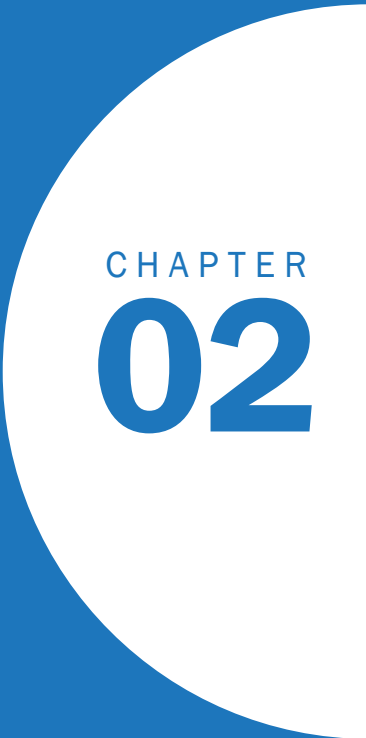


Recent Evolution of the National Economy

This chapter details the evolution of Timor-Leste's economy in 2022 and the respective projections for 2022 and 2023, also highlighting the main developments in our country's public, financial, and external sectors.





CHAPTER
02



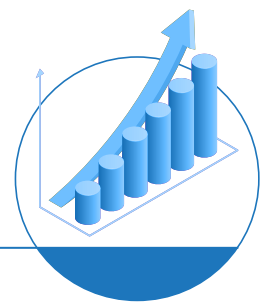
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As described in more detail below, the main developments concerning the national economy consist of:

- The economy of Timor-Leste registered an acceleration of the GDP growth rate in 2022, continuing the growth trajectory after the recession felt with the COVID-19 pandemic. The growth rate of 4.0% in 2022 compared to 2021, is mainly because of the increase in public spending during the year, valued at \$299 million (+21%). Also of note is a slight slowdown in household consumption in 2022, while there was a growth in exports. However, our forecasts also consider the negative impacts of increased inflationary pressures and reduced consumer purchasing power.
- For 2023, the BCTL foresees a continuation of the economic recovery, although it forecasts a deceleration of economic growth to 3.1%. This expectation is based on a slowdown in the contribution of domestic demand growth in 2023 compared to that observed in 2022, while, on the other hand, the contribution of net external demand increases. Public consumption is also expected to grow by 2.4% and household consumption by 1.4% in 2023 relative to 2022. In contrast to 2022, we expect public investment to decline slightly (-0.4%), contrary to the significant increase observed in 2022 relative to 2021 (\$34 million)
- In terms of fiscal policy, 2022 was marked by a significant increase in expenditure (+\$299 million) and in the public deficit, due to the increase in current expenditure (+18%), in line with the increase in the respective budget and following the same dynamics already observed in 2021. Also noteworthy is the growth in public investment in 2022 (\$63 million), due to a higher execution rate of the respective budget. For 2023, the BCTL expects a new increase in expenditure and in the public budget deficit, mostly explained by the recovery of the capacity to execute investment in infrastructure and buildings, so that fiscal policy will continue to support the economic recovery from the pandemic crisis of 2020.
- In line with the global trend, there was a notable increase in domestic inflationary pressures in 2022, with the average inflation rate standing at 7.1%, up from 3.8% and 0.5% in 2021 and 2020, respectively. The rise in inflation was mainly due to worsening external inflationary pressures, explained by the robustness of the recovery in global demand and the persistence of global production and logistics constraints in 2022, as well as the outbreak of war in Ukraine that has put pressure on food and energy commodities. In terms of the outlook, the BCTL anticipates an acceleration of inflationary pressures throughout 2023, followed by a marginal easing of the inflation rate this year, forecasting an average inflation rate of 6.9%.

- Timor-Leste continued to register a deficit in the external current account, which registered a significant increase in 2022, registering in this year the negative value of \$950 million, explained by the growth in imports of goods and services. Although oil revenues have registered a significant decrease over the last few years, they continue to be a factor in mitigating the impact of the high trade deficit on our country's current account balance. However, the mitigation of oil activity was substantially lower in 2022 than in previous years.
- Notwithstanding the challenging macroeconomic context, the financial sector continued to remain robust and highly dynamic in terms of the growth of its captivity, assets and funds raised. It is illustrative to note that bank credit continued to grow in 2022, as did deposits and funds raised by banks operating in the country.





2.1 Economic Activity and Inflation

2.1.1. Economy - Recent Developments and Global Prospects

In 2022, according to the projections made by the BCTL, the domestic economy will have recorded an acceleration in its economic growth, registering in this year a 4.0% increase in GDP compared to 2021, a year that also displayed a growth rate of 2.9%, after an economic recession in 2020, when real GDP contracted by 8.3%.

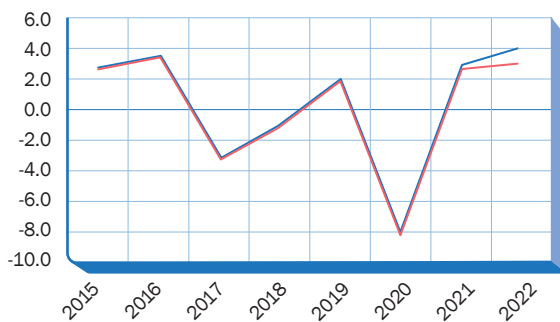
In 2022, the GDP growth rate accelerated to 4.0% from 2.9% in 2021.

The economic growth registered in 2022 counted with the important contribution of the public sector, whose contribution totaled almost 60% of the real GDP verified in 2022. In fact, the public sector registered an increase in expenditure of \$299 million in 2022 relative to 2021, an increase that was still slightly lower than that registered in 2021 relative to 2020 (just over \$306 million USD). In proportional terms, this increase in public spending represented a year-on-year change of 21%. Additionally, investment, as well as exports represented a growth rates.

Economic growth was mainly due to the contribution of public spending.

Chart 2.1a

Real GDP Growth



% change year

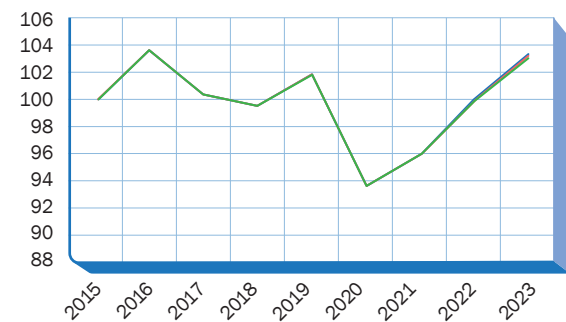
— BCTL

— MdFinancas

Source: BCTL, 2023 propose Budget, and IMF

Chart 2.1b

Real GDP



2015=100

— BCTL

— FMI

— MdFinancas

Source: BCTL, 2023 propose Budget, and IMF

As mentioned, the recovery in growth in 2022 was due to the increase in the public sector, as well as in private demand, which recorded a net positive contribution of 3.7 p.p. in the 4% growth rate in 2022. However, the increase in domestic demand may have negative implications on net external demand. In the case of 2022, and despite the economic growth rate verified, we can see that total imports increased, albeit slightly. However, and even though imports increased not only in absolute value, imports as a percentage of GDP decreased marginally (46.9% of GDP in

Private demand represented a positive impact of more than 90% of the growth rate observed in 2022.

2022 versus 47.6% of GDP in 2021). In terms of net exports, there was an external deficit in 2022 of \$686 million and corresponding to 43.2% of GDP, in line with the figure reached in 2021, when there was a negative balance of net exports of \$688.5 million, equivalent to 45% of Timor-Leste's GDP.

When we disaggregate the various components of real GDP, we can see that, regarding the public sector in 2022, its contribution to the observed growth rate was essentially due to an increase with the public administration wage bill by 13.4% compared to 2021, an increase in public investment by 64.3% and a growth in transfers in the order of 34%. On the other hand, consumption of goods and services fell by 3.3% in 2022 compared to 2021. Still, and despite this increase in the assorted items, it should be noted the high degree of budget execution that allowed the public sector to contribute significantly to economic growth.

About private demand, the BCTL estimates that household consumption had a negative impact on the evolution of GDP in 2022, given that the consumption of these economic agents registered a slight decrease of 0.4% compared to 2021, contributing, in 2022 with an amount of \$962 million. At the same time, there was a significant decrease in private investment of 26% compared to 2021, totaling \$38 million, offset by the 19.6% growth in public investment in 2022, which registered \$204 million.

In 2023, a growth rate of 3.1% is projected, representing a slower pace compared to the observed rate for 2022.

Regarding the projections for the year 2023, the BCTL foresees a positive evolution of GDP, despite forecasting a slowdown in economic growth for the current year. According to the estimates made, it is projected that in 2023, the economy of Timor-Leste may register a positive growth rate of 3.1% compared to 2022. This projection for 2023 is based on a 2.3 p.p. contribution from domestic demand, which represents a slowdown in this contribution of 3.7 p.p. recorded in 2022, and on a 0.6 p.p. increase in the contribution of net external demand in 2023 (the contribution of net exports for the 2023 growth rate is 0.8 p.p.). In fact, and according to the projections made, the negative balance of net exports is projected to decrease, essentially explained by a decrease in imports of goods and services to values close to 41% of GDP in 2023, thus increasing the contribution of net external demand to economic growth in 2023, despite the already mentioned reduction of the slowdown in the contribution that domestic demand will have in 2023.

Regarding the consumption dynamics of Timorese families, it is expected that this should increase by 1.4% in 2023 compared to 2022, which represents a reversal of the negative trend recorded since 2022, when a reduction of 0.4 p.p. is expected, totaling in 2023 an amount of approximately \$981 million. Regarding investment, both public and private investment are expected to register a negative variation, in the same direction as that observed in 2022 relative to 2021. In detail, a growth rate of public investment of -0.4% is expected, as well as a decrease in private investment of about 1.1% in 2023 compared to 2022.

For 2023, the private sector of the economy is expected to reduce its importance...

In summary, the projections made by BCTL maintain a more conservative outlook for the economic development of Timor-Leste in 2023, which is mainly due to a slowdown in the private sector of the economy, given that there is some stagnation, and even reduction, of private demand in the economy, only offset by an increase in public spending in 2023, of 1.4%. Depending on the developments forecast for 2023, the BCTL estimates that 2023 will already see a level of real GDP almost 3 p.p. higher than in 2019, which was interrupted by the COVID-19 pandemic, with all its negative economic and social consequences.

To 2022, and when comparing the estimated values for Timor-Leste's real GDP dynamics with the Ministry of Finance and the IMF, the BCTL's values present a greater optimism. Specifically, while the BCTL forecasts a 4.0% growth in 2022, the Ministry of Finance and the IMF present a more conservative value for the real GDP growth rate of 2.7% and 3.3%, respectively.

The economic projections made by the BCTL are in line with other national and international institutions.

Finally, it should be noted that this scenario of projections for 2022 and 2023, as happened between 2017 and 2020, once again confirms the excessive weight of the public sector in the domestic economy, thus delaying the economic development led by private productive sectors and that can contribute decisively to greater resilience in the face of constant negative net export balances, which could compromise economic sustainability in the medium and long term. Only with greater promotion of the most productive sectors of activity will it be possible to create quality jobs, especially for the younger population, and thus be able to better remunerate both productive factors and, on the other hand, to promote a more robust and intergenerationally sustainable economic development.

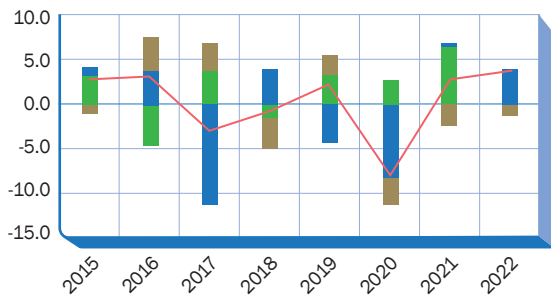
2.1.2 Evolution of the GDP - Optics and Components

Although there are only official estimates of Timor-Leste's National Accounts up to 2021, BCTL has internally developed a model that allows it to estimate the evolution of the most relevant components of domestic and external demand in more current terms, and thus assess the evolution of GDP and its aggregates in 2022. In this sense, the analysis that follows is based on the official data from the DGE up to 2021 and on the BCTL estimates for 2022, seeking to focus on the medium-term trends most relevant for our domestic economy.

According to the National Accounts of Timor-Leste projected by BCTL, there was an acceleration of the real growth rate of the non-oil Gross Domestic Product (GDP) in 2022 of 4.0%, after already observed a positive GDP growth rate in 2021 of 2.9%. The resumption of growth in 2021, like other countries, was due to the normalized recovery of economic activity after the restrictions on the freedom of movement imposed caused by the COVID-19 pandemic, felt in 2020 and still a little in 2021.

Chart 2.2a

Real GDP growth - Expenditure approach

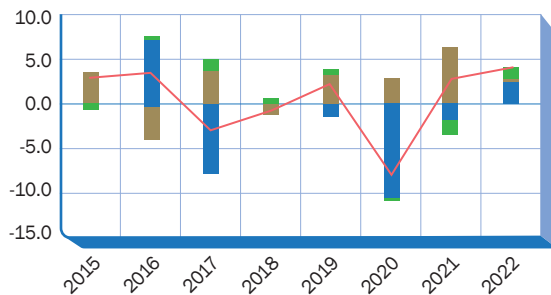


annual % change and p.p. contributions
█ External Demand █ Public Sector
█ Private sector — GDP

Source: DGE and BCTL

Chart 2.2b

Real GDP growth - Expenditure approach



annual % change and p.p. contributions
█ Domestic Demand █ External Demand
█ Changes in inventories — GDP

Source: DGE and BCTL



According to these projections, the increase in GDP was mostly due to the acceleration of activities related to public consumption, which contributes with more than 70% (3.7 p.p. for a 4.0% growth rate of GDP in 2022), representing almost 63% of GDP in 2022, a slight decrease from the 64% in the 2021 GDP.

