

Economic Bulletin



A Quarterly Publication of the Central Bank of Timor-Leste

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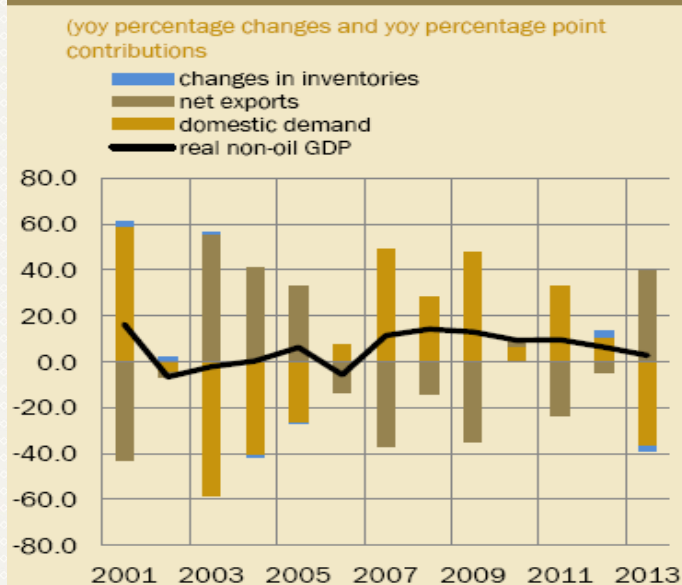
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I. Economic activity

The National Directorate of Statistics has recently published Timor-Leste's National account for 2000–2013, in which demonstrated that the economy is slowing down. Real GDP grew by only 2.8% in 2013, after having been 6.4% in 2012 (see chart 1). The experience occurred in several previous years proves that the increase in GDP growth mostly was driven by domestic demand. In fact for 2013, the slowing down in GDP growth rate was suggested by the downward in the contribution of domestic demand. While, net export has made huge positive contribution to growth in some years, includes 2013, however it was due to the negative contribution in both export and import.

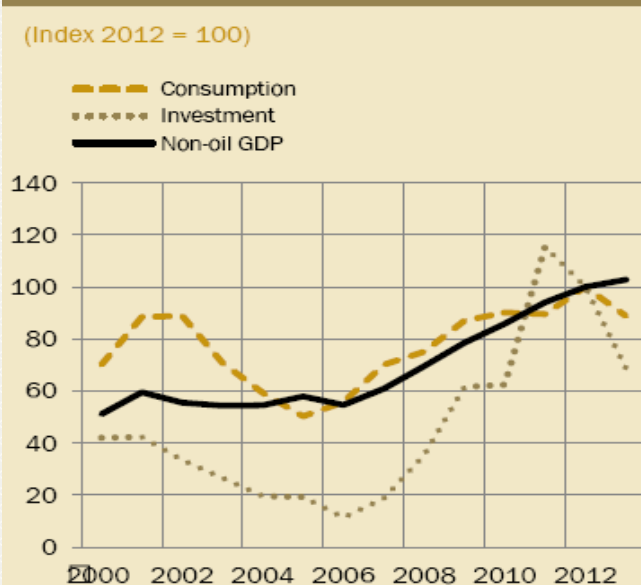
This development can also be validated by the tendency of both consumption and investment, they drive the movements of total GDP (see chart 2). After 2006, these two components of domestic demand continue with the increase trend in supporting the economy growth while has gone down after 2011, mostly in 2013. The public sector share on the GDP growth still representing a determinant factor, while seems declining in recent year. The weighted of government consumption and investment has declined to 46% and 77% respectively in 2013 from 54% and 85% in 2012. Furthermore, private sector share on investment by contrast increased to 18% from 10% in 2012, as far as the consumption rose from 41% to 50% in 2013.

Chart 1 Timor-Leste real GDP and its components' contribution to growth



Source: General Directorate of Statistics and BCTL analysis

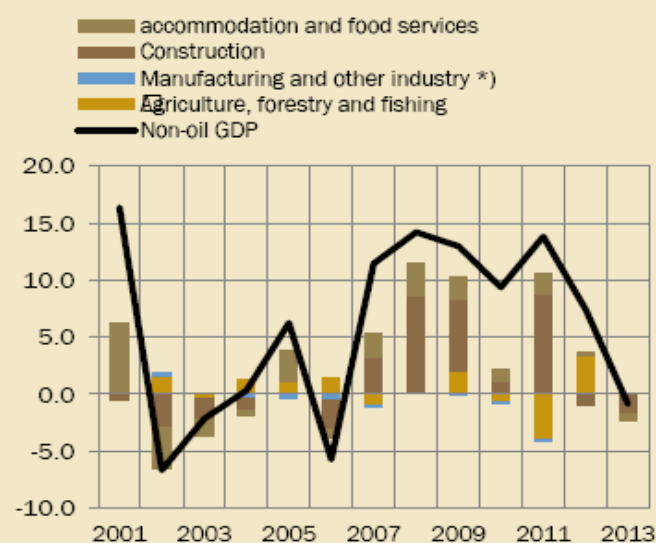
Chart 2 Timor-Leste real GDP, investment and consumption



