

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

Second quarter 2011

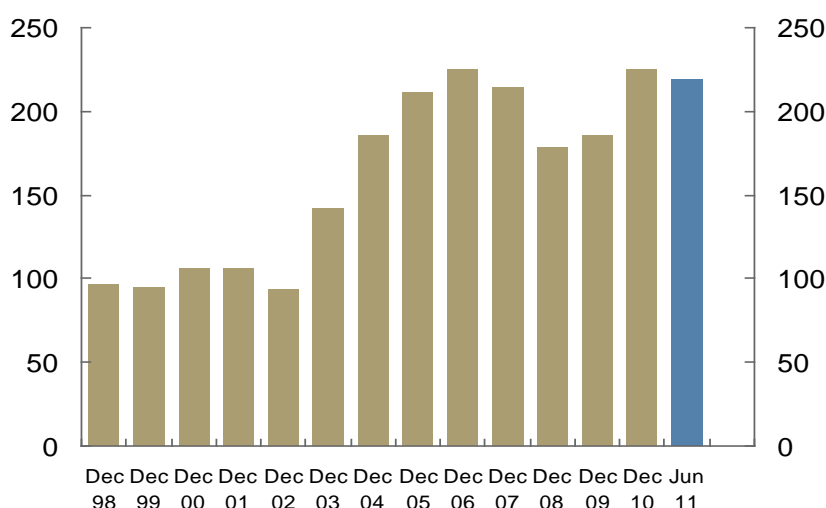
The foreign exchange reserves are to be available for intervention in the foreign exchange market in connection with the implementation of monetary policy or to promote financial stability. The reserves are divided into a money market portfolio and a long-term portfolio. In addition, a buffer portfolio 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 portfolio has a strategic allocation to equities of 40 percent and a strategic allocation to bonds of 60 percent. In March 2011 the Executive Board made a number of changes to the guidelines for the investment of the foreign exchange reserves. The main aim of these changes, which entered into force on 1 April 2011, was to further strengthen the liquidity requirement. The implementation of the revised guidelines is ongoing and is expected to be completed during the course of 2011.

1 Key figures

The market value of the long-term portfolio was 219 billion kroner on 30 June 2011. The portfolio returned 1.01 percent in the second quarter, which was 0.02 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 5.02 percent. The annual net real return (i.e. the nominal return less management costs and inflation) since 1998 has been 2.96 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 annual excess return during the period has been 0.17 percentage point.

Table 1-1 Key figures to 30 June 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)	10.68	6.02	4.30	5.02	5.02
Benchmark return (percent)	9.44	5.10	4.17	4.81	4.85
Excess return (percentage points)	1.24	0.92	0.14	0.21	0.17
Standard deviation (percent) ¹⁾	4.36	9.52	8.08	6.10	5.40
Actual tracking error (percentage points)	0.55	1.77	1.47	1.04	0.91
Information ratio ²⁾	2.28	0.52	0.09	0.21	0.19
Gross annual return (percent)	10.68	6.02	4.30	5.02	5.02
Annual price inflation (percent)	3.0	1.4	2.1	2.0	1.9
Annual management costs (percent)	0.05	0.08	0.07	0.07	0.07
Annual net real return (percent)	7.43	4.43	2.11	2.86	2.96
Annual gross excess return (percentage points)	1.24	0.92	0.14	0.21	0.17

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 219 billion kroner at the end of the second quarter, a decrease of 2.1 billion kroner during the quarter. A positive return on investment increased its value by 2 billion kroner, while a stronger krone in relation to the currencies in which the portfolio is invested reduced its value by 4.1 billion kroner. No capital was transferred to the portfolio during the quarter.

The long-term portfolio returned 1.01 percent in the second quarter, measured in international currency. There was a return of -0.51 percent on the equity portfolio and 2.13

percent on the fixed-income portfolio. The annualised return for the overall portfolio over the past ten years was 5.02 percent.

The return on the actual portfolio was 0.02 percentage point higher than the return on the benchmark portfolio in the second quarter of 2011, and 0.21 percentage point higher over the past ten years.

