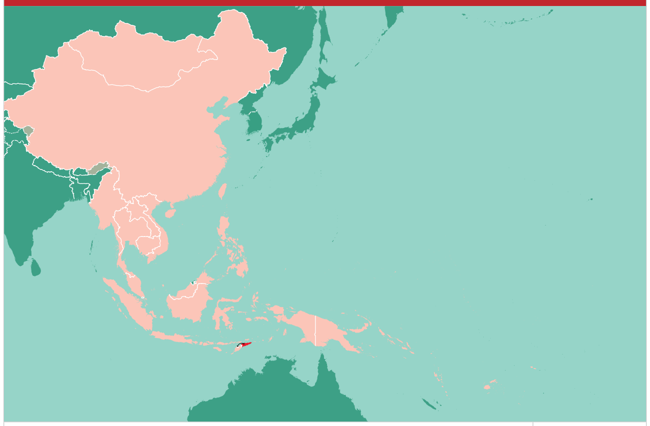
## TIMOR-LESTE



| | 2016 |
|---|---|
| Population, million | 1.3 |
| GDP, current US$ billion | 1.8 |
| GDP per capita, current US$ | 1,458 |
| International poverty rate ($1.9)[a] | 30.3 |
| Basic Needs Poverty Rate[a] | 41.8 |
| School enrolment, primary (% gross)[b] | 136.8 |
| Life expectancy at birth, years[b] | 68.3 |

*Source:* WDI, Macro Poverty Outlook, and official data.
*Notes:* (a) Most recent value (2014), 2011 PPPs. (b) Most recent WDI value (2014).

### Summary

*The current year has seen both Presidential and Parliamentary elections, with a hiatus in public spending growth over the course of the elections. While there are some signs of growth in the private sector, particularly in the non-tradable and tourism sectors, but it remains to be seen whether this growth can be sustained, and may depend on effectiveness of the incoming government's economic program. Growth for 2017 is forecast to be 2.4 percent, on lower government expenditure with the government in caretaker mode over the election period.*

### Recent Developments

Gross domestic product is expected to have grown by 5.7 percent in 2016, but slowed significantly in 2017 to date. Government spending was 20 percent higher over 2016 and government consumption is expected to have grown by 7 percent in real terms. Proxies for private consumption were strong in 2016, with car registrations 8 percent higher, international visitor arrivals 6.6 percent up and consumer imports buoyant. Private consumption is projected to have grown by 4.2 percent in 2016. Investment-related imports such as iron, steel and cement imports were 70 percent higher in 2016, and with government investment sharply higher, total investment growth is projected at 50 percent for 2016. The offshore petroleum sector, not part of GDP presented here, continues to decline with production falling by 8 percent in 2016 and 16 percent further in H1 2017 year-on-year.

While most consumption proxies continued to show strength in 2017—international visitors up 40 percent in Q1 2017 year-on-year, car registrations 12 percent higher—government expenditure has weakened which is expected to drag growth down.

The government budget position has moved from a large surplus in 2014 and previous years to a deficit of 14.7 percent in 2015 and 29.8 percent of non-oil GDP in 2016. Petroleum revenues have declined, with total government receipts falling from 190 percent of GDP in 2014 to 80 percent in 2015 and further to 72 percent in 2016. Over the three years, expenditure has remained around 100 percent of GDP. The balance of the Petroleum Fund stood at US$16.5 billion at end 2014, and by end 2015 has declined to US$16.2bn and further to US$15.8 billion by end 2016. Public debt outstanding is relatively low, at 3.9 percent of GDP, or around US$66 million, at end 2016. In 2016, domestic revenues were slightly stronger than the previous year, at 11.9 percent of non-oil GDP, but now look to have subsided again, with first half 2017 domestic revenues 4 percent lower year-on-year. Government expenditure slowed to date in 2017 and is 12 percent lower in the first half year-on-year. Overall the first-half 2017 government accounts were in surplus of around 36 percent of GDP, although this is likely to deteriorate as expenditure nearly always accelerates rapidly in the second half of the year.

