

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

First quarter 2011

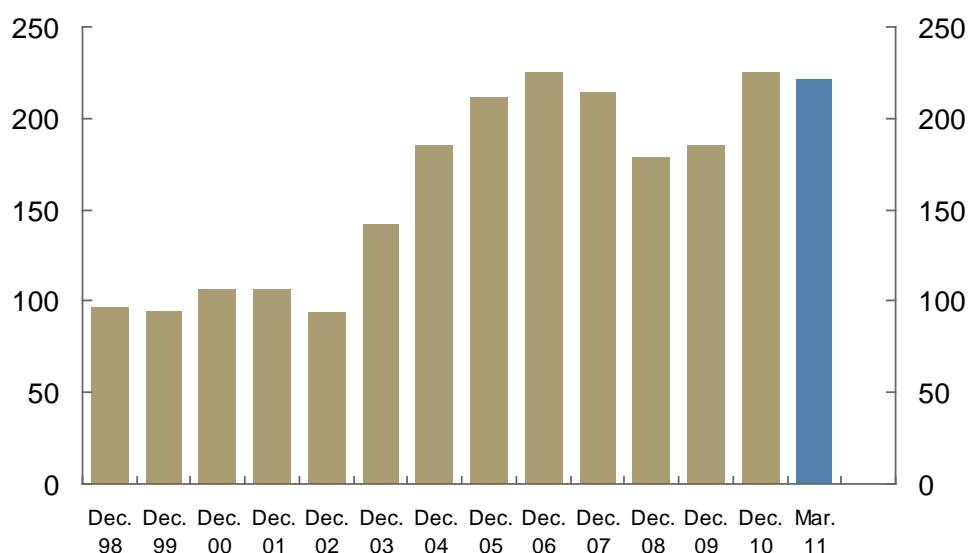
The foreign exchange reserves are to be available for intervention in the foreign exchange market in connection with the implementation of monetary policy or to promote financial stability. The reserves are divided into a money market portfolio and a long-term portfolio. In addition, a buffer portfolio 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 long-term 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 long-term 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 adopted new guidelines in 2010 for the investment of the foreign exchange reserves, including a new benchmark portfolio for the long-term portfolio. The portfolio has a strategic allocation to equities of 40 percent and a strategic allocation to bonds of 60 percent. The implementation of the new guidelines is ongoing and is expected to be completed in the second half of 2011.

1 Key figures

The market value of the long-term portfolio was 221.1 billion kroner on 31 March 2011. The portfolio returned 1.55 percent in the first quarter, which was 0.42 percentage point higher than the return on the benchmark portfolio defined by Norges Bank's Executive Board.

Chart 1-1 Long-term portfolio. Market value. In billions of kroner



Since 1998, the long-term portfolio has generated an annual return of 5.04 percent. The annual net real return (i.e. the nominal return less management costs and inflation) since 1998 has been 3.01 percent. The return that NBIM generates on the actual portfolio is measured against the return on a benchmark portfolio defined by the Executive Board. The average excess return during the period has been 0.18 percentage point.

Table 1-1 Key figures to 31 March 2011. 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)	6.47	5.07	3.78	4.84	5.04
Benchmark return (percent)	5.26	4.09	3.65	4.63	4.86
Excess return (percentage points)	1.21	0.98	0.12	0.22	0.18
Standard deviation (percent) ¹⁾	5.33	9.85	8.10	6.08	5.42
Tracking error (percentage points)	0.58	1.77	1.47	1.04	0.91
Information ratio ²⁾	2.08	0.56	0.08	0.21	0.19
Gross annual return (percent)	6.47	5.07	3.78	4.84	5.04
Annual price inflation (percent)	2.60	1.70	2.10	2.10	1.90
Annual management costs (percent)	0.06	0.08	0.08	0.07	0.07
Annual net real return (percent)	3.76	3.23	1.54	2.66	3.01
Annual gross excess return (percentage points)	1.21	0.98	0.12	0.22	0.18

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 long-term portfolio's market value was 222.1 billion kroner at the end of the first quarter, a decrease of 3.6 billion kroner during the quarter. A positive return on investment increased its value by 3.5 billion kroner, while a stronger krone in relation to the currencies in which the portfolio is invested reduced its value by 7.1 billion kroner. No capital was transferred to the portfolio during the quarter.

