

Introduction

The **annual report of the Banco Central de Timor- Leste (BCTL)** synthesizes and presents the main national and international economic developments in 2019, as well as the activities performed by the BCTL throughout the year. The Organic Law of the Central Bank establishes and provides the framework for annual reporting of the Central Bank in relation to the President of the Republic, the National Parliament, the Prime Minister and the Minister of Finance. The report consists of two major sections, specifically, the analysis of the domestic and international economic developments and outlook and the presentation of the Bank's activity report, which also includes the disclosure of relevant financial information.

Given the current importance and the serious impacts of the new coronavirus economic crisis, this report already includes a first assessment of the international economic impacts, based on the IMF's latest world economic outlook, published in April of 2020.

In 2019, the **world economy** grew 3%, which translated into a slight slowdown compared to the previous year (3.6%), but allowed it to continue the recovery cycle from the global financial crisis of 2008-2009. This slowdown was due to slowing growth both in developed and developing economies. Regionally, Asia has continued to lead in terms of GDP growth (5.9%) in 2019, despite the slight slowdown compared to 2018. The growth in ASEAN's five largest economies amounted to 4.8% in 2019, representing a slight reduction over the previous year's growth rate of 5.2%.

Given the impacts of Covid-19 crisis, the IMF significantly cut its economic growth forecasts for 2020 and now expects that the world economy to fall -3% in 2020. It should also be highlighted that the economic impact is expected to be higher for Developed Economies, whose GDP should fall -6.1% in 2020, than for Developing Economies (-1.1%). On the optimistic side, the IMF also expects a substantial recovery in economic growth for the world in 2021 and for those two major economic blocks, forecasting a full and relatively quick recovery from the recessive levels of 2020.



In 2019 there was an easing of inflationary pressures in the major world economies, reversing the upward inflationary trend observed since 2016. The US closed 2019 with an inflation rate of 1.8%, below the FED's official target and 2018's 2.4% level. This allowed the FED to cut interest rates multiple times in 2019 to mitigate the growing risks related to the worsening of trade tensions between the US and China.

In terms of the main international financial markets, 2-year interest rates, more sensitive to monetary policy changes and outlook, recorded a significant decline in 2019, especially in the US market. This development reversed the rising interest rate cycle observed since 2013 in the US market, and resulted from the multiple cuts in FED's interest rates in 2019, following its growing concerns over the unfavorable impact in its economy of trade tensions with China. The US 2-year interest rate thus declined from 2.49% to 1.57% at the end of 2019. Nonetheless, in both 2 and 10-year terms, US interest rates remained at levels well above those recorded in the Eurozone and Japan, as a result of the better US economic performance along the last years, and the sustained rise of FED's interest rates from 2013 to 2018.

