

# ECONOMIC BULLETIN

A Quarterly Publication of the Banking and Payments Authority of Timor-Leste

Volume 2 Number 4  
January / 2005

## 2004: world economic growth with the fall of the dollar and the increase of oil prices

### IN THIS ISSUE

2004: USD downturn and oil prices increase	1
Oil and gas price evolution	2
Oil Fund Law: BPA Role	3
Coffee price	3
How to read the monetary statistics	4
Monetary statistics	5
Prices: BPA balance sheet	6
Financial and Foreign Exchange markets	7
World economy: forecasts	8
Inflation: Timor-Leste vs. Indonesia	9
BPA in the internet	9

### Note that...

- In 2004 the world economy registered an increase in the GDP growth with a sinking USD and a higher oil price
- Forecasts for 2005 are less optimistic
- BPA will be in charge of the daily operation of the Oil Fund but the profits of this are mainly dependent on the guidelines to be established by the Ministry of Planning and Finance
- BPA official internet site is now available at [www.bctl.east-timor.org](http://www.bctl.east-timor.org)
- Monetary statistics give us some fundamental informations about a country economy
- Inflation rate was 1.8% in 2004, well below the estimated 3%

During 2004 the international economy evolved favourably, but two phenomena were considered to be reasons for concern: the increase in the price of oil (mainly at the end of the year) and the ongoing fall of the exchange rate of the American dollar towards the other top currencies (euro, yen, and Australian dollar). The latter is due to the gradual worsening of the country's "double deficit" (public accounts and current transactions).

At the same time, most Asian countries, namely the two with the most people (China and India) have also had a time of prosperity, with China reaching a growth rate of nearly 10% in a year.

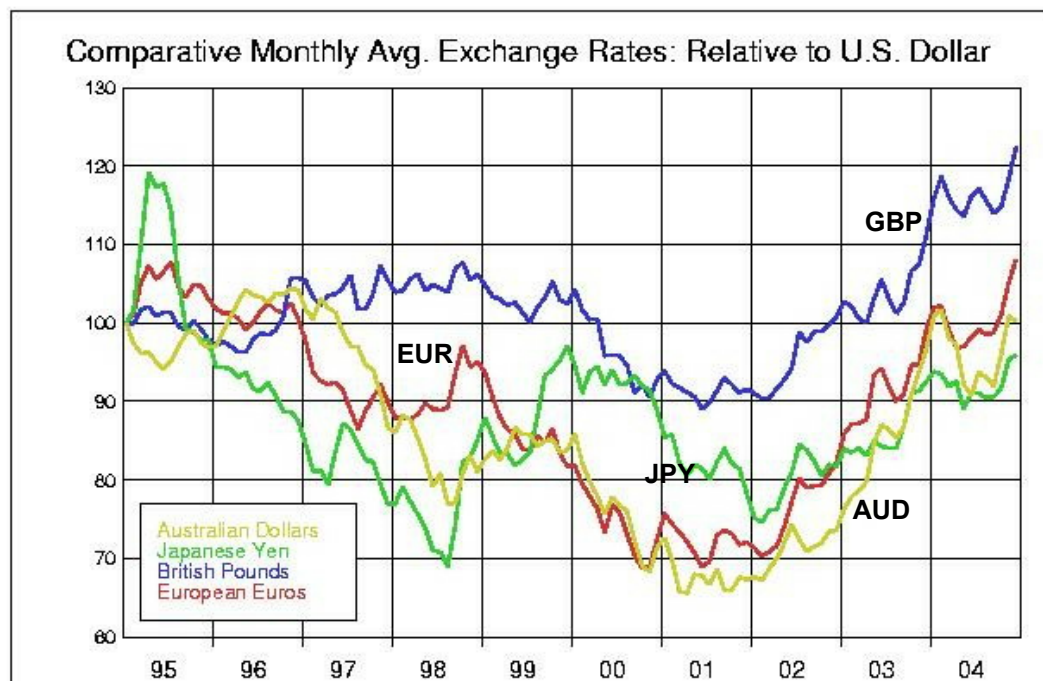
Unfortunately, this positive economic outlook ended under some dark clouds in several countries, due to the effects of the tsunami last December 26. The damages are incalculable and include a human loss of around 300 thousand lives, most of which resided in the province of Aceh, in neighboring Indonesia.

### The fall of the dollar

The deficits of the current account and of the US budget, as well as the apparent lack of efficient measures to combat them – on the contrary, it is estimated that the public deficit will continue to grow in 2005 and 2006 – have created an atmosphere of distrust regarding the American dollar during 2004. This is one of the main reasons for its fall. On the other hand, the low interest rate levels in the United States – lower than those in Europe and in Australia – have led to the departure of much capital from that country, seeking better remunerations in other locations. Only recently have the American interest rates started going up, surpassing the European ones, which together with the fact that American assets are now cheaper due to the weakness of the USD, may lead to the return of much capital to the United States.

The policy of maintaining a weak dollar aims to reduce the current account deficit by increasing exports (and consequently the production) and reducing imports, particularly those from

*Continues ; see last page*



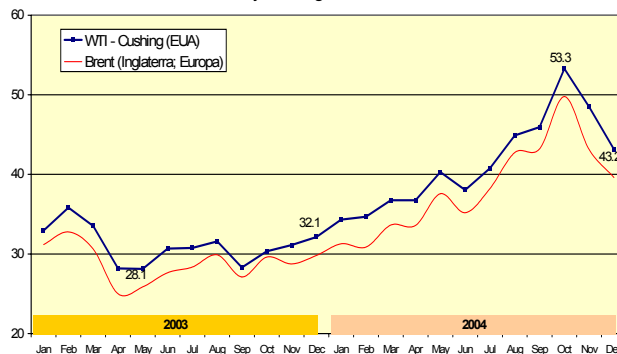
Note: Base: January 1995 average = 100; a downturn means a depreciation of the currency against the USD = appreciation of the USD. An upturn means the reverse: an USD depreciation against the currency. Note the almost constant USD appreciation from 1995 to 2001 and its depreciation onwards. Until when? What will be the USD "normal" value? The present one, almost the same of 1995, or the higher one of 2001? It seems that the USA authorities think it is the first one...

