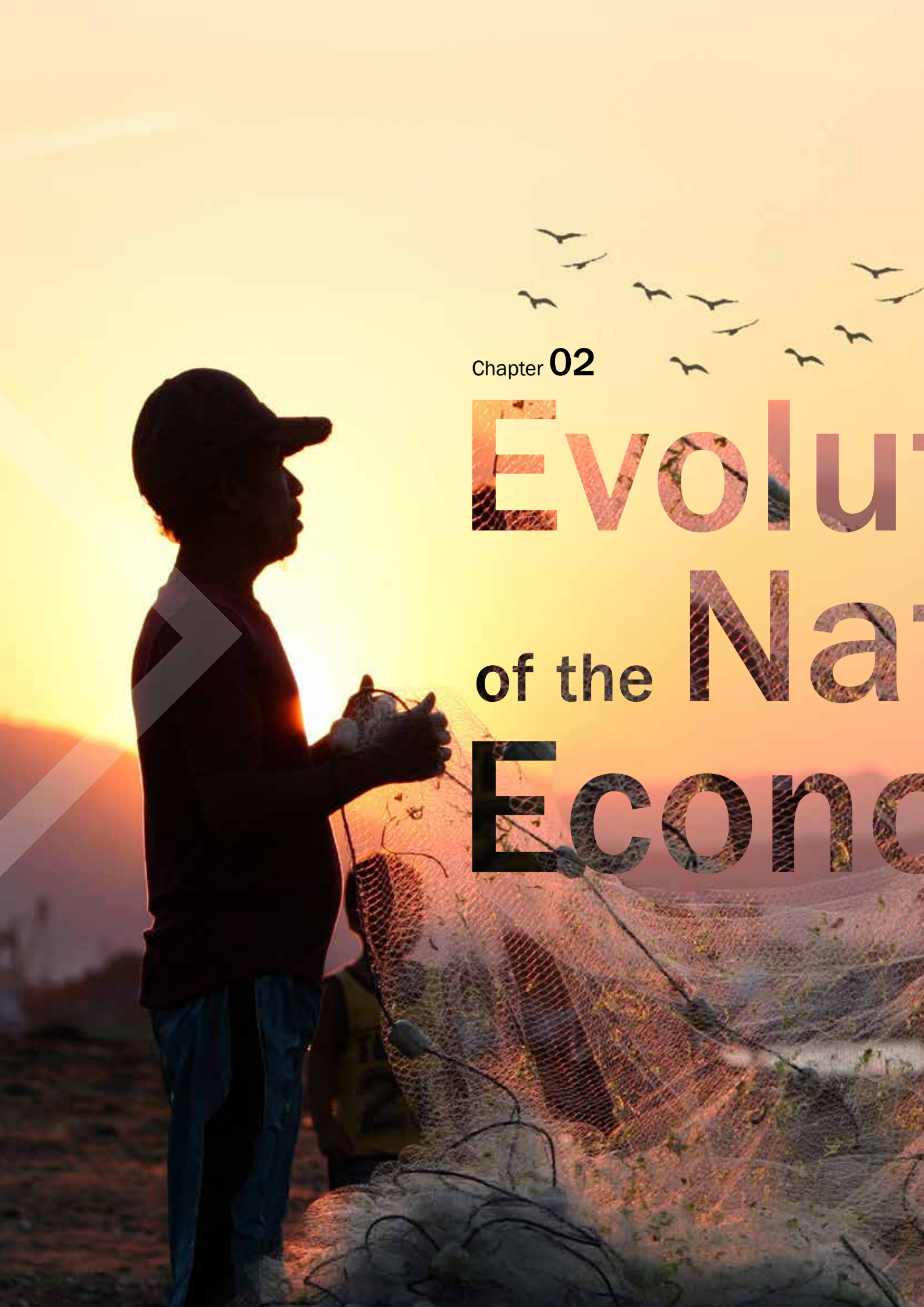


Chapter **02**

Evolution of the National Economy





tion tional omy in 2023

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This chapter details the recent evolution of Timor-Leste's economy and the respective projections for 2023 and 2024, also highlighting the main developments relating to the public, financial and external sectors of our country.

As described below in greater detail, the main developments relating to the national economy consist of:

- > Timor-Leste's economy is expected to slow down in 2023 with the non-oil GDP growth rate of 2.3%, following a period of accelerated economic expansion seen in 2022, after the recession induced by the COVID-19 pandemic. The slowdown in growth compared to that seen in 2022 is mainly due to the effect of the difficulty in executing public expenditure in an election year. It is also worth noting a slight slowdown in household consumption and a reduction in exports in 2023, of 8.7% and -0.3% compared to 2022. However, our forecasts also consider the negative impacts arising from increased inflationary pressures which reduced consumer purchasing power in 2023.
- > For 2024, the BCTL predicts economic recovery, envisaging an acceleration in economic growth to 4.2%. This expectation is based, above all, on the increase in the contribution of domestic demand in 2024 compared to that observed in 2023, and, a slight increase in the contribution of net external demand. A growth of 0.5% in public consumption and 5.2% in household consumption are also expected for the current year compared to 2023. Unlike 2023, we expect public and private investment to increase slightly (2.1% and 0.6 %) in 2024 compared to 2023 (14% and 0.8%).
- > In terms of budgetary policy, 2023 was marked by a significant reduction in expenditure execution of -14% (-\$248 million), mainly due to the reduction in recurrent expenditure (-18%), in line with the decrease in the respective budget after the rectifying budget. It is also worth highlighting the growth in public investment in 2023 (14%), due to a higher budget execution rate, while at the same time, there was a reduction in the budget itself (43.7%) after the amending budget.
- > After the slowdown in global inflation for 2023 steadily in relation to 2022, Timor-Leste recorded a notable increase in domestic inflationary pressures, with the average inflation rate standing at 8.4%, following the high average rate of inflation already occurring in 2022 of 7%. The reduction in external inflationary pressures, in a context of tightening monetary policy to combat the high inflation that has been observed since 2022, and the slowdown in inflation in Timor-Leste's main trading partners, has not yet been reflected in Timor-Leste's internal price dynamics. In part, this gap reflects the previous government's policy of increasing import taxes and the worsening of the price of imported rice at the end of 2023 due to the shortage of rice in India, one of the main countries that supply rice to Timor-Leste. In terms of future prospects, a lower average inflation rate is expected for 2024 at 4.5%, driven by a reduction in global raw material prices, the continued slowdown of inflation in the country's trading partners, and the tax reduction policy introduced by the current government.

- Timor-Leste continued to record an external current account deficit, which registered a significant increase in 2023, recording a negative value of \$601 million this year, mainly explained by the deterioration of the goods balance, mainly, a reduction in the export of petroleum products. The reduction in the services account deficit, together with a substantial increase in primary income, helped alleviate the effects of the country's high current account deficit in 2023.
- Despite the challenging macroeconomic context, the financial sector continued to remain robust and record high dynamism in terms of growth in its activity, assets and resources raised. It is illustrative to note that bank credit continued to grow in 2023, as did deposits and resources raised by banks operating in the country.





2.1

Economic Activity and Inflation

2.1.1. Economy - Recent Developments and Global Perspectives

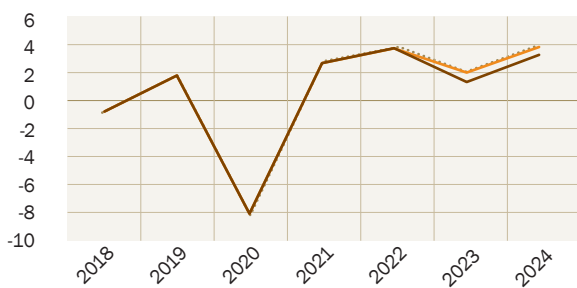
In 2023, according to the projection of BCTL, the domestic economy recorded a slowdown of 2.3% compared to 4% in 2022 and 2.9% in 2021.

The slowdown of economic growth in 2023 was primarily attributed to the reduction in the public sector consumption, whose share totaled around 59.3%. In proportional terms, the public consumption contracted by 6.2% compared to the previous year. Additionally, investment continued to show a positive growth rate, with public investment increasing by 14% compared to 2022. In turn, exports of goods and services registered a negative annual change of -9.6%. Private demand, despite depending on the dynamic of public demand, grew by 4.1% in 2023, which equivalent to a contribution of 6.3 p.p. to GDP growth compared to 10.3 p.p. in 2022.

In 2023, it foresees a slowdown in the GDP growth rate to 2.3% compared to the 4% recorded in 2022.



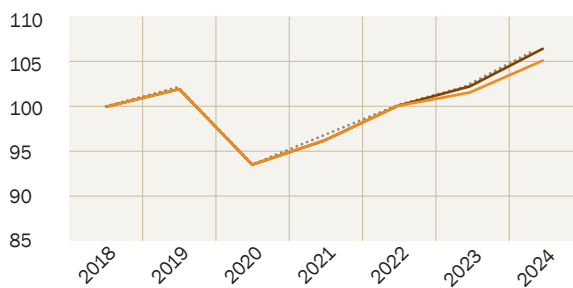
Chart 2.1a
Real GDP growth



% annual change
 ... BCTL
 — MoF
 — IMF

Source: BCTL, proposed OGE 2024, and IMF

Chart 2.1b
Real GDP



2018 = 100
 ... BCTL
 — MoF
 — IMF

Source: BCTL, proposed OGE 2024, and IMF

In 2023, net exports as a percentage of GDP remain in deficit, as in 2022

As mentioned, the slowdown in growth in 2023 was mainly due to the reduction in public sector consumption, as well as the slowdown in its investment, which registered a positive net contribution of 1.9 p.p. to the 2023 growth rate. However, the reduction in domestic demand had positive implications on net external demand. In the case of 2023, and despite the rate of economic growth observed, we can see that total imports have increased, albeit slightly. Imports increased not only in absolute value, but also as a percentage of GDP which continued raising to 61.2% in 2023 from 56.2% in 2022, which remains high. In terms of net exports, an external deficit corresponding to 59.2% of GDP was recorded in 2023, a reduction compared to the value achieved in 2022, when there was a negative export balance equivalent to 54.1% of GDP.

By disaggregating the different components of real GDP, we can see that, with regard to the public sector in 2023, its contribution to the observed growth rate was essentially due to a decrease of 38% in public administration goods and services compared to 2022. A slowdown in public investment of 14% and a drop of 35.2% in public transfers. On the other hand, the wage and salary recorded an annual increase of 74.7% in 2023. The low public execution rate in 2023 that contributed to the growth slowdown.

Regarding private demand, the BCTL estimates that household consumption had a positive impact on the evolution of GDP in 2023, given that the consumption of these economic agents registered a slight increase of 8.7% compared to 2022. The increase in consumption of families was mainly due to government transfers and remittances from families emigrating abroad, which are the main factors stimulating family consumption in Timor-Leste. Remittances recorded an increase of 6.9% in 2023, a slower growth compared to the 31.2% growth observed in 2022. At the same time, there was a slight annual increase in private investment of 0.8%, following the slowdown in growth of public investment of 14.5% in 2023 compared to 36.6% in 2022.

In 2024, a growth rate of 4.2% is projected, which is higher compared to 2023.

Regarding projections for the year 2024, the BCTL predicts a positive evolution of GDP, envisaging an acceleration in economic growth for the current year. According to estimates made, it is projected that in 2024 the economy of Timor-Leste could register a positive growth rate of 4.2% compared to 2023. This projection is based, above all, on the 4.4% contribution from domestic demand, which represents an increase in this contribution of 8.6% recorded in 2023, and a reduction of -0.2% in the contribution of net external demand in 2024. In fact, a worsening of the negative balance of net exports is projected, essentially explained by an increase in imports of goods and services despite a slight increase in exports of goods and services. Thus reducing the contribution of net external demand to economic growth in 2024, despite the increase, already discussed, in the contribution that domestic demand will have in 2024.

For 2024, a slight growth in the private sector of the economy is expected.

Regarding the consumption dynamics of Timorese families, an annual increase of 5.2% is expected in 2024, which represents a slowdown compared to 2023, the year in which a growth of 9.1% in private consumption is expected. With regard to investment, it is expected that both public and private investment will register a positive variation, in the same direction as observed in 2023. In particular, an annual growth rate in public investment is expected to be 2.1%, as well as an increase in private investment of 1.2% in 2024.

In summary, the projections made by the BCTL maintain a more conservative perspective regarding the economic development of Timor-Leste in 2024, which is mainly due to the dynamism of the private sector, given that there is some increase in private demand in the economy just from the contained increase in public expenditure of 6%.

The economic projections carried out by BCTL are in line with other national and international institutions.

In relation to 2023, and when comparing the estimated values for the real dynamics of Timor-Leste's GDP with the Ministry of Finance and the IMF, the BCTL values present greater optimism. Specifically, while BCTL predicts that growth in 2023 will be 2.3%, the Ministry of Finance and the IMF present a more conservative value for the real GDP growth rate of 2.2% and 1.5%, respectively. It can be considered that, essentially, the various forecasts present a high degree of reasonableness.

Finally, it should be noted that this projection scenario for 2023 and 2024, as in previous years, continues to confirm the excessive weight of the public sector in the domestic economy, thus delaying economic development led by private and productive sectors. This transition would contribute decisively to mitigating the constant negative balances of net exports that compromise economic sustainability in the medium and long term. Promoting private-sector led economic activities would be possible to create more quality jobs with better remuneration for young population. This will eventually lead to a robust and sustainable economic development.

