Quarterly Report

Government Pension Fund – Global Third quarter 2008

NBIM
Norges Bank Investment Management

Norges Bank is the central bank of Norway. Its primary responsibilities are price stability through monetary policy, financial stability and investment management. Norges Bank Investment Management (NBIM) is responsible for investment management activities. NBIM manages the Government Pension Fund – Global on behalf of the Ministry of Finance.

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Contents

- Return for the quarter of -7.7 per cent – the lowest in the fund's history
- Crisis of confidence in the financial system
- Markets pricing in hard landing for the economy
- Record-high transfers to Government Pension Fund – Global
- Excess return from NBIM's management -1.84 percentage points – the weakest in the fund's history

Key figures

The market value of the Government Pension Fund – Global at the end of the third quarter was NOK 2 120 billion (see Chart 2-1), an increase of NOK 128 billion during the quarter

The downturn in equity markets during the quarter was the main reason for a return of -7.7 per cent measured in an international currency basket (see Chart 2-2), the lowest quarterly return in the fund's history. NBIM generated a return 1.84 percentage points below that on the benchmark portfolio, the weakest excess return in the fund's history. The annualised excess return over the past three years has been -0.68 percentage point (see Chart 2-3).

The quarter brought record-high transfers of new capital to the fund of NOK 128 billion. There was a negative return of NOK 173 billion, while a weaker krone increased the value of the fund by NOK 173 billion.

Global financial markets were unusually turbulent in the third quarter, with large day-to-day fluctuations in the market value of the fund and the return relative to the benchmark portfolio. The fund's expected absolute volatility, which gives a statistical estimate of variations in market value over the coming year, has risen considerably in the past year and stood at 15 per cent or more than NOK 330 billion at the end of the third quarter.

Chart 2-1 Market value 1999-2008. In billions of NOK

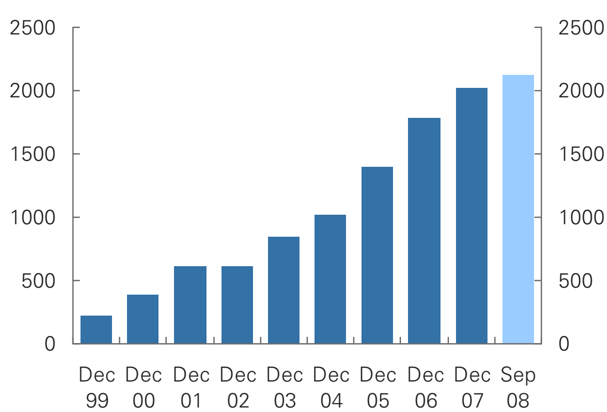


Chart 2-2 Quarterly return and three-year rolling annualised return 2001-2008. Per cent

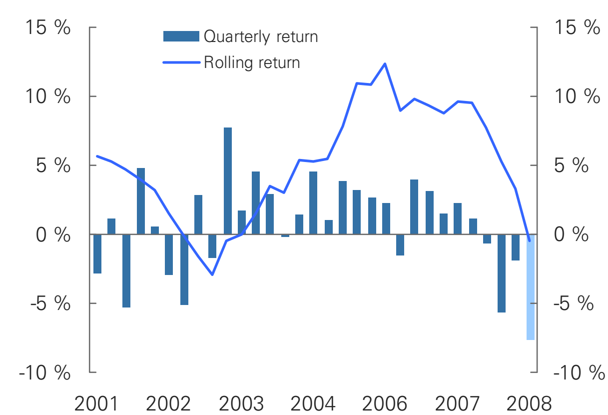


Chart 2-3 Quarterly excess return and three-year rolling annualised excess return 2001-2008. Percentage points

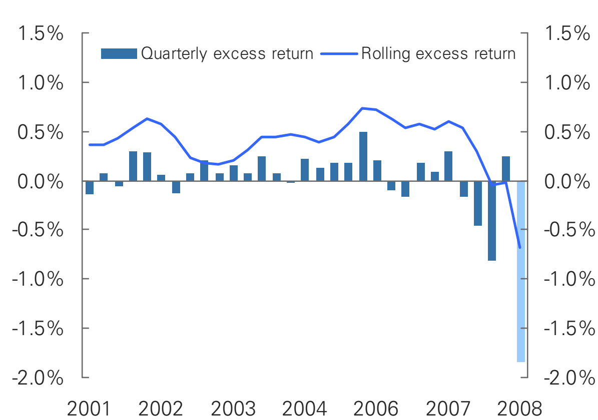
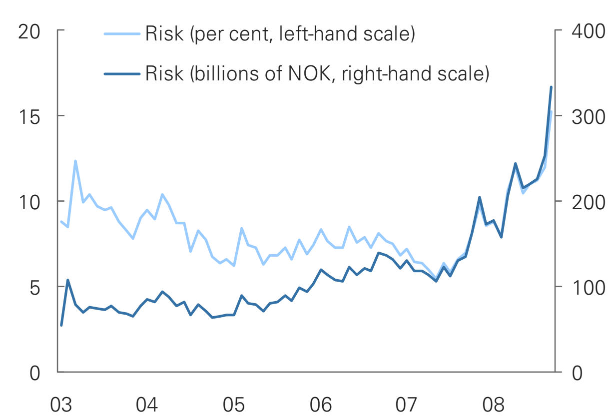


Chart 2-4 Absolute volatility 2003-2008. Per cent and billions of NOK



The markets

During the third quarter, the crisis in the financial sector evolved into a fundamental crisis of confidence in the financial system. A number of large financial institutions received funding from national authorities, some were nationalised, and others were allowed to fail. Steep falls in equity prices and lower bond yields reflected an increased likelihood of a hard landing for the economy and lower corporate earnings as a result of a dwindling supply of credit.

The financial crisis began in summer 2007 with a drop in the prices of securities backed by US sub-prime mortgages. Since then, the credit quality of US banks' loans has grown worse and worse. One important sign of this is the rising proportion of non-performing loans (see Chart 3-1). At the same time, the value of the collateral held by banks has fallen due to lower property prices. The big US mortgage lenders Freddie Mac and Fannie Mae did not have sufficient capital to handle this situation and were therefore taken over by the authorities.

The size of the market for financial derivatives backed by mortgage portfolios and other types of credit has grown considerably in recent years. Banks and other financial institutions have been able to take out insurance against losses on investments in these derivatives with big insurers. The world's largest insurer, AIG, played a key role in this market and had problems refinancing its loans. The US authorities therefore decided to take control of the company by injecting large loans.

The increased uncertainty resulted in banks demanding a higher premium for lending to one another. The spread between interbank interest rates and US Treasury yields can be viewed as an expression of banks' valuation of counterparty risk in the financial system. This spread had been very high since summer 2007, but climbed to new record levels following the bankruptcy of Lehman Brothers, the fourth largest US investment bank (see Chart 3-2). This bankruptcy had significant knock-on effects in the market that are still difficult to quantify.

Over the past year, existing financial institutions have raised new equity capital of about USD 350 billion (see Chart 3-3). As losses in the sector have grown, it has become harder for banks to raise capital in the market. For a number of banks, the combination of heavy losses and dwindling funding options has led to bankruptcy or takeover. Large institutions such as Washington Mutual and Wachovia are examples of this.

