Annual Report

Safeguarding the Future:

Building Economic Resilience and Financial Stability.

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Preface

It is with great pleasure that we present the Annual Report of the Central Bank of Timor-Leste (BCTL) for the financial year 2023. The BCTL Annual Report summarizes and presents the international and national economic developments in 2023, as well as the range of activities carried out by BCTL throughout the year, including the provision of relevant financial information. The Organic Law of the Central Bank establishes and frames the Central Bank's annual reporting duties to the President of the Republic, the National Parliament, the Prime Minister, and the Minister of Finance.

The Bank remains actively committed to promoting monetary and financial stability, as well as financial inclusion, having developed particularly relevant initiatives in this context. One of the main activities carried out by BCTL was the digital payment system program. In 2023, BCTL, in partnership with financial institutions and P24 service providers, successfully integrated the tax payment system, the electronic wallet system, and BNU POS.

Also in 2023, the Central Bank continued to operationalize its partnership with the Ministry of Education, working together to implement the Financial Literacy Program in the country's public schools. The celebration of the 9th anniversary of National Savings Day, on November 29, 2023, was held at Timor Plaza in the municipality of Dili and included the celebration of the third anniversary of the digital camp.

In the context of the national payment system, the Central Bank continued to make every effort to always maintain sufficient liquidity reserves to meet cash payment needs and ensure the modernization and full functioning of the national payment and interbank settlement system, R-Timor.

BCTL made several decisions throughout 2023, notably the approval of instructions for the implementation of International Financial Reporting Standards (IFRS). In 2023, BNU Timor, in collaboration with Mastercard, BCTL, and its service provider, completed the integration of Mastercard into the P24 system. At the same time, BNCTL's collaboration with BCTL and its service provider on the development of Union Pay card issuance (contactless & 3D Secure) made significant progress in 2023 and is expected to be completed in the first half of 2024.

In the 2023 financial year, BCTL's accounts recorded a positive net result of $17.9 million, primarily generated by interest received from BCTL's reserve applications and revenues from Petroleum Fund management fees.

BCTL continued to work with the Ministry of Finance, as well as with the Investment Advisory Board of the Petroleum Fund in the ongoing reassessment of the Petroleum Fund's investment strategy and its rigorous implementation.

The Bank continued to strengthen its internal policy of enhancing the quality and capacity of its staff, allocating significant financial resources for this purpose.

Finally, as usual, I, as Governor of BCTL, would like to thank all Central Bank employees and our partners and interlocutors at various moments who have continued to actively contribute to the consolidation of the Central Bank and the economic development of our country.

Dili, 30 april 2024

Helder Lopes
Governor

Executive Summary

The development of global economies remained slow in 2023, growing by 3.1% after the remarkable recovery in 2021 from the global COVID-19 pandemic. Although positive, global economic development in 2023 remained sluggish and on a decelerating trajectory following the strong recovery in 2021 and still fell below the historical 20-year average growth rate (2000-2019) of 3.8%.

Looking ahead to 2024 and 2025, the IMF forecasts stable growth for the global economy and the economies of some countries and regions in 2024, before a new increase in 2025. Specifically, the IMF estimates that the global economy will grow by 3.1% in 2024 and 3.2% in 2025.

Global inflationary pressures were notably high in 2023, although they slowed, with greater evidence in the economies of the US, the euro area, Japan, and ASEAN, reaching historical values in recent decades. In the US and the euro area, average inflation rates were 4.1% and 5.6%, respectively. The IMF expects inflation rates to begin converging to 3% and 2% in 2024 and 2025.

In the money and bond markets, a sharp decline in two-year interest rates stood out, especially in the US and the euro area. In the currency markets, the dollar continued to register a slight appreciation against major international currencies. On the other hand, global stock markets accumulated substantial gains. Meanwhile, the global commodity market ended up with modest losses, in line with the slowdown in global economic progress.

The Petroleum Fund investments performed positively due to rising stock market prices and falling two-year interest rates. However, global oil and gas prices declined, affecting related sector revenues.

Asian economies once again experienced more pronounced economic activity growth than others in 2023. The IMF expects the region to maintain substantial and widespread economic recovery in 2024.

Within the national framework, Timor-Leste's economy experienced a slowdown in growth in 2023 compared to 2022, mainly due to difficulties in public spending execution during the election year. The projected economic growth rate of 2.3% in 2023 marked a deceleration of 1.7 percentage points from the GDP growth observed in 2022.

For 2024, BCTL projects a significantly positive economic growth rate of 4.2%, in line with the Government's forecast plan of 5% for the next five years.

In fiscal policy terms, 2023 was marked by a significant reduction in expenditure, down by $248 million (-14%), mainly due to a decrease in current expenditure (-13.8%), in line with the reduced budget after the revised budget.

Contrary to global trends, there was a notable increase in domestic inflationary pressures in 2023, with the average inflation rate reaching 8.4%, up from 7% in 2022 and 3.8% in 2021.

Timor-Leste continued to record a significant increase in the external current account deficit in 2023, reaching -$601 million, primarily due to a sharp increase in goods imports and a reduction in petroleum product exports.

Despite the challenging macroeconomic context, the financial sector remained robust and dynamic in terms of activity growth, assets, and resources captured. It is notable that bank credit continued to grow in 2023, as did deposits and resources captured by banks operating in the country.

Chapter 01

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CHAPTER 01

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This chapter evaluates the major global economic developments in 2023 as well as the economies of Timor-Leste's main trading partners, together with the more relevant international trends in global financial and commodity markets for our economy.

After these evaluations, the chapter further looks into the spillovers of main transmission channels of external development to domestic economy, detailing the influences observed in 2023 and the prospects expected for 2024 and 2025. This analysis is based mainly on the most recent IMF's estimates and perspectives, presented in its update version of "World Economic Outlook" released in January 2024 and October 2023.

In terms of the most relevant developments described in this chapter, we highlight the following:

> Development of global economies remains slow in 2023 after the remarkable recovery in 2021 from the global pandemic covid-19. The world economy's GDP grew 3.1% in 2023, after the huge deceleration in 2022, but remains below the 20 years historical (2000-2019) average growth of 3.8% across broader income group.

> The estimation of the IMF shows that the GDP growth in developed countries has already below pre-pandemic levels in 2023 as tightening policy starting takes effect in addition to the impact of the on-going war in Ukraine and the increase of tension in the red sea, but the GDP growth in developing countries in 2023 remain above 2019's pre-pandemic level by 0.5 percentage point.

> In terms of projections for 2024 and 2025, the IMF expects a stable growth of the world economy as well as the economies of some countries and regions in 2024 before they increase again in 2025. The IMF specifically forecasts that the world economy will grow 3.1% in 2024 and 3.2% in 2025. This projection is made among other things based on the perpetuation of the increasing geoeconomic fragmentation, policy adjustments, household consumption booming and normalized supply chains which bring down the logistical cost and delivery time back to pre-pandemic level underpin the IMF perspectives.

> Even so, the Fund has also warned that the world's economy continues to face downside risks, having highlighted the crisis in China property sector, volatile commodity price and a sharp repricing risk in emerging markets which could further appreciate the US dollar, trigger capital outflow and increase the cost of borrowing.

> Inflationary pressures remained a remarkable high although has slowdown in 2023, especially evident in the US, Eurozone, Japan and ASEAN economies, to record levels in recent decades. In these four blocs, annual inflation reached values well above 3%, which tends to be the benchmark for most central banks, with average inflation in the US and Eurozone standing at 4.1% and 5.6% in 2023.

> However, the IMF foresees a gradual convergence of average inflation rates in 2024 and 2025 towards 3% and 2%, admitting that the current inflationary episode will tend to be "temporary". This scenario is based on the understanding that the current inflationary pressures result, above all, from the still persistent productive and logistical constraints, and that the economic policy authorities worldwide will be able to reverse the respective stimulus programs in 2024 and 2025, moderating and adapting the expansion of aggregate demand to the productive capacity of the various economies.

> Asian economies once again performed above world average in 2023, which was due to the China reopening from the pandemic and the recovery of production processes and economic

activity which resulted from robust domestic demand in the region. In line with its global optimism, the IMF expects the continued substantial and widespread recovery of economic activity in the region in 2024 before a modest slowdown in 2025 due to slowdown in China, and predicting that the bloc will continue to lead the world in terms of economic growth.

> In the monetary and bond markets, 2023 was marked by a general fall in 2-year interest rates in the US and Europe, in line with the deceleration of inflationary pressures and the current development of the economic recovery, especially in the US.

> In the foreign exchange markets, the dollar ended up registering a modest appreciation against the main international currencies especially yen and yuan in 2023, driven by the upward trend in the dollar interest differential. In the Asian context, there was a general appreciation of the US dollar against Asian currencies, within a background of regional exchange market stability.

> Global equity markets ended up accumulating substantial gains in 2023, benefiting from the current development of the economic recovery, supported by the success of macroeconomic stabilization policies and the substantial reduction in investor pessimism.

> Global commodity market ended up with accumulating modest losses in 2023, in line with slowdown of world economic progress, resulting from sluggish economic activities, high bank interest rates and long-term geoeconomic fragmentation due to the geopolitical tension in addition to strong oil output growth in the US and ample supply of natural gas in Norway and Northern Africa.

> The performance of the petroleum fund's investments seems to benefit from the rise in world share prices and the fall of 2-year interest rates in 2023, but was penalized by fall in the prices of oil and gas in the global markets, minimizing its revenue from oil and gas sectors.

1.1

Major World Economies

1.1.1. Economic Growth in Major World Economies

Despite facing many persistent challenges, the world economic growth remains in the positive shape, it grew 3.1% in 2023. Consequently, the global level of gross domestic product (GDP) remains above the pre-pandemic growth of 2.8% recorded in 2019, prolonging the record in 2021 and 2022.

The world economy remains in the positive shape despite facing many persistent challenges in 2023.

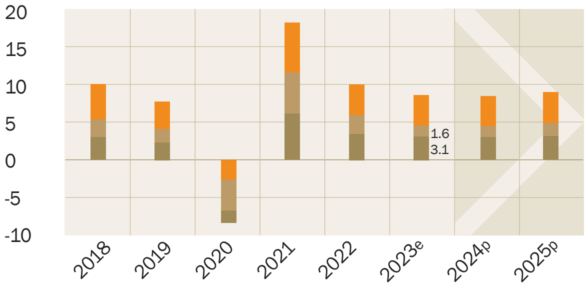
Although positive, the global economic development in 2023 remain slow and in decelerating path after a strong recovery in 2021, following the global pandemic and its respective economic and social impacts in 2020. The estimate growth remains below the 20 years (2000-2019) historical average growth of 3.8% across broader income group.

However, the global economies remain slow and in deccelerating path after strong recovery in 2021

According to IMF, this slowdown was the result of globally synchronous central bank contraction monetary policy to tackle the high inflationary pressures, withdrawal of fiscal support amid high debt, extreme weather events and idiosyncratic development such as property crisis in China which categorised as cyclical in nature. It is also the result of long-term consequence of global pandemic Covid-19 and increasing geoeconomic fragmentation due to geopolitics tension including the tension in the red sea.

Chart 1.1

GDP growth – 3 major blocks

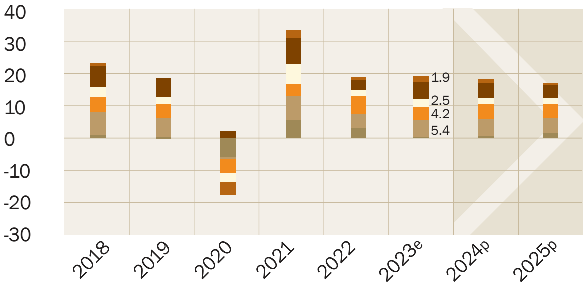


% variação ano
- World
- Developed Economies
- Emerging Economies

Source: IMF WEO

Chart 1.2

GDP growth – selected regions and countries



% annual change
- E.U
- Emerging Asia
- ASEAN-5
- US
- China
- Japan

Source: IMF WEO

The growth of world advanced economies was slower than the world average

The IMF estimation shows that the economies in developed countries in aggregate grew 1.6% in 2023, while emerging economies grew 4.1%. By comparison, the growth in advanced economies was slower than the world average, decelerated by 1.0 percent point from 2.6% in 2022 while in emerging market and developing economies, the growth was remained same as recorded in 2022, but remains higher compared to the world average and to the advanced economies.

It should be noted that the deceleration was stronger in advanced economies due to weaker economic performance in Euro area amid the stronger growth than expected in the US economies, confirming the impact of the tightening policy as well as the impact of on-going war in Ukraine, as evident with weak consumer sentiment, lingering effect of high energy prices and weak interest-rate sensitive manufacturing and investment in the Euro area. Constant growth in emerging market and developing economies reflect the property crisis in China amid the improvement in consumption and services as well as improvement in some emerging and developing countries. High interest rates and currencies depreciation in some low-income economies further contributed to this constant growth, contributing to overall output loss of >6.5% in other emerging market and developing economies.

At the regional level, noticeable economic performance of the Asia-Pacific economies was observed, relative to global peers. The GDP of Emerging Asia and the five ASEAN largest economies grew 5.4% and 4.2% in 2023, remain at the 2019's growth level although the growth of the five largest ASEAN economies slightly lower by 0.1 percentage point than the growth in 2019.

Noticeable economic performance of the Asia-Pacific was observed in 2023 relative to their global peers.

With regard to the developed world especially the US and the eurozone, as already mentioned that the US economy has performed more robustly than the economies in the Eurozone, growing 2.5% in 2023, while the economy of the eurozone is still 0.5%, where all still below the 2019's growth level, reverse the growth level in 2021 and 2022, especially the Eurozone which already above the growth in 2019.

Charts 1.2 presents the comparative economic performance of the four largest world economies, which help us to confirm the above-average performance. Among the four largest economies, the economies of China outperform the economies of the US, Eurozone and Japan. In 2022, the growths were almost same between the Eurozone (3.3%) and China (3.0%) with Japan had the lowest growth (%1%), but in 2023, Eurozone had the lowest growth among the world four largest economies.

Unlike the Euro area, the economies of the US, China and Japan were accelerating in 2023, accelerated by 0.4 percent point, 2.0 percentage points and 0.9 percentage point from their respective growths in 2022. Strong external demand due to recovery in domestic demand, inbound tourism and automobile export due to the supply chain normalization contributed to Japan's economic acceleration while acceleration of China economies was contributed by growth in industry value added and rebound in consumption and services in addition to fiscal support mentioned previously. The expansionary in the US was supported by fiscal policy easing and boosting of domestic consumption.

It should also be noted that although the China's economy was expanding, it faced a slowdown compared to estimation made in the earlier, due to property crisis and labour market uncertainty. It was revised downward by 3.7 percent points from estimated growth of 8.9% made in the first quarter of 2023.

In terms of growth prospects, the IMF expects the economy continue to have broadly stable growth in 2024 with a peak up in 2025. The IMF specifically forecasts that the world economy will grow by 3.1% in 2024 and 3.2% in 2025, the values which are slightly higher by 0.4 percentage point and 0.5 percentage point compared to the average growth of 2.7% recorded during 2018-2022.

The IMF's global outlook for 2024 and 2025 remains optimistic and broadly stable.

The IMF furthermore expects that the economies will stable in emerging and developing economies and slightly slower in advanced economies in 2024, then will peak up in 2025. It has projected that the advanced economies expect to grow by a respective of 1.5% and 1.8% in 2024 and 2025 while emerging market and developing economies is expected to grow by 4.1% and 4.2% in 2024 and 2025, respectively.

Regionally, the IMF expects the economies of Euro area will accelerate in 2024 and 2025 while the economies of five ASEAN major economies, the emerging and developing Asia and the US will slow in 2024 and 2025 as their growth rates lower than their estimated growth for 2023. Specifically, the economies in Eurozone expects to grow by 0.9% and 1.7% in 2024 and 2025 while the five ASEAN major economies expect to grow by 4.7% and 4.4% in 2024 and 2025, the economies of emerging and developing Asia will grow by 5.2% and 4.8% and the economies of the US will grow by 2.1% and 1.7% in 2024 and 2025, respectively.

Contrary to 2023, the economies of China and Japan expected to decelerate in the next two years as their growth rates lower than their growth rates in 2023 and 2024, follow the path of their peer in the US. As shown in Chart 1.3.1 that the economies of China expect to grow by 4.6% and 4.1% in 2024 and 2025 while the economies of Japan expect to grow by 0.9% and 0.8% in 2024 and 2025. In 2023 the economies of China and Japan were estimated 5.2% and 1.9%, respectively.

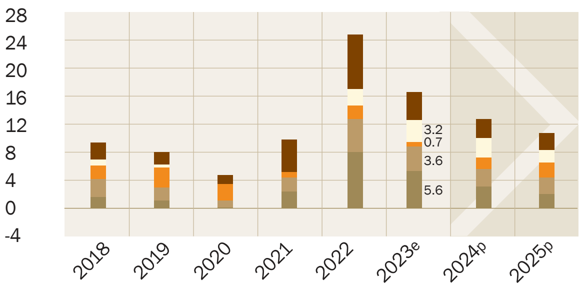
Several factors were contributing to these projections in overall. In advanced economies, they are the lagged effect of monetary tightening, gradual fiscal easing, a softening in labour market slowing aggregate demand in the US, stronger household consumption and inflation deceleration especially in the Euro area. In emerging and developing economies including most of the ASEAN five major economies, contributing factors for the growth in 2024 and 2025 was attributed to the property crisis in China.

It is also important to notice that an upward revision was observed compared to estimation made in October 2023, due to greater resilience in the US economies as well as in some large emerging market and developing economies than was expected. However, there are also upside and downside effects of these estimations. On the upside effect, faster disinflation could lead to further easing financial condition by easing the monetary policy which can push the growth further and revise at a later date with great cost. On the downside effect, geopolitical tension, supply disruption and still high inflation pressure could prolong tight monetary policy, resulting in disappointing growth projection.

1.1.2. Inflation in Major World Economies

The following graphs show the evolution of annual average inflation rates and price levels in five of the main world economies.

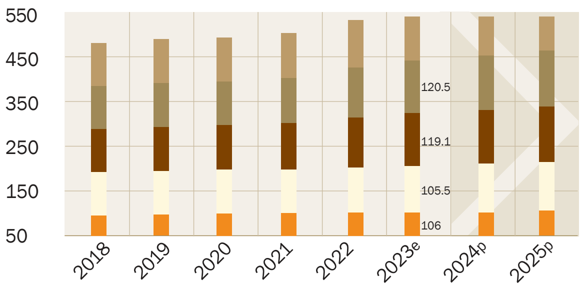
Chart 1.3.1
Inflation rates – 5 selected economies



% annual change
- E.U
- ASEAN-5
- China
- Japan
- U.S

Source: IMF WEO

Chart 1.3.2
Price level inflation – five selected economies



2019 = 100
- China
- Japan
- US
- E.U
- ASEAN-5

Source: IMF WEO

As shown in chart 1.3.1 that inflationary pressure registered a notable decline in 2023, especially in China, the US, Eurozone and in the five ASEAN largest economies after multidecade high observed in 2022, due to the tighten monetary policy, decline in commodity prices and largely normalization of supply chain which bring down the logistic cost and delivery time. Moreover, easing in labour market tightness with a decline in job vacancies and greater labour supply in part due to the strong inflow of migration also contributed to this inflation pressure declination. However, with exception of China, the annual average inflation still remains high, reached values well above 3%, which tend to be the benchmark for most central banks to not reverse the current monetary policy sharply and quickly, with average inflation in the US and Eurozone standing at 4.1% and 5.6% in 2023.

Global inflationary pressures fall in 2023 due to the contraction monetary policy, fall in commodity prices and due to the largely normalized supply chains.

These still high average rates obscure the sustained and worrying growth of inflationary pressures observed throughout 2023, with the year-on-year inflation rate in December 2023 being already on average above 2%. This value, which has not been observed during 2015-2021, reveals the scale and dimension of the current inflationary episode. However, it should be noted that inflation levels in the Chinese economies have been kept relatively low during 2021-2023 compared to its global peers, with its 2023's average inflation being 0.7%.

As already reported in 2021 annual report that the robustness of the global economic recovery and the high stimulating degree of the implemented monetary and fiscal stimulus policies in the major developed economies contributed to the worsening of global inflationary pressures observed in 2021. Moreover, aggravate inflationary risks in most economies also resulted from the persistence of social and economic restrictions, together with the worsening of constraints and failures in global logistics and production chains alongside the significant recovery in global demand.

It should also be noted that inflation in emerging market and developing economies was higher than those in advanced economies. This was due to as indicated in the IMF report that advanced economies take advantage from their improved monetary policy framework and communication strategy which facilitate disinflation, where inflation in advanced economies was influenced by forward looking inflation considering their monetary policy, unlike backward looking which very significant in emerging market and developing economies, indicating that current inflationary pressure influenced significantly by previous inflation in emerging markets and developing economies. The difference also occurred due to lower exposure to shock to commodity price and exchange rate and also because of unstable fiscal position such as high public debt and persistent deficit.

The IMF anticipates that inflationary pressures will gradually decline in 2024 and 2025.

In terms of perspectives, the IMF foresees a gradual convergence of average inflation rates in 2024 and 2025 towards 2% in practically all world economies, which constitutes the policy reference of many central banks. This means the Fund admits that the current inflationary episode will tend to be temporary, with annual inflation in the US and in the Eurozone expected to slow down to 3.3% and 2.8% in 2024 and to 2.2% and 2.4% in 2025 as more money would be demanded.

China's inflation will slightly be accelerating in 2024 and 2025, contrary to the US, Japan, Eurozone and ASEAN5

Similarly, inflationary projection of the five ASEAN largest economies and Japan are expected to slow down from 2.5% and 2.9% in 2024 to 2.4% and 1.9% in 2025, respectively, contrary to inflationary projections in the Chinese economy which admit a slight acceleration in annual inflation to 1.7% in 2024 and 2.2% in 2025. This is also supported with inflation of China at the end of 2023 (0.9%) which was higher than annual average of 0.7%, indicating that China's inflationary pressure was accelerating in 2023, confirming its slow growth projected for 2024 and 2025. Unlike the US, China has eased its interest rate in July and August 2023, this could be another reason for China's inflation accelerating in 2024 and 2025.

The scenario is made based on the current inflationary pressures result, above all, from the productive, logistical constraints and geopolitical tension that are still evident, and that the economic policy authorities worldwide will be able to successfully monitor the respective stimulus programs in 2024 and 2025, moderating and adjusting the expansion of aggregate demand to the productive capacity of the various economies.

The IMF expects that the economies of the five major economies will continue to register the same inflation rates in the next biennium, which should continue to register average inflation rates below the mentioned 3% and requires two to three years to reach a target of 2%.

1.1.3. Global Commodity Markets

Unlike 2022, the year 2023 was marked by the general decline in market prices of the main traded commodities.

Commodity prices recorded broad-based loss in 2023.

This price declination occurred naturally in the global context of a substantial pickup in inflationary pressures as mentioned in the previous section, causing low demand. The overall downward trend in non-energy, in line with what had already happened in 2022, especially February onwards, hence, resulted in the contraction of the prices observed since the prices of most of these items recorded their highest values in 2022, following their lowest value being observed in 2015/2016. For countries exporting these commodities, especially developing countries, the decline of international prices represents a negative development, conversely, the rise of the prices of these commodities in international markets represents a positive development.

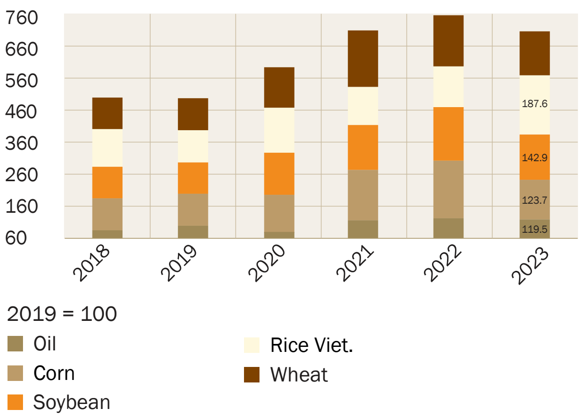
The oil price showed a slightly loss in 2023, a decrease of -3%, due to low demand, in line with modest recovery in world economic activity due to weaker rebound of oil consumption in China, interest rate hikes and growing uncertainty regarding the geoeconomic fragmentation despite the supply side pressure due to OPEC+ countries (the organization of the petroleum exporting counties plus selected non-member countries) cutting 1.3 million barrels of oil per day in addition to a total voluntary cut of 1.3 million barrels of oil per day by Saudi Arabia and Rusia, after being one of the few commodities that recorded a price rise of 7% in 2022.

The loss in oil prices was due to the weaker rebound of oil consumption in China, high interest rate and the strong oil output growth in the US despite the supply side pressures and geopolitical tension.

It should also be noted that this oil price declination was also associated with strong oil output growth in non-OPEC member countries, especially in the U.S. With this development, oil price in overall has already declined to its lowest level since June 2022, evident with annual average price declination of around 17% in 2023 from an average price of $97.10 per barrel in 2022.

Chart 1.4.1

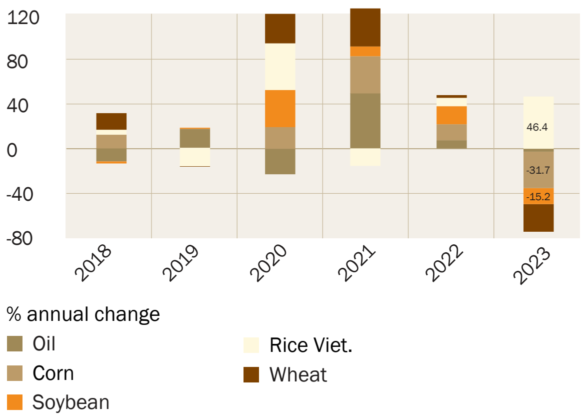
Major commodity prices – level



Source: World Bank

Chart 1.4.2

Major commodity prices



Source: World Bank

CHAPTER 01

The recovery in oil prices over the last few years and price declination in 2023, clearly highlighted the structural difficulties in the transition of the world's energy model. The recent reinforcement of the measures adopted towards the development of renewable energy sources and the reduction of CO2 emission levels coupled with oil production cut in OPEC+ countries in addition to increase geoeconomic fragmentation limited the production and supply of fossil fuels worldwide.

This greater rigidity of supply and the inability to accommodate a global demand that has proved to be relatively stable, means that the world energy markets are increasingly impacted by greater price volatility and an increasing cost of supplying oil, gas, coal and liquid fuels. This trend is expected to be persistent in the medium term, while the necessary technology is developed and the necessary investments are made to underpin the effective energy transition and decarbonization of the world economy.

1.1.4. Major Global Financial Markets

In terms of financial markets, we start the analysis with trends across major bond markets, especially those for treasury bonds, which helps us to assess trends and changes, as well as expectations, of monetary policies, economic growth and inflationary pressures of the various world economies.

Two-year interest rates decline in the US, in line with declining inflationary pressures and strong economic performance.

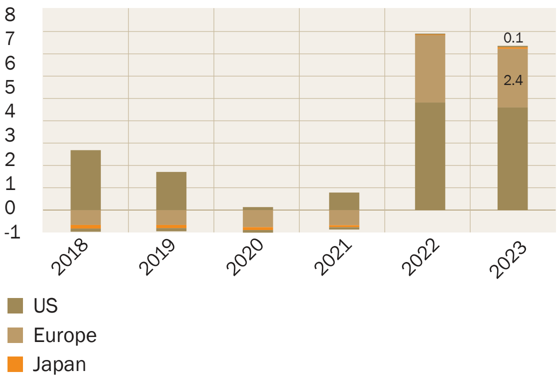
There was a decrease in two-year rates in 2023, especially in the US and the Germany markets, as a result of decelerating inflationary pressures and the expectations of a slight reversal of the monetary policy cycle in the major economies. This trend counteracted the widespread and broad rise in interest rates recorded in 2022, following the implementation of highly stimulating monetary programs to stabilize the world's economies.

Generally, two-year interest rates, short-run interest rates, which are more sensitive to changes in monetary policy, slightly decline in 2023 after a remarkable increased in 2022, especially in the US and Germany. In economies where the level of short-term interest rates was below the zero threshold (0%), this fall was minor to the respective central banks which prefer to maintain their accommodative position for longer.

Two-year interest rates are more sensitive to changes in monetary policy than 10-year rate.

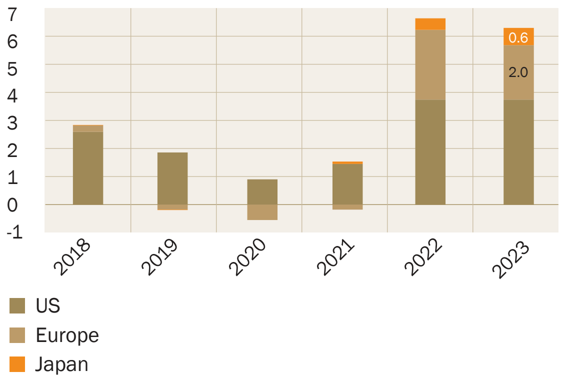
In the case of the US, the fall in two-year interest rates was substantial, having decreased from 4.43% at the end of 2022 to 4.25% at the end of 2023. Despite this fall, two-year interest rates in the US well above their pre-pandemic levels, which was 1.57% at the end of 2019. This development, clearly shows that the monetary stimulus program of the Federal Reserve System (the Fed), including its key rates, is still at dissimulating levels for the US economy although its economic performance was better than those in the Eurozone.

Chart 1.5
2-years interest rates (%)



Source: Bloomberg

Chart 1.6
10-years interest rates (%)



Source: Bloomberg

Given the deceleration level of inflationary pressures in the US at the end of 2023, the Fed needs to implement a continue and notable recovery in monetary stimulus throughout 2024, in order to maintain the current economic recovery growth without compromising to stabilize the inflationary expectations.

However, it should be noted that the Fed had already stated that it goes to adopt "higher-for-long" approaches which means that policy to bring the interest rates down sharply may not happen soon. This is evident with the Fed increased its policy rate along the central bank of European Union, Bank of England and Bank of Canada in July 2023.

Unlike two-year interest rates, 10-year interest rates in the US slightly increased in 2023.

In the case of 10-year interest rates, with the exception of Germany, there was a slight increase in 2023 compared to 2022, thus maintaining the rise recorded in the previous years. Like the two-year rates, the 10-year interest rates in the US market, valued at 3.88% at the end of 2023, well above the pre-pandemic levels, as this interest rate was 2.68% and 1.92% at the end of 2018 and 2019, respectively.

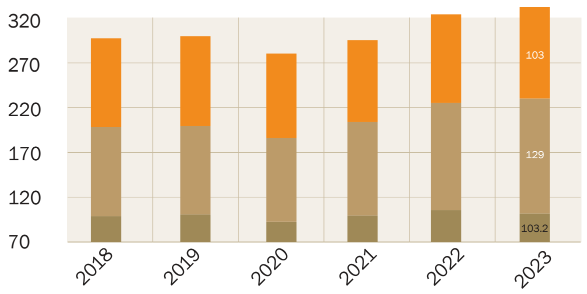
It should also be noted that the reference for German 10-year bonds was also positive in 2022 and 2023, reversing the negative rates during December 2014-December 2021, meaning the interest rate was increased substantially in 2022 and 2023. The 10-year interest rate in Germany was already 2.02% at the end of 2023, greatly above its pre-pandemic level of -0.19% in 2019.

In both two and 10 years, interest rates in the US remained at levels well above those observed for the Eurozone and Japan, similarly to what has happened since 2013, which seems to result from the perpetuation of the viewpoint that the US economy should continue to register a relatively better performance over the next few years.

As is common, bond markets developments, together with the economic developments that had been analysed, also determined a large part of the changes registered in the main foreign exchange and equity markets worldwide.

O mercado acionista norte-americano – representado pelo Dow Jones – registou ganhos de 13,5% em 2023, depois de ter registado uma queda de 9,0% em 2022. Estes rendimentos têm sido suportados pelo otimismo relativamente aos sectores dos serviços e da indústria, que representa uma parcela crescente e mais significativa deste mercado, quando comparado com outros mercados acionistas mundiais.

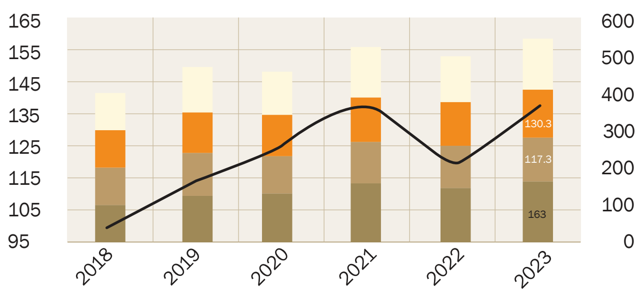
Chart 1.7
Major currencies against USD



2018=100
- Euro
- Yen
- Chinese Yuan

Source: Bloomberg

Chart 1.8
Stock markets



- US
- E.U
- Asia
- Australia
- Average

Source: Bloomberg

In the foreign exchange markets, the dollar appreciated against the yuan and the yen, but lost value against the Euro, contrary to the generalized appreciation seen in 2022, indicating that demand for the US dollar in Japan and China were higher than in the Euro area. These changes resulted from the growing global inflationary pressures seen in 2021 and 2022. This fact, evidenced by the rise in US interest rates compared to other blocs, tended to reinforce the demand for dollars in the foreign exchange markets, which offer higher rates of return than most debts from other developed countries.

The high interest rates in the US market contributed to the appreciation of the dollar against the major world currencies.

In equity markets, all of the selected markets continue to record a strong performance in 2023, and that, reversing the values loose seen in 2022. As shown in chart 1.8 that the average equity markets accumulated gains in 2023, with the US and Asian markets outperformed their European and Australian peers.

The major world equity markets recorded notable gains in 2023, reversing the values loose recorded in 2022.

The US equity market - represented by Dow Jones - recorded gains of 13.5% in 2023, after experiencing a decline of 9.0% in 2022. These returns have been supported by the optimism regarding service and industry sectors, which represents a growing and more significant portion of this market, when compared to other world's equity markets.

In addition to the US, the overall equity market recorded gains of 14% in 2023, with the US and Asian markets – gaining almost same percentages, 13.5% vs 12.5%. The European markets, representing by the UK recorded gains below its global peers, having risen only 2.8% in the year.

In sum, the US and the Asian stock markets outperformed the other selected markets in 2023, having continued to benefit from the greater dynamism of its economy, despite the recent confusing and disturbing political episodes.

1.2

Asian Economic Developments

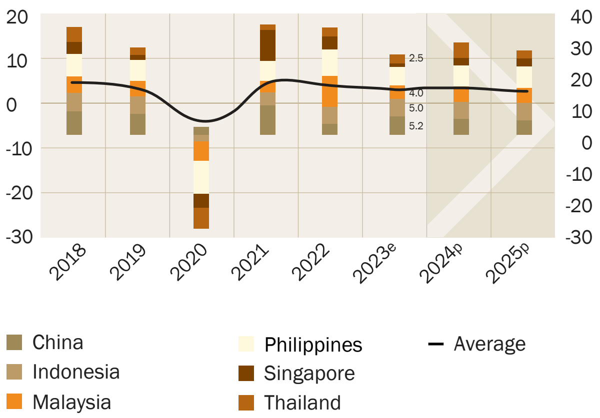
After analysing the wider global macroeconomic development in the previous section, it is vital to detail the assessment of economic developments across the Asian countries, especially ASEAN, as the main trading partners of Timor-Leste are located in this region.

The largest Asian economies experienced a remarkable deceleration in 2023, after a 5.1% growth recorded in 2022.

The analysis of this section specifically focuses on five ASEAN major economies and China, whose economy has increasingly taken a more global and regional relevance. From these six economies, Indonesia continues to be the Timor-Leste's main trading partner, which justifies some further specific comments and assessments on its economic developments.

Chart 1.9.a

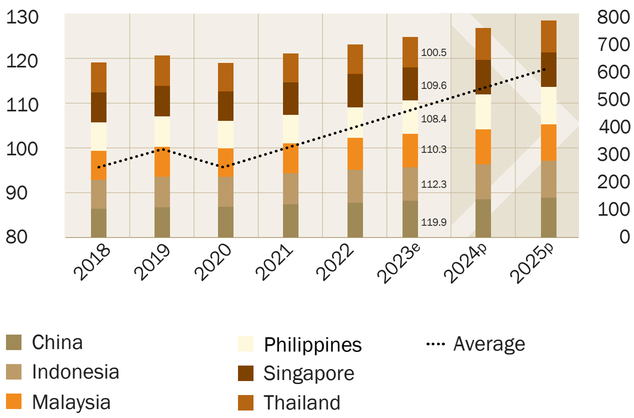
GDP growth rates - % annual change



Source: IMF WEO

Chart 1.9.b

Price level GDP – 2019 = 100



Source: IMF WEO

In terms of relevant developments for these economies, the GDP of the six countries registered a generalized deceleration, with average economic growth estimated at 3.8% in 2023, compared to an overall growth of 5.1% recorded in 2022, as a result of slowdown in Indonesia, Malaysia, Philippines and Singapore

The Asian economies hence record a moderate slowdown in 2023, when compared to the economies in the Euro area, which was due to the negative contribution of service sectors in high income countries in the region and also due to the property sector crisis in China.

The deceleration in Asia has been a moderate than in the Euro area.

It also important to mention that, in 2023, all these selected Asian countries - had an annual GDP level that was greater by >9% than that of 2019 (pre-pandemic), with special emphasis on Thailand, whose GDP in 2023 was only 0.5% above the 2019 level while China, its GDP level in 2023 was 20% above that of 2019.

