

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

Second quarter 2008

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 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 second quarter of 2008. Prices in both fixed income and equity markets fell during the quarter.

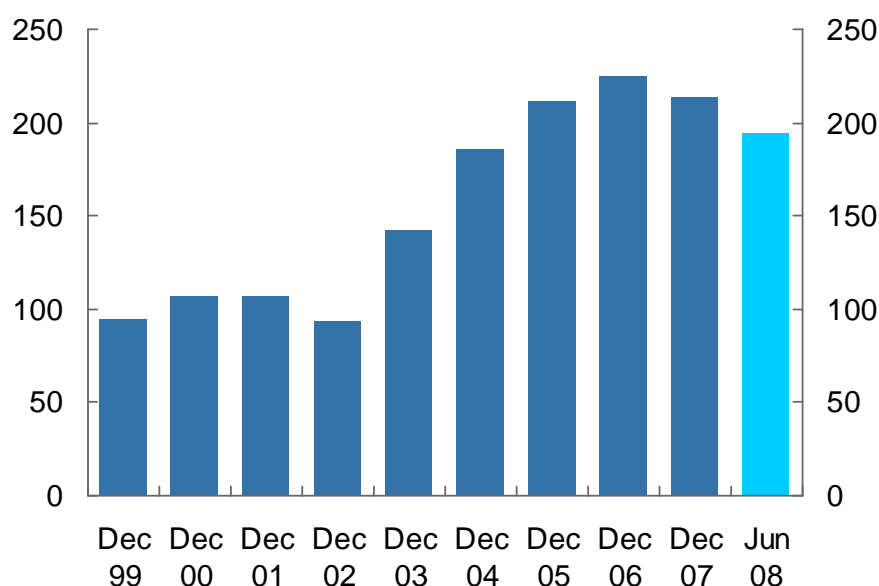
The decrease in prices in international markets led to a return on the investment portfolio in the second quarter of -1.66 per cent in international currency. The return on the equity portfolio was -1.88 per cent, and the return on the fixed income portfolio was -1.54 per cent. The return on the investment portfolio was 0.22 percentage point higher than the return on the benchmark portfolio defined by the Executive Board of Norges Bank. The market value of the portfolio at the end of the quarter was NOK 195 billion.

Table 1-1 provides a historical overview of risks and returns for the investment portfolio, while Chart 1-1 shows movements in the portfolio's market value.

Table 1-1 Investment portfolio. Risks and returns measured in NOK. Annualised figures as at 30 June 2008

	Last 2 years	Last 3 years	Last 5 years	Last 7 years	Since 01.01.98
Actual return (per cent)	-2.65	-1.08	1.19	0.99	3.45
Benchmark return (per cent)	-1.70	-0.50	1.46	1.07	3.49
Excess return (percentage points)	-0.96	-0.58	-0.27	-0.08	-0.04
Standard deviation (per cent)	8.01	7.84	7.78	7.67	7.22
Tracking error (percentage points)	0.76	0.64	0.52	0.46	0.41
Information ratio	-1.26	-0.91	-0.52	-0.18	-0.09

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



2 Market value and return

The investment portfolio's market value was NOK 194.9 billion at the end of the second quarter of 2008, a decrease of NOK 4.0 billion during the quarter (see Table 2-1). A negative return on investment decreased the value of the portfolio by NOK 3.3 billion, while a stronger krone against the currencies in which the portfolio is invested reduced its value by NOK 0.7 billion. A change in the krone exchange rate has no effect, however, on the portfolio's international purchasing power.

