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

Annual Report

2002/2003

(1 July 2002 – 30 June 2003)

Dili
2003

Introduction

The year from July 2002 to June 2003 was the first complete fiscal year in the life of the Banking & Payments Authority of Timor-Leste (BPA) since the institution was founded under the present statute in November 2001. Despite our youth, we are able to say that during this period the BPA achieved a degree of internal consolidation and corporate cohesion that has far exceeded our initial expectations.

During the period 2002/3 the BPA had a clearly defined form, and was unequivocally able to set its own direction. This was achieved while continuing to work closely not only with government organizations and the Public Administration of Timor-Leste, but also with international institutions such as the International Monetary Fund, the World Bank and the Asian Development Bank. We hasten to mention that these relationships neither threaten nor diminish the autonomy that the BPA – in common with many other central banks these days – enjoys in fulfilling the functions assigned to it in its founding documents. In this regard we recognize and note the understanding and respect for the BPA's autonomy shown by the Prime Minister, and the Minister and Vice Minister of Planning and Finance.

During 2002/3 the BPA was not only able to fulfill its primary functions, being those of any central bank (supervision of the banking system, managing the payments system including circulation of money) but it was also able to record significant developments in other areas that had earlier not existed or were at most embryonic. These areas were Economics Research and Statistics, Internal Audit, and Procurement. No less importantly, the BPA was able to take up two new challenges, the project for issuing national coins, and preparing for the regulation and supervision of the insurance sector in Timor-Leste.

To be able to best respond to these challenges and others that will emerge in future, the Authority has been investing heavily in training and improving the qualifications of its personnel. All of its senior staff and many others at other levels have had the opportunity to participate in training programmes, both in Timor-Leste and abroad, selected to meet present needs as well as those foreseen for the future, in their respective areas of operation.

In this connection, it is very fitting to recognize the support and assistance that the BPA received from various institutions, particularly other central banks that received our staff, or sent their own experts to Timor-Leste to provide training for our personnel. In the same vein, it is also appropriate to acknowledge the role that the majority of international staff placed in the BPA play in the training programmes, in technical areas (banking, finance, economics, accounting and IT) as well as in languages.

During the year the BPA was represented by members of its Governing Board or its senior staff in the following conferences and congresses: the *"12th Lisbon Meetings"* for central banks in countries having Portuguese as the official language, held in September 2002; the conference *"The Challenge of Sustainable Outreach,"* organized by the Asia-Pacific Rural and Agricultural Credit Association with GTZ (German Agency for Cooperation) in Sri Lanka, in January 2003; the conference *"Bank Note 2003,"* in Washington in February 2003; the *"Spring Meetings"* of the IMF and World Bank in Washington; and the conference *"Payment Systems – Major Trends,"* hosted by the Bank of Cape Verde for central banks of Portuguese-speaking nations, in July 2003.

With regard to institutional structure, no significant changes were made to the previously existing organization, in general maintaining the structure of departments, divisions, and offices described in our last annual report. Several new personnel were however recruited, and some structural units were reorganized so that at present all units have personnel consistent with their functions and present needs. The main change of note was the evolution of the Payments and Banking Operations Department, clearly the largest department in the BPA, into four Divisions. We also note that the Internal Audit Office and the Procurement Division that had barely existed on paper in June 2002 are now functioning units, contributing fully to the effectiveness of the Authority.

While on the subject of human resources, it is important at this point to record a well-deserved note of gratitude for the professionalism of all personnel and employees, both Timorese and international, who have worked for the Authority. It is to their concerted efforts that the achievements of the year are due.

At the risk of drawing attention to an individual incident that disrupted the consistent performance during the other 364 days of the year, I would like to commend the exemplary behaviour of all staff during the emergency of 4th December 2002 and the days following, when their professionalism and dedication to the Authority were beyond question. This was evidenced by the fact that the great majority for BPA staff arrived for work at 8 o'clock on the morning of 5th December ready for a normal day's work.

The final point to highlight is that a major project of the BPA during the fiscal year was – and will certainly continue to be next year – the issuance of the national coins that will be put into circulation next November. While this report has a dedicated section to record this process, we believe that the Authority and all its personnel have excellent reason to feel proud, having contributed, albeit on a small scale, to the history of Timor-Leste, because the first emission of currency in a newly independent country is a unique occurrence that cannot be repeated.

Luis Quintaneiro
General Manager

1 – THE ECONOMY OF TIMOR-LESTE: RECENT DEVELOPMENTS

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International Context

We referred at this same point in last year's Annual Report of the BPA that the increasing globalization of international economic relations obliges the economics and governmental authorities of all countries to constantly follow political and international economic movements, both at international and regional levels. Indeed, countries that are dependent on the evolution of the rest of the world and their own region probably have to do so to an even greater extent.

While Timor-Leste has been in a special situation since 1999, the truth is that as an independent country it will progressively tend towards “normality.” Whatever “normality” may mean, it will certainly include a growing interdependence with the world economy, and the economies of its neighbours. Our report therefore gives special attention to the analysis of aspects that already, or will do so in the future, influence the economic environment in which our national economy operates.

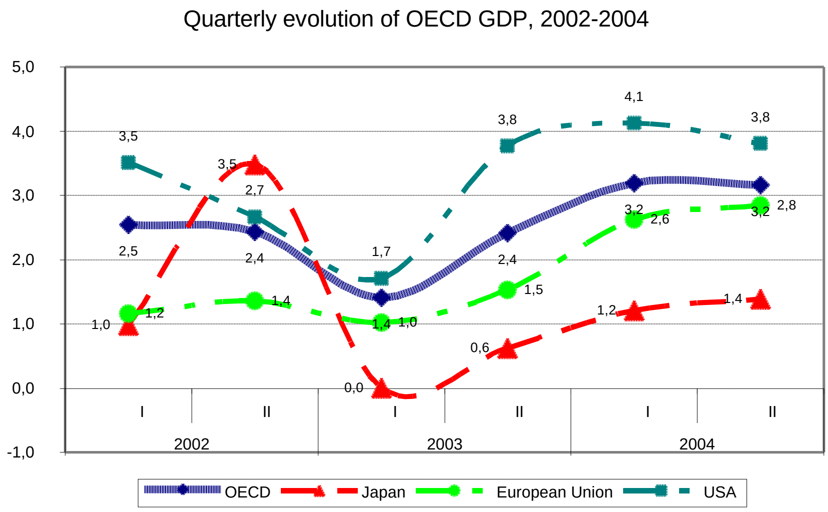
Two of the better-known documents that chart the world’s economic evolution are the “*World Economic Outlook*”, and “*Economic Outlook*” published in alternate quarters by the International Monetary Fund in Washington, and the Organization for Economic Co-operation and Development (OECD) in Paris.

In the latest issue of its *Economic Outlook*, published last June and written shortly after the hottest phase of the war in Iraq, the OECD reported that:

> “short-term economic perspectives for the OECD group of countries are for weak and hesitant growth. [However] Following the rapid resolution of the conflict in Iraq, economic activity should improve faster at the end of 2003 as geopolitical tensions are reduced.”

A larger recovery of economic activity in the more economically advanced countries was only expected, however, in 2004, as operational structural deficiencies in some of the leading economies, from USA to Europe, are overcome. The recovery in the remaining OECD countries will be, according to the report, closely linked with the economy of the United States. It has been playing the role of virtually the only engine of the world economy since Japan, for almost a decade in a prolonged phase of slow growth (0.4% in 2001 and 0.3% in 2002) and the European Union – particularly its largest economy, Germany – have been experiencing difficulties with growth.

These developments will allow the **GDP (Gross Domestic Product)** of the United States, according to OECD forecasts, to grow around 2.5% in 2003 and 4% in 2004, these estimates being almost identical to those published in September by the IMF.



The Euro zone itself should grow 2.5% during the next year, after growth of only 1% in 2003. This rate of growth should also occur in Japan, in 2004 the slow growth there should continue, with the change of production being stable at a modest 1.1%. It is worth noting that last September, possibly being influenced by economic development since April 2002, the IMF appeared to be more cautious in forecasting the rates of growth in 2003 and 2004 at 0.5% and 1.9% respectively.

It appears that the positive growth in production (all other things being equal) is not being reflected in growth in the job market, with levels of unemployment in the OECD remaining high, because the restructuring of some companies has been achieved by reducing labour costs.

Unemployment will therefore continue to be a preoccupation of many countries, such as Japan where unemployment has reached a record 5.25%-5.5%. This rate, considered to be low by European standards – where countries normally register much higher rates, for example the current 9.4% in France and 11.4% in Spain – was until very recently unthinkable in Japan.

With regard to ***consumer prices*** the average rate of increase in the euro area and the United States should be around 2% and 1.8% respectively. Japan will have, as it has since 1999, an absolute reduction of about 1.1%.

In this domain – inflation – the International Monetary Fund has a very similar perspective to the OECD. In its publication, the *World Economic Outlook*, published last September, it estimates inflation for 2003 in the Euro area and the United States to be 2% and 2.1% respectively. During 2004, both rates are anticipated to decrease to 1.6% and 1.3%.

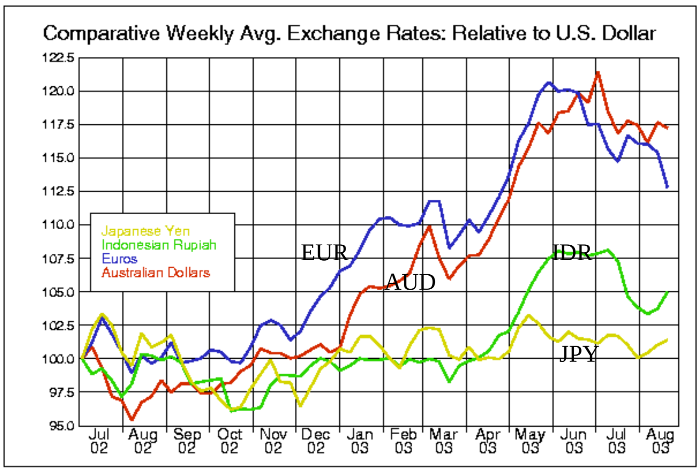
One of the most important aspects of economic development in various developed countries during 2003 and 2004, as forecast by the OECD, has been the significant degradation in ***public finance***, either as a result of a budget strategy of increasing public expenditure to boost the economy, or from a decrease in receipts as a result of the present downturn in the economic cycle: businesses with low sales do not pay taxes, and nor do unemployed workers, who nonetheless receive unemployment benefits that increase public expenditure.

Japan with 7.7% and the United States with 4.6% (relative to the global value of production, GDP) are championing this form of public deficit, while France and Germany have also passed the 3% deficit limit imposed by the Maastrich Criteria to be followed by countries in the Euro area, which in total is nonetheless within the required limit. It should be noted that the IMF's *World Economic Outlook* of September 2003 forecasts the United States deficit for this year at 6%, double the European average, and a significant increase on the OECD forecasts of last April. An important element in the explanation is now well-known: Iraq.

The fiscal deficit of the United States appears to be unsustainable, but the reality is that the countries show well-differentiated situation regarding their capacity to fund the deficit and that is related to their external (im)balances. For example, this year the United States will have a ***current account deficit*** of approximately 5.5% of GDP, whereas Japan has an external surplus estimated to be around 3.1% in 2003 and 3.9% in 2004.

The situation of the Balance of Payments in the United States (balance of –5.1% of GDP which, according to the IMF, is well above the –1.5% of 1995-97 and even the -3.2% of 1999) is an indicator that the "cheap dollar" policy (similar to what was observed in 1987/8 and 1994/5) will continue to ensure an increase in American exports and possibly a reduction in its imports.

While there are other elements that may put upward pressure on the US dollar, rather than allow it to depreciate – such as a recovery of capital flows into the stock and bond markets – the reality is that most analysts estimate that the US dollar ***exchange rate*** will continue to fall until the end of the first quarter of 2004, at which time that exchange rate of the USD against the EUR may be around 1.25 USD per Euro (1.15 as at the end of September 2003).



In summary, the OECD forecasts indicate that these conditions are now in place for the start of an economic recovery in the more developed countries (those in the OECD) lead by an economic recovery in the United States and followed by Europe and Japan.

However, there is still a significant risk of these economies remaining in a slow growth cycle, since the imbalances in the American economy (large public and current account deficits) and the American involvement in Iraq could completely alter this scenario, and precipitate deflation in a group of OECD countries that, in common with Japan, could take several years to overcome.

These positive perspectives (while not enthusiastically so) are more or less agreed with by many other analysts, who have identified signs of economic activity that suggest that the world economy will improve in the next six to twelve months.

Two of these signs are the reduction in the oil price from recent highs, and activity in the financial markets.

As noted above, it was the turn of the IMF last September to publish, in the *World Economic Outlook*, its own analysis the world economy and its development.

It recognises that the economy of the United States is stronger today than it was some time ago, but there are still two problems that affect it, namely the deterioration in two of the key economic deficits: the fiscal and foreign accounts. According to the IMF, this makes for,

"The ongoing existence of a set of risks that tend to worsen the economy, and, as historical experience tells us, even a "corrective" adjustment of the balance of current transactions will be followed by a weaker growth of either GDP, or worse, domestic demand. While such risks (of recession) are clearly reduced by a strong growth in productivity, it is less probable, looking to the future, that the United States can or should give to the world economy the degree of help (in the medium term) that it gave in the past."

The Fund found the landscape of the European economy looking even darker than that of the United States, with the economies of Germany, Italy and Holland in a technical recession. This results in the forecasts of production falling during the second half of the year in the Euro area, with a reduction of 0.5 percentage points from their earlier estimates for growth in 2003 and 2004. Thus, the IMF's forecasted rates of growth will be 0.5% and 1.9% in these two years, significantly below the forecasts of 2.6% and 3.9% for the United States.

Japan is currently experiencing increasing economic activity (the rate of growth forecast by the IMF for 2003 being 2% — or 2.9% according to other forecasters — compared with 0.4% and 0.2% in the past two years) and that may not be sustainable because a slowdown in growth could occur in 2004.

In turn, the more advanced economies which in the second half of the 1990s grew at annual rates of about 3-3.5%, will grow at about 1.8% this year, and 2.9% next year.

More positively, according to the IMF, the behaviour of the developing economies will grow this year at a rate of 5%, and 5.6% in 2004. Asia, especially China, will be the continent showing the greatest growth at about 6.4-6.5% in the two years. In each of these two years it is forecast that the Chinese economy will grow 7.5%, while the main group of developing countries in South-East Asia (Philippines, Indonesia, Malaysia, and Thailand) should grow during these two years at rates varying between 3.5% and 4.5%.

The perspectives on growth in East Asia are satisfactory, after the real scare of SARS and the resulting decline in economic activity – particularly in some countries (China, Hong Kong and Singapore) – in the second quarter of this year.

Once the difficulties associated with that epidemic are overcome, various indicators point to a return of consistent economic activity in the region.

The primary factor appears to be the rapid take-off of economic activity in ***China***, pushed by the country's dynamic exports. These, in fact, had seen the cycle of expansion fall significantly on 2001 and 2002 as a result of the cooling of the economies in the more developed countries that form the destination for Chinese exports.

