

*Annual Report*

Fiscal Year 2003/2004  
(1/Jul/2003-30/Jun/2004)

Dili  
2004



## ***Introduction***

Economic activities in Timor-Leste slowed down during the year 2003 as the result of a long drought which affected agricultural production. Additionally there was the impact of a significant downsizing in the presence of internationals, civilian support staff and military which affected the service sector, including hotels and restaurants. However, there are indications that a period of sustained recovery will take place over the next 2-3 years. It is recognised that due to limitations in the available macroeconomic statistical data it is difficult to present a comprehensive analysis.

The banking system showed remarkable growth during the 2003/4 year, mainly due to changes in bank strategic policy regarding their lending activities, but also influenced by the arrival of a new bank licensed in August 2003. There was a considerable growth in lending to the private sector, primarily in the construction, trade and transportation sectors, although there was also a sharp increase in personal loans. In spite of this expansion in lending, the non-performing loans have continued to remain low.

As part of the national programme to enhance economic activity and to promote private sector development, the BPA has been requested to draft laws for insurance and payments. These laws have been drafted and are in the process of consultation with interested parties. It is expected that the draft laws will be ready for submission to the relevant authorities in the near future.

The insurance law, in common with other countries, establishes a sound legal framework for effective licensing and supervision of the insurance industry. The draft law has been prepared based on the core principles of the International Association of Insurance Supervisors. As well as drafting the law, the BPA with assistance from the International Monetary Fund initiated a survey on the potential of the insurance market, focusing initially on compulsory third party liability insurance for motor vehicles. The results of the survey are now available for insurance companies potentially seeking a licence in Timor-Leste. Meantime the payments law establishes the legal framework for payments transactions, negotiable instruments, and the supervision of the payment and settlement systems.

In order to enhance the effectiveness of its supervisory activities to maintain the credibility of the banking system, the BPA issued three important Instructions during the year, namely an Instruction on the reporting of consolidated financial condition, the opening and maintenance of deposit accounts, and an Instruction on the prevention of money laundering, customer identification and record keeping. An Instruction concerning banking holidays was also issued.

During the year the BPA issued a level "A" banking licence to PT Bank Mandiri Tbk to operate a branch in Timor-Leste. In the meantime, two other applications for banking licences were declined during the year.

As a young institution, the BPA continues to evolve its organisation to encompass new functions. During the year the Department of Supervision became the Department of Financial System Supervision to accommodate the new role assigned to the BPA to supervise the insurance industry. This



department now comprises three divisions: banking supervision, insurance supervision, and licensing and regulation.

In terms of staff development the BPA continued to invest intensively in building the capacity of its staff by allowing staff to attend training courses, seminars, and attachments to other central banks to further enhance their management and technical skills in central banking.

As part of the long term plan for the institutional building, the BPA continues to endeavour and promote cooperation with other central banks and/or supervisory authorities in other countries. We have established good and cooperative relationships with the Bank of Portugal, Bank Negara Malaysia and Bank Indonesia as well as the Portuguese Insurance Supervisor.

The BPA together with insurance supervisors from other Portuguese speaking countries (including the Monetary Authority of Macao) have founded an association of insurance supervisors (Associação de Supervisores de Seguros Lusófonos) which is located in Lisbon.

During its formative years, the BPA has been fortunate to benefit from presence of international staff who have worked alongside national staff to develop the various services in the institution. The management of BPA would like to express its sincere appreciation of their contribution to the Institution. It is equally important to underscore the support that the institution has continued to receive from the Prime Minister and the Minister of Planning and Finance, as well as from its development partners.

This Annual Report and the audited financial statements are presented in accordance with Section 56 of Regulation 2001/30 on the Banking and Payments Authority of Timor-Leste.

Dili, October 25<sup>th</sup>, 2004

**Abraão de Vasconcelos**  
General Manager



*Timorese from Gleno (Ermera District)*

## 1 – TIMOR-LESTE ECONOMY: RECENT DEVELOPMENTS

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### ***International framework***

During the 2003/4 fiscal year Timor-Leste completed its second year as an independent country.

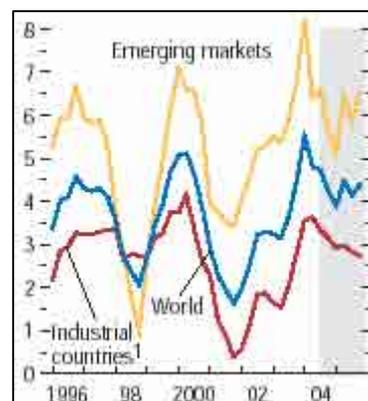
During these past two years, as well as the years since 1999, its history has provided a good example of how countries become more and more interdependent, both from political and economic points of view.

In common with our approach in the two past reports, and in line with reports produced by similar institutions, we start by reviewing developments in the international economy during the period under review, since this provides the background for our country's economic development. Although we focus our attention on the recent past we will also try, as far as possible, to present views on how international economies may develop into 2005, for these will influence the development of our national economy. Reflect on the extent to which Timor Sea revenues will be influenced by international oil prices.

Two international organizations regularly publish analyses on the world economic developments. The International Monetary Fund and the OECD – Organization for Economic Cooperation and Development – publish reports that are the basis for what follows. We also source

information from specialized reports published by other central banks and global commercial banks. At the end of this chapter is a bibliography for those who wish to study these matters further.

The beginning of the decade was noticeable for a relatively slow **growth in GDP** (vd, graphic at right) and the first half of 2003 showed an even slower annual rate (about 1.5%) as a consequence of the second Iraq war. The OECD economies – those of the more industrialized economies – experienced the significant recovery foreshadowed in our report last year.



This recovery was more rapid than anticipated and the American economy, the growth engine of many countries, grew in 2003 by 3.1% compared with an expected 2.5%.

This rapid growth is continuing into 2004, with the IMF now

forecasting a 4.3% growth for the American economy (*World Economic Outlook*, September 2004, the source of several graphics in this section on the international economic situation) last year's estimate being a "meagre" 4%. The United States central bank (Federal Reserve) forecasts that the country's GDP growth of 2004 will be in the range 4.5-4.75%. Their forecast for 2005 is in the range 3.5-4%.

The IMF forecasts a production growth rate for 2005 of 3.5%, 0.4 percentage points lower than last April, when their forecast was 3.9%.

As mentioned, these positive economic developments in America help to accelerate growth in other economies. One of these is

the "Euro area" (comprising the EU countries that have adopted the Euro as their national currency), which after relatively slow growth in 2003 (0.5% compared with 3% in the USA), which finally seems to be seeing some economic recovery; two contributors to this recovery were Germany and France, being the two major economies in the European Union framework. Although their GDP growth rates were 2% and 2.6% respectively, they still lagged behind America.

Growth prospects for European economies in 2005 are now lower (2.2%) than last April when the forecast was 2.3%, the rate being similar to that for 2004. We must point out that while the US growth rate is forecast to be decreasing during 2005 alongside Japan (where the IMF projects the growth rate to fall from 4.4% in 2004 to 2.5% in 2005) the European rate will continue to be rising or stabilizing. This seems to corroborate the existence of a time lag between European and American

	2003	2004				2005	
	T4	T1	T2	T3	T4	T1	T2
<b>Annual GDP growth rate by quarter</b>							
United States	4.1	4.6	4.3	3.8	3.9	3.6	3.6
Japan	6.4	1.7	2.2	2.5	2.7	2.8	3.0
Euro Area	1.4	1.4	1.9	2.3	2.3	2.5	2.5
Total OECD	4.0	3.1	3.2	3.2	3.2	3.2	3.3
<b>Idem, inflation</b>							
United States	1.5	2.1	2.0	1.3	1.3	1.8	1.5
Japan	-4.4	-0.8	-1.4	-1.2	-1.1	-1.1	1.0
Euro Area	1.6	1.5	1.6	1.8	1.8	1.6	1.7
Total OECD	1.1	2.2	1.8	1.6	1.6	1.6	1.5
<b>Unemployment rate</b>							
United States	5.9	5.6	5.6	5.5	5.4	5.3	5.3
Japan	5.1	5.0	5.0	4.9	4.9	4.8	4.7
Euro Area	8.8	8.8	8.8	8.8	8.8	8.7	8.6
Total OECD	7.1	7.0	7.0	6.9	6.9	6.8	6.7
<b>Short term interest rate</b>							
United States	1.1	1.2	1.2	1.4	1.6	2.1	2.6
Japan	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Euro Area	2.2	2.1	1.7	1.5	1.5	1.5	1.5

Source. OECD

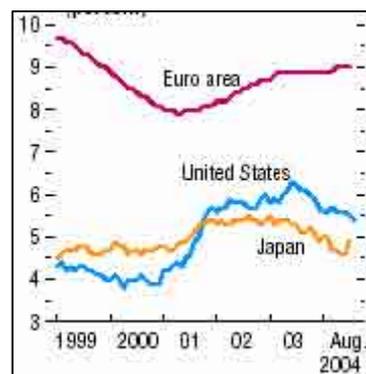
economies, the former following the latter with a lag of about 6 months to one year. This may well mean that in 2006 European growth will start decreasing following the fall in the American growth rate in 2005. This transmission of influence can be seen in the table showing the quarterly development of growth rate in the more industrialized economies.

The Japanese economy, in turn, appears to have broken out of its lethargic behaviour of the 1990s: in 2003 the GDP growth rate was 2.7%, well above the European rate and approaching the United States rate of 3.1%, and is forecast to be 3.4% in 2004.

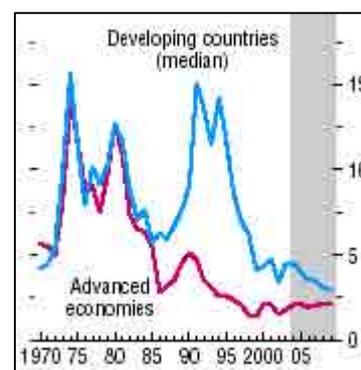
This recovery is not unrelated to the American economy, because America is a major client of Japanese products. The recovery is also driven by an increasing growth rate in China, an ever more important client of products “made in Japan”, ranging from equipment to durable goods.

As noted last year, production recovery is having difficulty in extending itself into the labour market: *unemployment* rates (see graphic at right) are still high and are showing considerable resistance to falling, implying a somewhat dangerous trend for the future: that growth may be translating itself into proportionately fewer offers of new employment, and complicating efforts to maintain the “work for all” ethic introduced in the “golden 30s” and consolidated through the 1950s to the 1970s.

Nevertheless, a trend for unemployment to fall, albeit sluggishly, can be discerned. The structure of unemployment has tended to change, more often impacting the younger population and in general lasting longer, in itself creating analytical difficulties, arising in part from a mismatch between the qualifications of the unemployed and the requirements of modern economies.



In contrast, the *inflation* (vd. graphic at right) rate has stabilized in most industrialized countries at about 2%. This is primarily as a result of monetary policy that has focused on the maintenance of low inflation. It is also partly a result of the existence of unused productive capacity and a higher level of unemployment than desired, which produces downward pressure on price increases arising from higher wage rates, and partly a result of neoclassically-influenced policies to control inflation tightly. Another contributing factor that has kept salary pressures relatively low is the European Union’s opening-up to the East European countries, with the inclusion of several countries having “interesting” levels of productivity but low salaries.



It is important to note that the accelerating increase in production in many countries - particularly the US, Japan and the Euro area - and the recent significant rise in oil prices have strained some economies, and may lead to rising prices (hopefully not too much ...). Monetary authorities (central banks) are alert to this, and in most cases have given unequivocal signs that they will not allow inflation to increase significantly, resorting if necessary, to cooling off their respective economies by increasing interest rates, for example.

*Interest rates* have been kept at historically low levels (less than 2% in the Euro area and the US), and it is forecast that in 2005 there will be a slight increase.

With regard to *public finance* the trends mentioned in our previous report have been confirmed. There is increasing stress in the United States, mainly as a result of that country's participation in the Iraq war. The same is true in Japan and the Euro area (namely Germany and France) where governments have adopted policies to stimulate economic recovery through public expenditure.

As a result, following the years of balanced public accounts during the Clinton Presidency, the US has now a fiscal deficit of 4.8-4.9% of GDP, and the financing of this deficit is starting to pose a serious problem. That the US is not in more serious trouble is because several Asian countries have been buying huge amounts of American public debt. This translates into the US being now being partly a hostage to Asian countries for the financing of their public accounts. Should a change (although it is unlikely) in this policy occur the USA may see its financial and economic situation worsen.

The Euro countries decided to relax the criteria requiring them to limit the deficit to 3% of GDP. We do not believe, however, that this amount will be significantly exceeded or put the economic recovery now taking place in Europe at risk. The average size of the public deficit in these countries today is about 2.8%.

Japan, whose deficit reached a record value of 8.2% of GDP last year, hopes that this value will have already started to reduce in 2004 as a result of an improvement in fiscal income geared by the economic recovery and by some contraction in fiscal expenditure in order to give more room for the private sector (investment and household consumption) to manoeuvre during the process of national economic recovery.

#### ***Balance of Payments of several countries as a % of its GDP***

	2002	2003	2004	2005
<b>Advanced economies</b> (whole group)	-0.8	-0.8	-0.8	-0.8
United States	-4.5	-4.8	-5.4	-5.1
Euro area	0.8	0.3	0.8	0.9
Germany	2.2	2.2	4.4	4.8
France	1.0	0.3	-0.6	-0.6
Italy	-0.6	-1.5	-1.1	-0.8
Spain	-2.4	-2.8	-3.4	-3.6
Portugal	-6.8	-5.1	-6.1	-6.3
Japan	2.8	3.2	3.4	3.2
United Kingdom	-1.7	-1.9	-2.0	-1.9
Australia	-4.4	-5.9	-5.3	-4.9
<b>Asia New Industrialised Economies</b>	5.8	7.6	6.8	6.5

Fonte: FMI *World Economic Outlook*, September 2004, pg 15

comparing with the Euro area's positive balance and particularly Japan's – is one of the main weaknesses of American economy and may have consequences on both interest rates and USD exchange rates. Indeed and at least in the medium term it seems difficult to see how it will be possible to maintain the policy of low interest rates that led numerous operators to favour holding their financial assets in other currencies (Euro, Australian dollar, etc.) and as a result, lowered the USD exchange rate – which potentially was of benefit to American exports.

One has to point out that between April and September 2004, the IMF adjusted its forecast for the balance of American external trade, significantly worsening the outlook from -4.2% to -5.4% this year and from -4.1% to -5.1% for 2005.

Primarily due to the positive performance of German exports and other countries, the Euro area has achieved a sustained positive balance in their current accounts. This situation has helped to reinforce the Euro exchange rate against the USD.

Japan continues to be a very important exporting nation, which allows it to ensure a comfortable positive balance: about 3.2%-3.4% of GNP.

With respect to the external economic relationships of these countries, measured by their balance of payments and, in particular, the balances of their current accounts, we draw attention to the position of the United States, with a deficit of 4.8% of GDP in 2003, an increase of 0.3 percentage points compared with the previous year.

Similar to what is happening in the public accounts, this disparity –

In brief, the estimated economic recovery in 2004 forecasted last year has been confirmed, with GDP growth rates reaching the highest levels in 20 years. It is important to note that the estimates for 2005 are less optimistic than those for the present year (2004), envisaging a slowing down of economic growth rates for the United States and the economies most dependent on US developments – such as some Asian economies including Japan. However this slowdown does not mean the onset of an economic crisis, particularly in East Asia.

With regard to regional developments in the group of developing countries, special emphasis is given to China, which is more and more becoming an engine for regional development arising from a significant increase in its imports. Indeed the country is no longer, as it seemed a few years ago, merely a “production platform” for exports of international (and Chinese) companies. As a major importer, it is increasingly becoming a regular full-time player in international markets.

In this regard it is important to draw attention to the ever increasing importance of international exchanges between China relative to several of its neighbours, particularly Japan and South Korea. These changes are significantly modifying the landscape of economic relations in the region as China increases in importance.

Last year China saw rapid economic growth (9.1%), most of it originating in unusually high expenditure on investment (about 45% of the GDP, an unthinkable rate for most countries), some of it admittedly with a doubtful rate of return.

This overheating of the economy translated into accelerating price increases (inflation rates of -0.8%, +1.2% and +4% from 2002 to 2004) and that led the authorities to implement a policy of quantitative restriction of credit in the economy. The expectations are that this will lower GDP growth rate to 8.5% this year (2004), still an exceptionally high rate. According to the IMF estimates the growth rate of GDP in 2005 will be in the order of 7.5% but other observers point out to forecasts of 7% and some even of 6% (for instance, the ANZ Bank in its *East Regional Asia Report* dated 12 July 2004).

