Autoridade Bancária e de Pagamentos de Timor-Leste

Banking and Payments Authority of Timor-Leste

Annual Report

Fiscal year 2004/2005

(1/Jul/2004 – 30/Jun/2005)

Dili
2005

Introduction

Economic activity in Timor-Leste picked up in 2004 impacted by favorable crops in agriculture sector and expanded banking activity. This positive result reverses the weak performance observed in the previous year, when the non-oil GDP declined sharply. In 2005, the economy's output is expected to grow at a faster pace and gradually converge toward its potential level thereafter.

The banking system showed remarkable growth, the net foreign assets increased in line with the accumulation of government deposits. As of June 2005, the net foreign asset corresponded to over fifteen months of projected goods and services imports. Credit to the private sector from commercial banks increased considerably compared to the year before. Bank loans were directed mainly to construction, trade and finance and individual loans.

The overall condition of the banking system remained healthy and efforts have been made to strengthened financial system in Timor-Leste. During the year the BPA initiated three projects to develop legislation relating to the financial system. Draft laws in the areas of payment system, payment transactions, and anti-money-laundering were prepared. The BPA is currently working on a major project to prepare legislation to transform the institution into a fully-fledged central bank. The government demonstrated its clear commitment to transform the BPA into a central bank by fully capitalizing the BPA in July 2005.

The law on the Regime for Licensing, Supervision and Regulation of Insurance Company and Insurance Intermediary was approved by Parliament and promulgated. The BPA also involved very actively in the setting up of the petroleum fund framework.

One of the major achievements as which stands as an important milestone in the development of the future central bank of Timor-Leste was the Timorization of the most senior management positions in the organisation being the positions of General Manager and two Deputy General Managers.

Efforts continued to be made to strengthen the institution and to build a professional team of staff. In November 2004 a Working Committee was formed to prepare procedures and manuals in the various units in BPA. As the result, over 300 new procedures and manuals were written during the year, with more than 260 procedures being formally approved.

The BPA also conducted a comprehensive training needs assessment as the basis for developing a medium and long-term capacity development plan. However, to accommodate the recent expansion in the BPA mandate, BPA management initiated a project during the fourth quarter to review the training strategy to include the development of staff capacity to manage the Petroleum Fund. This development is very important as a road map for the institution as it prepares to transform itself into a fully fledged central bank.

In term of staff capacity development, the BPA continued a programme of intensive investment. A number of bilateral arrangements were made or further developed with other central banks such as Bank of Portugal, Bank Indonesia and Bank Negara Malaysia. Apart from those institutions, the BPA also continued to benefit from other training institutes and universities such as the IMF – Singapore

Training Institute, SEACEN training institute, Instituto Superior da Economia e Gestão in Lisbon, amongst others. During the year, 41 staff (2,648 person-hours) participated in various training overseas including study visits and attachments to other central banks.

During the year, the BPA continue to benefit from presence of international staff who has worked alongside national staff to develop the various services in the institution. The Bank of Portugal provided a number of training programmes for BPA staff as well as providing a resident economics advisor to the BPA. Valuable assistance and staff training was also received from other central banks including Bank Negara Malaysia, Bank Indonesia, and the Norwegian central bank.

The International Monetary Fund also continued to provide substantive amount of technical support in a number of critical areas, including reserves management, banking and insurance supervision, payment systems, anti-money laundering, and others. The resident/peripatetic advisor programme was supported by staff advisory missions that significantly contributed to developments in a number of critical areas.

The BPA also continued to receive strong support and commitment from the government, particularly the Prime Minister and the Minister of Planning and Finance.

The management of BPA would like to express its sincere appreciation of their contribution to the development of the institution. The support of other development partners is acknowledged and appreciated.

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

Dili, October 31, 2005

Abraão de Vasconselos
General Manager

Context

Water jug, from Manatuto, view from the top

International framework

In the fiscal year that just finished at 30 June this year, period covered in this present Annual Report for BPA, was characterized, in general, by some significant transformations, either in our country or overseas, from the political perspective as well as economic. Naturally, is this last one that is important for us to analyse and the first part of this Report has the objective, like traditionally, of making first an analysis of the evolution of the international economic situation and then of the country itself.

We start with the first one because of the need to define, from the beginning, the international framework of evolution of our own economy because like the majority of other countries, it increasingly articulates with the world economy. Two examples: the revenues form the Timor Sea – and, with them, our own actual and future development – are dependent on the evolution of petroleum price in the international market, which will influence and be influenced by the international economy situation. The expenses that we incurred with our imports – and they are many – depend, in part, of the USD exchange rate in the international market.

In a recent report, IMF mentions that the growth of the world economy was, in 2004, the fastest of the last 30 years: 5.1%. For that contributed mainly the growth in some industrialised countries – as United States, with 4.4% - but also some development countries, with special emphasis to China and their 8.5% growth in the production rate.

As the numbers shows, the economic growth happened, however, with different levels from region to region and country to country.

Table 1.1 – OECD: main economic indicators

	2004	2005				2005	2006
	Year	*T1*	*T2*	*T3*	*T4*	Year	Year
	Annual average rate of GDP variation						
United States	4.4	3.6	3.4	3.6	3.3	3.6	3.3
Japan	2.6	5.3	0.8	1.2	1.5	1.5	1.7
Euro Area	1.8	1.5	1.1	1.3	1.7	1.2	2.0
Total of OECD	3.4	3.3	2.5	2.7	2.8	2.6	2.8
	Idem. Inflation						
United States	2.1	3.2	1.9	2.1	2.1	2.4	2.2
Japan	-1.2	-2.8	-0.8	-0.4	-0.1	-0.9	0.0
Euro Area	1.9	1.2	1.9	1.8	1.6	1.5	1.7
Total of OECD	2.0	1.5	1.8	1.8	1.8	1.9	1.9
	Unemployment Rate						
United States	5.5	5.3	5.2	5.1	5.0	5.1	4.8
Japan	4.7	4.5	4.4	4.4	4.4	4.4	4.1
Euro Area	8.9	9.0	9.1	9.1	9.0	9.0	8.7
Total of OECD	6.7	6.7	6.7	6.7	6.6	6.7	6.4
	Short term interest rate						
United States	1.6	2.8	3.2	3.6	4.2	3.4	4.7
Japan	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Euro Area	2.1	2.1	2.0	1.6	1.6	1.8	1.9

Source: OECD *Economic outlook nº 77*, Paris, May 2005

The *Economic Outlook* from May (see table 1.1) released by OECD – Organization for Economic Co-operation and Development, consider that in 2004, in the total of OECD, registered a growth in production of 3.4%. This is mainly due to the rapid economic growth in the United States during the year (4.4%, one of the highest in the last years) after a slow growth in 2002 (1.9%) and 2003 (3%). This positive climb will amend this year since the forecasts for the behaviour of the group of OECD economies – particularly the United States and the "Euro Area"- have slide down. This is mainly due to the rise of oil price in the international markets but also to the rise of negative expectations from the consumers and investors, which will reflect in the production.

The result is a drop (estimated) in production for OECD during the two first quarters of 2005, particularly in the second quarter, when the variation rate of production dropped from 3.3% in the first quarter to 2.5%. In total, expects that in 2005 there is a growth of 2.6%, against the 3.4% last year.

It must be noted that in the most recent edition of their *World Economic Outlook*, released in September 2005, the IMF estimates a 2.5% growth for the industrialized countries (in fact the ones in OECD) during 2005. This means that the estimative did not change significantly (just –0.1% in view of the estimated values in past May) however there is the feeling of a minor rise in pessimism than a couple of months ago which is not strange with the high increase of oil prices.

The decrease in the level of economic activity is contributing to relief the pressure for an increase in the **inflation rate** – in spite the increase of energy (oil) costs consumed for production. Therefore, the inflation rate on the OECD group of countries positioned in 2004 at 2%, and should maintain a similar value this year. This rate is confirmed by the most recent estimative (Sept 2005) from IMF.

One must note that the slow down on growth may occur without any impact on the labour market through increase of **unemployment**. It will position itself near the actual values: 6.7%, with a differentiated situation in the three major "regions" of OECD – United States, Japan and "Euroland"-, with the Euro area maintaining, as usual, a higher value (9%) and without predictions of significant decrease in future.

For 2006, OECD *Economic Outlook* conjectures a slight recovery of the economic situation for this group of countries. However with different behaviours between the three "main players":

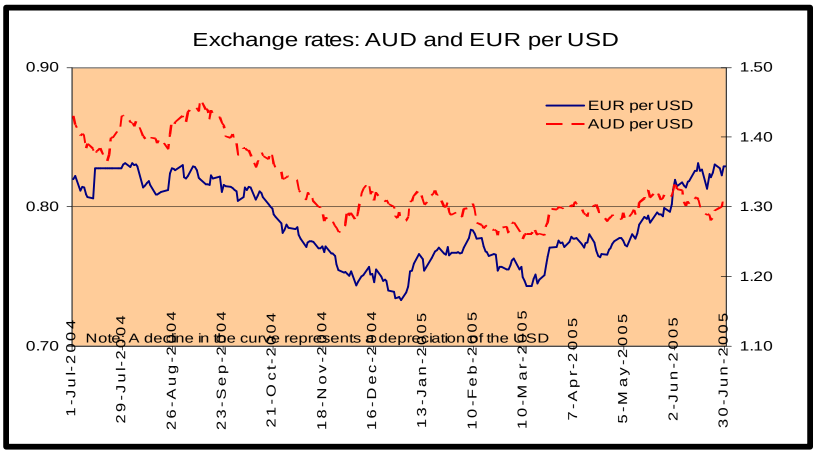
improvement in Europe and Japan (more prominent in the first one than second) and continue decrease in the growth rate in the Unites States in spite of maintaining a rate above the other two big economic spaces of OECD (3.3% against 1.7 – 2% in Japan and Europe). The IMF predicts for 2006 a growth of 2.7%, against the 2.8% estimated by OECD some months ago.

Nonetheless, other observers also prepared differentiated estimative but altogether the picture for the group is not reassuring, at least for Europe and Japan.

This "cooling off" from the international economy or, at least, from some of the major "players" may signify, namely, a slow down in the demand of energy and therefore a decrease in its prices. This will have a reflection on Timor-Leste through the reduction of revenue from the Timor Sea; the influence on the national production will be minimum due to the weak relations between this (the non-oil product) and the international economy.

Must be noted that in relation to the price of energy, the recently published *Asian Development Outlook 2005*, from the *Asian Development Bank*, assess that oil (Brent), after increased from the 28.8 USD/barrel (annual medium) to 38.3USD/barrel in 2003 and 2004 respectively, will stabilise at 41 USD/barrel this year and 39 USD/ barrel in 2006.

The ***exchange rates*** for the principal currencies maintained in 2004-2005 some stability between them, with the USD dropping down up to the end of 2004. Later recovered part of its value in relation to Euro and Yen, yet maintained some of the depreciation in relation to the Australian dollar.

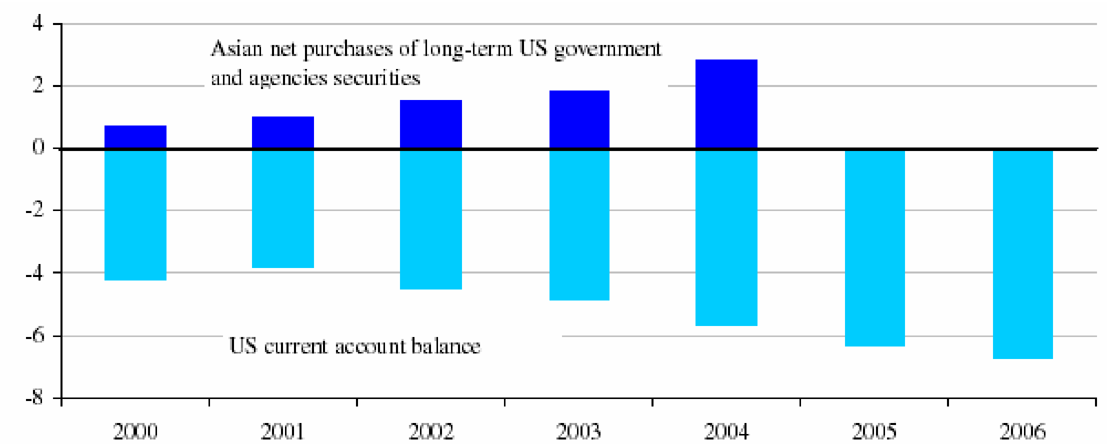


The ***interest rates*** maintained very low historic levels (around 2% in the Euro zone and 0% in Japan). In spite of this, the tendency is to increase for the United States, in part due to the necessity to bring back to the country lots of funds that exited looking for better remunerations (in Australia and in Europe, for example, leading to the valorisation of relevant currencies and lost of value of USD). The perspectives are to reduce the differential between the European and American taxes, which will contribute to the revalorisation of USD in regards to Euro and other currencies – however this is not happening in a clear and consistent way.

In relation to the ***public finances***, the progresses on controlling the current deficit in several countries have been slow. This make of the Unites States, for example, a real "absorber" of the world savings, namely from West Asia, were are located some of the major countries with higher savings rate in the world and they are that high that became difficult to make investments in the country that take in completely.

This absorption of financial resources aims equally to finance the important deficit form ***external accounts*** of the country (-5.7% of GDP in 2004 and –6.4%, estimated, in 2005). Overall, the international finance system is relatively dependent on policies adopted by the countries with higher surpluses and funds the major deficits – essentially the United States of America.

Asia is funding a big percentage of the USA external accounts deficit
% of GDP from USA



In summary, after confirmed in 2004 the perspectives for economic recovery, the year of 2005 presents itself a little bit daunting for the majority of observers and for the majority of industrialized economies. As a fact, although confirmed low growth rates in the first two quarters of this year, is expected that the second semester confirm the negative projections of the first – mainly in relation to the European economy. This dilapidation of the economic situation is dependent of the progression, high, of the oil price and the negative expectation development from the economic agents.

However, there are some hope for 2006 relatively to the European and Japanese economies, with slight recoveries which, added to the other countries of OECD, will make the group increase 2005 growth rate in spite of the Unites States decrease.

Must be noted, that there are several indicators that points to a high frailty of the recovery and, because of that, it can be translated "more less" (in 2005) to: an economy growing at a relatively low pace and with minor (or none) sustainability in the medium term perspective.

We analysed the evolution of economy in the past (recent) and future (near) for the most industrialised countries. Knowing that they have been the "drivers" of the international economy, we must be alert about the future, if it is true that there is hope for improvement of the situation, its also true that these can, with great facility, become deteriorated – if the oil prices maintain a high note.

And relatively to the countries near to us, as the Asia Pacific in general, and the countries, like Indonesia and Australia, with whom we maintain more intense economic relations?

