

Autoridade Bancária e de Pagamentos de Timor-Leste

Banking and Payments Authority of Timor-Leste

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PETROLEUM FUND OF TIMOR-LESTE

QUARTERLY REPORT

For the Quarter ended 30 June 2007

Presented to the Minister of Planning & Finance

by

Banking and Payments Authority of Timor-Leste

INTRODUCTION

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

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

EXECUTIVE SUMMARY

The Petroleum Fund was formed by the enactment of the Petroleum Fund law promulgated on 3 August 2005. The law gives the Banking & Payments Authority (BPA) of Timor-Leste the responsibility for the operational management of the Fund.

This report covers the period from 1 April to 30 June 2007.

During this period, the BPA continued to invest all funds received according to the investment mandate agreed with the Ministry of Planning and Finance in which a benchmark index of United States Treasury Securities with maturities up to five years is specified together with defined performance measures.

In the course of the quarter the capital of the Fund grew from \$1,217.98 million to \$ 1,394.22 million, including gross cash inflows to the fund was \$308.26 million. The cash outflows were US\$140.22 million while the net cash inflow was \$168.04 million.

The return in the period was 0.62%, equivalent to an annual return at 2.49%, for the Petroleum Fund portfolio and the benchmark return was 0.63%.

1. PETROLEUM FUND MANAGEMENT MANDATE

The Banking and Payments Authority has been appointed to undertake the operational management of the Fund in accordance with Article 11.3 of the Petroleum Fund Law which states that the Minister shall enter into an agreement with the Central Bank for the operational management of the Petroleum Fund and the Central Bank shall be responsible for the operational management of the Petroleum Fund.

The management agreement was negotiated and agreed between the Ministry of Planning and Finance and the Banking & Payments Authority, and signed on 12 October 2005.

This mandate set out in the Management Agreement has not changed since the previous report, and is as follows:

1. QUALIFYING INSTRUMENTS

The assets of the Fund shall be invested in the classes of instruments as described below. The indices indicated with each asset class shall be used to measure the performance of the Fund.

Debt instruments issued by the United States and other qualifying sovereign governments:

Index: Merrill Lynch 0-5 year government bond index

Short-term liquidity instruments maintained by the Fund limited to budgeted monthly appropriations from the Fund to the state budget account described in Article 13 based on cash projections supplied to the Central Bank by the Minister shall be excluded from the Fund for the purpose of benchmark comparison, but the Central Bank shall otherwise be accountable for the return on these instruments.

2. MANDATE

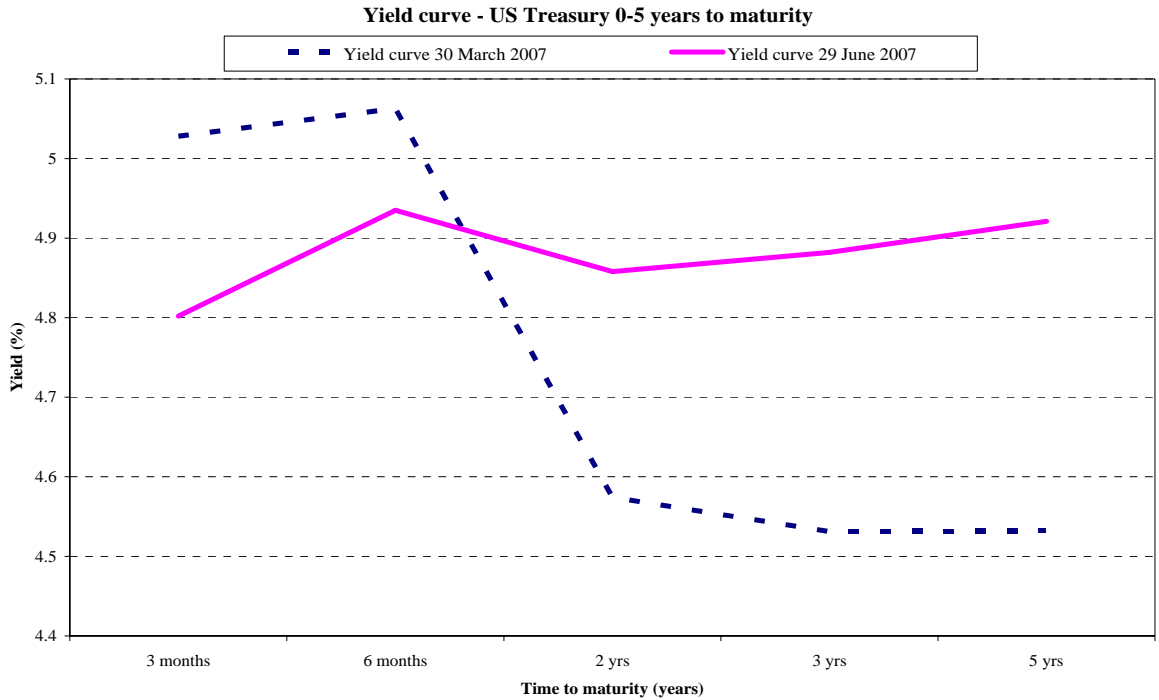
1. The nature of the mandate established by the Minister shall be to passively manage the Fund close to the benchmark, so that in normal circumstances the objective shall be to achieve a return within 25 basis points of the benchmark.
2. The difference in the modified duration between the portfolio and the benchmark shall be less than 0.2 years.

