



<i>Population</i>	1.1 million
<i>Population growth</i>	3.2 percent
<i>Surface area</i>	14,870 sq. km.
<i>Capital</i>	Dili

*Source:* World Development Indicators.

Real non-oil GDP (excluding the UN mission) is estimated to have grown by 8.5 percent in 2010. This follows two consecutive years of more than 12 percent expansion in this measure of economic activity. Petroleum receipts grew by 25 percent in 2010 and amounted to 350 percent of non-oil GDP. The slower, albeit still robust, economic growth in 2010 is explained by a weaker performance of the agriculture sector stemming from weather-related events, with both rice and coffee being adversely impacted. Public sector spending has been the key driver of growth in recent years. Elevated government spending has spurred growth in the local private construction sector, which in turn is creating opportunities for suppliers of locally sourced materials and labor. In 2011, with public spending remaining strong and agriculture set to recover, growth is expected to return to double digits. Petroleum receipts are projected to continue rising in 2011 mainly on account of higher prices. Beyond 2011, production from oil fields with approved development plans is expected to decline before ceasing in 2024.

Inflation in 2011, as measured by movements in the CPI for Dili, has been in the double digits and recorded 13.1 percent year-on-year in August. Increases in the international prices of food and fuel, combined with the depreciation of the US dollar, explain much of

the uptick in inflation. Rice prices, which account for a large share of the CPI, moved higher on account of unfavorable weather conditions impacting domestic production, as well as due to a reduction in the subsidy on imported rice. The stimulus to aggregate demand through higher government spending is also having an impact on inflation, for example, through prices of locally sourced building materials. With public spending likely to be elevated in the coming years, it will remain a potential source of inflationary pressure.

In 2011 the government released its Strategic Development Plan (SDP) which aims to transform Timor-Leste to an “upper middle income country, with a healthy, well educated and safe population by 2030.” The Budget for 2012 and accompanying medium-term expenditure plans are aimed at implementing the SDP, with a significant scaling-up of capital spending to address pressing infrastructure constraints. The overall size of the 2012 budget (excluding development partner commitments) shows an increase of 35 percent over the 2011 level, with capital expenditure rising by around 50 percent to constitute 60 percent of total expenditure. The budgeted level of capital expenditure in 2012 is more than four times the actual spending for 2010. In 2010, capital expenditure amounted to nearly 40 percent of non-oil GDP while total expenditure amounted to around 115 percent.

The bulk of the capital expenditure will be routed through the Infrastructure Fund (IF) which was set up in 2010 as part of the State Budget to finance multi-year projects with a value of more than one million dollars. Key areas of investment include electricity, transport, and education. The government is also aiming to develop infrastructure on the South Coast to attract investment in the downstream petroleum sector as envisaged in the SDP. Seed capital for the newly established Timor-Leste Investment Corporation (TLIC) is another major area of expenditure. The TLIC will have a commercial orientation and will aim to invest in strategic projects such as the undersea cable and projects that will help diversify the economy away from the oil sector.

Mindful of the importance of ensuring the quality of ramped-up expenditure, the government is strengthening its institutional setup for public investment management. The Secretariat of Major Projects will review all projects submitted for financing to the IF by line ministries. A newly established board of the IF will take the decision on financing, and a National Development Agency will be responsible for supervising project implementation and for quality control. A Procurement Commission will be responsible for procuring large projects. These new institutions will likely face a large workload in the coming months, and will need to strike a balance between speed and quality in executing their mandates.

Non-oil revenues are expected to finance about 8 percent of the budget in 2012, with withdrawals from the Petroleum Fund (PF) continuing to provide bulk of the financing. In the 2012 budget, the government will for the first time, undertake debt financing as a way to diversify its funding sources. This debt financing, about 3 percent of the 2011 Budget, is to be on concessional terms and will be directed towards selected infrastructure projects. Given the size of financing needs, withdrawals from the PF will exceed the Estimated Sustainable Income (ESI) for the third year running, and under current investment plans will continue to do so for the next five years. According to government projections, the ESI itself, based on fields with approved development plans, is expected to decline from 734 million dollars in 2011 to 577 million dollars in 2016.

Aided by high oil prices, the PF balance rose from 6.9 billion dollars at end-2010 to 8.3 billion dollars at the end of the second quarter of 2011 (more than 8 times non-oil GDP). The return on investments was 3.8 percent in 2010 (2.3 in real terms), with the annualized return on the fund since its inception in 2005 being 4.2 percent (2.2 in real terms). In a move to raise the long term rate of return, the PF Law was amended in 2011 to allow for a maximum of 50 percent of the Fund to be invested in equities. Earlier, the Law required at least 90 percent of the investments to be in US dollar denominated bonds issued or guaranteed by governments and cash deposits.

The currently unsettled global financial outlook poses some complexities for the government in diversifying towards equities. The governance of the PF is based on the “Santiago principles” and incorporates a high degree of transparency and disclosure of information.