending institutions to secure an additional grant of $10 million to support road infrastructure projects

Table 15: Total Investment Costs, US$

Budget Category	Total (US$)	Loan (USD)	Infrastructure Fund (USD)	Grant (USD)
Civil Works	522,483,282.48	371,105,523.58	148,445,354.43	2,932,404.47
Supervision	51,676,661.14	51,676,661.14	N/A	N/A
Other	22,267,746.57	13,767,746.57	8,500,000.00	N/A
Total	**596,427,690.19**	**436,549,931.29**	**156,945,354.43**	**2,932,404.47**

Source: Ministry of Finance, June 2025

4.13. Additionally, the breakdown of the sector reveals that the road sector accounts for most of the funding and the contracts, followed by the airport and the energy sectors. The table also indicates that most of the road projects have been completed or are close to completion, while the airport and the energy projects are still under review. Two road projects currently under construction are the routes from Baucau to Viqueque Highway Project and TL Branch Road Project.

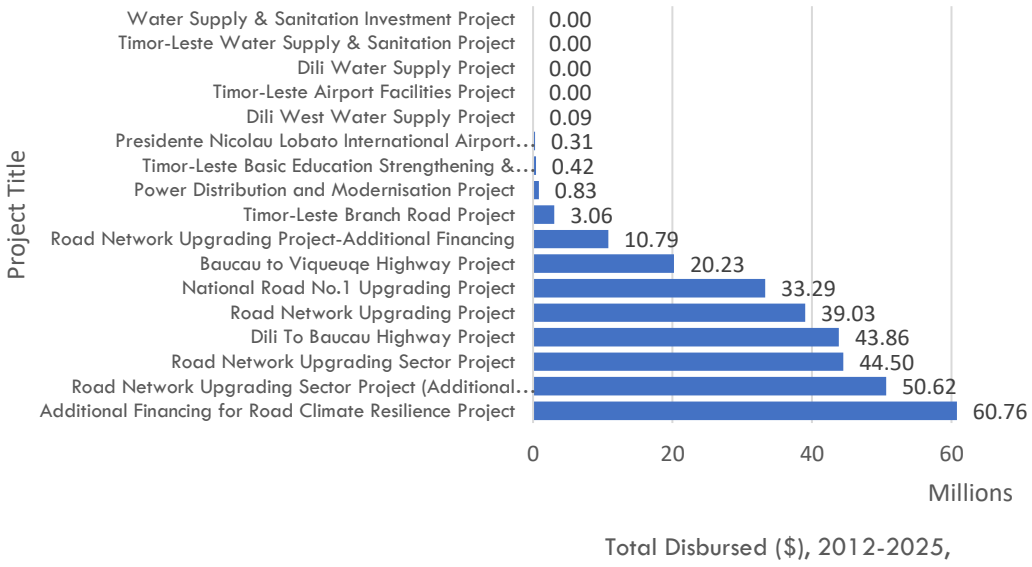
Table 16: Sector Breakdown

Sector	Total Budget (US$)	Number of Civil Works Contracts	Number of Supervision Contracts	Number of Concluded Projects
Road	496,435,584.23	16	7	14
Airport	93,000,000.00	1	1	Under Review
Energy	6,992,105.96	1	1	Under Review
Total	**596,427,690.19**	**18**	**10**	

Source: Ministry of Finance, June 2025

4.14. As shown in the following graph, the projects with the highest disbursement rate are the road network expansion. These projects have contributed to improving the country's connectivity and living conditions for both the urban and rural population. On the other hand, the projects with the lowest disbursement rate are the water supply and sanitation, the education sector development, airport as well as energy projects. It is important to emphasize that although financing agreements between government and international financing institutions have been executed, these projects are currently under review.

Figure 22: Project Disbursement, US$ Million



Source: Ministry of Finance, June 2025

Acceleration of Debt Repayments

4.15. The Government of Timor-Leste is considering the option of early debt repayments as a key component of its fiscal policy for the year 2026. This strategic move aims to further enhance the country's economic stability and investor confidence. Early debt repayments offer several benefits to the economy of Timor-Leste. Firstly, it ensures economic stability by reducing the reliance on external financing and minimizing the risk of default. Secondly, early debt repayments allow Timor-Leste to take advantage of prolonged high market interest rates by saving significant interest expenses over the long term. This translates into a more favourable debt profile, ultimately contributing to sustainable economic development.

4.16. In line with these considerations, the Government has proactively notified key lending agencies, namely the Japan International Cooperation Agency (JICA), the World Bank, and the Asian Development Bank (ADB), about its plans to accelerate debt repayments. In response, it has been affirmed that there are currently six loan agreements that are eligible for early debt repayments.

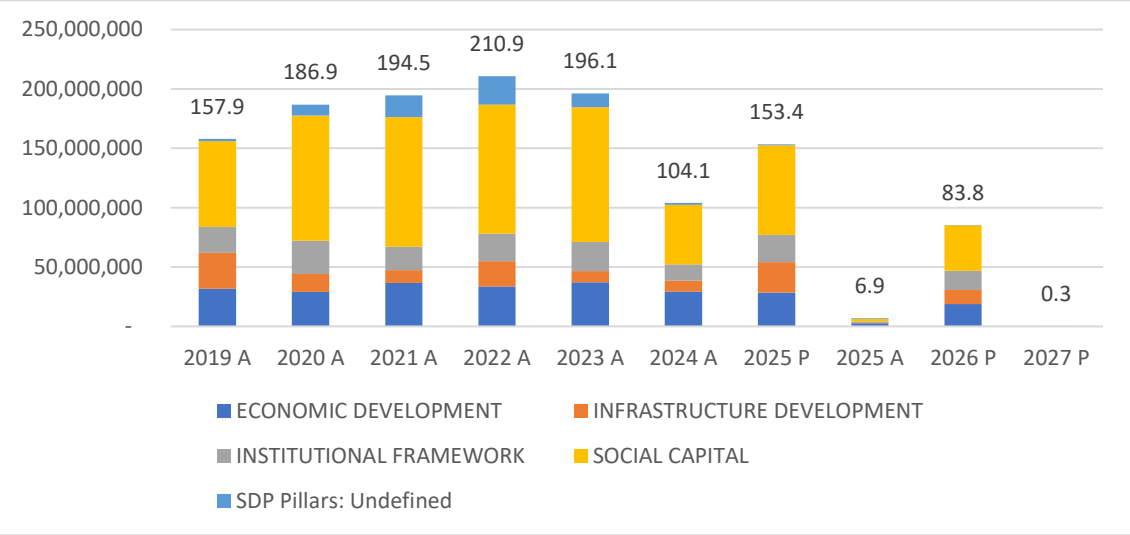
4.17. By 2026, six more agreements may be considered for early repayments, resulting in a total of twelve agreements.