One of the consequences, not foreseen by many observers, of the rapid growth in China has been an increasing demand for oil. It has been the presence of China as a significant buyer of this form of energy in the international markets that has contributed, along with political instability resulting from the war in Iraq, to the large increase in the price of oil experienced during recent months, which in turn has influenced the previously optimistic perspective of future development in the more industrialized economies.

Regarding other East and South-East Asian countries, we should mention that nearly all of them have been seeing increased growth rates in 2004, a fact that is not inconsistent with their relationships with the United States economy and, more recently, the Chinese economy. Both of those economies are, as we noted earlier, now on an accelerating growth path, accompanied by a growth in imports at least part of which is sourced from Asia.

As for Timor-Leste’s immediate neighbours, we noted last year that we have a particular interest in the development of the Australian and Indonesian economies.

After the slowdown in 2001, when the GDP growth rate was 2.7%, the Australian economy is, as we noted in the last year’s report, exhibiting a remarkable resurgence: with growth rates of 3.3% in 2003 and, according to OECD estimates, projected to be 3.8% in 2004.

The OECD predicts that during 2005 there will be a slight decrease in the growth rate to about 3.5%. However, other observers believe that in 2005 the GDP growth rate may be a little higher than this year.

As a result of this rapid growth, unemployment has been decreasing significantly and is now 5.5%, the lowest rate in 23 years.

This development arises from strong domestic demand, particularly household consumption (which increased 6.2% last year), while external demand has suffered the consequences of a rising AUD exchange rate against the USD over a long period up to February 2004 (see graphic below).

The improvement of the growth rate for next year foreseen by some is linked to the possibility of a slight recovery in external demand for Australian production which will be related to a depreciation in the Australian dollar against a “basket” of currencies of its main economic partners of about 10% since the beginning of this year. One of these currencies is the USD, with the ANZ forecasting that by the end of 2005 the AUD will have depreciated against the USD from an exchange rate of 0.80 to 0.65. This will make Australian production internationally more competitive and easier to export.

The observable resurgence of economic growth in the group of Asian countries may also contribute to a recovery in Australian exports, particularly for agriculture and natural resources.

This recovery will lead to a stimulation of further investment, which has been important due to the consistent performance of the economy.

In turn, inflation has been decreasing and according to OECD estimates appears to be stabilising at 2% in 2004 after being 2.8% in 2003. A fall in the prices of imported goods resulting from the revaluation of the AUD has contributed to this decrease. However, with the anticipated reversal of this trend in 2005, it seems almost certain that the inflation rate will increase to 2.5-2.8%.

This increase in inflation cannot avoid echoing increases in interest rates. These have been kept at relatively high levels compared with other OECD countries (compare the short-term interest rate of 5.7% in 2004 with 1.3% in the United States and 1.7% in the Euro area), and will tend to increase further.

With respect to Indonesia, expectations of an increase in economic growth were confirmed for 2003. Indeed growth was even more rapid than previously forecast, with last year's forecasts indicating growth in 2003 and 2004 of about 3-3.5% and the actual rate eventuating at 4.2%. This year the rate of growth is anticipated to rise further, to about 4.5% or even 4.8%, according to the Asian Development Bank (see *ADB Asian Development Outlook 2004 Update*, October 2004). The final outcome will depend not only on the degree of political stability following the elections but also on a number of other elements, including the place Indonesia finds in the new economic context of the Asia-Pacific, with China further penetrating markets in competition with Indonesian products such as textiles. A growth rate of 5.2% is expected in 2005, higher relative to earlier ADB forecasts of 4.5%.

The inflation rate has also been falling, with predictions that this year it will be about 6%, with a slight reduction in 2005 to 5.5%. Other estimates (see ADB) that take into account recent increases in oil prices and the accelerating growth path of the country predict that the inflation rate in 2005 could rise to 6.5-7%.

The exchange rate of the Rupiah was stable in the range 8,500-8,600 IDR/USD for a considerable period of time but then in the middle of last year depreciated and has been trading in the 9,200-9,300 IDR/USD band, which caused the country's exports to be cheaper when denominated in USD.

90-day interest rates fell from 9.2% in July 2003 to 7.3% in March 2004.

The growth of our neighbours' economies is primarily due to domestic demand because external demand seems to be expanding less rapidly. This is consistent with a loss of competitiveness by the Indonesian economy compared with other East Asian economies, particularly China, in spite of the depreciation of the Rupiah since 1998.

This review on developments in the international economy in 2003 and 2004 and the forecasts for its development in 2005 allow us to repeat with almost no changes the last paragraph published at this point in our Report published in 2003. There we said:

“In summary, the picture that we wish to paint of developments in the world economy, of the region in which Timor-Leste is situated, of its principal economic partners, is one of moderated optimism. There are indeed signs of an albeit slow recovery in the international economy that will have a positive impact on the economies of East Asia (including South-East Asia where we belong) but there are also signs on a global scale, particularly in the financial markets, that recovery is on a knife-edge, and destabilising factors could arise that could easily put recovery in jeopardy.

One of these factors could be a rise in the price of oil and a deterioration in the international political situation (Middle East, North Korea, etc) in such a way as to dampen the expectations of economic agents, particularly entrepreneurs and consumers.”

The most important change to make to this paragraph is that for next year (2005) it is not a “slow recovery in the international economy” that is forecasted but a softening of the growth of the world economy. One proviso is that developments in the international oil market don't become even worse bringing high price increases which in turn would force the major industrialized countries to implement anti-inflationary and recessionary policies.

With this review of developments in the international economy complete, we propose to analyse the development of the national economy in the period covered by this report (fiscal year 2003-04) and more generally during 2003 and early 2004.

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## ***Recent developments in the national economy***

### ***Production***

In our Annual Report last year we gave space to the analysis of the available data on the development of production in our country, drawing attention to the difficulties that arose from the fact that there are no National Accounts. In the same vein we have drawn attention to this issue in our quarterly “*Economic Bulletin*”.

Because we do not yet know the result of the survey of production being undertaken by the Boston Institute for Developing Economies, we can but record the value of GDP growth rate as cited in the International Monetary Fund’s latest published document (October 2004) on Timor-Leste . This report was produced by its latest mission (April 2004) under Article IV of the IMF Statutes.

In this report the IMF states that the real Gross Domestic Product (GDP) dropped at an annual rate of 3% during 2003, a sizeable decrease, particularly if we take into account its impact in terms of per capita income, which would have decreased about 5% in a single year if we accept the IMF estimate for the population growth rate in Timor-Leste, 1.9%, as in the 90s.

The report forecasts a GDP increase of 1% for 2004, the same rate being forecasted for 2005. As will be seen below, the government uses a different estimate in its budget, although it is for the fiscal year to June 2005 and not for the 2004 calendar year.

The decline in production during 2003 arose from two main factors coming together: the drought with its resulting bad year for agriculture, and the departure of a significant number of international personnel, civil and military, who were the source of high turnover in the hotel and restaurant sectors, as well as in the housing sector (rehabilitation of houses and rental payments, sometimes at high rates).

This negative perspective on production growth during 2003 and the lack of optimism for its growth in 2004 seems to contradict a sharp increase (about 6 times) in credit being granted to the private sector by the banking system. However, we shall see later that a very significant part of this credit is to finance imports (taxis, mini-buses, consumables for kiosks, etc) and thus an important part of its potential effect on the economy is leaking out of the country.

The reality is that reviewing production may be more complex than looking at IMF forecasts. Indeed the preparatory document for the 2004/5 State Budget forecasted that the rate of growth in production during the period (fiscal year ended June 2005, which does not exactly coincide with the 2004 calendar year used in the Fund's forecast) would still be negative: -1%, in contrast with the +1% estimated by the Fund.

This difference (2 percentage points) underlines the urgent need to initiate a regular compilation of National Accounts. The studies being undertaken on this topic by the Boston Institute for Developing Economies would be a good starting point for this work.

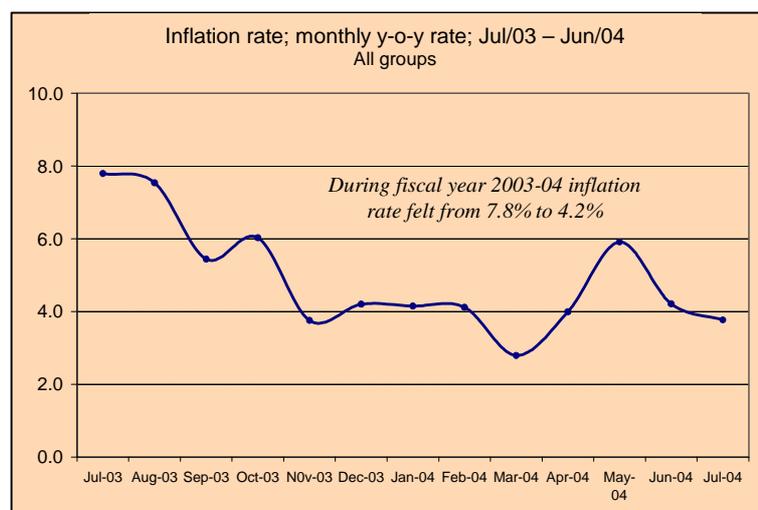
This mention of the state budget allows us to call attention to the fact that it forecasts the following GDP growth for the following years: a slight improvement in the economic situation in 2005-06 with GDP increasing 2% and a small acceleration of this rate in the two subsequent fiscal years. Indeed GDP growth is projected to be 4% in 2006-07 and 5% in 2007-08. These growth rates do not diverge significantly from the projections made by IMF for the same periods.

Given an estimated annual population growth rate in Timor-Leste of 1.9%, these GDP growth rates mean that per capita income will only begin to improve in 2006 or later. Therefore, the population needs to realise that its economic situation will continue to be difficult in the short term.

According to statistics recently published by IMF, national GDP will be \$328 million (at current prices) in 2004, which means that with the population levels reported in the latest census per capita income is about \$350, well below the previously estimated \$415.

### Prices

During the last fiscal year the inflation rate trended downwards, being 4.2% in the year to June 2004, which was about half the 8.2% rate of the previous fiscal year. If we take calendar years instead of fiscal years, the 2003 inflation rate was also 4.2%. It is possible that in 2004 it will be about 3% because, according to the National Statistics Department, the annual rates (i.e., year-on-year against the same month the previous year) for July and August were 3.8% and 2% respectively.



The fall in the inflation rate is due to the reduction of price rises in various categories of products including housing and contents, entertainment, education, alcohol and tobacco products, and transportation.

Prices in the main product category, food expense (almost 57% of the total Index), remained almost constant, which resulted in negligible pressure on the inflation rate. This was the result of markets being well supplied with those items in greater demand by the population, both imported goods and national agricultural production.

An improvement in the transportation for this production from rural areas to Dili seems to have played its part in this behaviour of agricultural prices.

### Consumer Price Index, 2001-2004

(December 2001=100.0)

Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>2002</b>												
Index	100.9	101.0	100.7	101.2	102.0	103.1	103.9	104.8	106.6	106.2	109.2	109.5
Monthly change	0.90	0.10	-0.30	0.50	0.79	1.08	0.78	0.87	1.72	-0.38	2.82	0.27
Y-o-Y monthly change*	...	...	...	...	...	...	...	...	...	...	...	9.50
<b>2003</b>												
Index	109.3	109.4	111.0	110.2	110.0	111.6	112.0	112.7	112.4	112.6	113.3	114.1
Monthly change	-0.18	0.09	1.46	-0.72	-0.18	1.45	0.36	0.63	-0.27	0.18	0.62	0.71
Y-o-Y monthly change*	8.3	8.3	10.2	8.9	7.8	8.2	7.8	7.5	5.4	6.0	3.8	4.2
<b>2004</b>												
Index	113.8	113.9	114.1	114.6	116.5	116.3	116.2					
Monthly change	-0.23	0.06	0.18	0.44	1.66	-0.17	-0.07					
Y-o-Y monthly change*	4.2	4.1	2.8	4.0	5.9	4.2	3.8					

Source: Direcção Nacional de Estatística

= annual inflation rate

= 2003/04 Fiscal year

NOTA: \* change since the same month of the previous year

#### Y-o-Y monthly inflation rate by groups of goods (%)

GROUPS	Dec-02	Jun-03	Dec-03	Jun-04
Food	0.0	8.1	14.0	7.8
Alcohol and tobacco	0.0	20.4	32.8	-9.7
Clothing and footwear	0.0	13.6	26.0	1.7
Housing	0.0	8.8	6.5	0.9
Housing furnishings, etc	0.0	3.1	8.7	-3.3
Health	9.3	1.5	-1.5	4.1
Recreation and education	9.2	3.4	1.7	-1.8
Transport and communication	6.2	2.4	-1.9	2.3
<b>TOTAL</b>		8.2	4.2	4.2

An analysis of monthly CPI behaviour shows that only three of the twelve months in the 2004 fiscal year saw an absolute fall in prices: September 2003 and January and June 2004. The month with the largest rise was May 2004, when a monthly increase of +1.7% corresponding to a year-on-year increase of 5.9% which was well above the 4.2% at the end of the fiscal year (June 2004).

The change in May was due to the rise in the food CPI of about 2.9% in the previous month. This was not only due to an significant increase of 20% in the component "eggs, milk and their derivatives" but also to an increase in the price of rice, which resulted in an increase of 9% of the group "cereals, roots and their derivatives". In turn, this was in line with the trend of significant price rises for this cereal in the international market (see the text box next page, where continuing price rises are forecast).

***The price of the rice is increasing in the international market***

According to the FAO – the Food and Agriculture Organization of the United Nations, which is headquartered in Rome – the international rice market has been experiencing significant changes during recent months.

The main influence on prices is the fact that despite an increase in production, reserve stocks have been decreasing. The same has happened to the volume of international trade in rice (a decrease of 2.3 million tons between 2003 and 2004).

Considering this reality, it is natural that prices have increased: for example, the FAO price index for a group that includes several rice varieties went from 80 in May 2003 to 109 in May this year (2004), an increase of 36%! This same index increased from 98 to 108 between February and April this year, an increase of about 10% in two months. The 2002 and 2003 averages were 72 and 82 respectively.

One of the most widely marketed varieties, a white rice known as “Thai, 100%, 2nd grade”, rose from \$202/ton to \$234/ton in the same period.

Forecasts for the future predict continuing price increases. Thus FAO forecasts that its index mentioned above will increase another 18% from 2003/04 to 2004/05.

Based on these trends we predict further price increases for rice imported by Timor-Leste, resulting in price increases for consumers and pressure on the inflation rate, because rice is an important component of the Consumer Price Index (CPI).

Source: FAO [Rice Market Monitor, May 2004](#) and FAO [Food Outlook, n° 2, June 2004](#)

***Wages***

It is widely accepted that the changes in wage rates need to be seen against the background of changes in the inflation rate by looking at changes in real wages, i.e., the rate of change of nominal wages taking account of inflation.

Considering the lack of official statistical information on this issue – another area where development of the statistical system could usefully take place – only limited analysis can be undertaken.

If, as we noted in our report last year, we assume that a significant part of the employed population works in the Public Service and that there has been no change in civil service wages for several years, then we have to add another year of diminishing purchasing power resulting from inflation during the past year. This means that the purchasing power of civil service wages has fallen about 20-25% since 2000 when the current wage levels were established.

Since we do not have any evidence that nominal wages in the private sector are increasing – on the contrary, there is anecdotic evidence that they are going down – this means that this sector has also experienced a decline in purchasing power, especially because there has been no change in the minimum wage which is defined as the minimum wage paid by the civil service.

However, one must take note that changes in the wages paid in the service sector depends in part on the international organizations that operate in Timor-Leste.

### *International trade*

As well noting as the lack of reliable statistical information from the National Accounts as being one of the main problems of our statistical system, our Annual Report last year also noted a lack of proper statistics on international trade.

At that time we noted that the Timor-Leste Customs Service was making efforts to improve the situation and we favourably observe that important steps have subsequently been taken that allow us to access systematically and reliably compiled information (although still subject to some improvement) on our international trade.

The statistics on exports include only those for coffee, which is actually the only export of Timor-Leste these days. The very nature of coffee means that exports are strongly seasonal, with the largest volumes being recorded in the months following the harvest and/or when exporters deliver crops to their clients.

The decision to not include other elements in aggregate exports is a result of the fact that they are minimal and have no statistical significance. Thus it is as if the country were a mono-exporter of coffee.

The main client for our coffee continues to be the United States, which is well ahead of Indonesia and Portugal.