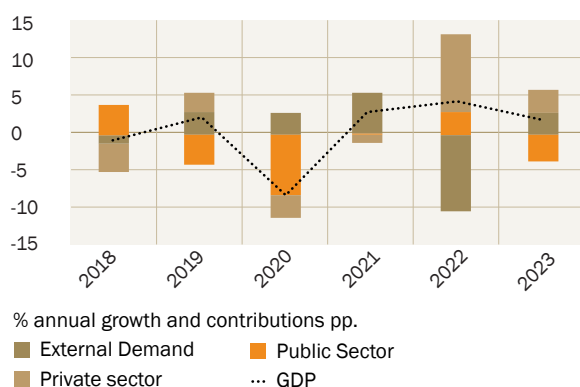
2.1.2. GDP Evolution – Optics and Components

The official data from the National Accounts of Timor-Leste for 2022 was officially published in September 2023. The BCTL developed an estimation model that allow it to estimate the most recent evolution of the relevant components of domestic and external demand and, in this way, evaluate the evolution of GDP and its respective aggregates in 2023. In this sense, the analysis that follows is based on official data from the National Institute of Statistics of Timor-Leste (INE-TL) until 2022 and on BCTL estimates for 2023, seeking to focus on the most relevant medium-term trends for the domestic economy.

BCTL estimated the real non-oil GDP growth rate at 2.3%. A slowdown compared to the positive GDP growth of 4% in 2022. This continues the non-oil economic recovery in 2022, after the resumption of growth in 2021, which was due to the normalization of economic activity following the lifting of restrictions on movement imposed in the context of the COVID-19 pandemic.

Chart 2.2a

Real GDP growth - Expenditure approach



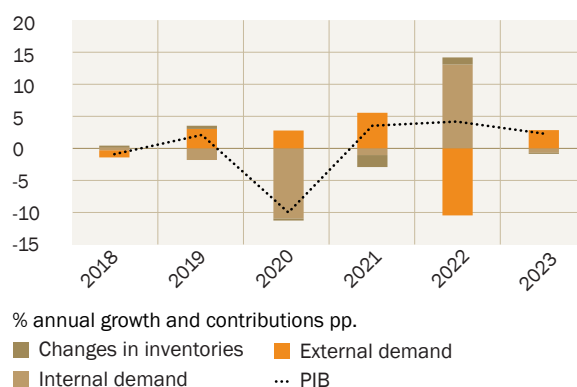
% annual growth and contributions pp.

■ External Demand ■ Public Sector
■ Private sector ... GDP

Source: INE-TL and analysis of BCTL

Chart 2.2b

Real GDP - Main components



% annual growth and contributions pp.

■ Changes in inventories ■ External demand
■ Internal demand ... PIB

Source: INE-TL and analysis of BCTL

According to these projections, the slowdown in GDP was mainly due to the decrease in public consumption, which contributed -0.2 p.p. to GDP growth of 2.3% in 2023, on the other hand, public consumption represented around 59.3 % of GDP in 2023, a slight decrease compared to the value of 60.9% recorded in 2022.

In 2023, there was an increase in public investment.

Regarding the expenditure perspective, as already mentioned and in accordance with the graphs presented below, we highlight that the evolution of the economy in 2022 and 2023 is due, above all, to the dynamics of public consumption and investment, which increased in 2022 and decreased in 2023. The relevance of the evolution of public demand for the trajectory of our economy has, in fact, been one of the main trends of the last decade.

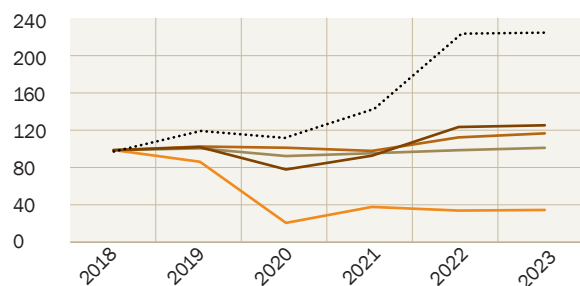
In the graph that shows the evolution in terms of real GDP, private and public demand since 2018, it is confirmed that the decreasing trend in economic activity observed in 2019 and 2020 were resulted from the gradual reduction in public demand. The increase in public expenditure between 2021 and 2022 explains the resumption of GDP growth in the corresponding years. It should also be noted that private demand has only recorded a moderate growth. For this reason, the private sector's contribution to the GDP will not be sufficient to compensate for the decrease in the public sector and the corresponding impact that this had on the evolution of Timor-Leste's economy in recent years. In graphs 2.2c and 2.2d we present the evolution of the subcomponents of private and public demand, compared with the GDP trajectory since 2018.

The year 2023 is marked by a slowdown in economic activity after the recovery in 2021 and 2022 following the COVID-19 pandemic

With regard to private sector demand, it should be noted that its volatility has exceeded GDP volatility since 2018, a phenomenon explained mainly by the dynamics of private consumption. On the other hand, private investment has been the subcomponent of private demand with the worst performance, particularly since 2019, being 81.2% below, in 2023, the level observed in 2018. This dynamic is alarming for the future of Timor-Leste's economy. With this trajectory in the short and medium term, we could see an economy excessively dependent on public investment, which increased in 2023 compared to 2022 and which could jeopardize the resilience of Timor-Leste's future economic development. The negative dynamics of investment in the private sector of the economy has quite severe impacts on the future productivity of the Timor-Leste economy, with unpredictable consequences on capital income and, consequently, on the labor factor.

Chart 2.2c

Real GDP and Private Demand



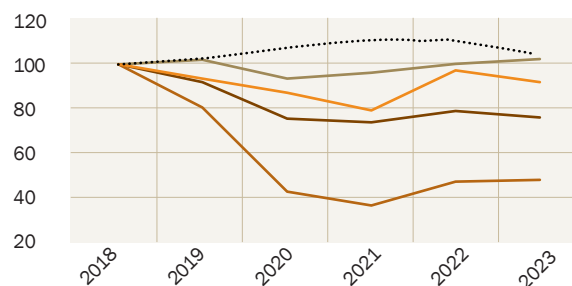
2018 = 100

- GDP
- Private investment
- Household consumption
- Private demand
- ... Household investment

Source: INE-TL and analysis of BCTL

Chart 2.2d

Real GDP, Public Demand, and Imports



2018 = 100

- GDP
- Imports
- Public demand
- Public investment
- ... Public consumption

Source: INE-TL and analysis of BCTL

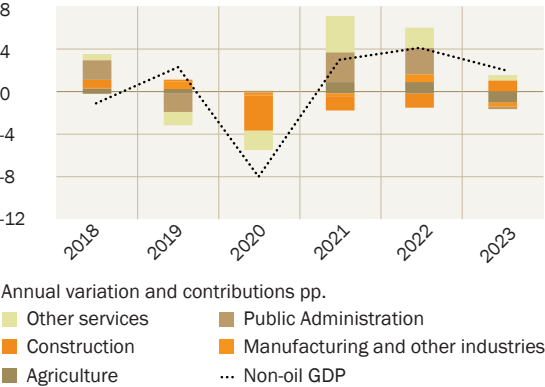
The other services sector, in addition to public administration, contributed decisively to the slowdown in economic growth in 2023

As regards to demand from the public sector, there are much lower amounts compared to 2018. In particular, the value of public demand in 2023 represented only 80% of the value observed in 2018, whereas in 2022 it represented around 77%. The fact that public investment only accounts for 58% of the value recorded in 2018 contributes negatively to this fact, thus elucidating the impact that the drop in public investment represents for the overall public demand in the economy of Timor-Leste. On the other hand, it should be noted that public investment can have important consequences for private investment decision-making. In this sense, public investment must be reinforced in order to increase the infrastructure necessary for the development and promotion of the private sector, particularly private investment.

Regarding the productive structure of the Timorese economy, the graphs below (2.3a and 2.3b) allow us to understand which sectors of activity have contributed in greater proportion to a greater dynamic of economic activity in Timor-Leste. More specifically, it is highlighted that the other services sector, in addition to public administration, contributed decisively to the slowdown in economic growth in 2023, contrary to what happened in 2022. In 2023, there was also a smaller contribution from the manufacturing industry, which is not a good sign for the future development of the secondary sector of the economy. In 2023, it is expected that the manufacturing industry will have recorded levels lower than those recorded in 2022. On the contrary, looking at the sector that contributed most to the performance of the economy in 2023, the civil construction sector stands out, which continued to decline since 2018, returning to a marginal increase.

Chart 2.3.a

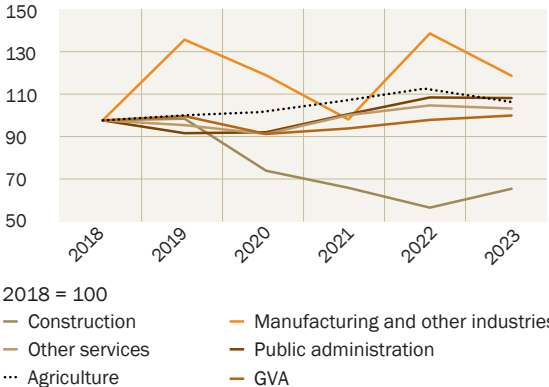
TL: Real GDP growth: production approach



Source: INE-TL and BCTL

Chart 2.3.b

Real GDP - by sector of production approach



Source: INE-TL and BCTL

Since 2015 and until 2023, according to what we can assess through graph 2.3c, the main change in the productive structure consisted of the significant drops in the share of the construction sector (from 17% to 9% of GVA) while at the same the public administration recorded an increase from 29% in 2018 to almost 32% in 2023. The services sector continued to maintain the dominant position in the economic structure, representing 35% of GVA in 2023, compared to 49% in 2018.

The industrial sector has seen considerable development, having grown by more than 360% in the last 7 years.

As regards 2024, the BCTL expects this production structure to remain relatively stable, with the exception of expecting a slight increase in the share of the manufacturing sector, depending on the expected recovery in private and public investment.

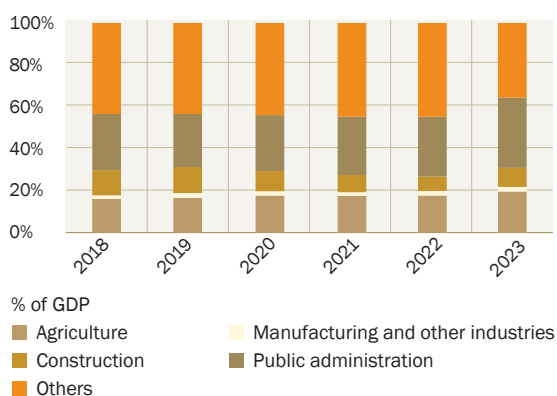
Looking at the positive aspect, the industrial sector has registered a notable expansion in its activity, with its GVA growing 20% between 2018 and 2023. Despite this robust expansion, this sector continues to represent a minor part of the domestic economy, representing just 2% of GDP in 2023, to the detriment of other sectors of economic activity.

This productive structure demonstrates that the country's economy continues to depend on a large scale on the public sector, as the sectors that are least dependent on the State - agriculture, fishing, industry, hotels and restaurants - only represented 35% of GDP in 2023. The shares of these sectors are relatively stable in the economy of Timor-Leste.

Despite the significant increase in the industrial sector, the anemic growth of the agricultural and fisheries sectors, which registered an accumulated growth of 9% since 2018, combined with weak dynamics in other sectors of activity between 2018 and 2023, as previously described, reflect the limited economic development of these sectors, which rely less on the public sector.

Chart 2.3c

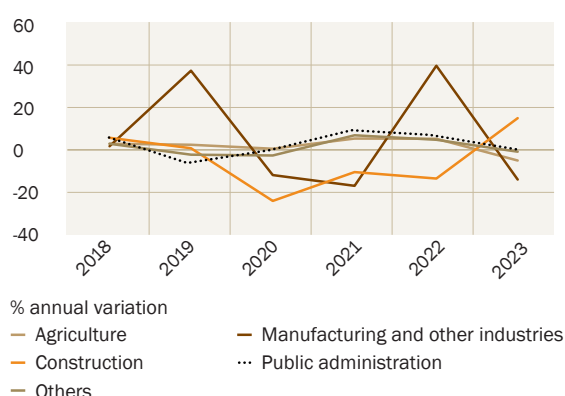
Share of GDP by industries: Production approach



Source: INE-TL and BCTL

Chart 2.3d

Growth rate by sector



Source: INE-TL and BCTL

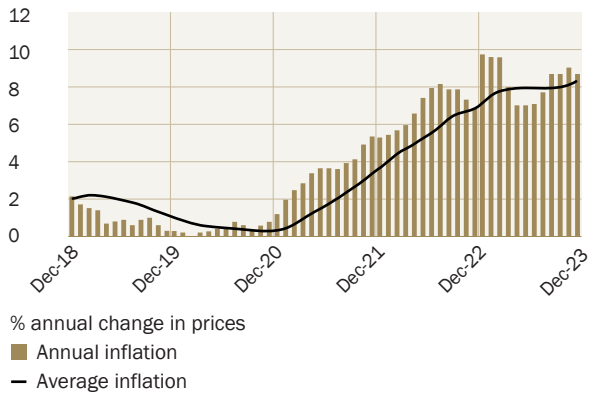
2.1.3. Prices and Inflation

The average annual inflation rate in 2023 was 8.4%, compared to 7% in 2022.

The average annual inflation rate in Timor-Leste, according to INE-TL, stood at 8.4% in 2023, which represented a notable increase in domestic inflationary pressures in 2023, following a high average inflation rate already occurring in 2022 of 7%. In year-on-year terms, the rise in the inflation rate is even more visible, having accelerated from 6.9% in December 2022, to 8.7% in December 2023.

