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MAGYAR NEMZETI BANK

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2010 Business Report and Financial Statements of the Magyar Nemzeti Bank

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2010 business report of the Magyar Nemzeti Bank

1 The Governor's foreword

Overshooting the 3% inflation target of the Magyar Nemzeti Bank ('MNB' or 'Bank'), average inflation reached 4.9% in 2010. The inflation of items more sensitive to the influence of monetary policy has been low since the beginning of the crisis, and in 2010 the month-on-month indicators capturing underlying inflation pointed to low inflationary pressures as well. Nevertheless, this was not sufficient to fully offset the inflationary pressures emanating from the tax measures in the first half of the year. In the second half of the year price indices sharply increased amid dynamically rising global food and oil prices. In addition to cost shocks, high inflation expectations may be another factor explaining why price stability could not be achieved in Hungary, despite the historically low level of capacity utilisation.

At the beginning of 2010 the economic recession and projections about a massive disinflationary period justified, and the improving risk assessment of forint assets allowed the easing cycle started by the Monetary Council. By May the central bank base rate was lowered to 5.25%. Primarily reflecting soaring energy prices, the May issue of the Report on Inflation indicated a turning point in the expectations about the inflation outlook. In the context of the bleak inflation outlook and rising sovereign credit spreads reflecting concerns about the sustainability of the euro area and the public debt paths, a further easing of monetary conditions was not plausible and in May the Council decided to keep the key policy rate unchanged.

The outlook for inflation deteriorated further in the third quarter, while the global investor environment remained fragile. In view of the disinflationary effect of weak demand and loose labour market conditions, as well as the fact that output fell below its potential levels on a permanent basis, the Council voted for keeping the central bank base rate unchanged until November. Prompted by the upside risks presented in the November issue of the Report on Inflation and the threat of second-round inflationary effects of cost shocks, the central bank base rate was raised, in two steps, to 5.75% in the last two months of 2010.

Over the past four years the growth rate of consumer prices has significantly outpaced the MNB's inflation target. Since the introduction of the 3% continuous inflation target on 1 January 2007, the Hungarian economy has been hit by a number of shocks, which raised the consumer price level and, at the same time, reduced whole-economy output. In view of the real economic costs of monetary tightening and the output gap assumed to be negative at the time the shocks hit, the Bank decided not to offset the direct upward effect these shocks exerted on prices. In the absence of robust monetary policy response, the repeated cost shocks prevented inflation expectations from stabilising at around the 3% target. In addition to the cost shocks, high inflation expectations may be another factor explaining why price stability could not be achieved in Hungary, despite the historically low level of capacity utilisation.

Past international experience suggests that small, open economies – both advanced and emerging ones – have succeeded in bringing down inflation expectations and stabilising them at a low level by the application of an inflation targeting regime. To ensure the success of the inflation targeting regime in Hungary, the main priorities of monetary policy should be anchoring inflation expectations and making appropriate, well-timed responses to future inflation shocks.

The monetary policy instruments of the MNB provide the best support to the central bank's interest rate policy if they can facilitate an environment where short-term money market yields closely mirror changes in the key policy rate. Since this requires sufficiently liquid financial markets, the central bank's monetary policy instruments are most efficient in influencing the developments in forint rates if they support the liquidity management of credit institutions at the same time. The introduction of the modifiable required reserve ratio and the publication of the banking system's liquidity forecast starting from 2010 both served this purpose.

With a view to reinforcing financial stability and the efficiency of the interest rate transmission mechanism, in 2010 the MNB announced a forint-denominated mortgage bond programme. While the volume of primary market issues was below expectations and thus domestic banks did not achieve real progress in raising long-term forint funds, the mortgage bond purchase programme of the MNB contributed to narrowing the yield spreads on forint-denominated mortgage bonds. Since market conditions are not expected to change considerably over the short term, the MNB suspended the programme from the beginning of 2011; however, under the right economic and financial circumstances and with the active support of market participants, the Bank is prepared to launch similar programmes in the future.

In the course of 2010 the MNB continued to focus particularly on the tasks of monitoring risks to financial stability, instructing competent authorities to manage such risks and, by way of the limited tools at its disposal, mitigating the real economic costs caused by the financial and economic crisis. Lending is not only restrained from the demand side by the real economic adjustment, but also from the supply side by weak risk tolerance on the back of increased credit losses. The strong Swiss franc combined with the bank levy introduced in the summer of 2010 and the upholding of the moratorium on evictions and foreclosures had an adverse effect on the portfolio quality and income generating capacity of the banking system. As a result, the regional competitiveness of the banking system deteriorated as well, which contributed to the fact that the turning point in lending has not materialised.

The MNB intended to foster more efficient money and capital market operations through three significant regulatory initiatives: a regulatory proposal aimed at ensuring the transparent pricing of mortgage loans; the review of a possible extension of the range of eligible mortgage bond issuers; and a regulatory proposal aimed at reducing the high open foreign currency position in domestic banks' balance sheets and preventing the further shortening of the maturities of their external liabilities. The government and Parliament did not incorporate the transparency proposals related to retail lending into the regulatory changes, and thus the transparency of retail loans improved only slightly, failing to assist households in making reasonable borrowing decisions.

In violation of its clear obligations under the applicable laws, in numerous cases the government failed to provide the MNB with preliminary information regarding the drafts of decisions and legislative provisions related to the tasks of the MNB and the operation of the financial system in due time, and did not allow the MNB to exercise its right of consultation pursuant to the provisions of Act LVIII of 2001 on the Magyar Nemzeti Bank (hereinafter the MNB Act). In view of the fact that the tasks of central banks can be performed most efficiently by a central bank operating in a stable institutional environment with responsible decision-making, and are significantly hindered by a restricted flow of information, the MNB believes that compliance with the relevant provisions of the MNB Act is of key importance.

As a result of the crisis market participants follow the developments in foreign exchange reserves far more closely than usual. 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. With an increase of EUR 3 billion during the year, the official foreign exchange reserves amounted to EUR 33.7 billion at end-2010.

In 2010 the MNB adopted a regulation for the Hungarian banking system, effective from 1 July 2012, requiring electronic forint transfer orders to be fulfilled within a maximum of 4 hours instead of the existing 1-day settlement period. Accordingly, the execution of payment orders will be much faster than today, allowing beneficiaries to receive the funds within the same day. In 2010 comprehensive, on-site inspections were conducted at 12 payment service providers. By improving legal compliance on the part of payment service providers, the payment inspections conducted by the central bank contribute to ensuring a more reliable operation of the financial intermediary system, and the transparent payment processes for customers, through which customers using the services can be served more efficiently.

In line with the MNB's expectations, after the substantial decline observed in 2009, the cash volume started to increase again in 2010. Accordingly, the value of banknotes and coins in circulation reached the level observed in 2008 and stood at HUF 2,362 billion on 31 December 2010, representing a 9% year-on-year increase.

By the end of 2010 forint banknote counterfeiting had declined. This can be partly attributed to the fact that efficient cooperation between the MNB and the police led to the elimination of the counterfeiting plant which had produced the most deceptive 10,000-forint counterfeits to date. In 2010 high-denomination notes continued to dominate forint banknote counterfeiting.

As regards the area of cash circulation – in close cooperation with market participants throughout the entire process – significant progress has been made in fostering measures aimed at improving the efficiency of money circulation, a key strategic task of the MNB, including preparations for the new notes-held-to-order scheme and the simplification of coin logistics.

One of the objectives of the MNB is to contribute, in support of its statutory duties, to improving the financial literacy of citizens, especially youth. To that end, over the years it has organised numerous programmes for the population – in particular, students – focused on shaping financial attitudes and awareness. In late 2008 the MNB decided to set up a Financial Literacy Centre. In the past two years several new initiatives have been added to the set of former successful central bank programmes.

After having generated a profit in 2009, in 2010 the Magyar Nemzeti Bank incurred a loss of HUF 41.6 billion. This deterioration resulted primarily from the sharp decline in the previously extraordinarily high profit arising from exchange rate changes on the one hand and, on the other, from the reduced income realised on financial operations. By contrast, net interest and interest-related income improved in line with the shrinking difference between forint and foreign exchange yields, and net expenditures arising from other profit/loss factors declined as well.

As a result of the project launched several years ago with the aim of improving the efficiency of operations, in 2010 the MNB achieved substantial savings (of above HUF 900 million) in operating costs, which implies a 6.9% expenditure reduction compared to the previous year. In addition to personal expenditures, efforts to improve operational efficiency were focused on information technology and operational costs as well. Overall, the operating costs of the MNB for 2010 remained below HUF 13 billion, the lowest level of operating costs in the history of the MNB since 2003.

The value of investment implemented in 2010 was HUF 1,839 million, roughly the same as in the previous year. The vast majority of investment expenditures were incurred in relation to projects linked to the objectives of the approved information technology strategy of the MNB. In line with the reduction in the number of buildings occupied by the MNB, new workplaces were created in the building at Szabadság tér 8–9. The MNB exerted significant efforts to enhance the planning methods of investment projects, as well as the scheduled and project-oriented implementation of the plans, which both contribute to improving purposefulness.

In my judgement, on balance, the Magyar Nemzeti Bank operated successfully in 2010.

5 April 2011, 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. Pursuant to the MNB Act, 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.
Date of foundation: 1924
Owner (shareholder): the Hungarian State, represented by the minister responsible for the 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 pursuant to the provisions of the MNB Act. 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, organisational, personal and financial independence, 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.

In addition to implementing (achieving and maintaining) price stability, and in order to achieve this objective, 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 qualifying as the legal tender of the Republic of Hungary, including commemorative banknotes and coins;

– it holds and manages official reserves in foreign exchange and gold;

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

– it develops and regulates the domestic payment and settlement systems and securities settlement systems and, as part of its oversight duties, monitors their activities in order to ensure sound and efficient operation and smooth money circulation;

– 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 system.

Further to the above, the MNB may only perform other activities based on statutory authorisation, without prejudice to the achievement of its primary objective and performance of its basic tasks.

In the spirit of the central bank's independence and within the framework provided by the MNB Act, the Bank independently defines the monetary policy aimed at achieving and sustaining 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 and using other central bank instruments.

The Bank's account management services are limited to the entities defined by the MNB Act. The Bank manages the single Treasury account and the bank account of the Government Debt Management Agency Private Company Limited by Shares (ÁKK). In addition, pursuant to separate legislation, the Bank is entitled to manage forint and foreign exchange bank accounts for organisations performing payment services, clearing house activities, payment system operations or cash processing activities; for the central securities depository, the National Deposit Insurance Fund and the Investor Protection Fund; and in connection with the performance of its basic tasks for any other domestic or foreign organisations, and also for foreign organisations in respect of fulfilling obligations arising from international agreements.

2.2 THE BODIES AND MANAGEMENT OF THE MNB

The various bodies of the MNB are primarily governed by the MNB Act. 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 MNB operates as business entity in sole proprietorship. The Hungarian State as the shareholder is represented by the minister responsible for the state budget. The MNB operates without a General Meeting or a Board of Directors. **The shareholder** is entitled to make decisions, by way of a shareholder's resolution, on the establishment and amendment of the Statutes, the approval of the balance sheet and the profit and loss statement, the dividend payment from the profit for the reference year or from the accumulated profit reserve and the election, dismissal and remuneration of the auditor who guarantees statutory operations. In respect of the Annual Report of the Magyar Nemzeti Bank, which consists of two parts, namely the Business Report and the Financial Statements, the powers of the shareholder are separated. As regards the Financial Statements, the shareholder is entitled to exercise its right of approval, whereas in respect of the Business Report on the basic tasks, in view of the principle of central bank independence, its right is limited to the acknowledgement thereof.

In line with European Union requirements, and as an additional guarantee of independence, contrary to the practice of other companies limited by shares, the remuneration of the MNB's Governor, the Deputy Governors and other members of the Monetary Council, as well as members of the Supervisory Board, is determined by the MNB Act rather than the shareholder.

In matters related to the performance of the MNB's basic tasks, the exchange rate regime and all the characteristics thereof and issues related to its role as a lender of last resort for credit institutions, the MNB's supreme decision-making body is the **Monetary Council.** The members of the Monetary Council are: the Governor of the MNB who acts as Chairman of the Monetary Council, the Deputy Governors of the MNB and a maximum of 4 members appointed by the President of the Republic of Hungary for a period of six years. The Monetary Council has a minimum of five and a maximum of seven members.

Each year – at the first meeting of the year – the Monetary Council elects a Deputy Chairman who substitutes the Chairman if the latter is unable to attend. In 2010 Deputy Governor Ferenc Karvalits was elected as Deputy Chairman.

In addition to the members, a representative of the Government as a permanent attendee must also be invited to the meetings of the Monetary Council. However, such representative shall not have voting rights as, in accordance with Article 127 of the Treaty on the Functioning of the European Union, Article 1 (2) of the MNB Act stipulates that: 'The MNB and the members of its decision-making bodies shall be independent in carrying out the tasks and meeting their obligations conferred upon them by this Act, and shall neither seek nor take instructions from the government, the institutions and bodies of the European Union, the governments of its Member States and any other bodies, except from the European Central Bank.'

In 2010 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, member of the Monetary Council,
- Dr Tamás Bánfi, member of the Monetary Council,
- Dr Péter Bihari, member of the Monetary Council,
- Vilmos Bihari, member of the Monetary Council (until 1 March, 2010),
- Dr Csaba Csáki, member of the Monetary Council,
- Dr Ilona Hardy, member of the Monetary Council (until 1 March, 2010),
- Judit Neményi, member of the Monetary Council.

Responsibility for implementing the Monetary Council's decisions and managing the operations of the MNB rests with the **Governor of the MNB.** The Governor shall:

- supervise the performance of basic tasks;

- supervise the internal audit organisation of the MNB with regard to the responsibilities outside the competence of the Supervisory Board;

- exercise employer's rights over the employees of the MNB (excluding the non-deputy governor members of the

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

Dr Tamás Bánfi
member of the Monetary Council

Dr Péter Bihari
member of the Monetary Council

Vilmos Bihari
member of the Monetary Council
(until 1 March 2010)

Dr Csaba Csáki
member of the Monetary Council

Dr Ilona Hardy
member of the Monetary Council
(until 1 March 2010)

Judit Neményi
member of the Monetary Council

Members of the Supervisory Board of the Magyar Nemzeti Bank

Until 15 November 2010 (left to right):
Back row – Dr László Urbán, Mrs Imre Karácsony, László Baranyay, Dr Éva Várhegyi, Dr Gábor András Szényei;
Front row – Dr József Kajdi, Dr Ákos Balassa (Chairman), Dr Gábor Csányi.

From 16 November 2010 (left to right):
István Varga, László Madarász, Zsigmond Járai (Chairman), Dr Róbert Thuma (from 24 November 2010), Dr Péter Róna, Dr Gábor András Szényei, Dr Tamás Katona, Roland Nátrán (from 24 November 2010).

Monetary Council), with the exception of the powers related to the appointment and dismissal of the Deputy Governors;

– take all other decisions related to the governance of the operation of the MNB that do not fall within the competence of the Monetary Council.

Provisions relating to the legal status, powers, functions and operating procedures of the Monetary Council are set forth in the MNB Act, the Bank's Statutes, the Organisational and Operational Procedures, as well as the rules of procedures formulated by the Monetary Council.

In addition to the auditor appointed by the shareholder, the Magyar Nemzeti Bank is also inspected 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 supervises the financial management of the Magyar Nemzeti Bank and activities under the MNB Act that are not included in its basic tasks. The State Audit Office supervises the MNB's compliance with statutory regulations, its Statutes and the shareholder's resolutions.

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

The members of the Supervisory Board as defined in the MNB Act are: its Chairman elected by the Parliament, other members elected by Parliament as well as the representative of the minister responsible for the state budget and a consultant commissioned by the minister responsible for the state budget. The total number of the members of the Supervisory Board and its Chairman elected by Parliament shall be determined at the date of the commencement of the procedure for their election, by taking into consideration the number of the parliamentary panels of the ruling parties and the opposition parties in Parliament. The Chairman of the Supervisory Board, elected by Parliament, is nominated by the parliamentary panel(s) of the governing parties, whereas the other members elected by Parliament are nominated by the parliamentary panels of the governing parties and the opposition parties.

The members' term of office coincides with the Parliament's mandate. The Supervisory Board remains in office until a new Parliament elects new Supervisory Board members within three months from the date when the Parliament first convenes. Should the new Parliament fail to elect new Supervisory Board members within this time limit, the members of the Supervisory Board remain in office until the new Parliament elects the Supervisory Board members.

In 2010 the members of the Supervisory Board of the MNB were:

Until 15 November, 2010:

– Dr Ákos Balassa, Chairman,
– László Baranyay,
– Dr Gábor Csányi,
– Dr József Kajdi,
– Mrs Imre Karácsony (representative of the minister responsible for the state budget),
– Dr Gábor András Szényei,
– Dr László Urbán (consultant commissioned by the minister responsible for the state budget),
– Dr Éva Várhegyi.

From 16 November, 2010:

– Zsigmond Járai, Chairman,
– Dr Tamás Katona,
– László Madarász,
– Dr Péter Róna,
– Dr Gábor András Szényei,
– István Varga,

and

– Roland Nátrán (representative of the minister responsible for the state budget from 24 November, 2010),
– Dr Róbert Thuma (consultant commissioned by the minister responsible for the state budget from 24 November, 2010).

Neither the State Audit Office nor the Supervisory Board is entitled to supervise activities qualifying as basic central bank 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 central bank's most important task 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 and stability of the legal tender alike.

The organisational and management system set out in 2007 and its subsequent modifications thereof also serve the successful and cost-effective accomplishment of these objectives.

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

In order to provide assistance to the MNB in managing its operations, attaining the objectives and fulfilling the duties defined in the MNB Act, the Bank operates **committees** in **support of decision-making** with the task of discussing issues falling within the competence of the Governor, the Deputy Governors and the Executive Director, as well as supporting the process of decision-making.

The **Management Committee** is a consultative body providing assistance in decision-making to the Governor responsible for managing the operation of the Bank, thereby ensuring the transparency of the Governor's decisions.

The **Implementation Committee,** by performing the necessary preparatory work and by putting forward proposals and opinions, facilitates support in decision-making related to the implementation of the Monetary Council's decisions.

The responsibility of the **Financial System Overseeing Committee** is to support – through preparatory work, proposals and opinions – central bank decisions within the fields of competence of the Chairman of the Committee in relation to the functioning of the institutional system, financial markets and financial infrastructure.

The **Investment and Cost Management Committee** facilitates assistance in decision-making by performing the necessary preparatory work and putting forward proposals and opinions related to investments and cost management.

By performing the necessary preparatory work and putting forward proposals and opinions, the **Asset Liability Committee (ALCO)** supports decision-making related to the Bank's foreign exchange activities affecting the Bank's balance sheet.

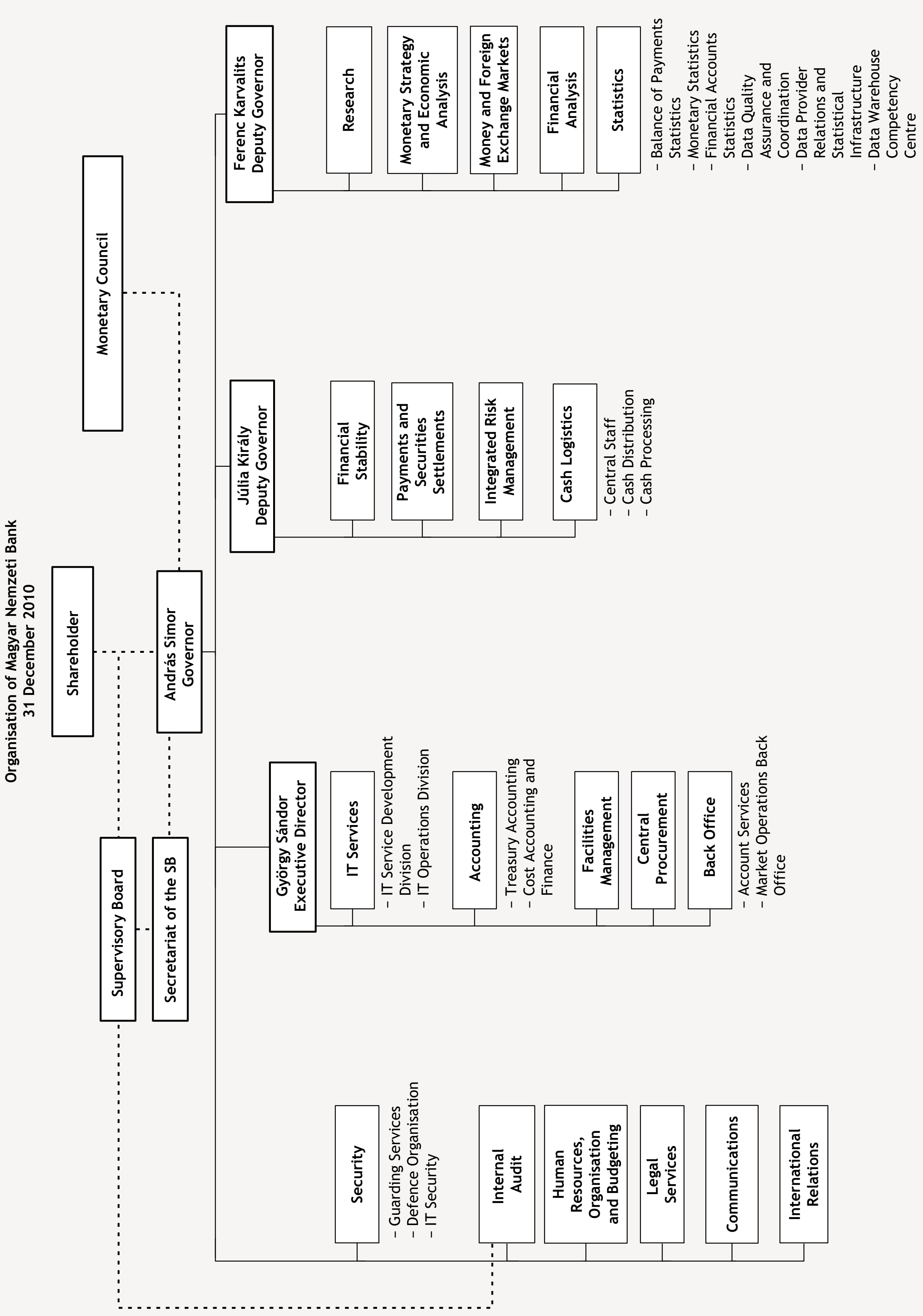
The **Operative Crisis Management Committee** supports the decision-making related to distressed credit institutions and discusses the results and experience of stress tests.

Designed to carry out the tasks, the organisational structure as it was on 31 December 2010 is shown in the organisational chart on page 16.

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 ECB and 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 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 on 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

Organisation chart



Members of the Management Committee of the Magyar Nemzeti Bank

András Simor
Governor

Ferenc Karvalits
Deputy Governor with general responsibilities

Júlia Király
Deputy Governor

György Sándor
Executive Director

Dr Zsuzsanna Arnold Csenterics
Director
Human Resources, Organisation and Budgeting

mandate of the General Council will expire on the date when all Member States have adopted the euro.

In 2010 the number of ESCB members did not increase; however, the Council of the EU adopted a decision on 13 July 2010 allowing Estonia to introduce the euro as of 1 January 2011, which increased the number of euro area Member States to 17 as of 2011.

ESCB members are also owners of the ECB. Ownership share is based on demographic and GDP data. As of 29 December 2010, the ECB increased its subscribed capital by EUR 5 billion, from EUR 5.76 billion to EUR 10.76 billion.

Currently euro area central banks subscribe to 70% of the ECB's capital, while the remaining 30% is divided among the central banks of non-euro area Member States, these 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 the contribution of non-euro area central banks was defined as 3.75% of their subscriptions (previously it was 7%).

Between 1 May 2004 and 31 December 2006 the ownership share of the MNB in the ECB's capital amounted to 1.3884%. As a non-euro area EU Member State, upon accession to the EU and the ESCB (on 1 May 2004) it had to pay (according to the rules prevailing at that time) 7% of its ownership share, i.e. a total of EUR 5.4 million, to the ECB's capital.

As set forth in the Statutes of the ESCB and the ECB, the capital keys are adjusted every five years and whenever a new Member State joins the EU. The capital keys were adjusted following the accession of Bulgaria and Romania to the EU. Consequently, as from 1 January 2007, the MNB's share in the ECB's capital and its paid-up capital fell to 1.3141% and EUR 5.3 million, respectively.

The aforementioned five-yearly revision became due in 2008; therefore, the capital keys were adjusted again. Accordingly, as from 1 January 2009, the MNB's share in the ECB's capital and its paid-up capital increased to 1.3856% and EUR 5.587 million, respectively.

Following the capital increase of the ECB on 29 December 2010 and the modification of the payment contribution of non-euro area central banks (reducing the pre-defined percentage of subscriptions to be paid from 7% to 3.75%) the share of the MNB in the ECB's capital did not change as from 1 January 2011 (it remained 1.3856%). However, the capital increase raised the amount of its paid-up capital to EUR 5.591 million, requiring the MNB to pay additional capital contribution in the amount of EUR 3,863.01.

The central banks of Member States transferred to the ECB the additional contributions necessitated by the ECB's capital increase on 29 December 2010. Non-euro area central banks transferred the whole amount of the additional capital in one instalment, while euro area central banks paid only the first instalment of their additional contribution (which was set to be paid in three equal instalments with the remaining two instalments to be paid at the end of 2011 and 2012, respectively).

The so-called 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 co-ordination 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 2010 the ESCB committee work continued to be a very useful forum for exchange of professional experience.

3 Review of the MNB's performance in 2010

3.1 MONETARY POLICY

Monetary policy framework

Pursuant to the MNB Act, the primary objective of the Bank is to achieve and maintain price stability. To further the goal of price stability, monetary policy has been determined by the MNB within the framework of inflation targeting since 2001. 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 this pre-defined inflation target. The continuous inflation target of the MNB is 3%. This level is low enough to minimise the inflation-generated costs that reduce social welfare, and at the same time provides protection against the risk of deflation.

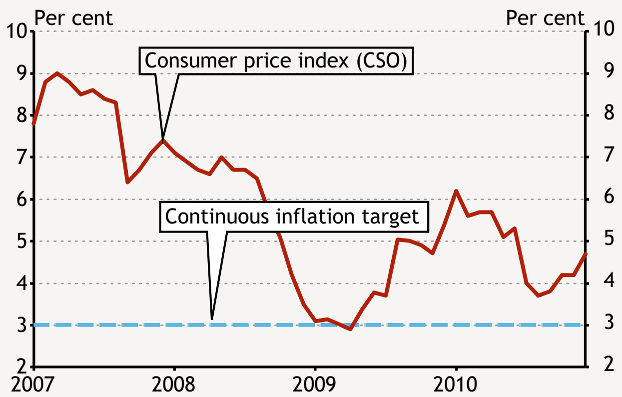
In line with the legislation effective from July 2007, the number of Monetary Council members is gradually declining to a maximum of seven and a minimum of five. This reduction in the number of members will be implemented by not appointing new members after the expiry of the mandate of current members. Accordingly, in 2010 the number of Monetary Council members decreased from 9 to 7.

