Management of the Government Petroleum Fund
Report for the first quarter 2005

Summary

The return on the Government Petroleum Fund in the first quarter of 2005 was 1.03 per cent measured in terms of the currency basket that corresponds to the composition of the Fund's benchmark portfolio.

The return on the equity portfolio was 2.01 per cent in the first quarter. Equity markets in Japan and Europe experienced an upswing, while stock prices fell somewhat in the US for the quarter as a whole. The return on the fixed income portfolio was 0.37 per cent measured in terms of the currency basket. Prices rose in the European and Asian bond markets, compared with a price decline in the US market.

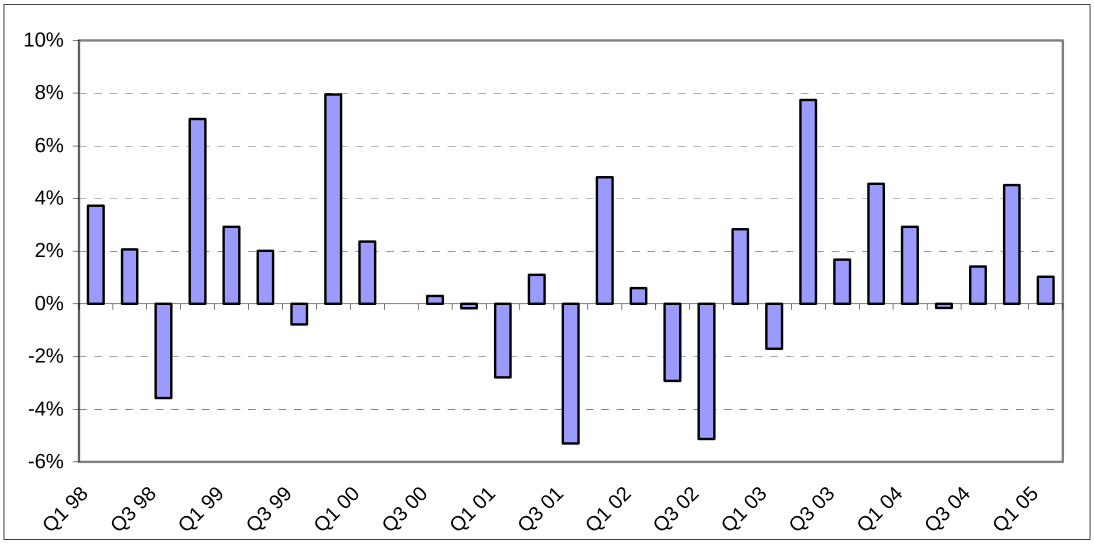
In the first quarter of 2005, the return on the Petroleum Fund's portfolio was 0.13 percentage point higher than the return on the benchmark portfolio defined by the Ministry of Finance.

The market value of the Fund's combined portfolio of securities was NOK 1 090.1 billion at the end of the first quarter, an increase of NOK 73.7 billion since year-end. A positive return measured in international currency accounted for NOK 10.8 billion, the transfer of new capital accounted for NOK 45.8 billion, while the depreciation of the krone in relation to the investment currencies accounted for NOK 17.2 billion. A change in the krone exchange rate has no effect, however, on the Fund's international purchasing power.

1. Key figures

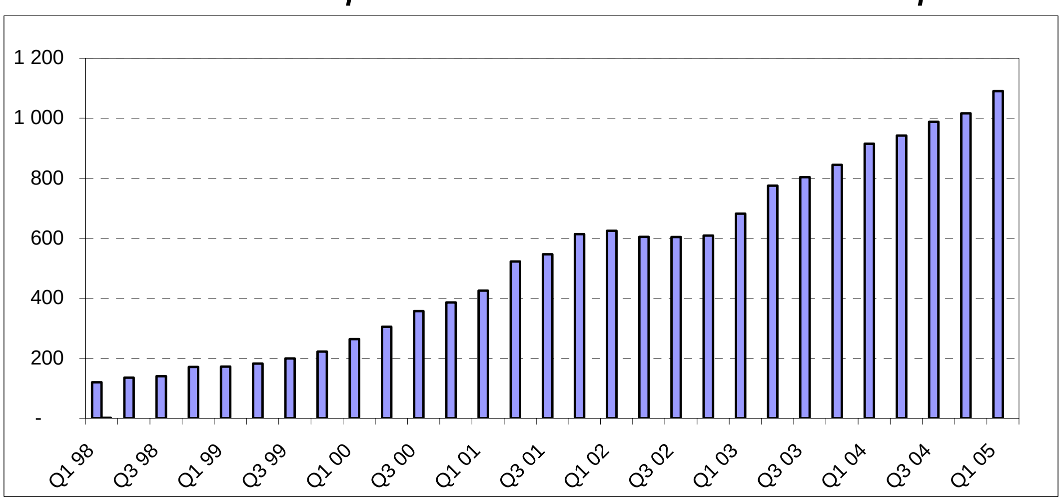
The return on the Government Petroleum Fund in the first quarter of 2005 was 1.03 per cent, measured in terms of the currency basket corresponding to the composition of the Fund's benchmark portfolio. Chart 1 shows the return for each quarter since the Fund was first invested in equities in 1998. The average quarterly return during the period was 1.35 per cent.

Chart 1: Quarterly return on the Petroleum Fund measured in terms of the Fund's currency basket



Since 1 January 1998, the Petroleum Fund has grown by NOK 977 billion (see Chart 2). During the period, NOK 871 billion has been added to the Fund. The return measured in international currency has contributed NOK 190 billion, whereas a stronger krone in relation to the investment currencies has reduced the value of the Fund by NOK 84 billion during the period. A change in the krone exchange rate has no effect, however, on the Fund's international purchasing power.

Chart 2: The market value of the Petroleum Fund 1998-2005. In billions of NOK



Since 1 January 1997, the annual net real return on the Petroleum Fund (after deductions for management costs and price inflation) has been 4.00 per cent. Table 1 shows the return to the end of the first quarter of 2005, calculated annually from 1 January of each of the years in the period 1997-2004. Price inflation is a weighted average of consumer price inflation in the countries represented in the benchmark portfolio.