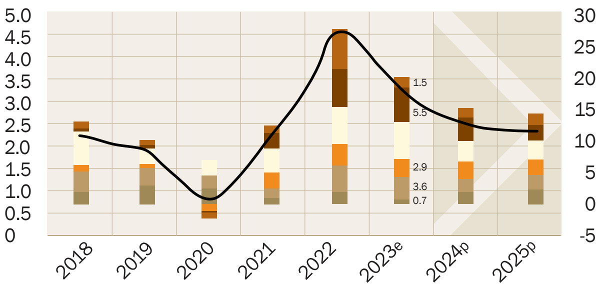
The economy in developing Asia and the pacific in overall was expanding as their growth in 2023 higher than in 2022 due to robust domestic demand, China reopening after the pandemic, rebounding of tourism and stable financial condition although the export sector is still weak due to global economic slowdown. From the supply side, growth in Asia was supported by agriculture, industry and service sectors.

In terms of prospects, contrary to the global growth, the IMF expects the economic activity in the region to expand modestly in 2024 before slowing down in 2025, predicting that the region will continue to lead the world in terms of economic growth. In this regard, the IMF expects that all the six economies will continue to regain their 2019's GDP levels in the coming two years, predicting an average growth rate in the six economies of 4.4% in 2024 and 4.0% in 2025.

The prospects for economic growth in the region remain optimistic for 2024 and 2025.

Chart 1.10.a

Inflation rates - % annual change

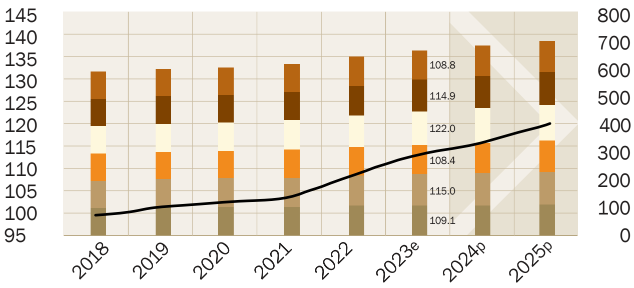


China
Indonesia
Malaysia
Philippines
Singapore
Thailand
Average

Source: IMF WEO

Chart 1.10.b

Price level inflation – 2018 = 100



China
Indonesia
Malaysia
Philippines
Singapore
Thailand
Average

Source: IMF WEO

The same forecasts also indicates that, at the end of 2025, it is expected that China, Indonesia's, Malaysia's and the Philippines' GDP to be 30%, 24%, 20% and 22% above the value of the 2019, which are the economies with the highest growth rates. On the contrary, Thailand is expected to be the lowest growth economies by 2025 in the region, as its output will only be about 7% above its 2019 level.

Inflation in the region dccelerated in 2023, in line with the global trend.

In line with the global trend, inflation in the region decelerated in 2023, contradicting the high inflationary pressured seen in 2022. The average inflation rate of the six Asian economies fall to 3.3% in 2023, compared to 4.6% in 2022 and 2.1% 2021. It is also important to note that only three economies – China, Malaysia and Thailand – recorded below the average inflation rates, valued at 0.7%, 2.9% and 1.5%, respectively while the rest, their inflation rate remain above the six economies average.

The IMF expects the materialization of a scenario of general inflation stability in the region for 2024 and 2025, with average annual inflation remaining below 2%, annually. Despite the geopolitical tension, oil supply pressured and logistical constraints due to the ongoing war, the Fund believes that Asian economies and their monetary authorities will be able to guarantee that price stability is continue to maintain during the next two years.

The rise in inflation rates in the various economies and the average appreciation of the dollar against the six Asian currencies, amounting to 0.4% in 2023, after an appreciation of 6.3% in 2022 explained, in turn, the decrease in regional inflationary pressures, when measured in the US dollar terms.

These relevant developments of the main macroeconomic indicators - economic activity and inflation - help to explain and as are also explained by the developments registered in the two main financial markets, the regional foreign exchange and bond markets.

Regional currencies on average deppreciated against the US dollar in 2023.

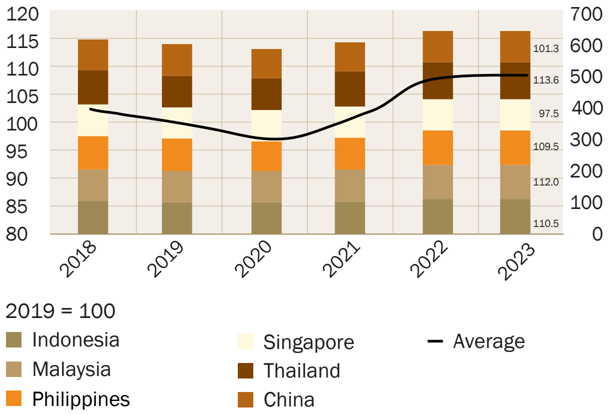
In exchange markets, despite the high volatility recorded throughout the year, 2023 ended up being marked by the 0.4% average depreciation of regional currencies against the dollar, with Indonesian, the Philippines, Singapore and Thailand currencies being the only currencies with annual appreciation rates of 1.5%, 0.2%, 1.8% and 0.9%, respectively. High interest rates in the US contributed to the appreciation of the US dollar against these overall Asian currencies.

In contrast with the US and Germany, 2-year interest rates in the region in overall increased in 2023, prolonging the rise recorded in 2022.

Bond market interest rates, represented here by two-year bonds, registered a general increase in the region in 2023, in contrast with the US and Germany, thus prolonging the rise recorded in 2022.

Chart 1.11

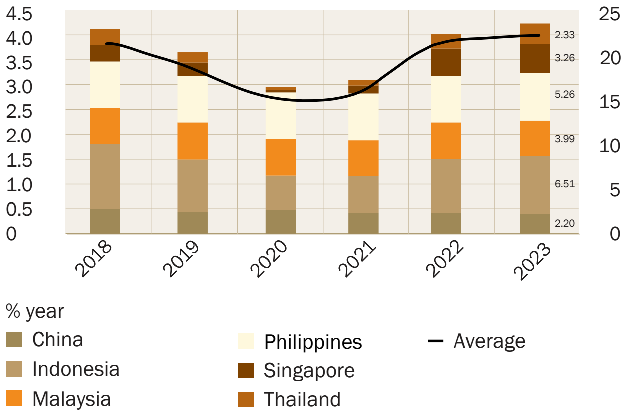
Exchange rate of ASEAN5 + CHY vs. USD



Source: Bloomberg

Chart 1.12

Two-year interest rates



Source: Bloomberg

The average two-year interest rate of the six economies rose from 3.73% in 2022 to 3.93% at the end of 2023, well above the level observed at end of 2019 (3.39%) and was the highest one since the level observed at the end of 2013 (4.03%). The rose in two-year interest rates in the various economies resulted from the rose in reference rates by some central banks and also from their economic performance and prospects. It should also be noted that the interest rates in the region are almost similar to the US, showing that the markets in the region followed the dollar market changes. Furthermore, the interest rates in the region are still above the rates observed in Japanese and Germany markets, reflects their better relative economic performance.

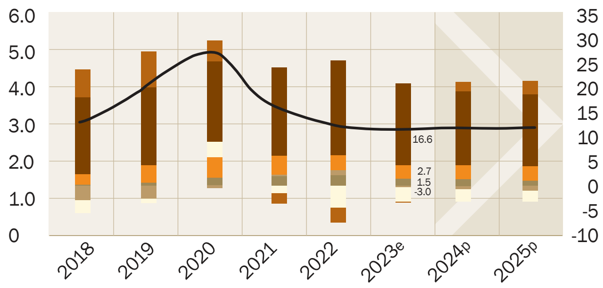
Regarding the current external account balances, it can be concluded that the partner countries continued to maintain substantial external surpluses in 2023, with the exception of Indonesia, the Philippines and Thailand, which recorded a respective current external account deficit of -0.3%, -3.0% and -0.2 % of their GDP in 2023. It should also be noted that, although there was a slight reduction in the region's average external surplus in 2023 compared to 2022, they managed to maintain positive current external account balances, despite the strong disruptions to economic activity and trade worldwide, indicating that they have surplus of saving for other countries.

The regional current external accounts remained in surplus in 2023, with the exception of Indonesia, Philippines and Thailand.

For 2024 and 2025, the IMF continues to predict stability in net external balances in the region, although it is important to note that the Philippines and Indonesian economies continue to record current external account deficits, with Indonesia specifically to continue experienced increased external account deficit in these two years. In contrast, Thailand is expected to have surplus of saving in the next two years, following the path of its peers in these economies.

Chart 1.13

Current external account balance



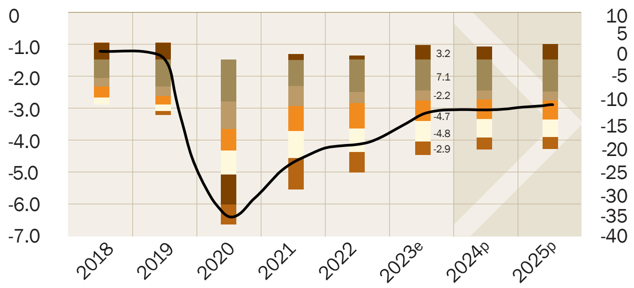
% PIB

China
Indonesia
Malaysia
Philippines
Singapore
Thailand
— Average

Source: IMF WEO

Chart 1.14

Fiscal balance



% GDP

China
Indonesia
Malaysia
Philippines
Singapore
Thailand
— Average

Source: IMF WEO

In 2023, fiscal balances continued improved in the region, partially offset the fiscal deterioration observed in 2022.

In terms of budgetary balances, 2023 was marked by a noticeable improvement of public deficits in the region, with the average deficit falling from -4.2% in 2022 to -3.1% of GDP in 2023. This improvement cancelled out some portions of the public deficits' deterioration of the various Asian economies in 2022. Consequently, at the end of 2023, public deficits were the lowest one since 2020 but still exceeded the respective average value of -1.1% and -1.5% of GDP, recorded in 2018 and 2019. It should also be noted that Thailand recorded the largest deficit reduction in 2023, which fell from - 4.6% in 2022 to -2.9% of GDP in 2023 with Singapore recorded a fiscal surplus of 3.2% of its GDP. It is also worthed to note that Singapore is only recorded a fiscal deficit in 2020 due to the pandemic covid-19 impact.

For 2024 and 2025, the IMF expects a gradual reduction in budget deficits in the region, anticipating an average deficit of -3.0% and -2.8% of GDP in 2024 and 2025, respectively. As a result, most economies should maintain a stimulative fiscal policy stance over the next two years, which will certainly help to explain the strength of economic growth in the next biennium. This also means that the focus of the governments in the region in overall is on improving domestic revenue and minimizing deficit without sacrificing their growth.

With the exception of Singapore, which continues to register a budget surplus, the remaining five economies should continue to record deficits around -2% to -7% of their GDP over the next few years. And with the exception of China, the fiscal policies of the partners in the region will continue to be more on fiscal balance improvement, with their respective public deficits as percentages of GDP decreasing in the next two years.

In short, in line with the global trends, the economic development of the main trading partners in the region were slower in 2023 as their growth rates was lower than in 2022 but remain above the 2020 level which made it possible to recover completely from the 2020's fall in economic activity.

It is also important to note that the relative stability of regional currencies against the dollar and the maintenance of external surpluses in most economies, although in tandem with the maintenance of moderate public deficits in the region, will continue to provide a substantial scope for macroeconomic adjustment and policy flexibility in these Asian economies.

However, this does not mean that this general background does fully apply to the Indonesian economy, the largest trading partner of Timor-Leste. In one hand, we highlight the vigorous recovery of its economy, which has already managed to recover since the 2021, maintaining its pre-pandemic GDP level of 2019, as well as its price and foreign exchange rate stability. On the other hand, the country continues to record a deficit in public accounts, -2.2% and an external deficit of -0.3% of GDP in 2023.

In terms of outlook, the IMF continues to expect the current performance for the Indonesian economy to be maintained over the next two years, with an average annual growth rate of 5.0%, as well as in maintaining a stable and moderate inflation rate of 2.5% per year. Although public and external deficits are expected to continue, the IMF forecasts clearly assure that the country will manage to the macroeconomic stability, visible above all in the appreciation of the rupiah, the decrease in inflationary pressures and the fall in external revenues, resulting from the flip in international prices of many commodities the country exported.

In line with the global trend, the economic development of the main trading partners in the region were slower in 2023 as their growth was lower than in 2022.

Naturally, the decrease in the price of raw materials after the pluriannual recovery, particularly visible in 2021 and 2022, is expected to underpin the recovery of economic activity and the earnings of exports in the country. In any case, the continued economic dependence on the export of these products implies that the macroeconomic and financial performance of our neighbouring country will continue to be strongly determined by the development of the commodity price in the global markets and the world economy.

The importance of this partner for our country and economy implies to continue monitor these developments, with the expectation that the continuity of the policy measures introduced by its government and the stricter vigilance by its central bank will continue to gradually reduce the respective macroeconomic risks.

1.3

Timor-Leste Economic Transmission Channels

The major international economic and financial developments described above together with Asian economic developments, which are relevant for Timor-Leste, would be incomplete without understanding the respective repercussions on our economy.

Therefore, this section tries to expose the main transmission channels of the international developments to our economy. At present, it is important to admit that these effects affect some certain sectorial aspects of the economy in the country. This chapter seeks to demonstrate the mechanism of operation of the main channels, specifically: the impact on domestic inflation levels, influence over oil revenues and effects on the petroleum fund's investments valuations. 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 permit us to analyse this relationship properly. Hence, this section mostly developed based on data showed in Figure 1.5, 1.8, 1.10a and 1.11.

We expect that external developments will increasingly shape the domestic economic developments as our economy develops and effectively deepens interdependence relations with the regional economic partners, expanding the number and influence of the various transmission channels.

1.3.1. Imported Inflation

One of the main transmission channels for our economy is the impact of international prices on domestic inflation developments and its respective expectations. As Timor-Leste is an economy with great import activity - imports of goods and services on average accounted 52% of non-oil GDP in 2021 and 2022, therefore, it is very common and related to expect that international prices of imported goods and services will continue to significantly affect domestic inflation along with economic development in the country.

BCTL's inflation model is based on two key drivers - domestic economic performance and average inflation rates across the Asian region.

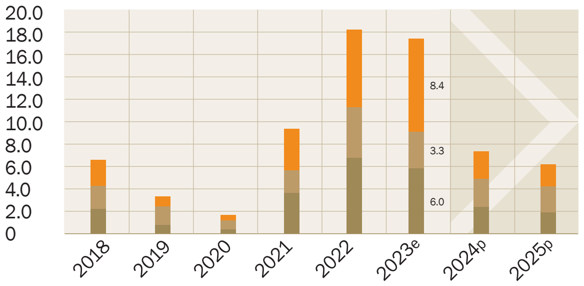
The empirical research and economic modelling of BCTL has confirmed the importance of this channel. One of the studies conducted in 2014 has indicated that a 10% increase of foreign inflation above its average level would result in a cumulative increase of 8.7%, 7.3% and 1.5% of total, food and non-food inflation in the country, respectively, clearly indicating that external inflation affects the domestic inflation. It further shows that economic development in the country influence domestic inflation by 10.7%, 8.2% and 8% of total, food and non-food inflation when domestic economic activities rise $100 million above the long-term average. However, one of the main issues in this context arise from the difficulty in defining an appropriate variable to measure the level of "external inflation" for Timor-Leste, given the large variability of import baskets and of the geographical structure of our imports.

After evaluating with several functional forms for this variable, it was concluded that the most appropriate empirical variable seems to be an average of the inflation rates of the five largest economies of ASEAN and China converted into dollars. In practice, this measure corresponds to an average of the regional inflation rate measured in dollar terms, which at the same time captures the impact of regional exchange rate variations against the dollar and local currency inflation rates.

Foreign inflation tends to influence the inflation trajectory in Timor-Leste.

Chart 1.15

Internal and external inflation



% annual change

- Inflação doméstica FMI
- Inflacao external
- Inflação doméstica INE-TL

Fonte: INE-TL, FMI e BCTL

As can be seen on the chart 1.15 above that domestic inflation tends to reasonably follow the development of foreign inflation rates with lower volatility. It is important to note that the external inflation rate is the average of the six Asian economies as mentioned previously, BCTL's inflation forecasting models use this variable and respective expectations to construct inflation forecasts.

The acceleration and deceleration of external inflation in overall supported the rise and fall of inflation in Timor-Leste.

Additionally, it can be concluded from the above two charts that the rise and fall in the domestic inflation rates in overall, influenced by the rise and fall in external inflation rates. Normally, the relationship is not perfect, as Timor-Leste's non-oil economic developments, especially over the last few years, strongly affect the domestic inflation rate trajectory.

It should also be noted that unlike external inflation and global inflation in general, inflation in Timor-Leste was accelerating in 2023, reflecting higher import taxes and some selected imported goods applied during the first semester of that year. Government doubled the import tax on all imported goods and applied progressive taxes on some selected items such as sugar, cigarette and soft drinks. They were reversed by the current government in the third semester of 2023 after took control the government in June 2023.

In terms of trajectory, 2021-2022 was naturally marked by the intensification of external inflation pressures, which exerted upward pressures over domestic inflation, reversing the trend recorded in 2019 and 2020 towards lower inflationary pressures. Domestic inflation contradicted global trend in 2023, reflecting the fiscal policy of increasing import taxes, adopted by the government at the end of 2022. In 2023, our external inflation metric ascended to 2.0%, resulting from the combination of a 2.4% external inflation rate in local currency terms and a 0.4% average depreciation rate of regional currencies against the US dollar.

As external inflation rates in local currency terms, except 2022 and 2023, are relatively stable over time, it can be concluded that the developments of local currencies against the dollar in the partner countries are, in turn, a very important factor in determining domestic inflation.

Considering the importance of this transmission channel, the future trajectory of external inflation, strongly influence by exchange rate developments, will continue to be one of the most influential factors in determining the evolution of domestic inflation.

The expected stability for regional currencies in 2024 and 2025 is a relevant assumption of BCTL's projected slowdown in domestic inflationary pressures.

In this context, the BCTL expects that, in line with the IMF, regional currencies will remain relatively stable against the dollar in 2024 and 2025 (depreciation of 0.4% per year), which, together with the maintenance of moderate inflation rates of trading partners, around 2.5% per year, leads us to expect that imported inflation will remain stable over the same time horizon (2.1% year), helping to stabilize inflationary pressures in Timor-Leste in both 2024 and 2025. Therefore, BCTL expects that the average domestic inflation rate will slow down over the next two years, gradually decelerating from 8.4% in 2023 to 4.6% and 2.0% in 2024 and 2025, respectively.

As the performance of the domestic economy also contributes to explaining inflationary trends, the domestic growth forecasts will be discussed in the chapter covering domestic economic developments, which also provides greater detail regarding inflation forecasts.

1.3.2. Energy Markets and Oil Revenues

Price of energy commodities such as oil, natural gas and coal in global markets are highly volatile, fluctuating widely between periods both with regimes of high and low-price levels. Charts 1.16 and 1.17 below show these price fluctuations and help us to place the recent developments in energy prices on a longer time-frame perspective. It should be noted that it is common for energy prices to fall by >50% and rise by more than the same percentage within a year, as the 2023's commodity prices demonstrate. In terms of levels, the sharp decline in oil prices from the end of 2014 cancelled out all nominal price gains recorded since 2009.

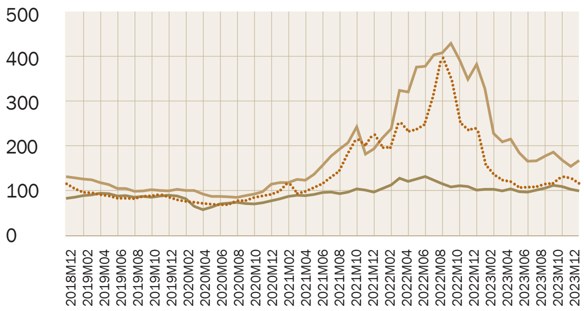
Oil and most commodities' prices recorded a notable fall in 2023, after the sharp increase recorded in 2021 and 2022.

In 2023, there was a remarkable loss of practically all energy resources, with particular emphasis on natural gas and coal. Of the energy commodities considered in the charts below, natural gas and coal are now at their record lowest of the last three years, reversed the high prices recorded in 2020, 2021 and 2022, which clearly confirms the difficulties of energy supply in adjusting and satisfying the global demand's recovery in 2023. The IMF report indicates that low demand, high storage overhang in the past winter, the ample supply of liquified natural gas and of pipeline from Norway and Northern Africa contributed to the natural gas price fall in 2023.

Oil price - brent reference - fall 3.8% at the end of 2023, and annually it fell 17.2%, partly cancelled out the pronounced recovery observed in 2022, caused by economic factors mentioned previously. Even so, oil continues to be traded at lower prices than in 2012, continue minimizing the recovery recorded during 2021-2022.

Chart 1.16

Energy prices – spot level

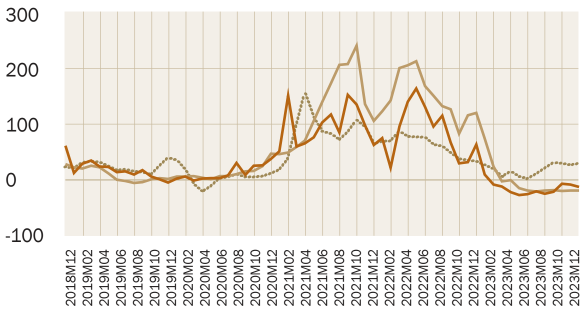


2012 = 100
— Oil
— Coal
··· Natural gas

Source: World Bank

Chart 1.17

Energy prices - % annual change



% annual change
··· Oil
— Coal
— Natural gas, US

Source: World Bank

Future energy prices trends are, however, not easy to anticipate, as it results both from the interdependence between aggregate demand and supply in physical markets, and, increasingly, from the less measurable and unpredictable effects resulting from the financialization of these markets, evident in the expansion of the financial derivatives market and increasing participation of financial intermediaries and speculators. A clear proof of this prediction shortcoming is, clearly, the recent fall in oil prices in 2023, after the substantial rise in 2021 and 2022, whose speed and magnitude were in no way predicted by most market participants and analysts. Transition to green energy and geoeconomic fragmentation due to geopolitical tension, resulted in fragmentation of world commodity markets further complicate the trend of future energy prices to anticipate. Fragmentation of commodity markets especially critical minerals for energy transition also make it more difficult to achieve the goal of decarbonizing world economies.

The country's oil revenues are now practically marginal when compared to the revenues obtained in the past years.

It should also be noted that the impact of energy price fluctuations on the country's oil wealth is now much lower than in previous years. This is due to the fact that oil revenues, taking into account Bayu-Undan, the fields actively in exploration, was ceased to produce completely at the end of 2023. Estimated gross revenues in 2023 amounted to $427 million, which represents a renewed decrease of 61.4% from the 2022's expected gross value of $1,106 million. This is equal to a total volume of around 7.01 million barrel of oil equivalent produced in 2023, a decreased of around 60%, compared to total barrel of oil equivalent produced in 2022, proofing further the depletion of oil and gas in Bayu-Undan. In 2022, the country produced a total of 17.3 million barrel of oil equivalent from the Joint Petroleum Development Area production.

Taking into account this current cease of oil production and uncertainties of future investment in greater sunrise, it is impossible to detail future earning estimation from oil and gas in this report, as has already done in the previous years, the sensitivity analysis of domestic oil revenues in terms of various oil prices. Although there has been petroleum exploration in dry lands such as the one in Covalima, the fields need to be proven both commercially and economically first.

1.3.3. Financial Markets and the Petroleum Fund

Lastly, we consider another transmission channel of international financial market developments to our economy, which relates to the Petroleum Fund (PF), established to efficiently manage the oil wealth of the country. The working mechanism of this channel is similar to the price of oil, to the extent that the price changes of international financial assets drive the value of the PF and, in turn, the 'Estimated Sustainable Income' (ESI) of the fund. Insofar as they drive changes in these two aggregates, financial asset prices end up influencing the amount of revenue available to finance the state budget and, consequently, the path and scale of spending and public investment policies.

Financial asset prices influence the PF ESI, in turn, overall funding of the State Budget.

The PF concluded in the last quarter of 2023 recording a total net financial assets of $18,252 million, which represents a renewed increase of $979 million versus 2022's closing balance of $17,273 million. The Fund is mainly invested in treasury bonds of developed countries as marked with liquidity portfolio and fixed income portfolio (70.13%) and around a third (29.87%) of the fund invested in shares of developed markets' companies.

In 2023 the fund invests 70.13% of its value in bonds and 29.87% in equities.

In 2023, the Fund recorded an overall, after fees and taxes, net profit of $1,642.667 million, reversing the net profit of -$2,050.438 million recorded in 2022, and added to the net profit of $1,144 million recorded in 2021. This performance was practically due to the rise in 10-year bond interest rate, rise in equity price and the marginal impact of the exchange rates appreciation as 2-year bond portfolio recorded a global fall in 2023.

Since the beginning, the fund has broadened its investment universe, starting, first, with only investing in US Treasury securities, it then gradually investing in shares and, finally, extend it to investing in bonds issued by several global Treasuries. This gradual extension of investment was driven by the increasing demand for a higher expected return for the fund and look for greater diversification of its investments in relevant markets.

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, it allows to build a more solid portfolio whose return is to be more efficient.

The performance of the fund is crucially driven by price changes in global bonds and equities markets.

So far, the Fund invests only in fixed interest rate bonds and equities, so that, received interest and dividends on bonds and shares provide the Fund with a fixed and constant income, at least on 'a priori' basis. Naturally, when investing in bonds and stocks, the Fund benefits from increases in market values of these securities, and on the contrary, it can be adversely affected by eventual negative price changes. Therefore, the Fund's main financial risks correspond to possible losses arising from the fall in the prices of the bonds or socks in which the Fund is invested.

Foreign exchange fluctuations also affect the fund, which has invested in markets other than in the USD.

In addition, since the fund invests in several markets denominated in currencies other than the US dollar, the fund is also subject to exchange rate risks, which understands as the possibility of depreciation of the various investment currencies against the dollar. As already reported previously that financial risks of the petroleum fund include three types of risks namely: equity risk, or risk of falling global stock prices, interest rate risks, which translates to the risk of falling Treasury bond prices; and currency risk, which refers to the risk of depreciation of the investment currencies against the US dollar.

The price changes of petroleum fund assets and the various investment currencies constitutes the true channel of transmission between international markets, the value of petroleum fund and its estimated sustainable investment (ESI) and the economy of the country.

In 2023, the fund recorded a positive performance, mostly due to the gains of its equity investments.

In terms of returns, 2023 was marked with positive return on the fund, which returned 9.60% in terms of its 2023's closing value, reversing the loss recorded in 2022 (-10.36%) and adding to the gains it recorded in 2021 (6.25%). The loss in the Fund's growth portfolio especially in the third quarter cancelled out part of the gains from its investments in 2023, especially from equity portfolio where most of the gains came from.

Bond investments recorded a net gain in 2023, due to the general fall in 2-year interest rates, partially cancelled out the interest rate rise recorded in 2022.

In the European market, representing by Germany, long-term interest rates also fall slightly, but remained in positive territory, prolonging the positive rate recorded in 2022 which was greatly above the zero threshold, where they have been since 2019. This generalized fall in rates due to fall in Germany, reversed the cycle of interest rate rose in 2022, contrary to the rate in the US market, which represents the majority of the Fund's bond investments, positively impacted the Fund return. This development can be interpreted as a global gain for the fund's bond portfolio in 2023 as the fund's bond portfolio yielded 9.16%, cancelled out part of its losses recorded in 2022 (-7.09%) and in 2021 (-2.25%). Unlike the European market, Japanese market follows the path of bond market in the US, its long-term interest rate increased by 0.19 percentage point from 0.42% recorded at the end of 2022.

In terms of equity markets, the fund's equity benchmark (developed markets) accumulated gains in 2023. The gains in the equity portfolios were due to the increased trend in the US market and also due to upward trend in most global equity markets. The petroleum fund investments in equities recorded a gain of 23.67% in 2023, reversing the substantial loss of -16.84% recorded in 2022 and added to the substantial gains of 22.72% it recorded in 2021. In terms of foreign exchange impacts, the petroleum fund was also affected positively by the depreciation of the USD against the investment in other currencies.

The fund investments in shares have again benefited from the robust performance of practically all global equity markets, led by the US market.

In short, the PF currently holds a portfolio of a vast and diverse set of securities and is invested in major global stock and bond markets, that efficiently optimizes its return profile, and at the same time minimized its associated risks.

However, given its substantial investments in global bonds and equities, the future financial value of the petroleum fund and its returns trajectory continue to depend on price developments for these financial assets, which are naturally also affected by the development of the dollar against the respective investment currencies.

The value of petroleum fund and returns continues to depend on the price developments of the global financial assets.

For a longer term, a need to consider the risk of a global stock or bond market correction is important, given the current and simultaneous high stock market valuations and the still high levels of global bond interest rates, despite the rates recorded in 2022. The trends evidenced in 2023 have further reinforced this historical high valuation of securities in both investment markets. With inflation pressures decline, market expects that future policy rates will decline which further contributes to decline in long-term interest rates and rising equity markets. Additionally, central banks' policy rate decisions are becoming increasingly asynchronous, some already easing their policy rates and some are not yet pushing for further risk consideration.

However, the long-time investment of the Fund and its institutional framework was designed to deal with the market fluctuation in a rational way to benefit from the occasional episodes of price fluctuation that regularly occur across markets, by implementing the investment fund discipline rigorously and a targeted asset allocation.

On the contrary, the complete cease of production from Bayu-Undan at the end of 2023 and the lack of significant future oil revenue due to uncertain greater Sunrise exploration development and the waiting of technical and economical proven of petroleum exploration in the dry land, together with continued maintenance of a level of public expenditure that requires reduction of the Fund's capital is now present significant risks to the success of the strategy and respective investment horizon of the Fund. Therefore, the fund objectives and its implementation strategies need to reassess in line with this current development.

CHAPTER 01

Chapter 02

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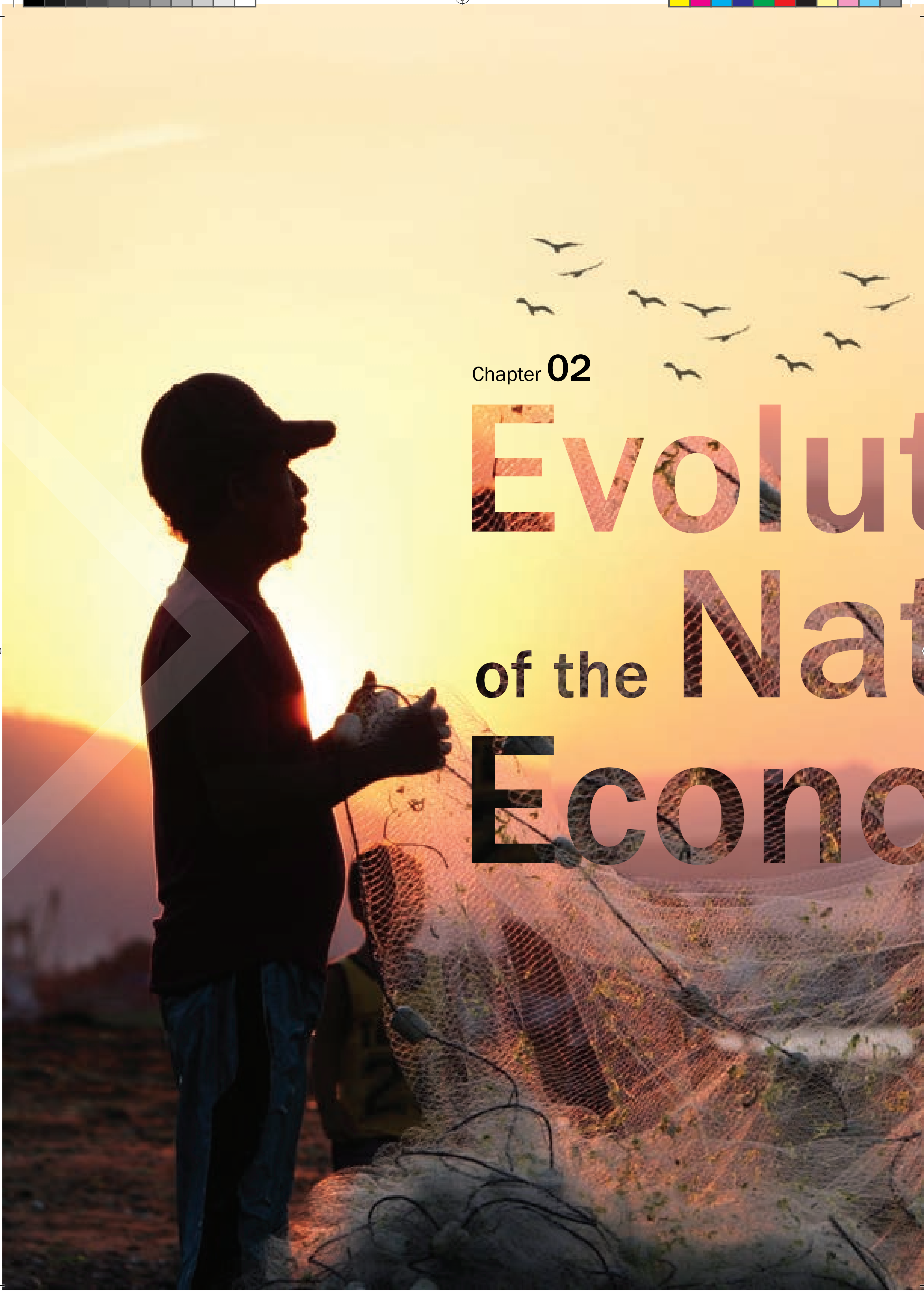

CHAPTER 02

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omy in 2023

This chapter details the recent evolution of Timor-Leste's economy and the respective projections for 2023 and 2024, also highlighting the main developments relating to the public, financial and external sectors of our country.

As described below in greater detail, the main developments relating to the national economy consist of:

> Timor-Leste's economy is expected to slow down in 2023 with the non-oil GDP growth rate of 2.3%, following a period of accelerated economic expansion seen in 2022, after the recession induced by the COVID-19 pandemic. The slowdown in growth compared to that seen in 2022 is mainly due to the effect of the difficulty in executing public expenditure in an election year. It is also worth noting a slight slowdown in household consumption and a reduction in exports in 2023, of 8.7% and -0.3% compared to 2022. However, our forecasts also consider the negative impacts arising from increased inflationary pressures which reduced consumer purchasing power in 2023.

> For 2024, the BCTL predicts economic recovery, envisaging an acceleration in economic growth to 4.2%. This expectation is based, above all, on the increase in the contribution of domestic demand in 2024 compared to that observed in 2023, and, a slight increase in the contribution of net external demand. A growth of 0.5% in public consumption and 5.2% in household consumption are also expected for the current year compared to 2023. Unlike 2023, we expect public and private investment to increase slightly (2.1% and 0.6 %) in 2024 compared to 2023 (14% and 0.8%).

> In terms of budgetary policy, 2023 was marked by a significant reduction in expenditure execution of -14% (-$248 million), mainly due to the reduction in recurrent expenditure (-18%), in line with the decrease in the respective budget after the rectifying budget. It is also worth highlighting the growth in public investment in 2023 (14%), due to a higher budget execution rate, while at the same time, there was a reduction in the budget itself (43.7%) after the amending budget.

> After the slowdown in global inflation for 2023 steadily in relation to 2022, Timor-Leste recorded a notable increase in domestic inflationary pressures, with the average inflation rate standing at 8.4%, following the high average rate of inflation already occurring in 2022 of 7%. The reduction in external inflationary pressures, in a context of tightening monetary policy to combat the high inflation that has been observed since 2022, and the slowdown in inflation in Timor-Leste's main trading partners, has not yet been reflected in Timor'Leste's internal price dynamics. In part, this gap reflects the previous government's policy of increasing import taxes and the worsening of the price of imported rice at the end of 2023 due to the shortage of rice in India, one of the main countries that supply rice to Timor-Leste. In terms of future prospects, a lower average inflation rate is expected for 2024 at 4.5%, driven by a reduction in global raw material prices, the continued slowdown of inflation in the country's trading partners, and the tax reduction policy introduced by the current government.

- Timor-Leste continued to record an external current account deficit, which registered a significant increase in 2023, recording a negative value of $601 million this year, mainly explained by the deterioration of the goods balance, mainly, a reduction in the export of petroleum products. The reduction in the services account deficit, together with a substantial increase in primary income, helped alleviate the effects of the country's high current account deficit in 2023.

- Despite the challenging macroeconomic context, the financial sector continued to remain robust and record high dynamism in terms of growth in its activity, assets and resources raised. It is illustrative to note that bank credit continued to grow in 2023, as did deposits and resources raised by banks operating in the country.

2.1

Economic Activity and Inflation

2.1.1. Economy - Recent Developments and Global Perspectives

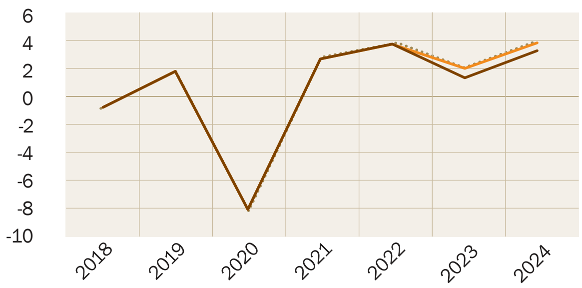
In 2023, according to the projection of BCTL, the domestic economy recorded a slowdown of 2.3% compared to 4% in 2022 and 2.9% in 2021.

In 2023, it foresees a slowdown in the GDP growth rate to 2.3% compared to the 4% recorded in 2022.

