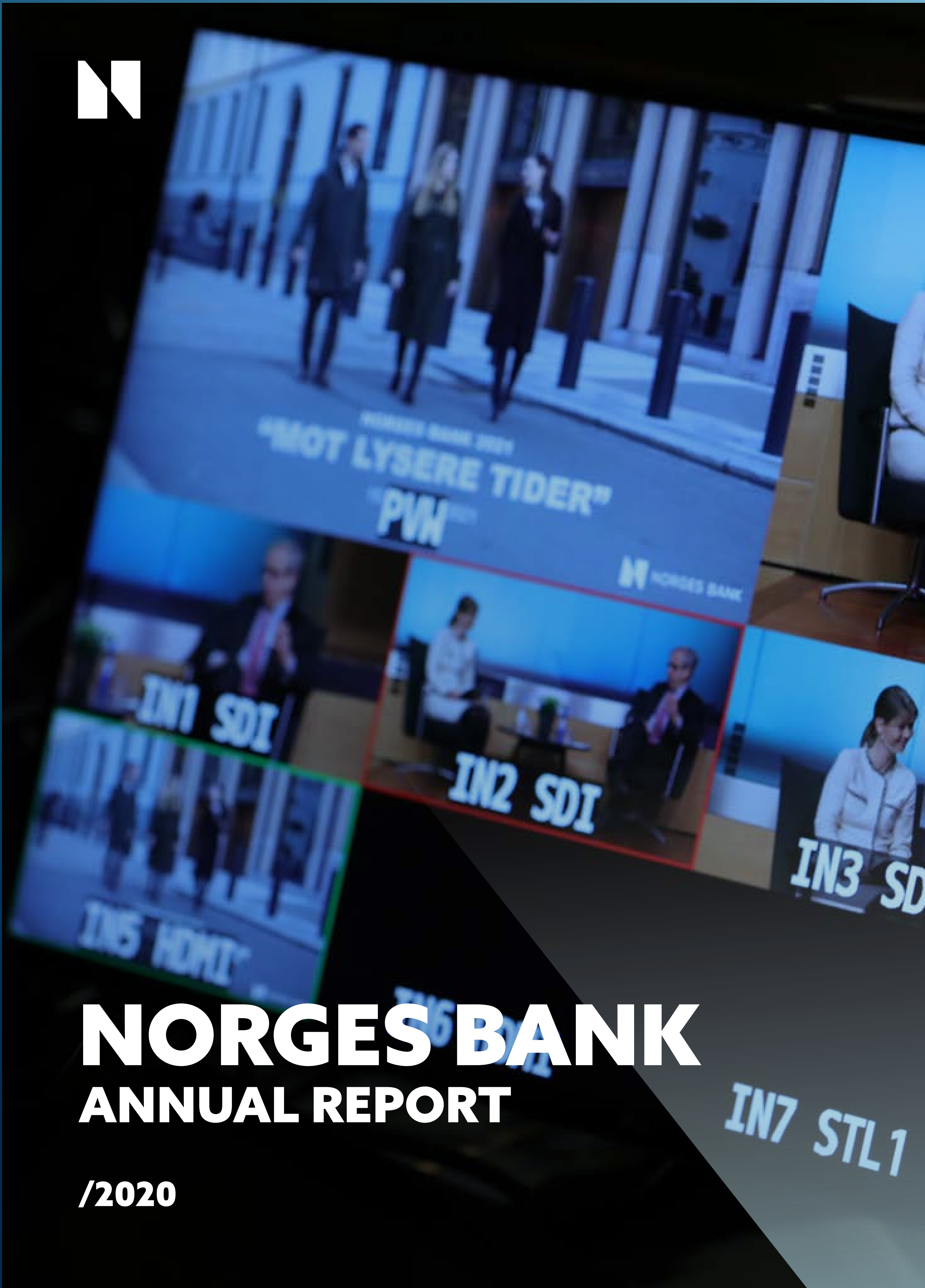


NORGES BANK
ANNUAL REPORT

/2020

Annual Report of the Executive Board 2020

A dramatic year

On 1 January, a new Central Bank Act entered into force, resulting in a new governance structure and the establishment of a committee for monetary policy and financial stability. Nevertheless, it was the Covid-19 pandemic that had the largest impact on Norges Bank in 2020.

The Covid-19 pandemic led to a severe down-turn in the Norwegian economy in 2020. Economic activity fell abruptly in March and April, and unemployment rose to historically high levels. There was also considerable financial market volatility.

The Monetary Policy and Financial Stability Committee reduced the policy rate from 1.5% to 0% in the course of spring. In addition, a number of measures were implemented to improve the functioning of financial markets. The Committee advised the Ministry of Finance to reduce the level of the countercyclical capital buffer for banks from 2.5% to 1%. The Ministry followed Norges Bank's advice. See the Annual Report of the Monetary Policy and Financial Committee for 2020 on page 18.

Investments in the Government Pension Fund Global (GPFG) were affected by the global economic crisis, and the GPFG's returns varied widely during 2020. When the Covid-19 pandemic spread in March, the value of the GPFG's equity investments fell markedly over a short period of time. At year-end 2020, the market value of the GPFG was NOK 10 914bn and the return on the GPFG in 2020 was equivalent to NOK 1 070bn. In a year with operational challenges and in part difficult market conditions, the return on the GPFG before management costs was 0.27 percentage point higher than the GPFG's benchmark index. Withdrawals by the Norwegian government totalled NOK 302bn after payment of management costs.

In parallel with the economic crisis, the Executive Board completed a thorough and important recruitment process. On 26 March, Nicolai Tangen was presented as Yngve Slyngstad's successor as CEO of Norges Bank Investment Management (NBIM). Tangen was chosen based on his leadership skills and experience in international investment management. Tangen's contract of employ-ment was signed on 27 May. The appointment led to questions from the Supervisory Council, the media and politicians about impartiality and the risk of conflicts of interest relating to the position of CEO and Tangen's financial assets. A revised contract was signed on 24 August after the announcement by Tangen of a substantial transfer and changes to his financial ownership interests and assets. Tangen took up the position of CEO on 1 September.

On 1 April, Egil Matsen resigned as Deputy Governor, and Deputy Governor Jon Nicolaisen took over his tasks related to the management of the GPFG. At the same time, Ida Wolden Bache became the new Deputy Governor with special responsibility for central banking operations. Jon Nicolaisen announced his intention to resign on 4 December.

2020 was a demanding year for Norges Bank's employees. The economic crisis required an extra effort by staff. At the same time, the health crisis challenged the way the Bank organised its work. Operations and analyses were performed remotely in collaboration with certain key persons who were physically at the Bank. Several of the overseas offices were closed for long periods. Despite this, the Bank's employees performed their tasks with a high degree of professionalism throughout the year.

Norges Bank had 13 confirmed infections of Covid-19 in 2020.

Management of the GPFG

Norges Bank is responsible for the management of the GPFG, with a view to achieving the highest possible return over time within the constraints laid down in the mandate from the Ministry of Finance. Norges Bank pursues a variety of investment strategies. For the period from 2013, these strategies are grouped into three main categories: fund allocation, security selection and asset management. The different strategies build on the GPFG's special characteristics as a large, long-term investor with limited liquidity needs.

Management of the GPFG in 2020

At year-end 2020, the market value of the GPFG was NOK 10 914bn. Changes in market value reflect return on investments, transfers to or withdrawals from the GPFG and changes in the value of the Norwegian krone measured against the currencies the GPFG is invested in. The return in 2020 was equivalent to NOK 1 070bn. Movements in the krone exchange rate increased the market value of the GPFG by NOK 58bn, although this has no bearing on the GPFG's international purchasing power.

Withdrawals by the Norwegian government totalled NOK 302bn after payment of management costs. Withdrawals increased substantially during 2020 to finance the extra costs related to managing the Covid-19 pandemic.

In 2020, the return on the GPFG before management costs was 10.9% measured in the GPFG's currency basket. Equities returned 12.1% and bonds 7.5%. Investments in unlisted real estate returned -0.1%.

The return on the GPFG varied considerably during the year. When the coronavirus pandemic spread in March 2020, the value of the GPFG's equity investments dropped sharply. This caused a decrease in the equity share in the fund's strategic benchmark index and triggered a gradual rebalancing back to 70%. In 2020 Q1, the return on the GPFG was the lowest in its history, both in kroner and in percentage terms. Both the strong recovery in equity prices during spring and withdrawals of capital from the GPFG by the government reduced the need to purchase equities, and the equity share was back to 70% by the end of Q2.

There were substantial variations in equity returns between sectors, which also contributed to equities in different regions performing differently. Containment measures in response to the coronavirus pandemic contributed to negative returns on both listed and unlisted real estate investments.

The Covid-19 outbreak and the partial shutdown of Norges Bank's offices in Norway and abroad presented challenges for the management of the GPFG. The Executive Board recognises that Norges Bank has been able, at all times, to perform its mission and has managed the GPFG in line with approved strategies. In a year of operational challenges and sometimes demanding market conditions, the return on the GPFG before management costs was 0.27 percentage point higher than that on the GPFG's benchmark index.

The return contributions from the various strategies in 2020 show that fund allocation contributed negatively to the relative return, while asset management and security selection both contributed positively. The single largest contribution to relative return was from internal security selection in equity and fixed income management. Management costs amounted to 0.05% of assets under management.

The contributions to the relative return from equity, fixed income and real estate management, show a negative contribution from real estate management, reflecting the poor performance of the sector in 2020, but positive contributions from both equity and fixed income management.

