

GOVERNMENT PENSION FUND GLOBAL **SECOND QUARTER 2012**



2Q  
2012

**NBIM**

Norges Bank Investment Management

# Second quarter 2012 in brief

- *The Government Pension Fund Global returned -2.2 percent, or -77 billion kroner, in the second quarter of 2012.*
- *Equity investments returned -4.6 percent and fixed-income investments returned 1.5 percent. The overall return was 0.2 percentage point lower than the return on the fund's benchmark indices.*
- *Investments in real estate returned 0.3 percent.*
- *The fund's market value rose 65 billion kroner to 3,561 billion kroner.*
- *The fund held 59.6 percent in equities, 40.1 percent in fixed income and 0.3 percent in real estate at the end of the quarter.*

# Content

<b>Fund management</b>	Weak quarter after stock market decline	2
	Investment risk	11
	Responsible investment and active ownership	13
	Operational risk management and internal control	13
<b>Accounting</b>	Financial reporting	14
	Notes to financial reporting	19
	Auditor's report	29

Norges Bank Investment Management (NBIM) manages the Government Pension Fund Global. Our mission is to safeguard and build financial wealth for future generations.

[www.nbim.no](http://www.nbim.no)

## FUND MANAGEMENT

### Weak quarter after stock market decline

The Government Pension Fund Global returned -2.2 percent, or -77 billion kroner, in the second quarter of 2012 as global stock markets declined.

Equity investments returned -4.6 percent and accounted for 59.6 percent of the fund at the end of the quarter. Signs of weaker global economic growth and concern over a deepening of the European sovereign debt crisis reduced investors' risk appetite and pushed down most stock sectors.

The fund's investments in the basic materials sector, which is particularly sensitive to swings in the global economy, led declines with a return of -9.7 percent. Institutions including the European Central Bank and Federal Reserve cut their growth forecasts after weaker-than-expected development in Europe, the US and China. The Organisation for Economic Cooperation and Development (OECD) in May warned of potentially serious consequences for the global economy should authorities fail to support growth and prevent the debt crisis from worsening.

Holdings of oil and gas shares returned -7.8 percent and were the second worst-performing sector. Benchmark crude oil prices fell 20.4 percent in London and 17.5 percent in New York in the quarter, as weaker economic growth prospects reduced expectations for oil demand. Shares of Royal Dutch Shell, Exxon Mobil and BP fell 1.7 percent, 1.3 percent and 8.8 percent, respectively. The companies were among the fund's 10 largest shareholdings at the end of the quarter.

Lower growth prospects also pushed down shares in the technology, industrial and consumer goods sectors, which returned -7.5 percent, -6.9 percent and -3.4 percent, respectively.

Investments in financial stocks returned -6.1 percent. The largest decline was in Europe, where Spain and Cyprus became the fourth and fifth countries since 2010 to request financial support from euro-area authorities. Spain on 10 June asked for an emergency loan of as much as 100 billion euros to help its banks cover loan losses after

a slump in property prices. Concern that losses would mount pushed European bank stocks down 11 percent, as measured by the Stoxx Europe 600 Index. Uncertainty about the ability of Spain and other euro-area countries to repay their debt also weighed on the banks, which have large holdings of European government bonds.

The fund's investments in European financial stocks returned -8.4 percent, while US and Asian financial shares returned -5.1 percent and -1.7 percent, respectively. Financials were the fund's largest equity sector, accounting for 21 percent of the shares at the end of the quarter.

Healthcare stocks were the fund's best-performing equity sector, returning 3.6 percent in the quarter. This was followed by investments in telecommunications shares, which returned 1.6 percent. Healthcare is often considered a safer investment in volatile markets.

#### Regional performance

The fund's equity investments were distributed with 49 percent in Europe, 36 percent in the Americas, Africa and the Middle East and 15 percent in Asia and Oceania at

**Table 1-1** Return on the fund's equity investments in 2Q 2012. By sector. Percent

Sector	Return in international currency	Share of equity investments
Financials	-6.1	21.0
Consumer goods	-3.4	13.0
Industrials	-6.9	12.9
Oil and gas	-7.8	10.7
Consumer services	-1.0	9.5
Healthcare	3.6	9.2
Technology	-7.5	8.2
Basic materials	-9.7	7.2
Telecommunications	1.6	4.3
Utilities	-0.2	4.2

## Returns in international currency

The fund's investments in international securities are not converted into kroner in connection with financial reporting and are not hedged against moves in the currency. Changes in the exchange rate do not affect the fund's international purchasing power. Consequently, the return is generally measured in international currency – a weighted combination of the currencies in the fund's benchmark indices for equities and bonds. The fund's currency basket consisted of 35 currencies at the end of the second quarter. The krone weakened 2 percent against the basket in the quarter. The fund had 80 percent of its investments in euros, pounds, dollars and yen at the end of the period.

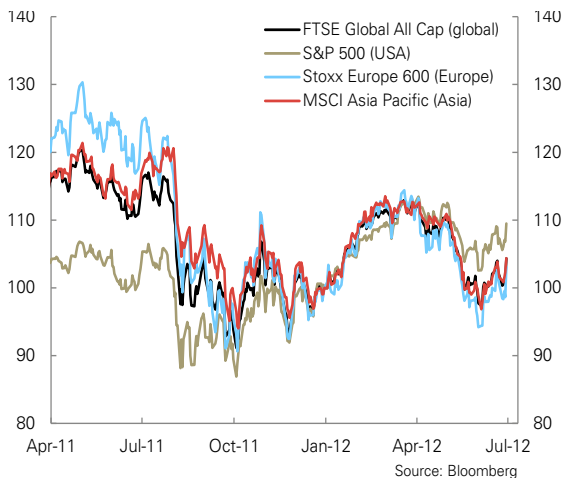
the end of the quarter. Equity investments in these regions returned -5.6 percent, -2.7 percent and -5.3 percent, respectively.

The fund held 30 percent of its stocks in the US at the end of the quarter, the largest share in a single country. The Federal Reserve in June said it would extend Operation Twist, a programme aimed at reducing long-term yields and spurring economic growth by swapping investments in short-term debt for longer-maturity bonds.

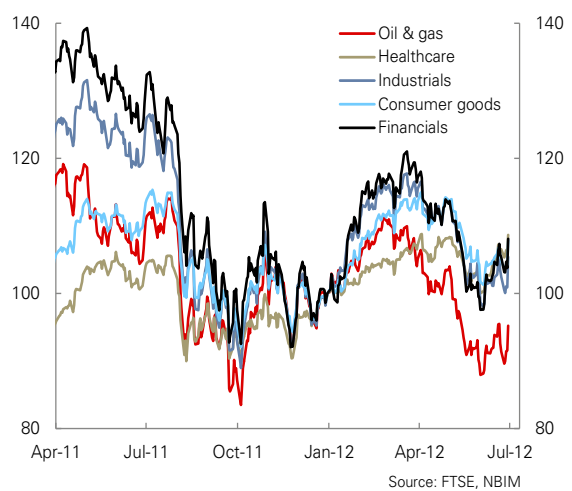
The central bank also said it would consider further action should the labour market fail to improve after job creation in May fell to its lowest level in a year. The fund's US shareholdings returned -3.8 percent in the quarter, measured in local currency. Declines were led by technology companies, followed by financial stocks and oil and gas shares.

Equity investments in China, the world's second-largest economy after the US, returned -9.3 percent, measured

**Chart 1-1** Price developments in regional and global equity markets, measured in US dollars. Indexed. 30 Dec 2011 = 100



**Chart 1-2** Price moves in stock sectors in the FTSE Global All Cap Index. Measured in US dollars. Indexed. 30 Dec 2011 = 100



in local currency. Investments in the telecommunications, basic materials and technology sectors fell the most. Chinese authorities in April said the country's economic growth slowed in the first quarter to 8.1 percent, the lowest level in almost three years, from 8.9 percent the previous quarter. Weaker European growth prospects also raised concern that demand for Chinese goods would wane in Europe, China's largest export market.

Chinese authorities in June announced several measures to stimulate the economy. The central bank lowered its key interest rate for the first time since 2008. It also raised the ceiling for deposit rates at Chinese banks and allowed the banks to offer loans at lower rates. The authorities in the same month increased the total quota for foreign investors' holdings of Chinese A-shares to 80 billion dollars from 30 billion dollars. The fund in the quarter became the first foreign investor to be awarded the maximum quota of 1 billion dollars, an increase of 300 million dollars on its previous quota. Investments in China, excluding Hong Kong-listed stocks, constituted 1.3 percent of the fund's equity holdings at the end of the quarter.

#### Individual stocks

The fund's worst-performing stock investment in the quarter was UK bank Barclays, followed by German engineering company Siemens and UK natural gas producer BG Group. British mobile-phone operator Vodafone was the best-performing stock investment, followed by US telecommunications group AT&T and UK drugmaker GlaxoSmithKline.

Globally, sales of new and existing shares at listed companies fell to 123 billion dollars in the second quarter from 143 billion dollars in the previous quarter, according to Dealogic. The financial sector accounted for 24 billion dollars, followed by information technology and electronics companies with 22 billion dollars and the real estate sector with 12 billion dollars. Initial public offerings fell 34 percent in the quarter to 41 billion dollars, the lowest second-quarter level since 2009, according to Bloomberg.

The largest capital raising the fund bought shares in was the IPO of social network Facebook, which in May sold shares for 16 billion dollars, or 96 billion kroner. This was followed by sales of shares in insurer AIA Group for 5.8

billion dollars and fund manager BlackRock for 4.6 billion dollars.

