

# Economic Bulletin

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## What are the functions of a Central Bank?

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### To be noted...

- ? **The Banking and Payments Authority, a central bank “de facto”, but not “de jure” yet**
- ? The Economic Studies and Statistics Division is responsible for the regular monitoring of the Timor-Leste's economy, for the elaboration of the monetary statistics and for the publication of the “Economic Bulletin”.
- ? **The AFTA—ASEAN Free Trade Association could be instrumental in increasing Timor-Leste's exports and economic growth.**
- ? Foreign Direct Investment is pivotal for Timor-Leste's economic development. It may require the setting up of specific measures so to attract such inflows, but also some supportive measures tailored to domestic enterprises.

On the occasion of the entry into circulation of the Timor-Leste's coins, the “centavos”, on 10 November 2003, a lot has been said on the need for Timor-Leste to have a central bank.

Because there is some confusion on the role of central bank, this article reviews the traditional functions of a central bank and related to that addresses the functions that a central bank in Timor-Leste is expected and entitled to perform.

Nowadays, the functions of a central bank are fairly standardised, i.e. almost all central banks have similar functions. However, there is a specific central bank case which may deserve some particular attention, namely the case of a central bank of a dollarised country such as Timor-Leste. Such a case is addressed later in this article as the traditional functions are reviewed first.

The first “central bank” (the Bank of England) was created at the end of the 17th century, but it was endowed with the monopoly of issuing banknotes and coins only in mid-19th century. Such a privilege together with the fact that the Bank of England enjoyed substantial financial resources provided the latter with the ability to play the role of being “the bank of the banks”. And indeed, the bank of England was able to lend money to the banks any time it was needed. Having said that, the majority of European countries created their central bank in the 19th century, and the majority of the remaining countries only in the 20th century.

At their inception, central banks were also performing the role of being the “bank of the State”, thereby lending money to the latter. Later on, in order to avoid a substantial recourse by the national governments to central bank's money and thus to avoid increasing the monetary base (i.e. the volume of coins and banknotes in circulation) — which had triggered inflationary pressures in many countries — central banks were prohibited to grant loans to their national governments. This still holds. Governments may be granted loans, however, they may get these through commercial banks as any other client. However, loans to governments are not so common as the later traditionally favours issuing treasury bills so as to raise funds with the public at large as well as with commercial banks.

As a result of the evolution of the central banks' functions, the following functions are nowadays usually performed by central banks:

- 1) To issue the domestic currency through the coinage of coins and the printing of banknotes;
- 2) To ensure the internal stability of the domestic currency through the regulation of the monetary base growth so as to not jeopardise economic growth with unwarranted inflationary pressures;
- 3) To ensure the external stability of the domestic

currency through the conduct of a predefined exchange rate policy, potentially intervening in the foreign exchange market so as to defend the defined exchange rate level;

- 4) To be the “bank of the banks”, thereby accepting deposits from them and in some cases providing them with loans against collateral. However, as a matter of principle, commercial banks should resort to other commercial banks to get funded;
- 5) To regulate the proper functioning of financial institutions so as to ensure that deposits are not at risk;
- 6) To promote the stability of the banking sector through the setting up of a banking supervision framework as well as through an efficient and reliable operating of payment systems (cheques and interbank transactions);
- 7) To manage the foreign exchange reserves of the country, or the own reserves of the central banks, and sometimes to act as the agent of the State both for processing expenses and revenues;
- 8) To advice the government on fiscal policy related issues as well as on any issue related to economic policies pursued by the government.

### What about Timor-Leste?

Since November 2001, Timor-Leste has been endowed with an institution called the “Banking and Payments Authority”, the ABP/BPA. Is the ABP/BPA a central bank?

The BPA is currently performing the bulk of the functions which characterise a central bank, and so in spite of not being officially called “central bank”. However, does the official labelling in that case really matter?

The only function, which the ABP/BPA does not perform relates to the issuance of a domestic currency (although it has somehow changed since 10 November 2003) and linked to that the functions related to currency issuance, namely the functions 1, 2 and 3 listed above.

Indeed, Timor-Leste is a so called “dollarised country”. It does not issue its own domestic currency, instead it has granted the US dollar the status of legal tender since January 2000. This was decided during the time of the UNTAET administration and thus in agreement with the local authority in place at that time.

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# What are the functions of a Central Bank? (follow up of page 1)

In the May 2003 special issue of the Economic Bulletin, addressing the issuance of the "centavos" coins, it was explained why the required conditions providing for the issuance of a domestic currency are not currently in place in Timor-Leste, and may continue not to be in place for the next 3 or 4 years. In this connection, the reader may wish to refer to the May 2003 special issue of the Economic Bulletin.

It should be restated that as long as Timor-Leste maintains the use of the US Dollar as national currency, the "central bank"'s functions, which the ABP/BPA is already "de facto", but not "de jure" yet performing — it is expected to become a central bank "de jure" during the first semester of 2004 — will be somehow constrained. As a consequence, the impact of such functions on the conduct of economic policies in Timor-Leste are somehow limited.

Indeed, some limitation exists on two

components of economic policies which fall within the responsibility of the ABP/BPA, namely monetary and exchange rate policies. Indeed, exchange rate policy does not exist per se as no national currency exists. In addition, the impact of the monetary policy instruments, currently available (e.g. minimum reserve requirements) is marginal.

Moreover, the Central Bank cannot influence money market interest rate as it does not lend money to commercial banks, whose volume of deposits exceeds by far the volume of credit granted.

Still, if the future "Central Bank" of Timor-Leste were to be able to issue its own currency, it would nevertheless not be the sole entity responsible for the design and successful implementation of economic policies.

