COUNTRY REVIEW

Timor-Leste

2 November 2009

ANALYST: David Atkinson

<u>EULER HERMES COUNTRY RISK GRADE: D</u>

Country Risk Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest risk.

COUNTRY PROFILE

Capital city:	Dili
GDP:	USD2915 mn (non-oil USD499mn) (2007e)
Population:	1.08mn (2008e)
GDP per capita:	USD1650 (non-oil USD379mn) (2007e)
Currency:	US Dollar
Form of state:	Republic
Head of government:	Prime Minister Kay Rala Xanana Gusmao
Next elections:	2012

Internationally recognised as an independent democratic state since May 2002, Timor-Leste is one of the world's newest nations. Formerly a Portuguese colony it was annexed by Indonesia in 1975 and under UN administration between 1999 and 2002. A referendum in 1999, in which a majority had voted for independence from Indonesia, was followed by widespread violence and instability. An estimated 75% of the population was displaced and around 70% of the economic structure was destroyed. Following independence, the security situation improved but broke down in 2006, leading to another 150,000 displaced people and a UN peace keeping force was required to restore order. While there were attacks on the President and PM in 2008 and UN peacekeepers still remain in place, the past year has been one of relative calm. Whether that can hold, however, remains to be seen. A key issue will be the transfer of policing responsibilities from the UN to the national police force without triggering military unrest. In the 2007 legislative elections, Fretelin won the largest proportion of votes but not enough to allow it to form a government on its own and PM Gusmao of the National Congress for Timorese Reconstruction was able to construct a coalition government, which has served since then with Fretelin as the main opposition, in a relatively stable framework.

The legacy of 1999-02 is poor infrastructure, limited local administration capacity, high unemployment, 50% of the population living below the poverty line (mainly in rural areas) a literacy rate of just 47% and a primarily subsistence based agricultural sector (85% of employment). In addition the economy is vulnerable to droughts, floods and landslides, earthquakes and tropical cyclones. Data are very poor. Non-oil GDP increased by 13% in 2008 according to ADB estimates, driven largely by public spending, utilising revenues from oil, which provide the bulk of government revenues and are five times the size of non-oil GDP according to IMF estimates. The fiscal balance is in massive surplus and there is a transparent oil stabilisation fund, which helps manage these resources. The authorities also have the benefit of having no outstanding public sector debt and a strong level of international commitment. High oil revenues also mean that the external current account balance is in huge surplus. The fiscal and current account balances will have remained in 2009 even though oil prices are lower.

Inconvertibility risk is very limited, as the US dollar is legal tender, and exploitation of oil and gas reserves offers potentially a positive medium-term outlook. However, political instability, the low level of economic development and business infrastructure (our Structural Business Environment Indicator ranks Timor-Leste 197 of 210 economies assessed) are high risk.

David Atkinson **London: +44 (0)20 7860 2807**