The price per kilo at which the product is sold varies significantly from country to country because each country purchases a different quality of coffee, based on the extent to which it has been processed prior to export and of the type of beans. It is known, for example, that the average quality of coffee exported to Indonesia is lower than for other countries.

During the first half of 2004 exports went to the following countries:

#### *Coffee exports*

	<b>TOTAL 1st Semester 2004</b>			<b>Price average =100</b>	<b>% buyers</b>	<i>Estimate of total value (USD) if all was sold at the average price for...</i>
	<b>Quantity (kg)</b>	<b>Value (USD)</b>	<b>price kilo (USD)</b>	<b>index</b>		
United States	984,204	919,775	0.93	120	47.3	<i>EUA</i> 2,327,269
Indonesia	1,112,476	601,477	0.54	69	30.9	<i>Portugal</i> 2,999,463
Australia	188,970	261,056	1.38	177	13.4	<i>Australia</i> 3,440,257
Portugal	54,000	65,041	1.20	154	3.3	
Singapore	48,000	35,250	0.73	94	1.8	
Germany	66,640	34,151	0.51	66	1.8	
Taiwan	18,000	19,650	1.09	140	1.0	
Grenada	18,000	8,000	0.44	57	0.4	
<b>TOTAL</b>	<b>2,490,291</b>	<b>1,944,401</b>	<b>0.78</b>	<b>100</b>	<b>100.0</b>	

From the previous table we can draw three main conclusions:

1 - Our main customer (almost half of the gross value) is the United States, which is well ahead of Indonesia (which buys the largest volume) and, even further behind, Australia. These three buy more than 90% of our exports, which means our country is very dependent on only three countries; implying a very high degree of concentration that should perhaps be diversified;

2 - The highest average price per kilo is paid by Australia; however, it only takes about 13% of the total value of our exports. Of the large buyers, it is Indonesia that pays the lowest average price, as a result of the type of coffee that it buys, usually a lower quality with less processing;

3 - If it were possible to sell all the coffee produced at the same average price of exports to the USA, Portugal or Australia, export income would increase significantly. This would imply a policy of re-orientating our exports to those countries but that would only be possible if we change the level of export quality because this is what primarily determines the price received.

In short, there should be increased emphasis on increasing the quality of Timor-Leste coffee because this will allow a diversification in our markets and increase the average sale price. To do this would require a degree of attention to the sector that has neither occurred as a result of falling prices in the international markets nor through the intervention of a public sector that seems not to have found an optimal solution to the issue.

The currently available data on imports available from official sources (Timor-Leste Customs and National Statistics Office) are, as for exports, available from October 2003 to June 2004.

The latest data supplied by the Timor-Leste Customs on imports for the fiscal year 2003/04 are summarised in the table below. Note that present system of computation has only been used only since October 2003.

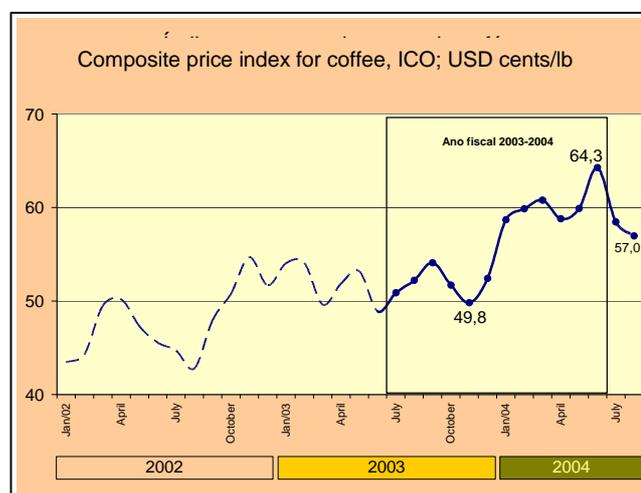
Values CIF (thousand USD)									
	Oct 03	Nov 03	Dec 03	Jan 04	Feb 04	Mar 04	Apr 04	May 04	Jun 04
1 - Taxable	3262	4219	5243	6406	4809	5734	4908	4831	5836
2 - Non-taxable	7050	5838	6103	5943	4605	5081	3143	3782	2799
3 - To the Government	3492	1007	736	491	661	259	952	113	1183
4- CIF value (imports) (before taxes)	<b>13803</b>	<b>11064</b>	<b>12082</b>	<b>12840</b>	<b>10075</b>	<b>11074</b>	<b>9003</b>	<b>8726</b>	<b>9818</b>
5 - Taxes paid	576	972	1511	1882	1063	1408	1267	1225	1563
6 - Taxes paid + to be paid by government	1007	1144	1650	2090	1148	1473	1385	1239	1709
<b>Total IMPORTS (4 + 6 above)</b>	<b>14811</b>	<b>12208</b>	<b>13732</b>	<b>14929</b>	<b>11223</b>	<b>12547</b>	<b>10388</b>	<b>9964</b>	<b>11527</b>

In the table the goods subject to duties are differentiated from those that are exempt, because they are imported by UNMISSET, embassies of foreign countries and other exempt importers (e.g., NGOs) and government imports.

### The coffee international price

After a crisis that lasts for several years, with very low prices due to overproduction, the coffee international market price began to increase. So, prices are now higher than in the near past.

The graphic below represents the evolution since January 2002 according to the International Coffee Organization (ICO), with headquarters in London.



For the first and last categories duties are computed but only the first actually pays them because the Government has a special regime for accounting for the payment of duties (the duty is computed but not actually paid).

Of the three classes of goods, those with the most importance to us are the group that pays duties and the government. In the latter case the figures for July and August 2004 exhibit a high degree of seasonality, being noticeably higher at the start of the fiscal year and much less during most of the remaining months.

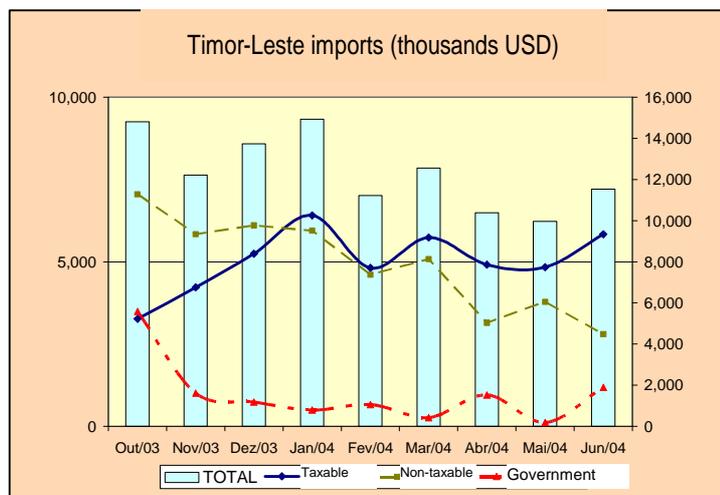
The group that pays duties – which we may call the true commercial imports – pays about \$6 million each month on average. This figure seems to be consistent with the idea that national production has almost stagnated as shown by the production figures mentioned earlier.

We also underline the consistent fall of the value of exempt goods, as a result of the progressive exit of UNMISSET and of a more rigorous policy for granting exemptions to those that apply for them. This policy and the partial withdrawal of UNMISSET civil and military personnel in May and June this year are the main reason why the ratio of exempt goods to total imports before taxes has declined by about half, from 52% for the last quarter of 2003 to 26% to the last reported quarter, June-August 2004.

The table above also shows us that the total value of imports during the first half of 2004 was about \$70 million. If we reflect that because of Christmas and New Year it is usual for imports during the second half to be larger than the first, and also taking into account the number of UNMISSET staff present after May 2004, it is possible to predict that imports for the present calendar year will be roughly \$150 million – considerably less than the \$200 million referred to in the IMF document for imports last year.

From the available data it is possible to see that the average tax burden on imports of goods that are subject to duty is 25.7%, an apparently high value but one that is consistent with the fiscal policies of countries at a level of development similar to that of Timor-Leste: those facing common difficulties in taxing the incomes of individuals and companies, and taxing expenses using sales taxes or Value Added Taxes (VAT). The solution is to obtain income from international trade. In future, as the economic and financial situation of the country progressively improves, the fiscal mechanism will allow the situation to be changed, but for the time being the present regime seems to be inevitable – and it should further encourage domestic production of goods that are now being imported. This is drawn to the attention of entrepreneurs, be they national or international.

From the countries of origin (see the small table to the right) it is Indonesia that, as expected, supplies us with most dutiable products: being about half the CIF value, i.e., before duties. Australia appears in second place, with 20%, followed by Singapore with about 15%. These three countries are the source of more than 86% of our imports that are potentially subject to duty (i.e., including government imports).



Indonesia	50.7%
Australia	20.2%
Singapore	15.4%
Vietnam	5.3%
Índia	2.5%
Thailand	1.8%
Malaysia	1.1%

Australia is the main country of origin for exempted goods (43% of the total of these products), followed well behind by Indonesia (12%), Portugal (11%), Japan (6%), Singapore and Malaysia (about 5% each).

As pointed out in our report last year, the fact that many of these exempted imports have UNMISSET and its staff as the final user means that, with the end of its mission in 2005, there will be a tendency for Australia to progressively decrease in importance as a supplier, and for Indonesia and the other ASEAN countries to increase in importance.

### *Type of products*

When reviewing the type of products forming the basis of international trade in our country, it can be seen that exports concentrate mainly on coffee and on the sending abroad of goods (mainly equipment) that were used by the United Nations and are being returned to its warehouses abroad or to other countries. These are not actually classified as exports.

The main products being imported are summarised in the table below:

<b>5 main types of imported goods (1<sup>o</sup> semester 2004)</b>			
class of goods		Milion USD	%
27	Oil and its derivatives	12.3	17.4
87	vehicles	11.5	16.2
85	Electrical appliances and its parts	6.3	8.9
10	Cereals (including rice)	4.8	6.8
84	Mechanical appliances	3.7	5.2
<b>TOTAL of the 5 groups above</b>		<b>38.6</b>	<b>54.5</b>

Note: the values are the sum of CIF values (before taxes), taxes paid and value of the non-taxable goods  
Source: Timor-Leste Customs

It is worthy of note that there are variations amongst the groups of goods in the proportions between those that are dutiable and those that are exempt. For example, in the group "electrical equipment and related parts", nearly 20% of the total value was subject to duty; this percentage rises to 80% in the groups "petroleum and derivatives" and "cereals", while for "vehicles", this percentage is about 70%.

As regards this last group of imported goods, its high value and importance as a percentage of total imports should be emphasised. Even if we were to remove the value of exempt imports, it would still be 11.2% as a percentage of total imports – which seems to us to be too high in relation to economic realities. It is probable that financial institution credit policies have contributed to this high expenditure on imported vehicles – which in the form of taxis and mini-buses help to reduce unemployment but increase underemployment.

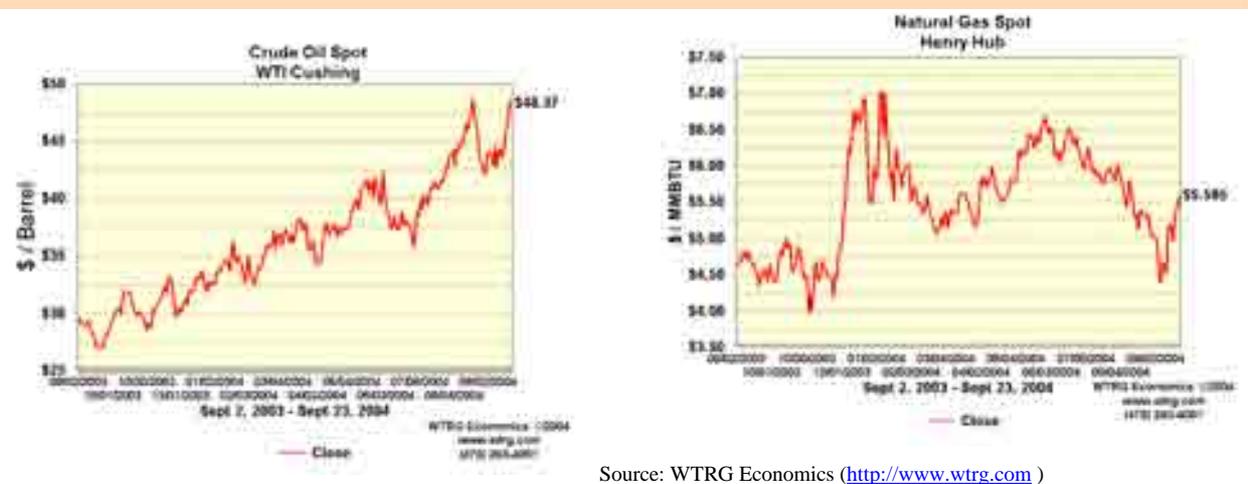
## International Oil Price Developments

During the fiscal year under review (July 2003 to June 2004) a significant increase in the international oil price has been seen, which is clearly shown in the graph below of movements in the price of Brent crude. Those movements have been influenced by a number of factors, and we underline that two of them were, first, the instability (political and production) that emerged following the invasion of Iraq by the coalition led by the USA and United Kingdom and, second, an increase in energy consumption (hence purchases in the international market) by China, drawn along by 8-9% year-on-year economic growth.

Added to these are more structural short-term factors, and we draw attention to the recent influence of both natural factors (hurricanes in the Gulf of Mexico) and production factors (problems with the largest Russian producer).

All these elements have combined to almost double the price of crude oil in a single year (see graph of oil price movements Sept 2003 to Sept 2004)

This behavior has had two main effects on our country: on the one hand, there has been an increase in the oil bills that we have had to pay; on the other, there has been an increase in revenue received from the Timor Sea. The first effect is short term; the second, although it has also a short-term component, will primarily show through in the revenues to be received for some time – if the trend continues, in the sense of continuing high prices, even if they are lower than at present. Remember here that Timor Sea revenue forecasts used in the national State Budget are based on average prices much lower than at present (about \$24-25 per barrel, about half of today's prices).



## Exchange rates

The behaviour of the USD exchange rate with respect to other major currencies (Euro, Yen, and our important economic partners) during the fiscal year under review was characterized by two very different phases.

As can be seen in the graph to the side, the USD depreciated – shown by a rising curve – until early in 2004, following which it entered a recovery phase. The exception to this pattern was its behaviour in relation to the Indonesian Rupiah (IDR) because after a period of stability during the second half of 2003, in the first half of 2004 the Rupiah progressively depreciated against the American dollar. Our neighbour's election period was certainly part of the explanation for this behaviour.

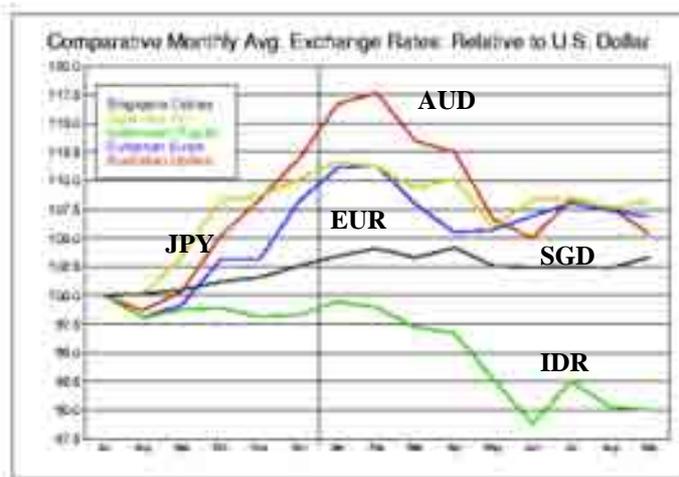
Should this trend continue it is possible that trends in our domestic prices will continue downwards because a substantial part of our imports comes from Indonesia. This is a contributor to the predicted inflation rate of approximately 3% by the end of 2004 as we have noted elsewhere.

## Public finances

The main document available for analysing public finance in Timor-Leste is the *Combined Sources Budget 2004-2005* published in July this year by the Ministry of Planning and Finance.

Its table 2.1 - Budget of Combined Sources and Financing Needs (page 8 of the document) reproduced below provides us with some essential information about the development of public finance in the past (fiscal year of 2003/04) and in the immediate future (budgets of the present and following fiscal years). It shows total expenses disbursed in the country and financed either by the National Budget (FCTL) or by bilateral and multilateral donors reaching almost \$220 million in 2003/04 and forecast to be \$245 million in 2004/05.

This represents a very high percentage, about 75%, of the national product (GDP).



