Management of the Government Petroleum Fund
Report for the second quarter 2002

Summary

In the second quarter of 2002, the return on the Government Petroleum Fund, including the Environmental Fund, was -2.93 per cent measured by the currency basket that corresponds to the composition of the Fund's benchmark portfolio. The overall return in the first half of 2002 was -2.35 per cent.

The currency basket in which the Petroleum Fund is invested depreciated by 8.5 per cent against the Norwegian krone in the second quarter. Measured in NOK, the return in the second quarter was therefore negative, at -11.19 per cent. The overall return for the first six months, measured in Norwegian kroner, was -13.02 per cent. However, changes in the value of the krone have no effect on the Fund's international purchasing power.

The second quarter return on the ordinary equity portfolio (excluding the Environmental Fund) was -12.01 per cent measured in terms of the benchmark portfolio's currency basket. This reflects the sharp fall during the quarter of share prices in the three main markets, the US, Europe and Japan. Following the fall in interest rates in the US and Europe in particular, a positive return of 3.55 per cent, measured in terms of the currency basket, was recorded for the fixed income portfolio.

The return on the Petroleum Fund's ordinary portfolio in the second quarter of 2002 was 0.01 percentage point lower than the return on the benchmark portfolio defined by the Ministry of Finance. In the first half of 2002 overall, the actual portfolio outperformed the benchmark by 0.21 percentage point.

The return on Environmental Fund in the second quarter was -12.39 per cent measured in terms of the benchmark portfolio currency basket, and -19.85 per cent measured in NOK. The return for the first half of 2002 was -11.25 per cent measured in terms of the currency basket and -20.94 per cent measured in NOK.

In the second quarter capital equivalent to NOK 53.5 billion was transferred to the Petroleum Fund's equity and fixed income portfolios. The market value of the Fund's total securities portfolio, measured in NOK, had nevertheless fallen by almost NOK 20 billion, to NOK 605.4 billion, by the end of the second quarter. This is to some extent due to the negative returns in the stock markets. The most important reason, however, is that during the quarter the krone appreciated against the currencies in which the Fund is invested.

1. Main figures

The return on the Government Petroleum Fund in the second quarter of 2002 was -2.93 per cent measured in terms of the currency basket corresponding to the composition of the Fund's benchmark portfolio. Chart 1 shows that the quarter was the third weakest since the Petroleum Fund first invested in equities in 1998. There have been large fluctuations in the return figures. The performance of the equity portfolio has fluctuated considerably more than the performance of the fixed income portfolio.

Chart 1: Quarterly return on the Petroleum Fund since 1998 measured by the Fund's currency basket

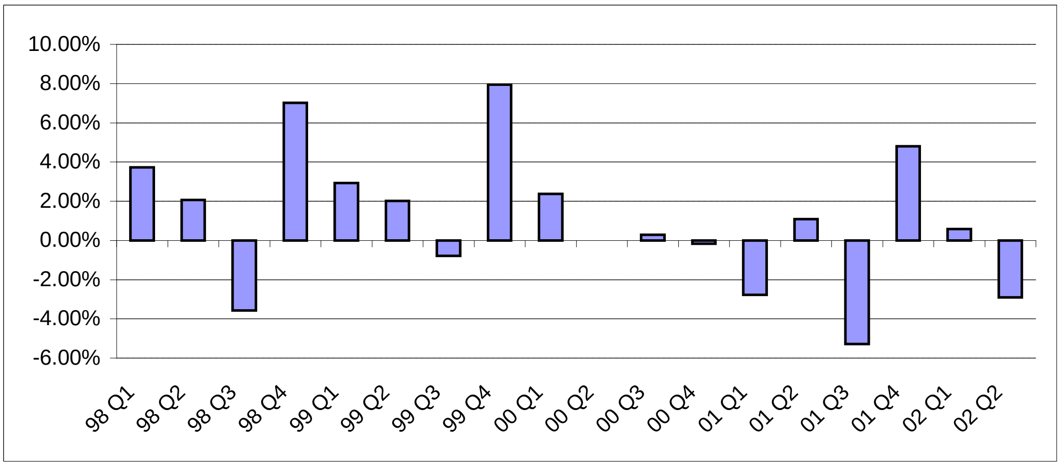
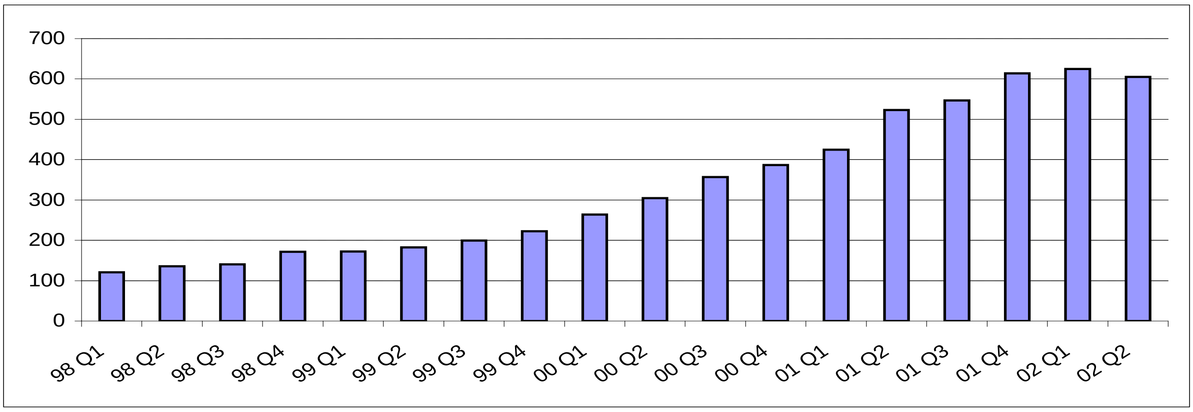


Chart 2 shows that the Petroleum Fund grew from NOK 113.4 billion on 1 January 1998 to NOK 625.0 billion at the end of the first quarter of 2002, but that its value in NOK then declined to NOK 605.4 billion at the end of the second quarter. This reduction took place despite the transfer of NOK 53.5 billion in new capital from the Ministry of Finance. It is due partly to negative returns in the stock market, but to a far greater extent to the fact that the currencies in which the Fund is invested have depreciated by 8.5 per cent against NOK. The objective of the management of the Petroleum Fund is to achieve the highest possible international purchasing power, and the appreciation of the krone does not affect this objective. With an unchanged krone exchange rate, the market value of the fund would have increased by about NOK 35 billion in the second quarter.

Chart 2**: **The market value of the Petroleum Fund 1998-2002, measured in billions of NOK



Since January 1998, the annual net real return on the Petroleum Fund (after deductions for management costs and price inflation) has been 2.6 per cent. Table 1 shows the real return up to the end of the first quarter of 2002, calculated as an annual rate from 1 January for 1998, 1999, 2000 and 2001 respectively. Price inflation is a weighted average of the price inflation rates in the countries in the benchmark portfolio defined by the Ministry of Finance.

The right-hand column shows the excess return. This is the difference between the return actually achieved by Norges Bank and the return on the benchmark portfolio defined by the Ministry of Finance. A positive excess return indicates that Norges Bank creates added value through its management. Since January 1998, the annual excess return has averaged 0.40 percentage point.

Table 1: Annualised rates of return up to the end of the second quarter of 2002, measured against the Fund's currency basket. Per cent

	Nominal annual return	Annual price inflation	Annual managemen t costs	Annual net real return	Annual excess return
From 1 Jan 1998	4.13	1.48	0.08	2.57	0.40
From 1 Jan 1999	2.72	1.61	0.09	1.02	0.46
From 1 Jan 2000	-0.94	1.69	0.09	-2.71	0.18
From 1 Jan 2001	-3.16	1.44	0.08	-4.68	0.17

Chart 3 shows cumulative rates of return from 1 January 1998 for the fixed income and equity portfolios. In the course of these 18 quarters, there has been a cumulative nominal return on equity investments of 10.1 per cent and a nominal return on bonds and other fixed income instruments of 26.8 per cent.