Source: General Directorate of Statistics and BCTL analysis

Chart 3 Timor-Leste real GDP and its components' contribution to growth

(yoy percentage changes and yoy percentage point contributions)

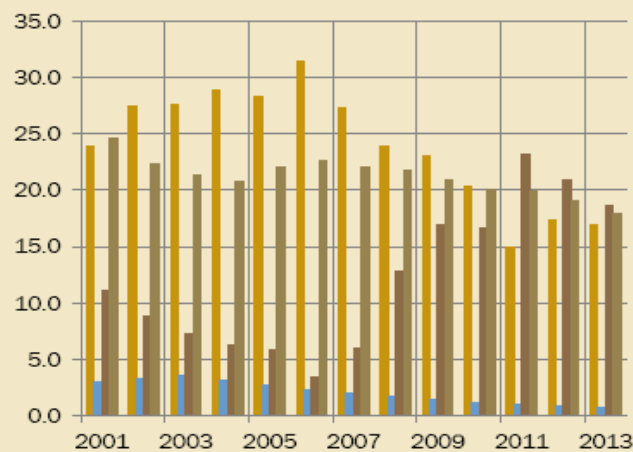


Source: General Directorate of Statistics and BCTL analysis

Chart 4 Timor-Leste real GDP and its share on growth

Legend:

- Agriculture, forestry and fishing
- Manufacturing and other industry *)
- Construction
- accommodation and food services



Source: General Directorate of Statistics and BCTL analysis

This phenomenon is expected to be continue for the future. The strong private sector contribution to the development of economy in any country is important, beside can be viewed in terms of pushing the demand, it also is expected, and more important, to produce the production of goods and services of the country.

However, we can see also the interesting tendency of several components important in the non-oil GDP by production approach, manufacturing for instance. This field has very small portion and small contribution to the economy growth of the country since 2000, hence the tendency is declining, which does contrary with our expectation to drive and/ or to produce domestically.

II. Recent Monetary and Credit Development

II. a. Money Supply

In an environment of high interest rate, people tend or is encouraged to save more than borrow. In turn, high interest rate will reduce people's disposable income because they will spend more on interest payment, then less consumption. Timor-Leste's banking system has very low interest rate on deposits with high lending rate. This situation has affected money and loans' growth. Moreover, the reduction in the growth rate of government budget and its execution, affecting slow-down in private sector and household saving.

The same tendency could be seen in agriculture, while has significant share in the GDP but also declined. Performed an unfortunately negative contribution in 2011 however has recovered in 2012, but then dropped again in 2013. Represent an unsustainable behavior. This situation could be reasonable as it was backed by other field, construction in this regard.

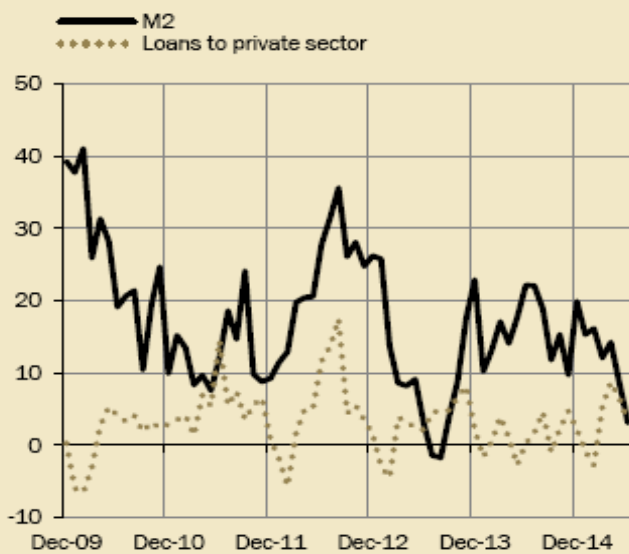
Hotel services has a good behavior. It seems sustained. A well performance in maintaining services for tourists in the country. The tourism services should be continue driving to attract more tourist, then the development of production of services and income for the country.

