Management of the Government Petroleum Fund
Report for the second quarter of 2005

Summary

The return on the Government Petroleum Fund in the second quarter of 2005 was 3.83 per cent measured in terms of the currency basket that corresponds to the composition of the Fund's benchmark portfolio. The overall return in the first half of 2005 was 4.91 per cent.

The return on the equity portfolio was 4.87 per cent in the second quarter. Equity markets in Europe and the US experienced an upswing, while stock prices in Japan were stable for the quarter as a whole. The return on the fixed income portfolio was 3.10 per cent measured in terms of the currency basket. Bond prices rose in all the main markets - the US, Europe and Asia.

In the second quarter of 2005, the return on the Petroleum Fund's portfolio was 0.18 percentage point higher than the return on the benchmark portfolio defined by the Ministry of Finance. The overall excess return in the first half of 2005 was 0.33 percentage point.

The market value of the Fund's combined portfolio of securities was NOK 1 183.9 billion at the end of the second quarter, an increase of NOK 93.8 billion during the quarter. The increase in the Fund's market value is a result of a positive return, NOK 42.5 billion measured in international currency, and the supply of new capital, NOK 55.1 billion. A stronger krone in relation to the investment currencies reduced the market value of the Fund by NOK 3.8 billion. A change in the krone exchange rate has no effect, however, on the Fund's international purchasing power.

1. Key figures

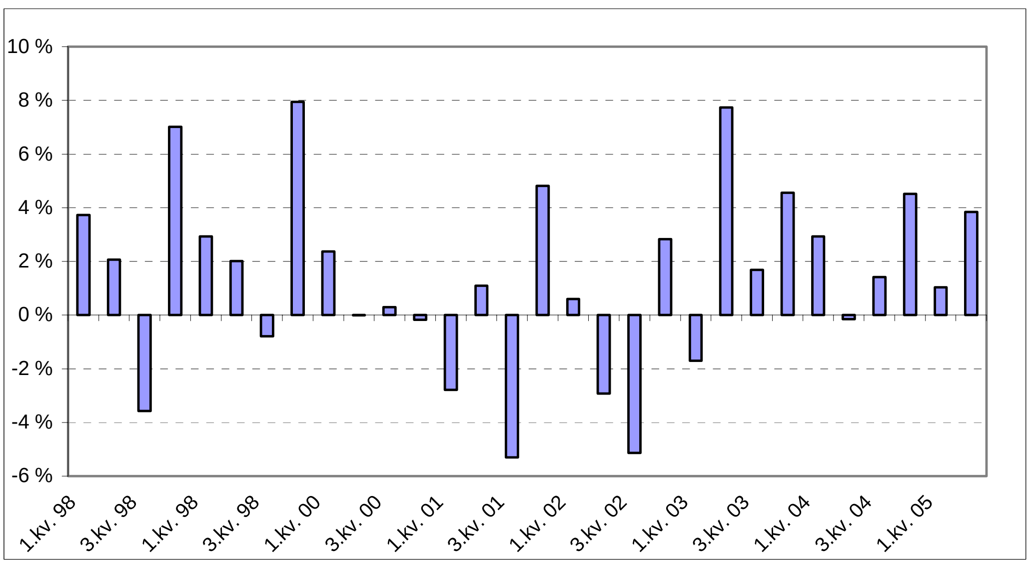
The return on the Government Petroleum Fund in the second quarter of 2005 was 3.83 per cent, measured in terms of the currency basket corresponding to the composition of the Petroleum Fund's benchmark portfolio. In terms of the benchmark portfolio's currency basket, the return on the equity portfolio was 4.87 per cent during the quarter, while the return on the fixed income portfolio was 3.10 per cent. Table 1 shows return figures measured against various currencies.

Table 1: Return on the Petroleum Fund in the second quarter of 2005 measured against various benchmark currencies. Per cent

	Equities	Fixed income instruments	Total
Fund's currency basket	4.87	3.10	3.83
Import-weighted currency basket	6.96	5.15	5.91
USD	0.90	-0.80	-0.09
EUR	8.33	6.50	7.26
NOK	4.47	2.71	3.44

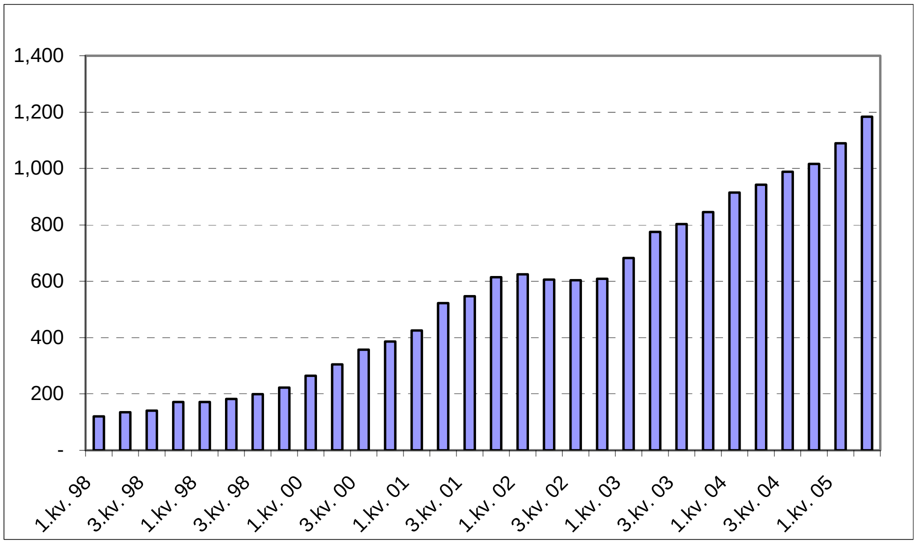
Since the first equity investments were made in 1998, the average quarterly return has been 1.43 per cent. Chart 1 shows the quarterly return.

Chart 1: Quarterly return on the Petroleum Fund measured in terms of the benchmark portfolio's currency basket. Per cent



Since 1 January 1998, the Petroleum Fund has grown by NOK 1 071 billion (see Chart 2). During these years, NOK 927 billion has been added to the Fund. The return measured in international currency has increased the value of the Fund by NOK 230 billion, whereas a stronger krone in relation to the investment currencies has reduced the value of the Fund by NOK 86 billion during the period. A change in the krone exchange rate has no effect, however, on the Fund's international purchasing power.

Chart 2: The market value of the Petroleum Fund 1998-2005. In billions of NOK



Since 1 January 1997, the annual net real return on the Petroleum Fund (after deductions for management costs and price inflation) has been 4.18 per cent. Table 2 shows the return up to the end of the second quarter of 2005, annualised from 1 January for each of the years 1997-2004. Price inflation is a weighted average of consumer price inflation in the countries represented in the benchmark portfolio.

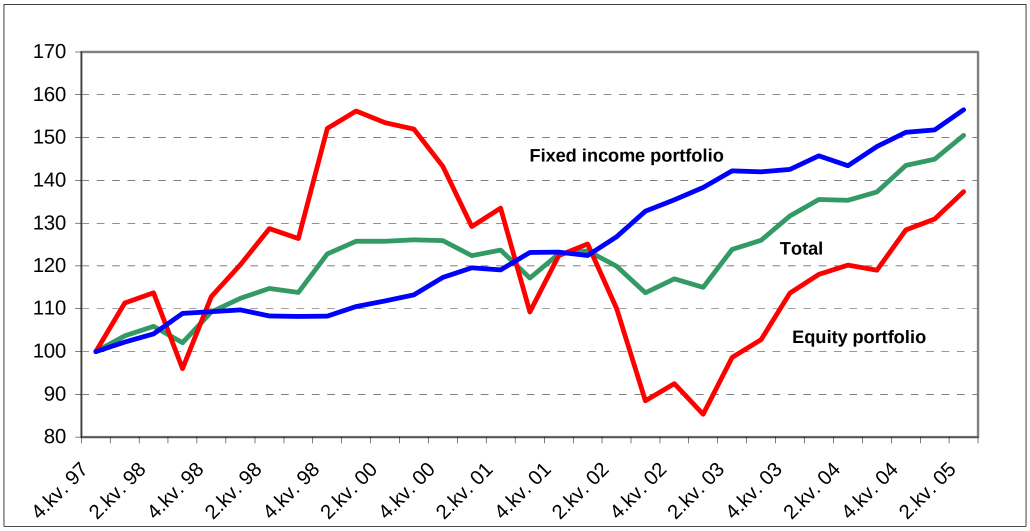
Table 2: Annual rates of return for the Petroleum Fund to the end of the second quarter of 2005. Measured in terms of the benchmark portfolio's currency basket. Per cent per year