Contributing to the process of China's rapid expansion (7-7.5% in 2002 and 2003) are the increasing restructuring of the country's economy by its leaders – in the sense of the increasing role being given to the private sector and reduction on the role of the State entrepreneurial sector – and a dynamic introduced by accelerating levels of direct foreign investment attracted by the forecasted rebound of China's economy, based on its recent entry to membership in the World Trade Organization.

Continuing with the review of the IMF's report, ***the remaining countries of Asia*** are demonstrating – and in the short term will continue to do so – a different pattern of behaviour. Together, they (excluding China) will have growth of around 3.25% in 2003. In 2004 it is forecast that this group of countries will improve their economic performance, and could grow at 4-5%.

From amongst these countries it is worth focusing on India, since it has been gradually increasing its growth pattern, reaching the "almost Chinese" rates of 6-7% growth each year.

Given the region where Timor-Leste is located, and having regard to its principal external economic relations, it is of particular interest to analyse developments in the Australian and Indonesian economies. These countries are our main economic partners, but because of the special characteristics being experienced during this period of national reconstruction, the impact of these developments on our national economy are smaller today than they potentially may be in the future. However, there is still a need – even if only for didactic reasons – to highlight and follow the development of our closest neighbours.

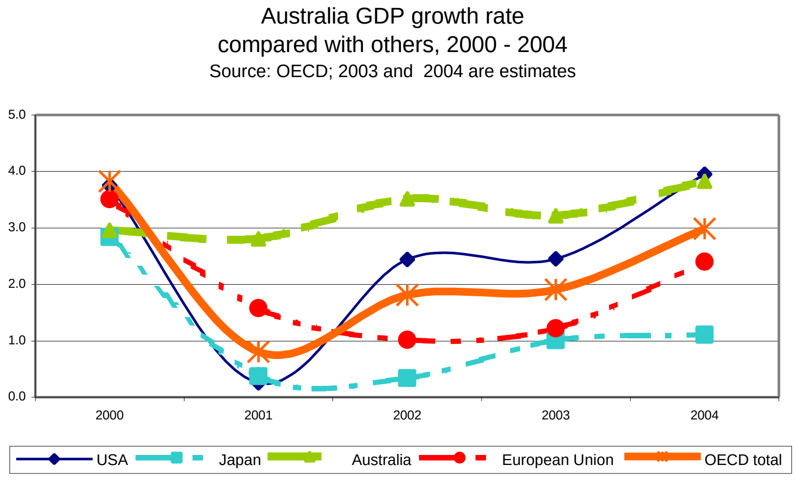
The ***Australian*** economy has in recent years recorded a remarkable performance when compared with other more industrialized countries.

The gradual slowing of the economy recorded in 2003 is mainly due to the drought that hit the country causing a reduction in exports. Proof that the non-agricultural economy is still resilient is provided by the developments in the sector formed by private, business and government spending, and by variations in the stock market that in the year ended last March, grew 6.3%, the highest rate in the last 3-5 years.

The rebound of the world economy – including the economies of Australia's main trading partners – obviated the effects of the drought that occurred in the country, and a significant increase in personal consumption that will help to strengthen the country's economic growth in 2004 when compared to 2003.

Underpinning the forecasted strengthening of economic growth in 2004 are positive trends in housing expenditure and the residential market, and strong fundamentals in financial and macro-economic behaviour. Having slowed down in recent months, the increasing credit being allocated to construction and renovations is giving rise to a sector that will also continue to contribute significantly to the economic growth of the country.

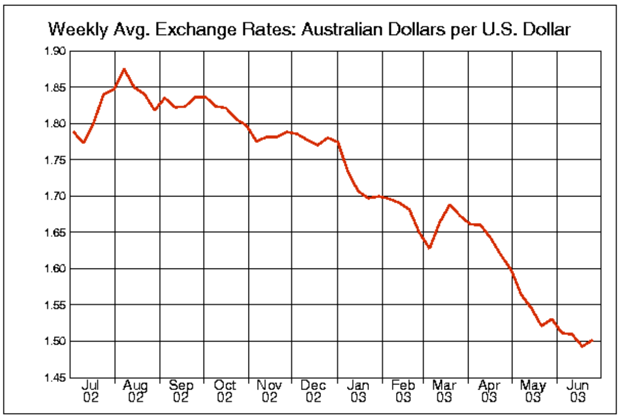
On the other hand, the improvement of the situation for food products – due to the alleviation of the drought, the price of oil, and the value of the Australian dollar (AUD) against the United States dollar (USD) are contributing to a positive outlook for ***prices***, with the OECD anticipating that the Consumer Price Index (CPI) will fall from 3%



to 2.7% in 2004, within the range of 2-3% that serves as the inflation benchmark for the national economic authorities, in particular the Reserve Bank of Australia (RBA).

The country's net exports, because of a fall in exports of primary products and the increase in value of the Australian dollar, have had a negative contribution on the country's Gross Domestic Product, the variance of which depends heavily on internal demand. This demand, however, has been falling, causing the slowing-down in the growth of the country's GDP. Improvements in exports in 2004 should compensate for falling domestic demand, helping to increase the rise in GDP from 3.2% in 2003 to 3.8% in 2004.

The ***increasing strength of the AUD*** against the USD noted earlier, shown in the adjacent graph, has reached 30% since the beginning of 2002. This increase in value is due to external factors – the previously mentioned weakness in the US dollar consequent on the problems affecting that country's economy – and internal factors, because the AUD has itself risen due to economic policy – particularly monetary policy – undertaken by the authorities, particularly by maintaining an interest rate well above other markets, especially the United States. Interest rates in the Australian inter-bank market were 4.8%, compared with 2.2% in the European markets and 1.1% in the North American market.



With such differences in rates, it is hardly surprising to observe the interest shown by investors in the Australian dollar, and this has contributed significantly to its strength. This movement has created a direct rise in prices of Australian commodities overseas – as has been experienced with a number of imports into Timor-Leste.

Regarding the Indonesian economy, it is also notable that after the instability that the country experienced from 1997 to its most recent presidential election, Indonesia looks to be progressively discovering the path to greater stability with growth. This stability translates itself into the fact that the rate of growth in production has been 3.4% and 3.7% in 2001 and 2002, and it is forecast that in 2003 and 2004 these rates will remain in the 3-3.5% range. Bank Indonesia, the central bank, was however more optimistic, forecasting last May that the rate of growth of ***production*** would be between 3.5% and 4%, arising from the long-awaited recovery of the international economy, and hopefully, the country's exports.

Inflation, on the other hand, is showing a very favourable improvement from 2002 to 2003, with its rate forecast to drop from 12% last year to about half that value this year. The most important factor in this slowing of price rises was the increasing strength of the Rupiah against the USD: from an average of IDR8977 per USD in July 2002 the ***exchange rate*** had moved to IDR8224 per USD in July this year.

The observed strengthening of the Rupiah was not only caused by external factors, such as the general depreciation of the USD against the majority of other currencies, but also from domestic factors, such as the intensification of the privatisation policy (the source of a stronger inflow of external capital) and from a general perception that the macro-economy had improved. The policy of maintaining relatively high interest rates (in the case of JIBOR, the rate fell from 15.5% in July 2002 to 11% in May 2003) also contributed to the strength of the Rupiah. It is hoped that this will not translate into a reduction in the expansion of the country's exports, industrial production, or the economy in general.

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

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

With regard to Timor-Leste and its specific situation, the primary danger that could emanate from the international economic situation is the continuing strengthening of the currencies of its two main trading partners, Australia and to a lesser degree Indonesia, that would cause upward pressure on prices, rising ***inflation*** and a decrease in ***real salaries***.

Recent Developments in the National Economy

Production

The BPA has called attention several times to the difficulty in being able to track developments in the national economy to deficiencies in the national system of statistics. At last, it appears that decisive steps are being taken to correct the lack of primary statistics on economic matters.

With this lack of locally produced statistics, we are left to concur – without necessarily agreeing – with the estimates being produced by international organizations about economic development, particularly in the area of national production/income.

The IMF's Asia Pacific Department has published in several documents on the economy of Timor-Leste, a number of estimates of developments in national production during 2002, which are notable for their variability and unreliability.

The first estimate, published in April 2002, indicated that the GDP in 2002 would be USD371 million, corresponding to a change of about +0.5% from 2001. However, seven months later, in a document released in November, the forecast of development had been downgraded, since the rate of growth had moved to –1.1%, corresponding to an estimate of USD368 million. Then in April 2003, after the end of the year, the IMF's Article IV consultation report estimated growth of GDP in Timor-Leste during 2002 to be +3%.

One can see from the estimates published by the Fund for Timor-Leste's GDP growth ranged from –1.1% to +3%, which should not be possible, because they were not prepared by the Fund itself, but derived from estimates. Furthermore, it is worth noting that the trend in the revisions was not constant, from April to November 2002 the estimates worsened, while from November 2002 to April 2003 the estimates were considerably better.

Unfortunately we do not have the statistical information that would allow us to prepare a technical comment on these values, although partial and general information lead us to conclude that in 2002 there appears to have been a slight decrease in national production. We hope that with future developments in the national statistical service we will be able to offer more concrete comments about the main macroeconomic aggregates.

With regard to forecasted growth in 2003, and considering the lack of satisfactory statistical information about production, we recommend caution and alert our readers to the fallibility of estimates made under these circumstances – once again using "feelings" rather than reliable estimates – and call attention to potential events that could influence the growth in production.

In this context, we are referring to agricultural production, which is influenced by whatever happens in the coffee sector. With international prices of coffee dropping for several years, it seems likely that there will be a decline in production, with some producers choosing to abstain from harvesting the coffee berries because of an unfavourable margin between labour costs (which are most likely higher than those in other coffee-producing countries) and the sale price of coffee.

In the service sector, the dominant force is the Public Administration, and it is known that there was no significant increase in employment in the Administration (which without potential gains in productivity contributes to a slow increase in production) and that there has been a gradual, and for the meantime not too significant, downsizing of the presence of the United Nations in Timor-Leste.

This last factor has produced a natural decline in hotel and restaurant activity in Dili, and these carry significant weight in economic activity and employment.

All these factors lead to the conclusion that this year's level of economic activity is lower than last year. The IMF predicts that there will be a drop of 2% during 2003 in relation to last year. However, that same organization forecasts a positive growth rate of 1% for 2004 compared with 2003. Unfortunately, for the moment we do not have cause to be as optimistic as the IMF …

Prices and Salaries

The official statistical services has recently commenced publishing a new ***Consumer Price Index*** (CPI) for the city of Dili, but there is not yet a satisfactory Index for the whole country. This Index is considerably more complete and reflects more realistically the actual levels of consumption, the previous Index having been based on enquiries made in the middle of the last decade. According to this new Index, the ***homogeneous inflation rate*** in 2002 (December 2001 to December 2002) was 9.5% including various classes of goods, including housing. If we consider the period June 2002 to June 2003 – corresponding to the period covered by this report – the variation in prices was around 8.2%.

Food items represent 56.7% of the basket of items included in the new CPI, and for that class the increase in price determines the increase in the consolidated Index. This is evidenced by the fact that the rate of food price increase was, during 2002, 9.2%, and therefore almost identical to the consolidated rate.

Analysing the monthly price changes during 2002, it can be seen that prices enjoyed a period of stability during the dry season (usually from March/April to October/November) but at the beginning and end of this period there was relative instability. Therefore, in relation to the decrease, note the fall in the monthly price variation from 1.2% in January 2002 to –0.4% the following March, corresponding to a situation of well-stocked markets during the period of the wet season.

Note that in the month of November there is a sharp increase, with a monthly rate of 2.9%, immediately reducing the following month to 0.3%. This increase was influenced by the price of vegetables (5.7% of the total "basket" in the price index) immediately before the start of the wet season (+24.6% in October and November 2002). This rise would have contributed to the rise in the class of "nuts" (particularly peanuts), the rise of 17% in the price of fruit, and 17% in the price of soft drinks.

Meantime, the cycle of price rises slowed down considerably in the initial months of 2003. Indeed, the cumulative level of price rises was only 0.5% through to the end of May. After that, the prices (global index) increased again at a relatively high rate, with values of +1.5%, +0.4% and +0.6% respectively for the months of June, July and August.

The values recorded through to August 2003 allow us to tentatively predict that inflation in 2003 will be around 5.5% to 6.5%. These values take into consideration an eventual rapid rise in prices at the beginning of the wet season, when markets are general poorly supplied with seasonal agricultural produce. We note however that the limited size of the statistical base does not allow us to use robust techniques to establish such estimates, increasing the possibility of an eventual divergence between the forecasts and the measured (*a posteriori*) reality.

Therefore if the beginning of the wet season is delayed (as happened last year) or if weather conditions are unfavourable for agriculture (and for the distribution of goods), it wouldn't be impossible to see prices rise faster than the levels mentioned earlier.

The situation of ***salaries*** needs to be seen in the context of price movements.

It is well-known that wages in the public sector were fixed by UNTAET in July 2000 in Directive 2000/4.

Since that time the State, by far the country's largest employer and traditionally (at least in many developing countries) the determinant of salary levels, has not modified them. Meantime, during that same time, prices have risen significantly (about 12% since the end of 2001; the inflation data for 2000 and 2001 not being comparable because of deficiencies in the preparation of the CPI).

Therefore it is probably not too far from the truth to say that the real value of wages in the public sector have fallen 15% to 20% from their initial level in June 2000. This fact could be acting as a brake to inflation, with vendors afraid that large increases in prices could not be borne by many consumers, thereby reducing demand.

It should be noted that this "freeze" of nominal salaries is a result of tight budget restrictions on the one hand, and, on the other, of the need not to contribute to an even larger competitive disparity between wages in Timor-Leste and those in other regional economies.

It is noted, however, that according to data in the public domain, the stagnation of public service salaries has not been experienced in the International Organizations and NGOs present in Timor-Leste. They offer salaries for national staff that are significantly higher and are also able to offer other benefits. For example, a driver in the public sector receives USD85 per month, while the identical job in an international organization is remunerated at about twice that amount. This proportion is repeated across almost all levels, and there is the constant threat of a drain of the better public service personnel.

Foreign Trade

One of the greater faults of the national statistical system is the absence of reliable published information about external trade. The Customs Service of Timor-Leste is currently working to resolve this problem, but for the moment it is only possible to obtain minimally consistent information about imports for 2003. As the focus of this report is on the period from July 2002 to June 2003, we will use, with thanks to those services that provided the information, data for the first half of the present calendar year. From this information it is possible to extract some tentative conclusions about the principal characteristics of Timor-Leste external trade.

According to the available figures, during the first half of 2003 Timor-Leste imported about USD105 million of merchandise. This figure can be compared with the USD216 million and USD186 million reported in 2001 and 2002 respectively.

The monthly distribution of these imports was as follows (in USD millions):

January	***February***	***March***	***April***	***May***	***June***
26.9	14.2	22.3	13.2	11.2	17.4

The January and March figures are noticeably different from the "trend" observed in the other months, and are particularly influenced by imports by the military contingents of the PKF (Peace Keeping Force) as outlined below. This type of import is not subject to taxes and customs duties, which would otherwise require greater care in analysing trade flows.

