BANCO CENTRAL DE TIMOR-LESTE

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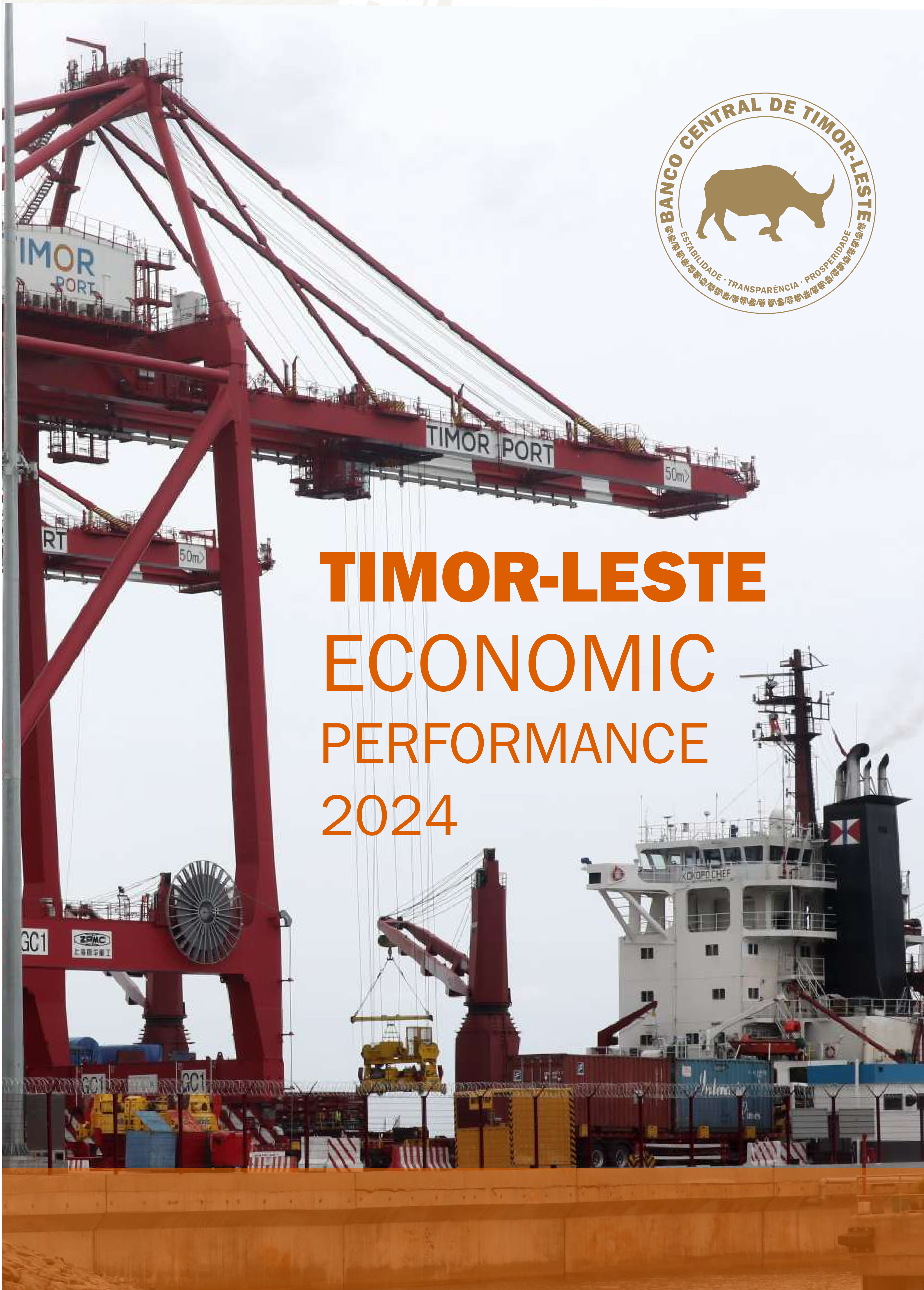
TIMOR-LESTE ECONOMIC PERFORMANCE 2024



TIMOR-LESTE ECONOMIC PERFORMANCE 2024

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MESSAGE OF GOVERNOR

Distinguished citizens of Timor-Leste, esteemed government officials, development partners, private sector representatives, and all stakeholders.

It is with great privilege that I present the Central Bank of Timor-Leste's Annual Economic Performance Report for 2024. This report provides a rigorous assessment of our economic trajectory, reflecting both the progress achieved and the persistent structural challenges that must be addressed to secure sustainable, broad-based growth.

In 2024, Timor-Leste's economy demonstrated notable resilience, recording a growth rate of 4.0%, an improvement from 2.4% in 2023. While this upward momentum is encouraging, it remains below the government's 5.0% target and underscores the need for comprehensive structural reforms. Growth has been predominantly fueled by public sector investment, which has stimulated private sector activity through increased public spending and capital formation. However, limited absorptive capacity and a continued dependence on imports have tempered the full economic impact of these expenditures, reinforcing the urgency of diversifying the economy.

The Central Bank remains steadfast in its commitment to safeguarding macroeconomic stability, strengthening the financial sector, and ensuring the integrity of our monetary and fiscal frameworks. Enhancing access to finance, fostering a more competitive business environment, and promoting investment in key growth sectors such as agriculture, tourism, and industry are imperative to reducing economic vulnerabilities and fostering long-term prosperity. Furthermore, prudent fiscal management and disciplined public spending are critical to mitigating risks associated with the depletion of national reserves.

As we navigate an increasingly complex global economic landscape, collaborative efforts between the government, private sector, and development partners will be paramount in unlocking Timor-Leste's full economic potential. By implementing targeted reforms, prioritizing human capital development, and embracing innovation, we can lay the foundation for a more dynamic, inclusive, and resilient economy.

On behalf of the Central Bank of Timor-Leste, I extend my deepest appreciation to all stakeholders who contribute to our nation's economic advancement. Let us remain steadfast in our collective pursuit of a prosperous and self-sustaining Timor-Leste.

Helder Lopes
Governor of BCTL

EXECUTIVE SUMMARY

Economic Growth

Timor-Leste's economic growth is expected to accelerate to 4.0% in 2024, reflecting a 1.6 percentage point (pp) increase from 2.4% in 2023. While this upward trajectory is encouraging, it still falls short of the government's 5.0% target.

Economic growth has been primarily driven by public sector expansion, with the private sector following suit. Public sector growth has stimulated private sector activity through the crowding-in effect of public investment on private investment, as well as the influence of public transfers and consumption on private spending. However, Timor-Leste's limited absorptive capacity constrains the economy's ability to fully internalize these expenditures, leading to a higher reliance on imported goods and services, which in turn partially offsets overall growth.

In terms of Timor-Leste's productive structure, **public administration have remained the primary drivers of economic growth in 2024**, mirroring trends observed in 2023. The construction sector made only a marginal contribution, largely driven by increased public investment. Although the manufacturing industry showed slight improvement compared to the previous year, its overall impact on growth in 2024 remained limited, highlighting its continued stagnation.

For 2025, the BCTL anticipates robust economic growth, surpassing the 4.0% recorded in 2024, with a projected rate of 4.4%. This aligns with the government's target of 5% annual growth over the next five years. The expansion is primarily driven by rising aggregate demand, supported by increased government expenditures. Household consumption and non-oil exports are also expected to strengthen, while private investment is projected to grow alongside public sector investment, further stimulating economic activity.

Inflation

Reflecting global trends, domestic inflationary pressures eased significantly in 2024, with the average inflation rate falling to 2.1%—a sharp decline from 8.4% in 2023 and 7.0% in 2022. On a year-on-year basis, disinflation was even more pronounced, resulting in deflation of -0.4%, compared to inflation rates of 8.7% in 2023 and 6.9% in 2022. This decline was primarily driven by global economic conditions and the government's decision to repeal the higher import taxes imposed by the previous administration.

The slowdown in domestic inflation in 2024 was largely driven by a decline in the relative prices of food products, alcoholic beverages, and tobacco—key inflationary contributors since 2021. Initially, price pressures stemmed from the economic downturn caused by COVID-19, followed by global market disruptions triggered by the Russia-Ukraine war in 2022, and further intensified by new domestic import duties introduced in 2023. Despite persistent global economic uncertainties, domestic inflation is expected to decline further, reaching an average of 1.8% in 2025—the lowest level since 2021.

Public Sector

The government remains committed to reducing Timor-Leste's dependence on Petroleum Fund financing, with tax reform at the core of its fiscal strategy to enhance non-oil revenues. **In 2024, domestic non-oil revenues totaled $260 million, marking a 9% decline from 2023**. While tax revenue surged by 12% to $216 million—driven by a sharp rise in income tax from $43 million to $160 million—non-tax revenues fell by 61%. However, import tax revenues dropped by 73%, from $82.3 million to $22.2 million, due to the repeal of the import tax law, which lowered rates from 5% to 2.5%. Despite this, other tax categories saw a 67% increase, highlighting ongoing fiscal adjustments.

The government withdrew $1,300 million from the Petroleum Fund in 2024, comprising $522.1 million from the Estimated Sustainable Income (ESI) and $777.9 million from excess withdrawals, to finance its expenditures. This marked an increase of $210 million compared to 2023, driven by higher public spending that domestic revenue could not sustain. Petroleum Fund withdrawals continued to significantly exceed the ESI, raising concerns about the fund's long-term sustainability.

The Petroleum Fund remained the primary source of financing, accounting for 83% of total public expenditure, up from 73% in 2023, while domestic revenue contributed only 17%. This trend underscores the country's ongoing reliance on oil revenues, with the cessation of oil production posing a risk to the fund's capital and the long-term stability of public finances.

Timor-Leste's public expenditure saw a notable increase of $260 million, reaching $1,754 million in 2024, driven by a higher actual budget execution rate of 78%—up from 2023. Recurrent expenditure accounted for the largest share, with a 79% execution rate, while capital expenditure reached 74%.

The rise in public spending, particularly on capital investments, is expected to foster future economic growth by enhancing capital accumulation and productivity, notably within the private sector. The country's fiscal deficit widened, as expenditures continued to surpass revenues, resulting in a 30% increase in excess withdrawals from the Petroleum Fund. This trend raises concerns about the long-term sustainability of the fund. While higher public expenditure contributes to short-term growth, ensuring the quality of these expenditures is crucial for achieving sustainable economic outcomes in the future.

The government allocated approximately $413.7 million for capital and development expenditure, marking a significant increase from the $258.9 million allocated in 2023. Despite the higher allocation, the actual execution rate for 2024 reached 73%, a slight improvement from 71% in 2023, representing the highest execution rate in the past five years. A significant portion of the capital expenditure was directed towards infrastructure programs, which accounted for 59% of the total public investment, up from 47% in 2023. Roads and bridges remained the primary focus, with combined expenditure rising to $98 million. The IT and communication technology sector also saw substantial investment, totaling $26 million, or 8% of total public investment. Additionally, the public investment in minor capital slightly decreased to $47 million in 2024. Public infrastructure investment plays a crucial role in capital formation, stimulating economic activity, and promoting long-term growth, while also crowding in private investment in the short term.

Monetary

Overall, the financial environment shows gradual improvements in lending and deposit rates. Loan interest rates remain high, mainly due to the banking sector's risk, despite government concessional loans at a 3% rate. The average loan interest rate decreased slightly from 10.65% in December 2023 to 10.5% in December 2024. Deposit rates also saw a minor increase from 0.65% to 0.66% in the same period. These changes resulted in a slight reduction in the interest rate spread, from 10% to 9.87%.

The USD appreciated against the Singapore dollar and Indonesian rupiah, which alleviated domestic inflationary pressures due to Timor-Leste's reliance on imports. The Real Effective Exchange Rate Index (REERI) showed a 0.7% increase, reflecting reduced competitiveness as exports became pricier. Conversely, the Nominal Effective Exchange Rate (NEER) appreciated by 2.3%, enhancing purchasing power and boosting imports. Despite a downward trend in the REERI, **with a -1.1% annual change, the NEER remained stable, indicating relatively low volatility and suggesting improved market competitiveness**.

The monetary base of Timor-Leste continued its upward trend, with M2 (broad money - money circulating in the economy) reaching $1,339 million, reflecting a growth of $91 million from the previous year. This expansion was primarily driven by a significant increase in total deposits, which rose by $88.7 million to $1,305.5 million. Despite the country's dollarized economy, the BCTL has made progress in assessing the money supply by excluding physical US dollar bills in circulation. The composition of deposits also shifted, with individuals holding 59.9% and private companies holding 40.1%. This change, alongside growth in business-owned deposits, underscores the ongoing development of the financial sector. However, the increase in the money supply was partially offset by a reduction in net external assets.

Timor-Leste's financial deepening, as measured by the **M2-to-GDP ratio, rose to 79.1%, a 2.4 percentage point increase from 2023. Similarly, the credit-to-GDP ratio improved by 8.1 percentage points, reaching 38.4%**. These trends highlight the growing monetization and credit accessibility within the economy. Despite fluctuations, both indicators show positive growth in financial inclusion and economic development.

Banking System

Timor-Leste's banking sector remained robust, driven by resident deposit funding and comprising five key financial institutions. Banking assets grew by 9%, underpinned by an increase in commercial bank assets and continued credit expansion. The sector also saw improved profitability, evidenced by higher net income, while the growth of transfer services highlighted the increasing reliance on formal financial channels for remittances and transactions.

Credit disbursed to the private sector continued its upward trajectory, reaching $583.1 million, an increase of $143.2 million from 2023. The transport and communications sectors saw the highest credit growth, followed by construction and trade sectors, while agriculture remained stagnant with only 0.3% of total credit. The share of credit granted to individuals declined slightly, while sectors like construction and trade saw increases. Despite this growth, credit quality remains strong with a low Non-Performing Loan ratio of 2.1%, although excess liquidity in commercial banks persists, with funds being invested abroad rather than domestically.

Total banking assets in Timor-Leste grew by 9%, reaching $2,662.3 million, driven largely by a 33.5% increase in total credit, particularly to individuals and the construction sector. Credit, which accounted for 21% of total assets, continued its upward trend, paralleling the growth in overall banking assets. Placements with other banks remained the largest component, making up 61.5% of total assets, amounting to $1,637.5 million in 2024, reflecting a modest year-on-year increase.

Customer deposits continued to underpin banking liabilities, comprising approximately 78.7% of total liabilities—only a marginal decline from 80.2% in 2023. Demand deposits have consistently dominated the deposit mix, representing 50.1% of liabilities, with time deposits at 28.7% and savings deposits filling the remaining portion. Notably, time deposits exhibited significant volatility, peaking in mid-2023 and sustaining robust growth of 40.6% in 2024, despite a deceleration in demand deposit growth over the past two years. Savings deposits, on the other hand, maintained steady expansion, growing by 7.8% by December 2024. Additionally, individual depositors retained the largest share of deposits at 59.9%, although a gradual increase in private company deposits has signaled a shifting landscape in deposit ownership over the long term.

Timor-Leste's banking sector exhibited marked financial strength, with revenues from interest and commissions reaching $98.8 million—a $6.6 million increase from 2023. Interest income grew by 15.8%, fueling a 7.1% rise in gross operating income and translating into a 29.5% surge in net operating income, up by $12.4 million. After factoring in extraordinary items and profit taxes, consolidated net income climbed to $47.6 million, compared to $36.9 million the previous year. This performance bolstered key profitability metrics, with return on assets (RoA) rising to 1.8% from 1.5% and return on equity (RoE) increasing to 15.5% from 14%. Furthermore, banks maintained liquidity ratios well above regulatory minimums, reinforcing the sector's overall financial resilience.

Commercial banks in Timor-Leste processed approximately 101,000 outbound money transfers totaling $1,960 million—a decline of 18.5% in transaction volume and 10.7% in aggregate value compared to 2023—while inbound transfers surged by 13% in number and 12% in value to reach 114,000 transactions and $911 million, respectively, resulting in an improved, though still negative, net balance of -$1,049 million.

Other Money Transfer Operators (OTOs) experienced a recalibration in remittance flows with outbound transfers declined to $187 million, whereas inbound transfers increased to $245 million, shifting the net balance from a marginal positive of $2 million in 2023 to a surplus of $58 million in 2024. Personal transfers dominated, representing 47% of inflows and 79% of outflows, largely driven by remittances for family support, education, and savings. Geographically, Europe emerged as the primary source of inflows—rising from $99 million to $117 million—attributable to remittances from Timorese expatriates, while the majority of outflows, totaling $162 million, were directed toward Asia, with Indonesia absorbing 77% of this amount due to remittances from Indonesian nationals working in Timor-Leste.

External Sector

Timor-Leste's external sector further deteriorated, as the current account deficit widened to $529.7 million due to pronounced shortfalls in both goods and services, with primary and secondary revenue inflows proving insufficient. Including oil income, the deficit surged to 31.3% of GDP—a stark 20-percentage point jump—while, excluding oil-related activities, it expanded to 35.4% of GDP. In contrast, the financial account demonstrated remarkable resilience, with net financial capacity increasing by $411 million to reach $446.0 million, or 26.4% of GDP—a 24-percentage point improvement. These figures underscore deep-seated structural imbalances in Timor-Leste's external accounts, even as robust financial inflows offer a partial buffer against mounting deficits.

In recent years, Timor-Leste's goods account experienced a sharp decline after peaking at $2,248 million in 2021, dropping to negative balances of $140.4 million in 2023 and $644.2 million in 2024. The positive balances from 2019 to 2022 were largely due to petroleum product sales, but reduced oil production from the Timor Sea caused negative balances thereafter. **Excluding oil-related sales, the deficit worsened to $784.3 million in 2024. This was driven by Timor-Leste's reliance on imported goods, with imports rising to $840.2 million in 2024**.

Non-oil exports increased by 21.7% in 2024, reaching $21 million, with coffee as the main commodity. Indonesia and the USA remained the primary export destinations, though exports to Indonesia fell by 27.8%. Exports to Australia also rose significantly. Meanwhile, Timor-Leste's imports grew by 12.5% in 2024, totaling $923.2 million, with Indonesia and China as major suppliers. Key imports included fuels, vehicles, and cereals.

The services account deficit improved by $51.9 million in 2024, reaching $275.1 million. This improvement was mainly due to reduced imports of manufacturing-related services and an increase in service exports, especially from travel and tourism, which saw an 18.2% rise.
Following the maritime boundary treaty with Australia in 2019, income from the Joint Petroleum Development Area (JPDA) was reclassified under the goods subaccount, affecting the reported income over the past five years. After two years of deficits, Timor-Leste's primary income account returned to a surplus of $231.1 million in 2024, driven by a notable rise in investment income receivable, while income payable remained stable. The secondary income account also showed strong improvement, with a surplus of $158.4 million in 2024, a significant increase from 2023, largely due to a decline in payments to the rest of the world. **Receivable secondary income totaled $262.2 million, with work remittances from Timorese migrant workers abroad accounting for 81% of this total**.

Since 2019, Timor-Leste's capital account has declined significantly, reaching only $1.3 million in 2024, a 69% decrease from 2023, largely due to reduced capital transfers from ongoing donor grants. **The financial account, however, showed a substantial improvement, recording a net financing capacity of $446.0 million in 2024, up from $35.4 million in 2023**. This was driven by a strong portfolio investment performance, particularly from the Petroleum Fund's overseas investments, totaling $671.2 million. However, the foreign direct investment inflows amounted to $227.7 million, reflecting the financing needs of the country. Other investment assets improved, while reserve assets continued to show a financing need of $44.1 million. Timor-Leste's Net International Reserves (NIR) decreased by 6% to $694.9 million in 2024, though it remained above the decade's average, with import coverage slightly reduced to nine months for goods.

Spillover of Global Development to Timor-Leste

International developments impact Timor-Leste's economy primarily through key transmission channels: influencing domestic inflation, oil revenues, and the valuation of Petroleum Fund investments. These effects are essential for understanding their broader implications on the country's economic stability.

Timor-Leste's economy is highly influenced by international prices, with imports of goods and services accounting for approximately 57% of non-oil GDP in 2024. This reliance means that external inflation significantly impacts domestic inflation levels. A study by the BCTL confirms with a 10% rise in foreign inflation leading to a cumulative increase in domestic inflation. With regional exchange rates remaining relatively stable, external inflation is expected to stabilize at 2.3% per year through 2026, contributing to a gradual deceleration of domestic inflation from 2.1% in 2024 to 1.5% in 2026.