Coffee exports continued to recover in 2016, with export volumes reaching 29,000 tonnes, 20 percent higher than in 2015. Petroleum tax receipts and investment returns have continued to more than offset a large deficit in goods and services trade to produce current account surpluses, although falling petroleum earnings means the surplus is declining, from US$ 1.1. billion in 2015 to a projected US$300 million in 2016.

Annual average CPI continues to be subdued with deflation of 1.3 percent in 2016, but positive inflation of 1.0 in 2017 to July. Recent inflation trends have been largely driven by prices in the tradable sector. While Timor-Leste's REER remains heightened, it depreciated just over 2 percent in 2016 and a further 2 percent in the first half of 2017. Credit to the private sector has been stagnant for the last two years, contracting by 1.8 percent in 2016, with a slight recovery of 2.8 percent Q-on-Q in the first quarter of 2017, with an absence of basic domestic financial frameworks constraining domestic credit growth.

Poverty in Timor-Leste has declined since 2007. The latest survey estimates that the basic needs poverty rate declined from about 50 percent in 2007 to nearly 42 percent in 2014. Measured using the international poverty line (US$1.9/day in 2011 PPP), poverty declined even more rapidly, from 46.8 percent in 2007 to 30.3 percent in 2014. These reductions in monetary poverty have been accompanied by other improvements in living standards, including increased electricity access, dwelling quality and asset ownership.

## Outlook

Growth for 2017 is forecast to be 2.4 percent, on lower government expenditure with the government in caretaker mode over the election period. Based on first-half execution levels, it is unlikely that spending will reach the same level as 2016. Growth is then forecast to pick up, to 4.2 percent in 2018 and 5.0 percent in 2019, although there is significant uncertainty around this forecast, which will be affected by the program of the incoming government.

The outlook for private investment in the coming years looks to be gradually strengthening and there are a small number of sizeable private investment projects underway. Construction commenced in mid-2017 on a new container port, with an initial private investment of US$150m and government contribution of US$129m. Hilton recently announced a partnership with a local company to develop a new 150 room hotel in Dili, with construction already underway. Business and adventure tourism is anticipated to be a source of increased demand in the coming years and also in 2017 Citilink launched a new, price-competitive daily flight service via Bali to Jakarta.

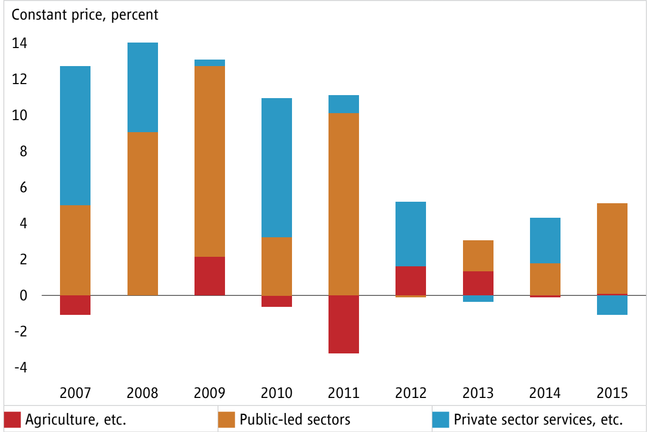
The current account is not forecast to fall into deficit over the forecast period while there continues to be both significant overseas earnings from the Petroleum Fund and further petroleum receipts for the next three years.

## Risks and Challenges

The petroleum fields that have fueled government spending to date are fast-depleting, and the uncertain prospect of new revenues will only offer, at best, temporary respite from the difficult tasks of diversifying the economy and improving public services that are needed in order to bring down the alarmingly high levels of poverty. While some of the conditions for private sector led-growth seem to be improving, the private sector remains very small and to build on the modest gains in private sector development made so far, the government could take a leading role in addressing binding constraints in the public sphere. Major weaknesses exist in the legislative frameworks and institutional capacity in areas of economic property and commercial justice—such as contract enforcement, secure land leasing, national payments systems, and bankruptcy legislation. At the same time, the public sector lacks the basis for domestic revenue mobilization in a post-oil environment, and would need to develop new frameworks, such as the planned value-added tax, in the near-term. It is unlikely that domestic taxation, levied at a level competitive with ASEAN peers and in an efficient manner, would be a significant deterrent to new business development when coupled with a commitment to improving the institutional and operating environment for business.