To enable the orderly acquisition of suitable investments, the parameters in this Annex 1 shall apply only from thirty (30) days after the date of entering into force of this Management Agreement.

All royalty payments and funds received from taxpayers, other than small amounts that do not collectively reach the minimum investment threshold set by the BPA, have been invested in the mandated benchmark from the day following receipt.

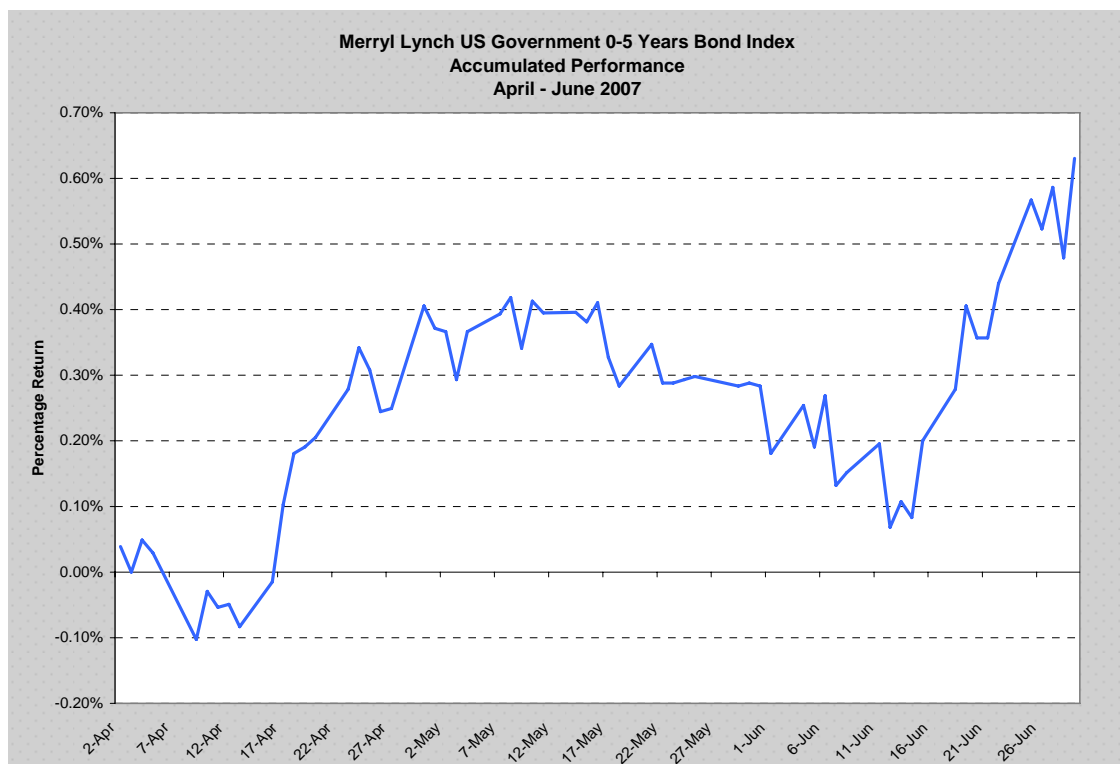
2. MARKET TRENDS DURING THE QUARTER

During the period from 30 March 2007 to 29 June 2007 the yields of the 3 and 6 months US Treasury benchmark reference bills fell with 23 and 13 basis points respectively, while the yields of the 2, 3 and 5 years US Treasury benchmark reference notes rose with between 28 and 39 basis points. The bond prices and yield move in opposite direction. The change in the yields during the quarter have therefore resulted in higher prices for the securities with 3 and 6 months to maturity and lower prices for the notes with 2, 3 and 5 years to maturity. The graph below shows the 0-5 years US Government yield curve on 29 June 2007 compared with the previous quarter end 30 March 2007.



