

Øystein Olsen: Management of the Government Pension Fund Global

Introductory statement by Mr Øystein Olsen, Governor of Norges Bank (Central Bank of Norway), before the Standing Committee on Finance and Economic Affairs of the Storting, Oslo, 2 May 2017.

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In 2016, it was 20 years since the Ministry of Finance made the first capital transfer to the Government Petroleum Fund, as the Government Pension Fund Global (GPFG) was aptly named at the time. This transfer marked the start of a transformation of petroleum wealth in the form of oil and gas in the ground into financial assets invested outside Norway.

Since the first capital transfer was made, the GPFG has grown considerably, to more than 2.5 times the size of GDP. The year 2016 also saw the first net withdrawal from the GPFG. Ahead, the value of the GPFG will therefore, to a greater extent than previously, depend on the return on the fund's investments. The period of steady growth in the GPFG as a share of the economy is now probably over.

The key variables determining the GPFG's long-term performance have been specified by the Ministry of Finance and approved by the Storting. For its part, Norges Bank has developed its management assignment in accordance with the fund's growth and in line with the owner's mandate. At the same time, Norges Bank has focused on its role as advisor in the further development of the fund's investment strategy. In 2016, the Executive Board's capacity was strengthened by the appointment of a second deputy governor and an increase in the number of board members.

At the end of 2016, the cumulative value of transfers to the GPFG was approximately equal to the cumulative return on the fund, reflecting the fund's solid performance over time. Last year, the return on the GPFG was 6.9 percent.¹ Over the period since inception, the return has averaged 5.7 percent. Adjusting for inflation and management costs, this gives an average real return of 3.8 percent. Developments in international financial markets and the growth outlook for the global economy suggest that the expected real return ahead will be somewhat lower than has been the case in recent years.

The GPFG closely tracks the benchmark index; it is invested across a broad range of countries and markets. This strategy has so far generated a solid return within the defined risk limits. Restrictions imposed on the fund's scope for investment, or instructions that disregard the trade-off between return and risk, will limit the fund's potential to achieve solid performance over time.

In the execution of our management assignment, it is important that Norges Bank's role is that of financial investor. It is crucial to the GPFG's reputation in investee countries that the fund is not perceived as a political instrument.

Norges Bank aims to be at the forefront of global efforts in the area of responsible investment. Responsible investment is an integral part of the investment strategy and includes the exclusion of companies on an ethical basis. In 2016, the Ministry of Finance, at the request of the Storting, introduced two new criteria for ethics-based exclusions: a climate criterion and a coal criterion. Norges Bank has conducted extensive research to collect data and perform analyses to identify the companies that fall under the coal criterion. Based on the results, the Executive Board decided to exclude 69 companies and place 13 companies under observation in 2016. On the advice of the Council on Ethics, the Board also decided to exclude a further eight companies and place one company under observation, while the exclusion of one company was revoked. The exchange of information and division of responsibilities between Norges Bank and the Council on

Ethics functions smoothly.

At the end of 2016, Norges Bank submitted a recommendation to the Ministry of Finance to increase the share of equities in the GPFG. Historically, equities have generated a higher return than bonds, but the return has also been more volatile. A lower return on bonds is the price we pay to dampen fluctuations in the fund's value. In recent years, bonds have become a more efficient, but also more costly, hedge against security market volatility. Both factors suggest that the bond allocation should be somewhat lower. In addition, Norway's petroleum wealth as a whole has become more diversified over the past ten years. The share of oil and gas resources still in the ground has decreased considerably. This means we can tolerate slightly higher volatility in our financial wealth.

The GPFG is managed on behalf of the Norwegian people. Good governance, control and transparency with regard to the management of the fund are important democratic principles. A broad set of reports on the GPFG's performance and operations are published on a regular basis.

Through 2016, Norges Bank worked on preparing its strategy for 2017–2019, including the strategy for the management of the Government Pension Fund Global. The strategic plan builds on the main elements of the plan for the previous period. We will continue to place emphasis on our role as a long-term, professional owner with in-depth knowledge about the largest companies and to actively contribute to the development of international standards and principles. As from 2017, the level and composition of the GPFG's real estate investments will be decided by Norges Bank's Executive Board.

Norges Bank is committed to performing its investment management assignment in a cost-efficient manner, taking advantage of the fund's unique characteristics. The goal is to achieve the highest possible return within the framework of the investment management mandate.

¹ Return before management costs and measured in terms of the fund's currency basket.