Chart 3: Index for cumulative return on sub-portfolios in the Petroleum Fund 1998-2002. The Fund's currency basket as at 31 December 1997 = 100

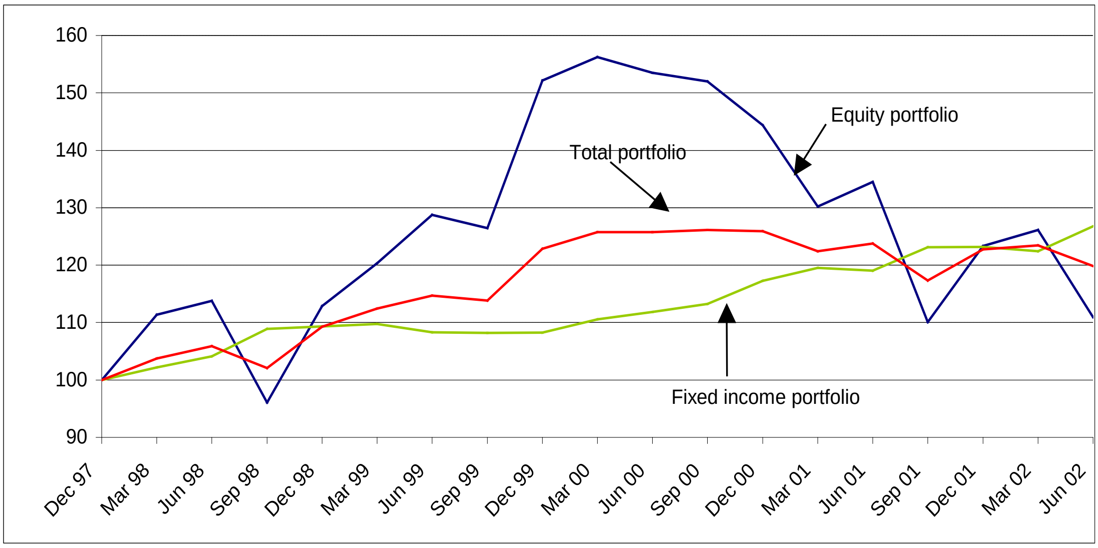


Chart 4 shows the cumulative return on the Petroleum Fund as a whole since 1 January 1998. The return up to the end of the second quarter of 2002 was 20.0 per cent. During the same period, the return on the benchmark was 18.0 per cent. The difference between the actual return and the return on the benchmark is the excess return achieved by Norges Bank. The cumulative excess return since 1998 is 2.0 percentage points.

Chart 4: Index for cumulative return on the actual portfolio and on the benchmark, 1998-2002. The Fund's currency basket as at 31 December 1997 = 100

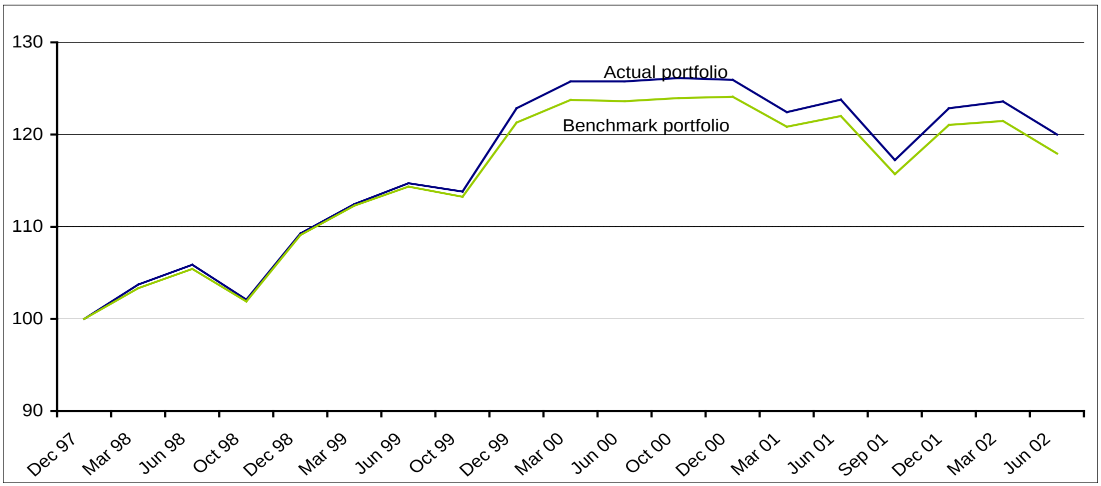
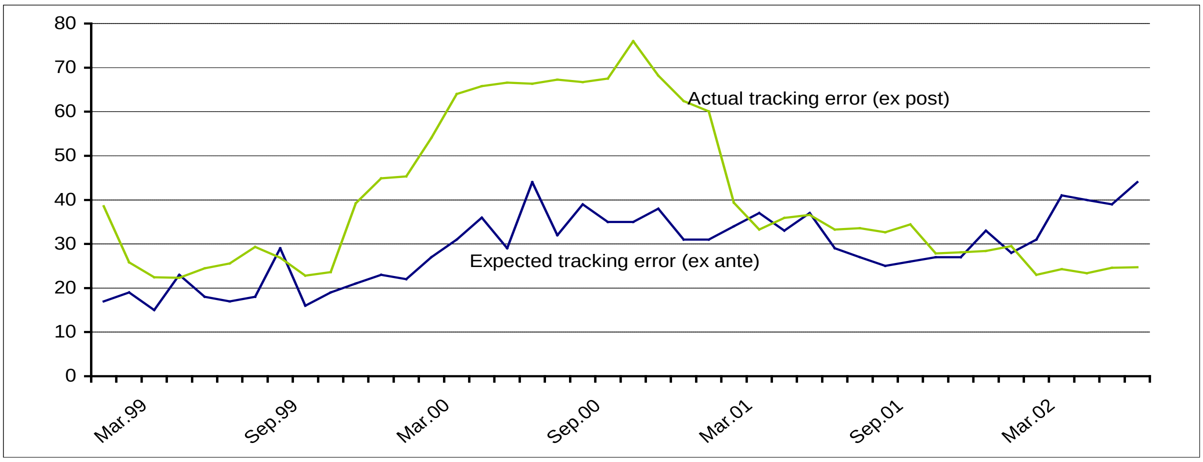


Chart 5 shows developments in relative market risk from December 1998, measured in two different ways. In the guidelines from the Ministry of Finance, expected tracking error (often called relative or active risk – the concept is explained in Chapter 6 below) is used as an upper limit to how far Norges Bank can deviate from the benchmark portfolio. Ex post we can use the variation in the excess return, i.e. the difference between the return on the actual portfolio and on the benchmark portfolio, as a measure of the risk Norges Bank has taken in its management in relation to the benchmark portfolio. In Chart 5, this actual tracking error is calculated as an annualised rate using 12-month moving windows.

Chart 5: Relative market risk at the end of each month, measured ex ante by expected tracking error and ex post by calculated tracking error on the return differential for the past 12 months. Figures in basis points (hundredths of a percentage point)

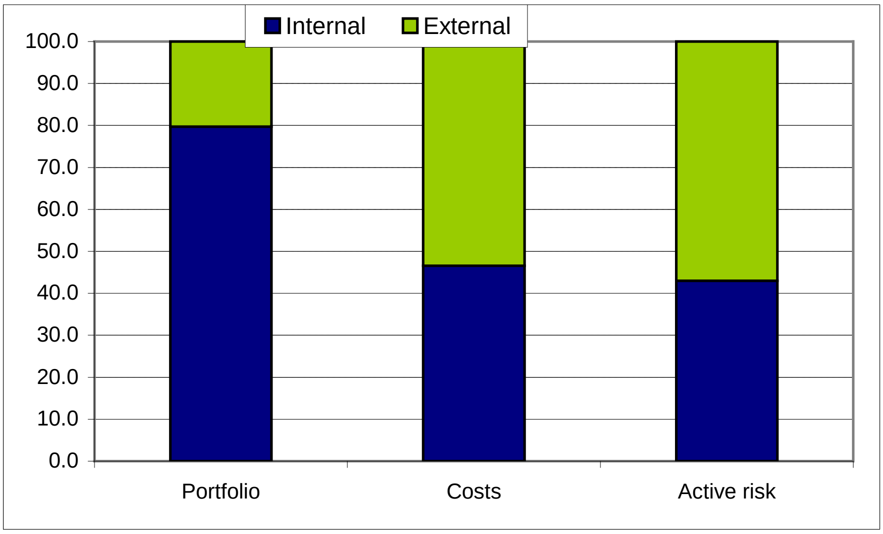


Up to 2001, the actual variation in monthly excess return was quite considerably higher than the expected tracking error. Since then, however, the figures have been similar. Both expected tracking error and actual tracking error may fluctuate considerably even when the degree of active management is unchanged. This is due to the fact that the measures are influenced by various market developments, such as changes in correlations between the various asset classes and securities. Expected tracking error has been well below the 1.5 percentage point limit set by the Ministry of Finance for the relative market risk in the Petroleum Fund's portfolio.