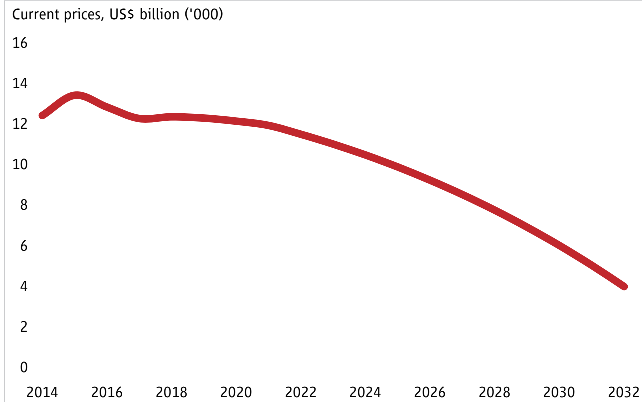
While over 2007 to 2014 there has been noticeable reduction in poverty, consumption inequality has remained largely unchanged within the same period, as presented by the Gini index of 0.28 in 2007 and 0.29 in 2014. This signifies the need for continued efforts in poverty and inequality reduction to continue apace efforts to strengthen overall economic growth.

**Figure 1.** Contributions to real GDP growth




*Sources:* Government of Timor-Leste and World Bank staff estimates.

**Figure 2.** Petroleum Fund wealth per capita




*Sources:* Government of Timor-Leste and World Bank staff estimates.

| **TIMOR-LESTE Selected Indicators** | *2014* | *2015* | *2016e* | *2017f* | *2018f* | *2019f* |
|---|---|---|---|---|---|---|
| Real GDP growth, at constant market prices | 4.2 | 4.0 | 5.7 | 2.4 | 4.2 | 5.0 |
| Private Consumption | 5.6 | 1.6 | 4.2 | 2.9 | 5.1 | 4.3 |
| Government Consumption | 12.3 | 3.7 | 7.4 | -5.6 | -0.1 | 2.9 |
| Gross Fixed Capital Investment | 6.1 | -4.1 | 39.2 | -38.6 | 34.4 | 8.8 |
| Exports, Goods and Services | -20.1 | -5.3 | 16.3 | 16.0 | 15.4 | 20.0 |
| Imports, Goods and Services | 11.5 | -4.8 | 25.0 | -29.2 | 18.8 | 5.9 |
| Real GDP growth, at constant factor prices | 4.4 | 6.0 | 5.3 | 2.2 | 4.2 | 5.0 |
| Agriculture | -0.5 | 0.3 | 0.0 | 0.5 | 0.6 | 0.8 |
| Industry | -9.9 | 24.4 | 14.8 | -6.6 | 4.5 | 3.0 |
| Services | 10.3 | 3.1 | 4.0 | 5.6 | 5.0 | 6.6 |
| Inflation (Consumer Price Index) | 0.7 | 0.6 | -1.3 | 0.8 | 1.5 | 2.5 |
| Current Account Balance (% of GDP) | 137.7 | 67.7 | 12.8 | 44.5 | 35.6 | 21.4 |
| Fiscal Balance (% of GDP) | 78.1 | -14.7 | -29.9 | -12.1 | -20.7 | -23.3 |
| Debt (% of GDP) | 2.0 | 4.6 | 5.7 | 7.5 | 9.6 | 12.8 |
| Primary Balance (% of GDP) | 78.1 | -14.7 | -29.9 | -12.1 | -20.7 | -23.3 |

*Sources:* World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
*Notes:* e = estimate, f = forecast.