The slowdown of economic growth in 2023 was primarily attributed to the reduction in the public sector consumption, whose share totaled around 59.3%. In proportional terms, the public consumption contracted by 6.2% compared to the previous year. Additionally, investment continued to show a positive growth rate, with public investment increasing by 14% compared to 2022. In turn, exports of goods and services registered a negative annual change of -9.6%. Private demand, despite depending on the dynamic of public demand, grew by 4.1% in 2023, which equivalent to a contribution of 6.3 p.p. to GDP growth compared to 10.3 p.p. in 2022.

Chart 2.1a

Real GDP growth



% annual change

··· BCTL

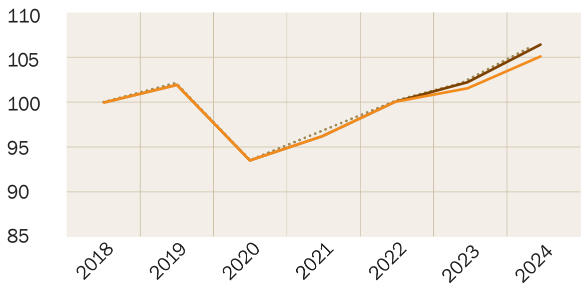
— MoF

— IMF

Source: BCTL, proposed OGE 2024, and IMF

Chart 2.1b

Real GDP



2018 = 100

··· BCTL

— MoF

— IMF

Source: BCTL, proposed OGE 2024, and IMF

In 2023, net exports as a percentage of GDP remain in deficit, as in 2022

As mentioned, the slowdown in growth in 2023 was mainly due to the reduction in public sector consumption, as well as the slowdown in its investment, which registered a positive net contribution of 1.9 p.p. to the 2023 growth rate. However, the reduction in domestic demand had positive implications on net external demand. In the case of 2023, and despite the rate of economic growth observed, we can see that total imports have increased, albeit slightly. Imports increased not only in absolute value, but also as a percentage of GDP which continued raising to 61.2% in 2023 from 56.2% in 2022, which remains high. In terms of net exports, an external deficit corresponding to 59.2% of GDP was recorded in 2023, a reduction compared to the value achieved in 2022, when there was a negative export balance equivalent to 54.1% of GDP.

By disaggregating the different components of real GDP, we can see that, with regard to the public sector in 2023, its contribution to the observed growth rate was essentially due to a decrease of 38% in public administration goods and services compared to 2022. A slowdown in public investment of 14% and a drop of 35.2% in public transfers. On the other hand, the wage and salary recorded an annual increase of 74.7% in 2023. The low public execution rate in 2023 that contributed to the growth slowdown.

In 2024, a growth rate of 4.2% is projected, which is higher compared to 2023.

Regarding private demand, the BCTL estimates that household consumption had a positive impact on the evolution of GDP in 2023, given that the consumption of these economic agents registered a slight increase of 8.7% compared to 2022. The increase in consumption of families was mainly due to government transfers and remittances from families emigrating abroad, which are the main factors stimulating family consumption in Timor-Leste. Remittances recorded an increase of 6.9% in 2023, a slower growth compared to the 31.2% growth observed in 2022. At the same time, there was a slight annual increase in private investment of 0.8%, following the slowdown in growth of public investment of 14.5% in 2023 compared to 36.6% in 2022.

For 2024, a slight growth in the private sector of the economy is expected.

Regarding projections for the year 2024, the BCTL predicts a positive evolution of GDP, envisaging an acceleration in economic growth for the current year. According to estimates made, it is projected that in 2024 the economy of Timor-Leste could register a positive growth rate of 4.2% compared to 2023. This projection is based, above all, on the 4.4% contribution from domestic demand, which represents an increase in this contribution of 8.6% recorded in 2023, and a reduction of -0.2% in the contribution of net external demand in 2024. In fact, a worsening of the negative balance of net exports is projected, essentially explained by an increase in imports of goods and services despite a slight increase in exports of goods and services. Thus reducing the contribution of net external demand to economic growth in 2024, despite the increase, already discussed, in the contribution that domestic demand will have in 2024.

Regarding the consumption dynamics of Timorese families, an annual increase of 5.2% is expected in 2024, which represents a slowdown compared to 2023, the year in which a growth of 9.1% in private consumption is expected. With regard to investment, it is expected that both public and private investment will register a positive variation, in the same direction as observed in 2023. In particular, an annual growth rate in public investment is expected to be 2.1%, as well as an increase in private investment of 1.2% in 2024.

The economic projections carried out by BCTL are in line with other national and international institutions.

In summary, the projections made by the BCTL maintain a more conservative perspective regarding the economic development of Timor-Leste in 2024, which is mainly due to the dynamism of the private sector, given that there is some increase in private demand in the economy just from the contained increase in public expenditure of 6%.

In relation to 2023, and when comparing the estimated values for the real dynamics of Timor-Leste's GDP with the Ministry of Finance and the IMF, the BCTL values present greater optimism. Specifically, while BCTL predicts that growth in 2023 will be 2.3%, the Ministry of Finance and the IMF present a more conservative value for the real GDP growth rate of 2.2% and 1.5%, respectively. It can be considered that, essentially, the various forecasts present a high degree of reasonableness.

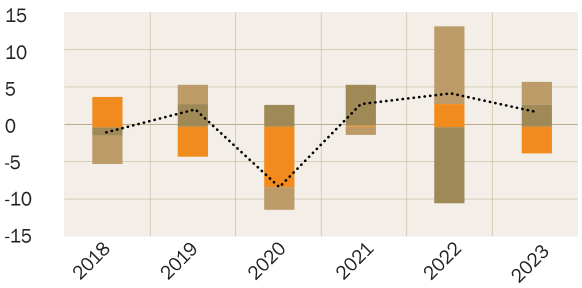
Finally, it should be noted that this projection scenario for 2023 and 2024, as in previous years, continues to confirm the excessive weight of the public sector in the domestic economy, thus delaying economic development led by private and productive sectors. This transition would contribute decisively to mitigating the constant negative balances of net exports that compromise economic sustainability in the medium and long term. Promoting private-sector led economic activities would be possible to create more quality jobs with better remuneration for young population. This will eventually lead to a robust and sustainable economic development.

2.1.2. GDP Evolution – Optics and Components

The official data from the National Accounts of Timor-Leste for 2022 was officially published in September 2023. The BCTL developed an estimation model that allow it to estimate the most recent evolution of the relevant components of domestic and external demand and, in this way, evaluate the evolution of GDP and its respective aggregates in 2023. In this sense, the analysis that follows is based on official data from the National Institute of Statistics of Timor-Leste (INE-TL) until 2022 and on BCTL estimates for 2023, seeking to focus on the most relevant medium-term trends for the domestic economy.

BCTL estimated the real non-oil GDP growth rate at 2.3%. A slowdown compared to the positive GDP growth of 4% in 2022. This continues the non-oil economic recovery in 2022, after the resumption of growth in 2021, which was due to the normalization of economic activity following the lifting of restrictions on movement imposed in the context of the COVID-19 pandemic.

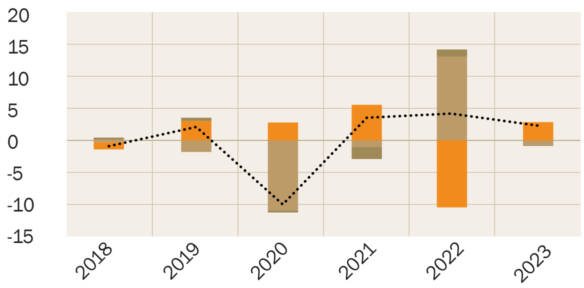
Chart 2.2a
Real GDP growth - Expenditure approach



% annual growth and contributions pp.
External Demand
Public Sector
Private sector
··· GDP

Source: INE-TL and analysis of BCTL

Chart 2.2b
Real GDP - Main components



% annual growth and contributions pp.
Changes in inventories
External demand
Internal demand
··· PIB

Source: INE-TL and analysis of BCTL

According to these projections, the slowdown in GDP was mainly due to the decrease in public consumption, which contributed -0.2 p.p. to GDP growth of 2.3% in 2023, on the other hand, public consumption represented around 59.3 % of GDP in 2023, a slight decrease compared to the value of 60.9% recorded in 2022.

In 2023, there was an increase in public investment.

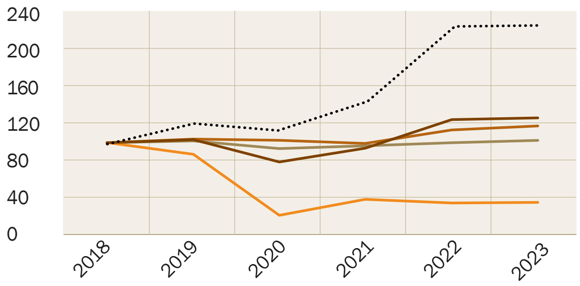
Regarding the expenditure perspective, as already mentioned and in accordance with the graphs presented below, we highlight that the evolution of the economy in 2022 and 2023 is due, above all, to the dynamics of public consumption and investment, which increased in 2022 and decreased in 2023. The relevance of the evolution of public demand for the trajectory of our economy has, in fact, been one of the main trends of the last decade.
In the graph that shows the evolution in terms of real GDP, private and public demand since 2018, it is confirmed that the decreasing trend in economic activity observed in 2019 and 2020 were resulted from the gradual reduction in public demand. The increase in public expenditure between 2021 and 2022 explains the resumption of GDP growth in the corresponding years. It should also be noted that private demand has only recorded a moderate growth. For this reason, the private sector's contribution to the GDP will not be sufficient to compensate for the decrease in the public sector and the corresponding impact that this had on the evolution of Timor-Leste's economy in recent years.
In graphs 2.2c and 2.2d we present the evolution of the subcomponents of private and public demand, compared with the GDP trajectory since 2018.

The year 2023 is marked by a slowdown in economic activity after the recovery in 2021 and 2022 following the COVID-19 pandemic

With regard to private sector demand, it should be noted that its volatility has exceeded GDP volatility since 2018, a phenomenon explained mainly by the dynamics of private consumption. On the other hand, private investment has been the subcomponent of private demand with the worst performance, particularly since 2019, being 81.2% below, in 2023, the level observed in 2018. This dynamic is alarming for the future of Timor-Leste's economy . With this trajectory in the short and medium term, we could see an economy excessively dependent on public investment, which increased in 2023 compared to 2022 and which could jeopardize the resilience of Timor-Leste's future economic development. The negative dynamics of investment in the private sector of the economy has quite severe impacts on the future productivity of the Timor-Leste economy, with unpredictable consequences on capital income and, consequently, on the labor factor.

Chart 2.2c

Real GDP and Private Demand

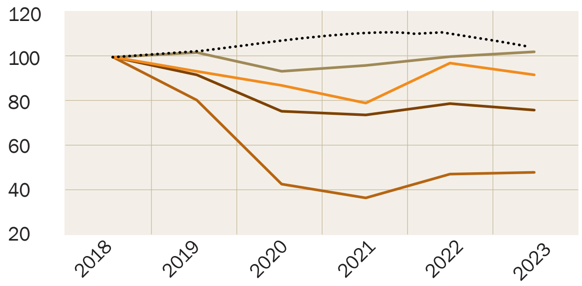


2018 = 100
— GDP
— Household consumption
— Private investment
— Private demand
··· Household investment

Source: INE-TL and analysis of BCTL

Chart 2.2d

Real GDP, Public Demand, and Imports



2018 = 100
— GDP
— Public demand
— Imports
— Public investment
··· Public consumption

Source: INE-TL and analysis of BCTL

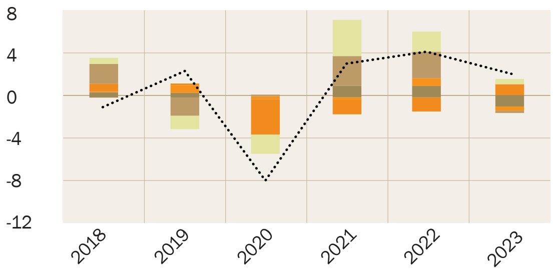
The other services sector, in addition to public administration, contributed decisively to the slowdown in economic growth in 2023

As regards to demand from the public sector, there are much lower amounts compared to 2018. In particular, the value of public demand in 2023 represented only 80% of the value observed in 2018, whereas in 2022 it represented around 77%. The fact that public investment only accounts for 58% of the value recorded in 2018 contributes negatively to this fact, thus elucidating the impact that the drop in public investment represents for the overall public demand in the economy of Timor-Leste. On the other hand, it should be noted that public investment can have important consequences for private investment decision-making. In this sense, public investment must be reinforced in order to increase the infrastructure necessary for the development and promotion of the private sector, particularly private investment.

Regarding the productive structure of the Timorese economy, the graphs below (2.3a and 2.3b) allow us to understand which sectors of activity have contributed in greater proportion to a greater dynamic of economic activity in Timor-Leste. More specifically, it is highlighted that the other services sector, in addition to public administration, contributed decisively to the slowdown in economic growth in 2023, contrary to what happened in 2022. In 2023, there was also a smaller contribution from the manufacturing industry, which is not a good sign for the future development of the secondary sector of the economy. In 2023, it is expected that the manufacturing industry will have recorded levels lower than those recorded in 2022. On the contrary, looking at the sector that contributed most to the performance of the economy in 2023, the civil construction sector stands out, which continued to decline since 2018, returning to a marginal increase.

Chart 2.3.a

TL: Real GDP growth: production approach



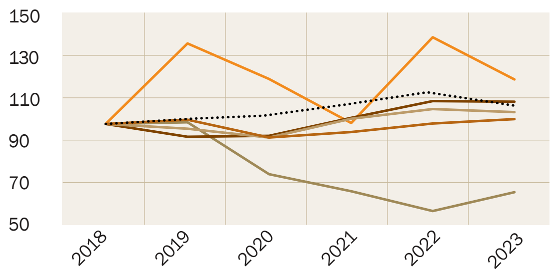
Annual variation and contributions pp.

- Other services
- Construction
- Agriculture
- Public Administration
- Manufacturing and other industries
- Non-oil GDP

Source: INE-TL and BCTL

Chart 2.3.b

Real GDP - by sector of production approach



2018 = 100

- Construction
- Other services
- Agriculture
- Manufacturing and other industries
- Public administration
- GVA

Source: INE-TL and BCTL

Since 2015 and until 2023, according to what we can assess through graph 2.3c, the main change in the productive structure consisted of the significant drops in the share of the construction sector (from 17% to 9% of GVA) while at the same the public administration recorded an increase from 29% in 2018 to almost 32% in 2023. The services sector continued to maintain the dominant position in the economic structure, representing 35% of GVA in 2023, compared to 49% in 2018.

The industrial sector has seen considerable development, having grown by more than 360% in the last 7 years.

As regards 2024, the BCTL expects this production structure to remain relatively stable, with the exception of expecting a slight increase in the share of the manufacturing sector, depending on the expected recovery in private and public investment.

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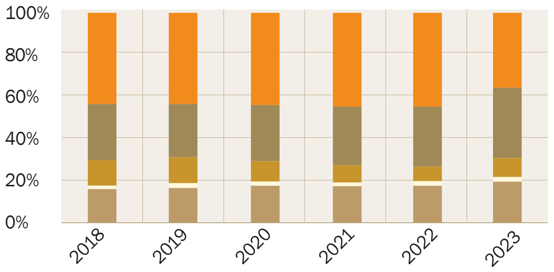
Looking at the positive aspect, the industrial sector has registered a notable expansion in its activity, with its GVA growing 20% between 2018 and 2023. Despite this robust expansion, this sector continues to represent a minor part of the domestic economy, representing just 2% of GDP in 2023, to the detriment of other sectors of economic activity.

This productive structure demonstrates that the country's economy continues to depend on a large scale on the public sector, as the sectors that are least dependent on the State - agriculture, fishing, industry, hotels and restaurants - only represented 35% of GDP in 2023. The shares of these sectors are reletively stable in the economy of Timor-Leste.

Despite the significant increase in the industrial sector, the anemic growth of the agricultural and fisheries sectors, which registered an accumulated growth of 9% since 2018, combined with weak dynamics in other sectors of activity between 2018 and 2023, as previously described, reflect the limited economic development of these sectors, which rely less on the public sector.

Chart 2.3c

Share of GDP by industries: Production approach



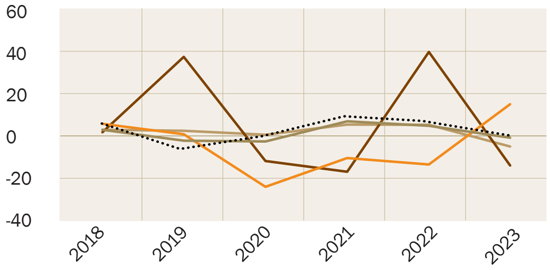
% of GDP

Agriculture
Construction
Others
Manufacturing and other industries
Public administration

Source: INE-TL and BCTL

Chart 2.3d

Growth rate by sector



% annual variation

Agriculture
Construction
Others
Manufacturing and other industries
Public administration

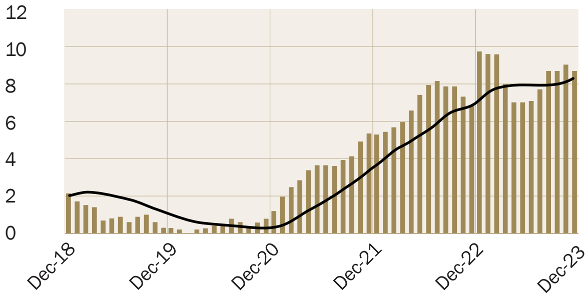
Source: INE-TL and BCTL

2.1.3. Prices and Inflation

The average annual inflation rate in 2023 was 8.4%, compared to 7% in 2022.

The average annual inflation rate in Timor-Leste, according to INE-TL, stood at 8.4% in 2023, which represented a notable increase in domestic inflationary pressures in 2023, following a high average inflation rate already occurring in 2022 of 7%. In year-on-year terms, the rise in the inflation rate is even more visible, having accelerated from 6.9% in December 2022, to 8.7% in December 2023.

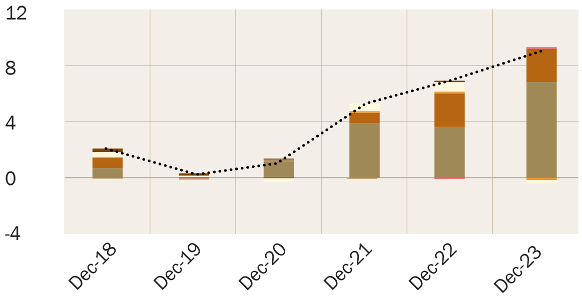
Chart 2.4
Inflation rate in Timor-Leste



% annual change in prices
Annual inflation
Average inflation

Source: INE-TL and calculation of BCTL

Chart 2.5
Inflation rate in Timor-Leste



% annual change and contribution
Food
Alcohol and Tobacco
Clothing and Footwear
Housing
Equip. of Housing
Health
Transport
Communication
Education
Total

Source: INE-Tl and BCTL analysis

The price level grew more rapidly in 2023 compared to that observed in 2022.

As can be seen in the graphs and tables that follow, in 2023 the inflation reached its maximum level in the last decade. This trend is in line with what has been happening in the various external economies following inflationary pressures resulting from the negative supply shock caused by the conflict in Ukraine.

The rise in prices is mainly explained by an accelerated increase in the prices of alcoholic beverages and food.

It should be noted that the acceleration of inflation in 2023 in Timor-Leste was essentially due to the rise in the prices of alcoholic beverages and tobacco, whose prices registered an increase in prices of around 32% (compared to an increase of 24% recorded in 2022) , followed by the food group, which recorded a price increase of 10.2% compared to an increase of 7.5% in 2022. Finally, the education group which registered an average inflation rate of 6.9% in December 2023 compared to a rate of just 2.5% recorded in the same month of the previous year. On the contrary, the sector of housing, recreation and cultural equipment, and transport registered a decrease in prices by 1.6%, 1%, and 0.6%, respectively in the year 2023.

Table 2.1 offers greater detail in terms of inflationary trends, breaking down the average inflation rate by large groups of goods/services:

Table 2.1.
Inflation Rate by CPI Groups - % annual average

	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23
Food	1.7	0.9	0.9	5.8	7.5	10.2
Alcohol & Tobacco	8.3	3.5	-0.4	7.2	23.8	32.0
Clothing & Footwear	0.6	0.2	1.6	0.0	-0.2	1.5
Housing	1.2	0.5	-0.6	0.4	1.4	0.7
Household Equip.	0.4	-0.6	-0.2	-0.3	2.9	-1.6
Health	0.0	0.0	0.0	0.2	0.8	0.0
Transport	3.0	0.8	-1.3	2.7	12.1	-0.6
Communication	0.3	-0.2	-0.4	0.0	0.0	0.7
Rec. & Cult.	-0.6	0.1	0.1	0.1	1.7	-1.0
Education	16.6	9.0	2.6	0.0	2.5	6.9
Total	**2.0**	**0.9**	**0.5**	**3.8**	**7.0**	**8.4**

Source: INE-TL & BCTL analysis

CHAPTER 02

The inflation rate observed in 2023 in Timor-Leste is slightly different from the values recorded worldwide.

As can be seen from the table above, the “Food” and “Alcoholic beverages and tobacco” groups were mainly responsible for the acceleration of the price level in 2023, not only due to the sectoral inflation rates observed – 10.2% for the “ Food” and 32% for the “alcoholic beverages and tobacco” sector - but also due to the very significant weights of these sectors as a whole in the representative basket of goods and services consumed in the Timor-Leste economy.

It should be noted, however, that the acceleration in the inflation rate seen in 2023 in Timor-Leste presents a different dynamic to that occurring in most world economies. However, this trend was not at all generalized to all categories, with some sectors such as “Health”, “Clothing and footwear” and “Communication” showing modest inflation rates when compared to other sectors.

The rigidity of supply, as well as the war in Ukraine, accentuated the price rise observed in 2023.

With regard to the macroeconomic determinants of the inflation rate observed in 2023, the acceleration in price levels is, above all, due to the inflationary pressures originating from the external sector. However, these pressures were partially contained by the appreciation of the USD against the currencies of our economy’s trading partners.

In the chapter that explores the evolution of the international economy, it was noted that to face the inflationary pressures experienced in 2023, the majority of central banks adopted contractionary monetary policies, marked by increasing in interest rates, with the aim of containing the monetary expansion in the economy. Although global and trading partner inflation rates have eased, Timor-Leste continues to struggle with persistent inflation, partly attributed to shortages of rice from India and reactions to the government’s policy of increasing import duties. Despite the subsequent rollback of the import tax to its initial level by the new government, it has not yet produced the desired reductions in prices.

The economic growth recorded in 2023, and the growing inflation felt in 2023, leads us to conclude that investments, whether public or private, must be stimulated to promote a more productive supply, with more robust jobs and wages that allow the economy of Timor-Leste to be more resilient to adverse external shocks such as those experienced in 2023. In line with this conclusion, the BCTL predicts that the level of economic activity in Timor-Leste will continue below the potential GDP, generating underemployment problems in the various productive sectors .

In terms of future perspectives, the BCTL anticipates an easing of inflationary pressures throughout 2024. In this context, the BCTL expects the average inflation rate, in 2024, to reduce to levels below those recorded in 2023, more specifically, to slow down to 4.5% in 2024.

These projections are naturally based on the assumption of exchange rate stability of the dollar against Asian currencies, the gradual reduction over the next few years of international inflationary pressures, particularly in the economies of our country's main partners, the new government's policy of reversing tax increases on imports, which should produce positive results in reducing domestic prices, and also on the fact that the domestic economy continues to operate below its potential level.

Despite the economic recovery seen between 2021 and 2022, sluggish performance over the past five years, coupled with the slowdown in 2023, has led to a decrease in job creation and, consequently, a decline in labor force participation. The 2021 labor force survey highlights the stagnation of labor force growth. Currently, the labor force participation is 30.5%, comparable to the figure of 30.6% recorded in 2013. This means that of Timor-Leste's working age population of approximately 809.4 thousand individuals aged 15 or over , only 30.5% are considered workers, employed and unemployed. The BCTL therefore estimates that the current level of GDP is currently below its potential or full employment level. This fact, together with the expectation that the expected economic recovery will not be enough to eliminate the domestic "output gap" by 2024, leads us to believe that inflationary pressures on the domestic economy will decrease next year.

2.2

Public finances

2.2.1. 2023 Budget Program

In 2023, according to the data in table 2.2 below, public expenditure, on an effective cash basis, recorded a significant reduction of $247 million.

In 2023, public expenditure recorded a significant reduction of $246 million.

Therefore, the overall actual value of expenditure fell to $1.494 million in 2023. The decrease in public expenditure compared to 2022 is explained, above all, by a lower degree of execution of expenditure from the 2023 budget compared to 2022. Namely, the execution rate of public expenditure in 2023 reduced by 2.5 p.p. to 76%. It should be noted that the initial amount of expenditure of $2,155 million USD allocated in the 2023 State Budget was ratified to $1,960 million, thus resulting in a reduction of 9% compared to the initial budget, and 11% compared to the budgeted amount in 2022.

The expenditure execution rate in 2023 was lower than that observed in 2022.

The decrease in the execution rate of the 2023 budget compared to the 2022 budget is explained by the reduction in budget execution in the Recurrent expenditure by 18% in 2023 compared to 2022 (76.9% of execution in 2023 compared to 90.7% of execution in 2022). However, it is important to highlight that the level of execution of capital expenditure is notably higher compared to the previous two years - a notable increase in execution of 33 p.p. of the execution rate for capital expenditure (73% in 2023 compared to a degree of execution of 39% in 2022). From our perspective, this constitutes a positive indicator for future economic activity, as public investment plays a crucial role in promoting the development of Timor-Leste's private sector economy.

Table 2.2.

State Budget – evolution and execution rate

	Millions USD		Annual change	Execution rate	
	2022	2023	2023	2022	2023
Total Revenues	**730**	**776**	**6%**	**104%**	**78%**
Domestic Revenues	**176**	**286**	63%	117%	56%
Tax Revenues	143	193	35%	117%	108%
Non-Tax Revenues	18	92	416%	108%	28%
Agency Retention Revenues	11	0	-100%	95%	
Grants & Contribution	4	0	-100%		
Estimated Sustainable Income	**554**	**490**	**-12%**	**100%**	**100%**
Total Spending	**1,741**	**1,494**	**-14%**	**79%**	**76%**
Recurrent Expenditures	1,538	1,263	-18%	91%	77%
Capital Expenditures	203	231	14%	39%	73%
Financing	1,011	718			
Excess Withdrawals from the Petroleum Fund	850	600	-29%	112%	84%
Use of Cash Balances	116	87	-25%	28%	44%
Loans	30	20	-32%	58%	58%

Source: TL Transparency Portal, Budget Book, and BCTL analysis

In annual terms, on a cash basis, the reduction in public expenditure of $247 million was explained by the substantial decrease in recurrent expenditure, which represented a negative growth rate of 18% compared to 2022, totaling $1.263 million, and positive growth in the value of capital expenditure at $28 million in 2023 compared to 2022, which represents an increase of 14% compared to the value executed in 2022.

Regarding revenues, the Government forecast in its 2023 OGE a total of non-oil revenues of $507 million, excluding loans and donations. This forecast, although ambitious, reflects a positive perspective, anticipating a notable growth of 237% compared to 2022. However, as it can be seen from Table 2.2, this budgeted revenue was reduced by 60 p.p., i.e., an execution rate of 56.4%, reaching a value of $286 million. However, it surpasses the 2022 run value of $176 million, marking 63% growth.

The revenue collected by the government was 54% below the budgeted amount.

Due to the substantial reduction in public expenditure (-$247 million) and despite a slight increase in non-oil revenue (+$110 million) of the Central State, the deficit calculated on a cash basis, excluding oil revenue, decreased in 2023 by an amount of $357 million, to $1,208 million (in 2022 the budget balance excluding oil revenues recorded a deficit of -$1,565 million).

2.2.2. Public Revenue

In 2023, non-oil revenues totaled $286 million, which represented an increase of 63% compared to 2022.

One of the Government's main priorities is to reduce the country's dependence on financing from the Petroleum Fund. Efforts in this regard remain fundamental in the Government's budget discussions and planning. In the 2023 OGE, for example, the Government continued to highlight its "tax reform" policy, with the aim of improving the country's fiscal framework and increasing domestic revenues, obtained based on non-oil resources and activities.

In 2023, on a cash basis, domestic non-oil revenues reached $286 million, registering a growth of 63% compared to the $176 million recorded in 2022. With regard to each of the category, tax revenue registered an increase of 35%, a significant increase, totaling $193 million, while non-tax revenues registered a very significant increase of 416% compared to the previous year. In detail, in 2023 there was a total of non-tax revenue of $92 million (in 2022, the amount of this revenue item was $18 million).

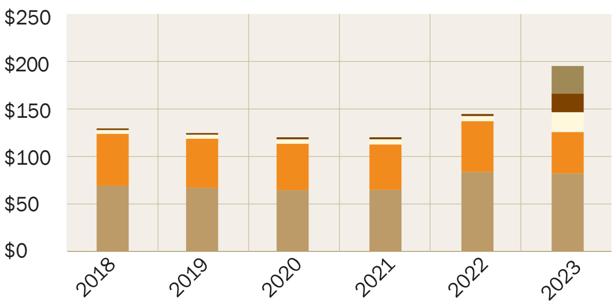
Taxes on goods continued to represent the largest share of tax revenues.

Graph 2.6 highlights the variations in tax revenue and its main components over recent years, namely taxes levied on the income of individuals and companies and taxes charged on the import of goods (taxes on goods include excise taxes , sales and import). With the increase in tax revenue collected, it is worth noting a slight reduction in revenue from taxes on goods, which totaled almost $82 million compared to 2022 revenue totaled more than $84 million. On the other hand, income tax recorded a decline of $10 million in revenue collected, and in 2023 the amount of taxes received on income totaled $43 million, a reduction of approximately 10% compared to 2022. Revenues from of other taxes and service charges registered a very significant increase in 2023, representing 10% and 11% of tax revenues in total taxes collected by the government, respectively. The increase in tax revenues in 2023 is in part attributed to the inclusion of payroll tax revenues of $26.5 million, constituting approximately 14% of total tax revenues for the year.

It should be noted that the advantage of the increase in tax revenue lies in the reduction of excessive withdrawals from the petroleum fund to finance the State budget in 2023. This decrease amounted to $250 million, representing a drop of 29% compared to 2022.

Chart 2.6

TL - Fiscal revenue - cash basis



2.2.3. Public Expenditure

In 2023, the overall public expenditure execution rate decreased to 76%, sustaining the downward trend in budget execution observed in 2020, although exceeding the 2021 execution rate (71%). The lower execution rate was partly due to the parliamentary election period. To achieve the expected economic growth, it is essential that budget execution is high, at least corresponding to or even exceeding the levels recorded in 2018 and 2017, when execution rates of 91% and 85% were achieved, respectively.

The execution rate of the public expenditures was lower compared to 2022.

The amount of expenditure budgeted in 2023 was lower than that budgeted in 2022 by around $251 million, at the same time the amount of budget expenditure executed was lower than that of 2022, not only due to the reduction in budgeted expenditure for 2023 compared to 2022, but also by a slight reduction in the expenditure execution rate, as expressed previously, which ended up explaining an effective reduction in expenditure of more than $247 million, a decrease of almost 14% in expenditure compared to that observed in 2022.

Finally, the overall expenditure carried out by the government decreased, as previously mentioned, by $247 million, which is essentially due to the reduction in current expenditure of $275 million, and also included an increase in capital expenditure. Capital expenditure increased by $28 million in 2023 compared to 2022, which translates into a percentage increase of almost 14%. This increase in public investment expenditure was due to the fact that, despite having a reduction in this budget item compared to 2022, the amount executed was significantly higher, which translated into an overall amount in 2023 greater than that in 2022.

Global spending decreased by $247 million in 2023.

2.2.3.1. Current Expenditure

The current expenditure decreased by 18% in 2023.

In 2023, the current expenditure decreased by 18%, thus reverting to the expansions already seen in 2022 (18%), in 2021 of +35%, and in 2020 of 7%. The current expenditure, which totaled approximately $1263 million in 2023, once again records a historic reduction, after a constant increase since 2020, with a total amount of effective public expenditure of $967 million, and below the values recorded in 2021 and 2022, with a expenditure amount of $1302 million and $1538, respectively.

These represent more than 84% of total expenditure incurred in 2023.

Current expenditure thus continued to be the main component of public expenditure, amounting to 84% of the total, which represented a slight decrease of 4 p.p. below the proportion of this expenditure in the total expenditure executed in 2022. It is also worth highlighting that The reduction in expenditure was mainly due to a lower execution of this expenditure component, reaching an execution rate of 76.9% in 2023 compared to an execution rate of 90.7% in 2022.

In 2023, there was a substantial decrease in transfer expenses.

Graph 2.7 shows the annual evolution in millions of dollars of the components of public expenditure, determined on an effective cash basis, or expenditure actually carried out in each year. As can be seen, unlike the previous year, the reduction in expenditure on transfers (-$308 million) and on goods and services (-$150 million) explained the significant reduction in current expenditure, while the increase in expenditure on public investment by $26 million helped offset the decrease in total expenditure recorded in 2022.

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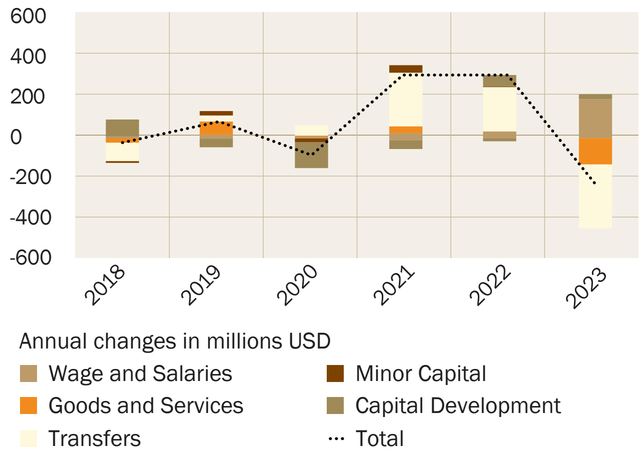
Chart 2.7

Public expenditure changes by category - cash basis



Source: TL Transparency Portal and BCTL analysis

Due to this evolution, expenditure on transfers represented the largest category of total expenditure in 2023, with 38% of the total (50% in 2022, 46% and 34% in 2021 and 2020, respectively), followed by expenditure on salaries with 30% (15% and 16% in 2022 and 2021, respectively) and goods and services with 17% (23% and 28% in 2022 and 2021, respectively).

2.2.3.2. Capital and Development Expenditure

The government estimated in the 2023 OGE a global capital expenditure, including the loan program, in the amount of $318 million, representing a significant decrease of around $198 million, translating a decrease of approximately 38% compared to the value stated in the 2022 budget ($515 million), a year in which the budget increased by $51 million (11%). However, this increase in 2022 is far from the amount budgeted in 2021, a year in which an amount of $464 million was budgeted and which represented an increase of $244 million (+111%) compared to 2020.

On the other hand, capital expenditure decreased by 38% compared to 2022, totaling $318 million in 2023.

However, despite the budgeted amounts, there was a high execution rate, around 73%, which was higher than the weak budget execution of this expenditure component in 2022 and 2021, when a rate of 39% and 30% was recorded, respectively. Therefore, it should be noted that in 2023 the total amount of public investment executed totaled $231 million, an increase in executed expenditure of $28 million compared to 2022.

The majority of capital development expenditure was spent within the scope of the construction of infrastrucute program, also including loans, the weight of which represents 47% of total public investment, a figure quite far from the 73% recorded in 2022. The Infrastructure Fund Program continues assuming the greatest relevance in terms of public investment, as its expenditure corresponds to 47% of the category's total in 2022.

The construction of infrastructure was the most favored program among the total executed capital expenditures.

Table 2.3 details information regarding the main components of the national public investment program, identifying the highest priorities in terms of the most relevant infrastructure programs.

Table 2.3.

Composition of Public Investment

	Millions USD - cash basis			% Public Investment		
	2021	2022	2023	2021	2022	2023
Minor Capital	44	46	48	32%	23%	21%
Development Capital	96	157	183	68%	77%	79%
Total Infrastructure	91	147	109	65%	73%	47%
Total Public Investment	140	203	231	10%	12%	16%
Total Expenditures	1442	1741	1448			

Major infrastructure asset investment sectors

	Millions USD - cash basis			% Public Investment		
	2021	2022	2023	2021	2022	2023
Agriculture	2	3	4	2%	1%	2%
Rural & urban dev.			4	0%	0%	2%
Maint. & rehab.			10	0%	0%	4%
Court services			3	0%	0%	1%
Infromation and com. Tech.			16	0%	0%	7%
Water and sanitation		2	1	0%	1%	0%
Health	8	5	2	6%	3%	1%
Airport			2	0%	0%	1%
Education	0	28	1	0%	14%	1%
Road and bridge	3	18	58	2%	9%	25%
Other infrastructure	78	91	8	56%	45%	3%
Total infrastructures	91	147	109	65%	73%	47%

Source: TL Transparency Portal and BCTL calculation

As it can be seen, investment in minor capital increased by $2 million in 2023 compared to the value of $46 million recorded in 2022, representing 21% of public investment. In terms of sectoral priorities for public investment in infrastructure, investment in roads and bridges constituted the main investment programs, with a combined annual expenditure of $58 million in 2023, with the importance of these priorities significantly higher than in 2022 ($18 millions). One of the main focuses of government public investment in 2023 was the IT and communications technology sector, with a total expenditure of $16 million, constituting 7% of global public investment for the year.

