ANNUAL REPORT
2012

MAGYAR NEMZETI BANK

ANNUAL REPORT

2012 Business Report and Financial Statements of the Magyar Nemzeti Bank

Published by the Magyar Nemzeti Bank

Publisher in charge: dr. András Simon

Szabadság tér 8–9., H-1850 Budapest

www.mnb.hu

ISSN 1585-4604 (online)

Contents

Part A)
2012 business report of the Magyar Nemzeti Bank

Part B)
Audited financial statements of the Magyar Nemzeti Bank

Part A)
2012 business report of the Magyar Nemzeti Bank

1 The Governor's foreword

In 2012, the annual average rate of inflation was 5.7 per cent. For the entire year, the rate of increase in prices substantially exceeded the 3±1 per cent tolerance band considered acceptable ex post in terms of meeting the inflation target. The high rate of inflation resulted primarily from indirect tax increases; measures of underlying inflation indicated subdued inflationary pressure from the demand side.

The monetary policy dilemma seen since the start of the crisis continued in 2012. Weak domestic demand would have justified looser monetary conditions, but – due to tax measures and other cost shocks – persistently high inflation also posed a risk to the medium-term outlook for inflation. Risk aversion, which intensified from time to time, also narrowed the scope for monetary policy manoeuvre.

With regard to the volatile risk environment and medium-term inflation risks, during the first half of the year the Monetary Council did not change the central bank base rate and viewed starting an interest rate reduction cycle as being dependent on a decline in the risks.

During the second half of the year, global risk appetite increased considerably and the risk perception of domestic financial assets improved significantly, which in itself increased the room for manoeuvre in monetary policy. At the same time, despite the deteriorating macroeconomic outlook, inflation remained high and the Bank's forecasts also pointed to inflation persistently exceeding the inflation target. The Monetary Council was divided in its views about medium-term inflation risks. The majority of Council members felt that, despite the slowdown in potential growth, the economy was still characterised by a significant degree of surplus capacity. Consequently, weak domestic demand would substantially mitigate the inflationary effects of cost shocks and indirect taxes, and the inflation target could be met as their effect faded. However, some Council members thought that on the one hand inflation expectations were not adequately anchored as a result of the consumer price index persistently exceeding the inflation target, and that on the other hand, due to the decline in the potential growth rate, the disinflationary impact of weak demand might also weaken significantly and therefore the medium-term inflation risks did not allow for any monetary easing. After due consideration of the above aspects, a majority of the Monetary Council decided to initiate a cycle of interest rate reductions, and by the end of the year the Council had lowered the central bank base rate by a total of 125 basis points to 5.75 per cent. In its announcements published after the interest rate decisions, the Monetary Council noted that the interest rate would only continue to be reduced if the financial market environment remained favourable and incoming data confirmed that the inflation target could be met on the monetary policy horizon.

Over the long term, monetary policy can best contribute to a predictable macroeconomic environment and economic growth by maintaining price stability and ensuring the stability of the financial system. In the future, the Monetary Council will continue to conduct its monetary policy to ensure that medium-term developments in the consumer price index are consistent with the inflation target.

In order to strengthen banks' lending capacity, in the first half of 2012 the Bank introduced a two-year collateralised loan tender and announced the start of a mortgage bond purchase programme, in the event that mortgage bond issuing rights were expanded. Furthermore, the MNB widened the range of eligible collateral accepted in its lending facilities. In February, the euro sale tenders related to the early repayment scheme were completed, with the MNB allocating a total euro amount equivalent to HUF 810 billion to credit institutions with the aim of protecting the exchange rate and mitigating credit institutions' risks stemming from early repayment. Between May and June, the MNB conducted a new FX sale tender in connection with the statutory conversion of foreign exchange loans more than 90 days overdue into forints, and allocated EUR 36 million to credit institutions. While the banking system last used the Bank's three-month euro liquidity-providing EUR/HUF FX-swap facility in March, it raised euros from the MNB through the similar overnight facility on several occasions during the year. At the end of the year, the Bank announced a two-week euro liquidity-providing EUR/HUF FX-swap tender on an ad hoc basis.

In 2012, the Magyar Nemzeti Bank published its *Report on Financial Stability* twice and the results of its lending survey in each quarter. The shock absorption capacity of the liquidity and capital of the domestic financial system is satisfactory: the reports revealed that many of the risks threatening the domestic financial system diminished in 2012. The financial system fulfilled its function as the intermediary of financial resources to a rather limited degree, however, as it exerted a strongly procyclical effect on corporate lending, due to low willingness to lend. The MNB identified a number of risks in the external environment and in the internal operation of the financial system, which maintain this contractionary effect and may undermine the currently adequate shock absorption capacity in the future. The November 2012 issue of the Report reflected a new approach: the Bank performed and presented the assessment of the state of financial stability on the basis of four key financial stability indices.

The MNB Act[1] adopted at the end of 2011 granted a macroprudential mandate for the MNB in accordance with best international practice. With this mandate, the Governor of the MNB was authorised to issue decrees on the basis of decisions of the Monetary Council, in order to prevent the build-up of systemic risks or to reduce risks – exclusively in areas not regulated in acts or government decrees. In line with its statutory duties, the MNB began to elaborate the framework of the domestic macroprudential strategy during the course of 2012. Based on its new responsibilities, the Bank identified the high swap holdings of the banking system as a critical factor, and in line with the Monetary Council's decision it called on banks to reduce and keep their off-balance sheet open foreign currency positions below 15 per cent of their balance sheet total.

This year, the MNB continued to actively assist the work of the Financial Stability Board (FSB), comprised of the Minister for National Economy, the President of the Hungarian Financial Supervisory Authority (HFSA) and the Governor of the Magyar Nemzeti Bank. At its meetings the Council regularly reviewed the risks of the Hungarian financial system and tasks related to financial regulation. Amongst other things, the FSB discussed tasks relating to the national bank resolution tools being developed, as well as its experience in the regulation of the transparent pricing of retail lending and further methods of improving such. In addition, the FSB members drew up alternatives for expanding the set of tools aimed at helping retail mortgage loan debtors in a difficult situation, assessed the potential impacts on Hungary of the proposed legislative package on the banking union, and identified the advantages and risks of joining or opting out.

On 2 July 2012, the intraday credit transfer system was launched successfully, as a result of which the settlement time of electronically submitted credit transfers was reduced from the earlier one working day to a maximum of 4 hours. Based on current practical experience, however, we can state that in the quickest cases customers can expect settlement of their credit transfers within 30 minutes. Owing to the shortened settlement time, retail and corporate customers of payment service providers can save time and money. Last year, with turnover increasing in terms of volume and somewhat decreasing in value, VIBER operated with an availability exceeding the level of international standards. In 2012, partly in connection with the introduction of the intraday credit transfer system, and partly on the basis of the several years of experience the Bank has gained in the areas of supervision and the interpretation of law, an overall review and reworking of the MNB decree[2] on the execution of payment transactions was carried out. In 2012, on-site payment inspections were conducted at 17 payment service providers. In established cases of non-compliance with the regulations pertaining to payment services, the MNB instructed the inspected payment service providers to take the necessary measures and in more severe cases a fine was imposed.

In 2012, the MNB paid particular attention to retail payments, basically consisting of topics related to household and corporate payments, in respect of which it has published several studies in past years. In 2012, having realised that with more intensive use of non-cash payment solutions it would be possible to save considerable funds in Hungary, efforts to increase the efficiency of domestic payments continued. At the same time, in order for these solutions to spread, it is essential to improve access to basic payment services both on the payer's and the payee's side. To this end, the MNB elaborated and submitted to the Ministry of National Economy a regulation proposal to increase the safety of the voucher market, to restrict the usage of cash among the economic agents, and to reduce the level of interchange fees charged on bankcard payments. Another step forward in the effort to reduce cash usage is that, with the introduction of the transaction tax, cash withdrawals will be subject to higher charges than non-cash transactions.

In 2012, the Magyar Nemzeti Bank first published the *Report on Payment Systems*, in which it wishes to provide comprehensive analyses of the trends and main risks arising in domestic payments and the operation of the overseen payment and securities clearing and settlement systems. The publication also contains information on what tools the MNB can mobilise, should it become necessary, to

[1] Act CCVIII of 2011 on the Magyar Nemzeti Bank.

[2] MNB Decree No. 18/2009 (VIII. 6.) on the Execution of Payment Transactions.

discharge its basic responsibility, i.e. facilitating the reliable and efficient operation of payment services, as well as the payment and securities clearing and settlement systems.

During the year, the amount of official foreign exchange reserves dropped by EUR 3.9 billion to EUR 33.9 billion as of the end of 2012. The primary reason behind this decline lies in the euro sales provided for the Hungarian government's debt repayments (EUR 5.1 billion) and those related to the early repayment of foreign currency loans (EUR 1.7 billion), which were only partly offset by transfers received from the European Commission (EUR 3.1 billion), due to the lack of funds raised from the international capital market.

At the end of 2012, the total value of currency in circulation amounted to HUF 2,721.6 billion, representing a 1 per cent year-on-year increase. The seasonally adjusted cash figures show a 1 per cent rise, reflecting stagnation in proportion to GDP.

Credit institutions, the postal service and professional cash logistics providers using up-to-date technology play an increasingly crucial role in ensuring the high quality of cash in circulation, in line with the emphasis on the Bank's control function. To ensure that the cash in circulation and cash payment services provided to retail customers are of high quality, the Bank further intensified its regular official inspections in 2012. In addition to controlling the professional participants of the cash cycle, the Bank also broadened the range of services provided to them, placing even more emphasis on technological support than before, which greatly contributed to the safety of cash payments.

The decline in the counterfeiting of forint banknotes which began at the end of 2010 continued in 2012: the number of counterfeit forint banknotes withdrawn from circulation fell by 9 per cent compared to 2011. Last year, in light of the favourable counterfeit figures, the Bank continued to implement its cash strategy focusing on prevention and preparation. To this end, in 2012 the Bank placed even more emphasis on providing cashiers, who primarily work in the retail sector and thus play a key role in the detection of counterfeits, with banknote-related knowledge. Last year, at free on-site trainings held by MNB experts, four thousand cashiers acquired the most up-do-date knowledge and methods of banknote checking.

As opposed to the profit registered in 2011, the MNB recorded a loss of HUF 39.8 billion in 2012. The change in income was determined by the substantial decline in interest income and income from financial operations, which is mostly attributable to the growing difference between forint and foreign currency interest rates. At the same time, the profit from exchange rate changes rose by some 60 billion forints, and net expenses resulting from other income factors were also lower than a year earlier.

In 2012, the Bank once again achieved substantial savings of more than HUF 230 million in operating costs. This corresponds to a 2 per cent decrease compared to expenditures in the previous year. In 2008, the year when the project to improve operational efficiency was launched, the MNB's operating costs were HUF 14.9 billion. Total savings in the past four years amount to more than HUF 3.3 billion at the annual level, representing a decline of over 22 per cent in nominal terms compared to the 2008 expenditures. These savings were possible partly due to the initiatives included in the project, and partly as a consequence of a change in focus resulting in an emphasis on cost-effective solutions. In addition, the good results were also attributable to the changes in legislation that took place in the meantime and entailed a decline in costs. The 2012 operating costs (HUF 11.6 billion) were the lowest registered in the period since 1997.

The value of investment implemented in 2012 amounted to approximately HUF 1.1 billion, which is considerably higher than the figures for earlier years. In addition to the improved execution of plans, another factor contributing to this amount was that some of the investment projects commenced in 2011 were completed in 2012. Most of the investments made involved IT developments associated with strategic objectives, and aimed to increase the accountability of IT operators, the version upgrade of the business management system (SAP), and the modernisation of the data centre tools of the IT network. Furthermore, the completion of several development projects was postponed to 2013, and many assets were procured at a lower price than planned.

In past years, the MNB has launched several campaigns and initiatives, and continued to develop its social responsibility scheme. In 2012, for the first time, a report on achievements in the area of social responsibility activities was prepared in accordance with the International Reporting Framework (GRI G3) and integrated into the annual report.

The MNB is engaged in continuous dialogue with the stakeholders of its activities on an equal footing. It presents its activities, goals and the set of tools serving their achievement, and has conducted social consultations with stakeholders, representatives of the financial and trade sector and, where relevant, the widest possible sphere of the public as an integral part of its legislative processes.

Such discussions preceded the improvements made to the tools of monetary policy and the introduction of the intraday credit transfer system.

The Bank continued and extended its successful programmes focusing on the improvement of financial culture in 2012. As a result of the Bank's function-related initiatives, as well as the developments implemented in the Visitor Centre during the year – as well as owing to the increasing activity of Pénziránytű Alapítvány (Money Compass Foundation) – the size of target group reached has grown several fold, to a total of 1.1 million.

In the operation of the Bank, the issue of transparency also arises in connection with decision-making and cost management. Transparent decision-making enhances the efficiency of monetary policy and supports macroeconomic stability, while at the same time ensuring control. It is a statutory obligation for the Bank to render account to Parliament on a regular basis, and take part in ad hoc hearings. It is required to disclose the abridged minutes of meetings where interest rate decisions are made, as well as the underlying analyses and forecasts, and to hold press conferences to answer the questions of journalists. In the spirit of transparent financial management, the Bank endeavours to reach, beyond its statutory obligation, an even higher degree of transparency. It has cooperated with Transparency International on two occasions in public procurement procedures, and obtained excellent ratings from the organisation.

Overall, in my judgment, the operation of the Magyar Nemzeti Bank was successful in 2012.

25 February 2013, Budapest

András Simor
Governor of the Magyar Nemzeti Bank

2 A brief overview of the Magyar Nemzeti Bank

Company name: Magyar Nemzeti Bank
Registered office: 1054 Budapest, Szabadság tér 8–9.
Form of operation: company limited by shares. The form of operation, i.e. the designation 'company limited by shares' or its abbreviation, need not be indicated in the company name of the MNB.
Year of foundation: 1924
Owner (shareholder): the Hungarian State, represented by the minister responsible for state budget.
Scope of activities: as defined by the MNB Act.
Subscribed capital: HUF 10 billion.

2.1 OBJECTIVES AND BASIC TASKS OF THE MNB

The Magyar Nemzeti Bank is a legal entity operating as a special company limited by shares, which conducts its operations as provided for by the MNB Act effective as of 1 January 2012. The Magyar Nemzeti Bank is a member of the European System of Central Banks.

In accordance with Article 127 of the Treaty on the Functioning of the European Union, the MNB Act, which establishes the Bank's primary objectives and basic tasks as well as its institutional, operational, personal and financial independence and operation, stipulates that the primary objective of the MNB is to achieve and maintain price stability. Without prejudice to its primary objective, the MNB supports the economic policy of the Government, using the monetary policy instruments at its disposal.

The MNB Act also stipulates the independence of the Bank in accordance with Article 130 of the Treaty on the Functioning of the European Union. On the basis of central bank independence, the MNB and the members of bodies shall be independent in carrying out the tasks and performing the obligations conferred upon them by the MNB Act, and shall neither seek nor take instructions from the Government, the institutions and offices of the European Union, the governments of its Member States or any other organisations or political parties, except from the European Central Bank. The Government or any other organisation shall respect this principle, and shall not attempt to influence the MNB or any member of its bodies in the course of performance of their tasks.

In addition to and with the aim of achieving and maintaining price stability, the Bank performs the following basic tasks specified in the MNB Act:

– it defines and implements the monetary policy;

– it has the exclusive right to issue banknotes and coins, including commemorative banknotes and coins, qualifying as legal tender;

– it creates and manages official reserves in foreign exchange and gold, in order to maintain the external stability of the Hungarian economy;

– it conducts foreign exchange operations in relation to the management of foreign exchange reserves and the implementation of exchange rate policy;

– it oversees the domestic payment and settlement systems as well as securities settlement systems, and, as part of this oversight duty, monitors the operation of the system, and the operation of the organisation performing central counterparty activities in order to ensure the sound and efficient operation of these systems as well as smooth money circulation, and takes part in the development of these systems within the scope of its powers defined in the MNB Act;

– it collects and publishes the statistical information required for carrying out its tasks;

– in cooperation with other competent authorities, it supports the efficient development and conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial intermediary system. For this purpose, it shall, in particular explore the business and economic risks to the whole of the financial intermediary system. facilitate the prevention of potential systemic risks and the reduction or elimination of evolved systemic risks.

Any further tasks of the MNB shall be defined by law, and shall comply with the MNB's central bank functions and responsibilities specified in the MNB Act. Further to the above, the MNB may only pursue other activities based on statutory authorisation, without prejudice to the achievement of its primary objective and the performance of the basic tasks listed above.

In the spirit of central bank independence and within the framework provided by the MNB Act, the Bank independently defines the monetary policy aimed at achieving and maintaining price stability and the instruments for implementing such policy. Such instruments include, within the scope of its bank account management, accepting deposits and, subject to the restrictions set forth in the MNB Act, lending based on adequate collateral; buying and selling securities as well as acting as an intermediary of securities in the spot and derivative markets within the framework of open market operations and repurchase agreements; issuing its own securities; influencing and setting exchange rates and interest rates; discounting (rediscounting) securities; regulating minimum reserves or using other central bank instruments.

2.2 THE BODIES AND MANAGEMENT OF THE MNB

The MNB operates as a single-member business entity. The general rules pertaining to companies limited by shares, namely the provisions of Act IV of 2006 on Business Associations apply to the MNB, with due consideration for the derogations set forth in the MNB Act.

The Hungarian State as shareholder is represented by the minister responsible for state budget. The MNB operates without a General Meeting.

The **shareholder** is entitled to make decisions, by way of a shareholder's resolution, on the establishment of and amendment to the Statutes as well as the election, dismissal and remuneration of the auditor. From 1 January 2012, certain issues formerly belonging to the competence of the shareholder, such as the establishment of the accounting report of the MNB and taking the decision on dividend payment, belong to the scope of competence of the Executive Board.

As a guarantee of independence, contrary to the practice of other companies limited by shares, the remuneration of the MNB's Governor, Deputy Governors and other members of the Monetary Council as well as the members of the Supervisory Board are determined by the MNB Act rather than the shareholder.

Similarly, bodies of the MNB are specified by the MNB Act as follows: Monetary Council, Executive Board, Supervisory Board.

Regarding the duties defined by the MNB Act, the supreme decision-making body of the MNB is the **Monetary Council.**

The scope of competence of the Monetary Council includes:

– strategic decisions relating to the basic tasks, as defined by the MNB Act, such as: decisions on the reserve ratio and the rate of interest to be paid on reserves, decisions on the exchange rate regime, and decisions on the central bank tasks related to the identification and management of systemic risks, including decisions on providing loans as lender of last resort for credit institutions as well as decisions on the allocation of loans to the National Deposit Insurance Fund;

– decisions on any other issues that the MNB Act refers to the exclusive competence of the Monetary Council.

Members of the Monetary Council are: the Governor of the MNB, as the Chairman of the Monetary Council, the Deputy Governors of the MNB and members elected by Parliament for six years. The Monetary Council has at least five and a maximum of nine members.

At the first meeting of each year, the Monetary Council elects a Deputy Chairperson from among the Deputy Governors of the MNB, who substitutes the Chairman – except in issuing decrees – if the latter is unable to attend. In 2012, Deputy Governor Ferenc Karvalits was elected Deputy Chairman.

In 2012 the members of the Monetary Council were:

– András Simor, Governor, Chairman of the Monetary Council,
– Ferenc Karvalits, Deputy Governor, Deputy Chairman of the Monetary Council,
– Júlia Király, Deputy Governor,
– Andrea Bártfai-Mager,
– Dr Ferenc Gerhardt,
– Dr János Béla Cinkotai,
– Dr György Kocziszky.

The MNB Act also defined a new operational model: it introduced a corporate governance and decision-making mechanism, thus eliminating the sole responsibility of the Bank's Governor for implementing the decisions of the Monetary Council and for managing the Bank's operation.

This change required, throughout the entire governance structure of the Bank, a review of the decision-making procedure as well as the scopes of responsibilities, competences and authorities, and a restructuring of the operational governance model, which was carried out within the deadline set forth by the MNB Act.

Prior to establishment of the Executive Board on 29 March 2012, pursuant to the MNB Act, the Governor of the MNB – or the person acting on his behalf – exercised competences of the Board in accordance with the provisions of law in force on 31 December 2011.

In accordance with the MNB Act, responsibility for implementing the Monetary Council's decisions and managing the operations of the MNB rests with the **Executive Board.**

The scope of competence of the Executive Board shall include:

- managing implementation of the decisions of the Monetary Council;
- confirming the financial report of the MNB and issuing decisions on the payment of dividends;
- approving the draft report to be sent to the shareholder on the management and assets of the MNB;
- approving matters related to the organisation and internal management of the MNB;
- approving study plans and programmes relating to the operation of the MNB and the performance of its tasks, including the development and operating budget plans;
- managing the MNB's internal audit organisation in respect of tasks falling outside the scope of competence of the Supervisory Board, and discussing the observations of plans of the internal audit;
- amending the collective agreement in respect of employment rights and obligations, the exercise and performance of these rights and obligations, and the associated procedures; and
- making decisions on the account management rights of the Bank.

The members of the Executive Board, which is the executive body of the MNB, are the Governor, as the Chairman of the Board, and the Deputy Governors of the Bank.

Provisions relating to the functions and operational procedures of the Monetary Council and the Executive Board are set forth in the MNB Act, the Bank's Statutes, Organisational and Operational Rules as well as the rules of procedure formulated by these bodies.

In order to provide assistance to the MNB in achieving the objectives and fulfilling the duties defined in the MNB Act and in managing its operations, the Bank operates **committees in support of decision-making** with the task of supporting decision-making on issues that fall within the competence of members of the Executive Board, as defined in the Executive Board's rules of procedure.

The responsibility of the **Financial System Oversight Committee** is to support – through preparatory work, proposals and opinions – central bank decisions (within the competence of the Board member designated in the Board's rules of procedure and acting as the Chairman of the Committee) related to the functioning of the financial intermediary system, the financial markets and financial infrastructure.

By performing the necessary preparatory work and putting forward proposals and opinions, the **Asset-Liability Committee (ALCO)** supports decision-making (within the competence of the Board member designated in the Board's rules of procedure and acting as the Chairman of the Committee) related to the Bank's foreign exchange activities that affect the Bank's balance sheet.

By performing the necessary preparatory work and putting forward proposals and opinions, the **Owners' Committee** supports central bank decision-making (within the competence of the Board member designated in the Board's rules of procedure and acting as the Chairman of the Committee) in the course of exercising certain decision-making powers affecting the Bank's investments.

In addition to the auditor appointed by the shareholder, the MNB is also audited by the State Audit Office and the Supervisory Board.

The supervisory competence of the **State Audit Office** in relation to the MNB is set forth in the Act on the State Audit Office. The State Audit Office audits the financial management of the MNB and its activities carried out pursuant to the provisions of the MNB Act and not included in the basic tasks. In this regard, the State Audit Office examines if the MNB operates in accordance with the applicable law, its Statutes and the shareholder's resolutions.

Prior to putting forward a proposal for the election or dismissal of the **MNB's auditor,** the President of the State Audit Office shall be consulted. The shareholder decides on

Members of the Monetary Council of the Magyar Nemzeti Bank

Ferenc Karvalits
Deputy Governor with general responsibilities, Deputy Chairman of the Monetary Council

András Simor
Governor,
Chairman of the Monetary Council

Júlia Király
Deputy Governor,
Member of the Monetary Council

Andrea Bártfai-Mager
Member of the Monetary Council

Dr Ferenc Gerhardt
Member of the Monetary Council

Dr János Béla Cinkotai
Member of the Monetary Council

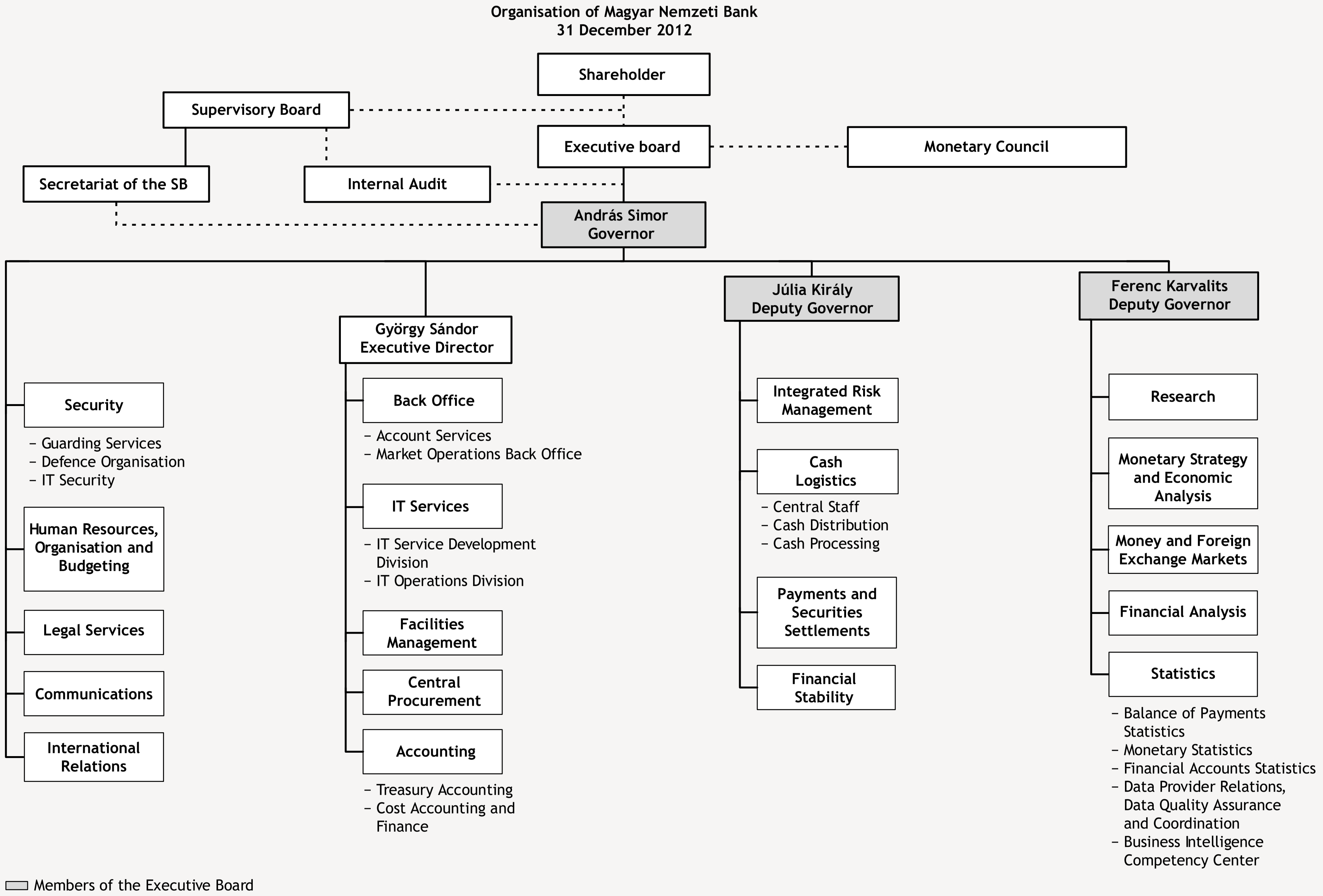
Dr György Kocziszky
Member of the Monetary Council

Members of the Supervisory Board of the Magyar Nemzeti Bank

Left to right: István Varga, László Madarász, Zsigmond Járai (Chairman), Dr Róbert Thuma (until 15 November 2012), Dr Péter Róna, Dr Gábor András Szényei, Dr Tamás Katona, Roland Nátrán (until 30 June 2012).

Left to right: Dr Gábor András Szényei, László Madarász, Dr Csaba Kandrács (from 16 November 2012), Dániel Palotai (from 1 July 2012), Zsigmond Járai (Chairman), Dr Péter Róna, István Varga, Dr Tamás Katona.

Organisation chart



Members of the Magyar Nemzeti Bank's Management Committee (until 28 March 2012) and Executive Board (from 29 March 2012)

András Simor
Governor

Ferenc Karvalits
Deputy Governor with general responsibilities

Júlia Király
Deputy Governor

György Sándor
Executive Director
Member of the Management Committee
(until 28 March 2012)

Dr Zsuzsanna Arnold Csenterics
Director
Human Resources, Organisation and Budgeting
Member of the Management Committee
(until 28 March 2012)

the appointment, dismissal and remuneration of the auditor by way of a shareholder's resolution.

As set forth in the MNB Act, the **Supervisory Board** is the body responsible for the continuous supervision of the MNB on behalf of the owner. The supervisory competence of the Supervisory Board defined by the MNB Act excludes the supervision of the Bank's performance of its basic tasks and the impact thereof on the MNB's profit and loss. Accordingly, the report it is required to prepare pursuant to the Act on Business Associations in respect of the annual report prescribed in the Accounting Act is subject to these restrictions.

The members of the Supervisory Board defined in the MNB Act are its Chairperson elected by the Parliament, further 3 members elected by the Parliament as well as a representative of the minister responsible for the state budget and an expert appointed by the minister responsible for the state budget.[3] The Chairman of the Supervisory Board, who is elected by the Parliament, is nominated by the governing parties, whereas the other members elected by the Parliament are nominated by the parliamentary groups.

The members' term of office coincides with the mandate of the Parliament.

In 2012, the members of the Supervisory Board of the MNB were:

- Zsigmond Járai, Chairman,
- Dr Tamás Katona,
- László Madarász,
- Dr Péter Róna,
- Dr Gábor András Szényei,
- István Varga,
- Roland Nátrán (representative of the minister responsible for the state budget until 30 June 2012),
- Dániel Palotai (representative of the minister responsible for the state budget as of 1 July 2012),
- Dr Róbert Thuma (expert appointed by the minister responsible for the state budget until 15 November 2012).
- Dr Csaba Kandrács (expert appointed by the minister responsible for the state budget as of 16 November 2012).

Neither the State Audit Office nor the Supervisory Board is entitled to supervise activities qualifying as basic central banking tasks.

2.3 ORGANISATIONAL STRUCTURE OF THE BANK

The organisational objective of the Bank is to be excellent, both in terms of professionalism and operational conditions, and to be among the best central banks. The motto of its strategy adopted in 2007 is 'The Magyar Nemzeti Bank for Stability'. Accordingly, the most important task of the Bank is to ensure the stability required for the proper development of the economy in the fields of price stability, stability of the financial intermediary system, the payment system and the legal tender as well.

There are 20 organisational units operating within the Bank under the control of the Governor, the two Deputy Governors and the Executive Director.

The organisational structure as of 31 December 2012 is shown in the **organisation chart.**

2.4 RELATIONS BETWEEN THE MNB AND THE EUROPEAN SYSTEM OF CENTRAL BANKS

Hungary's accession to the European Union also entailed the MNB's membership in the European System of Central Banks (ESCB). The ESCB comprises the European Central Bank (ECB), which was established in June 1998 with its seat in Frankfurt, and the national central banks of EU Member States. Its governing bodies are the Executive Board and the Governing Council, the latter consisting of the members of the ECB's Executive Board and the governors of the central banks of euro area Member States. The third decision-making body of the ECB is the General Council, which is responsible for maintaining an institutional relationship between the Eurosystem and the central banks of non-euro area Member States. Holding its meetings quarterly, the General Council comprises the President and the Vice-President of the European Central Bank (ECB) as well as the respective governors of the central banks of all EU Member States. The key responsibilities of the General Council include consultancy concerning preparations for accession to the euro area, approval of the convergence reports of the ECB and monitoring the functioning of ERM II. Within the framework of this latter activity, it assesses the sustainability of the bilateral exchange rate of non-euro currencies participating in ERM II against the euro, provides a forum for the alignment of monetary and exchange rate policies and the management of intervention and financing

[3] The provisions of the MNB Act pertaining to Supervisory Board members did not affect the mandate of Supervisory Board members conferred under the former MNB Act (Act LVIII of 2001).

mechanisms in ERM II. In addition, the General Council is involved in verifying whether the central banks of EU Member States and the ECB comply with the prohibition of monetary financing of the budget and privileged access of the public sector to financial institutions. The General Council also contributes to the ECB's advisory functions and to the collection of statistical information; it must be consulted in respect of any changes in the rules of accounting and financial data supply, as well as issues related to the adjustment of the ECB's key for capital subscription. The mandate of the General Council will expire on the date when all the Member States have adopted the euro.

In 2012, neither the number of ESCB members nor that of euro-area Member States changed. In view of the EU accession of Croatia in July 2013, the representatives of the Croatian Central Bank were granted an observer status in December 2011, allowing them to attend the meetings of the General Council and the ESCB committees.

ESCB members are also owners of the ECB. The respective ownership shares of Member States are determined according to their shares in GDP and total population of the EU (on the basis of statistical data compiled by the European Commission). Since 29 December 2010, the ECB's capital has been EUR 10.76 billion.

Currently, euro-area central banks subscribe to 70 per cent of the ECB's capital, while the remaining 30 per cent is divided among the central banks of non-euro area Member States. These latter central banks pay a pre-defined minimum percentage of their respective subscriptions to the ECB's capital as a contribution to the operational costs of the ECB that are incurred in connection with their ESCB membership. With effect from 29 December 2010, this contribution was defined as 3.75 per cent of the respective subscriptions (previously it was 7 per cent).

Since 1 January 2011, the share of the MNB (1.3856 per cent) in the ECB's capital and the amount of MNB's paid-up capital therein have not changed (remaining at EUR 5.591 million).

The ESCB Committees play an important role in the work of the ECB's decision-making bodies. The basic role of these committees is to prepare decisions and facilitate coordination as per the division of the various central bank duties, covering all areas of central banking operations from monetary policy through communication to statistical data reporting. Experts from the central banks of non-euro area Member States attend those committee meetings whose agenda includes items affecting the ESCB as a whole and which fall within the competence of the General Council. (For a detailed description of the ESCB Committees and the activities of the various fora assisting them, see Chapter 3.11). The committees meet and discuss current issues relevant to their professional areas 4-5 times a year on average, according to a schedule determined for a year in advance.

The senior executives and relevant experts of the MNB continue to play an active role in the activities of these committees and their working groups. In 2012, the ESCB committee work continued to be a very useful forum for exchange of professional experience.

3 Review of the MNB's performance in 2012

3.1 MONETARY POLICY

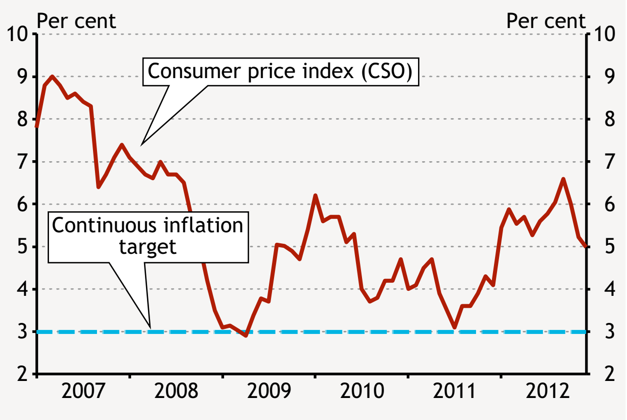
Monetary policy framework

Pursuant to Act CCVIII of 2011 on the Magyar Nemzeti Bank (hereinafter referred to as: the MNB Act), the primary objective of the Bank is to achieve and maintain price stability. To further the goal of price stability, since 2001 monetary policy has been determined by the MNB within the framework of inflation targeting. Under the inflation targeting regime, the Monetary Council of the MNB determines a numerical value for the inflation target in line with price stability, and the monetary policy it conducts is aimed at achieving the pre-defined inflation target. The continuous inflation target of the MNB is 3 per cent. This level is low enough to minimise the social welfare-related costs of inflation, while at the same time providing protection against the risk of deflation.

Trends in inflation in 2012

Average annual inflation was 5.7 per cent in 2012. In evaluating the achievement of the inflation target, fluctuations stemming from unexpected shocks must also be taken into account. Therefore, a consumer price index deviating from the 3 per cent target by not more than ±1 percentage point is ex post acceptable in terms of price stability. In 2012 as a whole, inflation considerably exceeded the 3±1 per cent tolerance band.

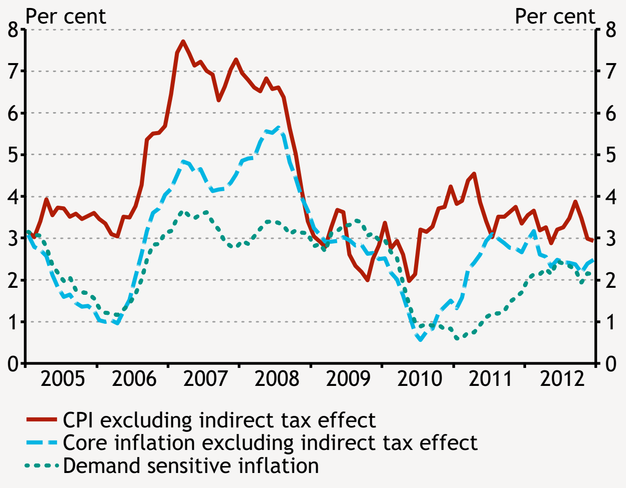
Chart 1
Inflation target and inflation developments



Source: CSO and MNB.

