



MAGYAR NEMZETI BANK

ANNUAL REPORT

2008

Annual Report

Business Report and Financial Statements of the Magyar Nemzeti Bank 2008



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Part A

**2008 Business Report
of the Magyar Nemzeti Bank**





1 The Governor's foreword

In the first half of 2008, the greatest challenge for monetary policy was to prevent the series of cost and supply shocks to the economy from leading to a permanent increase in inflation. The risk of inflation expectations persisting was exacerbated not only by the increase in imported inflation and the high rate of wage growth, but also by the fact that despite the slack growth there was no moderation in the components of inflation which are sensitive to domestic economic activity. Removal of the exchange rate band in February 2008 expanded the room for manoeuvre in terms of monetary policy and strengthened the credibility of the anti-inflationary commitment.

In September, events in the crisis which originated in the US subprime mortgage loan market caused a shift in the conduct of monetary policy. The drastic deterioration in growth prospects and the significant correction in commodity prices put the Hungarian economy on track for rapid disinflation, and the focus of the Central Bank's policy shifted to maintaining the solvency of the economy and the stability of the financial sector. Following the agreement with the International Monetary Fund, the risk assessment of Hungary improved and the vulnerability of the financial intermediary system decreased considerably. At the same time, the vulnerability of the economy and the unfavourable international risk assessment continued to justify a cautious interest rate policy.

One prerequisite for the efficiency of monetary policy instruments is the smooth functioning of the interbank markets. In the third quarter of 2008, the redistribution of liquidity declined compared to pre-crisis levels, as a result of the global financial crisis. Due to the turbulences in the operation of the forint money markets, this took place in spite of the surplus liquidity which typically characterises the domestic banking sector. Developments in the interbank markets of major currencies played a prominent role in this, further exacerbated by the substantial decline in the liquidity of the Hungarian government securities market. Therefore, the MNB introduced several measures which contributed to a better distribution of interbank forint and FX liquidity and to maintaining domestic financial markets' ability to function.

The financial and real economy crisis affecting all developed economies had a strong impact on Hungary as well in the second half of 2008. After Lehman Brothers was not bailed out by the US government, an extraordinary severe confidence crisis emerged in the financial markets, which

required significant central bank and government interventions. Due to the vulnerability of the Hungarian economy, the crisis had strong impacts on the financial markets and the banking sector. The liquidity of the forint government securities market and the FX swap market, which ensures the hedging of banks' FX position, declined considerably, while yields increased significantly. In order to reinforce the financial markets and the liquidity of the banking sector, the Magyar Nemzeti Bank introduced new monetary policy instruments to increase forint and foreign exchange liquidity, and more emphasis was placed on financial stability considerations in its decisions. The Magyar Nemzeti Bank participated in the preparation of the agreements with the IMF and the EU, which substantially increased the level of foreign exchange reserves and facilitated the financing of the general government. All these steps contributed to normalising the situation in the financial markets and preserving the stability of the financial intermediary system.

Compared with one year earlier, official foreign exchange reserves increased by EUR 7.6 billion, amounting to EUR 24 billion at the end of December 2008. The level of reserves remained stable during the first three quarters, and then increased by EUR 6.6 billion in the fourth quarter. In net terms, foreign exchange market transactions related to the debt management activities of the ÁKK (Government Debt Management Agency) and the MNB increased reserves by approximately EUR 7.6 billion, the conversion of transfers received from the European Union added more than EUR 1 billion to the reserves, while euro sales announced in advance resulted in a decline of EUR 38 million. In addition, disbursements in foreign exchange commissioned by budgetary institutions led to an approximately EUR 1.3 billion decrease in the reserves. Compared to previous years, there was no significant change in the quality of foreign exchange reserves. As a result of the IMF loan, and in contrast to previous practice, the reserves not only comprise euro and US dollar assets, but also bonds denominated in Japanese yen and pound sterling. Although the year-end level of reserves is slightly below the indicator most often used to determine the optimum size of reserves and linked to short-term debt, reserves are expected to reach the desirable level in the near future with the drawing down of the IMF loans.

Operation of the real-time gross settlement system was marked by rising turnover and declining fees in 2008 as well, with the system's availability exceeding both international standards and the level from the previous year. Aware of the

needs of credit institution clients and the findings of surveys on liquidity effects, the Monetary Council decided to support and propose the introduction of intraday settlement in the Interbank Clearing System. For customers of credit institutions, this would allow the crediting of beneficiaries' bank accounts with a significant part of transfer orders submitted to banks on the same business day, as opposed to the current practice where this is only performed on the following day. With the aim of reducing risks, the central counterparty and the central securities depository functions of KELER (Central Clearing House and Depository) were separated into legally independent companies in 2008. As a result of regular on-site inspections of payment services, legal compliance on the part of credit institutions conducting payment transactions continued to improve. On 28 January 2008, with the introduction of the credit transfer scheme, practical implementation of the Single Euro Payments Area (SEPA) began in Europe. At present, more than a dozen banks are already able to receive and send SEPA credit transfers in Hungary. The Hungarian SEPA Association was registered in the first half of 2008; its main task is the coordination of the preparation of the domestic banking sector for the introduction of the SEPA payment schemes.

The MNB achieved significant results in the domain of cash in 2008. Early in the year it successfully withdrew the 1-forint and 2-forint coins, carried out the preparations for the introduction of the 200-forint coin, and smoothly switched over to operating the cash processing and distribution from its new logistics centre in Soroksár.

The amount of banknotes and coins in circulation increased by 4.8% in 2008, amounting to HUF 2,288.9 billion at the end of the year. As a result of the global financial crisis, an off-the-trend expansion in the amount of cash in circulation was experienced in October, which declined by December. The MNB and the financial intermediary system handled this period without problems.

In 2008, forint banknote counterfeiting declined significantly compared to 2007, mainly thanks to the spread of the new type of 1,000-forint banknotes. The rate of counterfeit banknotes does not jeopardise the safety of cash circulation.

In the field of statistics, in order to satisfy user requirements at a higher level, the Central Bank renewed its statistical releases and continued to deepen its cooperation with the reporting domestic institutions.

As regards the balance of payments statistics, following the best European practice, in 2008 the Central Bank introduced data collection which is based on direct reporting of respondents. In the new data collection system, which has

been operating since January 2008, the (indirect) data supply based on reports on payments has ceased to exist, and the Central Bank obtains the information required for compiling statistics directly from economic agents. At the national level, introduction of the new data collection system resulted in a decline in the production costs of balance of payments statistics.

In 2008, the most important results of the MNB's activity aimed at promoting the financial literacy of the general public were the drafting of a version of the Financial Education Programme suitable for instruction at secondary schools, the launch of a pilot training programme for the whole school year at 25 schools, increased attendance at the Visitor Centre, the popularity of the Monetary contest, the establishment of the Foundation for Financial Awareness, development of the 'Pénziránytű' (Money Compass) website, the organisation of an international conference which attracted considerable attention and efficient professional cooperation with the Supervisory Authority and the Competition Authority.

Although the number of Member States within the EU, and thus the members of the European System of Central Banks (ESCB) did not increase in 2008, an important event of the year was that – with the accession of Cyprus and Malta – the number of countries using the euro expanded from 13 to 15 as from 1 January 2008. With the entry of Slovakia, the number of euro area Member States increased again (to 16 Member States) as of 1 January 2009.

The General Council, the ESCB committees and the working groups established by the committees continued to be useful fora for exchanging professional experience in 2008 as well, contributing to Hungary's preparations for joining the Eurosystem.

In line with the institutional strategy elaborated in 2007, a new human resource strategy was prepared in 2008, determining the main directions of the organisation's human resource management until 2011. Over the past six years, human resource strategy has focused on the creation, introduction and institutionalisation of modern HR systems. In the years ahead the MNB intends to place emphasis on the successful, effective application of the existing HR systems, paying special attention to promoting the personal development of staff members, to ensuring the attraction and retention of talented employees and to the further developing the commitment of the Bank's employees. Achievement of this target is supported by the introduction and institutionalisation of the new HR partner role. Maintaining and strengthening performance, our results-oriented institutional culture and operations continues to be our vital mission.

In 2008, the Magyar Nemzeti Bank incurred a loss of HUF 5.5 billion, as opposed to a loss of HUF 16.6 billion in 2007. This improvement was a result of a HUF 8.3 billion increase in interest and interest-related income and HUF 8.3 billion growth in the realised income from financial transactions, which was decreased by an increase of HUF 5.7 billion in net expenditures stemming from other profit/loss factors.

The MNB's internal operation in 2008 continued to be characterised by efforts aimed at reasonable cost-efficiency. As a result, annual operating costs were lower than planned. This outcome was partly the outcome of conscious, continuous improvement in the efficiency of staff employment, which resulted in a 7.1% decline in the average number of employees compared to the previous year, allowing for permanent saving on annual personnel costs. In the financial management related to the operation of IT equipment and systems, the optimisation of service levels, which influence the efficiency of the operation of various banking applications and which started in the course of the year, also contributed to the reduction in operating costs.

Operating costs in 2008 exceeded actual expenditures in 2007 by 2.3%. This was partly attributable to the initial additional costs of operating the new building complex of the Logistics Centre, a major investment which took several years and was completed during the year, and the systems installed at that facility. In addition, the lump-sum fee paid for the cost efficiency survey constituted a one-off expense in 2008. The cost efficiency project was aimed at a comprehensive survey and improvement of the efficiency and success of central banking activity, covering the whole spectrum of operations and related costs, keeping in mind the preservation of the high quality of the MNB's professional activity against the background of increased cost awareness. Implementation of the approved proposals of the project will result in a 14% decline in the number of employees and a HUF 1.7 billion decrease in operating costs, creating the conditions for the MNB to operate as an exemplary public institution over the long term.

The volume of investment implemented in 2008 was lower than in the previous years, partly as a result of the cost-saving decisions taken during the year and partly as a result of an improvement in the method of preparing decisions.

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. By virtue of the MNB Act, the form of the company “company limited by shares” or its abbreviation need not be indicated in the company name of the MNB.

Date of foundation: 1924

Owner (shareholder): Hungarian State, represented by the minister responsible for the state budget

Basic tasks: as defined by the Act on the Magyar Nemzeti Bank

Subscribed capital: HUF 10 billion

2.1 OBJECTIVES AND BASIC TASKS OF THE MNB

The Magyar Nemzeti Bank (MNB) is a legal entity operating as a special company limited by shares, which conducts its operations as provided for by Act LVIII of 2001 on the Magyar Nemzeti Bank (hereinafter referred to as the ‘MNB Act’). The MNB is a member of the European System of Central Banks (ESCB).