Exchange rates				
<i>Beginning and end 2003-2004 Fiscal Year</i>				
	1/Jul/03		30/Jun/04	
Yen (JPY/USD)	119,83		108,40	
Dollar Singapore (SGD/USD)	1,76		1,72	
Rupiah Indonesia (IDR/USD)	8252,70		9430,30	
Euro (USD/EUR)	1,15		1,21	
Dollar Australia (USD/AUD)	0,67		0,69	

<i>Higher and lower rates between 1/Jul/03 and 30/Jun/04</i>				
	Higher USD value		Lower USD value	
	value	date	value	date
Yen (JPY/USD)	103.78	02/04/04	120.59	01/08/03
Dollar Singapore (SGD/USD)	1.666	13/04/04	1.765	07/08/04
Rupiah Indonesia (IDR/USD)	8173	10/07/03	9442	17/06/04
Euro (USD/EUR)	1.283	12/01/04	1.182	14/05/04
Dollar Australia (USD/AUD)	0.637	03/09/03	0.798	18/02/04

During the three years covered by the table, the State Budget managed by the government – usually abbreviated as CFET – Consolidated Fund of East Timor, or FCTL in Portuguese – is about \$75 million, being a little higher (\$79 million) in the following year (2005/06). This means that about one-third of the expenses under the responsibility of the State and its donors is, in fact, under the direct control of the Timorese Administration, and shows the extent to which Timor-Leste is still dependent on international aid.

<b>COMBINED SOURCE BUDGET</b>	2003-04	2004-05	2005-06
<b>A-Total das Despesas</b>	<b>218.5</b>	<b>245.4</b>	<b>245.9</b>
CFET-Consolidated Fund for East Timor	74.6	75.1	78.9
Bilateral / Multilateral	143.9	170.3	167.0
<b>B-Available Financing</b>	<b>213.5</b>	<b>195.4</b>	<b>116.0</b>
CFET	74.6	75.1	59.0
Donnor Support (grants)	35.7	30.8	0.0
CFET revenues (excluding FTP-First Tranche Petroleum)	52.8	41.3	59.0
Change in CFET Reserves (- Increase)	-13.9	2.9	0.0
Bilateral / Multilateral	138.9	120.3	57.0
TFET- Trust Fund for East Timor	34.6	24.4	11.5
Bilateral / Multilateral projects	96.3	88.9	45.5
<b>C = A-B Additional Financing Required</b>	<b>5.0</b>	<b>50.0</b>	<b>110.0</b>
CFET	5.0	50.0	129.9
Bilateral / Multilateral	0.0	0.0	19.9

Source: Table 2.1 – Combined Souce Budget and Financing Required (\$m) in *Combined Sources Budget of the Democratic Republic of Timor-Leste, 2004-05, Budget Paper 1, MPF-RDTL, Dili, May/2004*

<b>CFET BUDGET</b>	2003-04	2004-05	2005-06
<b>A - REVENUE</b>	<b>57.4</b>	<b>67.1</b>	<b>86.4</b>
Domestic revenues	26.1	23.0	23.8
Timor Sea revenues	31.3	44.1	62.6
Tax revenues	26.7	18.3	35.2
FTP “Royalties” & Interests	4.6	25.8	27.4
FTP	4.5	25.5	26.1
Interests	0.1	0.3	1.3
<b>B – CFET EXPENDITURES</b>	<b>74.6</b>	<b>75.1</b>	<b>78.9</b>
Salary and wages	26.1	28.2	28.9
Goods and Services	38.2	36.8	37.8
Minor Capital	3.4	1.7	2.9
Capital Development	7.0	8.4	9.3
<b>C = A - B OVERALL BALANCE (- déficit)</b>	<b>-17.2</b>	<b>-8.0</b>	<b>7.5</b>
<b>FINANCING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Donor support (grants)	35.7	30.8	0.0
Change in CFET Balances (- increase)	-13.9	2.9	0.0
Timor Sea Changes	-4.6	-25.8	-27.4
Financing “gap”	0.0	0.0	19.9

Source: Table 2.2 – Combined Souce Budget and Financing Required (\$m) in *Combined Sources Budget of the Democratic Republic of Timor-Leste, 2004-05, Budget Paper 1, MPF-RDTL, Dili, May/2004*

The government has acknowledged that donor support will decrease in the immediate future by assuming a policy of significant cutbacks in expenditure, primarily current expenditure (including personnel) and minor capital equipment.

Capital expenditure has also shown some decrease as a result in part of the difficulty in delineating and implementing appropriate projects by the ministries – a weakness that in turn is the result of the low level of qualification of the available human resources, a problem that can only be solved in the medium to long term.

This weakness in human resources will be no easier to overcome in the short term than it has been up to now, and is one of the worst inheritances of our history. If this limitation didn't exist, it would be advisable to have a policy of contracting loans to supplement existing resources and applying them to investments to stimulate the economy. But recognising this limitation, obtaining such loans in significant amounts would merely contribute to a waste of resources in poorly planned projects that may even be worse in implementation. For this reason a fair balance between several aspects needs to be struck – including an acceleration of the economy whose growth has been so slow while at the same time trying to define viable projects that will actually contribute to the betterment of the economic and social situation of the country. This is seemingly what is being attempted with Sector Investment Plans (SIP) that are being prepared and that will be implemented in the near future.

The “ascetic” policy for public expenditure, together with a recent increase in income from the Timor Sea, has made a decrease possible in the net requirement for budget financing from donors, now set at \$30 million for 2004/05 – well below the forecast of \$126 million made in the half-yearly revision of the 2003/04 budget. It is predicted that from 2005/06 donor support will not be needed. The forecasted evolution of the Budget revenues will contribute to that.

We draw attention to the high level of fiscal collection achieved in the Budget during 2003/04 resulting both from an ongoing improvement of the fiscal framework, and from some significant collections from some large taxpayers. This was a one-off situation and will not occur again; so the domestic incomes forecast for the present and next fiscal years are lower than last year (about \$23 million against \$26 million).

Timor Sea revenue has also increased significantly as a result of exceptional collections from operators in the exploration area, these reaching almost \$27 million in tax collections, to which must be added \$4.5 million in royalties received in the 2003/04 fiscal year.

With exploitation actually beginning this year, these revenues will increase considerably, reaching \$26 million in 2004/05.

Nonetheless, after a predictable fall this year, fiscal revenue will increase later. Weakness in domestic revenue – resulting both from global economic weakness as well as the present short-term economic situation – means that Timor Sea revenue will become more and more important for the future of the country. This revenue will depend to a great extent on changes in the international prices of crude and gas, which have seen strong cyclical swings during recent months, hindering the ability to forecast future revenue receipts.

Based on data currently at hand the State Budget presents a forecast for the future developments of Bayu-Undan income – for the time being the main source of

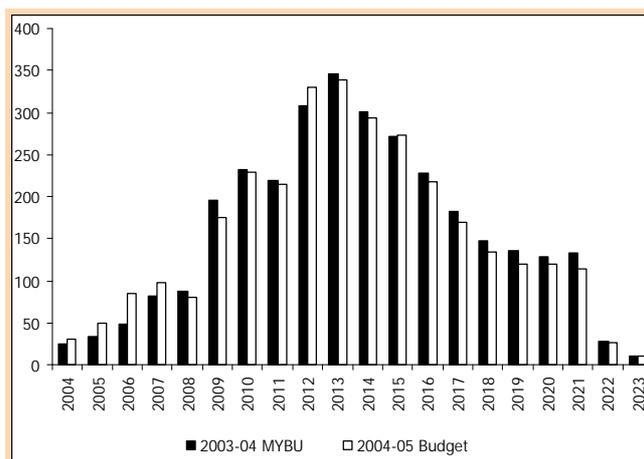
<b>Year</b>	<b>MYBR 2003-04</b>	<b>Budget 2004-05</b>
2004	25	30
2005	34	50
2006	48	85
2007	82	98
2008	88	80
2009	196	175
2010	232	229
2011	219	215
2012	308	330
2013	346	338
2014	301	293
2015	271	273
2016	228	218
2017	183	170
2018	148	134
2019	136	120
2020	128	119
2021	133	114
2022	28	27
2023	10	10

Nota: MYBR = Mid-year Budget revision, Nov/2003

Timor Sea revenue – which is shown in the table on the previous page and in the graph at right.

As pointed out in the document, these forecasts have a high degree of uncertainty resulting from the level of doubt that hovers over developments in the oil international market. Therefore the Banking and Payments Authority through its Division of Economic Studies and Statistics will continue to monitor and study the situation closely as it develops.

To get an idea of the degree of latent uncertainty in this field, note the differences that exist between three alternative scenarios developed to analyse this issue: a median scenario – as adopted by the Budget – a high value scenario and a low value scenario. The median scenario is based on an estimate for international prices for oil that start at \$24 per barrel – in this context remember that recent prices have surpassed \$50, and for this reason the median scenario could almost be considered as a low one – while the high scenario is based on a price of \$28 per barrel. The low value scenario is based on a price of \$22 per barrel.



#### *Fiscal incomes of the Sea of Timor-Analysis of Sceneries (million USD)*

	2004-05	2005-06	2006-07	2007-08	Total 4 years
Estimates 2004-05 Budget (median scenario)	18.3	35.2	56.4	47.7	157.6
High Value scenario	29.0	66.3	90.3	92.3	277.9
Low Value scenario	15.5	8.1	12.5	13.7	49.8

Source: Table 2.7 of *Combined Sources Budget of the Democratic Republic of Timor-Leste, 2004-05*, MOPF, Dili, May 2004, pg 13

As mentioned in the Budget document at page 13, “Timor-Leste should manage these very significant risks through the implementation of appropriate policies, including for instance the creation of an adequate level of reserves. Timor-Leste seeks the support of its development partners to help achieve this.”

#### *Currency, Credit, Interest and Taxes*

One of the fundamental aspects in the development of an economy is its monetary situation. One important piece of information usually compiled and used to describe the behaviour of a country’s economy and economic policy is money in circulation, either in the form of liquid means of payment (notes, coins and demand deposits) or in the form of other money aggregates.

As noted in our previous reports, as a result of the fact that we use the currency of another country as our national currency and the fact there is not complete information about the flow of money in the economy – both to and from abroad – it is not possible to compute the level of money in circulation in Timor-Leste and, consequently, to calculate any changes in it – these changes, for economic policy purposes, being actually more important than the base amount.

However, the lack of this piece of information does not mean a total absence of information on the monetary aspects of the economy. Monetary statistics are compiled by the Banking and Payments Authority of Timor-Leste and made available quarterly in its “Economic Bulletin” and provide this other monetary information.

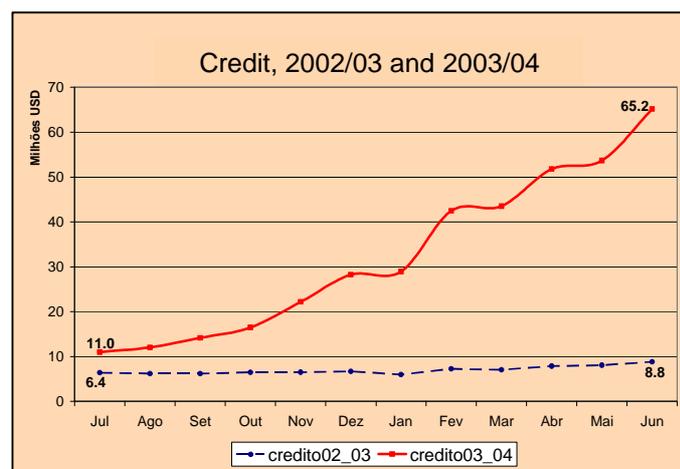
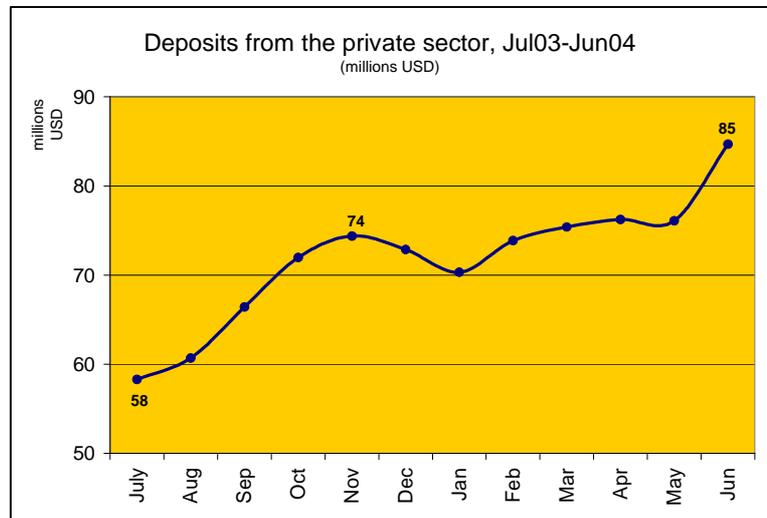
One piece of information available from these statistics is the level of demand and time deposits (for individuals and companies) in the banking system. In June 2003, the last month of the previous fiscal year, these were \$58.5 million but at the end of June 2004 they had risen to \$84.7 million, an increase of \$26 million (+45%) compared with the increase of about \$7 million in the previous fiscal year.

One factor that influenced this rapid growth was the commencement of operations by a new banking institution in August 2003; another factor was the increasing use by individuals and companies of the banking system as a partner for their economic activities.

At the end of June 2004 the BPA held about \$6.1 million of commercial bank deposits, a relatively small amount when compared with the \$78.7 million in deposits from the Central Administration, a large increase compared with the \$41.5 million held in June 2003. The growth in deposits of the Administration with the BPA was not constant, having two important “jumps” (both of them of about \$20 million) in December 2003 and in March 2004.

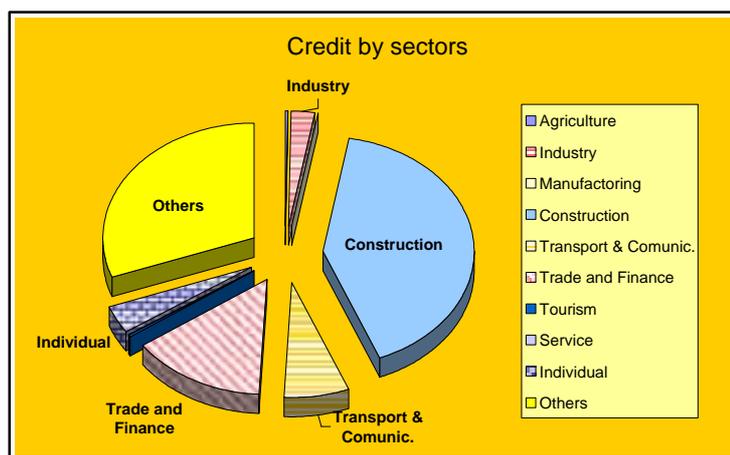
Commercial banks mainly use customer deposits to finance the credit they give to the economy. The banks operating in Timor-Leste have adopted different strategies in implementing their credit policies and while one of them is specialising in micro-credit and limiting its activity to this specific business area, the others have adopted different policies.

The graph at the side provides a picture of the rapid credit growth in the private sector during the fiscal year 2003-04 compared to the previous year. Credit jumped from \$11 million in July 2003 to \$65 million in June 2004. This represents a six-fold increase in credit provided to the economy.



When analysing the loans by economic sector, it is clear that the three main sectors that benefited from this increase were construction (refurbishing houses destroyed in the 1999 violence or

constructing new ones), trade (supporting the establishment and operation of stores and *kiosks*), and transportation (particularly taxis and mini-buses). Of concern is the fact that there are so few loans supporting the industrial sector, which reflects the weakness of industrial development in the country despite of the existence of a significant place for it. It seems that measures to encourage industrial investment are not producing the desired effect. This means that there is room to re-think this situation. It is the sort of outcome that occurs when waiting for the development of a reliable legal system – essential for resolving any conflicts that arise in connection with economic activity – and the passing of an investment law, for example.



It needs to be pointed out that contrary to many observers' fears loan performance has been high, with the rate of non-performing loans being only 1-2% – enough to make bankers in industrialized countries jealous.

But we need to continue highlighting one important aspect in connection with credit: the import component of the goods being bought with this credit is very high, meaning that the presumed impact of this credit on the economy is actually draining abroad to Indonesia, Singapore, Japan, Australia, etc. Moreover, the apparently excessive number of vehicles – at least in Dili – implies both an increase in energy consumption (imported petrol, diesel, oil) – and increased expenditure on spare parts, at least in the medium term if not in the short term, and the state of the streets and highways of the country will in time begin to cost ...

Corresponding to the growth in deposits and loans of commercial banks, the deposit/loan ratio – one of the indicators of the health of the financial system of a country – has dropped sharply from 6.7 in June 2003 to 1.1 now. This does not imply that the situation is becoming any more dangerous. Rather, this drop reflects progress towards a more normal situation, and the deepening of the role of the banking system in our country's economy. This is a good sign, a sign of modernisation.