	Gross annual return	Annual price inflation	Annual management costs	Annual net real return	Annual gross excess return
From 01.01.97	6.01	1.67	0.09	4.18	0.44
From 01.01.98	5.60	1.65	0.09	3.80	0.46
From 01.01.99	5.05	1.77	0.09	3.14	0.50
From 01.01.00	3.76	1.86	0.09	1.78	0.37
From 01.01.01	4.05	1.82	0.10	2.09	0.39
From 01.01.02	5.99	2.01	0.10	3.80	0.47
From 01.01.03	10.61	2.05	0.10	8.29	0.58
From 01.01.04	9.31	2.36	0.11	6.68	0.58

The return achieved by Norges Bank on the actual portfolio is measured in relation to the return on the benchmark portfolio defined by the Ministry of Finance. The difference between the return figures reflects the gross excess return achieved by Norges Bank. The right-hand column of Table 2 shows that the average gross excess return has been 0.44 percentage point per year since 1 January 1997.

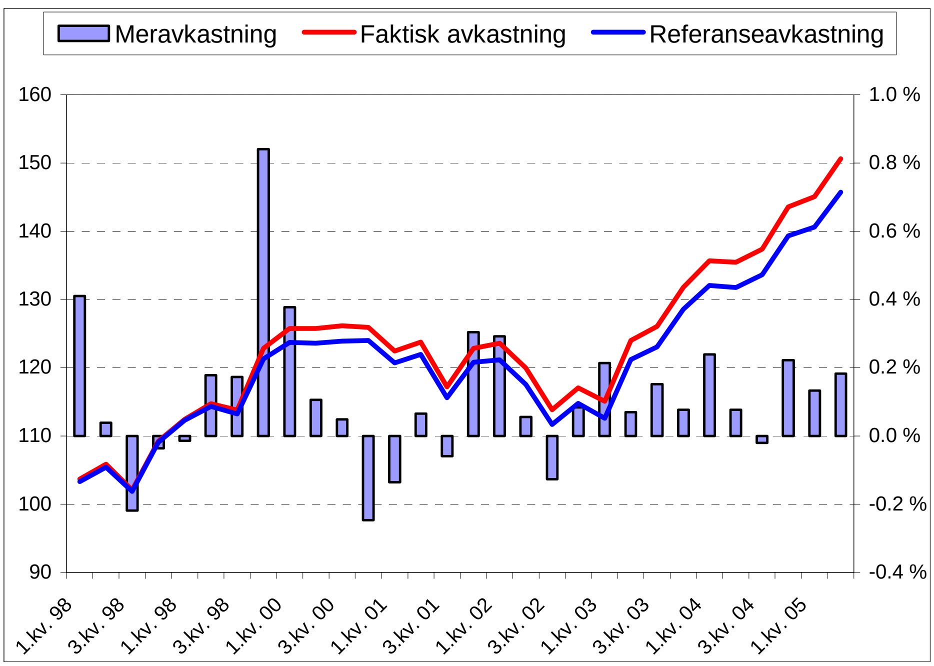
The cumulative return on the Petroleum Fund from 1 January 1998 until the end of the second quarter of 2005 has been 50.5 per cent (see Chart 3). During this period, the cumulative return has been 37.4 per cent on the equity portfolio and 56.5 per cent on the fixed income portfolio.

Chart 3: Index for cumulative return on the sub-portfolios in the Petroleum Fund (1998-2005)



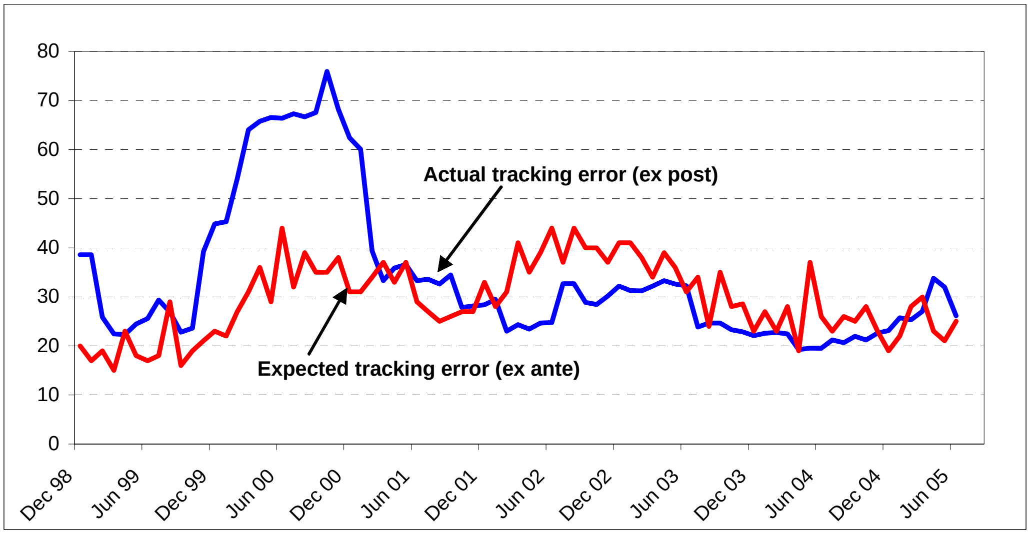
Since 1998, the cumulative return on the benchmark portfolio has been 45.6 per cent whereas the actual return has been 50.5 per cent (see Chart 4). The cumulative gross excess return measured in terms of the currency basket has been 4.9 percentage points, which corresponds to NOK 17.6 billion.

Chart 4: Index for cumulative actual return and benchmark return measured in terms of the currency basket (left-hand axis) and quarterly gross excess return in percentage points (right-hand axis)



The Ministry of Finance has set a limit on the extent to which the Fund's portfolio can differ from the benchmark portfolio. This has been accomplished by setting a limit for the expected deviation between the returns on the actual portfolio and the benchmark portfolio. This limit for relative market risk in the management of the Petroleum Fund has been at 1.5 percentage point tracking error (explained in Section 5 below). The red line in Chart 5 maps developments in expected tracking error since December 1998.

Chart 5: Expected relative tracking error and actual tracking error at the end of each month in the period 1999 – 2005. Basis points



In retrospect, we can use the variation in the difference between the returns on the actual and benchmark portfolios (i.e. the variation in excess return) as a measure of actual relative market risk in the period (the blue line in the chart). This tracking error is annualised using 12-month rolling windows.

Both expected tracking error and actual tracking error may fluctuate considerably, even when the degree of active management is unchanged. This is because the measures are influenced by various market developments, such as changes in market volatility and changes in correlations between the various asset classes and securities. Tracking error has consistently remained well below the limit for relative market risk in the Petroleum Fund's portfolio that has been stipulated by the Ministry of Finance.

The information ratio is a measure of skill in the operational management. This ratio is the ratio between the gross excess return for the year and relative market risk (measured here as the actual standard deviation of the return differential). The average information ratio for the Fund from the first quarter of 1998 to the second quarter of 2005 has been 1.19, annualised. Table 3 provides a historical overview of the information ratio for the Fund as a whole and for each asset class.

