

The top of the page features a blue header with a background of faint, semi-transparent graphics. On the left, there is a stylized image of the Statue of Liberty. In the center and right, there are digital-style displays showing city names and times: 'New York 02:50', 'London 07:50', 'Tokyo', '08:50', and 'Date/Time'.

**NBIM**

Norges Bank Investment Management

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

Third quarter 2009

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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.

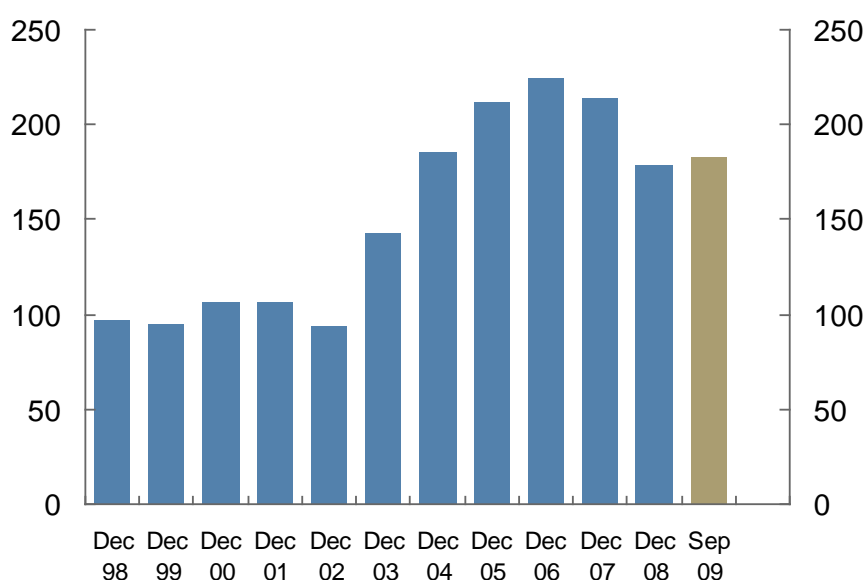
The investment portfolio has a long-term investment horizon where the aim is to generate the highest possible return within the constraints set out in the guidelines issued by Norges Bank's Executive Board. The Executive Board has defined a strategic benchmark portfolio for the investment portfolio.

### 1 Key figures

Market developments in the third quarter were largely a continuation of the previous quarter. Uncertainty in the markets decreased further, equity prices climbed sharply, and the credit spread between corporate and government bonds continued to narrow.

The upswing in prices led to a positive return on the investment portfolio in the third quarter of 11.5 percent in international currency (i.e. measured in terms of a currency basket corresponding to the composition of the portfolio's benchmark portfolio). The return on the equity portfolio was 17.6 percent, and the return on the fixed income portfolio was 7.4 percent. The return on the investment portfolio was 2.2 percentage points higher than the return on the benchmark portfolio defined by Norges Bank's Executive Board. The market value of the investment portfolio was 183 billion kroner on 30 September 2009.

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



**Table 1-1** Key figures to 30 September 2009. 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 (percent)	9.52	1.24	4.12	4.58	4.70
Benchmark return (percent)	8.14	1.82	4.39	4.59	4.71
Excess return (percentage points)	1.39	-0.58	-0.27	-0.01	-0.01
Standard deviation (percent)	14.10	9.64	7.73	5.78	5.45
Tracking error (percentage points)	2.93	1.83	1.41	1.01	0.94
Information ratio	0.47	-0.32	-0.19	-0.01	-0.01
Gross annual return (percent)	9.52	1.24	4.12	4.58	4.70
Annual price inflation (percent)	-0.47	1.93	2.14	1.98	1.85
Annual management costs (percent)	0.08	0.07	0.07	0.07	0.07
Annual net real return (percent)	9.96	-0.75	1.87	2.48	2.73

## 2 Market value and return

The investment portfolio's market value was 183.0 billion kroner at the end of the third quarter, an increase of 5.4 billion kroner during the quarter. A positive return on investment increased its value by 21.3 billion kroner, while a stronger krone in relation to the currencies in which the portfolio is invested reduced the value of the portfolio by 16.0 billion kroner. A change in the krone exchange rate has no effect, however, on the portfolio's international purchasing power.

