



# Annual Report 2017

Modernizing  
the financial  
system for a  
better future

01-Oct-09  
01-Nov-09  
01-Dec-09  
01-Jan-10  
01-Feb-10  
01-Mar-10  
01-Apr-10  
01-Jun-10





# Annual Report 2017

**Modernizing  
the financial  
system for a  
better future**

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## Chapter

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*The Central Bank of Timor-Leste (BCTL) annual report synthesizes and presents relevant national and international economic developments in 2017, as well as the activities undertaken by the BCTL throughout the year.*

## Introduction

The Organic Law of the Central Bank establishes the annual reporting duties of the Central Bank vis-à-vis the President of the Republic, the National Parliament, the Prime Minister and the Minister of Finance. The report is composed of two main sections, specifically: the analysis of national and international economic trends; and a review of the Bank's activities, including statutory financial information.

In 2017, the world economy registered an acceleration in terms of growth (3.6%). The pace of growth of the more developed economies remained strong, above 2%, while the accelerating growth of emerging economies (4.6% in 2017) explained the acceleration of global growth. In terms of regions,



Asia continued to lead in terms of growth (6.5%) while Latin America was the region with the lowest growth rate in 2017 (1.2%). Growth for all of ASEAN's five largest economies accelerated to 5.2%. For 2018 and 2019, the IMF expects continued strong growth for the world economy, underpinned by the dynamism of the emerging economies, which should offset a slight slowdown in growth in more developed countries.

In 2017, there was a slight acceleration in inflation rates in the major world economies. Of particular note was the US and EU, which averaged annual inflation rates of about 2.1% and 1.7% compared to virtually zero (0%) in 2015.

In terms of the international financial markets, the two-year interest rates, more sensitive to changes in monetary policy trajectories, continued to show a clear divergence in policies among the world's 3 largest economic blocs, with markets continuing to gradually incorporate the impact of rising policy rates in the US. With regard to 10-year interest rates, US interest rates remained stable in 2017, while in Germany there was a small pickup in interest rates. In both 2 and 10 years, US interest rates remained much higher than those in the Euro-Zone and Japan.

In the Asian economic space, growth levels remained robust in 2017, with an average growth rate at around 5%, with growth accelerating in almost all economies. In terms of inflation, on average, the region recorded rates of around 2.4%. Continued



economic dynamism in the region in 2017, together with the pickup in inflation in the various economies, and the slight depreciation of the regional currencies against the dollar, has in turn explained the slight increase in regional inflationary pressures, when measured in US dollars.

In terms of our domestic economy, the growth rate of non-oil GDP (Gross Domestic Product) in 2016 was 5.3%, while, according to the BCTL's economic activity indicator data, the economy appears to have slowed in terms of growth in 2017 to 3.5%, versus 2016.

The domestic inflation rate, computed on the basis of the Consumer Price Index (CPI) by the DGE, stood at 0.6% in December 2017. In terms of annual averages, Dili's CPI data shows that the annual inflation stood at -1.6% and 0.6% in 2016 and 2017 respectively. The slight increase in inflation in 2017 is due in large part to the pickup of external inflation, despite the relative stability of Timor-Leste's economic partners' currencies against the dollar and rising international commodity prices.

In budgetary terms, the Public Sector continues to register a substantial budget deficit, with non-oil revenues financing only a small part of total public expenditure. In 2017, the State registered a total collection of non-oil domestic revenues of US\$ 203 million. The overall budgeted amount for State Expenditure was USD 1,387 million, of which only 88.3% was spent.

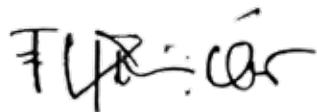
On the external front, the small increase in oil revenues in 2017, as a result of the rise in the international oil price, resulted in a slight reduction of the country's current account deficit (excluding other primary incomes) of US\$ 64 million to US\$ 705 million of GDP in 2017. The continuing decline in income from resources exploited in the Timor Sea (taxes and royalties) and the maintenance of high levels of imports of goods and services continued to be the main drivers of a substantial current account deficit in the Timor-Leste balance of payments.

In terms of BCTL's annual activity, the Bank remains actively committed to promoting monetary and financial stability and has developed particularly relevant initiatives in this context. One of the main activities developed by the BCTL during the period was the continued implementation of the Timor-Leste Financial Sector Master Plan and the continued management of the financial literacy development program, which covered several primary schools and was attended by 56 teachers from 39 primary schools in 12 municipalities, and the Special Administrative Region of Oé-Cusse Ambeno (RAEOA). As part of the National Savings Day celebration, the BCTL organized

role-playing activities on November 27 in coordination with the RAEOA Authority - in particular with the Education Department - under the theme “save now for a better future”. The Central Bank continued to act in a consistent manner to support the development of the National Payments System. During the year, the R-TiMOR support unit at the BCTL supported banks and State Authorities in various initiatives to strengthen electronic integration (STP, or Straight Through Processing) between R-TiMOR and their internal systems. In March 2017, the BCTL hired SIBS International of Portugal to supply and implement a National Card and a Payment Switch. The switch, designated “P24” (the “P” associated with the words Pagamentu, Pagamento, Payment and Pembayaran) will offer a full range of payment services. As far as the Timorese banking system is concerned, available information shows that it remained stable and robust, maintaining high levels of liquidity and reduced provisions for credit risks, while also registering strong asset growth, which have grown 1.8% in 2017, to a total of US\$ 1,170 million. In the 2017 financial year, the BCTL’s accounts recorded a positive net result of US \$ 3.1 million, generated mainly by the revenues from the management fees of the Petroleum Fund and interest received from the investments made with BCTL’s own assets.

The Bank continues to maintain its strong commitment to staff training and allocates significant financial resources to this end. This has been reflected positively in the quality of the work developed by the institution, recognised as one of the best in the country.

Finally and as usual, I, as Governor of the BCTL, am grateful to all the staff of the Central Bank and our partners during the year, who continued to contribute actively and collaboratively to the development of the BCTL and the economic development of our country.



**Abraão de Vasconcelos, Governador**

Dili, 28th April 2018

# International Economic Trends



# Chapter 01

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*This chapter briefly describes the world's major economic developments in 2017 as well as for the economies of Timor Leste's main economic partners, together with the most relevant global financial markets trends for our economy.*

*Based on this brief description, the chapter then reviews the main channels of transmission of external economic and financial trends to our domestic economy, detailing the influences observed in 2017 and the perspectives expected for the years ahead.*

**The world economy continued to show robust growth in 2017, while solid growth is also expected in 2018 and 2019...**



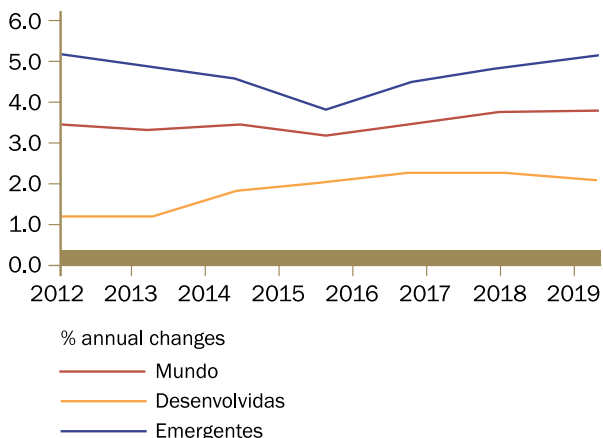
## Major World Economies

### 1.1.1. Economic Growth in Major Economies

In 2017, the world economy recorded an acceleration in terms of growth (3.6%), compared to the average levels recorded in the last 3 years, prolonging the economic recovery of the global financial crisis of 2008-2009. The growth rate of developed economies remained strong in 2017, above 2%, which, together with the acceleration of the growth of the emerging economies (4.6% in 2017), explained the acceleration of world growth. For 2018 and 2019, the IMF expects a continued strong growth in the world economy, underpinned by the dynamism of the emerging bloc, which should offset a slight slowdown in growth in more developed countries.

**Chart 1.1**

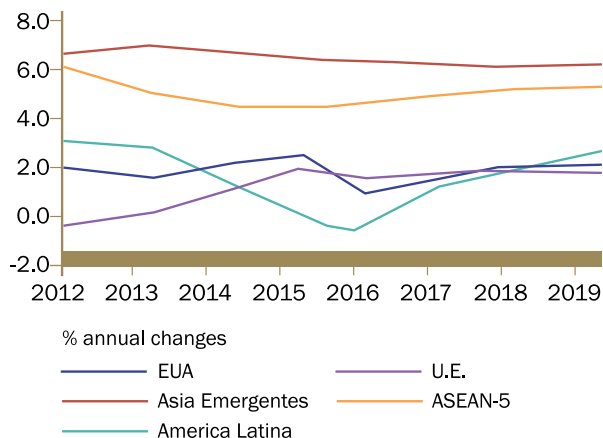
GDP % Growth - 3 Main Blocs



Source: FMI, World Economic Outlook, Outubro 2017

**Chart 1.2**

GDP growth - Selected Regions



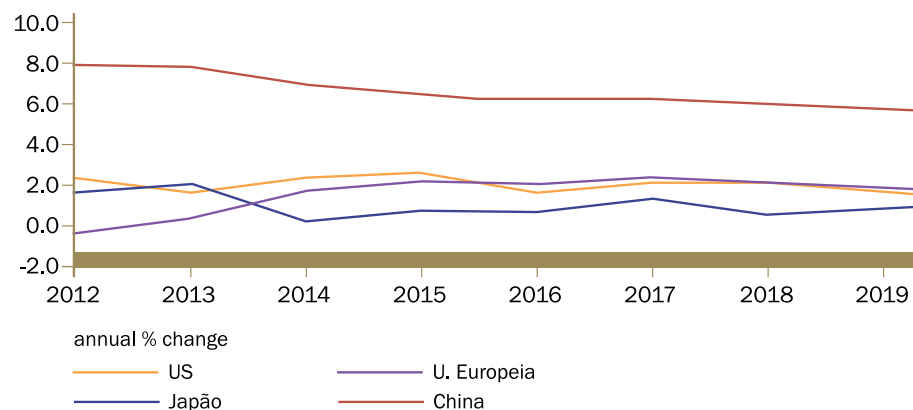
Source: FMI, World Economic Outlook, Outubro 2017

**.... ASEAN economies also kept their robust growth levels.**

In terms of regions, Asia continued to lead in terms of growth (6.5%) while Latin America was the laggard in terms of GDP growth in 2017 (1.2%), although this region continues to recover from the marked slowdown of 2014 and 2015. Growth in all of ASEAN's five largest economies accelerated to 5.2%, which represents the strongest growth rate for the region since 2013. In line with the IMF's optimism for 2018 and 2019, the Fund expects continued strong economic growth in the US, EU and Asia, while simultaneously projecting an acceleration in growth levels in Latin America, the Middle East and Africa.

**Chart 1.3**

GDP real % Growth - 4 Largest World Economies



Source: FMI, World Economic Outlook Database, Outubro 2017

Lastly, a comparison of the performance of the 4 major world economies - the US, EU, Japan, and China - shows that China maintained a stable level of growth in 2017, with a gradual and slight deceleration expected to occur in 2018 and 2019. The US experienced a slight economic acceleration in 2017 (2.2%) compared to 2016. While Japan continued to record lower growth levels than the US and EU, it closed the gap versus the other two economies in 2017. In line with the aforementioned IMF forecasts, the world's top 4 economies are expected to maintain their respective levels of growth in 2018 and 2019, with the prospect of further expansion of their respective economies above potential growth levels.

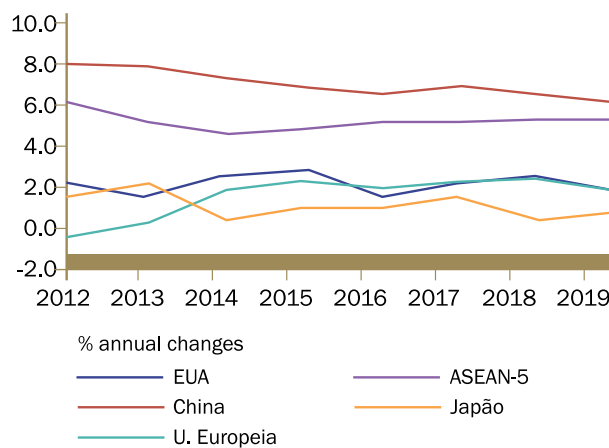
### 1.1.2. Inflationary Trends in Major Economies

**Global inflationary pressures rose in 2017...**

In 2017 there was a slight acceleration in inflation rates in the major world economies, building on the trend registered in 2016, with particular emphasis on the US and EU, whose annual average inflation rates rose to about 2.1% and 1.7%, compared to virtually zero (0%) in 2015.

**Chart 1.4**

Inflation Rates % - Selected Economies



Source: FMI, World Economic Outlook Database, Outubro 2017

**.... on the back of continued strong global economic growth and commodity prices recovery.**

The gradual recovery in inflation was mainly due to the rise in prices of the main world commodities in 2017, especially the rise in energy prices compared to the depressed values of 2015. For 2018 and 2019, the IMF envisions a scenario of stable price pressures in the main economies, highlighting the possibility of a further acceleration of US inflation in 2019, resulting from the maintenance of solid growth levels, as effective GDP is now expected to grow increasingly above potential GDP level.

It should be noted that the IMF expects the Japanese and EU economies to continue to experience lower rates of inflation than the US, given the existence of “space” in terms of resources not used in these economies, which continue to operate below their potential level. However, in spite of the marked economic recovery in the EU and Japan, it will be necessary that both economies continue to grow robustly for several consecutive years in order to effectively close the deficit in the use of economic resources and to materialize substantial inflationary pressures in these economies. Japan, despite continuing to adopt a highly expansionary set of monetary measures, continued to record anemic inflation levels around the levels recorded in the last decade.

### 1.1.3. Commodity Markets

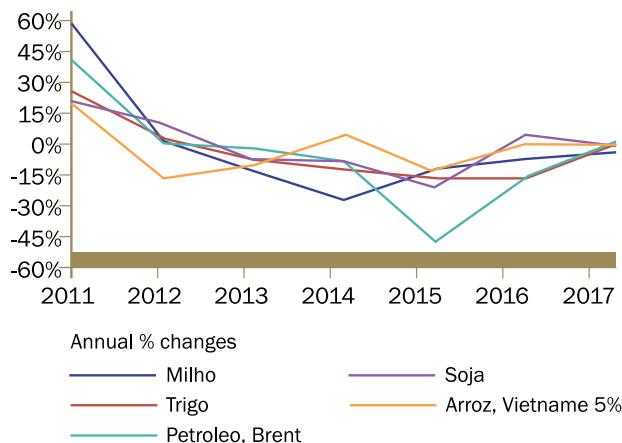
**Commodity prices have partially recovered from the substantial falls of 2015....**

In the global commodity markets, 2017 was marked by the continued recovery in international prices of energy and industrial metals inputs, following the substantial declines registered in 2015 and the anemic evolution of food prices. As shown below, of the four food commodities considered, only wheat and rice recorded price increases in 2017. The price of oil and other energy sources continued to recover some of the lost ground of 2015, but international prices remain substantially below the price peaks in the last decade. Considering that the main world economies presented robust growth levels in 2017, the recovery of the prices of energy inputs and industrial metals justifies the already mentioned recovery of the inflationary pressures in the respective economies.

**.... supporting growth in commodity producer and exporter countries.**

For the exporting economies of these goods, typically developing countries, the recovery of international prices represents a positive stimulus to their incomes and, consequently, on their economies. A clear example of this is of course Latin America and Russia, which benefited from the recovery in energy commodity and metals prices in 2017. On the other hand, the continued decline in the price of food staples had a negative impact on the countries that export this type of goods.

**Chart 1.5**  
Major Commodities Prices



Source: Banco Mundial, Commodities Datasheet, Fevereiro 2017



### 1.1.4. Major Financial Markets

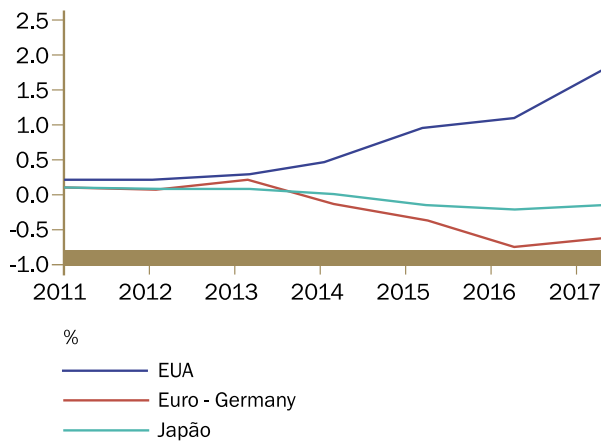
**US 2 year interest rates rose again in 2017, in line with monetary policy trajectory....**

In terms of financial markets, we start by analyzing the evolution of the main bond markets, namely those of Treasury bonds, which allow us to gauge the evolution, and respective expectations, of the monetary policies of the various economies, as well as their respective rates of growth and inflationary expectations.

Two-year interest rates, which are more sensitive to changes in monetary policy, continued to show the clear divergence in policies between the world's 3 largest economies in 2017, with markets gradually incorporating in 2017 the impact of rising policy rates in the US monetary policy.

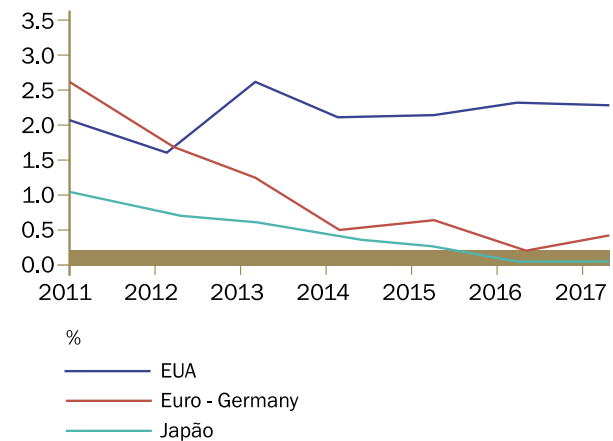
With regard to 10-year interest rates, US interest rates remained stable in 2017, with a slight recovery in interest rates in Germany. For both 2 and 10 years, US interest rates remained at much higher levels than those in the Euro-Zone and Japan, as a result of the improved performance of the US economy in recent years, which eventually justified the continuation of the rate increase by the FRB in 2017.

**Chart 1.6**  
2 Year Treasury Bond Yields



Source: Bloomberg

**Chart 1.7**  
10 Year Treasury Bond Yields



Source: Bloomberg

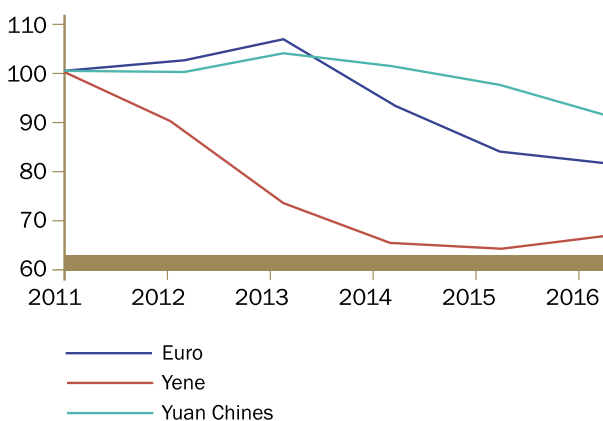
**.... but the USD lost ground vs major world currencies in 2017.**

Of course, the trends in bond markets, together with the economic developments already analyzed, have also determined a large part of the developments in the main global foreign exchange and equity markets.

However, in foreign exchange markets the dollar depreciated against the euro and the yen in 2017, due to both the excessive appreciation of the dollar in previous years and the consolidation of reduction of monetary stimulus in the euro area and Japan throughout 2017 as a result of the recovery of their respective economies.

**Chart 1.8**

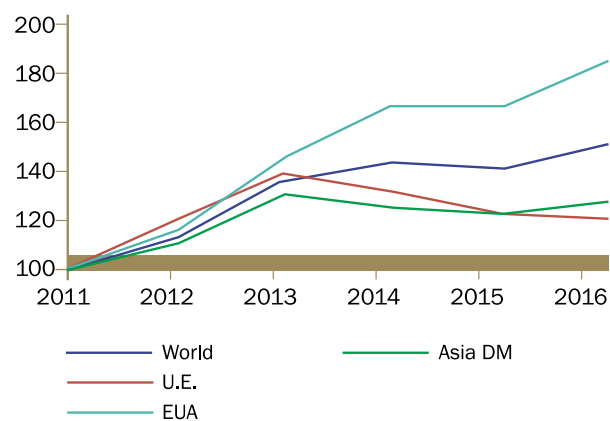
Major FX rates vs US \$. 2011=100;  
A decrease means depreciation



Source: Google

**Chart 1.9**

Major Equity Markets, Prices Indexed in USD.  
2011=100



Source: Google

**Major global equity markets registered strong gains in 2017.**

On the other hand, the US stock market again recorded remarkable gains in 2017, similar to 2016, benefiting from the strong recovery after the conclusion of the Presidential election and the approval of a substantial fiscal stimulus program, continuing to trend above other major world markets. In 2017, as shown above, despite the remarkable performance of the North American equity market, it is also worth mentioning the substantial rise in share prices in the Asian and European markets, which recovered part of the lost ground between 2013 and 2016.

Given the substantial out-performance of US equities over the past eight years that have resulted in substantial price appreciation in proportion to business results, it should be noted that a possible economic downturn in the US economy or in corporate profits could result in a correction in this stock market.



*After synthesizing the macroeconomic trends for the major world economies, it will also be relevant to deepen the analysis of economic developments in Asia, in particular ASEAN, as the main economic partners of Timor-Leste are located in this region.*

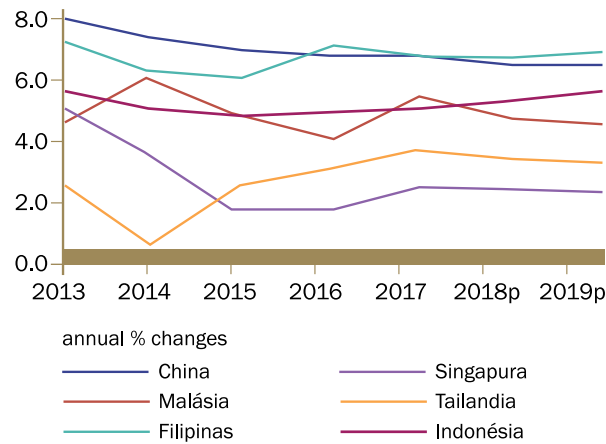
# 1.2

## Asian Economic Trends and Outlook

Our analysis focuses on the 5 largest economies of ASEAN and China, whose economy is assuming increasing regional and global relevance, because these are the main partners of our economy. On the other hand, of these 6 economies, Indonesia remains the major economic partner of Timor-Leste, which justifies some specific comments on its evolution.

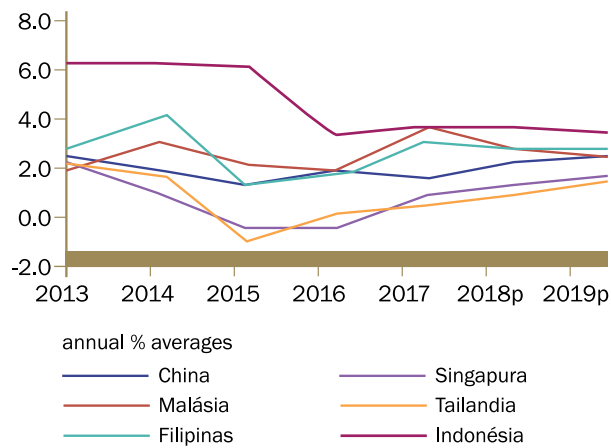
In terms of the 2 main macroeconomic indicators, GDP growth and inflation rates, growth levels remained robust in the region in 2017, with an average growth rate of around 5% for all 6 economies. In terms of inflation, the region recorded average rates of 2.4%, up from 1.5% in 2016. The Indonesian economy continued to maintain a high local inflation levels versus those of the other partners.

**Chart 1.10**  
GDP real growth rates



Source: IMF WEO

**Chart 1.11**  
Inflation Rates - Annual % changes



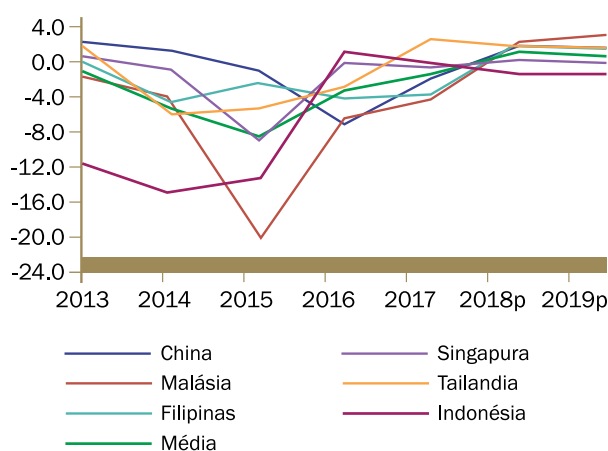
Source: IMF WEO

Continued economic dynamism in the region in 2017, and the resulting increase in inflation in the various economies, together with the slight depreciation of the regional currencies against the dollar, has in turn explained the slight increase in regional inflationary pressures, when measured in US dollars.

**Regional Asian currencies registered a slight depreciation vs the USD in 2017....**

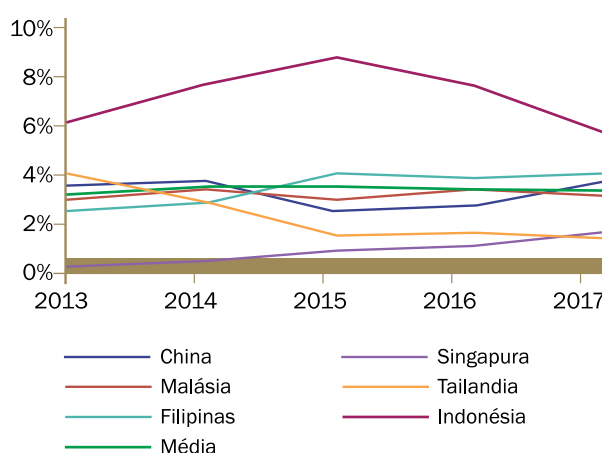
The evolution of the macroeconomic determinants helps to explain, as is also explained, the developments in the two main financial markets, the exchange rate and the bond market. In terms of exchange rates, 2017 was also marked by the generalized depreciation of regional currencies against the dollar, resulting from the gradual elimination of expansionary monetary policies in the US. On average, the region's currencies declined against the dollar by -1.7% 2017 (-3.4% in 2016), but the IMF expects regional currencies to remain stable against the US dollar in 2018 and 2019, which will help to stabilize inflationary pressures in the region and, above all, to stabilize the prices of goods imported into Timor-Leste.

**Chart 1.12**  
Exchange Rates - % changes vs USD



Source: IMF WEO

**Chart 1.13**  
2 Years Treasury Bond Yields



Source: ADB

.... while the regional 2 year rates were stable, except for Indonesia, whose rates continued on a downward trajectory.

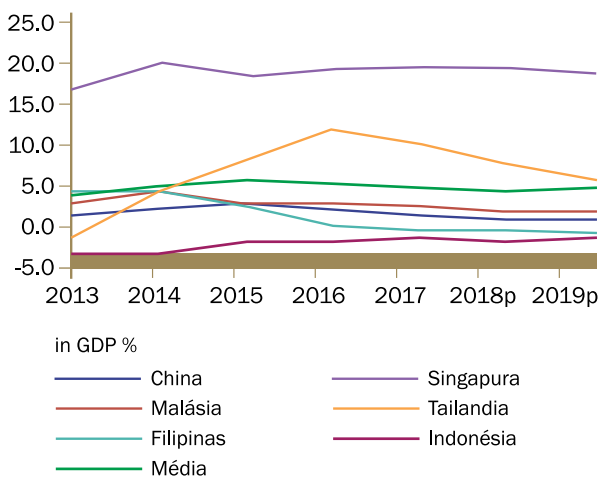
Regional current accounts were kept in surplus, except for Indonesia and Philippines.

Bond market interest rates, represented here by 2-year regional Treasury Bonds, were generally stable in the region, with Indonesia being the only exception. In the case of Indonesia, interest rates continued to decline substantially starting in 2016, benefiting from the successive decrease in the interest rates of the respective central bank, in response to the moderation of inflationary pressures in the economy, as well as the reduction of the respective external deficit.

Concerning the balance of external and public accounts, we can conclude that most of the partners continued to maintain substantial external surpluses in 2017, with the exception of the Philippines and Indonesia, which maintained a current external account deficit of -1.7%. Since Indonesia is an exporting country of raw materials, especially energy and industrial metals, the decline in international prices of these commodities in the last 3 years has resulted in a substantial negative shock to its economy, requiring stronger restrictive macroeconomic policies to contain the dynamism of domestic demand, to correct the external deficit and to contain the depreciation of the rupiah against the dollar.

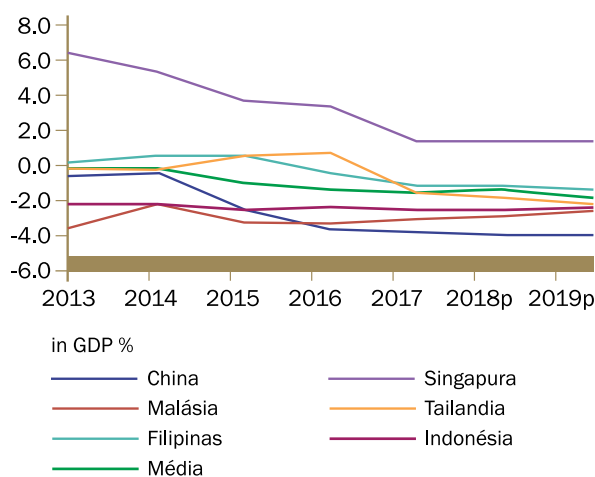
In terms of budgetary balances, 2017 was characterized by a slight increase in public deficits in the region, adding to the deterioration already registered in 2016, while Singapore has registered a declining surplus over the last few years. The two regional exceptions remain Singapore (+1.7%) and Malaysia (negative), with a government deficit of -3% in 2017.

Chart 1.14 Partners External Accounts Surplus



Source: IMF WEO

Chart 1.15 Partners Public Budget Surplus



Source: IMF WEO



**In general, regional economies were robust and stable in 2017.**

In sum, the region's macroeconomic background remained relatively stable in 2017, with a notable reduction in the degree of depreciation of the regional currencies against the dollar in 2017 and 2016, when compared to the substantial depreciations of 2015. This depreciation seems in general, more due to the beginning of the cycle of rising interest rates in the US than to macroeconomic imbalances in the region given the maintenance of strong economic growth rates and the strong external position of regional economies.

It should be noted, however, that this general idea does not fully apply to the Indonesian economy, Timor-Leste's largest partner. However, the Indonesian rupiah was relatively stable in 2017, after having experienced substantial losses vis-a-vis the dollar between 2013 and 2015. Although experiencing remarkable levels of exchange rate volatility, along with the imbalances already mentioned, the Indonesian economy managed to maintain a robust annual growth of 5.2% in 2017, compared to +5% in 2016. The importance of this economy for our economy naturally implies the maintenance of an adequate monitoring of these developments, but it is expected that the policies introduced by its Government and closer surveillance by its Central Bank, will gradually reduce these macroeconomic risks.



*The above review of major international economic and financial developments as well as of Asian economic developments, which are much more relevant for Timor-Leste, would not be complete without understanding the respective repercussions on our economy.*

# 1.3

## Economic Transmission Channels to Timor-Leste

### 1.3.1. Summary

This point tries to identify the main channels of transmission of the international developments to our economy. At present, it is reasonable to accept that these effects are still small and limited to certain sectoral aspects of our economy. This chapter seeks to illustrate the mechanism of operation of the main channels, namely: the impact on the evolution of domestic inflation levels, determination of the value of oil revenues and effects on the value of the investments made under the Petroleum Fund. Foreign Direct Investment is certainly one of the variables most influenced by the external context, but the scarcity of effective investments and reliable data in Timor-Leste does not allow us to analyze this relationship properly.

Of course, as our economy develops and effectively deepens interdependence relations with its regional economic partners, we expect that external developments will increasingly influence the evolution of our economy, expanding the number influence of each transmission channel.



### 1.3.2. Imported Inflation

**BCTL's inflation modelling approach uses 2 main drivers for domestic inflation: external inflation and domestic economic activity.**

One of the main transmission channels for our economy is the impact of international prices on the evolution of domestic inflation and respective expectations. Since Timor-Leste is primarily an import economy - imports of goods and services accounted for 58% of non-oil GDP in 2017 - it is expected that the evolution of international prices of imported goods and services will substantially affect domestic inflation.