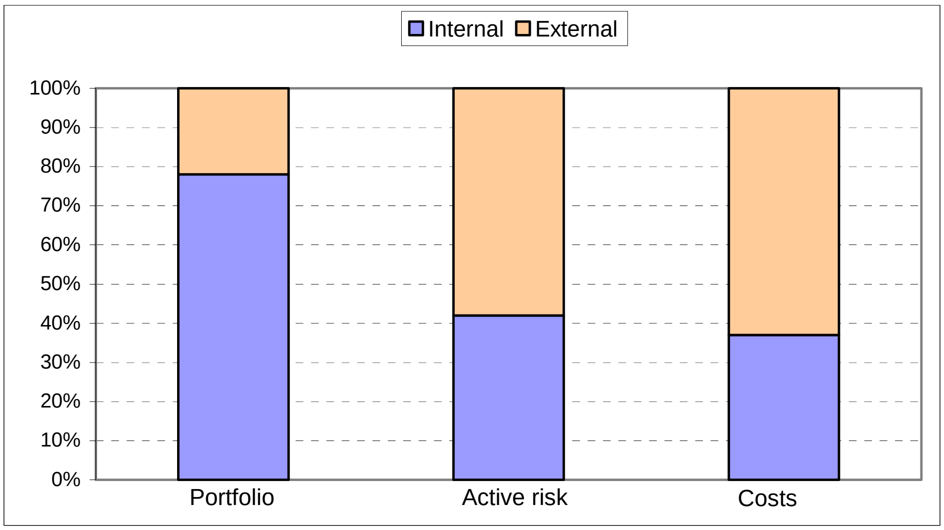
Table 3: Information ratios

Period	Petroleum Fund	Equities	Fixed income instruments
Last 12 months	1.71	1.04	3.22
Since 2002	1.80	0.99	3.39
Since 1999	1.31	1.07	1.92

At the end of the second quarter, 22 per cent of the Petroleum Fund was managed by external investment managers. Costs associated with external management accounted for 63 per cent of total management costs. External management accounted for approximately 58 per cent of the overall risk associated with active management (see Chart 6).

The external managers are primarily engaged in active management, whereas a larger part of the internal management is based on enhanced indexing. Active management is clearly more expensive than index management. One of the reasons for this is that unit costs in external management are far higher than unit costs in internal management. However, comparable management (active or passive) is also less expensive when internal rather than external managers are used. External managers with specialised expertise are used to achieve sufficient breadth and scope in the active management, and the excess return from external managers has clearly surpassed the additional costs.

Chart 6: Distribution of portfolios, management costs and active risk* between internal and external management. Per cent



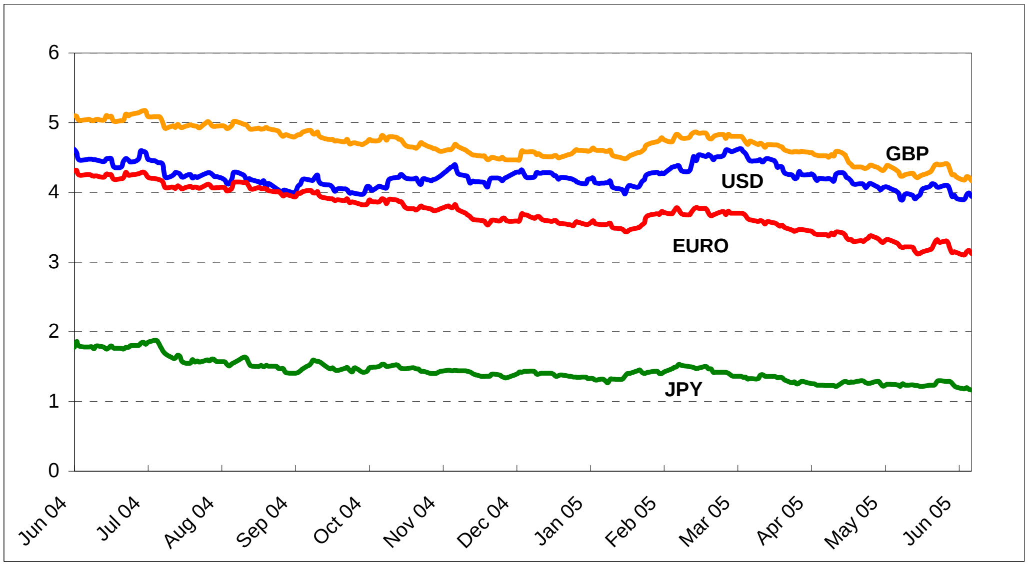
*There is no absolutely correct method of calculating the distribution of active risk. The distribution in the chart is based on summation of the value at risk (VaR) of each mandate, disregarding the correlation between mandates.

2. Market developments

Fixed income markets

The main markets were characterised by falling bond yields in the second quarter. Ten-year government bond yields fell by more than 0.50 percentage point in the US and Europe, whereas in Japan bond yields fell by approximately 0.15 percentage point in Japan (see Chart 7).

Chart 7: Developments in the most important bond markets in the last 12 months. Yields on government bonds with approximately 10 years to maturity. Per cent per year



The fall in long-term US government bond yields reflects somewhat slower economic growth which is a result of reduced growth in domestic demand and a further deterioration in the balance of trade. Unrest in the market for bonds with credit risk has also resulted in relatively higher demand for government bonds.

The Federal Reserve continued its gradual monetary tightening and increased the federal funds rate by 0.5 percentage point to 3.25 per cent during the second quarter. The increase was prompted by fairly robust economic growth, a decline in unemployment and the risk of accelerating inflation. Since June 2004, the federal funds rate has been increased by 2.25 percentage points. The Federal Reserve has indicated that it will gradually increase the federal funds rate until it reaches a neutral level for monetary policy.

Europe also experienced a decline in bond yields through the quarter. This reflects low economic growth, particularly in Germany and Italy. The result of the referendums about the new EU Constitution has created uncertainty about the future of the EMU and may have contributed to a further decline in bond yields.

The decline in bond yields was far more moderate in Japan than in the US and Europe. Key macroeconomic aggregates in Japan also indicated a slight decline in economic growth. Figures for consumer price inflation have also shown a falling trend over the last quarter.

Chart 8: Movements in Lehman Global Aggregate government bond indices in the main markets during the last 12 months (31.12.04 = 100)

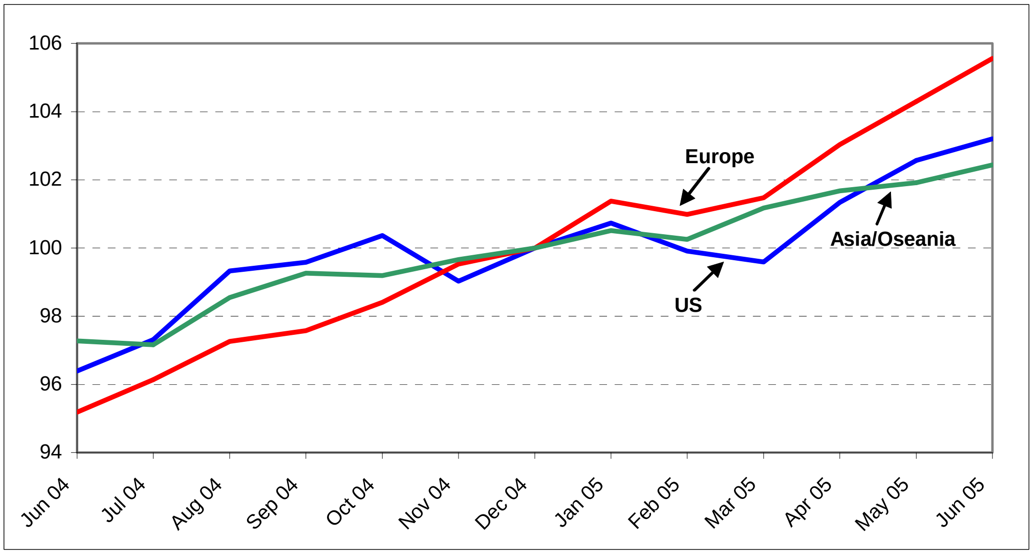
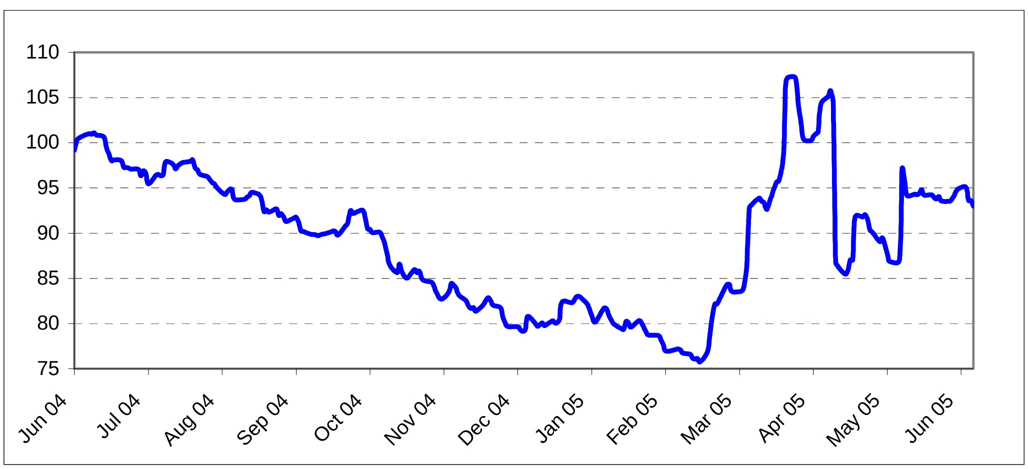


Chart 8 shows developments in the Lehman Global Aggregates government bond indices in the main markets during the last 12 months. Yields in the second quarter of 2005 were 4.0 per cent in Europe, 1.3 per cent in Asia and 3.6 per cent in the US.

