

Norges Bank's foreign exchange reserves

Report for the fourth quarter and for the year 2003

1. Introduction

At the end of the fourth quarter of 2003, Norges Bank's foreign exchange reserves totalled NOK 189.1 billion. The foreign exchange reserves are managed in various portfolios according to purpose. The value of the three portfolios totalled NOK 192.3 billion.¹ This report concerns the management of the foreign exchange reserves' various portfolios in the fourth quarter 2003 and in 2003 as a whole, and the management of Norges Bank's gold reserves in the second half of 2003.²

2. The size and composition of the reserves

Table 1 shows the size of the individual portfolios at the end of each quarter in 2003 in billions of NOK.

Table 1: Size of the portfolios³

Date	Investment portfolio	Money market portfolio	Buffer portfolio	Liquidity portfolio	Immunisation portfolio	Total in portfolios	Gold
31.12.02	93.6	-	29.5	32.8	4.3	160.3	2.6
31.03.03	101.0	-	24.0	35.5	-	160.5	
30.06.03	109.1	-	31.8	36.4	-	177.3	2.7
30.09.03	140.7	5.0	33.4	-	-	179.2	
31.12.03	142.3	6.2	43.7	-	-	192.3	3.0

3. Return on the reserves

Tables 2 and 3 show the percentage return on the money market portfolio and the investment portfolio respectively for the fourth quarter and for 2003 as a whole, and the excess return compared with the respective benchmark portfolios. The return is presented both in NOK and in terms of the basket of currencies in the benchmark portfolio. The return measured in foreign currency provides the most accurate picture of developments in the reserves' international purchasing power.

In the fourth quarter, the return on fixed income investments was slightly positive, whereas the return on equity investments was high. As a result, the return on the investment portfolio, measured in terms of the benchmark portfolio's currency basket, was positive. The krone appreciated against the currencies in which the portfolio was invested during the quarter, resulting in a lower portfolio return measured in NOK.

¹ The NOK 3.2 billion difference is a result of the fact that the portfolios also contained holdings that are not part of the foreign exchange reserves (i.e. foreign exchange forwards purchased against NOK in the buffer portfolio, and foreign exchange claims against Norwegian counterparties in the investment portfolio). On the other hand, working accounts are part of the foreign exchange reserves but are not part of the managed portfolios.

² Norges Bank's international reserves comprise the foreign exchange reserves, gold and claims on the IMF. Norges Bank's claims on the IMF are not discussed in this report.

³ The table reflects the change in the portfolio structure in 2003. The immunisation portfolio was discontinued at the end of the first quarter and securities worth NOK 0.5 billion which were in the portfolio were transferred to the long-term portfolio. At the end of the third quarter, fixed income instruments worth NOK 31.9 billion were transferred from the liquidity portfolio to the long-term portfolio. The liquidity portfolio was subsequently discontinued and the remaining NOK 5.0 billion was managed in a newly established money market portfolio. After the transfer, the long-term portfolio changed name to become the investment portfolio.

3.1 Liquidity portfolio and money market portfolio

Table 2: Liquidity portfolio (discontinued 30.09.03) and the money market portfolio (established 30.09.03). Periodic return. Per cent

	Measured in terms of the benchmark currency basket		Measured in NOK		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Excess return
Liquidity portfolio Q1 – Q3	2.36	2.30	10.97	10.91	0.06
Money market portfolio Q4	0.40	0.36	-1.43	-1.47	0.04

Measured in NOK, the actual return on the money market portfolio was -1.43 per cent in the fourth quarter. This was equivalent to a loss of NOK -0.1 billion. The return was 0.04 percentage point higher than the return on the benchmark portfolio defined by Norges Bank's Governor.

3.2 Investment portfolio

Table 3: Investment portfolio. Periodic return. Per cent

Total	Measured in terms of the benchmark currency basket		Measured in NOK		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Excess return
Q1	0.06	0.01	6.80	6.74	0.06
Q2	5.12	4.99	8.01	7.88	0.13
Q3	0.66	0.58	-0.29	-0.37	0.07
Q4	2.27	2.22	1.13	1.08	0.05
2003 as a whole	8.28	7.95	16.31	15.96	0.35
Gross excess return in 2003*					0.58

* The actual return is affected by the cost of the changeover from bonds to equities (which started in December 2002) and from government bonds to non-government bonds (which started in January 2003), and the change from GDP-based to market-based weights in the fixed income portfolio (which took place in January 2003). The return is also influenced by tax paid on dividends in some countries. None of these costs were deducted when the benchmark return was calculated. The gross excess return has been adjusted accordingly.