2.2.4. Financing source

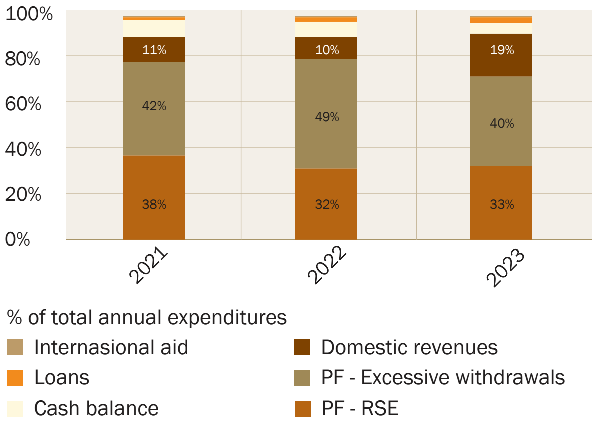
The FP financed $1,090 million of public expenditure in 2023

In 2023 Budget, the Government planned to use $1,207 million from the Petroleum Fund, but actually withdrew a lower amount, around $1,090 million, to finance its actual expenditure throughout the year. Note that this value represents a decrease of $314 million compared to 2022, due to lower public spending and a reduction in the value of the non-oil fiscal deficit.

Despite registering a reduction, the annual value withdrawn from PF continues to be well above its Estimated Sustainable Income (ESI), valued at $490 million ($554 million in 2022 and $548 million in 2021), which translates into a continued reduction in capital of the PF.

Chart 2.8

Source of Public Expenditure Funding



Source: TL Tranparency Portal, OGE, and BCTL analysis

The PF continues to be the main source of financing for the State budget.

With regard to the sources of financing used to finance public expenditure in 2023, it should be noted that the PF continues, despite the reduction, to be the main source of financing, with this source representing 73% of total financing, when, in 2022, it represented 81% of the total financing carried out to finance the expenditure incurred. On the other hand, domestic public revenue represented only 19% of total financing, a value marginally higher than that recorded in 2022 and 2021 of 10% and 11%, respectively. Contributing to this upward trend is the fact that the total expenditure fell in 2023, at the same time as the non-oil revenues increased.

Regarding loans, these have represented a reduced proportion of 2%. These loans, which have mainly been used to finance investment in roads in the country, amounted to $20 million in 2023 ($30 million and $15 million, in 2022 and 2021), corresponding to an execution rate, in 2023, of 58%, which represents a slightly lower execution of the loans foreseen in the OGE.

In short, these considerations allow us to verify the continued enormous dependence of the State budgets on financing originating from oil revenues or, more specifically, from transfers from the Petroleum Fund, in an amount that substantially exceeds its sustainable income. Despite the existence of substantial energy reserves in Timor's water, the fact that the exploration projects currently underway are scheduled to end in 2023, means that the continued and substantial reduction in the Fund's capital represents a material risk to the sustainability of our public finances in the medium term.

CHAPTER 02

2.3 Monetary and Exchange Rate Sector

2.3.1. Interest Rates

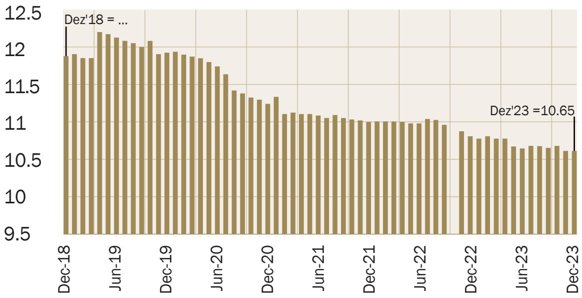
Loan interest rates continue to be significantly high despite the credit granting program at lower rates.

The level of interest rates on loans continues to be relatively high when compared to international reference rate levels in dollars. In fact, economic theory says that when a small country adopts the currency of a large economy as its own, its interest rates tend to converge with those of its reference. In Timor-Leste this does not happen, especially for credit interest rates for several reasons, the main one being the risk of the banking business. On the other hand, the government of Timor-Leste provides financial capital to grant loans (soft loans) at lower rates (3%). However, this economic policy is not yet having an effect on the rates currently observed in Timor-Leste's banking system.

Similar to the evolution of the previous year, the high average interest rates on loans to the private sector continued to decline from 10.83% to 10.65% from December 2022 to December 2023, which represents a positive sign for companies and families that use bank credit to finance themselves. However, there was a slight decrease in the average rate paid on deposits with 6-month maturities at the end of 2023 compared to 2022. More specifically, while in December 2022 6-month deposits were remunerated at a rate of 0.67%, in December 2023 the interest rate for deposits with the same maturity was 0.62%, a slight reduction of 0.05 p.p. in a period of one year. This dynamic of active and passive interest rates caused the "spread", that is, the interest rate differential, to fall to 10.15%, when at the end of 2022, the same differential was approximately 10. 30%.

Chart 2.9a

TL: Lending interest rate - weighted average

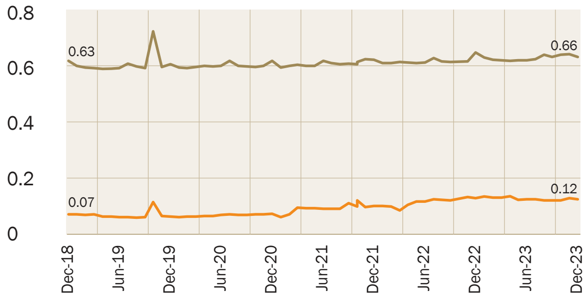


% annual

Source: BCTL

Chart 2.9b

TL: Deposit interest rates



% annual

— Demand deposit

— Time deposit, 12 months

Source: BCTL

Table 2.4.

Interest Rates of Commercial Banks – weighted average (% annual)

Periods	Loans + 6 months Libor	Demand deposit	Saving deposit	Time deposits			
				1 month	3 months	6 months	12 months
2022 Dec	10.83	0.13	0.52	0.59	0.62	0.67	0.67
2023 Jan	10.80	0.13	0.49	0.59	0.62	0.67	0.65
Feb	10.84	0.13	0.48	0.59	0.61	0.67	0.64
Mar	10.80	0.13	0.47	0.58	0.61	0.66	0.64
Apr	10.81	0.13	0.47	0.58	0.60	0.65	0.63
May	10.70	0.12	0.47	0.59	0.62	0.69	0.64
Jun	10.67	0.12	0.48	0.63	0.65	0.71	0.64
Jul	10.70	0.12	0.48	0.62	0.65	0.70	0.64
Aug	10.71	0.12	0.51	0.62	0.65	0.70	0.66
Sep	10.68	0.12	0.50	0.62	0.65	0.70	0.65
Oct	10.71	0.12	0.51	0.62	0.65	0.70	0.66
Nov	10.64	0.12	0.51	0.60	0.63	0.67	0.66
Dec	10.65	0.12	0.50	0.55	0.57	0.62	0.65

Source: BCTL

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2.3.2. Exchange rates

In 2023, the USD depreciated by 0.6% against the rupiah of Indonesia, Timor-Leste's main economic partner.

Similar to what happened in 2022, the North American dollar, the official currency of Timor-Leste, showed the same dynamics of exchange rate devaluation against the two currencies of Timor-Leste's main trading partners. More specifically, between December 2022 and December 2023, the USD depreciated against the Singapore dollar, a reference currency in the Asian context, by around 1.5%, and depreciated by 0.6% against the Indonesian rupiah, which is Timor-Leste's main partner economy. It should be noted, however, that in 2023 there was greater exchange rate stability than the volatility observed in 2022.

Chart 2.10

Nominal Exchange Rate vs USD

Source: Bloomberg

The slight devaluation of the USD against the currencies of Timor-Leste's main trading partners, the Singapore dollar and the Indonesian rupiah, contributes to the destabilization of domestic inflation. Therefore, given that Timor-Leste maintains a high dependence on imported goods and services to meet existing domestic demand, the net effect of the two exchange rate dynamics contributed to the observed worsening of the inflation rate in 2023.

2.3.3. Monetary Base (BM)

The monetary base increased, in 2023, by $111 million, contrary to the decrease observed in 2022.

The Monetary Base, which is one of the determining variables in terms of monetary policy, increased significantly in 2023 by $111 million, contrary to the decrease recorded in 2022 (-$145 million). The monetary base was valued at $283 million at the end of 2023, with $31 million corresponding to the currency in circulation and the remaining $252 million to bank deposits with the BCTL. The increase in the monetary base in 2023 is explained by the increase in bank deposits with the BCTL by $107 million, mainly deposits related to the capital reserve account and the bank loan reserve account. These two accounts, which banks are required to open with the Central Bank if they fail to comply with Central Bank instructions regarding the maintenance of minimum loan-to-deposit ratios (LDR), played an important role in driving the increase in the monetary base during the period 2023.

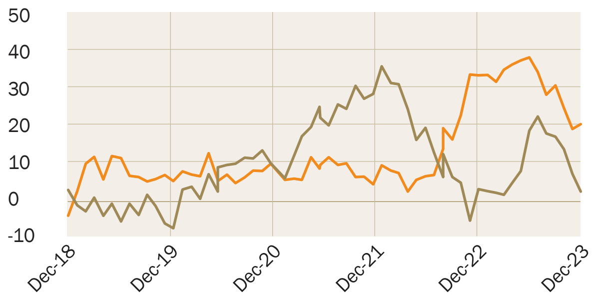
2.3.4. Money Supply

Financial sector development plays a vital role in fostering economic growth and poverty reduction. The compilation and analysis of monetary and financial statistics make it possible to assess the development and changes in a country's monetary and financial systems. The Central Bank of Timor-Leste has been systematically collecting and compiling these statistics with the aim of developing a comprehensive and detailed view of our financial sector, in order to develop the functions of the BCTL within the scope of macroprudential supervision and the implementation of a monetary policy. However, to date, the BCTL still does not have monetary policy instruments as our country continues to use a foreign currency, the US dollar, as its official currency.

M2 rose to 1,248 million in December 2023, an increase of $33 million.

Chart 2.11

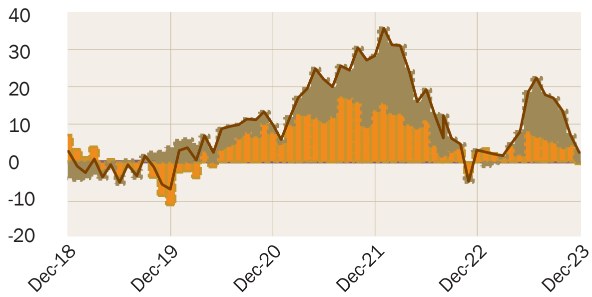
Money Supply Growth



% annual change
— Credit to private sector
— M2
Source: BCTL

Chart 2.12

M2 and its components



% annual change and contributions
Other deposit
Transferable deposit
Currency in circulation (centavos)
— M2
Source: BCTL

Although Timor-Leste is a "dollarized" economy, it is possible for the BCTL to reasonably calculate the aggregate monetary mass (the M2 aggregate), excluding dollar bills in circulation, which in most countries is used as a measure of the availability of resources of payment. As is customary, the monetary supply in Timor-Leste is calculated by summing the currency in circulation with demand deposits (which, like the former, can be mobilized immediately to make payments through checks) and the "quasi-money" (savings and term deposits), which can also be mobilized at relatively short notice to make payments.

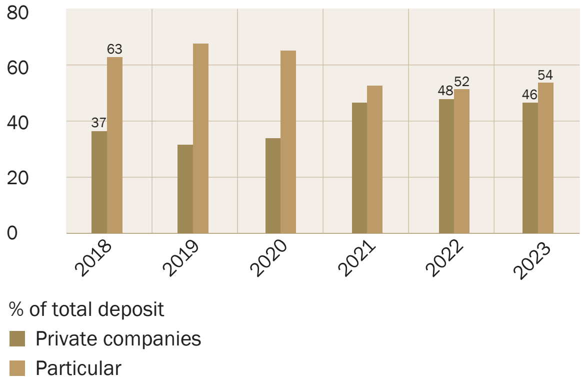
Graphs 2.11 and 2.12 show the evolution of the monetary aggregate M2, over the period from 2018 to 2023. Note that the M2 values are approximate, because, as the country uses the North American dollar, it is difficult to calculate the value of banknotes in circulation accurately. However, as this must constitute a small and stable proportion of the amounts available for payments, the approximate M2 serves reasonably well for the purposes of measuring the size and variation of the money supply in our economy.
The M2 thus calculated amounted to $1,248 million in December 2023, having recorded an expansion of $33 million, an increase well below the $96 million increase in the money supply that was recorded between December 2022 and December 2021.

Of the total deposits, there has been an increasing convergence in the percentage of deposits held by private companies and individuals since 2019.

It is also important to analyze the evolution of the components of the monetary supply, shown in graph 2.12. The total deposits raised by financial institutions were decisive in the expansion of the money supply, with an increase of $30 million, reinforcing the increase of $94 million in 2022.

Chart 2.13

Share of Deposit by Ownership



Source: BCTLL

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Regarding their ownership by institutional sector, as can be seen in graph 2.13, it can be seen that 54% of deposits are held by individuals and 46% by private companies. These percentages reflect a slight increase of 2 p.p. in the share of deposits held by individuals, instead of what had happened with private companies whose total weight of deposits decreased by the same magnitude (-2 p.p.). Despite the slight decrease in the weight of deposits held by private companies in 2023, the weight of company deposits is practically high compared to 32% in 2019 and 14% in 2012.

Another perspective on the analysis of M2, according to Table 2.5 below, the increase in credit and government deposits explained the bulk of the increase in money supply, despite being offset by a significant reduction in net external assets.

Table 2.5.
Drivers and Changes of Money Supply

In millions USD

	Annual Flow 2022	Annual Flow 2023
Credit to the Economy	104.6	84.3
Government	-193.8	133.0
BCTL Complaints	-0.3	0.8
Deposits	-193.5	132.2
Net External Assets	312.4	-173.0
Others	127.0	11.3
M2	96.3	32.9

Source: BCTL

2.3.5. Bank credit

In 2023, credit granted by banks to the private sector increased, a trend that has been recorded since 2021. However, the increase in 2023 was slightly lower than that in 2022 - an increase of $78.3 million, compared to an increase of $89 million in 2022. This evolution is equivalent to an increase of 22%, exceeding the increase recorded in 2021 in the amount of $14.8 million, or even the maximum increase recorded in that period of $26 million in 2020 compared to 2019.

Bank credit increased in 2023 (22%), with special emphasis on credit granted to the commerce and finance and tourism and services sectors, and individuals.

Table 2.6.

Evolution and Composition of Bank Credit

Credit by sector	Balance (millions USD)		Growth		Composition	
	2022	2023	Nominal	%	2022	2023
Agriculture, Water and Forestry	1.5	1.7	0.2	13.7%	0.4%	0.4%
Industry and Manufacturing	16.6	19.9	3.3	20.2%	4.6%	4.5%
Construction	65.8	62.8	-2.9	-4.4%	18.2%	14.3%
Transport and Communications	48.2	18.5	-29.7	-61.6%	13.3%	4.2%
Trade & Finances	26.5	61.6	35.1	132.4%	7.3%	14.0%
Tourism and Services	11.1	19.8	8.7	78.4%	3.1%	4.5%
Individual & Others	192.0	255.5	63.5	33.1%	53.1%	58.1%
Total	**361.6**	**439.9**	78.3	22%	100%	100%

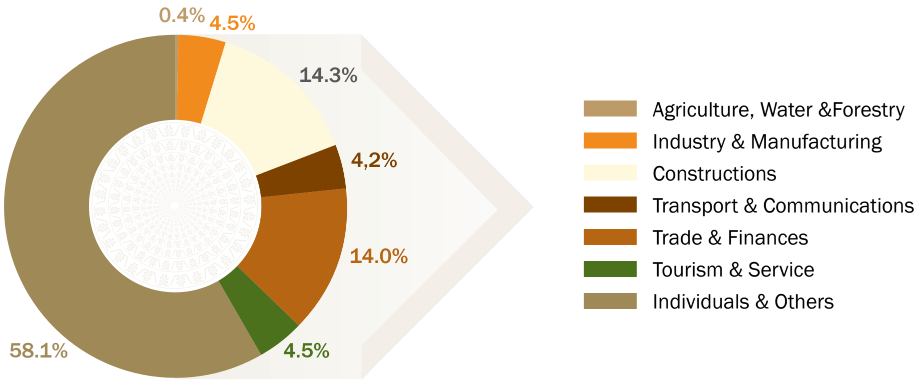
Source: Commercial Banks and BCTL analysis

When analyzing credit granted by sector of activity, we can see that the commerce and tourism sectors recorded the highest credit growth in 2023 - 132% and 78.4% for a total value of $61.6 million and $19.8 million, respectively. This evolution translates into an increase in credit granted in 2023 for these sectors of $35.1 million and $8.7 million, respectively. On the other hand, unlike the previous year, credit granted to the construction and transport sectors fell by 4.4% and 61.6% (equivalent to -$2.9 million and -$29.7 million), to a total of $62.8 million and $18.5 million, respectively.

It is also worth highlighting the increase observed in credit granted to Timorese families, with the increase recorded in 2023 compared to 2022 totaling $63.5 million, the largest increase in nominal terms in the last decade, which added to the increase in credit already observed of $9.2 million in 2022 and $17 million in 2021. With this increase, the proportion of credit granted to individuals increased to 58% in 2023 compared to 53.1% of credit granted in 2022. The increase in the relative weight of credit granted to individuals is mainly due to the decrease in the weight of credit granted to the construction and transport and communication sectors, as can be seen from the table above.

Chart 2.14

Credit by Sectors - Dec 2023 - % Total



Source: BCTL

Unlike the previous year, the agriculture, water and forestry sector was one of the sectors of activity that saw credit granted increase, albeit marginally, with a growth of 13.7% for a total accumulated value of $1.7 million. As previously mentioned, one of the two sectors that recorded a decrease in credit granted was the construction sector, with a decrease of $2.9 million. The other sector that also recorded a decrease in credit granted was the transport and communications sector, with a larger reduction of around $29.7 million. On the other hand, one of the sectors that recorded the greatest growth was industry and manufacturing, with a growth rate of 20.2% for a total credit granted in 2023 of $19.9 million, despite a reduction in its share to 4.5% compared to 4.6% in 2022. After credit to individuals, credit to the construction and commerce and industry sectors were the next dominant sectors, jointly representing a total of 24.3% of total credit granted to the Timor-Leste economy in 2023.

On the other hand, the agriculture sector recorded a reduction in credit granted.

In addition to the "quantity" of loans, it is also important to analyze their "quality", which can be done based on indicators such as the amount of "doubtful loans" and the system's provisions for credit risks. It should also be noted that the value of provisions for credit risks is beginning to show an upward trend, with a very high level in 2023, worth $20.1 million, when, in 2022, it was recorded at a historically low level of $6.8 millions. However, this increase should be related to the increase in credit granted in 2023. It should also be noted that banking institutions remain quite robust in terms of their ability to face a possible deterioration in credit quality, given that current levels the non-performing loans are very low, 2.3%, and that the sector's operating profit margin offers a robust basis to finance this eventuality.

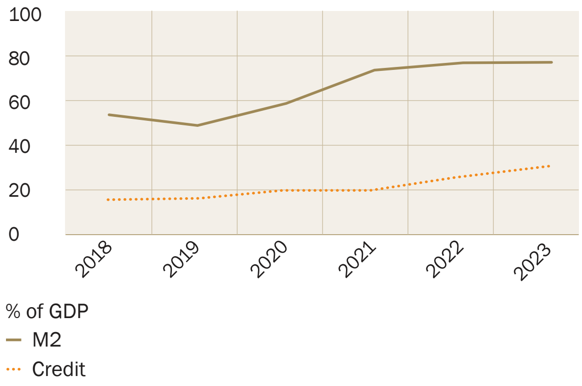
Despite the improvement in the quality of financial institutions' balance sheets, the aggregate value of credit has remained at levels much lower than those of deposits captured, providing commercial banks with excess liquidity that tends to be invested preferentially, by banks, in deposits abroad.

2.3.6. Financial Deepening Indicators

The degree of financial deepening increased by 3.6 pp in 2022 compared to 2021.

The degree of financial deepening, also known as the degree of monetization of the economy, can be measured based on the ratio of M2 to GDP. This ratio rose by 0.3 p.p. in 2023 to 76.8% of GDP (76.5% in 2022), showing the increasing trend seen in the recent past, albeit with some variations. Another indicator that can also be used to monitor the degree of financial deepening is the credit to GDP ratio. This ratio registered a value of 30.3% at the end of 2023, compared to the end of 2022, which registered a value of 25.7%, a percentage increase of 4.6 p.p. after a very significant increase of 5.8 p.p. in 2022.

Chart 2.15
Growth of monetary aggregates



Source: INE-TL and BCTL analysis

2.4

External Sector

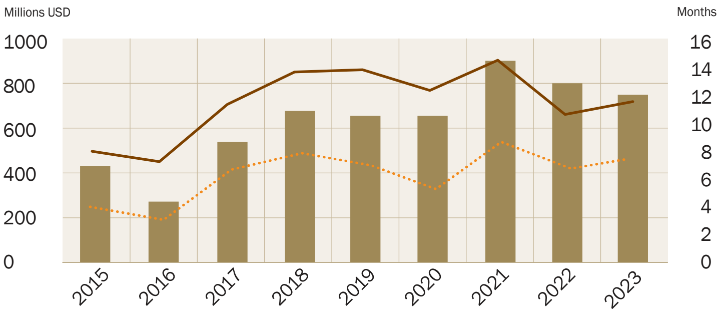
2.4.1. Net International Reserves

At the end of 2023, the balance of Net International Reserves (NIR) stood at $739 million, which represents a decrease compared to the value recorded in 2022 ($788 million) but, still, well above the average values observed since 2016. Expressed in months of coverage of total imports of goods and services, NIR corresponded to 8 months last year, which represents a slight increase compared to the 7 months in 2022..

NIR registers a decrease in 2023, however the import coverage rate increased.

Chart 2.16

Net International Reserve



NIR coverage ratio of imports in months
- NIR
- Covered-imports of Goods
- Covered-imports of Goods and Services

Source: INE-TL and BCTL analysis

2.4.2. Real Effective Exchange Rate Index

REERI appreciated by 17.6% in 2023.

The Real Effective Exchange Rate Index (REERI) – an indicator used to assess the competitiveness of countries in terms of tradable national products – appreciated by 17.6% in 2023, accelerating the real appreciation already recorded in 2022 (10%), presented in graph 2.17a. It should also be noted that REERI registered greater volatility in 2023 compared to the previous year, explained by the recovery in global economic activity at the same time as there is an increase in internal inflationary pressures in relation to trading partners.

This evolution was mainly due to the contribution of the nominal appreciation of the dollar against the currencies of our trading partners. It should be noted, therefore, that the Nominal Effective Exchange Rate Index (NEERI) registered a year-on-year appreciation of 18.7% in 2023, an acceleration compared to 2022, when a year-on-year appreciation of 6.4% was observed.

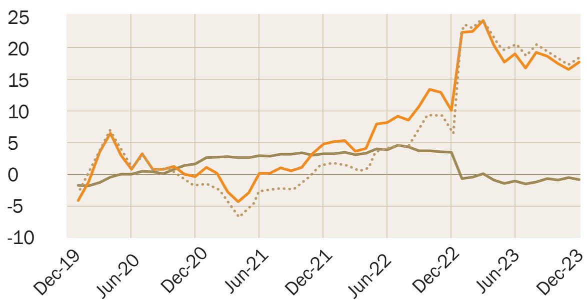
Coffee exports continue to be the country's main export.

In terms of average annual variations (graph 2.17b), REERI registered a significant appreciation at the end of the year of 19.2%, in line with the appreciation recorded in 2022 of 8.2%. In terms of bilateral, specifically in relation to the currencies of Indonesia and China, two of the country's main trading partners, the dollar recorded a notable appreciation of 4.4% against the rupiah and 12.2% against the Chinese Yuan. This evolution followed the trend observed for the global REERI, with an appreciation of the dollar during 2023.

Exports of Coffee continue to be the country's primary export commodity, and almost the only export. However, international prices continue to be the strongest determinant of this type of export, as the respective export volumes are only slightly influenced by the evolution of these effective exchange rates.

Chart 2.17a

Real Effective Exchange Rate Index

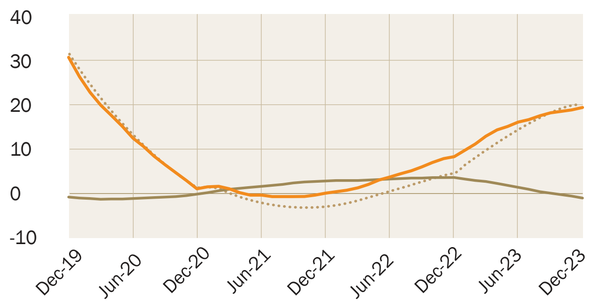


% Annual changes
- CPI
- NEER
- REER

Source: Bloomberg and BCTL analysis

Chart 2.17b

Real Effective Exchange Rate Index - Average



% average annual changes
- CPI
- NEER
- REER

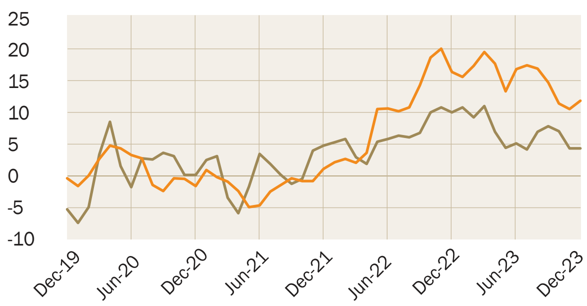
Source: Bloomberg and BCTL analysis

In bilateral terms, it is important to note that the prices of goods imported from Indonesia continue to be more competitive than those of similar goods from China during 2023, which is also confirmed by the greater importance of Indonesia as a trading partner for our economy. However, during 2020 until the beginning of 2022 the prices of these two commercial partners were really competitive.

Goods imported from Indonesia are more competitive compared to those from China in terms of price.

Chart 2.18

Selected Bilateral Real Exchange Rate



% annual change
- RERI vs Indonesia
- RERI vs China

Source: Bloomberg and BCTL analysis

2.5

Balance of payments

The year 2023 will be marked by a significant worsening of the external deficit.

Timor-Leste's external current account recorded, once again, a significant deficit of -$601 million in 2023, excluding oil activity (a reduction of $37 million). However, if oil activities are included, the deficit improved to -$228 million, although in 2022 this current account was in surplus. The deterioration of the goods balance, from $894 million in 2022 to -$149 million in 2023, contributed significantly to this current account deficit in 2023. The reduction in the services account deficit from -$441 million in 2022 to -$328 million in 2023, and the significant increase in the primary income contributeed to improving the current account deficit in 2023. This current account deficit corresponded to -37% of GDP in 2023, which represents an improvement of 3 pp compared to 2022 and a worsening of more than 400 p.p., if oil activity is included.

The evolution of the current account balance determines the economy's overall net external financing needs, which can be observed through the capital and financial accounts.

Table 2.7.
Balance of Payment of Timor-Leste

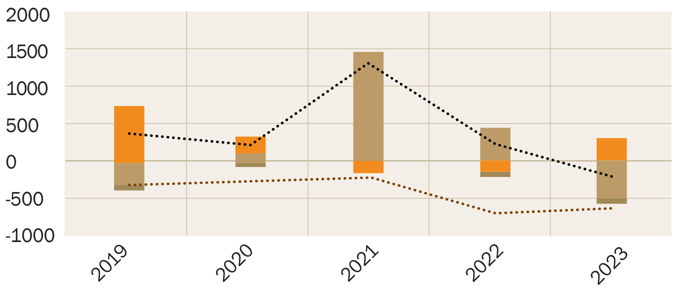
	Million USD			% GDP	
	2022	2023	% change	2022	2023
Current balance -Exc. Petroleum activities	-639	-601	-6	-40	-37
Current account	256	-228	-189	16	-14
Goods account	894	-149	-117	56	-9
Services account	-441	-328	-26	-28	-20
Primary income account	-128	333	-361	-8	21
Secondary income account	-69	-84	21	-4	-5
Capital account	17	4	-75	1	0
Financial account	735	-406	-155	46	-25
Direct investment	395	-13	-103	25	-1
Portfolio Investment	152	--219	-244	10	-13
Other investment	289	-125	-143	18	-8
Errors and Omissions	462	-183	-140	29	-11
Global balance	1,007	-629	-162	63	-39
Reserve assets (change)	-102	-49	-52	-6	-3

Source: BCTL

2.5.1. Current Account

As it can be seen in graph 2.19 below, the current account balance recorded a new deficit in 2023, which, as mentioned above, was mainly due to the increase in imports of goods, while the reduction in the services deficit and the increase of primary income contributed to improving the deficit.

Chart 2.19
Timor-Leste - Current Account Balance



Source: BCTL

The goods account recorded a deficit of $149 million, representing an increase compared to the surplus observed in 2022.

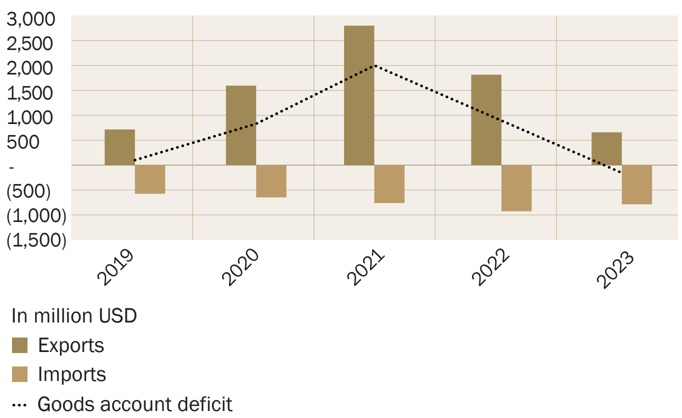
2.5.1.1. Goods Account

In the year under review, the goods subaccount of the trade balance, including the export of petroleum products, recorded a deficit of -$149 million, which translated into an increase in the deficit compared to the surplus observed in 2022 of $894 million. This evolution was mainly due to a reduction in the export of petroleum products to $577 million in 2023 from $1,745 million in 2022, or dropped by $1,168 million.

It should also be noted that the increase in exports since 2019 is due to the fact that revenues from petroleum products are now recorded in this subaccount instead of in the primary income account.

Chart 2.20

TL Goods Accounts



Source: BCTL

However, when oil revenues are excluded from the goods trade account, this subaccount recorded a worsening of its deficit in 2023, valued at -$679 million, due to the increase in imports of goods during the year, as the country's non-oil exports of goods remain insignificant.

Indonesia was the main destination for Timor-Leste's exports.

Export of Goods

Unlike in 2022, the main destination for our exports during 2023 was Indonesia, with a total weight of 44%, which corresponded to $7.5 million. In turn, the USA saw its share reduced as the main destination for Timor-Leste's exports by 13 p.p., representing just 13% of total exports, with a total value of $2.3 million.

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Table 2.8.
Destination of Exports

	Millions USD			% Total	
	2022	2023	% change	2022	2023
United State of America	7.6	2.3	-69%	26%	13%
Indonesia	4.0	7.5	89%	14%	44%
Portugal	0.7	1.8	173%	2%	10%
Australia	2.1	1.4	-34%	7%	8%
Germany	3.3	0.1	-97%	11%	1%
Taiwan	0.2	0.7	229%	1%	4%
Japan	1.5	1.0	-32%	5%	6%
Other	10.1	2.5	-75%	34%	14%
Total	**29.4**	**17.3**	**-41%**	**100%**	**100%**

Source: INE-TL and BCTL calculation

Import of Goods

According to INE-TL and before the respective adjustments in the balance of payments, the value of imports reduced by $18 million to $821 million in 2023, thus contradicting the increase seen in 2022 from 2021 ($250 million).

On the other hand, imports decreased by $18 million in 2023.

The main products imported by the country continued to be fuels (23% of the total, compared to 26% in 2022), followed by vehicles (11%) and cereals (9%). It is noteworthy that the majority of the most important imported items recorded an annual increase in their respective import values, partly due to the rise in prices. This increase resulted from the increase in taxes by the previous Timorese government and the inflationary pressures in international markets in 2023. This is the case with vehicles and cereals, electrical machinery, cement, and iron. It is also because of the recovery of domestic demand in the corresponding year that continues to depend on the import of goods produced abroad.

Fuels continue to account for the largest share of imports of goods.

Table 2.9.
Main imports of Goods by Commodities

	Millions USD			% Total	
	2022	2023	% change	2022	2023
Fuels	219	186	-15%	26%	23%
Vehicle	72	94	30%	9%	11%
Cereal	67	78	16%	8%	9%
Beverages	29	9	-69%	3%	1%
Electrical Machinery	38	46	21%	5%	6%
Mechanical Machinery	58	42	-27%	7%	5%
Meat & Derivatives	33	28	-15%	4%	3%
Cement & Substitutes	22	26	19%	3%	3%
Cereal - Refined	26	28	8%	3%	3%
Iron & Steel - Article	20	21	2%	2%	3%
Furniture; bedding, & mattresses	15	19	27%	2%	2%
Iron & Steel	21	31	48%	2%	4%
Others	219	213	-2%	26%	26%
Total	**839**	**821**	**-2%**	**100%**	**100%**

Source: INE-TL and BCTL calculation

The geographical structure of imports and their evolution are shown in the table below.

Indonesia continues to be the main seller of goods to the Timor-Leste.

Table 2.10

Imports of Goods – Countries of Origin

	Millions USD			% Total	
	2022	2023	Var % Ano	2022	2023
Indonesia	250	292	17%	30%	36%
China, Peoples Republic of	106	123	16%	13%	15%
Singapura	89	94	6%	11%	11%
Hong Kong	21	20	-3%	3%	2%
Viet Nam	19	20	5%	2%	2%
Thailand	16	12	-25%	2%	1%
Australia	17	15	-15%	2%	2%
Malaysia	54	29	-45%	6%	4%
Japan	10	11	20%	1%	1%
Brazil	17	14	-19%	2%	2%
Portugal	5	4	-14%	1%	1%
Korea Republic of	7	3	-57%	1%	0%
Other	227	182	-20%	27%	22%
Total	**839**	**821**	**-2%**	**100%**	**100%**

Source: INE-TL and BCTL calculation

Indonesia, which has remained the country's main trading partner, represented 36% of total imports in 2023. This share rose slightly by 6 p.p. compared to 2022, with the imports of goods from this country growing by 17% to $292 million. However, it is important to note that the rise in the relative importance of Indonesian goods was due to the stronger decline in the imports from other countries such as Malaysia, Thailand, and Brazil.

In addition to Indonesia, imports from China and Singapore continued to be the top second and third origin of imports, representing 15% and 11% of total imports in 2023. It is also due to the reduction in the aggregate imports from other countries that are not included in the list of the country's main traditional partners.

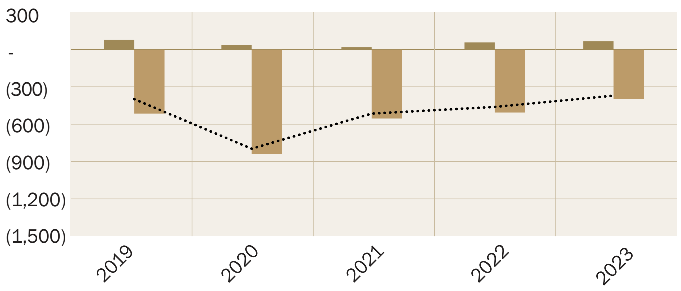
2.5.1.2. Service Account

The services account records an improvement of $113 million, although the balance of this account is still in deficit.

In 2023, the services trade account recorded a deficit balance of -$328 million, an improvement of $113 million compared to the deficit recorded in 2022 of -$441 million. As shown in graph 2.21, this trend was mainly due to the reduction in service imports in 2023, amounting to $104 million, but also due to a slight increase in service exports of $9 million in the same year.

Chart 2.21

TL Services Account



In millions USD

Exports of Services

Imports of Services

··· Services

Source: BCTL

The export of travel services was the sector that grew the most in 2023.

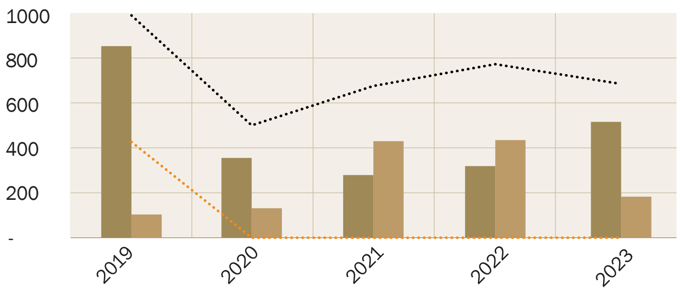
The increase in services exports was essentially explained by the increase in the export of travel services ($8 million). On the import side, it is worth highlighting in 2023 the reduction in imports of maintenance and repair services ($34 million), other business services ($16 million), construction ($6 million), and imports of services related to manufacturing needs ($131 million). Conversely, there was an increase in the import of services related to transport ($6 million) and travel ($75 million).

2.5.1.3. Primary Income Account

As previously mentioned, oil revenues were no longer recorded in the primary income account since the end of 2019, they were included in the goods subaccount after Timor-Leste ratified the agreement defining maritime borderies with Australia. This change explains the substantial decline in the surplus of the primary income account recorded since then.

Chart 2.22

TL Primary Income Account



In million USD

Received

Paid

··· Surplus

··· which are: invome from JPDA/ ACDP

Fonte: BCTL

In 2023, there was a surplus of $333 million compared to the deficit value of -$128 million observed in 2022.

There was an increase in remittances from emigrant Timorese citizens, worth $58 million in 2023.

2.5.1.4. Secondary Income Account

The balance of the secondary income account recorded a net outflow of resources of $84 million in 2023, which translated into a substantial increase compared to the negative balance of -$69 million recorded in 2022.

It is worth highlighting that remittances from foreign workers in Timor-Leste increased again ($44 million) to $407 million in 2023. Simultaneously, in the same year, the value of remittances from Timorese migrant workers, once again, recorded an increase of $58 million to $239 million, thereby contributing to alleviating the impact of the growth of remmittances sent in the deficit of the subaccount.