Energy commodity prices, particularly oil, natural gas, and coal, exhibit pronounced volatility, with significant fluctuations driven by factors such as geopolitical tensions, supply disruptions, and shifting demand patterns. In 2024, global energy prices experienced a notable decline, especially in crude oil and coal, while natural gas prices surged due to high demand in Asia, colder weather, and geopolitical uncertainties, particularly in the Middle East and Russia's impact on European gas supplies. Despite the recovery in 2021 and 2022, oil prices fell by 4.5% in 2024, signaling a broader trend of price instability. Simultaneously, Timor-Leste's oil revenues have sharply decreased as production from the Bayu-Undan field nears depletion, with government income from taxes and royalties falling by 80% in 2024, reflecting a broader decline in oil and gas output.

The uncertainty surrounding future energy price trends and potential new exploration ventures further complicates the country's fiscal outlook, necessitating rigorous evaluation of any future developments.

The Petroleum Fund (PF) of Timor-Leste, established to manage the country's oil wealth, saw a modest increase in its total net financial assets in 2024, reaching $18.27 billion. The fund primarily invests in treasury bonds of developed countries and shares in developed market companies, which helped it achieve a gross revenue of $1.22 billion in 2024, slightly lower than the previous year's performance. In 2024, the fund's return was 6.80%, primarily driven by gains in its equity portfolio, which benefited from the strong performance of global stock markets, particularly in the US. The fund also saw positive results from its bond portfolio, boosted by rising long-term interest rates in markets like the US, Japan, and Germany. However, the PF did not experience any significant currency gains or losses in 2024, unlike the previous year. Despite these positive developments, the fund remains vulnerable to fluctuations in global markets and currency depreciation, which could affect its future returns and the country's estimated sustainable income (ESI).

RECOMMENDATIONS

There is a pressing need for Timor-Leste to **focus** on and **consistently** implement policies that address fundamental challenges and unlock economic growth potential. By tackling key barriers such as infrastructure deficits, regulatory inefficiencies, and limited diversification, the country can create a more conducive environment for investment and sustainable development. These policies will enable Timor-Leste to fully harness its resources, diversify its economy, and build a foundation for long-term economic growth and prosperity.

1. Promoting and maintaining macroeconomic stability

Rationale: As the country heavily reliant on oil revenues and imports, stability helps mitigate risks from external shocks, such as fluctuations in commodity prices and exchange rate volatility. Maintaining macroeconomic stability in Timor-Leste is crucial for ensuring sustainable economic growth, attracting investment, and safeguarding public finances.

Recommendation: The government to promote prudent fiscal policies, ensuring sustainable public spending while effectively managing Petroleum Fund withdrawals; Diversify the economy beyond oil by investing in agriculture, tourism, and small businesses to reduce dependency on oil economy; Enhance financial sector development; Improving infrastructure; Attract foreign investment to support economic resilience; And maintain strong governance, transparency, and long-term planning to help mitigate external risks and ensure sustainable economic growth.

2. Focus on and consistently implementing structural reform for a resilient, diversified and sustainable economy

- **Enhancing fiscal consolidation for quality and sustainable expenditure**

Rationale: With oil revenues rapidly declining and limited domestic revenue generation, uncontrolled spending could lead to more wider budget deficits and depletion of the Petroleum Fund. It is paramount to promote fiscal consolidation to ensure long-term economic stability, diminish excessive dependence on the Petroleum Fund, establish a sustainable framework and preserve investors confidence.

Recommendation: Prioritize efficient public spending, focusing on essential sectors like infrastructure, education, and healthcare while eliminating inefficiencies in government operations; Strengthening tax collection, expanding the tax base, and addressing tax evasion to enhance domestic revenue generation; Improving public financial management through robust budget planning, monitoring, and accountability to ensure fiscal discipline; Adopt prudent debt management practices to avoid excessive borrowing; Promoting economic diversification to reduce reliance on oil revenues; and Improve the business climate and attract foreign investment for long-term growth.

- **Establishing a strong foundation for a competitive business environment**

Rationale: Timor-Leste's business environment is hindered by structural and institutional deficiencies that elevate operational costs and stifle economic efficiency. Inadequate infrastructure—characterized by poor road networks, unreliable electricity, and limited digital connectivity—impairs productivity and restricts market access. Bureaucratic inefficiencies, protracted regulatory procedures, and weak legal enforcement create significant barriers to business registration, investment, and contract security. Furthermore, constrained access to finance, heavy reliance on imports, and a small domestic market limit private sector expansion. The shortage of skilled labor and the underdevelopment of key industries further undermine the country's competitiveness, making it difficult to integrate into regional and global markets.

Recommendation: Government to implement long-term policies that enhance economic resilience and diversification. Key strategies include:

» Continue strengthening infrastructure – Invest in reliable transportation networks, energy supply, and digital connectivity to reduce business costs and improve market access.

» Continue enhancing governance and institutions – Streamline regulatory processes and ensure a transparent legal framework to foster investor confidence and business growth.

» Continue developing human capital – Improve education, vocational training, and workforce development to create a skilled labor force capable of driving economic expansion.

» Continue expanding financial access – Strengthen banking systems and microfinance institutions to provide businesses, especially SMEs, with greater access to credit and investment opportunities.

» Continue fostering a business-friendly environment – Implement policies that encourage entrepreneurship, attract foreign direct investment, and support small and medium enterprises (SMEs).

- **Maximizing resource allocation to engines of growth to unlock economic growth potentials**

Rationale: Focusing on productive sectors such as agriculture, tourism, manufacturing to unlock sustainable growth and create employment opportunities. Strategic investment in these areas will enhance productivity, attract foreign investment, improve global competitiveness, and ensure a more stable and diversified economy.

Recommendation: Focusing on strategic investments in key sectors with the highest growth potential. First, prioritize infrastructure development, such as improving transportation, energy, and digital connectivity, to reduce business costs and stimulate economic activity. Second, invest in human capital by enhancing education, skills training, and healthcare to create a skilled workforce. Third, promote innovation and entrepreneurship, particularly in agriculture, tourism, and manufacturing, by providing incentives and improving access to finance. Additionally, fostering public-private partnerships can help leverage additional investment. Finally, implementing sound governance, regulatory frameworks, and transparent processes will ensure efficient use of resources and maximize their impact on economic growth.

- **Enabling access to finance to stimulate private sector growth**

Rationale: Enabling access to finance is crucial for fostering economic growth and development. It empowers businesses, particularly small and medium enterprises (SMEs), by providing them with the necessary capital to expand operations, innovate, and create jobs. It facilitates entrepreneurship, enabling individuals to start new ventures, thereby diversifying the economy. Furthermore, it strengthens the private sector, boosts productivity, and encourages investment in productive sectors. A well-developed financial system enhances overall economic stability and sustainability.

Recommendation: Build a robust financial system that supports private sector growth, fosters innovation, and contributes to long-term economic development through:

» Enhancing financial infrastructure - Strengthen the banking and microfinance sectors to expand credit availability for businesses, especially for SMEs. This include improving lending mechanisms and offering more accessible and affordable loan products tailored to the needs of local businesses.

» Promoting financial inclusion - Improve access to financial services in rural areas through mobile banking and digital financial solutions. By making financial services more accessible, more businesses and individuals can participate in the economy.

» Improving legal and regulatory framework - Strengthen property rights, contract enforcement, and insolvency laws to build investor confidence and improve access to credit. A more secure legal environment will encourage financial institutions to lend to businesses.

» Supporting venture capital and private equity - Create incentives for venture capital and private equity firms to invest in emerging businesses, particularly in sectors like agriculture, tourism, and technology. This could include providing tax breaks or subsidies to encourage investment in high-growth sectors.

» Developing and enhancing credit guarantee schemes - Implement government-backed credit guarantee programs to reduce the risks for financial institutions when lending to startups and SMEs. These schemes make it easier for businesses to access financing without requiring significant collateral.

» Enhancing financial literacy - Promote financial education programs to help businesses understand how to manage finances, build creditworthiness, and access different types of financing. Financial literacy will enable better utilization of available resources

» Creating public-private partnerships - Encourage collaboration between the government, private sector, and international development organizations to provide affordable loans and investment opportunities for high-potential industries. These partnerships can also facilitate infrastructure development that will stimulate private sector activity.

- **Unlocking challenges to maximizing benefits of economic integration**

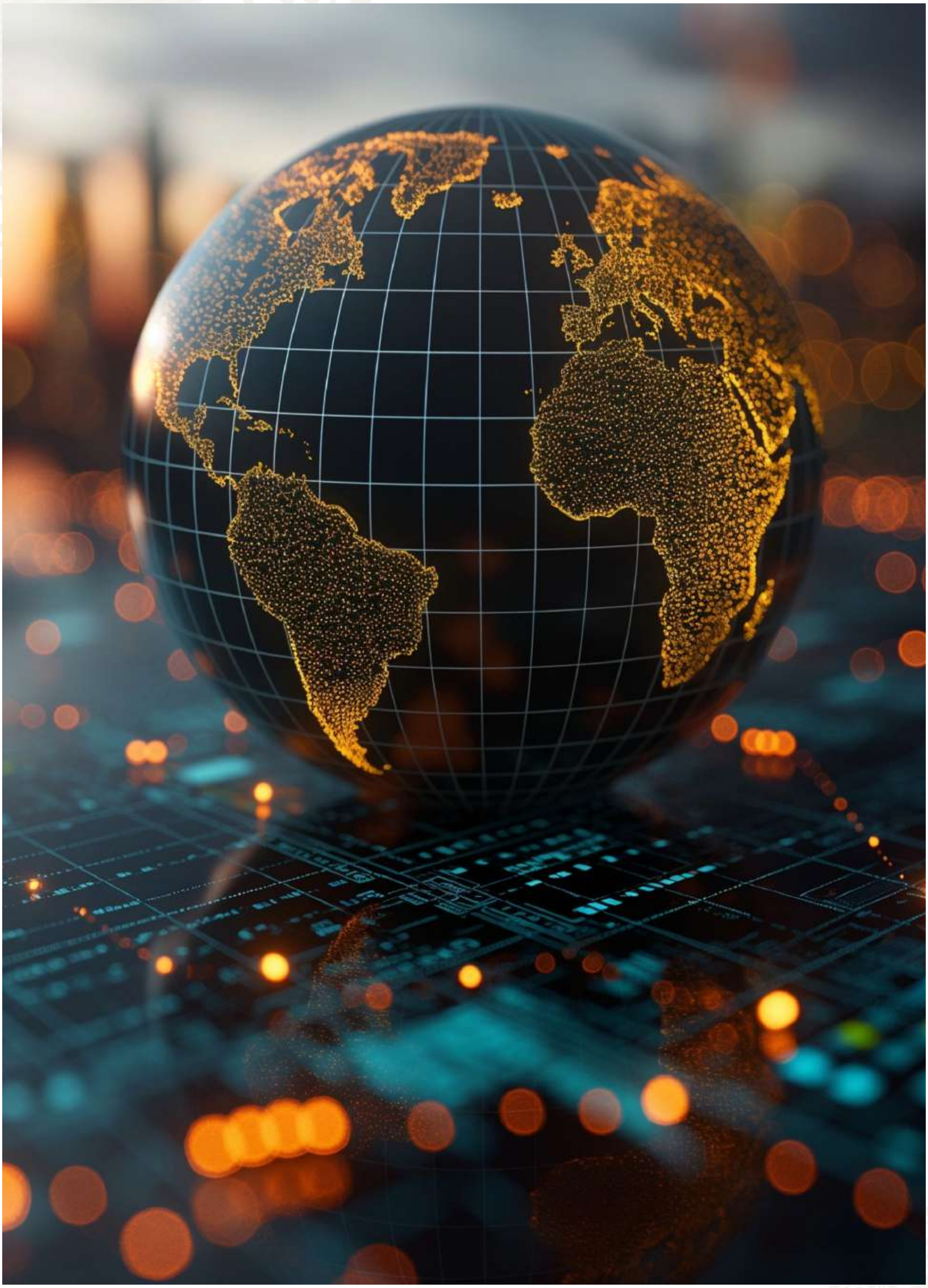
Rationale: Economic integration with WTO, ASEAN and others is crucial for Timor-Leste to diversify its economy, enhance export opportunities, and attract foreign investment. By joining regional and global trade networks, the country can access larger markets, adopt advanced technologies, and improve competitiveness. Integration also encourages policy reforms and alignment with international standards, fostering long-term economic resilience. Ultimately, it will reduce dependency on oil revenues and support sustainable growth.

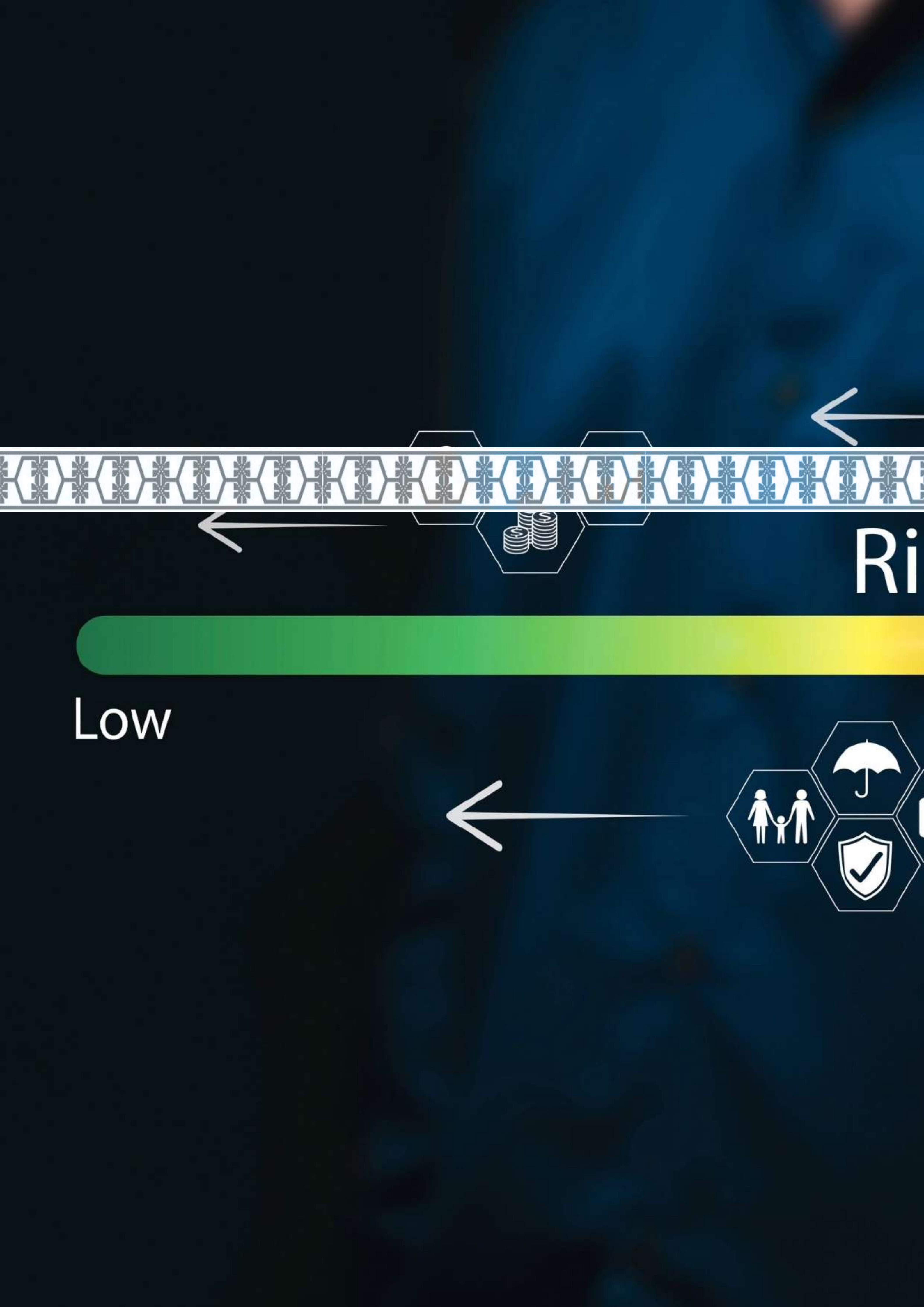
Recommendation: To maximize the benefits of economic integration, Timor-Leste must address key challenges by enhancing infrastructure, particularly in transport, digital connectivity, and energy, to facilitate efficient trade. Strengthening regulatory frameworks and aligning with international standards to help attract foreign investment and promote business competitiveness. Further, investing in workforce skills and fostering innovation is essential for local industries to meet global market demands. Timor-Leste to also streamline customs procedures and reduce trade barriers to enhance regional and international market access. Active engagement in diplomatic efforts will help secure advantageous trade agreements and investment partnerships. By addressing these areas, Timor-Leste can unlock substantial economic growth through integration.

3. Systematic monitoring to economic development

Rationale: Regular monitoring is essential for assessing progress, identifying challenges, and refining policies to ensure sustainable growth. It enhances resource allocation, measures policy effectiveness, and strengthens transparency to build investor and public confidence. Ultimately, systematic oversight enables timely interventions, mitigating risks and fostering long-term economic resilience.

Recommendation: The Government of Timor-Leste to ensure systematic economic monitoring by strengthening institutional coordination, enhancing statistical capacity, and leveraging digital analytics for real-time data tracking. Regular publication of economic indicators, sectoral assessments, and independent audits to enhance transparency and policy responsiveness. Integrating feedback from businesses, investors, and development partners ensures dynamic adaptation to evolving economic conditions. Collaboration with international institutions further refines monitoring frameworks, aligning strategies with global best practices for sustainable growth.

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ECONOMIC ACTIVITY AND INFLATION

Economic Activity and Inflation

This chapter outlines the recent evolution of Timor-Leste's economy and projections for 2024 and 2025, focusing on key developments in public finance, monetary and financial sectors, and the external sector.

The following are the key developments in Timor-Leste's national economy in 2024:

» Timor-Leste's non-oil economy is expected to grow by 4% in 2024 following a slowdown in 2023, continuing the recovery since 2021 after the COVID-19-induced downturn in 2020. Growth is driven by higher household consumption, increased public spending, and a slight rise in private investment supported by public investment. Disinflation in 2024 helped restore market confidence, further boosting consumption. However, rising imports, driven by stronger domestic demand, partly offset this growth.

» For 2025, BCTL projects a stronger growth, with non-oil GDP expected to accelerate to 4.4%, driven by a higher aggregate demand from expanded government expenditures.

Household consumption and non-oil exports are also expected to rise, while private investment is set to grow alongside public investment. However, due to Timor-Leste's limited absorptive capacity, increased public and private spending will boost imports of goods and services, partially offsetting growth.

» In 2024, public expenditure saw a significant rise, an increase of 11% ($165 million), driven by a 51% rise in capital expenditure and a 4% increase in the recurrent expenditure, with public transfers surging 21% compared to 2023.

» With global inflation slowing in 2024, Timor-Leste experienced sharp disinflation, with the average inflation dropping to 2.1%, down from 8.4% in 2023 and 7% in 2022. This decline was driven by global trends and the government's repeal of higher import taxes imposed by the previous administration. Despite global economic uncertainties, the domestic average inflation is expected to fall further to 1.8% in 2025, the lowest since 2021.

» Timor-Leste's current account deficit widened significantly in 2024, reaching a negative of $529 million, mainly due to a decline in petroleum product exports. However, a narrower services account deficit and a substantial rise in primary and secondary incomes helped mitigate the impact of the high deficit recorded in 2024.

» Despite challenges in financial sector development, the sector continued to grow, experiencing a strong expansion in activity, assets, and resources. Notably, bank credit, deposits, and other financial resources continued to expand in 2024.

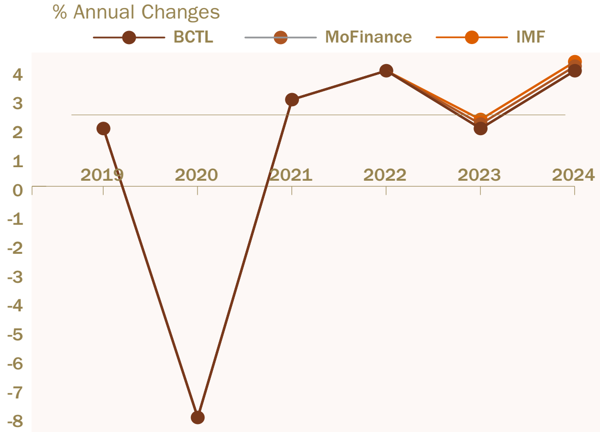
1.1. Economy - Recent Developments and Global Perspectives

The economy is projected to grow by 4% in 2024, rebounding from a slowdown to 2.4% in the previous year. This expansion was mainly attributed to a strong public expenditure in both final consumption and capital investment. Public consumption, comprising over 58% of Non-Oil GDP, grew by 2.9% in 2024, while public investment surged 16.5%, maintaining its positive trend since 2022. As a public-driven economy, Timor-Leste's high public spending boosted private demand, with private investment and consumption rising by 16.3% and 4.4.%, respectively.