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

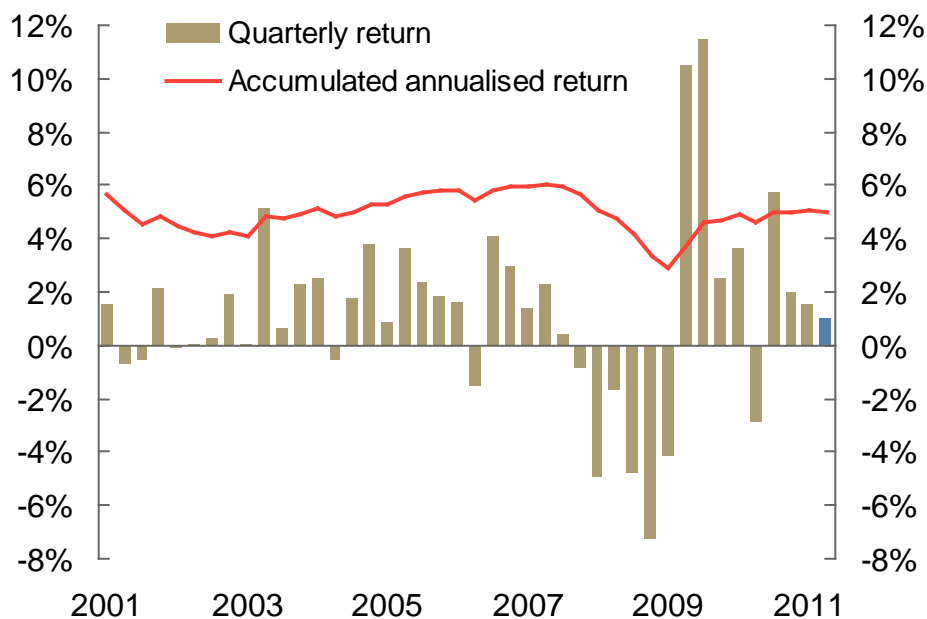


Chart 2-2 Quarterly and accumulated annualised excess return since 1 January 1998. Percentage points