In 2022, public investment registered a positive growth rate.

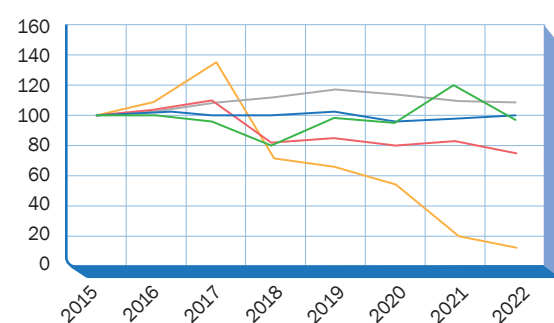
Regarding the perspective of expenditure, as already mentioned and according to the graphs below, we stress that the recovery of the economy in 2021 and 2022 is due to a greater contribution of consumption and public investment, caused by increased spending by the government of Timor-Leste in these 2 years. This relevance of the evolution of public demand for the trajectory of our economy has been, in fact, one of the main trends of our economy in the last decade.

The chart showing the evolution of real GDP and of private and public demand since 2015 confirms that the downward trend in the level of activity (GDP) from 2016 to 2020 was due to the gradual reduction in public demand, while the increase in public expenditure between 2021 and 2022 explains the resumption of GDP growth after 2020. It should also be noted that private demand has recorded some growth since 2016, albeit moderate, and for this reason, the contribution of the private sector of the economy will not have been sufficient to offset the decrease in the public sector and the corresponding impact that it has had on the evolution of the economy of Timor-Leste in recent years.

In charts 2.2c and 2.2d, below, we present the evolution of the subcomponents of private and public demand, compared with the trajectory of GDP since 2015.

Chart 2.2c

Real GDP and Private Demand



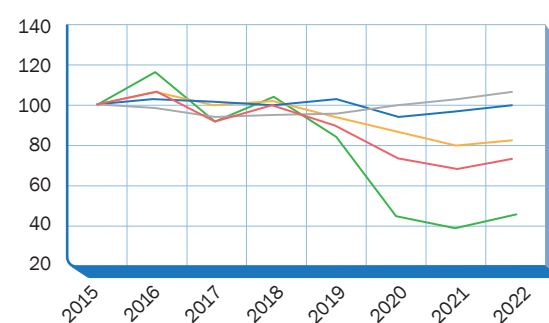
2015=100

— GDP — Private Demand — Households cons.
— Invest. Households — Firms

Source: DGE and BCTL

Chart 2.2d

Real GDP, Public Demand and Imports



2015=100

— GDP — Public demand — Public consumption
— Public investment — Imports

Source: DGE and BCTL

The year of 2022 is also marked by a no total recovery from the reduction in economic activity recorded during the pandemic of COVID-19.

In what concerns the demand of the private sector of the economy, it should be noted that it has shown a less volatile trajectory than the trajectory of GDP since 2016, a phenomenon explained by the dynamics of private consumption. In contrast, private investment has been the worst performing subcomponent of private demand, particularly since 2017, which will be 96.6% below its 2015 level by 2022. This dynamic is alarming for the future of Timor-Leste's economy. With this trajectory in the short and medium-term, we may see an economy excessively dependent on public investment, which increased in 2022 compared to 2021 and which could jeopardize the resilience of the future economic development of Timor-Leste. The negative dynamics of investment in the private sector of the economy has very severe impacts on the future productivity of the economy of Timor-Leste, with unpredictable consequences on capital income and, consequently, on the labor factor.

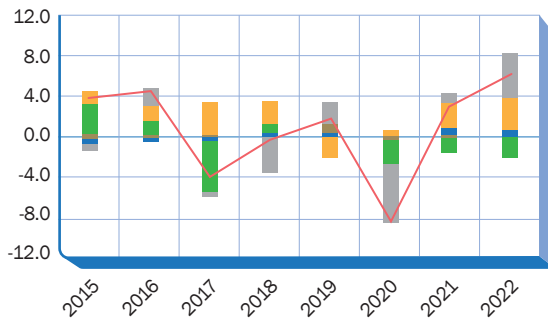
Despite the positive dynamics of public investment in 2022, it must be strengthened in order to promote a long-term sustainable development.

As for public sector demand, it has shown much lower amounts when compared to 2015. In particular, the value of public demand in 2022 represented only 76% of the value observed in 2015. A negative contribution to this fact is the fact that public investment only accounts for 45% of the value recorded in 2015, thus elucidating the impact that the fall in public investment represents for 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 decisions. In this sense, public investment should be strengthened in order to increase the infrastructure necessary for the development and promotion of the private sector, namely 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 dynamism of economic activity in Timor-Leste. More specifically, it is highlighted that in 2022, and even in 2021, the other services sector, in addition to public administration, have decisively contributed to accelerate economic growth. In 2022 there was also a greater contribution from manufacturing, which is an important sign for the future development of the secondary sector of the economy. By 2022, the manufacturing industry is expected to have surpassed the levels of value added to the economy that were recorded in 2018, and if the trend observed in 2022 continues, it is projected to reach values close to those reached in 2019, the year before the COVID-19 pandemic occurred. Conversely, and recording the sector that contributed to the performance of the economy in 2022, the construction sector stands out, which continued to decline since 2016, although a marginal increase in 2019.

Chart 2.3a

Real GDP Growth - Production approach



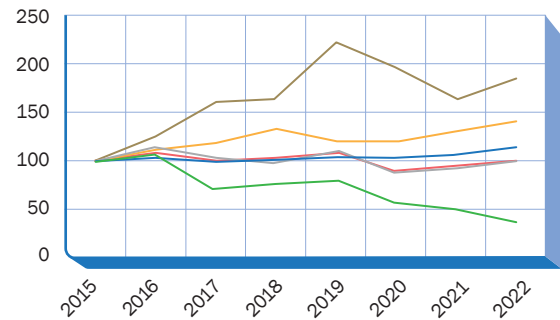
Annual percentage changes and p.p. contributions

- Agriculture
- Construction sector
- Other services
- Manufacturing sector
- Public administration
- Non-oil GDP

Source: DGE and BCTL

Chart 2.3b

Real GDP - Production Sectors



2015 = 100

- Agriculture
- Construction sector
- Other services
- Manufacturing sector
- Public administration
- GVA

Source: DGE and BCTL

In terms of the outlook for 2022 and 2023, we note that the recovery in GDP growth should be driven more, in 2022, by the growth of services, construction, and manufacturing, together with the growth forecast by the public sector. Naturally, the growth of public expenditure, namely the growth of public investment may lead through the effects of fiscal stimuli to promote the growth of the other sectors previously discussed.

When the GDP is analyzed resorting to the production approach, it should be highlighted the contribution of construction services and manufacturing for the economic development in Timor-Leste.

Since 2015 and until 2022, according to what we can see in graph 2.3c, the main change in the production structure consisted of significant decreases in the weights of the construction sector (from 17% to 7% of GVA) while there is an increase in the contribution of public administration, from 24% in 2015 to almost 33% in 2022. The services sector continued to maintain its dominant position in the economic structure, accounting for 39% of GVA in 2022, up from 40% in 2015.

As for 2022 and 2023, the BCTL expects this production structure to remain relatively stable, with the exception that the importance of the manufacturing sector is expected to grow slightly as a result of the expected recovery in private and public investment.

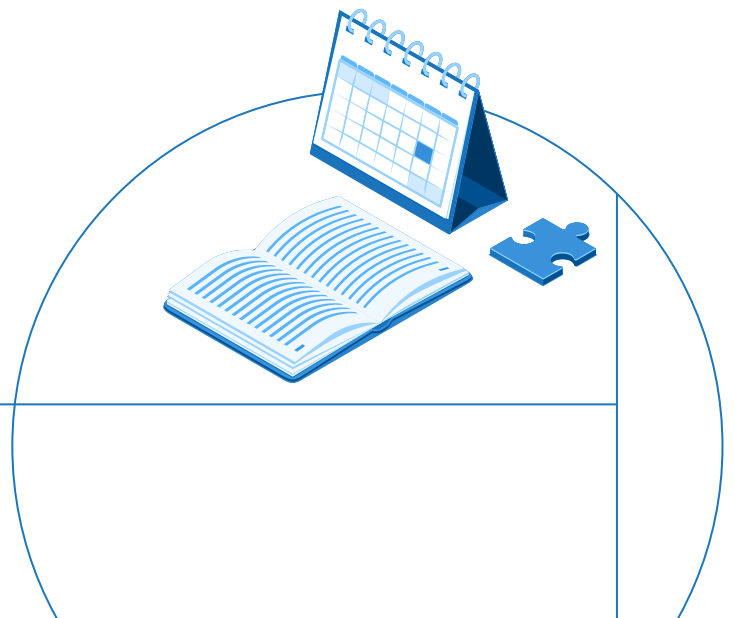


Chart 2.3c

GDP composition by production sectors

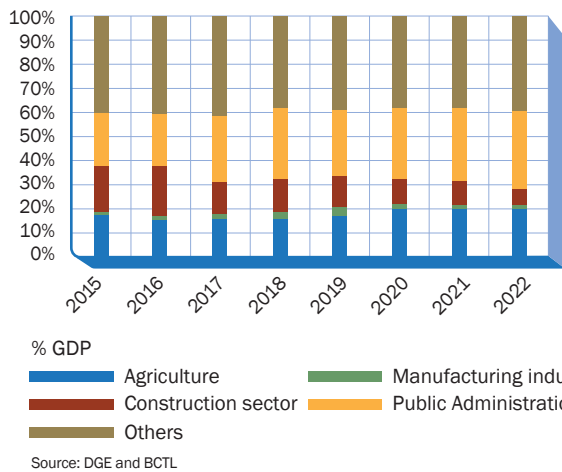
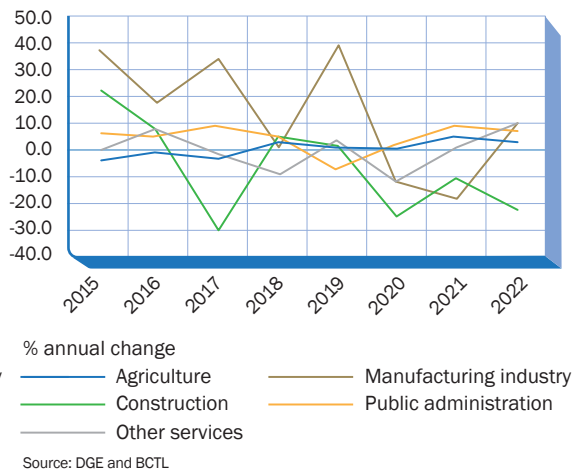


Chart 2.3d

Sectoral Growth Rates



The industrial sector has seen a very appreciable development, growing by more than 360% in the last 7 years.

On the positive side, the industrial sector has seen a remarkable expansion of its activity, with its GVA growing 367% between 2015 and 2022. Yet, despite this robust expansion, this sector continues to represent an insubstantial share of the domestic economy, accounting for only 6.9% of GDP in 2022, to the detriment of other sectors of economic activity.

This productive structure shows that the country's economy continues to depend heavily on the public sector, since the sectors less dependent on the State - agriculture, fisheries, industry, hotels and restaurants - would only represent 39% of GDP in 2022, with the weight of these sectors being relatively stable in the economy of Timor-Leste.

Despite the significant increase in the industrial sector, the anemic growth of the agriculture and fisheries sector, which has recorded a cumulative growth of 11.7% since 2015, coupled with weak dynamics of other activity sectors between 2015 and 2022 already described above, have resulted in a limitation of the economic development of these sectors less dependent on the public sector.

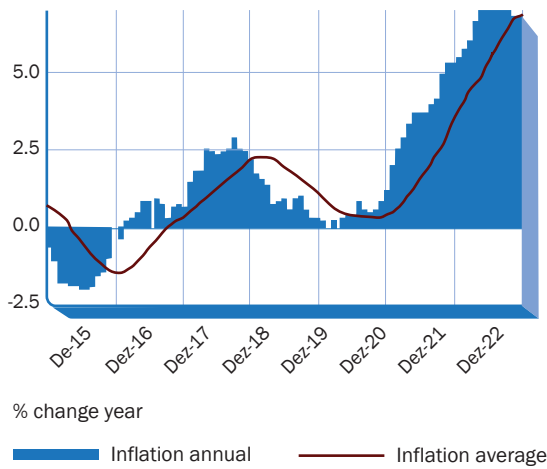
2.1.3. Prices and Inflation

The price level grew even faster in 2022 than in 2021.

The average annual inflation rate in Timor-Leste, according to the DGE, was 7.1% in 2022, which represented a strong increase compared to the 3.8% and 0.5% registered in 2021 and 2020, respectively. In year-on-year terms, the rise in the inflation rate is even more visible, having accelerated from 5.3% in December 2021, to 6.9% in December 2022.

Chart 2.4

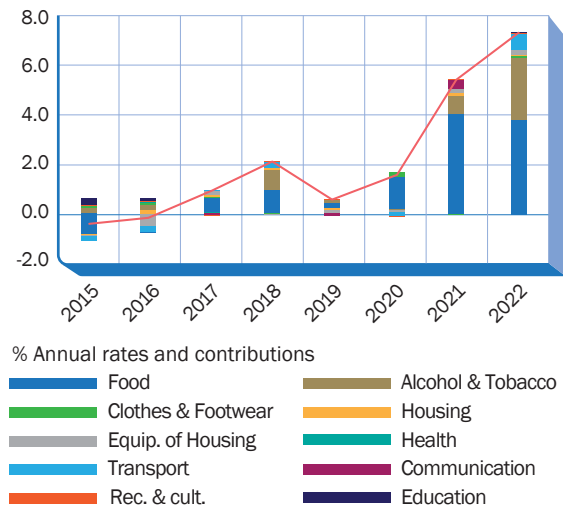
Inflation rate in East Timor



Source: DGE

Chart 2.5

Inflation rate in East Timor



Source: DGE and BCTL analysis

As shown in the graphs and tables below, in 2022 there was a general rise in inflation to the maximum levels of the last decade, recorded in 2015. This trend, in line with what has been happening in the various world economies following the inflationary pressures arising from the negative supply shock, combined with the economic recovery from the 2020 pandemic, culminated in the end of the trajectory of a stable inflation rate dynamic recorded between 2015 and 2020.