Table 1.2 – East Asia and Southeast Asia – main indicators

		2003	2004	2005	2006	2007
GDP	***East Asia***	***6.7***	***7.8***	***6.7***	***7.0***	***7.2***
	China	9.3	9.5	8.5	8.7	8.9
	South Korea	3.1	4.6	4.1	5.1	4.9
	Southeast Asia	***5.0***	***6.3***	***5.4***	***5.6***	***5.9***
	Indonesia	5.0	5.1	5.5	6.0	6.5
	Malaysia	5.3	7.1	5.7	5.3	5.8
	Singapore	1.4	8.4	4.1	4.5	4.4
	Thailand	6.9	6.1	5.6	5.8	6.0
Prices (CPI, %)	***East Asia***	***1.3***	***3.3***	***3.1***	***3.0***	***3.0***
	China	1.2	3.9	3.6	3.3	3.2
	South Korea	3.6	3.6	3.0	3.3	3.6
	Southeast Asia	***3.3***	***4.2***	***4.3***	***3.9***	***3.8***
	Indonesia	6.6	6.2	5.9	5.4	5.5
	Malaysia	1.2	1.4	2.4	2.5	2.5
	Singapore	0.5	1.7	1.4	1.2	1.2
	Thailand	1.8	2.7	3.5	3.0	2.5
CAB (% GDP)	***East Asia***	***4.3***	***4.2***	***2.9***	***2.4***	***1.7***
	China	3.2	3.3	1.2	0.4	-0.2
	South Korea	2.0	4.0	3.9	3.5	2.8
	Southeast Asia	***7.8***	***7.1***	***6.2***	***5.3***	***4.9***
	Indonesia	3.2	2.6	2.1	1.5	1.0
	Malaysia	12.9	12.5	10.1	8.3	6.7
	Singapore	29.2	26.1	26.0	25.7	26.2
	Thailand	5.6	4.5	2.3	1.3	1.3

Source: ADB *Asian Development Outlook 2005*, several tables; 2003 and 2004: effective data, 2005-2007: projections

In the evolution of this region it is important to highlight China, considered today as the main "driver" in all East Asia, and more and more, also of the world economy or, at least, acts as conditionality in several aspects. These range from the market prices (low) of its many products to the influence pressure on oil prices; of their crescent role as importer (mainly of other asian countries, which help them in their own growth) to becoming one important financier of the international system. This is because of the high savings and the role that plays in the financing of the double American deficit (from public finances to external trade).

Notwithstanding the efforts from the Chinese authorities to reduce the growth rate of the national economy due to the inflated pressures that started to feel, the truth is that the GDP of China increased in 2004, more that in 2003 (9.5% against 9.3%). For 2005, expectantly, it will be possible to decrease the growth ratio to 8.5%.

Following this controlled "cool down" of economy, it is anticipated that the inflation rate decreases slightly, around 3.6% after reaching in 2004 the 3.9%. It should be noted that the monetary authorities of the country opted to let their currency appreciate in real terms – thanks to the inflation, their products are now slightly more expensive – instead of letting the Yuan exchange rate appreciated in nominal terms – although proceeded in July 2005 to a minor (2%) nominal variation. It served as a "test balloon" to study the reaction to exports at a new value and, above all, to study the reaction of international markets comparatively to the exchange situation of Hong Kong – that have a fixed exchange rate for the last 20 years credited to their exchange regiment.

The soft landing of the Chinese economy – gradual reduction of (excessive and potentially inflator) growth rate of production – will contribute to a change in the importance of exports and internal expense (family spending and investment, private and public), with this last, primarily the private expending, that assumes a major importance as a dynamic force of the Chinese economy. If this change occurs, we are before good news for China economic partners in the Asiatic region for the reason that she will import more, as such helping to sustain the economic growth in the Southeast Asia, for example seemly less dependent of the American market.

That has happened, for example, in 2004. This year, the increase of exports from the region, associated with the significant increase of investment (mainly public, in infrastructures), permitted an increase in the growth rate, this from 5% in 2003 moved to 6.3% in 2004. The drop on growth in China and of other purchasers (United States and Europe but also Japan) estimated for 2005 will be responsible, in part, for the reduction in growth rate of the group of economies in Southeast Asia (5.4 – 5.6, 6% in 2005 and 2006 respectively).

As for the region where Timor-Leste is located, it is worth it to follow closely the evolution of the economies in Indonesia (our main supplier) and Australia.

Indonesia is facing in the last couple of years a rapid economic growth and relatively stable: around 5% per annum in 2003 and 2004. Recent indications of the country Central Bank points to a growth rate for production in the range of 5.5% to 6%, while the Government bets in a higher rate of this range. The effective value will depend on the oil prices evolution, from which the country is producer (however it became the net imports for the last years), but in truth, these growth rates are more positive towards the economy evolution. For 2006, there are forewarnings that this rate will remain high (around 5.7%).

This evolution, is in part, a result of a consistent economic policy and, in particular, of a monetary policy supportive of growth, trying to maintain a monetary supply that allows the maintenance of attractive interest rates for the investment. However, simultaneously, try not to punish heavily those with bank savings, since they tend to receive negative real interest rates, as an incentive to consume and make pressure to the inflation rise.

The rapid mutability of the monetary supply has a price: ***inflation rates*** that are one of the highest in the region (6.1% in 2004 but there are estimative that, due to subsidy cuts to oil goods, it can reach 9-10% in 2005).

An elevated inflation rate (compared with 2004 of 1.4%, 1.7% and 2.7% in Malaysia, Singapore and Thailand, some of the main country competitors in the world market) forces a policy of exchange rate that maintains the external economic competition. This allows the maintenance of high export rates (12.6% in 2004 and, probably, around 15% this year, profiting in part with the increase of oil exports). Therefore and on average there was a lost of value for the rupia between 2003 and 2004 (from 8465 IDR/USD to 9270 IDR/USD) which have accentuated this year – the actual exchange rate (end of September 2005) is around 10300 IDR/USD.

The monetary policy pursued is also responsible for the interest rates that, as referred before, are, in real terms, relatively inviting for the investors – that have taken advantage of the circumstances and, with that, contributed to the improvement of the country's economic position. In fact, the last 3 months interest rate of the monetary market was, at the end of this year first quarter, in the vicinity of 8.3% that, if confirmed the inflation rate of nearly 7.7% this year, would result in a real interest rate of less than 1%.

The increase in expectation towards the inflation rate (to nearly 9-10%) will change the perspectives of both the investors, which will face difficulties, and the consumers, driven to purchase before the price rise – if they have real income that will let them do it…

As for the Australian economy, one must observe firstly, the rapid economic growth that took place in 2004 (4.1%), somewhat higher to the one registered in previous year. However, for this year (2005) the expectation is to see a drop to nearly half of the product growth rate: 2%. This tendency was present in the second half of last year and is because of the decrease in internal consume. This, according to OECD, moved from a growth of 6.3% in 2003 to 4.4% in 2004, and the expectation is that will drop to 3% in 2005 as a result, above all, of the decrease in private consume – 5.4% in 2004 and 2.6% in 2005. Furthermore, the net exports (exports – imports) have known negative growth rates, especially in 2003 and 2004, and the probability is that the situation improve partially (but maintaining the negative rates) in 2005 due to the decrease in the level of growth of imports as a result of the economic slow down.

The relatively rapid economic growth endorsed the gradual reduction of the ***unemployment rate***, which will stabilise at around 5% in 2005, after reached 6.4% in 2002.

The ***inflation*** rate, in turn, have maintain relatively stable near the 2.5% because of the monetary policy adopted by the Reserve Bank of Australia, which established the benchmark of 3%.

The AUD ***exchange rate*** face to USD suffered a stable appreciation at the start of 2005 but after that dropped down slightly, with estimates that will remain at the end of this year around USD 0,70 per AUD (USD 0,76 by mid August 2005).

Completed the analyses of the international economic evolution, will focus now in some elements related to the economic evolution of our country for the period covered by this report.

Oil and natural gas: actual importance

1 – The various sources of energy and their relative importance

The oil and natural gas are two of the principal sources of energy of the contemporary world. These two sources of energy represent actually, by itself, near 60% of the energy consumed in the world, with the oil representing around 40% and the natural gas 20%. This last one has increased its relative importance during the last couple of years.

The remaining sources of energy (coal, hydraulic energy and nuclear energy) are responsible for the remaining 40% do the world expend in energy and is noted the supremacy of coal, which have a relative importance slightly superior the natural gas.

However, the relative importance of each of the energy sources referred above is different from region to region. As a fact, in the United States and in Europe the oil and natural gas represents near 2/3 of the energy use, with a minor vantage for Europe in the use of natural gas and of the United States in the use of oil. On the other hand, in the Asia-Pacific the use of coal is significant and by itself represents sensibly the same as the use of oil and natural gas. The situation in China, a big producer and consumer of coal, influences vastly this position.

Nevertheless, the difference between the various world regions (and countries) is not only due to the structural type of the energy used. Besides, the consume *per capita* can also be a factor that marks the big differences between countries and regions, being obvious the importance of the Unites States – and of the Saudi Arabia, maybe with a smaller population scale.

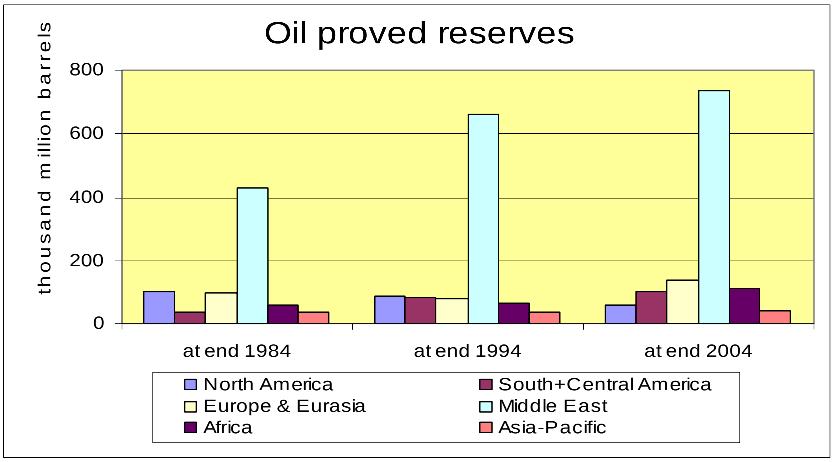
Knowing that several of these energy sources are not-renewable – as the oil, coal and natural gas -, one of the questions that can be put forward is to know what the estimated magnitude of each of them is: 10 years? 50 years? 100 years?

Last century, in the early seventies, an important study was published – the so called “1st Report of Rome Club” – that, considering as data the rate of use of oil at the time and the product reserves which were known then, calculated that the “black gold” will deplete completely by end of 2000. This was, at the time, a big shock on the basis of the importance of the product in the production of energy, viewing its lost as a risk to the way of life and, principally, of the industrialised countries.

Today it is of agreement that the existing reserves correspond to around 40 years of production similar to the one in 2004. This will cause the possibility of oil vanishing before we reach the mid of this century, hence its necessary to look for alternatives, probably, in the renewable energies (wind, solar, hydraulic, etc.) but also considering the nuclear energy – as long as it is possible to limit eventual disasters.

2 – The oil in the modern world

The oil is regionally distributed in an unequal fashion as can be seen in the opposite graph: The majority of known reserves are in the Middle East (62%). 72% of these reserves are in countries that are members of OPEC; 10% are in the old Soviet Union and the remaining 15% in non-member countries of OPEC, more precisely western countries.



In regard to the effective world production, the Middle East produced, in 2004, 31% of the world total. They are followed by the total of Europe and Eurasia, with 22% (including 12% from the Russian Federation), the North America, with 17% (8.5% of the United States), the Africa with 11% (almost half in Nigeria and Angola), the Asia-Pacific, with 10% (almost half in China) and the South and central America, with near 9% (4% in Venezuela). The three main individual producers were the Saudi Arabia, with 13% of the world production, the Russian Federation, with 12% and the United States, with 8.5%. The Iran, with 5.2% was the fourth producer, followed by Mexico (4.9%).

The picture of consume is somewhat very different. The United States front the list of main consumers with 25% of the world total corresponding the an average of near 20 million barrels per day (in 2004) when the second consumer, China, use 8.2% of the total (6,7 million barrels), followed by Japan with 6.4% (5.3 million). The Unites States produce only 7.2 million barrels per day and needs to import near 12,8 million barrels, i.e., almost double the quantity they produce. China produces 3,5 million and consumes 6,7 million barrels per day, necessitating to import 3,2 million, almost as much as what produces. The OECD countries consume 60% of the total, with the Economic European Countries, overall, consuming 18.4% (14,6 million of barrels per day), making it, as a group, the second consumer after the United States.

It is also important to stress the different ***stage of consumption growth*** between the various countries. While the use in the United States increased 2.8% in 2004 relatively to 2003, the rise in China was of 15.8% because of the quick economic growth of the country.

The different capacities of production and needs for consume creates one *international market* between the different regions. This have become very important, with the Middle East region playing a fundamental role in the supply to almost all areas of the world – from Europe to the United States, from Japan to China, as examples – by providing near 975 out off the 2400 million tons of oil marketed internationally. Therefore, whatever happens in that world region will have a determinant impact in the evolution of the oil economy at the world level. With 320 million tons provided, the former Soviet Union is the second world supplier, followed by West Africa, with 200 million, offered by the “giants” Nigeria and Angola.

As per Asia-Pacific, it is important to reiterate the geo-strategic importance of the South East Asia for the reason of being the mandatory route for the major part of the supply flux in the region. Near 630 million tons arrive from Middle East (more than half of the imports of Asia-Pacific), which will make it the most dependent region in the world (absorbing around 2/3 of the exports).

3 – Natural gas

The natural gas in considered the “younger brother” of the oil. For example, in 1980, world consumption use was a slightly more than 1/3 of the oil although today is almost 2/3. Its relative importance as a source of energy have increased significantly over time, what is not strange as a result of being cheaper per unit of energy produced and less polluted.

The known *reserves* are concentrated essentially in two regions: The Middle East with 41%, and the Europe and former Soviet Union, with near 37%, which computes to almost ¾ of the world total. The third region with big reserves is the Asia-Pacific, particularly the South East Asia.

The principal production regions are the North America (essentially the United States with 20% of the world total) and the Western Europe and former Soviet Union, with 39% of the world total production. The Asia-Pacific is responsible for 12% of the production.

The world *consumption* is concentrated essentially in the United States (24% of the world total) and in the Russian Federation (15%), but Western European countries (mainly the United Kingdom and the Germany, but also France) have increased their use in the last couple of years.

The *consumption* per capita increased significantly and the main consumers are the producing countries, nonetheless nowadays there is an important *international market* for the product through, mainly, a vast network of pipelines that link, for example, the former Soviet Union region, and Algeria, in North Africa to Europe. The commerce through this system was near the 500 billion squares cubic (2004), while the use of liquid gas (LNG, as the one to be produced by the Timor Sea) was around 180 billion.