In accordance with Article 105 of the Treaty establishing the European Community, the MNB Act, which establishes the Bank’s primary objectives and basic tasks, as well as its institutional, organisational, personal, and financial independence, stipulates: ‘The primary objective of the MNB shall be to achieve and maintain price stability. Without prejudice to its primary objective, the MNB shall support the economic policy of the Government using the monetary policy instruments at its disposal.’

In addition to implementing (achieving and maintaining) price stability, the Bank carries out the following basic tasks specified in the MNB Act:

- it defines and implements monetary policy;
- it has the exclusive right to issue banknotes and coins, including commemorative banknotes and coins, qualifying as the legal tender of the Republic of Hungary;
- 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 operation in order to ensure their safe and efficient operation as well as smooth money circulation;

– in order to perform its tasks, it collects and publishes statistical information; and

– it promotes the stability of the financial system and the development and smooth conduct of policies related to the prudential supervision of the financial system.

Further to the above, the Bank may only perform additional tasks upon proper statutory authorisation, provided that such tasks do not jeopardise or interfere with its primary objective and performance of the tasks listed above.

In the spirit of central bank independence and within the framework provided by the MNB Act, the Bank independently defines the monetary policy aimed at achieving and maintaining price stability and the instruments for the implementation of such. Such instruments include, within the scope of its bank account management services, accepting deposits and, subject to restrictions set forth in the Act, lending against adequate collateral; buying, selling and mediating securities in open market operations and under repurchase agreements in the spot and derivatives markets; issuing its own securities; influencing and setting exchange rates and interest rates, discounting (rediscounting) securities as well as formulating and operating the system of rules regulating minimum reserves.

The Bank’s account management services cover the entities defined by law. Thus, for instance, the Bank manages the accounts of credit institutions, the single Treasury account, the current accounts of the Government Debt Management Agency Private Company Limited by Shares (ÁKK), clearing houses, the National Deposit Insurance Fund and the Investor Protection Fund.

2.2 BODIES AND MANAGEMENT OF THE MNB

The various bodies of the MNB are primarily governed by the MNB Act. The regulations of Act IV of 2006 on Business Associations are applied for the MNB, with the discrepancies set forth in the MNB Act.

The MNB operates as a single-member business entity. The Hungarian State as the shareholder is represented by the minister responsible for the state budget. The MNB operates without a general assembly 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, approval of the balance sheet and the profit and loss statement, 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 operation. In respect of the Annual Report of the MNB, 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 accordance with 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, in contrast with the practice of other companies limited by shares, the remuneration of the MNB's Governor, the Deputy Governors and the other members of the Monetary Council as well as members of the Supervisory Board, is determined by the MNB Act and not by 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 further, at most 4, members appointed by the President of the Republic of Hungary for six years. The Monetary Council has at least five and at most seven members. The number of Monetary Council members may exceed the maximum seven until the number of members who already had MC membership on 3 July 2007 i.e. at the time when Act LXXXV of 2007 amending the MNB Act entered into force, remains above four, exclusive of the Governor and Deputy Governors of the MNB.

Each year – at the first meeting of the year – the Monetary Council elects a Deputy Chairman who deputises for the Chairman if the latter is unable to attend. In 2008, 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

Monetary Council meetings. However, such representative does not have voting rights, as, in accordance with European Union directives, the MNB Act stipulates that 'The Government may not instruct the MNB regarding its duties set forth herein'.

The members of the **Monetary Council** in 2008 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,
- Dr. Csaba Csáki, member of the Monetary Council,
- Dr. Ilona Hardy, member of the Monetary Council,
- Dr. Béla Kádár, member of the Monetary Council (until 23 September 2008),
- Dr. György Kopits, member of the Monetary Council,
- Judit Neményi, member of the Monetary Council,
- Dr. Gábor Oblath, 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**. Amongst other things, his competences include:

- managing the implementation of the basic tasks;
- in respect of tasks other than those falling within the Supervisory Board's competence, the management of the internal audit unit of the MNB;
- exercising employer's rights over the employees of the MNB other than the non-deputy governor members of the Monetary Council, except the powers related to the appointment and dismissal of the Deputy Governors;
- taking all other decisions related to the operation of the MNB that do not fall under 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 it has formulated. In addition to the auditor appointed by the shareholder, the MNB is also audited by the State Audit Office (SAO) and the Supervisory Board.

Members of the Monetary Council of the Magyar Nemzeti Bank



András Simor

Governor,
Chairman of the Monetary Council



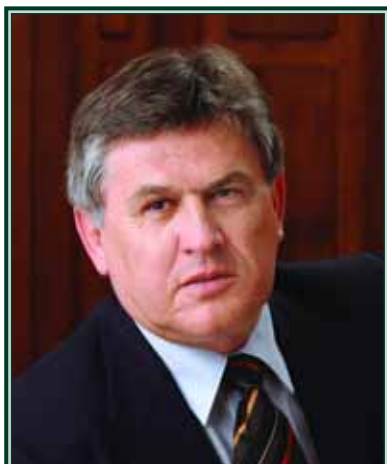
Ferenc Karvalits

Deputy Governor with general responsibilities,
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



Dr. Csaba Csáki
member of the Monetary Council



Dr. Ilona Hardy
member of the Monetary Council



Dr. Béla Kádár
member of the Monetary Council



György Kopits
member of the Monetary Council



Judit Neményi
member of the Monetary Council



Dr. Gábor Oblath
member of the Monetary Council

The supervisory competence of the **SAO** in relation to the MNB is set forth in the Act on the SAO. The SAO supervises the financial management of the MNB and its activities under the MNB Act that are not included among its basic tasks. The SAO 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 opinion of the President of the SAO must be sought. 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 supervision of the Bank's performance of its basic tasks and the impact thereof on the MNB's profit and loss. Accordingly, the report which the Supervisory Board is required to prepare pursuant to the Act on Business Associations is subject to these restrictions.

The members of the Supervisory Board defined in the MNB Act are its Chairman elected by Parliament, other members elected by Parliament as well as the representative of the minister responsible for the state budget and a consultant appointed by the minister responsible for the state budget.

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

In 2008, the members of the Supervisory Board of the MNB were:

- Dr. Ákos Balassa, Chairman,
- László Baranyay,
- Dr. Gábor Csányi,
- Dr. József Kajdi,
- Dr. Gábor András Szényei,
- Dr. László Urbán (the consultant appointed by the minister responsible for the state budget)
- Dr. István Várfalvi
- Dr. Éva Várhegyi.

Neither the SAO nor the Supervisory Board is entitled to supervise activities qualifying as basic central bank tasks.

2.3 ORGANISATIONAL STRUCTURE OF THE CENTRAL BANK

The Bank's fundamental aim is to be one of the best central banks in terms of both professionalism and operational conditions. The motto of its mission is: 'The Magyar Nemzeti Bank for Stability'. This motto reflects the cornerstone of the Bank's strategy, which stipulates that the Central Bank's most important task is to ensure the stability required for the proper development of the economy in the domains of price stability, the stability of the financial intermediary system and the stability of the legal tender alike.

The organisational and management system formulated in 2007 and the changes which took place therein in 2008 also serve the successful and cost-effective attainment of the above objectives.

In addition to regrouping tasks and modifications concerning spheres of activity and the internal organisational structure, in 2008 the Bank's management also launched a project screening the entire Bank, including all of its activities, processes and functions in order to assess, with the help of a consultant, whether the Bank's operation and financial management is sufficiently efficient and whether there is any room for improvement and savings. The organisational effect of the conclusions drawn from the project and the proposals adopted will be felt in 2009.

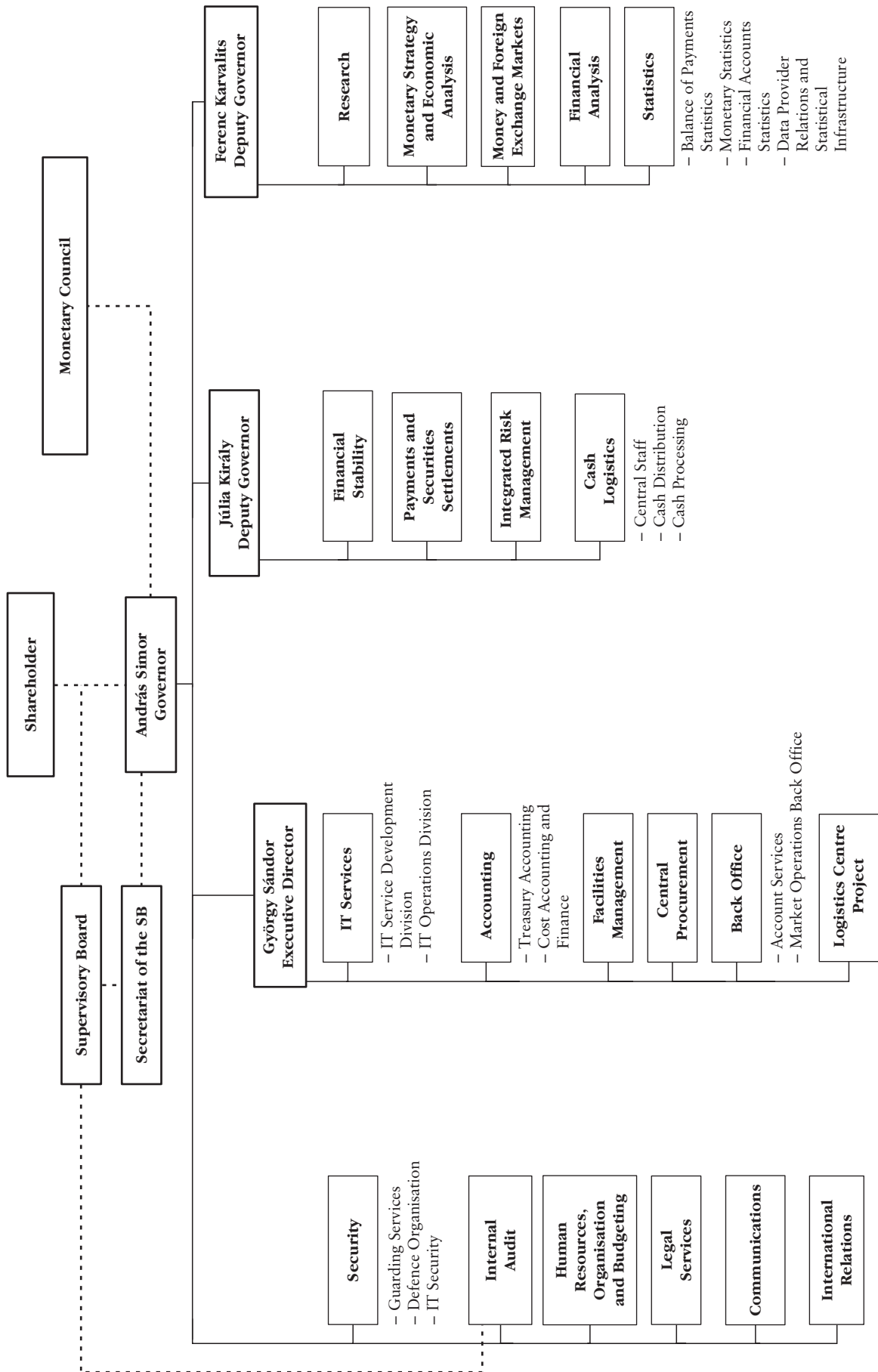
Both on 1 January and on 31 December 2008, there were 21 organisational units (and 15 departments within 6 organisational units of them) in operation at the Bank under the control of the Governor, the two Deputy Governors and the Executive Director.