BCTL's empirical research and economic modelling has confirmed the importance of this channel. One of the main problems of our work in this context stems from the difficulty in defining an appropriate variable to measure the level of "external inflation" for Timor-Leste, given the absence of an import price index and the large variability of import basket and of the geographical structure of our imports. After experimenting with several functional forms for this variable, we concluded that the most appropriate empirical variable seems to be an average of the inflation rates of the 5 largest economies of ASEAN and China converted into dollars. In practice, this measure corresponds to an average of the regional inflation rate measured in dollars, which at the same time captures the impact of regional exchange rate variations against the dollar and local currency inflation rates.

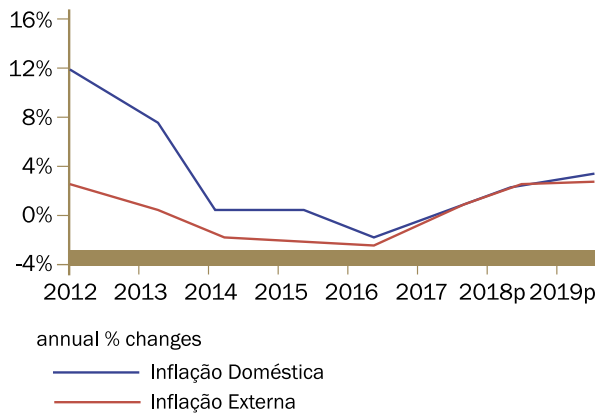
**External inflation has continued to drive domestic inflation trends....**

As can be seen in the chart below and to the left, the domestic inflation rate tends to reasonably follow the movements of the external inflation rate, albeit with less volatility. Insofar as the external inflation rate corresponds to the average of the six economies already mentioned, the BCTL inflation forecast models use these variable and respective expectations to construct inflation forecasts.

**.... pushing domestic inflation upwards, and is expected to continue to exert upward pressure in 2018 and 2019.**

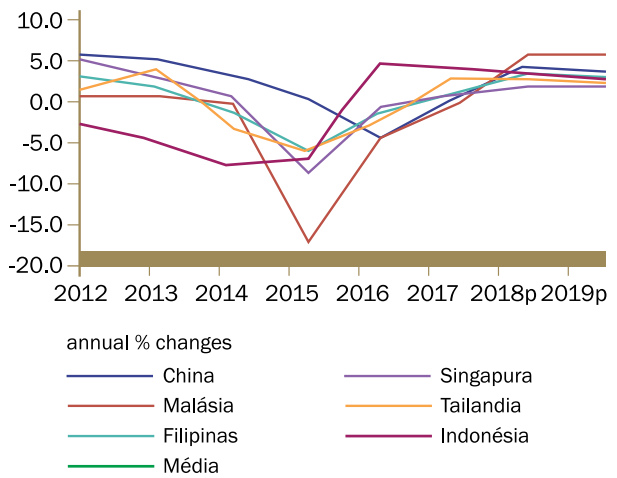
In addition, as can be seen from the two graphs below, the recent sharp increase in the rate of inflation in Timor Leste has been reinforced by the rise in external inflation rates. Of course, the relationship is not perfect, since the evolution of Timor-Leste's non-oil economy, especially in the last decade, has also strongly affected the evolution of the domestic inflation rate.

**Chart 1.16**  
Domestic vs External Inflation



Source: IMF WEO

**Chart 1.17**  
Regional Inflation Rates in USD



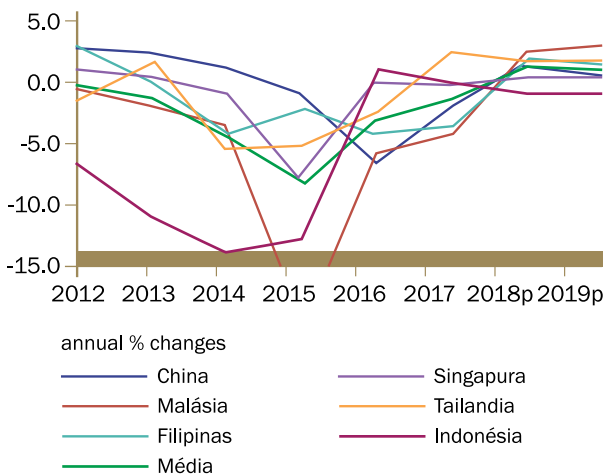
Source: IMF WEO

**Rising regional inflation in USD was mostly due to rising to domestic inflation rates across the region, in local currency terms.**

In 2017, the slight increase in regional dollar inflation rates observed for practically all economies was mainly due to the rise in inflation rates in local currency and the relative stability of Asian currencies against the dollar, as can be seen in the charts below. In fact, the continued widespread depreciation of regional currencies after declines from 2013 to 2015 has been one of the factors that have contributed most to the substantial decline and maintenance of historically low inflation in Timor-Leste, as they cheapened imported goods and services.

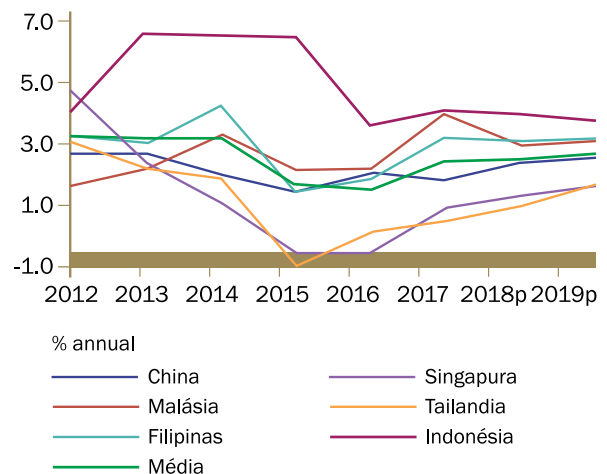
Since external inflation rates in local currency are relatively stable over time, the movements of the partners' currencies against the dollar are, in turn, a very important driver of domestic inflation. It should also be noted that the substantial reduction in inflation in Timor-Leste is also a result of declines in international prices of the most representative commodities, such as oil and food, as previously mentioned.

**Chart 1.18**  
Asian Currencies vs the USD



Source: IMF WEO

**Chart 1.19**  
Partners Inflation Rates - in local currency



Source: IMF WEO

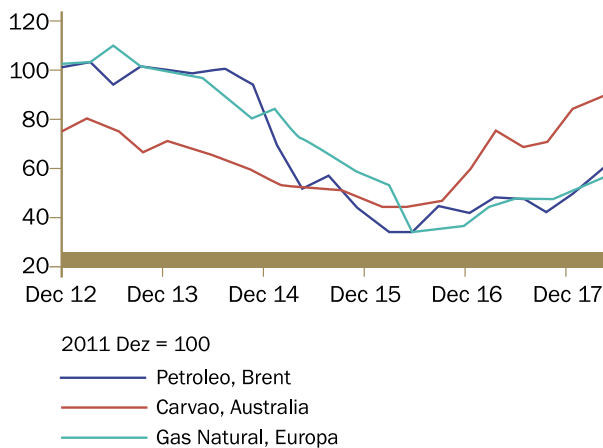
Given the importance of this transmission channel, the future developments in “external inflation” trends, strongly determined by the exchange rate changes, will continue to be one of the most influential factors in determining the evolution of domestic inflation. In this regard, the BCTL now expects, in line with the IMF, that regional currencies will remain stable against the dollar in 2018 and 2019, which together with the maintenance of moderate partner inflation rates, leads us to predict that imported inflation will increase, but only slightly, over the same timeframe, contributing to rising, but controlled, inflationary pressures in Timor-Leste in 2018 and 2019.

### 1.3.3. Global Energy Markets and Petroleum Revenues

**Oil prices continued to recover in 2017, but have not yet fully recovered from the substantial falls registered in 2014 and 2015.**

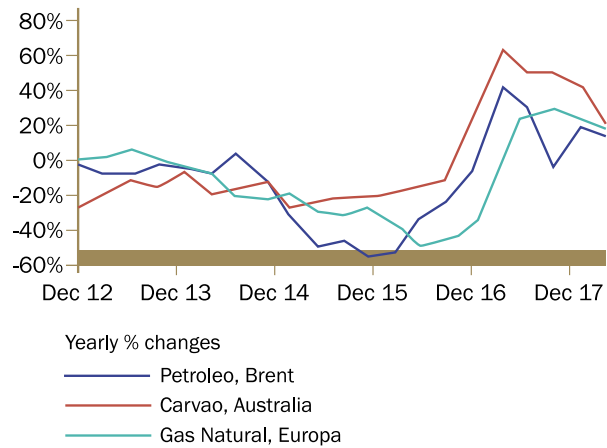
Prices for oil, natural gas and other energy resources are highly volatile, fluctuating substantially between periods of high and low-price levels. The graphs below show these fluctuations and allow us to place the recent drop in energy prices in a multi-year perspective. It should be noted that it is not uncommon for prices to fall by 50% and rise by more than 50% within 1 year. In terms of levels, the sharp decline in oil prices from the end of 2014 resulted in prices similar to those of 2006, canceling out all the nominal price gains registered in 9 years. However, in 2017, there was a substantial recovery in the price of these inputs, especially of coal, but still to price levels well below the highs of the last 5 years.

**Chart 1.20**  
Spot Energy Prices



Source: Banco Mundial

**Chart 1.21**  
Spot Energy Prices - % change



Source: Banco Mundial

However, the evolution of energy prices is not easy to anticipate, as it results both from the interdependence between demand and aggregate supply on physical markets and, increasingly, from the less measurable and unpredictable effects resulting from the “financialisation” of these markets, yielded by the expansion of the financial derivatives market and increasing participation of financial intermediaries and speculators. An obvious proof of this inability to predict is clearly the recent drop in the price of oil, the speed and breadth of which were in no way predicted by the majority of market players and analysts.

**Expected future petroleum volumes are now substantially lower than in the past, greatly reducing the impact of fluctuating oil prices on Petroleum Wealth.**

This observation is important because it prevents us from accepting simplistic scenarios and extrapolating further price declines, based only on the recent drop in oil prices. On the other hand, the evolution of the price of petroleum products is important for Timor-Leste, since significant oil revenues are still expected in coming years.

It should also be noted that the impact of fluctuations in energy prices on the country’s oil wealth is much lower today than in previous years. This is due to the fact that future oil volumes are now much reduced compared to what has already been extracted from the Timor Sea reserves, with the prospect of the exploitation of the existing fields completely ceasing until 2021. It should therefore be noted that future revenues envisaged from 2017 to 2021 amount to only 551 million dollars, corresponding to only 2.6% of the accumulated revenues obtained from 2002 to 2016, totalling US\$ 21,412 million. In 2015, the value of future revenues was 868 million, or 4.1% of revenues obtained until that year. At the end of 2015, future revenues of around US\$ 1,400 millions were expected between 2016 and 2021, which is much higher than the current estimate by the State, due to the fall in oil and gas production forecasts in the Timor Sea and lower prices for these goods.

Given the small estimate of the future oil revenues of the Timor Sea, we prefer not to develop in this report, as we have done in previous years, the sensitivity analysis of revenues in relation to the oil price.

### 1.3.4. Financial Markets and the Petroleum Fund

**Financial market prices influence the Petroleum Fund's value and its sustainable income and, subsequently, public spending policies.**

Lastly, we also address another channel of transmission of international developments to our economy, which relates to the Petroleum Fund created to efficiently manage the country's oil wealth. The mechanism of operation of this channel is similar to that of the price of oil, as the evolution of prices of international financial assets determines the value of the Petroleum Fund and, in turn, the value of its 'Estimated Sustainable Income (ESI)'. Insofar as they affect these two aggregates, financial asset prices ultimately influence the amount of revenue available to finance the State Budget and, consequently, the pace and size of spending and public investment policies.

**The PF has now invested 60% of its assets in Treasury Bonds and the remaining 40% in equities.**

The Petroleum Fund (PF) closed the year 2017 with the value of financial assets amounting to US \$ 16.799 million, mostly invested (60%) in Treasury bonds of the most developed countries and in shares (40%) of nearly two thousand companies based in these same countries. The Fund was able to reverse the declines in the total value of assets recorded in 2015 and 2016, increasing by \$US 955 million in 2017. Since its inception, the PF has been expanding its investment universe, firstly by first investing in US Treasury securities, then gradually investing in equities and, finally, extending investments to bonds issued by major worldwide Treasuries. The gradual extension of the investment mandate was driven by the increasing demand for a higher expected return to the Fund and the greater diversification of the investments and markets under consideration.

**PF performance is now crucially driven by price trends in global bond and equities markets....**

Of course, this institutional development exposes the Fund to new risks and markets, but which, by benefiting from the diversification of the prices of the various assets, allows a more solid Portfolio to be built and whose risk-return profile is more efficient. At present the Fund invests only in fixed interest rate bonds and equities, so that interest on bonds and dividends on shares provide the Fund with a fixed and constant income, at least 'a priori'. Of course, by investing in bond and equity securities, the Fund benefits from increases in market values or, on the contrary, can be adversely affected by its decline. Accordingly, the Fund's main financial risks correspond to possible losses arising from the fall in the prices of the bonds or the shares acquired. In addition, since the PF invests in several markets, denominated in currencies other than the US dollar, the Fund is also exposed to the exchange rate risk of investments, understood as the possibility of depreciation of the various investment currencies against the dollar. In short, the financial risk of the PF includes 3 types of market risks: equity risk, or risk of falling prices of the main world stock markets, interest rate risk, which corresponds to the risk of falling treasury bond prices; and currency risk, which consists of the risk of depreciation of the investment currencies against the US dollar.

**....but foreign exchange fluctuants also affect the FP, which has invested in currencies beyond the USD.**

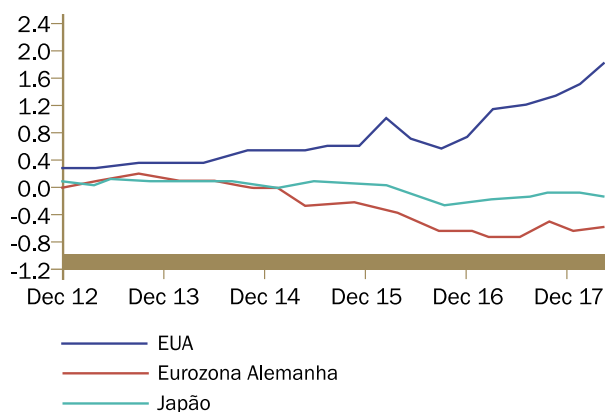
**In 2017, the FP registered solid gains, boosted by gains across world equities and bond markets.**

**Treasury Bonds investments registered moderate gains in 2017.**

The evolution of the prices of PF's assets and of the various investment currencies thus consists of the true transmission channel between international markets, the FP valuation and the its 'estimated sustainable income' level. In terms of returns, the year 2017 was very positive for the PF (+ 10.4%), the highest annual gain in its history, benefiting from the gains of both equity investments (22.3%) and the bond portfolio holdings (2.7%). The excellent performance of the stock and bond markets and the benefit of the small depreciation of the US dollar against the PF's investment currencies resulted in a substantial profitability for the year as a whole.

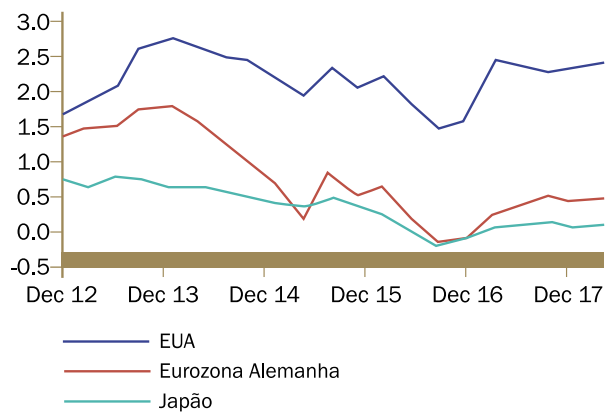
In the world's Treasury bond markets in 2017, there has been a generalized rise in interest rates, particularly for the shorter maturities of yield curves. Nevertheless, in spite of the trend towards higher interest rates, which tended to undermine the value of the bonds, the FP was able to accumulate the income of the coupons received, registering an overall performance of 2.7% in this type of investment.

**Chart 1.22**  
2 Year Yields - %



Source: Bloomberg

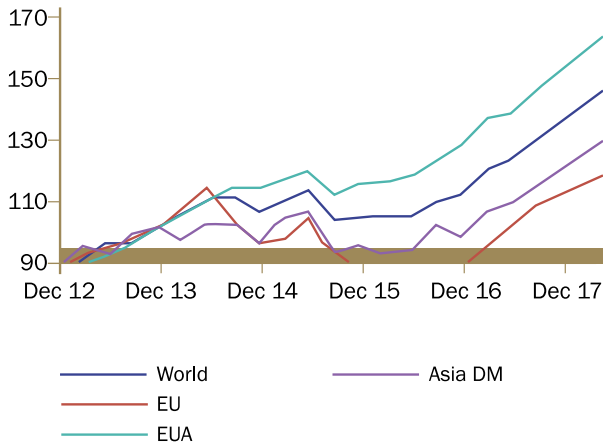
**Chart 1.23**  
10 Year Yields - %



Source: Bloomberg

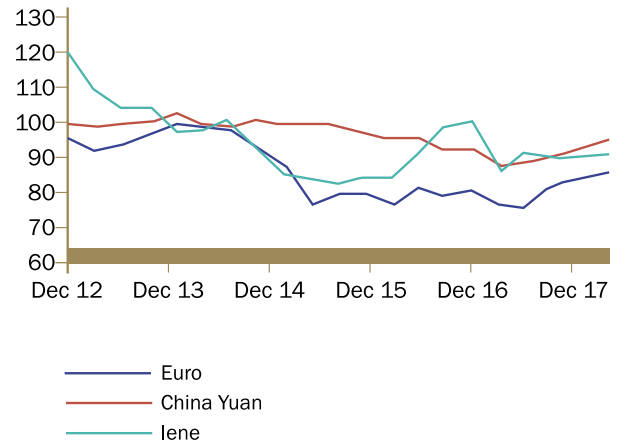
In terms of equity markets, the Fund's benchmark ("MSCI World") saw substantial gains in 2017, mostly driven by the steep rise in the US equity market but also by the majority of global equity markets. In terms of exchange rates, the depreciation of the US dollar against most of the PF investment debt in 2017 helped to recoup some of the foreign exchange losses recorded in previous years, thus reinforcing equity markets' gains in local currency terms.

**Chart 1.24**  
Equity Markets- 2012 Dez = 100



Source: Google

**Chart 1.25**  
Currencies vs USD – 2012 Dez = 100



Source: Google

**PF value and expected income will continue to depend on future price trajectories of global equities and bonds.**

In summary, the Petroleum Fund is now invested in a very diversified portfolio of securities traded in the main equity and bond markets worldwide, allowing it to optimize its return-income profile. However, given the substantial investments in global bonds and equities, we can conclude that the value and yield of the PF is intrinsically dependent on the evolution of the global prices of these assets, which is naturally affected by the dollar's evolution against the currencies of the respective investments.

Looking at a longer time-frame, we do think that the risk of a global stock or bond market fall is now substantial, given the current high stock market valuations and the historically low level of bond interest rates. It should be noted in this regard that the US stock market registered in 2017 the eighth consecutive year of gains since 2009, more than doubling its price level since December 2009.

However, the long investment horizon of the Fund and its institutional framework should allow us to deal with the fluctuations of the markets in a rational way and even to benefit from episodic price declines that occasionally arise in these markets.







# Domestic Economy Recent Developments

## Chapter 02

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*The latest publication of the National Accounts of Timor-Leste, which was released by the Directorate-General of Statistics (DGE) in January 2018, showed that the growth rate of non-oil GDP in 2016 was 5.3% in real terms, an acceleration of 1.3% compared to 2015.*

**DGE estimates that 2016 annual GDP growth was 5.3% in real terms.**

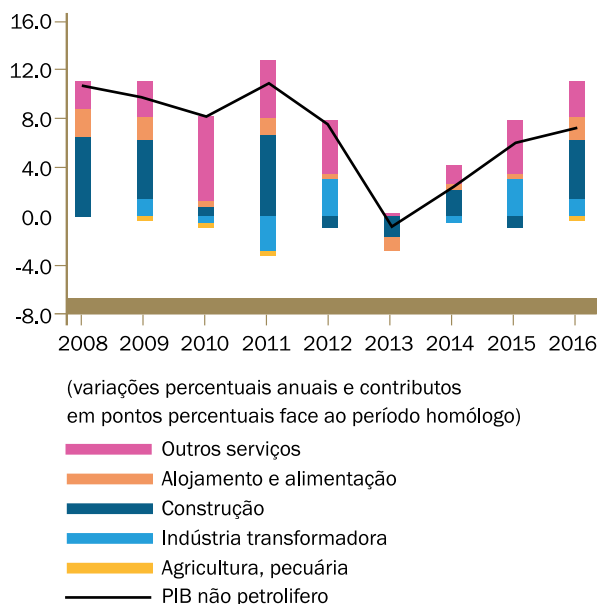
## 2.1 Real Sector

### 2.1.1. Production, Spending and Economic Activity

The increase in GDP was mainly due to the acceleration of activities related to construction and public administration services, which, with a combined weight of 42% of GDP in 2016 (41.0% in 2015), contributed to GDP growth of 2.8%. The combined contribution of the agriculture, manufacturing, information and communication technology, housing and other services sectors including financial services, contributed 3.2% to GDP growth and together accounted for 58% of the total product (59% in 2015).

**Chart 2.1.a**

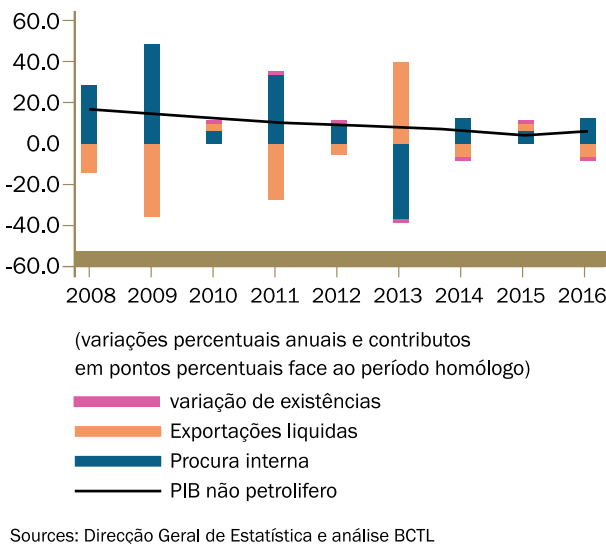
TL: GDP growth and composition;  
Production Perspective



Sources: Direcção Geral de Estatística e análise BCTL

**Chart 2.1.b**

TL: GDP growth and composition;  
Expenditure Perspective



Sources: Direcção Geral de Estatística e análise BCTL

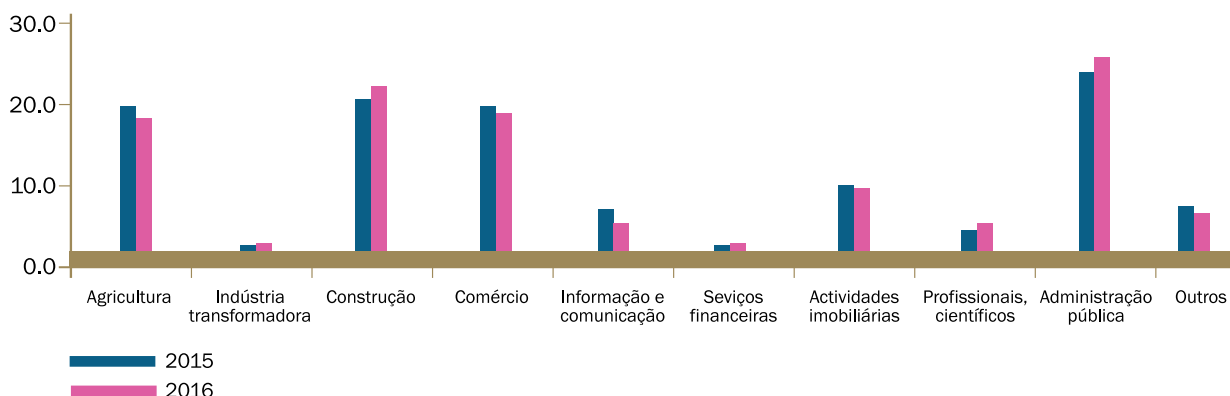
Contributions to GDP growth from an expenditure perspective can be seen in chart 1.b. Domestic demand, having registered a significant slowdown in 2015, once again grew in 2016. The increase in domestic demand was mainly due to the increase in private consumption, public and private investment as well as imports, which increased in the order of 6.0%, 18.3% and 7.2%, and 8.2%, respectively, while public consumption registered a decrease of 0.2%.

**Public Sector maintained its dominant position in the domestic economy.**

It should be noted that, in sectoral terms, according to figure 2.2, the public administration maintained its dominant position in the economy in 2016, accounting for 24.2% of total GDP, followed by commerce (18.3%), construction (17.3%), which is also very dependent on the levels of public investment, agriculture (16.9%, whose importance in GDP continued to decline), real estate activities (11%) and manufacturing and financial services, which represent only 1.3% and 1.2%, respectively.

**Chart 2.2**

TL: GDP Sectorial Structure (%)



Sources: Direcção Geral de Estatística e análise BCTL

**O Governo, estima, no OGE 2017, uma taxa de crescimento de 5,4% e 3,9% para 2016 e 2017**

The Government, in its proposal for the General State Budget (OGE) for 2017 - we refer to the 2017 OGE due to the fact that there is still no program and OGE for 2018 - expects a slowdown to 3.9% in 2017 (OGE17 - Book 1, page 18).

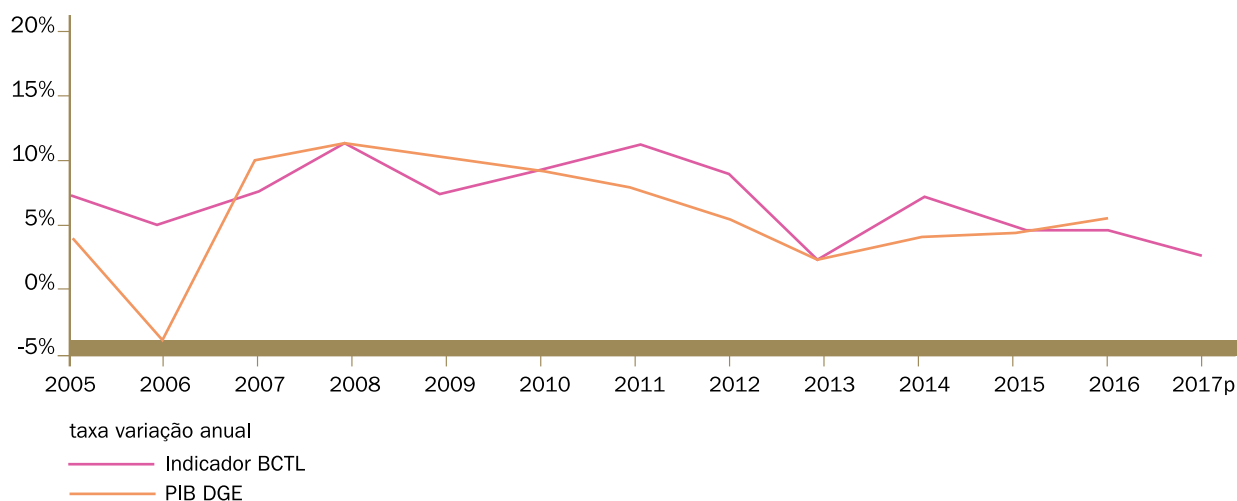
Note also that, usually, the annual National Accounts estimates have taken about 2 years to be publicly disclosed - by early 2018, there were only official data for 2016. However, there has been some progress, as these last figures were published earlier than previously.

The BCTL, to support its economic assessment framework, developed and generally uses an economic activity indicator that allows it to calculate in a simplistic, but timely fashion, the evolution of the domestic economy. This indicator uses all available information relating to a set of sectors of the national economy - imports, public expenditure (total and capital expenditure development, the financial sector and domestic revenues - to calculate a simple average of the annual variations of the relevant variables. Indeed, this indicator is not intended to replace national accounts data, but rather to complement and enable us to quantitatively measure recent developments in the domestic economy in a timely manner, which can be used as inputs for the discussion and eventual implementation of appropriate economic stabilization policies.

As shown in chart 2.3, the BCTL indicator allows us to calculate the annual growth rates of the economy for 2017.

**Chart 2.3**

GDP Growth and BCTL Economic Indicator

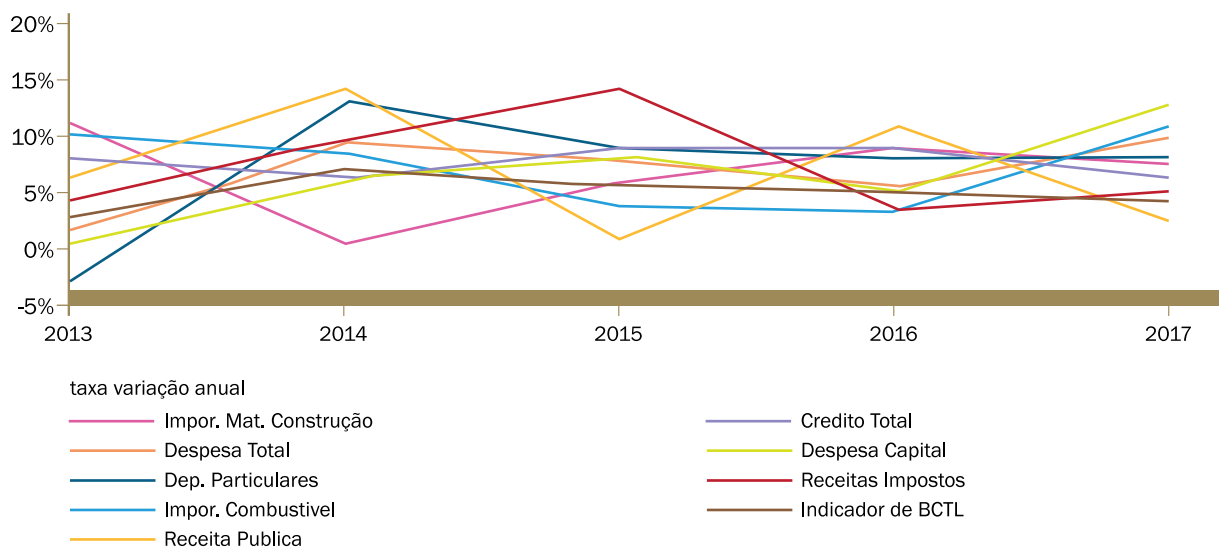


Source: DGE, Ministerio das Financas e BCTL

According to the BCTL indicator, the domestic economy appears to have decelerated in terms of growth in 2017 to 3.5%, compared to the 4.4% growth (5.3% in the DGE National Accounts) registered in 2016. It should be noted that the economic performance in 2017, as measured by our indicator, is in line with the most recent official forecasts of the Ministry of Finance (3,9 - OGE 2017) and the IMF (Art IV, October 2017), although the forecast of the IMF for 2017 is slightly higher (3%), compared to the value calculated by our activity indicator (3.5%).

In order to better understand the recent developments in the national non-oil economy, we also present below the performance of the various components of the activity indicator, which provide an indication of the economic trends for the most relevant domestic sectors (and for which data are currently available), such as imports, public expenditure and the financial sector, as well as domestic revenues. Figure 2.4 shows the growth rate of each sub-indicator, normalized in terms of the average growth rate of the non-oil GDP / economy.

**Chart 2.4**  
Economic Activity Indicator



Sources: DGE, Ministerio das Financas e BCTL

As can be seen, the deceleration of growth in 2017 (line in black) is due to a decline in the pace of expansion of the indicator components in the same years, with the exception of imports of fuel, construction materials, credit and tax revenues. It should also be noted that, despite the decline in the various components, there was only an overall small growth slowdown in 2017 (3.5%).

However, despite the maintenance of positive growth rates between 2013 and 2017, with an average growth of 4%, the domestic economy registered a substantial slowdown compared to the growth rates observed between 2008 and 2012 (with average rates of 8% per annum). Although part of this deceleration has resulted from the slowing down of the rate of increase in Public Expenditure, resulting in a positive stabilization of domestic inflationary pressures, the economic evolution of the last 5 years also shows that our economy remains highly dependent on public expenditure policies and programs, which continues to postpone the implementation of a development and investment process led by the private sector.