4 - Prices

In its "Economic Bulletin", mainly in the last numbers, the BPA have started to give basic information regarding the evolution of prices in the international market for the last periods. We direct the readers to these analyses and in here just refer to the oil price evolution by BTU (*British Thermal Unit*, a measurement unit of the energetic potential of each raw material) for the crude compared with the natural gas and of LNG.

In 1990 the LNG in Japan cost 3,64 USD per million of BTUs, value that increased to 4.72 USD in 2000 and 5.18 in 2004. The natural gas cost in the same years and in the United States (Henry Hub). Respectively, 1.70 USD, 4.23 USD and 5.85 USD. The crude, in turn, cost (average from the OECD countries) 3.82 USD, 4.83 USD and 6.27 USD.

Hence it confirms that, per unit of heat produced, the natural gas is cheaper that the crude, as well as less polluted.

Source: *BP Statistical Review of World Energy*, July 2005

Mirrors; Oécussi

Recent evolution of the national economy

Production

In the previous reports, as well as in some of our quarterly "Economic Bulletin" editions, we call the attention to the difficulty in following the evolution of the national production as a result of non-existence, in a systematic way, of the Timor-Leste "national accounts" from the National Directorate of Statistics in the Ministry of Planning and Finance. We acknowledge the efforts done, as we know, in order to overcome this gap in the national statistic system.

What was not done by us, was nonetheless done by external entities to the country, namely the International Monetary Fund (IMF) and the *Boston Institute for Developing Economies* (BIDE). However, not always these two entities have agreed in the estimated values for the national production and, more, their own calculus have been subject to subsequently reviews, making the published numbers in a year different from the one published before. The introduction review of values of the national accounts is, by itself, a normal procedure en situations like the one in our country, where the "basic" information are relatively precarious and, as such, subject to great amendments whenever there are data to do so. It was what happened recently with the introduction of profound reviews of the previous estimative about the national production.

Compare, for example, the data published by IMF, when they organised the analysis of national economy under the IMF Act, Art. IV. The bellow table, in the analysis for 2004 and 2005, portrays the production evolution:

	1999	2000	2001	2002	2003	2004e	2005p
FMI: Artº IV - 2004	-35	15.0	14.6	3.0	-2.7	***1.0***	--
FMI: Artº IV - 2005	--	15.4	16.6	-6.7	-6.2	***1.8***	***2.5***

Note: the figures for 2004 and 2005 are estimative and projections

What is relevant to point here is the great disparity between the figures for the years of 2002 and 2003 (essentially in the first, at the time of independence and withdraw of the UN personnel). This difference is in the figures estimated initially and the results of the subsequent revision – namely by BIDE and IMF used that as bases for their own review of the estimated production evolution.

The amplitude of this dimension, between the previous estimative and the subsequent ones are not common, when they are signalling economic behaviours of contrary sign (satisfactorily positive in 2004 and very negative in 2005). These divergences emphasises the need of, urgently, Timor-Leste start to calculate, as a regular matter, the referred National Accounts. As a consequence, the risk of the divergences between the estimated of evolution and the reality places an effect in the quality of the economic politic persecuted and to become dependent on calculus methodology that may not be the most desirable ones – as, apparently, have occurred in the recent past and that helps to explain the differences in estimative.

The study by BIDE presents, in turn, the following figures (below table):

GDP by industrial origin at constant prices of 2000

(USD Million and % of variation)

Sector	2000		2001	2002	2003	
In millions of USD (the figures between brackets correspond to the structure of production)						
Agriculture	81.5	(20.7%)	88.6	93.9	93.5	(25.0%)
Extraction Industries	81.2	(20.6%)	54.2	51.0	54.4	(14.5%)
Transformed Industries	8.7	(2.2%)	10.9	11.0	11.0	(2.9%)
Electricity and water	2.6	(0.7%)	1.4	2.7	3.3	(0.9%)
Construction	43.3	(11.0%)	44.1	36.9	28.8	(7.7%)
Commerce, housing and renovation	24.7	(6.3%)	25.6	23.9	23.3	(6.2%)
Transport and Communications	22.9	(5.8%)	25.4	27.4	29.3	(7.8%)
Financial, patrimonial and entrepreneurial Services	20.5	(5.2%)	24.1	24.8	24.5	(6.5%)
Other services	108.2	(27.5%)	144.5	120.0	106.4	(28.4%)
From which: UN	*83.4*	*(21.2%)*	*91.5*	*60.3*	*38.6*	*(10.3%)*
GDP total	**393.7**	**(100%)**	**418.8**	**391.7**	**374.4**	**(100%)**
Same without UN	*310.3*		*327.3*	*331.4*	*335.8*	
% of variation in relation to previous year						
Agriculture			8.7	6.0		-0.4
Extraction Industries			-33.3	-5.9		6.7
Transformed Industries			25	1.1		-0.4
Electricity and water			-47.3	93.3		22.9
Construction			1.7	-16.2		-22.0
Commerce, housing and renovation			3.6	-6.6		-2.7
Transport and Communications			10.8	8.0		6.8
Financial, patrimonial and entrepreneurial Services			17.7	2.9		-1.5
Other services			33.6	-17.0		-11.4
From which: UN			*9.7*	*-34.1*		*-36.1*
GDP total			**6.4**	**-6.5**		**-4.4**
Same without UN			*5.5*	*1.3*		*1.3*

Source: Tables 8 and 9 of DNE/MoPF *Timor-Leste National Accounts, 2000-2003*, March 2005

As a result of different methods of calculation, there are some differences between the growth rates mentioned in this table and the ones referred in the IMF document. The more salient difference is the one related to the year 2001.

Although without practical significance for not being possible to separate the effects of the UN presence between us as an element perfectly autonomous, it is however curious to emphasise that the growth rates calculated by BIDE without the UN, was always positive in all three years covered. We say again that the use of this information cannot stretch. However, it must be considered that either from the production view point or from the international market view point (to be studied further in the report), only now our country shifted to a certain "normality", which will make more difficult the comparisons between the period of strong UN presence and the future years. We have to be alert to this fact because the environment we lived in until now has been absolutely, "artificial".

The State Budget information complements the information about the National Accounts and the production evolution and offers us the structure of production according to its origin for the period of 2000 to 2003:

Production by sector of origin (USD million)

	2000	2001	2002	2003
Oil	77.5	50.4	47.8	51.9
GDP non-oil	***316.2***	***368.4***	***343.9***	***322.5 (100%)***
Food	68.6	76.0	73.9	68.9 (21%)
Government	106.3	142.7	118.0	104.5 (32%)
United Nations	*83.4*	*91.5*	*60.3*	*38.6 (12%)*
Other (Public Administration, etc)	*22.9*	*51.1*	*57.7*	*65.9 (20%)*
Private sector	141.3	149.7	152	149.1 (46%)
TOTAL	393.7	418.8	391.7	374.4

Source: *SB 2005-06*, table 3.1

Note that in the 1st three years the oil production represented, on average, near 14% of the non-oil production. This situation changed significantly in 2004 with the opening of the oil exploration area in Bayu-Undan. According to the State Budget, will be the main responsible for the evolution of what is expected of oil product during the fiscal year (and not civil year) of 2004-05; almost double the GDP for non-oil as a result of the great increase in oil prices (refer to other section of report).

Given the nature of the oil exploration in the Timor sea, the repercussions on the non-oil product will be minimal, situation that can change drastically in future if, as a result of the negotiations in place, it is possible to install in national territory the facilities that will support the exploration of the petroleum zone of Greater Sunrise.

Lastly and taken advantage of the information available in the GBS document, the Government estimates for the fiscal years 2005-06 to 2008-09 the following growth rates for the GDP of non-oil products:

Estimated medium growth rate per year of the GDP non-oil according to GBS 2005-06

2005-06	2006-07	2007-08	2008-09
6%	4%	4%	3%

Source: *GBS 2005-06*, table3.3

Firstly, the significant difference between the product growths rates in 2005, estimated by both the IMF and the Government: 2.5% in the first case and 6% in the second. The fact that the IMF estimate refers to the civil year of 2005 and that the Government estimate concerns fiscal year 2005/06 is certainly part of the explanation for the difference in results. However, the above fact seems to be too broad to justify this difference. Unfortunately, there is no information available to help us establish which is the most realistic, and because we do not know neither the method of calculation used by both parts and nor the related assumptions. The future will tell.

In second instance, note that these rates, if occurring, will have a repercussion in the increase, slightly reduced, of the product per capita. This is due to the great population growth rate of the country (near 3% per year according to the latest statistics; the recently published Human Development Report of 2005 attributed to Timor-Leste a population growth rate of 4.9% for the period 2003-2015).

Therefore, the need to find acceleration mechanisms of the economic growth that allows, in a consistent way, the contribution for the generalized improvement of the population economic and social conditions and, namely, the reduction of the high poverty level that exists among us as a way to meet the goal defined for the Millennium Development Goals.

This evolution of non-oil production growth rates will become more relevant when is certain that, continue to verify, our relative position compared to out partners in South East Asia –and, in general, the East Asia – will continue to decline. This evolution can be confirmed with table 1.2, where it is illustrated that the production growth rates in all the main countries of the region are superior to the rates of Timor-Leste.

To change this perception there is a need for a supplementary effort, which will require actions either at the level of "production of goods and services" (need to increase) and/or "production" of people (need to decrease), even if only possible in the long term.

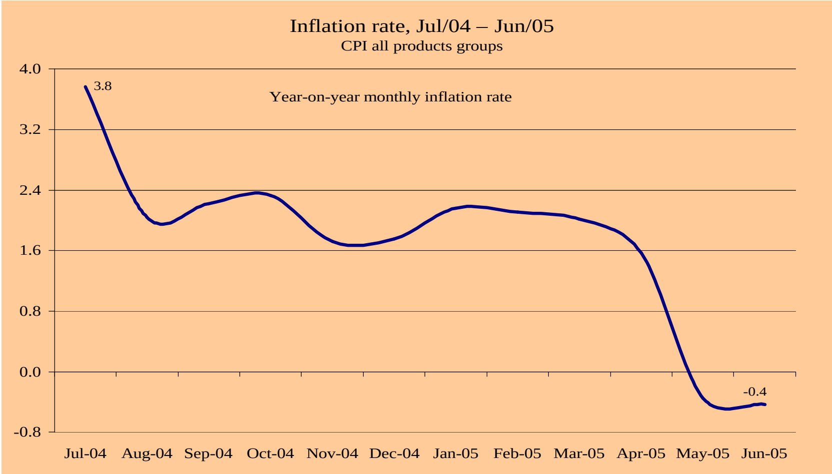
As for the first, the construction of infrastructures – roads, new and rehabilitated schools, hospitals, etc. – and a particular attention to the improvement of the housing sector of the country – principally in the 2-3 biggest cities – are two lines of action that looks fundamental and to which the government will be aware off. Recent news about the study of reorganization of the territory in Dili and Baucau can be the signal that something is happening in this domain, very important also for the beneficial effects that will bring to public health.

Returning to the analysis of the product growth rates as presented in the national accounts disseminated by IMF, must be noted the significant alteration in the situation between 2002 and 2003, by one side, and 2004, on the other hand, with those years registering strong negative rates (higher that –6%) and this one showing an increase of 1.8%. This increase was mainly due to the recovery of the agriculture sector after a period of draught and to the good performance of the banking sector, specifically to the increase of near 50% of credit provided and which have impacted positively on the production, essentially the private sector (ex: construction).

Prices

In the last fiscal year the inflation decreased, reached the –0.4% in June of this year compare with the same period of 2004. In the previous fiscal year, the inflation was near the 4.2%. If we take into consideration the civil years – and, as such the figures of December each year – and not the financial years, the inflation rate for 2004 was 1.8%, bellow the 3% from some estimative.

The decrease of the inflation rate was due mainly to the reduction of the prices variation rate in several categories of products, principally in food, that have an impact of 56.7% in the calculation of the Consumer Price Index (CPI). This incurred a slide down on value of –3.9% during the twelve months that ended in June last, thanks, between other factors, to the good supply of markets as a result of increased production with the end of the draught season and a better production transport mechanisms.



The decrease of food prices was due to a slide down of –6.2% from "Cereals, roots and its products prices and of –1.4% from "vegetables". The first group includes the rice, the main cereal consumed in the urban areas.

Nonetheless, other category of products will put pressure to increase the prices; on the contrary, as a result of the low impact on CPI they will not affect significantly the inflation rate. The categories "alcohol and tobacco", housing" and "transport and communications" where the prices index increased, 9.8%, 7.7% and 9.6%, respectively, reflects that. These rises were a result of the increase in costs of transport, a consequence of the oil prices increase.

Consumer Price Index, 2004-2005

(December 2001=100)

Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2004												
CPI	**113.8**	**113.9**	**114.1**	**114.6**	**116.5**	**116.3**	**116.2**	**115.0**	**114.9**	**115.2**	**115.3**	116.1
Monthly rate	-0.2	0.1	0.2	0.4	1.7	-0.2	-0.1	-1.0	-0.1	0.3	0.0	0.7
Y-o-Y Monthly change*	4.2	4.1	2.8	4.0	5.9	**4.2**	3.8	2.0	2.2	2.3	1.7	**1.8**
2005												
CPI	116.3	116.3	116.4	116.4	116.1	115.8						
Monthly rate	0.2	0.0	0.1	0.0	-0.3	-0.3						
Y-o-Y Monthly change *	2.2	2.1	2.0	1.6	-0.3	**-0.4**						

Source: National Directorate of Statistics **Annual Inflation Rate** **Fiscal Year 2004/05**

NOTE: * variation relative to the same month of previous year

Year-on-Year monthly inflation rate by groups of goods (%)

GROUPS	Jun-03	Dec-03	Jun-04	Dec-04	Jun-05
Food	8.1	14.0	7.8	2.5	-3.9
Alcohol and tobacco	20.4	32.8	-9.7	-12.7	9.8
Clothing and footwear	13.6	26.0	1.7	3.5	0.8
Housing	8.8	6.5	0.9	4.9	7.7
Housing Furnishings, etc	3.1	8.7	-3.3	-2.5	-1.6
Health	1.5	-1.5	4.1	3.6	8.2
Recreation & Education	3.4	1.7	-1.8	-1.2	-0.1
Transport & communications	2.4	-1.9	2.3	6.9	9.6
TOTAL	***8.2***	***4.2***	***4.2***	***1.8***	***-0.4***

An analysis of the behaviour on the monthly variation rates of CPI in these twelve months for the fiscal year 2004-05 presents a tendency relatively consistent with its the slide down or, at the minimum, with its stability. The major increases happened in October and December of last year and the higher slide downs in May and June of 2005. In total as we have referred before, there was a drop of –0.4% between June 2004 and June 2005.

International Trade

Until now the principal and, virtually unique, export product in Timor-Leste has been the coffee, and is the only product that has accurate statistical information collected. The country emerges as a mono-exporter, in this instance the coffee – this if we exclude the oil products exports that have intensified in middle of 2004.