Indeed, although monetary and exchange rate policies are pivotal for achieving macroeconomic stability in an

environment free of acute inflationary pressures (which may not be achievable through administrated prices, which are more detrimental to the economic than beneficial), fiscal as well as structural policies, in particular those geared towards the private sector (domestic or international, agricultural and non-agricultural) are instrumental in this respect.

To use a metaphor, the Central Bank would possibly put the tablecloth on; However, it will lie with other actors to fully set the table, namely with plates, glasses and cutlery and in particular to fill plates with appropriate food...The Central Bank should not be asked to fulfil more than its natural duties...Likewise, one should not attempt to draw up and allocate new duties to the Central Bank...

What belongs to Caesar should remain with Caesar...

## Behind the glass wall — What is and what does the ABP/BPA?

There is a Division of particular relevance within the ABP/BPA organigramme: this is the Economic Studies and Statistics Division. The Economic Studies and Statistics Division operates as a proper "research cabinet" and is composed of 4 staff members (one of those being an International Economic Advisor).

More specifically, the Division is in charge of conceiving and producing the monetary statistics of the country, conducting studies on a wide range of issues related to the Timor-Leste economy and of drafting the three regular publications (respectively a daily, a quarterly and an yearly publication) published in Timor-Leste and addressing economic issues: a daily informative sheet (on exchange rates, stock exchanges and interest rates), the Economic Bulletin and the Annual Report on the activities of the ABP/BPA.

In addition, the Economic Studies and Statistics Division contributes substantially to the technical training of both its own staff and the ABP/BPA staff as a whole. At the current juncture, technical training is certainly crucial for Timor-Leste.

In more details, the following diverse tasks are performed by the Economic Studies and Statistics Division:

1—Regular monitoring of the economy of Timor-Leste through :

? The production of the monetary statistics since July 2002.

? Studies on various issues related to the Timor-Leste economy — included some studies covering some international economic aspects, such as the coffee economy, the oil economy of the Timor Sea.

? The set up of a database encompassing statistical data available on Timor-Leste and

stemming from various national and international entities.

2—Publication of economic information through :

? A daily informative sheet on exchange rates for the major currencies, on interest rates and indexes of the major stock exchanges.

? The publication of a quarterly "Economic Bulletin", addressing economic issues related to the Timorese economy both under an analytical and a pedagogical view-point.

3—Consultation with third parties on a wide range of economic issues:

? Participation, as the central point for the ABP/BPA, in consultation discussions with international financial institutions.

? Co-operation with third national entities such as the Ministry of Finance and Planning (training activities) and its Statistical Department (statistical issues, e.g. inflation rate related issues).

4—Co-operation activities with other business areas of the ABP/BPA:

? Contribution to the technical training of the staff members of the Economic Studies and Statistics Division as well as of the staff members of the ABP/BPA as a whole.

? Co-ordination with other business areas of the drawing up of the Annual Report on the ABP/BPA's activities.

Finally, last but not least, the Division has played a crucial role in defining the characteristics of the coins that Timor-Leste put into circulations on last 10 November.

Indeed, the Division has been responsible for drawing up preliminary studies with regard to the graphism of the centavos coins, some of which have been finally retained.

### **The information campaign on the Timor-Leste's coins**

With a two-fold objective of getting the Timorese population acquainted with the new Timorese coins and of creating some incentive for the exchange of the American coins against the new ones, an intense information campaign has been launched on 13 October 2003. The information campaign lasted four weeks and covered all Timor Leste districts. Several communication means, such as direct contacts with the population through meetings in villages, posters, radio and television interviews were used. The feedback received was very positive, underlying the satisfaction of the population with regard to the circulation of the new coins for, as mentioned in the poster, these being "nice and easy to use" and in addition, being "ours"!

### **Inauguration of the ABP/BPA's new vault**

As part of the overall campaign related to the entry into circulation of the new coins, the ABP/BPA inaugurated on the occasion of its second anniversary a new vault, which displays all required and necessary safety characteristics.

# The ASEAN

## What is it and how important is it for the future of Timor-Leste?

The ASEAN- Association of South-East Asian Nations- was established in 1967 through the so-called "Bangkok declaration", signed on 8 August 1967 by the five founding countries (Philippines, Indonesia, Malaysia, Singapore and Thailand).



As it emerged shortly after the fight for power in Indonesia (1965-66) and during the intensification phase of the Vietnam War, the ASEAN emerged more as a political alliance against "communism" through the set up of a sanitary string around Vietnam than as an economic association. Still, the Declaration continued to stress that one of the main objectives pursued by the ASEAN was to foster economic growth in the region through trade co-operation among countries.

However, the economic objectives set by the ASEAN only started to gain momentum by 1977, through inter alia the signature, on 24 February 1977, of the PTA—Preferential Trade Agreement. This agreement aimed at fostering trade among member countries. At that time, however, the association did not aim at following a path similar to the one followed by the European Economic Community (EEC) ( Encompassing at that time nine countries).

The main tool used to implement the PTA was the establishment of preferential customs tariffs between the association member countries so as to foster international trade between the member countries.

In spite of the PTA, the member countries, which were more competing with each other than complementing each other, maintained protective trade policies so as to shield their respective domestic markets. As a result, the outcome of the PTA was somehow marginal.