Inflation of items that can be influenced by monetary policy has been low since the beginning of the crisis, but it could not completely offset the inflationary pressure attributable partly to tax increases and partly to non-core inflation items. Inflation considerably above the target in 2012 is primarily due to the indirect tax increases (according to the releases of the Central Statistical Office these caused a 2.2 percentage point rise in the annual index) and the drought. Measures capturing underlying inflation continued to signal low demand-side inflationary pressure. Another consequence of the tax increases was that the indicators measuring the inflation expectations of households and analysts fluctuated near the high pre-crisis levels, and uncertainty associated with the expected inflationary environment was also high.

Chart 2
Range of underlying inflation indicators



Source: MNB.

A more detailed analysis of inflation developments reveals that the indicators capturing underlying inflation remained below the pre-crisis level, but exceeded the figures of the 2010–2011 period to some extent. This may suggest that as a result of the prolonged economic crisis some surplus

Table 1
The consumer price index and its components
(percentage change, year-on-year)

	2010	2011	2012	2012			
				Q1	Q2	Q3	Q4
Core inflation	3.0	2.7	5.1	5.1	4.9	5.2	5.0
Unprocessed food	6.6	4.3	6.8	–1.0	1.7	12.2	14.2
Fuel and energy	18.1	13.8	11.9	15.3	14.4	12.5	5.5
Regulated prices	6.2	4.0	4.7	5.4	4.7	4.9	4.0
Consumer price index	4.9	3.9	5.7	5.6	5.5	6.1	5.4
CPI excluding indirect taxes and subsidies	2.6	3.8	3.5	3.6	3.3	3.8	3.3

Note: In the case of price indices with unchanged tax content, the CSO adjusts the consumer price index for the technical effect of changes in indirect taxes. The time series of certain inflation groups may differ, even retroactively, from those published in earlier years due to the reclassification of some partial items at the beginning of 2012.
Source: CSO and MNB.

capacities were closed, and therefore the disinflationary effect of weak domestic demand declined somewhat. It is also worth highlighting that in 2012 the indirect tax increase implemented at the beginning of the year enabled a coordinated price increase, with companies believed to have brought forward price increases. This may be reflected in the surge in service price inflation early in the year, which gradually faded later in the year. A similar pattern can be observed in the change in tradable inflation, where the higher index at the start of the year was also attributable to the depreciation of exchange rate in the second half of 2011, in addition to coordinated price increases. The unfavourable weather caused a substantial increase in food prices sensitive to cost shocks. However, the slow pass-through of cost shocks into processed food prices leads to the conclusion that falling household demand may restrict the price-increasing efforts of producers and retailers also in the case of food prices.

The fiscal policy measures taken in 2012 also increased the price index to a considerable degree. At the beginning of the year, the VAT and excise tax increase, and in the middle of the year the tax levied on telecommunication services and the further increase in excise tax on tobacco resulted in a significant rise in consumer prices. While the tax measures caused direct prices increases, fiscal policy also indirectly contributed to rising inflation. In a deteriorating economic environment, the increase in administrative wages not subject to compensation materially raised the cost of labour per unit of output, which may have exerted inflationary pressure from the cost side. At the same time, similarly to 2011, the change in regulated prices also remained moderate in 2012, which lowered the inflation rate.

Monetary policy

One of the basic characteristics of monetary policy decisions is that they affect consumer prices only with a lag of several quarters. Consequently, it is essential to take a forward-looking approach in decision-making and to estimate the most probable outcome of economic developments. Under the inflation targeting regime, decision-makers primarily rely on quarterly macroeconomic forecasts prepared for a two-year time horizon. Monetary policy also aims to ensure that the achievement of its inflation target does not entail an unreasonably high sacrifice in terms of the real economy. For this reason, it typically does not respond to the direct short-term inflationary impact of cost shocks, such as indirect tax increases and oil prices, but aims to prevent second-round effects evolving over a longer period of time.

Global risk aversion, which became more pronounced in the second half of 2011, as well as the unfavourable perceptions of domestic financial market assets limited the room for the monetary policy to a significant degree. Whilst the financial market environment also remained adverse at the start of 2012, the Monetary Council established that the base rate, which had risen to 7 per cent by the end of 2011, was high enough to preserve the stability of domestic financial markets. Based on the forecast in the March issue of the *Quarterly Report on Inflation*, the Monetary Council was of the opinion that weak demand justified easing, while the inflationary processes required a cautious monetary policy. During the first few months of the year, consumer prices grew more than expected, which was due partly to the strong pass-through of indirect tax increases and the passing-on some of the costs of the weak exchange rate and rising raw material prices by companies facing deteriorating profits, despite subdued domestic demand. In its press release following the interest rate decision in March, the Monetary Council made the launching of the reduction cycle dependent on developments in underlying inflation and an improvement in risk perceptions.

Data in the second quarter indicated a substantial deterioration in growth prospects. The unfavourable inflation trends from the beginning of the year did not continue, partly owing to a decline in global commodity prices. Nevertheless, inflation prospects worsened temporarily. In order to stabilise the budget, the government announced a new package of measures in April. Some of the measures increased the production costs of companies, which would be gradually incorporated into consumer prices. Having weighed the above, the Monetary Council decided not to change the base rate in the second quarter, either. In its press release published in June, the Council pointed out that the volatile risk environment and the rate of inflation remaining persistently above the target warranted a careful monetary policy, and interest rates would not be reduced unless risks diminished.

In the third quarter, financial and macroeconomic developments deepened the monetary policy dilemma. Substantial improvement in risk perceptions and ongoing deterioration in real economic prospects warranted looser monetary conditions, whereas the failure of inflation to fall despite weak demand pointed to an unchanged monetary policy. Weighing these factors, after maintaining interest rates in July, the Monetary Council decided to start the interest rate reduction cycle in August. In its statement released in September, the Monetary Council explained that the medium-term prospects for inflation played a key role in interest rate decisions. Most Council members felt that – despite the slowdown in potential growth – the economy was still characterised by a substantial degree of surplus capacity. Consequently, weak domestic demand would significantly mitigate the inflationary effects of cost shocks, and after their fading the inflation target would be met. In its opinion issued in September, the Monetary Council pointed out that it would consider a further reduction in interest rates if the improvement in financial market sentiment continued and medium-term upside risks to inflation remained moderate.

In the fourth quarter, global risk sentiment continued to improve, reducing Hungarian risk premia and expanding the room for monetary policy to a substantial extent; this made it possible to continue the interest rate reductions. In the statement published in December, most members of the Monetary Council were convinced that the high level of idle capacities would offset the medium-term inflationary risks. In the weak demand environment, the corporate sector was compelled to adjust to the cost-increasing effects of government measures with moderate pricing. In its December statement, the Monetary Council indicated that it would consider a further reduction in interest rates only if the improvement in financial market sentiment continued and incoming data confirmed that the inflation target was achievable on the horizon relevant for monetary policy.

Changes in monetary policy instruments

Forint market instruments

New instruments

In order to strengthen the lending capacity of banks, on 15 February 2012 the Bank announced two new liquidity-providing monetary policy operations: the MNB was prepared to counter the weakening lending capacity of banks observed in the past period partly by means of a two-year collateralised loan and partly by launching a universal mortgage bond purchase programme. Furthermore, the MNB widened the range of eligible collateral accepted for its lending facilities.

Two-year loan

Since 3 April 2012, the Bank has provided the option of a two-year loan for credit institutions on the first working Tuesday of each calendar month so that they can strengthen their balance sheet by improving their maturity matching. The MNB eased the conditions on this loan instrument as of 2 October 2012. Since then, during the term of the loan the borrower is required to keep the sum of its outstanding loans to non-financial corporations reduced by domestic commercial real estate loans and its net refinancing loans to non-financial corporations at least at the level of 30 June 2012. At the same time, the Bank introduced a limit system and mitigated the sanctions to be imposed in the event of non-compliance with the tender conditions.

By the end of the year, the MNB had allocated collateralised, variable rate loans in a total amount of HUF 122 billion to credit institutions at an interest rate cost equivalent to the central bank base rate effective during the term of the loan. The moderate use of the instrument is partly due to the low willingness of banks to lend. Another reason is that their liquidity considerably improved as compared to the beginning of 2012, which is also underpinned by the fact that according to the MNB's lending surveys from the second quarter of 2012 the liquidity of credit institutions did not substantiate the tightening of lending conditions.

Therefore, until willingness to lend becomes stronger, the two-year loan will primarily have a protective function.

Mortgage bond purchase

The Bank is trying to contribute to the stimulation of retail lending by launching a universal mortgage bond purchase programme. Based on experience from the Bank's programme operated in 2010, using primary market purchases the MNB can only provide efficient assistance to raising bank funds related to HUF mortgage loans if willingness to issue is at an adequate level. In this respect, a major step forward would be if the universal right to issue mortgage bonds was granted by law.

Collateral

To increase the liquidity buffer of credit institutions, from 16 April 2012 the MNB widened the range of collateral eligible for the Bank's lending operations:

– in the case of certain securities foreign exchange denomination is allowed in addition to the formerly exclusive option of forint denomination;

– requirements regarding the credit rating of the issuer of the security became less rigorous;

– corporate bonds and HUF-denominated mortgage bonds traded on regulated markets other than the Budapest Stock Exchange (BÉT) and on non-regulated markets accepted by the MNB are eligible collateral for the MNB's lending operations.

The newly accepted securities enlarged the scope of collateral by some HUF 150 billion. In order to keep the risks it assumes at a low level, the MNB modified the acceptance ratio applied to daily collateral valuation as of 16 April 2012.

Forint liquidity management of the banking system

Since the two-week central bank bill, the Bank's key policy instrument, is also an instrument for absorbing surplus liquidity, optimally the banking system ties down its surplus liquidity in the two-week bill and only makes use of overnight central bank deposits to a small extent. In the period following the crisis in 2008, due to cautious liquidity management the banking system has been continuously using the MNB's overnight deposit instrument and to a considerable degree. However, in the second half of 2012 this attitude was not so overcautious. This was reflected, for example, in credit institutions' practice observed in the last several months, in which the balance they kept on their settlement accounts and thus their reserve surpluses at the beginning of each month were far lower than usual.

In November 2012, after the scheduled review of compulsory reserve ratios variable on a semi-annual basis, the average required reserve ratio of the banking system as a whole increased to 2.84 per cent. The main goal of the flexible required reserve system is to reduce further the volatility of short-term interbank rates via the averaging mechanism.

Instruments providing foreign exchange liquidity

Foreign exchange tenders

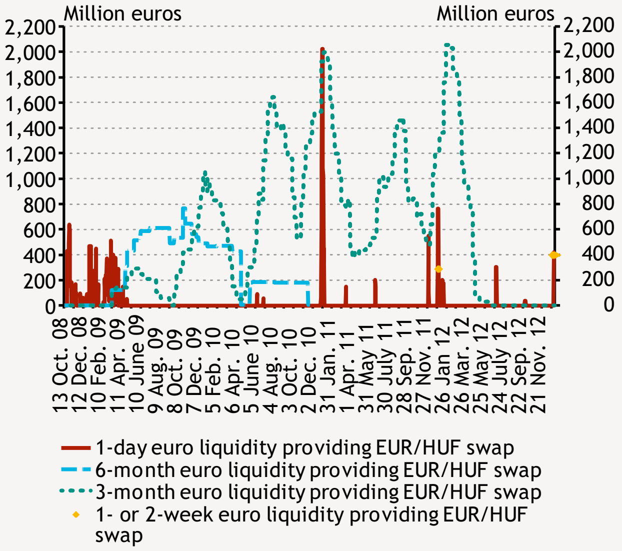
On 27 February 2012 the euro sale tenders related to the early loan repayment scheme were closed. From 3 October 2011, the MNB held foreign currency tenders on a weekly basis, with a total amount of HUF 810 billion in euros allocated to credit institutions. They bought euros equivalent to as much as HUF 781 billion from the Bank, and on 12 March they redeemed the remaining amount, which they had allocated to the MNB by means of an overnight and continuously renewed FX swap, at the Bank. The purpose of the foreign currency tenders was to protect the forint exchange rate and to lower the risks of credit institutions arising from early loan repayment.

The MNB operated a new foreign currency sale tender between 15 May and 15 June. Credit institutions were given an opportunity to buy the euros required for the conversion into forints of foreign currency denominated loans with overdue instalments, as prescribed by law, also with the primary aim of protecting the exchange rate and reducing the risk of credit institutions. This latter scheme represented a lower burden on the Bank's foreign exchange reserves than the previous one: credit institutions reported conversions of EUR 178.1 million out of the total EUR 438 million foreign exchange loans eligible for the scheme to the MNB, and the MNB allocated a total amount of EUR 36 million to the banking system for this purpose.

FX swap instruments

As a result of sharply rising FX swap spreads, at the end of January 2012 the outstanding amount of the EUR/HUF FX swap facility providing three-month euro liquidity rose to a historic peak, reaching EUR 2,055 million. Later, as market conditions stabilised, this outstanding amount faded and completely ceased to exist by June. The banking system used the EUR/HUF instrument providing overnight euro liquidity not only in January, but also in June, September and December, due to the soaring market premia relating

Chart 3
Recourse to the MNB's FX swap instruments – outstanding amounts



Source: MNB.

to the closing of positions at the end of calendar quarters. Similar to 2011, the Bank announced a short-term, two-week euro liquidity providing EUR/HUF FX swap facility at the end of 2012, with a total amount of EUR 400 million allocated to the banking system. On the whole, parallel with the decline in the sovereign CDS spread of Hungary, the premium of currency interest rate swaps with a maturity over one year also fell.

3.2 STABILITY OF THE FINANCIAL INTERMEDIARY SYSTEM

Under the MNB Act, the MNB – in co-operation with other competent authorities (particularly with the Hungarian Financial Supervisory Authority [PSZÁF] and the Ministry of National Economy) – supports the efficient development and conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial intermediary system. To this end, it explores the business and economic risks to the financial intermediary system as a whole, promotes the prevention of the development of systemic risks, and mitigates or eliminates systemic risks which have evolved. The Bank discloses a summary of its regular work aimed at revealing risks to financial stability and its recommendations for a possible reduction in such risks in its stability report.

Therefore, in 2012 the Magyar Nemzeti Bank published its *Report on Financial Stability* (hereinafter referred to as: Stability Report) twice and the results of its lending survey in each quarter. In 2012, some of the threats to the domestic financial system declined, and thus the shock-absorbing capacity of the liquidity and capital of the Hungarian financial system was satisfactory; however, it fulfilled its function as the intermediary of financial resources to a rather limited degree, as it exerted a strongly procyclical effect on corporate lending due to low willingness to lend. The risks identified in the external environment and the internal operation of the financial system are likely to sustain this contraction effect and may weaken the currently adequate shock absorption capacity. The Stability Report of November 2012 was renewed in terms of its methodology: the present state of financial stability was assessed on the basis of four key financial stability indices.

The MNB Act adopted at the end of 2011 granted a macroprudential mandate for the Bank in accordance with best international practice. With these powers, the Governor of the MNB was authorised to issue decrees on the basis of the decisions of the Monetary Council – exclusively in areas not regulated in acts or government decrees – in order to prevent the build-up of systemic risks or to reduce risks. To fulfil its statutory function, in 2012 the MNB started to elaborate a framework for Hungary's macroprudential policy strategy, mapped out the possible directions for enlarging the set of macroprudential tools, and elaborated concepts for the completion of macroprudential tasks, taking account of the recommendations of the European Systemic Risk Board (ESRB).

This year, the Bank continued to assist the work of the Financial Stability Board (FSB). The Board is made up of the Minister for National Economy, the President of the Hungarian Financial Supervisory Authority, and the Governor of the MNB. In the course of 2012, they regularly reviewed the key financial stability risks detected in the Hungarian financial system, the regulatory tasks concerning the financial intermediary system, the proposal package on the banking union elaborated by the European Union, and the prevailing issues relating to bank resolution in Hungary.

Key developments in the financial intermediary system

The MNB published its Stability Reports on 26 April and 5 November 2012. In the new Stability Report of November 2012, the Bank performed and presented the assessment of the state of financial stability on the basis of four key financial stability indices. These indices reflect a current state, and therefore they do not always carry information in respect of future risks that may jeopardise financial stability. Therefore, qualitative aspects have still been used for the assessment of financial stability risks. The group of indices can be divided into two parts: indices measuring the

Chart 4
Financial Stability Heat Map

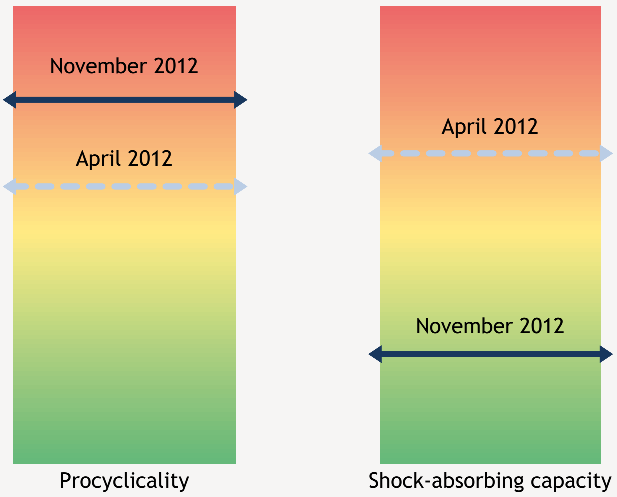
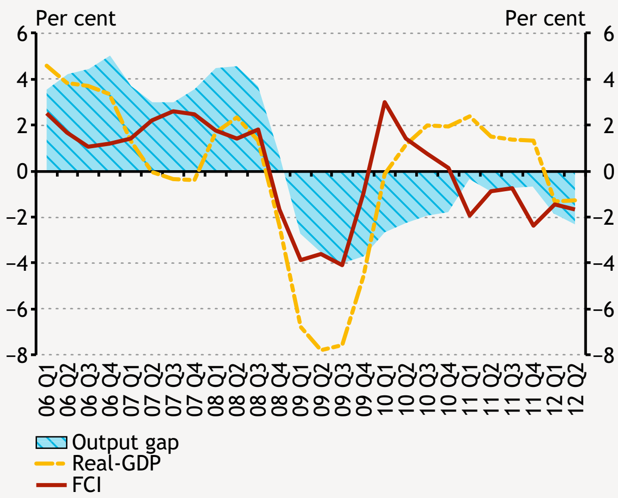


Chart 5
Financial Conditions Index (FCI), real GDP and output gap



Note: If the sign of the FCI is identical to that of the output gap, the banking sector behaves procyclically. The FCI refers to contribution to economic growth; if it is negative, it decreases, if it is positive, it increases GDP.

economic growth supporting function of the financial system (procyclicality) and its shock-absorbing capacity.[4] Resilience to shocks is approximated by the lowest value of three partial indicators (System-wide Financial Stress Index [SWFSI], Liquidity Stress Index [LSI], and Solvency Stress Index [CSI]).[5] The first heat map showing procyclicality can be calculated on the basis of the Financial Conditions Index [FCI], while the second heat map describes the shock-absorbing capacity based on the lowest level of the three indicators specified above.

The financial system functions adequately if it is resilient to shocks and supports economic growth via lending. The resilience of the Hungarian financial system in terms of liquidity and capital is adequate, but its is only performing its function as a financial intermediary to a very limited extent, as its low willingness to lend is having a strongly procyclical impact on corporate lending.

The MNB identified the fact that the domestic banking system does not support economic growth as a financial stability risk. The value of the FCI – which shows the extent to which the financial intermediary sector (banking system) contributes to the annual growth rate of real GDP – shows that the banking system is strongly procyclical. The FCI exhibits a highly negative value, while the output gap is also negative. The financial system is contractionary, which means that it is exacerbating the economic downturn through the tight credit supply.

Tight credit conditions, particularly in the corporate segment, have led to a long period of subdued lending. The two most recent Lending Surveys indicated that the reason for further tightening is the banks' lower willingness to lend rather than deterioration in their lending capacity (i.e. liquidity and capital position). The banks explained the increasingly tight conditions with the economic prospects and industry-specific problems. In addition, subdued credit demand caused by the drop in corporate investment and weakening business sentiment point to a further contraction in lending.

In contrast to corporate lending, household lending is dominated by demand factors. Weak household credit demand is related to the uncertain income outlook and deleveraging by households. As a result of the over-indebtedness arising before the crisis, households' willingness to borrow is at a rather low level now. In the household sector, according to the Lending Surveys, conditions for household loans became less tight in the second and third quarters of 2012, which means a slight adjustment from the extensive tightening at the end of 2011. In the future, credit supply factors may continue to improve, particularly in the mortgage loan market, owing to the new government-subsidised mortgage facilities further modified to meet the requirements at the beginning of

[4] Financial stability risks are low if procyclicality is low, i.e. the banking system does not hinder, but rather facilitates economic growth, and its shock-absorbing capacity is high, i.e. it is capable of absorbing external shocks in a way that its operation remains undisturbed.
[5] For a description of the index family, see MNB (2012), "Methodological description of key financial stability indices", *Report on Financial Stability*, November.

2013, offered with interest costs 4-5 percentage points lower than current market rates for the first four to five years of the mortgage term.

In the first half of 2012, the ratio of non-performing loans continued to rise both in corporate and household lending. In the case of corporate loans, this was the result of portfolio deterioration, and portfolio cleaning still remains sluggish. Within the corporate portfolio, the ratio of loans 90 days past due fell slightly in the third quarter following a sharp increase in the first half of the year. Because of the rising level of non-performing loans, it is becoming increasingly important to provide adequate loan loss coverage. This reduces the risk of financing, as well as the risk of substantial losses the banking sector may be exposed to in the event of a potential shock. Mainly in the case of project loans and restructured foreign currency mortgage loans, loan loss provisioning and the value of collateral indicate inadequate coverage.

In the household sector, portfolio quality suffered considerable deterioration during the first half of the year as a result of the contraction in the outstanding stock caused by the early repayment scheme. For the first time in a long period, the ratio of non-performing loans dropped in the household portfolio in the third quarter. The government programmes played a key role in this decline, and so did the conversion of loans into forints executed by the banks within their own competence. In 2012, a new comprehensive scheme was launched, and the government involved the MNB in its elaboration. The key elements of the programme were the exchange rate cap and the conversion of non-performing foreign currency-denominated mortgage loans into forints. In the framework of the conversion of non-performing loans into forints, the banks converted loans worth HUF 23 billion into forints (17.5 per cent of eligible loans). In addition, some banks converted loans into forints along with debt cancellation also outside this scheme in return for a bank tax allowance, which involved loans worth HUF 25 billion. The value of loans converted into forints totalled HUF 48 billion, which is 6.4 per cent of all non-performing loans. The conversion scheme had a positive impact on non-performing loans partly because some debts were cancelled, and partly because some loans became performing again. Similarly, the increasing use of the exchange rate cap resulted in an improvement. At the end of November loans involved in the exchange rate cap facility exceeded HUF 800 billion, which is 28 per cent of eligible foreign currency-denominated loans, also including restructured loans. The operation of the National Asset Management Agency still has a marginal effect, since the contracts are in the preparatory stage.

The profitability of the Hungarian banking sector is very low, representing a competitive disadvantage in the regional allocation of funds. The pre-tax profit of the banking sector at end-September 2012 amounted to HUF 6 billion, well below the profit of HUF 109 billion recorded in the previous year. The ROE and ROA profitability indicators are still in negative territory, and profitability is also extremely low in an international comparison, which continues to cause a substantial comparative disadvantage in terms of profitability. Profitability within the banking system shows a remarkable asymmetry. 53 per cent of all positive results were achieved by three banks, while the three most unprofitable banks produced 79 per cent of the total gross loss of the banking sector. At the same time, the interest rate margin of the domestic banking sector is relatively high in international comparison, implying that if costs decrease the Hungarian banking sector may regain its competitiveness in the region over the medium term. Looking ahead, two negative factors emerged in terms of profitability: first, the bank levy will be of the same amount in 2013, second, the risk of additional loan loss provisioning needs on outstanding loans is elevated.

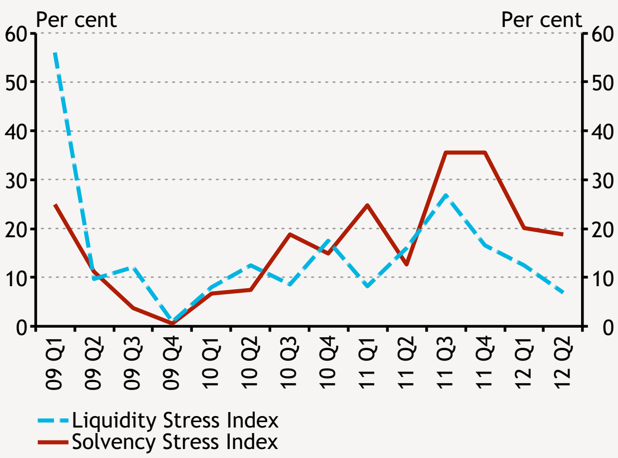
At present, banks are attempting to partially offset rising loan losses by increasing interest rate margins. This, however, is not sustainable in the long run. In a regional comparison, the interest margin of the Hungarian banking sector is the highest. Rising interest rate margins imply higher debt servicing burdens for non-defaulted bank customers, which feeds back into the deteriorating portfolio quality and impairs consumption and economic growth. This may lead to the development of a negative spiral: the poorer portfolio quality and the rising interest rate margins meant to offset it may reinforce one another. This is not a sustainable process.

Outflows of external funds from the domestic banking sector continue at a dynamic pace, while the reliance of the banking sector on the swap market remains high despite moderating. Parent banks are characterised by two kinds of behaviour due to the preservation of financial stability and deleveraging: while they are implementing recapitalisations (EUR 2.4 billion since early 2009), they withdraw external funds from their subsidiaries to a larger extent (from the beginning of 2009 to September 2012 EUR 10 billion and EUR 16 billion outflow of parent bank and total external funds, respectively). The outflow of external funds continue at a rapid pace. However, unlike at the end of 2011, this has not led to liquidity tensions, due to the appreciation of the forint, decreasing FX swap exposure and the drop in CDS spreads. The outflow of external funds is partly a natural process, because the decrease in household foreign exchange loans leads to a lower level of reliance on external funds. However, external funds decline faster than what is fundamentally reasonable, so it is not only a consequence, but also a cause of the downturn in lending. Strong outflow contributes to the shrinking of corporate lending. Stopping this trend and stimulating corporate lending are of key significance for the potential growth of the economy.

Banks' capital position improved further in 2012, with the overall capital adequacy ratio rising from 13 per cent at the end of December 2011 to 14.7 per cent in September 2012. This increase is basically the result of capital injections and the contraction in lending, while the negative result had an adverse effect. Although the sector-level capital adequacy ratio is nearly double the regulatory minimum, capital buffers remain highly concentrated, while internal capital accumulation is weak.

The Solvency Stress Index (SSI), which provides for the comparability of stress tests over time, declined markedly. The index is forward-looking, as it takes into account the higher tax burdens of banks, and expects a higher loan loss coverage ratio for non-performing loans than the current level. The Liquidity Stress Index (LSI) also shows a low value. This means that upon the occurrence of the stress scenario the balance sheet coverage indicator of the banking sector would be only slightly below the 10 per cent regulatory minimum. It is favourable that no bank would fall below zero, i.e. all banks would remain liquid even in a stress situation.

Chart 6
Liquidity Stress Index and Solvency Stress Index



Note: The Liquidity Stress Index is the sum of normalised liquidity deficits relative to the 10 per cent level, weighted by the balance sheet total. The higher the value of the index, the higher the liquidity risk in the stress scenario. The Solvency Stress Index is the sum of normalised capital shortages relative to the 8 per cent level, weighted by the capital requirement. The higher the value of the index, the higher the solvency risk in the stress scenario.

Regulatory proposals by the MNB and participation in the implementation of regulations

The MNB Act adopted at the end of 2011 granted a macroprudential mandate for the MNB in accordance with best international practice. With these powers, the Governor of the MNB was authorised to issue decrees on the basis of the decisions of the Monetary Council – exclusively in areas not regulated in acts or government decrees – and to regulate measures to be taken in order to prevent the accumulation of systemic risks or to reduce these risks:

– regulations preventing excessive outflows of loans,

– liquidity requirements preventing the build-up of systemic liquidity risks,

– timing structure and operating conditions of counter-cyclical capital buffers,

– additional requirements reducing the probability of the bankruptcy of systemically important financial institutions.

In line with its statutory duties, the MNB began to elaborate the framework of the domestic macroprudential strategy in 2012. The Bank mapped out the possible directions for enlarging the set of macroprudential tools, and elaborated concepts for the completion of macroprudential tasks, taking account of the recommendations of the European Systemic Risk Board.

Based on its macroprudential responsibility, in 2012 the MNB identified a critical factor that required a more detailed analysis: the high foreign exchange swap holdings of the banking sector within the scope of systemic liquidity risks. In relation to a potential macroprudential decree, it analysed the driving forces behind the risk, the probability and expected effects of an increase in risk exposure, the possible regulatory instruments, and the foreseeable costs of such regulation. Based on the Monetary Council's decision, the MNB called on banks to reduce and keep their off-balance sheet open foreign exchange positions below 15 per cent of their balance sheet total.

To strengthen financial stability, in 2012 the MNB continued to play an active role in regulatory work aimed at reducing the risks of the financial system. In addition to providing opinions on national legislative initiatives, it contributed to the preparation of a government decree on regulating credit institutions' liquidity level and maturity matching in foreign exchange positions. The Bank carried out analyses regarding the possible impacts of the introduction of the financial transaction tax and took part in discussions on the tax, where it presented its findings and represented its views.

At the Bank's proposal, a regulation responding to the problem of the unilateral setting of interest rates was introduced in 2012. Customers may be offered two types of loan facilities: mortgage loans tied to a reference interest rate with a premium that cannot be raised or loans with an interest rate fixed for a longer period (3-5 years). This caused a substantial change mainly in the case of newly allocated forint based household loans; the regulation did not take effect in the case of existing foreign-currency denominated mortgages, and the number of conversions to loan products at reference interest rates was negligible.

The Bank stressed the need for introducing personal bankruptcy on several occasions. A carefully formulated personal bankruptcy regulation may have a positive impact on financial stability by assisting debtors who are more or less able to pay their instalments in restoring their solvency and those who have become insolvent in starting a new life.

In 2012, the Bank initiated the development of a legal framework for the regulation of crisis management in Hungary. In this respect, it reviewed the draft guidelines of the European Commission on the recovery of credit institutions in financial crises and made proposals regarding the possible directions of national regulation. As another initiative, it conducted an analysis on the possibilities of securitisation in Hungary as well as on the risks and potential legal framework of the introduction of a universal mortgage bond issuance model.

The MNB's staff also monitored international, particularly European Union regulatory processes. In 2012, they expressed their opinions on proposals regarding the prudent operation and resolution of credit institutions and investment firms, which fundamentally determine banking regulations to be applied in the next period.

The next step of the European Union towards an even closer integration will be the establishment of a 'banking union', the first element of which will be the introduction of the single supervisory mechanism (SSM). Under this mechanism, the European Central Bank will exercise supervisory powers over the credit institutions of the monetary union, but the option to join will also be open to Member States outside the euro area. The MNB has followed the regulatory steps with utmost attention, and prepared a comprehensive analysis, in which it assesses the advantages and disadvantages of joining or opting out, and formulates criteria on the basis of which, if fulfilled, Hungary would benefit from accession.

Domestic and international cooperation

This year, the Bank continued to assist the work of the Financial Stability Board (FSB). In 2012, the Board, comprised of the Minister for National Economy, the President of the HFSA and the Governor of the MNB regularly reviewed the key financial stability risks detected in the Hungarian financial system, the regulatory tasks concerning the financial intermediary system, the proposal package on the banking union elaborated by the European Union, and topical issues relating to bank resolution in Hungary. The FSB also provided its opinion on the Stability Report prepared by the MNB and the HFSA's risk report.

In addition to national regulatory issues, the Bank was represented at the second stage of the regional-level discussions initiated by international organisations (Vienna Initiative), and based on its macroprudential mandate it also continued to support the work of the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA) during the year under review. The Bank's employees, as guest lecturers, expressed their professional points of view at conferences focusing on a range of regulatory issues (Basel III, liquidity regulation, crisis management, etc.).

3.3 PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

The MNB plays various roles in the payment and securities clearing and settlement systems. In support of interbank co-operation, the MNB facilitates the development of the clearing and settlement infrastructure in areas which require the joint decision of payments market participants. As an overseer, the MNB performs regulatory, licensing and supervisory functions in respect of the infrastructure as a whole. As a service provider, it operates, inter alia, the real time gross settlement system (VIBER), in which the final settlements of payments from interbank transactions are performed. The MNB is the majority owner of the Central Clearing House and Depository Ltd. (KELER Zrt.), co-owner of GIRO Clearing House Limited (GIRO Zrt.), the Budapest Stock Exchange (BÉT) and KELER Central Counterparty Ltd. (KELER KSZF Zrt.), and is a participant in VIBER, the Interbank Clearing System (ICS) and the securities clearing and settlement system. The MNB regulates the execution of payment services in decrees and checks compliance with the regulations in the framework of its supervisory activity.

Steps taken to increase the efficiency of payment services

In 2012, the MNB continued to pay particular attention to retail (basically household and corporate) payments a subject on which it has published several studies in past years. In 2011 already, based on the results of its analyses the MNB made a number of proposals for public policy actions, and initiated social dialogue with the stakeholders with a view to increasing the efficiency of payment services. It forwarded these recommendations to the government along with proposals regarding the rationalisation of government payment services. The efficiency of domestic payment services can be increased through measures aimed at the promotion of cashless payments, as a more intensive use of cashless payment solutions could result in considerable savings in Hungary.

At the same time, in order to spread these solutions, it is essential to improve access to basic payment services both on the payer’s and the payee’s side. This, among others, can be facilitated by introducing a low-cost basic account scheme and a programme supporting the installation of POS terminals. As regards the terminal installation programme, the MNB elaborated the details and held discussions on its implementation with governmental and market participants. According to the plans, the programme would be financed from European Union funds or contributions from private stakeholders.

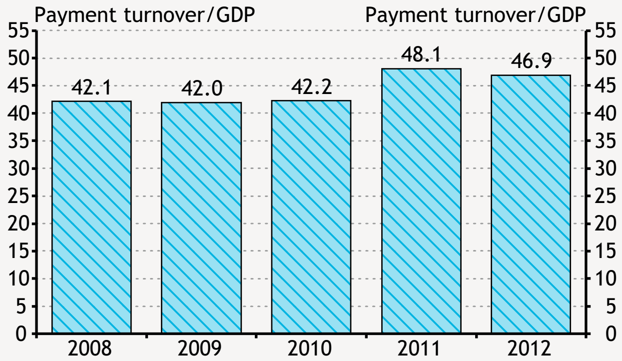
To achieve a much more rapid change in payment habits, it would also be required to phase in mandatory payment card acceptance, gradually restrict the use of cash, pricing the various payment methods transparently and separately of the basic services, and to reduce the current domestic level of interchange fees. It is seen as another step forward that – by introducing the transaction tax – cash withdrawals are subject to higher charges than non-cash transactions. In the past period, discussions were continuously going on with the concerned participants regarding regulatory issues aimed at the reduction of cash usage, a detailed proposal was drawn up on the gradual introduction of mandatory acceptance of payment cards, and the MNB, together with the Hungarian Competition Authority, elaborated a legislative proposal on the regulation of interchange fees. The regulation intended for the reduction of cash payments can also help to decrease the hidden economy, but additional analyses are needed into the ways in which intercompany cash payments could be further reduced in the medium term. In this respect, the MNB has already made a proposal for a schedule.

With regard to the risks arising from the size and operational logic of the voucher market, the MNB drew up a plan for the regulation of the market of negotiable vouchers. It was formulated as a basic requirement that the operation of the voucher market should be transparent, predictable and safe for everyone.

Operation and development of VIBER

At the end of 2012, VIBER had 60 participants. In terms of value, of the total HUF 1,242.4 trillion (thousand billion) turnover of the ICS (Interbank Clearing System), VIBER and the account management system of the MNB (hereinafter collectively referred to as: the systems), 93.5 per cent was settled in VIBER, while ICS accounted for a higher share in the volume of transactions (99.2 per cent). The total turnover of the systems was 46.9 times Hungary’s gross domestic product (GDP) forecast for 2012.

Chart 7
Annual turnover of the ICS, VIBER and the MNB’s account management systems in terms of absolute value, as a proportion of GDP

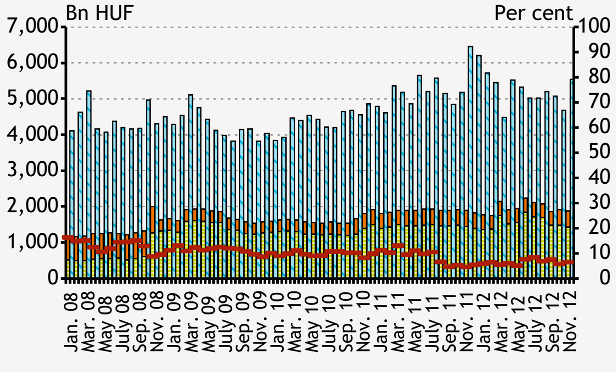


Note: For 2012, preliminary GDP based on current prices.

