

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

Third quarter 2010

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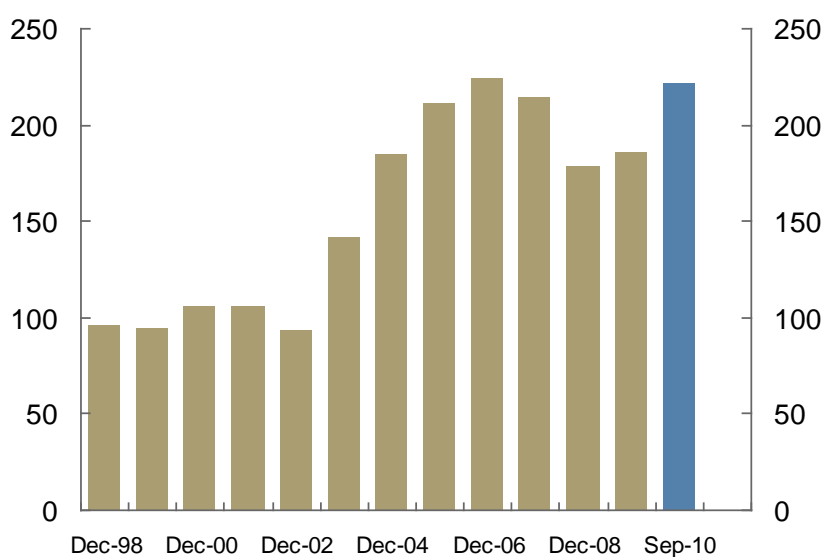
The foreign exchange reserves are to be available for intervention in the foreign exchange market in connection with the implementation of monetary policy or to promote financial stability. The reserves are divided into a money market portfolio and an investment portfolio. In addition, a buffer portfolio 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. On 3 February 2010 the Executive Board adopted new guidelines for the investment of the foreign exchange reserves. See the report for the second quarter of 2010 for a presentation of the changes.

1 Key figures

The market value of the investment portfolio was 222 billion kroner on 30 September 2010. The return in the third quarter was 5.8 percent, which was 0.60 percentage point higher than the return on the benchmark portfolio defined by Norges Bank's Executive Board.

Chart 1-1 Investment portfolio. Market value. In billions of kroner



Since 1998, the portfolio has generated an annual nominal return of 4.95 percent. The annual net real return (i.e. the nominal return less management costs and inflation) since 1998 has been 3.0 percent. The average excess return during the period has been 0.14 percentage point.

Table 1-1 Key figures to 30 September 2010. 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) | 9.19 | 1.82 | 3.75 | 5.00 | 4.95 |
| Benchmark return (percent) | 7.30 | 1.69 | 3.71 | 4.84 | 4.81 |
| Excess return (percentage points) | 1.89 | 0.14 | 0.04 | 0.16 | 0.14 |
| Standard deviation (percent) ¹⁾ | 6.13 | 10.16 | 8.10 | 6.06 | 5.49 |
| Tracking error (percentage points) | 0.63 | 1.87 | 1.46 | 1.03 | 0.93 |
| Information ratio ²⁾ | 2.99 | 0.07 | 0.03 | 0.16 | 0.15 |
| Gross annual return (percent) | 9.19 | 1.82 | 3.75 | 5.00 | 4.95 |
| Annual price inflation (percent) | 1.54 | 1.73 | 1.82 | 1.92 | 1.82 |
| Annual management costs (percent) | 0.07 | 0.08 | 0.07 | 0.07 | 0.07 |
| Annual net real return (percent) | 7.47 | 0.02 | 1.82 | 2.96 | 3.00 |

1) The standard deviation is a measure of variations in the return/excess return during a period. Each monthly return/excess return is compared with the mean for the period. The higher the standard deviation, the greater the variations relative to the mean and the higher the risk.

2) The information ratio (IR) is a measure of risk-adjusted return. It is calculated as the ratio of excess return to the actual relative market risk (as measured by tracking error) to which the portfolio has been exposed. The IR indicates how much excess return has been achieved per unit of risk.

2 Market value and return

The investment portfolio's market value fell by 5.1 billion kroner during the third quarter of 2010. This follows the transfer of 4.7 billion kroner to the money market portfolio. A positive return on investment increased the investment portfolio's value by 12.7 billion kroner, while a stronger krone in relation to the currencies in which the portfolio is invested reduced its value by 13.2 billion kroner.

