Timor-Leste 2026 State Budget

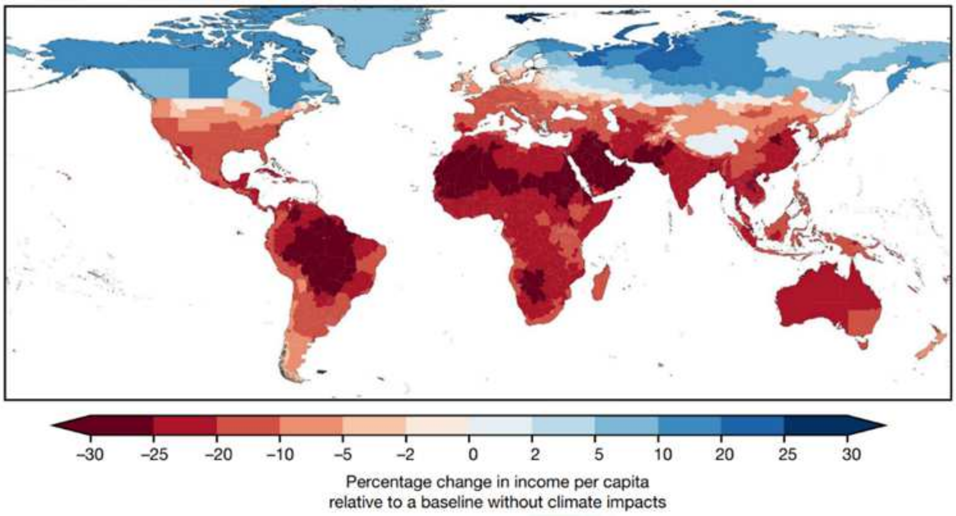
Presentation for the National Budget Seminar,

October 17, 2025

WORLD BANK GROUP

Regional Outlook and Key Risks

Climate change impacts are projected to increase, with losses concentrated in countries with high exposure and limited adaptation capacity



Kotz et al. 2025. The economic commitment of climate change. Nature

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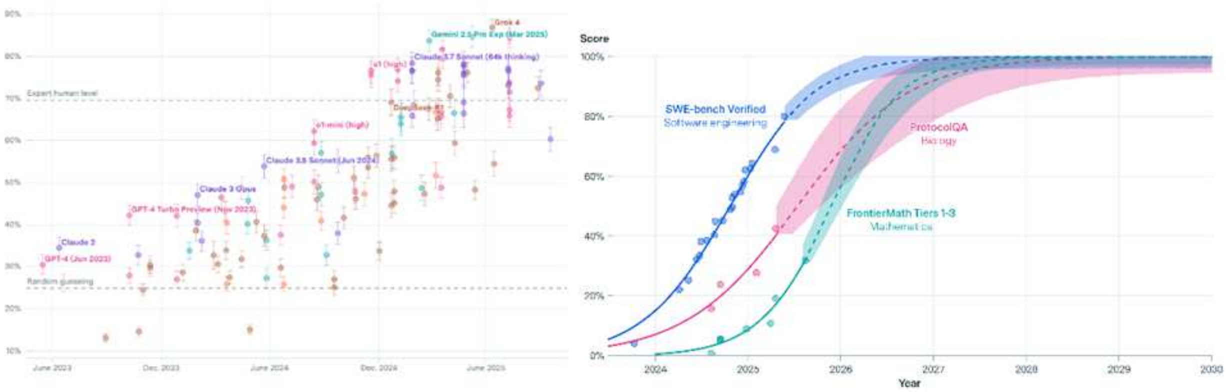
Development of AI technology will have profound long-term impacts



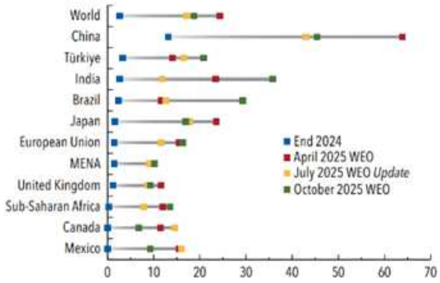
"On current trends, frontier AI models in 2030 will require investments of hundreds of billions of dollars, and gigawatts of electrical power. Although these are daunting challenges, they are surmountable. Such investments will be justified if AI can generate corresponding economic returns by increasing productivity."