The average annual inflation rate in 2022 was 7.2%, up from 3.8% in 2021.

It should be noted that the acceleration of prices in 2022 in Timor-Leste was essentially due to an acceleration in the prices of alcoholic beverages and tobacco, whose prices registered a price increase of around 24% (compared with an increase of 7.2% registered in 2021), followed by the transport sector, with this sector registering a price increase of 12.5% when, in 2021, prices had only registered an increase of 2.7%, and, finally, the food sector which registered an inflation rate of 7.5% in December 2022 against an increase of 5.8% registered in the same month of the previous year. In contrast, only the clothing and footwear sector recorded a 0.2% decrease in prices in 2022.

The price rise is mainly explained by an increasing growth of the alcoholic and beverages as well as transportation sector prices.

Table 2.1 provides more detail in terms of inflationary trends, disaggregating the average inflation rate by major goods/services groups: O quadro 2.1 oferece maior detalhe em termos das tendências inflacionistas, desagregando a taxa de inflação média por grandes grupos de bens/serviços:

Table 2.1

Average inflation of the CPI consumer basket sub-groups - % average year

	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
Food	0.3	-2.1	0.5	1.7	0.1	0.9	5.8	7.5
Alcohol & tobacco	2.6	1.8	0.1	8.3	3.2	-0.4	7.2	23.8
Clothing & footwear	4.6	1.0	-0.3	0.6	1.5	1.6	0.0	-0.2
Housing	-0.7	-1.3	-0.9	1.2	-0.4	-0.6	0.4	1.4
Household	-0.2	-3.2	-0.2	0.4	-0.8	-0.2	-0.3	2.9
Health	1.5	1.3	0.3	0.0	0.8	0.0	0.2	0.8
Transport	-6.3	-4.3	-0.8	3.0	-2.1	-1.3	2.7	12.1
Communication	-0.4	0.3	-0.8	0.3	-0.1	-0.4	0.0	0.0
Rec. & cult.	1.8	1.4	0.0	-0.6	-0.6	0.1	0.1	1.7
Education	18.6	6.1	0.2	16.6	10.3	2.6	0.0	2.5
Total	0.5	-1.4	0.4	2.0	0.4	0.5	3.8	7.0

Source: DGE and BCTL analysis

The inflation rate verified in 2022 in Timor-Leste is in line with the values registered worldwide.

As can be seen from the table above, the “Food” and “Alcoholic beverages and tobacco” sectors were the main responsible for the acceleration of the price level in 2022, not only because of the observed sectoral inflation rates - 7.5% for the “Food” sector and 23.8% for the “Alcoholic beverages and tobacco” sector, but also because of the quite significant proportion of these sectors in the representative basket of goods and services consumed in the economy of Timor-Leste.

It should be noted, however, that the acceleration of the inflation rate in Timor-Leste in 2022 shows a dynamic like to what has occurred in most world economies, this trend was not at all homogeneous, and some sectors such as “Health”, “Clothing and footwear” and “Communication” showed modest inflation rates when compared with other sectors.

Supply rigidity as well as the war in Ukraine have accentuated the price rise seen in 2022.

About the macroeconomic determinants of the inflation rate in 2022, the acceleration in price levels is due to inflationary pressures coming from the external sector and an appreciation of the currencies of our economy’s trading partners against the USD. As previously mentioned, in the chapter



that analyzes the developments in the international economy, the inflationary pressure felt in 2022 is explained by a set of factors such as the war in Ukraine, with the increasing monetary expansions in developed economies without the necessary repercussions in economic activity and, in parallel, the resumption of aggregate demand in a way that the existing supply has not yet been able to respond.

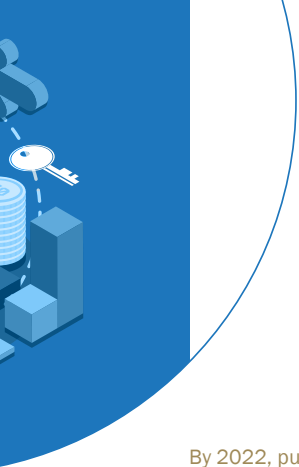
Bearing this in mind, and despite the economic growth registered in 2022, the growing inflation felt in 2022 leads us to the conclusion that investment, both public and private, should be stimulated to promote a more productive supply, with higher wages and high-quality jobs that will allow the Timor-Leste economy to be more resilient to adverse external shocks such as those felt in 2022. In line with this conclusion, the BCTL predicts that the level of economic activity in Timor-Leste will remain below potential GDP, creating problems of underemployment of the various productive.

In terms of prospects for 2023 and 2024, it anticipates a continued increase in the price level, with greater expressiveness in 2023 than in 2024, in line with the expected inflation rates for 2023 and 2024 for the world economy and for the trading partners of the Timorese economy. In this context, BCTL expects that the average inflation rate, in 2022, will remain at similar levels higher than those recorded in 2021, more specifically, 7.2% in 2022 against the 4.0% observed in 2021, but that it will then slow down to 6.9% in 2023.

These projections are naturally based on the assumption of exchange rate stability of the dollar against Asian currencies, on the gradual stabilization over the next few years of international inflationary pressures and on the economies of our country's main partners, and on the fact that the domestic economy should continue to operate below its potential level. Despite the economic recovery expected from 2021 to 2023, the anemic performance of the past 5 years has resulted in the current underemployment of labor and capital resources. The BCTL thus estimates that the current level of GDP is currently below its potential, or full employment, level. This, coupled with the expectation that the expected economic recovery will not be sufficient to close the domestic output gap by 2023 and that sustained growth in the future level of public spending will be difficult to expect given the absence of budgetary resources and the growing risks to the sustainability of public finances, leads us to believe that inflationary pressures on the domestic side will remain almost non-existent over the next few years.



For 2023 it is expected an inflation rate close to that observed in 2022.



2.2 Public Finance

2.2.1. 2022 Budget Program

By 2022, public spending has registered a significant increase of \$299 million.

In 2022, according to the data in table 2.2 below, public spending on a cash effective basis increased significantly by \$299 million, marginally less than the \$301 increase recorded in 2021 versus 2020.

Therefore, the overall value of realized expenditure amounted to \$1,741 million in 2022. The increase in public spending compared to 2021 is explained by a higher degree of spending execution of the 2022 budget compared to 2021. Namely, the execution rate of public spending in 2022 increased 8 p.p. to 79%. Note that the 2022 State Budget budgeted a total expenditure of \$2210 million (excluding expenditure on transfers to the PF), thus resulting in an increase of \$181 million in 2022 from the amount budgeted in 2021.

The expenditure execution rate in 2022 was higher than that observed in 2021.

The increase in the execution rate of the 2022 budget compared to the 2021 budget is explained by an increase in budget execution in both expenditure items. More specifically, there was an increase in the execution rate of Recurrent Expenditure by 8 p.p. in 2022 compared with 2021 (91% execution in 2022 compared with 83% execution in 2021) and an increase of 9 p.p. in the execution rate for capital expenditure (39% in 2022 compared with a degree of execution of 30% in 2021). It should be noted, however, that the degree of execution of capital expenditures is quite low which, in our view, may compromise future economic activity, since public investment is essential to promote the development of the private sector of Timor-Leste's economy.



Table 2.2

State Budget - Evolution and Execution

	Millions of USD		Growth rate	Implementation rate	
	2021	2022	2022	2021	2022
Total Revenues	709	730	3%	96%	104%
Domestic Revenues	161	176	9%	86%	117%
Tax Revenues	119	143	21%	95%	117%
Non-Tax Revenues	26	18	-31%	46%	108%
Agency Retention Revenues	17	11	-33%	266%	95%
Grants & Contribution	0	4	100%	0%	100%
Estimated Sustainable Income	548	554	1%	100%	100%
Total Spending	1,442	1,741	21%	71%	79%
Recurrent Expenditures	1,302	1,538	18%	83%	91%
Capital Expenditures	140	203	45%	30%	39%
Financing					
Excess Withdrawals from the Petroleum Fund	600	850	42%	72%	112%
Use of Cash Balances	108	116	7%	28%	28%
Loans	15	30	94%	22%	58%

Source: TL Transparency Portal and BCTL calculations

In annual terms, on a cash basis, the \$299 million increase in public spending was explained by a substantial increase in capital expenditure, which represented a 45% growth rate compared to 2021, amounting \$203 million, and a significant growth in volume of Recurrent Expenditure by \$236 million in 2022 compared to 2021, which translates as an 18% increase over the amount executed in 2021.

The increase in public spending is explained by a significant increase in recurrent spending (\$236 million).

Regarding revenue, the government forecast in its 2022 State Budget, a total non-oil revenue of \$150 million, excluding loans and grants. However, as can be seen in Table 2.2, this budgeted revenue was exceeded by 17 p.p., i.e., a 117% execution rate, reaching the value of \$176 million. The higher revenues achieved than budgeted resulted in the collection of more tax revenue than initially budgeted, which equaled \$143 million with a corresponding execution rate of 117%. Moreover, this and the subsidies and contributions item were the only revenue items with a growth rate.

The revenue collected by the government was 17% above the projected in the state budget.

Due to the substantial increase in public expenditure (+\$299 million) and despite a slight increase in non-oil revenue (+\$15 million) from the Central State, the deficit on a cash basis, excluding oil revenues, increased in 2022 by \$285 million, to \$1565 million (in 2021 the budget balance excluding oil revenues recorded a deficit of -\$1281 million).

2.2.2 Revenue

One of the Government's main priorities is to reduce the country's dependence on funding from the Petroleum Fund. Efforts in this direction remain central to the Government's budget discussions and planning. In the 2022 SGB, for example, the Government continued to emphasize its policy of "tax reform" to improve the country's fiscal framework and increase domestic revenues from non-oil resources and activities, as well as rebalancing the external accounts by increasing tax rates on imports.

In 2022, non-oil revenues totalled \$176 million, an increase of more than \$9 million over 2021.

In 2022, on a cash basis, domestic non-oil revenues reached \$176 million, registering a growth of 9.3 million compared to the \$161 million recorded in 2021. Regarding each of the items, tax revenue recorded a 21% increase, a significant increase, totaling an amount of \$143 million, while non-tax revenue and agency withholding revenue recorded a drop of 31% and 33%, respectively, compared to the previous year. In detail, in 2022 a total of non-tax revenues and agency retention revenues of \$18 million (in 2021, the amount of this revenue line was \$26 million) and \$11 million (in 2021, the amount of this revenue line was \$17 million), respectively, were accounted for.

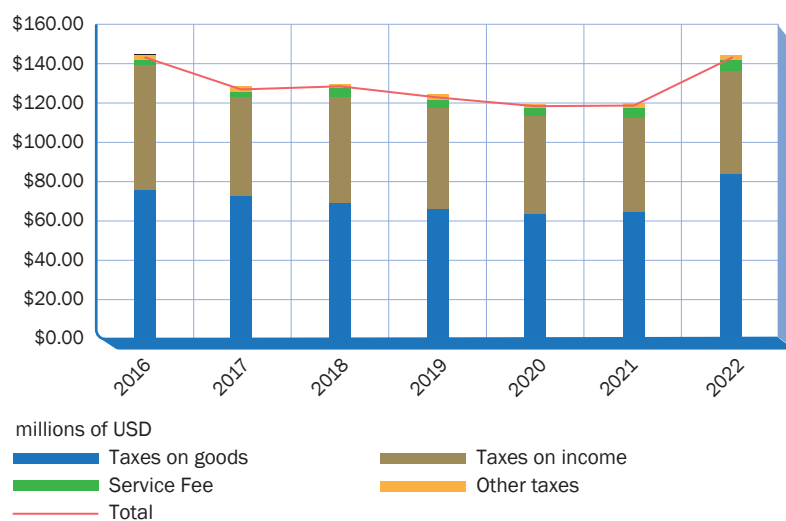
Taxes on goods continued to account for the largest share of tax revenues.

Chart 2.6 shows the changes in tax revenue and its main components over the past few years, namely taxes levied on personal and corporate income and taxes levied on the importation of goods. With the rise in tax revenue collected, it is worth noting the huge increase in revenue from taxes on goods, which was almost \$84 million, when in the year 2021 the revenue from this tax amounted to \$65 million. On the other hand, income taxes saw a \$5 million increase in revenue collected, with the amount of income taxes received of \$53 million in 2022, an increase of approximately 12% over 2021. Revenue from other taxes and service fees, on the other hand, collected almost the same amount as in 2022, representing a negligible share of tax revenue in the overall amount of taxes collected by the government.



Chart 2.6

ET - Evolution of Tax Revenues - cash basis



Source: TL Portal de Transparencia and BCTL analysis

2.2.3. Public Expenditure

In 2022, the overall execution rate of public expenditure rose to 79%, reversing the downward trend in budget execution recorded between 2019 (83%) and 2021 (71%), while remaining short of the much more significant budget execution figures recorded in 2018 and 2017, where execution rates of 91% and 88% were achieved, respectively.

The expenditure execution rate increased compared to 2021, reversing the trend observed until then.