The total net external assets of the country increased from about \$100 million in June 2003 to \$122 million in June 2004, an increase of 22%. These values are meaningful in such a country as Timor-Leste at two different levels of analysis: on the one hand, as we emphasised last year, Timor-Leste is a net creditor of the rest of the world – meaning that it is lending part of its resources to others; on the other hand the size of the change is of itself important.

Investment in this kind of asset is a result, in part, of the fact that it is not possible to find sufficient investment opportunities in Timor-Leste due to the state of the economy. The holders of these financial resources – commercial banks and the central bank – are acting perfectly rationally, and their attitude should not be confused by thinking that it indicates a lack of confidence in the national financial system or that the national wealth is being exploited (in the negative sense of the term) by being diverted abroad. The alternative to investing abroad for higher returns would be to simply store the cash in a safe. And cash stored in a safe does not generate wealth.

At the end of the 2003/4 fiscal year the composition of the net external assets was \$92 million held by the BPA and \$30 million being the net assets of commercial banks.

On the development of interest rates, positive trends in inflation (falling), the decreased risk of doing business in the country, increased competition in the banking system and (mainly?) the adoption of a more aggressive strategy of using available resources by the banks all resulted in a fall of about 3 percentage points in lending rates relative to the previous year, and prime rates of 11-12% (and less) are now available for the best clients of banks.

This development in lending rates narrowed the margin received by banks for market intermediation – but it continues to be high – because deposit rates are kept at low levels and, when compared with inflation, real deposit rates may even be negative. However, this does not seem to be reflected in the amount of deposits, which as mentioned earlier have significantly increased.

## **Monetary Statistics of Timor-Leste**

July 2003 to June 2004





*Moedas numismáticas de Timor-Leste*

## 2 – BPA 2003/04 ACTIVITY

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## 2.1 – General Analysis

During the four years of its establishment, the BPA has successfully achieved all important elements of a central bank. All the necessary statutory requirements have been put in place such as the Banking Regulation, a set of Instructions which were prepared based on international best practices and the Regulation of Currency Exchange Bureau which have established clear and transparent provisions for the supervision and licensing. The currency exchange regime has also been determined by adopting the United States Dollar as the country's legal tender and the introduction of the national coins, centavos. The BPA clearing house is operating on daily basis. The economics and statistics has a fully functional and a number of statistical reports are regularly produced.

During the year 2003/2004, the BPA continued to invest intensively in building its staff capacities and skills by allowing them to attend training courses, seminars as well as attachment to other central banks. In addition to sending staff overseas, internal training courses and seminars were also conducted including the Portuguese and English courses to improve languages skills of staffs.

Regarding the timorization process, all divisional responsibilities have been passed on to national staff. The remaining senior management positions are ready to be taken over by the national staffs in the near term.

The following are the highlights of key important events and activities undertaken during the year:

1. The BPA was requested to prepare the draft laws on Insurance and Payments. These draft laws have been finalized and are in the process of consultation with relevant interested parties. The BPA received the assistance from International Monetary Fund and the Portuguese Insurance Institute to prepare the insurance law. The payments law was also prepared with the assistance from the IMF.
2. The Department of Supervision has been reorganized and has become the Department of Financial System Supervision to accommodate the new role assigned to the BPA to supervise the insurance sector with three divisions; banking supervision, insurance supervision and licensing and regulation.
3. A new banking license has been issued to PT Bank Mandiri, while two applications were denied during the year under review.
4. The centavos coins were minted and successfully introduce in to circulation.
5. The BPA has initiated a compensation survey to implement a new remuneration scheme to staff.
6. A security committee which is composed of senior staff from various departments was established to review present arrangement and develop a more viable and integrated security procedures.
7. The Division of Information Technology has initiated a project to prepare a Disaster Recovery Plan for BPA.
8. The annual audit program which must be approved by the General Manager at the beginning of each fiscal year was completed. The Internal Audit Office is now regularly reporting to the Governing Board (on quarterly basis).
9. The BPA, together with insurance supervisors from other Portuguese speaking countries (including the Monetary Authority of Macao) has founded an association of insurance supervisors (Associação de Supervisores de Seguros Lusófonos) which is located in Lisbon. The main objectives of the Association are; to promote cooperation among the supervisory institutions and to support the development of the supervisory and regulatory framework for insurance industry.

## 2.2 – Department of Supervision of the Financial System

The Department of Financial System Supervision (DFS) is a new name created in 2004 to reflect the expansion in the role of the former Department of Banking Supervision used in previous years. Three divisions were created during the year, namely Division of Bank Supervision (DSB), Division of Insurance Supervision (DSS) and Division of Licensing and Regulation (DLR) all reporting to the Deputy General Manager of Supervision.

During the year the Department continued to focus on on-site and off-site examination to ensure the activities of the commercial banks comply with the regulations. During the year the department held a workshop on credit analysis that was organized locally by BPA and participants included staff from all commercial banks in Timor-Leste.

### 2.2.1 - Division of Bank Supervision (DSB)

The Division of Bank Supervision covered two main areas, namely on-site supervisions and off-site supervision. In general, the *on-site* supervision conducts on-site inspections of commercial banks, while the *off-site* division carries out surveillance of commercial bank's financial conditions and compliance with statutory requirements.

#### *Off-site Supervision*

During the year, the DFS conducted off-site surveillance by continuous monitoring and analyzing the performance of banking institutions on the basis of reports submitted to BPA, information obtained from public sources and obtained during other supervisory actions. The division also participated in the preparation of banking regulatory instruments.

Analysis of the reports for 2003/2004 constituted periodic monthly and quarterly assessment of the bank's financial soundness. Any problems identified in this manner served, among other factors, as a basis for planning on-site inspections.

#### *On-site Supervision*

During the year, full scope examinations and special investigations were conducted in two commercial banks. The objective of the examinations of those commercial banks was to verify the financial returns submitted to BPA and compliance with banking regulations and instructions. This included an assessment of assets, liabilities, and income statements. Special investigations focused on specific issues that arose during the year. All recommendations relating to these examinations were sent to the banks concerned.

### 2.2.2 - Division of Insurance Supervision (DSS)

In order to prepare for the regulation and supervision of insurance industry in the near future, the three staff of the division who were attending the medium-term course in Portugal returned to BPA.

During the year, the Division conducted a survey and prepared a report on compulsory third party liability for motor vehicles. The survey included collecting of data on numbers of vehicles, reported injuries, costs and market potential. The report entitled "Planning for the Introduction of Insurance" has been finalized and is now available.

In April 2004, Timor Leste became one of founding members of ASEL the (Association of Insurance Supervisors of Lusophone Countries).

### **2.2.3- Division of Licensing and Regulation (DLR)**

The legal framework for the licensing and supervision of banks is the banking regulation which was passed on 25 February 2000.

During 2003/2004, four instructions were approved:

- a) Instruction on the Report of Consolidated Financial Condition which aims to establish a standard and uniform report of the consolidated financial conditions of banks operating in Timor-Leste concerning their administration, operation, liquidity, solvency and profitability;
- b) Instruction on the Opening and Maintenance of Deposit Accounts for banks operating in Timor-Leste is intended to ensure a complete identification of depositors as a means of avoiding the banking system being used for money laundering and criminal activities
- c) Instruction on Banking Holidays regulates the minimum working hours and working days on which banks shall offer services to the public; and finally, an
- d) Instruction on the Prevention of Money Laundering Customer Identification and Record Keeping regulates the risk that the banking system may be exposed to reputational, operational, legal and other risk related with money laundering activities.

In August 2003, a license was issued to PT. Bank Mandiri, an Indonesian state owned bank. Two other applications for banking licenses were denied during the year.

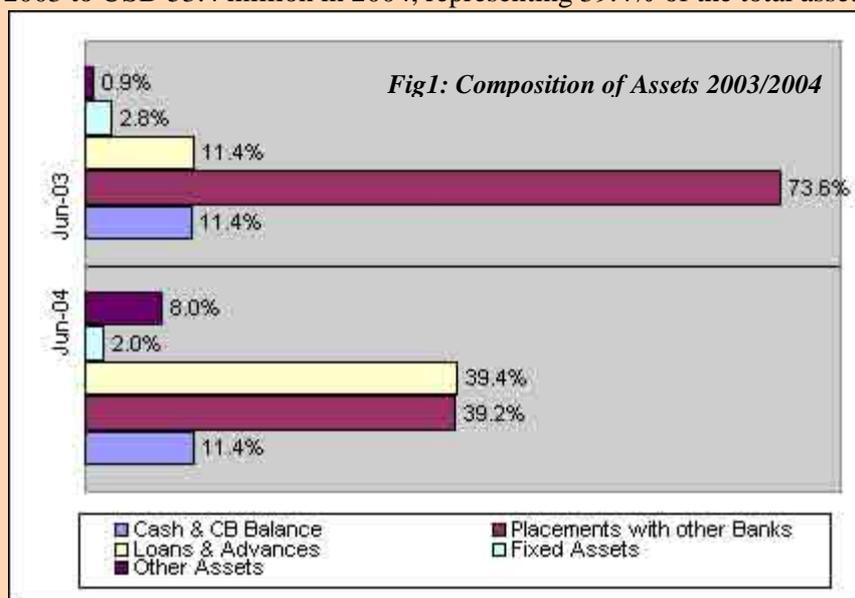
## Trends in the Timor-Leste Banking System

### Composition of Assets

During the year, the overall financial conditions of the banking sector continue to register at a moderate/satisfactory rate compared with the previous years.

Total assets of the banking system as at June 30, 2004 amounted to USD 135.6 million, representing a growth rate of 97.4 percent compared with USD 68.7 million in the previous year. The main factors contributing to this significant growth are shown in figure 1 and may be summarized as follows: cash and balances with BPA grew by 98.8 percent, reaching USD 15.5 million on 30 June 2004 and representing 11.4% of the total assets, as a result of commercial banks maintaining high liquidity and changing their lending policy to expand loans. Loans and advances increased from USD 7.8 million at the end of June 2003 to USD 53.4 million in 2004, representing 39.4% of the total assets.

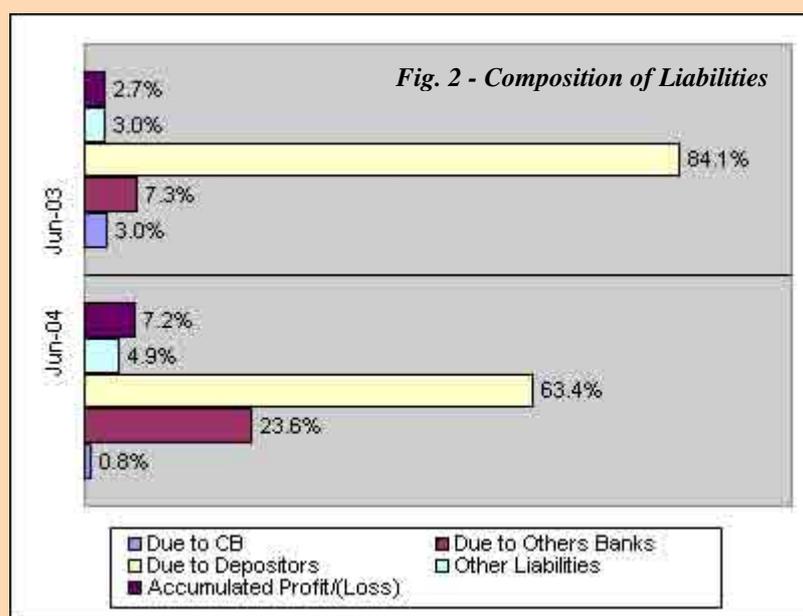
Loans were mainly concentrated in the construction sector and personal loans. Meanwhile, placements with other banks increased by 5.5% from US\$50.5 million in 2003 to US\$53.2 million in 2004 which representing 39.2% of the total assets, due to an increase in inter-branch transaction accounts.



### Composition of Liabilities

The composition of liabilities, as reflected in Figure 2, reveals a significant change, with respect to the percentages represented by deposit amounts due to other banks compared to June 2003.

Deposits from the public constituted the main source of funding for the banking sector and amounted to USD 86.0 million, representing 63.4 percent of the total funding and an increase of 49.0 percent over the previous year. There was also increase in the level of deposits as the result of an increase in temporary placements by head offices with their Timor-Leste branches.



## **2.3 – Payments and Banking Operations Department**

The Payments Department continued to provide operational banking and payment services to BPA's clients, and the emphasis during the year was on consolidation of systems, procedures and practices.

The Department maintained a total complement of eighteen national staff throughout the year who completed daily operations to a consistently high standard. Two full-time advisors working under UNMISSET and IMF technical assistance programmes provided technical assistance and training to the department for most of the year.

### **2.3.1 - Banking Operations Division**

The Banking Operations Division continued to service the banking needs of the customers of the BPA, primarily the Government of Timor-Leste. In this regard, the Division continued to disburse civil service salaries, cash government cheques, and to a more limited extent manage government receipts.

These transactions included the cashing of nearly 2,000 cheques, and in addition, nearly 40,000 civil service salary disbursements were made. This number of payments was lower than previous years, reflecting the increasing number of government suppliers and employees whose payments are transferred through the clearing house. The total value of cash payments made by BPA tellers during the year was \$12.5 million.

The Division also handled the sale of numismatic coins in Timor-Leste, with nearly 1,000 sets being sold. A further 12,000 sets of numismatic sets were sold internationally through an agent in Portugal.

### **2.3.2 -Currency Operations Division**

#### *Introduction of Centavos coins*

The most important activity of the Division during the year was the introduction of the Timor Leste Centavos coins, which became legal tender on 10 November 2003. From the perspective of the Currency Division, this required the construction of a new vault, the organisation of a national publicity programme, and the introduction of procedures, including accounting, for the handling of the Centavos coins.

The socialisation programme for the coins involved the employment of ten temporary staff who travelled with BPA staff in teams to visit all districts, distributing promotional materials, and providing the public with information. The programme was supported with a media campaign involving newspaper, radio and television publicity. A special "centavos song" was commissioned and used in association with these activities, to give the overall campaign a consistent base. An exhibition was arranged in Uma Fukun, in conjunction with the official launch of the Centavos by the President and Prime Minister. Additionally, the BPA arranged for exchange centres in each district where the public could change the former US coins (which remain legal tender) for the new Centavos. Approximately 5 million of the 8 million centavos minted with a face value of about \$800,000 had been put into circulation by the end of the fiscal year.



*Official launch of the Centavos – 28 November 2003*

The Division wishes to express its appreciation to officials of the Ministry of Planning and Finance, and to UNMISSET for their valuable assistance during the Centavos campaign.

#### *Other Activities*

Currency imports continued to be made on a regular basis, and the overall value of banknotes imported was higher than the previous year. It is thought that the increase of currency in circulation reflects an increase in economic activity, particularly as the denominations included far less \$100 and \$50 notes than previously.

The larger demand for the high denominations in previous years was attributed to the lack of banking facilities enabling settlement of payments between Timor-Leste and Indonesia, and to the number of internationals in Timor-Leste. With the establishment of the branch of an Indonesian bank in Dili early in the fiscal year, a large number of the trade-related cash transactions were apparently converted to bank transfers, with a consequent drop in demand for high denomination cash.

## Summary of Currency Transactions

July 2003 - June 2004 (USD millions)

Denomination	Importation	Circulating Currency		Withdrawal from Circulation
		Issuance	Re-deposits	
\$100	12.40	16.12	14.38	0.89
\$50	5.96	9.09	8.03	0.31
\$20	15.68	38.80	34.56	1.35
\$10	7.84	27.27	25.28	4.12
\$5	3.96	14.47	12.49	4.58
\$1	1.20	3.34	1.78	1.60
50 centavos	-	0.28	-	-
25 centavos	-	0.35	-	0.35
10 centavos	-	0.26	-	0.18
5 centavos	-	0.06	-	0.11
1 centavo	-	0.00	-	0.09
<b>Total</b>	<b>47.04</b>	<b>110.04</b>	<b>96.52</b>	<b>13.58</b>

The US dollar having been well established in Timor-Leste meant that the quality of notes in circulation was closely monitored. Two repatriations of unfit notes, with a total value of \$13.6 million, primarily in small denomination notes, were made to the United States. The quality of notes in circulation remains a concern, and because many of the population do not use the banking system, the development of a policy of how to withdraw unfit currency from circulation – other than through commercial banks – is under consideration.



*Repatriation of US Coins*

The number of counterfeit US notes detected in Timor-Leste since the US dollar was mandated as the official currency continues to be minimal, and the Division continued to act as the official depository for counterfeit notes, and acted as the primary liaison point for the local police service, as well as the United States authorities. With the introduction of a new \$20 note during the year, publicity was given through the commercial banks to the features of the new currency.