The return on the investment portfolio in the third quarter was 5.8 percent measured in international currency. There was a return of 9.6 percent on the equity portfolio and 3.5 percent on the fixed-income portfolio. At the end of the quarter, the three-year rolling annualised return for the overall portfolio was 1.8 percent.

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 0.60 percentage point higher than the return on the benchmark portfolio.

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

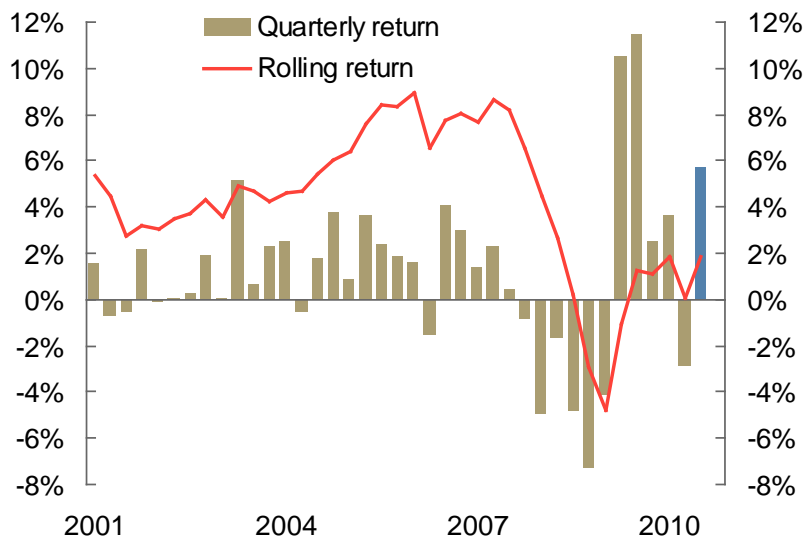


Chart 2-2 Quarterly excess return and three-year rolling annualised excess return. Percentage points

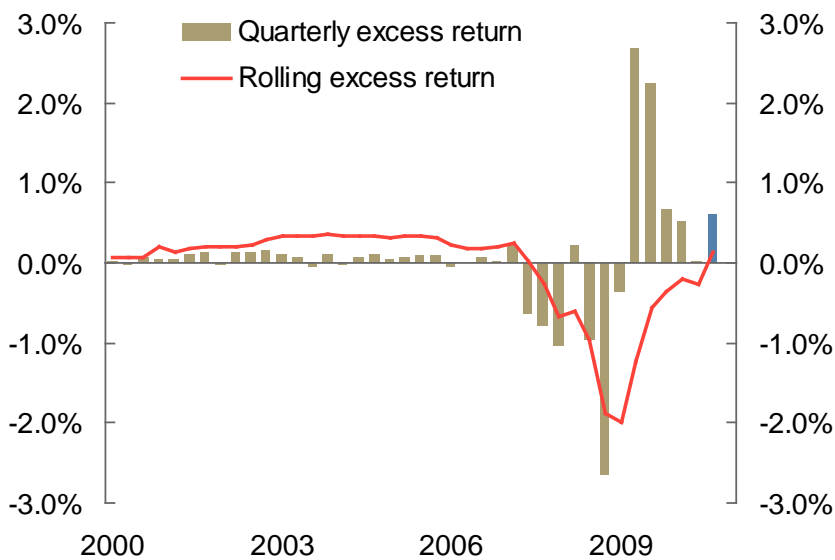


Table 2-1 Key figures. Quarterly data

| | 3Q 2010 | 2Q 2010 | 1Q 2010 | 4Q 2009 | 3Q 2009 |
|---|------------|------------|------------|---------|------------|
| Market value (billions of kroner) | | | | | |
| Fixed-income portfolio | 135.7 | 143.7 | 135.4 | 102.6 | 103.0 |
| Equity portfolio | 86.3 | 83.4 | 87.2 | 82.9 | 80.0 |
| Overall portfolio | 222.0 | 227.1 | 222.6 | 185.4 | 183.0 |
| | | | | | |
| Inflows of new capital | -4.7 | 0.0 | 31.0 | 0.0 | 0.0 |
| Return | 12.7 | -7.1 | 6.7 | 4.9 | 21.3 |
| Change due to movements in krone | -13.2 | 11.6 | -0.5 | -2.5 | -16.0 |
| | | | | | |
| Return in international currency (percent) | | | | | |
| Equity portfolio | 9.63 | -9.17 | 5.06 | 4.39 | 17.59 |
| Fixed-income portfolio | 3.48 | 1.27 | 2.50 | 1.03 | 7.36 |
| Overall portfolio | 5.75 | -2.84 | 3.66 | 2.51 | 11.51 |
| Benchmark portfolio | 5.16 | -2.87 | 3.16 | 1.86 | 9.28 |
| Excess return | 0.60 | 0.03 | 0.50 | 0.65 | 2.23 |
| | | | | | |
| Return in kroner (percent) | | | | | |
| Equity portfolio | 3.46 | -4.62 | 4.71 | 3.17 | 8.63 |
| Fixed-income portfolio | -2.35 | 6.35 | 2.17 | -0.14 | -0.81 |
| Overall portfolio | -0.20 | 2.04 | 3.32 | 1.32 | 3.02 |
| Benchmark portfolio | -0.76 | 2.01 | 2.82 | 0.67 | 0.96 |

