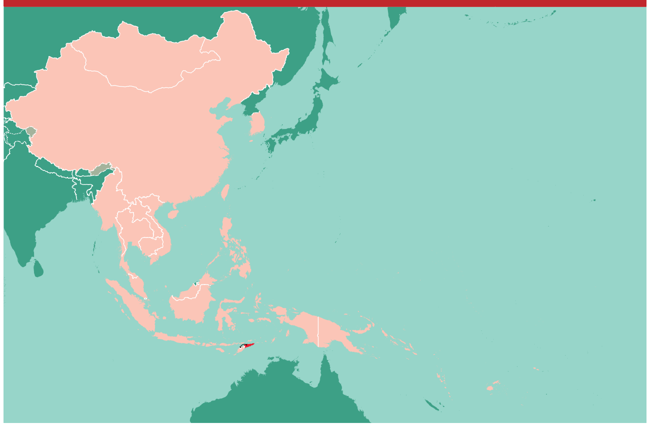
TIMOR-LESTE



	2012
Population, mn [1/]	1.1
GDP, US$, bn [2/]	1.3
GDP per Capita, US$	1,058
GDP per Capita, US$ PPP	2,076
Life expectancy (2012)	62.5

Sources: World Development Indicators; Timor-Leste Ministry of Finance.
Notes: 1/ 2012. 2/ 2012. Non-oil. 3/ Gross school enrollment, primary, 2011.

Timor-Leste's economy remains heavily dependent on petroleum. *The FY15 budget is US$1.57 billion, just US$70 million higher than FY14, but with higher recurrent spending and lower capital spending, and higher medium term spending plans than FY14. The government has lowered medium term growth forecasts. Estimates of petroleum production from current fields have been reduced, which lowers estimates of petroleum wealth and the sustainable income from that wealth. However, the Petroleum Fund passed US$16.5billion in December 2014. Headline inflation dropped in 2014.*

Recent developments

In May 2014, the government released 2012 GDP numbers, and revised upwards the 2011 non-oil real GDP growth from 12.1 percent to 14.7 percent, as adjustments were made to deflators in the construction sector. In 2012 non-oil GDP growth nearly halved to 7.8 percent, confirming the sensitivity of growth to slowing public spending and slow growth in private activity. The 2013 and 2014 estimates for non-oil GDP growth have similarly been reduced from 8 percent and 8.8 percent respectively, to 5.6 percent and 7.1 percent. The steep increase in 2014 budget execution resulting in a 27 percent nominal increase in public spending between 2013 and 2014, may improve the final 2014 growth outturn. Other upside factors include growing vehicle ownership, which by Q3 2014 was 63 percent higher than the total for 2013, driven largely by heavy vehicles. Household electricity consumption also grew in 2014. Credit to the private sector grew 1.7 percent in Q4, after two consecutive drops in previous quarters, albeit still from a low level of 11 percent of GDP, relative to the region.

The good and services trade deficit widened by 11 percent relative to 2013 to 59 percent of non-oil GDP. The Petroleum Fund, Timor-Leste's Sovereign Wealth Fund, reached a value of US$16.5 billion at the end of 2014, 11 times the estimated 2014 non-oil GDP, and together with official Central Bank reserves capable of covering up to 200 months of imports.

Inflation remained low in 2014, at an average of 0.4 percent year-on-year following a dramatic drop in Q4 2013 from 12 percent year on year. Food items dominate the CPI basket (now 64 percent). Slower public spending, and hence domestic demand pressures, and lower oil prices may also have contributed.

Prime Minister Kay Rala Xanana Gusmao resigned from his post in the first week of February 2015. Dr. Rui Araujo, a leading member of the opposition Fretilin party and a former Deputy Prime Minister and Health Minister, replaced him. The government has been reduced from 55 members to 38, and includes Xanana Gusmao as minister for a new Ministry of Development Planning and Strategic Investment.