Chart 2.4

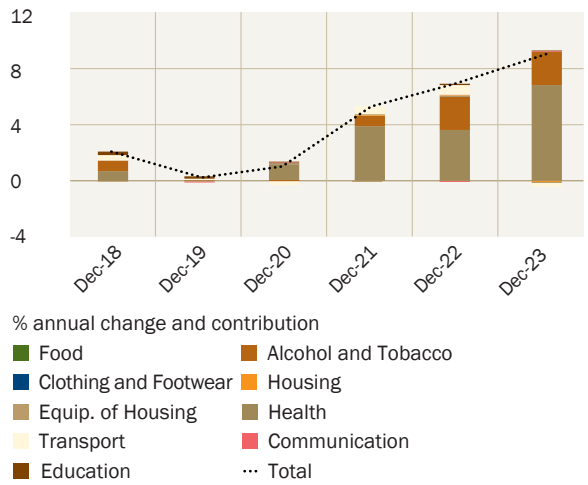
Inflation rate in Timor-Leste



Source: INE-TL and calculation of BCTL

Chart 2.5

Inflation rate in Timor-Leste



Source: INE-TI and BCTL analysis

The price level grew more rapidly in 2023 compared to that observed in 2022.

The rise in prices is mainly explained by an accelerated increase in the prices of alcoholic beverages and food.

As can be seen in the graphs and tables that follow, in 2023 the inflation reached its maximum level in the last decade. This trend is in line with what has been happening in the various external economies following inflationary pressures resulting from the negative supply shock caused by the conflict in Ukraine.

It should be noted that the acceleration of inflation in 2023 in Timor-Leste was essentially due to the rise in the prices of alcoholic beverages and tobacco, whose prices registered an increase in prices of around 32% (compared to an increase of 24% recorded in 2022), followed by the food group, which recorded a price increase of 10.2% compared to an increase of 7.5% in 2022. Finally, the education group which registered an average inflation rate of 6.9% in December 2023 compared to a rate of just 2.5% recorded in the same month of the previous year. On the contrary, the sector of housing, recreation and cultural equipment, and transport registered a decrease in prices by 1.6%, 1%, and 0.6%, respectively in the year 2023.

Table 2.1 offers greater detail in terms of inflationary trends, breaking down the average inflation rate by large groups of goods/services:

Table 2.1.

Inflation Rate by CPI Groups - % annual average

	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23
Food	1.7	0.9	0.9	5.8	7.5	10.2
Alcohol & Tobacco	8.3	3.5	-0.4	7.2	23.8	32.0
Clothing & Footwear	0.6	0.2	1.6	0.0	-0.2	1.5
Housing	1.2	0.5	-0.6	0.4	1.4	0.7
Household Equip.	0.4	-0.6	-0.2	-0.3	2.9	-1.6
Health	0.0	0.0	0.0	0.2	0.8	0.0
Transport	3.0	0.8	-1.3	2.7	12.1	-0.6
Communication	0.3	-0.2	-0.4	0.0	0.0	0.7
Rec. & Cult.	-0.6	0.1	0.1	0.1	1.7	-1.0
Education	16.6	9.0	2.6	0.0	2.5	6.9
Total	2.0	0.9	0.5	3.8	7.0	8.4

Source: INE-TL & BCTL analysis

The inflation rate observed in 2023 in Timor-Leste is slightly different from the values recorded worldwide.

As can be seen from the table above, the “Food” and “Alcoholic beverages and tobacco” groups were mainly responsible for the acceleration of the price level in 2023, not only due to the sectoral inflation rates observed – 10.2% for the “Food” and 32% for the “alcoholic beverages and tobacco” sector - but also due to the very significant weights of these sectors as a whole in the representative basket of goods and services consumed in the Timor-Leste economy.

It should be noted, however, that the acceleration in the inflation rate seen in 2023 in Timor-Leste presents a different dynamic to that occurring in most world economies. However, this trend was not at all generalized to all categories, with some sectors such as “Health”, “Clothing and footwear” and “Communication” showing modest inflation rates when compared to other sectors.

The rigidity of supply, as well as the war in Ukraine, accentuated the price rise observed in 2023.

With regard to the macroeconomic determinants of the inflation rate observed in 2023, the acceleration in price levels is, above all, due to the inflationary pressures originating from the external sector. However, these pressures were partially contained by the appreciation of the USD against the currencies of our economy’s trading partners.

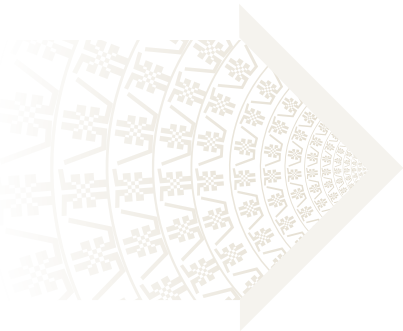
In the chapter that explores the evolution of the international economy, it was noted that to face the inflationary pressures experienced in 2023, the majority of central banks adopted contractionary monetary policies, marked by increasing in interest rates, with the aim of containing the monetary expansion in the economy. Although global and trading partner inflation rates have eased, Timor-Leste continues to struggle with persistent inflation, partly attributed to shortages of rice from India and reactions to the government’s policy of increasing import duties. Despite the subsequent rollback of the import tax to its initial level by the new government, it has not yet produced the desired reductions in prices.

The economic growth recorded in 2023, and the growing inflation felt in 2023, leads us to conclude that investments, whether public or private, must be stimulated to promote a more productive supply, with more robust jobs and wages that allow the economy of Timor-Leste to be more resilient to adverse external shocks such as those experienced in 2023. In line with this conclusion, the BCTL predicts that the level of economic activity in Timor-Leste will continue below the potential GDP, generating underemployment problems in the various productive sectors .

In terms of future perspectives, the BCTL anticipates an easing of inflationary pressures throughout 2024. In this context, the BCTL expects the average inflation rate, in 2024, to reduce to levels below those recorded in 2023, more specifically, to slow down to 4.5% in 2024.

These projections are naturally based on the assumption of exchange rate stability of the dollar against Asian currencies, the gradual reduction over the next few years of international inflationary pressures, particularly in the economies of our country's main partners, the new government's policy of reversing tax increases on imports, which should produce positive results in reducing domestic prices, and also on the fact that the domestic economy continues to operate below its potential level.

Despite the economic recovery seen between 2021 and 2022, sluggish performance over the past five years, coupled with the slowdown in 2023, has led to a decrease in job creation and, consequently, a decline in labor force participation. The 2021 labor force survey highlights the stagnation of labor force growth. Currently, the labor force participation is 30.5%, comparable to the figure of 30.6% recorded in 2013. This means that of Timor-Leste's working age population of approximately 809.4 thousand individuals aged 15 or over , only 30.5% are considered workers, employed and unemployed. The BCTL therefore estimates that the current level of GDP is currently below its potential or full employment level. This fact, together with the expectation that the expected economic recovery will not be enough to eliminate the domestic "output gap" by 2024, leads us to believe that inflationary pressures on the domestic economy will decrease next year.





2.2

Public finances

2.2.1. 2023 Budget Program

In 2023, according to the data in table 2.2 below, public expenditure, on an effective cash basis, recorded a significant reduction of \$247 million.

In 2023, public expenditure recorded a significant reduction of \$246 million.

Therefore, the overall actual value of expenditure fell to \$1.494 million in 2023. The decrease in public expenditure compared to 2022 is explained, above all, by a lower degree of execution of expenditure from the 2023 budget compared to 2022. Namely, the execution rate of public expenditure in 2023 reduced by 2.5 p.p. to 76%. It should be noted that the initial amount of expenditure of \$2,155 million USD allocated in the 2023 State Budget was ratified to \$1,960 million, thus resulting in a reduction of 9% compared to the initial budget, and 11% compared to the budgeted amount in 2022.

The expenditure execution rate in 2023 was lower than that observed in 2022.

The decrease in the execution rate of the 2023 budget compared to the 2022 budget is explained by the reduction in budget execution in the Recurrent expenditure by 18% in 2023 compared to 2022 (76.9% of execution in 2023 compared to 90.7% of execution in 2022). However, it is important to highlight that the level of execution of capital expenditure is notably higher compared to the previous two years - a notable increase in execution of 33 p.p. of the execution rate for capital expenditure (73% in 2023 compared to a degree of execution of 39% in 2022). From our perspective, this constitutes a positive indicator for future economic activity, as public investment plays a crucial role in promoting the development of Timor-Leste's private sector economy.

Table 2.2.

State Budget – evolution and execution rate

	Millions USD		Annual change	Execution rate	
	2022	2023	2023	2022	2023
Total Revenues	730	776	6%	104%	78%
Domestic Revenues	176	286	63%	117%	56%
Tax Revenues	143	193	35%	117%	108%
Non-Tax Revenues	18	92	416%	108%	28%
Agency Retention Revenues	11	0	-100%	95%	
Grants & Contribution	4	0	-100%		
Estimated Sustainable Income	554	490	-12%	100%	100%
Total Spending	1,741	1,494	-14%	79%	76%
Recurrent Expenditures	1,538	1,263	-18%	91%	77%
Capital Expenditures	203	231	14%	39%	73%
Financing	1,011	718			
Excess Withdrawals from the Petroleum Fund	850	600	-29%	112%	84%
Use of Cash Balances	116	87	-25%	28%	44%
Loans	30	20	-32%	58%	58%

Source: TL Transparency Portal, Budget Book, and BCTL analysis

In annual terms, on a cash basis, the reduction in public expenditure of \$247 million was explained by the substantial decrease in recurrent expenditure, which represented a negative growth rate of 18% compared to 2022, totaling \$1.263 million, and positive growth in the value of capital expenditure at \$28 million in 2023 compared to 2022, which represents an increase of 14% compared to the value executed in 2022.

Regarding revenues, the Government forecast in its 2023 OGE a total of non-oil revenues of \$507 million, excluding loans and donations. This forecast, although ambitious, reflects a positive perspective, anticipating a notable growth of 237% compared to 2022. However, as it can be seen from Table 2.2, this budgeted revenue was reduced by 60 p.p., i.e., an execution rate of 56.4%, reaching a value of \$286 million. However, it surpasses the 2022 run value of \$176 million, marking 63% growth.

The revenue collected by the government was 54% below the budgeted amount.

Due to the substantial reduction in public expenditure (-\$247 million) and despite a slight increase in non-oil revenue (+\$110 million) of the Central State, the deficit calculated on a cash basis, excluding oil revenue, decreased in 2023 by an amount of \$357 million, to \$1,208 million (in 2022 the budget balance excluding oil revenues recorded a deficit of -\$1,565 million).

2.2.2. Public Revenue

In 2023, non-oil revenues totaled \$286 million, which represented an increase of 63% compared to 2022.

One of the Government's main priorities is to reduce the country's dependence on financing from the Petroleum Fund. Efforts in this regard remain fundamental in the Government's budget discussions and planning. In the 2023 OGE, for example, the Government continued to highlight its "tax reform" policy, with the aim of improving the country's fiscal framework and increasing domestic revenues, obtained based on non-oil resources and activities.

In 2023, on a cash basis, domestic non-oil revenues reached \$286 million, registering a growth of 63% compared to the \$176 million recorded in 2022. With regard to each of the category, tax revenue registered an increase of 35%, a significant increase, totaling \$193 million, while non-tax revenues registered a very significant increase of 416% compared to the previous year. In detail, in 2023 there was a total of non-tax revenue of \$92 million (in 2022, the amount of this revenue item was \$18 million).

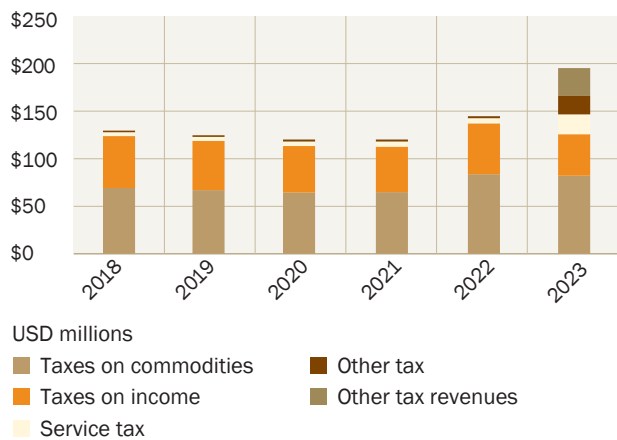
Taxes on goods continued to represent the largest share of tax revenues.

Graph 2.6 highlights the variations in tax revenue and its main components over recent years, namely taxes levied on the income of individuals and companies and taxes charged on the import of goods (taxes on goods include excise taxes, sales and import). With the increase in tax revenue collected, it is worth noting a slight reduction in revenue from taxes on goods, which totaled almost \$82 million compared to 2022 revenue totaled more than \$84 million. On the other hand, income tax recorded a decline of \$10 million in revenue collected, and in 2023 the amount of taxes received on income totaled \$43 million, a reduction of approximately 10% compared to 2022. Revenues from other taxes and service charges registered a very significant increase in 2023, representing 10% and 11% of tax revenues in total taxes collected by the government, respectively. The increase in tax revenues in 2023 is in part attributed to the inclusion of payroll tax revenues of \$26.5 million, constituting approximately 14% of total tax revenues for the year.

It should be noted that the advantage of the increase in tax revenue lies in the reduction of excessive withdrawals from the petroleum fund to finance the State budget in 2023. This decrease amounted to \$250 million, representing a drop of 29% compared to 2022.