**Table 2-1** Movements in market value. Millions of NOK

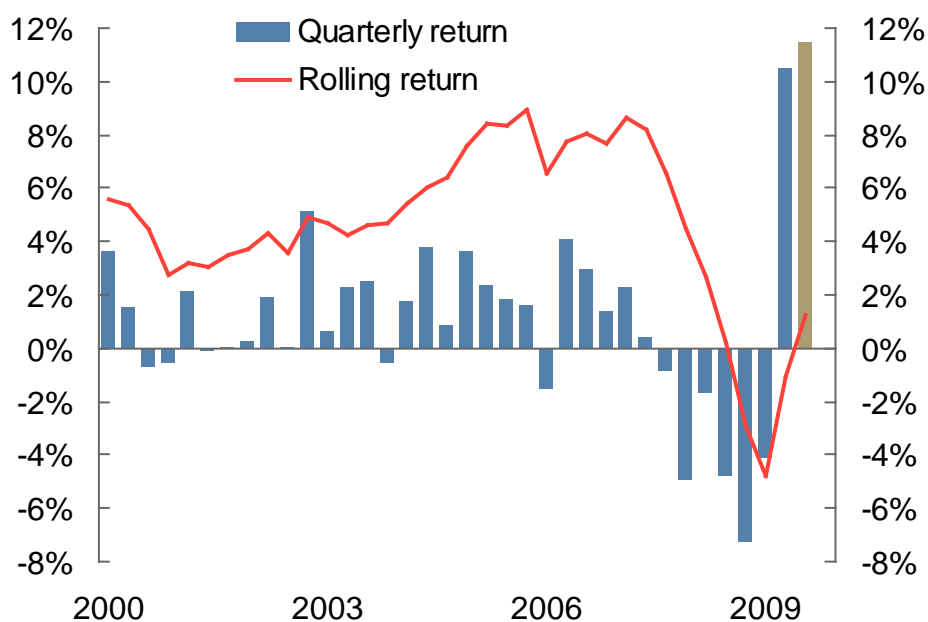
	Equities	Fixed income	Total
30 September 2008	67 143	124 722	191 865
31 December 2008	70 552	108 340	178 892
31 March 2009	59 959	100 838	160 797
30 June 2009	71 364	106 300	177 664
Inflows of new capital			0
Return			21 346
Movements in krone			- 15 983
<b>30 September 2009</b>	<b>79 989</b>	<b>103 039</b>	<b>183 027</b>

The return on the investment portfolio in the third quarter was 11.5 percent measured in international currency. There was a return of 17.6 percent on the equity portfolio and 7.4 percent on the fixed income portfolio. At the end of the quarter, the three-year rolling annualised return for the overall portfolio was 1.2 percent.

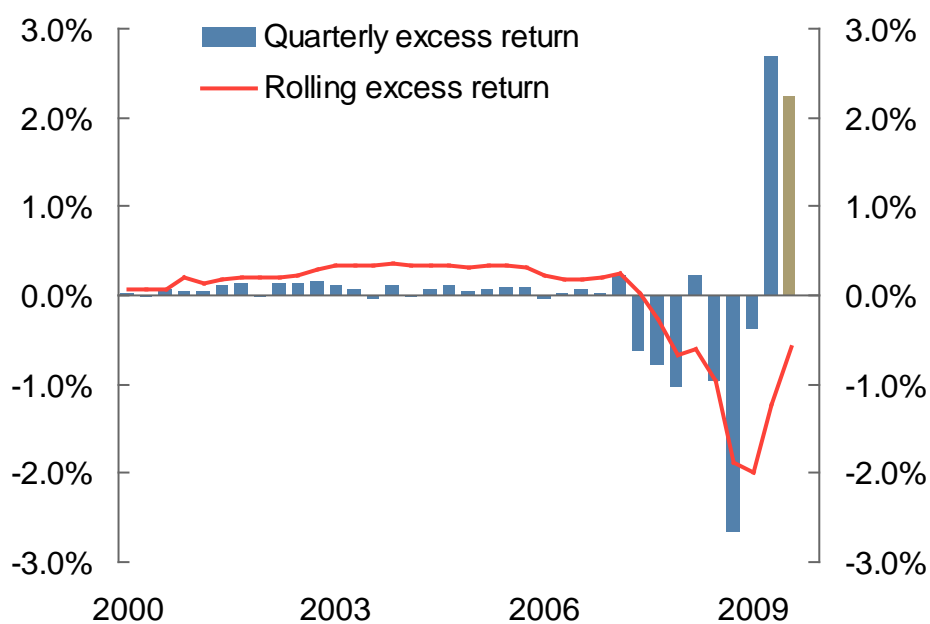
Measured in kroner, the overall return in the third quarter was 3.0 percent. The difference between the return in international currency and the return in kroner is because the krone appreciated during the quarter against the currencies included in the benchmark portfolio.

