

# FOREIGN EXCHANGE RESERVES

## Management of Norges Bank's foreign exchange reserves

**2 | 2014**  
**JULY 2014**

REPORT FOR SECOND  
QUARTER 2014

## Main points

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- The market value of Norges Bank's foreign exchange reserves was NOK 366.3bn, or SDR 39bn, at the end of 2014 Q2. The reserves were invested in short-term fixed income instruments (21 percent), long-term fixed income instruments (45 percent) and equities (34 percent).
- The return on the foreign exchange reserves, measured in international currency, was 2.5 percent in 2014 Q2. The return on equity investments was 4.5 percent, the return on long-term fixed income investments was 1.6 percent, and the return on short-term fixed income investments was approximately zero.
- Expected annual volatility in the value of the foreign exchange reserves – measured in domestic currency – was 6.1 percent for the equities and long-term fixed income investment portfolio and 0.1 percent for money market instruments. Changes in market value owing to fluctuations in the krone exchange rate will not affect the use of the foreign exchange reserves in a crisis situation but will have an impact on Norges Bank's equity.

## Part I: Management

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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 to meet 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 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 instruments. 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.

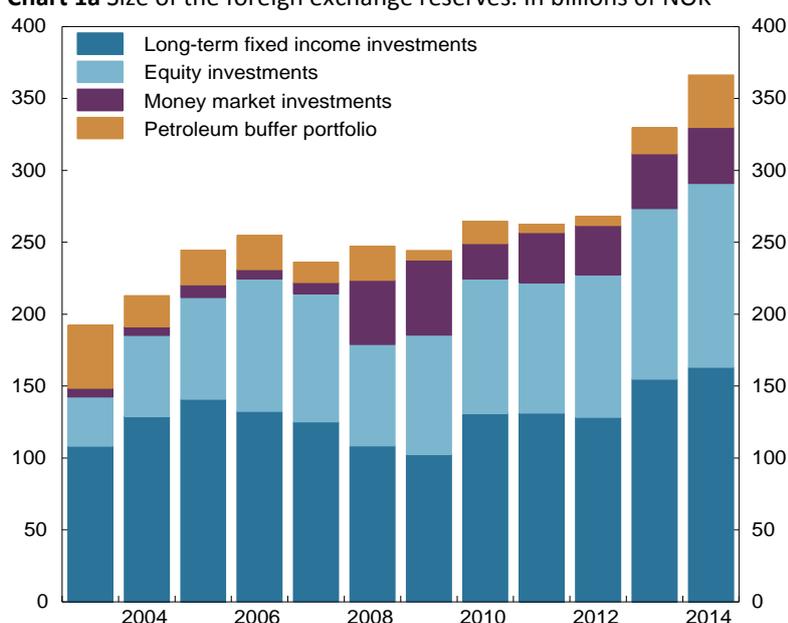
The purpose of the petroleum buffer portfolio is to ensure that the Government Pension Fund Global (GPF) is provided with an adequate supply of fresh capital. Norges Bank builds up the portfolio by regularly purchasing foreign exchange from the State's Direct Financial Interest in petroleum activities (SDFI) and by purchasing foreign exchange in the market. Transfers from the portfolio to the GPF are normally made each month. The petroleum buffer portfolio is invested in short-term fixed income instruments. No benchmark index has been set for the petroleum buffer portfolio.

# 1. Size of the foreign exchange reserves

The market value of the foreign exchange reserves was NOK 366.3bn at the end of 2014 Q2. Equities and long-term fixed income investments totalled NOK 290.8bn, while money market investments and the petroleum buffer portfolio came to NOK 38.9bn and 36.6bn, respectively. The value of the reserves increased by NOK 19.1bn in the quarter, primarily as the result of returns and the depreciation of the krone. The return in international currency increased the value of the reserves by approximately NOK 8.9bn, while the depreciation of the krone increased the value by NOK 9.0bn.

The petroleum buffer portfolio was created by Norges Bank to ensure cost-efficient transfers of funds to the GPFG and is not a part of the foreign exchanges reserves held for the purpose of crisis management. The value of the portfolio increased by NOK 2.4bn during 2014 Q2, primarily because foreign exchange purchases from the SDFI were greater than the transfers to the GPFG and because of the depreciation of the krone.

**Chart 1a** Size of the foreign exchange reserves. In billions of NOK<sup>1</sup>



<sup>1</sup> 2014 at end of Q2.

**Table 1a** Market value. In billions of NOK

	2014 Q2	2014 Q1	2013 Q4	2013 Q3	2013 Q2
Money market investments	38.9	38.1	38.3	37.6	37.2
Long-term fixed income investments	163.1	156.1	154.8	153.9	148.6
Equity investments	127.8	118.9	118.5	108.7	104.9
Petroleum buffer portfolio	36.6	34.2	18.0	29.0	28.2
<b>Foreign exchange reserves</b>	<b>366.3</b>	<b>347.3</b>	<b>329.6</b>	<b>329.2</b>	<b>318.9</b>
<b>Total change during the quarter</b>	<b>19.1</b>	<b>17.7</b>	<b>0.4</b>	<b>10.3</b>	<b>20.6</b>
Transfers during the quarter	1.1	16.9	-11.2	0.8	7.1
Return during the quarter	8.9	4.2	8.8	7.7	0.5
Change due to fluctuations in NOK exchange rate	9.0	-3.4	2.8	1.7	13.0

## 2. Return

The foreign exchange reserves are held for the purpose of crisis management. Changes in value in NOK terms are thus of secondary importance. Movements in the krone exchange rate will primarily affect Norges Bank's equity, and not its ability to meet commitments in foreign currency. Therefore, unless stated otherwise, return will henceforth be measured in international currency. The petroleum buffer portfolio, which is not held for the purpose of crisis management as discussed above, is excluded from the measurement of return.

### **Return measured in terms of the foreign exchange reserves' currency baskets**

The foreign exchange reserves are invested in international financial instruments in foreign currency. The return on the foreign exchange reserves is measured primarily in international currency, i.e. weighted composites of the currencies in the portfolios' benchmark indices. These composites are referred to as the foreign exchange reserves' currency baskets, and comprised 14 currencies at the end of 2014 Q2 for equity and long-term fixed income investments. For money market investments, the currency basket comprised EUR and USD. Unless otherwise specified in the text, return is measured in terms of the foreign exchange reserves' currency basket.