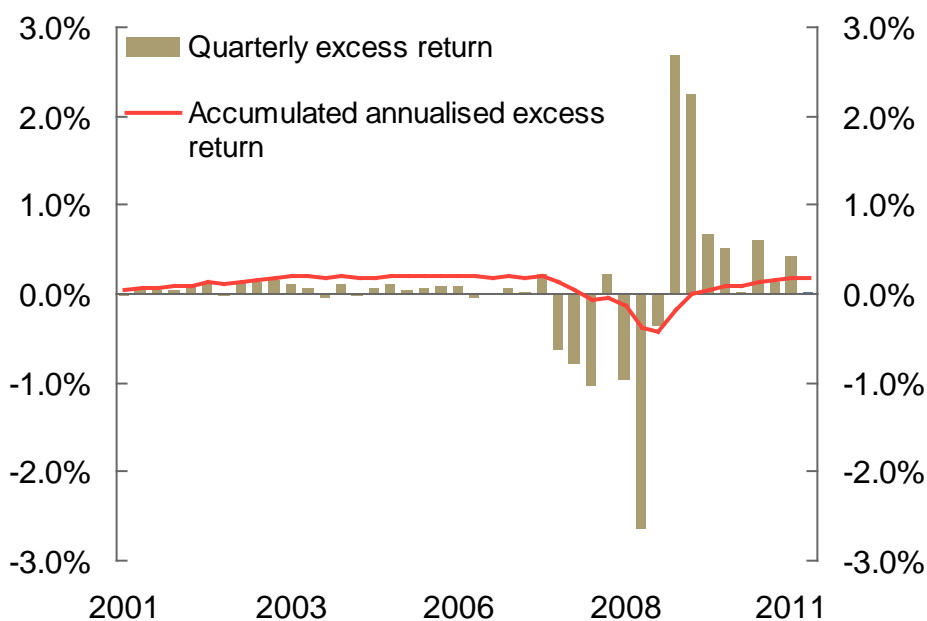


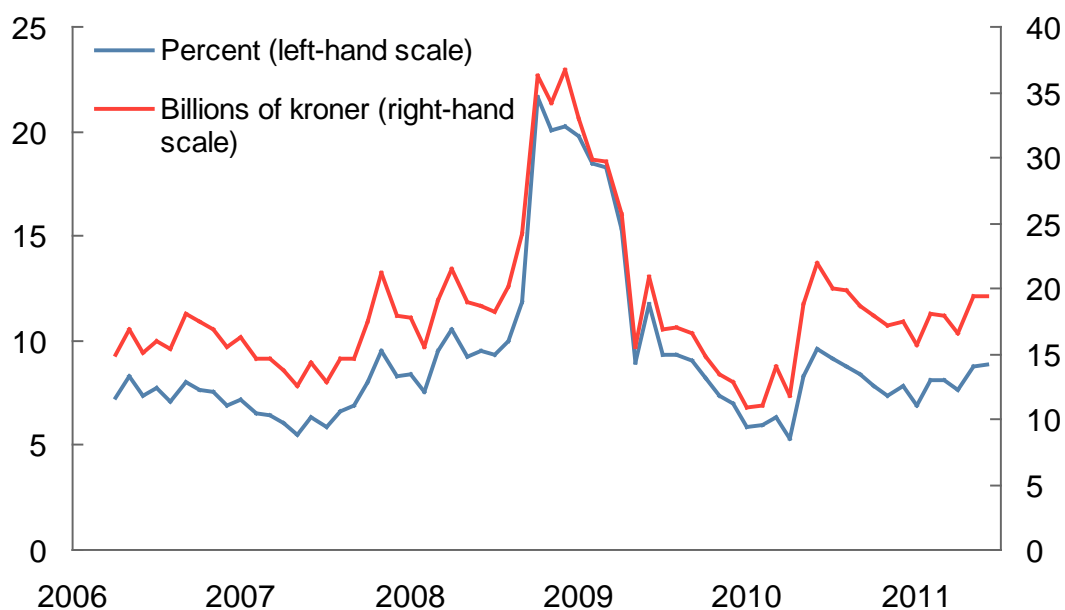
Table 2-1 Key figures. Quarterly data

	2Q 2011	1Q 2011	4Q 2010	3Q 2010	2Q 2010
Market value (billions of kroner)					
Fixed-income portfolio	127.0	126.8	130.9	135.7	143.7
Equity portfolio	92.0	94.3	93.8	86.3	83.4
Overall portfolio	219.0	221.1	224.7	222.0	227.1
Inflows of new capital					
Inflows of new capital	0.0	0.0	0.0	-4.7	0.0
Return					
Return	2.0	3.5	4.4	13.6	-7.1
Change due to movements in krone					
Change due to movements in krone	-4.1	-7.1	-1.7	-14.0	11.6
Return in international currency (percent)					
Equity portfolio	-0.51	3.18	9.48	9.63	-9.17
Fixed-income portfolio	2.13	0.39	-2.71	3.48	1.27
Overall portfolio	1.01	1.55	2.03	5.75	-2.84
Benchmark portfolio	0.99	1.13	1.90	5.16	-2.87
Excess return (percentage points)	0.02	0.42	0.13	0.60	0.03
Return in kroner (percent)					
Equity portfolio	-2.43	-0.03	8.63	3.46	-4.62
Fixed-income portfolio	0.16	-2.73	-3.47	-2.35	6.35
Overall portfolio	-0.95	-1.60	1.24	-0.20	2.04
Benchmark portfolio	-0.96	-2.02	1.11	-0.76	2.01

3 Market risk and management guidelines

The level of absolute risk in the portfolio increased somewhat during the second quarter but was still moderate 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 guidelines for the long-term portfolio issued by Norges Bank's Executive Board require the portfolio to be managed with the aim that expected tracking error does not exceed 1 percentage point (100 basis points). At this limit, the annual return on the actual portfolio under normal market conditions can be 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 second 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