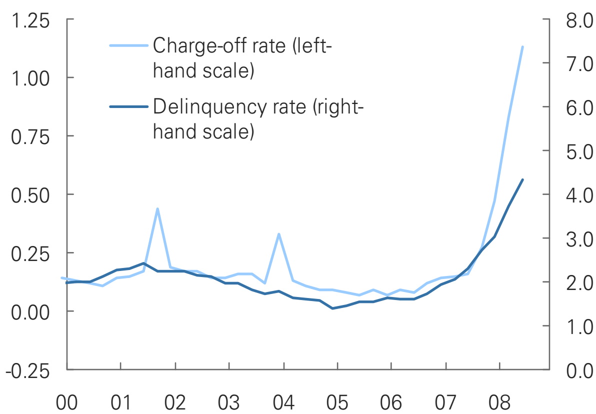
Merrill Lynch, the third-largest US investment bank, applied to be taken over by Bank of America, while the two remaining big investment banks, Morgan Stanley and Goldman Sachs, were brought under the same type of regulation as the rest of the bank sector. This means that all of the big US investment banks have ceased to operate in their original form.

The crisis has also bitten in Europe. The authorities in several countries have decided to inject new equity capital into the banking system or issue explicit guarantees for the capital of depositors and, in some cases, investors in debt instruments. The US authorities have decided to set up a scheme to acquire problem assets from financial institutions in order to improve the capital situation.

Financial institutions' debt has grown rapidly in recent years, and the shortage of funding means that all players are attempting to reduce the size of their balance sheets. However, the sale of assets puts increased pressure on the prices of these assets, and can in itself make the problem worse. A number of large financial institutions outside the bank sector are dependent on short-term funding for their operations. When this funding became unavailable, their positions had to be scaled down rapidly. This unwinding of risk led to increased volatility and had a major impact on a number of securities markets.

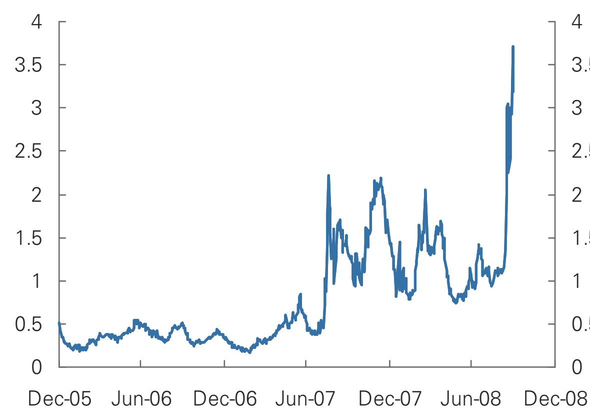
There is a growing risk of banks' inability and unwillingness to issue credit having major consequences for economic growth and corporate earnings. At the beginning of the quarter, the market was attaching considerable importance to rising inflation expectations, but attention quickly shifted to the increased likelihood of a hard landing for the economy and corporate earnings due to a dwindling supply of credit. This was reflected in steep falls in equity prices and lower bond yields.

Chart 3-1 US banks' residential mortgage lending. Seasonally adjusted rates



Source: Federal Reserve

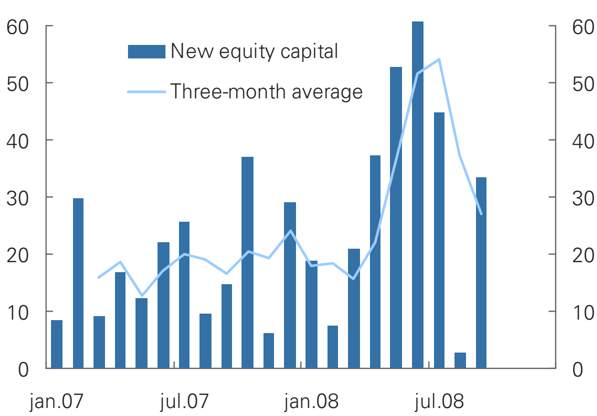
Chart 3-2 Spread between bank borrowing rates in the money market and US Treasury bill rates.[1] Percentage points



[1] Three-month rates

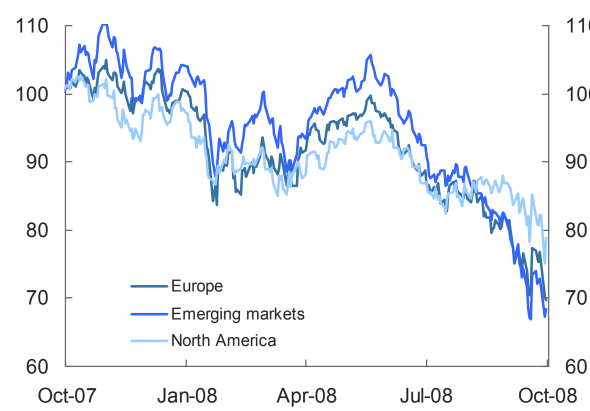
Source: EcoWin

Chart 3-3 Equity raised by financial institutions. Billions of USD



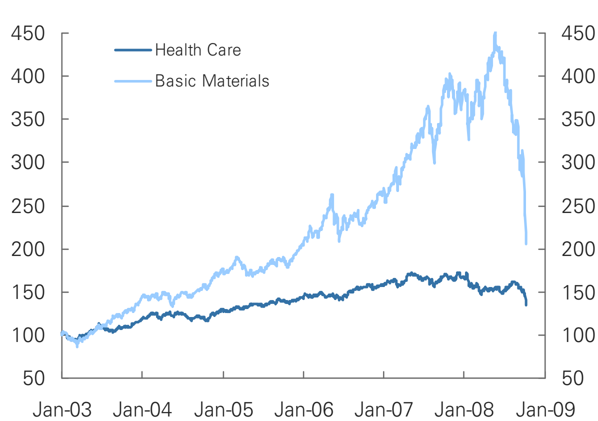
Source: Dealogic

Chart 3-4 Regional equity market returns. Common currency. Index



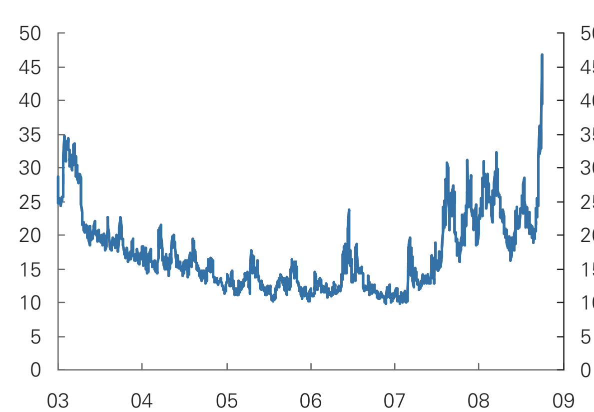
Source: FTSE

Chart 3-5 Return on investments in the Health Care and Basic Materials sectors. Index



Source: FTSE All-World Index

Chart 3-6 Expected volatility in the US equity market



Source: CBOE Volatility Index (VIX), EcoWin

Equity markets

The return on the broad FTSE Global All Cap index was -16.2 per cent measured in USD. In recent years, emerging markets have produced a much higher return than the industrialised countries. This trend reversed to some extent in the third quarter. Emerging markets fell 17 percentage points further than North America, which was the strongest region (see Chart 3-4).

This variation in regional returns reflects a shift in market expectations of future economic growth. This picture is even clearer when it comes to returns in different industrial sectors (see Table 3-1). For several years, the Basic Materials sector has generated much stronger returns than less cyclical sectors such as Health Care. This trend has clearly been broken in recent months (see Chart 3-5).

The downturn in equity markets was sudden and dramatic. This can, for example, be seen from the VIX index, which measures the volatility in equity markets anticipated in the US equity index option market (see Chart 3-6). Pricing in the equity market seems low by historical standards – for example, the estimated dividend yield is high (see Chart 3-7).

