

2013 | 02

Foreign exchange reserves

August 2013

Management of Norges Bank's foreign exchange reserves

Report for second quarter 2013

Main points in 2013 Q2

- The market value of Norges Bank's foreign exchange reserves at the end of Q2 was NOK 319bn, or SDR 35bn. Reserves were invested in short-term fixed income instruments (21 percent), long-term fixed income instruments (47 percent) and equities (32 percent).
- The foreign exchange reserves earned a return of NOK 0.5bn.
- The return on equity investments was 1.4 percent, while the return on long-term fixed income investments was -1.4 percent. The return on short-term fixed income investments was approximately zero.

PART 1 Management

Norges Bank's foreign exchange reserves shall be available for use as part of the conduct of monetary policy with a view to promoting financial stability and for meeting Norges Bank's international commitments to the IMF and individual countries. The reserves are divided into a long-term portfolio, a money market portfolio and a petroleum buffer portfolio. Norges Bank Investment Management (NBIM) manages the long-term portfolio, while the money market portfolio and petroleum buffer portfolio are managed by Norges Bank Markets and Banking Services.

The foreign exchange reserves shall be invested so that at least SDR 10bn, including the entire money market portfolio, can be used within a single trading day without having to realise any appreciable losses. The money market portfolio shall be between SDR 3.5bn and SDR 4.5bn and be invested in short-term fixed income instruments. The benchmark index for the money market portfolio is a composite of USD and EUR overnight money market indices and Treasury bill indices for the same currencies. The long-term portfolio shall be invested in equities and fixed income securities. The benchmark index for the long-term portfolio is a composite of global equity and bond indices. The equity allocation in the strategic benchmark index is 40 percent.

The purpose of the petroleum buffer portfolio is to ensure that the Government Pension Fund Global (GPF) is provided with an adequate supply of fresh capital. Funds accumulate in the portfolio through transfers of foreign currencies from the State's Direct Financial Interest in petroleum activities (SDFI) and through foreign exchange purchases Norges Bank undertakes in the markets on the basis of the Ministry of Finance's monthly allocations to the GPF. Funds are normally transferred each month. No benchmark index has been set for the petroleum buffer portfolio.

As from 2013 Q2, a comprehensive report on the management of the Bank's foreign exchange reserves will be published.

1 Market value

The market value of the foreign exchange reserves was NOK 318.9bn at the end of 2013 Q2. The long-term portfolio was the largest at NOK 253.5bn, while the market value of the money market portfolio and petroleum buffer portfolio came to NOK 37.2bn and NOK 28.2bn, respectively. Reserves increased by NOK 20.6bn during Q2, primarily owing to foreign exchange gains following a depreciation of the krone and an injection of foreign exchange to build up the petroleum buffer portfolio. At the end of May, the equity allocation in the actual benchmark index was more than 4 percentage points higher than the 40 percent allocation to equities in the strategic benchmark index. Therefore, a full rebalancing of the benchmark index was carried out at the end of the quarter.

Chart 1-1 Size of the foreign exchange reserves. In billions of NOK.