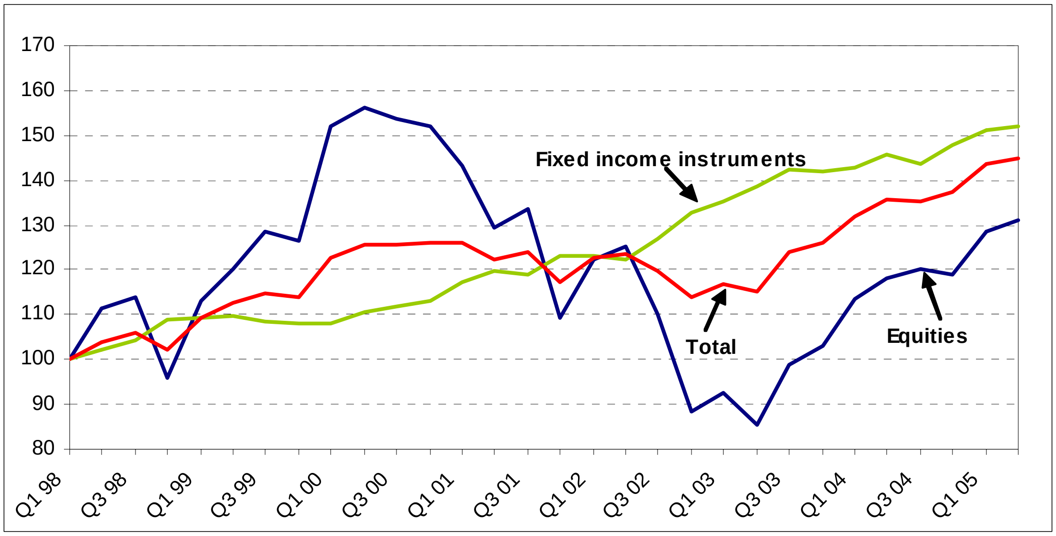
The return achieved by Norges Bank on the actual portfolio is measured in relation to the return on the benchmark portfolio defined by the Ministry of Finance. The difference between the return figures reflects the gross excess return achieved by Norges Bank. The right-hand column of the table shows that the average gross excess return has been 0.42 percentage point per year since 1 January 1997. This is the annualised arithmetic difference between the return actually achieved by Norges Bank and the annualised return on the benchmark portfolio.

Table 1: Annual rates of return for the Petroleum Fund to the end of the first quarter of 2005, measured in terms of the Fund's currency basket. Per cent per year

	Gross annual return	Annual price inflation	Annual management costs	Annual net real return	Annual gross excess return
From 01.01.97	5.71	1.57	0.08	4.00	0.42
From 01.01.1998	5.26	1.54	0.08	3.58	0.44
From 01.01.99	4.63	1.64	0.08	2.86	0.48
From 01.01.00	3.21	1.71	0.08	1.39	0.35
From 01.01.01	3.37	1.64	0.08	1.62	0.38
From 01.01.02	5.24	1.79	0.09	3.30	0.46
From 01.01.03	10.00	1.73	0.10	8.03	0.54
From 01.01.04	7.97	1.86	0.11	5.89	0.55

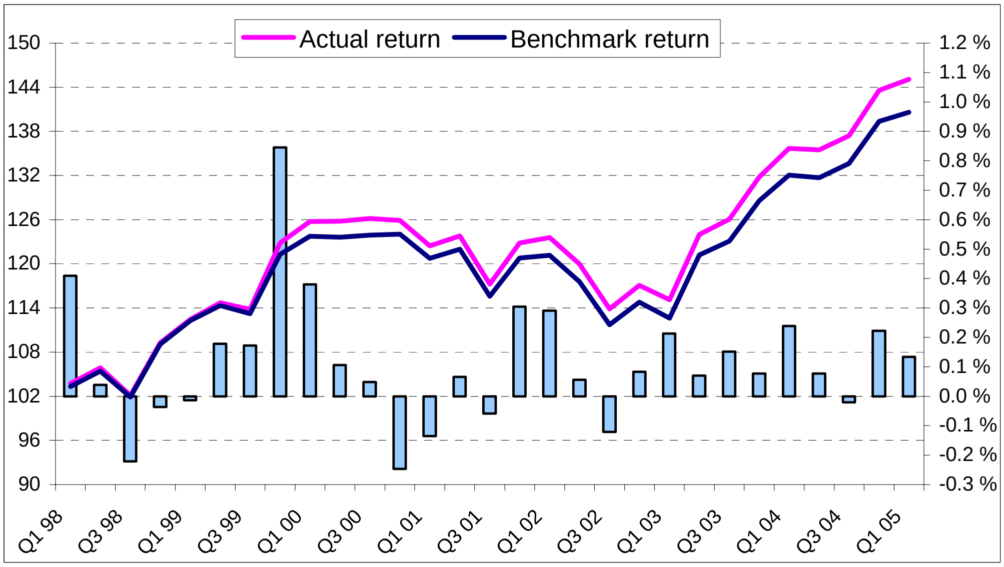
Chart 3 shows the cumulative return from 1 January 1998 for the fixed income and equity portfolios. During this period, the cumulative nominal return has been 31.05 per cent on equity investments and 51.84 per cent on fixed income investments.

Chart 3: Index for cumulative return on the sub-portfolios in the Petroleum Fund in the period 1998-2005



The cumulative return on the Petroleum Fund from 1 January 1998 until the end of the first quarter of 2005 has been 45.1 per cent. During the same period, the return on the benchmark portfolio was 40.6 per cent. The difference between the actual return and the return on the benchmark portfolio is the excess return achieved by Norges Bank. Since 1998, the cumulative gross excess return measured in terms of the currency basket has been 4.5 percentage points, which corresponds to NOK 15.6 billion.

Chart 4: Index for cumulative actual return and benchmark return measured in terms of the currency basket (left-hand axis) and quarterly gross excess return in percentage points (right-hand axis)

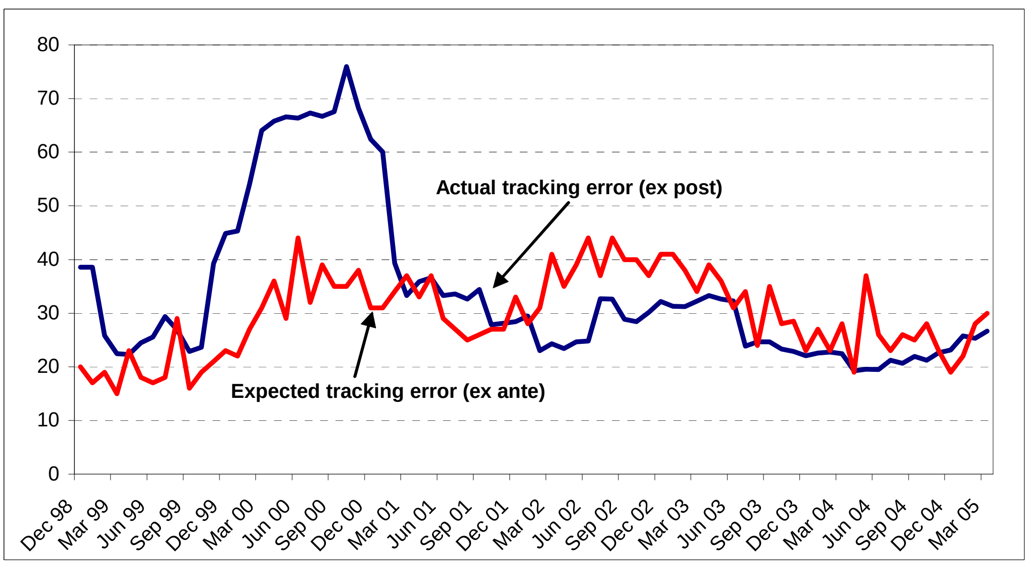


The Ministry of Finance has set a limit on the extent to which the Fund's portfolio can differ from the benchmark portfolio. This has been accomplished by setting a limit for the expected deviation between the returns on the actual portfolio and the benchmark portfolio. This limit for relative market risk in the management of the Petroleum Fund has been defined as 1.5 per cent tracking error (explained in section 5 below). The red line in Chart 5 maps developments in expected tracking error since December 1998.