While the amount of expenditure budgeted in 2022 was higher than that budgeted in 2021, by about \$180 million, the amount of budgeted expenditure executed was much higher than in 2021, not only because of the increase in budgeted expenditure in 2022 compared to 2021, but also because of a significant increase in the expenditure execution rate, as expressed above, which ultimately explained an actual increase in expenditure of more than \$299 million, an increase of almost 21% in realized expenditure compared to that observed in 2021.

Finally, the overall expenditure executed by the government increased, as previously mentioned, by \$299 million, which is essentially the result of an increase in current expenditure, as already documented, it also included an increase in capital expenditure with an increase in capital expenditure of \$66 million in 2022 compared to 2021, which translates into a percentage increase of almost 28%. For this increase in public investment expenditure contributed the fact that, despite having slightly reduced the implementation of this budget line in relation to 2022, the budgeted amount was significantly higher which resulted in an overall amount in 2022 higher than in 2021.

2.2.3.1 Current Expenditure

Current expenditure increased by 18% in 2022.

In 2022, current spending increased by 18%, adding to the expansions already seen in 2021 (+33%) and in 2020 of 7%, which together reversed the decline recorded in 2017 and 2018. Current spending, which totaled approximately \$1538 million in 2022, once again records an all-time high, above the values seen in 2021, with an amount of effective public spending of \$1302 million, a year that had already recorded a maximum observed in relation to the values totaled in 2015 and 2016, about \$1030 million.

These expenditures represented more than 85% of the total expenditure in 2022.

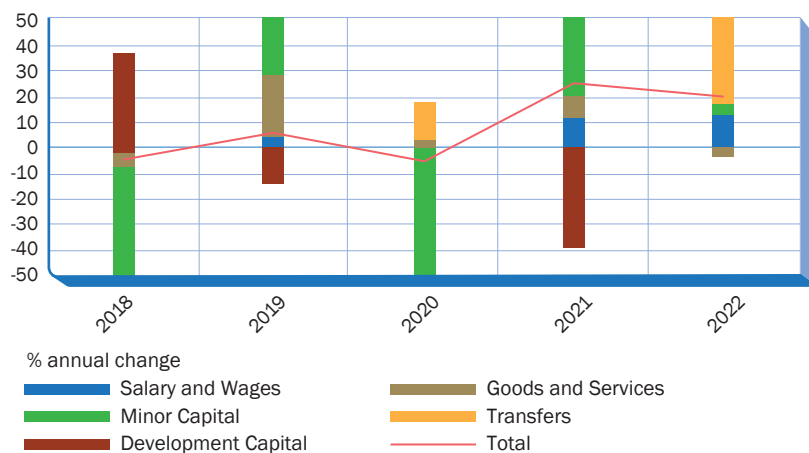
Thus, current expenditure continued to be the main component of public spending, amounting to 88% of the total, which represented a slight decrease, 2 p.p. below the proportion of this expenditure in the total expenditure executed in 2020. It should also be noted that the increase in expenditure was due to greater execution of this component of expenditure, reaching an execution rate of 90.7% in 2022 compared to an execution rate of 83.1% in 2021.

In 2022 there was a substantial increase in transfer spending.

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 incurred in each of the years. As can be seen, as in the previous year, the increase in transfers (+\$220 million) and in salaries (+\$13 million) and a slight reduction in goods and services (-\$3 million) explained the significant increase in current expenditure, while the increase in public investment expenditure of around \$63 million helps to complement the explanation for the increase in total expenditure recorded in 2022.

Chart 2.7

ET - Evolution of Public Expenditures



Source: TL Portal de Transparencia and BCTL analysis

As a result of these developments, spending on transfers represented the largest category of total spending in 2022, with 50% of the total (46% and 34% in 2021 and 2020, respectively), followed by spending on goods and services with 23% (29% and 33% in 2020 and 2019, respectively) and wages with 15% (16% and 18% in 2021 and 2020, respectively).

2.2.3.2 Capital and Development Expenditure

The government estimated in the 2022 SGB an overall capital expenditure, including the loan program, of \$515 million, representing an appreciable increase in the order of \$51 million, representing an increase of 11% compared to the amount in the 2021 budget. However, this increase is far from the amount budgeted in 2021, when \$464 million was budgeted, representing an increase of \$244 million (+111%) over the \$220 million allocated in 2020.

On the other hand, capital expenditure increased by 11% compared to 2021, totalling \$515 million in 2022.

However, and despite the amounts budgeted, there was still a low execution rate of around 39%, a value which was nevertheless higher than the low budget execution of this component of expenditure in 2021, when there was a rate of 30%. These low execution rates contrast with a much more significant execution rate in 2020, around 73%. Thus, it should be noted that in 2022 the total executed amount of public investment totaled \$203 million, an increase in executed expenditure of \$63 million compared to 2021.

Most of the capital development expenditure was spent under the infrastructure construction program, also including loans, whose weight amounted to 73%, a value 9 p.p. above the value recorded in 2021 (68%) and quite far from the value recorded in 2020, of approximately 86%. The Infrastructure Fund Program continues to be the most relevant in terms of public investment since its expenditure corresponds to 73% of the total category in 2022.

Infrastructure construction was the program that benefited most from the total capital expenditures.

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



Table 2.3
Composition of Public Investment

	Million USD - cash basis			% Public Investment		
	2020	2021	2022	2020	2021	2022
Minor Capital	5	44	46	3%	32%	23%
Development Capital	155	96	157	97%	68%	77%
Total Infrastructure	153	91	147	96%	65%	73%
Total Public Investment	160	140	203	14%	10%	12%
Total Expenditures	1136	1442	1741			

Major infrastructure asset investment sectors

	Million USD - cash basis			% Public Investment		
	2020	2021	2022	2020	2021	2022
Agriculture	5	2	3	3%	2%	1%
Infrastructure	43	13	73	27%	9%	36%
Private Sector Industry Commerce	4	1	1	2%	1%	0%
Macroeconomic Management	11	4	2	7%	3%	1%
Water and sanitation			2	0%	0%	1%
Health	5	8	5	3%	6%	3%
Education		0	28	0%	0%	14%
Roads	0	3	18	0%	2%	9%
Other infrastructures	85	60	15	53%	43%	7%
Total infrastructures	153	91	147	96%	65%	73%

Source: TL Transparency Portal and BCTL calculations

Investment in infrastructure and schools has registered a significant increase of \$103 million by 2022.

As can be seen, investment in minor capital saw its importance reduce by \$2 million in 2022 from \$44 million in 2021, the previous year accounting for 23% of public investment. In terms of the sectoral priorities of public investment in infrastructure, investment in roads and education were the main investment programs, with a combined annual expenditure of \$119 million in 2022, with the importance of these priorities significantly higher than in 2021 (\$16 million).

2.2.4. Funding Sources

In its 2022 Budget, the Government planned to use \$1,311 million from the Petroleum Fund, having withdrawn a higher amount from the PF, in the order of \$1,404 million to finance its actual expenditure during the year. Note that this figure represents an increase from the \$256 million withdrawn in 2021, due to higher public spending and the higher value of the non-oil fiscal deficit.

PF financed \$1,404 million of public spending in 2022.

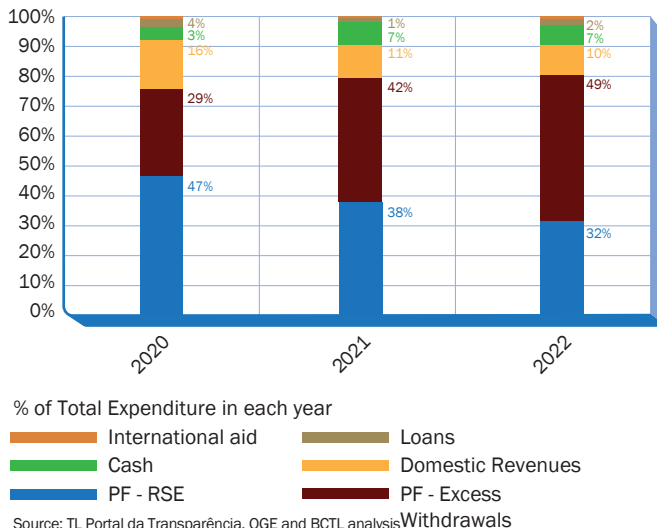
With this continued use of funds, the annual amount taken from the FP continues to be well above its estimated sustainable income (ESI), valued at \$554 million (\$548 million in 2021 and \$544 million in 2020), which translates into a continued reduction of the FP's capital.

About the sources of funding used to finance public expenditure in 2022, it should be noted that the PF remains the main source of funding, with this source representing 66% of the total funding, while in 2021 this source of funding represented 68% of the total funding used to finance the expenditure incurred. This slight decrease in the proportion of FP funding is mainly due to an increase in funding from the cash balance arising from the 2021 fiscal year. On the other hand, domestic public revenues accounted for only 9% of total financing, marginally higher than in 2021 and well below the 16% observed in 2020. Contributing to this downward dynamic is the fact that total expenditure rose between 2022 and 2021, while non-oil revenues recorded in 2022 were unable to keep up with the increase in expenditure.

The PF continues to be the main source of funding for the state budget.

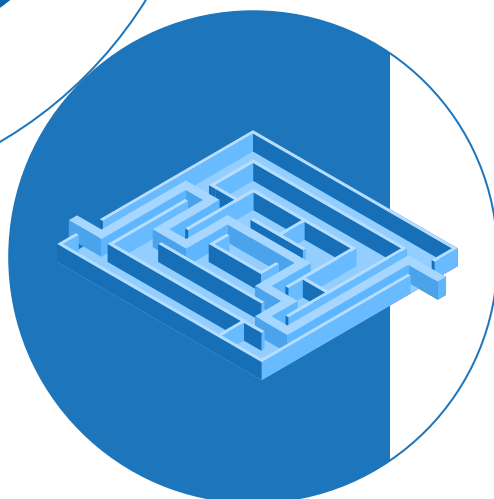
Chart 2.8

Public Expenditure Funding Sources



Regarding loans, these have represented similar proportions in recent years, between 3% and 4% between 2020 and 2022, with the latter year representing 3% of total public expenditure financing. These loans, which have served to finance investment in roads in the country, amounted to \$51 million in 2022 (\$71 million and \$30 million in 2021 and 2020), corresponding to an execution rate, in 2022, of 100%, which represents a relevant execution capacity for loans foreseen in the State Budget.

In short, these considerations allow us to see the continuity of the enormous dependence of the State budgets on funding from petroleum revenues or, more specifically, transfers from the Petroleum Fund, in a value that exceeds its sustainable income. Despite the existence of substantial energy reserves in Timor's waters, the fact that the exploration projects currently underway are scheduled to end in 2023 means that the continued and substantial reduction of the Fund's capital represents a material risk to the sustainability of our public finances in the medium term.



2.3 Monetary and Exchange Sector

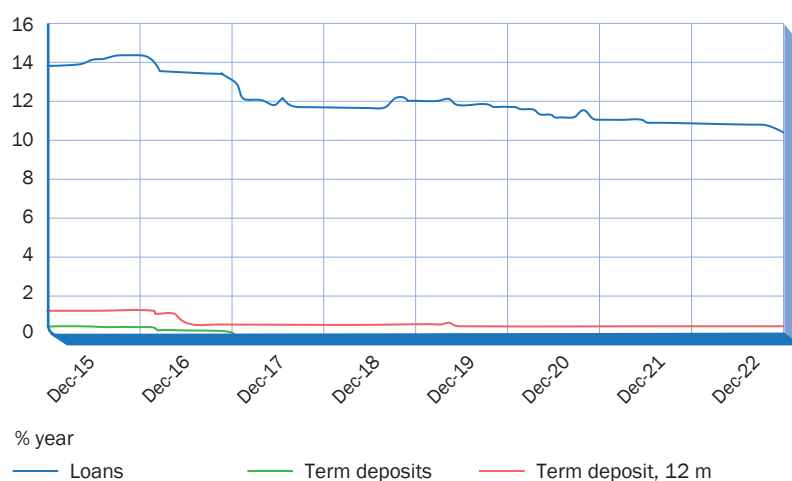
2.3.1. Interest Rates

The level of interest rates on loans remains high when compared to the levels of the international dollar benchmark rates. In fact, economic theory states that when a small country adopts as its currency the currency of a large economy, its interest rates tend to converge with those of its benchmark. In Timor-Leste this is not the case, especially for interest rates on credit 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 for lending at lower rates (3%). However, this economic policy is not yet producing effects on the rates currently seen in the banking system of Timor-Leste.

Loan interest rates remain significantly high despite the program of lending at lower rates.

Chart 2.9

ET: Interest Rates on Loans and Deposits



Source: BCTL

Like the evolution of the previous year, the high average interest rates on loans to the private sector continued to decline from 11.03% at the end of 2021 to 10.83% in December 2022, which is a positive sign for companies and families that use bank loans to finance themselves. However, there was only a slight decrease in the average rate paid on 6-month deposits compared to 2021. More specifically, while in December 2021 the 6 month deposits were rewarded with a rate of 0.69%, in December 2022

the interest rate for deposits with the same maturity was 0.67%, a slight reduction of 0.02 p.p. in one year. This dynamic in lending and borrowing interest rates has caused the spread, i.e., the interest rate differential, to fall to 10.16%, when at the end of 2021, the same differential was approximately 10.48%.