The decline in M2 growth has strengthened. The annual growth rate of M2 in June has decreased to 3.1%, down from 12.1% in the first quarter of 2015 and was 22.2% in June 2014. The tendency of the monetary data seems constant when it is viewed from 2010, however is declining when it is pulled from 2009. The decline, in some extend, was followed by both positive credit development from the banking system to private sector, while still low, and the increase in its net foreign assets (NFA), albeit slowing.

The development in cash withdrawal by depositors in June was increasing, a reflection of support the slow-down in the growth rate of M2. In fact the deposits of

Chart 5 Broad money growth

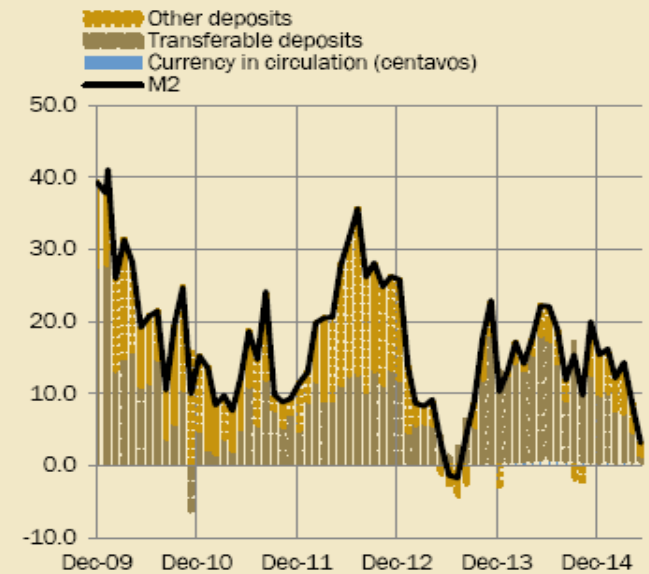
Year on year percentage changes



Source: BCTL

Chart 6 M2 and its components

Annual percentage changes; percentage point contributions



Source: BCTL

both corporations and individuals were declining. The annual growth of Deposits of corporations declined by 1.2% in the quarter compare to an increased of 22.1 in the previous quarter. Further, the individuals' deposits declined by 4.5% compared with a 7.5% increase arose in the last quarter.

The quarterly growth rate of broad money declined by 6.4% followed a 19.1% drop observe in the last first quarter of 2015.

The reduction mostly was driven by most of the sector of deposits in the banking system that include in broad money. Demand deposits, as transferable deposits, declined by 7.1% followed by a decrease of 21.6% in last first quarter of 2015, which contributed 3.8% to the decline of M2 in June quarter. Time and savings deposits or called other deposits in monetary statistics, in conjunction, declined by 6% from 16.7% in the last first quarter 2015. Together they contributed by 2.6% to the decline of the M2 in the quarter.

The currency in circulation (centavos) continues grow, rising by 4.8%, followed by a 3.6% increase in the last first quarter of 2015, a reverse contribution of 0.1% to brake and slow down the decline of M2 in the quarter.

Credit to private sector just grew by 8.5%, year on year, after having a 5.4% growth in the last first quarter of 2015. In fact, the development of credit growth continues low as the banking system continue take in

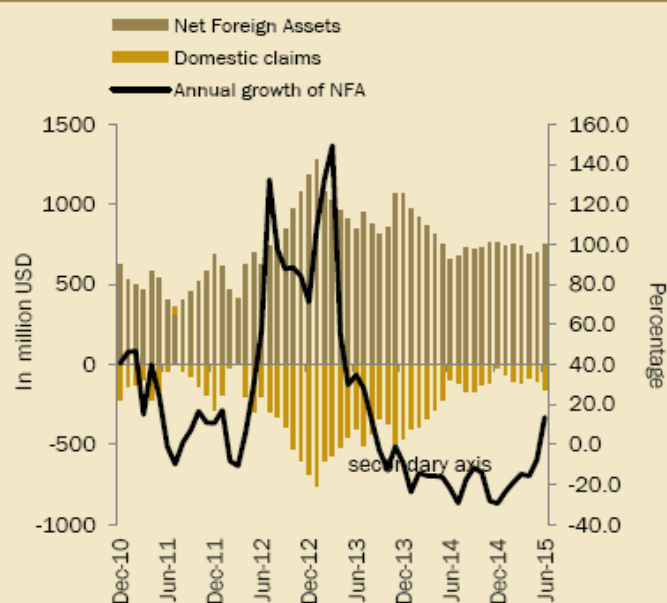
to consideration the high risk of loan. It can be seen the relation with the analysis on bank lending survey. The bank lending survey of June 2015 showed that banks continued to not changes their credit standard or continue tighten the credit standard to enterprises, while easy somewhat to household. Factors that contributed to tighten the banks' credit standard was related to the cost of fund and balance sheet constraint, risk on collateral demanded, and the issue of non-performance loans. This condition has pushed banks to continue tighten their credit terms and condition for approving loans.