In retrospect, we can use the variation in the difference between the returns on the actual and benchmark portfolios (i.e. the variation in excess return) as a measure of actual relative market risk in the period (the blue line in the chart). This tracking error is annualised using 12-month rolling windows.

Both expected tracking error and actual tracking error may fluctuate considerably even when the degree of active management is unchanged. This is because the measures are influenced by various market developments, such as changes in market volatility and changes in correlations between the various asset classes and securities. Tracking error has consistently remained well below the limit for relative market risk in the Petroleum Fund's portfolio that has been stipulated by the Ministry of Finance.

Chart 5: Expected tracking error and actual tracking error at the end of each month in the period 1999 – 2005. In basis points



The information ratio is a widely used measure of the skill of operational managers. The information ratio is the ratio between the gross excess return for the year and relative market risk (measured here as the actual standard deviation of the return differential). The average annualised information ratio for the Fund from the first quarter of 1998 to the end of the first quarter of 2005 has been 1.16. Table 2 provides a historical overview of the information ratio for the Fund as a whole and for each asset class.

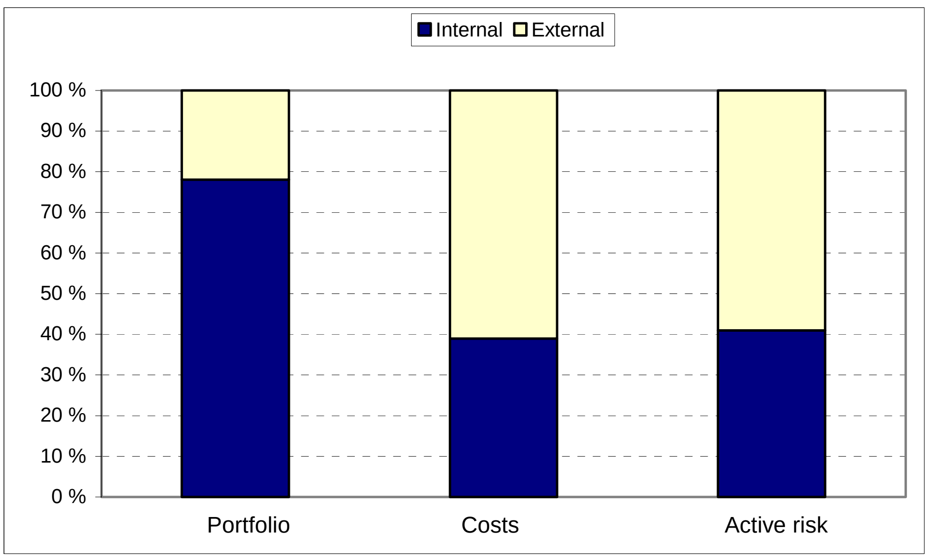
Table 2: Information ratios

Period	Petroleum Fund	Equities	Fixed income instruments
Last 12 months	1.57	0.62	4.32
Since 2002	1.75	0.87	3.62
Since 1999	1.28	1.03	1.96

At the end of the first quarter, 20 per cent of the Petroleum Fund was managed by external investment managers. Costs associated with external management accounted for 62 per cent of total management costs. External management accounted for approximately 59 per cent of the overall risk associated with active management (see Chart 6).

The external managers are primarily engaged in active management, whereas a larger part of the internal management is based on enhanced indexing. Active management is clearly more expensive than index management. One of the reasons for this is that unit costs in external management are far higher than unit costs in internal management. However, comparable management (active or passive) is also less expensive when internal rather than external managers are used. The internal managers have limited capacity for active management, however, and external managers are used to achieve sufficient breadth and scope in risk-taking.

Chart 6: Distribution of portfolios, management costs and active risk* between internal and external management. Per cent

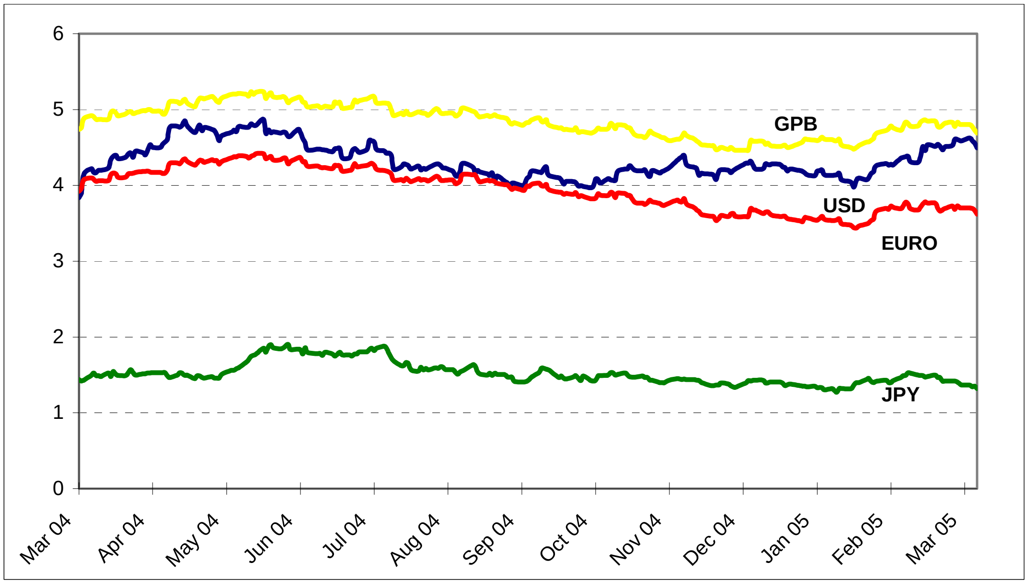


*There is no absolutely correct method of calculating the distribution of active risk. The distribution in the chart is based on summation of the value at risk (VaR) of each mandate, disregarding the correlation between mandates.

2. Market developments

Fixed income markets
Developments in bond yields in the main markets were mixed in the first quarter. Yields on 10-year government bonds rose by more than 0.25 percentage point in the US and more than 0.10 percentage point in the UK. Bond yields fell by more than 0.10 percentage point in Japan, whereas there was only a marginal decline in the euro area during the quarter (see Chart 7).

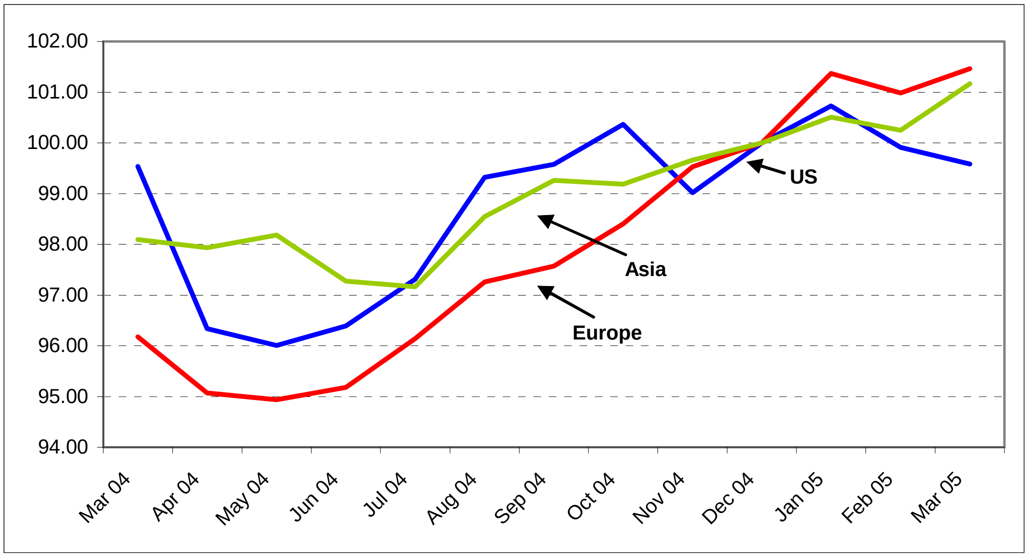
Chart 7: Developments in the most important bond markets in the last 12 months. Yields on government bonds with approximately 10 years to maturity. Per cent per year