The main client of our coffee continues to be, according to the statistics provided by the national Directorate of Statistics, the United States of America:

59% of product (in value) was exported to this country, followed by 15% exported to Indonesia. Our third client is Germany with 10% of our exports, which have reached USD 6,5 million in the fiscal year in question.

Evolution of the international price of rice

According to FAO, a specialized UN agency for food and agriculture (see FAO *Food Outlook*, June 2005), the international price of rice progressed as illustrated in the bellow graphic (2004 and first months of 2005). As seen, there was and escalated increase of price in the last months of 2004; in 2005 the prices maintained a stable level, although high.

The estimative pictures a slide down on prices that have started to note since March this year.

For a country like Timor-Leste, that imports the big majority of rice consumed, this can mean less pressure for the rice prices rise in the national market and, with that, less pressure on the inflation rate which can maintain itself at a low level, as it happened recently.

Export of coffee by country of destination
(Fiscal year 2004/05)

Country	Export (USD)	% of total exported
United States	3,815,213	58.7
Indonesia	973,801	15.0
Singapore	140,614	2.2
Portugal	588,041	9.0
Australia	319,414	4.9
Germany	664,039	10.2
Total	**6,501,122**	**100.0**

The global value of exports seems to stabilise be more or less. An increase in the short-term can result from two factors: an improvement on the international market price and improvement on the medium quality of product exported. In the actual framework of applied techniques of production the gains with production come across as relatively limited.

Considering this last aspect, the changes occurred with the last governmental restructure seem to be significant in regards to the direction they want to pursue by creating an specific Secretary of State to deal with coffee (and forest) issues. It is expected that this new structure can deal efficiently with the issue of increase in the national coffee quality, engaging since production until release in the markets, which will allow the increase of receipts by kilo of coffee produced and, consequently, increase the farmers' income.

Evolution of coffee's international price

In March 2005 the price of coffee reached 101,44 USD cents for libra in weight (1 lb = 453 grams, therefore 1kg = 2,2 lb; this value of coffee corresponds to near USD 2,25 per kilo). This price corresponds to an increase of 67% relatively to the value payed for the coffee a year before and is the result of significative alterations in the conditions of the coffee international market: reduction of production, increase of consumes and slides down of stocks. During the agriculture year of 2005/06 (Oct 05 to Sep 06) the production should decrease relatively to the previous agriculture year of near 6% as a result of the slide down in production by the two main producers: -18% in Brazil and -11% in Vietnam. This will have a reflection in the continue increase of coffee prices in the international market. It seems like, for the time being, that the recent crisis that led to lower prices will abate.

If considering coffee as the only export product that can be seen as truly national, the truth is that the Timor-Leste external commerce is much more complex.

In 2004 and during the first quarter of 2005 the total international commerce of our country was as follows:

TIMOR - LESTE: International Trade Statistics

	Imports			Exports			Balance	"Trade" Balance
Month/Year	**Commercials** (US$000)	**Non-commercial** (US$000)	**TOTAL** (US$000)	**Exports** (US$000)	**Re-export** (US$000)	**TOTAL** (US$000)	**TOTAL**	(5) – (2)
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
January/04	8.630	5.370	14.000	77	7.496	7.573	-6.427	-8.553
February/04	7.902	3.548	11.450	1.036	2.254	3.290	-8.160	-6.866
March/04	8.368	3.073	11.441	106	11.271	11.377	-64	-8.262
April/04	7.723	2.385	10.108	106	4.843	4.949	-5.159	-7.617
May/04	6.656	2.938	9.594	303	10.030	10.333	739	-6.353
June/04	8.122	1.956	10.078	323	52.694	53.017	42.939	-7.799
1º Quarter	**47.401**	**19.270**	**66.671**	**1.951**	**88.588**	**90.539**	**23.868**	**-45.450**
July/04	16.770	1.556	18.326	828	1.835	2.663	-15.663	-15.942
August/04	9.943	1.751	11.694	1.093	1.241	2.334	-9.360	-8.850
September/04	10.185	1.657	11.842	1.318	106	1.424	-10.418	-8.867
October/04	8.900	6.075	14.975	973	4.869	5.842	-9.133	-7.927
November/04	10.663	1.057	11.720	835	940	1.775	-9.945	-9.828
Dezember/04	9.623	1.282	10.905	338	753	1.091	-9.814	-9.285
2º Quarter	**66.084**	**13.378**	**79.462**	**5.385**	**9.744**	**15.129**	**-64.333**	**-60.699**
2004 (Year)	**113.485**	**32.648**	**146.133**	**7.336**	**98.332**	**105.668**	**-40.465**	**-106.149**
January/05	7.044	716	7.760	298	459	757	-7.003	-6.746
February/05	8.190	1.045	9.235	1.280	7.255	8.535	-700	-6.910
March/05	12.117	1.073	13.190	207	662	869	-12.321	-11.910
April/05	7.392	1.134	8.526	226	1.141	1.367	-7.159	-7.166
May/05	7.013	693	7.706	71	3.872	3.943	-3.763	-6.942
June/05	7.217	206	7.423	79	15.047	15.126	7.703	-7.138
1º Quarter/05	**48.973**	**4.867**	**53.840**	**2.161**	**28.436**	**30.597**	**-23.243**	**-46.812**

NOTES: The **"commercial" imports** of goods exclude the figures of goods imported for use by the foreign Embassies and High Commissioners, goods imported for the supply of foreign army forces and goods imported by UNMISET. The goods imported by organizations mentioned before are classified as "non-commercial imports"; **exports** are goods that include at least 50% of the Timor-Leste national added value; the **re-exports** are goods exported that were previously imported to Timor-Leste and that include at least 50% of the national added value.

From the above table one can conclude that Timor-Leste commercial imports had an increase of near 3% between the total of 2004 first quarter and 2005 first quarter, which can be a sign , although slightly shaky and insufficient , that there was an improvement of the economic activity level in our country.

Must be noted that the "non-commercial" imports has, as one can expect face to the progressive "phasing out" of UN, a strong contraction between the two referred periods: of USD 19 million in the first quarter of 2004 to something less that 5 million in 2005 first quarter.

In relation to the commercial exports – which are limited to coffee and little less -, they increased from 1, 9 million USD in the first quarter of 2004 to 2,2 million in 2005. Note that the export of this product is highly seasonal, concentrating its production principally in the second quarter and not in the first.

Because of this evolution, there was a large deficit in our balance (effectively) of external commerce ("exports"-"commercial imports" in the above table): near USD 45,5 million in the first quarter of 2004 and 46,8 in the correspondent quarter of 2005.

The total for 2004 was of USD 106 million. However, the total balance of exports and the total imports were of a much of a much lower value (-USD 40 million) as a reason of the big volume of re-exports which have occurred in the months of May (USD 10 million) and June (USD 53 million) as a result of the end of the UN personnel.

Although there was this big "commercial" deficit – the commercial exports of 2004 were just 6.5% of the "commercial" imports – its curious to see that at the end of fiscal year 2004 (USD 186,6 million), the total net availabilities on the exterior retained by Timor-Leste allowed to pay 1,6 times more the 2004 imports, i.e., almost 20 months of imports. This was possible due to the big increase in oil profits. If we repeat the calculations with June 2005 net availabilities (USD 355 million) and the 2005 first quarter monthly average of commercial imports, then "the coverage" will be 43,6 months, almost three and half years.

As in many situations, this reality can be seen (at least) as two similar perspectives to "glass half full" to some, or "half empty" to others: one tells us that we are in a comfortable financial situation and almost unique in the world…

The other tells us that this proportion only occurs because the imports were lower than normal if our development level was higher and if there was a quick economic growth. In this case, the imports will be higher because include an important component of import of equipments, more expensive than consume goods, and allow accelerating the growth and, eventually, the exports. It is probable that this will be the future forecast.

Types of products of international commerce

We mentioned before that (almost) the only export product of our country and as such accounted for in the statistics are coffee. However there are many other products that leaves our country: which, almost integrally, products repatriated by UN – UNMISET, inclusive the military and civil components – and other international agents either to their own storehouses or to the countries that supported the military presence in the ground. These goods constitute the re-exports identified in the statistics of international commerce of our country and classified as imports, at the time of arrival in the country.

As for the imports, the principal groups of products were the following (see bellow table):

Group of imported goods		1º quarter 2004		Fiscal Year 2004/05	
		USD Million	%	USD Million	%
27	Oil and derivates	12.3	17.4	39.6	33.9
87	Vehicles	11.5	16.2	12.7	10.9
85	Equipment electric and parts	6.3	8.9	10.4	8.9
10	Cereals (including rice)	4.8	6.8	6.2	5.3
84	Mechanic appliances	3.7	5.2	5.3	4.5
30	Pharmaceutical products			3.2	2.7
19	Wheat and other cereals derivates, etc			2.3	2.0
	TOTAL			**79.7**	**68.3**

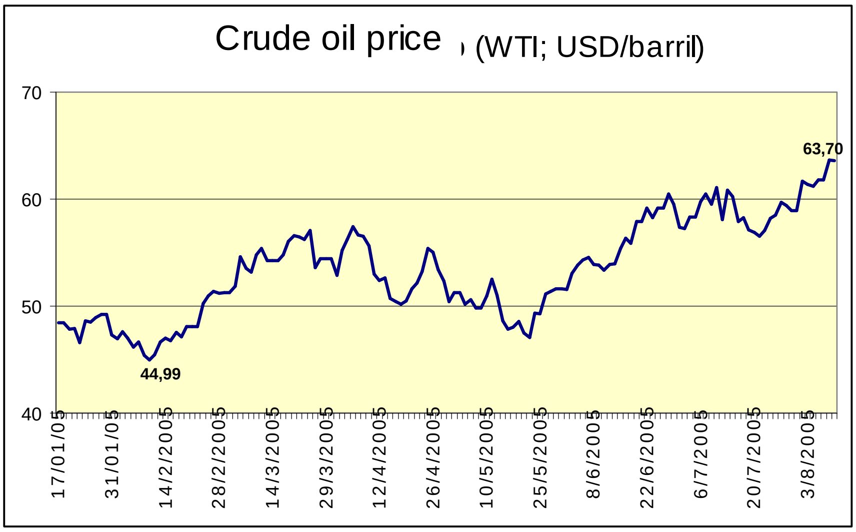
Note: the figures are the sum of CIF values (before taxes and rates), paid rates and value of the exempt products.

Evolution of the international oil price

Several factors have transpired in the last couple of months to impact in the significative increase of the crude price. They range from bad weather (which affected, several times, the production in the Mexican Golf), to concerns related to the political and social arrest in Nigeria. They are problems with the production and export in Iraq to the difficulties of production in former Soviet Union, increase of demand from western countries to the great increase of demand (and acquisition in the international market) of oil by China as a follow up to the rapid economic growth in the last years (near 8-9% per year).

Another aspect – increase of oil price – is the difficult expansion of product offer - either crude or, mainly refined – which results, in good part of the weak investment done in the refinery area some years back, when the price of crude was lowest than the present one, positioned at the end of 2001 on a lower value at near 17 USD per barrel (in less that 4 years, the value have almost increased four times!...).

In mid 2004, the price was near 37 USD per barrel at the beginning of this year positioned around 45-47 USD per barrel, having since then increased near 40%. These increases are forcibly reflected in the price that the end consumer has to pay – essentially the drivers – and, hence the inflation rate.



Planning the management of the Timor-Leste Petroleum Fund

The idea to create a Petroleum Fund to manage the oil health of the country in benefit of the present and future generations is prior to the obtention of full sovereignty in 2002. The BPA regulation (2001) and the Republic Constitution (2002) predicted the establishment of the fund. All royalties received since 1999 banked in an account managed by BPA known as "Timor Gap Account". The account was created as an embryonic account of the future Petroleum Fund and the accumulated balance at the end of June 2005 was 70 millions USD. At that time, the account closed and used as initial capital for the Petroleum Fund.

In 2004, the RDTL Government started an initiative to give the required legal base to this Fund. It was then elaborated a law, that was discussed afterwards in process of public consultations and presentation of suggestions since end of 2004. This exercise culminated with the endorsement by the National Parliament, in June 2005, of the final version of the law.

Although the ministry of planning and finance conducted the process, BPA was also involved from the beginning in the process of drafting the Law. This attributes to the Ministry of Planning and Finance the responsibility maximum for the management of the Fund but delegate to BPA the responsibility for the operational management of the Fund.

A management agreement regulates the relationship between the Ministry and BPA, and establishes the way by which BPA must implement the orientations about the management of the Fund assets.

The BPA have the following fundamental responsibilities in relation to the Fund:

- Invest the assets as per mandate delegated by the Ministry of Planning and Finance. The initial mandate give the authority to manage the Fund in such a way that the profit is comparable with the international index through the exclusive investment in titles of the United States Treasury with a maturity of five years;
- Receive all entries of new capitals in the Fund and all incomes of investments in an account specially open and used for this effect. This account is already created in the name of BPA near the Federal Reserve Bank of New York;
- Maintain the account books of resources of the Fund in name of the National Treasury. Although the assets are on BPA's name, the accounting is done in books totally independent from the ones used by the current activities of the Authority;
- Designate dealers, brokers, and custodian entities for the values as well as other financial intermediates. In the initial period of the Fund, BPA established the necessary agreements in order for the market transactions and custodian of value functions be secured by the Federal Reserve Bank of New York;
- Designate external managers for the Fund's assets. During the initial period the resources of the fund are managed by BPA to gain the necessary experience to delegate and supervise the activities of the external managers of commercial nature;
- Prepare and present management reports to the Minister of Planning and Finance and to the public in general. The Petroleum Fund Law defines the need to present quarterly reports with an high level of transparency;
- Maintain the Secretariat of Consultative Committee for Investments (CCI). This Secretariat is responsible for the organisational aspects of CCI functioning as well as the coordination of advisory activities organize by the CCI.

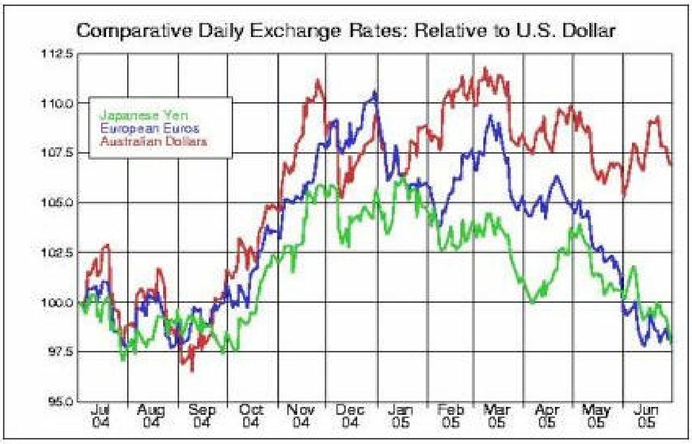
To be able to deliver its operational responsibilities BPA set up an autonomous Department for the management of the Petroleum Fund under the management of an Executive Director. The new Department have the roles of front and middle office in regards to issues related with the management of the Fund. However, the existent BPA structures will perform the functions of back office. The staff of the Division of Economic Studies and Statistics of the Authority will perform the responsibilities of the Secretariat of CCI, under the management of their general-manager.