The yield spread between corporate securities and government securities (credit spread) in the US has varied considerably in the last months, and widened somewhat in the second quarter as a whole (see Chart 9). The increase in the credit spread from mid-March to mid-May was partly due to a profit warning from General Motors (GM). This led to expectations that credit rating agencies would downgrade GM, which could have a negative impact on credit markets. Standard & Poor's downgraded GM and Ford at the beginning of May to below investment grade. From mid-May there was a slight decline in the credit spread, which was probably related to a general upswing in the equity markets.

Chart 9: The difference between yields on corporate securities[1] and government securities in the US

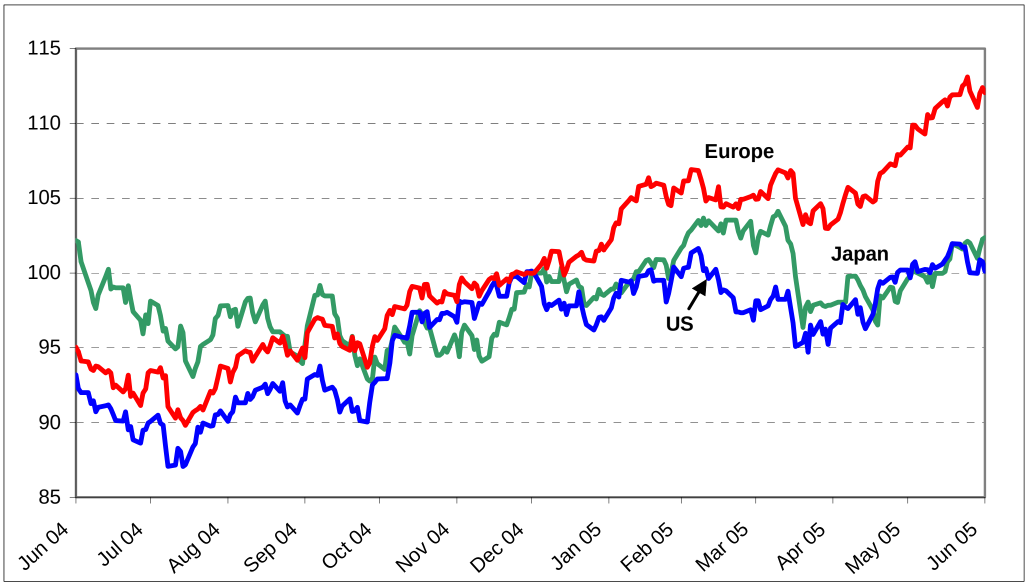


Equity markets

[1] Companies with credit rating AAA from Standard &Poor's

The beginning of the second quarter was marked by falling equity prices in the main markets, especially in Japan where the stock market declined by more than 7 per cent in the course of 10 days at the beginning of April. At the end of April, the falling trend was reversed and both the US and Europe experienced a rise in market prices for the quarter as a whole. Measured by the FTSE index, equity markets rose by 6.8 per cent in Europe and 2.0 per cent in the US. The equity market in Japan was stable for the quarter as a whole.

Chart 10: Movements in the FTSE equity indices for the main markets during the last 12 months. (31.12.04 = 100). In local currencies



The price of oil continued to rise in the second quarter, boosting earnings expectations for oil and energy companies. The rise in equity prices has been highest for companies in these sectors during the quarter. The European stock exchanges are more heavily exposed to these sectors than the US stock exchanges and this has contributed to stronger growth in the European stock exchange indices. A weakening of the euro in relation to the US dollar also contributed to a rise in equity prices in European markets.

Developments in the technology sector have been relatively weak during the last quarter. In Asia, production capacity has been increased considerably even though there has not been a comparable increase in demand. There is increasing pressure on prices for most mobile services while there has been little development in the range of services. Cable companies have also become part of the telecommunications market, thus intensifying the competition for traditional market players.

Table 4 shows equity price movements in the main sectors and in the ten largest sub-sectors of the FTSE world index in the second quarter of 2005. Equities in the resources and utilities sectors have posted the most substantial price rise. Sub-sectors related to oil production and the processing of petroleum products have made a strong contribution to the rise in prices.

Table 4: Return on the main sectors and the ten largest sub-sectors in the FTSE All-World Index in the second quarter of 2005. Measured against USD, NOK and the benchmark portfolio's currency basket. Per cent

	USD	NOK	Currency basket
Resources	**3.55**	**7.21**	**7.62**
- of which oil and gas	4.41	8.10	8.51
Basic industries	**-3.41**	**0.00**	**0.38**
General industrials	**-1.27**	**2.22**	**2.61**
Cyclical consumer goods	**-1.37**	**2.12**	**2.51**
Non-cyclical consumer goods	**2.39**	**6.02**	**6.42**
- of which pharmaceuticals and biotechnology	4.17	7.86	8.27
Cyclical services	**-2.05**	**1.41**	**1.80**
- of which retail trade	0.33	3.88	4.27
- of which media and photo	-4.52	-1.14	-0.77
Non-cyclical services	**-0.18**	**3.36**	**3.75**
- of which telecommunications	-0.41	3.11	3.50
Utilities	**6.55**	**10.32**	**10.73**
Financials	**1.45**	**5.03**	**5.43**
- of which banks	0.50	4.05	4.45
- of which insurance companies	0.16	3.70	4.10
- of which financial institutions	2.91	6.55	6.95
Information technology	**2.58**	**6.21**	**6.61**
- of which hardware	4.27	7.96	8.37
- of which software and computer services	-0.35	3.17	3.56

3. Management of the portfolio

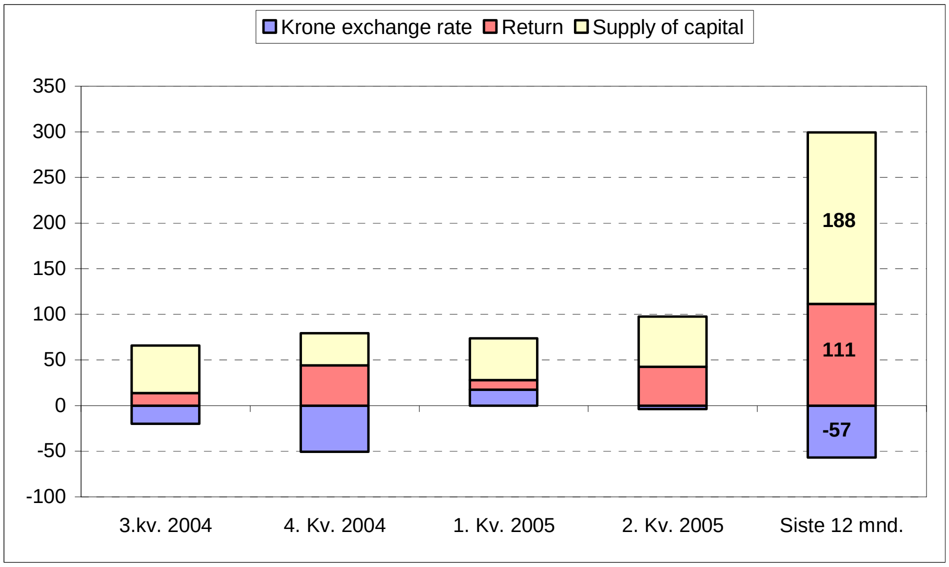
At 30 June 2005, the market value of the Petroleum Fund's international portfolio was NOK 1 183.9 billion. During the second quarter, the Fund's market value rose by NOK 93.8 billion. Table 5 presents the market value at the end of the last four quarters, and the change in market value in the second quarter of 2005 due to transfers, return in international currency and changes in the international value of the Norwegian krone.