Table 3-1 Return in USD on the FTSE index in the third quarter of 2008 by industrial sector. Per cent

Sector	Return
Health Care	-2.57
Consumer Goods	-7.43
Consumer Services	-7.94
Financials	-10.21
Technology	-15.40
Telecommunications	-16.04
FTSE All-World Index	**-16.24**
Utilities	-18.10
Industrials	-18.67
Oil & Gas	-28.89
Basic Materials	-37.46

Fixed income markets

Yields in the major markets fell in the third quarter (see Chart 3-8). The ten-year US Treasury yield fell by around 0.15 percentage point, and equivalent yields in Europe and Japan by 0.60 and 0.15 percentage point respectively.

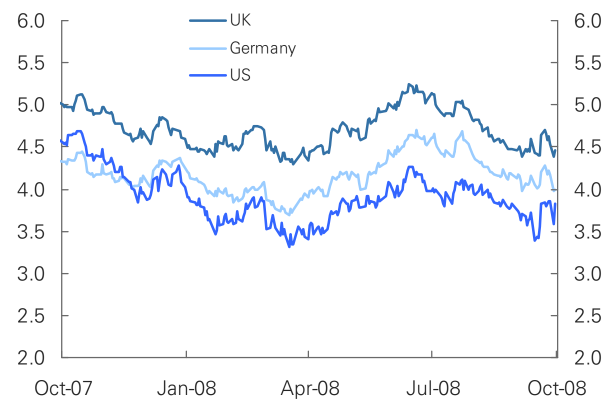
Overall, the quarter brought a return of 0.8 per cent on the broad Lehman Global Aggregate fixed income index. However, there were considerable variations in return between the constituent markets. The return on corporate bonds was around 5 percentage points lower than that on government bonds during the quarter, which is a substantial difference (see Chart 3-9). Within the corporate bond market, bonds issued by financial institutions performed particularly poorly (see Chart 3-10). This can be attributed to the bankruptcies and crisis of confidence in the financial sector.

While developments in the second quarter were shaped by higher commodity prices and uncertainty about the effects on inflation, the picture changed considerably in the third quarter. Indicators of economic activity, such as freight rates, fell dramatically (see Chart 3-11). Lower growth expectations and steep falls in commodity prices led to lower inflation expectations. For example, the inflation expectations implied by the spread between yields on inflation-linked bonds and nominal bonds narrowed sharply (see Chart 3-12).

Chart 3-7 Estimated dividend yield in the equity market

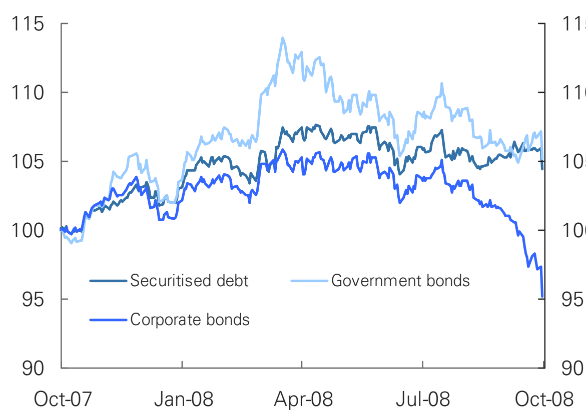
Source: FTSE, NBIM

Chart 3-8 Yield on government bonds with ten years to maturity. Per cent



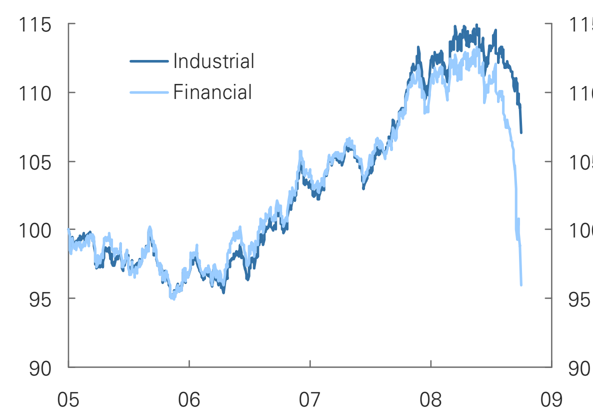
Source: EcoWin

Chart 3-9 Return on different types of bond



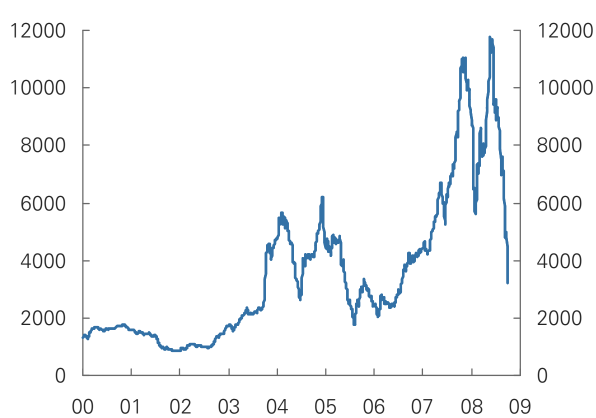
Source: Lehman Global Aggregate

Chart 3-10 Return on different types of corporate bond



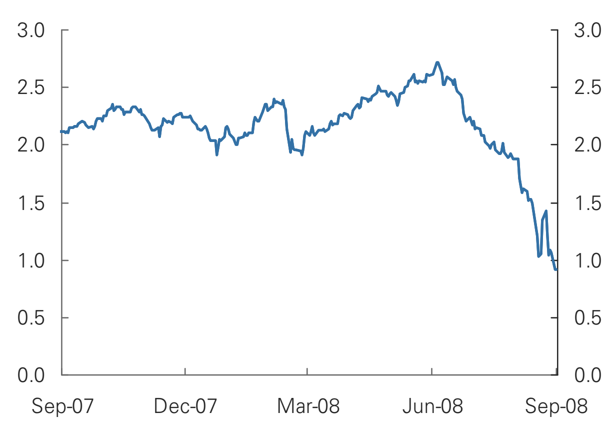
Source: Lehman Global Aggregate

Chart 3-11 Dry bulk freight rates. Index



Source: The Baltic Exchange, EcoWin

Chart 3-12 Inflation expectations priced into the US market for inflation-linked bonds. Per cent.



The portfolio

The strategic allocation to equities was raised from 40 to 60 per cent in summer 2007. The phasing-in of this increase in the actual portfolio is ongoing. The allocation to equities was largely unchanged in the third quarter (see Chart 4-1). The increase in the strategic allocation to equities and inflows of new capital into the fund mean that the size of the fund's holdings in equity markets is growing.

During the third quarter, the value of the fund's holdings of European equities increased to 1.25 per cent of the total value of the companies included in the benchmark portfolio (see Chart 4-2). The fund's average holding also increased in the other two geographical regions, but is somewhat lower there because of the fund's smaller share of market capitalisation. The flipside of larger equity holdings is smaller holdings in fixed income markets (see Chart 4-3).

NBIM employs external managers in the implementation of its management mandate. At the end of the third quarter, assets under the management of external managers accounted for 13.5 per cent of the fund's total assets (see Chart 4-4).

In both the equity and fixed income portfolios, the fund has a strategic overweight of European investments in terms of these markets' size in a global context. This means that there will be a tendency for large European companies and bond issuers to dominate the list of the fund's largest investments (see Tables 4-1 and 4-2).

The fund may hold up to 10 per cent of a company's voting shares. The limit was raised from 5 per cent after the Storting (Norwegian parliament) approved the change in June 2008. At the end of the third quarter, the fund's largest ownership interests in individual companies were close to 6 per cent.