### **2.1 Absolute return**

Overall, the return on the foreign exchange reserves was 2.53 percent in 2014 Q2. The return on equity investments was 4.54 percent and the return on long-term fixed income investments was 1.60 percent. As they represent 39 percent and 49 percent of overall foreign exchange reserves, respectively, these portfolios have the greatest impact on the total return on the foreign exchange reserves.

The largest contribution to the return on the equity portfolio came from North America. Approximately 60 percent of the equity portfolio is invested in North America. From a sector perspective, the highest return in 2014 Q2 was in oil and gas.

The return on long-term fixed income investments was 1.60 percent in 2014 Q2. The largest contribution to the return was made by EUR bonds. GBP and USD bonds also made a positive contribution in the period. The portfolio's largest position is in US government bonds.

Money market investments, which account for the remaining 12 percent of the foreign exchange reserves, earned a return of 0.04 percent. The return on money market instruments primarily came from EUR bonds as German short-dated government bond yields fell during 2014 Q2.

## 2.2 Relative return

The return on equities and long-term fixed income investments is measured against the return on global benchmark indices compiled by FTSE Group and Barclays Capital, respectively.

### Benchmark indices

The strategic benchmark index for equity investments is a tax-adjusted version of the FTSE All-Cap Developed Market Index.

The strategic benchmark index for long-term fixed income investments is based on Barclays Capital Global Aggregate Bond Index, but limited to sovereign bonds issued by the governments of France, Germany, Japan, the UK and the US. The currency weighting of the index is 35 percent EUR, 45 percent USD, 10 percent GBP and 10 percent JPY.

Fixed income securities comprise 60 percent of the strategic benchmark index for equity and long-term fixed income investments and equities comprise 40 percent.

The benchmark index for the cash portion of the money market portfolio is the Merrill Lynch Overnight Index for USD and EUR. The benchmark index for the securities portion of the portfolio comprises Barclays Capital Treasury bill indices; German Bubill Index and US T-bills. The index comprises 75 percent USD and 25 percent EUR. A minimum of 10 percent of foreign exchange holdings shall be held in cash.

The return on equity investments was 0.01 percentage point higher than the return on the benchmark index for equities, while the return on long-term fixed income investments was 0.01 percentage point lower than the return on the benchmark index for bonds in the period.

Money market investments earned a return in the period that was 0.01 percent higher than the return on the benchmark index.

**Table 2-2a** Return measured in international currency. Percent

<sup>1</sup> Excluding petroleum buffer portfolio.

	2014 Q2	2014 Q1	2013 Q4	2013 Q3	2013 Q2
<i>Return:</i>					
Money market investments	0.04	0.03	0.02	0.05	0.01
Long-term fixed income investments	1.60	1.91	-0.24	0.45	-1.44
Equity investments	4.54	1.37	8.11	6.72	1.37
<b>Foreign exchange reserves<sup>1</sup></b>	<b>2.53</b>	<b>1.47</b>	<b>2.82</b>	<b>2.66</b>	<b>-0.09</b>
<i>Return on benchmark indices:</i>					
Money market investments	0.03	0.02	0.01	0.02	0.02
Long-term fixed income investments	1.62	1.92	-0.28	0.54	-1.51
Equity investments	4.53	1.32	7.93	6.64	1.15

**Table 2-2b** Return measured in NOK. Percent

	2014 Q2	2014 Q1	2013 Q4	2013 Q3	2013 Q2
Money market investments	2.37	-1.27	1.35	-0.44	4.73
Long-term fixed income investments	4.48	0.83	0.60	0.96	2.66
Equity investments	7.50	0.29	9.01	7.25	5.59
<b>Foreign exchange reserves<sup>1</sup></b>	<b>5.37</b>	<b>0.36</b>	<b>3.74</b>	<b>3.05</b>	<b>4.14</b>

<sup>1</sup> Excluding petroleum buffer portfolio.

## 2.3 Return over the past ten 10 years

Over the past four quarters to the end of 2014 Q2, the return on the foreign exchange reserves was 9.81 percent. Over the past ten years, the annualised rate of return was 6.16 percent. Equity investments in particular have contributed to the return, but the realised fluctuations have been substantially higher than for fixed income investments.

The return on equity investments has been approximately in line with the benchmark index over the past ten years, while long-term fixed income investments have earned an annualised excess return of 0.4 percentage point. The excess return for the money market portfolio for the past three years has been 0.04 percentage point.

