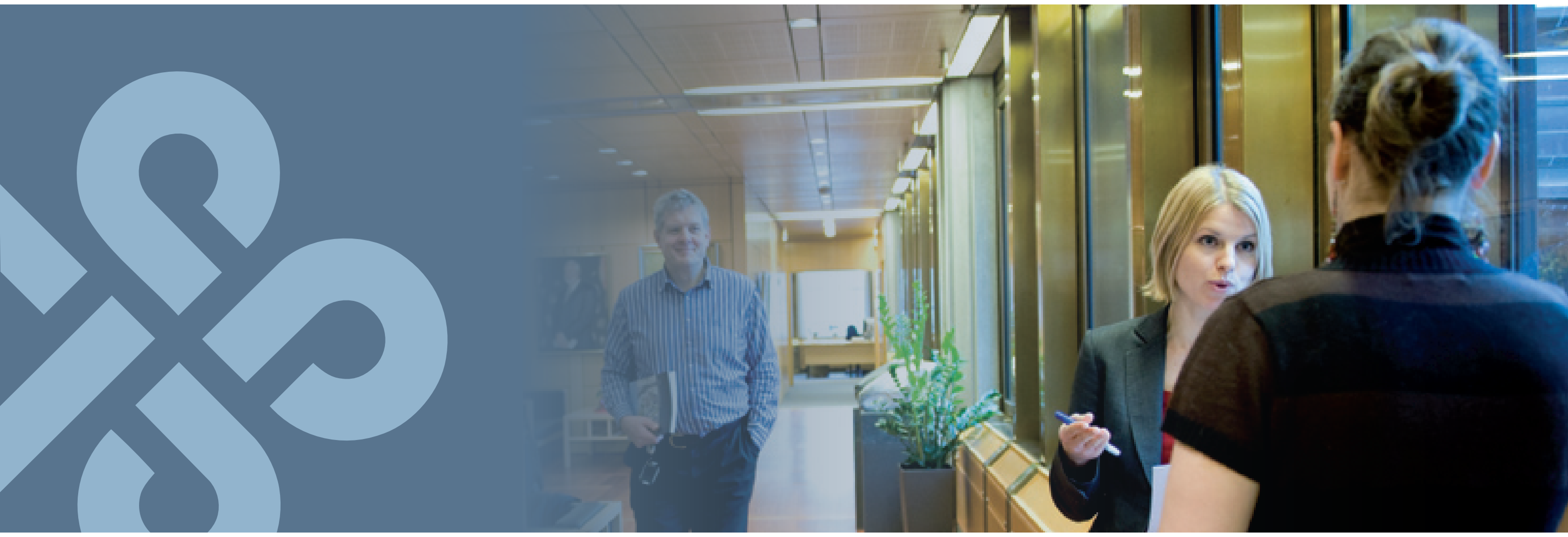
Annual Report 2009



NORGES BANK

Annual Report 2009

NORGES BANK

Norges Bank | Oslo 2010

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Highlights in 2009

- During the first half of 2009, Norges Bank's key policy rate was reduced to 1.25% in June – the lowest ever. Despite the risk that new shocks might result in a downturn, activity held up. Against the background of signs of improved prospects for the Norwegian economy, the Executive Board increased the key policy rate by 0.5 percentage point in the latter half of the year.

- In order to facilitate banks' access to long-term funding, Norges Bank assisted in establishing a swap arrangement in autumn 2008, where banks were permitted to borrow government securities in return for covered bonds. Banks' access to money market funding improved through 2009, and banks did not submit any bids in the last swap auction in autumn. The temporary measures that were implemented in 2008 to increase banks' access to loans in Norges Bank were reversed in autumn 2009.

- In April, Norges Bank implemented a new interbank settlement system. The introduction of the new system was successful and operations have been stable.

- The financial crisis revealed weak aspects of banking regulation. In *Financial Stability* reports 1/09 and 2/09, Norges Bank recommended changes to bank liquidity and capital regulations.

- In April 2009, the IMF made a number of proposals for strengthening the IMF's lending capacity and the financial safety net for member countries. Following discussions between Norges Bank and the IMF, and the approval of the Storting (Norwegian parliament), a loan agreement was signed on 30 June 2009. Under the agreement, the IMF has drawing rights corresponding to NOK 30bn. The IMF drew the first amount in July.

- The Nordic countries jointly committed to meeting Iceland's funding needs. In July, Norges Bank extended a loan to the Icelandic government for an amount of up to USD 675m with a maturity of up to 12 years. The Icelandic government has guaranteed repayment of the loan to Norges Bank. The Nordic countries made it a condition of the loans that Iceland should adhere to the IMF stabilisation programme. The first disbursement of loans to Iceland was made in December 2009.

- The return on the Government Pension Fund Global was 25.6% in 2009. International financial markets suffered a rapid and sharp setback from March to the end of the year. At end-2009, the market value of the Government Pension Fund Global was NOK 2640bn. Active management yielded positive results in 2009 after large losses the previous year.

- Norges Bank's Executive Board adopted new principles for risk management for investment management. The principles are based on a common framework, with four risk categories. Within each category, the principles are supplemented by more specific operational risk limits. The limits are set out in the investment mandate for the executive director of Norges Bank Investment Management.

- The Executive Board established a Remuneration Committee. The Remuneration Committee is a preparatory body that is responsible for assisting in thorough consideration of matters regarding pay and remuneration arrangements at the Bank.

- In December 2009, the Government appointed new members to Norges Bank's Executive Board. The new board consists of Brit Rugland, Ida Helliesen, Eirik Wærness, Asbjørn Rødseth and Liselott Kilaas, in addition to the Governor and Deputy Governor. Egil Matsen and Gøril Bjerkan were appointed as alternate members. Alternate members shall, as far a possible, be given access to the same information as the ordinary members. They shall also participate in discussions, but do not have the right to vote.

Executive Board Back row from left: Eirik Wærness, Ida Helliesen, Asbjørn Rødseth and Liselott Kilaas.
Front row from left: Jan F. Qvigstad, Brit K. Rugland and Svein Gjedrem.

Annual Report of the Executive Board 2009

Annual Report of the Executive Board 2009

Pursuant to the Norges Bank Act, executive and advisory authority in Norges Bank is vested in the Executive Board, which is in charge of the Bank's operations and the management of its resources. The Executive Board seeks to fulfil the Bank's objectives and values, with particular emphasis on ensuring price stability, financial stability and prudent and effective asset management that generates added value.

The turbulence in the financial markets and the unfolding of the financial crisis in autumn 2008 had a strong impact on all these core tasks of the Bank and affected the Executive Board's activities throughout 2009.

The Executive Board is particularly concerned that internal control and risk management at the Bank shall be satisfactory in all areas of the Bank's operations.

Since 2006, Norges Bank has had an Audit Committee and from 2007 an Internal Audit Unit accountable to the Executive Board. In June 2009, the Executive Board decided in addition to set up a separate Remuneration Committee. The Remuneration Committee is a preparatory body for the Executive Board responsible for assisting in thorough consideration of matters regarding pay and remuneration arrangements at the Bank. In December 2009, special regulations were issued concerning risk management and internal control at Norges Bank (see Internal control and risk management).

The Executive Board held 15 meetings in 2009 and dealt with 188 matters compared with 180 in 2008.

Monetary policy and financial stability

The operational target of monetary policy is annual consumer price inflation of approximately 2.5% over time. Viewed over time, inflation has been low and stable, remaining fairly close to, although somewhat below 2.5%. Consumer price inflation varies considerably from year to year and from month to month, partly as a result of short-term fluctuations in energy prices. Excluding energy prices, the underlying rise in consumer prices slowed throughout 2009, and was 2.4% at the end of the year.

Interest rate decisions during the first half of 2009 reflected the abrupt deterioration in the economic outlook in autumn 2008. The key rate was lowered by a total of 4.5 percentage points from October 2008 to June 2009. In interest rate setting, emphasis was placed on staving off particularly adverse outcomes for the economy.

During the summer, there were signs of better prospects for the economy. Despite the continued risk that new shocks might result in a downturn, activity held up, and unemployment increased markedly less than had been expected early in the year. In August, the Executive Board therefore made it clear that it might be appropriate to raise the key rate earlier than had been expected. During the fourth quarter, the key rate was increased by a total of 0.5 percentage points to 1.75%.

The financial market crisis in autumn 2008 led to the most severe downturn in the global economy for several decades. There was abnormally high uncertainty concerning economic developments, and activity fell steeply in many countries. The confidence crisis reduced the capacity and willingness of banks to redistribute liquidity, resulting in money market rates far higher than central bank key interest rates. The Norwegian economy was also affected. Increased funding costs prompted banks to increase their lending rates.

In autumn 2008, Norges Bank implemented a number of measures to ease the turbulence and improve the flow of credit in financial markets. These measures were continued during the first half of 2009.

In order to keep the shortest market rates close to the key rate, NOK liquidity was maintained at a far higher level than normal. Banks were given access to more loans and loans with longer maturities, and collateral requirements for bank's loans were eased. Ample NOK liquidity improved the flow of credit in the financial sector. The difference between the key rate and longer money market rates was greater than normal throughout the year, but decreased in pace with improvement of the situation in the financial markets. The high level of NOK liquidity could therefore be gradually reduced during the summer and autumn.

In order to facilitate banks' access to long-term funding, Norges Bank has helped to set up a swap arrangement whereby banks were able to borrow government securities in return for covered bonds. Banks could sell government securities or use them as collateral for loans. Loans with longer maturities eased the funding situation for the smaller banks. The swap arrangement gave banks access to long-term funding during a period when the bond market was not functioning as normal. The arrangement probably helped to keep banks' lending rates lower than they would otherwise have been. At the end of the year, money and financial markets functioned almost as normal.

The prospects for financial stability improved through 2009. Banks improved their financial strength. This improved their capacity to absorb losses and to provide credit. The payment system has remained stable during the financial turbulence.

The financial crisis has revealed weak aspects of the financial system and banking regulation. It is particularly important that banks improve liquidity management. In *Financial stability* reports 1/09 and 2/09, Norges Bank recommended a number of changes to banking regulations.

In April, a new solution for Norges Banks settlement system was successfully implemented.

Investment management

Norges Bank manages the Government Pension Fund Global (GPFG) on behalf of the Ministry of Finance. The Bank also manages Norway's foreign exchange reserves, which comprise three subportfolios: the investment portfolio, the money market portfolio and the buffer portfolio. Moreover, the Bank manages the Government Petroleum Insurance Fund on behalf of the Ministry of Petroleum and Energy. At the end of 2009, Norges Bank managed assets totalling NOK 2985bn in international capital markets.

2008 and 2009 have been demanding years for Norges Bank Investment Management (NBIM). The financial crisis, which began in summer 2007 and resulted in a major fall in the markets in 2008, continued into the first quarter of 2009. The valuation of equity and bond markets was then consistent with a very serious macroeconomic outcome of the financial crisis. The turnaround in financial markets from March to the end of the year came swiftly and with considerable force. Many countries' governments had introduced powerful and coordinated measures which stabilised expectations, and investors gradually returned to high-risk investments. The areas of the Bank's investment management that had faced particular challenges during the financial crisis benefited considerably from this normalisation.

Equity markets fell during the first quarter of 2009, while the last nine months were marked by a sharp rise. The overall upturn in the equity markets during the year contributed to a large positive return on the GPFG and foreign exchange reserves, measured in terms of a currency basket corresponding to the composition of the individual portfolio's benchmark index. At end-2009, the market value of the GPFG and was NOK 2640bn and the market value of the investment portfolio was NOK 188bn. The return in 2009 for the two funds was respectively 25.6 and 21.1%.

Since 1998, both the GPFG and the investment portfolio recorded an average return less inflation and management costs of 2.7% per year.

Active management yielded positive results in 2009. The actual gross return on the GPFG was 4.1 percentage points higher than the return on the benchmark portfolio defined by the Ministry of Finance. Since 1998, the average excess return per year has been 0.25 percentage points. The investment portfolio for foreign exchange reserves recorded a gross excess return of 5.6 percentage points in 2009. During the same period, the average excess return on this portfolio was 0.05 percentage points per year.

Norges Bank's Executive Board has adopted a strategy plan for investment management. The primary objectives of the plan are to generate added value by means of active management of the Government's and Norges Bank's foreign financial assets, to foster the owners' long-term financial interests through active corporate governance and to implement the owners' management strategy in a cost-effective, prudent and confidence-inspiring manner.

In recent years, the Executive Board has attached increasing importance to monitoring investment management at Norges Bank. In 2008, the Board adopted a new job description for the executive director of Norges Bank Investment Management (NBIM). In 2009, the Executive Board adopted new principles for risk management for investment management. The principles are based on a common framework, with a division of risk types into four different categories: market risk, credit risk, counterparty risk and operational risk. Within each risk category, the principles are supplemented by more specific operational risk limits for the Bank's operations. The specific risk limits are laid down in an investment mandate for NBIM's executive director within the investment limits specified by the delegating authorities. The investment mandate also describes the risk profile specified by the Executive Board, including principles and parameters for risk management and measurement. The monthly, quarterly and annual reporting from NBIM to the Executive Board must reflect the guidelines laid down in the investment mandate.

Some of the principal risk limits in investment management have been specified on the basis of a risk-based model under so-called normal market conditions. Since market fluctuations in recent years have been far from normal, the model has been less accurate than earlier. It appears that the model-based relative risk for the GPFG and foreign exchange reserves has underestimated the actual risk in the portfolios. In 2009, relative risk, as measured in terms of the model, approached pre-crisis levels. Most of the increase in measured relative risk observed towards the end of 2008 and into 2009 is due to changes in the markets, particularly absolute market fluctuations and correlation between different investment strategies, and not an increase in active risk-taking by the GPFG. In the investment mandates, the Executive Board has therefore supplemented the model-based risk measurements with quantitative measurements, for example for maximum permitted deviation between the actual investments and the benchmark portfolios, distributed by asset classes, geographical regions and industry sectors.

In 2009, the Executive Board provided consultative comments on the Ministry of Finance's draft regulation on the management of the GPFG, and stated its views to the Ministry with analyses and assessment of the active management of the Fund.

Norges Bank exercises active ownership in order to secure and generate financial wealth for future generations. The Bank promotes shareholder rights and seeks to improve social and environmental standards in the companies invested in. Norges Bank's corporate governance is based on the principles expressed in the UN Global Compact and in the OECD Principles of Corporate Governance and Guidelines for Multinational Enterprises. In 2009, the Executive Board revised the principles and strategy for corporate governance in the equity portfolios as a supplement to the Ministry of Finance's guidelines for the GPFG portfolio. Norges Bank votes at the general meetings of the vast majority of companies in the portfolios.

The Ministry of Finance has also established ethical guidelines for GPFG investments. The Council on Ethics advises the Ministry of Finance on how the guidelines for negative screening and the exclusion of companies from the investment universe shall be applied. The Executive Board has established similar rules for negative screening and exclusion of companies from the foreign exchange reserves.

Norges Bank publishes a separate annual report on the management of the GPFG.

Organisation and personnel

Use of resources and restructuring

Norges Bank is managed from the head office in Oslo, and has offices in London, New York and Shanghai. The Executive Board attaches importance to high standards and low costs in the Bank's performance of its responsibilities. Operations must be well managed, reflect a strong ethical awareness and be consistent with international best practice. The Bank must show willingness and capacity to adapt to change.

In recent years, the Bank has concentrated its operations on the core responsibilities of monetary policy, financial stability and investment management and operational and support responsibilities associated with these functions. This has resulted in considerable restructuring.

Norges Bank's personnel policy objectives involve ensuring that the Bank continues to attract, develop and retain qualified staff. This level of ambition is dependent on appropriate personnel policy instruments, that these instruments are used according to intentions and that they provide the desired results.

At end-2009, Norges Bank had a total of 589 permanent employees compared with 549 at end-2008. Since the end of the 1990s, the number of employees has been reduced by approximately 600. This has been accompanied by an increase in the use of resources in the Bank's core areas. In NBIM, there has been a marked increase in the number of employees in recent years. This is particularly due to the strong growth in the total GPFG assets. The number of permanent employees in NBIM at the end of 2009 was 249, compared with 217 the previous year. The number employed in this area of the Bank's activities will also be increased in

“The Executive Board’s activities were also marked by the financial market turbulence and unfolding of the financial crisis in autumn 2008.”

the years ahead, which will strengthen control and support functions and prepare the Bank for the challenges that will accompany a sharp rise in capital under management and inclusion of new asset classes. The increase in the number of employees at Norges Bank excluding NBIM from 2008 to 2009 was due to vacant posts at end-2008.

Norges Bank uses personnel policy programmes to facilitate employees’ adaptation to restructuring at the Bank. Since 1998, a total of 338 termination agreements have been concluded. No further termination agreements were concluded in 2009. NOK 95m has been set aside in the accounts to cover future payments related to restructuring.

Conversion of the industrial premises of the former printing works to offices was completed in autumn 2009. Finanstilsynet (the Financial Supervisory Authority of Norway) moved into these premises in December the same year. The lease will expire in June 2025 with the option to prolong for up to two periods of five years. The total cost of conversion was approximately NOK 400m. In the accounts for 2009, the value was written down by NOK 80m on the basis of the assumed return at the start of the project. The building project was completed during a period of considerable market pressure. Moreover, the conversion was technically demanding owing to the design of the premises and the security requirements. An extensive environmental clean-up of the premises used for the galvanisation plant was also necessary.

Gender equality and diversity

Norges Bank aims to have a sound and inclusive working environment characterised by good cooperation. The working environment must foster equality and diversity, and allow for adaptation to individual needs and living situations. At end-2009, the Bank had employees from 20 nations with the greatest ethnic diversity in NBIM. The bank provides language training and introduction assistance.

It is important to ensure a good balance between men and women at all levels of the organisation. The total proportion of female staff at Norges Bank is 37%. The target of 40% for the various occupational categories has been met in the two lowest occupational categories at the Bank with the exclusion of NBIM. In the two highest occupational categories, the level is somewhat below the target. In NBIM, there is some way to go before reaching the targets of 33% for the lowest occupational categories and 25% for the highest. The Executive Board notes a positive development at the middle management level. Efforts will be made to increase the proportion of women in managerial posts by attempting to find female candidates for vacant managerial posts, both externally and internally. Both women and men will be offered opportunities for development and managerial training. As far as practically possible, provisions will be made for flexible working hours.

The Executive Board is closely following developments in gender equality at Norges Bank via regular reporting from the Bank’s administration.

Health environment and safety

Norges Bank has entered into an agreement to be an inclusive workplace enterprise. In 2009, sickness absence accounted for 3.0% of working days, as against 2.9% in 2008. Of this, long-term absences (16 days or more) constituted 1.5%, as against 1.7% in 2008.

Norges Bank is conducting a systematic survey of the working environment. All employees will be offered an occupational health interview, and all workplaces will be ergonomically assessed. In 2009, 15 sections with 146 employees were surveyed by the Bank’s occupational health service. The occupational health service collaborates actively with managers to implement measures and make necessary improvements.

The Executive Board attaches considerable importance to ensuring adequate safety in all areas of the Bank’s operations. The objective is to protect the lives and health of employees and associates, while securing the considerable assets managed by the Bank. No serious injuries or accidents were recorded in connection with the Bank’s operations in 2009. Norges Bank has no significant impact on the external environment.

Buildings are being adapted to accommodate the needs of employees with disabilities. They are also entitled to rehabilitation support/wage subsidies, and their duties are adapted to their functional abilities.

The Bank’s Working Environment Committee assesses the working environment and social climate as satisfactory. The quality of the physical working environment is found to be very high, and the occupational health service provides aids and equipment as needed. The results of health, environment and safety surveys conducted at the Bank are reported to the Committee on a regular basis.

Internal control and risk management

Risk management and internal control are essential to the Bank's operations, and are an integral part of ordinary line management responsibilities and the management system at the Bank. Processes have been implemented to identify, measure and monitor all the principal sources of risk exposure at Norges Bank. The principal areas are market risk, credit risk, counterparty risk and operational risk.

The Bank reports to the Executive Board on the risk situation as an integral part of management. The content and frequency of such reports is adapted to the activities concerned. The Executive Board is informed of major changes in the risk situation. An overall assessment must be submitted at least once a year. Norges Bank Investment Management reports more often.

Developments, particularly in the management of the GPFG, but also in other core responsibilities of the Bank, involve greater operational risk and reputational risk. This poses considerable challenges to the Bank and its governing bodies.

In 2006, Norges Bank established an Audit Committee and, in 2007, an Internal Audit Unit accountable to the Executive Board. Following the Storting's adoption in June 2009 of certain changes in the Bank's audit and supervisory arrangements, this now has a statutory basis in the Norges Bank Act. The Act now specifically provides that "the Executive Board shall ensure sound organisation of, and establish satisfactory framework, objectives and principles for, the Bank's operations. The Executive Board shall ensure that the Bank's operations, including accounts and capital management, are subject to adequate management and control". On 17 December 2009, pursuant to another statutory amendment, the Ministry of Finance issued separate regulations on risk management and internal control at Norges Bank. The Executive Board has also adopted principles for risk management.

Three of the external members of the Executive Board attend the Audit Committee, which is a preparatory body for the Executive Board in matters particularly associated with supervisory functions and the responsibility of the Executive Board for risk management and control. The Internal Audit Unit is also accountable to the Executive Board and is the secretariat for the Audit Committee. The Audit Committee and the Internal Audit Unit have been established by agreement with the Supervisory Council, but do not otherwise affect the competence and responsibility of the Supervisory Council pursuant to the Norges Bank Act regarding supervision of the Bank's operations and organisation of Central Bank Audit's activities. 2009 saw further development of risk management and reporting. This work will continue during 2010. For more information on risk management in investment management, see the Notes section.

In June 2009, the Executive Board decided to establish a separate Remuneration Committee including two of the external members of the Executive Board. Like the Audit Committee, the Remuneration Committee is a preparatory body, responsible for helping to ensure thorough and independent treatment of matters concerning pay and remuneration arrangements at the Bank.

Ethical rules

For Norges Bank to be able to fulfil its responsibilities, the general public must have confidence that the Bank will perform its duties in a professional and independent manner. The Executive Board attaches particular importance to ensuring that the Bank's employees always conduct themselves with the necessary ethical awareness. The Executive Board has therefore issued rules for ethical conduct, last amended in 2008, in order to prevent its employees from exploiting their positions to achieve unfair advantages for themselves or others or from disloyal conduct in relation to the Bank. Ethical rules have also been issued for members of the Executive Board (cf. the Regulations issued by the Ministry of Finance on 7 August 2000 concerning relations with other credit institutions and companies for members of the Executive Board of Norges Bank, last amended in 2007). In autumn 2009, the Executive Board issued new principles for internal notification of censurable conditions at Norges Bank. The notification arrangement is intended to ensure that information is given concerning censurable conditions in cases where ordinary reporting cannot be used. In connection

with follow-up of the rules concerning money laundering, 13 suspicious matters were reported in 2009 in consultation with Økokrim (the Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime). These cases mainly concerned claims from abroad for compensation in connection with delivery of large quantities of damaged Norwegian coins.

Norges Bank's financial statements

Norges Bank's accounting principles have been adopted by the Supervisory Council. The annual financial statements are prepared in accordance with these policies.

Net international reserves constitute Norges Bank's main asset, with the exclusion of the GPFG, which has no effect on the Bank's results. Norges Bank holds interest-free liabilities in the form of notes and coins in circulation. In addition, the Bank has domestic deposits from the central government and banks. This balance sheet composition normally generates a positive return over time, particularly because the Bank holds equity capital in addition to its liabilities in the form of notes and coins in circulation. The Bank's assets consist primarily of investments that generate returns.

However, since the Bank's assets are largely invested in foreign exchange and liabilities are denominated in NOK, a foreign exchange risk arises that requires adequate capital.

Norges Bank's income consists primarily of interest and any net exchange gains from investments in foreign exchange. Exchange gains are the result of changes in exchange rates, equity prices and interest rates affecting bond prices. Norges Bank's results are dependent on developments in these parameters, which may give rise to considerable annual fluctuations in the Bank's results.

Norges Bank's annual accounts for 2009 show a deficit of NOK 7.6bn compared with a surplus of NOK 3.3bn in 2008. The appreciation of the Norwegian krone against most of the main currencies in the foreign exchange reserves resulted in an overall exchange loss translated into NOK of NOK 53.1bn in 2009, compared with a gain of NOK 63.5bn in 2008. Gains and losses resulting from changes in the krone exchange rate have no effect on the international purchasing power of the foreign exchange reserves.

Movements in international securities markets in 2009 resulted in a capital gain of NOK 32.7bn compared with a loss of NOK 54.3bn in 2008. Interest income and dividends from foreign investments amounted to NOK7.3bn, which is NOK 5.3bn less than in 2008.

Interest payments to the Treasury amounted to NOK 2.6bn in 2009 compared with NOK 6.3bn in 2008.

The Adjustment Fund stood at NOK 58.9bn at end-2008. After year-end allocations for 2009, the Adjustment Fund amounted to NOK 51.3bn. The Ministry of Finance has stipulated how much Norges Bank may allocate to the Adjustment Fund as a buffer against changes in exchange rates and securities prices (see description under 'Distribution of profit', below). The size of the international reserves and the domestic assets at year-end provide a basis for allocation of up to NOK 96.5bn to the Adjustment Fund.

Norges Bank's total balance sheet amounted to NOK 3012.0bn. The GPFG is integrated into Norges Bank's accounts, and constitutes approximately 88% of the Bank's balance sheet. The NOK deposits in the GPFG are a liability item for Norges Bank and at year-end amounted to NOK 2636.8bn. Norges Bank invests the equivalent of the NOK deposits abroad in an earmarked portfolio. The return achieved on the international portfolio is transferred to the Fund's NOK account. The costs incurred by Norges Bank in connection with management of the GPFG are covered by the Ministry of Finance subject to an upper limit. See note 24 for detailed information on the financial statements for GPFG.

For more information, see the financial statements for 2009, which include the profit and loss account, the balance sheet and additional information in the notes.

Distribution of profit

Pursuant to the Norges Bank Act of 24 May 1985, guidelines for allocation and distribution of Norges Bank's profit were originally adopted by the Council of State on 7 February 1986. The guidelines have been revised several times, most recently by Royal Decree of 6 December 2002, and now read as follows:

1 Allocations shall be made from Norges Bank's profit to the Adjustment Fund until the Fund has reached 5% of the Bank's holdings of Norwegian securities and 40% of the Bank's net foreign exchange reserves, ex-

cluding the immunisation portfolio and capital managed for the Government Petroleum Fund (now called the Government Pension Fund Global), other claims/liabilities abroad or any other commitments that the Executive Board considers to involve a not insignificant exchange risk.

The immunisation portfolio is that part of Norges Bank's foreign exchange reserves that is included in a separate portfolio. The return on this portfolio will be credited to/debited from the Treasury in the accounts of the same year. The same applies to the Government Petroleum Fund portfolio.

If the size of the Adjustment Fund exceeds the levels specified in point 1, first paragraph, the surplus shall be reversed to the profit and loss account.

2 If the Adjustment Fund falls below 25% of the Bank's net foreign exchange reserves excluding the immunisation portfolio and capital managed by the Government Petroleum Fund and other claims/liabilities abroad at the end of the year, available capital shall be reversed from the Transfer Fund to Norges Bank's accounts until the Adjustment Fund reaches full size according to point 1.

3 Any surplus after provisions for or transfers from the Adjustment Fund shall be allocated to the Transfer Fund.

4 Any deficit in Norges Bank's accounts following the allocations described in point 2 shall be covered by transfers from the Adjustment Fund.

5 In connection with the closing of the books each year, an amount corresponding to one third of the capital in the Transfer Fund shall be transferred to the Treasury.

In accordance with a statement from the Ministry of Finance, NOK 40.0m is to be transferred from other capital to cover the write-down on previously revalued assets. The amount will be transferred to the profit and loss account for allocation.

In accordance with the guidelines, the Executive Board proposes the following transfers and allocations:

In accordance with point 4, the loss for the year after allocations, NOK 7 567m, is to be transferred from the Adjustment Fund.

As there are no funds in the Transfer Fund, no transfer will be made to the Treasury.

Oslo, 24 February 2010

Svein Gjedrem *(Chair)*	Jan Fredrik Qvigstad *(Deputy Chair)*	Ida Helliesen
Liselott Kilaas	Brit K. Rugland	Asbjørn Rødseth
Eirik Wærness	Gøril Bjerkan *(Alternate)*	Egil Matsen *(Alternate)*
	Jan Erik Martinsen *(Employees' representative)*	Tore Vamraak *(Employees' representative)*

Financial statements and notes Norges Bank 2009

Profit and loss account

Figures in millions of NOK

	Note	2009	2008
Interest income and dividends	1	7 328	12 599
Change in value financial instruments	2	32 734	-54 318
Valuation adjustment of foreign exchange	3	-53 139	63 522
Return on international reserves		**-13 077**	**21 803**
Share dividends, BIS	14	22	19
Gain/loss on other foreign financial instruments	4	8 904	-16 379
Gain/loss on domestic financial instruments in foreign currency	5	-3 609	1 242
Gain/loss on domestic financial instruments in NOK	6	3 131	1 862
Interest expenses, Treasury, banks etc.	7	-2 054	-4 614
Net other central bank financial activities		**6 394**	**-17 870**
Total return financial activities		**-6 683**	**3 933**
Return on investments for Government Pension Fund Global	**24**	**195 177**	**-127 046**
Transferred from/to krone account Government Pension Fund Global	**24**	**-195 177**	**127 046**
Management fees Government Pension Fund Global	8	3 228	2 165
Other operating income		104	295
Total operating income		**3 332**	**2 460**
Personnel expenses	8	-892	-745
Depreciation and write-downs	17	-167	-82
Other operating expenses	8	-3 197	-2 227
Total operating expenses		**-4 256**	**-3 054**
Net operating expenses		**-924**	**-594**
Profit/loss for the year		**-7 607**	**3 339**
Transferred from Adjustment Fund	22	7 567	0
Transferred from 'Other capital'	23	40	37
Available for allocation		**0**	**3 376**
Allocated to Adjustment Fund	22	0	-3 376
Total allocations		**0**	**-3 376**

Balance sheet at 31 December 2009

figures in millions of NOK

ASSETS	Note	2009	2008
FOREIGN FINANCIAL ASSETS			
Equities	9	74 618	59 309
Equities lent	9,10	8 445	10 653
Bonds and other fixed income instruments	9	107 052	166 346
Bonds lent	9,10	18 135	29 252
Deposits in foreign banks		4 345	36 970
Lending	10	50 437	52 980
Financial derivatives	11	364	4 648
Claims on the IMF	12	18 145	5 699
Total international reserves	**13**	**281 541**	**365 857**
Other assets in foreign currency	14	1 625	7 816
Other assets in NOK	10	0	55 807
Total other foreign assets		**1 625**	**63 623**
Total foreign assets excl Government Pension Fund Global		**283 166**	**429 480**
DOMESTIC FINANCIAL AND OTHER ASSETS			
Lending to banks etc	15	75 929	80 158
Other assets in foreign currency		16	57 811
Other assets in NOK	16	6 629	2 359
Total domestic financial assets		**82 574**	**140 328**
Fixed assets	17	1 604	1 568
Gold		291	291
Total other domestic assets		**1 895**	**1 859**
Total domestic financial and other assets		**84 469**	**142 187**
Total assets excl Government Pension Fund Global		**367 635**	**571 667**
Investments, Government Pension Fund Global	**24**	**2 636 815**	**2 273 289**
TOTAL ASSETS		**3 004 450**	**2 844 956**

figures in millions of NOK

LIABILITIES AND CAPITAL	Note	2009	2008
Deposits in NOK		4	55 873
Borrowing in foreign currency	10	8 905	85 673
Cash collateral received	10	16 733	27 222
Financial derivatives	11	297	8 555
Other liabilities in foreign currency	18	2 197	12 135
Equivalent value of allocated Special Drawing Rights	12	14 156	1 811
Total foreign liabilities		**42 292**	**191 269**
DOMESTIC LIABILITIES			
Notes and coins in circulation	19	54 303	55 159
Treasury deposits		138 036	147 359
Deposits from banks etc	20	80 308	100 951
Borrowing in foreign currency		0	52
Financial derivatives in foreign currency	11	0	225
Other liabilities in NOK	21	415	16 765
Total domestic liabilities		**273 062**	**320 511**
Total liabilities excl Government Pension Fund Global		**315 354**	**511 780**
Deposits in krone account Government Pension Fund Global	**24**	**2 636 815**	**2 273 289**
Total liabilities		**2 952 169**	**2 785 069**
CAPITAL			
Adjustment Fund	22	51 298	58 864
Other capital	23	983	1 023
Total capital		**52 281**	**59 887**
TOTAL LIABILITIES AND CAPITAL		**3 004 450**	**2 844 956**

Norges Bank's Executive Board – Oslo, 24 February 2010

Svein Gjedrem
(Chair)

Jan Fredrik Qvigstad
(Deputy Chair)

Ida Helliesen

Liselott Kilaas

Brit K. Rugland

Asbjørn Rødseth

Eirik Wærness

Gøril Bjerkan
(Alternate)

Egil Matsen
(Alternate)

Jan Erik Martinsen
(Employee representative)

Tore Vamraak
(Employee representative)

Notes

Note 0. Accounting policies

The accounting policies at Norges Bank have been adopted by the Supervisory Council. Pursuant to an agreement with the Ministry of Finance, Norges Bank's accounting policies are also applied to the financial reporting for the Government Pension Fund Global.

1. GENERAL

Basis for preparing the annual financial statements

Norges Bank is subject to the Act of 24 May 1985 relating to Norges Bank and the Monetary System etc and is not required to comply with the Accounting Act. The financial statements are, nevertheless, with only a few exceptions, prepared in accordance with the Norwegian Accounting Act of 1998, regulations pursuant to the Act and generally accepted accounting principles in Norway. The few reporting exceptions are due primarily to special conditions specific to a central bank as indicated below:

The reporting exceptions from the Norwegian Accounting Act are:

- The profit and loss account and balance sheet are presented in a manner appropriate to the Bank's activities.
- A cash flow statement has not been prepared.
- The foreign exchange element linked to realised and unrealised changes in the value of financial instruments is entered on a separate line.
- The information in the notes is presented in a manner appropriate to the Bank's activities.
- All equities, bonds and other fixed income securities and financial derivatives are measured at fair value.

