Economic growth decelerated in 2023 as budget expenditure fell. Inflation accelerated further to its highest level since 2013, and the current account balance weakened. Growth will accelerate in 2024 and 2025 as capital investment increases and consumption remains robust. Inflation will moderate due to eased pressure on prices of imported goods and services, and the current account deficit will expand as imports increase. Timor-Leste needs a multi-sectoral food and nutrition security approach that will provide a productive labor force to sustain growth.

Economic Performance

**Economic growth slowed in 2023, driven by declining budget expenditure.** Following modest growth of 2.9% in 2021 and a strong 4.0% economic rebound in 2022, estimated GDP (nonpetroleum) growth slowed to 1.9% last year mainly due to lower budget expenditure and high inflation. Despite the considerable expenditure initially budgeted, actual spending decreased due to an underperforming budget during an election year. Following the May 2023 elections and formation of the new government in July, public spending was curtailed by the new government’s expenditure cuts. Regaining consumer confidence since 2022, government transfers, worker remittances, and a steady recovery in household income have supported private consumption. Government consumption is estimated to have increased by 2.9% in 2023. Net exports dragged growth down by 3.2 percentage points as the current account deficit deteriorated by an equivalent 36.4% of estimated GDP (Figure 2.31.1).

**On the supply side, growth slowed across key sectors.** The estimated GDP growth in services and agriculture slowed, decreasing their contribution to growth by 3.0 percentage points to 1.6 points in line with the drop in domestic demand. Manufacturing growth normalized after a strong rebound in 2022, contributing only 0.2 percentage points to growth. However, construction recovered slightly after 4 years of deep contractions, contributing a mere 0.1 percentage points to growth (Figure 2.31.2).

**Inflation hit a 10-year high despite targeted subsidies.** Average consumer price inflation accelerated from 7.0% in 2022 to 8.4% in 2023, with prices 8.7% higher in December 2023 than a year earlier. Elevated food and non-alcoholic beverage prices, and high alcohol and tobacco prices were significant drivers of the surge. Despite subsidies to rice importers, average annual rice prices jumped by 9.4 percentage points to 15.9% in 2023 (Figure 2.31.3).

**The fiscal deficit decreased in 2023 due to lower spending.** A 14.1% drop in expenditure outpaced a 5.9% revenue decline, resulting in a 22.1% decrease.
Figure 2.31.2 Supply-Side Contributions to Growth
Growth slowed across key economic sectors.

![Graph showing supply-side contributions to growth](image)

Note: Supply-side contributions to growth were adjusted by net taxes on products.

Figure 2.31.3 Inflation
Consumer price inflation hit a 10-year high in 2023.
![Graph showing consumer price index](image)


in the estimated budget deficit in 2023 to the equivalent of 41% of GDP. The estimated tax ratio stayed low at 8.3% because of the low tax base and underdeveloped private sector. Government debt remained flat, and the estimated debt-to-GDP ratio decreased slightly from 15.2% in 2022 to 14.0%, only 2.5 percentage points higher than the pre-pandemic ratio (Figure 2.31.4).

The external account balance weakened largely due to lower petroleum income. Despite the goods and services deficit marginally narrowing by 2.6% in 2023, the estimated current account balance fell into a deficit equal to 20.1% of GDP. Combined

Figure 2.31.4 Government Budget
Spending cuts narrowed the fiscal deficit in 2023.

![Graph showing government budget](image)

GDP = gross domestic product.
Sources: National Institute of Statistics of Timor-Leste; Ministry of Finance; International Monetary Fund; Asian Development Bank estimates.

Figure 2.31.5 Current Account Balance
The external balance weakened due to the persistent trade deficit and lower primary income.

![Graph showing current account balance](image)

CAB = current account balance, GDP = gross domestic product.
Sources: National Institute of Statistics of Timor-Leste; International Monetary Fund; Asian Development Bank estimates.

primary and secondary income declined by 52.4% due to a 63% reduction in income from the petroleum sector as reserves ran out at the Bayu-Undan field (Figure 2.31.5).

The Petroleum Fund balance grew by 5.7% to $18.2 billion in 2023 as investment income increased. Lower receipts and increased pressure on drawdowns highlight the need to better leverage
development financing opportunities for productive and long-term investments in human capital, infrastructure, public services, and private sector development (Figure 2.31.6).

**Figure 2.31.6 The Petroleum Fund**
A reversal in net investment income raised the sovereign wealth fund balance.

Remittances, the second largest source of capital inflows, recovered strongly over the past 4 years. Worker remittances have been increasing as more workers migrate due to limited domestic employment opportunities, the impact of seasonal worker programs, and improved money transfer services. Coffee is a strategically significant agricultural export, accounting for over 95% of nonpetroleum merchandise exports, though it remains small and volatile. The combined ratio of coffee exports and personal remittances to GDP averaged 12% over the past 4 years but remains 5.4 percentage points lower than its 2010 peak (Figure 2.31.7).

**Figure 2.31.7 Coffee Exports and Personal Remittances**
Remittances have grown steadily, while coffee exports remain modest.

