The global economic crisis and its impact on Sovereign Wealth Funds: The example of Norway

Deputy Governor Jan F. Qvigstad
Norges Bank
Geneva, 11 May 2009

“The global economy is in a severe recession inflicted by a massive financial crisis and acute loss of confidence”

IMF, World Economic Outlook, April 2009
Fall in all countries and markets
Index. 1 January 2004 = 100 and per cent (global trade)

1) Sum exports and imports in the US, Japan, Germany and China.
USD 12-month change. Per cent

Fall in equity markets
Ten-year rolling real return on global equity markets 1908-2008. Per cent

Sources: Dimson, Marsh and Staunton and Norges Bank
Higher credit spreads for private securities
Credit spread between corporate and US government securities\textsuperscript{1)}.
Percentage points

\textbf{Increased market risk}
Absolute volatility 2004-2008. Per cent and in billions of USD

\textsuperscript{1)} Moody's Baa classified 10-year yields.

Source: Thomson Reuters

Source: Norges Bank
Major Sovereign Wealth Funds

Assets in billions of USD

1) Based on figures available to Sovereign Wealth Fund Institute in March 2009.

Source: Sovereign Wealth Fund Institute and Norges Bank

Petroleum production in Norway

Mill. scm oil equivalents per year. 1970-2030

Source: Norwegian Petroleum Directorate
Governance Structure
Norway’s Government Pension Fund – Global

Main properties of the Fund

- **Accountability**
  A clear division of responsibilities and a system of checks and balances

- **Transparency**
  Open information on performance, risk, costs and investments

- **Professionalism**
  All investment decisions delegated to professionals in a clear line structure division
Benchmark for the Fund

Strategic benchmark

Equities 60 %

Fixed Income 40 %

America and Africa 35 %

Europe 50 %

Asia and Oceania 15 %

America and Africa 35 %

Europe 60 %

Asia and Oceania 5 %

Source: Ministry of Finance

Ownership of equity markets
Per cent. 1998 – 2008

Europe
Americas
Asia and Oceania

Sources: FTSE and Norges Bank
Norway’s GPFG – large equity holdings
Holdings on 31 December 2008

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Millions of USD</th>
<th>Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Largest equity holdings</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Royal Dutch Shell plc</td>
<td>UK</td>
<td>2 355</td>
<td>1.37 %</td>
</tr>
<tr>
<td>Nestlé SA</td>
<td>Switzerland</td>
<td>2 299</td>
<td>1.42 %</td>
</tr>
<tr>
<td>BP plc</td>
<td>UK</td>
<td>2 029</td>
<td>1.33 %</td>
</tr>
<tr>
<td>Exxon Mobil Corporation</td>
<td>US</td>
<td>1 885</td>
<td>0.43 %</td>
</tr>
<tr>
<td><strong>Largest ownership interests</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mondi plc</td>
<td>UK</td>
<td>101</td>
<td>8.71 %</td>
</tr>
<tr>
<td>Babcock &amp; Brown Infrastr. Gr.</td>
<td>Australia</td>
<td>15</td>
<td>7.84 %</td>
</tr>
<tr>
<td>UPM-Kymmenne OYJ</td>
<td>Finland</td>
<td>406</td>
<td>5.77 %</td>
</tr>
<tr>
<td><strong>Other large investments in Switzerland</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Novartis AG</td>
<td></td>
<td>1 597</td>
<td>1.13 %</td>
</tr>
<tr>
<td>Roche Holding AG</td>
<td></td>
<td>1 542</td>
<td>1.08 %</td>
</tr>
<tr>
<td>Zurich Financial Services AG</td>
<td></td>
<td>622</td>
<td>1.90 %</td>
</tr>
</tbody>
</table>

Ownership of fixed income markets
Per cent\(^1\). 1998 – 2008

1) Per cent of Barclays index's market capitalisation.

Sources: Barclays and Norges Bank
Active ownership

Our goal
- Promote sustainable development and sound corporate governance in order to safeguard the financial interests of the fund

Our tools
- Proxy voting
- Company dialogue and engagement
- Investor networks
- Contact with regulators and standard setters
- Communicate principles for good corporate governance

Active ownership

What do we do?

Address topics relating to traditional shareholder rights
- The right to vote
- The right to participate in board elections
- The right to sell
- The right to information

Focus on topics that influence the development and regulation of companies' input factors
- Social issues – children's rights / child labour
- Environmental issues
2008 – An unusually demanding year
Annual changes in market value 1996-2008. In billions of USD

Market value of Norway’s Pension Fund
Per cent of mainland GDP and in billions of USD

Source: Norges Bank

Source: Ministry of Finance and Norges Bank
### The losses in perspective

Lower market values of government assets in 2008. In billions of USD

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Loss (bn USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Pension Fund – Norway</td>
<td>-5</td>
</tr>
<tr>
<td>Government direct ownership</td>
<td>-35</td>
</tr>
<tr>
<td>Government share of subsea petroleum resources</td>
<td>-350</td>
</tr>
<tr>
<td>Government Pension Fund – Global</td>
<td>-20 (-98)</td>
</tr>
<tr>
<td>Household housing wealth</td>
<td>-60</td>
</tr>
</tbody>
</table>

1) Negative return adjusted for dividends. Listed companies
2) Estimated decrease in value based on reduced oil price
3) Negative return measured in NOK. Negative return measured in international currency in brackets
4) Reduced value of housing wealth from August 2007 to Q4 2008 (nominal values)

### Return 1998 – 2008

Benchmark portfolio and actual portfolio. Indexed, 31 Dec 1997 = 100

Source: Norges Bank
Return on equities 1998 – 2008
Benchmark portfolio and actual portfolio. Indexed, 31 Dec1997=100

Return on fixed income 1998 – 2008
Benchmark portfolio and actual portfolio. Indexed, 31 Dec1997=100
Lessons from the crisis

- Investment strategy: Correlation between diverse assets in the fixed income portfolio. Liquidity may have been structurally underpriced
- Risk management: Statistical models based on historical prices and correlations proved insufficient
- Organisation and governance: Ensure clear responsibilities and limits to delegation

Focus from Norges Bank’s Executive Board

- Maintain an incentive structure in order to retain and build long-term competence
- Ensure the quality of the investment management organisation. If you aim for the average the outcome will be mediocre
- Our size and active ownership strategy requires an active investment strategy