In fact, due to the many exemptions relating to the particular stage that the country is going through (and particularly noting those that benefit the various UN missions and many NGOs operating in this country) that the dutiable level of merchandise is in the minority (albeit an increasing one) when compared with total imports: USD 46 million during the first half of 2003, or 44.5% of the total imports of merchandise (USD 105 million).

As a reminder, the same percentages were 28% in 2001 and 25% in 2002. There is still much room for improvement in customs duties receivable – but the scope for improvement may be less than believed because many of the current exemptions are related to UNMISET activities (including PKF) that will in the nature of things disappear rather than transferring to the dutiable component of the statistics.

The principal ***supply countries*** for imports were Australia (USD 46.5 million; 44% of total imports), Indonesia (USD 17.7 million; 16.8% of total imports), Singapore (USD 13.7 million; 12.9% of total imports), Japan (USD 8.2 million; 7.3%) and Portugal (USD 4.7 million, 4.2%).

One question underlying the structure of the source of imports is to know what the effect is of the international presence in Timor-Leste (being the various United Nations missions, or individual international advisors) on the structure of international trade. There are no objective data that would allow us to provide a definitive answer to this question, but we believe that the weight of Australia as the primary source of supply will start to reduce once the downsizing of the international presence here begins.

This is also evident if we analyse external trade in terms of the value of imports that are subject to customs duties and taxes, and the value of imports not subject to duties and taxes. The latter have a close relationship to the presence of the United Nations and the many NGOs that are in many cases exempt from customs duties.

The following table uses the figures quoted earlier to make the comparison:

Source countries (10 largest)	**Value of imports subject to Customs duties (USD millions)**
1 – Indonesia	13.415
2 – Singapore	10.841
3 – Australia	8.964
4 – Portugal	2.762
5 – India	2.325
6 – Vietnam	1.378
7 – Italy	1.132
8 – China	1.110
9 – United States	0.914
10 – Japan	0.316
TOTAL IMPORTS	**46.421**

Source Countries (10 largest)	**Value of imports exempt from Customs duties (USD millions)**
1 – Australia	37.522
2 – Japan	7.884
3 – Indonesia	4.294
4 – Singapore	2.830
5 – Portugal	2.532
6 – United States	0.558
7 – Holland	0.371
8 – Italy	0.361
9 – South Korea	0.277
10 – Malaysia	0.171
TOTAL IMPORTS	**59.240**

Source: *Customs Department of Timor-Leste*

It can be clearly observed how much the landscape changes depending on whether or not customs duties are imposed.

If we consider the imports subject to customs duty to be of a more commercial nature (those not subject to duty including supplies of various types – some commercial e.g. office equipment for UNMISET and food and drink for its personnel, while others are not, e.g. spare parts for UN helicopters) we conclude that Indonesia is the main "commercial" supplier for Timor-Leste (29%), putting Australia in third place (19%). Singapore takes second place, with USD 10.8 million (19% of these imports plus 13% in aggregate).

In addition, note that 76% of imports from Indonesia are subject to duties, compared with only 19% from Australia. 79% of imports from Singapore are subject to duty.

The main ***type of product*** (whether subject to duty or not) imported by Timor-Leste during the first half of the year was "white goods" (Chapter 85 of the Customs Schedule) with USD 12 million (11.4%) followed by "aircraft and spare parts" (Chapter 90) with USD 10.1 million (9.6%).

If we consider only those goods that are subject to duty, "products for graphic industries" and "white goods" emerge first equal with USD 8 million each, followed by "mechanical equipment" (Chapter 84) and "pharmaceutical products" with USD 2.3 million and USD 2.1 million respectively.

The main dutiable imports from Indonesia were cereals (USD 2 million, including rice), motor vehicles (USD 1.2 million), mechanical equipment and electrical machines (about USD 0.9 million each). From Singapore, the major imports were books, magazines and other products for the graphic industry (USD 7.3 million) followed by electrical equipment (USD 1.7 million) and motor vehicles (USD 0.6 million).

Australian exports to Timor-Leste subject to duty were USD 1.5 million in motor vehicles, USD 1.2 million in fuel, and USD 0.9 million in electrical machines and equipment.

Regarding "aircraft and spare parts" (Chapter 88), USD 9.8 million was imported, mainly exempt, from Australia, and was essentially equipment for the PKF. Next came "quality control equipment" (USD 9.4 million), and then a long way back and almost at the same level, were machines and electrical equipment, and motor vehicles (about USD 2.5 million each).

Machines and electrical equipment were the main imports from Portugal, at USD 2.3 million, 86% of which were subject to duty.

Cereals, especially rice, being an important element of the Timorese diet, it is important to know their origins and costs. During the first half of 2003 USD 4.4 million was imported, of which USD 2 million (46%) came from Indonesia, and USD 1.4 million from Vietnam.

We note that from the available statistics it is possible to determine the average cost of ***imported rice*** at the Port of Dili on a CIF (Cost, Insurance and Freight) basis at USD 0.14 per kilogram, making a bag of 50kg, after taxes (6% + 6%) to be about USD 7.68 (being an average cost, the actual being variable according to quality and country of origin). Considering that the average price in the Dili markets is about USD 12.75, this means that the commercial expenses and profits of various middlemen (including the importer, wholesaler and retailer) have added about USD 5, i.e. around 40% to the final price, in what appears to be an adequate margin, below what might be expected.

With regard to ***exports***, the only product of note is coffee. In total, coffee exports have been about USD 3 million and USD 5 million respectively in the years 2001 and 2002, out of total exports of USD 4-6 million in each of those years.

Exchange Rates

The period July 2002 to June 2003 was essentially characterised by a continuous process of devaluation of the United States dollar against the main currencies of the world, and against the main trading partners of Timor-Leste.

The table on page 17 sets out the exchanges rates of the US dollar against the Euro (EUR), Australian Dollar (AUD) and Indonesian Rupiah (IDR).

Exchange rates (monthly averages)			
	EUR/USD	AUD/USD	IDR/USD
Jul 2002	1,007	1,807	8 977
Ago 2002	1,022	1,845	8 917
Set 2002	1,021	1,828	8 963
Out 2002	1,019	1,819	9 186
Nov 2002	0,998	1,781	9 089
Dez 2002	0,981	1,777	8 921
Jan 2003	0,941	1,715	8 899
Fev 2003	0,928	1,683	8 893
Mar 2003	0,927	1,662	8 926
Abr 2003	0,921	1,643	8 842
Mai 2003	0,866	1,546	8 444
Jun 2003	0,857	1,507	8257

As can be seen, the USD fell significantly against the AUD and the EUR, and to a lesser extent against the IDR. The exchange rate against the Yen did not change significantly, as a result of Japanese policy to not allow their currency to rise significantly against the US dollar in order to protect their exports to the United States.

Note that up to the end of June 2003 the USD lost about 15% of its value against the EUR, with its value going from an average of EUR/USD 1.007 in July 2002 to an average of 0.856 in June 2003.

The devaluation against the Australian dollar was similar during the same period: falling from AUD/USD 1.807 to 1.503. The rise in value of the AUD is particularly important because it increases the cost of imports from Australia, which in turn exerts an upward pressure on prices.

The change in the value of the Indonesian Rupiah against the USD was smaller than the Euro, being about 8% since July last year. This increases the cost of Timorese imports from Indonesia, and this is one factor (some of the others being more important) contributing to the explanation of the inflation rate of about 10% in our country during 2002.

Public Finance

Regarding public finance, the available data allows us to say that total expenditure in 2002/3 was about USD 70.6 million. Of this, the major portion was for Education (USD 17 million; 24%), followed by "Economic Issues" (23%) and expenditure for general administration (17%).

It should be noted that the two major sectors in social expenditure (Education and Health) represented in total almost 35% of the Sate Budget for Timor-Leste during 2002/3. Expenditure on public order and security represented about 21% of the budget. "Social" expenditure surpassed this latter category by about USD 10 million.

Expenditure increased by 28% between 2001/2 and 2002/3 with the major increases (at least in the more important sectors) being health, internal security and education. The increase in expenditure on internal security is accounted by the ongoing replacement of international forces by national forces, and the expansion of those forces since the events of 4th December 2002.

In economic terms, 82% of expenditure was current – with about half of total expenditure on goods and services, and a third on salaries – and only 18% of expenditure being for capital items. It should be noted that this is a trend that many may regard as negative, because in the fiscal year 2000/1 capital expenditure formed 24% of the budget, decreasing to 22% in 2001/2.

However, it needs to be noted that those earlier years were focused on the reconstruction of the public service, with all the demands to be expected during such a period (buildings and equipment, etc). As time passed, the initial reconstruction phase was replaced with a phase of more normal operations, and it is only to be expected that the proportion of current expenditure should increase relative to the proportion of capital expenditure.

But in saying so, it is not to say that all is well in this area. Indeed, an analysis such as the above can show – and in part does show – that the public service is experiencing an increasing difficulty in completing its investment projects, and certainly

that fact is a negative sign for the future. It is even more so when considered in the light of the anticipated reduction in support from international experts that will further diminish the government's capacity to realise its investments in capital projects.

But the expenditure from the State budget is not the only public expenditure in Timor-Leste. Public expenditure also includes the expenditure of autonomous agencies, (e.g. the Port of Dili, the Timor-Leste Electricity Company), the TFET (Trust Fund for East Timor), and bilateral and multilateral support from UNMISET.

In total, public expenditure under this definition totalled about USD 333 million, having been USD 400 million the previous fiscal year. The majority of the decrease is attributable to the decline in UNTAET/UNMISET expenditure, from USD 183 million to USD 108 million, as a result of the progressive downsizing of the UN presence in our country.

The financing of the State Budget ("CFET") has been assured from the country's self-generated income and by the support of donors. National receipts (internal plus petrol/gas) finance a little less than two-thirds of the CFET expenditure (more exactly, USD 44 million, with internal finance being USD 17.4 million and donor contributions being USD 433 million).

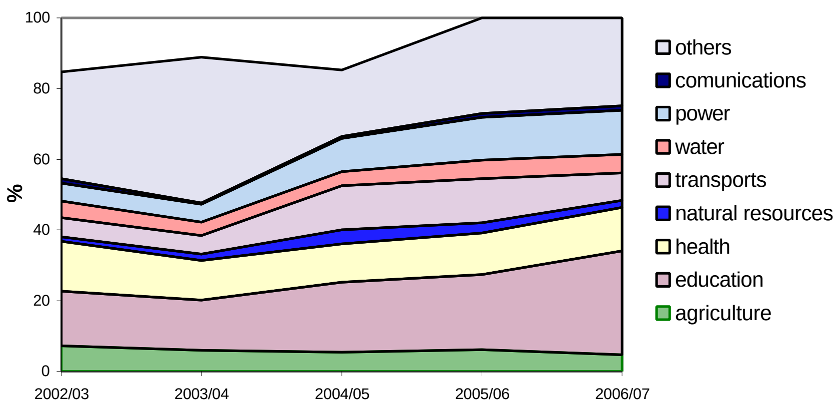
From this has resulted a net accumulation of resources that have translated into an increase in the deposits of the government in the central bank from USD 17.1 million to USD 41.5 million between July 2002 and June 2003. It is these accumulated resources that will in part help the government to overcome a period of greater financial difficulty forecasted for the years 2004 to 2006, arising from a slowdown in donor transfers, and possible delays in receipts from the Timor Sea, caused by delays in the agreements between the parties on the division of the resources that will be managed.

Another analysis that can be made is to identify the main sectors where financial resources have been applied since 1999. The next graph provides the essence of this information.

It should be noted that in the graph (above right), the data for 2002/3 and 2003/4 is based on official estimates, while the data of the other two years are based on forecasts subject to change by the two major participants: the government, through the

Public expenditure: structure

(CFET + donnors)



Percentage (Government + donnors)	Budget (CFET) *2002/03*	*2003/04*	Donors *2002/03*	*2003/04*
Agriculture	1.2	1.1	10.0	8.0
Education + training	22.1	23.5	12.4	10.3
Health	10.5	11.5	15.7	11.0
Natural resources and environment	1.2	1.4	1.3	2.1
Transports	9.0	11.0	3.0	1.7
Water and sanitation	3.3	3.5	5.2	3.9
Power	14.7	15.3	0.6	0.3
Communications	1.5	1.2	1.4	0.0
Total of the sectoral programmes	65.3	70.2	53.7	41.1
Other programmes	34.7	29.8	27.9	46.5
Total	*100.0*	*100.0*	*81.6*	*87.6*

State Budget, and the Donors, through alterations that they may introduce into the size and structure of their contributions.

It can be deduced from the graph that the main beneficiaries of the expenditure of the State and the Donors have been the social sectors, education and health. This policy is entirely in accordance with modern economic practices, particularly those emphasized in the concept of "human development" and the so-called "Millennium Objectives" approved by the UN General Assembly in September 2000 and adopted by Timor-Leste.

Money, Credit, and Interest Rates

In BPA's Annual Report last year, we said, "the currency situation of Timor-Leste is strongly influenced by the fact that a foreign currency, the US dollar, has been chosen as the legal tender in this country." Nothing has changed about this situation, and the comment is still valid, although one consequence is that it is impossible to accurately know the volume of currency in circulation.

In fact, while the amounts of currency imported by the BPA and put into circulation either by the BPA or the commercial banks is known exactly, in fact the freedom of capital flows (including currency) that applies in our country prevents us from knowing with any certainty the volume of currency in circulation. We mention again two of those mechanisms referred to in last year's report: cash payments for imports, and transfers abroad, also in cash, can be significant, as is the income of the international personnel working amongst us.

But, with the exception of the total currency in circulation, there is much information available in the public domain, especially since the BPA started compiling economics statistics for our country in July 2002. They were published in the first edition of the "Economics Bulletin" last April, and from these statistics it can be seen that at the end of June 2003 the total amount of private deposits (both short and long term) in the commercial banking sector was USD 58.5 million, and increase of about USD 7 million from the same month last year. It should be noted that the statistics for July this year, unlike last year, include those from the *Microfinance Institution of Timor-Leste*.

The BPA, the government's sole banker, itself has USD 41.5 million of government deposits. This value compares with the USD 17.2 million at the end of June 2002, being the result noted above of an accumulation in public financial resources.

Bank deposits are traditionally the primary source of finance for what, in principle, is the banks' main source of revenue, namely ***bank credit***. For this, it is important to compare the volume of credit with the volume of deposits.

From the monetary statistics compiled by the BPA, the volume of credit at the end of June 2002 was about USD 6.4 million.

According to the bank most active in the granting of domestic credit, it has lent since its inception about USD 12.3 million, being the contracted value, although the total credit actually utilized by borrowers has been USD 10.4 million.

The great majority of these borrowings (93%) has been for housing construction or reconstruction, representing 60% of credit granted. The average value of a loan was about USD 2,000.

A smaller number of loans (236, corresponding to about 7% of total borrowers, but accounting for 40% of the value of credit) was destined for other activities, namely domestic trade (12% of total value), international trade (2.8%), construction (13.4%), industry (10 loans representing 3.9% of total value) and agriculture (only one loan contract).