Performance measured over time

The Executive Board emphasises the importance of assessing the performance of the GPFG over time. Viewed over the full period from 1998 to 2020 the annual return on the GPFG has been 6.3%. The annual net real return, after deductions for inflation and management costs, has been 4.4% in the same period. The annual return before management costs has been 0.25 percentage point higher than the return on the benchmark index set by the Ministry of Finance for the period.

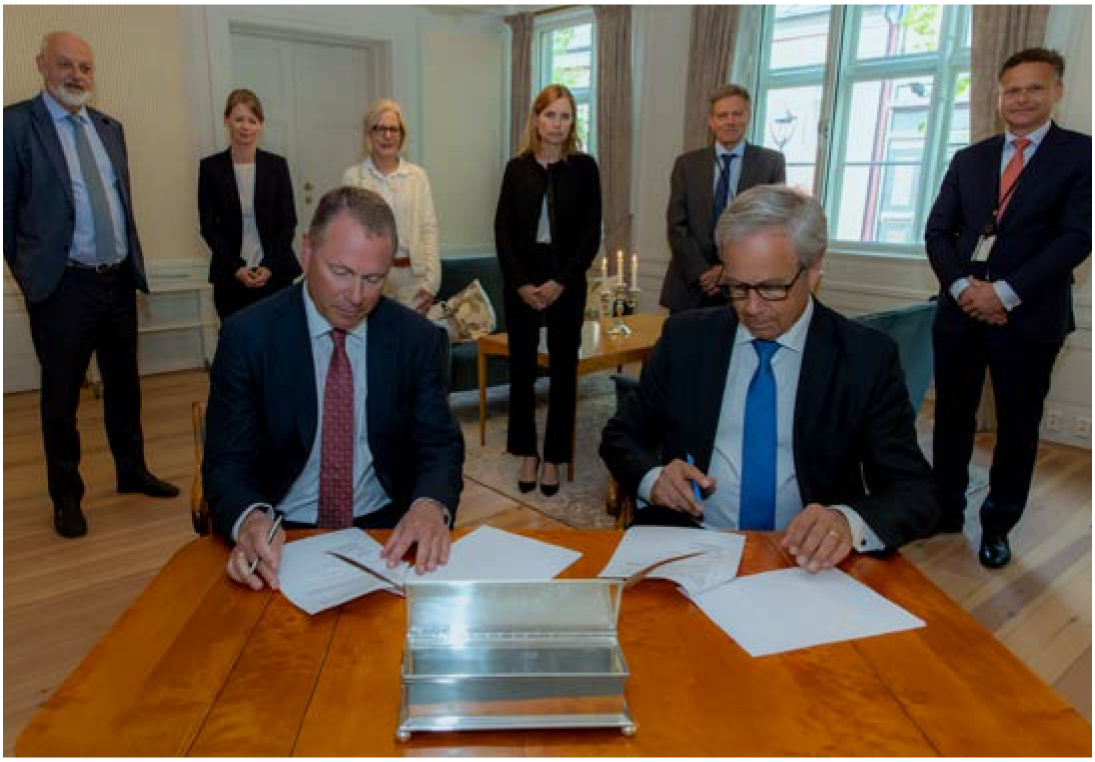
In the period from 2013, the annual excess return before management costs has been 0.20 percentage point. The contributions from the three groups of strategies show that fund allocation has contributed negatively to the relative return during the period, while asset management and security selection have both contributed positively.

The objective of Norges Bank's management of the GPFG is the highest possible return after costs. This is to be achieved with acceptable risk. Risk is measured, analysed and followed up using a broad set of measures and analyses. One key provision in the mandate from the Ministry of Finance requires the Bank to manage the GPFG with the aim that expected relative volatility (tracking error) does not exceed 1.25 percentage points.

Expected relative volatility was 0.56 percentage point at the end of 2020, up from 0.33 percentage point a year earlier. The increase is not primarily a result of wider deviation between the GPFG and the benchmark index, but is due to the increase in measured risk owing to the fluctuations observed in the market during 2020. Measured over the full period from 1998 to 2020, realised relative volatility has been 0.66 percentage point.

The management of the GPFG is to be cost-effective. Cost-effective management supports the objective of the highest possible return after costs. In the period 2013–2020 annual management costs averaged 0.06% of assets under management. In 2020, total management costs amounted to NOK 5.3bn, or 0.05% of assets under management. Investment management costs are low compared with other fund managers.

In line with the management mandate from the Ministry of Finance, the GPFG's performance and the Executive Board's assessment of the performance are presented in an annual report on the management of the GPFG. The Executive Board is satisfied that return has been good both in 2020 and over time, and



Signing of Nicolai Tangen's contract of employment with Øystein Olsen and the Executive Board

higher than the return on the benchmark index, against which the return is measured.

Advice and new CEO

An important part of the Executive Board's work relating to the GPFG is to advise on the further development of the GPFG's management. The Executive Board responded to a number of enquiries from the Ministry of Finance related to the GPFG's strategy in the course of 2020. Among other things, Norges Bank reported on its experiences of the operational management of the GPFG since the outbreak of the Covid-19 pandemic.

Under the Central Bank Act, the Executive Board shall appoint a general manager of NBIM. In March 2020, the Executive Board presented Nicolai Tangen as the new CEO of NBIM. Tangen took up the position of CEO on 1 September 2020.

Foreign exchange reserves

Norges Bank holds foreign exchange reserves for the purpose of crisis management. These reserves are to be available for use in foreign exchange market transactions, as part of the conduct of monetary policy, with a view to promoting financial stability and meeting

Norges Bank's international commitments. The importance of investing the reserves in liquid assets is given considerable weight. The aim of the management of the foreign exchange reserves is to attain the highest possible return within the management framework.

The foreign exchange reserves are divided between a fixed income portfolio and an equity portfolio. In addition, the foreign exchange reserves include a petroleum buffer portfolio, which is intended to receive the government's cash flow from petroleum activities in foreign currency. The purpose of the petroleum buffer portfolio is to provide for an appropriate management of the government's need for converting between foreign currency and NOK, and to conduct transfers to and from the GPFG. The petroleum buffer portfolio is invested in short-term fixed income instruments.

Principles for management of the foreign exchange reserves

Norges Bank's Executive Board lays down the principles for the management of the Bank's foreign exchange reserves. The principles determine the investment universe and the benchmark index for the equity and fixed income portfolios, as well as the strategic equity allocation and maximum expected relative volatility. The Executive Board annually assesses the strategy and framework for the management of the foreign exchange reserves.

In accordance with the Executive Board's principles, rebalancing is to take place if the equity allocation deviates from the strategic equity allocation by more than 4 percentage points. Following strong growth in the value of the equity portfolio, such a rebalancing was implemented in December by transferring NOK 27bn from the equity portfolio to the fixed income portfolio.

Management of the foreign exchange reserves in 2020

At year-end 2020, the market value of the foreign exchange reserves was NOK 598.4bn. The total for the equity portfolio was NOK 118.6bn, for the fixed income portfolio NOK 459.8bn and for the petroleum buffer portfolio NOK 20.0bn. The value of the foreign exchange reserves increased by NOK 51.3bn in the course of 2020. Return in international currency terms increased the value of the foreign exchange reserves by NOK 36.2bn, while an appreciation of the krone reduced the value of the reserves by NOK 5.1bn. Net inflows increased the value of the foreign exchange reserves by NOK 20.2bn. The net inflows were primarily a result of the transfers from the GPFG to the petroleum buffer portfolio. In 2020, Norges Bank conducted foreign exchange interventions by exchanging EUR for NOK, a measure which reduces the value of the foreign exchange reserves.

Movements in the krone exchange rate will primarily affect Norges Bank's equity and will not affect the Bank's ability to meet foreign currency commitments.

The return on the foreign exchange reserves, excluding the petroleum buffer portfolio, was 5.9% measured in foreign currency in 2020. The return on equity investments was 14.9%, while the return on fixed income investments was 3.1%. Equity investments amounted to 20.5% of the total equity and fixed income portfolio at year-end 2020.

The equity portfolio earned a negative excess return of 0.03 percentage point relative to the benchmark index. The excess return on fixed income investments was 0.01 percentage point. In the assessment of the Executive Board, reserve management performance in 2020 and over the past 10 years has been positive.

Payment system

Norges Bank facilitates a secure and efficient system for settling payments and issues banknotes and coins. Norges Bank is tasked with overseeing the payment system and other financial infrastructure and contributing to contingency arrangements. Under the Payment Systems Act, Norges Bank is the supervisory authority for interbank systems.

The operation of the financial infrastructure has been stable during the Covid-19 pandemic. The Executive Board considers the operation of the Norwegian financial infrastructure to be secure and efficient.

Norges Bank's settlement system

Settlement between banks and other institutions with an account at Norges Bank takes place in Norges Bank's settlement system (NBO). Most payments in NOK are ultimately settled in NBO. With the exception of two brief disruptions in external electronic communication, the operation of Norges Bank's settlement system was stable through 2020. The settlement system handled a daily average of approximately NOK 421bn in payment transactions. At year-end 2020, banks' sight deposits and reserves on deposit with Norges Bank totalled NOK 40.6bn.

The Executive Board is satisfied that NBO's operation was stable in 2020 and without severe disruptions in settlement or secured lending.

Better solutions for fast payments

A well-functioning solution for real-time payments is an important part of an efficient payment system. In 2017, Finance Norway and Norges Bank launched a project to introduce an improved infrastructure for payments between bank customers with manageable risk for banks. Banks adopted the new system in 2020.