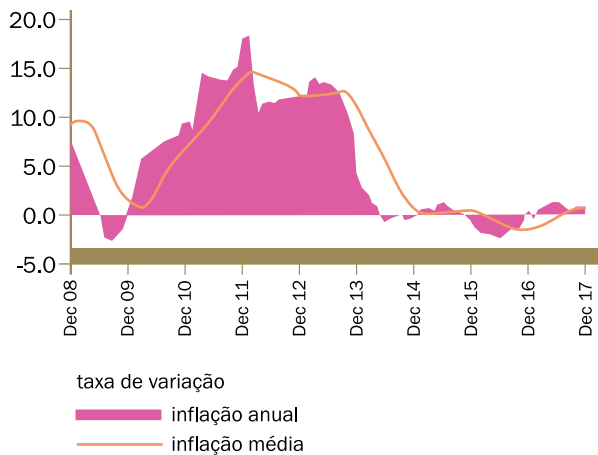
We continue to emphasize that the need to reinvigorate the national productive

sector today is particularly necessary and completely important in order to meet the growing challenges in terms of job creation for our young population and to prepare the country for the need to implement a reduction in the level of public expenditure and investment, in view of the substantial reduction of future oil revenues and/or the accumulated returns in the Petroleum Fund.

## 2.1.2. Prices and Inflation

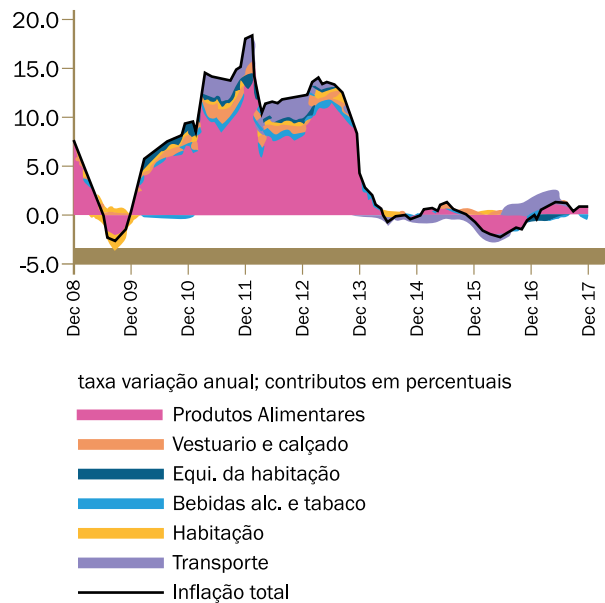
Annual inflation in the capital Dili, according to the DGE data, stood at 0.6% in December 2017, corresponding to an increase of around 0.5% compared to 0.1% in the same period of 2016. During the year 2017, the domestic inflation rate, calculated on the basis of the consumer price index (CPI) by the DGE, returned to the positive camp, compared to the negative rate registered during 2016. It can be seen that, in terms of annual averages, Dili's CPI inflation rate was -1.6%, and 0.6% in 2016 and 2017 respectively.

**Chart 2.5**  
TL Inflation (Dili)



Sources: Direcção Geral de Estatística e análise BCTL

**Chart 2.6**  
TL Inflation (Dili)



Sources: Direcção Geral de Estatística e análise BCTL

Table 1 shows the following trends in the breakdown of the CPI by large groups of goods and services:

- Food products – which continue to dominate the CPI basket, with a weight of 64.3%, recorded a price increase of 0.7% (0.3% in 2016), contributing 0.5% to annual inflation in December 2017.

- Non-food products - with an annual growth of 0.3% in prices (-4.2% in 2016), contributed 0.09% to the rise of total inflation in December 2017.

**The recent inflation increase was mostly due to rising external inflationary pressures.**

The slight increase in inflation in 2017 was due, in large part, to the rise in external inflation, despite the relative stability of Timor-Leste’s economic partners’ currencies against the dollar and rising international commodity prices. However, these price rises were offset by the depreciation of regional currencies, thus resulting in a fall in the price of imported goods from our country’s main trading partners. This effect was further reinforced by the slowdown in domestic economic growth in recent years, when compared to the extremely high growth observed between 2008 and 2012, contributing to stabilize inflation pressures in the country.

**Table 2.1. CPI products with greater CPI weights (%) - Dili**

Classes de Produtos	Dez 16	Mar 17	Jun 17	Set 17	Dez 17
Produtos Alimentares	0.29	1.36	1.55	0.39	0.67
Bebidas alc. e tabaco	4.01	1.45	0.50	0.17	-0.59
Vestuário e calçado	0.94	0.00	0.00	0.37	0.47
Habituação	-1.94	-2.04	-0.49	-0.30	0.59
Equi. da habitação	-6.61	-3.90	-1.35	1.06	2.15
Saúde	2.13	2.13	0.00	0.00	0.00
Transporte	16.69	20.02	19.89	0.00	0.00
Comunicação	-9.18	-9.18	-8.56	0.27	1.23
Rec. & culto.	-26.86	-28.51	-28.51	-1.99	-0.63
Educação	-16.82	-20.00	-20.00	-1.62	-0.92
<b>Inflação total</b>	<b>0.10</b>	<b>0.58</b>	<b>1.08</b>	<b>0.29</b>	<b>0.58</b>

Sources: Direcção Geral de Estatística e análise BCTL





*The previous government's policy of ensuring a prudent level of public expenditure by stabilizing the overall budget and revising existing programs, yielded an overall decrease in total budgeted spending for 2017.*

**The Government expected for 2017 total non-oil domestic revenues of US \$ 206 million.**

# 2.2

## Public Finance

### 2.2.1. 2017 Budget Program

The Government, in its general state budget for 2017, as set out in table 2.2, expected domestic non-oil revenues of around US\$ 206 million. This amount results in an expected increase in total revenue of 20.4% vs 2016. From the total revenue, US\$ 149 million corresponds to tax revenues, or 72.4% of the total, resulting in a nominal increase of 28.3% of this category for 2016 (or USD 33 million).

**The total spending amount approved for 2017 was US\$ 1,387 million.**

In terms of expenditure, the overall budget budgeted for 2017, approved by the National Parliament, was US\$ 1,387 million, of which US\$ 1,037 million was budgeted for current expenditure and US\$ 349 million for development capital spending (including external loans), representing a nominal variation of -7.3% and -58.1% respectively versus 2016.

**Table 2.2. Orçamento do Estado e Execução**

Rubricas	2016		2017		Taxa de variação			Taxa de Execução 2017
	Realizado	Orçamentado	Realizado	Orçamentado	2016	2017		
					Realizado	Orçamentado	Realizado	
Receitas Totais	212	206	203	0.6	9.1	20.4	-4.0	98.4
Receitas Fiscais	142	149	127	-7.3	18.2	28.3	-10.0	85.4
Receitas Não Fiscais	46	52	48	23.7	5.0	12.6	4.2	92.4
Receitas Retenção de Agências	8	5	6	16.7	19.5	-43.4	-27.8	113.1
Outros Passivos de Longo Prazo	16	0	22		-32.0		35.9	
Despesas Totais	1718	1387	1225	24.4	28.2	-29.0	-28.7	88.3
Despesa corrente	1069	1037	961	-4.7	0.1	-7.3	-10.0	92.7
Capital Dez. (inc. Empréstimo)	650	349	264	110.5	100.8	-58.1	-59.4	75.5
Saldo Global antes Donativos	-1507	-1181	-1022	27.3	31.4	-33.7	-32.2	86.6
Donativos	160	157	153	-35.4	-28.3	9.2	-4.3	97.6
Saldo Global após Donativos	-1347	-1024	-869	39.1	45.9	-37.5	-35.5	84.9
Financiamento	1705	1181	1103	-0.6	45.7	-15.1	-35.3	93.4
RSE	545	482	482	-14.7	-14.7	-11.6	11.5	100.1
Excesso retiradas do Fundo Pet.	1130	597	597	7.3	76.5	-19.2	-47.2	100.0
Uso do saldo de caixa	0	0						
Empréstimo	30	102	24	52.9	26.9	-4.9	-21.2	23.4

Source: TL Portal da Transparência, Livro OGE no. 1, GAE e análise do BCTL

## 2.2.2. Budget Execution in 2017

### 2.2.2.1. Revenue

One of the government's main priorities is to reduce the country's dependence on withdrawals from the oil fund. Efforts to invigorate domestic revenue remain central to government budget discussions and planning. In OGE's book for 2017, for example, the government describes a tax reform policy to improve and increase domestic revenues based on non-oil resources.

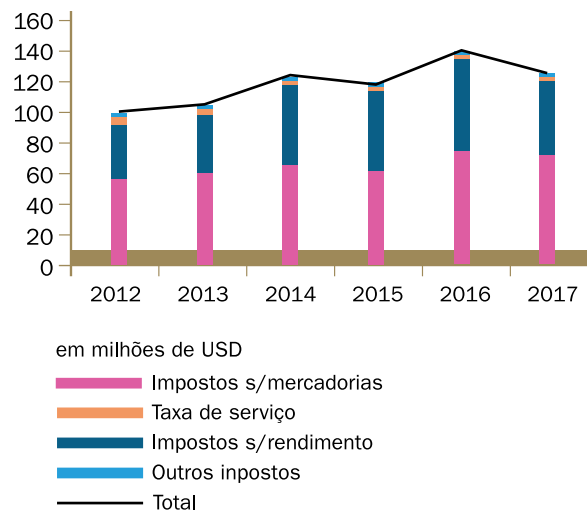
**Actually, overall and effective domestic revenue in 2017 was US \$ 203 million.**

It should be noted that, in line with the expansion of the domestic economy, domestic revenues have risen significantly in recent years, except in 2017, in which, with the slowdown in the economy, revenues received were slightly reduced. Domestic revenues received in 2017 amounted to US \$ 203 million, with a nominal reduction of 4%, mainly reflecting decreases of: (i) US \$ 14 million in the tax component, from US\$ 141.6 million USD in 2016 to USD 127.5 million in 2017; (ii) US \$ 2 million in revenue from autonomous state institutions, from US \$ 8 million in 2016 to US \$ 6 million in 2017. However, the impact of the abovementioned reduction in revenues was offset by the increase in funds from non-tax revenues (mainly fee and service charges) of USD 2 million, from USD 46 million in 2016 to USD 48 million in 2017, and USD 6 million from long-term loans, which rose from \$ 16 million in 2016 to \$ 22 million in 2017.

Figure 2.7 shows the changes in total tax revenue and its main components, specifically, taxes on the income of individuals and companies and taxes levied on the importation of goods.

**Chart 2.7**

TL - Public revenue



Sources: TL Portal de Transparencia e análise do BCTL

## 2.2.2.2. Spending

**Effective public spending in 2017 was US\$ 1,225 million, which corresponded to an execution rate of 88.3%.**

The government maintained a performance almost the same as that of 2016, in the execution of the expenditure, having spent 88.3% of the budgeted amount. The amount actually spent was lower than that of 2016, valued at USD 1,225 million, resulting in a nominal annual reduction of 28.7%. This reduction was due to the substantial reduction of the total 2017 budget of 29%, resulting mainly from cuts in public investment, 58.1% compared to 2016, from USD 833 million in 2016 (including the rectifying budget) to USD 349 million in 2017.

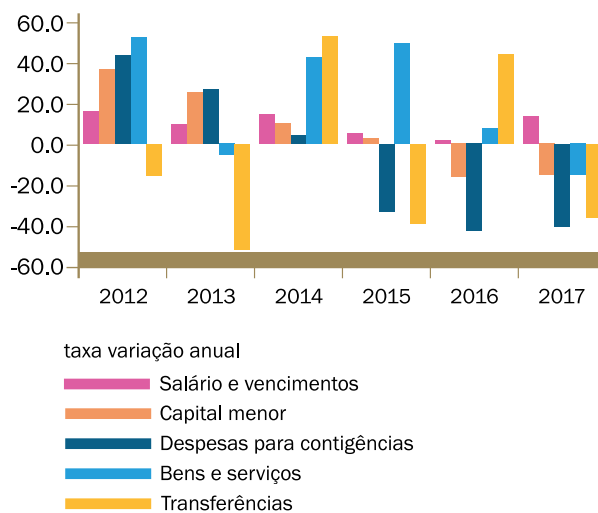
### Current Spending

The substantial reduction in overall public spending was also a consequence of the decline in the level of current expenditure, which registered a nominal decrease of 10% in 2017. It should be noted that current expenditure remained the main component of public spending, amounting to US\$ 961 million, or about 78.5% of total expenditure in 2017, after having registered USD 1,069 million in 2016, or 62.2% of total expenditure.

Chart 2.8 presents the evolution of the growth rate of the main components of current expenditure. Execution is calculated as the sum of the “payments” and “obligations” assumed for each category.

**Chart 2.8**

TL Current Public Expenditure



Sources: TL Portal de Transparencia e análise do BCTL

**Transfers and subsidies continued to be the largest spending category in 2017, corresponding to 41,7% of the total spent.**

Expenditure on transfers (mainly personal and institutional allowances) continued to be the largest component of current expenditure (41.7%) in 2017, having exceeded expenditure on goods and services in 2016. Goods and services, in turn, were second with 35.5%, followed by wages and salaries (20.4%). It should also be noted that public transfers include the allocation of the budget for the Oecusse region's development program (USD 171.9 million), which is part of the ZEESM project, which registered a nominal decline of 21.1% compared to 2016, accounting for 42.9% of total transfers made in 2017.

On the other hand the budget allocated to social support programs, including subsidies to former liberation fighters, reached 23.6% of the total budget for the category of transfers, or 7.7% of the total budget, having been reduced by 3.2% compared to 2016, with an execution rate of 92.8% to 97.8% in 2016.

## Capital and Development Spending

**Capital expenditure was US\$ 264 millions in 2017...**

The government estimated in the 2017 Budget a global expenditure on capital and development assets of USD 349 million, of which only USD 264 million was executed, corresponding to an execution rate of 75.5%.

**.... the largest part of which corresponded to infrastructure investment (99.5%), while capital spending was 75% of the budgeted amount.**

The majority (99.5%) of capital and development spending was allocated to the infrastructure construction program, with only 75.1% of the budgeted plan being executed. The road program was responsible for the largest slice in of infrastructure costs, 38.6% of the total budgeted, while in terms of execution, the respective weight reached 70%, followed by projects of Tasi Mane and water and sanitation, with a weight of 19.3% and 9, 2% of the budget and with an implementation rate of 100.5% and 1%, respectively.

Table 2.3 summarizes information on existing programs at the level of the Infrastructure Fund (IF) of more than USD 5 million, including its budgetary allocation and the amount actually spent in 2017.

**Table 2.3. Detalhes do Orçamento de Infraestrutura (milhões USD)**

Classes de Produtos	Orçamento	Obrigações	Real	Execução %
<b>Total</b>	1386.83	40.13	1184.78	88.3
<b>Capital de Desenvolvimento</b>	349.37	23.41	240.21	75.5
<b>Infraestrutura</b>	349.37	22.84	239.38	75.1
Estradas	135.0	0.3	1.9	1.6
Tasi Mane	67.6	-	-	0.0
Água e saneamento	32.2	0.2	0.3	1.6
Aeroportos	18.2	-	7.2	39.3
Programa de Empréstimos	15.2	0.2	0.0	1.4
Planos integrado de desenvolvimento distrital	14.7	0.3	6.8	47.8
Energia Eléctrica	12.4	-	0.0	0.3
Pontes	7.8	-	-	0.0
Programa de Manutenção e Reabilitação	7.1	0.2	5.0	73.2
Programa Sector das Finanças	7.0	-	-	0.0
Boa governança e gestão institucional	6.8	-	-	0.0
Desenvolvimento Rural e Urbano	5.5	0.1	12.2	221.3

Source: Portal de Transparência de Timor-Leste

**IF spending amounted to 25.2% of total public expenditure in 2017.**

The first relevant point concerns the maintenance of the implementation rate of the IF in 2017, of 75,1% compared to the rate of 76,3% recorded in 2016. It should be noted that if we calculate the execution rate only with the cash amount spent, then it fell to 68.5%, a rate virtually identical (but slightly above) to that of the previous year of 67.7%.

The second point to note is that, although the State Budget allocated to the IF represents 25.2% of the total budgeted expenditure (42.6% in the 2016 Budget), the expenses actually made were 21.4% of the total, a figure below the equivalent of 2016 (37.1%).

### 2.2.2.3. Budget Balance and Funding Sources

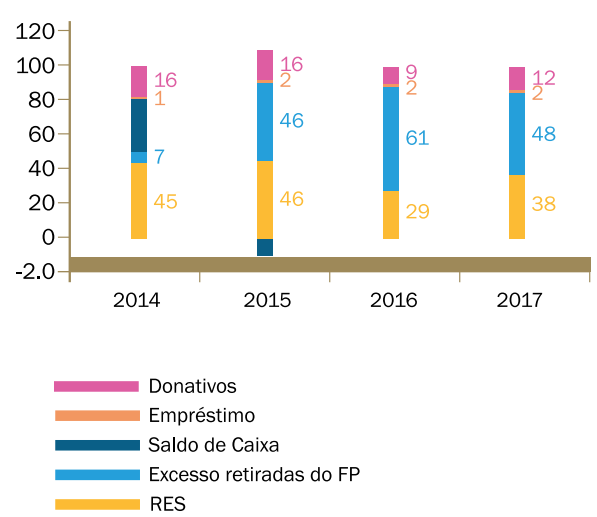
**The State expected PF transfers of 1,079 million in 2017 to finance the deficit....**

The Government of Timor-Leste expected, in its budget program for 2017 excluding donations, a global deficit of about \$ 1,181 million, to be funded through: donor grants of \$157 million; foreign loans in the amount of US\$ 102 million; and Petroleum Fund (PF) transfers amounting to US\$ 1,079 million. In terms of PF funding, US\$ 482 million corresponds to the “estimated sustainable income” (ESI) of the FP and the remaining balance of USD 597 million, to an actual reduction in the capital of the FP as it exceeds the relevant ESI. Indeed, the overall pre-donation deficit stood at US\$ 1,022 million in 2017.

... clearly above the PF's ESI of US\$ 482 million, thus public deficit funding reduced the PF's capital, as in previous years.

In its budget execution, the Government used the following sources to finance the deficit: (i) Donations of US\$ 153 million, (ii) External Loans of US\$ 24 million, and total PF transfers of US \$ 1,079 million.

**Chart 2.9**  
TL: Public Deficit Funding Sources



Sources: TL Portal da Transparência, Livro OGE no. 1, GAE e análise do BCTL

In 2017 PF's excess withdrawals above the ESI rose to 38% of the public deficit.

The analysis of the evolution of the public deficit and its financing structure shows that most of the deficit was financed by transfers from the PF. It should be noted that, in the last three years, the amounts withdrawn from the PF has exceeded 100% of the deficit, around 111,5%, 111,1% and 105,6% in 2015, 2016 and 2017 respectively. However, in 2017, the decrease of PF capital (by withdrawing an amount above ESI), having financed 38% of the 2017 deficit, registered a nominal reduction of 47.2%, or US \$ 533 million compared to 2016.

These facts highlight the continuing need to fund the substantial Public Budget deficits from oil revenues or, more specifically, from transfers originating from the Petroleum Fund, as the State continues to withdraw amounts that substantially exceed the Fund's sustainable income.



*The Monetary Base (MB), which is one of the determining variables in terms of monetary policy, increased by about US\$ 82.7 million (90.7%) in 2017, of which, or most of this increase, US\$ 82.1 million (99,3%) was in the form of bank deposits in USD held at the BCTL*

**In 2017, the average private loan interest rate declined to 12,5%, which represents a slight improvement for the country's borrowers.**



## Monetary and Exchange Sector

### 2.3.1. High-Powered Money (MB)

(mainly related to bank settlement accounts with the BCTL) and US\$ 0.6 million in the form of cash outside the central bank, whose value was estimated, at the end of December 2017, at US\$ 15.1 million. Cash outside BCTL grew 4.2% compared to 2016, valued at US\$ 14.5 million in this year.



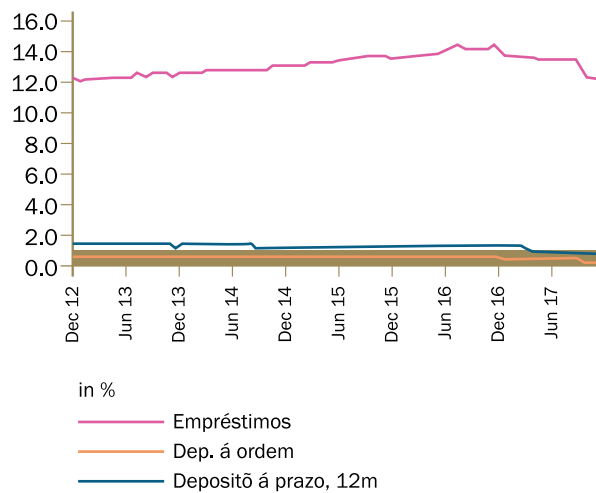
## 2.3.2. Interest Rates

**In 2017, the average private loan interest rate declined to 12,5%, which represents a slight improvement for the country's borrowers.**

The level of weighted average interest rates on loans continues to be relatively high compared to those of the issuing country of the country's currency, the United States dollar. In fact, economic theory says that when a small country adopts as its currency, one from a large country, interest rates in one and the other tend to converge. In Timor-Leste, this is not the case, especially for interest rates on credit, for a number of reasons, the main one being the risk of the banking business, which has to account for the debtors' risk of default and the country's own risk.

**Chart 2.10**

TL: Deposits and Loans Interest Rates



Source: BCTL

Interest rates on bank loans to the private sector decreased by 2.02%, as can be seen in chart 2.10, to 12.46 in December 2017. In average annual terms, interest rates on loans stood at 12.9%, compared to 14.2% in 2016. On the other hand, the average rate paid to deposits increased in the same period by 0.30% to 0.61%, which meant that the “spread” (differential) between active and passive rates decreased by 0.46% to 12.68% in December 2017, versus the previous year.

**Table 2.4. Taxa de juro média ponderada dos Bancos Comerciais**  
(Em percentagem)

Período	Empréstimos + 6 meses Libor	Depósitos a Ordem	Depósitos de Poupança	Depósitos a Prazo			
				1 mês	3 meses	6 meses	12 meses
<b>2016</b> Dez	14.46	0.54	0.75	0.76	1.00	1.14	1.25
<b>2017</b> Jan	12.94	0.35	0.26	1.28	1.49	1.76	2.08
Fev	12.94	0.35	0.26	1.26	1.47	1.72	2.04
Mar	12.95	0.41	0.26	1.36	1.52	1.77	2.09
Abr	12.95	0.41	0.26	1.41	1.55	1.76	2.07
Mai	12.88	0.43	0.25	1.44	1.59	1.77	2.06
Jun	12.85	0.41	0.26	1.56	1.63	1.77	2.04
Jul	12.87	0.42	0.26	1.60	1.67	1.80	2.04
Ago	12.88	0.41	0.26	1.61	1.68	1.79	2.04
Set	12.86	0.35	0.26	1.56	1.63	1.74	1.99
Out	12.88	0.35	0.26	1.56	1.66	1.80	2.04
Nov	12.92	0.35	0.26	1.59	1.70	1.86	2.09
Dez	13.09	0.30	0.27	1.62	1.72	1.85	2.08

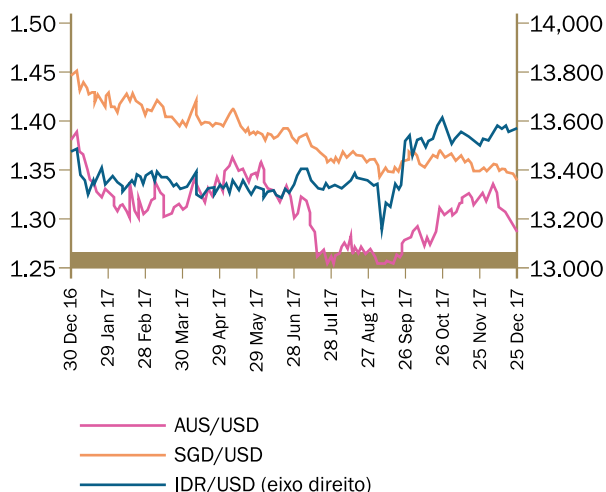
Source: BCTL

### 2.3.3. Exchange Rates

**The USD continued in 2017 its appreciation trend versus the currencies of Timor Leste Trading Partners.**

The US dollar, the official currency of Timor-Leste, depreciated slightly against the currencies of the main economic partners during the first half of 2017, but then resumed its traditional appreciation trend in the second half of the year, as can be observed in chart 2.11. For the year as a whole, the dollar appreciated by 0.7% against the Indonesian rupiah, Timor-Leste's main trading partner. Contrary to the Indonesian Rupiah, the USD lost ground against the Australian dollar, declining by 2.9% in 2017.

**Chart 2.11**  
Nominal Exchange Rates



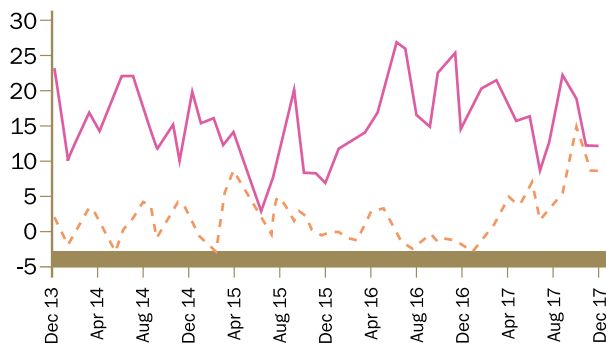
Source: Bloomberg

Note also that, as our country is heavily dependent on imported goods and services to meet domestic demand, an appreciation of the dollar contributes to contain the prices of imported products and, in turn, stabilize domestic inflation.

### 2.3.4. Monetary Aggregates

The development of the financial sector plays a vital role in facilitating economic growth and poverty reduction. The compilation and analysis of monetary and financial statistics allow us to gauge the development and changes in the monetary and financial system of a country. The Central Bank of Timor-Leste has been collecting and compiling these statistics in order to gain a comprehensive and detailed view of Timor-Leste’s financial sector in order to support the BCTL in macro prudential and monetary policies. However, to date, the BCTL does not yet have monetary policy instruments since our country continues to use as its official currency a foreign currency, the US dollar.

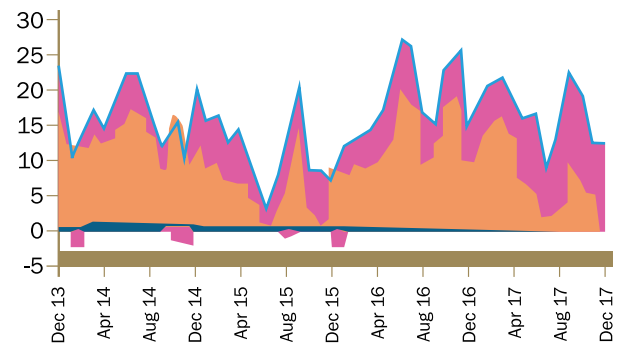
**Chart 2.12**  
Money Supply Growth



Taxa de variação homólogo, em percentagem  
 — M2  
 - - - Crédito ao setor privado

Source: BCTL

**Chart 2.13**  
M2 and its components



% contribution to annual changes  
 — Outros depósitos  
 — Depositos transferíveis  
 — Moeda em circulação (centavos)  
 — M2

Source: BCTL

**Although Timor Leste is a dollarized economy, we can reasonably estimate the aggregate Money Supply (M2)**

Although Timor-Leste is a “dollarized” economy, it is possible for the BCTL to reasonably compute the aggregate money supply (the M2 aggregate), which in most countries is used as a measure of the availability of means of payment. As usual, money supply in Timor Leste is calculated as the sum of banknotes and currency in circulation with demand deposits (which, as the previous category, can be immediately mobilized to make payments through checks) and the “quasi-currency”, which includes savings and term deposits that can be mobilized “quickly” to make payments.

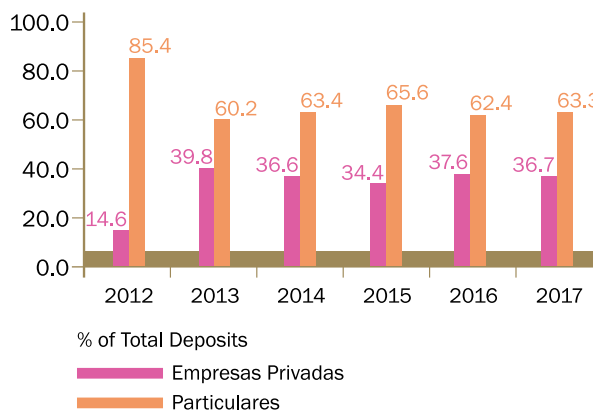
Charts 2.12 and 2.13 shows the evolution of the money supply, the approximate M2 for Timor-Leste, over the period from 2013 to 2017. It should be noted that the figures are approximate since, since the country uses the US dollar it is difficult to accurately calculate the value of banknotes and coins in circulation. However, since this should constitute a small and stable percentage of the available values for payments, the approximate M2 - the total of currencies, deposits and quasi-currency - is a reasonable estimate to measure the amount of money in circulation in the domestic economy.

**M2 amounted to US\$ 822.9 million at the end of 2017, rising US \$ 89 millions, or +16.3%.**

The M2 balance thus calculated amounted to US\$ 822.9 million in December 2017 - an increase of US\$ 89 million (16.3%) over the same period in 2016 - which was due to increased economic activity, stimulated by the government's economic policies. It is also important to analyze the evolution of the components of money supply, as can be seen in Chart 13, which shows the following:

- Total deposits were decisive in the increase of the monetary mass, with an inflow of USD 88.4 million (increase of 12.3%), a growth similar to that of the previous year of USD 89 million (14.1%).
- Banknotes and coins grew only US \$ 0.61 million (4.2%), in contrast to a growth of 19.4% in 2016;
- In terms of denomination, the national currency deposit (USD) component grew by USD 88.4 million (12.3%) and foreign currency denominated deposits decreased by USD 8 thousand (-1.7%);
- As regards their ownership by institutional sector, as can be seen in chart 2.14, 63.3% of deposits are privately owned (up by 0.9% compared to 2016) and 36.7% by private companies.

**Chart 2.14**  
Banking Deposits Ownership



Source: BCTL

According to table 2.5 below, the change in net foreign assets of USD 158.8 million was the main source of monetary expansion in 2017, together with the increase in other net liabilities of USD 64.8 million, government deposits of USD 56.6 million, and credit to the economy, amounting to USD 51.7 million (25% increase), which confirms a significant expansion in bank lending over the last few years.

**Table 2.5. Money Supply Growth Determinants (M2)**

US \$ million

	Fluxo Anual 2016	Fluxo Anual 2017
Crédito à Economia	-3,909	51,661
Governo	-76,855	-56,616
Reclamações do BCTL	0,001	-0,001
Depósitos	76,856	56,615
Activos Externo Líquidos	76,165	158,796
Outros liq.	-96,103	64,846
M2	91,504	89,017

Source: BCTL

### 2.3.5. Bank Credit

**Private sector borrowings from the domestic banking sector rose 21% to US\$ 220.9 million.**

In 2017, direct indebtedness of the private sector to the Timor-Leste banking system increased by US\$ 38.355 million (21%) to a balance of US\$ 220.9 million, as can be seen in table 2.6.

**Table 2.6. Evolução do Crédito à Economia**

Em milhões de USD

Sector	Saldo		Variação		contributos em pontos percentuais	Peso (%)
	Dez 16	Dez 17	Nominal	%		
Agricultura, Água e Florestas	3.95	5.74	1.79	45.4	1.0	2.6
Indústria e fabricação	2.47	11.43	8.96	362.0	4.9	5.2
Construção	48.62	64.88	16.26	33.4	8.9	29.4
Transportes e Comunicação	2.07	3.39	1.32	63.7	0.7	1.5
Comércio e Finanças	32.98	44.20	11.23	34.0	6.2	20.0
Turismo e Serviço	17.72	27.75	10.03	56.6	5.5	12.6
Particulares	74.69	63.46	-11.23	-15.0	-6.2	28.7
<b>Total</b>	<b>182.50</b>	<b>220.86</b>	<b>38.35</b>	<b>21.0</b>	<b>21.0</b>	<b>100.0</b>

Source: Bancos Comerciais e análise de BCTL

... the largest lending growth rate was registered for the construction sector.

The analysis of the evolution of credit to the economy in 2017 shows that the most significant increase (nominal variation) occurred in the construction sector, whose credit rose by about US\$ 16.3 million (33.4%), followed by trade and (USD 11.2 million or 34%), tourism (USD 10 million or 56.6%), and industry (US\$ 9 million or 362%). This last sector thus registered the highest growth in 2017. Agriculture and transport, on the other hand, registered a significant growth, however, with a very low nominal absolute change, at 1.8 and 1.3 million US\$ respectively. However, the decline in credit to individuals has dampened the increase in total credit, with the sector's credit falling by 11.2 million US\$ (-15%) in 2017.

NPL's weight has continued to gradually decline in the last few years, amounting to only 14% of overall credit at the end of 2017.