**Table 2-3a** Key figures at 30 June 2014. Annualised. Measured in international currency

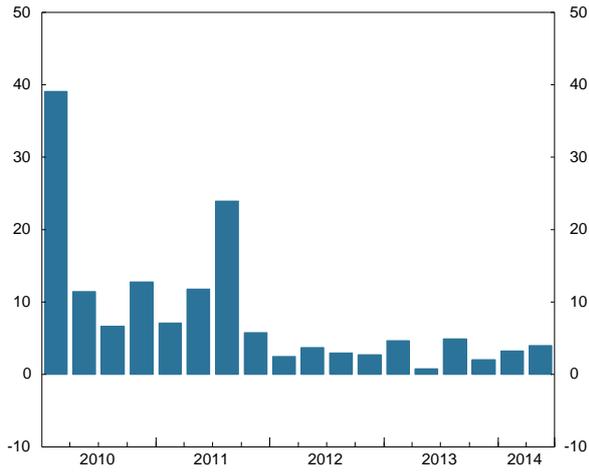
	Past year	Past 3 years	Past 5 years <sup>1</sup>	Past 10 years <sup>1</sup>
<i>Foreign exchange reserves excluding the petroleum buffer portfolio:</i>				
Gross annual return (percent)	9.81	7.35	10.23	6.16
<i>Money market investments:</i>				
Portfolio return (percent)	0.14	0.20	-	-
Benchmark return (percent)	0.07	0.16	-	-
Excess return (percentage points)	0.07	0.04	-	-
Realised absolute volatility (percent) <sup>2</sup>	0.03	0.08	-	-
Realised relative volatility (percentage points) <sup>2</sup>	0.03	0.03	-	-
Information rate (IR) <sup>3</sup>	2.66	1.61	-	-
<i>Long-term fixed income investments:</i>				
Portfolio return (percent)	3.77	4.44	5.77	4.66
Benchmark return (percent)	3.83	4.26	4.19	4.27
Excess return (percentage points)	-0.06	0.17	1.58	0.39
Realised absolute volatility (percent) <sup>2</sup>	2.33	3.25	3.45	3.57
Realised relative volatility (percentage points) <sup>2</sup>	0.17	0.40	1.05	1.58
Information rate (IR) <sup>3</sup>	-0.37	0.44	1.50	0.24
<i>Equity investments:</i>				
Portfolio return (percent)	22.25	13.64	16.19	7.94
Benchmark return (percent)	21.89	13.34	15.81	7.92
Excess return (percentage points)	0.36	0.29	0.38	0.01
Realised absolute volatility (percent) <sup>2</sup>	8.35	11.93	12.53	14.50
Realised relative volatility (percentage points) <sup>2</sup>	0.17	0.15	0.28	0.41
Information rate (IR) <sup>3</sup>	2.05	1.92	1.33	0.03

<sup>1</sup> Pertains only to equities and long-term fixed income investments.

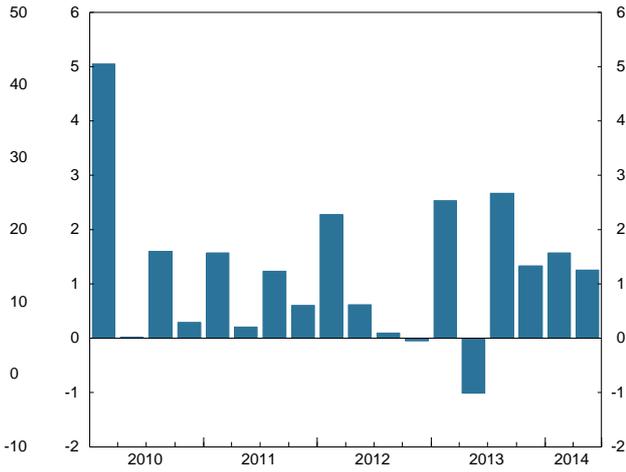
<sup>2</sup> Realised volatility is a measure of the fluctuation in monthly return values, expressed here by the annualised empirical standard deviation of monthly return series. Absolute/relative volatility expresses risk related to absolute/relative return.

<sup>3</sup> IR is a risk-adjusted return measure. IR is the ratio between excess return and the portfolio's realised relative market risk (measured by relative volatility).

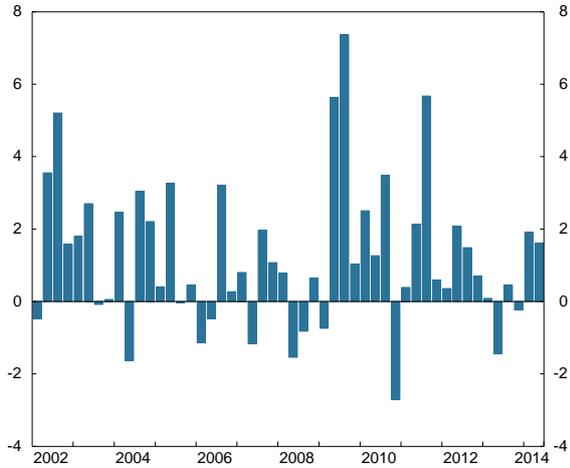
**Chart 2-3a** Absolute return<sup>1</sup>.  
Money market investments. Basis points



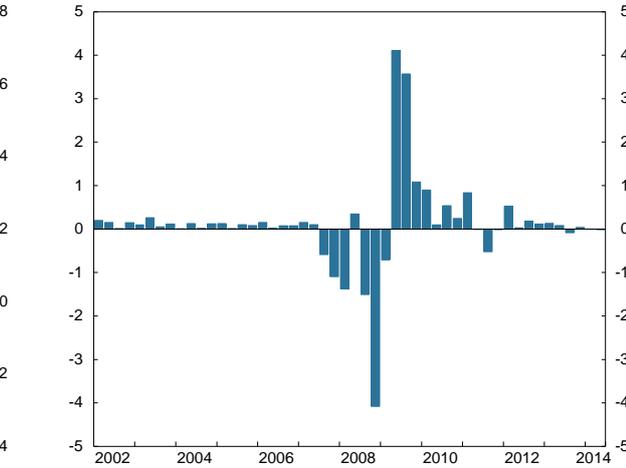
**Chart 2-3b** Relative return<sup>1</sup>.  
Money market investments. Basis points



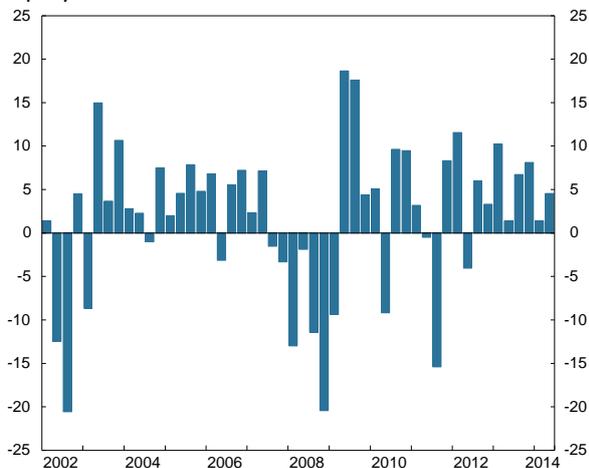
**Chart 2-3c** Absolute return<sup>1</sup>.  
Long-term fixed income investments. Percent



