VOLUME 7 ISSUE XX

Petroleum Fund of Timor-Leste

Quarterly Report

31 DECEMBER 2011

Inside This Report

INTRODUCTION

This report is produced in accordance with Article 13 of the Petroleum Fund Law which requires the Central Bank to report on the performance and activities of the Petroleum Fund of Timor-Leste, referred to in this report as the Fund unless the context suggests otherwise.

All monetary references in this report are to United States dollars as the official currency of Timor-Leste.

While every effort has been made to ensure accuracy, the information is based on management reports and has not been independently audited or reviewed and is subject to change, in which case the changes will be incorporated into subsequent reports.

Executive Summary

The Petroleum Fund was formed by the enactment of the Petroleum Fund law promulgated on 3 August 2005 and amended by Law no.12/2011 on 28 September 2011 The law gives the Central Bank of Timor-Leste the responsibility for the operational management of the Fund.

This report covers the period from 1 October to 31 December 2011.

Key statistics for the quarter include:

- The capital of the Fund grew from $8,903.14 million to US$ 9,310,321 million.
- Gross cash inflows to the fund from royalties and taxes were US$ 860.96 million.
- Cash outflows were US$ 508.07 million in which US$ 505.00 million for transfer to the State Budget US$ 2.24 million for direct external and internal management costs and accrued for external management and custody fees US$ 0.83 million.
- Net cash inflows during the period were US$ 352.89 million.
- The portfolio return in the period was 0.59% compared with the benchmark return for the quarter of 0.67%.

The total Fund's returns by quarter, one year, FYTD, three years and since inception of the Fund up to 31 December 2011 as follows:

Currency $USD	(%)				
	QTR	FYTD	1 Year	3 Years	Since Inc
Total Fund*	0.59	2.83	2.83	2.40	4.08
Benchmark	0.67	2.87	2.87	2.41	4.11
Excess	-0.08	-0.04	-0.04	-0.01	-0.03

* The BIS transition during December 2011 impacted the Total Fund return by -0.04%.

1. PETROLEUM FUND MANAGEMENT MANDATE

An updated revised management agreement including a new investment mandate between the Ministry of Finance and the Central Bank was signed on 25 June 2009 and its annex 1 was further updated on 8 October 2010. As part of the efforts to further diversify the Fund to equities, the BIS mandate has been revised by eliminated non qualifying instruments. The new benchmarks as of December 2011 may be summarized as follows:

Global Benchmark

US Government Bonds	*96%*
Global Equity Mandate	*4%*

Subsidiary Benchmarks

BCTL Internal Management (76% of global portfolio)

US Government 0-5 years	100%

Bank for International Settlements (20% of global portfolio)

US Government 5-10 years	100%

Schroder Investment Management Limited (3-5% of the Fund)

Global Equities listed in developed market exchange-MSCI World Index Net Dividend Reinvested	100%

Following Minister's decision to restructure the BCTL's benchmark from a single 0-5 Years Index to two bencmarks namely 1-3 Years and 3-5 Years US Treasury Indices, operational logistics been in place in December but due to proximitiy to Christmas holiday the implementation has been defered to January 2012.