4.18. Budget 2026 presents a forward-thinking approach to financing key petroleum infrastructure development facilities. The Government's loan ceiling of US$850 million aims to facilitate negotiations with potential lenders, opening doors to funding these crucial initiatives. With a relatively low debt-to-GDP ratio of 14.1%, this responsible borrowing plan ensures that debt levels remain sustainable over the medium term. By investing in this strategic sector, the Government aims to generate new or additional sources of income for the state in the medium to long term, further securing Timor-Leste's financial stability and development

Non-Lending Forecasts

4.19. Figure 23 shows the evolution of disbursements of non-Lending development assistance from 2019 onwards. The steep increase in funding from 2019 to 2020 reflects the increase in assistance as a result of the COVID-19 pandemic. 2026 Planned disbursements are currently reported as USD $83.8 million. These figures appear to be low, however planned spending figures are often underreported. Furthermore, reported planned spending is expected to increase as annual budgets become clearer.

Figure 23: 2019-2025 Actual Disbursements and 2025-2027 Planned Disbursements, US$ millions



Source: Aid Transparency Portal, report generated on 23 June 2025. The data does not include Direct Budget Support figures.

4.20. In addition, we see an increase in the infrastructure pillar, this reflects the upcoming investment in the "Project for the Improvement of Presidente Nicolau Lobato International Airport."

Table 17: Planned Development Partner Disbursements by Fund Source for 2026, US$

Fund Source	2026 Planned US$
Government of Australia	55,710,169
Government of Japan	17,696,036
Korean International Cooperation Agency	2,805,594
World Health Organization	2,776,950
European Union	1,521,072
New Zealand Aid Programme, Ministry of Foreign Affairs and Trade	1,087,904
Green Climate Fund	1,046,485
World Bank	551,757
Asian Development Bank	450,000
UN Women	132,766
TOTALS	**83,778,734**

*Figures do not include Direct Budget Support to be provided by Australia (see below). Source: General Directorate for External Resource Mobilisation (DGMRE), Ministry of Finance, June 2025

Table 18: Planned Disbursements by SDP Sub-pillar and Pillar for 2026, US$

SDP	SDP Sub-pillar	2026 Planned
Social Capital	Health	17,304,564
	Education and Training	11,851,660
	Social Inclusion	5,965,969
	Environment	1,391,006
Subtotal		**36,513,199**
Economic Development	Rural Development	10,976,146
	Agriculture	5,946,124
	Private Sector Investment	1,962,355
Subtotal		**18,884,624**
Infrastructure Development	Airports	10,863,811
	Water and Sanitation	732,763
	Electricity	200,000
	Roads and Bridges	50,000
Subtotal		**11,846,575**
Institutional Framework	Public Sector Management and Good Governance	11,692,379
	Security	3,597,650
	Justice	608,872
	National Investment Agency and Economic Policy and Investment Agency	236,881
Subtotal		**16,135,782**
SDP Undefined		398,553
TOTAL		83,778,734

Source: Aid Transparency Portal, Ministry of Finance, June 2025

Direct Budget Support

4.21. Timor-Leste has previously received direct budget support from the European Union, the Government of Australia and the International Labour Organization (one-off support in 2020). DBS is considered as financing for 2026 State Budget because it uses Government systems (the money is into Treasury) and on-budget, where the funding is used directly by the beneficiary ministries.

4.22. In 2026, Australia will be making use of this method of delivery of support to support the Ministry of Health's Nutrition program. The European Union will also provide budget support to bolster the Government's efforts in improving PFM and Digitalization. The numbers below are not included in the reporting above since these will be reflected in other areas of the Budget information.

Table 19: Donor Budget Support 2026

Donor Budget Support	Government program	2026	2027	2028
Government of Australia	Support to Nutrition program	4.5m AUS		
European Union	Partnership for Public Financial Management and Digital Transition in Timor-Leste	1m EUR (fixed)	0.5m EUR (fixed)	0.5m EUR (fixed)
		2m EUR (variable)	2m EUR (variable)	2m EUR (variable)

Source: General Directorate for Mobilising External Resources, DGMRE, June 2025

Table 20: Summary of Development Partner Support to Beneficiary Ministry 25-27 Planned, US$m

Beneficiary Ministry	2025 Plan	2026 Plan	2027 Plan
Ministry of Health	23.5	14.3	0.0
Ministry of Transportation and Communications	24.5	12.4	0.0
Ministry of Education	15.1	7.8	0.0
Ministry of Agriculture, Livestock, Fisheries and Forestry	15.6	6.5	0.0
Ministry of Public Works	8.0	6.0	0.0
Ministry of State Administration	5.3	5.5	0.0
Ministry of Interior	6.0	4.3	0.0
Presidency of the Council of Ministers	4.3	3.0	0.0
Minister Coordinator of Economic Affairs	3.9	2.9	0.0
RDTL Institution Unspecified	7.8	2.8	0.3
Ministry of Higher Education, Science and Culture	5.4	2.0	0.0
Ministry of Foreign Affairs and Cooperation	2.5	1.3	0.0
Ministry of Social Solidarity and Inclusion	1.6	1.7	0.0
Ministry of Finance	4.5	1.1	0.0
Ministry of Rural Development and Community Housing	1.1	1.1	0.0
Ministry of Youth, Sport, Art, and Culture	5.9	0.3	0.0
Ministry of Planning and Strategic Investment	0.5	0.3	0.0
Ministry of Trade and Industry	1.1	0.2	0.0
Ministry of Tourism and Environment	2.0	0.2	0.0
Ministry of Justice	0.1	0.0	0.0
Office of the Prime Minister	0.2	0.0	0.0
Secretary of State for Professional Training and Employment Policy	1.9	0.0	0.0
Secretary of State for Equality and Inclusion	0.1	0.0	0.0
Non-government sector	12.6	10.1	0.0
Totals	153.4	83.8	0.3

Source: General Directorate for External Resource Mobilisation (DGMRE), Ministry of Finance, June 2025

Public Private Partnerships

4.23. In general terms, the Public Private Partnerships (PPP) refers to long term arrangements in which the private sector build infrastructure assets and provides services that traditionally have been provided by the State. Ownership of the infrastructure asset remains in the hand of the Government and the private sector needs to transfer it back in good condition at the end of the contract.