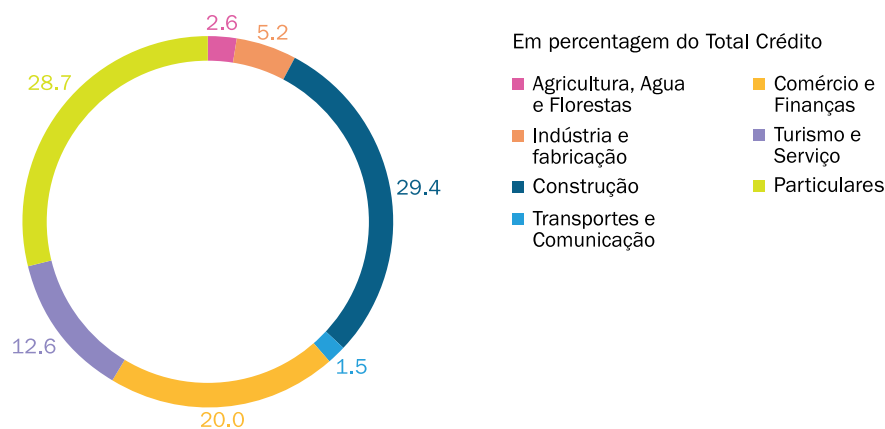
In addition to the "quantity" of the loans, it is also important to assess their "quality". An indicator of this is the amount of "bad debt" in the banking sector (NPLs). In the case of Timor-Leste's banking system, the amount of these low-quality loans has gradually declined in recent years: to 14% of total loans granted at the end of 2017 compared to 27%, 23% and 15% in 2014, 2015 and 2016 respectively. However, banking institutions remain quite robust in terms of their capacity to deal with this type of low quality credit, since the value of the credit risk provisions already established is more than sufficient to cover these losses, amounting to 17 % of the credit granted at the end of 2017.

In fact, the substantial size of 'non-performing loans' has been one of the factors often cited to justify the difficulty in the expansion of bank credit in Timor-Leste. As a result, the aggregate value of credit has remained at much lower levels than that of deposits raised, providing commercial banks with an excess of liquidity that tends to be preferentially invested by banks in deposits abroad.

Loans to the construction sector are the largest, corresponding to 29,4% of the overall lending portfolio.

In terms of credit composition, construction loans reassumed the top position, with a weight of 29.4%, followed by individuals (28.7% of the total), which were the largest share in 2016 (40.9%), and commerce and finance (20%). The sectors of agriculture and industry, two important sectors for the economic development of the Country, represent only 2.6% and 5.2% of total loans granted.

**Chart 2.15**  
Banking Credit Sectorial Composition - Dez 2017



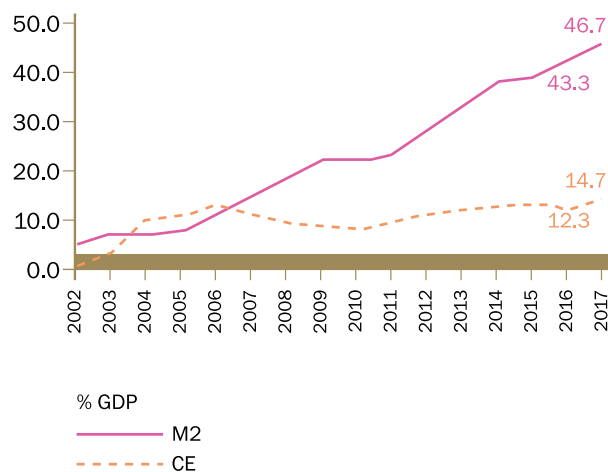
Source: BCTL



### 2.3.6. Financial Deepening Indicators

The degree of financial deepening, also known as the degree of monetization of the economy, can be measured using the M2 to GDP ratio. This ratio increased by 3.4% in 2017 to 46.7%. On the other hand, another indicator that could be used to monitor the degree of financial deepening is the ratio of credit to GDP, which amounted to 14.7%, thus rising 2.5% in 2017.

**Chart 2.16**  
Money Supply Growth



Source: DGE, MoF Livro 1 OGE 2017 e BCTL análise



*At the end of 2017, the balance of net international reserves stood at US\$ 533 million, corresponding to an increase of USD 263 million in the year, following a decrease of USD 157 million in 2016. This balance corresponds to 7 months of imports of goods and services (3 months in 2016).*

**Net International Reserves rose by US\$ 263 million.**

**NIR now cover 7 months of imports of goods and services.**



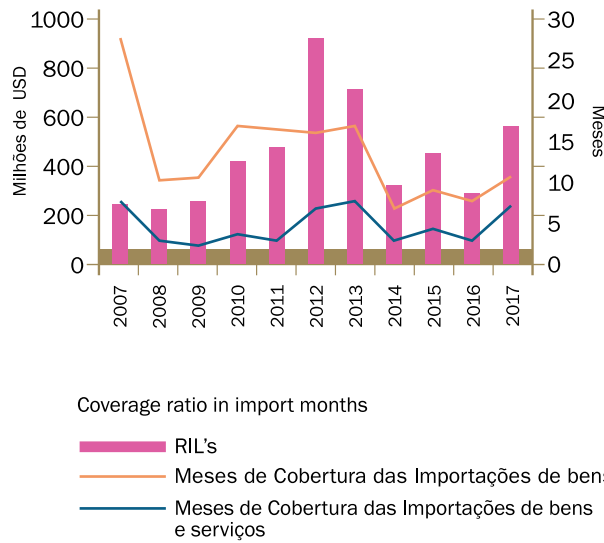
## External Sector

### 2.4.1. Net International Reserves (NIR)

The increase in the country's NIR in 2017 was mainly due to the increase in other deposits amounting to US\$ 249.7 million, especially overnight deposits, and to the currency/cash balance of the BCTL (cash and bank deposits) in the amount of USD 14.3 million. These components, together with the various receipts and payments ordered by the State and the withdrawal of resources from the Petroleum Fund in favor of the state account with the central bank (USD 1,079 million in 2017) determined the evolution of the country's international reserves.



**Gráfico 2.17**  
Net International Reserves



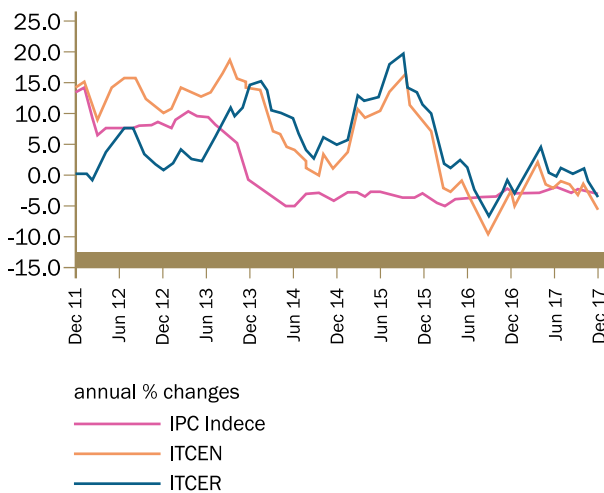
Sources: DGE e BCTL

## 2.4.2. Real Effective Exchange Rate Index

### The REER depreciated 2.7% in 2017.

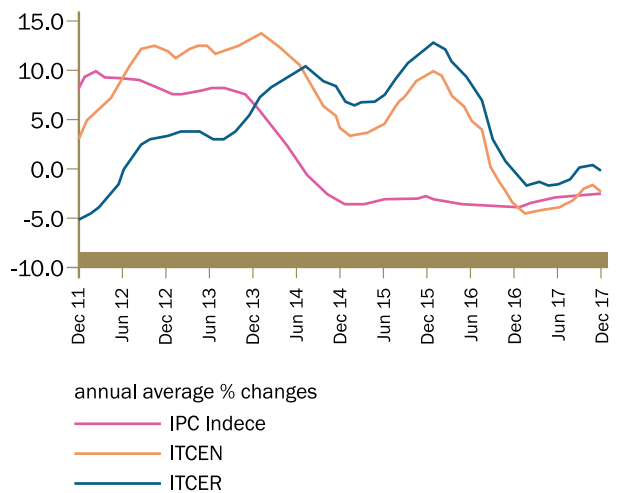
The Real Effective Exchange Rate (REER) index - an indicator used to assess the country's competitiveness in terms of tradeable goods and services - depreciated 2.7% in 2017, following a depreciation of 0.7% in 2016 (chart 2.18). In terms of annual averages, the REER appreciated by 0.5%, after having registered a small average appreciation of 0.3% in 2016 (figure 2.19).

**Chart 2.18**  
REER Index



Sources: Bloomberg e BCTL análise

**Chart 2.19**  
REER Index

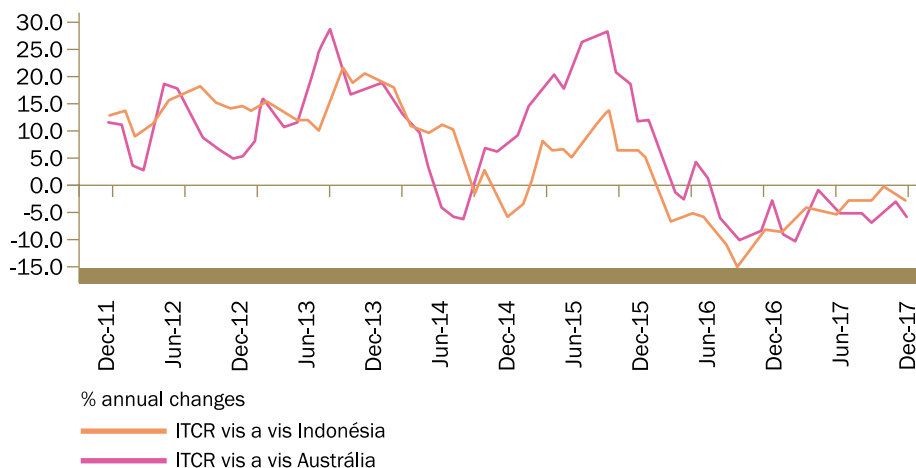


Sources: Bloomberg e BCTL análise

This change was, in turn, determined by the depreciation registered by the Effective Nominal Exchange Rate Index (ENER) of 5%, following a nominal depreciation of 2.4% in 2016.

In bilateral terms, specifically against the currencies of Indonesia and Australia, two of the main trading partners of the country that comprise the index, there was a real depreciation of 1.7% and 5% respectively, following a depreciation of 5.9% and 2.6% in 2016 (chart 2.20).

**Chart 20**  
BILLATERAL REERs



Sources: Bloomberg e BCTL análise

The export of coffee continues to be the main, and almost unique, export of our country. However, international prices continue to be the strongest determinant of the price of this type of export, since the respective volumes exported are weakly influenced by the evolution of these effective exchange rates. As our economy continues to be highly dependent on imports to meet domestic aggregate demand, the depreciation of the ERC should translate into a rise in the prices of imported goods in the domestic market and consequently the acceleration of inflation. In bilateral terms, it should be noted that the prices of imported goods from Indonesia are generally more competitive than those from Australia.



*There was a slight reduction in the current account deficit (excluding other primary income) of USD 64 million to USD 705 million, the equivalent of 40.1% of GDP in 2017 (projection), or less 5.3% compared to 2016. In addition, the joint current account and capital deficit in 2017, which determines the net external external financing need of the Timorese economy, decreased 4.5% to 38.1% of GDP.*

# 2.5

## Balance of Payments

**The external deficit of the BoP slightly improved in 2017...**

**... reflecting also the declining deficit of the current account, excluding primary income, which amounted to US\$ 705 million.**

Of course, and for the sake of accounting balance, the high deficit in the current and capital accounts had to be financed by an equivalent but opposite sign in the financial account. In terms of sources of financing of the external deficit, the importance of resources related to equity participation and foreign direct investment, deposits of the banking system applied in foreign countries, and public investment (including the Petroleum Fund) abroad is highlighted below. The need to cope with payments abroad during 2017 has resulted in the overall reduction of the country's international reserves to USD 263 million (15% of GDP).

**Table 2.7. Balança de Pagamentos**

	Milhões de USD			% PIB	
	2016	2017	Var %	2016	2017
Conta Corrente exclui Outros Rendimento Primário	-769.2	-705.2	-8.3	-45.4	-40.1
Conta Corrente	-545.5	-283.5	-48.0	-32.2	-16.1
Conta de Bens	-546.5	-614.8	12.5	-32.3	-34.9
Conta de Serviços	-568.6	-342.8	-39.7	-33.6	-19.5
Conta de Rendimentos Primários	543.1	735.3	35.4	32.1	41.8
Conta de Rendimentos Secundários	26	61	-329.9	1.6	-3.5
Conta Capital	47	34	-28.2	2.8	1.9
Conta Financeira	485	475	-2.1	28.7	27.0
Investimento Directo	-7	7	-193.4	-0.4	0.4
Investimento de Carteira	690	340	-50.7	40.7	19.3
Outro Investimento	-197	128	-164.9	-11.7	7.3
Erros e Omissões Líquidos	-144	38	-126.2	-8.5	2.1
Saldo Global	-13	226	-1890.1	-0.7	12.8
Activos de Reserva	157	-263	-268.0	9.3	-15.0

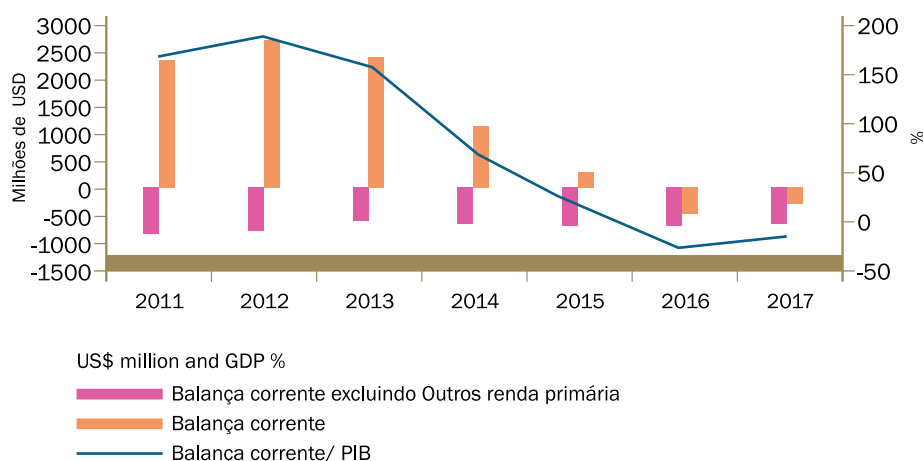
Source: BCTL

## 2.5.1. Current Account

Data on commercial transactions between Timor-Leste and its trading partners in 2017 have enabled us to ascertain a current deficit of USD 283 million (including other primary income), or about -16% of non-oil GDP. This balance represents an improvement of the deficit position by 48%, or USD 261 million over 2016. The slight increase in the income of resources exploited in the Timor Sea (taxes and royalties) in 2017 and the reduction of services imported are the main determinants of the reduction in the current account deficit of the balance of payments of Timor-Leste in 2017. However, the current account (including other primary income - oil revenues) continued to register a global deficit in 2017, although it had been positive up to 2015.

**Chart 2.21**

TL Current Account Surplus



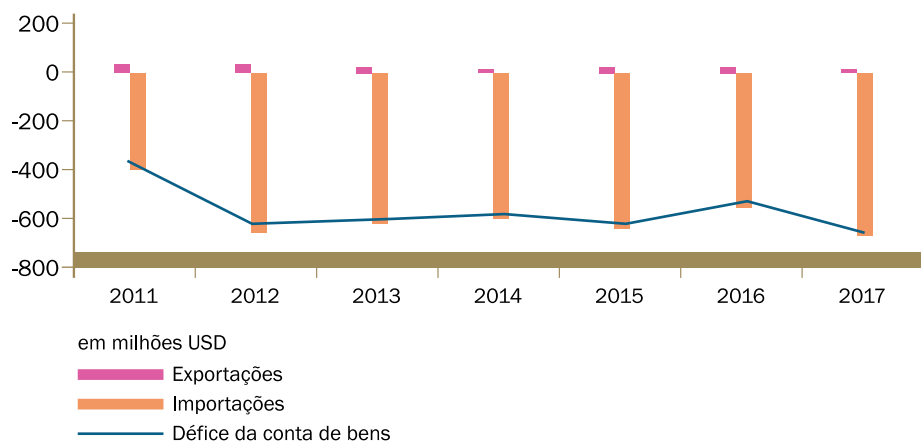
Source: BCTL

### 2.5.1.1. Goods Account

In the year under review, the net deficit balance of the goods account was US\$ 615 million, having deteriorated by 12.5% compared to 2016. This deterioration was explained by a 16.7% decrease in exports to USD 17 million, but above all by the acceleration of spending on imports of goods of 31.6% to 567.6 million USD in 2017.

Chart 2.22

TL Goods External Account



Source: BCTL

### Goods Exports

As is well known, the country's almost unique export - at least that which is systematically registered by official statistical services - is coffee. The export of coffee is marked by a strong seasonality, concentrating almost exclusively on the second half of each year, after the harvest.

Table 2.8. Exportações por países

	Milhões de USD			% PIB	
	2016	2017	Var %	2016	2017
Estados Unidos de América	7.143	4.894	(31.5)	0.42	0.28
Indonésia	0.269	1.083	302.0	0.02	0.06
Portugal	0.283	0.937	231.0	0.02	0.05
Australia	0.470	0.531	12.9	0.03	0.03
Alemanha	3.309	3.297	(0.4)	0.20	0.19
Taiwan	0.094	0.573	507.1	0.01	0.03
Japão	0.574	0.547	(4.7)	0.03	0.03
Outros	6.007	2.095	(65.1)	0.35	0.12
<b>Total</b>	<b>18.149</b>	<b>13.955</b>	<b>(23.1)</b>	<b>1.07</b>	<b>0.79</b>

Source: DGE e BCTL análise

The nominal value of coffee exported in 2017 decreased by 23.1% compared to 2016 to USD 14 million , which is equivalent to 0.8% of GDP (down 0.3%). The main destination of our coffee exports in 2017 continues to be the US, which, with a weight of 35.1%, received USD 4.9 million of this product (Table 2.8), down 31.5% compared to 2016.

## Goods Imports

**Refined petroleum products are the main import of Timor Leste.**

In 2017, there was an increase in imports of goods of 31.6% to 567.6 million USD.

The main products imported by the country are petroleum products, followed by vehicles and mechanical machines. Energy goods accounted for about 19% of total imports in 2017 and increased 42% to a sub-total of USD 120 million.

Cereals, which account for only 5.4% of all imported goods, recorded a 13.6% increase versus 2016, a deceleration versus the 36% rise in 2016. The increase in value of imports of this type of product, compared to 2016, was due to the increase in the price of the same cereals, albeit with some depreciation of the currencies of trading partners against the dollar.

The geographical structure of imports and its evolution are as follows in table 2.9.

**China's weight of overall imports has continued to rise, amounting to 15.5% in 2017.**

**Table 2.9. Importações por países**

	Milhões de USD			% PIB		
	2016	2017	Var %	Peso	2016	2017
Indonesia	136.78	179.28	31.1	31.6	8.1	10.2
China, República popular da	88.08	83.50	-5.2	14.7	5.2	4.7
Singapura	51.99	75.69	45.6	13.3	3.1	4.3
Hong Kong	52.17	59.22	13.5	10.4	3.1	3.4
Viet Nam	26.87	36.96	37.6	6.5	1.6	2.1
Thailandia	10.38	17.58	69.4	3.1	0.6	1.0
Australia	11.48	13.55	18.1	2.4	0.7	0.8
Malaysia	10.91	15.74	44.2	2.8	0.6	0.9
Japão	5.74	10.95	90.9	1.9	0.3	0.6
Brasil	9.66	15.17	57.0	2.7	0.6	0.9
Portugal	8.41	6.42	-23.7	1.1	0.5	0.4
Korea, República da	8.94	5.56	-37.8	1.0	0.5	0.3
Outros	24.53	48.04	95.9	8.5	1.4	2.7
<b>Total</b>	<b>445.91</b>	<b>567.65</b>	<b>27.3</b>	<b>100</b>	<b>26.3</b>	<b>32.2</b>

Source: DGE e BCTL análise

**However, Indonesia continues to be our largest Trading Partner.**

The geographical composition of imports of goods has not been stable in recent years. It should be noted, however, that the relative importance of China has gradually increased over the last few years. This country maintains its 2nd position, which was reached last year in terms of the origin of imported goods, exceeding Singapore. This Partner now originates 14.7% of total imports, which yielded a decline of -5,2% to USD 83,5 million. Indonesia, which has remained the country's main trading partner, reached a weight of 31.6% in 2017, with imports sourced in this country increasing substantially in 2017 (31.1%).

**Table 2.10. Importações por tipo de produtos**

	Milhões de USD			Peso	% PIB	
	2016	2017	Var %		2016	2017
Cereais (10)	29.08	31.91	9.7	5.4	1.7	1.8
Petróleo (27)	84.72	120.29	42.0	20.5	5.0	6.8
Máquinas mecânicas (84)	44.43	42.06	-5.3	7.2	2.6	2.4
Máquinas Elétricas (85)	25.77	31.40	21.8	5.4	1.5	1.8
Veículos (87)	56.89	69.97	23.0	11.9	3.4	4.0
Outros	205.03	291.13	42.0	49.6	12.1	16.5
<b>Total</b>	<b>445.91</b>	<b>586.77</b>	<b>31.6</b>	<b>100.0</b>	<b>26.3</b>	<b>33.3</b>

Sources: DGE e BCTL análise

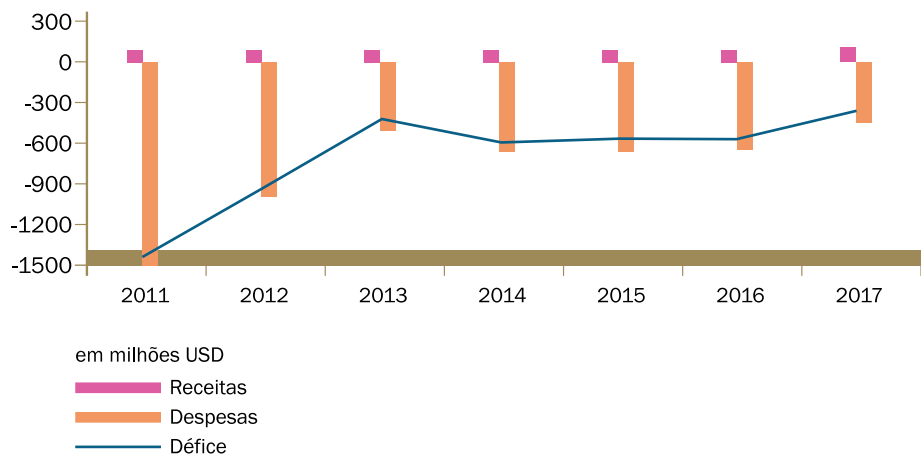
Nota: 1 - o número entre parenteses na primeira coluna é o da classe da pauta aduaneira

### 2.5.1.2. Services Account

2017 net services account deficit was USD 348 million, which resulted in a reduction of around 38.7%, equivalent to USD 220 million, when compared to the 2016 deficit. According to chart 2.22, the reduction in the deficit resulted from a rise in service exports of: (i) transport, which rose 42.7% (ii) travel, with an improvement of 26.2%, (iii) and other services (including government services), with an improvement of 6.7%. On the other hand, the external deficit improvement was dampened by the rise in construction import services of 67.3%, other business services by 26%, and government services by 34.4%.

**Chart 2.23**

TL Services External Account



Source: BCTL

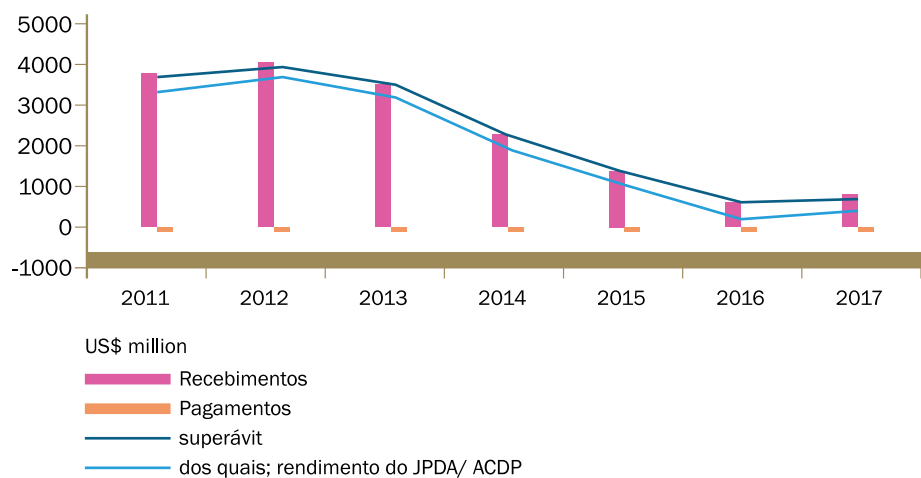
### 2.5.1.3. Primary Income Account

**The small rise of offshore petroleum revenues in 2017 yielded a slight improvement in the overall BoP's external deficit.**

The rise in oil prices in 2017 drove an increase in oil fund income, royalties and royalties from oil exploration in the Timor Sea - the joint oil development area (JPDA) - and resulted in a rise of the surplus of the primary income account in 2017. This increase has, in turn, resulted in a reduction in the deficit of the overall balance of payments in Timor-Leste. Chart 2.23 shows the increase in JPDA income in 2017, which increased by 88.5% to US\$ 422 million in 2017, compared with US\$ 224 million in 2016. The primary income account surplus stood at 24% of Non-oil GDP in 2017, compared to 13% in 2016.

**Chart 2.24**

TL Primary Income Account



Source: BCTL



### 2.5.1.4. Secondary Income Account

Secondary income account recorded a net outflow of resources of US\$ 61 million in 2017, justified by the reduction in donor disbursements to direct state budget support of 35.2%, to USD 119 million and a slowdown in net outflow of workers' remittances of 12.7% to 263 million USD (Table 2.11).

**Table 2.11. Remessas de Trabalhadores**

Em milhões de USD

	2011	2012	2013	2014	2015	2016	2017
Entrada	11	23	71	76	57	76	83
Saida	83	84	91	140	124	233	263

Source: BCTL

### 2.5.2. Financial Flows

**The financial account recorded a net outflow of US\$ 509 million.**

In the period under review the financial account, which includes inflows from external sources of finance, recorded a net outflow of funds of USD 509 million, or 29% of non-oil GDP, which represents an improvement of the overall account deficit of US\$ 25 million. The evolution of the financial account continues to be determined by the portfolio investment flows, which totaled USD 340 million (USD 350 million less than in 2016). The reduction of oil production in the Timor Sea, despite the increase in the price of oil in 2017, together with the withdrawal of capital from the Petroleum Fund to finance the State Budget, have resulted in the continued net decrease of the country's foreign assets in 2017 (Table 2.11).

**Table 2.12. Fontes de Financiamento**

Em milhões de USD

	2016	2017
Conta de Operações Financeiras	<b>485.48</b>	<b>475.24</b>
Investimento directo em Timor-Leste	-7.19	6.72
Investimento de carteira	690.06	340.39
d/q. investimento do FP nos estrangeiros	690.06	340.39
Outro investimento, activos	-200.52	86.92
Outro investimento, passivos	3.13	41.22

Source: BCTL



*The banking system in Timor-Leste remained stable and solid during the period under review. The banking system continues to be almost exclusively financed by deposits, whereas only a fraction of these depositions is lent out to companies and individuals, so that, as a whole, the banking system has a surplus liquidity position.*

# 2.6

## Banking System Development in Timor Leste

### 2.6.1. Banking Assets and Liabilities

#### 2.6.1.1. Banking Assets Composition and Developments

**The Banking sector remained stable and solid in 2017.**

The tables and charts below detail various aspects of the country's banking system, which comprised, at the end of 2017, a national bank based in Timor Leste -- the National Bank of Commerce of Timor-Leste - and bank branches of four major overseas banks, headquartered in: Portugal (CGD / BNU),

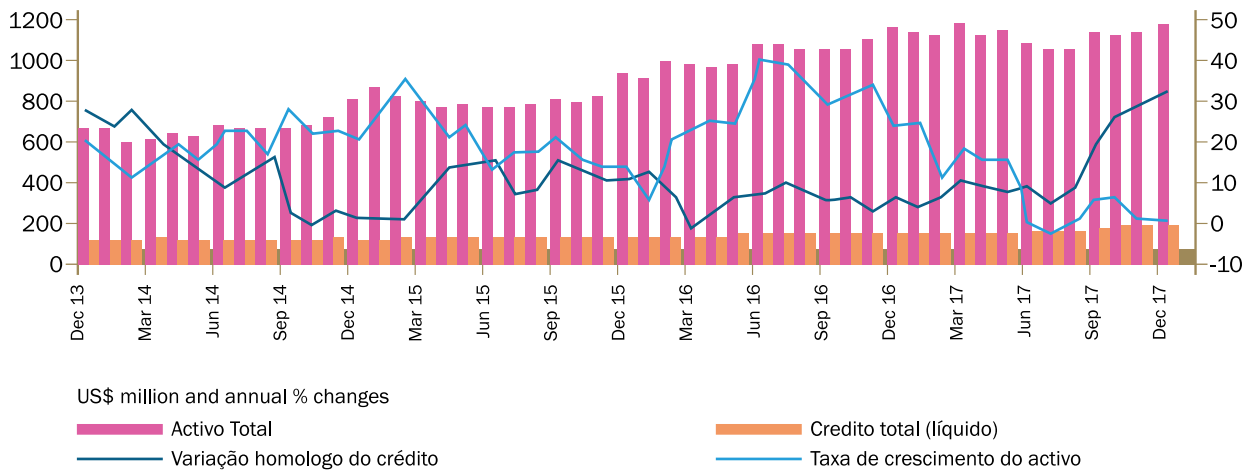
Australia (ANZ) and Indonesia (Mandiri and BRI, the new bank that was granted the operating license by BCTL in 2017).

**Banking assets increased 1.8% to US 1,170 million.**

Total banking system assets grew by 1.8% at the end of 2017 (24% in 2016) to US\$ 1,170 million, increasing by US\$ 21 million compared to 2016 (chart 24). This growth was mostly due to the increase in investments at the Central Bank (54.1%), but also to the increase in: loans (net) (32.3%), tangible assets (31.6%) and other assets (14.5%). Meanwhile, deposits made with other credit institutions fell by 11.4%, and there was no investment in the period.

The deceleration of the growth rate of financial assets, was due to a large extent to the lower growth rate of the funds of commercial banks in Timor-Leste deposited with other credit institutions abroad and/or their own headquarters.

**Chart 2.25**  
Banking Assets

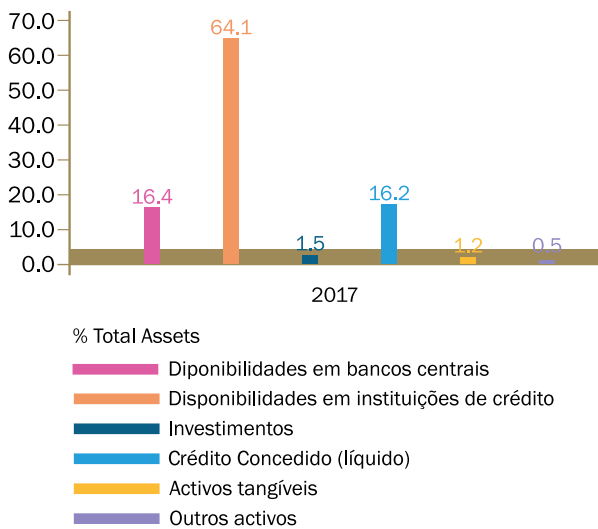


Source: BCTL

**The overall banking portfolio continues to be dominated by funds deposited with other banking institutions.**

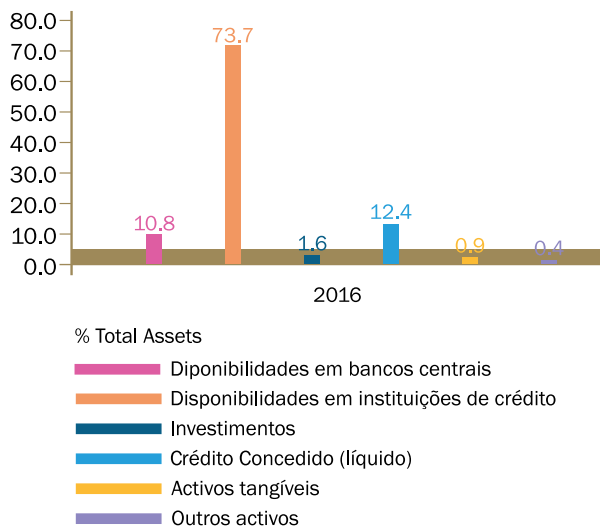
Despite the decline of banking funds deposited with other credit institutions, this category continues to dominate the banking assets portfolio. In 2017 the category accounted for 64.1% of total assets (USD 750 million), versus 73.7% (847 million USD) registered in 2016 (chart 2.25).

**Chart 2.26.a**  
Banking Assets Composition



Source: BCTL

**Chart 2.26.b**  
Banking Assets Composition



Source: BCTL

Deposits made with the Central Bank now occupy the second position in the banking assets' structure, thus displacing from the 2nd place credits granted to the private sector. In December 2017, the total value of the assets deposited with the BCTL amounted to US\$ 192 million, corresponding to 16.4% of total assets, an increase of 54.1% over December 2016.