The fund also bought shares in Formula One, which owns the commercial rights to the Formula 1 races. The company's management said it intends to apply for a listing in Singapore, and the investment was the fund's first in an unlisted company planning to go public.

The fund held shares in 7,803 listed companies at the end of the quarter, compared with 7,957 companies three months earlier.

**Table 1-2** The fund's largest equity holdings as of 30 June 2012

Company	Country	Holdings in millions of kroner
Royal Dutch Shell Plc	UK	29,421
Nestlé SA	Switzerland	26,936
HSBC Holdings Plc	UK	24,009
Apple Inc	US	23,295
Novartis AG	Switzerland	19,620
Vodafone Group Plc	UK	19,381
BG Group Plc	UK	18,105
Exxon Mobil Corp	US	17,611
Roche Holding AG	Switzerland	16,528
BP Plc	UK	16,479

#### External management

NBIM awards investment mandates to external managers with specialist expertise in clearly defined areas. A total of 3.7 percent of the fund's assets were managed externally at the end of the second quarter, down from 4.1 percent three months earlier. External equity investments amounted to 126.8 billion kroner and external fixed-income investments were worth 4.3 billion kroner.

### Fixed-income investments

The fund's fixed-income investments returned 1.5 percent in the second quarter, helped by rising prices of government bonds that were deemed the safest. Fixed-income investments accounted for 40.1 percent of the fund at the end of the quarter. The bulk of the investments was in bonds, while the remainder was in short-term securities, bank deposits and derivatives.

Yields on government bonds from countries such as the US, Germany and the UK fell to record lows in the quarter as investors increasingly sought safer investments. In contrast, government bond yields in Italy and Spain, the third- and fourth-largest economies in the euro area, rose amid growing concern over potential sovereign-debt defaults.

Yields on 10-year Spanish government bonds rose to 7.2 percent on 18 June, their highest level since the euro was introduced, from 5.4 percent at the start of the quarter. Italian 10-year government bond yields increased in the quarter to 5.8 percent from 5.1 percent. German 10-year government bond yields, a benchmark for European sovereign debt, fell to 1.6 percent from 1.8 percent after reaching a record low of 1.2 percent on 1 June.

### Gains for government bonds

Government bonds were the fund's best-performing

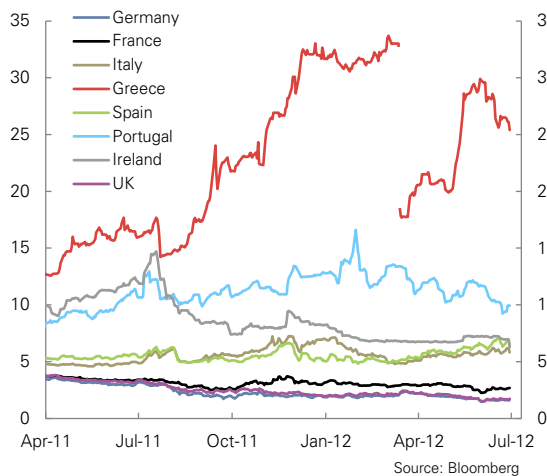
fixed-income sector, returning 2.9 percent in the second quarter. Rising prices of government bonds that were deemed the safest outweighed a decline in sovereign debt issued by several euro countries.

US treasuries returned 3.3 percent, measured in dollars, and accounted for 20 percent of the fund's fixed-income investments at the end of the quarter. UK government debt returned 5.1 percent, measured in pounds, and constituted 4 percent of the fixed-income holdings. Investments in euro-denominated government bonds,

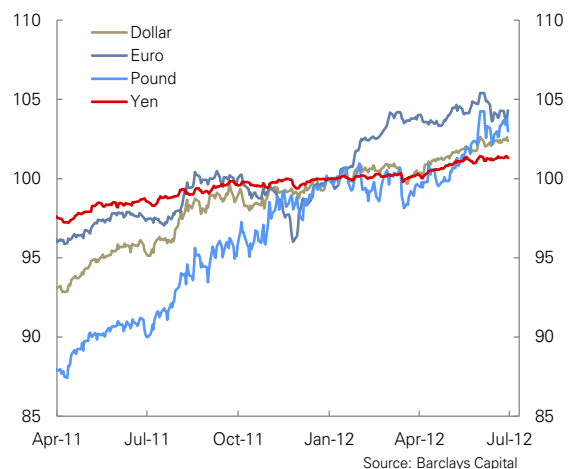
**Table 1-3** The fund's largest bond holdings as of 30 June 2012

Issuer	Country	Holdings in millions of kroner
United States of America	US	310,351
Japanese government	Japan	85,580
UK government	UK	81,538
French Republic	France	70,891
Federal Republic of Germany	Germany	57,773
Italian Republic	Italy	24,444
Government of Canada	Canada	24,152
Kreditanstalt für Wiederaufbau	Germany	23,724
European Investment Bank	Supranational	22,531
Government of the Netherlands	The Netherlands	20,587

**Chart 1-3** 10-year government bond yields. Percent



**Chart 1-4** Price developments for bonds issued in dollars, euros, pounds and yen in the Barclays Global Aggregate Index, measured in local currencies. Indexed. 30 Dec 2011 = 100



which amounted to 14 percent of the holdings, returned 0.6 percent, measured in euros. Government bonds made up 51 percent of the fund's fixed-income investments at the end of the quarter.

The fund also invests in bonds from government-related institutions such as the World Bank, the European Investment Bank and Kreditanstalt für Wiederaufbau. These returned 1.2 percent and comprised 12 percent of the fund's fixed-income investments at the end of the quarter.

**Securitized debt underperforms**

Securitized debt, consisting of bonds issued by banks and backed by mortgages and other loans, was the fund's weakest-performing fixed-income sector with a return of -1.4 percent. Demand for securitized debt issued by Spanish banks fell in the quarter amid concern over a potential increase in bank-loan defaults following the slump in Spanish property prices. Increased uncertainty about Spain's ability to repay its sovereign debt also eroded investors' interest in Spanish bonds.

The fund's investments in euro-denominated securitized debt returned -1.1 percent, measured in euros, and

accounted for 10 percent of fixed-income investments at the end of the quarter. About a third of these bonds were issued by Spanish banks. In total, securitized debt made up 15 percent of the fund's fixed-income holdings at the end of the quarter.

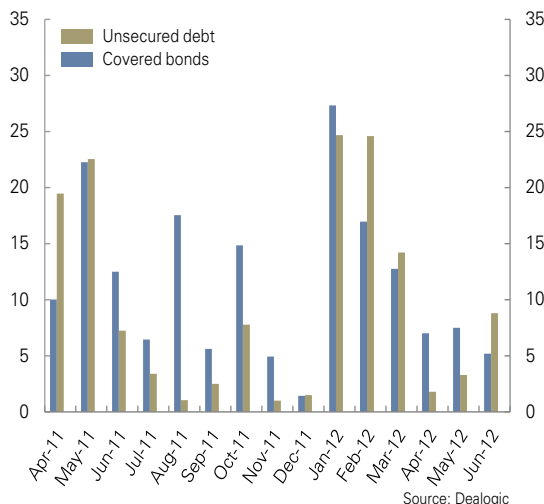
Investments in corporate bonds returned 1.6 percent, driven by rising prices of bonds issued by companies in countries such as the US and the UK. Corporate bonds amounted to 13 percent of fixed-income investments at the end of the quarter.

**Bond issuances decline**

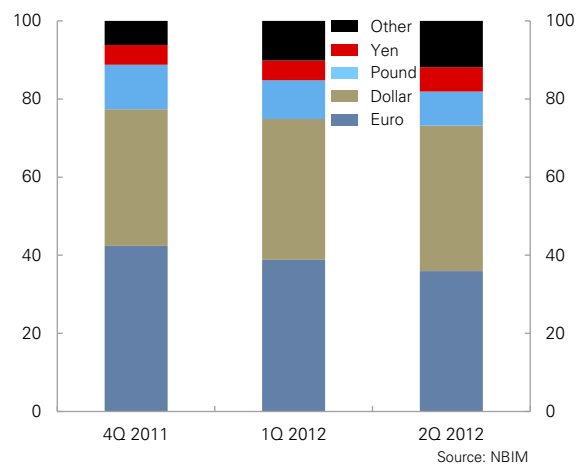
Globally, new bond issuances fell to 2,435 billion dollars in the second quarter from 3,389 billion dollars in the first quarter, according to Dealogic. The biggest drop was at financial institutions, which issued bonds for 687 billion dollars in the quarter, compared with 1,219 billion dollars three months earlier. Issuances of covered bonds, a type of securitized debt, fell to 75 billion dollars from 203 billion dollars.

The fund's three largest investments in new bonds other than government debt were in bonds issued by the

**Chart 1-5** Issuance of euro-denominated covered bonds and senior unsecured debt. Billions of euros



**Chart 1-6** Currency composition of the fund's fixed-income investments. Percent





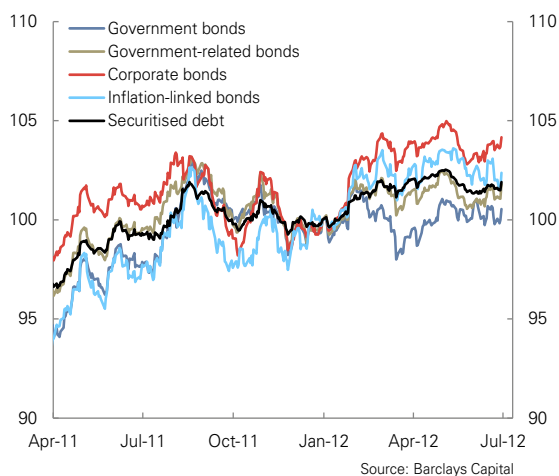
European Union (EU), FMS Wertmanagement and Kreditanstalt für Wiederaufbau.

