

NATIONAL DIRECTORATE FOR ECONOMIC POLICY

INTERNATIONAL ECONOMIC UPDATE

AUGUST 2019

EXECUTIVE SUMMARY

After strong growth in 2017 and early 2018, global growth is now projected to slow from 3.6 in 2018 to 3.3 percent in 2019. This reduction was driven by the decline in the growth rate of advanced economies and emerging markets and developing Asia, US-China trade tensions, tighter policy in response to macroeconomic imbalances in Argentina and Turkey, credit tightening in China, weakness in Germany's auto sector, and higher interest rates. However, the global growth is projected to stabilize in 2020 at around 3.6 percent, mainly due to a rebound in emerging markets and developing economies especially in Argentina, Turkey and a few other stressed economies. Nevertheless high levels of growth, especially in Asia, still provides a solid foundation for Timorese exporters and economic development. The international environment provides favourable conditions for Timor-Leste to take advantage of in 2020 and beyond.

GLOBAL GROWTH

Table 1: Global and Regional Growth Rates (%)

Country	Actual		Forecast	
	2017	2018	2019	2020
World	3.8%	3.6%	3.3%	3.6%
Advanced Economies	2.4%	2.2%	1.8%	1.7%
Emerging and Developing Economies	4.8%	4.5%	4.4%	4.8%
Emerging and Developing Asia	6.6%	6.4%	6.3%	6.3%
China	6.8%	6.6%	6.3%	6.1%

Sources: IMF World Economic Outlook April 2019.

Advanced Economies. In advanced economies growth is projected to slow from 1.8 percent in 2019 to 1.7 percent in 2020. The slowdown in growth is mainly due to the unwinding of US fiscal stimulus, and US-China trade tensions.

- Euro area growth is projected to grow at 1.3 percent in 2019 and 1.5 percent in 2020. Growth rates have been marked down for many economies due to the sharp fall in industrial production caused by low foreign demand in Germany, weak domestic demand in Italy, and the negative impact of street protest in France. However, growth is projected to remain soft in 2020-21 at 1.4 percent, with softness in trade and domestic demand.
- In the United States, growth is projected to decline to 2.2 percent in 2019 compared to 2.7 in 2018. The downward revision to 2019 growth reflects the impact of the government shutdown and lower fiscal spending, while the modest upward revision for 2020 reflects a more accommodative stance of monetary policy.

Emerging and Developing Economies. Growth in 2019 is projected to slow in the emerging market and developing economy group. Growth is expected to tick down to 4.4 percent in 2019, from 4.5 percent in 2018. The decline in growth relative to 2018 reflects lower growth in China and the recession in Turkey, as well as deepening contraction in Iran.

- Growth in China is expected to slow to 6.2 percent this year as domestic and external rebalancing continues.
- Growth in Indonesia is projected to grow at 5.2 percent in 2019 and 2020. This projection is supported by the strong private consumption and a stronger fiscal position that allows more government investment.
- Growth prospects among the smaller economies in the East-Asia Pacific region remain favourable.

The international environment provides favourable conditions for Timor-Leste to take advantage of in 2019 and beyond.

GLOBAL INFLATION

Table 2: Global and Regional Inflation Rates (%)

Country	Actual		Forecast	
	2017	2018	2019	2020
World	3.2%	3.6%	3.6%	3.6%
Advanced Economies	1.7%	2.0%	1.6%	2.1%
Emerging and Developing Economies	4.3%	4.8%	4.9%	4.7%
Emerging and Developing Asia	2.4%	2.6%	2.8%	3.1%
Timor-Leste*	0.5%	2.3%	1.1%	2.7%

Sources: IMF World Economic Outlook April 2019. *Ministry of Finance forecast.

Consumer price inflation is set to remain favourable, with global inflation forecast at 3.6% by the IMF. The decline in commodity prices, especially lower oil prices, have contributed to the sharp fall in consumer price inflation in the advanced economies. However, inflation is projected to soften in the coming years. For emerging market economies, inflation has risen reflecting the impact of currency depreciation and higher commodity prices, but it is projected to moderate as the impact of tighter monetary policy and recent declines in oil prices. Inflationary pressures have already fallen sharply in China as activity has moderated. Low inflation in Timor-Leste in this context will help to improve competitiveness.

OIL PRICES

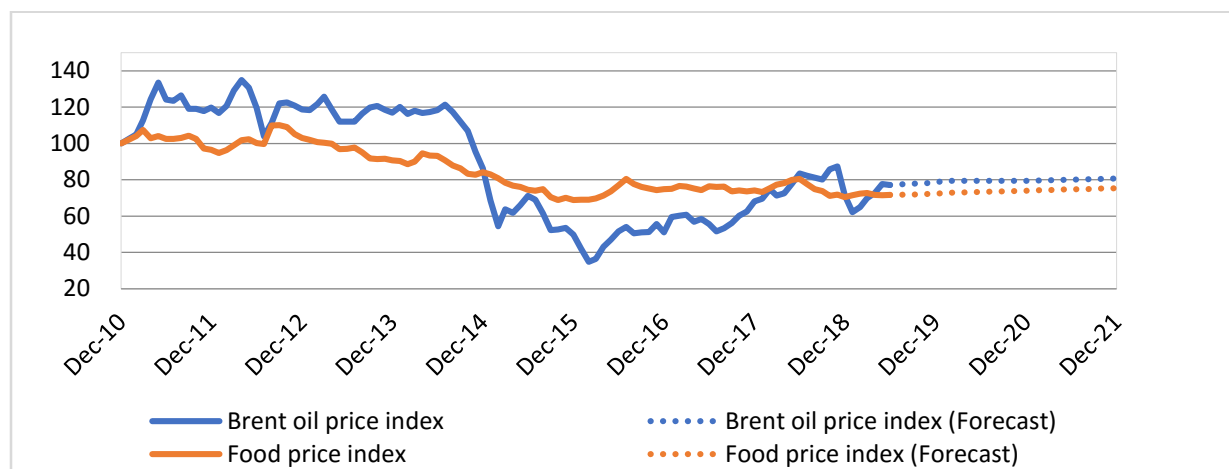
Oil prices are important to Timor-Leste both for consumers, through consumer prices, and as an oil exporting country. The international price of Brent oil has witnessed dramatic declines since June 2014 from highs of \$112 per barrel to lows of \$32.2 per barrel in January 2016. The decline in oil prices was driven by the increased global supply during a period of low global demand. However, for the period following this, the oil market began to recover reaching an average of \$77 per barrel in May 2019. But it's still lower than average price seen in September 2018 at \$81 per barrel. This strengthening recovery has been driven by the production cut by OPEC. The oil price is projected to increase only moderately in the near future.

