TIMOR-LESTE

Table 1	2023
Population, million	1.4
GDP, current US$ billion	1.7
GDP per capita, current US$	1275.8
International poverty rate ($2.15)[a]	24.4
Lower middle-income poverty rate ($3.65)[a]	69.2
Gini index[a]	28.7
School enrollment, primary (% gross)[b]	110.7
Life expectancy at birth, years[b]	67.7
Total GHG emissions (mtCO2e)	5.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2014), 2017 PPPs.
b/ WDI for School enrollment (2020); Life expectancy (2021).

The economy continues to recover following the pandemic and Cyclone Seroja. Growth decelerated to an estimated 2.1 percent of GDP in 2023 due to election-related fiscal drag. Inflation peaked at 9.0 percent (y/y) in November 2023 but has since declined. Medium-term growth is expected to reach 4.0 percent, supported largely by increased government infrastructure spending. Downside risks include escalated global commodity prices of food and energy.

Key conditions and challenges

Despite development gains since independence, Timor-Leste remains a fragile post-conflict country grappling with economic challenges stemming from its size and geographical location. An institutional framework for macroeconomic management, supported by the Petroleum Fund (PF), the country's sovereign wealth fund, has facilitated major infrastructure improvements. Advances in basic healthcare access and school enrollment rates have also materialized. However, low and volatile economic growth persists, hindering progress in development outcomes and poverty reduction.

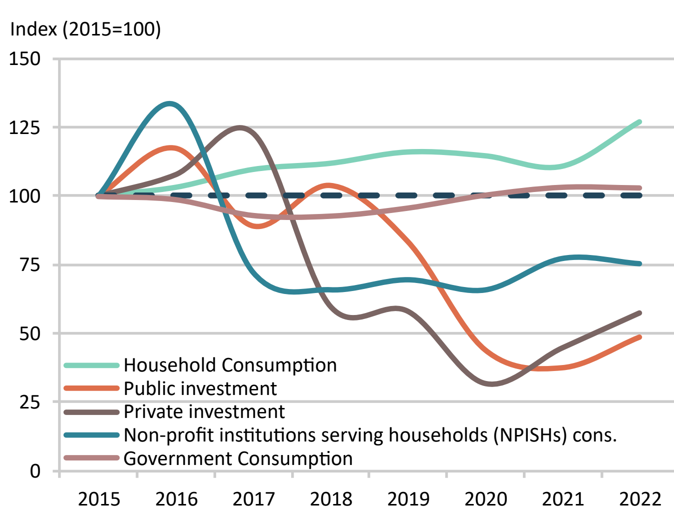
Fragility is exacerbated by a lack of economic diversification and significant fiscal and external imbalances. The economy heavily relies on the public sector, benefiting primarily certain public-sector-linked service sectors such as construction. Diversifying the economy has been a perennial goal of the government, but progress has been hindered by a lack of enabling factors, including unreliable electricity and access to finance. Ample bank liquidity has not been channeled to the real sector, with the loan-to-deposit ratio remaining low. Challenges in assessing borrower risk and the absence of a robust legal framework persist as structural impediments to access to finance. Oil and gas production ended in 2023, leaving coffee as the main commodity export. Tourism-driven services account for less than 4 percent of total exports. In contrast, a lack of domestic production necessitates imports to meet domestic consumption, resulting in susceptibility to commodity price volatility.

Timor-Leste is facing a fiscal cliff. Government spending reached 87 percent of GDP in 2023, among the highest globally, while non-oil-related revenue stood at merely 14.1 percent of GDP. To bridge the resulting large budget gap, Timor-Leste is drawing down on its diminishing Petroleum Fund. The balance of the Fund stood at 18.2 billion by the end of 2023 (10.6 times of GDP). However, due to the cessation of oil and gas production, the revenues of the Petroleum Fund are outweighed by the annual withdrawals needed to finance the budget. Official estimates predict that the Petroleum Fund will be depleted by 2034. The government must urgently identify alternative sources to replace the rapidly declining revenues from the oil and gas sector. Alternatively, significant spending cuts are inevitable, leading to a sharp decrease in public service provision.

Recent developments

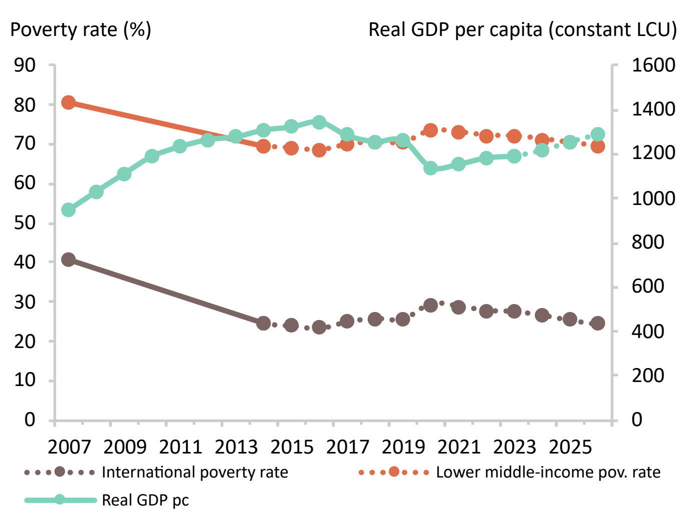
Following the pandemic-induced decline of 8.3 percent in 2020, the non-oil economy expanded by 2.9 percent and 4.0 percent in 2021 and 2022, respectively. Despite the gains, economic output has not returned to its pre-pandemic levels. Amidst challenges in budget implementation, attributable to electoral processes, fiscal drag resulted in a

FIGURE 1 Timor-Leste / Public and private investment are still below the 2015 level.



