TIMOR-LESTE AND DEVELOPMENT PARTNERS' MEETING
Dili, April 2–4, 2009
IMF Statement

1. **The performance of Timor-Leste's economy remained very strong in 2008.** On the back of a marked improvement in security, higher government spending, and a good harvest, real non-oil GDP is estimated to have grown by some 12½ percent in 2008. Moreover, while inflation is always a concern when spending increases rapidly, consumer prices are now stabilizing. Mainly driven by higher food prices, inflation peaked at 11 percent in the year to June 2008 but has since fallen along with international commodity prices and reflecting government intervention in the rice market.

2. **However, the global environment has abruptly changed.** Since the last TLDPM one year ago, the world economy has suffered a major downturn. A crisis that started in the U.S. subprime mortgage market has spread throughout the global financial system. Credit flows have been severely disrupted and asset values have fallen sharply. The strain is pulling down economic activity and world output is now projected to contract by ½ to 1½ percent in 2009, the first such fall in 60 years.

3. **Timor-Leste has been isolated from much of the financial crisis but is not unaffected.** As petroleum revenue represents about 95 percent of total government income, the country is highly exposed to oil prices and these have plummeted along with global growth. At the current price, Timor-Leste's petroleum receipts can be expected to fall by some 60 percent from the level in 2008 when oil averaged about $100 per barrel. The Petroleum Fund has cushioned the impact but lower oil prices, should they persist, will eventually mean a much tighter budget constraint. The 2009 budget, well above the sustainable level and with an increase of almost 25 percent over last year's actual spending, was already on the high side when oil was at $60 per barrel. Now, expenditure should be reduced at least to reflect the lower cost of government imports. Without adjustment, the 2009 budget would imply a non-oil fiscal deficit of over 100 percent of non-oil GDP, up from an estimated 97 percent in 2008.

4. **A darkened global environment underscores the challenge of securing sustainable growth and poverty reduction.** Due to rising oil prices, Timor-Leste was able to more than quadruple government expenditure in just two years and still have enough left over to bring the Petroleum Fund to $4.2 billion at the end of 2008. This expenditure helped address pressing near-term demands and stimulated the economy. Indeed, bustling with activity, Dili has changed to the point that it is hard to recognize. But economic growth cannot be sustained on very rapid increases in government outlays. Given current oil prices, spending will have to be tightly controlled to avoid depleting savings. That, in turn, highlights the need to prioritize and to get more value for money from government spending.

5. **Lasting progress toward development objectives will, therefore, require a long and consistent effort.** Oil revenue has expanded the scope for action. It is important to recognize,

however, that oil resources have a finite life while raising living standards is a very long-term endeavor. The original national development plan included a petroleum revenue saving policy, arrangements for well-targeted spending, and a monetary regime aimed at preserving macroeconomic stability. Results have been uneven but the objectives remain valid and should be preserved as the strategy is updated. A macroeconomic framework can provide essential guidance and the authorities' recent effort to establish one is very welcome.

6. **Promoting private sector investment and activity will be crucial.** Unless private business expands, it will not be possible to generate the jobs demanded by a rapidly growing population and there will be little to fall back on when oil runs out. In this respect, it is encouraging to see movement on the long-awaited land law. Much more can be done, however, to simplify regulations and improve the business environment. In the financial area, the three fully licensed commercial banks reach only a small segment of the population and, with non-performing loans stuck at about 30 percent of the total since late 2006, credit remains depressed. Being branches of foreign parents, the banks do not appear at risk, but additional effort is needed to complete pending financial legislation and enable the financial sector to support a more vibrant economy.

7. **Above all, the Petroleum Fund has to be seen as a cornerstone for sound management of the country's resources.** By emphasizing transparency and sustainability, the Petroleum Fund helps shield against the "oil curse" that has afflicted so many resource rich countries. Given conservative investments in U.S. government bonds, the fund produced a 6.9 percent return in 2008. That was a strong result for a year where most asset classes endured large declines. Some diversification of the portfolio may now be a good idea and should be carefully considered. When amending the Petroleum Fund Law to accommodate a new investment strategy, however, we urge the authorities to maintain its basic principles. There will always be pressure to spend more and the current law provides flexibility, but ignoring or weakening the existing framework is not in the long-term interest of the country.

8. **The future will be challenging but optimism is warranted.** Timor-Leste has overcome great obstacles in gaining independence and made remarkable progress in securing peace. Falling oil prices present a new hurdle. Given the country's formidable resolve and patience, the economic challenges can surely be overcome.