# Oil and natural gas price evolution

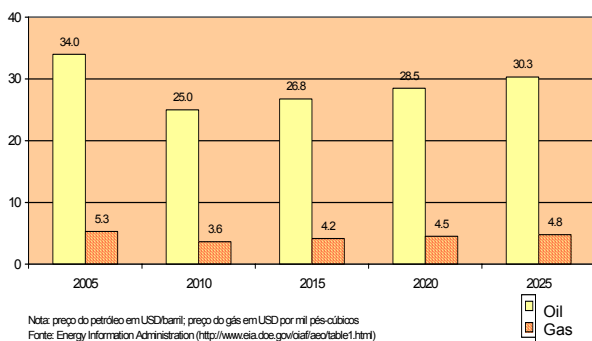
Crude price evolution since Jan/1986  
USD/Barrel



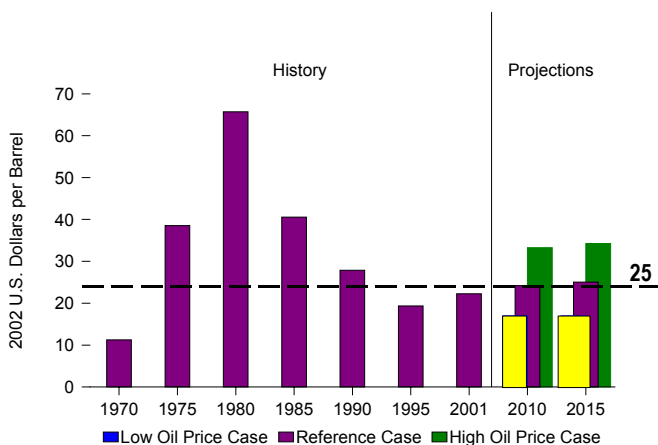
Recent (2003—2004) evolution of the crude price;  
monthly average; USD/barrel



Estimates for the oil and gas price evolution;  
2005—2025



Nota: preço do petróleo em USD/barrel; preço do gás em USD por mil pés-cúbicos.  
Fonte: Energy Information Administration (<http://www.eia.doe.gov/cdf/aeo/table1.html>)



Fonte: EIA, *International Energy Outlook 2004*

The decrease in the price of oil will reflect on the fiscal revenues, but their values will still be much higher than the initial estimates, which were made considering much lower oil prices per barrel than the current ones (for 2005 the estimate at the time of the drafting of the State General Budget was an average price of USD 24 per barrel, and for 2006 an average price of USD 23.5 per barrel). The current estimates suggest that the country will receive during the present fiscal year around USD 130 million, almost three times (!) what had been initially foreseen (USD 44 million). In 2005-06 and 2006-07 the values will be around USD 140 million. However, they depend a great deal of the actual evolution of the prices.

The said different estimates tell of the difficulty felt by the persons responsible for drafting our State Budget, since the actual revenues from the Timor Sea may differ a great deal from the estimates, as was the case this year – fortunately for the best, but it might as well have been for the worse... Hence the need for a very cautious approach in the programming of public expenses, since their funding may be compromised by a fall in the prices of oil and natural gas.

The graphs above and on the side reflect the instability of the international oil prices. Consequently it is difficult to foresee the future evolution of the prices of this raw material.

This is an essential aspect for Timor-Leste, in order to make a realistic estimate of the Timor Sea revenues and of the part to take from them so as to fund each year the State General Budget, i.e. the expenses for the current development of our country.

The estimates on the evolution of prices presented here point to the maintenance of high oil prices in 2005, but suggest that later on they will go down, and that in 2010 they will be around USD 9 below the current value, i.e. a decrease of almost 30%. The fall of the gas price, in which the Timor Sea is rich, may be even greater. Later on all prices will tend to increase, but it will be difficult for them to reach again the current (high) nominal prices – which are still far below (less than half) the real values of the 70's, during the oil chocks verified at the start and at the end of that decade.

Indeed, one can compare at the graph on the side and below the prices of the time, translated into 2002 USD, with the current prices and the alternative estimates for their evolution, any of them with real values far below those verified in the 70's.

## The evolution of the oil price in and Timor-Leste

The evolution of oil and natural gas prices is important for Timor-Leste, since currently we are oil producers and in the future we will also be producing gas.

## Oil Fund Law: BPA role

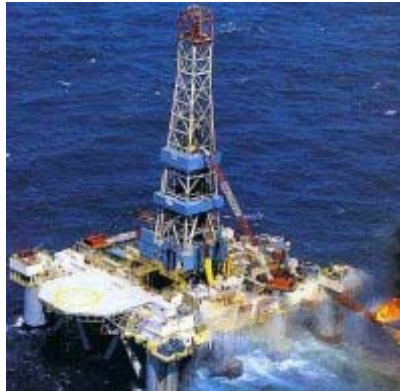
A proposed law to establish a Petroleum Fund for Timor-Leste is currently in the process of public consultation. This enactment of this law will be one of the most important acts of the present government because it establishes how petroleum wealth will be preserved and increased for the benefit of future generations in this country.

The BPA will play a key role in managing the Fund, but it will not be the BPA's actions alone that will determine how much the Fund will be worth in future years. This article explains the proposed arrangements for investing the Fund.

The Constitution makes it clear that wealth acquired from the exploitation of petroleum resources should lead to the establishment of mandatory financial reserves. These reserves will belong to the State, whose responsibilities as owner will be given to the Ministry of Planning and Finance. The Ministry will be required to seek advice from an Investment Advisory Board, but will itself be responsible for deciding on the actual policies and rules for investing the Fund. The overall rate of return (the benchmark) on the Fund's assets will be a direct function of the investment policies that the Ministry selects.

For the first few years, the invest-

ment rules will be very conservative, and are set out in the draft law. The proposed rules will guarantee a reasonable level of short-term returns, an important factor in building credibility during the formative years of the Fund. In subsequent years it is anticipated that a wider range of investments will be permitted, allowing the Fund to achieve higher yields over the medium-long term, when the size of the Fund is such that greater risks can (and ought to) be taken.