Changes in classification and presentation in 2009

With effect from the financial statements for 2009, the following changes have been made in classification and presentation:

- Financial derivatives and unsettled trades are not netted in the balance sheet.
- Securities lent are presented on separate lines in the balance sheet.

Comparative figures for 2008, originally presented at net, have been restated.

Presentation of the Government Pension Fund Global (GPFG)

The Ministry of Finance has a krone account in Norges Bank for the GPFG. The corresponding value of the krone account is invested by Norges Bank in foreign currency securities in a separate portfolio. The asset management is performed in accordance with management guidelines. The entire return on the portfolio is transferred to the krone account. Norges Bank bears no financial risk in connection with changes in the value of the GPFG. The performance of the GPFG does not therefore affect Norges Bank's profit and loss account or Norges Bank's capital. The GPFG's net investments are recognised as an asset on a separate line. The GPFG's krone account is recognised as a liability in the same amount to the Ministry of Finance. Separate financial statements are prepared for the GPFG and included as a separate note in Norges Bank's annual financial statements.

2. USE OF ESTIMATES WHEN PREPARING THE ANNUAL FINANCIAL STATEMENTS

The preparation of the financial statements for Norges Bank involves the use of estimates and valuations that can affect assets, liabilities, income and expenses. Estimates and discretionary valuations are updated regularly and are based on historical experience and expectations of future events that are considered probable at the time the financial statements are presented. The estimates are based on best judgement, but may differ from actual results. Any use of estimates is indicated in the relevant notes.

3. CURRENCY

Norges Bank's functional currency is the Norwegian krone (NOK). Transactions in foreign currency are recognised in the financial statements at the exchange rate prevailing on the transaction date. Assets and liabilities in foreign currency are translated into NOK at the exchange rate prevailing on the balance sheet date.

In the profit and loss account, the foreign exchange element linked to realised and unrealised gains and losses on financial instruments is presented on a separate line. Foreign exchange adjustments for the period are estimated based on the initial cost price in foreign currency and changes in exchange rates between the time of purchase, or the previous balance sheet date for financial instruments purchased in earlier periods, and the balance sheet date. At realisation, the exchange rate at the time of transaction is used.

4. FINANCIAL INSTRUMENTS

4.1 Recognition and derecognition

Financial assets or liabilities are recognised on the balance sheet when Norges Bank becomes a party to the contractual terms of the instrument. Transactions are recognised on the trade date.

Financial assets are derecognised from the balance sheet when the contractual rights to the cash flows expire or when the financial asset and the significant risks and returns relating to ownership of the asset have been substantially transferred. At derecognition, average cost price is used.

Financial liabilities are derecognised from the balance sheet when the liability has been settled or no longer exists.

4.2 Fair value measurement

Initial measurement

A financial asset or liability is recognised at the purchase price including direct transaction costs. Direct transaction costs include commissions, stamp duty and commissions paid under commission sharing agreements (CSA).

Subsequent measurement

Financial assets and liabilities are recognised at fair value on the balance sheet date. Fair value is the estimated realisable value of an asset or the cost of settling a liability in an arm's length transaction between well-informed and willing parties.

The price quoted by a stock exchange, broker or price provider is used for securities that are traded in an active market.

Valuation methods are used to estimate fair value for securities that are not traded in an active market. Valuation methods include the use of recent arm's length market transactions between well-informed and willing parties, if such information is available, reference to the current fair value of another instrument that is essentially another similar and comparable instrument, discounted cash flow calculations and option pricing models. If a valuation method is commonly used by market participants to price the instrument and this technique has provided reliable estimates of prices achieved in actual market transactions, this technique is used. Market information is used in the valuation methods to the extent possible.

Changes in fair value are recognised in the profit and loss account. Direct transaction costs relating to financial instruments measured at fair value are presented in the profit and loss account on the same line as the instruments to which the respective costs relate. Receivables and current liabilities other than derivatives are carried at amortised cost and the effective interest is booked in the profit and loss account.

4.3 Securities lending

Securities lending transactions consist of a transfer of securities from Norges Bank to a borrower against collateral in the form of cash or securities. When the loan is terminated, the identical securities are to be returned to Norges Bank. The borrower is obligated to compensate the lender for various events relating to the securities, such as subscription rights or dividends. The borrower also pays a fee to the lender. The borrower takes over the voting rights attached to the securities during the lending period.

Securities lent are not derecognised from Norges Bank's balance sheet. During the contract period, these securities are accounted for in the same way as other securities holdings. Lending fees are accrued as interest income.

Cash collateral received is recognised on the balance sheet together with a corresponding financial liability measured at amortised cost. Collateral in the form of securities is recognised if reinvested. Unrealised and realised gains and losses on reinvestments are recognised at fair value in the profit and loss account.

4.4 Repurchase/reverse repurchase agreements

In connection with repurchase agreements, the security is not derecognised from the balance sheet when the agreement is entered into. During the contract period, the accounting for the underlying securities is in accordance with Norges Bank accounting policies for financial instruments. Cash received is recognised as a financial asset and the corresponding short-term financial liability is recognised at amortised cost.

In connection with reverse repurchase agreements, the underlying security is not recognised on the balance sheet. The cash paid is derecognised from the balance sheet and a corresponding receivable reflecting the cash amount to be returned is recognised at amortised cost.

4.5 Accrued interest income and expenses

Accrued interest income and expenses are recognised on the balance sheet on the same line as the related financial asset or liability.

5. TAXATION

Norges Bank's activities are not subject to tax.

Paid withholding tax on foreign dividends and coupons is presented as a reduction in the corresponding income item. If the withholding tax can be refunded upon request it is recognised as a receivable.

6. MANAGEMENT FEE

Norges Bank's costs related to the management of the GPFG are covered by the Ministry of Finance up to a set limit. The management fee is accrued in the current year financial statements, with payment received in the following year.

7. LENDING TO BANKS ETC.

Lending is recognised at nominal value less any write-downs. Income related to maintenance of banks' accounts and lending services are recorded under 'Other operating income'.

Actual loan losses/bad debts are recognised as expenses. Estimated losses are recognised as an expense on the basis of a concrete assessment of each loan/debt. In the balance sheet, estimated losses are recorded as a reduction in loans outstanding.

8. FIXED ASSETS

Fixed assets are valued at purchase price less scheduled linear depreciation. If the fair value of fixed assets is lower than the book value and the decrease in value is not expected to be temporary, the assets are written down to fair value.

9. GOLD, ART COLLECTION ETC

Norges Bank has a collection of gold coins and gold bars. The holdings are valued at purchase price, which is the value at the time the gold was reclassified from international reserves to assets and the purpose changed to long-term ownership. If the fair value (metal value) is persistently and substantially lower in the long term, the value will be written down. If the fair value of gold rises, the value of the holdings is not written up. Norges Bank has a substantial collection of art, gifts and museum pieces such as medals, banknotes and coins. This collection is registered, but not recognised on the balance sheet.

10. PENSION AND PAYMENT OBLIGATIONS

Pensions and payment obligations are recognised in the financial statements in accordance with NRS 6 Pension costs. Norges Bank has two pension schemes, a secured scheme for the Bank's employees, which is financed through the Bank's pension fund, and an unsecured scheme for a number of other employees.

The Bank's payment obligations are related to restructuring measures in the form of severance pay and early retirement schemes. For fund-based schemes through Norges Bank's pension fund, the calculations are based on actuarial assumptions regarding life expectancy, expected wage growth and adjustment of the basic amount in the National Insurance Scheme. The economic assumptions on which the computation of pension obligations is based may change over time. Net pension obligations are the difference between the present value of the pension obligations and the value of pension capital that has been allocated for payment of pension benefits. Pension capital is recognised at fair value. Pension obligations and pension capital are measured on the balance sheet date. Employers' National Insurance contributions are included in the figures and are estimated on the basis of actual net underfunding.

The estimation of pension costs is based on linear distribution of pension earnings and consists of the year's accrued pension earnings less return on capital allocated for pensions.

Pursuant to NRS 6 Pension costs, the accumulated effect of changes in estimates and deviations of up to 10% in pension obligations or pension capital, whichever is the larger, may be derecognised in the profit and loss account for the year in order to equalise the results.

Note 1. Interest income and dividends

Figures in millions of NOK

	2009	2008
Interest income on deposits	66	84
Equity dividends	2 106	2 313
Interest income on securities	6 224	7 829
Interest income on lending	289	2 145
Interest income, securities lending	179	278
Interest income relating to IMF and SDRs	13	86
Interest income from financial derivatives	-1 549	-135
Interest income and dividends	**7 328**	**12 599**

Note 2. Change in value financial instruments

Figures in millions of NOK

	2009	2008
Realised gains/losses, equities	-1 108	-2 328
Unrealised gains/losses, equities	23 812	-39 711
Realised gains/losses, fixed income instruments	296	-1 389
Unrealised gains/losses, fixed income instruments	7 874	-6 914
Unrealised gains/losses, bonds reinvested in lending programme	301	-814
Gains/losses, derivatives	1 559	-3 162
Change in value financial instruments	**32 734**	**-54 318**

Note 3. Valuation adjustment of foreign exchange

Figures in millions of NOK

	2009	2008
Realised gains/losses, foreign exchange	-9 541	12 054
Unrealised gains/losses, foreign exchange	-43 598	51 468
Valuation adjustment of foreign exchange	**-53 139**	**63 522**

Note 4. Net other foreign financial instruments

Figures in millions of NOK

	2009	2008
Interest on borrowing	-358	-2 498
Gains/losses, borrowing in foreign currency	8 412	-13 284
Exchange rate change SDR	856	-369
Long-term lending	-7	0
Other	1	-229
Net other foreign financial instruments	**8 904**	**-16 379**

Note 5. Net domestic financial instruments in foreign currency

Figures in millions of NOK

	2009	2008
Interest	275	351
Foreign exchange gains/losses	-3 884	891
Net domestic financial instruments in foreign currency	**-3 609**	**1 242**

Note 6. Net domestic financial instruments in NOK

Figures in millions of NOK

	2009	2008
Interest expenses, borrowing	-67	-274
Gains/losses on forward exchange contracts	3 198	2 135
Net domestic financial instruments in NOK	**3 131**	**1 862**

Note 7. Interest expenses, paid to Treasury, banks etc.

Figures in millions of NOK

	2009	2008
Interest expenses, paid to Treasury	-2 607	-6 307
Interest expenses on deposits from banks	-1 348	-2 138
Interest expenses, depots operated by banks	-19	-64
Interest income on lending	1 920	3 894
Other interest income	0	1
Interest expenses, paid to Treasury, banks etc.	**-2 054**	**-4 614**

Interest on Treasury deposits in 2009 was paid at an annual 3.50% in Q1, 1.50% in Q2, 0.75% in Q3 and 0.50% in Q4.

The same interest rates apply for deposits from public account holders who receive interest on their deposits.

Note 8. Operating income and expenses

Management fee, Government Pension Fund Global (GPFG)

The Bank's operating income and operating expenses include income and expenses of NOK 3 228m related to the management of the GPFG. These expenses are covered by the Ministry of Finance up to a set limit. The expenses related to management also include distributed indirect and imputed costs. The management fee covers these components, which are included in the Bank's operating expenses, including personnel expenses and depreciation

Figures in millions of NOK

	2009	2008
Internal costs	780	658
Custody and settlement costs	289	341
Minimum fees to external managers	432	420
Performance-based fees to external managers	1 402	487
Other costs	325	259
Total management costs	**3 228**	**2 165**
Total management costs excl. performance-based fees	1 826	1 678

Personnel expenses

Included in Norges Bank's operating expenses are the Bank's total personnel expenses of NOK 892m, consisting of the following components:

Figures in millions of NOK

	2009	2008
Salaries and fees	-587	-485
Employer's social security contributions	-80	-67
Pension costs (cf. 8.1)	-140	-94
Restructuring costs (cf. 8.2)	-17	-33
Other personnel expenses	-68	-65
Total personnel expenses	**-892**	**-745**

Norges Bank had 589 permanent employees on 31 December 2009, corresponding to 579.3 full-time equivalents.

Salaries, pensions and restructuring

Remuneration to governing bodies

The chair of the Supervisory Council receives an annual remuneration of NOK 43 000, the deputy chair receives NOK 27 000 and the other members of the Council receive NOK 21 000. Alternates receive an annual remuneration of NOK 3 500. Members of the Permanent Committee receive an annual remuneration of NOK 43 000. Remuneration to members of the Permanent Committee and the Supervisory Council totalled NOK 641 000 in 2009.

The five external members of the Executive Board receive an annual remuneration of NOK 182 000 each. Alternates receive a fixed annual remuneration of NOK 37 000 with an additional NOK 5 000 for each meeting attended. The chair of the Audit Committee receives an annual remuneration of NOK 66 000, while the other members of the Committee receive NOK 55 000 annually. The members of the Remuneration Committee receive NOK 5 000 for each meeting attended. Total remuneration in 2009 was NOK 1 329 790.

Salaries and pension benefits for Governor of Norges Bank S. Gjedrem, Deputy Governor J.F. Qvigstad

The salaries of the governor and deputy governor of Norges Bank are determined by the Ministry of Finance, and in 2009 a salary of NOK 1 689 964 was disbursed to Svein Gjedrem and NOK 1 605 504 to J.F. Qvigstad. In addition, they each have a company car at their disposal, a free telephone and insurance covered by their employer. The combined value of these benefits is NOK 122 904 and NOK 135 899 respectively. A full retirement pension for the governor is 2/3 of the prevailing salary for the position. A full retirement pension for the deputy governor is 2/3 of final salary adjusted in line with pensions in the National Insurance Scheme. Retirement pensions are payable from the date of retirement, albeit not before the age of 65. The earning period for a full pension is 12 years. The pension is subject to coordination with other public pension schemes. At end-2009, these pension obligations were determined by actuarial assessment to be NOK 11.5m for Governor Gjedrem and NOK 2.1m for Deputy Governor Qvigstad (for his period as deputy governor), taking into account coordination with the National Insurance Scheme. Coordination with other public pension schemes will reduce Norges Bank's expenses. This is not taken into account in the calculations. Changes in 2009 were charged to Norges Bank's operations. Deputy Governor Qvigstad also has pension benefits accrued from his previous period of service at Norges Bank.

Disbursed salaries and pension benefits for other directors at Norges Bank

Figures in millions of NOK

Director	Name	Salary	Total value of other benefits
Norges Bank Financial Stability	K. Gulbrandsen	1 217 976	13 800
Norges Bank Investment Management	Y. Slyngstad	4 044 489	13 800
Norges Bank Monetary Policy	J. Nicolaisen	1 215 531	13 475
Norges Bank Administration	J. Ebbesen	1 178 076	11 800
Legal Department	M. Ryel	1 295 980	19 738
Communications Department	S. Meisingseth	1 115 151	13 800
Internal Audi	I. Valvatne	1 236 121	21 100

Executive directors' salaries are set by the governor of Norges Bank according to guidelines laid down by the Executive Board and annual assessments.

The same pension rights apply to Norges Bank's directors as to other Bank employees, cf. the paragraph on pension schemes. Directors have the same borrowing rights in Norges Bank as the Bank's other employees. Borrowing terms are described in Note 15.

Norges Bank's pension schemes

Norges Bank's ordinary pension obligations are covered by the Bank's own pension fund, which is organised as a separate legal entity. Pension benefits are equal to 2/3 of the employee's salary at the time of retirement. The earning period for a full pension is 30 years of service. Employees contribute 2% of their gross annual salary to the pension fund. Norges Bank's contribution for 2009 was covered partly by cash payments and partly by capital saved in the premium fund. Benefits from the pension fund are coordinated with benefits from the National Insurance Scheme. As from 1 January 2007, the basis for pension benefits covered by funded schemes is limited to an amount equivalent to 12 times the basic pension (G). An unfunded pension scheme funded by operations has been established to cover that portion of salaries that is in excess of 12G for those employees who already had an agreement entitling them to pension over and above this limit. For those employed after 1 January 2007, the basis for pension benefits is limited to 12G. The pension scheme complies with public service pension requirements.

Pension obligations related to funded schemes in Norges Bank amount to NOK 2 108.4m. As from 2009, the assumptions concerning mortality and other demographic factors have been changed from K 1963 to the standard K 2005 basis for group pension insurance. For Norges Bank, the one-time premium was NOK 31.6m. The IR 73 rate is used as a basis for calculating disability provisions. A 3% supplement for future administration costs is priced into the pension obligations. The basis for calculating individual pension obligations is the pension benefits the individual has earned or is receiving at 31 December 2009. Pension obligations are equivalent to the calculated cash value of earned benefits. The Bank's pension scheme covers 2 214 persons, of whom 981 are drawing pensions, 672 are active members (including all those affected by restructuring) and 561 are former members with deferred rights.

Norges Bank's pension and payment obligations

Pension and payment obligations are calculated based on Norwegian accounting standards for pension costs. Norges Bank has funded pension schemes associated with membership in Norges Bank's pension fund. In addition, the Bank has unfunded schemes that are financed directly through operations. These are special and allocated pensions, the unfunded portion of pensions for employees with salaries higher than 12G, as well as early retirement pensions and redundancy pay agreements related to restructuring. The payment obligations related to restructuring include the present value of all agreements, including agreements with disbursements in 2009 or later.

Economic assumptions underlying the calculations:

	2009	2008
Discount rate	5.5 per cent	5.5 per cent
Pension and basic pension rate adjustment	4.25 per cent	3.75 per cent
Expected wage growth	4.5 per cent	4.0 per cent
Expected return on pension capital	6.0 per cent	6.0 per cent
Expected annual attrition	2-3% up to age 50, then 0	do.
Demographic assumptions	K 2005 for death, IR 73 for disability	do.

The Bank's overall pension and payment obligations including employer's contribution were overfunded at the end of 2009. This overfunding can be utilised at a later date and has therefore been recognised on the balance sheet under 'Other liabilities'. It has the following components:

Pension and payment obligations

Figures in millions of NOK

	2009	2008
Funded schemes (overfunding)	–247	–217
Special pensions and allocated pensions	64	58
Payment obligations associated with restructuring	95	114
Unfunded portion of pension, for salaries in excess of 12G	53	46
Norsk Kontantservice AS, part of one-time premium	14	17
Total overfunding of pension and payment obligations	**–21**	**18**

8.1 Pension costs

At end-2009, funded schemes were overfunded. Pension costs are computed in accordance with Norwegian accounting standards for pension costs and include earnings, interest expenses and expected return on the capital in the pension fund for the year.

Figures in millions of NOK

	2009		2008	
Pension costs, funded schemes,which consist of:		122		79
- net present value earnings for the year	71		64	
- interest expenses on pension obligations	134		129	
- expected return on pension capital	–127		–133	
- changes in estimates recognised in the profit and loss account	37		16	
- members' contributions	–8		–7	
- employer's social security contributions	15		10	
Special pensions and allocated pensions		10		7
Pensions financed through operations		7		7
Norsk Kontantservice AS, employees previously employed at Norges		1		1
Net pension costs for the year		**140**		**94**

Norges Bank's share of one-time premiums for employees of Norsk Kontantservice AS formerly employed by Norges Bank is included in pension costs.

The increase in special and allocated pensions (unfunded) is included in the Bank's overall pension costs. These pension costs are shown in the table above.

8.2 Restructuring expenses

Restructuring expenses are related to study packages, redundancy pay and early retirement pensions.

Figures in millions of NOK

	2009	2008
Change in payment obligations during the period	–19	–15
Disbursements from the scheme	36	48
Restructuring expenses including employer's social security contributions	**17**	**33**

8.3 Other operating expenses

Figures in millions of NOK

	2009	2008
Custody and settlement costs	-295	-361
Minimum fees to external managers	-445	-433
Performance-based fees to external managers	-1 425	-508
Other costs	-1 032	-925
Other operating expenses	**-3 197**	**-2 227**

Auditing expenses

Total expenses for Central Bank Audit amounted to NOK 25.9m in 2009, including auditing and certification of the Bank's financial reporting and supervision of the Bank's operations on behalf of the Supervisory Council. The amount includes NOK 12.1m (including VAT) paid to an auditing company for auditing the financial reporting for the GPFG in collaboration with Central Bank Audit. The same auditing company also performed a certification assignment related to the Bank's investment management for NOK 3.3m.

Note 9. Foreign securities

Figures in millions of NOK

	Purchase-price	Fair value	Earned dividend/ yield	Total fair value
Equities:				
Listed equities	94 266	82 966	97	83 063
Total equities	**94 266**	**82 966**	**97**	**83 063**
O which equities lent				***8 445***
Government and government-related bonds:	35 765	34 823	378	35 201
Government bonds	3 753	3 787	79	3 866
Bonds issued by local government	2 011	1 917	35	1 952
Bonds issued by supranational entities	9 712	8 790	180	8 970
Bonds issued by mortgage companies	**51 241**	**49 317**	**672**	**49 989**
Government and government-related bonds				
Inflation-linked bonds:				
Bonds issued by central government	8 213	8 749	44	8 793
Total inflation-linked bonds	**8 213**	**8 749**	**44**	**8 793**

	Purchase price	Fair value	Earned dividend/ yield	Total fair value
Corporate bonds:				
Bonds issued by utilities	2 213	2 179	40	2 219
Bonds issued by financial institutions	15 124	13 171	279	13 450
Bonds issued by industrial companies	8 339	8 230	166	8 396
Total corporate bonds	**25 676**	**23 580**	**485**	**24 065**
Securitised debt:				
Covered bonds	24 840	25 611	544	26 155
Mortgage-backed securities	8 206	7 329	28	7 357
Asset-backed securities	2 900	2 400	7	2 407
Commercial mortgage-backed securities	5 204	3 434	27	3 461
Total securitised debt	**41 150**	**38 774**	**606**	**39 380**
Total Treasury bonds	**0**	**2 960**	**0**	**2 960**
Total bonds and other fixed income instruments	**126 280**	**123 380**	**1 807**	**125 187**
Of which bonds lent				***18 135***

Note 10. Repurchase and reverse repurchase agreements, securities lending and cash collateral paid/received

10.1 Repurchase and reverse repurchase agreements

Norges Bank enters into repurchase and reverse repurchase agreements to finance positions at the lowest possible price and to generate additional income for the portfolio.

The following tables present the repurchase and reverse repurchase agreements recognised on the balance sheet as at 31 December 2009:

Lending

Figures in millions of NOK

	2009	2008
Cash lending	0	1 461
Lending related to repurchase agreements, financing	40 668	37 058
Lending related to repurchase agreements, reinvestment of cash collateral related to securities lending	9 762	14 423
Earned interest, securities lending	7	38
Lending	**50 437**	**52 980**

Borrowing in foreign currency

Figures in millions of NOK

	2009	2008
Borrowing related to deposits	0	57 661
Borrowing related to repurchase agreements	8 633	28 012
Other borrowing	272	0
Borrowing in foreign currency	**8 905**	**85 673**

'Borrowing related to deposits' refers to the credit arrangement with the Federal Reserve Bank, discontinued in 2009, where Norges Bank borrowed USD against equivalent collateral in NOK. In 2008, this collateral was recognised under 'Other assets in NOK'.

10.2 Cash collateral

The portfolio receives cash collateral in connection with securities lending. This collateral is recognised as Norges Bank has access to these holdings in bank accounts. The table below shows the amounts recognised on the balance sheet at year-end:

Figures in millions of NOK

	2009	2008
Cash collateral received in connection with securities lending	16 733	25 738
Cash collateral received in connection with credit agreement with Sedlabanki	0	1 484
Cash collateral received	**16 733**	**27 222**

10.3 Securities lending

Securities lent

The table below shows securities lent out through lending programmes at year-end. These securities are recognised on the balance sheet under 'Equities lent' and 'Bonds lent'.

Figures in millions of NOK

	2009	2008
Equities lent	8 445	10 653
Bonds lent	18 135	29 252
Total securities lending against collateral	**26 580**	**39 905**

Norges Bank has entered into lending agreements with external lending agents. These agreements contain provisions which protect Norges Bank's interests if the borrower of the securities is unable to return them or if the collateral provided for the loan is not sufficient to cover losses.

Collateral received in connection with securities lending

Figures in millions of NOK

	2009		2008	
	Book value	**Fair value**	**Book value**	**Fair value**
Collateral in the form of cash	16 733	16 733	25 738	25 738
Collateral in the form of equities	-	5 163	-	8 026
Collateral in the form of bonds	-	5 570	-	7 367
Total collateral	**16 733**	**27 466**	**25 738**	**41 131**

Reinvestment of cash collateral

Collateral in the form of cash is reinvested in reverse repurchase agreements or diversified bond funds with short maturities and the highest credit rating (Aaa from Moody's). Norges Bank has entered into agreements with foreign commercial banks that manage these funds. The table below shows reinvestments at the end of the year as recorded on the balance sheet (at fair value).

Figures in millions of NOK

	2009	**2008**
Lending associated with reverse repurchase agreements	**9 762**	**14 425**
Asset-backed securities	4 870	6 926
Structured investment vehicles	50	185
Other fixed income instruments	1 664	2 940
Total reinvestment in the form of bonds and other fixed income instruments	**6 584**	**10 051**
Total reinvestment in connection with securities lending	**16 346**	**24 476**

Reinvestments are recognised on the balance sheet under 'Lending associated with reverse repurchase agreements' and 'Bonds and other fixed income instruments'.

Net income of NOK 100m from equities lending and NOK 79m from lending of bonds and other fixed income instruments has been recognised in the profit and loss account under 'Interest income and dividends'. This comprises both income and costs related to lending activities. As a result of positive market developments in 2009, previously recognised unrealised losses of NOK 885m on reinvested cash collateral in the lending programme were reversed in 2009 under 'Change in value financial instruments'. Parts of this relate to holdings sold during the year and are matched by realised gains or losses included in net income from securities lending. The change in unrealised losses during the year for bonds still held at the end of 2009 was recorded to income at NOK 507m. An unrealised loss of NOK 814m was recognised in the profit and loss account for these reinvestments in 2008.

Note 11. Financial derivatives

The table below shows the nominal value of financial derivatives for purchased (long) and sold (short) positions, as exposure. Nominal values are the basis for the calculation of any payment flows and gains/losses for the contracts. Assets (positive) and liabilities (negative) are also shown, at market value

Figures in millions of NOK

	Exposure				Fair value		
	2009		Average 2009		2009		
	Purchased	Sold	Purchased	Sold	Asset	Liability	Net
Foreign exchange contracts	**876**	**307**	**1 142**	**22 839**	**1**	**2**	**-1**
Listed futures	**21 729**	**3 611**	**12 824**	**4 869**	**45**	**12**	**33**
Interest rate swaps	416	5 039	8 516	5 336	137	196	-59
Total return swaps	0	0	1	0	0	0	0
Credit default swaps	364	41	127	1 022	0	22	-22
Equity swaps	6	0	67	1	0	1	-1
Total swaps	**786**	**5 080**	**8 711**	**6 359**	**137**	**219**	**-82**
Options	**3 911**	**1 234**	**4 372**	**1 846**	**181**	**64**	**117**
Total financial derivatives	**27 302**	**10 232**	**27 049**	**35 913**	**364**	**297**	**67**

Foreign exchange contracts

This item consists of foreign exchange transactions (futures contracts) with normal settlement for future delivery. Exposure is the sum of the nominal value of the contracts entered into.

Listed futures

Exposure is the market value of the underlying instruments.

Unlisted (OTC) financial derivatives

Interest rate swaps

Interest rate swaps and foreign exchange swaps are included in this item. Exposure is nominal and indicates whether Norges Bank receives (contracts purchased) or pays (contracts sold) a fixed rate.

Total return swaps

With a total return swap (TRS), the protection purchaser transfers the total return on an underlying credit to the protection seller in return for a fixed or floating rate of interest. Total return denotes the sum of coupon payments and any change in value. The underlying assets for the TRSs in which the investment portfolio is invested are commercial mortgage-backed security (CMBS) and mortgage-backed security (MBS) indices.

Exposure is nominal and indicates whether Norges Bank receives (contracts purchased) or pays (contracts sold) the index return.

Credit default swaps

With a credit default swap, the protection seller receives a periodic premium or lump sum from the protection purchaser as compensation for assuming the credit risk. The protection purchaser receives payment from the seller only if the credit protection of the underlying credit is triggered (credit event). A credit event might include default on the underlying credit/bond. The protection normally expires after the first credit event.

The underlying assets for credit default swaps are corporate bonds, securities issued by nation states, corporate bond indices, asset-backed security (ABS) indices and commercial mortgage-backed security (CMBS) indices.

Exposure indicates whether Norges Bank has purchased or sold protection for all or part of the credit risk associated with the various types of underlying assets.

Equity swaps

Equity swaps are agreements between two counterparties to swap cash flows based on changes in the underlying instrument, which may be an equity, a group of equities or an index. In addition, payments are received in connection with dividends and corporate events.

Exposure corresponds to the market value of the underlying equities or indices.

Options

Exposure is the market value of the underlying security. Options written by the Norges Bank portfolio are shown in the table under 'Sold'. Options where Norges Bank pays a premium are shown in the table under 'Purchased'.

Note 12. Claims on the IMF

Figures in millions of NOK

	2009	2008
Quota in the IMF	15 139	18 045
Holdings in constant SDRs	-12 198	-15 410
Reserve position in the IMF	**2 941**	**2 635**
Special Drawing Rights (SDRs)	14 493	3 060
Loans to the IMF	710	0
Earned interest	1	4
Claims on the IMF	**18 145**	**5 699**
Equivalent value of allocated Special Drawing Rights	**-14 156**	**-1 811**

The IMF's task is to promote international monetary and financial stability. The GPFG gives advice to member countries and provides temporary funding in the event of balance of payments problems. The IMF quota (SDR 1 671.7m) determines the member country's financial contribution to the IMF and provides the basis for determining the amount of financing the member can obtain in the event of balance of payments problems.

The IMF can use Special Drawing Rights (SDRs) as an instrument for supplying international liquidity. The value of SDRs is calculated on the basis of a currency basket comprising US dollars, euros, sterling and Japanese yen.

The equivalent value of allocated SDRs in the IMF shows total allocations of SDRs since the scheme entered into force in 1970. SDR 1 395.3m was allocated in 2009, and total allocations stood at SDR 1 563m at the end of the year.

Note 13. International reserves, by portfolio

Relationship between different reserve terms used in Norges Bank's publications:

Portefolios

Figures in millions of NOK

	2009				
	Portfolios				
	Invest-ment	Money-market	Buffer	IMF reser-ves, etc.	Total
Securities and deposits	198 658	13 881	13	49	212 602
Other foreign exchange reserves	12 643	29 631	8 520	710	51 505
Foreign exchange reserves according to IMF definition	**211 301**	**43 512**	**8 534**	**760**	**264 107**
IMF reserve position/SDRs	0	0	0	17 434	17 434
International reserves	**211 301**	**43 512**	**8 534**	**18 194**	**281 541**
Foreign exchange claims, foreign	816	0	0	809	1 625
Foreign exchange liabilities, foreign	-1 821	-6	0	-668	-2 494
- IMF reserve position/drawing rights and loans	0	0	0	-18 145	-18 145
Borrowing (foreign exchange liabilities)	-25 638	0	0	0	-25 638
Foreign exchange reserves according to Norges Bank's financial statements	**184 658**	**43 507**	**8 534**	**191**	**236 890**
Foreign exchange claims, domestic	16	0	0	0	16
Outstanding accounts, separate portfolios under management	769	0	2 424	0	3 193
Unrecognised unsettled cash agreements	0	0	-4 386	0	-4 386
Foreign exchange for management	**185 444**	**43 507**	**6 572**	**191**	**235 713**

Distribution of foreign exchange reserves under 'Foreign exchange for management'

Figures in millions of NOK

	2009							
	USD	CAD	EUR	GBP	JPY	SDR	Other	Total
Securities and deposits	73 155	4 424	78 649	27 102	10 287	0	18 985	212 602
Other foreign currency reserves	18 258	0	30 463	1 697	-31	710	406	51 505
Foreign exchange reserves according to IMF definition	**91 413**	**4 425**	**109 112**	**28 799**	**10 256**	**710**	**19 392**	**264 107**
IMF reserve position/SDRs	0	0	0	0	0	17 434	0	17 434
International reserves	**91 413**	**4 425**	**109 112**	**28 799**	**10 256**	**18 145**	**19 392**	**281 541**
Foreign exchange claims, foreign	804	0	692	11	3	94	21	1 625
Foreign exchange liabilities, foreign	-1 851	26	-322	-294	-15	-23	-14	-2 494
- IMF reserve position/drawing rights and loans	0	0	0	0	0	-18 145	0	-18 145
Borrowing (foreign exchange liabilities)	-8 356	-202	-11 515	-5 238	-79	0	-249	-25 638
Foreign exchange reserves according to Norges Bank's financial statements	**82 010**	**4 248**	**97 967**	**23 278**	**10 165**	**71**	**19 150**	**236 890**
Foreign exchange claims, domestic	0	0	0	0	0	0	16	16
Outstanding accounts, separate portfolios under management.	2 033	66	1 101	131	-140	0	2	3 193
Unrecognised unsettled cash agreements	-1 794	0	-2 592	0	0	0	0	-4 386
Foreign exchange for management	**82 250**	**4 314**	**96 476**	**23 409**	**10 025**	**71**	**19 168**	**235 713**

Risk and valuation

Norges Bank's foreign exchange reserves include an investment portfolio and a money market portfolio. These portfolios have different purposes, and their risk profiles will therefore differ. The following presents briefly how each portfolio is risk-assessed and valued.

Risk management is a key activity for Norges Bank. Processes have been established to identify, measure and monitor the most important risks to which Norges Bank is exposed through its operations. The four main areas are: market risk, credit risk, counterparty risk and operational risk. Requirements relating to risk management and measurement are laid down in the Executive Board's guidelines.

Risk and valuation in the investment portfolio

Financial markets stabilised during the course of 2009. Greater risk appetite, somewhat better growth expectations for the global economy and improved liquidity in bond markets led to rising prices for equities, bonds and commodities from March 2009 through to the end of the year. Although still considered to be substantial in parts of the portfolio, price uncertainty overall is very different to the end of 2008 and is now believed to have returned to a level that lends credibility to valuations.

Market risk

Market risk is risk related to changes in the value of the portfolio due to changes in interest rates, equity prices and/or exchange rates. Norges Bank measures the portfolio's absolute and relative market risk.

