

The top of the page features a blue header with a background of faint, semi-transparent graphics. On the left, the NBIM logo is visible. The background includes a stylized figure of a person in a white protective suit, a digital clock showing '02:50', '03:50', and '08:50', and city names like 'New York', 'London', 'Tokyo', and 'Date(Shanghai)'.

NBIM

Norges Bank Investment Management

Report on the management of Norges Bank's foreign exchange reserves

Fourth quarter 2008

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The foreign exchange reserves are to be available for intervention in the foreign exchange market in connection with the implementation of monetary policy or to promote financial stability. The reserves are divided into a money market portfolio and an investment portfolio. In addition, a buffer portfolio is used for the regular foreign exchange purchases for the Government Pension Fund – Global. Transfers are made to the buffer portfolio from the State's Direct Financial Interest in petroleum activities (SDFI) and from Norges Bank's foreign exchange purchases in the market. Within Norges Bank, the investment portfolio and buffer portfolio are managed by Norges Bank Investment Management (NBIM), while the money market portfolio is managed by Norges Bank Monetary Policy and reported on separately.

The investment portfolio has a long-term investment horizon where the aim is to generate the highest possible return within the constraints set out in the guidelines issued by Norges Bank's Executive Board. The Executive Board has defined a strategic benchmark portfolio for the investment portfolio.

1 Key figures

The financial turmoil that began with problems in the US mortgage market in early 2007 and subsequently developed into a wider global confidence and liquidity crisis continued to dominate in the fourth quarter of 2008. Equity prices fell sharply during the quarter.

The decrease in prices in international markets led to a negative return on the investment portfolio in the fourth quarter of 7.25 per cent in international currency. The return on the equity portfolio was -20.45 per cent, and the return on the fixed income portfolio was 0.64 per cent. The return on the investment portfolio was 2.65 percentage points lower than the return on the benchmark portfolio defined by Norges Bank's Executive Board. The market value of the portfolio at the end of 2008 was NOK 179 billion.

Chart 1-1 Investment portfolio. Market value 1999-2008. In billions of NOK

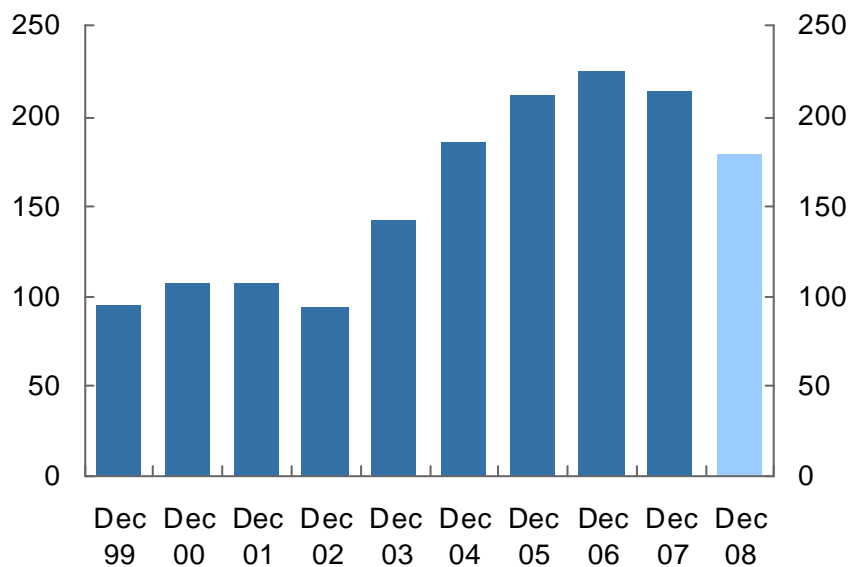


Table 1-1 Key figures as at 31 December 2008. Annualised data

(Measured in an international currency basket)	Past year	Past 3 years	Past 5 years	Past 10 years	Since 01.01.98
Portfolio return (per cent)	-17.47	-2.90	1.47	2.72	3.34
Benchmark return (per cent)	-13.51	-1.02	2.57	3.14	3.74
Excess return (percentage points)	-3.96	-1.88	-1.09	-0.42	-0.39
Standard deviation (per cent)	10.62	7.37	6.14	4.78	4.64
Tracking error (percentage points)	1.85	1.28	1.03	0.76	0.74
Information ratio	-2.14	-1.47	-1.06	-0.56	-0.53
Gross annual return (per cent)	-17.47	-2.90	1.47	2.72	3.34
Annual price inflation (per cent)	1.4	2.2	2.3	2.0	1.9
Annual management costs (per cent)	0.08	0.07	0.07	0.07	0.07
Annual net real return (per cent)	-18.65	-5.07	-0.85	0.67	1.37
Annual gross excess return (per cent)	-3.96	-1.88	-1.09	-0.42	-0.39