The share of payments settled in real time will likely increase in the coming years. There is therefore a continuing need to further develop payment infrastructure. In 2020, Norges Bank explored whether the Bank should offer real-time gross interbank settlement of retail payments in central bank money or whether the current settlement solution should be enhanced based on the current division of responsibility between Norges Bank and the banking industry. This will be explored further in 2021.

Cash

Access to central bank money by the general public in the form of cash has been and remains a key feature of the payment system. Cash usage in Norway has declined over many years. In Norges Bank's opinion, it is important to ensure that cash is available and easy to use so that it can fulfil its functions in the payment system.

Under the Central Bank Act, cash is legal tender. Over time, Norges Bank has observed a trend where many physical points of sale do not accept payment in cash. Norges Bank has previously stated in a letter of 31 January 2019 to the Ministry of Finance that the scope of the provision of the Financial Contracts Act regarding the right of consumers in all cases to effect settlement with the payee in legal tender should be clarified.

On 2 September 2020, the Ministry of Finance tasked Finanstilsynet (Financial Supervisory Authority of Norway) with surveying and assessing banks' total provision of cash services and sharing data and assessments with Norges Bank. The work is to be completed by end-February 2021. The results of the assessments will provide a basis for determining whether new measures or regulatory changes are needed to ensure cash availability.

New payment solutions and a central bank digital currency

In recent years, new payment operators and new payment solutions have entered the payments market. Fintech giants may become more influential in the payment system at the expense of banks and other financial institutions. Payment infrastructure providers are also undergoing structural changes, as global operators are taking positions in Norway and the Nordic region.

The structural changes in the payment system raise questions around whether there is a need for Norges Bank to implement measures to ensure that payments can continue to be made efficiently and securely in NOK in the future. One key question is whether Norges Bank should provide central bank money to the public in digital as well as physical form. Norges Bank is in the process of exploring this issue, motivated by both declining cash usage and a precautionary approach. The Bank wants to be prepared to be able to introduce a central bank digital currency (CBDC) if it is necessary for an efficient and secure payment system. In the first half of 2021, Norges Bank will decide on how work on a CBDC will continue.

Cyber security

The payment system is increasingly digital. Increasing risk associated with cybercrime and potential attacks against key ICT systems are a challenge to payment system efficiency and security. In 2018, the European Central Bank (ECB) published TIBER-EU, a framework for testing financial sector cyber security. Several of Norway's neighbours, including Denmark, Sweden and Finland have implemented national TIBER frameworks. Norges Bank and Finanstilsynet (Financial Supervisory Authority of Norway) have invited the industry and relevant authorities to a dialogue in the work to draw up a national framework proposal (TIBER-NO) to also test the cyber resilience of financial sector undertakings in Norway.

On a number of occasions, Norges Bank has recommended further study of how key ICT providers and data centres can best be supervised. In 2020, the European Commission conducted a consultation on regulatory changes to enhance the cyber resilience of the financial sector. The Ministry of Finance asked for input on the Norwegian position. In a letter of 14 February 2020 to the Ministry, Norges Bank noted that the European Commission addresses many of the same issues raised by Norges Bank about ICT service providers.

Personnel

Norges Bank's employees

At year-end 2020, Norges Bank had 925 permanent employees, of which 518 were in Norges Bank Investment Management (NBIM), 257 in Norges Bank Central Banking Operations (NBCBO) and 143 in Norges Bank Administration (NBA). In addition, there were seven employees at the Office of the Supervisory Council. The Bank has employees from a total of 35 countries and offices in Oslo, London, New York, Shanghai and Singapore.

The share of women on the permanent staff of Norges Bank at year-end 2020 was 33%. In the various areas of the Bank, the share of women was 25% in NBIM, 33% in NBCBO and 57% in NBA.

The Executive Board has set a minimum target of 40% female employees as an overall long-term goal. This objective is integrated into strategic work and action plans and is given emphasis in the planning and execution of recruitment processes.

Employees during the Covid-19 pandemic

2020 was a challenging year for all Norges Bank staff. The economic crisis required an extra effort by employees, far beyond what is typical for a normal year. At the same time, the health crisis complicated working conditions. Employees worked remotely during much of the year, and a number of the foreign offices were closed for long periods. Market operations and analyses were conducted remotely in collaboration with certain key persons who were at times physically present at the Bank. The Bank's employees nevertheless performed their tasks throughout the year with a high degree of professionalism.

Health and safety

Norges Bank's priority is protecting the health and safety of all those who work in the Bank. Once the Covid-19 pandemic was confirmed, many measures were immediately implemented to secure the health of the Bank's employees. For example, house rules on social distancing and hygiene were introduced, occupancy limits were designated for all meeting rooms, hand sanitiser was made available throughout the Bank and the canteen was reorganised to ensure food safety and social distancing. When Norway locked down on 12 March, Norges Bank introduced mandatory remote working in periods of high infection rates and partial remote working in periods of low infection rates. To ensure a safe meeting place, a system for digital meetings with a high security level was quickly scaled up. The Governor and Deputy Governors' planned speeches during the most critical periods were cancelled or moved online, as were all of the Bank's in-house social activities.

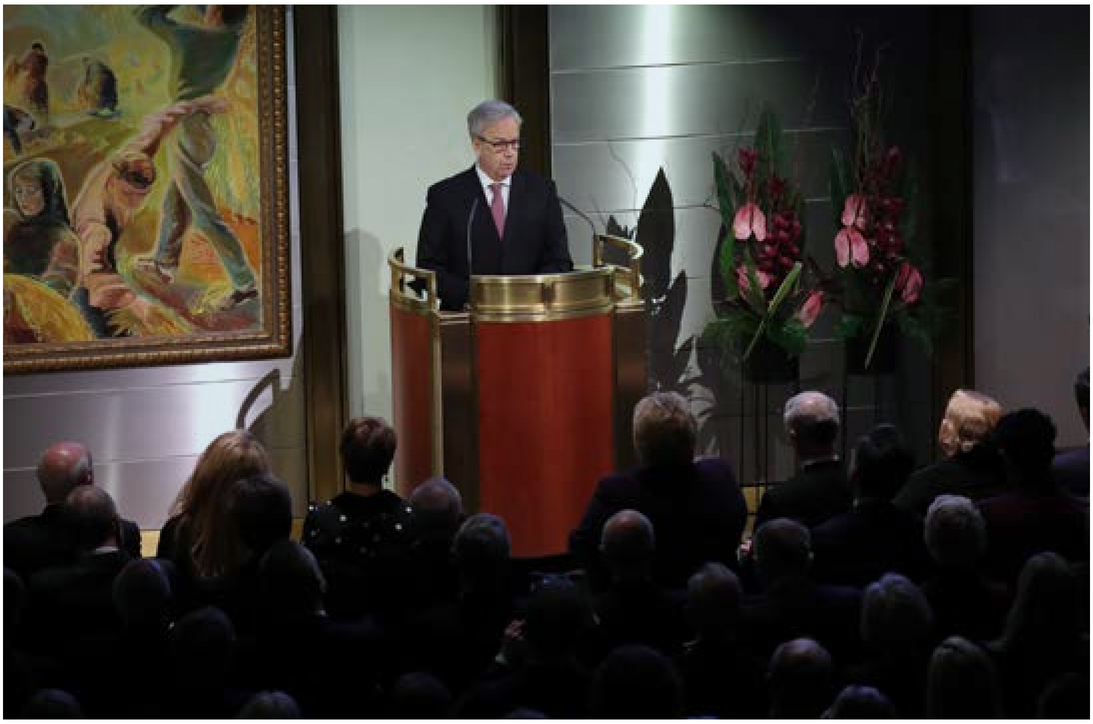
Thirteen Norges Bank employees were infected with Covid-19, and there was no known spread of the virus within the Bank in 2020.

In 2020, seven incidents/injuries directly relating to work conducted at Norges Bank's premises were reported. None of the workplace accidents or injuries was serious, and no occupational injuries were reported to the Norwegian Labour Inspection Authority in 2020. Sickness absence remained stable in 2020 at a low level of 1.7%.

Collaboration with trade unions

Norges Bank's management has close and regular contact with the trade unions at the Bank. The Bank engages in negotiations and discussions to create the basis for a well-functioning workplace.

The collaboration with the trade unions was particularly important in 2020, as the Bank's employees were working under challenging conditions. As a result of close and constructive contact between the Bank's management and the trade unions, joint efforts have resulted in conditions that are as satisfactory as possible.



The Governor's annual address on 13 February 2020

Corporate governance, risk management and internal control

Corporate governance

The work to implement the new Central Bank Act and put in place a new governance model was given high priority. The Bank's governance model and organisational structure now conforms to the new Act. In early 2020, rules of procedure were adopted for both the Executive Board and the Monetary Policy and Financial Stability Committee, as well as the division of duties and responsibilities between the Committee and the Executive Board.

In 2019, the Executive Board approved the establishment of the new area Norges Bank Administration (NBA). NBA was officially launched on 10 December 2019. The reorganisation entailed a merger of the NBCBO Corporate and Shared Services Department and some support functions in NBIM to form the new area. NBA performs Bank-wide tasks on behalf of the Governor, making the most of overall expertise, strengthening a shared culture, promoting cost-efficient solutions and underpinning the Bank as a single institution. The establishment of NBA has led to changes in the division of duties and responsibilities between the Governor, as general manager of Norges Bank, and the CEO of NBIM. The Executive Board has approved new job descriptions for the

Governor and the CEO of NBIM that reflect the new division of duties and responsibilities.

Norges Bank's governance framework is to be in line with best practice. The Executive Board follows up the Bank's operations through periodic reporting on performance and performance measurement, action plans, budgets, financial and operational risk and compliance.