4.24. DL 8/2014 stipulates the formation of PPP Unit (PPPU), 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 PPPU 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.

4.25. Currently, one PPP project is in the Implementation and Operation Stage (Tibar Bay Port PPP), one is in the Feasibility Stage (Affordable Housing) and several in in the Initiation stage identified with line ministries and agencies such as Ministry of Tourism and Environment, Ministry of Commerce and Industry, Ministry of Rural Development and Community Housing, APORTIL and Dili Municipal Authority. The latest status of these projects is reported below.

4.26. The PPP modality chosen for Tibar Bay Port was a 30-year concession, including the design, build, finance, operation and transfer (DBFOT) 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 (TPSA) as Concessionaire. The concession agreement was signed on 3rd June 2016 between the GoTL and Concessionaire (TPSA) and the 30-year concession includes a three-year construction period which started on 30 August 2018.

4.27. The construction was concluded on 29 April 2023 with issuance of Completion Certificate from Independent Engineer to the Tibar Bay Port Project. The only remaining work is Bluezone Construction, pending attribution of land to the Ministry of Finance and to Timor Port for the construction of the above facility. Upon construction, Bluezone will be equipped with multipurpose facilities for sport and social activities, such as football, basketball, futsal, media centre and library with full internet access and other community events.

4.28. The Services Commencement date fell on 30th September 2022 (early commencement). Since then up to 30 May 2025 (32 months), 461 vessels had called at Tibar Bay Port. During this period, Tibar Bay Port handled 202,917 TEUs containers include 273 TEUs Containers of first ever Transhipment handle at Tibar Bay Port which was discharged by Meratus and ANL Darwin Trader in April 2024. In addition, 694,341 Tonnage of breakbulk cargo was also handled at Tibar Bay Port. Meanwhile, the total Grantor revenue during the period from Oct 2022 to May 2025 is US$3,668,931.80

4.29. The Affordable housing PPP is undergoing a feasibility study and transaction structuring phase. The project has benefited from advisory services from the World Bank Group's International Financial Corporation (IFC). In May 2024, the IFC submitted an updated Transaction Structuring Report (TSR).

4.30. The Affordable Housing PPP project is a residential project designed to provide housing units to eligible buyers at an affordable price. This objective is to be achieved through the construction of approximately 500 housing units – about 90 percent at affordable price point while the rest at market rate, all on 200 sq. m of land parcels. Affordable units will be a mix of studio, one bedroom, two bedroom and three-bedroom units while the type of market units will be decided by the winning bidder.

4.31. Affordable housing under a PPP model has been proven to be successful in several countries. For this particular project, the Government has selected a 20-ha government owned land in Suco Hera, about 14km east of Dili. Besides the design, finance and construction, the developer will be responsible for the sale of housing units while responsible entity for certain O&M obligations such as O&M of utility infrastructure and maintenance of common areas will be clarified at a later stage. Target beneficiaries for the project are households with formal employment and incomes in the range of USD 300 to USD 600 per month. The project was authorized to proceed to the next steps by CAFI during a meeting on 23 October 2023. Inter-Ministerial Working Group has been re-enacted and has conducted its first meeting on 21 October 2024. Several critical issues regarding registration of the 20 Ha land and subsequent sub-division of the land into 200 sq. m land parcels were discussed at the meeting. A series of discussions were conducted with Ministry of Justice in Q1 of 2025 resulting in the issuance of MoJ dispatch for the recognition of the project site as state owned land. Currently, awaiting land attribution from MoJ to Ministry of Public Work as the project owner.

4.32. Based on the Government decision, the Hybrid Public Private Partnership (PPP) modality that was opted for the development of the Presidente Nicolau Lobato International Airport project has been revisited, and several administrative issues need to be addressed with the International Finance Corporation (IFC). Therefore, a provisional budget for FY 2026 has been prepared, anticipating administrative costs of the PPP cancellation as reflected in the table below.

4.33. New PPP initiatives are being prepared within the framework of World Bank grant implementation. The grant is a successful collaboration between DGGMRE-DNPPP with the World Bank with objectives for capacity building, preparation of new initiatives as well as improvement to legal and regulatory environment for PPP project facilitation. So far under this grant program, several basic PPP trainings were conducted with the line ministries, culminated with a workshop on PPP project development. A “long list” of fourteen potential projects have been identified with several line ministries and agencies including Ministry of Tourism and Environment, Ministry of Commerce and Industry, Ministry of Rural Development and Community Housing, Dili Municipal Authority and APORTIL. From these fourteen projects, two will be selected to go through a pre-feasibility study to be implemented by a consulting team procured through the grant. Previously identified new initiative with Ministry of Tourism and Environment will proceed as part of the pre-feasibility study.

4.34. Table 21 contains actual government expenditure for 2022 to 2024, estimated expenditure for 2025, proposed general budget allocation for 2026 and estimated budget allocation for 2027 onward for PPP projects.