A total of 1,556 thousand payment transactions in the amount of HUF 1,242 trillion (thousand billion) were settled in VIBER during the year. The value of transactions decreased by 0.4 per cent and the volume of transactions increased by 20.3 per cent, relative to the preceding year. The average daily volume of transactions was 6,176 while the average daily turnover amounted to HUF 4,930 billion.

The liquidity available for the payments of VIBER participants proved to be completely adequate in 2012 as well. The average daily intraday credit line of the participants (which is provided by the MNB for the purpose of settling payments against pledged securities held as collateral and supplements the current account balance) amounted to HUF 1,546 billion in 2012, exceeding the previous year’s figure by 5.6 per cent. Compared to the previous year, the aggregate average daily balance available on the current accounts of credit institutions dropped by 4.6 per cent and showed an annual average

Chart 8
Monthly changes in average daily interbank payment turnover and liquidity (account balance and credit line) between 2008 and 2012



value of HUF 403 billion. Total liquidity for settlements – originating from the two aforementioned sources – facilitated the settlement of the total turnover of the systems at an average daily value of HUF 5,275 billion, exceeding the average daily turnover recorded in the previous year by 0.6 per cent. In 2012, average daily turnover was 2.7 times the average daily liquidity.

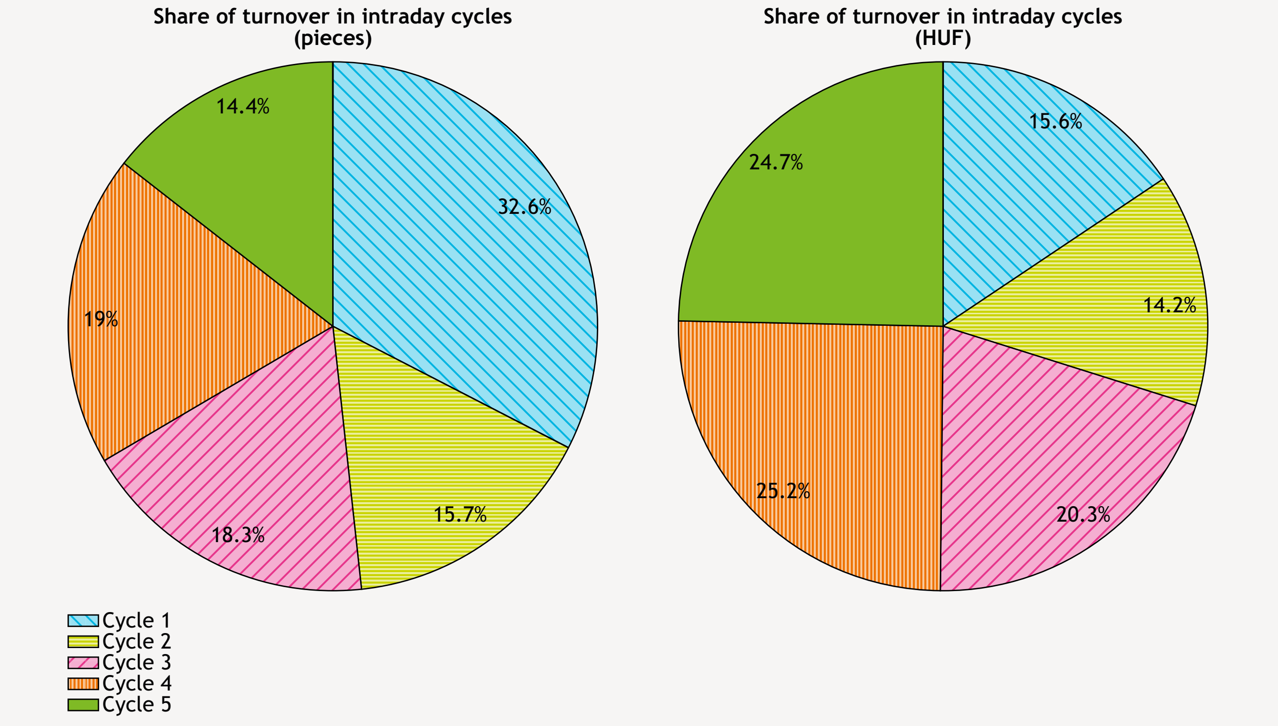
In 2012, VIBER's availability was 99.943 per cent, which exceeds international standards, but is slightly lower than the previous year's level.

The MNB carries out an annual revision of the fees charged for payment services in consideration of the costs arising in connection with the provision of the service. Compared to the fee in 2011, the fee charged for a VIBER item decreased by HUF 100 (to HUF 330) in 2012.

Operation and development of ICS

Thanks to the two-year development project, on 2 July 2012 the system providing for the intraday clearing of electronic transfers was successfully launched. From this date, electronically submitted credit transfers are settled within four hours, instead of the former one working day. The four-hour rule refers to the maximum time of settlement of credit transfers, and since the ICS operated by GIRO Zrt. clears items submitted to it by the banks in every two hours, the payment orders of the customers of payment service providers are settled within a shorter time in most cases. During the day, the system clears the submitted interbank transactions in five cycles, while the night clearing service is maintained as well. So far, the new system has proved to be successful. Clearing in each cycle takes 8-10 minutes in general, and the customers of payment service providers

Chart 9
Share of turnover of intraday clearing by cycle



Source: MNB.

can expect their orders to be settled as quickly as within 10-30 minutes from the submission time.

One of the advantages of this development is that customers can keep one day's interest, and the funds received during the day can be used for further payments on the same day. A further benefit for corporates is that they can automate their accounting systems using the new international SEPA payment standard.

Operation of the securities clearing and settlement system

In 2012, KELER Zrt. decided to transfer its clearing business unit relating to markets guaranteed by KELER KSZF Zrt. to KELER KSZF Zrt. as of 1 January 2013. As a result of the transfer (which took place in the form of a contribution in kind), the direct share of the MNB and BÉT as co-owner decreased, while their direct share in KELER KSZF Zrt. increased to the same extent. From 1 January 2013, KELER KSZF Zrt. will provide the services belonging to the scope of the aforementioned clearing business unit in an unchanged form.

In 2012, KELER Zrt. signed the framework agreement on joining the TARGET2-Securities (T2S) European settlement platform with its securities leg, whereas the MNB decided not to join the system at the time of its launching with its cash leg, i.e. it will not make the forint subject to the T2S system. As a consequence of these two decisions, settlement will take place in the T2S system only in part (for euro transactions), while KELER Zrt. will continue to settle forint transactions, although it must meet its reporting obligation towards the T2S platform. Having signed the framework agreement, the account management systems of KELER Zrt. needed to be replaced. The first stage of the multi-annual project was commenced in 2012.

In 2012, the preparation of the platform ensuring regulated gas trading (gas exchange) to be operated by CEEGEX Zrt. as of 1 January 2013 was begun, with KELER KSZF Zrt. undertaking a guarantee for the execution of deals.

Oversight activity of the MNB

VIBER

In accordance with international recommendations, the comprehensive oversight assessment of VIBER was carried out on the basis of the self-evaluation of MNB units taking part in the operation of the VIBER system. In the course of the assessment the MNB also examined VIBER's compliance with the provisions of the two relevant MNB decrees.[6] As a result of the assessment, the overseer elaborated recommendations in four topics, including, in particular, logical safety, operational reliability, regulations and certain elements of the rules of governance, which are intended to further increase the operational reliability of VIBER in a proactive manner.

The overseer provides its opinion on any proposed changes to the terms and conditions of bank accounts managed by the MNB and on the settlement of forint and foreign exchange payments. In 2012, this happened in two cases. During the procedure, the MNB checked compliance with the provisions of MNB Decree 34/2009 (XII. 28.) on the requirements of business terms and conditions and other regulations of operators of the payment system and found that the modified terms and conditions complied with those provisions.

Methodological improvement of business continuity and intraday interruption tests continued in 2012. Improvement meant involving the settlement of the cash leg of DvP transactions and intraday credit line modifications in the scope of testing. The VIBER oversight actively participates in formulating the expectations applied in such a test. The test was rated as successful.

ICS

The comprehensive assessment of ICS due every two years was carried out in 2012. Since the last comprehensive assessment, GIRO Zrt. has implemented several modifications to the night clearing system which increased its reliability and safe operation, and on 2 July 2012 it launched intraday clearing in Hungary. The assessment found that basically commencement of the new system had taken place in a smooth and problem-free way, and the operation of the system as a whole was robust and reliable. Taking these aspects into account, the assessment of the ICS improved even further. During the year, the MNB approved the ICS's new regulations, which were supplemented with procedures for intraday clearing. From 2013, GIRO Zrt. reduced the clearing fee by 1 forint.

In 2012, the MNB modified the data supply obligation of GIRO Zrt. in order to ensure the continuous availability of detailed information on the operation and turnover of the new intraday clearing system. In addition, during the year

[6] MNB Decree 34/2009 (XII. 28.) on the requirements of business terms and conditions and other regulations of operators of the payment system and MNB Decree 35/2009 (XII. 28.) on the material, technical, security and business continuity requirements related to the operation of the payment system.

the two institutions held a number of discussions regarding the transformation of the pricing methodology of GIRO Zrt., so in 2012 some of its points were modified (e.g. cost sharing), and further aspects are expected to be changed by the end of 2013. In the course of its annual oversight work, the MNB carried out detailed investigations into the incidents concerning the clearing system, and formulated proposals, where necessary, in order to avoid such events in the future.

On 12 December 2012 a trilateral cooperation agreement entered into force between GIRO, the MNB and the HFSA, which contains clear guidelines on what actions the parties should take in the event of insolvency proceedings, if the participation of an institution is to be suspended.

In 2012 the MNB conducted two official licensing proceedings as the overseer of ICS.

Securities clearing and settlement system

Within the framework of the oversight of the securities clearing and settlement system operated by the KELER Group, in 2012 the MNB examined settlement failures. In 2011, settlement failures increased significantly on the cash market compared to the previous year, and this trend continued in the first half of 2012. The reason behind these failures is that the relatively early settlement deadline (11:30 a.m.) left little time for arranging OTC transactions to provide coverage. From 4 June 2012 the settlement deadline of the cash market was extended from 11:30 a.m. to 2:00 p.m., which proved to fulfil the hopes. The frequency of failures dropped substantially after extension of the settlement time.

In 2012, in respect of the securities clearing and settlement system, the MNB conducted 16 official licensing proceedings (including the authorisation of the clearing function for KELER KSZF Zrt. as a new activity), and started a comprehensive oversight assessment of the system carrying out on-site work. In addition, the MNB actively participates in the negotiation of the European draft regulation on central depositories, as well as in the national legal harmonisation work relating to an EU regulation on OTC derivatives, central counterparties and trade repositories.

The regulation and supervision of payment services

In 2012, partly in connection with the introduction of the ICS's intraday credit transfer system, and partly on the basis of the several years of experience the Bank had gained in the areas of supervision and the interpretation of law, an overall review and overhaul of MNB Decree 18/2009 (VIII. 6.) (hereinafter in this section: the MNB Decree) on the execution of payment transactions was carried out. This involved the introduction of new regulations to ensure that forint credit transfers cleared in the ICS intraday credit transfer system be credited to the payees' payment account on the same day, and modified the rules of rejecting payment orders which could not be fulfilled in the operational framework of the aforementioned system. Some of the amendments aimed to increase public confidence in direct debits, thus facilitating the spread of this payment method. Moreover, clarifications facilitating the correct legal interpretation were made.

In 2012, the payment services of 17 credit institutions were inspected. One of the key criteria of the payment inspections carried out at credit institutions was to check their compliance with the new regulations that became effective in 2012. In each case, the Bank found that the credit institutions failed to comply with several of its payment regulations. The most common deficiency at the inspected institutions was non-compliance with the rules pertaining to the execution, queuing and refusal of payment orders and their crediting to the payment accounts. Most of these non-compliances affected a wide range of payment orders, sometimes causing financial loss to customers. Three credit institutions were subject to compliance inspections regarding the regulations that had entered into force as of 1 July 2012, and two inspections found non-compliance with the new rules relating to payments to be cleared in the domestic intraday clearing system. Twelve of the payment inspections have been completed. The MNB called upon the credit institutions to observe the relevant legislation in their procedures by prescribing deadlines for 66 measures. One of the completed inspections resulted in a HUF 1 million fine imposed on the credit institution due to the severity of the deficiencies. In the case of five credit institutions the payment inspections have still not been completed.

In 2012, the MNB inspected a cash in transit company for compliance with the money laundering prevention rules. The MNB did not establish non-compliance with the rules on the prevention of money laundering, and therefore the audit was closed without taking any measures.

International conference organised by the European Central Bank (ECB) and the MNB

The MNB and the ECB organised a joint conference on retail payments in Budapest on 15-16 November 2012. The conference had approximately one hundred participants, including the decision-making representatives of international financial institutions (World Bank, BIS), European central banks, the central banks of other countries and the European Commission, as well as the most outstanding and internationally recognised experts of the subject. The topic of the conference was the social costs of retail payments, focusing, in particular, on how central banks can promote the widespread use of more efficient payment solutions for the society with the available instruments.

Publications

For the first time in July 2012, the *Report on payment systems*[7] was published. This annual publication presents the MNB's activities aimed at facilitating the reliable and efficient operation of payment services, as well as the payment and securities clearing and settlement systems. The Report provides a comprehensive review of the trends in payments and the functioning of overseen payment and securities settlement systems in Hungary, the risks arising, and any measures taken by the MNB to fulfil its basic task as mentioned above. The Monetary Council published a statement on the new Report.[8]

In 2012, the MNB published a study under the title *Pricing of payment services,*[9] which describes the pricing practice applied in the main payment methods in the payment services of credit institutions and in the indirectly related services, paying special attention to the pricing implications of paper-based and electronic submission channels.

The MNB monitors trends in the market of cafeteria vouchers, basically because of its linkage with infrastructure. By 2012, the domestic voucher market had undergone substantial transformation as a result of changes in the related tax allowances, and therefore, the MNB analysed the key criteria associated with the domestic voucher infrastructure in order to enhance efficient implementation from social, technological and 'business' points of view.[10]

In the first half of the year, by adopting Regulation (EU) No 260/2012 of the European Parliament and of the Council, the EU legislative procedure regarding the end-date of SEPA was completed. The regulation was prepared by the Hungarian EU Presidency with the participation of the MNB's experts in 2011, and in 2012 an analysis was conducted on the key issues and the international and national effects of the regulation.[11]

The MNB monitors the security issues of payment methods. In the spring of 2012 it conducted a representative survey with 1,000 respondents on the security of payment methods with the aim of getting to know and analysing what the Hungarian population thought and what knowledge they had of the security of specific payment methods and what the security reasons were, if any, for the insufficiently intensive use of electronic payment instruments. We published an article in all three subjects in the MNB Bulletin.[12]

3.4 MANAGEMENT OF FOREIGN EXCHANGE RESERVES

Objectives of holding reserves

Similarly to other central banks, one of the most essential tasks of the Magyar Nemzeti Bank, as stipulated in the MNB Act, is the management of the country's foreign exchange reserves. The foreign exchange reserves held by the MNB serve various purposes, the most important of which include:

- to ensure the level of reserves expected by market participants ('international collateral');
- to support the monetary policy (ensure intervention capacity and the banking system's foreign exchange liquidity);
- to provide foreign exchange required for transactions (support government debt management, satisfy the Government's foreign currency payment obligations etc.),
- to preserve the external stability of the Hungarian economy.

In the current crisis, market participants have been monitoring development in foreign exchange reserves even more closely than before. The MNB itself regularly reviews the desired level of reserves and, as required and so far as possible, takes measures to ensure the appropriate level. Overall, in the course of 2012 reserves satisfied the role of 'international collateral'.

[7] http://english.mnb.hu/Root/ENMNB/Kiadvanyok/report-on-payment-systems
[8] http://english.mnb.hu/Monetaris_politika/decision-making/mnben_allasfolglalasok/statement_20120712
[9] Divéki Éva and Olasz Henrietta (2012), "A pénzforgalmi szolgáltatások árazása", [Pricing of payment services], *MNB-tanulmányok,* 101.
[10] Divéki, Éva (2012), "Card or print? How to issue cafeteria vouchers electronically", *MNB Bulletin,* June.
[11] Turján, Anikó and Judit Brosch (2012), "Single Euro Payment Area (SEPA): Full speed ahead!", *MNB Bulletin,* June.
[12] Divéki, Éva and Dániel Listár (2012), "Better safe than sorry: views of the Hungarian public on the security of payment instruments", *MNB Bulletin,* October.

One of the guarantees for a predictable and stable exchange rate regime is an adequate level of reserves, which, if necessary, allows for central bank intervention in the interest of protecting the exchange rate. As regards monetary instruments, a sufficient level of foreign exchange reserves and the repurchase facility provided by the ECB were behind the FX swap facilities introduced in recent years in support of the foreign exchange liquidity of the banking system.

In terms of transaction goals, servicing the management of government debt continued to be the most important objective last year. In this regard, continuous meeting the foreign currency needs of budgetary organisations should also be considered. Transfers from the European Union are also received through the MNB. These transfers have been significant sources for the accumulation of reserves in recent years – and will continue to be in years to come. In the course of 2012, these transaction goals were once again accomplished smoothly.

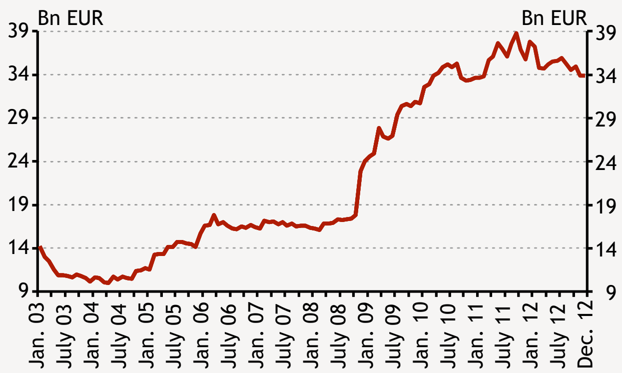
The MNB still does not intend to maintain reserves solely for the purpose of accumulating wealth. At the same time, however, it strives to meet total return criteria when managing foreign exchange reserves in the required amount at all times, i.e. as a responsible asset manager, it intends to preserve their value and, as far as possible, attain extra return.

Amount of the reserves

The amount of official foreign exchange reserves dropped by EUR 3.9 billion during the year to stand at EUR 33.9 billion at the end of 2012. The primary reason behind this decline was the euro sales provided for the government's debt repayments (EUR 5.1 billion) and those related to early repayments of foreign currency loans (EUR 1.7 billion), which were only partly offset by the transfers received from the European Commission (EUR 3.1 billion) due to the lack of funds raised from the international capital market.

The most outstanding debt repayment items reducing the foreign exchange reserve were the repayment of the IMF loan (in several instalments, totalling SDR 3.2 billion), as well as the maturing bonds with face value of JPY 45 billion in July and EUR 1 billion in November, respectively. There were outflows from the foreign exchange reserves in the amount of EUR 1.72 billion because of the foreign exchange tenders related to early repayments and EUR 36 million as a result of the Bank's euro sales due to the conversion of foreign currency debts overdue for a period of more than 90 days. In addition, disbursements in foreign currency commissioned by budgetary institutions reduced the reserves by a total amount of some EUR 730 million. Similarly to earlier years, the most significant item increasing the reserves was the transfer of funds from the European Union, which amounted to EUR 3.1 billion in 2012. The own return on foreign exchange reserves was EUR 0.51 billion.

Chart 10
Changes in foreign exchange reserves



The MNB's financial risk management

Inevitably, the MNB faces financial risks in conducting its basic statutory tasks and managing the country's foreign exchange reserves. These risks do not result from a conscious choice, in fact, they are much more of an intrinsic property for the MNB. As a general principle, the magnitude of risks taken should be consistent with the objectives of the core activity, the degree of the risks assumed should be obvious and visible, and risk assumption should be purposeful and in harmony with the institution's risk-taking capacity. In managing foreign exchange reserves, the bank must meet the three targets of liquidity, security and return, which means it strives to reach the highest possible level of return while continuously keeping to the predefined low risk level.

The most important risk categories associated with the management of foreign exchange reserves are market risk, liquidity risk, credit risk and counterparty risk. The MNB applies limits to mitigate the financial risks related to the management of foreign exchange reserves. In line with the conservative reserve policy typical of central banks, in its reserve management the MNB applies a strict limit system, which takes account of market and other indicators as well, in addition to the required high-level credit ratings.

Similarly to other basic central banking tasks, the Monetary Council is the supreme decision-making board in respect of the management of foreign exchange reserves. The Bank operates a multi-level decision-making system with a division of authority in taking strategic and operational decisions.

The Monetary Council lays down the basic principles of the risk-taking policy and makes decisions on strategic issues. Accordingly, it sets targets and requirements in relation to foreign exchange reserves, such as the reserve level and liquidity, and takes decisions on optimisation foreign exchange. In the risk-taking strategy it determines the general risk-taking principles and operational frameworks of reserve management. In developing the investment strategy it makes decisions on the key strategic numerical parameters of investing reserves in consideration of long-term market trends and the Bank's risk tolerance.

The powers of making operational decisions are exercised and the foreign exchange reserve management strategy is implemented by the Executive Board (by the Implementation Committee in the first quarter), the Asset-Liability Committee (ALCO) and the dealers of the Money and Foreign Exchange Market Unit within the frameworks specified by the Monetary Council.

Within the framework defined by the Monetary Council, the limit system is approved by the Chairman of the MNB's Implementation Committee, including the maximum acceptable deviations of the risks affecting the reserve portfolios vis-à-vis the benchmarks, counterparty limits and the range of investment instruments accepted for the purpose of reserve management. The Asset-Liability Committee (ALCO) reviews market developments and monitors the Bank's risk exposure on a monthly basis.

The two main pillars of the risk management policy are the two-tier benchmark system and the limit system. The independent measurement of performance is a key element of the risk-taking policy. In order to measure the success of portfolio management, the performance of each reserve portfolio is compared to that of a reference portfolio (the benchmark portfolio). Benchmark portfolios show what yield would have been produced by a passively managed portfolio that represents a wide market segment if investment parameters had been the same. The performance of the foreign exchange management activity is reported in the context of these reference portfolios. The benchmarks – reflecting the return/risk preference of the MNB and measuring the performance of the portfolios – are maintained by a risk management institutional unit, which is independent of the business area.

As a consequence of the financial crisis, the role of the various risk-reducing instruments became more decisive than before, with particular emphasis on contracts regulating financial market transactions and their execution. A common practice for managing increased credit risks assumed by financial market participants is to enter into risk mitigating agreements. Accordingly, the MNB continued to conclude credit support (collateral) arrangements (Credit Support Annexes – CSA) attached to the standard master agreement elaborated by the International Swaps and Derivatives Association (ISDA) with its counterparties during the year, and by the end of the year these contracts had been concluded with the key counterparties.

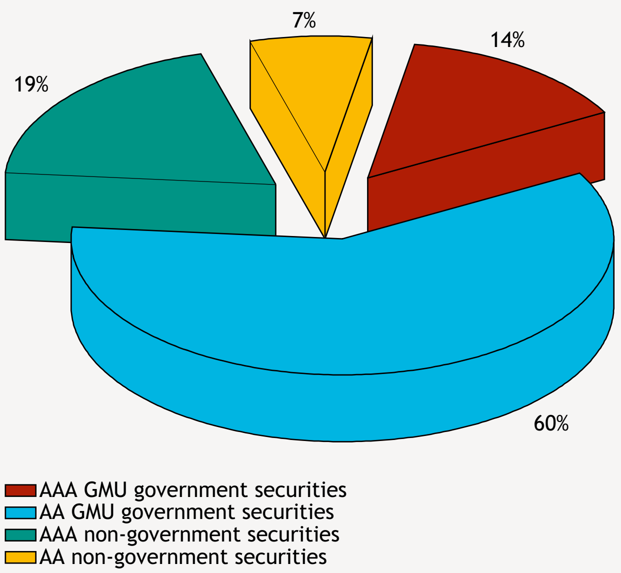
In 2012, the Bank joined the Continuous Linked Settlement (CLS) system as an indirect member. The settlement risk of FX transactions settled through the CLS system is much lower, which is of utmost significance for the MNB due to the large-volume foreign exchange swap portfolio required for keeping the foreign exchange benchmark. From October 2012, foreign exchange transactions executed in CLS eligible currencies are settled through the CLS system. CLS settled payment instructions relating to FX transactions provide the best practice for market participants , so the MNB's trading capacity has increased by its accession.

In the past, the MNB managed its foreign exchange reserves exclusively in euro and dollar-denominated portfolios. In November 2011, the Monetary Council decided to continue the diversification of investments: while increasing the size of the dollar portfolio, from February 2012 the Bank built two index-tracking portfolios: one is denominated in pound sterling and the other in Japanese yen. However, the MNB undertakes exchange rate exposure only in euro, covering the risk of the foreign currencies/euro cross rate with derivative instruments. Holding other foreign exchange assets with exchange rate coverage is justified by the need to achieve a higher level of diversification and, in the case of the dollar, to provide increased liquidity. In addition to the index-tracking portfolios, the MNB actively manages five other euro and dollar portfolios as well. In dollar, it holds a money market and an investment portfolio, and in euro it holds a so-called credit risk free portfolio and an investment portfolio in addition to the money market portfolio. In accordance with the Monetary Council's relevant decision, the Bank manages the newly established pound sterling and yen portfolios as index-linked portfolios, with strict tracking of the benchmark. The target durations of both the pound sterling and yen portfolios correspond to the reference index duration of the 1-3-year government securities. The benchmarking of the yen portfolio uses the Barclay's 'Global Treasury Japan 1-3 years' sub-index, while that of the pound-dominated investment portfolio is based on the 'Global Treasury United Kingdom 1-3 years' index. Furthermore, based on the Monetary Council's decision taken in 2011, in Q4 the MNB started to incorporate the American Agency Mortgage-Backed Securities (MBS instruments) into its investment strategy in the form of a mandate given to an external asset manager and a custodian. The activity was launched in an initial volume of USD 300 million.

The credit risk free euro portfolio, which constitutes the majority of the foreign exchange reserves, exclusively consists of high-rated government papers, high-rated government guaranteed securities and issuances of international (supranational) institutions. Its benchmark includes euro benchmark bonds with an AA credit rating at the minimum. In addition to the above, the euro investment portfolio can only include high-rated corporate and bank issuances as well as collateralised securities; in this portfolio, government securities typically serve the purpose of adjusting the maturity structure. Accordingly, the benchmark of the investment portfolio is representative of the performance of a broad range of euro-denominated market issuances with a high credit rating.

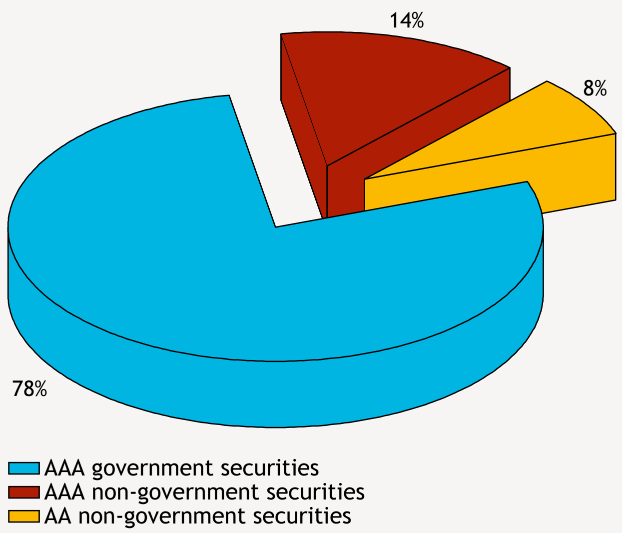
On 31 December 2012, of the total euro-denominated benchmark portfolio 14 per cent were AAA-rated and 60 per cent were AA-rated euro area government securities, while 19 per cent were AAA and 7 per cent were AA-rated other securities. 100 per cent of the credit risk free euro-denominated benchmark portfolio consisted of AAA-AA-rated euro area government securities.

Chart 11
Structure of the overall euro-denominated benchmark portfolio



The performance of the dollar investment portfolio reflects the yields of US Treasury securities and – similarly to the credit risk carrying securities managed in the euro investment portfolio – high-rated dollar-denominated bonds. AAA-rated US Treasury securities accounted for 78 per cent, AAA-rated other bonds for 14 per cent and

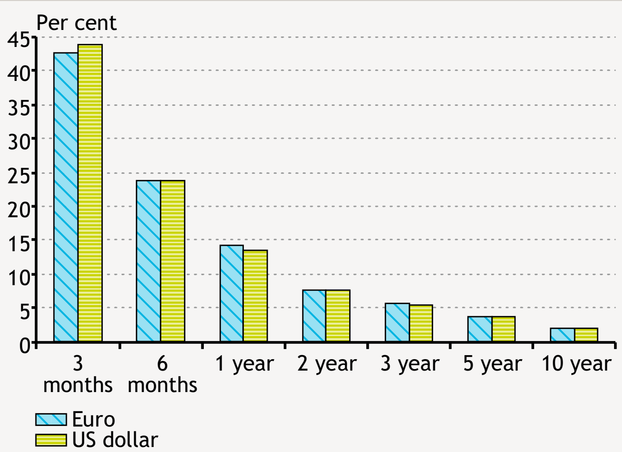
Chart 12
Composition of the dollar-denominated investment benchmark portfolio based on credit rating



AA-rated other securities for 8 per cent of the dollar-denominated investment benchmark portfolio.

The benchmark of both the euro and the dollar-denominated investment portfolios contains high-rated government securities, corporate and bank bonds as well as money and capital market assets with a maximum remaining maturity of 10.5 years. The composition of the benchmark portfolios according to the credit ratings of assets and residual maturity reflects the conservative risk appetite typical of central banks.

Chart 13
Composition of the dollar-denominated and the (combined) euro-denominated investment benchmark portfolios based on residual maturity at end of 2012



As the return on the reserves primarily depends on the market performance of the specific investment asset class, its size only partly reflects the actual effectiveness of active reserve management.

Compared to the low yield environment, both in absolute terms and relative to the comparable benchmarks, the Bank achieved good performance in 2012 with the foreign exchange reserves. The liquidity required for the attainment of monetary policy objectives was available throughout the year, with no credit risk incidents adversely affecting the reputation of the MNB. Exceeding the 0.53 per cent yield on the benchmark portfolio by 48 basis points, the annualised performance of the so-called credit risk free euro portfolio was 1.01 per cent. The euro-denominated investment portfolio showed the best performance: it yielded an annualised return of 3.56 per cent, 159 basis points above its benchmark. The annualised yield on the dollar-denominated investment portfolio – adjusted by the cost of the exchange rate hedging – exceeded its benchmark by 19 basis points and stood at 0.7 per cent. The annual return of 0.41 per cent on the euro-denominated money market portfolio exceeded the relevant benchmark by 33 basis points, while that on the dollar-denominated money market portfolio amounted to 0.32 per cent, thus outperforming the 0.15 per cent result of the benchmark by 17 basis points. Exceeding the 0.93 per cent return on the weighted benchmark by 76 basis points, the annual return on actively managed portfolios weighted with market value amounted to 1.69 per cent.

The duration of investment portfolios set as a strategic target is 1 year. A 19 basis point fall in the yields on euro-denominated government securities with corresponding duration was observed. Yields on dollar-denominated government securities declined at a more moderate rate during the year: for the relevant 1 year these yields were 6 basis points below the previous year's level. The weighted average yield change was also characterised by a downward trend both in the case of the euro and the dollar. The high absolute performance of the investment portfolios relative to the yield environment can be partly attributed to the downward shift of the yield curve, and the relatively good performances can be explained with the selection of securities and their allocation among countries by the portfolio management.

Similarly to the previous years, the environment of foreign exchange reserve management was still strongly influenced by the impact of the credit crisis on European sovereign issuers. While the sovereign debt crisis of euro area periphery countries resulted in a significant and prolonged increase in the credit risk premia of these countries, as a result of flight to quality, the securities of higher-rated issuers, which constitute the majority of the foreign exchange reserves of Hungary, appreciated.

As regards the future performance of the foreign exchange reserves, the extremely low level of yields on high-rated instruments still poses a risk, so it is unlikely that the yield observed in the reference period will be attained in the near future. The exceptionally low yield level also means that in the case of a possible yield increase the revaluation loss caused by the depreciation of existing bonds may result in negative performance even if the strategic duration is kept below that of previous years.

The value-at-risk of the items in the MNB's foreign exchange balance corresponding to the changes in the interest rate amounted to EUR 72.8 million at the end of the year (95 per cent confidence level VaR over a one-month time horizon).

3.5 CASH LOGISTICS ACTIVITIES

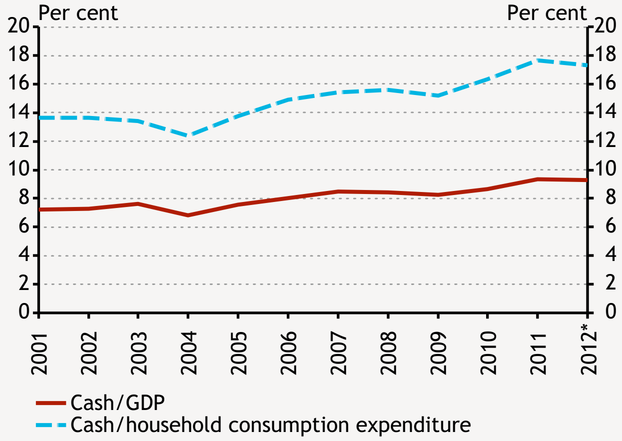
Currency in circulation

On 31 December 2012, the value of currency in circulation amounted to HUF 2,721.7 billion, up by 1 per cent, i.e. HUF 28.3 billion, compared to the end of the previous year.

The seasonally adjusted cash figure also shows a 1 per cent rise, reflecting stagnation in proportion to GDP, which can be attributed to the fact in the previous year the increase in the amount of currency in circulation was presumably caused by the modest increase in nominal consumption. This assumption is also supported by the negligible change in the ratio of cash over household consumption expenditure in 2012.

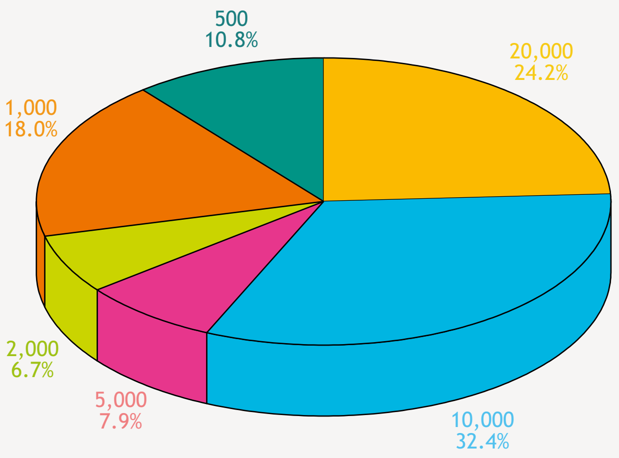
As opposed to the past years' trend, in 2012 the volume of 20,000-forint and 10,000-forint banknotes in circulation did

Chart 14
Cash/household consumption expenditure and cash/GDP



** The 2012 GDP data and the data of household consumption expenditure are MNB estimates.*

Chart 15
Breakdown of banknotes in circulation by number as at end-2012



not grow, while the quantity of 5,000-forint, 2,000-forint, 1,000-forint and 500-forint banknotes rose by 8 per cent, 3 per cent, 6 per cent and 2 per cent, respectively, as compared to the end of 2011.

The two highest denominations continued to dominate in the volume of cash, accounting for some 57 per cent of the total number of banknotes in circulation at the end of 2012. The reason for this is that besides their payment function they also have a wealth accumulation function, and they have a key role in the operation of illegal economy as well.

As for coins, it is mostly the 200-forint and 20-forint denominations and the 5-forint coins that increased in amount. On the whole, the volume of coins in circulation was 4 per cent higher than in the previous year.

Cash distribution

In 2012, the MNB handled cash turnover in an amount of HUF 3,224 billion and provided 235 million banknotes to its clients, i.e. credit institutions and the Hungarian Post Office. At the same time, 229 million banknotes were delivered to the Bank.

Last year, the MNB qualified some 71 million banknotes as unfit for circulation and replaced them with new banknotes.

Since 2011, within a contractual relationship the MNB allows major credit institutions and the Hungarian Post Office to hold so-called notes held to order, i.e. cash owned by the MNB, in their depositories. The objective of the introduction of the NHTO scheme was to facilitate the flow of banknotes between the Bank engaged in wholesale logistics and the credit institutions and the postal services, which employ smaller logistical (packaging) units. The MNB limits the maximum amount of the NHTO; as a result, the amount of the NHTO remains below 1 per cent of all banknotes in circulation. The NHTO scheme facilitates compliance with central bank logistics standards and contributes to a reduction in banknote transportation. In 2011–2012 this

Table 2
Quantity and value of banknotes and coins in circulation on 31 December 2012

Banknotes	Volume (Million pieces)	Value (Billion HUF)	Ratio (%)	
			Volume	Value
20,000 forint	73.0	1,459.4	24.2	54.8
10,000 forint	97.7	976.9	32.4	36.6
5,000 forint	23.8	119.2	7.9	4.5
2,000 forint	20.1	40.3	6.7	1.5
1,000 forint	54.1	54.1	18.0	2.0
500 forint	32.7	16.3	10.8	0.6
Total	**301.4**	**2,666.2**	**100.0**	**100.0**

Coins	Volume (Million pieces)	Value (Billion HUF)	Ratio (%)	
			Volume	Value
200 forint	93.5	18.7	7.3	38.5
100 forint	144.4	14.4	11.3	29.7
50 forint	120.0	6.0	9.4	12.4
20 forint	228.7	4.6	17.8	9.5
10 forint	271.3	2.7	21.2	5.6
5 forint	421.8	2.1	33.0	4.3
Total	**1,279.7**	**48.5**	**100.0**	**100.0**

Note: The table does not contain commemorative coins issued by the Bank; at par value these coins are legal tender.

system operated in accordance with the pre-defined rules, thus serving the objectives of wholesale cash distribution with the help of an appropriate structure of cash handling fees.