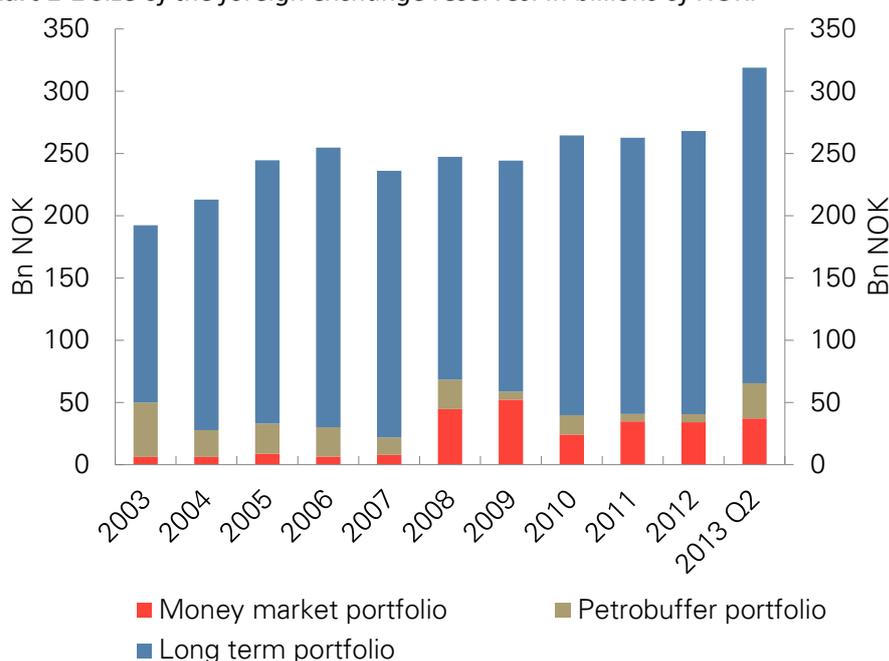


Table 1-1 Market value. In billions of NOK

	2013 Q2	2013 Q1	2012 Q4	2012 Q3	2012 Q2
Money market investments	37.2	35.2	34.2	34.9	36.0
Long-term portfolio - fixed income investments	148.6	131.5	128.2	131.1	132.7
Long-term portfolio - equity investments	104.9	112.2	99.2	99.0	95.9
Petroleum buffer portfolio	28.2	19.4	6.5	20.6	31.8
Foreign exchange reserves	318.9	298.3	268.0	285.6	296.5
Total change during the quarter	20.6	30.3	-17.6	-10.9	13.3
Transfers during the quarter	7.1	11.6	-13.7	-9.6	7.1
Return during the quarter	0.5	11.2	4.4	7.4	-1.1
Change owing to fluctuations in the NOK exchange rate	13.0	7.5	-8.3	-8.7	7.4

2 Return

The return on the foreign exchange reserves, measured in international currency, was NOK 0.5bn in 2013 Q2.

The return on the long-term portfolio was –0.11 percent. The return on the long-term portfolio is compared with the return on global benchmark indices for equities and bonds, which is based on indices from FTSE Group and Barclays Capital. The return on the portfolio was 0.25 percentage point higher than the return on the benchmark index in 2013 Q2. The excess return was primarily the result of adjustments in the equity allocation in advance of the rebalancing of the benchmark index at the end of the quarter. Investments in Spanish covered bonds also made a positive contribution.

The money market portfolio earned a return in Q2 of 0.03 percent, an excess return of 0.01 percentage point. The low return must be viewed in the context of the liquidity requirements for the money market portfolio and to the restrictions in the portfolio's investment universe.

Table 2-1 Return measured in international currency. Percent

	2013 Q2	2013 Q1	2012 Q4	2012 Q3	2012 Q2
<i>Money market portfolio:</i>					
Portfolio	0.03	0.04	0.03	0.03	0.03
Benchmark index	0.02	0.02	0.03	0.03	0.03
Excess return (percentage points)	0.01	0.02	0.01	0.00	0.00
<i>Long-term portfolio:</i>					
Fixed income investments	-1.44	0.08	0.70	1.49	2.07
Equity investments	1.37	10.25	3.30	5.98	-4.04
<i>Long-term portfolio:</i>	<i>-0.11</i>	<i>4.52</i>	<i>1.82</i>	<i>3.37</i>	<i>-0.58</i>
Benchmark index	-0.35	4.19	1.67	3.13	-0.48
Excess return (percentage points)	0.25	0.33	0.15	0.24	-0.11
Foreign exchange reserves*)	-0.09	3.92	1.59	2.94	-0.50

*) Excluding the petroleum buffer portfolio

Table 2-2 Return measured in NOK terms. Percent

	2013 Q2	2013 Q1	2012 Q4	2012 Q3	2012 Q2
Money market portfolio	4.73	4.48	-2.16	-3.32	3.07
Long-term portfolio, fixed income investments	2.66	2.62	-2.25	-1.21	5.01
Long-term portfolio, equity investments	5.59	13.04	0.27	3.16	-1.27
Foreign exchange reserves*)	4.14	6.81	-1.30	0.11	2.38

*) Excluding the petroleum buffer portfolio

The gross rate of return on the foreign exchange reserves (excluding the petroleum buffer portfolio) was 8.6 percent over the past four quarters, which corresponds to a real return of 7.0 percent. Over the past ten years, the gross annual return was 5.6 percent and the real annual return 3.4 percent.

