# Timor-Leste 2026
# Mid-Year Economic Review

## Economic Resilience Amid Structural Adjustment

Macroeconomic, Fiscal, Monetary, Financial, and External Sector Developments



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# EXECUTIVE SUMMARY

Timor-Leste's near-term economic outlook remains favorable, although structural constraints continue to weigh on the sustainability and breadth of growth. Real non-oil GDP growth is projected to strengthen from 4.5 percent in 2025 to 5.0 percent in 2026, supported by public expenditure, household consumption, and a gradual recovery in private investment. Public investment, particularly in infrastructure, remains an important source of domestic demand. However, limited domestic productive capacity and absorptive constraints continue to constrain the supply response. High import dependence further limits domestic value added from demand expansion and contributes to persistent external imbalances.

Inflation remains contained. Headline inflation declined from 1.0 percent at end-2025 to 0.5 percent in June 2026, reflecting lower food prices and subdued domestic price pressures. Inflation is projected to average around 1 percent in 2026. The outlook remains subject to upside risks from higher transport and energy costs. Given the economy's high import dependence and full dollarization, external price shocks could pass through to domestic prices, underscoring the importance of maintaining price stability and strengthening domestic supply capacity.

Fiscal policy remains supportive of activity, while the end of Bayu-Undan production has materially altered the fiscal and external environment. The decline in petroleum-related revenues increases the urgency of strengthening domestic revenue mobilization, improving expenditure efficiency, and maintaining prudent management of Petroleum Fund resources. Fiscal policy will need to balance near-term development objectives with medium-term fiscal sustainability. Stronger prioritization and efficiency of public investment will be essential to preserve fiscal space and ensure that public spending contributes to productive capacity and diversification.

Financial conditions remain characterized by ample liquidity, but financial intermediation remains limited. Broad money expanded strongly during the first half of 2026, while private-sector credit continued to recover. In June 2026, banking-system assets increased by 19.5 percent year-on-year, with placements with other banks accounting for 60 percent of the increase, compared with 23 percent for loans. The composition of balance-sheet expansion therefore suggests that the principal constraint is increasingly the transmission of liquidity into domestic credit rather than liquidity availability itself. Strengthening financial infrastructure and access to finance will be important to support private investment.

The external position weakened significantly in the first half of 2026. The current account deficit widened to USD 374.1 million, mainly reflecting a larger goods deficit. Imports remained elevated, while non-oil exports, despite strong growth, remained small relative to import demand. A narrower services deficit and stronger secondary income provided some offset but were insufficient to reverse the deterioration in the trade balance. The financial account recorded a substantial net outflow of USD 705.9 million, driven mainly by higher portfolio and other investment outflows, further underscoring external vulnerability.

Overall, the near-term outlook remains supported by domestic demand and low inflation, but medium-term vulnerabilities remain significant. High import dependence limited productive capacity, weak export diversification, declining petroleum revenues, and shallow financial intermediation constrain the economy's adjustment capacity. Under full dollarization, policy space is more limited, placing greater emphasis on fiscal prudence, productivity-enhancing reforms, domestic revenue mobilization, export diversification, and deeper financial intermediation. These reforms are essential to strengthen external resilience, support private-sector-led growth, and preserve intergenerational wealth.



# TECHNICAL ABSTRACT

Economic activity is expected to remain resilient, with real non-oil GDP growth projected to increase from a preliminary estimate of 4.5 percent in 2025 to 5.0 percent in 2026. Growth is expected to be supported by public expenditure, household consumption, and private investment. Government consumption is projected to increase by 5.4 percent and remain an important contributor to aggregate demand, while public investment, particularly in infrastructure, is expected to support private-sector activity. However, limited domestic productive and absorptive capacity continues to constrain the supply response to stronger domestic demand. Consequently, a substantial share of additional demand continues to leak into imports, limiting the contribution of domestic production to growth and reinforcing external imbalances.

Inflation remains subdued. Annual headline inflation declined from 1.0 percent in December 2025 to 0.5 percent in June 2026, while average inflation during the first half of 2026 remained low. The moderation was primarily driven by lower food prices and broadly contained domestic price pressures. Nevertheless, rising transportation costs pose an upside risk, particularly given Timor-Leste's high dependence on imported goods and energy. Inflation is projected to average around 1 percent in 2026. Under full dollarization, the absence of nominal exchange-rate adjustment places greater emphasis on maintaining price stability through fiscal discipline, productivity gains, and policies that strengthen domestic supply.

Fiscal policy remained supportive of domestic activity. Domestic revenue increased by 4.7 percent year-on-year to USD 129.9 million during the first half of 2026, while government expenditure increased by 28.6 percent. Public investment execution also strengthened, with infrastructure accounting for most investment expenditure. While higher public investment supports growth and infrastructure development, continued attention to expenditure efficiency, project implementation capacity, and fiscal sustainability will be important.

The cessation of Bayu-Undan production represents a structural shift in Timor-Leste's fiscal and external environment. With petroleum production no longer providing a significant source of current revenue, fiscal sustainability will increasingly depend on domestic revenue mobilization, expenditure prioritization, and prudent management of Petroleum Fund resources. This transition reinforces the need to strengthen the non-oil economy, improve the productivity of public expenditure, and preserve fiscal space for priority development needs.

Monetary conditions remained characterized by ample liquidity. Broad money growth accelerated to approximately 24 percent year-on-year in May 2026 before moderating to 12 percent in June. The expansion supported by stronger deposit accumulation, supported by higher govrnment spending and turnaround in net foreign assets (NFA). NFA shifted from a negative contribution of USD 37.2 million in June 2025 to a positive contribution of USD 133.4 million in June 2026. The improvement in NFA strengthened the external asset position and supported monetary expansion. However, continued accumulation of foreign assets by commercial banks may limit the transmission of domestic liquidity into productive domestic credit, underscoring the importance of strengthening financial intermediation.

The banking system remained resilient, but financial intermediation remains relatively weak compared with the liquidity available in the system. Total banking assets increased by 19.5 percent year-on-year to approximately USD 3.0 billion in June 2026. Placements with other banks increased by 18 percent to USD 1.8 billion and accounted for 60 percent of total asset growth, while loans increased by 10 percent to USD 679 million, contributing only 23 percent of asset growth. The composition of balance-sheet expansion therefore indicates a continued preference for liquid and externally placed assets over domestic lending. This suggests that the principal constraint is increasingly the effective intermediation of available liquidity rather than its availability. Strengthening credit infrastructure, improving access to finance, addressing credit risk, and developing the capacity of firms to access bank financing could help channel savings toward productive domestic investment. At the same time, stronger credit growth should remain consistent with prudent underwriting and financial-sector stability.

The external position weakened considerably during the first half of 2026. The current account deficit widened by 21 percent to USD 374.1 million, mainly reflecting a larger goods deficit. Goods imports reached approximately USD 565.6 million, while non-oil exports, despite increasing by 143 percent, amounted to only USD 15.5 million.

The large asymmetry between imports and exports highlights the continued structural dependence on imported goods and the limited diversification and scale of the domestic export base. The strong increase in non-oil exports is encouraging, but the low export base means that its contribution remains insufficient to offset the scale of import demand.

The growth outlook nevertheless needs to be assessed in the context of the economy's underlying production structure. Public expenditure can sustain aggregate demand in the near term, but its impact on potential output will depend on the quality, timeliness, and productivity of investment. Infrastructure spending can reduce domestic production costs and improve connectivity, but implementation bottlenecks and limited absorptive capacity may reduce its economic return. A stronger supply response will require complementary reforms to the business environment, human capital, infrastructure management, and access to finance. Without such reforms, demand-led growth may continue to generate relatively limited domestic value added and a high import content.

The composition of fiscal expansion also warrants close monitoring. The increase in expenditure during the first half of 2026, alongside stronger public investment execution, provides important support to economic activity. However, as petroleum-related revenues decline, the fiscal impulse will need to be assessed against available non-oil revenues and the sustainable use of Petroleum Fund assets. Strengthening domestic revenue collection, including through improvements in tax administration and compliance, would help reduce reliance on petroleum wealth and create a more predictable fiscal base. Expenditure reforms should focus on prioritization, project appraisal, procurement, execution, and monitoring so that scarce fiscal resources are directed toward high-return investments and essential public services.

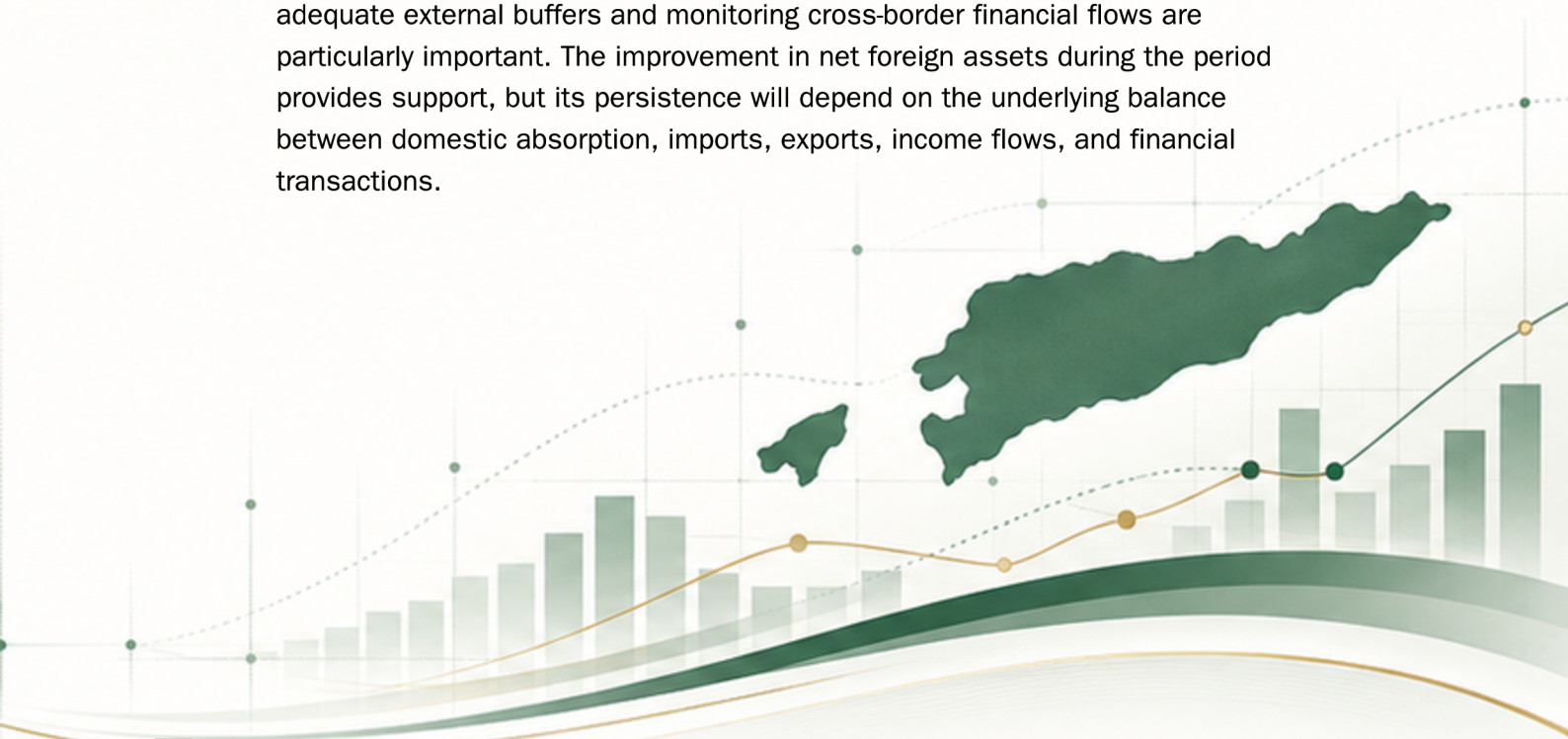
The post-Bayu-Undan transition also has implications for the balance between fiscal and external adjustment. In a fully dollarized economy, fiscal policy and structural reforms carry greater weight in maintaining competitiveness and containing domestic absorption. A sustained widening of the goods deficit would be difficult to address through nominal exchange-rate adjustment. Consequently, policies should aim to increase the supply of tradable goods and services, improve productivity, and encourage investment in sectors with export potential. Developing agriculture, tourism, and other non-oil activities could broaden the export base, although progress will depend on infrastructure, skills, market access, and private-sector capabilities.

The monetary and financial developments point to an important opportunity. Strong broad money growth and the increase in banking assets indicate that financial resources are available, but the relatively large share of assets held in

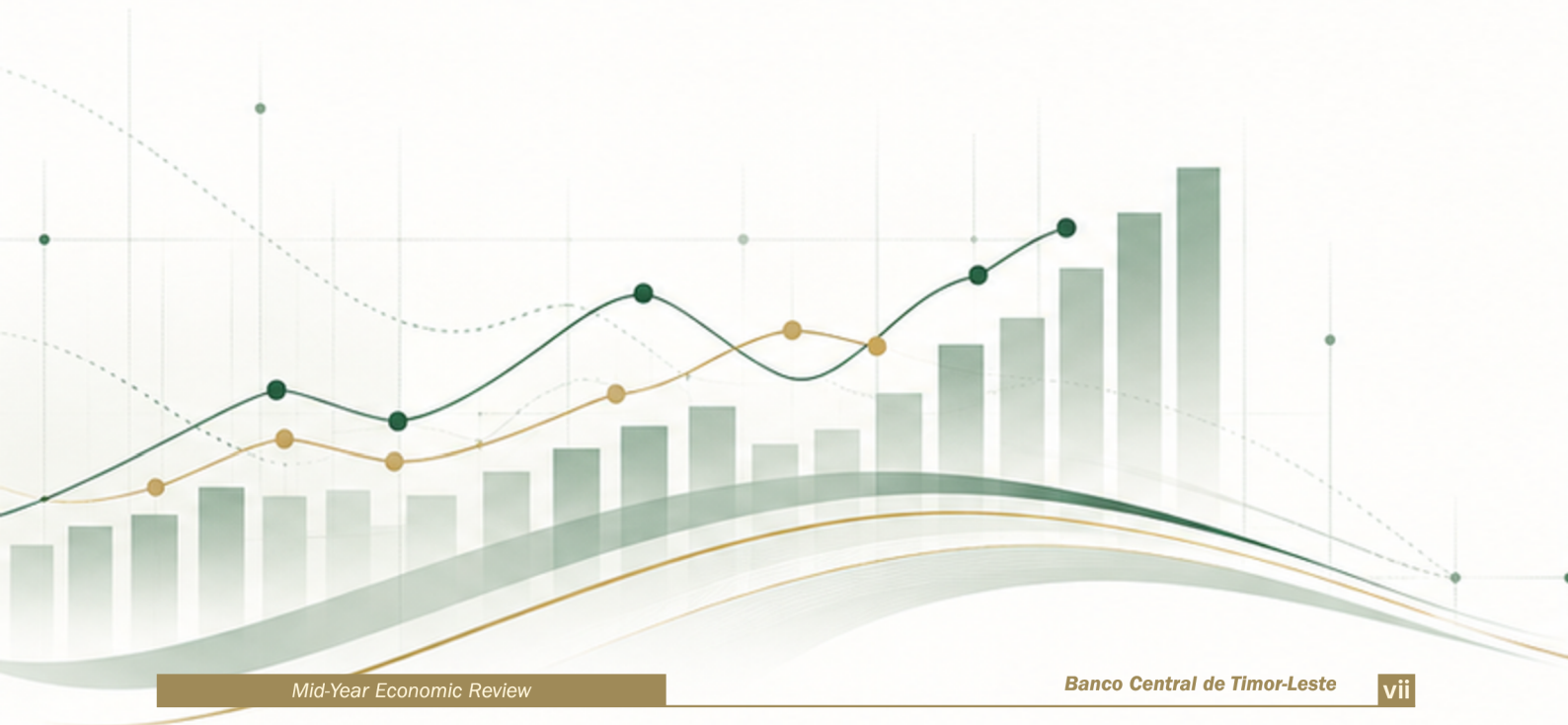
placements with other banks suggests that intermediation toward the domestic economy remains incomplete. The authorities and financial institutions should therefore continue efforts to strengthen the legal and institutional framework for lending, improve credit information, collateral arrangements, and insolvency procedures, and support responsible financial innovation. At the same time, the concentration of liquidity in external or interbank placements should be monitored from a financial-stability perspective, particularly if external conditions or counterparty risks change.