The draft law proposes that the BPA will be the manager of the Fund under a management agreement to be signed with the Ministry. The BPA will be required to act on the investment policies and rules determined by the Ministry, but

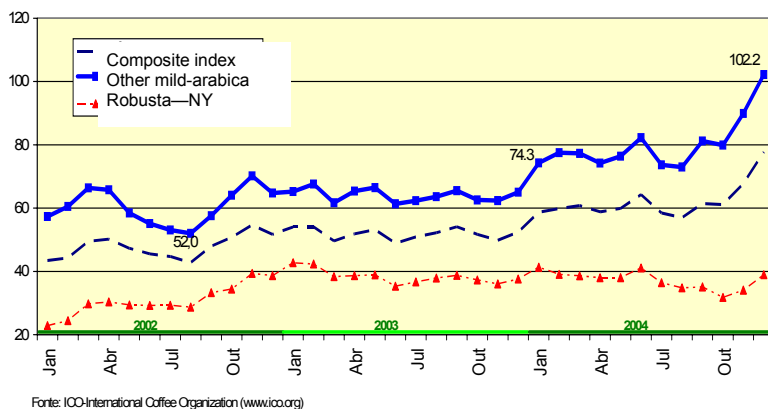
will otherwise have flexibility in implementing day-to-day investment decisions, including the possibility of delegating part of its responsibilities to specialist investment managers who would manage specific types of investments, for example (in the longer term) managing separate portfolios of government bonds, corporate bonds, equities, and so on.

The income on the Fund therefore will depend primarily on the Ministry's policies, and to a lesser extent on the BPA's daily investment decisions. The BPA will periodically be required to account for the actual income received by comparing it with the Ministry's benchmark.

Overseeing the whole process will be a Consultative Council which is charged with making sure the management of the Fund is sound, and giving its opinions to parliament. The proposed framework of the Consultative Council, the Investment Advisory Board, the Ministry of Planning and Finance, and the BPA has been designed to ensure that not only are there checks and balances between responsibilities of the various bodies, but that policy decisions and the results of investment activities will all be undertaken and monitored in a fully accountable and transparent manner.

## International coffee price: recent evolution

ICO international coffee prices  
Monthly average; USD cents per pound; Jan2002-Dec2004



Fonte: ICO-International Coffee Organization ([www.ico.org](http://www.ico.org))

New Guinea), the price paid to the producer is around 60% of the price in New York. If we consider the same percentage for Timor-Leste, our coffee growers should receive around USD 1.2 per kilogram of coffee this year. Unfortunately the low quality of the product prevents us from reaching such values. This is another incentive for a great effort in order to improve the quality of our country's coffee.

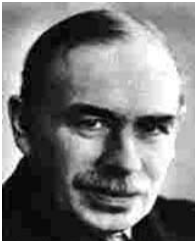
After reaching a record price in mid 1997 (USD 267.27 cents / lb in May), the international price of the "other Arabica" – a good term for comparing with the Arabica coffee of Timor-Leste – went down gradually to a minimum of 52 cents in August 2002, around two and a half years ago.

Since then the price has been steadily going up, with the average in June 2004 being 42.21, continuing to increase until the current (December 2004) 102.2 cents / lb, equivalent to around USD 2.00 per kilogram. This value gives better perspectives to our coffee planters, but it appears that this year's crop will be better than last year's, which is no good for us!

It should be noted that in our closest coffee-growing neighbours (Indonesia and Papua

## How to read the monetary statistics

During the “golden 30's” of the highest personal income countries – the period from the end of World War II, in 1945, to the first oil shock, in 1973 – the budget policy (collection of taxes and mainly carrying out of public expenses) was the foremost component of the economic policy, due to the influence of the conceptions by John Maynard Keynes (English economist; 1883-1946).



It was that, translated into a significant intervention by the State in the economy in favour of the increase of the production, which allowed for the economic reconstruction of the countries after the economic crisis of 1929-33 and World War II. The currency – the monetary circuit – and the monetary policy had a subordinated role, almost limited to ensuring that there would be no lack of the money necessary for the growth.

With the first and the second oil shocks at the start and at the end of the 70's, everything changed. The main goal of the economic policy set became controlling the inflation that had reached high and concerning levels; the economic growth was then relegated to number two, being placed “in the wings”, even more so because it was thought that it could only be achieved with low inflation rates. Well, since the “monetarists” had managed to show that the inflation of that time was mainly a monetary and almost “anti-growth” phenomenon, the monetary policy became more important, more so than the budget policy.

Accompanying (and controlling!...) the evolution of the currency available in the economy then became fundamental. Thus the availability of good monetary statistics became more important.

Perhaps the main economic information to take from this type of statistics is an aggregate designated by economists as “M2”. This consists in the sum of the so called “immediate means of payment” (bills and coins in circulation + demand deposits) and those that, while not being immediately ready for use, can become usable within a very short time (e.g. short term deposits).

Unfortunately in the case of Timor-Leste, and because we do not have our own currency, it is not easy to quantify the M2, since while BPA knows the amount of bills and coins placed in circulation, it does not know how many are indeed circulating in the country and how many have been sent abroad. In order to understand the difficulty of knowing what the amount in circulation is, some estimates – which are just that, and thus extremely fallible – suggest that around 80% to 90% of the USD 100 bills placed in circulation by our “Central Bank” will be sooner or later taken abroad – which is perfectly legal.

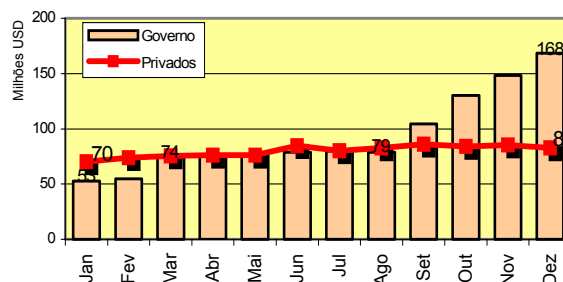
As far as the demand and term deposits from companies and private persons in the national banking system go, their sum was USD 70 million at the start of 2004 and USD 83 million in last December, after reaching USD 86 million in September 2004.