Absolute risk is estimated on the basis of the actual portfolio. The standard deviation is a statistical term that indicates the magnitude of variation that can be expected in the return on the portfolio. The table below illustrates market risk, expressed as expected annual standard deviation, in the actual investment portfolio at an overall level and for the two asset classes.

	Risk measure	31 Dec 2009	Min 2009	Max 2009	Average 2009	31 Dec 2009
Total risk, portfolio	St. deviation	7.0 %	7.0 %	20.1 %	12.6 %	20.3 %
Equity portfolio	St. deviation	9,8 %	9,8 %	35,2 %	20,4 %	36,4 %
Fixed income portfolio	St. deviation	9,7 %	9,7 %	22,3 %	15,5 %	22,1 %

The figure for risk at end-2009 means that in two out of every three years the value of the portfolio is expected to fluctuate within +/-7.19% of total market value (one standard deviation) based on the actual portfolio at that time. Market risk decreased considerably in 2009, with the estimated expected risk of fluctuations falling particularly in the first half of the year. Market risk can also be expressed based on the actual fluctuations in the portfolio through the year. Based on actual portfolio fluctuations, this risk measure averaged 12.1% during the year and stood at 6.5% on 31 December 2009.

The decrease in risk level is due to a reduction in volatility and to the market situation largely normalising during the course of 2009. No changes were made to the benchmark portfolio for the foreign exchange reserves during the year.

Risk model

The model used calculates the expected standard deviation for the portfolio based on the composition of the portfolio and assumptions about sensitivity to fluctuations in relevant market factors and correlations between them. Norges Bank conducts risk calculations on a regular basis. Parametric calculation and calculation based on Monte Carlo simulation are both used. Parametric calculation involves risk modelling based on an assumption that changes in market prices are normally distributed, while Monte Carlo simulation involves generating a large number of simulated returns and the associated distribution. In both cases, expected risk can be inferred from the distribution in the form of a standard deviation, i.e. a measure of expected fluctuations in the value of the portfolio. Parametric calculation was used in the calculation of the figures in the table above. Volatility and correlation are estimated based on daily historical data where more importance is attached to recent market data than to older data. As a result, this risk model reacts very quickly to market changes.

Risk models, strengths and weaknesses

Estimated volatility is a strategic measure of risk which captures and measures correlation in the portfolio's exposure across asset classes, markets, instruments and currencies.

A risk model capable of capturing these relationships and providing an overall estimate of risk is important because the GPFG is well-diversified. As this is a model-based estimate, its accuracy will depend entirely on the assumptions behind the model. When using this model, it is essential to be aware of its most important weaknesses:

- Estimated volatility estimates risk over a given time period and assumes that exposure is liquid and can be closed within the designated time period.
- Estimated volatility says something about risk under normal market conditions and will underestimate risk in stressed markets.
- Estimated volatility gives a point estimate of risk, but says little about the overall risk profile (tail risk).
- Annualisation of daily risk data means that volatility and portfolio composition are expected to be constant over time. There is also an assumption that the expected return in successive periods is zero (random walk).

Liquidity risk

Norges Bank defines liquidity risk in relation to the management of the foreign exchange reserves as the ability to make planned or unexpected changes in the composition of the investment portfolio due to exogenous or endogenous factors without incurring unusually high transaction costs. Management of liquidity risk is integrated throughout the control structure.

For the portfolio's positions in equity markets, the measurement of these management variables is not associated with major challenges since the portfolio comprises equities listed on regulated exchanges. There are a few exceptions, however, as some local exchanges do not function satisfactorily. For fixed income instruments, measurement is automatically more complex due to a high proportion of unlisted instruments. Market developments since summer 2007 have also presented a number of problems in terms of quantitative measures of liquidity for fixed income instruments.

Relative to 2008, liquidity risk fell back substantially during 2009. Liquidity has gradually returned to large parts of the fixed income market, which came to a virtual standstill following the Lehman Brothers bankruptcy. The ability to change the composition of the fixed income portfolio is therefore much greater now than in 2008. Liquidity in the fixed income market is nevertheless still markedly lower than before the turmoil erupted.

Credit risk

Credit risk is the risk of losses if issuers of fixed income instruments default on their payment obligations to Norges Bank. Another form of credit risk is the counterparty risk that arises through derivatives, foreign exchange contracts and repurchase/reverse repurchase agreements. Settlement risk, which arises in connection with the purchase and sale of securities, where not all transactions take place in real time, also involves counterparty risk.

Credit risk arises in the investment portfolio partly in the fixed income portfolio as a result of the Ministry of Finance's choice of investment strategy and partly as a result of Norges Bank's active management. All fixed income instruments in the portfolio's benchmark index have a rating from one of the major credit rating agencies: Standard & Poor's, Moody's and Fitch. All three agencies classify the issuers of fixed income instruments on the basis of their creditworthiness. A credit rating scale from AAA to D is used for long-term bonds. The highest rating is AAA from S&P and Fitch and Aaa from Moody's. The lowest investment grade ratings are BBB from S&P and Fitch and Baa from Moody's. Lower ratings are termed non-investment grade. All bonds in the portfolio's benchmark index have an investment grade rating. The table below breaks down the fixed income portfolio on the basis of credit ratings from at least one of the rating agencies at the end of the year.

Fixed income portfolio by credit rating[1]:

Figures in millions of NOK

	Aaa\AAA	Aa\AA	A	Baa\BBB	Ba\BB	Lower	No rating	Totalt
Government and government-related bonds	31 116	7 262	2 099	1 416	-	22	890	42 805
Inflation-linked bonds	5 020	3 493	179	-	-	-	101	8 793
Corporate bonds	365	4 773	10 986	7 116	535	247	43	24 065
Securitised debt	28 923	7 582	594	354	223	1 582	123	39 381
Total bonds and other fixed income instruments	**65 424**	**23 110**	**13 858**	**8 886**	**758**	**1 851**	**1 157**	**115 044**

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

The table below shows exposure to credit derivatives:

Figures in millions of NOK

	Nominal amount	Fair value
Credit default swaps, protection purchased	364	-21
Credit default swaps, protection sold	41	0

Protection purchased implies that the portfolio's credit risk has been reduced, while protection sold implies increased credit risk. Overall, credit exposure has been reduced slightly through credit default swaps. These contracts relate primarily to credit risk in the Baa, Ba and lower categories.

Norges Bank introduced credit risk models for parts of the fixed income portfolio (corporate bonds) during the course of 2009. These provide a basis for statistically based calculations of the probability of default and expected losses in the longer term.

Counterparty risk

Norges Bank is also exposed to risk vis-à-vis counterparties in the execution of transactions, vis-à-vis the custodian institutions with which securities are deposited, and vis-à-vis international settlement and custody systems (counterparty risk). The equity and fixed income portfolios include investments in unsecured bank deposits, OTC derivatives and foreign exchange contracts. Derivatives are used for both trading and hedging purposes in the portfolio. Repurchase/reverse repurchase agreements also give rise to counterparty risk.

Norges Bank monitors counterparty risk partly by demanding high credit ratings of counterparties both initially and subsequently. These requirements are more stringent for unsecured credit exposure than for credit exposure with some form of collateral. The Executive Board has decided that no counterparties involved in such transactions may have a credit rating lower than A-/A3/A- from Fitch, Moody's or S&P, respectively. 76% of Norges Bank's approved counterparties have a rating of AAA to A. Transactions with other counterparties are made only where settlement is on a delivery-versus-payment basis, i.e. ownership of an asset and payment are simultaneous. Changes in counterparties' credit quality are monitored continuously, partly through the use of alternative credit indicators such as equity volatility and the price of bankruptcy insurance. Counterparty risk is controlled against fixed credit risk limits set for each counterparty by measuring expected future exposure.

The table below shows counterparty risk associated with positions in financial derivatives, foreign exchange contracts and repurchase/reverse repurchase agreements (contracts with a positive market value) at year-end, and bank balances and receivables related to unsettled trades. Both book values and expected future exposure (counterparty risk) are shown in the table below. The method used to calculate counterparty exposure is in accordance with the UK Financial Services Authority (FSA) method described in its Handbook. This method is called the mark-to-market method, and counterparty exposure is calculated based on market value with an add-on to reflect the degree of volatility. With repurchase/reverse repurchase agreements, allowance is made for actual collateral.

Figures in millions of NOK

	2009		2008
	Counterparty risk	**Book value**	**Book value**
Foreign exchange contracts	6	1	50
Credit default swaps	4	-	813
Interest rate swaps	171	136	2 841
Total return swaps	-	-	16
Equity swaps	-	-	12
Options	175	182	739
Total financial derivatives	**356**	**319**	**4 471**
Bank deposits	**561**	**561**	**3 145**
Repurchase/reverse repurchase agreements	**2 733**	**3 648**	**-**
Unsettled trades – assets	**802**	**802**	**7 644**
Total	**4 452**	**5 330**	**15 260**

The positions are shown before netting, and collateral provided is not taken into account. To reduce counterparty risk, Norges Bank has entered into bilateral netting agreements for OTC derivatives and foreign exchange contracts. Norges Bank has strict collateral requirements for such exposures. The thresholds for requiring collateral are set at between EUR/USD 0 and EUR/USD 50m, measured as the net positive market value per counterparty.

Fair value measurement of financial instruments

Control environment

An extensive process for daily valuation of the positions in the portfolio has been established involving sourcing and verification of prices from both external accounting service providers and Norges Bank's operating units. Valuations are subject to a number of additional control procedures at Norges Bank at each month-end with the aim of ensuring that prices used for valuations are in line with established valuation procedures and the fair value principle. At the end of each quarter, a valuation memo and report are prepared documenting the results of the controls performed and the status of the valuations. These are reviewed by a valuation committee, which is a forum for escalating significant pricing issues and which formally approves the valuations.

Establishing fair value

A hierarchy of independent price sources established by Norges Bank is used. Holdings included in the benchmark indices are normally priced in accordance with the index suppliers' pricing, while the remaining holdings of equities and bonds are mostly priced by recognised external independent price providers. Price verification analyses are performed to compare prices from the established hierarchy with alternative available price sources. Where alternative price sources will be more representative of fair value, price adjustments are made to bring valuations closer to expected fair value.

All equity and bond holdings in the portfolio have been divided into categories of estimated price uncertainty. Category 1 consists of investments that are valued based on observable market prices in active markets and are considered to have very limited valuation risk. Investments in category 2 are priced based on models with observable data points. These holdings are subject to some price uncertainty in terms of establishing fair value, but overall this valuation risk is considered to be limited. Holdings allocated to category 3 are model-priced with considerable uncertainty surrounding the establishment of fair value. However, a substantial share of these investments is priced by external professional price providers considered to provide the best available estimates of fair value, and the overall valuation from different price providers varies to only a limited extent.

The table below breaks down investments into categories of estimated price uncertainty as at 31 December 2009:

Figures in millions of NOK

Categories of investments by price uncertainty	Observable market prices		Model pricing with observable data points		Model pricing with greater uncertainty about fair value		Total	
	2009	**2008**	**2009**	**2008**	**2009**	**2008**	**2009**	**2008**
Equities and units	83 050	69 943	13	7	1	13	83 064	69 962
Bonds	52 501	65 794	58 517	85 818	4 026	11 099	115 044	162 711
Total	**135 551**	**135 737**	**58 530**	**85 825**	**4 027**	**11 112**	**198 108**	**232 673**

Almost all of the equity holdings in the portfolio are classified as category 1 positions with limited valuation risk, as official closing prices are available from an exchange in an active transaction market. Equity holdings classified as category 2 consist mainly of relatively illiquid equities where pricing is modelled based on similar but more liquid equities issued by the same company. Valuation risk is generally relatively limited, as the modelling is simple and the data points included in the model are observable. Equities classified as category 3 consist of a small number of equities where pricing is particularly uncertain as a result of suspension of trading due to special situations such as bankruptcy, nationalisation, liquidation etc.

The price uncertainty picture is more complex for bond investments. Norges Bank performs analyses to determine levels of actual transactions and price transparency with the associated liquidity in the market for the various types of bond and for a number of specific bonds at the balance sheet date. The pricing of most government bonds is based on observable market prices in an active market with quotes and frequent transactions. Government-related and inflation-linked bonds are divided between categories 1 and 2 based on the Bank's analyses of liquidity and levels of trading and price transparency in the markets. This analysis shows a relatively high level of observed liquidity for these bonds. Most corporate bonds are considered to be priced by models with observable data points, while a small number of particularly illiquid corporate bonds belong to category 3. Securitised debt is distributed across all three categories based on the complexity of model data points and levels of liquidity, actual transactions and price transparency in the markets. Covered bonds are included in the observable categories 1 and 2 based on relatively high levels of liquidity and price transparency in the markets. A number of highly liquid guaranteed mortgage-backed securities that are not tranched are classified as priced using models with observable data points. Securitised debt considered to be tranched, with the result that it has particularly high exposure to model data points that are not observable, belongs to category 3. Other securitised debt is divided between the model pricing categories 2 and 3 based on lower observed levels of liquidity and price transparency in the markets.

Total exposure considered particularly uncertain in terms of correct pricing was NOK 4.0bn at the end of 2009. This consisted almost exclusively of US securitised debt not guaranteed by a federal agency (NOK 0.7bn) where comparisons of available price sources suggest high levels of price uncertainty. In addition, some types of US securitised debt guaranteed by a federal agency have been reclassified from category 2 to category 3 due to considerable uncertainty about one of the input parameters in the models, first and foremost the risk of early repayment of principal. The remaining exposure consists of various other types of investments where pricing was considered particularly uncertain due to limited availability of prices from external price providers or large observed discrepancies between prices from different price providers.

The size of the price uncertainty associated with category 3 positions is difficult to estimate precisely. While the average price uncertainty for individual securities in this category is expected to be +/-10%, the group as a whole is expected to have somewhat lower price uncertainty due to diversification effects. Estimated valuation uncertainty for this category has therefore been calculated at approximately +/-NOK 2-3bn.

There was an overall decrease of NOK 7.1bn in exposure to investments classified as particularly uncertain in terms of establishing fair value, from NOK 11.1bn at the end of 2008. Much of the decrease can be attributed to the reclassification of most European securitised debt from category 3 to category 2 due to improved liquidity and price transparency (NOK 5.5bn). The remainder of the decrease in exposure was due to maturation and repayment of principal, as well as some sales of securitised debt.

The evaluation of price uncertainty for the most illiquid investments was refined further during the course of 2009. The main aim of this evaluation is to identify whether there is a need for further value adjustments in the establishment of fair value. Although uncertainty about fair value in some segments of the portfolio is still considered to be substantial, the result of the valuation based on ordinary price sources in line with the established price provider hierarchy as at 31 December 2009 is perceived to give an accurate picture of market values in accordance with the fair value principle without a need for accounting provisions for price uncertainty. Norges Bank's analyses show that the price sources have largely priced in the illiquidity prevailing in the market at the end of 2009.

Comparisons of valuations of particularly uncertain positions from the various external price providers performed at the end of 2009 confirm the valuation based on the established pricing hierarchy, and the total valuation differences are considered to be acceptable. Overall, the valuation of these uncertain positions performed by alternative price sources was marginally higher than the valuation used. The valuation adjustment of NOK 0.5bn recognised at the end of 2008 was therefore reversed in full during the course of 2009.

RISK IN THE MONEY MARKET PORTFOLIO

Purpose of the portfolio

The money market portfolio is to be invested in such a way that it can be used at short notice as a monetary policy instrument or to promote financial stability. The portfolio is also used to meet Norges Bank's international obligations, including transactions with the IMF and loans to individual countries, and to carry out foreign exchange transactions on behalf of the Government Petroleum Insurance Fund.

Market risk

Market risk is risk related to changes in the value of the portfolio due to changes in interest rates and/or exchange rates. Norges Bank measures the portfolio's absolute and relative market risk.

The portfolio's market risk is largely determined by the benchmark portfolio's market risk. The normalisation of financial markets towards the end of 2009 meant that the management of the money market portfolio could be restructured. During this restructuring period, Norges Bank had only very limited risk beyond the risk associated with the benchmark portfolio's market risk.

Absolute risk is estimated based on the actual portfolio, as the standard deviation of the return. The standard deviation is a statistical term that indicates the magnitude of variation that can be expected in the return on the portfolio. The expected annual standard deviation in the actual portfolio was 0.6% in local currency and 11.9% in NOK at the end of 2009.

The figure for risk at end-2009 means that in two out of every three years the value of the portfolio is expected to fluctuate within +/-0.6% of total market value (one standard deviation) based on the actual portfolio at that time.

Market risk at the end of 2009 was moderate relative to historical market risk for equivalent portfolios.

Risk model

The model used calculates the expected standard deviation for the value of the portfolio based on the composition of the portfolio and assumptions about sensitivity to fluctuations in relevant market factors and correlations between them. A parametric weighted model was used to calculate the figures above.

Liquidity risk

Norges Bank defines liquidity risk in relation to the management of the money market portfolio as the ability to make planned or unexpected changes in the composition of the portfolio due to exogenous or endogenous factors without incurring unusually high transaction costs. Liquidity risk in the money market portfolio is very limited, as the portfolio must consist of at least 10% cash, and the securities portion of the portfolio may consist only of US and European government bills and bonds and standardised exchange-traded futures.

Credit risk

Credit risk is the risk of losses if issuers of fixed income instruments default on their payment obligations to Norges Bank. Another form of credit risk is the counterparty risk that arises through derivatives and foreign exchange contracts. Settlement risk, which arises in connection with the purchase and sale of securities, where not all transactions take place in real time, also gives rise to counterparty risk.

The limits for exposure to a particular bank (exposure limits) include time deposits and trading in foreign exchange (spot, forward and swap transactions). Maximum exposure to the most creditworthy banks has been set at NOK 1bn. Unsecured deposits may be made with counterparties with a minimum long-term rating of AA-/AA-/Aa3 respectively from one of the three major rating agencies: S&P, Fitch and Moody's. Transactions are not permitted with a counterparty that has received a rating lower than A-/A-/A3 from one of the three agencies.

Money market portfolio

Figures in millions of NOK

	Aaa/AAA
US government bonds	6 024
US Treasury bills	4 125
Exchange-traded interest rate futures	–2
Total	**10 147**

The money market portfolio also had the equivalent of NOK 42.1bn in cash invested as deposits against collateral in the form of government securities

Note 14. Other assets in foreign currency

Figures in millions of NOK

	2009	**2008**
BIS shares	94	94
Unsettled trades	802	7 644
Other assets	58	78
Long-term lending, foreign	671	0
Other assets in foreign currency	**1 625**	**7 816**
Allocated, unpaid shares in BIS	**-269**	**-324**

Norges Bank has been allocated a total of 8 000 shares at SDR 5 000 in the Bank for International Settlements (BIS). 25% of the shares, valued at NOK 25m, have been paid for. Norges Bank has not paid up the share capital for 75% of the shares. There is a conditional liability amounting to NOK 292m attached to shares purchased and allotted. The portion of the conditional liability corresponding to the value of the shares at the time of allotment, i.e. NOK 23m, is recognised under the item 'Other foreign liabilities'. The remainder of the conditional liability, NOK 269m, is not recognised on the balance sheet but shown in the Notes. In 2009, dividends on BIS shares amounted to NOK 22m.

Sedlabanki Islands drew NOK 671m under a bilateral loan agreement with Norges Bank in 2009. The loan is guaranteed by the Icelandic and Norwegian governments.

Note 15. Lending to banks etc.

Figures in millions of NOK

	2009	2008
Lending to banks, fixed-rate loans	75 442	79 662
Lending to Norges Bank's employees	487	496
Lending to banks etc.	**75 929**	**80 158**

Lending to banks is in the form of fixed-rate loans provided against collateral in approved securities. Loan maturities averaged 2 months in 2009, as against an average of 4.2 months in 2008.

The Bank's loan scheme for its employees comprises mortgages and consumer loans. Mortgages are provided in accordance with guidelines from the Supervisory Council as first mortgages within 85% of estimated value, limited to NOK 2 230 000 and a maximum term of 30 years. Consumer loans are limited to a maximum of four times the monthly salary. The loan schemes apply to all employees. In 2009, the interest rate was linked to the norm rate (i.e. the norm rate for low-interest loans from an employer). The Ministry of Finance sets the norm rate up to 6 times a year, and in 2009 interest rates decreased from 6.00% to 2.0%.

Note 16. Other financial assets in NOK

Figures in millions of NOK

	2009	2008
Fee for management of the GPFG	3 228	2 165
Capital deposited in Norges Bank's pension fund	142	142
Domestic deposits	38	26
Other assets	3 221	27
Other financial assets in NOK	**6 629**	**2 359**

Note 17. Fixed assets

Figures in millions of NOK

	Vehicles Machinery IT-equipment	Security system	Machinery Fixtures	Building with installa-tions	Head office Bankpl. 2	Building under construc-tion	Bank's holiday cabins	Land	Total
Original cost at. 1.1.	209 337	70 036	13 211	418 710	1 657 410	302 494	3 386	59 881	2 734 465
+Transfers from building under construction	80 303	0	0	221 153	0	-301 456	0	0	0
+Additions	31 797	0	254	149 756	0	25 658	0	0	207 465
- Disposals	63 593	7 409	101	0	0	0	2 950	0	74 053
-/+Adjustments	0	0	0	0	0	0	0	0	0
Original cost as at 31.12.	257 844	62 626	13 364	789 619	1 657 410	26 696	436	59 881	2 867 876
- Accum. depreciation and write-downs	115 015	37 120	7 130	395 717	709 213	0	0	0	1 264 195
Book value as at 31.12.	**142 829**	**25 506**	**6 233**	**393 902**	**948 197**	**26 696**	**436**	**59 881**	**1 603 681**
Undepreciated remainder of previously revalued assets	0	0	0	3 086	923 576	0	0	56 580	983 242
Ord. depr. for the year	**19 566**	**9 383**	**1 751**	**18 799**	**37 193**	**0**	**0**	**0**	**86 692**
Write-downs for the year	**0**	**0**	**0**	**80 000**	**0**	**0**	**0**	**0**	**80 000**
Share of ord. depr. relating to previously revalued assets	0	0	0	771	36 243	0	0	0	37 014
Depreciation schedule, no of years	5-10	5-10	5-10	5-27	20-50	0	0	0	

The conversion of the former printing works' industrial premises into offices was completed in autumn 2009 at a total cost of around NOK 400m. A calculation of fair value based on a 2% required rate of return and a 30-year depreciation period has resulted in this asset being written down by NOK 80m. The premises have been let for a period of 15 years with options to extend for up to two further five-year periods.

Note 18. Other liabilities in foreign currency

Figures in millions of NOK

	2009	2008
Share capital in BIS not paid up (cf. Note 14)	23	23
Unsettled trades	1 528	10 929
Other liabilities	646	1 183
Other liabilities in foreign currency	**2 197**	**12 135**

Note 19. Notes and coins in circulation

The Bank's cash holdings have been deducted from the item 'Notes and coins in circulation'. Notes and coins in circulation are recognised at NOK 54.3bn and consist of NOK 49.5bn in banknotes and NOK 4.8bn in coins.

Norges Bank is obliged to redeem notes and coins for 10 years following the decision to withdraw them as legal tender. Norges Bank has been flexible about redeeming expired notes after the expiry of the 10-year time-limit. In 2009, redeemed/invalidated banknotes and coins amounting to NOK 4.4m were charged as an expense in Norges Bank's financial statements.

At 31 December 2009, there were a total of approximately 5.4m commemorative coins in circulation with a nominal value of about NOK 0.5bn. This amount is not included in the item 'Notes and coins in circulation'. Norges Bank is under obligation to redeem the coins at their nominal value.

Note 20. Deposits from banks etc.

Figures in millions of NOK

	2009	2008
Deposits from banks	80 215	100 858
Other deposits	93	92
Deposits from banks etc	**80 308**	**100 951**

Note 21. Other liabilities in NOK

Figures in millions of NOK

	2009	2008
Outstanding accounts with other portfolios under management	0	16 259
Pension and payment obligations (cf. Note 8)	-21	19
Other liabilities	436	487
Other liabilities in NOK	**415**	**16 765**

Outstanding accounts with other portfolios under management comprises the net value of deposits, short-term borrowing, repurchase agreements and reverse repurchase agreements vis-à-vis other portfolios managed by Norges Bank. These related-party transactions were performed on an arm's length basis.

Note 22. Adjustment fund

Figures in millions of NOK

	2009	2008
Adjustment Fund balance as at 1 January	58 864	55 488
Transferred from	-7 567	0
Allocated to	0	3 376
Adjustment Fund balance as at 31 December	**51 298**	**58 864**

Note 23. Other capital

Figures in millions of NOK

	2009	2008
Revaluation Fund as at 1 January	1 023	1 060
Reversals from the Fund during the year	-40	-37
Revaluation Fund as at 31 December	**983**	**1 023**

Note 24. Government Pension Fund Global (GPFG)

The Ministry of Finance has a krone account in Norges Bank relating to the GPFG of NOK 2 636.8bn. The corresponding value of the krone account is managed by Norges Bank and is invested in foreign currency securities in a separate portfolio. The krone deposits and the managed portfolio are recognised in Norges Bank's balance sheet under 'Deposits in krone account Government Pension Fund Global' (liabilities) and 'Investments for Government Pension Fund Global' (assets). The return on the portfolio was positive in 2009 and NOK 195.2bn was transferred to the krone account. This is recognised in the profit and loss account under 'Return on investments for Government Petroleum Fund Global' and 'Transferred from/ to krone account for Government Pension Fund Global'. The investments represent no financial risk to Norges Bank.

Separate financial statements have been prepared for the GPFG. The profit and loss account, balance sheet and notes (GPFG 1-9) follow:

Profit and loss account

Figures in millions of NOK

	Note	2009	2008
Profit/loss on the management of the GPFG before exchange rate			
Interest income, deposits in foreign banks		462	494
Interest income, lending related to reverse repurchase agreements		696	14 189
Net income/expenses and gains/losses from:			
- equities and units	3	488 082	-595 304
- bonds and other fixed income instruments	3	118 971	-686
- financial derivatives		7 398	-31 210
Interest expenses, borrowing related to repurchase agreements		-2 571	-20 124
Other interest expenses		-60	-613
Other expenses		-193	45
Profit/loss before exchange rate adjustments	**1**	**612 785**	**-633 209**
Exchange rate adjustments		-417 607	506 163
Profit/loss before management fee		**195 178**	**-127 046**
Management fee	2	-3 228	-2 165
Profit/loss for the year		**191 950**	**-129 211**

	Note	2009	2008
BALANCE SHEET			
ASSETS	**Note**	**2009**	**2008**
FINANCIAL ASSETS			
Bank deposits		4 644	18 111
Lending associated with reverse repurchase agreements	3	191 473	274 132
Cash collateral paid	3	140	114
Equitied and units	4	1 496 759	943 337
Equities lent	3,4	150 847	182 612
Bonds and other fixed income instruments	4	908 222	1 421 565
Bonds lent	3,4	161 990	191 482
Financial derivatives	5	2 263	39 579
Unsettled trades		17 572	102 574
Other assets	6	251	17 164
Total financial assets	**8,9**	**2 934 161**	**3 190 670**

LIABILITIES AND CAPITAL			
FINANCIAL LIABILITIES			
Short-term borrowing	3	6 238	133
Borrowing associated with repurchase agreements	3	109 536	514 395
Cash collateral received	3	154 676	188 608
FInancial derivatives	5	8 118	75 899
Unsettled trades		11 925	132 718
Other liabilities	6	3 625	3 463
Management fee payable		3 228	2 165
Total financial liabilities	**8,9**	**297 346**	**917 381**
Owners' capital	7	2 636 815	2 273 289
Total liabilities and owners capital		**2 934 161**	**3 190 670**
The Government Pension Fund Global is presented in the following way on the balance sheet of Norges Bank:			
Assets			
Investment for the Government Pension Fund Global		2 636 815	2 273 289
Liabilities			
Deposits in krone account Government Pension Fund Global		2 636 815	2 273 289

GPFG 1. Profit/loss before exchange rate adjustments

Figures in millions of NOK

	Interest	Divi-dends	Income/ expensn	Realised gains/ losses	Unre-alised. gains/ losses	Total
Interest income, deposits in foreign banks	462	0	0	0	0	462
Interest income, lending associated with reverse repurchase agreements	696	0	0	0	0	696
Net income/expenses and gains/losses from:						
- equities and units	0	38 632	1 707	-69 134	516 877	488 082
- bonds and other fixed income instruments	56 800	0	457	1 081	60 633	118 971
- financial derivatives	-6 195	0	0	-15 483	29 076	7 398
Interest expenses, borrowing associated with Repurchase agreements	-2 571	0	0	0	0	-2 571
Other interest expenses	-60	0	0	0	0	-60
Other expenses	0	0	-193	0	0	-193
Profit/loss before exchange rate adjustments	**49 132**	**38 632**	**1 971**	**-83 536**	**606 586**	**612 785**

GPFG 2. Management costs

Figures in thousands of NOK

	2009		2008	
	Amount	**Per cent**	**Amount**	**Per cent**
Internal costs	779 520		658 423	
Custody and settlement costs	289 279		341 135	
Minimum fees to external managers	431 931		420 376	
Performance-based fees to external managers	1 401 762		486 859	
Other costs	325 488		258 430	
Total management fee	**3 227 979**	**0,14**	**2 165 223**	**0,11**
Total management fee excl. performance-based fees	1 826 217	0,08	1 678 364	0,08

GPFG 3. Repurchase and reverse repurchase agreements, cash collateral paid/ received and securities lending

3.1 Repurchase/reverse repurchase agreements

Norges Bank enters into repurchase and reverse repurchase agreements to finance positions at the lowest possible price and to generate additional income for the GPFG. The following tables present the repurchase and reverse repurchase agreements recognised on the balance sheet at 31 December 2009:

Lending associated with reverse repurchase agreements

Figures in millions of NOK

	2009	2008
Lending associated with reverse repurchase agreements, ordinary activity	65 824	160 009
Lending associated with reverse repurchase agreements, reinvestment of cash collateral in connection with securities lending	125 649	114 123
Lending associated with reverse repurchase agreements	**191 473**	**274 132**

Short-term borrowing

This item comprises borrowing used in the liquidity management of the portfolio with a maturity of between one and ten days and amounted to NOK 6 238m at 31 December 2009.

Borrowing associated with repurchase agreements

Figures in millions of NOK

	2009	2008
Borrowing associated with repurchase agreements	**109 536**	**514 395**

3.2 Cash collateral

The GPFG pays and receives cash collateral in a number of contexts. These include the monitoring of positions in OTC financial derivatives, securities lending, and the margining of positions in repurchase and reverse repurchase agreements. This cash collateral is recognised on the balance sheet because Norges Bank has access to the bank deposits. The following tables show the amounts recognised on the balance sheet at year-end.

Cash collateral paid

Figures in millions of NOK

	2009	2008
Cash collateral paid in connection with unlisted financial derivatives	0	114
Cash collateral paid in connection with unlisted financial derivatives	140	0
Cash collateral paid	**140**	**114**

Cash collateral received

Figures in millions of NOK

	2009	2008
Cash collateral received in connection with securities lending	154 676	185 606
Cash collateral received in connection with unlisted financial derivatives	0	2 883
Cash collateral received in connection with margining of repurchase and reverse repurchase agreements	0	119
Cash collateral received	**154 676**	**188 608**

3.3 Securities lending

Securities lent

The table below shows securities lent via lending programmes at year-end. These assets are recognised on the balance sheet under 'Equities lent' and 'Bonds lent'.

Figures in millions of NOK

	2009	2008
Equities lent	150 847	182 612
Bonds lent	161 990	191 482
Total securities lending against collateral	**312 837**	**374 094**

Norges Bank has entered into lending agreements with external lending agents. These agreements contain provisions which protect Norges Bank's interests if the borrower of the securities is unable to return them or if the collateral provided for the loan is not sufficient to cover losses.

Collateral received in connection with securities lent

Figures in millions of NOK

	2009		2008	
Collateral received	Book value	Fair value	Book value	Fair value
Collateral in the form of cash	**154 676**	**154 676**	**185 606**	**185 606**
Collateral in the form of equities	-	92 191	-	137 628
Collateral in the form of bonds	-	79 896	-	66 721
Total collateral	**154 676**	**326 763**	**185 606**	**389 955**

Reinvestment of cash collateral

Collateral in the form of cash is reinvested in reverse repurchase agreements or bonds and other fixed income instruments with the highest credit rating (Aaa from Moody's). The table below shows reinvestments at the end of the year as recorded on the balance sheet (at fair value).

Figures in millions of NOK

	2009	2008
Lending associated with reverse repurchase agreements	**125 649**	**114 124**
Asset-Backed securities	21 338	39 150
Structured investment vehicles	692	2 461
Other fixed income instruments	4 600	21 564
Total reinvestment in the form of bonds and other fixed income instruments	**26 630**	**63 175**
Total reinvestment in connection with securities lending	**152 279**	**177 299**

Reinvestments are recognised on the balance sheet under 'Lending associated with reverse repurchase agreements' and 'Lending associated with bonds and other fixed income instruments'.

Net income of NOK 1 707m from equities lending has been recorded in the profit and loss account under 'Net income/expenses and gains/losses from equities and units'. This comprises both income and costs related to lending activities. Net income of NOK 457m from lending of bonds and other fixed income instruments has been recognised under 'Net income/expenses and gains/losses from bonds and other fixed income instruments'. As a result of positive market developments in 2009 and sales/maturation, previously recognised unrealised losses of NOK 6 377m related to investments in bonds were reversed in 2009 under 'Net income/expenses and gains/losses from bonds and other fixed income instruments'. Parts of this relate to holdings sold during the year and are matched by realised gains or losses included in net income from securities lending. The change in unrealised losses during the year for bonds still held at the end of 2009 was recorded to income at NOK 2 922m. An unrealised loss of NOK 5 640m was recognised in the profit and loss account for these reinvestments in 2008.

