



TIMOR-LESTE

2017

Population, million	1.3
GDP, current US\$ billion	1.6
GDP per capita, current US\$	1,249
School enrolment, primary (% gross) ^a	109.5
Life expectancy at birth, years ^a	68.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes: a. Most recent WDI value (2016).

Summary

A sharp decline in public spending weakened economic activity in 2017 and is also affecting 2018. This ‘forced’ fiscal consolidation resulted from a year-long political deadlock that was eventually resolved by mid-2018. With capital spending declining by 57 percent, resilient private consumption and lower imports probably averted a larger economic contraction. The outlook for 2018 remains subdued, but economic activity is expected to pick up in 2019—under a scenario of political stability. Fiscal sustainability and spending efficiency remain key concerns.

Recent Developments

A political stalemate severely constrained public spending—which fell by 25 percent in 2017—mainly through delayed capital investments. This was due to a combination of factors: the 2017 budget was more conservative than the previous budget—in anticipation of mid-year elections—while the ensuing (minority)

government was unable to pass a budget rectification or obtain parliamentary approval for additional Petroleum Fund withdrawals. With a scarce resource envelope, public spending was severely hampered. Since the public sector has a large weight in the economy—accounting for over half of total domestic expenditure—GDP is estimated to have contracted by 4.7 percent. Private consumption was supported by public sector wage growth and social transfer programs, both critical for sustaining household incomes. Imports declined by 7 percent, owing to lower demand for goods and services linked to large public infrastructure projects. Construction, commerce and public services were likely the most affected sectors. Although bank credit to the construction sector grew strongly in late 2017, this was probably due to companies trying to offset government payment delays. Capital spending declined by 57 percent in 2017 with major road projects being delayed. Wages & salaries was the only budget item to increase (by over 10 percent) as civil service salary scales were revised for the first time in several years. Government expenditure remained significantly constrained until now. Petroleum revenues increased considerably, as Petroleum Fund investment returns benefited from a bullish international stock market in 2017—though unlikely to be repeated this year. Paradoxically, this did not prevent the largest expenditure contraction in Timor-Leste’s history—since parliamentary approval is required to transfer petroleum revenues to the state budget. Domestic tax revenues declined by about 8 percent in 2017, mainly due to lower withholding tax receipts from public infrastructure projects, and are declining further in 2018. Domestic resource mobilization remains weak, with a tax-to-GDP ratio below 12 percent. The overall balance improved due to the ‘forced’ fiscal consolidation. Consumer price inflation increased but remains low at 2.6 percent in the second quarter of 2018 (year-on-year) due to a combination of food, tobacco and education price increases. Because food has a large weight in the consumption basket and much of it is imported, international food prices and exchange rates have a strong impact on overall domestic inflation. Credit to the private sector grew substantially in 2017, likely because businesses dependent on government contracts faced severe cashflow problems. Credit growth

collapsed in the first half of 2018, predominantly due to lower individual borrowing. A declining loan-to-deposit ratio and evidence of excess liquidity in the banking sector suggest that financial intermediation remains weak. The recently approved government program envisages the establishment of a state-owned development bank (BDTL) to enhance access to credit. The current account improved in 2017, as income from the Joint Petroleum Development Area (JPDA) increased and total imports declined. Non-oil exports remain small—below \$60 million—with coffee and travel services accounting for most export earnings. (Oil proceeds are not accounted as exports but rather as primary income in the balance of payments.) Portfolio investment has dwindled through time as large outflows—mainly relating to Petroleum Fund investments abroad—turned into inflows (divestment), which has financed the current account deficit to a significant extent. Foreign direct investment is relatively small and has declined in recent years. Improving the business environment will be critical to attract foreign investors in strategic economic sectors, such as tourism. Despite the economic downturn, poverty levels are unlikely to have changed significantly. Household consumption was sustained by ringfenced social transfer programs and public wage increases—the latter accounting for a considerable proportion of total wage employment.

