The economy recovered in 2022 on increased government expenditure and a rebound in private consumption. It will likely sustain similar growth rates in 2023 and 2024 with public spending continuing as the main growth driver in the medium term. Inflation nearly doubled in 2022 but is forecast to ease this year and next. A major challenge is to ensure cost-effective, high-quality investment in human capital accumulation to allow the rising generation to put Timor-Leste on a sustainable, resilient growth path.

Economic Performance

The economy grew by an estimated 3.2% in 2022. A presidential election in the first quarter of 2022 instilled confidence that the economy would return to normal. Government spending on transfers and other safety net programs stimulated private consumption and investment (Figure 2.31.1). Private consumption reversed 2.7% decline in 2021 to grow by an estimated 5.0% as consumer confidence and household income steadily recovered from the pandemic and flooding in April 2021. Government consumption was supported by the country’s largest-ever budget, a supplement in May 2022 taking it to $2.4 billion (Figure 2.31.2). Transfers increased by an amount equal to almost a third of 2021 transfers spending. A high budget ceiling notwithstanding, execution continued to lag. A $1 billion allocation for the Veterans’ Fund went unspent in 2022. Capital development spending was also low, reaching only 29% of its budget allocation and recording real annual growth at a paltry 1.0% (Figure 2.31.3).

Figure 2.31.1 Demand-Side Contributions to Growth

Growth was maintained despite falling net exports.

Figure 2.31.2 Cumulative Recurrent Expenditure

Current expenditure accelerated last year.
Growth in exports of goods and services normalized down to 6.1% in 2022 after a rebound in 2021. Coffee production stabilized, but the value of coffee exports softened as the world price for Arabica varieties suffered a 22% decline (Figure 2.31.5). Imports, on the other hand, increased by 9.2% on higher government spending on transfers, particularly through the Cesta Basica food subsidy program and the Bolsa de Mae–Jerusal Foun support scheme for pregnant women and children. This generated a current account deficit equal to 22% of GDP (Figure 2.31.6).

Consumer price inflation spiked sharply from 3.8% in 2021 to 7.0% in 2022. Domestic prices for food and fuel rose on surges in global energy, food, and fertilizer

**Figure 2.31.3** Cumulative Capital Expenditure

*Capital expenditure slowed.*

![Cumulative Capital Expenditure](image)

Sources: Ministry of Finance; Asian Development Bank estimates.

**Figure 2.31.4** Petroleum Fund Balance

*Global market turmoil contributed to a decline in the fund.*

![Petroleum Fund Balance](image)

Sources: Ministry of Finance; Banco Central de Timor-Leste; Asian Development Bank estimates.

**Figure 2.31.5** Coffee Exports

*World coffee prices declined, dragging down exports.*

![Coffee Exports](image)

Sources: General Directorate of Statistics; Asian Development Bank estimates.

**Figure 2.31.6** Current Account

*The current account balance is forecast to fall deeper into deficit.*

![Current Account](image)

Sources: Banco Central de Timor-Leste; Asian Development Bank estimates.

Domestic revenue aside from oil increased by an estimated 10.8% in 2022 but remained low, equal to just 10% of GDP. Leaving aside the large offshore petroleum industry, tax collection grew by an estimated 12.5% on stronger economic growth and increases in excise, sales, and withholding taxes. Despite growth in domestic revenue, government spending, financed mainly through the Petroleum Fund, generated a fiscal deficit equal to 49.1% of GDP. The Petroleum Fund suffered its largest-ever net investment loss as a $1.9 billion decline in 2022 reversed $1.1 billion in net investment income in 2021. Losses incurred by the Petroleum Fund, attributable to global financial market fluctuations, reduced the fund balance from $19.6 billion at the end of December 2021 to an estimated $17.4 billion a year later (Figure 2.31.4).
prices following the Russian invasion of Ukraine and on increased tax rates for alcoholic beverages and tobacco. Inflation had a disproportionate impact on poorer households.

**Economic Prospects**

**The economy is forecast to grow by 3.1% in 2023 and 3.0% in 2024.** Parliament approved a budget ceiling for the 2023 budget at $2.2 billion, an 8.3% reduction from 2022, with over a third budgeted for transfers. Budget execution rates are expected to be higher thanks to an improved economic and health context, supporting private consumption. However, real GDP growth is expected to be constrained by a dim global growth outlook (Table 2.31.1).