In the past years, the MNB laid special emphasis on modernising coin distribution, increasing the efficiency of domestic coin logistics and enhancing coin trading among banks, the postal services and cash logistics service providers. The key means of the change was the system of central bank coin stocks (coin depo) held by cash logistics service providers with the aim of minimising the MNB's buffer role in daily coin distribution. The scheme introduced in 2011 continued to operate smoothly in 2012 and attracted significant international interest.

The Bank's cash controlling activity

Credit institutions, the postal services and professional cash logistics service providers using up-to-date technology play an increasingly crucial role in ensuring the high quality of cash in circulation, with an emphasis on the Bank's control function.

To ensure that cash payment services provided to household customers are of high quality, the Bank carries out official checks. The checks conducted in 2012 focused on the following subject areas:

- compliance with the provisions of the relevant MNB decree on the authenticity and fitness check of banknotes,

- compliance with the provisions of the relevant MNB decree on banknotes distributed via banknote dispensers (ATMs),

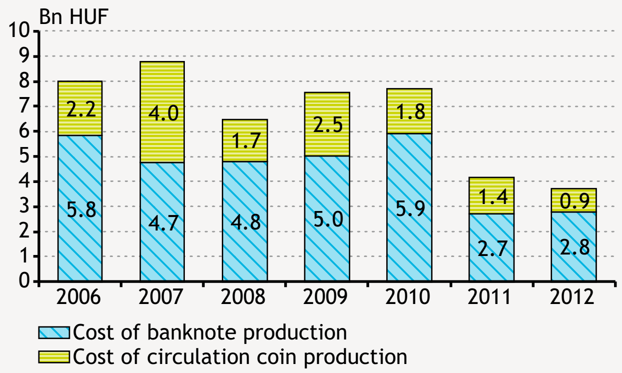
- compliance with the provisions of the MNB Act and a relevant MNB decree on services provided to households (exchange of denominations, exchange of banknotes withdrawn from circulation, treatment of incomplete banknotes).

While controlling the professional participants of the cash cycle, the Bank broadened the range of services provided to them, thus laying even more emphasis on technological support than before, which largely contributed to the safety of cash payments.

Banknote and coin production

In order to meet the increasingly large cash demand and replace unfit and therefore destroyed banknotes and coins, the Bank has banknotes and coins produced.

Chart 16
Production of banknotes and coins in circulation
(gross cost)



In 2012, the cost of cash production was a gross amount of HUF 3.7 billion, which is almost 10 per cent less than in the previous year. In the past five years, the Bank took a number of strategic cash-related measures that may result in total savings of tens of billions of forints over the longer term. The rationalisation of production and the efficient inventory management contributed to the decline in production costs, which is expected to remain at a lower level in the future, as compared to the years preceding 2011.

In 2012, the average acquisition cost of one banknote was gross HUF 57 and that of one coin amounted to gross HUF 30.

Prevention and reduction of counterfeiting

The decline in the counterfeiting of forint banknotes that started at the end of 2010 continued in 2012. In 2012, the number of counterfeit forint banknotes withdrawn from

Chart 17
Changes in the number of counterfeits per one million genuine banknotes and the amount of the losses caused

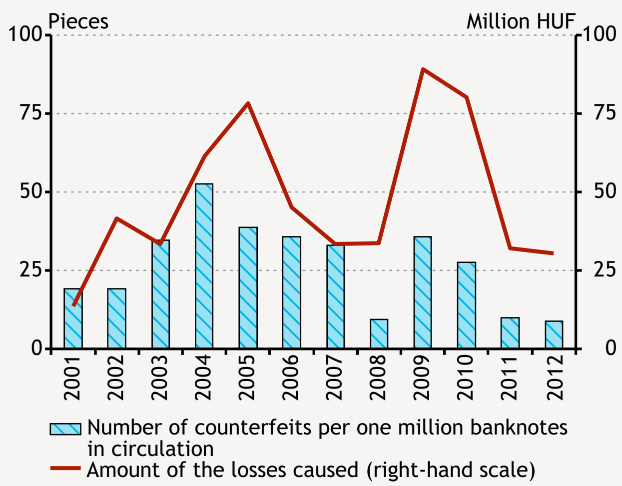


Table 3
Discovered counterfeit HUF banknotes broken down by denomination in 2012

Denominations	500	1,000	2,000	5,000	10,000	20,000
Breakdown (%)	7.6	0.5	4.3	12.1	43.4	32.1

circulation was 2,655 – representing a nearly 9 per cent decline compared to 2011. Accordingly, the value of direct losses caused by counterfeits also dropped to a slight extent. This positive change was also reflected in the indicator of counterfeits per one million genuine banknotes per year; its value is 9, which can be considered good even in an international comparison, among national currencies similar to the forint.

The counterfeiting of forint banknotes is still characterised by the dominance of higher-value banknote denominations: the 10,000-forint and 20,000-forint banknotes accounted for 76 per cent of all discovered counterfeits.

The methods used for making counterfeit forint banknotes have not changed; they were primarily produced with office reproduction equipment, such as photocopiers and printers. Despite the use of simple devices, some of the counterfeits of higher denominations are of a misleading quality, therefore, it is crucial to pay careful attention when checking banknotes. These counterfeits can be detected using simple methods and appropriate devices (e.g. UV-A/C lamps) or with a simple human examination (e.g. touching, holding against the light or tilting the banknote).

Last year, in the light of the favourable counterfeit figures, the Bank went on with the implementation of its cash strategy focusing on prevention and preparation. For this purpose, in 2012 the Bank placed even more emphasis on providing cashiers primarily in the retail sector who play a key role in the detection of counterfeits, with banknote related knowledge. Last year, at free on-site trainings held by MNB experts, four thousand cashiers acquired the most up-do-date knowledge and methods of banknote checking.

The MNB's initiative launched in 2011 and repeated in 2012 also aimed to facilitate the activity of cashiers working in trade by promoting a more wide-spread use of a state-of-the-art cashier's method, i.e. the application of the combined lamp (which contains both UV-A and UV-C tubes). Through the tender announced by the MNB for retail shops and service providers predominantly using cash, applicants could buy the combined UV-A and UV-C devices with significant financial support granted by the Bank, so as to make the work of cash-handling staff safer. As a result of the programme, these modern devices are used in almost 1,500 more cash desks than two years earlier.

The 'dissemination' of information on the most important features of banknotes via a smartphone application is regarded as a pioneer initiative also in international central banking practice. In 2012, the MNB was among the first in Europe – besides the ECB and the central banks of the Czech Republic and the Netherlands – to take advantage of the opportunities give by this information channel. In addition to the dissemination of information on banknotes among professional users, the MNB puts an emphasis on raising awareness for the conscious use of cash and the related information in accessible language and in an attractive, perceivable manner. Taking advantage of the opportunities of smartphones, the freely available multi-platform (iOS and Android) application provides interactive, accessible information to those interested in banknotes via animations.

Issue of commemorative coins

In 2012, the MNB issued two gold, six silver and two cupronickel commemorative coins. In accordance with earlier practices, the topics were chosen after public consultation also in 2012.

The first commemorative coin of the year was issued in January with a face value of HUF 3,000 for the 150th anniversary of the publication of The Tragedy of Man by Imre Madách, followed by a silver collector coin with a face value of HUF 5,000 issued in commemoration of sculptor, coin designer and plaquette artist József Reményi. This latter was issued as part of the 'EUROPA' international silver coin programme.

As the fourth member of the coin series 'Major Figures of Hungarian Literature', a silver collector coin with a face value of HUF 5,000 was issued to celebrate the 100th anniversary of the birth of István Örkény. Issued on the international Space Exploration Day, a cupronickel collector coin with a face value of HUF 1,000 and with the familiar specifications was added to the 'Series of coins presenting the technical innovations and inventions of Hungarian engineers and inventors' in honour of the launch into orbit of MASAT-1, the first Hungarian satellite.

A new series of gold collector coins was launched in 2012 under the name 'Medieval Hungarian Gold Florins' by issuing the gold florin of King Charles with a face value of

HUF 10,000, both in 'standard', i.e. its original size, and in a so-called 'piedfort' version, which is four times the weight of the original. As in the years of the pervious Summer Olympic Games, a commemorative coin was issued in relation to the London Olympics in 2012. On the day of the ceremonial Olympic oath of the Hungarian participants, both silver and gold collector coins were issued. The gold collector coin has a face value of 5,000 HUF, is 11 mm in diameter, and was issued as part of the 'Smallest Gold Coin in the World' international collector programme.

In September, the MNB issued a cupronickel collector coin to celebrate the 100th anniversary of the foundation of the Hungarian Scouting Association. Its face value of HUF 100 refers to the occasion, and its dodecagonal shape is a real curiosity.

The MNB issued another new series of silver collector coins entitled 'Hungarian Nobel Laureates' with an oval shape resembling a special face gallery. The first coin of the series is dedicated to the memory of Albert Szent-Györgyi on the occasion of his being awarded the Nobel Prize 75 years ago. The coin issued in October has a face value of HUF 3,000. The last issue in 2012 was on October 16, namely a silver coin with a face value of HUF 3,000 issued in commemoration of the 150th anniversary of the birth of the MNB's first Governor Sándor Popovics.

3.6 STATISTICAL SERVICE

Based on the authorisation granted by the MNB Act, in order to carry out its fundamental duties, including, inter alia, the analysis of financial trends, the preparation of monetary policy decisions, ensuring smooth money circulation, the oversight of the operation of payment and settlement systems as well as support for the stability of the financial system, the MNB collects statistical information (not qualifying as personal data) and releases statistics derived from such data.

The MNB prepares and publishes monetary, balance of payments, financial accounts and securities statistics, statistics on financial stability as well as time series on prices, exchange rate statistics and money and capital markets on its website according to a release calendar disclosed to the public. The MNB also publishes methodological documents related to the individual statistical areas.

In addition to issuing MNB Decree 20/2012 (X. 15.) on the requirements of information supply applicable in 2013, the scope of data to be reported was modified and extended also during the year.

In response to the legislative changes, in order to fulfil the tasks relating to the financial stability and monetary policy tools, intra-year information supplies and modifications to the related obligation were ordered in four cases. These were implemented via the amendment of MNB Decree 14/2011 (X. 13.) applicable to 2012 and the issue of a new decree on data supply. (Intra-year data supplies and their modifications were ordered in relation to the deposit coverage and balance sheet coverage indicators to be reported as of January 2012, the new rules pertaining to the foreign currency financing adequacy ratio, the 'list of positive debtors' of the central credit information system, and the treatment of foreign exchange loans.)

Preparation for changes in statistical methodology

In 2012, preparatory work continued regarding the application of the new European methodological standards regulating the compiling of national accounts and the related statistics. The new standards of national accounts and balance of payments statistics are to be adopted from 2014. In the course of preparation for the methodological changes, the MNB and the Hungarian Central Statistical Office (HCSO) held regular discussions in 2012 and found solutions to a number of methodological and technical issues. This ensures that the effect of the methodological changes can be consistently reflected in the inter-linked financial statistics of the two institutions. In parallel with the methodological preparations, the modification of the related statistical data collection and processing systems of the MNB began in 2012.

In its MNB Decree 20/2012 (X. 15) on information supply applicable to 2013, the MNB already stipulated the new or modified data collections that serve the purpose of meeting the currently known data requirements relating to the changes in international statistical methodology. Owing to the thorough assessment and preparatory work, some of the new data requirements can be produced using the existing data collections and administrative data sources, so only two new data collections needed to be introduced and some existing central bank data collections modified to adopt the methodological changes. To avoid an increase in the administrative burdens of data suppliers, some of the existing data collections were cancelled in the case of data suppliers subject to the new data collection requirements.

In 2012, the Freiburg Pension Model was adopted, which provides a tool for calculating the implicit pension debt of the social security system in compliance with the Eurostat and ECB standards. Furthermore, the introduction of a model for measuring the sustainability of pension systems was commenced.

At the beginning of 2012, the MNB launched a three-year project (ISTAT 2014) in order to prepare the Bank's integrated statistical information system to be adapted to the international methodological changes. The three-year project includes changes to several components of the information system, such as those supporting the balance of payments and financial accounts statistics that are most involved in the methodological changes.

Other events

In the area of balance of payments statistics, several methodological changes were introduced with the aim of improving the quality of data. In the quarterly publications on balance of payments statistics capital movements predominantly appearing as direct investments, which do not directly affect the external financing of the national economy (capital in transit), were presented separately, retrospectively to 2008. When releasing the annual balance of payments statistics, the MNB published bridges between the direct investment income resulting from normal business operations and the accounting profit of financial and non-financial companies. In addition, the MNB – in cooperation with the HCSO – fine-tuned the methodology of VAT resident corrections applied with respect to export and import data, further increasing the weight of individual corporate-level corrections as compared to the general model-based estimate.

In 2012, the publication titled *Hungary's balance of payments and international investment position statistics* was issued, presenting both the international methodology and the domestic practice applied to balance of payments and international investment position statistics.

As regards monetary statistics, the quarterly publication on the composition of household loans, first released in 2011, was supplemented in 2012 to cover detailed data on the components of changes in stocks of household loans and loans broken down by residual maturity.

In November 2012, the *Monetary Statistics Manual* was published to present the methodology of monetary statistics and the practice of compiling publications released on the website.

Both the statistical information system processing the data and the Data Warehouse underwent extensive upgrading in 2012. Within the Data Warehouse new data markets were provided for the analyst units and improvements supporting the accessibility and processing of data were carried out.

International data reporting and cooperation

The MNB complied with all of the reporting obligations pertaining to EU Member States in 2012. Accordingly, it regularly provided data to the statistical office of the European Union (Eurostat), the European Central Bank and the Bank for International Settlements (BIS). In accordance with its status as a central bank, and in line with the expectations arising from international cooperation as well as its membership obligations, the MNB provides data and information on a regular basis to the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Co-operation and Development (OECD). The MNB played and active role in international statistical working groups in 2012 as well.

3.7 PRACTICAL PREPARATIONS FOR EURO CHANGEOVER

The National Euro Co-ordination Committee (NEC) was established by Government Decree 1071/2007 (IX. 21.) in September 2007. In order to better reflect the new government structure, and also because of the uncertainty surrounding the expected date of the euro changeover and its impact on the scheduling of the related tasks, a decision was made to amend the above Government Decree by adopting Government Decree No 1296/3010 (XII. 21.) in December 2010. Since the Governor of the MNB is also the co-chair of the NEC, the MNB plays a key role in the preparatory tasks associated with euro adoption in Hungary. On the one hand, this role involves analysing and monitoring developments in the macroeconomic criteria of adoption, supporting its macroeconomic foundation and preparing the domestic payment and securities settlement systems and their participants, while on the other hand it also requires the MNB to manage practical preparations for euro adoption at a national level. The practical tasks relating to the introduction of the euro can be specified even if its future target date is not set for the time being, and practical preparation can be launched even in the absence of a valid target date.

In fact, the financial crisis and its consequences have postponed the possibility of setting a target date for the adoption of the euro. Based on the experience of several other Member States already using the euro, fulfilment of the convergence criteria (the so-called Maastricht criteria) is not sufficient for creating the conditions of adoption of the euro. In addition to complying with the economic conditions, the establishment of the practical, logistical, IT and legal frameworks related to the currency changeover also constitutes an important prerequisite. It is also clear that it is not enough to specify and commence practical preparations at a stage when the macroeconomic criteria have already been met, because this may lead to further delays in the introduction of the euro.

The major responsibilities of the NEC, which is in charge of managing the national preparations, are as follows:

– With the involvement of all relevant parties, it draws up the National Changeover Plan (NCP), which summarises the tasks and schedules relating to the changeover of the financial, corporate and public sectors, the legal and IT systems as well as consumer protection, accounting and statistics, and which is required for the adoption of the euro, the NEC reviews the NCP when it deems it necessary, and continuously monitors its implementation.

– Through the issuance of professional recommendations on IT, price-display and accounting systems, currency exchange and cash changeover practices, the NEC actively supports the preparation of the public and private sectors for the adoption of the euro.

– It uses efficient communication methods in order to raise the awareness of and provide information to the public in relation to the specific stages of preparation.

– It puts forward proposals with respect to the development of the legal framework of changeover and initiates legislation, where necessary.

Pursuant to the dual objective set forth in the medium-term strategy for 2007–2013 (conducting macroeconomic analyses, supporting practical preparation), within the scope of preparations for the adoption of the euro, the MNB regularly evaluates the progress of the convergence process and Hungary's 'euro maturity'. Based on the core responsibilities of the MNB defined in the MNB Act and its role in the European System of Central Banks, it is the primary objective and interest of the MNB to ensure that the Hungarian financial system is duly prepared for the adoption of the euro, regardless of the actual date of the changeover. The preparatory phase is a multi-annual process, in the course of which the MNB and the Ministry for National Economy jointly manage the elaboration and implementation of national tasks relating to the changeover within the framework of the NEC and in accordance with the applicable government decree.

Within the scope of its core responsibility arising from its function as the head of the Financial Sector Sub-Committee (FSSC), the MNB provides for the smooth implementation of the currency changeover and ensures that the entire system of domestic payment services (including payment and securities clearing systems and all relevant market participants) is prepared for adopting the euro. The conversion into euro of bank accounts, loans and other financial products, the transformation of insurance products, the adjustment of retirement account services and the securities market, and the provision of IT and infrastructure background support for the changeover involve tasks which will directly affect Hungarian society as a whole. Through its chairmanship of the Communication Sub-Committee (CSC) and relying on its extensive network of relations as well as on its own expertise gained in this special field the MNB is also given the responsibility to play a leading role in the communication and information activities associated with the changeover. A fundamental requirement for the dissemination of information on the euro changeover is that it should be credible, concerted, efficient and comprehensive when targeting the private and, in particular, the households sector.

In parallel with its leading role in updating the National Changeover Plan and in line with the provisions of the NCP, the MNB regularly updates its own preparatory tasks in the Bank's intra-institutional euro changeover programme.

3.8 FACTORS SHAPING THE COMMUNICATION OF THE MNB IN 2012; TARGETS AND RESULTS

As regards central banking communications, in respect of the Bank's objectives priority was given to improving the operation of the MNB's communication tools that support the financial stability and inflation targeting systems via solutions based on the involvement of an expert team as well as on transparency and proactive measures. Furthermore, the MNB continued to focus on increasing its reputation, recognition and credibility, as well as on familiarising the general public with its duties and activities. In addition to the above, the introduction of the intraday credit transfer system was another central issue in the MNB's communication activity in 2012.

The results of the image survey carried out in 2012 show that the number of people familiar with and having a true understanding of the MNB rose to a considerable extent. A vast majority of the public are of the opinion that the independence of the MNB is essential, and approximately half of Hungarian society gives a positive rating as to the Bank's insistence on sovereignty. The indicator reflecting public confidence in the MNB has also become higher, and the fact that confidence in other key institutions has been stagnating or has declined to some extent in the past period shows the significance of this growth.

Almost three fourths of the households were informed of the launching of intraday transfers, and two thirds of the respondents thought the MNB had informed the public to an adequate level. In 2012, the Bank continued and expanded its programmes for the public, as a result of which more than 10 per cent (approximately 1.1 million people) of the total Hungarian population were active participants of the Bank's public programmes (Visitor Centre, Money Compass, POP schools, youth festivals, Everyday Finances Programme, etc.). The lectures on banknote protection and the history of money held at the Visitor Centre (VC) were renewed, and new booklets on banknote safety and price stability were added to the series of VC publications. New and – according to feedback from the target group – successful educational films were produced for the lectures on price stability and financial stability.

The MNB was the first among European central banks to launch a YouTube page in June 2012. The animations available at the website support the achievement of the MNB's institutional goals to increase its credibility and the communication of the Bank's objectives to the public, thus contributing to the enhancement of financial literacy.

Coordinated by Money Compass Foundation, a Facebook page called 'Pénzbook' (Money Book) was launched with financial-economic and, in particular, central bank specific topics targeting secondary school students. The aim of page is to share practical information on finances using the features of Facebook. As a pilot project, the MNB's smartphone applications are now available on iOS and Android platforms: a new application demonstrating the security elements of banknotes and one using the MNB's exchange rate information service was launched.

All in all, the MNB has used the most up-to-date tools of strategic communication to ensure that its complex activity serving the interests of the public good are transparent and effective, and its messages reach the target audiences efficiently.

3.9 THE MNB'S INCOME IN 2012

In 2012, the operations of the Magyar Nemzeti Bank resulted in a loss of HUF 39.8 billion. The financial result and balance sheet structure of the Bank are primarily determined by the domestic and international macroeconomic developments and the objectives and selected measures of monetary policy. In 2012, the following main developments had an effect on the balance sheet and the profit/loss:

– the level and composition of foreign exchange reserves defined by monetary policy, and foreign exchange purchases and sales affecting the level of reserves: operations performed by the Government Debt Management Agency in relation to debt management, net foreign exchange inflows from EU transfers, foreign exchange conversions performed by the Hungarian Treasury for purposes other than debt-financing, and euro sales tenders linked to the early repayment of foreign exchange mortgage loans allocated to households;

Table 4
Abbreviated income statement and individual balance sheet items of the MNB

HUF billions

No.	Description (P/L line)	2011	2012	Change
1	Net interest and interest related income (I+II)–(X+XI)	–94.0	–153.6	–59.6
2	*net forint interest and interest related income (I–X)*	*–312.7*	*–341.2*	*–28.5*
3	*net foreign exchange interest and interest related income (II–XI)*	*218.7*	*187.7*	*–31.0*
4	Realised gains/losses arising from financial operations (IV–XIV)	24.7	–33.2	–57.9
5	Income arising from exchange rate changes (III–XII)	98.7	158.3	59.6
6	Other constituents of net income* (V+VI+VII+VIII)–(XIII+XV+XVI+XVII+XVIII)	–15.8	–11.3	4.5
7	**Profit/loss for the year (1+4+5+6)**	**13.6**	**–39.8**	**–53.4**
	Revaluation reserves in the balance sheet			
8	*due to unrealised foreign exchange gain/loss*	*1,325.0*	*564.0*	*–761.0*
9	*due to changes in the market value of the foreign currency securities*	*5.6*	*–30.2*	*–35.8*

** Net P&L of banking operations, costs of issuing banknotes and coins, net creation and release of provisions, income/expenses from commission and from other items.*

– developments in instruments absorbing forint liquidity, which are correlated with changes in foreign exchange reserves and the MNB's net foreign currency receivables;

– changes in forint interest rates and international foreign exchange interest rates; and

– changes in the forint exchange rate.

The MNB's net interest income is typically negative, because the MNB finances its foreign exchange reserves, which account for more than 90 per cent of its balance sheet total, predominantly from forint sources, and foreign exchange yields are lower than the average forint interest rates. In 2012, the net interest and interest-related losses amounted to HUF 153.6 billion, HUF 59.6 billion higher than a year earlier. The main reason for this is that the difference between forint and foreign exchange interest rates grew in 2012.

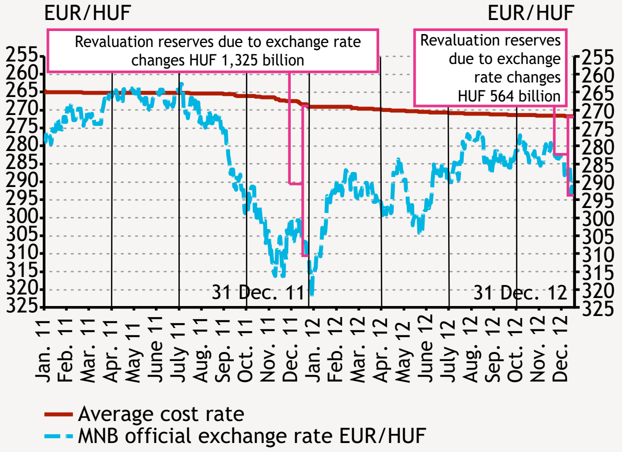
Net forint interest and interest-related losses amounted to HUF 341.2 billion, HUF 28.5 billion more than in 2011. The average central bank base rate weighted with calendar days was 73 basis points higher in 2012 than in the previous year. Forint liabilities where interest-bearing is pegged to the base rate (forint deposits of the central government, minimum reserves and liquidity absorbing instruments) rose slightly in the first half of the year, but dropped in the last quarter. In this period, the reduction in interest rates that started at the end of August had a positive impact on net forint interest income.

Net foreign exchange interest and interest-related profit amounted to HUF 187.7 billion, which was HUF 31 billion less than a year earlier owing to the lower interest income on foreign exchange reserves. This was attributable to the decrease in reserves and the lower euro yields as compared to the previous year. The average interest rate on FX reserves converted into HUF was 2.1 per cent, i.e. 0.5 per cent lower than in 2011.

The realised total loss arising from financial operations amounted to HUF 33.2 billion. This category of P&L mainly states gains and losses realised from changes in the market prices of securities included in the FX reserves as well as realised gains or losses on Hungarian government bonds and mortgage bonds in the case of maturing instruments or the sales of instruments. Fixed-income, high-coupon securities represent a substantial proportion in foreign exchange reserves, continuously earning above-market interest income. These securities are purchased above par value, causing a loss upon maturity or sale. This is the reason behind the realised total loss on financial operations.

The two main factors determining the income arising from exchange rate changes are the difference between the official and the cost rate as well as the volume of foreign exchange sales. In January, the Bank's foreign currency sales materially exceeded the normal level as a result of the euro sale tenders relating to the early repayment of foreign exchange mortgage loans. In the following period of the year, an exchange gain was earned on foreign currency sales executed with the Government Debt Management Agency. These transactions were required due to the payment of instalments of the IMF loan raised by the Hungarian government and the maturity of foreign currency bonds. The other main factor determining foreign exchange gains or losses is the difference between the official and cost rates, which started increasing in early January from the 42.11 HUF/EUR of 31 December 2011, but declined considerably during the rest of the year, resulting in a much lower difference of 19.55 HUF/EUR on 31 December 2012 as compared to the beginning of the year. The difference between the official and the cost rate was the largest in January, when the volume of foreign currency sales reached a peak, resulting in outstanding exchange rate gains. In the course of the year, the exchange rate gains earned by the MNB amounted to HUF 158.3 billion, which was the Bank's most remarkable profit.

Chart 18
Changes in the forint exchange rate
(inverse scale)



Other constituents of net income include general operating income, costs and expenses, costs of issuing banknotes and coins, creation and release of provisions, and income/expenses from fees and commissions and other income/expenses. Net expenses decreased by HUF 4.5 billion in 2012 as a result of the lower costs of production of banknotes and coins and lower operating costs, and the positive changes in provisions and impairment loss also improved the Bank's financial performance.

The MNB's equity amounted to HUF 551.1 billion at the end of the year. It was basically determined by the level of revaluation reserves – mainly by the reserves due to exchange rate changes – and the annual profit/loss also contributed to changes in the amount of equity.

Revaluation reserves due to exchange rate changes, fell by HUF 836.6 billion compared to the end of 2011. The main reason for this is the growing gap between the official forint exchange rate and the average cost rate, while the lower stock of revalued foreign currencies (net FX position) also contributed to the decrease. On 31 December 2012, the closing value of revaluation reserves due to exchange rate changes was HUF 564 billion.

On 31 December 2012, the MNB's balance sheet showed unrealised losses of HUF 30.2 billion on foreign currency securities marked to market, which was reflected in the revaluation reserves of foreign currency securities.

Pursuant to the MNB Act: where the amount of loss incurred in the reporting year exceeds the Bank's retained earnings, the difference shall be reimbursed from the central budget. Since the MNB's retained earnings (HUF 47 billion) cover the 2012 losses, the central government did not have a loss reimbursement obligation pursuant to the MNB Act.

Furthermore, the MNB Act prescribes: if the total balance of the two revaluation reserves shows a negative balance at any year end, and exceeds the total amount of retained earnings and the profit/loss for the year, the negative balance is reimbursed by the central government until 31 March of the year following the reporting year. This way the Act guarantees that the Bank's equity is positive at the end of the year and cannot fall below the level of its subscribed capital (HUF 10 billion). On 31 December 2012 the total balance of the two revaluation reserves amounted to HUF 533.8 billion, therefore, the central government had no reimbursement obligation.

3.10 FINANCIAL PERFORMANCE OF THE MNB

Internal operations of the MNB in 2012

The internal operations of the MNB are essentially aimed at providing the resources required for an efficient discharge of the duties stipulated by the MNB Act and for facilitating risk-free operations in the most cost-effective manner.

Operating costs amounted to HUF 11,648 million in 2012, which was 2 per cent (HUF 234 million) lower than in 2011. The reduction relative to the previous year is due primarily to the absence of expenses incurred in relation to the Holocaust litigation (included in the category of other costs), the lower staff level (included in staff expenditures), and the smaller amount of amortisation. The downward trend was somewhat restrained by the moderate increase in IT costs.

In 2008, the year when the project to improve operational efficiency was launched, the operating costs of the MNB amounted to HUF 14.9 billion. As a result of the continuous cutbacks, the total savings achieved in the past four years is more than HUF 3.3 billion at annual level, representing a decline of over 22 per cent in nominal terms compared to the expenditures in 2008. The Bank achieved this partly by implementing the efficiency-improving project, and partly by a change in focus, that is, giving priority to cost-effective solutions as an outcome of the project. The savings in expenditures were also attributable to the interim legislative changes leading to lower costs.

The 2012 operating costs were the lowest in the period since 1997.

The financially realised value of investment implemented in 2012 was close to HUF 1.1 billion, considerably higher than in the previous year. Another contributing factor, in

Table 5
Operating costs of the MNB in 2012

Description	Actual data for 2011	Budget for 2012	Actual data for 2012	Index (2012 actual / 2012 budgeted)	Index (2012 actual / 2011 actual)
	HUF millions			%	
1. Staff expenditures	6,884	6,868	6,791	98.9	98.6
2. General operating costs	4,998	5,089	4,857	95.4	97.2
Total	**11,882**	**11,957**	**11,648**	**97.4**	**98.0**

addition to the improved implementation of plans, is that some of the investment projects (e.g. reconstruction of the working areas of the Back Office organisational unit) commenced in 2011 were completed in 2012, and some unscheduled investments were realised (e.g. purchase of vehicles).

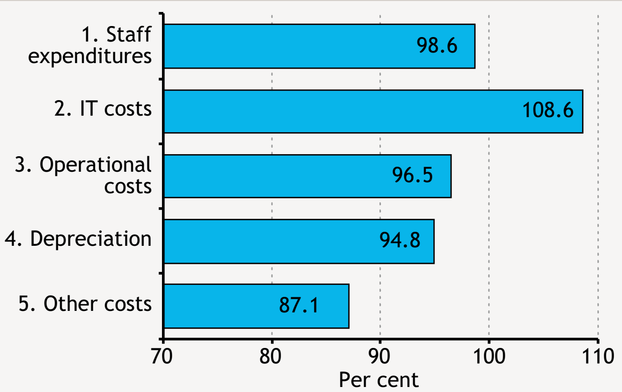
Most of the investment projects made involved IT developments associated with strategic objectives and aimed to increase the accountability of IT operators (HUF 68 million), the version upgrade of the business management system (SAP) (HUF 61 million), the modernisation of the data centre tools of the IT network (HUF 49 million), and the procurement of user workstations (HUF 35 million).

In addition, the completion of several development projects was postponed to 2013, and many devices were procured at a lower price than planned. The highest-budget developments planned to be completed in 2012, but postponed to 2013 are investments relating to the integrated statistical system (HUF 69 million), the renewal of the telecommunication system used by the sales staff (HUF 57 million), the replacement of the building amplification system (HUF 30 million), and implementation of the Date Storage strategy (HUF 19 million).

Operating costs

The approved operating cost budget for 2012 (net of central reserves) was HUF 11,957 million, whereas actual costs amounted to HUF 11,648 million. This amount represents a 2 per cent (HUF 234 million) reduction in operating costs compared to 2011, and this cutback affected all cost types, except IT costs, with other costs accounting for the largest amount and extent.

Chart 19
Ratio of operating costs in 2012 to actual data in 2011



Staff expenditures

Personnel expenses in 2012 (HUF 6,791 million) dropped by an overall 1.4 per cent (more than HUF 90 million) relative to 2011.

The rise in staff costs caused by the 1 per cent general wage increase and the 0.8 per cent promotion-related increase was offset by the cost reduction resulting from the 1.4 per cent shrinkage in staff (8.4 persons). Similarly, costs were lowered by the decrease in management bonus payments in accordance with the rates specified in the remuneration strategy for 2012-2014 as well as the payment of allowances for shiftwork pursuant to the rules set forth in the Labour Code effective as of July 2012. Dismissal and redundancy costs remained below the amounts paid in 2011, whereas the legislative changes to contribution payments led to an increase in costs.

General operating costs

Compared to 2011, general operating costs in 2012 (HUF 4,857 million) fell by 2.8 per cent due to the effect of opposite changes in the components.

Facility operation costs in 2012 were HUF 47 million lower than in 2011. The security guarding system of the Logistics Centre changed: from 2012, only one service providers is responsible for the security guarding tasks of the facility instead of the former two. The maintenance costs of the headquarters in Szabadság Square also declined, partly owing to the fact that some of the maintenance works due every 2-3 years were not required in 2012 and partly to the introduction of new cost-efficiency measures. Expert fees paid in 2012 in relation to technical consultancy were also far below the previous year's amount, as some procurement procedures and contracts fell behind schedule. However, the above cost savings were counterbalanced by additional expenses incurred under other titles. For example, the operation of (first leased and then new) motor vehicles provided to members of the Monetary Council and the replacement of combined access cards prescribed by the modified MNB Act led to new expenditures.

Relative to the previous year, IT costs were more than HUF 100 million higher in 2012 primarily owing to the operating costs related to the new portfolio management system, appearing as a new item among the MNB's operating costs in 2012. Compared to 2011, some new or additional costs arose in connection with the support given to the linked certification service, for example, and the maintenance of the virtual backup unit.

In 2012, the amount of depreciation write-offs was 5.1 per cent (more than HUF 90 million) lower than in the previous year, mainly as a result of the decline in the volume of capital investments.

Other costs also fell relative to the previous year (by nearly HUF 106 million), basically due to the absence of expenses incurred in connection with the Holocaust litigation, as the Minister of National Development acting on behalf of the Hungarian Government took over responsibility for the tasks – along with the relevant costs – relating to the litigation from the MNB (in 2011, the MNB incurred litigation expenses in the amount of HUF 91 million).

General operating costs were also reduced by the lease fee paid by Magyar Pénzverő Zrt. for using a part of the Logistics Centre, the operating costs of VIBER, and minor income from services related to welfare activities and recognised as a book transfer.

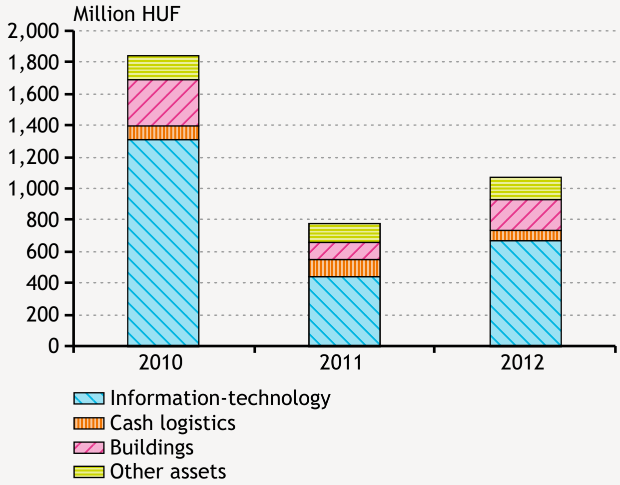
Capital expenditure

In December 2011, the Governor of the MNB approved a capital expenditure budget of HUF 1,450 million for new investments in 2012 and investments with an updated schedule, taking account of appropriations for investments already in progress pursuant to earlier decisions. The MNB spent approximately three fourths of the scheduled capital expenditure appropriations on the procurement of IT equipment.

The value of investments implemented in 2012 amounted to HUF 1,069 million, which exceeds the value of capital expenditure in 2011. Another reason for this besides the lower budget of capital investments in 2011 relative to that of the previous years is that some of the capital projects commenced in 2011 were completed in 2012. The value of capital expenditure in 2012 was also influenced by the fact that as a result of the joint efforts made by the cost bearers and Central Procurement, several assets were purchased at a price lower than planned. Another contributor to savings was that due to the interim changes in requirements some upgrades were carried out with a different technical content or in lower volumes than originally planned.