2. MARKET TRENDS DURING THE QUARTER

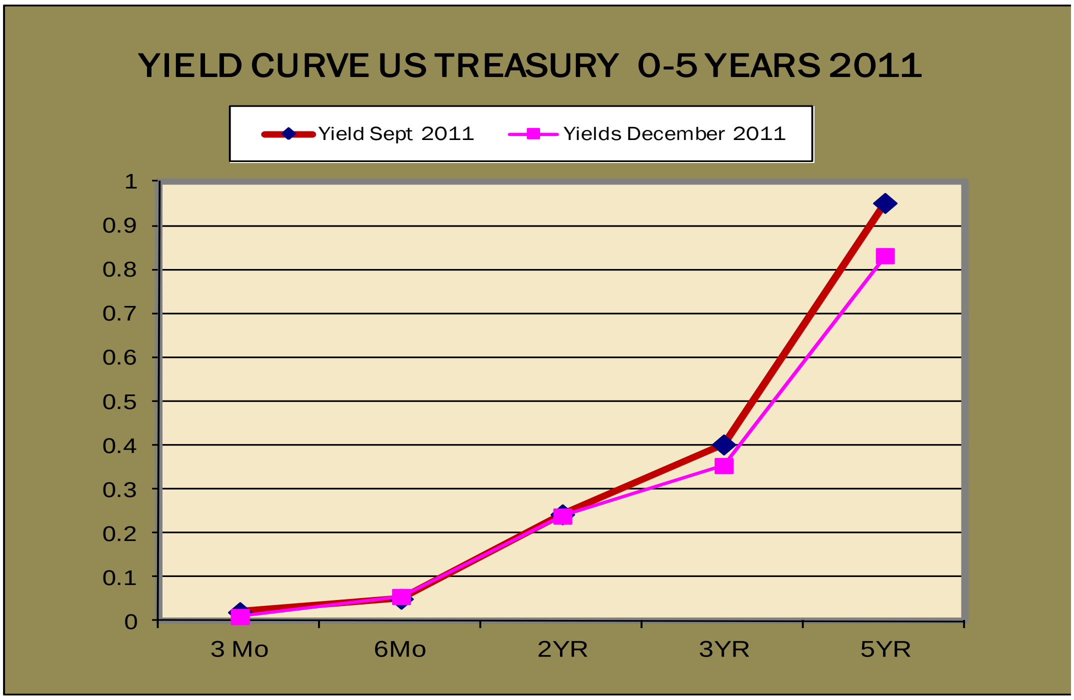
Global Market

Incoming economic data continued to show some signs of recovery combined with some apparent effects of the uncertainty caused by the global financial system stress. In mid December US Treasury yields declined, and just rose until before Christmas before rallied sharply in year end. There was little news in the statement released after the December FOMC meeting that FOMC noted again the “strains in global financial market” and the risk these strains posed to the economic outlook. In Euro zone yields some government’s yields curve flattened in December like German’ bunds and the United Kingdom’ gilt.

US Treasury Market

During the period from 30 September 2011 to 31 December 2011 US Treasury bonds 0 to 5 years yields decreased significantly. At the short end 3 months US Treasury benchmark reference bills increased by -1 basis point and 6 months US Treasury benchmark reference bills increased by 1 basis points, while 2 year bond yields remain the same. The 3 and 5 year US Treasury benchmark reference notes decreased by -5 and -12 basis points respectively compared to the previous quarter end. Bond prices and yields move in opposite directions.

The graph below shows the 0-5 year US Government yield curve on 31 December 2011 compared to the previous quarter end 30 September 2011.



US Treasury bond yields decreased significantly. The 3 and 6 month US Treasury benchmark reference bills decreased by 1 basis point. The 3 and 5 years yield decreased by -5 and -12 basis points respectively.

There has been no change to the U.S. Federal Reserve Bank’s key overnight lending rate (the US Federal Funds target rate), with the current level target range remaining at 0 – 0.25% as of December 2011.

3. MANAGEMENT DURING THE QUARTER

Objectives

For the Internal Mandate, the Central Bank's objective in managing the portfolio is to achieve a portfolio return close to the return of the agreed benchmark; while the BIS's portfolio will be managed in an active manner and the objective is the expected outperformance of the portfolio gross of management fees is 25 basis points over the Benchmark performance, on an annual basis over a rolling three year period, while maintaining the ex ante tracking error within 100 basis points.

The objective of the internal mandate is to achieve the portfolio return close to the benchmark within +/- 25 bps while the objective of BIS mandate is the expected outperformance of the portfolio gross of management fees is 25 basis points over a rolling 3 yrs period.

The objective of Schroder mandate is to mange the portfolio in an enhanced passive indexing style and maintained within a tracking error relative to the benchmark that does not normally exceed 100 basis points.

The BIS benchmark changed from composite to a single US Treasury 5-10 years index with the same risk and return characteristics as described above. The old BIS portfolio ceased on 9th December for transition to 22 December 2011 and the new mandate commenced from close of business of 22 December 2011.

The objective of Schroders mandate is to manage the portfolio in an enhanced passive indexing style and maintained within a tracking error relative to the benchmark that does not normally exceed100 basis points, and with load differences maintained within 0.5% (security level) and 2.5% (country and sector levels). At no time shall the ex-ante tracking error exceed 150 basis points.

For the Central Bank's internal mandate, cash received by the Fund has been invested in the portfolio in a timely manner, normally within two working days. This policy is consistent with the passive investment mandate given to the Central Bank by the Ministry of Finance.

For the BIS portfolio, cash received by the BIS has been invested in the portfolio within the benchmark as described in Subsidiary Benchmark section in page 2 of this report.

For Schroders mandate, cash received invested in equities listed on developed market exchange (i.e. in countries belonging to developed markets as defined by the MSCI market classification framework).