Trends in inflation in 2010

Average annual inflation was 4.9% in 2010. The increase in the consumer price index significantly exceeded the MNB's 3% inflation target throughout the year. In the second half of 2010 core inflation fell below 2% from the 4-5% peaks observed at the beginning of the year.

Although the inflation of items more sensitive to the influence of monetary policy has been moderate since the onset of the crisis, this did not completely offset the inflationary pressures stemming partly from tax increases and partly from non-core inflation components, primarily food and commodity price developments. In addition to cost shocks, high inflation expectations may be another factor explaining why price stability could not be achieved in Hungary, despite the historically low level of capacity utilisation.

Chart 1
Inflation target and inflation developments



Sources: CSO and MNB.

A more detailed analysis of the developments reveals that, reflecting the disinflationary effect of subdued domestic demand and loose labour market conditions, core inflation dropped below 2% in the second half of the year. The level

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

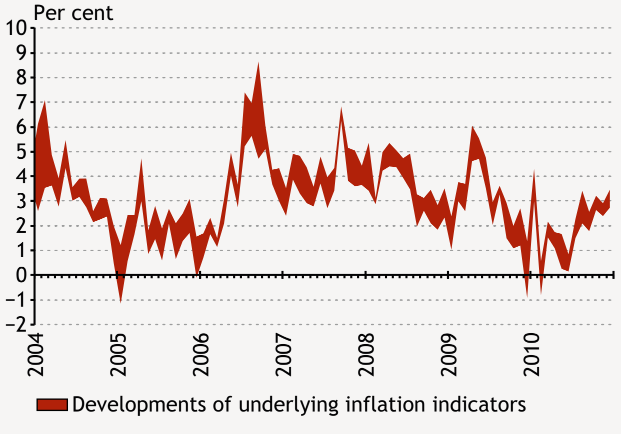
	2008	2009	2010	2010			
				Q1	Q2	Q3	Q4
Core inflation	5.2	4.1	3.0	4.8	3.9	1.4	1.9
Unprocessed food	5.8	5.0	6.6	1.1	−2.7	12.6	15.4
Fuel and energy	9.9	−5.2	18.1	21.3	20.8	14.4	15.9
Regulated prices	8.7	8.0	6.5	6.5	8.0	6.0	5.6
Consumer price index	6.1	4.2	4.9	6.0	5.3	3.8	4.4

Note: As a result of the restructuring of certain sub-components in 2009, the time series of the main components of inflation may differ, even on a retrospective basis, from those published in previous years.
Source: CSO.

of price increases in market services significantly fell behind the levels observed in pre-crisis years. These factors restrained the price increases in tradable items as well; indeed, the weaker forint exchange rate generated a lower increase in the price index than would be expected on the basis of previous estimations. Overall – apart from the inflationary effect of the VAT increase – price indices remained continuously low for market services and tradable goods throughout 2010.

The month-on-month indicators capturing underlying inflation and general trends also pointed to low inflationary pressures in 2010. However, in mid-2010 this declining trend, which started in early 2009, faltered. While the turnaround can be primarily attributed to the inflationary pressures emanating from higher food prices, it may also reflect the weakening disinflationary effect of the slowly closing negative output gap, or suggest a negative turn in inflation expectations. By the end of 2010, the decline in indicators of inflation expectations observed since 2009 had halted before the indicators reached a level consistent with the inflation target.

Chart 2
The range of underlying inflation indicators



Source: MNB.

In summary: despite favourable underlying inflation developments, in 2010 the price index rose sharply on the back of the tax measures adopted in 2009 and dynamically increasing global food and oil prices. In the first half year VAT and excise tax increases contributed considerably to the high price indices. In July the impact of the VAT increase dropped out of the annual indices; however, the impact of the excise tax increase in January was perceived throughout the year. As a result of unfavourable weather conditions and the rising commodity prices accompanying the global recovery, unprocessed food and commodity prices exerted increasingly severe upward price pressures from the second half of the year.

Monetary policy

One of the basic characteristics of monetary policy decisions is the fact that they can affect consumer prices only with a lag of several quarters. Consequently, it is essential to have a forward-looking attitude in decision-making, in other words, 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 at the start of 2010 faced a backdrop of the stabilisation process following the global financial crisis. Real economic and inflation developments were determined by the duality of a recovering external economic environment and continued weak domestic demand. In view of the improving global economic and financial market environment and the moderation of risks to financial stability and sustainability, the Monetary Council started an easing cycle in the summer of 2009, which continued into 2010. The easing was justified by the economic recession and projections about a massive disinflationary period, and allowed by the improving risk assessment of forint assets. As a result of the interest rate cuts which lasted until the end of April 2010, the key policy rate was lowered to 5.25%.

However, the May issue of the Report on Inflation indicated a turning point as expectations about the inflation outlook worsened. The pick-up in global activity and rising energy prices driven by the weakening of the euro started to dampen the price-reducing effect of subdued domestic demand. In view of the expected rebound in domestic demand in the coming years, the forecast projected rising core inflation. A turnaround took place in investor sentiment as well. The general decline in risk appetite amid concerns about the sustainability of the euro area and the public debt trajectories, increased the risk premia of countries with a weaker fiscal position, such as Hungary. This was reflected in the depreciation of the forint exchange rate in the spring. Therefore, as intensifying inflationary risks and worsening risk assessment did not allow the continuation of the easing cycle, the Council did not change the key policy rate in the second half of 2010.

However, the outlook for inflation deteriorated further during the third quarter. According to the August issue of the Report on Inflation, inflation was expected to overshoot the inflation target across the entire two-year forecast horizon. Global investor sentiment remained fragile and the risk assessment of the Hungarian economy has departed from that of the region. Investors perceived mounting tension between the MNB and the Hungarian government, which may have aggravated the uncertainty about future developments in risk assessment. During these months, in view of the disinflationary effect of weak demand and loose labour market conditions, as well as output falling permanently below potential output levels, the Monetary Council voted for keeping the base rate unchanged. However, in its communications about the rate-setting meetings, the Monetary Council emphasised that raising the central bank base rate may become necessary if upside risks to inflation materialise or there is a sustained increase in perceptions of the risks associated with the economy.

The November issue of the Report on Inflation continued to forecast that inflation would remain above target in 2011 and 2012; moreover, risks surrounding the baseline scenario pointed to higher inflation as well. Eventually, at the end of 2010 the Monetary Council raised the central bank base rate in two steps to 5.75%, by 25 basis points respectively. In the Monetary Council's judgement, the tightening of monetary conditions was necessary in view of the fact that subdued domestic demand and low wage dynamics alone are not sufficient to alleviate the inflationary pressures arising from the pass-through of external cost shocks and the partial passing of special sectoral taxes on to customers. Meanwhile, as inflation expectations are not anchored there is an increased risk that cost-push shocks will have second-round inflationary effects.

Changes in monetary policy instruments

Supporting the liquidity management of domestic banks

Introduction of the modifiable required reserve ratio

In accordance with the decision of the Monetary Council, since November 2010 credit institutions subject to reserve requirements are free to decide whether to apply the previously valid 2% reserve ratio, or select from reserve ratios 2, 3, 4 and 5 per cent. Subsequently they may change their decision on a semi-annual basis with effective dates of 1 May and 1 November. The modification of the reserve requirement system was necessitated by the low liquidity of interbank markets since the outbreak of the financial crisis. By introducing optional higher reserve ratios, the MNB intends to ensure that the reserve requirement system will support the liquidity management of all domestic credit institutions with appropriate efficiency, contributing to the narrowing of the gap between interbank interest rates and the central bank base rate. The option has been used by one fourth of the credit institutions, increasing the average required reserve ratio of the banking system to 2.5% in November 2010. In line with its strategy, over the long term the MNB will strive to align the reserve requirement system to that of the euro area, which currently prescribes a uniform 2% required reserve ratio for all credit institutions.

Publication of a liquidity forecast for the banking system

As from September 2010, the MNB started to publish its forecast of the overall impact of factors affecting the banking sector's aggregate liquidity need, for an initial trial period of six months. The forecast is aimed at facilitating the optimal recourse to the Bank's main policy instrument, the two-week MNB bill, through supporting credit institutions' liquidity planning, and ensuring that credit institutions rely increasingly less on the overnight standing lending and deposit facilities. Accordingly, overnight interbank interest rates can co-move more closely with the prevailing central bank base rate. Each week before the auction of the two-week MNB bill (currently on Tuesdays) the MNB publishes the expected average effect of the factors influencing the level of HUF liquidity for the next 7 days.

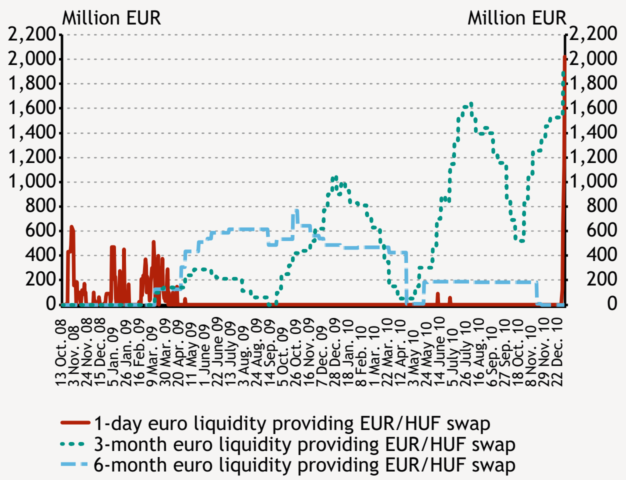
Changes in the instruments supporting banks' foreign exchange liquidity

As of 25 January 2010 the Swiss National Bank, the European Central Bank, the Narodowy Bank Polski and the Magyar Nemzeti Bank discontinued their EUR/CHF foreign exchange swaps, whereby Swiss francs were provided against euros with a maturity of 7 days. The change did not have a perceivable market impact, as conditions of Swiss franc funding opportunities had improved significantly and the banking system had not relied on this central bank instrument since the autumn of 2009.

The Hungarian banking system had recourse to the six-month central bank EUR/HUF FX swap instrument providing euro liquidity for the last time on 26 May 2010. As of July, the MNB suspended this instrument and henceforth it has conducted similar EUR/HUF FX swap operations to provide euro liquidity to the banking system for a term of three months. After having peaked at EUR 1,642 million at the end of July 2010, the outstanding volume of the latter instrument dropped to EUR 522 million by October. However, owing to rising spreads on the FX swap market and year-end seasonality, by the end of the year the outstanding portfolio jumped to its all-time high, EUR 1,922 million.

Counterparties did not have recourse to the MNB's euro liquidity providing overnight FX swap standing facility for the most part of the year except on two occasions in June, in smaller amounts. However, in relation to end-of-year position closing, the FX liquidity need of the banking system increased temporarily, and the volume of overnight swaps jumped to EUR 2 billion by 31 December.

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



Strengthening the transmission of domestic financial markets

The MNB's mortgage bond purchase programme for 2010

With a view to removing the obstacles from the autonomous development of the forint mortgage bond market and hence facilitate financial stability and the efficiency of interest rate transmission, on 8 February 2010 the MNB announced a programme to purchase forint-denominated mortgage bonds. Under the programme the MNB purchased domestically issued forint mortgage bonds listed as eligible central bank collateral in the primary and secondary markets. An amount of HUF 100 billion was earmarked for the programme, which focused on primary market purchases initiated by mortgage bond issuer domestic mortgage banks. The MNB required the provision of continuous, binding price quotes for the mortgage bonds purchased, which may improve the transparency of the secondary market of mortgage bonds.

While the volume of primary market issues was below expectations and thus real progress in raising long-term forint funding of domestic banks was not achieved, the mortgage bond purchase programme of the MNB contributed to narrowing the yield spreads on forint-denominated mortgage bonds.

In the course of 2010 only one domestic mortgage bank requested the participation of the MNB in subscribing to a new series of bonds issued by it in several parts. The MNB bought bonds from this series at six primary market auctions in a value of slightly over HUF 7 billion. In contrast, secondary market purchases were in line with expectations in the course of the year, with the MNB purchasing mortgage bonds amounting to a total of nearly HUF 30 billion through eleven secondary market tenders.

The fact that mortgage banks' mortgage bond issuance fell short of expectations can be partly attributed to the slow growth rate of forint-denominated mortgage lending in 2010, and partly to banks' propensity to fund it at a shorter maturity than that of mortgage bonds. Owing to factors such as the upholding of the eviction moratorium and modifications affecting the private pension fund system, significant changes are not expected to take place in mortgage market conditions over the short term. Consequently, in December 2010 the MNB decided to discontinue its mortgage bond purchase programme; however, it is open to launching similar programmes in the future should the conditions be favourable.

Introduction of the overnight interbank interest rate and interest rate swap quotes (HUFONIA swap)

The overnight interbank interest rate is an underlying product of Overnight Indexed Swaps (OIS) in developed money markets, and their regular use in Hungary may help market participants manage their interest rate risk more efficiently and define realistic levels of short-term (i.e. below one year) interbank rates. From 1 September 2010 the MNB has been publishing the HUFONIA (Hungarian Forint Overnight Index Average), the weighted average interest rate of unsecured forint overnight transactions in the interbank market, derived from daily reports by credit institutions.

In order to support the development of an OIS market in Hungary, as from mid-October 2010 the official OIS rates are published daily (HUFONIA Swap Index) under the joint operation of the MNB and the Hungarian Forex Association, based on quotes by twelve Hungarian banks. Quotes range from one-week to one-year maturity and refer to a total of eight different maturities.

3.2 STABILITY OF THE FINANCIAL INTERMEDIARY SYSTEM

Setting up a new macroprudential decision-making framework

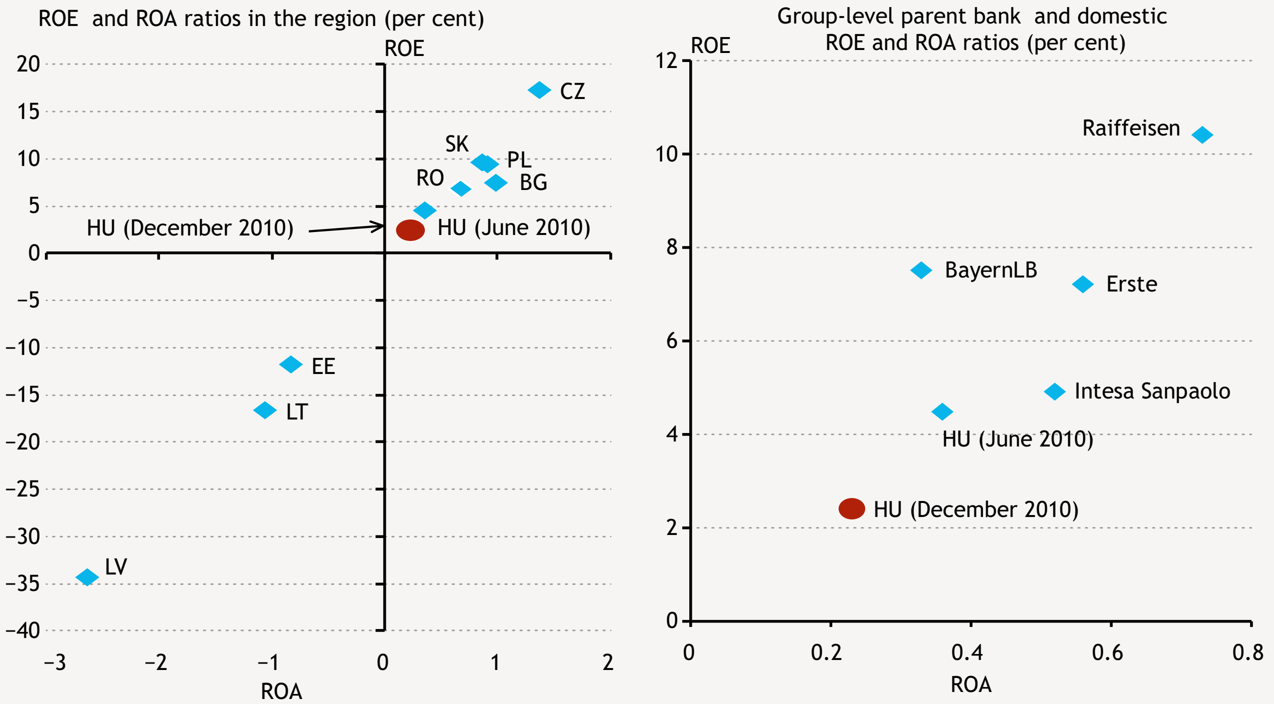
In 2010 the Magyar Nemzeti Bank continued to focus particularly on monitoring and mitigating the risks to financial stability and reducing the real economic costs caused by frictions in the financial system. Accordingly, in 2010 the Bank published two Reports on Financial Stability as well as the results of the lending survey on a quarterly basis.

In addition to drawing lessons from the crisis, the MNB reconsidered its macroprudential decision-making framework. This endeavour was based on the legislative changes effective from the beginning of 2010, which ensure the participation of the Governor of the central bank of Hungary in the work of the Financial Stability Board (FSB) and state that, in the interests of maintaining the stability of the financial intermediary system, the Governor of the MNB may submit a proposal either to the government or to any member thereof, to adopt a legal regulation or to propose new legislation. In response to such proposal, the addressee is required to inform the MNB of the start of the procedure for the adoption of a legal instrument or for a legislative initiative within 15 working days or, in the case of a regulation to be set out in law, of the deadline for submitting such to Parliament, and, in the case of a regulation to be set out in a decree, of the deadline for the promulgation of such; or in the absence of such, of the explanations for the decision. Similarly, the Financial Stability Board was entitled to initiate such regulations, to which the government or the addressee of the initiative was required to respond within 15 working days ('to act or explain the reason for the lack of action'). Amendments to the Act on the Hungarian Financial Supervisory Authority at the end of 2010 restricted such powers of the FSB to the effect that the government would be no longer required to respond to the regulatory proposals of the FSB; however, the relevant entitlement of the MNB was retained in the same format.

Key processes in the financial intermediary system

It was of key importance for the domestic banking system that, owing to significant fiscal adjustments in recent years and to the strengthening of the net financing capacity of the private sector, by the beginning of 2010 the external equilibrium of the economy significantly improved and net external debt decreased. Nevertheless, due to its high external debt and public debt, the high loan-to-deposit ratio of the banking system and the substantial FX loan portfolio of households, the Hungarian economy continues to be vulnerable to external shocks. Subdued investment sentiment, sluggishly recovering production and households' increased savings restricted lending from the demand side,

Chart 4
Profitability situation of the Hungarian banking system in 2010, in regional comparison and relative to individual parent banks



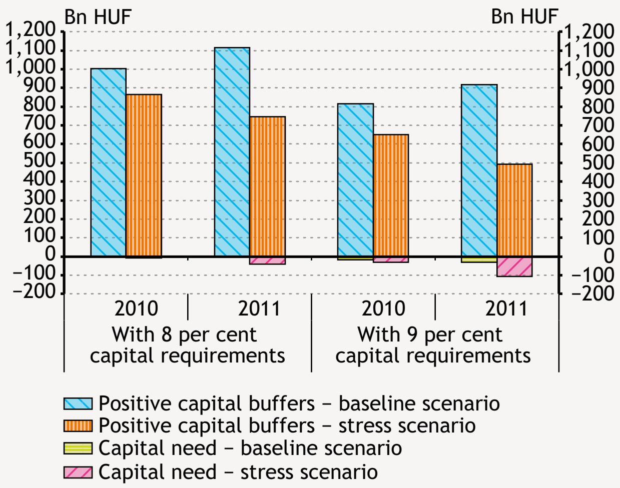
Note: LV: Latvia, LT: Lithuania, RO: Romania, SK: Slovakia, PL: Poland, EE: Estonia, HU: Hungary, BG: Bulgaria, CZ: Czech Republic. National data refer to the end of June 2010; annualised data; 12-month rolling values for Hungary. From the Report on Financial Stability. Group-level parent bank data are annualised values for 2010 Q2.
Source: MNB, ECB CDB database, homepages of individual banks.

while the weakening of risk tolerance on the back of substantial credit losses exerted a dampening effect from the credit supply side. Tightening their non-price conditions, banks are determined to limit their lending to clients with better credit ratings than before. Experiences of previous crises affecting other countries confirm that lending follows the turnaround of the business cycle with a lag. Currently this process is even more protracted in the Hungarian economy than in other countries, which hinders economic recovery in Hungary.

The strong Swiss franc, the bank tax introduced in the summer of 2010 and the upholding of the moratorium on evictions and foreclosures had an adverse effect on the profit-generating capacity of the banking system. The profitability of the domestic banking sector deteriorated significantly. By December 2010 the 12-month historical pre-tax ROA indicator stood at 0.2%, while the ROE indicator reached 2.8%. These values imply a substantial decline compared to those recorded at the end of 2009 (ROA 0.9%, ROE 12.5%)[1]. Profitability ratios are low not only in regional comparison, but also relative to the performance of parent banks. In another negative development, the profitability differences among Hungarian banks continued to grow. At the end of 2010 twenty-one banks recorded losses. The aggregate balance sheet total of these banks with loss accounted for more than 35% of the banking system as a whole.

Chart 5
Capital buffer and additional capital need of the banking system along the baseline and stress scenarios

(Report on Financial Stability, autumn 2010)



Note: The additional capital need is the sum of the capital needs of individual banks. Data for 2011 also contain the required capital increase in 2010. The chart was prepared on the basis of the stress test depicted in the November 2010 issue of the Report on Financial Stability.
Main assumptions of the baseline scenario: GDP growth 0.9% (2010), 2.8% (2011); total employment −0.3% (2010), 0.3% (2011); CPI 4.6% (2010), 3.4% (2011); HUF/EUR 277; HUF/CHF 203; CDS spread 320 basis points.
Main assumptions of the stress scenario: GDP growth 0.8% (2010), -0.5% (2011); total employment −0.3% (2010), -0.5% (2011); CPI 4.7% (2010), 4.8% (2011); HUF/EUR 319; HUF/CHF 234; CDS spread 520 basis points.
Source: MNB.

Having lost its regional competitive advantage, the domestic banking system may find itself in a disadvantageous position with respect to the allocation of parent bank funds and capital. This increases the risk of a further decline in the loan issue of the financial system and hence its contribution to economic growth. Given the stable parent bank background and high capital adequacy of Hungarian banks, the significant deterioration observed recently in the operating environment of the domestic banking system does not threaten financial stability. According to the stress test conducted by the MNB in the autumn of 2010, since the capital adequacy of the banking system can be considered broadly sufficient, based on the baseline scenario of the central bank's forecast the additional capital need of the banking system will be marginal. Under this scenario the capital adequacy ratio of the banking system will remain above 13% throughout the year, and will increase further by the end of 2011. On the other hand, if the stress scenario materialises the capital adequacy ratio would decline in 2011; however, even then it would not drop below 12%. In the case of some banks, a potential stress scenario is expected to generate only a rather small additional capital need, totalling around HUF 40 billion.

Regulatory proposals of the MNB

Although the MNB lacks regulatory powers and instruments in the domain of supporting the stability of the financial intermediary system, in the interest of strengthening financial stability it participated actively (often as an initiator) in regulatory tasks aimed at mitigating risks to the financial system.

In January 2010 the Financial Stability Board (FSB) started its operations. The FSB is a body assisting the work of the Hungarian Financial Supervisory Authority (HFSA). Its members comprise the Minister of Finance, the Chairman of the HFSA and the Governor of the MNB. Until the end of 2010 the consent of the FSB was required for the issuance of the HFSA's recommendations and for the semi-annual definition of its key supervisory target areas. The provisions of the new HFSA Act effective from 1 January 2011

[1] As they can be recorded under expenditures, these indicators already include the effect of the bank tax.

significantly restricted the scope and competence of the Financial Stability Board.

At the meetings of the Financial Stability Board major current macroprudential risks and regulatory initiatives were discussed. The FSB discussed the three most important regulatory proposals for 2010 of the central bank: in addition to the propositions of the MNB in relation to the enhancement of the mortgage loan and mortgage bond market, based on the proposition of the MNB the FSB discussed regulatory options aimed at reducing the high open foreign currency position in domestic banks' balance sheets and preventing the further shortening of their external funding.

As noted above, in February 2010 the MNB announced a programme to support the development of the HUF mortgage loan and the HUF mortgage bond market. Within the framework of this programme, the MNB has purchased covered mortgage bonds denominated in HUF and made further steps to facilitate the development of HUF mortgage lending. These steps were aimed at rendering mortgage loan products more transparent and reviewing the scope of institutions entitled to issue covered mortgage bonds.

After a lengthy preparatory process, in September 2010 the MNB published on its homepage its proposed regulations addressed to the Ministry of National Economy aimed at safeguarding customers' interests and strengthening bank transparency. In essence, the proposed regulation would allow two kinds of loan products to be offered to customers in the future: loans with fixed spread linked to a reference interest rate or products with an interest rate fixed for a longer interest period (measurable in years). According to the MNB's proposal, these rules should also apply to existing outstanding loans, provided that an appropriate legal solution has been identified.[2] In its response to the initiative, the Ministry of National Economy indicated that it agreed with the objectives put forward by the MNB, and pledged to coordinate with representatives of the financial sector about the MNB's proposals during the legislative process. This was followed by several rounds of negotiations between the stakeholders; however, the MNB's proposals were eventually not included in the legislation. The regulatory elements adopted in the field of household lending fail to achieve the objective set by the MNB, i.e. safeguarding customers' interests through the transparency of lending conditions. The new regulation's contribution to improving the transparency of retail loans is extremely limited.

In the November 2010 issue of the Report on Financial Stability the experts of the Bank presented the main conclusions of the impact study related to broadening the range of eligible mortgage bond issuers. The development of the market of long-term (HUF) funds is indispensable for a new post-crisis growth path relying predominantly on domestic funding. A key segment of long-term funding is the market of mortgage covered bonds, the development of which the MNB considers as one of its special responsibilities. The analysis of the MNB concludes that a new structure of covered bond issuers based on universal bank principle may contribute to the evolution of a more efficient covered bond market in Hungary. However, the advantages of switching to the new model cannot be reached without sufficient potential and willingness to issue. According to our projection, banks' potential to issue covered bonds based on a future HUF-denominated mortgage loan portfolio does not reach a marketable level. Although the existing foreign currency denominated loan portfolio represents an adequate issuance potential, the banking system's willingness to issue covered bonds is low, mainly because of the cost advantage of alternative short-term foreign funding. Thus, the potential advantages of switching to a new model could only be exploited if banks had incentives to improve their practice for maturity matching, and hence rely on covered bond funding more heavily. In view of the above factors and the current economic and regulatory environment, experts of the MNB believe that changing the existing system of covered bond issuance is not appropriate at the moment; nevertheless, reconsideration of this issue could be meaningful at a later date.