9. **Knowing that this is my last TLDPM, I participate with mixed feelings.** In June the IMF office in Dili will be closing. We will still be providing technical assistance and be closely engaged via regular missions from headquarters. However, our specially intensive presence here was intended to help set up and establish the country's economic institutions and systems. That task can now be said to be completed. So, while I will miss the close daily interactions, the closing of the IMF office here is another example of Timor-Leste's coming of age.

Timor-Leste: Selected Social and Economic Indicators

I. Social and Demographic Indicators

Income		**Education and health**	
GNI per capita (2007, in U.S. dollars)	1,650	Literacy rate (2004, in percent)	50.1
Non-oil GDP per capita (2007, in U.S. dollars)	379	Infant mortality rate (2007, per 1000 births)	68
Population characteristics		**Poverty and access to services**	
Total population (2006, in millions)	1.015	Poverty rate (2007, in percent)	49.9
Population growth (2006, in percent)	3.2	Access to improved water (2007, in percent)	63.1
Life expectancy at birth (2006, years)	57	Access to electricity (2007, in percent)	36.6

II. Economic Indicators

	2004	2005	2006	2007	2008 Prel.	2009 Proj.	2010 Proj.
Output and prices							
GNI at current prices (US$ million)	460	695	972	1,728	2,916	1,635	1,961
Non-oil GDP at current prices (US$ million)	309	332	327	398	499	599	706
Real non-oil GDP growth (percentage change)	4.2	6.2	-5.8	8.4	12.8	7.2	7.9
Including United Nations 1/	0.4	2.3	-3.4	16.8	12.3	7.7	2.3
Inflation (percentage change, end-period)	2.5	1.0	6.7	7.6	6.1	4.0	4.0
Inflation (percentage change, period average)	3.2	1.8	4.1	8.9	7.6	2.7	4.0
			(in percent of non-oil GDP)				
Savings and investment							
Gross investment 2/	21	21	23	26	46	50	56
Gross national savings	42	99	188	322	455	116	106
External savings	-21	-78	-165	-296	-408	-66	-49
Central government finances 3/							
Revenues	67	128	206	344	490	179	184
Domestic revenues	10	11	10	11	9	10	9
Oil/gas revenues	46	107	195	330	481	170	175
Grants	11	10	0	3	0	0	0
Expenditure (cash basis)	20	26	32	59	106	110	129
Recurrent expenditure	17	19	27	46	70	69	81
Capital expenditure	3	7	5	13	36	41	48
Overall balance	46	102	174	285	384	69	55
Non-oil fiscal balance	1	-5	-21	-46	-97	-100	-120
Combined sources fiscal operations 3/ 4/							
Domestic revenue and budget grants	23	24	13	15	11	11	10
Expenditure	66	67	73	88	130	133	150
Recurrent expenditure	50	47	55	66	88	87	98
Capital expenditure	17	20	18	22	41	45	52
Overall balance	-43	-43	-60	-73	-119	-122	-140
Money and credit							
Broad money (end-period) 5/	21	23	31	36	38	…	…
Net domestic assets (end-period)	-38	-24	-3	-43	-38	…	…
			(in millions of U.S. dollars, unless otherwise indicated)				
External sector							
Current account	64	260	540	1,177	2,038	397	348
Merchandise exports 2/	8	8	9	7	12	12	13
Merchandise imports	122	112	101	176	372	598	818
Memorandum items:							
Crude oil price ($ per barrel) 6/	38	53	64	71	97	52	63
Petroleum receipts	141	349	612	1,258	2,284	972	1,144
Petroleum Fund withdrawals		0	0	300	396	589	889
Petroleum Fund balance (end-period)		370	1,012	2,086	4,197	4,624	4,974
Cumulative oil/gas savings (percent of non-oil GDP) 7/	5	112	310	525	841	772	705

Sources: Data provided by the Timor-Leste authorities; and Fund staff estimates.

1/ Includes locally paid compensation of UN peacekeeping mission staff.
2/ Excludes oil/gas sector.
3/ Excludes revenue from government rice sales (estimated at $17 million in 2008 and $15 million in 2009), with only the net subsidy included in recurrent expenditure.
4/ Includes autonomous agencies and quasi-fiscal expenditure by donors outside the central government budget. The revenue decline in 2005 reflects the creation of the Petroleum Fund to which all oil revenue now accrues. Income from the fund and donor assistance finances the deficit.
5/ Excludes currency holdings by the public, for which no data are available.
6/ Simple average of three spot prices; Dated Brent, West Texas Intermediate, and the Dubai Fateh.
7/ Refers to the Petroleum Fund from its inception in August 2005 and to the Timor-Sea account prior to that.