Norges Bank's use of resources is to be cost-efficient and prudent, with a cost level that is reasonable compared with that of similar organisations. The Executive Board uses benchmarking, ie external comparisons of the Bank's use of resources with that of other similar organisations, as a corporate governance tool. During 2020, several cost comparisons were completed for expenses related to the management of the Government Pension Fund Global (GPFG). The Executive Board is satisfied with the Bank's favourable results in these comparisons. In 2020, the Executive Board focused in particular on cost-efficiency. The Executive Board followed up the budgeting process closely, and planning and the budget for 2021 were discussed at several Executive Board meetings in the second half of 2020. In September, the Executive Board also discussed a plan for realising efficiency gains from a new organisation of administrative functions in NBA.

Risk management and internal control

Norges Bank complies with the regulation on risk management and internal control at Norges Bank issued by the Ministry of Finance. In addition, the Ministry of Finance lays down a number of guidelines for the management of the GPFG, which include asset allocation and a benchmark index. The Executive Board sets similar limits for the management of the foreign exchange reserves. There were no breaches of the limits for the management of the GPFG or the foreign exchange reserves in 2020.

The reporting and follow-up of incidents constitute an important part of the measures to improve operations and internal control. Significant risks are followed up through regular reporting and the follow up of the Executive Board's measures. For NBIM, the Executive Board has decided that over a 12-month period, the probability that operational risk factors will result in a gross loss of NOK 750m or more must not exceed 20%. This limit is referred to as the Board's risk tolerance. In 2020, operational risk exposure was within the Board's risk tolerance.

Information security and stable IT systems

Norges Bank's operations are IT- and information-intensive. The transaction processes on which financial reporting is based are highly automated. The Bank's IT systems are largely standard systems adapted to the Bank's needs and are supplied and operated by third parties.

Stable IT systems are essential if Norges Bank is to perform its social mission. Norges Bank works systematically to ensure a high level of operational stability and has robust processes in place for handling deviations and changes. Operational stability is critical for managing the GPFG, which performs close to 1 300 transactions daily. Norges Bank's settlement system (NBO) is the Bank's most critical system, whose purpose is to settle payments securely and efficiently between banks with an account in Norges Bank. An objective is for the settlement function in NBO to be stable and without material deviations.

In NBCBO, a project is under way to modernise the IT platform and replace the operating services provider. In addition, the internal IT organisation has added staff to further enhance control of onsite and security-related functions. All project contracts have now been signed, and the project is in its implementation phase. This is in line with the project timetable, with scheduled completion in 2022.

Norges Bank works continuously to ensure satisfactory processes and adequate staffing in the Bank's ICT function. The Bank faces a complex threat landscape, and as a provider of critical infrastructure, Norges Bank will be a target of sophisticated threat actors. Risk reduction measures are continuously identified and implemented. A number of training activities are organised, such as phishing drills and e-learning modules, to boost employee awareness. Relevant controls are performed based on frameworks and standards for best practice. Norges Bank uses the US National Institute of Standards and Technology Cyber Security Framework (NIST CSF) for managing information and IT security risk.

To deal with critical and serious operational and security incidents, round-the-clock surveillance has been established. There were no security incidents with serious consequences in 2020.

The Covid-19 pandemic has led to extensive use of remote work and video conferencing. There has been a particular focus on the security of remote work arrangements. During the pandemic there has been a rise in the number of cyber attacks. However, owing to robust controls, none of these attacks had serious consequences.

Norges Bank processes personal data for various purposes, including statistics compilation and analyses, sending out e-mail news alerts, processing queries and receiving visits by the public, for administrative procedures and to safeguard the Bank's security. Personal data are processed in accordance with the Personal Data Act and other relevant rules. Pursuant to the new Central Bank Act, the Bank may obtain data from even more sources. These also include personal data. Specific security controls and procedures have been established for storing and processing sensitive personal data.

The Executive Board maintains a high level of IT and information security awareness, including monitoring outsourced IT functions. The Executive Board continuously monitors operational and financial risk related to the use of IT systems through its assessment of operational risk and internal control. Based on reporting by the administration and Internal Audit, the Executive Board submits an annual assessment of the risk situation to the Supervisory Council. No material deficiencies in the risk management and control regime were identified in 2020, and the Executive Board assesses the control environment and control systems at Norges Bank as satisfactory.

Verification

The calculation of the GPFG's performance results is verified by an independent third party in compliance with the Global Investment Performance Standards (GIPS). The GIPS verification report is in compliance with GIPS.

Balance sheet composition and financial outlook

Norges Bank's balance sheet

Norges Bank's balance sheet comprises a number of items directly related to the Bank's tasks. The balance sheet total at year-end 2020 was NOK 11 679bn. The balance sheet is dominated by the GPFG and the foreign exchange reserves, while deposits from the government and banks, cash in circulation and claims on and liabilities to the IMF are other large items.

The Ministry of Finance has placed a portion of the government's assets in a separate account in Norges Bank (the GPFG's krone account). The Bank reinvests these funds, in its own name, in accordance with a management mandate from the Ministry of Finance. The net value of the investment portfolio is presented on a separate line as an asset in Norges Bank's balance sheet. The value of the krone account will always equal the value of the investment portfolio less accrued management fee.

At year-end 2020, the market value of the GPFG's investments was NOK 10 914bn. Accrued management costs were NOK 5.3bn.

Detailed financial reporting for the investment portfolio of the GPFG is presented in Note 20 to the financial statements. In addition, an annual report on the management of the GPFG is produced, which includes the financial statements of the investment portfolio. Norges Bank, in its role as asset manager, bears no financial risk associated with the management of the GPFG.

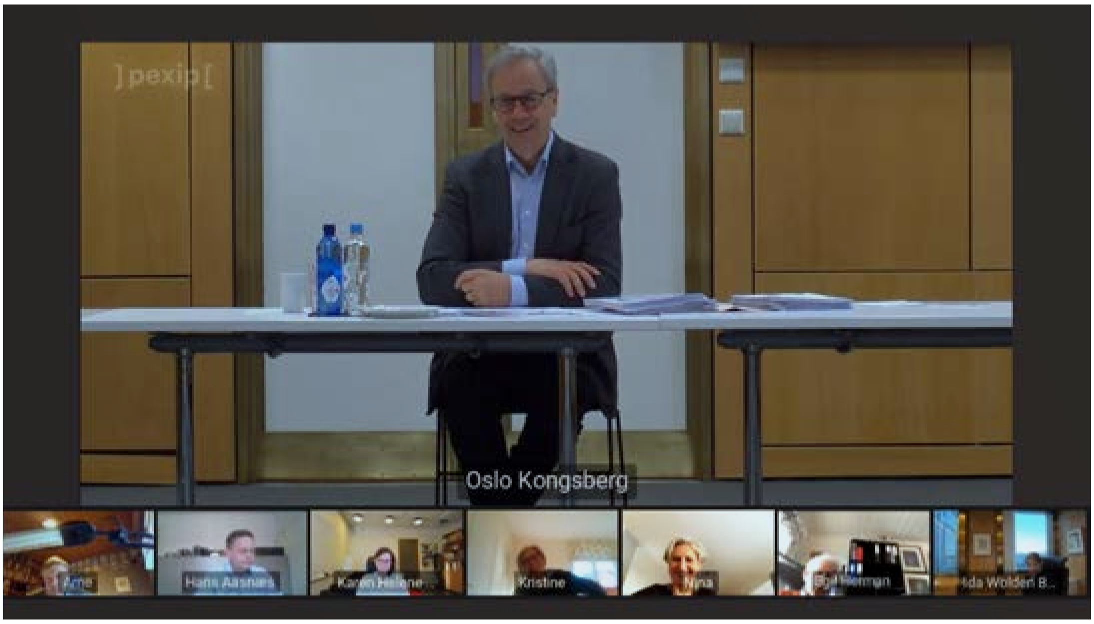
Excluding the GPFG, the Bank's foreign exchange reserves are the largest balance sheet asset. The foreign exchange reserves are primarily invested in equities, fixed income instruments and cash. Net foreign exchange reserves amounted to NOK 595.9bn at year-end 20202 compared with NOK 546.3bn at year-end 2019.

See the relevant sections of the *Report* for more details on the management of the GPFG on page 3 and the foreign exchange reserves on page 5.

Through the government's consolidated account system, all government liquidity is collected in government accounts at Norges Bank. At year-end 20202, deposits amounted to NOK 313bn. This is thus the largest liability item in the balance sheet, except for the GPFG krone account. This item fluctuates considerably through the year owing to substantial incoming and outgoing payments over the government's accounts. The average amount on deposit was around NOK 260bn in 2020, compared with NOK 190bn in 2019. The primary reason for the increase is the larger amounts transferred from the GPFG to the government's accounts in 2020, but the government's deposits are affected by many factors, and the change cannot entirely be attributed to the extraordinary transfers from the GPFG.

Banknotes and coins in circulation are a liability item for Norges Bank. This amount is driven by the public's demand for cash. Over the past few years, the lower demand for cash has reduced this liability item. At year-end 2020, banknotes and coins in circulation amounted to NOK 41bn, compared with NOK 41.6bn at year-end 2019.

Deposits from banks, which comprise sight deposits, reserve deposits and F-deposits, are



The Executive Board in a new meeting arena

managed by Norges Bank through its liquidity management policy. At 31 December 2020, these deposits amounted to NOK 52.8bn, compared with NOK 58.9bn at year-end 2019.