The external accounts also highlight the importance of distinguishing between the direction and the scale of export growth. The 143 percent increase in non-oil exports represents a significant improvement, but exports of USD 15.5 million remain small relative to goods imports of USD 565.6 million. The improvement in the services balance provides an additional source of diversification, but the services deficit of USD 119.5 million remains substantial. Continued development of tourism and other tradable services could therefore contribute to external adjustment over time. However, sustainable adjustment will require a broad-based increase in export capacity rather than reliance on a small number of products or temporary increases in external demand.

The financial account outflow of USD 705.9 million, together with the widening current account deficit, warrants continued surveillance of the external position. The increase in portfolio and other investment outflows may reflect changes in the allocation of financial assets, but sustained outflows could affect the composition of external assets and financing. In the absence of an independent monetary policy and exchange-rate instrument, maintaining adequate external buffers and monitoring cross-border financial flows are particularly important. The improvement in net foreign assets during the period provides support, but its persistence will depend on the underlying balance between domestic absorption, imports, exports, income flows, and financial transactions.



The policy mix should therefore seek to avoid a situation in which strong domestic demand persistently outpaces the expansion of domestic supply. In the near term, continued public investment can support growth provided projects are well selected and efficiently implemented. Over the medium term, however, growth should increasingly be driven by productivity and private investment rather than by recurrent fiscal expansion alone. This would reduce the import intensity of growth, strengthen employment opportunities, and improve the resilience of the non-oil economy. Greater coordination between fiscal policy, financial-sector development, and structural reforms will be important to achieve this transition. Continued reforms will also help strengthen policy credibility and create conditions for more predictable private investment and lasting external adjustment over time.





# 01

# Economic Activity and Inflation

**This 2026 Mid-Year Economic Review assesses recent economic developments in Timor-Leste, covering 2025 outturns and the outlook for 2026. It focuses on developments in public finances, the monetary and financial sectors, and the external sector, while examining the key channels through which global spillovers could affect domestic economic activity and financial conditions.**

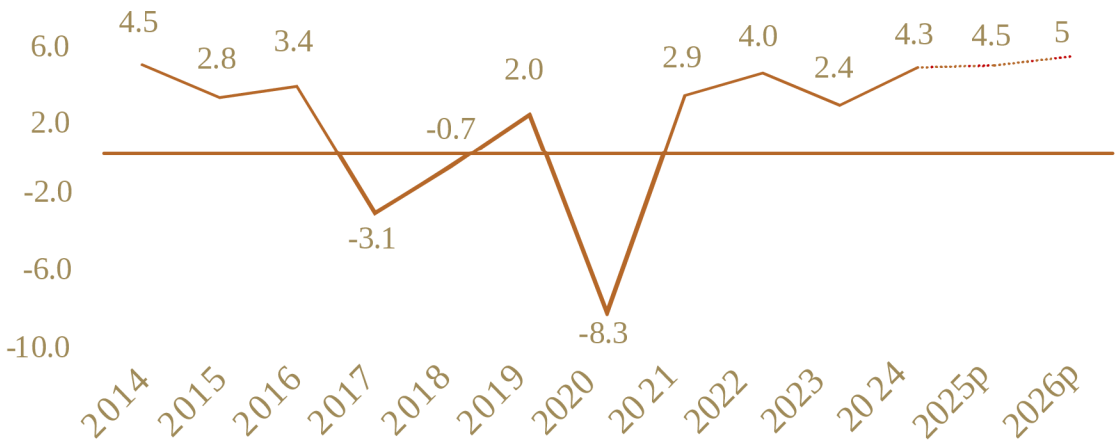
## 1.1. Economic Development and Outlook

In 2026, real non-oil GDP grew by 5 percent, up from 4.5 percent in 2025

Timor-Leste economic is expected to remain positive over the medium term, with real GDP growth projected to strengthen from 4.5 percent in 2025 to 5 percent in 2026. Growth was driven by public spending, household consumption, and modest private investment. Despite that, limited absorptive capacity pushes up imports, partially offsetting growth.

Chart 1.1. Real GDP Growth

% Annual Change




Source: BCTL

Final consumption is expected to the main driver of the economic growth in 2026, with government consumption estimated to rise by 5.4 percent, contributing 3.1 percentage points (pp) to overall growth, led by a sharp increase in purchases of goods and services. Public investment is also projected to grow 5.5 percent (1.5 pp), driven by expanded capital expenditure.

Real household consumption is also estimated to grow 3.4 percent (2.4 pp), despite a decline in government spending on wages and salaries and public transfers. This suggests that household demand remains relatively resilient, supported by income from remittances, and credit to individuals. The sharp fall in average inflation for the year has also restored confidence and strengthened households' purchasing power, further boosting consumption expenditure.

In 2026, significant growth in the private sector is expected due to the crowding-in effect.

Private investment is projected to increase by 4.5 percent (0.3 percent), driven by the crowding-in effect of higher public investment. The construction sector stands as the primary beneficiary, particularly through government-funded infrastructure projects such as roads and bridges. These public investments generate significant spillover effects, stimulating private investment across a range of other sectors. Moreover, infrastructure development is fundamental to advancing economic diversification and ensuring long-term sustainable growth.

Despite the positive contributions from consumption and investment, Timor-Leste continues to face a substantial trade deficit, driven by the growing demand for imported goods and services. In constant terms, total imports are projected to increase by 2.9 percent (1.9 pp) in 2026. This surge in imports reflects higher domestic demand for foreign consumption, intermediate, and capital goods, while non-oil exports remain largely confined to coffee in modest volumes, underscoring the economy's limited productive capacity to meet internal demand.

## 1.2 Expenditures' Compositions of Gross Domestic Product: Expenditure Approach

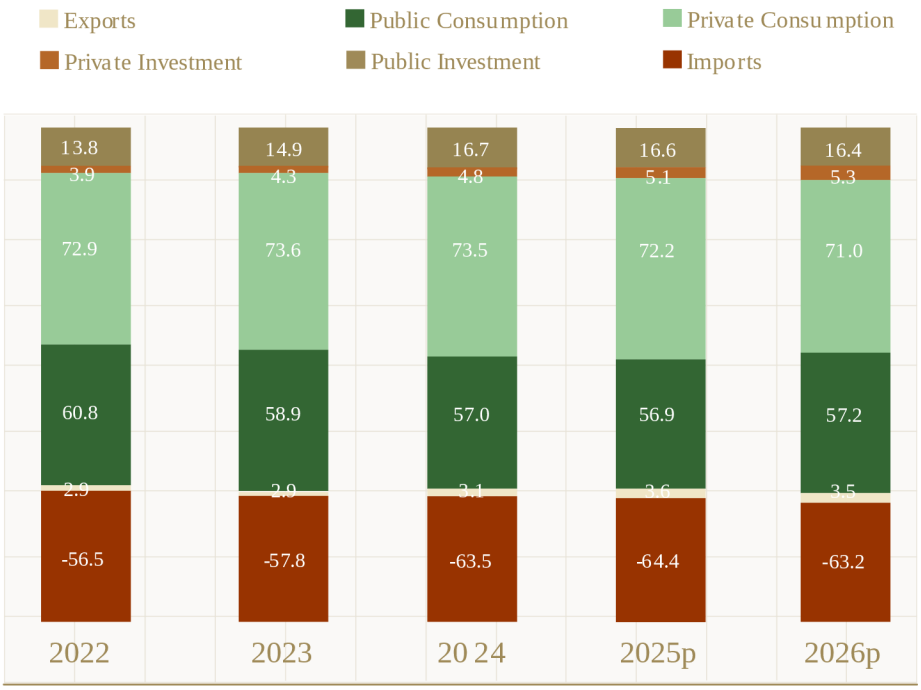
Public Investment slowing down in 2026, driven by decrease in capital development spending.

From the perspective of the expenditure approach, the economy remains heavily consumption-driven, with private consumption accounting for 71 percent of GDP and public consumption for 57.2 percent. In contrast, the share of total investment remains relatively small, despite the shares of both public and private investment having grown considerably over the past five years. This reliance on consumption reflects the continued country's weak productive capacity, high dependence on imports, persistent trade deficits, all of which stifle long-term growth potential.

As shown in Chart 1.2, the share of imports is projected to decline modestly, from 63.2 percent of GDP in 2026, while remain very large relative to the size of the economy, reflecting the country's continued reliance on imported goods and services to meet domestic consumption and investment demand. In contrast, the share of exports remains relatively modest, accounting for 16.4 percent of GDP in 2026. Exports remain concentrated mainly in coffee and other limited products.



Chart 1.2. Expenditure composition of GDP




Source: INETL - NA 2022 & 2024, BCTL rev. projection 2025 & 2026

## 1.3. Inflation

The average annual inflation rate is expected to slight increase to 1 percent in 2026 and 1.6 percent in 2027.

Domestic inflation continued to moderate during the first half of 2026, with year-on-year inflation declining from 1.0 percent in December 2025 to 0.5 percent in June 2026, reflecting a further easing of consumer price pressures. Average annual inflation increased marginally to 0.7 percent in June 2026 from 0.5 percent a year earlier. The continued moderation in inflation represents a favourable development following a peak of 8.7 percent in 2023, as subdued price pressures are helping to ease the erosion of purchasing power and support a gradual strengthening of consumer confidence. The moderation in inflation was driven primarily by the gradual easing of global commodity prices. In the first half of 2026, Timor-Leste recorded average inflation of 0.6 percent, the lowest semester average in the past eight years.

The decline in inflation was mainly attributable to lower prices for food and non-alcoholic beverages, which had been a major source of inflationary pressure during the review period. Given the relatively large weight of this category in Timor-Leste's consumption basket, price developments in food and non-alcoholic beverages have a substantial influence on headline inflation. Food inflation declined from 2.0 percent in December 2025 to 0.8 percent in June 2026.

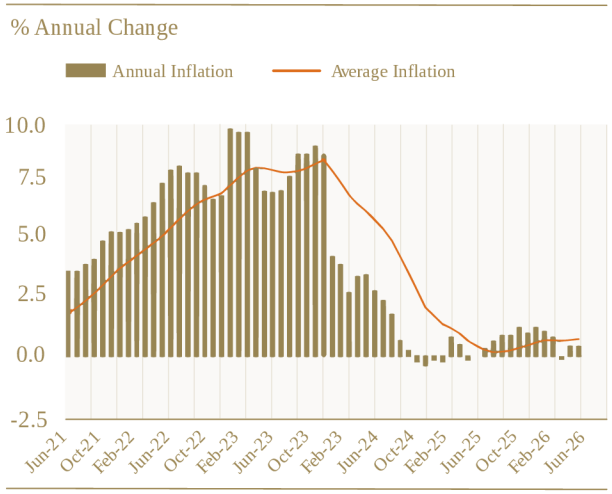
The significant disinflation is primarily due to the sharp decline in prices within the food and non-alcoholic beverages category.

Price pressures also remained contained in other major categories, including alcoholic and tobacco, clothing and footwear, equipment and household goods, communications, and recreation remained subdued or declined. These developments helped contain overall inflation, despite emerging price pressures in selected categories of the consumption basket.

The annual inflation fell sharply in 2024 after three years of high inflation.

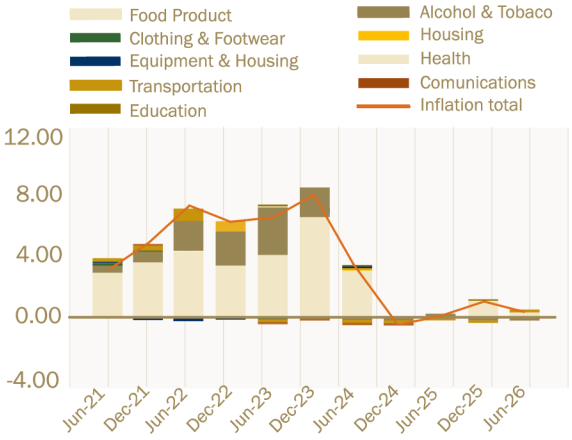
However, transportation was the main exception, with inflation rising to 7.0 percent in June 2026, from -0.1 percent at end-2025. The increase likely reflects higher transport and fuel costs, partly driven by the recent rise in global oil prices, and constitutes an important upside risk to the inflation outlook. Nevertheless, the pass-through to headline inflation remains limited, given the moderation in food prices and subdued price increases in other CPI components.

Chart 1.3. Inflation Ra te in Timor-Leste




Source: INETL and BCTL analysis

**Chart 1.4. Inflation ate in Timor-Leste**




**Source:** INE-TL and BCTL analysis

Looking forward, the inflation rate is projected to remain low but edge slightly higher than in 2025. BCTL forecasts an average of 1 percent for 2026, reflecting lingering global market uncertainties. Despite this slight increase, the rate is still considered positive as it remains well below the government's annual inflation threshold.

# 02
# Public Finance



## 2.1. Revenue

By mid-2026, non-oil revenues totaled USD 129.9 million, representing an increase of 4.7 percent compared to the same semester in 2025.

Domestic revenue reached USD 129.9 million in the first half of 2026, representing a 4.7 percent increase compared with the corresponding period of 2025. The increase was driven mainly by stronger tax collections and higher receipts from other revenue sources. Nevertheless, domestic revenue was 14.1 percent lower than in the second half of 2025, reflecting the seasonal pattern of revenue collection, which typically strengthens toward the end of the year as tax payments, sales activity, and other revenue collections increase.

It should be noted that the domestic revenue reported above excludes Estimated Sustainable Income (ESI) and excess withdrawals from the Petroleum Fund (PF). ESI receipts are typically transferred to the Government during the first half of the year, while any excess withdrawals are generally undertaken during the second half. As of June 2026, ESI receipts amounted to USD 500 million, unchanged from the corresponding period of 2025. However, unlike in June 2025, USD 300 million was transferred to the Government's account as part of the approved excess withdrawal. Consequently, total withdrawals from the PF during the first half of 2026 amounted to USD 800 million.

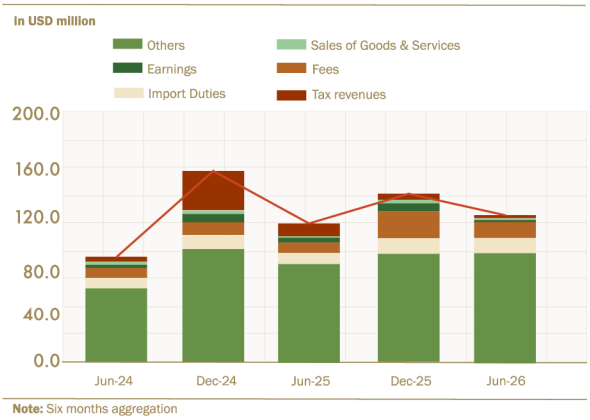
## 2.2. Expenditure

Actual expenditure was higher in mid-2026, due to increase in the actual expenditure on capital development, goods and services, and salaries and wages.

In the first half of 2026, actual government expenditure increased by 28.6 percent year-on-year, reflecting higher execution of both public consumption and public investment, which increased in the same direction. The overall budget execution rate reached 33.7 percent, up from 25.5 percent in the corresponding period of 2025.

The increase in public consumption was driven primarily by higher expenditure on goods and services, as well as salaries and wages. Meanwhile, the increase in public investment reflected a significant expansion in capital development expenditure. Although minor capital expenditure declined during the semester, the moderate increase in capital development more than offset this decline, given that capital development accounts for a substantially larger share of total public investment.