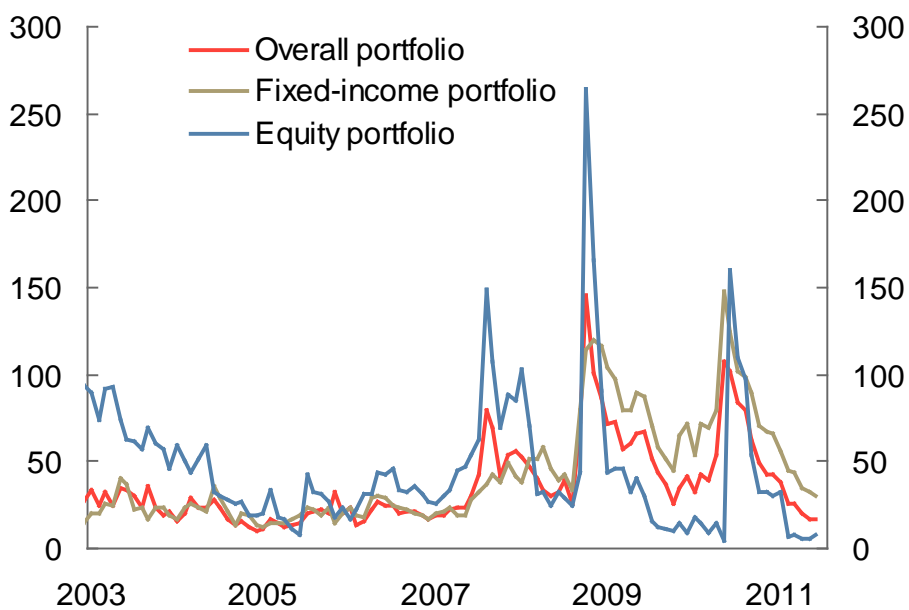
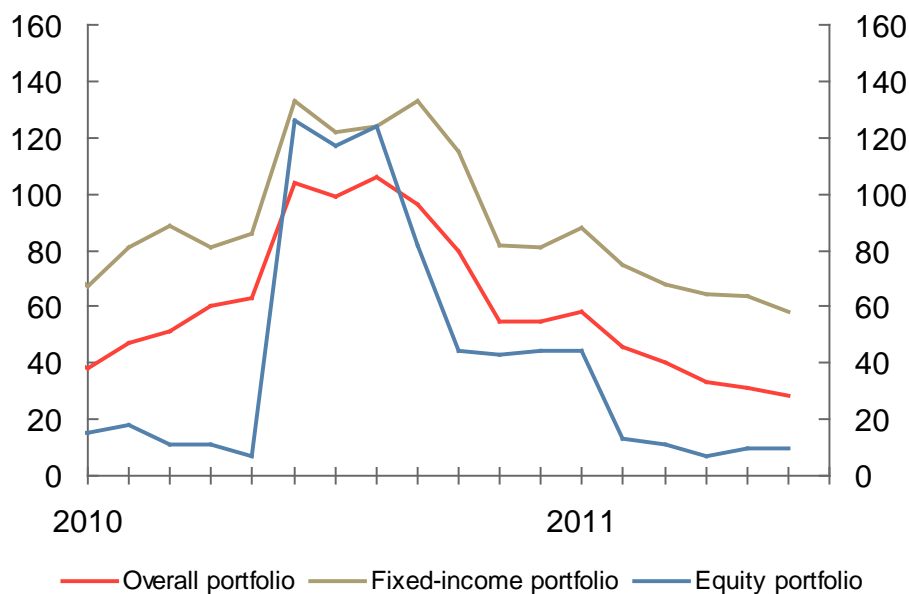


Chart 3-3 Expected tracking error. New calculation method². Basis points



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 30 June 2011

(Percentage of fixed-income portfolio)	Aaa	Aa	A	Baa	Lower	Total
Government bonds	67.31	9.18	-	0.14	0.19	76.82
Government-related bonds	3.95	0.17	0.10	0.14	0.05	4.41
Inflation-linked bonds	-	1.05	-	-	-	1.05
Corporate bonds	0.04	0.56	1.49	0.77	0.18	3.05
Securitised bonds	9.90	4.38	0.20	0.04	0.17	14.68
Total fixed-income securities	81.20	15.33	1.78	1.09	0.60	100.00

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 second quarter of 2011, both of which need to be seen in the light of the revised guidelines entering into force on 1 April 2011. One breach concerned the limit on the percentage of the fixed-income portfolio that may be invested in corporate and securitised bonds, which is a new requirement from 1 April. The portfolio was brought within the new limit during the course of the quarter. The other breach concerned the lending of fixed-income securities, which is no longer permitted under the revised guidelines. These lending operations will be phased out during the course of 2011.

Table 3-2 Key figures for risk and exposure

Risk	Limits	Actual		
		31.12.10	31.03.10	30.06.11
Market risk	1.0 percentage point expected tracking error	0.43	0.40	0.29
Asset mix	Fixed-income portfolio	58.2	57.3	58.0
	Equity portfolio	41.8	42.7	42.0
Ownership	Max. 10% of a company	0.24	0.27	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 second quarter of 2011, 44.6 billion kroner was transferred to the buffer portfolio from the SDFI, and 52.9 billion kroner was transferred from the buffer portfolio to the Government Pension Fund Global.