In order to provide assistance for the MNB in managing its operations, attaining the objectives and fulfilling the duties defined in the MNB Act, the Bank operates **special committees** in charge of discussing issues that fall within the competence of the Governor, Deputy Governors and the Executive Director, and of supporting the pertaining decision-making process.

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

Organisation chart

Organisation of Magyar Nemzeti Bank
December 31, 2008



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

Responsibilities of the **Financial System Overseeing Committee** are to support central bank decisions concerning financial stability, including the functioning of the institutional system, financial markets and financial infrastructure, and the Bank's operational risk management through preparing decisions and putting forward proposals and opinions.

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

The **ALCO (Assets-Liabilities Committee)**, through doing the necessary preparatory work and putting forward proposals and opinions, supports decision-making related to the Bank's activities performed in foreign exchange, affecting the Bank's balance sheet.

The **Operative Crisis Management Committee** supports decision-making related to the emergence of crises of credit institutions, and discusses the results and experience of crisis simulation exercises.

The structure of the organisation as at 31 December 2008 designed to ensure the fulfilment of tasks is shown in the organisational chart on page 15.

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

Hungary's accession to the European Union also entailed MNB 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 (NCBs) 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 preparation for joining the euro area, approval of the convergence reports stipulated by the EU Treaty and monitoring the functioning of ERM II (Exchange Rate Mechanism 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 the intervention and financing mechanisms of ERM II. In addition, the General Council continually checks whether the central banks of EU Member States and the ECB observe 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; its opinion concerning any changes in the rules of accounting and financial data supply and issues related to the ECB's key for capital subscription must be requested. The mandate of the General Council will expire at the date when all Member States have adopted the euro.

In 2008, the number of ESCB members did not increase, but from 1 January 2008 the number of countries using the euro expanded from 13 to 15 with Cyprus and Malta, and later to 16 with Slovakia joining the euro area on 1 January 2009.

ESCB members are also owners of the ECB. Ownership share is based on demographic and GDP data. Euro area central banks subscribe to 70% of the ECB's shareholder's equity. The remaining 30% is divided among the central banks of non-euro area Member States in a manner that these central banks pay 7% of their respective subscriptions to the ECB's capital as contribution to the operational costs of the ECB that are incurred in connection with their ESCB membership. Between 1 May 2004 and 31 December 2006 Hungary's ownership share in the ECB's capital amounted to 1.3884%. On 1 May 2004, upon accession to the EU and the ESCB, Hungary paid 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, Hungary's share in the ECB's capital and its paid-up capital fell to 1.3141% and to EUR 5.3 million, respectively.

The aforementioned five-year revision became due in 2008; therefore, the capital keys were adjusted again. Accordingly, as from 1 January 2009 Hungary's share in the ECB's capital and its paid-up capital increased to 1.3856% and EUR 5.6 million, 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 coordination as per the division of the various central bank duties, covering all areas of central banking operation from monetary policy through communication to statistical data reporting. Experts from the central banks of non-euro area Member States attend those committee meetings the agenda of which includes items affecting the ESCB as a whole and which fall under the competence of the General Council. (For a detailed description of the 13 ESCB Committees and the

activities of other fora providing assistance for 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 competent experts of the MNB continue to play an active role in the activities of these committees and their working groups. ESCB committee work continued to be a very useful forum for the exchange of professional experience in 2008 as well, contributing to Hungary's preparations for joining the Eurosystem.

3 Review of the MNB's performance in 2008

3.1 MONETARY POLICY

Monetary policy framework

Pursuant to the MNB Act, the primary objective of the MNB is to achieve and maintain price stability. To this end, monetary policy is determined by the Central Bank within the framework of inflation targeting. The numerical value of the inflation target is determined by the annual rate of increase in consumer prices corresponding to price stability. When the continuous target was set in 2005, the Monetary Council, in agreement with the Government of the Republic of Hungary, considered a 3% inflation level as optimal for the Hungarian economy. The first triennial revision of the numerical value of the inflation target was performed in 2008. The revision of the inflation target reinforced the 3% medium-term inflation target previously set by the Government and the MNB's Monetary Council and valid throughout the period starting in 2007. This level is in conformity with international practice, providing protection against the risk of deflation at the same time.

Effective from 26 February 2008, in agreement with the Government, the Monetary Council abandoned the flexible peg of the forint to the euro within a fluctuation band, and decided to adopt a floating exchange rate regime. The floating exchange rate regime creates more favourable conditions for the MNB to attain the inflation target and to fulfil the nominal Maastricht criteria through it.

In line with the MNB Act effective from July 2007, the number of Monetary Council members is gradually declining to a maximum of seven and a minimum of five. This change in the number of members will be implemented by not appointing new members following the expiry of the mandate of current members. Accordingly, the number of

Monetary Council members decreased from 12 to 11 in 2008.

In 2008, the Monetary Council deviated from the pre-announced meeting schedule on two occasions, which was justified by extraordinary market events. On 22 October 2008, it decided to increase the central bank base rate by 300 basis points and to reduce the width of the interest rate corridor at an extraordinary meeting. At its meeting on 8 December 2008 the Council, deviating from its usual decision-making practice, also adopted a decision on a 50 basis point cut of the central bank base rate, which it justified with the significant change in the circumstances that had served as a basis for the earlier 300 basis point rate increase.

Trends in inflation in 2008

Average inflation in 2008 amounted to 6.1%. As a result of the declining trend observed in the second half of the year, inflation, which had been at 6.9% in the first quarter, fell to 4.3% in the fourth quarter. Average annual inflation fell to 6.1% from 8% in the previous year, while average annual core inflation declined from 5.3% to 5.2%. In the course of the year, year-on-year inflation exceeded the medium-term objective of 3% every month, and, apart from the last month of the year, it also fell outside the $\pm 1\%$ tolerance band. As a result, the primary objective of the MNB was not attained in 2008.

The difference between actual inflation and the inflation target of the MNB is predominantly attributable to cost shocks of global origin beyond the control of monetary policy. These shocks were primarily the result of developments in oil and food prices. Food and oil prices started to increase extremely quickly and in an unforeseeable manner in the summer and autumn of 2007, respectively.

Table 1

The consumer price index and its components

(percentage change, year-on-year)

	2006	2007 annual average	2008	2008			
				Q1	Q2	Q3	Q4
Core inflation	2.3	5.3	5.2	5.2	5.8	5.6	4.2
Unprocessed food	17.8	13.7	5.8	13.8	11.3	2.1	-4.1
Fuel and energy	7.8	2.2	9.9	14.8	13.3	12.8	-1.3
Regulated prices	3.7	14.7	7.9	6.9	7.1	8.5	9.1
Consumer price index	3.9	8.0	6.1	6.9	6.8	6.3	4.3

The prices of unprocessed food already surged in the second half of 2007; year-on-year unprocessed food inflation reached 20% in October. The rate of price increase declined gradually in 2008, and at the end of the year price developments already indicated a downward trend in inflation. By contrast, processed food inflation started to rise later, and the upward trend persisted until mid-2008. In the second half of 2008, a significant improvement was experienced in this area as well. Nevertheless, processed food prices made a positive contribution to inflation during the whole year.

The rise in the world market price of oil was felt the earliest in the increase of the prices of domestic vehicle fuels and market energy. The increase in energy prices feeds through, with some delay, to the prices of tradable goods and processed food through the producer prices of the sectors producing for secondary consumption, then through the producer prices of the sectors manufacturing consumer goods. Among the main product groups, the effect of the energy price increase can mainly be identified in the price increases of tradable goods and market services experienced in the first half of the year.

The inflation of market services and tradable goods shows that in 2008 there was no considerable improvement compared to the previous year, even in sectors only indirectly affected by cost shocks and which can be influenced by monetary policy to a greater extent.

Monetary Policy

As monetary policy affects consumer prices only indirectly and with a lag, the central bank can only neutralise the immediate, direct impact of shocks on inflation completely at the expense of high real economic costs. Therefore, similarly to modern central banks with an inflation targeting policy, the Monetary Council of the MNB also considers a longer, typically one- to two-year horizon to be relevant when taking its interest rate decisions. Consequently, when evaluating the developments in inflation in 2008, it is justified to concentrate on the monetary policy decisions taken at end-2006 and in 2007.

In early 2007, the Hungarian economy was characterised by an inflation environment significantly exceeding price stability and GDP lagging behind the level of potential output. As a result of the developments in regulated prices and the restructuring of government subsidy systems, the MNB expected inflation to peak at a high level before sharp disinflation took place. Looking at a horizon relevant for monetary policy, the decelerating economy would have allowed for a loosening of monetary policy, but the effects of

the fiscal adjustment in 2006 and the anchored nature of inflation expectations were surrounded by considerable uncertainty. The MNB's attention was also called to the latter by the high increase in wages. Caution was also warranted by the increase in core inflation, which may have indicated that inflation in some product groups might rise over the longer term as well. Considering the high level of uncertainty, the Monetary Council decided to maintain the level of the central bank base rate at several of its meetings. Subsequently, despite the improving economic environment, the Council emphasised that cutting the central bank base rate would only be possible if the risks pointing to higher inflation could be ruled out with more certainty.