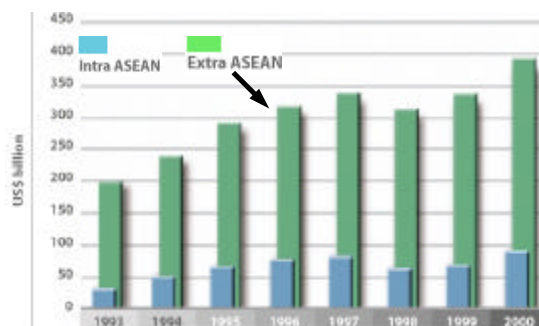
Some 15 years have been required for the association to move forward to the effective enhancement of regional trade co-operation, through a facilitated access to the respective domestic markets. Indeed, it was on the occasion of the Singapore Summit in January 1992 that the ASEAN member

countries (by that time, encompassing 6 countries, further to Brunei Darussalam membership in 1984) decided to "establish (...) the ASEAN Free Trade Association [AFTA] within a timeframe of 15 years, i.e. as from 1 January 1993". Consequently, it was foreseen to launch the AFTA in January 2008, date from which the customs tariffs were expected to be reduced to a 0 to 5% range (scheme called the Common Effective Preferential Tariff, CEPT). The requirement for such a CEPT was that traded goods would fulfil the so-called "rule of origin" of a minimum 40%. In other words, a product was deemed to be originating from ASEAN member countries, if at least 40% of its content originated from any member country.

In 1995, it was decided to bring forward by five years (to 2003 instead of 2008) the entry into force of this agreement. Meanwhile, the ASEAN members, which had joined at a later stage (namely Vietnam in 1995, Laos and Myanmar in 1997 and Cambodia in 1999) were required to implement the intra-ASEAN custom tariffs within the same 10 years timeframe.

In spite of the main objective being the gradual removal of customs tariffs for the entire intra-ASEAN trade, it has to be acknowledged that the reduction or even the removal of customs tariffs somehow required member countries to adjust their respective economic structures. Indeed, some adjustments were needed so as for the countries to cope with the increasing competition.

### External trade of ASEAN



In this context, three different lists of goods were established in accordance with their respective degree of sensitivity of the sector concerned.

- ✍ A list of "sensitive" goods, such as non processed food goods, for which the implementation of the CEPT was somehow delayed,
- ✍ A list of "temporarily excluded" goods, for which the customs tariffs



would be reduced to 0-5%. Still, these goods enjoyed some protectionism measures which aimed at shielding them from international competition.

- ✍ A list of "effectively excluded" goods.

The implementation of such a scheme aiming at fostering intra-ASEAN trade had proven to be fruitful. Indeed, intra-ASEAN trade increased from USD 44 million in 1993 to USD 95 million (more than the double) in 2000, thereby representing an yearly increase of around 12%. As a consequence, the intra-ASEAN trade accounted for around 23% of the international trade of the region.

However, such a trade volume was still considered as being relatively marginal. This might have resulted from the fact that economic structures across countries were much more competing with each other than complementing each other. Meanwhile, however, some complementary features have been fostered owing inter alia to foreign

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## The ASEAN and Timor-Leste (conclusion)

Follow up to page 3 **What about Timor-Leste?**

enterprises (e.g. Japanese enterprises).

Nevertheless, the ASEAN's international trade continued to remain mainly triggered by trade with partners located outside ASEAN.

Discontent about such an outcome and taking benefit from the time which had elapsed, thereby decreasing the reticence towards further "economic integration", the ASEAN member countries decided in September 2003 on the occasion of the Phnom Penh Summit (Cambodia) to agree on the deepening of the intra-ASEAN regional integration through the creation of the "ASEAN Economic Community" (AEC). As mentioned in the relevant press communiqué, "as a AEC, the ASEAN will be [in 2020] a single market characterised by the free circulation of goods, services, specialised labor as well as capital".

What about Timor-Leste? How does Timor-Leste, with its nascent and still fairly fragile economy, come into play in such an increasing regional integration scheme? Can Timor-Leste remain aside of this process? In fact, it is hard to believe that Timor-Leste could be left aside from a region in which it "naturally" finds itself integrated.

In this connection, the two following questions can be put forward: when would the integration take place? And according to which conditions? Certainly, the answers to these two questions are not independent from each other.

As far as the first question is concerned, it encompasses both an economic and a political component. In this respect, the Timorese authorities (and not the ASEAN member countries) will have to define a suitable calendar putting emphasis on a long term economic perspective instead of a short term one.

As far as the second question is

concerned, and bearing in mind that the Timor-Leste's membership to the ASEAN will trigger a reduction of customs tariffs and a liberalisation of imports, one should use the ASEAN tools, as presented above, to limit on a temporary basis both effects so as to limit the shock on public accounts (namely triggered by the reduction of revenues stemming from customs tariffs) but also so as to ensure that national enterprises (let's say at least some of those) gain not only some resilience to competition stemming from ASEAN countries but also gain the capability to export to ASEAN countries, relying or not relying on foreign investors.

## FDIs and economic development

*(follow up to page. 8)*

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Some other countries are extremely cautious with regard to opening their economies to FDIs. This is the case of India (cf box) and South Korea. The latter, during its most important phase of development, namely from the 60s to the 80s, opted for providing particular support to the domestic enterprises, having recourse to external borrowing so as to finance those enterprises at a preferential interest rate thereby supporting their expansion.

Such cases, namely countries which are reluctant to FDIs, are however an exception. Indeed, the majority of countries tries to attract those investments. Also, Timor-Leste would have to do so and to do so, it will have to become aware of what are the elements which play a crucial role in investors decisions.

A condition "sine qua non" to FDIs is macroeconomic, political and social stability. This includes the existence of a transparent legal framework and its efficient functioning, which is pivotal for the resolution of potentially arising conflicts of interest. In this connection, it is of utmost importance that the legal framework be properly applied.

Equally important for attracting FDIs is the existence of a reliable taxation framework, which is not more burdensome than in other countries.