*Currency Import*

In order to maintain an acceptable level of service, the Division responded to the continuing increase in the volumes of currency handled in the Division by purchasing additional cash processing equipment, upgrading the currency processing room facilities and increasing the number of staff by two.

### **2.3.3 - Investments and Settlements Division**

The main function of the Division during the year was the routine settlement of client account payments, primarily by making payments on behalf of the government.

The Division continued to support the administration of payments of pensions and payments to ex Indonesian civil servants, but with the establishment of an Indonesian bank in Dili, it is anticipated that the BPA's role will be reduced in future.

The account opened at the Federal Reserve Bank of New York became operational, and investment of BPA funds is now managed through the FRB's investment pool, which it operates on behalf of a large number of central banks.

Numbers and values of settlements completed during the year, analysed by currency, were as follows (values in thousands):

United States Dollars	Domestic Settlements		International Settlements		International Receipts	
	Number	Value	Number	Value	Number	Value
July 2003	339	5.1	36	12.1	34	10.0
August	286	3.1	40	3.3	30	7.0
September	305	4.4	28	25.1	38	11.6
October	281	3.1	35	6.2	42	10.2
November	156	2.1	17	10.2	45	11.9
December	232	3.4	34	2.4	53	23.7
January 2004	143	2.4	23	13.2	45	8.0
February	228	2.0	39	7.4	42	8.7
March	288	3.0	26	8.7	65	20.9
April	225	3.2	28	4.7	53	9.7
May	325	3.6	18	4.1	49	14.8
June	325	3.3	36	14.2	66	11.1
<b>Total</b>	<b>3,133</b>	<b>38.6</b>	<b>360</b>	<b>111.3</b>	<b>562</b>	<b>147.6</b>

Australian Dollars	International Settlements		International Receipts	
	Number	Value	Number	Value
July 2003	8	0.4	3	1.0
August	7	0.1	-	-
September	4	0.2	-	-
October	6	0.0	1	0.1
November	2	0.0	-	-
December	6	0.3	2	4.0
January 2004	1	0.0	2	0.5
February	6	0.1	1	0.1
March	6	0.0	2	4.1
April	1	0.0	1	0.1
May	4	7.3	1	0.0
June	4	0.1	2	0.2
<b>Total</b>	<b>55</b>	<b>8.6</b>	<b>15</b>	<b>10.1</b>

(Values in USD \$000 )

### 2.3.4 - Payment Systems Division

The volume of transactions processed in the Dili Clearing House continued to increase steadily.

With the establishment of Bank Mandiri in Dili, the number of clearing participants increased to five.

Volumes and values exchanged in the clearinghouse during the year were as follows:

Month	Items Cleared				Items returned	
	Number		Value (US\$000)		Total	Value (USD000)
	Total	Daily Average	Total	Average Value		
July	833	36	6,470	7.7	7	39.0
August	672	33	3,918	5.8	10	41.0
September	770	35	4,929	6.4	8	11.0
October	896	36	4,477	4.9	7	16.0
November	719	42	3,407	4.7	3	6.0
December	987	47	4,523	4.5	10	128.0
January	627	31	5,289	8.4	5	13.0
February	833	41	3,111	3.7	9	31.0
March	986	42	4,631	4.6	5	32.0
April	884	42	4,142	4.7	6	78.0
May	1,022	51	10,251	10.0	9	41.0
June	1,112	51	6,917	6.2	6	14.0
<b>Total (2004)</b>	<b>10,341</b>	<b>40.6</b>	<b>62,065</b>	<b>6.0</b>	<b>85</b>	<b>450.0</b>
<b>Total (2003)</b>	<b>6,227</b>	<b>25.3</b>	<b>40,945</b>	<b>6.6</b>	<b>87</b>	<b>42.0</b>
<b>Total (2002)</b>	<b>3,206</b>	<b>13.5</b>	<b>18,575</b>	<b>5.8</b>	-	-

Initial steps were taken to introduce an enhanced collection system for government revenues, allowing customers to make payments to government through any commercial bank, but the implementation is awaiting Treasury approval.

## 2.4 - Accounting and Budget Division

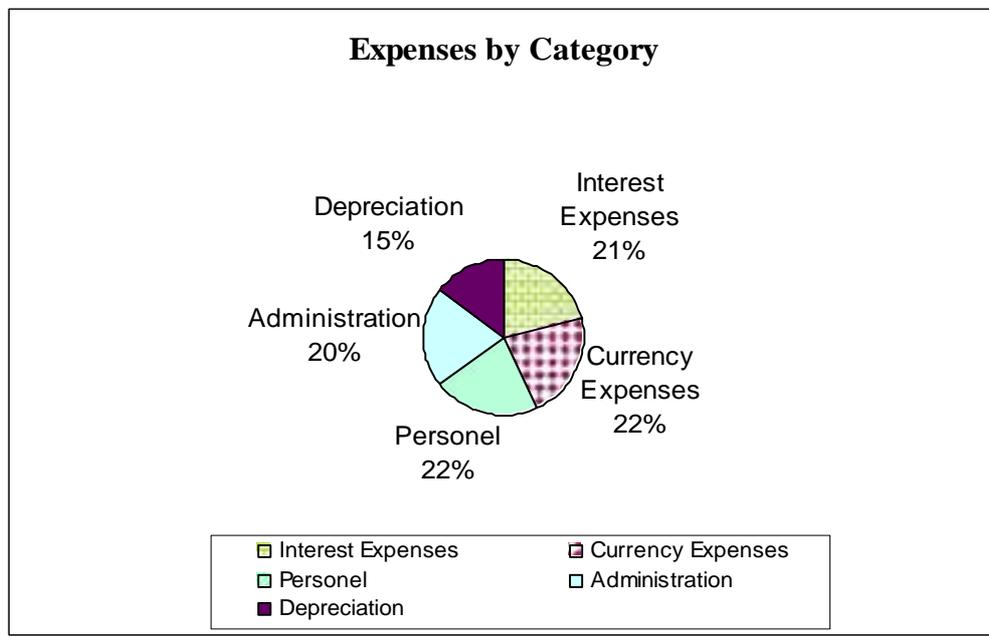
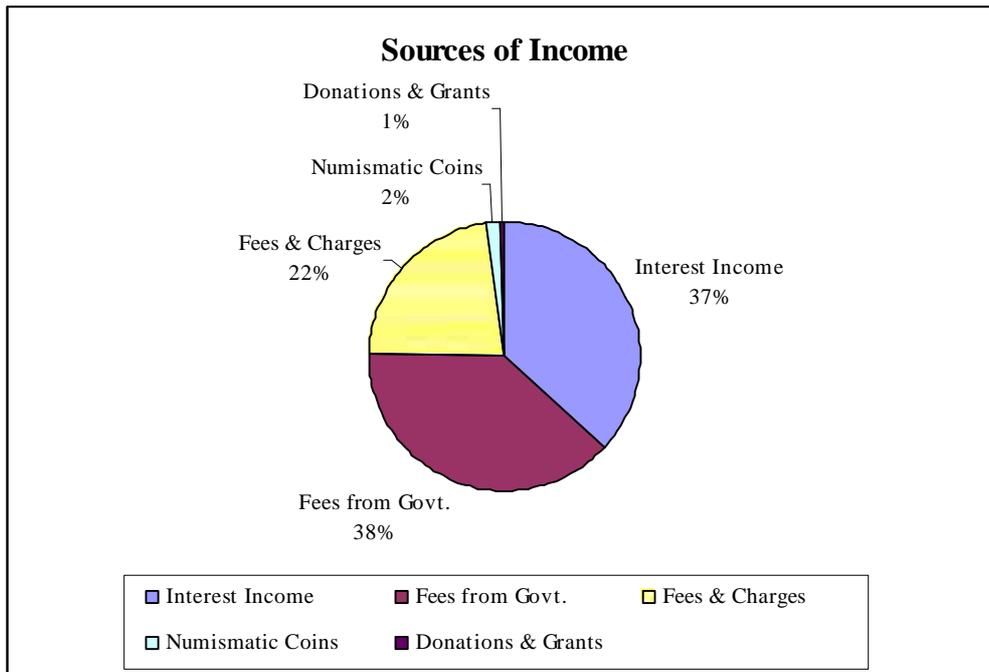
- The main activities of the Accounting Division during the year focused on the consolidation of financial reporting and analysis. External financial reports were all achieved within the stipulated deadlines – including the publication of quarterly summary financial statements in the local press, and the completion of the annual audited financial statements. Management accounts were produced monthly, and discussed in detail by the Management Committee, thereby achieving not only a good level of management control, but also enabling staff outside the accounting division to increase their skills in interpreting financial information. The primary focus of management reporting was the monthly Budget Performance Report that tracks revenue and expenditure against budget. These reports were usually supplemented with further analysis, particularly with respect to investment income and currency operations.

The Division took primary responsibility for submitting BPA's periodic reports to government, a requirement that is necessary while the BPA receives budgetary support from that source.

For the greater part of the year a senior member of the Division attended a training course in the United Kingdom with the objective of preparing him for future responsibilities. During his absence, other staff in the Division continued to develop their skills largely through on the job training, supported by an international advisor who held the position of Chief Accountant.

### *Income and Expenditure*

Government remains the single most important source of income contributing 38% of total income as revenue appropriation, and 22% as fees for services rendered by BPA, hence a total contribution of 60%. Interest income was 37%, numismatic coins 2%, and donations and grant 1%, thus USD 601,353 in absolute terms compared to interest expenses of USD 192,340, hence a positive interest margin of USD 408,663 despite declining interest rates worldwide, which curtailed opportunities for higher rates of return. Recoverable charges on cash withdrawals contributed 17%, and other income was 1%. In a nutshell, total income realized was USD 1,137,346 which within 12% of the budget amount. Currency and personnel is the largest expense item constituting 22% of the total expenses, followed by Interest and bank charges 21%, administration 20% and depreciation 15%. Overall, the net profit of USD 181,824 attained at the end of the year is largely attributable to prudent resource management, particularly with regard to the budgetary aspects of income and expenditure.



**2.5 – Department of Administration**

The department of administration, comprising three separate divisions, provides administrative and organizational support to BPA core BPA operations. The principal activities of the respective divisions are outlined below.

*Corporate Service*

The Corporate Service division continues to undertake improvements of BPA offices and general locale. The most significant development during the year was the addition to the premises of BPA has been the completion of a new vault in the payments area. The new vault has significantly

expanded the storage capacity and has facilitated easy and more controlled environment of currency handling operations.

The vault facility was completed in time to receive the newly introduced Centvos coins which were introduced towards the end of 2003. As a result of increased operational activities and generation of work documents, the division has prepared archiving facilities to store and organize official records of the institution. Two separate locations have been set up to store and secure accounting and payments.

To organize vehicle traffic around the premises and create secure space for vehicles used for cash movements, a new car park was added to the compound to house BPA staff and official vehicles.

The present office facilities are currently fully occupied and it will be necessary to plan ahead and anticipate space need in the medium term. Although there was marginal retrenchment of international staff positions during the year under review, the institution continues to recruit new staff in the various services.

Security procedures continue to be enhanced during the year. Additional security cameras were at various locations of the BPA office compound. The cameras are new additions to the central electronic security surveillance system which are monitored by police guards on a twenty four hour basis. The division has also continued to maintain close relationship with the Timor Leste police service to ensure that BPA premises are given priority and police agents assigned there have the requisite numbers as well as equipment, including firearms. Security agents from East Timor Public Administration supplement this arrangement and provide surveillance of general surveillance and control of access to the premises of outside persons.

The recruitment of new staff have allowed the division to streamline administrative procedures, develop control records for the distribution of office supplies and stationary, improve the processing and follow up of payment of suppliers' invoices, and regular updating of BPA asset register.

#### *Procurement Activities*

The BPA Procurement function is fully independent from that of central government. It manages all purchases, rental or sale of equipment, services, supplies, work and other requirements on behalf of BPA, and operates under procurement policies and procedures established for this purpose. These procedures are designed to ensure that the BPA obtains good quality products or services at competitive prices in a fair and transparent manner.

To support its activities, the division maintains and regularly updates a central data base of suppliers and contractors in Timor-Leste and the neighbouring countries (presently there are 650 suppliers and contractors has registered in the data base). This information greatly facilitates identification of suitable supplier and contractors for procurement needs.

Including the new vault, the division has processed procurement of goods and services for a total value of USD 431,319.46 during the period under review. In addition, the division has put in place three system contracts relating to staff uniforms, office supplies and stationery and freight forwarding services handled by a local company.

## Human Resource Management

### a) Capacity Building

As a matter of policy, from the start, BPA has put emphasis on regular enhancement of staff technical knowledge and skills development. Over the past four years, the institution has organized and implemented an extensive training program for staff - both in Dili and abroad.

The following table gives an overview of the level of resources allocated to this activity.

<b>BPA STAFF TRAINING (2000 – 2004) (Man Days)</b>			
	<b>Total</b>	<b>Skill Development</b>	<b>Technical Training</b>
Formal Training			
Internal	1455	1185	270
External	1220	120	1100
Expert Visits	374	-	374
Sub-total	3049	1305	1744
Int'l Advisors (Full Time)	7600		
<b>Total</b>	<b>10649</b>		

Out of the total resources allocated to date, approximately 20 per cent relates to training activities undertaken during the year under review. The data shows that, on average, each staff member at BPA has received approximately 76 man days of formal training related to skill development and technical training. Staff have also benefited from the equivalent of 30 man years of on-the-job training as a result of international staff presence in the various services (190 per staff member).

The bulk of the resources to fund the foregoing training were mobilized from bilateral and multilateral sources. Over the past few years, BPA was able to establish cooperation programs with Bank of Indonesia, Bank Negara Malaysia, Thai Technical Cooperation and the Bank of Portugal. ABP also received a substantial support from multilateral institutions like IMF, SEACEN (SouthEast Asia Central Banks Association), Asian Development Bank, the Portuguese technical cooperation and the Camões Institute, from Portugal, that financed our staff training

In addition, the BPA has allocated about \$150 000 from own budget resources to allow staff undergo attachment periods in other organizations in order to get practical work experience and participate in training programs on their respective specialization areas

The following table summarizes the training activities of the 2003-2004 fiscal year:

<b>External training activities</b>		
<b>NAME OF THE COURSE</b>	<b>ORGANIZER</b>	<b>STAFF/DAY</b>
Insurance Institute of Portugal (incl. Portuguese course)	ISP and Instituto Camões, Portugal	528
On the job training	Banco de Portugal	47
Conference on payment systems for Portuguese speaking countries Central Banks	Banco de Portugal	3
Regional seminar on Training Trainers	APEC + Bank Central of Philippines	5
APG 2003 Annual meeting and <i>Forum</i> on technical assistance and training	APG + Macau Government	5
Post-Graduation – Business Administration	Luton Business College	264
Post-Graduation – Monetary Economy and Policy	ISEG – Portugal	110
Course on Central Banks activities	Bank Negara Malaysia	88

APEC Financial Regulators Training Initiative (Onsite Examination)	APEC e Bank of Taipei	10
On the job training at Bank of Indonesia	Bank of Indonesia	39
Study visit to the Central Bank Samoa	Bank Central Samoa	20
Financial Programming and Policies	IMF and Banco de Portugal	5
Financial sector stability patterns	IMF-STI	10
Monetary and Financial Statistics	FMI - STI	21
Banking Supervision Fundamentals	Bank Negara Malaysia	64
IV Forum of Information Technology of the CLP Central Banks	Banco de Portugal	5
Monetary Statistics	SEACEN	14
Balance of Payments Statistics and international investment	FMI – STI	13
Roundtable on Banking Supervision in Lusophone Countries	Banco de Portugal	8

### b) Compensation Review

Terms on conditions of employment were revised during the year and reflected the autonomous nature of this institution. Since its foundation, the BPA staff salary levels were the same as for the Central Administration of Timor-Leste. Although this policy was useful for BPA first years, it was needed to implement a more flexible scheme of salaries useful for a better human resources management.

One of the main goals behind this revision was the need to make BPA staff compensation more competitive vis-à-vis the local labour market and retain trained employees in the institution. Actually, a study conducted for this purpose by an IMF human resources expert, concluded that BPA salary levels fell far short of those of similar positions in the local market.

In addition to a modest increase in basic salaries, a number of allowances were introduced in the new scheme. These included:

- A transportation allowance to ease difficulties encountered by staff in finding affordable means of travel between their homes to the work place
- A special responsibility allowance, introduced over time as national staff progressively assumes managerial responsibilities in the various services and payable to managers heading an administrative unit in BPA organizational structure.
- An “employer only” savings scheme at the rate of 5 % of basic salary intended to provide long term benefits to staff.