The fund in the quarter increased investments in US, German and Japanese government bonds. It boosted holdings of government bonds issued in the currencies of emerging markets such as China, Brazil and India to 5.3 percent of the fixed-income investments from 4.7 percent. The fund also increased its holdings of bonds issued by the EU, while reducing investments in French, British and Spanish government debt. Holdings of

unsecured bonds issued by US financial institutions were also scaled back.

The fund's bond holdings consisted of 4,424 securities from 1,247 issuers at the end of the second quarter, compared with 4,717 securities from 1,322 issuers three months earlier. The investments had, on average, a duration of 5.6 years and a yield of 2.4 percent. Duration is the average time it takes for an investor to receive the cashflow on a bond.

**Chart 1-7** Price developments in fixed-income sectors in the Barclays Global Aggregate Index, measured in US dollars. Indexed. 30 Dec 2011 = 100



**Table 1-4** Return on the fund's bond investments in 2Q 2012. By sector. Percent

Sector	Return in international currency	Share of fixed-income investments*
Government bonds**	2.9	50.8
Government-related bonds**	1.2	11.8
Inflation-linked bonds**	2.3	6.5
Corporate bonds	1.6	12.7
Securitized debt	-1.4	14.7

\* The individual percentages do not add up to 100 percent as the table excludes investments in short-term securities, bank deposits and derivatives.

\*\* Governments may issue different types of bonds and the fund's investments in these bonds are grouped accordingly. Bonds issued by a country's government in the country's own currency are categorised as government bonds. Bonds issued by a country's government in another country's currency are grouped with government-related bonds. Inflation-linked bonds issued by governments are grouped with inflation-linked bonds.

**Table 1-5** The fund's bond investments as of 30 June 2012 based on credit ratings\*. Percentage of holdings

	AAA	AA	A	BBB	Lower rating	Total
Government bonds	40.6	6.8	2.4	2.7	0.3	52.7
Government-related bonds	7.4	2.4	0.9	1.3	0.2	12.2
Inflation-linked bonds	5.6	0.7	0.4	-	-	6.7
Corporate bonds	0.0	1.1	6.9	5.0	0.2	13.2
Securitized debt	9.6	1.1	3.0	1.2	0.3	15.2
<b>Total bonds</b>	<b>63.1</b>	<b>12.1</b>	<b>13.6</b>	<b>10.2</b>	<b>1.0</b>	<b>100.0</b>

\*Based on credit ratings from at least one of the following agencies: Moody's, Standard & Poor's and Fitch.

### Real estate investments

Real estate investments amounted to 0.3 percent of the fund at the end of the second quarter. This share shall gradually increase to as much as 5 percent through a corresponding decrease in bond holdings. New investments will generally be in well-developed markets and properties such as offices and retail premises.

The fund made no new real estate investments in the second quarter. It held 25 percent of a portfolio of properties on Regent Street in London and 50 percent of 10 properties in and around Paris. These investments were held in partnership with The Crown Estate in London and AXA Group in Paris.

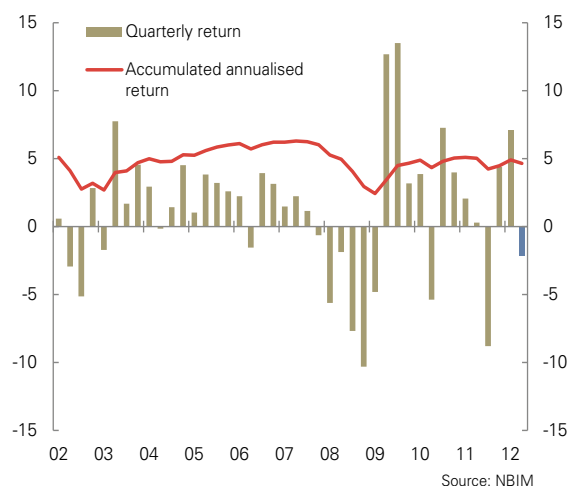
The return on the fund's real estate investments is largely determined by rental income, changes in property values and currency movements. Transaction costs may also impact significantly on results, particularly in the start-up phase. The fund's real estate investments returned 0.3 percent in the second quarter, helped by rental income and an increase in the estimated value of the property investments because of higher actual and expected rental income. This was partly offset by the negative currency impact of a weakening of the euro against the fund's currency basket.

*Go to note 6 in the financial-reporting section for more information on the fund's real estate investments.*

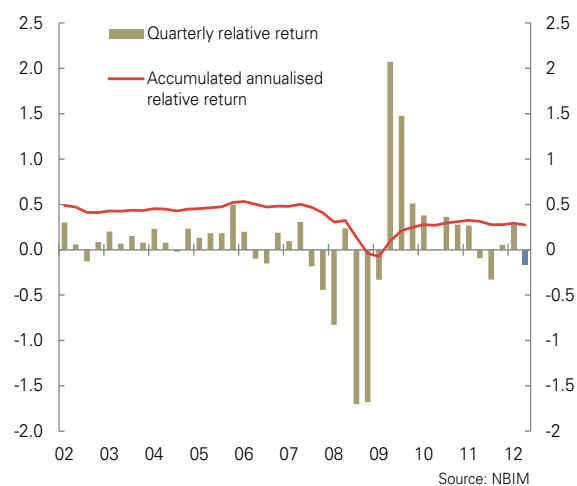
Table 1-6 Returns as of 30 June 2012

	2Q 2012	1Q 2012	4Q 2011	3Q 2011	2Q 2011	Year-to-date 30 Jan12
<b>Returns in international currency</b>						
Return on equity investments (percent)	-4.57	10.99	7.36	-16.95	-0.65	5.91
Return on fixed-income investments (percent)	1.52	1.58	0.74	3.65	1.78	3.12
Return on real estate investments (percent)	0.31	2.18	0.44	-0.10	-4.70	2.50
Return on fund (percent)	-2.18	7.11	4.39	-8.80	0.29	4.78
Return on equity and fixed-income investments (percent)	-2.18	7.13	4.41	-8.82	0.30	4.79
Return on benchmark equity and fixed-income indices (percent)	-2.02	6.87	4.35	-8.49	0.39	4.71
Relative return on equity and fixed-income investments (percentage points)	-0.16	0.27	0.06	-0.33	-0.09	0.08
Relative return on equity investments (percentage points)	-0.17	0.33	0.12	-0.50	-0.16	0.13
Relative return on fixed-income investments (percentage points)	-0.07	0.11	-0.01	0.00	0.03	0.05
Management costs (percentage points)	0.02	0.02	0.02	0.02	0.02	0.03
Return on fund after management costs (percent)	-2.19	7.10	4.37	-8.82	0.27	4.75
<b>Returns in kroner (percent)</b>						
Return on equity investments	-2.66	7.49	7.94	-12.85	-2.32	4.63
Return on fixed-income investments	3.56	-1.63	1.28	8.76	0.07	1.88
Return on real estate investments	2.33	-1.04	0.99	4.83	-6.30	1.27
Return on fund	-0.21	3.74	4.96	-4.30	-1.39	3.52
Return on equity and fixed-income investments	-0.22	3.76	4.97	-4.32	-1.38	3.53

**Chart 1-8** The fund's quarterly and accumulated annualised return. Percent



**Chart 1-9** Quarterly relative return and accumulated annualised relative return on the fund, excluding real estate investments. Percentage points



**Table 1-7** Historical key figures as of 30 June 2012. Annualised data, measured in the fund's international currency basket

	Last 12 months	Last 3 years	Last 5 years	Last 10 years	Since 1 Jan 1998
Return on fund (percent)	-0.24	9.45	1.62	4.90	4.65
Return on equity and fixed-income investments (percent)	-0.24	9.45	1.62	4.90	4.66
Return on benchmark equity and fixed-income indices (percent)	0.02	8.45	1.76	4.71	4.38
Relative return on equity and fixed-income investments (percentage points)	-0.22	1.00	-0.14	0.18	0.27
Standard deviation (percent)	10.28	9.24	11.33	8.62	7.84
Tracking error for equity and fixed-income investments (percentage points)	0.44	0.57	1.23	0.90	0.78
Information ratio (IR) for equity and fixed-income investments*	-0.51	1.74	-0.11	0.21	0.35
Return on fund (percent)	-0.24	9.45	1.62	4.90	4.65
Annual price inflation (percent)	2.00	2.33	2.17	2.16	1.94
Annual management costs (percent)	0.07	0.10	0.10	0.10	0.09
Annual net return on fund (percent)	-2.27	6.85	-0.63	2.58	2.57

\*The information ratio (IR) is a measure of risk-adjusted return. It is calculated as the ratio of relative return to the relative market risk that the fund has been exposed to. The IR indicates how much relative return has been achieved per unit of risk

**Table 1-8** Key figures as of 30 June 2012

	2Q 2012	1Q 2012	4Q 2011	3Q 2011	2Q 2011
<b>Market value (billions of kroner)*</b>					
Market value of equity investments	2,122	2,122	1,945	1,699	1,881
Market value of fixed-income investments	1,428	1,364	1,356	1,346	1,226
Market value of real estate investments	11	11	11	10	4
Market value of fund	3,561	3,496	3,312	3,055	3,111
<b>Inflow of new capital*</b>					
Inflow of new capital*	72	60	102	78	53
<b>Return on fund</b>					
Return on fund	-77	234	135	-284	4
<b>Change due to fluctuations in krone</b>					
Change due to fluctuations in krone	70	-110	19	150	-48
Total change in fund	65	185	257	-56	9
<b>Management costs (percent)</b>					
Estimated transition costs	0.01	0.01	0.02	0.01	0.01
Annualised management costs	0.07	0.07	0.08	0.08	0.08
<b>Changes in value since first capital inflow in 1996 (billions of kroner)</b>					
Gross inflow of new capital	2,915	2,842	2,782	2,679	2,600
Management costs	20	19	19	18	17
Inflow of capital after management costs	2,895	2,823	2,763	2,661	2,583
Return on fund	817	894	660	525	809
Change due to fluctuations in krone	-151	-221	-111	-131	-281
Market value of fund	3,561	3,496	3,312	3,055	3,111
Return after management costs	798	875	641	506	791

\* The fund's market value in this table does not take into account the management fee to NBIM from the Ministry of Finance. The market value will therefore differ slightly from the Statement of cash flows and the Statement of changes in owner's capital in the financial accounts. The inflows in this table differ slightly from those in the financial accounts (see Statement of cash flows and Statement of changes in owner's capital) due to differences in the treatment of management fees.