**Chart 2.1: TL - Domestic Revenues, excluding ESI**

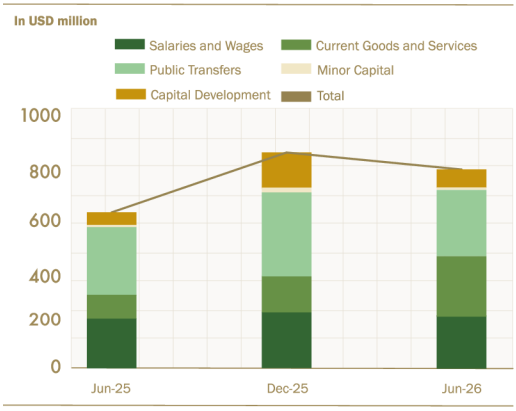



**Note:** Six months aggregation
**Source:** TL Transparency Portal and BCTL Calculation

## 2.2.1. Current expenditure

Current expenditure, comprising public consumption and public transfers, increased, primarily reflecting higher spending on goods and services, which rose by 160.8 percent (USD 160.1 million), and salaries and wages, which increased by 2.8 percent (USD 6.1 million).

**Chart 2.2: Public expenditure by categories**




**Note:** Six months aggregation
**Source:** TL Portal Transparancy and BCTL analysis,2026

These increases more than offset the 1.0 percent (USD 2.9 million) decline in public transfers.
Current expenditure is expected to increase further in the second half of the year, as scheduled payments to registered veterans are expected to be made during this period, thereby contributing to higher overall government expenditure.

## 2.2.2. Capital expenditure

Government allocated USD 401 million on capital development in 2026, reflecting a decrease of 9.0 percent.

In the 2026 State Budget, the Government allocated USD 401.0 million for capital development, approximately USD 39.7 million lower than the USD 440.8 million allocated in 2025, representing a 9.0 percent decline. Despite the lower budget allocation, capital development execution reached 18.9 percent by June 2026, compared with 10.8 percent in the corresponding period of 2025. Consequently, total public investment expenditure amounted to USD 76.8 million by mid-2026, an increase of USD 27.3 million compared with the same period in 2025.

During the first half of 2026, infrastructure program accounted for the bulk of capital development expenditure, representing 92 percent of total public investment, up by 31 percentage points from the corresponding period of 2025.

Most capital development expenditures in the first semester of 2026 were directed to infrastructure programs.

Within infrastructure spending, roads and bridges accounted for 52 percent of total public investment, compared with 28.3 percent in the same period of 2025. This share, however, was 4.1 percentage points lower than at end-2025, suggesting some moderation in the concentration of investment spending on road and bridge projects during the first half of 2026.

Table 2.2.2 provides a detailed breakdown of the main components of the public investment program and highlights the key priority areas within infrastructure investment.

Table 2.2.2. Composition of Public Investment

| | Million USD - Cash Basis | | | | | % Public Investment | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Jun-24 | Dec-24 | Jun-25 | Dec-25 | Jun-26 | Jun-24 | Dec-24 | Jun-25 | Dec-25 | Jun-26 |
| Capital Minor | 5.8 | 41.4 | 1.8 | 23.6 | 1.2 | 14.5 | 13.5 | 3.6 | 7.8 | 1.5 |
| Capital Desenvolvimento | 34.4 | 265.8 | 47.7 | 277.5 | 75.6 | 85.5 | 86.5 | 96.4 | 92.2 | 98.5 |
| Total Infrastructure | 30.3 | 194.4 | 30.3 | 252.5 | 70.5 | 75.3 | 63.3 | 61.2 | 83.8 | 91.8 |
| Total Public Investment | 40.2 | 307.1 | 49.5 | 301.1 | 76.8 | 6.7 | 26.7 | 7.4 | 26.1 | 9.0 |
| **Total Expenditures** | **597.4** | **1149.9** | **667.6** | **1152.4** | **858.3** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |

| Main Investment in Infrastructure Assets | Million USD - Cash Basis | | | | | % Public Investment | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Jun-24 | Dec-24 | Jun-25 | Dec-25 | Jun-26 | Jun-24 | Dec-24 | Jun-25 | Dec-25 | Jun-26 |
| Agriculture | 1.8 | 9.7 | 4.9 | 16.1 | 1.3 | 4.6 | 3.1 | 9.9 | 5.3 | 1.7 |
| Rural and Urban Development | 0.1 | 5.2 | 2.3 | 2.2 | 0.7 | 0.3 | 1.7 | 4.6 | 0.7 | 0.9 |
| Maintenance Rehabilitation | 1.7 | 23.7 | 2.4 | 24.5 | 6.6 | 4.2 | 7.7 | 4.8 | 8.1 | 8.6 |
| Approximate or Serviços de Tribunais | 0.0 | 0.0 | 0.0 | 0.2 | 0.1 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 |
| Information and Communications Technology | 6.6 | 19.6 | 2.3 | 8.7 | 0.0 | 16.5 | 6.4 | 4.7 | 2.9 | 0.0 |
| Water and Sanitation | 1.0 | 1.3 | 0.0 | 1.0 | 1.3 | 2.5 | 0.4 | 0.0 | 0.3 | 1.7 |
| Health | 0.0 | 2.6 | 0.0 | 0.0 | 1.0 | 0.1 | 0.8 | 0.0 | 0.0 | 1.4 |
| Airport | 0.0 | 0.5 | 1.8 | 2.3 | 10.5 | 0.1 | 0.2 | 3.6 | 0.8 | 1<br>3.6 |
| Ports | 0.6 | 2.5 | 0.0 | 2.1 | 0.2 | 1.5 | 0.8 | 0.0 | 0.7 | 0.3 |
| Roads and Bridges | 15.9 | 99.7 | 11.6 | 168.0 | 39.7 | 39.5 | 32.5 | 23.3 | 55.8 | 51.7 |
| Others Infrastructure | 2.4 | 29.6 | 5.0 | 27.4 | 9.2 | 6.0 | 9.6 | 10.1 | 9.1 | 12.0 |
| **Total Infrastructure** | **30.3** | **194.4** | **30.3** | **252.5** | **70.5** | **75.3** | **63.3** | **61.2** | **83.8** | **91.8** |

**Source:** MoF, Portal Transparency and BCTL

## 2.3. Fiscal Balance

During the period, the government withdrew US$500 million under the Estimated Sustainable Income (ESI) and a further US$300 million through excess withdrawals, bringing total Petroleum Fund withdrawals to US$800 million. These withdrawals were equivalent to 58.3 percent and 35.0 percent of total government expenditure, respectively, and together accounted for 93.2 percent of total expenditure. The total withdrawals plus domestic revenue exceeded the fiscal deficit, indicating that part of the additional financing was used to meet broader government financing and cash-management requirements rather than solely to finance the recorded fiscal deficit.

Domestic revenue amounted to only 15.1 percent of total government expenditure during the first half of 2026. This low revenue coverage highlights the continued structural dependence of the government budget on Petroleum Fund withdrawals. While the ESI provides a sustainable source of petroleum wealth financing under the fiscal framework, the reliance on substantial excess withdrawals underscores persistent fiscal pressures and the need to strengthen domestic revenue mobilization, improve expenditure efficiency, and enhance the long-term sustainability of public finances as petroleum-related revenues decline.

# 03
# Monetary


REPÚBLICA DEMOCRÁTICA DE TIMOR LESTE
2012
REPÚBLICA DEMOCRÁTICA DE TIMOR LESTE
2012

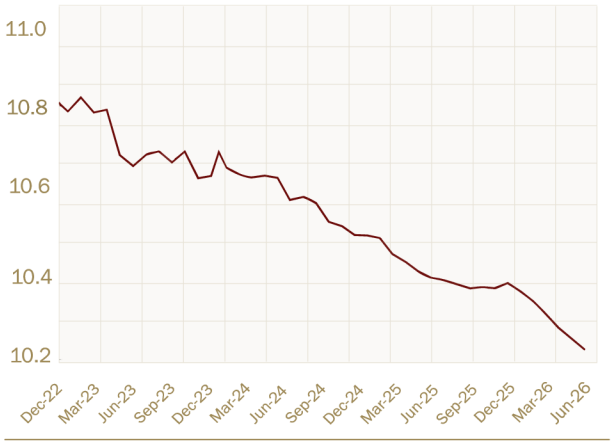
## 3.1. Interest Rates

**The banking sector's average lending rate has continued its gradual downward trend, declining from approximately 10.8 percent in December 2022 to around 10.2 percent by June 2026.** Although the reduction has been modest, amounting to roughly 0.6 percentage points over the period, it reflects a sustained easing in borrowing costs and suggests a relatively stable interest rate environment.

Despite a gradual decline in lending rates, loan interest rates remained elevated, at above 10 percent.

The decline appears to have been gradual rather than abrupt, indicating that commercial banks have progressively adjusted their lending rates in response to abundant liquidity within the banking system, stable macroeconomic conditions, and relatively subdued inflationary pressures. The absence of sharp fluctuations also suggests that credit pricing has remained predictable, providing greater certainty for borrowers and investors.

**Chart 3.1a: Lending**




**Source:** BCTL

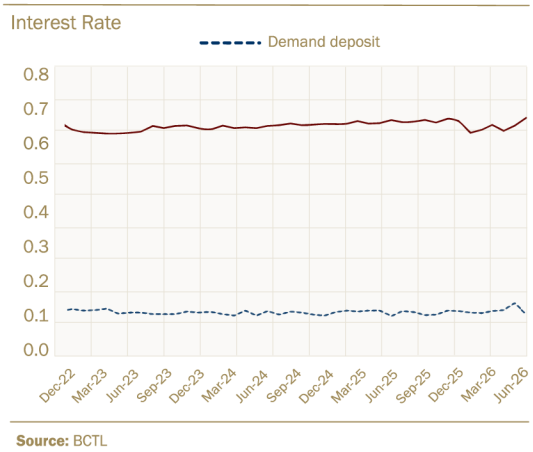
Despite this improvement, lending rates remain above 10 percent, which continues to represent a relatively high cost of financing for households and businesses. Consequently, the modest decline in lending rates alone may not be sufficient to significantly stimulate private sector borrowing or accelerate financial intermediation. Structural constraints, including elevated credit risk, limited availability of bankable projects, weak collateral frameworks, and the absence of diversified financing channels, are likely to remain more influential determinants of credit growth than the cost of borrowing itself.

At the same time, the banking sector's deposit interest rates remained broadly stable during the period from December 2022 to June 2026, reflecting the banking system's persistent liquidity surplus and the limited competitive pressure among banks to mobilize additional deposits. The interest rate on time deposits fluctuated within a narrow range of approximately 0.65 percent to 0.68 percent, ending the period at around 0.68 percent. Although this represents a marginal upward trend, the increase has been gradual and relatively insignificant. This suggests that banks have had little incentive to raise deposit rates, as existing deposit inflows have remained sufficient to meet their funding requirements.

The slight increase observed toward mid-2026 may indicate a modest adjustment in banks' funding strategies or pricing policies, but it does not represent a material shift in overall liquidity conditions.

Similarly, demand deposit rates remained virtually unchanged throughout the review period, averaging around 0.13 percent, with only minor short-term fluctuations. The temporary increase recorded in early 2026 was quickly reversed, indicating that banks continue to view demand deposits as a low-cost and stable funding source.

**Chart 3.1a: Deposit**




**Source:** BCTL

The persistently low remuneration on these deposits reflects the abundant availability of liquidity within the banking system and the absence of significant competition for deposit mobilization.

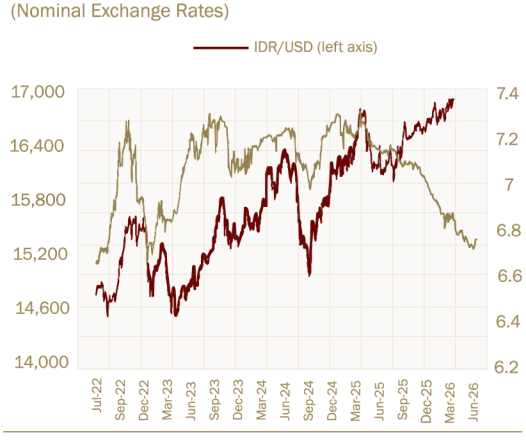
The combination of low and stable deposit rates and the gradual decline in lending rates illustrates a banking sector characterized by comfortable funding conditions. However, the exceptionally widespread between lending rates (above 10 percent) and deposit rates (below 1 percent) continues to indicate that the cost of financial intermediation remains relatively high. While part of this spread reflects operational costs, credit risk, provisioning requirements, and the small scale of the financial system, it also suggests that abundant liquidity has not translated into a proportionate reduction in borrowing costs.

## 3.2. Exchange rates

The Indonesian rupiah has depreciated steadily against the US dollar in recent years, weakening by around 10 percent in the year to June 2026.

**Figure 3.2a illustrates the movements of the Indonesian Rupiah (IDR) and the Chinese Yuan (CNY) against the US dollar from July 2022 to June 2026, two of Timor-Lestes' main trading partner.** During the review period, the two currencies exhibited divergent trends, reflecting differences in domestic economic conditions, monetary policy responses, and external market developments.

**Chart 3.2a. IDR and CNY vs USD**




**Source:** BCTL

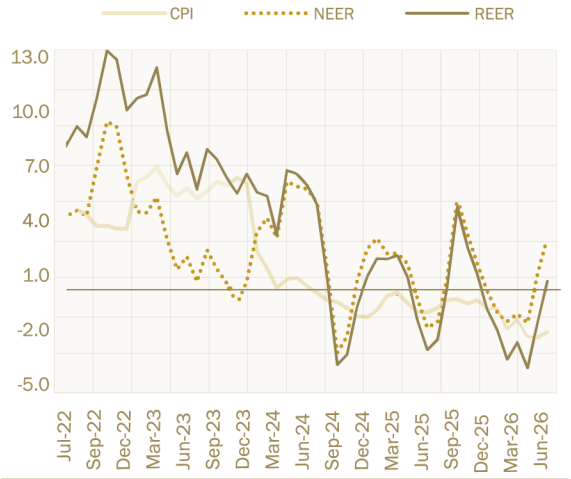
The Indonesian rupiah depreciated steadily against the US dollar over the past several years, with the exchange rate weakening from around IDR 14,800 per US dollar in mid-2022 to approximately IDR 17,000 per US dollar by June 2026. Although the rupiah experienced temporary periods of appreciation, particularly during early 2023 and late 2024, these gains were short-lived as the currency remained under persistent pressure from a stronger US dollar, elevated US interest rates, and continued capital outflows from emerging markets. Between June 2025 and June 2026, the rupiah weakened further by around 10 percent against the US dollar, reflecting a combination of external and domestic factors, including global financial market volatility, changes in investor risk sentiment, and domestic economic uncertainties. The depreciation highlights the continued challenges faced by emerging-market currencies amid a prolonged period of global monetary tightening and US dollar strength.

In contrast, the Chinese Yuan remained relatively stable through most of 2023 and 2024 before gradually appreciating against the US dollar from early 2025 onwards, with the exchange rate declining from around CNY 7.2 to approximately CNY 6.8 per US dollar by June 2026. The appreciation was supported by improving market confidence, stronger external balances, and policy measures aimed at maintaining exchange rate stability.

For Timor-Leste, a fully dollarized economy, fluctuations in the exchange rates of major trading partners have important implications for imported inflation and trade competitiveness. The depreciation of the Indonesian Rupiah reduces the domestic currency cost of imports from Indonesia, potentially easing inflationary pressures on imported consumer goods. Conversely, the appreciation of the Chinese Yuan may increase the US dollar cost of imports from China, placing upward pressure on import prices for machinery, construction materials, and manufactured goods. Given that Indonesia and China are among Timor-Leste's principal trading partners, continued monitoring of their exchange rate movements remains important for assessing inflation dynamics and external sector developments.