Concerning the deposits by the Public Administration / Government at the “Central Bank”, they went up from USD 53 million in January 2004 to USD 168 million at the end of the year. This increase is due mainly to the start of the flow of the revenues from the Timor Sea, and had two important moments: the first in March, where a threshold of around USD 75 million was reached, and the second in August, when the value began to go up each month reaching USD 168 million last December 2004.

Usually deposits serve as a basis for the granting of bank credit (which, as far as the commercial banks are concerned,

went up from USD 29 million to USD 89 million between the start and the end of 2004). However, due to the weakness of our economy, part of them end up being forwarded to deposits abroad in search of income (interests) that can meet the passive interests paid by the banks to their depositors and meet

Deposits: Government with BPA  
Private sector with commercial banks  
Comercial

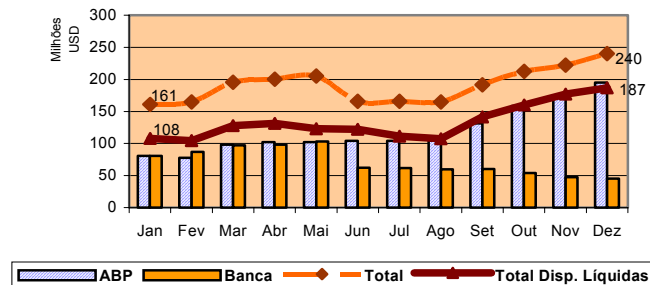


the commitments undertaken with foreign bodies.

Thus the “net availabilities over abroad” have been increasing in a significant manner, going up around 80% in 2004 (from 108 in January to 183 in December).

It should be noted here that BPA and the commercial banks have started the year in a rather similar situation as far as “gross” availabilities were concerned (USD 80 million each) but that at the end of the year the positions were very different, with the “Central Bank” having USD 200 million, against the

Claims on non-residents



USD 45 million by the commercial banks.

Indeed, due to the near impossibility of making more profitable investments in Timor-Leste with the resources it has (most of which belong to the Government of the RDTL, with the “Authority” paying it interests for the deposits), and in view of the need to avoid putting too much money in circulation, which would only cause inflation, the BPA is forced to apply a very significant part of its values abroad and in USD (as its basic law requests) in the form of deposits and US Treasury Bonds, so as to obtain some income.

The important thing, however, is to analyse the net availabilities, i.e. the (gross) availabilities after deducing the responsibilities assumed in relation to abroad. In this field the situation is very different, since at the end of 2004 BPA's net availabilities were USD 183 million, while those of the commercial banks, due to their great responsibilities in relation to abroad (USD 42 million), were only USD 3.5 million.

## Monetary statistics

Thousands USD	September	October	November	December
<b>Net Foreign Assets</b>	<b>141,251</b>	<b>159,891</b>	<b>176,967</b>	<b>186,600</b>
<i>Claims on non residents</i>	<i>191,746</i>	<i>212,367</i>	<i>222,325</i>	<i>240,238</i>
Claims of ABP/BPA	131,435	158,556	174,890	195,094
Claims of commercial banks (1)	60,311	53,812	47,435	45,144
<i>Liabilities to non residents</i>	<i>50,494</i>	<i>52,476</i>	<i>45,358</i>	<i>53,638</i>
Liabilities of ABP/BPA	12,023	12,023	12,023	12,024
Liabilities of commercial banks (1)	38,471	40,453	33,335	41,614
<b>Domestic Claims (2)</b>	<b>-33,135</b>	<b>-54,288</b>	<b>-67,678</b>	<b>-79,690</b>
Claims on central government	0	0	0	0
Claims of ABP/BPA	0	0	0	0
Claims of commercial banks	0	0	0	0
Deposits of Central Government	104,314	130,075	148,178	168,408
at ABP/BPA	104,314	130,075	148,178	168,408
at commercial banks	0	0	0	0
<i>(Net claims on Central Government = Loans minus Deposits) (2)</i>	<i>-104,314</i>	<i>-130,075</i>	<i>-148,178</i>	<i>-168,408</i>
Credit (to private sector = private and enterprises)	71,179	75,787	80,499	88,718
Credit of ABP/BPA	-280	-335	-455	-560
Credit of commercial banks (1)	71,459	76,122	80,954	89,278
<b>Deposits of commercial banks at ABP/BPA</b>	<b>6,936</b>	<b>8,325</b>	<b>6,833</b>	<b>6,049</b>
<b>Deposits (Demand and time)</b>	<b>85,868</b>	<b>83,903</b>	<b>85,350</b>	<b>82,836</b>
<b>Demand deposits at commercial banks (1)</b>	<b>53,918</b>	<b>50,812</b>	<b>53,270</b>	<b>49,779</b>
Public non-financial corporations	316	427	397	423
Other resident sectors	53,602	50,385	52,873	49,356
<b>Time and Savings Deposits (1)</b>	<b>31,950</b>	<b>33,090</b>	<b>32,080</b>	<b>33,057</b>
Deposits of ABP/BPA	0	0	0	0
Time deposits of other residents	31,950	33,090	32,080	33,057
<b>Others Items (Net)</b>	<b>-820</b>	<b>115</b>	<b>74</b>	<b>100</b>
idem, ABP/BPA	-886	-855	-824	-877
idem, commercial banks (1)	67	970	897	976
<b>Capital and reserves</b>	<b>20,193</b>	<b>20,851</b>	<b>21,859</b>	<b>23,125</b>
<b>Capital</b>	<b>19,541</b>	<b>19,551</b>	<b>19,664</b>	<b>20,474</b>
idem, of ABP/BPA	7,727	7,727	7,727	7,727
idem, of commercial banks (1)	11,814	11,824	11,936	12,747
<b>Retained earnings</b>	<b>9</b>	<b>658</b>	<b>1,553</b>	<b>2,008</b>
Retained earnings of ABP/BPA	255	260	557	666
Retained earnings of commercial banks (1)	-246	397	995	1,341
<b>General and special reserve</b>	<b>643</b>	<b>643</b>	<b>643</b>	<b>643</b>
Reserve of ABP/BPA	643	643	643	643
Reserves of commercial banks (1)	0	0	0	0

- 1) Since August 2003 the monetary statistics have included Bank Mandiri, with the Banking sector comprising four institutions (three commercial banks and a micro-credit institution).
- 2) The negative value of "net claims on central government" means that the banking system is holding more government deposits than government debt (of which there is none in Timor-Leste). For a similar reason "domestic claims" is also negative

In the last quarter of 2004, the net availabilities of Timor-Leste over abroad went from 141 (at the start of October) to USD 187 million, despite a decrease that took place in the last quarter, due to alterations in the availabilities of the commercial banks.