The return achieved by NBIM on the actual portfolio is measured in relation to the return on a benchmark portfolio defined by the Executive Board. The return on the actual portfolio in the third quarter was 2.2 percentage points higher than the return on the benchmark portfolio.

**Chart 2-1** Quarterly return and three-year rolling annualised return. Percent



**Chart 2-2** Quarterly excess return and three-year rolling annualised excess return. Percentage points



**Table 2-2** Key figures. Quarterly data

	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
<b>Market value (billions of NOK)</b>						
Fixed income portfolio	121.6	124.7	108.3	100.8	106.3	103.0
Equity portfolio	73.3	67.1	70.6	60.0	71.4	80.0
Overall portfolio	194.9	191.9	178.9	160.8	177.7	183.0
<b>Inflows of new capital</b>						
Inflows of new capital	0.0	-8.9	-25.0	0.0	0.0	0.0
<b>Return</b>						
Return	-3.2	-11.3	-20.3	-4.2	17.6	21.3
Change due to movements in krone	-0.8	17.1	32.4	-13.9	-0.7	-16.0
<b>Return in international currency (percent)</b>						
Equity portfolio	-1.88	-11.41	-20.45	-9.37	18.64	17.59
Fixed income portfolio	-1.54	-0.82	0.64	-0.74	5.63	7.36
Overall portfolio	-1.66	-4.80	-7.25	-4.14	10.48	11.51
Benchmark portfolio	-1.88	-3.84	-4.60	-3.77	7.79	9.28
Excess return	0.22	-0.96	-2.66	-0.37	2.69	2.23
<b>Return in NOK (percent)</b>						
Equity portfolio	-2.21	-4.16	-7.93	-15.02	18.66	8.63
Fixed income portfolio	-1.88	7.30	16.48	-6.92	5.64	-0.81
Overall portfolio	-2.00	2.99	7.34	-10.12	10.49	3.02
Benchmark portfolio	-2.22	4.03	10.41	-9.76	7.80	0.96

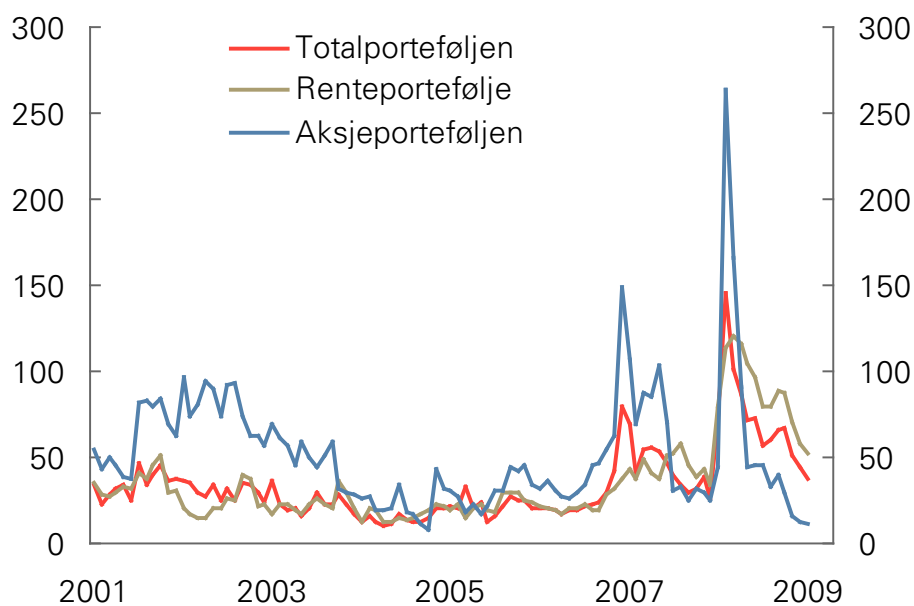
### 3 Market risk and management guidelines

Market risk in the investment portfolio is measured as expected tracking error. This is a statistically-defined 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 has stipulated that market risk in the investment portfolio must always be less than expected tracking error of 1.5 percentage points (150 basis points). This means that, under normal market conditions, the annual return on the actual portfolio is expected to deviate from the return on the benchmark portfolio by less than 1.5 percentage points in two out of every three years.

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.

Although markets remain turbulent, volatility has eased considerably since autumn 2008. Expected tracking error for the investment portfolio was 67 basis points at the beginning of the third quarter and 37 basis points at the end of the quarter (see Chart 3-1).