In the summer of 2007 the Monetary Council was of the opinion that the inflationary effect of the 2006 fiscal measures would fade away within a reasonable time, and the risk of inflation expectations becoming stuck at a high level declined, which allowed a loosening of the strict monetary conditions. In June 2007, the decision-making body launched a rate cutting cycle.

Starting from the autumn of 2007, the factors influencing the conduct of monetary policy gradually changed in an increasingly unfavourable direction. The surge in commodity and food prices at the end of the summer and in the autumn resulted in a rapid increase in imported inflation, while the uncertain atmosphere in international capital markets stemming from problems on the US mortgage market led to an increase in the risk premium expected of forint instruments. For several reasons, the disinflation which took place until then was also slower than the MNB's expectations.

On the one hand, the decline in the potential rate of growth was greater than expected. Consequently, until the autumn of 2008 the fall in demand resulting from the fiscal adjustment did not result in any substantial increase in spare capacity in the economy, so its disinflationary effect was also smaller. The direct disinflationary effect on demand, and on households' consumption within that, was also attenuated by the expansion of households' foreign currency loans. Developments in the labour market also contributed to the slower-than-expected disinflation. In its wage-related decisions, the competitive sector did not adjust fast enough to the unfavourable outlook for economic activity. Presumably, the permanently high inflation of previous years also kept economic agents' inflation expectations at a high level, and this may have retarded wage adjustment.

In the changed economic situation, only one more interest rate cut was possible in September 2007. At end-2007, the Council took a wait-and-see attitude, continuously indicating

that the series of cost shocks concealed significant upside risks to inflation expectations, which did not allow a further reduction of the base rate during the last quarter.

The direct impact of the increase in food and commodity prices on inflation could only have been offset completely by a rapid and drastic tightening of monetary conditions. On the one hand, this was not possible until February 2008 because of the exchange rate band. On the other hand, owing to the temporary character of the shocks and because of the excessive real economic costs, the Monetary Council did not consider such tightening justified. The fundamental aim of Hungarian monetary policy was to prevent the feed-through of temporary inflationary shocks into inflation expectations, thereby avoiding the emergence of lasting inflation effects.

In 2008, the deterioration of the international inflation environment, which was also observed earlier, continued. This deterioration was basically related to the increase in energy and food prices. The inflationary effect of the cost shocks of domestic and international origin were only offset by the slow growth of the economy to a limited extent. The increased producer prices of energy appeared in the inflation of tradable goods and market services. The risk of inflation expectations remaining at a permanently high level could not be ruled out with adequate certainty. In addition, as a result of the money market turbulence stemming from the US mortgage market, the repricing of risks continued in March.

While any considerable tightening of monetary conditions had previously been limited by the exchange rate band, the Monetary Council, in agreement with the Government, decided to introduce a floating exchange rate regime effective from 26 February 2008. Owing to the risk of above-target inflation and following the increase in the premium expected of forint instruments, the Council raised the central bank base rate by 100 basis points, and the exchange rate also strengthened considerably.

Although monetary conditions tightened significantly, the strengthening of the forint exchange rate only partially offset the effect of the higher international inflation environment. Based on experience, companies largely adapted by downsizing staff, while, in the opinion of the Council, the rise in wages was not in line with the inflation target. In view of the increased uncertainty, in the summer of 2008 the Monetary Council stopped its rate increasing cycle and adopted a wait-and-see attitude.

The September turn of the crisis which had originated in the US subprime mortgage loan market in 2007 had a decisive effect on the monetary policy of the final quarter of 2008.

The uncertainty that emerged in international markets raised interbank rates to unusual levels. Global financial turmoil spread to the domestic markets as well, primarily to the government securities and FX swap markets. Compared with other countries in the region, the impact on Hungary was stronger, partly due to Hungary's high vulnerability (high ratio of government debt and external debt as well as foreign exchange loans). The MNB attempted to alleviate the turmoil by expanding its set of instruments and with other, non-interest measures.

On 21-22 October the exchange rate of the forint was subject to significant devaluation pressure in excess of a fundamentally justifiable magnitude. At its extraordinary meeting, the Council reacted with a decision to increase the base rate by 300 basis points. The aim of the rate increase was to maintain the stability of the financial intermediary system, to contain a further strengthening of capital outflows and devaluation expectations and to make speculation against the forint more expensive.

In parallel with this decision, negotiations were held with the International Monetary Fund (IMF) and other organisations, as a result of which a total credit line of EUR 20 billion was provided to Hungary. The agreements with the IMF and the EU contributed to restoring international investor confidence and the financial equilibrium. Hungary's risk assessment improved and the vulnerability of the financial intermediary system decreased considerably. Utilisation of the IMF/EU loan sources is reflected in the extraordinary 57% increase in the balance sheet total of the Magyar Nemzeti Bank.

The *Quarterly Report on Inflation* published in November projected significantly lower economic growth than the previous forecast and an inflation path sinking below the target over the time horizon relevant for monetary policy. According to the forecast, the significant deterioration in external economic activity, the declining lending activity of the domestic banking sector and the temporary negative effects of the fiscal deficit reducing measures together will result in a temporary economic downturn, which will only be followed by a slow correction. In 2010, inflation may be below 2%. At the end of the year, the Council reduced its base rate in 3 steps by a total 150 basis points, which was allowed by the stabilisation of financial markets. Consequently, the central bank base rate declined to 10% by the end of the year. The Monetary Council indicated that the expected economic slowdown and the strong disinflation justified further loosening of monetary conditions, which may take place if it is allowed by the continuity of capital flows and the stability of the financial intermediary system.

New instruments introduced to alleviate liquidity pressures in the interbank forint and foreign exchange markets

As a result of the global financial crisis, owing to the stresses in the functioning of the forint money markets and despite the excess liquidity typical of the domestic banking sector, redistribution of liquidity decreased compared to the level preceding the crisis. In addition, domestic financial institutions were also affected by the fact that liquidity declined strongly both in the interbank markets of major currencies and in the domestic government securities market. Therefore, the MNB took several steps which contributed to a better distribution of interbank forint and FX liquidity and to maintaining the functionality of the domestic financial markets.

FX swap instruments introduced to facilitate foreign exchange liquidity of domestic banks

In order to support the distribution of foreign exchange liquidity, starting from 13 October the MNB introduced its two-way O/N FX swap quick tenders (providing euro and forint liquidity). With the help of the new instrument, the MNB connects the euro demand and supply sides of the market, i.e. it acts as a mediator between market participants. In the tenders held on a daily basis, banks which have excess euro liquidity but are unable to place it in the market because of counterparty limit problems may bring their excess liquidity to the MNB, which matches it with other banks' demand for euro.

Although the two-way FX swap quick tender offers a solution to market participants' counterparty limit problems vis-à-vis one another, it does not solve the situation when the euro liquidity demand of the domestic banking sector exceeds supply. Therefore, on 16 October the MNB and the ECB concluded a cooperation agreement, based on which the ECB provides a credit line of EUR 5 billion to the MNB. Using this credit line, in order to support the foreign exchange liquidity of credit institutions, the MNB introduced an overnight FX swap standing facility providing euro liquidity, in the framework of which the MNB provides liquidity for domestic credit institutions at a higher interest rate than the market rate.

New instruments introduced to alleviate tensions in the forint interbank market

To ensure foreign exchange liquidity within the framework of FX swaps, the domestic banking sector had to use its forint liquidity in a more active manner than previously, and thus tensions were observed in the forint interbank market as well.

To support banks' forint liquidity management and thereby reduce the volatility of forint interbank rates, the MNB introduced several new instruments increasing forint liquidity.

Two-week and six-month loan tenders

Although the excess forint liquidity of the banking sector as a whole remained in place in spite of the global financial crisis, at individual bank level there were occurrences of forint liquidity shortages, attributable to low interbank market counterparty limits. In order to eliminate individual forint liquidity shortages, two new central bank loan-side instruments were introduced in October 2008. The two-week, fixed-rate, weekly collateralised loan tender is available for all loan counterparties of the MNB, and until the end of January 2009 Primary Dealers were allowed to participate in the six-month, variable-rate collateralised loan tender. By means of secondary market government securities purchases and the new loan instruments, the MNB increased the excess liquidity of the banking sector, contributing to alleviating interbank market tensions.

Broadening the range of eligible collaterals

The MNB performs all of its credit operations against adequate securities collateral. In order to prevent a shortage of securities collateral of adequate quantity from limiting the satisfaction of the increased demand for loans, the MNB broadened the range of collaterals eligible for credit operations in two steps. Starting from 28 October, the MNB accepts covered bank bonds issued by any entity with which the counterparty has close links as collateral, provided that they meet all other eligibility criteria. In addition, effective from 18 November, regarding eligible collaterals the MNB amended the minimum classification criteria for bonds from the previous 'A' to 'BBB-'. Both steps by the MNB brought the range of collateral eligible for the MNB closer to the set of instruments applied by the ECB.

Reducing the reserve ratio

As from the maintenance period starting on 1 December, the MNB reduced the minimum reserve ratio from the earlier 5% to 2%. In addition to increasing the amount of forint liquidity available for domestic credit institutions, this step represented a continued convergence with the ECB's set of instruments, as the 2% reserve ratio is identical with the one applied by the ECB.

Auctions to purchase government securities

In order to mitigate the liquidity problems on the government securities market and to alleviate forint

interbank market tensions, the MNB held secondary-market auctions to purchase government securities starting from 17 October, on seven occasions altogether. At these auctions, the MNB purchased government securities with a total nominal value of HUF 243 billion at the secondary market at current market prices, which also added to the forint liquidity available for the banking sector.

Changes in instruments in connection with the abolition of the exchange rate band

Effective from 1 April 2008, the MNB amended the business terms and conditions of its forint and FX market transactions. The changes were mainly related to the abolition of the exchange rate band: in a free floating exchange rate regime the MNB naturally does not perform operations at the edge of the band. In addition, in order to better comply with market practices, the MNB can perform spot foreign exchange market operations during more flexible business hours.

3.2 STABILITY OF THE FINANCIAL INTERMEDIARY SYSTEM

The MNB paid special attention to assessing the impacts of developments in international money markets on Hungary and identifying the possible risks in 2008 as well. The set of instruments with which the Central Bank monitors the risks of the domestic financial intermediary system was strengthened.