The long-term portfolio returned 1.55 percent in the first quarter, measured in international currency. There was a return of 3.18 percent on the equity portfolio and 0.39 percent on the fixed-income portfolio. The annualised return for the overall portfolio over the past ten years was 4.84 per cent.

The return on the actual portfolio was 0.42 percentage point higher than the return on the benchmark portfolio in the first quarter of 2011, and 0.22 percentage point higher over the past ten years.

Chart 2-1 Quarterly and accumulated annualised return since 1 January 1998. Percent

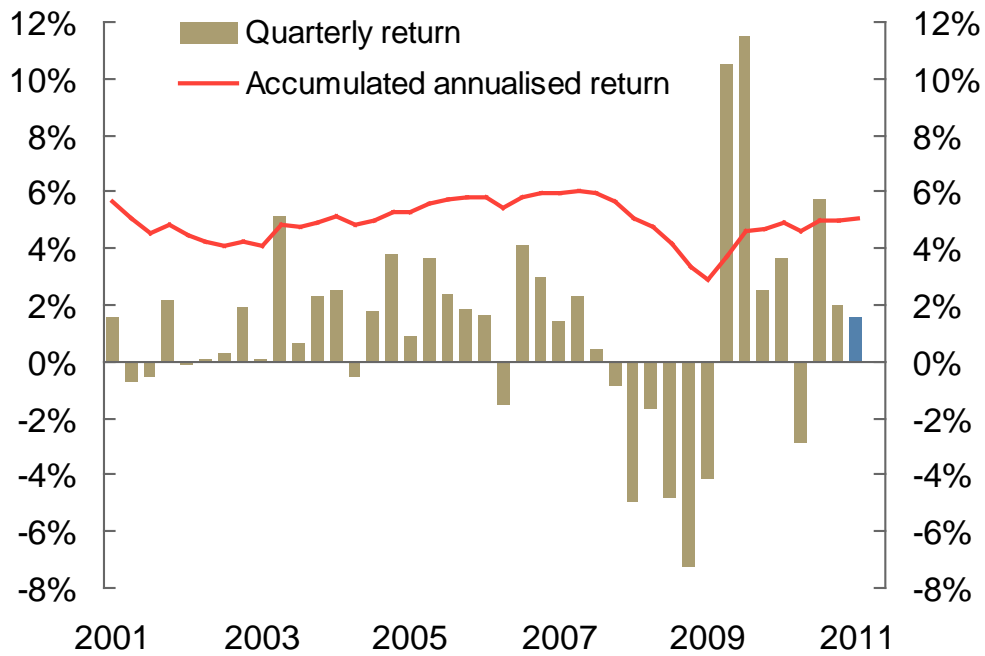


Chart 2-2 Quarterly and accumulated annualised excess return since 1 January 1998. Percentage points