Chart 2.6

TL - Fiscal revenue - cash basis



2.2.3. Public Expenditure

In 2023, the overall public expenditure execution rate decreased to 76%, sustaining the downward trend in budget execution observed in 2020, although exceeding the 2021 execution rate (71%). The lower execution rate was partly due to the parliamentary election period. To achieve the expected economic growth, it is essential that budget execution is high, at least corresponding to or even exceeding the levels recorded in 2018 and 2017, when execution rates of 91% and 85% were achieved, respectively.

The execution rate of the public expenditures was lower compared to 2022.

The amount of expenditure budgeted in 2023 was lower than that budgeted in 2022 by around \$251 million, at the same time the amount of budget expenditure executed was lower than that of 2022, not only due to the reduction in budgeted expenditure for 2023 compared to 2022, but also by a slight reduction in the expenditure execution rate, as expressed previously, which ended up explaining an effective reduction in expenditure of more than \$247 million, a decrease of almost 14% in expenditure compared to that observed in 2022.

Finally, the overall expenditure carried out by the government decreased, as previously mentioned, by \$247 million, which is essentially due to the reduction in current expenditure of \$275 million, and also included an increase in capital expenditure. Capital expenditure increased by \$28 million in 2023 compared to 2022, which translates into a percentage increase of almost 14%. This increase in public investment expenditure was due to the fact that, despite having a reduction in this budget item compared to 2022, the amount executed was significantly higher, which translated into an overall amount in 2023 greater than that in 2022.

Global spending decreased by \$247 million in 2023.

2.2.3.1. Current Expenditure

The current expenditure decreased by 18% in 2023.

In 2023, the current expenditure decreased by 18%, thus reverting to the expansions already seen in 2022 (18%), in 2021 of +35%, and in 2020 of 7%. The current expenditure, which totaled approximately \$1263 million in 2023, once again records a historic reduction, after a constant increase since 2020, with a total amount of effective public expenditure of \$967 million, and below the values recorded in 2021 and 2022, with a expenditure amount of \$1302 million and \$1538, respectively.

These represent more than 84% of total expenditure incurred in 2023.

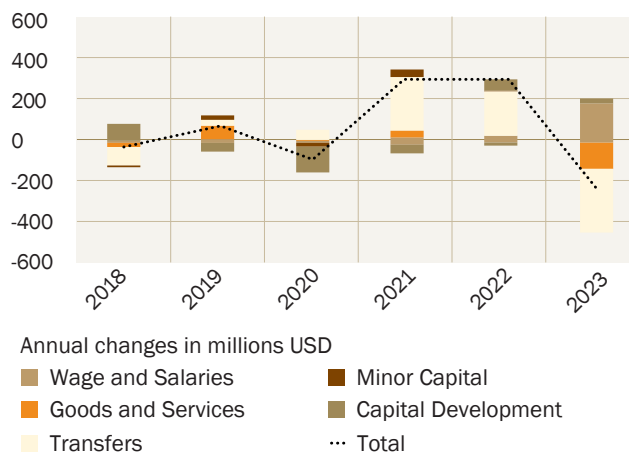
Current expenditure thus continued to be the main component of public expenditure, amounting to 84% of the total, which represented a slight decrease of 4 p.p. below the proportion of this expenditure in the total expenditure executed in 2022. It is also worth highlighting that The reduction in expenditure was mainly due to a lower execution of this expenditure component, reaching an execution rate of 76.9% in 2023 compared to an execution rate of 90.7% in 2022.

In 2023, there was a substantial decrease in transfer expenses.

Graph 2.7 shows the annual evolution in millions of dollars of the components of public expenditure, determined on an effective cash basis, or expenditure actually carried out in each year. As can be seen, unlike the previous year, the reduction in expenditure on transfers (-\$308 million) and on goods and services (-\$150 million) explained the significant reduction in current expenditure, while the increase in expenditure on public investment by \$26 million helped offset the decrease in total expenditure recorded in 2022.

Chart 2.7

Public expenditure changes by category - cash basis



Source: TL Transparency Portal and BCTL analysis

Due to this evolution, expenditure on transfers represented the largest category of total expenditure in 2023, with 38% of the total (50% in 2022, 46% and 34% in 2021 and 2020, respectively), followed by expenditure on salaries with 30% (15% and 16% in 2022 and 2021, respectively) and goods and services with 17% (23% and 28% in 2022 and 2021, respectively).

2.2.3.2. Capital and Development Expenditure

The government estimated in the 2023 OGE a global capital expenditure, including the loan program, in the amount of \$318 million, representing a significant decrease of around \$198 million, translating a decrease of approximately 38% compared to the value stated in the 2022 budget (\$515 million), a year in which the budget increased by \$51 million (11%). However, this increase in 2022 is far from the amount budgeted in 2021, a year in which an amount of \$464 million was budgeted and which represented an increase of \$244 million (+111%) compared to 2020.

On the other hand, capital expenditure decreased by 38% compared to 2022, totaling \$318 million in 2023.

However, despite the budgeted amounts, there was a high execution rate, around 73%, which was higher than the weak budget execution of this expenditure component in 2022 and 2021, when a rate of 39% and 30% was recorded, respectively. Therefore, it should be noted that in 2023 the total amount of public investment executed totaled \$231 million, an increase in executed expenditure of \$28 million compared to 2022.

The majority of capital development expenditure was spent within the scope of the construction of infrastructure program, also including loans, the weight of which represents 47% of total public investment, a figure quite far from the 73% recorded in 2022. The Infrastructure Fund Program continues assuming the greatest relevance in terms of public investment, as its expenditure corresponds to 47% of the category's total in 2022.

The construction of infrastructure was the most favored program among the total executed capital expenditures.

Table 2.3 details information regarding the main components of the national public investment program, identifying the highest priorities in terms of the most relevant infrastructure programs.



Table 2.3.
Composition of Public Investment

	Millions USD - cash basis			% Public Investment		
	2021	2022	2023	2021	2022	2023
Minor Capital	44	46	48	32%	23%	21%
Development Capital	96	157	183	68%	77%	79%
Total Infrastructure	91	147	109	65%	73%	47%
Total Public Investment	140	203	231	10%	12%	16%
Total Expenditures	1442	1741	1448			

Major infrastructure asset investment sectors

	Millions USD - cash basis			% Public Investment		
	2021	2022	2023	2021	2022	2023
Agriculture	2	3	4	2%	1%	2%
Rural & urban dev.			4	0%	0%	2%
Maint. & rehab.			10	0%	0%	4%
Court services			3	0%	0%	1%
Information and com. Tech.			16	0%	0%	7%
Water and sanitation		2	1	0%	1%	0%
Health	8	5	2	6%	3%	1%
Airport			2	0%	0%	1%
Education	0	28	1	0%	14%	1%
Road and bridge	3	18	58	2%	9%	25%
Other infrastructure	78	91	8	56%	45%	3%
Total infrastructures	91	147	109	65%	73%	47%

Source: TL Transparency Portal and BCTL calculation

As it can be seen, investment in minor capital increased by \$2 million in 2023 compared to the value of \$46 million recorded in 2022, representing 21% of public investment. In terms of sectoral priorities for public investment in infrastructure, investment in roads and bridges constituted the main investment programs, with a combined annual expenditure of \$58 million in 2023, with the importance of these priorities significantly higher than in 2022 (\$18 millions). One of the main focuses of government public investment in 2023 was the IT and communications technology sector, with a total expenditure of \$16 million, constituting 7% of global public investment for the year.

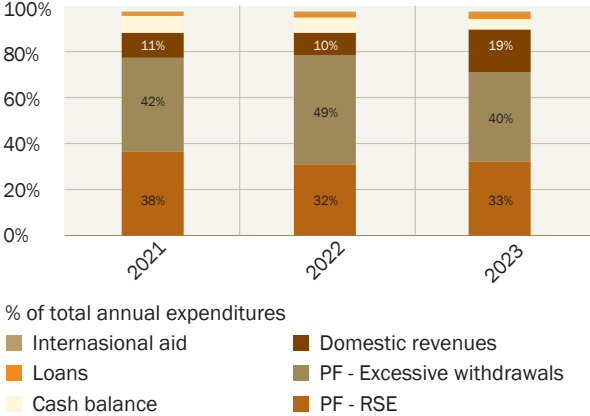
2.2.4. Financing source

The FP financed \$1,090 million of public expenditure in 2023

In 2023 Budget, the Government planned to use \$1,207 million from the Petroleum Fund, but actually withdrew a lower amount, around \$1,090 million, to finance its actual expenditure throughout the year. Note that this value represents a decrease of \$314 million compared to 2022, due to lower public spending and a reduction in the value of the non-oil fiscal deficit.

Despite registering a reduction, the annual value withdrawn from PF continues to be well above its Estimated Sustainable Income (ESI), valued at \$490 million (\$554 million in 2022 and \$548 million in 2021), which translates into a continued reduction in capital of the PF.

Chart 2.8
Source of Public Expenditure Funding



Source: TL Transparency Portal, OGE, and BCTL analysis

With regard to the sources of financing used to finance public expenditure in 2023, it should be noted that the PF continues, despite the reduction, to be the main source of financing, with this source representing 73% of total financing, when, in 2022, it represented 81% of the total financing carried out to finance the expenditure incurred. On the other hand, domestic public revenue represented only 19% of total financing, a value marginally higher than that recorded in 2022 and 2021 of 10% and 11%, respectively. Contributing to this upward trend is the fact that the total expenditure fell in 2023, at the same time as the non-oil revenues increased.

The PF continues to be the main source of financing for the State budget.

Regarding loans, these have represented a reduced proportion of 2%. These loans, which have mainly been used to finance investment in roads in the country, amounted to \$20 million in 2023 (\$30 million and \$15 million, in 2022 and 2021), corresponding to an execution rate, in 2023, of 58%, which represents a slightly lower execution of the loans foreseen in the OGE.

In short, these considerations allow us to verify the continued enormous dependence of the State budgets on financing originating from oil revenues or, more specifically, from transfers from the Petroleum Fund, in an amount that substantially exceeds its sustainable income. Despite the existence of substantial energy reserves in Timor’s water, the fact that the exploration projects currently underway are scheduled to end in 2023, means that the continued and substantial reduction in the Fund’s capital represents a material risk to the sustainability of our public finances in the medium term.



2.3

Monetary and Exchange Rate Sector

2.3.1. Interest Rates

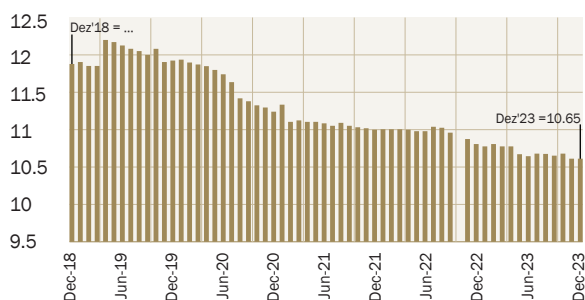
Loan interest rates continue to be significantly high despite the credit granting program at lower rates.

The level of interest rates on loans continues to be relatively high when compared to international reference rate levels in dollars. In fact, economic theory says that when a small country adopts the currency of a large economy as its own, its interest rates tend to converge with those of its reference. In Timor-Leste this does not happen, especially for credit interest rates for several reasons, the main one being the risk of the banking business. On the other hand, the government of Timor-Leste provides financial capital to grant loans (soft loans) at lower rates (3%). However, this economic policy is not yet having an effect on the rates currently observed in Timor-Leste's banking system.

Similar to the evolution of the previous year, the high average interest rates on loans to the private sector continued to decline from 10.83% to 10.65% from December 2022 to December 2023, which represents a positive sign for companies and families that use bank credit to finance themselves. However, there was a slight decrease in the average rate paid on deposits with 6-month maturities at the end of 2023 compared to 2022. More specifically, while in December 2022 6-month deposits were remunerated at a rate of 0.67%, in December 2023 the interest rate for deposits with the same maturity was 0.62%, a slight reduction of 0.05 p.p. in a period of one year. This dynamic of active and passive interest rates caused the "spread", that is, the interest rate differential, to fall to 10.15%, when at the end of 2022, the same differential was approximately 10.30%.

Chart 2.9a

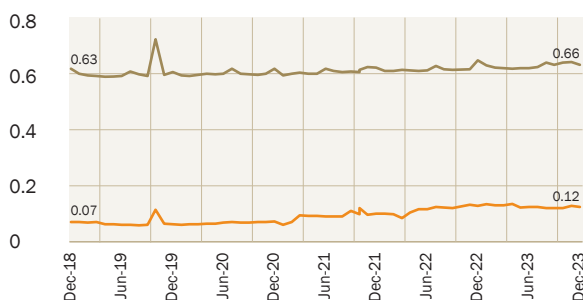
TL: Lending interest rate - weighted average



% annual
Source: BCTL

Chart 2.9b

TL: Deposit interest rates



% annual
— Demand deposit
— Time deposit, 12 months
Source: BCTL

Table 2.4.