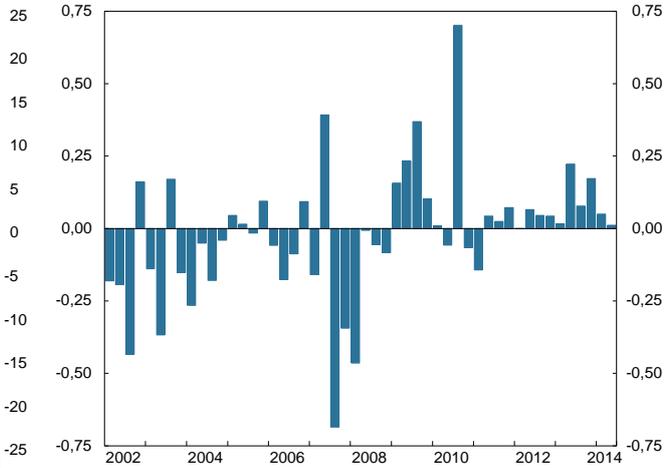
**Chart 2-3d** Relative return<sup>1</sup>.  
Long-term fixed income investments. Percent



**Chart 2-3e** Absolute return<sup>1</sup>.  
Equity investments. Percent



**Chart 2-3f** Relative return<sup>1</sup>.  
Equity investments. Percent



<sup>1</sup>Measured in international currency.

### 3. Risk

Market risk is expressed here by a standard deviation movement in market values. Expected absolute volatility is an indication of the expected variation in market value over a given period.

For equities, expected absolute volatility was 15.2 percent at the end of 2014 Q2. This means that the value of equity holdings, in a normal situation, is expected to fluctuate within an interval of  $\pm 15.2$  percent in the course of a year, given the current portfolio composition. In this case, the effect of movements in the krone exchange rate is excluded. Expected volatility provides no indication of the maximum extent to which the value of the portfolio can change. For long-term fixed income investments, expected absolute volatility was 3.2 percent, while expected volatility for equity and fixed income investments overall was 6.1 percent. For money market investments, expected absolute volatility was 0.1 percent.

Expected absolute volatility measured for the value of the portfolios in NOK was 13.3 percent, 9.6 percent and 8.9 percent for equity investments, fixed income investments and money market investments, respectively.

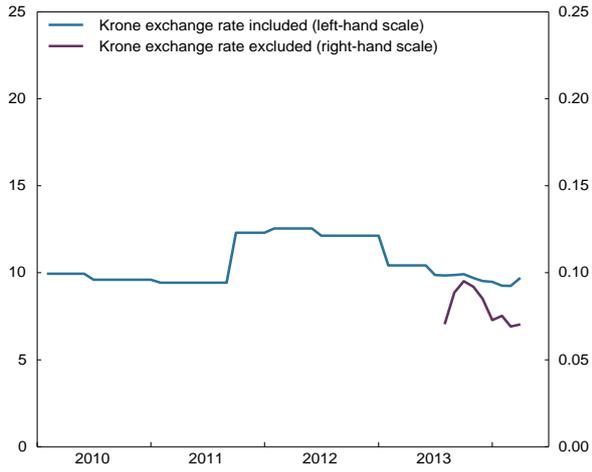
For the fixed income portfolios, volatility increases because foreign exchange movements are included. For the money market portfolio, the risk is approximately the same as holding the basket of foreign currencies. For the equity portfolio, however, volatility is somewhat reduced on account of the diversification effect of movements in foreign exchange rates.

While absolute risk provides an indication of how much the foreign exchange reserves are expected to fluctuate in value, relative risk provides an indication of how much the portfolios can be expected to fluctuate in value compared with the portfolio's benchmark index.<sup>2</sup> At the end of 2014 Q2, expected relative volatility for both the equity portfolio and long-term fixed income investments was 0.11 percent. The expected relative volatility of the money market investment portfolio was 0.04 percent at the end of 2014 Q2. The very low level of relative volatility indicates that there is very little deviation from the appurtenant benchmark indices with regard to both instrument composition and currency allocation.

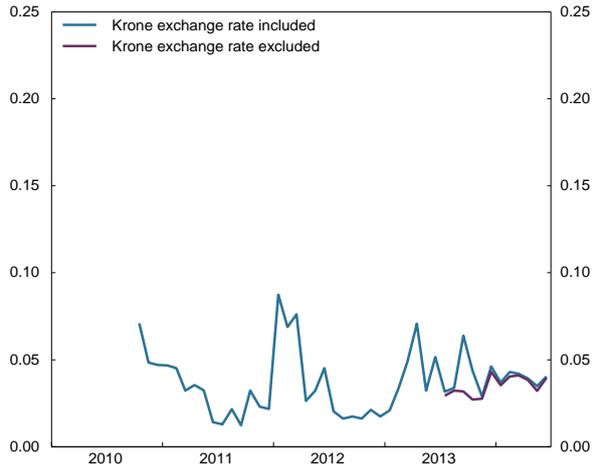
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<sup>2</sup>Under the guidelines for equities and long-term fixed income investments issued by the Governor, the aim of management is to limit expected relative volatility to no more than 1.0 percentage point (100 basis points). In the guidelines for 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 excess return on the portfolio is expected to be within the interval  $\pm 1.0$  percentage point in two out of three years.

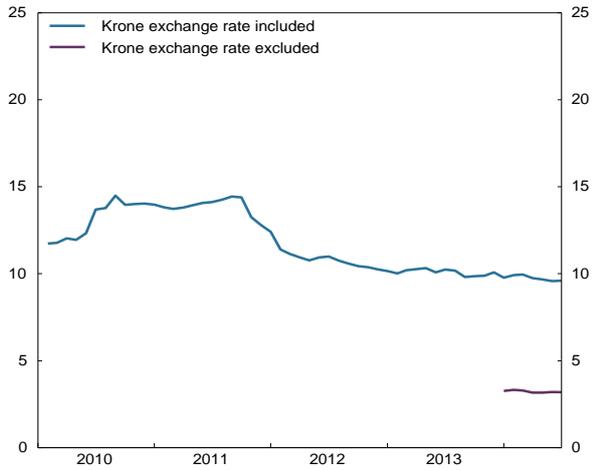
**Chart 3a** Expected absolute volatility.  
Money market investments. Percent



