





Introduction

The annual report of the Banco Central de Timor-Leste (BCTL) summarizes and presents the main national and international economic developments in 2021, as well as the activities carried out by the BCTL throughout the year. The Organic Law of the Central Bank establishes and provides the duties and framework for the Bank's annual reporting to the President of the Republic, the National Parliament, the Prime Minister and the Minister of Finance. The report includes two major sections, specifically, the assessment of relevant domestic and international economic developments, including also near term projection scenarios and the presentation of the Bank's activity report, which encompasses as well the relevant financial information.

2021 was marked by the remarkable recovery of the world economy, after the pandemic crisis and the respective global recession of 2020. The world economy grew 5.9% in 2021, after having retreated -3.1% in 2020. Analogous to the 2020 crisis, the economic recovery was transversal and synchronized across practically all geographies. According to the IMF, developed countries' aggregate GDP has already reached its pre-pandemic levels in 2021, but developing countries' GDP level in 2021 is already 4% above that of 2019.

In terms of prospects for 2022 and 2023, the IMF expects the world economic recovery to continue. The IMF specifically forecasts that the world economy will grow 4.9% in 2022 and 3.6% in 2023. This optimism is based on the perpetuation of the success of vaccination programs and containment of the degree of severity of the virus, as well as the gradual reduction of restrictions on economic and social activity over the next two years. This assumption, together with the ongoing robust economic recovery, supported by ample economic policy stimulus programs, justify the optimistic perspectives of the IMF. Even so, the Fund and most international institutions have repeatedly warned that the world economy continues to face substantial downside risks, highlighting the resurgence of global inflationary pressures to the highest levels of the last 30 years and the difficulty of properly adapting and withdrawing the monetary and budgetary stimulus programs implemented over the last two years. Additionally, despite the fact that the risk of the virus has already been partially mitigated with vaccination programs, the evolution of the virus and its variants continues to represent a material risk to expected extension of the global recovery.




Global inflationary pressures increased notably in 2021, visible in the USA, Euro-Zone and ASEAN economies, to record levels in recent decades. In these 3 blocs, annual inflation reached values well above 2%, which tend to be the benchmark for most central banks, with average inflation in the US and Eurozone standing at 4.3% and 2.2% in 2021. However, the IMF foresees a gradual convergence of average inflation rates in 2022 and 2023 towards 2%, in practically all world economies, admitting that the current inflationary episode will tend to be “temporary”. This scenario is based on the understanding that the current inflationary pressures result, above all, from temporary productive and logistical constraints and that the economic policy authorities worldwide will be able to successfully reverse their stimulus programs in 2022 and 2023, moderating and adapting aggregate demand growth to the productive capacity of the respective economies.

In the money and bond markets, there was a general rise in interest rates in practically all geographies and maturities, especially in the USA, due to higher inflationary pressures and the economic recovery’s strength. In the foreign exchange markets, the dollar ended up registering a slight appreciation against the main international currencies in 2021, driven by the rise in the dollar interest rate differential.

The performance of the Petroleum Fund’s investments continued to benefit from the renewed elevation of world equity prices, but was penalized by the rise in interest rates in 2021, which resulted in losses for the Fund’s bond portfolio. However, the materialization and reinforcement of a scenario of historically high valuations, especially for equity markets in 2021, should naturally limit the future performance of the Fund in the coming years.

Asian economies once again performed above average in 2021, which was due to the general success in containing the virus and the rapid and synchronized recovery of production processes and economic activity in the region’s countries. In line with global optimism, the IMF expects the continued substantial and widespread recovery of economic activity in the region in 2022 and 2023, predicting that the bloc will continue to lead the world in terms of economic growth.



In the national context, Timor-Leste's economy returned to growth in 2021, but only recovered partially from the recession recorded in 2020 (fall of -8.6% of GDP). The recovery 2021 was mainly due to the stabilizing effect arising from the significant increase in public expenditure throughout the year, amounting to \$306 million, and the expected recovery in private demand. However, despite the substantial increase in public spending, our estimates also consider the negative impacts arising from the extension of the pandemic mitigation measures, the massive floods of April 2021 and their respective damages, as well as the increase in inflationary pressures and the corresponding reduction in consumers' purchasing power.