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

	Equities	Fixed income	Total
30.06.07	97 443	126 535	223 978
30.09.07	90 900	122 211	213 111
31.12.07	88 953	125 033	213 986
31.03.08	75 278	123 609	198 887
Inflows of new capital	-300	300	0
Return	-1 399	-1 900	-3 299
Movements in krone	-245	-429	-673
30.06.08	73 335	121 580	194 914

The return on the investment portfolio in the second quarter of 2008 was -1.66 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 -

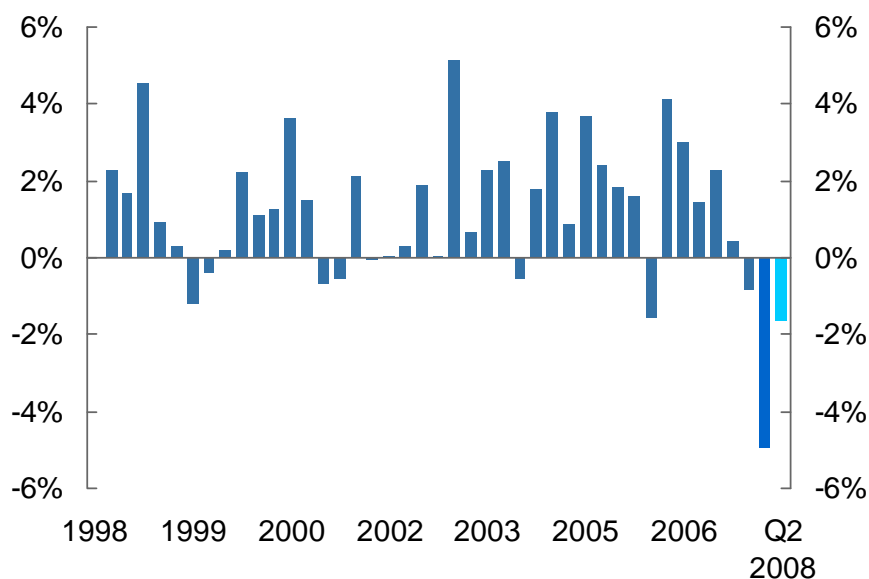
1.88 per cent on the equity portfolio and -1.54 per cent on the fixed income portfolio. In NOK terms, the aggregate return on the portfolio was -2.0 per cent. The difference between the return in international currency and the return in NOK is due to the appreciation of the krone during the quarter against the currencies included in the benchmark portfolio.

Table 2-2 Investment portfolio. Return. Per cent

	Measured in international currency		Measured in NOK		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Excess return
2007	3.37	4.59	-4.69	-3.57	-1.12
Q1 2008	-4.94	-3.91	7.06	-6.04	-1.01
April 2008	2.06	1.97	1.51	1.43	0.08
May 2008	0.24	0.06	-0.03	-0.22	0.19
June 2008	-3.88	-3.83	-3.43	-3.38	-0.04
Q2 2008	-1.66	-1.88	-2.00	-2.22	0.22
H1 2008	-6.52	-5.72	-8.91	-8.13	-0.79

Since 1998, the average quarterly return in international currency has been 1.18 per cent (see Chart 2-1). There has been a positive return in 32 out of 42 quarters.

Chart 2-1 Investment portfolio. Quarterly return 1998-2008. Per cent



The nominal annual return in international currency from 1 January 1998 to the end of the second quarter of 2008 was 4.74 per cent (see Table 2-3). After deductions for inflation and management costs, the table shows an annual net real return since 1 January 1998 of 2.55 per cent.