The banking net loan portfolio assumed the third position in 2017, but its weight of total assets at the end of 2017 increased by 16.2%, compared to 12.4% at the end of 2016.

**Table 2.13. Estrutura dos Activos dos Bancos Comerciais**

Em milhões de USD

	Dez 16	Dez 17	Peso	Variação	
				%	Valor
Diponibilidades em bancos centrais	124	192	16.4	54.1	67
Disponibilidades em instituições de crédito	847	750	64.1	-11.4	-97
Investimentos	18	18	1.5	0.0	0
Crédito Concedido (líquido)	143	189	16.2	32.3	46
Activos tangíveis	11	14	1.2	31.6	3
Outros activos	6	7	0.6	14.5	1
<b>Total</b>	<b>1149</b>	<b>1170</b>	<b>100</b>	<b>1.8</b>	<b>21</b>

Source: BCTL

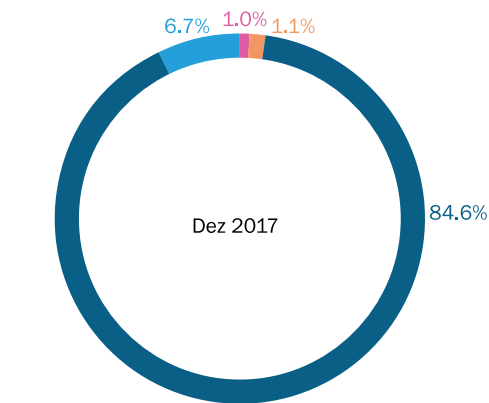
## 2.6.1.2. Liabilities

**Deposits continue to be the largest funding source for the sector.**

Deposits continue to represent the main source of funds for credit institutions, whose overall weight of liabilities increased 4.8% to 84.6% in December 2017 compared to 79.8% in December 2016 (chart 2.26). In terms of nominal variation, deposits raised by the banking sector increased 7.9% compared to the previous year.

In 2017, resources obtained from the Central Bank registered a reduction of 87.6% compared to a growth of 22.1% in 2016, and as result, there was a decrease in their weight in total liabilities, 7.9% from 2016 to 1% in December 2017. On the other hand, deposits received from other credit institutions declined by 54.6% in December 2017, following to a significant increase of 141.6% in 2016.

**Chart 2.27.a**  
Banking Liabilities Composition

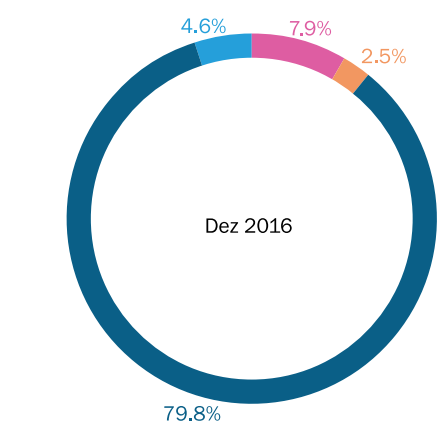


% Total

- Devido ao BCTL
- Depósitos
- Depósitos de outros bancos
- Outros

Source: BCTL

**Chart 2.27.b**  
Banking Liabilities Composition



% Total

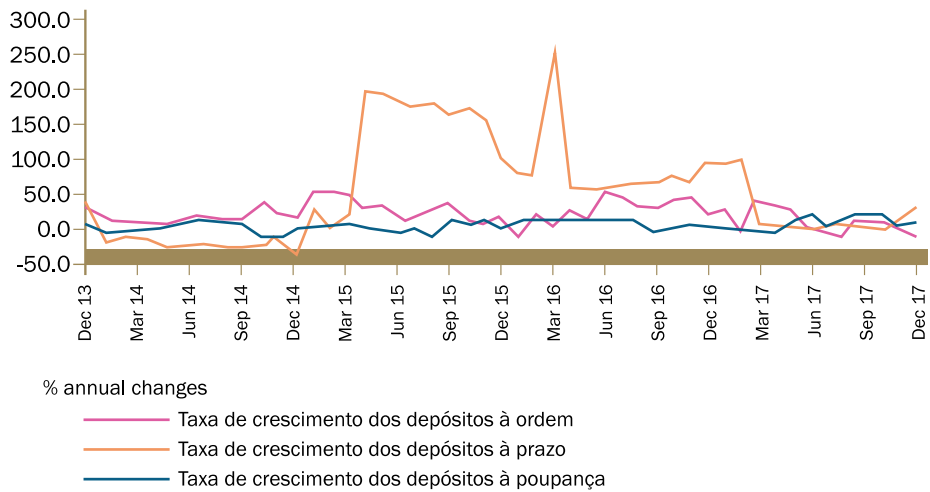
- Devido ao BCTL
- Depósitos
- Depósitos de outros bancos
- Outros

Source: BCTL

**Time deposits' growth exceeded demand deposits growth in 2017.**

The growth rates of time deposits exceeded those of demand deposits during 2017, growing 34.6% versus 2016. On the other hand, demand deposits recorded a negative growth rate in 2017, decreasing 2.4 % at the end of the year in homologous terms.

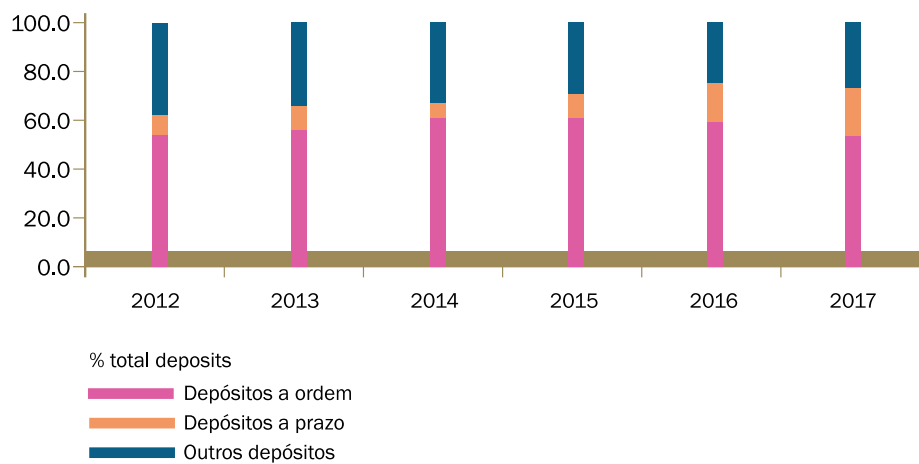
**Chart 2.28**  
Banking Deposits Growth



Source: BCTL

The deposit structure continues to follow the trend recorded in previous years. Demand deposits continued to represent the largest component of total deposits, reaching 54.7% of the total, despite a slight reduction compared to December 2016 (60.5%). Savings deposits accounted for around 26.2% of total deposits at the end of 2017, down from 24.2% in 2016. The amount invested in time deposits continued to increase substantially, amounting to 19,2% of total deposits collected, compared to 15.4% in the previous year.

**Chart 2.29**  
Deposits % composition

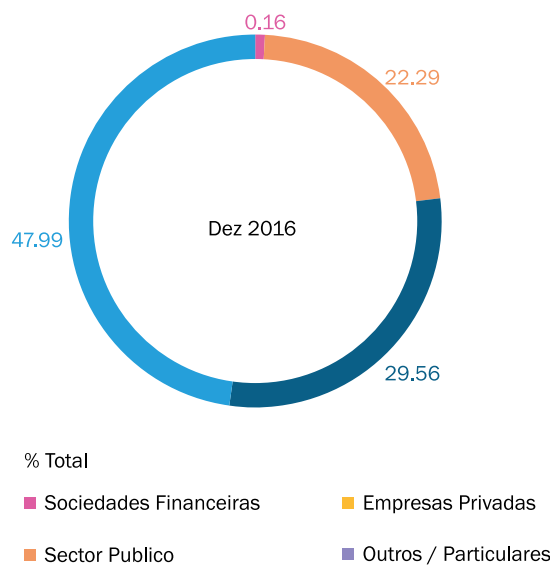


Source: BCTL

**Private retail deposits continue to be the largest source of banking deposits.**

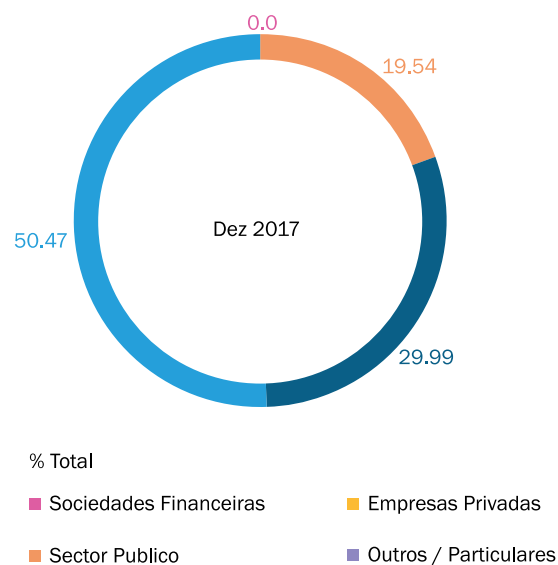
With regard to deposits held by residents, there were no significant changes in composition, with private deposits continuing to represent the largest component of deposits, increasing in importance from 48% in 2016 to 50.5% of the total in December of 2017 (chart 2.29). Deposits from private companies maintained the second position in the deposit structure, with a weight of 30% (+ 0.4% compared to 2016). However, Public Sector deposits increased by USD 25.8 million compared to December 2016. At the end of 2017, State deposits amounted to USD 193.4 million, or 19.5% of the total, which corresponded to a decrease of 2.8% compared to 2016.

**Chart 2.30.a**  
Deposit Ownership



Source: BCTL

**Chart 2.30.b**  
Deposit Ownership



Source: BCTL

### 2.6.1.3. Profitability

**Banking revenue rose substantially by 19%, to US\$ 41.6 million.**

Banks' revenues were composed of interest and commissions charged to their clients, amounting to a total of USD 41.6 million. This corresponds to an annual growth of 19%, or USD 6.6 million.

As a result of their activity, banks reported the following results in 2017 (the 2016 figures are presented to facilitate comparison):

**Table 2.14. Resultados das Atividades Bancárias**

Em milhões de USD

	Dec 16	Dec 17
<b>Rendimento Bruto</b>	<b>34.93</b>	<b>41.57</b>
Rendimento líquido antes de impostos	13.21	16.87
	0	0
Impostos sobre o rendimento	1.31	1.00
	0	0
<b>Rendimento líquido depois de Impostos</b>	<b>11.89</b>	<b>15.78</b>
<b>Rendimento em % dos activos</b>	<b>Dec 16</b>	<b>Dec 17</b>
Juros recebidos de bancos	0.73%	0.54%
Juros de investimentos 'overnight'	0.00%	0.00%
Juros e taxas derivados de empréstimos	1.71%	1.62%
Outros juros recebidos	0.32%	0.34%
Outros rendimentos operacionais	2.76%	1.31%

Source: BCTL

Return on assets (RoA) rose to 1.4% in 2017 from 1.04% in 2016. The increase in RoA is mainly due to the increase in the value of gross revenues equivalent to USD 6.6 million. In terms of determinants, the increase in RoA was due to the increase in interest rates received from deposits with other banks and loans, when considered as a percentage of banking assets. Banks continue to maintain liquidity ratios higher than those required by the Central Bank.



## 2.6.2. Transfer Services

### 2.6.2.1. Money Transfer Services (MTS)

**Outward transfers rose to US\$ 1,500 million.**

During 2017, money transfer services reported by commercial banks operating in Timor Leste, recorded a total number of transfers abroad of 86,200 transactions, with a nominal value of US \$ 1,500 million, representing a reduction of 9.4% compared to 2016. On the other hand, transfers from abroad amounted to 12.4 thousand operations, with a nominal value of US\$ 590 million, which represents a reduction of 36,3% compared to 2016.

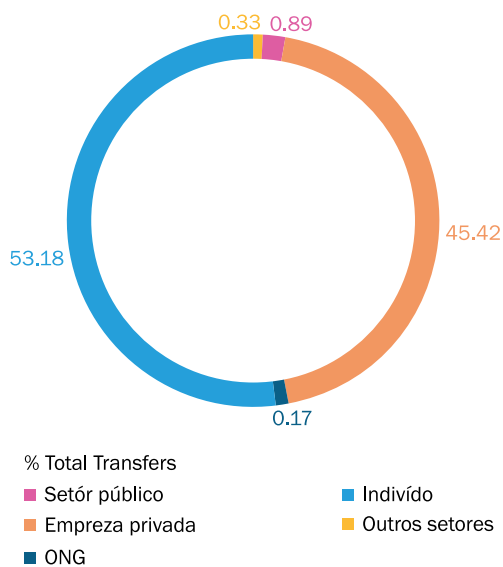
### 2.6.2.2. Money Transfer Operators (MTO)

**MTO's were responsible for outward transfers of US\$128.6 million.**

In 2017, this sector recorded a total amount of foreign transfers of US\$ 128.6 million, while transfers from abroad totaled US\$ 51.8 million. These figures represent annual growth rates of 7.1% and 24.8%, respectively. It should also be noted that personal transfers continued to make the greatest contribution to the growth of both types of transfer - to (18%) and from abroad (52%). In terms of origin, most of the inflows came from Europe, which accounted for a 24.1% contribution to the growth of 2017. These inflows consisted mostly of remittances from Timorese workers living and working in Europe. Most transfers abroad were made to the Asia Pacific region (17.9%), especially Indonesia (17.8%), taking up 75.8 per cent of total remittances, which mostly consisted of outward remittances of Indonesian citizens residing and working in Timor-Leste.

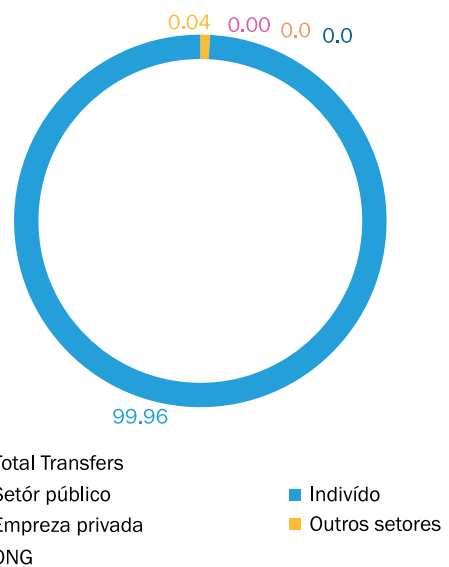
Figure 2.30 shows the weight of the transfers made by each sector through the money transfer operators in 2017.

**Chart 2.31.a**  
Outward Transfers



Source: BCTL

**Chart 2.31.b**  
Inward Transfers



Source: BCTL



The background of the page is a dark, textured grid filled with various financial data points, including numbers and symbols, overlaid with a candlestick chart and a line graph. The text is centered and reads: 

# Main mission and mandates, organization, governance and activities

## Chapter 03

3.1.	Main Mandates and Functions	77
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*The main task of the Central Bank of Timor-Leste (BCTL) is to continue to maintain and improve the quality of the services it provides to the community, while maintaining a stable monetary system, as well as promoting a robust and functional financial system.*

This mission is pursued by maintaining a low and stable rate of inflation, a secure and efficient payment system, and the credible functioning of all financial institutions – through the implementation of appropriate legal and regulatory standards and banking supervision – the financial education of the population and studies on the national economy, supported by useful statistics and quality.

Taking into account the BCTL's mission, this chapter provides an overview of the institution's mandates and functions, its governance structure and key activities carried out during the 2017 financial year, as well as its 2018 action plan. The brief summary of annual activities also details the main initiatives developed throughout the year by each of the various functional areas of BCTL.



# 3.1

## Main Mandates and Functions

The Central Bank of Timor-Leste is a legal person governed by public law, with administrative and financial autonomy and its own assets. The BCTL, its organs, employees and agents, enjoy independence and cannot receive instructions from external entities, and its Organic Law guarantees the independence of the Central Bank vis-à-vis the Government.

As is the practice in most international central banks, the BCTL's main objective is to ensure the stability of domestic prices in the area of economic policy. Other equally important objectives are the promotion of a financial system based on the principles of a market economy and, therefore, ensuring competition that

works for citizens and the general economy general. within the guidelines of these objectives and principles, the Central Bank also supports the government's overall economic policy.

In order to achieve its objectives, the functions of BCTL are, under the terms of the law:

- a) Define and implement the country's monetary policy;
- b) Define and adopt the exchange rate regime as well as the associated exchange rate policy;
- c) To conduct operations in foreign currencies;
- d) Hold and manage the official external reserves of the country;
- e) Hold and manage the State's gold reserves;
- f) Issue and manage the official currency of Timor-Leste – at this time the country uses the US currency;
- (g) collect and publish statistical information in the areas of its competence (notably monetary and balance of payments statistics);
- h) Inform the National Parliament, the Government and the general public about the policies it implements;
- i) Establish, promote and oversee secure and efficient payment systems;
- j) Regulate, license, register and supervise financial institutions operating in the country;
- k) To advise the Government on matters within its competence;
- l) Act as fiscal agent of the Government;
- m) Participate in international organizations and meetings that focus on the above points;
- n) Establish contracts, agreements and protocols with national or foreign entities, public or private; and
- o) Perform any other activities as assigned by law.

Currently, some of these functions are not yet fully performed by the Central Bank of Timor-Leste due to the adoption of the US dollar as the official currency of the country.



*The ultimate authority of the BCTL is its Board of Directors, which formulates the strategies and policies for the institution and supervises their implementation, including oversight of the Bank's administration and operational activities.*

## 3.2

### BCTL Organization and Governance

The Governor is the executive body of the BCTL and is responsible for day-to-day management, assisted by two Deputy Governors and a Management Committee composed of the executive directors and heads of the Bank's various departments. At the end of 2017, the year to which this report refers, the Governing Board was composed of the Governor, two Deputy Governors and three non-executive members. In 2017 one of the Deputy Governors, Ms. Sara Lobo Brites, resigned her post to take up an appointment as Deputy Finance Minister, and Mr. Venancio Alves Maria was named as her successor in November 2017. At the same time one of the non-executive members, Dr. Aurélio Guterres, resigned his position to assume the responsibility as the Foreign Affairs Minister. The composition of the

Board of Directors and the Management Committee is presented at the end of the chapter.

The BCTL is organized into four main departments: Financial System Supervision; Banking Operations and Payment Systems; Management of the Petroleum Fund; and Department of Administration. Some Divisions and Offices report directly to the Governor, namely: the Legal Unit, Internal Audit, the Economics and Statistics Division and the Financial Information Unit. The Accounting and Budget Division is under the responsibility of the Deputy Governor responsible for overseeing the financial system.

The Central Bank is also in charge of the secretariat of the Investment Advisory Board of the Petroleum Fund.

The Board of Directors of the BCTL continues to adopt the motto abbreviated by the acronym TIMOR, representing Transparency, Integrity, Mobilization, Obligation and Responsibility, essential words in the day-to-day of the institution and its employees.

## **T**ransparência **I**ntegridade **M**obilização **O**brigaçãO **R**esponsabilidade

Somos um exemplo para a sociedade e para as instituições, os nossos procedimentos e regulamentações são aplicados interna e externamente de forma universal, consistente e rigorosa.

Exercemos a nossa actividade com honestidade e altos padrões ético-morais, respeitando a confidencialidade e legalidade em todas as decisões que envolvem os nossos interesses e recursos.

Movemo-nos para prestar o melhor serviço à comunidade de Timor-Leste, através da nossa determinação e empenho para ouvir, aprender e assessorar.

Demonstramos um sentimento de pertença e envolvimento, estabelecendo como prioridade os objectivos da instituição e exibindo disponibilidade para desempenhar tarefas para lá do que nos é pedido.

Investimos no desenvolvimento das nossas capacidades técnico-profissionais, cumprimos com as responsabilidades que nos são atribuídas e que proactivamente procuramos, através da permanente monitorização das consequências das nossas decisões e acções.

A code of ethics applicable to all its employees, including external persons related to the Bank, is also in place at the BCTL. The code of ethics includes strict rules on various aspects of the behavior of those to whom it applies. It should be noted, for example, that each Bank official is required to perform his or her duties solely in the interests of the general public and the BCTL and not his or her individual interests, which includes not receiving any instructions whatsoever, from entities other than those within the Central Bank's legal structure. Bank employees are also, of course, prohibited from receiving any pecuniary amounts or other remunerative elements from any persons who may have an interest in influencing their decisions.





*As part of the BCTL's mission to promote monetary and financial stability, the development of the financial system and the promotion of a secure and efficient payment system, a number of activities were planned and implemented in 2017.*

## 3.3

### BCTL Activities in 2017

Proceeding with the implementation of the Master Plan for the Financial Sector in Timor Leste, the BCTL in 2017 continued to organize the financial literacy training program for primary schools. This training program was attended by 56 teachers from 39 primary schools in 12 municipalities, and the Special Administrative Region of Oé-Cusse Ambeno (RAEOA).

Before the National Savings Day ceremony, the BCTL organized several educational activities on November 27 in coordination with the RAEOA Authority, in particular with the Education Department. The theme of these activities and the celebration of National Savings Day was "save now for a better future". The ceremony to celebrate the third anniversary of National Savings Day, in RAEOA on November 29, 2017, was attended by the Minister of Education and

Culture, the President-in-Office of the authority of RAEOA, students and teachers from Primary Schools and representatives of commercial banks.

At the end of 2017, 10,900 “Ha’u-nia Futuru” accounts with a face value of savings of USD 2.5 million were open, representing a 63% increase in the number of accounts, and of 176% in value, compared with the end of 2016.

Within the initiatives to promote national savings, a national Road Show for the Financial Education Program was officially launched on National Savings Day. After this inauguration, the BCTL developed and led the program throughout the country, with the aim of encouraging people to improve their spending habits and increase their savings.

Taking into account the issues identified in the national risk assessments conducted in 2016, in particular the risks and vulnerabilities related to money laundering and terrorist financing in the financial sector, the BCTL, in collaboration with the World Bank Group, conducted a workshop to introduce the risk database approach to preventing money laundering and countering the financing of terrorism to Banks, ODTIs and MTOs.

The BCTL also carried out the monitoring and evaluation of the training program in the register and accounting of companies, including Micro, Small and Medium Enterprises (SMME), in order to observe and evaluate the performance of participants, so that BCTL and Chamber of Commerce and Industry (ITC-TL) could measure the program effectiveness and relevance to participants.

In 2017, the BCTL signed a cooperation agreement with RAEOA/ZEEMS on the implementation of the financial literacy program in basic education in Oecusse. To begin teaching the financial literacy program in basic education at RAEOA, the BCTL signed the memorandum of understanding with the Oecusse-Ambeno Special Administrative Region Authority on February 17, 2017 in Oecusse.

The BCTL also signed a cooperation agreement with the United Nations Development Program (UNDP) on cost sharing for 3 months on the implementation of the National Financial Inclusion Strategy Action Plan.

During the year, the R-TiMOR support unit at BCTL supported banks and the State Authorities in various initiatives to strengthen electronic integration (STP, or Straight Through Processing) between R-TiMOR and its internal systems.

In March 2017, the BCTL hired SIBS International of Portugal to supply and implement a National Card and a Payment Switch. The switch, designated “P24” (the “P” associated with the words Pagamentu, Pagamento, Payment and Pembayaran) will offer a full range of payment services.

Finally, in order to deepen the relationship with its international counterparts, the BCTL organized in 2017 the XVII Meeting of Human Resources of the Central Banks of the Portuguese Speaking Countries (CPLP).

The main activities of the BCTL, carried out during 2017, are described in more detail in the following section.

### 3.3.1. National Payment System

#### 3.3.1.1. Interbank Clearing and Settlement System

During the period covered by this report - the year 2017 - the Central Bank continued to act consistently so as to always maintain a sufficient cash reserve to meet the pecuniary payment needs of both the Government and commercial banks. It was in this context that the BCTL ensured, in particular, the consistent processing of financial transactions through the Automatic Clearinghouse and the Real Time Gross Settlement (RTGS) system. Table 3.1 summarizes the transactions registered in Dili's Interbank Clearing and Settlement System (CEL). The CEL system worked steadily in 2017, with 22,100 transactions being processed, corresponding to USD 134.4 million. However, these numbers represent a reduction of 1.9% in terms of quantity and 1.8% in terms of value, compared to 2016.

**Table 3.1. Transacções na CEL de Dili**  
(Valores em milhões de USD, Quantidade em 10<sup>3</sup>)

Mês	Cheques 2016		Cheques 2017		Variação (%)	
	Quantidade	Valor	Quantidade	Valor	Quantidade	Valor
Janeiro	1.659	12.118	1.684	12.365	1.5	2.0
Fevereiro	1.859	11.178	1.732	10.455	-6.8	-6.5
Março	1.877	12.233	1.959	12.358	4.4	1.0
Abril	1.842	11.393	1.698	10.536	-7.8	-7.5
Maiο	1.763	9.733	1.986	11.790	12.6	21.1
Junho	2.132	11.897	1.896	10.844	-11.1	-8.9
Julho	1.743	10.005	1.871	12.685	7.3	26.8
Agosto	1.943	11.297	1.816	10.794	-6.5	-4.5
Setembro	1.944	12.403	1.856	10.559	-4.5	-14.9
Outubro	1.914	11.609	1.894	12.065	-1.0	3.9
Novembro	1.772	10.504	1.620	8.741	-8.6	-16.8
Dezembro	2.053	12.485	2.070	11.217	0.8	-10.2
<b>Total</b>	<b>22.501</b>	<b>136.856</b>	<b>22.082</b>	<b>134.408</b>	<b>-1.9</b>	<b>-1.8</b>

Source: BCTL

### 3.3.1.2. SWIFT and RTGS (R-Timor) Systems

Payment services provided by the BCTL are subdivided into two categories: domestic and international. Domestic payments are, in turn, of two types: large value and retail. International payments are made from Timor-Leste to other countries and vice versa, always through the SWIFT system. Domestic payments, particularly electronic retail payments, are directly executed through the Automatic Clearing House twice a day, processing payments for wages, veterans' allowances, payments to suppliers, which are, inter alia, processed and transferred to commercial banks. The payments of large amounts, over USD 200 thousand, are always made through the RTGS.

**Table 3.2. Pagamentos Nacionais e Internacionais**

(Valores em milhões de USD, Quantidade em 10<sup>3</sup>)

	2016		2017		Valuation (%)	
	Quantidade	Valor	Quantidade	Valor	Quantidade	Valor
<b>Pagamentos Nacionais</b>						
Câmara de Compensação Automática			19.04	43.78		
Saída de RTGS - FICT	7.61	973.72	0.45	553.45	-94.1	-43.2
Entrada de RTGS - SCCT	44.68	254.46	3.51	136.01	-92.1	-46.5
<b>Sub Total</b>	<b>52.29</b>	<b>1228.18</b>	<b>23.00</b>	<b>733.24</b>	<b>-186.23</b>	<b>-89.71</b>
<b>Pagamentos Internacionais</b>						
Transferência para o exterior - SWIFT	4.58	1520.72	3.39	1098.24	-26.0	-27.8
Transferência proveniente do exterior - não SWIFT	0.31	23.76	0.58	320.53	87.1	1249.0
<b>Sub Total</b>	<b>4.89</b>	<b>1544.48</b>	<b>3.97</b>	<b>1418.77</b>	<b>-18.8</b>	<b>-8.1</b>
<b>Total</b>	<b>57.18</b>	<b>2772.66</b>	<b>26.97</b>	<b>2152.01</b>	<b>-205.0</b>	<b>-97.9</b>

Source: BCTL

Table 3.2 exhibits the statistics of payments, both national and international, during the period under review. With regard to national payments, 23,000 documents were processed, corresponding to a total of USD 733.24 million, representing a reduction of 186.2% in terms of number and 89.7% in terms of value, compared to 2016. The reduction recorded for national payments was determined by the decline in the amount of payments made via RTGS (the R-TIMOR system), both out and inbound, which declined 93% in terms of quantity and 45% in value, respectively. As part of the international payments activity, four thousand documents were processed, corresponding to USD 1,419 million, representing a decrease of 19% in terms of quantity and 8% in value, compared to 2016. This decrease in activity was mainly due to the reduction in the number of transfers made abroad.

In addition, international operations corresponding to transfer and receipt transactions carried out by commercial banks in 2017 are shown in Table 3.3.

The foreign transfer operations received and carried out in 2017 via SWIFT amounted to a total of 28.18 thousand, corresponding to USD 317.3 million, representing a reduction of 0.1% in terms of quantity and 9,5% in relation to the value. In the meantime, transfers abroad rose to 72.4 thousand transactions, corresponding to USD 1,483 million, representing an increase of 6.3% in terms of quantity and a decrease of 4.2% in respect of the transferred value.

**Table 3.3. Entradas e Saídas de Transferências (SWIFT)**

(Valores em milhões de USD, Quantidade em 10<sup>3</sup>)

	2016		2017		Variação (%)	
	Quantidade	Valor	Quantidade	Valor	Quantidade	Valor
<b>Transferências proveniente do exterior</b>						
SWIFT	28.2	350.7	28.2	317.3	-0.1	-9.5
Non-SWIFT	6.2	147.7	6.5	141.1	4.5	-4.4
<b>Sub Total</b>	<b>34.4</b>	<b>498.4</b>	<b>34.7</b>	<b>458.5</b>	<b>0.7</b>	<b>-8.0</b>
<b>Transferências para o exterior</b>						
SWIFT	22.0	1103.4	23.6	1069.8	7.3	-3.1
Non-SWIFT	46.1	443.8	48.8	413.3	5.8	-6.9
<b>Sub Total</b>	<b>68.2</b>	<b>1547.2</b>	<b>72.4</b>	<b>1483.0</b>	<b>6.3</b>	<b>-4.2</b>
<b>Total</b>	<b>102.6</b>	<b>2045.6</b>	<b>107.1</b>	<b>1941.5</b>	<b>4.4</b>	<b>-5.1</b>

Source: BCTL

### 3.3.1.3. E-Banking

Table 3.4 shows the evolution of non-cash money and other transactions by commercial banks in Timor-Leste. As can be seen, the number of currency transactions in the country totaled in 2017, about 15.6 thousand, or 98% of total transactions, with a value of USD 2.9 million. The level of activity declined by 2.9% in terms of quantity and 42.4% in value, compared to 2016. Note that transactions using non-currency means, were 287 thousand in number, but corresponded to a transaction value of 2.4 million USD, about 45.3% of the total. These totals represent a decrease of 3.3% and 30% in terms of quantity and value, respectively, compared to 2016.

**Table 3.4. Transacções em Moeda e não em Moeda**

(Valores em milhões de USD, Quantidade em 10<sup>3</sup>)

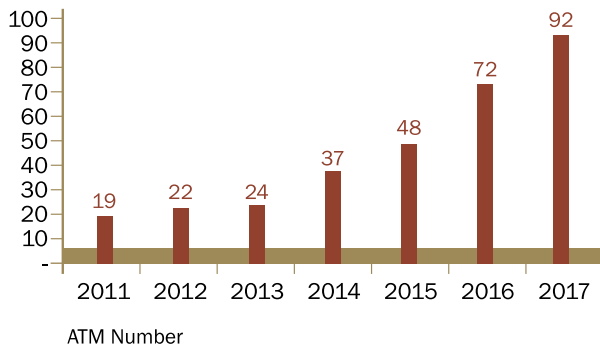
	2016		2017		Variação (%)	
	Quantidade	Valor	Quantidade	Valor	Quantidade	Valor
<b>Transacções em Moeda</b>	16070	5065	15604	2915	-2.9	-42.4
<b>Transacções não em Moeda</b>	366	2562	287	2410	-21.8	-5.9
<b>Total</b>	<b>16436</b>	<b>7626</b>	<b>15891</b>	<b>5325</b>	<b>-3.3</b>	<b>-30.2</b>

Source: BCTL

The BCTL intends that the settlement of operations in the economy be progressively more efficient and effective through the use of electronic payment means and digital financial services. As a result, BCTL continues to focus on substantially extending the network of non-cash based automatic payment services using the national switch for the expansion of payment services, stimulating the widespread use of credit and debit cards.

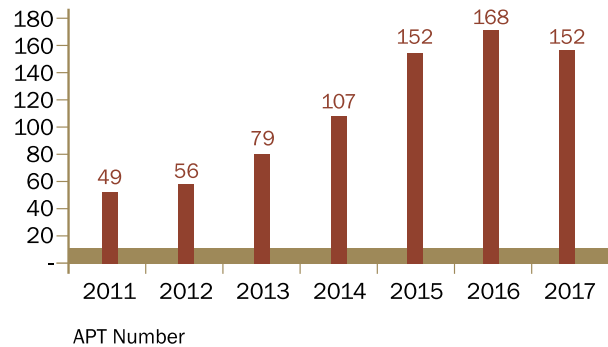
Charts 3.1 and 3.2 show the total number of payment terminals installed in the country, including ATMs totaling 92 units in 2017 and 152 Automatic Payment Terminals (APTs) units. Compared with December 2016, these figures represent a growth of 28% for the ATMs, while the number of ATPs registered a reduction of 10 terminals, probably explained by the damages to the machines used.