GPFG 4. Equities and units, bonds and other fixed income instruments

Figures in millions of NOK

	Cost	Fair value	Accured interest/ dividends	Total fair value
Equities and units:				
- listed equities and units	1 637 821	1 645 746	1 860	1 647 606
Total equities and units	**1 637 821**	**1 645 746**	**1 860**	**1 647 606**
Of which equities lent				***150 847***
Government and government-related bonds				
Government bonds	329 580	320 011	4 541	324 552
Bonds issued by local authorities	30 739	31 213	682	31 895
Bonds issued by supranational bodies	25 105	25 733	418	26 151
Bonds issues by US federal agencies	85 057	82 552	1 343	83 895
Total government and government-related bonds	**470 481**	**459 509**	**6 984**	**466 493**
Inflation-linked bonds:				
Bonds issued by government authorities	81 879	87 646	455	88 101
Corporate bonds	586	511	1	512
Total inflation-linked bonds	**82 465**	**88 157**	**456**	**88 613**
Corporate bonds				
Bonds issued by utilities	22 458	21 610	399	22 009
Bonds issued by financial institutions	144 379	125 119	2 427	127 546
Bonds issued by industrial companies	79 360	76 616	1 496	78 112
Total corporate bonds	**246 197**	**223 345**	**4 322**	**227 667**
Securitised debt:				
Covered bonds	200 692	205 907	4 444	210 351
Mortgage-backed securities	62 503	50 888	259	51 147
Asset-backed securities	20 623	14 621	71	14 692
Commercial mortgage-backed securities	12 449	10 453	67	10 520
Total securitised debt	**296 267**	**281 869**	**4 841**	**286 710**
Units in securities funds	**644**	**729**	**0**	**729**
Total bonds and other fixed income instruments	**1 096 054**	**1 053 609**	**16 603**	**1 070 212**
Of which bonds lent				***161 990***

GPFG 5. Financial derivatives

The table below shows the nominal value of financial derivatives for purchased (long) and sold (short) positions, as exposure. Nominal values are the basis for the calculation of any payment flows and gains/losses for the contracts. Assets (positive) and liabilities (negative) are also shown, at market value.

Figures in millions of NOK

	Exposure				Fair value		
	2009		Average 2009		2009		
	Purchased	Sold	Purchased	Sold	Asset	Liability	Net
Foreign exchange contracts	**16 233**	**0**	**10 662**	**0**	**178**	**30**	**148**
Listed futures contracts	**20 185**	**11 037**	**23 890**	**22 655**	**105**	**394**	**-289**
Interest rate swaps	826	64 571	62 351	109 385	120	5 418	-5298
Credit default swaps	24 254	2 953	32 193	19 299	144	1 166	-1022
Equity swaps	2 453	28	1 747	83	183	11	172
Total swaps	**27 533**	**67 552**	**96 291**	**128 767**	**447**	**6 595**	**-6 148**
Options	**34 764**	**19 149**	**33 859**	**20 986**	**1 533**	**1 099**	**434**
Total financial derivatives	**98 715**	**97 738**	**164 702**	**172 408**	**2 263**	**8 118**	**-5 855**

Foreign exchange contracts
This item consists of foreign exchange transactions with normal settlement for future delivery. Exposure is the sum of the nominal value of the contracts entered into.

Listed futures
Exposure is the market value of the underlying instruments.

Unlisted (OTC) financial derivatives
Interest rate swaps
This item includes both interest rate swaps and combined interest rate and currency swaps.

Exposure is nominal and indicates whether Norges Bank receives (contracts purchased) or pays (contracts sold) at a fixed rate.

Credit default swaps
With a credit default swap, the protection seller receives a periodic premium or lump sum from the protection purchaser as compensation for assuming the credit risk. The protection purchaser receives payment from the seller only if the credit protection of the underlying credit is triggered (credit event). A credit event might include default on the underlying credit/bond. The protection normally expires after the first credit event.

The underlying assets for credit default swaps are corporate bonds, securities issued by sovereign states, corporate bond indices, asset-backed security (ABS) indices and commercial mortgage-backed security (CMBS) indices.

Exposure expresses whether Norges Bank has purchased or sold protection for all or part of the credit risk associated with the various types of underlying asset.

Equity swaps

Equity swaps are agreements between two counterparties to swap cash flows based on changes in the underlying instrument, which may be an equity, a group of equities or an index. In addition to the periodic cash flow, payments are received in connection with dividends and corporate events.

Exposure corresponds to the market value of the underlying equities or equity indices.

Options

Exposure is the market value of the underlying instrument. Options written by the GPFG are reported under 'Sold'. Options where Norges Bank pays a premium are reported under 'Purchased'.

GPFG 6. Other assets / Other liabilities

Figures in millions of NOK

	2009	2008
Withholding tax	176	663
Outstanding accounts with other portfolios under management	0	16 259
Accrued interest, securities lending	75	242
Total other assets	**251**	**17 164**

Figures in millions of NOK

	2009	2008
Capital gains tax payable abroad	255	87
Other liabilities	176	3 376
Outstanding accounts with other portfolios under management	3 193	0
Total other liabilities	**3 625**	**3 463**

Outstanding accounts with other portfolios under management' comprises the net value of deposits, lending, repurchase agreements and reverse repurchase agreements vis-à-vis other portfolios managed by Norges Bank. These related-party transactions were performed on an arm's length basis.

GPFG 7. Owners capital – deposits in krone account

Figures in millions of NOK

	2009	2008
Deposits in krone account as at 1 January	2 273 289	2 016 955
Inflows during the year	171 577	385 545
Management fee to Norges Bank	-3 228	-2 165
Profit/loss transferred to/from krone account	195 177	-127 046
Capital – deposits in krone account as at 31 December	**2 636 815**	**2 273 289**

GPFG 8. Currency distribution

Figures in millions of NOK

							2009
	USD	**CAD**	**EUR**	**GBP**	**JPY**	**Other**	**SUM**
Bank deposits	1 806	27	432	66	151	2 161	4 644
Lending associated with reverse repurchase agreements	76 516	0	89 846	18 437	534	6 139	191 473
Cash collateral paid	140	0	0	0	0	0	140
Equities and units (incl. lent)	515 140	46 119	424 693	240 512	89 018	332 124	1 647 606
Bonds and other fixed income instruments (incl. lent)	352 835	22 133	503 028	121 222	45 310	25 684	1 070 212
Financial derivatives	3 344	682	-6 149	91	-3	4 298	2 263
Unsettled trades	15 358	62	599	246	159	1 150	17 572
Other assets	64	1	116	9	0	62	251
Total financial assets	**965 203**	**69 023**	**1 012 565**	**380 583**	**135 170**	**371 618**	**2 934 161**
Short-term borrowing	2 071	-141	-18	3 245	793	289	6 238
Borrowing associated with repurchase agreements	41 163	1 081	20 589	40 357	1 433	4 914	109 536
Cash collateral received	52 399	0	101 357	920	0	0	154 676
Financial derivatives	5 985	306	4 316	2 974	78	-5 541	8 118
Unsettled trades	7 747	151	584	141	191	3 111	11 925
Other liabilities	2 209	66	1 101	131	-140	257	3 625
Management fee payable	0	0	0	0	0	3 228	3 228
Total financial liabilities	**111 574**	**1 463**	**127 929**	**47 768**	**2 355**	**6 258**	**297 346**

GPFG 9. Risk and valuation

Risk management is a key activity for Norges Bank. Processes have been established for identifying, measuring and monitoring all of the most important risks to which Norges Bank and the GPFG's owners are exposed through the activities conducted. The four most important areas are market risk, credit risk, counterparty risk and operational risk. Requirements for the management and measurement of these risk categories are laid down in guidelines from the Executive Board based on the Ministry of Finance's extended guidelines.

Financial markets stabilised during the course of 2009. As a result of a decrease in risk aversion, improved growth expectations for the global economy and better liquidity in bond markets, there was a general increase in stock, bond and commodity markets from March 2009 through to the end of the year. Even though price uncertainty continues to remain at a fairly high level for segments of the portfolio, the market outlook is completely different than at the end of 2008 and has return to a level with sufficient reliability related to the estimation of market values.

Market risk

Market risk is the risk of changes in the value of the GPFG due to movements in interest rates, equity prices and/or exchange rates. Norges Bank measures risk in both absolute terms and the relative market risk for the GPFG.

Absolute risk can be estimated based on the actual portfolio at any given time. Standard deviation is a statistical metric which indicates the size of the variations that can be expected in the return on the GPFG. The table below illustrates market risk as expressed by expected annual standard deviation in the GPFG's actual portfolio both overall and for the two asset classes, equities and fixed income.

	Riskmeasure	31.12.2009	Min 2009	Max 2009	Average 2009	31.12.2008
Total risk, portfolio	St. deviation	7.2 %	7.2%	21.7 %	13.7 %	22.2 %
Equity portfolio	St. deviation	10.0 %	10.0 %	35.8 %	20.6 %	36.7 %
Fixed income portfolio	St. deviation	10.0 %	10.0 %	22.6 %	15.6 %	21.5 %

The standard deviation at end-2009 means that in two out of every three years the value of the GPFG is expected to fluctuate within +/-7.2% of total market value (one standard deviation) based on the actual portfolio at that time. Market risk measured in this way decreased considerably in 2009, with the expected risk of fluctuations falling particularly in the first half of the year. Market risk can also be expressed based on the actual fluctuations in the portfolio through the year. Based on actual portfolio fluctuations, the standard deviation averaged 13.4% during the year and stood at 7.0% on 31 December 2009.

The reduction in market risk is due to lower market volatility and a normalisation of the market situation during the year. There were no changes to the GPFG's benchmark portfolio in 2009 other than the completion of the implementation of the increased weight of the equity assets class of the total Fund from 40% to 60% of the GPFG during 2009 Q2.

Risk model

The model used calculates expected standard deviation in the value of the GPFG on the basis of portfolio composition and assumptions about its sensitivity to fluctuations in relevant market factors and the correlation between them. Norges Bank conducts risk calculations on a regular basis. Both parametric calculations and calculations based on Monte Carlo simulations are used. Parametric calculation involves risk modelling based on an assumption that changes in market prices are normally distributed, while Monte Carlo simulation involves generating a large number of simulated returns and the associated distribution. In both cases, expected risk can be inferred from the distribution in the form of a standard deviation, i.e. a measure of expected fluctuations in the value of the portfolio. The parametric method was used in the calculation of the figures in the table above. Volatility and correlation are estimated based on daily historical data where more importance is attached to recent market data than to older data. As a result, this risk model responds very quickly to market changes.

Risk models, strengths and weaknesses

Estimated volatility is a statistical measure of risk that captures and measures the correlation in the portfolio's exposure across asset classes, markets, instruments and currencies.

As the GPFG is well-diversified, it is important to use a risk model that captures these interdependencies and provides an overall estimate of risk. The accuracy of any risk model is dependent on the assumptions on which the model is based. The most important weaknesses of the model are:

- Estimated volatility measures risk over a defined time period and assumes that exposure is related to liquid holdings that can be closed within the allowed time period.
- The model assumes normal market conditions and will underestimate volatility under turbulent or abnormal market conditions.
- The estimated variance is a point risk estimate, but is statistically less informative related to the overall risk profile and the magnitude of the risk in the tail ends of the distribution.
- Annualised risk measures based on daily risk figures assume that both the volatility and composition of the portfolio are constant over time. It is also assumed that the expected return in future periods is zero (random walk assumption).

Liquidity risk

Norges Bank defines liquidity risk in relation to the management of the GPFG as the ability to make planned or unexpected changes in the composition of the portfolio due to exogenous or endogenous factors without incurring unusually high transaction costs. Management of liquidity risk is integrated into the control structure.

For the GPFG's positions in the equity market, the measurement of these management variables is not associated with major challenges, since the GPFG largely comprises equities listed on regulated exchanges. There are a few exceptions, however, as some local exchanges do not function satisfactorily. For fixed income instruments, measurement is automatically more complex due to a high proportion of unlisted instruments. Market developments since summer 2007 have also presented additional problems in terms of quantitative measures of liquidity for fixed income instruments.

Compared with 2008, liquidity risk fell back substantially during 2009. Liquidity has gradually returned to large parts of the fixed income market, which came to a virtual standstill following the Lehman Brothers bankruptcy. The ability to change the composition of the fixed income portfolio is therefore much greater now than in 2008. Liquidity in the fixed income market is nevertheless still markedly lower than pre-crisis levels.

Credit risk

Credit risk is the risk of losses from issuers of fixed income instruments defaulting on their payment obligations to the GPFG. Another form of credit risk is the counterparty risk that arises through derivatives, foreign exchange contracts and repurchase/reverse repurchase agreements. Settlement risk, which arises in connection with the purchase and sale of securities, where not all transactions take place in real time, also gives rise to counterparty risk.

Credit risk arises in the GPFG's fixed income portfolio partly as a result of the Ministry of Finance's choice of investment strategy and partly as a result of Norges Bank's active management. All fixed income instruments in the GPFG's benchmark index have a rating from one of the major credit rating agencies: Standard & Poor's, Moody's and Fitch. All three agencies classify the issuers of fixed income instruments on the basis of their creditworthiness. A credit rating scale from AAA to D is used for long-term bonds. The highest rating is AAA from S&P and Fitch and Aaa from Moody's. The lowest investment grade ratings are BBB from S&P and Fitch and Baa from Moody's. Lower ratings are termed non-investment grade. All bonds in the GPFG's benchmark index have an investment grade rating. The table below breaks down the fixed income portfolio on the basis of credit ratings from at least one of the rating agencies at the end of the year.

Fixed income portfolio by credit rating[1]:

Figures in millions of NOK

	Aaa\AAA	Aa\AA	A	Baa\BBB	Ba\BB	Lower	No rating	Total
Government and government-related bonds	356 777	73 915	25 210	9 784	-	142	666	466 494
Inflation-linked bonds	45 671	40 449	1 231	-	-	-	1 262	88 613
Corporate bonds	4 631	42 339	99 149	71 337	6 666	2 310	1 235	227 667
Securitised debt	221 246	42 243	3 016	3 792	2 474	13 309	629	286 709
Units in securities funds							729	729
Total bonds and other fixed income instruments	**628 325**	**198 946**	**128 606**	**84 913**	**9 140**	**15 761**	**4 521**	**1 070 212**

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

The following table shows exposure to credit derivatives:

Figures in millions of NOK

	Nominal amount	Fair value
Credit default swaps, protection purchased	24 254	-938
Credit default swaps, protection sold	2 953	-84

Protection purchased means that the GPFG's credit risk has been reduced, while protection sold means increased credit risk. Overall, credit exposure has been reduced slightly through credit default swaps. These contracts relate primarily to credit risk in the Baa, Ba and lower categories.

Norges Bank implemented a new credit risk model in 2009 for parts of the fixed income portfolio (corporate bonds). The model provides a better basis for a statistical calculation of the probability of default and expected longer-term losses.

Counterparty risk

Norges Bank is also exposed to risk vis-à-vis counterparties in the execution of transactions, vis-à-vis the custodian institutions with which securities are deposited, and vis-à-vis international settlement and custody systems (counterparty risk). The equity and fixed income portfolios include investments in unsecured bank deposits, OTC derivatives and foreign exchange contracts. Derivatives are used for both trading and hedging purposes in the portfolio. Repurchase/reverse repurchase agreements also give rise to counterparty risk.

Norges Bank manages counterparty risk partly through requirements for high credit ratings when selecting and evaluating counterparties. These requirements are more stringent for unsecured credit exposure than for credit exposure with some form of collateral. The Executive Board has decided that no counterparties involved in such transactions may have a credit rating lower than A-/A3/A- from Fitch, Moody's or S&P, respectively. 76% of Norges Bank's approved counterparties have a rating of AAA to A. Transactions with other counterparties are made only where settlement is on a delivery-versus-payment basis, i.e. ownership of an asset and payment are simultaneous. Changes in counterparties' credit quality are monitored continuously, partly through the use of alternative credit indicators such as equity volatility and the price of bankruptcy insurance. Counterparty risk is controlled against fixed credit risk limits set for each counterparty by measuring expected future exposure.

The table below shows counterparty risk associated with positions in financial derivatives, foreign exchange contracts and repurchase/reverse repurchase agreements (contracts with a positive market value) at year-end, and bank balances and receivables related to unsettled trades. Both book values and expected future exposure (counterparty risk) are shown in the table below. The method used to calculate counterparty exposure is in accordance with the UK Financial Services Authority (FSA) method described in its Handbook. This method is called the mark-to-market method, and counterparty exposure is calculated based on market value with an add-on to reflect the degree of volatility. With repurchase/reverse repurchase agreements, allowance is made for actual collateral.

Figures in millions of NOK

	2009		2008
	Counterparty risk	**Book value**	**Book value**
Foreign exchange contracts	320	178	423
Credit default swaps	726	144	6 288
Interest rate swaps	195	120	26 280
Total return swaps	-	-	41
Equity swaps	483	183	820
Options	1 639	1 533	4 037
Total financial derivatives	**3 363**	**2 158**	**37 889**
Bank deposits	**4 644**	**4 644**	**18 111**
Repurchase and reverse repurchase agreements	**44 492**	**81 938**	**-**
Unsettled trades – assets	**17 572**	**17 572**	**102 574**
Total	**70 071**	**106 312**	**158 574**

The positions are shown before netting, and collateral provided is not taken into account. To reduce counterparty risk, Norges Bank has entered into bilateral netting agreements for OTC derivatives and foreign exchange contracts. Norges Bank has strict collateral requirements for such exposures. Norges Bank held no cash collateral in connection with financial derivatives at the end of 2009, as compared to NOK 2 882m as at 31 December 2008 (see Note 3). The thresholds for requiring collateral are set at between EUR/USD 0 and EUR/USD 50m, measured as the net positive market value per counterparty.

Fair value measurement of financial instruments

Control environment

An effective process for daily valuation of the positions in the GPFG has been established involving sourcing and verification of prices from both external accounting service providers and Norges Bank's operating units. Valuations are subject to a number of additional control procedures at Norges Bank at each month-end with the aim of ensuring that prices used for valuations are in line with established valuation procedures and the fair value principle. At the end of each quarter, a valuation memo and report are prepared documenting the results of the controls performed and the status of the valuations. These are reviewed by a valuation committee, which is a forum for escalating significant pricing issues and, which, formally approves the valuations.

Establishing fair value

A hierarchy of independent price sources established by Norges Bank is used. Holdings included in the benchmark indices are normally priced in accordance with the index suppliers' pricing, while the remaining holdings of equities and bonds are priced almost exclusively by recognised external independent price providers. Price verification analyses are performed to compare prices from the established hierarchy with alternative available price sources. Where alternative price sources are regarded to be more representative of fair value, price adjustments are made to bring valuations closer to expected fair value.

All equity and bond holdings in the GPFG have been allocated to categories of estimated pricing uncertainty. Category 1 consists of investments that are valued based on observable market prices in active markets and are regarded as having limited pricing risk. Investments in category 2 are priced based on models with observable data points. These holdings are associated with some pricing uncertainty in terms of establishing fair value, but overall this valuation risk is considered to be limited. Holdings allocated to category 3 are model-priced with considerable uncertainty surrounding the establishment of fair value. However, a majority of these investments have been valued by external price providers regarded as giving the best estimate of fair value and where the total valuation from different price providers varies to only a limited extent.

The table below breaks down investments into categories of estimated price uncertainty as at 31 December 2009:

Figures in millions of NOK

Categories of investments by price uncertainty	Observable market prices in active markets		Model pricing with observable data points		Model pricing with greater uncertainty about fair value		Total	
	2009	2008	2009	2008	2009	2008	2009	2008
Equities & units	1 646 147	1 124 096	1 453	1 641	5	212	1 647 606	1 125 949
Bonds	514 290	712 224	522 404	826 800	33 518	74 023	1 070 212	1 613 047
Total	**2 160 437**	**1 836 320**	**523 857**	**828 441**	**33 523**	**74 235**	**2 717 818**	**2 738 996**

The vast majority of the GPFG's equity holdings are actively traded on listed stock exchanges with an official closing price, and are therefore considered to have limited risk related to pricing (category 1). Equity investments classified as category 2 holdings consist mainly of relatively illiquid equity holdings where the fair value estimate is modelled from similar more liquid equities issued by the same company. The pricing risk is generally quite limited also here because the modelling is simple and the input factors are observable. Equities classified as category 3 consist of a small number of equities for which the valuation is particularly uncertain because of suspension from trading based on special circumstances, for instance bankruptcy, nationalisation, liquidation etc.

Compared to equity pricing, the pricing of bonds is less certain and more complex. Norges Bank carries out analyses on balance sheet dates to obtain information on the degree of actual transactions, price transparency and liquidity in the markets, for different types of bonds and for a large amount of specific bond holdings. The pricing of most of the GPFG's government bonds is based on observable market prices in an active market with quoted prices and frequent transactions (category 1). Government-related and inflation-linked bonds are categorised into either category 1 or 2 based on the bank's analyses of liquidity and the degree of trading and price transparency in the markets. The analysis shows a relatively high degree of liquidity for these bonds. Most corporate bonds are assessed as priced by models with observable input factors, while some especially illiquid corporate bonds belong to category 3. Securitised bonds are allocated to all three categories based on the complexity of the data factors and the degree of liquidity, actual transactions and price transparency in the markets. Covered bonds are placed in category 1 or 2 based on a relatively high, observed degree of liquidity and price transparency in the markets. Some very liquid guaranteed mortgage backed securities belong to category 1 with observable market prices in active markets. Other guaranteed mortgage backed securities that are not tranched have been classified as priced by models using observable data inputs. Securitised bonds that are seen to be tranched such that they are associated with especially high exposure to unobservable data input factors belong to category 3. Other securitised bonds are allocated to categories 2 and 3 based on a lower observed degree of liquidity and price transparency in the markets.

The total exposure that is assessed as being particularly uncertain related to a correct fair value estimation was NOK 33.5bn at year-end 2009. This consisted mainly of US securitised bonds not guaranteed by a federal agency (NOK 21.6bn), and where comparisons between available price sources revealed high pricing uncertainty. In addition some types of US securitised bonds guaranteed by agencies (Fannie Mae, Freddie Mac etc.) were reclassified from category 2 to category 3 because of high uncertainty related to an input factor in the model, primarily pre-payment speed (NOK 4.8bn). The remaining exposure consisted of miscellaneous other types of investments where the estimation of fair value was especially uncertain due to limited availability of prices from external price sources or large observed differences in prices between different price providers.

The size of the price uncertainty around the category 3 positions is difficult to estimate exactly. While the average price uncertainty on individual securities in this category is expected to be approximately +/- 10%, the group as a whole is expected to have a somewhat lower price uncertainty due to diversification effects. Estimated valuation uncertainty has therefore been calculated to approximately +/- NOK 2 to 3bn within this category.

There was a decrease in the total fair value exposure to investments classified as particularly uncertain of NOK 40.7bn from year-end 2008 when the exposure was NOK 74.2bn. The decrease in exposure can for the most part be attributed to the reclassification of securitized bonds from category 3 to category 2 due to improved liquidity and transparency in pricing (NOK 25.3bn). The remaining reduction in exposure was primarily because of maturity, repayment of principal and sales of securitised bonds.

The price uncertainty analysis of the most illiquid investments was further refined over the course of 2009. The main purpose of the evaluation is to identify if there is a need for additional adjustments in the determination of fair value. Although uncertainty concerning fair value estimation is still considerable for certain segments of the portfolio, Norges Bank perceives the result of the valuation, based on ordinary price sources as at the established pricing hierarchy as of 31 December 2009, to give an accurate picture of market values in accordance with the fair value principle and thus not requiring further accounting provisions related to price uncertainty. Norges Bank's analyses show that the price sources generally have priced in the remaining illiquidity that existed in the market at the end of 2009.

Comparisons performed as of year-end 2009 on the pricing from different pricing sources for the particularly uncertain holdings confirmed the valuation following from the established pricing hierarchies. The total valuation differences were viewed as acceptable, and overall the valuation of these holdings performed by alternative pricing sources was marginally higher than the valuation used in the financial reporting. The previous provision for pricing uncertainty, which amounted to NOK 3 424bn at the end of 2008, was therefore reversed in full in 2009.

Auditor's reports for 2009

To the Supervisory Council of Norges Bank

Auditor's report for Norges Bank for 2009

We have audited the annual financial statements of Norges Bank for 2009, which show a loss of NOK 7 607m. We have also audited the information in the Executive Board's report concerning the financial statements and the proposal for covering the loss. The annual financial statements comprise the profit and loss account, the balance sheet and notes to the accounts, including the financial reporting of the Government Pension Fund Global. The annual financial statements have been prepared based on the provisions in the Accounting Act and generally accepted accounting principles in Norway, with the departures set out in the accounting policies in the notes to the financial statements. The financial statements and the *Annual Report* are the responsibility of the Executive Board. Our responsibility is to express an opinion on the financial statements and other information according to the requirements of the Norges Bank Act.

We conducted our audit in accordance with the Norges Bank Act, the Audit Charter issued by the Supervisory Council and good auditing practice in Norway, including standards on auditing adopted by Den norske Revisorforening (the Norwegian Institute of Public Accountants). These auditing standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. To the extent required by good auditing practice and the Audit Charter, our audit also includes a review of Norges Bank's financial affairs and its accounting and internal control systems. We believe that our audit provides a reasonable basis for our opinion.

The audit of the accounts for the Government Pension Fund Global has been conducted in cooperation with Deloitte AS in accordance with its agreement with the Supervisory Council. A separate auditor's report has been submitted jointly with Deloitte AS for the Government Pension Fund Global.

In our opinion,
- the financial statements have been presented in accordance with laws and regulations and provide a true and fair view of the Bank's financial position as of 31 December 2009 and of the results of its operations for the year then ended in accordance with the provisions of the Accounting Act and generally accepted accounting principles in Norway with the departures set out in the notes on accounting policies;
- management has fulfilled its duty of producing a proper and clearly set out recording and documentation of accounting information;
- the information in the *Annual Report* concerning the financial statements and the proposal for covering the loss are consistent with the financial statements and comply with the laws and guidelines adopted in the Council of State.

Oslo, 24 February 2010

Central Bank Auditor

Svenn Erik Forsstrøm (sign.)
State Authorised Public Accountant (Norway)

To the Supervisory Council of Norges Bank

Auditor’s report on the financial reporting of the Government Pension Fund Global for 2009

We have audited the financial reporting of the Government Pension Fund Global for 2009 included in Norges Bank’s annual financial statements. The financial reporting, showing a net profit for the year of NOK 191 950m, comprises a profit and loss account, a balance sheet and notes to the financial reporting. The financial reporting of the Government Pension Fund Global has been prepared in accordance with the provisions of the Norwegian Accounting Act and generally accepted accounting principles in Norway with the departures set out in the accounting policies in the notes to the financial reporting. The financial reporting has been submitted by Norges Bank’s Executive Board as part of Norges Bank’s annual financial statements. Our responsibility is to express an opinion on the financial reporting.

We have conducted our audit in accordance with the Norwegian Act on Auditing and Auditors and generally accepted auditing practice in Norway, including auditing standards adopted by the Norwegian Institute of Public Accountants, and issue our auditor’s report in accordance with International Standard on Auditing 800 “The auditor’s report on special-purpose audit engagements”. These auditing standards require that we plan and perform our audit to obtain reasonable assurance that the financial reporting is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting policies and significant accounting estimates applied, as well as evaluating the overall content and presentation of the financial reporting. To the extent required by generally accepted auditing practice, our audit also comprises a review of Norges Bank’s financial affairs and its accounting and internal control systems relevant to the Government Pension Fund Global. We believe that our audit provides a reasonable basis for our opinion.

In our opinion,

- the financial reporting gives a true and fair view of the Government Pension Fund Global’s financial position as at 31 December 2009 and of the results of its operations for the year then ended in accordance with the provisions of the Accounting Act and generally accepted accounting principles in Norway with the departures set out in the accounting policies in the notes to the financial reporting;
- management has fulfilled its duty to ensure proper and well arranged recording and documentation of accounting information.

Oslo, 24 February 2010

Central Bank Auditor

Svenn Erik Forsstrøm (sign.)
State Authorised Public Accountant (Norway)

Deloitte AS

Aase Aa. Lundgaard (sign.)
State Authorised Public Accountant (Norway)

Resolution of the Supervisory Council on the financial statements for 2009

In accordance with the current guidelines for the allocation and distribution of Norges Bank's profit[1], the Supervisory Council adopted the following decision at its meeting on 4 March 2010:

- The Supervisory Council takes note of the Executive Board's Annual Report for 2009.
- The Supervisory Council takes note of the auditor's report for Norges Bank for 2009 and the auditor's report on the financial reporting for the Government Pension Fund Global for 2009.
- The Supervisory Council approves Norges Bank's accounts for 2009 with the following transfers and allocations:
  - In accordance with a statement from the Ministry of Finance, the sum of NOK 40.0m is to be transferred from 'Other capital' to profit/loss for the year.
  - In accordance with the guidelines, NOK 7 567m is to be transferred from the Adjustment Fund to cover the loss after other allocations.

[1] Originally adopted in the Council of State on 7 February 1986, last amended by Royal Decree of 6 December 2002.

The Supervisory Council's statement on the minutes of the meetings of the Executive Board and its supervision of the Bank in 2009

Pursuant to the Act relating to Norges Bank and the Monetary System (Norges Bank Act, Section 5, third paragraph, point four), the Supervisory Council issues the following statement concerning the minutes of the meetings of the Executive Board and its supervision of the Bank.

Mandate for the Supervisory Council's supervision of the Bank

In 2008, the Supervisory Council supervised the Bank in accordance with Section 5 of the Norges Bank Act, as worded until amended with effect from 1 January 2010:

In accordance with the Norges Bank Act, executive and advisory authority is vested in the Executive Board. The Executive Board is in charge of the Bank's operations and manages its resources (Section 5, second paragraph of the Act). The Supervisory Council supervises the Bank's operations and ensures that the rules governing the Bank's activities are observed. It organises the auditing of the Bank, including the appointment of a central bank auditor, and draws up instructions for Central Bank Audit. The Supervisory Council adopts the Bank's annual financial statements and, on the recommendation of the Executive Board, approves the budget.

(Section 5, third paragraph, points 1 and 2 of the Act).

In June 2009 the Storting adopted amendments to the Norges Bank Act concerning the accounting and auditing system etc involving important changes within the Supervisory Council's areas of responsibility. The changes are largely in line with the views expressed by the Supervisory Council in their response to consultation papers. In the amended Act, the Supervisory Council's and the Executive Board's responsibilities for supervision and control have been defined more precisely. The Bank has a statutory obligation to keep accounting records according to the Accounting Act and a new audit system is to be introduced whereby Central Bank Audit is to be replaced by an external auditor. A new statutory secretariat for the Supervisory Council is also to be established. The secretariat shall take over and develop supervisory tasks for which Central Bank Audit is currently responsible, organise the Supervisory Council's activities and administer the agreement with the external auditor. Based on the amendments to the Norges Bank Act, the Supervisory Council established in December 2009 new rules of procedure and strategy for its supervision activities and selected Deloitte AS as external auditor after a public invitation to tender.

Deloitte will be formally appointed in connection with the Supervisory Council meeting on 6 May 2010 and will audit the Bank's annual accounts as from 2010. Central Bank Audit will be the responsible auditor until this date and will audit the Bank's annual accounts for 2009. The secretariat for the Supervisory Council will be established by transferring staff from Central Bank Audit.

The entry into force of new accounting rules requires a separate regulation, which is currently under preparation, and the rules are expected to come into effect on 1 January 2011.

A more precise definition of the Council's supervisory tasks is provided in the amended Section 5 of the Norges Bank Act:

The Supervisory Council shall in this respect supervise the Executive Board to ensure satisfactory management and control of the Bank's administration and operations and the establishment of appropriate procedures to ensure that the Bank's activities are conducted in accordance with legislation, agreements, decisions and other regulatory frameworks.... The Executive Board's exercise of discretionary authority under the Act is not subject to the Supervisory Council's supervision. The Supervisory Council has the right of access with respect to all of the Bank's affairs and may conduct any investigations it deems necessary in order to fulfil its responsibilities under the Act. The Supervisory Council shall have a secretariat.

The amendments do not entail any material change in the Council's supervisory responsibilities, but provide a more precise definition of the established structure and practices, previously regulated by the Supervisory Council's rules of procedure.

The Supervisory Council shall through its activities and reporting provide assurance to the Storting that Norges Bank, as the central bank and manager of the Government Pension Fund Global, is operated in a satisfactory and appropriate manner, in accordance with legislation and other regulatory frameworks.

Organisation and conduct of supervision

The Council's supervision is based on an assessment of risk and materiality. The supervision can be document-based and/or conducted by means of the Council's own investigations. Document-based supervision is conducted in connection with the Supervisory Council's meetings and through Central Bank Audit's supervision. Document-based supervision includes a review of the minutes of Executive Board meetings and processing of matters submitted by the Executive Board, including annual reports on risk management and internal control, individual matters of relevance to the supervision of Norges Bank's activities and reports from Internal Audit. The Supervisory Council can request the submission of documentation and reports by the Executive Board. The Supervisory Council can also conduct investigations itself, or have them conducted by the Permanent Committee, by Central Bank Audit or by external expertise.

The Supervisory Council held 6 meetings and dealt with 87 matters in 2009. In addition to discussing matters on its regular agenda, the Supervisory Council receives updated information at the meetings and through seminars.

The Supervisory Council has established the Permanent Committee, comprising the Council Chair, Deputy Chair and three other Council members, who prepare matters to be discussed and draw up recommendations for the Council. The Committee held 6 meetings in 2009. The process related to changes in the Norges Bank Act resulted in considerable activity in addition to the regular meetings, for all the Committee members or for the Committee represented by the chair and deputy chair, in 2009. Activities have included work on consultative documents, strategies and plans, meetings with the Ministry of Finance, an open hearing in the parliamentary Standing Committee on Finance and

Economic Affairs, meetings with the Executive Board and with Central Bank Audit. In addition, the Committee played an active role as steering committee in the process of selecting an external auditor for Norges Bank, including participation in meetings with tenderers.

The Supervisory Council organises the auditing of the Bank, including the appointment of the central bank auditor, and draws up instructions for the central bank auditor. Central Bank Audit reports professionally and administratively directly to the Supervisory Council, which approves Central Bank Audit's annual plans for auditing and supervision activities, budget and accounts. The central bank auditor is present at meetings held by the Supervisory Council and the Permanent Committee and can express an opinion on matters raised and provide information on current matters relevant to the Council's supervisory responsibility.