**Table 1-9** Accumulated returns since first capital inflow in 1996. Billions of kroner

	2Q 2012	1Q 2012	4Q 2011	3Q 2011	2Q 2011
Return on equity investments	338	437	226	104	432
Return on fixed-income investments	480	457	434	421	377
Return on real estate investments	0	0	0	0	0
Return on fund	817	894	660	525	809

### The fund's relative return

Returns on the fund's equity and fixed-income investments are compared with returns on global benchmark indices for stocks and bonds. The return on equity and fixed-income investments was 0.16 percentage point lower than the return on the benchmark indices in the quarter.

The fund's equity investments lagged the benchmark index by 0.17 percentage point in the quarter. The technology and utilities sectors were the best-performing stock sectors compared with the benchmark, while investments in oil and gas shares and financial stocks performed the worst. Sorted by country, investments in Spain and South Korea performed the best against the benchmark, while stockholdings in the US and China performed the worst.

The fund's fixed-income investments underperformed the benchmark index by 0.07 percentage point in the quarter, in part because of investments in emerging markets. The fund's bond investments also had a shorter duration, on average, than bonds in the benchmark, making them less sensitive to falling yields. A lower exposure than the benchmark to Italian and Spanish government bonds contributed positively to the relative return.

The Ministry of Finance sets the benchmark indices, which are based on indices from FTSE Group and Barclays Capital. The benchmark indices for equities and bonds were modified with effect from the end of the second quarter. The benchmark index for bonds also earlier this year underwent changes that became effective on 1 February. The overall changes will be implemented over time.

*Go to [www.nbim.no](http://www.nbim.no) for more information on the benchmark indices.*

### Operational reference portfolios

NBIM has constructed internal operational reference portfolios for equities and bonds. These reflect the types of securities we believe represent a neutral and appropriate investment strategy given the fund's size, long-term approach and objective. The reference portfolios are designed to over time produce a better trade-off between expected return and risk than the benchmark indices set by the Ministry of Finance. They may deviate from the

benchmark indices in accordance with the fund's risk limits.

The operational reference portfolio for equity investments returned -4.4 percent in the second quarter, the same as the benchmark index set by the Ministry of Finance. The operational reference portfolio consisted of shares in 7,164 companies at the end of the quarter, compared with 7,204 companies in the ministry's benchmark index.

The operational reference portfolio for bond investments returned 1.6 percent in the second quarter, which was 0.02 percentage point less than the benchmark index set by the ministry. The operational reference portfolio comprised 4,138 bonds at the end of the quarter, against 9,066 bonds in the ministry's benchmark index.

**Table 1-10** Contributions from equity and fixed-income management to the fund's relative return in 2Q 2012. Percentage points

	External management	Internal management	Total*
Equity investments	-0.01	-0.10	-0.12
Fixed-income investments	-0.00	-0.04	-0.05
Total	-0.02	-0.15	-0.16

\*The figures in the table do not always add up to the sub totals and total due to the rounding of decimals.

## Investment risk

NBIM focuses on three main types of investment risk: market, credit and counterparty. We have set up frameworks in each category for how risk is measured, checked and managed.

Market risk is determined by the composition of the fund's investments and will be influenced by movements in share prices, exchange rates, interest rates and credit risk premiums. As no single measure or analysis can fully capture the fund's market risk, we use a variety of measures and analyses, including expected tracking error, factor exposures, concentration analysis and liquidity risk.

The fund's expected absolute volatility, calculated using the statistical measure standard deviation, uses a three-year price history to estimate how much the annual return

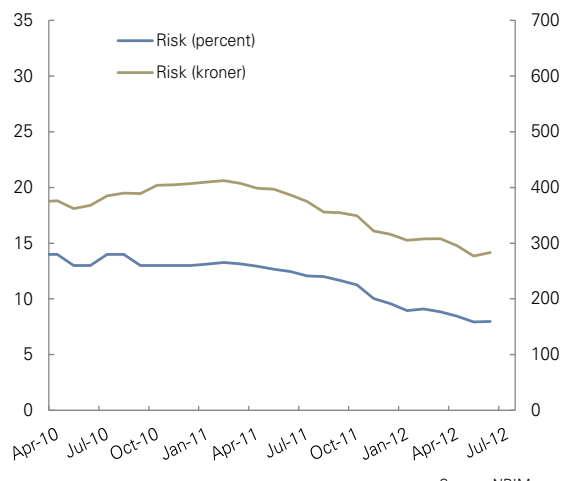
on the fund's equity and fixed-income investments may fluctuate. The fund's expected absolute volatility was 8 percent, or about 300 billion kroner, at the end of the second quarter, compared with 8.8 percent three months earlier.

The Ministry of Finance has set limits for how much NBIM may deviate from the benchmark indices in managing the fund's equity and fixed-income investments. Expected relative volatility (tracking error) is one of these limits and

caps how much the return on these investments may be expected to deviate from the return on the benchmark indices. NBIM should aim for expected tracking error of no more than 1 percentage point. The actual figure was 0.4 percentage point at the end of the quarter, compared with 0.5 percentage point three months earlier.

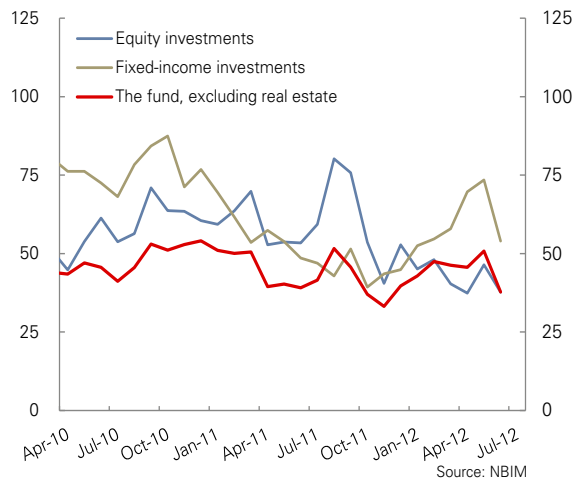
Go to note 8 in the financial-reporting section for more information on the fund's investment risk.

**Chart 1-10** Expected absolute volatility of the fund, excluding real estate. Percent (left-hand axis) and billions of kroner (right-hand axis)



Source: NBIM

**Chart 1-11** Expected relative volatility of the fund, excluding real estate. Basis points



Source: NBIM

**Table 1-11** Key figures for the fund's risk and exposure

Risk	Limits set by the Ministry of Finance and Norges Bank's Executive Board	Actual			
		30 Jun 2012	31 Mar 2012	31 Dec 2011	30 Sep 2011
Net market value*	Equities 50-70% of fund's market value	59.6	60.7	58.7	55.6
	Bonds 30-50% of fund's market value	40.1	39.0	41.0	44.1
	Real estate 0-5% of fund's market value	0.3	0.3	0.3	0.3
Exposure**	Equities 50-70% of fund's market value	59.0	60.7	58.6	56.0
	Bonds 30-50% of fund's market value	38.1	37.0	39.5	44.1
	Real estate 0-7.5% of fund's market value***	0.3	0.3	0.3	0.3
Counterparty risk	Any one counterparty maximum 0.75% of fund's market value	0.2	0.2	0.2	0.2

\* The net market value is the value of all securities, financial instruments and cash within each asset class.

\*\* The exposure is calculated using the full underlying value of derivatives, but not taking into account cash balances. As a result, the actual share of each asset class may vary from the corresponding net market value. The total exposure may also amount to more or less than 100 percent depending on the use of derivatives and the fund's cash balances.

\*\*\*The exposure limit for real estate includes leverage.

## Responsible investment and active ownership

A good long-term return on the fund depends on sustainable economic, environmental and social development. NBIM encourages companies to take responsibility for improving social and environmental practices that may negatively impact their profitability. We also promote the development of good corporate governance standards.

We actively use our voting rights as a shareholder in almost 8,000 companies to safeguard the fund's long-term interests. We voted at 6,523 general meetings in the second quarter and noted that shareholders in Europe and the US increasingly held the board accountable for its actions. The roles and responsibilities of the board is also a focus area in NBIM's ownership activities. Shareholders at four US companies in the quarter voted on proposals by NBIM to give shareholders the right to nominate board candidates on company ballots, so-called proxy access. The proposals garnered the support of between 31 percent and 38 percent of the votes that were cast at the companies' annual general meetings.