"By 2030, AI will be able to implement complex scientific software from natural language, assist mathematicians formalising proof sketches, and answer open-ended questions about biology protocols. We expect AI capabilities will be transformative across several scientific fields, although it may take longer than 2030 to see them deployed to full effect."

Source: Epoch AI

US effective tariff rates have increased dramatically in 2025, contributing to acute uncertainty

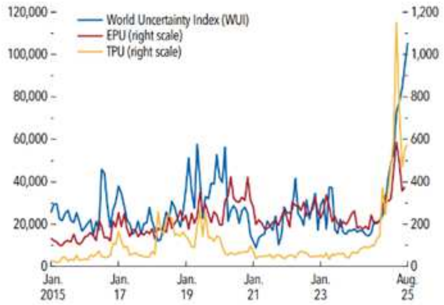
Figure 1.1. US Effective Tariff Rates by Country
(Percent)



Sources: US International Trade Commission; WTO-IMF Tariff Tracker; and IMF staff calculations.

Note: The effective tariff rate is a weighted average of announced statutory rates. MENA = Middle East and North Africa; WEO = *World Economic Outlook*; WTO = World Trade Organization.

Figure 1.2. Overall, Economic Policy, and Trade Policy Uncertainty
(Index)



Sources: Ahir, Bloom, and Furceri 2022; Caldara and others 2020; Davis 2016; and IMF staff calculations.

Note: The uncertainty measures are news- and media-outlet-based indices that quantify media attention to global news related to overall uncertainty (WUI), economic policy uncertainty (EPU), and trade policy uncertainty (TPU).

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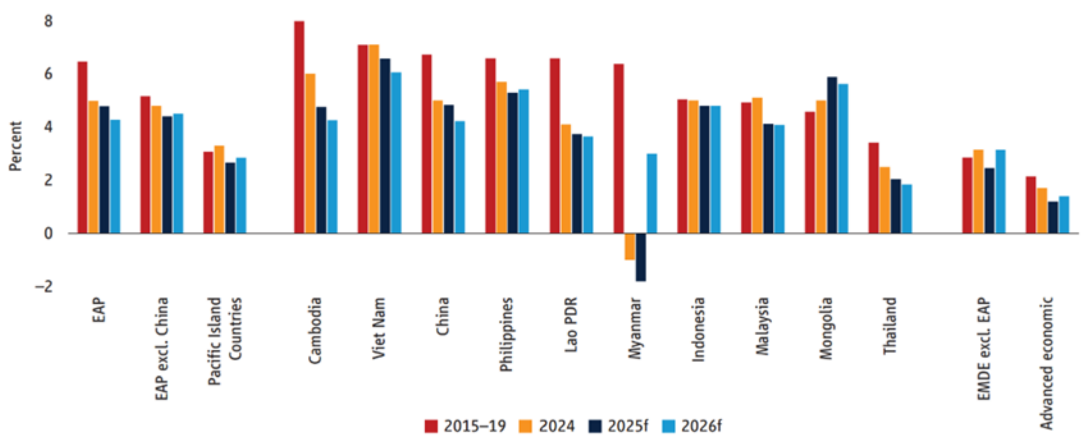
In East Asia and the Pacific, growth is projected to decline during 2025-2026