II. b. Net Foreign Assets

The annual growth rate of net foreign assets (NFA) were increased, rose by 13.6%, reversing a decline of 14.7% in the last first quarter of 2015. In fact this progress mostly was due to the increase in the commercial banks' NFAs, rose by 26.8%, following a 40.9% increase observed in the last first quarter of 2015. While, the central bank's NFA was decreased, has reduced by 4%, followed a reduction of 55.3% observed in the last quarter.

The main driver of the changes in the commercial banks' NFAs was the increased in its claims on non-residents, mostly from the deposit, rising by 31.4%, followed by a 37.1% upsurge record in the last first

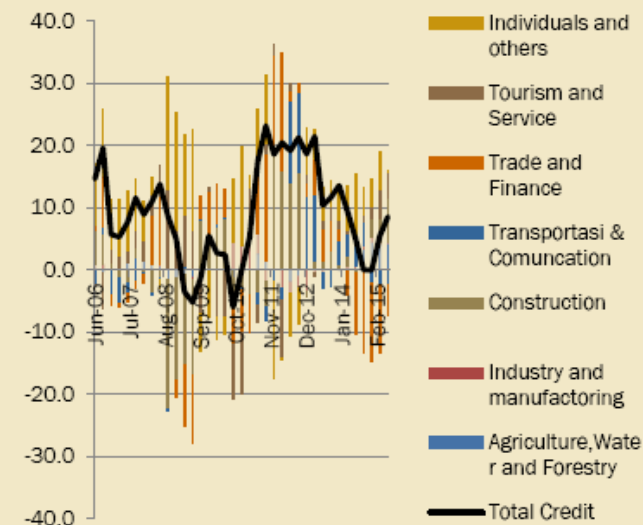
Chart 7 Net Foreign and Net Domestic Assets



Source: BCTL

Chart 8 Loans to private sector

Annual percentage change; percentage point contributions



Source: Commercial banks and BCTL analysis

quarter of 2015. Its liabilities declined by 13.3% after having lifted by 1.7% in the first quarter 2015.

While the decline in the central bank's NFAs was due to the reduction in its security investment abroad, reversing the increase of foreign currency and other deposits by 67% and 107% respectively. The BCTL's liability on non-resident also was decreased, mostly due to exchange rate changes in the SDR allocation with the IMF, has reduced by 8.7% after a reduction of 10.4% in the first quarter 2015.

II. c. Net Domestic Assets

Domestic assets mostly composed by claims on central government (net) and claims on private sector. Net claims on central government contain credit and liabilities to central government from the financial system. Actually, there is no credit from the financial system to the government of Timor-Leste, therefore the net claims on the central government, in the monetary statistics' point of view, is negative, which means that all corresponding amount is government deposits or the depository corporations liabilities to the central government. Simultaneously, claims on the private sector consist of credit to domestic private sector and others claims.

The annual growth of Domestic Claims has increased in the second quarter of 2015, risen by 63.5%, reversing

a 65.3% decline observing in the last March quarter. This development of domestic claims mostly has contributed by the increase in the liabilities of depository institutions, especially the central bank, to the central government, record about 83.6%.

The credit from commercial banks to private sectors contributed negatively by 20.2%, while it is observed an increase in the growth rate. The annual growth of credit was of 8.5%, followed by a 5.4% growth in the last first quarter of 2015. Part of subdued increase is accounted by sharp rise in provision for non-performing loans by banks, which is deducted from gross lending to arrive at the reported net figure of borrowing.

An expectation to support the development of agriculture sector in the country is the involvement of banking system, and this can be seen through the lending. Credit to agriculture sector has significant growth in June quarter of 2015, rose by 577.5%, which contributed about 4.2% to the total credit growth. This important progress is expected be continue for the future. The second area that required attention is industry and manufacturing, which is expected to support the production of goods in the country. The lending to this area represents only 1.8% of total credit, contributed about 0.2% of the growth, rising by 10.5%, followed a 34% increase in the last first quarter of 2015.

The liquid fund is not a matter for the banking system in Timor-Leste. The banks hold liquid asset more than the requirement of the Central Bank. The risk of loans is the case and that oblige the banks to save the fund abroad, increasing the foreign assets.