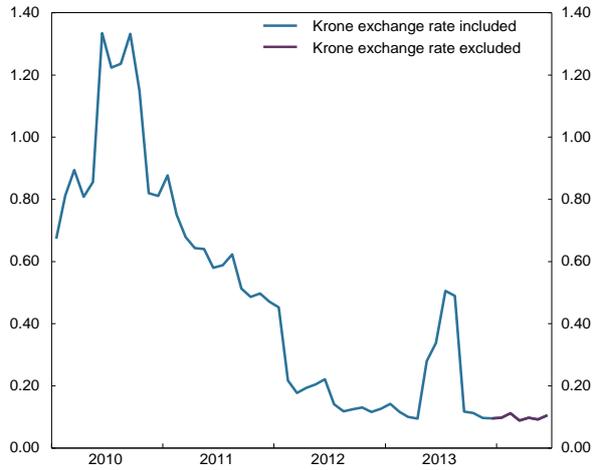
**Chart 3b** Expected relative volatility.  
Money market investments. Percent



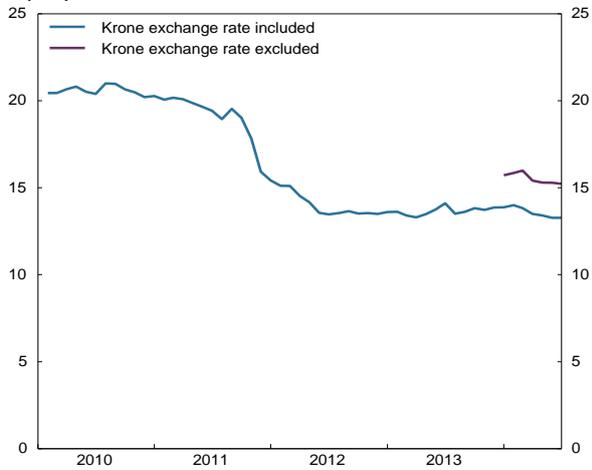
**Chart 3c** Expected absolute volatility.  
Long-term fixed income investments. Percent



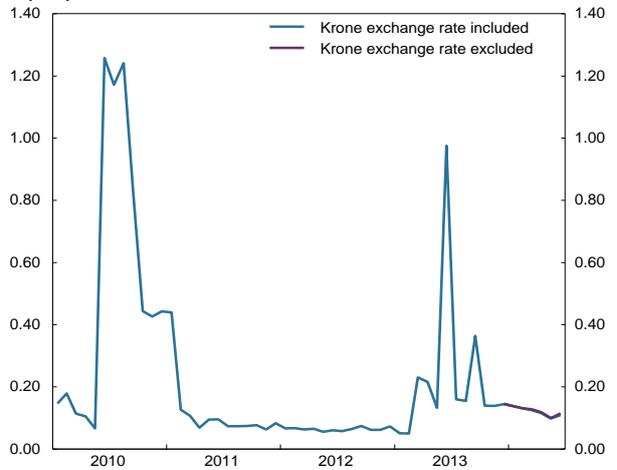
**Chart 3d** Expected relative volatility.  
Long-term fixed income investments. Percent



**Chart 3e** Expected absolute volatility.  
Equity investments. Percent



**Chart 3f** Expected relative volatility.  
Equity investments. Percent



Credit risk on the Bank’s fixed income investments is low. At the end of 2014 Q2, 99.97 percent of the portfolio was invested in government securities rated AA or higher and only 0.02 percent was invested in corporate bonds.

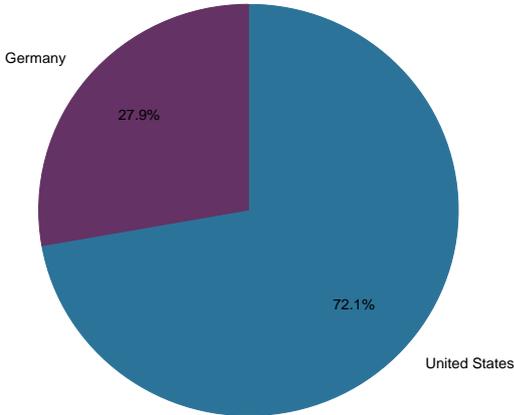
**Table 3a** Foreign exchange reserves, fixed income investments, by credit rating. Percent<sup>1</sup>

	AAA	AA	A	BBB	Lower	Total
Treasury bills	17.6	0.0	0.0	0.0	0.0	17.6
Sovereign bonds	49.8	32.6	0.0	0.0	0.0	82.3
Corporate bonds	0.0	0.0	0.0	0.0	0.0	0.0
Collateralised bonds	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total fixed income securities</b>	<b>67.4</b>	<b>32.6</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>100.0</b>

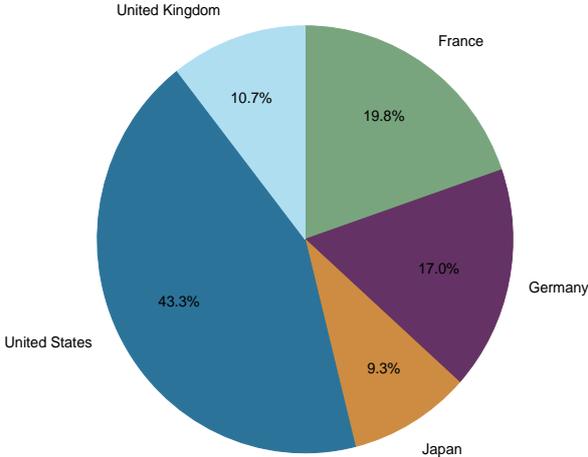
<sup>1</sup>Percentage of fixed income investments in the Bank’s foreign exchange reserves.

A considerable portion of the fixed income investments are government securities issued in the US, i.e. 72 percent of Treasury bills and 43 percent of sovereign bonds.