The interest rate most frequently applied was 15%, but the average interest rate for housing was higher, with the majority being at 15.7%.

It needs to be taken into consideration that apart from the credit being offered by the banks, there are also others sources of credit such as NGOs and international organizations.

The comparison of the total value of lending in the banking system with the total value of deposits accepted by it (USD 51.7 million) allows us to conclude that the ***loans/deposits ratio*** was 0.12 in July 2002, which level was maintained until March 2003, when further credit was granted increasing the ratio to 0.18 by June, and 0.2 in August. It is worth noting that in economies with more advanced banking systems the ratio can rise above 0.5 or even 0.6.

There are two principal conclusions that can be derived from the values of this ratio for Timor-Leste.

Firstly, that there is not a sufficient quantity of profitable loan applications for the amounts of money that banks have at their disposal, so that the commercial banks have to place a significant amount of their domestic assets abroad. The ***total gross assets of commercial banks invested abroad*** increased from USD 44.3 million to USD 53.3 million between July 2002 and June 2003; while the net assets of the BPA invested abroad were USD 51.3 million at the end of June 2003, representing an increase of USD 23 million over July the previous year. These values relate essentially to the financial resources deposited by the government with the BPA. The country's ***total net external assets*** increased from USD 73.3 million in July 2002 to USD 99.7 at the end of June 2003, putting Timor-Leste in the unusual situation (when viewed against its level of development) of being a net creditor of the rest of the world.

Secondly, despite the cost of money being kept relatively low (low interest rates paid to depositors), the banks have a necessity to charge high interest rates (on loan contracts) to offset their financial and operational costs, and business risks. The increase of competition in the banking sector, with the entry of new banks into the market, could influence these rates downward, although we do not believe there will be significant changes.

Of equal note, the fact that banks are granting small amounts of credit in comparison with the resources at their disposal means that their operational costs must be covered by a limited number of borrowers. A significant increase in this number could also have a positive influence by decreasing interest rates.

Naturally, these are not the sole, nor even the main, reasons for the rate of interest charged to be reasonably high (around 15% to 17%, except for the best clients) when compared with current interest rate on USD loans in international markets.

The rates are primarily justified by the business risk, namely the fragility of the economy and the lack of sufficient real guarantee able to be given by borrowers on urban or rural property. We referred to this point in our report last year, and the problem will tend to become entrenched if the authorities cannot provide greater clarity for land ownership, and promulgate laws that regulate commercial activity.

However, given that the rate of loan failure is relatively small (about 2-3% of credit granted) the question can be asked whether the rate of risk is as high as it seems. We are not overlooking the fact that the failure rate may be low because borrowers are carefully chosen by banks, and any relaxation of their criteria would almost certainly result in an increase in the level of so-called "non-performing loans" – which would imply the need for a higher interest rate.

It should also be noted that the interest rate on borrowings must be reconciled with the rate of inflation to determine the ***real rate of interest***. Therefore based on the rate of inflation (9.5% in 2002, but tending to decrease to 5-6% this year) real interest rates can be determined to be about 7-8% in 2002 and 11-12% in 2003, clearly high when viewed in an international context.

On the other hand, investors with deposits are receiving negative real interest rates, since interest rates on deposits are either zero (current accounts) or very low (about 1% on term deposits). This situation is generally considered as a disincentive for the creation of savings in banks, a situation that does not contribute to the economic and social development of the country.

Monetary Statistics of Timor-Leste

July 2002 to June 2003

MONETARY STATISTICS OF TIMOR-LESTE

1.JULY.2002 to 30.JUNE.2003

Thousands of USD	July 2002	Aug	Sep	Oct	Nov	Dec 2002	January 2003	Feb	Mar	Apr	May	June 2003
Net foreign assets	**69969**	**77266**	**77330**	**74800**	**83559**	**89875**	**88955**	**88089**	**92791**	**93087**	**92315**	**99669**
Claim on non residents	72817	80258	80451	79202	97822	104199	103411	102736	107846	108747	108095	116000
Monetary gold and SDR holdings												
Foreign currency	8295	14011	12395	9312	15170	18072	14996	12589	15078	11554	15482	10535
Foreign currency (Central Bank = BPA)	5851	11317	8474	6202	11686	13042	12366	9858	12224	8886	12669	7745
Foreign currency (Commercial Banks = ComBk)	2444	2694	3921	3110	3484	5030	2629	2732	2855	2668	2813	2790
Deposits	64522	66247	68056	69890	71796	75270	77559	79290	81911	85845	81265	94116
Deposits (BPA)	22661	22347	24770	26886	27133	30483	31707	32411	34110	40822	36074	43649
Deposits (ComBk)	41861	43900	43286	43004	44663	44786	45852	46879	47801	45023	45191	50467
Others	0	0	0	0	10857	10857	10857	10857	10857	11348	11348	11348
Subscription of the IMF quota (BPA)	0	0	0	0	10857	10857	10857	10857	10857	11348	11348	11348
Less: Liabilities to nonresidents	2848	2991	3121	4402	14264	14324	14457	14648	15056	15660	15781	16330
Subscription of the IMF quota (BPA)	0	0	0	0	10857	10857	10857	10857	10857	11348	11348	11348
External credit (ComBk)	2848	2991	3121	4402	3407	3466	3600	3790	4198	4312	4432	4982
Domestic Claims	**-10771**	**-16992**	**-14662**	**-15315**	**-18889**	**-26943**	**-25047**	**-22115**	**-29224**	**-29104**	**-29345**	**-32716**
Net claims on central Government	-17156	-23205	-20860	-21802	-25404	-33673	-31048	-29391	-36298	-37001	-37418	-41535
Claims on Central Government	0	0	0	0	0	0	0	0	0	0	0	0
Claims on Central Government (BPA)	0	0	0	0	0	0	0	0	0	0	0	0
Claims on Central Government (ComBk)	0	0	0	0	0	0	0	0	0	0	0	0
Less:Liabilities to Central Government	17156	23205	20860	21802	25404	33673	31048	29391	36298	37001	37418	41535
Liabilities to Central Government (BPA)	17156	23205	20860	21802	25404	33673	31048	29391	36298	37001	37418	41535
Liabilities to Central Government (ComBk))	0	0	0	0	0	0	0	0	0	0	0	0
Claims on Others (private) sector	6386	6213	6198	6487	6514	6730	6002	7276	7074	7897	8073	8819
Other financial Corporation	0	0	0	0	0	0	0	0	0	0	0	0
Accounts receivable (BPA)	0	0	0	0	0	0	0	0	0	0	0	0
Claims on other sectors (ComBk))	0	0	0	0	0	0	0	0	0	0	0	0
Other resident Sector	6386	6213	6198	6487	6514	6730	6002	7276	7074	7897	8073	8819
Accounts receivable (BPA)	0	0	0	21	0	0	33	46	64	78	93	102
Claims on other resident sector (ComBk))	6386	6213	6198	6465	6514	6730	5969	7230	7009	7819	7981	8717

Broad Money liabilities (M2)	**51668**	**52907**	**54837**	**51526**	**56284**	**54883**	**56030**	**57977**	**55286**	**55905**	**54648**	**58494**
Transferable deposits	45641	46771	49058	46116	50501	49165	50329	52243	49471	50113	48621	52637
Other financial Corporation	0	0	0	0	0	0	0	0	0	0	0	0
Public nonfinancial Corporations	74	133	52	155	262	274	244	896	869	861	758	755
Public nonfinancial Corporation (BPA)	74	133	52	155	262	274	244	896	869	861	758	755
Public nonfinancial Corporation (ComBk))	0	0	0	0	0	0	0	0	0	0	0	0
Other nonfinancial corporations	0	0	0	0	0	0	0	0	0	0	0	0
Other resident Sector	45566	46637	49006	45961	50238	48891	50085	51347	48603	49252	47864	51882
Demand deposit (ComBk)	45566	46637	49006	45961	50238	48891	50085	51347	48603	49252	47864	51882
Other Deposits	6027	6137	5779	5410	5784	5718	5701	5734	5815	5792	6027	5856
Other resident Sector	6027	6137	5779	5410	5784	5718	5701	5734	5815	5792	6027	5856
Fixed deposits - regular / term. (ComBk)	6027	6137	5779	5410	5426	5343	5243	5190	5196	5050	5185	4900
Saving deposits (ComBk)	0	0	0	0	357	375	459	544	619	742	842	956
Shares and other Equity	**7247**	**7270**	**7236**	**7333**	**9416**	**9304**	**9326**	**9137**	**9092**	**9096**	**9144**	**9045**
Fund contributed by owners	7209	7209	7209	7039	9039	9100	9339	9084	9084	9084	9084	9084
Fund contributed by the State (BPA)	6885	6885	6885	6885	6885	6885	7351	7351	7351	7351	7351	7351
Fund contributed by owners (ComBk)	325	325	325	155	2155	2215	1988	1733	1733	1733	1733	1733
Retained earning	-429	-406	-389	-173	-90	-263	-13	53	8	12	60	-39
Retained earning (BPA)	41	54	115	161	193	180	299	396	389	429	481	389
Retained earning (ComBk))	-470	-460	-504	-334	-283	-443	-312	-343	-381	-417	-422	-428
General and Special Reserve	467	467	467	467	467	467	0	0	0	0	0	0
General and Special Reserve (BPA)	467	467	467	467	467	467	0	0	0	0	0	0
General and Special Reserve (ComBk))	0	0	0	0	0	0	0	0	0	0	0	0
Valuation adjustment	0	0	-51	0	0	0	0	0	0	0	0	0
Valuation adjustment (BPA)												
Valuation adjustment (ComBk)	0	0	-51	0	0	0	0	0	0	0	0	0
Others items (net)	284	97	595	626	-1031	-1254	-1447	-1140	-811	-1018	-822	-586

2 – BPA ACTIVITIES

Index

2.1 - GENERAL ANALYSIS

The period 2002/3 was the first complete fiscal year in the life of the Banking and Payments Authority of Timor-Leste (BPA), because, as is known, this institution was created on 30 November 2001. It was also the first year in the life of the BPA as the central bank (even though that is not yet its name) of an independent country, because the Democratic Republic of Timor-Leste itself came into being only forty-one days before the start of the fiscal year.

In the twelve months under review the progress registered in all units and areas of the BPA was significant and varied, and it will be impossible to mention all of them in this introduction, so we will confine ourselves to the highlights.

In the area of **banking supervision** the most noteworthy occurrence was the appointment, in December 2002, of a Timorese member of the Governing Board, with

Abraão de Vasconselos being promoted to the position of Deputy General Manager for Supervision, the position of second-most importance in the corporate hierarchy. Equally important was the sending overseas of two senior staff from this department for extensive training, to prepare them for the future regulation and supervision of insurance activity in Timor-Leste. For this reason, existing staff of the BPA were transferred to this Department. Still in the area of supervision, it needs to be recorded that the application of Bank Mandiri to open a branch in Timor-Leste was given preliminary approval in March 2003, and the bank commenced operations in August the same year.

In the area of **payments and banking operations** the most relevant event was the reorganisation of the department into four Divisions that correspond to the four main areas in which the BPA operates: importation, distribution and management of currency (cash); banking operations; management and supervision of the payment system; and the management of financial operations and settlement of foreign transactions. Local managers head each of these Divisions. It is also of note that a member of this department participated for the first time, representing the BPA, in a conference organised by the Bank of Cape Verde for the central banks of Portuguese-speaking countries, demonstrating the recognition by the organisers of the role that the BPA plays as the “central bank” of Timor-Leste.

In **accounting and budgeting** despite the reduction in size after one member of staff was transferred to manage Internal Audit, great progress was achieved. Perhaps the best example of this progress was the introduction of the discussion and analysis of the monthly management reports, including progress against budget. The training of the manager of this Division and the potential of its local staff (one of whom has been granted access to train for additional academic qualifications by the BPA) mean that in the medium term the management of this important division can be assumed by Timorese staff.

The Administration Department, through its three areas of responsibility – **human resources, corporate services, and procurement**, was intensively busy throughout the year, with new requests being handed to them almost continually. In **human resources** new reforms were implemented that covered all the existing norms and procedures, and the division also assumed responsibility for handling all the administrative aspects of internal and external training. The intensification of internal training programmes obliged the BPA to create its own training centre. **Corporate services** has an ongoing responsibility for maintaining physical security (exterior perimeter, electronic systems), the functioning of the premises (water and electricity) as well as the BPA’s plant and equipment. The newly created, if small, **procurement** division was able to respond quickly and efficiently to all of BPA’s purchasing needs, even for projects of an unusual size in comparison with the scale of BPA’s operations (evaluation and selection of contractors to construct an exterior perimeter fence, the construction of the new training centre, and preparations for the construction of a new vault).

Equally, much progress was evident in the area of **economic studies and statistics**. Having been created in March 2002, the division exploded into action with the decisive and dedicated contribution of the international advisor to the division. The compilation of monetary statistics, the publication since April of a quarterly economic bulletin (unique in Timor-Leste) and the pioneering of similar activities, and the regular organisation of conferences and seminars (also open to outside parties) on themes of interest to the Timor-Leste economy, have all contributed to the remarkable activity in the division. It is also worth noting that the same Division was the focal point for the discussions with the IMF mission that visited Timor-Leste in April 2003 in connection with the consultations made under Article IV of the constitution of that organisation, of which Timor-Leste is a member.

The **information technology** division maintained the continuous operation of IT equipment. Significant progress was achieved in the development of an internal network. In addition, some custom application software, such as personnel processing and salary payments (for the public administration, as well as BPA staff), were implemented.

The sole member of the **legal office** was moved temporarily from his regular functions to receive training overseas, to enable him to effectively collaborate in the creation of the legal framework that will including the legislative and regulatory structure of future insurance activity in Timor-Leste.

Finally, the **internal audit office** gained a new dynamism from December, with the restructuring of its human resources, as well as the support (which became permanent from July 2003) from an experienced international advisor.

2.2 - DEPARTMENT OF BANKING SUPERVISION

The Department of Banking Supervision has the responsibility to licence, regulate and supervise banking institutions and currency exchange bureaus. Three main areas have been established within the Department namely licensing, off-site examination, and on-site examination. The Department is now has seven professional positions and one clerical position and is headed by the Deputy General Manager of Supervision. The position has been occupied by a Timorese since December 2002.

During the financial year three new staff were recruited and trained in all areas, meanwhile two senior staff have attended a six-month training course on insurance, in Portugal.

The Department conducted a three-month induction course for Bank Supervisors for the new staff with the assistance from MFS Department of the International Monetary Fund.

As at 30 June 2003, two branches of foreign banks and a microfinance institution were licensed under the Banking Regulation and continue to operate in Timor-Leste. The Microfinance Institution of East Timor was fully licensed to operate as a quasi bank under Section 2.6 of the Regulation. The Institution is wholly owned by the Foundation for Poverty Reduction in Timor-Leste that was established with technical assistance from Asian Development Bank. As a quasi bank the Institution cannot use the word ‘bank’ in its name and its deposit liability may not exceed one million US dollars.