Implementation of international regulatory initiatives

In the second quarter of 2010 members of the Financial Stability Board signed an agreement in which the respective authorities made a commitment to cooperate closely in carrying out the upcoming Hungarian EU presidency's tasks in relation to financial regulation during the first half of 2011. As part of this task, the Ministry of Finance (since then: the Ministry of National Economy) set up working groups, to which the MNB delegated experts in relation to issues within its own professional competence. In the course of 2010 the working groups assisted in the preparations, while in 2011 they are providing professional assistance in the development and representation of the concept of the presidency. Throughout 2010 the agenda of the Financial Stability Board regularly included items which may come to the foreground in the area of financial services during the Hungarian EU presidency in the first half of 2011.

[2] http://www.mnb.hu/Root/MNB/Sajtoszoba/mnbhu_pressreleases/mnbhu_pressreleases_2010/mnbhu_kozlemeny_20100920 (in Hungarian).

In 2010 the MNB continued to participate in the efforts – both national and international – in relation to regulation of the financial intermediary system. Its specialists have been consulted in respect of several EU proposals and have participated in revisiting the relevant internal organisational issues. The most important of these initiatives include the topic of domestic and EU-wide macroprudential decision-making; a proposal about broadening the range of the bank crisis resolution framework; and a regulatory proposal concerning Capital Requirements Directive 4 (known as CRD 4), which targets the reinforcement of the Capital Requirements Directive currently in effect. The draft of the latter extends, among other things, to the introduction of liquidity ratios and the leverage limits; the tightening of the range of eligible regulatory capital components and proposals about containing the procyclicality of the financial system (commonly referred to as the Basel III regulation). The liquidity rules of the regulation were subject to further examination by the MNB in the third quarter of 2010. As part of this work, the MNB conducted bilateral discussions with major domestic banks about the expected implications of the new regulatory environment, and reviewed its expected impacts on the financial system. In addition, the MNB commented on the CRD 4 directive, which is designed to implement Basel III in the EU, and put forward its own opinion on the occasion of the public consultation of the European Commission concerning the use of countercyclical capital buffers. Moreover, the MNB presented an opinion regarding the draft EU directive developed by the Council of the European Union about deposit insurance, as well as the regulation widely known as EMIR, which prescribes the trading of bilaterally cleared OTC derivatives through central counterparties.

In line with its macroprudential role, the MNB participated actively in the preparatory and consultation work related to setting up the two basic pillars of the new European supervisory structure to be established in 2011, namely the European Systemic Risk Board and the European Supervisory Authorities (ESAs).

Consultation activities regarding Hungarian draft legislation

The MNB provided opinions on the proposals put forward by the government amending the Act on the Hungarian Financial Supervisory Authority; participated in the preparatory work related to the drafting of legislation 'on the creation and amendment of certain laws on economic and financial issues'; and submitted recommendations in respect of the draft legislation pertaining to 'amendments for the purpose of aiding consumers in a severe situation due to having housing loans'. In the judgement of the MNB the HFSA Act effective through the end of 2010 sufficiently regulated the operational framework of the Financial Stability Board, and ensured appropriate coordination between the three institutions (Ministry of National Economy, HFSA and MNB); therefore the Bank did not support amendments to the essential elements of the law. At the same time, it welcomed the fact that the draft legislation concerning the legal status of the Hungarian Financial Supervisory Authority reinforced the independence of the HFSA through legislation, and the President of the HFSA was empowered to adopt regulations in several financial areas. At the same time, the MNB was concerned that the reduced meeting frequency of the FSB, the elimination of the transparency of its functioning and the curtailment of its decision-making powers would restrain the risk-mitigating role of the FSB, which gives reason for concern about proper response to a potential financial crisis. The MNB regretted to see that, in violation of its clear obligations under the applicable laws, in numerous cases the government failed to provide the MNB with preliminary information regarding the drafts of decisions and legislative provisions related to the central bank's tasks and the operation of the financial system in due time, and did not allow the MNB to exercise its right of consultation pursuant to the provisions of Act LVIII of 2001 on the Magyar Nemzeti Bank (i.e. the MNB Act).

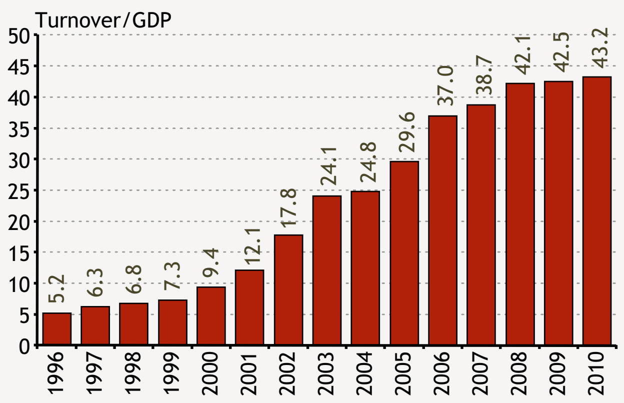
3.3 PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

The MNB plays various roles in the payment and securities settlement systems. In support of interbank cooperation, the MNB facilitates the development of infrastructure in areas which require the joint decision of stakeholders. As an overseer, the MNB performs regulatory, licensing and supervisory functions in respect of the payment and securities settlement infrastructure. As a service provider, it operates the real time gross settlement system (VIBER) in which the payments from interbank transactions are settled. In the Interbank Clearing System (ICS) it functions as settlement agent. It is majority owner of the Central Clearing House and Depository Ltd. (KELER Zrt.), minority owner of GIRO Clearing House Limited (GIRO Zrt.) and KELER Central Counterparty LLC. (KELER KSZF Kft.) and a participant in VIBER, ICS and the securities clearing and settlement system.

Operation and development of VIBER

In 2010 the number of VIBER participants was 56, the same as at the end of the previous year. Of the total HUF 1,123.4 trillion (thousand billion) turnover of the Interbank Clearing System (ICS) and VIBER, 95% was settled in VIBER in value, while ICS accounted for a higher share in the volume of transactions (99.4%). The total turnover of the two systems was 43.2 times the expected Gross Domestic Product (GDP) figure for 2010.

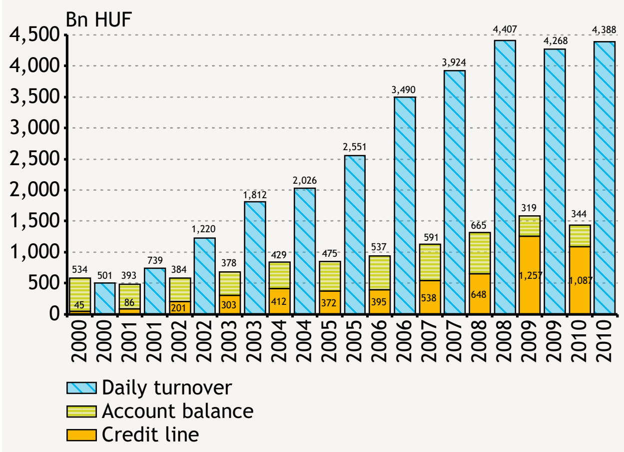
Chart 6
The annual turnover of the ICS and VIBER compared to GDP



A total of 1,097.9 thousand payment transactions in the amount of HUF 1,042.9 trillion (thousand billion) were settled in VIBER during the year. The value of transactions increased by nearly 11%, while the number of transactions increased by 12% compared to the previous year. In 2010 the average value per transaction amounted to HUF 950 million, down by 1.1% compared to the previous year. The average daily volume of transactions reached 4,288, while average daily turnover amounted to HUF 4,073.9 billion. The highest turnover in terms of volume was 9,462 transactions, settled in September 2010. The daily turnover value peaked at HUF 13,338 billion, also in September 2010.

In international comparison, the liquidity available for the payments of VIBER participants continues to be high. In 2010 banks' average daily intraday credit line – which supplements the bank account balance and is provided by the MNB for the purposes of settling payments against blocked securities held as collateral – amounted to HUF 1,087 billion, i.e. 77% of the amount recorded in 2009. Compared to the previous year, the combined average daily account balance available on banks' accounts increased by nearly 8% and stood at an average daily value of HUF 344 billion. Total liquidity for settlements – arising from the two sources above – facilitated the settlement of the whole turnover of VIBER and ICS at an average daily value of HUF 4,388 billion, exceeding the average daily turnover recorded in the previous year by 3%. The average daily turnover was 2.76 times the daily liquidity during the year, compared to the previous year's average of 2.47 times.

Chart 7
Year-on-year average daily interbank payment turnover and liquidity (account balance + credit line)



Exceeding the previous year's figure as well as international standards, VIBER's availability was 99.843% in 2010.

The MNB revises the fees charged for payment services annually. Compared to 2009, the fee charged for one VIBER transaction remained unchanged in 2010, i.e. it amounted to HUF 260 per transaction. Except for the transaction fee, no other system-related costs are imposed on VIBER participants.

In view of the introduction of intraday ICS settlement in 2012 and cash distribution needs, in 2010 the MNB decided that, as of 1 January 2012, the operating hours of VIBER would be extended by 1 hour to 6 p.m. and furthermore, in 2011 a 'Payment versus Payment' development would take place to support the smooth and risk-free execution of the large client transactions of credit institutions participating in VIBER.

Development of ICS – the acceleration of domestic payments

In autumn 2009 the Payment System Council made a decision about the introduction of intra-day settlement in the Interbank Clearing System and the domestic application of the credit transfer scheme of SEPA (Single Euro Payments Area), and in June 2010 it defined the specific target date for the implementation. In most of the Member States of the European Union interbank settlement systems provide intra-day, typically multiple settlement options for small value client payments. In 2010 the MNB adopted a regulation to the effect that from 1 July 2012 electronic forint transfer orders will be settled within a maximum 4 hours instead of the 1 day settlement it currently takes. The measure will ensure the intra-day settlement of payment orders, allowing beneficiaries to receive the funds within the same day.

Oversight of payment and securities settlement systems

VIBER, operated by the MNB, and ICS, operated by GIRO Zrt., were subject to an overall oversight assessment in 2010.

VIBER was assessed on the basis of international principles and recommendations, and compliance with the MNB decrees No. 34/2009 and No. 35/2009 in respect of organisations operating payment systems, effective from 1 July 2010. In addition to self-evaluation questionnaires, the assessment was based on data and information disclosed to the overseer, as well as internal interviews conducted after the self-evaluation. As a result of the assessment, the overseer put forward recommendations in relation to four topics, in particular concerning specific elements of logical security, operational reliability, business continuity, governance and system efficiency, which are basically intended to enhance the operational reliability of VIBER proactively.

Similarly, in line with international practice, the overall oversight assessment of ICS was based on the self-evaluation of the operator, followed by a joint on-site inspection by the HFSA and the MNB, focusing on an in-depth assessment of specific topics, primarily information security. As a result of the assessment, proposals were put forward concerning three topics which, after detailed discussions, the MNB forwarded along with a request for an action plan to the operator of ICS, GIRO Zrt. The objective of the proposals is to enhance information security and the level of preparedness for emergency situations; in addition, they emphasise potential areas for improvement in terms of the efficiency of the system.

In 2010 the MNB published overseer recommendations on business continuity practice of payment system participants. In its overseer role, the MNB pays special attention to promoting the secure and effective functioning of the payment and settlement systems and to assuring their business continuity. The aim of the oversight recommendations is to ensure that business continuity in the area of payments becomes an activity that is sufficiently regulated, well documented, thorough but transparent in its context, functioning, and that uses optimal resources and provides security. The oversight recommendations represent a uniform approach, for which all participants of the payment system can be prepared on the basis of the same principles. Following public consultation and a detailed discussion, the recommendations on business continuity were published on the website of the MNB.

Payment services and anti money laundering supervisory activity

By improving legal compliance on the part of payment service providers, payment inspections conducted by the MNB contribute to ensuring more reliable operation of the financial intermediary system and transparent payment processes for customers, thereby strengthening the confidence of customers using the services. The major inspection goals for 2010 included those regulations – new or amended – which were included in the MNB Decree No. 18/2009. (VIII. 6.) on execution of payment transactions effective from 1 November 2009 for the purpose of implementing Directive 2007/64/EC on payment services in the internal market (hereinafter PSD).

In 2010 on-site payment inspections were conducted at 12 payment service providers. In ten cases there were scheduled comprehensive inspections, while one payment service provider was subject to a scheduled targeted, and another provider was subject to an ad-hoc inspection. The latter was conducted as part of an HFSA inspection which was performed in order to address a matter within the MNB's competence. Another objective set by the MNB for 2010 was to identify the obstacles of the more frequent usage of direct debit transactions – an efficient method of processing utility-type payments. To this end, on-site inspections were conducted at 7 service providers with a significant direct debit transaction volume. In addition, the MNB conducted off-site inspections in order to check compliance with a direct debit regulation, which prescribes that the beneficiary must submit the direct debit order to its payment service provider at least five working days before the specified debit date. The inspection evaluated 27 payment service providers in respect of their compliance with this regulation. In its capacity as a supervisory authority, the MNB performed regulatory on-site inspections at 3 cash-in-transit companies on the basis of Act CXXXVI of 2007 on the Prevention and Combating of Money Laundering and Terrorist Financing (Pmt.).

During the payment inspections the MNB found that payment service providers carried out the majority of their payment transactions in compliance with central bank regulations; however, at each supervised payment service provider the inspections revealed some violations, which affected the transparency of the payment system or may have generated some degree of financial loss to customers. In the case of four payment service providers, in view of the significance of the revealed breach, the MNB imposed fines in addition to requiring action to be taken.

In 2009 two cash-in-transit companies were fined for deficiencies discovered during the inspection of compliance with the Pmt. Both of them were subject to an on-site inspection in 2010 as well. One of the cash-in-transit companies now fully complies with regulations, while the other company has adopted all but one of the required measures. Implementation of the remaining measure will be completed in 2011. Furthermore, the MNB also supervised the compliance with the Pmt. at a cash-in-transit company not inspected during the previous year, and found no violation of law.

One of the main benefits of central bank inspections is the fact that the experiences gained are fed directly into other main tasks of the MNB in the domain of payment and settlement services (such as oversight, payment system development, regulation). In 2010 the experiences gained from the series of inspections concerning direct debits and the crediting practice of incoming FX transactions of the payment service providers proved to be very useful in the areas of analysis and payment services regulations.

Publications

The MNB continues to consider it important to disseminate information to the general public as well as the professional audience regarding issues related to payments and payments systems. To this end, a number of publications were issued, including the Occasional Papers entitled 'Innovatív fizetési megoldások' (Innovative Payment Solutions),[3] 'A magyarországi pénzforgalom térképe' (A Map of Hungarian Payment Services),[4] 'Értékpapír-elszámolás és letétkezelés Magyarországon' (Securities Settlement and Custody Services)[5] and 'Channelling government securities redemption into VIBER and its effects on payment systems and its participants',[6] an article published in the June 2010 issue of the MNB Bulletin.

Based on wide-ranging cooperation, in the course of 2010 the MNB estimated the social costs of main domestic payment instruments, assessed the payment habits of the public sector and developed measures to promote the use of direct debits. The publication of the analyses is expected to take place in the first half of 2011; however, the main findings were summed up as early as March 2011 on the occasion of a central bank conference. According to the MNB's estimate, around 3.7 billion payment transactions were made in 2009 in Hungary, the social cost – resource requirement – of which amounted to HUF 427.52 billion (1.49% of GDP). If Hungary had used electronic payment instruments at a share similar to Scandinavian countries, nearly 0.5% of GDP could have been saved at the level of society. The analyses are a foundation for discussions with the public and private sector, and the resulting measures may assist in using socially more efficient payment instruments by customers over the long term.

3.4 MANAGEMENT OF FOREIGN EXCHANGE RESERVES

Objectives of holding reserves

Similarly to other central banks, one of the core tasks of the MNB, as stipulated in the MNB Act, involves the management of the foreign exchange reserves of Hungary. 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 monetary policy (ensure intervention capacity);

– to ensure foreign currency transaction requirements (support government debt management, satisfy the government's foreign currency payment obligations, etc.).

During the current crisis market participants watch the developments 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. In the course of 2010 reserves satisfied the role of 'international collateral' overall.

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, there was a sufficient level of FX reserves 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

[3] http://www.mnb.hu/Root/MNB/Kiadvanyok/mnbhu_mnbtanulmanyok/mnbhu_mt_85 (in Hungarian).
[4] http://www.mnb.hu/Root/MNB/Kiadvanyok/mnbhu_mnbtanulmanyok/mnbhu_mt_84 (in Hungarian).
[5] http://www.mnb.hu/Root/MNB/Kiadvanyok/mnbhu_mnbtanulmanyok/mnbhu_mt86 (in Hungarian).
[6] http://english.mnb.hu/Root/ENMNB/Kiadvanyok/mnben_mnbszemle/mnben_mnb_bulletin_june_2010.

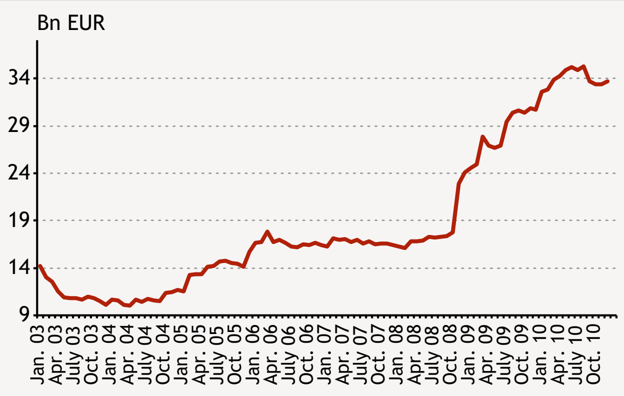
objective last year. In this regard, the continuous provision of the foreign currency needs of budgetary organisations should be also considered. Transfers from the European Union are also received through the MNB. These transfers have been significant sources for the accumulation of reserves in recent years – and will continue to be in years to come. In the course of 2010, once again, these transaction goals were 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

With an increase of EUR 3 billion during the year, the official foreign exchange reserves amounted to EUR 33.7 billion at end-2010. The increment was largely due to European Union transfers amounting to EUR 2.6 billion. Of the debt service items, the bonds issued by the Hungarian government with a face value of USD 2 billion contributed to the increase in reserves in the first quarter. Prepayments in the amount of EUR 0.7 billion in relation to the loan contracts signed in 2009 with domestic credit institutions were received in March 2010. The return on foreign exchange reserves contributed to the increment by nearly EUR 0.5 billion. In the second half of the year, the level of reserves was reduced by the face value of maturing JPY and EUR denominated bonds, i.e. by JPY 30 billion and EUR 1 billion. Other debt management related items of the Government Debt Management Agency (ÁKK) (e.g. interest payments, mark-to-market payments) reduced the reserves by EUR 0.1 billion in net terms. In addition, an outflow of around EUR 1.1 billion resulted from disbursements in foreign currency commissioned by budgetary institutions.

Chart 8
Developments in foreign exchange reserves



The MNB's financial risk management

Inevitably, the MNB faces financial risks when carrying out its basic tasks. As a general principle, the degree of risks assumed should be obvious and visible, risk assumption should be purposeful, and the magnitude of risks taken should be consistent with the objectives of the basic tasks. The MNB applies limits to mitigate the financial risks related to the management of foreign exchange reserves. 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. In order to measure the success of portfolio management, the performance of each reserve portfolio is compared to that of a benchmark (reference) portfolio. Benchmark portfolios indicate the size of the return that would have been realised, with identical investment parameters, on a passively managed portfolio representative of a broad market segment. The performance of foreign exchange reserve management is measured against these benchmark portfolios.

As a rule, the framework of risk-taking is set by the Monetary Council. Accordingly, it determines the basic principles of reserve and risk management and the degree of market, liquidity and credit risks affecting individual portfolios. In addition, it takes a decision on the benchmark policy, establishes strategic benchmarks and specifies the currency denominations of the securities to be held in the foreign exchange reserves.

The limit system was approved – within the framework defined by the Monetary Council – 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. Throughout the year, the Asset-Liability Committee (ALCO) reviews market developments and monitors the Bank's risks exposure with monthly regularity.

The two main pillars of the risk management policy are the two-tier benchmark system and the limit system attached to the benchmarks. The benchmarks – reflecting the return/risk preference of the MNB and measuring the performance of the portfolios – is maintained by the risk management institutional unit, a unit independent of the business area.

The MNB invests the foreign exchange reserves in two currencies: euro and US dollar. However, it takes exchange rate exposure in euro only – it covers the risk of the dollar/euro cross rate by derivative instruments. In 2009 the government deposited a part of the amounts disbursed by the IMF with the central bank. Temporarily, the MNB invested these funds in the same foreign currency structure, and subsequently, with a prudent management of exchange rate risks, it gradually incorporated the funds into the actively managed foreign exchange reserve portfolios. Holding dollar assets with exchange rate coverage is justified by two objectives: to achieve a higher level of diversification on the one hand, and to provide dollar liquidity on the other. The MNB manages a total of five portfolios denominated in the two currencies and each portfolio is based upon a different strategy. It holds a money market and an investment portfolio in each currency, and the euro-denominated portfolio also includes a credit risk free portfolio. The credit risk free euro portfolio, which constitutes the majority of the foreign exchange reserves, consists of investment grade government papers and the issuances of international (supranational) institutions only, and its benchmark only includes government securities of euro area Member States with a credit rating of at least AAA or AA. As regards the investment portfolio, it may only include investment grade corporate and bank issuances, as well as collateralised securities; if this portfolio contains government securities, it is typically for liquidity management purposes. Accordingly, the benchmark of the investment portfolio is representative of the performance of a broad range of euro-denominated corporate issuances with a high credit rating.

Chart 9
Composition of the dollar-denominated investment benchmark portfolio based on credit rating

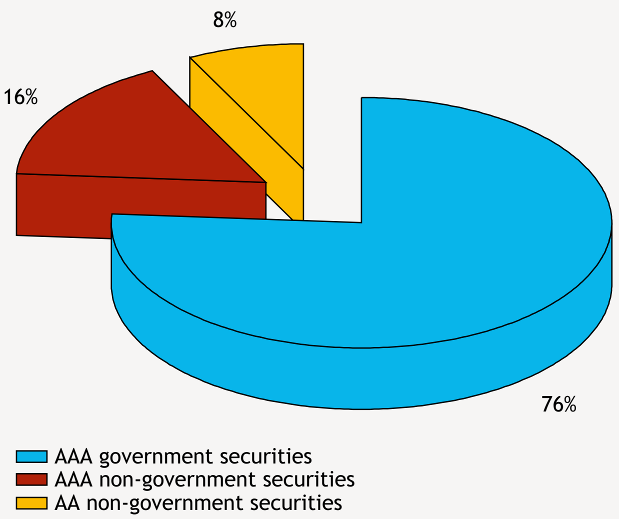
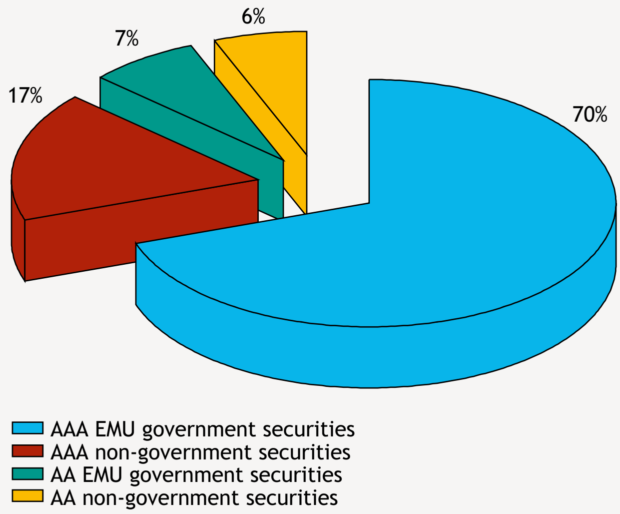


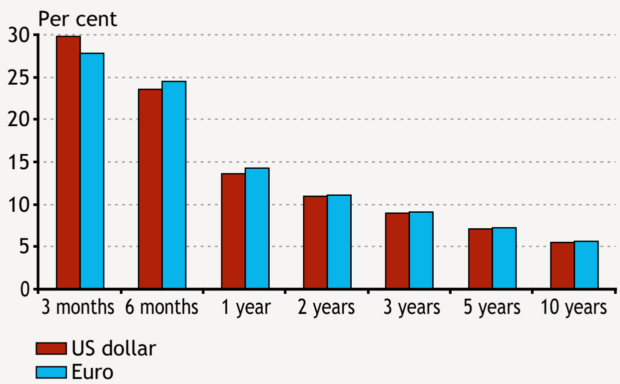
Chart 10
Structure of the overall euro-denominated benchmark portfolio



The benchmark of both the euro and the dollar-denominated investment and credit risk free portfolios contain investment grade government securities and corporate bonds, as well as money market 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 remaining maturity reflects the conservative risk appetite typical of central banks.

On 31 December 2010, 90% of the credit risk free euro-denominated benchmark portfolio consisted of AAA-rated euro area government securities, while the remaining 10% was composed of AA-rated government securities. As regards the euro-denominated investment benchmark portfolio, AAA-rated euro area government securities had a

Chart 11
Composition of the dollar-denominated and the (combined) euro-denominated investment benchmark portfolios based on residual maturity



share of 19% in the portfolio, while AAA-rated and AA-rated other securities had a share of 59% and 22%, respectively.

Both in absolute terms and relative to the comparable benchmarks, the Bank performed well in 2010 with respect to foreign currency reserves. The liquidity required for the attainment of monetary policy objectives was available throughout the year, with no credit risk incidents affecting the reputation of the MNB adversely. Exceeding the 1.7% yield on the benchmark portfolio by 2 basis points, the annualised performance of the credit risk free portfolio was 1.72%. The euro-denominated investment portfolio yielded a return of 2.06%, 40 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 40 basis points and stood at 2.14%. The annual return of 0.86% on the euro-denominated money market portfolio exceeded the relevant benchmark by 54 basis points, while that on the dollar-denominated money market portfolio amounted to 0.39%, also outperforming – by 15 basis points – the 0.24% result of the benchmark. Exceeding the 1.69% return on the weighted benchmark by 14 basis points, the annual return on the portfolios weighted with market value amounted to 1.83%.

In the course of the year the environment of foreign exchange reserve management was strongly influenced by the impact of the financial crisis on the markets relevant for reserve management, and by the weakening of investors' confidence about the sustainability of the public debt financing of the so-called GIIPS countries' (Greece, Ireland, Italy, Portugal and Spain). The sovereign debt crisis of the peripheral countries of the euro area significantly increased the credit risk premia of these countries. Yields declined by 30 basis points on the euro-denominated government securities corresponding to the 1.5-year strategic target duration of the investment portfolios, which contributed to the good performance of both the benchmark and the portfolio. Similarly, yields declined by nearly 30 basis points on dollar-denominated government securities as well.

The relatively high absolute performance of the investment portfolios can be partly attributed to market reasons (such as the downward shift of the yield curve and declining credit risk premia), and partly to a careful selection of securities by the portfolio management. In addition, the longer duration yield curve position purposefully undertaken in view of the declining yields also contributed to surpassing the performance of the benchmark. Another factor assisting in outperforming the benchmark was the higher weight of certain credit market segments performing better than the benchmark in the context of the narrowing of credit risk premia, which predominantly characterised the second half of the year.