**Chart 3.1**  
Automatic Teller Machines



Source: BCTL

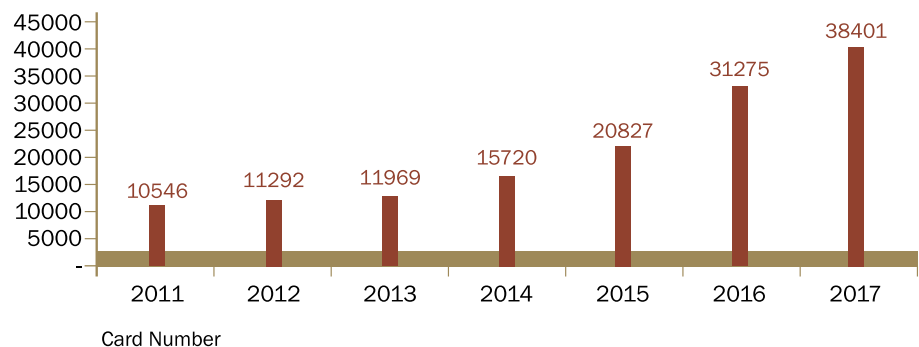
**Chart 3.2**  
Automatic Payment Terminals



Source: BCTL

The evolution of bank cards issued in Timor-Leste can be seen in chart 3.3. The number of cards in circulation in the country amounted to 38.4 thousand in December 2017, which corresponds to an increase of 23% over December 2016. Regarding the composition of the total number of cards in circulation in the country, 61% were debit cards (23,400) and 39% credit cards (15,000). In fact, in 2017, debit cards registered a slowdown in terms of growth, growing only 11%, compared to the 83% increase observed in 2016. On the other hand, the number of credit cards grew 48% compared to the growth of 10% in 2016.

**Chart 3.3**  
Banking Cards



Source: BCTL



## Box 1. National Strategy for Financial Inclusion

In September 2016 the BCTL carried out an historic initiative and published the Financial Inclusion report, based on data from the country's main financial service providers, including commercial banks, insurance companies, microfinance, credit cooperatives, money transfer operators, and exchange agencies.

The report listed and described the current level of inclusion in the country, and highlighted the urgent need to improve the level of understanding and financial inclusion in the country, as well as its challenges. Following the publication of the financial inclusion report, BCTL continued to have the implementation of the strategy for financial inclusion as its main priority. In 2017 the BCTL specifically defined the national financial inclusion strategy, establishing action plans for the next five years, from 2017 to 2022.

The report describes its “vision” in terms of financial inclusion, together with the identification of the main obstacles. The BCTL also decided to adopt four main strategies, or pillars, that will materialize this “vision” for financial inclusion. The implementation of the specific action plans, identified for each of these strategies, will be prioritized and sequenced over the expected timeframe.

The report is available on the BCTL website at: Publications> Main publications> National Strategy for Financial Inclusion:

[https://www.bancocentral.tl/uploads/documentos/documento\\_1504856113\\_7162.pdf](https://www.bancocentral.tl/uploads/documentos/documento_1504856113_7162.pdf)

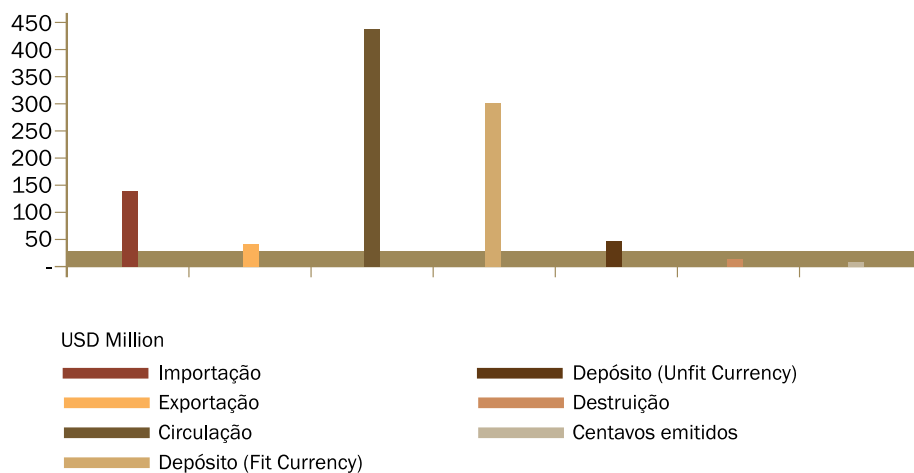


### 3.3.1.4. Currency Imports and Exports

One of the central functions of the Central Bank is to ensure that the national economy has the necessary means of payment for its economic growth and the current economic activity of its agents. In this regard, the Central Bank plays the role of protecting public trust in the currency of the country by supplying banknotes that must, at all times, meet the public's demand and guarantee the physical integrity of banknotes.

Since the country uses banknotes of another country and its own national coins, which are not manufactured in the national territory, supplies of immediate means of payment (coins and banknotes) to the national economy require their importation and, in the case of banknotes, when they reach a low degree of fitness, their re-export to the country of origin, the United States.

**Chart 3.4**  
Currency Transactions



Source: BCTL

During 2017 BCTL imported US \$ 137.7 million in US dollar notes, representing a decrease of 9.1% compared to 2016, and total of US \$ 423.6 million was released for circulation, including coins. In fact, the amount put into circulation is larger than imported due to the inflows of deposits and the holding of reserves. It should also be noted that USD 20 notes continue to be the most used in transactions in the country, accounting for: 53.7% of total imports, 62.5% of circulation in the economy and 65% of the total deposited by the banks with the central bank (Table 3.5). As for coins, it should be noted that in September 2017 the BCTL issued and started to circulate the new coin of 200 centavos, the total amount of which, issued until December 2017, was 261 thousand centavos. The

denominations of 100 and 50 centavos remain the most sought after in Timor Leste coin transactions, amounting to 1.752 million centavos and 1.243 million, representing 43.9% and 31.1% of total centavos in circulation respectively. However, these figures corresponded to a slight increase of 3.1% for the coin of 100 centavos, and a growth of 27.4% (165.4% in 2016), in terms of denomination of 50 centavos compared to 2016.



**Table 3.5. Movimento da Moeda**

(Valores em milhões de USD)

Denominação	Importação		Re-circulação		Depósito		Peso 2017			Variação (%)		
	2016	2017	2016	2017	2016	2017	Importação	Re-circulação	Depósito	Importação	Re-circulação	Depósito
100	12.800	6.400	11.600	6.400	1.700	0.800	4,8	2,8	1,5	-50,0	-44,8	-52,9
50	19.200	23.200	23.650	17.450	3.750	1.750	17,2	5,8	4,2	20,8	-26,2	-53,3
20	76.800	72.320	256.580	272.841	171.261	206.061	53,7	62,5	65,0	-5,8	6,3	20,3
10	33.280	27.840	103.150	107.220	68.750	82.050	20,7	25,1	25,6	-16,3	3,9	19,3
5	6.160	4.960	15.515	15.660	10.598	8.481	3,7	3,8	3,7	-19,5	0,9	-20,0
<b>Total</b>	<b>148.240</b>	<b>134.720</b>	<b>410.496</b>	<b>419.572</b>	<b>256.059</b>	<b>299.143</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>-9,1</b>	<b>2,2</b>	<b>16,8</b>

Source: BCTL

## Box 2. Upgrading Timor Leste Payment System

### 1. R-TiMOR

The launch of the R-TiMOR system in April 2015 allowed for the implementation of the four key pillars of the National Payments System, namely:

- A Real Time Gross Settlement (RTGS) system that gives banks the ability to make high-value and urgent payments between banks in real time;
- An interbank financial network that provides participants with a secure electronic network to undertake transfers and other financial activities, based on a fiber optic network, with the backup of a redundant microwave network;
- An Automated Clearing House (ACH) that gives participants the ability to make low value and non-urgent payments individually or in batches; and
- A Settlement Accounting Module for BCTL clients, namely commercial banks and various public entities.

During the year, the R-TiMOR support unit at BCTL continued to support banks and the State in various initiatives to strengthen electronic integration (STP or Straight Through Processing) between R-TiMOR and its internal systems, namely:

- Bank Rakyat Indonesia obtained a bank license in March 2017 and finalized its full integration of STP with R-TiMOR shortly thereafter.
- Mandiri Bank implemented its STP for submission of payments to R-TiMOR.
- In September, the National Bank of Commerce of Timor-Leste (BNCTL) implemented a new global technology infrastructure to support the banking business, which required the development and testing of a new STP application, within the framework of the implementation of that technology platform;
- The Ministry of Finance made substantial progress during the year in terms of the integration of STPs of its GRP system with R-TiMOR, which was formally launched by the Prime Minister at a ceremony held in February 2018.

### 2. National Card and Payment Switch

In March 2017, the BCTL hired SIBS International of Portugal to supply and implement a National Card and Payment Switch. The switch, designated “P24” (the “P” associated with the words Pagamentu, Pagamento, Payment and Pembayaran) will offer a full range of payment services, specifically:

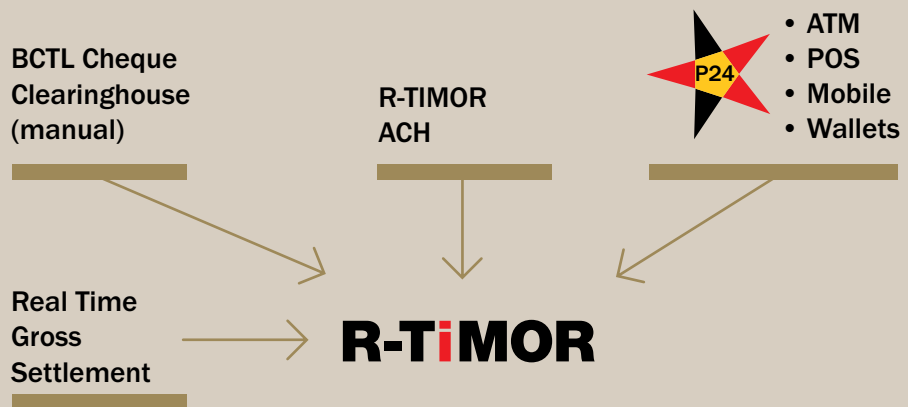
- Allow credit and debit card holders issued in East Timor to use the ATMs of any bank to carry out cash withdrawals, balance inquiries, funds transfers, account payments and other functions in the P24 system. There are currently around 100,000 debit and credit cards issued to customers of banks in Timor-Leste.
- It will enable cardholders of any bank to purchase goods and services from any merchant using point of sale (POS) terminals.
- Provide mobile banking services, including consultation of balances, purchase of non-banking services (telecommunications and electricity) and transfers, to bank customers with a mobile phone and internet, estimated at around 400,000 people.
- Provide mobile wallet services that will allow everyone with a mobile phone and internet, with or without a bank account, to make payments to other users of the wallet product.

The project has been the most complex project undertaken by the Central Bank to date because it not only involves the implementation of the core P24 system, but also because each participating bank created a dedicated project team to complete the interfaces with its main banking systems to allow carry out a wide variety of transactions, including issuing and managing cards, checking balances, managing cash and processing transactions.

The P24 system will make use of the R-TiMOR interbank network and will be linked to the R-TiMOR, allowing the P24 to automatically settle the net transaction value of each bank on a daily basis.

The Central Bank believes that the P24 system will bring substantial benefits to our economy, particularly in terms of promoting financial inclusion, particularly as it will reduce reliance on physical cash in our citizens' day-to-day transactions, and those who are far from banks, may have electronic means of payment, in addition to money, that will be accepted in local markets and stores.

When the P24 system is launched in the second quarter of 2018, the main elements of the East Timor National Payments System will be in place. The following image shows the various systems developed to date and the way they fit into R-TiMOR.



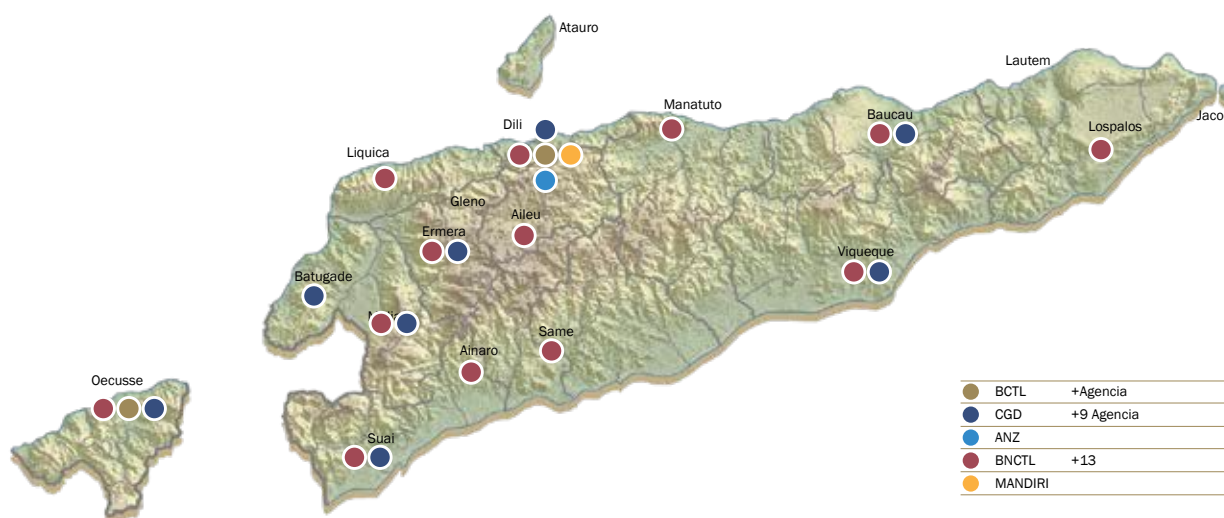
Future developments of the P24 system may include the ability to: make tax and other payments directly to the government, for example by facilitating the sale of electricity coupons (by EDTL); allow bank customers to apply for credit electronically by expanding the range of payment options for accounts and a full range of other electronic payment services.

## 3.3.2. Financial System and Banking Services

### 3.3.2.1. Financial System Licensing and Regulation

Timor-Leste's financial system is composed of commercial banks, insurance companies, other deposit takers, money exchange operators, money transfer operators (MTOs) and also several credit unions. The functioning of the financial system has evolved in a sound and secure manner throughout the year and continues to contribute significantly to the country's economic stability.

### Banking Services in Timor-Leste



Articles 5 and 29 of Law No. 5/2011 of June 15 and the Organic Law of the Central Bank of Timor-Leste grant BCTL the exclusive power to regulate, license and supervise all financial institutions. The Licensing and Regulatory Division is responsible for assessing new licenses for banks, exchange offices, insurance companies or insurance intermediaries, other deposit takers and money transfer operators (MTOs).

In 2017, the Division submitted to the Board of Directors for approval the following: a bank license approval to the PT. Bank Rakyat Indonesia (Persero) Tbk. for the establishment of a branch office in East Timor, and a preliminary approval of the application for the license of transfer operators of money to Loja 21 de Junho Unipessoal, Lda. At the same time, it recommended that the Board of Directors refuse to grant a license to three prospective money transfer operators and one bank to be established in Timor-Leste.

The Division continues to work together with the Banking Supervision Division and the Insurance Division to monitor the activities of the fund transfer service providers in accordance with the laws and regulations in force and other companies/persons suspected of undertaking transfer services without being duly licensed by the BCTL. During the year the BCTL, in the context of this supervision, applied a monetary fine to an individual who was identified as an unlicensed money transfer operator.

## Box 3. Financial Education Program - National Strategy Implementation

### 3.1. Financial Literacy Program in Primary Schools

As described in the 2016 annual report, BCTL officials initiated the financial literacy program in primary schools in the country, which, after the agreement with the Ministry of Education, was included as an extracurricular program.

In order to improve its teaching skills in the Financial Education program, the BCTL organized refresher sessions for the current teacher groups and new training sessions for a new group of teachers, who were responsible for implementing the financial education program in their schools, starting in mid-2017.

Teachers are thus better able to carry out their mission and disseminate training material so that knowledge can reach all primary schools in their municipal areas. The BCTL will continue to coordinate with the Ministry of Education to monitor the performance of teachers during the program.

In order to maintain the quality of the financial literacy program in primary schools and to address the problems faced by teachers, BCTL's financial literacy program team will continue to monitor primary schools where financial literacy programs are now ongoing. The issues raised during the monitoring process will be used to improve the quality of this program.

The financial literacy team traveled and visited all the schools that run the financial literacy program, and it was recognized that there are still many steps to be taken to have a good quality program that can achieve the stated objectives.

Currently there are 56 teachers from 39 primary schools who teach the financial literacy program in the country, and the program already covers 12 municipalities and the Oé-Cusse Special Administrative Region.





### 3.2. National Savings Day

The celebration of the third anniversary of National Savings Day was held at the Numbei Parish Hall in the Special Administrative Region of Oé-Cusse Ambeno (RAEOA).

Participants at the National Savings Day ceremony included the Minister of Education and Culture, the President of the Special Administrative Region Authority Oé-Cusse Ambeno (RAEOA), representatives of commercial banks and teachers and students of RAEOA primary schools.

Before the National Savings Day ceremony, the BCTL organized educational activities on November 27 in coordination with the RAEOA Authority, in particular with its Education Department. The theme for the activities leading up to the event and the celebration of national savings day was: “save now for a better future”. The aim was to increase the knowledge and awareness of students, particularly those in primary schools, about the benefits of saving for the future.

Pre-event activities included drawing, speaking, and poetry competitions. Eight primary schools joined a drawing, speech and poetry competition, resulting in four winners, while a competition in the form of a questionnaire resulted in four winning groups.

Certificates were also delivered to teachers who contributed most and continue to demonstrate great dedication in teaching the financial literacy program in their respective schools since the program’s inception. BCTL certificates of recognition were delivered to: Mrs. Onarata Martins, EBF Professor Dona Ana Lemos, Ermera Municipality; Ms. Aurelia da Costa, EBF One Form teacher from the municipality of Ainaro; and Mr. Rudolfo Do Carmo Soares, a professor at EBC Perola de Atauro in the municipality of Dili.

The purpose of awarding these certificates is to demonstrate the recognition of the contribution of these teachers in the implementation of the financial literacy program in primary schools, which should strengthen their motivation and the other teachers currently teaching the program.

During this ceremony, Governor Abraão de Vasconcelos stated that the financial education program and the road show are programs to educate

people, particularly children, to be responsible for their own financial future and the BCTL will request that the program may be included in the curriculum of the Ministry of Education RDTL. The Governor added that 53 teachers from 39 schools are now teaching the financial literacy program, which has already covered a total of 8,640 students. The Governor also noted that a total of 10,945 child savings accounts (called “Ha’u Nia Futuru” or “My Future”) had already been opened in the five commercial banks operating in East Timor from the end of 2015 until 31 October 2017, accumulating total savings of 2.5 million USD.

At that ceremony, the Minister of Education recognized that this program is very important and that the financial literacy program should be taught from basic education to encourage young people to save for their future. The Minister supported the positive initiatives of the BCTL and the implementation of the financial literacy program in schools.

RAEOA, through the Interim-President, expressed support for this program and its intention to expand the financial literacy program in the Region so that all RAEOA primary schools can teach it.

### **3.3. Financial Education Itinerant Program**

The National Road Show for the Financial Education Program was officially launched during the National Savings Day ceremony.

The itinerant program is part of the financial education program to encourage people to improve their spending habits and increase their safety and financial stability by saving more.

In the days following the official launch of the financial education program road show, representatives from the BCTL, commercial banks and local authorities continued their educational campaign at three administrative posts, namely Pante Makasar, Oesilo and Nitibe. The aim of the initiative was to disseminate information about the importance of saving for a better future, again through the “Ha’u Nia Futuru” children’s saving product. A total of 151 new accounts were opened during the two days of activity. The itinerant activities will continue in twelve municipalities in 2018.







## Box 4. Implementation of National Financial Sector Development Master Plan

### 4.1 Accounting and Corporate Registry Training

As mentioned in BCTL's annual report for 2016, the BCTL completed the training program of four groups, with 20 participants in each group.

In 2017, the BCTL in cooperation with the CCI-TL and the training entity carried out a monitoring and evaluation program for all the participants who completed the training. The objective of this monitoring and evaluation program was to observe and evaluate the performance of each participant so that BCTL and CCI-TL can evaluate the effectiveness of the program.

The team visited and noted the progress made by the participants. This activity should continue to be implemented for the next groups of trainees.

It was also observed that the majority of the participants had started preparing and carrying out their reports, such as the balance sheet, the income statement and the statement of cash flows in their daily activities. In addition, they have become accustomed to filling these documents and supporting information of the financial transactions. Most participants also expressed their willingness to continue to participate in future training sessions.

Despite the positive results, it was also observed that the BCTL and CCITL need to improve the quality of the selection process, namely in terms of participants' level of knowledge, understanding, technical capacity and business awareness. In addition, training should include more female entrepreneurs to achieve a better gender balance.





## 4.2. National Strategy for Financial Inclusion

In 2017, the BCTL launched the National Strategy for Financial Inclusion 2017-2022. The strategy will serve as a guide to define the path towards a stronger, more innovative and inclusive financial sector for Timor-Leste. The National Financial Inclusion Strategy is a call to action to harness and align the efforts of all stakeholders in order to achieve inclusive and sustainable financial sector development.

Financial inclusion is the provision of essential financial services at affordable costs to all segments

of society. This will allow more Timorese to increase their savings, manage financial risk and empower more people to improve their children's education, save for retirement, and support their health care in the long run.

The main stakeholders in this objective have actively contributed to the development of the strategy and their commitment will be essential for its implementation.

## Financial Inclusion Broad Strategies



The Guide also includes specific action plans that focus on women. The aim is to create an enabling environment that will accelerate the financial inclusion of women.

The strategy sets out action plans for the coming years, across the following elements: access to financial services, development of financial products, product price adjustment, capacity building, institutional arrangements, financial literacy and consumer protection. It also includes the results of an in-depth analysis of the current situation in terms of financial inclusion, defines financial sector development objectives and establishes benchmarks based on best international practice.

### 4.3. Workshop on Risk-Based Approach to Prevent Money Laundering and Terrorism Financing

Taking into account the issues identified in the national risk assessments conducted in 2016, in particular the risks and vulnerabilities in controls of money laundering and terrorist financing in the financial sector, the BCTL, in collaboration with the World Bank Group, held a “workshop to introduce the Risk-Based Approach to Money Laundering and Combating Terrorist Financing risks for Banks, ODTIs and MTOs.

This workshop was held from 3 to 5 May 2017 and was financially supported by the Government of Canada.

The two-day workshop was attended by all commercial banks, ODTIs and MTOs that are licensed and currently operate in Timor-Leste. This workshop was attended by three speakers from the World Bank with a high level of knowledge in AML/CFT. At the end of the workshop, all participants received the respective certificate.

The objective of the workshop was to increase the capacity for identifying and assessing the ML/TF risks in Timor Leste in order to implement adequate corrective and risk mitigation measures, thereby helping to define and implement the Monitoring and Control Policies of the BCTL in this context.

The Workshop Program addressed the following sub-themes:

1. Introduction to the National Risk Assessment in this context;
2. Details of RBA Approach in terms of supervision, namely: Supervisory Tools and Alerts, KY Transactions, Funds Origins and Destinations, Transactions justifications, Customer behavior, KY Intermediaries, KY Agents, Threats to Terrorism Financing; and the Suspicious Transaction Report).
3. Implementation of the RBA Approach and specific supervisory measures, namely: Need for Management Involvement, definition of the role and functions of the Compliance Officer, AML/CFT Control Policies and Procedures, and development of internal control procedures for institutions.





#### 4.4. Central Bank Prize For Financial Inclusion Promotors

The Central Bank Prize was created in 2017 to highlight the Bank's appreciation for people who stand out in contributing to the development of the Financial Sector of Timor-Leste and for the promotion of Financial Inclusion in our Country.

During the BCTL 6th anniversary celebrations, the BCTL management team recognized the outstanding contribution of BNCTL Board Director Dr. Brigido de Sousa and BNU/CGD National Director Dr. Fernando Torrão Alves. The two Directors were distinguished by the fact that they have been leading financial inclusion projects in their organizations and have demonstrated a high degree of professional and personal commitment to the development of East Timor's financial sector.



#### Box 5. Signature of Memorandum of Understanding (MoU) with RAEOA

##### 5.1. MoU with RAEOA/ZEEMS for the Implementation of the Financial Literacy Program for Primary Schools

The beginning of the financial literacy program in RAEOA primary schools was preceded by the signing of the Memorandum of Understanding with the Oecusse-Ambeno Special Administrative Region Authority on February 17, 2017 in Oecusse. This MoU is valid for a period of 2 years with the possibility of being extended, ensuring that the financial literacy program will be taught as an extracurricular program. The MoU itself was signed by Governor Abraão de Vasconcelos and the President of RAEOA, Dr. Mari Bim Amude Alkatiri.



The objective of the Memorandum is to establish the framework for the joint implementation between the BCTL and RAEOA Authority of the financial literacy program for teachers in primary schools and joint evaluation, as well as the process of monitoring the implementation of the project in primary schools in RAEOA.



The scope of the Memorandum includes: collaboration in monitoring the implementation of the financial literacy program in primary schools in RAEOA; participation and collaboration with the project management team whenever necessary, collaboration in the evaluation of the project to be carried out by the BCTL team concerned with this program, offer support and mutual assistance in the financial literacy program, in particular if it is extended to teaching.

It also includes the possibility for BCTL to assist RAEOA in the preparation of project materials; the duty of the RAEOA Authority to encourage teachers to participate in the financial education program and, in the context of the implementation of the project in schools, to provide whatever resources are needed.

Finally, the scope of the Memorandum also describes that both BCTL and RAEOA should receive and evaluate the monthly reports submitted by teachers and cooperate to find funding solutions for project costs and, where appropriate, provide financial support to participating teachers.

In its initial period, only 2 teachers from 2 primary schools taught the financial literacy program in their schools. By the end of 2017, there were already 6 teachers in 4 RAEOA primary schools teaching the financial literacy program, namely: EBF 1 May Palaban, EBF 28 de Agosto, EBF Mahata and EBC Santo Antônio. The RAEOA Authority also expressed its support for expanding this program to cover all RAEOA primary schools.

## 5.2. MoU Signature with UNDP

During the year, the Central Bank of Timor-Leste and the United Nations Development Program (UNDP) signed a 3-month cost-sharing agreement on the implementation of the National Financial Inclusion Strategy's action plan.

The implementation covered the need for coordination of all relevant stakeholders to establish the National Coordination Committee (NCC) and a Technical Committee (TC) in Timor Leste (hereinafter referred to as the National Strategy for Financial Inclusion), as described in the National Strategy for Financial Inclusion.





The signing ceremony was ratified by the Governor of BCTL, Dr. Abraão de Vasconcelos and Mr. Claudio Providas, Director of UNDP and Resident Representative of UNDP.

This was the first cost sharing agreement signed by the BCTL, focused on the imperative need to promote financial inclusion in our country, which is considered one of the basic pillars supporting the country's macroeconomic and financial stability.

## Box 6. Meetings and Ceremonies

### 6.1. XVI Meeting of Human Resources of the Central Banks of Portuguese-Speaking Countries

The XVI Meeting of Human Resources of the Central Banks of Portuguese-Speaking Countries was held in Dili on September 12 and 13, 2017. It was attended by delegations from the Central Banks of Angola, Cape Verde, Mozambique, Portugal and Timor-Leste.

The main points discussed and shared at this meeting were the following:

1. Recent developments in the structure and activities of the Human Resources Departments;
2. Talent Management in Central Banks as a strategy for capturing, retaining and developing competencies and careers of the staff and raising performance and organizational excellence;
3. Role of training in the development of the skills of the employees, in the cohesion of the teams and in the Identity and culture of the Central Banks;
4. Improvement of the Management Profile and Leadership in Central Banks.

This is the second time that the BCTL has held a meeting of Portuguese Speaking Central Banks, the first being the 9th Statistical Meeting held in 2016.

## Insurance Sector

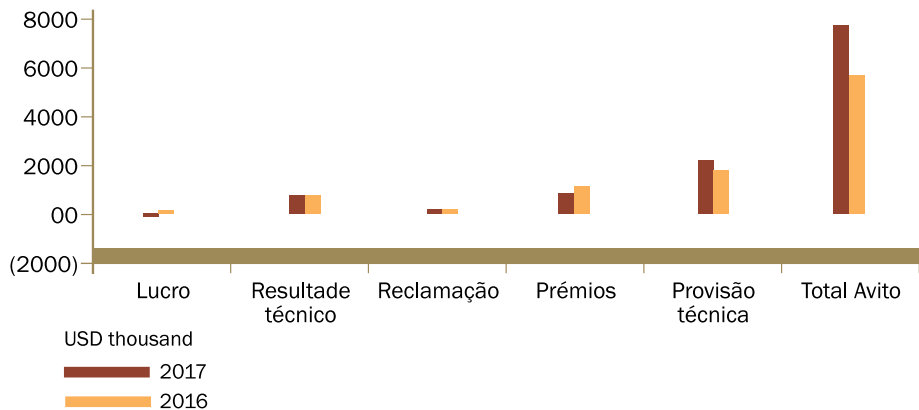
### Insurance Companies

In 2017, the insurance industry continued to rely on the existence of three insurance companies in East Timor: NITL-National Insurance of Timor-Leste, SinarMas (SMI) and Federal Insurance Timor (FIT) SA. With time, BCTL has gradually registered a progressive improvement of the range of services offered by the insurance companies in the country, the provision of general insurance for the various sectors of activity, with affordable rates and an adequate level of competition.

The total assets of the sector amounted to USD 7.5 million in December 2017, having increased by 32% compared to 2016. During the year 2017, total liabilities increased by 12%, amounting to USD 4.3 million at the end of the year. The sector's shareholders' equity value increased by 73% to USD 3.2 million.

Chart 3.5 illustrates the business performance of insurance companies in East Timor during the period.

**Chart 3.5. Insurance Sector Performance**



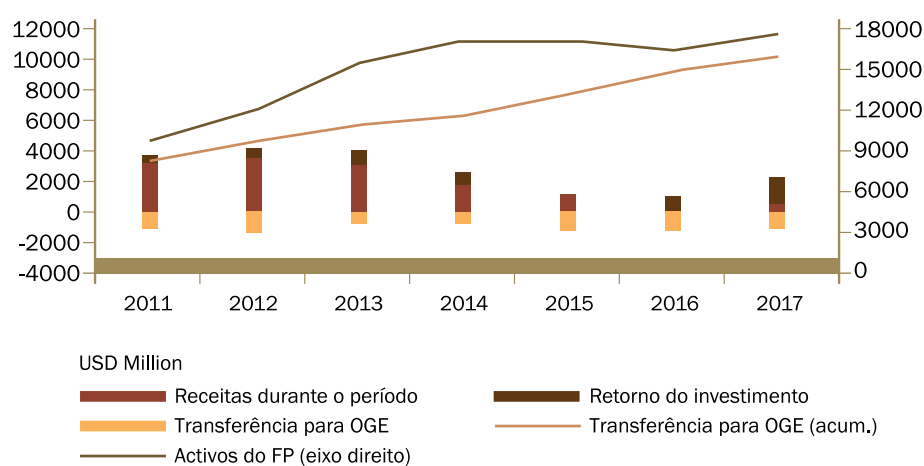
Source: BCTL



### 3.3.3. Petroleum Fund Management

In accordance with the framework defined in the Petroleum Fund Law, the Central Bank continues to be responsible for the operational management of the Fund. At the end of 2017, the capital of the Fund amounted to USD 16,799 million, an increase of around 6% over the previous year. Annual oil revenues - taxes and royalties - amounted to US \$ 422 million (US \$ 979 million and US \$ 224 million in 2015 and 2016, respectively). Additionally, projections for the financing of the General State Budget for 2017 were USD 1,079 million (1,244.8 million in 2016), recording a reduction of 13.3%. The management costs of the Fund, both external and internal, amounted to USD 13,421 million in 2017, a decrease of 8.2% over 2016.

**Chart 3.6**  
Petroleum Fund Assets and Flows



With regards to performance during the year, the Fund accumulated a gross income of USD 409 million, corresponding to 2.5% of the average value invested in the Fund in 2017 (EUR 16,564 million). The breakdown of these figures allows us to observe that the income from the receipt of interest and dividends totaled 0.5% of the average value of the Fund in 2017, while capital appreciation during the year amounted to 1.48% equivalent to a rise of 0.80% compared to 2016.