The Supervisory Council's approval of Norges Bank's budget and adoption of financial statements

In accordance with the Norges Bank Act, the Supervisory Council adopts the Bank's annual financial statements and, on the recommendation of the Executive Board, approves the budget. The budget is communicated to the Ministry of Finance, while the revised annual financial statements are submitted to the Ministry for submission to the King in Council and communication to the Storting, together with the Report of the Executive Board and the Supervisory Council's statement on the minutes of Executive Board meetings and its supervision of the Bank.

The Supervisory Council has laid down the Bank's regulations for financial management as a framework for the Bank's budget and internal accounts and has laid down the Bank's accounting principles as a framework for the Bank's external financial reporting.

In December 2008 the Supervisory Council approved the Bank's budget for 2009. The use of resources has been followed up through the year in the Council's review of period reports and individual matters affecting the budget. The Supervisory Council reviewed the Bank's internal accounts and adopted the Bank's official financial statements for 2009, including financial reporting for the Government Pension Fund Global, at its meeting on 4 March 2010. In connection with its adoption of the annual financial statements, the Supervisory Council approved the Executive Board's proposals for allocations and equity capital transfers according to guidelines laid down by the King in Council.

Supervision of the Bank's investment management activities

Management of the Government Pension Fund Global and the Bank's foreign exchange reserves totalled more than NOK 2800bn at the end of 2009. These activities account for more than 90% of the Bank's balance sheet and a considerable share of the Bank's resources. Audit and supervision of this part of the Bank constitute a large proportion of Central Bank Audit's and the Supervisory Council's activities. In 2007 the Supervisory Council entered into an agreement with the auditing firm Deloitte AS for the audit of the Government Pension Fund Global in cooperation with Central Bank Audit. The arrangement has facilitated appropriate and effective access to international auditing resources. The Office of the Auditor General bases its audit of the Government Pension Fund Global in the national accounts on the audit performed by Central Bank Audit and Deloitte. An agreement regulating this cooperation has been established.

The Supervisory Council's supervision of the Bank's investment management activities is based on reviews of quarterly and annual reports, budgets and guidelines issued by the Executive Board, reports on risk exposure and compliance with guidelines, operational risk management and internal control and reports from Internal Audit and Central Bank Audit/Deloitte.

The financial market turbulence entailed particular challenges with regard to results and risk management in investment management in 2008. The Supervisory Council has in 2009 followed up the measures implemented by the Bank with regard to risk management, including adopting principles and a mandate for the executive director of investment management and organising and establishing risk management frameworks.

Against this background, the Supervisory Council, represented by Central Bank Audit, in consultation with the Ministry of Finance, drew up a plan in 2009 for the independent review and assurance of various operational risk management areas in Norges Banks Investment Management (NBIM). As part of the implementation of this plan, Deloitte conducted a review in 2009 of the organisational structure and framework for operational risk management in NBIM. The assurance report from the review has been discussed by the Supervisory Council.

The Supervisory Council also submitted a consultative statement to the Ministry of Finance in 2009 regarding proposals for new investment management rules for the Government Pension Fund Global and a new regulation concerning risk management and internal control for Norges Bank.

Conclusion

The Supervisory Council has received all the information requested.

In 2009 the Supervisory Council had no comments concerning the minutes of Executive Board meetings, nor has its supervision of the Bank's operations revealed circumstances that constitute grounds for special remarks pursuant to Section 30, second paragraph of the Norges Bank Act.

The Supervisory Council's priorities ahead

As referred to above, a new audit and supervision system will become effective in 2010. One of the main tasks will be to establish an efficient audit and supervision system in accordance with the intentions of the Act and the strategy adopted by the Supervisory Council in 2009. The strategy includes the Supervisory Council's vision that «The Supervisory Council shall be widely recognised for its attendance to ensuring democratic access to Norges Bank's activities and its supervision of Norges Bank and contribute to ensuring that public confidence in Norges Bank is high».

The expressed objective is that there should be a high level of knowledge about and recognition of the Supervisory Council's activities among the general public and in the Storting and the Ministry of Finance. There should also be a perception in the Bank that the Supervisory Council, its secretariat and external auditor perform their tasks in an appropriate and professional manner that contributes to the achievement of the Bank's objectives and to its standing. An efficient and holistic audit and supervision model shall also be established for the Government Pension Fund Global that can also contribute in an appropriate manner to complying with the Ministry of Finance's and the Auditor General's requirements for follow-up and supervisory activities in Norges Bank.

The Supervisory Council's secretariat and external auditor are important resources and essential to the fulfilment of the Supervisory Council's responsibilities. Priority tasks ahead will be to establish an appropriate secretariat of high professional standard and the efficient phasing-in of the new external auditor.

Supervision of investment management activities will continue to have high priority ahead and will be an important driver for further development of expertise in the Supervisory Council and its secretariat. As part of its adoption of the supervision plan for 2010/11, the Supervisory Council will consider pursuing the plan drawn up in 2009 for assurance responsibilities for the external auditor. The Ministry of Finance is in the process of drawing up new rules for the management of the Government Pension Fund Global, including rules for future investments in real estate. This will be an important framework for Norges Bank and for the Supervisory Council's activities ahead.

In a submission to the Ministry of Finance in December 2009, the Supervisory Council took the initiative for an assessment of the possibility of expanded reporting direct to the Storting and the possibility of transferring the authority to determine the remuneration for Supervisory Council members to the Storting. In the view of the Supervisory Council, this can make a further contribution to clearly defining and strengthening the Supervisory Council's position as the Storting's supervisory body. In February 2010, the Ministry of Finance has circulated for comment proposed amendments to the Norges Bank Act in keeping with those outlined in the submission from the Supervisory Council.

Oslo, 4 March 2010
for Norges Bank's Supervisory Council

Reidar Sandal (sign)	Frank Sve (sign)
Chair	Deputy Chair

In accordance with Section 30, second paragraph of the Norges Bank Act, the annual report, annual financial statements, auditor's reports and the Supervisory Council's statement on the minutes of the Executive Board meetings and its supervision of the Bank are hereby submitted to the Ministry of Finance for submission to the King in Council and communication to the Storting.

Norges Bank’s activities

CHAPTER 1 .

Organisation, management and use of resources

Promoting financial stability in Norway

Norges Bank's activities are regulated by the Norges Bank Act of 1985. The Act states that Norges Bank shall be an executive and advisory body for monetary, credit and foreign exchange policy. The Bank shall issue banknotes and coins, promote an efficient payment system domestically as well as vis-à-vis other countries, and monitor developments in the money, credit and foreign exchange markets. The Act authorises the Bank to implement measures customarily or ordinarily taken by a central bank.

The Government has defined an inflation target for monetary policy in regulations issued pursuant to the Norges Bank Act.

Norges Bank's responsibilities in managing the Government Pension Fund Global (GPFG) are regulated by means of regulations issued pursuant to the Act relating to the Government Pension Fund Global and a separate management agreement with the Ministry of Finance.

Organisation with an emphasis on core activities

The Executive Board supervises the executive and advisory activities of the Bank and consists of seven members, all appointed by the King. Two employee representatives supplement the Executive Board when administrative matters are discussed. The Governor and Deputy Governor are chairman and deputy chairman respectively of the Executive Board. The Governor is responsible for the day-to-day management of the Bank, and represents the Bank externally.

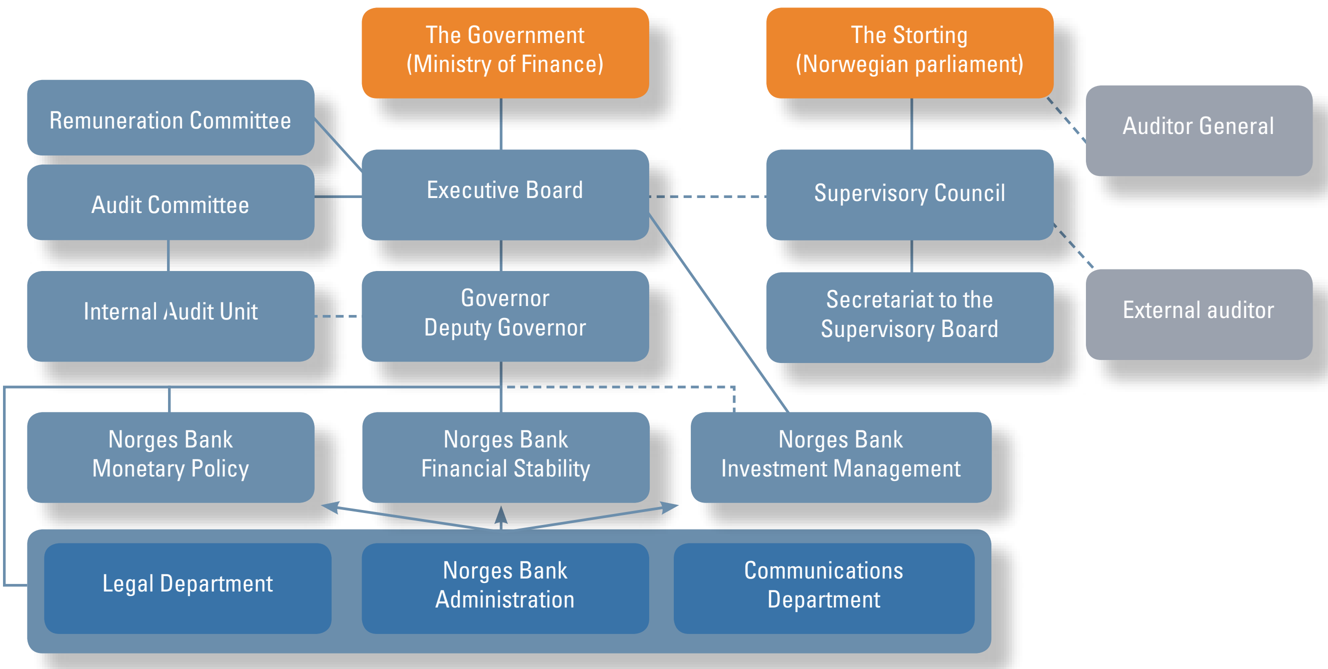


Chart 1 Organisation of the Bank

Audit and oversight

Norges Bank's Supervisory Council is composed of 15 members, all elected by the Storting for four-year terms. By means of its activities and reports, it shall provide safeguards to the Storting to ensure that Norges Bank, and accordingly the management of the GPFG, is operated satisfactorily and appropriately, and in accordance with statutes and intentions. The chair and deputy chair are appointed by the Storting from among the council's members for two-year terms.

Amendments to the Norges Bank Act regarding audit and oversight were adopted by the Storting in June 2009 and entered into force on 1 January 2010. Under the amendments, Central Bank Audit will be replaced by a selected external auditor. The Supervisory Council has concluded an agreement with Deloitte AS concerning the audit of Norges Bank's annual accounts as from 2010. A new statutory secretariat to the Supervisory Council was also established. This secretariat is to continue and develop the oversight work currently performed by Central Bank Audit, organise the Supervisory Board's activities and manage the agreement with the external auditor. See report on pp. 67-70.

Organisation of the bank's operations is based on clearly defined core activities. Norges Bank shall

- promote price stability by means of monetary policy
- promote financial stability and contribute to robust and efficient financial infrastructures and payment systems
- manage the portfolios of the GPFG, the bank's own foreign exchange reserves and the Government Petroleum Insurance Fund in an efficient and confidence-inspiring manner

The Bank's operations are concentrated on the three operational areas, Norges Bank Monetary Policy, Norges Bank Financial Stability and Norges Bank Investment Management. Additional units provide staff and support services (see Chart 1).

The division into a few relatively large units provides an appropriate span of control for the Governor and Deputy Governor. The operational areas have clearly defined interfaces with the other units, and their staffs currently number from over 80 to approximately 250 employees.

At end-2009, Norges Bank had 589 permanent employees.

The main management principle is line management

The Executive Board delegates a large share of the day-to-day operations of the Bank to the Governor, who further delegates these to the operational areas. Pursuant to Section 5, final paragraph, of the Norges Bank Act, the Governor is in charge of the Bank's administration and the implementation of the decisions.

Within the annual frameworks allocated for FTEs and budgets, the individual operational areas are allowed considerable freedom with respect to personnel management and budget disposal. An upper limit on the number of FTEs that may be utilised over a three-year period is recommended for most of the Bank's operations.

A strong degree of line management results in a clearly structured organisation with clear lines of responsibility. The operational areas prepare annual action plans for activities with associated performance targets subject to approval by the Governor. The Governor reviews the performance of each area throughout the year by means of appraisal dialogues in the spring and follow-up dialogues in the autumn. About every third week throughout the year, follow-up discussions are held between the Governor or Deputy Governor and each executive director.

All managers have clearly defined responsibility consistent with the organisation of the Bank's operations and the line management principle. Each year, managers are subjected to appraisal by their immediate superiors and subordinates. The appraisal criteria are direction, result orientation, interpersonal skills and professional qualities.

A leaner Norges Bank

Norges Bank must be well managed and pursue a goal-oriented approach, as consistent as possible with international best practice. The Bank must show the willingness and capacity to adapt to changes and to secure the confidence of the external community. Norges Bank must be prudent in its use of resources.

Major reduction in the number of employees and net costs since the end of the 1990s

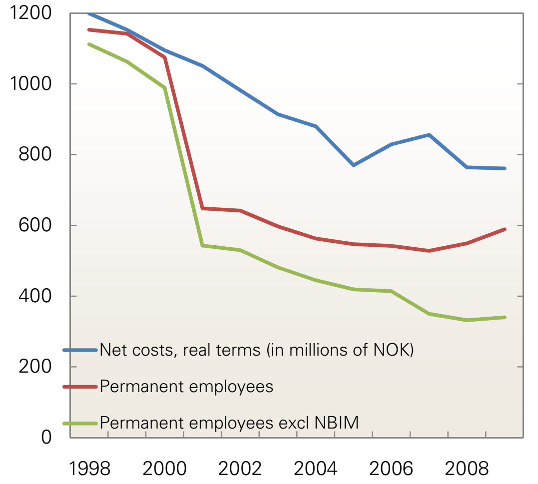
The development of Norges Bank has been concentrated on its three core activities. As a result of the establishment of limited companies, outsourcing, discontinuation of tasks and general increase in efficiency, the number of permanent employees has been halved since the end of the 1990s to 589 at end-2009. At the same time, the Bank has built up a unit for investment management with approximately 250 employees. During the same period, net operating expenses, measured in relation to the price index for public expenditure, were reduced by 37%. This does not include restructuring costs (cf. the Report of the Executive Board). The costs of managing the GPFG are covered by income from the Ministry of Finance. It is Norges Bank's objective to be a lean and efficient specialist enterprise with a strong focus on its core responsibilities. Chart 2 provides an overview of developments in net costs and staffing.

Distribution of costs by main function

Norges Bank distributes costs by main function. The purpose of this is to illustrate total costs for the various functions. The overview has also increased awareness with regard to cost-effectiveness.

"Recruitment of new staff is geared towards securing first-class managers and professionals of the highest quality."

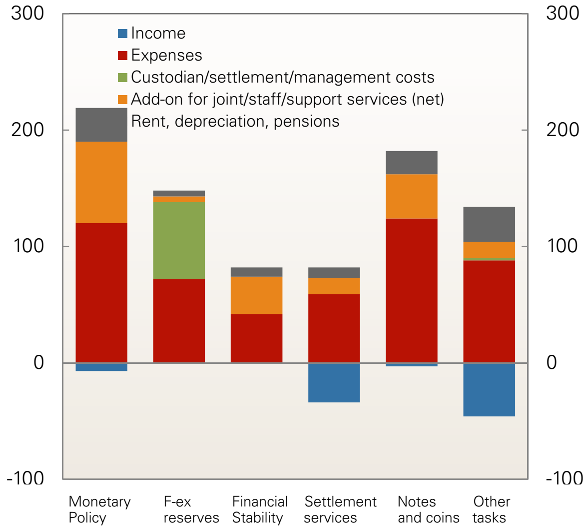
Chart 2 Developments in net costs and permanent employees



[1)] Deflated by price index for public expenditure

Source: Norges Bank

Chart 3 Distribution of resource use by main function excluding the Government Pension Fund Global (in millions of NOK)



Source: Norges Bank

In 2009, costs were distributed between the following main function categories:

- Monetary policy
- Management of the GPFG
- Management of long-term foreign exchange reserves
- Financial stability
- Settlement services
- Purchase, production and distribution of notes and coins
- Other functions[1]

The point of departure is operating expenses and operating income in the Bank's internal accounts, with the addition of depreciation and imputed pension costs[2]. Emphasis has been placed on including costs and income that give a picture of what ordinary bank operations cost. Restructuring costs and extraordinary income are therefore excluded. At the same time, internal rent has been used instead of depreciation of the building in Oslo. These factors result in deviations in relation to the figures for operating expenses and operating income in the annual accounts.

The distribution is based on cost driver analysis. The proportions of the distribution keys are based on discretion. The analyses comprise both costs that the individual sections of the Bank can influence, and more central bank-specific costs, which are mainly fixed.

Gross costs in 2009 amounted to NOK 4 079m and net costs to NOK 761m. The corresponding figures for 2008 were NOK 2 982m and NOK 734m, respectively. The net use of resources has increased by just over NOK 25m. The costs for the main function "notes and coins" has increased. Chart 3 shows the distribution of costs. The GPFG is not included in the graphic representation.

Management of the GPFG is by far the most resource-intensive function. Gross costs were NOK 3 232m in 2009 and NOK 2 171m in 2008. Norges Bank's costs are covered by the Ministry of Finance according to the principle of full cost coverage.

Apart from management of the GPFG, the functions "monetary policy", "notes and coins" and "management of the investment portfolio in the foreign exchange reserves" are the most resource-intensive.

[1] These include the organisation of historical archives, management of buildings, the Banking Law Commission, services for the government and the management of the Government Petroleum Insurance Fund.

[2] Return and interest resulting from the Bank's tasks relating to monetary policy and management of financial wealth are not included.

Norges Bank – a developing specialist enterprise

Norges Bank is a complex specialist enterprise. Integrated management of our employees' competence is crucial to the Bank's capacity to exercise its core responsibilities in the best possible way. The Bank's HR strategy shall help to ensure that the Bank's operations attract and retain staff capable of further developing the Bank in accordance with the guidelines laid down by the Ministry of Finance.

Within the adopted objectives and values of the Bank, personnel policy must reflect the many and various phases that a working career normally consists of from start to finish. Norges Bank makes targeted efforts to strengthen the brand name and to be one of Norway's most attractive workplaces. Recruitment of new staff aims at securing first-class managers and professional staff with the highest standard of competence. Internally, efforts in the direction of a common labour market will be strengthened. Clear requirements will be imposed through active use of individual competence, while the Bank will establish conditions to ensure that highly motivated and qualified staff members are given the opportunity for lifelong learning.

Maintaining and further developing the right competence in the Bank is a major challenge. At the same time as we continue to downsize staff, the quality and efficiency of our operations must be maintained. This requires new ways of working. The Bank can establish conditions for building new expertise by means of high-quality scholarships and study arrangements. The Bank's managers are offered various management development schemes to ensure integrated management of the Bank.

A key instrument in ensuring that the Bank attracts and retains staff with critical competence is the pay and incentive system. The pay system is based on individual assessments, with an emphasis on effort and performance for professionals and managers. Performance-related pay is used extensively in Norges Bank Investment Management (NBIM).

It is the Bank's aim to achieve a more even gender distribution. This is dealt with in more detail in the Report of the Executive Board.

Norges Bank has a sound and inclusive working environment. This results in a stable low level of sickness absenteeism. HMS reports and annual manager appraisals provide managers at the Bank with a sound basis for assessing what functions well and what must be improved. Cooperation between management and the employee organisations functions well through various cooperation and representation arrangements and provides valuable input to constructive solutions to the Bank's challenges.

Communications activities

Pursuant to the Norges Bank Act, Norges Bank is obliged to "inform the public about the monetary, credit and foreign exchange situation". In addition, the Bank wishes, by means of active communications activities, to achieve the broadest possible understanding of current monetary policy, of the mechanisms contributing to financial stability and of the Bank's investment management activities. Norges Bank attaches considerable importance to responding to growing interest with transparency and predictability.

In 2009, Norges Bank webcast the Governor's Annual Address and 15 press conferences in connection with the Executive Board's monetary policy meetings and in connection with the publication of the *Financial Stability* report, the *Monetary Policy Report* and the annual and quarterly reports of the GPFG. In addition, press conferences are available by podcast and direct mobile television streaming. The public can also subscribe to a text message alert of the interest rate decisions. Last year also saw the introduction of news about the Bank on Twitter.

Speeches

Speeches given by the Governor and Deputy Governor of Norges Bank are an important part of the Bank's external communications. In 2009, 56 speeches were given, an increase from the previous year, and 17 of them were published on Norges Bank's website at the same time as they were given. A number of the unpublished speeches had similar content to those that had already been published, and the Bank's website therefore merely referred to these.

Fringe benefits

Norges Bank has consistently placed emphasis on the importance of providing good working conditions.

The Bank has a loan scheme for employees where the interest rate is equal to the norm interest rate[3].

The employee insurance programme covers personal guarantees (including compulsory occupational injury and occupational health insurance), group life insurance, group accident and illness insurance, business travel insurance and accident insurance for especially exposed occupations. These costs make up 1% of the Bank's total personnel expenses. Norges Bank has its own pension fund for employees. Pension benefits are equal to 2/3 of the employee's salary, up to a ceiling of 12G, at the time of retirement. A separate scheme funded through the Bank's operations has been established for those who earned more than this amount as of 31 December 2006. Benefits from the pension fund are coordinated with benefits from the National Insurance Scheme. Employees contribute 2% of their gross annual salary to the pension fund.

The Bank has 76 parking places at the head office which are used by employees at no cost. The Bank owns two conference and holiday facilities: Venastul, which is located in Ringebu municipality, near Lillehammer, is open for 8–9 months a year, and recorded a total of 5 709 guest nights in 2009. Vindåsen, on the island of Tjøme in the county of Vestfold, is only open in summer, and had 2 500 guest nights in 2009. Net operating grants to the holiday facilities in 2009 amounted to NOK 4.1m. Capital costs are not taken into account. In addition, Norges Bank owns a holiday cabin at Meheia near Kongsberg. The Bank also has agreements with central banks in Denmark, the Netherlands, the Czech Republic and Germany for reciprocal use of holiday facilities.

[3] The interest rate determined by the Ministry of Finance for use in the calculation of the taxable benefit on low–interest loans for employees

Website

Norges Bank's website plays a key role in the Bank's information strategy. The website is therefore continuously being developed and, after its redesign in 2008, efforts have been made to enhance user-friendliness. Functions requested by users have been implemented, and adaptations have been made in connection with the requirements for quality labelling of public websites. In addition to news reports, the pages contain extensive information about the Bank's responsibilities. Electronic versions of the Bank's publications are also available. User statistics show an average of 757 000 hits per month in 2009, an increase from 743 000 the previous year.

Publications

In addition to the *Annual Report*, online information and the other reports mentioned above, Norges Bank issues the following publications: the journal *Penger og Kreditt* and its English version *Economic Bulletin* are published biannually. A report on payment systems is published annually. Research projects are documented in the *Working Papers* series, of which 29 were issued in 2009. Some of these are later printed as articles in external books and journals. *Staff Memos* contain other documentation or reports that form part of the Bank's work on key issues, and 11 were published only on the website. In its monitoring of financial stability, Norges Bank makes use of extensive credit and financial market statistics. In order to expand its information base, Norges Bank conducts a quarterly survey of bank lending, which is published four times a year.

The translation service is responsible for translating core documents and other important information into English. These include major speeches, press releases, reports, brochures, circulars, monetary policy meeting documents and information published on the Bank's website.

CHAPTER 2.

Monetary policy

MONETARY POLICY IN 2009

Monetary policy functions

The year of 2009 was characterised by the international financial crisis. Norges Bank rapidly implemented measures to reduce uncertainty and stave off particularly adverse outcomes for the economy. The key rate was lowered further in order to prevent inflation from falling too far, and the use of extraordinary measures was continued. Due to the combination of a steep rise in government expenditure, a sustained high level of activity in the petroleum sector and the measures implemented by Norges Bank, it seems that the downturn in Norway will be relatively mild.

The financial market crisis in autumn 2008 led to the most severe downturn in the global economy for several decades. Following the bankruptcy of the US investment bank Lehman Brothers on 15 September 2008, financial market turbulence developed into an international financial crisis. At times money markets ceased to function. Because of high risk premiums, money market rates were far higher than central bank key rates.

Banks raised their lending rates because of the increased cost of funding in money and credit markets. Financial institutions became more reluctant to lend to each other. Share prices and petroleum and commodity prices fell markedly. Uncertainty regarding economic developments was unusually high. The Norwegian economy was also affected, but the downturn in Norway has been milder than in most other countries. The krone exchange rate fell to very low levels in early 2009, but appreciated again thereafter. At the beginning of 2009, underlying inflation was approximately 2¾%, but was falling (see Chart 4).

The risk of a more pronounced downturn

Norges Bank rapidly implemented measures to reduce uncertainty and stave off particularly adverse outcomes for the economy. In order to improve credit flows in the financial sector, banks' liquidity was strengthened. They were given access to more loans and loans with longer maturities, and collateral requirements for bank's loans were relaxed. On the advice of Norges Bank, the Government presented a package of measures enabling banks to exchange secure but illiquid covered bonds with highly liquid government securities. From 15 October 2008 to 4 February 2009 the key policy rate was lowered four times by a total of 3.25 percentage points. In addition, the Government made provisions for a marked increase in government expenditure.

At the monetary policy meeting on 25 March, *Monetary Policy Report* 1/09 was submitted and the key policy rate was lowered by a further 0.50 percentage point to 2.00%. The interest rate forecast indicated that the key policy rate should be gradually reduced to a level of around 1% in the second half of 2009. This was somewhat lower than indicated by the updated forecast of December and considerably lower than the forecast in the October *Monetary Policy Report* of the previous year (see Chart 5).

In the period up to the monetary policy meeting in March, inflation was unexpectedly high. The sharp fall in the value of the krone had probably fed through to prices more rapidly than usual. Underlying inflation was assessed to be approximately 3%. It appeared that lower global inflation and reduced capacity utilisation in the Norwegian economy would restrain inflation ahead. In the assessment of the use of instruments, weight was placed, on the one hand, on the risk that the global downturn might be deeper and more prolonged than previously anticipated. This would result in a pronounced downturn in the Norwegian economy and indicated that the interest rate should be rapidly reduced. On the other hand, the interest rate was already at a low level, and it might take time before the full effects of the interest rate reduction fed through fully in the economy. This indicated in isolation that the interest rate should be reduced gradually or that further interest rate cuts should be put on hold.

Approximately as expected, but still fragile

Developments in spring confirmed the picture that the global economy was in the midst of the deepest downturn in the post-war period. In line with the strategy, the interest rate was lowered by 0.5 percentage point at the monetary policy meeting on 6 May to 1.50%. At the monetary policy meeting

The mandate for monetary policy in Norway

Monetary policy in Norway is conducted by Norges Bank. The Bank's activities are subject to the Norges Bank Act of 1985. Pursuant to Sections 19 and 20 of the Act, Norges Bank stipulates the conditions for the interest rates on banks' deposits with and loans from the central bank.

The mandate for monetary policy was laid down by the Government in 2001. Section 1 of the regulation states:

"Monetary policy shall be aimed at stability in the Norwegian krone's national and international value, contributing to stable expectations concerning exchange rate developments. At the same time, monetary policy shall underpin fiscal policy by contributing to stable developments in output and employment. Norges Bank is responsible for the implementation of monetary policy.

Norges Bank's implementation of monetary policy shall, in accordance with the first paragraph, be oriented towards low and stable inflation. The operational target of monetary policy shall be annual consumer price inflation of approximately 2.5% over time. In general, the direct effects on consumer prices resulting from changes in interest rates, taxes, excise duties and extraordinary temporary disturbances shall not be taken into account."

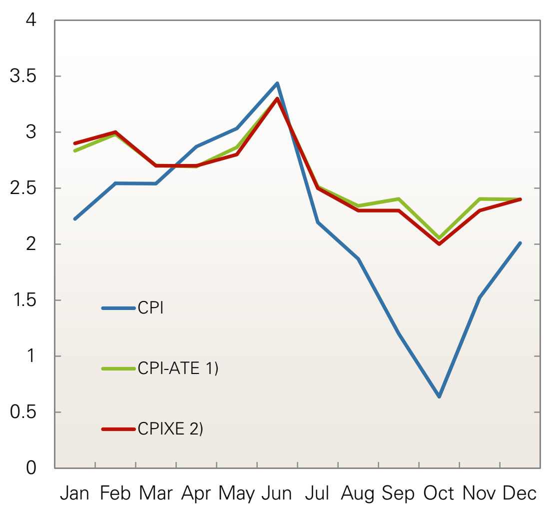
Norges Bank issued its opinion on the mandate in a submission to the Ministry of Finance in 2001:

"Monetary policy affects the economy with considerable and variable lags. Consequently, the Bank must be forward-looking in its interest rate setting. The effects of interest rate changes are uncertain and vary over time."

Regarding the implementation of monetary policy, the Bank stated:

"If price inflation deviates substantially from the target for a period, Norges Bank will set the interest rate with a view to gradually returning consumer price inflation to the target. Norges Bank will seek to avoid unnecessary fluctuations in output and demand."

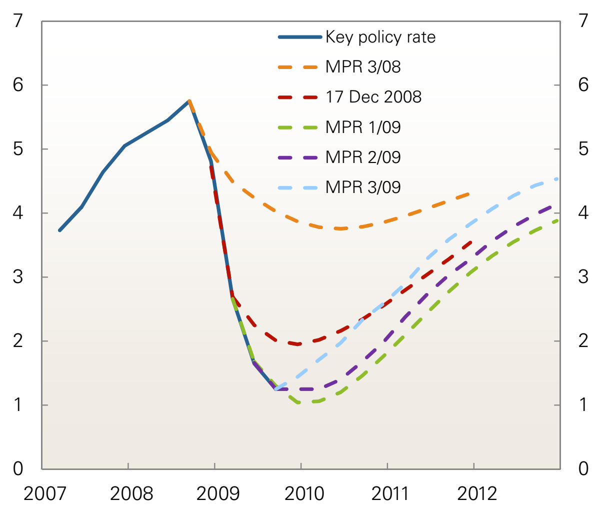
Chart 4 Consumer prices. 12-month change. Per cent. 2009



[1] CPI adjusted for tax changes and excluding energy products
[2] CPI adjusted for tax changes and excluding temporary changes in energy prices.

Sources: Statistics Norway and Norges Bank

Chart 5 Key policy rate in the baseline scenario MPR 3/08, 17 December 2008, MPR 1/09, MPR 2/09 and MPR 3/09. Percentage points. 2007 Q1– 2012 Q4



Source: Norges Bank

on 17 June, *Monetary Policy Report* 2/09 was published and the key rate was lowered by a further 0.25 percentage point to 1.25%, the lowest level during the downturn.

Norges Bank's projections were approximately the same as in March, and the analyses in the report indicated that the key rate could remain close to 1% for a period ahead. Output in the Norwegian economy had, as expected, fallen during the first half of 2009. Unemployment increased less than anticipated. House prices and share prices had risen, and households' access to credit had improved since autumn 2008. At the same time, commercial property prices continued to fall and business sector investment slowed markedly. On the other hand, oil investment appeared to remain firm. Underlying inflation measured by the CPIXE was 2.8%. As in March, lower global inflation and lower capacity utilisation were expected to curb inflation. A more rapid turnaround or a depreciation of the krone might result in higher-than-projected inflation. On the other hand, there was still a risk that the global downturn might be deeper and more prolonged. This could result in lower inflation, necessitating a more forceful use of monetary policy instruments.

Through summer there were signs of improvement in the global economy. In many countries, key rates were set at very low levels in order to mitigate the impact of the crisis.

Flexible inflation targeting

Monetary policy in Norway is oriented towards low and stable inflation. The operational target for monetary policy is annual consumer price inflation of approximately 2.5% over time. This target provides economic agents with an anchor for inflation expectations. When there is confidence in the inflation target, monetary policy can also contribute to stabilising developments in output and employment.

Norges Bank operates a flexible inflation targeting regime, so that smoothing fluctuations both in inflation and in output and employment is given weight in interest rate setting. Flexible inflation targeting builds a bridge between the long-term objective of monetary policy, which is to keep inflation low and provide an anchor for inflation expectations, and the more short-term objective of smoothing developments in output.

The instrument of monetary policy is the key policy rate, which is the interest rate on banks' overnight deposits in Norges Bank. The key rate has an impact on the shortest money market rates, and expectations regarding the future key policy rate have a decisive impact on the level of market rates for loans with longer maturities.

Market rates have an effect on the exchange rate, securities prices, house prices and credit and investment demand. Norges Bank's key policy rate can also influence expectations regarding future inflation and economic developments. The interest rate operates through all these channels to influence overall demand and output as well as prices and wages.

Decisions concerning changes in the key rate and other important changes are normally taken at the Executive Board's monetary policy meeting every sixth week. Three times a year, publication of the Monetary Policy Report coincides with the key rate decision. In the Report, Norges Bank analyses the current economic situation and provides forecasts for economic developments and for the key rate. On the basis of the analysis in the report, the Executive Board adopts the monetary policy strategy in the form of an interval for the key rate for the period up to the next Monetary Policy Report.

Forecasts for the interest rate and other economic variables are based on incomplete information concerning the economic situation and how the economy functions. Should developments in the economy differ from assumptions or should the central bank change its view of the functioning of the economy, developments in the interest rate and other variables may deviate from the forecasts. The Bank provides an account of any changes in the interest rate forecast and of the factors underlying such changes in the Monetary Policy Report. A summary of the changes described in the reports issued throughout the year is published in the Annual Report. An extensive review of the forecasts for the key policy rate and other economic variables is published annually in a separate article.

Governments throughout the world had implemented measures to increase demand and put the money and credit markets back on their feet. These measures appeared to be effective. The level of activity in the advanced economies had fallen considerably, although the pace of decline had slowed. In China and other emergent economies, there were signs of renewed growth. The financial markets were marked by growing optimism and greater risk appetite.