For 2022, BCTL predicts the economic recovery to continue and economic growth to accelerate in Timor-Leste. This expectation is based, above all, on the continued growth of public demand in the coming year and on the acceleration of the growth in private demand, while higher net imports will once again cancel out part of the improvement in domestic demand.

In terms of budgetary policy, 2021 was marked by a significant increase in expenditure (+\$306 million) and in the public deficit, practically due to the increase in current expenditure (+\$326 million), in line with the increase in the respective budget. However, public investment continued to fall in 2021 (-\$20 million), due to the weak execution rate of the respective budget. For 2022, BCTL expects a further increase in public expenditure and public budget deficit, mostly explained by the recovery in public investment in infrastructure and buildings, so that budgetary policy stimulus will continue to support the economic recovery from the 2020 pandemic crisis.

In line with the global trend, there was a notable increase in domestic inflationary pressures in 2021, with the average inflation rate standing at 3.8%, up from 0.5% and 0.9% in 2020 and 2019, respectively. The rise in inflation was mainly due to rising external inflationary pressures, explained by the strength of global demand recovery and the persistence of global production and logistical constraints in 2021.

Timor-Leste continued to record an external current account deficit, which increased in 2021, mostly driven by higher imports of goods and services. Despite the fact that oil revenues have registered a significant decline over the last years, these still remain an important factor in mitigating the impact of the substantial trade deficit on our country's current account balance.

Despite the challenging macroeconomic context, **the financial sector continued to remain robust and to record high dynamism** in terms of growth of its activity level, assets and funding resources. It is illustrative to note that bank credit continued to grow in 2021, as well as deposits and funds received by banks operating in the country.

It should also be noted that during 2021, BCTL developed several **relevant initiatives within the scope of monitoring the economic situation** and mitigating the economic impact of the pandemic crisis and the 2021's floods. In this context, we highlight particularly the continued implementation of the credit moratorium and loan subsidization program for households and companies, as well as the undertaking of households surveys in order to assess their degree of financial inclusion and socio-economic conditions.

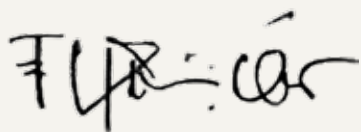
In terms of activities, the Bank remains actively committed to promoting monetary and financial stability and the respective financial inclusion, having developed initiatives that are particularly relevant in this context. One of the main activities developed by BCTL was the "Campo Digital" program, which aims to promote knowledge and widespread use of new technological tools - mobile phones, electronic money wallets, ATMs and PoS - in the financial activities of our population. Also in 2021, the BCTL continued to operationalize its partnership with the Ministry of Education, Youth and Sports to continue to improve the teaching, monitoring and evaluation of the Financial Literacy program in schools across the country, taught to students from 1st to 6th grade. The celebration of the 7th anniversary of the National Savings Day, on 29 November 2021, took place at the administrative post of Maubisse, in the municipality of Ainaro and was attended by local authorities, representatives of commercial banks, fintech companies and their respective agencies, financial service users, students and the Maubisse community.

In the context of the **national payment system**, the Central Bank continued to make every effort to maintain sufficient liquidity reserves at all times to meet the needs for cash payments and to ensure the modernization and full functioning of the national payment and interbank settlement system, the R-Timor. The main developments registered in 2021 in this area consisted in the implementation of additional functionalities in the R-TiMOR system to serve the needs of the Ministry of Finance and its sub-accounts, now allowing national taxpayers to pay their taxes from the bank's ATM network or from their electronic money wallets. The implementation of the "B2W2B" functionality, in addition to making it possible to pay taxes, now allows any holder of a P24 bank card to transfer money from a bank account to an "e-wallet" account and vice versa. Additionally, the project to interconnect the P24 network with an Indonesian payments network under the responsibility of BCTL continued to be implemented, which will allow holders of domestic bank cards to use these in banks in Indonesia.

The 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 and its rigorous implementation.

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 institution's work quality, which continues to be recognized as one of 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, April 28th 2022