Chart 4-1 Breakdown by asset class 2004-2008. Per cent

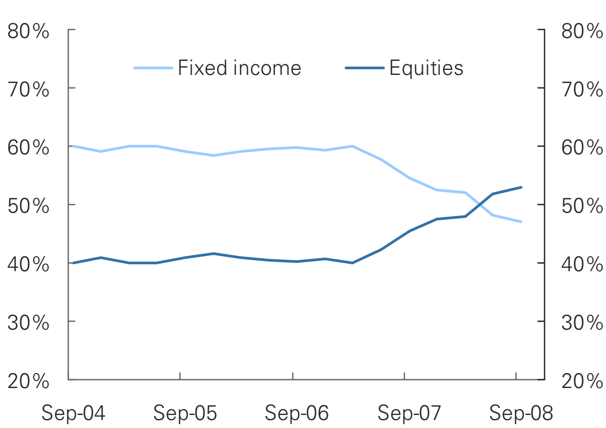
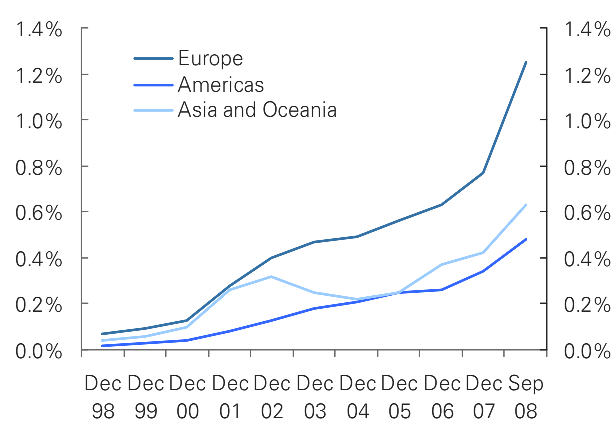
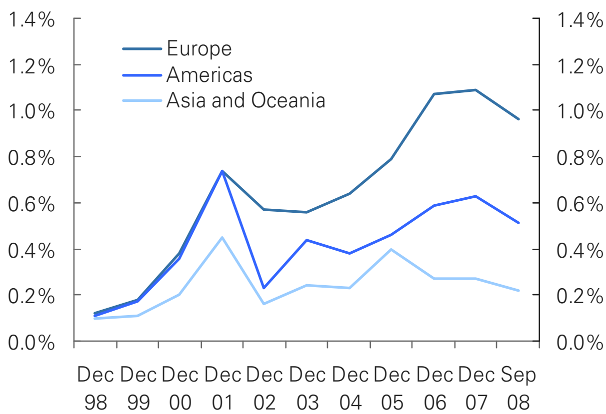


Chart 4-2 Ownership interests in equity markets[1)] 1998-2008. Per cent



[1)] Percentage of FTSE index's market capitalisation.
Source: FTSE, NBIM

Chart 4-3 Ownership interests in fixed income markets[1)] 1998-2008. Per cent



[1)] Percentage of Lehman index's market capitalisation.
Source: Lehman, NBIM

Chart 4-4 External management 1998-2008. In billions of NOK and per cent

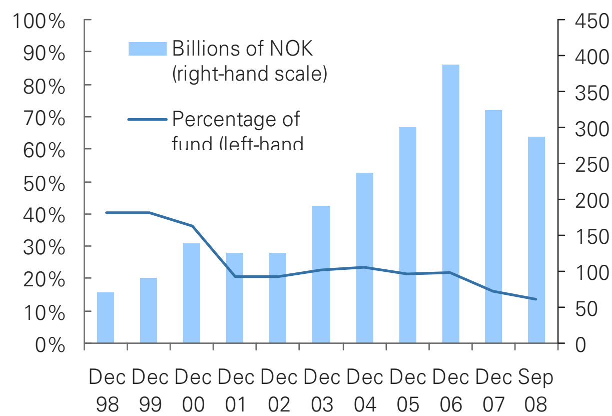


Chart 4-5 Regional breakdown of the equity portfolio as at 30 September 2008. Per cent

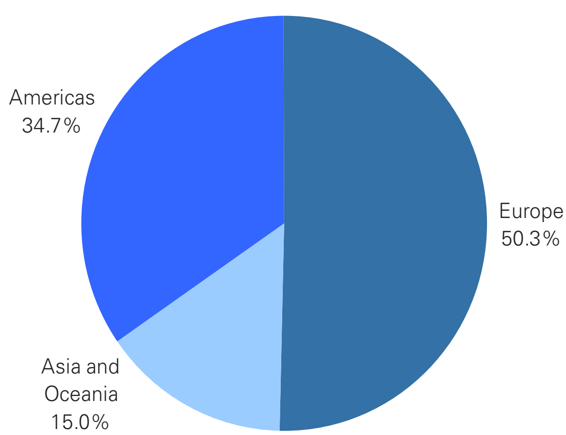


Chart 4-6 Regional breakdown of the fixed income portfolio as at 30 September 2008. Per cent

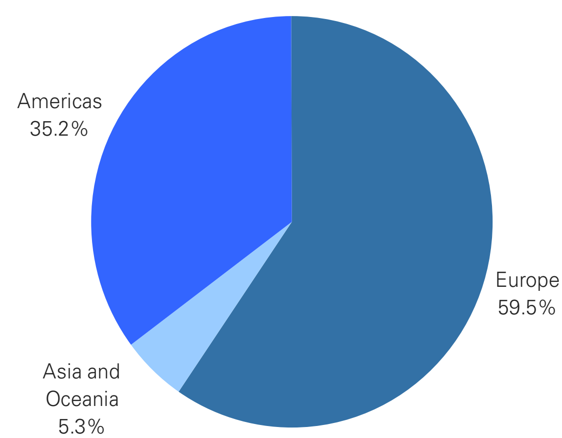


Table 4-1 Largest equity holdings as at 30 September 2008

Company	Country	Holding in millions of NOK
HSBC Holdings plc	UK	14 199
Royal Dutch Shell plc	Netherlands	13 481
Nestle SA	Switzerland	13 418
BP plc	UK	11 315
TOTAL SA	France	9 417
Exxon Mobil Corporation	USA	9 255
Vodafone Group plc	UK	8 581
Novartis AG	Switzerland	7 962
E.ON AG	Germany	7 941
Roche Holding AG	Switzerland	7 806

Table 4-2 Largest bond holdings as at 30 September 2008

Issuer	Country	Holding in millions of NOK
Federal Republic of Germany	Germany	108 228
Fannie Mae	USA	74 364
Italian Republic	Italy	62 924
European Investment Bank	Supranational	47 383
Japanese Government	Japan	47 122
Freddie Mac	USA	37 599
French Republic	France	26 600
HBOS plc	UK	22 970
Hellenic Republic	Greece	18 529
AyT Cedulas Cajas	Spain	16 634

Market value, risk and return

The market value of the Government Pension Fund – Global at the end of the third quarter was NOK 2 120 billion. The fund generated a return of -7.68 per cent and an excess return relative to the benchmark portfolio of -1.84 per cent.

New capital of NOK 128 billion was transferred to the fund during the quarter (see Table 5-1), the largest quarterly inflow in the fund's history. A negative return on investment reduced the value of the fund by NOK 173 billion, while a weaker krone in relation to the currencies in which the fund is invested increased its value in NOK terms by NOK 173 billion. A change in the krone exchange rate has no effect, however, on the fund's international purchasing power.

Over the past 12 months, the fund's market value has increased by NOK 188 billion (see Chart 5-1). New capital of NOK 384 billion has been transferred, while a negative return in international currency has reduced the market value of the fund by NOK 341 billion, and a weaker krone has increased its market value by NOK 145 billion.