GDP growth



Source: World Bank

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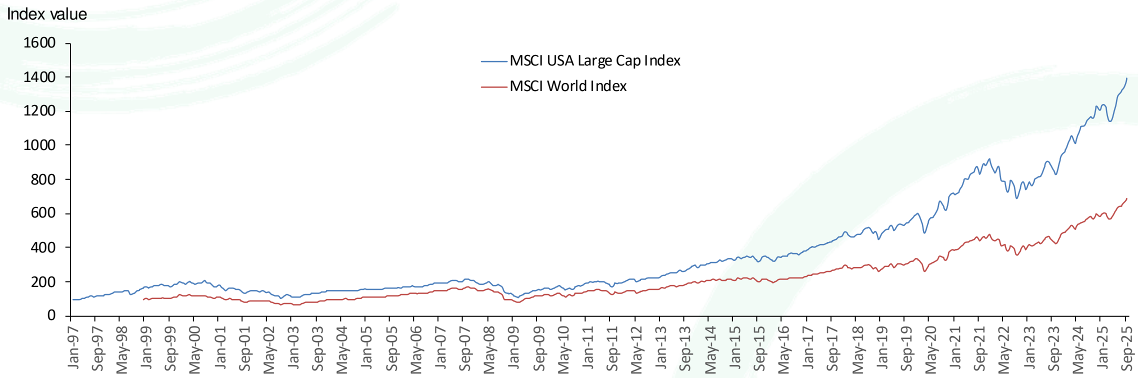
Despite slowing growth, stock markets have recorded strong growth reflecting optimism about the impact of AI and new technologies



Source: MSCI

"the current AI boom presents some parallels with the dot-com boom of the late 1990s. Market optimism about a new technology…is pushing up stock valuations, fueling a tech-centered investment boom, and sustaining consumption on the back of strong capital gains"

"the risk is also that lofty profit expectations will ultimately be unmet…A significant market repricing…could impact aggregate wealth and consumption and spill over to broader financial markets"

IMF. World Economic Outlook, October 2025

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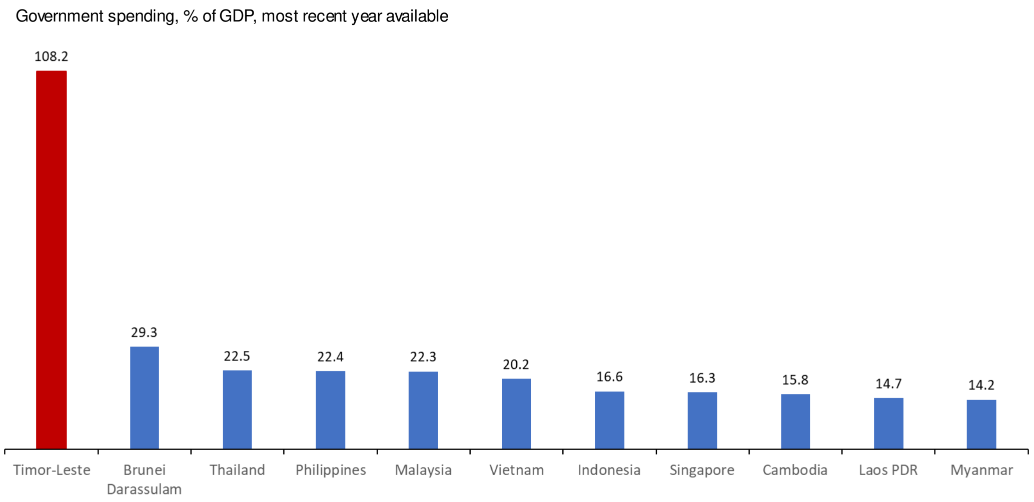
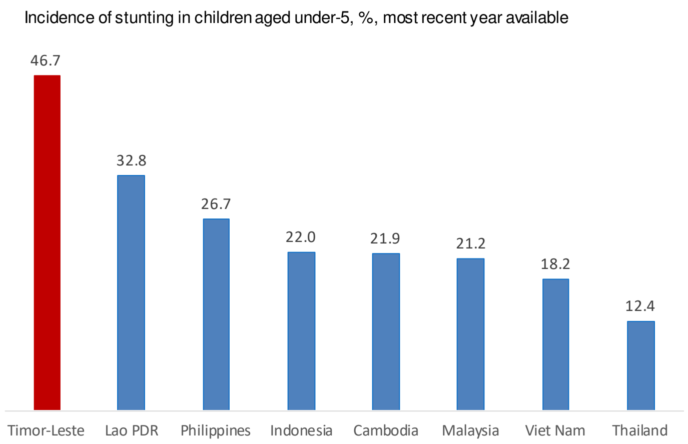
Framing the 2026 State Budget

Public spending in Timor-Leste is far above the other ASEAN member states..