Table 2-3 Key figures as at 28 June 2013. Annualised figures. Measured in international currency

	Past year	Past 3 years	Past 5 years ¹⁾	Past 10 years ¹⁾
<i>Foreign exchange reserves excluding the petroleum buffer portfolio:</i>				
Gross annual return (percent)	8.62	7.36	6.46	5.55
Annual inflation (percent)	1.58	1.72	1.49	2.07
Annual management costs (percent)	0.03	0.04	0.06	0.06
Annual net real return (percent)	7.00	5.61	4.91	3.42
<i>Money market portfolio:</i>				
Portfolio return (percent)	0.13	0.29	-	-
Benchmark return (prosent)	0.10	0.25	-	-
Excess return (percentage points)	0.03	0.03	-	-
Realised absolute volatility (percent) ²⁾	0.03	0.09	-	-
Realised relative volatility (percentage points) ²⁾	0.03	0.02	-	-
Information rate (IR) ³⁾	1.40	1.56	-	-
<i>Long-term portfolio:</i>				
Portfolio return (percent)	9.89	8.31	6.46	5.55
Benchmark return (prosent)	8.86	7.49	5.67	5.29
Excess return (percentage points)	1.04	0.82	0.79	0.25
Realised absolute volatility (percent) ²⁾	3.50	4.49	7.88	6.25
Realised relative volatility (percentage points) ²⁾	0.21	0.55	1.41	1.07
Information rate (IR) ³⁾	4.84	1.47	0.56	0.24

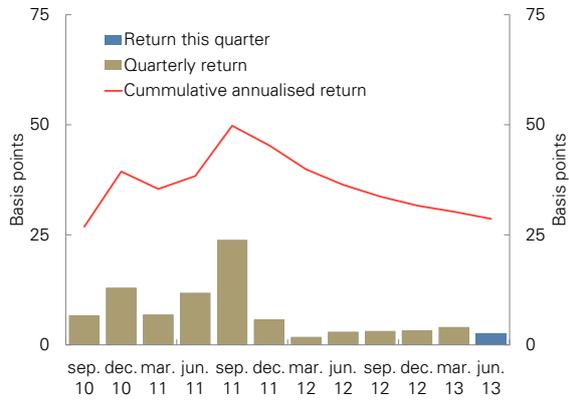
1) Pertains only to the long-term portfolio.

2) Realised volatility is a measure of the fluctuation in monthly return figures, expressed her by the annualised empirical standard deviation of monthly return series. Absolute/relative volatility expresses risk relatede to absolute/relative return.

3) IR is a risk-adjusted return measure and is used to measure performance in investment management. IR is the ratio between excess return and the portfolio's actual relative market risk (measured by relative volatility). IR shows the level of excess return achieved for each unit of risk.