Operational Implementation

The Central Bank internal mandate is operationalised by holding ten of the approximately 152 US Treasury Securities that form the defined benchmark index. The bonds are selected to best replicate the risk and return characteristics of the benchmark.

As of December 2011 the BIS mandate is operationalised by holding US Treasury bonds of 5-10 Years per BIS's new benchmark.

Schroders mandate operatinalized by holding equities in equities listed in developed market exchange.

Regular financial reports on the performance of the Fund under Central Bank management are produced for Central Bank management and regular position reports for the total Fund including the BIS and Schroders mandates are produced by the Fund's custodian as part of the management process.

External Managers

The Fund as of December 2011 has 2 external managers namely Bank for International Settlements (BIS) managing 20% of the total portfolio investing in US Treasury 5-10 years and Schroder Invesment Management Limited (Schroders) managing 4% of the total portfolio investing in global equities.

State Street Global Advisors (SSgA) has been appointed as an external manager of an Indexed global equities mandate to manage 4% of the Fund and an Investment Management Agreement been signed with the SSgA in December 2011 but given the proximity to Christmas holiday, the implementation of the mandate has been defferred to January 2012.

4. PORTFOLIO PERFORMANCE

This section contains a number of tables and charts describing the performance of the Petroleum Fund.

The following notes are intended to assist in interpreting this information:

- The percentage figures show the return of the Fund, or a part of it, and compare the result with a benchmark. The benchmark represents the investment strategy established by the Minister and is used to set a goal against which the performance of the actual investments is measured. The Minister's benchmarks for the Petroleum Fund mandates are described earlier in this report.

- The excess is the difference (even if negative) between the benchmark and the portfolio being measured. In general a portfolio and its benchmark will respond in a similar manner to movements in the financial markets. The excess occurs because the benchmark does not recognise transaction costs, and because the actual portfolio usually contains a different mix of financial instruments to the benchmark.

GLOBAL PORTFOLIO

In the course of the quarter the Petroleum Fund increased from $8, 903, 14 million to $ 9, 310. 32 million as follows:

Capital Account, Quarter October - December 2011	In thousand $
Opening book value (1 October 2011)	8,903,141
Receipts during the period	860,956
Transfer to General State Budget during the period	(505,000)
Management Fees	(3,070)
Return in the period	54,293
Closing book value (31 Dec 2011)	9,310,321

The balance was invested in the following financial assets:

Assets	In Thousand ($)
Cash and Cash Equivalent	24,053
Marketable Deb Securities	8,886,193
Global Equities	355,244
Receivables and other Assets	46,659
Less; Pending Purchase of Securities	(1,000)
Other Liabilities	(828)
Total	9,310,321

The Net Income for the quarter comprised the following:

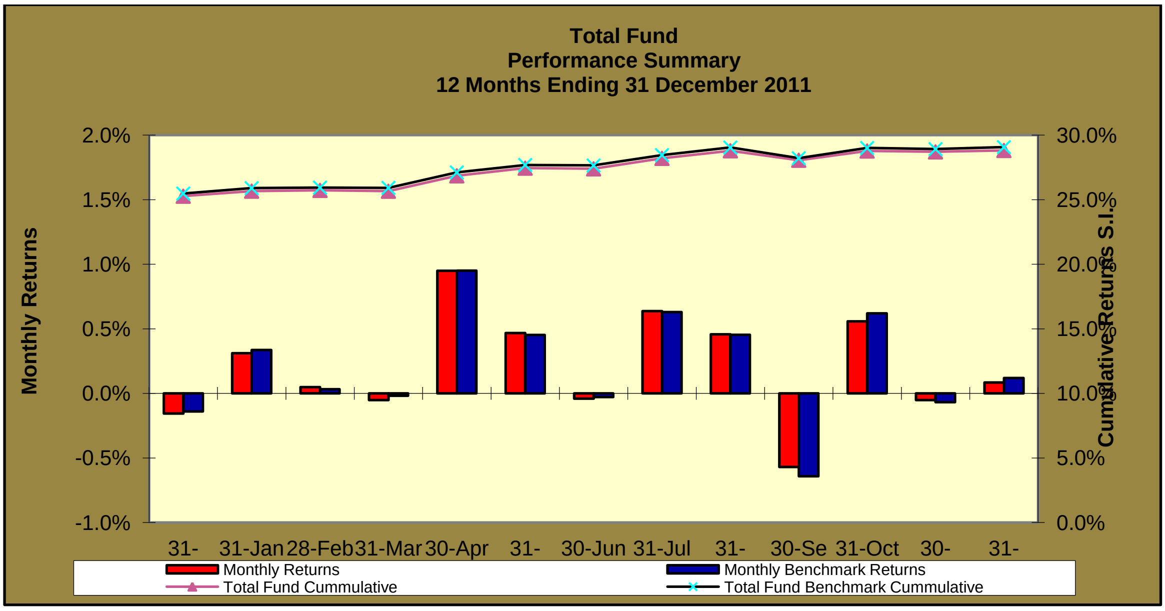
INCOME	In thousand ($)
Investment Income	65,992
Income	65,992
Market Revaluations	(11,699)
Less: Management Fees	(3,070)
Net Result for the Period	51,224