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 128 million at the end of the year (95% confidence level VaR over a one-month time horizon). The average daily foreign exchange risk calculated for 2010 amounted to EUR 8,267 (1-day VaR with a 95% confidence level). These values reflect the implementation of the conservative guiding principles laid down in the risk-taking policy.

Managing operational risks

Against the backdrop of the external environment resulting from the protracted global financial crisis, the cost-efficient management of operational risks remained a key priority in 2010. The new tools and procedures adopted in response to the crisis functioned properly. Although most of the additional tasks have remained on the agenda, they have been partly integrated into the daily routine and have partly received, as required, appropriate information technology support.

The methodology of the regular, annual review of the MNB's operational risks has been aligned, to a large extent, to the methodology and recommendations developed by the European System of Central Banks with a view to supporting joint central bank tasks which, in part, are still being implemented.

In 2010 one of the special objectives of the MNB was the enhancement of risk awareness, which was aimed at reducing the probability of risk events emerging. Such forward-looking practices include increasingly detailed record keeping in relation to critical work processes; cross-training between professional areas; a consistent rotation of staff; practicing infrequently occurring tasks and the development of internal intelligence.

On 30 August 2010 the MNB had an opportunity to test its most important business continuity plans 'live' when the Szabadság tér building of the Bank had to be evacuated because of an unexploded bomb from World War II. After a series of previously performed simulation tests, the Disaster Recovery Centre now demonstrated, under very realistic circumstances, that the MNB can rely on an information technology backup basis in an emergency situation, which allows the Bank to carry out the tasks required for operating the financial system of Hungary, as stipulated by the MNB

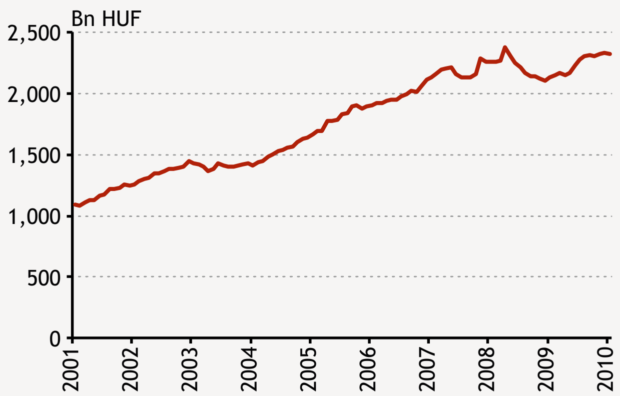
Act. The preparedness gained from regular testing and the routine acquired during the tests contributed significantly to the smooth changeover.

In 2010 business continuity planning placed great emphasis on the management of risks related to human resources in general, and to the loss of key personnel, in particular. During the summer the MNB drew up a detailed preparation and action plan designed to mitigate the risks attached to key personnel.

3.5 CASH LOGISTICS ACTIVITIES

Currency in circulation

Chart 12
The value of currency in circulation



Following a temporary decline in 2009, in 2010 the value of the currency in circulation amounted to a pre-crisis level, which was in keeping with the MNB's expectations. Accordingly, on 31 December 2010 the value of the currency in circulation amounted to approximately HUF 2,362 billion, i.e. 9% higher than a year earlier.

Despite the spread of the various methods of cashless payment, the cash intensity of the Hungarian economy has not decreased over the past decade; it can still be considered high in international comparison.

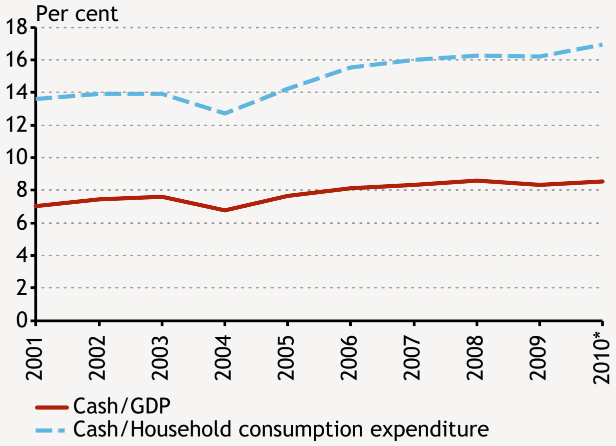
As a milestone of a series of analyses launched in 2008, the MNB held a conference entitled 'Use of Cash and the Shadow Economy' on 26 January 2010. The objective of the conference was to provide an opportunity where business and government sector participants and academic researchers exchange ideas on the interconnection between cash intensity, the use of cash and the operation of the economy. There was a general consensus at the conference that high domestic demand for cash is boosted by, besides the cash demand of the shadow economy, the lack of trust between individual businesses. Furthermore, the government also encourages it through its payment patterns seen in tax collection and the disbursement of social transfers. In order for the room for manoeuvre of the shadow economy to be limited and the overuse of cash to be reduced, it is important that the solutions facilitating

Table 2
Quantity and value of banknotes and coins in circulation on 31 December 2010

Banknotes	Volume (Million pieces)	Value (Billion HUF)	Ratio (%)	
			Volume	Value
20,000 forint	61.5	1,229.6	23.0	53.2
10,000 forint	87.5	875.5	32.7	37.9
5,000 forint	20.7	103.3	7.7	4.5
2,000 forint	19.0	38.0	7.1	1.6
1,000 forint	48.6	48.6	18.2	2.1
500 forint	30.1	15.0	11.3	0.7
Sum	**267.4**	**2,310.0**	**100**	**100**

Coins	Volume (Million pieces)	Value (Billion HUF)	Ratio (%)	
			Volume	Value
200 forint	83.1	16.6	7.1	36.8
100 forint	143.1	14.3	12.1	31.7
50 forint	112.0	5.6	9.5	12.4
20 forint	210.8	4.2	17.9	9.3
10 forint	253.0	2.5	21.5	5.6
5 forint	375.7	1.9	31.9	4.2
Sum	**1,177.7**	**45.1**	**100**	**100**

Chart 13
Cash/GDP and cash/household consumption expenditure



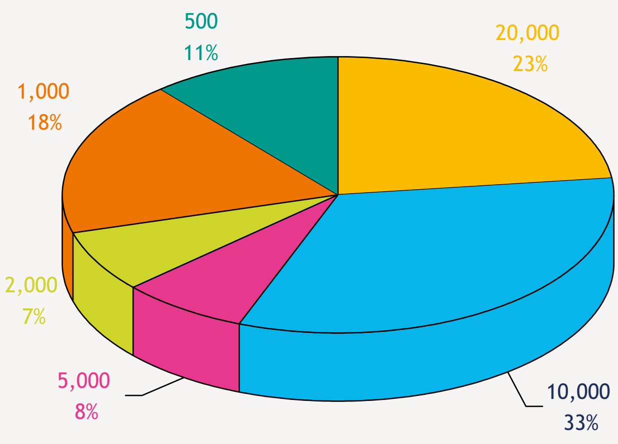
** The 2010 GDP and the data of household consumption expenditure are MNB estimates.*

electronic payment should be more widely adopted and applied by all the parties concerned.

Parallel to the conference, the MNB also published a research report on this topic.

Fundamentally, a rise in cash in circulation in 2010 was due to an increase in the volume of the two highest-value denominations in circulation; thus, the dominance of the HUF 20,000 and HUF 10,000 strengthened further, accounting for nearly 56% of the total number of banknotes, which suggests that these banknote denominations also perform an asset accumulation function besides their transaction role.

Chart 14
A breakdown of banknotes in circulation by their number as at end-2010



Cash distribution and control

The MNB participates in the domestic cash supply chain as a wholesale distributor. Banknotes and coins reach end users through the customers of the MNB, i.e. credit institutions and the Hungarian Post. Over the past decade the MNB has striven consistently to stimulate and support increased efficiency of the cash supply chain.

One of the first major efficiency improving measures was to allow market participants – typically cash logistics service providers – to re-circulate banknotes. Professional and quality standards in respect of this activity are regulated in a decree and checked by the Central Bank regularly. Although these measures reduced the role of the central bank in this segment, the quantity of the banknotes paid annually to the MNB is nearly the same as those in circulation. The MNB can strengthen the quality control of the banknotes in circulation through checking the banknotes returned to it for fitness and authenticity, and the replacement of unfit and destroyed banknotes with new ones.

In 2010 the central bank introduced a limited so called Notes-Held-to-Order (NHTO) balance sheet relief scheme to the credit institutions and the Hungarian Post; the scheme went into effect on the first working day of 2011. The objective of the introduction of the scheme, which has been operating efficiently across the world, was to facilitate the flow of banknotes between the central bank engaged in wholesale logistics and the credit institutions and the Hungarian Post, which employ smaller logistical (packaging) units. The central bank expects the introduction of NHTO to improve the efficiency of cash distribution between market participants and increase the security of cash supply, as the MNB is available outside its opening hours up to the amount in the NHTO.

Coins do not deteriorate or get faked due to their durable design and relatively lower value. Therefore, in the MNB's opinion, optimal coin logistics materialises if coins are fully re-circulated into market circulation, where the MNB only meets the net demand arising from economic growth. Under this method, coins in circulation in the economy, by-passing the central bank (as the former receiver of excess daily coins and the party satisfying daily market needs), are redistributed directly between professional actors of cash circulation, which helps reduce a large amount of (unnecessary) transport and cash handling. In order to achieve this goal, the MNB provided coin storage facilities for the most important companies engaged in cash handling; in 2010 it also coordinated the distribution of the flows of coins between the individual storage facilities. The process of coin distribution in a manner that is more efficient at a national economy level, where several milestones have already been achieved is expected to end in 2011 if, in keeping with the MNB's expectations, the operation of the market reaches an optimum level without any intervention on the central bank's part.

In 2010 the MNB handled cash turnover in an amount of HUF 4,491 billion and provided 311 million banknotes to its clients. Meanwhile credit institutions and the Hungarian Post had 297 million banknotes lodged to the central bank.

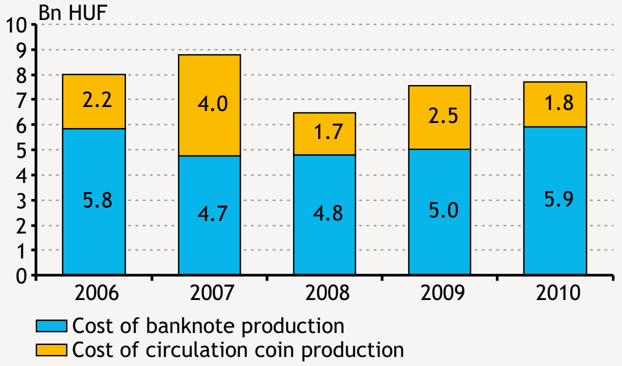
In 2010 the Central Bank judged 21% of the banknotes it processed (i.e. approximately 70 million banknotes) as unfit for circulation and replaced them with new and good-quality banknotes.

Banknote and coin production

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

In 2010 the MNB had nearly 119 million banknotes and 70 million coins produced. In 2010 the MNB's total cost of cash production amounted to approximately HUF 7.7 billion (incl. VAT).

Chart 15
Gross cost of the production of banknotes and coins in circulation



In 2010 the average cost of production of one banknote was approximately gross HUF 49 and that of one coin amounted to gross HUF 27.

Prevention and reduction of counterfeiting

In 2010 the MNB withdrew 7,375 counterfeit banknotes from circulation, which represented close to 20% reduction on a year earlier. The fact that, thanks to effective cooperation between the Hungarian Police and the MNB, a counterfeiting facility producing counterfeit HUF 10,000 banknotes in a quality that made counterfeits harder to detect than in the past was eliminated in 2010 contributed to a decline in the number of counterfeits.

Similar to 2009, higher-value banknote denominations were also dominant in counterfeiting in 2010; ten and twenty thousand forint banknotes accounted for 83% of all discovered counterfeits.

Relative to 2009, in 2010 the amount of direct losses caused by counterfeits decreased slightly; however, because of the spread of the counterfeiting of large-value denominations, it still exceeds the amount experienced in previous years. The anticipated further decline in the counterfeiting of the HUF 10,000 banknote also directs attention, especially that of cashiers at commercial outlets, to the often baffling semblance between genuine and counterfeit HUF 20,000 banknotes. However, the use of specialised equipment (e.g. UV-A/C lights) helps identify the counterfeits.

The decline observed in the number of counterfeits is also reflected in the fact that the number of counterfeits

Chart 16
Developments in the number of counterfeits per one million genuine banknotes and the amount of the losses caused

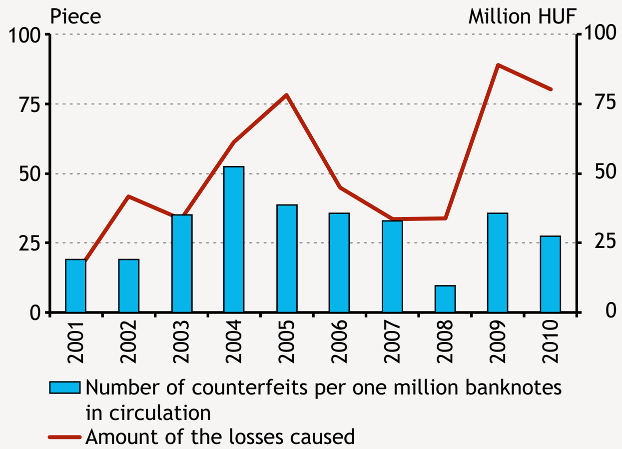


Table 3
Discovered counterfeit HUF banknotes in a breakdown by denominations in 2010

Denomination	500	1,000	2,000	5,000	10,000	20,000
Breakdown (%)	5.0	0.5	1.5	10.0	62.0	21.0

per one million genuine banknotes decreased in 2010. Hungary fared middling in regard to internationally and widely used currencies; however, there were much better performances than Hungary's in the countries using national currencies.

In order to mitigate the increasing damage resulting from the counterfeiting of high-value denominations, during the year the MNB put more emphasis than earlier on supporting the activity of cash desks in the trade sector, which play a significant 'filtering' role in cash circulation, the assessment of needs and the dissemination of information on banknotes and modern equipment-aided detection methods (e.g. combined UV-A/C lamps).

Apart from a small number of counterfeits prepared using typographic methods, forint counterfeits were typically produced with office reproduction equipment. Counterfeits can be identified with the use of modern equipment (UV-A/C lamps); however, if appropriate knowledge of genuine banknotes is available, no equipment is needed to spot counterfeits, a physical examination ('Look, feel and tilt') is enough.

The experts of the MNB examined a total of 1,681 different currency counterfeits in 2010. Overall, the number of counterfeit euro banknotes found remains insignificant. In 2010 a total of 1,094 counterfeits were examined and withdrawn from circulation; most of them were 50 and 100 euro banknotes.

Regulatory changes

In 2010 the MNB started reviewing and revising MNB Decrees nos. 2/2009. (I. 23.) and 3/2009. (I. 23.) on the tasks related to the distribution, processing and protection against counterfeiting of banknotes and coins. Within the framework of this activity, besides making the modifications justified by experience related to the application of the statutory regulations, the MNB will also include new requirements in the decrees. The MNB sets great store by compliance with the denomination exchange obligation of credit institutions and the Hungarian Post, therefore, it will adopt regulations on customer information aimed at the protection of the interest of clients.

In order to increase the security of cash supply, the regulations will also include requirements for the assessment and management of the operational risks involved in cash distribution.

The MNB submitted the revised decrees to a public debate at the end of 2010. After the evaluation of the remarks and proposals received, as well as consultations with the European Central Bank, the new decrees are expected to be promulgated in the second half of 2011.

Issue of commemorative coins

In 2010 the MNB issued eight commemorative coins (three gold ones, four silver ones and one cupronickel coin), increasing the total value of collector coins and commemorative banknotes issued before end-2010 by HUF 680 million.

The Central Bank issued a silver commemorative coin with a face value of HUF 5,000 marking the 125th anniversary of the birth of the Hungarian poet Dezső Kosztolányi and paid tribute to the Hungarian composer Ferenc Erkel on the 200th anniversary of his birth by issuing a gold commemorative coin with a face value of HUF 5,000 and a silver one with a face value of HUF 5,000. Due to its size, the gold coin is a true rarity because it was the first time that a commemorative coin issued in Hungary had been included in the international collector coins series 'The World's Smallest Gold Coin'.

Launched in 2005, the programme of issuing a series of commemorative coins presenting the technical innovations and inventions of Hungarian engineers and inventors continued; this time a cupronickel coin with a face value of HUF 1,000 honouring László Bíró, the inventor of the ball-point pen ('biro') was issued. By issuing a commemorative silver coin entitled 'Őrség National Park' with a face value of HUF 5,000, the Central Bank launched a new series presenting Hungary's national parks. The coins to be produced as part of the series will have the same face value and technical specifications. In 2010 the MNB issued a commemorative silver coin with a face value of HUF 5,000 to mark the European Championship of Swimming, Diving, Synchro & Open Water Swimming held in Hungary, as well as two gold ones, one with a face value of HUF 50,000 and another with a face value of HUF 500,000, to mark the millennium of King St. Stephen writing his admonitions to his son Prince St. Imre.

Issued in 2009 as a part of the 'World heritage in Hungary' series, the 'Budapest' commemorative silver coin designed by Mihály Fritz earned the public award of 'Coin of the Year' in the competition initiated by Krause Publishers. (75% of participants voted for the commemorative coin minted by Magyar Pénzverő Zrt.)

3.6 STATISTICAL SERVICES

Based on the powers vested in it by the Central Bank Act, in order to carry out its fundamental duties – including the analysis of financial trends, the preparation of monetary decisions, smooth money circulation, the oversight of the operation of the domestic payment and settlement systems and securities settlement systems, as well as support for the stability of the financial intermediary system – the Central Bank collects statistical data (not qualifying as personal data) and publishes statistics compiled on the basis of such data.

The Central Bank's statistical activity comprises the collection, processing and publication of data serving the MNB's basic functions, meeting the MNB's data reporting obligations as well as the user support related to the statistics released.

In compliance with international standards and Community law, particularly the regulations of the ECB, while taking account of any changes in the conditions and requirements related to the performance of its duties, the MNB revises the collection of statistical data once each year, and specifies the reporting obligations for one calendar year. Provisions for data reporting obligations for 2010 (the scope of information to be provided for the central bank information system and that of the reporting agents, the method and deadline of reporting) were stipulated by the Central Bank in the MNB Decree 32/2009. (XII. 1.).

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

Harmonisation among individual statistics, preparation for methodological changes

In 2010 the continuation of harmonisation played a key role in the MNB's statistical activity; this aimed at the alignment of CSO and MNB statistics and at the reduction in the differences between the MNB's own statistical products.

The differences between the balance of payment statistics prepared by the MNB and the rest of the world accounts prepared by the Central Statistical Office (CSO) were assessed. As a result of the discussions the differences between the two statistics diminished markedly, so much so that the extent of the difference is now negligible in international comparison, too. As of September 2010, the MNB and the CSO adjusted goods import to be recognised in the balance of payments and the national accounts for the CIF/FOB in accordance with a new methodology. This reduced net errors and omissions in the balance of payments significantly, by 0.5% of GDP.

Harmonisation between financial and non-financial accounts continued in 2010. The MNB worked in co-operation in the CSO in order to clarify the recording of the transactions of the financial sector and to compile a dividend matrix.

The MNB worked in close co-operation with the experts of the CSO and the Ministry of the National Economy while compiling the report on government deficit and debt (Excessive Deficit Procedure, EDP report) for the European Commission. The EDP reports were compiled by the deadlines specified and in an appropriate quality.

In 2010 the upgrading of the methodological standards to be applied to the compilation of the European System of Accounts (ESA 95) regulating the compilation of national accounts and the related statistics continued. Preparation for the application of the upgraded methodological standards commenced. The MNB and the CSO worked out a time schedule for the implementation of the related tasks.

In addition to the methodology to be applied to national accounts, the rules of the compilation of the balance of payments statistics also changed. Similar to the national accounts, the upgraded methodology will have to be applied from 2014. A number of consultations were held among professionals about the new methodological and data collection requirements.

Improvement of the quality of data, system developments

Due to the modifications of the ECB regulations, which entered into force in 2010, the MNB introduced, with effect from 1 January 2010, more comprehensive data collection and improved statistical reports by the MNB to the ECB with regard to the statistical balance reports of the monetary financial institutions and interest rate statistics.

In 2010 the MNB introduced a new system for the purpose of the compilation of securities and monetary statistics. In the new system of securities processing, the pricing of securities portfolios is performed with using more information and therefore is at a higher professional standard. In addition, more accurate methods are used for calculating the breakdown of the changes of stocks. The monetary statistical compilation system made it possible to use information on securities at an individual level and to implement the calculation and assessment procedures of monetary statistics at an individual level.

As one of its objectives realised, in 2010 the MNB stabilised and consolidated the data warehouse that had been established in 2004 with the aim of providing support for internal decisions. In respect of certain areas (such as the RTGSS, MNB transactions and payment systems) data assets of the data warehouse have been extended. Thanks to this work, the operation of the data warehouse is now safer, and it has become more transparent and easier to handle for its users.

International data reporting and global co-operation

The MNB complied with all of the reporting obligations pertaining to EU Member States in 2010. 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 of a central bank and in keeping 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 also played an active role in international statistical working groups in 2010.

3.7 PRACTICAL PREPARATIONS FOR THE EURO CHANGEOVER

The National Euro Co-ordination Committee (NEC) was established by the government through Government Decree 1071/2007. (IX. 21.) in September 2007. Partly in order for the new government structure to be reflected and partly due to the impacts of the uncertainties surrounding the date of the changeover on the scheduling of tasks, a decision on the modification of the government decree was made in Government Decree no. 1296/2010. (XII. 21.) in December 2010. As the government appointed the minister for national economy as president of NEC and the governor of the MNB as co-president, the MNB will play a key role in identifying the preparatory tasks related to the adoption of the euro. It is possible to identify the practical tasks of the introduction of the euro irrespective of fixing a future target date for adoption, and the practical preparations can be launched even in the absence of a valid target date. It is also a fact that the financial crisis and its consequences somewhat postponed the possibility of fixing a target date for the adoption of the euro.

Meeting the convergence criteria (the Maastricht criteria) alone is not sufficient for creating the conditions for the euro changeover, as is seen from the experience of a number of countries that use the euro today. In addition to the economic conditions, determining the system of practical, logistical, IT and legal changes related to the euro changeover also constitutes an important precondition.

Obviously, it is not sufficient to define and start the practical preparation tasks only when the macroeconomic criteria are already in place, because that may lead to further delays in the adoption of the euro.

The main tasks of the NEC, which is in charge of directing the national preparations, are as follows:

- involving all relevant parties to develop a National Changeover Plan (NCP) required for the practical adoption of the euro, which outlines the tasks and schedules related to the changeover of the financial, corporate and public sectors, the legal and information technology areas, as well as consumer protection, accounting and statistics; reviewing the plan as appropriate and continuously monitoring its completion;

- actively supporting the preparations of the public and private sectors for the adoption of the euro by providing professional recommendations in respect of the information, price display and accounting systems, as well as the currency and cash changeover;

- providing information in relation to the individual preparatory phases for the preparations of the euro changeover through efficient communication methods;

- elaborating proposals with respect to the development of a legal framework to support the changeover and initiate the required legislation.

Moreover, preparation for the introduction of the euro has been recognised as an item of special significance in the MNB's mid-term strategy, which was developed in 2007 and remains in effect until 2013:

- 'Changeover to the euro is a significant milestone in the European integration process of the Hungarian national economy. Based on the basic tasks of the MNB as defined by the MNB Act, as well as its role in the ESCB, it is a primary objective and interest of the MNB to ensure that the Hungarian financial system is prepared for the adoption of the euro, regardless of the actual date of the changeover.'

- 'In the course of preparations for the adoption of the euro, the MNB plays a role in analysing and monitoring the macroeconomic conditions of the changeover and in supporting its macroeconomic foundation on the one hand, and on the other hand, in preparing the domestic payments and securities settlement systems and the relevant participants.'

– 'In order to facilitate the smooth implementation of a carefully planned and developed action plan, the MNB intends to play a leading role at a national level in the practical preparations for the introduction of the euro and in the preparation of the domestic payments and securities settlement systems and the relevant participants.'

The financial sector will have an undoubtedly decisive role in preparing the economy and society as a whole for membership in the euro area and in the preparation process. With a leading role in the management of the Financial Sector Sub-Committee (FSSC) and the Communications Sub-Committee (CSC), the MNB is aware of the fact that the financial sector will be in the front line during the changeover process and has an important initiative role, as well as a role in raising awareness and providing information. At the same time, the conversion of bank accounts, loans and other financial products into euro, the transition of insurance products, the adjustment of retirement account services and the securities market to the future currency, and the provision of information technology and infrastructural support for the euro changeover involve tasks directly affecting society as a whole. The compilation and maintenance of a preliminary action plan is a great challenge for participants in the financial sector, while its successful execution will result in major benefits and opportunities.

In the course of practical preparations for the introduction of the euro, government agents, the MNB and representatives of the private sector and non-profit organisations are working in close co-operation, as only a jointly developed and approved implementation programme – one which is based on efficient co-operation – may guarantee a smooth changeover to the new currency.

In 2009 the most important task of the NEC (and thus the MNB) was the revision and updating of the first draft of the NCP. A second version of the scenario of Hungary's euro changeover had been prepared by the end of 2009 and was approved by the government in December 2009 as the most recent national working document serving as guidance for practical preparation for the adoption of the euro. The NCP is a public document, which can be accessed by all economic agents as well as the general public.

In parallel with its leading role in the updating of the NCP, and in line with the provisions of the NCP, the MNB also keeps updating its own preparation tasks in the Central Bank's institutional-level euro changeover programme.

As regards major events in 2010, the Hungarian-French-Slovak twinning project launched by the National Euro Co-ordination Committee on 1 April 2009 should be highlighted; the objective of the project is to familiarise Hungarian stakeholders with experience related to the changeover in France and Slovakia. Supported financially by the Commission and organised within the framework of the project, events with Budapest, Paris and Bratislava as venues were held in 2010. Experts discussed issues related to the responsibilities of the public sector, legislation and consumer production at the first meeting. The topic of the second one was the details of corporations' changeover to the euro. Two study trips were also organised. Participants discussed the communication of the euro changeover to vulnerable groups. Related events enabled the experts of the MNB to gain experience that will help them with their tasks related to the adoption of the euro.

3.8 CENTRAL BANK ACTIVITIES AIMED AT IMPROVING THE FINANCIAL LITERACY OF CITIZENS

As in previous years, the Bank prepared its information brochure entitled 'A pénz beszél! Te is érted?' (Money talks. Do you understand?), which it mailed to nearly 1,200 secondary schools. Complete with downloadable presentations and knowledge tests, the brochure was mailed to nearly 139,000 secondary school students in 2010. The target audience of the 'Monetary' contest with 346 registered teams in 2010 comprises secondary school students.

In 2010 the MNB's Visitor Centre received close to 36,000 visitors, a great number of whom participated in programmes aiming at the development of economic knowledge and financial awareness. Attendance was boosted by cultural events such as the increasingly popular weekend Open Days organised traditionally in May and September, as well as the participation of the MNB in 'The Night of Museums' held in June 2010. These events attracted a further nearly 10,000 visitors. In 2010 it was the first time that the MNB had participated in the 'Civil Island' programme series at the Island Festival. It was a great success and contributed to broad-based public awareness raising and dissemination of information.