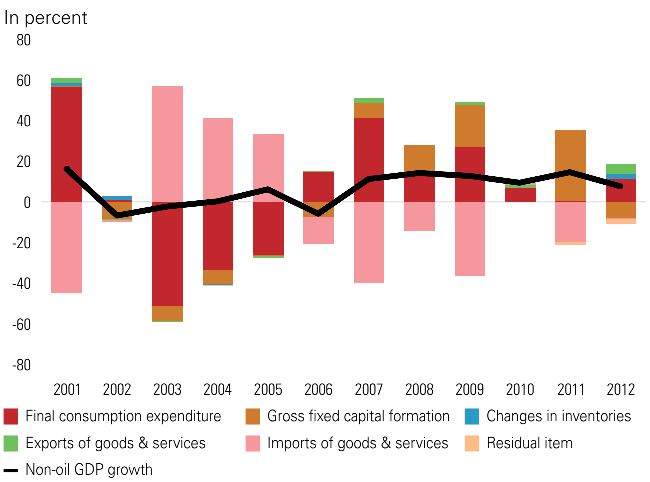
Outlook

Global oil prices and domestic oil production, public spending, and the timing of a private sector pick-up dominate the outlook for Timor-Leste—one of the World's most petroleum dependent economies. In 2014, petroleum represented 99 percent of Timor-

Leste's export earnings, 93 percent of its fiscal revenue, and 80 percent of its overall GDP, and financed 85 percent of the budget. However, the impact of the recent collapse in oil prices is dampened by the fact that the government uses conservative estimates for oil production and prices in fiscal and economic forecasts; roughly 70 percent of petroleum in fields currently under production have already been exploited; and the off-shore Petroleum Fund and associated fiscal rule provide a buffer against volatile petroleum revenues.

While impacts on total GDP will be significant as the value of oil production and income falls, there is little impact on non-oil GDP. The new government decided not to use post-reshuffle rectification budget to cut planned spending, a significant determinant of aggregate demand, to align with lower ESI. As a rule of thumb, ESI may fall by roughly US$20 million for each permanent US$10 dollar reduction in global oil price. The current fall in prices could lower ESI by an amount equivalent to the Education recurrent budget, or three times the agriculture budget. The fall in the cost of imported diesel fuel for publicly provided electricity, currently 7 percent of the state budget, may partially offset the fall in ESI.

Figure 1. Contributions to annual GDP growth



Source: World Bank.

The 2015 estimate for non-oil GDP growth has been reduced from 9.4 to 7 percent as prospects for a pick-up in the private sector remain uncertain. A new investment law under preparation could accelerate investor friendly policies.

Petroleum fields currently under development are expected to end by 2021. Prospects for the rapid development of the Greater Sunrise oil and gas field remain uncertain, with the recent fall in oil prices being factored in to development options.

An ongoing nationwide household living standards survey is expected to provide an estimate of poverty in 2015, comparable with the incidence measured in 2007.

Challenges

The main challenge remains translating public spending into long-term private sector driven growth and improved living standards. Investment in human capital remains critical, alongside careful selection of physical infrastructure projects, at the right scale, and with adequate maintenance.

Fiscal sustainability remains a challenge. The FY15 budget is 20 percent larger than the fiscal envelope and spending is forecast to peak at US$1.99 billion in 2017. More of the budgets are being executed—increasing from 66 percent in 2013 to 90 percent in 2014. The share of recurrent spending is increasing driven in 2015 by a 21 percent planned increase in transfers for social assistance programs. At the same time growth in domestic revenues will slow to 2.5 percent in 2015. Withdrawals in excess of ESI will be required to finance not just capital spending, but also recurrent spending. A mix of tax policy and administration measures are urgently required. A VAT is being considered.

The FY15 budget transfers US$81.9 million to a new Administrative Authority for Oecusse as a Special Zone for Social Market Economy, established by law in July 2014. Development plans for the 65,000 inhabitants now include agriculture and agro-forestry. Systems for spending the appropriated budget are being finalized.

Timor-Leste / Macro Poverty Outlook Indicators

	2012	2013	2014	2015 e	2016 f
Real gross domestic product	-10.4	-10.7	-10.2	10.3	-1.1
Exports, goods & services	33	16	13	30	37
Imports, goods & services	672	843	934	800	867
CPI Inflation , period average	11.8	11.3	0.4	4.0	3.7
Current account balance, % of GDP	2,668	2,224	1,090	1,445	1,499