Source: Asian Development Bank, Key Statistical Indicators

..but despite high spending there are still significant unmet needs



Source: World Development Indicators

The need for re-balancing is well understood

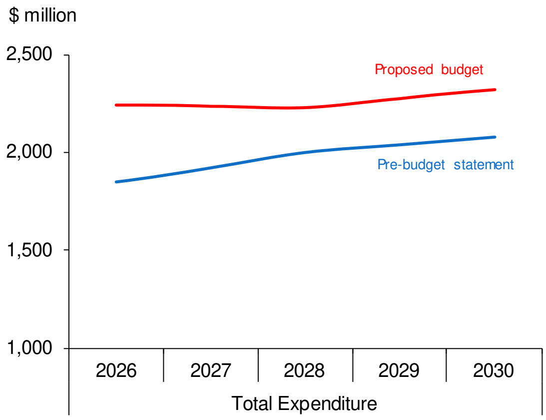
Core challenge
- Rebalance the economy through increased private investment and job creation
- Control public spending and increase domestic revenue collection to ensure sustainability
- Improve the efficiency of public spending to increase impact

Key Economic Targets
- Non-oil GDP growth > 5%
- Private investment growth – 10% per annum
- Domestic revenues – 15% of non-oil GDP by 2028
- Job creation – TBD
- Poverty reduction - TBD

The 2026 State Budget was initially framed as the start of fiscal consolidation..

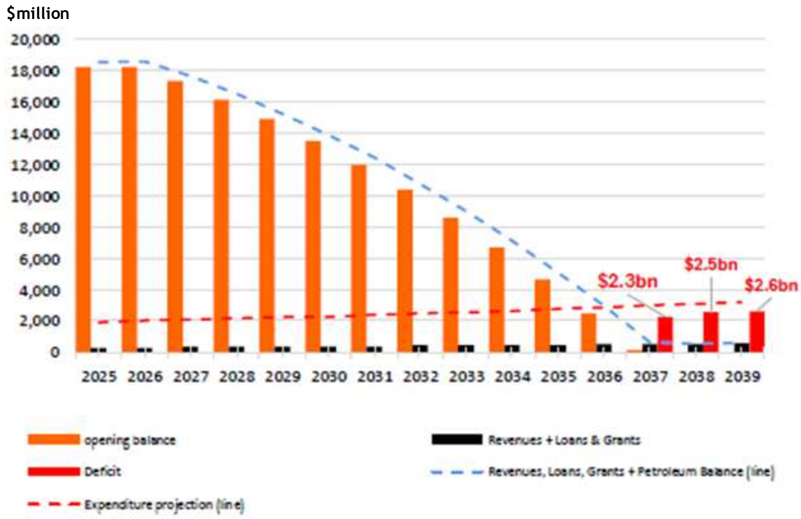
Pre-Budget Statement (PBS)
- Projected **US$1.85 billion**
- Targeted deficit around 40% of GDP
- More conservative allocations, especially for recurrent spending.

Proposed Budget Final 2026
- Approved at US$2.24 billion
- Deficit rises to >50% of GDP
- Raised ceilings for **wage bill, subsidies, and transfers to SOEs**, with limited adjustment on capital investment.



Source: WBG Saff estimates using GoTL data

In the absence of fiscal consolidation, depletion of the Petroleum Fund is now projected for 2037



Source: GoTL. 2026 State Budget, Book 1

What to do?