The information ratio is a widely used measure of the skill of operational managers. The information ratio is the ratio between the excess return for the year and relative market risk (measured here as actual tracking error). The average information ratio for the Fund from the first quarter of 1998 to the second quarter of 2002 has been 0.88, measured as an annualised ratio. The management objective is to achieve an information ratio of at least 0.2-0.3.

Chart 6 shows some key figures associated with the distribution of external and internal management. It shows that at the end of the second quarter, 20 per cent of the Petroleum Fund was managed by external managers. At the same time, expenses in connection with external management accounted for 53 per cent of total management costs. The active risk associated with external management represented about 57 per cent of the total risk associated with active management.

Chart 6: Distribution of portfolio, management costs and active risk* between internal and external management. Per cent



* There is no absolutely correct way to calculate the distribution of active risk. The distribution in the chart is based on a summation of the risk (Value at Risk) associated with each mandate, irrespective of the correlation between the mandates.

Active management costs appreciably more than index management, and this is one reason that unit costs are far higher for external than for internal management. An additional explanation is that economies of scale in capital management can make internal management of large portfolios cost-effective compared with buying management services in the market. Norges Bank's strategy is to allow external managers with specialist expertise to be responsible for a significant proportion of the overall active management. Please refer to the article on this subject published on Norges Bank’s website, and the Bank’s submission of 5 September 2000 to the Ministry of Finance.

2. Mandate

Norges Bank manages the Government Petroleum Fund pursuant to a regulation issued by the Ministry of Finance on 3 October 1997, last amended on 16 January 2002. The Petroleum Fund consists of an ordinary portfolio of equity and fixed income instruments and a separate Environmental Fund which is invested only in equity instruments.

The Ministry of Finance has defined a benchmark portfolio for the Petroleum Fund pursuant to the Petroleum Fund Regulation. The benchmark for the ordinary portfolio is composed of the stocks in the FTSE equity indices in 27 countries and of the bonds in the Lehman Global Aggregate bond indices in the currencies of the 22 countries that are approved for fixed income investments. As from 28 February 2002, the fixed income benchmark contains not only government bonds, but also other bonds issued by the public sector, bonds issued by international organisations, corporate bonds and mortgage-backed bonds.

Equities shall account for 40 per cent of the benchmark portfolio for the Petroleum Fund excluding the Environmental Fund, and fixed income instruments shall account for 60 per cent. The equity portion of the benchmark consists of securities listed in Europe (50 per cent) the Americas (30 per cent) and Asia/Oceania (20 per cent). These regions have shares of 55, 35 and 10 per cent, respectively, in the fixed income benchmark.

However, the asset classes and regional weightings in the benchmark change continually as a result of changes in market prices for the securities in the benchmark. New capital is normally transferred to the Petroleum Fund at the end of each month. This capital is used to restore the asset classes and regional weightings in the benchmark as closely as possible to the original weightings, providing this does not necessitate selling anything in the actual portfolio. Thus there may be minor differences between the weightings in the strategic benchmark described above and those in the actual benchmark even after the transfer of new capital. It is the actual benchmark that provides the basis for managing risk and measuring the performance of the Petroleum Fund. The weightings in both the strategic and the actual benchmark at end-June 2002 are shown in Table 2. The weightings in the fixed income benchmark apply to the currency in which the bonds are issued, and shares of the euro weighting are therefore not listed for individual euro area countries.

The separate Environmental Fund is an equity portfolio with the same regional distribution as the ordinary equity portfolio, and may be invested in the same countries, with the exception of the emerging markets of Brazil, South Korea, Mexico, Taiwan and Turkey.

The Ministry of Finance has set an upper limit for how far the Petroleum Fund's actual portfolio may deviate from the benchmark portfolio. In the ordinary portfolio, relative market risk, measured as expected tracking error, shall always be less than 1.5 percentage point. The limit for the Environmental Fund is 1 percentage point. The concept of tracking error is explained in Chapter 6.

Table 2: Benchmark portfolio at 30 June 2002 for the Petroleum Fund's ordinary portfolio (excluding the Environmental Fund). Per cent

	Equities		**Interest**	
	Strategic benchmark	Actual benchmark	Strategic benchmark	Actual benchmark
Weightings asset classes	**40.0**	**38.5**	**60.0**	**61.5**
Local currency	**Country weights**		**Currency weights**	
Belgium		0.8		
Finland		1.1		
France		7.3		
Greece		0.4		
Ireland		0.5		
Italy		2.7		
Netherlands		4.2		
Portugal		0.3		
Spain		2.2		
Germany		5.4		
Austria		0.1		
Euro area countries (EUR)		*24.9*		47.7
UK (GBP)		18.6		6.0
Denmark (DKK)		0.5		1.2
Switzerland (CHF)		5.4		0.7
Sweden (SEK)		1.5		1.0
Turkey		0.1		
Total Europe	**50.0**	**51.1**	**55.0**	**56.6**
US (USD)		27.4		30.4
Brazil		0.2		
Canada (CAD)		1.1		3.2
Mexico		0.2		
Total America	**30.0**	**28.8**	**35.0**	**33.6**
Australia (AUD)		2.5		0.5
Hong Kong		1.5		
Japan (JPY)		12.8		8.9
New Zealand (NZD)		0.1		0.1
Singapore (SGD)		0.5		0.3
South Korea		1.2		
Taiwan		1.4		
Total Asia and Oceania	**20.0**	**20.1**	**10.0**	**9.9**

3. Market developments

3.1 Main features

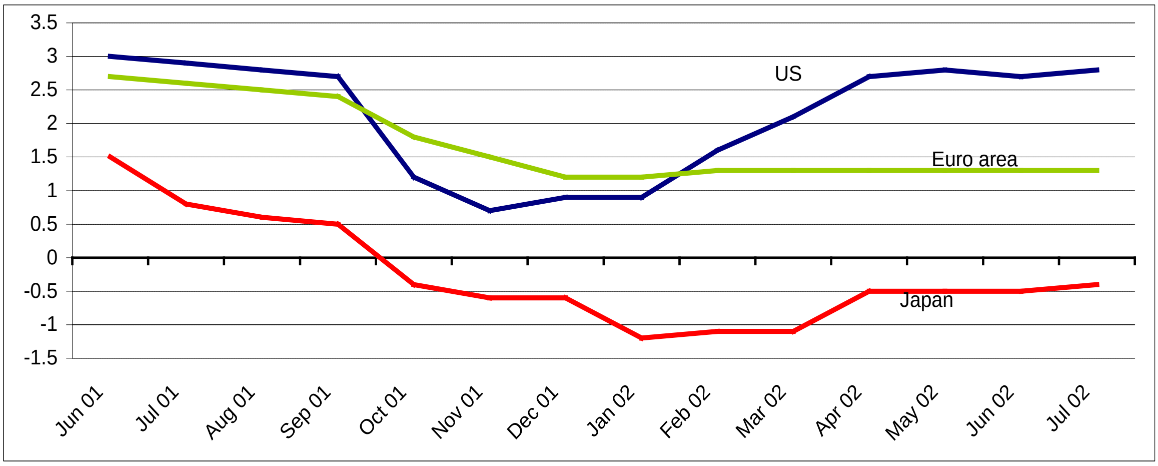
Growth in the world economy has been sluggish for the past two years, largely because enterprises have cut back substantially on investment and run down stocks during the period. This has happened concurrently in all regions. There have been a number of reasons underlying this trend. First, investment up to 2000, particularly in infrastructure for telecommunications and in computer equipment, took place on a larger scale than there proved to be a basis for. Second, enterprises' labour costs have risen more rapidly in recent years than the prices of their products. Finally, the debt-equity ratio in many enterprises rose through the nineties. In response to these developments, enterprises have reduced investment considerably during the past two years, and at the same time run down stocks and reduced their workforces.

In the US, there were signs that economic growth was picking up again in the first half of 2002, following a decline in GDP growth through the first three quarters of 2001. Enterprise destocking and staff cutbacks appear to have come to a halt. Investment continued to decline in the second quarter, but substantially less than in the first quarter. Neverthless, growth in consumption and GDP growth were weaker in the second quarter than in the first.

Leading indicators for the US, Japan and Europe point to somewhat stronger growth in the period ahead. Capacity utilisation in the main economies is still low compared to what has been normal. Growth in the euro area has not been as strong as in the US so far this year. In Europe, especially in Germany, private consumer demand has shown a weaker trend. Exports, however, have contributed positively to growth in the euro area. Economic developments in the UK resemble those in the US more closely. Private consumer demand is fuelling economic growth, partly as a result of sharply rising house prices.

The Japanese economy is still showing no growth, although consumer demand has remained buoyant there as well.

Chart 7: Expected GDP growth in 2002 in the euro area, the US and Japan, measured at various times in 2001-2002. Per cent



Source: Consensus Economics Inc.