3 Market risk and management guidelines

Market risk in the investment portfolio is measured partly by 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 new guidelines for the foreign exchange reserves (see above) introduced an expected level of active risk in the management of the portfolio of 1 percentage point (100 basis points) expected tracking error under normal market conditions, replacing the previous maximum limit of 1.5 percentage points under any market conditions. 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 percentage point in two out of every three years.

The investment portfolio's expected tracking error decreased somewhat in the third quarter of 2010.

Chart 3-1 Expected tracking error. Basis points

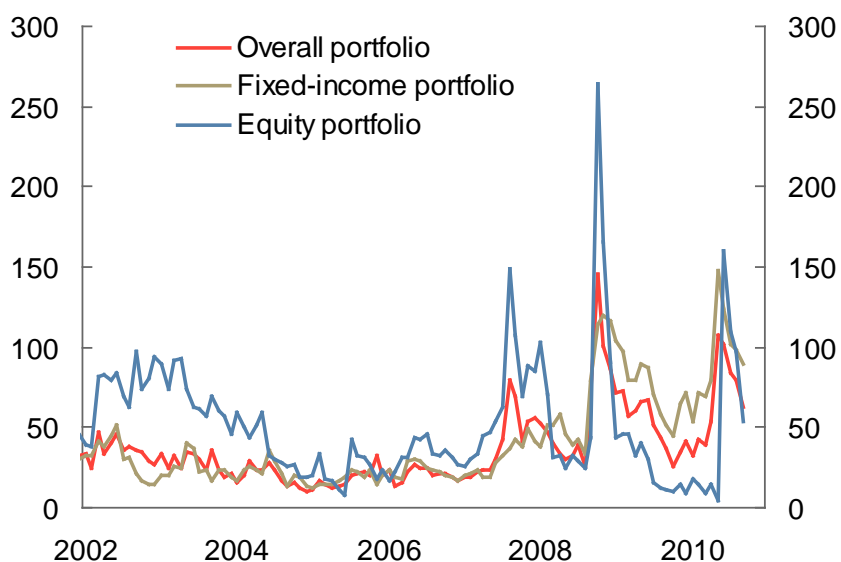


Table 3-1 Fixed-income portfolio by credit rating as at 30 September 2010 ¹⁾

| Percentage of fixed-income portfolio | Aaa | Aa | A | Baa | Ba | Lower | No rating |
|---|-------------|-------------|------------|------------|------------|------------|------------|
| Government and govt-related bonds | 56.7 | 9.0 | 0.4 | 0.4 | 0.4 | 0.0 | 0.1 |
| Inflation-linked bonds | 0.0 | 2.3 | - | - | - | - | - |
| Corporate bonds | 0.1 | 2.3 | 4.4 | 3.3 | 0.2 | 0.1 | 0.1 |
| Securitised debt | 13.9 | 4.6 | 0.2 | 0.1 | 0.1 | 1.3 | 0.0 |
| Total bonds and other fixed-income instruments | 70.7 | 18.2 | 5.0 | 3.8 | 0.7 | 1.4 | 0.2 |

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 guidelines in the third quarter of 2010.