Successful fiscal adjustment will require consistent focus

1. **Ensure Budget Credibility**
   - Macroeconomic stability
   - Medium term perspective
2. **Improve Budget Efficiency**
   - Allocation
   - Financing
   - Execution
3. **Safeguard Equity & Inclusion**
   - Regional
   - Social groups
   - Generations

In the remainder of this presentation, we offer some initial thoughts on 6 key challenges

1. Ensuring macroeconomic stability
2. Optimizing public sector employment
3. Upgrading infrastructure
4. Catalyzing private investment
5. Optimizing government financing
6. Ensuring equity

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1. Ensuring Macro-economic stability

Budget credibility is crucial for overall development
- Unsustainable fiscal policy: ↑ risks ; ↓ time horizon ; ↓ investment
- Sustainable fiscal policy: ↓ risks; ↑ time horizon; ↑ investment

Current situation
- ESI is no longer effective as a ‘fiscal rule’ – excess withdrawals are essential
- PF projections don’t reflect key prospects – i.e. Greater Sunrise
- Elevated uncertainty - will future revenues from new developments be sufficient?

Key recommendations
- Clear and definitive commitment to maintain macro-economic stability
- Additional measures to ensure credibility
  - Updated fiscal rules – ESI++
  - Clearer analysis / integration of GS and other prospects in the macro-fiscal framework

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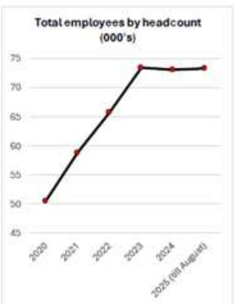
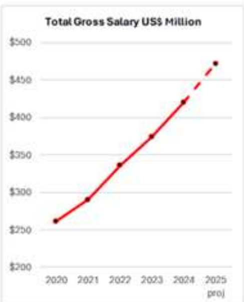
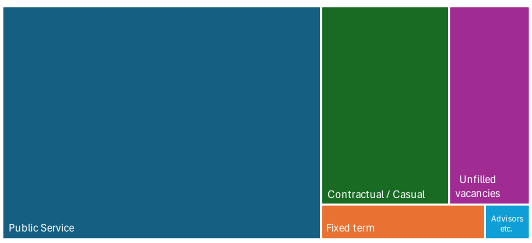
2. A well-designed public service reform is crucial for optimizing public sector employment





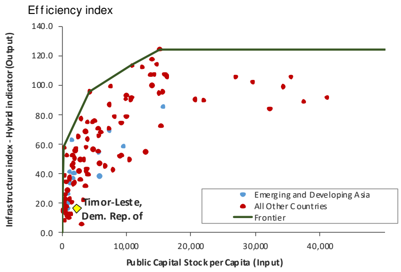


Source: WBG Saff estimates using GoTL data

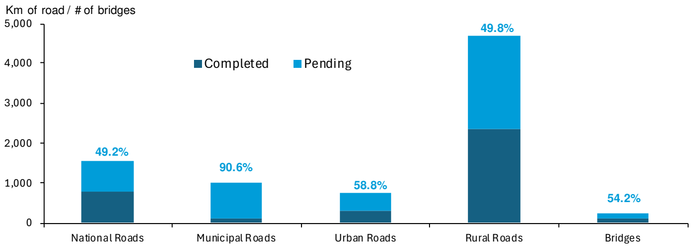
The scale of public employment is unusual
- Public sector employment
  - 52.8% of all formal employment
  - 9.1% of all working age adults
- Contractual / casual staff ~ 20% of total
- Unfilled vacancies ~ 13% of total

A well-designed reform can ↓ costs and ↑ productivity while safeguarding welfare
- Compulsory retirement at 65 years
- Enhanced performance management
- Rationalization of casual / contractual workforce

3. Strengthening public investment management will help to ensure the quality and efficiency of infrastructure development



Source: IMF. 2016. Timor-Leste Public Investment Management Assessment



Source: 2026 State Budget

PIM System reforms can help ↑ efficiency

- Project selection → preparation → procurement → implementation → O&M
- Legal framework & regulations
  - PFM
  - PIM
  - Procurement
- Capacity & system development