Table 5: Market value of the Petroleum Fund's sub-portfolios at the end of the last four quarters, and changes in market value in the second quarter of 2005. In millions of NOK

	Equity portfolio	Benchmark portfolio	Petroleum Fund total
30 June 2004	391 858	550 499	942 357
30 September 2004	392 938	595 203	988 141
31 December 2004	416 298	600 104	1 016 402
31 March 2005	**435 467**	**654 674**	**1 090 141**
Transfers	16 343	38 754	55 097
Return	22 109	20 358	42 467
Change in krone value	- 1 483	- 2 294	- 3 777
30 June 2005	**472 436**	**711 491**	**1 183 927**

The Petroleum Fund has increased by NOK 242 billion during the last 12 months (see Chart 11). NOK 188 billion has been transfered to the Fund, the return on the Fund has been NOK 111 billion, and a stronger krone in relation to the investment currencies has reduced the value of the Fund by NOK 57 billion. The chart shows that the appreciation of the krone was most pronounced in the fourth quarter of 2004. The return measured in international currency was highest in the fourth quarter of 2004 and the second quarter of 2005.

Chart 11: Quarterly change in the market value of the Fund in the last 12 months due to supply of capital, returns and the effects of changes in the international value of the Norwegian krone. In billions of NOK



Please refer to Appendix 1 for a description of both the management mandate and the composition of the benchmark portfolio. Effective 31 May 2005, the Ministry of Finance decided that Kerr-McGee Corporation, a US company, should be excluded from the Petroleum Fund's investment universe. The decision, which was based on a recommendation from the Petroleum Fund's Advisory Council on Ethics, was in accordance with the ethical guidelines that entered into force on 1 December 2004. The background for the exclusion is discussed in more detail in a press release issued by the Ministry of Finance on 6 June 2005.

Companies that are excluded from the Petroleum Fund's investment universe

Name	Country	Date of exclusion
Singapore Technologies Engineering Ltd.	Singapore	26 April 2002
Kerr-McGee Corporation	US	31 May 2005

Management of the fixed income portfolio

The market value of the fixed income portfolio increased by NOK 56.8 billion to NOK 711.5 billion in the second quarter. At the end of the quarter, about 90 per cent of the fixed income portfolio was managed internally by Norges Bank. There are two types of management, enhanced indexing and active management. Both external and internal mandates have been established to manage the portfolio.

Enhanced indexing is used to manage three sub-portfolios: government guaranteed bonds, corporate bonds and securitised bonds. Most of the index portfolio is managed internally, whereas US mortgage-backed bonds are indexed by external managers.

About 10 per cent of the fixed income portfolio is managed by external managers. This portion includes the mandates for US mortgage-backed bonds and active mandates with a variety of strategies for outperforming the benchmark.

In the second quarter of 2005, capital was transferred to two new mandates assigned to external managers. Barclays Global Investors N.A. and PanAgora Asset Management Inc. have been awarded specialist mandates in the US.

Management of the equity portfolio

At the end of the second quarter, the market value of the equity portfolio was NOK 472.4 billion, an increase of NOK 37.0 billion since the beginning of the quarter.

At the end of the second quarter, just under 60 per cent of the equity portfolio was managed internally in Norges Bank. All internal equity portfolios are managed actively and with analysis-based active management in the financial, telecommunications, energy, media and trade sectors. Global sector allocation mandates and enhanced indexing mandates are also managed internally.

In the second quarter of 2005, capital was transferred to three new regional mandates assigned to external equity managers: APS Asset Management Pte Ltd., Fidelity Pensions Management and Schroder Investment Management Limited.

4. Return on the Petroleum Fund

In the second quarter of 2005, the return on the Petroleum Fund was 3.83 per cent, measured in terms of the benchmark portfolio's currency basket (see Table 6). The return was negative in April but positive in May and June following the upswing in the equity markets. Measured in NOK, the total return in the second quarter was 3.44 per cent. The difference is due to the approximately 0.4 per cent appreciation, on average, of the krone against the currencies in the benchmark portfolio during the quarter. This has no effect, however, on the international purchasing power of the Fund.

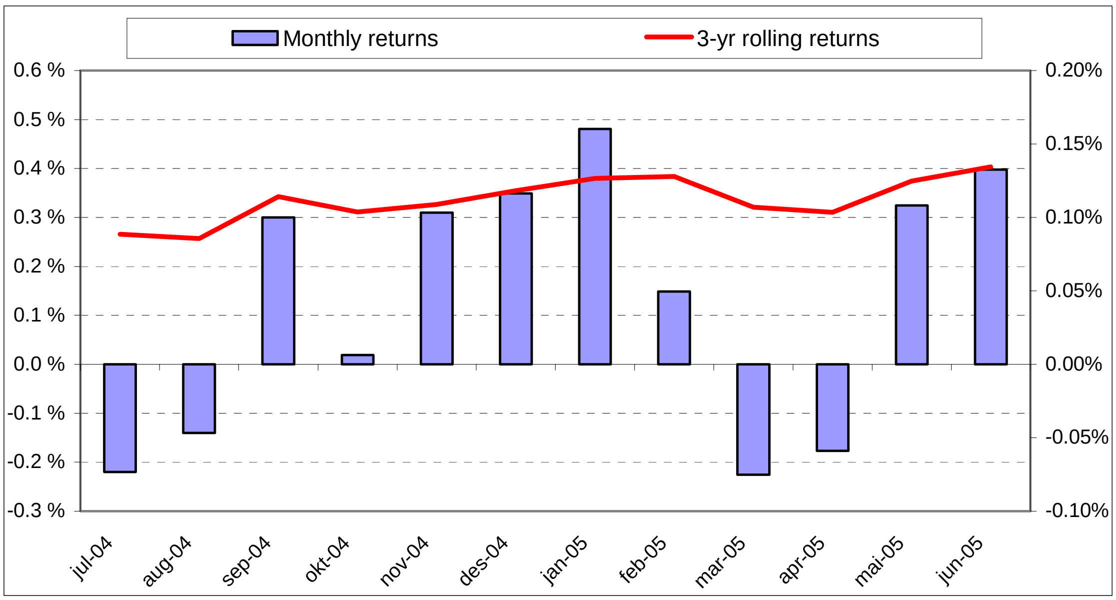
Table 6: Return on the Petroleum Fund. Actual and benchmark portfolios in the second quarter of 2005. Per cent

	Return measured in terms of the benchmark currency basket		**Return measured in NOK**		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Excess return
Q1	**1.03**	**0.90**	**2.76**	**2.63**	**0.13**
April	-0.20	-0.14	-0.55	-0.49	-0.06
May	2.39	2.28	1.60	1.49	0.11
June	1.61	1.48	2.38	2.25	0.13
Q2	**3.83**	**3.65**	**3.44**	**3.26**	**0.18**
Year to date	**4.91**	**4.59**	**6.30**	**5.97**	**0.33**

During the second quarter, the excess return on the Petroleum Fund was 0.18 percentage point in relation to the benchmark portfolio or approximately NOK 2.1 billion. Contributions to excess return came primarily from external equity management.

In the last 12 months, the cumulative excess return has been 0.53 percentage point. In the last three years to the end of the second quarter of 2005, the annualised excess return has been 0.47 percentage point (see Chart 12).