2.5.2. Financial Account

The portfolio investment contributed the most to the financial account in 2023 than the contribution of the foreign direct investment.

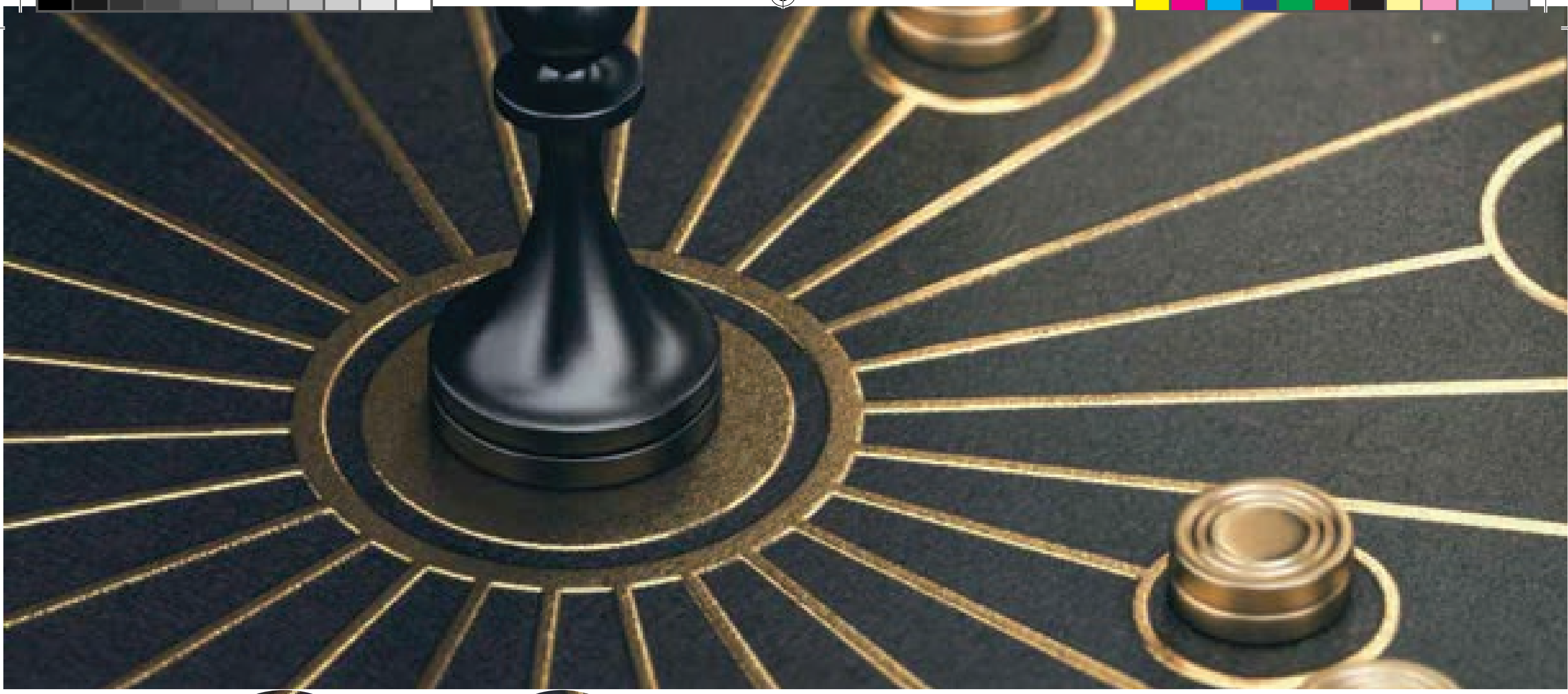
In the period under review, the financial account, which includes flows related to the economy's external financing sources, recorded a net financing need of $406 million, which corresponds to an increase compared to the net financing capacity of $735 million in 2022.

Despite the significant contribution of portfolio investments resulting from PF investment abroad, amounting to -$219 million, the increase in foreign direct investment in the country, which represents an increase in the country's liability to the abroad, also contributed to the increase in the financing need of the financial account. This subaccount registered an increase of -$13 million compared to the value of $395 million observed in 2022. This variation demonstrates that, unlike the previous year, in 2023 the country has a significant need of net financing.

Table 2.11
Source of Financing

	Millions USD	
	2022	2023
Financial Account	735	-406
Direct Investment in TL	395	-13
Portfolio Investment	152	-219
PF investment abroad	152	-219
Other Investment, Asset	366	-64
Other Investment, Liabilities	77	61
Changes in Reserves	-102	-49

Source: BCTL



2.6

Banking system

2.6.1. Bank Assets

The banking system in Timor-Leste remained stable and solid during the period under review. The sector continues to be financed practically based on resident deposits, lending only a fraction of these resources to companies and individuals, meaning that, as a whole, the banking system continues to record a very high level of liquidity.

It is worth highlighting the robustness of Timor-Leste's banking system.

The tables and graphs that follow provide a set of information about the country's banking system, which was constituted, at the end of 2023, by a bank based in Timor-Leste – the Banco Nacional de Comércio de Timor-Leste – and local branches of four important foreign banks, based in Portugal (CGD/BNU), Australia (ANZ) and Indonesia (Banco Mandiri and BRI), plus two other deposit-taking institutions and financial service providers Moris Rasik, SA and Kaebauk Investment and Finance, SA.

Total banking system assets once again recorded a slight growth of 5% to $2,441 million, slowing down compared to the significant increase seen in 2022 (27%), resulting in an increase of +$106 million. The growth recorded in total assets in 2023 was lower than the growth recorded since 2019. The positive evolution seen in 2023 results mainly from an increase in deposit at

Total banking system assets grew 5% to $2,451 million in 2023.

the central bank of $105 million, and an increase in credit granted [1] (+$63.6 million), but with a reduction in investments (-$13 million) and deposits in credit institutions (-$53 million), respectively.

Tables 2.12

Composition Banking System Assets

In millions USD	Dec-22	Dec-23	% share	Change	
				%	Valor
Cash & BCTL Balance	203	308	13	52	105
Placement at Credit Institutions (oter banks)	1,598	1,545	63	-3	-53
Investment	144	131	5	-9	-13
Credit Granted	356	420	17	18	64
Tangible Asset	15	16	1	11	2
Other Asset	20	22	1	9	2
Total	**2,335**	**2,441**	**100**	**5**	**106**

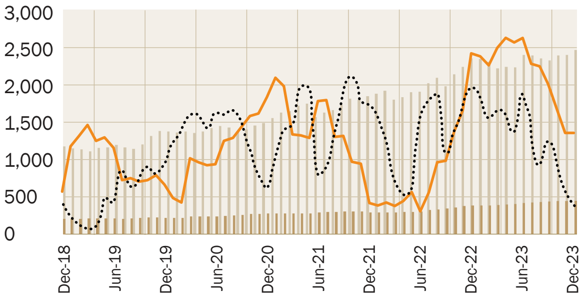
Source: BCTL

It is worth highlighting the importance of deposits in credit institutions for the composition of the assets of Timor-leste's banking sector.

It should be noted, once again, and as seen in previous years, that the growth rate of credit granted has registered a high growth rate, showing a similar trend (as shown in graph 2.23) to the growth rate of assets, thus contributing to the growth rate of assets in the banking system of Timor-Leste, thus translating into a sustained growth in the relative importance of credit in all the set of applications of commercial banks.

[1] The net credit, which excludes provisions for non-performing loans (NPLs), results in an increase in total assets.

Chart 2.23
Evolution of Banking Asset



USD millions and % annual change

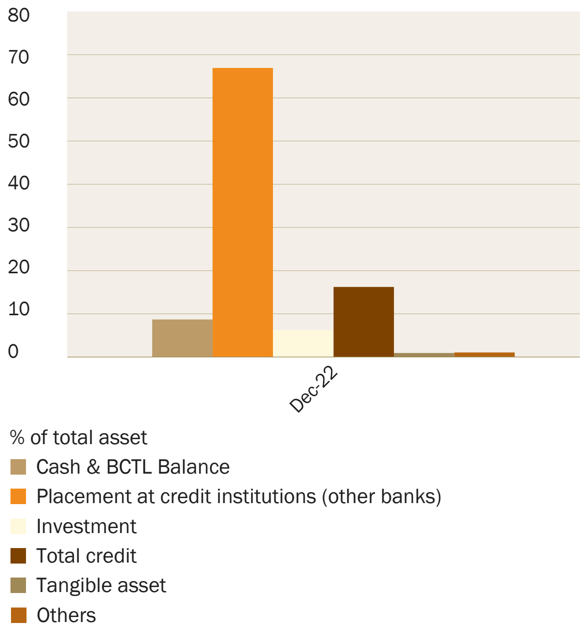
- Banking asset
- Total credit
- % change in credit
- % change in asset

Source: BCTL

The investment of funds with other banking institutions continued to represent the largest proportion of banking assets, reaching 63% of the asset structure at the end of the year in 2023, registering a reduction compared to 2022. In more detail, while the investment of funds with other banking institutions decreased from 68% in 2022, to 63% in 2023, that is, a reduction of 7 p.p. compared to 2022, in 2022, the same proportion had increased by 8 p.p. compared to the value recorded in 2021, where the weight of assets in asset institution represented 60% (graphs 2.24a and 2.24b). This decrease was mainly due to the increase in the weight of applications in BCTL and credit granted.

Chart 2.24.a

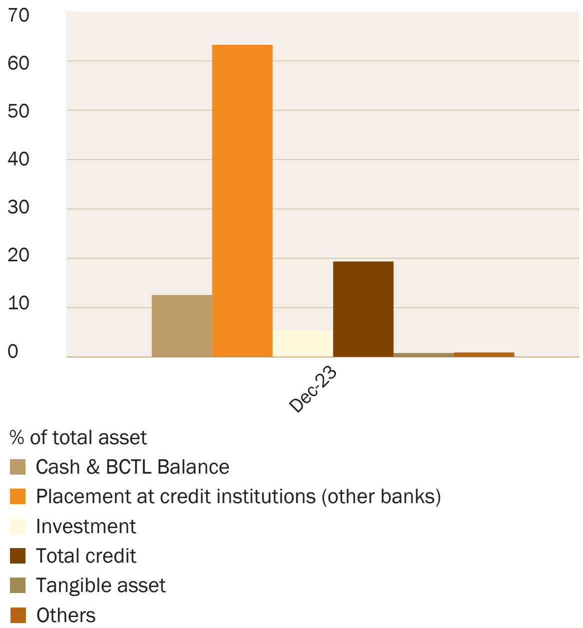
Composition of Banking Asset



Source: BCTL

Chart 2.24.b

Composition of Banking Asset



Source: BCTL

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Credit granted occupies the second largest proportion in the structure of banking assets (17%), as in 2022, when the proportion of credit granted was 15.3%. The value of the bank credit portfolio reached $420 million at the end of 2023, which compares with the value of $356 million at the end of 2022, growing by 18% throughout the year, despite the challenging macroeconomic environment and structural issues related to legal issues.

In December 2023, the overall value of deposits with BCTL amounted to $308 million, which corresponds to 12.6% of total assets, registering an increase compared to the value of $203 million recorded at the end of 2022 (8.7% of the total asset).

2.6.2. Bank Liabilities

In 2023, deposits from customers represented more than 71.5% of bank liabilities.

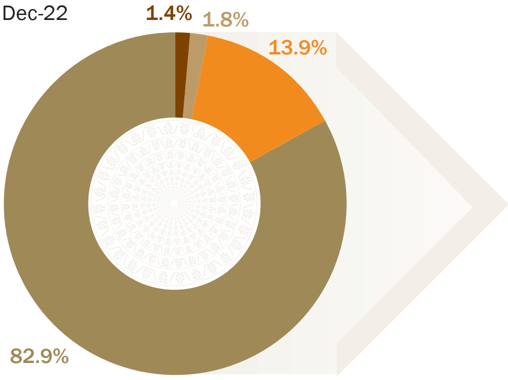
Raising customer deposits continues to represent the largest source of funds for credit institutions. Deposits raised represented 71.5% of banks' liabilities and capital at the end of 2023, increasing by $28 million in 2023, when in 2022 deposits were $1,718 million and represented 73.6% of liabilities and capital availability.

Chart 2.25a

Composition of Banking Liabilities

% of total

Dec-22



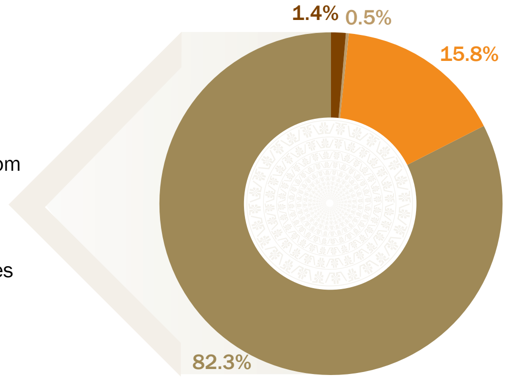
Source: BCTL

Chart 2.25b

Composition of Banking Liabilities

% of total

Dec-23



Source: BCTL

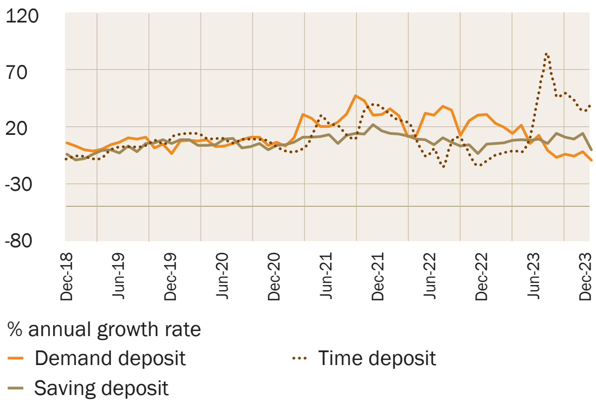
In 2023, resources obtained from the Central Bank increased by $29 million, representing a total of 0.5% of total resources, while deposits owed to other financial institutions increased, once again, by $61 million, representing 15.8 % of consolidated liabilities. It should be noted that deposits received from other financial institutions have registered a persistent increase.

Time and savings deposits collectively increased by $117 million in 2023.

In terms of the type of customer deposits, demand deposits decreased by $90 million in 2023, while time and savings deposits recorded an increase of $112 million and $5 million, respectively.

Chart 2.26

Deposit Growth



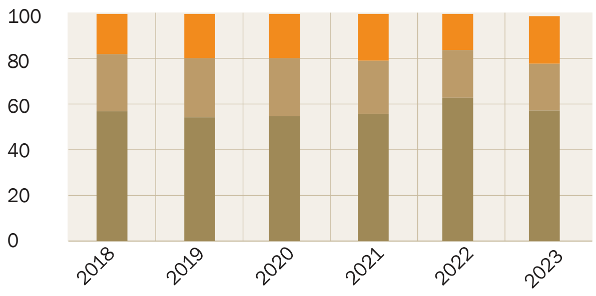
Source: BCTL

However, demand deposits maintain their importance in the structure of deposits

Due to these variations, the deposit structure registered a growth trend in time deposits, contrary to what was observed in 2022. However, demand deposits lost some importance in the deposit structure (-6.1 p.p. compared to 2022), representing a total of 58% of the deposit structure. The demand deposits thus continued to represent the largest component of total deposits.

Chart 2.27

Composition of deposit



% of total deposit
- Demand deposit
- Time deposit
- Other deposit

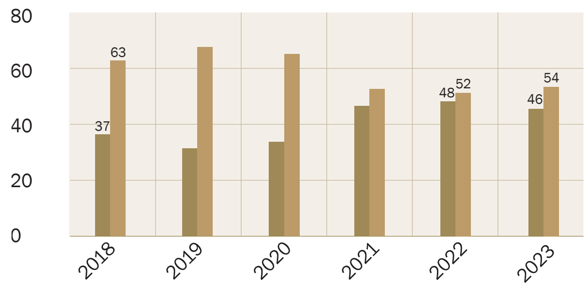
Source: BCTL

In terms of ownership of deposits in banks, there was, as observed in 2022, an increase in deposits held by private residents, with individual deposits increasing in importance to 54% of total deposits, while the share of deposits of private companies reduced to 46% of the total deposits in 2023. Despite the reduction, there is a significant increase in the share of the private company's deposits in the total resources raised, when compared to their relative average share of the last 10 years from 2011 to 2020, which stood at 31%.

Chart 2.28

Share of Deposit by Ownership

2023 will be marked by greater convergence in deposit ownership, a trend that began in 2021.



% of total deposit
- Private companies
- Particular

Source: BCTL

CHAPTER 02

As can be seen in the previous graph, there was a slight increase in the absolute value of deposits from individuals of $30 million, and this increase contributed to explaining the relative increase in deposits of individuals in total deposits in 2023, while the deposits of companies reduced, but only by $12 million in the same year.

2.6.3. Bank Profitability

Bank revenues, consisting of interest received and commissions charged to their customers, amounted to a total of $99.4 million, registering a significant increase of $39.4 million compared to 2022.

Bank revenues increased significantly to $84.1 million in 2022 from $25.8 million in 2021.

As a result of their activity, the banks presented the following consolidated results in 2023, which are compared with the corresponding values for 2022 in table 2.13 below:

Table 2.13

Consolidated Income of Banking System

Items	In Millions USD		% annual change	% Gross Op. Income	
	2022	2023		2022	2023
Interest Received	48.9	98	100.2%	81.5%	98.4%
Interest Paid	5.1	14.3	179.6%	8.5%	14.4%
Net Interest Income	43.8	83.5	90.9%	73.0%	84.0%
Commission & Other Op. Revenues	16.2	15.9	-2.0%	27.0%	16.0%
Gross Operating Income	**59.9**	**99.4**	65.8%	100.0%	100.0%
Provision & Impairments	-2.2	-8.8	297.3%	-3.7%	-8.9%
Operational Expenses	-28.2	-32.7	16.0%	-47.0%	-32.9%
Net Operating Income	**29.5**	**57.9**	95.9%	49.3%	58.2%
Extraordinary Income/Expenses	1.1	0.3		1.8%	0.3%
Net Income Before Taxes	**30.7**	**58.2**	89.7%	51.1%	58.5%
Income Taxes	-2.4	-5.3	119.7%	-4.0%	-5.4%
Net Income	**28.2**	**52.8**	87.1%	47.1%	53.1%
RoA % - Return on Assets	1.2	2.2	80.3%	2.0%	2.2%
RoE % - Return on Equity	12.9	20.0	55.0%	21.5%	20.1%

The profitability of assets and capital grew significantly in 2023.

As we can see, interest received grew by more than 100% in 2023 compared to 2022. The gross operating income of Timor-Leste's banking system recorded an increase of $39.4 million, translating to a growth of 65.8% compared to 2022. Therefore, the net operating income grew by $28.3 million compared to 2022, which is equivalent to a growth of 95.9%.

Finally, taking into account extraordinary income and costs and taxes on profits for the year, the system's consolidated net income increased to $52.8 million in 2022, compared to $28.2 million recorded in the previous year.

This increase explained the increase in return on assets (RoA, or Return on Assets) observed in 2023 to 2.2%, compared to 1.2% seen in 2022, as well as the growth in return on equity (RoE, or Return on Equity) for 20%, when, in 2022, this return was 12.9%. Banks continue to maintain liquidity ratios higher than those required by the Central Bank and the regulatory framework in force.

2.6.4. Transfer Services

2.6.4.1. Remittance Transfer – Commercial Banks

The number of transfers decreased by 40% in 2023 compared to 2022.

During 2023, money transfer services, reported by commercial banks operating in Timor-Leste, recorded a total of transfers abroad of around 124 thousand transactions, with an aggregate nominal value of $2,194 million. The number of operations carried out reduced by 39.8% and the total value transferred decreased by 37.4%, compared to 2022.

The negative net balance of transfers registered a significantly high value in 2023.

At the same time, the number of transfer transactions received decreased by 41% in 2023 to 100 thousand transactions, with the value received also decreasing by 43% to $812 million.

Therefore, the net balance of transfers received and originated by commercial banks recorded a substantial negative growth, reaching -$1,382 million in 2023, when compared to the also negative balance of -$2,078 million in the previous year.

Personal transfers continue to be the largest share of total transfers in 2023.

2.6.4.2. Transfer of Remittances – Specialized Operators (OTO) Em In 2023, the group of Other Money Transfer Operators (OTOs) recorded a total value of transfers to abroad of $202 million, compared to $196 million in 2022. Transfers originating from abroad through these operators recorded, in 2023, an amount of approximately $204 million, compared to the $147 million recorded in 2022. This evolution led to an improvement from the deficit balance observed in 2022, with the amount of -$49 million, to a surplus value of $1,973 million in 2023.

Personal transfers continued to represent the largest share, both in terms of inflows and outflows, amounting to 40% and 82% of total transfers, respectively. Personal transfers combine reasons of transfers for 'family', 'education' and 'savings' generated from the transfer operations.

In geographic terms, the majority of inflows continued to come from Europe, accounting for $98 million in 2023 (48% of the total), compared to $80 million in 2022, and were mostly explained by the sending of remittances from Timorese workers living and working in Europe. Remittance outflows operated by OTOs were, for the most part, routed to the Asian region, totaling an amount of $179 million, with Indonesia being the largest destination for transfers from Timor-Leste, with a total of $159 million, which equivalent to 79% of the total. This amount is explained by remittances sent by Indonesian citizens who reside and work in Timor-Leste.

Europe continues to be the main origin of remittances.

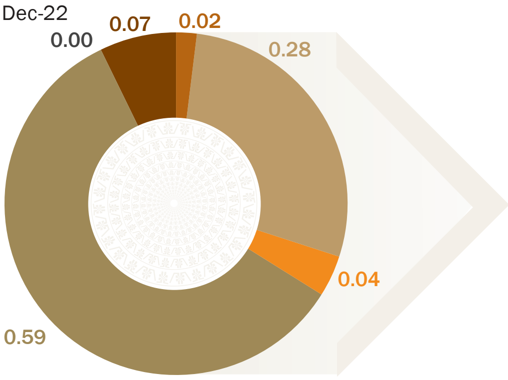
Graphs 2.29a and 2.29b show the weight of transfers made to and from Timor-Leste, by purpose, using the services of money transfer operators in 2023.

Chart 2.29a

Outward Transfers, by purpose (OTOs)

% of total

Dec-22



Source: BCTL

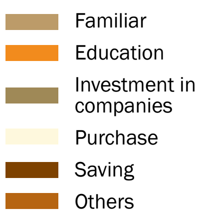
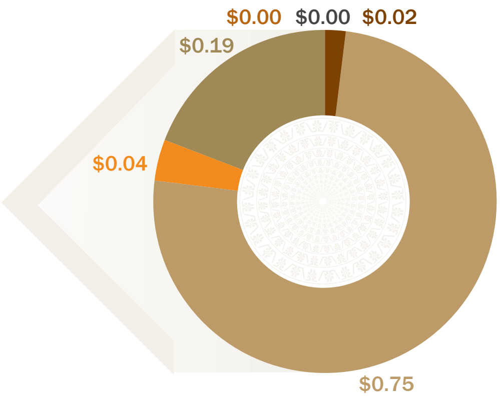


Chart 2.29b

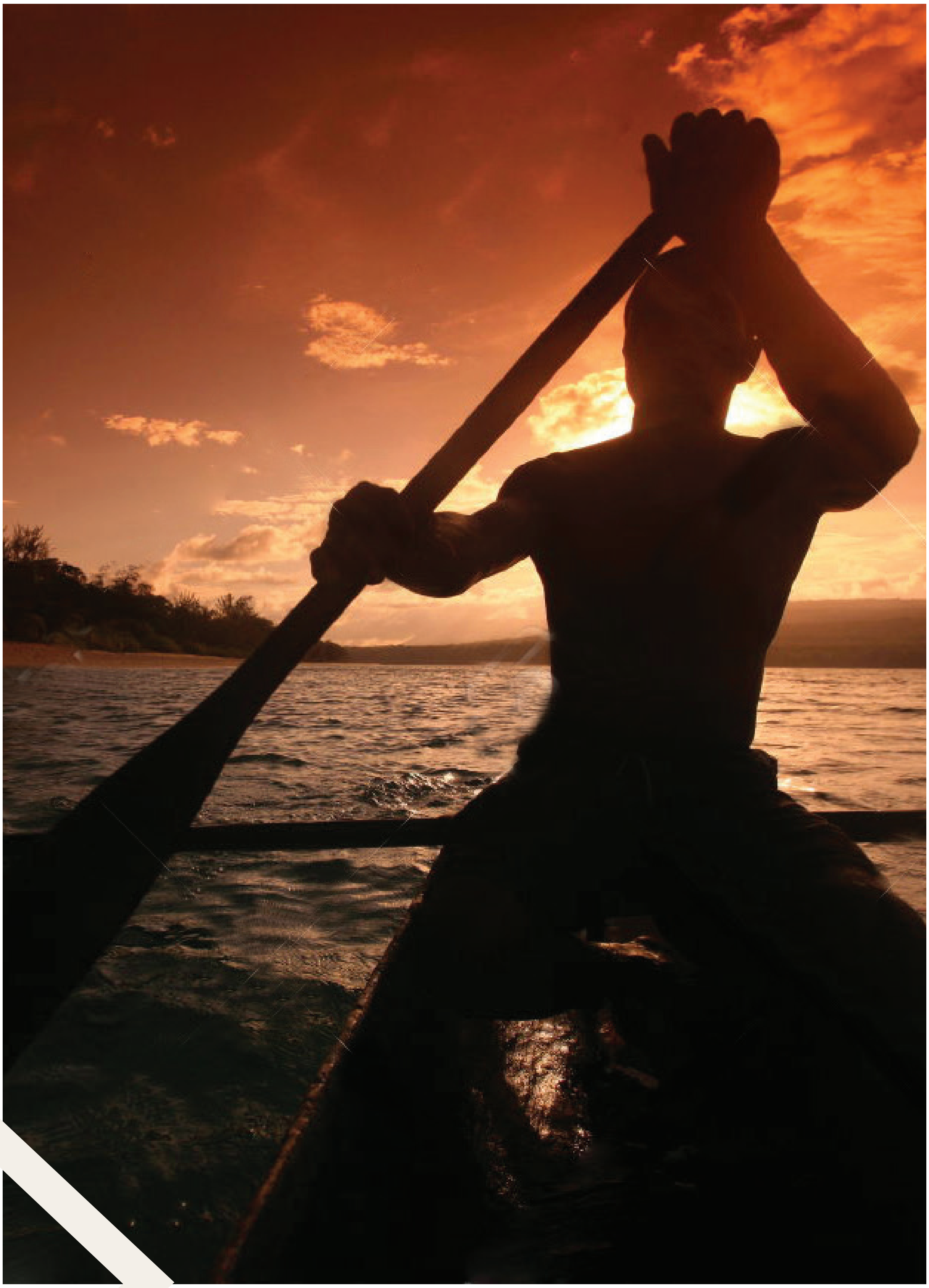
Inward Transfers, by purpose (OTOs)

% of total

Dec-23



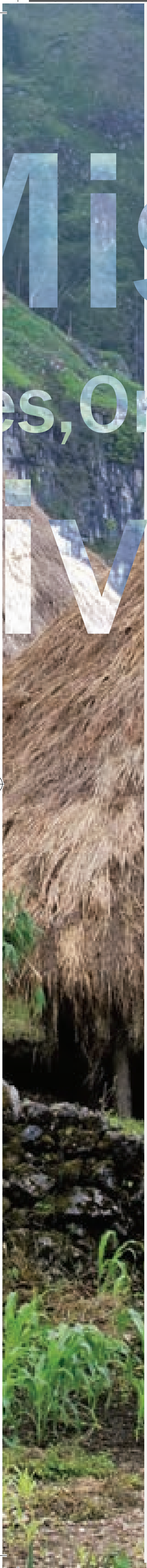
Source: BCTL



CHAPTER 02

Chapter 03

The BCTL: M
Core Mandates
and Acti



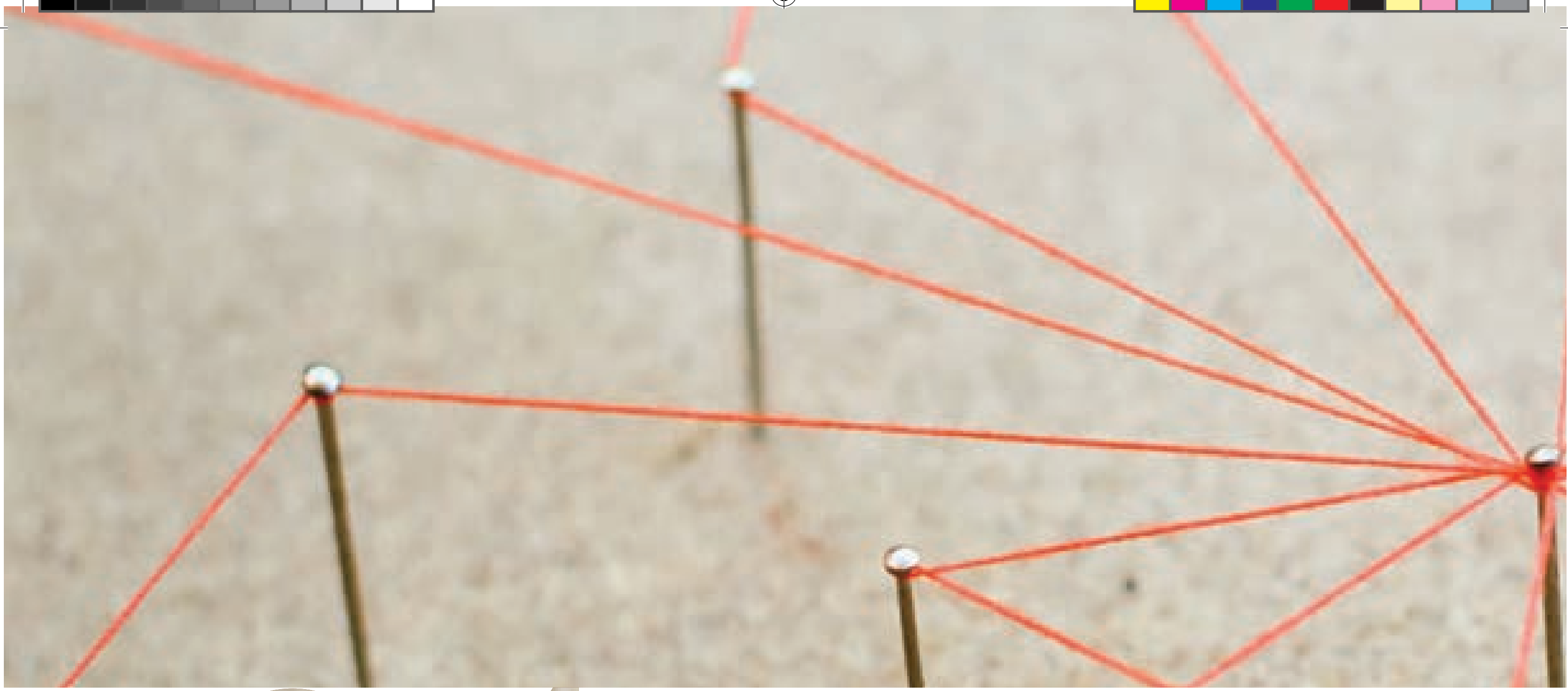
Missions and
es, Organization, Governance
ivities

CHAPTER 03

The BCTL main mission consists of continuing to ensure 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 inflation rate, a secure and efficient payment system; 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 conducting studies on the national economy, supported by rigorous and accurate statistics.

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 2023, as well as its 2024 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.

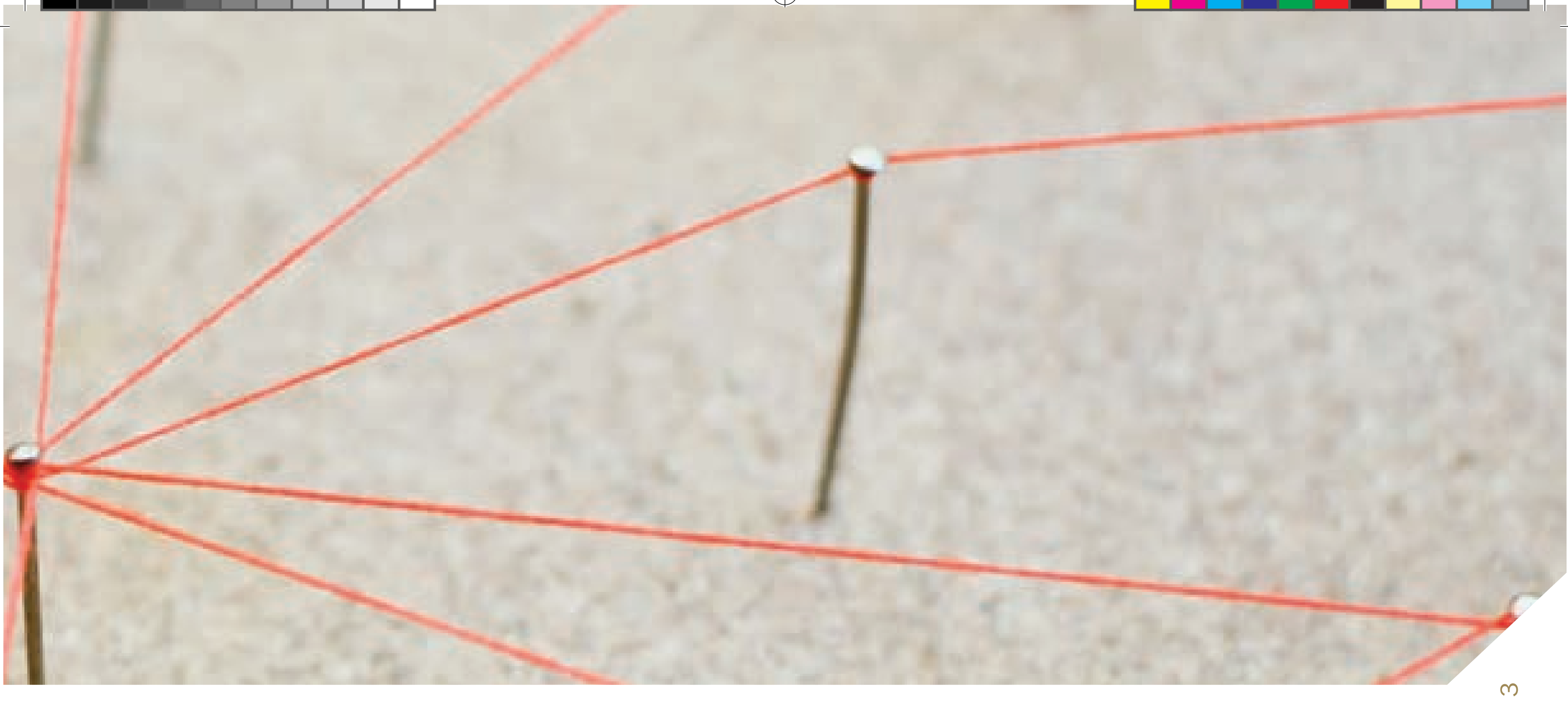


3.1

Core Mandates and Functions

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

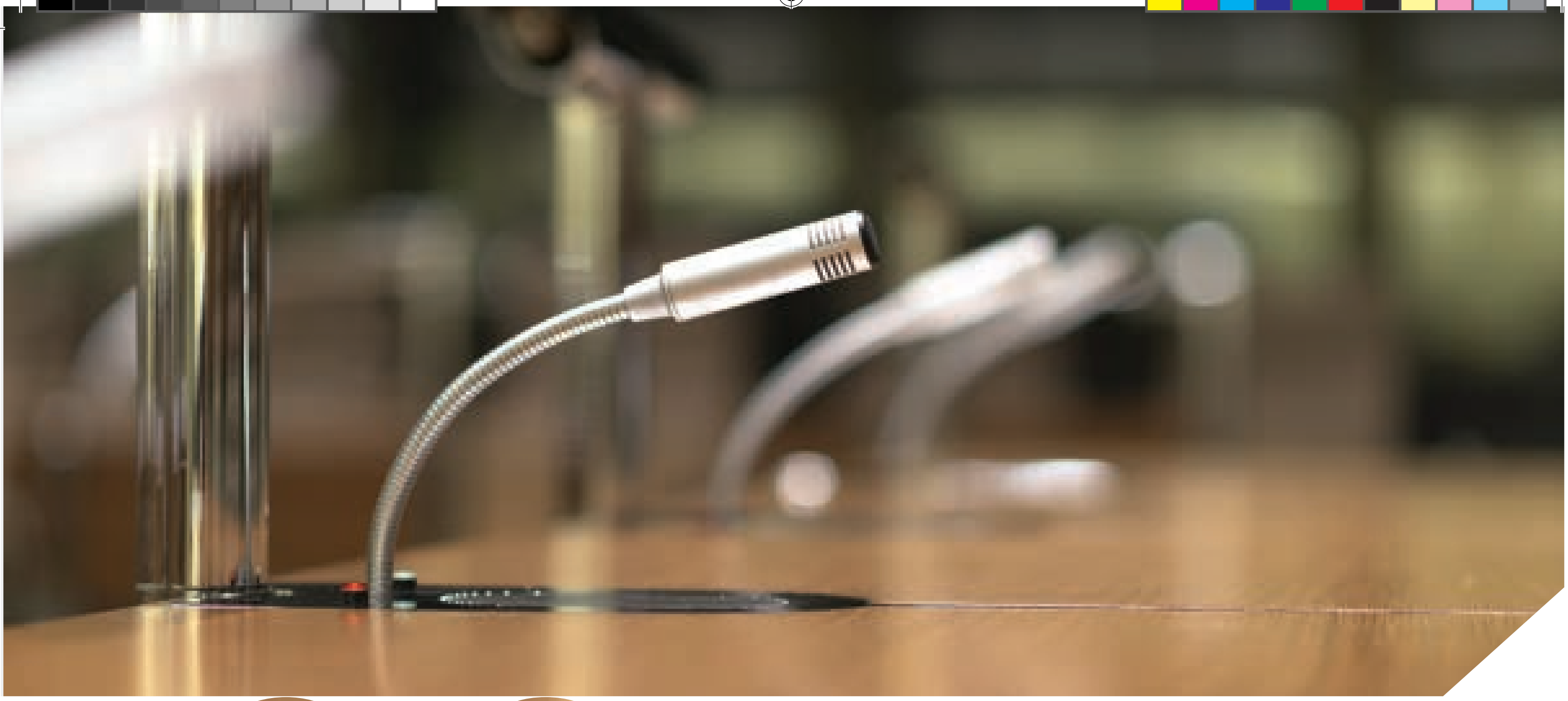
As is common in most international central banks within the area of economic policy, BCTL's main objective is to ensure the stability of domestic prices. Other equally important objectives are the promotion and the maintenance of a financial system stability based on free market economy's principles, where there is appropriate competition. Having these objectives and principles as a guideline, the Central Bank should also support the Government economic policies.