In economic terms, the dimension of the domestic market is crucial. The size of the domestic market tends to be marginal in developing countries such as Timor-Leste, which displays a USD 470 per capita GDP. Therefore, it is essential that countries establish links with each other, through e.g. Associations, so as to enable enterprises—and particularly

foreign enterprises—to produce for an enlarged market, which goes beyond the national borders. In the case of Timor-Leste, its potential membership with ASEAN could be seen under such a perspective.

The creation of a "Special Economic Zone", within which foreign enterprises would benefit from preferential legal and taxation scheme could be considered. However, this would certainly not be the panacea in order to attract FDIs. Indeed, these enterprises, usually already benefit from preferential customs tariffs resulting from world-wide trade agreements, which somehow undermine the attractiveness of such Special Economic Zones.

On the other hand, it is legitimate that foreign enterprises are particularly keen on maximizing their return on investment. For this reason, the government of the hosting country may have to be particularly cautious, and in some cases, even should not hesitate to request something in return from these enterprises. As an example, it may be appropriate to ensure that foreign enterprises ensure the proper technical training of local staff and even the gradual involvement of local staff members in managerial positions, as soon as these are ready to take over such responsibilities.

Depending on the sector in which foreign enterprises are performing, some incentive so as for them to achieve a certain objective in terms of export, thereby contributing to increasing the revenues of the countries, could be contemplated.

Incentives so as for these enterprises to gradually increase their purchases in the domestic market, thereby ensuring the development of other business, domestic or foreign, and the proper economic development of the country, could also be considered.

# Monetary statistics

Million of USD	Jan.	Feb.	Mar.	Apr.	May	Jun.
<b>Net Foreign Assets</b>	<b>88,955</b>	<b>88,089</b>	<b>92,791</b>	<b>93,087</b>	<b>92,315</b>	<b>99,671</b>
<i>Claim on non resident</i>	<i>103,411</i>	<i>102,736</i>	<i>107,846</i>	<i>108,747</i>	<i>108,095</i>	<i>116,141</i>
Claims of ABP/BPA	54,930	53,125	57,191	61,056	60,092	62,884
Claims of commercial banks	48,481	49,611	50,656	47,691	48,004	53,257
<i>Liabilities to non resident</i>	<i>14,457</i>	<i>14,648</i>	<i>15,056</i>	<i>15,660</i>	<i>15,781</i>	<i>16,469</i>
Liabilities of ABP/BPA	10,857	10,857	10,857	11,348	11,348	11,487
Liabilities of commercial banks	3,600	3,790	4,198	4,312	4,432	4,982
<b>Domestic Claims (2)</b>	<b>-25,047</b>	<b>-22,115</b>	<b>-29,224</b>	<b>-29,104</b>	<b>-29,345</b>	<b>-32,716</b>
Claims on central government	0	0	0	0	0	0
Claims of ABP/BPA	0	0	0	0	0	0
Claims of commercial banks	0	0	0	0	0	0
Deposits of Central Government	31,048	29,391	36,298	37,001	37,418	41,535
at ABP/BPA	31,048	29,391	36,298	37,001	37,418	41,535
at commercial banks	0	0	0	0	0	0
<i>(Net claims on Central Government = Loans minus Deposits) (1)</i>	<i>-31,048</i>	<i>-29,391</i>	<i>-36,298</i>	<i>-37,001</i>	<i>-37,418</i>	<i>-41,535</i>
Credit (to private sector = private and enterprises)	6,002	7,276	7,074	7,897	8,073	8,819
Credit of ABP/BPA	33	46	64	78	93	102
Credit of commercial banks	5,969	7,230	7,009	7,819	7,981	8,717
<b>Deposits of commercial banks at ABP/BPA</b>	<b>6,897</b>	<b>8,126</b>	<b>4,087</b>	<b>6,324</b>	<b>4,626</b>	<b>4,823</b>
<b>Deposits (Demand and time)</b>	<b>56,030</b>	<b>57,977</b>	<b>55,286</b>	<b>55,905</b>	<b>54,648</b>	<b>58,494</b>
<b>Demand deposits at commercial banks</b>	<b>50,329</b>	<b>52,243</b>	<b>49,471</b>	<b>50,113</b>	<b>48,621</b>	<b>52,637</b>
Public non-financial corporation	244	896	869	861	758	755
Other residents sectors	50,085	51,347	48,603	49,252	47,864	51,882
<b>Time and Savings Deposits</b>	<b>5,701</b>	<b>5,734</b>	<b>5,815</b>	<b>5,792</b>	<b>6,027</b>	<b>5,856</b>
Deposits of ABP/BPA	0	0	0	0	0	0
Time deposits of other residents	5,701	5,734	5,815	5,792	6,027	5,856
<b>Others Items (Net)</b>	<b>1,302</b>	<b>676</b>	<b>841</b>	<b>1,021</b>	<b>803</b>	<b>599</b>
idem, ABP/BPA	-113	-5	-9	314	348	547
idem, commercial banks	1,415	681	849	707	454	52
<b>Capital and reserves</b>	<b>9,326</b>	<b>9,137</b>	<b>9,092</b>	<b>9,096</b>	<b>9,144</b>	<b>9,117</b>
<b>Capital</b>	<b>9,339</b>	<b>9,084</b>	<b>9,084</b>	<b>9,084</b>	<b>9,084</b>	<b>9,084</b>
idem, of ABP/BPA	7,351	7,351	7,351	7,351	7,351	7,351
idem, of commercial banks	1,988	1,733	1,733	1,733	1,733	1,733
<b>Retained earnings</b>	<b>-13</b>	<b>53</b>	<b>8</b>	<b>12</b>	<b>60</b>	<b>33</b>
Retained earnings of ABP/BPA	299	396	389	429	481	461
Retained earnings of commercial banks	-312	-343	-381	-417	-422	-428
<b>General and special reserve</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Reserve of ABP/BPA	0	0	0	0	0	0
Reserves of commercial banks	0	0	0	0	0	0

(\*) Data for June 2003 are in line with the data published by the ABP/BPA as approved at the end of the fiscal year 2002/2003.