Chart 12: Monthly (right-hand scale) returns and 3-year rolling returns (left-hand scale). Per cent

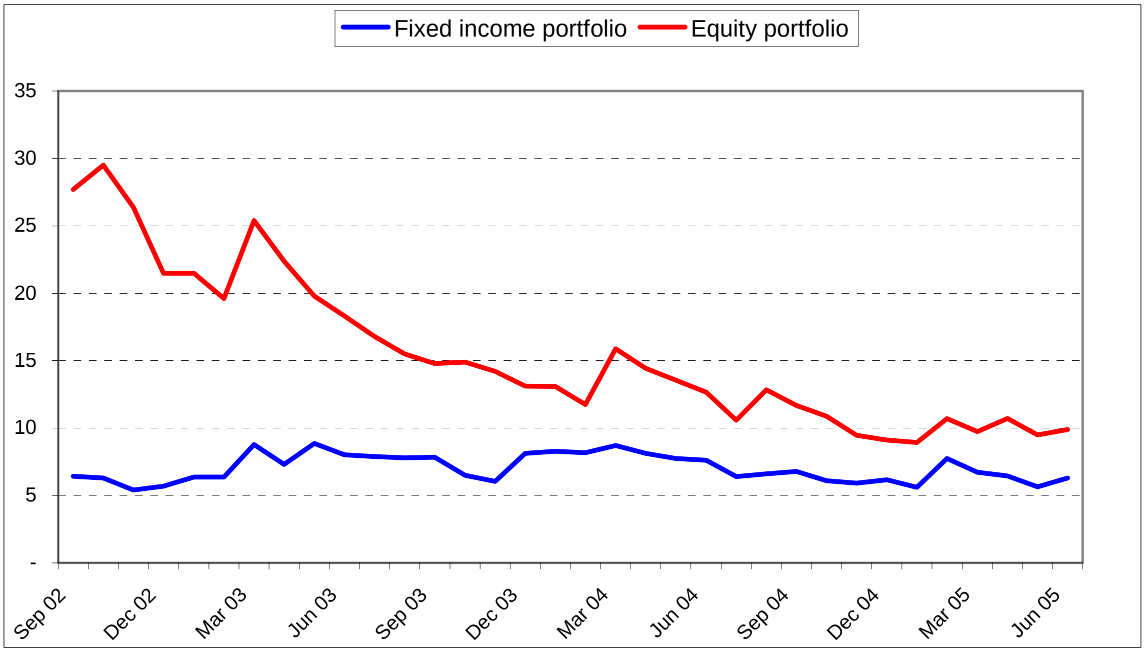


The return figures presented in this report have not been adjusted for costs associated with phasing in new capital. Norges Bank has estimated the direct and indirect transaction costs associated with phasing in new capital in the second quarter of 2005 at NOK 121.6 million. This amounted to 0.22 per cent of the total amount transferred, i.e. NOK 55.1 billion, and 0.01 per cent of the market value of the Petroleum Fund at the beginning of the quarter. Appendix 2 provides information concerning the methodology for calculating transaction costs.

5. Risk

The Petroleum Fund's absolute market risk, measured as the expected tracking error of the return in NOK, fluctuates with market volatility. Chart 13 shows that the absolute tracking error for the equity portfolio at the end of the second quarter of 2005 was roughly one-third of the level measured at the end of 2002. Changes in the market risk associated with the fixed income portfolio have been less dramatic.

Chart 13: Absolute tracking error at each month-end. Basis points. In NOK

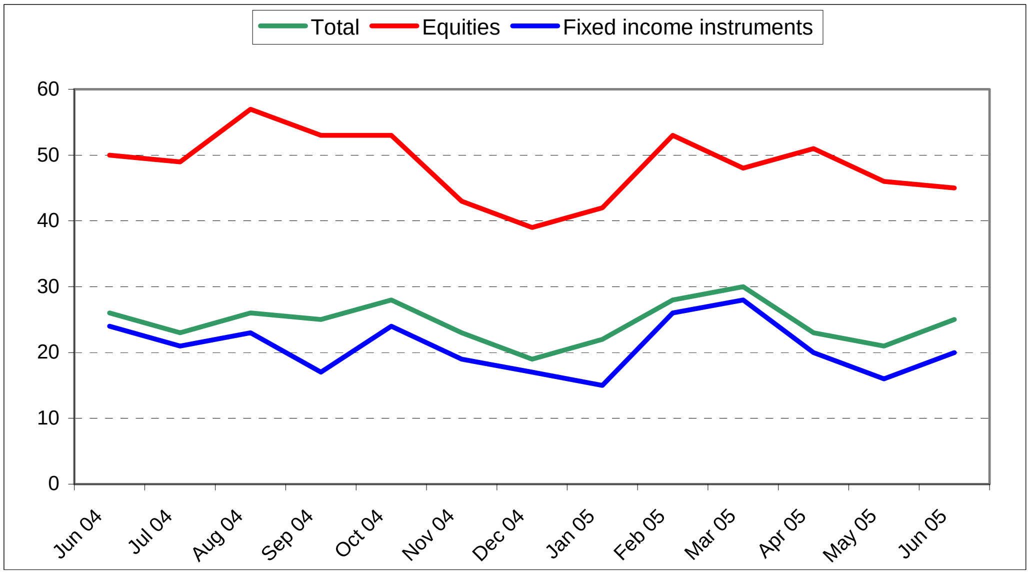


The Ministry of Finance has set a limit for the market risk in the actual portfolio relative to the benchmark portfolio. This relative market risk shall always be less than an expected tracking error of 1.5 percentage points (150 basis points), as measured in the RiskManager risk model. In the second quarter of 2005, relative market risk remained well within this upper limit. Expected tracking error has not been higher than approximately 30 basis points.

Expected tracking error

The Ministry of Finance has set the limit for relative market risk in the management of the Petroleum Fund in relation to the risk measure *expected tracking error*. This measure is defined as the expected value of the standard deviation of the difference between the annual returns on the actual portfolio and the benchmark. When deviations from the benchmark are controlled by means of an upper limit for expected tracking error, it is highly probable that the actual return will lie within a band around the return on the benchmark. The lower the limit for tracking error, the narrower the band will be. Given an expected tracking error of 1.5 percentage points or 150 basis points, the actual return on the portfolio will probably deviate from the benchmark return by less than 1.5 percentage points in two out of three years.

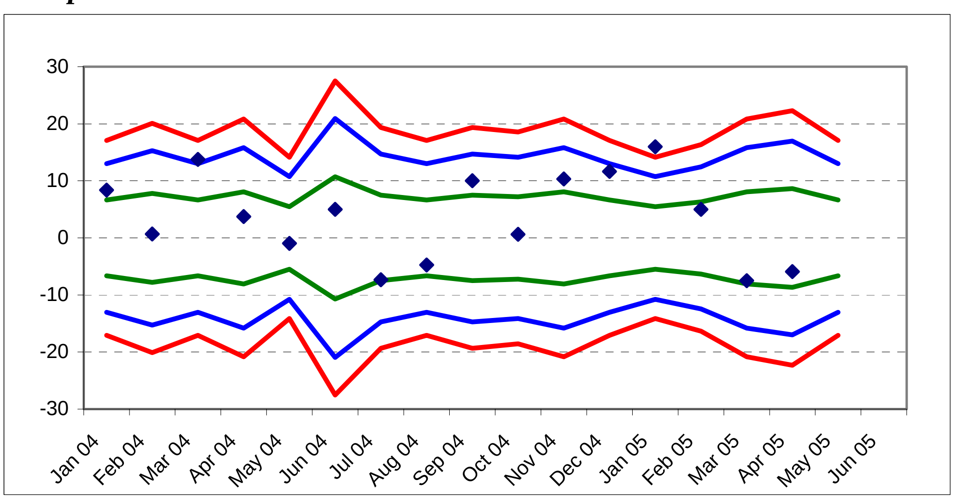
Chart 14: Expected tracking error at each month-end for the last 12 months. Basis points. Measured in NOK



Relative market risk is higher in equity management than in fixed income management. This reflects that equity markets fluctuate more than fixed income markets, so that there is more risk associated with an equity management position than with a fixed income position of the same size. It is also related to the fact that the scope of active equity management has been somewhat larger than the scope of active fixed income management.

Norges Bank is testing whether actual excess return on the Petroleum Fund varies in line with what might be expected based on the risk model used. This is illustrated in Chart 15. The chart shows the realised monthly excess return from January 2004 (diamonds) and the confidence interval measured by the standard deviation. The model indicates that in approximately 67 per cent of the cases, the actual return should be within the interval formed by the green lines. The equivalent for the orange and red intervals is 95 and 99 per cent respectively. The chart indicates that the actual return is in line with what might be expected based on the risk model used. Analyses of longer time series provide similar results.

Chart 15: Confidence interval for risk and realised excess return for the Petroleum Fund. Basis points



According to the Ministry of Finance's guidelines for credit risk, the Petroleum Fund may not normally be invested in securities with a credit rating lower than Baa from Moody's, BBB from S&P or BBB from Fitch. Nevertheless, up to 0.5 per cent of the fixed income portfolio may be invested in securities with ratings of Ba, BB or BB as the highest rating from one of the three agencies - Moody's, S&P or Fitch, respectively. Table 7 shows the composition of the bond portfolio (fixed income portfolio excluding cash) based on Moody's and Standard and Poor's (S&P) credit ratings.