In 2024, real non-oil GDP grew by 4%, up from 2.4% in 2023.

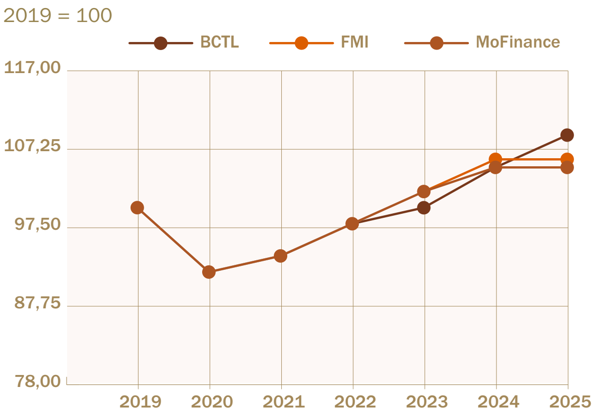
In 2024, net exports as a percentage of GDP remained in deficit, as in 2023.

Chart 1.1a
Real GDP Growth



Source: BCTL, Budget Proposal 2024, and IMF

Chart 1.1b
Real GDP



Source: BCTL, Budget Proposal 2024, and IMF

Public consumption and investment, which were the key drivers of the economic expansion in 2024, contributed 1.7 p.p. and 2.5 p.p., respectively. While private consumption grew at a slower rate than public spending, it made a higher contribution of 3.2 p.p. to overall growth.

The significant increase in public sector goods and services primarily drove the growth in public consumption

A breakdown of real GDP components in 2024 shows that the public sector's contribution to growth was mainly driven by a 13.3% increase in goods and services spending, while wages and salaries remained largely unchanged from 2023. The growth in public investment was primarily attributed to higher capital spending. Although public transfers do not directly impact GDP, their 21% increase – including veteran benefits and other social transfers – played a significant role in stimulating household consumption.

In the private sector, private demand increased, primarily driven by household consumption, which grew by 4.5%, contributing 3.2 p.p. to overall growth compared to 2023. This was partly due to higher remittances and family transfers from emigrants abroad, as well as government spending and transfers to households, which played a crucial role in stimulating household spending. Additionally, disinflation in 2024 boosted consumer confidence, further supporting household consumption.

Remittance grew by 12% in 2024, a slower pace than the 33% increase in 2023. The United Kingdom remained the largest sources of remittances, followed by Australia and South Korea.

Meanwhile, private investment surged, driven mainly by corporate and household investments. In Timor-Leste, private investment growth is often stimulated by public projects funded though capital investment.

In terms of trade, the international trade performance was mixed. Exports of goods and services grew modestly by 2.9%, slowing down from the previous year, while imports rose 7.7% due to the strong domestic demand, extending the country's persistent trade deficit in the non-oil sector. The increased domestic consumption and investment further widened the trade deficit in 2024, as imports surged not only in absolute terms but also as a share of GDP rising from approximately 58% in 2023 to nearly 60% in 2024. Meanwhile, exports stagnated at just 2.8% of GDP.

In 2025, non-oil GDP is projected to grow by 4.4%, exceeding the growth rate of 2024.

The BCTL projects a stronger economic growth in 2025, driven by robust public expenditures. The economy is expected to grow by 4.4%, up from 4% in 2024. This projection is primarily based on a 5.4% contribution from domestic demand, fuelled by both public and private spending. However, the trade deficit is expected to worsen, as imports continue to outpace exports, leading to a decline in net external demand's contribution to growth, partially offsetting the gains from stronger domestic activity.

In 2025, substantial growth in the private sector is expected

Regarding household consumption dynamics, private consumption is expected to grow by 6.9% in 2025, surpassing the estimated growth for 2024. This increase is primarily driven by rising remittances and public transfers, particularly government's planned transfers to 2009-registered veterans. Additionally, low and stable inflation will help sustain consumer purchasing power that will further stimulate consumption spending.

Both public and private investment are projected to maintain growth, continuing the trend observed in 2024. Specifically, public investment is expected to grow by 3.2% annually, while private investment is projected to increase by 8.2% in 2025.

BCTL's economic projection closely aligns with those of other institutions.

In summary, BCTL's projections for Timor-Leste's economic development in 2025 remain conservative, primarily due to the dynamism of the private sector. The anticipated increase in private demand is supported by projected growth in public consumption (3.7%) and public investment (3.8%), contributing to overall economic expansion.

In comparison to estimates from the Ministry of Finance and the IMF, BCTL presents a more optimistic outlook for Timor-Leste's economic growth in 2024. While BCTL projects real non-oil GDP growth at 4%, the Ministry of Finance and the IMF estimate a more conservative growth rate of 3.7% and 3.5%, respectively. Despite these differences, all projections indicate that the economic growth is rebounding from 2023.

However, the excessive reliance on the public sector remains a key challenge, delaying the shift toward a private-sector-driven economy. This dependence perpetuates persistent net export deficits, undermining medium- to long-term economic sustainability. Accelerating private-sector-led growth is crucial for creating higher-quality and well-paying jobs for the growing youth population, ultimately fostering robust and sustainable economic development.

1.2. Gross Domestic Product

Public Investment rose significantly in 2024, driven by a higher capital and development spending.

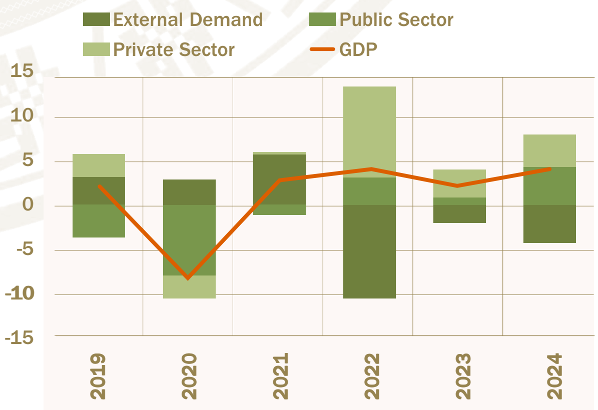
The official National Account data for Timor-Leste in 2023 was published in September 2024. The BCTL developed an estimation model to assess the latest trends in domestic and external demand, followed by an evaluation of non-oil GDP and its key components for 2024. This analysis is based on official data from the National Institute of Statistics of Timor-Leste (INE-TL) up to 2023, supplemented by BCTL estimates for 2024, focusing on the most relevant short-term trends in the domestic economy.

The Central Bank of Timor-Leste (BCTL) projected a 4% real non-oil GDP growth rate for 2024, reflecting an improvement from the previous year. This reflects the continued non-oil economic growth since 2021, following the sharp downturn in 2020 – the steepest decline since Timor-Leste's independence. According to the 2024 projection, the non-oil GDP increase was primarily due to higher public expenditures, contributing a total of 4.2 p.p., of which public investment contributed 2.5 p.p. (16.7% of non-oil GDP) and public consumption 1.7 p.p. (58.3% of non-oil GDP). Additionally, private consumption contributed 3.2 p.p. (73.9% of non-oil GDP).

Regarding the expenditure perspective, as already mentioned and in accordance with the graphs presented below, the economic growth in 2024 was primarily driven by the expansion of the public sector, followed by the private sector. The growth of the public sector has, in turn, influenced the private sector due to the crowding-in effect of public investment on private investment, as well as the impact of public transfers and consumption on private consumption.

Chart 1.2a
Real GDP growth - Expenditure approach

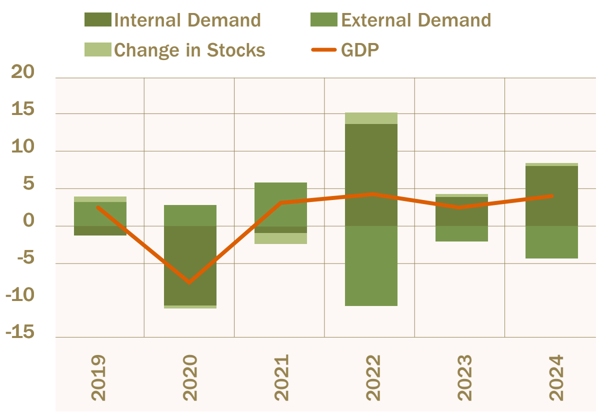
% Annual chnage and contribution to growth (pp).



Source: INE-TL, and BCTL analysis

Chart 1.2b
Real GDP - Principal components

% Annual chnage and contribution to growth (pp).



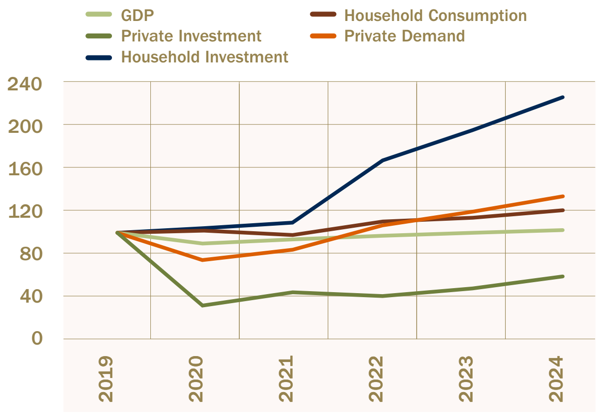
Source: INE-TL, and BCTL analysis

In graphs 1.2c and 1.2d we present the evolution of the subcomponents of private and public demand, compared with the GDP trajectory since 2019.

The graphs illustrate the evolution of real GDP, private demand, and public demand since 2019, confirming that the decline in economic activity observed in 2019 and 2020 resulted from a sharp reduction in public demand. The increase in public expenditure between 2021 and 2022 contributed to the subsequent recovery in GDP growth during these years. Additionally, private demand has experienced moderate growth, surpassing its 2019 level. However, despite its rapid recovery, its contribution to GDP appears to be relatively limited compared to public demand.

Chart 1.2c
Real PIB and Private Demand

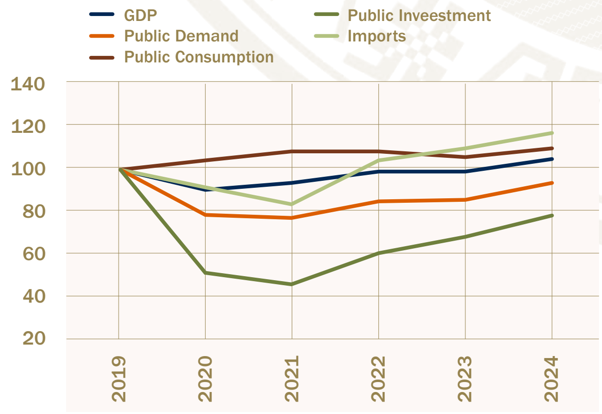
2019=100 (index)



Source: INE-TL, and BCTL analysis

Chart 1.2d
Real GDP Public Demand and Imports

2019=100 (index)



Source: INE-TL, and BCTL analysis

Regarding private demand, its volatility has exceeded GDP volatility since 2022, primarily driven by fluctuations in private consumption. Meanwhile, private investment has been the weakest-performing subcomponent of private demand since 2019, despite showing signs of gradual recovery. This trend raises concerns for the future of Timor-Leste's economy. If this trajectory continues in the short and medium terms, the economy may remain excessively dependent on public sector, potentially undermining its long-term resilience. The persistent decline in private investment over the past five years would have adverse effects on future productivity and sustainable economic growth in Timor-Leste.

With respect to public demand, its level remains lower than in 2019, despite a gradual growth since 2021. In particular, public demand level in 2014 reached 94.1, rising slightly from 87 in 2023, yet still below its 2019 level. While public consumption has gradually improved, surpassing its 2019 level, public investment remains stagnant, despite notable progress over the past three years.

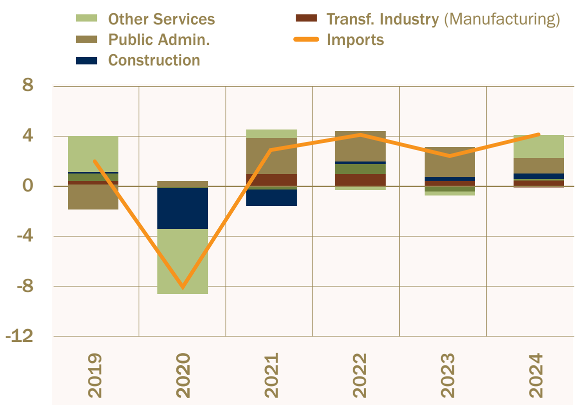
It is important to note that public investment plays a crucial role in shaping private investment decisions. As clearly illustrated in the graphs above, both public and private investment have followed a similar trend over the past five years. In this context, reinforcing public investment is essential to expanding infrastructure and fostering private sector development, particularly in stimulating private investment.

Other services and public administration played a key role in driving growth in 2024.

Regarding the productive structure of the Timorese economy, the graph below (1.2e and 1.2f) illustrate which industries have contributed most significantly to the dynamics of economic activity in Timor-Leste. Notably, other services and public administration have played decisive roles in driving economic growth in 2024, following a similar trend observed in 2023. The construction industry made only a slight contribution, primarily driven by increased public investment. Although the manufacturing industry showed some improvement compared to the previous year, its overall contribution to growth in 2024 remained minor, reflecting its continued stagnation over the period.

Chart 1.2e
TL: Real GDP growth; Production approach

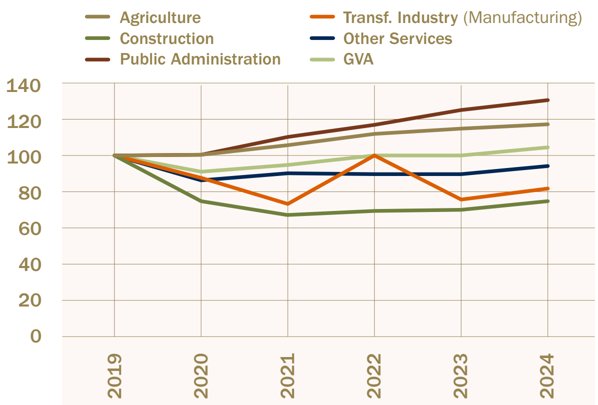
Annual percentage changes and contribution to growth (pp)



Source: INE-TL and BCTL

Chart 1.2f
Real GDP, - By industry

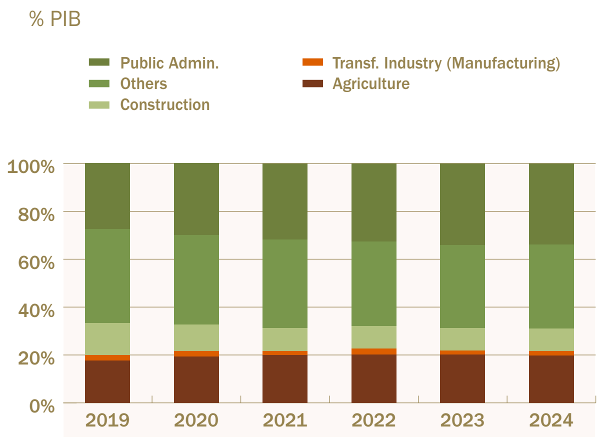
2019=100



Source: INE-TL and BCTL

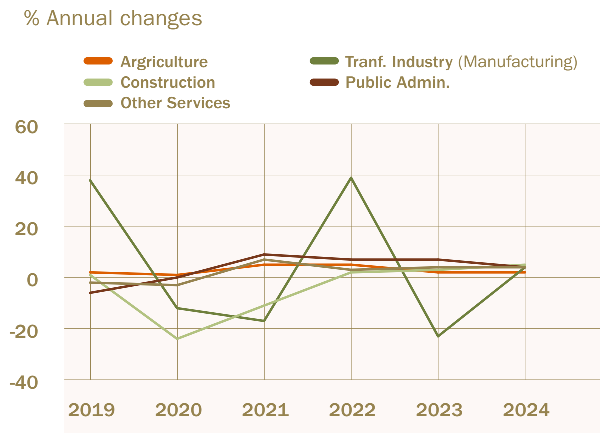
From 2019 to 2024, as seen in Graph 1.2g, the primary shift in the productive structure was a considerable decline in the share of the construction industry, dropping from 13.4% to 9.6% of non-oil GDP. During the same period, the share of public administration in non-oil GDP saw a notable increase, rising from 27.4% in 2029 to nearly 34% in 2024. This highlights the economy's continued and strong reliance on the public sector, raising sustainability concerns as the petroleum fund approaches its depletion.

Chart 1.2g
Shares of GDP by Industry



Source: INE-TL and BCTL

Chart 1.2h
Industries' growth rates



Source: INE-TL and BCTL

The "other services" industry, which encompasses smaller industries, continued to hold the dominant position in the economy, accounting for nearly 35% of non-oil GDP in 2024, down from 39.3% in 2019. While the economy remains heavily dependent on the public sector, the agriculture industry, which is the least reliant on the state, has made limited progress over the past five years. As a result, imports of agricultural products remain high, undermining the country's external balance. Looking forward to 2025, BCTL expects the productive structure to remain relatively little changed.

In terms of growth, the agriculture industry has again shown little progress, slowing down to 2.4% in 2024 from 2.5% in 2019. The public administration and other services have demonstrated significant growth over the past five years. In addition, the construction industry plummeted in 2020 before rebounding and stabilizing in the last three years. The manufacturing industry, however, has fluctuated substantially over the years.

The stagnation of the private sectors, due to structural challenges over the years, has resulted in limited employment opportunities. Despite the economic recovery since 2021, the sluggish performance of the past seven years has led to a decrease in job opportunities and, consequently, a decline in labor force participation. The 2021 labor force survey highlights a low labor participation rate. Currently, the labor force participation rate stands at 30.5%, almost unchanged from the 30.6% observed in 2013.

This means that, out of Timor-Leste's working-age population of approximately 809,400 individuals aged 15 or over, only 30.5% are considered active in the labor market, either employed or unemployment. BCTL, therefore, estimates that the current level of GDP remains below its potential, or not at its full employment level. This, along with the expectation that economic expansion will not be sufficient to close the domestic "output gap" by 2025, underscores the challenges facing the economy.

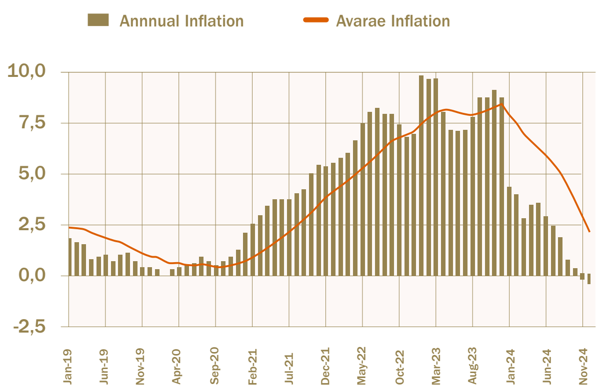
1.3. Inflation

The average annual inflation rate in 2024 fell to 2.1%, from 8.4% in 2023.

The average annual inflation has decelerated in Timor-Leste, down to 2.1% in 2024 from its peak of 8.4% in 2023 and 7% in 2022. In year-on-year terms, the disinflation was even more significant, reaching deflation at -0.4%, compared to inflation of 8.7% in 2023 and 6.9% in 2022. This trend is considered a positive development because it reduces inflationary pressure in the domestic market and restores consumer confidence as pressure on purchasing power slowly fades away. This disinflation occurred following the gradual reduction of global inflation and the current government's decision to revoke import tax introduced by its predecessor.