Chart 7 shows how analysts' expectations regarding GDP growth for 2002 changed from June 2001 to June 2002. In particular, expectations regarding growth in the US economy have been revised upwards since the end of 2001. Analysts have found no reason to revise their growth forecasts for Europe upwards.

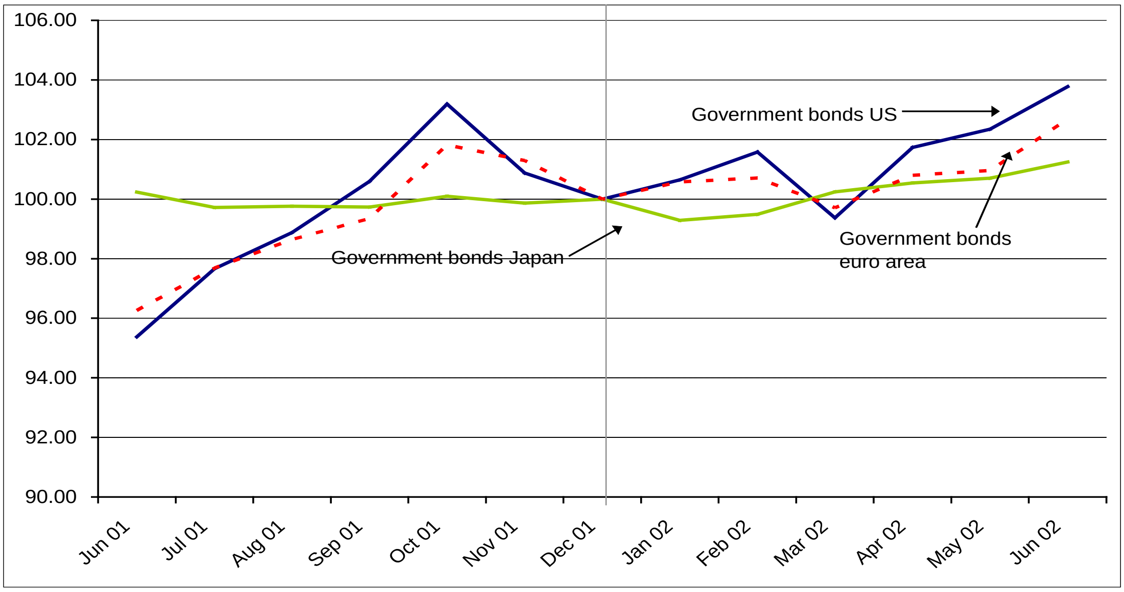
In the foreign exchange market, the US dollar depreciated substantially against other currencies in the second quarter of 2002. The euro was approximately at parity with the dollar at the end of the quarter. The depreciation of the dollar appears to be related to the increased wariness of the US financial market following the accounting scandals exposed in large US companies this year. Market operators also take a negative view of the strongly expansionary fiscal policy with large central government deficits, the sizeable current account deficit and the lower interest rate level in the US than in many other countries.

3.2 Fixed-income markets

Yields on 10-year government bonds fell in the US, Europe and Japan in the second quarter. The fall was sharpest in the US, where 10-year yields dropped from 5.35 per cent at the beginning of the quarter to 4.8 per cent at the end, but yields on long bonds in the euro area also dropped substantially. The main reason for the decline in yields in the US and the euro area appears to be that many investors have moved capital from the falling equity market to the more secure government bond market. In the US, the fact that market operators now expect the Federal Reserve not to raise short-term interest rates before investment demand begins rising may also be playing a part.

Chart 8 shows that, as a result of the decline in interest rates, government bond returns in all three main markets were positive in the second quarter. The return in the US was 4.4 per cent, in the euro area 3.0 per cent, and in Japan 1.0 per cent.

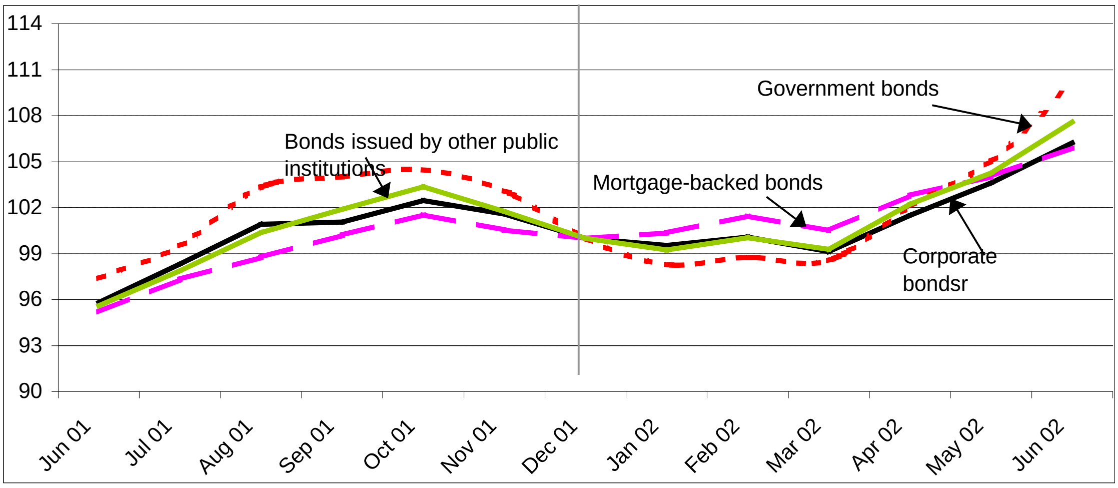
Chart 8: Movements in Lehman Global Aggregate government bond indices in the main markets from June 2001 to June 2002, measured in local currency (31.12.01 = 100)



In the market for bonds with credit risk, the spread between yields for these bonds and for government bonds widened during the quarter. This was especially the case for bonds issued by telecoms companies, after many companies in this sector were downgraded by the credit rating agencies. The downgrading is a reaction to steadily declining earnings, while companies failed to reduce debt at the rate they had planned.

Chart 9 shows the global performance of each of the market segments in which the Petroleum Fund's fixed income portfolio is invested, measured in USD. The depreciation of the dollar against other currencies is the cause of the higher return figures in this chart than in Chart 8, where returns are shown in local currency. But the chart illustrates the fact that returns in other market segments have been lower than those in the government bond market. This is due to the widening of the yield spread between these bonds and government paper.

Chart 9: Movements in Lehman Global Aggregate indices for bonds with credit risk in the main markets from June 2001 to June 2002, measured in USD (31.12.01 = 100)

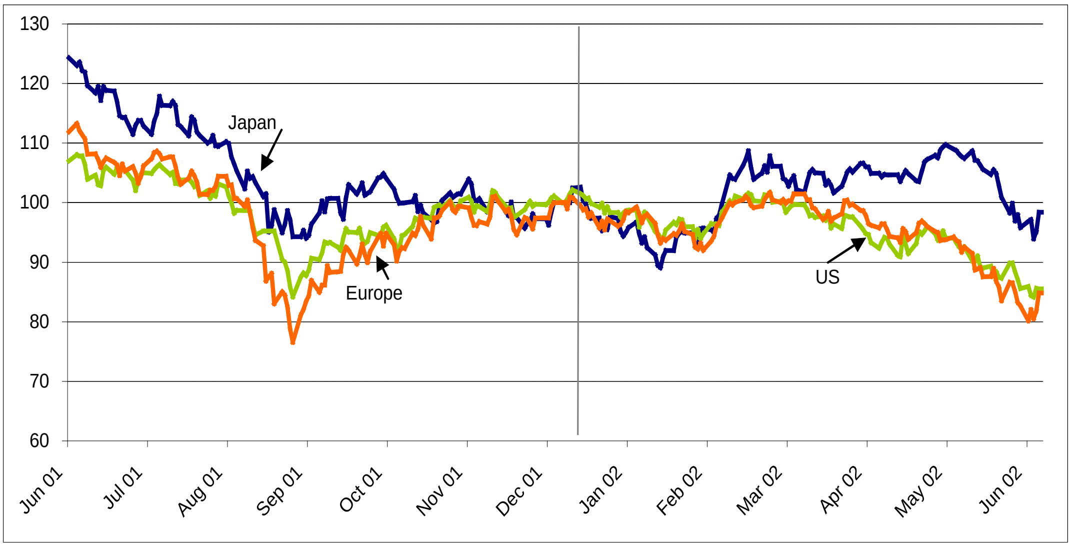


3.3 Equity markets

Share prices in the US, Europe and Japan dropped in the second quarter. The fall was particularly sharp in the US, with a decline of 14.2 per cent, and in Europe, where prices fell 16.4 per cent. Much of the fall took place in June, and is probably related to discoveries regarding the accounting practices of some large US companies. These have culminated for the present in the exposure of the fact that WorldCom, a major US telecoms company, has provided misleading information in its accounts. This has given rise to a general lack of confidence in published accounts figures from listed companies, both in the US and in the rest of the world.