Table 2-3 Investment portfolio. Return. Per cent

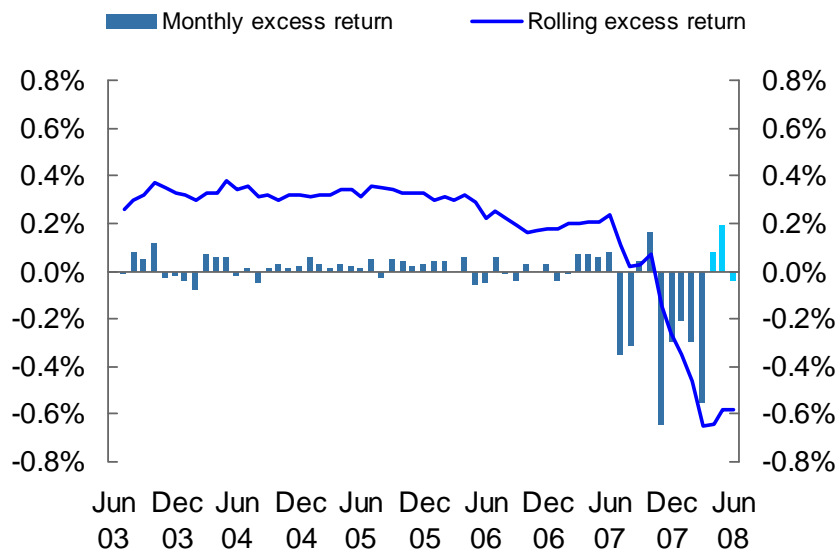
Period	Nominal annual return	Annual inflation*	Management costs	Annual net real return	Annual gross excess return
Since 01.01.98	4.74	2.07	0.06	2.55	-0.04
Since 01.01.99	4.22	2.19	0.07	1.92	-0.03
Since 01.01.00	4.87	2.29	0.07	2.45	-0.05
Since 01.01.01	4.40	2.32	0.07	1.97	-0.07
Since 01.01.02	4.70	2.47	0.06	2.12	-0.11
Since 01.01.03	5.17	2.55	0.06	2.49	-0.20
Since 01.01.04	4.49	2.78	0.06	1.60	-0.35
Since 01.01.05	3.58	2.89	0.07	0.61	-0.48
Since 01.01.06	1.46	3.10	0.07	-1.66	-0.78
Since 01.01.07	-2.26	3.72	0.07	-5.84	-1.33

* Weighted average of the increase in consumer prices in the countries included in the benchmark portfolio during the years in question.

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 difference between these return figures is the gross excess return achieved by NBIM.

The return on the portfolio in the second quarter of 2008 was 0.22 percentage point higher than the return on the benchmark portfolio (see Table 2-2). Monthly and cumulative excess returns over the past three years are presented in Chart 2-2. The line in the chart shows movements in the three-year rolling excess return. At the end of the second quarter of 2008, the three-year rolling annualised excess return was -0.58 percentage point. The column at the far right of Table 2-3 shows that the average excess return has been -0.04 percentage point per year since 1 January 1998.

Chart 2-2 Investment portfolio. Monthly excess return and three-year rolling excess return 2003-2008. Percentage points



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 lighter line in Chart 3-1 shows developments in expected tracking error since December 1999. Expected tracking error was 32 basis points at the end of the second quarter of 2008. In retrospect, we can use the variation in the deviation 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 darker line in the chart). This tracking error is annualised using 12-month rolling windows.

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

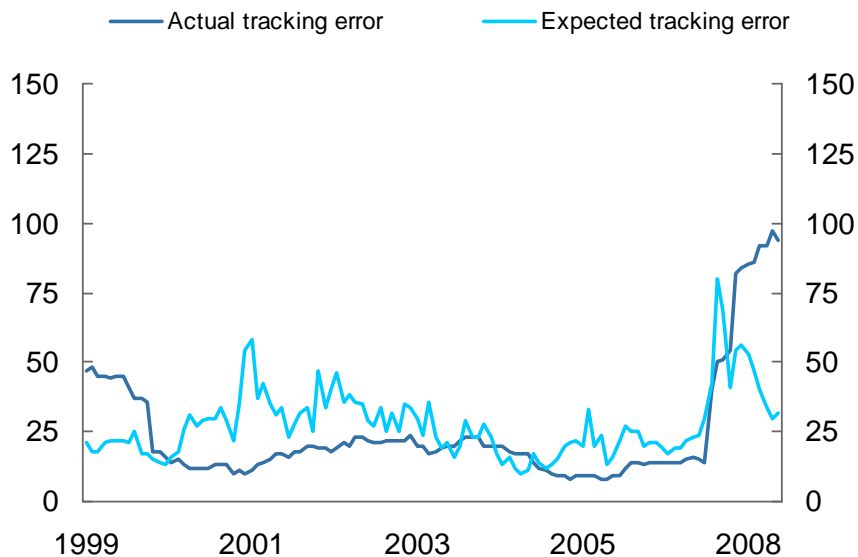


Chart 3-2 shows developments in expected tracking error in the equity and fixed income portfolios over the past 12 months.