Norges Bank also administers Norway's financial obligations and rights ensuing from participation in the International Monetary Fund (IMF). Norges Bank therefore has both claims on and liabilities to the IMF. See Note 17 in the notes to the financial statements for more details. At year-end 2020, net positions with the IMF amounted to a claim of NOK 17.2bn, compared with NOK 11.8bn at year-end 2019.

The Covid-19 pandemic has affected the balance sheet

The Covid-19 pandemic had a considerable impact on Norges Bank's balance sheet through 2020.

Norges Bank has provided extraordinary liquidity to the banking system in the form of extraordinary F-loans. These loans are extended to ensure that the policy rate passes through the money market rates. At 31 December 2020, F-loans to banks amounted to NOK 80.2bn, compared with NOK 6.6bn at year-end 2019. F-loans increase the balance sheet item *Lending to banks*. Surplus liquidity was withdrawn using daily F-deposits and amounted to NOK 12bn at year-end 2020, compared with NOK 18bn at year-end 2019.

F-deposits affect the balance sheet line *Deposits from banks*.

Owing to considerable market demand for US dollars, temporary swap lines were established with the US Federal Reserve. The arrangement ensures that Norwegian banks can be provided with USD F-loans. Norges Bank borrows the equivalent amount from the Federal Reserve, that the banks are allotted in the F-loan auctions. At year-end 2020, there are no outstanding USD F-loans, nor does Norges Bank hold any loans from the Fed.

Financial outlook

This balance sheet composition will normally generate an expected positive return over time, disregarding foreign currency effects, as returns on the Bank's investments in equities and fixed income instruments are expected to exceed the cost of the Bank's liabilities. The Bank's assets are primarily invested in foreign currency, whereas its liabilities are primarily in NOK.

However, market interest rates are currently very low, even long rates. The low market rates imply a lower current return and contribute to reducing return expectations for fixed income securities in the period ahead. The potential for further price gains on fixed income investments is limited, while the potential for price losses from rising market interest rates is considerable. Since a large portion of the foreign exchange reserves and some of the GPFG are invested in bonds, it must be expected that movements in market interest rates ahead may reduce the overall return for a period.

The Covid-19 pandemic plunged the world economy into a deep crisis in 2020. Financial markets saw considerable volatility through the year, marked variation across industries and countries and extraordinary government support measures. Equity markets in a number of countries have posted positive returns, and several ended the year at historic highs. However, the outlook for the global economy remains shrouded in uncertainty, owing in part to further uncertainty regarding Covid-19. Developments in 2020 are a reminder that market values may vary substantially ahead, also to the downside.

As a long-term investor, the Bank seeks to understand how climate change affects the pricing of assets, and how it best can manage appurtenant risks. Climate risks affect companies' capacity to generate shareholder value in both the short and long term, and may arise in different ways. Understanding risks of this kind may contribute to risk management and investment decisions.

Future increases in the value of the GPFG will be affected by, among other things, transfers to/from the fund. The level of the transfers ahead is uncertain, partly owing to oil price volatility.

Movements in the krone exchange rate can also have a substantial impact on the value of the foreign exchange reserves and of the GPFG in NOK terms. The Bank must be prepared for considerable volatility from year to year in the return on the foreign exchange reserves and on the GPFG.

Managing financial risk

Norges Bank attaches considerable weight to managing and controlling financial risk. The Executive Board has issued principles for risk management, which are further defined in rules and guidelines for the operational areas.

Investment risk includes market risk, credit risk and counterparty risk. The Bank employs several measurement techniques, processes and systems to control investment risk. Robust and widely accepted risk management systems and processes are complemented by internally developed measurement techniques and processes.

Valuations, performance measurement, management and control of risk in investment management are required to comply with internationally recognised standards and techniques. See the notes to the financial statements for more details.

Income statement

Total comprehensive income

Norges Bank's total comprehensive income for 2020 shows a profit of NOK 28.8bn, compared with a profit of NOK 43.8bn in 2019. Net income from financial instruments was NOK 29.9bn in 2020, compared with NOK 44.6bn in 2019. Equity investments posted a gain of NOK 18.1bn, while fixed income investments posted a gain of NOK 12.6bn. Net income from financial instruments also includes a loss of NOK 0.5bn as a result of foreign currency effects owing to a weaker krone. Foreign currency effects in 2019 resulted in a gain of NOK 7bn.

The GPFG's total comprehensive income amounted to NOK 1 122.4bn, comprising a gain on the portfolio of NOK 1 127.7bn net of management costs of NOK 5.3bn. Total comprehensive income was recognised against the GPFG's krone account at 31 December 2020. The return on the portfolio, after management costs reimbursed to Norges Bank have been deducted, is transferred in its entirety to the krone account and thus does not affect Norges Bank's total comprehensive income or equity.

In accordance with the GPFG's management mandate, Norges Bank is reimbursed by the Ministry of Finance for its expenses related to the management of the GPFG within an upper limit. The Bank was reimbursed in the amount of NOK 5.3bn in 2020, compared with NOK 4.3bn in 2019. Norges Bank also earns income from services provided to banks and the government and rent from external tenants. Income other than the reimbursement for the management of the GPFG totalled NOK 121m in 2020, compared with NOK 139m in 2019.

Operating expenses

Operating expenses amounted to NOK 6.5bn in 2020, compared with NOK 5.4bn in 2019. The increase in expenses is primarily the result of a NOK 1.1bn increase in fees for external asset managers owing to a higher excess return on the GPFG, a higher share of capital allocated to external asset managers and currency effects. Personnel expenses rose by NOK 82m, primarily owing to higher performance-based pay, higher pension costs, ordinary wage growth and currency effects. This was partly offset by lower travel expenses and somewhat fewer employees. In addition, expenses were reduced in connection with the procurement of banknotes and the use of consultant services and owing to lower depreciation. Costs for custody services rose.

NOK 5.3bn of the expenses in 2020 is related to management of the GPFG, including personnel costs, custody and settlement services, IT expenses, analytical research services and fees for external asset managers. The internal operating expenses (excluding fees for external asset managers) for the management of the GPFG are in accordance with Norges Bank's maximum target for internal operating expenses of five basis points.

Equity

Norges Bank's equity at 31 December 2020 was NOK 276.8bn, compared with NOK 263.2bn at 31 December 2019. The Adjustment Fund and the Transfer Fund comprise the Bank's equity. At year-end 2020, the Adjustment Fund stood at NOK 246.5bn and the Transfer Fund at NOK 30.3bn. Norges Bank's equity was 35.9% of the balance sheet total, excluding the GPFG, compared with 40.9% in 2019. The Executive Board deems that equity is sufficient to fulfil the Bank's purpose (cf Section 3-11, Sub-section 1, of the Central Bank Act).

Distribution of total comprehensive income

The distribution of Norges Bank's total comprehensive income follows guidelines laid down by Royal Decree of 13 December 2019, pursuant to Section 3-11, Sub-section 2, of the Central Bank Act.

The guidelines state that total comprehensive income must be allocated to the Adjustment Fund until the Fund has reached 40% of the Bank's net foreign exchange reserves. Any surplus is allocated to the Transfer Fund. A third of the Transfer Fund is transferred annually to the Treasury.

In accordance with the guidelines, the following transfers and allocations will be made: Norges Bank's total comprehensive income of NOK 28.8bn is to be transferred as follows: NOK 22.7bn to the Adjustment Fund and NOK 6.1bn to the Transfer Fund.
NOK 15.2bn will be transferred from the Transfer Fund to the Treasury.

Oslo, 4 February 2021

Øystein Olsen
(Governor/Chair of the Executive Board)
Ida Wolden Bache
(Deputy Chair)
Karen Helene UlltveitMoe
Kristine Ryssdal
Arne Hyttnes
Hans Aasnæs
Nina Udnes Tronstad
Egil Herman Sjursen
Mona Helen Sørensen
(Employee representative)
Truls Oppedal
(Employee representative)

Annual Report of the Monetary Policy and Financial Stability Committee for 2020

The Storting (Norwegian parliament) passed a new Central Bank Act on 28 May 2019. The new act established a committee for monetary policy and financial stability. The Monetary Policy and Financial Stability Committee became operative on 1 January 2020.

The Committee is Norges Bank's executive and advisory authority in monetary policy, including the use of instruments to reach monetary policy objectives. Its aim is to contribute to promoting financial stability by providing advice and using the instruments at its disposal.

Policy rate decisions are usually made at scheduled monetary policy meetings. In 2020, eight such meetings were scheduled, but the Covid-19 pandemic led to the replacement of the regular meeting in March with two extraordinary meetings.

2020 – a dramatic year

The Norwegian economy was assessed to be near a cyclical peak in December 2019. The outlook changed dramatically in a short period of time. The Covid-19 pandemic led to a deep downturn in the Norwegian economy in 2020. Economic activity fell abruptly in March and April, and unemployment rose to historically high levels. There was also considerable turbulence in financial markets.

The Monetary Policy and Financial Stability Committee reduced the policy rate from 1.5% to 0% in the course of spring. A number of measures were also implemented to improve the functioning of financial markets. After the krone had reached record-weak levels against a number of currencies, Norges Bank undertook NOK purchases to support a well-functioning NOK market. The Committee advised the Ministry of Finance to reduce the level of the countercyclical capital buffer for banks from 2.5% to 1%. The Ministry followed the Committee's advice.

The market volatility subsided in the course of spring, and the krone appreciated. The appreciation coincided with a rise in oil prices. Through the year, economic activity increased and unemployment declined. After strict containment measures had led to a pronounced decline in private consumption, household consumption of goods picked up markedly. Through autumn, infection rates increased in Norway, and new containment measures led to a drop in household demand. The pandemic and the measures to contain it also dampened the willingness and ability of mainland firms to invest. The drop in foreign tourists caused a decline in exports, and low travel activity caused a decline in imports.