Chart 1.3a
Inflation Rate in Timor-Leste

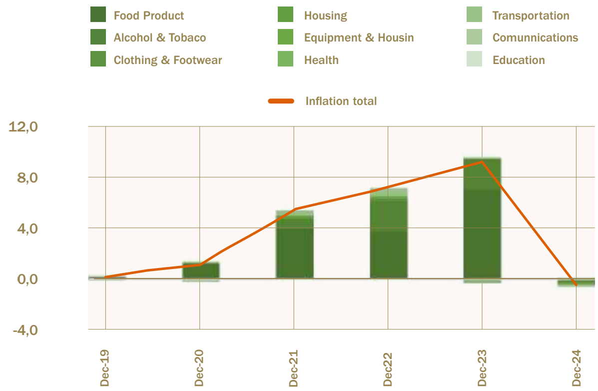
% annual change



Source: INE-TL and BCTL calculation

Chart 1.3b
Inflation rate in Timor-Leste

% Inflation (y-o-y) and its drivers



Source: INE-TL and BCTL calculation

Chart 1.3b shows that the deceleration of domestic inflation in 2024 was mainly due to the drop in the relative prices of food products and alcoholic beverages and tobacco. These two groups had been key inflation drivers since 2021, following the Covid-19 economic downturn, which was then amplified by global market disruptions due to the Russia-Ukraine war in 2022, before being exacerbated by the introduction of new domestic import duties in 2023.

Table 1.1 offers greater detail in terms of inflationary trends, breaking down the average inflation rate by large groups of goods/services:

Table 1.1. Inflation Rate by CPI Groups - % annual average

The drop in relative prices was mainly driven by the slower price growth in the food group and alcoholic beverages and tobacco group.

	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
Food	0.9	0.9	5.8	7.5	10.2	4.3
Alc. & tobaco	3.5	-0.4	7.2	23.8	32.0	-2.3
Clo. & foot	0.2	1.6	0.0	-0.2	1.5	0.4
Housing	0.5	-0.6	0.4	1.4	0.7	-0.7
Household eq.	-0.6	-0.2	-0.3	2.9	-1.6	-1.6
Health	0.0	0.0	0.2	0.8	0.0	1.7
Transport	0.8	-1.3	2.7	12.1	-0.6	-1.7
Communication	-0.2	-0.4	0.0	0.0	0.7	-0.4
Rec. & cult.	0.1	0.1	0.1	1.7	-1.0	1.7
Education	9.0	2.6	0.0	2.5	6.9	2.0
Total:	**0.9**	**0-5**	**3.8**	**7.0**	**8.4**	**2.1**

Source: INE-TL and BCTL calculation

As seen in the table above, the “food” and “alcoholic beverages and tobacco” groups were the key drivers for disinflation in 2024. The average food inflation dropped to just 4.3% in 2024, after rising in the previous three consecutive years, peaking in 2023. This drop was due to a decrease in the relative prices in the global market and the repeal of the domestic import tax in late 2023. Despite this decline, the prices of imported rice remain elevated in the domestic market, which has affected low- and middle-income households in Timor-Leste, particularly those living in municipalities with higher rice prices due to transport margins. As the food group accounts for more than 54% of the total weight in the consumer price index basket, this drop in the relative price of food commodities greatly impacted inflation dynamic in the domestic market.

The average relative prices of alcoholic beverages and tobacco plummeted to -2.3% in 2024, after skyrocketing to

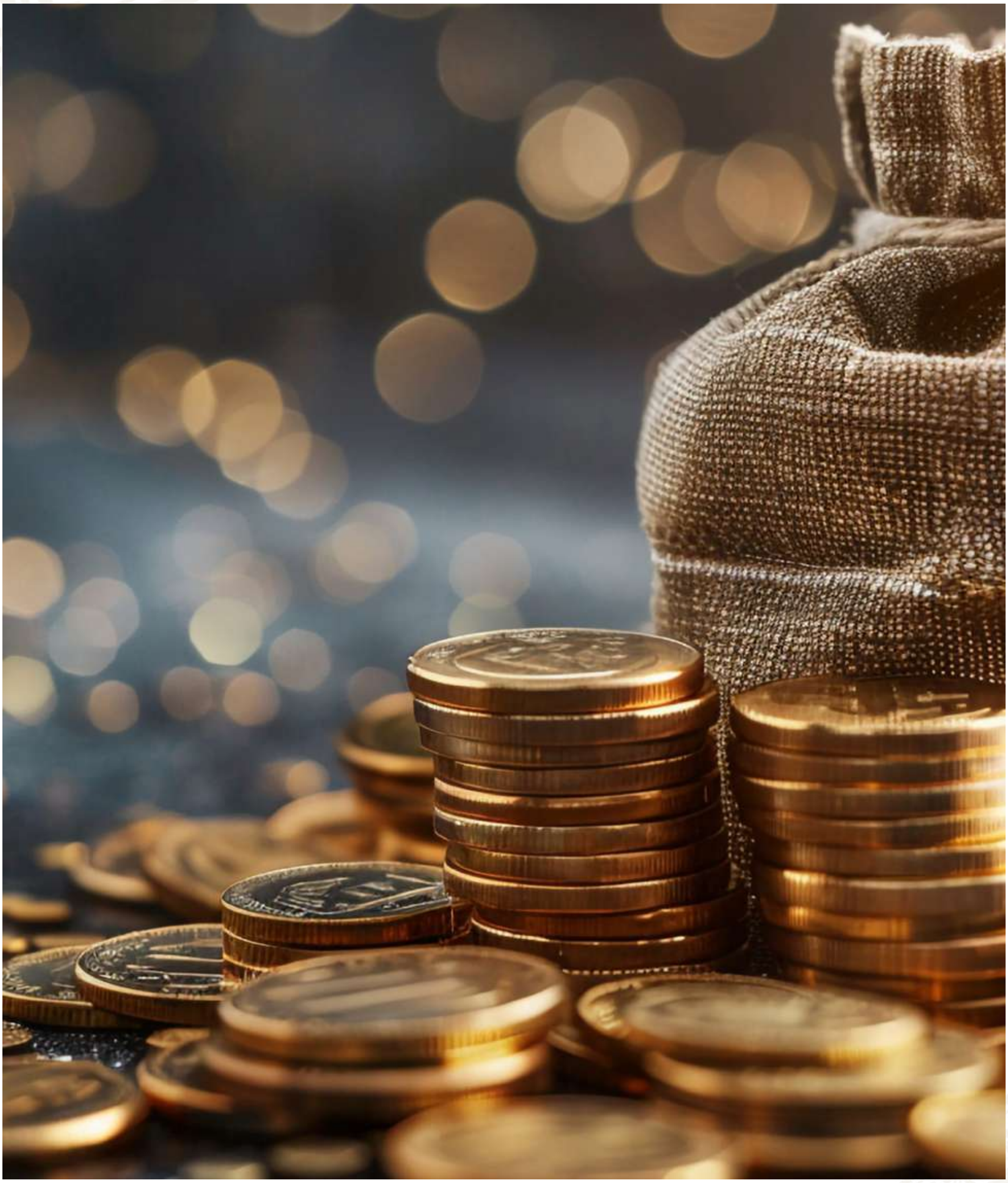
32% in 2023 and 23.8% in 2022. This fall was also due to improvements in the global supply chain and the revocation of the domestic import tax in late 2023. In addition to these factors, the appreciation of USD against the currency of most of Timor-Leste's trading partners, such as Indonesia, also contributed to the inflation slowdown in 2024. However, due to the smaller weight of the alcoholic and tobacco group relative to the food group, the considerable reduction did not have the same magnitude of effect as the food group on the overall inflation in Timor-Leste. Other gorups also experienced reduction, but with lesser impact, such as education and clothing and footwear.

Furthermore, in recent years, the majority of central banks have adopted contractionary monetary policies, characterised by increases in interest rates, with the aim of containing the monetary expansion in the economy during the Covid-19 period. This global trend contributed to the easing of domestic inflation in Timor-leste in 2024.

Excessive dependency on imports exposes the domestic economy to external shocks, which leads to inflationary pressures. This underscores the need to stimulate both public and private investments to enhance domestic supply, create job opportunities, and increase wages, thereby making Timor-Leste's economy more resilient to adverse external shocks.

In terms of future perspectives, BCTL projects that the disinflationary trend will continue throughout 2025. In this context, BCTL expects the average inflation rate to fall further, reaching 1.8% in 2025. This will stabilize the price level, alleviate inflationary pressure, and establish strong market confidence, which will lead to increased consumption and, ultimately, growth in non-oil GDP.

These projections are naturally based on the assumption that relative prices in the international market will continue to stabilize and the exchange rate of the U.S. dollar against the currencies of Timor-Leste's main partners remains stable.




Connection

02

PUBLIC FINANCE

Public Finance

2.1. Revenue

One of the Government's main priorities is to reduce the country's dependence on financing from the Petroleum Fund. Efforts in this regard remain central to budget discussions and planning. In the 2024 State Budget, for example, the government reaffirmed its commitment to "tax reform," aiming to strengthen the fiscal framework and boost non-oil domestic revenues through economic diversification.

In 2024, non-oil revenues totaled $260 million, which represented a decrease of -9% compared to 2023.

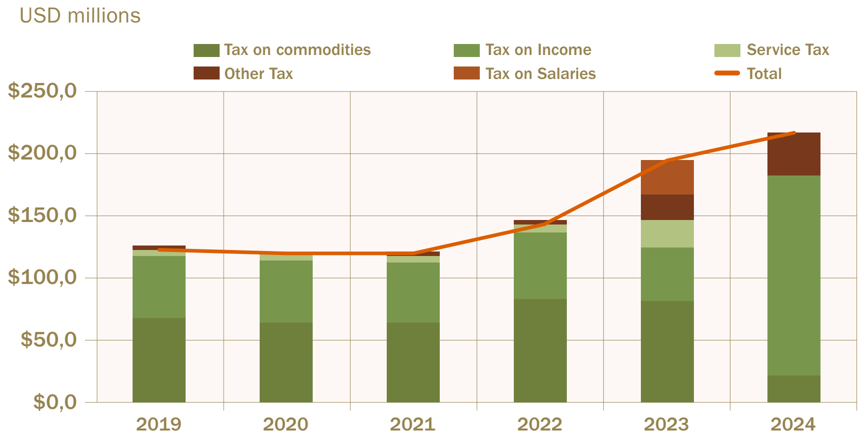
In 2024, on a cash basis, domestic non-oil revenues totalled $260 million, reflecting a 9% decline from the $286 million recorded in 2023. Across revenue categories, tax revenue saw a significant increase of 12%, reaching $216 million, while non-tax revenues experienced a substantial decline of 52% compared to the previous year.

Chart 2.1 highlights the variations in tax revenue and its key components over recent years, specifically taxes on individual and corporate income, as well as taxes on imported goods (including excise tax, sale taxes, and import duties). The increase in tax revenue in 2024 was primarily driven by a substantial rise in income tax, which reached $160 million, up from just $43 million in 2023.

Taxes on income represented the largest share of tax revenues in 2024.

However, taxes on goods imported declined significantly by approximately 73%, falling from $82.3 million in 2023 to $22.2 million in 2024. This decrease was mainly driven by the revocation of the import tax law, including a reduction in the tax rate from 5% to 2.5%. Meanwhile, other tax categories recorded a significant increase of 67% in 2024.

Chart 2.1
TL - Fiscal revenue - cash basis



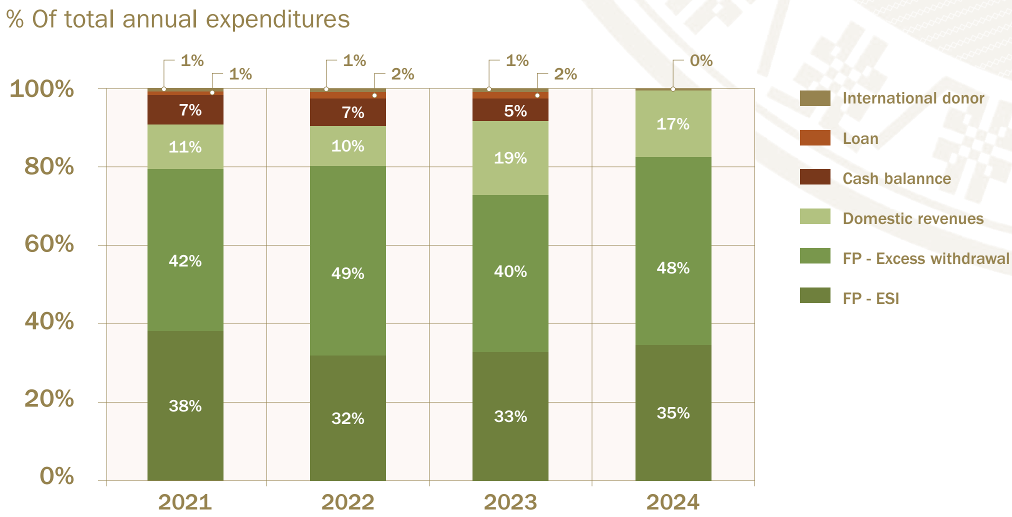
Source: TL Transparency Portal and BCTL calculation

2.2. Financing source

The FP financed $1,300 million of public expenditure in 2024

In the 2024 budget, the government withdrew approximately $1,300 million from the Petroleum Fund, comprising $522.1 million from the ESI and $777.9 million from excess withdrawals, to finance its expenditures throughout the year. This represents an increase of $210 million compared to 2023, driven by higher public spending that could not be sustained by total domestic revenue. The annual withdrawals from the Petroleum Fund continue to exceed the ESI significantly, raising concerns about the fund’s long-term sustainability.

Chart 2.2
Source of Public Expenditure Funding



Source: TL Transparency Portal, State Budget, and BCTL analysis

Regarding the sources of financing for public expenditure in 2024, the Petroleum Fund (PF) remained the dominant source, accounting for 83% of total financing – an increase from 73% in 2023. Conversely, domestic public revenue contributed only 17% of total financing, a slight decline from the previous year. This trend highlights the continued stagnation of domestic revenue, underscoring the county's persistent reliance on the Petroleum Fund.

The PF continues to be the main source of financing for the State budget.

In summary, these considerations highlight the state budget's continued heavy dependence on financing from oil revenues, particularly transfers from the Petroleum Fund, which substantially exceed its sustainable income. Despite the presence of significant energy reserves in Timor's sea, the cessation of oil production in 2024 means that the excessive withdrawals will lead to a continued and substantial decline in the fund's capital, posing a sustainability risk to public finances in the medium and long terms.

2.3. Budget and Expenditure

In 2024, public expenditure increased significantly by $260 million.

In 2024, according to the data in table 1.2 below, public expenditure, on an effective cash basis, recorded a significant increase of $260 million.

The overall actual value of expenditure rose to $1,754 million in 2024. The increase in public expenditure compared to 2023 is primarily attributed to a higher execution rate of the 2024 budget. The actual execution rate of public expenditure in 2024 increased to 78%, with recurrent expenditure achieving the highest execution rate at 79%, while capital expenditure reached 74%. In addition to the improved execution rate, the total budget allocation for 2024 exceeded the 2023 budget by more than $278 million.

The increase in the execution rate of the 2024 budget is primarily due to a rise in the actual execution of recurrent expenditure, which increased by 2 p.p. (79% in 2024 compared to 77% in 2023). Meanwhile, the execution rate of capital expenditure was just above the 2023 level. However, in nominal terms, the total executed amount was substantially higher than in 2023. Apart from its short-term contribution to the economic growth, the increase in public expense on capital is expected to contribute to a greater capital accumulation, which, in turn, will support future economic activities and enhance productivity, as public investment plays a crucial role in fostering the development of Timor-Leste's private sector economy.

The execution rate in 2024 was significantly higher than in 2023.

Table 1.2. State Budget – evolution and execution rate

	Million USD		Annual Change	Execution Rate	
	2023	2024	2024	2023	2024
Total revenues	**776**	**782**	**0.8%**	**78%**	**104%**
Domestic revenues	286	260	-9%	56%	112%
Fiscal revenues	193	216	12%	108%	111%
Non-Fiscal revenues	92	44	-52%	28%	116%
Non-fiscal revenues	0	0			
Grants & contribution	0	0			
Estoimated Sustainable Income (ESI)	**490**	**522**	**7%**	**100%**	**100%**
Total Expenditure	**1,494**	**1,754**	**17%**	**76%**	**78%**
Recurrent expenditure	1,263	1,406	11%	77%	79%
Capital expenditure	231	348	51%	73%	74%
Financing	**718**	**815**	**-**	**-**	**-**
Excess Withrawal from FP	600	778	30%	84%	91%
Use of cash balance	73	0	-100%	36%	0%
Loans	35	35	0%	100%	140%
International donor	10	242%	-77%	100%	16%

Source: TL Transparancy Portal, Budet Book, and BCTL analysis

Regarding revenues, the total revenue in 2024 amounted to $782 million, marking a 1% increase compared to the previous year. This growth was driven by an increase in the Estimated Sustainable Income to $522 million and domestic revenue to $260 million. Despite this improvement, the fiscal deficit persisted, with total expenditures continuing to exceed total revenue. In fact, the deficit was higher in 2024 compared to 2023, leading to a greater excess withdrawal from the petroleum fund, which poses a risk to the fund's long-term sustainability. As shown in the table above, the excess withdrawal in 2024 was significantly high, increasing by 30% compared to the previous year.

2.3.1. Current Expenditure

The execution rate of the public expenditures was higher compared to 2023.

In 2024, the overall actual executed expenditure amount increased by 17% compared to 2023, reaching its highest level in the past five years. While a high execution rate is important for increasing the economic growth, ensuring the quality of expenditure is crucial to achieving broader and more sustainable economic outcomes. The overall expenditure carried out by the government increased, as previously mentioned, by $260 million, which is essentially due to the increase in both capital and current expenditure.

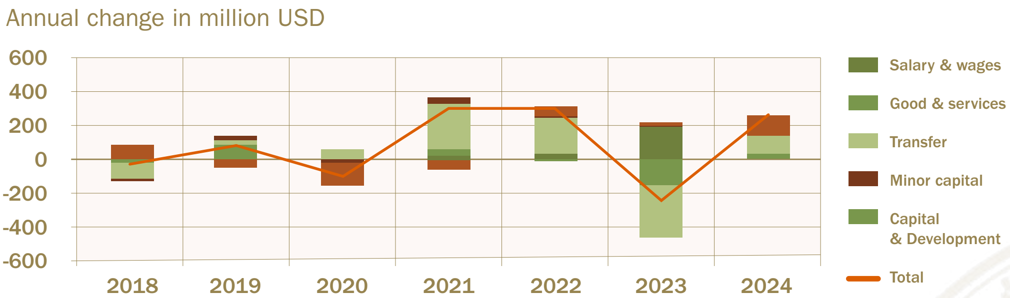
The current expenditure increases by 4% in 2024.

In 2024, the current expenditure increased by 11%, marking a recovery from the slowdown in 2023. Totaling approximately $1,406 million, the current expenditure rebounded from the previous year, continuing its expansion trend since 2018.

Graph 2.3 illustrates the annual changes in public expenditure, measured in millions of dollars on an effective cash basis, reflecting actual expenditures incurred each year. As shown, unlike the previous year, there was a notable increase in expenditure on transfers ($117.9 million), capital and development ($117.6 million), and goods and services ($26.6 million). Meanwhile, expenditures on salaries and wages, as well as minor capital, slightly offset the overall expansion.

In 2024, there were substantial increases in public transfers and capital and development.

Chart 2.3
Public expenditure changes by category - cash basis



Source: TL Transparency Portal and BCTL analysis

2.3..2. Capital Expenditure

Capital expenditure rose by 53%, reaching $394 million in 2024, up from $258.9 million in 2023.

In 2024 budget, the government allocated approximately $413.7 million for capital and development expenditure, marking a significant increase of around $154.8 million compared to 2023. This represents a 60% rise from the $258.9 million allocated in the 2023 budget.

Despite the higher budget allocation of capital and development, the actual execution rate in 2024 only reached 73%, a slight improvement compared to 2023 with 71%. However, the 2024 execution rate was the highest achieved in the last five years. Therefore, the total public investment executed in 2024 amounted to $348 million, reflecting an increase of $117 million from 2023.

The majority of capital development expenditure in 2024 was allocated to infrastructure programs, which accounted for 59% of total public investment – an increase from 47% in 2023. Expenditure on construction and bridges represented approximately 28%, up from 25% in the previous year. The Infrastructure Fund program remains critical investment, facilitating capital formation, stimulating economic activity, and promoting long-term growth. Additionally, the public investment tends to have a short-term crowding-in effect on private investment, further accelerating economic growth in the near term.