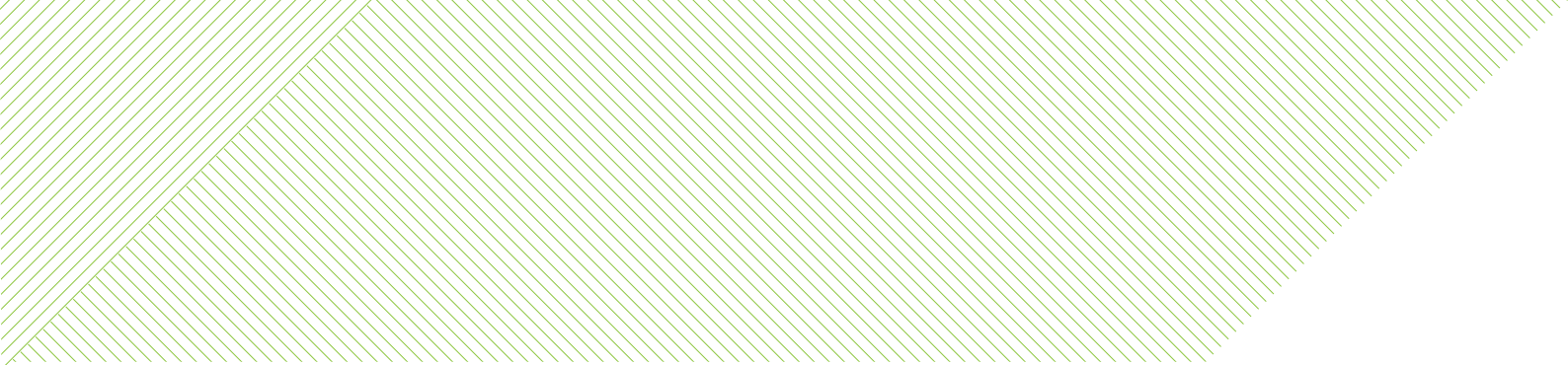
Naturally, bond market developments, together with the already mentioned economic developments, also explained most of the changes in major foreign exchange and equity markets. With the exception of the yen, the dollar appreciated slightly against major world currencies, which resulted from the continued divergence in terms of interest rates levels, despite recent FED rate cuts, and robust US economic outperformance. In equity markets, 2019 was marked by the general recovery of the major world indices, supported by the implementation of monetary policy support measures in virtually all geographies and the easing of global trade tensions. This was especially visible at the end of 2019, on the back of the increasing expectation of the completion of the first phase of the trade agreement between China and the US. In terms of performance, the US market continued to lead, recording a gain of 28% in 2019, despite the remarkable performance of the European market (+21%) and developed markets in Asia (+15%). The overall world equity market gained 24% in 2019. These substantial gains have allowed global markets to fully recoup the losses experienced in 2018.



In the **Asian economic space**, growth levels remained robust in 2019, with the average GDP growth rate in the region standing at 4.1%, but which translates into a further gradual slowdown compared to the average growth rates recorded in 2017 and 2018. With regard to inflation, on average, the region recorded an annual rate of 1.8% in local currency terms, which translates into an easing from the 2.2% of 2018. Despite the strong decline in Indonesia's inflation since 2015, this economy continues to register the highest inflation levels in the region, or 3.2% in 2019. The slight slowdown in economic growth in the region in 2019, more moderate inflation rates in the various economies and the slight average depreciation of regional currencies against the dollar, explained in turn, the easing of regional inflationary pressures, when measured in dollar terms. Given the new coronavirus crisis impacts, the IMF now expects a substantial fall in Asian economic activity levels in 2020, especially in Thailand, Singapore and Malaysia, which should register economic recessions in this year. In line with its global optimism for 2021, the IMF expects a quick and substantial economic recovery across major Asian economies and full recovery of the lost ground in 2020.

In the **national economy**, economic growth recovered substantially in 2019, as the economy has expanded 4.5% in the year, after the substantial economic contraction recorded in 2017 and 2018. The recovery was mainly due, as has been normal, to the substantial increase in public spending in 2019. BCTL's projects a renewed slowdown in annual economic growth to 1% in 2020, followed by a recovery in 2021. The weak optimism for 2020 is mostly due to the recent failure to approve the new Budget proposal for 2020, in January 2020, which intensified the level of political uncertainty in the country. The increasing degree of political uncertainty, the implementation of the 'duodécimos' regime in the 2020's budget execution and possible early elections resulted in a worsening of the economic risks, which undermine the confidence of economic agents and, above all, reduce the economic clout of the public sector, which continues to be the main driver of Timor-Leste's economy.

Domestic annual inflation rate stood at 1% in December 2019, which represented a decrease compared to 2.5% in December 2018. Inflation thus slowed down during the year, retracing the pickups recorded in 2017 and 2018. Inflation's decline in 2019 was due mostly to the stabilization of external inflationary pressures in a context of dollar stability against the currencies of the country's trading partners. In terms of its outlook for 2020 and 2021, BCTL



expects inflation to remain low and stable, below 2% annually over the next 2 years, given expected external inflation stability amidst the continued stability of the dollar versus our trading partners' currencies.