The rise in yields in the US has been driven by market expectations that the Fed will raise the key rate. After a period of relatively weak labour market figures, key figures for February reflected more robust developments. Core inflation, i.e. consumer prices excluding energy and food, has increased every month since the beginning of 2004. The Federal Reserve increased the federal funds rate by 0.25 percentage point twice during the quarter to 2.75 per cent.

There has been no comparable increase in key rates in Japan and Europe during the quarter. This reflects lower inflation rates and more sluggish economic activity, especially in Europe, than in the US. Unemployment has risen in many European countries since the beginning of the year due to a strong currency and heavy focus on cost reductions, especially in German manufacturing. European imports from China have surged, resulting in increased competition, especially for manufacturers of consumer goods such as textiles and household articles. A stronger currency has dampened the price impulses from higher oil and metal prices, while central banks in both Europe and Japan have kept key rates unchanged. This has eased the pressure on long-term interest rates in Europe and Japan compared with the US.

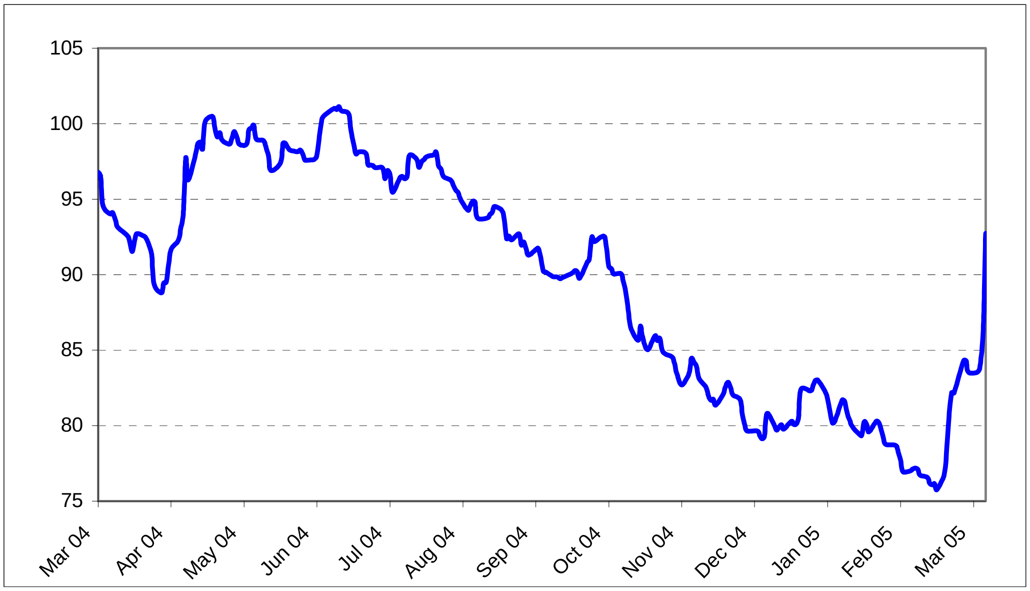
Chart 8: Movements in Lehman Global Aggregate government bond indices in the main markets during the last 12 months (31.12.04 = 100)



The chart above shows developments in Lehman Global Aggregates government bond indices in the main markets during the last 12 months. The return in the first quarter of 2005 was 1.5 per cent in Europe, 1.2 per cent in Asia and -0.4 per cent in the US.

The credit spread between corporate securities and government securities in the US has narrowed in pace with the general economic upturn and the declining debt burden in US enterprises. The credit spread is at a historically low level and is underpinned by few bankruptcies in both the corporate and household sectors. The trend was broken in March when General Motors (GM) issued a profit warning (Chart 9). This created uncertainty in the market as to whether GM would be downgraded further, which could in turn lead to a general widening of the credit spread. Weak developments in the US equity market in March also contributed to increasing the credit spread.

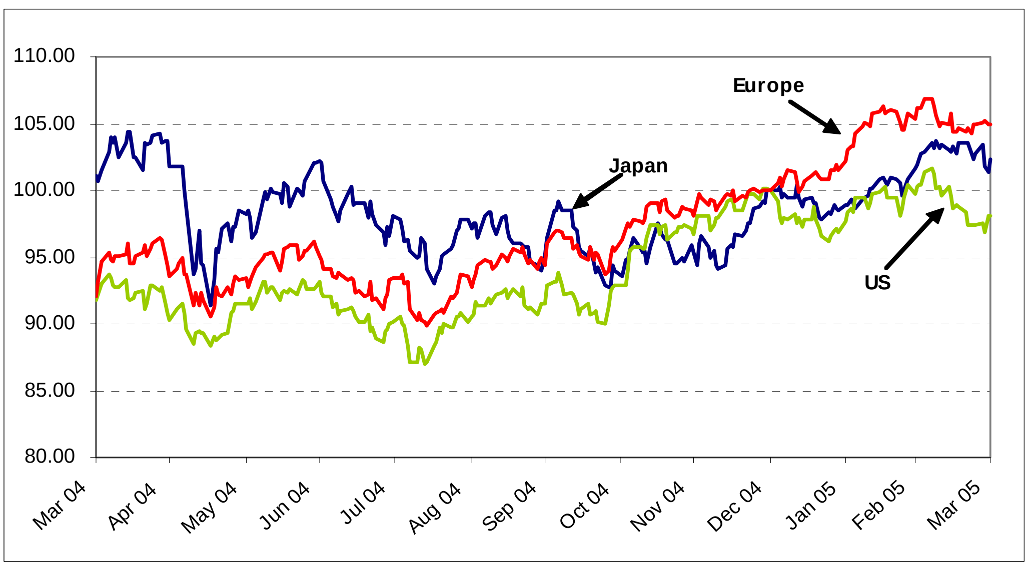
Chart 9: The difference between yields on corporate securities[1] and government securities in the US



Equity markets

Equity prices rose in Japan and Europe but fell in the US for the quarter as a whole. Measured by the FTSE index, equity markets rose by 4.9 per cent in Europe and 2.4 per cent in Japan compared with a 1.9 per cent decline in the US.

Chart 10: Movements in the FTSE equity indices for the main markets during the last 12 months. (31.12.04 = 100). In local currencies



Growth in the world economy has remained strong in the first quarter of 2005. This has contributed to a continued rise in commodity prices. Prices for crude oil and petroleum

[1] Corporate securities with a AAA credit rating from Standard & Poor's

products in particular rose sharply in the first quarter. Equities in these sectors have posted the most substantial price rise so far this year.