Chart 2-1 Return ^{*)}

Money market portfolio



Long-term portfolio

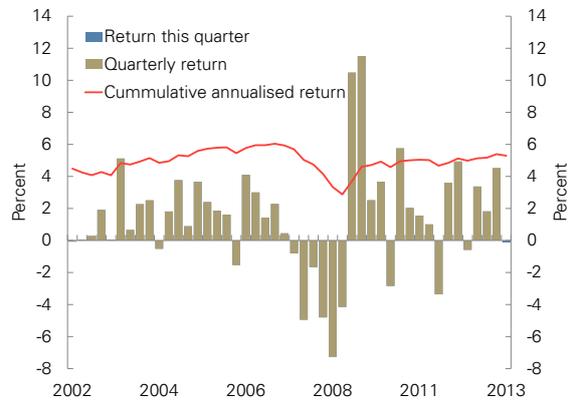
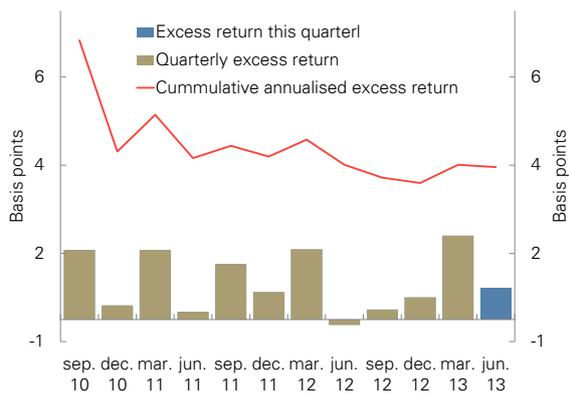
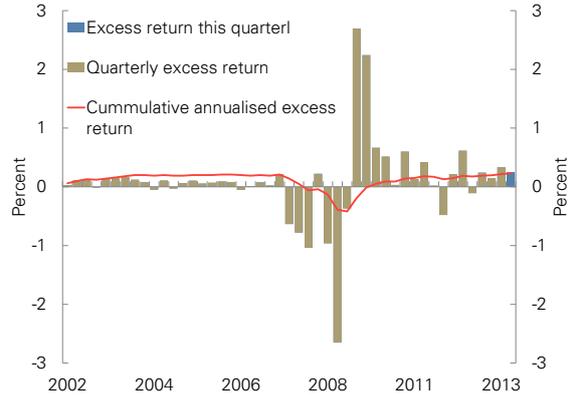


Chart 2-2 Excess return

Money market portfolio



Long-term portfolio



^{*)} Cumulative return figures have been calculated from September 2010 and January 1998, for the money market portfolio and the long-term portfolio respectively.

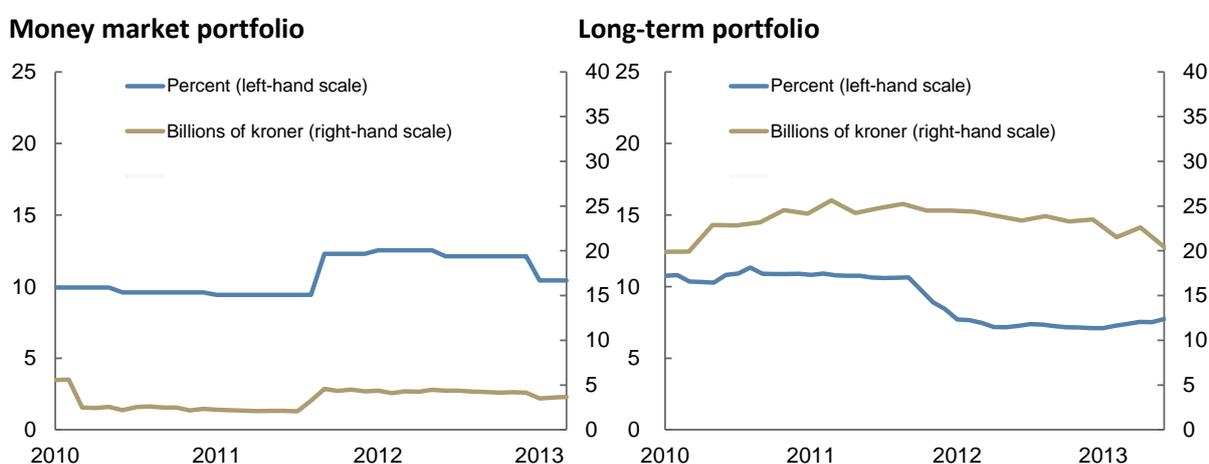
3 Risk

Expected absolute volatility is an indication of the amplitude of the variations in return that can be expected over a given period.