In the third quarter, the fund generated a return of -7.68 per cent measured in international currency (see Table 5-1). There was a return of -13.12 per cent on the equity portfolio and -1.19 per cent on the fixed income portfolio. Since 1 January 1998, the fund has generated an annualised annual gross return of 4.1 per cent (see Table 5-2). Once management costs and inflation are deducted, the annual net real return has been 1.9 per cent.

The return achieved by Norges Bank on the actual portfolio is measured in relation to the return on the benchmark portfolio defined by the Ministry of Finance. The difference between these return figures is NBIM's contribution to the fund's performance. In the third quarter, the return on the fund was 1.84 percentage points lower than the return on the benchmark portfolio (see Table 5-1). There were negative contributions from both equity and fixed income management. Fixed income management in particular performed badly, due primarily to exposure to US mortgage bonds and bonds issued by financial institutions in Europe. The bulk of the losses in equity management were in the US bank sector.

There were negative contributions from both equity and fixed income management. Somewhat less that fifty per cent of the third quarter losses came from equity management. As a share of total losses, one quarter is attributed to internal equity management, one sixth to external equity management and less than one tenth to participation in the raising of new capital for six financial institutions. Fixed income management had losses primarily from exposure to US mortgage bonds, bonds issued by financial institutions in Europe and inflation-linked bonds. These investments were primarily made before the start of the financial crisis in 2007 and are not very liquid today. The losses are a continuation of the developments we have experienced since the summer of 2007.

Chart 5-1 Changes in market value Q4 2007 to Q3 2008. In billions of NOK

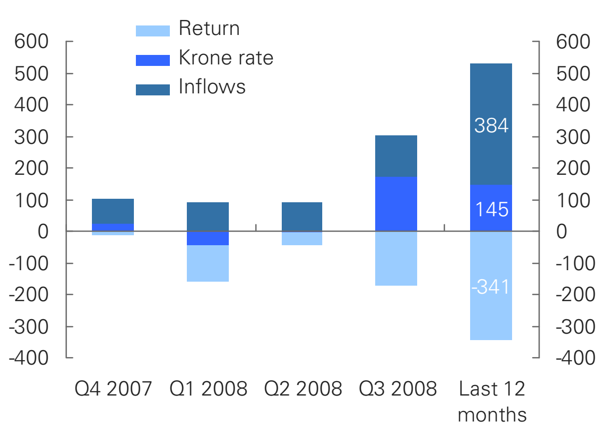


Chart 5-2 Absolute volatility 2004-2008 measured in NOK. Per cent

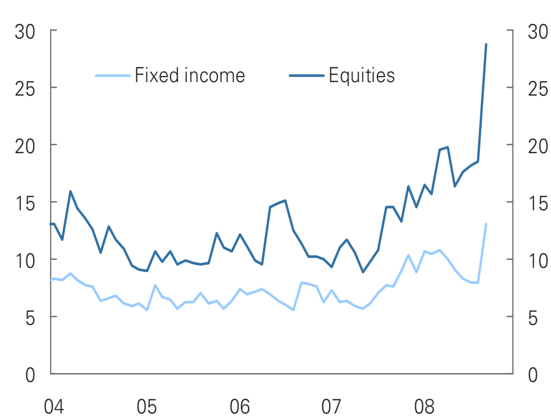


Table 5-1 Key figures as at 30 September 2008. Quarterly figures

	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008
Market value (billions of NOK)						
Fixed income portfolio	1 120	1 054	1 061	1 011	961	997
Equity portfolio	819	878	958	935	1 031	1 123
Fund	1 939	1 932	2 019	1 946	1 992	2 120
Inflows of new capital	68	76	77	88	91	128
Return	42	21	-14	-115	-39	-173
Change due to movements in krone	-46	-104	24	-46	-6	173
Return in international currency (per cent)						
Equity portfolio	7.40	-0.30	-2.77	-12.67	-1.60	-13.12
Fixed income portfolio	-1.19	2.10	1.30	0.87	-1.72	-1.19
Fund	2.23	1.15	-0.64	-5.62	-1.87	-7.68
Benchmark portfolio	1.93	1.33	-0.20	-4.79	-2.10	-5.98
Return in NOK (per cent)						
Equity portfolio	4.86	-5.57	-1.59	-14.71	-1.90	-5.84
Fixed income portfolio	-3.53	-3.29	2.53	-1.49	-2.02	7.08
Fund	-0.19	-4.20	0.56	-7.83	-2.17	0.06
Benchmark portfolio	-0.49	-4.03	1.01	-7.02	-2.41	1.89
Excess return	0.30	-0.17	-0.45	-0.81	0.24	-1.84
Management costs (per cent)						
Estimated transition costs	0.01	0.02	0.04	0.05	0.03	0.08
Annualised management costs	0.09	0.09	0.09	0.10	0.10	0.09
Changes in value since start-up (billions of NOK)						
Inflows of new capital	1 603	1 679	1 756	1 844	1 935	2 063
Return	496	518	504	390	352	179
Change due to movements in krone	-160	-265	-242	-288	-295	-122
Market value of fund	1 939	1 932	2 019	1 946	1 992	2 120

Transaction costs are incurred when new capital is phased into the fund and when re-weighting the benchmark portfolio. The estimated transaction costs associated with phasing in new capital are NOK 1.7 billion in the third quarter of 2008. This is equivalent to 1.3 per cent of the amount transferred and 0.08 per cent of the market value of the fund at the beginning of the quarter.

The turmoil in global equity and fixed income markets has resulted in major variations in the market value of the fund. The fund's expected absolute volatility is a statistical measure that gives a model-based estimate of "normal" variations in its market value over the coming year. Since summer 2007, market movements have been far from normal, making the model less accurate than before. Market fluctuations as measured by absolute volatility have increased since summer 2007 (see Chart 5-2). At the end of the third quarter, the fund's absolute volatility in NOK terms was around NOK 330 billion.

The risk limit in the management mandate from the Ministry of Finance is expressed as maximum expected relative volatility of 1.5 percentage points under normal market conditions. The risk model estimates the size of the variations in returns that can be expected based on the portfolio's composition relative to the benchmark portfolio, and uses historical market data for known risk factors to which the portfolio is exposed. The model's assumptions will to some extent fail to hold in periods of abnormally large market fluctuations such as those that have been witnessed in the past 18 months and provisionally culminated in the wake of the Lehman Brothers bankruptcy. Over the past year, and especially the past quarter, it would appear that modelled risk, as expressed by expected tracking error, has underestimated the actual risk in the portfolio, (se Chart 5-3).

Expected tracking error can vary widely even with an unchanged level of active management. This is because these measures are influenced by various market developments, such as changes in market volatility and changes in correlations between the various asset classes and securities. NBIM has reduced the level of active management in 2008, but expected tracking error still rose sharply in the third quarter (see Charts 5-4 and 5-5).

Through the Regulation on the Management of the Government Pension Fund – Global and supplementary guidelines for the fund, the Ministry of Finance has set limits for risk and exposure. These limits and the portfolio's actual exposure are shown in Table 5-4. There were no breaches of the investment guidelines during the quarter.

