

# NATIONAL DIRECTORATE FOR ECONOMIC POLICY

## QUARTERLY INFLATION REVIEW

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JUNE -SEPTEMBER 2021

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### KEY STATISTICS

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- In September 2021 over the last year (Year on Year, **YoY**) inflation in Timor-Leste has risen to 4.1%. This is a large increase considering the same time last year was only 0.3%
- During the third quarter of 2021 (Quarter on Quarter, **QoQ**) inflation in the whole country was 0.4%.
- Between June and September (QoQ) inflation in Dili was slightly higher than in districts (0.5% in Dili vs 0.2% in districts).
- Core inflation ie removing volatile categories such as food, is 1.5% when compared the same quarter last year.
- CPI category with biggest increase in the third quarter of the year was Alcohol and tobacco 7.2% (QoQ).
- CPI category with the biggest decrease was furnishings, Housing -0.5% over the third quarter (QoQ).
- The World Bank (WB) food price index increased a huge 27% between September 2020 and September 2021 (YoY) but decreased -3% over the last 3 months (QoQ).
- Domestic food prices rose in September though these remained muted at 6.4% (YoY) and 0.6% (QoQ). This benefits poorer households who spend most of their income on food.
- Rice is a main staple of the diet in Timor and the world rice price has fallen -21% since September 2020 (YoY) and -14% over the last 3 months (QoQ). There was a brief spike in prices in April 2020 but are now in line with 2019 prices. This is good for Timorese consumers.
- Coffee is one of Timor's most important non-oil exports. The world price of coffee (Arabica) has increased 35% over the last year (YoY) and increased 17% in the third quarter (QoQ). This is still around 75% the peak price seen in 2011, but steady recovery from a 10 year low seen in May 2019. This should be good news for coffee farmers and exporters.
- The price of oil halved in the 1<sup>st</sup> and 2<sup>st</sup> quarter of 2020 year due to the fall in global demand during the height of the Covid-19 crisis, bottoming out at \$21.04 per barrel in April 2020, but prices have recovered since, increasing to \$72.80 per barrel in September 2021. This is a 79% increase since the same time last year. The price of oil is now higher than it was before the start of the Covid-19 crisis in Dec 2019. Oil is an important component of everyday items and essential for transportation. This is likely a large reason for the steady increase in general price levels over the last year.
- The Nominal Effective Exchange Rate (NEER) decreased -2.3% (YoY) while the Real Effective Exchange Rate (REER) decreased -2.2% (YoY). This will have a negative on consumers and importers in Timor Leste as imports become more expensive but will have a positive effect on exporters whose products become cheaper overseas.