There have been no changes to the US Fed Funds target rate during the quarter. The last rate change was on 29 June 2006 when the interest rate increased with 25 basis points to 5.25%.

The following graph shows the performance of the Merrill Lynch US Government bond 0-5 year's index during the quarter.



3. MANAGEMENT DURING THE QUARTER

Objectives

The BPA's objective in managing the Fund is to achieve a portfolio return closed to the return of the agreed benchmark. Cash received by the Fund has been invested in the portfolio in a timely manner, normally within two working days. This policy is consistent with the passive investment mandate given to the BPA by the Ministry of Planning and Finance.

Operational Implementation

The mandate is operationalised by holding ten of the approximately 90 US Treasury Securities that form the defined benchmark index. The bonds are selected to best replicate the risk and return characteristics of the benchmark

During the quarter, staff assigned to the Petroleum Fund Department continued to engage in capacity building, primarily in the form of on-the job training and an ongoing finance training course.

Daily financial reports on the performance of the Fund are produced for BPA management as part of the management process.

The Petroleum Fund Procedures Manual has been developed and implemented to ensure the operational management of the fund. The risk based audit programs been developed and fully operational.

Technical Assistance

The BPA acknowledges with appreciation the receipt of technical assistance from the Ministry of Foreign Affairs of Norway funded a resident advisor for the entire quarter to further support capacity building and institutional development. The position is organised through the International Monetary Fund.

4. PORTFOLIO PERFORMANCE

The performance of the Fund relative to the benchmark is calculated and reported using the same basis as the benchmark.

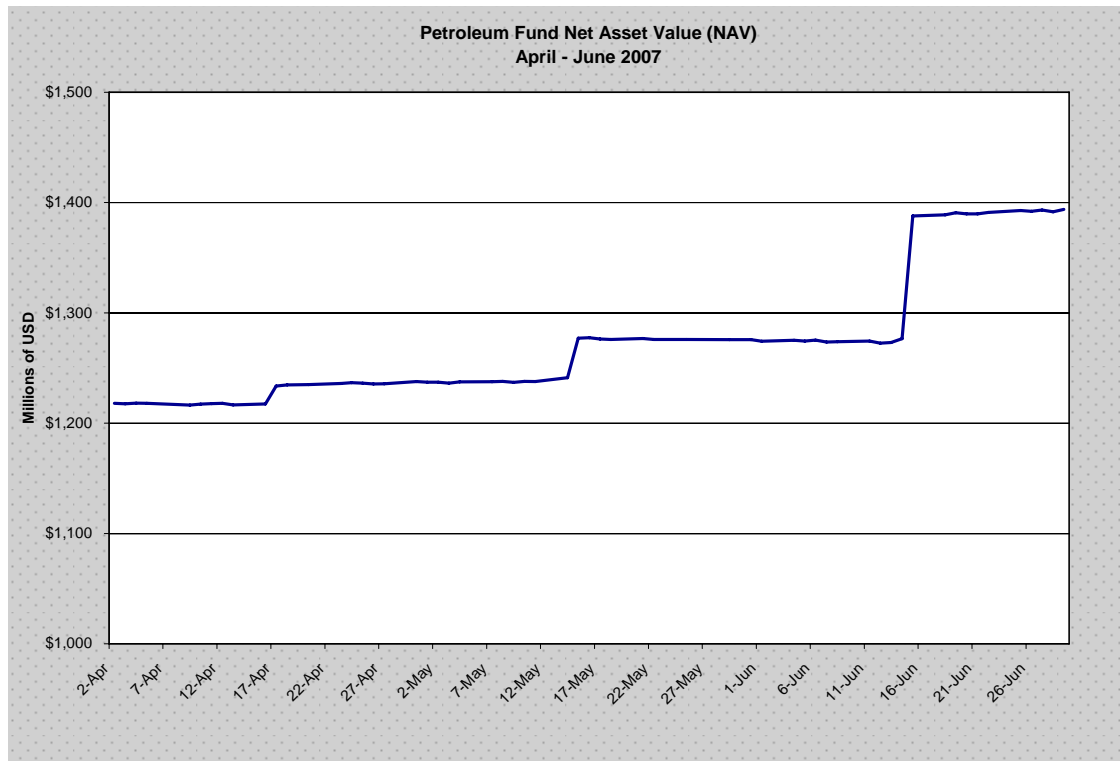
Absolute Return

	In million US\$
Absolute Return for Quarter April-June 07	
Opening book value (31 Mar 07)	1,217.98
Receipts during the period	308.26
Transfer to General State Budget during the period	(140.07)
Management Fees	(0.16)
Absolute Return in the period	8.21
Closing book value (30 June 07)	1,394.22