On the other hand the demand and term deposits at the banks went down slightly (-3.5%) between the start of the quarter and its end, going from USD 86 million to USD 83 million. This did not affect in the least the credit capacity of the commercial banks, which went from USD 71 million at the start of September to USD 89 million at the end of last year, a growth of 25%.

The deposits of the Central Administration at the Banking and Payments Authority, the only body legally authorized to receive deposits from the Administration, went up from USD 104 million at the start of October to USD 168 million at the end of December, an increase of around 60%, due mainly to the increase of the revenues with taxes from the Timor Sea oil. In the previous page one can read an analysis of the evolution of the monetary aggregates during 2004.

## Dili price evolution

Consumer Price Index (CPI). 2001-2004													
(December 2001=100.0)													
Month	Dec-01	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
<b>2002</b>													
CPI absolute value	100.0	100.9	101.0	100.7	101.2	102.0	103.1	103.9	104.8	106.6	106.2	109.2	109.5
Change in the month		0.90	0.10	-0.30	0.50	0.79	1.08	0.78	0.87	1.72	-0.38	2.82	0.27
Change towards the same month of the last year		...	...	...	...	...	...	...	...	...	...	...	9.50
<b>2003</b>													
CPI absolute value		109.3	109.4	111.0	110.2	110.0	111.6	112.0	112.7	112.4	112.6	113.3	114.1
Change in the month		-0.18	0.09	1.46	-0.72	-0.18	1.45	0.36	0.63	-0.27	0.18	0.62	0.71
Change towards the same month of the last year		8.3	8.3	10.2	8.9	7.8	8.2	7.8	7.5	5.4	6.0	3.8	4.2
<b>2004</b>													
CPI absolute value		113.8	113.9	114.1	114.6	116.5	116.3	116.2	115.0	114.9	115.2	115.3	116.1
Change in the month		-0.2	0.1	0.2	0.4	1.7	-0.2	-0.1	-1.0	-0.1	0.3	0.0	0.7
Change towards the same month of the last year		4.2	4.1	2.8	4.0	5.9	4.2	3.8	2.0	2.2	2.3	1.7	1.8

Source: Direcção Nacional de Estatística

The Consumer Prices Index continued to have its variation rate decrease. That is, with one or two monthly exceptions, the inflation rate has been gradually going down along the time. During 2003 it was 4.2% but on December 2004, comparing with December 2003, it was only 1.8%. This represents a significant decrease from 2002, when it was 9.5%.

It should be noted that the greatest fall in the rate happened during the second quarter of 2004, since on June it was still 4.2% in relation to June 2003, after a period of ups and downs. Since then the rate started decreasing towards the current 1.8%, well below the initial estimates for this year (3%).

Despite this decrease in the inflation rate, the truth is that the prices kept on going up during the last quarter of 2004, even if it was very slowly (around 1%). This was due to the increases of 15% in the item "eggs" and of 5.8%, 2.4% and 2.2% in the items "transportation", "meat and derivatives" and "housing", respectively. The increases in these items are partially connected with the Christmas time we had during the previous quarter, which led to an increase in the demand and to a consequent increase in the prices, due to the structural difficulties of the supply, as well as to some seasonal speculation.

## Interim Summary Financial Statements of ABP/BPA

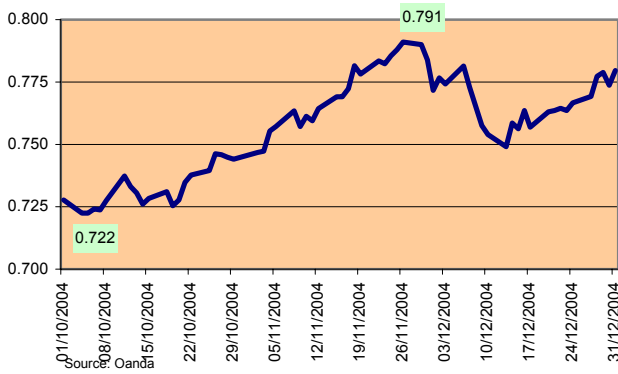
<b>BALANCE SHEET as at 31 December 2004 (USD)</b>		<b>PROFIT AND LOSS STATEMENT</b>	
		<b>Quarter ending in 31 December 2004</b>	
<b>ASSETS</b>		<b>INCOME</b>	
Cash and Bank	50,331,051	Income from Financial Assets	481,274
Investments	145,345,888	Income from Government	309,999
Other Assets	1,200,240	Rendimento de títulos de governos estrangeiros	480,210
<b>TOTAL ASSETS</b>	<b>196,877,179</b>	Fees and Charges Recover	173,826
<b>LIABILITIES</b>		Other Income	256,225
Currency Issued	1,104,499	<b>TOTAL INCOME</b>	<b>1,701,534</b>
Government Deposits	168,634,400	<b>EXPENSES</b>	
Domestic Financial Institutions	5,467,500	Interest and Bank Charges	622,652
International Financial Institutions	12,024,448	Distribution of Currency	92,338
Other Liabilities	610,148	Personnel	107,464
<b>TOTAL LIABILITIES</b>	<b>187,840,995</b>	Administration	129,390
<b>NET ASSETS</b>	<b>9,036,184</b>	Depreciation	83,293
<b>EQUITY</b>		<b>TOTAL EXPENCES</b>	<b>1,035,137</b>
Capital	7,727,188	<b>NET PROFIT</b>	<b>666,397</b>
General Reserve	642,599	<i>Prepared on an accrual basis from the financial records of BPA as at 31 December 2004. These Financial Statements are unaudited.</i>	
Retained Earnings	666,397		
<b>TOTAL EQUITY</b>	<b>9,036,184</b>		