Chart 10 shows that share prices in Japan have fared better than those in the other two main markets, sliding only 3.7 per cent in the second quarter. The price level in other Asian stock markets has also remained fairly stable. Developments in the Japanese equity market are partly attributable to the fact that export enterprises have benefitted from the yen being weak in relation to the dollar for a period, coupled with strong demand for Japanese goods in the US and Asia. In addition to robust demand in the US, enterprises in Asia excluding Japan have benefitted from buoyant demand in their domestic markets. This demand has been partly financed by substantial household borrowing, following the liberalisation of credit markets in these countries.

Chart 10: Developments in FTSE equity indices for the main markets, the US, Europe and Japan, from June 2001 to June 2002, measured in local currency (31.12.2001 = 100)



The fall in the equity market was sharpest for the TMT sectors – telecoms, media and technology. Telecoms showed a particularly poor performance during this quarter. The reason is that many of the companies in this sector have high debt in relation to earnings. The industry is also characterised by sharp price competition because of the high level of available capacity following the substantial investment of recent years. New services have not generated the earnings the market expected a couple of years ago. Telecoms companies all over the world have reacted to this situation by making cost cutbacks, particularly in their investment budgets. This in turn has had an impact on all enterprises that have delivered goods and services to these companies. Most of the enterprises have been in the technology sector, but media enterprises have also been affected by less promotion of telecoms products. Chart 11 shows developments in the TMT sectors compared with all other companies in the FTSE All-World Equity Index.

Chart 11: The FTSE All-World Equity Index, 1999-2002: Total and for the TMT sectors, technology, media and telecommunications (31.12.98 = 100)

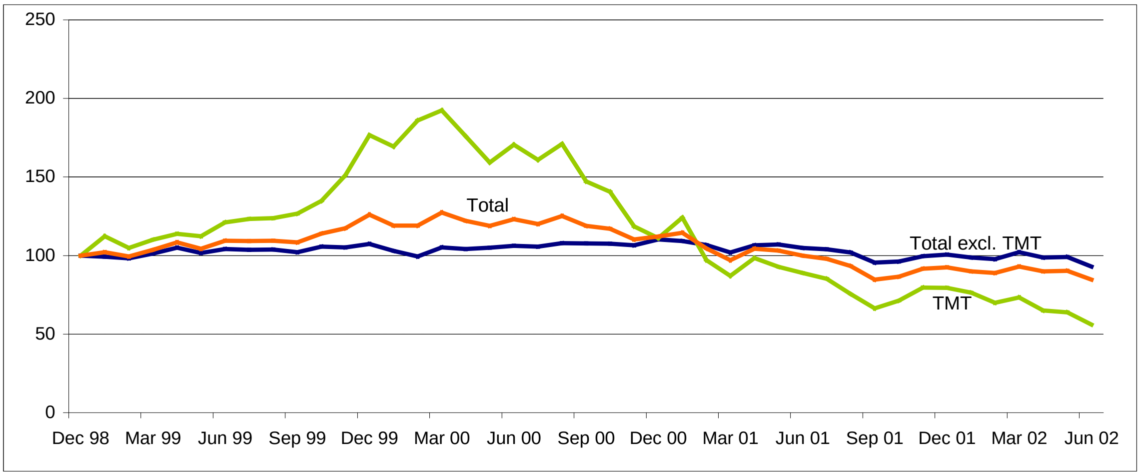


Table 3 shows the performance of the FTSE World Equity Index in the second quarter of 2002, by economic sector. The performances of the most important segments are also shown. In addition to the TMT sectors, share prices in the pharmaceuticals sector have dropped sharply. The most important reasons for this are expectations of increased competition from cheaper copies of important drugs, and uncertainty as to whether pharmaceuticals companies will succeed in having new products approved by the authorities.

Table 3: Performance of the FTSE Equity World Index in the second quarter of 2002, measured in USD and in terms of the Fund's currency basket

Sector	USD	The Petroleum Fund's currency basket
Resources	**-2.07**	**-9.04**
- of which oil and gas	-2.07	-9.04
Basic industry	**3.74**	**-3.65**
General industrials	**-8.26**	**-14.79**
- of which diversified industrials	-16.53	-22.47
Cyclical consumer goods	**-1.49**	**-8.51**
Non-cyclical consumer goods	**-7.17**	**-13.78**
- of which pharmaceuticals and biotechnology	-12.89	-19.09
Cyclical services	**-10.47**	**-16.84**
- of which general retailers	-7.27	-13.87
Non-cyclical services	**-16.77**	**-22.69**
- of which telecommunication services	-20.08	-25.77
Utilities	**-5.66**	**-12.38**
Financials	**-3.51**	**-10.38**
- of which banks	-1.67	-8.67
- of which insurance	-5.49	-12.21
- of which specialty and other finance	-6.92	-13.54
Information technology	**-26.25**	**-31.50**
- of which information technology hardware	-29.12	-34.17
- of which software and computer services	-20.28	-25.96

Source: Datastream

4. Management of the Fund

The market value of the Petroleum Fund's currency portfolio at the end of the first quarter of 2002 was NOK 625.0 billion. In the second quarter, the Ministry of Finance transferred new capital to the fund in the amounts of NOK 12.0 billion on 2 April, NOK 12.9 billion on 30 April, NOK 15.6 billion on 31 May and NOK 13.0 billion on 28 June. On the same dates, equivalent amounts in foreign currency were transferred to the securities portfolio. The transfer on 2 April was the one that would normally have taken place at the end of March, but because of expected weaker liquidity during the Easter weekend, it was postponed for a couple of days. Total transfers to the Petroleum Fund's portfolio of international securities in the second quarter were equivalent to NOK 53.5 billion. Nevertheless, at the end of the quarter, the market value of the Petroleum Fund's combined securities portfolio had dropped to NOK 605.4 billion. The decline is partly due to price falls in equity markets. However, the main reason is that the currencies in which the Fund is invested have depreciated by an average of 8.5 per cent against the Norwegian krone. This has no effect on the international purchasing power of the Fund.

Table 4: Market value of the Petroleum Fund's sub-portfolios. In millions of NOK

	Ordinary equity portfolio	**Fixed income portfolio**	**TAA portfolio***	**Environmental Fund**	**Petroleum Fund overall**
31 March 2001	169 540	248 229	6 316	863	424 948
30 June 2001	207 767	310 023	4 146	899	522 835
30 Sept. 2001	215 644	327 754	2 833	721	546 952
31 Dec. 2001	245 796	362 945	4 153	792	613 686
31 March 2002	258 179	360 718	4 341	1 794	625 032
30 April 2002	242 639	380 177	3 951	1 683	628 449
31 May 2002	243 068	377 770	3 731	1 618	626 187
30 June 2002	231 742	371 145	1 039	1 438	605 363

* Tactical asset allocation comprises both equity and fixed income instruments.

4.1. Management of the fixed income portfolio

New capital in the amount of NOK 12.0 billion was transferred to the fixed income portfolio on 2 April, NOK 12.9 billion on 30 April and a further NOK 5.7 billion on 31 May. On the same days, the fixed income benchmark was partially rebalanced to bring the regional weightings as close to the strategic weightings as the actual portfolio could come without making it necessary to reduce investment volumes in any market.

Since 28 February 2002 the benchmark portfolio has contained both government-guaranteed and non-government guaranteed bonds. Since this date, all sub-indices for investment grade bonds in the Lehman Global Aggregate index have positive weightings in the benchmark, and the weightings will gradually be changed until they reach the market capitalisation weightings in each region. Non-government-guaranteed bonds comprise bonds issued by international institutions or public institutions other than the government, corporate bonds and mortgage-backed bonds. The phasing of these bonds into the benchmark and the actual portfolio was continued in the second quarter.

The market value of the fixed income portfolio at the end of the first quarter was NOK 371.1 billion. The bulk of the portfolio is managed internally in Norges Bank by means of both enhanced indexing, where the main purpose is to achieve the same market exposure as the benchmark, and active strategies designed to outperform the benchmark.

The work of reviewing appplications for the new mandates for external management that were announced with a deadline of 15 January 2002 continued in the second quarter. Three new external managers were funded. These are Lincoln Capital Management Company, Merrill Lynch Investment Managers and State Street Global Advisors Investment Management. These three managers are to engage in enhanced index management of mortgage-backed securities in the US. The main purpose is to achieve cost-effective exposure to this market segment.