The Foundation for Financial Awareness, established on the initiative of the MNB, will continue to operate as Money Compass Foundation, a name that is easier to comprehend.

The Foundation has been providing professional and financial support for the Financial Education Programme aimed at financial awareness raising among secondary school students and involving 60 secondary schools (130 teachers and approx. 2,000 students) in the 2010–2011 academic year. The Foundation also provided a 30-hour accredited further education programme, with economics as its focus, for the teachers participating in the programme.

The MNB, the Money Compass Foundation and the Ministry of Education and Culture established the 'Money Compass School' network membership and title, announcing it for the first time in 2009. This title means a high-level recognition for schools that represent an outstandingly high standard of economic education and dissemination of financial knowledge within their pedagogical programme. The title and the network membership could be won in the competition announced by the Foundation for Financial Awareness. Currently, the network has 77 member schools of secondary education.

The Money Compass Foundation, with professional help from the MNB, the Competition Office and the HSFA, held a conference on savings in June 2010. The primary objective of the conference was to encourage participants with a stake in the development of savings and investment literacy, and to strengthen partnership in order to shape and influence the savings attitude of the public.

Improving financial literacy has also recently received increasingly sharp focus within the activity of international institutions. At the OECD's request the Bank's Financial Awareness Centre is a member of a working group established to implement a comparative international study mapping the standards of financial literacy. It is also a permanent member of the OECD's network for the development of financial literacy (International Gateway for Financial Education). The European Commission (Internal Market and Services Directorate General) is regularly informed about the Hungarian initiatives, and the ECB also receives such information from time to time.

3.9 FACTORS SHAPING THE COMMUNICATION OF THE MNB IN 2010, TARGETS AND RESULTS

The Bank's main objectives for its 2010 communications included the maintenance and strengthening of the success of the inflation targeting regime, the efficiency of the monetary policy decision support system and the stability of the Hungarian financial system, as well as their support by the means of communication. As in previous years, in 2010 the MNB's communication activity focused on enhancing the Bank's reputation, recognition and credibility, as well as providing information to the general public about its duties and activity.

As a result of the successful central bank communication (proactive relations with the press, analytical publications and publications for the general public, a completely revamped website with a new structure and array of colours, plus forums for professionals), the Bank's operation, activity and role have become more understandable and transparent for both the wider public and the professional audience. In 2010 the MNB issued 83 press releases; in other words, it relayed its messages consistently to the various target groups through the press. The MNB's Communications Area made adjustments to the new challenges of a changing environment through consistent theme management, the purposeful selection of dedicated experts representing the Bank's interests authorised to make announcements and the strengthening of media relations.

The Bank's visual image and website were refreshed in 2010. The new image reflects central bank interests better than before; furthermore, it is more straightforward and sophisticated. The overhaul of the visual image was based on prior research; the development itself took note of the remarks and needs of both external and internal stakeholders. While the new website was being designed, close attention was paid to the feedback and expectations of the various organisational units and external stakeholders, as a result of which the structure is more transparent than it used to be.

On the whole, using state-of-the-art strategic communication tools, the MNB ensured that all the complex activities it performs in the interest of the public good are transparent and effective, and its messages reach the target audiences efficiently.

3.10 FINANCIAL PERFORMANCE OF THE MNB

The MNB's income in 2010

The MNB incurred losses in an amount of HUF 41.6 billion in 2010. The financial result and balance sheet structure of the Central Bank are primarily determined by the domestic and international macroeconomic developments, and the objectives and selected measures of monetary policy. In 2010, the following main developments had an effect on the balance sheet and the profit:

– the level and composition of foreign exchange reserves defined by the monetary policy, and foreign exchange

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

HUF billions

No.	Description (P/L line)	2009	2010	Change
1	Net interest and interest related income (I+II)-(X+XI)	−63.7	−53.8	9.9
2	*– net forint interest and interest related income (I-X)*	−276.7	−245.3	31.4
3	*– net foreign exchange interest and interest related income (II-XI)*	213.0	191.5	−21.5
4	Realised gains/losses arising from financial operations (IV-XIV)	9.3	−21.7	−31.0
5	Income arising from exchange rate changes (III-XII)	136.7	50.4	−86.3
6	Other constituents of net income* (V+...+VIII)-(XIII+XV+...+XVIII)	−16.9	−16.5	0.4
7	**Profit/loss for the year (1+4+5+6)**	**65.4**	**−41.6**	**−107.0**
	Revaluation reserves in the balance sheet			
8	*– due to unrealised foreign exchange gain/loss*	230.8	415.9	185.1
9	*– due to changes in the market value of the foreign currency securities*	21.5	−29.1	−50.6

** Operating costs and expenses of banking operations, costs of issuing banknotes and coins, net release of provisions, profit/loss from fees and commission and from other items.*

purchases and sales affecting the level of reserves; operations by the Government Debt Management Agency linked to debt management, net foreign exchange inflows deriving from EU transfers, and the foreign exchange conversions performed by the Hungarian Treasury for purposes unrelated to debt-financing;

– the developments in instruments absorbing forint liquidity, which are correlated with the 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.

Net interest and interest-related losses amounted to HUF 53.8 billion, which means an improvement of HUF 9.9 billion on a year earlier. In 2010 as well, interest income continued to be fundamentally determined by increases in the Bank's net foreign currency receivables, which resulted in growth – in excess of an annual average HUF 1,000 billion – in interest bearing forint liabilities.

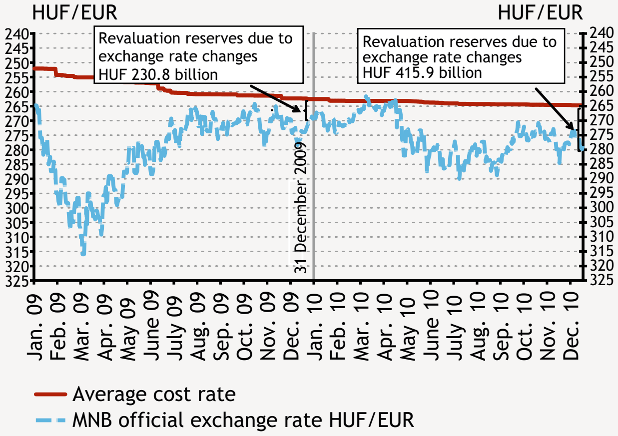
Net forint interest and interest-related losses amounted to HUF 245.3 billion in 2010, HUF 31.4 billion less than a year earlier. Improvement in forint interest income was attributable to base rate cuts, and materialised in the face of the fact that liquidity absorbing HUF liabilities rose significantly relative to a year earlier. The average central bank interest rate weighted with calendar days was 316 basis points lower than in 2009.

Foreign exchange interest and interest-related income amounted to HUF 191.5 billion, representing a HUF 21.5 billion decrease relative to a year earlier, the underlying reason for which was that while in 2009 the FX swaps concluded with the Government Debt Management Agency (ÁKK) improved FX interest-related income, in 2010 both the number and the portfolio of these transactions dropped significantly. In 2010 the amount of foreign exchange reserves was determined by the ÁKK's financing operations, EU transfers and foreign exchange conversions. Throughout the year FX yields were lower than in 2009. As a result, return on FX reserves calculated in HUF also decreased in 2010. In contrast, income from interest on the reserves rose by HUF 26.9 billion due to a rise in the stock of reserves.

Total losses realised on financial operations amounted to HUF 21.7 billion, the underlying reason for which was that sizeable losses were incurred when numerous securities included in the FX reserves matured in the course of the year. Typically, they were securities bearing higher interest than the prevailing market rate, and their purchase price exceeded their face value. Purchase price difference is only realised in profit/loss from financial operations when securities mature; however, higher interest counterbalancing this is recognised as interest income continuously.

The two main factors determining the income from exchange rate changes are the difference between the official and the cost rates, as well as the volume of foreign exchange sales. The HUF exchange rate fluctuated significantly in 2010 as well; the official and the cost rates diverged significantly in the summer and stood at HUF/EUR 41.01 at the end of 2010, i.e. HUF/EUR 5.73 higher than a year earlier. Overall, the forint depreciated by 2.9% against the euro during the year, and the exchange rate stood at 278.75 HUF/EUR on 31 December 2010. The volume of FX sales was in keeping with the usual volumes during the year. Conversions only became more frequent in the third quarter due to the government's foreign debt repayments. Realised gains on FX rate changes amounted to HUF 50.4 billion in 2010.

Chart 17
Changes in the forint-euro exchange rate



Other income and expense items include general operating income, costs and expenses, costs of issuing banknotes and coins, generation and release of provisions, income/expenses from fees and commissions and from items other than fees and commissions. A HUF 0.4 billion decline in the resulting net expenses relative to a year earlier was mainly due to a fall in the costs of banking operations.

Compared to the end of the previous year, the MNB's equity increased by HUF 122.1 billion to HUF 459.4 billion. The magnitude of the equity was fundamentally influenced by the level of revaluation reserves due to exchange rate changes, but developments in the annual profit/loss also played an important role in its change.

Revaluation reserves of the forint exchange rate increased by HUF 185.1 billion compared to the end of 2009. This is due primarily to the growing gap between the official forint exchange rate and the average cost rate, and the increasing stock of revalued foreign currencies (net FX position) also contributed to the growth. As at 31 December 2010 the closing value of the revaluation reserve due to exchange rate changes was HUF 415.9 billion.

On 31 December 2010 the MNB's balance sheet showed unrealised losses of HUF 29.1 billion on the foreign exchange securities marked to market, which was reflected in the revaluation reserves of foreign currency securities. Pursuant to the Central Bank Act, if the reserve shows a negative balance at any year end, the amount of the negative balance is reimbursed by the central government until 31 March of the year following the reporting year. Therefore, this amount was reclassified and recorded in the reporting year's balance sheet as claims from the central government.

As the Bank's retained earnings (HUF 75 billion) cover the 2010 losses, the central government did not have a loss reimbursement obligation pursuant to the MNB Act.

Internal operations of the MNB in 2010

The internal operations of the MNB are essentially aimed at providing the resources required for the efficient discharge of the duties stipulated by the MNB Act and facilitating risk-free operations in the most cost-effective manner. Upon inspection of the operation of the MNB, the State Audit Office (SAO) in fact verifies the institutional management's compliance with statutory regulations and internal rules, and checks whether the requirement of cost-effectiveness was observed in internal operations in terms of operating costs and investment. The SAO made no remarks or recommendations on these issues following the audit of the year 2009.

Mainly by continuing the implementation of the initiatives of the project launched in 2008 aiming at the improvement of the MNB's operating efficiency and by prioritising cost efficient solutions, in 2010 the MNB attained a 6.9% (over HUF 900 million) reduction in operating costs compared to the expenditures in the previous year. With the cost mitigating effects realised in 2009 of the implemented measures, the sum saved over the past two years exceeded HUF 2.1 billion.

Table 5
Operating costs of the MNB in 2010

Description	Actual data for 2009	Budget for 2010	Actual data for 2010	Index (2010 actual / 2010 budgeted)	Index (2010 actual / 2009 actual)
	HUF millions			%	
Staff expenditures	7,661	7,193	7,009	97.4	91.5
General operating costs	6,066	6,107	5,774	94.6	95.2
Total	**13,727**	**13,300**	**12,783**	**96.1**	**93.1**

In 2010 over two-thirds of the savings relative to the previous year, were attained predominantly in personnel costs, the main underlying reasons for which were the transformation of the compensation scheme and changes in taxation and contributions. At the same time, a further reduction was also realised in general operating costs, and within them especially in the amount of depreciation write-offs, since – as a result of a revision two years ago – amortisation rates are now adjusted to the actual useful life of the assets. IT and operational costs declined further, and operating efficiency improved due to the better utilisation of internal resources and the discontinuation of the use of the building in Hold utca in June. At the same time, however, other costs rose in 2010 relative to a year earlier due to the unplanned sizeable legal costs of the Holocaust litigation. (For the details of the litigation, see the section on other costs.)

As a result, on the whole the MNB's operating costs in 2010 did not reach HUF 13 billion in nominal terms for the first time since 2003.

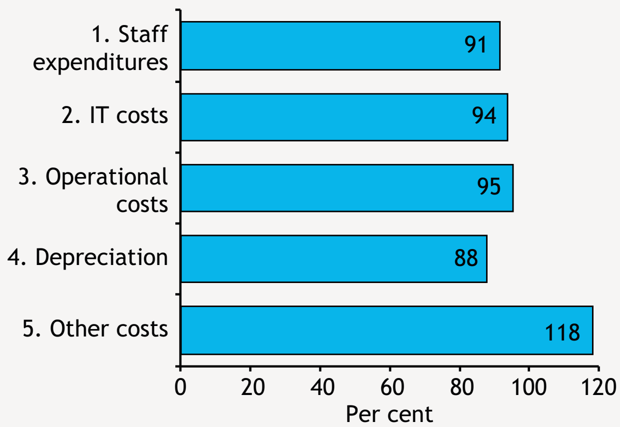
The financially realised value of investment implemented in 2010 was HUF 1,839 million, which is identical to the previous year's figure. Investment expenditures in 2010, the total combined amount of which accounted for over 70% of the 2010 expenses, were mainly influenced by the implementation of the investment related to the goals of the strategic IT strategy (e.g. the purchase of a redundant central data storage and backup system, high-speed data transmission equipment and the separation of the IT systems). Furthermore, new work stations were established in the building at 8–9 Szabadság tér necessitated by the discontinuation of the use of the building in Hold utca, in conformity with the adopted real estate strategy. The extent to which the capital investment plan had been fulfilled (95,9%) is unprecedented even from a multi-year perspective. Although this was due, in part, to investment projects brought forward from 2011, those carried over from 2009 as well as unplanned investment projects, overall this change suggests improvement in the planning and scheduling of capital projects.

The MNB falls under the scope of the Public Procurement Act with effect from 2004. Since then both the number and the proportion of legal remedy proceedings launched in connection with public purchase proceedings have been well below the national average; no complaints have been lodged over the past 2 years. The MNB launched an operation and organisation development programme in regard to the overall central procurement activity, the objective of which is compliance with the applicable statutory regulations as well as the approximation of the Central Bank's procurement practice to the best market practice. The management of strategic procurement as a single entity, category management, efficient tendering, the targeted management of supplier relations, procurement consolidation, compliance with the total cost principle and the management of the operational procurement processes from a systemic approach all serve the above goal. The number of e-auction and multi-round price negotiations rose markedly in the implemented public procurement proceedings in 2010, which contributed to the above savings significantly.

Operating costs

The approved operating cost budget for 2010 was HUF 13,500 million (including central reserves in the amount of HUF 200 million). In comparison, actual costs amounted to HUF 12,783 million. Relative to the operating costs in 2009, this amount translates into 6.9% (or HUF 944 million) in savings; except for other costs, a reduction was experienced in nearly all main cost types.

Chart 18
Ratio of operating costs in 2010 to actual data in 2009



Staff expenditures

Overall, personnel costs in 2010 (HUF 7,009 million) fell by 8.5% (i.e. over HUF 650 million) compared to 2009. This is one of the results of the operating efficiency improving project. In 2010 the compensation scheme was changed, as a result of which the costs of basic remuneration decreased markedly, and, due to the scheduling of the project, dismissal and severance pay costs were lower in 2010 than in 2009. Furthermore, changes in taxation and social contributions also led to savings. Reduction in costs was also due to the fact that as a result of an intra-year modification of the relevant law, the remuneration of the governor, the deputy governors as well as members of the

Monetary Committee and the Supervisory Board was reduced significantly with effect from September 2010 (in the case of the Supervisory Board until December 2010). The average headcount of the MNB declined by only 2.2% (13.5 people) relative to the previous year. At the same time, the protracted impact of significant reduction in the staffing level in 2009 reduced costs substantially in 2010. The savings from the above factors were reduced by a wage increase in 2010.

General operational costs

General operating costs in 2010 (HUF 5,774 million) fell by 4.8% compared to 2009.

The amount of *IT costs* incurred in 2010 (HUF 1,219 million) were 6.2% lower than in 2009. The majority of these expenses are software operating costs (monitoring, support, maintenance and consulting costs). Savings were related to the modernisation of the purchasing procedure, which increased the intensity of price competition in IT purchases, and thus, among others, the costs could be cut in supporting the operation of the new data warehousing system. In addition, contribution by external consultants to the operation of the IT specialisation is increasingly replaced by internal resources and a better utilisation of the knowledge available in the organisation, which moderated consultancy fees. The 2010 developments in IT costs were also affected by a one-off savings irrespective of business management decision, since due to technological modifications part of the fee charged for the European Central Bank's data transmission services used by the MNB were subsequently offset or reduced.

The amount of *operational costs* (HUF 1,550 million) declined by 4.6% compared to the previous year. This was to a major extent due to the fact that in the middle of 2010, the MNB stopped using the building at 7 Hold Street, resulting in subsequent savings but also in a single additional cost. Review of the security level of using the Logistics Centre and its modification from 2009 H2 resulted in savings that affected the whole year in respect of the 2010 security guarding expenses. Costs were also cut when the company in charge of security guarding was replaced by a new one that provides these services at a favourable price as a result of the requirements worded during the invitation of tenders. In addition, several consciously cost-cutting interim measures were taken, which resulted in the reduction of, among others, telephone and electricity costs. Part of these measures contributed to MNB's success in the Green Office competition. The above-mentioned savings were mitigated by the expenses of – partially seasonal – renovation work aimed at the conservation of real properties and assets.

The amount of the *depreciation* of tangible and intangible assets in 2010 (HUF 2,180 million) was 12% down on the previous year. This was primarily due to and increase in the completely depreciated assets, as part of the assets purchased in the previous years was depreciated in a shorter time than they were in actual use. As a result of the revision performed at the end of 2008, the depreciation rates match the actual useful lives of the assets.

The total amount of *other costs* was HUF 957 million in 2010, 18.3% (HUF 148 million) higher than in 2009, due for the most part to the significant amount paid as legal costs to specialists in the Holocaust litigation. This was preceded by a litigation called Holocaust Action, started under No. 10-cv-01884 in March 2010 before one of the Northern District courts of first instance in the State of Illinois in the United States of America. In this litigation the plaintiffs are the victims of bank thefts during the Holocaust, while the defendants include Magyar Nemzeti Bank, Erste Group Bank, MKB Bayerische Landesbank, OTP Bank and Creditanstalt Bank. In connection with the Holocaust Action, contribution by an American and a Hungarian law office was required and the 2010 costs of legal expertise reached HUF 179 million. In addition, translation and secondment costs were also incurred in connection with the litigation, in an additional total amount of HUF 8 million. The 2010 amounts of other elements of the other costs were, however, lower than in the previous year (e.g. secondment, economics consultation and data purchase costs, as well as expenses related to human resources expertise).

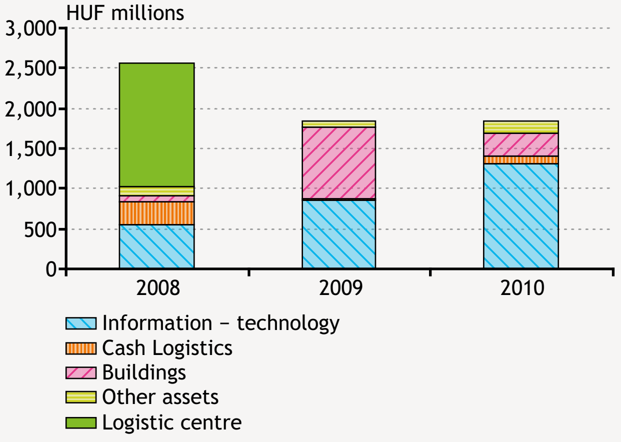
The rental fee paid for Magyar Pénzverő Zrt. using a part of the Logistics Centre and the lower revenues due to charity services and accounted as carry-over amounted to HUF 130 million, which reduced the general operating costs.

Capital investments

In December 2009 the Governor of the Bank approved the 2010 investment plan for new investment launched in 2010 and for re-scheduled and value-updated ongoing investment projects in the amount of HUF 1,917 million. He also acknowledged the appropriation for investment in progress based on earlier decisions.

Following the establishment of the Logistics Centre, a project closed in 2008, the annual capital investment expenditures were identical in 2009 and 2010, amounting to HUF 1,839 million in each year. The only discrepancy was seen in their composition, as the real property investments demanding considerable expenses in 2009 were closed in the first half of 2010.

Chart 19
Capital investments by MNB



The overwhelming majority of the 2010 capital investments were linked to IT infrastructure upgrading. The most significant was the purchase of the redundant central data warehouse and saving device, which has identical parameters and capacity at both sites (in the Logistics Centre and in the central building on Szabadság Square). Archiving included the development of a new saving architecture in the interest of accelerating saving and backfilling and increasing their security. High-speed data transmission between the two buildings was allowed by the performance of a project aimed at the exchange of DWDM tools, which resulted in another significant expenditure in 2010. Similarly significant progress was made by the separation of the various IT systems, performed in order to separate the critical systems by developing domains. In this way payment systems were assigned to a separate security segment, which allows a higher level of bank security liberalisation for other IT systems in the future.

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 2010 the programme of the Integrated Statistical System was carried on: the projects started in 2009, including the Monetary Statistical System development, were completed. Furthermore, the projects required in order to monitor regulatory changes were also realised in 2010.

The improvement of efficiency and effectiveness required numerous capital investment projects in 2010, among others the upgrading of the IT tool that supports cash logistics (Integrated Emission System), which was required in connection with the development of container banknote processing.

The timeliness of technological updating and the image change justified the renewal of MNB's website, which was also successfully completed in 2010.

The capital investment projects related to real properties and started in 2009 (creation of a new computer room in the building at 8–9 Szabadság Square to replace the Hold Street facility and the establishment of new work stations) were closed successfully. The completion of the work stations and the new computer room allowed MNB to stop using the building at 7 Hold Street. Further building modernisation in 2010 included the conversion of the fire alarm system and the replacement of certain air conditioners.

In the framework of other capital investment projects performed in 2010, new image building elements were introduced to renew the institutional brand. Moreover, a new corner was furnished in the Visitor Centre exhibition to develop the theme of financial culture. In addition, the security technological tools, for instance the video monitoring system, were modernised, and other tools required for operation were purchased.

Human resources management of MNB

In 2010 the performance of the realisation of the initiatives aimed at cutting the operating costs started in 2009 in the framework of an efficiency improving project were continued. In terms of human resources, this meant lay-offs and the conversion of the compensation structure. Since these changes profoundly affected the atmosphere of the working environment as well as general employee satisfaction within the bank, in 2010 our activities focused on improving and strengthening employee commitment. In order to achieve this objective, we paid special attention to the development of employee-superior relationships, promoting the staff members' personal development, and the creation of encouraging and incentive-generating working conditions. In the autumn of 2010 we conducted a commitment survey to follow up the previous one conducted two years earlier. This survey indicates considerable improvement both in satisfaction and in commitment in comparison to the findings of the 2008 survey.

Promotion of changes in the efficiency improving project affecting human resources management

The changes decided in the wake of the efficiency improving project took effect in the Bank's compensation system as of 1 January 2010: general cost reimbursement was incorporated in the optional fringe benefits and basic wages of the employees.

In the course of staff cuts performed in connection with the project initiatives, the Bank paid special attention to the lawful, equitable and humane arrangements. The leaving staff members were provided assistance in the form of an outplacement counselling programme to prepare them for handling changes in their personal life and finding new jobs. 4 of the 10 employments terminated in 2010 were by early retirement, and 6 by mutual agreement. 50% of the staff members dismissed by mutual agreement used the opportunity of career counselling offered by the Bank.

Realisation of the commitment survey, action planning and continuation of the commenced action

Far more staff members participated in the 2010 survey (73% of the Bank's employees) than in the 2008 one (when only 58.3% of them took this opportunity).

Nearly two-thirds (63%) of the Bank's employees have a favourable opinion of their working place, have emotional ties to the organisation, would find it difficult to part from the Bank, and consider themselves motivated to achieve outstanding performance. In comparison to the 51% found in the 2008 survey, this means a considerable improvement in the staff members' loyalty and commitment. In the past two years staff members' overall satisfaction has also improved. Nearly two-thirds of the employees are satisfied with their working place in general, like their duties more, and have experienced improvement in self realisation opportunities, efficiency of work procedures, and the definition and efficiency of authorities, policies, processes and roles.

However, the Bank's staff members expect incentives in the financial recognition of their achievements, in their professional and personal progress, are seeking a more intensive and closer relationship with the Bank's top and middle management in order to have regular dialogue about their work and professional achievements, and need more feedback.

Based on the findings of the survey, in order to improve staff members' commitment, the Bank's management is elaborating a longer-term development plan and will monitor its realisation in the next two years.

Promotion opportunities and career management

Based on the findings of the commitment and satisfaction survey organised by the Bank, it can be said that our career development efforts commenced in 2009 have been welcome, and our staff members' satisfaction with career development has improved considerably. In order to make career at the Bank easier to plan and increase awareness in planning, in 2010 we continued to draw organisational 'career maps'. In addition, we introduced a career training programme to reveal individual development and career ambitions and their realisation, as well as individual career consultations.

The success of the management potential programme is shown in the fact that during 2010 two of the staff members who had participated in this programme were promoted to management positions as unit heads, and a further two staff members were appointed to be deputy unit heads.

Working conditions

The working conditions and circumstances provided for the employees have a fundamental role in employee commitment and working place atmosphere, have a significant impact on the efficiency and effectiveness of performance, and contribute to a major extent to the creation of an open organisational culture built on the assumption of individual responsibility. For this reason in 2010 the MNB placed special emphasis on the development of the working place to support employees. Within this framework, in addition to the project called 'Community spaces' launched in 2009, the development of flexible work and employment was realised and the Bank's health management strategy was worded. During both projects, i.e. the improvement of the flexible work conditions and the elaboration of the Bank's health management strategy, special attention was paid to the involvement of the affected parties (managers and other staff members alike): questionnaires, executive interviews, executive and employee focus groups supported the survey of satisfaction with the current solutions, and the disclosure of needs and opportunities.

Expansion of the various forms of flexible employment

During the past few years, several specific actions were taken to lay the foundations of flexible jobs (e.g. mobile jobs among executives and the introduction of the bi-monthly minimum working time). Based on feedback to improve the operation of the current practice and demand for further changes, upgrading the applied forms of flexible work and employment had become an issue very much on the agenda. A consideration of major account in the course of development was the optimisation of the risk factors formulated by unit heads, and the promotion of operational conditions (e.g. IT infrastructure conditions, regulation, preparation by the executive, and extensive communication by and between the staff members). As a result of the project the Central Bank introduced new forms of employment (e.g. part-time work from home), created standard regulation, and 18% of the staff members started to work in one of several flexible job forms with the executives' approval. 30% of the staff members having flexible jobs perform part-time work from home.

Health management

MNB has elaborated a three-year health management programme, placing emphasis on the realisation of a number of steps significant for health promotion, including annual overall status surveys and screenings. To increase employee involvement, a Health Team was set up to determine the topics to be highlighted in each quarter, and contribute to the realisation of the related programmes and communication.