(1) As from August 2003 onwards, data include data reported by the Bank Mandiri. From that date onwards, the banking sector in Timor-Leste has included 4 institutions (one of these being a Micro Finance Institution).

(2) Owing to the way "net claims on central government" is defined, namely credit minus deposits, the obtained negative value means that the volume of deposits is higher than the volume of credit, which in the case of Timor-Leste is fairly marginal yet.

In 2003, Timor-Leste's monetary aggregates have undergone some significant developments. The following is noteworthy:

- Net foreign assets have gradually increased over the year, increasing by as much as 21.3% compared to December 2002. Also, foreign liabilities have substantially increased, by around 200% in 2003 (these are liabilities of commercial banks vis-à-vis non residents, including vis-à-vis headquarters located abroad).

- Government deposits with the ABP/BPA, while evidencing some gradual upward trend during the first and second quarters of 2003, have decreased by as much as 30% during the third quarter (from June to September 2003). Such a decrease may be somehow explained by the fact that at the end of the fiscal year (30 June), the government traditionally spends the remaining budgeted but non-spent yet revenues, thereby decreasing government deposits with the ABP/BPA in the following quarter. In December 2003, however, owing to income transfers stemming from international donors, government deposits have increased again to USD 50 million.

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# Monetary statistics

Million of USD	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
<b>Net Foreign Assets</b>	<b>99,390</b>	<b>98,745</b>	<b>103,107</b>	<b>108,799</b>	<b>99,159</b>	<b>108,299</b>
<i>Claim on non resident</i>	<i>115,159</i>	<i>112,974</i>	<i>117,468</i>	<i>129,737</i>	<i>132,109</i>	<i>153,108</i>
Claims of ABP/BPA	65,624	62,776	53,765	55,585	53,955	72,811
Claims of commercial banks	49,535	50,198	63,703	74,152	78,154	80,297
<i>Liabilities to non resident</i>	<i>15,769</i>	<i>14,228</i>	<i>14,361</i>	<i>20,938</i>	<i>32,950</i>	<i>44,809</i>
Liabilities of ABP/BPA	11,348	11,348	11,487	11,487	11,487	11,487
Liabilities of commercial banks	4,421	2,880	2,874	9,451	21,463	33,322
<b>Domestic Claims (2)</b>	<b>-26,253</b>	<b>-20,173</b>	<b>-14,143</b>	<b>-14,270</b>	<b>-7,980</b>	<b>-21,492</b>
Claims on central government	0	0	0	0	0	0
Claims of ABP/BPA	0	0	0	0	0	0
Claims of commercial banks	0	0	0	0	0	0
Deposits of Central Government	37,267	32,236	28,290	30,761	30,181	49,739
at ABP/BPA	37,267	32,236	28,290	30,761	30,181	49,739
at commercial banks	0	0	0	0	0	0
<i>(Net claims on Central Government = Loans minus Deposits)</i>	<i>-37,267</i>	<i>-32,236</i>	<i>-28,290</i>	<i>-30,761</i>	<i>-30,181</i>	<i>-49,739</i>
<i>(1)</i>						
Credit (to private sector = private and enterprises)	11,014	12,063	14,147	16,492	22,201	28,247
Credit of ABP/BPA	734	127	225	239	445	406
Credit of commercial banks	10,280	11,935	13,921	16,252	21,756	27,841
<b>Deposits of commercial banks at ABP/BPA</b>	<b>5,828</b>	<b>12,646</b>	<b>8,485</b>	<b>7,922</b>	<b>5,829</b>	<b>7,578</b>
<b>Deposits (Demand and time)</b>	<b>58,300</b>	<b>60,699</b>	<b>66,413</b>	<b>71,965</b>	<b>74,389</b>	<b>72,873</b>
<b>Demand deposits at commercial banks</b>	<b>52,152</b>	<b>54,355</b>	<b>55,101</b>	<b>59,670</b>	<b>60,593</b>	<b>58,128</b>
Public non-financial corporation	768	710	912	575	562	550
Other residents sectors	51,384	53,646	54,190	59,095	60,031	57,578
<b>Time and Savings Deposits</b>	<b>6,148</b>	<b>6,344</b>	<b>11,312</b>	<b>12,295</b>	<b>13,796</b>	<b>14,745</b>
Deposits of ABP/BPA	0	0	0	0	0	0
Time deposits of other residents	6,148	6,344	11,312	12,295	13,796	14,745
<b>Others Items (Net)</b>	<b>-5,907</b>	<b>-2,011</b>	<b>-6,396</b>	<b>-6,468</b>	<b>-831</b>	<b>-760</b>
idem, ABP/BPA	-5,890	273	226	330	-165	-148
idem, commercial banks	-17	-2,284	-6,622	-6,798	-666	-613
<b>Capital and reserves</b>	<b>9,052</b>	<b>15,501</b>	<b>16,934</b>	<b>17,428</b>	<b>17,176</b>	<b>17,101</b>
<b>Capital</b>	<b>9,084</b>	<b>15,460</b>	<b>16,553</b>	<b>17,447</b>	<b>17,495</b>	<b>17,418</b>
idem, of ABP/BPA	7,351	7,727	7,727	7,727	7,727	7,727
idem, of commercial banks	1,733	7,733	8,826	9,720	9,767	9,691
<b>Retained earnings</b>	<b>-493</b>	<b>-420</b>	<b>-80</b>	<b>-479</b>	<b>-779</b>	<b>-779</b>
Retained earnings of ABP/BPA	7	62	102	187	195	373
Retained earnings of commercial banks	-500	-482	-182	-667	-974	-1,151
<b>General and special reserve</b>	<b>461</b>	<b>461</b>	<b>461</b>	<b>461</b>	<b>461</b>	<b>461</b>
Reserve of ABP/BPA	461	461	461	461	461	461
Reserves of commercial banks	0	0	0	0	0	0

Follow up to page 5

- Credit granted by commercial banks to the private sector has increased substantially, by as much as four times compared to the beginning of 2003. As a consequence, the ratio credit/deposit has increased from 11% in January 2003 to around 40% in December 2003.