Interest Rates of Commercial Banks – weighted average (% annual)

Periods	Loans + 6 months Libor	Demand deposit	Saving deposit	Time deposits			
				1 month	3 months	6 months	12 months
2022 Dec	10.83	0.13	0.52	0.59	0.62	0.67	0.67
2023 Jan	10.80	0.13	0.49	0.59	0.62	0.67	0.65
Feb	10.84	0.13	0.48	0.59	0.61	0.67	0.64
Mar	10.80	0.13	0.47	0.58	0.61	0.66	0.64
Apr	10.81	0.13	0.47	0.58	0.60	0.65	0.63
May	10.70	0.12	0.47	0.59	0.62	0.69	0.64
Jun	10.67	0.12	0.48	0.63	0.65	0.71	0.64
Jul	10.70	0.12	0.48	0.62	0.65	0.70	0.64
Aug	10.71	0.12	0.51	0.62	0.65	0.70	0.66
Sep	10.68	0.12	0.50	0.62	0.65	0.70	0.65
Oct	10.71	0.12	0.51	0.62	0.65	0.70	0.66
Nov	10.64	0.12	0.51	0.60	0.63	0.67	0.66
Dec	10.65	0.12	0.50	0.55	0.57	0.62	0.65

Source: BCTL

2.3.2. Exchange rates

In 2023, the USD depreciated by 0.6% against the rupiah of Indonesia, Timor-Leste's main economic partner.

Similar to what happened in 2022, the North American dollar, the official currency of Timor-Leste, showed the same dynamics of exchange rate devaluation against the two currencies of Timor-Leste's main trading partners. More specifically, between December 2022 and December 2023, the USD depreciated against the Singapore dollar, a reference currency in the Asian context, by around 1.5%, and depreciated by 0.6% against the Indonesian rupiah, which is Timor-Leste's main partner economy. It should be noted, however, that in 2023 there was greater exchange rate stability than the volatility observed in 2022.

Chart 2.10

Nominal Exchange Rate vs USD



Source: Bloomberg

The slight devaluation of the USD against the currencies of Timor-Leste's main trading partners, the Singapore dollar and the Indonesian rupiah, contributes to the destabilization of domestic inflation. Therefore, given that Timor-Leste maintains a high dependence on imported goods and services to meet existing domestic demand, the net effect of the two exchange rate dynamics contributed to the observed worsening of the inflation rate in 2023.

2.3.3. Monetary Base (BM)

The monetary base increased, in 2023, by \$111 million, contrary to the decrease observed in 2022.

The Monetary Base, which is one of the determining variables in terms of monetary policy, increased significantly in 2023 by \$111 million, contrary to the decrease recorded in 2022 (-\$145 million). The monetary base was valued at \$283 million at the end of 2023, with \$31 million corresponding to the currency in circulation and the remaining \$252 million to bank deposits with the BCTL. The increase in the monetary base in 2023 is explained by the increase in bank

deposits with the BCTL by \$107 million, mainly deposits related to the capital reserve account and the bank loan reserve account. These two accounts, which banks are required to open with the Central Bank if they fail to comply with Central Bank instructions regarding the maintenance of minimum loan-to-deposit ratios (LDR), played an important role in driving the increase in the monetary base during the period 2023.

2.3.4. Money Supply

Financial sector development plays a vital role in fostering economic growth and poverty reduction. The compilation and analysis of monetary and financial statistics make it possible to assess the development and changes in a country’s monetary and financial systems. The Central Bank of Timor-Leste has been systematically collecting and compiling these statistics with the aim of developing a comprehensive and detailed view of our financial sector, in order to develop the functions of the BCTL within the scope of macroprudential supervision and the implementation of a monetary policy. However, to date, the BCTL still does not have monetary policy instruments as our country continues to use a foreign currency, the US dollar, as its official currency.

M2 rose to 1,248 million in December 2023, an increase of \$33 million.

Chart 2.11
Money Supply Growth

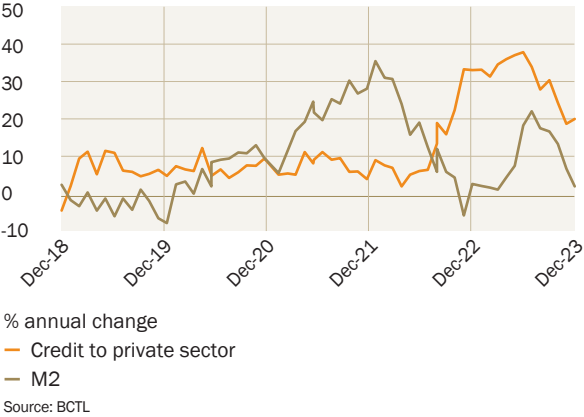
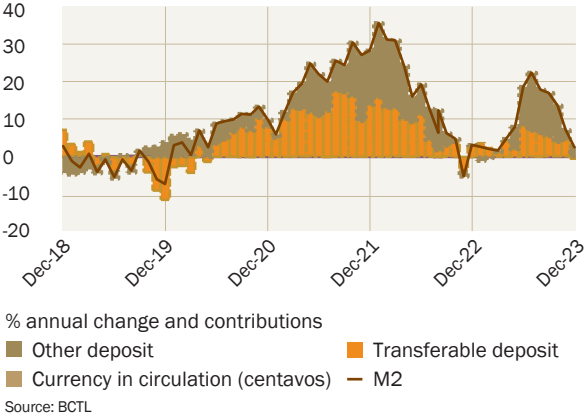


Chart 2.12
M2 and its components



Although Timor-Leste is a “dollarized” economy, it is possible for the BCTL to reasonably calculate the aggregate monetary mass (the M2 aggregate), excluding dollar bills in circulation, which in most countries is used as a measure of the availability of resources of payment. As is customary, the monetary supply in Timor-Leste is calculated by summing the currency in circulation with demand deposits (which, like the former, can be mobilized immediately to make payments through checks) and the “quasi-money” (savings and term deposits), which can also be mobilized at relatively short notice to make payments.

Graphs 2.11 and 2.12 show the evolution of the monetary aggregate M2, over the period from 2018 to 2023. Note that the M2 values are approximate, because, as the country uses the North American dollar, it is difficult to calculate the value of banknotes in circulation accurately. However, as this must constitute a small and stable proportion of the amounts available for payments, the approximate M2 serves reasonably well for the purposes of measuring the size and variation of the money supply in our economy.

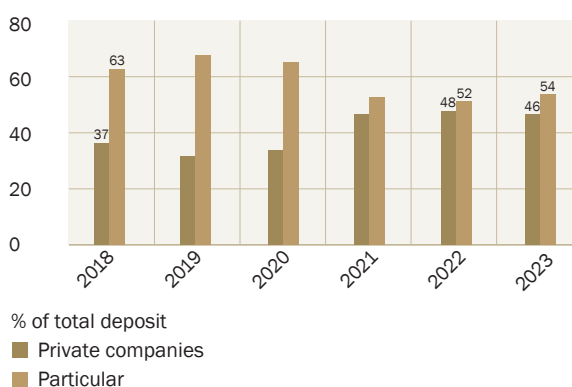
The M2 thus calculated amounted to \$1,248 million in December 2023, having recorded an expansion of \$33 million, an increase well below the \$96 million increase in the money supply that was recorded between December 2022 and December 2021.

Of the total deposits, there has been an increasing convergence in the percentage of deposits held by private companies and individuals since 2019.

It is also important to analyze the evolution of the components of the monetary supply, shown in graph 2.12. The total deposits raised by financial institutions were decisive in the expansion of the money supply, with an increase of \$30 million, reinforcing the increase of \$94 million in 2022.

Chart 2.13

Share of Deposit by Ownership



Regarding their ownership by institutional sector, as can be seen in graph 2.13, it can be seen that 54% of deposits are held by individuals and 46% by private companies. These percentages reflect a slight increase of 2 p.p. in the share of deposits held by individuals, instead of what had happened with private companies whose total weight of deposits decreased by the same magnitude (-2 p.p.). Despite the slight decrease in the weight of deposits held by private companies in 2023, the weight of company deposits is practically high compared to 32% in 2019 and 14% in 2012.

Another perspective on the analysis of M2, according to Table 2.5 below, the increase in credit and government deposits explained the bulk of the increase in money supply, despite being offset by a significant reduction in net external assets.

Table 2.5.
Drivers and Changes of Money Supply

In millions USD

	Annual Flow 2022	Annual Flow 2023
Credit to the Economy	104.6	84.3
Government	-193.8	133.0
BCTL Complaints	-0.3	0.8
Deposits	-193.5	132.2
Net External Assets	312.4	-173.0
Others	127.0	11.3
M2	96.3	32.9

Source: BCTL

2.3.5. Bank credit

In 2023, credit granted by banks to the private sector increased, a trend that has been recorded since 2021. However, the increase in 2023 was slightly lower than that in 2022 - an increase of \$78.3 million, compared to an increase of \$89 million in 2022. This evolution is equivalent to an increase of 22%, exceeding the increase recorded in 2021 in the amount of \$14.8 million, or even the maximum increase recorded in that period of \$26 million in 2020 compared to 2019.

Bank credit increased in 2023 (22%), with special emphasis on credit granted to the commerce and finance and tourism and services sectors, and individuals.

Table 2.6.
Evolution and Composition of Bank Credit

Credit by sector	Balance (millions USD)		Growth		Composition	
	2022	2023	Nominal	%	2022	2023
Agriculture, Water and Forestry	1.5	1.7	0.2	13.7%	0.4%	0.4%
Industry and Manufacturing	16.6	19.9	3.3	20.2%	4.6%	4.5%
Construction	65.8	62.8	-2.9	-4.4%	18.2%	14.3%
Transport and Communications	48.2	18.5	-29.7	-61.6%	13.3%	4.2%
Trade & Finances	26.5	61.6	35.1	132.4%	7.3%	14.0%
Tourism and Services	11.1	19.8	8.7	78.4%	3.1%	4.5%
Individual & Others	192.0	255.5	63.5	33.1%	53.1%	58.1%
Total	361.6	439.9	78.3	22%	100%	100%

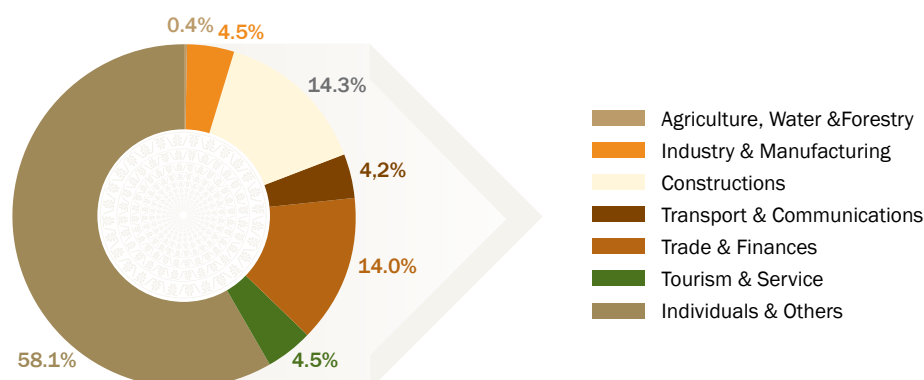
Source: Commercial Banks and BCTL analysis

When analyzing credit granted by sector of activity, we can see that the commerce and tourism sectors recorded the highest credit growth in 2023 - 132% and 78.4% for a total value of \$61.6 million and \$19.8 million, respectively. This evolution translates into an increase in credit granted in 2023 for these sectors of \$35.1 million and \$8.7 million, respectively. On the other hand, unlike the previous year, credit granted to the construction and transport sectors fell by 4.4% and 61.6% (equivalent to -\$2.9 million and -\$29.7 million), to a total of \$62.8 million and \$18.5 million, respectively.

It is also worth highlighting the increase observed in credit granted to Timorese families, with the increase recorded in 2023 compared to 2022 totaling \$63.5 million, the largest increase in nominal terms in the last decade, which added to the increase in credit already observed of \$9.2 million in 2022 and \$17 million in 2021. With this increase, the proportion of credit granted to individuals increased to 58% in 2023 compared to 53.1% of credit granted in 2022. The increase in the relative weight of credit granted to individuals is mainly due to the decrease in the weight of credit granted to the construction and transport and communication sectors, as can be seen from the table above.

Chart 2.14

Credit by Sectors - Dec 2023 - % Total



Source: BCTL

Unlike the previous year, the agriculture, water and forestry sector was one of the sectors of activity that saw credit granted increase, albeit marginally, with a growth of 13.7% for a total accumulated value of \$1.7 million. As previously mentioned, one of the two sectors that recorded a decrease in credit granted was the construction sector, with a decrease of \$2.9 million. The other sector that also recorded a decrease in credit granted was the transport and communications sector, with a larger reduction of around \$29.7 million. On the other hand, one of the sectors that recorded the greatest growth was industry and manufacturing, with a growth rate of 20.2% for a total credit granted in 2023 of \$19.9 million, despite a reduction in its share to 4.5% compared to 4.6% in 2022. After credit to individuals, credit to the construction and commerce and industry sectors were the next dominant sectors, jointly representing a total of 24.3% of total credit granted to the Timor-Leste economy in 2023.

On the other hand, the agriculture sector recorded a reduction in credit granted.

In addition to the “quantity” of loans, it is also important to analyze their “quality”, which can be done based on indicators such as the amount of “doubtful loans” and the system’s provisions for credit risks. It should also be noted that the value of provisions for credit risks is beginning to show an upward trend, with a very high level in 2023, worth \$20.1 million, when, in 2022, it was recorded at a historically low level of \$6.8 millions. However, this increase should be related to the increase in credit granted in 2023. It should also be noted that banking institutions remain quite robust in terms of their ability to face a possible deterioration in credit quality, given that current levels the non-performing loans are very low, 2.3%, and that the sector’s operating profit margin offers a robust basis to finance this eventuality.

Despite the improvement in the quality of financial institutions' balance sheets, the aggregate value of credit has remained at levels much lower than those of deposits captured, providing commercial banks with excess liquidity that tends to be invested preferentially, by banks, in deposits abroad.