**Chart 3.2b. Real Effective Exchange Rate Index**

(% Annual changes)




**Source:** Bloomberg and BCTL analysis

**Figure 3.2b presents the annual changes in Timor-Leste's Real Effective Exchange Rate (REER), together with movements in the**

**Nominal Effective Exchange Rate (NEER) and domestic Consumer Price Index (CPI) from June 2022 to June 2026.** During the review period, Timor-Leste's Real Effective Exchange Rate (REER) exhibited considerable volatility, reflecting the combined effects of global exchange rate movements, domestic inflation dynamics, and fluctuations in the currencies of its principal trading partners. A pronounced depreciation was observed during the second half of 2024, when the REER declined into negative territory, indicating a temporary real depreciation of the economy. This development was primarily driven by the weakening of the US dollar against several major and regional currencies, together with subdued domestic inflationary pressures. The decline in the REER implied a temporary improvement in Timor-Leste's external price competitiveness, as domestic goods and services became relatively more competitive than those of its trading partner.

Timor-Leste's Real Effective Exchange Rate (REER) exhibited considerable volatility.

Throughout 2025 and the first half of 2026, the REER continued to fluctuate, alternating between episodes of appreciation and depreciation. The marked decline recorded in the early months of 2026 was followed by a recovery in June 2026, signaling renewed appreciation pressures. These movements largely reflected exchange rate developments among Timor-Leste's key trading partners, particularly Indonesia and China, as well as evolving global financial conditions and changes in the value of the US dollar. Overall, the observed REER dynamics underscore the economy's continued exposure to external shocks arising from exchange rate and inflation differentials, which remain important determinants of Timor-Leste's international competitiveness.

For the medium term, maintaining competitiveness will require structural improvements, including strengthening domestic production capacity, improving productivity, reducing import dependency, and supporting export diversification. These measures are particularly important under dollarization, where exchange-rate adjustment through nominal depreciation is not available as a policy instrument.



## 3.3. Monetary Base

**In June 2026, the monetary base increased by 7.8 percent to USD 287 million.** Currency in circulation outside the banking system accounted for 13.0 percent of the total monetary base, while 79.4 percent consisted of commercial banks' deposits with the BCTL and the remaining 7.6 percent represented liabilities to other sectors. The expansion of the monetary base primarily reflected the ample liquidity held within the banking system rather than the use of central bank policy instruments. Under Timor-Leste's fully dollarized monetary regime, the BCTL has limited capacity to influence reserve balances or manage domestic credit conditions through conventional monetary policy operations.

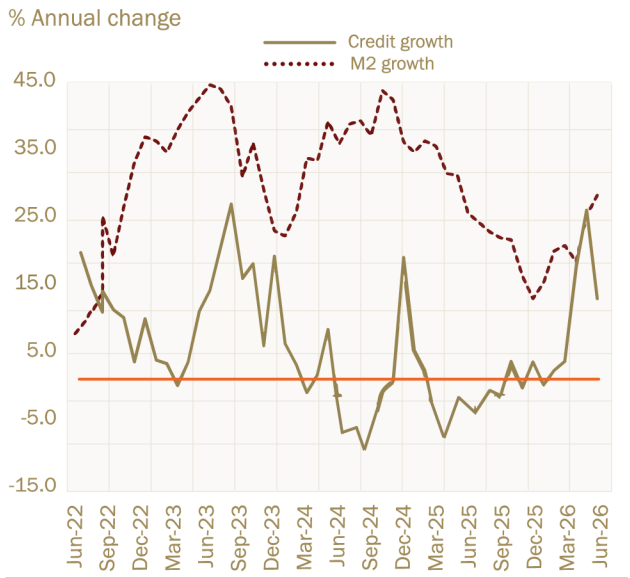
## 3.4. Money Supply

The money supply grew sharply by 24 percent in May 2026, before moderating to 12 percent in June, primarily driven by other deposits.

Figure 3.4a illustrates the annual growth of broad money (M2) and private sector credit from June 2022 to June 2026. During the first half of 2026, both monetary aggregates and credit recorded a marked improvement compared with the corresponding period of 2025. Broad money growth accelerated sharply, reaching approximately 24 percent year-on-year in May 2026 before moderating to around 9 percent in June 2026, reflecting a significant expansion in liquidity within the banking system. This increase was primarily driven by stronger deposit accumulation, supported by higher government spending and the continued resilience of the banking sector.

Private sector credit, including other claims, also strengthened over the review period, with annual growth rising steadily from approximately 14 percent in January 2026 to 26 percent in June 2026, compared with a declining trend observed during the same period of 2025. The recovery in credit growth suggests an improvement in banks' lending activities, supported by ample liquidity and stronger demand for financing from businesses and households. Nevertheless, the pace of credit expansion remained below the growth of broad money,

**Chart 3.4a. Monetary Aggregates and Credit Growth**




**Source:** BCTL

indicating that a substantial share of banking system liquidity continued to be held as deposits or invested abroad rather than being intermediated into the domestic economy.

Overall, the divergence between the rapid expansion of broad money and the more moderate growth in private sector credit highlights the persistent challenge of financial intermediation in Timor-Leste. Despite abundant liquidity in the banking sector, credit transmission to productive sectors remains relatively constrained. This underscores the need for continued structural reforms aimed at strengthening financial intermediation, broadening access to finance, and promoting greater private sector investment to support sustainable economic transformation.

The expansion of the money supply in 2025 was primarily driven by growth in its major components, particularly other deposits, comprising time and savings deposits. By June 2026, other deposits, which accounted for 52 percent of broad money (M2), had increased by 18.3 percent year-on-year. Transferable deposits also recorded positive growth of 4.7 percent over the same period, while currency in circulation—representing 3 percent of M2—rose by 9.0 percent.

The share of time deposits rose considerably during the period to June 2026.

Overall, total deposits continued to increase over the review period, reflecting sustained confidence in the other deposits taking institutions and continued growth in financial savings.

Compared with June 2025, total deposits increased further by June 2026, driven primarily by a significant expansion in other depostis, particularly time deposits. The share of time deposits rose considerably during the period, indicating that depositors increasingly preferred fixed-term savings instruments over more liquid demand deposits. This shift may reflect banks' efforts to mobilize longer-term funding through more attractive deposit rates, while depositors sought higher returns by locking funds into term deposits.

Demand deposits remained broadly stable, and continue to represent the largest component of the deposit base, although their slower growth suggests a gradual reallocation of liquid balances into interest-bearing time deposits. Meanwhile, other deposits maintained a relatively stable share of total deposits, contributing steadily to the overall expansion of deposit liabilities.

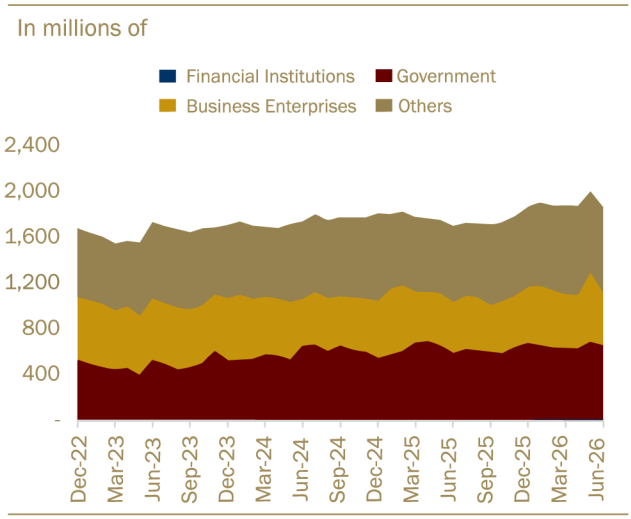
The continued increase in deposits, particularly time deposits, has strengthened the banking sector's funding base and enhanced liquidity available for financial intermediation. Nevertheless, despite the sustained growth in deposit mobilization, the expansion of bank credit has remained comparatively moderate, indicating that a significant portion of banking system liquidity continues to be invested abroad rather than intermediated

into the domestic economy. This highlights the importance of further strengthening financial intermediation to channel domestic savings into productive investment and support Timor-Leste's economic diversification and sustainable growth.

This development is consistent with the overall expansion of broad money (M2) during the review period and reflects the continued resilience of the banking sector despite a challenging external economic environment. The growing preference for time deposits also suggests increasing public confidence in the formal banking system and the effectiveness of banks in mobilizing domestic financial resources.

Chart 3.4b illustrates the evolution of deposits by depositor category between December 2022 and June 2026. Total deposits continued to increase steadily over the review period, reflecting sustained growth in banking system liquidity. On a year-on-year basis, total deposits expanded by 14.0 percent in May 2026 and 9 percent in June 2026, supported primarily by stronger growth in deposits from business enterprises and other depositors, while government deposits also recorded a moderate increase. Deposits from financial institutions remained relatively small throughout the period, reflecting their limited contribution to the overall deposit base.

**Chart 3.4b Deposit by Type of Depositors**



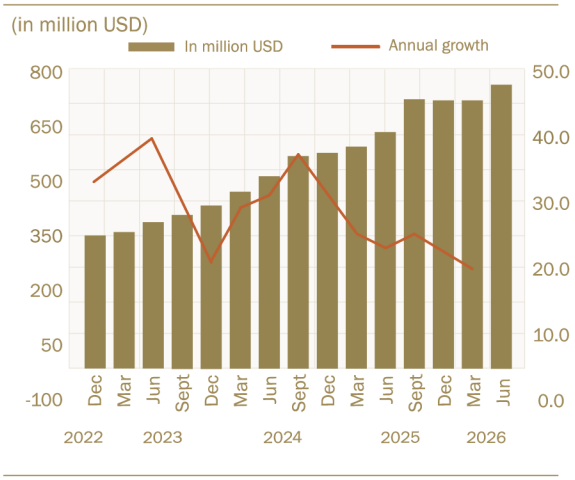

**Source:** BCTL

The continued expansion in deposits reflects sustained confidence in the the other deposits taking institutions, both banking system and microfinance institutions, and an improvement in domestic liquidity conditions. As of June 2026, other depositors accounted for approximately 40 percent of total deposits, followed by government deposits (34 percent) and business enterprises (26 percent), while financial institutions represented only a marginal share. The composition of deposits indicates that households and the government continue to constitute the principal sources of bank funding, providing a stable funding base for the banking system.

**Chart 3.4d 4c illustrates the continued expansion of credit to the private sector between December 2022 and June 2026, reflecting a gradual improvement in financial intermediation.**

Outstanding private sector credit increased from approximately USD 740 million in June 2025 to USD 768 million in June 2026, representing a year-on-year growth of around 20 percent. Although credit growth moderated compared with the strong expansion observed during 2024 and early 2025, lending continued to follow an upward trajectory, indicating sustained demand for bank financing.

**Chart 3.4d. Development of Loan to Private Sector**




**Source:** BCTL

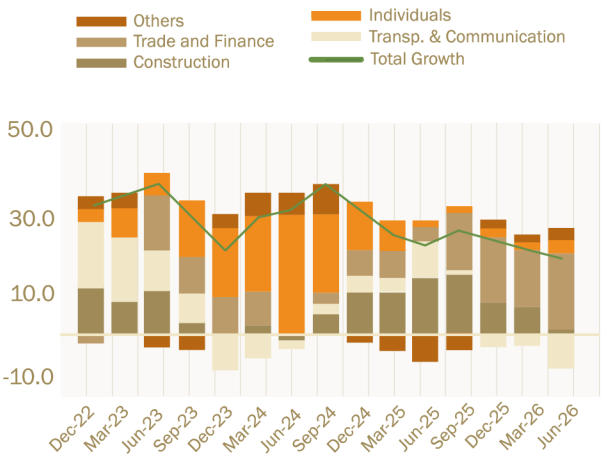
**Despite the continued expansion in deposits and private sector lending, credit growth remained slower than deposit growth over** the same period, indicating that the increase in bank funding has only been partially translated into domestic lending, particularly to productive sectors. This suggests that banking system liquidity remains ample, while financial intermediation continues to face constraints in effectively channeling available funds toward productive investment. Strengthening credit allocation and improving the efficiency of financial intermediation will therefore be important to support private sector development, economic diversification, and sustainable economic growth.

Private sector credit growth accelerated to around 20 percent year-on-year in June 2026, reaching its highest rate in recent years, supported primarily by strong lending to the trade and finance sectors.

**The continued expansion of bank deposits has strengthened the funding capacity and liquidity position of the banking system. However, the transmission of this available liquidity into private sector credit has remained uneven,** with credit growth concentrated in specific sectors rather than broadly supporting productive economic activities. The sectoral composition of credit growth in June 2026 shows a notable shift compared with the previous year, with the trade and finance sector becoming the main contributor to overall credit expansion, increasing its contribution from 3.8 percentage

**Chart 3.4e. Loans to Private Sector: Contribution to Growth**

**(In percent y/y)**




**Source:** BCTL

points in June 2025 to 19.4 percentage points in June 2026. This suggests stronger demand for financing related to commercial activities and financial services.

In contrast, credit contributions from sectors typically associated with investment and productive capacity expansion have weakened. The construction sector, which was a major driver of credit growth in June 2025 with a contribution of 15.1 percentage points, moderated significantly to 2.0 percentage points in June 2026. Similarly, the transport and communication sector shifted from a positive contribution of 9.1 percentage points to a negative contribution of 8.0 percentage points, reflecting a contraction in lending to these activities. Meanwhile, lending to individuals increased modestly, with its contribution rising from 1.5 percentage points to 3.4 percentage points, while other sectors recovered from a negative contribution of 6.3 percentage points to a positive contribution of 3.3 percentage points.

Overall, while the increase in deposits indicates continued availability of bank funding, the sectoral distribution of credit growth suggests that financial intermediation remains relatively limited in channeling liquidity toward a broad range of productive sectors. The concentration of credit expansion in trade and finance-related activities, combined with weaker contributions from construction, transport, and communication, highlights the importance of strengthening credit allocation mechanisms, improving access to finance, and supporting the development of productive investment opportunities to enhance the role of the banking sector in economic transformation.

Another perspective on the M2 analysis, as shown in Table 3.4 below, highlights that broad money (M2) expanded substantially in the year to June 2026, with the annual flow increasing to USD 105.6 million, compared with USD 43.7 million a year earlier. The acceleration in monetary expansion was driven primarily by stronger credit to the economy and a marked turnaround in net foreign assets (NFA), while the accumulation of government deposits at BCTL provided an important offset.

**Table 3.4. Sources of Variation in the Money Supply (M2)**

| In Million of USD | Annual Flows | |
|---|---|---|
| | Jun-25 | Jun-26 |
| Credit to the Economy | 135,9 | 169,6 |
| Government | 85,6 | -105,5 |
| Claims on BCTL | 0,0 | 0,4 |
| Deposits | 85,6 | -106,0 |
| NFA | -37,2 | 133,4 |
| Other Net Assets and Liabilities | 140,6 | 91,9 |
| M2 | 43,7 | 105,6 |

**Source:** BCTL

Credit to the economy remained an important domestic source of monetary expansion, with its contribution increasing from USD 135.9 million in June 2025 to USD 169.6 million in June 2026. This development is consistent with the continued strengthening of private sector credit, which accelerated during the review period. Nevertheless, the expansion of domestic credit remains relatively modest compared with the liquidity available within the banking system, as reflected in the relatively low loan-to-deposit ratio and the continued accumulation of liquid assets.

NFA recorded a substantial turnaround, shifting from a negative contribution of USD 37.2 million in June 2025 to a positive contribution of USD 133.4 million in June 2026. The increase in NFA provided an important source of monetary expansion and strengthened the external asset position of the financial system. However, its implications for domestic financial intermediation warrant close monitoring. Continued accumulation of NFA by commercial banks could weaken the transmission of additional liquidity to the domestic economy.

This dynamic is particularly relevant given the relatively low loan-to-deposit ratio and the banking system's substantial holdings of liquid assets and foreign placements. Thus, while the increase in NFA contributes positively to M2 growth, it may also represent a form of financial leakage from domestic intermediation when the additional liquidity is placed abroad rather than converted into domestic credit.

The government sector, meanwhile, provided a significant offset to monetary expansion, with its contribution shifting from a positive USD 85.6 million in June 2025 to a negative USD 106 million in June 2026. This negative contribution primarily reflected the accumulation of government deposits at BCTL in the absence of corresponding central bank credit to the government or commercial banks.