AGRICULTURAL COMMODITY PRICES

A significant portion of the food consumed in Timor-Leste is imported and thus changes in international food prices can have a significant impact on both the rate of inflation and standard of living. According to the World Bank Commodities Prices Forecast, international food prices have continued to decline from 2011, though prices started to increase from a low of 69 in January 2016, reaching 71.6 in May 2019. The increasing cost of energy and weather variability could stabilise food prices higher for the remainder of the year. The World Bank is forecasting that food prices will rise marginally throughout the rest of 2019 and 2020, however the increase is small, and overall food prices are expected to remain relatively low. This will benefit poorer

households in Timor-Leste. Coffee Prices (both Arabica and Robusta) are expected to increase 10% in 2020, providing a solid basis for coffee exporters in Timor-Leste.

Figure 1: Commodity Price Indices



Source: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance, 2019

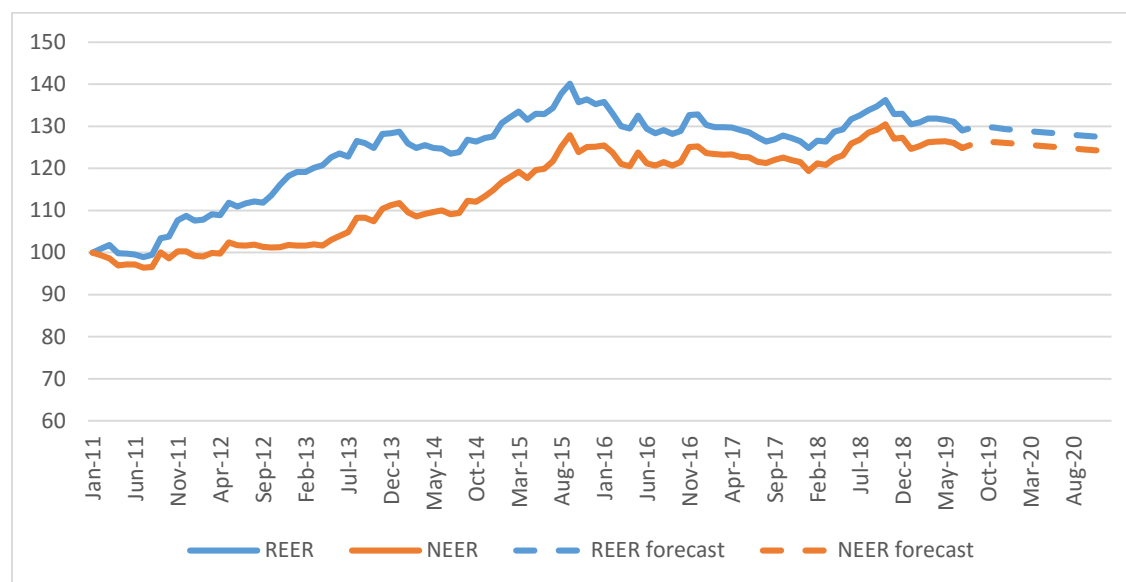
EXCHANGE RATES AND COMPETITIVENESS

Between May 2018 and May 2019 the US dollar appreciated by 2.7% against a weighted basket of currencies of Timor-Leste's trading partners (the nominal effective exchange rate, NEER). There has been a small overall appreciation in the last few years which has reduced the price of imports, placing downward pressure on domestic inflation, benefiting Timorese consumers. However, this appreciation makes Timorese non-oil exports more expensive in international markets constraining the development of the country's exports sector.

An inflation-adjusted measure of the exchange rate, the real effective exchange rate (REER), is a better measure of competitiveness. If inflation in Timor-Leste is lower than in other countries, this can help mitigate exchange rate appreciation. The REER has appreciated by 1.8% between May 2018 and May 2019, driven by the exchange rate changes captured in the NEER and lower inflation in Timor-Leste compared to its neighbours over the last year.

The inflation rate in Timor-Leste is expected to be lower than its neighbours in the near future, and so Timor-Leste can expect an improvement in competitiveness. This will help the Timorese export market be well-placed in the international market. While this is to be welcomed, the government is not complacent about the issue of competitiveness. A key priority is improving the business environment to encourage improved competitiveness, and the inflation target policy is a part of meeting the priority.

Figure 2: Exchange Rate Indices



Source: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance, 2019.

OVERALL IMPACT ON TIMOR-LESTE

The overall global growth environment remains good for the Timorese economy, providing positive growth opportunities for high returns on the Petroleum Fund. The prospect of medium term increases in coffee prices is welcome to Timorese exporters. The stable commodity market has resulted in low and stable inflation in Timor-Leste with CPI reaching 0.9% year-on-year in June 2019. Significant changes in prices will feed through to the living standards of Timorese consumers and are therefore being monitored closely.

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