Table 2.4
Weighted Average Interest Rate of Commercial Banks (In percentage)

Period	Loans + 6 months Libor	Term deposits	Savings Deposits	Term deposits			
				1 month	3 months	6 months	12 months
2021 Dec	11.03	0.10	0.48	0.63	0.65	0.69	0.64
2022 Jan	11.04	0.09	0.45	0.64	0.67	0.72	0.63
Feb	11.04	0.08	0.45	0.64	0.67	0.73	0.63
Mar	11.04	0.08	0.45	0.63	0.66	0.71	0.63
Apr	11.03	0.10	0.46	0.60	0.63	0.68	0.63
May	11.02	0.11	0.45	0.60	0.63	0.69	0.63
Jun	11.08	0.11	0.46	0.60	0.63	0.69	0.64
Jul	11.08	0.12	0.48	0.57	0.59	0.64	0.63
Aug	11.06	0.12	0.46	0.60	0.62	0.68	0.63
Sep	11.00	0.12	0.46	0.60	0.62	0.68	0.63
Oct	11.00	0.12	0.46	0.60	0.62	0.68	0.63
Nov	10.90	0.13	0.46	0.59	0.62	0.67	0.63
Dec	10.83	0.13	0.52	0.59	0.62	0.67	0.67

Source: BCTL

2.3.2. Exchange Rates

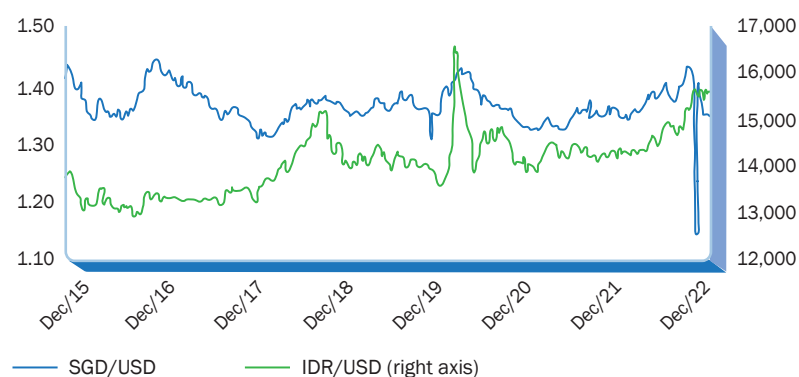
In 2022, the USD appreciated by 3.8% against the rupiah of Indonesia, Timor-Leste's main economic partner.

Contrary to what happened in 2021, the US dollar, the official currency of Timor-Leste, did not show the same dynamics of currency appreciation against the two currencies of Timor-Leste's main trading partners. More specifically, between December 2021 and December 2022, there was a devaluation of the USD against the Singapore dollar, a reference currency in the Asian context, of about 2.5%, while the currency of Timor-Leste appreciated by 3.8% against the Indonesian rupiah, which is Timor-Leste's main trading partner economy. It should be noted, however, that in 2022 there was a greater exchange rate volatility than the volatility observed in 2021.



Chart 2.10

Nominal Exchange Rates vs USD



Source: Bloomberg

Despite the appreciation of the USD against the currency of Timor-Leste's main trading partner, the rise in the value of the Singapore dollar ended up counterbalancing the positive effect that the devaluation of the Indonesian rupiah had on the stabilization of domestic inflation. Thus, and given that Timor-Leste maintains a high dependence on imported goods and services to meet the existing domestic demand, the net effect of the two exchange rate dynamics contributed to the observed worsening of the inflation rate in 2022.

The economy of Timor-Leste remains highly dependent on the external sector.

2.3.3 Monetary Base (BM)

The Monetary Base, which is one of the determinant variables in terms of monetary policy, decreases significantly in 2022 in the amount of \$145 million, contrary to the increase registered in 2021 (\$166 million). The monetary base is valued at \$172 million at the end of 2022, of which \$28 million is currency in circulation and the remaining \$144 million is deposits by banks with the BCTL. The reduction in the monetary base in 2022 is explained by the reduction in deposits of banks with the BCTL by \$147 million.

The monetary base decreased by \$145 million in 2022, contrary to the monetary expansion seen in 2021.

2.3.4 Money Supply

Financial sector development plays a vital role in facilitating economic growth and poverty reduction. The compilation and analysis of monetary and financial statistics allows us to gauge the development of and changes in a country's monetary and financial systems. The Central Bank of Timor-

M2 amounted in 1,215 million in December 2022, representing an increase of \$96 million.

Leste has been collecting and compiling these statistics systematically with the objective of developing a comprehensive and detailed overview of our financial sector in order to develop the BCTL's functions of macroprudential supervision and monetary policy implementation. However, to date, the BCTL still lacks monetary policy instruments as our country continues to use a foreign currency, the US dollar, as its official currency.

Chart 2.11
Money supply dynamics

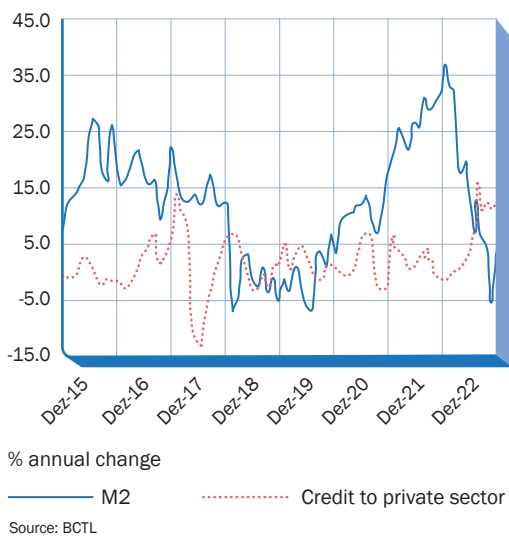
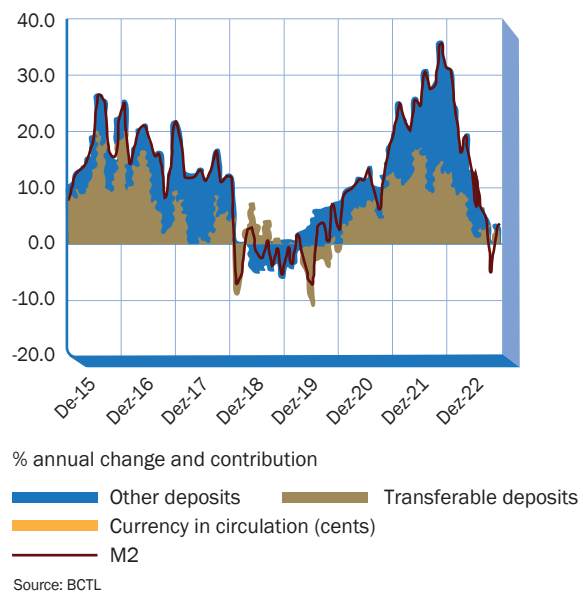


Chart 2.12
M2 and its components



Although Timor-Leste is a “dollarized” economy, it is possible for the BCTL to reasonably calculate the aggregate money supply (the M2 aggregate) excluding dollar bills in circulation, which in most countries is used as a measure of the availability of means of payment, the money supply in Timor-Leste is calculated by adding money in circulation to demand deposits (which, like the previous tranche, can be mobilized immediately to make payments by checks) and “quasi money” (savings and time 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 2015 to 2022. Note that the M2 figures are approximate because, as the country uses the US dollar, it is difficult to accurately calculate the value of banknotes in circulation. However, since this should constitute a small and stable proportion of the amounts available for payments, the approximate M2 serves well for the purposes of measuring the size and change in the money supply in our economy.

The M2 thus calculated amounted to \$1,215 million in December 2022, having expanded by \$96 million, an increase well below the \$250 million increase in money supply that occurred between December 2021 and December 2020.

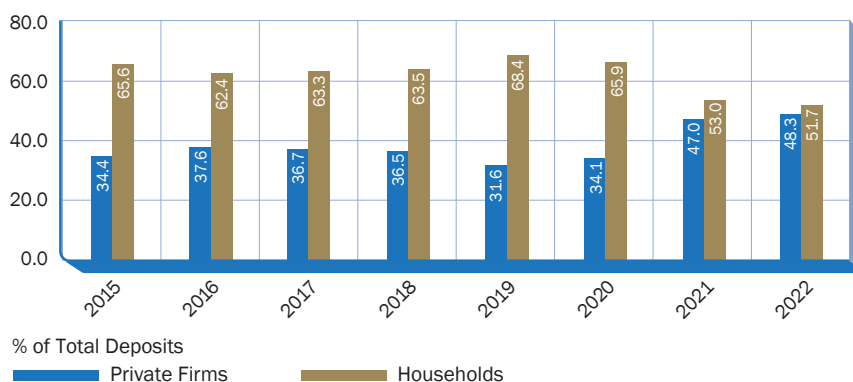
It is also important to analyze the evolution of the components of the money supply, presented in graph 2.12. Total deposits taken by financial institutions were determinant in the expansion of the money supply, with an increase of \$94 million, reinforcing the \$248 million increase of 2021.

In terms of ownership by institutional sector, as shown in Chart 2.13, 51.7% of deposits are held by individuals and 48.3% by private companies. These percentages reflect a slight increase of 1.3 p.p. in the proportion of deposits held by private companies, as opposed to individuals whose total proportion of deposits naturally declined by the same magnitude. With the trajectory of increase in the weight of deposits held by private companies from 2020, in 2022 the weight of deposits held by companies and individuals will be identical.

Of total deposits, an increasing convergence of the percentage of deposits held by private companies and individuals is observed since 2019...

Chart 2.13

Share of Deposits by Ownership



% of Total Deposits

Private Firms

Households

Source: BCTL

From another perspective of M2 analysis, according to table 2.6 below, the increase in credit and net foreign assets explained the bulk of the increase in the money supply, although they were countered by the significant increase in public sector deposits with the BCTL.

Table 2.5

Main explanatory sources of Money Supply (M2)

Millions of USD

	Annual Cash Flow 2021	Annual Cash Flow 2022
Credit to the Economy	13.3	104.6
Government	-78.3	-193.8
BCTL Complaints	0.7	-0.3
Deposits	-79.0	-193.5
Net External Assets	388.9	312.4
Others	74.3	127.0
M2	249.6	96.3

Source: BCTL

2.3.5. Bank Credit

Bank credit increased significantly in 2022 (33%), with special emphasis on credit granted to the construction and transport and communications sectors.

In 2022, the credit granted by banks to the private sector recorded an increase, a trend recorded since 2019. However, the increase in 2022 compared to 2021 broke a record of \$89 million, which is equivalent to a 33% increase and surpasses the increase recorded in 2021 of \$14.8 million, or even the maximum increase recorded in that period of \$26 million in 2020 compared to 2019.

Quadro 2.6

Credit to Economy

Sector	Balance (million USD)		Change		Composition	
	2021	2022	Nominal	%	2021	2022
Agriculture, Water and Forestry	1.9	1.5	-0.4	-21.3%	0.7%	0.4%
Industry and Manufacturing	16.2	16.6	0.4	2.2%	6.0%	4.6%
Construction	32.6	65.8	33.2	101.9%	12.0%	18.2%
Transport and Communications	2.7	48.2	45.5	1681.3%	1.0%	13.3%
Business and Finance	32.5	26.5	-6.0	-18.5%	12.0%	7.3%
Tourism and Services	3.3	11.1	7.7	231.7%	1.2%	3.1%
Households	182.7	192.0	9.3	5.1%	67.2%	53.1%
Total	271.9	361.6	89.7	33%	100%	100%

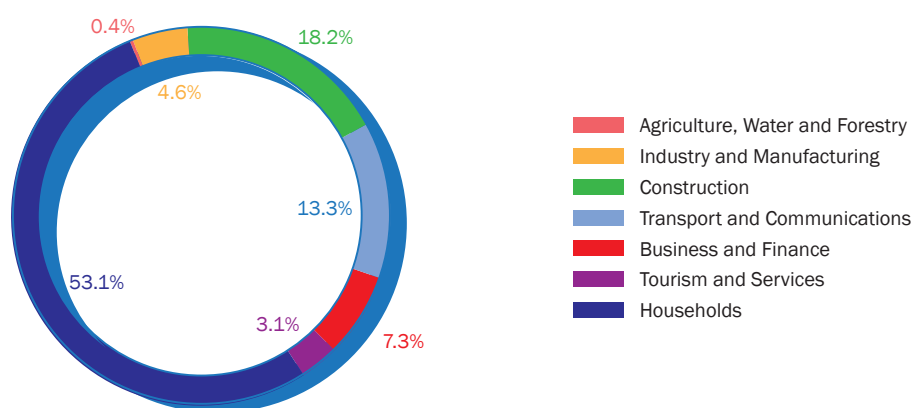
Sources: Commercial Banks and BCTL analysis.

When analyzing the credit granted by sector of activity, we can see that the transport and construction sectors were the ones that obtained the most credit, amounting to \$48.2 million and \$65.8 million, respectively. On the other hand, credit granted to the agricultural sector decreases slightly (-\$0.4 million), to a total of \$1.5 million.

Still, it should be noted the increase in credit granted to Timorese families, with the increase registered in 2022 compared to 2021 totaling \$9.2 million, in addition to the increase in credit already verified and that has been granted to individuals, of \$17 million in 2021 and \$40 million in 2020. However, and despite this increase, the proportion of credit granted to individuals decreased to 53.1% in 2022 when, in 2021, credit granted to individuals represented 67.2% of total credit granted. The decrease in the relative weight of credit granted to individuals is due to the increase in the weight of credit granted to the construction and transport and communication sectors, as can be seen in the table above.

Chart 2.14

Credit by Sector - Dec 2022 - % Total



Source: BCTL

As mentioned above, the agriculture, water and forestry sector were one of the two sectors of activity that saw lending decline, albeit marginally. The other sector that saw a decrease in credit granted was the trade and finance sector, with a decrease of almost \$6 million. On the other hand, the sectors that registered the highest growth were the transport sector (+1681%), the tourism and services sector, with a growth rate of 232%, and construction with a positive rate of change of 102%. After the credit granted to individuals, these three sectors together represented a total of 34.6% of total credit granted to the economy of Timor-Leste in 2022.