4.2. Management of the equity and tactical asset allocation portfolios

New capital in the amount of NOK 9.8 billion was transferred to the ordinary equity portfolio on 31 May, and a further NOK 13.0 billion on 28 June. The market value of the portfolio at the end of the second quarter was NOK 231.7 billion.

At the end of the quarter, about 60 per cent of the equity portfolio was being managed internally in Norges Bank. About 35 per cent of this internal management is enhanced (or active) indexing, where the primary goal is to achieve market exposure corresponding to the benchmark, but with the additional use of various techniques for taking advantage of special pricing situations. About a quarter of is sector management, where risk-taking is limited, while another quarter is active management in selected sectors. In addition come portfolios that are being held internally prior to transfer to external active managers.

About 40 per cent of the equity portfolio is managed externally. More than 60 per cent of this is active management in regional mandates, while about a quarter is external management in sector mandates. The remainder of the external portfolio is managed by external index managers with active strategies (enhanced indexing).

In the second quarter of 2002, one new external manager was funded. This is Citigroup Asset Management, which has a mandate for health sector management in the US.

The amount of tactical asset allocation was further reduced during the quarter. Management takes place partly by means of external managers and partly internally in Norges Bank. There is an internally managed portfolio consisting mainly of derivatives, i.e. equity and interest rate futures, which has a low net market value. No new managers were funded in the second quarter.

5. The return on the Fund

In the second quarter of 2002 the Petroleum Fund, including the Environmental Fund, had a return of -2.93 per cent, measured in terms of the benchmark currency basket. Measured in NOK, the total return in the second quarter was -11.19 per cent. The large difference is due to the substantial appreciation of NOK against the currencies in the benchmark portfolio during the quarter, so that the Fund’s currency basket was worth 8.51 per cent less in relation to NOK. This has no effect on the international purchasing power of the Fund, however.

Table 5 shows that the Petroleum Fund’s ordinary portfolio (excluding the Environmental Fund) had a second quarter return of -2.90 per cent. The return was negative in all three months of the quarter. Table 6 shows the performance of the equity and fixed income portions of the ordinary portfolio separately. In terms of the currency basket, the equity portfolio had a negative return of -12.01 per cent in the quarter, while the return on the fixed income portfolio was positive at 3.55 per cent. There has also been a distinct inverse relationship between the asset classes in previous quarters and years.

Table 5: Return on the Petroleum Fund's ordinary portfolio. Per cent Actual and benchmark portfolios in the second quarter

	Measured in terms of the Fund's currency basket		**Measured in NOK**		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Difference
Whole of 2001	-2.43	-2.45	-5.31	-5,33	0.02
First quarter	0.59	0.34	-2.05	-2,30	0.24
April	-0.50	-0.48	-3.37	-3,35	-0.02
May	-0.25	-0.18	-2.83	-2,77	-0.06
June	-2.17	-2.25	-5.39	-5,46	0.07
Second quarter	-2.90	-2.90	-11.17	-11,16	-0.01
So far this year	-2.33	-2.57	-13.00	-13,20	0.21
After adjustment items			-13.00	-13.27	0.27

Table 6 also shows return figures for the total portfolio (including the Environmental Fund) measured in USD, which depreciated sharply against the currency basket in the second quarter. Measured in USD, the Fund's return was therefore a positive 4.51 per cent. If we measure against the euro instead, we obtain a negative return of -7.68 per cent for the period. The return measured in terms of an import-weighted currency basket was -5.68 per cent.

Table 6: Return on the Petroleum Fund's total portfolio in the second quarter of 2002 measured against various benchmark currencies. Per cent

	Equities	**Fixed income**	**TAA**	**Environmental**	**Total**
The Petroleum Fund's currency basket	-12.01	3.55	-19.79	-12.39	-2.93
Import-weighted currency basket	-14.51	0.61	-22.07	-14.87	-5.68
USD	-5.27	11.48	-13.65	-5.68	4.51
EUR	-16.32	-1.52	-23.72	-16.68	-7.68
NOK	-19.51	-5.27	-26.63	-19.85	-11.19

In the second quarter the ordinary portfolio underperformed the benchmark portfolio by 0.01 per cent. Approximately the same performance as the benchmark portfolio was achieved in both equity and fixed income management.

When calculating the actual return figures in Tables 5 and 6, deductions were made for a number of costs for which deductions are not made when calculating the return on the benchmark. In the second quarter of 2002, these were primarily direct transaction and tax costs in connection with the phasing of non-government-guaranteed bonds into the fixed income portfolio. Costs also include transaction and tax costs in connection with the investment of new capital in equity markets, and tax on dividends in some countries. If these cost components were also deducted from the benchmark return, the excess return in the second quarter would be 4 basis points higher.

On the other hand, the actual return includes income from securities lending, while the benchmark return does not. This income consists of short-term lending to counterparties that not only have high credit ratings but also supply full collateral for the value of the securities they borrow. Lending income in the second quarter was NOK 76 million, accounting for 1 basis point of the average total portfolio. If this is added to the benchmark return, net adjustment items in the second quarter of 2002 will be about 3 basis points of the Fund's average total portfolio. The corresponding figure in the first quarter was 4 basis points. The last line in Table 5 shows that Norges Bank's contribution to excess return so far this year has thus been 27 basis points.

Table 7 shows that in the second quarter the Environmental Portfolio had a return of -12.39 per cent measured in terms of the currency basket and -19.85 per cent measured in NOK. The actual performance was in line with the benchmark performance. The benchmark return for the Environmental Fund in the first half of 2002 was 0.41 percentage point lower than the return on a comparable benchmark from which no companies had been excluded according to environmental criteria.

Table 7: Return on the Environmental Fund in the second quarter of 2002. Per cent

	Measured in terms of the Fund's currency basket		**Measured in NOK**		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Difference
Whole of 2001	-18.94	-18.90	-20.83	-20.79	-0,04
First quarter	1.30	1.32	-1.36	-1.35	-0,02
April	-3.39	-3.41	-6.17	-6.19	0,02
May	-1.29	-1.25	-3.86	-3.81	-0,04
June	-8.13	-8.15	-11.15	-11.17	0,02
Second quarter	-12.39	-12.39	-19.85	-19.85	0,00
So far this year	-11.25	-11.23	-20.94	-20.93	-0,02
Memorandum: Ordinary equity benchmark with country weights as in the Environmental Fund		-10.78		-20.52	

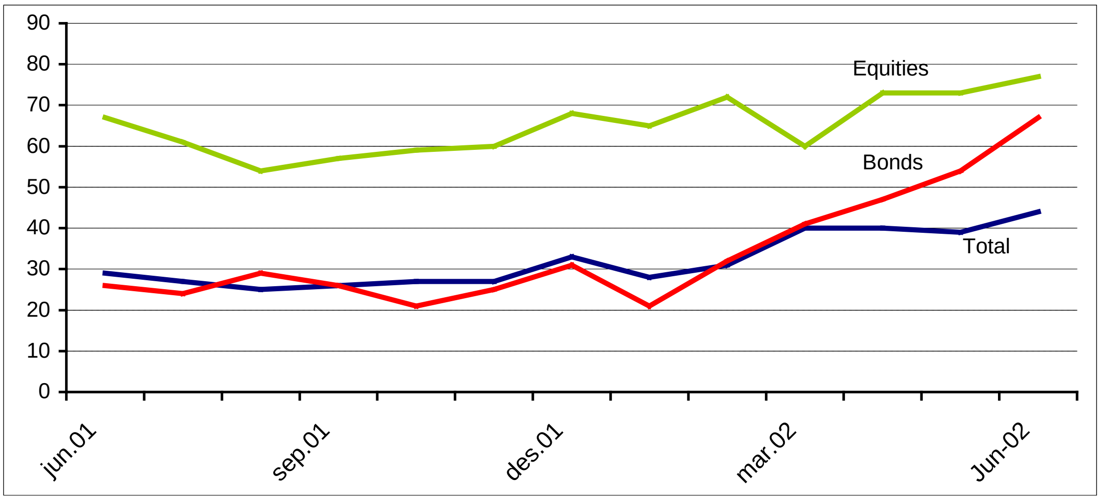
6. Risk exposure

The Ministry of Finance has set a limit to the market risk associated with the actual portfolio relative to the benchmark. This relative market risk shall always be less than 1.5 percentage points (150 basis points) of expected tracking error, as measured in the BARRA risk model. Chart 12 shows that in the second quarter of 2002, relative market risk remained well below the upper limit. At the end of the quarter, expected tracking error for the total portfolio was approximately 44 basis points.