The return on the buffer portfolio in the second quarter was -1.43 percent measured in kroner. The market value of the portfolio at the end of the quarter was 22.2 billion kroner. The portfolio is invested in short-term money market instruments, primarily in euros, 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
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
2Q2011	44 618	14 298	-52 891	0	22 169

5 Financial reporting

Operating expenses

NBIM's total costs associated with the management of the long-term portfolio amounted to 54.7 million kroner in the second 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		
	2Q 2011	2Q 2010	30.06.11	30.06.10	31.12.10
Interest income, deposits in foreign banks	17	2	26	2	10
Interest income, lending associated with reverse repurchase agreements	10	4	23	6	28
Net income/expenses and gains/losses from:					
- equities and units	-697	-9 698	2 607	-5 941	10 153
- bonds and other fixed-income securities	2 689	2 752	2 830	5 845	6 908
- financial derivatives	13	-147	34	-308	-377
Interest expenses, borrowing associated with repurchase agreements	-10	-6	-23	-12	-36
Other interest expenses	0	0	-1	0	-4
Other expenses	-6	-12	-12	-21	-27
Profit/loss before exchange rate adjustments	2 015	-7 103	5 484	-429	16 653
Exchange rate adjustments	-4 116	11 632	-11 198	11 112	-3 718
Profit/loss	-2 101	4 529	-5 714	10 683	12 935

Table 5-2 Long-term portfolio. Balance sheet

(Figures in millions of kroner)

	30.06.11	30.06.10	31.12.10
FINANCIAL ASSETS			
Deposits in foreign banks	182	830	422
Lending associated with reverse repurchase agreements	7 017	19 212	28 231
Equities and units	85 881	76 426	92 324
Equities lent	6 271	6 816	1 566
Bonds and other fixed-income securities	124 069	120 955	110 410
Bonds lent	5 288	26 340	24 830
Financial derivatives	16	510	21
Unsettled trades	1 822	23 243	1 972
Other assets	-250	4 103	-540
TOTAL FINANCIAL ASSETS	230 297	278 436	259 238
FINANCIAL LIABILITIES			
Short-term borrowing	0	103	0
Borrowing associated with repurchase agreements	2 675	9 365	14 432
Cash collateral received	6 443	20 282	17 893
Bonds and other fixed-income securities	0	0	1 492
Financial derivatives	7	628	212
Unsettled trades	2 134	20 909	470
Other liabilities	3	1	2
TOTAL FINANCIAL LIABILITIES	11 262	51 289	34 501
NET PORTFOLIO	219 034	227 147	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		
	2Q 2011	2Q 2010	30.06.11	30.06.10	31.12.10
Interest income, deposits in foreign banks	32	0	45	1	11
Interest income, lending associated with reverse repurchase agreements	5	9	14	13	29
Interest expenses, borrowing associated with repurchase agreements	0	0	0	0	-2
Profit/loss before exchange rate adjustments	37	8	59	14	38
Exchange rate adjustments	-989	1 029	-1 859	1 182	354
Profit/loss	-952	1 038	-1 800	1 196	392

Table 5-4 Buffer portfolio. Balance sheet

(Figures in millions of kroner)	30.06.11	30.06.10	31.12.10
FINANCIAL ASSETS			
Deposits in foreign banks	2	714	12
Lending associated with reverse repurchase agreements	29 964	14 606	8 720
Other assets	19 933	2 875	4 934
TOTAL FINANCIAL ASSETS	49 899	18 196	13 665
Short-term borrowing	0	3	0
Financial derivatives	0	1	0
Other liabilities	21 704	14 006	0
Unsettled trades	8 048	0	0
TOTAL FINANCIAL LIABILITIES	29 752	14 010	0
Unsettled contracts not recognised	2 022	1 203	1 878
NET PORTFOLIO	22 169	5 389	15 543

Appendices

Long-term portfolio Benchmark portfolio as at 30 June 2011. Percent

	Equities		Fixed-income securities	
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	42.0	60.0	58.0
Belgium		0.5		
Finland		0.5		
France		4.8		
Greece		0.1		
Ireland		0.2		
Italy		1.4		
Netherlands		1.2		
Portugal		0.1		
Spain		1.7		
Germany		3.9		
Austria		0.2		
<i>Euro area (euros)</i>		<i>14.6</i>		<i>37.8</i>
UK (pounds)		8.5		10.1
Denmark (kroner)		0.5		
Switzerland (francs)		3.6		
Sweden (kronor)		1.4		
Total Europe		28.7		47.9
US (dollars)		48.3		42.0
Canada (dollars)		5.0		
Israel (shekels)		0.3		
Total Americas and Africa/Middle East		53.6		42.0
Australia (dollars)		3.7		
Hong Kong		2.1		
Japan (yen)		8.		10.1
New Zealand (dollars)		0.1		
Singapore (dollars)		0.8		
South Korea		2.5		
Total Asia and Oceania		17.8		10.1