NBIM in the quarter also participated in the European Securities Market Authority's consultation on the regulatory framework for companies offering investors advice on voting, so-called proxy advisory services. NBIM buys a variety of services and analytical products from these companies and we vote using an electronic platform operated by one such company. We will support reforms and regulation of the industry if this increases the companies' transparency and the quality of the services they offer, while safeguarding their independence.

## Operational risk management and internal control

NBIM constantly seeks to identify and mitigate operational risks that could lead to financial or reputational losses. Risk reduction measures and internal controls are monitored to ensure acceptable levels.

NBIM each quarter estimates the size of the potential losses or gains it may incur because of unwanted events over the next four quarters. The estimate is based on past events and possible future events and represents NBIM's estimated risk exposure.

The Executive Board has decided there must be less than 20 percent probability that unwanted events will result in gains and losses of 500 million kroner or more over a 12-month period, a limit referred to as the Executive Board's risk tolerance. NBIM registered 52 unwanted events in the second quarter, resulting in an estimated financial loss of 3.5 million kroner. None of the events led to financial gains. NBIM's risk exposure was well within the board's bounds for risk tolerance at the end of the quarter.

The Ministry of Finance has set extensive guidelines for the fund's management. No significant breaches of these guidelines were registered in the second quarter and NBIM was not notified by external supervisory authorities of any significant breaches of market rules or general legislation.

# Financial reporting

Norges Bank's interim financial statements, which only encompass the interim financial reporting for the investment portfolio of the Government Pension Fund Global, were approved by Norges Bank's Executive Board on 8 August 2012. These accounts and an excerpt from Norges Bank's accounting policies are reproduced below.

Income statement	15
Statement of comprehensive income	15
Balance sheet	16
Statement of cash flows	17
Statement of owner's capital	18
Notes to the financial reporting	19
<b>Note 1</b> Accounting policies	19
<b>Note 2</b> Significant estimates and critical accounting judgements	20
<b>Note 3</b> Other expenses	20
<b>Note 4</b> Management costs	21
<b>Note 5</b> Equities and units / Bonds and other fixed-income instruments / Financial derivatives	22
<b>Note 6</b> Real estate	23
<b>Note 7</b> Fair value measurement	25
<b>Note 8</b> Risk	26
Auditor's report	29



## Income statement

<i>Amounts in NOK million</i>	Note	2Q 2012	2Q 2011	Year-to-date 30.06.2012	Year-to-date 30.06.2011	2011
Profit / loss on the portfolio excluding foreign exchange gains and losses						
Interest income from bank deposits		23	111	28	243	162
Interest income, lending associated with reverse repurchase agreements		35	306	128	487	1 004
Net income/expenses and gains / losses from:						
- Equities and units		-100,313	-18,461	111,692	37,489	-173,099
- Bonds and other fixed-income instruments		24,528	23,502	45,761	25,130	92,346
- Financial derivatives		-1 339	-843	-339	102	-5 693
- Financial assets real estate	6	121	-152	246	-152	86
- Investment properties	6	19	-	-21	-	-130
Share of the profit / loss in jointly controlled entities real estate	6	89	-	112	-	-31
Interest expense repurchase agreements		-54	-330	-90	-574	-629
Other interest expense		-4	-65	-6	-97	-286
Other expenses	3, 4	-39	40	-57	-11	24
<b>Profit / loss on the portfolio before foreign exchange gains and losses</b>		<b>-76,934</b>	<b>4,108</b>	<b>157,454</b>	<b>62,617</b>	<b>-86,246</b>
Foreign exchange gains and losses		69,752	-47,564	-40,050	-120,173	49,205
<b>Profit / loss on the portfolio</b>		<b>-7,182</b>	<b>-43,456</b>	<b>117,404</b>	<b>-57,556</b>	<b>-37,041</b>
Management fee	4	-546	-633	-1,125	-1,245	-2,539
<b>Profit / loss for the period</b>		<b>-7,728</b>	<b>-44,089</b>	<b>116,279</b>	<b>-58,801</b>	<b>-39,580</b>

## Statement of comprehensive income

<i>Amounts in NOK million</i>	Note	2Q 2012	2Q 2011	Year-to-date 30.06.2012	Year-to-date 30.06.2011	2011
Profit / loss for the period		-7,728	-44,089	116,279	-58,801	-39,580
Translation reserve arising from consolidation of foreign subsidiaries		5	2	5	2	-3
<b>Total comprehensive income</b>		<b>-7,723</b>	<b>-44,087</b>	<b>116,284</b>	<b>-58,799</b>	<b>-39,583</b>

## Balance sheet

<i>Amounts in NOK million</i>	<b>Note</b>	<b>30.06.2012</b>	<b>31.12.2011</b>	<b>30.06.2011</b>
<b>ASSETS</b>				
<b>Financial assets</b>				
Deposits in banks		9,433	7,276	11,565
Lending associated with reverse repurchase agreements		121,567	79,820	377,676
Unsettled trades		14,478	2,272	39,756
Equities and units	5	1,968,225	1,806,798	1,693,068
Equities lent	5	136,969	137,130	187,942
Bonds and other fixed-income instruments	5	1,373,816	1,324,255	953,984
Bonds lent	5	4,595	3,256	267,887
Financial derivatives	5	1,234	2,227	2,702
Financial assets real estate	6	4,760	4,415	3,894
Jointly controlled entities real estate	6	2,534	2,546	-
Other financial assets		4,189	3,244	23,254
<b>Total financial assets</b>		<b>3,641,800</b>	<b>3,373,239</b>	<b>3,561,728</b>
<b>Non-financial assets</b>				
Investment properties	6	3,823	4,062	-
Other non-financial assets		6	6	-
<b>Total non-financial assets</b>		<b>3,829</b>	<b>4,068</b>	<b>-</b>
<b>Total assets</b>	<b>7, 8</b>	<b>3,645,629</b>	<b>3,377,307</b>	<b>3,561,728</b>
<b>LIABILITIES AND OWNER'S CAPITAL</b>				
<b>Financial liabilities</b>				
Short-term borrowing		193	11	4,374
Borrowing associated with repurchase agreements		15,347	19,280	139,961
Cash collateral received		39,901	36,926	212,567
Unsettled trades		24,536	3,310	65,770
Financial derivatives	5	4,353	5,957	7,881
Other financial liabilities		235	251	19,923
Management fee payable		1,125	2,539	1,245
<b>Total financial liabilities</b>	<b>7, 8</b>	<b>85,690</b>	<b>68,274</b>	<b>451,721</b>
<b>Owner's capital</b>		<b>3,559,939</b>	<b>3,309,033</b>	<b>3,110,007</b>
<b>Total liabilities and owner's capital</b>		<b>3,645,629</b>	<b>3,377,307</b>	<b>3,561,728</b>

## Statement of cash flows

<i>Amounts in NOK million, cash received (+) / cash paid (-)</i>	<b>Year-to-date 30.06.2012</b>	<b>Year-to-date 30.06.2011</b>	<b>2011</b>
<b>Operating activities</b>			
Interest received on deposits in banks	256	1,170	179
Net cash flow in connection with reverse repurchase agreements	-37,945	-117,760	170,095
Net cash flows arising from purchase and sale of equities and units	-105,942	-41,193	-239,987
Net cash flows arising from purchase and sale of bonds and other fixed-income instruments	-42,941	-10,242	-21,094
Payments made to acquire financial assets real estate	-147	-4,067	-4,270
Payments made to acquire investment properties	-2	-	-4,301
Payments made / received in connection with jointly controlled entities real estate	19	-	-2,620
Net cash flows arising from financial derivatives	-1,524	-1,522	-9,147
Dividends received from investments in equities and units	35,537	28,722	49,208
Interest received on bonds and other fixed-income instruments	26,387	25,827	48,036
Income received in connection with equity and bond lending	1,553	1,336	2,230
Income received from investments in financial assets real estate	82	26	130
Dividends received from investments in jointly controlled entities real estate	38	-	-
Income received from investments in investment properties	115	-	60
Interest paid on short-term borrowing from banks	-2	-528	-21
Net cash flows related to repurchase agreements	-8,453	-2,848	-114,347
Cash collateral received / paid related to securities lending, derivatives and reverse repurchase agreements	2,974	40,258	-135,382
Cash flow related to other financial assets, other financial liabilities and other non-financial assets	1,866	15,553	-5,587
Payment of other expenses	-89	-284	-248
Management fee paid to Norges Bank*	-2,539	-2,959	-2,959
<b>Net cash outflow from operating activities</b>	<b>-130,757</b>	<b>-68,511</b>	<b>-270,025</b>
<b>Financing activities</b>			
Inflow from the Norwegian government**	132,642	72,642	274,155
<b>Net cash inflow from financing activities</b>	<b>132,642</b>	<b>72,642</b>	<b>274,155</b>
<b>Net change in cash and cash equivalents</b>			
Cash and cash equivalents on 1 January	7,265	3,363	3,363
Net cash payments in the period	1,885	4,131	4,130
Net foreign exchange gains and losses on cash and cash equivalents	90	-303	-228
<b>Cash and cash equivalents at the end of the period</b>	<b>9,240</b>	<b>7,191</b>	<b>7,265</b>
<b>Cash and cash equivalents comprise:</b>			
Deposits in banks	9,433	11,565	7,276
Short-term borrowing	-193	-4,374	-11
<b>Total cash and cash equivalents at the end of the period</b>	<b>9,240</b>	<b>7,191</b>	<b>7,265</b>

\* Management fee shown in the cash flow statement for a period is the settlement of the fee that was accrued and expensed in the previous year.