Meanwhile, two new applications for banking licenses were received during the year resulting in a preliminary approval being granted to PT. Bank Mandiri – an Indonesian state-owned bank to establish a branch office in Timor-Leste, while the other application is still being processed.

For the establishment of a foreign bank in Timor-Leste, BPA has an agreement with the home country supervisor regarding the consolidated supervision of the bank and the inclusion of the branch in Timor-Leste on a consolidated basis. However, BPA retains the authority under the Regulation to supervise branch offices of foreign banks.

During the financial year, BPA cancelled the licence of East Timor Currency Exchange Bureau which had been licensed in early 2001. Cancellation of the licence was due to the non operational status of the bureau from February 2002.

During the year, the Department conducted on-site examinations of the two banks – the ANZ and CGD Timor-Leste branches. The examination covered the validation and assessment of assets, liabilities and income statement, and in addition a partial examination focused on loans was also conducted.

During the financial year, a central credit registry - ‘credit risk bureau’ was being prepared to register all credit information of the commercial banks operating in Timor-Leste. The documents for the establishment of the bureau are being drafting and a database system is being developing to enable the Department to collect and maintain credit information.

The legal framework for the licensing and supervision of banks is the banking regulation which was passed on 25 February 2000. During the year two Instructions have been issued: an Instruction on Chart of Account for Banks and an Instruction on Banking Holidays.

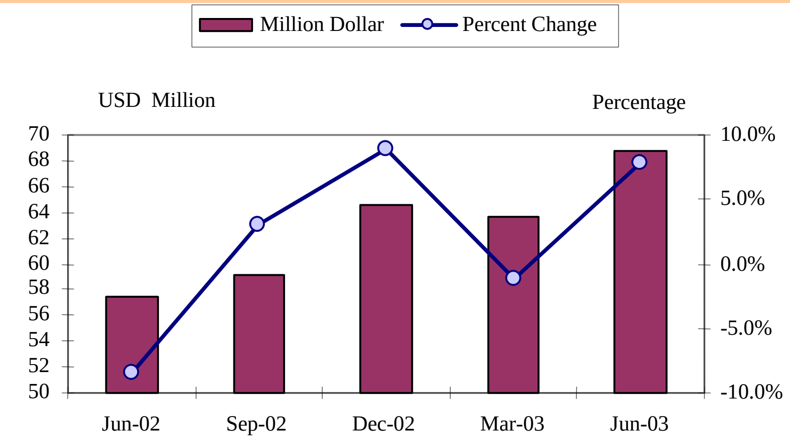
The new Instruction on Chart of Account for Banks supersedes an earlier Instruction issued last year which contains the accounting standards and procedures, reporting and publication forms, including the required minimum notes to the financial statements.

Two draft instructions have been prepared for adoption of the Governing Board of BPA: an Instruction on the Opening and Maintenance of Deposit Accounts and the Report of Consolidated Financial Conditions – 'Call Report'. The aim of the former is for banks to maintain complete identification of depositors as a means of avoiding the banking system being used for money laundering and criminal activities and maintaining the transparency of banks' services and fees to depositors. The Instruction on Call Report consolidates all the forms required for supervision, for the analysis of compliance with the prudential requirements and for the analysis of capital adequacy, asset quality, efficiency and earnings, liquidity and interest-rate sensibility. The Instruction includes detailed guidelines in the preparation of each report required for the off-site surveillance of banks in accordance with the established prudential requirements.

Financial Activity of the Banking Sector

Activity of the banking sector continued expanding during the year at a moderate rate compared with the previous years.
As at June 2003, the aggregated balance-sheet increased by 19.5 percent to USD 68.7 million, compared with USD 57.5 million as at June 2002 and USD 56.5 million as at June 2001.

FIGURE 1: AGGREGATED BALANCE-SHEET



SOURCE: Based on returns to BPA of banks

Figure 1 graphically depicts the quarterly balance, and percentage growth in, the aggregated balance-sheet of the banking sector for the period November 2000 to June 2003. The main factors contributing to this growth were the increase in credit of 81.4 percent, and deposit liabilities which increased by 14.5 percent.

Assets and Liabilities

Figure 2 graphically reflects a year-on-year comparison of the composition of assets as at 30 June 2003, 30 June 2002 and 30 June 2001. The banking sector's assets increased by USD 11.2 million (representing a growth rate of 19.5 percent) during the year, to a total of USD 68.7 million at the end of June 2003, compared with year-on-year growth rate of 1.8 percent in the end of June 2002.

Factors contributing to this growth were the following:

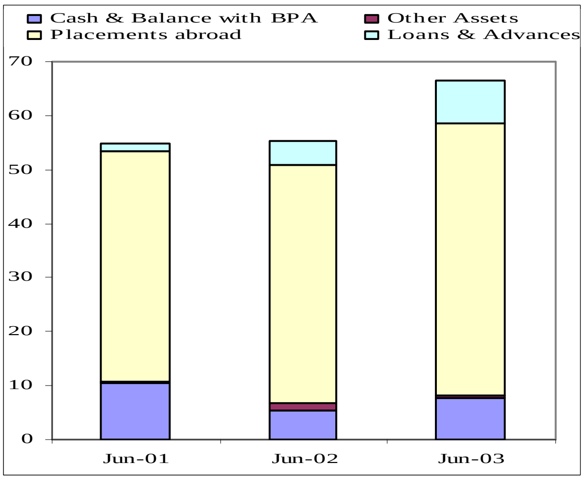
?? Cash and balances with BPA grew by 47.2 percent, from 5.3 million as at 30 June 2002 to USD 7.8 million as at 30 June 2003.

?? Placements abroad grew by USD 6.4 million (representing a growth rate of 14.5 percent) from 44.0 million of the end of June 2002 to USD 50.5 million a year later.

?? Loans and advances increased from USD 4.3 million at the end of June 2002 to USD 7.8 million at the end of June 2003, representing a growth rate of 81.4 percent.

Figure 2 also shows that assets still concentrated in placement with banks abroad which is attributed to the lack of a local legal framework. As at the end of

FIGURE 2: COMPOSITION OF ASSETS

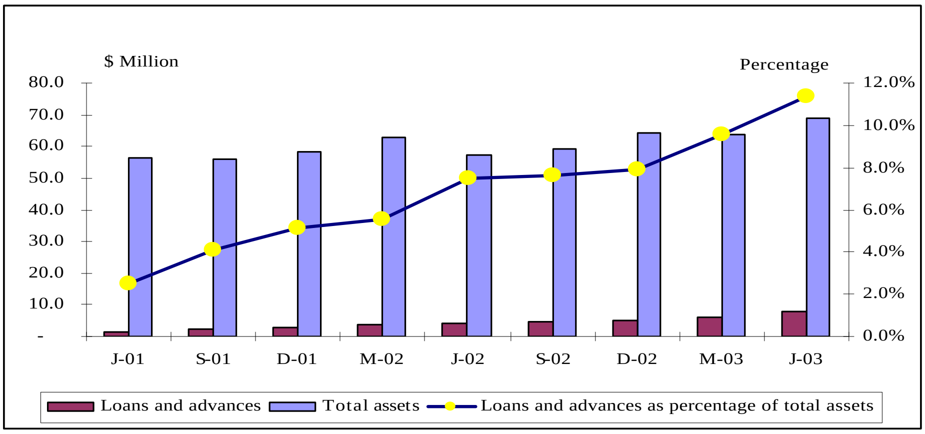


June 2003, placements constituted 73.5 percent (June 2002: 76.6 percent) of the banking sector's assets, thus, represented the main area of focus for the management of on-balance-sheet. However, as shown in Figure 3 during the period June 2001 to June 2003, loans and advances as a percentage of total assets continued to increase significantly, from just 2.5 percent in June 2001 to 11.4 percent in June 2003. Despite such a substantial increase in loans and advances however, the total is equivalent to approximately 14 percent of the banking sector's deposits.

The banking sector's portfolio is generally sound, with the non-performing loans remaining modest, less than 1.0 percent.

Total loans and advances as described above exclude loans to small enterprises channelled through banks but sourced from the Trust Fund for East Timor amounting to USD 1.8 million.

FIGURE 3: LOANS & ADVANCE AS A PERCENTAGE OF TOTAL ASSETS



SOURCE: Based on returns to BPA of banks

Domestic deposits from the public totaling USD 57.7 million remained the primary source of funding for the banking sector and constituted 84.0 percent of the total liabilities in June 2003, compared to 87.7 percent in June 2002. Deposits increased from USD 50.4 million at the end of June 2002 to USD 57.5 million at the end of June 2003, representing a growth rate of 14.5 percent.

2.3 – PAYMENTS DEPARTMENT

The Payments Department continued to provide much the same range of operational banking and payment services to BPA's clients as it had in previous years.

In the course of the year, the Department was restructured into four operating divisions, each having clearly defined responsibilities and roles. The Department maintained a total complement of about fifteen national staff throughout the year who completed daily operations to a consistently high standard. Three full-time advisors working under UNMISET and IMF technical assistance programmes provided technical assistance and training to the department.

1. Banking Operations Division

The Banking Operations Division continued to operate as in previous years, primarily servicing the banking needs of the Government of Timor-Leste. In this regard, the Division continued to disburse civil service salaries, cash government cheques, and to a more limited extent manage government receipts. A total of nearly 10,000 receipts and payments were managed for the government.

These transactions included the cashing of over 4,000 cheques, and in addition, approximately 46,000 civil service salary disbursements were made.

As a result of Timor-Leste becoming an independent nation, it became a member of the International Monetary Fund, the World Bank Group, and the Asian Development Bank. In each of these cases, the BPA was appointed as the official depository, and in consequence established a number of related accounts and security deposit arrangements.

2. Currency Operations Division

The year under review was the first full fiscal year during which the US Dollar was actually used by the people of Timor-Leste as the official currency. Accordingly, the number of cash transactions with commercial banks was higher than the previous year, particularly as some of the lower denomination notes began to deteriorate in quality and required replacement. The BPA therefore recognised this additional obligation, namely to repatriate unfit currency the United States, and towards the end of the reporting period repatriation procedures were in the process of being implemented.

Currency imports continued to be made on a regular basis, although the overall value of banknotes imported was lower than the previous year because the basic stock of currency in circulation had been established.

Summary of currency transactions
1.Jul.2002 to 30.Jun.2003 (USD millions)

Denomination	**importation**	**Circulating currency**		**Withdrawal from circulation**
		issuance	re-deposits	
USD 100	20.8	21.2	0.35	0.01
USD 50	5.5	7.37	0.83	0.07
USD 20	9.4	11.58	1.16	0.30
USD 10	4.8	13.78	8.98	0.68
USD 5	2.1	14.61	12.62	0.75
USD 1	0.5	2.72	2.88	1.21
25 cents	--	0.29	0.10	--
10 cents	--	0.20	0.06	--
5 cents	--	0.07	0.03	--
1 cent	--	--	--	--
TOTAL	***43.10***	***71.87***	***27.00***	***3.03***

Although the number of counterfeit US notes detected in Timor-Leste since the US dollar was mandated as the official currency has been minimal, the Division established a Counterfeit Notes Register to record and store all counterfeit notes, and act as the primary liaison point for the local police service, as well as the United States authorities. A number of seminars were held for staff of commercial banks and larger businesses and hotels in Díli to ensure that the level of public knowledge about the security features of US currency was developed, primarily as a preventive measure against Timor-Leste becoming a destination for counterfeit notes.

With the need to efficiently handle the increasing volume of unfit bank notes, the imminent arrival of Timor-Leste coins, and the possibility of further banks being registered, the Division issued an Instruction on Deposits and Withdrawals of United States Currency and Coin by Commercial banks.

The Division was also involved in the design and minting arrangements for the Timor-Leste coins that will be issued in November 2003.

3. Investments and Settlements Division

In addition to the routine settlement of client account payments – primarily payments for the government – the Division managed the disbursement of pension payments to ex-civil servants from the Republic of Indonesia through a commercial bank.

The move towards implementing systems for making payments and settlements electronically came to an abrupt halt at the time Timor Telecom assumed responsibility for telecommunications, and the technical problems remain unresolved.

One important correspondent banking relationship was confirmed during the year, with the Federal Reserve Bank of New York, and it is intended that as soon as the electronic infrastructure issues are resolved that this account would be used for the settlement of the majority of US dollar transactions.

Numbers and values of settlements completed during the year were as follows:

	Domestic Settlements		International Settlements		International Receipts	
	Number	Value*	Number	Value*	Number	Value*
July 2002	92	987	53	5,672	26	7,354
August	89	665	63	10,885	27	8,379
September	104	3,043	58	3,352	27	5,809
October	69	516	60	1,928	29	3,965
November	101	2,435	47	11,520	36	11,773
December	94	2,230	44	7,333	26	10,187
January 2003	141	2,168	28	7,246	24	3,538
February	130	1,652	28	864	24	1,459
March	167	5,318	32	9,319	45	11,173
April	277	2,841	37	1,229	28	7,992
May	230	4,336	44	9,525	34	4,888
June	307	3,039	38	2,023	43	9,676
Total	**1801**	**29,230**	**532**	**70,896**	**369**	**86,193**

* Value in USD thousands

4. Payment Systems Division

The Díli Clearing House continued to develop steadily during the year, and while the volumes are still small, the resulting overall growth in volume and value was about twice the previous year.

The number of clearing participants remained at four (BPA, the two commercial banks and the Institution of MicroFinance) for the year under review.

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

Month	Number		Value (USD'000)		Returns	
	Total	Daily average	Total	Average value	Number	Value
July 2002	464	20	2,647	5.7	-	-
August	395	20	1,027	2.6	-	-
September	393	20	3,127	7.9	-	-
October	403	18	2,511	6.2	-	-
November	417	23	3,546	8.5	-	-
December	472	26	2,858	6	-	-
January 2003	455	21	3,626	7.9	11	121
February	511	25	3,012	5.9	15	21
March	596	28	6,731	11	15	124
April	683	32	3,723	5.4	25	79
May	665	33	5,066	7.6	12	116
June	773	37	3,071	3.9	9	43
Total (2003)	**6,227**	**25.3**	**40,945**	**6.6**	**87**	**42**
Total (2002)	**3,206**	**13.5**	**18,575**	**5.8**	**-**	**-**

Initial steps were taken during the year to undertake a survey to establish a statistical database for payments in Timor-Leste, which will provide the foundation for future supervision of the payments system.

