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1. Overall GDP Projections

BCTL expects real GDP growth to plunge substantially in 2020 to -6%, thus cancelling 2019’s economic recovery (4.6%) from the 2017/2018 crisis. For 2021, we expect the domestic economy to pick up again to positive growth levels (3.2%), but this recovery should be relatively subdued when compared to past economic recoveries.

As is widely known, the non-oil domestic economy is facing two massive and negative shocks in 2020, firstly due to the continuation of the political crisis and successive delays in approving a Public Budget for 2020 and, secondly, and probably more impact fully, due to the Covid-19 pandemic crisis impact.

These two events should result in a substantial -7% fall in private domestic demand – which includes households’ consumption and investment as well as private business investment – and a -14% fall in public demand, due mostly to falling public investment, but also to lower public consumption. The fall in public demand in 2020 is due to the strict duodecimal regime in public spending and is especially due to lower public spending in goods and services and public investment, while public spending in wages and personal benefits is expected to rise in 2020, to address the pandemic impacts.

On an aggregate basis, BCTL expects domestic demand to fall -11% in real terms in 2020, but this negative impact should be minimized by a reduction of the country’s net external deficit, as we expect net external demand (imports less exports) to fall -18% in the same year, driven by a substantial decrease of the country’s goods and services imports. This means that lowered import levels in 2020 should cancel part of the fall in domestic demand, and non-oil GDP should decline only by -6%, when compared to the -11% real decrease in domestic demand.

For 2021, we expect a rebound in both private and public domestic demand, which should elevate domestic demand by 3% in the same year, but net external imports should rise slightly in line with domestic demand, which means that GDP growth should be broadly in line with domestic demand growth of around 3% in that year.

Note, however, that there are still substantial risks to these projections, as the current situation and respective impacts are highly uncertain and we still have very few available data to track developments in 2020. On the downside, 2020 and 2021 GDP projections could be revised lower in case the falls in private or public demand are larger than we anticipate, or in case imports levels do not fall more than domestic demand. On the positive side, successful public support policies, stabilization of the political situation and greater domestic demand resilience in 2020 could justify an eventual upgrade of BCTL’s projections versus these levels. Overall and currently, we consider negative risks to our central projections to be more probable than positive reviews.
2. Recent Updates and Expected Developments

As already mentioned above, BCTL macroeconomic projections face extraordinary uncertainties in 2020 and 2021, due to the material impact and difficulty to incorporate the Covid-19 and political/budgetary risks in our framework. Naturally, as the year progresses and further economic data is released – imports, financial and public budgetary data remain crucial in terms of tracking the domestic economic cycle – we will have greater certainty in terms of assessing the economic impact of these two major factors and review our projections accordingly.

Within this context, we expect to have, by the end of July, a useful set of those economic time-series with data up to the end of June of 2020, which will be fundamental to assess the respective progresses for GDP’s main spending components in 2020’s first half and reassess our near-term economic projections, especially if we identify relevant divergences versus our prior assumptions.

On the positive side, we can already recognize that the recent political stabilization process and greater certainty in terms of approving 2020’s Public Budget will contribute to reduce near-term economic risks. In fact, the materialization of a new majority backing in Parliament for the Government and the recent announcement of the budgetary envelope of $1,492 millions for 2020’s Budget, whose presentation and discussion process is scheduled to start by early September, represents a very positive step towards stabilizing our domestic economy and increasing the economic confidence of our country’s citizens and companies. Despite the late expected approval of 2020’s Budget, the stabilization of the Budgetary process should lend support to our economy’s recovery, especially in 2021.

On the other side, the public health efforts and policies put in place to address the first wave of Covid-19 infections have been very successful thus far, as Public Authorities managed to suppress altogether the virus dissemination in the country. Despite these important successes, the economic toll of restrictive public health policies and the isolation of the country to contain the virus cannot be afforded for much longer and the country is now transitioning, as most countries around the world, towards opening up its economy and lessening the rigid restriction in peoples’ movements and public gatherings. Given the fundamental need to gradually open up the economy, Public Authorities will need to keep a high degree of vigilance and control over public health risks, which is especially relevant given the disease’s spread in Indonesia, without the possibility of further using highly restrictive policies that substantially weaken the country’s economy.

The balance between public health risks and economic activity stimulation will be increasingly skewed towards the latter objective, which will require a very efficient planning and implementation of targeted public health policies and widespread population support and approval of such measures. The trajectory in terms of the virus control will be crucial in terms of driving economic performance in 2020 and 2021, while any substantial pickup in country’s cases or need to implement again highly restrictive public health policies represent substantial negative risks for the coming years.