II. d. Interest Rate

Despite some development in credit supply from banks in Timor-Leste arose, credit standards remain tight. In this respect, the tightening in credit package have contributed to continue increasing the borrowing cost, the bank lending rate continue high. The interest margins have remained relatively high in Timor-Leste. The weighted average interest rate of loan stood at 13.4% by June 2015, while the deposit rate about 0.9%, resulting the margin of 12.5%. The absence of reference rate applied by the Central Bank, the banks set their own rate taking in to consideration some determinant factor for the calculation, including the risk.

II. e. Price and inflation

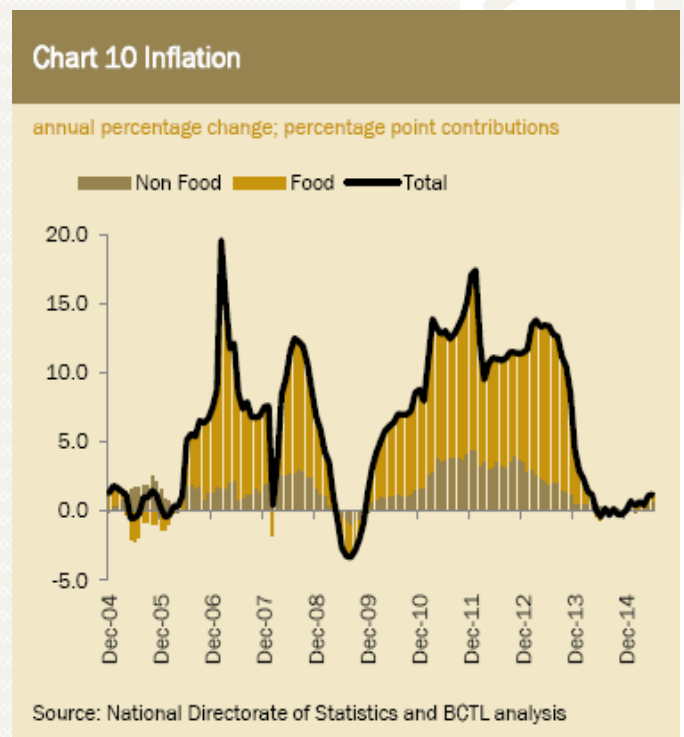
Inflation is the rate at which the general level of prices for goods and services is rising over a considerable period of time, and, subsequently, purchasing power is falling. "Inflation is always and everywhere a monetary phenomenon" (Milton Friedman, look at Frederik F. Miskin, 2010: 619). Means that, the source of all episodes of inflation is the high growth rate of the money

supply. Inflation can be caused by various factors, both in terms of very strong public demand for a variety of items so-called demand inflation, as well as due to the increase in production costs or cost inflation.

As inflation rises, every dollar will buy a smaller percentage of a good. For example, if the inflation rate is 2%, then a \$1 kg of sugar will cost \$1.02 in a year. Means that people is losing 2% of its purchasing power, considering everything held constant.

When look at the inflation experience in Timor-Leste, for an illustration let's put 2006 to 2015, the inflation rate is about 78.2% (CPI Dec 2006 – June 2015). If a kg of meat cost \$5 in 2006, today will cost \$8.9, an increase of 78.2% in price of meat. This mean that population in Timor-Leste is losing 78.2% of its purchasing power. If 50% of that population hold a constant income, then they become poor with the increase in that rate of inflation, as they will consume less goods today compare to 2006.

Considering that this high inflation experience was caused by the strong demand. Starting from the strong public sector demand and then spreads to the demand of households and private sector. It can be seen, for instance, from the contribution of domestic demand in supporting the GDP growth, albeit investment has been dominant by public sector, but appear signs from household's consumption which has now 50% share on total consumption in 2013.



High rate of inflation in some extent is expected by producers, as it can be augmented their income by selling in a high price of goods. However continues increase in price will affect also the behaviour of consumer then the reduction in their demand for goods, which does not expected by producer. Therefore a stable inflation is required for both producer and consumer then the development of the economy.

It is very pleasure as recent year inflation has slowing down. Since 2014 the inflation stood below the target band set by the government in its strategic development plan, of 4–6%. The annual inflation rate for June 2015 was about 1.5%, up from 0.5% in first quarter 2015, which was -0.7% at June 2014.

The most contributor to the change of inflation rate in Timor-Leste has been the component of food. In average food contribute about 8.4% in the increase of inflation during 2007, while non-food about 1.6%. In 2009 inflation was slowing down even negative in some month, and food contributed at 0.5% to this reduction. Still the same case for the other years in which food has significant influence to the change in the CPI inflation experience.