Other net assets and liabilities also remained a positive source of monetary expansion, although their contribution declined from USD 140.6 million in June 2025 to USD 92  million in June 2026.

Overall, the recent expansion of M2 has been supported by both stronger domestic credit creation and substantial NFA accumulation. However, the relatively low conversion of available liquidity into domestic lending suggests that the increase in monetary liquidity has not been fully transmitted to the domestic economy. The continued accumulation of foreign assets by commercial banks may be an important factor behind this weak transmission, highlighting the need to assess whether structural constraints, credit risk, limited demand for bank financing, or the relative attractiveness of foreign placements are constraining domestic financial intermediation.

## 3.5. Financial deepening

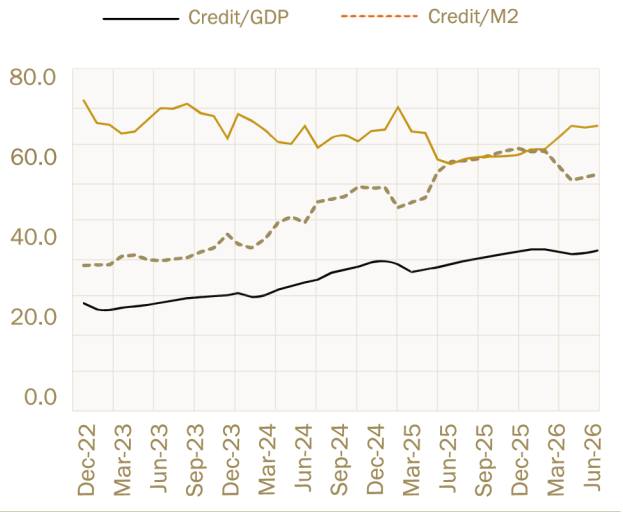
The M2-to-GDP ratio increased by 6.3 percentage points in June 2026, while the credit-to-GDP ratio rose by 1.5 percentage points to 36.6 percent.

The development of the financial sector remains a key determinant of sustainable economic growth and poverty reduction by facilitating financial intermediation, mobilizing savings, and supporting productive investment. A commonly used indicator of financial deepening is the ratio of broad money (M2) and private sector credit to gross domestic product (GDP), which provides insight into the size and depth of the financial system relative to the economy.

In June 2026, the M2-to-GDP ratio increased to 62 percent from 60.4 percent in June 2025, representing a rise of 1.6 percentage points. This improvement primarily reflected continued growth in deposits, particularly time and savings deposits, which expanded the domestic financial resource base. The relatively high M2-to-GDP ratio by historical standards suggests that the banking system continues to maintain a substantial level of financial depth and ample liquidity.

**Chart 3.5. M2 and Credit to the Economy as a**

(percentage)

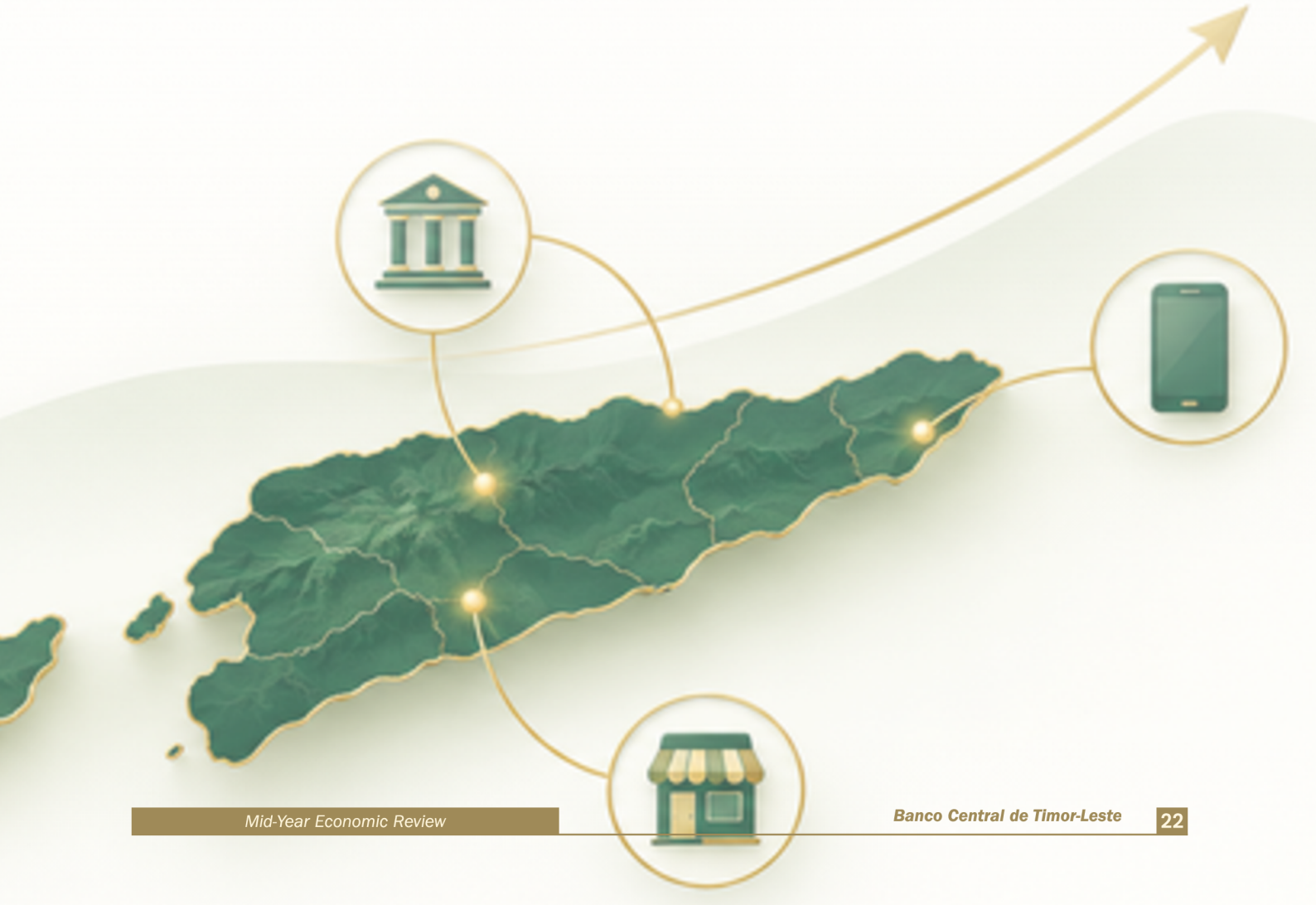



**Source:** BCTL

Credit deepening also improved during the review period. The credit-to-GDP ratio increased by 1.5 percentage points year-on-year to 36.6 percent in June 2026, reflecting continued expansion in private sector lending, particularly to construction while weakened, trade, and other productive sectors. Although this trend indicates a gradual strengthening of financial intermediation, the ratio remains modest relative to the size of the deposit base, suggesting that credit penetration in the economy is still limited.

This assessment is further supported by the credit-to-M2 ratio, which increased only marginally to 59 percent in June 2026 from 58 percent a year earlier. The limited improvement indicates that, despite robust deposit mobilization and abundant banking sector liquidity, the pace of credit expansion has remained broadly proportional to the growth in broad money. Consequently, a considerable share of financial resources continues to be held as liquid assets rather than being intermediated into private sector credit.

This finding is consistent with the earlier analysis showing that deposit growth has outpaced credit expansion, implying that excess liquidity has not yet been fully translated into productive lending. Strengthening financial intermediation by expanding access to credit for viable private sector activities therefore remains an important policy priority to enhance the contribution of the financial sector to economic diversification and long-term growth.



# 04
# Banking System



Timor-Leste's financial system comprises eight deposit-taking institutions, consisting of seven commercial banks and one other deposit-taking institution. The sector also includes Kaibauk Microfinance Institution, which has recently received preliminary authorization to transition to a commercial banking license.

Banking-sector assets expanded strongly by 19.5 percent year-on-year in June 2026, with the increase driven primarily by placements with other banks, particularly abroad, and to a lesser extent, by other assets. However, the asset-side expansion appears to have been driven more by the accumulation of liquid and externally placed assets than by a corresponding expansion of domestic credit.

Total banking system liabilities, excluding capital, increased by 19.0 percent year-on-year to USD 2.48 billion in June 2026, driven mainly by a 72.5 percent increase in interbank placements. While deposits remained the dominant funding source at 77.1 percent of total liabilities, their share declined from 83.4 percent a year earlier, indicating a shift toward greater reliance on interbank funding.

## 4.2. Banking Assets

Banking system assets increased sharply by 19.5 percent year-on-year in June 2026, driven primarily by a significant increase in placements with other banks.

The banking system continued to expand its balance sheet in June 2026, with total assets increasing by 19.5 percent year-on-year to USD 3.0 billion, equivalent to an increase of approximately USD 483 million. The expansion was broad-based across most asset categories, but was driven predominantly by placements with other banks, which accounted for the largest share of the increase. Placements with other banks rose by 18 percent to USD 1.8 billion, contributing USD 276 million, or 60 percent, of the overall increase in banking system assets. This indicates that a substantial portion of the banking system's balance-sheet expansion continued to be held in bank placements rather than being intermediated through domestic lending.

Cash and balances with BCTL increased by 11 percent to USD 275 million, contributing USD 27 million, or 9 percent, of total asset growth. The increase strengthened banks' immediately available liquidity buffers and supported their capacity to meet payment and withdrawal obligations. However, the relatively smaller contribution of cash and BCTL balances compared with placements with other banks suggests that the increase in banking assets was not primarily accumulated as central-bank balances.

Loans increased by 10 percent to USD 679 million, adding USD 61 million, or 23 percent, to total asset growth. Although lending expanded, its

contribution to overall asset growth remained substantially below that of placements with other banks. This suggests that balance-sheet expansion was only partly translated into additional credit intermediation to the domestic economy. The continued predominance of placements with other banks is therefore relevant to assessing the extent to which the banking system's growing deposit base is being transformed into domestic credit.

Investments increased by 37 percent to USD 96 million and contributed USD 26 million, or 3 percent, of total asset growth. Despite the relatively high growth rate, their small initial base limited their contribution to the overall expansion of banking assets. Fixed assets also increased, by 14 percent, but contributed only USD 3 million, or 1 percent, of total asset growth.

Other assets recorded the fastest rate of increase, rising by 297 percent from USD 31 million to USD 122 million. Although this represented an increase of USD 91 million, equivalent to 4 percent of total asset growth, the relatively large percentage increase partly reflects the low base in June 2025. The increase should therefore be interpreted cautiously and, where possible, examined by its underlying components to determine whether it reflects temporary or structural factors.

Overall, the composition of asset growth points to a continued preference for liquidity and bank placements over domestic credit expansion. Placements with other banks accounted for 60 percent of the increase in total banking assets, compared with 23 percent for loans. While this asset allocation may provide banks with substantial liquidity and support balance-sheet resilience, it also indicates that the rapid expansion of banking assets has not been fully matched by an equivalent expansion in credit to the domestic economy. This pattern is particularly relevant in the context of strengthening financial intermediation, as sustained financial deepening will depend not only on the expansion of bank assets and deposits but also on the extent to which these resources are channeled into productive domestic investment and private-sector credit.

Bank credit increased by 10.0 percent year-on-year, reaching USD 679 million in June 2026.

**Table 4.1. Banking System Assets: Levels, Annual Changes, and Composition (In million USD)**

| Items | Jun-25 | Jun-26 | Change | | Weighted Percent |
|---|---|---|---|---|---|
| | | | Percent | Value | |
| Cash and BCTL Balance | 248 | 275 | 11 | 27 | 9 |
| Placement to other Bank | 1.490 | 1.766 | 18 | 276 | 60 |
| Investment | 70 | 96 | 37 | 26 | 3 |
| Loans | 639 | 701 | 10 | 62 | 24 |
| Fixed assets | 23 | 24 | 4 | 1 | 1 |
| Other assets | 31 | 122 | 297 | 91 | 4 |
| **Total** | **2.500** | **2.984** | **19,2** | **481** | 100 |

**Source:** BCTL

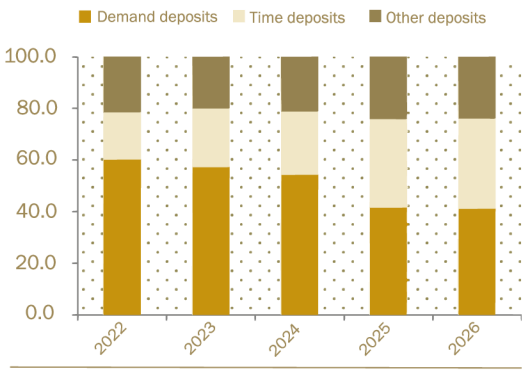
## 4.2. Bank Liabilities

Bank liability increased by 19.0 percent year-on-year, reaching USD 2,477 million in June 2026.

Total liabilities, excluding capital, increased to USD 2,476.9 million in June 2026, representing a 19.0 percent year-on-year increase. The expansion was driven primarily by a sharp increase in placements from other banks, which rose by 72.5 percent (USD 212 million), increasing their share of total liabilities to 20.4 percent, from a lower level in June 2025. Deposits remained the dominant source of bank funding, accounting for 77.1 percent of total liabilities. However, their share declined from 83.4 percent in June 2025, reflecting the relatively faster expansion of interbank funding. Liabilities to BCTL increased marginally by 0.3 percent, but their contribution to overall balance-sheet growth remained negligible given their small share of total liabilities (0.3 percent). Other liabilities also increased by 17.4 percent, contributing positively to the overall expansion of liabilities.

**Chart 4.1. Composition of Deposit**

**% of Total Deposito**



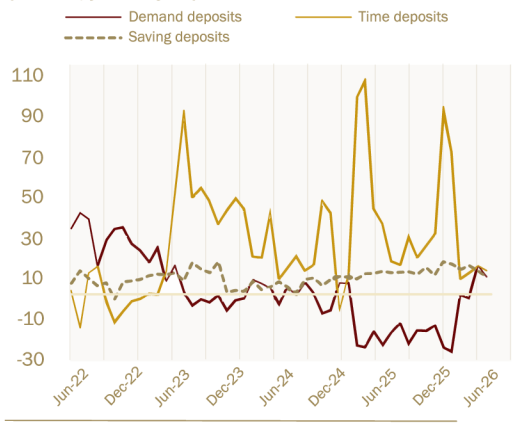

**Source:** BCTL

Capital strengthened further, increasing by 21.2 percent year-on-year and accounting for 16.3 percent of total balance-sheet liabilities and capital in June 2026. The simultaneous increase in capital and total assets points to a strengthening of the banking system's capital position and provides an additional buffer against potential balance sheet and credit risks, thereby enhancing the sector's overall resilience.

The composition of deposits has remained broadly stable, although the relative importance of individual deposit categories has shifted gradually over time. Demand deposits continued to account for the largest share of total deposits, but their share has declined progressively over the past five years, reaching 41.4 percent in June 2026. In contrast, the share of time deposits continued to increase, reaching 35.0 percent, while the remainder comprised savings

**Chart 4.2. Developments in Deposit Growth**

**(Percent, year-on-year)**




**Source:** BCTL

deposits (Chart 4.1). This shift toward time deposits suggests a gradual lengthening of the maturity structure of bank deposits, although demand deposits remain the principal source of deposit funding.

Deposit growth dynamics also point to a gradual change in the composition of funding. Following a period of consecutive declines since 2023, demand deposits resumed growth, increasing by 9.1 percent year-on-year in June 2026. Time deposits, meanwhile, continued to record relatively strong growth, with particularly pronounced increases in July 2023 and March 2025, when year-on-year growth reached 91.2 percent and 98.0 percent, respectively. Although growth moderated thereafter, time deposits continued to expand, increasing by 12.0 percent year-on-year in June 2026, following a substantially stronger 35.5 percent increase in June 2025 (Chart 4.2). The continued expansion of time deposits, despite the moderation in growth, contributed to the changing composition of bank funding and may provide banks with a relatively more stable funding base.