The performance of the Fund for the quarter, including the performance of the relative asset classes, was as follows:

Currency $USD	(%)				
	QTR	FYTD	1 Year	3 Years	Since Inc
Total Fund*	**0.59**	**2.83**	**2.83**	**2.40**	**4.08**
Benchmark	0.67	2.87	2.87	2.41	4.11
Excess	-0.08	-0.04	-0.04	-0.01	-0.03
International Fixed Interest	0.34	3.07	3.07	2.38	4.07
Benchmark	0.36	3.11	3.11	2.40	4.10
Excess	-0.02	-0.04	-0.04	-0.01	-0.03
International Equity	7.97	-3.99	n.a	n.a	1.80
Benchmark	7.59	-5.54	n.a	n.a	0.24
Excess	0.38	1.54	n.a	n.a	1.56

* The BIS transition during December 2011 impacted the Total Fund return by -0.04%

The cumulative performance of the Petroleum Fund compared with the performance of the Global Benchmark over the same period is shown in the below graph.



FIXED INTEREST

The performance of the investments in Fixed Interest investments for the quarter, including the performance of the managers responsible for those investments.

Currency $USD	QTR	FYTD	1 Year	3 Years	Since Inc
	(%)				
International Fixed Interest*	0.34	3.07	3.07	2.38	4.07
Benchmark	0.36	3.11	3.11	2.40	4.10
Excess	-0.02	-0.04	-0.04	-0.01	-0.03
Banco Central Internal Mandate	0.33	2.65	2.65	1.97	3.87
Benchmark	0.34	2.69	2.69	2.00	3.92
Excess	-0.01	-0.04	-0.04	-0.03	-0.04
Bank for International Settlement**	n.a	n.a	n.a	n.a	0.51
Benchmark	n.a	n.a	n.a	n.a	0.42
Excess	n.a	n.a	n.a	n.a	0.09

* The BIS transition during December 2011 impacted the International Fixed Interest sector return by -0.04%

** The BIS new mandate return series commenced from Close of Business 22 December 2011, therefeore partial month return is not relevant.

Below is the historical performance of the BIS up to 9 December 2011 where the BIS old benchmark was ceased for transition to the new benchmark.

Currency $USD	QTR	FYTD	1 Year	3 Years	Since Inc
Bank for International Settlement*	0.57	4.92	4.92	n.a	5.10
Benchmark	0.51	4.89	4.89	n.a	5.10
Excess	0.06	0.03	0.03	n/a	0.00

INTERNATIONAL EQUITIES

The performance of the investments in global equities for the quarter, including the performance of the managers responsible for those investments, was as follows:

Currency $USD	QTR	FYTD	(%) 1 Year	3 Years	Since Inc
International Equities	7.97	-3.99	-3.99	n.a	1.80
Benchmark	7.59	-5.54	-5.54	n.a	0.24
Excess	0.38	1.54	1.54	n.a	1.56
Schroder Investment Management	7.97	-3.99	-3.99	n.a	1.80
Benchmark	7.59	-5.54	-5.54	n.a	0.24
Excess	0.38	1.54	1.54	n.a	1.56

5. MANAGEMENT COSTS

A management fee of $2,241,571 for operational management costs was deducted and $828,000 was accrued from the fund during the quarter to cover the direct external expenses and internal operational expenses

The fee covered the following services expense

external Management and Custody expenses	1,361,100
Central Bank management expenses	845,127
IAB expenses	35,345
Accrued expenses for external managers and custody fees	828,000
Total Fees	3,069,571

6. TRANSFERS FROM THE PETROLEUM FUND

According to Article 7.1 of the Petroleum Fund law transfers from the Fund may only be made to the credit of a single State Budget account. During the quarter, total amount of US$ 505 million has been transfered from the Fund to the State Budget.