3. Detailed Projections and Assumptions

The table below further details BCTL’s projections for the various GDP components, from its spending perspective. BCTL’s projection model is based on the projection of nominal values for the main spending aggregates which are then aggregated to forecast nominal GDP levels from 2019 to 2021. Real GDP forecasts are then based on these nominal projections, which are converted into real value projections using the same GDP deflator projection across all GDP components – we consider inflation levels to be similar across components from 2019 to 2021. In addition, the Bank considers that the inflationary outlook is stable and low, as BCTL expects annual average inflation to be close to 1% in both 2020 and 2021.

<table>
<thead>
<tr>
<th>Nominal GDP – Demand Components – USD Millions</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>% Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Demand</td>
<td>$2,533</td>
<td>$2,463</td>
<td>$2,443</td>
<td>2.41%</td>
</tr>
<tr>
<td>Exports</td>
<td>$66</td>
<td>$49</td>
<td>$52</td>
<td>38</td>
</tr>
<tr>
<td>Imports</td>
<td>$1,591</td>
<td>$3,601</td>
<td>$3,636</td>
<td>871</td>
</tr>
<tr>
<td>Net Exports for Domestic Demand</td>
<td>$1,056</td>
<td>$890</td>
<td>$863</td>
<td>632</td>
</tr>
<tr>
<td>GDP</td>
<td>$2,699</td>
<td>$2,926</td>
<td>$2,985</td>
<td>$3,063</td>
</tr>
</tbody>
</table>

The table above highlights the key projection assumptions and highlights the major elements of risk and uncertainty. The Bank expects a strong economic performance in the coming years, driven by domestic demand and supported by favorable external conditions. The Bank also expects a gradual but steady improvement in the unemployment rate, with a significant reduction in poverty rates.
As can be seen in the table above, we project 4 main types of spending aggregates – private, public, external and add-ons – to arrive at our GDP projections. Note also that the projections for private demand aggregates – private consumption, investment and companies’ investment – and public demand in 2019 is based on various economic data available for the domestic economy, such as imports, credit and deposit data, as well as public revenue and spending available until December of 2019.

Projections for 2020 and 2021 result from a smoothened convergence of 2019’s aggregates towards medium-term projections, which are quantified by extracting medium-term economic trends and ratios using national account data available until 2018. Note, however, that given the extra-ordinary nature and high uncertainty related to the Covid-19 crisis impact, GDP components’ projections for 2020 and 2021, especially private spending components, were also adjusted using a discretionary basis, following econometric impact approaches used by international institutions like the IMF and the World Bank.

In terms of public domestic demand, public final consumption will continue to be its largest component and driver, as public investment should trend below its 36% weight of public demand recorded in 2018. Public demand is expected to decline in 2020 by -14%, driven by falls in both public consumption and investment levels and then rebound +5% in 2021, driven by the recovery in public consumption, while investment is expected to remain practically unchanged in that year. Note also that public consumption is expected to fall in 2020, mostly due to the significantly lower public goods and services spending. Naturally, we will need to revisit these perspectives later in the year, especially if the effective 2020 Budget to be approved later in the year, or indications for 2021 Budget, deviate materially from our scenario.

The rest of this report presents further detail in terms of the major domestic demand components, offering additional explanations of our projection scenarios for private demand, public demand, additional demand items and net external demand subcomponents.

In terms of domestic private demand, households’ consumption continues to be, by a far margin, its largest component and most important driver, whose growth is expected to rebound nominally to 3.5% in 2021, from an extraordinary decline of -3% in 2020. On the other hand, households’ investment and private companies’ investment is expected to follow the same trajectory, rebounding in 2021 from the expected slump in 2020.
‘Foreign Aid’, is the largest subcomponent followed by NPISHs’ demand. We mostly assume that these items will follow the trajectories of both private and public demand, which means that add-ons are expected to fall -10% in 2020 and rise 4% in 2021.

Finally, the last GDP’ aggregate is net external demand which nets overall goods and services exports and imports. Its largest components are and will continue to be goods and services imports which will continue to be needed to satisfy our domestic private and public demand.
As can be seen in the charts above, we expect net imports to fall in 2020 by -18% and then rebound 5% in 2021. The fall in 2020 should be mostly due to the decline in both goods and services imports, driven by the fall in domestic demand, which we assume will mostly lower the demand for foreign articles and services rather than domestically sourced products and services. Consequently, and as already mentioned above, we project the fall in net imports (-18%) to be larger than the fall in domestic demand in 2020 (-10%), which means that net external demand is expected to soften the negative impacts in terms of domestic GDP levels in the current year.

Note also that we expect a substantial fall in the export of goods, mostly coffee, in 2020, as the external demand markets for this commodity is significantly affected by the covid-19 pandemic impacts.