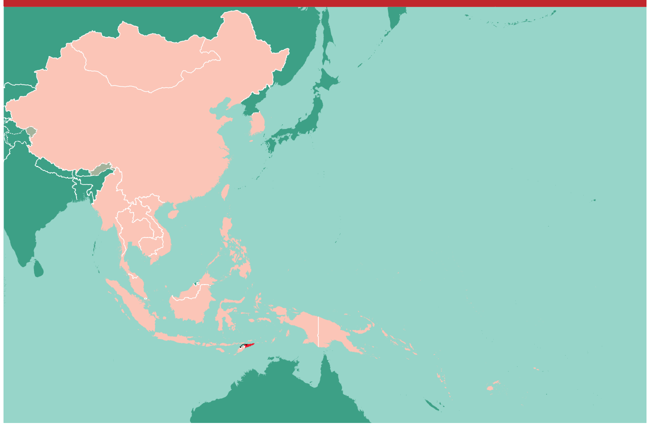
TIMOR-LESTE



	2014
Population, million	1.2
GDP, US$ billion	1.4
GDP per capita, current US$	1,170
Life expectancy /1	68
School enrollment rate, net primary /2	91

Source: National authorities; World Bank estimates.
1/ Data as of 2013.
2/ Data as of 2011.

Summary

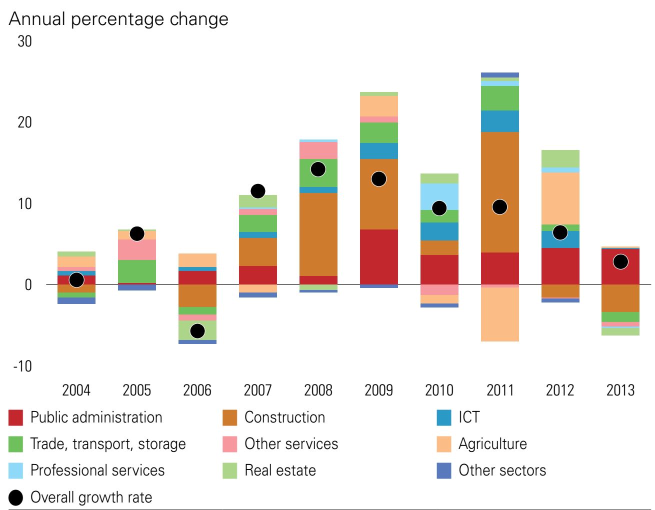
Economic growth dropped in 2013 due to a weakening in petroleum markets and associated lower government expenditure, although it likely rebounded in 2014. Timor-Leste's Petroleum Fund is doing its job of buffering the budget and, through that, the nonoil economy, from the recent volatility in oil prices. But the government will nevertheless need to carefully balance competing development priorities in light of tighter fiscal constraints.

Recent developments

Economic growth from the oil sector has been hit by declining international prices, with double-digit growth in 2011 falling to 5 percent over 2012, and a decline in 2013 of 18.7 percent. Growth in the nonoil sector has also been decreasing, from 9.5 percent in 2011 to 6.4 percent in 2012 and to just 2.8 percent in 2013. The decline in nonoil growth reflects its sensitivity to public spending growth, which fell by 10 percent in 2013. GDP estimates are not yet available for 2014, but GDP is likely to rebound given a strong increase in government-led investment.

Consumer price inflation, which had been running at above 10 percent in 2012 and 2013, dropped precipitously in 2014 to just 0.4 percent on average as a stronger dollar brought down prices of imported goods, especially foodstuffs, alcohol, and tobacco. Refinements to the weights of the CPI series have also led to some volatility in the estimates.

Figure 1. Industry contributions to non-oil real GDP growth



Source: Ministry of Finance.

The approved 2015 Government Budget of US$1.57 billion marked a continued expansionary fiscal policy, 5 percent higher than the 2014 Budget and 20 percent higher than the ceiling that was initially set for the 2015 Budget. The 2015 Budget reflects an adjustment toward recurrent spending—11 percent higher—while capital spending was 22 percent lower. The Rectification Budget following a Cabinet reshuffle part way through 2015 maintained the same level of budget expenditure, despite a dramatic fall in oil prices. As a result, growth in the Petroleum Fund is on course to fall below the estimated sustainable income for the first time since petroleum exports came on stream.