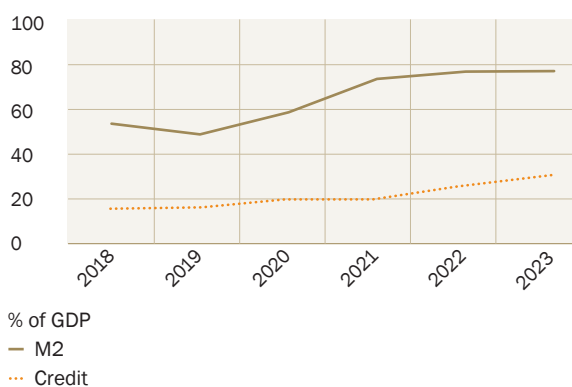
2.3.6. Financial Deepening Indicators

The degree of financial deepening increased by 3.6 pp in 2022 compared to 2021.

The degree of financial deepening, also known as the degree of monetization of the economy, can be measured based on the ratio of M2 to GDP. This ratio rose by 0.3 p.p. in 2023 to 76.8% of GDP (76.5% in 2022), showing the increasing trend seen in the recent past, albeit with some variations. Another indicator that can also be used to monitor the degree of financial deepening is the credit to GDP ratio. This ratio registered a value of 30.3% at the end of 2023, compared to the end of 2022, which registered a value of 25.7%, a percentage increase of 4.6 p.p. after a very significant increase of 5.8 p.p. in 2022.

Chart 2.15

Growth of monetary aggregates



Source: INE-TL and BCTL analysis



2.4

External Sector

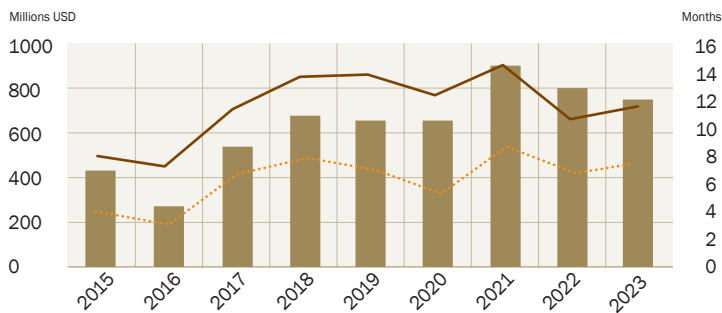
2.4.1. Net International Reserves

At the end of 2023, the balance of Net International Reserves (NIR) stood at \$739 million, which represents a decrease compared to the value recorded in 2022 (\$788 million) but, still, well above the average values observed since 2016. Expressed in months of coverage of total imports of goods and services, NIR corresponded to 8 months last year, which represents a slight increase compared to the 7 months in 2022..

NIR registers a decrease in 2023, however the import coverage rate increased.

Chart 2.16

Net International Reserve



NIR coverage ratio of imports in months

- NIR
- Covered-imports of Goods
- ⋯ Covered-imports of Goods and Services

Source: INE-TL and BCTL analysis



2.4.2. Real Effective Exchange Rate Index

REERI appreciated by 17.6% in 2023.

The Real Effective Exchange Rate Index (REERI) – an indicator used to assess the competitiveness of countries in terms of tradable national products – appreciated by 17.6% in 2023, accelerating the real appreciation already recorded in 2022 (10%), presented in graph 2.17a. It should also be noted that REERI registered greater volatility in 2023 compared to the previous year, explained by the recovery in global economic activity at the same time as there is an increase in internal inflationary pressures in relation to trading partners.

This evolution was mainly due to the contribution of the nominal appreciation of the dollar against the currencies of our trading partners. It should be noted, therefore, that the Nominal Effective Exchange Rate Index (NEERI) registered a year-on-year appreciation of 18.7% in 2023, an acceleration compared to 2022, when a year-on-year appreciation of 6.4% was observed.

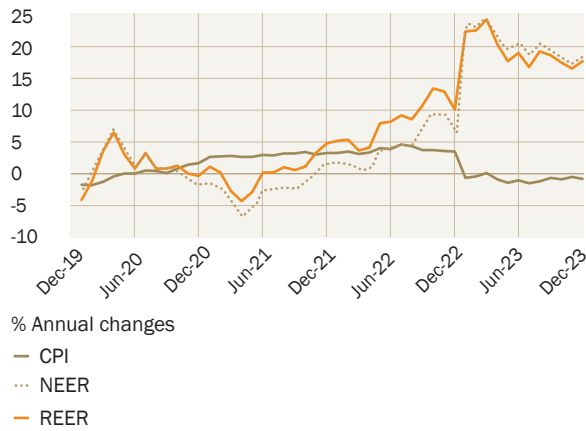
Coffee exports continue to be the country's main export.

In terms of average annual variations (graph 2.17b), REERI registered a significant appreciation at the end of the year of 19.2%, in line with the appreciation recorded in 2022 of 8.2%. In terms of bilateral, specifically in relation to the currencies of Indonesia and China, two of the country's main trading partners, the dollar recorded a notable appreciation of 4.4% against the rupiah and 12.2% against the Chinese Yuan. This evolution followed the trend observed for the global REERI, with an appreciation of the dollar during 2023.

Exports of Coffee continue to be the country's primary export commodity, and almost the only export. However, international prices continue to be the strongest determinant of this type of export, as the respective export volumes are only slightly influenced by the evolution of these effective exchange rates.

Chart 2.17a

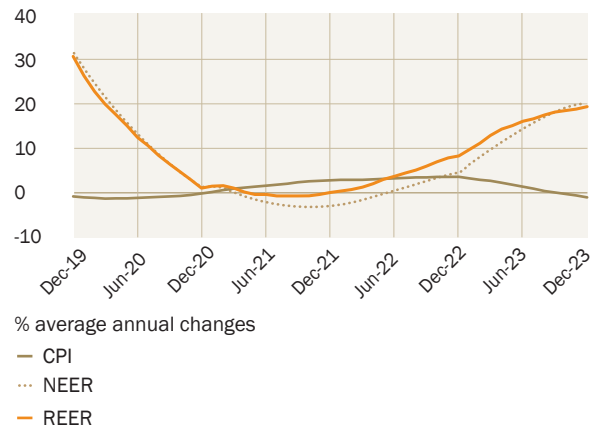
Real Effective Exchange Rate Index



Source: Bloomberg and BCTL analysis

Chart 2.17b

Real Effective Exchange Rate Index - Average



Source: Bloomberg and BCTL analysis

In bilateral terms, it is important to note that the prices of goods imported from Indonesia continue to be more competitive than those of similar goods from China during 2023, which is also confirmed by the greater importance of Indonesia as a trading partner for our economy. However, during 2020 until the beginning of 2022 the prices of these two commercial partners were really competitive.

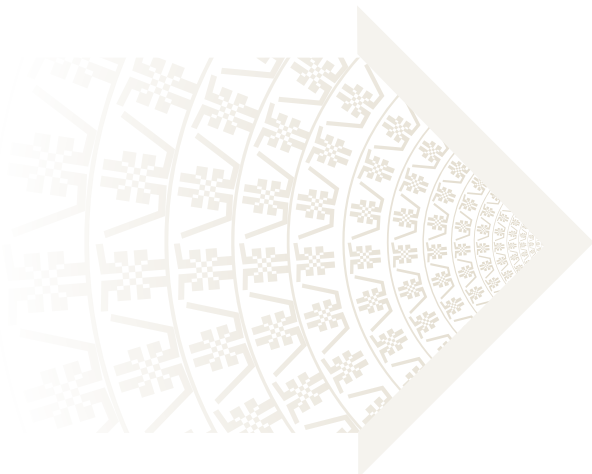
Goods imported from Indonesia are more competitive compared to those from China in terms of price.

Chart 2.18

Selected Bilateral Real Exchange Rate



Source: Bloomberg and BCTL analysis





2.5

Balance of payments

The year 2023 will be marked by a significant worsening of the external deficit.

Timor-Leste's external current account recorded, once again, a significant deficit of -\$601 million in 2023, excluding oil activity (a reduction of \$37 million). However, if oil activities are included, the deficit improved to -\$228 million, although in 2022 this current account was in surplus. The deterioration of the goods balance, from \$894 million in 2022 to -\$149 million in 2023, contributed significantly to this current account deficit in 2023. The reduction in the services account deficit from -\$441 million in 2022 to -\$328 million in 2023, and the significant increase in the primary income contributed to improving the current account deficit in 2023. This current account deficit corresponded to -37% of GDP in 2023, which represents an improvement of 3 pp compared to 2022 and a worsening of more than 400 p.p., if oil activity is included.

The evolution of the current account balance determines the economy's overall net external financing needs, which can be observed through the capital and financial accounts.

Table 2.7.
Balance of Payment of Timor-Leste

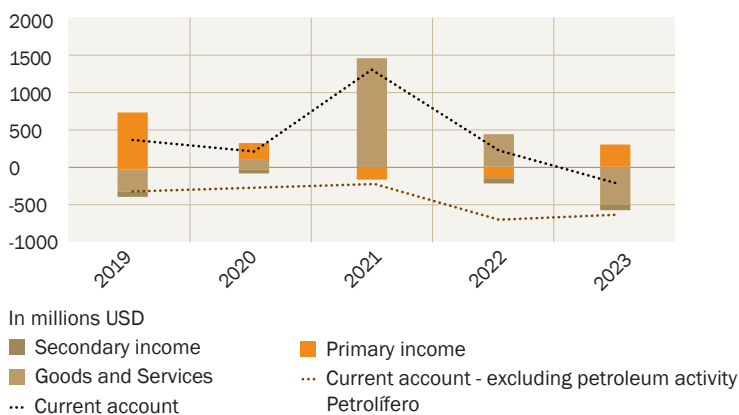
	Million USD			% GDP	
	2022	2023	% change	2022	2023
Current balance -Exc. Petroleum activities	-639	-601	-6	-40	-37
Current account	256	-228	-189	16	-14
Goods account	894	-149	-117	56	-9
Services account	-441	-328	-26	-28	-20
Primary income account	-128	333	-361	-8	21
Secondary income account	-69	-84	21	-4	-5
Capital account	17	4	-75	1	0
Financial account	735	-406	-155	46	-25
Direct investment	395	-13	-103	25	-1
Portfolio Investment	152	-219	-244	10	-13
Other investment	289	-125	-143	18	-8
Errors and Omissions	462	-183	-140	29	-11
Global balance	1,007	-629	-162	63	-39
Reserve assets (change)	-102	-49	-52	-6	-3

Source: BCTL

2.5.1. Current Account

As it can be seen in graph 2.19 below, the current account balance recorded a new deficit in 2023, which, as mentioned above, was mainly due to the increase in imports of goods, while the reduction in the services deficit and the increase of primary income contributed to improving the deficit.

Chart 2.19
Timor-Leste - Current Account Balance



Source: BCTL

The goods account recorded a deficit of \$149 million, representing an increase compared to the surplus observed in 2022.

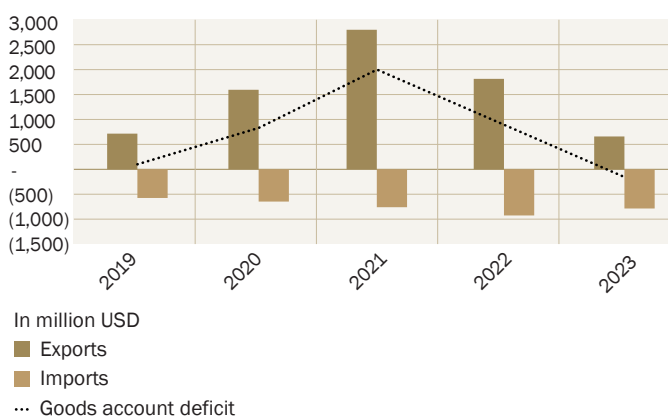
2.5.1.1. Goods Account

In the year under review, the goods subaccount of the trade balance, including the export of petroleum products, recorded a deficit of -\$149 million, which translated into an increase in the deficit compared to the surplus observed in 2022 of \$894 million. This evolution was mainly due to a reduction in the export of petroleum products to \$577 million in 2023 from \$1,745 million in 2022, or dropped by \$1,168 million.

It should also be noted that the increase in exports since 2019 is due to the fact that revenues from petroleum products are now recorded in this subaccount instead of in the primary income account.

Chart 2.20

TL Goods Accounts



However, when oil revenues are excluded from the goods trade account, this subaccount recorded a worsening of its deficit in 2023, valued at -\$679 million, due to the increase in imports of goods during the year, as the country's non-oil exports of goods remain insignificant.

Export of Goods

Indonesia was the main destination for Timor-Leste's exports.

Unlike in 2022, the main destination for our exports during 2023 was Indonesia, with a total weight of 44%, which corresponded to \$7.5 million. In turn, the USA saw its share reduced as the main destination for Timor-Leste's exports by 13 p.p., representing just 13% of total exports, with a total value of \$2.3 million.

Table 2.8.
Destination of Exports

	Millions USD			% Total	
	2022	2023	% change	2022	2023
United State of America	7.6	2.3	-69%	26%	13%
Indonesia	4.0	7.5	89%	14%	44%
Portugal	0.7	1.8	173%	2%	10%
Australia	2.1	1.4	-34%	7%	8%
Germany	3.3	0.1	-97%	11%	1%
Taiwan	0.2	0.7	229%	1%	4%
Japan	1.5	1.0	-32%	5%	6%
Other	10.1	2.5	-75%	34%	14%
Total	29.4	17.3	-41%	100%	100%

Source: INE-TL and BCTL calculation

Import of Goods

According to INE-TL and before the respective adjustments in the balance of payments, the value of imports reduced by \$18 million to \$821 million in 2023, thus contradicting the increase seen in 2022 from 2021 (\$250 million).