The majority of the capital projects implemented in 2012 were linked to the upgrading of IT infrastructure. Of these, the most important was the investment aimed at increasing accountability through the purchase of hardware and software that provide detection control over the activity of IT operators performed in the course of normal operations on systems that are critical from the aspect of vulnerability. The network upgrade project was another high-budget investment involving the purchase of expansion cards capable of regulating network traffic. The implementation of the upgrade project was necessitated by the ESCB guideline prescribing the replacement of outdated cryptographic modules, and shortened the response times in teleworking applications. In the framework of the procurement of user workstations, the Bank purchased desktops and laptops to replace obsolete devices. In 2012, the new version of the SAP business management system was installed, which was required due to the fact that manufacturer support terminated with respect to the earlier versions.

Chart 20
Trends in the MNB's capital expenditure



The quality of the information system supporting central bank statistics is of crucial importance, and an essential condition for this activity is the availability of high-quality IT support. In 2012, the MNB continued its integrated statistical system programme, in the course of which – among others – the upgrade projects carried over from 2011 were completed, and the IT system was prepared for the changes in statistical methodology, most of which are to be introduced in 2014. Furthermore, improvements were made to the statistical data receiving system in order to facilitate statistical data supply.

As part of the MNB's medium-term strategic objectives, several, mainly IT-related capital projects were carried out in 2012 with the aim of improving effectiveness and efficiency. The most noteworthy of these projects were the replacement of obsolete servers and the purchase of DWDM devices. This latter involved the purchase and installation of devices which increased the capacity of data transmission between the central MNB building and the Logistics Centre.

As regards capital projects linked to real property, the major investment was the replacement of windows in the Szabadság Square building scheduled for 2012. The windows installed in the framework of this project are up to the latest technological standards, yet they meet the criteria of monument conservation. Similarly, in the main building the necessary reconstruction works were carried out in the office areas of the Back Office and Statistics, and the power distribution switchboards were upgraded and standardised so as to comply with statutory requirements.

In 2012, Cash Logistics purchased new banknote handling machines for testing to enhance banknote protection, and also bought scales that were necessary for conducting banknote inventories. In addition, the required work safety equipment was purchased for the automatic depository.

Among other capital projects implemented in 2012, passenger cars were purchased partly to replace obsolete vehicles and partly to comply with the provisions of the modified MNB Act. Communication-related investments included the production of the educational films titled 'Financial Stability' and 'Price Stability', which aimed to enable the Bank to perform its financial stability function at the highest possible standard. In addition to the above, purchases needed for daily work, such as mobile telecommunication tools and uniforms for security guards, were made and recorded as other capital projects.

Human resources management of the MNB

In 2012, while performing normal operations, Human Resources set its strategic objectives for the next two years and performed preparatory tasks with respect to the implementation of the new Labour Code.

Ensuring compliance with legislative provisions

The new Labour Code that entered into force as of 1 July 2012 fundamentally affected a wide range of rules pertaining to employment. Following reconciliation with the concerned advocacy groups, the MNB incorporated these legislative changes into its human resources management, internal policies and collective bargaining agreement.

Career management

In 2012, the MNB took further efforts in support of its employees' career paths. For those who had joined the 'Leadership Potential Programme', a new series of practice-oriented management skills development programmes was launched, and the Bank's internship programme was also expanded both in terms of the number of participants and the organisational units involved.

Rotation is increasingly popular, especially in the analyst departments. In 2012, five new employees joined the rotation programme. In addition to enabling the participating colleagues to expand their professional experience and acquire new knowledge, the programme opened new horizons in their way of thinking regarding their professional career and strengthened cooperation among the individual departments by giving the participants the opportunity to gain a deeper insight into the activities of the various organisational units. (Rotation is also included in the Career Management Guideline, thus supporting the institutionalisation of this career development tool.)

In accordance with the 'HR potential review' model developed in 2011, the MNB carried out a comprehensive review of its staff as a whole so as to provide support for managers in identifying and training their key experts and talented individuals.

Electronic payroll system

With a view to adopting the paperless office approach aimed at increasing the efficiency of employment-related administrative tasks and the satisfaction of its employees, from January 2013 the monthly payrolls are made available to the employees on an internet interface, and from then on no more paper-based monthly payrolls are issued. With the help of the electronic payroll system the employees can download their e-payrolls after their monthly wage is transferred. They can save, print or email the downloaded monthly payrolls, if so required. The system provides access to monthly payrolls back to January 2010 in retrospect, and besides the monthly payrolls the annual wage statements are also available to the employees in an electronic format.

Employer image

In 2012, the Bank developed a more uniform and active employer image. In developing a new employer brand, the MNB intensively focused on the positive features that had already made the Bank an attractive workplace (high professional prestige, opportunities for individual advancement). As a result, the employer strengths already well known within the MNB (e.g. performance- and result-oriented operation, supportive working environment, community life, career opportunities) became visible to the outside world as well. The creative concept renewed with the involvement of colleagues selected on the basis of staff recommendations and undertaking the role of ambassadors was presented at the 2012 Career Expo with great success. In addition to ensuring a uniform external appearance, another aim of the renewed employer image was to boost staff commitment.

Staff number and fluctuation

In 2011, the average staff number of the MNB was 581, i.e. 10.3 fewer employees than in the previous year. At the end of 2012, the total headcount was 573, so the number of employees dropped by 9 (1.5 per cent) relative to the 2011 year-end staff number.

The changes in the MNB's staff number in 2012 were affected by the measures taken on the basis of the staffing plan drawn up for 2012. This involved an increase in the staff level owing to the filling of positions that had become vacant in 2011, the continued internship programme and changes in the work processes of the Back Office, and a reduction in staff due to redundancies in the Cash Logistics unit as a result of the introduction of automated, container-based banknote processing. In addition to the planned measures, the MNB's staff level was temporarily lowered owing to the fact that recruiting employees for positions becoming vacant due to rotation or promotion was carried over into 2013.

In 2012, the employment of 42 staff members was terminated. Termination was initiated by the employer in 12 cases and by employees in 17 cases, while 13 terminations were due to retirement or other reasons (e.g. expiry of fixed-term contract, etc.). On the other hand, 35 new employees joined the MNB in 2012, filling vacant or new positions.

As a consequence of these changes, the proportion of employees with a degree continued to increase in 2012. As regards the composition of staff by age, a slight increase can be observed: the average age of employees was 41.5 years in 2012. The average length of employment at the Bank changed from 12.6 years in 2011 to 13.1 years in 2012.

Procurement

The procurement procedures executed in 2012 also substantiated that the right decision was taken when the MNB introduced the best market practice. As compared to the previous year:

– the number of tenderers increased from 4.7 to 6.2,

– three quarters of the companies invited to tender submitted their bids,

– the average lead time of the procedures became even shorter than in 2011.

In 2011, one action for legal remedy was taken against the MNB's public procurement procedures, in which the Public Procurement Arbitration Board did not impose any penalty. The high court of appeal made positive decisions in all issues contested by the MNB in the legal remedy proceedings initiated ex officio by the chairman of the Public

Table 6
Changes in labour flow indicators in 2012

Indicators	2010	2011	2012
Fluctuation			
Fluctuation (departing employees + new entries / 2 x total headcount)	9.6%	10.6%	6.6%
Departure rate (departing employees / total headcount)	10.7%	11.9%	7.2%
Voluntary departure rate (ratio to total headcount)	4.4%	4.6%	2.9%
Voluntary departure of key employees	2	6	2
Voluntary departure rate of key employees leaving the country	0.0%	16.7%	100.0%
Recruitment			
Recruitment needs	52	46	51
Ratio of recruitments to replace departing employees to total rectruitment needs	63.5%	93.5%	78.4%
Ratio of new entries to total headcount	8.5%	9.3%	6.0%
Open positions filled internally	37.3%	22.2%	36.4%
Working time			
Working time exploitation *	85.1%	85.0%	83.9%
Sick leave time to total working time **	1.6%	1.7%	1.3%

** Working time exploitation = number of actual working hours / total working time*
*** Sick leave time = (sick-leave + number of days on sickness benefit) / total working time*

Procurement Council in relation to the communication agency tender launched in December 2010.

In 2012, the number of counterparties issuing e-bills continued to increase. In the last quarter, more than half of the bills were sent electronically.

After completing the pilot period, a fully electronic tendering process will be introduced. Electronic tendering is another step towards a further decrease in the number of paper-based documents, while it also has the advantage of a lower risk of less competition arising from late bids as well as reduced administrative burdens.

Managing operational risks

In the deteriorating external market environment resulting from the prolonged international financial crisis as well as in the rapidly changing domestic regulatory environment, the cost-effective management of operational risks remained a task of primary importance.

The appropriate management of operational risks is also a key element of cost-effective financial management, since, on the one hand, the realisation of risks may cause financial losses and, on the other hand, the reduction of risks entails direct costs as well. Therefore, it is important to ensure that conscious, focused and proportionate measures are taken in respect of the management of risks.

Structured registration and analysis of events and incidents with minor effects taking place in the course of the Bank's operation provides important information for a reasonable assessment of operational risks. These events may highlight the vulnerability of banking processes and the risk exposure of their values, allowing timely and more successful preparations in order to avoid more serious losses. Some organisational units have been collecting data on events for several years, and by now this practice has become general in the work of the Bank as a whole.

The MNB believes it is an important task to ensure that its employees have a high level of practical knowledge and skills regarding occupational safety. Therefore, in the first half of 2012, the MNB carried out a fire evacuation exercise that was not pre-announced. The exercise was directed by the Security organisational unit and was completed successfully.

The MNB has been continuously improving its ability to react to events that jeopardise the smooth performance of its basic tasks appropriately. This is achieved through the preparation of business continuity plans and regular tests. For the first time, the MNB carried out a test, under real circumstances, in which it operated its IT system and its critical work processes related to the operation of the payment system from a backup site located in the Logistics Centre. This successful multi-day test was suitable for checking how the action plan aimed to guarantee the uninterrupted operation of the payment system as a whole worked. In addition, further successful tests proved the operability of the business continuity concepts developed for the temporary management of the potential cash supply crises of the financial sector.

The MNB's commitment to corporate social responsibility made it necessary to manage operational risks that may jeopardise the Bank's good reputation through the possible illegal employment of any of its counterparties' staff. Therefore, the MNB decided to institutionalise inspections regarding the legality of employment and extend their scope of application to all contractual counterparties.

3.11 INTRODUCTION OF THE ESCB COMMITTEES

Since Hungary's accession to the European Union, the MNB's management and experts have been participating in the work of ESCB committees and their working groups. These committees and working group provide an opportunity for national central banks to work together and formulate joint positions. This cooperation also enables the representatives of national central banks to obtain information on the ECB's activities on a regular basis.

Below is a brief summary of the fields of activity (mandates) of each ESCB committee:

Accounting and Monetary Income Committee (AMICO): It develops and regularly reviews accounting policy principles which define the framework of financial statements in accordance with the Statute of the ESCB and the methodology of the preparation of regular financial reports, facilitating their coordination at an international level. It monitors the calculation of monetary income based on the risk management process developed by the security framework system of accounting.

Banknote Committee (BANCO): It determines the euro banknote needs of euro area countries, coordinates the production of banknotes and works out the stockpiling and banknote processing policies of euro banknotes. Its tasks include the exchange of experiences gained from the production of euro banknotes, the examination and development of security features to prevent euro banknotes from being counterfeited, and the assessment of security risks related to the production of the euro. It contributes to the harmonisation of practices applied in the euro area, the development of the system which monitors counterfeiting, and the verification of statistics regarding euro banknotes and coins.

Committee on Controlling (COMCO): COMCO has been an ESCB committee since July 2007 (only euro area NCBs participate in the work of this committee.). It contributes to the application and enhancement of the Common Eurosystem Cost Methodology, and it prepares analyses on the cost data and cost structure of certain functions and products of the Eurosystem/ESCB. In the area of management information systems, it serves as an important forum for cooperation and information exchange on issues concerning the ESCB as a whole. Between July 2007 and April 2012 COMCO operated under the name 'Committee on Cost Methodology', and on 18 April 2012 its name was modified to 'Committee on Controlling' (hence the name of the committee highlights the significance of the financial controlling function the committee fulfils in the preparation and implementation of euro area projects.)

Eurosystem/ESCB Communications Committee (ECCO): It contributes to the development of the external communication policy of the Eurosystem, the ESCB and the ECB with the aim of making the objectives defined by the Eurosystem/ESCB more transparent and understandable and informing the public of the tasks and activities of the Eurosystem and the ESCB.

Financial Stability Committee (FSC): The FSC has been operational since 2011, when the Banking Supervision Committee (BSC) ceased to operate. Its task is to provide professional support to the decision-making bodies of the European Central Bank in their functions relating to financial stability.

Internal Auditors Committee (IAC): By reviewing relevant common projects, systems and activities, and by providing for cooperation in certain auditing issues which are of 'common interest' for the ECB and national central banks, this Committee assists the ESCB in achieving its targets.

International Relations Committee (IRC): It assists in carrying out those tasks of the ESCB that are related to international cooperation. It contributes to formulating the position of the Eurosystem regarding the various areas of relations with non-EU countries; within the EU it analyses the status of the accession process to the EU and to the EMU and issues related to ERM II.

Information Technology Committee (ITC): It contributes to the development of the information technology policy and strategy of the Eurosystem and the ESCB, develops the related guidelines with special regard to security concerns, and provides technical advice to other committees. Furthermore, it initiates and implements Eurosystem and ESCB level developments and independent projects.

Legal Committee (LEGCO): It contributes to the maintenance of the regulatory framework of the Eurosystem and the ESCB, monitors and reports on how national authorities and the Community comply with their consultation obligations relating to draft legislation in areas falling within the ECB's competence.

Market Operations Committee (MOC): It assists the ESCB in the implementation of the single monetary policy and the execution of foreign exchange transactions, including those related to the operation of ERM II and to the management of the ECB's foreign reserves, as well as in the appropriate adaptation of monetary policy tools applied by the central banks of Member States where the euro is yet to be introduced.

Monetary Policy Committee (MPC): It assists the ESCB in the implementation of the single monetary and exchange rate policy of the Community. In addition, it provides assistance in the execution of the ESCB's tasks related to the coordination of the monetary and exchange rate policies of the NCBs of non-euro area Member States and the ECB.

Payment and Settlement Systems Committee (PSSC): It assists the ESCB in the smooth operation of the payment system, and the cross-border use of collaterals. Furthermore, it supports the ESCB in general and 'oversight' issues relating to payment systems, as well as issues concerning central banks in respect of securities clearing and settlement systems.

Risk Management Committee (RMC): The ECB approved the formation of this Committee in September 2010. The RMC has only euro area members, and its task is to assist the work of ECB decision-makers in managing and controlling risks arising from the market operations of the Eurosystem by means of analyses and proposals.

Statistics Committee (STC): It assists the ESCB in collecting statistical information required for the execution of its tasks. It contributes, inter alia, to the elaboration and cost-effective application of necessary modifications in statistical data collection.

Other committees assisting the work of the ESCB:

Budget Committee (BUCOM): It assists the Governing Council of the ECB on issues concerning the budget of the ECB, and it is composed of Eurosystem NCBs.

Human Resources Conference (HRC): The objective of this committee, which was established in 2005, is to serve as a forum for the central banks of the Eurosystem/ESCB in the exchange of information, opinions and experiences on issues concerning the management of human resources.

Eurosystem IT Steering Committee (ECCO): The EISC was established in 2007 for the purpose of managing ongoing information technology developments in the Eurosystem, with special regard to responsibilities relating to the IT governance of the Eurosystem. It assists the Governing Council of the ECB in its decision-making process regarding joint information technology projects and operations with the Eurosystem/ESCB, thus contributing to the effectiveness and efficiency of IT management. It is composed of euro area NCBs.

3.12 THE MNB'S RESEARCH ACTIVITIES IN 2012

At the MNB basic research is carried out primarily by the Research department, while applied research is conducted by the other units. Among these, special focus is given to cooperation and research networks initiated by the ECB (Macroprudential Research Network, MARS; Competitiveness Network, Compnet; AC Nielsen pricing project; Households' Finances and Consumption Network, HFCN). The results of these projects are mostly published in the MNB's own series of publications (MNB Working Papers, MNB Occasional Papers, MNB Bulletin) or disclosed in boxes in regular publications. Furthermore, the MNB's researchers have held lectures or have been invited as discussants at several national and international conferences, and their studies have been published in domestic and high quality international academic journals.

In addition to its direct research activity, the MNB has undertaken an active role in the academic community and its support. The Scientific Committee evaluating scientific grants has supported a number of domestic conferences, key academic journals as well as scientific organisations and events. Since 2009, the MNB has been organising courses of high international recognition and attendance in the framework of its School for Central Banking Studies. In cooperation with the London-based Centre for Economic Policy Research (CEPR), the Bank organised a joint academic conference entitled 'Microeconomic behaviour and its macroeconomic consequences during the financial crisis' again in 2012; and continues its regular series of public seminars with international lecturers.

The researchers of the Bank are highly recognised in Hungary's academic life. They regularly attend the annual conference of the Hungarian Society for Economics, with some of them being founding members of the Society, or current or former board members. They are representatives in the jury of the Hungarian Scientific Research Fund (OTKA), and they also participate in the work of the Economics Committee of the Hungarian Academy of Sciences (MTA). Several researchers teach or hold lectures at leading Hungarian universities and colleges and take part in doctoral committees.

In the Bank's research activity priority is given to the model-based support of the preparation of economic policy decisions. While operating and continuously improving the Monetary Policy Model (MPM), which provides a backbone for forecasts, a number of other key model developments were completed or initiated in 2012. An example is the medium-term fiscal and external sustainability model, and the analysis of the real economy's reaction to the financial crisis (rebalancing). Other analytical projects include, for example, the decomposition of financial market indicators, the filtering of transit capital out of the balance of payments data, an analysis of the consumption-saving figures and behaviour of households, the framework of macroprudential policy, the set of indicators describing the state of the financial intermediary system, and the development of a set of tools predicting its behaviour. Some of the MNB's staff members were involved – partly relying on their former research activities – in preparing the 2013 edition of *The Hungarian Labour Market* as authors or editors.

As a priority project, the Hungarian adaptation of the pension model of the University of Freiburg was completed, and on the basis of this the MNB's own pension model is being developed. On the one hand, this provides an appropriate background for meeting the data disclosure obligation regarding the implicit debt of the pension system taking effect from 2017, while, on the other hand, it can be used for analysing the medium- and long-term receipts and expenditures of the Hungarian pension system, as well as its implicit debt and sustainability.

In 2012, several surveys, analyses and research projects were conducted on domestic payments, particularly on trends in cash payments and on factors determining the excessive use of cash. A publication, also raising international interest, was issued on the network-based analysis of the past twenty years of domestic cash supply. Similarly, network-based analyses were carried out on the operation of domestic interbank and FX swap markets, partly in the form of external cooperation.

In the autumn of 2012 another external assessment was launched regarding the MNB's research activity. Its authors are Pierre Siklós from Wilfrid Laurier University and Anders Vredin from Sveriges Riskbank (the previous one was carried out by Loretta Mester from the Philadelphia FED and László Halpern from MTA-KTI). The report to be completed in the first few months of 2013 is expected to provide further recommendations promoting research activities at the level of the bank and the organisational units. On the basis of these, the process of a systemic review of the research activity going on in the individual organisational units can be started in 2013, with specific actions and proposals for measures to be developed along the recommendations.

3.13 PUBLICATIONS AND CONFERENCES ORGANISED BY THE MNB IN 2012

Publications

Quarterly Report on Inflation

The Report on Inflation is published quarterly in order to enable the public to understand and follow the Bank's policies. The Report provides a regular presentation of past and expected future trends in inflation, evaluates the macro-economic processes that are key to inflation, and provides a summary of the forecasts and considerations on the basis of which the Monetary Council takes its decisions.

Report on Financial Stability

Published twice a year, this report outlines the standpoint of the Bank regarding developments in the financial system and describes the effect of these changes on the stability of the financial system.

Report on Payment Systems

2012 is the first year that the MNB has published its Report on Payment Systems. Pursuant to the MNB Act, one of the main responsibilities of the MNB is to promote the smooth execution of payments and the reliable and efficient functioning of the payment and settlement systems. From now on, this new, annually published report will provide a comprehensive review of the trends in payments and the functioning of overseen payment and securities settlement systems in Hungary, the main risks, and the measures taken by the MNB in order to fulfil its basic task as mentioned above.

Quarterly Report: Quarterly report on the MNB's activities

In line with the central bank act enacted at the beginning of 2012, a new reporting framework was introduced in the MNB. This year only the Quarterly Report, which had formerly been published four times a year to provide a brief overview of the activities carried out by the Bank's organisational units in the previous quarter, was published only on two occasions, in January and in April. Then, this publication ceased to exist, as it was replaced by two new periodical publications: the Semi-annual Report and the Interim Report. This reporting system ensures compliance with the relevant legislative provisions, while it also enables the Bank to use its resources optimally.

Interim Report: Quarterly report on the MNB's activities

The content of the new publication is similar to that of the former Quarterly Report: monetary policy, overview of the financial system, foreign exchange reserves, payment transactions, currency-issuing activity, statistical changes. It is published twice a year, in April and November, between the annual and semi-annual reporting periods. The MNB published the first issue on 20 November 2012.

Semi-annual Report: Semi-annual report on the MNB's activities

The content of the new publication is similar to that of the Annual Report: it is the Bank's business report on the first half of the year. It is published once a year in September. The MNB published the first issue on 18 September 2012.

Annual Report

Published once a year this publication presents the Bank's business report on the previous year and its audited annual financial statements.

MNB Occasional Papers

The series comprises and discloses economic analyses related to the MNB's monetary decision-making process. The series aims at increasing the transparency of the monetary policy. Accordingly, in addition to studies describing the technical details of forecasting, the publication also covers the economic issues surrounding the preparatory work of decision-making.

MNB Working Papers

The series discloses the results of analyses and research conducted in the MNB. The analyses reflect the opinions of the authors and may not necessarily coincide with the official stance of the MNB. Since the autumn of 2005 the series has been available only in English.

MNB Bulletin

In 2012, the seventh issue of the Bulletin was published. The short articles it contains are intended to inform the general public in a comprehensible format about current economic trends and about the findings of research projects in which the Bank is involved. In 2012, the publication was issued three times.

Senior loan officer survey on bank lending practices

In the spring of 2003, the Magyar Nemzeti Bank first published this survey in order to facilitate a better grasp of bank lending processes. It supports an understanding of the way in which key domestic banks perceive and evaluate market processes, formulate their respective strategies and, within that, their lending policies. To enable closer monitoring of the qualitative aspects of the developments in loan supply, the Bank conducts the survey on a quarterly basis.

Public Finance Review

An expert team of the MNB conducts regular analyses of fiscal processes in order for the Bank to be able to conduct its tasks relating to the definition and implementation of monetary policy at the highest professional standard. A new publication titled Public Finance Review enables the wider public to familiarise itself with the main results of expert analyses. The findings and conclusions disclosed in the analyses reflect the opinions of the analysts and are not to be regarded as the official standpoint of the MNB or the Monetary Council. In 2012 the publication was issued twice.

Other publications

In 2012 a new edition of the publication *Monetary Policy in Hungary* was published (its former version was issued in 2006), along with a *Monetáris politikai fogalomtár* (Monetary Policy Glossary) as its appendix. These volumes provide the wider public with an overview of the current practices, mission and framework of the domestic monetary policy.

Also this year, a new edition of the publication titled *Hungary's balance of payments and international investment position statistics (international methodology and domestic practice)* was issued (the former version was published in 2006). The main purpose of this volume is to present and explain the basic terms of balance of payments statistics and the international investment position, the related conventions and the structure of the statistics. In addition, it provides an insight into the process of review of international methodology and the most important changes, summarises the key elements of the new methodology to be introduced in the near future, and presents the Hungarian practice as well.

This year, a new edition of the *Monetary Statistics Manual* was also published (its previous version was issued in 2005). The publication is intended to give general information on the monetary statistical data disclosed by the Magyar Nemzeti Bank, and to facilitate the use and correct interpretation of monetary statistics.

All publications of the Magyar Nemzeti Bank are available on its website (http://www.mnb.hu)

Conferences, lectures

Conferences and scientific meetings

14 June 2012 – Everyday Finances Conference (Money Compass Foundation – MNB)

19 June 2012 – RICS Corporate Real Estate Roundtable

30 August 2012 – Local meeting of the Statistics Working Group of the ESCB Internal Auditors Committee

6-7 September 2012 – 11th Macroeconomic Research Workshop Conference at the MNB (Microeconomic behaviour and its macroeconomic consequences during the financial crisis)

15-16 November 2012 – ECB-MNB Conference on the Future of Payments

29 November 2012 – Statistics Conference – Financial Crisis and New Directions in Data Collection

7 December 2012 – Horgony (Anchor) 2013

13 December 2012 – Teachers' Seminar in the Bank

BESS at MNB lectures

18 January – Ibolya Schindele (BI Norwegian Business School): Social Capital and the Viability of Stakeholder-Oriented Firms: Evidence from Savings Banks

1 February – Claudia Foroni (European University Institute): The Use of Mixed-Frequency Data to Identify Structural Models

2 February – Georgios Georgiadis (Goethe University, Frankfurt): Towards an Explanation of Cross-Country Asymmetries in Monetary Transmission

9 February – Zoltan Wolf (OECD, Vrije Universiteit Amsterdam): Forecasting Aggregate Productivity Using Information from Firm-Level Data

10 February – Michael Rousakis (University of Warwick): Expectations and Fluctuations: The Role of Monetary Policy

21 February – Petr Sedlaček (Universiteit van Amsterdam): Firm Age, Business Cycles and Aggregate Labour Market Dynamics

4 April – Gabor Pinter (University of Cambridge): Financial Frictions and Shocks

11 April – Peter Karadi (ECB): QE1 vs. 2 vs. 3: A Framework for Analysing Large Scale Asset Purchases as a Monetary Policy Tool

25 April – Henrik Jacobsen Kleven (London School of Economics): Behavioral Responses to Notches: Evidence from Pakistani Tax Records

9 May – Susanne Forstner (European University Institute): Job-to-Job Mobility and Wage Inequality: A quantitative assessment

16 May – Roland Straub (ECB): Bubble Thy Neighbour: Portfolio Effects and Externalities from Capital Controls

23 May – Viktoria Hnatkovska (Wharton Finance): The Exchange Rate Response Puzzle

30 May – Fabio Ghironi (Boston College): Market Deregulation and Optimal Monetary Policy in a Monetary Union

13 June – Michel Lenza (ECB): Money, Credit, Monetary Policy and the Business Cycle in the Euro Area

28 June – Dirk Krueger (University of Pennsylvania): Intergenerational Redistribution in the Great Recession

12 September – Christophe Deissenberg (Université de la Méditerranée and GREQAM): New Approaches in Macroeconomics: Agent-Based Modelling/Heterogeneous Agents. Promises and Limitations

26 September – Ralph De Haas (EBRD): Running for the Exit? International Bank Lending During a Financial Crisis

3 October – Mike Elsby (University of Edinburgh): On the Importance of the Participation Margin for Labor Market Fluctuations

10 October – Refet Gürkaynak (University of Bilkent): Judging the DGSE Model By Its Forecast

17 October – Paolo Sodini (Stockholm School of Economics): Twin Picks: Disentangling the Determinants of Risk-Taking in Household Portfolios

14 November – Livia Chitu (ECB): Was Unofficial Dollarisation/Euroisation an Amplifier of the 'Great Recession' of 2007-09 in Emerging Economies?

28 November – Thijs van Rens (CREI/UPF): Selective Hiring and the Welfare Costs of Business Cycles

Courses of the Bank's Education Centre

Spring course 2012 – week 1: 19–21 March 2012

I. Open economy macroeconomics

II. Fiscal policy in closed and open economies

Open economy macroeconomics – Prof. Gianluca Benigno (London School of Economics)

- Intertemporal approach to the balance of payments and the international real business cycle
- Calculation of the nominal foreign exchange rate
- The neo-keynesian open economy structure: inflationary dynamics and optimal policy
- Currency and sovereign debt crisis

Fiscal policy in closed and open economies – Prof. Evi Pappa (European University Institute)

– Empirical facts on the effects of fiscal policy

– Various methods for extracting information from data relating to the effects of government expenditure and tax shocks

– Fiscal policy in the RBC and neo-Keynesian models

– New theoretical macro-models describing governmental behaviour in a closed economy

– Fiscal policy in open economic models

– New theoretical open economy models describing empirical facts and governmental behaviour

– Fiscal policy in models based on labour market frictions

– An explanation of the impact of fiscal policy on the labour market in theoretical and empirical terms

– Fiscal and sovereign debt crises

– Empirical estimates of sudden stops, financial crises and fiscal space available in developed economies

Spring course 2012 – week 2: 26–30 March 2012

Bayesian methods for macroeconomics – Prof. Fabio Canova (ICREA Research Professor at UPF and CEPR)

– Solution to DSGE models

– ML estimate of DSGE models

– Bayesian estimate of DSGE models

– Political analyses and forecasts with the help of estimated DSGE models

Summer course 2012 – week 3: 30 July–3 August 2012

Analysis of business cycles – Prof. Adrian R. Pagan (University of Sidney)

– Types of cycles and measurement of the cyclical state – Dating automated cycles with the Boschen and Markov regime-switching algorithms

– A summary of the characteristics of single variable cycles – duration, amplitude, variability, asymmetry

– A summary of the characteristics of multi-variable cycles – synchronisation, reference Cycle, aggregation of turning points, heat maps

– Analysis of the cyclical characteristics of statistical and economic models – VARs, VECMs, DGSE

– Forecast of recessions – Model-based leading indicators

Summer course 2012 – week 4: 6–10 August 2012

Financial markets and the macroeconomy – Prof. Harald Uhlig (University of Chicago)

– Asset prices and macroeconomic dynamics

– Long-term risk and Epstein-Zin preferences

– System risk

– DSGE models covering the financial sector as well as the rise and fall of housing prices

– Sovereign debt crises

4 Corporate social responsibility activity

Within the scope of its corporate social responsibility activity, the Magyar Nemzeti Bank aims to

– gain the confidence of its stakeholders through its activity and operational method;

– apply the principles and aspects of responsible operation in its governance and decision-making systems, and take account of the social and, in a broader sense, the economic and environmental impacts of its activity during its operation;

– support – as far as possible – issues of general social significance, with particular focus on the enhancement of financial literacy, environmental protection and social equality.

The MNB finds it important to ensure that its Social Responsibility Report provides a true and fair view of the Bank's sustainability performance, therefore, it prepares a biannual report based on Requirement Level B of the Global Reporting Initiative (GRI G3), and has it authenticated by an external certifier. (A summary table of the GRI content index is available at MNB's website. The table also contains information on content.)

4.1 A CENTRAL BANK OF PUBLIC AWARENESS

The Magyar Nemzeti Bank can best meet the requirements of social responsibility and sustainable growth by fulfilling its functions set out in the law at a high standard and institutionalising the practice of responsible operation.

The Bank developed its social responsibility strategy in 2008.[13] Key principles followed in the implementation of the strategy:

– responsibility determined by the core activity,
– responsibility for the management of public funds,
– responsibility for staff,
– responsibility arising from the MNB's relations with its stakeholders,
– and responsibility for the natural and built environment.

The MNB's corporate social responsibility strategy was approved and its implementation is supervised by the Bank's senior management. Similarly, the approval of the MNB's Environmental Policy and Environmental Declaration falls under the Executive Board's competence.[14]

In harmony with its responsibility for the management of public funds, the MNB's social commitments are aimed at ensuring social cohesion and equal opportunities.

The Bank believes that social investments and grants that are surrounded by general social consensus are of key significance. Special emphasis is laid on responsible, transparent communication regarding the MNB's operation, and on making sure that the Bank's social responsibility activity is always in line with the leading principles and practices.

Again in 2012, as a unique initiative in the world, in the framework of the so-called banknote briquette programme non-profit organisations were invited to apply for briquettes of an excellent heating value, made from banknotes that had been destroyed and withdrawn from circulation. A scoring system is used to decide which three institutions win a total quantity of 60 tons of briquettes supplied by the MNB in the heating season continuously and free of charge.

The Bank issues commemorative coins in relation to major Hungarian historical, scientific and cultural events and anniversaries as well as international events, of which it intensively informs the public and its staff members for the purposes of awareness raising (via the internet, press releases, the intranet, and the internal paper 'MNB Hírmondó').

[13] http://english.mnb.hu/A_jegybank/the_responsible_central_bank/2012
[14] http://english.mnb.hu/A_jegybank/the_responsible_central_bank/2012

In 2012 the MNB provided 45 undergraduate students with the opportunity of spending their compulsory or voluntary internship in the Bank, thus supporting them in acquiring professional experience as well as in their career orientation. In the framework of the Roma Scholarship Programme successfully operating since 2004, in the academic year 2012–2013 the Bank is supporting 5 secondary school and 9 higher education students who come from disadvantaged backgrounds and self-identify as Roma in completing their banking studies.

4.2 ACTIVITY AIMED AT ENHANCING FINANCIAL LITERACY OF THE PUBLIC

As part of the Bank's activity focusing on the enhancement of financial literacy, the Bank continued and extended its successful central banking programmes in 2012. As a result of the Bank's function-related initiatives, as well as the developments implemented in the Visitor Centre during the year – as well as owing to the increasing activity of Pénziránytű Alapítvány (Money Compass – Foundation for Financial Awareness) – the size of the target group reached has grown several fold, to a total of 1.1 million.

Self-supported programmes of The Magyar Nemzeti Bank

A key element of the efforts aimed at the enhancement of financial literacy was the publication entitled 'Money talks – Do you understand?', also recognised by a survey of the European Commission, which was handed out to some 115,000 11th grade students in all, i.e. nearly 1,200 secondary schools in Hungary. An internet-based educational material and a quiz for testing the knowledge acquired helped schools in processing the survey. Of those who completed the quiz correctly, 110 students were invited to take part in a special awareness-raising visit to the MNB. Moreover, for the 5 school principals who made the greatest efforts to distribute the booklets the Bank organised a study trip to Frankfurt, focusing on central bank-specific topics.

The MNB also organised a seminar for more than 100 teachers involving the Bank's organisational units. In addition to sharing knowledge, the purpose of the seminar was to strengthen the professional relationship between the Bank and teachers taking part in practical training.

Another programme targeting the dissemination of knowledge on the driving forces of the Bank's operation and the monetary policy and the enhancement of general financial literacy was the series of secondary school competitions held under the name 'Monetary – Economise Smartly!'. In the school year 2011/2012, one thousand students in 250 teams participated in the competition.

The MNB provided financial assistance, among others, for the national finals of the secondary school competition organised by the Junior Achievement Foundation and focusing on economic studies, as well as for the series of lectures on financial literacy organised by the Federation of Economic and Scientific Societies at the University of Sciences of Pécs and then at the University of Debrecen, attended by some 400 students.

The MNB's Visitor Centre welcomed 31,359 visitors in 2012. Two-thirds of them also participated in thematic programmes aimed at the enhancement of economic literacy and financial awareness. In the course of reconstruction of the Visitor Centre, new installation schemes and layout plans were drawn up in 2012. The scope of available services was further expanded, for example with a monetary policy simulation game of the European Central Bank. With the involvement of the organisational units, lectures on banknote protection and the history of money, and new information booklets were published on banknote safety and price stability. New educational films were made for the lectures on price stability and financial stability, which form part of the new thematic educational programmes.

Widespread awareness for the Bank's activities was also raised with the help of a number of public events in 2012, such as: Open Days on weekends (1,200 and 3,200 visitors), Night of Museums (2,300), Autumn Festival of Museums (600). The Visitor Centre took part in four events with local programmes: 'May Day of Museums' (1,100), 'The City Park Children's Day of the International Service for the Safety of Children (2,500), Sziget Festival, and the VOLT Festival.

Money Compass – Foundation for Financial Awareness (Pénziránytű Alapítvány)

At the initiative of the Magyar Nemzeti Bank and with the wide-ranging support of public, professional and non-governmental organisations, Money Compass – Foundation for Financial Awareness provides opportunities for cooperation and takes an active part in programmes of social significance that are aimed at the enhancement of financial literacy. In 2012, the Foundation continued to offer professional and financial support to the Financial Education Programme (POP), which is intended to raise the financial awareness of students of secondary school age. In the academic year 2012/2013, the number of participating secondary schools rose from 60 to 70. In the framework of the programme, over 3,000 students have been trained with the involvement of 130 teachers during the school year. The

Foundation held a 30-hour accredited advanced education course for teachers newly joining the programme.

The educational institutions participating in the POP Programme form the backbone of the 'Money Compass School Network' jointly set up by the MNB, the Foundation and the Ministry of Education. At the end of 2012, the network comprised 104 educational institutions with some 100,000 students on the whole. The number of schools involved is increasing year by year, and in 2012 it had risen by 13 per cent compared to the previous year.

A Facebook page called 'Pénzbook' (Moneybook) was launched in 2012, with the aim of sharing practical information on finances with its secondary school student target group. On the occasion of World Savings Day, the Foundation organised a photo contest also via this communication channel.