III. Commercial Banks

The total number of banks as of June 2015, still stood at 4, which comprises by 3 branches of foreign banks

and 1 local bank (the BNCTL). Hence these banks has expanding their Subsidiary (foreign banks) and branches (BNCTL). The total subsidiary at the end of June 2015 are 18 while branches of BNCTL are 15, with the total of 33, an increase of 6.5% compared to 2014, still there is no changes from first quarter 2015.

The asset base of the banking system and its key elements continue posted strong growth; particularly the deposit base, while lending to private sector consistently stood with slight growth in a long period of time, increased over the second quarters of 2015 compare with correspondent quarter of 2014.

Total assets of all banks showed a net expansion of USD 90.8 million during a year from June 2014 and stood at USD 765.2 million. Hence the asset base of the banking system increased by 13.5% over the year to June 2015, while declined by 3% over the last March quarter of 2015. The annual trend of total deposits of the banking system continue increases, reached 22% growth at June quarter of 2015 to be arrived at USD 570.3 million, after record a 26.8% growth in last March 2015. Total lending in the quarter to June 2015 was of USD 188.8 million, record an increase of 8.5% from June 2014.

The annual income as percentage of assets (RoA, or Return on Assets) was 0.8% in June 2015, up from 0.7% as in June 2014 and 0.5% in last March. This

Table 1
Commercial Bank Outstanding Credit to Private Sector
(in thousand USD)

Sector	2014		2015		Change from June 2014	% point to contribution	June Share (%)
	June	March	June	March			
Agriculture, Water and Forestry	1,253	8,389	8,489		577.5	4.2	4.5
Industry and manufacturing	3,001	3,033	3,315		10.5	0.2	1.8
Construction	35,583	43,481	48,053		35.0	7.2	25.5
Transport & Comunication	19,737	16,431	15,370		-22.1	-2.5	8.1
Trade and Finance	21,424	15,199	12,783		-40.3	-5.0	6.8
Tourism and Service	8,007	14,848	15,005		87.4	4.0	7.9
Individuals	84,951	85,247	85,773		1.0	0.5	45.4
Total	173,956	186,628	188,788		8.5	8.5	100.0

Source: Commercial banks and BCTL analysis

Table 2.
Highlights of the Banking System
(in million USD)

	2010	2011	2012	2013	Dec-14	Jun-15
Total Assets	340.5	403.3	555.2	665.3	805.1	765.2
Liquid Assets	280.3	325.5	451.4	534.8	667.0	612.6
Investments	0.0	0.0	0.0	0.0	4.0	4.0
Total Loans	110.9	131.4	155.8	176.9	176.7	188.8
Non-performing loans	46.3	47.7	48.0	49.5	47.4	46.5
Provision for Loan Losses	59.5	63.5	62.4	58.4	55.8	54.3
Deposits	302.9	322.1	414.6	507.1	583.3	570.3
Capital	-6.1	-1.0	10.4	20.1	39.1	41.9
Income	33.3	98.5	40.4	35.8	33.8	24.5
Expenses	29.7	251.0	31.9	22.5	24.7	18.5
Net income	3.5	-152.5	8.5	13.3	9.1	6.0
ROA	1.0	-37.8	1.5	2.0	1.1	0.8

Source: Commercial Banks balance sheets and BCTL analysis

increase in ROA for June 2015 compared to the same month last year, was essentially due to the increase in income while followed by some increase in assets. In turn, the increase in RoA for in June compare to March 2015 was due to the increase in income (about 70.2%) reversing the decrease in assets.

In the other side, the banks continue to have liquidity ratios above the minimum required by the BCTL, with an excess of liquidity ratios of 69.7% in the quarter of June 2015. The requirement actual held about USD 612.4 million compared to liquid assets requirement of USD 108.5 million. All of the banks have high liquidity fund. It is recognized as the percentages allocation to the credit is too small. Then, no interbank transaction occur between banks, especially for lending's necessity. Loans to deposit ratio at June 2015, just situated at 33%, with the average for 5 years of 36%.