Remittances have grown steadily, while coffee exports remain modest. Worker remittances have been increasing as more workers migrate due to limited domestic employment opportunities, the impact of seasonal worker programs, and improved money transfer services. Coffee is a strategically significant agricultural export, accounting for over 95% of nonpetroleum merchandise exports, though it remains small and volatile. The combined ratio of coffee exports and personal remittances to GDP averaged 12% over the past 4 years but remains 5.4 percentage points lower than its 2010 peak (Figure 2.31.7).

**Figure 2.31.8 Money Supply**
Broad money growth moderated.

Sources: National Institute of Statistics of Timor-Leste; World Bank; Asian Development Bank estimates.

**Figure 2.31.9 Banking Sector Credit**
Driven by retail lending, domestic credit grew by 20.8% in 2023.

Sources: Central Bank of Timor-Leste; National Institute of Statistics of Timor-Leste; Asian Development Bank estimates.
Economic Prospects

The near-term economic outlook has improved with growth forecast to rise by 3.4% in 2024 and 4.1% in 2025 (Table 2.31.1). Expansionary fiscal policy will be the main growth driver for 2024–2025 along with steady consumption, keeping GDP growth above the average 3% annual growth rate between 2003–2022. The 2024 budget calls for 14.5% higher spending than in 2023, driven by the new government’s medium-term prioritization of public investment with a specific focus on the Greater Sunrise gas and condensate field and related South Coast infrastructure development.

<table>
<thead>
<tr>
<th>Table 2.31.1 Selected Economic Indicators, %</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth will rise, and inflation will moderate.</strong></td>
</tr>
<tr>
<td>2022</td>
</tr>
<tr>
<td>GDP growth</td>
</tr>
<tr>
<td>Inflation</td>
</tr>
</tbody>
</table>

GDP = gross domestic product.

Investment’s contribution to growth should increase in both years. Capital expenditure is planned to increase by over 52% year on year, representing more than four-fifths of total budget expenditure in 2024. Investment’s contribution to growth will accelerate in 2025, assuming the government concludes its review of investment projects financed by international financial institutions soon. This will enable disbursements to resume for these projects beginning the second half of this year. Investment will also grow in 2025 as new projects aimed at narrowing the country’s large infrastructure gap begin and capital investments related to the Greater Sunrise field start flowing.

Consumption will remain the main contributor to growth. A continued increase in current transfers, salaries and wages, consumer loans issued by local banks, and robust personal remittances amid a lower inflationary environment will support private consumption. The contribution of government consumption to growth will remain steady on recurrent government spending for goods and services.

Inflation will moderate over the forecast period, with the current account deficit expected to widen. Average inflation will moderate from its 2023 peak to 3.5% in 2024 and 2.9% in 2025 as price pressure from trading partners eases and global commodity price risks wane. Despite their impact on domestic revenue mobilization, reversed import duties, including excise taxes on tobacco, sugar, and sugary beverages, will contribute to lower inflation. The current account deficit is projected to widen in 2024 and 2025 as primary income declines further due to a rundown of reserves in the Bayu-Undan petroleum field, and imports of goods and services increase with greater domestic demand, supported by an expansionary budget.

There are downside risks to the outlook. These include climate-related disaster risk and extreme weather conditions associated with El Niño, terms-of-trade shocks, rising food and energy prices caused primarily by geopolitical tensions, trade and supply chain disruptions, and risks associated with public service delivery and lower spending on investment projects.

Policy Challenge—Ensuring Food Security

Food insecurity remains high for about 63% of the population. Ensuring adequate food supply remains a priority. The risk of a food supply shock persists due to high dependency on food imports, climate risks, and disasters caused by natural hazards. An estimated 27% of the population face high acute levels of food insecurity. About 47% of children under 5 years old are stunted, 9% of children suffer from acute malnutrition, and 23% of women of reproductive age are anemic. The maternal and child prevalence of undernourishment is high at 40%.

Ensuring food security is a fundamental and immediate policy challenge in Timor-Leste. Past government measures to improve food security included subsidies to rice importers to stabilize domestic prices, a School Meals initiative, and improving livestock disease control. Using a more holistic approach, Timor-Leste has great potential to improve its food security.
First, a multi-sectoral approach should be implemented. The recent establishment of the nutrition and food security working group as part of the inter-ministerial task force led by the Vice Prime Minister for Social Affairs is a welcoming step to monitor the implementation progress of multi-sectoral nutrition and food security action plans and achieve key policy targets.

Second, a more conducive environment for domestic food production and agricultural productivity should be supported. More than 70% of the population depends on rain-fed subsistence agriculture as their main source of income. Promoting climate-resilient agriculture and diversifying agriculture products will boost agriculture production and increase farmers’ income. This also requires risk mitigation and prevention, which include (i) reducing climate and disaster risk caused by natural hazards and El Niño by strengthening climate resilience; (ii) improving access to water, hygiene, sanitation, and waste management for disease control; and (iii) developing essential infrastructure for food and agriculture production, providing producer-and-consumer connectivity through properly maintained roads, market access, and value chains.

Third, access to finance should be increased for food producers and other key stakeholders, including related micro, small and medium-sized enterprises. This includes investments and financing for food production, warehousing, and trade and supply chain financing. It can be provided by local banks, development finance, on-lending, and public-private partnerships to help integrate farmers into food supply chains and markets, increase agricultural productivity, and promote rural employment.