## 4.3. Bank Sector Profitability and Earning Performance

Banking sector remained profitable and broadly resilient in June 2026, but profitability weakened moderately.

The banking sector remained profitable in June 2026, although performance weakened moderately compared with a year earlier. Gross operating profit declined by 2.5 percent year-on-year to USD 51.6 million, despite continued growth in core operating income. Interest income increased by 4.1 percent to USD 62.1 million, while commission income and transaction fees rose by 11.2 percent to USD 5.3 million. The continued expansion of these revenue sources indicates that banks' core income-generating activities remained resilient during the period.

However, the growth in operating income was more than offset by higher funding and operating costs. Interest expense increased by 37.8 percent, from USD 11.3 million to USD 15.6 million, indicating a significant increase in the cost of funding. This development is consistent with the changing composition of bank deposits, particularly the continued increase in time deposits observed in June 2026. While time deposits can provide banks with a more stable funding base, they generally entail higher funding costs than demand deposits. The increase in interest expense therefore suggests that the shift toward time deposits may have placed some pressure on banks' interest margins.

As a result, the increase in interest and commission income was insufficient to prevent a 2.5 percent decline in gross operating profit. Nevertheless, the structure of operating income remained broadly stable.

Interest income accounted for 120.3 percent of gross operating profit in June 2026, compared with 112.7 percent a year earlier, while commission income and transaction fees increased their contribution from 9.0 percent to 10.3 percent. The fact that interest income exceeded 100 percent of gross operating profit reflects the fact that gross operating profit is measured after deducting interest and commission-related expenses.

The deterioration in operating profitability was partly mitigated by lower provisioning costs. Provisioning expenses declined by 27.6 percent to USD 2.5 million, reducing their share of gross operating profit from 6.5 percent to 4.8 percent. This provided some support for net earnings and may indicate lower provisioning requirements during the period. However, operating expenses increased by 7.3 percent to USD 27.2 million, raising their share of gross operating profit from 47.9 percent to 52.7 percent. The increase in operating costs therefore added further pressure to banks' profitability.

Consequently, the net operating result declined by 9.3 percent to USD 21.9 million, from USD 24.1 million in June 2025. Despite this decline, the sector remained profitable, with net income decreasing by only 2.9 percent to USD 19.1 million. The relatively small decline in net income compared with the net operating result was supported by the reduction in provisioning expenses.

Profitability indicators also weakened modestly. Return on Assets (RoA) declined from 0.8 percent in June 2025 to 0.6 percent in June 2026, while Return on Equity (RoE) decreased from 4.9 percent to 4.0 percent. The decline in both indicators indicates that banks generated lower returns from their asset base and shareholders' equity than a year earlier. Nevertheless, both ratios remained positive, confirming that the banking sector continued to generate profits and that aggregate earnings remained sufficient to support positive returns to assets and equity.

The moderation in profitability should also be considered in the context of the banking sector's balance sheet expansion. Total banking assets increased substantially during the period, while profitability increased at a slower pace. As a result, the decline in RoA suggests that the additional assets generated relatively lower returns than the existing asset base. This may be particularly relevant given the continued high level of liquidity in the banking system and the relatively limited expansion of credit to the private sector. If a significant portion of banks' balance sheets remains allocated to relatively low-yield liquid assets or placements abroad, the capacity of asset growth to generate additional income may remain constrained.

At the same time, the increase in funding costs warrants close monitoring. The combination of higher interest expenses, continued growth in time deposits, and relatively moderate-income growth could place further pressure on banks' net interest margins if lending rates or yields on interest-earning assets do not adjust sufficiently. This creates an important link between the banking sector's funding structure, liquidity allocation, credit intermediation, and profitability. Stronger deposit mobilization improves the availability and stability of bank funding, but if the resulting increase in funding costs is not accompanied by stronger credit growth and asset yields, the benefits of greater financial intermediation may not translate fully into higher profitability.

Overall, the banking sector remained profitable and broadly resilient in June 2026, but profitability weakened moderately. The main pressures arose from higher interest and operating expenses, which more than offset the growth in interest and commission income. Lower provisioning expenses provided a partial offset, while positive net income, RoA, and RoE indicate that the sector continued to generate earnings.

**Table 4.2. Banking Sector Profitability and Earnings Performance, June 2025–June 2026**

| Items | In million of USD | | % Year-On Year Change | In % Gross Operating Profit | |
|---|---|---|---|---|---|
| | Jun-25 | Jun-26 | | Jun-25 | Jun-26 |
| Interest income | 59,6 | 62,1 | 4,1 | 112,7 | 120,3 |
| Commission Income & Transaction Fees | 4,8 | 5,3 | 11,2 | 9,0 | 10,3 |
| Interest expense | **-11,3** | **-15,6** | – | – | – |
| Commissions Supported | -0,2 | -0,2 | 17,5 | -0,4 | -0,4 |
| **Gross Operating Profit** | 52,9 | 51,6 | -2,5 | 100,0 | 100,0 |
| Provision | **-3,4** | **-2,5** | -27,6 | -6,5 | -4,8 |
| Operating expense | **-25,4** | **-27,2** | 7,3 | -47,9 | -52,7 |
| **Net Operating Result** | **24,1** | **21,9** | -9,3 | 45,6 | 42,4 |
| **Net income** | **19,7** | **19,1** | -2,9 | 37,1 | 37,0 |
| RoA % – Return on Assets | 0,8 | 0,6 | -18,7 | – | – |
| RoE % – Return on Equity | 4,9 | 4,0 | -19,9 | – | – |

**Source:** BCTL

## 4.4. International Transfer Services

### 4.4.1. Commercial Banks

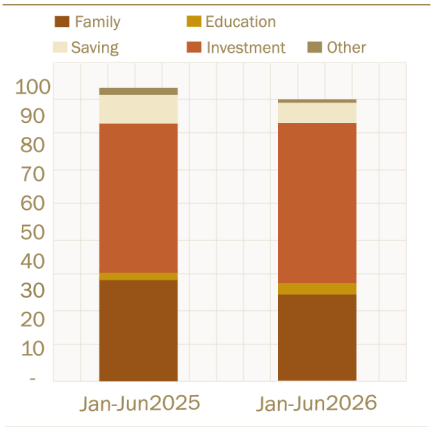
By June 2026, commercial banks in Timor-Leste reported outbound transfers totaling $1,005.9 million, reducing 0.8 percent from the same period in 2025. Inbound transfers rose slightly, increasing by 7.1 percent to $523.5 million. As a result, the net transfer balance showed a deficit of $482.5 million, improving from the $525.3 million deficit recorded a year earlier.

### 4.4.2. Money Transfers Operators (MTOs)

Over the same period, Money Transfer Operators (MTOs) recorded outbound transfers of $90.9 million, a 1.8 percent decline year-on-year, while inbound transfers increased sharply by 56 percent to $148.7 million. The composition of outward transfers remained broadly stable in the first half of 2026, although the relative importance of major transfer purposes shifted moderately. Investment-related transfers remained the largest component, increasing their share of total outward transfers to around 56 percent, from approximately 50 percent in the corresponding period of 2025. In contrast, the share of family transfers declined from around 35 percent to 28 percent. Transfer for education purpose increased marginally, while transfers for savings remained broadly stable. Overall, the composition indicates that investment continued to account for most outward transfers, while family-related transfers remained an important, albeit declining, component.

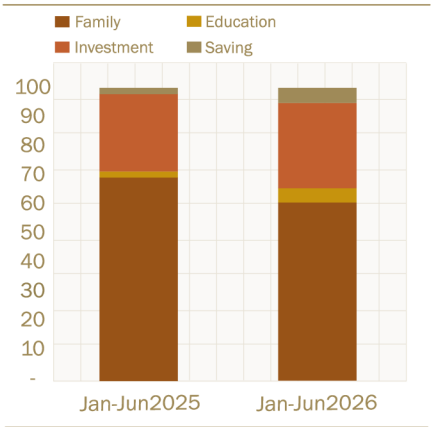
By contrast, the composition of inward transfers by purpose shifted toward greater diversification in the first half of 2026. Family-related transfers remained the predominant category but declined from approximately 71 percent of total inward transfers in Jan–Jun 2025 to 61 percent in Jan–Jun 2026.

**Chart 29a Composition of Outward Transfers**




**Source:** BCTL

**Chart 29b Composition of Inward Transfers**




**Source:** BCTL

In contrast, the shares of investment, education, and savings increased to around 27 percent, 6 percent, and 6 percent, respectively. The decline in the share of family transfers, alongside the increased allocation to investment, education, and savings, suggests that the strong growth in inward transfers was accompanied by a broader range of uses. In particular, the rise in investment and savings-related transfers may indicate a gradual shift toward longer-term financial and asset-building purposes, while the increase in education-related transfers points to continued use of remittance income to support human capital development.

# 05
# External Sector



Timor-Leste's external sector position weakened in the first semester of 2026 (SEM1 2026), with the current account deficit widening by 27.0 percent to US$374.1 million, from US$294.4 million in SEM1 2025. Excluding oil income, the current account deficit increased by 14.0 percent to US$374.0 million from US$326.7 million. The widening deficit was mainly driven by a larger goods deficit and lower primary income, partly offset by an improved services balance and higher secondary income.

Timor-Leste's current account deficit widened to US$374.1 million in the first semester of 2026, driven mainly by a larger goods deficit, despite an improvement in the services balance. net outflow of US$705.9 million,

The financial account recorded a net outflow of US$702.9 million, an increase of 87.0 percent from SEM1 2025, driven mainly by higher portfolio and other investment outflows. The capital account remained broadly unchanged at US$0.2 million.

The larger current account deficit and financial account outflows increased external financing pressures, resulting in a 114.0 percent increase in the drawdown of reserve assets to US$482.1 million.

**Table 5.1. Balance of Payment of Timor-Leste**

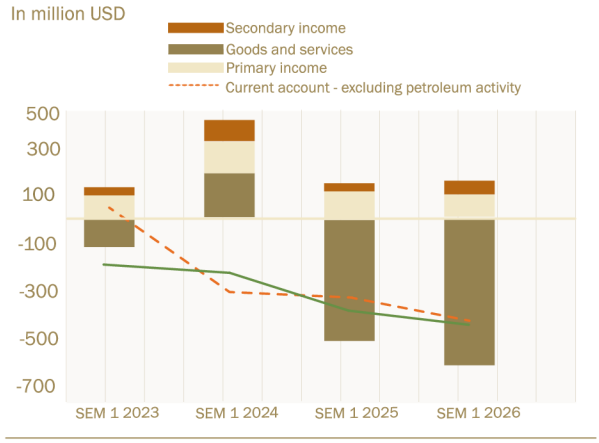
| | In million of USD | | |
|---|---|---|---|
| | SEM 1* 12025 | SEM 1 2026 | % Change |
| Current account, excluding oil income | -326.7 | -374.0 | 14 |
| Current Account | -294.4 | -374.1 | 27 |
| Goods, FoB | -303.0 | -463.0 | 53 |
| Service | -185.1 | -119.5 | -35 |
| Primary Income | 140.3 | 125.9 | -10 |
| Secondary Income | 53.4 | 82.6 | 55 |
| Capital Account | 0.2 | 0.2 | 0 |
| Financial Account | -376.8 | -702.9 | 87 |
| Direct Investment | -102.9 | -113.5 | 10 |
| Portfolio Investment | -235.6 | -524.9 | 123 |
| Other Investment | -23.8 | -106.5 | 348 |
| Net Errors and Omissions | -82.6 | -329.1 | 298 |
| Grand Total | -671.0 | -1076.8 | 60 |
| Reserve Asset (Change) | -225.3 | -482.1 | 114 |

**Source:** BCTL

## 5.1. Current Account

In the first semester of 2026, Timor-Leste's current account balance records a deep deficit of roughly 374 million US dollars. This imbalance is driven by a severe goods-and-services deficit of minus 582.5 million US dollars during this period. Primary and secondary income provide positive inflows of 125.88 million and 82.58 million US dollars, respectively, totaling roughly 208 million US dollars combined. However, these gains are far too small to offset the massive trade deficit. As a result, the total current account aligns with the non-petroleum current account baseline at -374 million US dollars in 2026, as shown in Chart 5.1.

**Chart 5.1. Timor-Leste - Current Account Balance**




**Source:** BCTL

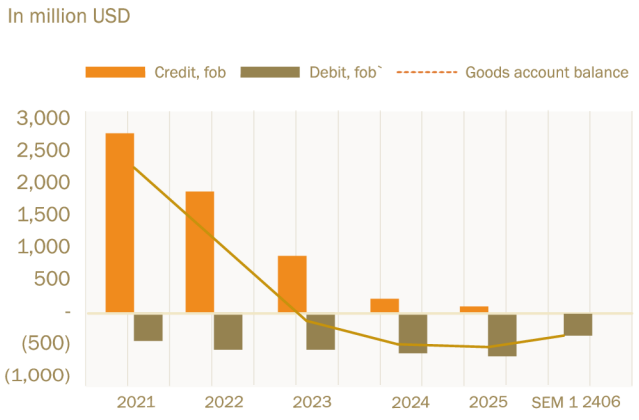
### 5.1.1 Trade Balance

### 5.1.1.1 Goods Account

The goods account deficit widened in the first half of 2026, as exports declined by 59.2 percent to $12.7 million, largely reflecting the closure of Bayu-Undan, while imports remained elevated at $565.6 million.

In the first semester of 2026, goods imports dropped to 176.8 8 million US dollars, down from 188.30 million US dollars in the first semester of 2025. This 11.43 million US dollar (or 6.1%) decline in import payments reduced outward foreign currency flows on the Balance of Payment goods account. Decreased imports of FOB helped suppress additional expansion of the country's trade deficit during the first half of 2026.

**Chart 5.1.1. TL Goods Accounts**




**Source:** BCTL

## Non-Oil Merchandise Trade of Goods

### Imports of Goods

As the first semester of 2026 imports reached $565.6 million as a surge in capital and intermediate goods offset a decline in consumer imports.

Timor-Leste's reliance on imports to satisfy domestic demand remained pronounced throughout the first semester of 2026. Measured on a cost, insurance, and freight (CIF) basis, imports rose 30 percent to about 565.6 million US dollars, reflecting an economy undergoing a structural transition. This growth was primarily driven by intermediate goods, which added 25.5 percentage points to the aggregate 30 percent increase. The marked surges in intermediate goods (77%) and consumption goods (38%, contributing 13.9 percentage points) highlight intensified demand for operational inputs and consumer goods. Conversely, capital goods contracted by 20%, contributing negative 5.4 percentage points, indicating a temporary deceleration in large-scale infrastructure and capital machinery investment.

**Table 5.1.1 - Import by Broad Economic Category (BEC)**

| BEC - Category | Nominal | | SEM 1 2026 Percentage (%) | | |
|---|---|---|---|---|---|
| | SEM 1 2025 | SEM 1 2026 | Share | Growth | Contribution to Growth |
| Capital goods | 114 | 90 | 16 | -20 | -5.4 |
| Consumption goods | 160 | 220 | 39 | 38 | 13.9 |
| Intermediate goods | 144 | 254 | 45 | 77 | 25.5 |
| Omitted Goods | 17 | 1 | 0 | -97 | -3.7 |
| **Total** | **433.9** | **565.6** | **100** | **30** | **30.3** |

**Sourcce:** INETL

Despite changes across broad categories, reliance on specific essential commodities remains heavily concentrated. The following categories represent the top imported commodities in Timor-Leste during the first semester of 2026, accounting for most of the total import expenditure:

- Mineral Fuels, Mineral Oils, and Products of Their Distillation: The largest single import category, valued at 175 million US dollars (30.9% of total imports). This sector recorded a remarkable growth of 99.9% compared to 87 million US dollars in the first semester of 2025.
- Vehicles (Other than Railway or Tramway Rolling Stock): The second-largest commodity group, valued at 59 million US dollars (10.5% of total imports), reflecting a 9.7% increase from 54 million US dollars in the first semester of 2025.