Poor execution hampered government expenditure plans in 2012 and 2013. An execution rate of

66 percent in 2013 meant that actual expenditure declined by 10 percent year-on-year, but execution improved sharply in 2014 to almost 90 percent and, as a result, actual expenditure in 2014 rebounded by 24 percent. Compared to 2012 and 2013, when less than half of budgeted capital works were completed, the equivalent figure in 2014 was 88 percent. This improvement was related to an amendment to the Budget Law that relaxed certain payment procedures passed late in 2014. Indications for 2015 are that execution rates are now improving year-round, with execution rates to May 2015 double what they were at the same time the year before.

Petroleum production is a nonresident activity so is not considered part of exports. The trade deficit in goods and services widened by 20 percent to US$1.34 billion in 2014, due for the most part to an increase in imports driven by a growing public works program.

The Petroleum Fund, Timor-Leste's sovereign wealth fund, reached a value of US$16.86 billion at end-June 2015, more than 10 times nonoil GDP. After growing rapidly in previous years, balances in the Petroleum Fund have been largely static for a year (a small increase from US$16.6 billion in June 2014) due to the anticipated slowdown in petroleum production from current fields, low oil prices, and persistently high levels of withdrawals to fund the government budget. The Central Bank also holds substantial foreign reserves, enough to cover hundreds of months of imports.

Timor-Leste uses the US dollar as its official currency. The real effective exchange rate (REER) has appreciated since 2013 due to an appreciation of the US dollar. However, the appreciation of the REER has slowed as inflation has fallen in Timor-Leste.

Outlook

Global oil prices, domestic oil production, and public spending dominate the outlook for Timor-Leste, one of the world's most petroleum-dependent economies. The government budget is the main linkage between the domestic economy and the much larger petroleum sector (which constitutes 80 percent of GDP). Petroleum revenues dominate public finances—comprising 93 percent of total government revenues. The contractionary impacts of recent falls in oil prices will mean that public spending is likely to need to remain at currently targeted levels or drop slightly if the Petroleum Fund is to be preserved. Growth is expected to remain lower than seen in previous years as government expenditure plateaus.

Challenges

Fiscal sustainability continues to present a challenge. Estimated sustainable income from the Petroleum Fund is currently projected at US$639 million, which, combined with domestic revenue, allows for approximately US$800 million of government expenditure each year that could be maintained for future generations. The 2015 budget was 20 percent higher than the budget ceiling of US$1.3 billion set to be consistent with a sustainable fiscal path. The 2016 budget ceiling has been set at the same level, with an indicative ceiling in 2017 of US$1.2 billion, which indicates the downward moderation in public expenditure that is still required to maintain sustainable Petroleum Fund asset levels in light of lower oil prices.

Timor-Leste has experienced high rates of growth and has a middle-income level of economic activity, yet a large proportion of the population still lives in extreme poverty and lacks the basics to seek a better life. Only half of the children aged 5 to 7 are enrolled in school, much of the population lack basic literacy, and almost half of the children are stunted due to poor nutrition. While Timor-Leste's domestic economy has grown at more than 10 percent a year for the last 8 years, two-thirds of people still work in the very low-productivity agricultural sector. The challenge remains to make use of limited fiscal resources to prioritize interventions that will support increased access for the poorest to the human and physical capital essential to move into more productive sectors or to improve their livelihoods in agriculture.

Timor-Leste Selected Indicators

Annual percentage change, unless stated	2013	2014	2015	2016	2017
Real gross domestic product (non-oil)	2.8	7.0	6.8	6.9	7.0
Exports, goods & services, US$ million	61.0	89.5	89.0	105.0	126.0
Imports, goods & services, US$ million	1,409	1,280	1,307	1,379	1,439
CPI inflation (average, %)	11.3	0.4	4.0	3.7	3.9
Current account balance (% of GDP)	49.1	24.0	30.2	32.2	28.1
Fiscal balance (% of GDP)	40.3	23.9	13.8	17.1	11.7

Sources: Statistics Time Leste; Timor Leste Ministry of Finance; Banco Central Timor Leste; World Bank staff estimates.