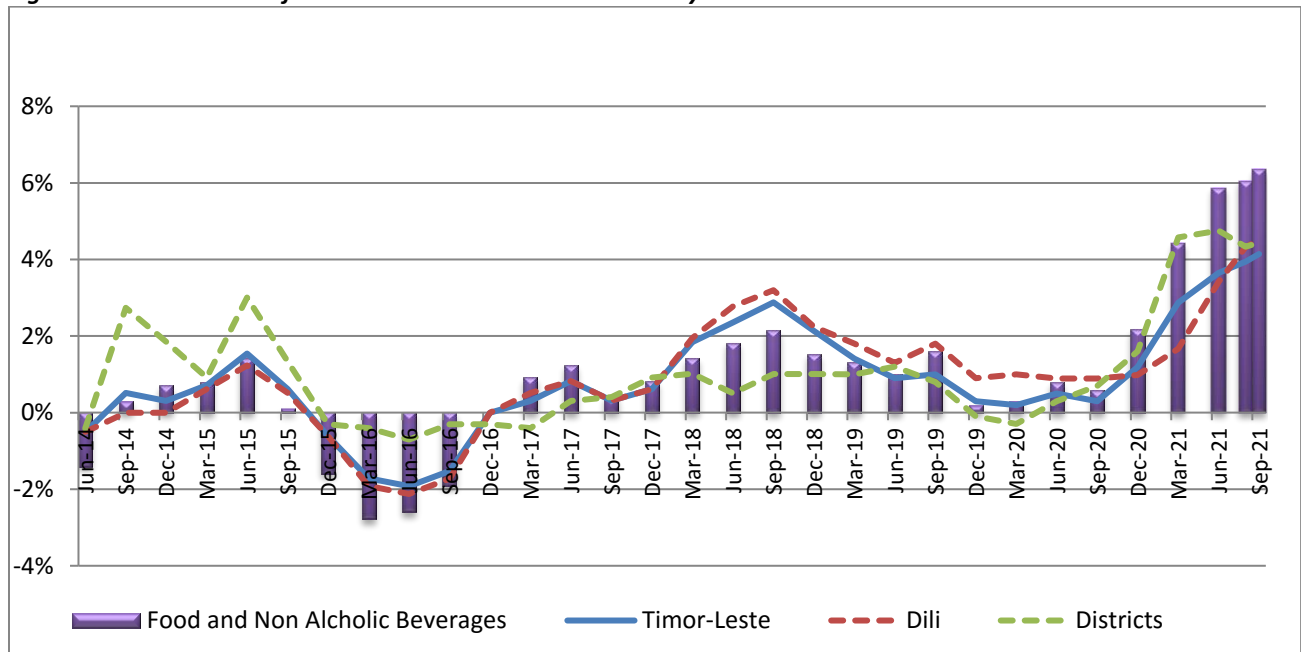
- Government Expenditure increased 85% when you compare Q3 2021 with Q3 2020.
- Money Supply in September 2021 increased YoY 5.4%.
- International supply chain issues, increased transportation costs and a rebound in oil prices in the aftermath of Covid is seeing global prices increase.
- As a small open economics, the current level of inflation witnessed in Timor-Leste is a result of international markets. This is corroborated by the fact that tradable goods have a higher level of inflation than non-tradables.

Inflation Outlook	2018	2019	2020	2021*	2022*	2023*
Timor-Leste*	2.3%	0.9%	0.5%	3.2%	1.7%	1.8%

### TRENDS IN INFLATION OVER TIME

In September 2021 YoY inflation in Timor-Leste was 4.1%; this means that a basket of goods and services that cost \$100.00 in September 2020 will now cost \$104.10 in September 2021– on average, prices are up compared to one year ago. The Government’s target range is 4%-6% as set out in the Government’s Strategic Development Plan. This is the first time inflation is in this range since December 2013 as the last few years in Timor has seen low inflation. YoY food and non-alcoholic beverage inflation in September 2021 was 6.4%, lower than the increase of 0.6% witnessed last September. Inflation in **Dili** was 4.5% (YoY) which is slightly more than inflation in **Districts** which rose by 4.4% over the same period.