TABELA 1: CRONOGRAMA DA MODIFIÇÃO DA REGULAMENTAÇÃO LEGAL DO FUNDO DAS INFRAESTRUTURAS

2011	2014	2015	2016	2024	2025
Lei n. ° 1/2011 **relativa ao Orçamento do Estado – criou FI** Decreto-Lei n. ° 8/2011 – **estabeleceu o Regulamento do FI** Diploma Ministerial n. ° 9/2011 – **aprovou o regulamento interno do CAFI**	**Decreto-Lei n. ° 25/2014 –** *1.° Alteração – ajustou a composição do CAFI com base na nova Estrutura Orgânica do Governo*	**Decreto-Lei n. ° 10/2015 – 2.°** *Alteração - ajustou a composição do CAFI com base na nova Estrutura Orgânica do Governo*	**Lei n. ° 1/2016** *relativa ao Orçamento do Estado – transformou do Fundo Especial numa Agência Autónoma* **Decreto-Lei n. ° 13/2016 –** *estabeleceu o novo regulamento do Fundo*	**Decreto-Lei n. ° 25/2024** *– Primeira alteração ao regulamento do Fundo, incluindo o ajustamento da composição do CAFI e os setores prioritários*	**Decreto-Lei n. ° 21/2025 -** *Segunda alteração ao regulamento do Fundo para bens destinados a dotar as infra-estruturas e também a participação do PM em projectos superiores a 5 milhões de dólares*

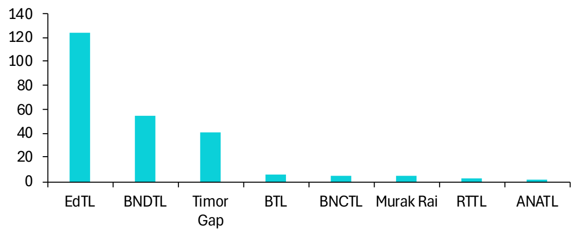
4. Public sector reforms and investments should be designed to 'catalyze' private investment

1. **Focus on high-impact foundational reforms**
   - Modernization of land administration
   - Digital economy and unique ID
   - Business enabling environment – 'Be-Ready'
2. **Ensure that expenditures in productive sectors are implemented in close coordination with the private sector**
   - E.g. tourism marketing;
   - Agriculture value chain development
3. **Apply commercial discipline and rigor to oversight and management of State-Owned enterprises (E.P.s)**
   - Policy objectives
   - Public / community service obligations
   - Corporate governance

State owned enterprises have emerged as a key part of the government's strategy for utilities, extractive industries, and financial services

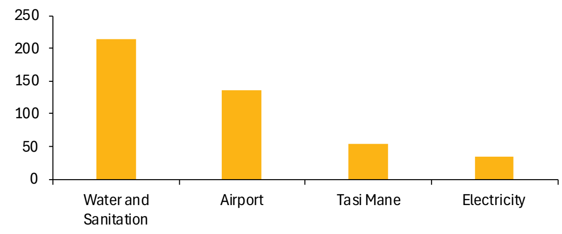
Budgeted transfers to SOEs total $239.7m, (11.5% of non-oil GDP) with an additional $437m (21.0% of non-oil GDP) of contracted investment through the Infrastructure Fund

Transfers, $m



Source: 2026 State Budget

Infrastructure Fund investment, $m



Source: 2026 State Budget

State owned enterprises also own/ manage significant state assets:

- BNCTL – total assets, $883m
- Timor Gap – 56.6% of the Greater Sunrise JV, other PSC shareholdings
- EdTL – Hera and Betano power plants, transmission and distribution system, etc.