The financial and real economic crisis affecting all developed economies had a strong impact on Hungary in the second half of 2008. After the collapse of Lehman, a confidence crisis evolved, which resulted in a strong increase in yields and a plunge in equity prices of financial institutions. All these required significant interventions by the Central Bank and the Government. Due to the vulnerability of the Hungarian economy, the crisis had strong effects on the financial markets and the banking sector. The liquidity of the forint government securities market and of the FX swap market, which ensures the hedging of banks' FX position, declined considerably, while yields increased markedly.

In order to reinforce financial markets and the liquidity of the banking sector, the MNB introduced new monetary policy instruments (euro liquidity providing FX swap tenders, two-week and six-month forint loan tenders, secondary-market auctions to purchase government securities, see in more detail in Chapter 3.1), and more emphasis was placed on financial stability in its decisions. Similarly to euro area member countries, Act CIV on strengthening the stability of the financial intermediary system, which was adopted by

Parliament at the end of December, allows for the strengthening of Hungarian credit institutions' capital position by the state and provides state guarantee for funding. The Financial Stability Department of the MNB was an active participant in preparing both the Central Bank's measures and the amendments to the relevant provisions of law. It participated in the formulation of the financial stability chapters of the IMF letter of intent and agreement and in the preparation of Act CIV of 2008 on strengthening the stability of the financial intermediary system.

The MNB published its *Report on Financial Stability* on 15 April 2008. The *Report* discussed the risks in the external environment and the internal operation of the financial intermediary system in detail. The *Report* underlined three risks: first, the danger of permanently low economic growth; second, the increase in asset- and liability-side liquidity risk and third, intensifying risk-based competition coupled with increasing household indebtedness.

In accordance with the special attention paid to the financial intermediary system, in October 2008 the MNB updated its *Report on Financial Stability* published in April 2008. According to the conclusion of the updated *Report*, the risks identified in April 2008 had strengthened in the second half of 2008. Owing to the increased risk aversion of investors, the unfavourable liquidity conditions of the domestic financial sector may become permanent, and economic growth may remain at a low level due to external and internal factors. Financial markets continue to be characterised by uncertainty, somewhat mitigated by the firm measures taken by the authorities. Strong deceleration was experienced in lending to both corporations and households, because banks were tightening lending conditions as a result of their increasing risk aversion and tighter funding conditions. Although the conditions of foreign financing clearly deteriorated, access to funds became more limited and the costs of funds increased, the foreign strategic owners of the Hungarian banking sector ensured the renewal of funds. Loan portfolio quality was deteriorating, but the ratio of bad loans to the total portfolio could still be considered low. The risks were mitigated by the fact that the domestic financial sector had significant capital reserves, its shock resilience was strong, and although its profitability was declining, it was still high in European comparison.

In the first half of 2008, financial institutions wished to prevent the deterioration of profitability by taking on increased credit and liquidity risks (risk-based competition). This was reflected by the appearance and expansion of Japanese yen-based loans as well as the loosening of non-price conditions in lending. On 15 February 2008, the Governor of the MNB and Chairman of the Board of the

Hungarian Financial Supervisory Authority (HFSA) issued a joint recommendation on the systemic risks of foreign currency lending and the institutional and consumer protection requirements of prudent risk assessment and management, with special regard to Japanese yen-based lending. Partly as a result of these recommendations and partly owing to a decline in credit institutions' willingness to take risks, Japanese yen-based lending decreased strongly in the second half of 2008.

Similarly to previous years, in 2008 the MNB compiled its lending survey on two occasions (in January and July), serving the better understanding of bank lending practices. The survey examined lending to households, the corporate sector and municipalities. The findings of the survey were published on the MNB's website and a press release was also prepared for the representatives of printed and electronic media. The survey conducted in July established that in the first half of 2008 Hungarian banks loosened their lending conditions to households to a smaller extent than earlier, while tightening continued to characterise the corporate sector. By the second half of 2008, banks indicated tightening in the household market, which showed up in actual figures as well.

In order to support continuous professional communication between the MNB's business areas and representatives of the banking sector, the so-called 'market intelligence' practice was launched in the first quarter of 2008, based on the practices of the Bank of England (BoE). Within its framework, the MNB's experts consulted representatives of the banking sector and professional associations of financial institutions. The aim of these discussions was to learn about market participants' assessment of current developments. The findings were used in the analyses of the *Report on Financial Stability* published in April 2008. The MNB will continue this practice in the future as well.

On 6 June 2008, the MNB organised a forum called 'Effects of market turbulences on Central and Eastern Europe', with the participation of the deputy governors responsible for financial stability and other senior executives of Central and Eastern European central banks. The participants of the conference discussed the effects of international financial market turbulences on the region, as well as possible ways to cooperate on financial stability issues. The participants considered this event, held for the first time, extremely useful, and the conference is expected to be organised in the future as well, at varying locations and with different topics.

Central bank experts also participated in giving opinions on and preparing the Hungarian implementation of the new European capital requirement directive (CRD) conforming to

the Basel II process (including, inter alia, the government decree on managing the credit risk exposure of investment enterprises) as well as drafts of the domestic and EU-level statutory provisions regarding financial services.

3.3 PAYMENT SYSTEMS AND SECURITIES SETTLEMENT SYSTEMS

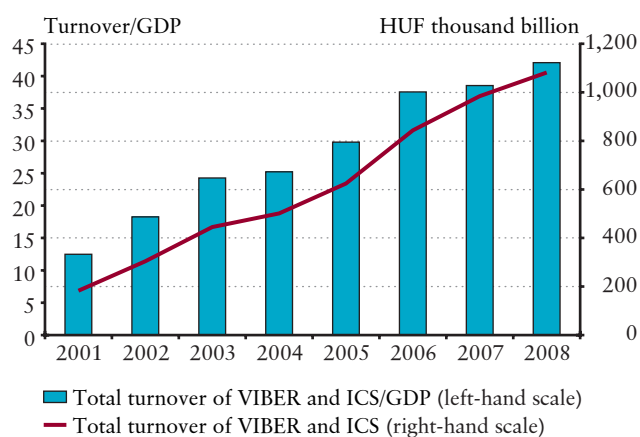
The MNB plays various roles in payment and securities settlement systems. As a neutral partner from the point of view of market competition and a catalyst for interbank cooperation, the MNB facilitates the development of infrastructure in areas requiring joint decisions by stakeholders. In respect of the clearing and settlement infrastructure, the MNB fulfils regulatory, licensing and supervisory functions as an overseer. As a service provider, it manages credit institutions' accounts, on which the payments from interbank transactions are settled with finality. It operates the real time gross settlement system (VIBER). It is a majority owner of the Central Clearing House and Depository Ltd. (KELER Zrt.), co-owner of GIRO Clearing House Limited (GIRO Zrt.) and is a participant in all three settlement systems.

Operation and development of VIBER

In 2008, the number of VIBER participants was 43, one more than at the end of the previous year. Of the total HUF 1,081.6 trillion (thousand billion) turnover of the Interbank Clearing System (ICS) and VIBER, 93.5% was settled in VIBER, while ICS accounted for a larger share in the volume of transactions (99.6%). The total turnover of the two systems was 40.7 times the projected GDP figure for the year, i.e. the average turnover of 9 days of the payment system is equal to GDP.

Chart 1

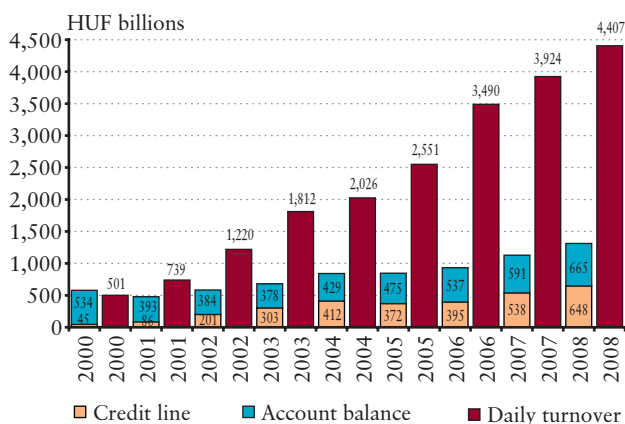
Annual turnover of the ICS and VIBER systems in absolute value and compared to GDP



A total of 1,005.2 thousand payment transactions in an amount of HUF 1,011.3 thousand billion was settled in VIBER during the year. The value of transactions grew by 11.1%, while the number of transactions was 12.6% higher compared to the preceding year. In 2008, the average value per item amounted to HUF 1,006 million, i.e. 1.4% lower than the average of the previous year. The average daily volume of transactions was 3,958, while average daily turnover amounted to HUF 3,981 billion. The largest daily turnover in terms of volume was 8,057 transactions settled on 14 October 2008. The value of turnover peaked with HUF 7,381 billion on 19 March 2008.

In international comparison, the liquidity available for payments of participants in VIBER can still be considered high. Banks' average daily intraday credit line – which is provided by the MNB for the purpose of settling payments against blocked securities held as collateral, and which supplements the bank account balance – amounted to HUF 647.8 billion in 2008, exceeding the previous year's figure by 20.4%. Compared to the previous year, the combined average daily balance available on banks' accounts increased by 12.4%, reaching HUF 664.5 billion. Total liquidity for settlements – arising from the two aforementioned sources – rendered it possible to settle the combined turnover of VIBER and ICS at an average daily value of HUF 4,406.6 billion, representing a 12.3% increase on the daily turnover in the previous year. During the year, the average daily turnover was 3.6 times the daily liquidity, compared to the previous year's average of 3.5 times.

Chart 2
Average daily interbank payment turnover and liquidity (account balance + credit line) between 2000 and 2008



VIBER's availability was 99.81% in 2008, exceeding both the previous year's figure and the internationally expected levels. 4 hours of operating time were lost. There was no incident lasting more than two hours.

The MNB revises the fees charged for the payment services every year. Relative to 2007, the fee charged for a VIBER item declined by HUF 20 to HUF 330 in 2008. Except for the transaction fee, no other system-related costs are imposed on VIBER participants.

During 2008, the MNB revised its earlier decision on joining the Eurosystem's Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET 2). Taking account of the experiences of the adoption of the euro in some member countries (Cyprus, Malta, Slovenia), the MNB decided that from a technical point of view it is sufficient to join TARGET 2 simultaneously with introduction of the euro.

Development of ICS

One of the MNB's important ambitions is to contribute to improving the quality of payment transaction services provided to the customers of credit institutions. In more than 20 countries of the European Union, it is already possible to channel customers' transfer orders through to the beneficiary on the same day. In Hungary, this is only possible for intra-bank transfers and transactions sent through VIBER. At the same time, because ICS, which settles the vast majority of payments, operates during the night, the transfer orders are not credited to the beneficiaries' respective bank accounts until the next working day.