Relative risk is higher in equity management than in fixed income management. Equity markets fluctuate more than fixed income markets, so that there is more risk associated with an equity management position than with a fixed income position of the same size. Another contributing factor is that there has been relatively more active management of the equity portfolio. However, the differences in relative risk have diminished in the course of the second quarter of 2002. The main reason is that non-government-guaranteed bonds account for an increasing share of the fixed income portfolio, and that these are indexed less precisely than government bonds.

The relative market risk in the Environmental Fund at the end of March was 25 basis points, measured as expected tracking error in relation to the benchmark for this portfolio. The Ministry of Finance has imposed an upper limit of 100 basis points.

Chart 12: Expected tracking error at each month-endfor the last 12 months. In basis points (hundredths of a percentage point)



Expected tracking error

The Ministry of Finance uses the risk measure *expected tracking error* to manage the market risk of the Petroleum Fund. This measure is defined as the expected value of the standard deviation of the difference between the annual return on actual investments and the return on the benchmark portfolio. When deviations from the benchmark are restricted by setting an upper limit to expected tracking error, there is a high probability that the actual return will vary within a range around the return on the benchmark. The lower the limit placed on the tracking error, the narrower this range will be. An expected tracking error of 1.5 percentage points or 150 basis points means that the actual return on a portfolio that remains unchanged over time will deviate by less than 1.5 percentage points from the return on the benchmark in two out of three years.

Table 8 shows the composition of the bond portfolio based on credit ratings by Moody's and Standard and Poor's. In the table, government bonds and government-guaranteed bonds without credit ratings have been assigned the credit rating of the issuing country. For example, government-guaranteed issues from the city of Kobe, denominated in USD, have been rated Aa/AA, which is the rating given to the Japanese state for bonds in a foreign currency. According to the Ministry of Finance's credit risk guidelines, the Petroleum Fund may not normally invest in securities with a lower credit rating than Baa from Moody's or BBB from S&P. However, up to 0.5 per cent of the fixed income portfolio may be invested in securities with a Ba rating from Moody's or a BB rating from S&P. The Fund complied with these guidelines in the second quarter of 2002.

Table 8: The fixed income portfolio as at 30 June 2002, by credit rating. Percentages of market value

Moody's		**Standard & Poor's**	
Rating	Share of total	***Rating***	Share of total
Aaa	67.5	AAA	59.4
Aa	16.9	AA	31.7
A	12.5	A	5.3
Baa	3.1	BBB	3.2
Lower	0.0	Lower	0.0
No rating	0.1	No rating	0.5

The fixed income portfolio consists of a small number of short-term securities and cash, in addition to bonds. All the short-term securities in the portfolio have a credit rating of P-1 and A-1 from Moody’s and Standard & Poor’s respectively.

Table 9 provides an overview of other risk limits stipulated in the Ministry of Finance's Regulation on the Management of the Government Petroleum Fund and guidelines for the ordinary portfolio, and of actual exposure during the quarter. The figures show that positions were within these limits throughout the quarter.

Table 9: Risk limits stipulated in the Regulation and the guidelines

Section	**Risk**	**Limits**	**Actual**				
			30.06.01	**30.09.01**	**31.12.01**	**31.03.02**	**28.06.02**
§ 4	Market risk	Maximum 1.5% tracking error	0.3	0.3	0.3	0.4	0.4
§ 5	Asset mix	Bonds 50-70%	60.2	60.0	59.2	57.9	61.5
		Equities 30-50%	39.8	40.0	40.8	42.1	38.5
§ 6	Currency distribution	Europe 40-60%	50.0	49.9	50.4	52.8	54.2
		Americas 20-40%	30.1	30.7	30.8	33.0	32.2
		Asia/Oceania 10-30%	19.9	19.4	18.8	14.2	13.6
	Emerging markets	< 5% of equity portfolio	1.3	1.2	1.9	2.2	2.6
§ 7	Interest rate risk	Modified duration 3-7	5.5	5.6	5.4	5.3	5.2
§ 8	Credit risk*	Max 20% in bank deposits	6.6	4.6	3.4	4.7	2.5
§ 10	Holding	Max. 3% of a company	1.1	1.7	2.0	2.6	2.6

* In addition to ordinary bank deposits, reinvested cash collateral from securities lending is included in the table. For other credit risk limits, see Table 8.

7. Management costs

Table 10 provides an overview of the costs of managing the Government Petroleum Fund in the second quarter of 2002. These costs consist partly of fees to external managers and custodian institutions and partly of the Bank's internal operating expenses. In addition to the Government Petroleum Fund, Norges Bank Investment Management manages the Government Petroleum Insurance Fund and the bulk of Norges Bank's foreign exchange reserves. The total internal costs are distributed between the three funds by means of a set of internal prices. The internal costs include not only Norges Bank Investment Management, but also all support functions provided by other parts of Norges Bank. The latter costs are calculated according to the guidelines applying to business operations in Norges Bank.

Annualised, the costs in the table are equivalent to 0.11 per cent (11 basis points) of the average equity portfolio and 0.04 per cent (4 basis points) of the average fixed income portfolio. A price of this type is of little relevance to tactical asset allocation, as management is based mainly on the equity and fixed-income portfolios, and in such a way that managers' net portfolios are small in relation to the risk taken.

In addition to the above costs come performance-based fees to external equity managers of NOK 29 million (2 basis points of the average equity portfolio) and performance-based fees to external fixed income managers of NOK 3.4 million. The amounts are determined by the managers' total excess returns over the past four quarters. Equity costs including these performance-related fees constitute 14 basis points and fixed income costs 5 basis points of average sub-portfolios.

Table 10: Management costs in the first half of 2002. In thousands of NOK and annualised basis points of the average portfolio

	***First half of 2002**		***First half of 2001**	
	NOK 1000	Basis points	NOK 1000	Basis points
Fee to external equity managers, excluding performance-related fees	63 025		37 209	
Costs of equity custodian and settlement	16 321		20 879	
Internal costs, equity management	61 595		29 630	
Total equity management	**140 942**	**11**	**87 718**	**12**
Performance-related fees to external equity managers	*29 365*		*24 207*	
Fees to external fixed-income managers, excluding performance-related fees	9 981		9 273	
Custodian costs fixed income	10 530		8 421	
Internal costs, fixed income management	61 264		26 184	
Total fixed income management	**81 775**	**4**	**43 878**	**4**
Performance-related fees to external fixed-income managers	3 367		*6962*	
Fees to external managers, tactical asset	3 442		3 572	
allocation	244		469	
Custodian costs, tactical asset allocation	1 806		5 761	
Internal costs, tactical asset allocation				
Total, tactical asset allocation	**5 491**	**-**	**9 802**	**-**
Total management costs, excluding performance-related fees	**228 208**	**7**	**141 397**	**7**
Total management costs	**260 940**	**8**	**166 300**	**9**

For the whole portfolio, including tactical asset allocation, annualised management costs excluding performance-based fees have amounted to 7 basis points of the average market value so far this year.

The management agreement between the Ministry of Finance and Norges Bank stipulates principles for the remuneration payable to Norges Bank for managing the Petroleum Fund's portfolios. The remuneration for 2002 shall be equal to the actual management costs, within an upper limit of 10 basis points of average total assets. Performance-based fees to external managers for excess return achieved shall nevertheless be covered even if they are over and above this upper limit. Agreements on performance-based fees have been concluded with the majority of external active managers, according to principles that have been approved by the Ministry of Finance.

8. Reporting of accounts

Table 11 shows the mix of different instruments as presented in Norges Bank's accounts at the end of the last five quarters. Table 12 shows the book return, which in the second quarter was NOK 73 399 million prior to the deduction of Norges Bank's management remuneration. The table shows that most of this amount is due to an appreciation of the Norwegian krone against the currencies in which the Fund is invested.

The accounts figures are based on holdings including unsettled trades (except cash). The figures indicate market values based on verified price information. Investments in foreign currency are converted to NOK at market rates as at 28 June quoted on WM/Reuters London. The recorded value of the Petroleum Fund deviates from the market value in Table 4 above largely because accrued management remuneration has not been deducted in the table above, but also because different assessment principles have been used for some items (see the appendix on methodology for calculating returns). Similarly, there are small variations in the return figures.

