IMF Executive Board Concludes 2016 Article IV Consultation with Timor-Leste

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On May 11, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV Consultation with Timor-Leste.[1]

Non-oil real GDP growth is estimated to have declined to 4.3 percent in 2015 from 5.5 percent in 2014, due to weaker government spending. Both headline and core inflation eased to below 1 percent in 2014 and 2015, reflecting lower commodity prices, a stronger U.S. dollar against Timor-Leste's trading partners' currencies, and some improvement in supply bottlenecks.

The fiscal position weakened in 2015 due largely to lower petroleum revenue. Petroleum revenue fell by 40 percent in 2015 mainly on account of the slump in global oil prices. Staff's estimate points to an overall fiscal surplus of 4.2 percent of GDP in 2015, a considerable reduction from the large surpluses in previous years. Prudent saving of its oil wealth in the Petroleum Fund (PF), Timor-Leste's sovereign wealth fund, has provided a financial cushion to help offset revenue losses. Withdrawals from the PF remained above the level consistent with the estimated sustainable income, in part to finance front-loaded capital investments. This, coupled with lower oil receipts and negative net investment returns due largely to foreign exchange valuation losses, saw the balance of the PF decline for the first time, to $16.2 billion as of end-2015.

The external current account surplus was halved to 25 percent of GDP in 2014 and is estimated to have shrunk further to 17 percent of GDP in 2015. This is largely due to lower income from declining oil and gas receipts and weak investment returns on the PF portfolio against weak global equity market performance in 2015. The banking system is highly liquid and well capitalized. Growth of private sector credit picked up to 10.5 percent (y/y) in December 2015 from 5.5 percent in December 2014. Excess liquidity in the banking system and banks' overseas placements of deposits have remained high.

The medium-term growth outlook depends critically on economic diversification and ensuring a sustainable fiscal position. Average non-oil real GDP growth in the medium-term is projected at 5.5 percent, supported by increasing public spending and foreign direct investment. This hinges on successful prioritization of government expenditures to facilitate high-return infrastructure investments in tandem with structural reforms that catalyze non-oil private sector growth.

The main sources of risk over the medium- to long-term are higher fiscal spending, public investments not yielding adequate returns and enhanced growth, and inadequate mobilization of domestic revenues.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors commended the authorities for the progress made in nation building and economic and social development. However, Directors noted that Timor-Leste faces difficult policy challenges from the fall in oil revenue and the country's large development needs. Going forward, they emphasized the importance of achieving fiscal sustainability and economic diversification.

Directors saw a need for continued fiscal consolidation. They encouraged the authorities to strengthen non-oil revenue, rationalize current spending, and adhere to a medium-term adjustment plan. Recognizing the need for capital spending, Directors encouraged the authorities to prioritize public investment plans, focusing on high-return infrastructure projects through rigorous investment appraisal, so that such spending is in line with implementation capacity and debt sustainability. Directors stressed that optimizing the composition and quality of spending to help close Timor-Leste's infrastructure gap will be key to long-term fiscal sustainability and inclusive growth.

Directors welcomed the authorities' commitment to preserving the assets of the Petroleum Fund. In this context, they supported higher use of concessional financing for large infrastructure projects, which would reduce reliance on withdrawals from the Petroleum Fund and support greater discipline in investment spending. Directors also welcomed plans to introduce a value-added tax, which will help achieve the government's target of raising non-oil revenues.

Directors supported the efforts to improve financial inclusion, underscoring the importance of striking the right balance with safeguarding financial stability. They saw a need for continued efforts in strengthening regulatory and supervisory capacity and improving central bank functions. Directors called for a strategy to fully resolve legacy non-performing loans.

Directors concurred that the use of the U.S. dollar as legal tender has served Timor-Leste well. They supported the authorities' plan to pursue further financial sector and institutional development to pave the way for any potential change in the monetary and exchange rate regime.