On the other hand, the agriculture sector registered a reduction in the 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 “non-performing loans” and the system’s provisions for credit risk. It should also be noted that the value of provisions for credit risk has continued its downward trend, registering once again a historically low level in 2022, amounting to \$6.8 million, when in 2021 there was also a low value for this item, amounting to 7.7 million.

It should also be noted that banking institutions remain quite robust in terms of their ability to cope with an eventual deterioration in credit quality, as the current levels of non-performing loans are exceptionally low, and the sector’s operating profitability margin provides a robust basis to finance such an eventuality.

Despite the improvement in the quality of the balance sheet of financial institutions, the aggregate value of credit has remained at levels well below those of deposits, providing commercial banks with excess liquidity that tends to be applied preferentially by banks in deposits abroad.

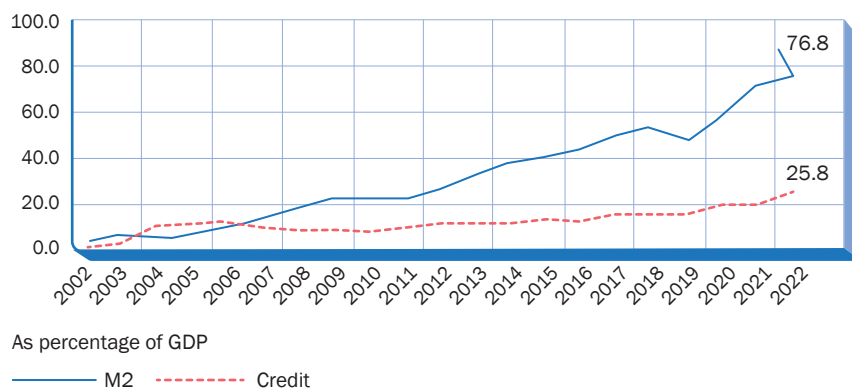
2.3.6 Financial Depth Indicators

The degree of financial deepening rose by 3.6 p.p. in 2022 compared to about 2021.

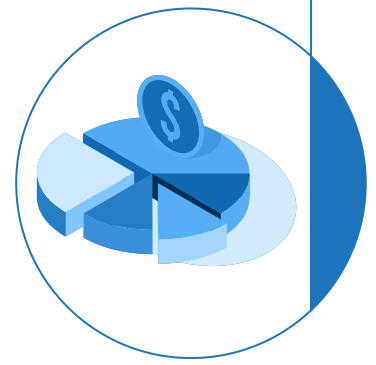
The degree of financial deepening, also known as the degree of monetization of the economy, can be measured based on the ratio of M2 to GDP. This ratio rises 3.6 p.p. in 2022 to 76.8% of GDP (73.2% in 2021), showing the increasing trend seen in the recent past, although with some variations. Another indicator that can also be used for monitoring the degree of financial deepening is the ratio of credit to GDP. This ratio recorded a value of 25.8% at the end of 2022, while at the end of 2021 this variable recorded a value of 19.9%, a significant percentage increase (+5.9 p.p.) compared to that observed in recent years.

Chart 2.15

Monetary aggregates growth rates



Source: DGE and BCTL analysis



2.4 External Sector

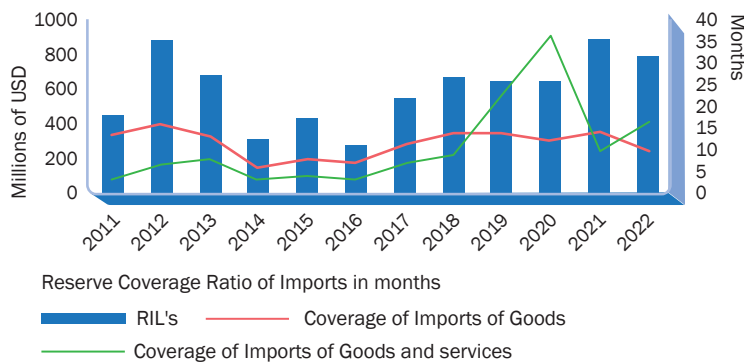
2.4.1. Net International Reserves (NIR)

At the end of 2022, the balance of net international reserves (NIR) stood at \$788 million, a decrease from the value recorded in 2021 (\$890 million) but still well above the average values observed since 2014. Expressed in months of coverage of total imports of goods and services, the NIR corresponded last year to 16 months, which corresponds to a significant increase compared to 9 months in 2021.

RIL had decreased by \$102 million in 2022 compared to 2021. On the other hand, the import coverage ratio increased significantly compared to 2021.

Chart 2.16

Net Foreign Reserves



Source: DGE and BCTL

2.4.2. Effective Real Exchange Rate Index

The Effective Real Exchange Rate Index (EERTI) - an indicator used to assess the competitiveness of countries in terms of tradable national products - appreciated 6.2% in 2022, accelerating the real appreciation already recorded in 2021 (2.9%), when there had been a devaluation in 2020 (-1.7%), shown in Chart 2.17a. It should also be noted that the ITCER recorded greater volatility in 2022 than in the previous year, explained by the recovery of global economic activity while inflationary pressures increased.

The ICTER appreciated to 6.2% in 2022 (2.9% in 2021).

This evolution was mostly 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 Effective Nominal Exchange Rate Index (ITCEN) recorded a year-on-year appreciation of 7.2% in 2022, an acceleration in relation to 2021, when a year-on-year appreciation of 6.5% was observed.

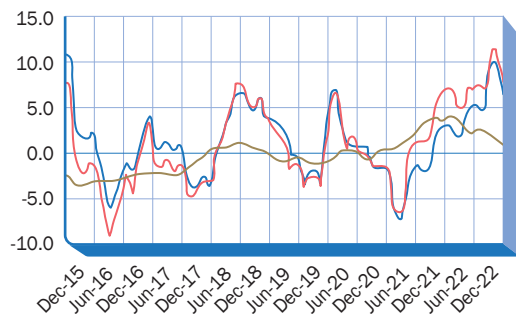
In terms of average annual changes (chart 2.17b), the ITCER recorded a slight significant appreciation at the end of the year of 5.3%, in line with the appreciation recorded since 2018, only interrupted by the devaluation that occurred in 2021 (-2.2%).

The export of coffee continues to be the country's main export commodity.

In bilateral terms, specifically against the currencies of Indonesia and Australia, two of the country's main trading partners, the dollar recorded a notable appreciation of 8.9% against the rupiah and 4.3% against the Australian dollar. This evolution also followed the context registered for the global ITCER, with the appreciation of the dollar during the year 2022. The export of coffee continues to be the main, and the only, export of our country. However, international prices remain the strongest determinant of this type of export, as the respective volumes exported are only slightly influenced by the evolution of these effective exchange rates.

Chart 2.17a

Real Effective Exchange Rate Index (REER)



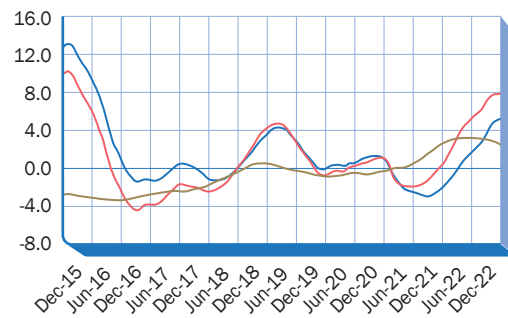
% Annual change

— CPI — ITCER — ITCEN

Source: Bloomberg and BCTL analysis

Chart 2.17b

Real Effective Exchange Rate Index Average



% Annual average change

— CPI — ITCER — ITCEN

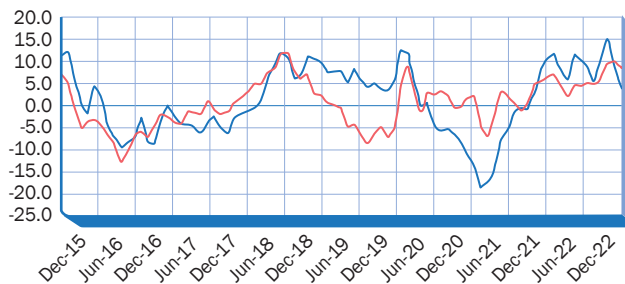
Source: Bloomberg and BCTL analysis

The goods imported from Indonesia are more price competitive with those from Australia.

In bilateral terms, it should be noted that the prices of imported goods from Indonesia continue to be more competitive than those of similar goods from Australia, which is also confirmed by the greater importance of Indonesia as a trading partner of our economy.

Chart 2.18

Bilateral Real Exchange Rates



% change year

— ITCR vs Indonesia — ITCR vs Australia

Source: Bloomberg and BCTL analysis

2.5 Balance of Payments

The external current account of Timor-Leste recorded, once again, in 2022 a significant worsening of its deficit by \$950 million (a worsening of \$318 million if oil activity is excluded). For this worsening, in 2022, mostly contributed by deterioration of the goods account, which recorded a net change of -\$785 million and a significant worsening of primary income by \$295 million compared to 2021. While the current account, including oil activity, recorded a deficit of \$1,043 million, compared to a surplus of \$9 million in 2021. This deficit corresponded to -65.8% of GDP in 2022, which represents an increase of 66.2 p.p. compared to 2021 and an increase of 6 p.p., if oil activity is excluded.

The year 2022 is marked by a significant worsening of the external deficit.

As a result of this evolution, the combined current and capital account balance, which determines the overall net external financing need of the economy, decreased to a negative -58,7% of GDP, from -40% of GDP in the previous year.

Table 2.7

Timor-Leste Balance of Payments

	Millions of USD			As % of GDP	
	2021	2022	% Var.	2021	2022
Current balance -Exc. Petroleum activities	-631	-950	50	-41	-60
Current account	9	-1,043	-11,847	1	-66
Goods account	1,878	1,093	-42	123	69
Services account	-752	-649	-14	-49	-41
Primary income account	-1,123	-1,418	26	-73	-89
Secondary income account	6	-69	-1,161	0	-4
Capital account	13	17	32	1	1
Financial account	-609	-261	-57	-40	-16
Direct investment	-755	262	-135	-49	17
Portfolio Investment	150	-152	-201	10	-10
Other investment	-4	-372	8,164	0	-23
Errors and Omissions	866	1,183	37	57	74
Global balance	-588	-1,287	119	-38	-81
Reserve assets (change)	-278	104	-137	-18	7

Source: BCTL

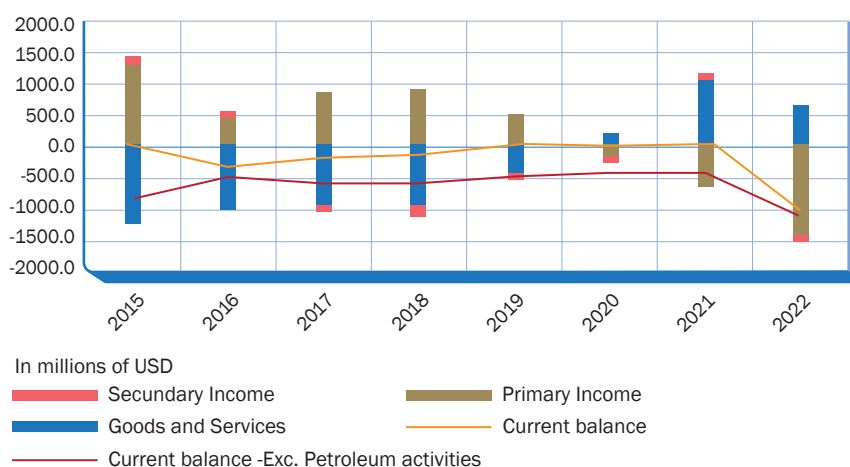


2.5.1. Current Account

As can be seen in graph 2.19 below, the current account balance recorded a further widening of the deficit in 2022, which, as noted above, was mostly due to increased imports of goods and services and lower FP income.

Chart 2.19

Timor-Leste - Current account Balance



Source: BCTL

Note: Until Q3 2019 petroleum revenues (taxes and royalties) are treated as other primary income. After Q3 2019 petroleum exports are treated as exports of the country.

2.5.1.1. Goods Account

The goods account recorded a surplus of \$1,190 million, representing a decrease from that observed in 2021.

In the year under review, the goods sub-account of the trade balance, including the export of petroleum products, recorded a surplus of \$1093 million, which resulted in a reduction from the value observed in 2021 of \$1,878 million. This evolution was due to a reduction in the export of petroleum products by \$6113 million compared to 2021.

It should also be noted that the rise in exports since 2019 - since exports of petroleum products will now be accounted for in this sub-account instead of in the primary income account.

Chart 2.20

ET - Goods account



Source: BCTL

However, when excluding oil revenues from the goods trade account, this sub-account recorded a worsening of its deficit in 2022, valued at \$135 million, due to increased imports of goods during the year, as the country's exports of non-oil goods remain negligible.

If oil revenues are excluded, the trade account for goods registers a deficit in 2022.

Export of Goods

The main destination of our exports during 2022 was, as registered in 2021, continua with the United State of America, with a total weight of 26%, which corresponded to \$7.6 million, reduced 19% compared to 2021.

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

Table 2.8

Export Destinations

	Million USD			% Total	
	2021	2022	Annual % change	2021	2022
United States of America	9.4	7.6	-19%	30%	26%
Indonesia	2.2	4.0	77%	7%	14%
Portugal	0.9	0.7	-30%	3%	2%
Australia	1.0	2.1	112%	3%	7%
Germany	4.9	3.3	-32%	16%	11%
Taiwan	0.1	0.2	274%	0	1%
Japan	1.1	1.5	29%	4%	5%
Others	11.9	10.1	-15%	38%	34%
Total	31.5	29.4	-7%	100%	100%

Source: DGE and BCTL calculations.

Importing Goods

On the other hand, imports increased by \$250 million in 2022.