**Figure 1: Year-on-Year Inflation in Timor-Leste over the last 5 years**



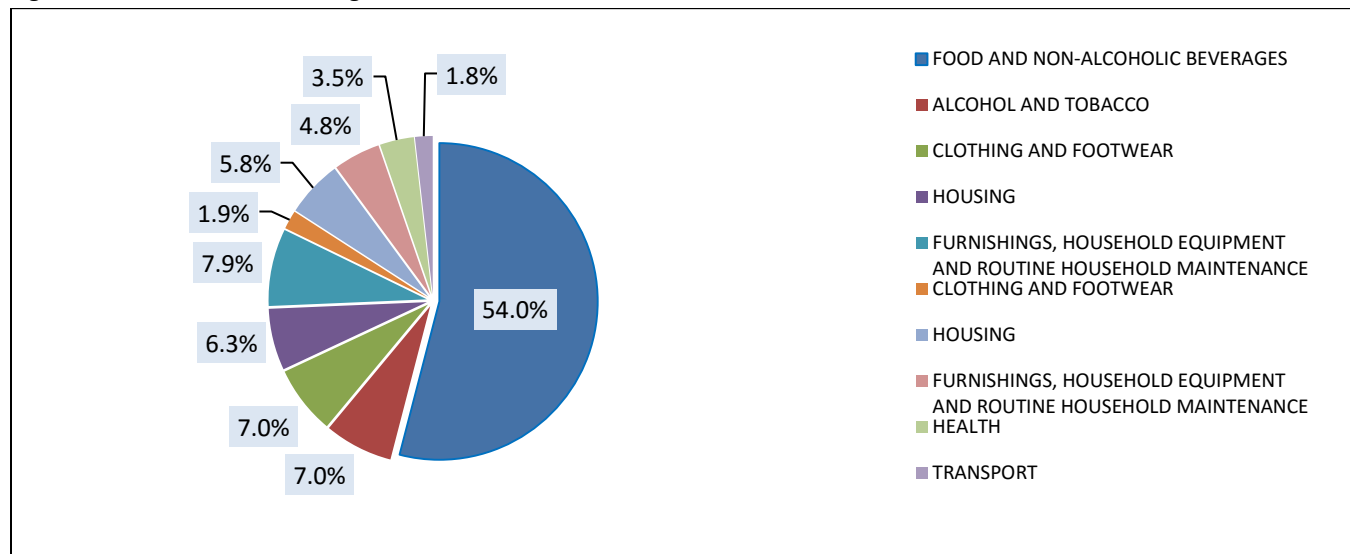
### TIMOR LESTE’S CPI BASKET

The Consumer Price Index (CPI)<sup>1</sup> is used to measure consumer price inflation. To understand CPI think of a large basket containing the goods and services bought by households, the CPI estimates the change to the total cost of the basket on a

<sup>1</sup> The CPI is a weighted index meaning that the influence on the CPI index of a given item is dependent on the item’s share in total household consumption.

monthly basis. Food and non-alcoholic beverages represent 54% of Timor-Leste’s CPI basket<sup>2</sup> as more than half of Timorese household expenditure is spent on this group. Thus price movements in this group will have a significant impact on the overall rate of inflation and the purchasing power of Timorese citizens.

**Figure 2: Timor Leste’s CPI Weights**



Over the 12 months from September 2020 to September 2021 there have been significant *price changes* in the following spending classes<sup>3</sup> :

- Alcohol and Tabacco (+7.2%)- *biggest increase*
- Food and Non Alcoholic Beverages (+6.4%)- *second biggest increase*
- Housing (-0.5%)- *biggest decrease*
- Recreation and Culture (-0.5%)- *joint biggest decrease*

Despite these price changes for the groups mentioned above, contribution to overall inflation can be very different. **Contribution to inflation rate** measures the contribution to the overall rate of inflation of a grouping of goods and services, eg, the combination of its *price change and weight* within the series<sup>4</sup>. Therefore a small change in the growth rate of Food and Non Alcoholic Beverages can still have a big contribution to overall inflation due to it being the most important category as we can see below.

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## CAUSES OF INFLATION<sup>5</sup>

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### International Factors

#### Commodity Prices

<sup>2</sup> Timor-Leste’s CPI basket is made up of the ten expenditure groupings seen in Figure Two.

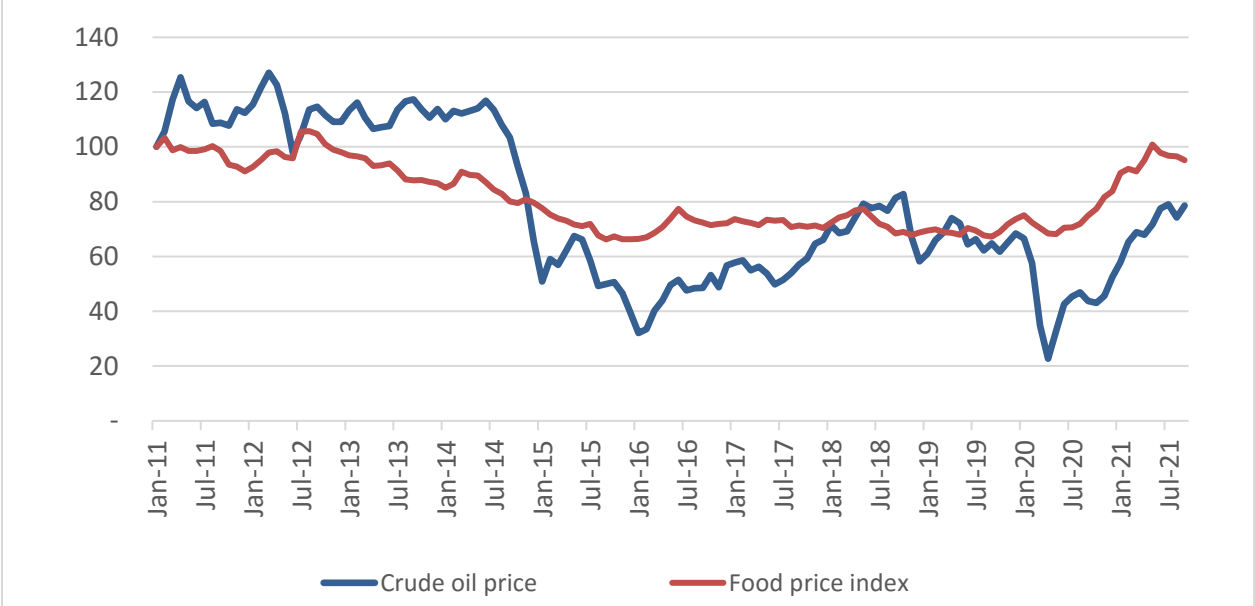
<sup>3</sup> Expenditure classes are the sub-categories within an expenditure group in a CPI index