\*\* The inflow includes only the transfers that have settled during the period. Inflows in the statement of changes in owner's capital are based on accrued inflows.

## Statement of changes in owner's capital

<i>Amounts in NOK million</i>	<b>Inflows from owner</b>	<b>Retained earnings</b>	<b>Translation reserve foreign subsidiaries</b>	<b>Deposits in krone account</b>
1 January 2011	2,504,711	569,750	.	3,074,461
Total comprehensive income	.	-58,801	2	-58,799
Inflows during the period*	94,345	.	.	94,345
<b>30 June 2011</b>	<b>2,599,056</b>	<b>510,949</b>	<b>2</b>	<b>3,110,007</b>
1 January 2012	2,778,866	530,170	-3	3,309,033
Total comprehensive income	.	116,279	5	116,284
Inflows during the period*	134,622	.	.	134,622
<b>30 June 2012</b>	<b>2,913,488</b>	<b>646,449</b>	<b>2</b>	<b>3,559,939</b>

\* Out of the total inflows to the krone account of the Government Pension Fund Global in the first half of 2012, NOK 2.5 billion was used to pay the 2011 accrued management fee to Norges Bank and NOK 132.1 billion was transferred into the investment portfolio. Comparative amounts for the first half of 2011 are NOK 3.0 billion and NOK 91.3 billion, respectively.

## Note 1 Accounting policies

### 1.1 Basis of Accounting

Norges Bank is Norway's central bank. The bank manages Norway's foreign exchange reserves and the Government Pension Fund Global. Norges Bank's interim financial statements, which only include the financial reporting for the investment portfolio of the Government Pension Fund Global, are prepared in accordance with International Financial reporting Standards as endorsed by the EU (IFRS). The regulation concerning the annual financial reporting for Norges Bank, which has been laid down by the Ministry of Finance, requires Norges Bank's financial statements to include the financial reporting of the investment portfolio of the Government Pension Fund Global, which shall be prepared in accordance with IFRS. As subsidiaries have been established that exclusively constitute investments as part of Norges Bank's management of the investment portfolio, consolidated financial statements are prepared for the investment portfolio of the Government Pension Fund Global.

Norges Bank prepares interim financial statements, which solely comprise the quarterly financial reporting of the investment portfolio of the Government Pension Fund Global, with closing dates of 31 March, 30 June and 30 September. The interim financial reporting for Norges Bank is prepared in accordance with IAS 34 Interim Financial Reporting.

The financial statements are presented in Norwegian kroner (NOK), rounded to the nearest million kroner.

The quarterly financial statements are prepared using the same accounting policies and calculation methods as used for the annual financial statements as of 31 December 2011. If the implementation of new standards, or changes in standards, causes a change in the accounting policies, these changes are specifically described in section 1.2. Norges Bank's accounting policies are presented in Norges Bank's annual financial statements 2011, and an extract of the policies relevant for the investment portfolio are also presented in the Government Pension Fund Global Annual Report 2011. The quarterly financial statements should also be read in conjunction with Norges Bank's annual financial statements 2011.

### 1.2 New standards implemented from 1 January 2012

Norges Bank does not expect that the changes in IAS 12 Income Taxes will have a material effect for the investment portfolio of the Government Pension Fund Global. The amended standard is effective for annual periods beginning on or after 1 January 2012, but has not yet been endorsed by the EU. Norges Bank expects to apply the amended standard with effect as from 1 January 2012, under the assumption that it will be endorsed by the EU prior to 31 December 2012.

### 1.3 IASB final standards and IFRIC interpretations with application dates after 2012

There are no IFRS standards or IFRIC interpretations approved by the IASB during the first half of 2012 with a material effect for the financial reporting of Norges Bank.

## Note 2 Significant estimates and critical accounting judgements

The preparation of the financial statements of Norges Bank, which includes the financial reporting for the investment portfolio of the Government Pension Fund Global in accordance with the accounting policies in note 1, involves the use of estimates and judgements that may affect assets, liabilities, income and expenses. Estimates and judgements are based on historical experience and expectations about future events that are considered probable at the time the financial statements are presented.

Estimates are based on best judgement; however, actual results may deviate from estimates. In cases of particularly uncertain estimates, this is described in the respective notes. For additional information on significant estimates and critical accounting judgements see note 2 in Norges Bank's annual financial statements 2011, which are also presented as an extract in the Government Pension Fund Global's Annual Report 2011.

## Note 3 Other expenses

Table 3.1 Specification other expenses

Amounts in NOK million	2Q 2012	2Q 2011	Year-to-date 30.06.2012	Year-to-date 30.06.2011	2011
Operating expenses, real estate subsidiaries	14	-7	26	-3	26
Other expenses, investment portfolio excluding subsidiaries	25	-33	31	14	-50
<b>Total other expenses</b>	<b>39</b>	<b>-40</b>	<b>57</b>	<b>11</b>	<b>-24</b>

Other expenses is deducted directly from Profit/loss on the portfolio before the management fee. Expenses included in Other Expenses do not form part of the management fee from the Ministry of Finance. For additional information see note 4 Management costs.

Operating expenses in subsidiaries related to the management of real estate investments, shown in table 3.1, amount to NOK 14 million for the second quarter of 2012. These expenses are specified in table 4.2 in note 4 Management costs.

Other expenses, investment portfolio excluding subsidiaries specified in table 3.1 includes various costs arising from investment activities that are not incurred by the subsidiaries, and that may be related to all asset classes. These are normally transaction related expenses.

Negative expenses normally consist of reversals of previous provisions.

## Note 4 Management costs

Operating costs related to the management of the Government Pension Fund Global are incurred both in Norges Bank (parent level) and in subsidiaries related to the real estate investments. Norges Bank's own operating costs related to the management are refunded by the management fee from the Ministry of Finance, and are specified in table 4.1. Operating expenses that are incurred in subsidiaries are not included in the management fee. These are specified in table 4.2.

Table 4.1 Specification management fee

Amounts in NOK million			Year-to-date			2011	
	2Q 2012	2Q 2011	30.06.2012	Percent*	Year-to-date	Percent*	30.06.2011
Salary, social security and other personnel related costs	111	96	233		206		447
IT, information and decision support systems	68	45	116		114		214
Custody and settlement costs	78	98	171		206		406
Outsourced IT and analysis costs	53	60	103		142		254
Consulting and legal fees	14	18	30		35		73
Base fees to external managers	83	88	176		211		371
Other costs	25	26	50		50		107
Allocated common costs Norges Bank	41	32	81		64		121
<b>Management fee excluding performance-based fees</b>	<b>472</b>	<b>463</b>	<b>962</b>	0.06	<b>1,028</b>	0.07	<b>1,993</b>
Performance-based fees to external managers	74	170	163		217		546
<b>Total management fee</b>	<b>546</b>	<b>633</b>	<b>1,125</b>	0.07	<b>1,245</b>	0.08	<b>2,539</b>

\* Percent of assets under management.

Table 4.1 shows costs incurred by Norges Bank that are reimbursed by the Ministry of Finance as the principal for the management of the investment portfolio of the Government Pension Fund Global. Fees to external managers and custody and settlement fees are invoiced directly and paid individually for each of the portfolios managed by Norges Bank. All other costs included in the basis for calculation of the management fee are costs that are common for the management of both portfolios, and are allocated to the individual portfolio using a cost allocation model based primarily on market values and asset class composition. The management fee is a function of expenses presented in the Norges Bank income statement as Total other operating expenses.

Table 4.2 Specification operating expenses, real estate subsidiaries

Amounts in NOK million	2Q 2012	2Q 2011	Year-to-date	Year to date	2011
			30.06.2012	30.06.2011	
Salary, social security and other personnel related costs	3	0	5	0	2
IT, information and decision support systems, out-sourced administrative services	1	0	2	0	2
Consulting and legal fees	2	-8	4	-4	11
Fees related to real estate asset management (external)	5	0	9	0	6
Other costs, subsidiaries	3	1	6	1	5
<b>Operating expenses, real estate subsidiaries</b>	<b>14</b>	<b>-7</b>	<b>26</b>	<b>-3</b>	<b>26</b>

In addition to the operating expenses that are shown in table 4.1 and that are reimbursed through the management fee from the Ministry of Finance, operating and administrative expenses are incurred in the subsidiary companies that are incorporated as a part of the management of real estate investments of the Government Pension Fund Global. These expenses are consolidated into the income statement of the investment portfolio, and are paid using funds received or earned by the portfolio. Operating expenses in subsidiaries do not form part of Norges Bank operating expenses as they are not consolidated into Norges Bank, as per the accounting regulation for Norges Bank § 2.3, paragraph 4. These expenses are presented as Other expenses in the income statement for the investment portfolio, and are deducted from Profit/loss on the portfolio. See note 3 for further information on Other expenses.

Within the real estate asset class additional costs related to property management exist, and are included in the income statement lines Net income / expenses - gains / losses on investment properties and Share of profit / loss in jointly controlled entities real estate. These costs are incurred by the company that owns the real estate property.