**Chart 3b** Treasury bills by issuer

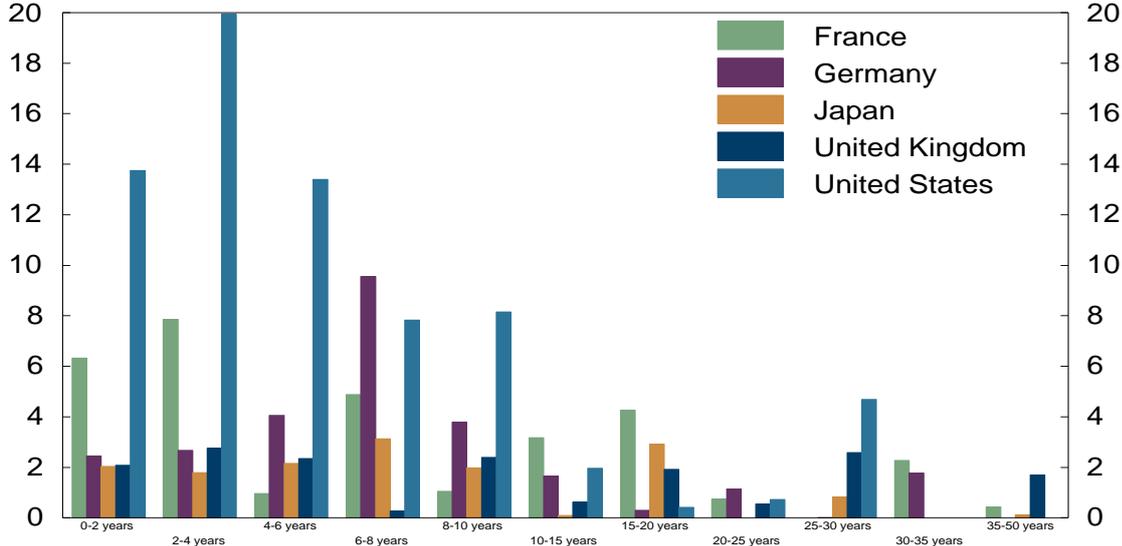


**Chart 3c** Sovereign bonds by issuer



In all, NOK 84bn is invested in US and German sovereign bonds with residual maturity of less than 10 years.

**Chart 3d** Sovereign bonds by issuer and years to maturity in billions of NOK



## 4. International commitments

In addition to being available for foreign exchange transactions as part of the conduct of monetary policy and for promoting financial stability, the foreign exchange reserves are also used to meet Norges Bank's international commitments.

### 4.1 Norges Bank's rights and obligations related to the International Monetary Fund (IMF)

Norges Bank has made the following commitments under various IMF programmes:<sup>3</sup>

- Loan resource commitments under the New Arrangements to Borrow (NAB) of SDR 3 871m, or NOK 36 788m<sup>4</sup>
- Borrowing facility under a bilateral borrowing arrangement of SDR 6 000m, or NOK 57 007m
- Loan resource commitments to the Poverty Reduction and Growth Trust (PRGT) of SDR 300m, or NOK 2 850m
- Purchases and sales of SDRs from/to other member countries

Norges Bank also has the following rights by virtue of Norway's quota subscriptions in the IMF:

- Voting power in the IMF
- Access to financing from the IMF if Norway experiences balance of payments problems
- Receiving SDRs under allocations by the IMF

Pursuant to Section 25 of the Norges Bank Act, Norges Bank shall meet the commitments ensuing from membership of the IMF. This membership entails a standing commitment to furnish foreign exchange for IMF loans to other member countries. Norway's total quota subscription was SDR 1 884m (NOK 17 900m) at the end of 2014 Q2.

The table below shows all asset and liability items related to the IMF at the end of 2014 Q2.

Norges Bank's loan commitments to the IMF through the IMF's various lending programmes indicate that an additional NOK 89bn may be drawn, equivalent to 27 percent of total foreign exchange reserves. At 30 June 2014, NOK 166bn of the foreign exchange reserves is invested in liquid financial instruments that can be used within a single trading day without having to realise any appreciable losses. The size and liquidity of the foreign exchange reserves are assessed to be sufficient to meet Norges Bank's commitments to the IMF.

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<sup>3</sup> Norges Bank's commitments to the IMF are in SDRs; the amount in NOK varies with the exchange rate.

<sup>4</sup> Amounts in NOK have been translated at the exchange rate at the end of 2014 Q2.

**Table 4-1a** Claims on and liabilities to the International Monetary Fund (IMF) at 30 June 2014. All amounts in millions of NOK.

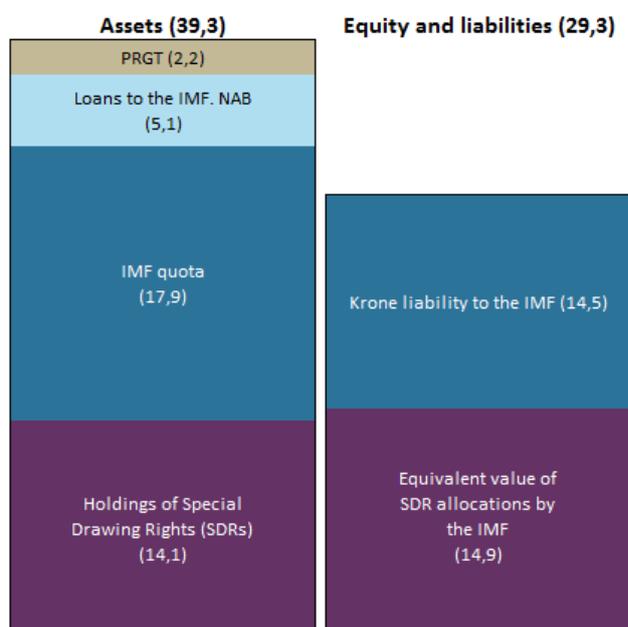
	Loan resource commitments <sup>2</sup>	RECOGNISED IN THE BALANCE SHEET			Total amount recognised
		Lending programmes	Subscriptions <sup>3</sup>	SDRs	
<i>Financial assets</i>					
IMF quota <sup>1</sup>			17 900		17 900
Holdings of Special Drawing Rights (SDRs)				14 122	14 122
Loans to the IMF, New Arrangements to Borrow (NAB)	36 788	5 056			5 056
Bilateral borrowing agreement with the IMF	57 007				
Poverty Reduction and Growth Trust (PRGT)	2 850	2 226			2 226
<b>Claims on the IMF</b>	<b>96 645</b>	<b>7 282</b>	<b>17 900</b>	<b>14 122</b>	<b>39 304</b>
<i>Financial liabilities</i>					
Krone liability to the IMF			14 475		14 475
Equivalent value of SDR allocations by the IMF				14 853	14 853
<b>Liabilities to the IMF</b>			<b>14 475</b>	<b>14 853</b>	<b>29 328</b>
<b>Net positions with the IMF</b>	<b>96 645</b>	<b>7 282</b>	<b>3 425</b>	<b>-732</b>	<b>9 976</b>