The European stock exchanges are more heavily exposed to these sectors than the US stock exchanges and this has contributed to stronger growth in the European stock exchange indices. In the US, developments were weak in the IT sectors as well as in car and airplane manufacturing. An appreciation of the US dollar towards the end of the quarter also contributed to curbing the rise in the US.

Developments in resources and general industrials have been particularly strong in Japan. The extensive development of both infrastructure and factories in China and the rest of Asia is contributing strongly to maintaining high demand for metals and oil. Considerable building activity in the US and parts of Europe is also contributing to growth in these sectors.

Table 3 shows equity price movements in the main sectors and in the ten largest sub-sectors in the FTSE world index in the first quarter of 2005. Prices in the resources sector have risen most sharply. The sub-sectors related to oil production and processing of petroleum products have contributed most strongly to the rise in prices.

Table 3: Return on the main sectors and the ten largest sub-sectors in the FTSE All-World Index in the first quarter of 2005, measured against USD, NOK and the Petroleum Fund's currency basket. Per cent

	USD	NOK	Currency basket
Resources	**12.49**	**17.28**	**15.31**
- of which oil and gas	13.35	18.17	16.18
Basic industries	**1.63**	**5.95**	**4.17**
General industrials	**-0.07**	**4.18**	**2.43**
Cyclical consumer goods	**-4.43**	**-0.36**	**-2.04**
Non-cyclical consumer goods	**0.15**	**4.42**	**2.66**
- of which pharmaceuticals and biotechnology	-2.21	1.95	0.23
Cyclical services	**-2.41**	**1.74**	**0.03**
- of which retail trade	-3.93	0.16	-1.52
- of which media and photo	-2.18	1.98	0.27
Non-cyclical services	**-3.91**	**0.18**	**-1.50**
- of which telecommunications	-5.49	-1.47	-3.13
Utilities	**2.01**	**6.35**	**4.56**
Financials	**-3.33**	**0.78**	**-0.91**
- of which banks	-2.87	1.26	-0.44
- of which insurance companies	-2.91	1.22	-0.48
- of which financial institutions	-6.13	-2.14	-3.78
Information technology	**-6.19**	**-2.20**	**-3.84**
- of which hardware	-4.93	-0.88	-2.55
- of which software and computer services	-8.32	-4.42	-6.03

3. Management of the portfolio

The market value of the Petroleum Fund's international portfolio was NOK 1 090.1 billion at the end of the quarter. During the first quarter, the Fund's market value increased by NOK 73.7 billion. Table 4 presents the market value at the end of the last four quarters, and the change in market value due to transfers, return and the effect of changes in the krone's international value in the first quarter of 2005. At the end of March, NOK 984 million was transferred from the Petroleum Fund to Norges Bank as remuneration for managing the Petroleum Fund in 2004.

Please refer to Appendix 1 for a description of both the management mandate and the composition of the benchmark portfolio.

Table 4: Market value of the Petroleum Fund's sub-portfolios at the end of the last four quarters, and changes in market value in the first quarter of 2005. In thousands of NOK

	Equity portfolio	Fixed income portfolio	Petroleum Fund total
31 March 2004	385 096	530 251	915 347
30 June 2004	391 858	550 499	942 357
30 September 2004	392 938	595 203	988 141
31 December 2004	**416 298**	**600 104**	**1 016 402**
Transfers	3 537	42 229	45 766
Return	8 495	2 259	10 755
Change in value of krone	7 137	10 081	17 218
31 March 2005	**435 467**	**654 674**	**1 090 141**

Management of the fixed income portfolio

In the first quarter, the market value of the fixed income portfolio increased by NOK 54.6 billion to NOK 654.7 billion.

At the end of the quarter, approximately 90 per cent of the fixed income portfolio was managed internally by Norges Bank. There are two types of management, enhanced indexing and active management. Both external and internal mandates have been established to manage the portfolio.

Three sub-portfolios are indexed: government guaranteed bonds, corporate bonds and securitised bonds. Most of the portfolio, i.e. the first two sub-portfolios and European securitised bonds, are indexed by internal managers. US mortgage-backed bonds are indexed by external managers.

About 10 per cent of the fixed income portfolio is managed by external investment managers. This portion includes the mandates for US mortgage-backed bonds and active mandates with a variety of strategies for outperforming the benchmark.

In the first quarter of 2005, capital was transferred to a new external fixed income manager. A specialised management mandate for the US was awarded to Advantus Capital Management Inc.

Management of the equity portfolio

At the end of the first quarter, the market value of the equity portfolio was NOK 435.5 billion, an increase of NOK 19.2 billion since the beginning of the quarter.

At the end of the first quarter, approximately 64 per cent of the equity portfolio was managed internally in Norges Bank. Of this, 22 per cent, representing the financial, telecommunications, energy, media and trade sectors, is under active management, while an enhanced indexing strategy is employed to manage the remainder.

In the first quarter of 2005, capital was transferred to three new mandates that were awarded to external equity managers: sector mandates for Japan were awarded to Fidelity Pensions Management and Sparx Asset Management Co. Ltd.; and a regional mandate for the US was awarded to Barrow, Hanley, Mewhinney & Strauss, Inc.

4. Return on the Petroleum Fund

In the first quarter of 2005, the return on the Petroleum Fund was 1.03 per cent, measured in terms of the benchmark portfolio's currency basket. The return was positive in January and February but negative in March. Measured in NOK, the total return in the first quarter was 2.76 per cent. The difference is due to a depreciation of the krone on average during the first quarter of approximately 1.7 per cent against the currencies in the benchmark portfolio. This has no effect, however, on the international purchasing power of the Fund.

Table 5: Return on the Petroleum Fund. Actual and benchmark portfolios, first quarter 2005. Per cent

	Return measured in terms of the benchmark currency basket		**Return measured in NOK**		
	Actual portfolio	Benchmark portfolio	Actual portfolio	Benchmark portfolio	Excess return
January	0.56	0.40	3.26	3.10	0.16
February	0.87	0.82	-0.69	-0.74	0.05
March	-0.39	-0.32	0.21	0.28	-0.08
Q1	**1.03**	**0.90**	**2.76**	**2.63**	**0.13**

During the first quarter, the excess return on the Petroleum Fund was 0.13 percentage point in relation to the benchmark portfolio or approximately NOK 1.4 billion. The internally managed fixed income portfolios made the largest contribution to excess return, but there was also a positive contribution from the management of the other portfolios.

In the first quarter of 2005, NOK 3.5 billion was transferred to the equity portfolio and NOK 42.2 billion was transferred to the fixed income portfolio. Norges Bank has estimated the direct and indirect transaction costs associated with phasing in new capital in the first quarter of 2005 at NOK 68 million. This amounted to 0.15 per cent of the total amount transferred, i.e. NOK 45.8 billion, and 0.005 per cent of the market value of the Petroleum Fund at the beginning of the quarter. The return figures presented in this report have not been adjusted for costs associated with phasing in new capital. Appendix 2 provides information concerning the methodology for calculating transaction costs.

In terms of the benchmark portfolio's currency basket, the return on the equity portfolio was 2.01 per cent during the quarter, while the return on the fixed income portfolio was 0.37 per cent. Table 6 presents return figures for the total portfolio, measured against various currencies.