Chart 5-3 Confidence interval for risk and realised excess return 1999-2008. Basis points

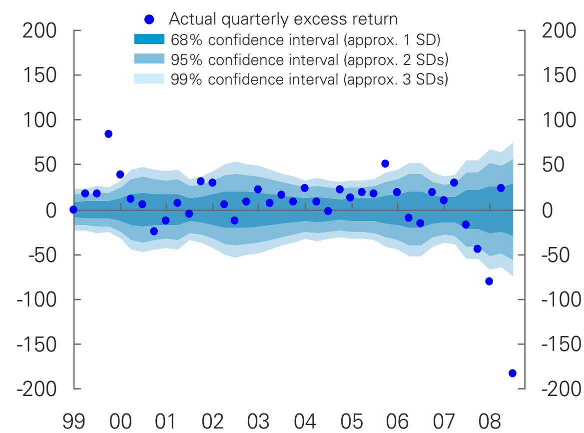


Chart 5-4 Expected and actual tracking error 1999-2008. Basis points

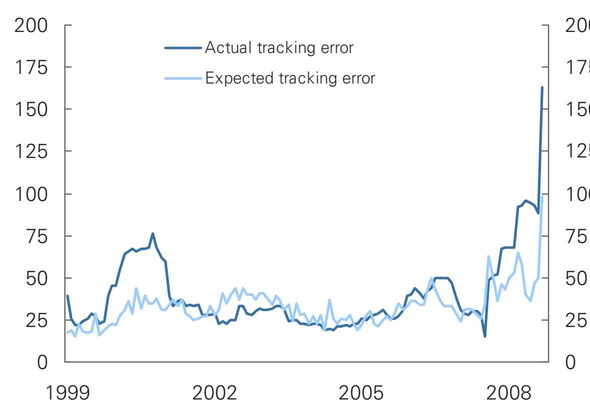


Chart 5-5 Expected tracking error September 2007 to September 2008. Basis points

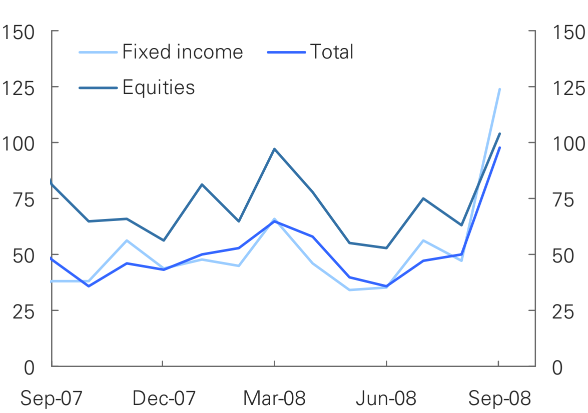


Table 5-2 Key figures as at 30 September 2008. Annualised figures

(Measured in NOK)	Last 12 months	Last 3 years	Last 5 years	Last 10 years	Since 01.01.98
Actual return (per cent)	-9.27	-1.28	2.40	3.30	3.55
Benchmark return (per cent)	-6.60	-0.60	2.61	3.18	3.42
Excess return (percentage points)	-2.67	-0.68	-0.20	0.13	0.14
Standard deviation (per cent)	8.71	8.39	8.19	8.56	8.43
Tracking error (percentage points)	1.63	1.09	0.87	0.69	0.67
Information ratio	-1.64	-0.61	-0.23	0.18	0.20
(Measured in international currency)					
Gross annual return (per cent)	-15.06	-0.43	4.01	4.15	4.06
Annual inflation (per cent)	3.48	2.86	2.57	2.06	2.01
Annual management costs (per cent)	0.09	0.10	0.10	0.09	0.09
Annual net real return (per cent)	-18.01	-3.30	1.30	1.95	1.91
Annual gross excess return (per cent)	-2.51	-0.69	-0.21	0.12	0.13

Table 5-3 Fixed income portfolio by credit rating[1)]

Percentage of fixed income portfolio	Aaa	Aa	A	Baa	Ba	Lower	P-1	No rating
Government and government-related bonds	19.9	12.3	2.5	0.5	0.2	0.1	-	0.9
Inflation-linked bonds	5.8	3.2	0.2	-	-	-	-	-
Corporate bonds	0.9	6.0	7.1	5.8	0.4	0.4	-	0.1
Securitised debt	30.7	1.4	0.9	0.2	0.1	0.1	-	0.2
Short-term certificates	-	-	-	-	-	-	0.1	0.0
Total bonds and other fixed income instruments	**57.3**	**22.9**	**10.7**	**6.5**	**0.7**	**0.6**	**0.1**	**1.1**

[1)] Based on credit ratings from at least one of the following rating agencies: Moody's, Standard & Poor's and Fitch. The "No rating" category consists of securities not rated by these three agencies; these securities may, however, have been rated by other, local agencies.

Table 5-4 Key figures for risk and exposure

Risk	Limits	Actual		
		31.12.07	30.06.08	30.09.08
Market risk	Tracking error max. 1.5 percentage points	0.43	0.36	0.98
Asset mix	Fixed income portfolio 30-70%	52.6	48.2	47.0
	Equity portfolio 30-70%	47.4	51.8	53.0
Market distribution, equities	Europe 40-60%	48.8	50.4	48.8
	Americas and Africa 25-45%	36.4	34.4	36.3
	Asia and Oceania 5-25%	14.8	15.2	14.9
Currency distribution, fixed income	Europe 50-70%	59.4	58.7	59.4
	Americas 25-45%	35.1	35.3	35.3
	Asia and Oceania 0-15%	5.5	6.0	5.3
Ownership interest	Max. 10% of a company (from June 2008)	4.99	4.99	5.96

From oil to equities

Transfers of new capital to the Government Pension Fund – Global are determined largely by the amount of revenue from oil and gas production accruing to the Norwegian State. The accumulation of the fund can therefore be seen as a way of converting non-renewable natural resources into savings in global financial markets. The fund is currently in a phase where the allocation to equities is being increased in order to improve the long-term trade-off between risk and return. This is happening at a time when the relative value of petroleum resources and equity investments is more favourable for an oil producer than previously in the fund's history.

Over the life of the fund, and especially in recent years, oil prices have been climbing (see Chart 6–1). This has paved the way for increased transfers to the fund. In the third quarter of 2008, NOK 128 billion was transferred to the fund, the largest amount yet in a single quarter (see Chart 6–2).

It was decided in June 2007 to increase the fund's allocation to equities from 40 to 60 per cent. This decision was intended to improve the long-term trade-off between risk and return in the fund, and reflects the owner's long strategic investment horizon and immense capacity to bear risk. For a fund as big as the Government Pension Fund – Global, such a strategic change needs to be phased in gradually.

Since the fund began investing in equity markets in 1998, returns in these markets have fluctuated considerably. A peak was reached during the IT bubble in 2000 and again before the financial crisis bit in 2007 (see Chart 6–3).

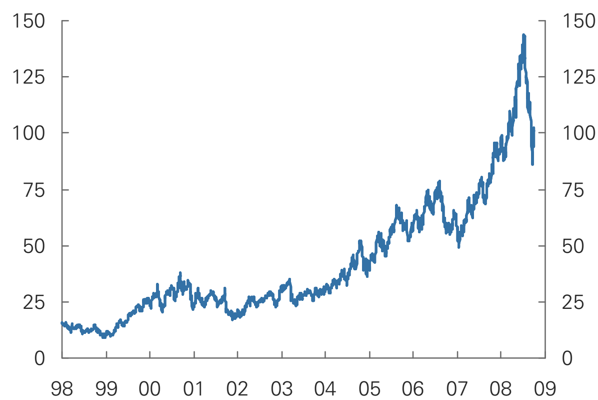
The allocation to equities is now being increased in a period when transfers to the fund are large but uncertain, due to high and volatile commodity prices. Volatility has been increasing this year in both the oil market and the equity market, but volatility has been significantly higher in the oil market than in the equity market over time (see Chart 6–4).

It is important that the change is made in such a way as to safeguard the fund's potential long-term returns. Uncertainty about future returns in financial markets is such that, for a fund that is building up ownership in equity markets over time, it will rarely be appropriate to try to time new investments.

However, the issue of timing investments can be viewed from another angle. Given that the increase in equity investments is being based on revenue generated in the petroleum sector, it is particularly interesting to observe how the relative value of oil and equity investments has changed over time.