Housing market activity fell in March and April, and house prices edged down. Through spring and summer, housing market activity and house price inflation picked up. Developments likely reflect lower lending rates and a temporary expansion of the flexibility quota in the regulation on requirements for new residential mortgage loans. House prices continued to rise markedly through autumn.

In the first months of 2020, consumer price inflation (CPI) slowed markedly, reflecting a fall in electricity prices. The CPI adjusted for tax changes and excluding energy products (CPI-ATE) picked up through spring and summer and remained above the inflation target of 2%, primarily owing to higher imported goods inflation.

In its monetary policy assessments through 2020, the Committee gave weight to the fact that the Norwegian economy was in the midst of a deep downturn. In the Committee's assessment, a lower policy rate would dampen the downturn in the Norwegian economy, which would in turn reduce the risk of unemployment becoming entrenched at a high level. In its assessment of the inflation outlook, the Committee gave weight to the likelihood that the pick-up in underlying inflation was temporary. In its discussion of the balance of risks, the Committee was concerned that a long period of low interest rates increases the risk of a build-up of financial imbalances.

Prior to the reduction in March, the countercyclical buffer requirement was set at 2.5%, against the background of a build-up of financial imbalances over a long period. In December, the Committee signalled that the buffer would return to 2.5% in the period ahead and that it would advise increasing the buffer in the course of 2021. The Committee assessed the Norwegian financial system as having weathered the Covid-19 pandemic well, supported by government measures, but that the outlook for financial stability was somewhat weakened owing to considerable uncertainty regarding the future path of the pandemic and the impact on the economy and financial markets.

Monetary policy

International economy

The outbreak of Covid-19 and the measures to contain it led to a severe downturn in the global economy in 2020. In many countries, the decline in GDP in 2020 Q2 was the largest ever recorded. The activity level picked up during summer, but higher infection rates and stricter containment measures held back the recovery through autumn. The rollout of vaccines increases the likelihood of a substantial upswing in global economic activity in 2021.

Global consumer price inflation fell markedly when the Covid-19 pandemic broke out and strict containment measures were introduced. Inflation picked up somewhat through summer. For 2020 as a whole, underlying inflation among trading partners was lower than in 2019 and below the inflation targets.

The sharp global downturn led to a marked contraction in global oil consumption and low oil prices. Total oil production was substantially higher than consumption, with little spare storage capacity. Oil spot prices fell from over USD 65 per barrel in December 2019 to below USD 10 in the second half of April. Prices rose markedly thereafter. This upswing reflects the pickup in oil consumption as economic activity rebounded. At the same time, a number of OPEC and non-OPEC countries set oil production limits. Oil prices rose further through autumn, owing in part to positive news about vaccines. At the end of 2020, oil prices were just above USD 50 per barrel. Futures prices indicate approximately unchanged oil prices in the coming years.

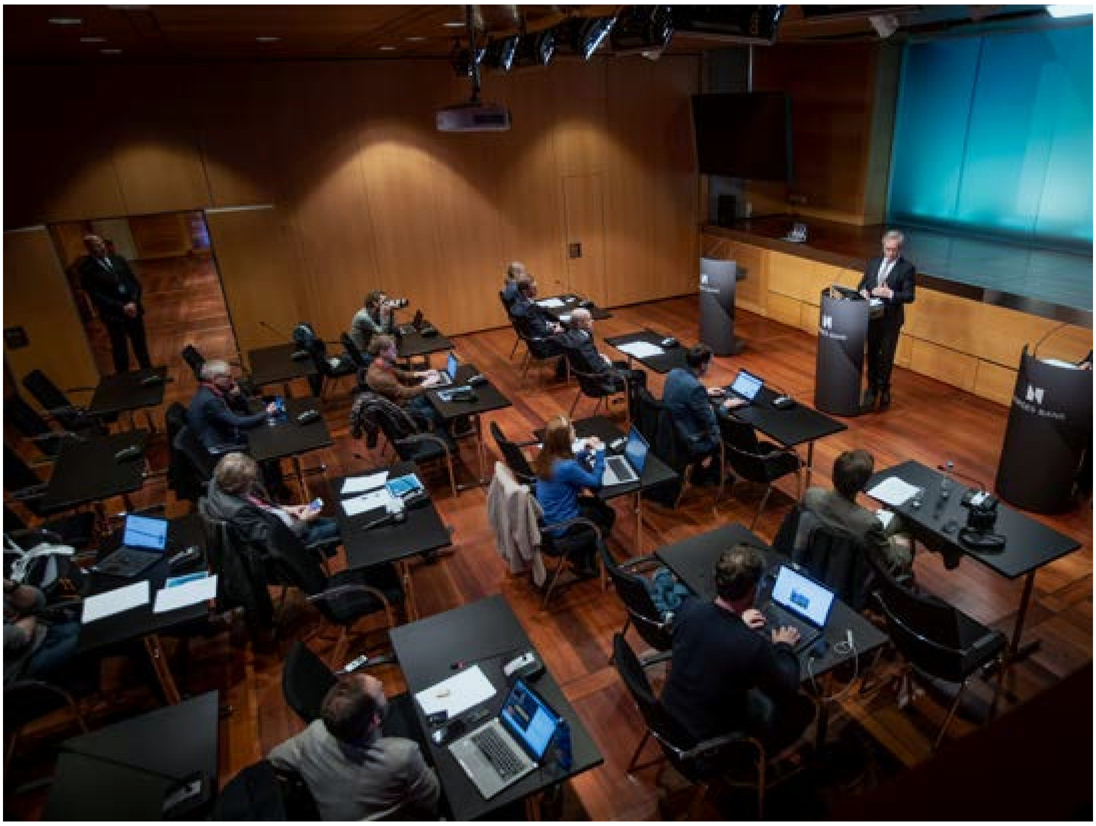
The Covid-19 outbreak led to substantial volatility in financial markets. Equity indexes fell, and bond and money market risk premiums rose.

The authorities in many countries implemented powerful fiscal policy measures to limit the economic impact of the outbreak. Central banks reduced policy rates and took extensive measures to stabilise financial markets. The measures included the provision of liquidity in the form of loans to the banking system and programmes involving purchases of government bonds and corporate bonds. In many countries, the measures deployed were more extensive than during the financial crisis. Expected money market rates among Norway's trading partners fell markedly. At the same time, long-term rates also fell considerably. Market-implied rates at year-end indicated expectations of very low interest rates among Norway's main trading partners for a long time ahead.

Financial conditions

When the pandemic hit the Norwegian economy at the beginning of March, the policy rate was 1.5%. It quickly became clear that the Committee had to act. Prior to the decisions made in March and in the weeks that followed, the Monetary Policy and Financial Stability Committee met frequently, often at short notice. The policy rate in Norway was lowered by 0.50 percentage point to 1.0% at an extraordinary meeting on 12 March, and further to 0.25% shortly thereafter at a second extraordinary meeting on 19 March. At the monetary policy meeting on 6 May, the Committee decided to reduce the policy rate to zero percent. At the same time, the Committee stated that in its current assessment of the outlook and balance of risks, the policy rate would most likely remain at that level for some time ahead.

In Norway, too, there was substantial volatility in financial markets in spring 2020. Risk premiums in the Norwegian money market rose sharply in the period to mid-March. Partly reflecting higher money market premiums, the policy rate cut in March did not result in a corresponding reduction in interest rates facing businesses and households. Like other central banks, Norges Bank implemented a number of measures to ensure the pass-through of the lower policy rate to money market rates and the improvement of funding market liquidity. Among other things, Norges Bank offered banks extraordinary liquidity in both NOK and USD. At their highest, extraordinary loans outstanding amounted to just under NOK 250bn. In advance of the monetary policy meeting in May, financial market volatility diminished and money market and bond premiums fell. Banks reduced mortgage lending rates, which reached historically low levels. However, banks reduced mortgage lending rates by less than the reduction in the policy rate. This may reflect banks' reluctance to charge negative deposit rates and their simultaneous desire to maintain margins between lending and deposit rates.



Press conference of 13 March

The krone depreciated at the beginning of 2020. A marked fall in oil prices and heightened uncertainty surrounding the Covid-19 outbreak caused the depreciation to accelerate in March. Between 18 and 19 March, the krone depreciated by approximately 14%, as measured by the import-weighted exchange rate (I-44), and reached record-weak levels against a number of currencies. The NOK market functioned very poorly. On 19 March, Norges Bank announced that, given the extraordinary conditions in the foreign exchange market, there might be a need to intervene in the market by purchasing NOK. In order to support a well-functioning NOK market, Norges Bank made extraordinary NOK purchases totalling NOK 3.5bn in the foreign exchange market in March. The krone then strengthened. The appreciation coincided with a rise in oil prices and reduced uncertainty in global financial markets. At the end of 2020, the krone exchange rate was approximately 3% weaker than at the beginning of the year, measured by the I-44.

Even though Norwegian banks at the beginning of 2020 were solid and had sufficient capital to weather a severe downturn, there were fears that tighter bank lending could amplify the downturn. On 13 March, Norges Bank therefore advised the Ministry of Finance to reduce the countercyclical capital buffer requirement from 2.5% to 1% with immediate effect. At the same time, banks were encouraged to take account of the extra-ordinary situation in decisions on dividend payouts for 2019. The Ministry of Finance reduced the buffer the same day. Extensive government measures, solid profitability and ample access to wholesale funding enabled banks to continue to maintain credit supply to both households and businesses through 2020.