2 Market value and return

The investment portfolio's market value was NOK 178.9 billion at the end of the fourth quarter of 2008, a decrease of NOK 13 billion during the quarter (see Table 2-1). A negative return on investment decreased the value of the portfolio by NOK 13.9 billion, and NOK 25 billion was transferred to the foreign exchange reserves' money market portfolio, while a weaker krone against the currencies in which the portfolio is invested increased its value by NOK 32.4 billion. A change in the krone exchange rate has no effect, however, on the portfolio's international purchasing power.

Table 2-1 Investment portfolio. Changes in market value. In millions of NOK

	Equities	Fixed income	Total
31.12.07	88 953	125 033	213 986
31.03.08	75 278	123 609	198 887
30.06.08	73 335	121 580	194 914
30.09.08	67 143	124 722	191 865
Inflows of new capital	8 253	(33 253)	(25 000)
Return	(13 839)	(43)	(13 882)
Movements in krone	9 942	17 080	32 370
31.12.08	70 552	108 340	178 892

The return on the investment portfolio in the fourth quarter of 2008 was -2.65 per cent in international currency (i.e. measured in terms of a currency basket corresponding to the composition of the portfolio's benchmark portfolio) (see Table 2-2). There was a return of -

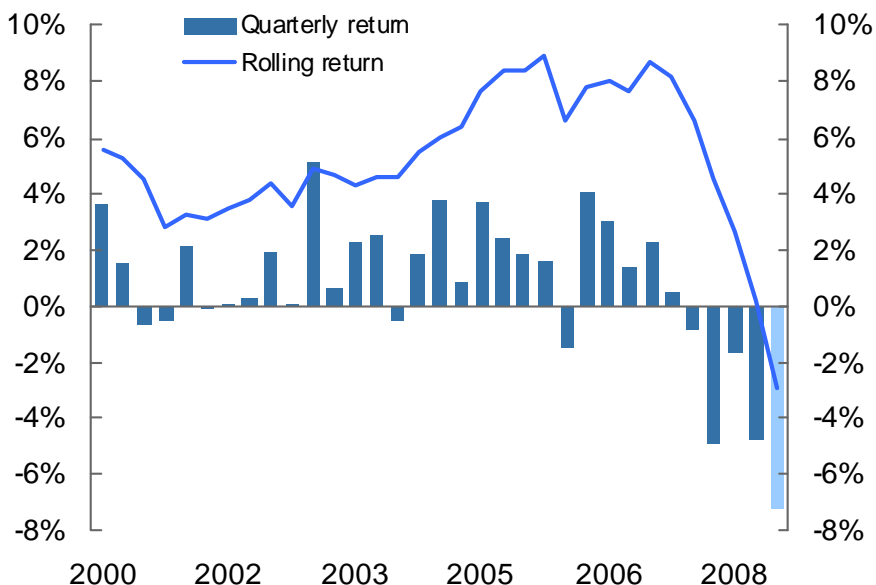
20.45 per cent on the equity portfolio and 0.64 per cent on the fixed income portfolio. At the end of the quarter, the three-year rolling annualised return on the investment portfolio was 2.9 per cent (see Chart 2-1).

Measured in NOK, the aggregate return in the fourth quarter was 7.3 per cent. The difference between the return in international currency and the return in NOK was due to the depreciation of the krone during the quarter against the currencies included in the benchmark portfolio.

