

Timor-Leste and the Pandemic
– Economic Resilience and
the Global Challenges

Annual Report **2020**

Introduction

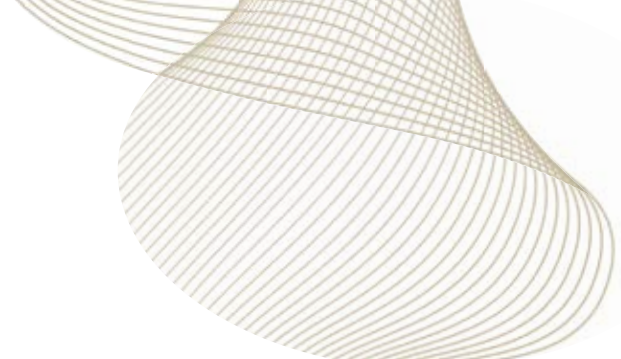
The annual report of the Banco Central de Timor-Leste (BCTL) summarizes and presents the main national and international economic developments in 2020, as well as the activities carried out by the BCTL throughout the year. The Organic Law of the Central Bank establishes and provides the duties and framework 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 consists of 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 comprises as well the relevant financial information.

The year of 2020 was undeniably and naturally impacted by the global pandemic crisis and its highly negative disruptions, which forced the widespread adoption of public health protection measures and highly restrictive constraints on social and economic activity worldwide. Given the current importance and impacts of the pandemic crisis, this report again devotes an important part of its attention to developments in this context, highlighting 2020's impacts, as well as the relief packages and economic support policies implemented at the national and international levels, including also the trajectories and consequences expected for the coming years.

The world economy experienced a recession in 2020 for the first time since the 2008/2009 crisis, with world GDP falling -3%, according to the latest estimates. This was the most pronounced annual drop in the past 30 years, which naturally reflects the devastating, global and synchronized impact of the pandemic crisis. However, the substantial and broad economic policy effort, at the monetary and budgetary levels, actively contributed to stabilize the respective impacts and to sustain a marked recovery of the world economy in the second half of the year, as the pandemic was reasonably contained in global terms. At the end of 2020, despite a further increase in infection levels in many countries, but especially in Europe and the Americas, the economic outlook was already much more optimistic, due to the approval of effective vaccines and the stabilization of the global commercial and financial markets.

In terms of prospects for 2021 and 2022, a substantial recovery is expected for the world economy and virtually all regional and national economies. The IMF specifically predicts that the world economy will grow 5.5% in 2021 and 4.2% in 2022. This optimism relies on the expectation of gradual and extensive implementation of vaccination programs in the main global economies, which, benefiting from the current





huge monetary and budgetary stimulus, and the return to “normality” and the opening of a set of economic sectors, should bring about a remarkable recovery in historical terms.


In terms of inflationary trends, 2020 was marked by the easing of inflationary pressures worldwide, in line with the general fall in economic activity. For 2021 and 2022, it is generally expected a pickup and recovery towards moderate inflation levels, for most world economies.

In the global monetary and bond markets, there was a marked reduction in interest rates across practically all geographies and maturities, in line with the substantial expansion of the monetary stimulus of major central banks. In the foreign exchange markets, the dollar ended up registering a slight depreciation against the main international currencies in 2020, resulting also from the reduction of the dollar’s interest rate premium. Despite the high volatility and pessimism prevailing in the first half of the year, the global equity and commodity markets ended up accumulating substantial gains in 2020, benefiting from the success of macroeconomic stabilization policies, the substantial reduction in investor pessimism and the beginning of worldwide vaccination programs.

The solid performance of Petroleum Fund’s investments in shares and bonds continued to benefit from the renewed rise in global share prices and the generalized fall in interest rates in 2020. However, the materialization and reinforcement of a historically high valuation scenario, both in the stock and bond markets in 2020, will naturally limit the Fund’s future performance over the coming years.

In the Asian economic space, in line with the global trajectory, the macroeconomic background also deteriorated. Despite the declines in activity, the Asian economies were still able to present a relatively robust performance, when compared to the rest of the world economies, which was due to the generic regional success in containing the virus and to the rapid and synchronized recovery of the productive processes and activity in the region. In terms of prospects, in line with global optimism, the IMF expects a substantial and widespread recovery in economic activity in Asian countries in 2021 and 2022, predicting that the region will continue to lead the world in terms of economic growth. As a result of these developments, there was a mixed evolution of Asian currencies against the dollar, which underpinned foreign exchange market stability and contributed to continue to anchor and limit inflation pressures for Timor Leste.