A summary of transfers to the State Budget Account is as follows:

	In Million ($)
Transfer - October 2011	125
Transfer - November 2011	150
Transfer December 2011	230
Transfer for this quarter	505
Total transfers previous quarters	550
Total transfer this fiscal year until December 2011	1,055

7. RISK EXPOSURE OF PORTFOLIO

7.1 Tracking Error

The tracking error illustrates the manner in which the Fund portfolio tracked the benchmark index. The “Excess Return” measures the difference between the return of the Fund’s portfolio and the benchmark. The excess return for the Fund’s global portfolio is -0.08% (or -8 basis points) while the excess return of the Central Bank internal mandate and Schroders mandate were -0.01% (or -1 basis point) and 0.38% (or 38 basis points) respectively. BIS tacking error for this quarter is not availabe since its mandate change in mid month.

7.2 Duration

The modified duration of the Central Bank internal portfolio shall be managed within ±0.2 years of the modified duration of the benchmark. The Modified duration of the BIS portfolio shall be less than six years. The duration was within the mandate during the quarter.

7.3. Credit Risk

The investments by the Petroleum Fund in US Treasury Securities with the high credit rating (AA+) or higher. Investments in global equities are not rated. All investments reflected the new investment mandate as reported in page 2 of this report.

Cash received by the Petroleum Fund pending investment is invested at overnight money market interest rates in an overnight repurchase pool operated by the Federal Reserve Bank of New York.

8. COMPLIANCE STATEMENT

Banco Central de Timor-Leste asserts the following statements relating to compliance with the mandates given by the Minister.

Qualifying Instruments

The Fund was invested in instruments within the investment universe specified in the mandate at all times during the quarter.

Return

The performance on the global portfolio for the quarter was 59 basis points compared with the benchmark performance of 67 basis points.

Modified Duration

The modified duration of the Fund's fixed interest investment portfolio remained within the mandate during the quarter.

Tracking Error

The tracking error of the Fund's investment portfolio was within the mandate during the quarter.

Internal Mandate

The Central Bank portfolio complied with the mandate throughout the quarter.

External Managers

The external managers investments was within the mandate during the quarter.

Internal Audit

In accordance with the provisions of Article 22 of the Petroleum Fund law no. 9/2005 that requires Central Bank's Internal Auditor to perform an audit of the Fund every six months. The Internal Auditor has performed an audit on the Fund to 30 September 2011.

9 FINANCIAL INFORMATION

The following financial information is presented for the purpose of assisting the Minister to review the quarterly performance of the Petroleum Fund as set out in this report. The figures have not been audited.

Balance Sheet

in thousand $

NET ASSETS	Dec-11	Sep-11	Dec-10
Cash and Cash Equivalent	24,053	16,080	7,143
Marketable Debt Securities	8,886,193	8,508,126	6,575,889
Equities at market value	355,244	283,856	281,770
Receivable and Other Assets	46,659	112,523	39,195
Less: Pending Purchase of Securities	(1,000)	(17,444)	-
Other Liabilities	(828)	-	-
TOTAL	9,310,321	8,903,141	6,903,996
CAPITAL			
Opening Balance	6,903,996	6,903,996	5,376,626
PF Law Art. 6.1 (a) Revenue Receipts	1,331,353	990,461	920,180
PF Law Art. 6.1 (b) DA Receipts	1,900,759	1,380,695	1,190,010
PF Law Art. 6.1 (e) Other Receipts	7,978	7,978	7,042
PF Law Art. 7.1 Transfer to General State Budget	(1,055,000)	(550,000)	(811,000)
Net Income	221,234	170,010	221,139
TOTAL	9,310,321	8,903,141	6,903,996

Profit & Loss Statement

in thousand $

	Quarter		Year To Date (YTD)	
INCOME	Dec-11	Dec-10	Dec-11	Dec-10
Investment Income	65,992	53,530	244,900	206,184
Income	65,992	53,530	244,900	206,184
Market Revaluations	(11,699)	(77,944)	(17,363)	18,411
Less: Management Fees	(3,070)	(1,378)	(6,303)	(3,456)
Net Result for the Period	51,224	(25,793)	221,234	221,139

Notes:

- *The accounting policies and method of computation used to prepare the above figures are the same as disclosed in the most recent annual financial statements of the Petroleum Fund.*

Dili, 26 January 2012

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Banco Central de Timor-Leste

Abraão de Vasconselos
Governor