Table 21: Actual Expenditure (2022 – 2024), Estimated Expenditure (2025), Allocation (2026) and Estimated Allocation (2027-2029), US$ Million

	2022 Actual	2023 Actual	2024 Actual	2025 Est.	2026 Est.	2027 Est.	2028 Est.	2029 Est.
Combined Sources Budget (DTG + IF)	**0.67**	**0.17**	**0.00**	**1.18**	**4.61**	**5.78**	**2.65**	**2.05**
Dotação *Todo Governo (DTG)*								
PMU Affordable Housing					0.13	0.13	0.13	0.13
TBP - Audit - TP-OMSU				0.30	0.49	0.02	0.02	0.02
SUB TOTAL	**0.00**	**0.00**	**0.00**	**0.30**	**0.62**	**0.15**	**0.15**	**0.15**
Infrastructure Fund (IF)								
TBP PPP								
Tibar Bay Port PPP O&M stage - Independent Hydrographic Survey				0.09	0.10			
Tibar Bay Port PPP O&M stage - Independent Hydrographic Expert					0.05			
SUB TOTAL	**0**	**0**	**0.00**	**0.085**	**0.15**	**0**	**0**	**0**
President Nicolau Lobato International Airport Hybrid PPP (FASA - FS & TSR - IFC)								
FASA - FS & TSR - IFC	0.67				1.11			
SUB TOTAL	**0.67**	**0**	**0**	**0**	**1.11**	**0**	**0**	**0**

Source: General Directorate for External Resource Mobilisation (DGMRE), Ministry of Finance, June 2025

Fiscal Risks and Contingent Liabilities Statement

4.31. Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts. Fiscal risks can arise from macroeconomic shocks or the realization of contingent liabilities - that is obligations triggered by an unexpected event or whose realization during the financial year is uncertain.

4.32. Contingent liabilities are a type of fiscal risk that involve obligations for governments to pay out but that do not arise unless a particular event occurs in the future to trigger it.

4.33. In the case of Timor-Leste, this can lead to further excess withdrawals, depleting the Petroleum Fund, and are detrimental to fiscal sustainability and macroeconomic stability. Countries with stronger institutions can better control and manage the underlying risks so that they are less exposed to contingent liabilities being triggered.

4.34. The Government is committed to improving the disclosure, analysis and management of Fiscal Risks and Contingent Liabilities.

4.35. Aside from this legal requirement, Timor-Leste has also committed to “Development of a Fiscal Risks Statement and Risk Management Strategy” within the PFM Reform Strategy 2022-2027.

4.36. According to the IMF, international best practices surrounding fiscal risk and contingent liabilities management involves a more complete understanding of potential risks, steps to quantify risks and steps to mitigate or provision for risks.

4.37. Therefore, in order to better manage fiscal risks and contingent liabilities, the Ministry of Finance seeks to take the following steps:

1. *Disclosure: outlining explicit and potential risks and commitment to manage them.*
2. *Collect: data from LMs and SOEs on their stock of risks.*
3. *Analysis: of concentration and correlation of risks.*
4. *Manage, mitigation and monitor: take steps to manage existing stock of risks and prevent from increasing; provision for contingencies; monitor crystallizations or changes in risk.*

4.38. The fiscal risks statements published in the budget report outline a key part of the overall risks management strategy. To this regard the following fiscal risk statement provides an outline of macroeconomic and specific risks. As well an assessment of potential impacts and mitigation measures.

Macroeconomic Risks

4.39. Macroeconomic risks are a category of fiscal risks that arise because of variations in macroeconomic assumptions and forecasts that are used in the Government forecasts. Fiscal risks are likely to arise if GDP is lower than anticipated or if inflation is significantly higher than the forecasts provided in the previous section.

4.40. As explained earlier, inflation in Timor-Leste is largely driven by global factors due to the high proportion of imports in domestic consumption[6]. Key risks to the inflation forecasts in this document are therefore an unanticipated depreciation in the US dollar, as this would increase the cost of imports and therefore increase prices, increases in oil prices and increases in the price of food imports such as rice and other staples. Higher inflation from these factors could lead to higher government spending than currently projected. Increases in the price of imports will lead to a rise in government consumption. Higher oil prices will lead to an increase in the subsidy provided to the state electricity company, EDTL.

4.41. A potential mitigation strategy for inflation related risks would be to boost investment in domestic agriculture and renewable energy. In the last few years EDTL has been among the largest recipients of transfer expenditure as the Government has protected citizens from rising costs of importing fuel by subsidising electricity purchases. To reduce exposure to fluctuations in shipping costs and global oil prices and reduce the fiscal risks that arise from the electricity subsidy, the Government should seek to invest in renewable energy alternatives.

[6] Analysis of trade and consumption data suggests that over 50% of domestic consumption is directly on imports.

4.42. Increasing domestic agriculture production, particularly rice production, would also reduce the reliance on imports to meet domestic demand and therefore shelter the country from fluctuations in global agricultural markets.

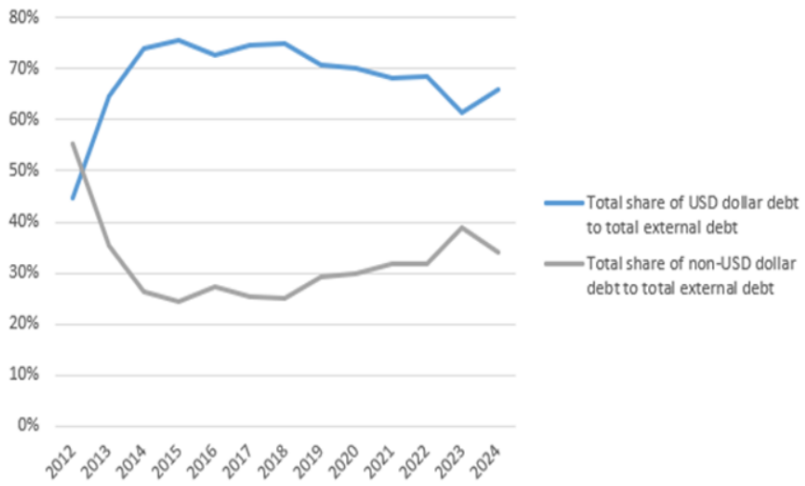
4.43. All things being equal, a fall in GDP is likely to be associated with a fall in domestic revenues. GDP is ultimately a measure of economic activity and - in the absence of changes to tax policy, administration or the size of the tax base - a fall in economic activity will mean lower incomes and therefore lower taxes collected. If nominal GDP is 10% lower than currently forecasted for 2026, domestic revenues could fall by around US$20 million.