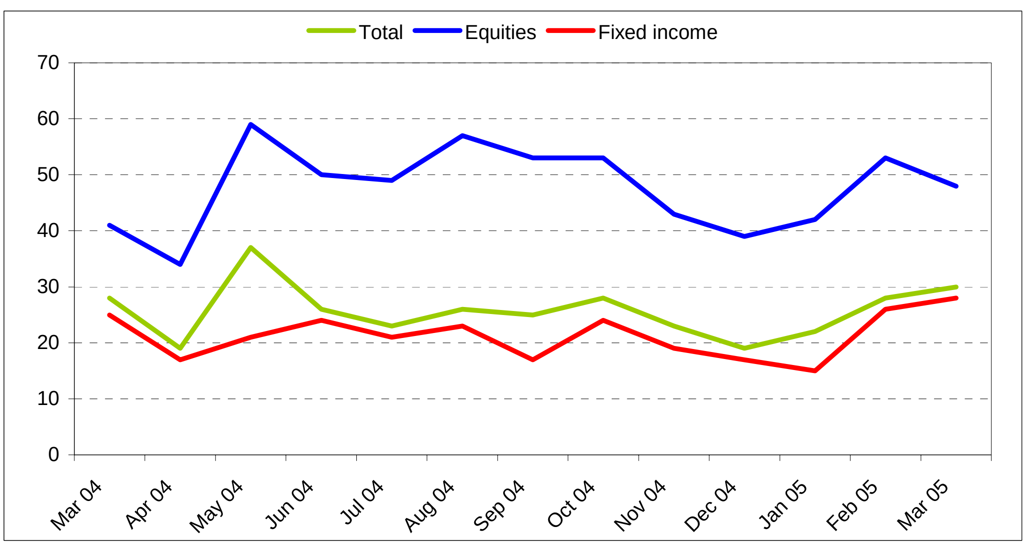
Table 6: Return on the Petroleum Fund's sub-portfolios and total portfolio in the first quarter of 2005 measured against various benchmark currencies. Per cent

	Equities	Fixed income instruments	Total
Fund's currency basket	2.01	0.37	1.03
Import-weighted currency basket	3.06	1.41	2.08
USD	-0.49	-2.08	-1.43
EUR	4.07	2.40	3.08
NOK	3.75	2.08	2.76

5. Risk

The Ministry of Finance has set a limit for the market risk in the actual portfolio relative to the benchmark portfolio. This relative market risk shall always be less than an expected tracking error of 1.5 percentage points (150 basis points), as measured in the RiskManager risk model. In the first quarter of 2005, the relative market risk remained well within this upper limit. Expected tracking error has not been higher than approximately 30 basis points.

Chart 11: Expected tracking error at each month-end for the last 12 months. Basis points



Relative market risk is higher in equity management than in fixed income management. This reflects that equity markets fluctuate more than fixed income markets, so that there is more risk associated with an equity management position than with a fixed income position of the same size. It is also related to the fact that the scope of active equity management has been somewhat larger than the scope of active fixed income management.

Expected tracking error
The Ministry of Finance has set the limit for relative market risk in the management of the Petroleum Fund in relation to the risk measure *expected tracking error*. This measure is defined as the expected value of the standard deviation of the difference between the annual returns on the actual portfolio and the benchmark. When deviations from the benchmark are controlled by means of an upper limit for expected tracking error, it is highly probable that the actual return will lie within a band around the return on the benchmark. The lower the limit for tracking error, the narrower the band will be. Given an expected tracking error of 1.5 percentage points or 150 basis points, the actual return on the portfolio will probably deviate from the benchmark return by less than 1.5 percentage points in two out of three years.

Table 7 shows the composition of the bond portfolio (fixed income portfolio excluding cash) based on Moody's and Standard and Poor's (S&P) credit ratings.

Table 7: The fixed income portfolio at 31 March 2005, by credit rating. Per cent of market value

Moody's		Standard & Poor's	
Rating	Per cent of total	Rating	Per cent of total
Aaa	53.30	AAA	50.33
Aa	14.28	AA	19.54
A	19.45	A	13.12
Baa	7.78	BBB	8.80
Ba	0.26	BB	0.26
Lower	0.01	Lower	0.01
No rating *	4.92	No rating	7.94

*If a security has no rating from Moody's, it has an approved rating from one of the other agencies (S&P or Fitch). The same applies for S&P.

In the table, government securities and government guaranteed bonds without credit ratings have been given the credit rating of the issuing country. According to the Ministry of Finance's guidelines for credit risk, the Petroleum Fund may not normally be invested in securities with a credit rating lower than Baa from Moody's, BBB from S&P or BBB from Fitch. Nevertheless, up to 0.5 per cent of the fixed income portfolio may be invested in securities with ratings of Ba, BB or BB as the highest rating from one of the three agencies - Moody's, S&P or Fitch, respectively. All fixed income securities have a credit rating from at least one of the agencies. In addition to bonds, the fixed income portfolio contains fixed income instruments with shorter maturities. These all have credit ratings of P-1 from Moody's and A-1 from S&P.

Table 8 provides an overview of the risk exposure limits stipulated in the Ministry of Finance's Regulation on the Management of the Government Petroleum Fund and guidelines for investments, and of actual exposure.

Management has been in compliance with the risk exposure limits stipulated by the regulation and the guidelines throughout the quarter.

Table 8: Risk limits stipulated in the regulation and the guidelines

	Risk	Limits	Actual				
			31.03.04	30.06.04	30.09.04	31.12.04	31.03.05
§ 4	Market risk	Maximum tracking error 1.5 percentage point	0.28	0.26	0.26	0.19	0.30
§ 5	Asset mix	Fixed income instruments 50-70%	58.0	58.5	60.3	59.0	60.1
		Equities 30-50%	42.0	41.5	39.7	41.0	39.9
§ 6	Market distribution equities	Europe 40-60%	47.8	47.3	50.0	49.0	49.4
		The Americas, Middle East/Africa, Asia and Oceania 40-60%	52.2	52.7	50.0	51.0	50.6
	New markets	< 5% of equity portfolio	3.1	2.6	2.7	3.0	3.3
	Currency distribution fixed income instruments	Europe 45-65%	54.9	54.8	55.3	56.0	54.4
		The Americas and the Middle East/Africa 25-45%	35.0	35.4	35.0	34.2	35.7
		Asia/Oceania 0-20%	10.1	9.7	9.7	9.8	9.9
§ 7	Interest rate risk	Modified duration 3-7	5.3	5.5	5.6	5.6	5.7
§ 11	Ownership stake	Maximum 3% of a company	2.7	2.7	2.6	2.7	2.6

6. Management costs

Table 9 provides an overview of the costs of managing the Government Petroleum Fund in the first quarter of 2005. In addition to the Petroleum Fund, Norges Bank Investment Management manages the Government Petroleum Insurance Fund and the bulk of Norges Bank's foreign exchange reserves. Fees to external managers and external settlement and custodian institutions are invoiced separately for each of the funds managed by Norges Bank. The other operating costs are overheads shared by all the funds managed by Norges Bank Investment Management. The shared overheads are distributed among the three funds by means of a cost distribution key. Besides the direct costs of Norges Bank Investment Management, these overheads include the costs of support functions provided by other parts of Norges Bank. These latter costs are calculated in accordance with the guidelines that apply to business operations at Norges Bank.