The expected absolute volatility, including movements in the krone exchange rate, of the long-term portfolio was 7.7 percent, or approximately NOK 20bn in 2013 Q2. This means that the annual variation in the portfolio's market value will be within the interval of +/- NOK 20bn in two out of three years.

The money market portfolio is invested in instruments with very low volatility so that expected volatility measured in international currency is very low, only 0.1 percent, or NOK 20m. Including variations in the krone exchange rate, the expected absolute volatility of the money market portfolio was 9.9 percent in 2013 Q2, or NOK 4bn.

Chart 3-1 Expected absolute volatility including movements in the krone exchange rate



Expected relative volatility (tracking error) indicates the extent to which the return on the actual portfolio can normally be expected to deviate from the return on the benchmark portfolio.¹⁾

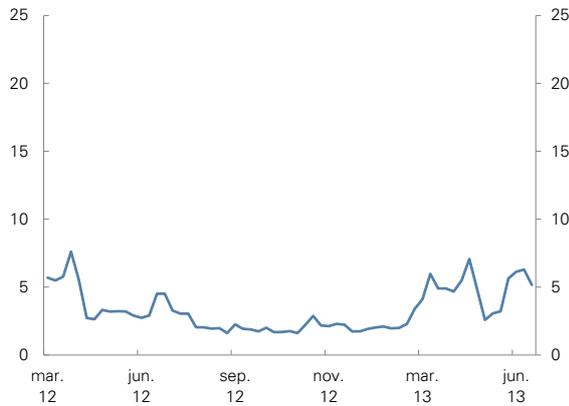
At the end of Q2, the expected relative volatility of the long-term portfolio was 0.56 percentage point. During the quarter, expected relative volatility varied considerably, reaching its lowest level in May, at 0.13 percentage point. The variation is due to a change in the overweight of equities compared with the actual benchmark index and was a part of the adjustments made in advance of the rebalancing of the benchmark index.

The relative volatility of the money market portfolio was somewhat higher than in the previous quarter, but was still low.

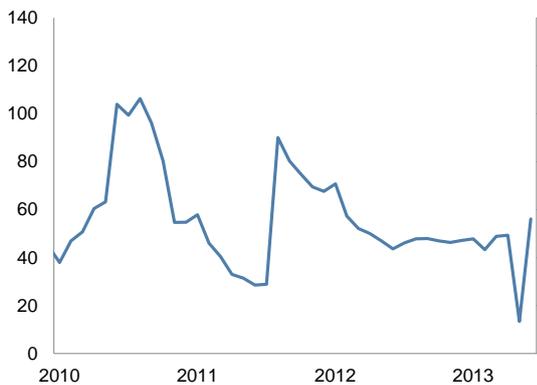
¹⁾ Under the guidelines for the long-term portfolio, the aim of management is to limit relative volatility to no more than 1.0 percentage point (100 basis points). In the guidelines for the money market portfolio, a limit of 1.0 percentage point has been set for expected relative volatility. Relative volatility of 1 percentage point means that the return on the portfolio is expected to be within the interval +/- 1.0 percentage point in two out of three years.