4.44. As explained earlier, the two main risks to the GDP forecasts are imports and government execution. Given the high reliance on government spending to drive economic growth, if execution falls below expectations, GDP growth will also be impacted. Similarly, a large portion of the Budget 2025 has been assigned to transfers to households. If a higher share of these transfers is spent on imports than suggested by historic trends, GDP growth will be lower than predicted.

4.45. However, the overall risks from this will be partially mitigated by the fact that higher imports will also see an increase in import duties collected. They are also mitigated by the fact that reduced spending also supports long term fiscal sustainability. If government execution falls below the current level, this will also reduce the existing fiscal deficit and potentially extend the lifetime of the Petroleum Fund.

4.46. Macroeconomic risks are also relevant to the current loan portfolio. Foreign exchange rates arise from loans in currencies other than the US dollar. In accordance with the loan policy, the US dollar is intended to remain the predominant currency in the Government's external debt portfolio due to the country's dollarized economy. However, since 2018 the share of US dollar debt has declined to reach 60%. The policy to maintain a significant portion of debt in US dollars is expected to continue, at least in the short to medium term.

Figure 24: US dollar debt vs non-US dollar Debt, %

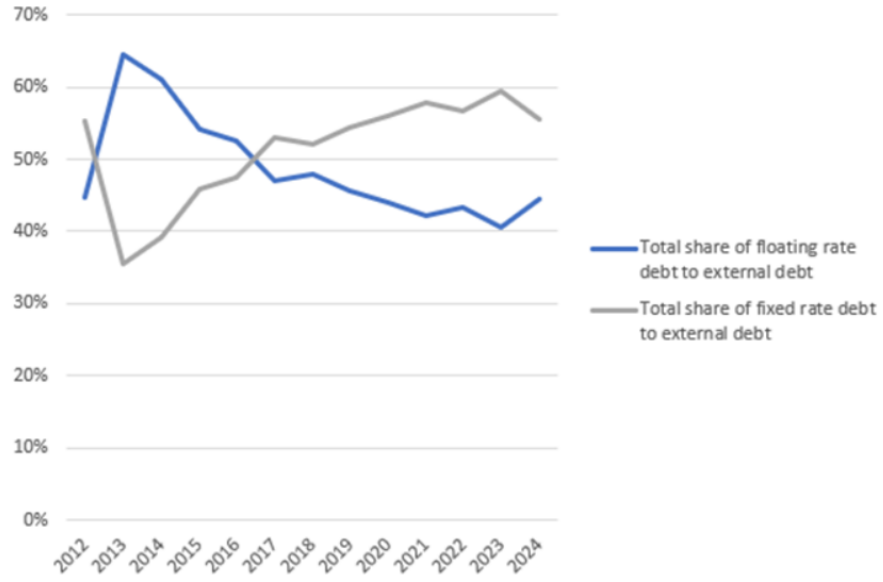


Source: DNPME, Ministry of Finance, September 2024

4.47. Interest rates also represent a risk, in the loan portfolio. Starting in 2013, the proportion of fixed-rate debt within the debt portfolio began to increase, eventually comprising the

majority share in 2017 and 2018. This shift was due to the Government's ability to manage interest rate risk by prioritizing disbursements from fixed-rate sources. As TL is now classified as a blend country, it is gradually being phased out of concessional financing by its external creditors, leading to an expected rise in borrowing costs.[7] To mitigate the risk of interest rate shocks, it is necessary to expand concessional financing at a fixed interest rate from bilateral loan providers.

Figure 25: Fixed vs Floating Debt, %



Source: DNPME, Ministry of Finance, September 2024.

4.48. In the medium term the Petroleum Fund is the main buffer to the macroeconomic risks. The existing level of the fund provides significant leeway in the coming years. For example, domestic revenues would have to be over 50% lower than the forecasts provided in this document for the Petroleum Fund to deplete one year earlier than currently forecasted.

Explicit Contingent Liabilities recognised by Law or Contract

4.49. Judicial litigation is an important source of contingent liabilities and the cost for the State is dependent on the outcome of the litigation that is still pending.

4.50. Below are the current litigation cases against the Democratic Republic of Timor-Leste, and their maximum potential cost if the case was to be decided in favour of the claimant.

4.51. Eastlog Projects Limited: Litigation case in the Hong Kong Arbitration Court related to the alleged breach of the Suai Supply Base construction contract, with a maximum liability of US$5,305,338.08.

[7] As a blended country, TL has restricted access to concessional lending at a fixed interest rate.

4.52. Timor Corp case: Judicial case in the District Court of Dili with a maximum liability of about US$2,371,815.36.

4.53. Bolloré Logistic Timor case: Judicial case in the Appeals Court with a maximum liability of about US$254,901.70.

4.54. Ensul Engenharia case: Judicial case in the District Court of Dili with a maximum liability of about US$1,444,617.8

4.55. The Credit guarantee system for Micro, Small and Medium Enterprises (MSME) is an initiative aimed at supporting businesses starting out, whereby a government guarantee covers up to 70% of the value of the business loan to MSME in order to encourage the development of the private sector in the country with the total guarantee of US$4 million. The Central Bank of Timor-Leste works with banks to share the risk and manage risks. The maximum size of the individual loan is $150,000. However, this initiative is already 100% budgeted for, so it poses no additional risk if the loans were to default.

4.56. Fasilidade Garantia Crédito Suave is a loan guarantee scheme to provide low interest loans for companies and individuals. The loans are awarded by financial institutions which contract with the Government (currently only BNCTL) to provide low interest loans that are guaranteed by the Government. The scheme had an initial budget of US$1,379,990, but that was reinforced with an additional US$50,000,000 by the Law No. 6/2022, *Primeira alteração ao Orçamento Geral do Estado para 2022*. However, this scheme is also 100% budgeted for, so it poses no additional risk if the loans were to default.

Public Private Partnerships (PPPs)

4.57. Public-Private–Partnerships contracts can involve guarantees or indemnities on particular risk variables, where the Government could be asked to compensate the private sector for loss of revenues from these risks.

4.58. Up to this date there is only one PPP in operation Tibar Port, which finished construction last year. The contingent liabilities associated with Tibar Port relate to currency fluctuations, occurrence of Force Majeure or acts of God i.e., events for which no party can be held account, unforeseen political circumstances and settlements related to different termination events.