## Note 5 Equities and units / Bonds and other fixed income instruments / Financial derivatives

Table 5.1 Specification of equities

Amounts in NOK million	30.06.2012			30.06.2011		
	Fair value excluding dividends	Accrued dividends	Fair value including dividends	Fair value excluding dividends	Accrued dividends	Fair value including dividends
Equities:						
Listed equities and units	2,099,864	5,330	2,105,194	1,940,789	3,139	1,943,928
<b>Total equities and units</b>	<b>2,099,864</b>	<b>5,330</b>	<b>2,105,194</b>	<b>1,940,789</b>	<b>3,139</b>	<b>1,943,928</b>
<i>Of which equities lent</i>			136,969			137,130

Table 5.2 Specification of bonds and other fixed-income instruments

Amounts in NOK million, 30 June 2012	Nominal value*	Fair value excluding accrued interest	Accrued interest	Fair value including accrued interest
Bonds and other fixed-income instruments:				
Government bonds**	653,262	719,128	7,113	726,241
Government related bonds	155,550	165,695	2,499	168,193
Inflation-linked bonds	68,446	91,812	578	92,390
Corporate bonds	171,772	178,720	2,892	181,612
Securitised bonds	217,703	206,871	3,104	209,975
<b>Total bonds and other fixed-income instruments</b>	<b>1,266,733</b>	<b>1,362,226</b>	<b>16,185</b>	<b>1,378,411</b>
<i>Of which bonds lent</i>				4,595

Amounts in NOK million, 31 December 2011	Nominal value*	Fair value excluding accrued interest	Accrued interest	Fair value including accrued interest
Bonds and other fixed-income instruments:				
Government bonds**	554,293	605,600	6,965	612,565
Government related bonds	166,691	174,346	2,818	177,164
Inflation-linked bonds	83,105	105,175	541	105,716
Corporate bonds	183,284	184,953	3,388	188,341
Securitised bonds	292,823	238,855	4,870	243,725
<b>Total bonds and other fixed income instruments</b>	<b>1,280,196</b>	<b>1,308,929</b>	<b>18,582</b>	<b>1,327,511</b>
<i>Of which bonds lent</i>				3,256

\* Nominal values have been translated into NOK at the closing rate at the balance sheet date.

\*\* Includes nominal bonds issued in the country's currency. Sovereign bonds (bonds issued by a state in a currency other than its own) are classified as government related bonds.

The holdings of bonds issued by Italy and Spain amounted to a fair value of NOK 36.3 billion as of 30 June 2012. Bond holdings issued by the Greek government were NOK 0.4 billion. The investment portfolio had no holdings of Portuguese or Irish debt.



Table 5.3 Specification of financial derivatives

Amounts in NOK million	Fair value 30.06.2012			Fair value 31.12.2011		
	Asset	Liability	Net	Asset	Liability	Nett
Financial derivatives:						
Foreign exchange contracts	220	1,009	-789	1,603	964	639
Listed futures contracts	179	255	-77	5	224	-219
Swap contracts	835	3,088	-2,253	619	4,769	-4,150
<b>Total financial derivatives</b>	<b>1,234</b>	<b>4,353</b>	<b>-3,119</b>	<b>2,227</b>	<b>5,957</b>	<b>-3,730</b>

## Note 6 Real Estate

Real estate investments in the investment portfolio of the Government Pension Fund Global consist of investments within the real estate asset class. This asset class consists of unlisted investments, classified as financial assets real estate, jointly controlled entities real estate and investment properties.

Financial assets real estate consists of the right to 25 percent of the net operating income generated from properties in and around Regent Street, in London, Great Britain. Investment properties are directly held properties. Jointly controlled entities real estate consists of an ownership share of investment properties and other assets (net) held by a jointly controlled entity.

Table 6.1 shows the profit / loss on the real estate asset class, specified on unrealised value changes for investment properties and financial assets, net operating income, and other income and expenses in the asset class. Table 6.2 specifies the changes in carrying amounts for the main balance sheet items within the real estate asset class.

Table 6.1 Income statement - real estate asset class

Amounts in NOK million	2Q 2012	2Q 2011	Year-to-date 30.06.2012	Year-to-date 30.06.2011	2011
Profit / loss on the portfolio excluding foreign exchange gains and losses, real estate asset class					
Net operating income from:					
Financial assets real estate	43	-152	77	-152	-52
Investment properties	52	.	115	.	60
Jointly controlled entities real estate	29	.	73	.	40
<b>Total net operating income, real estate</b>	<b>124</b>	<b>-152</b>	<b>265</b>	<b>-152</b>	<b>48</b>
Recognised fair value changes from:					
Financial assets real estate	78	.	169	.	138
Investment properties	-32	.	-135	.	-190
Jointly controlled entities real estate	60	.	39	.	-71
<b>Total recognised fair value changes, real estate</b>	<b>106</b>	<b>.</b>	<b>73</b>	<b>.</b>	<b>-123</b>
Net other income and expenses*	-32	-7	-47	-3	-4
<b>Profit / loss on the portfolio before foreign exchange gains and losses, real estate asset class</b>	<b>198</b>	<b>-159</b>	<b>291</b>	<b>-155</b>	<b>-79</b>

\*Includes interest income, interest expense, operating expenses in subsidiaries and other expenses incurred in the real estate asset class.

Table 6.2 Changes in carrying amounts for the main balance sheet items within the real estate asset class

Amounts in NOK million	01.01.2012 – 30.06.2012			Total
	Financial assets real estate	Jointly controlled entities real estate	Investment properties	
Carrying amounts for the main balance sheet items within the real estate asset class as at 01.01.2012	4,415	2,546	4,062	11,023
Purchases and additions	147	0	2	149
Fair value changes	169	39	-135	73
Operating profit from investments accounted for using the equity method	.	73	.	73
Paid dividend and changes in equity capital	.	-54	.	-54
Foreign currency translation effect	29	-70	-106	-147
<b>Carrying amounts for the main balance sheet items within the real estate asset class as of 30.06.2012</b>	<b>4,760</b>	<b>2,534</b>	<b>3,823</b>	<b>11,117</b>

Amounts in NOK million	01.01.2011–31.12.2011			Total
	Financial assets real estate	Jointly controlled entities real estate	Investment properties	
Carrying amounts for the main balance sheet items within the real estate asset class as at 01.01.2011	-	-	-	-
Purchases and additions	4,088	2,620	4,301	11,009
Fair value changes	138	-71	-190	-123
Operating profit from investments accounted for using the equity method	.	40	.	40
Foreign currency translation effect	189	-43	-49	97
<b>Carrying amounts for the main balance sheet items within the real estate asset class as of 31.12.2011</b>	<b>4,415</b>	<b>2,546</b>	<b>4,062</b>	<b>11,023</b>

In July 2012 the Government Pension Fund Global entered into an agreement with Generali Group to buy 50 percent of five properties in Paris for 275 million euros. The agreement is expected to be completed and the properties recognised in the balance sheet during the fourth quarter 2012.

For additional information see note 7 Fair value measurement.

## Note 7 Fair value measurement

All equities, bonds, financial derivatives and real estate investments have been allocated to categories reflecting assessed valuation uncertainty. Level 1 comprises investments that are valued on the basis of observable prices in active markets and are considered to have very limited valuation risk. Investments allocated to level 2 are valued using models with observable market data. These holdings have some pricing uncertainty. Holdings allocated to level 3 are priced using models with considerable use of unobservable inputs, which implies substantial uncertainty regarding the establishment of fair value. These investments, too, are valued by external professional valuers who are regarded as giving the best estimate of fair value and where the total valuation from the different providers differ only to a limited extent.

Table 7.1 divides the investments into categories of assessed pricing uncertainty as of 30 June 2012 and 31 December 2011.

Table 7.1 Specification of investments by level of valuation uncertainty

	Level 1		Level 2		Level 3		Total	
	30.06.2012	31.12.2011	30.06.2012	31.12.2011	30.06.2012	31.12.2011	30.06.2012	31.12.2011
Equities and units	2,102,577	1,942,777	709	995	1,908	156	2,105,194	1,943,928
<b>Total bonds</b>	<b>954,346</b>	<b>876,381</b>	<b>416,180</b>	<b>438,838</b>	<b>7,885</b>	<b>12,292</b>	<b>1,378,411</b>	<b>1,327,511</b>
Government bonds	673,975	600,790	52,266	11,775	-	-	726,241	612,565
Government-related bonds	116,757	98,370	51,311	78,148	125	646	168,193	177,164
Inflation-linked bonds	88,353	98,431	4,037	7,285	-	-	92,390	105,716
Corporate bonds	2,663	3,513	178,791	184,543	158	285	181,612	188,341
Securitised bonds	72,598	75,277	129,775	157,087	7,602	11,361	209,975	243,725
<b>Total financial derivatives</b>	<b>-76</b>	<b>-219</b>	<b>-3,043</b>	<b>-3,511</b>	<b>-</b>	<b>-</b>	<b>-3,119</b>	<b>-3,730</b>
Assets	179	5	1,055	2,222	-	-	1,234	2,227
<b>Liabilities</b>	<b>-255</b>	<b>-224</b>	<b>-4,098</b>	<b>-5,733</b>	<b>-</b>	<b>-</b>	<b>-4,353</b>	<b>-5,957</b>
<b>Total real estate</b>	<b>.</b>	<b>.</b>	<b>.</b>	<b>.</b>	<b>11,117</b>	<b>11,023</b>	<b>11,117</b>	<b>11,023</b>
Financial assets real estate	.	.	.	.	4,760	4,415	4,760	4,415
Jointly controlled entities real estate	.	.	.	.	2,534	2,546	2,534	2,546
Investment Properties	.	.	.	.	3,823	4,062	3,823	4,062
<b>Total</b>	<b>3,056,847</b>	<b>2,818,939</b>	<b>413,846</b>	<b>436,322</b>	<b>20,910</b>	<b>23,471</b>	<b>3,491,603</b>	<b>3,278,732</b>

Valuation uncertainty is relatively unchanged in the second quarter, as compared to the first quarter, but overall is somewhat lower when compared with the prior year-end. The reduction in level 3 bond holdings of NOK 1.6 billion in the second quarter continues the trend from the first quarter, and is primarily due to the sale of United States securitised bonds. This reduction in level 3 bond holdings was offset by an equivalent increase in newly acquired level 3 equity investments. The increase in level 3 equities is caused by an unlisted investment, to some extent offset by movement from level 3, value changes and foreign exchange losses.