In Norway, it appeared that output and employment would fall less than expected. In late summer, underlying inflation remained close to the inflation target of 2.5%. Unemployment was lower than projected, and the situation in financial markets improved considerably through summer. At the monetary policy meeting on 12 August, the Executive Board stated that these developments were uncertain and new figures could change the picture, but that it might be appropriate to increase the key rate earlier than envisaged in the previous *Monetary Policy Report* if the trend continued. The key policy rate was kept unchanged at the monetary policy meeting on 23 September, although the Executive Board considered the alternative of increasing the key policy rate.

Emerging from the economic crisis

In the period up to the October monetary policy meeting, there were prospects of higher inflation and stronger growth in output and employment than expected some months earlier. Following a sharp fall in autumn 2008, the price of oil rose steadily through 2009. This contributed to a fairly mild downturn in Norway. At the same time, monetary policy measures and growth in public spending had probably been effective. Household demand for goods and services and the willingness to pay for housing were on the increase. There were also signs of a pickup in global growth. The liquidity crisis in the banking sector had passed and the extraordinary measures were being phased out.

At the monetary policy meeting on 28 October, *Monetary Policy Report* 3/09 was published and the key policy rate was increased by 0.25 percentage point to 1.50%. The analyses in the report indicated that the key policy rate should thereafter be gradually increased in the period ahead.

In the period up to the monetary policy meeting in December, underlying inflation remained close to 2.5%. At the same time, low productivity had probably put pressure on enterprises' profitability. Enterprises appeared to choose to maintain their workforces in anticipation of a pickup in demand. Low productivity, higher corporate costs, growth in household demand and higher capacity utilisation might gradually lead to excessive inflation. This indicated that the interest rate should be raised. On the other hand, global growth was expected to be moderate. A marked interest rate rise in Norway and a wider interest rate differential between Norway and other countries might result in the risk of a stronger-than-projected krone and push down inflation. This indicated that the interest rate should not be raised too rapidly.

Table 1. Interest rate decisions in 2009

Monetary policy meeting	Change in percentage points	Key policy rate after meeting
4 February	–0,50	2,50
25 March	–0,50	2,00
5 May	–0,50	1,50
17 June	–0,25	1,25
12 August	0,00	1,25
23 September	0,00	1,25
28 October	0,25	1,50
16 December	0,25	1,75

Changes in the interest rate forecast through 2009

At the monetary policy meeting on 17 December 2008, a new and lower forecast was presented for developments in the key policy rate (see Chart 5). This forecast indicated that the key policy rate should be lowered to 2% in the second half of 2009. Through 2009, the interest rate forecast was revised down, and at the end of the year the key policy rate was below the level in the December 2008 forecast. Developments through the first half of 2009 indicated lower inflation prospects and a sharper fall in activity in the Norwegian economy than envisaged in December of the previous year. The picture changed through summer and autumn. It appeared that the upturn would occur more rapidly than expected, and the October forecast indicated that the key rate should be returned to a normal level at a somewhat faster pace than anticipated at the beginning of the year.

The total change in the interest rate forecast through the year was relatively small. Chart 6 shows the changes in the forecast for the key policy rate from 17 December 2008 to 28 October 2009. The bars in the chart illustrate how various factors contributed to the changes through their effects on inflation, output and employment.

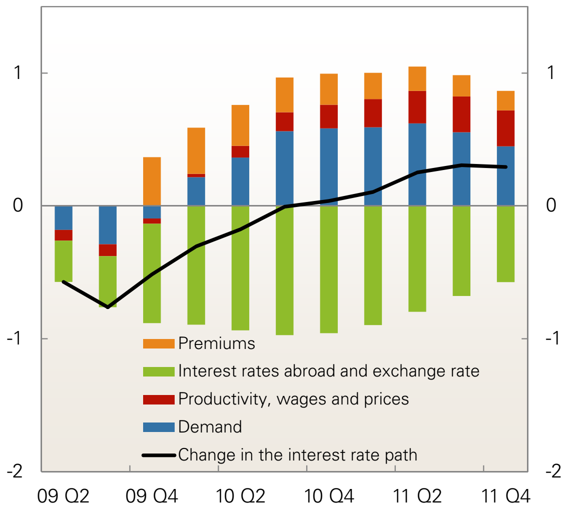
Markedly lower expectations regarding key rates among our trading partners would, all else being equal, result in a stronger krone, lower inflation and lower activity in the Norwegian economy. In isolation, this pushed down the interest rate forecast (green bars). In addition, the krone had appreciated as a result of lower risk premiums through 2009.

In the second and third quarters of 2009, there was an unexpectedly sharp fall in economic activity among Norway's trading partners. This might result in a greater fall in Norwegian exports than previously assumed and indicated a lower key rate in the short term (blue bars). At the same time, it appeared that oil investment would fall less and that capacity utilisation in the Norwegian economy would remain at a higher level than expected. Towards the end of the year, projected GDP growth among trading partners in 2009 and 2010 was revised up somewhat. Together with further improvement in the outlook for growth in demand for goods and services, this pushed up the forecast for the key rate ahead (blue bars).

Norwegian money market premiums fell somewhat more rapidly than expected in the period to summer 2009. Financial market conditions continued to improve through the year and premiums were expected to reach a normal level somewhat more rapidly than estimated in the December forecast. This pushed up the interest rate (orange bars).

At the beginning of 2009, prospects of lower global and domestic inflation pushed down inflation projections. This indicated a lower interest rate (red bars). Towards the end of the year, business sector productivity was lower than expected and costs were higher. It was expected that enterprises would attempt to increase profitability through a somewhat sharper rise in prices ahead. At the same time, unemployment had increased less than expected, pointing to somewhat higher wage and price inflation in the years ahead than previously envisaged. Both factors pushed up the forecast for the key policy rate ahead.

Chart 6 Change in the forecast for the key rate from the monetary policy meeting of December 2008 to *Monetary Policy Report* 3/09. Percentage points. 2009 Q2– 2011 Q4



Source: Norges Bank


"The overall change in the interest rate forecast
was not substantial."

At the final monetary policy meeting in 2009, on 16 December, the key policy rate was raised by a further 0.25 percentage point to 1.75%. The Executive Board considered the alternative of maintaining the interest rate unchanged, but the key rate increase in October had had a limited impact on bank lending rates and the key policy rate was still at a low level.

LIQUIDITY POLICY IN 2009

Reversal of crisis measures

The global crisis in the financial markets, which started in autumn 2008, influenced the Norwegian money market into 2009. In order to curb market turbulence, Norges Bank kept the supply of NOK liquidity at a markedly higher level than normal. Conditions in the money market gradually normalised through the year. Norges Bank returned liquidity to normal levels and phased out extraordinary measures through 2009.

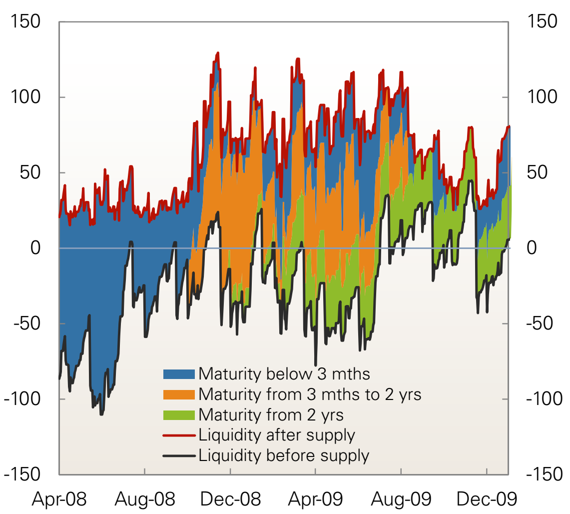
The money market rate is determined by the supply of and demand for liquidity. When overnight liquidity in the banking system as a whole shows a surplus, this surplus is deposited in a sight deposit account at Norges Bank with interest paid at the key rate. Thus, no banks will normally lend money overnight at a rate lower than the key rate. In its conduct of monetary policy, Norges Bank ensures that the supply of liquidity in the banking system is sufficient to bring short-term money market rates down to a level close to the key policy rate set by the Executive Board. Under normal market conditions, total liquidity of NOK 20–30bn is sufficient. At the end of a quarter or year, in connection with large tax payments and in the event of considerable uncertainty or turbulence in the markets, banks' capacity and willingness to redistribute liquidity may be reduced. Higher surplus liquidity may then be required to hold down short-term rates.

Turbulence in financial markets

At the beginning of 2009, in the wake of the Lehman Brothers bankruptcy, there was still considerable turbulence in international financial markets. Demand for USD was unusually high and it was difficult to obtain loans other than those with the shortest maturities. Like other central banks, Norges Bank entered into a credit agreement with the Federal Reserve in autumn 2008. Auctions of US dollar liquidity provided the necessary dollar funding for Norwegian banks. This was particularly important in the first half of 2009. The problems in the US dollar market gradually subsided, market rates decreased and it became easier to secure market funding. Norges Bank's measures were then wound down and gradually phased out.

The confidence crisis in the US dollar market spread to international money markets as a result of further uncertainty throughout the banking sector and greater demand for loans in currencies that could be swapped with USD. In order to keep the shortest market rates close to the key policy rate, the supply of NOK liquidity was maintained at a much higher level than normal. At the beginning of 2009, banks' deposits in sight deposit accounts at Norges Bank exceeded NOK 100bn (see Chart 7). The high level of deposits was maintained through the first half of 2009, but could then be gradually decreased.

Chart 7 Liquidity in the banking system before and after supply from Norges Bank. In billions of NOK. 1 April 2008 – 31 December 2009



Source: Norges Bank

Greater supply of NOK liquidity

Norges Bank supplied NOK liquidity partly by means of ordinary fixed-rate loans (F-loans) and partly through foreign exchange swap agreements. F-loans are fixed-rate loans with a specific maturity and are granted to banks established in Norway against collateral in the form of approved securities. The interest rate on fixed-rate loans is normally determined through multi-price auction.[3] As a rule, the maturity varies from one day to six weeks, depending on the liquidity situation. As part of the authorities' efforts to strengthen banks' funding, Norges Bank provided a two-year F-loan specifically for smaller banks in autumn 2008. Another long-term F-loan was made available in February 2009 with a three-year maturity. A total of 100 banks accepted the offer, borrowing over NOK 35bn in 2008 and 2009 through the two long-term F-loans. Uncertainty regarding the funding situation was thereby reduced for a number of smaller banks (see Chart 7). In order to increase banks' access to loans in Norges Bank, collateral requirements were temporarily eased.

[3] In a multi-price auction, also referred to as an American or ordinary auction, banks submit bids for the desired amount and interest rate. Norges Bank determines the total amount to be allocated. Banks' interest rate bids are ranked in descending order and allocations are made until the total amount is reached. Successful bidders pay the interest rate they have bid.

"Money market conditions gradually returned to normal through the year"

Foreign banks without access to F-loans were also given the opportunity to borrow NOK directly from Norges Bank through foreign exchange swap agreements. In a foreign exchange swap agreement, Norges Bank provides loans against collateral in another currency, for example by lending NOK against USD. On three occasions in 2009, NOK liquidity was provided against USD by means of foreign exchange swap agreements. Two of the loans were three-month loans, the last with a maturity of one month.

As a result of substantial fluctuations in the US dollar market, the variation in the Norwegian tomorrow/next (T/N) interest rate[4] increased considerably during the first half of 2009. However, very ample NOK liquidity ensured that the T/N interest rate, on average, remained close to the key rate (see Chart 8). The second half of 2009 saw a considerable decrease in the fluctuations in the dollar market. Even though NOK liquidity has been gradually reduced to a normal level, the Norwegian T/N interest rate has remained stable at a level just above the key policy rate.

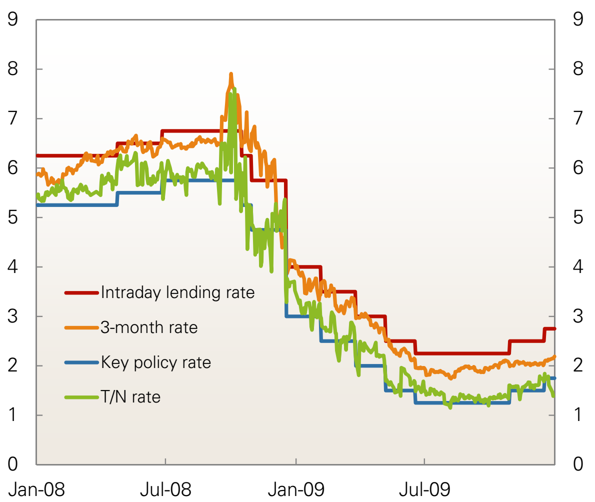
High money market premiums

Throughout 2009, long-term money market premiums both in Norway and abroad were higher than usual (see Chart 9). As conditions in financial markets improved, premiums have fallen markedly and approached a more normal level.

The swap arrangement was established in order to secure longer-term funding for banks, and this has helped to mitigate the problems in the money market (for further details, see separate box). The arrangement was an important prerequisite for banks' capacity to maintain normal lending to customers during the period of financial market turbulence. The measure has probably also contributed to keeping banks' lending rates lower than would otherwise have been the case. Through 2009 the price in the swap arrangement was gradually raised as long-term funding became more accessible in the market. The arrangement was phased out in December 2009.

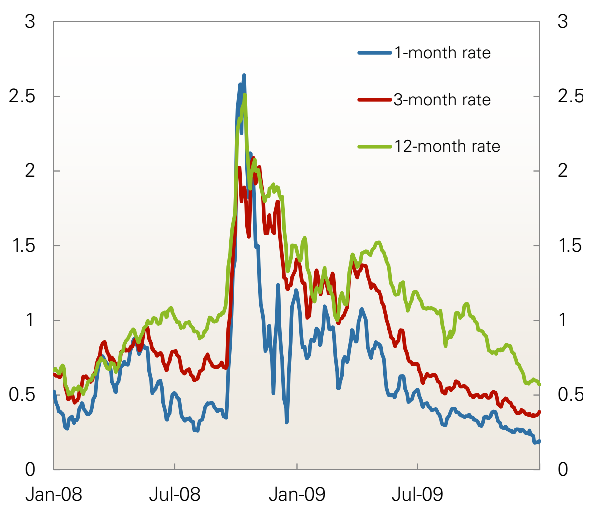
[4] Tomorrow/next (T/N) rate. The rate paid by banks on interbank loans from the following day to the day after.

Chart 8 Norges Bank's interest rates and short-term money market rates (money market rate one day ahead and 3 months ahead). Nominal rates. Per cent. 1 January 2008–31 December 2009



Sources: Thomson Reuters and Norges Bank

Chart 9 Difference between money market rates and expected key rate. Percentage points. 5-day moving average. 1 January 2008–31 December 2009



Sources: Thomson Reuters and Norges Bank

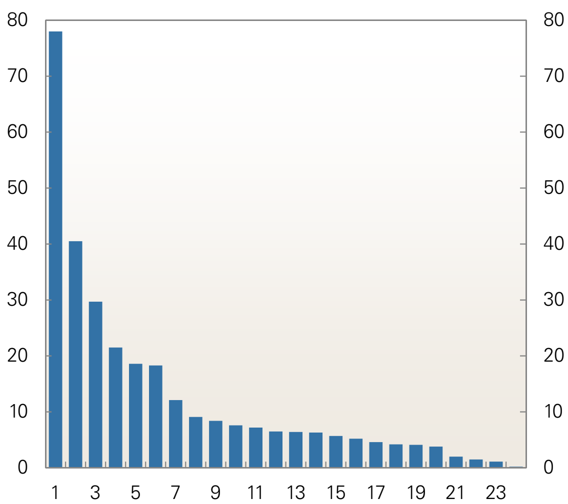
The swap arrangement

On 24 October 2008, on the advice of Norges Bank and proposals from the Ministry of Finance, the Storting authorised implementation of a swap arrangement whereby banks would receive government securities in exchange for covered bonds (OMF). The maximum limit of the arrangement was set at NOK 350bn. Norges Bank administered the arrangement on behalf of the Ministry of Finance.

The swap arrangement helped to reduce banks' liquidity risk by providing access to long-term funding in a period when bond markets did not function as normal. The arrangement facilitated access to funding as banks could sell the government securities or use them as collateral for loans.

All covered bonds issued in accordance with Norwegian regulations were accepted under the swap arrangement. The collateral pool for covered bonds could thus include residential mortgages, commercial property mortgages and municipal loans. Covered bonds issued in other countries backed by Norwegian assets were also accepted.

Chart 10 Allotment per bank (indicated by number) under the swap arrangement. Percentage of total assets. 31 December 2009



Source: Norges Bank

In 2009, 20 auctions were conducted under the swap arrangement. A total of 24 banks and mortgage companies took part in the arrangement, involving altogether 61 different covered bonds. The participants entered into swaps amounting to between 0.2% and 78% of their total assets (see Chart 10). A total of NOK 188bn in Treasury notes was allotted in 2009. In 2008 and 2009 together, NOK 230bn in Treasury notes was allotted under the swap arrangement (see Table 2). At all auctions up to 13 July 2009, Norges Bank set a minimum price of NIBOR minus 20 basis points. As market conditions improved, the minimum price was gradually increased. The last auction where bids were submitted was in October. The minimum price was then set at NIBOR plus 70 basis points. The last two auctions in November and December were cancelled owing to lack of interest. The swap arrangement was phased out in December. Administration of the swap agreements will be continued until they expire in a few years' time. At the end of the swap period, the participants must repurchase the covered bonds from the Government at the same price paid by the Government for these bonds.

"The swap arrangement was established to secure banks' longer-term funding."

Table 2 Overview of auction results under the swap arrangement

						Competitive and non-competitive bids	
Date	Minimum price	X (premium, bp)	Y (bp)	Auction rate	Total auction amount In billions of NOK	Volume of bids in billions of NOK	Volume allotted in billions of NOK
24.11.08	5.86	–20	0	5.86	10.0	10.00	10.00
01.12.08	5.68	–20	0	5.68	15.0	11.00	11.00
08.12.08	5.23	–20	0	5.23	10.0	11.50	10.00
15.12.08	3.99	–20	0	4.70	11.0	10.99	10.99
12.01.09	3.45	–20	0	3.45	15.0	22.00	15.00
26.01.09	3.27	–20	0	3.27	15.0	16.40	15.00
23.02.09	3.25	–20	0	3.25	10.0	1.00	1.00
09.03.09	2.74	–20	0	2.74	15.0	5.00	5.00
16.03.09	2.85	–20	0	2.85	10.0	1.96	1.96
01.04.09	2.66	–20	0	2.66	10.6	15.23	10.55
20.04.09	2.67	–20	0	2.67	10.0	15.83	10.00
04.05.09	2.60	–20	0	2.60	10.8	12.57	10.82
18.05.09	2.27	–20	0	2.27	10.0	18.68	10.00
02.06.09	2.37	–20	0	2.37	11.4	18.61	11.37
15.06.09	2.26	–20	0	2.26	11.0	19.40	11.00
29.06.09	1.99	–20	10	2.09	12.9	37.42	12.50
13.07.09	1.89	–20	16	2.05	11.2	27.66	11.17
27.07.09	2.07	0	1	2.08	12.0	25.15	12.01
10.08.09	1.94	0	1	1.95	12.0	19.49	11.99
24.08.09	2.83	20	1	2.84	11.7	22.46	11.75
07.09.09	2.91	20	4	2.95	11.7	18.77	11.69
21.09.09	3.15	50	1	3.16	10.8	11.68	10.80
05.10.09	2.88	50	2	2.90	5.2	2.42	2.42
19.10.09	3.03	70	0	3.03	5.0	1.50	1.50
				SUM	**267.30**	**356.71**	**229.50**

Minimum price = NIBOR(5) + X
Auction rate = NIBOR(5) + X + Y
NIBOR(5) = Average NIBOR over the last five trading days
Premium X = premium that may be positive or negative, depending on market conditions
Y = basis points in excess of the minimum price set for the auction

EVALUATION – USE OF INSTRUMENTS

Somewhat greater fluctuations in the money market

Norges Bank's communication of its monetary policy primarily aims to stabilise inflation expectations by giving the reasons for and explaining interest rate setting. The aim of publishing the Bank's interest rate forecasts and monetary policy strategy is to make it easier for others to anticipate and evaluate monetary policy. When market participants understand the central bank's response pattern, it is more likely that market rates will react to new information on economic developments in a stabilising manner.

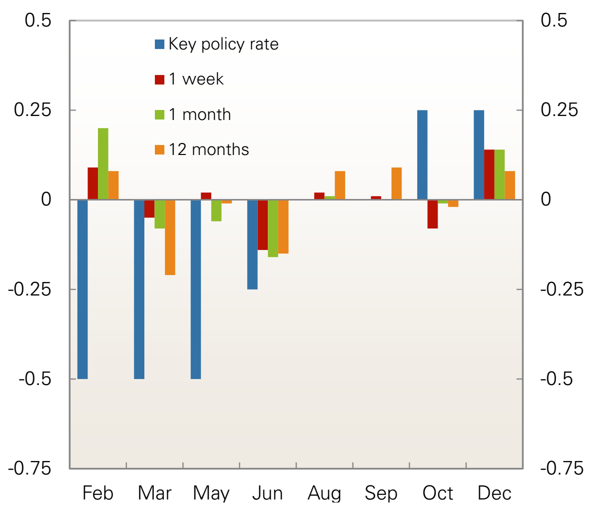
The effects on market rates of the Executive Board's monetary policy meeting are an indicator of market participants' ability to anticipate interest rate setting. Pronounced effects may indicate that the decision was unexpected. During the five-year period from 2005 to 2009, the average change in the one-week rate after the monetary policy meeting was 4 basis points. The average change in the one-month and twelve-month rates was 5 basis points. In 2009, the average change in the one-week, one-month and twelve-month rates was respectively 7, 8 and 9 basis points. The somewhat greater effects than in the previous years must be viewed in the context of wider general fluctuations in interest rates as a result of financial market turbulence. When the key policy rate was lowered by 0.5 percentage point at the monetary policy meeting in February, short-term money market rates increased by up to 20 basis points (see Chart 11). This was because, prior to the meeting, some market participants had expected cuts of up to 0.75 percentage point. When the interest rate was lowered by 0.25 percentage point on 17 June, short-term money market rates fell somewhat. Market participants were uncertain as to when the final interest rate cut would occur and the change was not fully priced into the market.

During the period prior to the monetary policy meeting on 16 December, the market priced in a 50% probability of an interest rate rise. When the interest rate was increased by 0.25 percentage point, short-term money market rates rose somewhat. Beyond this, short-term market rates only showed slight changes. The largest fall in the longest money market rates occurred after the monetary policy meeting on 25 March, when the twelve-month rate fell by 24 basis points as a result of a larger-than-expected downward revision of the interest rate forecast.

Historical response patterns

Market participants will attempt to envisage how the central bank responds to new information and how the key rate is set as a result of developments in economic variables. Norges Bank has estimated an interest rate rule that seeks to explain historical interest rate changes on the basis of changes in a few macroeconomic variables. The rule includes inflation developments, wage growth, mainland GDP and central bank key rates abroad. The interest rate in the previous period is also taken into account. Such an

Chart 11 Change in the key policy rate and effect on money market rates following monetary policy meetings in 2009. Percentage points.



Source: Norges Bank

estimated reaction function does not capture all the elements that are given weight and can only provide an indication of how Norges Bank has responded to a selection of variables. From autumn 2008 to summer 2009, Norges Bank reduced the key policy rate more rapidly than indicated by the historical response pattern (see Chart 12). Just as the financial crisis of autumn 2008 indicated bringing forward the reduction in the interest rate, the prospects in autumn 2009 indicated a rather more rapid interest rate rise than was indicated by the simple rule.

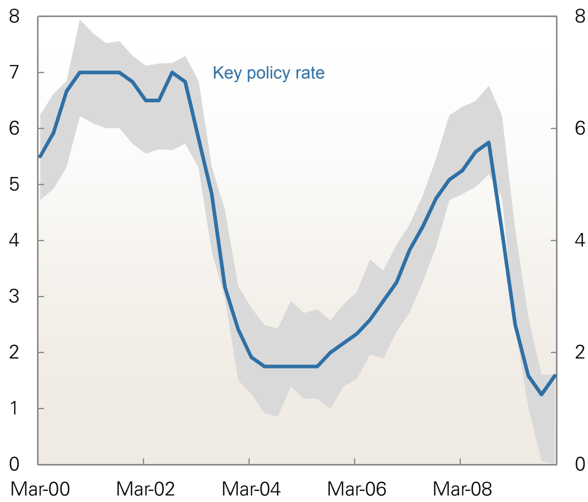
Monetary growth and inflation

Historically there has been a certain correlation between inflation and growth in the money supply (M2) in Norway (see Chart 13).[5] There is a tendency for stronger monetary growth to accompany higher inflation and for weaker monetary growth to accompany lower inflation. Trend monetary growth may serve as a rough cross-check of inflation projections generated by other models.

The ten years up to 2008 saw an increase in trend monetary growth despite large annual fluctuations. Strong growth in the Norwegian economy and high credit growth drove monetary growth up to a particularly high level in the period from 2006 to 2008. At the same time, consumer price inflation was low as a result of favourable conditions on the supply side in the Norwegian and international economy. Inflation picked up and exceeded the inflation target in 2008. Between 2008 and 2009, monetary growth fell rapidly, exhibiting a downward trend towards the end of the period. At the same time, inflation was falling.

[5] The money supply (M2) consists of banknotes and coins, unrestricted bank deposits, certificates of deposit and units in money market funds owned by the money-holding sector (households, non-financial enterprises, municipal administration and financial enterprises other than state lending institutions, banks and money market funds). Other financial enterprises includes financial enterprises other than banks, state lending institutions and money market funds.

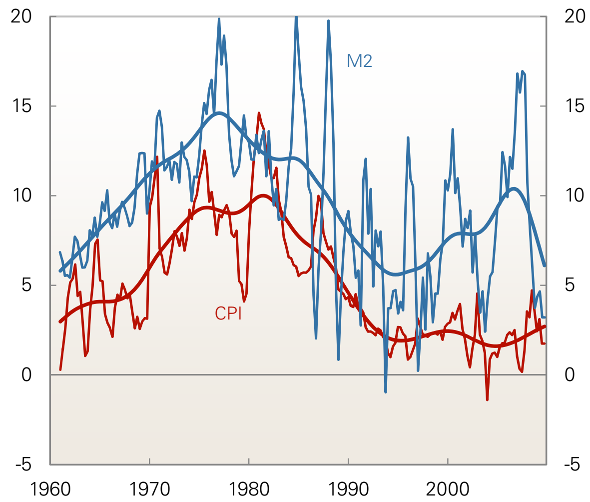
Chart 12 Key policy rate and interest rate developments following from Norges Bank's average pattern of interest rate setting. 1) Per cent. 2000 Q1– 2009 Q4



1) Interest rate movements are explained by developments in inflation, mainland GDP growth and key rates among trading partners. See Staff Memo 2008/3 for further discussion

Source: Norges Bank

Chart 13 Consumer prices (CPI) and money supply (M2). Estimated trend rise1). Four-quarter growth. Per cent. 1961 Q1 – 2009 Q4



1) Trend calculated using HP filter. See Staff Memo 2005/2 for further discussion

Sources: Statistics Norway and Norges Bank

"Confidence in the attainment of the inflation target is a precondition for monetary policy also being able to contribute to stabilising developments in output and employment."

EVALUATION –
PERFORMANCE OVER TIME

Inflation is low and stable

Inflation stabilised in the early 1990s after falling from the high level of the previous decade. Over the past ten years, average annual consumer price inflation has been 2.1%.

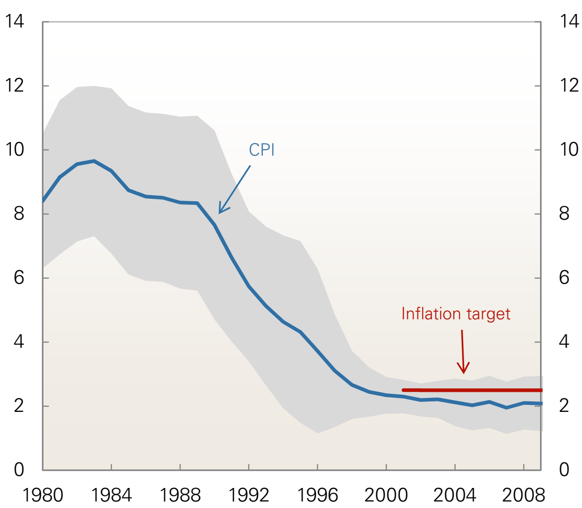
In accordance with Norges Bank's mandate for monetary policy, the operational target of monetary policy is annual consumer price inflation of close to 2.5% over time. Consumer price inflation over a short period does not provide an adequate basis for assessing whether monetary policy objectives have been achieved over time. Chart 14 shows the 10-year moving average for annual consumer price inflation.

Viewed over time, inflation has been low and stable, and has remained somewhat below, but fairly close to, 2.5%. The deviation is probably the result of a number of favourable supply-side shocks to the economy in previous years, including strong growth in productivity, an ample supply of labour from other countries and lower price rises on imported goods. This is reflected in strong growth in the Norwegian economy coupled with a period of lower-than-expected inflation.

Under a flexible inflation targeting regime, monetary policy also gives weight to stabilising developments in output and employment. Chart 15 shows the effects on the output gap since 1980. The output gap shows deviations between the actual level and the estimated normal level of mainland GDP. Thus measured, fluctuations in the economy have, on average, been somewhat less pronounced during the last ten years than around 1990. The impact on output in autumn 2008 and spring 2009 was nevertheless greater than for several years.

The band around average inflation in Chart 14 shows inflation variability. Over a longer time horizon, variability has decreased. Variability in the output gap shown in Chart 15 seems to have been diminishing since the end of the 1990s.

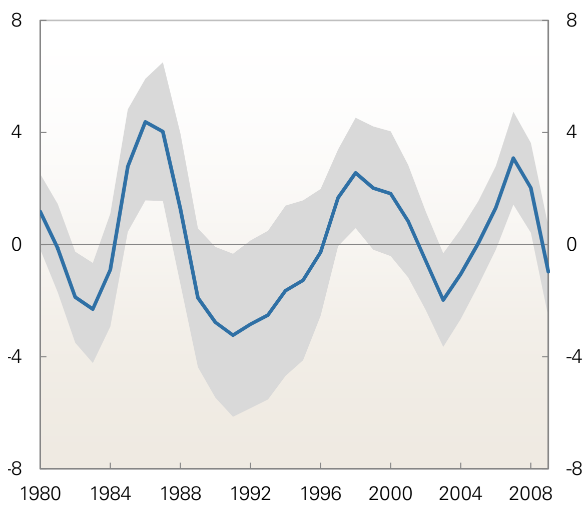
Chart 14 Inflation. Average inflation over past ten years and variation in CPI.[1] Per cent. 1980–2009



[1] The band around the CPI is the variation in the CPI adjusted for tax changes and excluding energy products in the average period, measured by +/- one standard deviation

Sources: Statistics Norway and Norges Bank

Chart 15 Output gap estimates[1]. Level and variation[2]. Per cent. 1980–2009



[1] The output gap measures the difference between actual and estimated potential mainland GDP.
[2] The band shows the variation in the output gap measured by +/- one standard deviation. The variation is calculated as the average standard deviation over the past ten years.

Source: Norges Bank

EVALUATION –
INFLATION EXPECTATIONS

Confidence in the inflation target

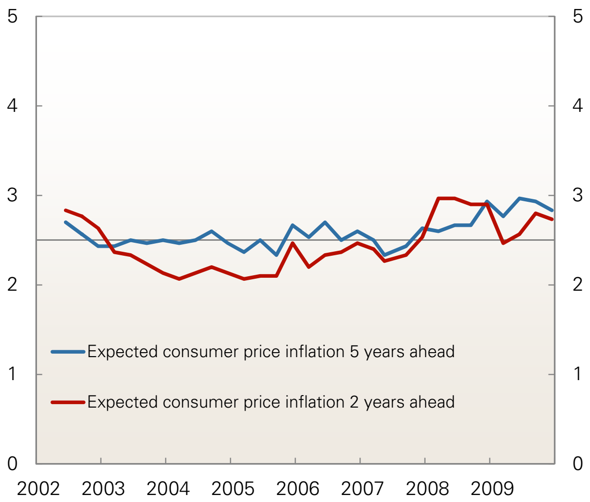
For many years, Norges Bank has given weight to anchoring inflation expectations at the inflation target of 2.5% and has succeeded in doing so. Confidence in achieving the inflation target is a precondition for the stabilising effect of monetary policy on developments in output and employment. Inflation will not be at target at all times, but if there is confidence in monetary policy, expected inflation will be close to the inflation target over time, which in itself contributes to stabilising inflation.

TNS Gallup has been commissioned by Norges Bank to carry out quarterly surveys on inflation expectations. According to these surveys, inflation expectations in 2009 Q4 were fairly close to, but somewhat above 2.5% (see Chart 16). Annual inflation expectations two years ahead stood at 2.7% and annual inflation expectations five years ahead at 2.8%.

Consensus Forecasts Inc. compares different institutions' forecasts for consumer price inflation in Norway. Annual consumer price inflation is expected to be 2.3% at both the five-year and ten-year horizon.

An indicator of price expectations among financial market participants is provided by the yield curve in fixed income markets. Long-term forward rates may – under certain conditions – provide an indication of expected inflation. Chart 17 shows the long-term forward rate differential between Norway and the euro area. Because of a higher inflation target in Norway, this differential will normally be around ½–1 percentage point, depending on risk premiums in fixed income markets. The differential was close to 1 percentage point through 2009, but narrowed to ¾ percentage point towards the end of the year. A larger deviation can be an indication that inflation expectations in Norway are increasing more than implied by the inflation target. Overall, the indicators suggest that there is confidence that inflation over time will be close to 2.5%.

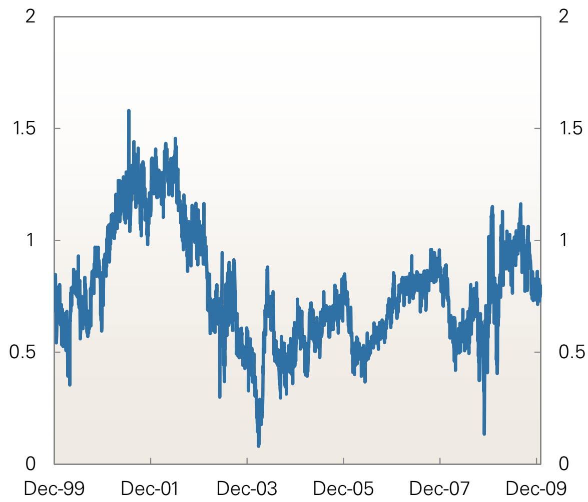
Chart 16 Expected consumer price inflation 2 and 5 years ahead.[1)] Per cent. 2002 Q2–2009 Q4



[1)] Average of expectations of employer/employee organisations and economists (financial industry employees and academia)

Sources: TNS Gallup and Perduco AS

Chart 17 Long-term forward rate differential betweenNorway and the euro area. Percentage points. 1 December 1999–31 December 2009



Sources: Thomson Reuters and Norges Bank

"Regulations should require banks to hold more capital against unexpected losses."