In terms of the **State's Finances**, the public sector continues to record a high budgetary deficit, with non-oil revenues funding only a small part of total public expenditures. After the substantial delay in the adoption and implementation of the 2018 State Budget (OGE), budgetary policy implementation was regularized in 2019, especially in its most formal approval plan. However, overall execution rates were slightly lower than in 2018. The Government's state budget allocated a total expenditure of \$ 1,464 million for 2019, but only managed to spend a total of \$1,229 million, or 84% of the State Budget. Compared to the amount actually spent in 2018, public spending rose 6% in 2019, due to the greater budgeted amount. On the public revenues side, the Government expected total non-oil revenues of \$198 million, excluding loans, but the value of actual revenue amounted only to \$188 million. Despite this, this figure represented a significant increase of 8% compared to the \$173 million received in 2018. In terms of public revenues' composition, tax revenues continued to represent the most important category.

Timor-Leste's **external current account** recorded for the first time since 2016, a positive balance of \$133 million in 2019, with improved +\$324 million versus the deficit recorded in 2018 (-\$191 million). Measured as a percentage of non-oil GDP, the surplus amounted to 7% in 2019, representing a remarkable increase compared to the -11% deficit to GDP in 2018. The substantial improvement in the current account balance (+\$324 million) was especially due to the increase in primary income account surplus of +\$284 million, but also, albeit to a lesser degree, to the improvement of the balance in the secondary income account (+\$25 million) and the goods trade account (+\$22 million).

In terms of **annual activity**, the BCTL remains actively committed to promoting monetary and financial stability as well as its inclusion, having developed particularly relevant initiatives in this context. One of the main activities carried out by BCTL was the launch of the Credit Guarantee System (CGS) for Micro, Small and Medium Enterprises, which is now ready to receive potential requests from interested companies. Also worthy of note is the continued implementation of the Financial Literacy Program, which covered several primary schools and already counts with the participation of 334 teachers from primary schools in



the 12 municipalities and the RAEOA. In cooperation with IADE and CCI-TL, BCTL also continued to implement the training program in accounting and business registration for Micro, Small and Medium Enterprises, aiming of strengthen their business management capacity and access to bank financing. The celebration of the 5th anniversary of the National Savings Day, on 29th November 2019, was held at the Administrative Post of Maliana, during which a poetry and speech contest was organized among students from 10 primary schools from that city.

In terms of the **national payment system**, the Central Bank continued to make every effort to always maintain sufficient liquidity reserves to meet the needs for cash payments and to ensure the modernization and permanent functioning of the National payment and interbank settlement system, 'R-Timor'. The most relevant development in this context consisted in the official launch of the 'P24 system', which, by using the 'R-TiMOR', interconnected the country's various banking networks and is now able to automatically settle interbank liabilities, substantially facilitating the access to bank accounts and respective services. Also noteworthy is the remarkable progress in terms of the provision of electronic money services (E-Wallets), with the entry of a new operator in the market in 2019 and the operational success of the first operator of this type of services.

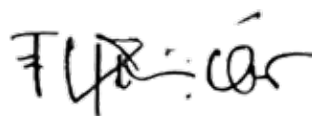
With regard to the **banking system**, the available information shows that it has remained stable and robust, underpinned by the high levels of liquidity, capital and provisions for credit risks as well as the continued robust growth of banking assets, which increased another 12% in 2019, to a total of \$1,394 million.

In the 2019 financial year, **BCTL's accounts** recorded a net profit of \$6.55 million, mostly due to interest received from the management of the Bank's own reserve assets and fee income, accruing from the Petroleum Fund's operational management.

BCTL continued to work closely with the Ministry of Finance as well as with the Petroleum Fund's Investment Advisory Committee to maintain an active and informed position within the ongoing discussions on the investment strategy of the Petroleum Fund.

The Bank continues to maintain its focus on further advancing staff capacities, allocating significant financial resources for this purpose. This investment has been reflected positively on the quality of work in the institution, admittedly amongst the best in the country.

Finally, as has been usual and as BCTL's Governor, I would like to thank all the employees of the Central Bank, as well as our partners and interlocutors at various times, which continued to actively contribute to the consolidation of the Central Bank and the economic development of our country.



Abraão de Vasconcelos

Governor

Dili, 30 April 2020