# Foreign Exchange markets

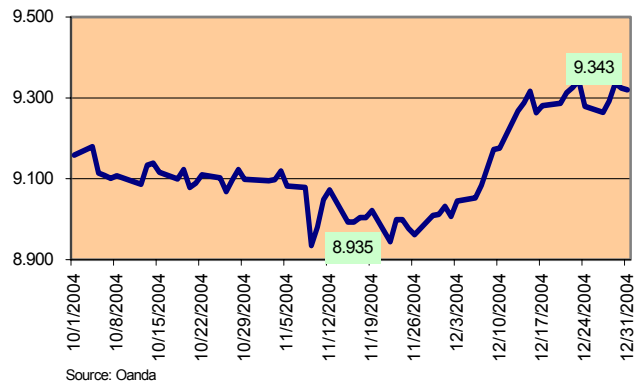
Latest developments

In the two graphs below and to the left, where we can see the amount of foreign currency (AUD-Australian dollar, and Euro) that each unit of national currency (USD) can buy, a depreciation of USD is represented by an ascent of the respective curve. In the graph of the right, representing the amount of Indonesian rupiahs bought by each USD, a depreciation of the USD is represented by a descent of the curve because it will allow to buy less rupiahs.

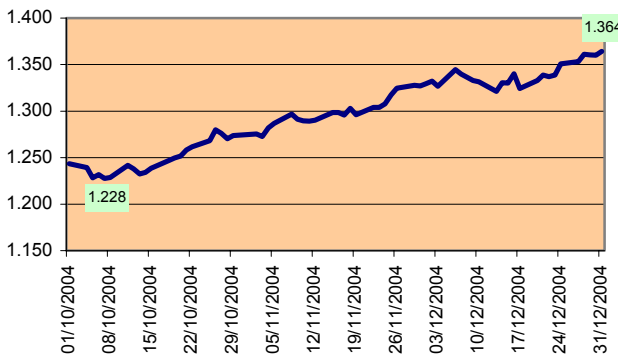
USD por AUD  
(Out 04- Dez 04)



IDR por USD  
(Out 04- Dez 04)



USD por Euro  
(Out 04- Dez 04)



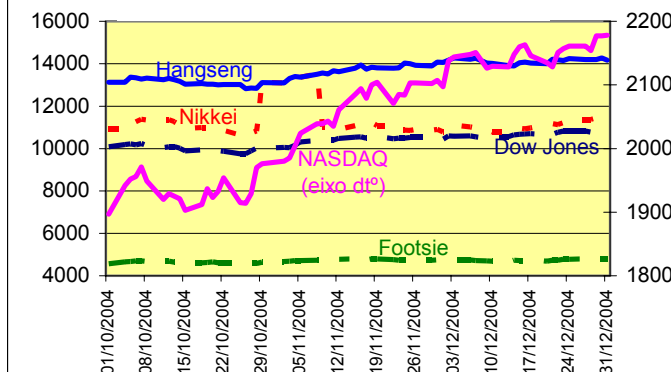
As can be seen by the graphs, the USD continued to devalue in relation to the Australian dollar and to the €uro for the most part of the last quarter of last year. This evolution is due in good part to the growing distrust by the economic agents as to the USD, since the USA has two huge deficits to cover: the commercial deficit and the public accounts one.

In relation to the Indonesian rupiah the behaviour was more variable, with the rupiah increasing until mid November and falling strongly since then. This variability of the exchange rate of our neighbour' currency is connected to the political uncertainty regarding the recent elections in the country and to the uncertainty as to the economic policy to pursue in the future. The devaluation of the rupiah has helped to keep a low pressure on the side of "imported inflation" on the prices in Timor-Leste.

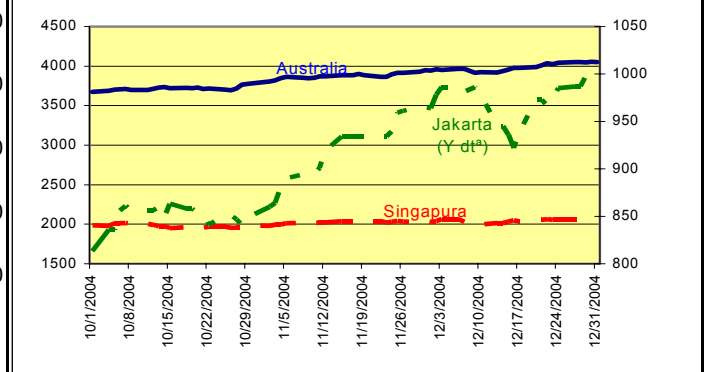
# Financial Markets

Latest developments

Main Stok Exchange indexes  
4th quarter 2004



Main Asian Stok Exchange indexes  
4th quarter 2004



## The world economy: some forecasts

The evolution of the *world's production* during 2005 is subjected to important factors of uncertainty, as has already happened in the last years, namely concerning the political evolution in the Middle East and regarding the evolution of oil prices (see previous page). However, there seems to be unanimity regarding the fact that there will be a slowing up in the growth rate of the world's total production in relation to last year's. According to the World Bank, this will have been 4%. In 2005, despite the said economic slowing up, there will be a growth rate of 3.2 - 3.5%, which may happen again in 2006.

The *oil price*, which at the end of 2004 was as high as around USD 56 per barrel, should come down and settle, according to some estimates, at USD 40 per barrel in 2005, falling again to USD 34 per barrel in 2006. It should be noted, however, that the World Bank in its recent (January 2005) publication on Global Economic Prospects 2005, foresaw that these prices will be respectively USD 36 and 32 per barrel. On the other hand, the US Energy Information Agency calculates that the average price in 2005 will be USD 34 per barrel, decreasing further to USD 25 per barrel in 2010. This difference in the estimates speaks volumes on the difficulty of foreseeing the future in this area (as in others).