GIRO Zrt. launched a project to modernise the processing system, allowing an increase in the service level ensured to final customers. Under the direction of the MNB, a working group was formed to assess customers' needs and to examine the liquidity effects of the shift to intraday settlement. The resulting analysis found that from a liquidity perspective, there is no practical obstacle to transition to intraday settlement.

The working group also surveyed whether there is any demand for intraday transfer to become a part of credit institutions' basic services. In this non-representative survey companies, municipalities and their personnel were asked to express their opinions. Based on the answers, it can be said that all customer groups would consider intraday settlement as significant progress.

Aware of the above and considering the expected costs and social benefit of the development, the Monetary Council of the MNB decided to support the introduction of intraday settlement in ICS and to propose the implementation of this development to the domestic banking sector. In the MNB's opinion, this development would generate a significant improvement in the quality of service provided to the

economy with a relatively low increase in costs, encouraging competition in the area of payment transactions.

Separation of CCP and CSD functions in KELER

In 2008, KELER, the majority owner of which is the MNB, acted as a central counterparty, a clearing house, a central securities depository and a securities account manager in the form of a specialised credit institution.

Prior to the EU accession of Hungary, the ECB carried out a comprehensive assessment of the accessing countries' securities clearing and settlement systems. The ECB concluded that the performance of the central securities depository and central counterparty function in one legal entity poses too much risk. The Governing Council of the ECB proposed the relevant Hungarian authorities to seek adequate risk management methods together with KELER to solve the above problem.

These consultations resulted in the professional opinion that from a risk aspect, it is justified to separate KELER's central counterparty and central depository functions into two legally independent entities. Following several modifications of the regulatory environment, the practical implementation of the separation was carried out in 2008, and on 1 January 2009 KELER Central Counterparty Ltd. started its operation. Its founding owners are KELER (74.5%), the MNB (13.6%) and the Budapest Stock Exchange (BSE) (11.9%).

Central bank inspection of regulations on payment services and instruments

Last year, the MNB's medium-term strategy on the examination of regulations on payment services and instruments issued by the MNB, as well as the updated examination methodology were adopted.

In 2008, on-site examination of regulations on payment services and instruments at 2 large credit institutions and of the quality of card payments data provided to the MNB at 7 credit institutions were carried out. In addition, off-site examinations of the MNB rules on the submission of direct debit payment instructions were performed at 54 credit institutions. Besides the examinations of credit institutions, the MNB examined all the cash-in-transit companies as well.

Credit institutions carried out their payment services broadly obeying central bank regulations, although the central bank examinations found certain circumvention of the rules at

each credit institution (e.g. in the acceptance and the settlement of payment instructions) which affected the supposed functioning of payment services or resulted in some financial losses for customers. As a consequence of the central bank measures following the examination, the credit institutions formulated action plans in order to fully comply with the central bank's requirements.

The examination found deficiencies in each cash-in-transit company; a fine was imposed on one of them.

The MNB uses the experience gained during central bank examinations in the oversight and development of the payment and securities settlement systems, in the regulation of payment transactions, in the data collection regarding payments and in the performance of central bank tasks serving the prevention of money laundering and the financing of terrorism.

Single Euro Payments Area

The aim of the European legislation and banks' self-regulation related to the implementation of the Single Euro Payments Area (SEPA) is to increase the efficiency of the settlement of retail payment orders within the EU by creating a common legal framework and applying rules and standards. Following the implementation of SEPA, a bank's customer in an EU Member State will be able to perform credit transfers, direct debits and card transactions anywhere within SEPA using one single bank account, as simply as he or she can do it now in case of domestic payment transactions.

The use of the SEPA credit transfer scheme started on 28 January 2008. At present, more than 4,000 European banks, including 13 Hungarian banks are able to send and receive payments in line with the new SEPA format. The SEPA direct debit scheme, the other most frequently used payment instrument is expected to be introduced in November 2009.

According to the expectations of the ECB and the European Payments Council, the currently applied various national payment instruments and standards will gradually – before end-2010 according to the accepted timetable – be replaced by methods of payment based on SEPA schemes.

With the MNB's support, the domestic banking community established the Hungarian SEPA Association in the first half of 2008. Its main task is to coordinate the preparation of the Hungarian banking sector for the adoption of the SEPA payment schemes.

3.4 MANAGEMENT OF FOREIGN EXCHANGE RESERVES

Objectives of holding reserves

Similarly to other central banks, one of the most important tasks of the MNB, as stipulated in the MNB Act, is the management of the country's foreign exchange reserves. The foreign exchange reserves contain the liquid foreign exchange assets of the central bank, which the monetary authority may directly use in the event of payment problems and which provide coverage for foreign exchange market intervention serving monetary policy objectives. Foreign exchange reserves of a country may serve various purposes, the most important of which are worth underlining:

- supporting monetary policy,
- transaction goals (supporting the management of government debt, satisfying the State's demand for foreign exchange and non-residents' claims in the event of a possible crisis),
- accumulation of wealth.

The primary aim of reserve management is to support monetary policy. One of the guarantees for the credibility of the exchange rate regime is an adequate level of reserves, which, if necessary, allows central bank intervention to protect the exchange rate, and supports the fulfilment of the Maastricht exchange rate criterion in relation to joining the Economic and Monetary Union (EMU). No open foreign exchange market intervention took place in 2008.

In terms of the transaction goals, supporting the management of government debt was the most important objective last year. In 2008, the Hungarian State borrowed foreign exchange in the amount of EUR 9.8 billion, which, even when netted with the interest and principal repayments, added more than EUR 7.8 billion to the foreign exchange reserves, since the State converts its foreign exchange resources into forints at the MNB. Transfers received from the European Union increased the reserves by more than EUR 1 billion.

The MNB still does not wish to maintain reserves solely for the purpose of accumulating wealth. At the same time, however, it aims to meet total return criteria when managing foreign exchange reserves in an amount necessary at all times, i.e. it intends to preserve their value as a responsible asset manager and achieve an additional return if possible. As a result of the expansion of the credit spreads of Hungarian bond issues, the costs of maintaining the reserves increased in 2008.

Investment policy

In formulating its investment policy, the MNB strives to adopt the best practice followed by central banks in developed countries. Similarly to the majority of central banks, the MNB pursues a fundamentally conservative investment policy. In our case, the conservative investment policy, in respect of the classical investment triad of return-safety-liquidity means that the emphasis is on the latter two, and thus the aim of holding reserves is maximising the return while maintaining safety and liquidity. Our investment universe is restricted in such a manner that the maximum maturity of bond market assets which can be purchased is 10.5 years, while their credit rating can be 'AA-AAA', or 'A' for euro area countries. Liquidity requirements, in addition to credit ratings, also allow only for purchase of securities issued by developed countries, large international financial institutions and government agencies, and rule out the purchase of securities with large price fluctuations. As a result of this conservative policy, the international credit crisis in 2008 affected the performance of the portfolios to a limited extent only.

The euro continues to play a key role in the foreign exchange structure of reserves. Its weight is justified by the exchange rate regime of Hungary, the country's economic integration into the euro area and the foreign exchange structure of government debt. In addition, the MNB keeps US dollar reserves and, in line with the foreign exchange structure of the IMF loan received, Japanese yen and pound sterling reserves as well.

Regarding the structure of the reserve portfolio, the MNB distinguishes between money market, credit risk free and investment portfolios based on function. The aim of the money market portfolios is to ensure daily liquidity fully (repayments of interest and principal, interventions, other transactions); thus, their value changes on a day-to-day basis with inflows and disbursed amounts. The essence of the difference between credit risk free and investment portfolios is that government securities account for a decisive share in the former, which means a higher degree of liquidity. Accordingly, more emphasis is placed on total return expectations in the case of investment portfolios. Although it is a basic requirement of the investment portfolios that securities be quickly and efficiently marketable, their stable composition also allows investments with longer average durations, depending on the market outlook. The MNB determines the proportion of the portfolio types to each other on the basis of the amount and spread of cash inflows and outflows observed in previous years. At the end of the year, approximately 20% of the reserves was held in the money market portfolio, while 80% was held in the credit risk free and investment portfolios.

Size of reserves

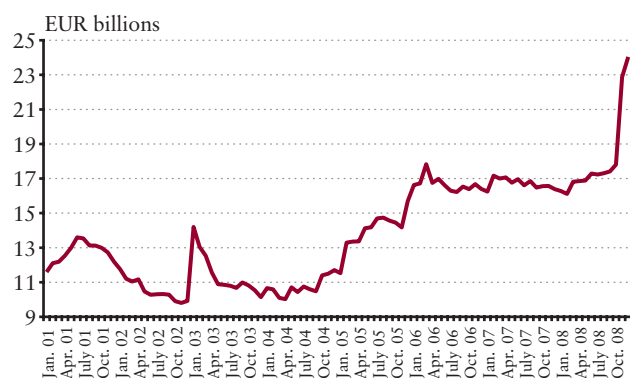
Growing by EUR 7.6 billion during the year, official foreign exchange reserves amounted to EUR 24 billion at end-2008. The level of reserves remained stable in the first three quarters, increasing sharply in the fourth quarter, as a result of receipt of the funds from the IMF and the EU (see Chart 3). On the basis of the indicators most often used to determine the optimum size of foreign exchange reserves and linked to short-term debt, the current level of reserves is somewhat below the optimum level, while based on the indicators linked to the money supply it is in line with it. However, taking account of the IMF and EU credit lines which can still be drawn down, the size of reserves is in conformity with the desirable level in every respect.

During the year, developments in reserves were mostly influenced by the items related to government debt management. The ten-year foreign exchange bond issued in June (maturing in 2018) added nearly EUR 1.5 billion, while the loans from the IMF and the European Commission added EUR 6.9 billion to the foreign exchange reserves. The MNB's other foreign exchange transactions related to debt management (loan repayments, interest payments, interest rate and foreign exchange swaps) resulted in a total decline of nearly EUR 0.2 billion.

Converting the transfers from the European Union resulted in an increase on the order of EUR 1 billion. The return on foreign exchange reserves amounted to nearly EUR 0.7 billion. The forint liquidity expanding effect of the transfers from the European Union and the raising of foreign exchange funds were offset by the sale of EUR 38 million within channelling to the market early during the year and the foreign exchange payments of EUR 1.3 billion effected on behalf of budgetary institutions.

