TIMOR-LESTE

Table 1	2019
Population, million	1.3
GDP, current US$ billion	1.7
GDP per capita, current US$	1297.3
School enrollment, primary (% gross)[a]	115.3
Life expectancy at birth, years[a]	69.3

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2018).

The COVID-19 pandemic and renewed political uncertainty have taken a heavy toll on the economy. The lack of an approved 2020 budget has constrained public spending, while public health measures aimed at containing COVID-19 have unintentionally weakened private sector activity. An economic policy package – financed through a special fund – provided some relief to households and businesses. Although this will not avert the deepest recession since independence, the recent political transition presents an opportunity to pursue much-needed structural reforms.

Recent developments

Economic activity fell considerably in the first half of 2020, owing to a political stand-off and the global COVID-19 outbreak. Public expenditure, which accounts for about 75 percent of GDP, was constrained by the failure to approve a state budget for 2020. Private consumption was affected by changes in consumer behavior and confidence, while firms delayed investment decisions due to high economic uncertainty. Imports decreased significantly because of lower domestic demand and supply disruptions, while international travel restrictions caused a sharp drop in travel service exports. On the supply side, construction and tourism-related sectors were particularly hard-hit by the deteriorating domestic and external environment, as public investment stalled and air passenger arrivals plummeted.

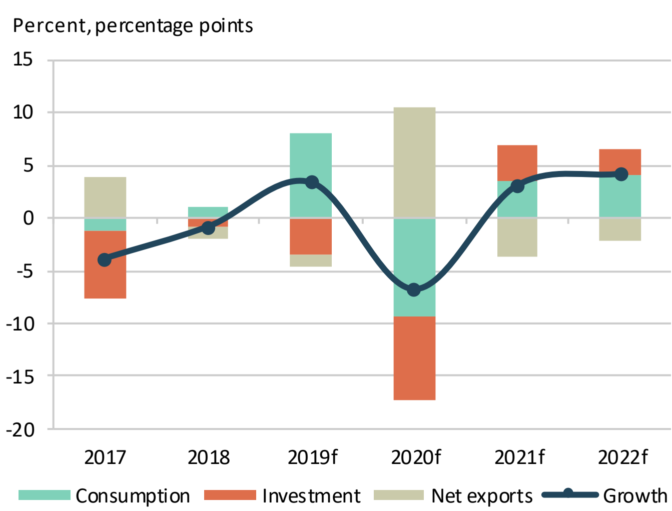
The current account weakened, predominantly due to lower primary income. Lower petroleum production and prices reduced income receipts from the Bayu-Undan field – which are recorded as primary income in the balance of payments. Imports declined by 20 percent, with services being particularly affected by lower domestic demand. Exports of travel services – the main export earner – declined by 95 percent in the second quarter of the year, as a direct result of international travel restrictions. Nonetheless, the trade deficit eased due to the very large weight of imports in total trade.

Total public expenditure was 7 percent lower in the first half of 2020, when compared to the same period in 2019. Spending on capital projects and goods & services were 56 and 16 percent lower, respectively, but public transfers were 15 percent higher – mostly owing to an ad-hoc cash transfer to households. Public expenditure includes expenses executed through an autonomous fund created to facilitate the health and economic response to COVID-19. Without these, spending would have declined by 27 percent. Domestic revenues declined by 10 percent owing to lower economic activity and the implementation of temporary relief measures. The fiscal deficit is predominantly financed by withdrawals from the Petroleum Fund.

Consumer price growth decelerated, but the real exchange rate appreciated. Inflation slowed to 0.4 percent in the second quarter of 2020 (year-on-year), while the real effective exchange rate appreciated by 4 percent due to the strengthening of the US dollar – the legal tender in Timor-Leste. Commercial credit to the private sector grew by 3 percent in June 2020 (year-on-year), as lending to individuals continued to expand. The proportion of non-performing loans has not increased, suggesting that the economic difficulties caused by the COVID-19 pandemic did not have an immediate repercussion on the financial sector.

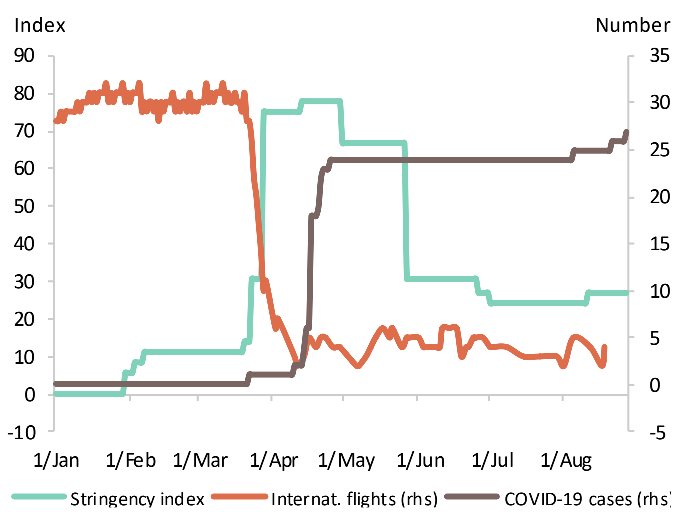
Public health measures helped prevent the spread of COVID-19, but they have had a damaging impact on private sector activity. Cognizant of this, the Government approved a policy package to support

FIGURE 1 Timor-Leste / Real GDP growth and contributions to real GDP growth



Sources: Ministry of Finance & World Bank staff estimates.