The extension of BPA investment mandate by the Ministry (and, consequently, the incomes susceptible of gaining) will depend of the level of development of the capacities of BPA. There are still, at this time, a great vacuum and need for development of our human capital and this will be one of the principal priorities of the board of the Authority.

The operational management of the Fund required also the introduction of new systems and technical infrastructures of management. Some of them are related to information about the developments in markets (Bloomberg) and payments, mainly international (SWIFT), which are in the process of being acquired. The same occurred with the need for an appropriated new accounting system. BPA signed an agreement with Timor Telecom to supply special telecommunication facilities dedicated to the needs. A system to protect the data against natural disasters and others is in the development stage.

All these initiatives establish the necessary conditions to start the operational functioning of management activities for the Petroleum Fund and are the basis upon which future developments of our capacities in managing the Fund will evolve.

Exchange Rates



Continuing a movement that started in mid 2001, the USD continues to lose value in relation to the main currencies (Euro and Yen) through the first quarter of the fiscal year 2004-05. However, in the second half of the period noted a recovery of the USD, less intensive in the case of Australian dollar, which maintains its strength. As such, the Euro and Yen ended the fiscal year in a position relatively similar to the one at the start of the period (each dollar trading near 0,82 Euro cents) in relation to the USD.

The same happened with several Asian currencies, with exception of the Indonesian rupia which had a loss of value in regards to USD through almost the whole period. This was the method used by the Indonesian authorities to try to defend the competitively of the country in relation to the exterior through an inflation rate higher that the one in other countries in the region and the United States.

Note that this behaviour of the rupia is contributing to the low inflation rate in Timor-Leste because half of our imports come from this country.

Exchange rates		
Start and end of fiscal year 2004-2005		
	01/07/04	30/06/05
Yen (JPY/USD)	108.85	110.58
Dollar Singapore (SGD/USD)	1.7184	1.6864
Rupia Indonesia (IDR/USD)	9411.4	9715.5
Euro (USD/Euro)	1.219	1.206
Dollar Australia (USD/AUD)	0.699	0.761

Source: OANDA (www.oanda.com)

Higher and Lower Rates for the period				
	Lower value in USD		Higher value in USD	
	Value	Date	Value	Date
Yen (JPY/USD)	102.02	17/01/05	112.2	30/07/04
Dollar Singapore (SGD/USD)	1.6199	11/03/05	1.7285	29/07/04
Rupia Indonesia (IDR/USD)	8811.7	13/07/04	9715.5	30/06/05
Euro (USD/Euro)	1.203	30/07/04	1.364	31/12/04
Dollar Australia (USD/AUD)	0.688	10/09/04	0.794	17/03/05

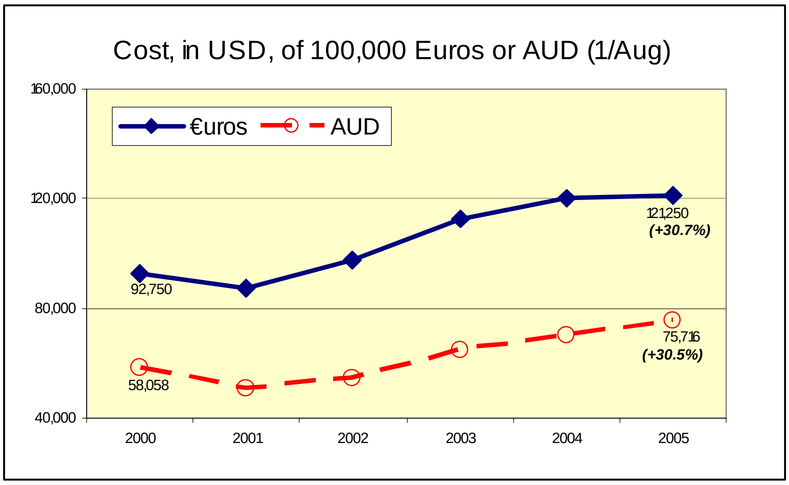
Source: Pacific Exchange Rate Service, in http://fx.sauder.ubc.ca/

The evolution of the USD exchange rate in relation the principal currencies is the result of the present worry of the markets concerning the public and external deficits of the United States and that have the tendency to maintain or become worse due, mainly, to the strong North American private (and public) consume. This is only possible, in part, through the financing of the American economy by other countries, particularly Asian (China, Korea, Japan, etc.).

To have a more precise idea of the evolution of the USD quotation since adopted by UN (2000) as Timor-Leste official currency, please consider the graphic below. It presents an image of how much it should cost to our country, in USD, to purchase equipments with a value of 100,000 euros, in

Europe, or for the value of 100,000 AUD, in Australia, for the last couple of years (1 August; see www.oanda.com).

From the graphic, we conclude that from the start to the end of the period Timor-Leste saw the costs in national currency (USD) of the referred equipments increase by 30% - although the price did not increase in the country of origin. In *real terms*, measured not in USD but for example in terms of electricity generators for the rural areas, the country is now poorer.



One way to reach a similar conclusion is to know that, with one hundred thousand USD, our country could buy, in 1 August 2000, European goods in the value of 107,871 €, today will only buy 82,474 € of goods and services made in Europe, i.e., almost ¼ of the previous value. The loss in purchase power of services from Australia is approximately the same.

In relation to Indonesia, for the contrary and as a result of the evolution of rupia exchange rate in relation to USD, the national currency increased value: the purchase of one million rupia in goods and services cost 111.73 USD in August 2000 and 101.90 in 1 August last, a valorisation of 10%.

Public Finance

The General Budget of the State is the main document available for the analysis of the public finances and is publish annually. The most recent document available is the General Budget of the State for 2005-2006, which has approval from the Government and published in July last (with data from 2004/05).

The table below shows, for the Timor-Leste Combined Budget – after removing the oil revenue -, the estimate related to public expenses, the State revenue and the sources of funding for the public expenses. Note that contains information about the last fiscal year and in relation to the current fiscal year budget. The estimate is up to 2008-09.

COMBINED BUDGET (GOVERNMENT AND DEVELOPMENT PARTNERS) UNTIL 2008-09

	2004-05	*2005-06*	*2006-07*	*2007-08*	*2008-09*	*4 years*
Total of financial **needs** according to SIPs.	**197 (100%)**	**234 (100%)**	**259 (100%)**	**262 (100%)**	**233 (100%)**	**988 (100%)**
General Budget of the State	*87 (44%)*	*122 (52%)*	*120 (46%)*	*127 (48%)*	*125 (54%)*	*494 (50%)*
Commitments needed from the development partners	110 (56%)	112 (48%)	139 (54%)	135 (52%)	108 (46%	494 (50%)
Total of decisions made	**197**	**180**	**152**	**141**	**132**	**604**
General Budget of the State	87	122	120	127	125	484
Development Partners	110	58	32	14	6	109
New commitments needed from partners	**2**	**54**	**107**	**121**	**102**	**385**

Source: Table 1.1 – Combined Sources Budget and Needed Funding (USD million) in *General Budget of the State 2005-06 - Budget Paper No 1*; RDTL Ministry of Planning and Finance, August 2005

This table shows that in 2004-05 the expenditure identified in the GBE correspond to 44% of the estimated total expenditure, with the development partners securing the remaining 56% of a total of USD 200 million.

In regards to the immediate future, the government will secure 52% of the estimated total expenditure; an increase accommodated in the medium term tendency (until 2008-09), which looks at, split in equal parts between the government and the development partners, the expenditure financed by the state sector of the economy.

This implies that the country needs still a significant support from the international community and that expects that, in this fundamental phase of consolidation of our development; continue to be as generous yet. If this support is not available, everything will be more difficult.

In the table above, note that after a significant increase in 2004-05 and 2005-06, the annual State expenditure practically stagnates near USD 120-125 million from this fiscal year. The option relates to the need to test the capacity of execution of (new) development projects by the State, before give a new quantitative jump in the public expenditure as well as, naturally with limitations in regards to the funding capacity. The State has demonstrated to have capacities inferior to the desirable and not able to execute the totality of Budgets so far approved.

Furthermore, in relation to the General Budget of the State and its funding, this looks systematically balanced, with the expenditure equal to the funding required – thanks to the revenue from the Petroleum Fund in accordance with the related Law and the approvals from National Parliament. Therefore, the origin of funding needs are the programs to be financed by development partners and that are far from being secured – only secured 22% of the projects for the 4 years. This is a common situation – the countries do not like/cannot commit for the long term – however we should be alert because some can argue that an increase in these contributions is not justifiable because of the access to oil revenue and a capacity for foreign loans that has not been yet used.

The sustainability of the Petroleum Fund referred above imply that, according to the studies made, is possible to withdraw revenue fro Timor Sea to cover the estimated expenditures in the General Budget of the State, amounts that fluctuate between USD 57 million in 2006-07 and 73 million in 2005-06.

Funding from the Petroleum Fund, 2005-06 to 2008-09 (USD million)

	2005-06	**2006-07**	**2007-08**	**2008-09**
Balance (start of the fiscal year)	63	108	235	352
+ Oil revenue	41	177	168	199
- Withdraws	**0**	**59**	**64**	**68**
+ Taxes	5	9	13	19
= Balance (end of fiscal year)	**108**	**235**	**352**	**503**

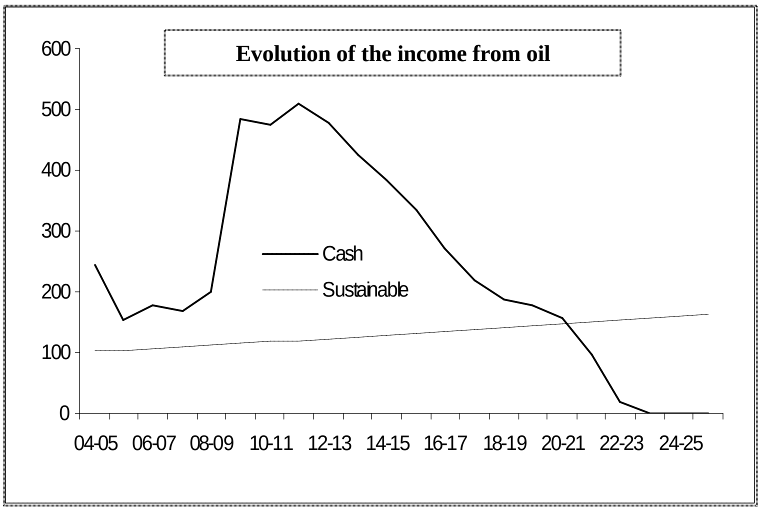
Source: Table 1.2 of the document referred in the above table

Note that until 2008-09 the Timor Sea can provide from its revenue near USD 191 million to finance the General Budget of the State. After these withdraws and assuming that the estimated revenues are correct, the Petroleum Fund can reach at the end of fiscal year 2008-09 an accumulative value of near USD 500 million.

The figures provided as interest are incorrect and will be, certainly, subject to review in the next GBE revision because they do not look realistic in relation to the profit of funds from PF.

Also related to PF note that the funds reflected in the above table indicate that, due to approval delays of appropriate legislation, the revenues will be only made of royalties owed, since the interests paid will enter directly as fiscal revenue of the State and not as revenue from the Petroleum Fund. Once this is rectified next year it will justify the great "jump" in PF revenue previewed for 2006-07.

For the period of 2006-07 to 2008-09 it is expected that it will be necessary to withdraw from the Timor Sea revenue near 35% of its total. The future trend depends on the evolution of international oil prices and of the evolution of oil and gas quantities extracted from Bayu-Undan and, of course, from the decisions taken in regards to public finance.



The two first ones are the principal factors of the total revenues to receive from this oil exploration camp. These profiles can be seen in the table above, where is expected that there will be a significant increase of revenues between 2008-09 and 2010-11 and that these will start to decrease gradually until the end of the extraction , around 2025.

The graphic also illustrates the behaviour of revenue that can be withdrawn from the Fund revenue without compromising its capacity to benefit, as is its purpose, the future generations.

Returning to the analysis of the General Budget of the State, please view the below figures for the fiscal year 2004-05 to which this Report refers to, and the data for the period 2005-06, being the one for the previous years to this fiscal year estimative.

General Budget of the State, 2004-05 e 2005-6 a 2008-09 (USD million)

	2004-05	2005-06	2006-07	2007-08	2008-09
TOTAL Revenue	**306**	**205**	**235**	**232**	**263**
Domestic	33	36	39	41	44
Taxes	27	27	28	29	30
Others	6	9	11	12	13
Petroleum	243	159	186	181	219
Taxes	194	112	135	127	113
Royalties and interests	49	41	42	41	85
Other revenues	0	6	9	13	19
Direct support from donors to budget	31	10	11	11	1
TOTAL Expenditure	**79**	**112**	**109**	**115**	**112**
Salaries	28	29	31	32	33
Goods and Services	34	47	48	47	48
Grants	5	4	4	6	5
Minor Capital	2	6	4	4	4
Large State Investments	9	24	19	24	18
Large Grants Investments by the State	--	2	2	3	3
BALANCE general budget	**228**	**93**	**126**	**118**	**150**

In the table there are some aspects that must be stressed. The first one is related to the fact that the domestic revenues in taxes increased at a low pace, reflecting both the projected slow economic growth and the concern in not increasing the fiscal burden in relation to business and individuals. The future will tell if the policy is advisable and sustainable.

Another aspect to be highlighted is the significant decrease of the direct support to GBS coming from the development partners, which is considered essential for the funding of the sector investment plans.

Notice also the great stability in salary spending, reflecting a cautious policy of wage revision – is not predict to happen soon - and the new recruitment for the Public Administration. It will not be from the employment side of the public service that the issue of unemployment will resolve, predicting that it continue to be one of the fundamental problems – for some, "the" problem – for the economic and social evolution of the country in the short/medium term.

In regards to the currents costs they will increase significantly and in a proportion that seems exaggerated but justifies if results in a significant improvement, strongly needed, of the quality and quantity of the services provided by the Public Administration, namely in a progressive replacement of the services provided by some of the donors but also (and mainly?) in an effort to improve the wellbeing of the population.

