GAMBLING HABITS DIE HARD

August 2016

The East Timor Petroleum Fund Report for 2015 was released in mid-August 2016.

******

Analysis of the report

- As of December 31st, 2015, the Petroleum Fund value had decreased by **–US$390,474,589**, despite receipts from oil and gas production of **+US$1,003,813,967**.

- The **loss on foreign exchange** is reported as being **–US$302,027,185** (it was **–US$425,542,866** in 2014)

- The **net loss on all financial assets** is reported as being **–US$21,060,960** (in **2014** there was an appreciation of +**US$627,313,626**). There is no detail in the report of what the loss consists of.

- **Overall equity value** decreased by **–US$155,776,892**

- **Overall fixed interest security value** decreased by **–US$234,910,978**

- **The value of derivatives increased by +US$213,281**

It is quite impossible to reliably trace the origin of the financial losses in the report, and in addition there are several errors in the equity security pages, but some dependable information could be deduced from the analysis of other figures:

- Withdrawal from the Petroleum Fund is reported as being **–US$1,278,500,000**

- Petroleum Fund receipts were **+US$1,003,813,967**

- Tax refunds were **–US$24,947,282**

- Dividends, interest, and other investment incomes were **+US$326,710,056**

- Financial fees and expenses were **–US$15,666,429** the total being **+US$11,410,312.** That is the amount by which the Petroleum Fund would have increased if the value of securities had remained unchanged

On the other hand, cash and cash equivalent increased by **+US$68,334,669**.

In fact the Fund decreased by **–US$390,474,589**, which means that securities actually lost during the period a value of **–US$390,474,589 – US$11,410,312 +US$68,334,669** = **–US$333,550,232.**

If the foreign exchange loss was **–US$302,027,185**, then the loss on security value, irrespective of the currency, is **–US$333,550,232 + US$302,027,185 = –US$31,523,047**, a value reasonably in line with the **–US$21,060,960** of the report.

Additionally, although inflation in the U.S. was extremely low, it was still 0.10% in 2015, which represents an extra **–US$16,076,302** loss.

******

To summarize:

1. Financial losses were **–US$333,550,232**, foreign exchange and equity combined, and **–US$349,626,534** when counting erosion due to inflation. That's one year of true non-petroleum East Timorese GDP. In 2014, the foreign exchange loss was **–US$425,542,866**, but financial gains were **+US$627,313,626**

2. The value of the Fund dropped by **–US$390,474,589**

******

From a close analysis of the accounts, it seems that of the total **US$300** million or so foreign exchange loss, about **US$115** million were incurred by fixed interest securities and **US$185** million by equities. If compounded with the overall net financial loss of about **$30** million, fixed interest securities lost probably **US$120** million and equities **US$210** million.

However, in the final accounts fixed interest securities decreased by **US$235** million and equities by **US$156** million, which means that **US$115** million worth of bonds were sold and **US$54** million worth of equities were purchased, the balance of **US$61** million being transferred to the cash accounts.

Not only is the sale of securities for cash quite contrary to the essence of the Petroleum Fund, it seems that to add insult to injury the managers of the Fund divested fixed interest securities in order to buy more equity and maintain the ratio between the two. An opportunity was lost to let the Fund find its equilibrium with increased fixed interest securities and decreased equity.

******

If there had been no diversification of assets, the Fund would have saved **+US$275,062,814** ***(****US$333,550,232 – US$58,487,418, this last figure being the difference between dividends earned from equity and interest the same amount of bonds would have earned}*. That's almost one year of true non-petroleum GDP.

The 2010 decision to diversify assets in the Petroleum Fund has so far cost the people of East Timor about a billion U.S. dollars. The rationale behind the decision to diversify was officially to protect the Fund against financial and foreign exchange risk, although it remains quite challenging to understand what risk was incurred by a country whose national currency is the U.S. dollar and who receives all its revenue in U.S. dollars.