Norwegian economy

After some years of solid growth, mainland economic growth declined through autumn 2019, and in December 2019, the Norwegian economy was assessed to be near a cyclical peak. There were prospects that unemployment would remain low and that inflation would remain close to target, while the assessment of the outlook and the balance of risks indicated that the policy rate would remain close to 1.5%. Economic growth was expected to slow in the years ahead, partly as a result of weaker prospects for petroleum investment.

The economic outlook changed dramatically in a short period of time. Norwegian economic activity fell abruptly in 2020 Q2 as a result of the Covid-19 pandemic. The virus outbreak and extensive containment measures led to production halts and lower activity across a range of businesses. Norwegian mainland GDP was around 11% lower in April than in February. The economic downturn was also amplified by the sharp contraction among Norway's trading partners in the wake of the Covid-19 outbreak and the pronounced fall in oil prices.

Many workers were furloughed or made redundant. Unemployment rose to very high levels. The stringent containment measures led to a sharp decline in private consumption. There was also a shift away from services and towards goods. Travel plans had to be put on hold and much of the cultural sector was shut down.

Following a marked decline in the Norwegian economy in March and April, economic activity picked up towards summer, and the recovery continued through Q3. Unemployment declined.

Higher household demand gave a boost to mainland economic activity. Household consumption of goods picked up markedly, but overall consumption remained low, which is mirrored by a marked rise in household saving. Higher saving was partly due to limitations on households' spending options. However, higher saving also reflects considerable uncertainty about the economic outlook. High household saving through 2020 provides room for strong consumption growth ahead.

The fall in oil prices, heightened uncertainty and containment measures led to a decline in petroleum investment in 2020 after strong growth in 2019. The pandemic and the containment measures also dampened the willingness and ability of mainland firms to invest.

Exports fell in 2020. Much of the decline reflected the drop in the number of foreign tourists in Norway. Oil service exports fell sharply owing to substantial cuts in investment plans in the global oil industry. In the same way as exports, imports were impacted by closed borders and the low number of Norwegian households travelling abroad, resulting in a fall in imports.

Through autumn, infection rates in Norway rose, and a new round of far-reaching containment measures were introduced in November. Household demand fell, and the economic recovery was put on hold. In November, the enterprises in Norges Bank's Regional Network reported that they expected weak growth in activity ahead.

The number of furloughed workers increased again owing to higher infection rates and stricter containment measures. Towards the end of 2020, there was a marked increase in the number of long-term unemployed, particularly among youth.

Housing market activity fell in March and April, and house prices edged down. Through spring and summer, housing market activity and house price inflations picked up, likely reflecting lower lending rates and a temporary expansion of the flexibility quota in the regulation on requirements for new residential mortgage loans. House prices continued to rise markedly through autumn. In December, the 12-month rise in house prices was 8.7%. House price inflation increased in all parts of the country but was highest in Oslo.

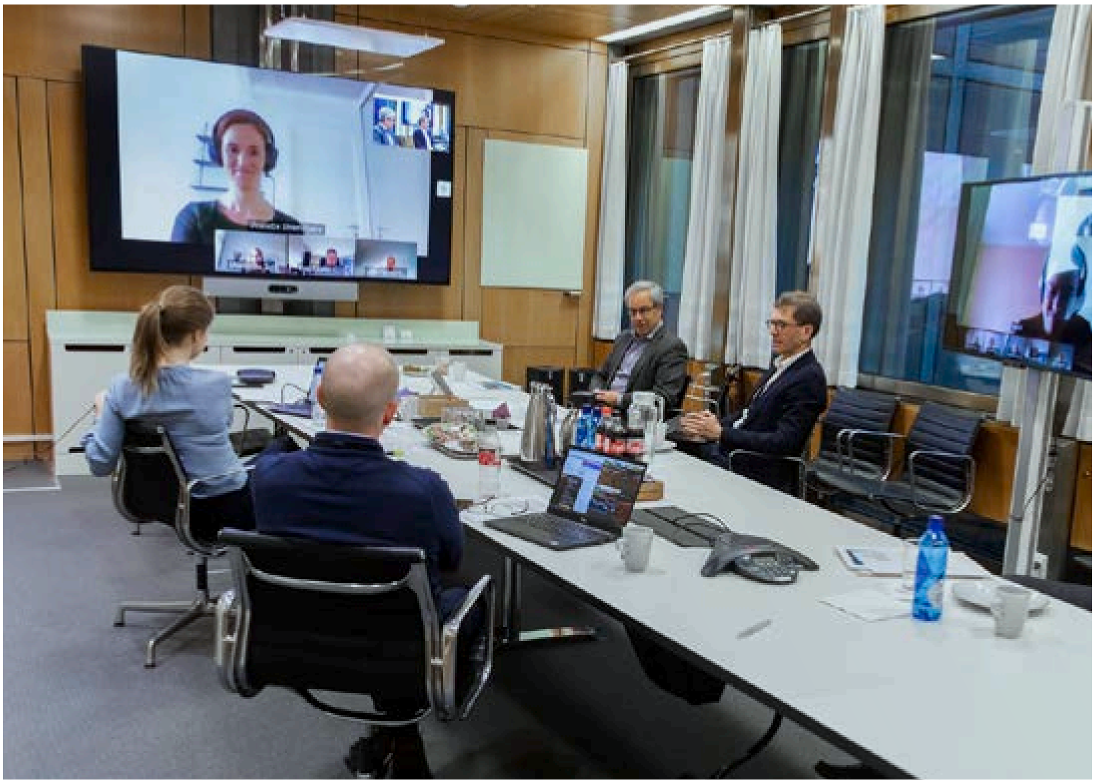
Following a rise over the past three years, wage growth slowed again slightly in 2020. The decline in wage growth must be viewed in the light of a sharp rise in unemployment caused by the Covid-19 outbreak, as well as markedly weaker business sector profitability.

In the first months of 2020, CPI inflation slowed markedly, reflecting a fall in electricity prices. The rise in the CPI adjusted for tax changes and excluding energy products (CPI-ATE) picked up through spring and summer and remained above the inflation target of 2%, primarily owing to higher imported goods inflation. Higher imported inflation reflects the krone depreciation early in the year. Annual consumer price inflation was 1.3% in 2020. Adjusted for tax changes and excluding energy products, inflation was 3.0%. Norges Bank's Expectations Survey in 2020 Q4 indicated that inflation expectations in the somewhat longer term are well anchored around the inflation target.

Trade-offs facing monetary policy

The operational target of monetary policy is annual consumer price inflation of close to 2% over time. Inflation targeting shall be forward-looking and flexible so that it can contribute to high and stable output and employment and to counteracting the build-up of financial imbalances.

In its discussions of the trade-offs facing monetary policy through 2020, the Committee gave weight to the fact that the Norwegian economy was in the midst of a deep downturn. The Committee's assessment was that a lower policy rate could contribute to dampening the Norwegian economic downturn. In the discussions, substantial weight was given to developments in the real economy and the labour market. In its assessment, the Committee placed weight on the contribution of low interest rates to



Online Committee meeting

speeding up the return to more normal output and employment levels, which in turn reduces the risk of unemployment becoming entrenched at a high level. In its assessment of the inflation outlook, the Committee gave weight to the likelihood that the pick-up in underlying inflation was temporary. The appreciation of the krone through 2020 and prospects for low wage growth suggested that inflation would moderate. In its discussion of the balance of risks, the Committee was concerned that a long period of low interest rates increases the risk of a build-up of financial imbalances.

After the pandemic hit Norway, the Committee's assessment was that the overall outlook and balance of risks implied a very expansionary monetary policy stance. In the Committee's assessment, the sharp economic downturn and considerable uncertainty surrounding the outlook suggested keeping the policy rate on hold until there are clear signs that economic conditions are normalising. The Committee did not envisage making further policy rate cuts.

In the first half of 2020, the policy rate path was revised down considerably. In the light of Covid-19 and the extraordinary situation in the

Norwegian economy, a monetary policy update was prepared with updated projections for the monetary policy meeting in May.

The forecast in the December 2020 *Monetary Policy Report* implied a policy rate of zero percent for over a year ahead, followed by a gradual rise from the first half of 2022 as activity approaches a more normal level. With such a policy rate path, there were prospects that capacity utilisation would gradually increase and that the output gap would close during 2022. Following a fall in GDP in 2020, solid growth in the Norwegian economy was expected in the coming years. According to the projections, an upturn in household consumption in particular will contribute to the economic recovery. With increasing economic activity, labour demand was also expected to rise so that employment rises and unemployment declines. However, the long-term consequences of the downturn were expected to result in somewhat higher unemployment at the end of 2023 than prior to the pandemic.

Ample spare capacity in the economy, prospects for low wage growth and the appreciation of the krone since March were expected to lead to a fall in inflation ahead. Nevertheless, in the Committee's assessment, there was limited risk that inflation would become too low as long as capacity utilisation was rising. Inflation was projected at somewhat above 1.5% at the end of 2023.

Financial stability and the decision basis for the countercyclical capital buffer

On the advice of the Committee, the Ministry of Finance decided to reduce the countercyclical capital buffer to 1% in March. The buffer was kept unchanged thereafter, in line with Norges Bank's advice. The lower buffer requirement reduced the risk of tighter bank lending standards, which could amplify the downturn.