<sup>4</sup> The contributions of each grouping will sum to give the overall rate of inflation

<sup>5</sup> Within this section inflation refers to YoY inflation

International food prices have increased significantly over the last year with the World Bank (WB) food price index increasing 27% between September 2020 and September 2021. World rice price (Thai benchmark) decreased -21% (YoY). Coffee Arabica Prices increased 35% (YoY). In Q3 2021, crude oil (Brent)<sup>6</sup> rise dramatically 79% YoY and now surpasses pre-Covid price levels.

**Figure 3: International Commodity Price Indices**

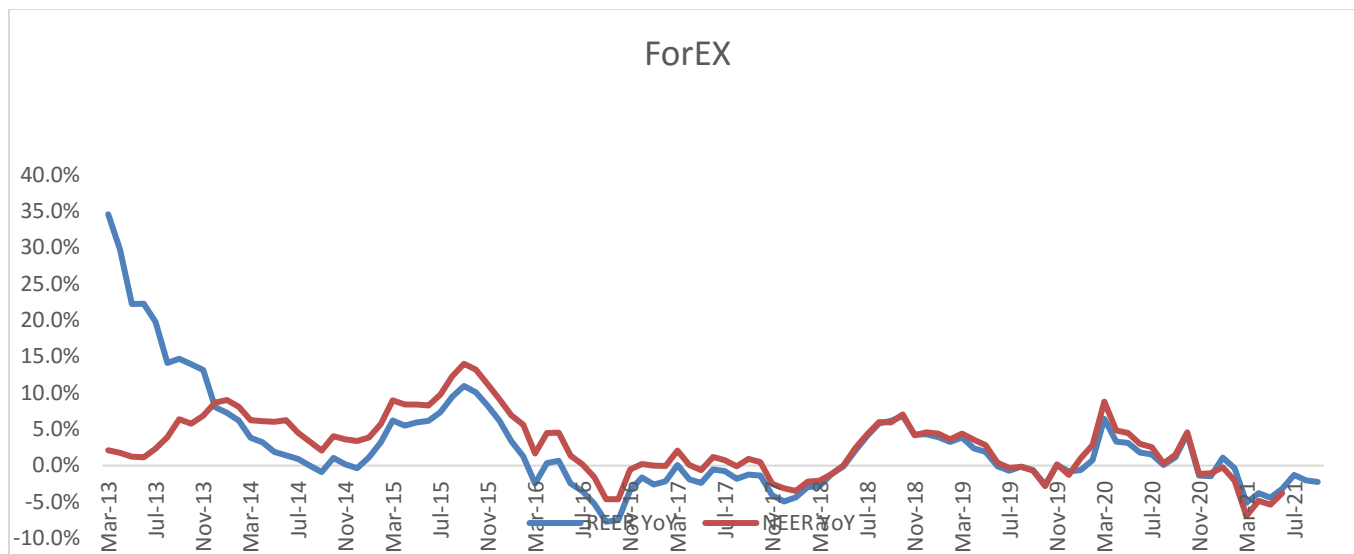


**Exchange Rate**

An appreciation (depreciation) of the US dollar against the currencies of Timor-Leste’s major trading partners will put downward (upward) pressure on the price of imports in Timor-Leste. However, the effects of exchange rate and international commodity price movements on prices in Timor-Leste are likely to be felt some time after they occur, as it takes time for the change in the price of imported goods to feed through to a change in the price of consumer goods. The **effective exchange rate** is the exchange rate of a country’s currency, measured as the weighted sum of the exchange rates with its commercial partners. The **nominal effective exchange rate (NEER)** is an unadjusted weighted average rate at which one country's currency exchanges for a basket of multiple foreign currencies. The **real effective exchange rate (REER)** is adjusted for the effects of inflation.