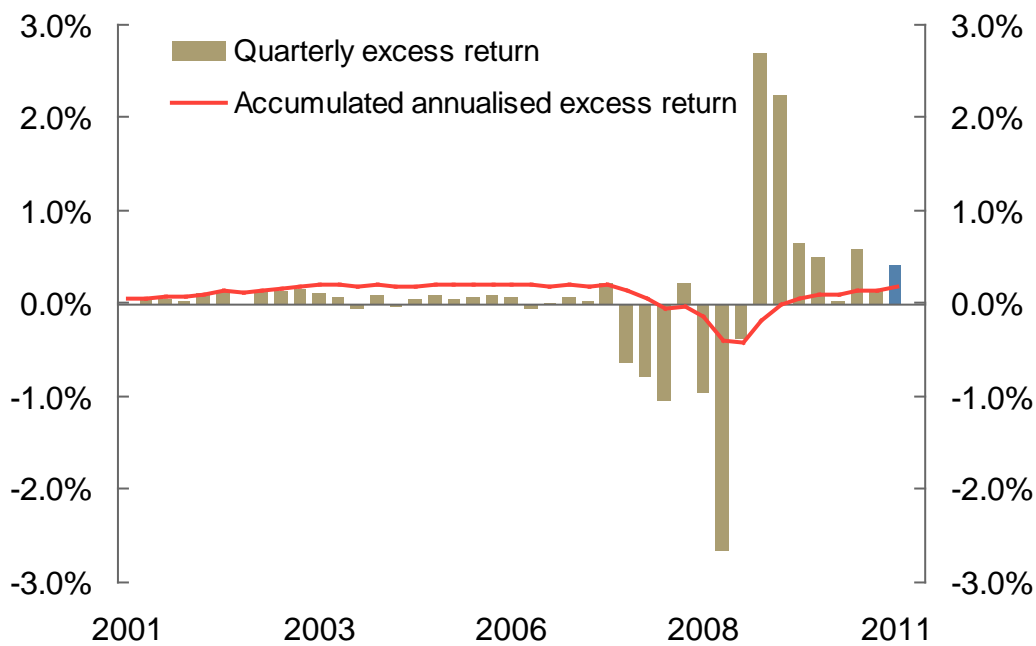


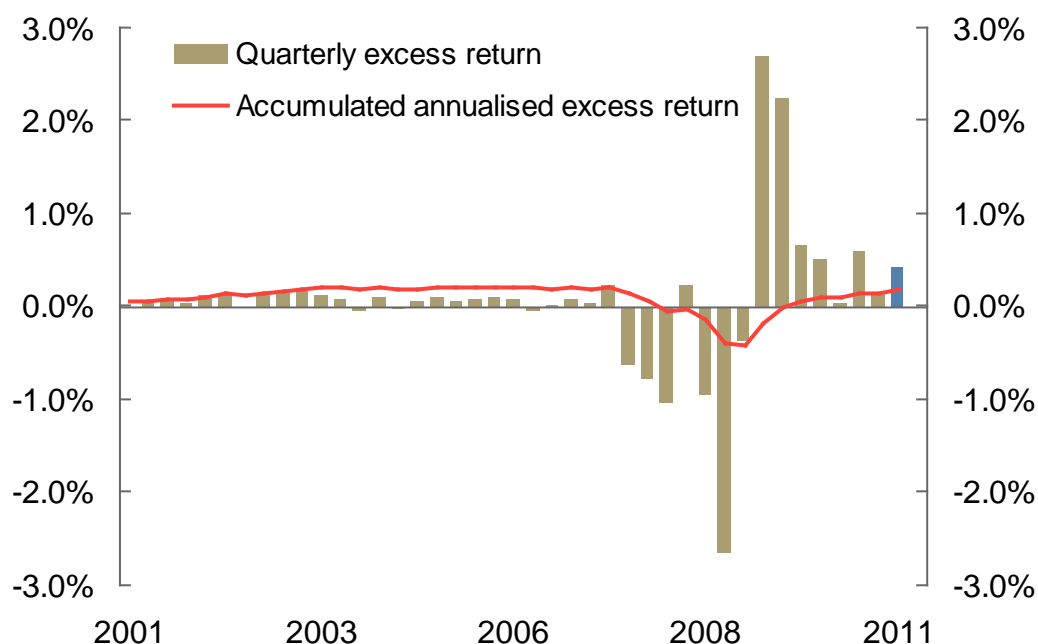
Table 2-1 Key figures. Quarterly data

	1Q 2011	4Q 2010	3Q 2010	2Q 2010	1Q 2010
Market value (billions of kroner)					
Fixed-income portfolio	126.8	130.9	135.7	143.7	135.4
Equity portfolio	94.3	93.8	86.3	83.4	87.2
Overall portfolio	221.1	224.7	222.0	227.1	222.6
Inflows of new capital					
Inflows of new capital	0.0	0.0	-4.7	0.0	31.0
Return					
Return	3.5	4.4	13.6	-7.1	6.7
Change due to movements in krone					
Change due to movements in krone	-7.1	-1.7	-14.0	11.6	-0.5
Return in international currency (percent)					
Equity portfolio	3.18	9.48	9.63	-9.17	5.06
Fixed-income portfolio	0.39	-2.71	3.48	1.27	2.50
Overall portfolio	1.55	2.03	5.75	-2.84	3.66
Benchmark portfolio	1.13	1.90	5.16	-2.87	3.16
Excess return (percentage points)	0.42	0.13	0.60	0.03	0.50
Return in kroner (percent)					
Equity portfolio	-0.03	8.63	3.46	-4.62	4.71
Fixed-income portfolio	-2.73	-3.47	-2.35	6.35	2.17
Overall portfolio	-1.60	1.24	-0.20	2.04	3.32
Benchmark portfolio	-2.02	1.11	-0.76	2.01	2.82

3 Market risk and management guidelines

The level of absolute risk in the portfolio increased somewhat during the first quarter but was still relatively low by the standards of recent years (see Chart 3-1).