In order to achieve its objectives, the functions of the 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) Carry out operations in foreign currency;
d) Hold and manage the country's official external reserves;
e) Hold and manage the State's gold reserves;
f) Issue and manage the official currency of Timor-Leste;
g) Collect and distribute statistical information regarding the areas within its competence, namely monetary, financial 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 supervise the national payment system, in order to guarantee the efficient and safe execution of payments;
j) Regulate, license and supervise financial institutions operating in the country;
k) Advise the Government on matters within its competence;
l) Act as fiscal agent of the Government;
m) Participate in international organizations and meetings that concern the above-mentioned points;
n) Be part of contracts and establish agreements and protocols with national or foreign, public or private entities; and
o) Perform any other activities as defined by law.

Currently, some of these functions are not yet performed by the BCTL due to the adoption of the US dollar (USD) as the official currency of the country.



3.2

BCTL Organization and Governance

BCTL's highest authority is its Board of Directors, which formulates the institution's strategies and policies and oversees their implementation, including the supervision of the Bank's executive management and operational activities.

The Governor is the highest executive body of BCTL, or its Chief Executive Officer and is assisted by two Vice-Governors and a Management Committee composed of the Directors and heads of various departments of the Bank. At the end of 2023, the year of this report, the Board of Directors was composed by the Governor, two Vice-Governors and four non-executive members. The composition of the Board of Directors and the Management Committee are presented at the end of the chapter.

The BCTL is internally organized into five main departments: Financial System Supervision; Banking and Payment Systems; Petroleum Fund Management; Administration; and Economic and Statistics Department (which previously the Division of Economics and Statistics). Some Divisions and Units report directly to the Governor, namely the: Legal Unit, Internal Audit, Institutional Cooperation Affairs Unit, Human Resources Division and the Financial Information Unit. The Accounting and Budget Division is dependent on the Deputy Governor responsible for supervising of the financial system. The Central Bank is also in charge of the Secretariat of the Advisory Board for the investment of the Petroleum Fund.

BCTL's Board of Directors continues to adopt the motto abbreviated by the acronym **TIMOR,** representing **T**ransparency, **I**ntegrity, **M**obilization, **O**bligation and **R**esponsibility, essential slogans in the day-to-day operations of the institution and of its employees.

Institutional Values

Transparency

We are a role model for society and for the institutions, our procedures and rules are clear and applied in a rigorous, universal and consistent way, both internally and externally.

Integrity

We exercise our business with honesty, high ethical and moral standards, respecting the confidentiality and legality in all actions and decisions involving our interests and resources.

Mobilization

We mobilize to provide the best service to the Timorese community, through the ability to consult, listen and learn so committed.

Ownership

We exhibit a sense of belonging and involvement, establishing as priority the objectives of the institution and showing availability to perform activities beyond the scope of our role.

Responsibility

We invest in expanding our technical and professional skills, deliver on the responsibilities that are assigned to us and that we proactively seek, through ongoing monitoring of the consequences of our decisions and actions.

BCTL has long adopted a code of ethics applicable to all employees, also covering appropriate guidelines in dealings with external entities to the Bank. The code of ethics includes strict rules on various aspects of the behavior of those to whom it applies. Note, for example, the obligation of every Bank employee is to perform its duties solely on the basis of serving the BCTL and general public interest, and not their individual interests, which includes not receiving instructions, whatever they may be, from entities other than the legally appointed structures of the Central Bank.

Bank employees are also, of course, forbidden to receive any remuneration from any persons or institutions who may be interested in influencing their decisions.

3.3

BCTL Activities in 2023

The BCTL implemented several activities in accordance with the plan defined in 2023, mainly those related to its mission to promote monetary and financial stability, develop the financial system and promote a safe and effective payments system.

In 2023, BCTL continued its mission to modernize the national payments system. In this regard, BCTL monitored the functioning of the implementation of R-TiMOR to serve the needs of the Government, mainly the Ministry of Finance. These services offer the Ministry of Finance access to historical statements of its accounts and sub-accounts, allowing treasury management and projection of cash flows in real time. BCTL continues to make efforts to ensure necessary improvements to the R-TiMOR service system while maintaining coordination with the supplier and service participants.

The BCTL continued to ensure the full operation of real-time gross settlement systems (RTGs) in order to carry out financial transactions with the purpose of meeting the needs of the public, namely the state and commercial banks. For this reason, BCTL also guarantees sufficient cash reserves.

BCTL maintained its commitment to improving the digital payments system and customer service. In partnership with financial institutions and service providers P24, successfully interconnected the tax payment system, the e-wallet system and the BNU POS. This measure increases the efficiency of paying taxes through electronic wallets and POS. Furthermore, BCTL has completed the certification process to become a Mastercard Acquirer in collaboration with BNU.

Still in 2023, BCTL and the Ministry of Education (ME) continued the work of implementing the financial literacy program in public basic education schools. The program was carried out in 144 public primary schools, with the commitment and full support of the Ministry of Education, in particular the General Directorate of Education and Teaching.

The BCTL Board of Directors took several decisions throughout 2023. These, among others, are the

approval of instructions on the implementation of International Financial Reporting Standards (IFRS) to commercial banks and other institutions receiving deposits (OIRD) in areas such as chart of accounts, liquidity management and ratios, solvency, reports and accounts and dissemination. The instructions were published in the Jornal da República and will become effective from July 30, 2024. They aim to reinforce public confidence in the financial system and promote the competitiveness of the sector.

The celebration of the 9th anniversary of National Savings Day, on November 29, 2023, took place in Timor-Plaza, municipality of Dili. The program consisted of celebrating the 3rd anniversary of the "Campo Digital" program. The event was attended by the Prime Minister, members of the BCTL Board of Directors, representatives of financial institutions, and directors of primary and secondary schools. As part of this celebration, BCTL presented an exhibition on the financial services and digital payment systems available in the country, such as ATM-P24, POS-P24, electronic wallet, internet banking and mobile banking. The exhibition was attended by financial institutions, mainly commercial banks, fintech companies, insurance companies and traders who adopt digital payments systems in their daily transactions.

In order to maintain relationship ties and increase information sharing, BCTL continued to deepen cooperation with its counterparts and other national and international institutions through the Institutional Cooperation Affairs Unit (UACI). Cooperation activities in 2023 have mainly focused on the areas of training, seminars, meetings and technical assistance. Most cooperation initiatives throughout 2023 were carried out in person.

These and other BCTL activities carried out in 2023 are described in a greater detail in the following section.

3.3.1. National Payment System

3.3.1.1. Interbank Clearing and Settlement System

During 2023, BCTL continued to act to ensure adequate cash reserves to meet the needs of monetary payments, both from the state and from commercial banks. To carry out the respective financial transactions, BCTL ensured the full functioning of the Real-Time Gross Settlement systems (RTGS).

The social distancing measures introduced in 2020 and 2021 to mitigate the impacts of the Covid-19 pandemic, the BCTL introduced a circular that defines the activities of the Automatic Clearing House (CCA) system to begin to be processed directly by commercial banks. This measure continued in 2022 and 2023, meaning that commercial banks only carry out credit notes, with no clearing check by BCTL. For this reason, it was not possible to record movements and values in the central bank's Interbank Clearing and Settlement System (CEL) since the implementation of this circular.

3.3.1.2. The SWIFT and R-TiMOR (RTGS)

The BCTL provides national and international payment services to the public. International payments made from the country to abroad and vice versa are always using the SWIFT system and also using non-SWIFT resources. National payments are, in turn, of two types: high value and retail. National payments, mainly with regard to retail payments, are directly executed by the CCA, processing payments relating to salaries, veterans' benefits, payments to suppliers, which, among others, are processed and transferred to

Table 3.1 presents statistics on national and international payments in 2023. With regard to national payments, 1.388 million transactions were processed, corresponding to a total of 8,266 million USD, representing a 2.9% growth in the number of transactions and 7% in value compared to 2022. Outgoing payments through RTGS continues to be the main driver of growth in operations, with an annual increase of 12%. At the same time, there is a significant number of operations in CCA, with a share of 92% in total operations in RTGS, even though, in value, the share is 8%. This is due to the fact that CCA only processes operations of low value.

Table 3.1.
Domestic and International Payments

(Value in millions of USD, Quantity in 10 ³)

	2022		2023		Change (%)	
National Payments	**Quantity**	**Value**	**Quantity**	**Value**	**Quantity**	**Value**
Automatic Clearing House	1,238.80	598,80	1,275.85	644.61	3.0	7.6
RTGS-FICT	18.21	5,561.73	29.25	6,256.72	60.7	12.5
RTGS-SCCT	92.16	1,565.51	83.44	1,365.19	-9.5	-12.8
Sub Total	**1,349.17**	**7,726.04**	**1,388.54**	**8,266.52**	**2.9**	**7.0**
International Payments						
Outgoing Transfers -SWIFT	1.4	1,638.6	2.8	1,585.7	101.2	-3.2
Incoming Transfers-SWIFT	0.2	196.3	0.2	381.8	29.1	94.5
Sub Total	1.58	1,834.88	3.05	1,967.51	93.3	7.2
Total	**1,350.75**	**9,560.92**	**1,391.59**	**10,234.03**	**3.0**	**7.0**

Source: BCTL

commercial banks. Meanwhile, payments of large amounts, above 200 thousand USD, are always made through RTGS. The RTGS system accepts all transaction amounts, on the contrary, the CCA system does not accept payments exceeding 200 thousand USD.

On the other hand, 3 thousand international operations were processed, corresponding to a value of 1,967 million USD, which represented an annual increase of 93% and 7%, respectively. The increase in the volume of international payments was mainly due to the increase in transfers made abroad, which represented 81% of international payments made in 2023. That year, transfers abroad increased by 101% in number and contracted by 3% in transaction value compared to 2022.

Table 3.2 also presents data relating to international transactions, corresponding to transfer and receipt transactions carried out by commercial banks in 2023, therefore only transactions carried out via SWIFT are included.

Table 3.2.

SWIFT Transfers Incoming and Outgoing (Value in millions of USD, Quantity in 10³)

	2022		2023		Variação (%)	
Transfer Incoming	**Quantity**	**Value**	**Quantity**	**Value**	**Quantity**	**Value**
SWIFT	29.2	176.4	44.7	506.4	53.4	187.1
Non-SWIFT	33.3	158.6	36.9	217.8	10.9	37.3
Sub-Total	**62.4**	**335.0**	**81.6**	**724.2**	**144.9**	**116.2**
Transfer Outgoing						
SWIFT	9.2	221.2	23.3	1,384.9	152.9	526.0
Non-SWIFT	107.1	1,237.2	75.6	1,008.4	-29.5	-18.5
Sub-Total	116.3	1,458.4	98.9	2,393.3	-15.0	64.1
Total	**178.8**	**1,793.5**	**180.5**	**3,177.6**	**20.6**	**73.8**

Source: BCTL

The number of external transfers received in 2023 via SWIFT amounted to a total of 45 thousand and corresponded to a value of 506 million USD, meaning they increased by 53% in number and 187% in value. On the other hand, transfers made outside the SWIFT network reached a volume of 37 thousand, which corresponded to a value of 218 million USD, which represented an increase of 11% and 37%, respectively. Meanwhile, transfers to abroad totaled 99 thousand transactions, with a value of 2,393 million USD, which resulted in a 15% drop in terms of quantity and a 64% increase in value transferred. Transfers outside the SWIFT network were those that contributed the most to the decrease in activity, having reduced by 29% in volume and 18% in value.

3.3.1.3. The P24 System

The P24 system makes use of the R-TiMOR interbank network, allowing the net value of each bank's transactions to be automatically settled on a daily basis, 24 hours a day and 7 days a week. The main objective of implementing the P24 electronic system is to reduce the use of physical money (cash) in citizens' daily transactions. P24 allowed people without bank accounts, and those who are far from banks, to access electronic means of bank transfers and payments that are accepted in local markets and stores.

Table 3.3 summarizes the evolution of transactions carried out in the P24 system in the country during 2023.

The numbers show significant growth in financial transactions in the P24. In 2023, 3 million cash withdrawal operations were carried out through the P24 system, corresponding to a value of 377 million USD, which resulted in an increase of 14% in quantity and 15% in value. In relation to the level of transfers carried out in P24, 13 thousand operations were registered, totaling $6 million, which corresponds to a decrease of 7% and 20%, respectively, compared to 2022.

Table 3.3.
P24 System

(Value in millions of USD, Quantity in 10 ³)

	Financial Transactions				Non-Financial Transaction
	Cash Withdrawal		Transfer		Balance Inquiry
	Quantity	Value	Quantity	Value	
2022	2,640.5	329.4	14.1	7.7	1.1
2023	3,008.8	377.4	13.1	6.1	1.4

Source: BCTL

3.3.1.4. The Electronic Wallet System Service (E-Wallet)

The Mosan and T-Pay system are electronic money wallet (E-Wallet) services that allow users to transfer funds, withdraw and deposit money into their wallets, top up mobile phone balances, make electricity prepayments and consult the balance sheets and history of transactions carried out.

For prudential reasons, limits were imposed on the Mosan and T-Pay systems. In the case of the Mosan system, a maximum account balance of 500 USD and a maximum deposit of 300 USD per day were stipulated. For the T-Pay system, the maximum transaction is 300 USD per day and the maximum balance per account is 300 USD. Mosan and T-Pay Agents, which function as 'transaction points', allow their customers to:

- Transfer and receive funds;
- Deposit and withdraw money;
- Make purchases (QR-Code), including charging mobile phone and electricity; and register the user/account and update customer information.

Mosan and T-Pay thus allow access to basic financial services to citizens of village and sub-villages who live far from the main urban centers and to citizens who do not yet have the possibility of accessing formal financial services in Timor-Leste.

Table 3.4 presents statistics related to transactions carried out by this service in 2023. The levels of use of the Mosan and T-Pay systems registered a moderate increase. In 2023, there were 5,958 thousand transactions, corresponding to 88 million USD, which represents an annual increase of 20% in volume and 43% in value.

Table 3.4.

E-wallet Service Transaction (Value in millions of USD, Quantity in 10³)

	2022		2023		Change (%)	
	Quantity	Value	Quantity	Value	Quantity	Value
Transfer	427.7	45.6	385.4	48.6	(9.9)	6.7
Cash-in	410.8	6.2	967.7	17.8	135.5	189.2
Cash-out	38.1	5.0	388.0	14.8	918.7	196.7
Top-up	3,124.1	3.1	2,544.0	3.0	(18.6)	(1.3)
Buy data	602.8	0.6	1,274.6	2.4	111.5	270.2
Untility Payment	336.1	1.2	398.9	1.6	18.7	34.2
Total	**4,939.6**	**61.6**	**5,958.5**	**88.2**	**20.6**	**43.2**

Source: BCTL

3.3.1.5. Banking System

The statistics in Table 3.5 summarize the evolution of transactions in 'cash' (coins or notes) and other means carried out by commercial banks in Timor-Leste. The number of 'currency' transactions carried out in 2023 totaled 5.6 million, corresponding to 0.11% of the total number of transactions carried out, with a nominal value of 5,378 million USD. These numbers translate into a reduction of 6.8% in number and an increase of 24.2% in value, compared to 2022. Transactions in means other than "currency", on the contrary, represented 99.9% of the total number of transactions in the country, or 4.959 million transactions, and corresponded to an aggregate value of 5,066 million USD. These values represent a decrease of 0.3% in number and an increase of 0.6% in value compared to 2022.

Table 3.5.

Cash and non-Cash Transaction (In millions of USD)

	2022		2023		Change (%)	
	Quantity	Value	Quantity	Value	Quantity	Value
Cash Transaction	6.02	4,330	5.61	5,378	-6.8	24.2
Non-Cash Transaction	4,973	5,034	4,959	5,066	-0.3	0.6
Total	**4,979**	**9,364**	**4,964**	**10,444**	**-0.3**	**11.5**

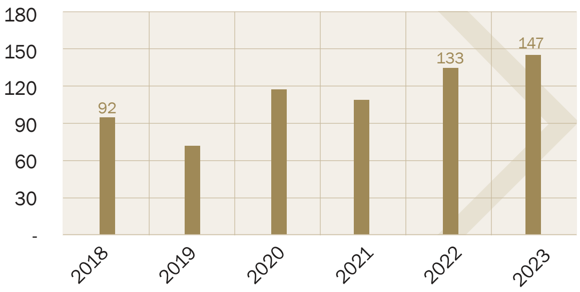
Source: BCTL

BCTL wants the settlement of economic transactions to become progressively more efficient and effective, through greater use of electronic payment methods and digital financial services. Therefore, BCTL continues to promote the substantial expansion of the network and range of automatic payment services that do not use banknotes/coins but use the national interconnection system to expand payment services. This strategy will encourage the widespread use of debit and credit cards and mobile phones as platforms for making payments.

Chart 3.1

Automated Teller Machine (ATM)

Number of ATM



Source: BCTL

Graphs 3.1 and 3.2 describe the evolution of the number of payment terminals installed in the country. In 2023, automatic teller machines (ATM) totaled 147 units, while automatic payment terminals (PoS) reached 403 units. These values represent an annual increase of 11% for automated teller machines (ATM) and 40% for PoS.

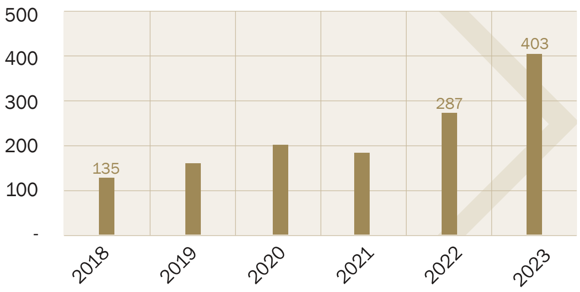
The evolution of bank cards issued in Timor-Leste can be seen in graph 3.3. The number of cards in circulation in the country totaled, in December 2023, around 107.4 thousand, which corresponds to an increase of 66% compared to the previous year. Regarding the composition of the total number of debit and credit cards, there is an annual increase in debit and credit cards of 67% and 17%, respectively. This evolution may explain the increase observed in access to the banking system and, on the other hand, the increase in the use of digital payment systems in the country.

The continued growth in the number and degree of use of bank cards reflects the effective interest of users in these means of payment and the modernization and increasing digitalization of our financial system.

Chart 3.2

Point of Sale (PoS)

Number of POS

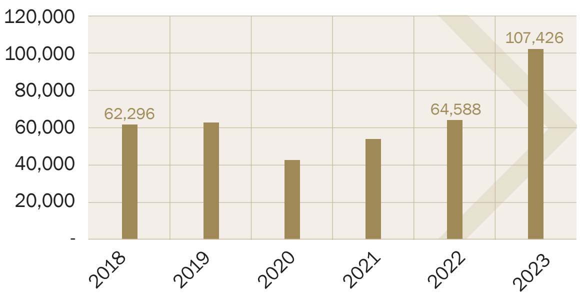


Source: BCTL

Chart 3.3

Number of Credit and Debit Card

Number of cards



Source: BCTL

3.3.1.6. Currency Imports and Exports

One of the fundamental functions of the BCTL is to manage the country's official currency. In this sense, the BCTL must ensure that the national economy has the means of payment necessary for its economic growth and the current economic activity of its agents. Therefore, BCTL's action is crucial to guarantee public confidence in the country's currency, whether through satisfying, at all times, the public's demand for banknotes and coins, or by guaranteeing the physical integrity of banknotes.

Since the country uses notes from another country and its own metallic coins, which are not manufactured in the national territory, supplying the national economy with physical means of payment (re)deposited ("fit currency") by banks at the central bank. Due to their frequent use, these two denominations register a very low degree of conservation, meaning that the amounts (re)

Table 3.6.

Coin Transaction and Movement (in millions of USD)

Denomination	Import		Re-circulation		Deposit		Weight 2023			Change (%)		
	2022	2023	2022	2023	2022	2023	Import	Re-circulation	Deposit	Import	Re-circulation	Deposit
100	0.000	3.200	3.800	5.500	2.800	1.700	1.7	1.3	0.6		45	-39
50	3.200	1.600	1.950	1.700	1.850	1.150	0.9	0.4	0.4	-50	-13	-38
20	74.240	120.640	187.400	257.900	66.531	153.080	64.3	59.4	56.8	63	38	130
10	33.920	60.160	113.090	166.800	53.808	112.135	32.1	38.4	41.6	77	47	108
5	1.200	2.000	2.235	1.985	1.333	1.495	1.1	0.5	0.6	67	-11	12
Total	**112.560**	**187.600**	**308.476**	**433.886**	**126.323**	**269.561**	**100**	**100**	**100**	**67**	**41**	**113**

Source: BCTL

(coins and notes) requires the importation of cash and, in the case of notes, when they reach a very low degree of conservation, its re-export to the country of origin, the United States of America.

During 2023, BCTL imported 187.6 million USD banknotes, representing an annual increase of 67%, having put into circulation a total of 441 million USD, including coins (cents), which corresponds to an increase annual rate of 40%. The amount put into circulation was greater than that imported by a difference of more than 246 million USD. This excess was due to the inflow of deposits and the existing reserves.

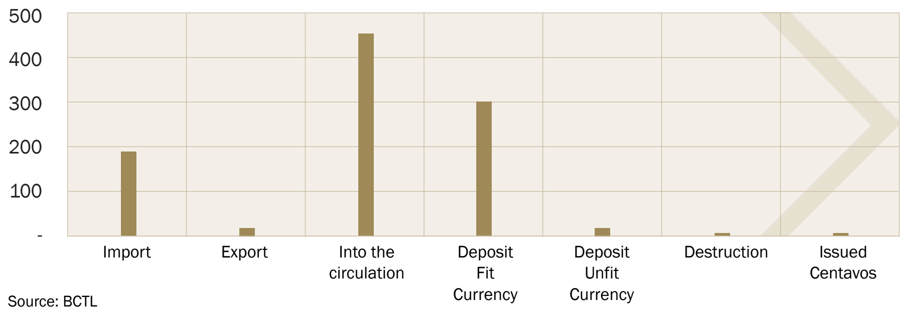
deposited of "unfit currency" and their repatriation to the country of origin had a significant weight, as in previous years - 47 % and 26% of (re)deposits, and 36% and 42% of repatriations, respectively, in 2023 (Table 3.6).

Cent coins worth a total of 7.4 million cents were put into circulation during 2023, with new coins worth 3.5 million cents being issued in 2023. The 200-cent coin recorded a total amount in circulation of 1.4 million cents, representing 19% of the total in circulation and an increase of 158% in 2023, after a drop of 46% in 2022. On the contrary, the 100-cent coin registered a decline of 15% after having recorded an increase

Chart 3.4

TL: Currency Transaction in 2023

In millions of USD



Source: BCTL

The 20-dollar bills continue to be the most used in transactions in the country, followed by the 10-dollar denomination. The 20- and 10-dollar notes represented, respectively, 64% and 32% of total imports, 59% and 38% of circulation in the economy, and 57% and 42% of the total of 43% in 2022, thus reaching a value of 3.4 million cents in 2023. The 50-cent denomination registered a value in circulation of 1.92 million cents, representing 26% of the total coins in circulation and a decrease of 1.3% compared to 2022.

Box 1. Modernization of Timor-Leste's Payment System

1. The R-TiMOR System

In 2015, BCTL launched the R-TiMOR system, an integrated network service that allows participants to make electronic payments in Timor-Leste between individuals, companies, public institutions and other entities. The R-TiMOR system is managed by the Central Bank, which guarantees the operationalization of services to its members and participants. BCTL continues to improve the quality of services provided by R-TiMOR in order to maintain an efficient and effective national payments system through 'Straight Through Processing (STP)'. In fact, the STP has already been implemented and is currently used in all commercial banks and the Ministry of Finance.

The number of participants in the R-TiMOR system is divided between direct and indirect participants. Until the end of 2023, the number of direct participants remained at 7 participants, while the number of indirect participants increased significantly, registering an annual increase of 29% for a total of 136 participants. Indirect participants consist of Autonomous Agencies, Municipalities and Special Funds. The system allows indirect participants to process their payments directly using the Government Resource Planning (GRP) system installed at their workplaces.

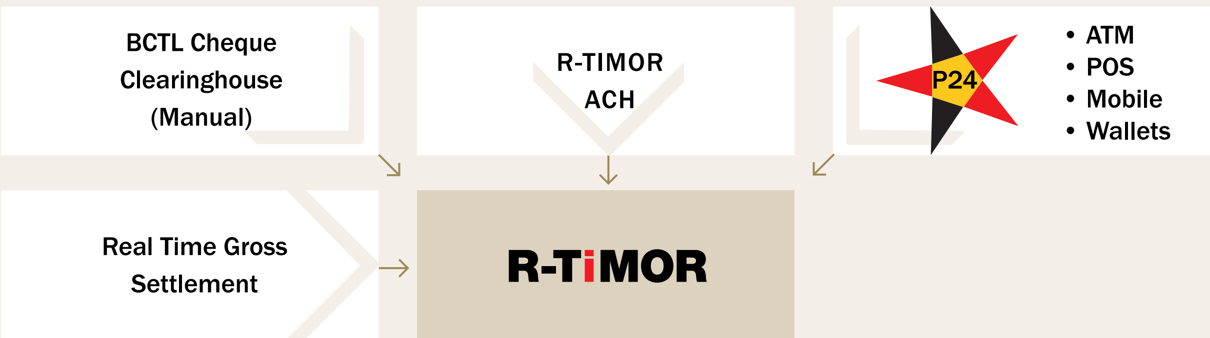
In 2023, the Central Bank continued efforts to ensure the necessary improvements to R-TiMOR, maintaining coordination with the service provider and participants. The additional objective of this effort is to facilitate direct payments in large amounts and make all payments to the State (taxes, tenders, etc.) from any bank participating in the R-TiMOR.

2. The National Card and the Payment Switch Projects

In partnership with SIBS International, from Portugal, hired in 2017, BCTL developed the National Card Project and Payment System Interconnection, called "P24" (the "P" derived from the words 'Pagamentu, Pagamento, Payment and Pembayaran'). The P24 system offers a wide range of financial services available 24 hours a day, 7 days a week.

Since the end of 2022, all banks operating in Timor-Leste - Caixa Geral de Depósito (CGD), Banco Mandiri, Bank Rakyat Indonesia (BRI), and BNCTL - have adhered to this P24 system. With the integration of these banks' ATM network into the P24 system, customers of each bank can carry out transactions at other banks' ATMs with the P24 logo.

In October 2020, BCTL, in collaboration with P24 participating banks and the Tax Authority of the Ministry of Finance, completed the Tax Payment functionality through P24 ATMs. This step is one of the essential elements of the National Payment System, allowing P24 cardholders to pay taxes electronically through any ATM that displays the P24 logo, without the need to go to their banks. In September 2023, the Central Bank, together with



the provider P24, made an additional resource available for paying taxes through POS devices. This solution offers an additional option for efficient tax payment, without the need to use a bank ATM, as soon as the Tax Authority of the Ministry of Finance makes POS devices available at its tax payment counters. The P24 system is linked to the Central Bank's R-TiMOR settlement system, ensuring that taxes received are subsequently credited directly through processing to the Government Consolidated Account via the R-TiMOR system.

These new tax payment features were jointly launched by BCTL and the Ministry of Finance, in an official ceremony on March 5, 2021. Providing access to these services has been one of the Central Bank's key strategies to modernize, strengthen and develop the financial sector to support economic growth and one of the Government's priorities to promote "e-government" in order to simplify and facilitate the provision of public services and the government inclusion of citizens.

In 2020 BCTL, in collaboration with P24 participants, completed the interconnection of the "Mobile Switch" with the P24 system. This step allowed electronic wallets, the e-wallet composed of Mosan (from Telemor Fintech Lda) and T-Pay (from Telin Solution Lda), to transfer funds from bank accounts to electronic wallet accounts and vice versa (B2W2B)

In 2022, BCTL and Banco Nacional de Comércio de Timor-Leste (BNCTL) finalized the process of integrating Union Pay International, Master Card validation and BNCTL POS into the P24 system. This integration allows travelers or Union Pay cardholders to carry out transactions at BNCTL ATM machines in Timor-Leste with the P24 logo. Following the completion of the Union Pay Acquisition, BNCTL also began, in collaboration with BCTL and its service provider, Union Payment Issuance (contactless and 3D Secure). The development of BNCTL Union Payment Issuance achieved significant progress in 2023 and is expected to be completed in the first half of 2024. Completion of this project will allow BNCTL to issue contactless and 3D Secure Union Pay International cards to interested BNCTL customers. This will make it easier for cardholders to carry out transactions at home and abroad. Additionally, 3D Secure, once completed, will make it easier for cardholders to efficiently conduct financial transactions online. Finally, the Central Bank also authorized BNCTL in 2023 to initiate and open a project with Mastercard for the Acquisition and Issuance of Mastercard.

BNU Timor's Visa contactless and 3D Secure had been integrated into the P24 in previous years. In 2023, BNU Timor, in collaboration with BCTL and relevant parties, completed the integration of Mastercard Acquiring into P24. International Mastercard holders visiting Timor-Leste can now carry out transactions at BNU ATMs and POS devices.

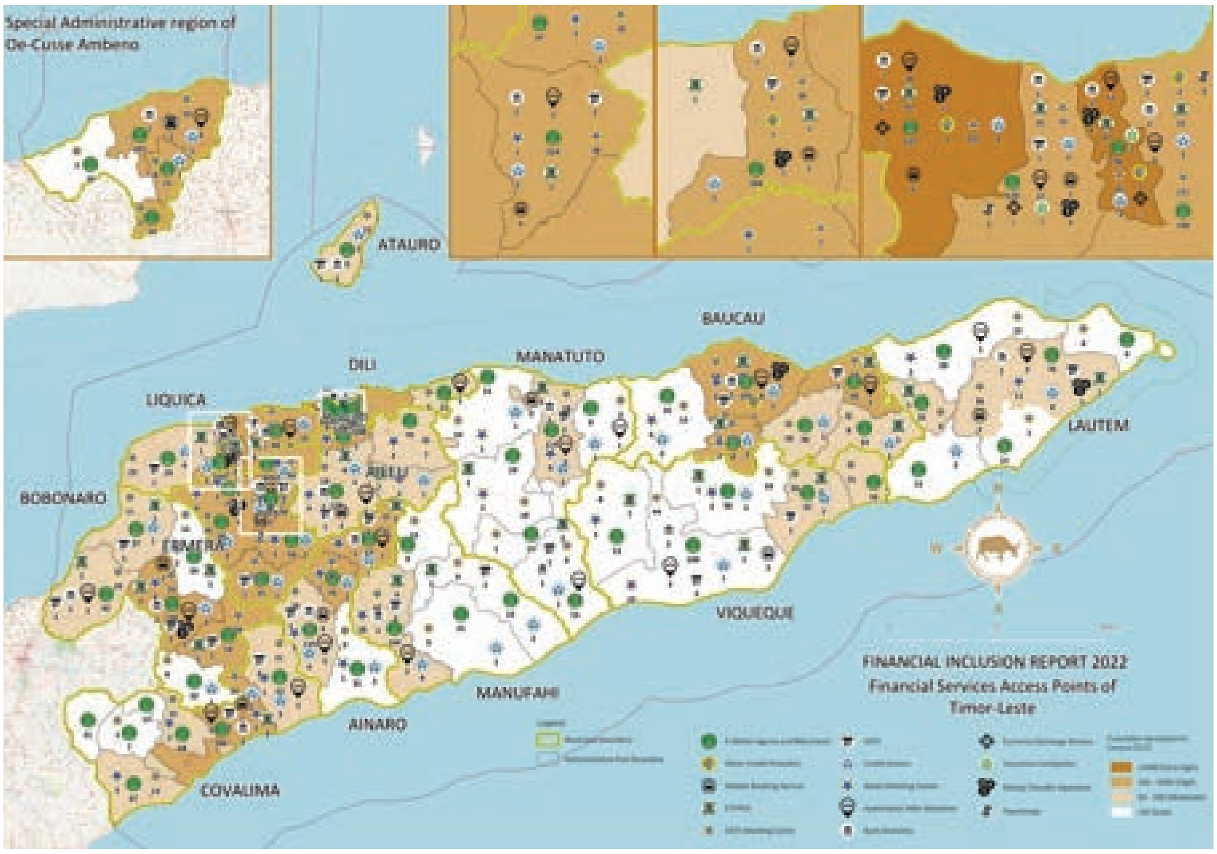
Development of the ASYCUDA interface with P24 has progressed well during 2023 and is expected to be completed in the first half of 2024. This will facilitate real-time digital customs clearance payments efficiently via POS devices once completed.

The integration of bank ATMs and POS devices, international payment schemes (such as Visa, Union Pay and Mastercard) and interconnection of electronic wallets into the P24 system allowed the system to be fully integrated, interconnected and interoperable. Thus, Timor-Leste has become a country that adopts the region's modern payment systems, facilitating efficient and systematic transactions necessary for the country's economic development and growth.

3.3.2. Financial and Banking Systems

3.3.2.1. Licensing and Supervision

Timor-Leste's financial system is made up of commercial banks, insurance companies, other deposit-taking institutions, exchange offices and money transfer operators (MTO), fintech companies and several credit cooperatives. The functioning of the financial system evolved in a solid and secure manner throughout the year, continuing to contribute significantly to the country's economic and financial stability.



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 BCTL Licensing Division and Supervision Division are responsible for granting licenses and supervising banks' activities, money changers, insurance companies or insurance intermediaries, other deposit-taking institutions and money transfer operators (MTOs), which operate in the country.

In 2023, the BCTL issued a new Instruction on the Licensing and Supervision of Financial Institutions that will allow the operation of a new form of non-bank financial services in Timor-Leste. The main objective of this measure is to promote access to credit for the private sector, especially for Micro, Small and Medium Enterprises (MSME) in the country.

The BCTL also issued new prudential regulations on the implementation of International Financial Reporting Standards for banks and other deposit-taking institutions (OIRD) licensed to operate in the country. The BCTL, through the Supervision Division, continues to supervise financial institutions to ensure full compliance with applicable laws and regulations.

During 2023, there were no new applications from financial institutions licensed to operate in the country. Although meetings were held with potential candidates wishing to open a bank or money transfer operators, BCTL did not receive any formal applications.

Box 2. Financial Education Program in Timor-Leste

2.1. Financial Literacy Program in Primary Schools

During 2023, the Central Bank of Timor-Leste (BCTL) and the Ministry of Education (ME) continued to work on implementing the financial literacy program in public basic education schools. This program was implemented in 144 public primary schools due to the commitment and full support of the Ministry of Education, in particular the General Directorate of Education and Teaching (DGEE) through the distribution of the circular letter ordering teachers to teach the program in their respective schools.

BCTL continues to coordinate and communicate closely with the Ministry of Education as the main player in the financial literacy program in primary schools. There were several technical meetings that were organized during the year. The objective of these meetings was to discuss the issues and find the best solutions, so that the implementation of the program was aligned with the determined objectives.

To ensure and guarantee the continuation of the financial literacy teaching program, BCTL and the Ministry of Education organized a technical meeting with the director of education and the superintendent of the municipalities. During this meeting, representatives from the Ministry of Education informed and emphasized that the financial literacy program continues in designated schools. Furthermore, BCTL also emphasized that it will continue to support this program and consider it as a national program, therefore the success of the implementation is subject to good and close coordination and collaboration with the Ministry of Education, especially at the municipality level. On this occasion, representatives from the Ministry of Education also distributed a circular letter to the directors of municipal educations that instructed schools to teach the financial literacy program as an extracurricular subject.

After the circular letters were distributed, BCTL carried out monitoring activities in two types of approaches. First, BCTL conducted pre-monitoring activities through telephone interviews with respective school principals. The purpose of this interview was to confirm whether the designated schools had received the circular letter and implemented it. Second, BCTL monitored teaching progress and distributed financial literacy books to schools that planned to expand the program to primary schools within its supervision zone.

Data collected by BCTL from each school delivering the financial literacy program indicated that the number of students who attended the financial literacy program from grades 1 to 6 in 2023 totaled 5,921.
As a result, the total number of students who attended the program from 2016 to 2023 was 42,198, made up of 20,841 females (49.4%) and 21,357 males (50.6%), as shown in the following table:

Number of Students

Year	Male	Female	Total
2016	2.577	2.749	5.326
2017	6.635	6.412	13.047
2018	5.652	5.668	11.32
2019	2.764	2.359	5.123
2020	767	694	1.461
2023	2.962	2.959	5.921
Total	**21.357**	**20.841**	**42.198**

Source: School reports, 2016-2023

2.2. Launch of the Fourth Edition of the 2022 Financial Inclusion Report

Every two years, since 2016, the Central Bank collects and analyzes information to measure and monitor the evolution of financial inclusion in Timor-Leste. In 2023, BCTL produced and published the fourth edition of the Financial Inclusion Report.