Chart 3

Developments in foreign exchange reserves between 2001–2008



Managing financial risks at the MNB

In the course of conducting its core tasks, the MNB is necessarily confronted with financial risks. As a general principle, the degree of the risks assumed should be known, risk assumption should be conscious, and the degree of the risks in question should correspond to the targets of the core tasks. The MNB mitigates financial risks related to the management of foreign exchange reserves by the use of limits. As a basis for comparison, it applies benchmarks in relation to the investment portfolios which reflect the MNB's preferences with regard to the safety of the managed reserve's value, the liquidity of the reserves and the rate of yield expected on the reserves. The performance of the foreign exchange management activity is indicated in the context of these reference portfolios.

The framework of conscious risk-taking to be applied in 2008 was decided by the Monetary Council. It determined the basic principles of reserve and risk management, defining market, liquidity and credit risks as risks which are consciously taken, decided on the benchmark policy, establishing strategic benchmarks and defining the types of currencies to be held on the assets side in the gross reserve structure.

The Implementation Committee of the MNB approved the limit system within the framework defined by the Monetary Council: maximum deviations of risks of reserve portfolios permitted vis-à-vis the benchmarks, the counterparty limits and the scope of investment instruments permitted in reserve management. Throughout the year, the Asset-Liability Committee (ALCO) reviewed market developments and the Bank's exposure to risks on a monthly basis at least.

The two main pillars of the risk management policy are the two-tier benchmark system and the limit system partly attached to the benchmarks. The risk management organisational unit, which is independent of the business area, reviewed the benchmarks serving yield risk preferences and the measurement of performance on a monthly basis.

The Bank manages the investment and money market portfolios on the basis of separate strategies. In 2008, the benchmark of both the euro- and the dollar-denominated investment portfolios contained high credit rating government securities, corporate bonds as well as money and capital market assets with a maximum remaining maturity of 10.5 years. The composition of the benchmark portfolios, according to credit ratings of assets and remaining maturity, reflects a conservative risk appetite, which is typical for central banks in general.

During the year, renewed waves of the financial crisis which started in the summer of 2007 were observed. From a local problem related to subprime debtors, the crisis turned into a global credit and liquidity crisis following a complete loss of confidence, and then spread to the real economy. In the first three quarters of the year, the effects of the crisis on Hungary were limited. Nevertheless, reserve management had to work in an extremely volatile and unfavourable environment. In line with the conservative investment and risk-taking policy, reserve management performed well. In the fourth quarter, the reserve had to be actually used, within the framework of the FX swap standing facility, and the probability of using a larger amount of reserves increased. The IMF, the World Bank and the European Commission approved a substantial credit line for reducing the effects of the crisis in Hungary. On 12 November, the Government drew down an amount of SDR 4.2 billion (EUR 4.9 billion) from the IMF, which was deposited in the Central Bank by SDR currencies. Without undertaking any exchange rate risk, this fund was placed by the MNB in separated portfolios in identical currencies. In order to minimise interest rate risk, the duration of assets and liabilities is being adjusted.

The technical framework of reserve management was also renewed in the course of the year. Accordingly, the euro-denominated investment portfolio was divided into a portfolio containing only credit risk free assets primarily serving the Bank's monetary policy and stability objectives and an investment portfolio, which also includes assets with credit risk. The change allowed an increased specialisation of reserve managers, an improvement in the quality of internal reporting, and the portfolio management activity better matching the functions became more traceable.

As a result of the yields on euro- and dollar-denominated government securities falling to extreme lows because of the crisis, the nominal return on portfolios was remarkably high in the period under review. The performance of the credit segment was below that of the well-performing government securities sector. The underlying reason for this weaker performance was that the credit spreads increased significantly in several sectors while the yield curve was declining. The aforementioned developments are reflected in the annual performance of the Bank's reserve portfolios. The annualised performance of the credit risk free portfolio created in September was 11.9%, as opposed to the 11.15% yield of the benchmark; the euro-denominated investment portfolio reached a 5.13% return in annualised terms, 67 basis points below its benchmark. The 5.24% annualised return on the dollar-denominated investment portfolio was 3 basis points higher than its benchmark. The annual return of 4.81% on the euro-denominated liquidity portfolio exceeded the relevant benchmark by 39 basis points, while that on the

dollar-denominated liquidity portfolio amounted to 3.43%, also exceeding the 2.84% result of the benchmark by 59 basis points.

The value-at-risk of the items in the Bank's foreign exchange balance according to the change in the interest rate amounted to EUR 60 million at the end of the year (95% confidence level VaR at a 1-month time horizon), while the value relating to the balance calculated with the benchmark portfolios was EUR 51 million (the calculated values amount to nearly 3‰ of the balance sheet total of the foreign exchange balance). The estimated magnitude of the risk of the difference between the investment and the relevant benchmark portfolios was EUR 10 million at a 95% confidence level. The average daily foreign exchange risk calculated for 2008 amounted to EUR 1.2 million (1-day VaR with a 95% confidence level). The magnitudes reflect the implementation of the conservative guiding principles laid down in the risk-taking policy.

Managing operational risks

One emphasised objective of the Bank's management is the efficient and effective management of operational risks. To this end, the MNB's operational risk strategy was completed in July 2008 and adopted by the Executive Committee. The strategy determines the main directions of the development of risk management for the period between 2008 and 2013.

The annual review and analysis of operational risks focused on activities entailing expressly high business, reputation or financial risks, and the collection of key risk indicators and extraordinary events related to them continued on the basis of a single methodology.

In 2008, the business continuity system underwent significant development, while the Disaster Recovery Centre was accommodated in the newly completed Logistics Centre. The most important working processes can be carried out in the Disaster Recovery Centre, which allows the MNB to remain operational even in crisis situations when work cannot continue in the central buildings. A series of tests in the course of the year proved that the Disaster Recovery Centre is able to operate in an adequate manner.

Annual information materials and proposals concerning operational risk management are discussed directly by the Executive Committee, while interim reports which require more detailed discussions are included in the agenda of the Financial System Oversight Committee.

Starting from January 2008, the MNB also participates in ESCB cooperation, which formerly only covered the central

banks belonging to the Eurosystem area but now includes the central banks of the 27 EU Member States. The primary objective of this cooperation is to facilitate cooperation and information sharing between operational risk and business continuity managers and experts across the Eurosystem/ESCB.

3.5 CASH LOGISTICS ACTIVITIES

One of the key tasks of the MNB is to provide citizens and the economy with cash of adequate quantity, quality and denomination. In consideration of this, the central bank introduced a number of important changes in 2008.

On 1 March 2008, the MNB withdrew 1- and 2-forint coins from circulation. As these coins had no significant purchasing power and citizens seldom used them, they were not in active circulation; nevertheless, their costs of production were quite substantial. The withdrawal of 1- and 2-forint coins required the adoption of rounding rules, which facilitated a smooth changeover. Following announcement of the withdrawal on 21 September 2007 and the ensuing communication campaign, the amount of coins returned to the MNB grew gradually and peaked in March 2008. In accordance with its legal obligation, the central bank will continue to exchange the coins at face value until 1 March 2013, and the Magyar Posta (Hungarian Post Office) also participates in exchanging the coins.

33% of the 2-forint coins in circulation flowed back to the central bank by the end of 2008, which amounted to a total of 220.7 million coins (695 tons). In the case of 1 forint coins, 22% of the coins in circulation were returned, amounting to a total of 187 million coins (393 tons).

During the summer of 2008, the MNB decided to replace the existing 200-forint banknotes with coins in 2009. Unprecedented in the history of Hungarian cash issuance, with respect to the final physical parameters and the image to be featured on the coin, the central bank involved not only

professional and civil organisations in the decision making process, but citizens as well.

The opening of the new Logistics Centre in Soroksár in the summer of 2008 represented an important change in the area of cash logistics. The new facility, which was constructed as a part of a greenfield investment project, enables the MNB to perform its key tasks related to cash distribution and cash processing in a modern, sophisticated environment.

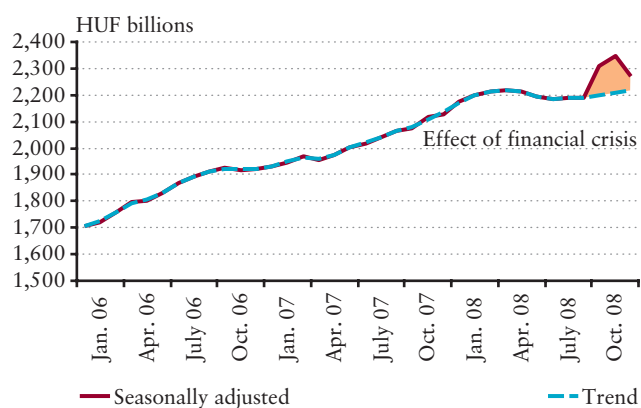
Currency in circulation

At the end of 2008, the value of banknotes and coins in circulation was HUF 2,288.9 billion, up 4.8% (HUF 104.6 billion) on the end of the previous year.

Reflecting the effects of the global financial crisis, in October 2008 the stock of currency in circulation increased (*Chart 4*). Nearly all of this growth affected the largest currency denomination, which suggests that a part of the savings economic agents held at the time was channelled into cash. However, the larger part of the excess growth flowed back to

Chart 4

Developments in the stock of forint banknotes and coins in recent years



Note: Seasonally adjusted monthly average stocks; the trend calculation excludes the growth in cash stock observed in October and November.

Table 2

Currency in circulation on 31 December 2008

Description	2007	2008	Change	
	HUF billions			%
Banknotes	2,153.2	2,259.4	106.2	4.9
Coins	31.1	29.5	-1.6	-5.1
Banknotes and coins	2,184.3	2,288.9	104.6	4.8
Collector coins and commemorative banknotes	4.7	5.2	0.5	10.6
Currency in circulation	2,188.9	2,294.1	105.2	4.8

Table 3**Banknotes in circulation on 31 December 2008**

Denomination	Quantity	Value	Distributions (%)	
	million pieces	HUF billions	quantity	value
HUF 20,000	57.7	1,154.4	18.3	51.1
HUF 10,000	88.3	883.0	27.9	39.1
HUF 5,000	22.4	112.2	7.1	5.0
HUF 2,000	18.3	36.7	5.8	1.6
HUF 1,000	47.4	47.4	15.0	2.1
HUF 500	31.3	15.6	9.9	0.7
HUF 200	50.4	10.1	16.0	0.4
Total	315.9	2,259.4	100.0	100.0

the banking sector in December. The MNB and the cash intermediary system (credit institutions, the Post Office and cash processing organisations) were able to satisfy the unexpected jump in cash demand smoothly.