The Management Agreement between the Ministry of Finance and Norges Bank establishes the principles for Norges Bank's remuneration for managing the Petroleum Fund's portfolios. For 2005, remuneration shall cover the Bank's actual costs, provided that these costs are less than 0.10 per cent (or 10 basis points) of the average market value of the Fund. Fees to external managers for excess return achieved are also covered. Norges Bank has entered into agreements concerning performance-based fees with the majority of external active managers, in accordance with the principles approved by the Ministry of Finance.

Table 9: Management costs in the first quarter of 2005. In thousands of NOK and in basis points of the average portfolio

	Q1 2005		Q1 2004*	
	NOK 1000	Per cent	1000 NOK 1000	Per cent
Internal costs, equity management	41 991		26 453	
Costs of equity custodians and fund administration	12 835		14 730	
Total costs, internal equity management	**54 826**	**0.09**	**41 183**	**0.07**
Internal costs, fixed income management	42 984		24 858	
Costs of fixed income custodians	8 854		6 332	
Total costs, internal fixed income management	**51 838**	**0.04**	**31 190**	**0.03**
Minimum fees to external managers	79 127		69 619	
Performance-based fees to external managers	63 678		27 236	
Other costs, external management	28 894		21 045	
Total costs, external management	**171 699**	**0.29**	**117 900**	**0.23**
Total all management costs	**278 363**	**0.11**	**190 273**	**0.09**
Total management costs, excluding performance-based fees	**214 685**	**0.08**	**163 037**	**0.07**

* The distribution of costs between internal and external management in the first quarter of 2004 has been reworked to provide comparable figures.

Annualised, the costs in the first quarter of 2005 amounted to 0.11 per cent of the average market value of the Fund. Excluding performance-based fees to external managers, costs amounted to 0.08 per cent of the market value of the Fund, up from 0.07 per cent in the first quarter of 2004. Internal costs rose because reported costs were somewhat lower in the first quarter of 2004 than in the last three quarters of 2004. This reflects the recognition of costs on an accruals basis. The increase in external costs is primarily due to an increase in performance-based management fees. The cost ratios between costs and assets under management in the first quarter of 2005 are only marginally higher than the figures for 2004 as a whole.

Costs are distributed between internal and external management by using a cost distribution key for internal costs and custodian costs. External management accounted for approximately 62 per cent of the costs, whereas about 20 per cent of the Fund's portfolio is managed externally. The unit cost of internal management was approximately 0.05 percentage point, compared with 0.29 percentage point for external management.

7. Reporting of accounts

Table 10 shows the distribution of different instruments as presented in Norges Bank's accounts at the end of the last five quarters. Off-balance sheet items are shown in a separate table. Table 11 shows the book return, which in the first quarter was NOK 27 964 million prior to the deduction of Norges Bank's management fee.

Table 10: The Petroleum Fund's international portfolio distributed by instrument, at 31 March 2005. In thousands of NOK

	31.03.2004	30.06.2004	30.09.2004	31.12.2004	31.03.2005
Short-term assets, incl. deposits in foreign banks	13 454 503	-3 119 231	-9 314 439	9 154 482	16 610 470
Money market investments in foreign financial institutions against collateral in the form of securities	279 864 129	461 264 065	432 512 541	380 117 331	428 782 315
Borrowing from foreign financial institutions against collateral in the form of securities	-311 010 300	-410 186 755	-429 229 543	-406 193 548	-414 346 235
Foreign interest-bearing securities	554 996 405	510 284 611	613 805 297	631 256 143	637 099 993
Foreign equities	378 557 669	385 180 752	384 626 561	407 673 369	427 485 816
Adjustment of forward contracts and derivatives	-555 004	-959 721	-4 171 094	-5 548 358	-5 441 346
Total portfolio before remuneration for management	**915 307 403**	**942 463 721**	**988 229 323**	**1 016 459 420**	**1 090 191 012**
Management remuneration due	-962 868	-448 123	-667 366	-984 136	-278 362
Advisory services	0	0	0	-4 169	0
Total portfolio	**914 344 535**	**942 015 598**	**987 561 957**	**1 015 471 115**	**1 089 912 650**

At 31 March 2005, market value differs slightly in the returns reporting and the accounts reporting. This is primarily due to book allocations and different valuation methods for money market investments.

In Table 11, income and expenses in foreign currency are converted to NOK according to the exchange rate on the transaction date, and are recognised as they have been earned or incurred, according to the accruals principle.

Off-balance sheet items (in NOK 1000)	**31.03.2004**	**30.06.2004**	**30.09.2004**	**31.12.2004**	**31.03.2005**
Forward exchange contracts sold	-26 235 470	-33 074 909	-30 594 274	-16 837 972	-17 470 264
Futures sold	-135 240 732	-125 873 033	-50 442 511	-118 994 375	-49 590 848
Equity swaps sold	-543 176	-2 646 383	-3 897 226	-8 115 796	-5 836 592
Interest rate swaps sold	-194 724 825	-363 569 782	-401 111 395	-390 663 205	-523 281 509
Liabilities sold	**-356 744 203**	**-525 164 107**	**-486 045 406**	**-534 611 348**	**-596 179 214**
Forward exchange contracts purchased	26 235 470	33 074 909	30 594 274	16 837 972	17 470 264
Futures purchased	117 672 014	113 943 091	81 482 879	114 744 349	39 891 287
Equity swaps purchased	535 574	2 078 643	5 667 609	9 489 246	2 921 660
Interest rate swaps purchased	194 169 293	362 614 141	396 889 890	385 089 073	517 985 864
Liabilities purchased	**338 612 351**	**511 710 784**	**514 634 651**	**526 160 641**	**578 269 075**
Futures options sold	-16 564 927	-35 643 955	-16 000 652	-2 231 822	-2 725 582
Equity options sold	0	0	-2 348	0	0
Rights sold	**-16 564 927**	**-35 643 955**	**-16 003 001**	**-2 231 822**	**-2 725 582**
Futures options purchased	24 464 671	36 878 601	20 087 665	3 992 457	15 684 846
Equity options purchased	0	0	0	0	0
Rights purchased	**24 464 671**	**36 878 601**	**20 087 665**	**3 992 457**	**15 684 846**

Table 11: Book return on the Petroleum Fund's international portfolio at 31 March 2005. In thousands of krone

Return on the Petroleum Fund	31.03.2004	30.06.2004	30.09.2004	31.12.2004	31.03.2005
Interest income	6 094 468	13 385 513	19 931 210	26 046 307	6 746 125
Dividends	2 011 522	5 150 084	6 900 116	8 246 151	2 154 460
Exchange rate adjustment*	21 583 389	21 386 950	1 897 354	-46 791 318	16 057 298
Unrealised securities losses/gains	11 235 128	-3 567 631	1 280 993	28 575 975	-10 332 170
Realised securities losses/gains	7 442 408	10 549 393	13 812 821	21 581 006	12 785 955
Brokers' commissions	5 810	7 093	-22 869	-49 031	-8 616
Gains/losses futures	29 670	-37 857	-155 296	251 854	49 483
Gains options	-6 609	11 674	19 949	21 021	-3 429
Gains/losses equity swaps	-16 808	37 004	165 544	393 109	14 040
Gains/losses interest rate swaps	-511 121	-705 034	-3 927 908	-5 337 664	500 471
Book return on investments	**47 867 858**	**46 217 190**	**39 901 915**	**32 937 408**	**27 963 618**
Accrued management fee	-190 273	-448 123	-667 366	-984 136	-278 362
Consulting services	0	0	0	-4 169	0
Net return	**47 677 585**	**45 769 067**	**39 234 549**	**31 949 103**	**27 685 255**

