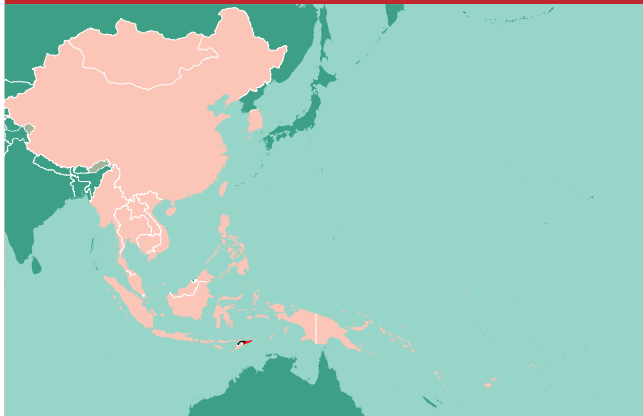


TIMOR-LESTE	
	
	2015
Population, million	1.2
GDP, current US\$ billion ^a	1.5
GDP per capita, current US\$ ^a	1,158
National basic needs poverty rate	41.8
School enrollment, net (% gross) ^b	96.6
Life expectancy at birth, years ^a	68.3
<small>Sources: National authorities and World Bank staff estimates. Notes: a) data as of 2014; b) data as of 2011.</small>	

Summary

Timor-Leste is facing an outlook starkly different to its recent past. Previously one of the most oil-dependent countries in the world, it could become a post-oil country in as little as five years' time. The nation has invested heavily in domestic infrastructure using oil receipts that were prudently saved. While the domestic economy remains very underdeveloped, reform efforts are beginning to show results, with a pipeline of FDI emerging. Timor-Leste must employ its finite resource effectively and implement key reforms to support a more diversified economy.

Recent Developments

Recently completed estimates show that national poverty was 41.8 percent in 2014, down from 50 percent in 2007.

While production in the offshore petroleum sector peaked in 2013 and has begun to decline rapidly, the domestic economy is largely delinked from trends in this sector aside from the fiscal use of oil revenue. Economic developments in the non-oil economy have been driven to a large extent by the public sector investment program financed from oil revenues. The economy grew by 5.9 percent in 2014 and by a projected 4.3 percent in 2015. A nationwide program of public roadworks and other projects have boosted construction and related activity while recent improvements in electricity coverage around the country are likely to have supported more economic activity. Consumer price inflation hovered just above zero in 2014 and 2015 as the US\$, the official currency of Timor-Leste, continued to appreciate which kept imported prices low and declining. While hurting existing export markets such as coffee and prospects for new export-oriented activities, the strong currency may also have brought a short-term growth dividend domestically.

Almost since independence, Timor-Leste has been an oil-dependent country, with oil production making up as much as 85 percent of total GDP and government revenues from the oil sector reaching 50 times the level of domestic revenues at its peak. By 2015, government receipts from the petroleum sector were just under US\$1 billion, one-third their level in 2013. While receipts have been hit by the drop in oil prices, production from existing wells is also declining with production down from 60 million barrels in 2013 to a projected 40 million in 2016. Oil revenues, however, have been prudently saved in a sovereign-wealth fund, the Petroleum Fund, and the country now has US\$16 billion invested. These resources are of critical value in financing the accelerated transition of Timor-Leste to a higher level of development if spent well.

The decline of the petroleum sector has meant that the government budget has moved rapidly from an overall budget surplus of 40 percent in 2013 to a deficit of 10 percent in 2015. According to law, the government publishes annually an independently-

audited estimate of the amount that can be sustainably drawn down each year from the Fund in perpetuity. That amount is currently around US\$500 million, but will fall inexorably each year as government draws down on the principal of the Fund.

The government's expansionary spending program is driven by an ambition to overhaul the nation's public infrastructure in order to crowd-in private sector investment and boost long-term growth prospects. While this represents a viable economic strategy in principal, it is dependent on the quality of the investments being made, and that public investment is indeed the binding constraint to private sector development. There are indications of limited capacity to implement the program, with execution rates for the infrastructure budget low and increasingly high prices demanded for construction works. A combination of marginal investments and high costs also raise important questions of the quality and prioritization of the investment program. One 30km stretch of road currently under construction in an underpopulated, rural area of the country costs an average of US\$10 million per kilometer (compared to a norm of US\$1–2m).

Timor-Leste's only significant non-oil export product is coffee. Export values and volumes fell from US\$18.8 million (34m kg) in 2012 to US\$13.8 million (10.2m kg) in 2014 with production recovering in 2015 to US\$15.2 million (19.2m kg). Overall, the current account surplus has declined along with falling oil exports, from 44 percent of GDP in 2013 to 13 percent in 2015.

Outlook

In 2016 and 2017, domestic growth is expected to continue in a similar range as the last two years, with growth forecast at 5.0 and 5.5 percent, respectively. While strong government spending, especially on infrastructure investment, will continue to stimulate growth, foreign direct investment is expected to increase

as well. The Government recently signed the concession agreement for its first public-private partnership which will see a major international operator invest US\$150 million for the construction of a new container port near the capital city. Construction has also begun on a Heineken factory, and other potential investors are showing interest in some sectors.