In 2010 applications could be submitted for items facilitating the maintenance of health (185 were distributed), and in order to realise the health management programme the Bank contracted a new health care service provider.

Training and coaching

Based on the findings of the survey of the operation of the performance management system, in 2010 executive feedback on performance was brought into focus. In order to enhance assistance to the practical application of skills, methodological innovations were incorporated in training programmes. In a part of the executive programmes, actors and actresses were hired to help staff members live the various situations and problems, and in the framework of the executive club, invited lecturers represented the appearance of new executive mindset. In order to develop middle executives, and more specifically, among executive consultants and group or team leaders, the method of action learning groups was introduced on a test basis. This method supports the development of executive skills and feedback culture. The skill trainings are organised increasingly to reinforce, follow up and develop previous development programmes. In many cases the staff members motioned for support of their development.

In 2010 the so-called '360 degree' assessment providing feedback on executive performance covered the entire management. According to the 2010 assessment based on the executives' individual results, personal development plans are made and realised, while the findings valid for the Bank as a whole serve as a basis for the Bank's executive development concept and the content of the training planned within this framework.

Staff number and fluctuation

In 2010 the average headcount of the MNB (591.4 employees) was 13.5 people lower than in the previous year. At the end of 2010 the staff was 589 strong; thus the headcount was only 4 people (0.7%) less than at the end of 2009. 2010 headcount developments were primarily affected by the 2010 continuation of the initiatives formulated during the operational efficiency project, and the employment of external specialists having the competence required for the new tasks that emerged in the course of the year.

In 2010 63 employments were terminated. Termination was initiated by the employer in 27 cases, by the employee in 26 cases, and 10 employments were terminated due to retirement and other reasons (e.g. expiry of fixed-term contracts). On the other hand, 50 new staff members were employed in vacant or new positions in 2010.

As a result of these changes, the share of employees with higher education continued to increase in 2010, reaching a 1% higher ratio compared to the previous year. An analysis of the age composition reveals that the average age of the employees slightly rose (41 years in 2010). Compared with the previous year, in 2010 the average duration of employment by the Bank dropped from 12.8 years to 12.6 years.

In 2009, the fluctuation rate slightly decreased since the overwhelming majority of the terminations of employment in connection with the operating efficiency improving project had been performed in 2009. The voluntary departure rate was higher in 2010 than in 2009, but fewer key employees left the Bank. In 2010 the ratio of vacant positions occupied by MNB staff members rose, and the in-house movement of executives was outstanding. In 2010 60% of the vacant unit head positions and 75% of the department head positions were filled by MNB staff members. Due to falling sick leave ratios, in 2010 staff members' working time utilisation increased.

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 as full members. Within the committees and working groups, the central banks of different nations have the opportunity to

Table 6
Changes in labour fluctuation indicators

Indicators	2009	2010
Fluctuation		
Fluctuation rate (departing employees + new entries / 2 x total headcount)	12.8%	9.6%
Departure rate (leaving employees / total headcount)	17.0%	10.7%
Voluntary departure rate (ratio to total headcount)	4.0%	4.4%
Voluntary departure of key employees	6	2
Voluntary departure rate of key employees leaving the country	0.0%	0.0%
Recruitment		
Demands for recruitment	54	52
Ratio of recruitments to replace leaving employees to total rectruitment needs	72.2%	63.5%
Ratio of new entries to total headcount	8.6%	8.5%
Open positions filled internally	21.5%	37.3%
Working time		
Working time exploitation	84.0%	85.1%
Sick leave time to total working time	2.4%	1.6%

work together and formulate joint positions. This co-operation allows the representatives of individual national banks to obtain information on the work of the ECB on a regular basis.

The fields of activity (mandate) of the ESCB committees can be briefly summarised as follows.

Accounting and Monetary Income Committee (AMICO): Develops and regularly reviews the 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 co-ordination at an international level. Monitors the calculation of monetary income in accordance with the risk management process developed by the security framework system of accounting.

Banknote Committee (BANCO): Determines the euro banknote needs of euro area countries, co-ordinates 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, examination and development of security features to prevent euro banknotes from being counterfeited, and assessment of security risks related to the production of euro. Contributes to the harmonisation of practices applied in the euro area, the development of the system which monitors counterfeiting, and the verification of statistics related to euro banknotes and coins.

Banking Supervision Committee (BSC): The BSC regularly examines the effect of developments in economic conditions on the EU banking sector, the stability and proper functioning of the EU banking sector, and the impact of medium-term structural changes on EU banks. Furthermore, it provides assistance to the ESCB in carrying out regulatory tasks related to prudential supervision and financial stability. The Magyar Nemzeti Bank represents Hungary in the committee jointly with the Hungarian Financial Supervisory Authority (HFSA).

With the establishment of the Advisory Technical Committee (ATC) of the European Systemic Risk Board (ESRB), the BSC ceased to exist as an ESCB committee at the end of 2010, and from 2011 the ECB's decision-making bodies are assisted in the performance of their tasks related to financial stability by a new Eurosystem/ESCB committee called Financial Stability Committee (FSC).

Committee on Cost Methodology (COMCO): COMCO was established as an ESCB committee in July 2007 (only euro area NCBs participate in the work of this committee). COMCO contributes to the application and enhancement of the Common Eurosystem Cost Methodology, and 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 co-operation and information exchange on issues concerning the ESCB as a whole.

Eurosystem/ESCB Communications Committee (ECCO): Contributes to the development of the external communications policy of the Eurosystem, the ESCB and the ECB for the purpose of making the objectives defined by the Eurosystem/ESCB more transparent and understandable, and to informing the public about the tasks and activities of the Eurosystem and the ESCB.

Financial Stability Committee (FSC): As a new committee of the Eurosystem/ESCB, FSC started work in 2011, after BSC finished its work. Its task is to provide support to the ECB's decision-making bodies in their tasks related to financial stability.

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

International Relations Committee (IRC): Assists in carrying out those tasks of the ESCB which are related to international co-operation. It contributes to formulating the position of the Eurosystem regarding 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): 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): Contributes to the maintenance of the regulatory framework of the Eurosystem and the ESCB, monitors and reports on how national authorities and the institutions of the European Union comply with their consultation obligations related to the draft legislation in areas falling within the competence of the ECB.

Market Operations Committee (MOC): Assists the ESCB in the realisation of the single monetary policy and foreign exchange transactions, in the management of the reserves of the ECB and in the proper adaptation of the set of monetary policy instruments applied by the central banks of those Member States that have not yet adopted the euro and also in the application of ERM II.

Monetary Policy Committee (MPC): Assists the ESCB in the implementation of the single monetary and exchange rate policy of the Community. Furthermore, it assists in the execution of the ESCB's tasks related to the co-ordination 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): Assists the ESCB in the smooth operation of the payment system, including the provision of advice on the operation of TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer System), TARGET2, TARGET2-Securities, the SEPA (Single Euro Payment Area) and the CCBM (Correspondent Central Banking Model), as well as the cross-border use of collaterals. Furthermore, it supports the ESCB in general and 'oversight' issues related to payment systems, as well as issues concerning central banks in respect of securities clearing and settlement systems.

Risk Management Committee (RMC): In September 2010 the ECB decided on the establishment of a new forum called Risk Management Committee. The RMC has only euro area members. Its task is to assist the decision-making bodies of the ECB by analysis of and recommendations on the management and control of risks arising from Eurosystem market operations.

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

Other committees assisting the work of the ESCB include:

Budget Committee (BUCO): Assists the Governing Council of the ECB on issues concerning the budget of the ECB; it is composed of euro area NCBs.

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

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

Eurosystem Procurement Coordination Office (EPCO): Established in 2008, this office has the following tasks: facilitating the adoption of tested purchasing practices in the Eurosystem and developing the infrastructure required for joint purchases (e.g. skills, functional tools, IT systems and procedures); elaboration of common requirements in co-operation with NCBs participating in the joint tender procedure; and supporting NCBs in joint purchasing procedures.

3.12 PUBLICATIONS AND CONFERENCES ORGANISED BY THE MNB IN 2010

Publications

Quarterly Report on Inflation

Published four times a year, the objective of the publication is to help the public understand and monitor the policy of the central bank. In this publication the MNB regularly reports past and expected developments in inflation and assesses the macroeconomic trends affecting inflation, and presents summaries of the forecasts and considerations that constitute a basis for the Monetary Council's decisions.

Report on Financial Stability

This report outlines the position of the central bank vis-à-vis the developments in the financial system, and describes the effect of these changes on the stability of the financial system. In 2010 the publication was issued twice.

Beszámoló az MNB adott negyedévi tevékenységéről (Quarterly Report on MNB's activities)

This quarterly publication briefly reports on the activities of the professional areas of the central bank in the previous quarter (monetary policy, overview of the financial system, foreign exchange reserves, payment transactions, currency issuing activity, statistical changes). This publication is available only in Hungarian.

Annual Report

This publication presents the central bank's business report on the previous year and its audited financial statements.

Analysis of the Convergence Porcess

This publication was first issued by the MNB in 2005 and it is usually published once a year. In 2010 it was also published. With this publication the MNB intends to inform decision-makers, experts and the wider public about the complex issues related to membership of the monetary union.

MNB Occasional Papers

In this series economic analyses related to monetary decision-making by the MNB are published. The series aims at increasing the transparency of 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

These publications contain the results of analyses and research conducted at 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 2010 the fifth 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 the research projects of public interest in which the central bank is involved. In 2010 the publication was issued four times.

Other publications

In 2010 the MNB published 'Tájékoztató az államháztartásért felelős új miniszter részére a Magyar Nemzeti Bank működéséről' (Information to the new minister in charge of the general government on the operation of the National Bank of Hungary). This publication describes the role, tasks, current activities and operating environment of the MNB, the most important challenges currently affecting operation to the largest extent, the various economic policy objectives behind the MNB's activities, and the institutional environment that determines the MNB's decision-making practice, management and supervision.

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

Conferences and presentations

Conferences and scientific events

1–25 June 2010 ESCB EPCO (purchasing and co-ordination office of the Eurosystem) expert group meeting

8 June 2010 Mortgage bond issue models and their potential impacts on the mortgage bond market

9–10 June 2010 Meeting No. LXVI of ESCB's Information Technology committee

14–10 June 2010 Meeting of the ESCB WG EAA (Working Group of Euro Area Accounts)

23 June 2010 The Future of Central European Banks after the Financial Crisis – SUERF/Magyar Nemzeti Bank conference and 2010 SUERF annual presentation

28–29 June 2010 XII. EABCN (Euro Area Business Cycle Network) workshop: (International Business Cycle – Linkages, Differences and Implications, Budapest

23–24 September 2010 ESCB BANCO meeting

30 September–1 October 2010 9th Macroeconomic Policy Research Workshop on Understanding Financial Frictions – CEPR/MNB

18–19 November 2010 CE Board of Directors meeting

7 December 2010 Anti-counterfeiting conference

17 December 2010 Anchor 2011

BESS at MNB lectures

13 January 2010 Adam Szeidl (University of Berkeley): Consumption Commitments and Risk Preferences

3 February 2010 Arturo Ormeno (Universitat Pompeu Fabra): Disciplining Expectations: Using Survey Data in Learning Models

8 February 2010 Roman Sysuyev (University of Rochester): Ambiguity In A Two-Country World

8 February 2010 Cosimo Pancaro (European University Institute): The Balassa-Samuelson and the Penn effect: are they really the same?

18 February 2010 Ctirad Slavic (University of Minnesota): Asset Prices and Business Cycles with Financial Frictions

26 February 2010 Zoltán Pozsár (NY FED): Shadow Banking

3 March 2010 Bernd Willing (Munster School of Business and Economics, Germany): Identification of speculative bubbles using state-space models with Markov-switching

10 March 2010 Michael Reiter (IHS, Vienna): Approximate and Almost-Exact Aggregation in Dynamic Stochastic Heterogeneous-Agent Models

17 March 2010 Lucio Sarno (City University London): Spot and Forward Volatility in Foreign Exchange

31 March 2010 Robert P. Lieli (University of Texas at Austin): The Construction of Empirical Credit Scoring Rules Based on Maximization Principles

31 March 2010 Matteo Iacoviello (Boston College, USA): Financial Business Cycles

5 May 2010 Gert Peersman (Ghent University): Time Variation in U.S. Wage Dynamics

12 May 2010 Regis Barnichon (Federal Reserve Board): What drives movements in the unemployment rate?

19 May 2010 Guglielmo-Maria Caporale (Brunel University, London): Inflation and Inflation Uncertainty in the Euro Area

27 May 2010 Elod Takats (BIS): Aging and asset prices

2 June 2010 Richild Moessner (BIS): Central bank co-operation and international liquidity in the financial crisis of 2008–9

16 June 2010 Mikhail Golosov (Yale University): Optimal Dynamic Taxes

24 June 2010 John Boyd (Carlson School of Management): Banking Crises and Crisis Dating: Theory and Evidence

15 September 2010 Kristoffer Nimark (CREI, Barcelona): Speculative dynamics in the term structure of interest rates

13 October 2010 Salvador Ortigueira (EUI, Florence): How important is intra-household risk sharing for savings and labour supply?

27 October 2010 Ugo Panizza (Graduate Institute of International and Development Studies, Geneva, and United Nations): The Economics of Sovereign Debt and Sovereign Default

11 November 2010 Dirk Niepelt (Study Center Gerzensee; University of Bern; IIES, Stockholm University): Debt Maturity without Commitment

19 November 2010 Thomas Lubik (FED Richmond): On-the-job search and the cyclical dynamics of the labour market

1 December 2010 Gernot Mueller (University of Bonn):

Debt consolidation, spending reversals, and the transmission of fiscal policy

Training courses at the MNB

2010 spring course, 1st week: 22–26 March 2010

Solving, calibrating and evaluating structural models – Instructor: Prof. Fabio Canova (Universitat Pompeu Fabra, ICREA, and CEPR)

Empirical time series methods for policy analyses – Instructor: Prof. Fabio Canova (Universitat Pompeu Fabra, ICREA, and CEPR)

2010 spring course, 2nd week: 29 March–2 April 2010:

Inflation and the nominal side of the economy: closed and open economy considerations – Instructor: Prof. Tommaso Monacelli (Università Bocconi, IGIER, and CEPR)

Managing monetary policy in a small developing economy – Instructor: Prof. Zvi Eckstein (Deputy Governor, Central Bank of Israel and Tel Aviv University)

2010 autumn course, 1st week: 30 August–2 September 2010:

Financial frictions and the macroeconomy – Instructor: Prof. Larry Christiano (Northwestern University and NBER)

2010 autumn course, 2nd week: 6–10 September 2010

The macroeconomics of labour markets: basic concepts – Instructor: Prof. Christopher Pissarrides (London School of Economics and CEPR)

The macroeconomics of labour markets: advanced topics – Instructor: Prof. Claudio Michelacci (CEMFI and CEPR)

3.13 EXPLANATION OF ABBREVIATIONS AND TERMS SPECIFIC TO CENTRAL BANKING

Abbreviations

ALCO: Asset-Liability Committee

AMICO: Accounting and Monetary Income Committee (an ESCB committee)

BANCO: Banknote Committee (an ESCB committee)

BIS: Bank for International Settlements

BSC: Banking Supervision Committee (an ESCB committee)

BUCOM: Budget Committee

COMCO: Committee on Cost Methodology (an ESCB committee)

CSO: Central Statistical Office

ECB: European Central Bank

ECCO: Eurosystem/ESCB Communications Committee (an ESCB committee)

EISC: Eurosystem IT Steering Committee

EMU: Economic and Monetary Union

EPCO: Eurosystem Purchasing Coordination Office

ERM II: An exchange rate mechanism starting from the third stage of EMU; it essentially links the currencies of non-Eurosystem Member States to the euro.

ESCB: European System of Central Banks

FSC: Financial Stability Committee (an ESCB committee)

FSSC: Financial Sector Sub-Committee (a sub-committee of the NEC)

GIRO: Giro Clearing House Ltd.

HFSA: Hungarian Financial Supervisory Authority

HRC: Human Resources Conference

IAC: Internal Auditors' Committee (an ESCB committee)

ICS: Interbank Clearing System

IMF: International Monetary Fund

IRC: International Relations Committee (an ESCB committee)

ITC: Information Technology Committee (an ESCB committee)

KELER: Central Clearing House and Depository Ltd.

KOMAB: Communications Sub-Committee (a sub-committee of the NEC)

LEGCO: Legal Committee (an ESCB committee)

MOC: Market Operations Committee (an ESCB committee)

MPC: Monetary Policy Committee (an ESCB committee)

NCP: National Changeover Plan

NEC: National Euro Co-ordination Committee

O/N: O/N, overnight (deposit/loan)

OECD: Organisation for Economic Cooperation and Development

OSAP: National Statistical Data Collection Programme (in Hungary)

PSSC: Payment and Settlement Systems Committee (an ESCB committee)

SAO: State Audit Office

SEPA: Single Euro(pean) Payments Area, an EU objective aimed at having the quality of internal market payment transactions achieve that of intra-member transactions in the foreseeable future

STC: Statistics Committee (an ESCB committee)

SWIFT: Society for Worldwide Interbank Financial Telecommunication, an international society specialised in secure financial messaging

TARGET: Trans-European Automated Real-time Gross Settlement Express Transfer system, the real-time gross settlement system of the euro area

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

Glossary

CIF, FOB: Parities of elaborated standards (called Incoterms) applicable in world trade. Such a standard lays down the conditions of a commercial contract, clearly determining the obligations and responsibilities of the seller and the buyer. The CIF parity calculates the value of goods in foreign trade at the border of the resident country, while the FOB parity calculates it at the border of the exporting country. In the case of exports, the two values are identical, however, in the case of imports, unless neighbouring countries are involved, they differ. By definition, the goods import calculated at CIF parity is higher than the one calculated at FOB parity. Pursuant to the international methodological standards, in the balance of payments and the national accounts goods import values calculated at CIF parity in foreign trade must be converted to FOB parity.

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, handling the arising financial risk.

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

ERM II, Exchange Rate Mechanism II: An exchange rate mechanism for establishing the conditions for an exchange rate policy co-operation between Eurosystem states and Member States not participating in the third stage of EMU. ERM II is a multilateral arrangement of fixed but adjustable exchange rates, where the mid-rate is surrounded by a normal, ±–15% 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 specific Member State, the euro area states, the ECB and other Member States participating in the mechanism.

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.

Haircut: A risk management measure applied to assets used as collateral, during which the central bank reduces the market value of the asset by a given percentage when calculating the value of the collateral asset.

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: An interest rate futures contract is 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 – adjusted to market rates and certain conditions – interest on principal at determined intervals.

Monetary financial institutions: Comprised of the central bank, financial institutions and money market funds, the institutional category of monetary financial institutions is listed within the group of financial corporations.

Money market funds: Money market funds are investment funds the investment units of which are similar to bank deposits in terms 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.

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 owner of the option exercises 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, 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 participation of banks playing a decisive role in payment transactions (OTP, MKB, CIB, CITI, ING, MTB, Raiffeisen, BB, K&H and Unicredit) as well as the Hungarian State Treasury, GIRO Zrt. and KELER Zrt.

Payments: The sum of payments to and from the Central Bank.

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 to be specified or 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 or 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 equity of MNB, which, in the event of a negative balance, to the extent of the negative balance, are paid by the government budget to the adequate revaluation reserve by 31 March of the year following the year in question. The amount of the reimbursement is recorded in the balance sheet of the current year as a receivable from the central government.

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 re-purchased foreign exchange bonds) are 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

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

VaR (Value at risk): A measure of risk, 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

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This is an English translation of the Independent Auditors' Report on the 2010 statutory Annual Report of Magyar Nemzeti Bank issued in Hungarian. If there are any differences, the Hungarian language original prevails. This report should be read in conjunction with the complete statutory Annual Report it refers to.

Independent Auditors' Report

To the shareholder of Magyar Nemzeti Bank

Report on the Annual Report

We have audited the accompanying 2010 annual report of Magyar Nemzeti Bank (hereinafter referred to as "the Bank"), which comprise the balance sheet as at 31 December 2010, which shows total assets of MHUF 10,177,497 and retained loss for the year of MHUF 41,577 and the income statement for the year then ended, and supplementary notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Annual Report

Management is responsible for the preparation and fair presentation of this annual report in accordance with the provisions of the Act on Accounting and accounting principles generally accepted in Hungary, and for such internal control as management determines is necessary to enable the preparation of annual report are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on this annual report based on our audit. We conducted our audit in accordance with the Hungarian National Standards on Auditing (which are consistent in all relevant aspects with the International Standards on Auditing) and 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 annual report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual report. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the annual report, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the annual report 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 annual report.

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

Opinion

We have audited the annual report of Magyar Nemzeti Bank, its components and elements and their accounting and documentary support in accordance with Hungarian National Standards on Auditing and gained sufficient and appropriate evidence that the annual report has been prepared in accordance with the provisions of the Act on Accounting and accounting principles generally accepted in Hungary. In our opinion, the annual report gives a true and fair view of the financial position of Magyar Nemzeti Bank as of 31 December 2010, and of its financial performance and of the result of its operations for the year then ended.

Report on the Business Report

We have audited the accompanying 2010 business report of Magyar Nemzeti Bank.

Management is responsible for the preparation of the business report in accordance with the provisions of the Act on Accounting and accounting principles generally accepted in Hungary. Our responsibility is to assess whether this business report is consistent with the 2010 annual report. Our work with respect to the business report was limited to the assessment of the consistency of the business report with the annual report, and did not include a review of any information other than that drawn from the audited accounting records of the Bank.

In our opinion, the 2010 business report of Magyar Nemzeti Bank is consistent with the data included in the 2010 annual report of Magyar Nemzeti Bank.

Budapest, 5 April 2011

KPMG Hungária Kft.
Registration number: 000202

István Henye
István Henye
Partner, Professional Accountant
Identification number: 005674

2 Balance sheet of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	ASSETS	31. 12. 2009	31. 12. 2010	Change
1	2	3	4	4–3
	I. Receivables denominated in forint	**279,028**	**313,642**	**34,614**
4.3.	1. Receivables from the central government	279,027	278,593	−434
4.17.	of which: receivables to refund the revaluation reserve of foreign currency securities*	0	29,142	29,142
4.7.	2. Receivables from credit institutions	0	35,041	35,041
	3. Other receivables	1	8	7
	II. Receivables denominated in foreign currency	**8,592,938**	**9,685,552**	**1,092,614**
4.9.	1. Gold and foreign currency reserves	8,193,669	9,280,373	1,086,704
4.4.	2. Receivables from the central government	4,497	1,792	−2,705
4.8.	3. Receivables from credit institutions	1,043	7,336	6,293
4.10.	4. Other receivables	393,729	396,051	2,322
	III. Banking assets	**34,776**	**34,670**	**−106**
4.13.	of which: invested assets	34,016	34,527	511
4.15.	**IV. Prepaid expenses/accrued income**	**152,933**	**143,633**	**−9,300**
	V. TOTAL ASSETS (I+II+III+IV)	**9,059,675**	**10,177,497**	**1,117,822**

Reference number to notes on the Accounts	LIABILITIES AND EQUITY	31. 12. 2009	31. 12. 2010	Change
1	2	3	4	4–3
	VI. Liabilities denominated in forint	**6,320,547**	**6,502,092**	**181,545**
4.5.	1. Central government deposits	247,858	272,559	24,701
4.8.	2. Deposits by credit institutions	755,154	830,600	75,446
	3. Banknotes and coins in circulation	2,170,782	2,361,601	190,819
4.11.	4. Other deposits and liabilities	3,146,753	3,037,332	−109,421
	VII. Liabilities denominated in foreign currency	**2,355,769**	**3,172,249**	**816,480**
4.5.	1. Central government deposits	740,569	804,216	63,647
4.8.	2. Deposits by credit institutions	21,763	31,035	9,272
4.11.	3. Other deposits and liabilities	1,593,437	2,336,998	743,561
4.14.	**VIII. Provisions**	**5,283**	**3,352**	**−1,931**
	IX. Other banking liabilities	**18,757**	**17,521**	**−1,236**
4.15.	**X. Accrued expenses/deferred income**	**22,009**	**22,920**	**911**
4.16.	**XI. Equity**	**337,310**	**459,363**	**122,053**
	1. Share capital	10,000	10,000	0
	2. Retained earnings	9,461	75,003	65,542
	3. Valuation reserves	0	0	0
4.17.	4. Revaluation reserves due to exchange rate changes	230,792	415,937	185,145
4.17.	5. Revaluation reserves of foreign currency securities	21,515	0	−21,515
	6. Profit/Loss for the year	65,542	−41,577	−107,119
	XII. TOTAL EQUITY AND LIABILITIES (VI+VII+VIII+IX+X+XI)	**9,059,675**	**10,177,497**	**1,117,822**

** Pursuant to the Article 17, paragraph (4) of Act on MNB the central government reimbursed the recievables by 31 March 2011.*

5 April 2011, Budapest

Simor András
Governor of the Magyar Nemzeti Bank

3 Income statement of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	INCOME	2009	2010	Difference
1	2	3	4	4-3
4.19.	**I. Interest and interest related income denominated in forint**	**52,856**	**24,724**	**–28,132**
	1. Interest on receivables from the central government	27,793	18,024	–9,769
	2. Interest on receivables from credit institutions	17,883	1,885	–15,998
	3. Interest on other receivables	0	0	0
	4. Interest related income	7,180	4,815	–2,365
4.19.	**II. Interest and interest related income denominated in foreign currency**	**282,066**	**254,292**	**–27,774**
	1. Interest on foreign currency reserves	200,721	227,578	26,857
	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	3,028	2,639	–389
	5. Interest related income	78,317	24,075	–54,242
4.20.	**III. Income arising from exchange rate changes**	**143,613**	**53,088**	**–90,525**
4.19.	**IV. Realised gains arising from financial operations**	**46,069**	**52,310**	**6,241**
4.22.	**V. Other income**	**6,197**	**6,362**	**165**
	1. Fees and commissions	834	821	–13
4.23.	2. Income other than fees and commissions	5,363	5,541	178
4.14.	**VI. Provisions released**	**4,617**	**2,623**	**–1,994**
4.14.	**VII. Impairment released**	**1**	**1**	**0**
4.24.	**VIII. Operating income**	**1,738**	**190**	**–1,548**
	IX. TOTAL INCOME (I+II+III+IV+V+VI+VII+VIII)	**537,157**	**393,590**	**–143,567**

Reference number to notes on the Accounts	EXPENSES	2009	2010	Difference
1	2	3	4	4–3
4.19.	**X. Interest and interest related expenses denominated in forint**	**329,581**	**270,038**	**–59,543**
	1. Interest on central government deposits	36,408	23,319	–13,089
	2. Interest on deposits by credit institutions	67,338	28,642	–38,696
	3. Interest on other deposits	225,835	217,690	–8,145
	4. Interest related expenses	0	387	387
4.19.	**XI. Interest and interest related expenses denominated in foreign currency**	**68,995**	**62,728**	**–6,267**
	1. Interest on central government deposits	9,988	2,324	–7,664
	2. Interest on deposits of credit institutions	62	63	1
	3. Interest on other liabilities	19,933	26,519	6,586
	4. Interest related expenses	39,012	33,822	–5,190
4.20.	**XII. Expenses resulting from exchange rate changes**	**6,862**	**2,718**	**–4,144**
4.21.	**XIII. Cost of issuing banknotes and coins**	**8,162**	**8,547**	**385**
4.19.	**XIV. Realised losses arising from financial operations**	**36,760**	**73,978**	**37,218**
4.22.	**XV. Other expenses**	**5,357**	**2,259**	**–3,098**
	1. Fees and commissions	2,496	660	–1,836
4.23.	2. Expenses other than fees and commissions	2,861	1,599	–1,262
4.14.	**XVI. Provisions charged**	**743**	**692**	**–51**
4.14.	**XVII. Impairment**	**0**	**1,252**	**1,252**
4.24.	**XVIII. Operating costs and expenses**	**15,155**	**12,955**	**–2,200**
	XIX. TOTAL EXPENSES (X+XI+XII+XIII+XIV+XV+XVI+XVII+XVIII)	**471,615**	**435,167**	**–36,448**
	XX. Profit/loss before dividends (IX–XIX)	**65,542**	**–41,577**	**–107,119**
	XXI. Dividends from retained earnings	**0**	**0**	**0**
	XXII. Dividends	**0**	**0**	**0**
	XXIII. Profit/loss for the year (XX+XXI-XXII)	**65,542**	**–41,577**	**–107,119**

5 April 2011, Budapest

Simor András
Governor of the Magyar Nemzeti Bank

4 Notes to the financial statement

4.1 THE BANK'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 LVIII of 2001 on the Magyar Nemzeti Bank (hereinafter: Act on MNB) and Government Decree 221/2000 (XII.19) on special reporting and accounting requirements applicable to the Magyar Nemzeti Bank (hereinafter: MNB Decree).