* The difference between the exchange rate adjustment in the accounts and the calculated exchange rate effect in the measurement of returns is primarily due to a difference in methodology for converting the return from local currency to NOK. In the measurement of returns, the market return in local currency is converted to NOK using the exchange rate at the beginning of the month. In the accounts, income and expenses are converted using the exchange rate prevailing on the transaction date, and assets and liabilities are converted to the market rate prevailing at the end of the month.
Due to this difference in methodology, the calculation of the exchange rate effect in the measurement of returns will always be lower than the exchange rate adjustment in the accounts when the krone is appreciating in relation to the investment currencies.

APPENDIX

1. Mandate and benchmark portfolio

The Ministry of Finance has delegated the operational management of the Government Petroleum Fund to Norges Bank, with a mandate stipulated in a regulation and written guidelines issued by the Ministry. A management agreement, which further defines the relationship between the Ministry of Finance as delegating authority and Norges Bank as operational manager, has also been drawn up.

According to the regulation, Norges Bank shall seek to achieve the highest possible return within the limits set out in the regulation. The Bank's strategy for achieving an excess return has been presented in earlier annual reports. The Ministry of Finance is informed about the Bank's management activities by means of quarterly and annual reports, which are also published.

The regulation was changed in 2004. Effective 1 January 2004, the Petroleum Fund's investment universe was expanded to include a number of new countries. The country list stipulates the markets and currencies in which the Fund may be invested.

Within this country list, the Ministry of Finance has specified countries and currencies that are to be included in the Fund's benchmark portfolio. The benchmark portfolio consists of specific equities and fixed income instruments and reflects the delegating authority's investment strategy for the Petroleum Fund. The benchmark portfolio provides the basis for managing risk in the operational management and for evaluating Norges Bank's management performance.

In November 2004, the Ministry of Finance approved new ethical guidelines for the Petroleum Fund's investments. The guidelines are based on the discussion in the Revised National Budget for 2004 (Report no. 2 to the Storting, 2003-2004) and on the proposal submitted in June 2003 by the government appointed Committee on Ethical Issues for the Petroleum Fund. The ethical basis for the Petroleum Fund shall be promoted using the following three mechanisms:

- Corporate governance based on the UN Global Compact and the OECD Principles of Corporate Governance and the OECD Guidelines for Multinational Enterprises in order to promote long-term financial returns
- Negative screening from the investment universe of companies that either themselves or through entities they control produce weapons which, with normal use, violate fundamental humanitarian principles
- Exclusion of companies from the investment universe where there is deemed to exist an unacceptable risk of contributing to:
    - Gross or systematic violation of human rights, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other child exploitation
    - Gross violation of individual rights in war or conflict situations
    - Severe environmental degradation
    - Gross corruption
    - Other particularly serious violations of fundamental ethical norms

Norges Bank is responsible for corporate governance in accordance with the guidelines from the Ministry of Finance. The Executive Board has approved Norges Bank's principles of corporate governance. The government has appointed an Advisory Council on Ethics which will advise the Ministry of Finance on negative screening and exclusion of companies. The Ministry makes the final decision on the exclusion of companies and instructs Norges Bank accordingly.

Benchmark at 31 March 2005 for the Petroleum Fund's ordinary portfolio. Per cent

	Equities		**Fixed income instruments**	
Country for equity benchmark Currency for fixed income benchmark	Strategic benchmark portfolio	Actual benchmark portfolio	Strategic benchmark portfolio	Actual benchmark portfolio
Asset class weights	**40.0**	**39.9**	**60.0**	**60.1**
Belgium		0.9		
Finland		0.9		
France		7.3		
Greece		0.4		
Ireland		0.5		
Italy		3.3		
Netherlands		3.5		
Portugal		0.3		
Spain		3.0		
Germany		5.2		
Austria		0.2		
Euro area (EUR)		*25.6*		*45.3*
UK (GBP)		17.4		7.2
Denmark (DKK)		0.6		0.8
Switzerland (CHF)		4.8		0.6
Sweden (SEK)		1.8		0.9
Total Europe	**50.0**	**50.3**	**55.0**	**54.7**
USA (USD)		36.0		33.6
Brazil		0.4		
Canada (CAD)		1.9		1.8
Mexico		0.3		
South Africa		0.5		
The Americas / Middle East / Africa			**35.0**	**35.3**
Australia (AUD)		1.6		0.4
Hong Kong		0.8		
Japan (JPY)		6.2		9.1
New Zealand (NZD)		0.1		0.2
Singapore (SGD)		0.3		0.3
South Korea		0.8		
Taiwan		0.8		
Total Asia and Oceania			**10.0**	**10.0**
The Americas / Middle East / Africa / Asia / Oceania	**50.0**	**49.7**		

2. Calculation of transactions costs for phasing in new capital

Until end-June 2004, capital was supplied to the Petroleum Fund by transferring securities. The transaction costs associated with securities purchases were charged to the buffer portfolio.

Since the beginning of the third quarter of 2004, new capital has been supplied to the Petroleum Fund in the form of cash. Thus, these transaction costs have been charged to the Petroleum Fund directly, thus reducing the return.

The investment of new capital in securities entails both direct and indirect transaction costs. A standard market practice for estimating phasing-in costs has not been established. Norges Bank's model is based on existing theory and empirical data on transaction costs. In addition, Norges Bank has conducted a study of the methods used by some of today's leading transition managers.

Since the beginning of 2005, Norges Bank has used a model that calculates direct and indirect transaction costs individually. Indirect transaction costs comprise three main components: liquidity costs, market impact and opportunity costs. Norges Bank's model calculates liquidity costs as the "bid-ask spread" for fixed income instruments and half the "bid-ask spread" for equities. Market impact is not taken into account in the fixed income portfolio, whereas market impact is estimated in the equity portfolio by using StockFactsPro®. Market impact in the fixed income market is a function of sector, market conditions, transaction size, size of the loan issued and the liquidity of the issuer. In most cases, the contributions from these variables are negligible.

The quality of the prices used in the estimates is very decisive to the accuracy of the estimates. In some markets, especially fixed income instruments, insufficient data are a problem. In order to have control over the in and out variables in a model, it is always necessary to simplify. StockFactsPro® ignores, for example, the time factor when determining market impact. Norges Bank's estimates must only be viewed as a guide. Estimates are useful because they give an impression of the size of the cost. Due to the many uncertainties in the model, however, the estimates should not be used to directly adjust the return.

Theory, empirical data, access to data, methods and tools for estimating transaction costs are being developed continuously. Therefore, Norges Bank's methods must be expected to change in pace with this development.