Outlook

The economic outlook for 2018 remains uncertain, partly hinging on the execution of the state budget and consumer confidence. The large expenditure increases planned for the last four months of the year present a significant challenge. Moreover, some funds will be used to settle previous financial commitments for activities already undertaken (expenditure arrears). GDP is forecast to grow by 0.8 percent in 2018. In the medium-term, economic growth is anticipated to recover by 2019. Expenditures will reach pre-crisis levels by 2019 and moderate in 2020 due to the expected conclusion of key capital projects—mostly relating to roads. Nonetheless, new projects might be brought into the pipeline, especially if the policy of

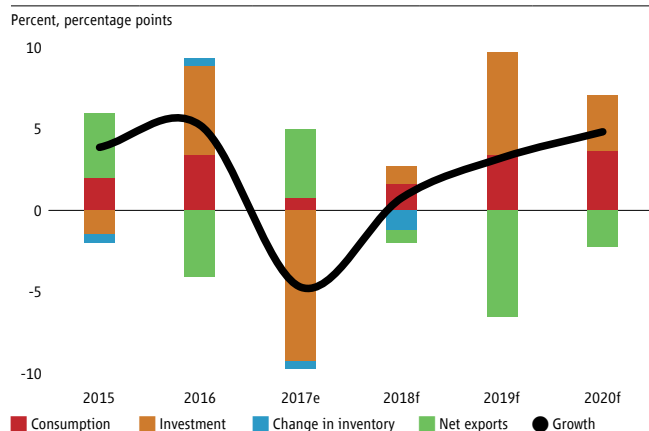
frontloading strategic capital investments continues. Growth is forecast to accelerate to 3.3 percent in 2019 and 4.9 percent in 2020. This rebound would be underpinned by stronger public and foreign investments, as well as renewed consumer and business confidence—which would also support credit growth. Inflation is expected to remain below the Strategic Development Plan's target range—4 to 6 percent—given the strength of the US dollar and expected stable food prices. Current account deficits are likely to be financed by additional Petroleum Fund divestments. Poverty trends are difficult to forecast due to the lack of recent data.

Risks and Challenges

Fiscal sustainability and the quality of public spending remain a key concern. Offshore petroleum production from the remaining field in JPDA is expected to cease by 2023, while the prospective Greater Sunrise Liquefied Natural Gas development is unlikely to be fully operational in the next decade. Meanwhile, systematic excess withdrawals are depleting the Petroleum Fund through a strategy of expenditure frontloading. Limiting withdrawals to the Estimated Sustainable Income (ESI) and improving domestic resource mobilization would simultaneously support fiscal sustainability, spending efficiency and accountability. These improvements would be critical to further reduce poverty.

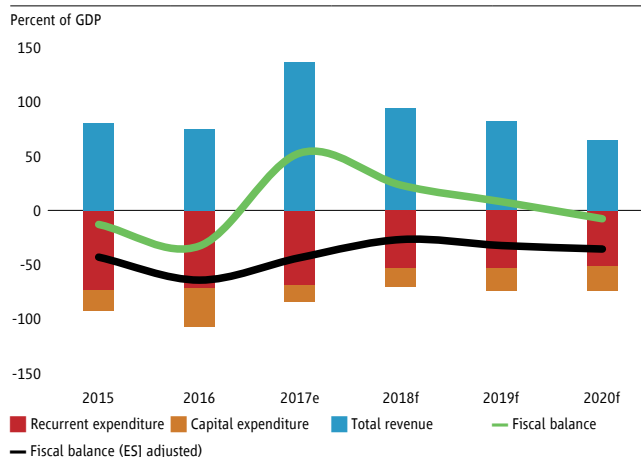
The domestic political situation may pose the greatest (short-term) risk to the economy. Stability within the government coalition is a prerequisite for a smooth and effectual implementation of the government program, while potential frictions could lead to further political and economic instability. A productive relationship between the President and the new government is also of vital importance. Approval of the 2019 budget will be critical for a new period of stability.

Figure 1. Real growth and contributions to real GDP growth



Sources: Ministry of Finance and World Bank staff estimates.

Figure 2. Fiscal aggregates



Sources: Ministry of Finance and World Bank staff estimates.