Table 3-2 Key figures for risk and exposure

| Risk | Limits | Actual | | |
|-------------------------------------|--|------------|------------|------------|
| | | 31.12.2009 | 30.06.2010 | 30.09.2010 |
| Market risk | Expected level of 1.0 percentage point expected tracking error | 0.41 | 1.02 | 0.63 |
| Asset mix | Fixed-income portfolio | 55.2 | 62.0 | 61.1 |
| | Equity portfolio | 44.8 | 38.0 | 38.9 |
| Currency distribution, fixed-income | Europe | 61.9 | 45.2 | 47.1 |
| | Americas | 33.5 | 45.0 | 42.9 |
| | Asia and Oceania | 4.6 | 9.9 | 10.0 |
| Market distribution, equities | Europe | 50.5 | 35.4 | 32.7 |
| | Americas and Africa | 34.0 | 47.0 | 49.7 |
| | Asia and Oceania | 15.5 | 17.6 | 17.6 |
| Ownership | Max. 5% of a company | 0.24 | 0.42 | 0.24 |

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 2010, 33.9 billion kroner was transferred to the buffer portfolio from the SDFI, and 48.7 billion kroner was transferred from the buffer portfolio to the Government Pension Fund Global.

The return on the buffer portfolio in the third quarter was -8.4 percent measured in kroner. The market value of the portfolio at the end of the quarter was 3.0 billion kroner. The portfolio 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 kroner

| Period | Transferred from SDFI | Norges Bank's foreign exchange purchases | Transferred to Government Pension Fund Global | Transferred to money market portfolio | Market value at end of period |
|---------------|-----------------------|--|---|---------------------------------------|-------------------------------|
| 2009 | 147 929 | 24 628 | - 169 412 | - 16 955 | 6 572 |
| 1Q 2010 | 25 325 | 0 | - 19 338 | - 4 019 | 8 751 |
| 2Q 2010 | 31 060 | 0 | -35 481 | 0 | 5 389 |
| 3Q2010 | 33 863 | 13 306 | 48 733 | 0 | 3 024 |

5 Financial reporting

Financial information for the investment and buffer portfolios is presented below. The financial reporting forms part of, and comprises excerpts from, Norges Bank's financial statements. For detailed information and notes, see the bank's Annual Report for 2009.

Accounting policies

The accounts for the third quarter of 2010 have been prepared in accordance with the accounting policies for Norges Bank. A presentation of the accounting policies applied in the preparation of the accounts can be found in the Annual Report for 2009.

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 2009 contain further information on significant estimates and assumptions.

Operating expenses

NBIM's total costs associated with the management of the investment portfolio amounted to 92.2 million kroner in the third quarter of 2010, which corresponds to 0.06 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 kroner) | Quarter | | | Year to date | |
|--|---------------|---------------|----------------|----------------|---------------|
| | 3Q 2010 | 3Q 2009 | 30.99.201 0 | 30.09.200 9 | 31.12.2009 |
| Interest income, deposits in foreign banks | 0 | 0 | 2 | -14 | 39 |
| Interest income, lending associated with reverse repurchase agreements | 3 | 1 | 9 | 73 | 75 |
| Net income/expenses and gains/losses from: | | | | | |
| - equities and units | 8 486 | 14 440 | 2 546 | 21 339 | 24 910 |
| - bonds and other fixed-income instruments | 4 268 | 7 082 | 10 113 | 13 503 | 14 798 |
| - financial derivatives | -70 | -144 | -378 | -5 | 24 |
| Interest expenses, borrowing associated with repurchase agreements | -2 | -24 | -15 | -213 | -227 |
| Other interest expenses | -5 | 0 | -5 | 48 | -3 |
| Other expenses | -6 | -27 | -27 | -59 | -70 |
| Profit/loss before exchange rate adjustments | 12 675 | 21 329 | 12 245 | 34 672 | 39 545 |
| Exchange rate adjustments | -13 170 | -15 983 | -2 058 | -30 581 | -33 048 |
| Profit/loss | -496 | 5 346 | 10 187 | 4 091 | 6 496 |

Table 5-2 Investment portfolio. Balance sheet

(Figures in millions of kroner)

| | 30.09.2010 | 30.09.2009 | 31.12.2009 |
|---|-------------------|-------------------|-------------------|
| FINANCIAL ASSETS | | | |
| Deposits in foreign banks | 404 | 1 401 | 561 |
| Lending associated with reverse repurchase agreements | 25 405 | 10 003 | 12 281 |
| Equities and units | 78 171 | 66 694 | 74 618 |
| Equities lent | 8 501 | 12 702 | 8 445 |
| Bonds and other fixed-income instruments | 117 184 | 111 749 | 96 909 |
| Bonds lent | 23 059 | 17 299 | 18 135 |
| Financial derivatives | 551 | 473 | 361 |
| Unsettled trades | 3 985 | 2 259 | 802 |
| Other assets | 1 243 | 57 | 790 |
| TOTAL FINANCIAL ASSETS | 258 503 | 222 637 | 212 903 |
| FINANCIAL LIABILITIES | | | |
| Short-term borrowing | 385 | 0 | 272 |
| Borrowing associated with repurchase agreements | 11 355 | 13 263 | 8 633 |
| Cash collateral received | 19 725 | 16 788 | 16 734 |
| Financial derivatives | 1 385 | 1 099 | 291 |
| Unsettled trades | 3 662 | 4 001 | 1 528 |
| Other liabilities | 2 | 4 459 | 1 |
| TOTAL FINANCIAL LIABILITIES | 36 514 | 39 610 | 27 459 |
| NET PORTFOLIO | 221 989 | 183 027 | 185 444 |