The new scheme takes account of progression of staff grades within the revised salary scale depending on number of years of “satisfactory” service at BPA. This feature provides a mechanism to recognize and reward performance in the work place, and encourage staff to pursue self development and growth in their jobs.

Step advancement will be carefully implemented through integration with the new staff performance evaluation system which will be centrally managed by the human resource division.

### c) Staffing level

During the year, a total of 8 new Timorese staff were recruited and two former members of our staff left the institution. In accordance with the Timor Leste National Development Plan, BPA overall staffing level are expected to stabilize around 67 and, therefore, no significant increase is expected in the near future.

The institution has been implementing a program of Timorization focussed on appointing national staff to all management position occupied by International staff. Although the number of International advisors was reduced from 9 to 6, the BPA continued to benefit from technical assistance experts provided by the International Monetary Fund and UN Mission in Timor-Leste.

The table below provides an overview of the staffing complement of BPA per Department/Division, including international staff positions.

### BPA STAFFING SITUATION

Department/Unit ?	Filled							Total	Interna- tional staff	TOTAL	
	Level ?	I	II	III	IV	V	VI				VII
G M Office				1	1	2			4	1	5
Payments			6	7	2	4			19	1	20
Supervision				1	5	2	1		9		9
Accounting				2	2				4	1	5
Administration		3	2	4	1	1			11	1	12
Econ& Stat					2	2			4	1	5
I. Technology				1	1	1			3	1	4
<b>TOTAL</b>		<b>3</b>	<b>8</b>	<b>16</b>	<b>14</b>	<b>12</b>	<b>1</b>		<b>54</b>	<b>6</b>	<b>60</b>

## 2.6 – Division of Economics and Statistics

The main goal of the BPA Division of Economic Studies and Statistics, a real "studies group" inside the institution, is to advise BPA Management in all that concerns BPA monetary and financial policies considering the economic situation of the country.

To develop their activities, which are listed below for the period of the fiscal year in consideration (2003/04), the Division has four technicians, having been helped during most of the time by a fifth element, an international consultant from UNMISSET (actually, they were two that followed each other during part of the fiscal year).

With the help of these consultants, the year of 2003/04 was of consolidation of the DESS activity, for what contributed the policy adopted by BPA Governing Board of providing to their technicians appropriate training for their tasks, an essential element to make possible that activity. This is so much more important as it is true that the Division is the only "studies group" of the Central Administration but with autonomy regarding the Government. These kind of "groups" usually assume, in most countries, a fundamental importance, the same that it is hoped to come to assume in Timor-Leste.

The activities carried out by the Division along the period of July/2003 to June/2004 were as follows:

1 - Publication of the "Boletim Económico"/ "Economic Bulletin", a quarterly publication of BPA in which, besides information on some issues of the national and international economy are presented the main activities of BPA;

2 - Publication of a daily leaflet with the essential of the information about exchange rates, interest rates and the evolution of the international financial markets, which aims to allow the public and the economic operators to access this type of information;

3 - Publication of the monetary statistics of Timor-Leste using the information gathered from the commercial banks and from BPA itself;

4 - Analysis of the statistical information produced by other official Timor-Leste institutions, namely the National Statistics Directorate and its information on the prices evolution (inflation rate) and international trade;

5 - "Focal point" of the relationships of the Authority with the yearly Art<sup>o</sup> IV International Monetary Fund missions;

6 – Organization of internal training activities on macroeconomic issues for the BPA staff;

7 - Statistical databases management Timor-Leste, produced or not in the country;

8 – Collection of documents on several economic and social issues of Timor-Leste both for direct use of the Division and for its training activities for all the staff.

#### *Perspectives for 2004/2005*

The Division will try to begin the process that will allow it, by itself or in association with National Statistics Directorate of the Ministry of the Plan and Finances, to publish the Timor-Leste Balance of payments.

### **2.7 - Information Technology Division (IT)**

The continuing commitment of the BPA to establishing a fully automated working environment meant that with increasing staff numbers, the size of the corporate network was proportionately increased. During the year, the implementation programme of a full corporate network, based on three servers and nearly 50 client workstations was completed. The Division continued its support for a number of application programs in other Divisions of the BPA, as well as maintaining *basic help desk* facilities.

The integration of the BPA data network with the government network allowed for basic internet access to be established for a limited number of users, and the technical infrastructure thus established will provide the basis for the future development of a BPA web site, email facilities, and more general access to internet services.

A high-level IT strategic plan was completed with assistance from the International Monetary Fund, and initial work commenced on the development of a Disaster Recovery Plan. Data storage facilities for backup and other media were upgraded during the year.

The Division was supported by an UMNISSET network advisor for part of the year.

### **2.8 - Law office**

During the fiscal year in analysis, the Law Office of BPA closely followed the writing process of the main laws prepared by BPA, namely on insurances and payments.

The Law Office continued to support the BPA operational units in developing legal documentation and to represent BPA in all legal matters and whenever required.

### **2.9 – Office of the Internal Auditor**

During the fiscal year of 2003/04 the activity of BPA internal auditing was intensified. Namely, a solid program of auditing was consistently implemented a program of internal auditing of the areas of BPA activity identified as of higher risk of wrong-doings.

Besides the tasks of internal auditing that were at the origin of periodic reports about the internal situation of the institution, it also accomplished some tasks at the request of BPA management.





Taibessi popular market saleswoman, in Dili, using the new “centavos” coins

### 3 – FINANCIAL STATEMENTS

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**Autoridade Bancária e de Pagamentos de Timor-Leste**  
**Banking and Payments Authority of Timor-Leste**

*Avenida Bispo Medeiros, PO Box 59, Dili, Timor-Leste*

**FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2004**

**16 August, 2004**

***BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE***

16 August, 2004

**STATEMENT OF COMPLIANCE**

The Financial Statements on pages 54 to 57 and the Notes from pages 58 to 63 which form an integral part of these Statements, have been prepared by Management and approved by the Governing Board of the Banking and Payments Authority of Timor-Leste. We declare that these Financial Statements comply with the requirements of Regulation 2001/30 and fairly present the true financial position and performance of the Banking and Payments Authority of Timor-Leste as at 30 June 2004.

Abraão de Vasconcelos  
**General Manager**

**BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE****BALANCE SHEET**

30 JUNE 2004

	Notes	2004 USD	2003 USD
<b>ASSETS</b>			
Cash and Bank	2	92,863,371	53,464,590
Investments		12,023,020	11,487,052
Property, Plant & Equipment	3	1,103,267	869,741
Other Assets	4	187,584	102,220
<b>Total Assets</b>		<b>106,177,242</b>	<b>65,923,604</b>
<b>LIABILITIES</b>			
Currency Issued		835,938	—
Government Deposits	5	79,010,827	41,535,076
Domestic Financial Institutions		5,769,802	4,767,246
International Financial Institutions	6	12,023,020	11,487,052
Other Liabilities	5	167,869	322,289
<b>Total Liabilities</b>		<b>97,807,455</b>	<b>58,111,663</b>
<b>NET ASSETS</b>		<b>8,369,787</b>	<b>7,811,941</b>
<b>EQUITY</b>			
Share Capital		7,727,188	7,351,166
General Reserve Account		642,599	460,775
<b>TOTAL EQUITY</b>		<b>8,369,787</b>	<b>7,811,941</b>

The notes on pages 58 to 63 form an integral part of this statement.

**BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE****PROFIT AND LOSS STATEMENT****FOR THE YEAR ENDED 30 JUNE 2004**

	Notes	2004 USD	2003 USD
<b>INCOME</b>			
Income from Financial Assets	7A	601,353	482,801
Income from Government	7B	628,978	552,379
Fees and Recoverable Charges	7C	365,066	274,390
Other Income	7D	37,001	3,350
Currency Gains (Losses)	8	(495,051)	58,791
<b>Total Income</b>		<b>1,137,348</b>	<b>1,371,710</b>
<b>EXPENSES</b>			
Interest Expenses and Bank Charges		192,690	255,785
Distribution of Currency		225,537	226,425
Personnel Expenses		209,681	140,142
Administration Expenses	9	192,827	168,023
Depreciation	1G, 3B	134,789	120,560
<b>Total Expenses</b>		<b>955,524</b>	<b>910,935</b>
<b>OPERATING PROFIT</b>		<b>181,824</b>	<b>460,775</b>

The notes on pages 58 to 63 form an integral part of this statement.

**BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE****STATEMENT OF CHANGES IN EQUITY****DURING THE YEAR ENDED 30 JUNE 2004**

	<b>2004</b>	<b>2003</b>
	<b>USD</b>	<b>USD</b>
<b>SHARE CAPITAL</b>		
Opening Balance	7,811,941	6,364,664
Cash Subscriptions from Government	376,022	520,000
Transfer from General Reserve	—	466,502
	<b>7,727,188</b>	<b>7,351,166</b>
<b>GENERAL RESERVE</b>		
<b>ACCOUNT</b>		
Opening Balance	460,775	466,502
Transfer to Capital	—	(466,502)
Retained Earnings	181,824	460,775
	<b>642,599</b>	<b>460,775</b>
<b>TOTAL EQUITY</b>	<b>8,369,787</b>	<b>7,811,941</b>

The notes on pages 58 to 63 form an integral part of this statement.

**BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE****CASH FLOW STATEMENT**

FOR THE YEAR ENDED 30 JUNE 2004

	<b>2004</b>	<b>2003</b>
	<b>USD</b>	<b>USD</b>
<b>OPERATING ACTIVITIES</b>		
Operating Profit	181,824	460,775
Depreciation	134,789	120,560
Changes in Receivables, Prepayments & Stock	(85,364)	(102,020)
Currency Issued	835,938	—
Changes in Government Deposits	37,475,751	22,236,056
Changes in Deposits of Domestic Financial Institutions	1,002,556	1,231,017
Changes in International Financial Institutions	535,968	—
Changes in Other Liabilities	(154,420)	118,187
<b>Operating Cash Flow</b>	<b>39,927,042</b>	<b>24,064,675</b>
<b>INVESTMENTS ACTIVITIES</b>		
Changes in Investments	(535,968)	—
Purchase of Property, Plant & Equipment	(368,315)	(243,073)
<b>Cash Flow from Investment Activities</b>	<b>(904,283)</b>	<b>(243,073)</b>
<b>FINANCING ACTIVITY</b>		
Capital Subscription	376,022	520,000
<b>Cash Flow from Financing Activity</b>	<b>376,022</b>	<b>520,000</b>
<b>INCREASE IN CASH &amp; CASH EQUIVALENTS</b>	<b>39,398,781</b>	<b>24,341,502</b>
Cash & Cash Equivalents at the beginning of year	53,464,590	29,123,089
<b>CASH &amp; CASH EQUIVALENTS AT THE END OF YEAR</b>	<b>92,863,371</b>	<b>53,464,590</b>

The notes on pages 58 to 63 form an integral part of this statement.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### **Basis of preparation**

These Financial Statements have been prepared in accordance with the historical cost convention and on accrual basis to conform with the accounting policies of the Banking and Payments Authority of Timor-Leste (BPA) and relevant International Accounting Standards. Unless stated otherwise, the policies followed in these statements are consistent with those adopted in the previous year.

### **Presentation**

The Chart of Accounts was revised during the year, and it was therefore necessary to reclassify some comparative information from the prior ended 30 June 2003, to harmonise it with that of the year ended 30 June 2004.

### **Unit of Account**

All amounts, unless specified otherwise, are expressed in United States dollars, the official currency in the Democratic Republic of Timor-Leste. Any minor differences are due to rounding of cents to the nearest dollar.

### **Foreign exchange rates**

Transactions involving foreign currencies have been converted at the rates ruling on the transaction dates. Monetary assets and liabilities have been translated at the rates of exchange ruling at the end of June 2004. Gains and losses arising from revaluation of monetary assets and liabilities have been recognized in the Profit and Loss Statement.

The significant foreign currency exchange rates as at 30 June 2004 were:

USD 1 = IDR 9,430

USD 1 = AUD 1.4497

USD 1 = IMF SDR 0.6820

USD 1 = EUR 0.8274

### **Income Recognition**

Interest income, fees & charges and other income have been recognized on accrual basis of accounting where it has been ascertained that the economic benefits will flow to the entity and that it can be reliably measured. Income from Government is recognized upon approval of the annual budgetary appropriation by Parliament.

### **Property, Plant & Equipment**

Property, Plant and Equipment are carried at cost. The respective classes are indicated in Note 3 to the accounts.

### **Depreciation**

Depreciation has been provided on a straight-line basis in order to write off the cost of depreciable property, plant and equipment over their estimated useful life spans, using the following rates:

Premises (improvements)	5%
Plant	20%
Office equipment	12.5%
Computers & electronic equipment	25%

### **Investments**

Investments are initially recognized at cost, being the base consideration including acquisition charges. The investments reported relate to transactions with the IMF and are deemed to be held to maturity, hence recognized at the initial cost in SDRs, and translated into US Dollars at the ruling rate on 30 June 2004.

### **Stock of Unissued Currency (Centavos)**

Unissued coins (Centavos) are held at cost of acquisition.

**Income Tax**

BPA is exempt from taxes on its income under the provisions of Section 61, Regulation 2001/30.

**Employee Entitlements**

There was no pension scheme for BPA employees during the year under review.

**2. ANALYSIS OF CASH AND CASH EQUIVALENTS****(A) Cash and Cash Equivalents**

Cash and cash equivalents comprise of at bank balances redeemable on demand and cash at hand.

**(B) Analysis by Institutions**

	<b><u>Rating*</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
<b>DOMESTIC CASH AND BANK</b>			
Cash	AAA	8,689,360	7,689,774
Other Central Banks	Aa2	82,092,729	43,585,158
Resident Banks	Aa3	935,025	2,067,697
Non-Resident Banks	Aa1	—	938
<b>Total Domestic Cash and Bank</b>		<b>91,717,114</b>	<b>53,343,567</b>
<b>FOREIGN CURRENCY CASH AND BANK</b>			
Central Banks	Aa2	1,094,427	62,714
Foreign Cash	Aa2	50,882	58,082
Non-resident banks	Aa1	948	228
<b>Total Foreign Currency Cash and Bank</b>		<b>1,146,257</b>	<b>121,024</b>
<b>TOTAL CASH AND BANK</b>		<b>92,863,371</b>	<b>53,464,590</b>

\*Where a central bank is not rated, the sovereign rating has been used.

**(C) Analysis by country exposure**

The country exposure has been determined according to the home country of the parent institution in which funds are held, or the issuing country of currency held.

<b><u>Country</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
USA	18,294,623	7,690,940
Australia	73,581,893	43,647,872
Indonesia	50,882	58,082
Portugal	935,973	2,067,697
<b>TOTAL CASH AND BANK</b>	<b>92,863,371</b>	<b>53,464,590</b>

### 3. PROPERTY, PLANT AND EQUIPMENT

#### (A) Property, Plant and Equipment at Cost

The value of property, plant and equipment excludes the land and base cost of buildings, but represents capitalized value of improvements only.

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	TOTAL 2004	TOTAL 2003
Opening Balance	580,933	73,618	98,808	213,839	71,890	1,039,087	796,014
Additions	227,559	1,450	23,716	42,215	81,866	376,806	243,073
Disposals & Adjustments	—	—	—	(8,491)	—	(8,491)	—
Value at Cost	808,492	75,068	122,524	247,563	153,756	1,407,402	1,039,087

#### (B) Depreciation Account

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	TOTAL 2004	TOTAL 2003
Opening Balance	41,483	22,568	14,545	68,322	22,429	169,346	48,786
Annual Depreciation	30,106	14,996	14,023	55,984	19,680	134,789	120,560
Accumulated Depreciation	71,589	37,564	28,568	124,305	42,109	304,135	169,346

#### (C) Net Book Value of Property, Plant and Equipment

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	TOTAL 2004	TOTAL 2003
PPE at Cost	808,492	75,068	122,524	247,563	153,756	1,407,402	1,039,087
Accumulated Depreciation	(71,589)	(37,564)	(28,568)	(124,305)	(42,109)	(304,135)	(169,346)
Net Book Value	736,903	37,504	93,956	123,258	111,647	1,103,267	869,741

### 4. OTHER ASSETS

Item	2004	2003
Accounts Receivable	107,443	98,810
Prepayments	36,743	3,410
Stock of Unissued Centavos at Cost	43,398	—
	<b>187,584</b>	<b>102,220</b>

**5. LIABILITIES AND INTEREST RATE RISK**

<b>DEPOSIT LIABILITIES</b>	<b>Basis of Interest</b>	<b>2004</b>	<b>2003</b>
<b>Government</b>			
Consolidated Fund	***	65,060,878	30,935,778
Timor Gap Fund		13,899,069	10,541,218
Other Funds		50,880	58,080
		<u>79,010,827</u>	<u>41,535,076</u>
<b>Financial Institutions</b>			
Domestic Financial Institutions	***	5,769,802	4,767,246
International Financial Institutions (Net)		12,023,020	11,487,052
		<u>17,792,822</u>	<u>16,254,298</u>
<b>Total Deposit Liabilities</b>		<u><b>96,803,649</b></u>	<u><b>57,789,374</b></u>
<b>CURRENCY ISSUED</b>		<u><b>835,938</b></u>	<u>—</u>
<b>OTHER LIABILITIES</b>			
Accruals		127,552	48,836
Other Accounts Payables		22,826	14,059
Ex R.I .Pension Fund		—	256,294
Salary Payments		17,491	3,100
<b>Total Other Liabilities</b>		<u><b>167,869</b></u>	<u><b>322,289</b></u>
<b>TOTAL LIABILITIES</b>		<u><b>97,807,456</b></u>	<u><b>58,111,663</b></u>

All liabilities will mature within six months.