The opening value of the Fund at the beginning of the quarter was \$1,217.98 million and the closing value as at 30 June 2007 was \$1,394.22 million. The petroleum revenue during the quarter was \$308.26 million consist of the petroleum tax payers' contribution to the fund was \$93.57 million and the royalties' contribution to the fund was \$214.70 million. Absolute return was \$8.21 million during the quarter, whereof the coupon and interest received was \$11.45 million and the change in the securities valuation was negative \$3.25 million. This represents a

return to the Fund based on the time weighted rate of return of 0.62%, or 62 basis points for the quarter.

A graphical presentation of the growth in the NAV of the Fund during the quarter is as follows:



The major movements in the value of the Fund took place as a result of the taxpayer receipts that are usually received around the middle of each month.

5. MANAGEMENT COSTS

The means by which the management costs of the Fund are to be recognised is determined in the Petroleum Fund law. Article 6.3 of the law states “From the amount received in accordance with Section 6.1, the Central Bank shall be entitled to deduct, by direct debit of the Petroleum Fund account, any reasonable management expenses, as provided for in the operational management agreement referred to in Section 11.3”.

The management fee is intended to cover the actual expenses incurred by the BPA in managing the Fund. A management fee of US\$524,000.00 for the fiscal year 2006/07 has been agreed between the Ministry of Planning and Finance and the BPA. An amount of US\$157.20 thousands management fee has been deducted from the Fund during this quarter.