Table 11: The Petroleum Fund's international portfolio distributed by instrument, at 30 June 2002. In thousands of NOK

	30.06.01	**30.09.01**	**31.12.01**	**31.03.02**	**30.06.02**
Short-term assets, incl. deposits in foreign banks	34 887 205	42 406 244	20 002 123	16 024 677	2 699 820
Money market placings in foreign financial institutions against collateral in the form of securities	106 908 470	105 857 427	121 848 011	117 783 989	111 666 155
Loans from foreign financial institutions against collateral in the form of securities	-103 543 138	-117 779 691	-119 092 695	-130 281 198	-125 929 639
Foreign interest-bearing securities	297 907 551	322 464 755	350 008 902	365 329 261	388 938 848
Foreign equities	186 712 315	194 013 322	240 884 381	256 209 363	227 800 284
Forward contract adjustments	-37 496	14 053	39 018	4 703	157 506
Total portfolio before remuneration for management	**522 834 907**	**546 976 110**	**613 689 740**	**625 070 795**	**605 332 974**
Accrued management remuneration	-159 459	-253 831	-372 255	-130 000	-260 000
Total portfolio recorded value	**522 675 448**	**546 722 279**	**613 317 485**	**624 940 795**	**605 072 974**

Off the balance sheet, financial futures with a total market value of NOK 41 226.8 million had been purchased and financial futures with a market value of NOK 45 350.3 million had been sold as at 28 June 2002. Interest rate swaps with a total market value of NOK 105 162.1 million were purchased and swaps for NOK 105 670.2 million were sold. Foreign exchange with a total contract value of NOK 15 449.0 million had also been bought and sold forward.

In table 12, income and costs in foreign currency are converted into NOK according to the exchange rate on the transaction date, and are recognised as they are earned or accrued, according to the accruals principle.

Table 12: Book return on the Petroleum Fund's international portfolio. As at 30 June 2002. In thousands of NOK

	30.06.01	30.09.01	31.12.01	31.03.02	30.06.02
Interest income	6 754 056	10 732 345	14 911 191	4 927 613	9 919 129
Dividends	1 579 770	2 246 593	2 738 851	1 071 776	2 635 581
Exchange rate adjustment	-2 554 261	-8 483 760	-16 242 683	-16 538 659	-72 943 773
Unrealised securities loss/gain	-13 870 491	-41 743 938	-19 308 721	3 245 737	-15 562 677
Realised securities gain	-284 868	-2 757 605	-4 190 744	-5 350 807	-8 888 435
Brokers' commissions	-26 080	-40 087	-48 960	-2 487	-1 030
Forward exchange trading	-6 077	-3 362	1 477	-214	72
Gains/losses futures	-402 570	-2 619 463	-1 816 099	105 566	-969 702
Book return on investments	**-8 810 521**	**-42 669 277**	**-23 955 688**	**-12 541 475**	**-85 810 835**
Accrued management remuneration	-159 459	-253 831	-372 255	-130 000	-260 000
Net return market value	**-8 969 980**	**-42 923 108**	**-24 327 943**	**-12 671 475**	**-86 070 835**

APPENDIX:
Methodology for calculating returns

Returns are calculated according to the market value principle, ie the opening and closing values of the portfolios are valued at the relevant market prices at the beginning and end of the period. Interest expenses and revenues, dividends, withholding tax, changes in holdings and changes in securities prices are accounted for on an accruals basis when calculating returns. The trade date is used for recognising income and expenses for agreed, unsettled transactions. The return is compared with the return on the benchmark portfolio. The return differential takes the form of an arithmetic difference between the returns on the actual and benchmark portfolios.

The time-weighted method should be used for calculating the return on a portfolio with incoming and outgoing payments. This method requires that the market value of the portfolio be calculated at the time of each incoming or outgoing payment, and the return found as the change in market value between one point in time and the next. Thus an index for the market value is arrived at for each point in time compared to the previous point in time for cash flow. By multiplying these index figures for the individual periods, the return for the whole period is obtained. Thus cash flow elements will only contribute to the return from the time of the incoming or outgoing payment[1].

To date, Norges Bank has performed a verification of market values only at month-end[1], and therefore does not calculate a time-weighted return at any other time during the month. Instead a money-weighted method (modified Dietz method) is used, whereby the monthly percentage return is calculated by distributing the various cash flows between incoming and outgoing value, and the return is found by dividing the portfolio's adjusted outgoing value by the adjusted incoming value[2].

The modified Dietz method can be described by means of the following formula:

$$R_M = \left[\left(\frac{MV_E - \frac{\sum_i i \cdot K_i}{T}}{MV_B + \frac{\sum_i (T-i) \cdot K_i}{T}} \right) - 1 \right] \cdot 100$$

[1] Norges Bank also calculates daily market values, but these are not satisfactorily verified as yet. There is ongoing work to achieve verified daily market values.

[2] No transfers to or withdrawals from the Government Petroleum Fund take place in the middle of the month, nor are there any transfers between the fixed income and equity portfolios in the middle of the month. This means that the monthly return calculated for the fund as a whole, the fixed income portfoio and the equity portfolio will be independent of the return method used (modified Dietz or time-weighted method). When the returns on subportfolios (currency portfolios and individual mandates) are calculated, there may be differences in return depending on the method used.

where R_M = Money-weighted return in the period (per cent)
MV_B = Incoming value
MV_E = Outgoing value
T = No. of days in the period
i = No. of days for cashflow K_i
K_i = Cash flow on day i

The geometrical return is used for long periods, such as quarterly and annual return and return so far this year. In other words, the return indices for the individual periods are multiplied together. Thus the return is a time-weighted return on the returns for the individual months.

The return is calculated in both NOK and local currency. The total return in NOK is found by totalling the market values in NOK of all currencies and distributing total cash flows in NOK, as expressed in the formula above. WM/Reuters exchange rates[3] are used for converting local currencies to NOK.

The NOK return on the benchmark portfolio is calculated as the geometrical difference between the returns in NOK and in local currency, measured in terms of the currency distribution of the benchmark portfolio. This indicates how much the Norwegian krone has appreciated or depreciated in relation to the currency distribution of the benchmark portfolio.

The calculations of the return are carried out in separate models, which are reconciled with the accounting system. Differences in calculated return between the models and the accounts occur as a result of the application of different assessment principles, for example in the treatment of accrued interest and tax withholdings that have not been repaid. In the accounts, allocations are also made to cover Norges Bank's management fee.

Benchmark portfolio

The benchmark portfolio consists of an equity benchmark and a fixed income benchmark, which are based on internationally recognised market indices. In the strategic benchmark, the distribution of assets is 60 per cent in fixed income instruments and 40 per cent in equities. In periods between two complete rebalancing operations, the Petroleum Fund's actual benchmark portfolio will move away from the stipulated weightings in the strategic benchmark as a result of actual market developments in each asset class. The actual benchmark portfolio is partially rebalanced in connection with the monthly transfers to the Petroleum Fund so that the asset mix in the actual benchmark will to the largest extent possible return to the weightings in the strategic benchmark.

The equity benchmark:
The equity benchmark portfolio is based on the FTSE All-World Index. It is distributed between the three regions Europe, the Americas, and Asia/Oceania. In the strategic benchmark portfolio, the regional distribution is 50 per cent, 30 per cent and 20 per cent respectively. Equity investments in each region are distributed among the approved countries[4] according to market values measured by the FTSE indices. Country and regional weightings in the actual benchmark follow market developments, but in connection with the monthly transfers will to the largest extent possible be returned to the weightings in the strategic benchmark.

[3] WM/Reuter Closing Spot Rates, fixed at 4 pm London time.
[4] See Section 6 of the regulation of 3 October 1997 on the Management of the Government Petroleum Fund.

The principles on which the compositions of the FTSE indices are based are described in "Ground Rules for the Management of the FTSE All-World Index, Version 1.12 June 2002".

The benchmark portfolio for the Environmental Fund consists of those companies in the FTSE All-World Index which fulfil specific requirements regarding environmental reporting or environmental management systems. The benchmark portfolio comprises the same countries as the ordinary equity benchmark, with the exception of five emerging markets. The Ministry of Finance has given the British consulting company Ethical Investment Research Service (EIRIS) responsibility for identifying these companies. The regional weightings in the Environment Fund are not rebalanced but follow market developments in the benchmark portfolio.

Benchmark for fixed income instruments

The benchmark for fixed income instruments is based on the Lehman Global Aggregate (LGA). It is distributed between the three regions Europe, North America, and Asia. In the strategic benchmark portfolio, the regional distribution is 55 per cent, 35 per cent and 10 per cent respectively. Investments in each region are apportioned among countries approved according to the market capitalisation weightings measured by the Lehman Index. However, an exception has been made for Japan, where the market capitalisation has been given a weighting of 0.25. The country and regional weightings in the actual benchmark follow market developments, but in connection with the monthly transfers will to the largest extent possible be returned to the weightings in the strategic benchmark. The "Guide to Lehman Family of Indices" (February 2002) provides an overview of the principles on which the composition of the LGA Index is based.