2.4 - DIVISION OF ACCOUNTING & BUDGET

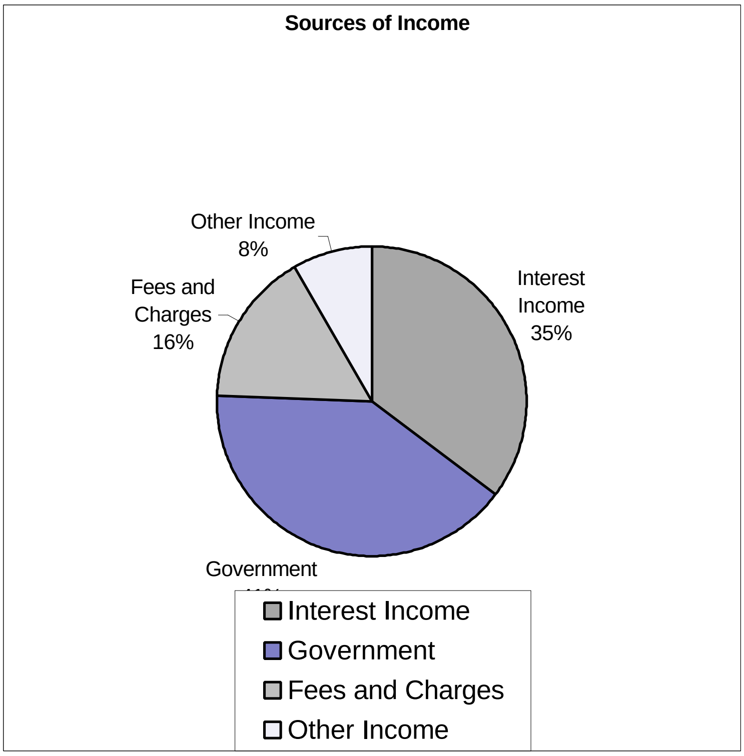
Overview

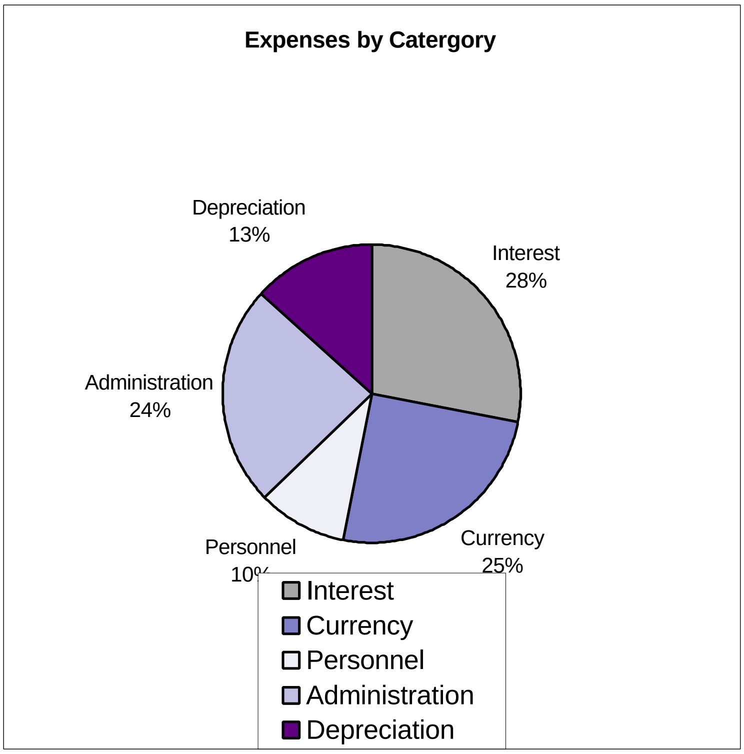
The quest for continuous improvement in financial reporting to fulfil both statutory and management requirements has been the driving force in the development of financial information systems for the BPA. Quarterly summary financial statements were produced within 15 working days after the close of each quarter, to comply with the provisions of Section 56.2 of Regulation 2001/30, and they were published in selected local newspapers. In addition, end of year financial statements were approved by the Governing Board and certified by the external auditors, within the stipulated timeframe. It is important to note that external audit mechanism and financial reporting are part of the safeguards recommended by IMF for transparency and accountability of Central Banks and Monetary Authorities. A clean audit report is a positive step in this direction. In addition, for the purpose of ensuring that the reports generated are reliable, the division reviewed the adequacy of internal control procedures relating to access to the accounting package, and instituted measures to regulate and monitor users through stricter controls, including daily checks on session reports, and enhanced periodic reconciliation reports.

Emphasis was also placed on prudent budgetary management. Budgetary performance reports are presented to management monthly for review to facilitate appropriate and prompt remedial measures where necessary. The reports are also submitted quarterly, to the Governing Board for consideration. Overall, the quality of financial information has improved significantly during the year. The active involvement of Timorese national staff under the guidance of international personnel has bolstered the capacity building process. Training in Basic Financial Accounting continued with another group of eight participants, seven from BPA, and one staff of the Australian Mission in Dili, whose participation demonstrated that the quality of BPA's internal training is now acknowledged and recognized by external institutions.

Income and expenditure

Government remains the single most important source of income contributing 23% of total income as revenue appropriation, and 18% as fees for services rendered by BPA, hence a total contribution of 41%. Interest income was 35%, thus USD 482,801 in absolute terms compared to interest expenses of USD 255,785, hence a positive interest margin of USD 227,016 despite the declining interest rates worldwide, which curtailed opportunities for higher rates of return. Recoverable charges on cash withdrawals contributed 16%, and other income was 8%. In a nutshell, total income realized was USD 1,371,710 which was within 4% of the budgeted amount. Interest & bank charges is the largest expense item constituting 29% of the total expenses, followed by currency expenses, depreciation and personnel expenses contributing to 28%, 12% and 9% respectively. Overall, the net profit of USD 460,775 attained at the end of the year is largely attributable to prudent resource management, particularly with regard to the budgetary aspects of income and expenditure.





2.5 – ADMINISTRATION DEPARTAMENT

Since the passage and subsequent implementation of UNTAET Regulation 2001/30, the BPA has operated as a fully autonomous public agency. To prepare the institution for its new mandate, it became necessary to streamline operations and restructure services to ensure operational and administrative effectiveness as well as overall organizational control.

The restructuring, which was carried out at the beginning of the year marked the establishment of a fully fledged department of Administration, which regrouped the three divisions of Corporate Services, Human Resource management and Procurement function under one organizational directorate. Earlier on these activities were being supervised on an ad-hoc basis by managers in other operating units

The creation of this new unit in the BPA organizational structure allowed centralization of essential services and organized support to all operating units. The responsibilities of the department include the proper upkeep of BPA premises and facilities and provide a conducive work environment, maintenance of office equipment and other assets at optimal working condition and procurement of goods and services required for operations in a timely fashion.

In the area of human resources management, the department undertakes manpower planning activities, with divisional managers, so that at all times BPA comprises an adequate complement of staff with requisite management and technical skills to support planned activities. The department pursues strategies for the identification and recruitment of potential candidates that meet required qualification and experience of new job openings, and periodically reviews the institution’s salary and compensation package to ensure retention of staff.

Security Arrangements

Corporate Services continued to monitor security procedures at the BPA locale to adequately safeguard day-to-day banking operations and other cash handling activities. During the year, a new electronic security surveillance system was installed for the main offices of BPA. The new system incorporates the important feature of allowing the sending of automatic distress signals to Dili central police station.

Overall security was further strengthened by the construction of a proper and secure fence around the entire perimeter of the BPA premises, including a lockable gate. The fence effectively cordoned BPA offices and has facilitated routine surveillance of movement of persons and equipment in and out of offices and control of access to the premises. Access control is presently performed by guards provided by the Government security agents, and contingency plans have been drawn to directly contract security services in the market in the event that service by government is withdrawn.

With expanding activities and ongoing recruitment of new staff, it became clear that present office facilities were insufficient to meet the needs of the institution. To secure additional space, it was decided to acquire and build five prefab Cogim structures on the present compound, to be used as additional offices and storage facility. A key consideration in the decision was the need to set up a properly equipped room to support ongoing internal staff training activities.

Other important activities included:

?? Installation of new telephone system to facilitate communication within the organization and with outside parties.

?? Setting up of central asset registers and procedures to systematically record all BPA assets and periodic verification to account for their physical existence as well as custodian.

?? Implementation of appropriate procedures for processing of official travel and controlled processing of related payments. In this respect, the services of a local travel agent have been retained to allow timely issuance of tickets.

Procurement Activities

Operating as an autonomous public entity meant that BPA had to undertake its own procurement operations, separate from that of central government procurement. This had lead to the creation of a new division charged with the responsibility to implement a BPA-proper procurement function, including elaboration of relevant policies and procedures for the acquisition of goods and services, as well as disposal of obsolete and redundant assets.

The division became fully operational at mid-year and continued to build its central data base to facilitate identification of suitable vendors and contractors in Timor-Leste as well as in neighbouring countries. Additionally, the division has been actively engaged in the routine integration of procurement procedures in the activities of organizational units to ensure systematic adherence to approved requisitioning, ordering and receipting procedures.

Since its inception, the division has processed procurement of goods and services for a total value of USD 204,000, including various acquisitions from overseas. In addition, the division has put in place system contracts covering provision of office supplies and purchase of staff uniforms.

Human Resource Management

Proper Management and deployment of human resources is central to overall organizational success. During the year, a qualified human resource manager (national staff) was recruited, following which the division has been able to initiate developmental activities and streamline services in this important function of the organization. The division has continued to build and organize central personnel records and review completeness and integrity of data retained in individual files. Appropriate guidelines have also been issued regarding confidentiality of personnel records and procedures to be followed by staff and managers to access them.

The division plans to implement a comprehensive human resource management system that supports better tracking of staff activities, more efficient processing of personnel payments, and controlled implementation of approved policies and directives. An important component of this effort is the need to put in place a new payroll system to replace the present one, which has proven to be cumbersome in application and limited in scope. A more versatile database system should allow flexibility in processing personnel expenditures and provide more detailed information to managers for effective staff deployment.

Capacity Building

Capacity building has been a priority in all areas of BPA operations, and staff training represented the central element in the effort to attain this important goal. In addition to in-house training, staff continued to participate in specialized courses and training programs organized by outside institutions, including central banks in the region.

To improve communication within the organization, a good deal of staff time was also allocated to language-training activities.

A human resource expert provided under an IMF technical assistance program conducted a specially designed management training course for senior-level staff. The training covered a general overview of the role and responsibilities of managers in an organization as well as discussion of management implements and techniques to effectively deploy resources. To complement instructional training, contacts were established with Bank Indonesia which was requested to host selected BPA staff so that they could benefit from a more developed work environment and gain more insight into central banking operations. It is intended to establish similar arrangements with other institutions in the region.

Staffing

The BPA continued to benefit from technical assistance provided under the UNMISET mandate. During the year, a total of 3 new international staff have joined the services of the institution to man specific operations identified under the mandate. All international experts work alongside their Timorese counterparts. The objective is to provide needed mentoring on a continuous basis and build national staff capacity to progressively assume more responsibility for operations.

During the same period, a total of 9 new Timorese staff were recruited and 3 staff members have left the services of the institution. The majority of the recruited staff were deployed in the area of supervision to attend to activities under the initiative to regulate the insurance sector in East Timor. A number of staff were also deployed in administration to strengthen ongoing developments in that area.

The table below provides an overview of the staffing complement of BPA per organizational unit as at the end June 2003.

Level / Dept/Unit	National Staff								International Staff	TOTAL
	Level									
	I	**II**	**III**	**IV**	**V**	**VI**	**VII**	**Total**		
GM Office				1	2			3	2	5
Payments Dept		4	7	1	4			16	3	19
Supervision Dept			1	4	4	1		10		10
Accounting			2	2				4	1	5
Administration	3		3	2	2			10	1	11
Economics & Stat. Division				2	1			3	1	4
I. Technology			1	1	1			3	1	4
Total	**3**	**4**	**14**	**13**	**14**	**1**		**49**	**9**	**58**

2.6 - ECONOMIC STUDIES AND STATISTICS DIVISION

In last year's annual report (2001/2) it was noted that the Economic Studies and Statistics Division was in a consolidation phase due to its recent creation. Today, we can say that this consolidation is significantly more advanced. Not that we are completely satisfied with the work done, nor that we have achieved "cruising speed" but rather that very important steps have been achieved in developing the division as the economic knowledge centre of the country.

Thus, during the past year divisional activity has been concentrated in the following areas, and the following projects were developed:

?? The creation from July 2002 of the country's monetary statistics. This information is available to whoever may be interested, and a quarterly summary is published in the BPA's Economic Bulletin (see below). With Timor-Leste being a member of the IMF, the information is regularly communicated to that organisation.

?? The creation and publication of a daily information sheet containing exchange rates for the major currencies, interest rates, and indices for leading stock markets.

?? The commencement of the publication – in the two official languages, Portuguese and Tetum – of a quarterly "Economic Bulletin", whose main focus is the analysis, with appropriate scientific rigour and didactical character, on selected aspects of the Timorese economy. In addition, a special edition was dedicated to the emission of the country's first coins.

?? Development of studies of various aspects of the Timor-Leste economy, namely the "coffee economy" and the "oil economy" of the Timor Sea. These studies are used as the basis for the content of the Economic Bulletin as well as for conferences and talks for the training of BPA staff.

?? Collaboration in the process of creating the first coins of Timor-Leste, being responsible for preparatory technical studies for the emission of coins and for the suggestion of alternative designs.

?? Participation in the training of the BPA's permanent staff through a number of presentations on various aspects of interest regarding the economies of Timor-Leste and the region.

?? Reinforcement of the technical and scientific training of the personnel in the division.

?? Invitations to parties external to the BPA to debate aspects of the nation's economy with staff of the division.

?? Participation in the gathering of the documentation useful for the BPA's work in its varied areas. Significant effort was spent in the creation of a "hardcopy" and "virtual" libraries. The latter includes references to a large number of Internet sites useful in the areas of interest to the division (other central banks, major international banks, international organizations specialising in various fields, economic research centres, and so on).

?? The creation of a database containing statistical information about Timor-Leste produced by various national and international entities, as well as obtaining information from those entities.

?? Acting as the focal point within the BPA for the IMF mission responsible for undertaking the first Article IV consultation with Timor-Leste.

?? Collaboration with external entities, including the Ministry of Finance and Planning (on training matters) and its National Statistics Division.

?? Coordination of the preparation of the 2001/2 BPA Annual Report.

2.7 – INFORMATION TECHNOLOGY DIVISION

The IT Division was primarily responsible for the development and maintenance of the technical infrastructure of the BPA during the year.

Major projects included continued development of an in-house payroll system, and the extension of the data network to the new Cogim offices.

With all BPA staff having desktop computers, the help desk provided support for the resolution of IT issues and problems, including supporting hardware and maintaining the office applications.

The Division was staffed by three national staff and an UNMISET network advisor.