In December, the Committee announced that on the basis of its current assessment of economic developments and prospects for bank losses and lending capacity, it would advise increasing the buffer in the course of 2021. Economic activity has picked up since March, and bank losses have declined. Banks are well equipped to absorb higher losses while maintaining credit supply. The Committee underscored that the outlook for losses was shrouded in considerable uncertainty.

Credit losses will probably be lower in 2021 than in 2020, but will remain markedly above the average for the past 20 years. It will probably take time for economic activity to return to pre-pandemic levels. Prior to the reduction in March, the countercyclical capital buffer requirement was set at 2.5 percent against the background of a build-up of financial imbalances over a long period. In December, the Committee stated that the buffer would return to 2.5% in the period ahead.

The Committee's assessment in *Financial Stability Report* 2020 was that the Norwegian financial system had weathered the Covid-19 pandemic well with the support of government measures, but that the outlook for financial stability is nevertheless somewhat weakened owing to considerable uncertainty regarding the future path of the pandemic and its impact on the economy and financial markets. High household debt and high property prices are still assessed as the key vulnerabilities in the Norwegian financial system, and the Committee placed weight on the fact that vulnerabilities could increase with persistently high house price inflation. The Committee supported a continuation of the requirements for prudent lending standards and recommended that the temporarily expanded flexibility quotas should not be extended beyond 2020 Q3.

The Committee further emphasised banks' capacity to absorb losses in an economic downturn is important for the stability of the financial system. Norwegian banks satisfy the capital requirements by an ample margin and have been capable of lending to households and businesses during the Covid-19 pandemic. Losses increased in 2020, but much of the losses were related to loans to oil service companies, which continue to face a difficult situation following the oil price fall in 2014. The baseline scenario in the stress test in *Financial Stability Report* 2020 showed that banks had enough capital to absorb higher losses than they had in 2020. This means that banks are able to draw on buffer capital to avoid tightening lending, even in a situation of weakening economic developments and losses that are higher than assumed by Norges Bank. In such a situation, the authorities could also reduce the countercyclical capital buffer to enable banks to maintain credit supply.

The Committee also pointed out that considerably stricter capital and liquidity requirements since the financial crisis in 2008/2009 had strengthened the financial system, but that the market turbulence in March uncovered some new challenges. Margin requirements in derivatives trades have helped reduce the risk that insolvency spreads through the network of derivatives contracts. At the same time, requirements for daily margin payments to counterparties entail a liquidity risk, and the Committee emphasised the importance that parties to derivatives contracts take account of this risk. The substantial movements in financial markets in March led to a high volume of margin calls, both in Norway and globally. In Norway, the sharp krone depreciation presented challenges to Norwegian asset managers. Liquidity challenges also affected other participants negatively, since they contributed to higher risk premiums in the bond market. Norges Bank will continue to assess the systemic risk associated with derivatives and, if necessary, propose changes to the rules for asset managers' risk management.

The Committee also focused on the effects that climate change and the transition to a low-carbon economy have on the financial system and specified the importance of banks taking account of climate risks in their risk assessments of both new and existing loans. The Committee regarded developments in the value of the oil and gas industry as the biggest risk facing Norway, but also pointed out that Norwegian banks hold loans to international shipping, which may face stricter climate regulations in the coming years.

Oslo, 4 February 2021

Øystein Olsen
(Governor / Chair of the Executive Board)
[SIGNATURE]
Ida Wolden Bache
(Deputy Governor)
[SIGNATURE]
Ingvild Almås
Jeanette Fjære-Lindkjenn

Income statement

Amounts in NOK millions	Note	2020	2019
NET INCOME/-EXPENSE FROM FINANCIAL INSTRUMENTS			
Net income/-expense from:			
-Equities	3	18 070	28 660
-Bonds	3	12 618	12 265
-Financial derivatives		591	-728
-Secured lending	9	-10	342
-Secured borrowing	9	-40	-
Interest income and expense from deposits and short-term borrowing		-30	21
Interest income from lending to banks	18	206	69
Interest expense on deposits from banks and the Treasury	18	-973	-3 042
Net interest income from the IMF	17	57	102
Tax expenses	3	-45	-50
Other financial income/-expenses		-1	-10
Net income/-expense from financial instruments before foreign exchange gains/losses		**30 443**	**37 629**
Foreign exchange gains/-losses	8	-499	7 007
Net income/-expense from financial instruments		**29 944**	**44 636**
MANAGEMENT OF THE GOVERNMENT PENSION FUND GLOBAL (GPFG)			
Total comprehensive income, GPFG	20	1 122 356	1 814 470
Withdrawn from/-transferred to the krone account of the GPFG	20	-1 122 356	-1 814 470
OTHER OPERATING INCOME			
Management fee, GPFG	13	5 305	4 312
Other operating income	15	121	139
Total other operating income		**5 426**	**4 451**
OPERATING EXPENSES			
Personnel expenses	12	-2 084	-2 001
Other operating expenses	15	-4 178	-3 129
Depreciation, amortisation and impairment losses	14	-219	-289
Total operating expenses		**-6 481**	**-5 419**
Profit/-loss for the period		**28 889**	**43 669**
STATEMENT OF COMPREHENSIVE INCOME			
Profit/-loss for the period		28 889	43 669
Change in actuarial gains/-losses	11	-65	114
Total comprehensive income		**28 824**	**43 783**

Balance sheet

Amounts in NOK millions	Note	31 Dec. 2020	31 Dec. 2019
ASSETS			
Financial assets			
Deposits in banks		24 920	17 231
Secured lending	9,10	18 340	7 665
Unsettled trades		888	642
Equities	4	114 931	121 295
Equities lent	4,9,10	4 600	6 303
Bonds	4	448 105	406 898
Financial derivatives		12	9
Claims on the IMF	17	71 081	69 075
Lending to banks	18	80 168	6 560
Other financial assets	13	5 683	4 804
Total financial assets		**768 728**	**640 482**
Net value, GPFG			
Net value, GPFG	**20**	**10 908 457**	**10 083 771**
Non-financial assets			
Pensions	11	155	331
Non-financial assets	14	2 119	2 294
Total non-financial assets		**2 274**	**2 625**
TOTAL ASSETS		**11 679 459**	**10 726 878**

Amounts in NOK millions	Note	31 Dec. 2020	31 Dec. 2019
LIABILITIES AND EQUITY			
Financial liabilities			
Secured borrowing	9,10	23	100
Unsettled trades	9,10	14 383	11 716
Financial derivatives		10	2
Other financial liabilities		2 942	2 248
Liabilities to the IMF	17	53 925	57 235
Deposits from banks	18	52 807	58 888
Deposits from the Treasury	18	313 131	187 727
Notes and coins in circulation	16	41 006	41 613
Total financial liabilities		**478 227**	**359 529**
Deposits in krone account, GPFG			
Deposits in krone account, GPFG	**20**	**10 908 457**	**10 083 771**
Other liabilities	**19**	**15 956**	**20 414**
Total liabilities		**11 402 640**	**10 463 714**
Equity		**276 819**	**263 164**
TOTAL LIABILITIES AND EQUITY		**11 679 459**	**10 726 878**

Oslo, 4 February 2021

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(Deputy Chair)

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Hans Aasnæs

Nina Udnes Tronstad

Egil Herman Sjursen

Mona Helen Sørensen
(Employee representative)

Truls Oppedal
(Employee representative)

Statement of cash flows

Amounts in NOK millions, inflows (+)/outflows (-)	2020	2019
Operating activities		
Receipts of dividend from equities	2 674	2 854
Receipts of interest from bonds	6 208	5 995
Net receipts of interest and fee from secured lending and borrowing	18	381
Receipts of dividend, interest and fee from holdings of equities and bonds	*8 900*	*9 230*
Net cash flow from purchase and sale of equities	23 808	-2 093
Net cash flow from purchase and sale of bonds	-25 527	-2 642
Net cash flow financial derivatives	1 672	-760
Net cash flow related to deposits in banks	564	23
Net cash flow secured lending and borrowing	-1 332	2 849
Net cash flow related to other expenses, other assets and other liabilities	-13 272	-13 422
Net cash flow related to other financial assets and other financial liabilities	-85 292	11 401
Net cash flow to/-from the Treasury	-171 364	17 725
Inflow from the Norwegian government to the GPFG	-5 032	-32 051
Withdrawals by the Norwegian government from the GPFG	301 800	14 400
Management fee received from the GPFG	4 312	4 544
Net cash flow from operating activities	**39 237**	**9 204**
Investing activities		
Net cash flow related to non-financial assets and liabilities	-38	-149
Net cash flow from investing activities	**-38**	**-149**
Financing activities		
Cash flow to the Treasury from the Transfer Fund	-19 706	-14 798
Net cash flow from financing activities	**-19 706**	**-14 798**
Net change in cash		
Deposits in banks at 1 January	17 230	23 208
Net increase/-decrease of cash in the period	19 493	-5 743
Net foreign exchange gains and losses on cash	-11 803	-235
Deposits in banks at 31 December	**24 920**	**17 230**

Statement of changes in equity

Amounts in NOK millions	Adjustment Fund	Transfer Fund	Total equity
1 January 2019	209 490	29 597	239 087
Total comprehensive income	14 261	29 522	43 783
31 December 2019 before transfer	*223 751*	*59 119*	*282 870*
Transferred to the Treasury	-	-19 706	-19 706
31 December 2019	**223 751**	**39 413**	**263 164**
1 January 2019	223 751	39 413	263 164
Total comprehensive income	22 730	6 094	28 824
31 December 2020 before transfer	*246 481*	*45 507*	*291 988*
Transferred to the Treasury	-	-15 169	-15 169
31 December 2020	**246 481**	**30 338**	**276 819**

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