Implicit Contingent Liabilities

4.59. Aside from the explicit contingent liabilities that are stated above, the Government must also consider implicit contingent liabilities. These are contingent liabilities where there isn't a legal obligation for the Government to intervene. Despite this, government intervention may be necessary to protect the economic welfare of its citizens. Such contingent liabilities in Timor-Leste are likely to occur as a result of environmental, social or economic crises. Any such crisis that leads to loss of livelihoods through damage, displacement or unemployment or other such economic hardships may lead to unexpected costs.

4.60. These costs would arise if the Government intervened through social assistance schemes and fiscal stimulus packages. Below we describe some of these contingent liabilities and explain how the Government can mitigate for them.

4.61. An implicit contingent liability is the support provided to state owned enterprises. Since loans are only issued to the Central Administration, State owned Enterprises in Timor-Leste do not have any debt risks or liabilities. However, several state-owned enterprises receive large transfers from the state annually. Details of transfers are available in the Budget Performance section of this document. The annex also provides available financial information from public entities.

4.62. Natural Disasters are another risk main risks faced by Timor-Leste. The country is situated close to the so called “Pacific Ring of Fire”, an area which has some of the most volatile earthquake and volcanic activity in the world. With the onset of climate change, the country is also at increased risk of floods and cyclones.

4.63. Over the past decade, the largest expenditure on environmental disasters occurred in 2021, where the Government was required to spend US$6.2 million, primarily as a result of Cyclone Seroja.

4.64. External economic shocks are another source of implicit Contingent Liabilities. As demonstrated by the COVID-19 crisis, health and economic crises can also be a major source of fiscal risks in Timor-Leste. Whilst pandemics are infrequent events, as a small open economy that is heavily reliant on imports, Timor-Leste is highly exposed to economic events in other countries.

4.65. Since independence the COVID-19 health crisis has certainly been the largest external shock to hit the Timorese Economy. The crisis had the largest impact on government spending in 2021 during which the Government spent US$201 million on measures to protect citizens from the health and economic impacts of COVID-19.

4.66. Political crises have also been a source of fiscal risks in recent years. Delays to budget approvals in 2017, 2018 and 2020 contributed to negative economic growth in those years. Negative economic growth can mean that there is a general fall in incomes among businesses and individuals. In the short term this leads to lower tax revenues. In the long run it slows down progress in economic diversification that is needed to help the country guarantee its long-term fiscal sustainability.

4.67. Some contingent liabilities that pose major fiscal risks in other countries have a lower probability of materializing in Timor. Many developing countries are exposed to risks through volatile exchange rate movements. Since Timor-Leste uses the US Dollar, which is among the most stable currencies in the world, such risks are less likely (although not completely unforeseeable).

4.68. However, it should be noted that Timor-Leste is only able to maintain a regular supply of dollars as a result of the Petroleum Fund. This means that this could materialize as a greater risk over the next decade as explained in the Fiscal Sustainability section of this report.

4.69. Given the infancy of the banking system, and the fact that several of the banks that operate in Timor are State Owned Enterprises in their respective countries and are subject to foreign lenders of last resort, there is also lower risk of a domestic financial crisis occurring in Timor-Leste as compared to other low- or middle-income countries.

4.70. Similarly, the debt to GDP ratio is set to remain relatively low meaning there is a low risk of a debt crisis in the medium term. A contingent liability that is unique to Timor-Leste is the risk to Petroleum Fund Revenues from volatility in financial markets. Factors that would affect the performance of the Petroleum Fund could be considered as contingent liabilities as losses in the Fund’s investment portfolio could lead to the Fund depleting sooner than anticipated. As described earlier, this would mean greater exposure to fiscal risks.

4.71. However, the investment horizon of the Fund has shortened given that the petroleum inflows from Bayu-Undan are ending and expenditure and withdrawals are expected to follow the current trend. Investment returns are not expected to fill the gap.

4.72. To adjust for the expected depletion of the Fund, a liquidity portfolio of low-risk investments was created in 2021 to finance the withdrawals over the next three years. This provides some protection against being forced to sell equities and bonds following a loss but is less effective when withdrawals significantly exceed projections. In addition, a prolonged period of poor investment performance would further shorten the Fund's expected life. As well as financial markets, the Fund is exposed to the future of the Greater Sunrise project.

4.73. In 2019, the Government decided on the Petroleum Fund lending US$650 million to Timor Gap E.P. and its subsidiaries to finance the acquisition of participating interests in the Greater Sunrise development project. These loans are independently valued each year for the Fund's audited financial statements. The repayments of the loans are linked to Timor Gap E.P.'s revenues from the petroleum project, meaning that the Fund is exposed to the success of the development project.

4.74. To guarantee that the contingency fund has enough allocation to cover any materializing fiscal risks, the new Budget and PFM Framework Law enshrined a minimum threshold for the contingency fund, which must amount to a minimum of 2% of total expenditure of the Budget and a maximum of 5% of total expenditure.

4.75. For Budget 2025, a total of US$42.6 million has been allocated for the contingency fund. This therefore fulfils the legal requirement as it is a little over 2% of the consolidated budget for RAEOA and the Central Administration. Budget 2026 will also ensure that at least 2% of proposed allocations for the consolidated budget are for the social security fund.

4.76. Aside from contingency funding, the Government and State-Owned Enterprises are able to draw upon cash balances in case of unexpected losses. As of 31st December 2023, cash balances are as follows:

Table 22: Cash Balances for Public Sector Entities in Timor-Leste, US$m

Entity	Cash Balance 31st December 2023
BNCTL	443.3
INSS	200.0
Central Administration	186.7
TIMOR GAP	106.1
RAEOA	92.2
EDTL	73.7
ANPM	55.9
Bee-TL	40.8
Cash Balance in Commercial Banks	31.7

Entity	Cash Balance 31st December 2023
Murak Rai Timor	1.9
RTTL	0.5
ANATL	0.0*
Total	**1,233**

Source: Available Financial Reports as at 31st December 2023. *Amount less than US$100k

4.77. The cash balances stated above is based on the latest publicly available information. Actual cash balances at the time the budget was approved may differ from these estimates. These numbers are awaiting updates following the publication of the financial reports of State-Owned Enterprises. The 2026 budget proposal, which will be submitted to Parliament on the first of October, will contain updated numbers.