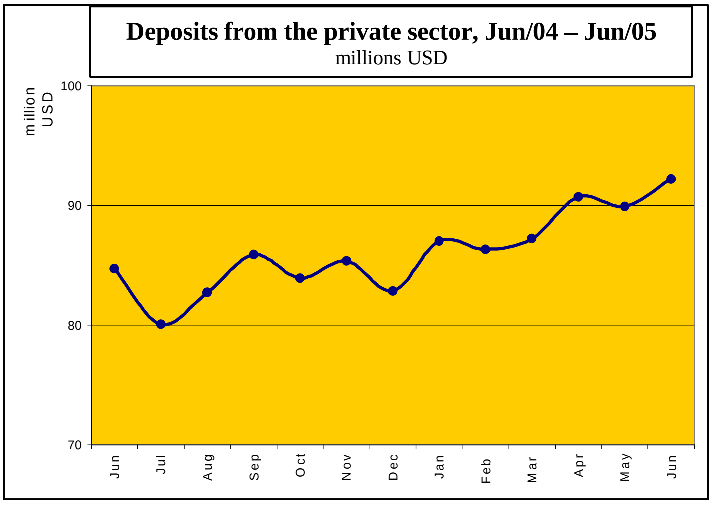
Finally – last but not least – the significant increase of expenditure with large State investments that result in orientations to develop, as a priority in the coming years, the infrastructures of the country (roads, energy production, ports, services to provide services of education and health to the community, etc.). The big challenges in this area are the increase of capacity to execute projects by, with and to the Timorese and the use of this dynamic to support the development of the national private sector – even if in partnership with foreign companies.

Money, credit and interest rates

One of the fundamental aspects of the economic situation in one economy is the monetary and exchange situation. This part of the report covers these topics.

An important part of the analysis of this situation is the monetary statistics, edited in Timor-Leste by the Banking Payments Authority.

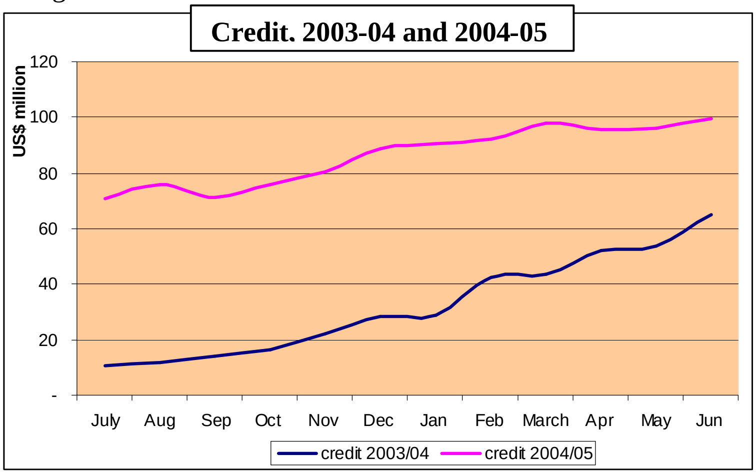
In them there is normally reference to the fundamental aggregates for the study of an economy. For example the monetary supply case that the economists usually call, in accordance with the elements that compose it, by M1 or M2.



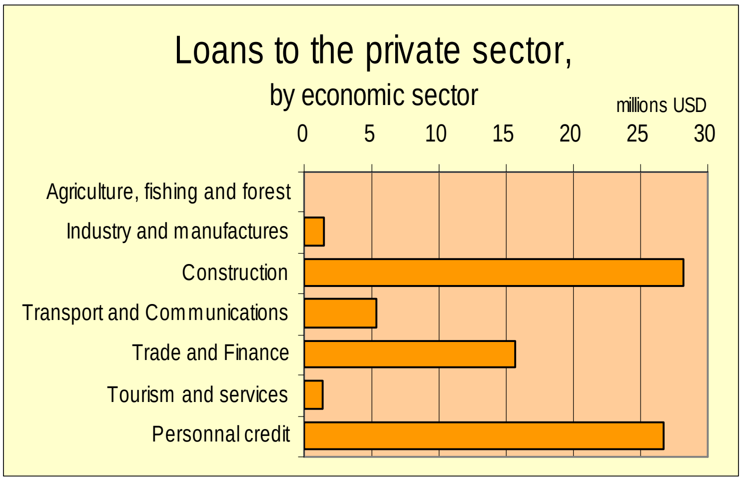
However, in our country it is very difficult to determine with certainty this aggregate because we adopt as our national currency the currency of another country and there are no significant controls about the entry and exit of moneys and the availability of currency to the public. Not being able to calculate its quantity it will be also impossible to calculate the variation rate, one of the most fundamental information.

Hence, the monetary statistics, released in this Report relatively to the fiscal year in analyse and quarterly in our "Economic Bulletin", give us other important information. One of them is the amount of deposits from individuals (people and business) in the commercial banks; they increased near USD 84 million in June 04 to approximately 92 million in June 05, which constitute a significant increase (+9%) if we take into account that the economic growth rate was only around 1.8-2%. Although is a minor increase compared with the previous fiscal year, we have evidence about the growing use of the Timorese banking system, which is a sign of trust in the same.

In the same direction are the numbers related to the increase of bank credit. Although increased in more slow steps than the previous year, it continues to rise significantly: from USD 65 million in July 2004 to USD 100 million in June 2005. The figure in June 2003 was USD 10 million.



The main sectors to benefit from this increase in credit were construction (mainly rehabilitation of houses and contents but also construction of new houses), with a total of USD 28 million, which represents an increase of 30% in relation to the previous period. Followed, in amount, by credit to commerce (support to supermarkets and *kiosks*) and public transports of small and medium dimension (*mikroletes /small buses*, taxis, etc.).



As reflected in the previous report, notice the low values related to the lending to sectors of industrial production which have origin and creates the weaknesses in the industrial production of our country even though there is space for such. The endorsement of appropriate legislation for national investment and foreigner investment will, hopefully, change this situation – the sooner the better.

The rate of performance of credit is traditionally high (around 98%), but the increased supply of credit and the economic difficulties made the non performing credit rate and the proportion of credit in arrears increase to near 6.8% in March 2005.

Corresponding to the growth in deposits and bank credits, the ratio between both aggregates (ratio deposits/credits) dropped from 6.7 in June 2003 to 1.1 in 2004 and 0.9 now (June 2005). This is another indicator of the crescent use of the financial system of the country and the trust of the public in the banking system – which is not a novelty to the BPA, since it is the monitoring the health of the country's financial system.

At the end of the fiscal year 2004/05 the composition of the net external assets in regards to its retainers was as follows: 352.2 million USD from BPA and 2.8 million in the commercial banks. These last ones –or at least part of them- adopted more and more a policy of increasing their applications (mainly in lending) in country instead of retaining assets overseas.

In regards to the evolution of the global volume, these increased near 12 million USD in June 2004 to 355 million in July 2005, which represents an increase of near 190% due to the increase of revenue coming from the Timor sea, the majority of which are invested in United States Treasury Bonds – making this country a borrower (in small scale) of Timor-Leste, as well as for many other countries, namely from Asia (China, Japan, Korea, Taiwan).

Please notice that this investment option is a result of both the existing legislation and, mainly related to the management options and economic policies, due to the fact that there are no conditions in our country to invest such volume of resources with a similar profit to the one received currently and with the same level of security. Last but not least, the investment of such important amounts in our country would necessarily impact in a significant increase of prices, i.e., inflation.

As for the interest rates used in the country, they have, in a general way, suffered less significant alterations since the various commercial banks started their operations. Everything evolved as if, in this area, the alterations in the international markets – mainly in the United States, where there are a visible increase of interest rates – had a small impact in the evolution of the interest rates practised in the national market.

In the last fiscal year this stability was noticed as the majority of rates remained unchanged. For example, it is usual to see the passive nominal rates of 1% (USD 3 months ago) and 1.25% (USD 12 months ago), and an active nominal rate, for 12 months credit, of 13%. The large differential (in international terms) between active and passive rates, which occurs in the majority of banks in the banking system, is mainly due to the credit concession risk in similar circumstances as in Timor-Leste.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Monetary Statistics of Timor-Leste

Fiscal Year 2004-05

2 - BPA ACTIVITIES DURING 2004/05

2.1 - General

The 2004/2005 year was the first during which the BPA was entirely under the management of Timorese national staff. In addition, the BPA enjoyed the benefit of visits from a number of international peripatetic experts.

The support of development partners is acknowledged and appreciated.

The Bank of Portugal provided a number of training programmes for BPA staff as well as providing a resident economics advisor to the BPA.

The International Monetary Fund continued to provide an extensive amount of technical support in a number of critical areas, including reserves management, banking and insurance supervision, payment systems, anti-money laundering, and others. The resident/peripatetic advisor programme was supported by staff advisory missions that significantly contributed to developments in a number of critical areas. Timor-Leste has been one of the greatest recipients of technical assistance from the IMF in recent years, and the regard in which the BPA is held is testimony to this commitment.

Valuable assistance and staff training was also received from other central banks including Bank Negara Malaysia, Bank Indonesia, and the Norwegian central bank.

The BPA also continued to receive strong support and commitment from the government, particularly the Prime Minister and the Minister of Planning and Finance.

During the year the BPA initiated three projects to develop legislation relating to the financial system. Draft laws in the areas of payment system, payment transactions, and anti-money-laundering were prepared. The BPA is currently working on a major project to prepare legislation to transform the institution into a fully-fledged central bank. The government demonstrated its clear commitment to transform the BPA into a central bank by fully capitalizing the BPA in July 2005.

2.2 - Legislative agenda

BPA has been working on legislation and related developments in the following areas:

? With the assistance from the Legal Department of the IMF the BPA has prepared a draft law covering Anti-Money Laundering/Financing of Terrorism. The draft law incorporates recent developments in combating money laundering and the financing of terrorism, and incorporates the most recent international standards.

? The law setting out the regime for the licensing and supervision of insurance companies and insurance intermediaries was approved and promulgated in July 2005.

The BPA, supported by several visits from experts in the insurance industry provided by the IMF, has prepared a set of regulations to implement the Law and these are in the process of final consideration by the Governing Board.

? Draft Central Bank Law.

A working draft was initially prepared by the Bank of Portugal. An internal working group was formed in September 2004 to review the proposed law and identify the necessary arrangements to transform the institution into a fully fledged central bank. The working group comprised most of the senior management. The BPA also received technical assistance from the IMF to support this initiative.

? A draft Law on Checks and Negotiable Instruments has been submitted to the Council of Ministers.

2.3 - Financial and payments system

Financial system

The BPA continues to oversee the financial system, especially the banking and insurance sectors. Several initiatives have been undertaken to enhance the capacity of the examiners to accomplish their tasks. The Monetary and Financial System Department of the IMF provided regular peripatetic visits of experts to assist the Department of Financial System Supervision of BPA to provide training and review the existing supervisory and regulatory frameworks. During the year BPA benefited from visits by experts in the areas of banking supervision and insurance. The latter assisted the BPA management to discuss a number of policy issues relating to the implementation of the insurance law as well as providing necessary training for the insurance supervision staff in the areas of licensing and basic introduction on offsite surveillance.

As part of the effort to promote a sound and effective financial system, the BPA continues to hold regular discussions with all banks operating in Timor-Leste. These meetings normally take place every month to discuss issues faced by the banking industry as well as providing an opportunity to exchange views on the development of the financial system. Notwithstanding these meetings, the BPA also holds discussions with individual banks to discuss specific issues.

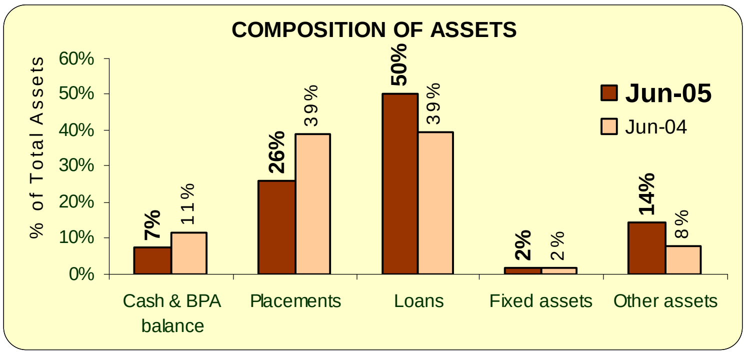
During the period under review, one application for a banking license was denied

A full scope onsite inspection was carried out in each bank during the year. Additionally, bank examiners continue to monitor regular quarterly reports for each bank as well as presenting quarterly consolidated financial system reports to the Governing Board.

With the expansion of credit activity in the banking system and the lack of a comprehensive legal framework to support bank lending activities, the BPA has worked very closely with the World Bank to establish a bank credit registry bureau to help banking system to limit their credit risk.

Overview of Timor-Leste Banking System

The overall condition of the banking system in Timor-Leste during the year remained healthy. Banks started to diversify their asset portfolios as can be seen from the graph below. Total assets of the banking system grew by 15.9% primarily due to an increase in deposits collected (8.3 %) and placements from overseas (35.2%). Below is a portrayal showing the composition of the assets and liabilities of the banking system.



Composition of Assets

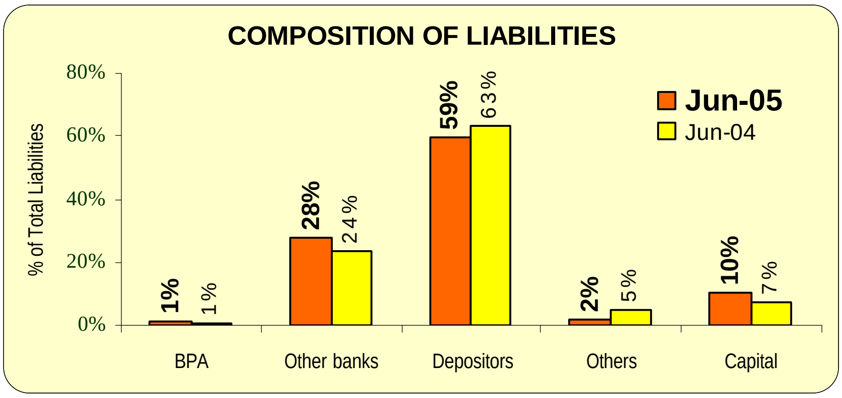
The total assets of the banking system at June 30, 2005 amounted to US$ 157.1 million, representing a growth rate of 15.9 percent from US$ 135.6 million the previous year. This was a consequence of the intensive mobilization of deposits from banks and due to other banks (mainly from overseas). During the year the banking sector started diversifying their asset portfolios significantly. This change of strategy has also significantly influenced the overall performance of the banking system. The composition of banking assets can be seen in the graph below which may be summarized as follows:

Loans and advances represented 50.2 percent of total assets, an increase from US$53.4 million at the end of June 2004 to US$78.8 million in June 2005 or an increase of 47.5 percent. Loans were mainly concentrated in the construction sector, trade and finance, and personal loans. In spite of the increase in the loan portfolios, non-performing loans (NPL) increased significantly by 371.2 percent as at 30 June 2005 to 7.8 percent of the total loans. However the banking system provides sufficient provisions against potential losses. These provisions amount to US$ 5.9 million (including general provisions).

Placements with other banks, mainly overseas institutions, represent 26.2 percent of total assets. Compared to the previous year this is a decrease of 22.5 percent.