An integrated policy framework for SOEs would help to ensure efficient use of resources and crowding-in or private capital

5. Optimizing the Government's financing strategy will enable greater development impact

Timor-Leste has significant financing needs. The Petroleum Fund provides a ready source of funding but developing an integrated financing framework will help increase impact while ensuring sustainability

Key Funding Sources

1. Petroleum Fund withdrawals
2. Domestic resource mobilization – VAT and modernization of the tax administration
3. Official development assistance
4. Concessional borrowing + climate finance
5. Domestic bond issuance
6. Private capital mobilization (PPP)

An integrated financing framework can help to balance the different funding sources and maximize total impact

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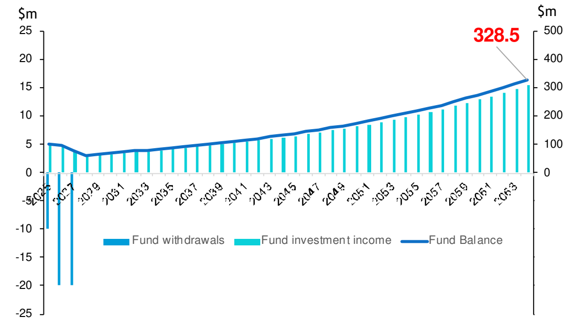
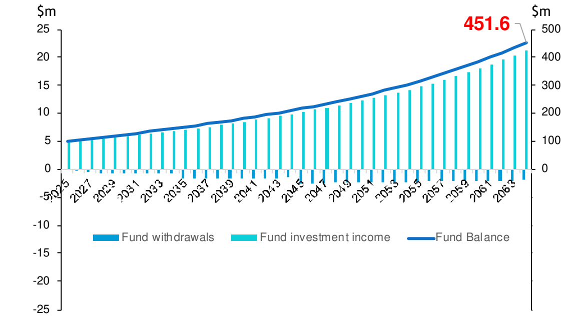
Concessional borrowing can help to preserve the Petroleum Fund through reduced financing costs..

<u>A Simple example of the benefits of concessional borrowing</u>
$50m project implemented over 3 years: $10m, $20m, $20m
Assume 'Fund' has initial balance of $100m
Fund investment return, 4.7%

Scenario 1 - Project funded by PF



Scenario 2 - Project funded by IDA credit, repaid from Fund



At the end of the loan repayment, the Fund balance is 37.5% higher!

..but it's important to ensure that borrowing is managed through a robust framework for debt management

- Ensure that borrowing is aligned to a clear strategy and supported by robust and transparent systems for debt management and reporting
- Prioritize financing sources based on the degree of concessionality and policy alignment / flexibility
- Maintain sustainable debt levels – as per IMF Debt Sustainability Analysis

6. Reforms to ensure fiscal sustainability should be designed and implemented with due consideration to equity

Policy choices in the State Budget have direct impacts on households

- Salaries and wages
- Transfer payments – e.g pensions, social assistance
- Tax collection
- Service provision – infrastructure, health, education, etc.

The 2026 State Budget includes measures to improve targeting and ensure equity. This can be further strengthened by leveraging new data and systems:

- 2022 National Census
- 2024 Living Standards Survey
- 2025 Demographic and Health Survey
- Unique ID project

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A recap of key recommendations

1. **Fiscal framework**
   - Build a strong consensus that macro-economic stability must be maintained
   - Develop updated fiscal rules (ESI++) and strengthen the medium-term fiscal framework

2. Public service reform
- Sustain the commitment to public service reforms, including rationalization of the workforce

3. Public investment management (PIM) reform
- Proceed with implementation of reforms to strengthen public investment management, including policies, regulations, systems, and capabilities.

4. Ensure that government programs and investments catalyze private investment
- Implement foundational reforms – land, business enabling environment, etc.
- Ensure close coordination with private sector
- Strengthen the policy frameworks for state owned enterprises

5. Optimize the financing strategy for the State Budget
- Develop an integrated framework
- Strengthen domestic resource mobilization and leverage concessional loans, climate finance, and private capital

6. Ensure the State Budget promotes equity and inclusion
- Leverage data and systems to guide policy design and improve implementation / delivery

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Thank you!

Obrigado wain!

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