<sup>1</sup>The IMF allocates quotas to member countries which primarily reflect member countries' relative size in the world economy. The quota provides the basis for determining the member country's voting power in the IMF, the member's financial contribution to the IMF, the amount of financing the member can access in the event of balance of payments problems and the amount of SDRs the member is allocated.

<sup>2</sup>Commitments giving the IMF a borrowing facility with Norges Bank up to an agreed amount. Only the portion drawn is recognised in the balance sheet. Norges Bank's commitments to the IMF are in SDRs; amounts have been translated into NOK.

<sup>3</sup>Net subscriptions are referred to as the Reserve Tranche Position (RTP) comprising Norway's IMF quota less Norway's krone liability to the IMF, i.e. the net amount at the bottom of the column. Norges Bank may if necessary draw up to the full amount of Norway's RTP at any time.

**Chart 4-1a** Claims on and liabilities to the International Monetary Fund (IMF) at 30 June 2014 (Amounts in billions of NOK)



## Part II: Income statement and balance sheet, foreign exchange reserves

INCOME STATEMENT		Amounts in millions of NOK			
	Quarter		Year-to-date		
	2014 Q2	2013 Q2	2014 Q2	2013 Q2	2013 Q4
<b>NET INCOME FROM FINANCIAL INSTRUMENTS</b>					
Interest income from deposits and claims	1	11	4	12	38
Interest income, lending associated with reverse repurchase agreements	12	7	21	13	24
Net income/expenses and gains/losses from:					
Equities	6 117	3 007	7 438	13 634	30 386
Bonds and other fixed income instruments	2 821	-2 520	5 763	-1 988	-2 260
Financial derivatives	-2	29	0	34	16
Interest expense, borrowing associated with repurchase agreements	-1	0	-1	-1	-22
Tax expense	-6	-30	-25	-38	-17
Other financial income/expenses	-1	2	-1	2	1
<b>NET INCOME FROM FINANCIAL INSTRUMENTS BEFORE FOREIGN EXCHANGE GAINS/LOSSES</b>	<b>8 941</b>	<b>506</b>	<b>13 200</b>	<b>11 668</b>	<b>28 167</b>
Foreign exchange gains/losses	8 989	13 018	5 514	20 565	25 193
<b>NET INCOME FROM FINANCIAL INSTRUMENTS *</b>	<b>17 931</b>	<b>13 524</b>	<b>18 713</b>	<b>32 233</b>	<b>53 360</b>

\* Net income from financial instruments includes profit and loss items associated with outstanding balances with the GPF (see Note 3).

BALANCE SHEET		Amounts in millions of NOK			
			2014 Q2	2013 Q4	2013 Q2
	<b>FINANCIAL ASSETS</b>				
Deposits in banks			3 472	6 214	2 078
Lending associated with reverse repurchase agreements			47 500	22 194	37 014
Unsettled trades			807	2	11 409
Equities			118 475	114 272	104 485
Equities lent			9 673	4 355	6 385
Bonds and other fixed income instruments			197 460	185 420	176 097
Financial derivatives			17	8	39
Other financial assets			58	159	2 961
<b>TOTAL FINANCIAL ASSETS</b>			<b>377 461</b>	<b>332 624</b>	<b>340 467</b>
<b>FINANCIAL LIABILITIES</b>					
Short-term borrowing			0	0	0
Borrowing associated with repurchase agreements			0	0	418
Cash collateral received			3 841	1 365	2 285
Unsettled trades			7 880	1 528	20 445
Short-sale bonds			0	-	-
Financial derivatives			1	21	8
Other financial liabilities			792	1 278	1 124
<b>TOTAL FINANCIAL LIABILITIES</b>			<b>12 513</b>	<b>4 193</b>	<b>24 280</b>
<b>TOTAL PORTFOLIOS *</b>			<b>364 948</b>	<b>328 431</b>	<b>316 187</b>

\* Total portfolios includes outstanding balances with the GPF (see Note 4).

**NOTES****Note 1 Accounting policies**

Financial reporting pertains solely to Norges Bank's foreign exchange reserves including outstanding balances with the Government Pension Fund Global (GPF) as at 30 June 2014. 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 methods of computation, see Norges Bank's annual financial statements for 2013. Financial reporting for Norges Bank's foreign exchange 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 Bank's foreign exchange 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 the estimates. For further information on significant estimates and critical accounting judgements, see Note 2 in Norges Bank's annual financial statements for 2013.

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

INCOME STATEMENT	Long-term portfolio	Money market portfolio	Petroleum buffer portfolio	Eliminations	Total foreign exchange reserves
	2014 Q2	2014 Q2	2014 Q2	2014 Q2	2014 Q2
Interest income, deposits in foreign banks	1	0	1	1	1
Interest income, lending associated with reverse repurchase agreements	-	2	11	-	12
Net income/expenses - gains/losses from:					
- Equities	6 117	-	-	-	6 117
- Bonds and other fixed-income instruments	2 809	12	0	-	2 821
- Financial derivatives	-1	-1	-	-	-2
Interest expense, borrowing associated with repurchase agreements	-1	-	-0	-1	-0
Tax expense	-6	-	-	-	-6
Other financial income/expenses	-0	-0	-0	-	-1
<b>NET INCOME FROM FINANCIAL INSTRUMENTS BEFORE FOREIGN EXCHANGE GAINS/LOSSES</b>	<b>8 918</b>	<b>12</b>	<b>11</b>	<b>0</b>	<b>8 941</b>
Foreign exchange gains/losses	6 987	889	1 114	5	8 984
<b>NET INCOME FROM FINANCIAL INSTRUMENTS *</b>	<b>15 905</b>	<b>901</b>	<b>1 125</b>	<b>6</b>	<b>17 925</b>

\* For the long-term portfolio, net income from financial instruments includes profit and loss items associated with outstanding balances with the GPF. These profit and loss items are excluded from the term foreign exchange reserves presented in Norges Bank's annual financial statements (cf. IMF definition).