4.78. Major economic shocks may require the Government to step in with much higher levels of economic support. If such a response requires spending levels that go beyond the contingency fund, the Government can rely on withdrawals from the Petroleum Fund. However, this comes at a cost as consistent unforeseen withdrawals from the Petroleum Fund will mean that the fund depletes sooner. This also demonstrates the importance of ensuring that fiscal policy can maximize the longevity of the Petroleum Fund.

4.79. Furthermore, if the Petroleum Fund depletes before domestic revenues are high enough to support contingency funding, contingent liabilities could pose greater fiscal risks.

4.80. The Ministry of Finance will continue to improve the information provided in the fiscal risks statement as data collection continues to improve.

Methodology and Assumptions

Fiscal Sustainability Model Methodology

4.81. The Ministry of Finance conducts fiscal sustainability analysis for the budget ceiling chosen each budget cycle. Using 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.

4.82. In order to produce the analysis, we need to project expenditure, domestic revenues and the performance of the Petroleum Fund. Below we summarize the main data and assumptions in the model that are used to achieve this.

Actual Data

4.83. Petroleum Withdrawal in 2025- The withdrawal figure from the Petroleum Fund in 2025 is as set out in the budget proposal for Budget 2025. The withdrawal figure for 2026, is also as set out in this document. Trend analysis suggests that budget execution will reach 93% in 2025. Any surplus from available financing exceeding budget execution is assumed to be added back into the Petroleum Fund.

4.84. Petroleum Fund Data– The model uses data from the Petroleum Fund as of May 2025. This includes the Petroleum Fund balance, information on the asset split of the Petroleum Fund, and latest information on Withdrawals and Estimated Sustainable Income.

4.85. Loans and Direct Budget Support Data – The model incorporates disbursement forecasts for loans and direct budget support mentioned in this document.

Assumptions/Projections

4.86. Government Expenditure - Government expenditure between 2027 and 2030 is assumed to increase in line with the levels outlined in the fiscal projections and expenditure ceilings sections above. A proposal for the level and breakdown of the expenditure is provided in the fiscal projections part of section 1 of this document. Beyond 2030, expenditure levels are assumed to increase with long run inflation and population growth (roughly 4% a year).

4.87. Domestic Revenues – The forecasts for domestic revenues are explained below

4.88. Petroleum Fund ROI - The model also uses up to date assumptions on the estimated rate of return on petroleum fund from the Petroleum Fund Unit in the Ministry of Finance. The Petroleum Fund is segmented into a growth and liquidity component. As per assumptions from the Petroleum Fund Unit as of June 2025, we assume that the growth component has an ROI of 4.7% whilst the liquidity component is assumed to have an ROI of 3.0% The liquidity component of the fund is assumed to be sufficient to finance three years of withdrawals. To model this, we assume that the liquidity component each year is three times the amount of the withdrawal.

4.89. Direct Budget Support (DBS) - Direct Budget Support estimates for 2026 are provided by the general directorate for mobilising external resources. Whilst estimates are not yet available beyond 2028, we assume that DBS will remain constant till 2030 and increase with inflation beyond that.

4.90. Loan Disbursement- Loan Disbursement forecasts in the medium term are provided by the general directorate for mobilising external resources. Beyond the medium term they are assumed to grow in line with inflation and population growth.

Domestic Revenue Forecast Method

4.91. Domestic revenues for 2025 are based on trend analysis (i.e., taking the first five months of data and assuming revenue growth is in line with previous years). Revenue forecasts for 2026 and beyond are produced as follows:

4.92. Sales taxes, import duties and excise taxes are assumed to grow in line with import growth. This is because these taxes are collected at the border and there are no changes to policy. Income, Wage and Service taxes are assumed to maintain a constant ratio with Nominal GDP in the absence of changes to the tax base or tax policy. Therefore, as GDP and imports rise, so do tax collections. Non-Tax revenues are assumed to grow in line with population and inflation growth.

4.93. As stated in section 1 of this document, domestic revenue forecasts have not yet considered revenue impacts from ASEAN accession. This analysis will be carried out in time for the Budget 2026 proposal.

4.94. The projections assume that a Value Added Tax is introduced in 2027. Whilst VAT policy is still subject to discussion, preliminary estimates are based on the assumption that the VAT rate will be 10%, will replace import duties, services taxes and sales taxes. We also assume that the impact of VAT on low-income households will be inflation neutral. This will be achieved through zero-rating on key products such as food and medicine.

Forecasting GDP

4.95. GDP forecasts in this document have been produced using a macroeconomic modelling framework developed through technical assistance from the IMF's Singapore Training Institute (STI) and Pacific Financial Technical Assistance Centre (PFTAC).

4.96. The Government's contribution to GDP is estimated by analysing the execution of government spending in 2025 and applying historic execution trends. For 2026 to 2030, we assume that government expenditure rises in line with the expenditure forecasts outlined in the macro-fiscal projections section of this document. We also assume that government execution rates of capital expenditure will see steady improvements as a result of the PFM and procurement improvements mentioned in this document.

4.97. Forecasts for private sector consumption and investment activity are informed by analysis of historical trends in consumption, investment, remittance information from the Balance of Payments and private sector credit. The private sector is assumed to see strong consistent growth from 2026 to 2030.

4.98. All assumptions related to oil and commodity price growth, global exchange rates and long-term inflation forecasts are taken from the IMFs World Economic Outlook. The latest publication is April 2025.

4.99. Economic forecasts in this document aim to predict annual GDP growth rates over the next five years. Whilst this is important to support government planning decisions, it should be noted that these predictions are dependent on assumptions and therefore include an element of uncertainty. These are also dependent on the successful implementation of the policies mentioned in section 2. Other than this, there is further uncertainty.

4.100. The key sources of uncertainties in the budget forecasts provided above are as follows:

- Execution of Budgets
- Allocation and quality of government expenditure
- Volume of Imports.

4.101. Execution rates can differ year on year and are subject to political and economic risks. For example, executed expenditure was impacted in 2017, 2019 and 2020 by political crisis and COVID-19.