Chart 3-2 *Expected relative volatility. Basis points*

Money market portfolio



Long-term portfolio, total



Long-term portfolio, equity and fixed income investments

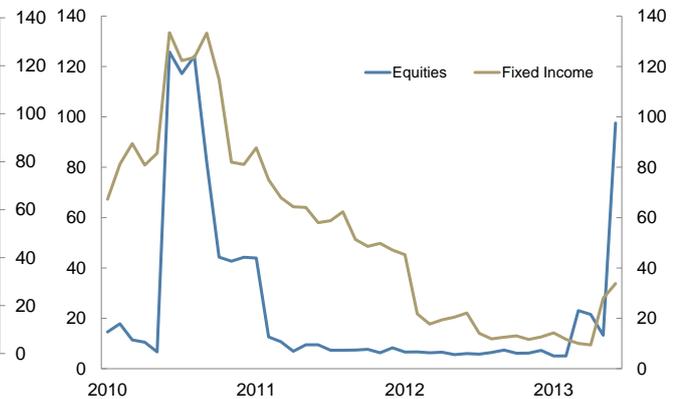


Table 3-1 *Key figures for risk and asset allocation*

Risk	Limits	Actual		
		28 Jun. 2013	31 Mar. 2013	31 Dec. 2012
<i>Money market portfolio:</i>				
Market risk	1.0 percentage point expected relative volatility	0.05	0.03	0.02
Asset allocation	Cash	16.41	16.65	20.24
	Securities	83.58	83.34	79.76
<i>Long-term portfolio:</i>				
Market risk	1.0 percentage point expected relative volatility	0.56	0.49	0.47
Asset allocation	Fixed income portfolio	58.61	53.97	56.36
	Equity portfolio	41.39	46.03	43.64

Table 3-2 Fixed income securities in the foreign exchange reserves by credit rating. End of 2013 Q2. Percent^{*)}

	AAA	AA	A	BBB	Lower	Total
Treasury bills	20.4	0.0	0.0	0.0	0.0	20.4
Sovereign bonds	49.3	29.5	0.0	0.0	0.0	78.8
Corporate bonds	0.0	0.0	0.0	0.0	0.1	0.1
Collateralised bonds	0.0	0.0	0.0	0.8	0.0	0.8
Total fixed income securities	69.7	29.5	0.0	0.8	0.1	100.0

^{*)} Percent of fixed income investments in the foreign exchange reserves

The portion of foreign exchange reserves invested in fixed income instruments primarily consists of highly rated securities. At the end of Q2, 99 percent was invested in government securities rated AA or higher.

4 International commitments

In the past quarter, SDR 46m was repaid to the IMF under the standing commitments, and the IMF drew a net amount of SDR 10m on separate borrowing agreements. These borrowing agreements total SDR 10 171m.

Table 4-1 International commitments at the end of 2013 Q2. Amounts in millions

	Commitment		Utilised as at 28 Jun. 2013	
	SDR	NOK	SDR	NOK
Loan to Seðlabanki Íslands			172	1,579
IMF				
Standing commitments	1,884	17,253	484	4,437
New Arrangements to Borrow (NAB)	3,871	35,455	496	4,538
Loan to Poverty Reduction and Growth Trust (PRGT)	300	2,748	234	2,143
The IMF's bilateral lending facilities	6,000	54,956	0	0
	Commitment		Holdings	
	SDR	NOK	SDR	NOK
Norges Bank's holdings of SDRs	782 - 2,345	7,163 - 21,479	1,478	13,541

Appendix: Benchmark indices at the end of 2013 Q2. Percent

Long-term portfolio

	Equities		Bonds	
Country for the equity benchmark	Strategic benchmark index	Actual benchmark index	Strategic benchmark index	Actual benchmark index
Currency for the fixed income benchmark				
Weight asset classes	40.0	40.0	60.0	60.0
Canada		4.1		
US (USD)		54.2		45.0
Total Americas		58.3		45.0
Belgium		0.5		
Finland		0.4		
France		3.3		
Greece		0.1		
Ireland		0.1		
Italy		0.9		
Netherlands		1.1		
Portugal		0.1		
Spain		1.1		
Germany		3.4		
Austria		0.1		
<i>Euro area (EUR)</i>		<i>11.1</i>		<i>35.0</i>
UK (GBP)		8.3		10.0
Denmark		0.5		
Switzerland		3.5		
Sweden		1.2		
Total Europe		24.6		45.0
Israel		0.2		
Total Middle East and		0.2		
Australia		3.2		
Hong Kong		1.5		
Japan (JPY)		9.5		10.0
New Zealand		0.1		
Singapore		0.7		
South Korea		1.8		
Total Asia and Oceania		16.9		10.0

Money market portfolio

	Overnight money		
Currency	market	Securities	Total
Total	10.0	90.0	100.0
EUR	2.5	22.5	25
USD	7.5	67.5	75