- Finally, developments in time deposits and savings, in particular during the second quarter, may be highlighted. Indeed, these have trebled from June to December 2003 (from USD 5,8 to 14,7 million). However, some caution may be required in interpreting such data, as it cannot be excluded that these may result from some discrepancy among commercial banks in classifying deposits.

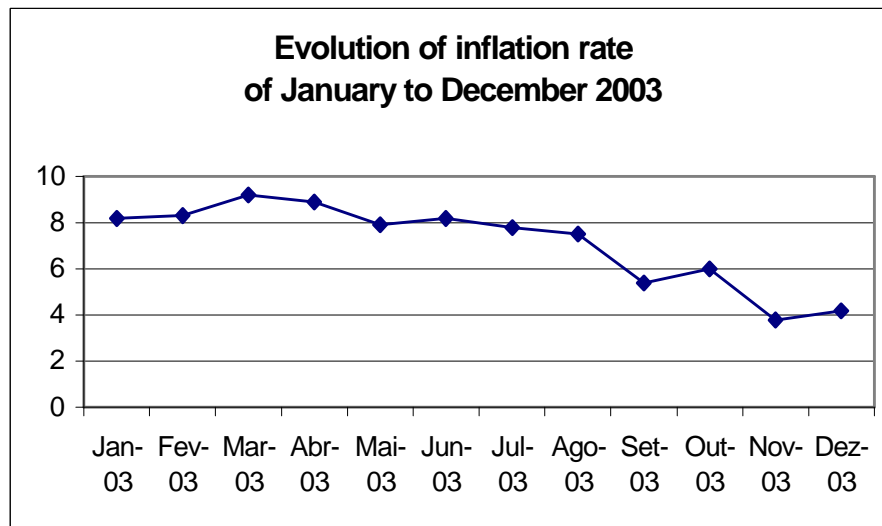
## Some statistics on our currency...the "centavos"...

10 November 2003 has marked the day on which the Timor-Leste's new coins, the "centavos", have entered into circulation. As of 31 December 2003, centavos coins for an amount of \$603,093.95 were reported as being out of the ABP/BPA's vault. More detailed information, namely by coin denomination, is presented below .

	Value in circulation	Number of coins in circulation
<b>50 Centavos</b>	264,007.50	528,015
<b>25 Centavos</b>	185,003.75	740,015
<b>10 Centavos</b>	70,801.50	708,015
<b>5 Centavos</b>	45,400.75	908,015
<b>1 Centavo</b>	37,880.15	3,788,015

## Price dynamics

In accordance with the figures released by Statistics Office, the inflation rate in December 2003 (year-on-year prices development, namely from December 2002 to December 2003) stood at 4.2% for all consumer goods covered by the "consumer basket" (versus 9.5% in December 2002). The inflation rate is determined by the "consumer basket" defined in order to measure price developments in Dili — there is no national measure available yet. Furthermore, when applying international standards and therefore deducting the price variation stemming from the housing sector, the inflation rate amounted to 4.3% (versus 10.2% in December 2002).



This inflation level provides some evidence of a gradual decrease in inflation over the year 2003. Indeed, the inflation rate amounted to 8.3% in January 2003. The pick observed in March 2003 mainly stemmed from an increase in tobacco prices (+14.1% in January compared to the previous month), partly offset by some decrease in prices in some other items of the consumer basket. As for the pick observed in October 2003, it mainly resulted from an increase in prices of food goods (which have increased by around 6% compared to the previous month, i.e. September 2003).

It is worth to underline that in the previous issue of the Economic Bulletin, published in October 2003, the ABP/BPA, through its Economic Studies and Statistics Division, had forecasted, although using rudimentary forecasting methods, that the inflation rate could stand at 4.3% in 2003, or within the range of 4%-5%. On this occasion, it was also stressed that the inflation rate could reach even higher levels, namely of a range of 5.5%-6.5%, in case of unfavourable weather conditions during the wet season, which would trigger some inflationary pressures in particular in the last quarter of 2003. Thanks, Timor-Leste did not experience anything of such.

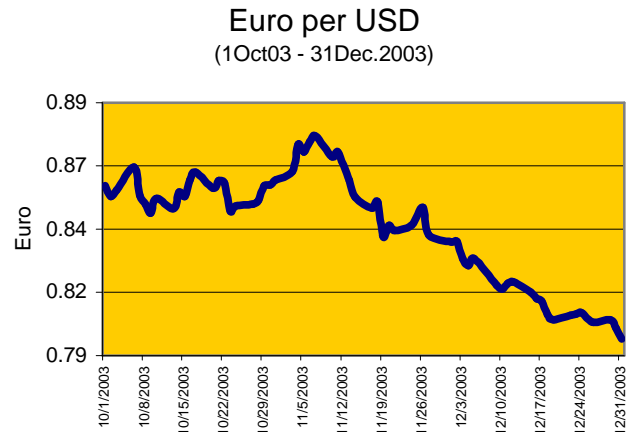
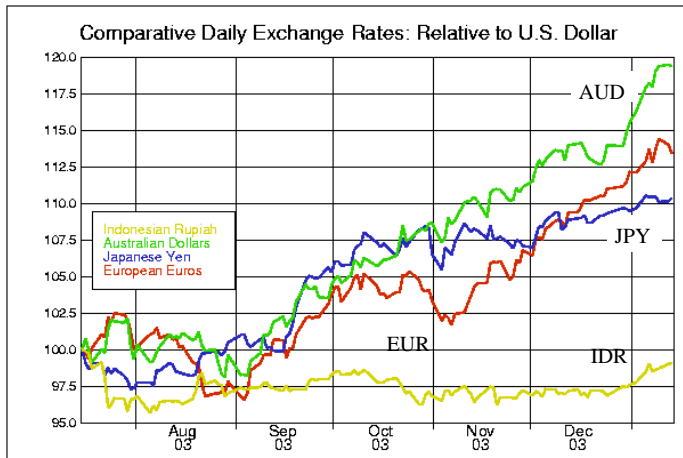
## Interim Summary Financial Statements of ABP/BPA