6. TRANSFERS FROM THE PETROLEUM FUND

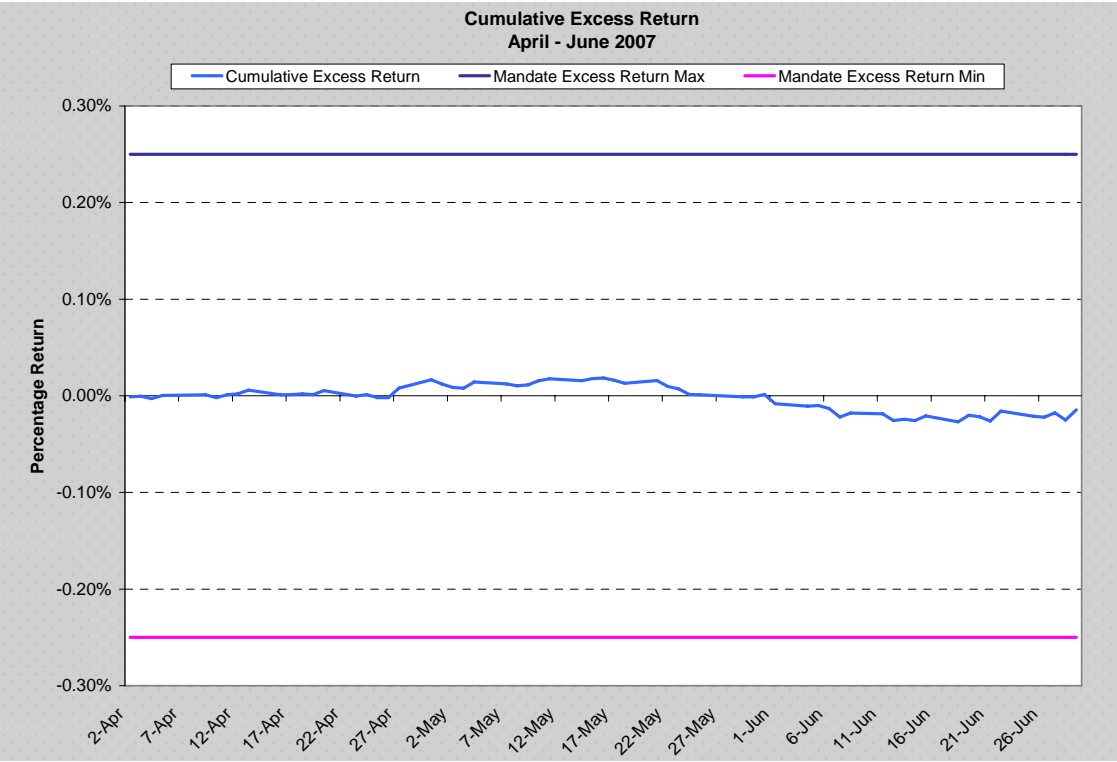
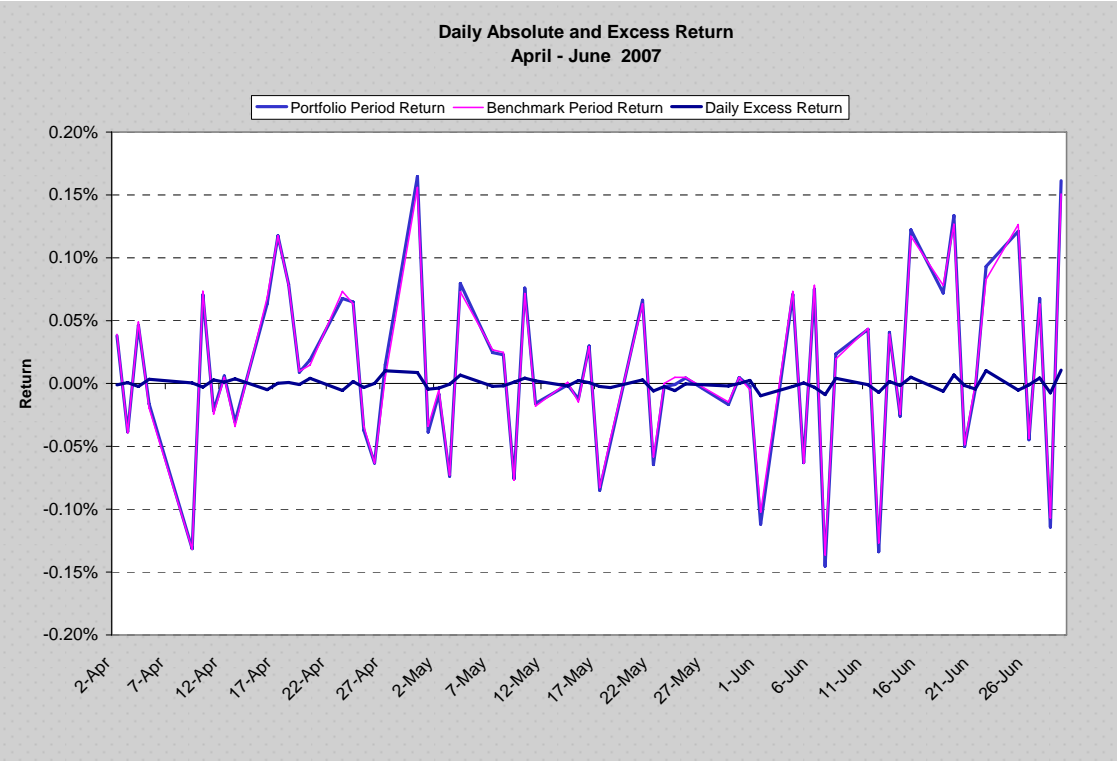
According to Article 7.1 of the Petroleum Fund law transfers from the Fund may only be made to the credit of a single State Budget account. During the quarter, an amount of US\$140.07 million has been deducted from the Fund as requested by the Government to transfer to the General State Budget account in accordance with Article 13 of the Operational Management Agreement. The transfers to the State Budget were US\$ 80.00 million in April and 60.07 million in May 2007.

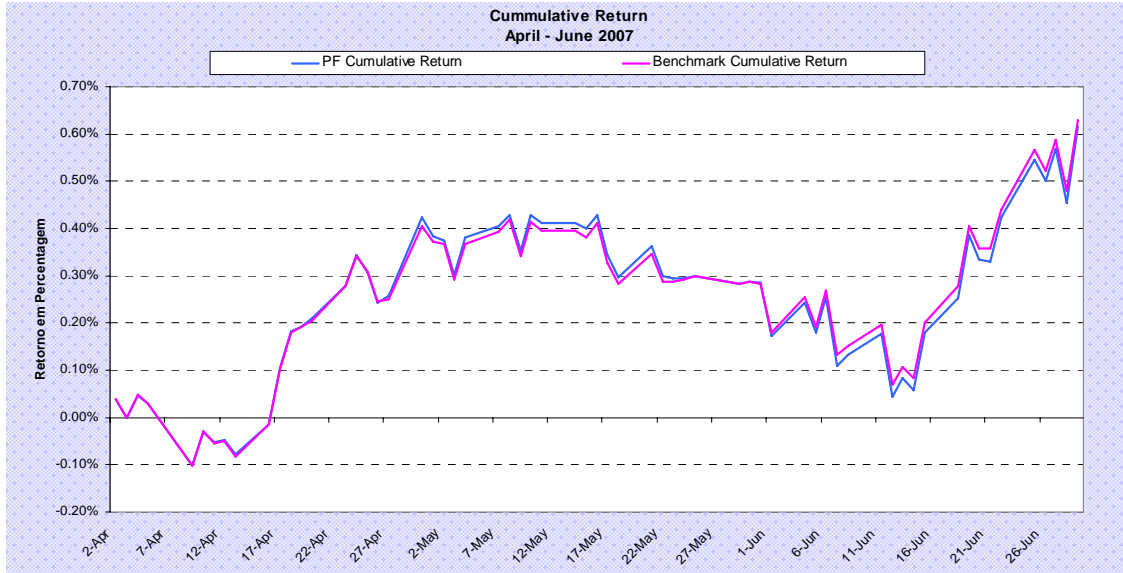
In accordance with Annex 1 of the Management Agreement, an accumulated incoming cash amount of USD 140.07 million for the purpose of the transfer to the General State Budget has been invested at overnight money market interest rates during 4 days in an overnight repurchase pool operated by the Federal Reserve Bank of New York and has been excluded from the fund for the purpose of benchmark comparison.