Oil's purchasing power has increased substantially in recent years. This can be illustrated by looking at the value of the world's total annual oil production relative to the market value of the world's equity markets. One year's oil production in the late 1990s amounted to just 2 to 3 per cent of the market value of companies included in the FTSE World Index, whereas the equivalent figure in 2008 is more than 10 per cent (see Chart 6–5), even allowing for the increase in oil production during the period.

Chart 6-1 Crude oil spot price (Brent). USD per barrel



Source: EcoWin

Chart 6-2 Transfers to the fund 2003-2008. In billions of NOK

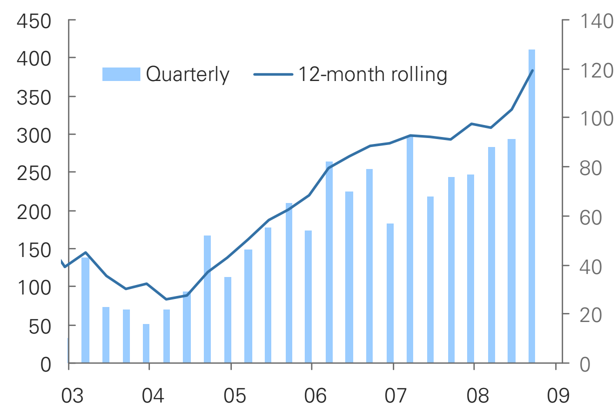
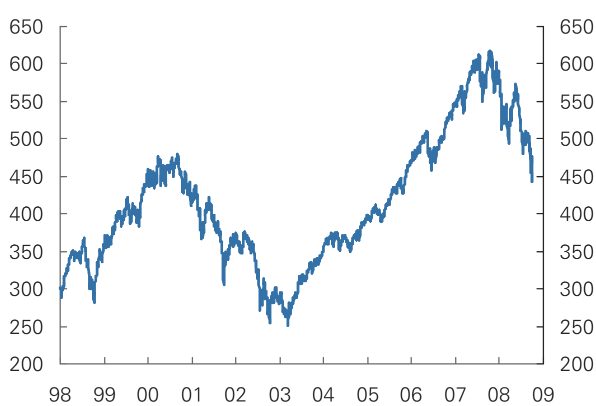


Chart 6-3 FTSE World Index



Source: FTSE, EcoWin

Chart 6-4 Annualised volatility. Per cent

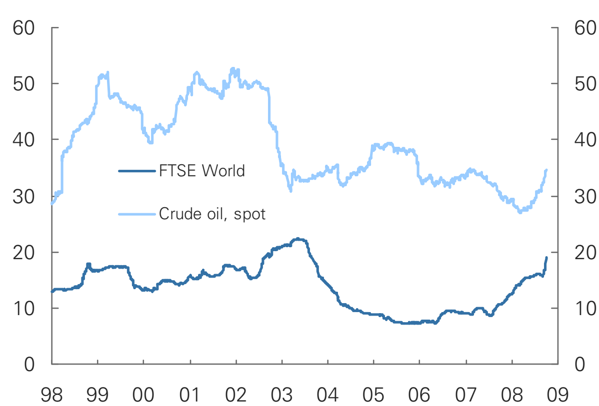


Chart 6–6 shows developments in the purchasing power of a barrel of oil relative to the market value of the global equity market. It can be seen that a barrel of oil has been able to buy more than three times as large a share of the equity market in 2008 as when the fund began to invest in equities in 1998. However, because the valuation of equity markets has fallen relative to underlying earnings at listed companies, the picture is even clearer if it is based on the level of exposure to actual earnings in which ownership of the equity market results. Selling a barrel of oil and buying global equity markets in 2008 has given exposure to actual earnings more than 10 times that in 1998.

The result of the developments outlined above is that the Government Pension Fund – Global's stake in global equity markets is rapidly rising (see Chart 6–7). This is due both to the phasing-in of a higher allocation to equities in the portfolio, and to the relative value of petroleum resources and equity investments being substantially more favourable than previously in the fund's history.

Chart 6-5 Purchasing power of a barrel of oil in the equity market

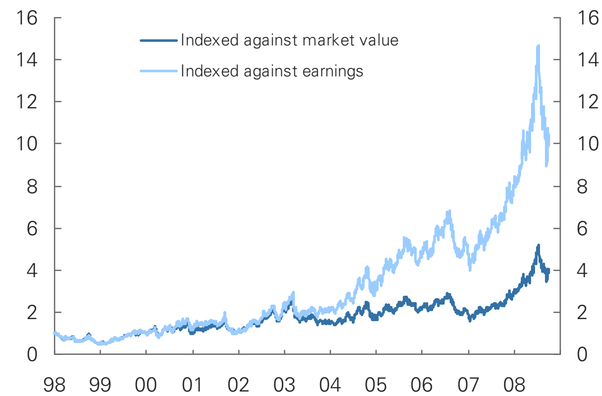
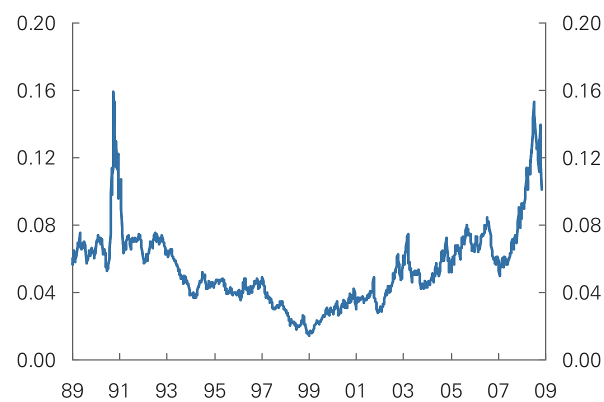


Chart 6-6 Value of world oil production relative to market value of FTSE World Index



Source: BP, EcoWin

Chart 6-7 Average ownership interest in the equity market

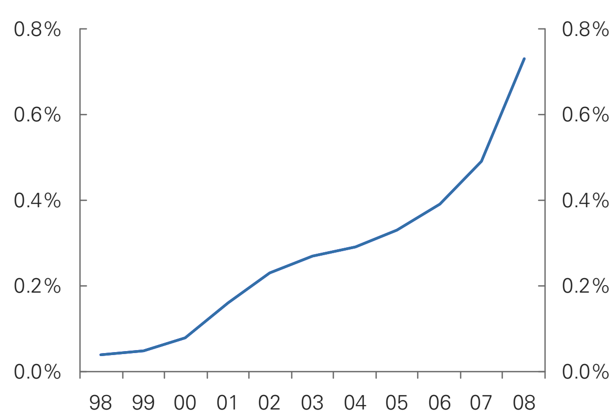


Photo: Helge Hansen / StatoilHydro

Financial reporting

Profit and loss account and balance sheet

Profit and loss account

(Figures in millions of NOK)	Q3 2007	Q3 2008	Year to date 31.12.07	30.09.07	30.09.08
Profit/loss on financial assets excl. exchange rate adjustments					
Interest income, deposits in foreign banks	70	113	431	298	335
Interest income, lending associated with reverse repurchase agreements	9 940	3 390	33 564	26 080	12 636
Net income/expenses and gains/losses from:					
- equities and units	-5 615	-162 980	41 627	65 152	-299 477
- bonds and other fixed income instruments	20 031	-11 775	19 750	6 445	-24 290
- financial derivatives	109	-9 165	5 265	7 397	-6 003
Interest expenses, borrowing associated with repurchase agreements	-8 263	-5 179	-32 509	-24 295	-16 469
Other interest expenses	-28	-38	-118	-174	-279
Other expenses	-42	6	-179	-139	93
Profit/loss before exchange rate adjustments	**16 202**	**-185 628**	**67 831**	**80 765**	**-333 455**
Exchange rate adjustments	-99 302	185 712	-146 412	-168 968	127 643
Profit/loss	**-83 100**	**83**	**-78 581**	**-88 203**	**-205 811**
Accrued management fee	-482	-408	-1 783	-1 320	-1 370
Profit/loss after management fee transferred to krone account	**-83 582**	**-325**	**-80 364**	**-89 523**	**-207 181**