- Cereals: A critical food import totaling 32 million US dollars (5.6% of total imports), registering a 6.2% rise from 30 million US dollars in the previous period.
- Nuclear Reactors, Boilers, Machinery, and Mechanical Appliances: Valued at 26 million US dollars (4.6% of total imports), experiencing a contraction of 10.8% compared to 29 million US dollars in the first semester of 2025.
- Beverages, Spirits, and Vinegar: Ranked as a rapidly expanding category at 26 million US dollars (4.5% of total imports), surging by 113.8% over first-semester 2025 levels (12 million US dollars).
- Electrical Machinery, Equipment, and Parts: Totaled 19 million US dollars (3.3% of total imports), declining by 23.1% relative to 25 million US dollars in the first semester of 2025.

**Table 5.1.2. Main import of goods by commodities**

| | SEM 1 2025 | SEM 1 2026 | Change % | SEM 1 2025 | SEM 1 2025 |
|---|---|---|---|---|---|
| Meat and edible meat offal | 15 | 17 | 8.7 | 3.6 | 3.0 |
| Cereals | 30 | 32 | 6.2 | 6.9 | 5.6 |
| Beverages, spirits and vinegar | 12 | 26 | 113.8 | 2.8 | 4.5 |
| Salt; sulphur; earths, stone; plastering materials, lime and cement | 14 | 15 | 9.9 | 3.2 | 2.7 |
| Mineral fuels, mineral oils and products of their distillation | 87 | 175 | 99.9 | 20.1 | 30.9 |
| Pharmaceutical products | 3 | 4 | 19.6 | 0.7 | 0.7 |
| Natural or cultured pearls; precious and semi-precious stones | 0 | 1 | 569.8 | 0.0 | 0.1 |
| Iron or steel articles | 14 | 9 | -30.2 | 3.1 | 1.7 |
| Nuclear reactors, boilers, machinery and mechanical | 29 | 26 | -10.8 | 6.8 | 4.6 |
| Electrical machinery and equipment and parts thereof | 25 | 19 | -23.1 | 5.7 | 3.3 |
| Vehicles; other than railway or tramway rolling stock | 54 | 59 | 9.7 | 12.5 | 10.5 |
| Furniture; bedding, mattresses and mattress supports | 9 | 10 | 9.8 | 2.1 | 1.8 |
| Others | 141 | 173 | 22.6 | 32.6 | 30.6 |
| **Total** | **434** | **566** | **30.3** | **100.0** | **100.0** |

## Exports of Goods

The value and distribution of Timor-Leste's non-oil exports across major international destination partners during the first semesters of 2025 and 2026, measured in millions of US dollars alongside annual percentage changes and market shares.

Non-oil exports rose 143% to $15.5 million in the first semester of 2026 but remain structurally fragile due to heavy market concentration in regional corridors and a massive trade deficit.

Overall, total export revenues experienced a substantial expansion, surging by 143 percent from 6.4 million US dollars in the first semester of 2025 to 15.5 million US dollars in the first semester of 2026.

Indonesia remained the primary export destination, capturing the largest market share at 35.4 percent as nominal values expanded by 93 percent from 2.8 million US dollars to 5.5 million US dollars. Australia followed as the second-largest partner, accounting for 26.6 percent of total exports following an 88 percent rise to 4.1 million US dollars.

Among other Asian markets, the People's Republic of China experienced the steepest growth at 887 percent, expanding its market share from 2.1 percent to 8.5 percent (1.3 million US dollars), while Japan grew by 341 percent to reach 1.3 million US dollars (8.1 percent share). Furthermore, exports to the United States of America rose by 703 percent to 0.8 million US dollars (5.0 percent share), and Singapore increased by 104 percent to 0.3 million US dollars (2.0 percent share). Conversely, exports to Germany dropped to zero (a 100 percent contraction), while all other cumulative destinations accounted for 2.2 million US dollars or 14.4 percent of the market share.

**Table 2.8 Destination of Exports**

| | In million of USD | | Annual Change % | Share | |
|---|---|---|---|---|---|
| | SEM 1 2025 | SEM 1 2026 | | SEM 1 2025 | SEM 1 2026 |
| United States of America | 0,1 | 0,8 | 703 | 1,5 | 5,0 |
| Indonesia | 2,8 | 5,5 | 93 | 44,4 | 35,4 |
| Australia | 2,2 | 4,1 | 88 | 34,2 | 26,6 |
| Japan | 0,3 | 1,3 | 341 | 4,4 | 8,1 |
| Germany | 0,1 | 0,0 | -100 | 2,2 | 0,0 |
| Peoples Republic of China | 0,1 | 1,3 | 887 | 2,1 | 8,5 |
| Singapore | 0,2 | 0,3 | 104 | 2,4 | 2,0 |
| Others | 0,6 | 2,2 | 304 | 8,6 | 14,4 |
| **Total** | **6,4** | **15,5** | **143** | **100** | **100** |

**Source:** INE-TL and BCTL Calculation

The services account deficit narrowed by 35.7 percent to US$119.5 million in SEM1 2026, supported by higher services exports and lower services imports.

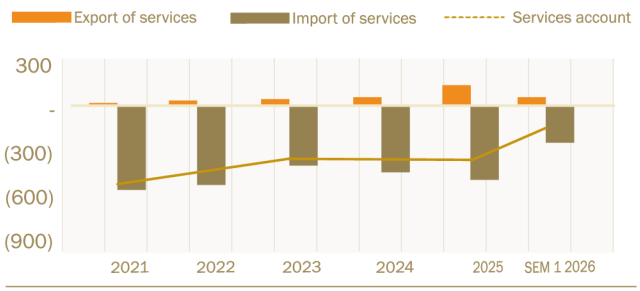
### 5.1.1.2. Service Account

The services account deficit narrowed significantly in SEM1 2026, declining by 35.7 percent from US$185.8 million in SEM1 2025 to US$119.5 million. This improvement followed a substantial widening of the deficit in SEM1 2025, when the services deficit increased from US$71.7 million in SEM1 2024 to US$185.8 million.

The improvement in SEM1 2026 was driven by both higher services exports and lower services imports. Services exports increased by 63.7 percent, from US$45.6 million in SEM1 2025 to US$74.7 million, while services imports declined by 16.1 percent, from US$231.4 million to US$194.1 million.

The narrowing of the services deficit continued the improvement observed since SEM1 2023, when the deficit stood at US$93.1 million. Despite the improvement in SEM1 2026, the services account remained in deficit, indicating continued reliance on imported services. Further development of the domestic services sector could support export growth and contribute to reducing the services deficit.

**Chart 5.1.2. TL Services Account**




**Source:** BCTL

The primary income surplus stood at US$125.9 million in SEM 1, remaining a positive contributor to the current account

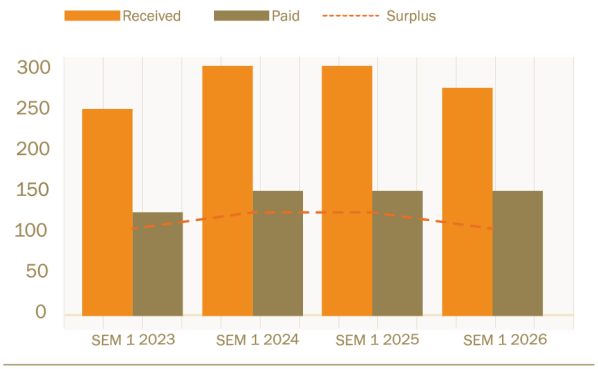
## 5.1.2. Primary and Secondary Income

### 5.1.2.1. Primary Income

The primary income account remained in surplus in SEM1 2026, recording a surplus of US$125.9 million, compared with US$140.3 million in SEM1 2025, representing a decline of 10.3 percent.

The reduction in the primary income surplus was driven by a decline in primary income received, which decreased by 3.0 percent from US$298.3 million in SEM1 2025 to US$289.5 million in SEM1 2026. Meanwhile, primary income paid increased by 3.5 percent, from US$158.0 million to US$163.6 million. The combination of lower income received, and higher income paid resulted in a narrower primary income surplus. Despite the decline, the primary income account remained in surplus and continued to make a positive contribution to the overall current account balance in SEM1 2026.

**Chart 5.1.3. TL Primary Income Account**




**Source:** BCTL

### 5.1.2.2. Secondary Income

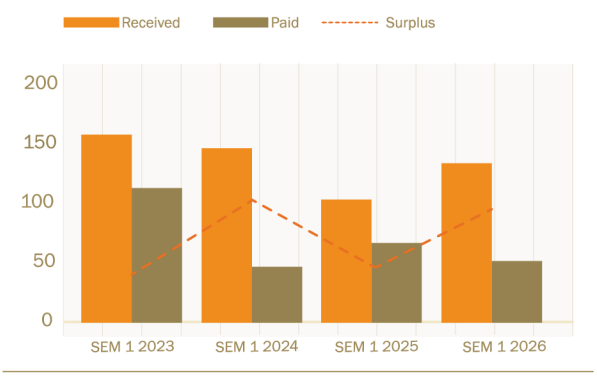
The secondary income surplus increased by 55 percent to US$82.6 million in SEM1 2026, supported by higher worker remittances and increased secondary income receipts

The secondary income account strengthened significantly in SEM1 2026, recording a surplus of US$82.6 million, compared with US$53.4 million in SEM1 2025, representing an increase of 55 percent.

The improvement was supported by higher secondary income received, which increased by 16.9 percent from US$111.9 million to US$130.8 million, while secondary income paid declined by 17.7 percent from US$58.5 million to US$48.2 million.

**Chart 5.1.4. TL Secondary Income Account**

In million USD




**Source:** BCTL

Worker remittances remained an important contributor to the secondary income balance, increasing by 30.0 percent from US$80.4 million in SEM1 2025 to US$104.5 million in SEM1 2026. The increase in remittance inflows contributed to the strengthening of the secondary income surplus.

## 5.2. Capital and Financial Accounts

### 5.2.1. Capital Account

The capital account remained unchanged at US$0.21 million in the first semester of 2026, reflecting stable capital transfer inflows compared with the corresponding period of 2025.

The capital account remained broadly unchanged in SEM1 2026, recording a balance of US$0.21 million, the same level recorded in SEM1 2025. This indicates that capital transfer inflows remained stable during the period, with no significant change compared with the corresponding period of the previous year.

The capital account continues to be largely associated with capital transfers, including grants from external partners. The stable balance suggests that capital transfer inflows remained limited during the period and did not materially affect Timor-Leste's overall external sector position.

### 5.2.2. Financial Account

The financial account net outflow increased by 87.0 percent to US$702.9 million in SEM1 2026, driven mainly by higher portfolio investment outflows, alongside increases in direct and other investment outflows

The financial account continued to record a substantial negative balance, widening from US$376.8 million in the first half of 2025 to US$702.9 million in the first half of 2026, an increase of 87.0 percent. The deterioration of negative balance largely reflects the structure of Timor-Leste's external financial transactions, particularly changes in the country's external financial assets and liabilities, such as the continued accumulation of foreign liabilities through direct investment and changes in the external assets of the Petroleum Fund.

Accordingly, the negative sign of the financial account and its individual components should be interpreted in the context of the underlying transactions rather than uniformly as conventional capital outflows.

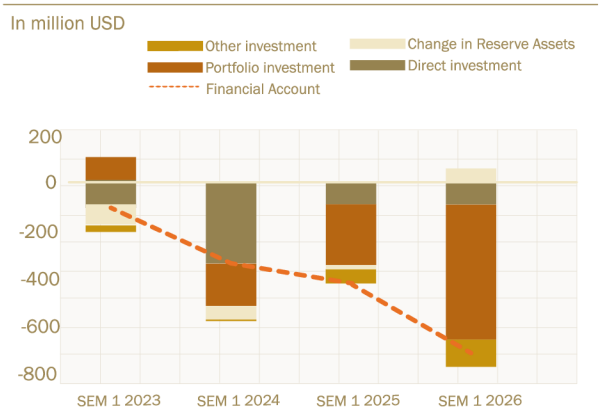
Direct investment remained negative at US$113.5 million in the first half of 2026, compared with US$102.9 million in the same period of 2025, an increase of 10.3 percent. Given that Timor-Leste does not currently record significant outward direct investment, this negative balance primarily reflects the net incurrence of liabilities associated with inward foreign direct investment. The negative balance should therefore not be interpreted as an outflow of domestic capital, but rather as an increase in foreign investors' claims on the domestic economy.

Portfolio investment remained the largest contributor to the negative financial account balance, increasing to US$524.9 million from US$235.6 million in the first half of 2025, representing an increase of 122.8 percent. This component is largely associated with the investment and management of Petroleum Fund assets abroad. The negative balance in this case primarily reflects a reduction in Timor-Leste's external portfolio assets, including transactions undertaken to meet government withdrawals from the Petroleum Fund. As government withdrawals exceed the Fund's receipts from petroleum-related income and investment returns, the Fund may need to draw down its existing foreign portfolio assets to meet these obligations. Accordingly, the negative portfolio investment balance should be interpreted as a drawdown of external financial assets associated with Petroleum Fund withdrawals, rather than simply as a conventional capital outflow.

Other investments also recorded a larger negative balance, increasing from US$23.8 million in the first half of 2025 to US$106.5 million in the first half of 2026. This further contributed to the overall negative financial account balance, although its magnitude remained considerably smaller than that of portfolio investment.

Reserve assets recorded a larger outflow of US$482.1 million in SEM1 2026, more than doubling from US$225.3 million in SEM1 2025

**Chart 5.1.5. TL Financial Account**




**Source:** BCTL

The deterioration in the financial account was accompanied by a substantial decline in official reserve assets. The reported change in reserve assets was –US$482.1 million in the first half of 2026, compared with –US$225.3 million in the corresponding period of 2025, representing a 114 percent increase in the magnitude of the decline. The decline in reserve assets indicates that official foreign exchange

buffers were drawn down substantially during the period, providing an important adjustment mechanism in the face of the country's external financing pressures.

Overall, the external position in the first half of 2026 reflected a combination of a widening current account deficit, increased foreign liabilities associated with inward investment, a substantial reduction in external financial assets, particularly Petroleum Fund portfolio assets, and the reduction in official reserve assets. This highlights the increasing importance of existing external financial buffers in absorbing external imbalances. This development warrants close monitoring, particularly as Bayu-Undan production has ceased and petroleum-related receipts are expected to decline, increasing the importance of the Petroleum Fund's accumulated financial assets and prudent management of the country's external liquidity.





# 06
# Global Spillover to Timor-Leste

This section explores the main channels through which regional and international developments affect the economy of the country. It explains how these channels operate, focusing specifically on their impact on domestic inflation, oil revenues, and the valuation of the Petroleum Fund's investments.

As the economy becomes more integrated with global and regional markets, external developments will play an increasingly significant role in shaping domestic economic performance. Greater interconnection with regional partners will broaden and strengthen the various transmission channels through which international trends influence the national economy.



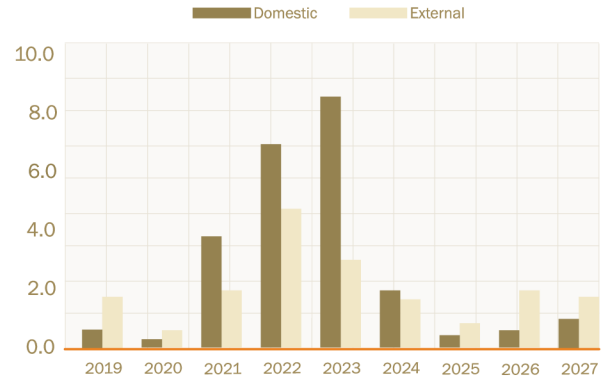
## 6.1. Imported Inflation

A key transmission channel of the economy is the influence of international prices on domestic inflation. Given Timor-Leste's high import dependence, changes in global prices for goods and services strongly shape inflation and overall economic conditions.

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

From 2023 to first quarter-2026, about 63 percent of the country's imports came from the five largest ASEAN economies plus China, while the remaining 37 percent originated elsewhere. This implies that movements of these countries' inflation can influence domestic inflation.