7. RISK EXPOSURE OF PORTFOLIO

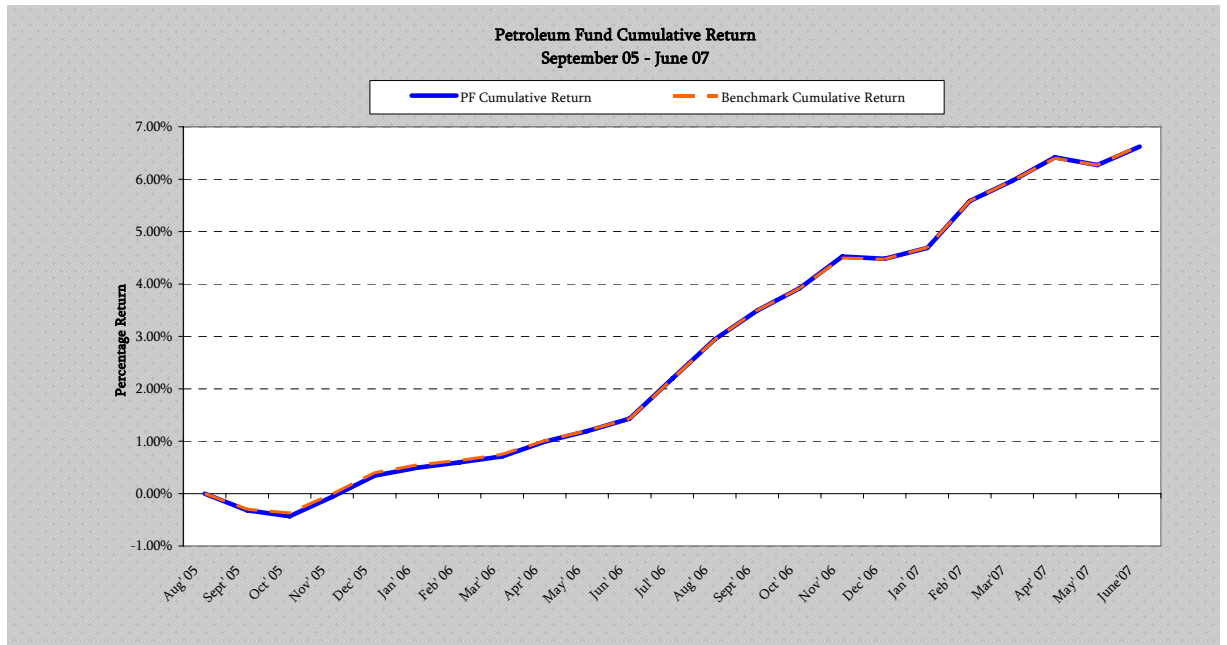
7.1 Tracking Error

The following graphs illustrate the manner in which the Fund portfolio tracked the benchmark index. The line “Daily Excess Return” measures the difference between the return on the Fund’s portfolio and the benchmark. The cumulative excess return for the quarter was 1 basis point below the benchmark, within the ± 25 basis points in the investment mandate.