Table 1.3 provides detailed information on the key components of the public investment program, highlighting the highest priorities within the infrastructure program.

Table 1.3. Composition of Public Investment

	Millions USD - cash basis				% of Public Investment			
	2021	2022	2023	2024	2021	2022	2023	2024
Minor capital	44	46	48	47	32%	23%	21%	14%
Capital development	96	157	183	301	68%	77%	79%	86%
Total infrastructure	91	147	109	206	65%	73%	47%	59%
Total public investment	140	203	231	348	10%	12%	16%	20%
Total expenditure	1442	1741	1488	1754				

The infrastructure was the most favored program among the total executed capital expense.

Main Investment in Infracture Assets	Millions USD - cash basis				% Public Investment			
	2021	2022	2023	2024	2021	2022	2023	2024
Agriculture	2	3	4	12	2%	1%	2%	3%
Rural & urban dev.			4	5	0%	0%	2%	2%
Maintainance & Rehabilitation			10	25	0%	0%	4%	7%
Court Services			3	0	0%	0%	1%	0%
Information & Communication Technologies			16	26	0%	0%	7%	8%
Water and Sanitation		2	1	6	0%	1%	0%	2%
Health	8	5	2	3	6%	3%	1%	1%
Airport			2	0	0%	0%	1%	0%
Education	0	28	1	3	0%	14%	1%	1%
Road and Bridge	3	18	58	98	2%	9%	25%	28%
Other Infrastructure	78	91	8	27	56%	45%	3%	8%
Total Infrastructure	91	147	109	206	65%	73%	47%	59%

Source: TL Transparancy Portal and BCTL calculation

Regarding sectoral priorities for public infrastructure investment, roads and bridges remained the primary focus, with combined annual expenditure rising to $98 million from $58 million in 2023. Moreover, the IT and communication technology sector received significant attention, with total public investment reaching $26 million, accounting for 8% of overall public investment in 2024. In addition, the public investment in minor capital slightly declined to $47 million in 2024 from $48 million in 2023.

03

MONETARY

Monetary

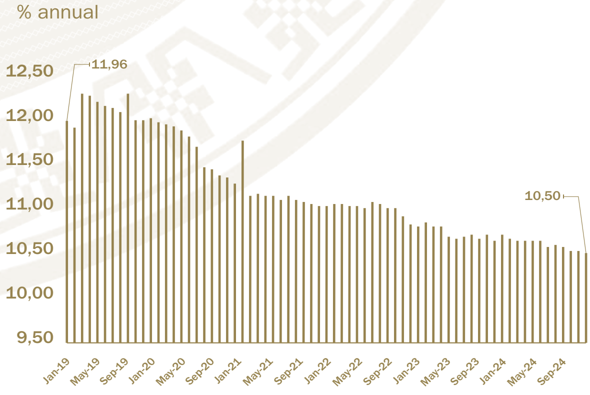
3.1. Interest Rates

Loan interest rates continue to be significantly high despite the credit granting program with lower rates.

The interest rate on loans in Timor-Leste remains relatively high compared to international reference rate in dollar. Economic theory suggests that when a small country adopts the currency of a larger economy, its interest rate should generally converge with those of its reference currency. However, this is not the case in Timor-Leste, particularly for credit interest rates, primarily due to the high risk associated with the banking sector.

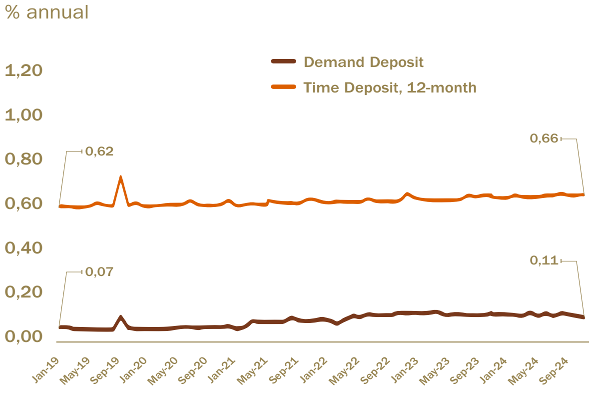
Meanwhile, the government of Timor-Leste provides financial capital to offer concession loans at a lower rate (3%). However, this policy has yet to impact the average interest rates currently observed in the country's banking system. Similar to the trend observed in the previous year, the average interest rate on loans to the private sector continued to decline, dropping from 10.65% in December 2023 to 10.5% in December 2024. Although the decrease was minimal, it signals a positive development for businesses and households relying on bank credit for financing.

Chart 1.3a
TL: Lending interest rate - weighted average



Source: BCTL

Chart 1.3b
TL: Deposit interest rates



Source: Bloomberg

At the same time, the average rate on 12-month deposit saw a slight increase at the end of 2024 compared to 2023. Specifically, while the rate for 12-month deposits stood at 0.65% in December 2023, it rose to 0.66% in December 2024, reflecting a 0.01 p.p. increase over the year.

This movement in lending and deposit rates reduced the interest rate spread, which fell from 10% in December 2023 to 9.87% in December 2024. In essence, loan interest rates are following a downward trend, while deposit rates are rising, albeit at a very slow pace.

Table 1.4. Average interest rates (commercial bank) - **weighted average** (In percentage)

Periods		Loans + 6 months LIBOR	Demand deposit	Saving deposit	Time deposit			
					1 month	3 months	6 months	12 months
2023	Dec	10.65	0.12	0.50	0.55	0.57	0.62	0.65
2024	Jan	10.71	0.12	0.49	0.54	0.57	0.61	0.65
	Feb	10.67	0.12	0.49	0.55	0.57	0.62	0.65
	Mar	10.65	0.12	0.51	0.51	0.53	0.59	0.66
	Apr	10.64	0.11	0.50	0.53	0.56	0.62	0.65
	May	10.65	0.13	0.50	0.56	0.59	0.66	0.65
	Jun	10.64	0.11	0.50	0.53	0.56	0.62	0.65
	Jul	10.59	0.13	0.51	0.53	0.56	0.62	0.66
	Aug	10.60	0.12	0.51	0.53	0.56	0.63	0.66
	Sep	10.58	0.12	0.52	0.54	0.57	0.63	0.67
	Oct	10.54	0.12	0.51	0.53	0.56	0.63	0.66
	Nov	10.53	0.12	0.51	0.54	0.57	0.64	0.66
	Dec	10.50	0.11	0.52	0.53	0.57	0.63	0.66

Source: BCTL

3.2. Exchange rates

In 2024, the USD appreciated by 3.2%, in average, against the rupiah of Indonesia, Timor-Leste's main economic partner.

The USD, the official currency of Timor-Leste, appreciated on average against the currencies of the country's two main trading partners. More specifically, from December 2023 to December 2024, the USD appreciated by approximately 1.2% against the Singapore dollar, a key reference currency in the Asian region, and by 3.2% against the Indonesian rupiah, Timor-Leste's primary trading partner. Overall, exchange rate fluctuations were more pronounced in 2024 compared to the relative stability observed in 2023.

Chart 3.2
Nominal exchange rate vs USD

Source: Bloomberg

The appreciation of the USD against the currencies of Timor-Leste's main trading partners, the Singapore dollar and the Indonesia rupiah, helped reduce inflationary pressures in the domestic market in 2024. Given Timor-Leste's high dependence on imported goods and services to meet domestic demand, the combined effect of these exchange rate dynamics contributed to the observed disinflation rate in 2024.

The Real Effective Exchange Rate Index (REERI), an indicator used to assess a country's competitiveness in terms of tradable national products, appreciated by 0.7% by the end of 2024 compared to 2023 (6.4%). The REERI trended downward after October 2022 (13.3%) until September 2024 (-4.2%), indicating that exports became relatively cheaper, and imports were relatively more expensive during that period (Chart 3.2a). The subsequent upward trend in the REER at the end of the year suggested a decline in international competitiveness as exports became relatively more expensive.

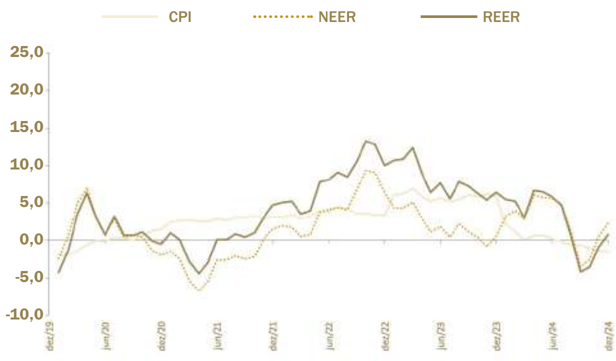
Timor-Leste's economy remains highly dependent on the outside world.

The Nominal Effective Exchange Rate (NEER), which reflects the nominal value of Timor-Leste's currency (the US dollar) relative to its trading partners, exhibited fluctuations throughout the period from 2019 to 2024. By the end of 2024, the NEER had appreciated by 2.3% compared to its trading partners, indicating an appreciation of the US dollar against the currencies of Timor-Leste's trading partners, which increased Timor-Leste's purchasing power. Consequently, Timor-Leste imported more goods and services due to its stronger purchasing power.

In terms of annual changes (Chart 3.2b), in 2024, the REER, reflecting Timor-Leste's inflation-adjusted competitiveness, continued its downward trend and recorded -1.1% by year-end, compared to 7.9% in 2023. This indicated increased competitiveness for Timor-Leste in the market. The NEER remained relatively stable with less volatility, recording 0.2% compared to 1.9% in 2023.

Chart 3.2a
Nominal exchange rate vs USD

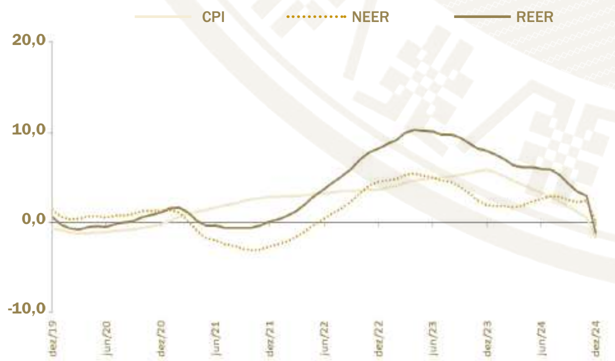
% annual



Source: BCTL

Chart 3.2b
Real Effective Exchange Rate Index - Average

% average annual changes

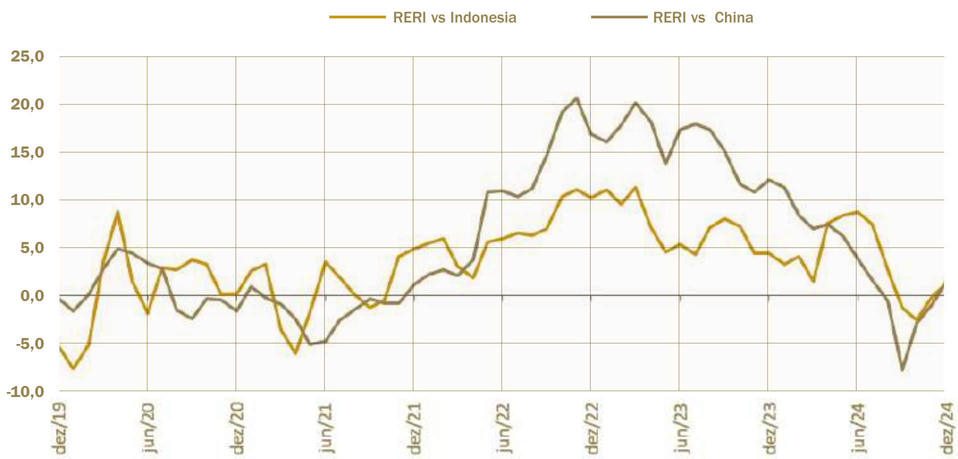


Source: BCTL

In terms of bilateral real exchange rates (Chart 3.2c), specifically with two of Timor-Leste's major trading partners, Indonesia and China, the US dollar continued to appreciate against both the Indonesian Rupiah and the Chinese Yuan, by 2.3% and 1.5% respectively. This boosted import demand from these countries. Despite depreciating for three consecutive months in 2024, the US dollar recovered against both currencies by the end of the year.

Chart 3.2c
Selected Bilateral Real Exchange Rate

% annual change



Source: BCTL

3.3. Monetary Base

The monetary base increased by $11 million in 2024 from the previous year.

The monetary base, a key variable in monetary policy, increased significantly in 2024 by $11 million, reaching a total of $294 million. Of this, $33 million was attributed to currency in circulation, while the remaining $261 million was in bank deposits with BCTL. The increase in the monetary base in 2024 was primarily driven by a $9 million rise in bank deposits with the BCTL, mainly related to higher required reserves and other liabilities accounts. These two accounts, which banks must maintain with BCTL if they fail to meet its requirements for minimum loan-to-deposit ratios, played a crucial role in driving the increase in the monetary base during 2024.

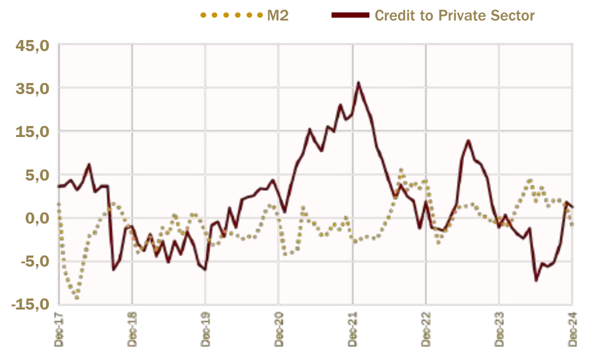
3.4. Money Supply

Financial sector development plays a vital role in fostering economic growth and poverty reduction. The compilation and analysis of monetary and financial statistics make it possible to assess the development and changes in a country's monetary and financial systems. The Central Bank of Timor-Leste has been systematically collecting and compiling these statistics with the aim of developing a comprehensive and detailed view of our financial sector, in order to develop the functions of the BCTL within the scope of macroprudential supervision and the implementation of a monetary policy. However, to date, the BCTL still does not have an independent monetary policy as our country continues to use a foreign currency, the US dollar, as its official currency.

Although Timor-Leste operates as a "dollarized" economy, the BCTL can reasonably calculate the aggregate broad monetary (M2) by excluding dollar bills in circulation. This measure is determined by summing the currency in circulation, demand deposits (which, like currency, can be immediately mobilized for payments), and “quasi-money” (saving and term deposits), which can also be accessed relatively quickly to make payments.

Chart 3.4a
Money supply growth

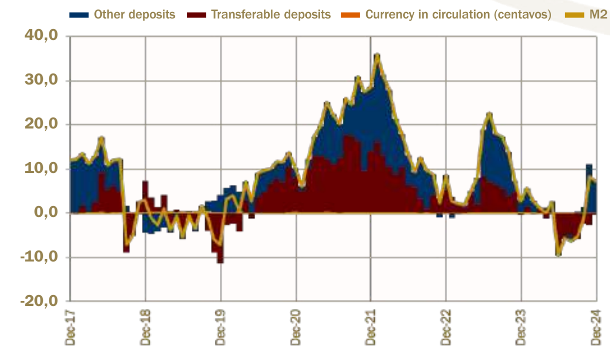
% annual change



Source: BCTL

Chart 3.4b
M2 and its components

% annual change and its contributions

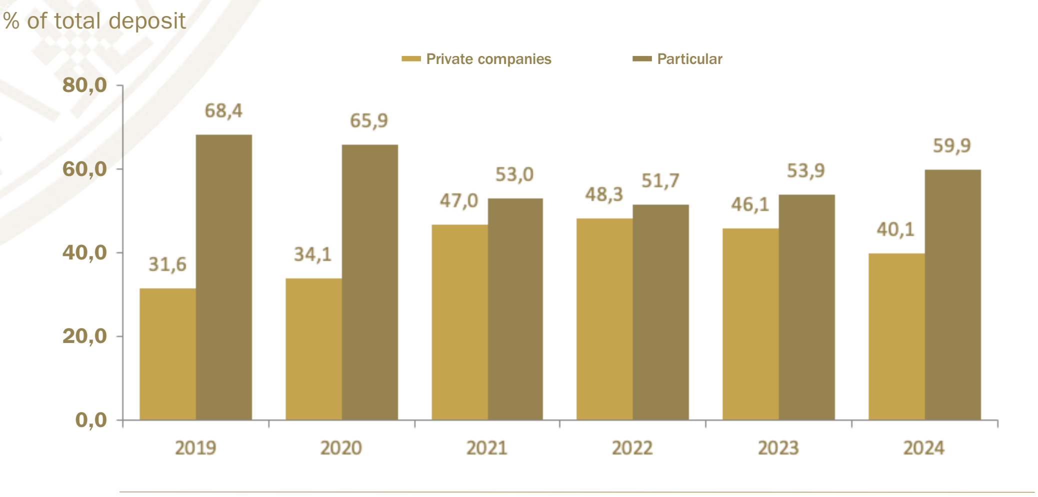


Source: BCTL

M2 rose to 1,339 million by December 2024, an increase of $91 million from the previous year.

Graph 3.4a and 3.4b show the evolution of the M2 from 2017 to 2024. Note that the M2 values are approximate, as it is challenging to accurately calculate the value of banknotes in circulation due to the use of the US dollar. However, since the physical currency circulation represents a relatively small and stable portion of the total payment resources, the approximate M2 provides a reasonable measure for assessing the size and fluctuations of the money supply in the economy. In 2024, the M2 amounted to $1,339 million, reflecting an expansion of $91 million from 2023, continuing the trend of growth over the years.

Chart 3.4c
Share of deposit by ownership



Source: BCTL

Of the total deposits, there has been an increasing convergence in the percentage of deposits held by private companies and individuals since 2019.

It is also important to analyze the evolution of the components of the money supply, as shown in Graph 3.4b, total deposits raised by financial institutions played a key role in the expansion of the money supply, with an increase of $88.7 million in 2024 reaching $1,305.5 million, compared to $29.5 million to $1,216.8 million in 2023.

Regarding the ownership of deposits by institutional sector, as shown in Graph 3.4c, 59.9% of deposits are held by individuals, while 40.1% were held by private companies. These percentages reflect a slight increase of 6 p.p. in the share of deposits held by individuals, while the share of deposits held by private companies decreased by the same amount (-6 p.p). Despite the slight decrease in the proportion of deposits held by private companies in 2024, their share remains signficantly higher than the 31.6% recorded in 2019, highlighting the growth in buinsess-owned deposits.

Another perspective on the analysis of M2, according to Table 1.5 below, the increase in credit and government deposits explained the bulk of the increase in money supply, despite being offset by a reduction in net external assets.

Table 1.5. Changes and Drivers of Money Supply

In million USD	Annual flow 2023	Annual flow 2024
Credit to economy	84.3	156.6
Government	133.0	101.4
Claims on BCTL	0.8	-1.3
Deposits	132.2	102.7
Net Foreign Assets	-173.0	-10.0
Other Net Assets	11.3	156.9
M2	32.9	91.1

Source: BCTL

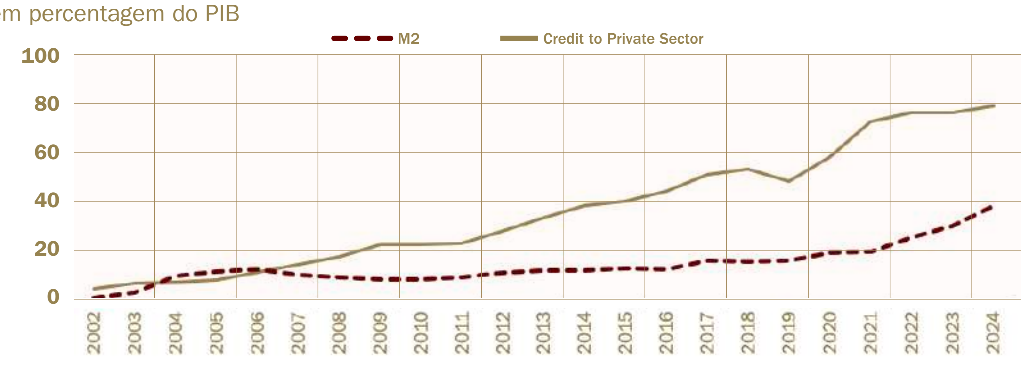
3..5. Financial deepening

The degree of financial deepening, measured as M2 to GDP, increased by 2.4 p.p. in 2024 compared to 2023.