Table 2-2 Key figures. Quarterly data

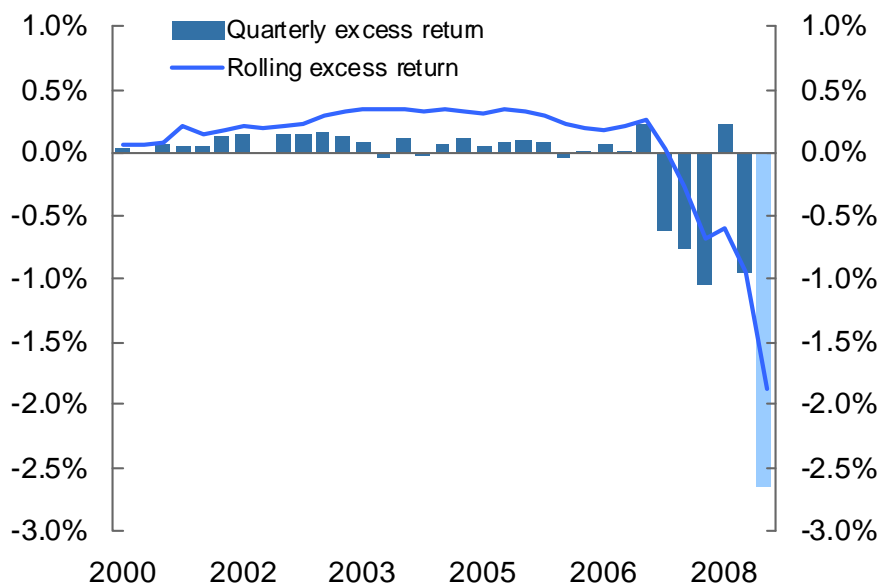
	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008
Market value (billions of NOK)						
Fixed income portfolio	122.2	125.0	123.6	121.6	124.7	108.3
Equity portfolio	90.9	89.0	75.3	73.3	67.1	70.6
Overall portfolio	213.1	214.0	198.9	194.9	191.9	178.9
Inflows of new capital	0.0	0.0	0.0	0.0	-8.9	-25.0
Return	0.9	-1.9	-10.8	-3.2	-11.3	-20.3
Change due to movements in krone	-11.7	2.8	-4.3	-0.8	17.1	32.4
Return in international currency (per cent)						
Equity portfolio	-1.52	-3.33	-12.99	-1.88	-11.41	-20.45
Fixed income portfolio	1.97	1.07	0.78	-1.54	-0.82	0.64
Overall portfolio	0.45	-0.80	-4.94	-1.66	-4.80	-7.25
Benchmark portfolio	1.08	-0.03	-3.91	-1.88	-3.84	-4.60
Excess return	-0.63	-0.78	-1.04	0.22	-0.96	-2.65
Return in NOK (per cent)						
Equity portfolio	-6.71	-2.14	-14.92	-2.21	-4.16	-7.93
Fixed income portfolio	-3.42	2.31	-1.46	-1.88	7.30	16.48
Overall portfolio	-4.85	0.41	-7.06	-2.00	2.99	7.34
Benchmark portfolio	-4.25	1.20	-6.04	-2.22	4.03	10.41

Chart 2-1 Investment portfolio. Quarterly return and three-year rolling annualised return 2000-2008. Per cent



The return achieved by NBIM on the actual portfolio is measured in relation to the return on the benchmark portfolio defined by the Executive Board. The return on the actual portfolio in the fourth quarter of 2008 was 2.65 percentage points lower than the return on the benchmark portfolio. Quarterly and three-year rolling annualised excess returns are presented in Chart 2-2.

Chart 2-2 Investment portfolio. Quarterly excess return and three-year rolling annualised excess return 2000-2008. Percentage points



Transaction costs were incurred during the fourth quarter when capital was transferred to the foreign exchange reserves' money market portfolio. The portfolio was also rebalanced to return the allocation to equities to 40 per cent, and costs were incurred in connection with the exclusion of two companies from the investment universe. Direct and indirect transaction costs in the fourth quarter of 2008 have been estimated at NOK 76.9 million. This is equivalent to 0.05 per cent of the market value of the portfolio at the beginning of the quarter. The benchmark portfolio has not been adjusted for these transaction costs.

3 Market risk and management guidelines

Market risk in the investment portfolio is measured as expected tracking error. This is a statistically-derived measure of risk which says something about the amount of variation we can normally expect in the difference between the return on the benchmark portfolio and the return on the actual portfolio. The Executive Board's guidelines set a limit for market risk in the actual portfolio relative to the benchmark portfolio. This relative market risk must always be less than expected tracking error of 1.5 percentage points.

Expected tracking error can vary widely even with an unchanged level of active management. This is because these measures are influenced by various market developments, such as changes in market volatility and changes in correlations between the various asset classes and securities.

The financial turmoil presented major challenges for NBIM's risk management. Historical relationships between risk factors collapsed, and liquidity was greatly reduced in most markets. Most model-based risk systems estimate risk on the basis of historical relationships of some kind. When these relationships change significantly in a short space of time, the model will not be in a position to provide reliable estimates of future risk.