By adding up these two components, the Fund achieved a gross profitability of 2%, not counting the exchange effects. However, the slight depreciation of the US dollar in 2017 vis-à-vis the currencies in which part of the Fund's investments is denominated has resulted in an exchange rate gain of USD 78.1 million in 2017, or 0.2% of the value of the Fund, after a loss of 302 and 28.9 million dollars in 2015 and 2016 respectively. It should also be noted that the absolute income

level of the Fund in 2017 was USD 1.7 billion, the highest absolute value in the history of PF. This annual return was due to: exchange gains of USD 312.4 million and USD 983 million mainly due to the gains resulting from changes in the market prices of the Fund's securities.

In terms of relevant activities and developments in this area, it should be noted that the Fund continues to maintain the proposed strategic allocation by investing 40% of the Fund's total in equity markets.

The BCTL continued to work closely with the Ministry of Finance as well as with the Investment Advisory Board (IAB) to continually reassess and monitor the adequacy of the Fund's strategic allocation, within the framework defined by the framework of the Petroleum Fund. It should be noted that the BCTL actively participated in the discussions held at the IAB level regarding the expansion of the investment universe, increasing the degree of diversification and adopting new management policies to achieve the expected return of the Fund from 3% over a period of years.

By the end of the year, there were 4 managers of fixed-income securities investments remain, of which 3 are external managers - AllianceBernstein, Wellington Management, and the Bank for International Settlements (BIS) - and the internal manager, the BCTL itself. The managers of the equity investments are three international companies - Schroders Investment Management, State Street Global Advisors and BlackRock Investment Management - and the BCTL itself, which was approved to manage 1% of the PF assets invested in Australian equities.

The BCTL continued to invest in human resources training policies and to increase the technical and financial resources available to support and improve the direct management of the Fund in order to internalize a growing share of this management. The implementation of the technology platform, "Bloomberg Asset Investment Management" (Bloomberg AIM), in 2015, substantially strengthened BCTL's internal capabilities in asset management, particularly with the implementation of internal equity management in 2016. In the BCTL continued to bear the costs of continuing academic training of its staff and its participation in training modules and international seminars, organized by BCTL institutional partners.

### **3.3.4. Institutional Improvements**

During 2017 the BCTL continued to prioritize a comprehensive review of the Timor-Leste Banking Act (UNTAET Regulation No. 2000/8 on Banking Licensing and Supervision). This regulation was established and implemented at the beginning of the United Nations Administration in East Timor, and it is now time to review and update the diploma in order to create a modern basis for the development of the banking system over the coming decades.

The Master Plan for the Financial Sector also provides for BCTL to become actively involved in enhancing the protection of bank customers and improving customer relations in retail banking. The existing standards - Public Instruction no. 06/2010 and section 2.5 of Regulation no. 2000/8 - already define some basic requirements in this regard.

The BCTL Board of Directors awarded Ernst & Young Audit & Associates-SROC, S.A a contract to conduct the annual independent external audit of the BCTL.

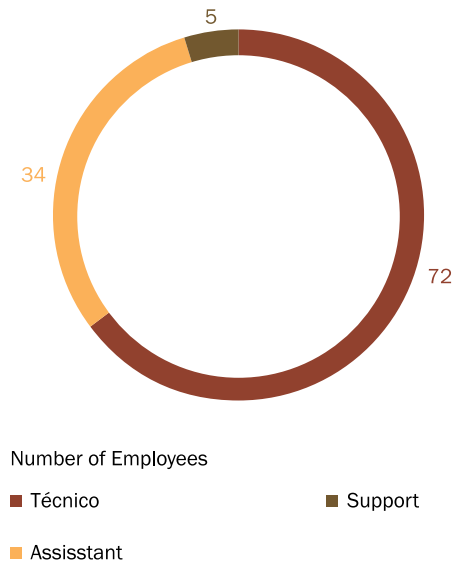
The BCTL was also able to complete the construction of its branch building in RAEOA. The construction was awarded to an East Timorese company based in Oe-Cusse. The BCTL expects that, with the existence of its building, its capacity to meet and respond to the needs and citizens of this region will be improved and, at the same time, to expand the number and type of activities carried out in the enclave.

### **3.3.5. Staff and Training Programs**

At the end of the reporting period, the BCTL had 88 employees. The planned recruitment plan for 2017 was carried out in February. Unfortunately the BCTL has not been able to fully achieve its goal in obtaining qualified staff to fill the staffing needs for key areas of the Bank. A candidate was also recruited to fill a position with the IT Department. The BCTL maintains its recruitment plan for the year 2018 and is expected to hire 20 additional employees for the professional careers of technicians and assistants.

The number of BCTL employees, including the employees to be recruited in 2018, distributed by professional categories, is shown in figure 3.7:

**Chart 3.7**  
Professional Categories

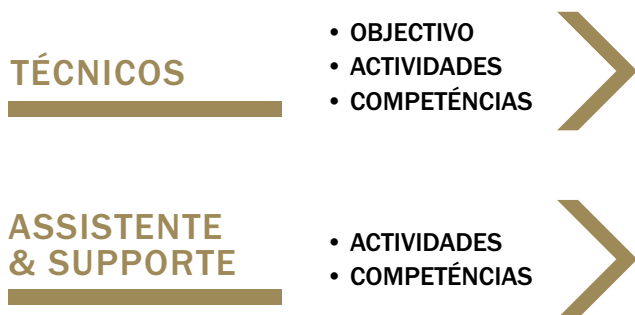


Source: BCTL

With respect to the Performance Evaluation system of BCTL employees throughout 2017, most employees were able to achieve the objectives set at the level of the institution and its departments and divisions.

The Performance Evaluation system is carried out by the various managers with the purpose of evaluating the work of their employees and analyzing their contributions to BCTL activity.

The dimensions used in the evaluation of the employees' performance remained unchanged from the previous year, as indicated in the following diagram, namely: Objectives, Activities and Skills for the employees of the Professional career of Technician and Activities and Skills for the employees of the careers.



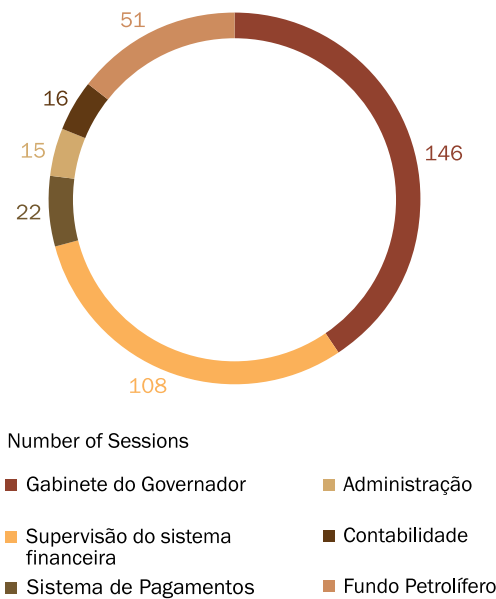
With regard to the development of the skills and knowledge of its employees, the BCTL continues to allocate an adequate amount annually for the fulfillment of its training program, which is spent on technical skills training given to its employees, both in Timor Leste and abroad.

In addition to training and study abroad, internal training in the BCTL continued to contribute to an improvement in the qualifications of employees. In 2017, BCTL's in-house training focused on enhancing the Leadership capabilities of the BCTL leadership.

BCTL employees also continued to participate in various training programs, conferences and seminars organized by other central banks and financial institutions. The BCTL expects its staff to continue to enjoy this kind of programs and training events.

Charts 3.8 and 3.9 detail information on the number of employees and days of participation in training, seminars and conferences throughout 2017.

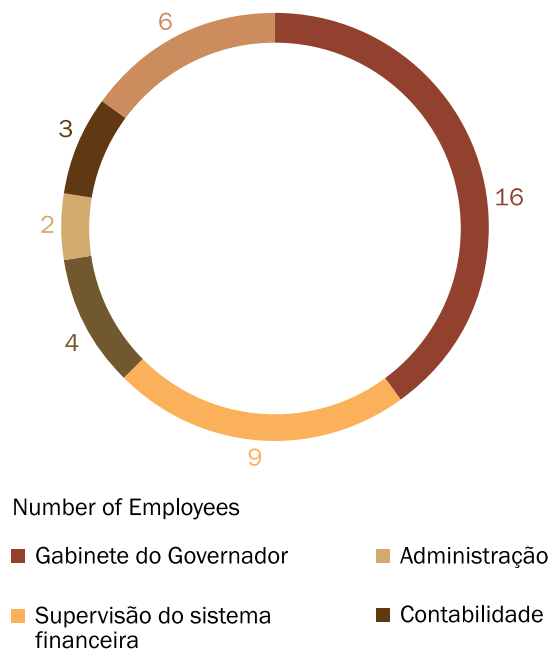
**Chart 3.8**  
Trainings and Workshops Sessions



Source: BCTL

**Chart 3.9**

**Employees Participating in Training Sessions**



### 3.3.6. International Relationships

The BCTL continues to hold discussions and establish agreements (Memoranda of Understanding) with entities with which it has partnerships or institutional relationships, such as JP Morgan, BlackRock, the Bank for International Settlements (BIS), Clifford Chance, KPMG, Credit Scheme Guarantee Berhad Malaysia, OJK Indonesia, Portugal's Insurance and Pension Supervision Authority (ASF), the Reserve Bank of Australia, the Australia Prudential Regulation Authority (APRA), Pusat Pelaporan dan Analisis Transaksi Keuangan (PPPTK) Yayasan Pendidikan Internal Audit in Jakarta and KPMG in Lisbon in order to strengthen the cooperation links with these entities and to provide training and internship programs as well as the provision of technical assistance to the BCTL.

The BCTL has continued to attach great importance to the deepening of its external relations, both as a form of asserting its role as the Central Bank of a newly independent country and as a means of ensuring support for the training of its staff through participation in training programs and placements, as well as the provision of technical assistance.

It is with this logic that continued good relations with institutions like Bank of Portugal, Bank Negara Malaysia, Reserve Bank of Australia, IMF Institute Singapore, Bank for International Settlements, OJK in Indonesia and Authority for Supervision of Insurance and Pension Funds in Portugal.

In addition, the BCTL continues to deepen its relations with commercial entities with whom it works, such as JP Morgan, Clifford Chance, KPMG, Deloitte, Malaysia Credit Guarantee Scheme, APRA PPTK, Yayasan Pendidikan Audit Jakarta and KPMG in Portugal, amongst other organizations.

## **Box 7. BCTL Action Plan for 2018**

BCTL plans to develop a wide range of initiatives in 2018, including the continued implementation of the Financial Development Master Plan and the National Payment System Plan. This chapter describes the various programs and initiatives planned by the BCTL for 2018.

### **Reformulate the Bank Accounting Framework in accordance with international standards (IAS/IFRS)**

The Central Bank considers that the current accounting framework used by commercial banks and other deposit institutions is not in accordance with the International Financial Reporting Standards (IAS/IFRS), so the BCTL will replace the current framework with requirements with accordance with IAS/IFRS. BCTL plans to hire a consultant for this purpose in 2018.

### **Introduction of the Credit Guarantee System in SME Financing**

The BCTL will introduce the first credit guarantee system in Timor-Leste to design the framework of the credit guarantee regime, specifically targeted at small and medium-sized enterprises (SMEs). The pilot project was started in 2015 and will be funded by the Government. In an initial phase, an amount of US \$10 million will be proposed for two schemes: the general guarantee for SMEs and guarantees for livestock. The government allocated an amount of US\$4 million for the project in OGE 2017. The Government approved the Credit Guarantee Scheme Law for Small and Medium Enterprises Act in July 2017. By fostering credit growth, the Central Bank will continue to implement the Small and Medium Enterprises (SMEs) training program in the area of basic accounting in 2018, covering about 100 entrepreneurs and organizing monitoring and evaluation for entrepreneurs who have already participated in the training. The BCTL also plans to extend this training program to include intermediate level technical content. The program will be implemented in cooperation with the Business Development Support Institute (IADE) and the Timor-Leste Chamber of Commerce and Industry (CCITL).

### **Implementation of the National Strategy for Financial Education**

Within the framework of the national financial development strategy and plan, the BCTL considers that the program to promote financial inclusion is a key element in achieving effective and sustainable development. The BCTL believes that education, or raising the level of financial literacy, will be one of the determining factors in extending the national provision of financial services to populations without access to banks in rural areas. In 2018, the Central Bank plans to continue the initiatives already implemented in 2016 and 2017 and, at the same time, to develop new activities in 2018, such as: training community and religious leaders to empower them as program enablers; organize an international conference with the aim of sharing the discussion of the best practice model in

this field; implement a pilot project called a “Smart Money” club at an university; and to conclude a qualitative and quantitative survey of the level of financial knowledge of the population at the national level.

The Central Bank will work in cooperation with the Ministry of Education in order to employ groups of teachers in basic education who already have the experience to administer and manage the teacher training program (ToT) through INFORDEPE, with the expansion of the financial education program to all municipal basic schools.

The BCTL will continue to carry out the roadshow in all municipalities, promoting a number of leisure and sports activities to increase public awareness of the benefits of the program “save now for a better future”.

### **Introduce an on-line Reporting System for FI and Install the off-site supervision system**

The BCTL intends to introduce an online reporting system for supervised financial institutions. An offsite surveillance system will also be implemented after completion of the system review process to facilitate the efficiency and comprehensiveness of the oversight process. The platform will substantially streamline the supervision process, allowing the automatic compilation of statistics and bank data. After a contract is concluded with the software supplier company for the off-site system, training will be carried out for all users of the tool and then the effective launch of the system, scheduled for the second quarter of 2018.

### **Implementation of the National Strategy for Financial Inclusion**

BCTL will establish a less administratively demanding legal basis for banking and insurance agents, in order to allow the expansion of communications networks in areas that cannot be accessed, thus promoting financial inclusion. It also intended to develop and implement initiatives that: lead to lower costs of providing financial services; encourage banks to offer financial products in areas not yet covered; to carry out a feasibility study on the introduction of basic savings accounts with appropriate costs for the development of micro-savings products; to adopt an appropriate legal framework and to establish the credit guarantee scheme in order to facilitate the access of small and medium-sized enterprises to financing; and establish the national council of SMEs.

### **Modernization of the National Payment System**

The implementation of the ATS system, R-TiMOR, was a great success for our financial system. The next phase of the project will be to update and review internal procedures in order to align and ensure the functioning of the system according to the rules already defined. The Central Bank will also introduce an adequate policy and clear and uniform administrative measures in order to facilitate the forecast of intra-daily liquidity and the optimization of bank liquidity used in the R-TiMOR system.



With the implementation of the “National Switch” for cards and mobile phones, BCTL-SIPA will prepare and introduce system management and operational rules, including the definition of fees and charges applicable to its users, in order to cover operational costs and investment in the infrastructure of said system.

### **Introduce the Lender of Last Resort Policy**

The BCTL, in accordance with the mandate in the Organic Law of the Central Bank, will develop a comprehensive legal framework that regulates and defines transparent and uniform rules regarding its role as lender of last resort, including the policies and agreements to be negotiated and contracted with Government and commercial banks.

### **The Study on the Adoption of a National Currency**

The BCTL continues to include in its strategic plan a project to develop an in-depth study on the possibility of introducing a national currency in East Timor, with the support of an external expert in this matter. The specialist should work closely with the BCTL Economics Division in the development of the study.

### **Economic Studies**

The BCTL will continue to carry out economic research projects and studies of issues related to the main functions of BCTL and the statistics published by the Bank.

### **Maintenance of the Bloomberg AIM Transaction**

The BCTL implemented in 2015 the technological trading platform - the “Bloomberg Asset Investment Management (Bloomberg AIM)” - which is intended to record, analyze and facilitate the overall management of BCTL’s financial assets. BCTL will maintain Bloomberg AIM as a trading platform to support the Bank’s investment activities.

### **Review of Strategic Investment Policies**

The Investment Advisory Board has decided to maintain the current investment policy and strategy of the Petroleum Fund. However, the Board will continue to review these guidelines annually, taking into account the developments on the financial markets. The BCTL will continue to allocate sufficient resources to support the annual review of this investment policy and strategy.

### **Implementation of the Multifactorial Strategy Mandate for the Stock Portfolio**

The PF Investment Advisory Board recommended the hiring of three external managers to implement a multi-factor strategy in the context of the management of investments in equity markets. The implementation will be gradual, starting first with only 1 manager. The implementation will be subject to the confirmation by the managers of certain operational matters, mainly related to the control of the sectorial and country risk, in the scope of the management of this type of investment. In anticipation of a favorable response from managers, the implementation of the multi-factor strategy should effectively start in 2018.

### **Establish the Central Bank Pension Fund**

The study on the establishment of the Pension Fund was completed by the Review Committee in 2016, which assessed the merits and disadvantages of the relevant options. In accordance with its opinion, the BCTL will establish and implement a Pension Fund for its employees in 2018.

### **Continuing the Fellowship Program**

BCTL will continue to facilitate the scholarship program to its employees by 2018, including at the PhD level.

### **Implementation of the New BCTL Organization Chart**

BCTL will introduce a new structure of the organization in 2018, which will take into account recent institutional developments and increased BCTL responsibilities.

## **Banco Central de Timor-Leste (BCTL) Key Management Bodies**

### **Board of Directors**

#### Governor

Abraão de Vasconcelos

#### Deputy Governor

Nur Aini Djafar Alkatiri

#### Deputy Governor

Venâncio Alves Maria

#### Non-Executive Members

Maria Madalena Brites Boavida

Aicha B.U. Bassarewan

Francisco da Costa Guterres

Note: In 2017, the Prime Minister approved the appointment of new Deputy Governor, Venâncio Alves Maria, to succeed Ms. Sara Lobo Brites. At the same time, another member (non-executive) of the Board of Directors, Mr. Aurélio Guterres, resigned to become Minister of Foreign Affairs.

### **Executive Management Committee**

The BCTL Management Committee includes senior management responsible for the main organizational areas of the Bank. They are:

Governor, Abraão de Vasconcelos

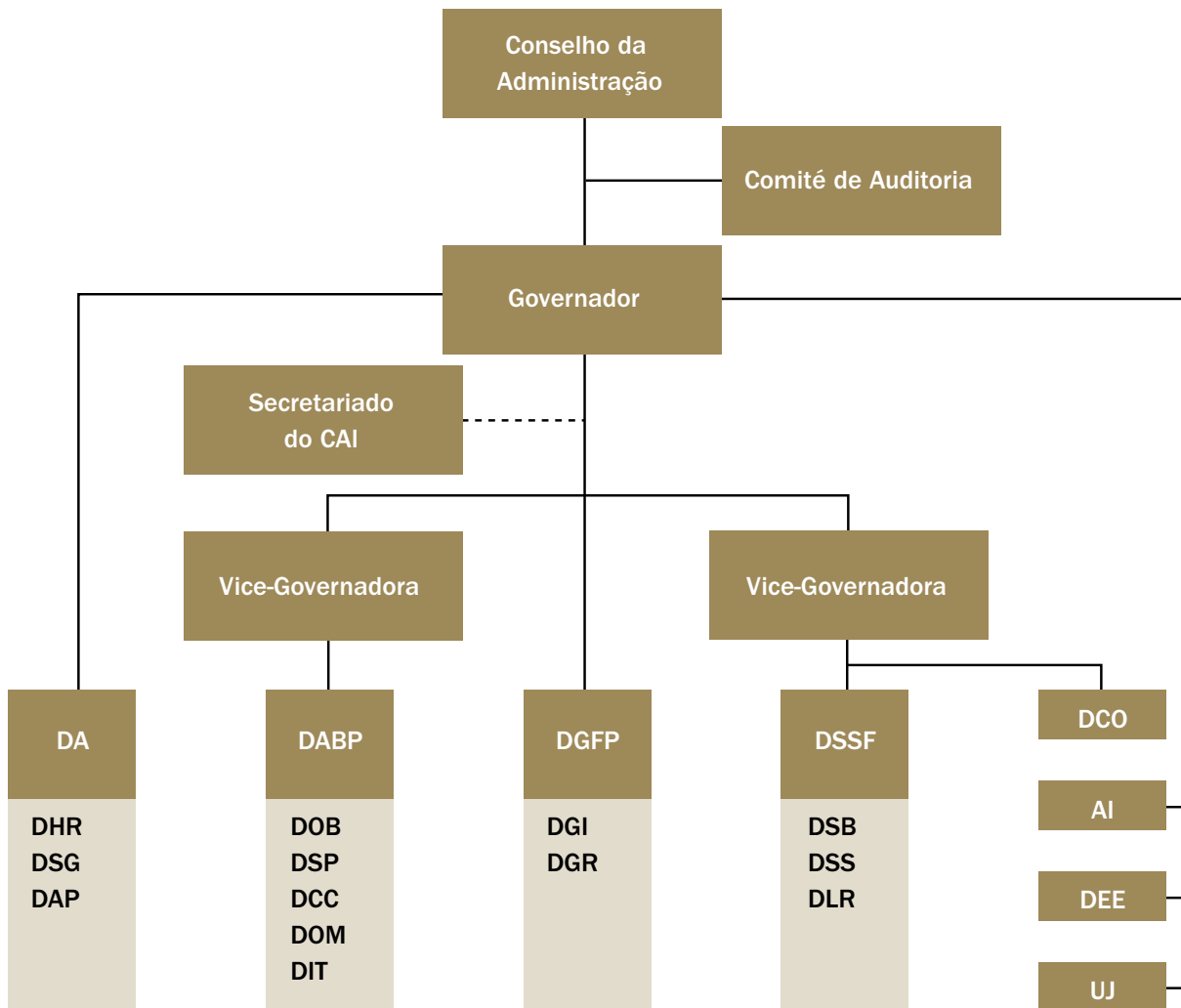
Deputy Governor, Nur Aini Djafar Alkatiri

Deputy Governor, Venâncio Alves Maria

Head of Accounting Department, Fernando de Carvalho

Head of Administration Department, Raquel Gonçalves

## BCTL Internal Organization, 31st December 2017



### Legenda:

CAI	Comité de Assessoria para o Investimento	DGFP	Departamento da Gestão do Fundo Petrolífero
DA	Departamento de Administração	DGI	Divisão de Gestão de Investimento
DRH	Divisão de Recursos Humanos	DGR	Divisão de Gestão de Risco
DSG	Divisão de Serviços Gerais	DSSF	Departamento de Supervisão do Sistema Financeiro
DAP	Divisão de Aprovisionamento	DSB	Divisão de Supervisão Bancária
DSBP	Departamento do Sistema Bancário e Sistemas de Pagamento	DSS	Divisão de Supervisão de Seguros
DOB	Divisão de Operações Bancárias	DLR	Divisão de Licenciamento e Regulamentação
DSP	Divisão de Sistemas Pagamento	DCO	Divisão de Contabilidade e Orçamento
DCC	Divisão de Câmara de Compensação	AI	Auditoria Interna
DOM	Divisão de Operação de Moeda	DEE	Divisão de Economia e Estatística
DIT	Divisão de Sistemas de Informação	UJ	Unidade Jurídica

# Financial Statements

For the period ended 31 December 2017

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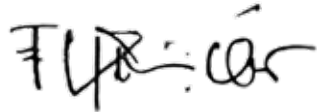


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## Statement of Compliance

The Financial Statements on pages 2 to 5 and the Notes from pages 6 to 31 which form an integral part of these statements have been prepared by the Management and approved by the Governing Board of Banco Central de Timor-Leste. I declare that these Financial Statements comply with the requirements of Central Bank Law no 5/2011 and fairly present the true financial position and performance of Banco Central de Timor-Leste as at 31 December 2017.



**Abraão de Vasconcelos, Governor**

Dili, 27 April 2018



## Statement of Financial Position as at 31 December 2017

	Note	2017 US\$ '000	2016 US\$ '000
<b>Assets</b>			
Cash and cash equivalents	7	547.150	361.429
Investments	10	35.103	34.689
Property, plant and equipments	11	2.212	1.837
Other assets	12	5.405	5.203
<b>Total Assets</b>		<b>589.870</b>	<b>403.158</b>
<b>Liabilities</b>			
Government deposits	13	287.761	212.311
Other deposits	14	193.919	111.379
Provision for transfer of surplus to Government	17	-	698
Other Liabilities	15	28.446	8.499
Currency issued		15.872	14.509
<b>Total Liabilities</b>		<b>525.998</b>	<b>347.396</b>
Capital	16	60.000	55.000
Reserve		762	762
Net profit		3.110	-
<b>Total Equity</b>		<b>63.872</b>	<b>55.762</b>
<b>Total liabilities and Equity</b>		<b>589.870</b>	<b>403.158</b>

# Statement of Profit or Loss and Other Comprehensive Income

For the period ended 31 December 2017

	Note	2017 US\$ '000	2016 US\$ '000
<b>Operating income</b>			
Investment income			
Interest income	19	2.556	1.454
Interest expense	19	(84)	(34)
<b>Net investment income</b>		<b>2.472</b>	<b>1.420</b>
Petroleum fund management fee	21	14.463	13.329
Petroleum fund administration expenses	21	(9.018)	(8.380)
<b>Net fee and commission income</b>		<b>5.445</b>	<b>4.949</b>
Fees and commissions	20	706	684
Other Income		115	126
<b>Total Operating Income</b>		<b>8.738</b>	<b>7.179</b>
<b>Expenses</b>			
Personnel expenses	22,25	1.925	1.818
Currency distribution expenses		846	1.007
Administration expenses	23	2.376	2.806
Depreciation	11	481	850
<b>Total Expenses</b>		<b>5.628</b>	<b>6.481</b>
<b>Profit</b>		<b>3.110</b>	<b>698</b>
Other comprehensive income		-	-
<b>Total profit and other comprehensive income</b>		<b>3.110</b>	<b>698</b>

# Statement for Changes in Equity

For the period ended 31 December 2017

	Note	2017 US\$ '000	2016 US\$ '000
<b>Capital</b>			
Opening balance	17	55.000	50.000
Increase in capital	17	5.000	5.000
<b>Closing balance</b>	17	<b>60.000</b>	<b>55.000</b>
<b>Reserve</b>			
Opening balance		762	762
Total profit and other comprehensive income		3.110	698
Transfer of surplus to Government		-	(698)
<b>Closing balance</b>		<b>3.872</b>	<b>762</b>
<b>Total Equity</b>		<b>63.872</b>	<b>55.762</b>

# Statement of Cash Flows

For the period ended 31 December 2017

	2017 US\$ '000	2016 US\$ '000
<b>Cash flows from the operating activities</b>		
Profit for the period	3.110	698
Depreciation	481	850
Net Interest income	(2.472)	(1.420)
<b>Total</b>	<b>1.119</b>	<b>128</b>
Changes in receivables, prepayments & stock	(202)	(554)
Changes in government deposits	75.450	(110.730)
Changes in other deposits	82.540	(28.675)
Changes in other liabilities	19.947	2.726
	<b>178.854</b>	<b>(137.105)</b>
Interest received	2.556	1.454
Interest paid	(84)	(34)
<b>Net cash from operating activities</b>	<b>(181.326)</b>	<b>(135.685)</b>
<b>Cash flows from investing activities</b>		
Acquisitions of investments	(413)	(10.766)
Acquisitions of property, plant & equipment	(855)	(198)
<b>Net cash from investing activities</b>	<b>(1.268)</b>	<b>(10.964)</b>
<b>Cash flows from financing activities</b>		
Currency issued	1.363	2.357
Capital subscription by government	5.000	5.000
Transfer of surplus to Government	(700)	(730)
<b>Net cash from financing activities</b>	<b>5.663</b>	<b>6.627</b>
<b>Increase in cash &amp; cash equivalents</b>	<b>185.721</b>	<b>(140.022)</b>
Cash & cash equivalents at the beginning of year	361.429	501.451
<b>Cash &amp; cash equivalents at the end of year</b>	<b>547.150</b>	<b>361.429</b>

# Notes to the Financial Statements

## 1. 1. Reporting Entity and Statutory Base

These are the financial statements of Banco Central de Timor-Leste (“the Bank” or BCTL), a distinct autonomous public legal entity established by Organic Law number 5/2011 on the Central Bank of Timor-Leste. The head office of Banco Central de Timor-Leste is at Avenida Xavier do Amaral, n.º 9, P.O. Box 59, Díli, Timor-Leste. The financial statements of the Bank are for the financial year ended 31 December 2017 and, in accordance with section 58 of the Organic Law no 5/2011, the accounts and records are maintained in accordance with International Financial Reporting Standards.

The primary objective of the Bank is to achieve and maintain domestic price stability. The other objectives of the Bank are to foster the liquidity and solvency of a stable market-based banking and financial system, to execute the foreign exchange policy of Timor-Leste, and to promote a safe, sound, and efficient payment system.

The Bank’s role is to function as the central bank of Timor-Leste. The role of the Bank is defined in the organic Law 5/2011 and other laws, and includes the following functions:

- to recommend broad policy guidelines to the government in areas under the Bank’s responsibility;
- to issue coins called centavos, that have legal tender status in addition to the United States dollar;
- to formulate and implement measures for, and supervise and regulate, payments and settlement systems for transactions in domestic and foreign currency in Timor-Leste;
- to own, operate, or participate in one or more payment systems;
- to act as banker to the government and related agencies;
- to act as fiscal agent of the government and related agencies;
- to hold and manage all public financial resources, including the official foreign exchange reserves;
- to undertake the operational management of the Petroleum Fund of Timor-Leste;
- to hold foreign currency deposits of Commercial Banks;
- to ensure an adequate supply of banknotes and coins for the settlement of cash transactions;
- to maintain a depository for safe keeping of currency and securities;
- to license, supervise, and regulate commercial banks;
- to license, supervise and regulate currency exchange activities;
- to license, supervise and regulate insurance companies and intermediaries; and
- to conduct regular economic and monetary analysis of the Timor-Leste economy, make public the results, and submit proposals and measures to the government on the basis of such analysis.

## 2. Basis of Preparation

### **a) Statement of compliance**

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by International Accounting Standard Board (IASB).

The financial statements were authorised for issue by the Governing Board on 27 April 2018.

### **b) Basis of Measurement**

The financial statements have been prepared on the historical cost basis except for certain investment securities which are measured at fair value.

### **c) Adoption of International Financial Reporting Standards**

These financial statements incorporate all International Financial Reporting Standards in force at 31 December 2017. No standards have been adopted before the effective date.

### **d) Functional and Presentation Currency**

The financial statements are presented in United States dollars, being the official currency of Timor-Leste and the Bank's functional and presentation currency. Financial information is presented in US dollars rounded to the nearest thousand dollars, unless otherwise stated. This may result in minor differences between accounts reported in the Income statement, Balance sheet and detailed supporting notes.

### **e) Use of Estimates and Judgements**

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 3.

### **f) Comparative amounts opening balances**

To ensure consistency with the current year, comparative figures have been restated where appropriate. Certain presentational changes have been made in the financial statements.

### 3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

#### a) Foreign currency transactions

Transactions in foreign currencies are translated into United States dollars at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated at balance date into United States dollars at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. The following United States dollar exchange rates have been used to convert foreign currency assets and liabilities to United States dollars for reporting purposes.

	31 DEC 2017	31 DEC 2016
Australian dollars (AUD)	1.2840	1.3810
Special Drawing Rights (SDR)	0.7439	0.7438
Euro (EUR)	0.8372	0.9458

#### b) Interest Rate Method

Interest income and expense are recognised in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses.

The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability. Interest income and expense presented in the profit and loss statement include:

- Interest on financial assets and liabilities at amortised cost on using effective interest rate basis

**c) Fees**

Fee income, including account service fees, cash distribution, and investment management fees, are recognised as the related services are performed. Fee income from government is recognised upon appropriation by parliament, and amortised over the period during which the services are provided.

Fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

**d) Operating Profit**

Operating profit comprises gains net of losses related to trading assets and liabilities, and includes all realised and unrealised fair value change.

**e) Taxation**

The Bank is exempt from taxes on its income under the provisions of Article 72, Organic Law no. 5/2011.

**f) Financial Assets and Liabilities****i) Recognition**

The Bank recognises loans, advances and deposits on the date at which they are originated. All other financial assets are initially recognised on the settlement date at which payment is made and title received according to market contractual arrangements.

A financial asset or financial liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

The Bank enters into transactions whereby it acquires assets but does not acquire all the risks and rewards of the assets or a portion of them. Such assets, including assets acquired in connection with the Bank's management of the Petroleum Fund, are not recognised on the balance sheet.

**ii) Classification**

See accounting policies 3 (g), and (h).



**iii) De-recognition**

Any interest in such transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability. On de-recognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

**iv) Offsetting**

Financial assets and liabilities are set off and the net amount presented in the balance sheet when, and only when, the Bank has a legal right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

**v) Amortised cost measurement**

The amortised cost of a financial asset is the amount at which the financial asset is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

**vi) Fair value measurement**

The determination of fair values of financial assets is based on quoted market prices for financial instruments traded in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

#### vii) Identification and measurement of impairment

At each balance date the Bank assesses whether or not there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows from the asset that can be estimated reliably.