IV. Fiscal development

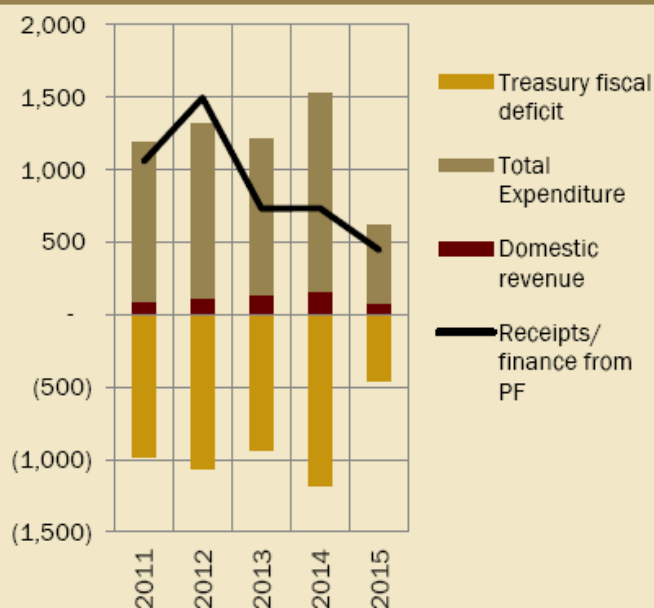
In most of the countries, it is expected to have a fiscal consolidation, beside to reduce the fiscal deficit it also could reduce fiscal debt accumulation. The effort is needed to set the high public deficit and debt ratio as a prudent fiscal policy. It could be given as a per cent of nominal GDP. This deficit can be reduced by economic growth leading to more revenues and less expenditure.

By looking to the experience of Timor-Leste's government budget, it is noted that government has decided to reduce its budget expenditure. There was some fiscal consolidation emerged. The government budget expenditure started to decline since 2012, which registered a growth of 38.3%, after having an increase of 55.9% in 2011, and continues to decline in 2013 and 2014, while has a slight increase in 2015 by 4.7%. It is noted also that the fiscal deficit continue high but declining in percentage of nominal GDP. In 2011 the deficit reached 86.6% of nominal GDP (non-oil GDP), declined further in 2012 and 2013 of 81.8% and 70.5% respectively. Fortunately that the deficit does not finance by public debt. Thanks to the availability of oil resources.

By contrast the government has continued rising its domestic revenue, in nominal terms, while it slow down in the growth rate in some years. The actual domestic revenue grew in 2012 by 23.6%, reduced to 7.5% in 2013 and recovered to 13.6% in 2014. It was projected to grow by 2.6% in 2015 to USD170.4 million. The actual domestic revenue received for 2015, up to the end of June, reached 48.5% or about USD82.7 million.

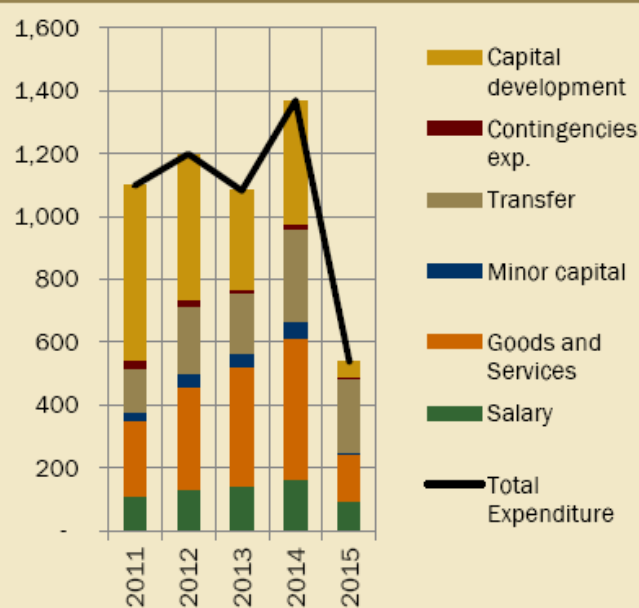
It is expected that the government of Timor-Leste will continue in the future with the fiscal consolidation and its prudent fiscal policy.

Chart 11 Fiscal deficit; Government budget execution



Source: Government transparency portal, BCTL analysis

Chart 12 Components; Government budget execution



Source: Government transparency portal, BCTL analysis

Table 3 GDP by Production approach

(In millions of US Dollars)

At Constant Prices

	2009	2010	2011	2012	2013
Agriculture, forestry and fishing	196	191	153	189	190
Mining and quarrying	3357	3135	3561	3736	3,037
Manufacturing and other industry	12	11	10	9	9
Construction	145	155	237	228	209
Wholesale and retail trade,.....	179	187	204	208	201
Information and communication	32	45	60	72	73
Financial and insurance activities	4	3	7	7	8
Real estate activities	77	84	87	99	94
Professional, scientific,	7	25	28	31	30
Public admin., defence,	155	175	197	222	246
Other service activities	73	66	64	63	60
GDP	4209	4068	4582	4823	4154
Oil sector	3355	3134	3559	3735	3036
Non-oil sector	854	934	1023	1088	1118
GDP Growth	-7.8	-3.3	12.6	5.3	-13.9
Oil sector	-12.0	-6.6	13.6	4.9	-18.7
Non-oil sector	13.0	9.4	9.5	6.4	2.8