Measured in NOK, the quarterly return on the actual portfolio, 1.13 per cent, is equivalent to a profit of NOK 1.6 billion. For 2003 as a whole, the profit was NOK 15.7 billion. The return in the fourth quarter was 0.05 percentage point higher than the return on the benchmark portfolio defined by the Executive Board. For 2003 as a whole, the gross (adjusted) excess return compared with the benchmark portfolio was 0.58 percentage point.

Table 4: Investment portfolio. Periodic return for the subportfolios. Per cent

	Measured in terms of the benchmark currency basket		Measured in NOK		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Excess return
Fixed income portfolio					
Q1	1.79	1.70	8.64	8.54	0.10
Q2	2.70	2.44	5.53	5.26	0.27
Q3	-0.08	-0.14	-1.03	-1.08	0.05
Q4	0.05	-0.06	-1.06	-1.18	0.12
2003 as a whole	4.51	3.97	12.27	11.69	0.58
Gross excess return in 2003*					0.78
Equity portfolio					
Q1	-8.65	-8.51	-2.51	-2.36	-0.15
Q2	14.97	15.34	18.13	18.51	-0.38
Q3	3.67	3.50	2.69	2.52	0.17
Q4	10.66	10.81	9.43	9.58	-0.15
2003 as a whole	20.48	21.01	29.42	29.99	-0.58
Gross excess return in 2003*					-0.25

* See comment to Table 3.

Tables 5 and 6 and Charts 1 and 2 provide an overview of returns through the last few years.

Table 5: Annual nominal and real return on the investment portfolio for the period 1998-2003, measured in terms of the portfolio's currency basket. Per cent

	1998	1999	2000	2001	2002	2003	1998-2003
Nominal return							
- on the equity portfolio	NA	NA	NA	-14.78	-26.36	20.48	-8.90
-on the fixed income portfolio	10.03	-1.15	8.49	5.15	9.46	4.51	6.01
- on the total portfolio	10.03	-1.15	8.49	2.45	2.17	8.28	4.96
Price inflation*	0.94	1.35	2.11	1.34	2.01	1.31	1.51
Real return	9.01	-2.46	6.25	1.09	0.15	6.88	3.40
Management costs	0.03	0.05	0.04	0.05	0.08	0.07	0.05
Net real return	8.97	-2.51	6.21	1.04	0.08	6.81	3.35

* Weighted average of consumer price inflation in the countries included in the portfolio's benchmark in the year in question.

Table 6: Excess return from management of the investment portfolio in each of the years for the period 1998-2003 and the average for the period. Percentage points

	1998	1999	2000	2001	2002	2003	1998-2003
Unadjusted excess return	-0.03	0.13	0.12	0.03	0.29	0.35	0.15
Gross excess return*	-0.03	0.13	0.12	0.15	0.32	0.58	0.22
Value added by active management**	-0.03	0.10	0.10	0.13	0.29	0.55	0.19

* Including extraordinary costs associated with the Executive Board's changes in the benchmark portfolio, tax on dividends and adjustments for errors in the FTSE index's return figures for French equities in 2002.

** Gross excess return with a deduction for active management costs and securities lending revenues, but with an addition for transaction costs in connection with ordinary indexing.

Chart 1: Index for cumulative return on the subportfolios in the investment portfolio for the period 1998-2003. The portfolio's currency basket at 31.12.2000 =100