Development of the domestic economy will be essential. With no new oil fields under development and current wells depleting rapidly, Timor-Leste is expected to be a post-oil country in as little as five year's time. Oil production, exports and gross value added from the offshore oil sector will decline rapidly each year for the next few years.

The Government recently submitted a supplementary budget for the current fiscal year to appropriate additional expenditure financed by excess drawdowns from the Petroleum Fund. As a result the budget deficit is expected to widen considerably in 2016 to more than 20 percent of GDP. In 2017 the budget deficit is forecast to widen even further as revenues from the oil sector decline.

Risks and Challenges

The government has focused a considerable amount of their resources and focused their political agenda on supporting improvements in physical infrastructure nationwide. Achieving the best results in terms of long-lasting economic and social impacts will require an effective management of the public investment program to ensure that projects are prioritized that have a high return and support steady and rapid progress along a viable path of economic development. This task requires careful planning, backed up by solid analysis, including of complementary investments in skill development and technology adoption required to ensure that infrastructure investments pay-offs are high. Introducing quality and productivity enhancing technologies in coffee production, for example, can

potentially benefit a large number of small farmers. Existing financial assets should also be used as effectively as possible. The investment strategy of the Petroleum Fund should be in line with the Government's use of the fund. A recent shift to invest more heavily in higher-risk equities is seemingly at odds with the Government's strategy of drawing down on the Fund's principal in the short-term. Securing a return, even a modest one, is a priority. Financial reports show the Petroleum Fund made a net loss on its assets in 2015. While Timor-Leste faces a daunting infrastructure gap, there are a variety of other constraints that would also need to be addressed to support private-sector-led, inclusive

growth. Timor-Leste still ranks as having one of the least conducive regulatory environments for business in the world. A lack of functioning state systems of identification, registration, and dispute resolution over land title make it extremely difficult to secure a claim over land, and it is difficult to see how businesses could commit to investments in this context. The lack of laws governing the enforcement of commercial and credit contracts also make doing business much more difficult. While Timor-Leste has much to offer, concerted effort is needed to address these critical constraints before it can realistically expect to attract large-scale foreign investment and spur domestic enterprise.

Figure 1. Gross domestic product, expenditure components

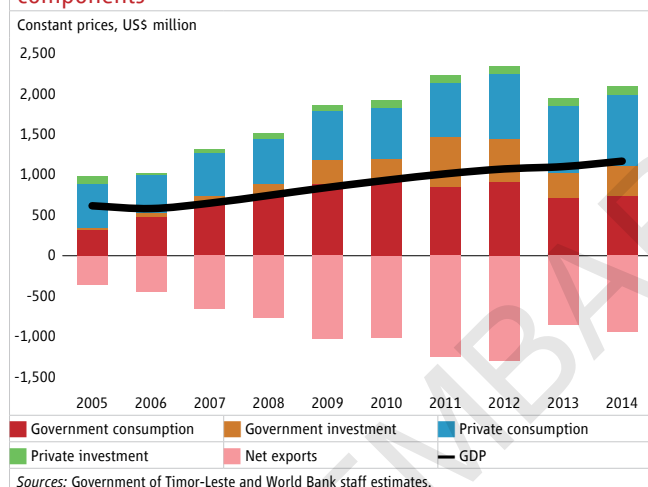
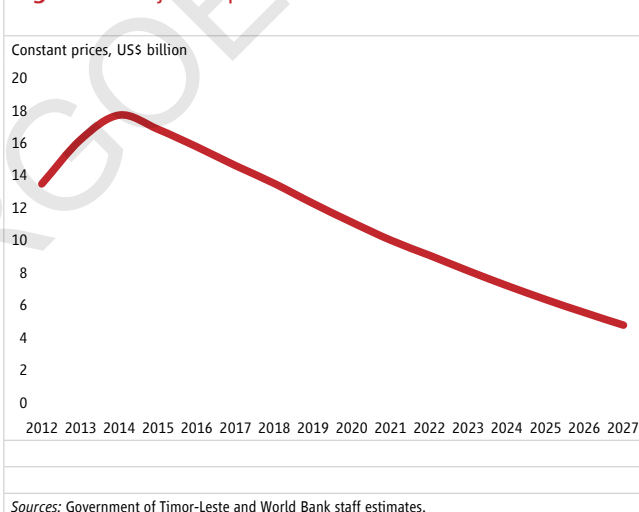


Figure 2. Projected petroleum fund balance



TIMOR-LESTE Selected Indicators	2013	2014	2015^e	2016^f	2017^f	2018^f
Real GDP growth, at constant market prices	2.8	5.9	4.3	5.0	5.5	6.0
Exports, goods and services, US\$ million ^a	87.9	89.3	91.6	100.0	113.0	128.0
Imports, goods and services, US\$ million	1,139	1,286	1,198	1,297	1,605	1,668
Consumer Price Inflation (annual average % change)	9.5	0.7	0.6	0.5	3.0	4.0
Current Account Balance (% of GDP)	43.6	26.2	13.3	2.0	-11.9	-12.2
Fiscal Balance (% of GDP) ^b	41.7	21.8	-8.7	-23.7	-29.5	-27.7

Sources: National authorities and World Bank staff estimates.
Note: f = forecast. a) exports exclude offshore petroleum shipments; b) overall fiscal balance as a proportion of total GDP, including petroleum sector.