Financial deepening, or the monetization of the economy, is measured by the M2-to-GDP ratio, which rose from 76.7% in 2023 to 79.1% in 2024, an increase of 2.4 p.p., continuing its upward trend despite some fluctuations. Another key indicator, the credit-to-GDP ratio, increased by 8.1 p.p., reaching 38.4% at the end of 2024, up from 30.3% in 2023.

Chart 3.5
Growth of monetary aggregates

em percentagem do PIB



Source: BCTL

BANCO CENTRAL DE TIMOR-LESTE

ESTABILIDADE · TRANSPARÊNCIA · PROSPERIDADE

04

BANKING SYSTEM

Banking system

Loan interest rates continue to be significantly high despite the credit granting program with lower rates.

The Timor-Leste banking system maintained stability and soundness throughout 2024, supported primarily by resident deposit funding. Continuous increases in liquidity characterized the sector. The system comprises of seven financial institutions operating in Timor-Leste, including the Banco Nacional de Comércio de Timor-Leste (BNCTL), branches of four significant foreign banks (CGD/BNU from Portugal, ANZ from Australia, and Banco Mandiri and BRI from Indonesia), and two other deposit-taking institutions and financial service providers, Moris Rasik, SA and Kaebauk Investment and Finance, SA.

The banking sector demonstrated positive growth in several key areas during 2024. Total banking assets expanded by 9%, largely driven by growth in commercial bank assets; total credit extension continued its upward trend. On the other hand, bank's liabilities were primarily contributed from deposits, indicating a reliance on domestic resource mobilization. Net income within the banking sector also registered growth, suggesting improved profitability. The expansion of transfer services continued, observed in both commercial banks and other money transfer operators (MTOs), pointing to increased usage of formal financial channels.

4.1. Banking Loans

In 2024, credit extended by banks to the private sector continued to increase, following a trend that began in 2021. The total credit disbursed amounted to $583.1 million in 2024, up from $439.9 million in 2023, reflecting an increase of $143.2 million.

Bank credit increased in 2024 (33%), with special emphasis on credit granted to Transport & communications and constructions.

Table 1.6. Evolution and Composition of Bank Credit

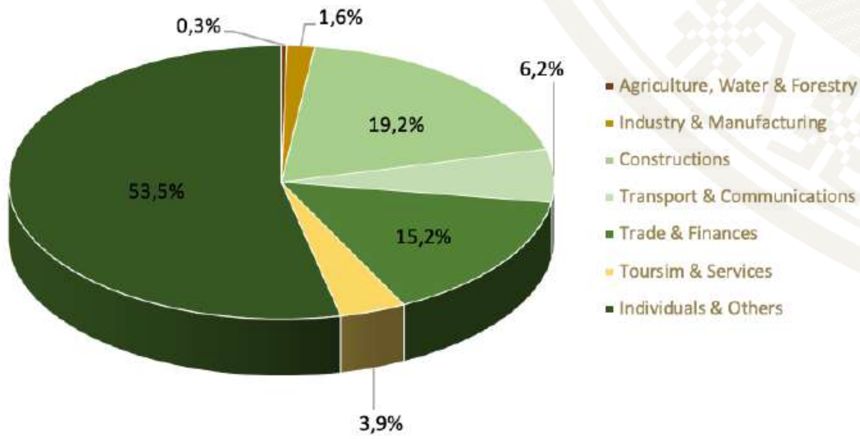
Credit by sector	Balance (million USD)		Growth		Shares	
	2023	2024	Nominal	%	2023	2024
Agriculture, Water & Forestry	1.7	1.9	0.2	11.1%	0.4%	0.3%
Industry & Manufacturing	19.9	9.5	-10.4	-52.3%	4.5%	1.6%
Constructions	62.8	111.8	49.0	77.9%	14.3%	19.2%
Transport & Communications	18.5	36.3	17.8	96.0%	4.2%	6.2%
Trade & Finances	61.6	88.9	27.3	44.3%	14.0%	15.2%
Toursim & Services	19.8	22.8	3.0	15.0%	4.5%	3.9%
Individuals & Others	255.5	311.9	56.4	22.1%	58.1%	53.5%
Total	**439.9**	**583.1**	143.2	33%	100%	100%

Source: Commercial Banks and BCTL analysis

When analysing credit granted by sector of activity, we see that the transport and communications sectors recorded the highest credit growth at 96% in 2024, followed by construction (77%), trade and finance (44%), individuals and others (22.1%), tourism and services (15%), and agriculture, water, forestry (11.1%). However, the industry and manufacturing sector experienced a contraction of 52.3%. The total credit granted to families (individual and others) has been the largest across sectors since 2005. Despite this, the proportion of credit granted to individuals fell slightly to 53.5% in 2024, down from 58.1% in 2023. This decrease in the relative share of credit to individuals was accompanied by increases in the shares of credit granted to the construction and trade and finance sectors, as shown in Table 1.6.

Chart 4.1
Credit by sector - Dec 2024 - % of Total

Credit for consumptive purposes continues to surpass that allocated to productive sectors.



Source: BCTL

As shown in Chart 4.1, credit granted to the agriculture sector accounted for only 0.3% in 2024. Despite its crucial role in the domestic economy – supporting the livelihoods of the majority of the population – access to credit in this sector remains stagnant. Meanwhile, credit disbursed for consumptive purposes continues to exceed that allocated to productive sectors.

Beyond the quantity of loans, assessing their quality is equally important. This can be measured through indicators such as the volume of doubtful loans and the financial system's provisions for credit risks. Notably, provisions for credit risks have shown an upward trend, reaching $22.9 million in 2024, compared to $20.1 million in 2023. However, this increase should be viewed in relation to the overall growth in credit granted during 2024.

Despite this, banking institutions remain resilient in managing potential credit quality deterioration. The Non-Performing Loan (NPL) ratio remains low at 2.1%, and the sector's strong operating profit margin provides a solid buffer against credit risks.

Although financial institutions have improved the quality of their balance sheets, the total value of credit disbursed remains significantly lower than the level of deposits. As a result, commercial banks hold excess liquidity, which they tend to invest abroad rather than channelling into the domestic economy.

4.2. Bank Assets

Table 1.7 shows the development of banking system assets. Total banking assets continued to show moderate growth in 2024 of 9% compared to 2023. Banking assets recorded an amount of $2,662.3 million, an increase of $221.3 million from 2023.

Table 1.7 Composition Banking System Assets

	In million USD		% of TA	change	
	Dec-23	Dec-24		%	Valor
Cash & BCTL balance	308.1	328.9	12.4	6.8	20.9
Placement to other banks	1,544.6	1,637.5	61.5	6.0	92.9
Investment	130.6	95.3	3.6	-27.1	-35.3
Total Credit	419.8	560.2	21.0	33.5	140.4
Fixed Assets	16.3	18.9	0.7	15.4	2.5
Other Assets	21.6	21.5	0.8	-0.3	-0.1
Total Assets	**2,441.0**	**2,662.3**	**100**	**9.1**	**221.3**

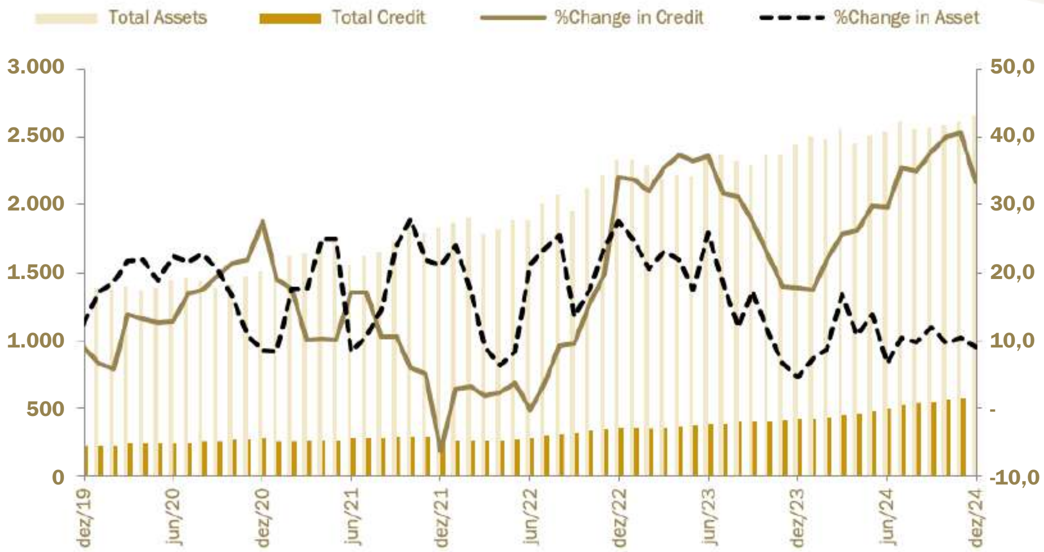
Fonte: BCTL

The growth in banking assets in 2024 was driven by an increase in total credit, which increased 33.5% or approximately $140.4 million, mainly contributed from credit to individuals and construction sector. This was followed by placements to other banks other than the central bank, which increased $92.9 million. In contrast, investment assets continued to decrease in 2024, dropping 27% to approximately $35 million from 2023, mainly contributed from the drop in foreign government securities.

Meanwhile, total assets and total credit have exhibited similar growth trends from 2019 to 2024, with minor fluctuations as illustrated in Chart 4.2. Total credit reached $560.2 million in 2024, representing approximately 21% of total assets, and is the second largest contributor to total assets.

Chart 4.2
Evolution of Banking Assets

In Millions of USD and % change per year

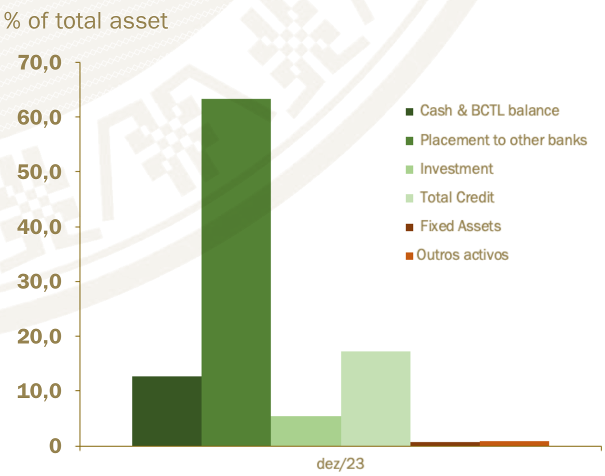


Source: BCTL

The year-on-year growth rate of total credit largely mirrors the trend in total assets, emphasizing the crucial role of credit in Timor-Leste's banking assets. Over the past five years, total credit has generally demonstrated positive growth, with exceptions in December 2021 and June 2022, when it experienced negative growth of 6.3% and 0.3%, respectively. As noted, total credit is the second largest component of total banking assets in Timor-Leste.

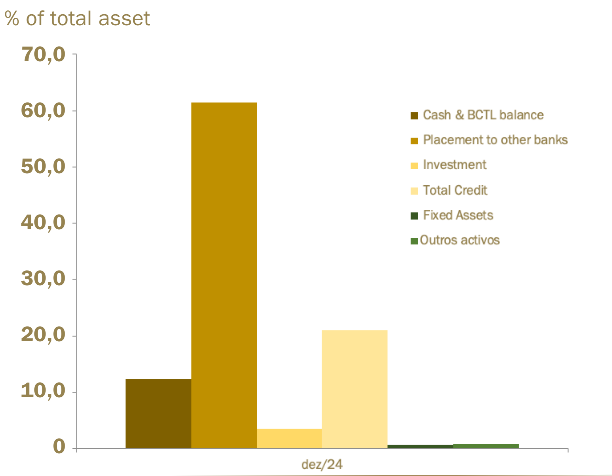
On the other side, placements with other banks have constituted the largest share of total banking assets, accounting for 63.3% in 2023 and 61.5% in 2024 (Charts 4.2a and 4.2b). In 2024, these placements totaled $1,637.5 million, an increase of $92.9 million from the previous year.

Chart 4.2a
Composition of Banking Asset



Source: BCTL

Chart 4.2b
Composition of Banking Asset



Source: BCTL

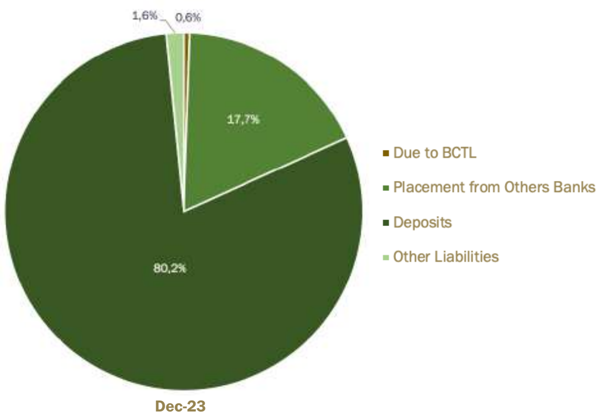
Cash and balances held with the central bank (BCTL) represented the third largest component of total banking assets. In 2024, this balance reached $328.9 million, a rise of $20.9 million (approximately 6.8%) from 2023 levels (Table 1.7).

4.3. Bank Liabilities

Customer deposits have remained the primary contributor to banking liabilities (chart 4.3a and chart 4.3b). At the end of December 2024, deposits totalled $1,852.3 million, representing approximately 78.7% of total banking liabilities. A similar pattern was observed in 2023, with deposits comprising 80.2% of total liabilities, amounting to $1,745.9 million.

Chart 4.3a
Composition of Banking Liabilities

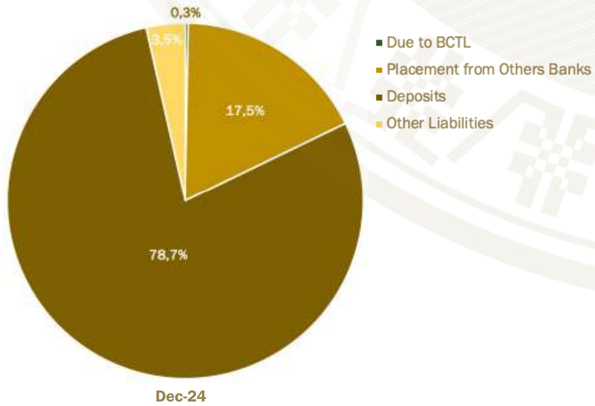
% of total liabilities



Source: BCTL

Chart 4.3b
Composition of Banking Liabilities

% of total liabilities



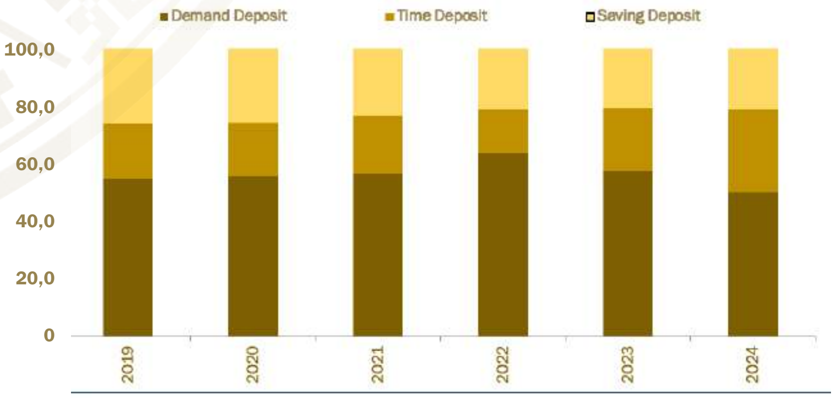
Source: BCTL

Placements from other banks constituted the second largest source of liabilities, reaching $412.4 million at the end of 2024 and $384.5 million in 2023, representing approximately 17.5% and 17.7% of total liabilities, respectively. Liabilities due to the central bank and other liabilities accounted for only a small percentage of total liabilities during these two years.

In terms of the composition of customer deposits (Chart 4.3c), demand deposits have consistently been the largest contributor to total liabilities over the past six years, annually representing more than 50% of the total. In 2024, demand deposits made up 50.1% of total liabilities, followed by time deposits at 28.7%, with the remainder coming from savings deposits.

Chart 4.3c
Composition of Deposit

% of total deposit

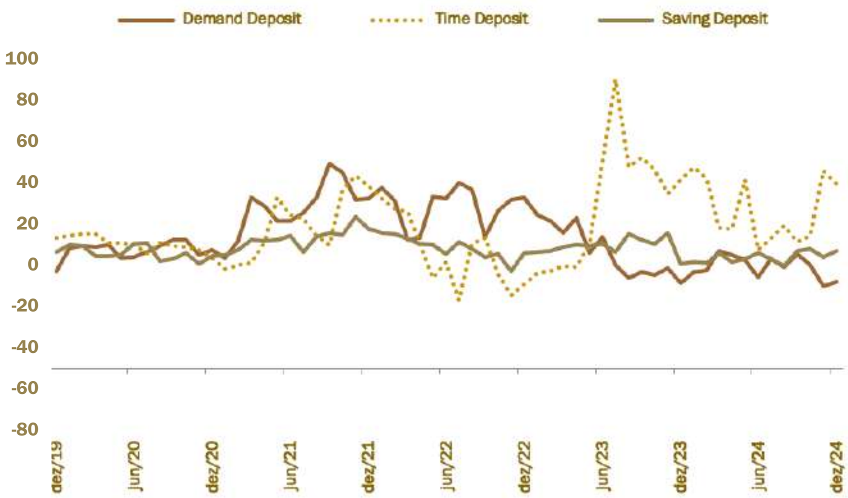


Source: BCTL

Over the past five years, the year-on-year growth rates for deposit types have shown minor fluctuations, with the exception of time deposits (Chart 4.3d). Time deposits experienced a significant peak in July 2023, reaching 91.2% growth compared to July 2022. This surge followed a period of negative growth in the preceding year, 2023. In 2024, time deposits continued to demonstrate substantial growth at 40.6%, equivalent to $153.7 million.

Chart 4.3d
Deposit Growth

% annual growth rate



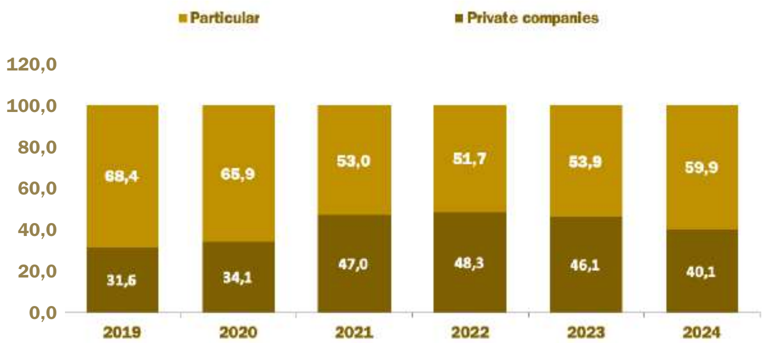
Source: BCTL

Demand deposit growth has declined in the last two years, decreasing by 7.5% at the end of 2024 and 8.2% at the end of 2023. In contrast, savings deposits have maintained positive growth over the five-year period. In December 2024, savings deposits grew by 7.8%, representing an increase of approximately $28.2 million from 2023.

In terms of the share of deposit by ownership (Chart 4.3e), particular deposits have been the largest contributor to total deposits over the past six years. In 2024, 59.9% of total deposits came from particular or individual depositors, with the remaining 40.1% originating from private companies. However, a long-term trend indicates a gradual increase in deposits from private companies, resulting in a decrease in the share of particular or individual deposits over the last six-year period.

Chart 4.3e
Share of deposit by ownership

% of total deposit



Source: BCTL

4.4. Bank Profitability

Bank revenues, consisting of interest received and commissions charged to their customers, amounted to a total of $98.8 million, registering a significant increase of $6.6 million compared to 2023.