External valuations are collected for the investments in the real estate asset class, and balance sheet carrying amounts are adjusted based on these. For the quarter, this resulted in a value increase for the Regent Street investment, and in total a slight value increase for the investments in France; for additional information see note 6 Real estate. The valuation uncertainty within the relevant segments of the real estate market continues, with limited comparable market activity, based on the uncertain economic situation in Europe.

## Note 8 Risk

### Market risk

Market risk is the risk of changes in the value of the portfolio due to movements in interest rates, equity prices, exchange rates and credit spreads. Norges Bank measures risk in both absolute terms and the relative market risk for holdings in the investment portfolio of the Government Pension Fund Global.

### Asset class per region

The portfolio is invested across several asset classes and regions as shown in table 8.1.

Table 8.1 Allocation by asset class and region

		Market value in percent by region		Market value in percent by asset class		Assets minus liabilities excluding management fee	
		30.06.2012	31.12.2011	30.06.2012	31.12.2011	30.06.2012	31.12.2011
Equities	Americas, Africa and the Middle East	36.0	35.9				
	Europe	49.0	49.7				
	Asia and Oceania	15.0	14.4				
Total equities				59.6	58.7	2,121,687	1,944,721
Bonds	Americas, Africa and the Middle East	40.4	37.7				
	Europe	48.1	56.1				
	Asia and Oceania	11.6	6.2				
Total bonds				40.1	41.0	1,428,107	1,355,722
Real Estate	Europe	100.0	100.0				
Total Real Estate				0.3	0.3	11,270	11,129

### Volatility

Norges Bank uses risk modelling to quantify the economic risk for the entire portfolio and for parts of the portfolio. One of the risk measures is expected volatility. Tables 8.2 and 8.3 present risk both in terms of the portfolio's absolute risk and in terms of the relative risk. Real estate investments are not included in the volatility calculations. This is in compliance with the investment mandates given by the Ministry of Finance and the Executive Board of Norges Bank and with the internal guidelines for investment and risk management.

Table 8.2 Portfolio risk in terms of expected volatility, in percent

	Expected volatility, actual portfolio							
	30.06.2012	Min. 2012	Max 2012	Average 2012	31.12.2011	Min. 2011	Max 2011	Average 2011
<b>Long-term model</b>								
Portfolio	8.0	7.9	9.9	8.7	9.6	9.5	13.4	12.1
Equity	13.9	13.9	16.6	15.0	16.4	16.4	21.2	19.9
Bonds	9.2	8.8	10.4	9.1	10.5	10.5	12.7	12.0

Table 8.3 Relative risk, expected relative volatility in basis points

	Expected relative volatility							
	30.06.2012	Min. 2012	Max 2012	Average 2012	31.12.2011	Min. 2011	Max 2011	Average 2011
<b>Long-term model</b>								
Portfolio	38	38	57	48	40	33	65	46
Equity	38	37	61	46	53	40	111	64
Bonds	54	40	77	59	45	38	76	51

The models that are used in the calculation of the above information are explained in note 24 GPFG note 14 Risk in Norges Bank's annual financial statements 2011.

Risk as measured by expected volatility indicates a decrease for equities in isolation and the portfolio in total, excluding real estate investments, for the first half of 2012. This is mainly attributable to the model using three years' historical data. At the end of the first half of 2012 historical data from especially volatile periods in the beginning of 2009 are no longer included in the data set. In addition, volatility in the equity and fixed-income markets has overall decreased slightly during the first half of 2012. Volatility decreased in the first quarter, but took an upturn during the second quarter due to renewed financial unrest in Europe. The risk figure indicates that at the end of the quarter an annual value change of 8.0 percent, or approximately NOK 300 billion, may be expected.

### Credit risk

Credit risk is the risk of losses from issuers of fixed-income instruments defaulting on their payment obligations. Credit risk in the bond portfolio is monitored among other things through the use of ratings. Table 8.4 shows the portfolio's distribution on different credit rating categories.

Table 8.4 Bond portfolio by credit rating

<i>Figures in NOK million, 30 June 2012</i>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>Lower rating</b>	<b>Total</b>
Government bonds	558,988	93,185	32,568	37,079	4,421	726,241
Government-related bonds	101,789	33,732	12,723	17,675	2,274	168,193
Inflation-linked bonds	76,926	9,342	6,122	0	0	92,390
Corporate bonds	217	14,700	94,920	69,374	2,401	181,612
Securitised bonds	132,293	15,753	40,886	16,587	4,456	209,975
<b>Total bonds and other fixed income instruments</b>	<b>870,212</b>	<b>166,713</b>	<b>187,220</b>	<b>140,715</b>	<b>13,551</b>	<b>1,378,411</b>

<i>Figures in NOK million, 31 December 2011</i>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>Lower rating</b>	<b>Total</b>
Government bonds	495,162	79,563	28,235	6,248	3,357	612,565
Government-related bonds	110,336	39,658	12,868	11,352	2,950	177,164
Inflation-linked bonds	77,634	21,011	6,857	-	214	105,716
Corporate bonds	283	25,219	94,555	65,667	2,617	188,341
Securitised bonds	183,963	35,719	12,476	6,672	4,895	243,725
<b>Total bonds and other fixed income instruments</b>	<b>867,378</b>	<b>201,170</b>	<b>154,991</b>	<b>89,939</b>	<b>14,033</b>	<b>1,327,511</b>

The holdings allocated to "lower rating" are marginally lower as compared to year-end 2011, while bond holdings rated A and BBB have increased compared to the holdings rated AAA and AA. This is due to a combination of the downgrading of a number of European bond issuers due to deterioration in credit quality, and the purchase of emerging market bonds.

### Counterparty risk

Counterparty risk is the risk of loss related to the possible bankruptcy or other similar events leading to a counterparty not being able to fulfil its payment obligations.

In table 8.5 the counterparty risk exposure is shown per type of activity / instrument type.

Table 8.5 Counterparty risk by instrument group

<i>Amounts in NOK million, 30 June 2012</i>	<b>Carrying amount adjusted for collateral</b>	<b>Gross exposure</b>	<b>Effect of netting</b>	<b>Collateral and guarantees</b>	<b>Net exposure</b>
Time deposits and unsecured bank deposits	9,432	5,865	-	-	5,865
OTC derivatives including foreign exchange contracts	-3,042	3,655	168	2,186	1,302
Repurchase and reverse repurchase agreements*	702	1,857	-14	-	1,871
Securities lending transactions**	-8,223	19,333	-	11,509	7,824
Bonds posted as collateral for futures trades	1,315	1,359	-	-	1,359
<b>Total</b>		<b>32,070</b>	<b>154</b>	<b>13,695</b>	<b>18,221</b>

<i>Amounts in NOK million, 31 December 2011</i>	<b>Carrying amount adjusted for collateral</b>	<b>Gross exposure</b>	<b>Effect of netting</b>	<b>Collateral and guarantees</b>	<b>Net exposure</b>
Time deposits and unsecured bank deposits	7,276	7,691	-	-	7,691
OTC derivatives including foreign exchange contracts	-3,511	5,355	1,601	2,009	1,745
Repurchase and reverse repurchase agreements*	-2,668	1,040	181	-	858
Securities lending transactions**	-9,526	18,097	-	7,624	10,472
Bonds posted as collateral for futures trades	762	772	-	-	772
<b>Total</b>		<b>32,955</b>	<b>1,782</b>	<b>9,633</b>	<b>21,538</b>

\* The column Carrying amount adjusted for collateral takes into account all positions in the repurchase market, including the reinvestment of cash collateral. The internal measurement and monitoring of counterparty risk for these types of instruments do not include these reinvestments.

\*\* The column Carrying amount adjusted for collateral includes securities lent and collateral received.

Table 8.5 shows that counterparty risk is relatively unchanged since year-end 2011.

**To the Supervisory Council of Norges Bank**

**REPORT ON REVIEW OF INTERIM FINANCIAL INFORMATION**

We have reviewed the consolidated financial reporting of the Government Pension Fund Global. Subsidiaries of Norges Bank that exclusively constitute investments as part of the management of the investment portfolio of the Government Pension Fund Global are included in the financial reporting. The financial reporting comprises the balance sheet as at June 30, 2012, the income statement, the statement of comprehensive income, the statement of changes in owner's capital, the statement of cash flows for the six-month period then ended and selected explanatory notes. Management is responsible for the preparation and presentation of this condensed interim financial information in accordance with International Accounting Standard No. 34 "Interim Financial Reporting" as adopted by the EU. Our responsibility is to express a conclusion on this interim financial information based on our review.

*Scope of review*

We conducted our review in accordance with International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with international standards on auditing, and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

*Conclusion*

Based on our review, nothing has come to our attention that causes us to believe that the condensed interim financial information is not prepared, in all material aspects, in accordance with International Accounting Standard No. 34 "Interim Financial Reporting" as adopted by the EU.

Oslo, 8 August 2012

**Deloitte AS**

Aase Aa. Lundgaard (signed)  
State Authorized Public Accountant (Norway)







Norges Bank Investment Management (NBIM)  
Bankplassen 2  
Postboks 1179 Sentrum  
N-0107 Oslo

Tel.: +47 24 07 30 00  
[www.nbim.no](http://www.nbim.no)