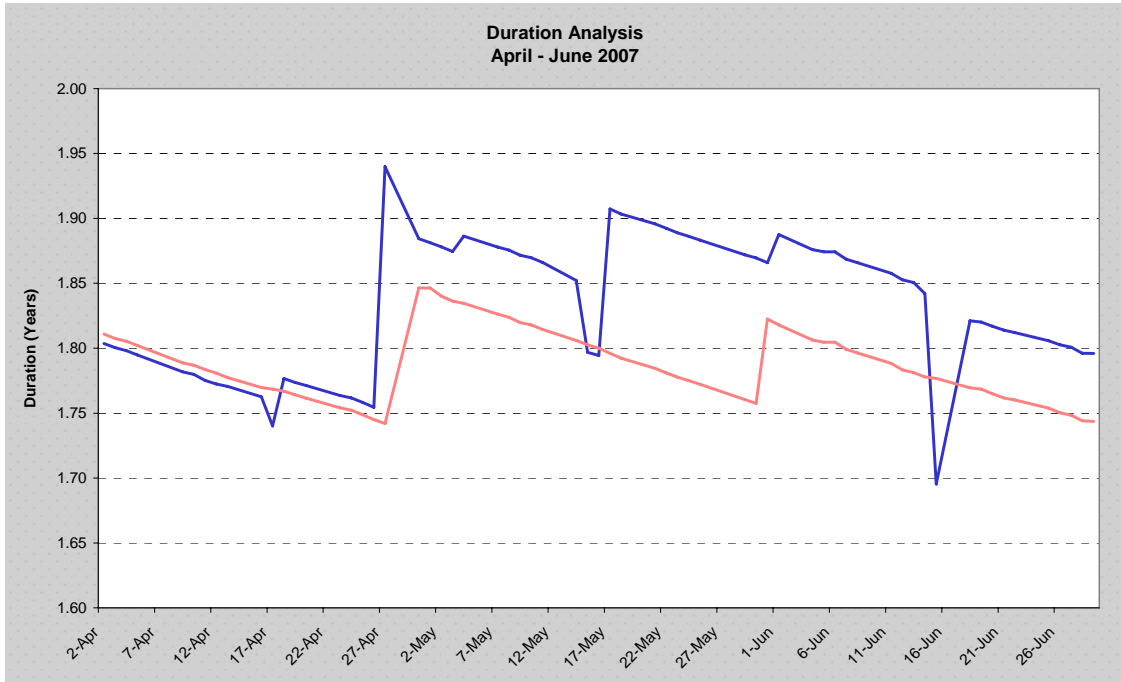


The performance of Petroleum Fund during the quarter compared with the performance of the benchmark over the same period is shown in the following graph.