According to the DGE and before the respective balance of payments adjustments, the value of imports in 2022 increased by \$250 million to \$839 million, thus countering the increases already seen in 2021 compared to 2020 (\$497 million).

The main products imported by the country continued to be fuels (26% of the total, compared to 21% in 2021), followed by vehicles (9%) and cereals (8%). It should also be noted that most of the most important items recorded an annual increase in their import value, which was due, in part, to price increases and inflationary pressures in international markets in 2022, as is the case of fuels, but also a recovery in domestic demand in the year under review, which continues to rely on imports of items produced abroad.

Fuels continue to have the highest weight in imports of goods.

Table 2.9
Main Imported Goods

	Million USD			% Total	
	2021	2022	Annual % change	2021	2022
Fuels	124	219	77%	21%	26%
Vehicles	55	72	31%	9%	9%
Grains	53	67	25%	9%	8%
Beverages	21	29	41%	4%	3%
Electrical Equipment	31	38	21%	5%	5%
Mechanical Equipment	26	58	125%	4%	7%
Meat and Derivatives	25	33	32%	4%	4%
Cement and Derivatives	20	22	14%	3%	3%
Grains - Refined	20	26	28%	3%	3%
Iron and Steel - Products	33	20	-40%	6%	2%
Food Oils	13	16	25%	2%	2%
Milk, Eggs, and Derivatives	7	7	-6%	1%	1%
Others	161	232	44%	27%	28%
Total	589	839	42%	100%	100%

Source: DGE and BCTL calculations

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



Table 2.10
Import Origins

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

	Million USD			% Total	
	2021	2022	Annual % change	2021	2022
Indonesia	194	250	29%	34%	32%
China, Peoples Republic of	112	106	-5%	19%	13%
Singapore	72	89	23%	12%	11%
Hong Kong	10	21	107%	2%	3%
Viet Nam	25	19	-25%	4%	2%
Thailand	7	16	115%	1%	2%
Australia	13	17	33%	2%	2%
Malaysia	24	54	125%	4%	7%
Japan	7	10	46%	1%	1%
Brazil	12	17	41%	2%	2%
Portugal	4	5	25%	1%	1%
Korea, Republic of	1	7	626%	0%	1%
Other	99	178	81%	17%	23%
Total	580	790	36%	100%	100%

Source: DGE and BCTL calculations.

Indonesia, which has remained the main trading partner of the country, accounted for 32% of total imports in 2022, reflecting a slight reduction of its weight in the origin of imports by 1 p.p. compared to 2021, with imports from this country increasing 32% to \$250 million. Note, then, that the decrease in the relative importance of Indonesian goods was due to the stronger increase in imports from other countries such as Malaysia, Hong Kong, and Singapore.

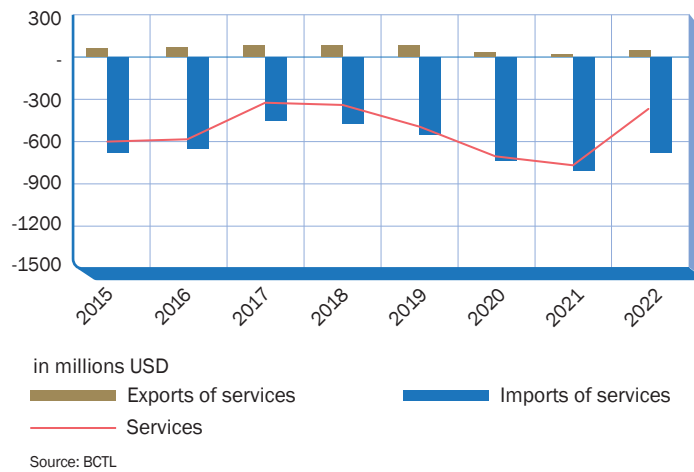
Besides Indonesia, imports from China and Singapore continued to occupy the 2nd and 3rd positions in the ranking, representing 13% and 11% of total imports in 2021. The continued increase in aggregate imports from other countries, which are not included in the list of the country's main traditional partners, should also be noted.

2.5.1.2. Service Account

In 2022, the trade services account recorded a deficit of -\$649 million, an improvement of \$103 million from the deficit of \$752 million recorded in 2021. As shown in graph 2.21, this was due to a \$79 million reduction in services imports in 2022, but also due to a slight increase in services exports of \$24 million in the same year.

The services account registered an improvement of \$379 million, although the balance of this account is still in deficit.

Chart 2.21
ET - Services account



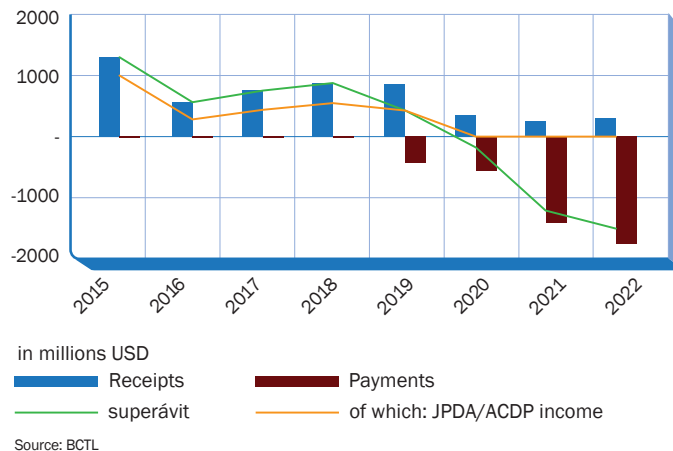
The export of travel services was the fastest growing sector in 2022.

The increase in exports of services was explained by the increase in the export of travel services (\$30 million). On the import side, imports of transportation (\$17 million) and travel services (\$29 million) increased while, in the opposite direction, imports of construction-related services declined (-\$35 million).

2.5.1.3 Primary Income Account

As mentioned earlier, petroleum revenues are no longer accounted for in the primary income account since the end of 2019 but are included in the goods sub-account after Timor-Leste ratified the maritime boundary-setting agreement with Australia. This change explains the substantial decline in the primary income account surplus since that date.

Chart 2.22
ET Primary income account



In 2022, there was a surplus of \$1418 million compared to \$1123 million observed in 2021.

2.5.1.4. Secondary Income Account

The secondary income account balance recorded a net outflow of resources of \$69 million in 2022, which was a substantial decrease from the positive balance of \$6 million recorded in 2021.

There has been an increase in remittances from emigrated Timorese citizens, worth \$10 million in 2022.

It should be noted here that remittances from foreign workers immigrating to Timor-Leste have increased again (\$45 million) to \$363 million in 2022. Simultaneously, and in the same year, the value of remittances from immigrant Timorese workers recorded, once again, a growth of \$10 million to \$181 million, thus contributing to alleviate the impact of the growth of remittances sent in the deficit of the sub-account.

2.5.2 Financial Account

In the period under review, the financial account, which includes the flows related to the economy's external financing sources, recorded a net inflow of \$261 million, which corresponds to an increase compared to the net outflow of \$609 million in 2021.

Although portfolio investments resulting from FP investment abroad, amounting to \$152 million, it was the significant increase in direct investment that contributed most significantly to the financial account, a sub-heading that recorded an increase of more than \$1 billion compared to the -\$755 million figure observed in 2021. This variation shows, as already explained in the 2021 edition of the BCTL report, that foreign direct investment (FDI) has continued to show sustainable dynamics since 2014.

Foreign direct investment was the largest contributor to the financial account, despite the FP contributions.

Table 2.11
Funding Sources

	In millions of USD	
	2021	2022
Financial Operations Account	-609	-261
Direct investment in Timor-Leste	-755	262
Portfolio Investment	150	-152
d/q. PF investment in foreigners	150	-152
Other investment, assets	-51	-397
Other investment, liabilities	46	25

Source: BCTL

2.6 Banking System

2.6.1. Bank Assets

The robustness of Timor-Leste's banking system should be highlighted.

The banking system in Timor-Leste has remained stable and sound during the period under review. The sector continues to be funded solely by residents' deposits, lending only a fraction of these resources to businesses and individuals, so that the banking system continues to have a remarkably high level of liquidity.

In the following tables and graphs, a set of information is provided about the country's banking system, which was composed, at the end of 2022, of a bank headquartered in Timor-Leste --- the National Bank of Commerce of Timor-Leste --- and local branches of four major foreign banks, headquartered in Portugal (CGD/BNU), Australia (ANZ), and Indonesia (Bank Mandiri and the BRI).

The total assets of the banking sector grew 27% to \$2,379 million in 2022.

The total assets of the banking system once again recorded a significant growth of 27% to \$2,337 million, an increase that exceeded the significant increase to that seen in 2021 (24%), resulting in an increase of +\$505 million. This growth recorded in total assets in 2022 follows the growth trend recorded since 2017. The positive development in 2022 is the result of an increase of \$488 million in deposits with credit institutions, an increase in loans granted (+\$90 million) and, to a greater extent, an increase in investments (+\$46 million).

Table 2.12

Commercial Banks Asset Structure

In millions of USD

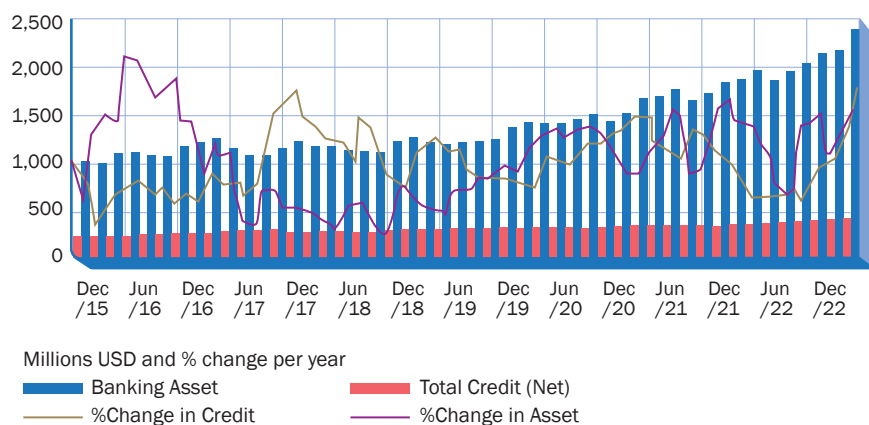
	Dec-21	Dec-22	Share %	Change	
				%	Amount
Central bank deposits	336	203	9	-40	-133
Deposits at credit institutions	1,110	1,598	68	44	488
Investment	98	144	6	46	46
Credit Granted (net)	266	356	15	34	90
Tangible Assets	15	15	1	3	0
Other assets	6	20	1	215	14
Total	1,831	2,337	100	28	505

Source: BCTL

It should be noted, once again, and similarly to what happened in 2021, the growth rate of credit granted has registered a growth rate similar to the growth rate of assets of the Timor-Leste banking system, thus translating into a sustained growth of the relative importance of credit in the set of applications of commercial banks.

Chart 2.23

Evolution of Banking Assets



The investment of funds with other banks continued to account for the largest proportion of banking assets, reaching 68% of the structure of assets at the end of the year in 2022, having reversed the fall in 2021 against 2020. In more detail, while the investment of funds with other banking institutions grew from 59.8% in 2021 to 68.4% in 2022, that is, a growth of 7.8 p.p. in relation to 2021, the same proportion had reduced by 7.3 p.p. in 2021 in relation to the value recorded in 2020, where the proportion of assets in an institution of assets represented 67.1% (Charts 2.24a and 2.24b). This decrease was due to the reduction in the weight of investments in BCTL.

We highlight the importance of deposits in credit institutions for the composition of the assets of Timor-Leste's banking sector.

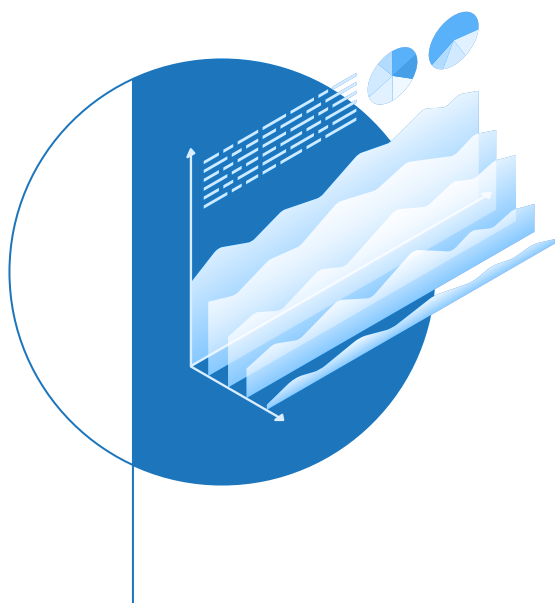
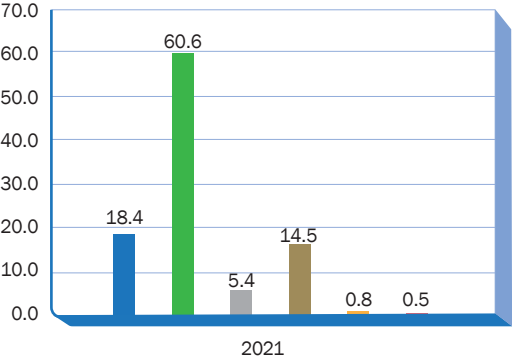


Chart 2.24a

Asset structure



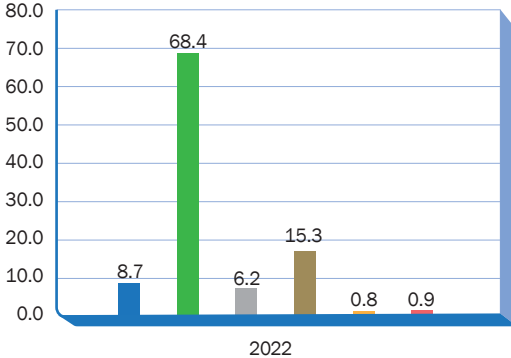
As % of total assets

- Central bank deposits
- Deposits at credit institutions
- Investments
- Lending (net)
- Tangible Assets
- Other assets

Source: BCTL

Chart 2.24b

Asset structure



As % of total assets

- Central bank deposits
- Deposits at credit institutions
- Investments
- Lending (net)
- Tangible Assets
- Other assets

Source: BCTL

Loans now occupy the second largest proportion position in the structure of banking assets (16.3%), when in 2021, loans were the third largest item in the structure of assets. The value of the bank loan portfolio (net), amounted to \$356 million at the end of 2022, compared to 266 million at the end of 2021, and continued to grow by 34.2% over the year, despite the challenging macroeconomic environment.