**Note 4 Specification of the balance sheet, end of quarter, by portfolio**

Amounts in millions of NOK

BALANCE SHEET	Long-term portfolio	Money market portfolio	Petroleum buffer portfolio	Eliminations	Total foreign exchange reserves
	30. Jun. 2014	30. Jun. 2014	30. Jun. 2014	30. Jun. 2014	30. Jun. 2014
<b>FINANCIAL ASSETS</b>					
Deposits in banks	45	1 347	2 080	-	3 472
Lending associated with reverse repurchase agreements	3 841	12 344	31 316	-	47 500
Unsettled trades	807	-	-	-	807
Equities	118 475	-	-	-	118 475
Equities lent	9 673	-	-	-	9 673
Bonds and other fixed income instruments	162 555	31 384	3 521	-	197 460
Financial derivatives	13	0	4	-	17
Other financial assets	58	-	-	-	58
<b>TOTAL FINANCIAL ASSETS</b>	<b>295 466</b>	<b>45 075</b>	<b>36 921</b>	<b>-</b>	<b>377 461</b>
<b>FINANCIAL LIABILITIES</b>					
Short-term borrowing	0	-	-	-	0
Borrowing associated with repurchase agreements	0	-	-	-	0
Cash collateral received	3 841	-	-	-	3 841
Unsettled trades	706	6 172	1 001	-	7 880
Short-sale bonds	0	-	-	-	0
Financial derivatives	0	0	0	-	1
Other liabilities	80	-	712	80	712
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>4 627</b>	<b>6 172</b>	<b>1 713</b>	<b>80</b>	<b>12 433</b>
<b>TOTAL PORTFOLIOS *</b>	<b>290 839</b>	<b>38 902</b>	<b>35 207</b>	<b>-80</b>	<b>365 029</b>

\* For the long-term portfolio, total portfolios includes outstanding balances with the GPFPG.

Outstanding balances are excluded from the term foreign exchange reserves presented in Norges Bank's annual financial statements (cf. IMF definition).

**Reconciliation between market value at the end of the period and net portfolio value for financial reporting purposes**

Amounts in millions of NOK

	Long-term portfolio	Money market portfolio	Petroleum buffer portfolio	Total foreign exchange reserves
	30. Jun. 2014	30. Jun. 2014	30. Jun. 2014	30. Jun. 2014
Market value (end of period)	290 839	38 904	36 591	366 334
Total portfolio	290 839	38 902	35 207	364 948
<b>Difference between market value and net portfolio</b>	<b>0</b>	<b>2</b>	<b>1 384</b>	<b>1 386</b>
Foreign exchange purchases, trade dates 27 June with settlement 1 July 2014	-	-	-1 383	-1 383
<b>Rounding difference</b>	<b>0</b>	<b>2</b>	<b>1</b>	<b>3</b>

**Note 5 Equities, bonds and other fixed income financial instruments**

Amounts in millions of NOK

Table 5.1 Specification equities	30. Jun. 2014		
	Fair value excl. dividends	Accrued dividends	Fair value incl. dividends
Equities:			
Listed equities	127 570	180	127 750
OTC equities	399	0	399
<b>Total equities</b>	<b>127 969</b>	<b>180</b>	<b>128 148</b>
<i>Of which equities lent</i>	9 673	-	9 673

## Note 6 Risiko

### Market risk

Market risk is the risk of changes in the value of the portfolio due to movements in interest rates, equity prices, foreign currency exchange rates and credit spreads. For the long-term portfolio, Norges Bank measures risk in both absolute terms for the actual portfolio and the relative market risk for investments in the portfolio. For the money market portfolio, the Bank measures both absolute and relative market risk.

### Asset classes and currencies

The Bank's foreign exchange reserves are invested across several asset classes and currencies as shown in the table below.

### Volatility

Norges Bank uses risk models to quantify the economic risk associated with all or portions of the portfolios. The expected relative risk associated with the portfolios is presented below.

#### Key figures for risk and asset allocation, Norges Bank's foreign exchange reserves

Risk	Limits	Actual		
		2014 Q2	2014 Q1	2013 Q4
<i>Money market investments:</i>				
Market risk	1.0 percentage point expected relative volatility	0.04	0.04	0.05
Asset allocation	Cash	19.33	17.93	19.1
	Securities	80.67	82.07	80.9
<i>Equities and long-term fixed income investments:</i>				
Market risk	1.0 percentage point expected relative volatility	0.08	0.07	0.08
Asset allocation	Fixed income portfolio	56.06	56.76	56.63
	Equity portfolio	43.94	43.24	43.37

#### Key figures for risk and asset allocation

The models used to calculate the information above are explained in Note 24 Risk in Norges Bank's annual financial statements for 2013.

### 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 long-term portfolio and money market portfolio into credit rating categories.

#### Foreign exchange reserves, fixed income securities, by credit rating. Percent <sup>1</sup>

	AAA	AA	A	BBB	Lower	Total
Treasury bills	17.6	0	0	0	0	17.6
Sovereign bonds	49.8	32.6	0	0	0	82.3
Corporate bonds	0	0	0	0	0	0
Collateralised bonds	0	0	0	0	0	0
<b>Total fixed income securities</b>	<b>67.4</b>	<b>32.7</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>100</b>

<sup>1</sup>Percent of fixed income investments in the Bank's foreign exchange reserves.

The portion of Bank's foreign exchange reserves invested in fixed income instruments primarily consists of highly rated securities. At the end of Q4, 99.98 percent was invested in government securities rated AA or higher and only 0.02 percent of the portfolio was invested in corporate bonds.