Buffer portfolio – profit and loss account and balance sheet

Table 5-3 Buffer portfolio. Profit and loss account

| (Figures in millions of kroner) | Quarter | | | Year to date | |
|--|-------------|---------------|----------------|----------------|---------------|
| | 3Q 2010 | 3Q2009 | 30.09.201 0 | 30.09.200 9 | 31.12.2009 |
| Interest income, deposits in foreign banks | 1 | 21 | 3 | 67 | 74 |
| Interest income, lending associated with reverse repurchase agreements | 7 | 5 | 21 | 66 | 76 |
| Other interest expenses | 0 | -2 | 0 | -11 | -11 |
| Other expenses | 0 | -1 | -1 | -1 | -1 |
| Profit/loss before exchange rate adjustments | 9 | 23 | 23 | 121 | 137 |
| Exchange rate adjustments | -814 | -2 599 | 368 | -3 581 | -3 536 |
| Profit/loss | -805 | -2 575 | 391 | -3 460 | -3 399 |

Table 5-4 Buffer portfolio. Balance sheet

| (Figures in millions of kroner) | 30.09.2010 | 30.09.2009 | 31.12.2009 |
|---|---------------|---------------|---------------|
| FINANCIAL ASSETS | | | |
| Deposits in foreign banks | 5 | 8 | 13 |
| Lending associated with reverse repurchase agreements | 9 710 | 16 060 | 8 520 |
| Other assets | 12 505 | 16 109 | 2 424 |
| TOTAL FINANCIAL ASSETS | 22 221 | 32 176 | 10 958 |
| Financial derivatives | 0 | 1 | 0 |
| Other liabilities | 20 870 | 8 457 | 0 |
| Unsettled trades not recognised | 1 674 | 885 | -4 386 |
| NET PORTFOLIO | 3 024 | 24 603 | 6 572 |

Appendix

Investment portfolio Benchmark portfolio as at 30 September 2010. Percent

| Country for equity benchmark Currency for fixed-income benchmark | Equities | | Fixed-income instruments | |
|--|-------------------------------------|-------------------------------|-------------------------------------|-------------------------------|
| | Strategic benchmark portfolio | Actual benchmark portfolio | Strategic benchmark portfolio | Actual benchmark portfolio |
| Asset class weights | 40.0 | 38.9 | 60.0 | 61.1 |
| Belgium | | 0.5 | | |
| Finland | | 0.6 | | |
| France | | 4.7 | | |
| Greece | | 0.1 | | |
| Ireland | | 0.1 | | |
| Italy | | 1.5 | | |
| Netherlands | | 1.3 | | |
| Portugal | | 0.2 | | |
| Spain | | 1.8 | | |
| Germany | | 3.6 | | |
| Austria | | 0.2 | | |
| <i>Euro area (euro)</i> | | <i>14.8</i> | | <i>37.1</i> |
| UK (pounds) | | 8.9 | | 10.1 |
| Denmark (kroner) | | 0.6 | | |
| Switzerland (francs) | | 3.5 | | |
| Sweden (kronor) | | 1.5 | | |
| Total Europe | | 29.3 | | 47.2 |
| US (dollars) | | 47.3 | | 42.9 |
| Canada (dollars) | | 4.8 | | |
| Israel (shekels) | | 0.4 | | |
| Total Americas and Africa | | 52.4 | | 42.9 |
| Australia (dollars) | | 3.8 | | |
| Hong Kong | | 2.1 | | |
| Japan (yen) | | 9.1 | | 9.9 |
| New Zealand (dollars) | | 0.1 | | |
| Singapore (dollars) | | 0.8 | | |
| South Korea | | 2.3 | | |
| Total Asia and Oceania | | 18.3 | | 9.9 |