The main theme of the report was preparing for the ongoing digital transformation. The report highlighted the transformative impact of the digital revolution on the financial services sector, from the preparation and personalization of digital currency transactions to online banking channels and the ascension of Fintech financial service providers. It also highlighted that the Central Bank itself must reimagine processes, systems and ways of working to keep up with this rapid ongoing transformation. Another highlight was the potential of artificial intelligence and other cutting-edge technologies to improve productivity, customer experiences and innovation in general. The report points out that although Timor-Leste has taken steps towards digitalization with e-wallet services, additional efforts are still needed to promote digital financial services more broadly. Digital financial literacy is essential in this process, helping people feel comfortable using digital financial products.
This report shows the continued improvement of key financial inclusion indicators, despite the persistent barrier of a lack of digital financial literacy. Low levels of financial literacy led to little use of financial services, even when available, as many people may not understand their benefits or how to use them effectively. The report also highlights the following additional points:

- Access points to Financial Services continue to expand, with all types of financial services having increased the number of access points since 2020, except Money Changer (MC). Electronic wallet services and Other Deposit-Taking Institutions (ODTI) have made the most significant progress.
- Access points to financial services cover all the villages in the municipalities of Díli, Ataúro and Liquiça. On the other hand, Ermera and Manufahi have the largest number of villages without any access points to financial services. There are 29 villages without access points to financial services.
- Timorese adults use more financial services compared to 2020. At the end of 2022, around 64% of the adult population were bank customers, 6% were ODTI customers and 22% were e-wallet customers. From a gender perspective, women use more financial services than men, except e-wallet services.
- The two ODTIs were very competitive in the credit market, serving 45% of private customers with credit from regulated financial institutions. The remainder of the credit market was served by the five banks operating in the country. 72% of ODTI customers have an active loan, while only 8% of bank customers had a bank loan.

2.3. The VII Meeting on Banking Supervision of the Central Banks of Portuguese-Speaking Countries (BCPLP)

Between the 24th and 26th of July 2023, the VII Meeting on Banking Supervision of the Central Banks of Portuguese-Speaking Countries was held in Timor-Leste, which aimed to exchange experience between BCPLP supervisors. Representatives of the central banks of Angola, Brazil, Cape Verde, Macau, Mozambique, Portugal and Timor-Leste were present at the meeting.

At the opening of the meeting, the Vice-Governor of BCTL, Rafael Borges, highlighted in his speech, after an initial greeting, the importance of banking supervision for the financial system. That said, he highlighted the need for continuous sharing of experiences through debates included in the annual supervisors' meetings. He also noted that BCTL owns and operates two critical payment systems, namely the automated transfer system that combines the functionalities of the Real-Time Gross Settlement (RTGS) and Automated Clearing House (ACH) systems and the retail payments network, known as P24, where all banks and fintech are connected.

He continued to highlight that, at the end of 2021, the (former) Governor of BCTL, Abraão de Vasconcelos, took the decision to fully adopt IFRS9 for banks and ODTIs, as well as the Basel III structure, with the process transition is scheduled to begin in June 2024.

In the opening session, participants shared the main transformations that occurred in the banking supervision function of each central bank. The issue of the rapid evolution of digital technology and money laundering received special attention, without neglecting other aspects of current supervision that require due care by banking supervisors.

2.4. Training Program for Micro, Small and Medium Enterprises

BCTL is committed to empowering micro, small and medium-sized enterprises (MSMEs) through cooperation and collaboration with IADE (Business Development Support Institute) and CCI-TL (Timor-Leste Chamber of Commerce and Industry), providing training in bookkeeping and accounting.

During 2023, 13 entrepreneurs (10 women and 3 men) participated in this program in Maliana, Municipality of Bobonaro. In terms of economic sectors, 5 entrepreneurs operate in the retail sector, 4 in the livestock sector and 4 in the services sector. The training was well organized as each institution performed its functions in accordance with the agreement contained in the memorandum of understanding. The central bank provided support in terms of teaching materials and food costs during the five days of training. In turn, CCI-TL nominated the participants to participate in the training and IADE provided training on basic bookkeeping and accounting.

On this occasion, BCTL took the opportunity to present a specific financial literacy theme that was personalized for entrepreneurs. This theme guided understanding of the importance of budget planning, savings and protecting business owners' assets through the facilities available in financial institutions. BCTL also coordinated with banks and ODTIs to contribute to this training program by providing information about its credit products. Additionally, BCTL shared information on the range of digital financial transactions currently available in Timor-Leste's financial markets.

Since the establishment of the partnership, the program has trained 285 participants in bookkeeping and basic accounting. The training was carried out in several locations such as Dili, Same, Oecusse, Baucau, Viqueque, Maubisse and Maliana. It was also noted that the participants were mostly women, totaling 158, and 127 were men.

2.5. Financial Literacy Program for Young People

In October and November 2023, BCTL organized digital financial literacy programs aimed at young people in secondary schools and universities. The objectives were to share information about digital financial literacy, so they were encouraged to use the digital payment platform for daily transactions. Furthermore, young people were encouraged to share this information with their friends or family, with a view to expanding the number of adults who use the online digital platform in daily transactions. BCTL took the opportunity to disseminate information about the various digital transaction tools available and the advantages of using digital transactions in everyday life. Participants also had the opportunity to learn about the importance of financial planning, saving and protecting their finances. Furthermore, they obtained information on the detection of counterfeit physical money.

This program was organized at the Dili Institute of Technology (DIT) and at a professional technical secondary school for business and economics in the capital. The program reached 155 students made up of 62 men and 93 women.

3.6. Digital Financial Literacy for Companies

With regards to the ninth National Savings Day and the third Digital Village Day in October 2023, BCTL organized a digital financial literacy program for companies. The program had the collaboration of interested parties such as CCI-TL, IADE and FCCHM (Hanai Malu Credit Cooperative Federation). This one-day digital financial literacy event was held at Hotel Novo Turismu in Dili.

Dili was chosen to hold the event since it is in the capital where many small, medium and large companies grow. Digital payment methods are an effective payment option if they are supported by fast internet telecommunications, which will greatly facilitate online transactions for all users of online payment products. In this socialization, the central bank directly involved banks and e-wallet providers to explain its online payment products to event participants.

The purpose of this disclosure is to provide information about available digital payment platforms, so that they can manage their businesses, use and familiarize themselves with online digital payment systems, such as P24 debit cards and electronic wallets, in their daily activities. This program covers 177 participants, with 88 being men and 89 being women.

2.7. National Savings Day and Campo Digital Program

The celebration of the ninth anniversary of National Savings Day and the third anniversary of Digital Village Day took place in Dili, on November 29th, in the Timor-Plaza car park. Before arriving at the main event, BCTL held a digital financial literacy pre-activity aimed at students and businesspeople in Dili. This event was an effort to increase public awareness about the importance of knowing the variety of banking products and online digital financial transaction facilities available in the community.

On this occasion, there was also an exhibition by banks, fintech services and insurance companies about their banking products and services to the public. The speakers openly explained to the public present the advantages of their products and services, including the available online payment platforms. This exhibition was inaugurated by the Governor of BCTL, Mr. Hélder Lopes and accompanied by the CEOs of banks, ODTIs, insurance companies and fintech companies.

The Governor took the opportunity to inform that the total amount that children saved in the “Ha’u-nia Futuru” accounts reached 13 million dollars in October 2023. He also requested the Government to increase investment in telecommunications networks to support the online digital payments system program.

This celebration was also attended by His Excellency the Prime Minister of Timor-Leste, Mr. José Alexandre Xanana Gusmão and several government officials. In his speech, the Prime Minister welcomed the initiatives that were underway so far and reiterated the Government’s commitment to supporting BCTL programs, particularly digital financial literacy programs.
At the end of the event, BCTL presented certificates of appreciation to relevant stakeholders who contributed to the successful implementation of the financial literacy program. Certificates were delivered to the current and former President of CCI-TL, to the director of IADE, to IADE instructors, to principals of primary schools who teach the subject of financial literacy in some primary schools in Dili, and to the coordinator of Basic Education Schools Taur Matan Ruak Branch, Basic Education Paiol Branch and Basic Education Mota Ulun Branch, Basic Education Aituri-laran Branch. There was also gratitude to the POS P24 digital transaction agents from some municipalities located in the Administrative Post of Baguia, Uatu-Lari and Cailaco. These agents made EFTPOS machines available in their stores/kiosks so that people could withdraw money.

2.8. “Há’u-Nia Futuru” Accounts

CHILDREN’S SAVINGS ACCOUNTS “HA’U-NIA FUTURU”

The Há’u-Nia Futuru savings program was developed for children up to the age of 17, with the main objective of promoting formal financial inclusion for children and families. Every month, banks provide BCTL with reports on the progress of Ha’u Nia Futuru savings, in order to monitor their developments. The benefits of these savings consist of the fact that children only need one dollar (USD 1) to open an account, there are no administration fees and they benefit from a remuneration rate of 1.5% per year. To open this account, only the birth certificate and the parents' identification card are required.

According to the report, the number of customers reached 26,594 at the end of 2023, 13,251 men and 13,343 women. The funds accumulated in these accounts reached USD 13.1 million, with $6.5 million belonging to men's accounts and USD 6.6 million belonging to women's accounts.

It was also found that the majority of the amount saved in this instrument was deposited in the accounts of children aged between 11 and 14 years old. However, it was also found that the majority of holders of these accounts were between 6 and 10 years old.

Observations on the annual evolution of deposited amounts indicate an increase of 14% (from USD 11,279,600 to USD 13,115,400). As in the previous year, the majority of savers from this product are concentrated in the municipalities of Dili, 68%. Next are the municipalities of Baucau (6%), Lautem, Covalima, Liquiçá, Aileu and Manufahi (3%), the municipalities of Bobonaro, Manatuto, Ermera, Viqueque and Oecusse (2%) and, finally, Ainaro (1%).

3.3.2.2. Insurance Company

There are three insurance institutions in Timor-Leste: SinarMas General Insurance (SMI), SinarMas Life Insurance (SMIL) and Federal Insurance Timor (FIT). In 2022, BCTL granted a definitive license to the insurance company SinarMas to manage the life insurance business in the country. For this reason, information for this life insurance business is only available for 2023. The sector registered positive developments in the set of services offered in the country and the provision of general insurance to the various sectors of activity. This information is detailed about two existing insurance products in the country: general insurance and life insurance.

3.3.2.2.1 General Insurance.

General insurance recorded total assets of 21.8 million USD in December 2023, a growth of 6% compared to 2022. This growth can be attributed to an increase in subscription premiums and observed investments. The majority of assets held by the insurance sector are cash and investments, which represent 29% and 59% of total assets, respectively.

In the same year, total liabilities decreased by 2.8%, totaling USD 13.8 million at the end of the year. The decline was affected by accumulated outstanding credits of 65% and accumulated deferred income of 33% due to the credit risk mitigation policy. The composition of liabilities was dominated by unearned premiums and pending claims of 76% and 14%, respectively.

Total net worth increased again, registering annual growth of 25% in 2023 (USD 6.4 million to USD 8.1 million). As in 2022, this increase largely came from retained profits and profits accumulated during the year (3.9 million dollars in 2023 and 1.9 million dollars in 2022).

Premiums decreased by 16% to 5.5 million USD compared to 6.6 million USD recorded in 2022, reflecting the impact of the decrease in the maturity of the insurance contract. Regarding the distribution of the premium profile, 76% are personal accident coverage, 10% motor vehicle coverage, 9% fire coverage, 4% civil liability coverage and 1% engineering coverage.

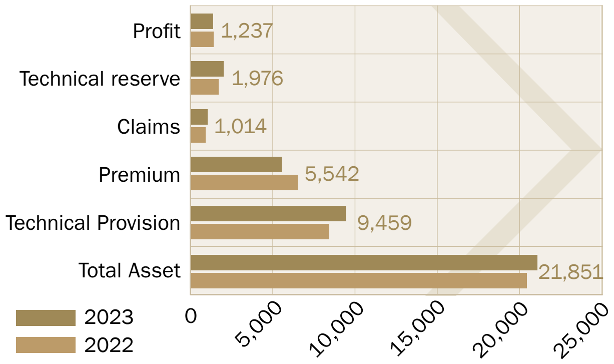
Profitability remains positive in the sector, but profits contracted by 6%, reaching USD 1.2 million in 2023, compared to USD 1.3 million in 2022. This reduction is explained by the increase in claims and associated expenses. Claims expenses exceeded USD 1 million in 2023 (USD 959 thousand in 2022), largely arising from motor vehicle policies, personal accidents and property accidents.

Graph 3.5 illustrates the evolution of the main measures for evaluating general insurance's annual performance.

Chart 3.5

General Insurance Performace

In millions of USD



Source: BCTL

3.3.2.2.2 Life Insurance

BCTL granted a license to a life insurance company on January 27, 2022. For this reason, annual financial performance data only became fully available in 2023. However, the result for the year shows that total assets increased 188%, from USD 1.4 million in December last year to USD 4 million in December 2023. This increase was mainly due to premiums and returned investments. The majority of total assets were concentrated in cash (55%) and bank deposits (44%), highlighting the high liquidity to meet obligations.

Total liabilities increased significantly by 497% to USD 1.8 million in December 2023 (USD 308 thousand in December 2022). This increase reflects the increase in premiums earned from credit insurance. The majority of total liabilities were concentrated at 96% in insurance contract liabilities (technical provisions).

Total owners' capital, which continued to increase by 101%, reaching USD$2.2 million in 2023, compared to USD1.1 million in December 2022. The increase is largely explained by retained earnings and accumulated profits.

A highlight also goes to the performance of attributed revenue, mainly due to the 126% increase in premiums, to USD 768 thousand in December 2023, compared to USD 389 thousand in December 2022. The growth was mainly driven by subscription associated with the personal accident policy to mitigate credit risk. The total number of policy registrations reached 288 as of December 2023, largely due to the credit insurance policy, recording only one claim where the SMLI settled payments in accordance.

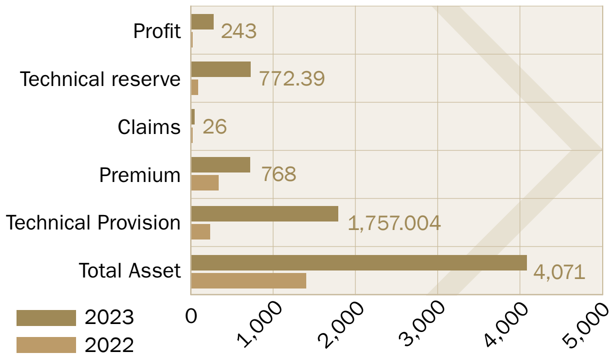
Profits recorded experienced a significant increase of 961% to USD 243 thousand in December 2023, compared to USD 23 thousand in December 2022, due to low claims registration.

Graph 3.6 Illustrates the evolution of the main measures for evaluating the annual performance of Life Insurance.

Chart 3.6

Life Insurance Performance

In Millions of USD



Source: BCTL

Box 3. Second Mutual Evaluation of the APG in Timor-Leste.

The objective of Asia/Pacific Group (APG) mutual assessments on anti-money laundering and countering the financing of terrorism (AML/CFT) in a country is to assess the effectiveness of its AML/CFT framework and measures. The main objectives of mutual evaluations include: assessing compliance, identifying strengths and weaknesses of the AML/CFT system, assessing the effectiveness of measures in place and providing recommendations to improve the AML/CFT framework. This assessment takes place every ten years.

On 25-27 October 2022, the APG Secretariat carried out its first pre-mutual assessment assistance (Pre-MER) visit to Dili to support Timor-Leste's preparations for its second Mutual Assessment in 2023-2024. The visit included a two-day workshop for government officials and the private sector and NGOs, aimed at informing their role in the Mutual Assessment process.

Between the 15th and 17th of August 2023, the APG carried out the second pre-Mutual Assessment visit to Timor-Leste as part of its Mutual Assessment process. This marked the second Mutual Assessment of Timor-Leste, following the initial assessment in 2011/2012.

During the visit, the evaluation team, assisted by the Secretariat, interacted with authorities in Dili, including representatives from the Central Bank of Timor-Leste, within the scope of the National Commission to Combat Money Laundering (CNCBC). Discussions focused on Timor-Leste's technical compliance, the note defining the scope of the Mutual Assessment and the planning of the direct visit scheduled to Dili, from 18 to 28 September 2023.

During the visit in September, the team carried out the mutual evaluation process, focused on evaluating the regime to combat money laundering, terrorist financing and the financing of the proliferation of weapons of mass destruction in Timor-Leste. It assessed not only technical compliance with FATF international standards as well as the effectiveness of Timor-Leste's implementation of AML/CFT measures in accordance with the 2013 FATF assessment methodology. During the site visit, the assessment team held meetings with government authorities, including the Central Bank of Timor-Leste, representatives of the private sector and civil society groups. Furthermore, the team highlighted, in meetings held with the Prime Minister and the Minister of Justice, Timor-Leste's dedication to the evaluation process. After the visit, the evaluation team will prepare the Mutual Evaluation Report, which will be reviewed and considered at the 2024 APG Annual Meeting.

3.3.3. Petroleum Fund Management

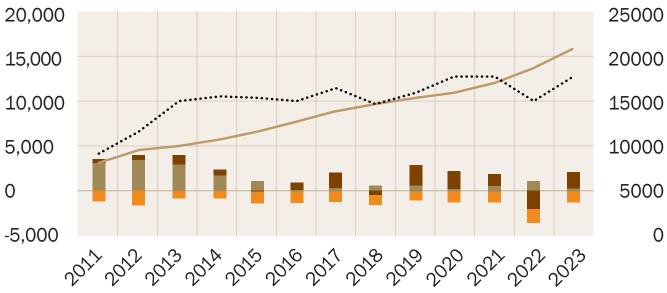
In accordance with the framework defined by the Petroleum Fund Law - Law no. 9/2005, later amended in 2011 - the Central Bank is the institution responsible for the operational management of the Fund. According to this legislation, the Ministry of Finance is responsible for defining the general and investment strategy of the Petroleum Fund and the Central Bank is responsible for the operational implementation and concrete management of the investments and mandates that result from this strategy.

At the end of 2023, the value of the Fund's capital was valued at USD 18,252 million, a slight increase of 4.8% compared to the previous year. Annual oil revenues - taxes and royalties - amounted to USD 427 million, which represents a significant drop of 61% compared to 2022. On the other hand, withdrawals intended to finance the execution of the 2023 General State Budget were valued at USD 1,090 million. The Fund's management expenses, both external and internal, amounted to USD 18.9 million in 2023.

Regarding annual financial performance, the Fund accumulated gross investment income of USD 1,643 million, which corresponds to approximately 9% of the value of the Fund at the end of 2023 (USD 18,252 million). The breakdown of this income allows us to observe that the income arising from the receipt of interest and dividends totaled 2.5% of the Fund's value (1.7% in 2022). The recorded capital gains amounted to 6.3%, resulting in an increase compared to the substantial capital gains of 2022, valued at -13.3% of the value of the Fund.

Chart 3.7

Petroleum Fund Management



Source: BCTL

The Petroleum Fund continued to invest in the segmentation of the liquidity portfolio and the growth portfolio in 2023. The liquidity portfolio is invested in highly liquid securities with maturities of less than 3 years in order to cover planned withdrawals to finance State Budgets designed in the following 3. The growth portfolio is mainly invested in fixed income securities (65%) and shares of multinational companies (35%).

In 2023, the performance of the liquidity portfolio was 4.25% annually, while the

The positive performance of the portfolio investment in the financial market during the year was mainly due to the impact of rising interest rates in the main advanced economies and the positive sentiment of investors about the global economic situation. The main world economies maintained high interest rate levels in order to bring inflation rates to more contained levels. At the same time, central banks' determination to keep inflation under control positively impacted investor sentiment. The increase in the reference interest rates led to a rise in interest rates on global sovereign bonds, particularly US Treasury bonds, which account for a significant part of the Petroleum Fund's investment portfolio. Equity markets recorded substantial gains in 2023, benefiting from the current development of the economic recovery, supported by the success of macroeconomic stabilization policies and the substantial reduction in the negative investor sentiment, mainly relating to the services and industry sectors.

At the end of 2023, the growth portfolio concentrated 82.97% of the Petroleum Fund's investment, while the remaining 17.03% was invested in the liquidity portfolio. The liquidity portfolio was entirely made up of US Treasury bonds - 14.45% with maturities of 3 months and 2.58% with maturities of 1 - 3 years. In relation to the growth portfolio, 51.31% was invested in a fixed portfolio, with 27.35% made up of US Treasury bonds between 3 - 5 years, 7.92% in US Treasury bonds between 5 - 10 years, and 8.12% in other sovereign bonds from developed countries other than the USA. The remaining 31.66% of the portfolio investment was allocated to the equity portfolio.

3.3.4. Institutional Strengthening

BCTL continues to develop and strengthen the Timorese financial system and modernize banking supervision. Below we highlight the most relevant actions developed in 2023, relating to the institutional strengthening of the Bank:

- In order to ensure the integrity of the banking system in Timor-Leste, the BCTL Board of Directors made the first amendment to Instruction No. 5/2017 regarding Customer Identification, Document Preservation and Operation Communication, in line with the recent developments in international standards that combat money laundering and terrorist financing.
- The BCTL Board of Directors approved Instruction No. 22/2023 on Liquidity Risk Management. This instruction defines a consistent and robust standard for risk and liquidity management, contributing to the security of the national banking system and financial stability in Timor-Leste. Furthermore, this instruction also establishes the methodology for determining the liquidity coverage ratio and the net stable funding ratio, important monitoring tools to be adopted by banks.

- The BCTL Board of Directors approved Instruction No. 23/2023 on the Chart of Accounts. The establishment of this instruction is intended to ensure a sound and consistent standard of accounting for banks and ODTIs that allows for effective supervision of the banking system and the preparation of reliable monetary statistics for Timor-Leste.
- The BCTL Board of Directors approved Instruction No. 24/2023 on Reporting and Publication, which establishes all reports that banks and ODTIs must deliver to BCTL and publish within the prescribed deadlines, consolidating banks' criteria to enable supervision of the banking system and the preparation of reliable monetary statistics in Timor-Leste.
- The BCTL Board of Directors approved Instruction No. 25/2023 on the Licensing and Supervision of Financial Companies. The establishment of this instruction aims to ensure that Financial Companies operate within transparent and well-defined organizational structures and operations. In this sense, it provides that institutions are managed prudently, are equipped with the necessary financial resources and have internal risk management systems. Therefore, it is intended that the interests of customers and stakeholders of Financial Companies are safeguarded, developing in a solid and prudent manner, thus contributing to the general stability of the financial sector.
- The Board of Directors of BCTL granted preliminary authorization for payment service activity to Ti-Oan Fintech to manage the branch of digital payment activity, specifically the electronic wallet in the country.
- The Board of Directors updated the structure of the Economic Studies and Statistics Division, taking into account BCTL's need to achieve its goals. Thus, the division now becomes one of the departments of the Bank.

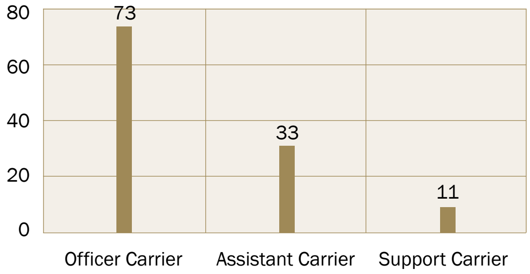
3.3.5. Employees and Training Programs

At the end of the 2023 period, BCTL had 106 employees, which represented a marginal increase compared to 105 in 2022.

By 2024, BCTL plans to recruit around 15 employees to fill official career positions in the departments of the Financial Intelligence Unit (UIF), Petroleum Fund, Economic Studies and Statistics, IT Technologies Division, Payment System and Governor's Office.

Chart 3.8

Professional Categories



Fonte: BCTL

In addition to current BCTL employees, 11 employees were hired to fill the support or assistance service. Graph 3.8 shows the distribution of employees across the various professional categories.

At the end of the year, BCTL evaluates the performance of its employees. The system used to carry out this evaluation is called Performance Improvement System (PIS). The result of the evaluation throughout 2023 shows that the majority of employees managed to achieve the objectives established at the level of the institution and their respective departments and divisions.

The Performance Assessment system is implemented by the various Departments' managers, with the aim of valuing the work of employees and analyzing their contributions to achieving the BCTL objectives, which were annually planned for each department and division.

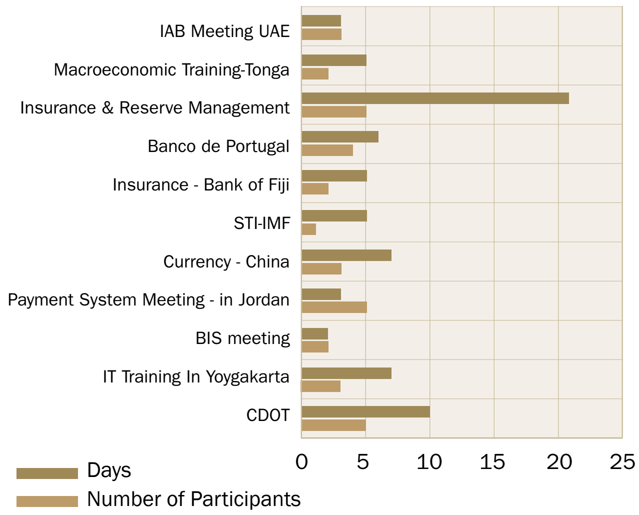
The dimensions used to evaluate employees' performance remained unchanged throughout the year, as indicated in the following diagram, namely: Objectives, Activities and Skills for employees in the technical professional career; and Activities and skills for employees in the Assistant and Support professional careers.

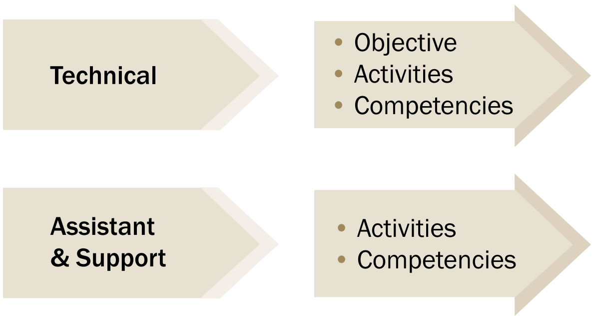
Regarding the development of skills and knowledge of its employees, BCTL continues, annually, to allocate an adequate amount to fulfill its training program, which involves training in technical skills in Timor-Leste and abroad. In addition to this training, BCTL continued to finance scholarships for its employees to attend master's and doctoral courses abroad.

Graph 3.9 shows the number of BCTL employees who participated in training, Seminars, Conferences and Meetings in 2023.

Chart 3.9

Presential Courses, Workshops and Conference in 2023





3.3.6. External Relations

The Institutional Cooperation Affairs Unit (UACI) carries out its functions related to BCTL's cooperation with other institutions, both internationally and nationally. The objective of institutional cooperation is, in addition to strengthening relationship ties, to increase information sharing in the areas in which central banks operate. This activity includes cooperation with its counterpart entities, financial institutions and organizations that present convergence and relevance to the activity and functions of BCTL, both internationally and nationally.

In addition to cooperation with the Central Banks of the Community of Portuguese Speaking Countries (CPLP), BCTL also carried out cooperation actions with other international financial institutions, namely: the Bank of Indonesia (BI), Bank Negara Malaysia, the Federal Reserve Banks of the United States of America and Australia, SEACEN, STI-IMF Singapore, APRA, International Monetary Fund, the central banks of the Pacific Islands and the Macau Monetary Authority. The context of cooperation with these entities is similar to that carried out with CPLP central banks.

In the respective areas of cooperation activities carried out in 2023, the majority of activities were carried out in person, both in training actions, seminars, meetings, working visits and sharing of information in fundamental areas. Participation in these activities showed a significant increase and was carried out satisfactorily.

Regarding cooperation at national level, during 2023 BCTL maintained initiatives with relevant entities to reinforce cooperation and promote greater public access to the financial sector. BCTL also maintained cooperation with the National University of Timor-Leste, through the promotion of internships for finalists at the Faculty of Law. Regarding cooperation with Australia's Griffith-Queensland University, established in 2020, BCTL continued joint research work at the level of economic investment. The result of this cooperation resulted in three joint working documents, published on the University and BCTL websites, related to government spending, remittances, and investments.

In addition to the cooperation activities mentioned above, the BCTL also maintained the role of host at high-level meetings of CPLP central banks. These meetings aim to reinforce cooperation ties between participating institutions and promote reflection in relevant areas in order to establish action strategies on matters of common interest. Throughout 2023, the BCTL hosted the VII Meeting of Supervisory Directors of Central Banks of CPLP Countries for three days and the meeting was positive.

BCTL continued the strategy of maintaining and strengthening cooperation ties with CPLP central banks and financial institutions that had already been established previously. Furthermore, it promoted new forms and actions of cooperation with other central banks and financial institutions, both internationally and nationally.

Box 4. BCTL Plan Implementation in 2023 and Action Plan for 2024

4.1. Implementation of action plan of BCTL for 2023

BCTL managed to carry out notable programs and initiatives in 2023, highlighting:

a. The BCTL has finalized instructions on the implementation of the International Financial Reporting Standards (IFRS) that apply to commercial banks and other ODTIs. The measure, which covers instruction on how the charts of accounts, management, liquidity ratio, solvency, reports and disclosure accounts, aims to contribute to a more adequate and binding financial system. The Instructions were published in the Journal da República and will take effect on July 30, 2024. The application of prudential rules will contribute to strengthening the stability and competitiveness of the financial system, and public confidence in the sector. The BCTL also finalized the instruction on risk-weighted assets, risk capital management, operation and capital requirements for market risk. Within the scope of AML/CFT, BCTL carried out, through Gabal and DSP, training for fintech companies and hosted APG's second mutual evaluation.

b. To improve the digital payment system and customer service, BCTL finalized in 2023, in collaboration with financial institutions and P24 service providers, the interconnection of the fee payment system, the electronic wallet system and the BNU POS. This action will allow customers to carry out a more efficient fee payment process through the electronic wallet and POS. Additionally, the Central Bank finalized, in collaboration with BNU, the certification of Mastercard acquiring. On the other hand, the Union Pay issuing development process between BNCTL and Union Pay has reached 45%. Finally, BCTL, in collaboration with the Customs Authority, has reached the final stage to support the integration of the ASYCUDA system into P24, which will increase the efficiency of import duty payments through POS and ATM machines with the P24 logo.

c. The Central Bank released the fourth edition of the 2020 financial inclusion report. The result of the report demonstrated that the number of access points to financial services continued to increase. The report highlights that all Municipalities and Administrative Posts already have access to financial services, only 29 villages left without financial services. The report also showed that 64% of the adult population already has access to existing financial services.

d. The Central Bank successfully carried out the information dissemination program on digital payment to the Directors (CEO) of financial institutions, Directors of relevant ministries, business people and credit union members. The aim of this program is to encourage participants to promote existing digital financial services such as ATM, P24, POS-P24, e-wallet services, internet banking and mobile banking.

e. In order to continue efforts to promote the financial education program, BCTL continued to implement key financial education and digital village programs in 2023 in Basic Education and in certain communities. At the same time, on November 29, 2023, as usual, BCTL celebrated the ninth anniversary of national savings and the third anniversary of the digital village in Timor-Plaza, Díli. As part of this celebration, the Central Bank held an exhibition to the public on existing financial services and digital payments available in the country, such as ATM-P24, POS-P24, Electronic Wallet, internet banking and mobile banking. The exhibition was attended by financial institutions mainly commercial banks, fintech companies, insurance companies and traders who adopt digital payment systems available in their daily transactions. Within the scope of this program, BCTL also promoted the Accounting Training Program aimed at Micro, Small and Medium Enterprises (MSMEs) in the municipality of Bobonaro.

f. In order to reinforce the management and investment capacity of the Petroleum Fund, BCTL defended the need for a study on investment policy and strategy, through its representative at the Investment Consulting Council (CCI/IAB). At the same time, BCTL maintained the reinforcement of operational investment management through the independent assessment of private debt, the Bloomberg AIM operation, the implementation of treasury management and the implementation of the independent review of the oil fund.

g. In order to strengthen and develop its institutional capacity, BCTL implemented an integrated system for human resources management in 2023, introducing the well-being program for its employees and the Cadena International provider system. Furthermore, to develop the technical capacity of employees, BCTL maintained its focus on capacity development programs, namely through financing scholarships and other training in relevant areas, including events and courses offered by international partners.

h. The Central Bank also carried out initiatives that are not included in the 2023 plan, as described in the following points:
   i. The Central Bank updated the strategic plan for financial education 2016-2020.
   ii. The central bank, in cooperation with International Finance Cooperation (IFC), concluded instruction no. 25/2023, July 4, on the licensing and supervision of financial companies. Furthermore, it contributed to its dissemination to the public. The instruction aims to promote access to credit by the private sector, mainly for MSMEs in Timor-Leste. Furthermore, BCTL continued to cooperate with IFC in order to prepare the draft of the security guarantee law, planning to submit for approval to the National Parliament in 2024. This law aims to encourage the granting of credit to companies and the private sector in order to develop the economy, develop the job market and improve the well-being of the people.

i. The BCTL will introduce the General Regime for Banking and Financial Activities. The drafting of this regime aims to replace or revoke the UNTAET 2000/8 regulation on banking licensing and supervision. By updating standards in line with the modern standard, it will improve gaps in relation to the licensing and supervision activities of financial institutions, namely through: defining the role of supervision in the behavioral and prudential supervision process; the inclusion of instructions on the Financial Institution's deposit guarantee fund with the BCTL; and the inclusion of instructions on the process of handling inactive or dormant accounts.

ii. The BCTL will introduce the Secured Transaction Law, a law designed to regulate commercial transactions within the scope of movable property security law. The law will also play an important role in promoting a healthy and stable financial system, through the structured provision, with legal clarity and in a predictable manner, of security, which can benefit creditors and debtors in the banking process.

iii. The BCTL will introduce the Insolvency Law. This law aims to manage supply problems, while ensuring fair treatment of creditors when debtors lack the capacity to repay their debts.

iv. Finally, the BCTL intends to introduce the Accounting Standards Law, a regulation that will become a reference for the preparation of financial reports for business entities. This law aims to ensure comparability between financial reports from different business entities and from different analysis periods.

4.2 4.2 The Strategic Priorities for 2024 Legislative Reform and Development of Legal Frameworks

To ensure and strengthen the quality of financial service in Timor-Leste in 2024, the BCTL will introduce four main laws that will act as legal bases for the implementation of monetary and financial policies, the bank's main functions enshrined in the BCTL Organic Law.

Furthermore, in order to ensure the quality of service in financial institutions, the BCTL will finalize, in 2024, the sanctioning action initiated against the financial institution that violates applicable laws and regulations. Furthermore, based on its disciplinary power, BCTL will finalize the administrative procedure to apply disciplinary sanctions to its employees. This administrative procedure aims to ensure transparency and the right of the interested party to exercise their right to participate in the administrative process. The drafting of ongoing processes is the responsibility of the legal support office.

On the other hand, to reinforce the legal framework of the financial system, the bank will finalize, in 2024, the instructions applicable to:

- Charts of accounts of insurance companies, financial reports and solvency margins of life insurance companies;
- Money transfer operators (MTO);
- Consumer protection, namely on opening, processing, and closing deposit and credit accounts;
- The national payments system, namely the legal framework on monitoring the payment system that will introduce instructions on establishing the R-Timor and P24 system.

Promote Digital Banking Service and Improve Public Service

In 2024, BCTL will begin production of the second master plan for the development of Timor-Leste's financial sector 2026-2036, which will be based on the first master plan. To modernize and promote the digital payments system and improve service to the public, BCTL commits to 2024:

i. To complete the integrations of main facilities in the P24 system, such as the payment of fees through an electronic wallet on the POS machine and other digital payment methods.
ii. Completing the acquisition of Module Recycling for ATMs, so customers can make bank deposits through ATMs, and also purchasing the Module Dual Dispenser at ATMs.
iii. Acquiring the BAM feature, which allows banks to carry out transaction monitoring and other activities in relation to commercial aspects.
iv. Continuing the implementation of the single mobile banking & Soft POS application.
v. Reactivating the integration process between the P24 system and the Indonesian retail payment system.
vi. Collaborating with acquirer banks to finalize the Mastercard and UPI certification process.
vii. Collaborating with the Tax Authority to continue the process of integrating SIGTAS V-3 into the P24 system, which allows tax payments to the government more efficiently.
viii. Introducing the use of payment systems via unique QR code.

In 2024, BCTL will continue to carry out a public campaign on the uses of electronic payment systems existing in the country through the national digital village program.

When it comes to improving banking services, BCTL is committed to investing in a more efficient service to customers, mainly the ministry of finance, government agencies and the general public. In terms of public service, the bank will install a currency exchange machine (cents and paper money) at some service counters to improve the efficiency of currency exchanges.

As part of improving the service of the counterfeiting unit, BCTL will continue cooperation with the Scientific Police and Criminal Investigation (PCIC) and other relevant authorities through exchanges of information on counterfeiting to minimize or prevent the circulation of counterfeit coins in the economy of Timor-Leste. At the same time, BCTL will maintain its focus on the awareness campaign about Timor-Leste's official currency. The program will extend to administrative posts and will integrate with the national digital village program.

Promote Financial Inclusion

To boost the financial education program in 2024, BCTL will continue with the implementation of the action plan defined in the National Financial Literacy Strategy (ENLF), namely the development of the financial competence matrix (for Women, Children and MSMEs). In particular, it will continue to develop the specific module aimed at women and an awareness campaign about the benefits of the financial literacy program for this target group.