**Chart 6.1a: Internal versus external inflaton**



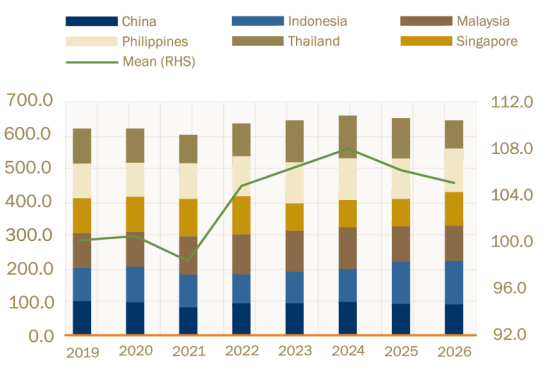

**Source:** IMF-WEO, INETL and BCTL

As can be seen on chart 6.1a that domestic inflation tends to reasonably follow the development of foreign inflation rates, indicating that changes in domestic inflation rates follow the shifts of external inflation. Only in 2023, it went in opposite direction due to domestic policy of tightening import taxes.

The exchange rate is another key driver of inflation in the country, hence, the movement of USD against the trading partners' currencies would affect the prices of imported goods. In the mid-2026, the US dollar weakened by an average of 1.1 percent against the currencies of our main trading partners in ASEAN Five plus China (Chart 6.1b), reflecting appreciations of the Malaysia's ringgit (7.2 percent), Singapore's dollar (2.2 percent), Thailand's baht (1.8 percent) and China's yuan (4.5 percent).

This depreciation raised imported inflation and eroded households' purchasing power while improving exporters' competitiveness.

**Chart 6.1b: Exchange rate of ASEAN 5 and China**




**Source:** Bloomberg

Exchange rate shifts among partners' currencies significantly influence domestic prices, with analysis indicated that a 1 percent appreciation of the US dollar can lower CPI inflation by 0.4 percent–0.9 percent.

Given the importance of this channel, external inflation—closely tied to exchange rate movements—will remain a major factor shaping domestic inflation trends. Hence, it is expected that regional currencies will remain relatively stable against the USD in 2027, and together with the maintenance of moderate inflation rates movement of trading partners, leads us to expect that imported inflation will remain stable over the same time horizon, helping to stabilize inflationary pressures in Timor-Leste. Therefore, it is further expected that the average domestic inflation rate will slightly accelerate this year and next year.

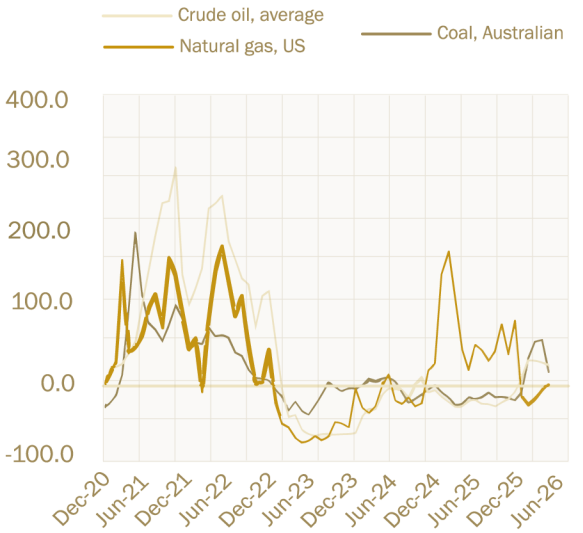
## 6.2. Energy Markets and Oil Revenues

Global energy prices of oil, natural gas, and coal are highly volatile, often fluctuating by more than 100-200 percent within a year (6.2b). The sharp decline in oil prices in some of the years erased all nominal gains made in some of the others.

Most energy commodities' prices recorded rise in the mid of 2026, after the fall during 2022-2025.

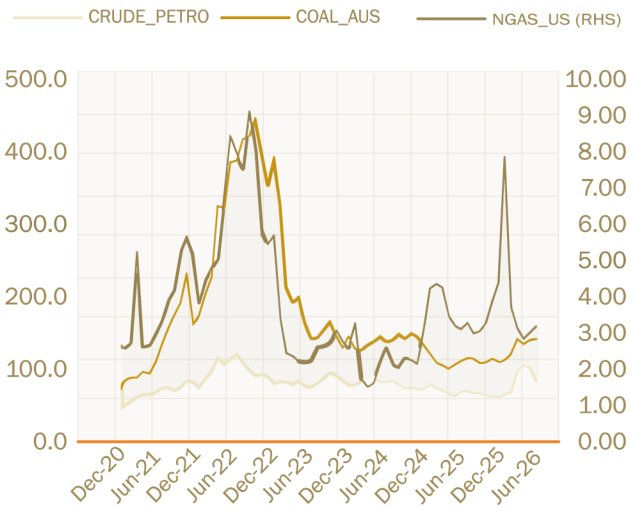
In mid-2026, there was a gain in most of the energy resources, with particular emphasis on crude oil and natural gas. As shown in charts 6.2a that crude oil, coal and natural gas are now at their record highest of the last three years. Although price of South Africa's coal fall (-3.9 percent), the overall price of crude oil, gas and coal increased by a respective of 22.1 percent, 6.6 percent and 8.3 percent in the first semester of 2026 compared to their prices in the same semester in 2025, due to heighten geopolitical tension in the middle east which disrupted global supply of fuel, resulted in sharp increase in wholesale oil and natural gas price in the markets.

**Chart 6.3a: Exchange rate of world major economies**




**Source:** Bloomberg

**Chart 6.2a. Energy prices – spot level**




**Source:** Bloomberg

They were associated with the war of the US and Israel against Iran, which was started at the end of February 2026, disrupting oil transportation in the Strait of Hormuz and Middle East in general which supply around 20 percent of global oil. It added to the conflict between Rusia and Ukraine which initially started in February 2014, and escalating further in February 2022 that affects the supply of oil and gas to European Union countries.

The country's oil revenues are now zero as Bayu-Undan field had ceased to operate completely in June 2025.

However, it is important to note that these current energy commodities prices development have no effect on the country's oil wealth as production from Bayu-Undan field, which was active until the earlier of 2025, ceased entirely in June of the same year, with only small volumes of oil and gas extracted between January and April 2025. Hence, no revenue was made in 2026 while in 2025, an estimated gross revenue of USD 49.4 million was recorded, a decrease of 67.9 percent from USD 159.3 million in 2024. Consequently, government revenue from taxes, royalties, and fees dropped to USD 24.63 million in the first semester of 2025 from USD 85.4 million in 2024. This marks a significant decline compared to 2022, when revenue reached USD 1.1 billion. In the first semester of this year, an amount of USD 18.62 million was received as part of taxes and royalties, a decrease of 24.4 percent from the same semester, last year.

With the cessation of oil production from Bayu-Undan and uncertainty surrounding future investment in Greater Sunrise, the Petroleum Fund's wealth now relies entirely on returns from financial market investments. While there are reports of potential petroleum resources in onshore (such as the one in Covalima) and offshore (like Kuda Tasi and Jahal) areas, they remain untapped and are regarded as prospective assets for the future.

## 6.3. Financial Markets and the Petroleum Fund

Financial asset prices in the global markets influence PF's ESI, in turn, overall funding of the State Budget.

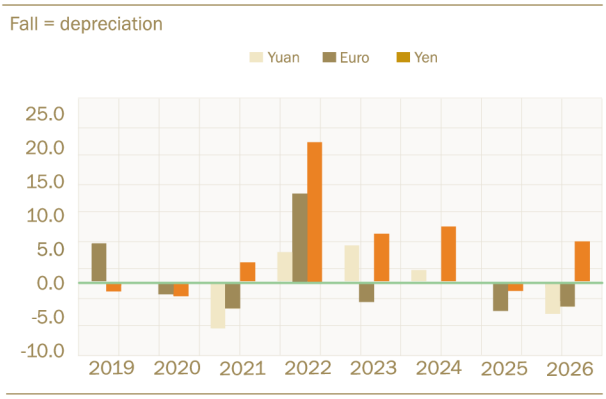
Another important transmission channel is the impact of international financial market developments on the economy, particularly through the management of the Petroleum Fund (PF). Fluctuations in global financial asset prices affect the value of the PF, consequently, its Estimated Sustainable Income (ESI). This, in turn, influences the revenue available to finance the state budget, shaping the scale and direction of public spending and investment policies.

The PF recorded a total net financial assets of USD 18.43 billion in the first semester of 2026, lowered by USD 0.31 billion from USD 18.74 billion in June 2025.

The PF reported in mid-2026 recording a total net financial assets of USD 18.43 billion, which represents a renewed increase of USD 0.12 billion against March 2026's closing balance of USD 18.31. However, it was lower by USD 0.18 billion and USD 0.31 billion against 2025's and June 2025's closing balance of USD 18.61 billion and USD 18.74 billion. The Fund is mainly invested in treasury bonds of developed countries (70.1 percent) as

marked with liquidity and fixed income portfolios and less than a third (29.9 percent) of it invested in shares of developed markets' companies.

**Chart 6.3a: Exchange rate of world major economies**




**Source:** Bloomberg

In the mid of 2026, the Fund recorded an overall gross revenue of USD 621.4 million with a net revenue of USD 609.7 million, prolonging gross revenue and net revenue of USD 962.5 million and USD 950.9 million it recorded in the mid of 2025, cancelled out gross revenue of -USD 97.7 million and net revenue of -USD 103.3 million recorded in the first quarter of 2026. This positive performance was practically due to the rise of global bond interest rates, and the rise in equity prices although 2-year and 10-year bond interest rates in the US fell in the first semester of 2026.

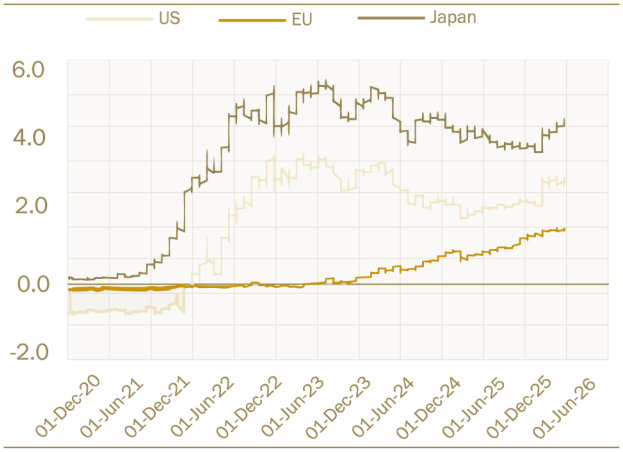
Foreign exchange fluctuations also affect the fund which has invested in markets other than the USD.

Since the fund invests in several markets denominated currencies other than the US dollar, it is exposed to exchange rate risks. By mid-2026, the dollar had depreciated by 3.4 percent and 4.5 percent against the euro and yuan and appreciated by 5.8 percent against the yen (Chart 6.3a). Hence, affect the value of the PF when converting the other investment currencies into the US dollar. Over the period from 2019 to mid-2026, the dollar appreciated on average by 0.3 percent against the euro, 4.8 percent against the yen, and depreciated by 0.02 percent against the yuan.

Like 2025, the fund recorded no gains or losses from currency fluctuations by mid-2026. In 2023, however, it realized gains of USD 31.2 million from investments across various currencies.

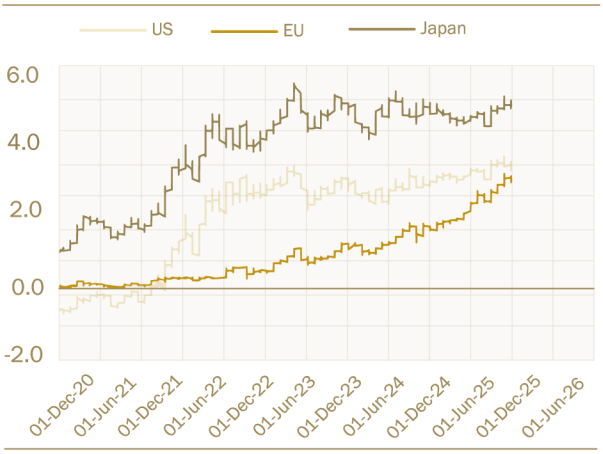
In terms of returns, it saw a positive performance for the funds, with an estimated return of 3.41 percent based on their financial year-to-date value. This follows the gains it made in 2025 and 2024, reversing the loss recorded in 2022. Most of the fund's gains in the mid of 2026 came from net gain on financial assets at fair value, which contributed 56.0 percent of the total returns.

**Chart 6.3b. Two-year bond interest rates**




**Source:** Bloomberg

**Chart 6.3c. 10-Year interest rates**




**Source:** Bloomberg

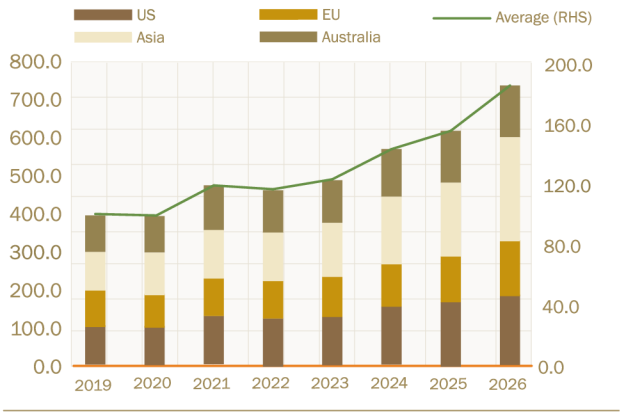
Bond investments recorded a net gain in the first semester of 2026, due to the general rise in two- and 10-year interest rates, prolonging the interest rose in 2025.

Bond interest rates in overall, rose in the mid-2026, and remained positive, particularly in Germany and Japan, where rates have been stayed below zero prior to 2021 (Chart 6.3b; 6.3c), boosted the fund returns. The bond portfolio yielded 4.37 percent in mid-2026, adding to the 11.4 percent return in 2025, offsetting losses of 7.09 percent in 2022 and 2.25 percent in 2021. The Japanese market mirrored the EU trends, with short- and long-term rates rising 0.6 and 1.0 percentage points from 1.3 percent and 2.4 percent with Germany short and long-term rate increasing by 0.4 percentage points from 2.4 percent and 2.9 percent in the mid-2025. In contrast, two-year and 10-year bond rates in the US fell by 0.2 and 0.1 percentage points, resulting in an overall rise of 0.3 and 0.4 percentage points in June 2026.

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

In terms of equity markets, the fund recorded accumulated gains in the mid of 2026. The gains in the equity portfolios were associated with stock price increases in the US market and upward trend in most of the global equity markets (Chart 6.3d). The fund investments in equities recorded a gain of 10.06 percent in the mid of 2026, prolonging the substantial gains of 22.01 percent, 17.79 percent and 23.67 percent recorded in 2025, 2024 and 2023, respectively, reversing the substantial loss recorded in 2022 and 2021.

**Chart 6.3d: Stock prices of selected countries**




**Source:** Bloomberg

The future value and the returns of the Fund depend on the changes in assets prices, exchange rate and unforeseen shocks.

With significant holdings in global bonds and equities, the future values and returns of the Petroleum Fund remain sensitive to changes in asset prices,

movements of the US dollar against investment currencies, and unforeseen shocks such as the ongoing conflict between the US and Israel against Iran, and the elevated US tariffs.

The Fund's long-term investment strategy and institutional framework were designed to manage market fluctuations through disciplined asset allocation. However, the complete cessation of Bayu-Undan production in June 2025 and uncertainties around Greater Sunrise exploration pose significant challenges, as the Fund now relies entirely on returns from global financial markets. Rising public expenditure, which draws down the Fund's capital, adds further pressure. Consequently, the Fund's objectives and strategies need to be reassessed, while unexplored resources in Greater Sunrise, in onshore areas and in other offshore remain important future national assets.



# Timor-Leste 2026
# Mid-Year Economic Review
## Economic Resilience Amid Structural Adjustment

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