Cash and balances with BPA representing 7.3 percent of total assets declined by 26.0 percent, from USD 15.5 million on 30 June 2004. In spite of this decrease, the overall liquidity position of the banking system remains strong.

Meanwhile, other assets, which amounted to 14.3 percent of total assets, grew by 106.7%, from USD 10.8 million as at 30 June 2004 to USD 22.4 million in 30 June 2005 primarily due to an increase in transactions with head offices.



Composition of Liabilities

Total liabilities of the banking system comprise external liabilities amounting to US$ 141.3 million (90.0 percent of total assets) and capital accounts amounting to US$ 15.8 million (10.0 percent). Liabilities grew by 12.4 percent compared to the same time last year. This growth is mainly due to an increase in the nominal amount of deposits and placements from other banks. In relation to deposits, 62.3% is attributable to demand deposits, 29.6% to saving deposits and 8.1% to term deposits. Meanwhile, capital accounts have increased by 60.8 percent to US$ 15.8 million in June 2005 compared to the same time the previous year. This increase derives from a significant increase in general provisions as required by BPA to cover potential losses that might occur in relation to the investment in risk assets.

Profitability

The depiction on the performance of the banking system is based on management reports only, because banks work with a financial year ending on 31 December.

The primary sources of income of the banking sector in the period ended 30 June 2005 consist of interest and related income amounting to US$ 5.9 million or 3.8% of the total assets. Compared to the previous year, this is an increase of 88.9 percent. Income from loans and advances increased significantly compared to the previous year and has contributed considerably to the total income of the banking system (representing 3.3 percent of total assets). Income from other operating activities amounting to US$ 2.6 million declined by 8.7 percent compared to the previous year and represents 1.7 percent of total assets.

Meanwhile interest expenses to the end of June 2005 amounted to US$ 0.5 million, an increase of 241.9 percent compared to the previous year, a consequence of the increase in the level of deposits. Total expenses for the year ended June 2005 amounted to US$ 4.9 million, a decline of 14.3 percent from the previous year. The total profit of the banking system as a whole for the period ended 30 June 2005 was US$ 2.3 million.

Consolidated Balance Sheet of the Banking System*)

Assets			Liabilities		
Items	**Jun-05**	**Jun-04**	**Items**	**Jun-05**	**Jun-04**
Cash & BPA balance	11,481	15,509	Due to BPA	2,240	1,103
Placements	41,181	53,159	Due to other banks	43,243	31,987
Loans	78,835	53,443	Due to depositors	93,209	86,033
Fixed assets	3,181	2,647	Other liabilities	2,661	6,688
Other assets	22,431	10,852	Capital accounts	15,755	9,799
Total	**157,107**	**135,610**	**Total**	**157,107**	**135,610**

**) Source: Based on information submitted to BPA*

Payments Systems

The BPA has an ongoing commitment to promote the development of a modern payments system in the country. Although the payments system in Timor-Leste is still relatively simple, in general it meets the current requirements of users of the system. Currently, available payment instruments include cheques, credit and interbank transfers, debit cards, ATM and money transfer services.

The BPA operates the Dili Clearing House (DCH) and the instruments cleared include cheques and credit transfers. In order to facilitate the settlement obligations in the DCH, the BPA developed a new computerized system during the year for performing the settlement calculations.

The volume of transactions processed in the Dili Clearing House continued to increase as more payments for government projects and civil servant salaries are directed through the clearing house.

The table below shows the number of items and value cleared through the Dili Clearing House during the year 2004-2005.

Month	Items Cleared				Items Returned	
	Number		Value (US$000)		Number	Value (US$000)
	Total	Daily Average	Total	Average Value		
July 2004	1168	53	7,145	6.1	13	31.0
August	1112	56	8,770	7.9	11	25.0
September	1334	64	8,439	6.3	21	76.0
October	1208	58	7,604	6.0	20	155.0
November	1260	60	7,488	5.9	12	23.0
December	1417	64	6,831	4.8	9	32.0
January 2005	1081	51	9,197	8.5	9	26.0
February	1229	61	6,354	5.2	13	118.0
March	1419	65	7,895	5.6	23	120.0
April	1405	67	7,030	5.0	14	61.0
May	1497	71	8,231	5.5	9	33.0
June	1621	74	8,379	5.2	14	37.0
Total 2004/05	**15,751**	**62**	**93,363**	**6.0**	**168**	**737.0**
Total 2003/04	**10,341**	**40.6**	**62,065**	**6.0**	**85**	**450.0**
Total 2002/03	**3,206**	**13.5**	**18,575**	**6.6**	**87**	**42.0**

The BPA introduced the monitoring of money transfers during the year by requiring the providers of money remittance services to provide BPA with information concerning their activities, including specific reporting of large transactions.

2.4 - Currency arrangements and banking services

Currency arrangements

The BPA continued to conduct public education mainly through leading shops in large district such as Dili on the identification of counterfeit bank notes and the usage of centavos coins. As previously, these efforts were conducted with the objective of informing the public, including commercial banks, on how to identify counterfeit notes.

One of the primary roles of the BPA is to ensure an adequate supply of banknotes and coins for the settlement of cash transactions. During 2004/05, the BPA continued to supply the currency necessary for the economy to operate. The table below shows a decrease in the currency imported compared to the previous year which was attributed to a decrease in cash transactions as the population starts to use banking services to undertake business transactions, especially cross-border payments. The following table summarises the currency operations during the year compared with the previous year.

(in millions of US dollars)

Denomination	Importation	Circulating Currency		Withdrawal from Circulation
		Circulated	Re-deposits	
$100	8.48	10.95	2.85	-
$50	1.60	5.80	3.80	-
$20	5.44	23.52	23.58	3.6
$10	4.48	24.58	22.18	2.2
$5	1.60	8.94	10.75	3.2
$1	1.97	1.02	1.03	1.06

50 Centavos	-	0.37	0.387	-
25 Centavos	-	0.23	0.246	-
10 Centavos	-	0.11	0.103	-
5 Centavos	-	0.06	0.048	-
1 Centavo	-	0.00	0.002	-
Total 2004-2005	**23.57**	**75.58**	**64.97**	**10.06**
Total 2003-2004	**47.04**	**110.04**	**96.52**	**13.58**

Banking services

The BPA as the official banker to the government has initiated discussions with the commercial banks and the Treasury Department of the Ministry of Planning and Finance with a view to involving all banks in collecting government revenues.

Early in 2005 the BPA encouraged all civil servants in Dili to transfer their monthly salary to their preferred bank to promote the usage of banking services as well as developing payments system in the country. As a result more than 2,100 out of about 2,500 civil servants who were still collecting their salaries in cash at the beginning of the year changed to having their salaries transferred to one of the commercial banks.

As part of the programme to facilitate the distribution of centavos coins and at a later stage to provide a wide range of payments services related to the government payments, the BPA established a branch in the District of Oecussi. This branch was opened by the Prime Minister on September 2004.

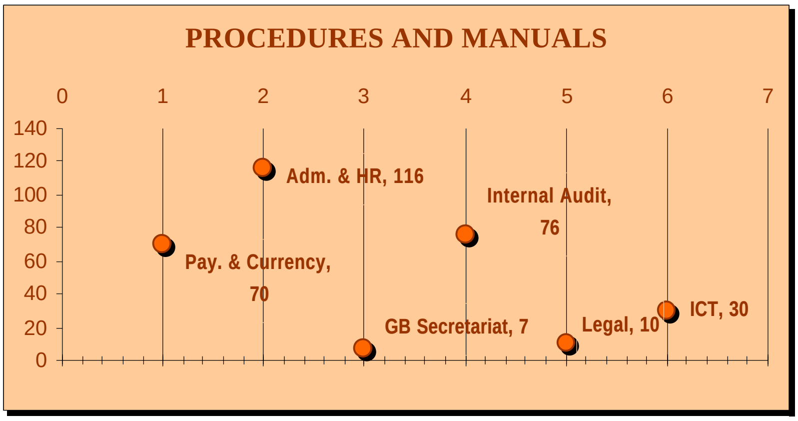
The following table summarises the domestic and international settlements undertaken by commercial banks. The table shows increases compared to the previous year arising from a greater number of payments instructions and also increasing receipts from taxpayers. It can also be seen that there is a decline in the number and value of inwards remittances from abroad. The statistics do not include revenues, particularly petroleum-related payments, deposited directly to the government account at the BPA.

United States Dollars	Domestic Settlements		International Settlements		International Receipts	
	Number	Value	Number	Value	Number	Value
Jul-04	338	3.86	33	5.28	53	8.70
August	316	4.71	28	52.21	51	7.19
September	475	6.71	32	42.87	42	31.59
October	290	4.06	30	29.37	36	30.65
November	286	5.12	35	24.32	45	24.67
December	326	4.08	36	36.72	51	30.53
Jan-05	235	7.63	40	17.9	45	22.39
February	303	3.89	32	33.63	48	71.01
March	302	3.65	25	23.06	46	25.10
April	329	4.13	46	35.88	47	37.88
May	312	5.06	21	10.12	42	28.38
June	434	6.22	36	31.9	47	19.22
Total 2004-2005	**3946**	**59.13**	**394**	**343.26**	**553**	**337.33**
Total 2003-2004	**3133**	**38.60**	**360**	**111.30**	**562**	**147.60**

Australian Dollars	International Settlement		International Receipt	
	Number	Value	Number	Value
July 2004	5	0.1	1	0.1
August	1	0.0	3	1.4
September	3	0.0	1	0.0
October	0	-	1	0.0
November	5	0.0	2	0.1
December	4	0.0	2	0.0
January 2005	1	0.0	3	0.0
February	4	2.0	2	0.0
March	4	0.0	4	0.0
April	4	0.0	4	0.0
May	2	0.0	4	6.0
June	6	7.0	4	0.1
Total 2004-2005	**39**	**9.2**	**31**	**7.9**
Total 2003-2004	**55**	**8.6**	**15**	**10.1**

2.5 - Institutional Strengthening

To strengthen the institution and to give confidence to the staff in fulfilling their obligations, over 300 new procedures and manuals were written during the year, with more than 260 procedures being formally approved. These procedures included a review of the existing procurement policies and procedures.



The BPA management has also developed and issued a comprehensive Delegation of Authority manual. During the year the BPA introduced new terms and conditions of employment including the introduction of a performance and service-based remuneration system that was approved by Prime Minister.

The BPA with the assistance of an advisor provided by the UNDP has put in place a comprehensive Information Technology (IT) infrastructure including defining the medium and long-term IT strategy to address the anticipated development of the institution. This includes the establishment of a BPA website – www.bancocentral.tl.

In anticipation of the Government's plan to give the responsibility to the BPA to manage the petroleum resources of Timor-Leste, the BPA restructured its organization to accommodate this new function. A new department was created, known as the Department of Petroleum Fund Management, with two internal divisions.

The Government has announced its intention to transform the institution into a fully fledged central bank in the near future, and parliament has resolved to fully capitalize the BPA in the fiscal year 2005/2006.

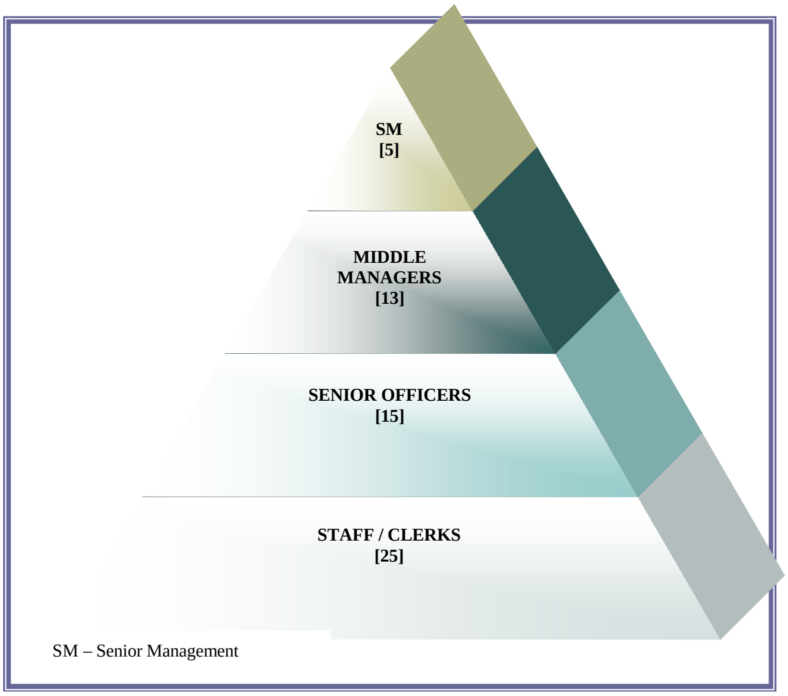
2.6 - Staff and capacity development

Management and staff

Since November 2004 the most senior management positions in the organisation, being the positions of General Manager and two Deputy General Managers have all been filled by Timorese national staff. This achievement was one of the most important milestones in the development of the future central bank of Timor-Leste.

The number of BPA staff increased compared to the previous year as the activities of the institution expanded in scope, relating to the introduction of insurance supervision, and an increased emphasis on audit compliance and information technology. As at end of the fiscal year 2004/2005 the total number of BPA staff stood at 58.

ORGANIZATIONAL HIERARCHY OF BPA



Capacity development

In term of staff capacity development, the BPA continued a programme of intensive investment. A number of bilateral arrangements were made or further developed with other central banks such as Bank of Portugal, Bank Indonesia and Bank Negara Malaysia. Apart from those institutions, the BPA also continued to benefit from other training institutes and universities such as the IMF – Singapore Training Institute, SEACEN training institute, *Instituto Superior da Economia e Gestão* in Lisbon, amongst others.

During the year the BPA conducted a comprehensive needs assessment as the basis for developing a medium and long-term capacity development plan. Nonetheless, as the mandate of the

BPA was expanded immediately after the year end to include the management of the Petroleum Fund of Timor-Leste, BPA management initiated a project during the fourth quarter to review the training strategy to include the development of staff capacity to manage the Petroleum Fund as well as providing scholarships for potential staff to take postgraduate studies. The upcoming plan will also cover the creation of the BPA's own induction module for newly recruited staff. This development is very important as a road map for the institution as it prepares to transform itself into a fully fledged central bank.

During the year, 41 staff (2,648 person-hours) participated in various training overseas including study visits and attachments to other central banks.

Staff Training July 2004 – June 2005 (Person-Hours)

Description	Total	Skill Dev.	Tech. Training
Training Courses			
Internal	10,020	6,925	3,095
External	2,648	552	2,096
Expert Visit	2,800	1,240	1,560
Int'l Advisors (Full time)	14,400		
Total	**29,868**	**8,717**	**6,751**

As well as sending staff overseas, the BPA also continue to conduct in-house training for its staff including training given by international experts attached to the BPA. The in-house training courses included Portuguese classes (4,080 hours) provided by *Instituto Camões*.