**Risks to the outlook tilt to the downside.** Timor-Leste depends heavily on exports of petroleum products and food imports, making it highly exposed to global economic developments and worsening geopolitical tensions. Climate-related disasters pose a risk to growth as well as to inflation forecasts.

**Table 2.31.1 Selected Economic Indicators, %**

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>2.9</td>
<td>3.2</td>
<td>3.1</td>
<td>3.0</td>
</tr>
<tr>
<td>Inflation</td>
<td>3.8</td>
<td>7.0</td>
<td>5.5</td>
<td>2.8</td>
</tr>
</tbody>
</table>

**Growth driven by government spending will depend on the Petroleum Fund.** The government will need to be prudent when spending Petroleum Fund assets. With production from the Bayu-Undan offshore field likely to end in 2023, Timor-Leste needs to strengthen its fiscal sustainability.

**Investment in roads, bridges, and other infrastructure is expected to continue.** Noteworthy projects include an extension of the Presidente Nicolau Lobato International Airport and a plan to develop the Dili Port to increase its domestic cargo and passenger capacity. Other government priorities are to boost agricultural productivity, enhance medical facilities, ensure affordable housing, and develop tourism.

**Inflation is forecast slowing to 5.5% in 2023 and 2.8% in 2024.** Prospects for medium-term economic recovery keep inflation from decelerating further. A risk to the inflation forecast is the vulnerability of Timor-Leste to climate change, in that extreme weather and disasters could drive up food prices.

**The current account is projected to fall into a significant deficit starting in 2023.** Trade in goods will record a substantial deficit with a decline in oil revenue and growth in imports as consumption increases. Coffee exports are expected to grow steadily, barring a slowdown in the US or the European Union.

**Policy Challenge—Investing in Skills for the Next Generation**

**Human capital development is essential to Timor-Leste’s economic transformation toward sustainable, resilient development.** A vital aspect of human capital development is the improvement of skills and productivity. As economies accumulate more physical and human capital, the focus shifts to pursuits with more potential for positive productivity spillover, such as higher education and advanced infrastructure. Historic trends in Timor-Leste’s total factor productivity have been more erratic than in other Southeast Asian countries, with the results generally lower than for its peers. Few jobs are available in either the public or private sector, and the labor market is further weakened by low productivity and a mismatch between skill supply and demand. Strengthening the environment for skill development and the labor market would enable Timor-Leste to capitalize on its young population and realize a demographic dividend.

**Timor-Leste has one of the youngest populations in the world, with a median age of 20.8.** With 37% of the population younger than 15 years old, the country’s currently high dependency ratio—69.3% in 2021—is projected to fall but then rise again by 2050 as the population ages. Meanwhile, unemployment among young workers aged 15–24 is 32.9%, significantly higher than the national average of 5.3%. The private sector should play a bigger role in creating jobs, but
its development is hindered by several impediments, notably poor access to finance and the skill mismatch in the labor market. To achieve higher human capital development, the government plans investments to fill gaps in infrastructure and ensure a healthy, adequately educated, and productive young population.

**Several indicators of education participation have improved.** Timor-Leste moved closer to achieving 100% primary school enrollment as the attendance rate rose from 65% in 2001 to an estimated 92% in 2019 across genders. Net enrollment in secondary education increased from 28.8% in 2015 to 42.8% in 2019, albeit below the 60% target in the National Education Strategic Plan.

**The government has identified investment in education as a key pillar of the country’s post-pandemic recovery.** An important component of this plan is to strengthen and expand technical and vocational education and training (TVET) to make the workforce more employable and productive. So far, TVET has had little impact on the job market because of its informal nature, the low number of training programs and centers in operation, and enrolment in secondary TVET languishing below target. The government recognizes that, alongside higher-quality of primary and secondary education, enhanced TVET programs would build human capital and create jobs.

**In 2022, the government conducted a review of its TVET Plan, 2011–2030.** The plan is intended to complement the current Education Sector Plan, 2020–2024 and the National Strategic Education Plan, 2011–2030. Reform of the TVET framework will include piloting education clusters by strategically selecting schools to upgrade and link them with relevant industries; realigning the curriculum by introducing more comprehensive core elective subjects to provide students with broader skill sets upon graduation; building a unified certification system; diversifying post-TVET opportunities and strengthening the link between vocational training and the labor market; training school personnel by undertaking a needs-assessment to identify specific areas of capacity development required for instructors; and employing technologies that will innovate tools and techniques for learning and teaching.