Money Compass – Foundation for Financial Awareness compiled a detailed proposal package for the promotion of financial-economic studies within public education in connection with the 2012 review of the National Curriculum, based on its authorisation to provide an opinion on the matter for discussion. At the request of the Institute for Educational Research and Development, the Foundation also worked out a proposal for a syllabus for financial studies as an independent, elective subject, covering four years.

In 2011–2012, the Foundation coordinated a financial awareness and information programme under the name 'Everyday Finances Programme', for the implementation of which it raised funds from 20 market participants in a total amount of HUF 75 million, in addition to the MNB's HUF 10 million targeted support. In this programme, 135 printed and 500 electronic articles are published in 22 media in monthly changing topics covering practical financial areas. According to the feedback, the programme was continuously followed by approximately 800,000 readers. When closing the first year of the programme in June, the Bank and the Foundation held a conference on the enhancement of financial literacy and savings, which attracted intensive media interest.

The Foundation and Mastercard continued to collaborate in granting the 'Bank of the Year' award, which can be won by commercial banks in 2012.

In September, the Financial Literacy Working Group composed of experts of the Hungarian Competition Authority, the Hungarian Financial Supervisory Authority and the Magyar Nemzeti Bank published a Manual summarising information on household borrowing, and made it available on the websites of the member institutions and also directly for banks interested in the publication, for further use.

The OECD published a study presenting the results of an international research project, which compares the financial literacy levels of 14 countries, and which attracted significant professional and media interest. The related domestic research was carried out with the Bank's financial support and the coordination of Money Compass – Foundation for Financial Awareness.

4.3 THE BANK'S RESPONSIBILITY AS AN EMPLOYER

As an employer, the MNB assumes the utmost responsibility for its staff. Its employees can take part in the development of various solutions for employment which best suit their life situations (e.g. health management, establishing conditions for flexible employment, improving the system of performance management, and the development of community spaces).

Staff involvement

Sensitisation for social responsibility

In 2012, a questionnaire survey involving the Bank's entire staff was conducted to familiarise employees with the efforts that already undertaken in the interest of corporate social responsibility, and they could join the process of planning and implementation, thus increasing their commitment to social participation. Nearly 40 per cent of the staff took part in the survey. More intensive internal communication activity was initiated, in order to incorporate these values into organisational culture. In addition to the use of traditional tools, employees could experience several new, creative solutions, in which the Bank had already achieved significant results (e.g. regular film club with the involvement of well-known moderators having expertise in the specific subject, all-day interactive event for presenting the MNB's corporate social responsibility activities).

Together for each other

In relation to the survey, a group of volunteers was formed to encourage the employees' own charity initiatives (e.g. collecting donations for Christmas). Each year from 2013, based on the staff's recommendations, the Bank will support an organisation dealing with disadvantaged children with voluntary work and employee donations. This practice is a good addition to the team building events organised in the framework of the charity activity of the organisational units.

Creating a work-life balance

The Bank encourages flexible and atypical employment models, and supports this kind of harmony between employer and employee interests in order to maintain and improve staff commitment and support a work-life balance. During the past two and a half years, many of the colleagues have been able to cope with difficulties in their private lives or occasionally arising, extraordinary life situations through homeworking or temporary part-time employment, while the options of compressed working time and teleworking essentially contributed to the maintenance of experts of the Logistics Centre and the reassuring handling of problems resulting from moving to Soroksár.

Supporting the reintegration of mothers

Special attention is paid to keeping in touch with mothers absent from work for raising small children (e.g. a website created for mothers employed by the MNB, annual questionnaire survey), who are regularly informed of events taking place in the Bank (e.g. by sending the MNB's own internal paper), and whose reintegration to their workplace is supported by the Bank.

A Mothers' Club ('Kismama Klub') was launched in 2012, led by a psychologist-consultant, which provides help to mothers in issues concerning them in the form of workshops (e.g. compatibility of career and work, conflicting roles), while giving them an opportunity to meet their superiors, colleagues and human partners and to keep in touch with other mothers. In 2012, 60 per cent of the mothers who wanted to return to work were taken back to employment, some of them on a temporary basis, and some for an indefinite term as part-time home workers. In the case of mothers who cannot be employed within the Bank, the Bank provides career advice based on their individual requirements and supports their training and development plans, so as to increase their employment chances.

Family-friendly Workplace

As a family-friendly workplace, the Bank assists its staff with a variety of programmes and information, so as to create a balanced and sound life. In 2012, the Family-friendly Club was started, with 3-4 sessions a year, in which inspirational and forward-looking lectures are given on the harmonisation of individual roles. The Bank organised a first aid course about children and, to establish a tradition, it created a day-care centre for the children of MNB employees to ease the problems of parents with small children during the summer holidays. Further goals of the Bank include the provision of assistance to other staff groups as well (e.g. workers close to pre-retirement age or those taking care of sick relatives) in solving their life situations successfully.

Life Quality Centre

In the framework of the MNB Life Quality Centre, which has been operating well for years, colleagues can sign up for a single consultation with an external advisor on an anonymous basis, where the expert provides help in solving personal problems and managing changes arising from a specific life situation. In addition, the MNB places special emphasis on preserving the physical-mental health of its staff: it organises regular check-ups and health screening, lectures, autogenic training, excursions, as well as backbone exercises, yoga, and office massage.

4.4 THE MNB'S RESPONSIBILITY FOR THE NATURAL AND BUILT ENVIRONMENT

Understanding its responsibility for the natural environment, the Bank continuously reviews and develops its operation with a view to reducing environmental burdens, promoting efficient management of natural resources, and protecting the built environment it possesses and uses in the course of its operation.

Environmental performance

In 2011, the Bank's Environmental Policy was issued and the KÖVHIR (Eco-Management and Audit Scheme) framework was developed and introduced, so after a successful external audit the MNB obtained EMAS accreditation. The Bank's environmental policy focuses on the improvement of energy efficiency, the reduction of air pollution, and the development of waste management. The Bank's objectives undertaken in its Environmental Declaration and aimed at improving its environmental performance by the end of 2012 were accomplished. The Bank operated in full compliance with the environmental legislation in 2012 as well, and thus no official fine or penalty was imposed.

Indirect and direct energy use

The amount of energy required for the operation of the MNB has been decreasing year by year.

In addition to the measures taken to rationalise operations (4.6 per cent), the 9.1 per cent decline in electricity

Table 7
Changes in energy consumption

Energy consumption (GJ)	2010	2011	2012
Electricity (indirect)	21,208	19,602	19,284
Natural gas (direct)	10,031	9,347	8,650
Fuel (direct)	1,896	1,696	1,754
Total	**33,134**	**30,645**	**29,689**

consumption achieved in the past two years was also attributable to the use of LED lights and the modernisation of the lighting system (3.3 per cent), the replacement of notebooks (0.7 per cent), as well as some other measures (voluntary abandonment of electric office equipment, conscious work: 0.5 per cent). The decrease in the MNB's natural gas consumption resulted partly from the more favourable weather conditions and partly the use of solar thermal collectors installed in the Logistics Centre. In 2012, 1.5 per cent of all electricity used came from renewable sources, and in 2013 the proportion of renewable energy is planned to increase to 5 per cent.

Air pollution

The downward trend in MNB's air pollution is primarily associated with its reduced energy consumption.

In the past two years, total CO_2 emissions fell by as much as 10 per cent.

Waste management

The strict monitoring system and the intensive internal communication led to a further decrease in the quantity of communal waste in 2012, and by increasing selective waste collection the recycling rate continued to rise.

Water management

The bank continuously monitors changes in water consumption and is also seeking environment-conscious solutions in this field. It is planning to introduce water-saving technological solutions in 2013.

Initiatives supporting environmental protection

In 2012, 35 per cent of incoming invoices were already submitted electronically. The Bank endeavours to liaise with its customers electronically and optimise its fleet of printers and photocopiers. In the building in Szabadság tér,

Table 8
Emissions of greenhouse gases

Greenhouse gases (indirect and direct)	2010	2011	2012
Electricity (indirect CO_2; tons)	3,336	3,082	3,032
Other indirect (posting, CO_2; tons)	516	485	428
Natural gas (direct CO_2; tons)	552	537	485
Fuel (direct CO_2; tons)	140	125	130
Total CO_2 (tons)	**4,544**	**4,229**	**4,075**
Nitrogen oxide (direct; kg)	573	462	335
Sulfur dioxide (direct; kg)	0.42	0.52	0.37
Solid materials (direct, dust; kg)	36	32	33

Table 9
Waste management figures

Waste (kg)	2010	2011	2012
Communal	159,480	103,698	75,769
Selective (plastic, glas)	3,542	6,175	6,826
Paper	26,500	64,558	41,271
IT-equipment, electronic and other non-hazardous waste	1,550	0	5,445
Hazardous waste	425	250	210
Total	**182,857**	**174,681**	**129,521**

Table 10
Changes in water consumption

Water consumption (m³)	2010	2011	2012
From supply network	9,918	7,299	8,495
From own well	6,108	6,987	10,504

electric power allocation fell in 2012, which resulted in annual savings amounting to HUF 580,000.

A questionnaire survey was conducted about the employees' travel habits, in which 60 per cent of the staff took part. A key finding of the survey was that the ratio of those using public transport for getting to work is rather high; the MNB's practice is better than the Budapest average and the international practice. The number of employees cycling to work continued to increase in 2012. In May 2012, an average of 27 staff members used their bikes daily (24 people in May 2011), so the MNB won the title 'Bicycle-friendly workplace' again. Future plans include 'green procurement' to be launched in 2013, and its extension to public procurements based on the experience gained.

4.5 OTHER PERFORMANCE INDICATORS (GRI INDICATORS)

Total workforce by type of employment, employment contract, region and gender (LA1)

Total number and rate of new employee hires and employee turnover by age group, gender and region, in terms of absolute numbers and ratios (LA2)

Benefits provided to full-time employees that are not provided to temporary or part-time employees, by significant locations of operation (LA3)

Table 11
LA1 indicator

Date		Part-time employees	Full-time employees	Total
31. 12. 2010	Person	23	566	589
	%	3.90%	96.10%	
31. 12. 2011	Person	27	555	582
	%	4.64%	95.36%	
31. 12. 2012	Person	20	553	573
	%	3.49%	96.51%	

Date		Employees with fixed-term contract	Employees with unlimited contract	Total
31. 12. 2010	Person	36	553	589
	%	6.11%	93.89%	
31. 12. 2011	Person	36	546	582
	%	6.19%	93.81%	
31. 12. 2012	Person	28	545	573
	%	4.89%	95.11%	

Date		Men	Women	Total
31. 12. 2010	Person	296	293	589
	%	50.25%	49.75%	
31. 12. 2011	Person	303	279	582
	%	52.06%	47.94%	
31. 12. 2012	Person	304	269	573
	%	53.05%	46.95%	

Table 12
LA2 indicator by age group

Year	Employee-turnover	Age group	<30	30-50	>50	MNB
2010	Entry	Person	20	25	5	50
		%	40.00%	50.00%	10.00%	
	Exit	Person	5	40	18	63
		%	7.94%	63.49%	28.57%	
2011	Entry	Person	21	25	9	55
		%	38.18%	45.45%	16.36%	
	Exit	Person	7	35	28	70
		%	10.00%	50.00%	40.00%	
2012	Entry	Person	23	11	1	35
		%	65.71%	31.43%	2.86%	
	Exit	Person	6	27	9	42
		%	14.29%	64.29%	21.43%	

Table 13
LA2 indicator by gender

Year	Employee-turnover	Gender	Men	Women	MNB
2010	Entry	Person	25	25	50
		%	50.00%	50.00%	
	Exit	Person	30	33	63
		%	47.62%	52.38%	
2011	Entry	Person	38	17	55
		%	69.09%	30.91%	
	Exit	Person	32	38	70
		%	45.71%	54.29%	
2012	Entry	Person	22	13	35
		%	62.86%	37.14%	
	Exit	Person	23	19	42
		%	54.76%	45.24%	

Table 14
LA4 indicator

Date		Employees subject to CBA	Employees not subject to CBA	Total
31. 12. 2010	Person	582	7	589
	%	98.81%	1.19%	
31. 12. 2011	Person	575	7	582
	%	98.80%	1.20%	
31. 12. 2012	Person	566	7	573
	%	98.78%	1.22%	

The same benefits are provided to employees with fixed-term employment contracts and those in part-time employment as to full-time employees. The basic wage of part-time employees and their cafeteria limit is set in proportion with the duration of their employment.

Persons employed on the basis service agreements are not entitled to further benefits in addition to the service fee.

Percentage of employees covered by collective bargaining agreements (LA4)

Rates of injury, occupational diseases, lost days and absenteeism, and total number of work-related fatalities, by region and by gender (LA7)

In 2010, 3 accidents occurred in the MNB, as a result of which the employees affected were forced to take sick leave for 55 days. In 2011, 1 accident happened with one of our colleagues being on sick leave for 11 days. In 2012, there were 2 injuries, for which an employee had to be on sick leave for 35 days. The rates of injury were 0.56, 0.19 and 0.39 in 2010, 2011 and 2012, respectively. (Rate of injury = number of injuries / number of actual working hours × 200 000)

Percentage of employees receiving regular assessments and career review, by gender (LA12)

The MNB's performance management system is applicable to all employees of the Bank. The system contains the individual performance objectives of the employees set for the current year, which are continuously monitored during the year and evaluated at the end of the year. The individual performance objectives serve and are derived from the medium-term institutional strategy and the annual objectives of the MNB. The employee development plans are drawn up and monitored and personal competencies are evaluated as part of the performance management system. Similarly, the performance management system – as part of the MNB's career management system – includes so-called career talks aimed at coordinating the interests of the Bank and its employees in the long run. The MNB's career management system provides an overview of opportunities for the employees' career development and career paths.

Ratio of basic salary and remuneration of women to men by employee category, by significant locations of operation. (LA14)

Return to work and retention rates after parental leave, by gender (LA15)

All employees returning from parental leave were women.

Total number of incidents of discrimination and corrective actions taken. (HR4)

No incidents of discrimination are known with respect to the years 2010–2012.

Operations identified in which the right to exercise freedom of association or collective bargaining may be at significant risk, and actions taken to support these rights. (HR8)

100 per cent of the security staff employed by the MNB and provided by a third-party contractor participated in training including theoretical and practical modules.

Coverage of the organisation's defined benefit plan obligations. (EC3)

The MNB provides a monthly employer's benefit to employees with a voluntary pension fund membership based on their basic wage. The rate of the benefit is set forth in the annually concluded wage agreement and is typically 3.8 per cent. All employees who are members of a voluntary pension fund and have been employed by the

Table 15
LA14 indicator

Employee category/ year	Executive	Department head	Analyst	Expert	Administration, skilled work
31. 12. 2010	97.86%	106.10%	106.09%	111.32%	84.01%
31. 12. 2011	98.58%	102.59%	107.37%	109.37%	85.72%
31. 12. 2012	95.71%	101.22%	102.82%	108.77%	86.43%

Note: Method of calculation of the ratio: average basic wage of men / average basic wage of women.

Table 16
LA15 indicator

Period	Number of employees on maternity leave	Number of employees returning from parental leave	Retention*	Ratio
2010	9	16	8	50.00%
2011	10	14	9	64.29%
2012	13	10	6	60.00%

** The data for 2010 and 2011 include employees returning from parental leave and working for at least 12 months after their return. The data for 2012 include employees returning from parental leave, as of 31 December 2012 (active staff members).*

Bank for at least three months are entitled to the benefit. In the past three years the following amounts of benefit were paid: HUF 145 million in 2010, HUF 146 million in 2011 and HUF 143 million in 2012.

Section 16(5) of the MNB Act guarantees that the Bank's equity is positive at the end of the year and cannot fall below the level of its subscribed capital (HUF 10 billion).

Significant financial assistance received from government. (EC4)

On 31 December 2010, the revaluation reserve of foreign exchange securities – recognised as part of the MNB's equity – showed a negative balance of HUF 29,142 million, which was compensated from the central budget by 31 March 2011 pursuant to the effective MNB Act (Act LVIII of 2011). On 31 December 2011, both revaluation reserves – the revaluation reserve of the forint exchange rate and the revaluation reserve of foreign exchange securities had a positive balance. The newly enacted Central Bank Act (Act CCVIII of 2011) modified the rules pertaining to the replenishment of revaluation reserves. According to the new regulation, the reimbursement obligation of the central budget applies only if the total balance of the two revaluation reserves is negative at the end of the year and exceeds the sum of retained earnings and profit for the year. On 31 December 2012, the revaluation reserve of foreign exchange securities became negative again, however, the total balance of the two revaluation reserves remained positive, and therefore, no reimbursement obligation arose.

Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations. (SO8)

No administrative proceedings established any non-compliance with laws or regulations or imposed any fine or other sanction.

Practices related to customer satisfaction, including results of surveys measuring customer satisfaction. (PR5)

One of the key stakeholder groups of the Bank comprises credit institutions, the Postal Service and cash processing organisations. Within this group, the MNB conducts annual questionnaire-based customer satisfaction surveys in relation to the cash delivery activity, so as to continuously improve the quality of services provided by the Cash Logistics Unit based on the partners' satisfaction levels. As regards the satisfaction survey, the Bank had set the objective of maintaining and further improving the results achieved in 2011. Based on the customer satisfaction survey of 2012, the Bank met this goal, with the average customer satisfaction level at 3.6 (as compared to the 3.5 average of 2010 and 2011).

4.6 LETTER OF CERTIFICATION

ERNST & YOUNG

Ernst & Young Kft.
H-1132 Budapest, Váci út 20.
1399 Budapest 62 Pf. 632, Hungary
Tel: +36 1 451 8100, Fax: +36 1 451 8199
www.ey.com/hu
Cg. 01-09-267553

This is a translation of the Hungarian Report

Independent assurance statement to Magyar Nemzeti Bank

The management of Magyar Nemzeti Bank (MNB) has prepared the MNB's Annual Report and the information provided on MNB's website[1] (the Reports), and are responsible for the collection and presentation of the information within the Reports. It is the responsibility of Ernst & Young Kft. (Ernst & Young), in accordance with management's instructions, to carry out a 'limited' level assurance engagement on selected Corporate Social Responsibility performance data for 2012 (the CSR data) contained within the reports. We do not, therefore, accept or assume any responsibility for any other purpose or to any other person or organisation. Any reliance any such third party may place on these Reports is entirely at its own risk.

WHAT DID WE DO TO FORM OUR CONCLUSIONS?

Our assurance engagement has been planned and performed in accordance with ISAE3000[2]. The CSR data have been evaluated against the criteria of the application of the Global Reporting Initiative G3.0 Sustainability Reporting Guidelines (the Guidelines) and against completeness and accuracy criteria agreed with the management of MNB as follows:

Completeness

- Whether all material data sources have been included and that boundary definitions have been appropriately interpreted and applied, when determining CSR data.

Accuracy

- Whether there is supporting information for the CSR data reported by the functional units.
- Whether the collected CSR data have been accurately transposed to the the Reports and assumptions and limitations to the data have been correctly reported.

GRI

- Whether CSR data presented in the Reports meet the requirements of the B+ application level of the GRI G3.0 Guidelines

  In order to form our conclusions we undertook the steps outlined below:

  1. Interviewed specialists responsible for managing, collecting, and reviewing CSR data.
  2. Reviewed a selection of documentation and reporting tools including templates and databases.
  3. Undertook visits at responsible departments to examine the systems and processes in place for collecting and reporting CSR data against the GRI guidelines and definitions, and to test the accuracy of a sample of reported data.
  4. Reviewed and challenged the CSR data validation and collation.

---

[1] http://www.mnb.hu/A_jegybank/mnbhu_a_felelos_jegybank
[2] International Federation of Accountants' International Standard for Assurance Engagements Other Than Audits or Reviews of Historical Financial Information

5. Reviewed the Reports for the appropriate presentation of the data including the discussion of limitations and assumptions relating to the data presented.
6. Reviewed whether MNB's reporting has applied the GRI G3.0 Guidelines to a level consistent with the B+ application level.

Level of assurance

Our evidence gathering procedures have been designed to obtain a sufficient level of evidence to provide a limited level of assurance in accordance with ISAE3000. The extent of evidence gathering procedures performed is less than that of a reasonable assurance engagement (such as a financial audit) and therefore a lower level of assurance is provided.

Limitations of our review

- Our scope of work was limited to selected CSR data relating to 2012 included in the Reports (CSR data within our scope are indicated by tick marks (✓) in the GRI content index provided on MNB website).
- We have not sought evidence to support the qualitative statements and claims presented within the Reports. We have not reviewed historical data, or trends described in the Reports that relate to MNB's CSR performance data.

OUR CONCLUSIONS

Based on our review:

- We are not aware of any material reporting units which have been excluded from the scope of CSR data, with the exception of those reporting units disclosed within the Reports.
- We are not aware of any errors that would materially affect the reported CSR data.
- Based on our review of the Reports, nothing has come to our attention that causes us to believe that MNB management's assertion that their CSR data reporting meets the requirements of the GRI B+ application level of the Guidelines is not fairly stated.

OUR OBSERVATIONS

Areas for potential improvement in the CSR reporting process have been addressed in a separate report to MNB management. Our observations do not affect our conclusions on the Reports set out above.

Ernst & Young Ltd.
Budapest
25 February 2013

(The original Hungarian language version has been signed.)

5 Explanation of abbreviations and terms specific to central banking

5.1 ABBREVIATIONS

ALCO: Asset-Liability Committee

BÉT: Budapest Értéktőzsde Zrt. (Budapest Stock Exchange Co. Ltd.)

BIS: Bank for International Settlements

CEBS: Committee of European Banking Supervisors

CSO: Central Statistical Office

EBA: European Banking Authority

ECB: European Central Bank

EMU: Economic and Monetary Union

ESRB: European Systemic Risk Board

FSB: Financial Stability Board

GIRO: Giro Clearing House Ltd.

HFSA: Hungarian Financial Supervisory Authority

ICS: Interbank Clearing System

IMF: International Monetary Fund

KELER: Central Clearing House and Depository Ltd.

MNB: Magyar Nemzeti Bank

MNE: Ministry for National Economy

MPP: Everyday Finances Programme

OECD: Organisation for Economic Cooperation and Development

POP: Financial Training Programme

SAO: State Audit Office

VIBER: Real-time gross settlement system, a payment system operated by the MNB.

5.2 GLOSSARY

Cash turnover: The sum of exchanges and payments to and from the Bank.

The Central Bank Act (MNB Act): Act CCVIII of 2011 on the Magyar Nemzeti Bank.

Clearing: Control and transmission of payment transactions, calculation of interbank balances in accordance with specified rules; in the case of securities transactions: matching and confirmation of positions, calculation of accounts receivable/payable and managing the arising financial risk.

Duration: Average remaining maturity of bonds. It is an indicator measuring the level of risk associated with the bond portfolio.

Eco-Management and Audit Scheme: A registered and authenticated management scheme operating on a voluntary basis and on the basis of European Union law, which is aimed at improving the environmental performance of organisations.

ERM II, Exchange Rate Mechanism II: An exchange rate mechanism for establishing the conditions for an exchange rate policy cooperation between euro area countries and EU Member States not participating in the third stage of EMU. The ERM II is a multilateral system of fixed but adjustable exchange rates, where the mid-rate is surrounded by a normal, ±15 per cent fluctuation band. All decisions in relation to the mid-rate and, as the case may be, a narrower fluctuation band, are made on the basis of a joint agreement between the Member State concerned, the euro area countries, the ECB, and the other Member States participating in the mechanism.

Foreign exchange funding adequacy ratio (FFAR): The ratio of the sum of stable foreign exchange funds and net foreign exchange swap stock with a maturity over a year and the weighted foreign currency denominated assets to be financed.

Foreign exchange swap: A usually short-term transaction involving the exchange of different currencies and, when the transaction is settled, exchange of the currencies again at the price determined in the contract by the cross rate and the interest rate of the currencies.

FX swap: See Foreign exchange swap.

GRI (Global Reporting Initiative): A tool of corporate responsibility, a guide, with its key elements being: a collection of reporting principles and a list of sustainability indicators. Its use ensures the comparability of reports published by the various business associations, while it also serves as a rating tool.

IMF reserve quota: The freely drawable, i.e. not yet drawn portion of the IMF quota paid to the International Monetary Fund in SDR (Special Drawing Right).

Interest bearing currency swap transaction: a usually medium- or long-term transaction involving the exchange of different currencies, a series of interest payments on the principal and repayment of principals when the transaction is settled.

Interest rate futures: A stock exchange transaction where the basis of future settlement is a certain amount of standardised (expressed-in-contract) deposits with the interest rate specified at the time of the deal.

Interest rate swap: The exchange of fix rate and variable rate interest on principal at determined intervals, adjusted to certain market rates and conditions.

Monetary financial institutions: The central bank, financial institutions and money market funds together constitute this institutional category within financial corporations.

Money market funds: Money market funds are investment funds the investment units of which are similar to bank deposits from the aspect of liquidity. Money market funds invest 85 per cent of their assets in money market instruments or transferable debt securities with a remaining maturity of maximum one year or instruments with a return similar to that of the interest rate of money market instruments.

Money market instruments: Low-risk, liquid securities traded in large amounts on markets where they can be exchanged for cash immediately at a low cost.

O/N: Overnight deposit/loan.

Option transaction: For the owner of the foreign exchange option this means a right, but not an obligation, to buy or sell a certain amount of currency against another currency at a pre-determined rate, at or before a pre-determined date. If the possessor of the option practises this right, it will become an obligation for the seller (writer) of the option.

Payment System Council: The decision-making body of the Payment System Forum.

Payment System Forum: An independent, self-organising, open professional organisation with consultative character committed to the matters of the domestic payment system and operating on the MNB's initiative, with the support of the Hungarian Banking Association and the involvement of market participants that play a decisive role in payment transactions as well as the Hungarian State Treasury, GIRO Zrt. and KELER Zrt. The supreme body of the Forum is the Payment System Council, which consists of the representatives of the members and operates under the co-chairmanship of the MNB and the Hungarian Banking Association.

Repurchase and reverse repurchase transaction: An agreement on the transfer of the ownership right of a security with a repurchase obligation at a pre-determined price at a future date specified or to be specified at the time when the contract is concluded. During the term of the contract the buyer may either obtain the security which is the subject of the transaction and freely dispose over it (delivery repo transaction) or may not obtain it and may not freely dispose over it, in which case the security is deposited as a bail to the benefit of the buyer during the term of the contract (hold-in-custody repo).

Revaluation reserve: The revaluation reserve of the forint exchange rate and the revaluation reserve of foreign exchange securities are reserves that are part of the MNB's equity.

Revaluation reserve due to forint exchange rate changes: Non-realised exchange rate gains and losses on the forint exchange rate changes of foreign currency assets and liabilities are to be indicated in the forint exchange rate revaluation reserve, which constitutes a part of the equity.

Revaluation reserve of foreign exchange securities: The valuation difference between the market value and cost rate of foreign exchange assets based on securities (except for repurchased foreign exchange bonds) is to be indicated in the revaluation reserve of foreign exchange securities, which constitutes a part of the equity.

ROA: Return on assets.

ROE: Return on equity.

SEPA (Single European Payment Area): Single Euro Payments Area, an area within which economic operators can effect and receive payments in euro anywhere, using one single payment account, in the same manner as in their own respective countries. Geographically, the Area covers the 27 EU Member States, Iceland, Liechtenstein, Norway, Switzerland and Monaco.

Settlement: Final settlement of interbank liabilities and receivables on an account managed by a common bank, typically the MNB.

Social Responsibility Report: a publication that is becoming increasingly widespread among economic operators, in which they give an account of their commitment to environmental protection and their awareness of social and economic impacts during their operation. More and more frequently, the organisations present these activities as an integral part of their annual reports.

VaR (value at risk): Value at risk – a method for measuring risks. VaR quantifies the maximum amount of loss to be expected at a given confidence level for a specific time horizon.

Part B)
Audited financial statements of the Magyar Nemzeti Bank

1 Independent auditor's report

Ernst & Young Kft.
H-1132 Budapest, Váci út 20.
1399 Budapest 62 Pf. 632, Hungary
Tel: +36 1 451 8100, Fax: +36 1 451 8199
www.ey.com/hu
Cg. 01-09-267553

This is a translation of the Hungarian Report

Independent Auditors' Report

To the Shareholder of Magyar Nemzeti Bank

Report on financial statements

1.) We have audited the accompanying 2012 annual financial statements of Magyar Nemzeti Bank ("the Company"), which comprise the balance sheet as at 31 December 2012 - showing a balance sheet total of HUF 10,681,897 million and a loss for the year of HUF 39,811 million -, the related profit and loss account for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

2.) Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with the Hungarian Accounting Law, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

3.) Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Hungarian National Auditing Standards and with applicable laws and regulations in Hungary. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

4.) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5.) We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

6.) In our opinion the annual financial statements give a true and fair view of the equity and financial position of Magyar Nemzeti Bank as at 31 December 2012 and of the results of its operations for the year then ended in accordance with the Hungarian Accounting Law.

Other matters

7.) The annual financial statements as at 31 December 2011 were audited by another auditor who expressed an unmodified opinion on those financial statements on 23 April 2012.

Other reporting requirement- Report on the business report

8.) We have reviewed the business report of Magyar Nemzeti Bank for 2012. Management is responsible for the preparation of the business report in accordance with the Hungarian Accounting Law. Our responsibility is to assess whether the business report is consistent with the financial statements for the same financial year. Our work regarding the business report has been restricted to assessing whether the business report is consistent with the financial statements and did not include reviewing other information originated from non-audited financial records. In our opinion, the business report of Magyar Nemzeti Bank for 2012 corresponds to the disclosures in the 2012 financial statements of Magyar Nemzeti Bank.

Budapest, 25 February 2013

(The original Hungarian language version has been signed.)

Szabó Gergely
Ernst & Young Kft.
Registration No.: 001165

Szabó Gergely
Registered auditor
Chamber membership No.: 005676

2 Balance sheet of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	ASSETS	31. 12. 2011	31. 12. 2012	Change
1	2	3	4	4–3
	I. Receivables denominated in forint	**287,150**	**325,865**	**38,715**
4.3.	1. Receivables from the central government	168,501	142,212	–26,289
4.17.	of which: receivables to refund the revaluation reserves	0	0	0
4.7.	2. Receivables from credit institutions	118,641	183,653	65,012
	3. Other receivables	8	0	–8
	II. Receivables denominated in foreign currency	**12,007,016**	**10,186,382**	**–1,820,634**
4.9.	1. Gold and foreign currency reserves	11,604,514	9,755,692	–1,848,822
4.4.	2. Receivables from the central government	747	0	–747
4.8.	3. Receivables from credit institutions	5,080	2,195	–2,885
4.10.	4. Other receivables	396,675	428,495	31,820
	III. Banking assets	**34,725**	**33,437**	**–1,288**
4.13.	of which: invested assets	34,450	33,217	–1,233
4.15.	**IV. Prepaid expenses/accrued income**	**172,908**	**136,213**	**–36,695**
	V. TOTAL ASSETS (I+II+III+IV)	**12,501,799**	**10,681,897**	**–1,819,902**

Reference number to notes on the Accounts	LIABILITIES AND EQUITY	31. 12. 2011	31. 12. 2012	Change
1	2	3	4	4–3
	VI. Liabilities denominated in forint	**8,030,365**	**7,747,150**	**–283,215**
4.5.	1. Central government deposits	597,010	442,829	–154,181
4.8.	2. Deposits by credit institutions	1,317,580	1,009,194	–308,386
	3. Banknotes and coins in circulation	2,693,412	2,721,674	28,262
4.11.	4. Other deposits and liabilities	3,422,363	3,573,453	151,090
	VII. Liabilities denominated in foreign currency	**3,046,512**	**2,342,660**	**–703,852**
4.5.	1. Central government deposits	786,048	935,756	149,708
4.8.	2. Deposits by credit institutions	0	0	0
4.11.	3. Other deposits and liabilities	2,260,464	1,406,904	–853,560
4.14.	**VIII. Provisions**	**4,166**	**4,291**	**125**
	IX. Other banking liabilities	**17,092**	**17,784**	**692**
4.15.	**X. Accrued expenses/deferred income**	**16,084**	**18,947**	**2,863**
4.16.	**XI. Equity**	**1,387,580**	**551,065**	**–836,515**
	1. Share capital	10,000	10,000	0
	2. Retained earnings	33,426	47,023	13,597
	3. Valuation reserves	0	0	0
4.17.	4. Revaluation reserves due to exchange rate changes	1,324,963	564,041	–760,922
4.17.	5. Revaluation reserves of foreign currency securities	5,593	–30,188	–35,781
	6. Profit/Loss for the year	13,598	–39,811	–53,409
	XII. TOTAL EQUITY AND LIABILITIES (VI+VII+VIII+IX+X+XI)	**12,501,799**	**10,681,897**	**–1,819,902**

25 February 2013, Budapest

András Simor
Governor of the Magyar Nemzeti Bank

3 Income statement of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	INCOME	2011	2012	Difference
1	2	3	4	4–3
4.19.	**I. Interest and interest related income denominated in forint**	**19,898**	**25,907**	**6,009**
	1. Interest on receivables from the central government	14,650	11,662	–2,988
	2. Interest on receivables from credit institutions	3,570	13,563	9,993
	3. Interest on other receivables	0	0	0
	4. Interest related income	1,678	682	–996
4.19.	**II. Interest and interest related income denominated in foreign currency**	**287,215**	**245,446**	**–41,769**
	1. Interest on foreign currency reserves	263,979	224,631	–39,348
	2. Interest on receivables from the central government	0	0	0
	3. Interest on receivables from credit institutions	0	0	0
	4. Interest on other receivables	2,055	2,176	121
	5. Interest related income	21,181	18,639	–2,542
4.20.	**III. Income arising from exchange rate changes**	**101,908**	**166,531**	**64,623**
4.19.	**IV. Realised gains arising from financial operations**	**81,273**	**31,833**	**–49,440**
4.22.	**V. Other income**	**4,167**	**3,893**	**–274**
	1. Fees and commissions	1,076	986	–90
4.23.	2. Income other than fees and commissions	3,091	2,907	–184
4.14.	**VI. Provisions released**	**950**	**3,242**	**2,292**
4.14.	**VII. Impairment released**	**155**	**1,950**	**1,795**
4.24.	**VIII. Operating income**	**202**	**163**	**–39**
	IX. TOTAL INCOME (I+II+III+IV+V+VI+VII+VIII)	**495,768**	**478,965**	**–16,803**

Reference number to notes on the Accounts	EXPENSES	2011	2012	Difference
1	2	3	4	4–3
4.19.	**X. Interest and interest related expenses denominated in forint**	**332,550**	**367,130**	**34,580**
	1. Interest on central government deposits	33,094	46,869	13,775
	2. Interest on deposits by credit institutions	41,090	42,247	1,157
	3. Interest on other deposits	257,416	277,691	20,275
	4. Interest related expenses	950	323	–627
4.19.	**XI. Interest and interest related expenses denominated in foreign currency**	**68,554**	**57,773**	**–10,781**
	1. Interest on central government deposits	9,753	1,312	–8,441
	2. Interest on deposits of credit institutions	129	3	–126
	3. Interest on other liabilities	22,822	20,702	–2,120
	4. Interest related expenses	35,850	35,756	–94
4.20.	**XII. Expenses resulting from exchange rate changes**	**3,223**	**8,261**	**5,038**
4.21.	**XIII. Cost of issuing banknotes and coins**	**4,887**	**4,149**	**–738**
4.19.	**XIV. Realised losses arising from financial operations**	**56,573**	**65,013**	**8,440**
4.22.	**XV. Other expenses**	**1,573**	**1,205**	**–368**
	1. Fees and commissions	743	780	37
4.23.	2. Expenses other than fees and commissions	830	425	–405
4.14.	**XVI. Provisions charged**	**1,764**	**3,367**	**1,603**
4.14.	**XVII. Impairment**	**982**	**0**	**–982**
4.24.	**XVIII. Operating costs and expenses**	**12,064**	**11,878**	**–186**
	XIX. TOTAL EXPENSES (X+XI+XII+XIII+XIV+XV+XVI+XVII+XVIII)	**482,170**	**518,776**	**36,606**
	XX. PROFIT/LOSS BEFORE DIVIDENDS (IX–XIX)	**13,598**	**–39,811**	**–53,409**
	XXI. Dividends from retained earnings	**0**	**0**	**0**
	XXII. Dividends	**0**	**0**	**0**
	XXIII. PROFIT/LOSS FOR THE YEAR (XX+XXI–XXII)	**13,598**	**–39,811**	**–53,409**

25 February 2013, Budapest

András Simor
Governor of the Magyar Nemzeti Bank

4 Notes to the financial statements

4.1. THE MNB'S ACCOUNTING POLICY

The Magyar Nemzeti Bank, the central bank of Hungary, is owned by the Hungarian State. Ownership rights are exercised by the minister in charge of public finances (hereinafter referred to as the shareholder).

The accounting policy of the Magyar Nemzeti Bank is based on the Act on Accounting (Act C of 2000), Act CCVIII of 2011 on the Magyar Nemzeti Bank (hereinafter: the MNB Act) and Government Decree 221/2000 (XII. 19) on the special reporting and accounting requirements applicable to the Magyar Nemzeti Bank (hereinafter: MNB Decree). Since the effective date of the Act promulgating the international treaty on the accession of Hungary to the EU, i.e. 1 May 2004, the Magyar Nemzeti Bank has been a member of the European System of Central Banks (ESCB).