As of the effective date of the Act promulgating the international treaty on the accession of the Republic 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 when they arise 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

– the 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,

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

– charging depreciation.

Upon the quarterly closing of accounts, the MNB qualifies 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 the invested assets, securities, claims and other off-balance sheet liabilities. As a result of this qualification, the Bank recognises impairment losses as necessary and makes provisions for liabilities and expected losses.

The balance sheet date is 15 January of the year following the reporting year.

By law, the MNB is also obliged 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 Act on MNB. 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 as defined by the Act on Accounting and adopted by the shareholder's resolution after approval by the supervisory board. The Annual Report is published in unabridged form on the Internet. The website is accessible at: http//english.mnb.hu.

The MNB Decree does not require the Bank to draw up consolidated financial statements. Consequently, as subsidiaries have no considerable 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/2006/16 (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 István Henye (KPMG Hungária Kft), Chamber membership number: 005674.

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 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 receivables associated with the reimbursement of revaluation reserves (due to their negative year-end balance).

No impairment loss may 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.

On mortgage bonds impairment losses 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, then 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 reported under gains/loss from exchange rate changes in the income statement.

The MNB carries out a 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.

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 shown under 'Equity', in the item 'Revaluation reserve due to exchange rate changes'.

Realised income is created as a result of selling and buying foreign currency. The latter occurs when the assets in a given currency are exceeded by counterpart 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 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 30 December, due to the fact that adequately liquid prices are not ensured on 31 December. As 31 December is not a trading day on European and Japanese stock exchanges, the valuation of securities is based on the latest available market prices.

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 historic 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 do not need to 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.

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 no effect on profit or loss if it is not 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 and are announced as hedging transactions at the start of the deal. 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. 2010
Concessions, licences and similar rights	17
Trade-marks patents and similar assets	14.5–50
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	6.5–33

** Residual value 20% 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 2010 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 2010, the MNB recorded a loss of HUF 41.6 billion. During the year the official forint exchange rate against the euro fluctuated widely and apart from a few days was weaker than the average cost rate. The difference between the official forint exchange rate and the average cost rate at the end of 2009 amounted to 8.28 forint/euro, which increased to 14.01 forint/euro by 31 December 2010. The total net revaluation effect was a gain of HUF 235.3 billion. The revaluation reserve due to exchange rate changes, as an unrealised foreign exchange gain, increased by HUF 185.1 billion to HUF 415.9 billion by 31 December 2010. In most of the year the volume of foreign currency sales was normal; it was higher only in the third quarter, when almost the half of the annual foreign exchange gain was realised. In this quarter the net EU funds were again re-channelled to the market by the MNB. Furthermore, two government foreign currency bonds matured, resulting in purchase of foreign currencies by ÁKK Zrt. mostly from the MNB. The realised foreign exchange gain amounted to HUF 50.4 billion in 2010.

In 2010 the bank recorded a HUF 53.8 billion net interest and interest-related loss, which was an advance of HUF 9.9 billion relative to the previous year. Net interest income was determined mainly by the increase in the Bank's net foreign currency receivables, which at the same time also resulted in an increase in forint liabilities bearing interest at the central bank base rate. Due to the effect of serial reduction in the central bank base rate at the beginning of the year, forint and foreign currency interest rates approached each other. That did not change significantly in the remaining part of the year, despite the year-end increase in the central bank rate implemented in two stages, since the average foreign currency interest rates increased in the last quarter as well. The average central bank base rate was 5.47% in 2010, which was lower by 316 basis points compared to the annual average of 2009.

For more details on impacts on net income, see Section 3.10 of the Business Report.

4.3 FORINT RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Remaining maturity	Balance 31. 12. 2009	Balance 31. 12. 2010	Change
	Government bonds maturing within 1 year	29,576	35,245	5,669
	Government bonds maturing within 1 to 5 years	101,834	66,589	–35,245
	Government bonds maturing over 5 years	147,617	147,617	0
	Government bonds	**279,027**	**249,451**	**–29,576**
	Receivables due to revaluation reserves of foreign currency securities	**0**	**29,142**	**29,142**
I.1.	**Total receivables from the central government**	**279,027**	**278,593**	**–434**

The amount of government bonds recorded at historic cost was HUF 249.5 billion at the end of 2010, a decrease of HUF 29.6 billion compared to end-2009. During the year there were no new purchases, but two bonds 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. The two maturities caused altogether a decrease of HUF 28.2 billion in the value of the securities and the scheduled repayment of an amortising bond (to be repaid annually over five years) resulted in a further decrease of HUF 1.4 billion.

Receivables due to the negative balance of revaluation reserves of foreign currency securities amounted to HUF 29.1 billion at the end of 2010; pursuant to Article 17, paragraph (4) of the Act on MNB, the central government must reimburse the negative balance by 31 March 2011; therefore, it is to be recorded as receivables from the central government in the year-end balance sheet. The central government reimbursed the amount of receivables on 31 March 2011.

4.4 FOREIGN CURRENCY RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance 31. 12. 2009	Balance 31. 12. 2010	Change
	Swap transactions with the central government	1,165	475	–690
	Currency swaps with the central government	3,332	1,317	–2,015
II.2.	**Foreign currency receivables from the central government**	**4,497**	**1,792**	**–2,705**

The balance of foreign exchange swap transactions with the central government derive from two HUF/EUR swaps dated 30 and 31 December 2010.

The HUF 1.3 billion balance of currency swaps with the central government contains currency swaps concluded with the ÁKK before July 2002, in the interests of adjusting the foreign currency and interest structure of foreign debt. The decrease of HUF 2.0 billion compared to the previous year resulted from expiry of one transaction matured in 2010, on the one hand, and from scheduled repayment of some transaction on the other. A further decrease of HUF 0.7 billion reflected the revaluation on the remaining amount.

Foreign currency receivables from the central government by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance 31. 12. 2009	Balance 31. 12. 2010	Change
	– within 1 year	2,886	1,031	–1,855
	– within 1 to 5 years	1,611	761	–850
	– over 5 years	0	0	0
II.2.	**Foreign currency receivables from the central government**	**4,497**	**1,792**	**–2,705**

Currency structure of swaps concluded with the central government

HUF millions

No.	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
1.	– HUF	296,156	203,826	–92,330
2.	– EUR currency group*	12,523	6,040	–6,483
3.	**Swap receivables (1+2)**	**308,679**	**209,866**	**–98,813**
4.	– HUF	746	432	–314
5.	– EUR currency group*	140,015	91,772	–48,243
6.	– JPY	32,413	25,788	–6,625
7.	– USD	131,008	90,082	–40,926
8.	**Swap payables (4+5+6+7)**	**304,182**	**208,074**	**–96,108**
9.	**Net swap receivables (3–8)**	**4,497**	**1,792**	**–2,705**

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

4.5 FORINT AND FOREIGN CURRENCY DEPOSITS OF THE CENTRAL GOVERNMENT

Forint deposits of the central government

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
	Single Treasury Account (KESZ)	247,426	272,099	24,673
	Deposit by Government Debt Management Agency (ÁKK Zrt)	369	397	28
	Other	63	63	0
VI.1.	**Forint deposits of the central government (total)**	**247,858**	**272,559**	**24,701**

Foreign currency deposits of the central government

The balance of the foreign currency liabilities of the central government amounted to HUF 804.2 billion on 31 December 2010, an increase of HUF 63.6 billion compared to the end of 2009.

The expiry dates of all central government foreign currency deposits are within a year; the total amount of deposits increased by nearly 9% compared to 31 December 2009. The average amount of foreign currency deposits in 2010 was HUF 162.7 billion lower relative to the previous year.

4.6 NET POSITIONS VIS-À-VIS CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
I.1.–VI.1.	Net forint position	31,169	6,034	–25,135
II.2.–VII.1.	Net foreign currency position	–736,072	–802,424	–66,352
	Total	**–704,903**	**–796,390**	**–91,487**

4.7 FORINT RECEIVABLES FROM CREDIT INSTITUTIONS

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2009	31. 12. 2010	
	Covered mortgage bonds maturing within 1 year	0	2,627	2,627
	Covered mortgage bonds maturing within 1 to 5 years	0	33,666	33,666
	Covered mortgage bonds maturing over 5 years	0	0	0
	Total receivables from credit institutions in gross value	**0**	**36,293**	**36,293**
	Impairment loss for covered mortgage bonds	**0**	**−1,252**	**−1,252**
I.2.	**Total receivables from credit institutions**	**0**	**35,041**	**35,041**

The total amount of the forint receivables from credit institutions at the end of 2010 includes receivables in connection with mortgage bonds. The amount of receivables in gross value contains the cost price difference besides the face value. In line with a February 2010 decision of the Monetary Council, the MNB started a mortgage bond buying programme in March 2010 in favour of the long-term development of the domestic mortgage bonds market. Within the framework of this activity the MNB could purchase mortgage bonds both in the primary market and secondary market. Purchased mortgage bonds are qualified as securities held for monetary purpose. Whereas these are not government bonds, in the case of bonds' market price falling below the purchase price, an impairment loss must be recorded on these bonds at the end of the year, as set forth in the MNB Decree. The market price of mortgage bonds was HUF 1.3 billion lower than their purchase price on 31 December 2010.

4.8 NET POSITIONS VIS-À-VIS CREDIT INSTITUTIONS

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
I.2.—VI.2.	Net forint position	−755,154	−795,559	−40,405
II.3.—VII.2.	Net foreign currency position	−20,720	−23,699	−2,979
	Total	**−775,874**	**−819,258**	**−43,384**

The net liabilities to credit institutions had increased by HUF 43.4 billion by the end of 2010. The net forint position deteriorated by HUF 40.4 billion compared to the previous year, in which the system of optional minimum reserve introduced by the MNB from November 2010 played an important role. Within the framework of this system banks could choose a minimum reserve rate over 2%. In the context of this the amount of minimum reserves rose in November and December. The change of position arising from the increase of the minimum reserve's amount was offset by receivables in connection with MNB's mortgage bond buying programme. The total amount of net foreign currency liabilities rose by HUF 3 billion compared to the end of the previous year. The net foreign currency position was increased by HUF 6.3 billion by the net swap receivables concluded with credit institutions. An increase totalling HUF 8.5 billion of short-term money market foreign currency deposits with the MNB placed by credit institutions exercised an opposite influence on net positions, and the amount of deposits was HUF 29.9 billion at the end of 2010.

4.9 GOLD AND FOREIGN EXCHANGE RESERVES OF THE CENTRAL BANK

Forint balances

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
	Gold reserve	20,545	29,071	8,526
	Reserve position in the IMF	21,690	23,725	2,035
	Foreign currency deposits	582,636	820,390	237,754
	Foreign currency securities	7,306,055	8,316,634	1,010,579
	Foreign currency repo transactions	262,743	90,553	−172,190
II.1.	**Gold and foreign currency reserves (total)**	**8,193,669**	**9,280,373**	**1,086,704**

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

Foreign exchange reserves not including accrued interest rose by HUF 1,086.7 billion to HUF 9,280.4 billion by 31 December 2010. The change was caused both by the rise in balances and by depreciation of the exchange rate.

Euro balances

EUR millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
	Gold reserve	76	104	28
	Reserve position in the IMF	80	85	5
	Foreign currency deposits	2,151	2,943	792
	Foreign currency securities	26,976	29,835	2,859
	Foreign currency repo transactions	970	325	–645
II.1.	**Gold and foreign currency reserves (total)**	**30,253**	**33,292**	**3,039**

The official exchange rate of the forint was 270.84 HUF/EUR on 31 December 2009 and 278.75 HUF/EUR on 31 December 2010.

The main causes of the increase in the amount of gold and foreign currency reserves were the conversion of foreign currency (into forint) with the MNB arising from Hungarian government securities issued by ÁKK in January, net EU transfers, prepayment from loans granted to domestic credit institutions by the Hungarian state within the scope of the financial stability package and market yields of the reserves. The maturity of two foreign exchange bonds issued earlier by ÁKK reduced the level of the gold and foreign currency reserves, as did 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 had increased by EUR 3 billion by 31 December 2010.

4.10 OTHER FOREIGN CURRENCY RECEIVABLES

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
	Forint payment of IMF quota	283,351	309,944	26,593
	Repurchased bonds	73,133	73,282	149
	Foreign hedging transactions*	36,794	11,859	–24,935
	Other	451	966	515
II.4.	**Other foreign currency receivables**	**393,729**	**396,051**	**2,322**

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

The forint payment of IMF quota increased due to the depreciation of the forint exchange rate in comparison to SDR by 6.7%.

The amount of bonds issued by the MNB abroad and subsequently repurchased decreased by HUF 12.7 billion owing to April maturity, but the depreciation of the forint exchange rate in comparison to Japanese yen and American dollar offset this; thus the amount had increased by HUF 12.8 billion at the end of the year.

The line 'Foreign hedging transactions' includes the swap transactions related to the IMF loan of 2009, and the over one year credit balance of currency swap transactions with non-resident counterparties concluded by the MNB in 2010.

4.11 OTHER DEPOSITS AND LIABILITIES

Other forint liabilities

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
	Two-week MNB bills	3,130,710	3,024,699	–106,011
	International financial institutions forint deposits	15,390	11,958	–3,432
	Other liabilities	653	675	22
VI.4.	**Other forint deposits and liabilities**	**3,146,753**	**3,037,332**	**–109,421**

The end-of-2010 balance of other forint deposits and liabilities showed a decrease of HUF 109.4 billion compared to the previous year-end, almost all due to the reduction in the amount of two-week MNB bills. However, the annual average stock of two-week MNB bills was higher by HUF 1,283.4 billion in 2010 than in 2009. Because of the foreign currency conversion fulfilled in the first half of 2010, the amount of increased Bank's net forint currency receivables supplied the economy with additional forint liquidity, and this was absorbed with an increasingly large volume of two-week bills. Though a rise of foreign currency swaps concluded with credit institutions occurred in the second half of the year, the result was still a decrease of the MNB bill's amount. 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. 2009	31. 12. 2010	
	Bonds	169,974	169,990	16
	Repo transactions	405,629	1,091,864	686,235
	IMF forint deposit	982,736	1,010,503	27,767
	Foreign deposits and loans	16,558	39,073	22,515
	Hedging transactions*	17,122	24,785	7,663
	Other liabilities	1,418	783	–635
VII.3.	**Other foreign currency liabilities**	**1,593,437**	**2,336,998**	**743,561**

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

An increase of HUF 743.6 billion in other foreign currency liabilities was caused by a HUF 686.2 billion growth of foreign currency liabilities from repo transactions. Repo transactions concluded with the ECB on the two last days of 2010 amounted to EUR 1.8 billion and formed a significant part of the end-of-year repo transactions. The line 'Hedging transactions' mainly consists of net swap liabilities, which are related to the IMF loan.

Other foreign currency liabilities by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2009	31. 12. 2010	
	– within 1 year	1,152,890	1,926,943	774,053
	– within 1 to 5 years	129,052	91,600	–37,452
	– over 5 years	311,495	318,455	6,960
VII.3.	**Other foreign currency liabilities**	**1,593,437**	**2,336,998**	**743,561**

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

HUF millions

No.	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
1.	– USD	48,204	48,232	28
2.	– EUR currency group*	411,874	1,124,742	712,868
3.	– JPY	132,360	128,260	–4,100
4.	– SDR	263,065	318,455	55,390
5.	– Other	720,812	692,524	–28,288
6.	**Other foreign currency liabilities**	**1,576,315**	**2,312,213**	**735,898**

** The euro 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 line 'Other' amounted to HUF 692.5 billion at the end of 2010 and mainly contains the forint coverage of the IMF quota, which accounted for HUF 673.6 billion.

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

HUF millions

No.	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
1.	– USD	46,805	46,743	–62
2.	– EUR currency group*	257,243	117,149	–140,094
3.	– JPY	197,583	139,111	–58,472
4.	– Other	0	382,104	382,104
5.	**Hedging transactions receivables (1+2+3+4)**	**501,631**	**685,107**	**183,476**
6.	– USD	148,011	0	–148,011
7.	– EUR currency group*	368,909	303,570	–65,339
8.	– JPY	1,833	0	–1,833
9.	– SDR	0	406,322	406,322
10.	**Hedging transactions payables (6+7+8+9)**	**518,753**	**709,892**	**191,139**
11.	**Net hedging transactions payables (10–5)**	**17,122**	**24,785**	**7,663**

** The euro 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. 2009	31. 12. 2010	
from II.1.	IMF quota paid in SDR	21,690	23,725	2,035
from II.1.	Deposit with IMF	277,139	240,882	–36,257
from II.1.	Deposit with IMF for Fund's programme purposes	2,713	2,968	255
from II.4.	IMF quota paid in HUF	283,351	309,944	26,593
from II.4.	Swap receivables from IMF	408,254	0	–408,254
from II.4.	Swap payables to IMF	–371,460	0	371,460
	Total receivables	**621,687**	**577,519**	**–44,168**
from VII.3.	Liabilities arising from SDR Allocations	291,131	318,454	27,323
from VII.3.	IMF No. 2. account	1	1	0
from VII.3.	IMF No. 1. account	691,604	692,048	444
from VII.3.	Swap receivables from IMF	0	–382,104	–382,104
from VII.3.	Swap payables to IMF	0	406,322	406,322
	Total liabilities	**982,736**	**1,034,721**	**51,985**
	Total	**–361,049**	**–457,202**	**–96,153**

The IMF loan amounting to SDR 1.3 billion was drawn down by the MNB in 2009. According to the IMF's instructions, 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 in 2010: the amount of forint receivables is determined by the IMF, and the volume of liabilities depends on the foreign exchange rate of SDR. The liability from IMF is shown in the line 'Swap payables to IMF' of the table and amounted to HUF 406.3 billion on 31 December 2010. 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 line 'Liabilities arising from SDR allocations' represents the unmatured liability of HUF 318.4 billion (i.e. SDR 991.1 million) 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 in 2010.

The forint-denominated promissory note related to the liability from 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 2,057.4 billion at 31 December 2009 and had decreased to HUF 1,925.6 billion by 31 December 2010.

4.13 INVESTED ASSETS

In addition to intangibles, tangibles and capital expenditure (HUF 16.2 billion), invested assets include shares in investments (HUF 7.8 billion in foreign investments and HUF 10.5 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. 2009	**7,881**	**81**	**12,070**	**11,116**	**227**	**277**	**31,652**
Installation/Repurchases	646	−65	350	983	6	−69	1,851
Other addition	139	6	0	0	0	0	145
Scrapping	−252	0	0	−227	0	0	−479
Selling	0	0	0	−184	0	0	−184
Transfer free of charge	0	0	−37	−812	0	0	−849
Other disposal/reclassification	−713	0	0	−9	−3	0	−725
31. 12. 2010	**7,701**	**22**	**12,383**	**10,867**	**230**	**208**	**31,411**
Details of depreciation							
31. 12. 2009	**6,332**	**0**	**1,920**	**6,822**	**0**	**0**	**15,074**
Planned depreciation	819	0	382	980	0	0	2,181
Removal from the account	−820	0	−37	−1,210	0	0	−2,067
Decrease due to reclassification	0	0	0	0	0	0	0
31. 12. 2010	**6,331**	**0**	**2,265**	**6,592**	**0**	**0**	**15,188**
Closing net value							
31. 12. 2009	**1,549**	**81**	**10,150**	**4,294**	**227**	**277**	**16,578**
31. 12. 2010	**1,370**	**22**	**10,118**	**4,275**	**230**	**208**	**16,223**
Change	**−179**	**−59**	**−32**	**−19**	**3**	**−69**	**−355**

Foreign investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2009	31. 12. 2010	31. 12. 2009	31. 12. 2010	2009	2010
BIS	1.43	1.43	5,404	6,225	671	1,967
SDR millions			*10*	*10*		
CHF millions			*13.5*	*13.5*		
European Central Bank	1.39	1.39	1,513	1,559	0	0
EUR thousands			*5,587*	*5,591*		
SWIFT	0.02	0.02	2	2	0	0
EUR thousands			*8.6*	*8.6*		
Total investments			**6,919**	**7,786**	**671**	**1,967**

** Dividends financially settled in the given year.*

In 2010 the BIS distributed a higher dividend than usual, being higher by HUF 1.3 billion in comparison with the previous year. The organization closed a successful business year, thus the normal size of dividend amounting to SDR/share 285 was supplemented by SDR/share 400 by the BIS.

On 1 May 2004 Hungary joined the European Union. 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 comprises the ECB and 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 which 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%, 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% i.e. EUR 79.8 million as of 1 January 2009.

Entering into force on 29 December 2010 the ECB's subscribed capital increased by EUR 5 billion to 10,761 million 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 has to be paid up by non-euro area NCBs changed as well; 3.75% of their share in the subscribed capital of the ECB shall be paid instead of the former 7%, pursuant to Article 47 of the Statute. As a consequence of the aforementioned changes, MNB paid a minor amount (EUR 3,863) on 29 December 2010, thus the value of participation in MNB's balance sheet remained EUR 5.6 million.

Since 1 January 2011 the legal tender of Estonia has been the euro, thus the Eesti Pank now constitutes one of the euro area NCBs.

Ownership distribution in the ECB on 31 December 2010

National Central Banks (NCBs)	Subscribed capital	Paid-up capital	Capital key (%)
	EUR thousands		
Nationale Bank van België / Banque Nationale de Belgique	261,010	180,157	2.4256
Deutsche Bundesbank	2,037,777	1,406,534	18.9373
Bank of Greece	211,436	145,939	1.9649
Banco de España	893,565	616,765	8.3040
Banque de France	1,530,294	1,056,254	14.2212
Central Bank and Financial Services Authority of Ireland	119,519	82,495	1.1107
Banca d'Italia	1,344,716	928,162	12.4966
Central Bank of Cyprus	14,731	10,168	0.1369
Banque centrale du Luxemburg	18,799	12,976	0.1747
Central Bank of Malta / Bank Centrali ta' Malta	6,801	4,694	0.0632
De Nederlandsche Bank	429,156	296,216	3.9882
Österreichische Nationalbank	208,940	144,216	1.9417
Banco de Portugal	188,354	130,008	1.7504
Banka Slovenije	35,381	24,421	0.3288
Národná banka Slovenska	74,614	51,501	0.6934
Suomen Pankki-Finlands Bank	134,928	93,131	1.2539
Subtotal for euro area NCBs	**7,510,021**	**5,183,637**	**69.7915**
Danmarks Nationalbank	159,634	5,986	1.4835
Sveriges Riksbank	242,997	9,112	2.2582
Bank of England	1,562,145	58,581	14.5172
Česká národní banka	155,728	5,840	1.4472
Eesti Pank	19,262	722	0.1790
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	**3,250,631**	**121,899**	**30.2085**
Total NCBs	**10,760,652**	**5,305,536**	**100.0000**

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 will be 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.

Domestic investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2009	31. 12. 2010	31. 12. 2009	31. 12. 2010	2009	2010
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 17.	100.0	100.0	8,927	8,927	1,120	1,688
Magyar Pénzverő Zrt. 1239 Budapest, Európa u. 1.	100.0	100.0	575	575	260	811
KELER Zrt. 1075 Budapest, Asbóth utca 9–11.	53.3	53.3	643	643	0	0
KELER KSZF Kft. 1075 Budapest, Asbóth utca 9–11.	13.6	13.6	7	7	0	0
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	7.3	7.3	46	46	154	132
Budapesti Értéktőzsde Zrt. 1062 Budapest, Andrássy út 93.	6.9	6.9	321	321	158	96
Total investments			**10,519**	**10,519**	**1,692**	**2,727**

** Dividends financially settled in the given year.*

Key indicators of domestic investments (preliminary data*)

HUF millions

Investment	Share capital	Reserves	Profit/loss for the year	Equity	Profit/loss for the year after taxation
	31. 12. 2010	31. 12. 2010	31. 12. 2010	31. 12. 2010	2010
Pénzjegynyomda Zrt.	8,927	83	0	9,010	890
Magyar Pénzverő Zrt.	575	346	0	921	415
KELER Zrt.	4,500	11,494	1,785	17,779	1,983
KELER KSZF Kft.	20	229	174	423	174
GIRO Elszámolásforgalmi Zrt.	2,496	3,600	15	6,111	1,675
Budapesti Értéktőzsde Zrt.	541	4,879	1,321	6,741	1,321

** Upon compilation of the Annual Report these are the latest data and in the case of affiliated firms with 100% ownership audited data.*

HUF millions

Investment	Net sales revenue		Financial income		Other income		Extraordinary income	
	2009	2010	2009	2010	2009	2010	2009	2010
Pénzjegynyomda Zrt.	7,642	7,752	472	286	20	19	0	0
Magyar Pénzverő Zrt.	3,689	3,556	75	41	201	4	0	0
KELER Zrt.	n. a.	n. a.	8,299	9,263	354	257	0	0
KELER KSZF Kft.	595	636	10	141	0	0	0	0
GIRO Elszámolásforgalmi Zrt.	n. a.	n. a.	4,687	4,641	1,268	1,320	0	0
Budapesti Értéktőzsde Zrt.	3,193*	3,397*	271	106	8	13	0	0

n. a.: revenue is not applicable data.
** Income from Stock Exchange related activities.*

Investment	Average number of staff	
	31. 12. 2009	31. 12. 2010
Pénzjegynyomda Zrt.	435	419
Magyar Pénzverő Zrt.	42	38
KELER Zrt.	121	113
KELER KSZF Kft.	4	0
GIRO Elszámolásforgalmi Zrt.	128	128
Budapesti Értéktőzsde Zrt.	61	59

The MNB's receivables from and liabilities to affiliated companies

HUF millions

Investment	Receivables	Liabilities
Pénzjegynyomda Zrt.	0	110
Magyar Pénzverő Zrt.	16	4
KELER Zrt.	0	4
KELER KSZF Kft.	0	0
GIRO Elszámolásforgalmi Zrt.	0	1
Budapesti Értéktőzsde Zrt.	0	0
Total	**16**	**119**

The above 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 up to the introduction of the euro. Then the production of forint banknotes will be terminated and, according to the decision of the MNB, Pénzjegynyomda Zrt. will not produce euro banknotes. This may incur potential but presently unquantifiable losses for the MNB, so the Bank has not recognised an impairment loss on the investment.