PART 2. Financial reporting

BALANCE SHEET		<i>Amounts in millions of NOK</i>		
FINANCIAL ASSETS	2013 Q2	2012 Q4	2012 Q2	
Deposits in banks	2,078	3,672	7,049	
Lending associated with reverse repurchase agreements	37,014	12,388	67,267	
Unsettled trades	11,409	1	450	
Equities	104,485	96,520	90,570	
Equities lent	6,385	2,821	5,522	
Bonds and other fixed income instruments	176,097	152,735	159,132	
Financial derivatives	39	6	2	
Other financial assets	2,961	195	192	
TOTAL FINANCIAL ASSETS	340,467	268,338	330,183	
FINANCIAL LIABILITIES				
Short-term borrowing	0	0	0	
Borrowing associated with repurchase agreements	418	0	0	
Cash collateral received	2,285	1,160	2,669	
Unsettled trades	20,445	1,450	33,081	
Financial derivatives	8	4	5	
Other liabilities	1,124	1,014	1,983	
TOTAL FINANCIAL LIABILITIES	24,280	3,629	37,738	
NET RESERVES	316,187	264,709	292,445	

INCOME STATEMENT		<i>Amounts in millions of NOK</i>			
	Quarter		Year-to-date		
	2013 Q2	2012 Q2	2013 Q2	2012 Q2	2012 Q4
Profit/loss from management excluding foreign exchange gains/losses					
Interest income from deposits in banks	10	6	11	7	12
Interest income, lending associated with reverse repurchase agreements	7	16	13	28	41
Net income/expenses and gains/losses from:					
- Equities	3,007	-4,338	13,634	6,363	15,597
- Bonds and other fixed income instruments	-2,520	3,279	-1,988	3,403	5,925
- Financial derivatives	29	-89	34	-38	-43
Interest expense, borrowing associated with repurchase agreements	-0	0	-0	0	0
Tax expenses	-30	-	-38	-	-13
Other expenses	2	-0	2	-0	-0
Profit/loss from management before foreign exchange gains/losses	505	-1,126	11,667	9,763	21,519
Foreign exchange gains/losses	12,905	7,180	20,563	-4,258	-21,210
Profit/loss for the period	13,410	6,053	32,230	5,505	309

NOTES**Note 1 Accounting policies**

Financial reporting pertains solely to Norges Bank's foreign reserves as at 30 June 2013. The financial statements of Norges Bank are prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the EU. For a description of accounting policies and calculation methods, see Norges Bank's annual financial statements for 2012. Financial reporting for Norges Bank's foreign reserves does not include a statement of cash flows and a statement of changes in equity, and is thus not fully compliant with IFRS.

Note 2 Significant estimates and critical accounting judgements

The preparation of the financial statements of Norges Bank, which include the financial reporting for the foreign reserves in accordance with the accounting policies in Note 1, involves the use of estimates and judgements that may affect assets, liabilities, income and expenses. Estimates and judgements are based on historical experience and expectations about future events that are considered probable at the time the financial statements are presented.

Estimates are based on best judgement; however, actual results may deviate from estimates. In cases of particularly uncertain estimates, this is described in Note 2 in Norges Bank's annual financial statements for 2012.

Note 3 Specification of income statement by portfolio*Amounts in millions of NOK*

Income statement	Long term	Money Market	Petrobuffer	Foreign reserves
	2013 Q2	2013 Q2	2013 Q2	2013 Q2
Interest income, deposits in foreign banks	10	0	0	10
Interest income, lending associated with reverse repurchase agreements	0	1	6	7
Net income/expenses and gain/losses from:				
- Equities	3,007	-	-	3,007
- Bonds and other fixed income instruments	-2,521	1	0	-2,520
- Financial derivatives	25	4	-	29
Interest expense, borrowing associated with repurchase agreements	-0	-	-	-0
Tax expenses	-30	-	-	-30
Other expenses	2	-0	-0	2
PROFIT/LOSS FROM MANAGEMENT BEFORE FOREIGN EXCHANGE GAINS/LOSSES	494	5	6	505
Foreign exchange gains/losses	9,261	1,628	2,015	12,905
PROFIT/LOSS FOR THE PERIOD	9,755	1,633	2,022	13,410