**Figure 4: Exchange Rates**

<sup>6</sup> World Bank Pink Sheet, updated September 2021



Between September 2020 and September 2021 Timor-Leste’s NEER depreciated by -2.3% while the REER depreciated -2.2%. Over this period the NEER also experience -7.3% against a weighted Thai Baht and Vietnamese Dong Hong-Kong dollar basket and, the REER depreciated by -8.9% against the same basket. This real depreciation places upwards pressure on rice prices and inflation in Timor-Leste (as Thailand and Vietnam export large quantities of rice to Timor-Leste).

## Domestic Factors

### *Government Spending*

Year on year total government expenditure increased in Q3 2021 by 84.5% compared with Q3 2020. A rise in government expenditure, particularly recurrent expenditures such as transfers and salaries & wages, can have an inflationary impact on the economy, however this is currently not the case in Timor-Leste which is a small open economy. The current rise in inflation in Timor-Leste is likely the result of a combination of international factors mentioned above.

### *Money Supply*

Taking the average change in money supply across the year to September 2021<sup>7</sup>, a 5.4% increase was witnessed. However is a small open economy such as Timor Leste, without local currency: money supply does not have any systematic and plausible effect over inflation in Timor Leste.

### **Tradable vs Non-tradable (International vs Domestic pressures)**

Tradable goods and services refer to those whose prices are largely determined on the world market, and all other goods and services are non-tradable. This enables splitting out the inflationary (or deflationary) pressures coming from international or domestic sources. Since September 2020 non-tradeable (domestic) prices have been lower than the tradeable (international) prices, with non-tradeable prices growing at 2.4% vs tradeable prices growing 4.9% (YoY) in September 2021. This suggests that the current level of inflation in Timor-Leste is largely determined by international markets.

<sup>7</sup> Taking the average change in money supply for the last 12 months compared to the previous 12 months.

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## CONSEQUENCES OF INFLATION

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Inflation can cause households' purchasing power to fall. **Purchasing power** measures the quantity of goods and services which can be purchased with a unit of currency. Therefore inflation decreases the amount of goods and services a consumer is able to purchase with their monthly salary which can reduce living standards and may increase poverty. The current low inflation level should benefit households on lower incomes.

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## INFLATION OUTLOOK

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Commodity Outlook- both oil and food are forecast to increase slightly in 2022 and then reduce and stabilise in the medium term.

Exchange Rate Outlook- both NEER and REER are both set to remain stable.

The inflation rate in Timor-Leste is expected to be lower than its neighbours in the near future as emerging and developing asia is forecast to have an inflation rate of 2.7% in 2022.

Inflation Outlook	2018	2019	2020	2021*	2022*	2023*
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## ANNEX 1: CONCEPTS AND TERMINOLOGY

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**Year-on-year (YoY) inflation** is the most commonly used measure and is calculated by comparing the price index from a given period with the same month in the previous year. For example, the year-on-year inflation in September 2021 measures the percentage change in prices between September 2020 and September 2021.

**Quarter-on-quarter inflation (QoQ)** is calculated by comparing the price index from the last month of a given quarter (March, June, September or December) with the last month of the previous quarter. Eg QoQ inflation in September 2021 measures the percentage change in prices between June 2020 and September 2021.

**Month-on-month inflation (MoM)** is calculated by comparing the price index from the latest month to the previous month. Eg, MoM inflation in September 2021 measures the percentage change in prices between August 2021 and September 2021. Timor-Leste's Consumer Price Index is published monthly by General Directorate of Statistics (MPF)<sup>8</sup>.

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## ANNEX 2: NOTES

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<sup>8</sup> See for latest CPI data from the General Directorate of Statistics (<http://www.statistics.gov.tl/category/survey-indicators/consumer-price-index/?lang=en>)