On the other hand, imports decreased by \$18 million in 2023.

The main products imported by the country continued to be fuels (23% of the total, compared to 26% in 2022), followed by vehicles (11%) and cereals (9%). It is noteworthy that the majority of the most important imported items recorded an annual increase in their respective import values, partly due to the rise in prices. This increase resulted from the increase in taxes by the previous Timorese government and the inflationary pressures in international markets in 2023. This is the case with vehicles and cereals, electrical machinery, cement, and iron. It is also because of the recovery of domestic demand in the corresponding year that continues to depend on the import of goods produced abroad.

Table 2.9.
Main imports of Goods by Commodities

	Millions USD			% Total	
	2022	2023	% change	2022	2023
Fuels	219	186	-15%	26%	23%
Vehicle	72	94	30%	9%	11%
Cereal	67	78	16%	8%	9%
Beverages	29	9	-69%	3%	1%
Electrical Machinery	38	46	21%	5%	6%
Mechanical Machinery	58	42	-27%	7%	5%
Meat & Derivatives	33	28	-15%	4%	3%
Cement & Substitutes	22	26	19%	3%	3%
Cereal - Refined	26	28	8%	3%	3%
Iron & Steel - Article	20	21	2%	2%	3%
Furniture; bedding, & mattresses	15	19	27%	2%	2%
Iron & Steel	21	31	48%	2%	4%
Others	219	213	-2%	26%	26%
Total	839	821	-2%	100%	100%

Source: INE-TL and BCTL calculation

Fuels continue to account for the largest share of imports of goods.

The geographical structure of imports and their evolution are shown in the table below.

Indonesia continues to be the main seller of goods to the Timor-Leste.

Table 2.10
Imports of Goods – Countries of Origin

	Millions USD			% Total	
	2022	2023	Var % Ano	2022	2023
Indonesia	250	292	17%	30%	36%
China, Peoples Republic of	106	123	16%	13%	15%
Singapura	89	94	6%	11%	11%
Hong Kong	21	20	-3%	3%	2%
Viet Nam	19	20	5%	2%	2%
Thailand	16	12	-25%	2%	1%
Australia	17	15	-15%	2%	2%
Malaysia	54	29	-45%	6%	4%
Japan	10	11	20%	1%	1%
Brazil	17	14	-19%	2%	2%
Portugal	5	4	-14%	1%	1%
Korea Republic of	7	3	-57%	1%	0%
Other	227	182	-20%	27%	22%
Total	839	821	-2%	100%	100%

Source: INE-TL and BCTL calculation

Indonesia, which has remained the country's main trading partner, represented 36% of total imports in 2023. This share rose slightly by 6 p.p. compared to 2022, with the imports of goods from this country growing by 17% to \$292 million. However, it is important to note that the rise in the relative importance of Indonesian goods was due to the stronger decline in the imports from other countries such as Malaysia, Thailand, and Brazil.

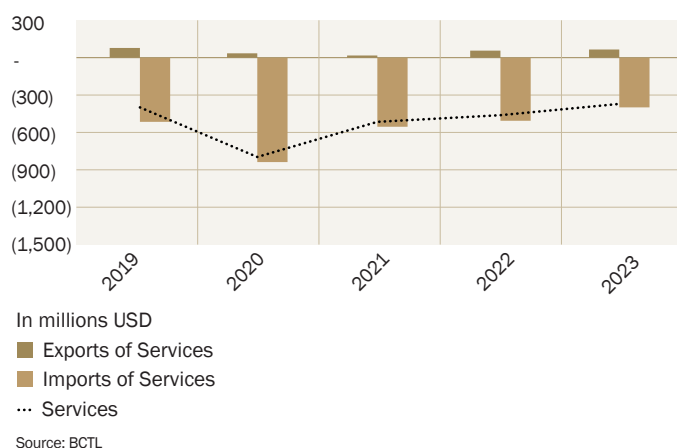
In addition to Indonesia, imports from China and Singapore continued to be the top second and third origin of imports, representing 15% and 11% of total imports in 2023. It is also due to the reduction in the aggregate imports from other countries that are not included in the list of the country's main traditional partners.

2.5.1.2. Service Account

The services account records an improvement of \$113 million, although the balance of this account is still in deficit.

In 2023, the services trade account recorded a deficit balance of -\$328 million, an improvement of \$113 million compared to the deficit recorded in 2022 of -\$441 million. As shown in graph 2.21, this trend was mainly due to the reduction in service imports in 2023, amounting to \$104 million, but also due to a slight increase in service exports of \$9 million in the same year.

Chart 2.21
TL Services Account



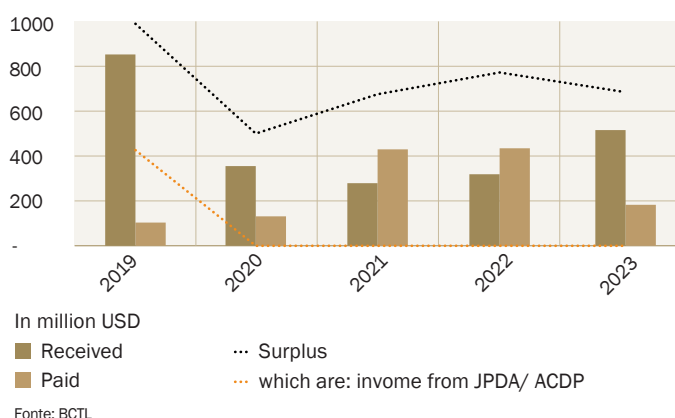
The export of travel services was the sector that grew the most in 2023.

The increase in services exports was essentially explained by the increase in the export of travel services (\$8 million). On the import side, it is worth highlighting in 2023 the reduction in imports of maintenance and repair services (\$34 million), other business services (\$16 million), construction (\$6 million), and imports of services related to manufacturing needs (\$131 million). Conversely, there was an increase in the import of services related to transport (\$6 million) and travel (\$75 million).

2.5.1.3. Primary Income Account

As previously mentioned, oil revenues were no longer recorded in the primary income account since the end of 2019, they were included in the goods subaccount after Timor-Leste ratified the agreement defining maritime borderies with Australia. This change explains the substantial decline in the surplus of the primary income account recorded since then.

Chart 2.22
TL Primary Income Account



In 2023, there was a surplus of \$333 million compared to the deficit value of -\$128 million observed in 2022.

2.5.1.4. Secondary Income Account

There was an increase in remittances from emigrant Timorese citizens, worth \$58 million in 2023.

The balance of the secondary income account recorded a net outflow of resources of \$84 million in 2023, which translated into a substantial increase compared to the negative balance of -\$69 million recorded in 2022.

It is worth highlighting that remittances from foreign workers in Timor-Leste increased again (\$44 million) to \$407 million in 2023. Simultaneously, in the same year, the value of remittances from Timorese migrant workers, once again, recorded an increase of \$58 million to \$239 million, thereby contributing to alleviating the impact of the growth of remittances sent in the deficit of the subaccount.

2.5.2. Financial Account

The portfolio investment contributed the most to the financial account in 2023 than the contribution of the foreign direct investment.

In the period under review, the financial account, which includes flows related to the economy's external financing sources, recorded a net financing need of \$406 million, which corresponds to an increase compared to the net financing capacity of \$735 million in 2022.

Despite the significant contribution of portfolio investments resulting from PF investment abroad, amounting to -\$219 million, the increase in foreign direct investment in the country, which represents an increase in the country's liability to the abroad, also contributed to the increase in the financing need of the financial account. This subaccount registered an increase of -\$13 million compared to the value of \$395 million observed in 2022. This variation demonstrates that, unlike the previous year, in 2023 the country has a significant need of net financing.

Table 2.11

Source of Financing

	Millions USD	
	2022	2023
Financial Account	735	-406
Direct Investment in TL	395	-13
Portfolio Investment	152	-219
PF investment abroad	152	-219
Other Investment, Asset	366	-64
Other Investment, Liabilities	77	61
Changes in Reserves	-102	-49

Source: BCTL



2.6

Banking system

2.6.1. Bank Assets

The banking system in Timor-Leste remained stable and solid during the period under review. The sector continues to be financed practically based on resident deposits, lending only a fraction of these resources to companies and individuals, meaning that, as a whole, the banking system continues to record a very high level of liquidity.

The tables and graphs that follow provide a set of information about the country's banking system, which was constituted, at the end of 2023, by a bank based in Timor-Leste – the Banco Nacional de Comércio de Timor-Leste – and local branches of four important foreign banks, based in Portugal (CGD/BNU), Australia (ANZ) and Indonesia (Banco Mandiri and BRI), plus two other deposit-taking institutions and financial service providers Moris Rasik, SA and Kaebauk Investment and Finance, SA.

Total banking system assets once again recorded a slight growth of 5% to \$2,441 million, slowing down compared to the significant increase seen in 2022 (27%), resulting in an increase of +\$106 million. The growth recorded in total assets in 2023 was lower than the growth recorded since 2019. The positive evolution seen in 2023 results mainly from an increase in deposit at

It is worth highlighting the robustness of Timor-Leste's banking system.

Total banking system assets grew 5% to \$2,451 million in 2023.

the central bank of \$105 million, and an increase in credit granted ¹ (+\$63.6 million), but with a reduction in investments (-\$13 million) and deposits in credit institutions (-\$53 million), respectively.

Tables 2.12

Composition Banking System Assets

In millions USD	Dec-22	Dec-23	% share	Change	
				%	Valor
Cash & BCTL Balance	203	308	13	52	105
Placement at Credit Institutions (oter banks)	1,598	1,545	63	-3	-53
Investment	144	131	5	-9	-13
Credit Granted	356	420	17	18	64
Tangible Asset	15	16	1	11	2
Other Asset	20	22	1	9	2
Total	2,335	2,441	100	5	106

Source: BCTL

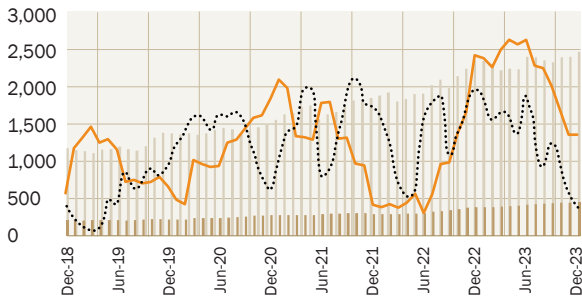
It is worth highlighting the importance of deposits in credit institutions for the composition of the assets of Timor-leste's banking sector.

It should be noted, once again, and as seen in previous years, that the growth rate of credit granted has registered a high growth rate, showing a similar trend (as shown in graph 2.23) to the growth rate of assets, thus contributing to the growth rate of assets in the banking system of Timor-Leste, thus translating into a sustained growth in the relative importance of credit in all the set of applications of commercial banks.

¹ The net credit, which excludes provisions for non-performing loans (NPLs), results in an increase in total assets.

Chart 2.23

Evolution of Banking Asset



USD millions and % annual change

- Banking asset
- Total credit
- % change in credit
- % change in asset

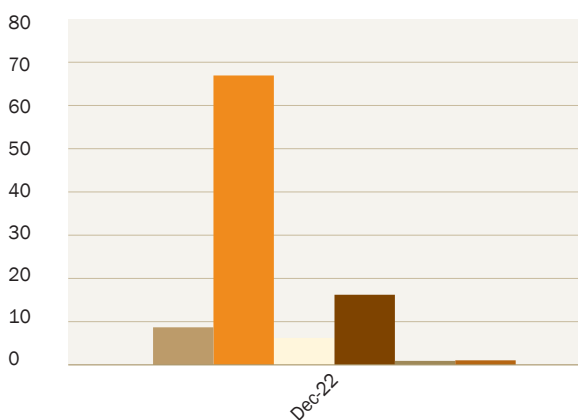
Source: BCTL

The investment of funds with other banking institutions continued to represent the largest proportion of banking assets, reaching 63% of the asset structure at the end of the year in 2023, registering a reduction compared to 2022. In more detail, while the investment of funds with other banking institutions decreased from 68% in 2022, to 63% in 2023, that is, a reduction of 7 p.p. compared to 2022, in 2022, the same proportion had increased by 8 p.p. compared to the value recorded in 2021, where the weight of assets in asset institution represented 60% (graphs 2.24a and 2.24b). This decrease was mainly due to the increase in the weight of applications in BCTL and credit granted.



Chart 2.24.a

Composition of Banking Asset

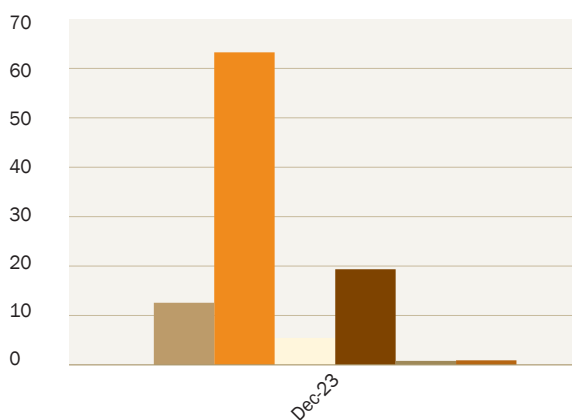


- % of total asset
- Cash & BCTL Balance
- Placement at credit institutions (other banks)
- Investment
- Total credit
- Tangible asset
- Others

Source: BCTL

Chart 2.24.b

Composition of Banking Asset



- % of total asset
- Cash & BCTL Balance
- Placement at credit institutions (other banks)
- Investment
- Total credit
- Tangible asset
- Others

Source: BCTL

Credit granted occupies the second largest proportion in the structure of banking assets (17%), as in 2022, when the proportion of credit granted was 15.3%. The value of the bank credit portfolio reached \$420 million at the end of 2023, which compares with the value of \$356 million at the end of 2022, growing by 18% throughout the year, despite the challenging macroeconomic environment and structural issues related to legal issues.