The slowing up of the world growth in 2005 will be accompanied by a trend to increase the *interest rates*, namely in the United States. This increase is necessary to attract capitals in order to help funding the US "double deficit": the public accounts deficit and the current account one (i.e. from international economical relations).

### Estimate of the evolution of the interest rates in the USA

	Dec 2004	Jun 2005	Dec 2005	Dec 2006
American Treasury bonds, 3 months (annual rate; %)	2.3	3.0	3.8	4.0
Idem, to 10 years (annual rate; %)	4.4	5.0	5.7	5.0

Interest rates in Europe will also go up, but less so than in the United States, becoming lower than theirs. Thus European rates to 6 months, which were 1.5% higher than the American ones in 2002 (3.3 against 1.8), should be this year around 1.1% lower (2.4 in the "Euro zone" against 3.5 in the United States).

Another element that has been characterizing the evolution of the world's economy (since middle 2001, i.e. for almost four years) is the fall of the US dollar in relation to the top world currencies, in particular the Japanese yen and the euro. In this case, it should be noted that the *exchange rate* of the USD in middle 2001 was around 1.2 per euro – i.e. each USD was converted into around 1.2 euros – while currently it is around 0.75 per euro – i.e. it is converted into only 75 cents. This represents a devaluation of over one third.

Some estimates for the future evolution of the *exchange rate* between the USD and the € suggest that the USD will continue to devalue along 2005, and that in the end of 2005 it will be necessary to pay USD 1.37 to buy € 1, while nowadays € 1 only costs USD 1.30. In 2006 a slight increase of the USD in relation to the €.



	Dec 2004	Jun 2005	Dec 2005	Dec 2006
€ - US\$	1.29	1.35	1.37	1.26
US\$ - ¥ 105	103	104	101	
US\$ - Yuan	8.28	8.25	8.15	8.0

As for the Japanese yen (¥) we expect some exchange stability. In relation to the Chinese yuan, the evolution may be different.

Indeed, China is currently the country to which the USA has its greatest external deficit, as a result of China's exports to the US. Thus the USA has been exerting a strong pressure on China for years, in order for them to re-evaluate the yuan.

It should not be assumed, however, that it will be easy to make China accept the appreciation of its currency through a change in the exchange rate it has been practicing for years, and that is steady in relation to the USD (CNY 8.28 for each USD). Just look at the recent analysis on the subject by HSBC-Hong Kong and Shanghai Bank Corporation, one of the issuing Hong Kong banks:

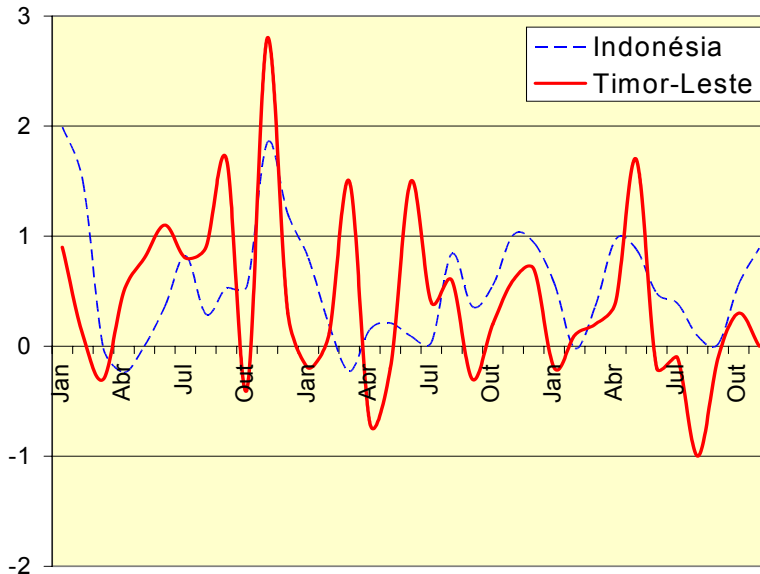
"An adjustment in the exchange rate of the Chinese yuan will have very little impact on the world economic unbalances. The sooner the Western economic policy makers acknowledge this, the better. China can be used as an excuse for, say, the ongoing and growing unbalance of the current transactions trade deficit of the United States, but it will be no more than an excuse: the real problem lies in the lack of American savings [= excess of consumption], not in the supposedly unfair competitive position of China [due to the sub-evaluation of the Chinese currency]."

It should be said that an important part of the exports to the United States, including from China, derive from American companies located abroad (China, Mexico, etc) as a result of the much smaller costs they have in those countries. In China's case, it will even be possible to "absorb" most of an eventual revalorization of the yuan without reducing the exports to the USA – making it almost meaningless to the United States, which will remain with a very high deficit towards China.



# Inflation: Timor-Leste vs. Indonesia

Monthly inflation rates  
Timor-Leste and Indonesia; 2002-2004



Correlation coefficient: 0,35  
Co-variance: 0,14

The graphic and the correlation coefficient show that there is some similarity between the behaviour of the prices in Timor-Leste and in Indonesia. We can even see, in the graphic, some paralelism of the curves in some periods. Note that half of the Timorese imports come from Indonesia.

The covariance coefficient, a coefficient that tells about the eventual causal relationships between both sets of figures, tells us that this is low, but positive. This means that Timor-Leste price evolution is not independent from that of Indonesia but that the price evolution in our country is only marginally caused by the evolution of Indonesian prices.

Fontes: Indonésia: BPS; Timor-Leste: DNEstatística

## Glass walls

**BPA in the net: [www.bctl.east-timor.org](http://www.bctl.east-timor.org)**

November 2004 saw the launching of BPA's website, with the main goal of providing information for a much broader audience on the functions performed by the "Authority". There are versions in Timor-Leste's two official languages (Portuguese and Tetum) and in English.

The site has been accessed daily by around 15 to 30 visitors, from over 35 countries. The number of visits has been growing fast, which is even more remarkable as there has been no campaign informing of its existence.

The project was led by the Division of Technology and Information and features a group of people responsible for the definition of the contents, as well as technical staff charged with ensuring the proper functioning of the site.