**Chart 3-1** Expected tracking error. Basis points



**Table 3-1** Fixed income portfolio by credit rating as at 30 September 2009 <sup>1)</sup>

Percentage of fixed income portfolio	Aaa	Aa	A	Baa	Ba	Lower	No rating
Government and govt-related bonds	26.4	7.3	2.2	1.2	0.1	0.2	1.1
Inflation-linked bonds	4.1	2.9	0.1	0.0	0.0	0.0	0.0
Corporate bonds	0.4	3.6	8.9	6.0	0.4	0.2	0.0
Securitised debt	29.7	3.5	0.3	0.2	0.2	1.3	0.1
<b>Total bonds and other fixed income instruments</b>	<b>60.5</b>	<b>17.2</b>	<b>11.5</b>	<b>7.4</b>	<b>0.7</b>	<b>1.5</b>	<b>1.3</b>

<sup>1)</sup> 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 guidelines for the foreign exchange reserves in the third quarter of 2009.

**Table 3-2** Key figures for risk and exposure

Risk	Limits	Actual			
		31.12.08	31.03.09	30.06.09	30.09.09
Market risk	Tracking error max. 1.5 percentage points	0.86	0.57	0.67	0.37
Asset mix	Fixed income portfolio	60.6	62.7	59.8	56.3
	Equity portfolio	39.4	37.3	40.2	43.7
Currency distribution, fixed income	Europe	61.6	61.0	62.1	62.0
	Americas	33.2	34.3	33.4	33.4
	Asia and Oceania	5.2	4.6	4.5	4.6
Market distribution, equities	Europe	51.2	49.3	49.7	51.4
	Americas and Africa	34.0	35.2	33.6	33.1
	Asia and Oceania	14.8	15.6	16.8	15.5
Ownership	Max. 5% of a company	0.19	0.19	0.16	0.20

## 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. With the exception of December, capital is normally transferred to the fund each month. A benchmark portfolio has not been defined for the buffer portfolio.

In the third quarter of 2009, 31.7 billion kroner was transferred to the buffer portfolio from the SDFI, and a further 17.4 billion kroner was transferred to the portfolio through Norges Bank's purchases of foreign exchange. A total of 48.9 billion kroner was transferred to the Government Pension Fund Global during the quarter. The return on the buffer portfolio in the third quarter was -7.2 percent in krone terms. The market value of the portfolio at the end of the quarter was 24.6 billion kroner. The fund is invested in short-term money market instruments, primarily in euro, US dollars and pounds sterling.

**Table 4-1** Buffer portfolio. Movements in market value. 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
2008	214 992	175 764	390 059	23 727
Q1 2009	46 867	2 042	44 179	27 438
Q2 2009	35 614	4 219	40 375	27 037
<b>Q3 2009</b>	<b>31 687</b>	<b>17 410</b>	<b>48 930</b>	<b>24 603</b>

## 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 third 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 the Annual Report for 2008. The interim accounts do not include all of the information required in a full set of annual financial statements and should be read in conjunction with the 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 the 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 Norges Bank's internal operating costs and partly of fees to external managers and custodian institutions. NBIM's total costs associated with the management of the investment portfolio, including performance-based fees to external managers, amounted to 110.5 million kroner in the first nine months of 2009, or 0.08 percent 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)	Year to date				
	Q3 2009	Q3 2008	30.09.09	30.09.08	31.12.08
<i>Profit/loss on financial assets excl. exchange rate adjustments</i>					
Interest income, deposits in foreign banks	-	29	-14	37	50
Interest income, lending associated with reverse repurchase agreements	1	299	73	1 258	1 325
Net income/expenses and gains/losses from:					
- equities and units	14 440	-9 369	21 339	-21 729	-39 627
- bonds and other fixed income instruments	7 082	-440	13 503	-1 906	-1 179
- financial derivatives	-144	-1 664	-5	-1 202	-3 284
Interest expenses, borrowing associated with repurchase agreements	-24	-575	-213	-2 146	-2 521
Other interest expenses	-	-5	48	-6	-54
Other expenses	-27	-8	-59	-48	-88
<b>Profit/loss before exchange rate adjustments</b>	<b>21 329</b>	<b>-11 732</b>	<b>34 672</b>	<b>-25 742</b>	<b>-45 379</b>
Exchange rate adjustments	-15 983	17 131	-30 581	12 018	44 388
<b>Profit/loss</b>	<b>5 346</b>	<b>5 398</b>	<b>4 091</b>	<b>-13 724</b>	<b>-991</b>