Chart 3-2 Investment portfolio. Expected tracking error July 2007 to June 2008. Basis points

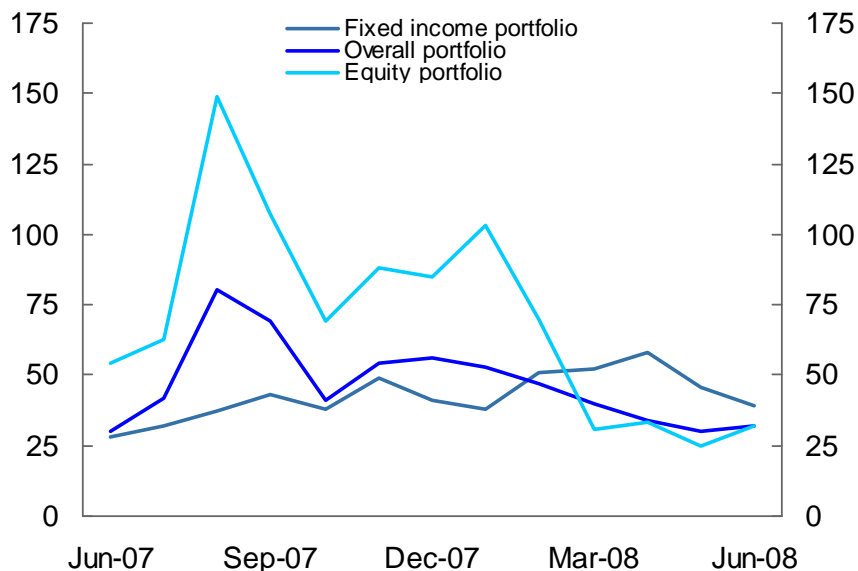


Table 3-1 breaks down the bond portfolio (fixed income portfolio excluding cash) by type of bond and credit rating.

Table 3-1 Investment portfolio. Bond portfolio by credit rating.¹⁾ As at 30 June 2008

Percentage of fixed income portfolio	Aaa	Aa	A	Baa	Ba	Lower	P-1	No rating
Government and govt-related bonds	22.2	14.8	2.5	0.8	0.4	0.6	-	0.1
Inflation-linked bonds	5.1	2.2	0.1	-	-	-	-	-
Corporate bonds	1.1	4.9	6.7	4.6	0.3	0.1	-	0.1
Securitised debt	30.4	1.3	0.8	0.4	0.1	0.1	-	0.2
Short-term certificates	-	-	-	-	-	-	0.3	-
Total bonds and other fixed income instruments	58.7	23.1	10.2	5.8	0.7	0.8	0.3	0.4

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 second quarter of 2008.

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

Risk	Limits	Actual		
		31.12.07	31.03.08	30.06.08
Market risk	Tracking error max. 1.5 percentage points	0.56	0.40	0.32
Asset mix	Fixed income portfolio	58.5	62.2	62.4
	Equity portfolio	41.5	37.9	37.6
Market distribution, equities	Europe	52.5	51.1	49.8
	Americas and Africa	33.5	34.2	34.6
	Asia and Oceania	14.0	14.7	15.6
Currency distribution, fixed income	Europe	60.6	62.2	61.5
	Americas	33.4	31.5	33.3
	Asia and Oceania	6.0	6.3	5.2
Ownership interest	Max. 5% of a company	4.62	0.96	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 second quarter of 2008, NOK 54.5 billion was transferred to the buffer portfolio from the SDFI, and a further NOK 36.7 billion was transferred to the portfolio through Norges Bank’s purchases of foreign exchange. A total of NOK 90.6 billion was transferred to the Government Pension Fund – Global during the quarter. The return on the buffer portfolio in the second quarter of 2008 was 1.21 per cent in NOK terms. The market value of the portfolio at the end of the quarter was NOK 10.3 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
April 2008	21 885	9 897	27 484	13 889
May 2008	14 440	9 997	29 353	8 942
June 2008	18 147	16 795	33 812	10 296
Q2 2008	54 472	36 688	90 649	10 296
H1 2008	108 998	65 740	178 714	

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 second 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 2007.

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 2007.