<b>BALANCE SHEET</b>		<b>PROFIT AND LOSS STATEMENT</b>	
As at 31 December 2003		For the six months ended 31 December 2003	
<b>ASSETS</b>	<b>US Dollars</b>	<b>INCOME</b>	<b>US Dollars</b>
Domestic Financial Assets	61,176,193	Income from Financial Assets	208,114
Foreign Financial Assets	14,675,659	Fees and Recoverable Charges	194,490
Other Assets	1,304,376	Government Appropriation	339,367
<b>TOTAL ASSETS</b>	<b>77,156,227</b>	Currency Gains	95,023
		Other Income	28,682
		<b>TOTAL INCOME</b>	<b>865,676</b>
<b>LIABILITIES</b>		<b>EXPENSES</b>	
Domestic Currency Liabilities	56,638,484	Financial Expenses	85,140
Foreign Currency Liabilities	11,545,132	Currency Expenses	155,444
Other Liabilities	411,773	Personal Expenses	138,066
<b>TOTAL LIABILITIES</b>	<b>68,595,389</b>	Operational Expenses	114,151
		<b>TOTAL EXPENSES</b>	<b>492,801</b>
<b>NET ASSETS (Assets minus Liabilities)</b>	<b>8,560,838</b>	<b>NET PROFIT</b>	<b>372,875</b>
<b>EQUITY</b>			
Capital	7,727,188		
General Reserve	460,775		
Retained Earnings	372,875		
<b>TOTAL EQUITY</b>	<b>8,560,838</b>		

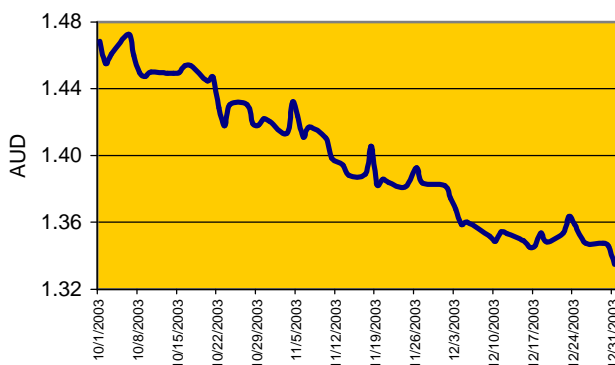
# Foreign Exchange markets

Latest developments

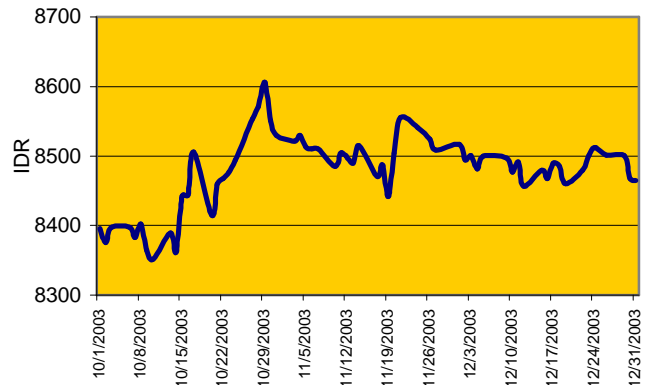
In the top left graph, and in contrast to the remaining graphs, figures are depicted as indexes and not as nominal values. As a consequence, an upward movement evidences a devaluation of the USD vis-à-vis the currency against which it is quoted. In contrast, in the remaining three graphs, in which values are depicted as nominal values, a downward trend evidences a devaluation of the USD vis-à-vis the currency against which it is quoted.



AUD per USD  
(1Out - 31Dec2003)



IDR per USD  
(1Out - 31Dec2003)

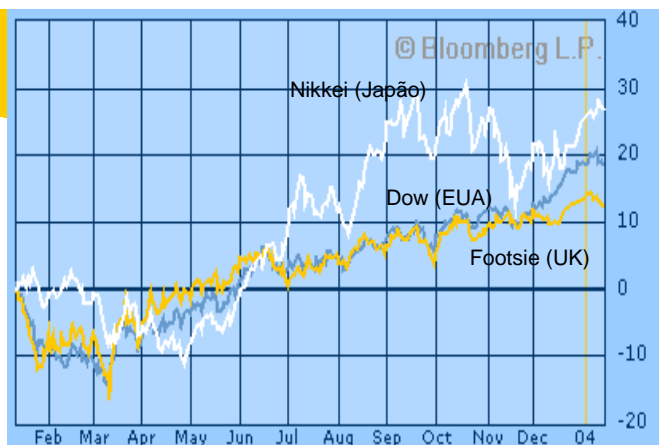


## Financial Markets

Stock Exchanges: latest developments

As evidenced in the graph attached (source: Bloomberg, a very well-know wire services agency) stock exchanges have been performing world-wise poorly during the first half of the year. Such a poor performance has been partly triggered by the uncertainty surrounding the Middle East conflict, hence pursuing further the overall negative trend registered since the first quarter of 2000.