Note 4 Specification of assets and liabilities, end of quarter by portfolio
Amounts in millions of NOK

	Long term	Money Market	Petrobuffer	Foreign reserves
	2013 Q2	2013 Q2	2013 Q2	2013 Q2
FINANCIAL ASSETS				
Deposits in banks	167	1,911	0	2,078
Lending associated with reverse repurchase agreements	2,261	8,370	26,382	37,014
Unsettled trades	11,409	-	-	11,409
Equities	104,485	-	-	104,485
Equities lent	6,385	-	-	6,385
Bonds and other fixed income instruments	140,181	31,032	4,885	176,097
Bonds lent	-	-	-	-
Financial derivatives	19	2	19	39
Other financial assets	2,961	-	-	2,961
TOTAL FINANCIAL ASSETS	267,867	41,314	31,286	340,467
TOTAL FINANCIAL ASSETS				
Short-term borrowing	0	-	-	0
Borrowing associated with repurchase agreements	418	-	-	418
Cash collateral received	2,285	-	-	2,285
Unsettled trades	11,606	4,185	4,654	20,445
Short-sale bonds	-	-	-	-
Financial derivatives	8	0	0	8
Other liabilities	-0	-	1,124	1,124
TOTAL FINANCIAL LIABILITIES	14,317	4,185	5,778	24,280
NET RESERVES	253,550	37,129	25,508	316,187

Note 5 Equities, bonds and other fixed-income securities
Amounts in millions of NOK

Specification equities	2013 Q2		
	Fair value excluding dividends	Accrued dividends	Fair value including dividends
Equities:			
Listed equities	110,682	188	110,870
Total equities	110,682	188	110,870
<i>Of which equities lent</i>			6,385

Market risk

Market risk is risk related to changes in the value of the portfolio due to changes in interest rates and/or foreign exchange rates.

Norges Bank uses risk models to quantify the economic risk associated with all or portions of the portfolio.

Key figures for risk and asset allocation.

Risk	Limits	Actual		
		28 Jun. 2013	31 Mar. 2013	31 Dec. 2012
<i>Money market portfolio:</i>				
Market risk	1.0 percentage point expected relative volatility	0,05	0,03	0,02
Asset allocation	Cash	16,41	16,65	20,24
	Securities	83,58	83,34	79,76
<i>Long-term portfolio:</i>				
Market risk	1.0 percentage point expected relative volatility	0,56	0,49	0,47
Asset allocation	Fixed income portfolio	58,61	53,97	56,36
	Equity portfolio	41,39	46,03	43,64

The models used to calculate the above information are explained in Note 24 Risk in Norges Bank's annual financial statements for 2012.

Credit risk

Credit risk is the risk of losses if issuers of fixed income instruments default on their payment obligations. Norges Bank uses credit ratings to monitor credit risk in the bond portfolio. The table below shows a breakdown of the money market portfolio and the long term portfolio into credit rating categories.

Fixed income securities in the foreign exchange reserves by credit rating. End of 2013 Q2. Percent)*

	AAA	AA	A	BBB	Lower	Total
Treasury bills	20.4	0.0	0.0	0.0	0.0	20.4
Sovereign bonds	49.3	29.5	0.0	0.0	0.0	78.8
Corporate bonds	0.0	0.0	0.0	0.0	0.1	0.1
Collateralised bonds	0.0	0.0	0.0	0.8	0.0	0.8
Total fixed income securities	69.7	29.5	0.0	0.8	0.1	100.0

*) Percent of fixed income investments in the foreign exchange reserves

The portion of foreign exchange reserves invested in fixed income instruments primarily consists of highly rated securities. At the end of Q2, 99 percent was invested in government securities rated AA or higher.