The rapid evolution of many financial instruments over the past decade has exacerbated the challenges facing us and comparable investment managers. These more complex instruments have largely been priced and risk-modelled using mathematical models based on the same historical relationships. The problems with the use of models and loss of liquidity have been particularly acute in fixed income management.

At the beginning of 2008, expected tracking error was 56 basis points, which is slightly higher than the historical average for the investment portfolio. Expected tracking error increased considerably during the year (see Chart 3-1). Towards the end of the year, observations were the highest ever seen for the investment portfolio. The increase in expected tracking error was due to changes in market dynamics (volatilities and correlations), transfers to the money market portfolio, and the rebalancing of the investment portfolio.

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 (the dark line in Chart 3-1). This tracking error is annualised using 12-month rolling windows.

Chart 3-1 Investment portfolio. Expected and actual tracking error 1999-2008. Basis points

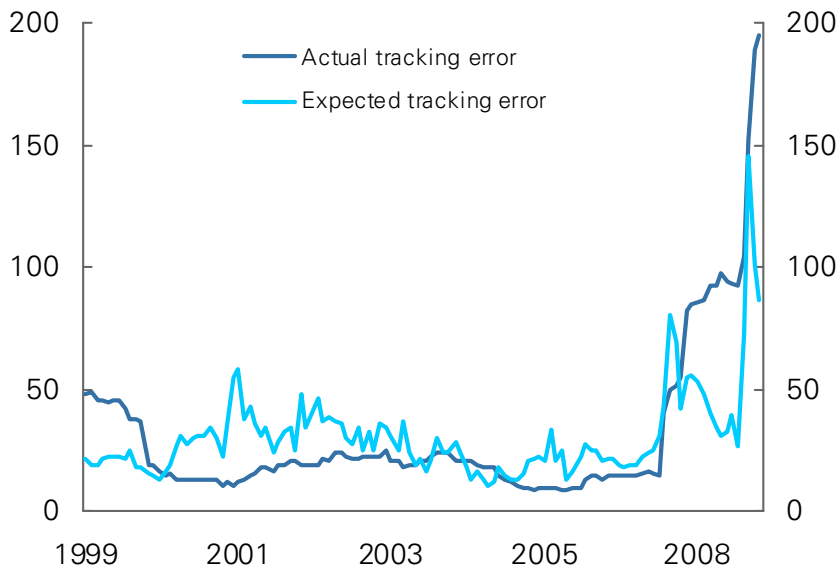


Chart 3-2 shows developments in expected tracking error in the equity and fixed income portfolios since 2002.

Chart 3-2 Investment portfolio. Expected tracking error 2002-2008. Basis points

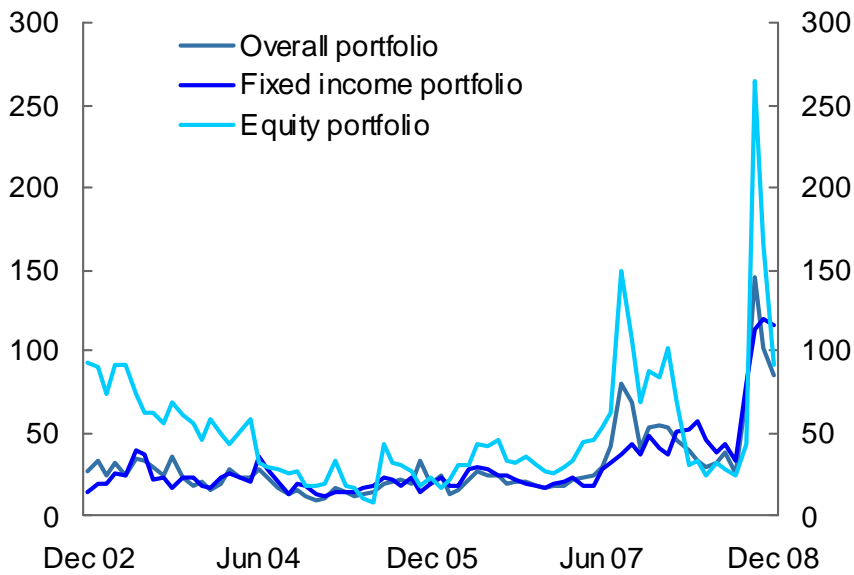


Table 3-1 breaks down the bond portfolio (fixed income portfolio excluding cash) by type of bond and credit rating.