By contrast, during the remainder of 2003, and in particular during the last quarter of the year, stock exchanges have undergone a gradual upward trend in the US, Japan and UK, thus concluding the year with a positive tone. Some positive developments related to the Middle East conflict, such as the capture of Saddam Hussein, have certainly contributed to such an upward trend experimented by stock exchanges.



And to conclude...

## Foreign Direct Investment and economic development

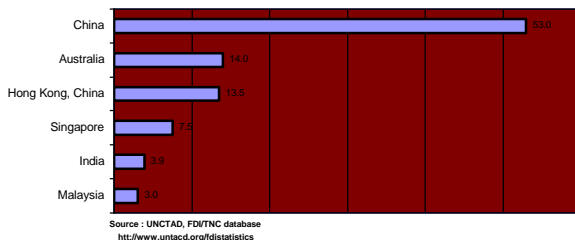
One of the main challenges developing countries are faced with in fostering economic development and fighting peverty relates to the availability or non-availability of the necessary human and financial capital resources. Let's leave aside the first one and therefore focus on the second one.

Financial resources may be ensured through two different means: an internal and an external one. Savings (private and public savings) represent the internal source of financial resources. The tax burden is instrumental in determining the auto-financing capacity of a country. In less developed countries, savings may account for around 20% of total national revenues while they may account for around 36% in more developed dynamic East Asian countries. Some of these countries may display particularly high saving ratios, e.g. China 40% and Malaysia 47% in 2001. In the second type of financial ressources, the external ones, are included external borrowings by the government or any other economic agent (enterprises and consumers), transfers from donors (third countries or international institutions), of which Timor-Leste has been benefiting substantially since 1999, and foreign investments stemming from foreign enterprises, the so-called Foreign Direct Investments (FDIs).

The benefits stemming from FDIs are significant: However they entail also some drawbacks ...Still, the overall benefits clearly offset the drawbacks, also because of the scarcity of alternative options.

The benefits lie for example with the fact that foreign enterprises provide the country with additional foreign reserves (which certainly contribute to balance trade relations), contribute to the jobs creation, grant access to more advanced technologies and in many cases contribute to increasing exports, thereby improving the penetration rate of national products into the international market. Equally

The Recipient of the foreign investment  
in Asia-Pacific region. 2002  
(billions of USD)



important is the fact that these enterpriese very often represent a market per se for other domestic enterprises, which sell their products to foreign enterprises thereby increasing the links between the various sectors of the economy.

One of the drawback that FDIs entail relates to the fact that at some stage, profit repatriation (either partly or fully) may

take place and may be particularly detrimental to the hosting country when the size and weight of the foreign enterprise is critical enough compared to the overall size of the economy. Indeed, the closing up of such a foreign enterprise might be disastrous jobs and exports-wise.

The last but not least, one should bear in mind that the presence of foreign enterprises in a country might be detrimental to the domestic enterprises. Indeed, when foreign enterprises overweight domestic enterprises, the economico-financial balance between the two groups may easily be put at risk. However, to prohibit the entry of foreign enterprises is certainly not a solution through which the issue is to be tackled. Indeed, foreign enterprises may contribute to improve efficiency of the private sector and contribute to more competitive prices. They also may contribute to set up best practices and represent good joint-ventures opportunities, of which domestic enterprises could take some benefit.

However, the benefits stemming from FDIs largely offset the drawbacks and this is indeed the reason why a fierce competition exists among countries to attract such inflows. Some countries are very keen on developping some specific activities so as to attract these investments. In this respect, Singapore is a relevant example.

### Two differing strategies towards FDIs: China open and India (almost) closed.

From 1990 to 2002, FDIs flows to China grew from USD 3.5 billion to USD 40 billion (aready deducting investment from locations abroad by Chinese investors). Those to India rose from USD 0.4 billion to USD 5.5 billion during the same period.

As a result, foreign enterprises in China currently account for 50% of total exports of the country, while they accounted for only 9% in 1989. In contrast, in India only 10% of total exports are generated by reign enterprises (3% at the beginning of the 90s).

China is much more open than India to FDIs, the latter having pursued for a long time a protective policy towards domestic enterprises or national enterprises located abroad. In doing so, India aimed at providing some alternatives to imports instead of being export-oriented as favoured by China and by a majority of East Asian countries.

As a consequence of such diverging policies towards FDI, in 2002 FDIs amounted to 10% of the annual investment in China, while they amounted to only 6% in India. Furthermore, FDIs accounted for 36% of GDP in China (versus 7% in 1990), while they accounted for only 8% (0.6% in 1990).

Such diverging strategies towards FDIs may partly explain some of the disparities observed over the last 25 years with regard to the economic performance registered in two countries. In China, per capita GDP has increased at a stronger pace than in India. Indeed, per capital GDP in India amounted to USD 668 in 1980 (in Purchasing Power Parity terms) almost 50% more than the one exhibited by China t that time, USD 464. However, in 2000, the trend has been inverted with China exhibiting a per capita GDP of almost USD 4000 against USD 2400 for India. Per capita GDP in China is around 70% higher than the one of India, being as much as 8.6 times higher than 20 years ago, while it has only trebled in China!

This is the ability to booster economic growth which turns FDIs so attractive and triggers fierce competition among countries so as to attract those.

Fonte: UNCTAD *World Investment Report 2003*, box II.4, pgs 43

This publication is prepared by the Economic Studies and Statistics Division of the Banking and Payments Authority of Timor Leste  
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