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 2007 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. In the second quarter of 2008, NBIM's total costs associated with the management of the investment portfolio, including performance-based fees, amounted to NOK 72.5 million, which corresponds to 0.07 per cent of the average portfolio (annualised).

Investment portfolio – profit and loss account and balance sheet

The financial reporting to 30 June 2008 is based on the accounting data used for Norges Bank's monthly balance sheet for June published on 14 July 2008.

Profit and loss account (Figures in millions of NOK)			Year to date		
	Q2 2007	Q2 2008	31.12.07	30.06.07	30.06.08
<i>Profit/loss on financial assets excl. exchange rate adjustments</i>					
Interest income, deposits in foreign banks	-19	9	-104	-22	8
Interest income, lending associated with reverse repurchase agreements	992	381	3 798	1 910	958
Net income/expenses and gains/losses from:					
- equities and units	6 273	-1 209	3 676	8 191	-12 360
- bonds and other fixed income instruments	-2 633	-3 276	2 572	-1 776	-1 466
- financial derivatives	1 395	1 306	1 032	1 843	462
Interest expenses, borrowing associated with repurchase agreements	-1 196	-684	-4 751	-2 403	-1 571
Other interest expenses	-15	2	-21	-34	-1
Other expenses	-19	-19	-118	-39	-40
Profit/loss before exchange rate adjustments	4 778	-3 490	6 085	7 670	-14 010
Exchange rate adjustments	-5 061	-788	-16 678	-8 220	-5 112
Profit/loss	-283	-4 279	-10 593	-550	-19 122

Balance sheet (Figures in millions of NOK)	31.12.07	30.06.07	30.06.08
FINANCIAL ASSETS			
Deposits in foreign banks	1 490	518	1 379
Lending associated with reverse repurchase agreements	61 849	106 137	33 309
Equities and units	88 489	97 984	72 564
Bonds and other fixed income instruments	158 017	140 654	147 415
Financial derivatives	0	1 401	33
Other assets	61	59	64
TOTAL FINANCIAL ASSETS	309 905	346 751	254 763
FINANCIAL LIABILITIES			
Short-term borrowing	5	456	95
Borrowing associated with repurchase agreements	85 196	93 592	44 393
Financial derivatives	436	0	0
Unsettled trades	2 773	6 092	3 517
Other liabilities	7 493	22 611	11 846
TOTAL FINANCIAL LIABILITIES	95 903	122 751	59 852
NET PORTFOLIO	214 002	224 000	194 911

Buffer portfolio – profit and loss account and balance sheet

The financial reporting to 30 June 2008 is based on the accounting data used for Norges Bank's monthly balance sheet for June published on 14 July 2008.

Profit and loss account (Figures in millions of NOK)			Year to date		
	Q2 2007	Q2 2008	31.12.07	30.06.07	30.06.08
<i>Profit/loss on financial assets excl. exchange rate adjustments</i>					
Interest income, deposits in foreign banks	52	63	197	116	63
Interest income, lending associated with reverse repurchase agreements	105	103	511	306	252
Interest expenses, borrowing associated with repurchase agreements	0	-2	-1	0	-2
Other interest expenses	-16	-39	-76	-16	-64
Other expenses	0	0	-1	-1	-1
Profit/loss before exchange rate adjustments	141	125	630	406	249
Exchange rate adjustments	-513	-186	-1 119	-1 058	-54
Profit/loss	-372	-60	-489	-651	196

Balance sheet (Figures in millions of NOK)	31.12.07	30.06.07	30.06.08
FINANCIAL ASSETS			
Deposits in foreign banks	7	120	2
Lending associated with reverse repurchase agreements	10 121	3 051	4 928
Financial derivatives	0	0	0
Other assets	0	0	16 716
TOTAL FINANCIAL ASSETS	10 128	3 171	21 646
FINANCIAL LIABILITIES			
Financial derivatives	0	21	16
Other liabilities	-2 273	2 035	14 397
TOTAL FINANCIAL LIABILITIES	-2 273	2 035	14 413
Unsettled contracts not recognised	1 651	2 386	3 066
NET PORTFOLIO	14 052	3 501	10 299