4.102. Execution rates will also depend on the absorptive capacity of different line ministries. This is the amount that line ministries are able to spend regardless of their budget. For example, line ministries that see a large increase in their budgets might not have the capacity to execute the higher spending due to resource constraints. If execution rates fall below expected (forecasts assume historic execution rates are maintained) then GDP forecasts presented in this document are likely to be overestimates.

4.103. Similarly, the forecasts presented above make assumptions on the allocation and quality of expenditure. The above forecasts assume that there will be a large shift towards capital expenditure as the Government looks to target higher growth rates. It also assumes that this expenditure will be spent on high quality investments that lead to improvements in the country's capital stock.

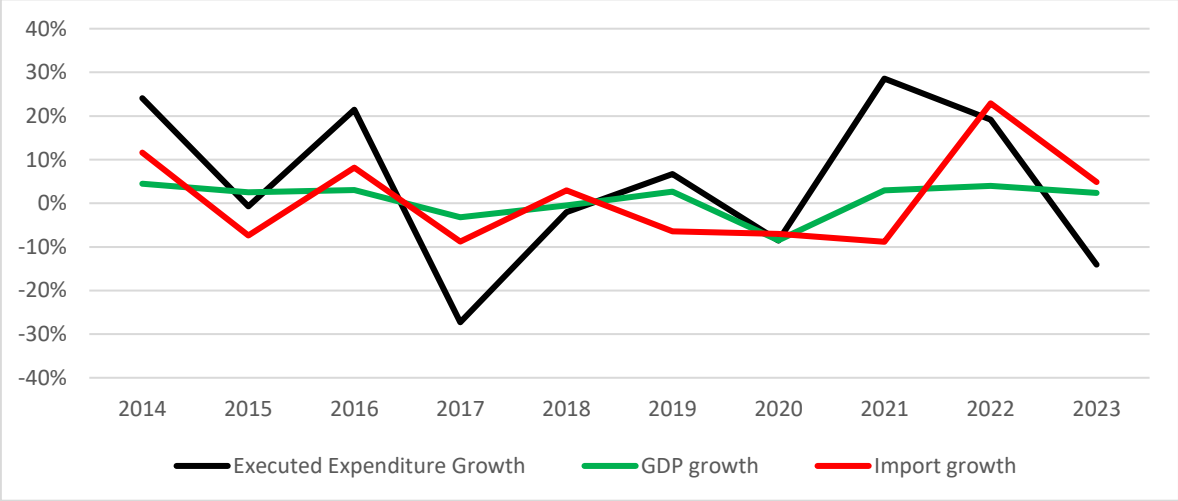
4.104. If higher budgets are instead allocated towards unproductive transfer spending or on inefficient projects, the GDP forecasts will not be attained.

4.105. Another major uncertainty arises from imports. 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.

4.106. The combination of quality of government expenditure and level of imports means that higher government expenditure in Timor-Leste has not been correlated with higher GDP growth. In the graph below, there appears to be some correlation between growth in government expenditure and growth in imports.

4.107. However, large spikes in government expenditure growth have not been correlated with large spikes in economic growth. This could be because increases in government expenditure do not necessarily correspond to improvements in quality expenditure. At the same time, lower budgets with more efficient and higher quality expenditure can potentially lead to higher economic growth and help preserve the Petroleum Fund.

Figure 26: GDP growth compared with expenditure and Imports growth, %



Source: Analysis National Directorate of Economic Policy, Ministry of Finance, September 2024 based on National Accounts Data from INETL and Fiscal Data, Ministry of Finance

Comparison between the macroeconomic and budget forecasts used and forecasts made by international reference bodies

4.108. A comparison of Ministry of Finance forecasts with forecasts from other institutions is provided below. All institutions use different assumptions or data sources when making their

forecasts and therefore there are often differences in projections between institutions. Often the Ministry of Finance will have more timely information related to public spending plans than other institutions.

Table 23: GDP growth rate forecast, %

Institution	2024	2025	2026	2027	2028	2029	2030
Ministry of Finance	4.1	4.3	2.7	3.9	4.3	4.7	5.0
IMF	4.1	3.4	3.2	3.2	3.1	3.0	3.0
World Bank	4.1	3.5	3.4	3.5			
ADB	3.3	4.0	3.8				
National Statistics Institute (INETL	4.1						

Source: IMF Forecasts: IMF World Economic Outlook April 2025, World Bank Forecasts: World Bank Global Economic Prospects, June 2025, https://www.worldbank.org/en/publication/global-economic-prospects; ADB Forecasts: Asian Development Outlook, April 2025, https://www.adb.org/where-we-work/timor-leste/economy

4.109. The table below provides a comparison between the macroeconomic and budget forecasts used in the OGE law for Budget 2025 and the actual evolution observed.

4.110. Growth for 2024 was forecasted to be 3.7% based on an estimate that government expenditure would see 86% execution. Final execution in December 2024 was higher than anticipated leading to a final execution rate of 88%. As a result, preliminary GDP estimates suggest that the economy grew at 4.1% in 2024.

4.111. The growth forecast for 2025 was forecasted at 4.1% in Budget 2025. Stronger than expected execution in the first five months of the year and positive indicators from the private sector (such has increased tourist arrivals and credit growth) mean that this forecast has been revised up to 4.3% (within the margin of error for the original forecast).

4.112. The growth forecast for 2026 has been revised down in this document. The original forecast for 2026 assumed strong growth in government expenditure (of around 7 to 8%). However, as explained in the macroeconomic and fiscal projections above, whilst lower government spending is likely to lead to lower growth, more efficient spending can actually improve living standards.

Table 24: Macroeconomic forecasts in 2025 budget report vs. 2026 Budget Strategy Statement, %

Item	2025 Budget Report			2026 Budget Strategy Statement		
	2024	2025	2026	2024	2025	2026
GDP growth %	3.7	4.1	4.4	4.1	4.3	2.7
CPI %	3.0	2.2	2.0	2.1	1.8	2.0

Source: National Directorate of Economic Policy, Ministry of Finance

IX Constitutional Government
Ministry of Finance
mof.gov.tl