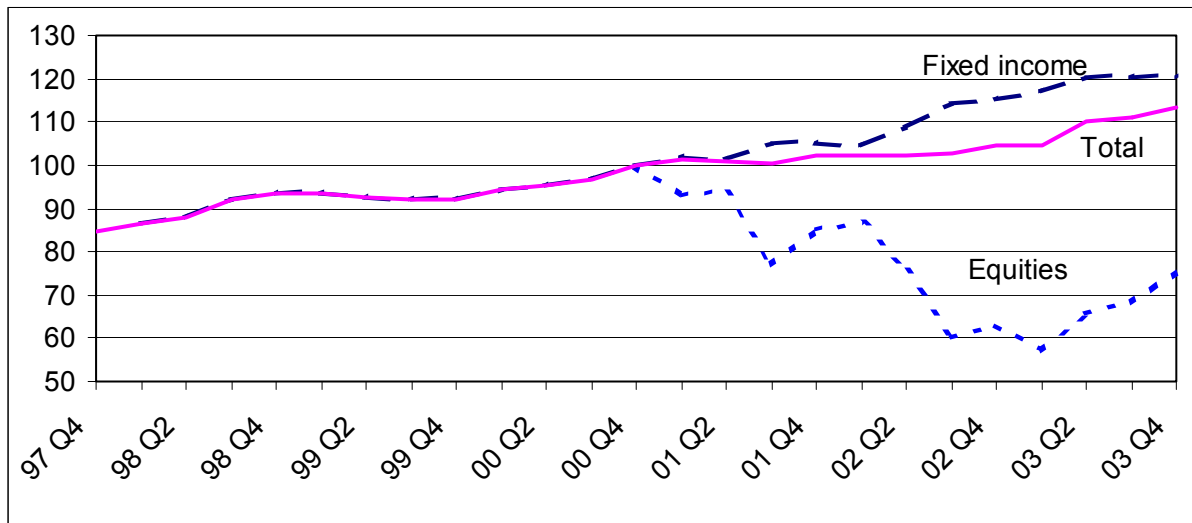
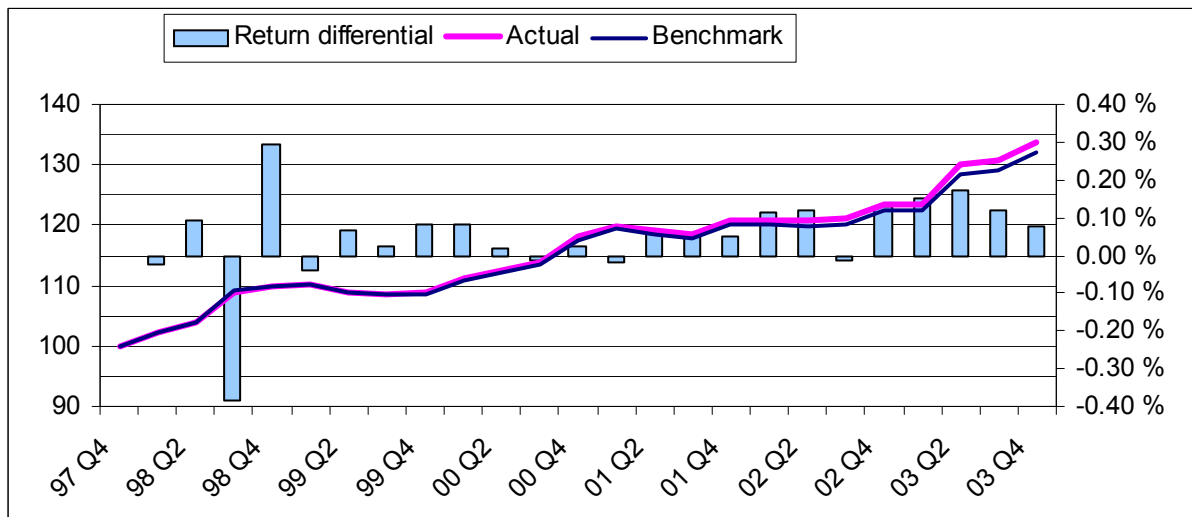


Chart 2: Index for the cumulative actual return on the investment portfolio and the return on the benchmark (31.12.1997=100, left-hand axis) and the quarterly gross excess return in percentage points (right-hand axis) 1998-2003



The information ratio is a commonly used measure of the skill of an investment manager. It may be calculated as the ratio of the annual gross excess return to the actual relative market risk taken. In other words, the information ratio shows how much excess return is achieved for each unit of risk. In the period from June 1998, when Norges Bank Investment Management took over management of the portfolio, to the end of 2003, the average information ratio for the investment portfolio, calculated in this manner, was 0.86.

3.3 Buffer portfolio

The return on the buffer portfolio measured in NOK was -0.26 per cent in the fourth quarter and 8.31 per cent in 2003 as a whole. This is equivalent to NOK -0.1 billion and NOK 2.6 billion respectively. In view of the purpose of the buffer portfolio, no benchmark portfolio has been defined.

3.4 Gold

The return on the gold reserves in the second half of 2003, including interest on gold lending, was 11.22 per cent measured in NOK and 20.93 per cent measured in USD. The return for 2003 as a whole was 16.81 per cent and 21.89 per cent respectively.

4. Status in relation to the risk limits stipulated in the guidelines

All portfolios have complied with the guidelines throughout the quarter.