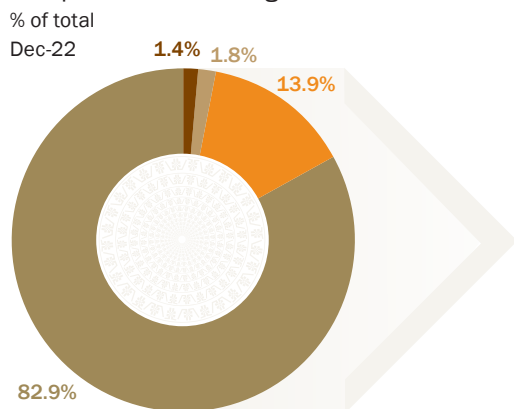
In December 2023, the overall value of deposits with BCTL amounted to \$308 million, which corresponds to 12.6% of total assets, registering an increase compared to the value of \$203 million recorded at the end of 2022 (8.7% of the total asset).

2.6.2. Bank Liabilities

In 2023, deposits from customers represented more than 71.5% of bank liabilities.

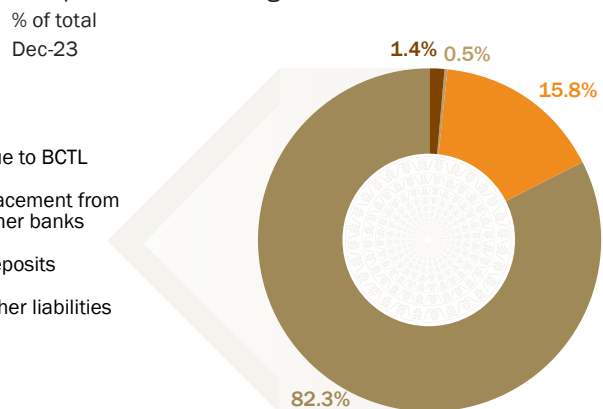
Raising customer deposits continues to represent the largest source of funds for credit institutions. Deposits raised represented 71.5% of banks' liabilities and capital at the end of 2023, increasing by \$28 million in 2023, when in 2022 deposits were \$1,718 million and represented 73.6% of liabilities and capital availability.

Chart 2.25a
Composition of Banking Liabilities



Source: BCTL

Chart 2.25b
Composition of Banking Liabilities



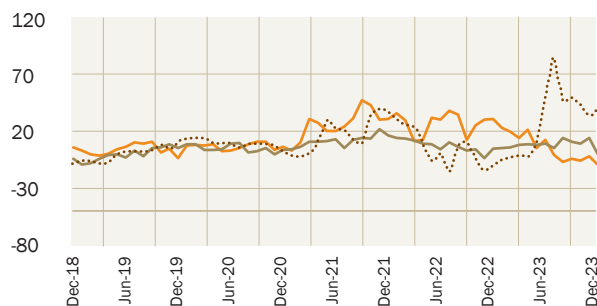
Source: BCTL

In 2023, resources obtained from the Central Bank increased by \$29 million, representing a total of 0.5% of total resources, while deposits owed to other financial institutions increased, once again, by \$61 million, representing 15.8 % of consolidated liabilities. It should be noted that deposits received from other financial institutions have registered a persistent increase.

Time and savings deposits collectively increased by \$117 million in 2023.

In terms of the type of customer deposits, demand deposits decreased by \$90 million in 2023, while time and savings deposits recorded an increase of \$112 million and \$5 million, respectively.

Chart 2.26
Deposit Growth

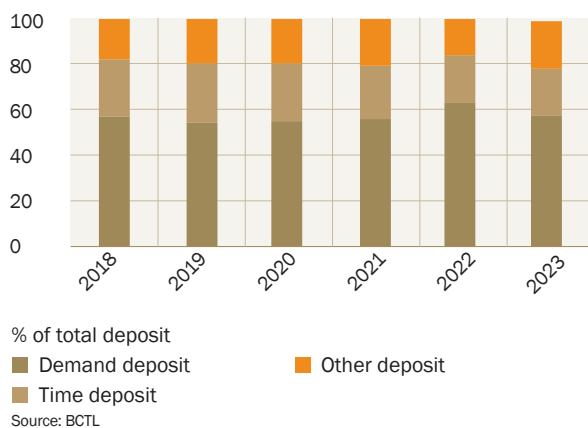


However, demand deposits maintain their importance in the structure of deposits

% annual growth rate
 — Demand deposit
 — Saving deposit
 ... Time deposit
 Source: BCTL

Due to these variations, the deposit structure registered a growth trend in time deposits, contrary to what was observed in 2022. However, demand deposits lost some importance in the deposit structure (-6.1 p.p. compared to 2022), representing a total of 58% of the deposit structure. The demand deposits thus continued to represent the largest component of total deposits.

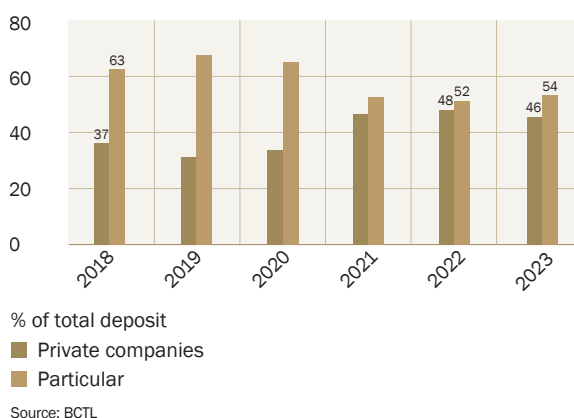
Chart 2.27
Composition of deposit



In terms of ownership of deposits in banks, there was, as observed in 2022, an increase in deposits held by private residents, with individual deposits increasing in importance to 54% of total deposits, while the share of deposits of private companies reduced to 46% of the total deposits in 2023. Despite the reduction, there is a significant increase in the share of the private company's deposits in the total resources raised, when compared to their relative average share of the last 10 years from 2011 to 2020, which stood at 31%.

Chart 2.28
Share of Deposit by Ownership

2023 will be marked by greater convergence in deposit ownership, a trend that began in 2021.



As can be seen in the previous graph, there was a slight increase in the absolute value of deposits from individuals of \$30 million, and this increase contributed to explaining the relative increase in deposits of individuals in total deposits in 2023, while the deposits of companies reduced, but only by \$12 million in the same year.

2.6.3. Bank Profitability

Bank revenues, consisting of interest received and commissions charged to their customers, amounted to a total of \$99.4 million, registering a significant increase of \$39.4 million compared to 2022.

Bank revenues increased significantly to \$84.1 million in 2022 from \$25.8 million in 2021.

As a result of their activity, the banks presented the following consolidated results in 2023, which are compared with the corresponding values for 2022 in table 2.13 below:

Table 2.13
Consolidated Income of Banking System

Items	In Millions USD		% annual change	% Gross Op. Income	
	2022	2023		2022	2023
Interest Received	48.9	98	100.2%	81.5%	98.4%
Interest Paid	5.1	14.3	179.6%	8.5%	14.4%
Net Interest Income	43.8	83.5	90.9%	73.0%	84.0%
Commission & Other Op. Revenues	16.2	15.9	-2.0%	27.0%	16.0%
Gross Operating Income	59.9	99.4	65.8%	100.0%	100.0%
Provision & Impairments	-2.2	-8.8	297.3%	-3.7%	-8.9%
Operational Expenses	-28.2	-32.7	16.0%	-47.0%	-32.9%
Net Operating Income	29.5	57.9	95.9%	49.3%	58.2%
Extraordinary Income/Expenses	1.1	0.3		1.8%	0.3%
Net Income Before Taxes	30.7	58.2	89.7%	51.1%	58.5%
Income Taxes	-2.4	-5.3	119.7%	-4.0%	-5.4%
Net Income	28.2	52.8	87.1%	47.1%	53.1%
RoA % - Return on Assets	1.2	2.2	80.3%	2.0%	2.2%
RoE % - Return on Equity	12.9	20.0	55.0%	21.5%	20.1%

The profitability of assets and capital grew significantly in 2023.

As we can see, interest received grew by more than 100% in 2023 compared to 2022. The gross operating income of Timor-Leste's banking system recorded an increase of \$39.4 million, translating to a growth of 65.8% compared to 2022. Therefore, the net operating income grew by \$28.3 million compared to 2022, which is equivalent to a growth of 95.9%.

Finally, taking into account extraordinary income and costs and taxes on profits for the year, the system's consolidated net income increased to \$52.8 million in 2022, compared to \$28.2 million recorded in the previous year.

This increase explained the increase in return on assets (RoA, or Return on Assets) observed in 2023 to 2.2%, compared to 1.2% seen in 2022, as well as the growth in return on equity (RoE, or Return on Equity) for 20%, when, in 2022, this return was 12.9%. Banks continue to maintain liquidity ratios higher than those required by the Central Bank and the regulatory framework in force.

2.6.4. Transfer Services

2.6.4.1. Remittance Transfer – Commercial Banks

The number of transfers decreased by 40% in 2023 compared to 2022.

During 2023, money transfer services, reported by commercial banks operating in Timor-Leste, recorded a total of transfers abroad of around 124 thousand transactions, with an aggregate nominal value of \$2,194 million. The number of operations carried out reduced by 39.8% and the total value transferred decreased by 37.4%, compared to 2022.

The negative net balance of transfers registered a significantly high value in 2023.

At the same time, the number of transfer transactions received decreased by 41% in 2023 to 100 thousand transactions, with the value received also decreasing by 43% to \$812 million.

Therefore, the net balance of transfers received and originated by commercial banks recorded a substantial negative growth, reaching -\$1,382 million in 2023, when compared to the also negative balance of -\$2,078 million in the previous year.

Personal transfers continue to be the largest share of total transfers in 2023.

2.6.4.2. Transfer of Remittances – Specialized Operators (OTO) Em In 2023, the group of Other Money Transfer Operators (OTOs) recorded a total value of transfers to abroad of \$202 million, compared to \$196 million in 2022. Transfers originating from abroad through these operators recorded, in 2023, an amount of approximately \$204 million, compared to the \$147 million recorded in 2022. This evolution led to an improvement from the deficit balance observed in 2022, with the amount of -\$49 million, to a surplus value of \$1,973 million in 2023.

Personal transfers continued to represent the largest share, both in terms of inflows and outflows, amounting to 40% and 82% of total transfers, respectively. Personal transfers combine reasons of transfers for ‘family’, ‘education’ and ‘savings’ generated from the transfer operations.

In geographic terms, the majority of inflows continued to come from Europe, accounting for \$98 million in 2023 (48% of the total), compared to \$80 million in 2022, and were mostly explained by the sending of remittances from Timorese workers living and working in Europe. Remittance outflows operated by OTOs were, for the most part, routed to the Asian region, totaling an amount of \$179 million, with Indonesia being the largest destination for transfers from Timor-Leste, with a total of \$159 million, which equivalent to 79% of the total. This amount is explained by remittances sent by Indonesian citizens who reside and work in Timor-Leste.

Europe continues to be the main origin of remittances.

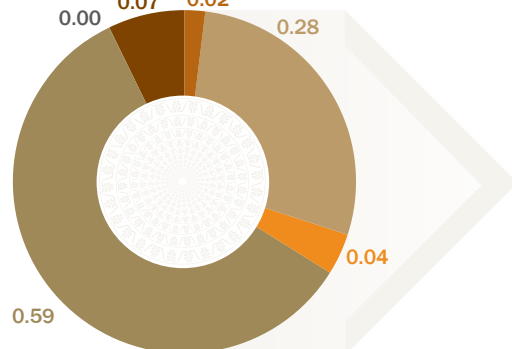
Graphs 2.29a and 2.29b show the weight of transfers made to and from Timor-Leste, by purpose, using the services of money transfer operators in 2023.

Chart 2.29a

Outward Transfers, by purpose (OTOs)

% of total

Dec-22



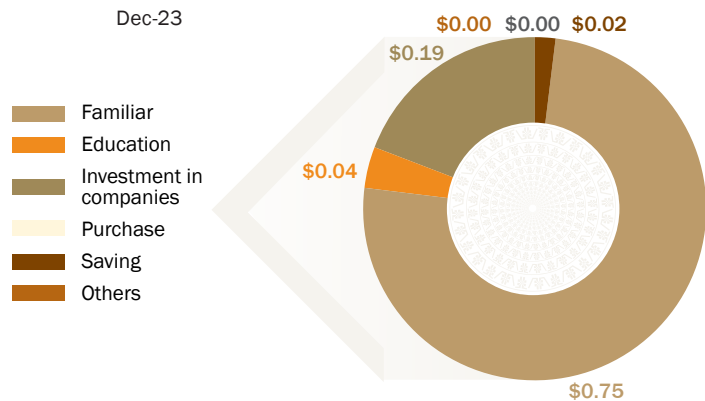
Source: BCTL

Chart 2.29b

Inward Transfers, by purpose (OTOs)

% of total

Dec-23



Source: BCTL

