**Timor Leste**

Since becoming independent on May 20, 2002, Timor-Leste has made solid progress in nation-building, maintaining peace and unity, and restoring public services and private sector activity. The country now faces the challenges of building on this early progress in the context of very limited human resources, embryonic institutions, a stagnant economy, and high levels of poverty and unemployment. The National Development Plan, prepared shortly before Independence, outlines Government’s development and poverty reduction objectives. A Stability Program, announced in January 2003, highlighted the areas of the NDP which the Government considers its immediate priorities, notably improvements in governance, service delivery in the social sectors, and job creation.

Subsequent to the ratification of the Timor Sea Treaty in March 2003, development of the Bayu-Undan oil and gas field has proceeded and liquids production began in April 2004. The second phase, scheduled to begin in 2006, entails piping of dry gas to Darwin, Australia, for recovery as liquefied natural gas. Although there may be some opportunities for service activities in Timor, the principal benefit will be from the significant revenues that the project is expected to generate over the next two or three decades.

In a context of historically high oil prices, Timor-Leste’s petroleum revenues were significantly higher than expected, increasing from US$ 41 million in 2004 to a projected US$ 244 million in 2005 (as compared to a budget of about US$ 75 million). Medium-term projections indicate that petroleum revenues will remain around US$ 200 million for the next four years. In the interest of prudently managing the influx of revenues, the Government has prepared a draft savings policy and associated Petroleum Fund Act consistent with the Extractive Industries Transparency Initiative (EITI), for which Timor-Leste is a pilot country. Consultations over these policies and laws have been broad-based, both externally and internally, which has contributed to the creation of a national consensus over principles which will determine the shape of Timor-Leste’s future. The draft savings policy and Petroleum Fund Act are expected to be submitted to Parliament in April 2005, with a view to having arrangements in place for the start of the next fiscal year.

With the initiation of petroleum production, Gross National Income is rising considerably. At the same time, per capita GDP is stagnating. After declining around 6 percent per year for two years, non-oil GDP is expected to have grown by 3.4 percent in 2004. This modest recovery reflects an increase in agricultural production following a period of drought as well as a significant expansion in banking sector activity.

Non-oil exports rose to US$ 8 million in 2004, of which US$ 7 million was coffee. Coffee exports are expected to rise somewhat in the medium term in response to higher improved marketing; other exports are growing at a higher rate but from a much lower base.

Inflation fell below 2 percent on a year on year basis in December 2004 in response to moderate domestic demand and the continued downsizing of the international presence and stable non-oil import prices. Inflation is expected to remain at around 2.5 percent on the basis of low international inflation and the continued absence of domestic demand pressures. The overall wage level remains relatively high in comparison with neighboring countries, undermining competitiveness and limiting job creation for unskilled labor. At the same time, unemployment rates are high. In 2001, unemployment reached 20 percent in the urban areas of Dili and Baucau, compared to 5 percent nationwide. Unemployment has most probably increased since then, particularly as members of the rapidly growing youth population approach working age.

While some interest has been shown in concessions for exploitation of natural resources, such as fisheries and forestry, there has been little new investment thus far. However, financial sector activity has expanded rapidly in the last year. Bank deposits increased to 25 percent of GDP in 2004, and there was a seven-fold increase in bank lending between January 2003 and March 2004. As of January 2005, the largest bank, Banco Nacional Ultramarino (BNU) held USD 63 million in outstanding loans, representing about 19 percent of GDP.