2.8 – LEGAL OFFICE AND INTERNAL AUDIT OFFICE

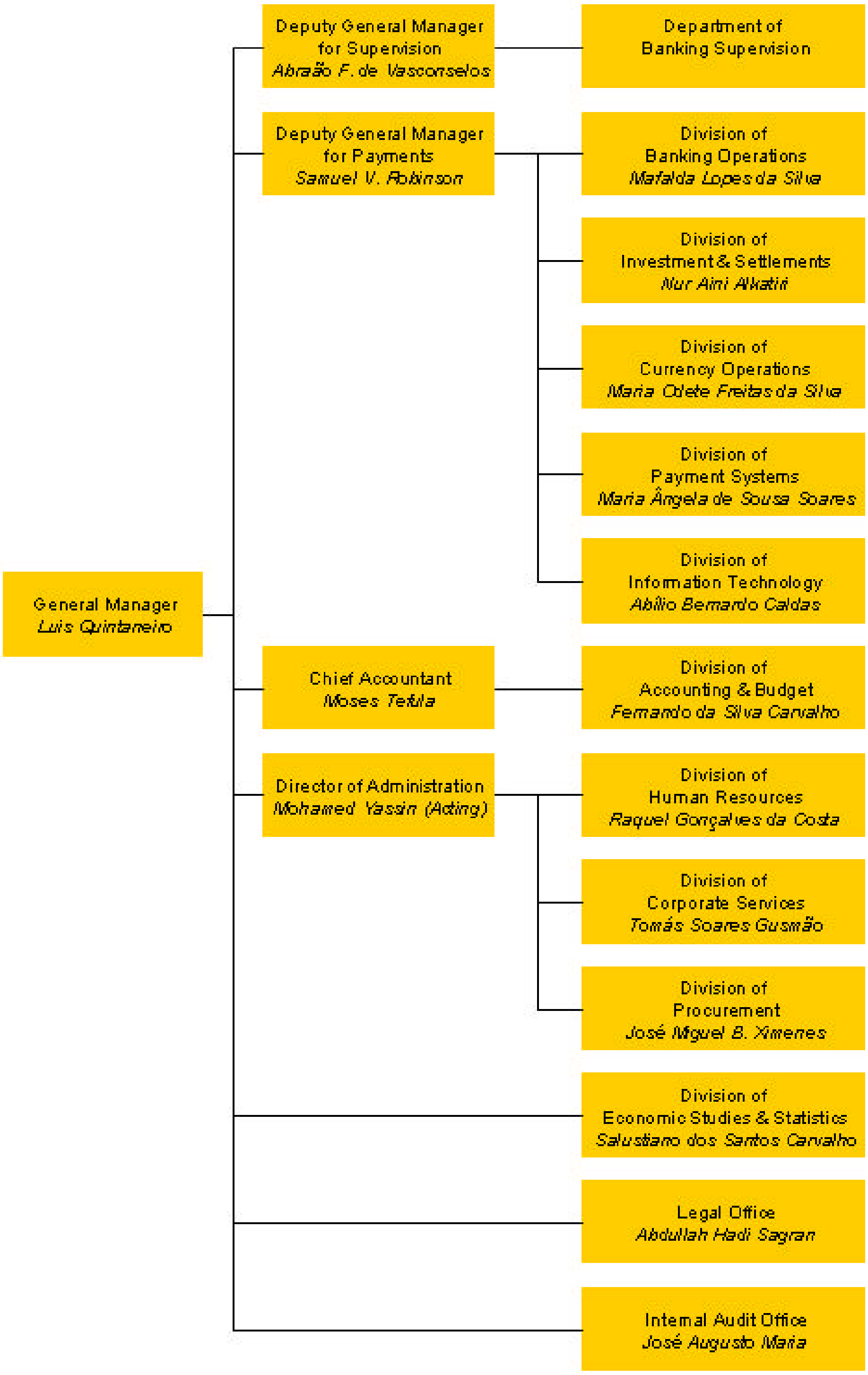
In the organizational structure of the BPA, the Legal Office and the Internal Audit Office report to the General Manager.

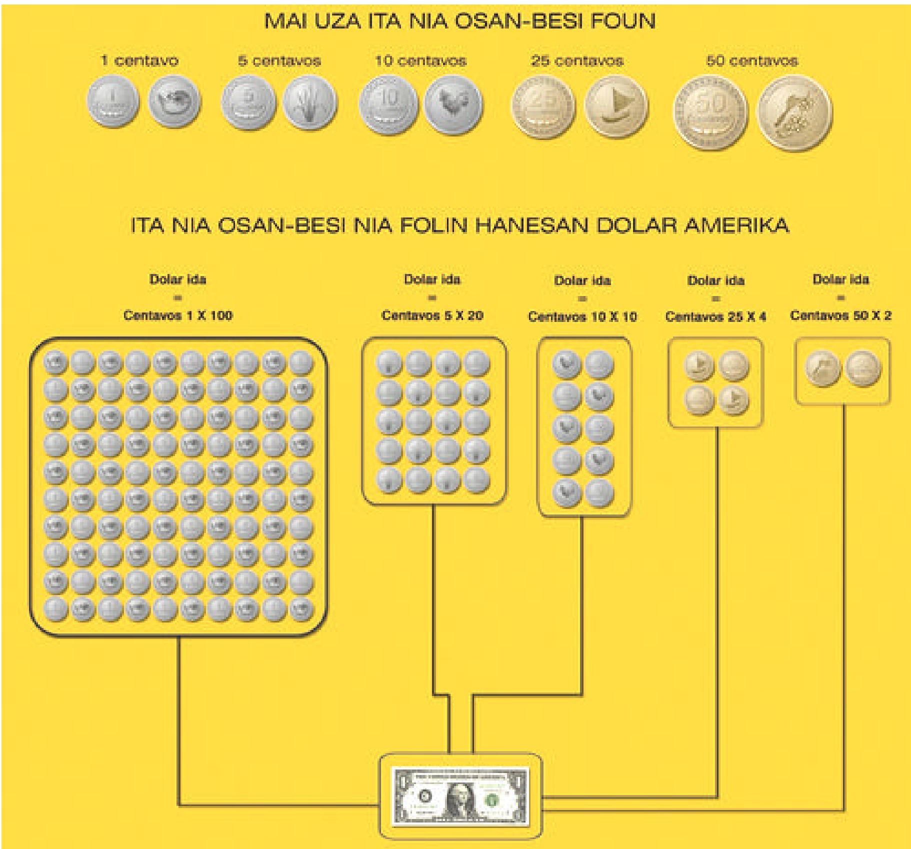
The Legal Office is staffed by a single legal officer, who provides legal assistance to all the units of the Authority. During the last four months of the financial year 2002/03, he was seconded to the Institute of Insurance in Portugal to study legal issues related with insurance regulation and supervision in order to enable him to contribute to the drafting and implementation of the regulatory framework of this sector in Timor-Leste.

The Internal Audit Office had already been established before the latter half of last fiscal year. However it was only in December 2002 that it started to engage in routine audit activities, with regular monthly reports being submitted to the General Manager. There were some staff changes in this office (by internal transfer and by recruitment) during the period. From June 2003 this Office has benefited from the full-time assistance of an international adviser, who earlier during a short-term visit, and then from a distance, had been providing advice.

An Internal Audit function has become fundamental in an environment with a progressively increasing volume and complexity of activities, and is able to assure that established rules and procedures are being followed, as well as detecting weaknesses that can be addressed in a timely manner, in order to ensure that the BPA is following best practice, as should be expected in an institution carrying out the functions of a central bank.

BPA ORGANIZATION CHART





3 – FINANCIAL STATEMENTS AND REPORT

Index

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

STATEMENT OF COMPLIANCE

The Financial Statements on pages 2 to 4 and the Notes from pages 5 to 11 which form an integral part of these statements, have been prepared by Management and approved by the Governing Board of the Banking and Payments Authority of Timor-Leste. We declare that these Financial Statements comply with the requirements of Regulation 2001/30 and fairly present the true financial position and performance of the Banking and Payments Authority of Timor-Leste as at 30 June 2003.

Luis Quintaneiro
General Manager

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

BALANCE SHEET

30 JUNE 2003

	Notes	2003 USD	2002 USD
ASSETS			
Cash and Bank	4	53,464,590	29,123,089
Prepayments & Receivables		102,220	200
Investments	3	11,487,052	—
Net Fixed Assets	5	869,741	747,228
Total Assets		**65,923,604**	**29,870,517**
LIABILITIES			
Government Deposits		41,535,076	19,299,020
Domestic Financial Institutions		4,767,246	3,536,229
International Financial Institutions	3	11,487,052	—
Other Liabilities	6	322,289	204,102
Total Liabilities		**58,111,663**	**23,039,351**
NET ASSETS		**7,811,941**	**6,831,166**
EQUITY			
Capital Account	7	7,351,166	6,364,664
General Reserve Account	7	460,775	466,502
TOTAL EQUITY		**7,811,941**	**6,831,166**

The notes on pages 48 to 53 form an integral part of this statement.

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

PROFIT AND LOSS STATEMENT

FOR THE YEAR ENDED 30 JUNE 2003

		2003	2002
INCOME	**8**		
Income from Financial Assets		482,801	155,459
Income from Government		552,379	581,231
Fees and Charges		220,890	233,650
Other Income		115,641	53,069
Total Income		**1,371,710**	**1,023,409**
EXPENSES			
Interest Expenses and Bank Charges		255,785	128,240
Distribution of Currency		226,425	277,707
Personnel Expenses		89,651	49,445
Administration Expenses	9	218,514	52,729
Depreciation of Fixed Assets	5	120,560	48,786
Total Expenses		**910,935**	**556,907**

The notes on pages 48 to 53 form an integral part of this statement.

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

CASH FLOW STATEMENT

FOR THE YEAR ENDED 30 JUNE 2003

	Notes	2003 USD	2002 USD
Operating Activities			
Operating Profit		460,775	466,502
Adjustment to Revenue Appropriation		—	40,396
Depreciation		120,560	48,786
		581,335	555,684
Movements in Working Capital Items			
Changes in Accounts Receivable		(102,020)	70,439
Changes in Government Deposits		22,236,056	(1,232,255)
Changes in Financial Institutions' Deposits		1,231,017	1,369,553
Changes in Other Liabilities		118,187	201,043
Changes in Currency Translation		—	36,412
		23,483,340	445,192
Investments and Financing Activities			
Purchase of Fixed Assets	5	(243,073)	(40,896)
Capital Subscription		520,000	569,150
		276,927	528,254
Net Change in Cash and Cash Equivalents		**24,341,502**	**1,529,130**
Opening Cash and Cash Equivalents		29,123,089	27,593,959
Closing Cash and Cash Equivalents	4	53,464,590	29,123,089

The notes on pages 48 to 53 form an integral part of this statement.

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

NOTES TO THE FINANCIAL STATEMENTS
30 JUNE 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

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

(b) Unit of Account and foreign currency

All amounts, unless specified otherwise, are expressed in United States dollars, the currency of the Democratic Republic of Timor-Leste. Any minor differences are due to rounding up cents to the nearest dollar. Transactions involving foreign currencies have been converted at the rates ruling on the transaction dates. Monetary assets and liabilities have been translated at the rates of exchange ruling at the end of June 2003. The significant foreign currency exchange rates as at 30 June 2003 were; USD 1 = IDR 8,272; USD 1 = AUD 1.4992; USD 1 = IMF SDR 0.713847.

(c) Income Recognition

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

(d) Fixed assets

Fixed assets have been recognized under the historical cost convention.

(e) Depreciation

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

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

(f) Income Tax

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

(g) Employee Entitlements

There was no pension scheme for BPA employees during the period of audit.

2. COMPARATIVE INFORMATION

The comparative information covers the period from 1 December 2001 to 30 June 2002. The comparative figures therefore relate to operations and activities covering **seven** months, whereas the period ended 30 June 2003 covers **twelve** months.

3. 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 2003.

(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 USD 32,209,545, of which USD 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 USD 349,842, of which USD 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 USD 541,000, of which USD 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 USD 4,222,225, partially funded by a Promissory Note for USD 171,904.88 held by BPA.

4. ANALYSIS OF CASH AND BANK BALANCES

(A) Analysis by Institutions

	Rating*	2003	2002
DOMESTIC CASH AND BANK			
Cash	AAA	7,689,774	5,636,968
Other Central Banks	Aa2	43,585,158	20,836,539
Resident Banks	Aa3	2,067,697	2,447,318
Non-Resident Banks	Aa1	938	1,301
Total Domestic Cash and Bank		**53,343,567**	**28,922,126**
FOREIGN CURRENCY CASH AND BANK			
Central Banks	Aa2	62,714	140,095
Foreign Cash	Aa2	58,082	1,805
Non-resident banks	Aa1	228	3,380
Total Foreign Currency Cash and Bank		**121,024**	**200,963**
TOTAL CASH AND BANK		**53,464,590**	**29,123,089**

*Where a central bank is not 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.

Country	2003	2002
USA	7,690,940	5,641,649
Australia	43,647,872	20,838,343
Indonesia	58,082	195,777
Portugal	2,067,697	2,447,318
TOTAL CASH AND BANK	**53,464,590**	**29,123,089**

5. FIXED ASSETS

(A) **Fixed Assets at Cost**

The value of fixed assets excludes the land and base cost of buildings, but represents capitalized value of improvements only.

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	**TOTAL 2003**	**TOTAL 2002**
Opening Balance	498,672	70,248	54,618	101,932	70,545	**796,014**	**755,118**
Additions	82,261	3,370	44,190	111,907	1,345	**243,073**	**40,896**
Disposals	(0)	(0)	(0)	(0)	(0)	**(0)**	**(0)**
Value at Cost	580,933	73,618	98,808	213,839	71,890	**1,039,087**	**796,014**

(B) **Depreciation Account**

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	**TOTAL 2003**	**TOTAL 2002**
Opening Balance	(14,545)	(8,196)	(3,983)	(13,833)	(8,230)	**(48,786)**	**(0)**
Annual Depreciation	(26,939)	(14,372)	(10,562)	(54,489)	(14,199)	**(120,560)**	**(48,786)**
Accumulated Depreciation	(41,483)	(22,568)	(14,545)	(68,322)	(22,429)	**(169,346)**	**(48,786)**

(C) **Net Book Value of Fixed Assets**

	Premises	Plant	Office Equipment	Computer Equipment	Vehicles	**TOTAL 2003**	**TOTAL 2002**
Fixed Assets at Cost	580,933	73,618	98,808	213,839	71,890	**1,039,087**	**796,014**
Accumulated Depreciation	(41,483)	(22,568)	(14,545)	(68,322)	(22,429)	**(169,346)**	**(48,786)**
Net Book Value	539,450	51,050	84,263	145,517	49,461	**869,741**	**747,228**

6. LIABILITIES AND INTEREST RATE RISK

DEPOSIT LIABILITIES	Basis of Interest	2003	2002
Government Budgetary Deposits	***	30,993,858	11,937,314
Government Non-Budgetary Deposits		10,541,218	7,361,706
Financial Institutions	***	4,767,246	3,536,229
International Financial Institutions (Net)		11,487,052	—
Total Deposit Liabilities		**57,789,374**	**22,835,249**
OTHER LIABILITIES			
Accounts Payable		14,059	109,846
Withholding Tax		—	2,352
Ex R.I .Pension Fund		256,294	88,236
Salary Payments		3,100	3,667
Provisions and Accrued Expenses		48,836	—
Total Other Liabilities		**322,289**	**204,102**
TOTAL LIABILITIES		**58,111,663**	**23,039,351**

***Federal Reserve Bank of New York Repurchase Rate less 65 basis points on qualifying balances.
All liabilities will mature within six months or less except for the IMF Accounts.