In 2024, BCTL will continue to work with MdEJD and INFORDEPE to hold regular meetings and coordination in order to explore the possibility of including financial literacy in the national curriculum, specifically in the mathematical subject of the 2nd cycle of Basic Education; address the progress and challenges of implementing the program in the 1st and 2nd cycle of Basic

Education; and discuss the monitoring of the implementation of the program in schools in 13 Municipalities and RAEOA.

In 2024, BCTL will continue efforts to extend the accounting training program for MSMEs. It will also introduce training on the credit guarantee system and digital payment system into the program. BCTL regularly celebrates national savings day and digital village day with schools that participate in the financial literacy activity and with digital village program targets in certain administrative posts. The priority activities at the celebration consist of the educational competition activity with primary school students and the distribution of the brochures promoting the money transfer service to the Há'u-Nia Futuru account through E-wallet or ATM.

BCTL continues to implement the accounting and financial literacy training program in MSMEs and credit cooperatives.

The Central Bank will continue to work with the Bank of Portugal to develop the online training platform, aimed at Basic Education, adult groups, MSMEs and cooperatives. The objective of this investment is to expand the training program to the public and in particular to help trainers in the process of learning financial literacy, while also helping MSMEs to organize and improve their budget balances.

As part of the financial inclusion program, BCTL intends to reinforce the implementation of the Credit Guarantee System (SGC) in 2024. For this purpose, it will begin by amending BCTL circular no.º 79/2019 of July 29 on the implementation of the credit guarantee system for MSMEs. It also plans to work in collaboration with commercial banks to organize a seminar on the implementation of the CMS in order to identify problems and solutions in implementing the program.

Strengthening Research and Statistics Capacity

a. The BCTL intends to continue the study of the national currency. The study will begin at the initiative of BCTL, but will have the support of IMF experts in its review. The work had already started in 2020 with the support of Banco de Portugal, but BCTL intends to continue the study in 2024 in order to identify more thoroughly the advantages and disadvantages of creating a national currency, in order to obtain more adequate information to support a possible strategic and operational decision on a monetary framework or alternative regime for Timor-Leste.
b. The BCTL will finalize the study on Central Bank Digital Currency (CBDC). CBDC is a non-physical currency (non-cash) or "digital" currency created by central banks. This currency would have the same functions as conventional currency, fulfilling the role of unit of account, store of value and means of payment. There are some benefits to the creation of CBDC, such as: strengthening monetary and financial stability, increasing financial inclusion and improving the payment system. Therefore, BCTL concludes that it would be beneficial to create and adopt CBDC in Timor-Leste.
c. To improve projection results, BCTL will continue to update its GDP projection model in 2024, using models already developed in cooperation with the Ministry of Finance through technical assistance from the IMF known as Macroeconomic Diagnostic. This projection method will be assisted by existing models and indicators, namely the economic activity indicator, the main component, mixed data sampling (midas) and ARIMA. It is expected that the adoption of this methodology will bring advantages to inflation projections. These projections allow BCTL to better monitor recent and future economic developments in real time.

d. In 2024, BCTL will develop and engage in several economic studies and research, including updating the survey of commercial banks and surveys on price fixing mechanisms in Timor-Leste. These planned initiatives aim to strengthen the understanding of Timor-Leste's macroeconomy through reliable statistics required for the high-quality models, tools and analyzes required to conduct monetary policy and solid support for BCTL's other functions. Those other functions to be explored in 2024:
    i. Timor-Leste's four macroeconomic sectors - real, fiscal, external and monetary sectors;
    ii. the structural form of the domestic economy, based on national accounts or GDP;
    iii. studies on factors determining inflation in Timor-Leste; and
    iv. the study on the development of Timor-Leste's financial system.
d. To improve the compilation and ensure the timely publication of balance of payments statistics and monetary statistics, at the end of 2023, the BCTL initiated the project to establish an automatic balance of payments statistics system, which is expected to be completed by the end of 2024. It also intends to extend the project to monetary statistics. It is expected that these initiatives will contribute to better data compilation and quality and to minimize errors. The system will automate the compilation, processing, analysis and reporting of statistical data.
f. In 2024, BCTL will receive technical assistance from Bank of Portugal in order to continue exploring how to establish central balance sheet statistics, i.e. the economic and financial data of non-financial companies in Timor-Leste. This information is relevant as sources for economic analysis, financial stability investigation, supervision in the financial system, risk assessment and management.

Strengthening Management and Investment Capacity

a. The Central Bank already has sufficient capacity for asset management and investment. However, it is necessary to continue strengthening this capacity, namely through a strategic study on relevant operational aspects and ensuring the management of the petroleum fund and other relevant funds delegated to the central bank for its operational management.
b. In 2024, BCTL will support and collaborate with other partners, an investment advisory committee and the ministry of finance, to carry out a strategic study on the management of petroleum fund and other relevant funds, where partners request the contribution of the Central Bank.
c. In 2024, BCTL will continue to promote a study on investment options for Central Bank reserves.
d. Subject to agreement with INSS, BCTL will reactivate in 2024 the discussion with INSS on the establishment of investment management of the Social Security Reserve Fund.

Development and Institutional Strengthening

To reinforce the administrative activity and management of BCTL, the Central Bank plans to carry out technical and physical capacity development activities in 2024, namely:

a. In the process of improving the physical infrastructure, in 2024, BCTL will finalize the design of the Central Bank Building and begin its construction process.
b. In order to improve the operational system, the Central bank plans to acquire the new accounting system or "Core Banking System (CBS)" to replace the current T1 system, with a view to providing services with greater quality and efficiency. The system will ensure key activities, such as: banking operation, treasury operation, registration of government

securities, currency operations, payment system operation, R-Timor system, accounting operation, settlement confirmation operation, provisioning, petroleum fund, special fund, human resources management and security and control system.

c. In order to improve the technology system and improve the development of financial activity in Timor-Leste, BCTL's Information Technology and Cyber Security Office Division will continue to modernize the supporting technology infrastructure and service provision. It will also design the control model to secure the prosthesis and available data such as the institution's important assets, including the national payment system and other information systems. In the part of development of the information technology system, the central bank will continue to update the systems to meet current changes in existing software and hardware.

d. In order to improve its technical capacity, the Central Bank plans to establish the BCTL Institute to provide structured training for its employees. In the future, it will be extended to technical employees of financial institutions and MSMEs. During the establishment process, it will have support from IFC. In addition, the central bank will continue to offer the master's scholarship program (S2) to its employees and provide technical training relevant to the bank's needs.

e. As part of enhancing its institutional cooperation and strengthening capacity, the BCTL intends, in 2024, to strengthen cooperation with counterparts in Asia Pacific and CPLP. Furthermore, to improve capacity and technical knowledge, the central bank will make the most of training programs (seminars, workshops and conferences) offered by entities such as the CPLP Central Bank, IMF, STHMF Singapore, BNM, Reserve Bank of Australia, Macau Monetary Authority and the central banks of the South Pacific. In addition, it will continue to strengthen cooperation with Griffith University-Australia in carrying out research programs in the area of economic studies. At the same time, within the scope of Timor-Leste's accession process as an ASEAN member, BCTL will actively participate as an observer in the ASEAN financial commission. In this regard, the BCTL has already introduced the required Task-Force in the area of the community's financial sector, and affirms its commitment to participate in programs established by the community, as well as in WTO-relevant events.

f. Finally, the BCTL will organize the VII Treasury Meeting of the CPLP central banks in 2024. The meeting is scheduled to take place in September 2024.

Main Governing Bodies of the Central Bank of Timor-Leste (BCTL)

Board of Directors

The Governor
Hélder Lopes

Deputy-Governors
Rafael Borges
Sara Lobo Brites

Non-Executive Members
Aicha B.U. Bassarewan
Benjamim de Araújo e Corte-Real
João Mariano Saldanha
Laurentina Barreto Soares

Management Committee

The BCTL Management Committee includes all those responsible for the Bank's main organizational areas, as indicated:

The Governor
Hélder Lopes

Deputy-Governor
Rafael Borges

Deputy-Governor
Sara Lobo Brites

Institutional Cooperation Affairs Unit Director
Raquel G. da Costa

Chief Financial Officer
Fernando da Silva Carvalho

Administration Department Director
Maria Ângela de Sousa Soares

Chapter 04

Financ
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For the year ended
31 December 2023

30 April 2024

CHAPTER 04

Statement of Compliance

The financial statements presented on pages 2 to 5, along with the accompanying notes on pages 6 to 35, constitute the complete financial picture of Banco Central de Timor-Leste as of December 31, 2023. These financial statements have been prepared by the Management and approved by the Governing Board. I hereby declare that these financial statements comply fully with the requirements of Central Bank Law No. 5/2011 and accurately represent the true financial position and performance of Banco Central de Timor-Leste at the aforementioned date.

Dili, 30 April 2024

Helder Lopes
Governor

Statement of Financial Position

As at 31 December

US$ '000US

	Note	2023	2022
Assets			
Cash and cash equivalents	7	633.390	688.499
Financial assets at fair value through other comprehensive income	8	119.699	145.363
IMF related assets	10	71.811	71.231
Other assets	12	5.278	3.939
Property, plant and equipment	11	1.538	1.702
Total Assets		**831.716**	**910.734**
Liabilities			
Government deposits	13	341.216	511.939
Other deposits	14	328.798	220.668
Other Liabilities	15	20.870	63.123
Currency issued		31.088	27.657
Total Liabilities		**721.972**	**823.387**
Capital	16	80.000	80.000
Fair value through OCI	27	-2.907	-4.431
General reserve		11.778	2.888
Net profit		20.873	8.890
Total Equity		**109.744**	**87.347**
Total Liabilities and Equity		**831.716**	**910.734**

The above statement is to be read in conjunction with the policies and notes on pages 136 to 160

Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31 December

US$ '000

	Note	2023	2022
Operating Income			
Investment income:			
Interest income	19	**30.181**	10.713
Interest expense	19	**-11.766**	-3.971
Net interest income		**18.415**	6.742
Petroleum fund management fee	22	**14.465**	13.155
Petroleum fund administration expenses		**-6.696**	-6.791
Net fee and commision income		**7.769**	6.364
Interest on financial assets at fair value through profit or loss	20	**4.955**	2.483
Fees and commissions	21	**656**	671
Other Income		**112**	385
Total Operating Income		**31.907**	16.645
Expenses			
Personnel expenses	23,26	**5.417**	2.716
Currency distribution expenses		**1.564**	1.043
Administration expenses	24	**3.593**	3.330
Depreciation	11	**460**	666
Total Expenses		**11.034**	7.755
Profit		**20.873**	8.890
Other comprehensive income		**-2.907**	-4.431
Total profit and other comprehensive income		**17.966**	**4.459**

The above statement is to be read in conjunction with the policies and notes on pages 136 to 160

CHAPTER 04

Statement of Changes in Equity

For the year ended 31 December

US$ '000

	Capital	General reserve	Fair value through OCI	Net Profit	Total equity
Balance at 31-1-2022	**80.000**	**2.888**	**-366**	**2.126**	**84.648**
Profit for the period				8.890	8.890
Other Comprehensive income			-4.065		-4.065
Total Comprehensive income			**-4.065**	**8.890**	**4.825**
General reserve				-2.126	-2.126
Capital Increase					
Cash dividends					
Balance at 31-12-2022	**80.000**	**2.888**	**-4.431**	**8.890**	**87.347**
Balance at 1-1-2023	**80.000**	**2.888**	**-4.431**	**8.890**	**87.347**
Profit for the period				20.873	20.873
Other Comprehensive income			1.524		-1.524
Total Comprehensive income			**1.524**	**20.873**	**22.397**
General reserve		**8.890**		8.890	
Capital Increase					
Cash dividends					
Balance at 31-12-2023	**80.000**	**11.778**	**-2.907**	**20.873**	**109.744**

The above statement is to be read in conjunction with the policies and notes on pages 136 to 160

Statement of Cash Flows

For the year ended 31 December
US$ '000

	Nota	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit for the period		**20.873**	8.890
Depreciation	11	**460**	666
Net Interest income	19	**-18.416**	-6.742
		2.917	2.814
Changes in receivables, prepayments & stock	12	**-1.337**	708
Changes in government deposits	13	**-170.723**	7.519
Changes in other deposits	14	**107.549**	-147.221
Changes in other liabilities	15	**-42.255**	40.602
Changes in fair value	27	**1.524**	-4.065
		-102.325	-99.643
Interest received	19	**30.181**	10.713
Interest paid	19	**-11.765**	-3.971
Net cash (used)/from operating activities		**-83.909**	-92.901
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisitions of investment from financial assets at fair value through other comprehensive income	8	**25.664**	104.009
Acquisitions of property, plant & equipment	11	**-296**	-62
Net cash from investing activities		**25.368**	103.947
CASH FLOWS FROM FINANCING ACTIVITIES	28	**3.432**	1.853
Currency issued			10.000
Capital subscription by government			
Transfer of surplus to Government			
Net cash from/used in financing activities		**3.432**	11.853
INCREASE/(DECREASE) IN CASH & CASH EQUIVALENTS		**-55.109**	22.899
Cash & cash equivalents at the beginning of year		**688.499**	665.600
CASH & CASH EQUIVALENTS AT THE END OF YEAR		**633.390**	688.499

The above statement is to be read in conjunction with the policies and notes on pages 136 to 160

Notes to the financial statements

For the year ended 31 December 2023

1. Reporting Entity and Statutory Base

These financial statements are presented for Banco Central de Timor-Leste (BCTL), an independent and autonomous public entity established under Organic Law No. 5/2011. BCTL's head office is located at Avenida Xavier do Amaral, no 9, P.O. Box 59, Díli, Timor-Leste.

The statements cover the financial year ending December 31, 2023, and comply with International Financial Reporting Standards (IFRS), as mandated by Article 58 of Organic Law No. 5/2011.

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, implement and manage Timor-Leste's foreign exchange policy, and to promote a safe, sound, and efficient payment system.

The Bank fulfils the role of Timor-Leste's central bank, outlined in organic Law 5/2011 and other relevant legislation. Key functions include:

- Advising the government on broad policy matters within BCTL's areas of responsibility.
- Issuing and maintaining centavos, Timor-Leste's legal tender alongside the US dollar.
- Developing and implementing measures for domestic and foreign currency payment and settlement systems in Timor-Leste, including supervision and regulation.
- Owning, operating, or participating in payment systems.
- Acting as banker for the government and related agencies.
- Serving as fiscal agent for the government and related agencies.
- Holding and managing all public financial resources, including official foreign exchange reserves.
- Overseeing the operational management of the Petroleum Fund of Timor-Leste.
- Holding commercial banks' foreign currency deposits.
- Ensuring an adequate supply of banknotes and coins for cash transactions.
- Maintaining a secure depository for currency and securities.
- Licensing, supervising, and regulating commercial banks, currency exchange activities, insurance companies, and intermediaries.
- Conducting regular economic and monetary analyses of Timor-Leste's economy, publishing findings, and proposing relevant measures to the government.

2. Basis of Presentation

(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 30 April 2024.

(b) Basis of Measurement

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

The Bank has prepared the financial statements on the basis that the Bank will continue to operate as a going concern.

(c) Adoption of International Financial Reporting Standards

These financial statements incorporate all International Financial Reporting Standards in force on 31 December 2023. During 2023, there was an amendment in place for IAS 1, related to the disclosure of material accounting polices instead of significant accounting policies.

(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 material effect on the amounts recognised in the financial statements are described in note 5.

3. Material 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-23	31-Dec-22
Australian dollars (AUD)	1,4666	1,4769
Special Drawing Rights (SDR)	0,7453	0,7514
Euro (EUR)	0,9060	0,9382

(b) The effective interest Rate Method

Interest income and expense are recognised in the profit and loss statement using the effective interest method. This method accurately reflects the financial instrument's true cost or benefit by calculating the rate that discounts the expected future cash flows to the instrument's carrying value. 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.

When determining the effective interest rate, the Bank considers all contractual terms of the instrument, including fees, points, discounts, premiums, and any transaction costs, but not future credit losses. Transaction costs specifically refer to direct expenses incurred when acquiring or issuing a financial asset or liability.

Interest income and expense presented in the profit and loss statement include Interest earned or paid on all financial assets and liabilities measured at amortized cost using the effective interest method.

(c) Fees

Fee income, including account service fees, cash distribution, and investment management fees, are recognised as the related services are performed.

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 at Fair Value Through Profit or Loss (FVTPL), 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), (h) and (i).

(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 recognises an allowance for expected credit losses (ECLs) for all debt instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Bank expects to receive, discounted at an approximation of the original effective interest rate.

ECLs are recognised in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next 12-months (a 12-month ECL). For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

The Bank considers a financial asset in default when contractual payments are 90 days past due. However, in certain cases, the Bank may also consider a financial asset to be in default when internal or external information indicates that it is unlikely to receive the outstanding contractual amounts in full before considering any credit enhancements held by the Bank. A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

The Bank considers evidence of impairment of financial assets at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment expected for the remaining life of exposure (lifetime ECL). Financial assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets with similar risk characteristics.

Impairment debt on financial assets subsequently measured at fair value through other comprehensive income 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 nominal amount in the balance sheet, which approximates fair value.

(h) Financial assets

On initial recognition, a financial asset is classified at amortised cost; Fair value through other comprehensive income (FVOCI); Fair value through profit or loss (FVTPL).

Financial assets are classified under these categories on the basis of both the Bank's business model for managing the financial asset and contractual cash flow characteristics of the financial asset.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- The financial asset are held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI).

A financial asset (debt instrument) shall be measured at fair value through other comprehensive income if both of the following conditions are met:

a. the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
b. the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The BCTL holds financial assets in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of business model, the entity's key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the business model. There are various objectives that may be consistent with this type of business model. For example, one objective of the business model is to manage the BCTL's everyday liquidity needs. To achieve such an objective, BCTL will both collect contractual cash flows and sell financial assets.

The BCTL reserves (debt instruments) meet both conditions (a) and (b) above, and accordingly are classified as Fair Value through Other Comprehensive Income.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest income is recognised in profit or loss in the same manner as for financial assets measured at amortised cost.

The ECL calculation for debt instruments at FVOCI is explained in Note [3f].

Where BCTL holds more than one investment in the same security, they are deemed to be disposed of on a first-in first-out basis. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

Fair value through profit or loss

This is the default classification if the financial assets do not meet the tests for amortised cost or fair value through other comprehensive income. As the BCTL holdings of debt instruments already meet one of the defined classifications, this classification is not applicable.

(i) 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) and (g) of Organic Law no. 5/2011 the Bank holds the Timor-Leste reserve position subscription in the IMF.

The recognition of the transactions and balances with the IMF follows the indications given by this institution, which consider the specific characteristics of the financial relations of the member countries with the Fund.

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. They are both subsequently measured at amortised cost.

(j) 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.

(k) Other Assets and Liabilitiess

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

(l) 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:

	2023	2023
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.

(m) 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.

(n) 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.

(o) 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 January 2023. These new standards, revisions, amendments and improvements to standards and interpretations are the following:

- IFRS 17 – Insurance Contracts
- Disclosure of Accounting Policies (Amendments to IAS 1)
- Definition of Accounting Estimates (Amendments to IAS 8)
- Deferred tax related to assets and liabilities arising from a single transaction (Amendments to IAS 12)

(iii) New standards and interpretations applicable in the future years

New and amended standards and interpretations that are issued but not yet effective will not have a material impact on the Bank's consolidated financial statements.

The Bank does not anticipate a material impact on the financial statements when these new standards revision, amendments and improvements to standards and interpretations are applied for the first time.

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.• O Artigo 39º autoriza o Banco a gerir fundos especiais propriedade do Estado, nos termos de um contrato de gestão e a manter receitas consignadas em contas especiais, desde que os ativos e as responsabilidades desses fundos sejam separados dos outros ativos e responsabilidades do Banco.
- 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 meets 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:

	Rating*	Dec-2022 US$ "000	Rating*	Dec-2021 US$ "000
Cash and cash equivalents				
Cash	AAA	61.684	AAA	34.381
Deposits at central banks	AAA	529.423	AAA	597.156
Resident banks	Baa2	14.421	BBB-	45.952
Non-resident banks	A-	27.861	A-	11.010
		633.389		688.499
Financial assets at fair value through other comprehensive income				
Investment in securities	AAA	119.699	N/A	145.363
IMF related assets				
International Monetary Fund - "SDR"	N/A	71.811	N/A	71.231
TOTAL ASSETS		**824.899**		905.093

Summary by credit rating	**Dec-2023**	**Dec-2023 US$ "000**	**Dec-2022**	**Dec-2022 US$ "000**
AAA	86%	710.806	86%	776.900
A-	3%	27.861	1%	11.010
Baa2	2%	14.421	5%	45.952
Not applicable	9%	71.811	8%	71.231
TOTAL ASSETS	**100%**	**824.899**	100%	905.093

*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.

	2023 Carrying amounts US$'000	"Contractual Cash Flow"	
		6 months or less US$'000	Over 6 months US$'000
Cash and Cash equivalents	633.390	633.390	
Financial assets at fair value through other comprehensive income	119.699	74.610	75.818
IMF related assets	71.811		71.231
Total assets (Excluding PPE and other assets)	**824.900**	**708.000**	**147.049**
Government deposits	341.216	341.216	
Other deposits	328.220	256.943	71.277
Other liabilities	20.868	20.868	
Currency issued	31.089	31.089	
Total liabilities	**721.393**	**650.116**	**71.277**

	2023 Carrying amounts US$'000	"Contractual Cash Flow"	
		6 months or less US$'000	Over 6 months US$'000
Cash and Cash equivalents	688,499	688,499	
Financial assets at fair value through other comprehensive income	145,363	69,545	75,818
IMF related assets	71,231		71.231
Total assets (Excluding PPE and other assets)	**905,093**	**758,044**	**147.049**
Government deposits	511,939	511,939	
Other deposits	220,668	149,449	71.279
Other liabilities	63,123	63,123	
Currency issued	27,657	27,657	
Total liabilities	**823,387**	**752,168**	**71.219**

(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:

	Total Carrying Amount 2023 US$'000	"Interest Sensitivity"	
		Non-Interest Sensitive US$'000	Interest Sensitive US$'000
Cash and cash equivalents	633.390	61.684	571.706
Financial assets at fair value through other comprehensive income	119.699		119.699
IMF related assets	71.811	71.811	
Other assets	5.278	5.278	
Total assets (Excluding PPE and other assets)	**830.178**	**138.773**	**691.405**
Government deposits			
Other deposits	341.216		341.216
Other liabilities	328.798	71.854	256.944
Currency issued	20.870	20.870	
	31.088	31.088	
Total liabilities	**721.972**	**123.812**	**598.160**
Interest Rate Sensitivity Gap	**108.206**	**14.961**	**93.245**

	Total Carrying Amount 2022 US$'000	"Interest Sensitivity"	
		Non-Interest Sensitive US$'000	Interest Sensitive US$'000
Cash and cash equivalents	688.499	34.381	654.118
Financial assets at fair value through other comprehensive income	145.363		145.363
IMF related assets	71.231	71.231	
Other assets	3.939	3.939	
Total assets (Excluding PPE and other assets)	**909.032**	**109.551**	**799.481**
Government deposits	511.939		511.939
Other deposits	220.668	71.219	149.449
Other liabilities	63.123	63.123	
Currency issued	27.657	27.657	
Total liabilities	**823.387**	**161.999**	**661.388**
Interest Rate Sensitivity Gap	**85.645**	**-52.448**	**138.093**

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(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. On 31 December 2023, it is estimated that a general increase/decrease of one percentage point in interest rates would increase/decrease the Bank's profit by approximately $932 thousand (2022 - $1,383 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 of 31 December 2023, the Bank's net exposure to major currencies was as follows:

	2023 US$'000	US Dollars	Australian Dollars	SDR	Euro
Cash and cash equivalents	633.390	630.687	211		2.492
Financial assets at fair value through other comprehensive income	119.699	119.699			
IMF related assets	71.811			71.811	
Other assets	5.278	5.278			
Total assets (Excluding PPE and other assets)	**830.178**	**755.664**	**211**	**71.811**	**2.492**
Government deposits	341.216	341.216			
Other deposits	328.798	256.944		71.854	
Other liabilities	20.870	20.870			
Currency issued	31.088	31.088			
Total liabilities	**721.972**	**650.118**		**71.854**	
Net Foreign Currency Exposure	**108.206**	**105.546**	**211**	**-43**	**2.492**

	2022 US$'000	US Dollars	Australian Dollars	SDR	Euro
Cash and cash equivalents	688.499	685.292	27		3.180
Financial assets at fair value through other comprehensive income	145.363	145.363			
IMF related assets	71.231			71.231	
Other assets	3.939	3.939			
Total assets (Excluding PPE and other assets)	**909.032**	**834.594**	**27**	**71.231**	**3.180**
Government deposits	511.939	511.939			
Other deposits	220.668	149.449		71.219	
Other liabilities	63.123	63.123			
Currency issued	27.657	27.657			
Total liabilities	**823.387**	**752.168**		**71.219**	
Net Foreign Currency Exposure	**85.645**	**82.426**	**27**	**12**	**3.180**

(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 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 $20,000,000, fully subscribed and paid-up.
- The capital of the Bank may be increased on the recommendation of the Governing Board and approved by the Government.
- 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 25 registered in the name of the Bank should for reporting purposes not be presented on the face of the Bank's balance sheet.
- Management has recognised the classification of the debt instruments at Fair value through other comprehensive income (FVOCI). The bank holds financial assets in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

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

	2023 US$'000	2022 US$'000
Cash and Cash Equivalents		
Cash	61.684	34.381
Deposits at central banks	529.423	597.156
Resident banks	14.421	45.952
Non-resident banks	27.861	11.010
Total	**633.389**	**688.499**

8. Financial Assets at fair value through other comprehensive income

	2023 US$'000	2022 US$'000
Designated as fair value through other comprehensive income		
US Government Treasury Bills		
US Government Treasury Notes	45.089	75.818
FIXBIS - Fixed-Rate Investments at the BIS	74.610	69.545
Total	**119.699**	**145.363**

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).

	Fair Value through Profit or Loss		Amortised Cost		Fair value through Other Comprehensive Income	
Financial assets	2023 US$ "000	2022 US$ "000	2023 US$ "000	2022 US$ "000	2023 US$ "000	2022 US$ "000
Cash and cash equivalents			633.390	688.499		
Financial assets at fair value through other comprehensive income					119.699	145.363
IMF related assets			71.811	71.231		
Other assets			5.278	3.939		
Total assets (Excluding PPE and other assets)			**710.479**	**763.669**	**119.699**	**145.363**
Financial liabilities						
Government deposits			341.216	511.939		
Other deposits			328.798	220.668		
Other liabilities			20.870	63.123		
Currency issued			31.088	27.657		
Total liabilities			**721.972**	**823.387**		

10. IMF related assets

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:

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.

	2023		2022	
	In SDR “000	In SDR “000	In SDR “000	In SDR “000
IMF Holdings of Currency	21.250	28.510	21.250	28.280
IMF SDR Holdings	32.264	43,288	32.274	42.951
Total	**53.514**	**71,798**	**53.524**	**71.231**

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:

11. Property, Plant and Equipment

	Buildings US$ '000	Plant US$ '000	Office equipment US$ '000	Computer equipment US$ '000	Vehicles US$ '000	Work in progress US$ '000	Total US$ '000
Cost							
Balance at 1 January 2021	**1.385**	**427**	1.456	4.305	858	476	8.907
Acquisitions	**306**	**2**	**4**	**190**	**0**	**0**	**502**
Adjustment	**-1**	**0**	0	0	0	0	-1
WIP	0	0	0	0	0	-439	-439
Balance at 31 December 2021	**1.690**	**429**	1.460	4.495	858	37	8.969
Acquisitions	**8**	**91**	**2**	**146**	**88**	**0**	**335**
Adjustment	**0**	**0**	0	0	0	0	0
Work in Progress	**0**	**0**	0	0	0	-37	-37
Balance at 31 December 2022	**1.698**	**520**	1462	4.641	946	0	9.267
Accumulated depreciation							
Balance at 1 January 2021	**931**	**414**	**1.025**	**3.593**	**638**	**0**	**6.601**
Depreciation for the year	**64**	**7**	**87**	**524**	**110**	**0**	**792**
Adjustment	**-10**	**-1**	**-7**	**-59**	**-49**	**0**	**-126**
Balance at 31 December 2021	**985**	**420**	**1.105**	**4.058**	**699**	**0**	**7.267**
Depreciation for the year	**56**	**17**	**77**	**252**	**58**	**0**	**460**
Adjustment	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Balance at 31 December 2022	**1.041**	**437**	**1.182**	**4.310**	**757**	**0**	**7.727**
Net carrying amounts							
As at 31 December 2022	**657**	**83**	**280**	**331**	**189**	**0**	**1.540**
As at 31 December 2021	**705**	**9**	**355**	**437**	**159**	**37**	**1.702**

Due to the ongoing development of a land and property registration system and the nascent commercial property market in Timor-Leste, the Bank's Governing Board has not yet been able to establish a fair value for the land and buildings occupied by its head office. Consequently, the current value of this property remains unavailable.

However, work in progress category includes costs associated with acquiring coin dispenser machine. These costs were subsequently capitalised and transferred to property, plant, and equipment in 2023.

There were no impairment losses at balance date.

12. Other Assets

Other assets comprise the following:

	2023 US$'000	2022 US$'000
Other Assets		
Accounts receivable	2.745	3.215
Advance, security & prepayment	374	373
Inventories	127	351
Total	**3.246**	**3.939**

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

13. Government deposits

	2023 US$'000	2022 US$'000
Government deposits		
Consolidated fund	140.905	245.976
Infrastructure fund	60.881	56.800
Human Development Capital fund	5.453	4
Autonomous agency accounts	120.394	72.441
Municípalities accounts	13.583	8.921
Social security fund		127.797
Total	**601.275**	**511.939**

14. Other deposits

	2023 US$'000	2022 US$'000
Other Deposits		
Domestic financial institutions	256.944	149.449
International financial institutions (Note 10a)	71.277	71.219
Total	**328.221**	**220.668**

15. Other Liabilities

	2023 US$'000	2022 US$'000
Other Liablities		
Accounts payable	4.426	4.834
Withholding tax payable	25	19
Provision for Long service account	1.510	126
Letters of Credit	6.982	7.462
Operating accounts	7.925	50.682
Total	**20.868**	**63.123**

16. Capital and Reserves

Based on the Governing Board decision, the capital of the Bank remains unchanged at $80,000,000 in 2023 (2022 - $80,000,000).
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

The Banco Central de Timor-Leste's Organic Law No. 5/2011 governs the distribution of its net profit. After deducting statutory allocations to reserve accounts, the remaining profit is transferred to the Government of Timor-Leste.

However, Article 10.1(a) of the same law specifies that 50% of the profit must be credited to the General Reserve Account until a combined total of capital and reserves reaches 10% of the Bank's total financial assets. once this threshold is met, profit distribution follows the schedule outlined in table below:

	2023 US$'000	2022 US$'000
Transfer to Government		
Net profit for the year ended 31 December 2023	20.873	8.890
Transfer to General Reserve Account	-20.873	-8.890
Total transfer to Government	**0**	**0**

Considering the Government's commitment to increasing the Bank's capital 20,873 to $100 million, the Governing Board made an exceptional decision for the year-end profit. Instead of following the usual distribution, the Governing Board opted to transfer the entire profit of $ million (compared to $8,890 million in 2022) to the General Reserve Account. This decision aims to accelerate the growth of the Bank's capital reserves, thereby strengthening its financial position.

18. Contingent Liabilities

There were no contingent liabilities as of 31 December 2023.

19. Net Interest Income

	2023 US$'000	2022 US$'000
Interest income from Financial Assets		
Interest on deposits at foreign central banks	28.887	10.486
Interest on deposits at domestic banks	1.294	227
Total interest income	30.181	10.713
Interest paid on Financial Liabilities		
Interest paid on Government accounts	11.589	3.950
Interest paid to commercial banks	177	21
Total interest expenses	**11.766**	**3.971**
Net Interest Income	**18.415**	**6.742**

20. Interest on financial assets at fair value through profit or loss

	2023 US$'000	2022 US$'000
Interest on financial assets at fair value through profit or loss		
Interest on financial assets at fair value through profit or loss	4.955	2.483
Total interest	**4.955**	**2.483**

There is no impairment on the financial assets at fair value through other comprehensive income during the year (2022 – nil).

21. Fee and Commission Income

	2023 US$'000	2022 US$'000
Fees and commissions		
Currency withdrawal fees	27	11
Licensing and supervision fees	133	160
Government account management fees	500	500
Total fees and commissions	**660**	**671**

22. Petroleum Fund Management Fee

As stipulated in the Petroleum Fund Law No 9/2005, Banco Central de Timor-Leste (BCTL) is authorized to charge a management fee for the operational oversight of the Petroleum Fund. This fee aims to reasonably represent the costs incurred in managing the fund.

At the end of 2023, the Petroleum Fund balance stood at $18,252 million, reflecting an increase compared to 2022's $17,414 million (unaudited). The Ministry of Finance agreed to cover BCTL's internal management fee up to a maximum of 4 basis points annually. However, the actual management fee received from the Petroleum Fund for the year ended December 31, 2023, amounted to $14,465 thousand, representing 8 basis points of the average fund balance. This translates to an increase from the $13,155 thousand (or 8 basis points) received in 2022.

The fees cover expenses associate with custody services and external managers, Investment Advisory Board, and the fees for BCTL internal management. Presented below is the petroleum fund management fee income by nature:

	2023 US$'000	2022 US$'000
Total Petroleum fund management fee income	**14.465**	**13.155**
External managers & custody mgmt services	-6.039	-6.857
Investment Advisory management expenses	-510	-142
Others	-147	208
Net fee and commission income	**7.769**	**6.364**

In 2023, the BCTL's internal fee receipts from managing the fund totalled $7.1 million, an increase from $6.3 million in 2022. These fees were allocated to various expenses, including personnel, operational costs, technology, and other administrative needs which is as shown below.

	2023 US$'000	2022 US$'000
Salary, capacity building and Other personnel related costs	1.554	1.273
IT services, systems and data	2.486	2.036
Research, consulting and legal fees	1.942	1.591
Allocated common costs BCTL	1.398	1.146
Other costs	388	318
Total BCTL operational expenses	**7.769**	**6.364**

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23. Personnel Expenses

	2023 US$'000	2022 US$'000
Personnel Expenses		
Salaries and related payments	2.414	2.082
Staff welfare payments	2.175	137
Capacity building and staff development	163	73
Representation at conferences and meetings	665	424
Total personnel expenses	**5.417**	**2.716**

24. Administration Expenses

	2023 US$'000	2022 US$'000
Administration Expenses		
Asset maintenance	27	62
Communications	111	86
Information systems	2.275	1.788
General expenses	148	19
Office Expenses	362	210
Professional fees	607	976
Other Assets management expenses	210	189
Total Administration Expenses	**3.740**	**3.330**

25. 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.

Considering 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 on 31 December 2023* were as follows:

	2023 US$'000	2022 US$'000
Petroleum Fund Assets		
Cash and Cash Equivalents	2.065.968	2.029.562
Other receivables	43.011	45.170
Financial assets at fair value through profit or loss	16.220.796	15.367.527
Less: Pending Purchase of Securities & Account payables	-41.370	-28.662
	18.288.405	**17.413.597**
Capital	18.288.405	17.413.597
Capital	**18.288.405**	**17.413.597**

(*) the PF balance sheet is unaudited

26. 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.

	2023 US$'000	2022 US$'000
Executive Board members Compensation (Included in personnel expenses)		
Short-term employee benefits	242	242
Long-term benefits	17	17
Total	**259**	**259**

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.

	2023 US$'000	2022 US$'000
Non-Executive Board members Compensation		
Sitting allowance (Included in personnel expenses)	82	93
Total	**82**	**93**

Key Management Personnel

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

	2023 US$'000	2022 US$'000
Key Management Personnel Compensation (Included in personnel expenses)		
Short-term employee benefits	78	78
Long-term benefits	5	5
Total	**83**	**83**

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, 16, 17, 23 and 26.

27. Fair value revaluations

	2023 US$'000	2022 US$'000
Fair value revaluation		
Opening balance	-4.431	
Fair value changes	1.524	-4.431
Total Fair value	**-2.907**	**-4.431**

28. Currency issued.

	2023 US$'000	2022 US$'000
Currency Issued		
Opening balance	27.657	25.809
Coins issuance	3.432	1.852
Total	**31.089**	**27.657**

29. Reintegration fund.

	2023 US$'000	2022 US$'000
Reintegration fund (include other liabilities)		
Opening balance	126	126
Reintegration fund	1.384	
Total	**1.510**	**126**

30. Authorisation and approval of the financial statements

As stated in the basis of preparation - Statement of compliance, these financial statements were authorised for issue by the Governing Board of the Bank on 30 April 2024.

31. Subsequent Events

As of the date of the financial statements' issuance, no material events have occurred that would require adjustments or disclosures beyond those already presented in the financial statements.

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Independent Auditor's Report

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the financial statements of Banco Central de Timor-Leste (the Bank), which comprise the statement of financial position as at 31 December 2023 (showing a total asset value of 831.716 thousand USD and a total equity of 109.744 thousand USD, including a net profit of 20.873 thousand USD), and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including material accounting policy information.

In our opinion, the accompanying financial statements present fairly, in all material respects, of the financial position of the Bank as at 31 December 2023, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs)

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 International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in East Timor, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

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

Responsibilities of management and the governing board for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for 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.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

The governing board is 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;

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- 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; and
- 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.

We communicate with the governing board 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

On the Management Report

Our responsibility also includes the verification that the information contained in the Management Report is consistent with the financial statements.

Lisbon, May 9th, 2024

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

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