**Table 5-2** Investment portfolio. Balance sheet

(Figures in millions of NOK)	30.09.09	30.09.08	31.12.08
<b>FINANCIAL ASSETS</b>			
Deposits in foreign banks	1 401	1 793	3 145
Lending associated with reverse repurchase agreements	10 003	63 165	20 002
Equities and units	79 397	66 676	69 962
Bonds and other fixed income instruments	129 048	156 267	162 711
Financial derivatives	0	8 405	0
Other assets	57	65	98
<b>TOTAL FINANCIAL ASSETS</b>	<b>219 905</b>	<b>296 372</b>	<b>255 917</b>
<b>FINANCIAL LIABILITIES</b>			
Short-term borrowing	0	93	65
Borrowing associated with repurchase agreements	13 263	41 103	28 012
Cash collateral received	16 788	40 457	25 738
Financial derivatives	625	701	2 972
Unsettled trades	1 742	0	3 285
Other liabilities	4 459	13 701	16 956
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>36 878</b>	<b>96 055</b>	<b>77 028</b>
<b>NET PORTFOLIO</b>	<b>183 028</b>	<b>200 317</b>	<b>178 889</b>

## Buffer portfolio – profit and loss account and balance sheet

**Table 5-3** Buffer portfolio. Profit and loss account

(Figures in millions of NOK)	Year to date				
	Q3 2009	Q3 2008	30.09.09	30.09.08	31.12.08
<i>Profit/loss on financial assets excl. exchange rate adjustments</i>					
Interest income, deposits in foreign banks	21	98	67	161	178
Interest income, lending associated with reverse repurchase agreements	5	123	66	375	505
Interest expenses, borrowing associated with repurchase agreements	0	0	0	-2	-2
Other interest expenses	-2	-49	-11	-113	-140
Other expenses	-1	0	-1	-1	-1
<b>Profit/loss before exchange rate adjustments</b>	<b>23</b>	<b>172</b>	<b>121</b>	<b>421</b>	<b>540</b>
Exchange rate adjustments	-2 599	1 103	-3 581	1 049	1 748
<b>Profit/loss</b>	<b>-2 575</b>	<b>1 274</b>	<b>-3 460</b>	<b>1 470</b>	<b>2 288</b>

**Table 5-4** Buffer portfolio. Balance sheet

(Figures in millions of NOK)	30.09.09	30.09.08	31.12.08
<b>FINANCIAL ASSETS</b>			
Deposits in foreign banks	8	4 153	8 404
Lending associated with reverse repurchase agreements	16 060	23 181	11 326
Financial derivatives	0	139	0
Other assets	16 109	0	0
<b>TOTAL FINANCIAL ASSETS</b>	<b>32 176</b>	<b>27 472</b>	<b>19 729</b>
<b>FINANCIAL LIABILITIES</b>			
Financial derivatives	1	0	0
Other liabilities	8 457	20 622	0
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>8 458</b>	<b>20 622</b>	<b>0</b>
Unsettled trades not recognised	885	4 032	3 997
<b>NET PORTFOLIO</b>	<b>24 603</b>	<b>10 882</b>	<b>23 726</b>

## Appendix

### Investment portfolio Benchmark portfolio as at 30 September 2009. Percent

	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
<b>Asset class weights</b>	<b>40.0</b>	<b>43.7</b>	<b>60.0</b>	<b>56.3</b>
Belgium		0.8		
Finland		1.0		
France		8.5		
Greece		0.5		
Ireland		0.4		
Italy		3.1		
Netherlands		2.2		
Portugal		0.4		
Spain		3.9		
Germany		6.2		
Austria		0.4		
<i>Euro area (EUR)</i>		<i>27.3</i>		<i>50.3</i>
UK (GBP)		15.4		9.9
Denmark (DKK)		0.9		0.8
Switzerland (CHF)		5.7		0.4
Sweden (SEK)		2.1		1.0
<b>Total Europe</b>	<b>50.0</b>	<b>51.4</b>	<b>60.0</b>	<b>62.3</b>
US (USD)		27.9		31.1
Brazil		1.4		
Canada (CAD)		2.6		1.9
Mexico		0.4		
South Africa (ZAR)		0.7		
<b>Total Americas and Africa</b>	<b>35.0</b>	<b>32.9</b>	<b>35.0</b>	<b>33.0</b>
Australia (AUD)		3.0		0.2
Hong Kong		1.3		
Japan (JPY)		7.6		4.2
New Zealand (NZD)		0.1		0.1
Singapore (SGD)		0.6		0.1
South Korea		1.7		
Taiwan		1.4		
<b>Total Asia and Oceania</b>	<b>15.0</b>	<b>15.7</b>	<b>5.0</b>	<b>4.7</b>