Tables 7-10 show the status at the end of the quarter for the money market portfolio, the investment portfolio and the buffer portfolio respectively.

Table 7: Money market portfolio and risk exposure

Risk	Limits	Actual	
		30.09.03	31.12.03
Currency distribution	EUR 40-60 %	50.20	50.23
	USD 40-60%	49.80	49.77
	GBP 0-10 %	0.00	0.00
	JPY 0-10 %	0.00	0.00

Table 8: Investment portfolio and risk exposure

Risk		Actual			
		31.03.03	30.06.03	30.09.03	31.12.03
Market risk*	Tracking error can be a maximum 1.5 percentage points	0.32	0.34	0.36	0.21
Asset mix**	Fixed income instruments	80.51	76.35	79.51	75.98
	Equities	19.49	23.65	20.49	24.02
Currency distribution**	Europe	61.16	60.96	49.39	55.12
	Americas	30.65	31.05	41.67	36.96
	Asia/Oceania	8.19	7.98	8.94	7.92
Interest rate risk	Modified duration	5.70	5.59	5.36	5.66
Maximum holding in an individual company*	Maximum 3%	0.47	0.42	0.41	0.42

* Before 30.09.03, the limits for tracking error and company holdings were 1.0 percentage point and 0.5 per cent respectively. There was also an upper and lower limit for duration (7 and 3 respectively).

** Changes in the asset mix and the currency distribution reflect the phasing in of a new benchmark portfolio, a process that began in December 2002 and is still underway. The equity portion of the investment portfolio as at 30.09.03 also reflects that the majority of the liquidity portfolio, which only contained fixed income instruments, was transferred to the investment portfolio on this date.

Table 9: The bond portion of the investment portfolio as at 31.12.2003, by credit rating. Per cent of market value*

Moody's		Standard & Poor's	
Rating	Per cent	Rating	Per cent
Aaa	68.91	AAA	64.37
Aa	12.30	AA	20.20
A	13.98	A	7.73
Baa	3.73	BBB	4.52
Ba	0.08	BB	0.12
No rating	1.00	No rating	3.07

*In the table, the agencies' subdivisions are grouped into general rating classifications. For example, Moody's Aa contains the subratings Aa1, Aa2 and Aa3. Government bonds and government-guaranteed bonds without credit ratings have been assigned the credit rating of the issuing country.

Table 10: Petroleum Fund buffer portfolio and risk exposure*

Risk	Limits	Actual		
		30.06.03	30.09.03	31.12.03
Asset mix	Fixed income instruments 0-100%	100.00	100.00	100.00
	Equity instruments 0-100%	0.00	0.00	0.00
Currency distribution	Europe 0-100%	88.43	68.1	60.6
	Americas 0-100%	10.56	31.6	39.1
	Asia/Oceania 0-100%	1.01	0.3	0.2
Interest rate risk	Modified duration 0-7	0.00	0.00	0.00

*The buffer portfolio is managed with the objective of reducing the need for transactions when the Petroleum Fund is rebalanced, in order to avoid unnecessary transaction costs. The limits are therefore less restrictive for the buffer portfolio than for the Petroleum Fund.

5. Internal and external management

At the end of the fourth quarter, approximately 90 per cent of the fixed income portion of the investment portfolio was managed internally by means of enhanced indexing, where the main purpose is to achieve a market exposure in line with that of the benchmark portfolio, and active strategies designed to achieve an excess return in relation to the benchmark portfolio. The remaining fixed income instruments in the investment portfolio are managed by six external managers with a total of eight investment mandates.

At the end of the fourth quarter, about 65 per cent of the equity portion of the investment portfolio was managed internally by means of enhanced (or active) indexing. This means that the primary objective is market exposure in line with the benchmark portfolio, but that various additional techniques are used to take advantage of special pricing situations. The remaining equities in the investment portfolio are managed by three external managers with a total of four regional mandates for active management.

6. Management costs

The investment portfolio and the buffer portfolio are managed by Norges Bank Investment Management (NBIM). The costs incurred by NBIM's management activities consist partly of fees to external managers and custodian institutions, and partly of Norges Bank's internal operating costs. In addition to managing these foreign exchange reserves portfolios, NBIM is also responsible for managing the Government Petroleum Fund and the Government Petroleum Insurance Fund. In 2003, NBIM's total costs (including performance-based fees) in connection with the management of the investment portfolio and the buffer portfolio (and the immunisation portfolio until it was discontinued on 31 March) amounted to 0.07 per cent of the average portfolio.