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. When its capacity allows, it produces non-legal tender commemorative coins and coins for foreign markets on the basis of its own coin programme and upon customized order. Within the range of its commercial activity the company sells commemorative coins, collector banknotes, medals and gold investment products. Professional support for coin acceptance by vending machines and enhancement of the protection against the counterfeit of forint and euro coins were the outstanding activities in 2010. Owing to falling demand for the production of circulation coins, further measures were taken and solutions were worked out to improve effectiveness and maintain profitability. In the field of commerce a webshop was opened for developing e-business. As a consequence of these efforts, the company achieved a high profit in 2010, exceeding even the profit of the base year.

4.14 IMPAIRMENT LOSS AND PROVISIONS

HUF millions

B/S line	Description	31. 12. 2009	Interim changes in 2010		31. 12. 2010
		Impairment loss / Provisions	Increase (+)	Reversal (–)	Total impairment loss / provisions
1	2	3	4	5	3+4+5
from I.2.	Forint receivables from credit institutions	0	1,252	0	1,252
from III.	Other assets	21	0	–1	20
VIII.	Liabilities	5,283	692	–2,623	3,352
	– derivatives	158	234	–158	234
	– bond lending	5,125	458	–2,465	3,118
	Total	**5,304**	**1,944**	**–2,624**	**4,624**

Impairment losses and provisions decreased by HUF 680 million in 2010.

For the mortgage bonds bought for monetary purposes shown in the line 'receivables from credit institutions' HUF 1,252 million were recorded as impairment losses due to the fact that the market value of the bonds was lower than their book value.

The whole amount of the provision for the negative market value of derivatives for purposes other than hedging created at the end of 2009 was released owing to maturity of transactions. Provisions amounting to HUF 234 million had to be created due to the negative market value of the open interest rate futures position on 31 December 2010 recorded as off-balance sheet item.

According to the international securities lending contracts the MNB is charged by the whole amount of the potential losses arising from cash-hedge investments made by agents. Covering this loss as a future liability provision has to be created based on the principle of prudence. Up to the end of 2010 additional provisions of HUF 458 million became necessary; however, HUF 2,465 million provisions created in 2009 was released in the course of the year owing to maturity or better market valuation of some securities. Provisions were not utilised because no loss was realised on the transactions.

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

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
	Due to banking transactions	152,797	143,523	−9,274
	Due to internal operation	136	110	-26
IV.	**Prepaid expenses/accrued income**	**152,933**	**143,633**	**−9,300**
	Due to banking transactions	21,083	21,917	834
	Due to internal operation	926	1,003	77
X.	**Accrued expenses/deferred income**	**22,009**	**22,920**	**911**

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 the financial settlement.

4.16 CHANGES IN EQUITY

HUF millions

B/S line	Description	31. 12. 2009	Interim changes	31. 12. 2010
XI.1.	Share capital	10,000	0	10,000
XI.2.	Retained earnings	9,461	65,542	75,003
XI.3.	Valuation reserves	0	0	0
XI.4.	Revaluation reserves due to exchange rate changes	230,792	185,145	415,937
XI.5.	Revaluation reserves of foreign currency securities	21,515	−21,515	0
XI.6.	Profit/Loss for the year	65,542	−107,119	−41,577
XI.	**Equity**	**337,310**	**122,053**	**459,363**

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

Pursuant to the Act on MNB, the MNB's dividend is specified by the shareholder. According to the decision of the shareholder, the MNB will not pay any dividend from the retained earnings for the year 2010.

For more details about the revaluation reserves, see Section 4.17.

4.17 REVALUATION RESERVES

HUF millions

B/S line	Description	31. 12. 2009	31. 12. 2010	Change
XI.4.	Revaluation reserves due to exchange rate changes	230,792	415,937	185,145
XI.5.	Revaluation reserves of foreign currency securities*	21,515	0	−21,515
	Total revaluation reserves	**252,307**	**415,937**	**163,630**

** The end-2010 balance on the revaluation reserves of foreign currency securities indicated a loss, which the central government reimbursed by 31 March 2011.*

The official forint exchange rate against the euro fluctuated in a wide range in 2010: it strengthened in the first quarter and weakened from April in accordance with the currencies of other central European countries, and in summer as a result of Hungary's risk perception. However, it started to strengthen from middle September. On the whole it weakened by HUF 7.91 in contrast with 2009, being 278.75 HUF/EUR as of 31 December 2010. The average cost rate rose by HUF 2.18 to 264.74 HUF/EUR. 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 185.1 billion to HUF 415.9 billion.

Revaluation reserves of foreign currency securities include the difference between market value and book value of securities; these represent non-realised gains or losses for the Bank. Due to the effects of yield changes on the market, non-realised gains on foreign currency securities rose by HUF 50.7 billion. The central government is obliged to reimburse the negative balance of non-realized losses on foreign currency securities amounting to HUF 29.1 billion up to 31 March 2011, thus this amount is shown in the line 'Receivables from central government' instead of 'Revaluation reserves of foreign currency securities'.

Annual changes in the forint exchange rate

forint/euro

Date	MNB official exchange rate	Average cost rate
31. 12. 2009	270.84	262.56
31. 12. 2010	278.75	264.74
Annual depreciation		
In 2009	2.3%	
In 2010	2.9%	

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

Liabilities arising from hedging transactions and related receivables

HUF millions

No.	Description	31. 12. 2009			31. 12. 2010		
		Receivables	Liabilities	Net market value	Receivables	Liabilities	Net market value
1.	Interest rate swap transaction	328,478	328,478	10,185	335,996	335,996	5,351
2.	CDS transaction	44,689	44,689	−148	11,150	11,150	489
3.	Interest rate future transaction	0	0	0	0	723,213	−1,473
4.	**Total hedging transaction (1+2+3)**	**373,167**	**373,167**	**10,037**	**347,146**	**1,070,359**	**4,367**

The aim of interest rate swap transactions for hedging purposes linked to the given bond issuing is to achieve the interest structure deemed desirable by the MNB.

Some of the interest rate swap transactions have been made 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.

Under the line 'CDS transaction' (Credit Default Swap) two transactions are recorded, the aim of which is to decrease the credit risk of securities. Transactions will mature in 2012 and in 2013.

The aim of interest rate future transactions with maximum one year maturity is to protect against an increase of yields of securities in MNB's portfolio and foreign government bonds.

Liabilities arising from other forward transactions

HUF millions

No.	Description	31. 12. 2009		31. 12. 2010	
		Balance	Market value	Balance	Market value
1.	Options	3,072	90	1,463	4
2.	Future transaction	39,594	62	0	0
3.	Swap transaction	27,084	2,673	66,900	1,380
4.	**Total other forward transactions (1+2+3)**	**69,750**	**2,825**	**68,363**	**1,384**

Breakdown of options

HUF millions

No.	Description	Net market value	
		31. 12. 2009	31. 12. 2010
1.	Long call option	0	4
2.	Long put option	90	0
3.	Short call option	0	0
4.	Short put option	0	0
5.	**Total (1+2+3+4)**	**90**	**4**

Liabilities arising from derivative transactions by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2009	31. 12. 2010	
	– within 1 year	33,961	912,520	878,559
	– within 1 to 5 years	322,711	152,264	–170,447
	– over five years	16,495	5,575	–10,920
1.	**Hedging transactions**	**373,167**	**1,070,359**	**697,192**
	– within 1 year	42,666	1,463	–41,203
	– within 1 to 5 years	0	66,900	66,900
	– over five years	27,084	0	–27,084
2.	**Other forward transactions**	**69,750**	**68,363**	**–1,387**
3.	**Total (1+2)**	**442,917**	**1,138,722**	**695,805**

Other off-balance sheet liabilities

HUF millions

No.	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
1.	IMF security deposit account	2,057,411	1,925,628	–131,783
2.	Guarantees	2,004	1,332	–672
3.	Other off-balance sheet liabilities	2	2	0
4.	**Total (1+2+3)**	**2,059,417**	**1,926,962**	**–132,455**

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 line '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 2010 the balance of guarantees decreased as a consequence of dissolution of 11 guarantees.

In March 2010 survivors of the Hungarian Holocaust and their descendants submitted a statement of claim to the United States District Court, Northern District of Illinois, Eastern Division against the MNB and four other Hungarian banks. The claim is based on the complaint that certain properties were expropriated by the defendants during World War II and they have not returned them since then. On 31 December 2010 off-balance sheet liability in connection with the Holocaust proceeding was not recorded, as the amount of potential damages is not known; furthermore, it seems plausible that the Bank's individual responsibility cannot be defined on the basis of the claim. For more details about the Holocaust proceeding, see Section 3.10 of the Business Report in the part 'General operating costs'.

Other off-balance sheet liabilities by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2009	31. 12. 2010	
	– within 1 year	1,981	1,305	–676
	– within 1 to 5 years	2,057,436	1,925,657	–131,779
	– over five years	0	0	0
1.	**Total other liabilities**	**2,059,417**	**1,926,962**	**–132,455**

Recording off-balance sheet security transactions

HUF millions

No.	Description	Balance		Change
		31. 12. 2009	31. 12. 2010	
1.	Face value of securities lent	957,468	883,386	–74,082
2.	Purchase cost of the non-cash hedge arising from security lending transactions	37,056	103,069	66,013
3.	Investment of cash hedge arising from security lending transactions			
	– at purchase cost	855,127	763,631	–91,496
	– at market value	850,002	760,513	–89,489
4.	Face value of securities bought under repo transactions	253,655	88,720	–164,935
5.	Face value of securities sold under reverse repo transactions	611,262	1,163,349	552,087

Regarding the 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	2009	2010	Change
1	2	3	4	4–3
(I.1.+II.2.)–(X.1.+XI.1.)	Central government	–18,603	–7,619	10,984
(I.2.+II.3.)–(X.2.+XI.2.)	Credit institutions	–49,517	–26,820	22,697
(I.3.+II.1.+II.4.)–(X.3.+XI.3.)	Other	–42,019	–13,992	28,027
	Net profit from interest	**–110,139**	**–48,431**	**61,708**
from lines (I.4.–X.4.)	Forint securities	7,180	4,427	–2,753
from lines (II.5.–XI.4.)	Derivative transactions for hedging and other purposes*	38,925	–9,177	–48,102
from lines (II.5–XI.4.)	Other	380	–569	–949
(I.4.+II.5.)–(X.4.+XI.4.)	**Net interest related profit**	**46,485**	**–5,319**	**–51,804**
(I.+II.)–(X.+XI.)	**Net interest and interest related income**	**–63,654**	**–53,750**	**9,904**

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

In 2010 the Bank recorded a HUF 53.8 billion net interest and interest related loss, an improvement of HUF 9.9 billion compared to the figure for end-2009, which amounted to a HUF 63.7 billion loss.

Net interest income was higher by HUF 61.7 billion in comparison with end-2009.

The net interest income was increased by the following factors:

– an increase of the interest income on foreign exchange reserves by HUF 26.9 billion in 2010 compared to the preceding year,

– lower interest expenses on government deposits denominated in forint and in foreign currency by HUF 20.8 billion relative to 2009,

– a decrease of the interest expenses on credit institutions' deposits by HUF 38.7 billion,

– lower interest expenses on two-week MNB bills by HUF 8.2 billion.

The net interest income was decreased by the following factors:

– a decrease of the interest income on government bonds by HUF 9.8 billion relative to 2009,

– lower interest income on forint receivables from credit institutions by HUF 16 billion,

– an increase of the interest expenses on other liabilities by HUF 6.6 billion, which was caused mainly by the interest payment related to the IMF loan. The loan was drawn down in June 2009, hence interest payment in 2009 did not effect the whole year, while in 2010 the whole year was effected.

The net interest related income fell by HUF 51.8 billion. The interest related income on securities denominated in forint (government bonds and mortgage bonds) saw a decrease of HUF 2.8 billion. This consists of the difference between the cost value and the face value of the securities recorded at cost, attributable to the reporting period. A drop of the interest related profit by HUF 48.1 billion was caused by the net gain or loss on derivative transactions that are not related to exchange rate changes.

Realised gains/losses from financial operations

HUF millions

P/L line	Description	2009	2010	Change
IV.	Realized gains from financial operations	46,069	52,310	6,241
XIV.	Realized losses from financial operations	36,760	73,978	37,218
IV.–XIV.	**Net financial gains/losses**	**9,309**	**–21,668**	**–30,977**

Realised gains and loss from financial operations include gains and losses arising from sales and maturities of securities.

The net realised losses from financial operations amounted to HUF 21.7 billion in 2010, having decreased by HUF 31 billion in comparison to the figure for 2009, which amounted to a HUF 9.3 billion gain.

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

HUF millions

No.	Description	2009	2010	Change
1.	– interest income on currency swaps	9,657	9,944	287
2.	– income like interest margin on hedge interest rate swaps	4,176	6,876	2,700
3.	– interest gains on hedge FX swaps	62,685	3,913	–58,772
4.	– FX gains on derivative transactions	0	0	0
5.	– interest income on other transactions	945	3,312	2,367
6.	**Income from derivative transactions (1+2+3+4+5)**	**77,463**	**24,045**	**–53,418**
7.	– interest expences on currency swaps	12,289	11,521	–768
8.	– expense like interest margin on hedge interest rate swaps	523	1,522	999
9.	– interest loss on hedge FX swaps	24,261	14,398	–9,863
10.	– FX losses and other expenses on derivative transactions	123	417	294
11.	– interest expenses on other transactions	1,342	5,364	4,022
12.	**Expenses on derivative transactions (7+8+9+10+11)**	**38,538**	**33,222**	**–5,316**
13.	– net interest on currency swaps (1–7)	-2,632	–1,577	1,055
14.	– interest margin on hedge interest rate swaps (2–8)	3,653	5,354	1,701
15.	– net interest gains on hedge FX swaps (3–9)	38,424	–10,485	–48,909
16.	– interest related income on derivative transactions, net (4–10)	–123	–417	–294
17.	– net interest on other transactions (5–11)	–397	–2,052	–1,655
18.	**Net income from derivative transactions (6–12)**	**38,925**	**–9,177**	**–48,102**

Currency swap transactions include derivative transactions concluded with foreign partners and with the ÁKK. The former provide for hedging exchange rate and interest rate risks arising from bonds issued by the MNB abroad before 1999. The net interest result of the currency swaps was a loss of HUF 1.6 billion, an improvement of HUF 1.1 billion compared to 2009.

The HUF 1.7 billion increase in the interest result on interest rate swaps was caused by the change in foreign exchange interest rates.

Net interest gains on FX swaps dropped by HUF 48.9 billion in 2010, due to a significant decline in the number of transactions and changes in foreign exchange interest rates.

4.20 COMPONENTS OF INCOME FROM THE REVALUATION OF FOREIGN EXCHANGE HOLDINGS

HUF millions

Description	2009	2010
Net income from exchange rate changes (realised and conversion spread)*	136,751	50,370
Change in revaluation reserves in the balance sheet** (due to unrealised revaluation net income)	–5,466	185,145
Total effect of exchange rate changes	**131,285**	**235,515**

** P/L line: III.-XII.*
*** Revaluation reserves due to exchange rate changes (balance sheet line XI.4.).*

In 2010 the total exchange rate change effect was a gain of HUF 235.5 billion, of which the Bank realised HUF 50.4 billion, while the amount of the revaluation reserve due to exchange rate changes (unrealised gain) increased by HUF 185.1 billion during the year.

For more details on the revaluation reserves see Section 4.17.

4.21 THE COST OF ISSUING BANKNOTES AND COINS

HUF millions

P/L line	Description	2009	2010	Change
	Cost of banknote production	5,039	5,901	862
	Cost of coin production	2,501	1,811	–690
	Cost of production of commemorative and collector coins	622	835	213
XIII.	**Cost of issuing banknotes and coins**	**8,162**	**8,547**	**385**

The cost of issuing banknotes and coins was HUF 8.5 billion in 2010, an increase of HUF 0.4 billion compared to the preceding year. This increase in cost stemmed mainly from the change in the quantity of production: i.e. an increase in the quantity of banknotes produced.

4.22 OTHER INCOME/EXPENSES

HUF millions

P/L line	Description	2009	2010	Change
V.1.	Income from fees and commissions	834	821	–13
XV.1.	Expenses of fees and commissions	2,496	660	–1,836
	Net income from fees and commisssions	**–1,662**	**161**	**1,823**
V.2.	Income from other than fees and commissions	5,363	5,541	178
XV.2.	Expenses of other than fees and commissions	2,861	1,599	–1,262
	Net income from other than fees and commisssions	**2,502**	**3,942**	**1,440**
V.-XV.	**Other net results**	**840**	**4,103**	**3,263**

Income from fees and commissions, mainly related to payment services, saw an improvement of HUF 1.8 billion compared to the figure for 2009. An explanation for this is that in 2009 the one-off service fee related to the loan taken out from the IMF boosted the expenses of fees and commissions by HUF 2.1 billion. Income from fees and commissions did not change materially in 2010 relative to the previous year.

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	2009	2010	Change
1.	Dividends from investments	2,363	4,694	2,331
2.	Income related to coins and commemorative coins	1,849	822	–1,027
3.	Income from sales transaction of invested financial assets	1,105	1	–1,104
4.	Paid-up bad debts	1	0	–1
5.	Other income	45	24	–21
6.	**Income from other than commissions and charges (1+2+3+4+5)**	**5,363**	**5,541**	**178**
7.	Expenses from assets assigned free of charge	1,374	681	–693
8.	Expenses related to coins and commemorative coins	670	702	32
9.	Expenses from sales transaction of invested financial assets	602	0	–602
10.	Final money transfer	171	204	33
11.	Other expenditures	44	12	–32
12.	**Expenses from other than commissions and charges (7+8+9+10+11)**	**2,861**	**1,599**	**–1,262**
13.	**Net income/expenses from other than commissions and charges (6–12)**	**2,502**	**3,942**	**1,440**

Income other than fees and commissions includes the following:

– Dividends received from investments increased by HUF 2.3 billion compared to 2009. The BIS paid a significantly high dividend in 2010, an increase of HUF 1.3 billion compared to the preceding year. Dividends arising from Pénzjegynyomda Zrt. and Magyar Pénzverő Zrt together were higher by HUF 1.2 billion than those in 2009.

– The line 'Expenses from assets assigned free of charge' includes the book value of HUF 501 million of the real estate at Nánási út, Budapest, which was taken over from Bankjóléti Kft. after dissolution of its business and the book value of HUF 160 million of a building at Könyves Kálmán körút, Budapest, which was possessed as interim dividend from Magyar Pénzverő Zrt. Both were transferred free of charge to the Hungarian State Holding Company (MNV Zrt.).

– Income related to coins and commemorative coins decreased by HUF 1 billion in 2010, since in 2009 one-off income stemmed from sales of the waste-coin resulting from withdrawal of the 1 and 2 forint coins.

– In 2010 no net income arose from sales transactions of invested financial assets. This line would include the results stemming from derecognition of the MNB's investment.

– The line 'Final money transfer' includes mainly donations to domestic organisations and to foundations.

4.24 OPERATING INCOME AND EXPENSES

HUF millions

P/L line	Description	2009	2010	Change
	Income from assets and inventories	1,246	8	–1,238
	Income from subcontracted services	30	32	2
	Income from invoiced services	149	130	–19
	Other income	312	19	–293
	Extraordinary income	1	1	0
VIII.	**Total operating income**	**1,738**	**190**	**–1,548**
	Cost of materials	3,841	3,835	–6
	Personnel-related costs	7,661	7,009	–652
	Depreciation	2,482	2,180	–302
	Transfer of costs of other activities	–257	–241	16
	Total operating costs	**13,727**	**12,783**	**–944**
	Expenses incurred on assets and inventories	1,242	11	–1,231
	Expenses incurred on subcontracted services	31	24	–7
	Expenses incurred on invoiced services	146	130	–16
	Other expenses	9	7	–2
	Total operating expenses	**1,428**	**172**	**–1,256**
XVIII.	**Total operating costs and expenses**	**15,155**	**12,955**	**–2,200**
VIII.–XVIII.	**Net operating expenses**	**–13,417**	**–12,765**	**652**

Net operating expenses amounted to HUF 12.8 billion in 2010, a decrease of HUF 652 million compared to the previous year. These expenses are primarily determined by total operating costs, which were lower by HUF 944 million in 2010 relative to 2009.

The *cost of materials* in the reporting year was at a level similar to that of 2009, as a result of different opposed effects:

– IT costs decreased by more than HUF 80 million compared to 2009. Savings derived, on the one hand, from the rationalisation of the procurement workflow causing a reduction in the cost of supporting the operation of the new data storage system. On the other hand, consulting costs decreased since the IT department made a practice of using to a greater extent the bank's own human resources and the knowledge accumulated in the organization instead of external consultants. Moreover, IT costs were also affected by the fact that service fees of ECB provided data transfer were partly discharged or reduced because of technological revision.

– Operating costs decreased by more than HUF 70 million relative to the previous year particularly because during 2010 the bank vacated the building at Hold u. 7, Budapest. Savings were generated in costs of guarding services after examination of the safety level of the Logistic Centre in 2009 and because of the lower rates offered by the new supplier providing guarding services of the main buildings. Furthermore, the deliberate actions with the aim of saving costs resulted in a decrease of the costs of phone calls and electricity.

– Other cost of materials increased almost by HUF 150 million, mainly due to the heavy expenditures for legal experts in relation to the Holocaust trial.

The audit fee amounted to HUF 36.3 million.

Personnel-related costs decreased by HUF 652 million. On the one hand this was a result of the initiatives of the cost rationalisation project: from the year 2010 the remuneration system of employees has been modified, which means that allowances have been reduced significantly. Payments on dismissals also decreased in 2010 compared to 2009, in line with the timing of the project mentioned above. On the other hand, savings were caused by changes in the rules for payment of contribution and by the reduction of remuneration of executive officers pursuant to the amendment of the Act on MNB. The latter concerned the Governor, the Deputy Governors, the members of the Monetary Council and the members of the Supervisory Board.

Depreciation decreased by HUF 302 million in 2010 in comparison with the preceding year, which was a result of the increase of the assets written off and the application of depreciation rates adjusted to the longer useful economic life of the assets.

4.25 CHANGES IN THE NUMBER OF EMPLOYEES, WAGE COSTS AND IN THE REMUNERATION OF THE BANK'S EXECUTIVE OFFICERS

Number of staff and wages information

HUF millions

Description	2009	2010	Change (%)
Wage costs incurred on staff	4,471	4,492	0
Other wage costs*	357	228	–36
Wages	**4,828**	**4,720**	**–2**
Other personnel payments	**1,061**	**846**	**–20**
Taxes on wages	**1,772**	**1,443**	**–19**
Personnel-related costs	**7,661**	**7,009**	**–9**

** Other wage costs include payments on dismissal and in exchange of vacation time used and amounts paid to non-staff and non-MNB employees.*

Description	2009	2010	Change (%)
Average number of staff	605	591	–2

Remuneration of executive officers

HUF millions

Bodies	Fees
Monetary Council*	124
Supervisory Board	61

** Includes the salaries of external members of the Monetary Council in an employment relationship with the MNB.*

The senior officers, such as members of the Management Committee and the Supervisory Board, had no loans outstanding in 2010.

The Bank has no obligation to pay pension benefits to its former senior officers.

4.26 DISTINCTION BETWEEN THE ESCB GUIDELINE AND THE 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 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 balance sheet and profit and loss account 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.

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 with 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.

According to MNB accounting policy, non-realised 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 non-realised 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 further 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.

Factors adjusted balance sheet total and equity in 2010

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 for 2010 according to HAS	**415,937**	**10,000**	**75,003**	**–41,577**	**459,363**
Adjustments on market valuation of foreign currency securities					
Revaluation reserves of foreign currency securities according to ESCB rules	30,801				30,801
Unrealised loss on foreign currency securities				–59,943	–59,943
Refund from the central government			29,142		29,142
Adjustments on market valuation of derivatives	10,423			–6,953	3,470
Adjustments on exchange rate changes					
Deduction of revaluation reserves due to exchange rate changes according to HAS	–415,937				–415,937
Revaluation reserves of exchange rate changes according to ESCB rules	430,752				430,752
Unrealised loss on exchange rate changes				–14,815	–14,815
Total value of adjustments according to ESCB rules	56,039	0	29,142	–81,711	3,470
Balance sheet data for 2010 according to ESCB rules	**471,976**	**10,000**	**104,145**	**–123,288**	**462,833**

HUF millions

Description	Assets	Liabilities
Totals according to HAS	**10,177,497**	**10,177,497**
Reclassification of repurchased bonds in order to show the net amount of the issued bonds in liability side	–73,282	–73,282
Adjustments on market valuation of foreign currency securities		
Revaluation reserves of foreign currency securities according to ESCB rules		30,801
Unrealised loss on foreign currency securities		–59,943
Refund from the central government		29,142
Adjustments on market valuation of derivatives	10,258	10,258
Adjustments on exchange rate changes		
Deduction of revaluation reserves due to exchange rate changes according to HAS		–415,937
Revaluation reserves of exchange rate changes according to ESCB rules		430,752
Unrealised loss on exchange rate changes		–14,815
Reclassification of loss for the year to the asset side	123,288	123,288
Total value of adjustments according to ESCB rules	60,264	60,264
Totals according to ESCB rules	**10,237,761**	**10,237,761**

As a result of the application of ESCB rules, the 2010 balance sheet total changed by HUF 60.3 billion and the profit for the year changed by HUF 81.7 billion.

Due to reclassification of the repurchased MNB foreign currency bonds (stated in net amount), the balance sheet total decreased by HUF 73.3 billion, whereas due to the market valuation of derivative transactions and the reclassification of loss for the year to the asset side it increased by HUF 10.3 billion and by HUF 123.3 billion respectively.

Loss for the year changed to HUF 123.3 billion as a whole as a result of the unrealised loss due to the foreign exchange rate changes and market valuation. Revaluation reserves amounted to HUF 472 billion according to ESCB rules, due to settlement of unrealised profit.

Pursuant to the Act on MNB the negative balance of revaluation reserves of foreign currency securities was reimbursed by the central government directly to the revaluation reserve by 31 March 2011. Since, according to ESCB rules, a negative balance of the revaluation accounts is not allowed, the amount of this acknowledged receivable was recorded in retained earnings.

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