Chart 3-1 Expected absolute volatility. Percent and billions of kroner



Market risk in the long-term portfolio is measured partly by expected tracking error (relative volatility). This is a statistically-defined measure of risk which says something about the amount of variation we can normally expect between the return on the benchmark portfolio and the return on the actual portfolio.

The Executive Board adopted new guidelines for the long-term portfolio in 2010 (see the report on the second quarter of 2010) with 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. 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. As can be seen from Charts 3-2 and 3-3, the portfolio's expected tracking error decreased somewhat in the first quarter of 2011.

The two charts show expected tracking error calculated in two different ways. The calculations in Chart 3-2 are based on a shorter dataset¹ and are therefore more sensitive to short-term changes in market conditions, while the dataset for Chart 3-3 consists of equally weighted weekly price observations over the past three years. The method in Chart 3-3 is the one used for the Government Pension Fund Global from 2011.

¹ When calculating expected volatility, both absolute and relative, historical price observations in the market are used to estimate volatilities and correlations for positions in the portfolio.

Chart 3-2 Expected tracking error. Basis points

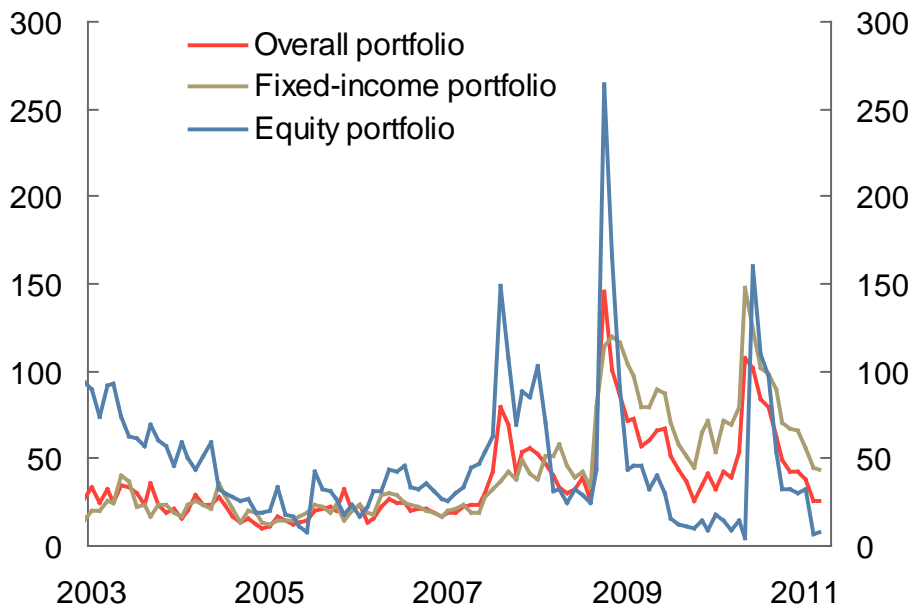
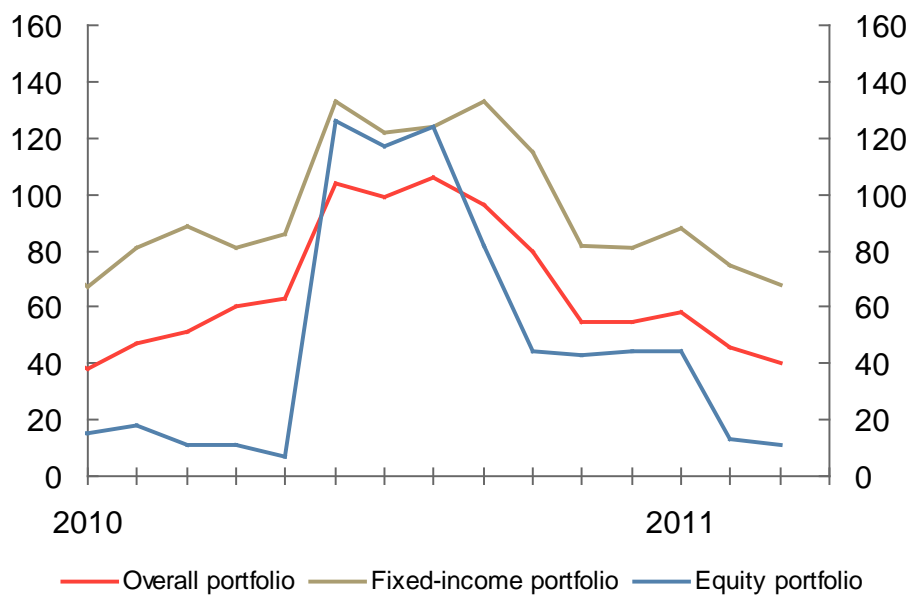