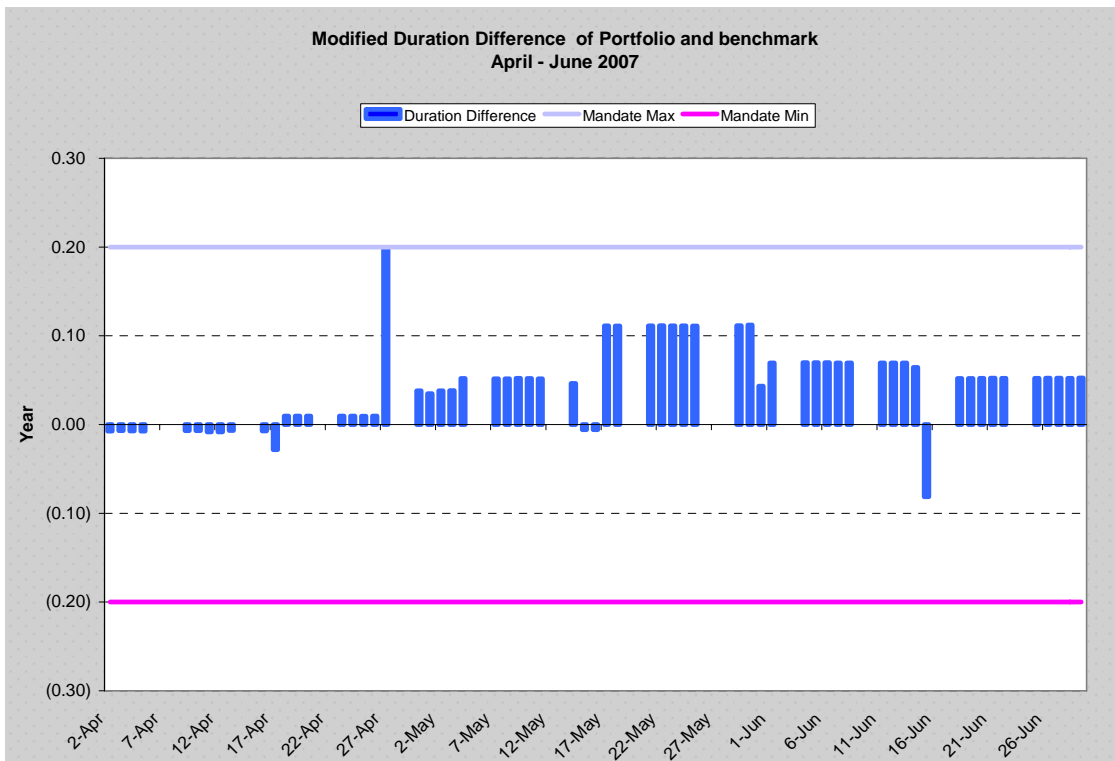


7.2 Duration

The mandate given by the Ministry of Planning and Finance to the BPA specifies that the Fund portfolio shall have a Modified Duration within 0.2 years of the benchmark index. The following graphs show, firstly, the modified durations of the portfolio and the index, and secondly, the difference between the portfolio and the index compared with the mandated maximum of ± 0.2 years.



The above graph shows the modified duration of the Petroleum Fund investment portfolio compared with the modified duration of the benchmark index.



The above graph shows the daily difference in modified duration between the investment portfolio and the benchmark. The Management Agreement states that

the modified duration of the portfolio shall be managed within ± 0.2 years of the modified duration of the benchmark. The duration was within the mandate during the quarter.

7.3. Credit Risk

The Merrill Lynch index comprises Treasury Securities issued by the United States Government, which is rated AAA.

All investments by the Petroleum Fund were also in US Treasury Securities with the highest credit rating (AAA).

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

8. COMPLIANCE STATEMENT

The BPA has undertaken the operational management of the Petroleum Fund within the terms of the mandate set out in the Management Agreement.

Qualifying Instruments

The Fund was invested in the qualifying instruments within the investment universe specified in the mandate at all times during the quarter. At no time was the Fund invested in instruments other than those disclosed in this report.

Return on the Portfolio

The performance on the portfolio for the quarter was 62 basis points compared with the benchmark performance of 63 basis points. The difference of 1 basis point is within the mandated target of ± 25 basis points.

Modified Duration of the Portfolio

The modified duration of the Fund's investment portfolio and the mandated index are measured by the BPA daily. The modified duration of the Petroleum Fund portfolio was within the mandate during the quarter.

Internal Audit

In accordance with the provisions of Article 22 of the Petroleum Fund law number 9/2005 that requires BPA's Internal Auditor to perform an audit of the Fund every six months. The Internal Auditor has performed an audit on the Fund to 30 June 2007.

Accounting Principle

In accordance with the provision of Article 21 of the Petroleum Fund Law, the accounts and records of the Petroleum Fund shall be presented by using the International Accounting Standard (IAS). The Financial Statements given in this report, as well as the previous reports, is prepared by using the mark-to-market accounting standard.

9. SUMMARY FINANCIAL INFORMATION

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

Balance Sheet

	in thousands \$	
NET ASSETS	Jun-07	Mar-07
Cash and Cash Equivalents	411	1,240
US Treasury Notes (Market Value)	1,386,781	1,199,804
Accrued Coupon	7,031	16,935
Less: Pending Purchases of Securities	-	-
TOTAL	1,394,223	1,217,979
CAPITAL		
Opening Balance as at 1 July 06	649,848	649,848
PF Law Art. 6.1(a) Revenue Receipts	498,471	404,906
PF Law Art. 6.1(b) DA Receipts	457,678	242,980
PF Law Art. 7.1 Transfer to General State Budget	(260,068)	(120,000)
Net Income	48,293	40,244
TOTAL	1,394,223	1,217,979

Profit and Loss Statement

	in thousands \$			
INCOME	Quarter		Year to Date (YTD)	
	Jun-07	Jun-06	Jun-07	Jun-06
Money Market Interest	155	86	458	253
Treasury Note Coupons	11,298	5,261	37,013	12,897
Income	11,453	5,346	37,471	13,150
Unrealised Market Revaluations	(3,247)	(1,205)	11,346	(5,832)
Less: Management Fees	(157)	(30)	(524)	(270)
Net Result for the Period	8,049	4,111	48,293	7,048

Notes:

- The Management Fees has been reclassified under Profit and Loss as it has been previously classified under Capital Account.*
- The basis on which these financial figures have been prepared is to recognize income as comprising (i) coupon income on an accruals basis, and (ii) changes in market value in the price of the investments that occur after purchase.*

Dili, 16 July 2007

Maria José J. Sarmento
Acting Executive Director

Abraão de Vasconcelos
General Manager