Source: Timor-Leste Ministry of Finance.

FIGURE 2 Timor-Leste / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

deceleration of growth in the non-oil economy to an estimated 2.1 percent in 2023. Nevertheless, the post-pandemic recovery has been driven by consumption. Public and private investment levels remain below their 2015 peak, constraining future output potential and productivity.

Consumer price inflation remained high, averaging 8.4 percent during 2023, driven by escalating prices of food, non-alcoholic beverages, alcohol, and tobacco. Price pressures were contained by an appreciation of the US Dollar, legal tender in Timor-Leste.

The government has set an ambitious target of creating 50,000 jobs over the next five years. However, the lack of economic dynamism has hindered job creation for the rapidly expanding workforce. Labor force participation has stagnated at approximately 30.6 percent in the past decade. Labor productivity has decreased, and employment is increasingly concentrated in sectors with the lowest labor productivity.

The 2023 budget was revised down by 12 percent to improve budget execution and align with the new government's objectives. Expenditures, excluding wages and salaries, were cut, with capital spending seeing the largest reduction. As of December 2023, 87 percent of the rectified budget was executed. The fiscal deficit is estimated to have declined to 44.4 percent of GDP from close to 60 percent in 2022.

The impact of recent developments on poverty reduction remains uncertain due to the absence of updated data. Between 2007 and 2014, poverty dropped from 50.4 percent to 41.8 percent. When assessed using an internationally comparable poverty line of US$2.15 per person per day (2017 PPP), the decline is even starker, with poverty rates dropping from 40.9 percent in 2007 to 24.4 percent in 2014. A new Living Standards Survey is planned for 2024.

Outlook

Economic growth is projected to average 4.1 percent in 2024 and 2025. The government's focus on capital expenditure and infrastructure investment, increasing the budget from 18.4 percent of GDP in 2023 to 24.5 percent of GDP in 2024, is likely to drive growth. However, export growth may face constraints, largely due to the dependence on coffee as the primary export commodity.

Inflation is projected to ease in 2024, driven by a moderation in global commodity prices. Reduced inflation rates in Timor-Leste's trading partners are expected to lessen the impact of imported inflation.

The fiscal deficit is expected to hover around 45 percent of GDP over the medium term. The budget shortfall is being covered through withdrawals from the rapidly declining Petroleum Fund.

The outlook is subject to several downside risks. Slow global growth may negatively affect the returns of the Petroleum Fund. Extreme weather events, notably those associated with El Niño, could disrupt rice availability and imports. Additionally, high energy prices are likely to increase transportation and electricity costs domestically.

Reaching the government's target of 5 percent annual economic growth will depend on policies that support a sustainable, diversified economy. As such, strong contributions of private consumption and investment are crucial. The success of the private sector, in turn, depends on policies that foster an environment conducive to dynamism and expansion.

TABLE 2 Timor-Leste / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	2.9	4.0	2.1	3.6	4.5	4.0
Private consumption	-2.7	14.0	3.0	4.0	5.0	5.5
Government consumption	2.9	-0.2	3.1	2.4	2.4	1.4
Gross fixed capital investment	-6.1	29.4	10.8	10.6	10.7	9.3
Exports, goods and services	79.3	30.3	1.0	2.0	2.0	2.0
Imports, goods and services	-9.0	22.8	5.5	5.0	5.0	5.0
Real GDP growth, at constant factor prices	3.9	3.8	2.1	3.6	4.5	4.0
Agriculture	5.5	5.4	2.9	2.9	2.9	2.9
Industry	-14.0	38.2	2.4	2.4	2.4	2.4
Services	4.0	2.6	1.9	3.9	5.0	4.3
Inflation (consumer price index)	3.8	7.0	8.4	3.3	2.8	2.5
Current account balance (% of GDP)	2.8	-17.0	-20.4	-41.7	-42.8	-45.1
Net foreign direct investment inflow (% of GDP)	-4.3	-4.1	1.7	1.7	1.6	1.6
Fiscal balance (% of GDP)[a]	-47.0	-60.7	-44.0	-43.1	-45.6	-47.6
Revenues (% of GDP)	45.5	43.4	42.2	40.7	39.0	37.5
Debt (% of GDP)	15.2	15.2	18.3	19.4	19.7	22.0
Primary balance (% of GDP)	-46.8	-60.5	-44.0	-43.1	-45.5	-47.6
International poverty rate ($2.15 in 2017 PPP)[b,c]	28.8	27.8	27.5	26.6	25.4	24.4
Lower middle-income poverty rate ($3.65 in 2017 PPP)[b,c]	72.9	72.1	71.9	71.2	70.2	69.4
GHG emissions growth (mtCO2e)	-3.3	-2.8	-2.7	-2.4	-2.1	-5.0
Energy related GHG emissions (% of total)	7.9	8.4	9.0	9.6	10.3	11.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ The ESI is part of total revenue, while excess withdrawals from the PF is a financing item.
b/ Calculations based on EAPPOV harmonization, using 2007-TLSLS and 2014-TLSLS. Actual data: 2014. Nowcast: 2015-2023. Forecasts are from 2024 to 2026.
c/ Projection using annualized elasticity (2007-2014) with pass-through = 1 based on GDP per capita in constant LCU.