CHAPTER 3.

Financial stability

WORK ON FINANCIAL STABILITY

Financial stability requires that the financial system shall be so robust that it functions as intended even in the event of major disturbances within or outside the system. The financial system must be able to channel capital, execute payments and redistribute risk in an effective manner. Norges Bank's work to promote financial stability consists of four major components:

- monitoring the risk of shocks to the financial system
- identifying measures to prevent instability
- promoting confidence in the means of payment
- maintaining contingencies for crisis management

In Norway, work on ensuring financial stability is shared between the Ministry of Finance, Norges Bank and Finanstilsynet (the Financial Supervisory Authority of Norway). Regular tripartite meetings are held between these three institutions to coordinate work on matters concerning financial stability.

FINANCIAL INSTITUTIONS AND FINANCIAL MARKETS

More emphasis on banking regulation

The international financial crisis revealed weak aspects of the financial system. In 2009, Norges Bank submitted assessments and recommendations concerning, among other things, banking regulation.

In semi-annual submissions to the Ministry of Finance in connection with the publication of the *Financial Stability* reports, Norges Bank provides an assessment of financial stability based on the reports. In 2009, Norwegian financial markets and financial institutions were marked by the international financial crisis, and in its submission of 25 May and *Financial Stability* report 1/09, Norges Bank called attention to the banks' need for additional capital. Norges Bank pointed out that, in the longer term, after the market turbulence had passed, a higher level of good quality capital should be required. Norges Bank also expressed the view that cooperation on banking regulation should be rooted in the Nordic countries' finance ministries. It was also noted that the tax system favoured housing investment and housing consumption, which gives rise to overinvestment and pushes up house prices in periods of expansion. A taxation system that taxes the benefit of home ownership, and where housing property is subject to mark-to-market valuation, would have curbed the fluctuations in house prices.

In its submission of 27 November and in *Financial stability* report 2/09, Norges Bank wrote that the prospects for financial stability in the short and medium term had improved somewhat, and that banks were in the process of improving their financial strength. At the same time, banks were recommended to improve their liquidity management. Norges Bank would review the requirements for liquidity management and reporting. The Bank submitted a number of proposals for amendments to banking regulations (see a more detailed account in the box on

The statutory basis for work on financial stability

The basis for the responsibilities of Norges Bank, including its responsibility for the stability of the financial system, is primarily provided for in Sections 1 and 3 of the Norges Bank Act. Section 1 states that the Bank shall issue banknotes and coin, promote an efficient payment system domestically as well as vis-à-vis other countries and monitor developments in the money, credit and foreign exchange markets. Section 3 states that the Bank shall inform the ministry when, in the opinion of the Bank, there is a need for measures to be taken by others than the Bank in the field of monetary, credit or foreign exchange policy. The Bank shall inform the public about the monetary, credit and foreign exchange situation.
Three other sections of the Norges Bank Act are also relevant: Section 13 grants Norges Bank the sole right to issue Norwegian banknotes and coins. Pursuant to Section 17, Norges Bank carries out banking services for the government. Section 19 provides that Norges Bank may grant loans and make deposits with commercial banks and savings banks. This entails a special responsibility for ensuring that the banking sector functions as intended. The Act relating to Payment Systems charges Norges Bank with the responsibility for authorising the banks' clearing and settlement systems, and for supervising these systems.

"The international financial crisis revealed weaknesses in the financial system."

page 101). As in the first submission, taxation of housing investment and housing consumption was also discussed. In addition, Norges Bank expressed the view that regulation limiting loan-to-value ratios on residential mortgages may reduce the risk of mounting financial imbalances and secure banks' collateral values.

The submissions to the Ministry of Finance provide information concerning various risk factors monitored by Norges Bank. In 2009, attention was particularly drawn to the risk of significantly weaker growth in the global economy and the risk of high losses on loans to commercial property and shipping for Norwegian banks.

In December 2008, Norges Bank recommended the Ministry of Finance to prepare measures to inject government capital into banks. At the beginning of 2009, the Bank participated in the working group that drafted the proposal for conditions for investments by the Government Finance Fund. Norges Bank also provided advice in connection with the establishment of the Government Bond Fund.

The financial crisis reminded us that the world can change very quickly, and that the ripple effects may be large even for participants far from the epicentre of the crisis. The changes that give rise to crises or financial instability are generally assessed as improbable during the period before they arise. Norges Bank therefore performs stress tests where banks are subjected to possible, but not probable, sudden changes. Stress test analyses are used to determine what happens to banks in such a scenario. The financial crisis has shown that the stress alternatives to which banks are subjected may need to include shocks that seem unlikely today. Both reports on financial stability in 2009 contained detailed accounts of stress tests.

Norges Bank uses broad-based underlying data to monitor the financial system, including both published material and information obtained directly from participants in the financial markets. Norges Bank's bank lending and liquidity surveys are examples of the latter. Regular meetings with banks are also held in order to discuss their current problems. This material is analysed, and constitutes the basis of the assessments provided by Norges Bank in the report on financial stability. A major purpose of the report is to increase knowledge and elicit debate on matters of importance for financial stability. Norges Bank aims to influence those who make decisions regarding the economy by providing a better basis for measures that can reduce risk.

Recommendations on amendments to banking regulation

Referred to in the submission to the Ministry of Finance of 27 November 2009 and in Financial Stability report 2/09

The global financial crisis has revealed weak aspects of the financial system. Banks had insufficient capital in relation to risk, insufficient liquidity and a lack of stable funding. Enhanced regulation of liquidity and capital would reduce the risk and impact of new financial crises. The Basel Committee on Banking Supervision is in the process of drafting recommendations on more stringent regulation of banks' capital and liquidity management. The Basel Committee is also considering how capital regulation can be designed to reduce the procyclicality of banking activity.

Such regulation should require banks to hold more capital against unexpected losses. In addition, higher Tier 1 capital requirements may increase loss-bearing capacity. Another approach is to introduce a required minimum equity to total assets ratio at financial institutions.

In regulating financial institutions, an attempt should be made to limit risk not only at each individual bank but also throughout the financial system. When banks prepare growth strategies, they pay little regard to the fact that their behaviour can influence other banks and the financial system as a whole.

The rules should be designed to stimulate banks in normal times to build up sound buffers beyond the minimum capital requirements, enabling them to weather bad times and absorb losses without needing to increase their equity capital. This may counter the need for banks to ration credit during a downturn.

The International Accounting Standards Board (IASB) has proposed amendments to the accounting rules for valuation of financial assets that could reduce the procyclicality of bank behaviour. Banks should be required to record expected losses throughout the life of a loan up to maturity, and not only when losses occur. The rules would then be more closely in line with accounting rules for other types of investment, where costs are recorded in better accord with investment income.

In recent years, less equity capital has been required for approving residential mortgages. This has resulted in an increase in the supply of residential mortgages. Banks have largely financed the growth in mortgage lending through market funding. This makes banks more vulnerable if access to market funding again becomes difficult. The low risk weights for residential mortgage loans therefore also increase liquidity risk in the banking system. Risk weights for residential mortgage loans should to a greater extent reflect the system risk associated with excessive growth in mortgage lending. Higher risk weights for residential mortgage loans and an equity capital requirement may curb banks' eagerness to extend residential mortgage loans.

A minimum requirement should be introduced stipulating the size of a bank's liquid assets necessary to enable it to withstand periods of funding market failures. In addition, a minimum requirement for funding stability should be introduced.

The financial crisis has required heavy use of state funds. This implies tighter regulation of systemically important banks. Such an amendment, for example involving higher capital requirements for systemically important banks than those that apply to other banks, would reduce the number and size of such banks and the risk of their failure.

In Norway, capital regulations have been somewhat more stringent than in other countries, based on the experience of the banking crisis in the early 1990s. All financial institutions are subject to capital requirements, and the Tier 1 eligibility requirements are more stringent than in other countries. Furthermore, all assets in a conglomerate must be included in the calculation of banks' capital requirements. This has placed banks in a stronger position to cope with the crisis. It has been an advantage that the Norwegian Banks' Guarantee Fund manages capital that can be used in a crisis. The Fund can also provide support by injecting capital into a bank in crisis. The system for membership fees should be designed so that banks supply more capital to the Fund without setting a low ceiling on the size of the Fund.

Preparing for and dealing with crises

Norges Bank prepares for dealing with crises in the Norwegian financial system. Large banks fund their operations in a number of countries and currencies, and are thus vulnerable to events in other countries. Almost half of Norwegian banks' funding is in foreign currency. Turbulence also spreads between countries because the same banks operate in several countries. Cross-border banking activities have increased in recent years. Dealing with crises in such banks is a particular challenge for the authorities.

After the acute liquidity crisis in autumn 2008, conditions gradually improved during 2009.[6] A major reason for this was the measures implemented by the authorities both in Norway and in other countries. In 2009 too, Norges Bank supplied more liquidity than normal to banks (see Chapter 2). In 2009, the Government established arrangements for supplying more capital to banks (Government Finance Fund) and for stimulating the bond market (Government Bond Fund).

The EU plans to strengthen monitoring of threats to financial stability by means of both increased microprudential supervision (European System of Financial Supervisors, ESFS) and increased macroprudential supervision (European Systemic Risk Board, ESRB). According to these plans, Norway will be an observer at the ESFS and will be invited to attend meetings of the ESRB on an ad-hoc basis. Norges Bank and Finanstilsynet (the Financial Supervisory Authority of Norway) have observer status in the EU Committee of European Banking Supervisors (CEBS) and in the Banking and Supervision Committee (BSC), which is part of the European System of Central Banks (ESCB).

The Contingency Committee for Financial Infrastructure

The Contingency Committee was established to ensure the best possible coordination of contingency work in the financial infrastructure. The Committee has also a responsibility for following up the Civil Emergency Planning System in the financial sector. Norges Bank chairs the Committee and provides the secretariat.

The Contingency Committee held three meetings in 2009, and discussed matters concerning operational stability, risk and vulnerability in the financial infrastructure. The Committee also reviewed experience of situations involving disruption. The Committee followed up the situation following the financial turbulence, and considered whether the development of swine flu required contingency measures. None of the institutions represented on the Committee had implemented special measures in this connection.

During 2009, the Committee completed the following reports: *"Alternative means of payment in an emergency situation"* and *"Proposals for prioritising of participants in financial infrastructure with regard to access to power supply and telecommunications in an emergency situation"*. The reports were forwarded to the Ministry of Finance for further processing. In 2009, the Contingency Committee was briefed concerning contingency work at the Ministry of Finance, the financial industry's assessment of threats, Finanstilsynet's analysis of risk and vulnerability and work on Norges Bank's new settlement system.

Norges Bank is holding discussions with Finanstilsynet on transfer of the responsibility for the management and secretariat of the Contingency Committee.

Norges Bank issued its opinion on the framework conditions

In 2009, Norges Bank submitted opinions on 21 matters concerning draft amendments to the rules for the financial sector circulated for comment, primarily by the Ministry of Finance. Among other things, the Bank submitted comments on draft provisions concerning capital composition and organisational structures of savings banks, amendments to the rules for life insurance and pensions, proposals concerning implementation of the Payment Service Directive in Norwegian law and draft regulations for clearing of trade in equity instruments. Norges Bank mainly concurred with the draft proposals, but had a number of comments on some of the matters. Norges Bank's consultative comments are available at http://www.norges-bank.no.

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[6] In autumn 2009, the Norwegian Banks' Guarantee Fund issued a report on management of the crisis in Icelandic banks the previous year, cf. http://www.bankenessikringsfond.no/no/Hoved/Nyheter/Evaluering-av-krisen-hosten-2008/.

THE PAYMENT SYSTEM

The payment system functioned well during the turbulence

The payment system in Norway and abroad functioned well in 2009 for banks, other financial institutions, enterprises and individuals. The payment system has helped to maintain economic activity during a period when confidence in counterparties has been at a low ebb.

A well functioning interbank system is a precondition for financial stability. Interbank claims and liabilities arise as a result of banks' financial transactions, payment services and customers' positions in cash settlement of securities transactions. Final settlement of these positions is made through entries in banks' accounts in Norges Bank or in a private settlement bank. Norges Bank is the ultimate settlement bank in Norway. The Bank monitors major interbank systems and supervises the systems licensed pursuant to the Act relating to Payment Systems, etc.

The organisation of the payment systems is crucial for how they function during periods of turbulence, how easily problems may be transmitted between banks and how this affects the banks' customers. During the turbulence, the systems functioned well, and measures implemented by the authorities helped to ensure that banks had sufficient liquidity to settle payments.

The interbank systems have bolstered financial stability

All payments between banks and between customers of different banks are cleared and settled in the interbank systems. If a bank's liquidity is weakened to the extent that it is unable to meet its commitments in payment settlements, this may lead to a reduction in the liquidity expected by other banks. During the financial turbulence, there was an increased risk of counterparties not being able to fulfil their obligations on time, but this did not result in problems for the interbank systems, and banks used the systems approximately as

Securities settlement

Trades in shares, certificates, and bonds are cleared and settled through the Norwegian Central Securities Depository (VPS). VPS registers the changes of ownership of the securities and clears the associated cash positions between banks before they are settled at Norges Bank.

Norges Bank monitors securities settlement in accordance with international recommendations. VPS is authorised to operate as a securities register by the Ministry of Finance. Finanstilsynet supervises the participants in securities settlement (VPO) and has approved the rules in VPO associated with the Payment Systems Act.

normal. The measures implemented by the authorities helped to ensure that banks had sufficient liquidity to settle payments. Norges Bank's settlement system functioned well.

Norges Bank implemented a new interbank settlement system on 17 April 2009. The new settlement system has the same principal functions as the previous system. An important change is that all payment orders are sent from banks to Norges Bank via the international messaging system SWIFT or by means of a system called NBO Online that resembles an Internet bank. The new settlement system has a number of functions that banks can use to improve their liquidity management and increase the efficiency of payments. The new settlement system was developed in South Africa and supplied by the Italian company SIASSB. SIASSB has supplied systems solutions to a number of central banks and financial operators in other countries, among others Sveriges Riksbank. Norges Bank is in contact with Sveriges Riksbank in order to exchange experience of using the settlement system.

The IT operations for the settlement system are still carried out by ErgoGroup AS by agreement with Norges Bank. Following implementation of the new settlement system, operational stability was on the whole better than during the previous year. In order to improve banks' access to NBO Online, measures were implemented to avoid repetitive logons.

Banks pay for the settlement services provided by Norges Bank. Prices are set so that the income covers Norges Bank's costs related to provision of these services. In connection with implementation of the new settlement system, Norges Bank changed the prices in consistency with the cost structure and banks' access to utilising the system. Banks have been given the opportunity to express their views on these changes.

All banks in Norway can have accounts at Norges Bank. In 2009 provision was made for companies that are central counterparties in securities trading to have accounts at Norges Bank on certain conditions. At end-2009, 140 banks had accounts at Norges Bank. Of these, 21 banks settled their payments on a daily basis at Norges Bank, either in the form of individual payments or as net positions in clearings. The other banks mainly used the account at Norges Bank for payments associated with loans from Norges Bank. Many banks have long-term loans with fixed maturity (F-loans), which Norges Bank offered in autumn 2008. The CLS Bank (Continuous Linked Settlement) has an account that is used for daily settlement of the NOK part of foreign exchange trades within the international system for settlement of such trades.

In 2009, an average of NOK 187bn per day was settled between banks in Norges Bank's settlement system. Chart 18 shows the turnover in Norges Bank's settlement system in recent years.

Collateral for loans from Norges Bank

Norges Bank extends loans to banks against collateral in the form of securities. Such loans help to increase the efficiency of the implementation of monetary policy and payment settlements. In order to be used as collateral, securities must satisfy a number of requirements. Borrowing facilities and collateral requirements are stated in the regulations and guidelines issued by Norges Bank.

In connection with the measures for strengthening banks' liquidity implemented in autumn 2008, the collateral requirements for banks' loans from Norges Bank were temporarily relaxed (see Norges Bank's Annual Report and Accounts for 2008, page 96). These measures resulted in a broader range of securities that could be used as collateral. The number of such securities (ISIN) was approximately doubled, and the total value of the collateral was increased considerably. Chart 19 shows banks' collateral for loans from Norges Bank in recent years.

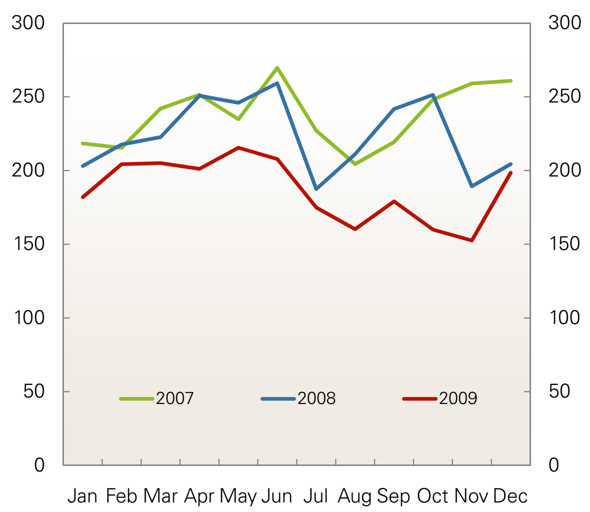
In 2009, Norges Bank notified of amendments to the guidelines for collateral for loans from Norges Bank (the decision was made in February 2010). This mainly involves reversal of the temporary relaxation in the guidelines implemented in autumn 2008. It was furthermore notified, among other things, that the use of securities issued by banks as loan collateral will be further limited, and that it will, from 2012, no longer be possible to use such bank-issued paper as collateral for loans from Norges Bank.

Measures for better securities settlement

A number of measures are in preparation to increase the safety and efficiency of trade in securities. Oslo Børs (the Oslo Stock Exchange) has decided to require that stock exchange transactions involving equity instruments, e.g. shares, shall be settled against a central counterparty. Oslo Clearing will provide this service as primary actor. Pursuant to the EU Code of Conduct, provisions will be made to allow investors to choose other central counterparties. LCH Clearnet in London will provide such a service, and there may be other actors of this kind. Money settlements between the participants and the central counterparty are effected in a bank. A bank that is no longer able to effect settlement may generate considerable problems for the financial system. International recommendations therefore set out very strict collateral requirements for settlement banks. Settlement at the central bank will always satisfy the requirements, and Norges Bank is prepared to effect money settlements for important central counterparties.

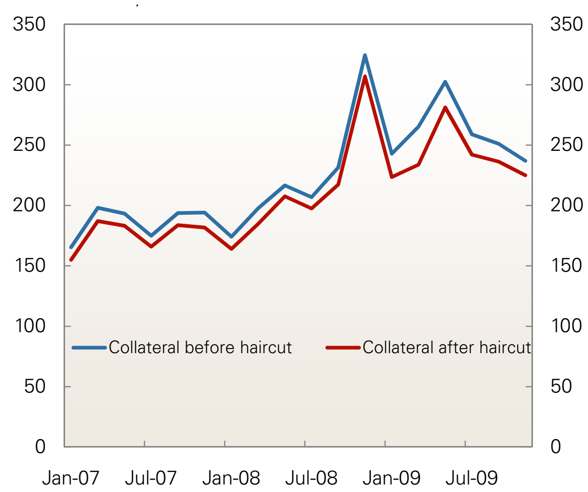
In February 2009, a working group including representatives from banks, investment firms, the Norwegian Central Securities Depository (VPS), Oslo Clearing and Norges Bank submitted a report containing recommendations for improvement of securities settlement in Norway. If the group's recommendations are implemented, settlement will be brought more in line with international recommendations.

Chart 18 Turnover in NBO 2007-2009. Daily average per month. In billions of NOK



Source: Norges Bank

Chart 19 Value of collateral pledged with NorgesBank 2007-2009. Last day of each month. In billions of NOK



Source: Norges Bank

In 2008, the European Central Bank (ECB) decided to make efforts to develop a centralised securities settlement for euro and other currencies known as TARGET2-Securities (T2S), planned to be implemented in 2013. At end-2009, 28 securities depositories in Europe, including VPS, concluded a Memorandum of Understanding with the Eurosystem on participation in the system. Following input from participants in the domestic markets, a number of central banks outside the euro area, including the Scandinavian central banks, have stated interest in negotiations on participation. Norges Bank has initiated work on enabling securities settlement in T2S to be settled in claims on Norges Bank by means of accounts at the ECB.

The advance of payment cards and Internet banking

In Norway, payments are carried out cost-effectively, rapidly and securely. Paper-based services have been replaced by payment cards and Internet banking. This has reduced the volume of manual operations, and has provided a major increase in productivity. Cash is still used for a large volume of payments, but has gradually become less important as a payment instrument.

Norges Bank has calculated the costs of payment services in Norway to be approximately NOK 11bn, or 0.5% of GDP. Banks have higher costs than income in connection with payment services. This particularly applies to cash handling services. If the banks do not succeed in covering their costs, the deficit in payment services must be covered by other areas of the banks' business. The results of the cost survey have been made available in Norges Bank publications and at international conferences.

In Europe, efforts are being made by the banking industry, central banks and public authorities to establish a common European payment area. This requires a common legal basis, which has now been secured through the EU Directive on Payment Services. The Directive was adopted on 13 November 2007, and incorporated in the EEA Agreement on 7 November 2008. A working group appointed by the Ministry of Finance and chaired by Norges Bank prepared proposals for implementation of the Directive in Norwegian law and drafted amendments to the Financial Contracts Act in order to bring the private law (civil) regulations in line with the requirements of the Directive. Following a public consultation round in spring 2009, the Storting adopted in June 2009 amendments that largely complied with the proposals of the working group. Many of the changes can be described as being more changes in legal technique than in realities as regards the rights and obligations of the parties in relation to payments. The working group drafted amendments to the Financial Institutions Act and the Payment Systems Act in order to bring the public law regulations in line with the requirements of the Directive. The deadline for comments was mid-September 2009 and the Government's proposal was submitted in March 2010. In the proposition, the Storting was invited to adopt the new chapters in the Financial Institutions Act and the Payment Systems Act. New chapters have been added to the Financial Institutions Act and the Payment Systems Act. Norwegian payers will notice that cross-border payments take place more rapidly. Competition in the payments market both in Norway and in the remainder of the EEA area may increase partly owing to rules permitting specialised payment institutions to provide payment services to the public in competition with banks.

Account maintenance for the Government

Norges Bank performs tasks relating to the management of the central government's liquid assets and debt in NOK. These responsibilities are authorised by the Norges Bank Act and are regulated by means of agreements between Norges Bank and the Ministry of Finance. A prime consideration is to gather government liquidity each day in the Government's sight deposit account at Norges Bank. At end-2009 approximately 400 government agencies had a total of approximately 1000 accounts at Norges Bank. The sum of deposits on these accounts constitutes the deposit on the Government's sight deposit account. The Government receives interest on these funds. The Government represented by the Ministry of Finance pays an annual fee to cover the costs of the banking services that Norges Bank performs for the Government.

IT operations for the accounting system are supplied by EDB Business Partner ASA by agreement with Norges Bank. Services for the Government's account maintenance at Norges Bank have also been stable in 2009.

Payment services for the Government are performed by banks by agreement with the Norwegian Government

Agency for Financial Management. In recent years, DnB NOR Bank ASA, Nordea Bank Norge ASA and SpareBank 1 Alliansen have had such an agreement with the Government. Norges Bank has special agreements with these banks on how the Government's capital shall be transferred between banks and Norges Bank each day.

NOTES AND COINS

Cash circulation fell slightly in 2009

During the past two years, cash circulation fell slightly, and amounted in 2009 to approximately NOK 50.4bn as an average for the year.

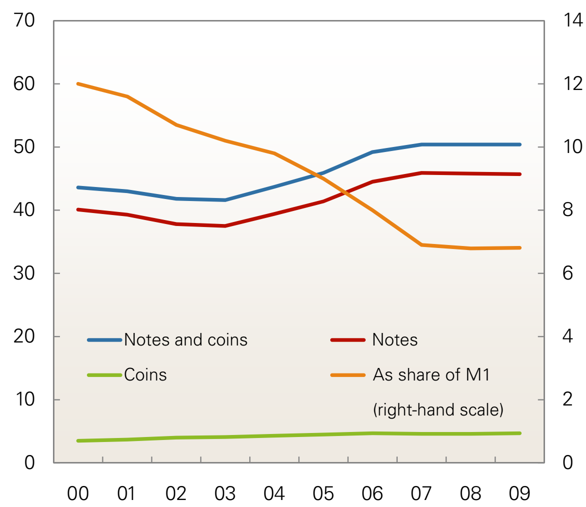
The average value of notes and coins in circulation increased each year during the period from 2003 to 2007. During the last two years, cash circulation has fallen somewhat, and amounted in 2009 to under NOK 50.4bn (see Chart 20). Calculated as a share of the total means of payment used by the public (M1) the value of notes and coins in circulation has been reduced in recent years.

The value of notes in circulation averaged NOK 45.7bn in 2009. The corresponding figure for 2008 was NOK 45.8bn. The value of coins in circulation averaged 4.7bn in 2009, an increase of NOK 0.1bn from 2008.

Very few counterfeit Norwegian notes have been seized

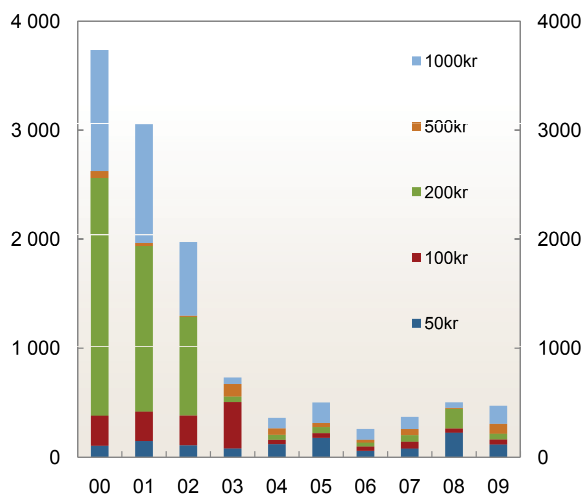
The extent of counterfeiting in Norway is low compared with many other countries. In 2009, approximately 470 counterfeit Norwegian notes were seized. The number increased during the latter half the 1990s, reaching a peak in 2000 of over 3700 counterfeit notes. The increase during the period up to 2000 was due to the widespread availability of colour photocopiers, PC scanners and printers. During the period from 2002 to 2004, Norges Bank inserted a new holographic feature in the 100-krone and 200-krone notes, which can be easily discerned by the general public and are difficult to imitate. The security of the 50-krone note was also improved in 2004. Following this, the number of counterfeit Norwegian notes has been low (see Chart 21).

Chart 20 Cash in circulation. In billions of NOK. 2000–2009



Source: Norges Bank

Chart 21 Counterfeit Norwegian banknotes. 2000-2009



Source: Kripos

Organisation of cash distribution

The Norges Bank Act assigns Norges Bank responsibility for issuing notes and coins. This involves ensuring that a sufficient quantity is produced to meet the general public's cash requirements and to ensure its availability. Norges Bank supplies banks with cash, and banks are responsible for further distribution to the general public. The central bank is also responsible for maintaining the quality of notes and coins in circulation by seeing to it that worn and damaged notes and coins are withdrawn from circulation and destroyed.

The objective of Norges Bank's activities in the area of cash handling is to promote the efficiency of cash distribution and of the payment system as a whole. Various measures have been implemented in recent years in order to ensure the optimal division of responsibilities and duties between participants and a clearer distinction between different types of service. The changes have resulted in a more clearly defined role as wholesaler for Norges Bank, and banks have taken greater responsibility for interbank distribution of cash.

Changes have included reducing the number of central bank depots to five and establishing an arrangement whereby banks, on the basis of specific conditions, receive interest compensation for cash holdings in private depots. At the end of 2009, a total of 16 private depots were established in different parts of Norway. The depots are operated by Norsk Kontantservice AS (NOKAS) and Loomis Norge AS.

The Norges Bank Act assigns Norges Bank the sole right to issue banknotes and coins. Norges Bank must therefore function as debtor for these means of payment. Production, destruction and distribution may be performed by others, but Norges Bank must ensure that these operations are carried out in accordance with the requirements that it imposes.

Norges Bank outsourced a number of operations in the area of cash handling (see Chart 22). Notes and coins are produced by external suppliers. Processing services associated with central bank responsibilities (destruction, etc.) and services associated with the management of central bank depots are performed by NOKAS.

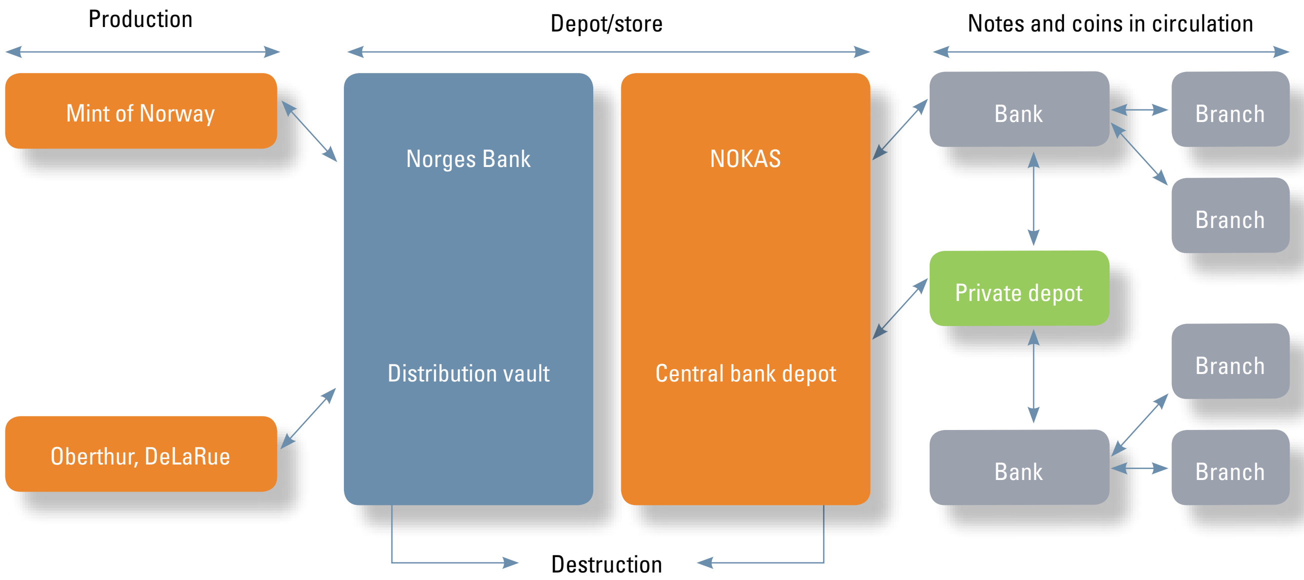


Chart 22 The banknote lifecycle

The author Knut Hamsun honoured by a commemorative coin in 2009

Pursuant to Sections 13 and 16 of the Norges Bank Act, Norges Bank issues jubilee and commemorative coins to mark important national occasions. In 2009, it was 150 years since the birth of Knut Hamsun. On 19 February, to mark this occasion, Norges Bank issued a commemorative coin in silver with a nominal value of NOK 200.

A design contest was held to decide the design of the reverse of the coin. The winning motif, designed by Enzo Finger, shows Hamsun's signature, an extract of notes for the novel Growth of the Soil and an outline of the author's facial features. An etching by Horst Janssen was used as a basis for the face. The Norwegian national coat of arms on the obverse of the coin was designed by Ingrid A. Rise, designer at Det Norske Myntverket AS.

The National Library of Norway on behalf of the Ministry of Culture and Church Affairs had the responsibility for the official commemoration of the Hamsun sesquicentennial. In connection with the issue of the coin, Norges Bank therefore cooperated with the National Library and a project forum established to organise and coordinate the anniversary.

CHAPTER 4.

Investment management

At the end of 2009, Norges Bank managed capital amounting to a total of NOK 2 985bn in international capital markets. The capital consisted mainly of the Government Pension Fund Global, which is managed on behalf of the Ministry of Finance. In addition the Bank manages the Government Petroleum Insurance Fund on behalf of the Ministry of Petroleum and Energy, and the Bank's international reserves.

Foreign exchange reserves and claims on the IMF

Norges Bank's international reserves consist of the foreign exchange reserves and claims on the International Monetary Fund (IMF). The foreign exchange reserves accounted for 84% of the Bank's total international reserves. Guidelines for management and performance reports for the foreign exchange reserves and the various funds managed by the Bank are published on Norges Bank's website.

The market value of foreign exchange reserves in the accounts, less borrowing in foreign currency, stood at NOK 237bn at the end of 2009. The foreign exchange reserves are to be available for interventions in the foreign exchange market in connection with the implementation of monetary policy or to promote financial stability.

Norges Bank's Executive Board issues guidelines for management of foreign exchange reserves, and has delegated responsibility to the Governor for issuing supplementary rules in certain areas. The reserves are divided into a money market portfolio and an investment portfolio. In addition, a buffer portfolio is used for the regular transfers to the Government Pension Fund Global.

The money market portfolio and buffer portfolio consist entirely of fixed income investments, while the investment portfolio has a 40% allocation to equities and a 60% allocation to fixed income. The main strategy for both the investment portfolio and the money market portfolio is defined by means of benchmark portfolios. These are constructed portfolios with a given country or currency distribution and with fixed income indices in various submarkets or currencies. The benchmark portfolio provides the basis for managing and monitoring risk exposure and for evaluating the actual return Norges Bank achieves in its reserve management.

The investment portfolio accounts for the largest part of the foreign exchange reserves, and at end-2009 amounted to NOK 185bn. The objective of management of the investment portfolio is a high return in the long term, but it should also be possible to use the portfolio for monetary policy purposes or to promote financial stability if this is considered necessary.