Table 7: The fixed income portfolio at 30 June 2005, by credit rating. Per cent of market value

Moody's		Standard & Poor's	
Rating	Per cent of total	Rating	Per cent of total
Aaa	60.83	AAA	58.80
Aa	13.41	AA	18.01
A	16.54	A	10.65
Baa	5.46	BBB	6.19
Ba	0.18	BB	0.29
Lower	0.01	Lower	0.03
No rating *	3.57	No rating	6.03

* If a security has no rating from Moody's, it has an approved rating from one of the other agencies (S&P or Fitch). The same is the case for S&P.

In the table, government securities and government guaranteed bonds without credit ratings have been given the credit rating of the issuing country. In addition to bonds, the fixed income portfolio contains fixed income instruments with shorter maturities. These all have credit ratings of P-1 from Moody's and A-1 from S&P.

Through the Regulation on the Management of the Government Petroleum Fund and guidelines for investments, the Ministry of Finance has set limits for risk and exposure. Table 8 presents these risk exposure limits and the portfolio's actual exposure.

Table 8: Risk and exposure limits stipulated in the regulation and guidelines

	Risk	Limits	Actual				
			30.06.04	**30.09.04**	**31.12.04**	**31.03.05**	**30.06.05**
§ 4	Market risk	Maximum tracking error 1.5 percentage point	0.26	0.26	0.20	0.30	0.25
§ 5	Asset mix	Fixed income instruments 50-70%	58.5	60.3	59.0	60.1	60.1
		Equities 30-50%	41.5	39.7	41.0	39.9	39.9
§ 6	Market distribution equities	Europe 40-60%	47.3	50.0	49.0	49.4	47.7
		The Americas, Middle East/Africa, Asia and Oceania 40-60%	52.7	50.0	51.0	50.6	52.3
	New markets	< 5% of equity portfolio	2.6	2.7	3.0	3.3	3.6
	Currency distribution fixed income instruments	Europe 45-65%	54.8	55.3	56.0	54.4	54.7
		The Americas and the Middle East/Africa 25-45%	35.4	35.0	34.2	35.7	35.1
		Asia/Oceania 0-20%	9.7	9.7	9.8	9.9	10.2
§ 7	Interest rate risk	Modified duration 3-7	5.5	5.6	5.6	5.7	6.0
§ 11	Ownership stake	Maximum 3% of a company	2.7	2.6	2.7	2.6	3.0

Management has been in compliance with the risk and exposure limits stipulated by the regulation and the guidelines throughout the quarter.

6. Management costs

The Management Agreement between the Ministry of Finance and Norges Bank establishes the principles for Norges Bank's remuneration for managing the Petroleum Fund's portfolios. For 2005, remuneration shall cover the Bank's actual costs, provided that these costs are less than 0.10 per cent of the Fund's average market value. Fees to external managers for excess return achieved are also covered. Norges Bank has entered into agreements concerning performance-based fees with the majority of external active managers, in accordance with the principles approved by the Ministry of Finance.

In addition to the Petroleum Fund, Norges Bank Investment Management manages the Government Petroleum Insurance Fund and the bulk of Norges Bank's foreign exchange reserves. Fees to external managers and external settlement and custodian institutions are invoiced separately for each fund. The other operating costs are overheads shared by all the funds managed by Norges Bank Investment Management. The shared overheads are distributed among the three funds by means of a cost distribution key. Besides the direct costs of Norges Bank Investment Management, these overheads include the costs of support functions provided by other parts of Norges Bank. These latter costs are calculated in accordance with the guidelines that apply to business operations at Norges Bank.

Table 9: Management costs in the first half of 2005. In thousands of NOK and in basis points of the average portfolio

	First half of 2005		**First half of 2004 ***	
	NOK 1000	Per cent	1000 NOK 1000	Per cent
Internal costs, equity management	74 965		63 885	
Costs of equity custodians and fund administration	25 165		25 695	
Total costs, internal equity management	**100 130**	**0,08**	**89 580**	**0,08**
Internal costs, fixed income management	71 527		65 874	
Costs of fixed income custodians	28 412		14 929	
Total costs, internal fixed income management	**99 939**	**0,03**	**80 803**	**0,04**
Minimum fees to external managers	168 882		151 840	
Performance-based fees to external managers	116 046		82 916	
Other costs, external management	52 847		42 984	
Total costs, external management	**337 775**	**0,29**	**277 740**	**0,28**
Total all management costs	**537 844**	**0,10**	**448 123**	**0,10**
Total management costs, excluding performance-based fees	**421 798**	**0,08**	**365 207**	**0,08**

* The distribution of costs between internal and external management in the first half of 2004 has been reworked to provide comparable figures.

Annualised, costs during the first half of 2005 amounted to 0.10 per cent of the average market value of the Fund (see Table 9). Excluding performance-based fees to external managers, costs amounted to 0.08 per cent of the market value of the Fund, representing no change in relation to the first half of 2004. The ratio of costs to capital under management has changed very little from the first half of 2004 to the first half of 2005 for both internal and external management.

Costs are distributed between internal and external management by using a cost distribution key for internal costs and custodian costs. External management accounted for approximately 63 per cent of the costs, whereas about 22 per cent of the Fund's portfolio is managed externally. The unit cost of internal management was approximately 0.05 percentage point, compared with 0.29 percentage point for external management.

7. Reporting of accounts

Table 10 shows the distribution of different instruments as presented in Norges Bank's accounts at the end of the last five quarters. Off-balance sheet items are shown in a separate table. Table 11 shows the book return, which in the second quarter was NOK 38 694 million before deduction of Norges Bank's management fee.

Table 10: The Petroleum Fund's international portfolio distributed by instrument, at 30 June 2005. In thousands of NOK

	30.06.2004	30.09.2004	31.12.2004	31.03.2005	30.06.2005
Short-term assets, incl. deposits in foreign banks	-3 119 231	-9 314 439	9 154 482	16 610 470	4 603 337
Money market investments in foreign financial institutions against collateral in the form of securities	461 264 065	432 512 541	380 117 331	428 782 315	279 340 857
Borrowing from foreign financial institutions against collateral in the form of securities	-410 186 755	-429 229 543	-406 193 548	-414 346 235	-404 917 926
Foreign interest-bearing securities	510 284 611	613 805 297	631 256 143	637 099 993	843 365 252
Foreign equities	385 180 752	384 626 561	407 673 369	427 485 816	468 491 790
Adjustment of forward contracts and derivatives	-959 721	-4 171 094	-5 548 358	-5 441 346	-6 901 991
Total portfolio before remuneration for management	**942 463 721**	**988 229 323**	**1 016 459 420**	**1 090 191 013**	**1 183 981 319**
Management remuneration due	-448 123	-667 366	-984 136	-278 362	-537 844
Advisory services	0	0	-4 169	0	0
Total portfolio	**942 015 598**	**987 561 957**	**1 015 471 115**	**1 089 912 651**	**1 183 443 475**

At 30 June 2005, market value differs slightly in the returns reporting and the accounts reporting. This is primarily due to book allocations and different valuation methods for money market investments.

In Table 11, income and expenses in foreign currency are converted to NOK according to the exchange rate on the transaction date, and are recognised as they have been earned or incurred, according to the accruals principle.