In December 2022, the overall value of deposits with the BCTL amounted to \$203 million, which corresponds to 8.7% of total assets, down from \$336 million at the end of 2021 (18% of total assets).

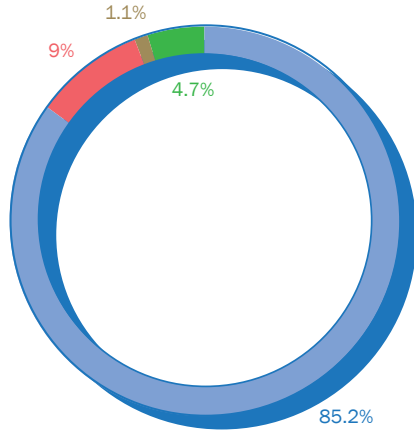
2.6.2 Bank Liabilities

By 2022, deposits from customers represented more than 72% of bank liabilities.

Raising customer deposits continues to represent the largest source of funds for credit institutions. Deposits taken represented 81.2% of banks' liabilities and capital at year-end 2022, having increased significantly by 30%, in 2022, to \$1.7 billion.

Chart 2.25a
Bank Liabilities Structure

Dec 2021



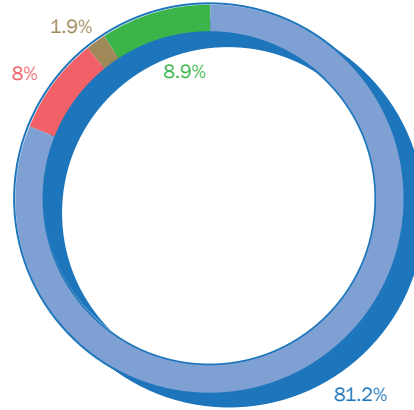
As % of Total

- Due to BCTL
- Placement from Other Banks
- Deposits
- Others

Source: BCTL

Chart 2.25b
Bank Liabilities Structure

Dec 2022



As % of Total

- Due to BCTL
- Placement from Other Banks
- Deposits
- Others

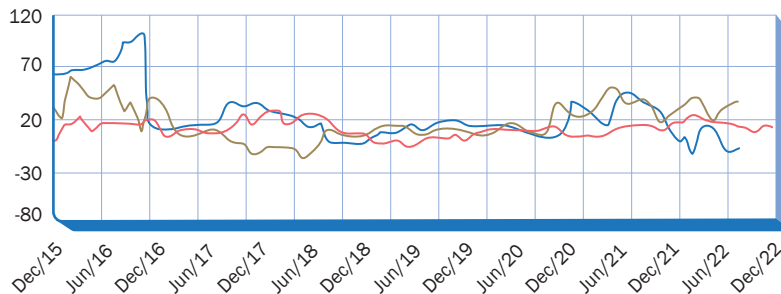
Source: BCTL

In 2022, resources obtained from the Central Bank recorded an increase of \$23 million, representing a total of 1.9% of total resources, while deposits due to other financial institutions increased once again in the amount of \$188 million, representing, for 8.9% of consolidated liabilities. Note that both categories, especially deposits received from other financial institutions, have seen a substantial increase since 2017.

Demand and savings deposits together increased by \$296 million in 2022.

In terms of the type of customer deposits, demand and savings deposits increased by \$274 million and \$22 million respectively in 2022, while time deposits decreased by \$24 million.

Chart 2.26
Deposit Evolution



Annual growth rate

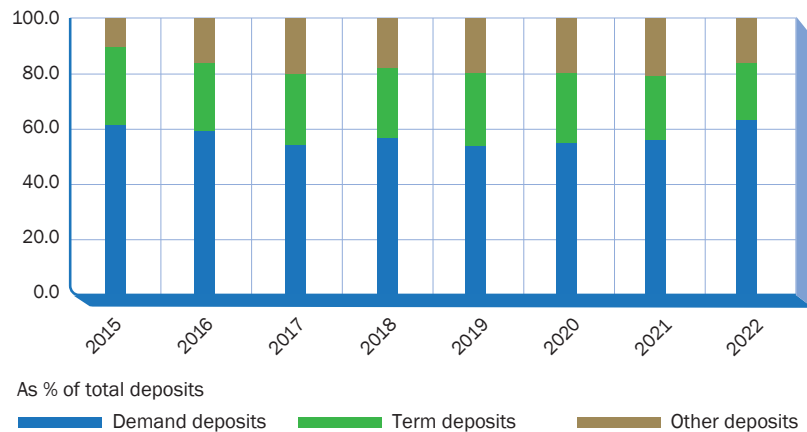
- Demand deposits
- Term deposits
- Savings deposits

Source: BCTL

However, time deposits have seen their importance in the structure of deposits to decline.

As a result of these variations, the structure of deposits recorded a growth trend in demand deposits, as observed in 2021. However, time deposits lost some importance in the deposit structure (-2.4 p.p. compared to 2021), representing a total of 20.8% of the deposit structure. Demand deposits thus continued to represent the largest component of total deposits, with 63.7% of the total.

Chart 2.27
Deposit structure



Source: BCTL

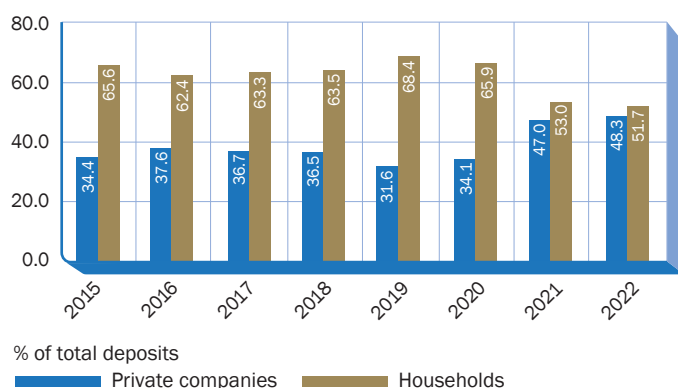
2022 is marked by greater convergence in deposit ownership, a trend that began in 2019.

In terms of ownership of deposits in banks, there was, as observed in 2021, a reduction in deposits held by private residents, with deposits by individuals reducing their importance to 51.7% of total deposits, as opposed to the increase in the relevance of resources from private companies to 48.3% of the total in 2022. This evolution therefore translated into a significant increase in the weight of corporate deposits in total resources taken, when compared to their relative importance over the last 10 years.



Chart 2.28

Share of Deposits by Ownership



Source: BCTL

2022 is marked by greater convergence in deposit ownership, a trend that began in 2019.

As can be seen in the previous graph, the slight increase in the absolute value of deposits from companies, amounting to \$60 million, has helped explain the relative increase in deposits from companies in total deposits in 2022, since deposits from individuals continued to increase by only \$34 million in the same year.

2.6.3 Bank profitability

The banks' revenues, consisting of interest received and commissions charged to their customers, amounted to a total of \$59.9 million, recording a significant increase of \$19.88 million compared to 2021, countering the decrease observed in 2021 compared to 2020.

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

As a result of their activity, the banks reported the following consolidated results in 2022, which are compared with the equivalent 2021 figures in table 2.13 below:

Table 2.13

Consolidated Results of the Banking System

Items	In millions of USD		annual % change	in % Gross operating income	
	2021	2022		2021	2022
Received Interest	30.7	49	59.0%	76.6%	81.5%
Paid interest	2.6	5.1	93.9%	6.6%	8.5%
Net interest income	28.1	43.8	55.7%	70.0%	73.0%
Commissions and Other Revenues	12.0	16.2	34.3%	30.0%	27.0%
Gross Operating Income	40.2	59.9	49.3%	100.0%	100.0%
Provisions and Impairments -	-2.5	-2.2	-10.6%	-6.2%	-3.7%
Operational Expenses	-21.9	-28.2	28.7%	-54.5%	-47.0%
Net Operating Income	15.8	29.5	87.2%	39.3%	49.3%
Extraordinary income/expenses	-0.1	1.1		-0.2%	1.8%
Net income before tax	15.7	30.7	95.1%	39.1%	51.1%
income tax	-1.4	-2.4	77.7%	-3.4%	-4.0%
Net income	14.3	28.2	96.8%	35.7%	47.1%
RoA % - Rendibilidade dos Activos	0.8	1.2	53.8%	1.9%	2.0%
RoE % - Rendibilidade do Capital	10.6	12.9	21.7%	26.4%	21.5%

Source: BCTL

The return on assets and return on equity grew significantly in 2022.

As we can see, both interests received, and commissions grew more than 30% in 2022 compared to 2021. The gross operating income of the Timor-Leste banking system registered an increase of \$19.8 million, representing a growth of 49% compared to 2021. Consequently, the net operating income grew \$13.8 million compared to 2021, which is equivalent to a growth of 87.2%.

Finally, considering extraordinary income and costs and taxes on profits for the year, the system’s consolidated net income increased to \$28.2 million in 2021 from \$14.3 million in the previous year.

This decrease explained the increase in the return on assets (RoA, or Return On Assets) observed in 2022 to 1.2%, up from 0.8% in 2021, as well as the growth in the return on equity (RoE, or Return On Equity) to 12.9%, when 2021, this return was 10.6%. Banks continue to maintain liquidity ratios above those required by the Central Bank and the regulatory framework in force.

2.6.4 Transfer Services

2.6.4.1 Transfer of Remittances - Commercial Banks

The number of transfers grew by 86.7% in 2022 compared to 2021.

During 2022, money transfer services, reported by commercial banks operating in Timor-Leste, recorded total outbound transfers of about 206 thousand transactions, with an aggregate nominal value of \$3,505 million. The number of transactions thus conducted increased by 86.7% and the total value transferred grew by 101.4%, compared to 2021.

On the other hand, the number of incoming transfer transactions increased a whopping 100.3% in 2021 to 169,000 transactions, with the amount received also growing 99% to \$1,427 million.

The net balance of transfers was significantly high in 2022.

As such, the net balance of transfers received and originated by commercial banks recorded substantial negative growth, registering at -\$2,078 million in 2022, when compared to the also negative balance of -\$1,024 million in the previous year.

2.6.4.2 Transfer of Remittances - Specialized Operators (OTO)

Personal transfers remain the largest share of total transfers in 2022.

In 2022, the group of Other Money Transfer Operators (OTOs) recorded a total value of transfers abroad of \$196 million, up from \$137 million in 2021. The transfers from abroad and intermediate by these operators recorded, in 2022, an amount of approximately \$147 million, compared with \$135 million recorded in 2021. This evolution led to an increase in the already loss-making balance observed in 2021 of -\$1.7 million to -\$49 million in 2022.

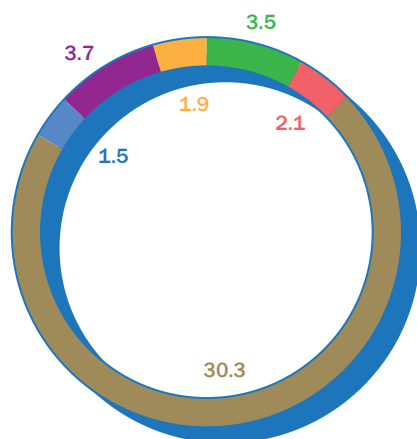
Personal transfers continued to represent the largest share, both in terms of inflows and outflows, amounting to 40% and 84% of total transfers, respectively. Personal transfers aggregate the reasons 'family', 'education' and 'savings' invoked in the operations.

In geographical terms, most inflows continued to come from Europe, accounting for \$80.5 million in 2022 (55% of the total), up from \$74 million in 2021, and were mostly explained by remittances sent by Timorese workers residing and working in Europe. The remittance outflows operated by the OTOs were mostly directed to the Asian region, reaching an amount of \$175 million, with Indonesia being the largest destination of transfers from Timor-Leste, with a total of \$149 million, equivalent to 76% of the total. This amount is explained by remittances sent by Indonesian citizens living and working in Timor-Leste.

Europe continues to be the main origin of where remittances come from.

Charts 2.29a and 2.29b present the weight of transfers made to and from Timor-Leste, by purpose, by use of the services of money transfer operators in 2022.

Chart 2.29a
External Transfers, by Type (OTOs)

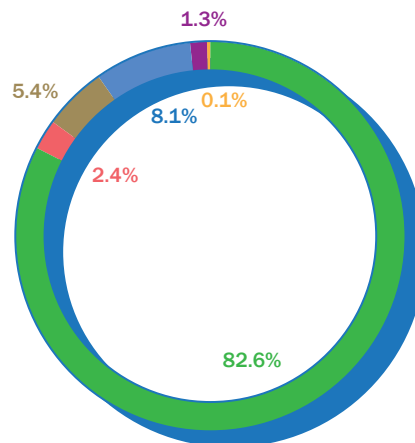


As % of total

- Households
- Education
- Investment on firms
- Purchase Payments
- Savings
- Others

Source: BCTL

Chart 2.29b
Received Transfers, by Type (OTOs)



As % of total

- Households
- Education
- Investment on firms
- Purchase Payments
- Savings
- Others

Source: BCTL