Chart 3-3 Expected tracking error. New calculation method². Basis points



² Volatility estimated on the basis of equally weighted weekly price observations over the past three years. Data since December 2009.

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

Table 3-1 Fixed-income portfolio by credit rating as at 31 March 2011 ¹⁾

(Percentage of fixed-income portfolio)	Aaa	Aa	A	Baa	Lower	Total
Government bonds	57.0	10.6	0.0	0.2	0.2	68.0
Government-related bonds	6.7	0.5	0.2	0.4	0.1	7.8
Inflation-linked bonds	0.0	1.9	0.0	0.0	0.0	1.9
Corporate bonds	0.1	1.2	2.4	1.8	0.3	5.8
Securitised bonds	10.9	4.5	0.2	0.2	0.8	16.6
Total bonds and other fixed-income instruments	74.6	18.6	2.8	2.6	1.4	100.0

¹⁾ Basert på kredittvurdering fra minst ett av kredittvurderingsbyråene Moody's, Standard & Poor's og Fitch.

Table 3-2 provides an overview of risk and exposure in the long-term portfolio. There were breaches of two of the Executive Board's guidelines in the first quarter of 2011. One concerned the overlap with the benchmark portfolio and needs to be seen in the light of the introduction of the new guidelines in 2010 with a new benchmark portfolio, as described in the report on the second quarter of 2010. The transition to the new benchmark portfolio is expected to be completed during the second half of 2011. The other breach concerned the limit for counterparty exposure and was quickly put right without financial loss.

Table 3-2 Key figures for risk and exposure

Risk	Limits	Actual		
		30.09.2010	31.12.2010	31.03.2011
Market risk	Expected level of 1.0 percentage point expected tracking error ¹⁾	0.63	0.43	0.40
Asset mix	Fixed-income portfolio	61.1	58.2	57.3
	Equity portfolio	38.9	41.8	42.7
Ownership	Max. 5% of a company	0.24	0.24	0.27

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 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 first quarter of 2011, 40.9 billion kroner was transferred to the buffer portfolio from the SDFI, and 38.5 billion kroner was transferred from the buffer portfolio to the Government Pension Fund Global.

The return on the buffer portfolio in the first quarter was -2.74 per cent, measured in kroner. The market value of the portfolio at the end of the quarter was 17.1 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
2Q2010	31 060	0	-35 481	0	5 389
3Q2010	33 863	13 306	-48 733	0	3 024
4Q2010	40 944	30 191	-58 613	0	15 543
1Q2011	40 914	0	-38 495	0	17 117

5 Financial reporting

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

Accounting policies

The accounting information for the first quarter of 2011 includes profit and loss accounts and balance sheets prepared in accordance with the classification, measurement and presentation policies for Norges Bank, but without notes. A presentation of the accounting policies applied in the preparation of the accounting information can be found in Norges Bank's interim accounts for the first quarter of 2011, which consist solely of the financial reporting for the investment portfolio of the Government Pension Fund Global.

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 interim accounts for Norges Bank for the first quarter of 2011 contain further information on significant estimates and assumptions.

Operating expenses

NBIM's total costs associated with the management of the long-term portfolio amounted to 30.2 million kroner in the first quarter of 2011, which corresponds to 0.05 percent of average assets under management.