At the national level, Timor-Leste’s economy again recorded a recession in 2020, with the BCTL estimating that non-oil GDP contracted -3%. This contraction seems to have been more due to the elongation of political uncertainty and the late approval of the 2020 State Budget, which resulted in the annual reduction of public expenditure, but also to the adverse impact of the pandemic and the respective lockdown and social interaction limitations. With this performance in 2020, the domestic economy ended a very anaemic economic growth cycle in the last 4 years, as real GDP was, at the end of 2020, still below its value in 2016. For 2021, the BCTL expects a strong and substantial recovery in growth, a year in which GDP is expected to expand 7.7%. This expectation heavily relies on the extraordinary growth of public expenditure forecasted for 2021, as the approved 2021 State Budget results in a 21% increase in budgeted expenditure, but also because we expect a marked pickup in expenditure execution rates in that year, compared to 2020.



In terms of fiscal policy, 2020 was marked by a reduction in public expenditure and in the public deficit, which was mostly due to the decrease in public investment and the fall in expenditure's execution rates, especially in goods and services and transfers. However, a substantial increase in expenditure is expected for 2021, due to the substantial expansion of expenditure budgeted for 2021 and the recovery of the budgetary execution rates.

Domestic inflationary pressures have remained controlled and low throughout 2019 and 2020, with annual inflation rates remaining close to 1%. The BCTL continues to expect the persistence of this low and stable inflation scenario in 2021 and 2022, which is based primarily on the assumptions of the stability of the dollar against most Asian currencies and a moderate inflation in our trading partners' economies in the same period.


Although Timor-Leste continues to record a current account deficit, **the gradual and continued reduction in the deficit in the goods and services' commercial accounts has resulted in the contraction of the Country's effective external deficit**. However, the progressive and substantial reduction in oil revenues over the recent years has been the major driver of the simultaneous and symmetric increase of the global external deficit.

Despite these macroeconomic challenges, **the financial sector continued to be highly dynamic in terms of the growth of its activity, assets and deposited funds, thus remaining stable and solid**, as is visible in the maintenance of ample liquidity levels and low levels of credit at risk. It is illustrative to note that, even in the

difficult year of 2020, bank credit continued to grow significantly, as well as deposits and operating revenues of banks operating in the Country.

It should also be noted that during the year 2020, the BCTL implemented several relevant initiatives within the scope of monitoring the economic situation at the national level and mitigating the economic impacts of the pandemic crisis. In this context, we highlight the design and implementation of the credit moratorium program and loan subsidization scheme for national families and companies, as well as the undertaking of surveys on families and informal businesses, with the aim of assessing the respective economic impacts during the lockdown and post-lockdown period.

In terms of activities, the Bank remains actively committed to promoting monetary and financial stability and the respective inclusion, having developed initiatives that are particularly relevant in this context. One of the main activities developed by BCTL in 2020 was the pilot program "Campo Digital", which aims to promote knowledge and the widespread use of new technological tools - mobile phones, electronic money wallets, ATMs and PoS - in rural populations financial activities. Within our private sector development initiatives, we continued to promote basic accounting training for national Micro, Small and Medium Enterprises, in collaboration with IADE and CCI-TL, to strengthen their management capacity and access to bank funding. Also in 2020, BCTL signed the second memorandum of understanding with the Ministries of Education and the Ministry of Youth and Sports to continue to improve the implementation, monitoring and evaluation of the Financial Literacy Program in schools in the country. The celebration of the National



Savings Day's 6th anniversary was held on November 29 in Maubissi, in the municipality of Ainaro. During the event, the winners of the composition contest were announced, which was participated by many national students from the third cycle of basic education and secondary education levels.

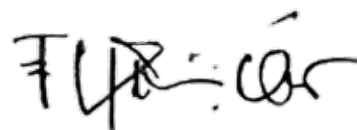
In the context of the **national payment system**, the Central Bank continued to make every effort to maintain sufficient liquidity reserves at all times to meet the needs for cash payments and to ensure the modernization and full functioning of the national payment and interbank settlement system, the R-Timor. The main development registered in 2020 in this area was the implementation of additional functionalities in the R-TIMOR system to serve the needs of the Ministry of Finance and its sub-accounts, allowing its users to have access to historical reports, prepare their treasury management operations and project cash flows in real time. The P24 system, which already integrates the networks of all banks and an electronic money wallet system, already allows the payment of public fees, including taxes, and the transfer of funds between individuals and companies, through the use of the national ATM network. In addition, the BCTL's project to interconnect the P24 network with an Indonesian payment network is already under implementation, which will allow domestic bank card holders to use them in banks in Indonesia.

In 2020 financial year, the **BCTL's financial statements** recorded a net profit of \$1.5 million, mostly due to interest received from the management of the Bank's own reserve assets and fee income, due to the Petroleum Fund's operational management.

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 quality of work in the institution, which is 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, 27 April 2021