\*\*\*Federal Reserve Bank of New York Repurchase Rate less 65 basis points on qualifying balances.

**6. INTERNATIONAL FINANCIAL INSTITUTIONS****International Monetary Fund**

The Democratic Republic of Timor-Leste became a member of the International Monetary Fund on 23 July 2002. The BPA was designated as the official depository under Article XIII of the IMF Articles of Association. In accordance with generally accepted accounting practice in central banks, the BPA funded Timor-Leste's subscription in the IMF from its balance sheet, and recognizes the IMF cash and security accounts as liabilities. The underlying balances of the IMF are denominated in SDR, as follows:

Subscription in IMF (Asset)	SDR	8,200,000
IMF Cash Accounts (Liability)	SDR	21,500
IMF Securities Account (Liability)	SDR	8,178,500

The IMF Securities Account reflects the value of a Promissory Note held by the BPA in favour of the IMF. The balance sheet records the US dollar equivalents of the SDR balances using the SDR/USD rate applicable at 30 June 2004.

### The World Bank Group

The Democratic Republic of Timor-Leste became a member of three institutions within the World Bank Group on 23 July 2002. Under the relevant Articles of Association, the BPA was designated as the official depository. In accordance with general practice, the BPA records the outstanding balances with the members of the World Bank Group on a net liability basis. The amounts subscribed are in US dollars, as follows:

#### *International Bank for Reconstruction and Development*

Timor-Leste has been issued with 267 shares of capital stock with a total capital value of \$32,209,545, of which \$1,739,315 has been paid in the form of a Promissory Note held at the BPA.

#### *International Development Association*

Timor-Leste has subscribed for \$349,842, of which \$314,858 has been paid in the form of a Promissory Note held at the BPA.

#### *Multilateral Investment Guarantee Agency*

Timor-Leste has subscribed to 50 shares with a total value of \$541,000, of which \$54,100 has been paid on the form of a Promissory Note held at the BPA.

### Asian Development Bank

The Democratic Republic of Timor-Leste became a member of the Asian Development Bank on 24 July 2002. In accordance with the ADB Articles of Association, the BPA was designated as the official depository. In accordance with general practice, the BPA records the outstanding balance with ADB on a net liability basis. The subscription in the ADB is 350 shares with a total value of \$4,222,225, partially funded by a Promissory Note for \$171,904.88 held by BPA.

## 7. ANALYSIS OF INCOME

	<b>2004</b>	<b>2003</b>
	<b>USD</b>	<b>USD</b>
<b>(A) INCOME FROM FINANCIAL ASSETS</b>		
Interest on deposits – Foreign Central Banks	592,408	473,114
Interest on deposits – Foreign Commercial Banks	—	436
Interest on deposits – Domestic Commercial Banks	6,801	9,251
Other Income	2,144	—
<b>Total Income from Financial Assets</b>	<b>601,353</b>	<b>482,801</b>
<b>(B) INCOME FROM GOVERNMENT</b>		
Service Fees	240,000	240,000
Revenue Appropriation	388,978	312,379
<b>Total Income from Government</b>	<b>628,978</b>	<b>552,379</b>
<b>(C) FEES AND RECOVERABLE CHARGES</b>		
Cost Recoveries (Cash Fees)	315,733	215,605
Licensing & Supervision	49,000	53,500
Miscellaneous Charges	333	5,285
<b>Total Charges and Cost Recoveries</b>	<b>365,066</b>	<b>274,390</b>
<b>(D) OTHER INCOME</b>		
Penalties	—	2,000
Sales of Numismatic Coins	27,221	—
Donations & Grants	9,780	1,350
<b>Total Other Income</b>	<b>37,001</b>	<b>3,350</b>
<b>(E) CURRENCY GAIN (LOSS)</b>	<b>(495,051)</b>	<b>58,791</b>
<b>TOTAL INCOME</b>	<b>1,137,348</b>	<b>1,371,710</b>

**8. CURRENCY EXCHANGE LOSS: USD 495,051**

Gains and losses arising from revaluation of monetary assets and liabilities have been recognized in the Profit and Loss Statement, and the net effect of movements in foreign currency exchange rates during the year under review was a loss equivalent to USD 495,051. This was largely attributable to the sharp depreciation of the US Dollar against reserves held in Australian Dollars.

**9. ADMINISTRATION EXPENSES**

	<b>2004</b>	<b>2003</b>
	<b>USD</b>	<b>USD</b>
Information Systems	3,005	10,366
Office Expenses	27,736	27,478
Communication Expenses	23,191	18,031
Professional Fees	26,870	67,655
Vehicle Expenses	10,627	8,954
Repairs & Maintenance	20,655	9,072
Water & Energy	56,552	17,295
Insurance	6,667	—
House Keeping	8,531	8,161
Security	500	—
Assets Management	8,491	1,013
<b>TOTAL</b>	<b>192,827</b>	<b>168,023</b>

**10. REMUNERATION TO MEMBERS OF THE GOVERNING BOARD**

The three members of the Governing Board as at 30 June 2004 are also executive members of management. Two of them were remunerated under the auspices of United Nations and IMF technical assistance programmes at no cost to the Democratic Republic of Timor-Leste. The third Board member was remunerated in accordance with the terms and conditions of service of regular executive staff of the BPA.

## External auditors report



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### INDEPENDENT AUDIT REPORT TO THE GOVERNING BOARD OF BANKING AND PAYMENTS AUTHORITY OF TIMOR LESTE

#### Scope

##### *The financial report and Governing Board responsibility*

The financial statement comprises Balance Sheet, Profit and Loss Statement, Statement of Changes in Equity and Cash Flow Statement, accompanying notes to the financial statements, and Statement of Compliance for Banking and Payments Authority of Timor-Leste ("BPA") for the year ended 30 June 2004.

The Governing Board of BPA are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the BPA, and that complies with International Accounting Standards, in accordance with the Regulation No. 2001/30 "on Banking and Payments Authority of East Timor". This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

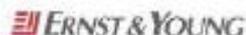
##### *Audit approach*

We conducted an independent audit of the financial report in order to express an opinion on it to the Governing Board of BPA. Our audit was conducted in accordance with International Standards on Auditing in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Regulation No. 2001/30 "on Banking and Payments Authority of East Timor", and including compliance with International Accounting Standards, a view which is consistent with our understanding of the BPA's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the Governing Board of BPA.



#### *Audit approach (cont'd)*

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

We performed procedures to assess whether the substance of business transactions was accurately reflected in the financial report. These and our other procedures did not include consideration or judgment of the appropriateness or reasonableness of the business plans or strategies adopted by BPA.

We believe that our audit provides a reasonable basis for our opinion.

#### *Independence*

We are independent of BPA, and have met the independence requirements of the International Federation of Accountants ("IFAC") Code of Ethics for Professional Accountants.

#### **Audit Opinion**

In our opinion the financial report of Banking and Payments Authority of Timor-Leste is in accordance with the Regulation No. 2001/30 "on Banking and Payments Authority of East Timor", including:

- (a) giving a true and fair view of the financial position of Banking and Payments Authority of Timor-Leste at 30 June 2004 and of its performance for the year ended on that date; and
- (b) complying with International Accounting Standards.

A handwritten signature in cursive script, appearing to read 'Ernst &amp; Young'.

Ernst & Young

A handwritten signature in cursive script, appearing to read 'Mike Reid'.

Mike Reid  
Partner

Brisbane  
28 September 2004

## Statement of Corporate Governance

### Overview

The Governing Board and management are committed to ensuring that the BPA maintains a high standard of governance and adheres to high ethical standards.

### The Governing Board

The Governing Board consisted of three executive members throughout the year, although there is statutory provision for the appointment of up to four other nonexecutive members. With the small number of members, no board committees have been formed.

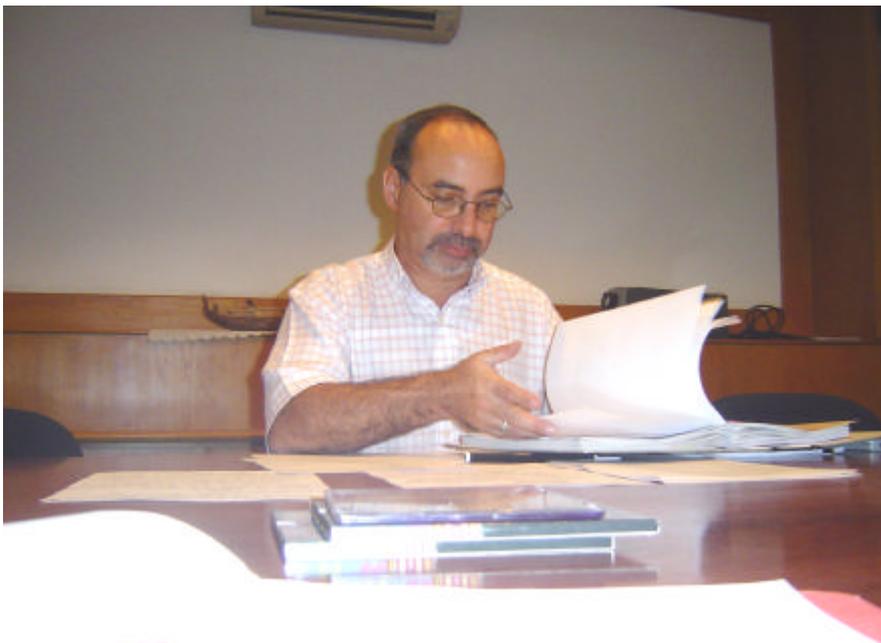
The Governing Board is required to meet not less frequently than once each calendar month. During the year twelve meetings of the Governing Board were held, and each meeting was attended by all members. In the absence of an independent chairperson, the General Manager chaired the meetings.

The Internal Auditor reports to the Governing Board each quarter and at other occasions on request.

### Management

The Management Committee comprises the General Manager, Deputy General Manager for Supervision, Deputy General Manager for Payments, Chief Accountant, and Director of Administration.

The Committee meets weekly to review progress, approve policy, and provide guidance on such matters as the General Manager may determine. Divisional Managers also attend these meetings.



*Luis Quintaneiro, General Manager April 2002 – July 2004*



## ***Corporate Plan, 2004-2007***

This Corporate Plan sets out a strategic direction for the Banking and Payments Authority of Timor-Leste (BPA) for the period through to 2007. The Plan describes the way in which we undertake our responsibilities and identifies our main functions and key objectives in a manner intended to improve our corporate effectiveness and transparency. (...)

As an institution that is less than four years old – in reality and not just in a legal sense – we have established ourselves as a fully-functioning and effective organisation. The challenge in the next three years is to not only consolidate these achievements but to further build and expand our functions and services to meet the expectations and needs of the people of Timor-Leste.

There is considerable emphasis throughout the Plan on the development of human resources. (...)

This Plan provides a broad overview of the direction we intend to take until 2007. It will be supported by the preparation of Annual Budgets that will be prepared each year identifying the resources required to achieve the planned results. The annual budget process is thus the mechanism that takes the intentions set out in this Corporate Plan and converts them into operating targets and activities. (...)

### *1.1 Charter*

The purposes of the Banking & Payments Authority of Timor-Leste (BPA) are established in several pieces of legislation, primarily UNTAET Regulation 2001/3 on the Banking and Payments Authority of East Timor, and other legislation detailed in the Appendix. The primary objectives of the BPA under these laws are: to achieve and maintain domestic price stability; to foster the liquidity and solvency of a stable market-based banking and financial system; to execute the foreign exchange policy of Timor-Leste; and to promote a safe, sound and efficient payment system.

Within these objectives BPA has the purposes of: advising the government on banking and monetary matters; issuing currency in the form of national coins; overseeing the nation's payment and settlement systems; acting as the banker to the government; ensuring a sufficient supply of paper currency; licensing, regulating and supervising banks and currency exchange bureaux; undertaking economic analysis and research.

In addition, the BPA has been requested to prepare a framework for the licensing, regulation and supervision of the insurance industry, though enabling legislation is still in preparation.

### *1.2 Vision*

To be a credible leader in preserving price stability to foster economic development in Timor-Leste.

### *1.3 Mission*

Our mission is to be a central bank staffed by a professional team that strives to continuously improve the quality of our services to our stakeholders by maintaining a sustainable monetary system with low inflation; ensuring that payments systems are efficient and effective; promoting a safe and credible system of financial institutions; communicating and providing information; undertaking sound economic research and analysis; by developing the necessary organizational and technical capacities.

## **Corporate Plan, 2004-2007 (cont.)**

### **5. Ethics and values**

#### *5.1 Good governance*

The BPA will adhere to international standards of good governance.

Members of the Governing Board will observe and foster high ethical standards.

Members of the Governing Board will require integrity in financial and other reporting.

The Governing Board will regularly verify that the BPA has appropriate processes in place to identify and manage potential and relevant risks.

The quality and independence of the internal and external audit processes will be maintained.

The Governing Board will foster constructive relationships with its stakeholders, and respect their interests within the fundamental purpose of the BPA.

#### *5.2 Integrity and Honesty*

The BPA will seek to undertake all its functions with total professionalism, honesty and integrity.

The BPA will conduct its affairs ethically and fairly, and respect all legal and other matters in preparing advice, which will be based on rigorous analysis.

The BPA will respect confidentiality in all its dealings and take all reasonable precautions to prevent unauthorized access to any information received.

#### *5.3 Openness*

The BPA will consult, listen, learn, and respond effectively to the needs of its stakeholders, customers, and the community at large.

The BPA will strive to trust and be trustworthy

#### *5.4 Prudence*

The BPA will exercise prudence in the execution of all its duties and responsibilities.

#### *5.5 Transparency*

The BPA will implement its policies credibly and transparently to encourage public scrutiny and seek to be judged by the community as a fair institution.

The BPA will advise and consult with those who can assist in the achievement of its objectives

The BPA will strive to improve its communication with a broad crosssection of the community to ensure that it is fulfilling its role and duties in a sound manner.

#### *5.6 Accountability*

The BPA will use its resources efficiently and effectively. The BPA will regularly review its performance and assess the cost effectiveness of all its activities through a systematic process of planning, budgeting and performance measurement.

The BPA will continue to ensure the effective functioning of an autonomous Internal Audit Office.

The BPA will maintain high standards of financial reporting consistent with international best practices.

#### *5.7 Progressive employment practices*

The BPA will develop a progressive and competitive work environment that motivates staff and recognizes performance.

The BPA will develop and implement personnel policies that will attract staff from the widest pool possible, respect equal opportunity principles and formulate clearly defined performance objectives, fair appraisal and remuneration structures.

The BPA will maintain transparent recruitment procedures.

The BPA will be environmentally responsible

The BPA will support the development of positive team relationships and encourage cooperation between individuals and functional areas to maximize the opportunity to achieve its goals.

*in ABP/BPA Plano Corporativo/Corporate Plan 2004-2007, Dili, Agosto de/August 2004*





*"Tais" of Bobonaro*

## **Governing Board**

Abraão Vasconcelos  
Maria José Sarmento  
Samuel Robinson

## **Management Committee**

General-Manager  
*Abraão Vasconcelos*

Deputy General-Manager  
for Supervision  
*Maria José Sarmento*

Deputy General-Manager  
for Payments  
*Samuel Vesey Robinson*

Director of Administration  
*Raquel Gonçalves da Costa*

Chief Accountant  
*Fernando Carvalho*

Contacts:

### **Banking and Payments Authority of Timor-Leste**

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