FIGURE 2 Timor-Leste / COVID-19 cases, stringency index, and flights



Sources: Oxford University & World Bank.
Note: Data on international flights represents 7-day moving sums.

households and businesses. The package comprised a one-off US$200 cash transfer to most households and a 60 percent wage subsidy for eligible (formal) firms. However, the absence of high-frequency surveys makes it difficult to assess the impact of the COVID-19 shock and policy response on households and enterprises.

Outlook

GDP growth is projected to decline by 6.8 percent in 2020, but there is still considerable uncertainty about the outlook. Public expenditure is expected to partly recover if the 2020 budget is promulgated by October, although capital spending will remain subdued. Domestic revenues will fall for a fourth consecutive year. The fiscal deficit is expected to remain at about 30 percent of GDP. Private consumption will decline by about 4 percent in 2020, despite a sizeable cash transfer to households. Imports will endure a considerable fall because of lower domestic demand, but may be supported by stronger public (recurrent) spending in the last quarter of the year. Total exports will halve in 2020, albeit from an already low base. The current account will return to a large deficit (about 14 percent of GDP), mostly because of lower petroleum-related incomes. Inflation will remain low, while the US dollar is expected to hold value against the currencies of Timor-Leste's main trading partners.

The economic recovery will be gradual, with GDP forecast to grow by 3.1 percent in 2021. Final consumption expenditure will grow at a moderate pace (around 3 percent in 2021), while investment and exports are anticipated to bounce back faster. External and domestic shocks have produced three contractions in four years – 2017, 2018 and 2020 – which will leave permanent scars on the economy. Reduced global demand, falling commodity prices, and a tighter financial environment have had a limited impact on domestic economic activity. However, continued restrictions on international travel, the approval of the 2020 and 2021 budgets, and a possible reinstatement of public health measures will likely shape the medium-term outlook.

Risks and challenges

Downside risks to the outlook include the return of stricter public health measures and ongoing political uncertainty. A potential second wave of COVID-19 cases remains a key concern from both health and economic perspectives. While an economic recovery plan for 2021-2023 was recently approved, a surge in cases could lead to the adoption of stricter containment measures – which would further inhibit economic activity. The new government coalition has a majority in Parliament, but political tensions remain high. Upholding political stability and creating a broad-based political consensus will be key for the continuation of the VIII Constitutional Government (2018-2023) and for supporting a smooth economic recovery.

Medium-term fiscal sustainability remains a key challenge to be addressed. It is crucial to ensure that (short-term) recovery measures are time-bound and do not crystallise as recurring public liabilities. A comprehensive fiscal reform to mobilise domestic revenues is needed, while a rationalisation of unnecessary expenses would help bring public spending to more sustainable levels. Meanwhile, the global economic recession and lower demand for transport services are contributing to a weak energy market outlook. This raises additional concerns over the proposed development of the Greater Sunrise petroleum fields – which in the absence of private investors would require very large public investments that could drain the Petroleum Fund.

TABLE 2 Timor-Leste / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017	2018	2019 e	2020 f	2021 f	2022 f
Real GDP growth, at constant market prices	-3.8	-0.8	3.4	-6.8	3.1	4.2
Private Consumption	3.6	2.6	3.2	-4.3	2.9	3.5
Government Consumption	-5.8	-1.0	10.9	-11.0	2.9	3.0
Gross Fixed Capital Investment	-16.7	-1.8	-10.1	-27.1	14.4	9.4
Exports, Goods and Services	-39.1	8.4	1.5	-51.8	47.6	8.0
Imports, Goods and Services	-8.7	2.3	2.2	-20.3	8.7	4.5
Real GDP growth, at constant factor prices	-3.6	-0.2	3.0	-6.8	3.1	4.2
Agriculture	-3.3	4.4	2.4	1.2	2.6	2.9
Industry	-26.5	5.3	3.2	-9.3	1.1	2.4
Services	3.1	-2.4	3.2	-8.2	3.8	5.0
Inflation (Consumer Price Index)	0.6	2.2	0.9	1.1	1.6	1.9
Current Account Balance (% of GDP)	-17.6	-12.2	3.5	-13.5	-22.1	-29.1
Fiscal Balance (% of GDP)[a]	-33.4	-27.5	-30.8	-30.4	-33.7	-37.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) The ESI is part of total revenue, while excess withdrawals from the PF is a financing item.