One of the main goals of the site is to diffuse the economic and statistic information produced by the "Authority", including quarterly economic bulletins (normally published in Portuguese, Tetum and English) and the annual report. There are links for obtaining daily information on the exchange rates.

The page's overall content is similar to the one of any other "Central Bank", being easy and quick to consult.

Temporarily the official website is [www.bctl.east-timor.org](http://www.bctl.east-timor.org), which should be changed to [www.bancocentral.tl](http://www.bancocentral.tl) as soon as the country code ".tl" is operational. It is expected that this will happen soon. The BPA will be among the first organizations in Timor-Leste to use the new code.

At that time BPA's e-mail addresses will also change. In order to avoid inconveniencing our readers, both addresses



(the current one and the future one) will work in parallel for some time.

The development of BPA's official website is ongoing. Regularly information will be updated and technical improvements will be introduced. Some specific applications for internet use will be created. The use of extranet techniques will make it possible for us to broaden the services provided by our site.

For more information on our site, please write to [info@bctl.east-timor.org](mailto:info@bctl.east-timor.org) or to [webmaster@bctl.east-timor.org](mailto:webmaster@bctl.east-timor.org).

## 2004: a dropping USD and an increasing oil price (from page 1)

China and Japan. In order to strengthen this evolution, American diplomacy has been exerting much pressure on China, so that it strengthens its national currency, the yuan, in order to make exports to the USA more expensive, therefore reducing US imports. This pressure includes the threat by some US senators to impose an import tax of 27.5% on all products from China imported by the USA, in order to achieve through the customs what the exchange rate cannot do, thereby forcing the re-evaluation of the yuan.

The curious thing is that China has been one of the main "allies" of the United States in its struggle for balancing its external accounts, since it has acquired very significant amounts of US Treasury bonds, which is simultaneously a funding of the external accounts of the country through the entry of capital in the USA and a funding of the American public accounts.

This means that the two American deficits are only "bearable" at this time since Asian countries (namely China and Japan) are financing the United States. If they decide to stop doing so with such high amounts that may be a serious problem for the American economy, and consequently to the world's economy – including that of the Asian countries, which derive an important part of their prosperity from their exports to the USA. Due to this interaction with US economy, China is almost obliged to keep on financing the USA, since the alternative would be an economic crisis that would end up "falling on their heads". What about that, Mao Tse Tung?!...

The consequence for Timor-Leste of the devaluation of the USD is the increase in the price of products imported from countries / regions such as Europe or Australia (from where 15% of our imports come). It should be noted, however, that most of our imports come from countries that have been having a relatively stable exchange rate towards the USD, or that have even had some devaluation despite of the dollar's own devaluation. These are the cases of Singapore (around 15% of our imports) and of Indonesia (50% of our imports), for example. With the exchange rate of those countries' currencies relatively stable towards the USD, there is no reason why there should be pressure on our prices, which is why it was possible to decrease our inflation rate (4.2% in 2003 and 1.8% in 2004).

### The price of oil

Another element that characterized the later part of 2004 was the increase in the price of oil (see page 2). This price, as for any other product, is determined by its supply and demand. However, its huge importance for world economy makes its price also especially sensitive to the evolution of the world's and each country's geopolitical situation.

The estimate for the world oil production during 2004 is in average 5.4 million barrels per day, a decrease (-4.3%) from the previous year (2003); in 2005 it is expected to be 5.58 million barrels per day.

On the other hand, the demand was very high due to the great energy demand in China, a consequence of its fast growth rate (almost 10% in 2004) and the insufficiency of its own production.

### The impact on Timor-Leste

The high cost of oil increases the costs of transportation and energy in our country, and through them the costs of almost all goods and services. Should this happen, the general price level (inflation) will increase. This may lead to a slowing down of the economic activities and to the increase of unemployment. Hence the need for a good macroeconomic policy coordination.

As was already said, a very significant part of the consumption goods of Timor-Leste is imported from Indonesia, a country which has its own problems resulting from the increase in the price of oil.

Indeed, this increase made the expenses of the State in terms of allowances for oil derivatives (fuel, diesel, etc.) go up considerably. With financial difficulties and not wishing to increase the public accounts deficit, the Government intends to reduce drastically – from around USD 70 million to around USD 25 million – the allowances paid to the various oil products. The exception will be the allowance to kerosene, consumed by poor families. All the other oil derivatives will see the granting of allowances come to a close, which will increase the price for the consumers.

The *Danareksa Research Institute* foresees that for each 10% of increase in the price of oil, the general level of prices in Indonesia will go up by 0.7%. Thus, if oil increases 40%, as expected, the inflation rate in the country will go up around 3% just because of that, making inflation in 2005 go up from 5.3% in 2004 to around 8% this year.

This may have a reflection on the prices of the goods we import from our neighbour. We shall see if it does happen and in what way, since it will also depend on the evolution of the exchange rate of the rupiah in relation to the USD. If the devaluation trend in relation to the USD remains, so as to compensate the increase in the prices and to keep up the external competitiveness of the economy, the impact of the greater inflation may be "absorbed" by that alteration of the exchange rates, thus reducing the effect on the prices in Timor-Leste.

It should be noted that the increase in the prices of the oil derivatives in Indonesia will not reflect on us, since Timor-Leste already pays the price of the international market, without allowances. The prices will only increase if the international market prices increase and if there is speculation by the importers and sellers of Indonesian products among us, justifying the higher prices with the increase of prices in Indonesia. We must be on the lookout for this situation, which may not be justifiable.

If there is an increase in the import price of oil beyond what the international market justifies, other companies will be able to enter the market by importing oil at lower prices, therefore decreasing the pressure for the decrease of the price of oil derivatives among us.

This publication is prepared by the Division of Economic Studies and Statistics of the Banking and Payments Authority of Timor-Leste  
Avº Bispo Medeiros (near ACAIT) POBox 59 Dili Timor-Leste Tel: ++670. 33 13 718 Fax: [...] 33 13 716

The opinions expressed in this publication are the ones of the authors and do not reflect the ABP/BPA official views. The latter rejects any responsibility with regard to the commercial use of the information and opinions presented, which have been elaborated based on the knowledge and information available at the time of the publication.