Directors emphasized that medium-term growth will depend critically on economic diversification. In this context, they agreed that priority should be given to boosting the private sector by building infrastructure, improving the business climate and enhancing competitiveness. Improvement in social conditions and investment in human capital will also be necessary. Directors called for continued efforts to improve statistical capacity as well as the quality and timeliness of data, which are crucial for policy formulation. They encouraged the authorities to further leverage technical assistance from the Fund and other development partners.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Table 1. Timor-Leste: Selected Economic and Financial Indicators, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
			Est.	Prel.			Proj.			
Real sector	(Annual percent change)									
Real total GDP	5.3	-13.9	-15.8	-0.6	-8.8	-12.9	-3.9	-9.4	-9.2	-8.8
Real non-oil GDP	6.4	2.8	5.5	4.3	5.0	5.5	6.0	6.5	5.5	5.5
CPI (annual average)	10.9	9.6	0.8	0.6	1.5	3.8	4.0	4.0	4.0	4.0
CPI (end-period)	10.9	4.0	0.3	-0.6	3.6	4.0	4.0	4.0	4.0	4.0
Central government operations	(In percent of GDP, unless otherwise indicated)									
Revenue	61.1	66.1	63.2	61.5	63.1	52.6	49.0	46.0	42.7	40.0
Domestic revenue	2.0	2.7	3.9	6.5	8.0	7.6	7.3	7.2	7.1	7.3
Petroleum revenue (incl. PF interest)	55.5	58.7	53.2	48.9	48.3	41.1	37.7	34.8	31.5	28.7
Grants	3.7	4.7	6.2	6.1	6.8	4.0	4.0	4.0	4.0	4.0
Expenditure	22.0	24.0	37.4	57.3	73.5	73.1	69.1	67.2	65.0	58.5
Recurrent expenditure	10.4	13.1	20.9	39.1	49.3	45.8	43.8	43.1	42.2	40.9
Capital expenditure	7.9	6.3	10.2	11.7	17.4	23.3	21.3	20.1	18.8	13.6
Donor project	3.7	4.7	6.2	6.1	6.8	4.0	4.0	4.0	4.0	4.0
Overall balance	39.1	42.1	25.9	4.2	-10.4	-20.5	-20.1	-21.2	-22.4	-18.5
Non-oil overall balance (in percent of non-oil GDP)	-86.0	-70.5	-86.9	-82.8	-83.3	-81.8	-73.5	-66.1	-59.7	-49.5
Money and credit	(Annual percent change, unless otherwise indicated)									
Deposits	26.5	22.4	19.6	22.8	21.6	21.3	21.9	21.6	21.6	21.7
Credit to the private sector	20.5	13.6	5.5	10.5	13.3	13.7	12.5	13.2	13.1	12.9
Lending interest rate (percent, end-period)	12.2	12.4	12.9	13.5	…	…	…	…	…	…
Balance of payments	(In millions of U.S. dollars, unless otherwise indicated)									
Current account balance 1/	2,736	2,391	1,096	431	41	-281	-315	-334	-359	-241
(In percent of GDP)	40.2	42.7	25.1	16.5	2.0	-11.9	-12.2	-12.2	-12.2	-7.8
Trade balance	-638	-679	-749	-684	-710	-844	-892	-901	-917	-892
Exports 2/	33	18	15	9	17	20	21	24	26	28
Imports	672	696	764	692	728	864	914	925	943	920
Services (net)	-920	-437	-388	-414	-486	-648	-647	-646	-637	-524
Petroleum revenue	3,775	3,286	2,319	1,281	1,014	972	976	955	925	889
Overall balance	422	-197	-376	127	8	6	3	1	1	1
Public foreign assets (end-period) 3/	12,659	15,639	16,849	16,655	16,552	16,247	15,944	15,600	15,226	14,816
(In months of imports)	91	156	165	169	153	122	115	110	106	110
Exchange rates										
NEER (2010=100, period average)	96.7	101.9	106.8	120.2	…	…	…	…	…	…
REER (2010=100, period average)	115.5	131.6	134.9	150.1	…	…	…	…	…	…

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Memorandum items:										
GDP at current prices:	6,807	5,595	4,361	2,620	2,100	2,368	2,589	2,746	2,933	3,094
Non-oil GDP	1,295	1,319	1,371	1,412	1,480	1,782	2,037	2,323	2,647	2,948
Oil GDP	5,512	4,276	2,990	1,207	620	587	552	423	286	147
GDP per capita	5,673	4,974	3,807	2,244	1,769	1,959	2,104	2,192	2,300	2,384
Crude oil prices (U.S. dollars per barrel, WEO) 4/	105	104	96	51	35	41	45	48	49	51
Petroleum Fund balance (in millions of U.S. dollars) 5/	11,775	14,952	16,539	16,218	16,106	15,795	15,489	15,144	14,769	14,359
Petroleum Fund balance (in percent of non-oil GDP)	909	1,134	1,206	1,148	1,088	887	760	652	558	487
Public debt (in millions of U.S. dollars)	0	6	22	46	153	326	541	777	1,059	1,219

Sources: Timor-Leste authorities; and IMF staff estimates and projections.

1/ Excludes trade in goods and services of entities located in the Joint Petroleum Development Area, which are considered non-resident.

2/ Excludes petroleum exports, the income of which is recorded under the income account.

3/ Includes Petroleum Fund balance and the central bank's official reserves.

4/ Simple average of UK Brent, Dubai, and WTI crude oil prices based on April 2016 WEO assumptions.

5/ Closing balance.

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