Off-balance sheet items (in NOK 1000)	30.06.2004	30.09.2004	31.12.2004	31.03.2005	30.06.2005
Forward exchange contracts sold	-33 074 909	-30 594 274	-16 837 972	-17 470 264	-35 667 277
Futures sold	-125 873 033	-50 442 511	-118 994 375	-49 590 848	-45 442 363
Equity swaps sold	-2 646 383	-3 897 226	-8 115 796	-5 836 592	-24 623 338
Interest rate swaps sold	-363 569 782	-401 111 395	-390 663 205	-523 281 509	-367 707 657
Liabilities sold	**-525 164 107**	**-486 045 406**	**-534 611 348**	**-596 179 213**	**-473 440 635**
Forward exchange contracts purchased	33 074 909	30 594 274	16 837 972	17 470 264	35 667 277
Futures purchased	113 943 091	81 482 879	114 744 349	39 891 287	56 353 691
Equity swaps purchased	2 078 643	5 667 609	9 489 246	2 921 660	23 823 850
Interest rate swaps purchased	362 614 141	396 889 890	385 089 073	517 985 864	360 701 334
Liabilities purchased	**511 710 784**	**514 634 651**	**526 160 641**	**578 269 075**	**476 546 153**
Futures options sold	-35 643 955	-16 000 652	-2 231 822	-2 725 582	-4 441 572
Interest rate swap options sold	0	-2 348	0	0	0
Rights sold	**-35 643 955**	**-16 003 001**	**-2 231 822**	**-2 725 582**	**-4 441 572**
Futures options purchased	36 878 601	20 087 665	3 992 457	15 684 846	20 903 887
Rights purchased	**36 878 601**	**20 087 665**	**3 992 457**	**15 684 846**	**20 903 887**

Table 11: Book return on the Petroleum Fund's international portfolio at 30 June 2005. In thousands of krone

Return on the Petroleum Fund	30.06.2004	30.09.2004	31.12.2004	31.03.2005	30.06.2005
Interest income	13 385 513	19 931 210	26 046 307	6 746 125	12 243 012
Dividends	5 150 084	6 900 116	8 246 151	2 154 460	6 348 413
Exchange rate adjustment*	21 386 950	1 897 354	-46 791 318	16 057 298	12 831 176
Unrealised securities losses/gains	-3 567 631	1 280 993	28 575 975	-10 332 170	12 597 879
Realised securities losses/gains	10 549 393	13 812 821	21 581 006	12 785 955	23 546 287
Brokers' commissions	7 093	-22 869	-49 031	-8 616	-17 534
Gains/losses futures	-37 857	-155 296	251 854	49 483	92 475
Gains options	11 674	19 949	21 021	-3 429	-22 551
Gains/losses equity swaps	37 004	165 544	393 109	14 040	264 995
Gains/losses interest rate swaps	-705 034	-3 927 908	-5 337 664	500 471	-1 226 754
Book return on investments	**46 217 190**	**39 901 915**	**32 937 408**	**27 963 618**	**66 657 398**
Accrued management fee	-448 123	-667 366	-984 136	-278 362	-537 844
Advisory services	0	0	-4 169	0	0
Net return	**45 769 067**	**39 234 549**	**31 949 103**	**27 685 255**	**66 119 554**

*The exchange rate adjustment in the accounts in the table above is calculated on the basis of the actual composition of the Petroleum Fund. Income and expenses are converted using the exchange rate prevailing on the transaction date, and assets and liabilities are converted to the market rate prevailing at the end of the month. This figure will differ from the estimated exchange rate effect in the measurement of returns. In measuring returns, the exchange rate effect is calculated on the basis of the benchmark's composition of currencies at the beginning of each month and appurtenant exchange rate adjustments.

APPENDIX

1. Mandate and benchmark portfolio

The Ministry of Finance has delegated the operational management of the Government Petroleum Fund to Norges Bank, with a mandate stipulated in a regulation and written guidelines issued by the Ministry. A management agreement, which further defines the relationship between the Ministry of Finance as delegating authority and Norges Bank as operational manager, has also been drawn up.

According to the regulation, Norges Bank shall seek to achieve the highest possible return within the limits set out in the regulation. The Bank's strategy for achieving an excess return has been presented in earlier annual reports. The Ministry of Finance is informed about the Bank's management activities by means of quarterly and annual reports, which are also published.

The Ministry of Finance has specified countries and currencies that are to be included in the Fund's benchmark portfolio. The benchmark portfolio consists of specific equities and fixed income instruments and reflects the delegating authority's investment strategy for the Petroleum Fund. The benchmark portfolio provides the basis for managing risk in the operational management and for evaluating Norges Bank's management performance.

The strategic benchmark portfolio for the Petroleum Fund is composed of FTSE equity indices for large and medium-size companies in 27 countries and of Lehman Global Aggregate fixed income indices in the currencies of 21 countries. Equities account for 40 per cent of the Petroleum Fund's strategic benchmark portfolio while fixed income instruments account for 60 per cent. The equity portion of the benchmark consists of equities listed on European exchanges (50 per cent) and equities listed on stock exchanges in the Americas/Asia/Oceania/Africa (50 per cent). The regional distribution in the fixed income benchmark is 55 per cent in Europe, 35 per cent in the Americas and 10 per cent in Asia/Oceania.

Asset classes and regional weights change continuously as a result of changes in market prices for the securities in the benchmark portfolio. The monthly transfers to the Petroleum Fund are to be used to bring the asset classes and regional weights back as close to the original weights as possible, providing this does not necessitate selling anything from the existing portfolio. Thus, even after the transfer of new capital, the strategic benchmark described above may differ slightly from the actual benchmark. The actual benchmark provides the basis for managing risk and measuring the performance of the Petroleum Fund.

A substantial difference between the actual benchmark and the strategic benchmark over time will trigger full rebalancing. Rebalancing of this kind did not occur in 2004.

The table below shows the weights in the actual benchmark at 31 December 2004. The weights in the fixed income benchmark apply to the foreign currency in which the securities are issued. Therefore, the weight for each country in the euro area is not listed.

Benchmark at 30 June 2005 for the Petroleum Fund's ordinary portfolio. Per cent

	Equities		**Fixed income instruments**	
Country for equity benchmark Currency for fixed income benchmark	Strategic benchmark portfolio	Actual benchmark portfolio	Strategic benchmark portfolio	Actual benchmark portfolio
Asset class weights	**40.0**	**39.9**	**60.0**	**60.1**
Belgium		0.8		
Finland		0.9		
France		7.1		
Greece		0.4		
Ireland		0.5		
Italy		3.1		
Netherlands		3.5		
Portugal		0.2		
Spain		3.0		
Germany		5.1		
Austria		0.3		
Euro area (EUR)		*24.8*		*44.9*
UK (GBP)		17.1		7.9
Denmark (DKK)		0.6		0.8
Switzerland (CHF)		4.7		0.5
Sweden (SEK)		1.7		0.9
Total Europe	**50.0**	**49.0**	**55.0**	**55.0**
USA (USD)		37.2		33.3
Brazil		0.5		
Canada (CAD)		2.0		1.8
Mexico		0.4		
South Africa		0.5		
The Americas / Middle East / Africa			**35.0**	**35.1**
Australia (AUD)		1.6		0.4
Hong Kong		0.9		
Japan (JPY)		6.0		9.0
New Zealand (NZD)		0.1		0.2
Singapore (SGD)		0.3		0.3
South Korea		0.8		
Taiwan		0.9		
Total Asia and Oceania			**10.0**	**9.9**
The Americas / Middle East / Africa / Asia / Oceania	**50.0**	**51.0**		

The Ministry of Finance has adopted ethical guidelines for the Petroleum Fund's investments. The ethical basis for the Petroleum Fund shall be promoted using the following three mechanisms:

- Corporate governance based on the UN Global Compact and the OECD Principles of Corporate Governance and the OECD Guidelines for Multinational Enterprises in order to promote long-term financial returns
- Negative screening from the investment universe of companies that either themselves or through entities they control produce weapons which, with normal use, violate fundamental humanitarian principles
- Exclusion of companies from the investment universe where there is deemed to exist an unacceptable risk of contributing to:

- Gross or systematic violation of human rights, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other forms of child exploitation
- Gross violations of individual rights in war or conflict situations
- Severe environmental degradation
- Gross corruption
- Other particularly serious violations of fundamental ethical norms

Norges Bank is responsible for corporate governance in accordance with the guidelines from the Ministry of Finance. The Executive Board has approved Norges Bank's principles of corporate governance. The government has appointed an Advisory Council on Ethics which will advise the Ministry of Finance on negative screening and exclusion of companies. The Ministry makes the final decision on the exclusion of companies and instructs Norges Bank accordingly.

2. Calculation of transactions costs for phasing in new capital

Norges Bank estimates transaction costs related to phasing in new capital into the Petroleum Fund. In line with normal market practice, Norges Bank has, since the beginning of 2005, used a model that calculates direct and indirect transaction costs individually. Indirect transaction costs comprise three main components: liquidity costs, market impact and opportunity costs. Norges Bank's model calculates liquidity costs as the "bid-ask spread" for fixed income instruments and half the "bid-ask spread" for equities. Market impact is not taken into account in the fixed income portfolio, whereas market impact is estimated in the equity portfolio by using StockFactsPro®. Market impact in the fixed income market is a function of sector, market conditions, transaction size, size of the loan issued and the liquidity of the issuer. In most cases, the contributions from these variables are negligible.