The following section presents a brief description of the accounting system of the MNB, and the valuation and profit recognition rules, whenever these differ from the general rules.

4.1.1. The MNB's accounting framework

One of the key accounting principles of the MNB is that transactions are booked for the period in which they occur, unless the financial year is already closed. This is especially important in terms of the accurate measurement of exchange rate gains and losses (see valuation rules), with special regard to foreign exchange sales and purchases. Spot foreign currency transactions which involve foreign exchange conversions are recorded in the books at the date of the transactions. Assets and liabilities arising from such transactions affect the MNB's foreign currency position from the date of entering into the transaction. The same procedure is applied to recording the revaluation difference in the balance sheet relating to derivative transactions for hedging purposes.

On a daily basis, the MNB records:

– exchange rate differences arising from revaluation of its foreign assets and liabilities and derivative transactions for hedging purposes recorded off-balance sheet, and

– accrued/deferred interest arising from on and off-balance sheet assets and liabilities from hedging transactions.

Pursuant to the MNB Decree, for the purpose of reporting data to the owner, the MNB is required to close accounts relating to its assets and liabilities and to net income on a quarterly basis, and to prepare trial balances following the procedure specified under its accounting policy.

For internal use, the MNB compiles a balance sheet and income statement every month, which are supported by the following:

– market valuation of foreign currency securities, with the exception of foreign currency bonds issued and repurchased by the Bank,

– breakdown and recording of realised and unrealised portions of foreign exchange gains and losses deriving from daily revaluation, and

– charging of depreciation and amortisation.

Upon the quarterly closing of accounts, the MNB measures its off-balance sheet contingent and future liabilities arising from derivative transactions for other purposes and securities lending operations based on international agreements (in this case the liabilities are equal to the purchase value of the collateral received), and at the end of the year in addition to the foregoing it also measures invested assets, securities, claims and other off-balance sheet liabilities. As a result of this measurement, the Bank recognises impairment losses as necessary and forms provisions for liabilities and expected losses.

The balance sheet date is 15 January of the year following the reporting year with the exception, if it is not a working day, the last working day before.

By law, the MNB is also required to report to Parliament. The MNB submits one single report to both Parliament and the Ministry for National Economy, which as it is in charge of public finances, exercises the rights of ownership as laid down in the MNB Act. This takes the form of an Annual Report, which contains a business report describing the MNB's structure, operations and state of affairs in the reporting year and the MNB's annual financial statements defined by the Act on Accounting, as adopted by the board of directors and approved by audit certificate. The supervisory board submits an opinion on the Annual Report and makes a report on such to the shareholder. The Annual Report is published in unabridged form on the Internet. The website is accessible at: http://english.mnb.hu.

The Governor of the MNB also reports to the Parliament's committee responsible for economic affairs on the half-year activity of the MNB. This report is the Half-year Report which contains a business report describing the MNB's structure, operations and state of affairs in the reporting period and the MNB's half-year financial statements defined by the Act on Accounting. The Half-year Report is also published on the Internet.

The MNB Decree does not require the Bank to draw up consolidated financial statements. Consequently, as subsidiaries have no material impact on its balance sheet or profit, the MNB does not prepare consolidated financial statements.

In the course of its credit qualification process, the IMF ordered the MNB to present the distinctions detailed in Section 4.26 between MNB's accounting policy and the Guideline of the European Central Bank on the legal framework for accounting and financial reporting in the European System of Central Banks ECB/2010/20 (hereinafter: ESCB Guideline) as well as the numeric effect of these differences in the notes to the financial statements.

The financial statements of the MNB must be audited by the statutory auditor in compliance with the Act on Accounting. The registered auditor of the MNB is Gergely Szabó (Ernst & Young Könyvvizsgáló Kft), Chamber membership number: 005676.

The person authorised to sign the Annual Report is András Simor, Governor of the Magyar Nemzeti Bank.

The person responsible for accounting services is Gábor Kalina, registration number: 176115.

4.1.2. Major principles of valuation

Receivables from the central government

Securities stated under receivables from the central government are recorded in the balance sheet at purchase price and include no interest. The difference between the purchase price excluding interest and the face value is shown in the MNB's income statement as a valuation gain or loss in proportion to the time elapsed.

Receivables from the central government also include any receivables associated with the reimbursement of revaluation reserves at year-end.

Impairment losses may not be recorded in connection with receivables from the central government.

Receivables from credit institutions

Mortgage bonds stated under receivables from credit institutions are recorded in the balance sheet at purchase price net of interest. The market value difference at acquisition is shown in the MNB's interest related income as a valuation gain or loss in proportion to the time elapsed.

Impairment losses on mortgage bonds must be accounted in proportion to the risk of losses.

Valuation of foreign currency assets and liabilities and the recording of exchange rate gains

In its books, the MNB records all foreign currency assets and liabilities at the official exchange rate prevailing on the date of acquisition. If a foreign currency asset or liability is created as a result of foreign exchange conversion, the exchange rate gain or loss arising from the difference between the actual rate and the official rate is recorded by the MNB as conversion income for that particular date and is recognised under gains/losses from exchange rate changes in the income statement.

The MNB carries out daily revaluation of foreign currency assets and liabilities as well as off-balance sheet assets and liabilities arising from derivative transactions for hedging purposes, taking account of variations in the official exchange rate. As a result of this revaluation, balance sheet items denominated in foreign currency are stated in an amount converted at the official exchange rate prevailing on 31 December. Banking assets and banking liabilities in foreign currencies (with the exception of foreign investments) and derivative transactions for purposes other than hedging do not form part of revaluation.

Income received in foreign currency is stated at the official exchange rate prevailing on that particular date.

Daily accounting for accrued income is preceded by reversing the accrued income on the previous day. As a result, foreign currency accruals are recorded in the balance sheet at the official exchange rate without revaluation.

In respect of the foreign exchange gains and losses arising in the course of daily revaluation, realised exchange rate gains can be stated as a profit item, while unrealised income is reported under 'Equity', in the item 'Revaluation reserve due to exchange rate changes'.

Realised income arises as a result of selling and buying foreign currency. The latter occurs when the assets in a given currency are exceeded by corresponding liabilities. Realised income arises as the difference between the value of the traded foreign currency at the official exchange rate and the average cost rate.

Foreign currency securities

Foreign currency securities are stated at market price. The difference between the market value (bid prices applied by the quoter) prevailing on the date of valuation and the book value is recorded in the revaluation reserve of foreign currency securities as part of equity. Exchange rate gains or losses realised on selling and maturing are stated under 'Realised gains/losses arising from financial operations'.

The Magyar Nemzeti Bank measures its securities on the basis of market prices prevailing on the last working day in December, however if adequately liquid prices are not ensured on this day, the valuation of securities is based on the market prices available on the previous working day.

In line with the decision of the Monetary Council, the foreign currency securities managed by external trustee and custodian on the grounds of a given mandate, purchased since December 2012, are also stated at a market price, applying the prices received from the custodian.

Securities issued by the MNB abroad and subsequently repurchased must be recognised in gross, i.e. in the item 'Other foreign currency receivables'. Repurchased own-issue foreign currency bonds are measured at historical cost. Interest on repurchased bonds is recorded under both income and expenses.

Security repurchase transactions are recorded as credit/deposit transactions, while the related receivables or liabilities are stated as off-balance sheet items.

Securities lent through securities lending operations based on international agreements need not be removed from foreign exchange reserves; they are recorded as off-balance sheet items. Non-cash collateral and investments from cash collateral must be recorded as contingent liabilities under off-balance sheet items and if their market value is negative a provision of equal amount must be created on the investments on a quarterly basis.

Accounting rules relating to the IMF quota

Part of the IMF quota subscribed in foreign currency and denominated in SDR as a callable loan is stated under foreign exchange reserve.

Part of the quota paid in forint, subscribed in SDR, is presented under 'Other foreign currency receivables' in the balance sheet. The related IMF forint deposit is presented on the liabilities side of the balance sheet. It is the MNB's duty to ensure at least annually that the amount of the IMF's forint deposit is equal to the amount of the quota paid in forint. As this deposit account is a HUF account only formally, it is presented under 'Other foreign currency payables' in the balance sheet.

The loan granted by the IMF raises the amount of foreign exchange reserves and the IMF's forint deposit. The disbursement is recorded in the form of a swap transaction, which means HUF receivables and SDR liabilities.

SDR allocation aims to increase the foreign exchange reserves of the IMF's members and creates an unmatured liability vis-à-vis the IMF on the liability side of the balance sheet. This transaction has an effect on profit or loss (interest must be paid on the SDR amount received), if it is utilised.

Accounting rules relating to derivatives

On the basis of transaction purpose, the MNB distinguishes between two groups of derivative transactions: hedging transactions and derivatives transactions for purposes other than hedging.

Hedging transactions are defined as transactions which reduce the risk arising from changes in the exchange rate or market value of a specific asset or liability or position, are directly related to such, are announced as hedging transactions at the start of the deal and cease or significantly mitigate the risk that is intended to be hedged. Furthermore, derivative transactions with the government or non-resident counterparts on behalf of the government are also regarded as hedging transactions.

Derivative transactions must be stated under off-balance sheet assets and liabilities. The aggregate revaluation difference of foreign currency assets and liabilities arising from hedging transactions must be stated in the balance sheet (depending on their balance, either in the item 'Other foreign currency receivables or liabilities', or 'Foreign currency receivables from or liabilities to the central government'), including the interest accrued in proportion to time elapsed (as accrued income or accrued expenses).

When derivative transactions for purposes other than hedging are closed, the income from such transactions must be stated in the lines of income and expenses arising from exchange rate changes when foreign exchange transactions are involved, and in the lines of interest related income and interest related expenses in the case of transactions linked to interest rate changes. While such transactions are not revalued, consistent with the principle of prudence, a quarterly provision is set aside equal to the negative market value of the transaction.

Banking assets and liabilities

Banking assets and liabilities are stated on the respective sides of the balance sheet. These are the following:

– assets and liabilities not directly related to central bank functions and bank operations (such as settlements relating to taxes, contributions, payments to employees, creditors, unsold precious metals held for non-central bank purposes), as well as

– liabilities arising from banknotes no longer accepted as legal tender but not yet exchanged,

– investments, and

– assets required for operating the organisation (such as intangibles, tangibles and inventories).

The MNB's balance sheet does not state cash among liquid assets. The central bank is the exclusive issuer of banknotes and coins. Notes and coins held at the Cashier and the Depository are not in circulation and therefore are deducted from banknotes and coins on the liabilities side of the balance sheet.

Depreciation rates applied by the Magyar Nemzeti Bank

Per cent

Description	31. 12. 2012
Concessions, licences and similar rights	17
Trade-marks patents and similar assets	10–50
Capitalized value of reorganization	20
Buildings	3
Vehicles*	20
Telecommunication devices, office equipment, machines	9–50
Office equipment	14.5–33
Computer hardware	9–33
Emission machinery	5–33
Instruments	9–33
Bank security devices	2–33
Other equipment and devices	3–33

** Residual value 20 per cent of the vehicles with 5-year time of use.*

The above listed ranges of depreciation rates are reference values based on estimated useful economic life. The Bank must deviate from the reference values depending on the actual time of use. Depreciation is charged on a straight line basis in every case.

4.2 EFFECTS OF MACROECONOMIC TRENDS ON THE 2012 BALANCE SHEET AND INCOME STATEMENT OF THE MAGYAR NEMZETI BANK

The balance sheet and income statement of the Magyar Nemzeti Bank are primarily influenced by the objectives and selected instruments of monetary policy, as well as by domestic and international economic events.

In 2012, the MNB recorded a loss of HUF 39.8 billion. In respect of macroeconomic events, changes in the forint exchange rate exerted the most important influence on the Bank's profit. The official forint exchange rate against the euro fluctuated in a rather wide band during the year; it strengthened in the first 8 months of the year, but then weakened. The official exchange rate was weaker than the average cost rate during the entire year, especially in the first half of 2012. The forint exchange rate approached the average cost rate due to the appreciation in the first and third quarter of the year. The difference between the two rates at the end of 2011 was 42.11 forint/euro, decreasing to 19.55 forint/euro it halved by 31 December 2012. In parallel, the balance of revaluation reserves due to exchange rate changes, as an unrealised foreign exchange gain, also became significantly lower, decreasing by HUF 760.9 billion to HUF 564 billion by the end of 2012. The total net revaluation effect was a loss of HUF 602.6 billion in 2012. The volume of foreign currency sales was higher than normal in the beginning of 2012 with special regard to EUR sales tenders related to the early repayment of foreign exchange mortgage loans, and later the volume of foreign currency sales increased due to the transactions with the ÁKK, mainly because of IMF loan repayments and the maturity of the Hungarian government securities. In 2012, the net foreign currency position of the MNB decreased by EUR 3.1 billion, its amount was EUR 28.2 billion (HUF 8,203 billion) at the year-end. Due to the decrease in the foreign currency position, the MNB realised a gain of HUF 158.3 billion during 2012.

The balance sheet total according to Hungarian Accounting Standards (HAS) was HUF 10,681.9 billion on 31 December 2012, decreasing by about 15 per cent relative to end-2011. This was caused partly by the strengthening of the foreign exchange rate relative to end-2011, partly by the lower balance of foreign exchange reserves.

In 2012, the bank recorded a net interest and interest-related loss of HUF 153.6 billion, representing a decrease of HUF 59.6 billion relative to the previous year. Net foreign currency interest income was determined mainly by the decrease in the Bank's net foreign currency receivables and by the foreign exchange yields. The increase of the HUF interest loss was partly generated by the significantly higher average central bank base rate in 2012. The average central bank base rate was 6.77 per cent in 2012, 73 basis points higher than the annual average in 2011.

For more details on impacts on net income, see Section 3.9 of the Business Report.

4.3 FORINT RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Government bonds maturing within 1 year	26,289	3,832	−22,457
	Government bonds maturing within 1 to 5 years	4,417	9,093	4,676
	Government bonds maturing over 5 years	137,795	129,287	−8,508
	Government bonds	**168,501**	**142,212**	**−26,289**
	Receivables due to revaluation reserves	**0**	**0**	**0**
I.1.	**Total receivables from the central government**	**168,501**	**142,212**	**−26,289**

The amount of government bonds recorded at historic cost was HUF 142.2 billion at the end of 2012, a decrease of HUF 26.3 billion compared to end-2011. During the year there were no new purchases, but one bond matured out of the government bonds purchased by the MNB in the autumn of 2008 in order to support the normal operation of the domestic market of government securities and reinforce the liquidity of the banking sector. Besides, the last instalment of the amortising bond (to be repaid annually over five years) was also repaid. The former decreased the balance by HUF 24.9 billion, the latter decreased it by HUF 1.4 billion.

The aggregate balance of revaluation reserves due to exchange rate changes and of revaluation reserves of foreign currency securities was positive on 31 December 2012 and therefore receivables from the central government did not arise in connection with the reimbursement.

4.4 FOREIGN CURRENCY RECEIVABLES FROM THE CENTRAL GOVERNMENT

The HUF 747 million balance of foreign currency receivables from the central government contained two currency swaps at the end of 2011. One of them matured during 2012, the other one was reclassified to the forint and foreign currency deposits of the central government (see Section 4.5).

4.5 FORINT AND FOREIGN CURRENCY LIABILITIES OF THE CENTRAL GOVERNMENT

Forint deposits of the central government

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Single Treasury Account (KESZ)	596,607	442,481	–154,126
	Deposit by Government Debt Management Agency (ÁKK Zrt)	340	286	–54
	Other	63	62	–1
VI.1.	**Forint deposits of the central government (total)**	**597,010**	**442,829**	**–154,181**

The total HUF 154.2 billion decrease in the balance of forint deposits of the central government relative to 2011 appeared on the one hand because the EU transfers, which were higher than forecasted, increased the balance in December 2011. On the other hand, this was also because the balance was permanently higher than the normal level during 2012 and decreased at the end of 2012 due to seasonal effects. The reason for the higher average balance (HUF 678.7 billion on average) of the forint deposits of the central government in 2012 is that the ÁKK surpassed the yearly issuance plan due to the favourable developments on the forint government security market.

Foreign currency liabilities of the central government

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Foreign currency deposits of the central government	786,048	935,065	149,017
	Hedging transactions*	0	691	691
VII.1.	**Foreign currency liabilities of the central government**	**786,048**	**935,756**	**149,708**

** In 2011, the debit balance of HUF 747 million appeared as II.2. Foreign currency receivables from the central government, in line with its opposite sign.*

At the end of 2012, the hedging transactions contained four currency swaps concluded with the ÁKK in order to set the foreign currency and interest rate structure of the foreign exchange rate debt.

Foreign currency liabilities of the central government in a breakdown by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2011	31. 12. 2012	
	– within 1 year	786,048	934,971	148,923
	– within 1 to 5 years	0	785	785
	– over five years	0	0	0
VII.1.	**Foreign currency liabilities of the central government**	**786,048**	**935,756**	**149,708**

The maturity dates of all central government foreign currency deposits are within a year. Half of the currency swaps mature within 2-3 years, the remaining (debit balance of HUF 94 million) balance matures within a year.

Currency structure of swaps concluded with the central government

HUF millions

No.	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
1.	– EUR	3,893	183,892	179,999
2.	**Swap receivables**	**3,893**	**183,892**	**179,999**
3.	– JPY	0	10,226	10,226
4.	– USD	3,146	174,357	171,211
5.	**Swap payables (3+4)**	**3,146**	**184,583**	**181,437**
6.	**Net swap payables (2–5)**	**–747**	**691**	**1,438**

4.6 NET POSITIONS VIS-À-VIS THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
I.1.–VI.1.	Net forint position	–428,509	–300,617	127,892
II.2.–VII.1.	Net foreign currency position	–785,301	–935,756	–150,455
	Total	**–1,213,810**	**–1,236,373**	**–22,563**

4.7 FORINT RECEIVABLES FROM CREDIT INSTITUTIONS

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Security-backed loans	35,000	122,000	87,000
	Covered mortgage bonds	85,580	61,653	–23,927
	Total receivables from credit institutions in gross value	**120,580**	**183,653**	**63,073**
	Impairment loss for covered mortgage bonds	–1,939	0	1,939
I.2.	**Total receivables from credit institutions**	**118,641**	**183,653**	**65,012**

On 31 December 2012, the HUF 122 billion balance of security-backed loans is due to the two-year loans launched in April 2012 and drawn by credit institutions. This new, active monetary tool was introduced by the central bank in order to strengthen the banks' lending capacity and to promote corporate lending. The interest cost of the loan is equal to the prevailing central bank base rate. The HUF 35 billion end-2011 balance of the two-week and six-month loan tenders to eliminate forint liquidity shortages matured, there was no new loan drawn in 2012.

Receivables in connection with mortgage bonds decreased by HUF 23.9 billion and amounted to HUF 61.7 billion on 31 December 2012. This value represents the balance of receivables in a gross value, which contains the cost price difference in addition to the face value. The stock of mortgage bonds was HUF 85.6 billion at the end of 2011, three bonds from this stock matured in 2012, amounting to HUF 19.4 billion in total and two mortgage bonds were repurchased by the issuer in the amount of HUF 4.5 billion. The mortgage bonds are qualified as securities held for monetary purpose, but as these are not government bonds, however, in the case of a bond's market price falling below the purchase price, an impairment loss must be recorded on the mortgage bonds at the end of the year, as set forth in the MNB Decree. Due to the year-end qualification of receivables – caused by the improved market valuations – the impairment losses created for mortgage bonds in 2011 were totally reversed.

Forint receivables from credit institutions by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2011	31. 12. 2012	
1.	– within 1 year	54,458	20,157	–34,301
2.	– within 1 to 5 years	55,912	153,842	97,930
3.	– over 5 years	10,210	9,654	–556
4.	**Total receivables from credit institutions in gross value (1+2+3)**	**120,580**	**183,653**	**63,073**

The HUF 97.9 billion increase in the balance of the receivables with a remaining maturity of 1-5 year is due to the two-year loan tenders drawn.

4.8 NET POSITIONS VIS-À-VIS CREDIT INSTITUTIONS

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
I.2.–VI.2.	Net forint position	–1,198,939	–825,541	373,398
II.3.–VII.2.	Net foreign currency position	5,080	2,195	–2,885
	Total	**–1,193,859**	**–823,346**	**370,513**

Net liabilities to credit institutions decreased by HUF 370.5 billion by 31 December 2012. Net forint liabilities decreased by HUF 373.4 billion compared to the previous year, and the balance was HUF 825.5 billion at 31 December 2012. The balance of deposits of domestic credit institutions stayed near the level of the previous year-end; however, the balance of one-day deposits (which accounts for an important share of the position) decreased by more than 30 per cent to HUF 648.3 billion by the end of 2012. The appearance of the two-year loans also decreased the position. Net foreign currency receivables amounted to HUF 5.1 billion at end-2011 and contained the swaps related to the early repayment tenders and to ensuring euro liquidity. The former transactions ceased in March 2012 as the tenders were finished, and the latter have matured. The end-2012 balance contains newly opened swaps related to ensuring euro liquidity. There were no short-term money market foreign currency deposits with the MNB placed by credit institutions, neither at the end of 2011 nor at the end of 2012.

4.9 GOLD AND FOREIGN EXCHANGE RESERVES OF THE CENTRAL BANK

Forint balances

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Gold reserve	37,153	36,268	–885
	Reserve position in the IMF	27,196	25,145	–2,051
	Foreign currency deposits	1,523,122	1,421,228	–101,894
	Foreign currency securities	9,455,887	7,801,021	–1,654,866
	Foreign currency repo transactions	561,156	472,030	–89,126
II.1.	**Gold and foreign currency reserves (total)**	**11,604,514**	**9,755,692**	**–1,848,822**

For statistical purposes, the MNB regularly publishes the amount of gold and foreign currency reserves. According to the statistical rules, foreign currency reserves also include accrued interest; consequently, gold and foreign currency reserves differ in amount according to statistical and accounting rules.

Foreign exchange reserves not including accrued interest decreased by HUF 1,848.8 billion to HUF 9,755.7 billion as at 31 December 2012. The change was caused approximately equally by the decrease in balances and by the appreciation of the exchange rate relative to previous year-end.

The balance of foreign currency securities contains only HUF 64.3 billion (less than 1 per cent) of securities managed by the external trustee and custodian on the grounds of the given mandate, in line with the decision of the Monetary Council, purchased since the fourth quarter of 2012.

Euro balances

EUR millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Gold reserve	119	125	6
	Reserve position in the IMF	87	86	−1
	Foreign currency deposits	4,896	4,879	−17
	Foreign currency securities	30,392	26,781	−3,611
	Foreign currency repo transactions	1,804	1,620	−184
II.1.	**Gold and foreign currency reserves (total)**	**37,298**	**33,491**	**−3,807**

The official exchange rate of the forint was EUR/HUF 311.13 on 31 December 2011 and EUR/HUF 291.29 on 31 December 2012.

The main causes of the increase in the amount of gold and foreign currency reserves were the foreign currency arising from net EU transfers and market yields of the reserves. Both the foreign currency outflow to the banking system in the course of EUR sales tenders related to the early repayment of foreign exchange mortgage loans granted to households and the debt management activity of the ÁKK (IMF loan instalments and maturity of government securities) reduced the level of gold and foreign currency reserves, as well as the payments by the MNB in connection with own debt management, and foreign currency conversion performed by the Hungarian State Treasury not related to debt-financing. As a consequence of the aforementioned effects, the stock of gold and foreign exchange reserves denominated in euro decreased by EUR 3.8 billion as at 31 December 2012.

4.10 OTHER FOREIGN CURRENCY RECEIVABLES

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Forint payment of IMF quota	355,288	328,493	−26,795
	Repurchased bonds	39,967	35,747	−4,220
	Foreign hedging transactions*	0	63,694	63,694
	Other	1,420	561	−859
II.4.	**Other foreign currency receivables**	**396,675**	**428,495**	**31,820**

** The revaluation difference of hedging derivative transactions is stated in net terms, in accordance with the MNB Decree.*

The forint payment of the IMF quota decreased due to the strengthening of the forint exchange rate in comparison to SDR by 7.5 per cent.

The amount of bonds issued abroad by the MNB and subsequently repurchased decreased by HUF 4.2 billion, owing to strengthening of the forint exchange rate versus the Japanese yen and the US dollar.

The item 'Foreign hedging transactions' includes the over one-year credit balance of currency swap transactions with non-resident counterparties concluded by the MNB in 2012, while due to the total balance of these transactions they were transferred to the liabilities side of the balance sheet in 2011.

4.11 OTHER DEPOSITS AND LIABILITIES

Other forint liabilities

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Two-week MNB bills	3,403,292	3,563,712	160,420
	International financial institutions forint deposits	4,460	2,439	–2,021
	Other liabilities	14,611	7,302	–7,309
VI.4.	**Other forint deposits and liabilities**	**3,422,363**	**3,573,453**	**151,090**

The end-2012 balance of other forint deposits and liabilities showed an increase of HUF 151 billion (4.4 per cent) compared to the previous year-end; which was almost entirely due to the rise in the amount of two-week MNB bills. The two-week MNB bill is the most important monetary policy instrument of the MNB. The issue yield on bills is equal to the prevailing central bank base rate.

Other foreign currency liabilities

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Bonds	79,187	69,882	–9,305
	Repo transactions	963,259	291,290	–671,969
	IMF deposit	1,084,749	986,192	–98,557
	Foreign deposits and loans	18,509	44,521	26,012
	Hedging transactions*	114,398	14,694	–99,704
	Other liabilities	362	325	–37
VII.3.	**Other foreign currency liabilities**	**2,260,464**	**1,406,904**	**–853,560**

** The revaluation difference of hedging transactions is stated in net terms, in accordance with the MNB Decree.*

The balance of other foreign currency liabilities fell by HUF 853.6 billion to HUF 1,406.9 billion as at 31 December 2012. Besides the strengthening of the forint exchange rate it was caused mainly by significant decline of HUF 672 billion in foreign currency liabilities derived from repo transactions which ensured euro liabilities to hedging swaps with the credit institutions and by repayment of HUF 106.4 billion of two repayment amounts of the IMF loan granted to the MNB in June 2009. The amount of IMF deposits increased owing to a switch over to the new official exchange rate ordered by the IMF, which is due once a year (in every April), while due to the strengthening of the forint exchange rate versus the SDR and the recoveries declined the amount. The item 'Hedging transactions' mainly includes the net liabilities of the IMF-swap related to the IMF loan (the amount of swap decreased due to the repayments) and of the over one-year currency swap transactions with non-resident counterparties concluded by the MNB.

Other foreign currency liabilities by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2011	31. 12. 2012	
	– within 1 year	1,728,487	1,042,765	–685,722
	– within 1 to 5 years	166,933	26,627	–140,306
	– over 5 years	365,044	337,512	–27,532
VII.3.	**Other foreign currency liabilities**	**2,260,464**	**1,406,904**	**–853,560**

Currency structure of other foreign currency liabilities (excluding hedging transactions)

HUF millions

No.	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
1.	– USD	57,979	47,569	–10,410
2.	– EUR currency group*	972,287	332,753	–639,534
3.	– JPY	31,051	25,696	–5,355
4.	– SDR	365,044	337,513	–27,531
5.	– Other	719,705	648,679	–71,026
6.	**Other foreign currency liabilities**	**2,146,066**	**1,392,210**	**–753,856**

** The EUR currency group includes the euro and other European currencies (such as GBP, CHF) that may be listed here with regard to foreign exchange risk.*

The item 'Other' amounted to HUF 648.7 billion at the end of 2012 and mainly contains the forint coverage of the IMF quota, which accounted for HUF 645.8 billion. The bulk of EUR currency group's decrease of HUF 639.5 billion resulted from the falling stock of repo transactions.

Currency structure of hedging transactions vis-à-vis non-residents

HUF millions

No.	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
1.	– USD	103,928	45,407	–58,521
2.	– EUR currency group*	328,479	1,394	–327,085
3.	– JPY	98,589	0	–98,589
4.	– Other	364,417	320,186	–44,231
5.	**Hedging transactions receivables (1+2+3+4)**	**895,413**	**366,987**	**–528,426**
6.	– USD	190,042	0	–190,042
7.	– EUR currency group*	330,715	58,702	–272,013
8.	– JPY	23,288	0	–23,288
9.	– SDR	465,766	322,979	–142,787
10.	**Hedging transactions payables (6+7+8+9)**	**1,009,811**	**381,681**	**–628,130**
11.	**Net hedging transactions payables (10–5)**	**114,398**	**14,694**	**–99,704**

** The EUR currency group includes the euro and other European currencies (such as GBP, CHF) that may be listed here with regard to foreign exchange risk.*

4.12 NET POSITION VIS-À-VIS THE IMF

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
from II.1.	IMF quota paid in SDR	27,196	25,145	–2,051
from II.1.	Deposit with IMF	202,047	80,784	–121,263
from II.1.	Deposit with IMF for Fund's programme purposes	3,403	3,146	–257
from II.4.	IMF quota paid in HUF	355,288	328,493	–26,795
	Total receivables	**587,934**	**437,568**	**–150,366**
from VII.3.	Liabilities arising from SDR Allocations	365,044	337,513	–27,531
from VII.3.	IMF No. 2. account	1	1	0
from VII.3.	IMF No. 1. account	719,705	648,678	–71,027
from VII.3.	Swap receivables from IMF	–364,417	–320,186	44,231
from VII.3.	Swap payables to IMF	465,766	322,979	–142,787
	Total liabilities	**1,186,099**	**988,985**	**–197,114**
	Total	**–598,165**	**–551,417**	**46,748**

The IMF loan amounting to SDR 1.3 billion was drawn down by the MNB in 2009. According to the IMF's regulations, disbursement is recorded in the form of a swap transaction, which means forint receivables and SDR liabilities. This swap transaction appeared on the liability side due to revaluations also in 2012: the amount of forint receivables is determined by the IMF, and the volume of liabilities depends on the foreign exchange rate of SDR. The loan granted by the IMF raises the amount of foreign exchange reserves and the balance of the IMF No. 1. account on the liability side (i.e. forint coverage of the IMF quota). The liability from the IMF shown in the item 'Swap payables to IMF' of the table decreased to HUF 323 billion as at 31 December 2012, because of repayment started during the year and of foreign exchange rate changes. The MNB repaid the two first instalments of HUF 106.4 billion in total (SDR 158 million each) in September and December.

The item 'Liabilities arising from SDR allocations' represents the liability of HUF 337.5 billion (i.e. SDR 991.1 million) with no maturity, arising from the allocation distributed by the IMF in 2009 on the one hand. This amount raised the deposit with the IMF on the other hand. The SDR allocation may be used for repaying the capital amount and interest of the loan from the IMF. The allocation was appropriated for interest payment and December capital repayment in 2012.

The HUF-denominated promissory note related to the liability from the Fund disbursements of the Hungarian State and placed with the MNB as a fiscal agent is shown as an off-balance sheet item in the balance sheet of the MNB (see Section 4.18.). The commitment amounted to HUF 1,836.5 billion at 31 December 2012 and had changed to HUF 1,171 billion by the end of 2012; it was decreased by the capital repayment (SDR 2.9 billion in total) started during the year, while the change of official exchange rate announced by IMF raised it.

4.13 INVESTED ASSETS

In addition to intangibles, tangibles and capital expenditure (HUF 14.3 billion), invested assets include shares in investments (HUF 8.3 billion in foreign investments and HUF 10.6 billion in domestic investments).

Changes in the gross value, depreciation and net value of intangibles, tangibles and capital expenditure

HUF millions

	Assets						Intangibles, tangibles and capital expenditure, total
	Immaterial goods		Tangible assets			Capital expenditure and advances given	
	Intangible assets	Software under development	Buildings	Equipment	Assets of banknote and coin		
Gross value							
31. 12. 2011	**7,845**	**31**	**12,030**	**10,832**	**235**	**12**	**30,985**
Installation/repurchases	543	–23	105	380	2	64	1,071
Other addition	0	0	0	0	0	0	0
Scrapping	–136	0	0	–301	0	0	–437
Selling	0	0	0	–3	0	0	–3
Transfer free of charge	–6	0	0	–63	0	0	–69
Other disposal/reclassification	0	0	0	–113	–1	0	–114
31. 12. 2012	**8,246**	**8**	**12,135**	**10,732**	**236**	**76**	**31,433**
Details of depreciation							
31. 12. 2011	**6,620**	**0**	**2,474**	**6,902**	**0**	**0**	**15,996**
Planned depreciation	431	0	375	905	0	0	1,711
Removal from the account	142	0	0	478	0	0	620
Decrease due to reclassification	0	0	0	0	0	0	0
31. 12. 2012	**6,909**	**0**	**2,849**	**7,329**	**0**	**0**	**17,087**
Balance							
31. 12. 2011	**1,225**	**31**	**9,556**	**3,930**	**235**	**12**	**14,989**
31. 12. 2012	**1,337**	**8**	**9,286**	**3,403**	**236**	**76**	**14,346**
Change	**112**	**–23**	**–270**	**–527**	**1**	**64**	**–643**

Foreign investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2011	31. 12. 2012	31. 12. 2011	31. 12. 2012	2011	2012
BIS	1.43	1.43	7,144	6,666	740	913
SDR millions			*10*	*10*		
CHF millions			*13.5*	*13.5*		
European Central Bank	1.39	1.39	1,739	1,629	0	0
EUR thousands			*5,591*	*5,591*		
SWIFT	0.02	0.02	3	2	0	0
EUR thousands			*8.6*	*8.6*		
Total investments			**8,886**	**8,297**	**740**	**913**

* *Dividends financially settled in the given year.*

The Republic of Hungary joined the European Union on 1 May 2004. Consequently, the MNB became a member of the ESCB. The ESCB comprises the European Central Bank (ECB) and the national central banks of the 27 EU Member States. The Eurosystem is composed of the ECB and of the national central banks of Member States which have already adopted the euro.

Pursuant to the provisions of Article 28 of the Statute of the ESCB and the ECB (hereinafter referred to as 'the Statute'), the MNB has become a subscriber to the capital of the ECB.

The sub-item 'Invested assets' among 'III. Banking assets' in the balance sheet of the MNB represents the MNB's participation in the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the Statute and must be adjusted every five years. Based on demographic and GDP data provided by the European Commission, Hungary's share in the ECB's capital was 1.3884 per cent, i.e. EUR 77.3 million at the time of accession. Shares can change in two ways: with a new accession to the EU or with the adjustment of capital key implemented every five years. As a result of the adjustment, the MNB's capital key changed to 1.3856 per cent i.e. EUR 79.8 million as of 1 January 2009.

Effective 29 December 2010, the ECB's subscribed capital increased by EUR 5 billion to 10,761 million, and thus Hungary's share in the ECB's capital rose to EUR 149.1 million, while the capital key remained unchanged. The measure of the contribution to the ECB's operational cost to be paid up by non-euro area NCBs changed as well; 3.75 per cent of their share in the subscribed capital of the ECB shall be paid instead of the earlier 7 per cent, pursuant to Article 47 of the Statute. The value of the investment amounted to EUR 5.6 million in the MNB's balance sheet as at 31 December 2012.

On 1 July 2004, the Magyar Nemzeti Bank undertook participation in the London-based CEBS Secretariat Ltd. established under UK law to provide, pursuant to its deed of foundation, administrative services to the Committee of European Banking Supervisors. Members contribute their respective quotas to its operating costs according to an annual payment schedule. As membership required the investment of a mere GBP 1, it is not recorded in the MNB's books. The activities of CEBS were taken over by the European Banking Authority from 2011, in which Hungary is represented by the Hungarian Financial Supervisory Authority. The MNB participates as an observer.

Ownership distribution in the ECB at 27 December 2012

National Central Banks (NCBs)	Subscribed capital	Paid-up capital	Capital key (%)
	EUR thousands		
Nationale Bank van België / Banque Nationale de Belgique	261,010	261,010	2.4256
Deutsche Bundesbank	2,037,777	2,037,777	18.9373
Eesti Pank	19,262	19,262	0.1790
Bank of Greece	211,436	211,436	1.9649
Banco de España	893,565	893,565	8.3040
Banque de France	1,530,294	1,530,294	14.2212
Central Bank of Ireland	119,518	119,518	1.1107
Banca d'Italia	1,344,716	1,344,716	12.4966
Central Bank of Cyprus	14,731	14,731	0.1369
Banque centrale du Luxemburg	18,799	18,799	0.1747
Central Bank of Malta / Bank Centrali ta' Malta	6,801	6,801	0.0632
De Nederlandsche Bank	429,156	429,156	3.9882
Österreichische Nationalbank	208,940	208,940	1.9417
Banco de Portugal	188,354	188,354	1.7504
Banka Slovenije	35,381	35,381	0.3288
Národná banka Slovenska	74,614	74,614	0.6934
Suomen Pankki-Finlands Bank	134,928	134,928	1.2539
Subtotal for euro area NCBs	**7,529,282**	**7,529,282**	**69.9705**
Danmarks Nationalbank	159,634	5,986	1.4835
Sveriges Riksbank	242,997	9,112	2.2582
Bank of England	1,562,146	58,581	14.5172
Česká národní banka	155,728	5,840	1.4472
Latvijas Banka	30,528	1,145	0.2837
Lietuvos bankas	45,797	1,718	0.4256
Magyar Nemzeti Bank	149,100	5,591	1.3856
Narodowy Bank Polski	526,777	19,754	4.8954
Bulgarian National Bank	93,467	3,505	0.8686
Banca Naţională a României	265,196	9,945	2.4645
Subtotal for non-euro area NCBs	**3,231,370**	**121,177**	**30.0295**
Total NCBs	**10,760,652**	**7,650,459**	**100.0000**

Domestic investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2011	31. 12. 2012	31. 12. 2011	31. 12. 2012	2011	2012
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 17.	100.0	100.0	8,927	8,927	897	0
Magyar Pénzverő Zrt. 1239 Budapest, Európa u. 1.	100.0	100.0	575	575	415	285
KELER Zrt. 1075 Budapest, Asbóth utca 9–11.	53.3	53.3	643	643	0	0
KELER KSZF Zrt.** 1075 Budapest, Asbóth utca 9–11.	13.6	13.6	62	62	0	0
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	7.3	7.3	46	46	121	120
Budapesti Értéktőzsde Zrt. 1062 Budapest, Andrássy út 93.	6.9	6.9	321	321	90	77
Total investments			**10,574**	**10,574**	**1,523**	**482**

** Dividends financially settled in the given year.*
*** KELER KSZF Kft. was transformed into private limited company by the court of registry's registration on 17 March 2011. The ratio of the MNB's investment did not change (13.6 per cent) but it's book value increased to HUF 62 million in 2011.*

Key indicators of domestic investments

Upon compilation of the Annual Report these are the latest data and in the case of affiliated firms with 100 per cent ownership audited data in the following tables.