Table 3-1 Investment portfolio. Fixed income portfolio by credit rating.¹⁾ As at 31 December 2008 Investeringssporteføljen.

Percentage of fixed income portfolio	Aaa	Aa	A	Baa	Ba	Lower	No rating
Government and govt-related bonds	26.8	10.0	1.7	0.6	0.6	0.8	0.1
Inflation-linked bonds	3.9	2.5	0.1	-	-	-	-
Corporate bonds	1.2	2.8	8.2	4.1	0.3	0.2	0.0
Securitised debt	33.9	0.8	0.8	0.2	0.1	0.4	0.1
Short-term certificates	65.8	16.2	10.7	4.9	0.9	1.4	0.1
Total bonds and other fixed income instruments	26.8	10.0	1.7	0.6	0.6	0.8	0.1

¹⁾ Based on credit ratings from at least one of the following rating agencies: Moody's, Standard & Poor's and Fitch. The "No rating" category consists of securities not rated by these three agencies; these securities may, however, have been rated by other, local agencies.

Table 3-2 provides an overview of risk and exposure in the investment portfolio. There were no breaches of the Executive Board's investment guidelines in the fourth quarter of 2008.

Table 3-2 Investment portfolio. Key figures for risk and exposure

Risk	Limits	Actual				
		31.12.07	31.03.08	30.6.08	30.9.08	31.12.08
Market risk	Tracking error max. 1.5 percentage points	0.56	0.40	0.32	0.72	0.86
Asset mix	Fixed income portfolio	58.5	62.2	62.4	65.2	60.9
	Equity portfolio	41.5	37.8	37.6	34.8	39.1
Currency distribution, fixed income	Europe	60.6	62.2	61.5	60.4	61.6
	Americas	33.4	31.5	33.3	34.1	33.2
	Asia and Oceania	6.0	6.3	5.2	5.5	5.2
Market distribution, equities	Europe	52.5	51.1	49.8	48.0	51.2
	Americas and Africa	33.5	34.2	34.6	37.6	34.0
	Asia and Oceania	14.0	14.7	15.6	14.4	14.8
Ownership	Max. 5% of a company	4.62	0.96	0.19	0.18	0.19

4 Buffer portfolio

The purpose of the buffer portfolio is to ensure an appropriate supply of new capital to the Government Pension Fund – Global. The portfolio is built up continuously by means of foreign exchange transfers to Norges Bank from the State's Direct Financial Interest in petroleum activities (SDFI) and by Norges Bank's foreign exchange purchases in the market to meet the foreign exchange requirements of the Government Pension Fund – Global. A benchmark portfolio has not been defined for the buffer portfolio. With the exception of December, capital is normally transferred to the Government Pension Fund – Global each month.

In the fourth quarter of 2008, NOK 54.8 billion was transferred to the buffer portfolio from the SDFI, and a further NOK 33.7 billion was transferred to the portfolio through Norges Bank's

purchases of foreign exchange. A total of NOK 76.7 billion was transferred to the Government Pension Fund – Global during the quarter. The return on the buffer portfolio in the fourth quarter of 2008 was 4.25 per cent in NOK terms. The market value of the portfolio at the end of the quarter was NOK 23.7 billion. The fund is invested in short-term money market instruments, primarily in EUR, USD and GBP.

Table 4-1 Buffer portfolio. Movements in market value. In millions of NOK

Period	Transferred from SDFI	Norges Bank's foreign exchange purchases	Transferred to Government Pension Fund – Global	Market value at end of period
2007	151 650	152 871	313 650	14 052
Q1 2008	54 526	29 051	88 065	9 842
Q2 2008	54 472	36 688	90 649	10 296
Q3 2008	51 195	76 306	128 275	10 882
Q4 2008	54 799	33 718	76 739	23 727
2008	214 992	175 764	390 059	

5 Financial reporting

Financial information for the investment and buffer portfolios is presented below. The financial reporting for Norges Bank's foreign exchange reserves forms part of, and comprises excerpts from, Norges Bank's financial statements.

Accounting policies

The interim accounts for the fourth quarter have been prepared in accordance with the accounting policies for Norges Bank approved by the Supervisory Council on 13 December 2007. A presentation of the accounting policies applied in the preparation of the accounts can be found in Norges Bank's Annual Report for 2008.

The preparation of the financial reporting for Norges Bank involves the use of estimates and judgements which can affect assets, liabilities, income and expenses. The accounting policies presented in Norges Bank's Annual Report for 2008 contain further information on significant estimates and assumptions.