TIMOR-LESTE Selected Indicators	2015	2016	2017e	2018f	2019f	2020f
Real GDP growth, at constant market prices	4.0	5.3	-4.7	0.8	3.3	4.9
Private Consumption	0.2	6.0	4.8	1.9	4.4	4.7
Government Consumption	3.2	-0.2	-3.8	0.7	1.0	1.0
Gross Fixed Capital Investment	-3.6	16.0	-23.8	3.9	19.9	9.4
Exports, Goods and Services	-29.2	15.2	-2.2	7.1	13.2	15.6
Imports, Goods and Services	-8.4	8.1	-7.4	1.8	12.3	4.7
Real GDP growth, at constant factor prices	5.8	4.9	-4.6	0.8	3.2	4.9
Agriculture	-4.3	3.0	-1.0	1.1	1.2	1.2
Industry	22.2	7.6	-5.0	0.6	4.6	4.8
Services	4.7	4.7	-5.5	0.8	3.4	6.0
Inflation (Consumer Price Index)	0.6	-1.3	0.6	1.2	2.5	3.3
Net Foreign Direct Investment (% of GDP)	1.9	-0.4	0.4	1.2	2.1	2.0
Fiscal Balance (% of GDP) ^a	-13.0	-32.9	52.7	23.1	7.9	-7.8
ESI-adjusted balance (% of GDP) ^a	-42.9	-64.1	-43.2	-26.4	-32.0	-35.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) The ESI-adjusted budget balance is calculated as domestic revenue plus ESI (sustainable disbursements from the Petroleum Fund) less total expenditure.



	2017
Population, million	93.7
GDP, current US\$ billion	223.9
GDP per capita, current US\$	2,391
International poverty rate (\$1.9) ^a	2.0
Lower middle-income poverty rate (\$3.2) ^a	8.2
Upper middle-income poverty rate (\$5.5) ^a	28.7
Gini index ^a	35.3
School enrollment, primary (% gross) ^b	110.0
Life expectancy at birth, years ^b	76.3

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2016), 2011 PPPs. b. Most recent WDI value (2016).

Summary

Vietnam's economy continues to perform well, propelled by the sustained global recovery and continued domestic reforms. Robust growth is boosting job creation and income growth, leading to broad-based welfare gains and poverty reduction. Despite improved short term prospects, external and domestic risks and longer-term challenges remain. These include risks of global financial volatility and rising protectionism as well as domestic vulnerabilities associated with remaining banking sector weaknesses, elevated public debt and limited fiscal space, and subdued productivity growth.

Recent Developments

Vietnam's gross domestic product (GDP) is estimated to have increased by 7.1 percent (y/y) in the first half of 2018.

GDP growth was broad-based, led by strong manufacturing growth of 13 percent, bolstered by strong external demand. Agriculture output growth also accelerated to 3.9 percent largely due to strong performance in the export oriented fishery sub-sector. Meanwhile, expansion of the service sector remained robust at 6.9 percent underpinned by strong underlying retail sector growth supported by buoyant private consumption and record tourist arrivals.

Strong GDP growth was accompanied by moderate inflation and a strengthening external position. Annual average headline CPI rose 3.5 percent (below the government's target of 4 percent this year) while core inflation hovered around 1.4 percent in the first seven months of 2018.

Robust economic performance is underpinned by a Government commitment to macroeconomic stability and private sector-led growth. Economic policies continue to focus on market-oriented reforms to reduce the economic role of the state, boost business conditions and open the economy for more private investment.

Vietnam's dynamic economy continues to translate into broad-based welfare gains and poverty reduction. Expanding wage employment and rising real wages have been the underlying drivers of poverty reduction, accounting for more than half of the poverty reduction since 2014. Evidence points to a continued improvement in job creation and income growth. More than 900,000 wage jobs were created in 2017 and real wages further increased by 4.3 percent, driven by strong labor demand in the manufacturing, construction and service sectors. Poverty is thus projected to continue declining at a high rate. Estimates of poverty based on the international lower middle-income poverty line (\$3.2 PPP 2011) are projected to have declined from around 8.2 percent in 2016 to 6.4 percent in 2018.

Vietnam's exports continued to perform strongly, benefiting from stronger external demand and expanding capacity, driven by robust FDI in export-oriented manufacturing. The value of merchandise exports from Vietnam increased 16 percent in January—July 2018. At the same time,