HUF millions

Investment	Share capital	Reserves	Profit/loss for the year	Equity	Profit/loss for the year after taxation
	31. 12. 2012	31. 12. 2012	31. 12. 2012	31. 12. 2012	2012
Pénzjegynyomda Zrt.	8,927	326	784	10,037	784
Magyar Pénzverő Zrt.	575	421	48	1,044	152
KELER Zrt.	4,500	15,248	2,033	21,781	2,260
KELER KSZF Zrt.	20	633	–76	577	–76
GIRO Elszámolásforgalmi Zrt.	2,496	3,625	1,684	7,805	1,684
Budapesti Értéktőzsde Zrt.	541	4,916	575	6,032	575

HUF millions

Investment	Net sales revenue		Financial income		Other income		Extraordinary income	
	2011	2012	2011	2012	2011	2012	2011	2012
Pénzjegynyomda Zrt.	5,183	6,256	103	96	166	23	0	0
Magyar Pénzverő Zrt.	3,350	2,057	28	18	7	1	0	0
KELER Zrt.	n. a.	n. a.	11,549	15,247	296	345	0	0
KELER KSZF Zrt.**	506	599	250	361	1	0	0	0
GIRO Elszámolásforgalmi Zrt.	n. a.	n. a.	4,400	4,902	1,339	1,576	0	0
Budapesti Értéktőzsde Zrt.	3,074*	2,397*	118	44	10	28	0	0

n. a.: revenue is not applicable data.
** Income from Stock Exchange related activities.*
*** The data of KELER KSZF Zrt. refer to the period from 1 April 2011 to 31 December 2011.*

Investment	Average number of staff	
	31. 12. 2011	31. 12. 2012
Pénzjegynyomda Zrt.	335	301
Magyar Pénzverő Zrt.	38	38
KELER Zrt.	128	131
KELER KSZF Zrt.	0	1
GIRO Elszámolásforgalmi Zrt.	128	135
Budapesti Értéktőzsde Zrt.	59	56

The MNB's receivables from and liabilities to affiliated companies

HUF millions

Investment	Receivables	Liabilities
	31. 12. 2012	31. 12. 2012
Pénzjegynyomda Zrt.	0	269
Magyar Pénzverő Zrt.	120	0
KELER Zrt.	0	2
KELER KSZF Zrt.	0	0
GIRO Elszámolásforgalmi Zrt.	0	0
Budapesti Értéktőzsde Zrt.	0	0
Total	**120**	**271**

The table presents short-term receivables and liabilities.

In addition to banknotes, **Pénzjegynyomda Zrt.** produces documents, tax stamps and securities, primarily for institutional clients. Developments were implemented to ensure the secure production of banknotes. With adoption of the euro, the production of forint banknotes will be terminated and, according to the decision of the MNB, Pénzjegynyomda Zrt. will not produce euro banknotes. The strategy of the company aims for its presence in market segments other than banknote production that could compensate the lost revenue, keeping Pénzjegynyomda Zrt. on a growth path and maintaining and enhancing shareholders' value.

Pursuant to the MNB's order, the primary duty of **Magyar Pénzverő Zrt.** is to produce circulation coins for cash turnover and commemorative coins issued by the MNB. Utilisation of the company's free capacity allows the production of non-legal tender commemorative coins and coins for foreign markets on the basis of its own coin programme and for customised orders. Within the range of its commercial activities, the company sells commemorative coins, collector banknotes, medals and gold investment products in Hungary and abroad as a wholesaler and retailer as well.

4.14 IMPAIRMENT LOSSES AND PROVISIONS

HUF millions

B/S line	Description	31. 12. 2011	Interim changes in 2012		31. 12. 2012
		Impairment losses / provisions	Increase (+)	Reversal (–)	Total impairment losses / provisions
1	2	3	4	5	3+4+5
from I.2.	Forint receivables from credit institutions	1,939	0	–1,939	0
from II.4.	Other foreign currency receivables	141	0	–9	132
from III.	Other assets	18	0	–2	16
VIII.	Liabilities	4,166	3,367	–3,242	4,291
	– derivatives	167	3,226	–167	3,226
	– bond lending	3,999	141	–3,075	1,065
	Total	**6,264**	**3,367**	**–5,192**	**4,439**

Impairment losses and provisions increased by HUF 1,825 million to HUF 4,439 million in 2012.

For the mortgage bonds bought for monetary purposes shown in the item 'Receivables from credit institutions' the previously recorded net amount of HUF 1,939 million in impairment losses was reversed, due to the fact that the market value of the bonds was significantly higher than their book value.

The additional provision created due to the changes in the market value of derivatives for purposes other than hedging amounted to HUF 3,059 million in 2012.

According to the international securities lending contracts, the MNB is charged by the entire amount of the potential losses arising from cash-hedge investments made by agents. Based on the principle of prudence, a provision must be created to cover this loss as a future liability. The end-2011 balance of provisions created for forint bond lending amounted to HUF 3,999 million and decreased to HUF 1,065 million up to the end of 2012, caused by the decrease of the balance of the securities for which the provisions were created on the one hand, and due to the better market qualification of most securities on the other hand.

4.15 PREPAID EXPENSES/ACCRUED INCOME AND ACCRUED EXPENSES/DEFERRED INCOME

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
	Due to banking transactions	172,292	136,094	−36,198
	Due to internal operation	616	119	−497
IV.	**Prepaid expenses/accrued income**	**172,908**	**136,213**	**−36,695**
	Due to banking transactions	15,223	18,145	2,922
	Due to internal operation	861	802	−59
X.	**Accrued expenses/deferred income**	**16,084**	**18,947**	**2,863**

Prepaid expenses, accrued income, accrued expenses and deferred income include interest received/charged and interest related income/charges and expenses incurred in the reporting period, independently of the date of financial settlement.

4.16 CHANGES IN EQUITY

HUF millions

B/S line	Description	31. 12. 2011	Interim changes	31. 12. 2012
XI.1.	Share capital	10,000	0	10,000
XI.2.	Retained earnings*	33,426	13,597	47,023
XI.3.	Valuation reserves	0	0	0
XI.4.	Revaluation reserves due to exchange rate changes	1,324,963	−760,922	564,041
XI.5.	Revaluation reserves of foreign currency securities	5,593	−35,781	−30,188
XI.6.	Profit/Loss for the year	13,598	−53,409	−39,811
XI.	**Equity**	**1,387,580**	**−836,515**	**551,065**

** The difference between the interim change of Retained earnings and the Profit for the year of 2011 is caused by rounding.*

The share capital consists of a single registered share with a nominal value of HUF 10 billion.

Pursuant to the MNB Act, the MNB’s dividend is specified by the board of directors. According to the decision of the board of directors, in 2013 the MNB will not pay any dividend from retained earnings for the year 2012.

For more details on revaluation reserves, see Section 4.17.

4.17 REVALUATION RESERVES

HUF millions

B/S line	Description	31. 12. 2011	31. 12. 2012	Change
XI.4.	Revaluation reserves due to exchange rate changes	1,324,963	564,041	−760,922
XI.5.	Revaluation reserves of foreign currency securities	5,593	−30,188	−35,781
	Total revaluation reserves	**1,330,556**	**533,853**	**−796,703**

The official forint exchange rate versus the euro fluctuated in a range between 276.07 and 321.93 in 2012, depending on the country’s risk perception. It reached its highest value at the beginning of January and the lowest in the second half of August. In the last quarter, the exchange rate fluctuated between EUR/HUF 280 and 285, only weakening over this level at the end of the year. As at 31 December 2012, the forint had strengthened by 6.4 per cent to EUR/HUF 291.29, compared to the exchange rate at 31 December 2011. The average cost rate weakened by HUF 2.72 to 271.74. The difference between the official and average cost rate was significantly lower compared to end-2011 (a decrease from EUR/HUF 42.11 to EUR/HUF 19.55). Consequently the revaluation reserves due to exchange rate changes, calculated as the difference of foreign exchange items converted into forint using the official and average cost rate, decreased by HUF 760.9 billion to HUF 564 billion.

Revaluation reserves of foreign currency securities is calculated as the difference between the market value and the book value of securities. Due to the effects of yield changes on the market, market price differences on foreign currency securities of MNB's portfolio decreased by HUF 35.8 billion and unrealised losses on foreign currency securities showed a negative balance of HUF 30.2 billion as at 31 December 2012. According to the MNB Act the central government is not required to reimburse the negative balance, while the aggregated balance of the two revaluation reserves was positive.

Annual changes in the forint exchange rate

EUR/HUF

Date	MNB official exchange rate	Average cost rate
31.12.2011	311.13	269.02
31.12.2012	291.29	271.74
Annual appreciation (+) / depreciation (–)		
In 2011	–11.6%	
In 2012	+6.4%	

4.18 OFF-BALANCE SHEET LIABILITIES OF THE MNB AND OTHER SIGNIFICANT OFF-BALANCE SHEET ITEMS

Liabilities arising from hedging and other forward transactions and related receivables

HUF millions

No.	Description	31. 12. 2011			31. 12. 2012		
		Receivables	Liabilities	Net market value	Receivables	Liabilities	Net market value
1.	Interest rate swap transaction	272,785	272,785	–1,824	434,002	434,002	–4,442
2.	Bond future transaction	0	1,262,719	–6,750	0	244,092	–473
3.	FX swap and forward transactions	1,834,998	1,834,428	3,424	1,625,825	1,560,231	65,834
4.	Currency swap transactions	55,176	66,593	–10,332	229,299	241,880	–13,058
5.	**Total hedging transaction (1+2+3+4)**	**2,162,959**	**3,436,525**	**–15,482**	**2,289,126**	**2,480,205**	**47,861**
6.	CDS transaction	230,236	230,236	2,653	203,903	203,903	–3,226
7.	Options	0	320	0	0	0	0
8.	FX swap and forward transactions	4,074	4,083	–10	6,419	6,370	49
9.	**Total other forward transactions (6+7+8)**	**234,310**	**234,639**	**2,643**	**210,322**	**210,273**	**–3,177**
10.	**Total (5+9)**	**2,397,269**	**3,671,164**	**–12,839**	**2,499,448**	**2,690,478**	**44,684**

The table above includes all types of the off balance sheet liabilities arising from derivative transactions; it also includes FX swap, currency swap and forward transactions for hedging purposes, which are part of the foreign currency position and are recorded in the balance sheet. Hedging transactions reduce risks related to the net foreign currency position and arising from cross rate fluctuations and interest rate changes. These transactions support the creation of the benchmark foreign currency structure determined by the Monetary Council.

FX swap and forward transactions are the main instruments for hedging foreign exchange risk. The aim of interest rate swap transactions for hedging purposes linked to the specific bond issuance is to achieve the interest structure deemed desired by the MNB.

Some of the interest rate swap transactions have been concluded with ÁKK and serve to limit the interest rate risks of foreign exchange rate debt. These are hedged by the MNB through reverse transactions on the capital market.

The aim of bond futures transactions is to reduce the duration of the reserve portfolio; these are hedging transactions maturing within 1 year.

Under the item 'CDS transaction' (Credit Default Swap) transactions are recorded, the aim of which is to decrease the credit risk of two benchmark securities. The transactions will mature in 2016. CDS transactions are other derivative transactions, and consequently MNB created a provision for loss arising from changes in their market value in line with the MNB Decree (see Section 4.14.).

As at 31 December 2012 there were no option transactions.

Other FX swap and forward transactions are based on expectations related to foreign exchange rate changes; their aim is to achieve the targeted foreign currency position, and their maturity is less than 1 year (typically 1 or 2 month).

Liabilities from derivative transactions by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2011	31. 12. 2012	
	– within 1 year	3,110,544	2,003,133	–1,107,411
	– within 1 to 5 years	319,758	477,072	157,314
	– over five years	6,223	0	–6,223
1.	**Hedging transactions**	**3,436,525**	**2,480,205**	**–956,320**
	– within 1 year	9,070	6,370	–2,700
	– within 1 to 5 years	225,569	203,903	–21,666
	– over five years	0	0	0
2.	**Other forward transactions**	**234,639**	**210,273**	**–24,366**
3.	**Total (1+2)**	**3,671,164**	**2,690,478**	**–980,686**

Other off-balance sheet liabilities

HUF millions

No.	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
1.	IMF security deposit account	1,836,493	1,170,998	–665,495
2.	Guarantees	1,534	1,398	–136
3.	Other off-balance sheet liabilities	3	3	0
4.	**Total (1+2+3)**	**1,838,030**	**1,172,399**	**–665,631**

The IMF security deposit account includes the HUF-denominated promissory note issued by the Hungarian State for the IMF and held by the MNB as bailment (see Section 4.12).

The item 'Guarantees' consists of export guarantees, to which an irrevocable indemnity bond is always linked. When exercising a guarantee, the MNB has the right to a reverse guarantee if needed. In 2012, the balance of guarantees decreased due to the termination of 5 guarantees.

Other off-balance sheet liabilities by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2011	31. 12. 2012	
	– within 1 year	760,706	1,077,098	316,392
	– within 1 to 5 years	1,077,324	95,301	–982,023
	– over five years	0	0	0
1.	**Total other liabilities**	**1,838,030**	**1,172,399**	**–665,631**

Recording off-balance sheet security transactions

HUF millions

No.	Description	Balance		Change
		31. 12. 2011	31. 12. 2012	
1.	Face value of securities lent	1,059,329	1,168,182	108,853
2.	Purchase cost of the non-cash hedge arising from security lending transactions	263,615	453,402	189,787
3.	Investment of cash hedge arising from security lending transactions			
	– at purchase cost	740,555	701,200	–39,355
	– at market value	736,556	700,135	–36,421
4.	Face value of securities bought under repo transactions	520,689	442,165	–78,524
5.	Face value of securities sold under reverse repo transactions	1,440,554	972,720	–467,834

Regarding securities bought under repo transactions, see Section 4.11.

4.19 NET INTEREST INCOME AND REALISED NET INCOME OF FINANCIAL OPERATIONS

Net forint and foreign currency interest and interest related income

HUF millions

P/L line	Description	2011	2012	Change
1	2	3	4	4–3
(I.1.+II.2.)–(X.1.+XI.1.)	Central government	–28,197	–36,519	–8,322
(I.2.+II.3.)–(X.2.+XI.2.)	Credit institutions	–37,649	–28,687	8,962
(I.3.+II.1.+II.4.)–(X.3.+XI.3.)	Other	–14,203	–71,586	–57,383
	Net profit from interest	**–80,049**	**–136,792**	**–56,743**
from lines (I.4.–X.4.)	Forint securities	727	359	–368
from lines (II.5.–XI.4.)	Derivative transactions for hedging and other purposes*	–16,553	–17,025	–472
from lines (II.5–XI.4.)	Other	1,884	–92	–1,976
(I.4.+II.5.)–(X.4.+XI.4.)	**Net interest related profit**	**–13,942**	**–16,758**	**–2,816**
(I.+II.)–(X.+XI.)	**Net interest and interest related income**	**–93,991**	**–153,550**	**–59,559**

** For details on derivative transactions for hedging and other purposes, see the last table in this section.*

In 2012, the MNB recorded a net interest and interest related loss of HUF 153.6 billion, up HUF 59.6 billion compared to the figure for end-2011, which was a loss of HUF 94 billion.

Net interest income was lower by HUF 56.7 billion in comparison with end-2011 mainly due to the increase of the average base rate, to the continuous decline of FX market yields and to the strengthening of the forint exchange rate.

The net interest income was increased by the following factors:

– an increase in interest income on loans to credit institutions of HUF 6.1 billion in 2012, mainly due to the introduction of security-backed loans with two-year maturity,

– higher interest income on covered mortgage bonds of HUF 3.9 billion caused by higher amount of bonds on a yearly average,

– a decrease in interest expenses on other foreign currency liabilities of HUF 2.1 billion. This was caused largely by the lower amount of repo transactions, which provided funds in euro for FX swaps contracted with credit institutions.

The net interest income was decreased by the following factors:

– a decrease in interest income on foreign exchange reserves of HUF 39.3 billion relative to 2011,

– lower interest income on government bonds of HUF 3 billion caused by the lower amount of bonds,

– an increase in interest expenses on two-week MNB bills of HUF 20.2 billion compared to the preceding year,

– higher interest expenses on government deposits denominated in forint and in foreign currency of HUF 5.3 billion arising from the joint effect of higher forint deposits and lower foreign currency deposits,

– higher interest expenses on credit institutions' deposits by HUF 1 billion.

Net interest related income fell by HUF 2.8 billion, due mainly to the net gain or loss on derivative transactions which are not related to exchange rate changes.

Details of income from derivative transactions for hedging and for purposes other than hedging represented in interest related income

HUF millions

No.	Description	2011	2012	Change
1.	– interest income on currency swaps	4,129	10,495	6,366
2.	– income like interest margin on hedge interest rate swaps	1,121	730	–391
3.	– interest gains on hedge FX swaps	4,863	5,108	245
4.	– interest gains on hedge futures transactions	7,714	2,032	–5,682
5.	– interest related gains on hedge swap transactions	0	0	0
6.	– income from fees on hedge option transactions	108	0	–108
7.	– interest income on other transactions	577	234	–343
8.	**Income from derivative transactions (1+2+3+4+5+6+7)**	**18,512**	**18,599**	**87**
9.	– interest expenses on currency swaps	4,468	11,031	6,563
10.	– expense like interest margin on hedge interest rate swaps	355	256	–99
11.	– interest loss on hedge FX swaps	11,463	7,880	–3,583
12.	– interest loss on hedge futures transactions	16,955	15,205	–1,750
13.	– interest related losses on hedge swap transactions	0	998	998
14.	– expenses from fees on hedge option transactions	384	0	–384
15.	– interest expenses on other transactions	1,440	254	–1,186
16.	**Expenses on derivative transactions (9+10+11+12+13+14+15)**	**35,065**	**35,624**	**559**
17.	– net interest on currency swaps (1–9)	–339	–536	–197
18.	– interest margin on hedge interest rate swaps (2–10)	766	474	–292
19.	– net interest gains on hedge FX swaps (3–11)	–6,600	–2,772	3,828
20.	– net interest gains on hedge futures transactions (4–12)	–9,241	–13,173	–3,932
21.	– net interest related income on hedge swap transactions (5–13)	0	–998	–998
22.	– net interest related income on hedge option transactions (6–14)	–276	0	276
23.	– net interest on other transactions (7–15)	–863	–20	843
24.	**Net income from derivative transactions (8–16)**	**–16,553**	**–17,025**	**–472**

Currency swap transactions include derivative transactions concluded with foreign partners and with the ÁKK. The transactions concluded with foreign partners serve to hedge exchange rate and interest rate risks arising from bonds issued in the past by the MNB abroad. The net interest result of the currency swaps was a loss of HUF 0.5 billion, a slight decline compared to 2011.

The HUF 0.3 billion decrease in the interest result on interest rate swaps was caused by lower FX market yields, despite the number of transactions rising in 2012.

Net interest gains on FX swaps increased by HUF 3.8 billion caused partly by the FX swaps related to early repayment early in the year and partly by the euro liquidity providing FX swaps. Both were contracted with credit institutions.

Net interest gains on hedge futures transactions decreased by HUF 3.9 billion, due to the lower interest income on bond futures transactions.

Net interest related income on hedge swap transactions include the loss of HUF 1 billion resulted from the closing of interest rate swaps before their maturity.

Net interest on other transactions increased by HUF 1 billion for two reasons: due to the increase of net interest on other futures transactions and to the maturity of other interest rate swaps.

Realised gains/losses from financial operations

HUF millions

P/L line	Description	2011	2012	Change
IV.	Realized gains from financial operations	81,273	31,833	–49,440
XIV.	Realized losses from financial operations	56,573	65,013	8,440
IV.–XIV.	**Net financial gains/losses**	**24,700**	**–33,180**	**–57,880**

Realised gains and loss from financial operations include gains and losses arising from sales and maturities of securities, from sales of investments arising from security lending transactions and gains and losses related to CDS transactions.

Net realised losses from financial operations amounted to HUF 33.2 billion in 2012, a decline of HUF 57.9 billion compared to the gains for 2011. Losses mainly occurred upon the maturity of bonds bearing high coupon and bought over nominal value.

4.20 COMPONENTS OF INCOME FROM THE REVALUATION OF FOREIGN EXCHANGE HOLDINGS

HUF millions

Description	2011	2012
Net income from exchange rate changes (realised and conversion spread)*	98,685	158,269
Change in revaluation reserves in the balance sheet** (due to unrealised revaluation net income)	909,026	–760,922
Total effect of exchange rate changes	**1,007,711**	**–602,653**

** P/L line: III.–XII.*
*** Revaluation reserves due to exchange rate changes (balance sheet line XI.4.).*

In 2012, the total exchange rate change effect was a loss of HUF 602.6 billion, due to the changes in the exchange rate of the forint. In the sales related to decreasing the daily net FX position, the Bank realised a gain of HUF 158.3 billion, while the amount of the revaluation reserve was decreased by the unrealised exchange rate changes losses of HUF 760.9 billion during the year.

For more details on revaluation reserves, see Section 4.17.

4.21 COST OF ISSUING BANKNOTES AND COINS

HUF millions

P/L line	Description	2011	2012	Change
	Cost of banknote production	2,711	2,796	85
	Cost of coin production	1,439	916	–523
	Cost of production of commemorative and collector coins	737	437	–300
XIII.	**Cost of issuing banknotes and coins**	**4,887**	**4,149**	**–738**

The cost of issuing banknotes and coins was HUF 4.1 billion in 2012, a decrease of HUF 0.7 billion compared to the preceding year. Cost of banknote production was at similar level as in 2011. Although the quantity of banknotes produced decreased by 2.4 per cent, the production of banknotes with higher denomination, those with higher acquisition cost as well, increased the costs of production. The cost of coin production and the production cost of commemorative coins decreased significantly due to lower raw material prices, in spite of the slight increase (1.2 per cent) in the quantity of coins produced.

4.22 OTHER INCOME/EXPENSES

HUF millions

P/L line	Description	2011	2012	Change
V.1.	Income from fees and commissions	1,076	986	–90
XV.1.	Expenses of fees and commissions	743	780	37
	Net income from fees and commisssions	**333**	**206**	**–127**
V.2.	Income from other than fees and commissions	3,091	2,907	–184
XV.2.	Expenses of other than fees and commissions	830	425	–405
	Net income from other than fees and commisssions	**2,261**	**2,482**	**221**
V.–XV.	**Other net results**	**2,594**	**2,688**	**94**

Income from fees and commissions mainly relates to payment services. Lower income from fees and commissions stemmed primarily from the lower fees connected to account management.

For more details on income other than fees and commissions, see Section 4.23.

4.23 INCOME OTHER THAN FEES AND COMMISSIONS

HUF millions

No.	Description	2011	2012	Change
1.	Dividends from investments	2,263	1,395	–868
2.	Non-repayable money received	0	1,009	1,009
3.	Income related to coins and commemorative coins	719	420	–299
4.	Income from sales or transformation of invested financial assets	62	0	–62
5.	Income from assets assigned free of charge	2	2	0
6.	Other income	45	81	36
7.	**V.2. Income from other than commissions and charges (1+2+3+4+5+6)**	**3,091**	**2,907**	**–184**
8.	Financial money transfer	225	239	14
9.	Expenses related to coins and commemorative coins	377	168	–209
10.	Expenses from sales or transformation of invested financial assets	7	0	–7
11.	Expenses from assets assigned free of charge	211	7	–204
12.	Other expenditures	10	11	1
13.	**XV.2. Expenses from other than commissions and charges (8+9+10+11+12)**	**830**	**425**	**–405**
14.	**Net income/expenses from other than commissions and charges (7–13)**	**2,261**	**2,482**	**221**

Income other than fees and commissions includes the following:

– Dividends from investments decreased by HUF 0.9 billion compared to 2011. In 2012, the BIS paid a dividend of HUF 913 million, Magyar Pénzverő Zrt of HUF 285 million, GIRO Zrt. of HUF 120 million, and BÉT of HUF 77 million. Pénzjegynyomda Zrt., in line with the decision of the shareholder, KELER Zrt. and KELER KSZF Zrt., according to the decision of their general meeting, did not pay any dividend from their 2011 results.

– The item 'Non-repayable money received' includes an amount more than SDR 3 million received from the IMF. IMF decided to distribute the remaining gold sales as windfall profit among its members in proportion to their quotas in the Fund. The aim of the decision was that members make a donation to low-income developing countries. The profit as the yield of the paid quota fell to the MNB. In accordance with the regulations concerning the prohibition on monetary financing, MNB is not allowed to make donation from its foreign currency reserves in the name of Hungary. The State has the right to decide on this donation. For the MNB, the HUF 1 billion received from the IMF means extraordinary income, which will not involve any expenses.

– The item 'Final money transfer' mainly includes donations to domestic organisations and foundations.

– Net income related to coins and commemorative coins depends mainly on the commemorative coin issue programme for the particular year. The decrease in net income was caused on the one hand by the lower quantity of gold and silver coins, and on the other hand by the drop in the quantity of double-weight (so-called piefort) coins.

4.24 OPERATING INCOME AND EXPENSES

HUF millions

P/L line	Description	2011	2012	Change
	Income from assets and inventories	36	5	–31
	Income from subcontracted services	16	28	12
	Income from invoiced services	127	116	–11
	Other income	22	13	–9
	Extraordinary income	1	1	0
VIII.	**Total operating income**	**202**	**163**	**–39**
	Cost of materials	3,433	3,399	–34
	Personnel-related costs	6,884	6,791	–93
	Depreciation	1,800	1,708	–92
	Transfer of costs of other activities	–235	–250	–15
	Total operating costs	**11,882**	**11,648**	**–234**
	Expenses incurred on assets and inventories	12	9	-3
	Expenses incurred on subcontracted services	16	23	7
	Expenses incurred on invoiced services	128	118	–10
	Other expenses	26	80	54
	Total operating expenses	**182**	**230**	**48**
XVIII.	**Total operating costs and expenses**	**12,064**	**11,878**	**–186**
VIII.–XVIII.	**Net operating expenses**	**–11,862**	**–11,715**	**147**

Net operating expenses amounted to HUF 11.7 billion in 2012, a decrease of HUF 147 million (1.2 per cent) compared to the previous year. This result is determined mainly by total operating costs, which were lower by HUF 234 million (2 per cent) in 2012 relative to 2011, due to the following changes in its components:

The *cost of materials* in the reporting year decreased slightly, by HUF 34 million compared to 2011, owing to the following:

– Operating costs decreased by more than HUF 47 million relative to the previous year. This was primarily the result of changing the guard strategy in the Logistic Centre using one supplier for these services from 2012. The costs related to facility operation of the central building were also lower partly due to the works completed in 2011 and partly due to emphasis on the cost saving approach. Consulting costs related to technical services dropped significantly in comparison to end-2011 due to a delay in the procurement process and conclusion of the contract. All these savings were offset by the increase of costs on other accounts, e.g. growing demand for automobiles arising from the amendment of the MNB Act and the replacement of the multipurpose MNB identity cards.

– IT costs increased by more than HUF 100 million compared to 2011. This was influenced by the higher operating cost of the installed new portfolio dealing system. Furthermore additional costs occurred in connection with the chained certification and with maintenance of the virtual backup unit.

– Other costs decreased by HUF 106 million primarily as a result of the tasks and costs related to the Holocaust trial being taken over by the minister of national development proceeding in the name of the Hungarian State in the first half of 2011.

The audit fee for the year 2012 amounted to HUF 33 million. The audit fee related to the Corporate Social Responsibility Report included in the Annual Report of the MNB has amounted HUF 4 million.

Personnel-related costs decreased by HUF 93 million (by 1.4 per cent), mainly due to the lower average number of stuff. Costs were reduced by the lower bonus level of the management and by the lower shift allowance in accordance with the amendment of the Labour Code. Moreover, payments on dismissal decreased as well, but the change of rules concerning contributions caused additional costs.

Depreciation decreased by HUF 92 million (by 5.1 per cent) in 2012 in comparison with the previous year, mainly as a result of the lower volume of investments in recent years.

Transfer of costs of other activities, as an item that reduces the operating costs, the majority of HUF 250 million consists of the rent paid by Magyar Pénzverő Zrt. for the partial use of the Logistics Centre and of the operational costs of VIBER (real-time gross settlement system).

4.25 CHANGES IN THE NUMBER OF EMPLOYEES, WAGE COSTS AND REMUNERATION OF THE BANK'S EXECUTIVE OFFICERS

Number of staff and wage information

HUF millions

Description	2011	2012	Change (%)
Wage costs incurred on staff	4,439	4,399	–0.9
Other wage costs*	214	218	1.9
Wages	**4,653**	**4,617**	**–0.8**
Other personnel payments	**800**	**708**	**–11.5**
Taxes on wages	**1,431**	**1,466**	**2.4**
Personnel-related costs	**6,884**	**6,791**	**–1.4**

* *Other wage costs include payments on dismissal and in exchange of vacation time used and amounts paid to non-staff and non-MNB workers.*

Persons

Description	2011	2012	Change (%)
Average number of staff	590	581	–1.5

Remuneration of executive officers

HUF millions

Bodies	Fees
Monetary Council*	64
Supervisory Board	82

** Includes the salaries and employer's voluntary pension fund contributions of external members of the Monetary Council in an employment relationship with the MNB, pursuant to Article 46 paragraph (4) c) of the Act on the MNB.*

The senior officers, such as members of the Board of Directors and the Supervisory Board, had no loans outstanding vis-à-vis the Bank in 2012.

The Bank has no obligation to pay pension benefits to its former senior officers.

4.26 DISTINCTIONS BETWEEN THE ESCB GUIDELINE AND MNB ACCOUNTING POLICY

In connection with the loan drawn down in 2009 by the MNB, the IMF specified that the MNB was obliged to present the quantified difference between its accounting policy and the ESCB guideline[15] in its annual report. These distinctions originated from reclassifications, different principles of valuation and asymmetrical recognition of profit typical of the ESCB's accounting. The results of the differences relating to the balance sheet total and equity are prepared as if each business year would be the first one compiled according to ESCB rules, i.e. the effects of previous years are not calculated. Consequently tables do not contain data for the preceding year.

According to ESCB rules, the balance of the foreign currency bonds repurchased by the MNB reduced the amount of MNB bonds presented on the liabilities side of the balance sheet, while the MNB records them as receivables on the assets side.

According to ESCB valuation rules, in contrast to the MNB's accounting policy, market valuation is used for a broader field of securities and derivative transactions. As an exception, securities classified as held-to-maturity must be valued at amortised cost and are subject to impairment if necessary.

Further distinction arising from the market valuation rules of securities: according to the guideline market prices used for revaluation of the stock shall be mid prices, while MNB uses bid prices. Moreover, under ESCB rules premiums and discounts shall be calculated as part of interest income and be amortised over the remaining life of the security. Calculating market price differences, this amortised historic cost shall be the book value of the security. MNB uses this method only for discount securities, by contrast the guideline regulation relates to interest bearing securities as well.

According to MNB accounting policy, unrealised gains and losses arising from market valuation and exchange rate changes shall be recognised in 'Revaluation reserves of foreign currency securities' and 'Revaluation reserves due to exchange rate changes', respectively. By contrast, under ESCB rules, only unrealised gains as a kind of reserve in 'Revaluation accounts' are recognised on the liability side of the balance sheet. The character of revaluation accounts is similar to the revaluation reserves applied by the MNB, but they are not a part of equity according to ESCB rules, and provide cover solely for possible foreign exchange losses and negative market price differences of later periods. The not realised loss has to be taken into account in the result for the year, but this loss is reduced partly or as a whole by the not realised gain arising on the given instruments and positions, which has accumulated on the revaluation accounts in the previous years.

As a result of the principle of prudential valuation and profit recognition (the latter means the asymmetrical recognition of unrealised profit or loss), in the balance sheet according to the ESCB rules a negative balance of the revaluation accounts is not allowed, as opposed to the Hungarian methodology. The revaluation accounts recorded by ESCB rules show higher balances than the revaluation reserves recorded by the MNB, but the realised profit for the year is lower at the same time.

[15] The application of the ESCB Guideline on accounting framework is compulsory for the central banks of those EU member states, which have adopted the euro already. The guideline establishes the necessary rules for standardising the accounting of the transactions executed by these central banks.

Factors adjusting the balance sheet total and equity in 2012

HUF millions

Description	Assets	Liabilities
Totals according to HAS	**10,681,897**	**10,681,897**
Reclassification of repurchased bonds in order to show the net amount of the issued bonds in liability side	−27,139	−27,139
Adjustments on market valuation of foreign currency securities		
Deduction of revaluation reserves of foreign currency securities due to HAS	30,188	30,188
Amortisation of premiums/discounts of interest bearing securities	−107,591	−107,591
Revaluation reserves of foreign currency securities according to ESCB rules	81,191	81,191
Unrealised loss on foreign currency securities according to ESCB rules	−778	−778
Adjustments on market valuation of derivatives	5,508	5,508
Adjustments on exchange rate changes		
Deduction of revaluation reserves due to exchange rate changes according to HAS		−564,041
Revaluation reserves of exchange rate changes		607,366
Unrealised loss on exchange rate changes		−43,325
Reclassification of loss for the year to the asset side	203,622	203,622
Total value of adjustments according to ESCB rules	**185,001**	**185,001**
Totals according to ESCB rules	**10,866,898**	**10,866,898**

HUF millions

Description	Revaluation reserves	Share capital	Retained earnings	Loss for the year	Total equity
Reference No. of HAS	**XI.4 + XI.5**	**XI.1.**	**XI.2.+XI.3.**	**XI.6.**	**XI.**
Balance sheet data according to HAS	**533,853**	**10,000**	**47,023**	**−39,811**	**551,065**
Market valuation of repurchased foreign currency securities				−2,966	−2,966
Adjustments on market valuation of foreign currency securities					
Deduction of revaluation reserves of foreign currency securities due to HAS	30,188				30,188
Amortisation of premiums/discounts of interest bearing securities				−107,591	−107,591
Revaluation reserves of foreign currency securities according to ESCB rules	81,191				81,191
Unrealised loss on foreign currency securities according to ESCB rules				−778	−778
Adjustments on market valuation of derivatives	5,508			−9,151	−3,643
Adjustments on exchange rate changes					
Deduction of revaluation reserves due to exchange rate changes according to HAS	−564,041				−564,041
Revaluation reserves of exchange rate changes	607,366				607,366
Unrealised loss on exchange rate changes				−43,325	−43,325
Total value of adjustments according to ESCB rules	**160,212**	**0**	**0**	**−163,811**	**−3,599**
Balance sheet data according to ESCB rules	**694,065**	**10,000**	**47,023**	**−203,622**	**547,466**

As a result of the application of ESCB rules, the 2012 balance sheet total changed by HUF 185 billion and the profit for the year changed by HUF 163.8 billion.

Due to reclassification of the repurchased MNB foreign currency bonds (stated in net amount), the balance sheet total decreased by HUF 27.1 billion, whereas due to the market valuation of derivative transactions, the market valuation of foreign currency securities and the amortisation of premiums/discounts as well as the loss for the year to the asset side it increased by HUF 5.5 billion, by HUF 3 billion and by HUF 203.6 billion, respectively.

The result for the year changed to a loss of HUF 203.6 billion as a consequence of recording the unrealised loss due to the foreign exchange rate changes, the market valuation and the amortisation of premiums / discounts. Revaluation reserves amounted to HUF 694 billion according to ESCB rules, due to settlement of unrealised profit.

25 February 2013, Budapest

András Simor
Governor of the Magyar Nemzeti Bank

ANNUAL REPORT
2012 BUSINESS REPORT AND FINANCIAL STATEMENTS
OF THE MAGYAR NEMZETI BANK

Print: D-Plus
H–1037 Budapest, Csillaghegyi út 19–21.