Balance sheet

(Figures in millions of NOK)		31.12.07	30.09.07	30.09.08
ASSETS				
FINANCIAL ASSETS				
Deposits in foreign banks		23 905	26 626	14 104
Lending associated with reverse repurchase agreements		669 607	698 791	383 538
Equities and units		945 113	854 437	1 115 384
Bonds and other fixed income instruments		1 120 540	1 105 502	1 218 268
Financial derivatives		2 094	4 110	0
Other assets		5 229	23 489	62 922
TOTAL FINANCIAL ASSETS		**2 766 488**	**2 712 955**	**2 794 216**
LIABILITIES AND CAPITAL				
FINANCIAL LIABILITIES				
Short-term borrowing		187	1 703	573
Borrowing associated with repurchase agreements		710 898	727 477	623 410
Financial derivatives		0	0	12 090
Unsettled trades		33 480	51 471	30 820
Other liabilities		3 185	0	7 373
Management fee due		1 783	1 320	1 370
TOTAL FINANCIAL LIABILITIES		**749 533**	**781 970**	**675 635**
Capital	Note 3	2 016 955	1 930 985	2 118 581 *)
TOTAL LIABILITIES AND CAPITAL		**2 766 488**	**2 712 955**	**2 794 216**

*) The capital shown here is NOK 72 million lower than reported in Norges Bank's monthly balance sheet for September. This is due to factors discovered after the publication of the monthly balance sheet.

The financial reporting for the fund forms part of, and comprises excerpts from, Norges Bank's financial statements.

Note 1. Accounting policies

The interim accounts for the third quarter have been prepared in accordance with the accounting policies for Norges Bank approved by the Supervisory Council on 13 December 2007. A presentation of the accounting policies applied in the preparation of the accounts can be found in the Annual Report for 2007.

The interim accounts do not include all of the information required in a full set of annual financial statements and should be read in conjunction with the Annual Report for 2007.

The preparation of the financial reporting for Norges Bank involves the use of estimates and judgements which can affect assets, liabilities, income and expenses. The accounting policies presented in the Annual Report for 2007 contain further information on significant estimates and assumptions.

Note 2. Operating expenses

The management agreement between the Ministry of Finance and Norges Bank establishes the principles for Norges Bank's remuneration for managing the Government Pension Fund – Global. For 2008, this fee is to cover the Bank's actual costs, provided that these costs are less than 0.10 per cent of the fund's average market value. Fees to external managers for excess return achieved are also covered. Norges Bank has entered into agreements on performance-based fees with the majority of external active managers in accordance with principles approved by the Ministry of Finance.

Annualised, total costs in the first three quarters of 2008 amounted to 0.09 per cent of the average market value of the fund (see table below). Excluding performance-based fees to external managers, costs amounted to 0.07 per cent of the fund's market value. By way of comparison, the equivalent costs in the first three quarters of 2007 amounted to 0.08 per cent of its market value.

Management costs in the first nine months of 2007 and 2008. In thousands of NOK and as a percentage of the fund's market value

Cost component	January-September 2008		January-September 2007	
	NOK 1 000	Per cent	NOK 1 000	Per cent
Internal costs	495 637		447 754	
Custodian and settlement costs	215 967		207 671	
Minimum fees to external managers	262 695		396 237	
Performance-based fees to external managers	259 721		198 394	
Other external costs	135 771		69 513	
Total management costs	**1 369 791**	**0.09**	**1 319 569**	**0.09**
Total management costs excluding performance-based fees	**1 110 070**	**0.07**	**1 121 175**	**0.08**

Note 3 Capital

(Figures in millions of NOK)	30.09.08	31.12.07	30.09.07
Deposits in krone account on 1 January	2 016 956	1 782 139	1 782 139
Transfers during the year	308 806	315 180	238 369
Profit/loss transferred to krone account	-205 811	-78 581	-88 203
Capital before deduction of management fee	**2 119 951**	**2 018 738**	**1 932 305**
Management fee to Norges Bank	-1 370	-1 783	-1 320
Capital – deposits in krone account	**2 118 581**	**2 016 955**	**1 930 985**

Note 4. Securities lending

Loans of securities through external lending programmes totalled NOK 435.1 billion on 30 September 2008. Total collateral of NOK 461.7 billion had been provided for these loans. Of this collateral, NOK 202 billion had been re-invested in reverse repurchase agreements and bonds. In line with the Bank's accounting policies, neither collateral nor re-investments are included in the balance sheet for 30 September 2008.

Provisions for unrealised losses on re-invested cash collateral totalled NOK 5.1 billion on 30 September 2008, compared with NOK 3.1 billion on 31 December 2007. These losses are calculated on the basis of the market value of the re-investments. Of these losses, NOK 4.1 billion relates to unrealised losses based on valuations using ordinary price sources (breaking down into NOK 1.9 billion on securitised debt, NOK 1.2 billion on corporate bonds, and NOK 1 billion on structured investment vehicles), while NOK 1 billion is a liquidity deduction resulting from the price adjustment method (see Note 5). New unrealised losses of NOK 2 billion on these re-investments were recognised in the first nine months of the year under "Net income/expenses and gains/losses from bonds and other fixed income instruments". This part of the re-investment programme was frozen a year ago, and these investments will decrease as the bonds mature.

Note 5. Valuation of financial instruments

I In September, turbulence in financial markets increased, and uncertainty about the pricing of individual instruments was greater than usual. However, for the bulk of the fund's investments, this uncertainty is considered limited, even during this period. The bulk of the fund's holdings of securities and financial derivatives carried at market value are valued using observable market prices. Prices are obtained from multiple sources, and a quality assurance process has been established to ensure the use of independent prices that reflect fair value as best possible.

Where observable market prices are not available because there is no active market for an instrument, models are used to value the portfolio's positions. This applies to a number of illiquid bonds, including securitised debt and OTC derivatives. For most of these, observable market data are used as input for the models, but a small proportion are valued using extrapolated or estimated data. Uncertainty about whether the resulting price reflects fair value will be greatest for the latter category. The proportion of instruments covered by model pricing increased somewhat during the quarter.

The valuation methods for the investments covered by model pricing using extrapolated or estimated data include the use of a price adjustment method for a number of securitised instruments. This method has been established through analyses and discussions with various participants in the market (price suppliers, brokers and external managers) and is intended to take account of the aforementioned uncertainty associated with the pricing of these instruments. These methods mean that the value of some types of securitised instrument, including structured investment vehicles, has been revised downwards by means of an uncertainty/liquidity deduction from the value reported from ordinary price sources. The size of this liquidity deduction depends on the estimated uncertainty about the price from the price source.

It is believed that the uncertainty associated with the valuation of the fund is greatest for the instruments covered by this price adjustment. These investments consist of securitised debt (ABSs, RMBSs and CMBSs) and a number of structured investment vehicles with a total market value close to NOK 100 billion. A liquidity deduction of NOK 3 billion for these instruments was recognised as at 30 September 2008. The liquidity deduction at the end of the quarter was recognised as an unrealised loss under "Net income/expenses and gains/losses from bonds and other fixed income instruments".

No new investments in these types of instrument were made during the quarter.

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