7. CHANGES IN EQUITY

CAPITAL	2003 USD	2002 USD
Opening Balance	6,364,664	5,000,000
Cash Subscriptions	520,000	569,150
Fixed Asset Contribution	—	795,514
Transfer from General Reserve	466,502	—
	7,351,166	**6,364,664**
GENERAL RESERVE ACCOUNT		
Opening Balance	466,502	—
Transfer to Capital	(466,502)	—
Retained Earnings	460,775	466,502
	460,775	**466,502**
TOTAL EQUITY	**7,811,941**	**6,831,166**

8. ANALYSIS OF INCOME

	2003 USD	2002 USD
INCOME FROM FINANCIAL ASSETS		
Interest on deposits – Foreign Central Banks	473,114	148,377
Interest on deposits – Foreign Commercial Banks	436	2,266
Interest on deposits – Domestic Commercial Banks	9,251	4,816
Total Income from Financial Assets	**482,801**	**155,459**
INCOME FROM GOVERNMENT		
Service Fee and Commission	240,000	140,600
Revenue Appropriation	312,379	440,631
Total Income from Government	**552,379**	**581,231**
Charges and Cost Recoveries	**220,890**	**233,650**
OTHER INCOME		
Bank License Application Fees	31,500	3,000
Annual Bank License Fees	24,000	20,000
Currency Gain	58,791	30,069
Miscellaneous Income	1,350	—
Total Other Income	**115,641**	**53,069**
TOTAL INCOME	**1,371,710**	**1,023,409**

9. ADMINISTRATION EXPENSES

	2003 USD	2002 USD
Information Systems Expenses	10,366	848
Office Expenses	45,509	17,091
Training and Travel Expenses	50,491	1,712
Professional Fees	67,655	8,386
Vehicle Expenses	8,954	5,317
Premises Repairs and Maintenance	9,072	12,944
Water and Energy	17,295	2,819
Housekeeping	9,174	3,612
TOTAL	**218,514**	**52,729**

10. REMUNERATION TO MEMBERS OF THE GOVERNING BOARD

The three members of the Governing Board as at 30 June 2003 are also executive members of management. Two of them are remunerated under the auspices of United Nations and IMF technical assistance programme at no cost to the Democratic Republic of Timor-Leste. The third Board member is remunerated in accordance with the terms and conditions of service of regular executive staff of the BPA.

BANKING AND PAYMENTS AUTHORITY OF TIMOR-LESTE

External Audit Report

ERNST & YOUNG

9-11 Cavenagh Street
Darwin NT 0800
Australia

GPO Box 3470
Darwin NT 0801

Tel 61 8 8982 1444
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INDEPENDENT AUDIT REPORT TO THE GOVERNING BOARD OF BANKING AND PAYMENTS AUTHORITY OF TIMOR LESTE

Scope

The financial report and Board of Directors responsibility

The financial statement comprises Balance Sheet, Profit and Loss Statement, Cash Flow Statement accompanying notes to the financial statements, and Statement of Compliance for Banking and Payments Authority of Timor-Leste ("BPA") for the year ended 30 June 2003.

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

Audit approach

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

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

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

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

Note: the document is a facsimile of the original; the BPA accounts to which it refers were audited using documents in English given to the auditors

ERNST & YOUNG

Audit approach (cont'd)

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

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

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

Independence

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

Audit Opinion

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

(a) giving a true and fair view of the financial position of Banking and Payments Authority of Timor-Leste at 30 June 2003 and of its performance for the year ended on that date; and

(b) complying with International Accounting Standards.

Ernst & Young

Ernst & Young

Aminul Islam

Aminul Islam

Partner

DARWIN

Date: 26 September 2003

Note: the document is a facsimile of the original; the BPA accounts to which it refers were audited using documents in English given to the auditors

MOEDA CORRENTE
PARA A
REPÚBLICA DEMOCRÁTICA DE TIMOR-LESTE

10 CENTAVOS

Ø 20,75 mm

INCM
IMPRENSA NACIONAL-CASA DA MOEDA, S. A.

4 – THE FIRST ISSUANCE OF COINS AS THE LEGAL TENDER OF TIMOR-LESTE

AN OVERVIEW

Index

To the best of our knowledge, it was at the *Melbourne Conference* organised by the National Council for the Resistance of East Timor (CNRT) in 1998 that the first reference was made to the issuance of a national currency by an independent East Timor, which at that time was no more than a distant dream for many Timorese.

We note that in fact the communication presented by Helder da Costa referred to the creation of an East Timorese monetary unit, and not to the simple issuance of coins for current use as is now taking place.

The idea of issuing specific coins as a sub-unit of the United States dollar, which had meantime been declared to be legal tender in East Timor, was strongly proposed by the Timorese leadership during the UNTAET administration. This proposal was formalised in Regulation 2001/30 on November 2001, the regulation that gave birth to the Banking and Payments Authority of East Timor.

This article summarises the process through which the characteristics of the first coins of the Democratic Republic of Timor-Leste were developed, up to the point of their planned issuance in November 2003.

The Beginning

As noted above, some elements of the Timorese leadership suggested that the law creating the BPA include from the outset the possibility of minting national coins, even within an environment in which the US dollar was the legal tender in the country. The coins would be a sub-denomination of the US dollar, and would be known as “centavos”. The authority was duly defined in the Regulation creating the BPA, which was also given the sole legal authority to issue these coins.

From the initial months of Timor-Leste’s independence this issue has continued to be a point of discussion and analysis between the government of Timor-Leste and the management of the BPA, and a consensus was reached that it would be desirable to introduce at an early stage national coins that would at least partially replace the American coins that are circulating. One of the reasons for this was to try and overcome the difficulties that the Timorese population were experiencing in using the American coins, that do not have values in numbers, and sizes of which do not correspond to relative values, an example being the American five cent coin that is larger than the ten cent coin.

More obviously, the leaders of Timor-Leste as a newly independent country wished to adopt one of the traditional symbols of sovereignty, and this factor also weighed heavy in favour of the preliminary decision to issue coins being made.

As a result of this decision, the BPA started developing plans for issuing coins, beginning with studies to determine the fundamental choices that needed to be made before a final decision to proceed could be taken.

Initial Suggestion

Having undertaken preliminary studies and engaged in internal debate, a number of fundamental issues were identified that would serve as the foundations on which the BPA could enter into discussions with the government of RDTL.

These issues included suggestions about the metal alloys that were considered to be most suitable, the quantities that should be produced, and the motifs to be used for preparing the designs. The recommendations of the BPA were collated in a document entitled “*Issues concerning Coins for the Democratic Republic of Timor-Leste*” which was dated 9th December 2002, and placed in the hands of the Prime Minister, Dr Mari Alkatiri.

The document suggested that the theme for the first issuance of coins should be based on reproductions of various types of typical houses in Timor-Leste, as described in a well-known book by Ruy Cinnati, “*Timorese Architecture*[1]”.

In choosing this theme, the BPA wished not only to recognise Timorese culture, but also to use the coins as a means of divulging that culture, including within the nation. The different Timorese houses would appear on one of the faces of the coins, the other face (with the value of the coin) being common to all the coins.

[1] Published by the Institute for Tropical Sciences Research – Ethnological Museum, Lisbon, 1987.

The document also recommended that the denominations to be issued should include the values of 1, 5, 10, 25, and 50 centavos. The background to this recommendation is contained in the document.

One topic involving much discussion was the decision to issue a 50 centavos coin, since it does not exist in the commonly used range of American coins. It was eventually decided to issue the coin with the objective of reducing the use of $1 notes, which are very widely used as a result of the price structure established in 1999, and which degrade rapidly in a tropical environment, requiring their early withdrawal from circulation and a repatriation process to the United States that involves significant transportation and insurance costs. Also taken into account was the fact that in the great majority of monetary systems, the value equivalent to $1 is usually a coin and not a note.

The coin design process and its outcome

During meetings between officials from the BPA and officials from the government during January 2003, the government expressed concerns that the designs should not indicate or suggest any form of preference for particular regions to the detriment of others, and it was also argued that the typicality of the traditional houses was, with the exception of Lautem/Los Palos, arguable, and it was considered preferable to pursue other avenues for a series of designs for the future coins.

In consideration of the opinions of the government, and also taking into account suggestions from the Department of Monetary and Exchange Affairs of the IMF that outlined some generally used international practices, the BPA decided to review its initial suggestions for the designs.

The new proposal put forward, still in January 2003, suggested that the various coins (1, 5, 10, 25 and 50 centavos) have the following respective designs: coffee beans, fighting rooster, crocodile, buffalo, and a typical house from Lautem/Los Palos.

As the basis of these new designs was a desire to use the coins to represent economic as well as cultural aspects of Timor-Leste.

The former were essentially represented by the pictures of the coffee beans and the buffalo – the coffee representing the main source of agricultural exports as well as agriculture more generically, being the main economic activity of the people of Timor-Leste, while the buffalo simultaneously represented an important element in the production of rice (the main food item of the Timorese) and an important element of personal wealth, and as such a valuable asset.

The elements having a more cultural nature were the fighting rooster, being a significant part of the Timorese culture; the crocodile, being a reference to the well-known legend about the creation of the island of Timor; and the Los Palos house, being a genuine symbol of Timor-Leste.

In order to evaluate the technical adequacy of these motifs for use on coins, contact was made with the INCM – Imprensa Nacional-Casa da Moeda, of Portugal. This contact was made as a result of that institution having earlier produced an issue of medallions commemorating the independence of Timor-Leste, and to use INCM's century of experience in the design and minting of coins.

As a result, on 15 February 2003 the BPA received some initial suggestions in the form of drawings for the coins prepared by INCM.

At the same time, contact was made with other well-known mints for the same purpose.

The drawings proposed by INCM were considered by the government, who received them favourably, but suggested that the designs include two additional themes, within the context of protecting the environment of Timor-Leste, one being connected with the land, the other with the sea.

At the same time, it was suggested that a relationship between the value of the coin and the “value” of the design be aligned, resulting in the following:

1. The 1 centavo coin would have as its theme the sea, and the need to preserve the country’s maritime resources, and the theme should be a shell or a turtle.
2. The 5 centavos coin should have the theme of preserving the country’s fauna, and the theme would be a typical parakeet, the *lorico*.
3. The 10 centavos coin would be the fighting rooster, promoted from the 5 centavos coin.
4. The 25 centavos coin would have the outline of a boat, a *beiro*¸ hitherto destined for the 10 centavos coin.
5. The 50 centavos coin should have a representation of the country’s most valuable export, coffee.

Suitable photographs were taken, and sent to INCM who responded on 26 March 2003 with a new set of drawings for the coins.

Meantime, on the same date an alternative set of designs based on the same motifs was received from another European mint.

The Government accepts the proposal from INCM

After analysing and comparing the two sets of drawings, and having discussed the matter with the President of the Republic, the government, through the Prime Minister, communicated to the BPA by way of letter dated 8 April 2003 its acceptance of the INCM designs for the coins.

The same letter contained a suggestion from the President that the *lorico* design on the 5 centavos coin be replaced with an alternative theme, namely rice. This new theme not only represented the main food item of the Timorese, but would also represent the need to fight against famine and poverty that affect a large number of national citizens.

Having obtained a number of alternative drawings representing the rice theme, on 8th May 2003 the Governing Board of the BPA formally adopted a set of drawings for the coins, and this decision was communicated to the government, which concurred with the decision.

After the signing of a contract with INCM in May 2003 the definitive set of drawings was publicly announced, and a special edition of the “Economic Bulletin” featuring the coins was produced in the Portuguese and Tetum languages.

The majority of the designs are based on photographs taken by the advisor in the Economics Division of the BPA, Prof. António Almeida Serra. The photo of the rice was obtained in Aileu, the fighting rooster was photographed at the so-called *Tais* market in Díli, the *beiro* boat is from Bidau Santana Beach near Díli, and the coffee is from a plantation near Ermera. Due to the impossibility of obtaining a live *nautilus* (the subject of the 1 centavo coin) for photographing, the design was based on an illustration obtained from the Internet.

The common face of the coins, where the value of each coin is clearly visible, contains an illustration of a *kaibauk*, a traditional Timorese item associated with the idea of social status and dignity. The borders of the common face, for the 1, 5, and 10 centavo coins on the one hand, and the 25 and 50 centavos on the other, are inspired by *tais* (woven cloth) patterns that represent in a stylised form the crocodile, representing the shape of Timor Island, and referring to the legend of its creation.

Signing a contract for the minting of the coins

Meanwhile, proposals with indicative costs for the coins had been received from three international mints, and INCM offered clearly the lowest cost. The overall cost to the BPA was subsequently further reduced because a marketing agreement was included in the contract whereby INCM was authorised to sell numismatic coins – outside Timor-Leste – to collectors. This will allow INCM to recover at least part of the reduced cost of production.

Once the terms had been agreed, and the characteristics of the coins finalised during May 2003, the contractual arrangements between BPA and INCM were concluded.

Significantly, the contract was signed on 20th May 2003, being the first anniversary of the independence of Timor-Leste. The signing took place in Lisbon, and the BPA was represented by a Deputy General Manager, Mr Abraão Fernandes de Vasconselos. Timor-Leste's ambassador to Portugal, Dr Pascoela Barreto and a number of BPA staff that were at that time in Lisbon for various purposes, witnessed the ceremony.

It is worth emphasising at this point that while the BPA took a central role in directing the process for producing the coins, this process also included the Timor-Leste government and, during the latter stages of the process, the President of the Republic. The Timorese coins were therefore the result of a collaborative effort resulting in a consensus meaning the coins are truly "our coins."

Preparation of the publicity campaign

By means of a press conference that took place in Díli immediately following the signing of the contract, the public was informed that the process for creating the coins was at an advanced stage. Additionally, the BPA produced and distributed a special edition of its "Economic Bulletin" exclusively dedicated to the emission of the coins. For the record, this was the first time that an official document of BPA was created and distributed in both the country's official languages.

Because the coins would only arrive in Timor-Leste at the end of October, to be released for use in November, it was decided to mount a concentrated promotional campaign in these two months. It was deemed to be inadvisable to stage the campaign in May or June because the coins would not be available for another six months.

Based on the experienced gained during the campaign to promote the use of the United States dollar as the official currency, held some two years previously, a special committee was formed to undertake the detailed planning of the new campaign, that should be running at the time this report is distributed. A comprehensive campaign is planned, covering the whole of the country, so that the new coins will be understood and used by the community at large.

Two large posters have been produced, in 10,000 copies, which with 50,000 smaller pamphlets will mean that practically every Timorese family will have in their home some form of reference material on the new coins.

Putting the coins into circulation

As a final note, the beginning of the promotional campaign has been set of 13th October 2003, and the coins will become legal tender on 10th November 2003, followed by an official ceremony marking the occasion on 28th November 2003. The choice of the 10th November was primarily set to avoid delays caused by the wet season in distributing coins to all districts in the country.

Governing Board

Luís Manuel Bastos Quintaneiro
Abraão Fernandes de Vasconselos
Samuel Vesey Robinson

Management Committee

General Manager
Luís Quintaneiro

Deputy General Manager for Supervision
Abraão Vasconselos

Deputy General Manager for Payments
Samuel Robinson

Director of Administration (Acting)
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