The Bank considers evidence of impairment for held-to-maturity investment securities at both a specific asset and collective level. All individually significant held-to-maturity investment securities are assessed for specific impairment. All individually significant held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Held-to-maturity investment securities that are not individually significant are then collectively assessed for impairment by grouping together held-to-maturity investment securities with similar risk characteristics.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised directly in equity to profit or loss. The cumulative loss that is removed from equity and recognised in profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

#### g) Cash and Cash Equivalents

Cash and cash equivalents includes notes and coins on hand, unrestricted balances held with other banks, which are subject to an insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments, including the maintenance of a supply of United States currency to ensure an adequate supply of banknotes and coins for the settlement of cash transactions in Timor-Leste.

Cash and cash equivalents are carried at amortised cost in the balance sheet, which approximates fair value.

#### **h) Investment Securities**

Investment securities are initially measured at fair value plus incremental direct transaction costs and subsequently accounted for depending on their classification as either held to maturity, fair value through profit or loss, or available-for-sale.

As at 31 December 2017, the Bank does not have investment securities.

#### **i) Held-to-Maturity**

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has a positive intent and ability to hold to maturity, and which are not designated at fair value through profit or loss, or available-for-sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method.

#### **ii) Fair value through profit or loss**

Fair value through profit or loss investments are assets designated at fair value through profit or loss when:

- The assets are managed, evaluated and reported internally on a fair value basis; or
- The designation eliminates or significantly reduces an accounting mismatch that would otherwise result; or
- The assets contain an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract

Fair value changes of this class of investments are recognised in profit and loss.

#### **i) Reverse-Repurchase Transactions**

The Bank enters into overnight reverse-repurchase agreements in the course of its cash management activities. These transactions are recognised in the balance sheet as cash and cash equivalents, and income is recognised in profit and loss on the transaction date.

#### **j) Other Assets and Liabilities**

Local and foreign currency cash, deposits, accounts receivable and payable, are valued at the transaction date, inclusive of any accrued interest.

Accounts receivable are recorded at expected realisable value after making due allowance for doubtful debts.

Unissued currency stocks are recorded as inventory at the cost of acquisition and expensed when issued. They are recorded at the lower of cost or net realisable value. Cost is determined on a weighted average basis.

#### **k) Property, Plant and Equipment**

##### **i) Recognition and measurement**

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are reasonably attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

The land and head office occupied by the Bank is recognised at the cost of acquisition in 2000 at nil value. The Bank still carries these assets at zero value pending the establishment of a fair value at a future time when the land and property market in Timor-Leste operates on a sound legal basis and objective valuations can be derived from observable property market transactions.

##### **ii) Subsequent Costs**

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The carrying amount of replaced part is derecognised. The costs of day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

### iii. Depreciation

Depreciation is recognised in profit and loss on a straight line basis over the estimated useful lives of each part of an item of property, plant and equipment.

The Bank categorises its assets into broad groups and depreciates them according to indicative useful lives as follows:

	2017	2016
Buildings and improvements	20 years	20 years
Plant	5 years	5 years
Office equipment	8 years	8 years
Computers and electronic equipment	4 years	4 years
Vehicles	5 years	5 years

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

### iv) Impairment

The carrying amounts of the Bank's fixed assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in profit and loss.

### I) Currency in circulation

Currency issued by the Bank in the form of centavos coins (which are legally a sub-unit of the United States dollar in Timor-Leste) represents a claim on the Bank in favour of the holder. The liability for the value of currency in circulation is recorded at face value on the balance sheet.

The Bank also issues collectors' currency. Although it is unlikely that significant amounts of collectors' currency will be returned for redemption, the Bank records the face value of the collectors' currency sold with currency in circulation.

#### **m) Employee benefits**

##### **i) Short term employee benefits**

A short term benefits include the full amount of all staff benefits, including salaries and accrued leave. Accruals of personnel costs are recorded in the balance sheet under other liabilities.

Short-term employee benefit obligations are expensed as the related service is provided. A liability is recognised for the amount expected to be paid if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be measured reliably.

##### **ii) Long-term employee benefits**

There is no pension scheme for employees of the Bank.

#### **n) Changes in accounting policies**

##### **i) Voluntary changes in accounting policies**

During the year there were no voluntary changes in accounting policies from the ones used in the preparation of the previous year's financial statements presented as comparative information.

##### **ii) New standards and interpretations applicable in the year**

There was no significant impact on the accounting policies and disclosures from the adoption by the Bank of new standards, revisions, amendments and improvements to standards and interpretations which were applicable as from 1 January 2017.

##### **iii) New standards and interpretations issued but not yet effective.**

The bank does not anticipate significant impacts with the adoption of the standards and interpretations recently issued by the IASB, which application is mandatory solely for annual periods beginning on or after 1 January 2018.

## **4. Financial Risk Management**

### **a) Introduction and Overview**

The Banco Central de Timor-Leste has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risks
- Operational risks

This note presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and procedures for measuring and managing risk, and the Bank's management of capital.

#### **b) Risk Management Framework**

The Governing Board has overall responsibility for the establishment and oversight of the Bank's risk management framework.

The Governing Board is guided by the Bank's establishing law (Organic Law 5/2011), which sets broad risk management guidelines, including the following:

- Article 19 states that the Bank may hold in its investment portfolio any or all the following foreign assets: Gold and other precious metals held by or for the account of the Bank, including credit balances on account representing such gold and other precious metals; Banknotes and coins denominated in freely convertible foreign currencies held by or for the account of the Bank; Credit balances and interbank deposits that are payable on demand or within a short term denominated in freely convertible foreign currencies and are held in the accounts of the Bank, on the books of foreign central banks, or international financial institutions; Readily-marketable debt securities denominated in freely convertible foreign currencies issued by, or backed by foreign governments, foreign central banks or international financial institutions; Claims on international financial institutions resulting from repurchase agreements, sale and buy back and securities lending agreements for the foresaid debt securities; Special drawing rights held in the account of Timor-Leste in the International Monetary Fund; The reserve position of Timor-Leste in the International Monetary Fund.
- Article 71.1 prohibits the Bank from granting credit, engaging in commerce, purchasing the shares of any corporation or company including the shares of any Financial Institution, or otherwise have an ownership interest in any financial, commercial, agricultural, industrial, or other undertaking or acquire by purchase, lease, or otherwise any real rights in or to immovable property, except as it shall consider necessary or expedient for the provision of premises for the conduct of its administration and operations.
- Article 39 authorises the Bank to manage special fund owned by the state on the basis of management contract and maintain earmarked receipts on its books special accounts provided that the assets and liabilities shall be segregated from the other assets and liabilities of the Bank.

The Bank has established an Internal Audit Office, whose duties are to undertake both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Governor, and, at the discretion of the Chief Internal Auditor, the Governing Board.

### c) Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally in connection with the Bank's investment and banking activities. Regular audits of the divisions responsible for the investment of funds are undertaken by Internal Audit.

The Bank's exposure to credit risk, based on the ratings issued by S&P Rating, is as follows:

US\$ '000	Rating*	Dec 2017	Rating*	Dec 2016
<b>Cash and cash equivalents</b>				
Cash	AAA	50.858	AAA	35.840
Deposits at central banks	AAA	479.487	AAA	230.042
Resident banks	BB-	13.039	B	90.982
Non-resident banks	A-	3.766	AA-	4.565
		547.150		361.429
				-
<b>Investments</b>				
International Monetary Fund - "SDR"	N/A	35.103	N/A	34.689
<b>Total Assets</b>		<b>582.253</b>		<b>396.118</b>
<b>Summary by credit rating</b>				
		Dec 2017	Dec 2017	Dec 2016
AAA		91,09%	530.345	67,12%
A-		0,65%	3.766	1,15%
B		2,24%	13.039	22,97%
Not applicable		6,03%	35.103	8,76%
<b>Total Assets</b>		<b>100,00%</b>	<b>582.253</b>	<b>100,00%</b>
			<b>396.118</b>	

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

There were no impairment losses at balance date.

The carrying amount of these assets approximates their fair value.



#### d) Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities. Liquidity risk is also the risk that the Bank will have to sell a financial asset quickly at much less than its fair value.

The Bank is responsible for managing the daily liquidity of the banking system. This role includes the management of the clearing system. The Bank is prohibited by statute from advancing funds to the banking system.

The Bank's approach to managing liquidity risk is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The investment management function considers the cash flows historically observed in the deposit accounts of both the government and the commercial banks. From this information, decisions are made that determine the size of the physical cash holdings held in Timor-Leste, the amount of cash to be maintained in correspondent bank accounts, and the nature of the investments to be made in short-term United States Treasury Bills, for which a deep and liquid market exists, such that there will always be bills close to maturity that may be sold if necessary without incurring the risk of suffering a material market loss.

The following are the remaining contractual maturities of financial liabilities at the reporting date. The amounts are gross and undiscounted, and include contractual interest payments and exclude the impact of netting arrangements.

US\$ '000	Total 2017	6 month or less	over 6 months
Cash and cash equivalents	547.150	547.150	-
<b>Total assets (Excluding PPE)</b>	<b>547.150</b>	<b>547.150</b>	-
Government deposits	287.761	287.761	-
Other deposits	193.919	158.882	35.087
Provision for transfer of surplus to Government	-	-	-
Other liabilities	28.446	28.446	-
Currency issued	15.872	15.872	-
<b>Total liabilities</b>	<b>525.998</b>	<b>490.911</b>	<b>35.087</b>

US\$ '000	Total 2016	6 month or less	over 6 months
Cash and cash equivalents	361.429	361.429	-
<b>Total assets (Excluding PPE)</b>	<b>361.429</b>	<b>361.429</b>	-
Government deposits	212.311	212.311	-
Other deposits	111.379	76.690	34.689
Provision for transfer of surplus to Government	698	698	-
Other liabilities	8.499	8.499	-
Currency issued	14.509	14.509	-
<b>Total liabilities</b>	<b>347.396</b>	<b>312.707</b>	<b>34.689</b>

#### **e) Market Risk**

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's/issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Bank's approach to the management of market risks is strongly guided by its legislative framework that requires investments to be in high quality financial instruments.

The Bank measures and manages its exposure to market risk in terms of interest rate risk and foreign currency risk, and information on these two risks is provided in the following sections.

#### **i) Interest Rate Risk**

Interest rate risk is the risk of loss arising from changes in interest rates. The Bank's management of interest rate risk is partially governed by the legal framework outlined above, and partly by a management policy of closely matching the re-pricing periods of its assets and liabilities.

The assets and liabilities of the Bank will mature or re-price within the following periods:

US\$ '000	Total 2017	Non-Interest Sensitive	6 month or less
Cash and cash equivalents	547.150	-	547.150
Investments	35.103	35.103	-
Other assets	5.405	5.405	-
<b>Total assets (Excluding PPE)</b>	<b>587.658</b>	<b>40.508</b>	<b>547.150</b>
Government deposits	287.761	-	287.761
Other deposits	193.919	35.087	158.832
Provision for transfer of surplus to Government	-	-	-
Other liabilities	28.446	28.446	-
Currency issued	15.872	15.872	-
<b>Total liabilities</b>	<b>525.998</b>	<b>79.405</b>	<b>446.593</b>
<b>Interest Rate Sensitivity Gap</b>	<b>61.660</b>	<b>(38.897)</b>	<b>100.557</b>

US\$ '000	Total 2016	Non-Interest Sensitive	6 month or less
Cash and cash equivalents	361.429	-	361.429
Investments	34.689	34.689	-
Other assets	5.203	5.203	-
<b>Total assets (Excluding PPE)</b>	<b>401.321</b>	<b>39.892</b>	<b>361.429</b>
Government deposits	212.311	-	212.311
Other deposits	111.379	34.689	76.690
Provision for transfer of surplus to Government	698	698	-
Other liabilities	8.499	8.499	-
Currency issued	14.509	14.509	-
<b>Total liabilities</b>	<b>347.396</b>	<b>58.395</b>	<b>289.001</b>
<b>Interest Rate Sensitivity Gap</b>	<b>53.925</b>	<b>(18.503)</b>	<b>72.428</b>

ii) **Sensitivity Analysis – Interest risk**

In managing interest rate risk the Bank aims to reduce the impact of short-term fluctuations on its net income. At 31 December 2017, it is estimated that a general increase/decrease of one percentage point in interest rates would increase/decrease the Bank's profit by approximately \$515 thousand (2016 - \$40 thousand).

iii) **Foreign Currency Risk**

Foreign currency risk is the risk of loss arising from changes in exchange rates. The management of the Bank maintains a low exposure to foreign currencies, which are maintained at levels sufficient to meet operational settlement obligations. The Bank does not engage in foreign currency intervention activities.

As at 31 December 2017, the Bank's net exposure to major currencies was as follows:

US\$ '000	Total 2017	US Dollars	Australian Dollars	SDR	Euro
Cash and cash equivalents	547.150	547.048	60	35.103	42
Investments	35.103	-	-	-	-
Other assets	5.405	5.405	-	<b>35.103</b>	-
<b>Total assets (Excluding PPE)</b>	<b>587.658</b>	<b>552.453</b>	<b>60</b>	<b>35.103</b>	<b>42</b>
Government deposits	287.761	287.761	-	35.087	-
Other deposits	193.919	158.832	-	-	-
Provision for transfer of surplus to Government	-	-	-	-	-
Other liabilities	28.446	28.446	-	-	-
Currency issued	15.998	15.872	-	<b>35.087</b>	-
<b>Total liabilities</b>	<b>525.998</b>	<b>490.911</b>	<b>-</b>	<b>35.087</b>	<b>-</b>
<b>Net Foreign Currency Exposure</b>	<b>61.660</b>	<b>61.542</b>	<b>244</b>	<b>16</b>	<b>42</b>

US\$ '000	Total 2016	US Dollars	Australian Dollars	SDR	Euro
Cash and cash equivalents	361.429	361.122	244	34.689	63
Investments	34.689	-	-	-	-
Other assets	5.203	5.203	-	<b>34.689</b>	-
<b>Total assets (Excluding PPE)</b>	<b>401.321</b>	<b>366.325</b>	<b>244</b>		<b>63</b>
Government deposits	212.311	212.311	-	34.689	-
Other deposits	111.379	76.690	-	-	-
Provision for transfer of surplus to				-	
Government	698	698	-	-	-
Other liabilities	8.499	8.499	-	-	-
Currency issued	14.509	14.509	-	<b>34.689</b>	-
<b>Total liabilities</b>	<b>347.396</b>	<b>312.707</b>	-		-
<b>Net Foreign Currency Exposure</b>	<b>53.925</b>	<b>53.618</b>	<b>244</b>		<b>63</b>

#### iv) Sensitivity analysis - Currency exchange risk

In managing currency exchange risk, the Bank only hold small net positions in foreign currency and therefore it's not materially exposed to changes in foreign exchange rate.

#### f) Operational Risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal requirements or adverse events in the community at large. Operational risks arise from all the Bank's operations and are faced by all business entities.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity. The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management in each business area. This responsibility is supported by the development of standards for the management of operational risk in the following areas:

- Requirements for the appropriate segregation of duties, including independent authorisation of transactions;
- Requirements for the timely reconciliation and monitoring of transactions;
- Compliance with regulatory and other legal requirements;

- Written documentation of all major operating procedures;
- Requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- Requirements for the reporting of operational losses and development of proposed remedial actions;
- Development of contingency plans;
- Ongoing capacity building and professional development;
- Establishment of ethical standards of behaviour; and
- Risk mitigation, including insurance for high risk operations.

Compliance with these standards is supported by a programme of risk-based periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business area in which they relate, with all findings submitted monthly to the Governor, and a summary of work undertaken submitted quarterly to the Governing Board.

#### **g) Capital Management**

The management of the capital of the Bank is subject to organic Law No 5/2011 on the Banco Central de Timor-Leste. In particular, the following requirements are stipulated in the law:

- The capital of the Bank must at least be \$55,000,000, fully subscribed and paid-up. Following the subscription of an additional \$5,000,000 in 2017, the capital may not be reduced below \$60,000,000.
- A general reserve account may be established to hold the paid-up capital up to the difference between ten percent of the total financial assets of the Bank.
- The capital of the Bank may not be transferable or subject to encumbrance of any kind.

There have been no material changes in the Bank's management of capital during the period.

The allocation of capital between specific operations and activities is, to a large extent, driven by the need to provide liquidity to the financial and economic systems of Timor-Leste. Accordingly, a significant proportion of capital is allocated to maintaining physical holdings of currency in Timor-Leste, which earn no interest, and cash balances in current accounts at correspondent banks.

## 5. Critical Accounting Judgements in applying the Bank's Accounting Policies

Critical accounting judgements made in applying the Bank's accounting policies include:

- Although article 39 of the Organic Law no. 5/2011 states that the Bank is authorised to manage and maintain special funds on its books, the assets and liabilities of which shall be segregated from the other assets and liabilities of the Bank, the management of the Bank, having taken advice concerning the provisions of the Petroleum Fund Law and IFRS, has determined that the liabilities and assets of the Petroleum Fund managed and registered in the name of the Bank should for reporting purposes not be presented on the face of the Bank's balance sheet.

## 6. Segment Reporting

The Bank's primary function is to act as the central bank of a single geographical area – Timor-Leste. The shares of the Bank are not tradable. Accordingly the Bank is not required to present segment information.

## 7. Cash and Cash Equivalents

US\$ '000	2017	2016
<b>Cash and cash equivalents</b>		
Cash	50.858	35.840
Deposits at central banks	479.487	230.042
Resident banks	13.039	90.982
Non-resident banks	3.766	4.565
<b>Total</b>	<b>547.150</b>	<b>361.429</b>

## 8. Marketable Securities

No investment in Marketable securities for 2017.

## 9. Financial Assets and Liabilities

The table below sets out the Bank's classification of each class of its assets and liabilities, identifying the nature and amounts of financial assets and liabilities, with their fair values (excluding accrued interest).

US\$ '000	2017		2016	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
	547.150	547.150	361.429	361.429
Cash and cash equivalents	35.103	35.103	34.689	34.689
Investments	5.405	5.405	5.203	5.203
Other assets	<b>587.658</b>	<b>587.658</b>	<b>401.321</b>	<b>401.321</b>
<b>Total assets (Excluding PPE)</b>				
Government deposits	287.761	287.761	212.311	212.311
Other deposits	193.919	193.919	111.379	111.379
Provision for transfer of surplus to Government	-	-	698	698
Other liabilities	28.446	28.446	8.499	8.499
Currency issued	15.872	15.872	14.509	14.509
<b>Total liabilities</b>	<b>525.998</b>	<b>525.998</b>	<b>347.396</b>	<b>347.396</b>

## 10. International Financial Institutions

### a) International Monetary Fund

The Democratic Republic of Timor-Leste became a member of the International Monetary Fund (IMF) on 23 July 2002. The Bank was designated as the official depository under Article XIII of the IMF Articles of Association. In accordance with article 19 (f) of Organic Law no. 5/2011 the Bank holds the Timor-Leste reserve position subscription in the IMF.

The IMF Securities Account reflects the value of a Promissory Note payable by the Ministry of Finance as the fiscal agent of the IMF in Timor-Leste held by the Bank in favour of the IMF.

The Bank recognises an asset and a liability account in relation to the IMF Securities. The underlying balances of the IMF are denominated as follows:

	2017		2016	
	In SDR'000	In USD'000	In SDR'000	In USD'000
IMF Holdings of Currency	21.250	30.263	21.250	30.118
IMF SDR Holdings	3.399	4.840	3.400	4.571
<b>Total</b>	<b>24.649</b>	<b>35.103</b>	<b>24.650</b>	<b>34.689</b>



**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 Bank was designated as the official depository. In accordance with general practice, the Bank 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**

The Bank records the outstanding balance with IBRD on a net liability basis.

**International Development Association**

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

**Multilateral Investment Guarantee Agency**

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

## 11. Property, Plant and Equipment

Cost	Buildings	Plant	Office	Computer	Vehicles	Work in	Total
	US\$ '000	US\$ '000	Equipment US\$ '000	Equipment US\$ '000	US\$ '000	Progress US\$ '000	US\$ '000
Balance at 1 January 2016	970	386	864	2.434	557	-	5.211
Acquisitions	-	6	42	124	-	-	172
Transfers	-	-	-	-	-	26	26
Balance at 31 Dec. 2016	970	392	906	2.558	557	26	5.409
Acquisitions	-	3	62	1	-	-	66
Work in Progress	-	-	-	-	-	789	789
Balance at 31 Dec. 2017	<b>970</b>	<b>395</b>	<b>968</b>	<b>2.558</b>	<b>557</b>	<b>815</b>	<b>6.263</b>
<b>Accumulated depreciation</b>							
Balance at 1 January 2016	602	314	481	950	376	-	2.723
Depreciation for the year	49	20	80	654	47	-	850
Balance at 31 Dec. 2016	650	334	561	1.604	423	-	3.572
Depreciation for the year	49	20	82	563	47	-	760
Adjustment	-	-	-	(280)	-	-	280
Balance at 31 Dec. 2017	<b>699</b>	<b>354</b>	<b>643</b>	<b>1.887</b>	<b>470</b>	-	<b>4.052</b>
<b>Net carrying amounts</b>							
Balance at 31 Dec. 2017	<b>271</b>	<b>42</b>	<b>325</b>	<b>671</b>	<b>87</b>	<b>815</b>	<b>2.211</b>
Balance at 31 Dec. 2016	<b>320</b>	<b>58</b>	<b>345</b>	<b>954</b>	<b>134</b>	<b>26</b>	<b>1.837</b>

Pending the establishment of a land and property registration system in Timor-Leste, and the commencement of a property market in which the valuation of commercial and other property can be established by reference to observable transactions, the Governing Board of the Bank has been unable to establish a fair value for the head office land and buildings occupied by the Bank. Work in progress includes costs incurred in relation to the implementation of projects on SINTRAF System, National Switch payment system and office building in Oecusse during 2017. There were subsequently capitalised and transferred to Computer equipment and buildings.

There were no impairment losses at balance date.

## 12. Other Assets

Other assets comprise the following:

US\$ '000	2017	2016
<b>Other Assets</b>		
Accounts receivable	3.569	4.445
Advance, security & prepayment	68	43
Inventories	1.769	716
<b>Total</b>	<b>5.203</b>	<b>5.204</b>

Inventories comprise the cost of unissued centavos coins held for circulation. There were no impairment losses at balance date.

## 13. Government deposits

US\$ '000	2017	2016
<b>Government deposits</b>		
Consolidated fund	216.681	185.338
Infrastructure fund	24.090	7.031
Human Development Capital fund	2.084	2.536
Autonomous agency accounts	32.636	17.406
Municipalities accounts	12.270	-
<b>Total</b>	<b>287.761</b>	<b>212.311</b>

## 14. Other deposits

US\$ '000	2017	2016
<b>Other deposits</b>		
Domestic financial institutions	158.832	76.720
International financial institutions	35.087	34.659
<b>Total</b>	<b>193.919</b>	<b>111.379</b>

## 15. Other Liabilities

O Artigo 9.º da Lei Orgânica do Banco Central, determina que o lucro líquido do Banco, depois das deduções estatutárias para a Conta de Reserva Geral e a Conta de Reserva Adicional, seja transferido para o Governo de Timor-Leste.

Uma quantia equivalente a 50 por cento dos lucros deverá ser debitada à conta de reserva geral até que o capital autorizado e as reservas gerais equivalem a 10 por cento do total de ativos financeiros do Banco, a transferência para o Governo será feita como segue:

US\$ '000	2017	2016
<b>Other Liabilities</b>		
Accounts payable	6.409	7.695
Withholding tax payable	20	47
Provision for Long service account	89	79
Letters of Credit	1.794	-
Operating accounts	20.135	678
<b>Total</b>	<b>28.447</b>	<b>8.499</b>

## 16. Capital and Reserves

The capital of the Bank is set at \$60,000,000 (2016 - \$55,000,000).

The following reserves are established by article 10.1 of the organic law:

- An amount equivalent to at least 50 percent of distributable earnings shall be credited to the general reserve account until the capital and general reserves equal 10 percent of the total financial assets of the Bank.
- A part of the remaining distributable earnings may, on the proposal of the Governing Board, approved by the Government, be credited to special reserve accounts that may be established by the Bank pursuant to paragraph 4 of Article 8 until such reserve accounts reach a sum that the Governing Board deems appropriate.
- After deduction of the amounts referred to in the previous sub-paragraphs (a) and (b), the remaining distributable earnings shall be used to redeem any securities issued by the Bank, the remainder being transferred to the Treasury as revenue for the general budget of the State.

## 17. Provision for Transfer of Surplus to Government of Timor-Leste

Article 9 of the organic law no. 5/2011 on the Banco Central de Timor-Leste requires that the net profit of the Bank, after statutory deductions to the General Reserve Account and the Supplementary Reserve Account shall be transferred to the Government of Timor-Leste.

Furthermore article 10.1 (a) of the organic law no. 5/2011 stated that an amount equivalent to 50 percent of distributable earnings shall be credited to the general reserve account until the capital and general reserves equal 10 percent of the total financial assets of the Bank, a transfer to the Government will be made as follows:

US\$ '000	2017	2016
<b>Transfer to Government</b>		
Balance of General Reserve Account	-	-
Net profit for the year ended 31 December 2017	3.110	698
Transfer to General Reserve Account	(3.110)	-
<b>Total transfer to Government</b>	<b>-</b>	<b>698</b>

For the year ended 31 December 2017, the transfer of surplus shall be the effect, when the Governing Board approved the distribution of earnings to Government of Timor-Leste within four months after the end of financial year.

## 18. Contingent Liabilities

There were no contingent liabilities as at 31 December 2017.

## 19. Net Interest Income

US\$ '000	2017	2016
<b>Interest income from Financial Assets</b>		
Interest on deposits at foreign central banks	2.205	644
Interest on deposits at domestic banks	351	810
<b>Total interest income</b>	<b>2.556</b>	<b>1.454</b>
<b>Interest paid on Financial Liabilities</b>		
Interest paid on Government accounts	84	34
<b>Total interest expenses</b>	<b>84</b>	<b>34</b>

## 20. Fee and Commission Income

US\$ '000	2017	2016
<b>Fees and commissions</b>		
Currency withdrawal fees	19	20
Licensing and supervision fees	187	164
Government account management fees	500	500
<b>Total fees and commissions</b>	<b>706</b>	<b>684</b>

## 21. Petroleum Fund Management Fee

In accordance with the provisions of the Petroleum Fund Law No 9/2005 the Bank is entitled to charge a management fee for the operational management of the Petroleum Fund of Timor-Leste that reasonably represents the cost of managing the Petroleum Fund. The balance of Petroleum Fund at 31 December 2017 (unaudited) was \$16,799 million (2016 – 15,844 million).

Ministry of Finance agreed to covered internal management fee of BCTL up to 4 basis points on annual basis. The management fee accrued on the Petroleum Fund account was represented 8 basis points or \$14,463 thousand (2016 – \$13,329 or 10.0 basis points) of the average balance of the funds under management during the year. Management fees for custody services, external managers and Investment Advisory Board expenses are accrued from the fund with the total cost of \$8,727 thousand or 60% of the entire cost. Management fees are deducted for internally operational management of internal mandate was \$5,465 thousand or 38% of the cost. Presented below is the petroleum fund management fee income per nature:

US\$ '000	2017	2016
Total Petroleum fund management income fee	14.463	13.329
External managers & custody mgmt services expenses	(8.744)	(8.217)
Investment Advisory management expenses	(274)	(163)
<b>Net fee and commission income</b>	<b>5.445</b>	<b>4.949</b>

The breakdown of BCTL internal management fee expenses are as shown below.

US\$ '000	2017	2016
Salary, capacity building and Other personnel related costs	1.065	1.125
IT services, systems and data	2.285	1.101
Research, consulting and legal fees	1.181	1.048
Allocated common costs BCTL	871	1.606
Other costs	44	69
<b>Total BCTL operational expenses</b>	<b>5.445</b>	<b>4.949</b>

## 22. Personnel Expenses

US\$ '000	2017	2016
<b>Personnel Expenses</b>		
Salaries and related payments	1.458	1.333
Staff welfare payments	79	90
Capacity building and staff development	251	201
Representation at conferences and meetings	137	194
<b>Total Personnel Expenses</b>	<b>1.925</b>	<b>1.818</b>

## 23. Administration Expenses

US\$ '000	2017	2016
<b>Administration Expenses</b>		
Asset maintenance	15	27
Communications	93	76
Information systems	1.001	1.061
General expenses	203	126
Office Expenses	91	254
Professional fees	803	1.103
Other Assets management expenses	170	159
<b>Total Administration Expenses</b>	<b>2.376</b>	<b>2.806</b>

## 24. Petroleum Fund of Timor-Leste

The Bank is responsible for the operational management of the Petroleum Fund of Timor-Leste in accordance with Law number 9/2005 on the Petroleum Fund Timor-Leste and an Operational Management Agreement signed between the Bank and the Minister of Finance.

Under those arrangements, the following mechanisms have been established by the Bank:

- An “earmarked receipts account” has been opened by the Bank in its own name at the Federal Reserve Bank of New York into which all payments made as petroleum receipts must be made.
- The investments of the Petroleum Fund and related custodial arrangements are made in the name of the Bank.
- The Bank is not liable for losses arising from the operations of the Petroleum Fund unless such losses arise from the negligence of the Bank or its employees.

Taking into account the recognition tests set out in international accounting standards, the assets and liabilities of the Petroleum Fund are not shown on the face of the Bank’s balance sheet.

The assets and liabilities of the Petroleum at 31 December 2017\* were as follows:

US\$ ‘000	2017	2016
<b>Petroleum Fund Assets</b>		
Cash and Cash Equivalents	318.007	108.617
Other receivables	31.422	28.001
Financial assets at fair value through profit or loss	16.462.178	15.715.874
Less: Pending Purchase of Securities & Account payables	(12.294)	(8.165)
	<b>16.799.313</b>	<b>15.844.327</b>
<b>Capital</b>	<b>16.799.313</b>	<b>15.844.327</b>

Notes: \*) the PF balance sheet is unaudited



## 25. Related Party transactions

### Ultimate Controlling Party

The capital of the Bank is held by the Democratic Republic of Timor-Leste, and carries no voting or other rights of control. The Bank is established as a distinct autonomous public legal entity, endowed with administrative and financial autonomy and of its own capital. Article 3.2 of Central Bank law no. 5/2011 gives the Bank complete legal, operational, administrative, and financial autonomy from any other person or entity, including the government and any of its agencies, and subsidiary organs or entities.

### Governing Board

There were three members of the Governing Board who were the executive management personnel. The compensation is determined by the Government through Government Decree No. 3/2015 of 21 January, which is disclosed below.

US\$ '000	2017	2016
<b>Executive Board members Compensation</b>		
Board members compensation (Included in personnel expenses)	258	258
<b>Total</b>	<b>258</b>	<b>258</b>

### Non-Executive Governing Board

There were four members of the Governing Board who were not one of the key management personnel, whose compensation is disclosed below.

US\$ '000	2017	2016
<b>Non-Executive Board members Compensation</b>		
Sitting allowance (Included in personnel expenses)	76	62
<b>Total</b>	<b>76</b>	<b>62</b>

### Key Management Personnel

The management of the Bank is undertaken by a Management Committee comprising the three senior staff.

US\$ '000	2017	2016
<b>Key Management Personnel Compensation</b>		
Short-term employee benefits (Included in personnel expenses)	92	87
<b>Total</b>	<b>92</b>	<b>87</b>

### Government-Related Entities

The Bank provides banking services on an arm's-length basis to the Ministry of Finance and other public entities which are exempt from the disclosure requirements of paragraph 18 of IAS 24 – "Related Party Disclosures" in relation to related party transactions and outstanding balances, including commitments. The nature and amount of each individually significant transaction with Government related entities are disclosed in Notes 13, 15, 22 and 25.

## 26. Authorisation of the financial statements

These financial statements were authorised for issue by the Governing Board of the Bank on 27 April 2018.

# Independent Auditor's Report



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## AUDIT REPORT

### REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

#### Opinion

We have audited the accompanying financial statements of Banco Central de Timor-Leste (the Bank), which comprise the balance sheet as at December 31, 2017 (which show a total of 589.870 thousands USD and a shareholders' equity total of 63.872 thousands USD), and the statement of profit or loss of comprehensive income, the statement of changes in equity, and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Banco Central de Timor-Leste as at December 31, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

#### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section of our report. We are independent of the Bank in accordance with the law and we comply with the ethical requirements of the ethic code of the Institute of Statutory Auditors.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Responsibilities of management and those charged with governance for the financial statements

The Bank's Governing Board is responsible for

- ▶ the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards;
- ▶ the preparation of the Management Report in accordance with the laws and regulations;
- ▶ such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
- ▶ adoption of appropriate accounting policies and principles for the circumstances;
- ▶ assessment of the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

#### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- ▶ identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- ▶ obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control;
- ▶ evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- ▶ conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern;
- ▶ evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- ▶ communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Lisbon 27th April, 2018

Ernst & Young Audit & Associados - SROC, S.A.  
Sociedade de Revisores Oficiais de Contas  
Represented by:



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Registered with the Portuguese Securities Market Commission under licence nr.º 20161271

## Notas



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