Source: Timor-Leste National Account 2000 - 2013 □
General Directorate of Statistics (GDS)

Table 4 Government budget execution

In million USD

	2011	2012	2013	2014	2015*
Budget Execution					
Revenue					
1 Domestic revenue	95	118	133	160	83
2 Tax revenue	79	99	105	142	57
3 Non tax revenue	16	20	28	18	25
4 Grant contributions	0	0	0	0	
5 Revenue retention agencies	17	19	19	24	3
6 Receipts from PF	1055	1495	730	732	445
7 Total receipts (1+4+5+6)	1167	1633	882	916	531
Expenditure					
8 Recurrent Expenditure	542	736	770	974	488
9 Salary	112	130	142	162	97
10 Goods and Services	239	329	381	449	148
11 Minor capital	26	40	40	54	6
12 Transfer	141	215	196	292	234
13 Contingencies exp.	24	22	10	17	3
14 Capital development	555	462	312	394	51
15 Total Expenditure	1097	1198	1082	1368	539
16 Treasury revenue surplus/ deficit	-430	-598	-618	-790	-402
17 Treasury fiscal deficit	-985	-1060	-930	-1184	-453

Source: MoF, Government transparency portal

Note: *2015 = June

Table 5 Timor-Leste Monetary Survey

Millions of US Dollars

	Jun-14	Mar-15	Jun-15	% point cont. 1 Y ago	% change 1 Y ago
NET FOREIGN ASSETS	660.71	741.06	750.64	13.61	13.61
CLAIMS ON NONRESIDENTS	763.26	820.85	840.07	11.63	10.06
LIABILITIES TO NONRESIDENTS	-102.54	-79.80	-89.42	1.99	-12.80
DOMESTIC CLAIMS	-96.15	-116.27	-157.19	63.48	63.48
NET CLAIMS ON CENTRAL GOVERNMENT	-285.55	-318.45	-365.98	83.65	28.17
CLAIMS ON CENTRAL GOVERNMENT	0.00	0.00	0.00	0.00	8.29
LIABILITIES TO CENTRAL GOVERNMENT	-285.55	-318.45	-365.98	28.17	28.17
CLAIMS ON OTHER SECTORS	189.40	202.18	208.79	-20.17	10.24
CLAIMS ON PRIVATE SECTOR	189.40	202.18	208.79	10.24	10.24
BROAD MONEY LIABILITIES	440.56	485.09	454.25	3.11	3.11
CURRENCY OUTSIDE DEPOSITORY CORPORATIONS	8.34	10.13	10.63	0.52	27.42
TRANSFERABLE DEPOSITS	238.58	261.05	242.50	0.89	1.64
OTHER DEPOSITS	193.64	213.91	201.13	1.70	3.87
SECURITIES OTHER THAN SHARES					
DEPOSITS EXCLUDED FROM BROAD MONEY	0.21	0.38	0.53	40.37	155.77
LOANS	0.08	0.19	0.13	-33.33	66.67
SHARES AND OTHER EQUITY	61.00	90.16	89.59	-0.63	46.87
OTHER ITEMS (NET)	62.72	48.97	48.96	-0.03	-21.94

Source: BCTL

Memorandum item: Petroleum Fund Assets 16,634 16,823 16,863

**PRO FORMA BALANCE SHEET**

As at 30 June 2015

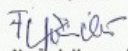
DESCRIPTION	\$ 000
ASSETS	
Cash and cash equivalents	329,353
Marketable Securities	-
Investments	25,147
Property, plant and equipment	2,684
Other assets	7,609
TOTAL ASSETS	364,793
LIABILITIES	
Government deposits	234,278
Other deposits	72,671
Other liabilities	4,566
Currency issued	10,840
Total liabilities	322,355
EQUITY	
Capital	40,000
Reserves	32
Retained earnings	2,406
TOTAL EQUITY	42,438
TOTAL LIABILITIES & EQUITY	364,793


Note:

1. At 30 June 2015 the balance of Petroleum Fund account managed by the BCTL was \$16,863 million. This is to recognise the reporting requirement under IFRS.

2. The Summary statements above are presented in accordance with article 56.6 of BCTL Law 2011/5 and have been prepared on an accrual basis from the financial records of BCTL, as at 30 June 2015. These Financial Statements are unaudited.

Dili, 20 July 2015


Abraão de Vasconcelos
Governor


Fernando da Silva Carvalho
Chief Accountant