Operating expenses

The costs incurred in NBIM's management activities consist partly of fees to external managers and custodian institutions, and partly of Norges Bank's internal operating costs. NBIM's total costs associated with the management of the investment portfolio, including performance-based fees, amounted to NOK 161 million in 2008, which corresponds to 0.08 per cent of average assets under management.

Investment portfolio – profit and loss account and balance sheet

Table 5-1 Investment portfolio. Profit and loss account

(Figures in millions of NOK)	2007	2008
<i>Profit/loss on financial assets excl. exchange rate adjustments</i>		
Interest income, deposits in foreign banks	-104	50
Interest income, lending associated with reverse repurchase agreements	3 798	1 325
Net income/expenses and gains/losses from:		
- equities and units	3 676	-39 627
- bonds and other fixed income instruments	2 572	-1 179
- financial derivatives	1 032	-3 284
Interest expenses, borrowing associated with repurchase agreements	-4 751	-2 521
Other interest expenses	-21	-54
Other expenses	-118	-88
Profit/loss before exchange rate adjustments	6 085	-45 379
Exchange rate adjustments	-16 678	44 388
Profit/loss	-10 593	-991

Table 5-2 Investment portfolio. Balance sheet

(Figures in millions of NOK)	31.12.07	31.12.08
FINANCIAL ASSETS		
Deposits in foreign banks	2 178	3 145
Lending associated with reverse repurchase agreements	81 957	20 002
Equities and units	88 489	69 962
Bonds and other fixed income instruments	174 018	162 711
Other assets	61	98
TOTAL FINANCIAL ASSETS	346 703	255 917
FINANCIAL LIABILITIES		
Short-term borrowing	5	65
Borrowing associated with repurchase agreements	85 196	28 012
Cash collateral received	36 797	25 738
Financial derivatives	436	2 972
Unsettled trades	2 773	3 285
Other liabilities	7 493	16 956
TOTAL FINANCIAL LIABILITIES	132 700	77 028
NET PORTFOLIO	214 003	178 889

Buffer portfolio – profit and loss account and balance sheet

Table 5-3 Buffer portfolio. Profit and loss account

(Figures in millions of NOK)

Profit/loss on financial assets excl. exchange rate adjustments

	2007	2008
Interest income, deposits in foreign banks	197	178
Interest income, lending associated with reverse repurchase agreements	511	505
Interest expenses, borrowing associated with repurchase agreements	-1	-2
Other interest expenses	-76	-140
Other expenses	-1	-1
Profit/loss before exchange rate adjustments	630	540
Exchange rate adjustments	-1 119	1 748
Profit/loss	-489	2 288

Table 5-4 Buffer portfolio. Balance sheet

(Figures in millions of NOK)

FINANCIAL ASSETS

	31.12.07	31.12.08
Deposits in foreign banks	7	8 404
Lending associated with reverse repurchase agreements	10 121	11 326
TOTAL FINANCIAL ASSETS	10 128	19 729

FINANCIAL LIABILITIES

Other liabilities	-2 273	0
TOTAL FINANCIAL LIABILITIES	-2 273	0
Unsettled trades not recognised	1 651	3 997
NET PORTFOLIO	14 052	23 726

Investment portfolio Benchmark portfolio as at 31 December 2008. 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	39.5	60.0	60.5
Belgium		0.7		
Finland		1.1		
France		8.7		
Greece		0.4		
Ireland		0.3		
Italy		3.0		
Netherlands		1.9		
Portugal		0.3		
Spain		3.8		
Germany		6.6		
Austria		0.3		
<i>Euro area (EUR)</i>		27.2		49.8
UK (GBP)		14.7		8.5
Denmark (DKK)		0.7		1.1
Switzerland (CHF)		6.1		0.5
Sweden (SEK)		1.6		1.0
Total Europe	50.0	50.4	60.0	61.0
USA (USD)		30.0		32.2
Brazil		0.9		
Canada (CAD)		2.1		1.8
Mexico		0.3		
South Africa (ZAR)		0.6		
Total Americas and Africa	35.0	33.9	35.0	34.0
Australia (AUD)		2.2		0.1
Hong Kong		1.5		
Japan (JPY)		9.0		4.7
New Zealand (NZD)		0.1		0.0
Singapore (SGD)		0.4		0.2
South Korea		1.3		
Taiwan		1.1		
Total Asia and Oceania	15.0	15.6	5.0	5.0