As a result of their activity, the banks presented the following consolidated results in 2024, which are compared with the corresponding values for 2023 in table 1.8 below:

Table 1.8 Consolidate Income of Banking System

Items	In Millions USD		% annual Change	% Gross op. Income	
	2023	2024		2023	2024
Interest Received	97.8	113.2	15.8	106.1	114.6
Interest Paid	14.3	23.2	62.7	15.5	23.5
Net Interest Income	83.5	90.0	7.7	90.6	91.1
Commission & Other Op. Revenues	8.7	8.8	1.1	9.4	8.9
Gross Operating Income	**92.2**	**98.8**	**7.1**	**100**	**100**
Provision & Impairments	-8.8	-1.7	-80.3	-9.6	-1.8
Operational Expenses	-41.5	-42.8	3.0	-45.0	-43.3
Net Operating Income	**41.9**	**54.3**	**29.5**	**45.5**	**55.0**
Extraordinary Income/Expenses	0.3	0.0	-105.8	0.3	0.0
Net Income Before Taxes	**42.2**	**54.3**	**28.7**	**45.7**	**54.9**
Income Taxes	-5.3	-6.6	24.7	-5.8	-6.7
Net Income	**36.9**	**47.6**	**29.2**	**40.0**	**48.2**
RoA % - Return on Assets	1.5	1.8	18.5	1.6	1.8
RoE % - Return on Equity	14.0	15.5	11.1	15.1	15.7

Source: BCTL

As we can see, interest received grew by 15.8% in 2024 compared to 2023. The gross operating income of Timor-Leste's banking system recorded an increase of $6.6 million, translating to a growth of 7.1% compared to 2023. Therefore, the net operating income grew by $12.4 million compared to 2023, which is equivalent to a growth of 29.5%.

Finally, taking into account extraordinary income and costs and taxes on profits for the year, the system's consolidated net income increased to $47.6 million in 2024, compared to $36.9 million recorded in the previous year.

This increase explained the increase in return on assets (RoA, or Return on Assets) observed in 2024 to 1.8%, compared to 1.5% seen in 2023, as well as the growth in return on equity (RoE, or Return on Equity) for 15.5%, when, in 2024, up from 14% in 2023. Banks continue to maintain liquidity ratios higher than those required by the Central Bank and the regulatory framework in force.

4.5. Transfer Services

4.5.1. Remittance Transfer – Commercial Banks

During 2024, money transfer services, reported by commercial banks operating in Timor-Leste, recorded a total of transfers abroad of around 101 thousand transactions, with an aggregate nominal value of $1,960 million. The number of operations carried out reduced by 18.5% and the total value transferred decreased by 10.7%, compared to 2023.

At the same time, the number of transfer transactions received increased by 13% in 2024 to 114 thousand transactions, with the value received also increasing by 12% to $911 million.

Therefore, the net balance of transfers received and originated by commercial banks recorded a substantial negative growth, reaching -$1,049 million in 2024, when compared to the also negative balance of $1,382 million in the previous year.

4.5.2. Transfer of Remittances – Specialized Operators (OTO)

In 2024, the group of Other Money Transfer Operators (OTOs) recorded a total value of transfers to abroad of $187 million, compared to $202 million in 2023. Transfers originating from abroad through these operators recorded, in 2024, an amount of approximately $245 million, compared to the $204 million recorded in 2023. This evolution led to an improvement from the positive balance observed in 2024, with the amount of $2 million, to a surplus value of $58 million in 2024.

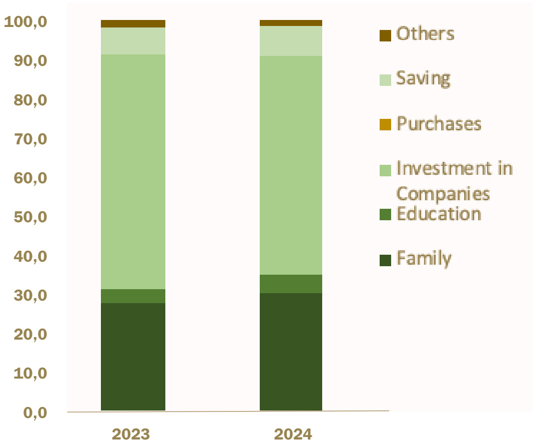
Personal transfers continued to represent the largest share, both in terms of inflows and outflows, amounting to 47% and 79% of total transfers, respectively. Personal transfers combine reasons of transfers for 'family', 'education' and 'savings' generated from the transfer operations.

In geographic terms, the majority of inflows continued to come from Europe, accounting for $117 million in 2024 (48% of the total), compared to $99 million in 2023, and were mostly explained by the sending of remittances from Timorese workers living and working in Europe. Remittance outflows operated by OTOs were, for the most part, routed to the Asian region, totaling an amount of $162 million, with Indonesia being the largest destination for transfers from Timor-Leste, with a total of $145 million, which equivalent to 77% of the total. This amount is explained by remittances sent by Indonesian citizens who reside and work in Timor-Leste.

Graphs 4.5a and 4.5b show the weight of transfers made to and from Timor-Leste, by purpose, using the services of money transfer operators in 2024.

Chart 4.5a
Outward Transfers, by purpose (MTOs)

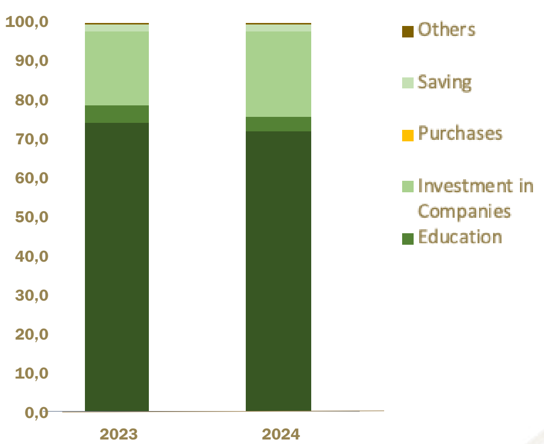
% of total



Source: BCTL

Chart 4.5b
Inward Transfers , by purpose (MTOs)

% of total



Source: BCTL

05

EXTERNAL SECTOR

External Sector

Timor-Leste's external sector continued to record a significant deficit as shown in table 1.9 for Timor-Leste's balance of payments. In 2024, the current account deficit reached $529.7 million, primarily driven by deficits in the goods and services accounts, which totaled $644.2 million and $275.1 million respectively. The primary and secondary revenue accounts, amounting to $231.1 million and $158.4 million respectively, were insufficient to counterbalance the current account deficit. In 2024, the deficit deteriorated further compared to 2023, declining by 198.7%, primarily driven by the shortfall in the goods account.

The current account deficit, including oil income, represented 31.3% of GDP in 2024, a 20-percentage point (pp) increase compared to 2023 (-10.9%). Excluding oil-related activities, the deficit widened, reaching 35.4% of GDP in 2024, approximately -$597.7 million.

In contrast, the financial account balance continued to reflect the economy's overall net financial capacity, reaching $446.0 million. This represented a $411 million improvement compared to the $35.4 million financial capacity in 2023. In 2024, the financial capacity accounted for approximately 26.4% of GDP, a 24 pp increase from 2023.

Table 1.9. Balance of Payment of Timor-Leste

	Million USD			% GDP	
	2023	2024	%Change	2023	2024
Current account, excluding oil Activity	-549.5	-597.7	-8.8	-33.8	-35.4
Current Account	-177.3	-529.7	-198.7	-10.9	-31.3
Goods, FoB	-140.4	-644.2	-358.7	-8.6	-38.1
Service	-327.0	-275.1	15.9	-20.1	-16.3
Primary Income	202.3	231.1	14.2	12.4	13.7
Secondary Income	87.7	158.4	80.6	5.4	9.4
Capital Account	4.3	1.3	-68.6	0.3	0.1
Financial Account	35.4	446.0	1,160.0	2.2	26.4
Direct Investment	-131.5	-227.7	-73.2	-8.1	-13.5
Portfolio Investment	332.4	635.9	91.3	20.5	37.6
Other Investment	-116.4	81.9	170.4	-7.2	4.8
Net Errors and Omissions	208.5	974.4	367.4	12.8	57.6
Grand Total	-137.7	-82.4	40.1	-8.5	-4.9
Reserve Asset (Change)	-49.1	-44.1	10.2	-3.0	-2.6

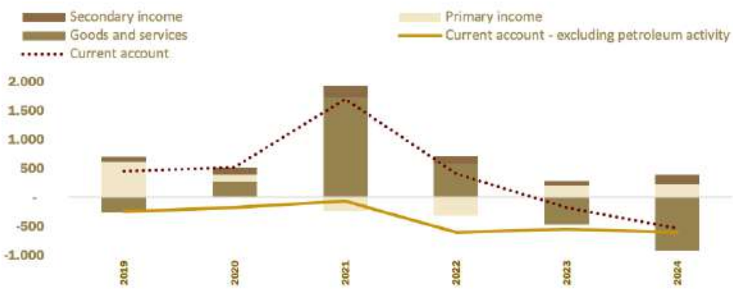
Source: BCTL

5.1. Current Account

The current account continued to experience a deficit, reaching -$529.7 million in 2024 (Chart 5.1). This was primarily driven by the persistent deficits in the goods and services accounts. Imports of both goods and services exceeded the combined surpluses in the primary and secondary income accounts during this period.

Chart 5.1
Timor-Leste - Current Account Balance

In millions USD



Source: BCTL

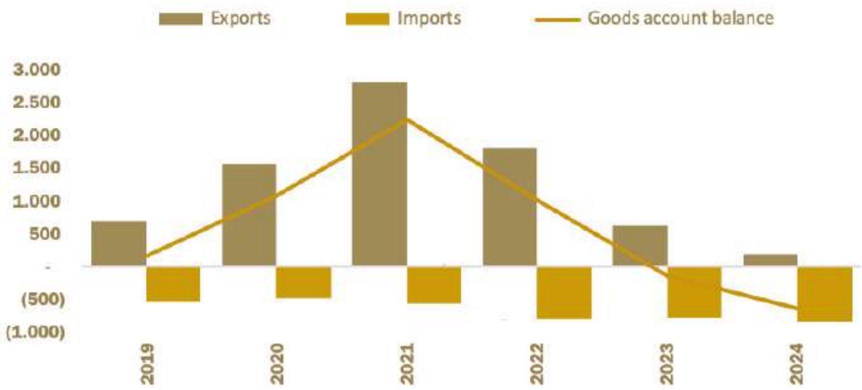
5.1.1. Trade Balance

Goods

The goods account balance experienced a significant downturn after reaching a peak of $2,248 million in 2021 (Chart 5.1a). Over the following two years, it recorded negative balances of $140.4 million in 2023 and $644.2 million in 2024.

Chart 5.1a
TL Goods Accounts

In millions USD



Source: BCTL

The positive goods balance from 2019 to 2022 was primarily attributed to revenues from petroleum product sales.
The subsequent negative balances resulted from low oil production in Timor Sea – South Coast.

However, when excluding oil-related sales from Timor Sea, the goods account deficit worsened, reaching $784.3 million in 2024 compared to $679.4 million in 2023.

This deficit was driven by Timor-Leste's market dependence on imported goods. In 2024, imports, adjusted for Free on Board (FoB), amounted to $840.2 million, up from $772.8 million in 2023.

Export of Goods

Non-oil exports increased to $21 million in 2024, a 21.7% rise from $17.3 million in 2023 (Table 1.10). Coffee remained the primary export commodity in 2024, accounting for $17.8 million, while other products such as kemiri (candlenut), konjac, copra, and others contributed the remaining $3.2 million.

Over the past two years, Indonesia and the United States of America (USA) have been Timor-Leste's main non-oil export trading partners. In 2024, 25.8% of total exports, or $5.4 million, went to Indonesia. However, this amount decreased by 27.8% compared to 2023. The primary export to Indonesia was coffee, totaling approximately $3 million.

The USA was the second-largest destination for Timor-Leste's exports in 2024, accounting for 24.7% of total exports, or approximately $5.2 million. The main export to the USA was also coffee, amounting to $5.1 million.

Table 1.10. Destination of Exports

	2023	2024	Annual (%)	2023	2024
United States of America	2.3	5.2	123.5	13.5	24.7
Indonesia	7.5	5.4	-27.8	43.6	25.8
Portugal	1.8	1.2	-31.0	10.4	5.9
Australia	1.4	2.3	62.8	8.1	10.9
Germany	0.1	1.4	1154.6	0.6	6.6
Taiwan	0.7	0.3	-49.4	3.8	1.6
Japan	1.0	1.6	66.0	5.7	7.8
Other	2.5	3.5	42.1	14.3	16.7
Total	**17.3**	**21.0**	**21.7**	**100**	**100**

Source: INE-TL and BCTL Calculation

Timor-Leste also exported a significant amount of locally produced goods to neighboring Australia, reaching $2.3 million in 2024, which represented 10.9% of total exports. This amount increased by 62.8% compared to 2023. The primary export to Australia was also predominantly coffee, totaling approximately $1.6 million.

Import of Goods

Timor-Leste continued to import a significant amount of goods to meet its needs. In 2024, goods imports on a cost, insurance, and freight (CIF) basis increased by 12.5% compared to 2023, reaching $923.2 million, up from $820.8 million in 2023 (Table 1.11).

Over the past two years, Indonesia and China have been the main import partners. In 2024, imports from Indonesia totaled $317.9 million, accounting for 34.4% of total imports, an 8.7% increase compared to 2023. Imports from China reached $138.4 million, representing 15% of Timor-Leste's total imports. Taiwan and Singapore also contributed significantly to Timor-Leste's imports in 2024, with imports of approximately $121.7 million and $58.8 million respectively.

Table 1.11 Imports of Goods – Countries of Origin

	In millions of USD		Var % Ano	Share (%)	
	2023	2024		2023	2024
Indonesia	292.5	317.9	8.7	35.6	34.4
China, Peoples Republic of	122.8	138.4	12.7	15.0	15.0
Singapore	94.1	58.8	-37.5	11.5	6.4
Hong Kong	20.5	24.8	21.2	2.5	2.7
Viet Nam	20.0	20.8	4.0	2.4	2.2
Thailand	12.1	20.8	72.4	1.5	2.3
Australia	14.9	22.7	52.9	1.8	2.5
Malaysia	29.5	21.1	-28.5	3.6	2.3
Japan	11.5	16.8	46.4	1.4	1.8
Brazil	14.0	22.7	62.8	1.7	2.5
Taiwan	81.9	121.7	48.6	10.0	13.2
India	50.9	47.6	-6.5	6.2	5.2
Other	56.4	89.1	58.0	6.9	9.6
Total	**820.8**	**923.2**	**12.5**	**100**	**100**

Source: INE-TL and BCTL Calculation

The main goods imported into Timor-Leste during 2024 were fuels (primarily from Taiwan), vehicles (mainly from Indonesia), and cereals (mostly from India), amounting to $199.5 million, $103.1 million, and $95.7 million respectively. These commodities represented 21.6%, 11.2%, and 10.4% of total imports in 2024 (Table 1.12).

Table 1.12 Main imports of Goods by Commodities

	2023	2024	Annual (%)	2023	2024
Fuels	186.3	199.5	7.1	22.7	21.6
Vehicles	93.6	103.1	10.1	11.4	11.2
Cereal	77.8	95.7	23.0	9.5	10.4
Beverages	9.0	22.8	152.0	1.1	2.5
Electrical Machinery	45.7	50.6	10.8	5.6	5.5
Mechanical Machinery	42.3	50.4	19.3	5.2	5.5
Meat & Derivatives	27.9	28.1	0.8	3.4	3.0
Cement & Substitutes	26.4	31.1	17.6	3.2	3.4
Cereal - Refine	28.2	29.7	5.3	3.4	3.2
Iron & Steel - Article	20.6	21.8	6.0	2.5	2.4
Furniture; bedding, & Mattresses	18.9	21.1	11.4	2.3	2.3
Iron & Steel	30.7	20.6	-32.9	3.7	2.2
Others	213.3	248.7	16.6	26.0	26.9
Total	**820.8**	**923.2**	**12.5**	**100**	**100**

Source: INE-TL and BCTL Calculation

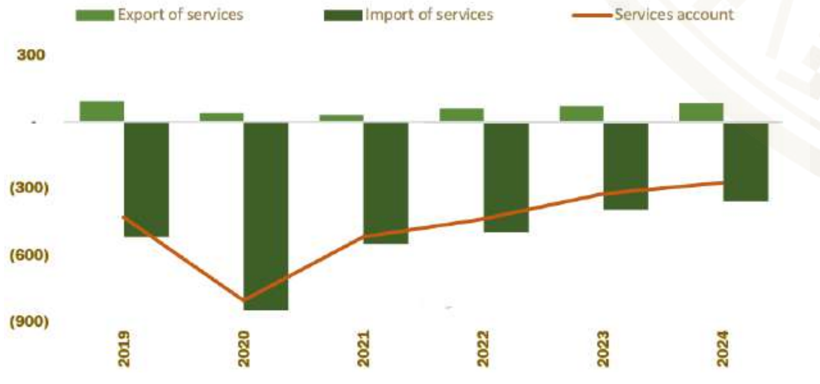
Service

Following a significant deficit in 2020, the services account deficit continued to improve over the past four years. In 2024, the services account deficit reached $275.1 million, a $51.9 million improvement, equivalent to a 15.9% increase compared to 2023.

As shown in Chart 5.1b, imports of services continued to decrease, totaling $357.2 million in 2024. An Improvement of $39.2 million increase from 2023 contributed to the reduction of the services account deficit.

Chart 5.1b
TL Services Account

In millions USD



Source: BCTL

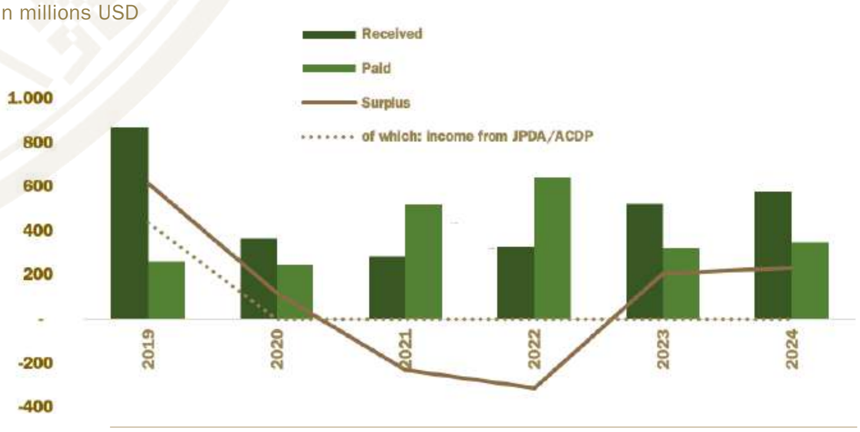
Imports of services related to the manufacturing industry were a major contributor to the reduced services account deficit, falling to $32.7 million in 2024, a $76 million improvement compared to 2023. Meanwhile, exports of services fluctuated over the past six years, reaching $82.1 million in 2024, an 18.2% increase compared to 2023. This increase primarily came from the travel and tourism industry, which generated $63.6 million in 2024, a $12.7 million increase (24.8%) compared to 2023.

5.1.2. Primary Income

Following the maritime boundary treaty with Australia on August 30, 2019, income from the Joint Petroleum Development Area/Area of Certain Development Cooperation (JPDA/ACDP) was reclassified under the goods subaccount, which affected the reported income received over the past five years.

Chart 5.1c
TL Primary Income Account

In millions USD



Source: BCTL

Over the last two years, the primary income account recovered after two consecutive years of deficit in 2021 ($232.6 million) and 2022 ($313.2 million). In 2024, the primary income account balance reached a surplus of $231.1 million (Chart 5.1c). Compared to 2023, the primary income balance increased by 14.2%, primarily due to a significant increase in investment income receivable. Conversely, income payable remained relatively stable at $344.9 million in 2024, an 8.8% increase compared to $317.2 million in 2023.

5.1.3. Secondary Income

The secondary income account recorded a surplus throughout the past six years, as shown in Chart 5.1d. In 2024, the secondary income balance reached $158.4 million, a $71 million increase from $87.7 million in 2023. This significant increase in the secondary account balance was due to a substantial decline in income paid to the rest of the world. In 2024, payments totalled $103.8 million, compared to $184.9 million in 2023.

Chart 5.1d
TL Secondary Income Account

In millions USD

Source: BCTL

Income received remained substantial. In 2024, receivable secondary income reached $262.2 million, a 4% decrease from $272.7 million in 2023. The substantial receivable secondary income primarily came from work remittances from Timorese migrant workers abroad, which amounted to $211.6 million in 2024, representing approximately 81% of total receivable secondary income.

5.2. Capital and Financial Accounts

Capital

The overall capital account balance has declined since 2019, reaching $1.3 million in 2024. This represents a 69% decrease compared to 2023, when it totaled $4.3 million. The capital account balance primarily consists of capital transfers from ongoing donors through grants.