2.7 - Governance

The BPA continues to promote good governance throughout the entire organization especially relating to the transparency of decision making processes and accountability to its stakeholders. The executive decision-making body is the Management Committee which is composed of five members of senior management. During the year participants in the management decision making process have been expanded to include other relevant units such as Head of Internal Audit Office, Legal Counsel, Head of Human Resource Division, Chief Economist and the Head of Information and Technology Division. Although the permanent participants do not have voting rights their views and observations are an integral part of every decision. The Management Committee regularly discusses important issues relating to the BPA's activities including monitoring financial reports, investment activities, reviewing currency operations, etc.

To ensure the implementation of the policies set by the Governing Board and the procedures as documented in the new manuals are followed, the Internal Audit Office conducts regular audits and prepares a monthly report for the General Manager. This task is essential to give the General Manager assurance that all policies and procedures are strictly complied with.

Internal Auditor also reports quarterly to the Governing Board, and has a mandate to raise whatever issues it considers important, including making recommendations for Board consideration.

The BPA being a distinct autonomous institution is committed to ensuring that it is accountable to the Government and the public at large concerning its activities.

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 2005

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BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

9 September, 2005

STATEMENT OF COMPLIANCE

The Financial Statements on pages 2 to 5 and the Notes from pages 6 to 13 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. I 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 2005.

Abraão de Vasconselos
General Manager

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

BALANCE SHEET

30 JUNE 2005

	Notes	2005 USD	2004 USD
ASSETS			
Cash and Bank	2	130,006,052	92,863,371
US Government Securities		222,830,279	-
Other Investments	6	11,944,229	12,023,020
Property, Plant & Equipment	3	1,027,006	1,103,267
Other Assets	4	157,272	187,584
Total Assets		**365,964,838**	**106,177,242**
LIABILITIES			
Currency Issued	5	1,465,161	835,938
Government Account	5	338,101,527	79,010,827
Domestic Financial Institutions	5	4,676,346	5,769,802
International Financial Institutions	6	11,944,229	12,023,020
Other Liabilities	5	128,625	167,869
Total Liabilities		**356,315,888**	**97,807,456**
NET ASSETS		**9,648,950**	**8,369,786**
EQUITY			
Share Capital		7,727,188	7,727,188
General Reserve Account		1,921,762	642,599
TOTAL EQUITY		**9,648,950**	**8,369,787**

The notes on pages 54 to 59 form an integral part of this statement.

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BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

PROFIT AND LOSS STATEMENT

FOR THE YEAR ENDED 30 JUNE 2005

	Notes	2005 USD	2004 USD
INCOME			
Income from Financial Assets	7A	956,935	601,353
Income from Govt. Securities	7A	3,412,352	-
Income from Government	7B	620,000	628,978
Fees and Recoverable Charges	7C	268,993	365,066
Other Income	7D	5,931	37,001
Revaluations Gains / (Losses)	7E	187,098	(495,050)
Total Income		**5,451,309**	**1,137,348**
EXPENSES			
Interest Expenses and Bank Charges		3,226,431	192,690
Distribution of Currency		168,251	225,537
Personnel Expenses		270,251	209,681
Administration Expenses	9	347,368	192,827
Depreciation	3B	159,845	134,789
Total Expenses		**4,172,146**	**955,524**
OPERATING PROFIT		**1,279,163**	**181,824**

The notes on pages 54 to 59 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 2005

	2005	**2004**
SHARE CAPITAL	**USD**	**USD**
Opening Balance	7,727,188	7,811,941
Cash Subscriptions from Government	-	376,022
	7,727,188	7,727,188
GENERAL RESERVE ACCOUNT		
Opening Balance	642,599	460,775
Retained Earnings	1,279,163	181,824
	1,921,762	**642,599**
TOTAL EQUITY	**9,648,950**	**8,369,787**

The notes on pages 54 to 59 form an integral part of this statement.

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

CASH FLOW STATEMENT

FOR THE YEAR ENDED 30 JUNE 2005

	2005 USD	2004 USD
OPERATING ACTIVITIES		
Operating Profit	1,279,163	181,824
Depreciation	159,845	134,789
Changes in Receivables, Prepayments & Stock	30,312	(85,364)
Currency Issued	629,223	835,938
Changes in Government Deposits	259,090,700	37,475,751
Changes in Deposits of Domestic Financial Institutions	(1,093,456)	1,002,556
Changes in International Financial Institutions	(78,791)	535,968
Changes in Other Liabilities	(39,244)	(154,420)
Operating Cash Flow	**259,977,752**	**39,927,042**
INVESTMENTS ACTIVITIES		
Changes in Investments	78,791	(535,968)
US Government Securities	(222,830,279)	-
Purchase of Property, Plant & Equipment	(83,583)	(368,315)
Cash Flow from Investment Activities	**(222,835,071)**	**(904,283)**
FINANCING ACTIVITY		
Capital Subscription	-	376,022
Cash Flow from Financing Activity	**-**	**376,022**
INCREASE IN CASH & CASH EQUIVALENTS	**37,142,681**	**39,398,781**
Cash & Cash Equivalents at the beginning of year	92,863,371	53,464,590
CASH & CASH EQUIVALENTS AT THE END OF YEAR	**130,006,052**	**92,863,371**

The notes on pages 54 to 59 form an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) 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 Financial Reporting Standards. Unless stated otherwise, the policies followed in these statements are consistent with those adopted in the previous year.

(B) Presentation

The Chart of Accounts was revised during the year, where the presentation has been reclassified in the current year comparative figures has been restated on the same basis as the year ended 30 June 2005.

(C) 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.

(D) 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 30 June 2005. 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 2005 were:
USD 1 = AUD $ 1.3132;
USD 1 = SDR 0.6865;
USD 1 = EUR 0.8290

(E) Income Recognition

Interest income, fees & charges and other income have been recognized on the 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.

(F) Property, Plant & Equipment

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

(G) 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:

	2005	2004
i. Premises (improvements)	5%	5%
ii. Plant	20%	20%
iii. Office equipment	12.5%	12.5%
iv. Computers & electronic equipment	25%	25%
v. Vehicles	20%	20%

(H) **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 2005.

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

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

(J) **Income Tax**

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

(K) **Employee Entitlements**

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

2. ANALYSIS OF FINANCIAL ASSETS

(A) **Analysis by Credit Rating**

	Rating*	2005 USD	2004 USD
US DENOMINATED ASSETS			
Cash	AAA	11,046,918	8,689,360
Other Central Banks	Aa2	116,511,460	82,092,729
Resident Banks	Aa3	2,238,478	935,025
Other cash Balances	Aa1	1,200	—
Total Domestic Cash and Bank		**129,798,056**	**91,717,114**
FOREIGN CURRENCY CASH AND BANK			
Central Banks	Aa2	205,668	1,094,427
Foreign Cash	Aa2	-	50,882
Non-resident banks	Aa1	2,328	948
Total Foreign Currency Cash and Bank		**207,996**	**1,146,257**
TOTAL CASH AND BANK		**130,006,052**	**92,863,371**

*Where a central bank isnot rated, the sovereign rating has been used.

(B) **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.

	2005 USD	**2004** USD
Country		
USA	112,072,889	18,294,623
Australia	15,692,357	73,581,893
Indonesia	-	50,882
Portugal	2,240,806	935,973
TOTAL CASH AND BANK	**130,006,052**	**92,863,371**

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 2005**	**TOTAL 2004**
Opening Balance	808,492	75,068	122,524	247,563	153,756	**1,407,403**	**1,039,087**
Additions	13,581	11,322	24,915	40,978	-	**90,796**	**376,806**
Disposals & Adjustments	(3,488)	(2,809)	(677)	(238)	-	**(7,212)**	**(8,491)**
Value at Cost	818,585	83,581	146,762	288,303	153,756	**1,490,987**	**1,407,402**

(B) **Depreciation Account**

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	**TOTAL 2005**	**TOTAL 2004**
Opening Balance	71,589	37,564	28,568	124,305	42,109	**304,135**	**169,346**
Annual Depreciation	39,758	16,295	16,433	64,296	30,751	**167,533**	**134,789**
Disposals & Adjustments	(68)	(474)	(50)	(7,096)	-	**(7,688)**	-
Accumulated Depreciation	111,279	53,385	44,951	181,505	72,860	**463,980**	**304,135**

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

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	**TOTAL 2005**	**TOTAL 2004**
PPE at Cost	818,585	83,581	146,762	288,303	153,756	**1,490,987**	**1,407,402**
Accumulated Depreciation	(111,279	(53,385)	(44,951)	(181,505)	(72,860)	**(463,980)**	**(304,135)**
Net Book Value	707,306	30,196	101,811	106,798	80,896	**1,027,007**	**1,103,267**

4. OTHER ASSETS

Item	2005 USD	2004 USD
Accounts Receivable	54,030	107,443
Oe-Cussi Branch Account	14,332	0
Prepayments	45,077	36,743
Unissued Centavos	43,833	43,398
	157,272	**187,584**

5. INTEREST BEARING LIABILITIES AND RELATED INTEREST RATE RISK

DEPOSIT LIABILITIES	Basis of Interest	2005	2004
Government			
Consolidated Fund Account	***	268,019,991	65,060,878
Timor Gap Account		70,081,536	13,899,069
Other Accounts		0	50,880
		338,101,527	79,010,827
Financial Institutions			
Domestic Financial Institutions		4,676,346	5,769,802
International Financial Institutions (Net)		11,944,229	12,023,020
		16,620,575	17,792,822
Total Deposit Liabilities		**354,722,102**	**96,803,649**
CURRENCY ISSUED		**1,465,161**	**835,938**
OTHER LIABILITIES			
Accruals		110,487	127,552
Accounts Payables		18,137	40,317
Total Other Liabilities		**128,624**	**167,869**
TOTAL LIABILITIES		**356,315,888**	**97,807,456**

All liabilities will mature within six months.

***Federal Reserve Bank of New York Repurchase Rate less 75 basis points on qualifying balances.

6. INTERNATIONAL FINANCIAL INSTITUTIONS

(A) 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 2005.

(B) **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.

(C) **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

		2005	2004
(A)	**INCOME FROM FINANCIAL ASSETS**	**USD**	**USD**
	Interest on deposits – Foreign Central Banks	948,527	592,408
	Interest on deposits – US Govt Securities	3,479,390	—
	Interest on deposits – Domestic Commercial Banks	8,409	6,801
	Unrealised Gains (Losses)	(67,039)	—
	Other Income	—	2,144
	Total Income from Financial Assets	**4,369,287**	**601,353**
(B)	**INCOME FROM GOVERNMENT**		
	Service Fees	240,000	240,000
	Revenue Appropriation	380,000	388,978

	Total Income from Government	**620,000**	**628,978**
(C)	**FEES AND RECOVERABLE CHARGES**		
	Cost Recoveries (Cash Fees)	204,993	315,733
	Licensing & Supervision	64,000	49,000
	Miscellaneous Charges	—	333
	Total Charges and Cost Recoveries	**268,993**	**365,066**
(D)	**OTHER INCOME**		
	Sales of Numismatic Coins	5,931	27,221
	Donations & Grants	—	9,780
	Total Other Income	**5,931**	**37,001**
(E)	**CURRENCY GAIN (LOSS)**	**187,098**	**(495,050)**
	TOTAL INCOME	**5,451,309**	**1,137,348**

8. CURRENCY EXCHANGE GAINS (LOSSES)

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 gain equivalent to USD 187,098 (2004:USD 495,050). This was largely attributable to the appreciation of the US Dollar against reserves held in Australian Dollars.

9. ADMINISTRATION EXPENSES

During the year under review the administration registered significant increase due to increase in BPA operational activities. The total amount of expenses where USD $347,368 compared to USD $192,827 last year. The main increase in the expenses comes mainly from increase in information & communications costs, office expenses, professional fees, and asset management and insurance expenses.

10. REMUNERATION TO MEMBERS OF THE GOVERNING BOARD

The three members of the Governing Board as at 30 June 2005 are also executive members of management. Three of them were remunerated in accordance with the terms and conditions of service of executive staff of the BPA.

Report of the external auditor

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Darwin NT 0800

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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 report comprises the balance sheet, profit and loss statement, statement of changes in equity and cash flows statement, accompanying notes to the financial statements, and statement of compliance for Banking and Payment Authority of Timor-Leste ('BPA') for the year ended 30 June 2005.

The Governing Board of BPA are responsible for the preparation and true and fair presentation of the financial report in accordance with the International Financial Reporting Standards and in accordance with the Regulation No. 2001/30 'on the 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 and independent audit in order to express an opinion to the members of 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 the Banking and Payments Authority of East Timor', International Financial Reporting Standards and other mandatory professional reporting requirements in Timor-Leste, a view which is consistent with our understanding of BPA's financial position, and of their performance as represented by the results of their 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.

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.

Independence

We are independent of BPA, and have met the independence requirements of professional ethical pronouncements.

Audit opinion

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

(a) giving a true and fair view of Banking and Payments Authority of Timor-Leste financial position as at 30 June 2005 and its performance for the year ended on that date; and

(b) complying with International Financial Reporting Standards and other mandatory financial reporting requirements in Timor-Leste

KPMG

KPMG

Devendra N Patel
Partner

Darwin
9 September 2005

The document is a facsimile of the original.
BPA accounts to which it refers to where audited using documents in English given to the auditors by BPA

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 report comprises the balance sheet, profit and loss statement, statement of changes in equity and cash flows statement, accompanying notes to the financial statements, and statement of compliance for Banking and Payment Authority of Timor-Leste ('BPA') for the year ended 30 June 2005.

The Governing Board of BPA are responsible for the preparation and true and fair presentation of the financial report in accordance with the International Financial Reporting Standards and in accordance with the Regulation No. 2001/30 'on the 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 and independent audit in order to express an opinion to the members of 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 the Banking and Payments Authority of East Timor', International Financial Reporting Standards and other mandatory professional reporting requirements in Timor-Leste, a view which is consistent with our understanding of BPA's financial position, and of their performance as represented by the results of their 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.

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.

Independence

We are independent of BPA, and have met the independence requirements of professional ethical pronouncements.

Audit opinion

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

(a) giving a true and fair view of Banking and Payments Authority of Timor-Leste financial position as at 30 June 2005 and its performance for the year ended on that date; and

(b) complying with International Financial Reporting Standards and other mandatory financial reporting requirements in Timor-Leste

KPMG

Devendra N Patel
Partner

Darwin
September 2005

Governing Board

Abrão de Vasconselos
Maria José Sarmento
Nur Aini Alkatiri

Management Council

General-Manager
Abrão de Vasconselos

Deputy General-Manager
for Supervision
Maria José Sarmento

Deputy General-Manger
for Payments
Nur Aini Alkatiri

Director of Administration
Raquel Gonçalves da Costa

Chief Accountant
Fernando Carvalho

Contacts:

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