Long-term portfolio – profit and loss account and balance sheet

Table 5-1 Long-term portfolio. Profit and loss account

(Figures in millions of kroner)	Quarter			Year to date	
	1Q 2011	1Q 2010	31.03.2011	31.03.2010	31.12.2010
Interest income, deposits in foreign banks	9	0	9	0	10
Interest income, lending associated with reverse repurchase agreements	13	2	13	2	28
Net income/expenses and gains/losses from:					
- equities and units	3 304	3 757	3 304	3 757	10 153
- bonds and other fixed-income instruments	141	3 093	141	3 093	6 908
- financial derivatives	21	-161	21	-161	-377
Interest expenses, borrowing associated with repurchase agreements	-13	-7	-13	-7	-36
Other interest expenses	-1	0	-1	0	-4
Other expenses	-6	-9	-6	-9	-27
Profit/loss before exchange rate adjustments	3 469	6 674	3 469	6 674	16 653
Exchange rate adjustments	-7 082	-520	-7 082	-520	-3 718
Profit/loss	-3 613	6 154	-3 613	6 154	12 935

Table 5-2 Long-term portfolio. Balance sheet

(Figures in millions of kroner)

	31.03.2011	31.03.2010	31.12.2010
FINANCIAL ASSETS			
Deposits in foreign banks	102	200	422
Lending associated with reverse repurchase agreements	25 091	13 365	28 231
Equities and units	84 634	80 007	92 324
Equities lent	9 865	7 388	1 566
Bonds and other fixed-income instruments	105 927	120 874	110 410
Bonds lent	21 690	18 981	24 830
Financial derivatives	1	323	21
Unsettled trades	3 735	5 717	1 972
Other assets	6 088	1 304	-540
TOTAL FINANCIAL ASSETS	257 132	248 160	259 238
FINANCIAL LIABILITIES			
Short-term borrowing	377	214	0
Borrowing associated with repurchase agreements	12 170	8 045	14 432
Cash collateral received	18 251	15 307	17 893
Bonds and other fixed-income instruments	0	33	1 492
Financial derivatives	140	377	212
Unsettled trades	5 063	19 667	470
Other liabilities	2	1	2
TOTAL FINANCIAL LIABILITIES	36 002	43 644	34 501
NET PORTFOLIO	221 130	204 517	224 737

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		
	1Q 2011	1Q 2010	31.03.2011	31.03.2010	31.12.2010
Interest income, deposits in foreign banks	13	1	13	1	11
Interest income, lending associated with reverse repurchase agreements	10	5	10	5	29
Other interest expenses	0	0	0	0	-2
Other expenses	0	0	0	0	-1
Profit/loss before exchange rate adjustments	22	6	22	6	38
Exchange rate adjustments	-870	152	-870	152	354
Profit/loss	-848	158	-848	158	392

Table 5-4 Buffer portfolio. Balance sheet

(Figures in millions of kroner)	31.03.2011	31.03.2010	31.12.2010
FINANCIAL ASSETS			
Deposits in foreign banks	1	1	12
Lending associated with reverse repurchase agreements	14 752	22 591	8 720
Financial derivatives	0	25	0
Other assets	11 934	1 156	4 934
TOTAL FINANCIAL ASSETS	26 688	23 772	13 665
Financial derivatives	0	34	0
Other liabilities	10 790	7 096	0
Unsettled trades not recognised	0	11 711	0
TOTAL FINANCIAL LIABILITIES	10 790	18 841	0
Unsettled contracts not recognised	1 219	3 820	1 878
NET PORTFOLIO	17 117	8 751	15 543

Appendices

Long-term portfolio Benchmark portfolio as at 31 March 2011. 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
Asset class weights	40.0	42.7	60.0	57.3
Belgium		0.5		
Finland		0.5		
France		4.6		
Greece		0.1		
Ireland		0.1		
Italy		1.4		
Netherlands		1.3		
Portugal		0.2		
Spain		1.7		
Germany		3.7		
Austria		0.2		
<i>Euro area (euro)</i>		<i>14.4</i>		<i>37.4</i>
UK (pounds)		8.4		10.2
Denmark (kroner)		0.6		
Switzerland (francs)		3.3		
Sweden (kronor)		1.5		
Total Europe		28.2		47.6
US (dollars)		48.2		42.4
Canada (dollars)		5.3		
Israel (shekels)		0.3		
Total Americas and Africa/Middle East		52.1		42.4
Australia (dollars)		3.8		
Hong Kong		2.1		
Japan (yen)		8.4		10.0
New Zealand (dollars)		0.1		
Singapore (dollars)		0.8		
South Korea		2.5		
Total Asia and Oceania		17.7		10.0