Financial Account

Over the past decade, the financial account balance experienced some fluctuation, reflecting flows related to Timor-Leste's external financing sources. In 2024, Timor-Leste continued to record a net financing capacity, reaching $446.0 million, compared to $35.4 million in 2023.

Despite the significant contribution of portfolio investment from the Petroleum Fund's investments abroad, which totaled $671.2 million, foreign direct investment in Timor-Leste continued to be negative, representing the country's liabilities to abroad, and amounted to -$227.7 million.

Conversely, other investment assets increased, reflecting a financing capacity of $135.2 million in 2024, compared to a financing need of $56.1 million in 2023. Additionally, changes in reserve assets continued to show a financing need of $44.1 million in 2024.

Table 1.13 Source of Financing

Million USD

	2023	2024
Financial Account	**35.4**	**446.0**
Direct Investment in Timor-Leste	-131.5	-227.7
Portfolio Investment	332.4	635.9
of which PF investment abroad	345.8	671.2
Other Investment, Assets	-56.1	135.2
Other Investment, Liabilities	60.3	53.3
Changes in Reserves	-49.1	-44.1

Source: BCTL

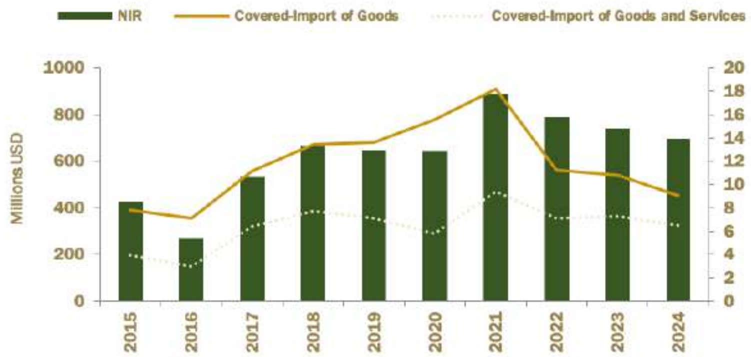
International Reserves

Following a strong position in 2021, Timor-Leste's Net International Reserves (NIR) continued to decrease, though the rate of decline slowed in 2024 (Chart 5.2). The NIR balance at the end of 2024 reached $694.9 million, a 6% decrease from $738.7 million in 2023. Despite this decline, the NIR remained higher than the average of the previous decade.

The coverage of NIR to import for goods alone fell from eleven months in 2023 to nine months in 2024. When considering both goods and services, coverage showed little change over the last three years, remaining around seven months.

Chart 5.2
Net Internatioal Reserve

NIR coverage ratio of imports in months



Source: INE-TL and BCTL analysis


CGM

06

GLOBAL SPILLOVER TO TIMOR-LESTE

Global Spillover to Timor-Leste

This section tries to expose the main transmission channels of the international developments to our economy. At present, it is important to admit that these effects affect some certain sectorial aspects of the economy in the country. This chapter seeks to demonstrate the mechanism of operation of the main channels, specifically: the impact on domestic inflation levels, influence over oil revenues and effects on the petroleum fund's investments valuations.

We expect that external developments will increasingly shape the domestic economic developments as our economy develops and effectively deepens interdependence relations with the regional economic partners, expanding the number and influence of the various transmission channels.

6.1. Imported Inflation

One of the main transmission channels for our economy

BCTL's inflation model is based on two key drivers - domestic economic performance and average inflation rates across the Asian region.

is the impact of international prices on domestic inflation developments and its respective expectations. As Timor-Leste is an economy with great import activity - imports of goods and services accounted approximately 57% of non-oil GDP in 2024, therefore, it is very common and related to expect that international prices of imported goods and services will continue to significantly affect domestic inflation along with economic development in the country.

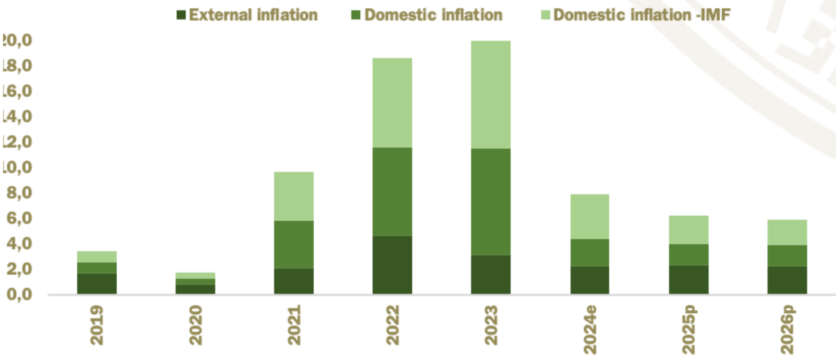
The empirical research and economic modelling of BCTL has confirmed the importance of this channel. One of the studies conducted in 2014 indicated that a 10% increase of foreign inflation above its average level would result in a respective cumulative increase of 8.7%, 7.3% and 1.5% of total, food and non-food inflation in the country, clearly indicates that external inflation affects the domestic inflation. However, one of the main issues in this context arise from the difficulty in defining an appropriate variable to measure the level of "external inflation" for Timor-Leste, given the large variability of import baskets and of the geographical structure of our imports.

Foreign inflation tends to influence the inflation trajectory in Timor-Leste.

After evaluating with several functional forms for this variable, it was concluded that the most appropriate empirical variable seems to be an average of the inflation rates of the five largest economies of ASEAN and China converted into dollars. In practice, this measure corresponds to an average of the regional inflation rate measured in dollar terms, which at the same time captures the impact of regional exchange rate variations against the dollar and local currency inflation rates.

Chart 6.1
Internal and external inflation

Annual Change (%)



Source: INE-TL, IMF and BCTL

As can be seen on the chart 6.1 above that domestic inflation tends to reasonably follow the development of foreign inflation rates with lower volatility. It is important to note that the external inflation rate is the average of the six Asian economies as mentioned previously, and that, we can use this variable and its respective expectations to construct the inflation forecasts.

The chart shows that changes in domestic inflation rates tend to follow shifts in external inflation rates. For example, when looking at rice prices in our country alongside those in Vietnam and Thailand, we can see a clear connection—they tend to move together, and the relationship is significant to some extent. Normally, the relationship is not perfect, as Timor-Leste's non-oil economic developments, especially over the last few years, strongly affect the domestic inflation rate trajectory which was proved with the result of BCTL's study in 2014 which showed that economic development in the country influence domestic inflation by 10.7%, 8.2% and 8% of total, food and non-food inflation when domestic economic activities rise by $100 million above the long-term average. Inflation in the country is influenced not only by economic activity and external inflation but also by domestic policies.

For example, in 2023, while external inflation slowed down, domestic inflation accelerated due to higher import taxes introduced in the first half of the year. The government doubled import taxes on all goods and imposed progressive taxes on select items such as sugar, cigarettes, and soft drinks. However, these measures were repealed by the new government in the third quarter of 2023 after it took office. As a result, domestic inflation eased and began aligning with external inflation trends in 2024.

Since external inflation rates in local currency terms remain relatively stable over time, fluctuating around 2%, it suggests that exchange rate movements of partner countries' currencies against the US dollar play a crucial role in shaping domestic inflation. Analysis shows that a 1% appreciation of the US dollar reduces the country's CPI inflation by 0.4% (or 0.5 index points). Conversely, a 1% depreciation of partner countries' currencies against the US dollar lowers imported CPI inflation in the country by the same margin.

Considering the importance of this transmission channel, the future trajectory of external inflation, strongly influence by exchange rate developments, will continue to be one of the most influential factors in determining the evolution of domestic inflation.

The expected stability for regional currencies in 2025 and 2026 is a relevant assumption of projected slowdown in domestic inflationary pressures.

In this context, it is expected in line with the IMF that regional currencies will remain relatively stable against the dollar in 2025 and 2026, which, together with the maintenance of moderate inflation deceleration rates of trading partners, leads us to expect that imported inflation will remain stable over the same time horizon (2.3% per year), helping to stabilize inflationary pressures in Timor-Leste. Therefore, it is further expected that the average domestic inflation rate will slow down over the next two years, gradually decelerating from 2.1% in 2024 to 1.8% in 2025 and 1.5% in 2026.

As the performance of the domestic economy also contributes to explaining inflationary trends, the domestic growth forecasts will be discussed in the chapter covering domestic economic developments, which also provides greater detail regarding inflation forecasts.

6.2. Energy Markets and Oil Revenues

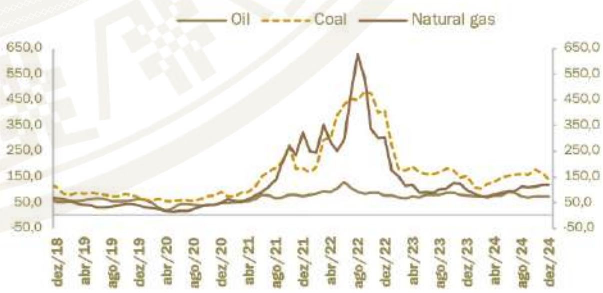
Price of energy commodities such as oil, natural gas and coal in global markets are highly volatile, fluctuating widely between periods both with regimes of high and low-price levels. Charts 6.2a and 6.2b below show these price fluctuations and help us to place the recent developments in energy prices on a longer time-frame perspective. It should be noted that it is common for energy prices to fall by >50% and rise by more than the same percentage within a year, as the 2023's and 2022's commodity prices demonstrate. In terms of levels, the sharp decline in oil prices from the end of 2014 cancelled out all nominal price gains recorded since 2012.

Oil and most commodities' prices recorded a slight fall in 2024, after the sharp increase recorded in 2021 and 2022.

In 2024, there was a slight loss of practically all energy resources, with particular emphasis on crude oil and coal. Of the energy commodities considered in the charts below, natural gas and coal are now at their record lowest of the last three years, reversed the high prices recorded in 2020, 2021 and 2022, which clearly confirms the difficulties of energy supply in adjusting and satisfying the global demand's recovery in 2024. Unlike oil and coal, price of gas increased at the end of 2024 compared to the same month in 2023, due to high demand in Asia and the contraction of global liquified natural gas in the first half of 2024. The increase was also driven by colder weather, which led to higher demand for gas for heating, as well as supply disruptions caused by ongoing conflicts in the Middle East. Additionally, global tensions and renewed uncertainty surrounding Russian piped gas to Europe further contributed to gas price volatility.

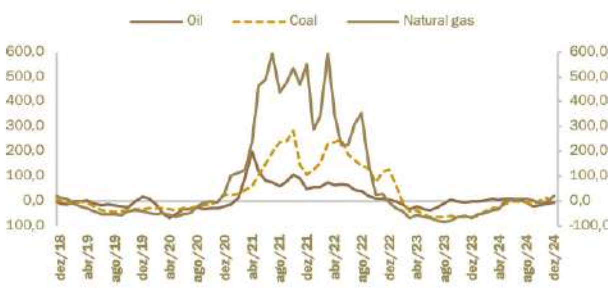
Chart 6.2a
Energy prices – Spot level

Energy Prices - Spot Level
2012=100



Source: World Bank

Chart 6.2b
Energy prices - % annual change



Source: World Bank

Oil price - in overall – fall, it was fallen by 4.5% at the end of 2024 supported by the fall of brent oil price (-5.2%), Dubai oil (-5.1%) and WTI oil (-3.2%), and annually it fell by 2.5%, partly cancelled out the pronounced recovery observed in 2022 and 2021, caused by economic factors mentioned previously. Moreover, oil continues to be traded at lower prices than in 2012, minimizing the price recovery recorded in some of the months.

Future energy prices trends are, however, hard to anticipate, as it results both from the interdependence between aggregate demand and supply in physical markets, and, increasingly, from the less measurable and unpredictable effects resulting from intermediaries, speculators, and politics. A clear proof of this prediction shortcoming is, clearly, the recent fall in oil prices in 2023 and 2024, after the substantial rise in 2021 and 2022, whose speed and magnitude were in no way predicted by most market participants and analysts. Transition to green energy and geoeconomic fragmentation due to geopolitical tension, resulted in fragmentation of world commodity markets further complicate the trend of future energy prices to anticipate. Fragmentation of commodity markets especially critical minerals for energy transition also make it more difficult to achieve the goal of decarbonizing world economies.

The country's oil revenues are now practically marginal when compared to the revenues obtained in the previous years.

It should also be noted that the impact of energy price fluctuations on the country's oil wealth is now much lower than in the preceding years. Since oil revenues from Bayu-Undan, the fields actively in exploration, will cease to produce completely by 2026 with only small volumes of oil and gas were observed in 2024. Estimated gross revenue in 2024 amounted to $133.03 million, which represents a renewed decrease of 76.5% from the 2023's expected gross value of $565.1 million. This is equal to a total volume of around 1.6 million barrel of oil equivalent (BOE) produced in 2024, a decreased of around 76.5%, compared to total BOE produced in 2023, proofing further the depletion of oil and gas in Bayu-Undan. In 2022, the country produced a total of 17.3 million BOE from the Joint Petroleum Development Area production while in 2023, it only produced 7.01 million BOE. As a result, government revenue from taxes, royalties, and fees dropped by 80.0% in 2024, falling from $428 million in 2023 to just $85.4 million. This marks a significant decline compared to 2022, when revenue reached $1.1 billion.

Considering this depletion, expected complete cease of oil production from the Bayu-Undan and uncertainties of future investment in greater sunrise, it is impossible to detail future earning estimation from oil and gas in this report, as has already been done in the previous years, the sensitivity analysis of domestic oil revenues in terms of various oil prices. Although there have been reports of potential petroleum exploration in dryland areas like Covalima, a thorough analysis is required to assess the commercial and economic viability of these fields before any development can proceed.

6.3. Financial Markets and the Petroleum Fund

Lastly, we consider another transmission channel of international financial market developments to our economy, Financial asset prices in the global markets influence the PF's ESI, in turn, overall funding of the State Budget.

which links to the Petroleum Fund (PF), established to efficiently manage the oil wealth of the country. The working mechanism of this channel is just like the price of oil, to the extent that the price changes of international financial assets drive the value of the PF and, in turn, the Estimated Sustainable Income (ESI) of the fund. As they drive changes in these two aggregates, financial asset prices end up influencing the amount of revenue available to finance the state budget, in turn, the path and scale of spending and public investment policies.

In 2024 the fund invests 67.8% of its value in bonds and 32.2% in equities.

The PF concluded in the last quarter of 2024 recording a total net financial assets of $18,274 million, which represents a renewed increase of $22 million versus 2023's closing balance of $18,252 million. The Fund is mainly invested in treasury bonds of developed countries as marked with liquidity and fixed income portfolios (67.8%) and around a third (32.2%) of the fund invested in shares of developed markets' companies.

In 2024, the Fund recorded an overall gross revenue of $1,223 million, prolonging gross revenue of $1,662 million recorded in 2023, cancelled out part of the gross revenue of -$2,050.438 million recorded in 2022, and added to the gross revenue of $1,144 million recorded in 2021. This performance was practically due to the rise in 10-year bond interest rate and the rise in equity prices and/or values as 2-year bond portfolio especially in the US and Germany recorded a global fall in 2024.

The fund has broadened its investment universe since the beginning, starting first, with only investing in US Treasury securities, it then gradually investing in shares and, finally, extend it to investing in bonds issued by several global Treasuries. This gradual extension of investment was driven by the increasing demand for a higher expected return for the fund and look for greater diversification of its investments in relevant markets.

This institutional development exposes the fund to new risks and markets, but which, by benefiting from the diversification of the prices of the various assets, it allows to build a more solid portfolio whose return is to be more efficient.

The performance of the fund is crucially driven by price changes in global bonds and equities markets.

So far, the Fund invests only in fixed interest rate bonds and equities, so that, received interest and dividends on bonds and shares provide the Fund with a fixed and constant income, at least on 'a priori' basis. Naturally, when investing in bonds and stocks, the Fund benefits from increases in market values of these securities, and on the contrary, it can be adversely affected by eventual negative price changes. Therefore, the Fund's main financial risks correspond to possible losses arising from the fall in the prices of the bonds or socks in which the fund is invested.

Foreign exchange fluctuations also affect the fund, which has invested in markets other than in the USD.

In addition, since the fund invests in several markets denominated in currencies other than the US dollar, the fund is also subject to exchange rate risks, which understands as the possibility of depreciation of the various investment currencies against the dollar. As already reported previously that financial risks of the petroleum fund include three types of risks namely: equity risk, or risk of falling global stock prices, interest rate risks, which translates to the risk of falling Treasury bond prices; and currency risk, which refers to the risk of depreciation of the investment currencies against the US dollar.

The price changes of petroleum fund assets and the various investment currencies constitutes the true channel of transmission between international markets, the value of petroleum fund and its estimated sustainable investment (ESI) and the economy of the country. Unlike 2023, there is no record the fund accumulates gain or loss in 2024 due to currency depreciation and/or appreciation while in 2023, the fund accumulated $31.2 million from investments in various currencies.

In 2024, the fund recorded a positive performance, mostly due to the gains of its equity investments.

In terms of returns, 2024 saw a positive performance for the fund, with an estimated return of 6.80% based on its year-end value. This follows a gain of 9.60% in 2023, reversing the loss of -10.36% recorded in 2022. Most of the fund's gains in 2024 came from the equity portfolio, which contributed 75% of the total returns.

Bond investments recorded a net gain in 2024, due to the general rise in both 2-year and 10-year interest rates, reversing the interest fall in 2023.

Unlike short-term interest rate, long-term interest rates rose in 2024 and remained in positive territory, prolonging the positive rate recorded in 2022 especially Germany and Japan which was greatly above the zero threshold, where they have been since 2019. This generalized rose reversed the cycle of interest rate fall in 2023 due to fall of interest rate in Germany and the US markets. This rose especially in the US which represents most of the Fund's bond investments, positively impacted the Fund return. This development can be interpreted as a global gain for the fund's bond portfolio in 2024 as the fund's bond portfolio yielded 7.33%, cancelled out part of its losses recorded in 2022 (-7.09%) and in 2021 (-2.25%). Like in previous years, Japanese market follows the path of bond market in the US, its long-term interest rate increased by 0.45pp from 0.61% recorded in 2023.

The fund investments in shares have again benefited from the robust performance of practically all global equity markets, led by the US market.

In terms of equity markets, the fund recorded accumulated gains in 2024. The gains in the equity portfolios were due to the increased trend in the US market and due to upward trend in most global equity markets. The petroleum fund investments in equities recorded a gain of 17.79% in 2024, reversing the substantial loss of -16.84% recorded in 2022 and added to the substantial gains of 22.72% recorded in 2021 and 23.67% in 2023.

In short, the PF currently holds a portfolio of a vast and diverse set of securities and is invested in major global stock and bond markets, that efficiently optimizes its return profile, and at the same time minimized its associated risks.

The value of petroleum fund and its returns continues to depend on the price developments of the global financial assets.

However, given its substantial investments in global bonds and equities, the future financial value of the petroleum fund and its returns trajectory continue to depend on price developments for these financial assets, which are naturally also affected by the development of the dollar against the respective investment.

For a longer term, a need to consider the risk of a global stock or bond market correction is important, given the current and simultaneous high stock market valuations and the still high levels of global bond interest rates, despite the rates recorded in 2022 and 2023. The trends evidenced in 2024 have further reinforced this historical high valuation of securities in both investment markets. With inflation pressures decline, market expects that future policy rates will decline which further contributes to decline in long-term interest rates and rising equity markets. Additionally, central banks' policy rate decisions are becoming increasingly asynchronous, some already easing their policy rates and some even maintaining the previous rate for further risk consideration.

However, the long-term investment of the Fund and its institutional framework was designed to deal with the market fluctuation in a rational way to benefit from the occasional episodes of price fluctuation that regularly occur across markets, by implementing the investment fund discipline rigorously and a targeted asset allocation.

On the contrary, the near complete cease of production of oil and gas from Bayu-Undan which estimated to completely depleted in 2026 and the uncertainty of greater Sunrise exploration development timeframe is now present a significant challenge to the success of the strategy and respective investment horizon of the Fund, at least up to 2024. Moreover, with continued increasing level of public expenditure which requires reduction of the Fund's capital presents another significant challenge for the Fund sustainability. Therefore, the fund objectives and its implementation strategies need to continue reassess in line with this current development. The current unexplored oil and gas in greater sun rise and oil and gas resources in the dry land areas are considered as the country's future capital assets.

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