Limits have been set for how far the actual portfolio may deviate from the benchmark portfolio. The limit applying to the investment portfolio is set in the form of an overall risk measure (expected relative volatility). The Bank uses a model based on historical market fluctuations. Under normal market conditions, the difference between the return on the actual portfolio and the return on the benchmark portfolio will generally be small. During the financial crisis, market conditions were far from normal and the differences wider than model-based expectations. The upper limit for expected relative volatility is 1.5 percentage points. In 2009, an average of 0.52 percentage point of this risk limit was used.

The return on the investment portfolio for 2009 was 21.1%, measured in terms of the currency basket that corresponds to the composition of the benchmark portfolio. Measured in NOK, the return was 3.7%. The difference is due to appreciation of the Norwegian krone in relation to the benchmark portfolio's currency basket.

In the past 10 years, the annual nominal return has been 4.8%, measured in terms of the Fund's currency basket. Net of management costs and adjusted for inflation, the net real return has been 2.7% per year. In 2009, investment management outperformed the benchmark portfolio by 5.6 percentage points.

The Executive Board has decided that the maximum ownership interest in an individual company is to be 5% of the voting shares. Ownership interest refers to investments in equity instruments that allow the owner or a proxy to exercise voting rights in companies. The same applies to agreements entitling the holder to achieve such an ownership position. Norges Bank's investments are not strategic, but are purely financial. The Executive Board has issued common guidelines for the exercise of owners-

hip rights for the foreign exchange reserves and the Government Pension Fund Global.

The money market portfolio is invested in short-term money market instruments, primarily secured lending to approved international banks. The portfolio is to be invested in such a way that it can be used at short notice as a monetary policy instrument or to promote financial stability. The money market portfolio is also used to meet Norges Bank's international obligations, among others, transactions involving the IMF and loans to individual countries, and to carry out foreign exchange transactions on behalf of the Government Petroleum Insurance Fund.

During the period up to and including October 2009, implementation of and preparation for market operations were given priority over achieving an excess return on the money market portfolio. The currency composition of the money market portfolio was at times very different from the currency composition of the benchmark portfolio as the need for market operations involving USD was greatest. In addition, parts of the money market portfolio were invested as short-term time deposits in other countries' central banks in preparation for Norges Bank's market operations. Norges Bank also had a standing agreement with the Federal Reserve on a credit facility of up to USD 15bn throughout 2009.

In 2009, the return on the portfolio was -0.1% measured in terms of the benchmark portfolio's currency basket, while the benchmark portfolio returned 0.3%. The negative return can be explained by the deviation between the currency composition of the actual portfolio and that of the benchmark portfolio. The loss resulting from this deviation was estimated at 0.4%.

The normalisation of financial markets towards the end of 2009 enabled restructuring of the management of the money market portfolio. During the restructuring period, the return on the actual portfolio was not compared with a benchmark portfolio.

At end-2009, the money market portfolio stood at NOK 52.2bn, an increase of NOK 7.5bn from end-2008.

The buffer portfolio receives capital when gross income in foreign currency is transferred from the Norwegian State's Direct Financial Interest in petroleum activities (SDFI) to Norges Bank. Norges Bank may also purchase in periods foreign currency directly in the market in order to cover the amount that is to be allocated to the Government Pension Fund Global. The routines for these transactions are described in Chapter 6.

Since only cash is transferred to the Government Pension Fund Global, the buffer portfolio is invested exclusively in money market instruments. At end-2009, the size of the portfolio was NOK 6.6bn. Capital is normally transferred from the buffer portfolio to the Government Pension Fund Global each month with the exception of December, when no transfers are made. This means that at year-end the portfolio will normally be larger than the average value at other month-ends (after transfers). In 2009, the return on the buffer portfolio was negative 6.9% in NOK terms.

Claims on the IMF consist of Special Drawing Rights (SDRs), the reserve position and Norges Bank's bilateral loans to the IMF. In 2009, Norges Bank was allocated SDR 1 395m by the IMF. The total allocated holding is now SDR 1 563m. Norges Bank has entered into an agreement with the IMF on voluntary purchase and sale of SDR bringing actual SDR holdings to between SDR 782m and SDR 2 345m. At end-2009, the SDR holding was 1 600m, equivalent to NOK 14 490m (based on the exchange rate at 31 December 2009). The reserve position in the IMF amounted to NOK 2 941bn. At end-2009, the IMF had drawn SDR 78m of the bilateral loan arrangement of SDR 3bn.

The Government Pension Fund Global

Norges Bank is responsible for operational management of the Government Pension Fund Global on behalf of the Ministry of Finance. The mandate is laid down in regulations and in a separate agreement between Norges Bank and the Ministry of Finance. The agreement stipulates that the Ministry shall cover the Bank's management costs.

At end-2009, the market value of the Government Pension Fund Global was NOK 2 640bn, before deduction of Norges Bank's management fee. In 2009, the Ministry of Finance transferred a total of NOK 169bn to the Fund.

The Ministry of Finance has established a strategic benchmark portfolio of equities and fixed income instruments. The benchmark portfolio consists of equity indices for 46 countries and fixed income indices in 11 currencies. The benchmark portfolio reflects the Ministry's investment strategy for the Government Pension Fund – Global, and is an important basis for managing the risk associated with the operational management of the Fund and for evaluating Norges Bank's management performance. The Ministry of Finance has set limits for how far the actual portfolio may deviate from the benchmark portfolio.

In 2007, the Ministry of Finance decided to increase the allocation to equities in the Government Pension Fund Global to 60%. The allocation to equities in the Fund's benchmark portfolio had stood at 40% since 1998. The increase was achieved over a period of two years and completed in June 2009. During this period Norges Bank purchased shares for over NOK 1000bn, and the average ownership interest in equity markets was doubled.

In 2009, the Fund achieved a return of 25.6% measured in terms of the currency basket corresponding to the composition of the benchmark portfolio. It is this measure of return that best describes developments in the international purchasing power of the Fund. In NOK terms, the return on the Fund was 7.9%. Measured in terms of the Fund's currency basket, the return on the equity portfolio was 34.3%, while the fixed income portfolio returned 12.5%.

Since 1998, the annual nominal return has been 4.1% measured in terms of the Fund's currency basket. Less management costs and inflation, the annual net real return has been 2.7%.

The return in 2009 was 4.1 percentage points higher than the return on the benchmark portfolio. The fixed income portfolio outperformed the benchmark by 7.4 percentage points and the equity portfolio by 1.8 percentage points.

For a more detailed presentation of investment management in 2009, see the annual report of the Government Pension Fund Global.

The Government Petroleum Insurance Fund

At end-2009, the market value of the Government Petroleum Insurance Fund stood at NOK 19bn. The Fund is owned by the Ministry of Petroleum and Energy, and its purpose is to support the Government's role as self-insurer of ownership interests in petroleum activities. The Fund is managed by Norges Bank.

In 2009, the return was 1.1% measured in terms of the currency basket corresponding to the composition of the Fund's benchmark portfolio. In NOK terms, the return was negative 13.9%. The return was 0.7 percentage point higher than the return on the benchmark portfolio.

CHAPTER 5.

International cooperation

Loans and support in connection with the international financial crisis

For Norges Bank, 2009 was marked in particular by the provision of loans and other support in connection with the international financial crisis. There was also extensive contact and cooperation with other central banks and international organisations.

Loan agreement with the International Monetary Fund (IMF)

On the initiative of the G20 countries, the International Monetary and Financial Committee (IMFC) submitted at the meeting of 25 April 2009 a number of proposals for strengthening the IMF's lending capacity and the financial safety net for member countries of the IMF. It was agreed that the IMF's capital for loans should be trebled. In the short term, the most rapid means of increasing the IMF's financial resources was that the IMF received bilateral loans from member countries. Norges Bank proposed in its submission of 12 March 2009 to the Ministry of Finance that Norway should hold discussions with the IMF on a drawing arrangement for the IMF. At the end of March 2009, Minister of Finance Kristin Halvorsen sent a letter to the IMF concerning a possible loan from Norway. Following negotiations between the IMF and Norges Bank, the Government presented the matter to the Storting (Norwegian Parliament) (see Proposition No. 81 (2008–2009) to the Storting). The Storting approved the loan agreement between Norges Bank and the IMF on 15 June 2009. The agreement, which gives the IMF a drawing arrangement corresponding approximately to NOK 30bn, applies for five years and was signed on 26 June 2009. On 30 July 2009, the IMF drew the first amount according to the agreement.

Allocation of SDRs – larger frameworks for voluntary purchase

Another measure to promote the financial security net for member countries of the IMF was to allocate special drawing rights (SDRs) equivalent to USD 250bn to member countries of the IMF. For member countries, this involves an extended right in relation to other members of the IMF to exchange foreign currency (USD, EUR, etc.). Norway was allocated SDR 1.2bn (NOK 11.7bn, based on the exchange rate of 6 August 2009), so that the total holding following allocation amounted to SDR 1.4bn. In 1986, the IMF entered into bilateral agreements with 13 holders of SDRs, including Norway, on voluntary purchase and sale of SDR. In order to adapt this arrangement to the increased amount of SDRs, a number of countries were requested to increase their voluntary purchases and sales of SDRs or to enter into the arrangement for the first time. On 17 August 2009, Norges Bank concluded an agreement with the IMF to hold 50–150% of the new allocation of SDR, i.e. between SDR 0.7bn and SDR 2.1bn.

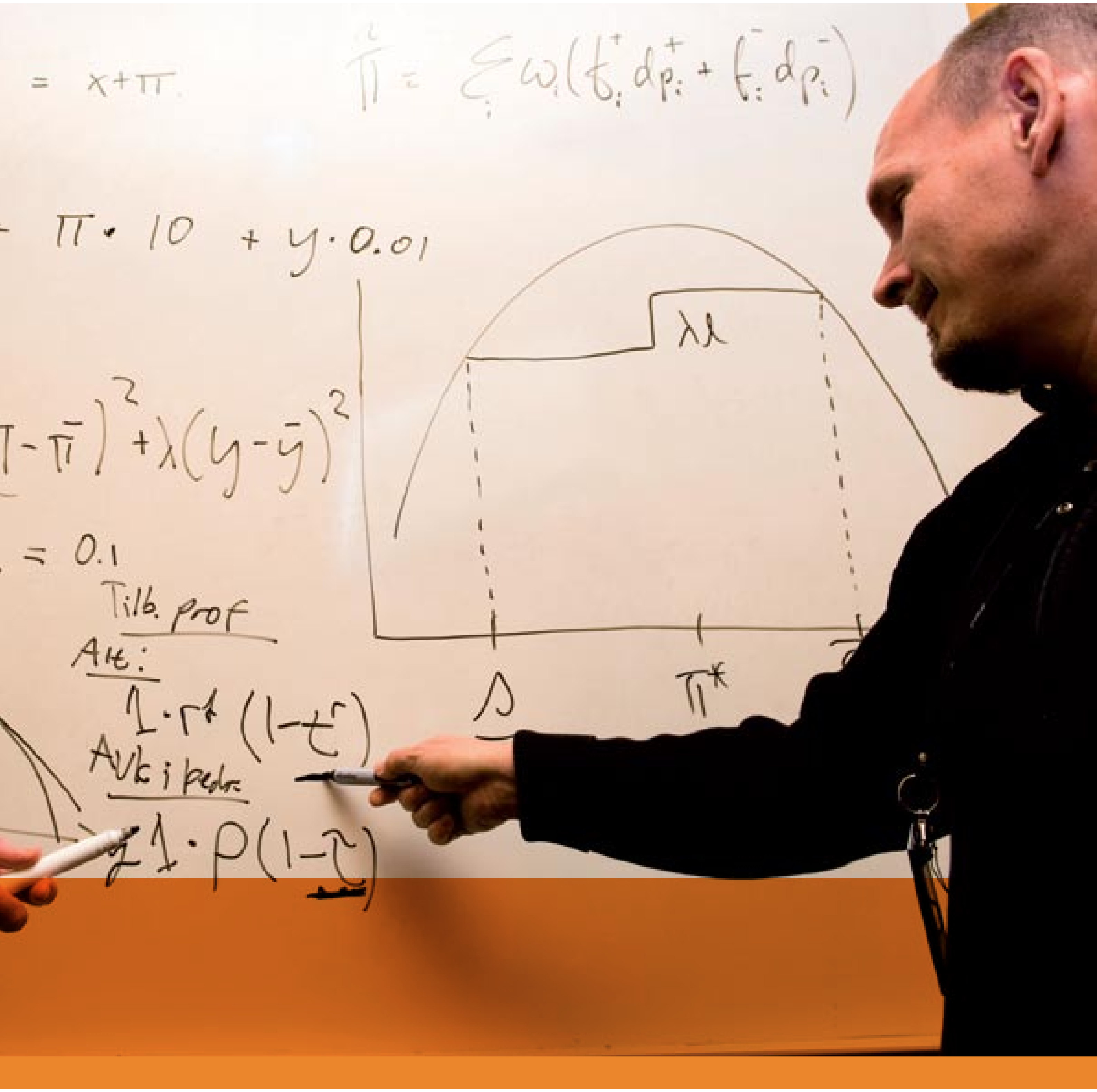
Credit agreements with Sedlabanki Islands

Iceland has experienced a severe economic downturn since its three largest banks were placed under administration in October 2008. Iceland then faced both a short-term and a long-term financing requirement.

On 19 November 2008, the IMF authorised a loan to Iceland of USD 2bn under a 2-year stand-by arrangement. The programme was based on additional external funding to the IMF totalling USD 3bn.

At the consent of the Storting, the Ministry of Finance in its letter of 22 June 2009 provided a government guarantee for an amount of up to USD 675m for a medium-term loan from Norges Bank to Sedlabanki Islands. At the same time, the Ministry approved the extension by Norges Bank of a loan of up to USD 675m for 12 years. The loan agreements between Iceland and the Nordic lenders, including Norges Bank, were signed on 1 July 2009. The Icelandic government has guaranteed repayment of the loan to Norges Bank.

This loan will constitute part of the total medium-term funding commitment of USD 2.5bn on the part of Denmark, Finland, Norway and Sweden in connection with Iceland's implementation of the IMF programme. The Nordic countries made it a condition of the loans that Iceland should adhere to the IMF stabilisation programme. This included the requirement that Iceland meet its international obligations, including deposit guarantee obligations according to EEA rules. Another precondition was that the countries most affected by shortfalls in the Icelandic deposit guarantee scheme should provide loans to finance the obligations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assumed by the Icelandic government in that connection. It is planned that the Nordic loans be disbursed in four portions, and that disbursements shall be effected after each review of Iceland's stabilisation programme by the IMF Executive Board. The first review took place on 28 October 2009. The first disbursement from Norges Bank to Sedlabanki Islands (EUR 81m) was made on 21 December.

Regular contact and cooperation with other central banks and international organisations

Norges Bank is a co-owner of the Bank for International Settlements (BIS), whose task is to foster cooperation between central banks. In addition to providing banking services to central banks, the BIS is a research body and discussion forum for its member banks. The Governor of Norges Bank regularly attends meetings at the BIS.

Pursuant to section 25 of the Norges Bank Act, Norges Bank shall administer Norway's financial rights and fulfil the corresponding obligations ensuing from membership of the International Monetary Fund (IMF). Norges Bank has been commissioned by the Ministry of Finance to be responsible for day-to-day IMF work in Norway. The Government's annual Credit Report to the Storting provides a detailed account of IMF activities.

The highest decision-making body of the IMF is the Board of Governors. Norway is represented by the Governor of Norges Bank, Svein Gjedrem, and the Secretary General of the Ministry of Finance, Tore Eriksen, is his alternate. The Board normally meets once a year at the annual meeting of the IMF. Apart from this meeting, the Board of Governors takes decisions by ballot. An Executive Board consisting of 24 executive directors is responsible for day-to-day business. The five Nordic and three Baltic countries comprise a single constituency with a joint representative on the board. The office of board member is rotated among the Nordic countries. Sweden held the office in 2008 and 2009, while it will be held by Denmark from 2010 to 2012.

The countries in the Nordic-Baltic constituency primarily coordinate their views on important IMF matters through the Nordic-Baltic Monetary and Financial Committee (NBMFC). The Norwegian members are the Secretary General of the Ministry of Finance and the Deputy Governor of Norges Bank. The other countries are represented at a comparable level. The NBMFC normally

meets twice a year. Coordination between the countries is aimed at arriving at a common stance, which the board member representing the group then presents to the IMF Executive Board. Norwegian policy on matters to be brought before the IMF Executive Board is decided by the Ministry of Finance on the advice of Norges Bank. The division of responsibility between the Ministry and the Bank is set out in a written joint understanding.

The International Monetary and Financial Committee (IMFC) has a key function as an advisory body to the Executive Board. The IMFC meets twice a year. The Committee provides policy guidelines for the activities of the IMF. The IMFC's members are ministers or central bank governors who represent either a country or a constituency of countries. In 2008–2009, the Swedish Minister of Finance was the Nordic-Baltic constituency's member of the IMFC.

An important part of the activities of the IMF involves monitoring economic developments in member countries, with particular emphasis on economic conditions and financial stability. The main emphasis is on bilateral surveillance through Article IV consultations, which take place annually for most countries. Norway holds such consultations every two years unless special circumstances call for annual consultations. In the intervening years, the IMF conducts a simplified consultation, and no written report is submitted to the Executive Board of the IMF. The IMF conducted an Article IV consultation 12–23 November 2009. The IMF submitted its interim conclusions on 23 November, and the Article IV report on Norway was considered by the IMF Executive Board on 22 January 2010.

Norges Bank cooperates extensively with the other Nordic central banks. The annual meeting of Nordic central banks was held in Sweden, hosted by Sveriges Riksbank (the central bank of Sweden). Staff from various departments in central banks meet at regular intervals to discuss issues associated with economic analysis, monetary policy, financial stability, payment systems, legal matters concerning central banks, personnel policy, etc.

The Bank also has regular contact with the European Central Bank (ECB) and with other central banks in EU countries. Norges Bank has established an arrangement with the ECB, the Bank of England and certain other central banks, which affords employees the opportunity work at these institutions for periods of up to 12 months.

Technical assistance to the Reserve Bank of Malawi

For many years, Norges Bank has provided various kinds of technical assistance to central banks in developing countries. In order to promote more efficient and performance-oriented technical assistance to central banks in developing countries, Norges Bank agreed to assume responsibility for technical assistance to the Reserve Bank of Malawi for a period of 3 to 5 years. Norges Bank's assistance to the Reserve Bank of Malawi is formally administered by the IMF, but financed by the Norwegian Ministry of Foreign Affairs. In 2008, the agreement was extended to the end of 2009.

Norges Bank placed up to two FTEs per year at the disposal of the Reserve Bank of Malawi, consisting of one FTE per year in the form of a long-term assignment as adviser to the Reserve Bank and up to one FTE per year in the form of short-term assignments. Short-term assignments cover a broad range of central bank tasks. In 2009, a total of 10 short-term assignments of approximately two weeks each were completed within a broad range of external and internal central bank activities.

The IMF has conducted an evaluation of the technical assistance to the Reserve Bank of Malawi during the period from October 2006 to December 2008. Norges Bank's technical assistance was assessed in general as performance-oriented and successful, and this was attributed to the positive institutional collaboration established between the two central banks under the auspices of the IMF. The combination of a permanent adviser located at the Reserve Bank and short term advisers who mainly came from the same central bank was emphasised as an important factor in the success of the project.

Executive Director Jon A. Solheim was employed by the IMF in the post of "Monetary and Central Bank Operations Adviser" to the Reserve Bank of Malawi from January 2007 to October 2009. Owing to the extensive technical assistance provided, and in order to ensure that the positive result of the technical assistance can be maintained and strengthened, it has been agreed that the agreement will be extended with somewhat reduced scope until the end of 2011. In October 2009, Executive Director Asbjørn Fidjestøl took over the post of "Monetary and Central Bank Operations Advisor".

CHAPTER 6.

Other functions

Foreign exchange transactions

In 2009, Norges Bank's commercial foreign exchange transactions mainly comprised foreign exchange purchases to build up the Government Pension Fund Global (GPFG). In addition, Norges Bank executed a number of transactions on behalf of the Government Petroleum Insurance Fund.

The GPFG is built up through transfer of foreign exchange income from the State's Direct Financial Interest in Petroleum Activities (SDFI) and through Norges Bank's purchases of foreign exchange in the market.

The system for transferring foreign exchange from SDFI and calculating Norges Bank's foreign exchange purchases was most recently changed in 2004. The Ministry of Finance stipulates the monthly allocation to the GPFG. If there is a need for Norges Bank to purchase foreign exchange in excess of the transfer from SDFI, Norges Bank purchases the balance of the foreign exchange in the market. Daily foreign exchange purchases are then fixed for a month at a time, and are announced on the final working day of the previous month. The actual transfers may differ from the estimates. Adjustments are made for any differences when foreign exchange purchases are made for the following month. As a result, Norges Bank's foreign exchange purchases may vary somewhat from month to month.

Capital is not normally transferred to the GPFG in December. It is therefore improbable that foreign exchange will be purchased from Norges Bank in December. Foreign exchange income from SDFI may nevertheless be transferred to Norges Bank in order to minimise the Government's exchange costs.

In 2009 Norges Bank purchased foreign exchange for NOK 24.6bn in the market (see table 3). Foreign exchange purchases to Norges Bank were significantly lower in 2009 than in previous years because the Government used more of the petroleum income domestically than in previous years. Transfers from SDFI amounted to NOK 147.9bn.

Table 3. Norges Bank's daily foreign exchange purchases for the GPFG in 2009

Month	Daily amounts (NOK millions)	Total per month (NOK millions)
January	0	0
February	150	3 000
March	0	0
April	0	0
May	0	0
June	200	4 200
July	300	6 900
August	500	10 500
September	0	0
October	0	0
November	0	0
December	0	0
2009		**24 600**

Government debt 2009

According to an agreement between the Ministry of Finance and Norges Bank, the Bank shall provide services as adviser, facilitator and payment agent in connection with raising and managing domestic government loans. The Ministry of Finance pays for bank-related services provided by Norges Bank to the Ministry in connection with government debt and liquidity management, and for variable costs incurred by Norges Bank in its capacity as provider of services for the Ministry of Finance.

The Government's schedule for the issue of short and long-term securities in 2009 was published in an auction calendar in December 2008. This calendar was replaced by a new calendar in April 2009 owing to prospects of an increase in the need for government loan following establishment of the Government Finance Fund and the Government Bond Fund. Ten auctions of government bonds and 10 auctions of short-term government paper (Treasury bills) were held in 2009. No ad hoc auctions were held.

The total volume issued, excluding the Government's own purchases in the primary market amounted to NOK 34bn in government bonds and NOK 46bn in Treasury bills.

The strategy for long-term government borrowing is based on maintaining a yield curve for government bonds with maturities of up to approximately 10 years. The pattern for government bond borrowing has been to issue a new 11-year bond every second year. No new bonds were issued in 2009. In May, a bond matured with an outstanding volume of NOK 44bn.

According to the issue programme for short government paper, new Treasury bills are issued on IMM dates[7], and mature on the IMM date one year later. The loans are increased through subsequent auctions.

The Government paper auctions have been held via the Oslo Stock Exchange trading system. The bid-to-cover ratio, which is the volume of bids in relation to the volume

[7] International Monetary Market dates: third Wednesday in March, June, September and December

allocated in the auction, averaged 2.63 for government bonds and 3.22 for Treasury bills.

Norges Bank has entered into agreements with six primary dealers, who are obliged to furnish binding bid and offer prices for agreed minimum amounts of government bonds and Treasury bills on the Oslo Stock Exchange. In return for furnishing these binding bid and offer prices, the primary dealers may borrow government paper for a limited period. In autumn 2009, demand for short-term paper was particularly high.

Lending limits for the shortest bonds were therefore increased from NOK 3.7bn to NOK 6bn in November 2009, while the limits remained unchanged at NOK 3.7bn for each of the other bonds. For Treasury bills the lending limits were NOK 6bn for each loan.

Since June 2005, the Government has used interest rate swaps in its domestic debt management. An interest rate swap is an agreement between two parties to exchange future interest payments associated with a given principal. Use of interest rate swaps gives the Government the flexibility to change the average period during which the interest rate on the debt portfolio is fixed without changing its borrowing strategy. The Ministry of Finance has entered into framework agreements with several counterparties. Norges Bank performs the operational functions in connection with entry into interest rate swap agreements on behalf of the Ministry of Finance. The commercial decisions are taken by the Ministry. At end-2009, the average fixed-rate period for government debt was 3.9 years. If existing interest rate swaps are taken into account, the fixed-rate period was 1.6 years.

Total government domestic securities debt, registered in the Norwegian Central Securities Depository at end-2009 amounted to NOK 496bn, calculated at face value. Of this the volume of Treasury bills used in the swap arrangement, amounted to NOK 230bn. Foreign investors own approximately 44%, while life insurance companies and private pension funds own approximately 11% of the total government securities debt. For government bonds, ownership stakes held by foreign investors constituted 63% while life insurance companies and private pension funds held 21%. The Government's domestic securities debt was equivalent to approximately 21% of GDP in 2009.

Research in 2009

Research at the Bank focuses on the fields of monetary policy and financial stability. In 2009, 17 articles were published in journals with peer review, some of them highly recognised journals, such as the Journal of Monetary Economics and the Journal of Money, Credit and Banking. The list of publications includes articles on research carried out several years ago. Ongoing research is documented in the Bank's Working Papers series.[8] In 2009, 29 papers were published in this series. There were 2667 downloads of Norges Bank's Working Papers from the Internet portal Research Papers in Economics (RepEc).

Participation in the research community

In 2009 Norges Bank hosted two research seminars. The sixth annual conference on monetary policy was held in June with the title "Inflation targeting twenty years on". The conference was organised in cooperation with the Institute for Monetary and Financial Stability (IMFS) at Goethe University. The conference papers were published in, *Twenty years of Inflation Targeting: Lessons Learned and Future Prospects,* Cambridge University Press, 2010, and are also available at www.norges-bank.no/conferences/. In August, the Bank hosted the fifth annual DYNARE Conference on numerical solutions to economic models.

A number of the Bank's research projects have been presented at Norwegian and international conferences and seminars. As part of an international research environment, Norges Bank has extensive contact with researchers at universities and other central banks. Norges Bank hosts research seminars with guest lecturers who present their work and take part in seminars and workshops.

Support for economic research

Norges Bank supports economic research activities in a number of ways. Through a sponsored chair at the University of Oslo, Norges Bank promotes a greater focus of macroeconomics and monetary policy issues. Norges Bank's Economic Research Fund provides financial support for researchers studying abroad, for researchers to attend international conferences to present their own research work and for holding research conferences in Norway.

At the Bank's research page on the web, www.norges-bank.no/research/, there is an overview of published articles, working papers, seminars and conferences as well as links to researchers' home pages.

Norges Bank's bicentenary project

In connection with Norges Bank's bicentenary in 2016, the Executive Board decided in December 2007 to launch a large-scale research project in two phases to be published in book form. "Norges Bank's bicentenary project 1816–2016" will be a joint project with contributions from the Norwegian and international research community. The steering committee comprises the international experts Professor Michael Bordo of Rutger's University, New Jersey, and Professor Marc Flandreau of the Graduate Institute in Geneva, Deputy Governor of Norges Bank Jan F. Qvigstad and Director of Research Øyvind Eitrheim. The goal is to produce three books dealing with various aspects of Norges Bank's activities over the past 200 years by the beginning of the centenary year. The project will also serve to highlight the role of Norges Bank as a public institution from a historical perspective. The project is to be carried out in accordance with set plans and budget.

The three books have the following working titles:

- The History of Norges Bank 1816–2016
- The Monetary History of Norway 1816–2016
- Topics in Central Banking

[8] Norges Bank's Working Papers are also available from the Internet portal Research Papers in Economics (RepEc) and BIS Central Bank Research Hub.

The books are also intended to meet the required standards of an internationally recognised academic publisher. The first two books will be published in both Norwegian and English, the third book only in English. Project manager/main author posts have been advertised for the first two books with a view to appointment in spring 2010.

In 2009, researchers at the Norwegian School of Economics and Business Administration, the University of Oslo and the Norwegian School of Management have conducted research into the history of Norges Bank in Oslo during WWII 1940–45, the Bank's role in financial crisis situations and the Bank's governance structure during different periods. In June, a seminar was held at Lysebu outside Oslo with broad attendance by all of the above research communities in Norway. Many subprojects were presented by students of economic history, who are writing their masters theses on various topics of Norwegian central bank history. The Faculty of Law at the University of Oslo has also been invited to participate in the first phase of the bicentenary project. In 2009, the international cooperation has been strengthened by the funding of a one-year post-doctoral scholarship at the Graduate Institute in Geneva and an international conference on "The sub-prime crisis and how it changed the past", to be held in Geneva in autumn 2010. Collaboration is also planned with the University of Venice on an international seminar for younger researchers in economic history.

In 2009, work was also initiated on documenting Norges Bank's history on the Web in the form of *timelines* for developments in organisation and governance structure in Norges Bank, means of payment (notes and coins), price stability and financial stability and investment management. A home page for "Norges Bank's bicentenary project 1816–2016" is available at Norges Bank's website (http://www.norges-bank.no/templates/article____70800.aspx). Information on the various subprojects will be made available here, and documentation of research work will be published as *Working Papers* and *Staff Memos*. Four such papers were published in 2009.

Appendix

Governing bodies, management and organisation

The Executive Board

Svein Gjedrem, Chair
Appointed Governor of Norges Bank 1 January 1999 for a period of up to six years, reappointed 1 January 2005 for a second six-year period.

Jan F. Qvigstad, Deputy Chair
Appointed Deputy Governor of Norges Bank 1 April 2008 for a term of up to six years.

Ida Helliesen
(appointed 1 January 2010 – 31 December 2013)

Liselott Kilaas
(reappointed 1 January 2008 – 31 December 2011)

Brit K. Rugland
(reappointed 1 January 2006 – 31 December 2009 and 1 January 2010 – 31 December 2013)

Asbjørn Rødseth
(reappointed 1 January 2008 – 31 December 2011)

Eirik Wærness
(appointed 1 January 2010 – 31 January 2013)

Alternates:
Gøril Bjerkan
(appointed 1 January 2010 – 31 December 2013)
Egil Matsen
(appointed 1 January 2010 – 31 December 2013)

Employee representatives:

Jan Erik Martinsen
(appointed 1 January 2001 –)
Tore Vamraak
(reappointed 1 January 2009 – 31 December 2010)
Petter Nordal (Alternate)
Gunnvald Grønvik (Alternate)

Supervisory Council

Reidar Sandal, 2010–2013 (Chair 2010–2011)
Alternate: **Ola Røtvei**, 2010–2013 (reelected)
Frank Sve, 2010–2013 (Deputy Chair 2010–2011, reelected)
Alternate: **Tone T. Johansen**, 2010–2013
Terje Ohnstad, 2008–2011 (reelected)
Alternate: **Anne Grethe Kvernrød**, 2008–2011
Eva Karin Gråberg, 2008–2011
Alternate: **Jan Elvheim**, 2008–2011
Tom Thoresen, 2008–2011
Alternate: **Hans Kolstad**, 2008–2011
Runbjørg Bremset Hansen, 2008–2011
Alternate: **Camilla Bakken Øvald**, 2008–2011
Kåre Harila, 2008–2011
Alternate: **Liv Sandven**, 2008–2011
Tormod Andreassen, 2008–2011
Alternate: **André Støylen**, 2010–2011
Gunvor Ulstein, 2008–2011
Alternate: **Beate Bø Nilsen**, 2008–2011
Morten Lund, 2010–2011
Alternate: **Torunn Hovde Kaasa**, 2008–2011
Synnøve Søndergaard, 2010–2013
Alternate: **Britt Hildeng** 2010–2013
Reidar Åsgård, 2006–2009
Alternate: **Kari-Anne Opsal**, 2006–2009
Erland Vestli, 2010–2013
Alternate: **Jan Blomseth**, 2010–2013
Marianne Lie, 2010–2013
Alternate: **Lars Gjedebo**, 2010–2013
Monica Salthella, 2010–2013
Alternate: **Frode Klemp**, 2010–2013

Audit

Svenn Erik Forsstrøm, State Authorised Public Accountant

Management
Svein Gjedrem, Governor
Jan F. Qvigstad, Deputy Governor

Norges Bank Monetary Policy
Jon Nicolaisen, Executive Director
Amund Holmsen, Deputy Executive Director

Research Department
Dagfinn Rime, Director (acting)
Human Resources and Administration
Ilse Bache, Director
International Department
Audun Grønn, Director
Department for Market Operations and Analysis
Kristine Falkgård, Director
Monetary Policy Department
Anne Berit Christiansen, Director
Economics Department
Ingvild Svendsen, Director

Norges Bank Financial Stability
Kristin Gulbrandsen, Executive Director
Trond Eklund, Deputy Executive Director (acting)

Contingency planning
Arild J. Lund, Director
Payment Systems
Knut Sandal, Director
Financial Markets Department
Snorre Evjen, Director
Research Department
Farooq Akram, Director
Interbank Settlement Department
Kjetil Heltne, Director
Cashier's Department
Trond Eklund, Director
Shared Services
Ragnhild Solberg, Director

Norges Bank Investment Management
Yngve Slyngstad, Chief Executive Officer
Stephen A. Hirsch, Deputy Chief Executive Officer

Jan Thomsen, Chief Compliance Officer
Dag Dyrdal, Chief Strategic Relations Officer
Bengt O. Enge, Chief Investment Officer
Jessica Irschick, Chief Treasurer
Mark Clemens, Chief Administrative Officer
Age Bakker, Chief Operating Officer
Trond Grande, Chief Risk Officer

Norges Bank Administration
Jannecke Ebbesen, Executive Director

Facility services
Marit Kristine Liverud, Director
HR
Jane K. Haugland, Director
ICT Department
Ola Jan Bjerke, Director (acting)
General Secretariat
Bjarne Gulbrandsen, Director
Security Department
Arne Haugen, Head of Security
Corporate governance
Nils T. Eide, Director
Accounting and documentation
Torkel Fagerli, Director

Communications Department
Siv Meisingseth, Director of Communications

Legal Department
Marius Ryel, Executive Director

Internal Audit
Ingunn Valvatne, Head of Internal Audit