In 2008, the value of banknotes in circulation increased by 5% compared to the previous year and stood at HUF 2,259 billion at the end of the year. The number of banknotes in circulation amounted to 315.9 million, which represents 3% growth compared to the end of the previous year. In recent years the share of the two largest denominations in the total stock in circulation has gradually increased, particularly that of the 20,000-forint note.

At the end of 2008, the number of coins in circulation was 1,064.1 million, representing a value of HUF 29.5 billion. The number of coins in circulation at the time¹ exceeded that of the previous year by 56 million coins.

Cash distribution and processing

The MNB participates in the cash distribution system as a wholesale distributor; the issued notes and coins reach the end users through the customers of the MNB, credit institutions and the Post Office.

In 2008, the cash turnover of the MNB amounted to a total of HUF 3,349.7 billion, which exceeds the level observed in the previous year by HUF 291.3 billion. However, the number of incoming and outgoing banknotes showed a decline compared to the previous year. In 2008, the MNB paid 294 million banknotes to its customers, while banks paid 284 million banknotes to the central bank. The frequency of the appearance of banknotes at the MNB was 0.96, which indicates a slight decline compared to 2007. In 2008 the MNB qualified 31% of the banknotes it processed² (a total of 293.9 million banknotes) unfit for circulation.

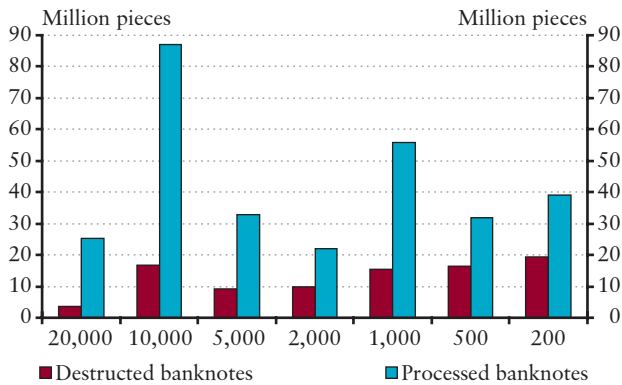
Table 4**Coins in circulation on 31 December 2008**

Denomination	Quantity	Value	Distributions (%)	
	million pieces	HUF millions	quantity	value
HUF 100	154.2	15,423.2	14.5	52.3
HUF 50	114.8	5,739.5	10.8	19.5
HUF 20	207.0	4,139.4	19.5	14.1
HUF 10	246.1	2,460.6	23.1	8.3
HUF 5	342.0	1,710.3	32.1	5.8
Total	1,064.1	29,473.0	100.0	100.0

¹ Number of coins excluding 1- and 2-forint coins.

² Processing: sorting machines examine and verify the authenticity of banknotes and coins returned to the central bank, as well as their fitness for circulation.

Chart 5
Cash processing and sorting of unfit currency, broken down by denomination



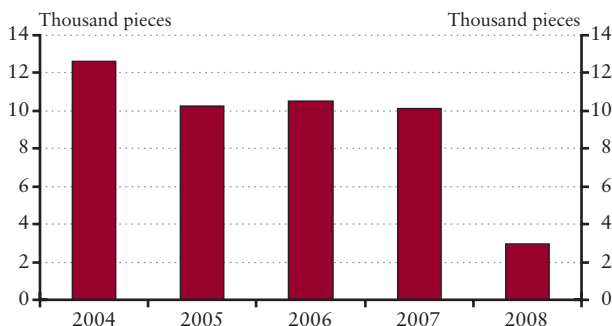
In the course of 2008, the MNB issued a total of 115.9 million banknotes and 70.1 million coins, the total production costs of which amounted to HUF 6.5 billion, 25% less than in 2007.

Prevention and reduction of counterfeiting

The MNB conducts a counterfeit test on suspected forint and foreign counterfeit banknotes and coins circulating in Hungary.

The rate of counterfeit forint banknotes in 2008 reflected a significant decline compared to 2007. In 2008, the experts of the MNB recorded 2,986 forint counterfeit banknotes withdrawn from circulation in a total of 2,789 cases. This decline can be attributed to the growing number of the new 1,000-forint banknotes. A favourable development was observed regarding the average number of counterfeit banknotes per one million banknotes in circulation: in 2008 it amounted to 9 banknotes compared to the 33 counterfeit banknotes recorded in 2007. In 2008, the 20,000-forint bill accounted for the largest share (41.1%) of all counterfeit forint banknotes.

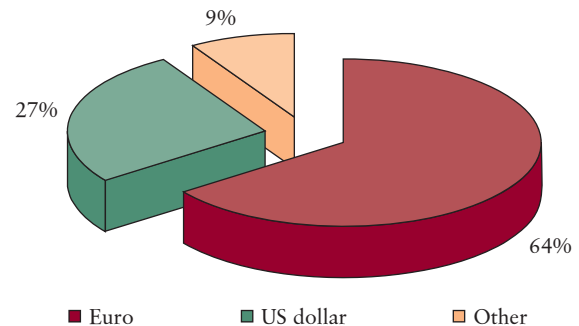
Chart 6
Counterfeiting of forint banknotes



All seized counterfeits were produced by means of office reproduction equipment (colour photocopier, printer). The rate of counterfeits does not jeopardise the safety of cash circulation.

While the number of foreign currency counterfeits did not change substantially during the year, the number of seized counterfeits decreased; the experts of the MNB examined a total of 1,523 different currency counterfeits. Overall, the number of euro counterfeits is relatively moderate; in 2008 a total of 989 euro counterfeits were examined and withdrawn from circulation.

Chart 7
Counterfeit currencies seized from circulation in 2008



Issue of collector coins

The MNB issued six collector coins in 2008, raising the value of collector coins in circulation to HUF 5.2 billion by the end of the year.

The central bank issued a gold collector coin with a face value of HUF 50,000 marking the 550th anniversary of the ascension to the throne of Mátyás Hunyadi, and a silver collector coin with a face value of HUF 5,000 marking the centenary of the birth of Ede Teller and celebrating the Games of the XXIX Olympiad in Beijing, respectively. In addition, as a part of its series of coins depicting Hungarian castles and the Hungarian world heritage sites, the MNB issued two silver collector coins with a face value of HUF 5,000 celebrating the castle of Siklós and the historic Tokaj wine growing region, respectively. The series commemorating the technical innovations and inventions of Hungarian engineers and inventors continued as well; on this occasion the central bank issued a cupronickel collector coin with a face value of HUF 1,000 celebrating Tivadar Puskás' invention, the telephone herald.

In the Hungarian castle series, the commemorative Gyula castle coin issued in 2007 earned prestigious international recognition by winning the public award of the 'Coin of the Year' competition.

3.6 STATISTICAL SERVICES

The MNB's statistical activity

According to Article 4 of the MNB Act, the basic tasks of the central bank include the collection of statistical information required by the Bank to carry out its tasks, the operation of the information system, and the publication of statistical data. The MNB collects statistical information directly from economic agents and receives data from other institutions (HFSA, Central Statistical Office [CSO]), processes the data received, develops and operates information systems, analyses and publishes the compiled statistics, and complies with its international reporting obligations.

The purpose of the statistical work performed by the MNB is to support the monetary policy decision-making process, money market operations, and activities related to stability and the payment system. In addition, as an institution of the National Statistical Service, the MNB is responsible for the compilation and publication of monetary, balance of payments and international investment position statistics, as well as financial accounts.

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. Data supply obligations for 2008 were stipulated by the MNB Decrees No. 14/2007 (XI. 29.) and 3/2007 (II.21.), and within the framework of the National Statistical Data Collection Programme (OSAP) for 2008. Due to the adoption of a new balance of payments data collection system, two MNB decrees specifying the scope of information to be supplied were in effect simultaneously pertaining to the year 2008. The MNB announced data collection requirements for the balance of payments as early as the spring of 2007, which ensured that data suppliers had sufficient time to prepare for the changeover on 1 January 2008.

Changes in 2008

The MNB compiled the 2008Q1 balance of payments and international investment position data and published on 30 June 2008 from information provided by the new data collection system. After the new data collection system was launched in January 2008, the old regime of indirect data provision based on settlements information was terminated, and the MNB now obtains the information required for the compilation of statistics directly from reporting agents. With

the new data collection system the MNB can now publish data based on reported information that have not been available before, such as the stock data of non-financial corporations and the related accrued income, or FDI transactions and positions between fellow companies (i.e. related parties within a corporate group).

In the new regime, financial account statistics provide a more comprehensive and more accurate presentation of inter-company financial relations. The MNB published a revised version of the publication *The Financial Accounts of Hungary* (originally issued in 2005), presenting the data of financial accounts, their possible use, and the methodology applied for the compilation of statistics.

In the course of 2008, the MNB completed its preparations for the harmonisation of securities statistics with data supplies on the balance sheet of investment funds. Starting from 2009 harmonised data supplies are published on the official website of the MNB. In this context, the MNB amended the decree on data supply without imposing a substantial amount of additional burden for investment fund manager data suppliers.

With a view to providing a more clearly organised structure, the MNB revised its statistical publications in 2008. The main section of the data releases presents the most important data and changes in the previous period. The sets of charts, diagrams, methodological notes and the 'Questions and Answers' forum can be accessed via links listed at the end of the press releases.

There was another new development in the year under review in connection with the MNB decree specifying the details of statistical data collections: the MNB launched its electronic data processing system (EBEAD), extending the system to all data suppliers. As a result, the transmission of data supplies became faster, while the quality of reports is easy to control through automated processes verifying compliance with pre-set rules.

International reporting and global co-operation

The MNB complied with all of the reporting obligations pertaining to EU Member States in 2008. Accordingly, it provided regular data supplies to the statistical office of the European Union (Eurostat), the ECB, and the Bank for International Settlements (BIS). In accordance with the requirements imposed by its status as being a central bank in one hand, and a global level of co-operation, as well as, its membership obligations on the other hand, the MNB supplies data and information on a regular basis to the IMF, the World Bank and the OECD.

Co-operation with domestic institutions

In performing its statistical activities, the central bank maintains close professional co-operation with international institutions as well as domestic partner institutions, particularly the CSO, the Ministry of Finance and the HFSA.

Co-operation with the Central Statistical Office was renewed at the highest level in 2008, when the Governor of the MNB and the President of the CSO signed a new co-operation agreement, which reflected the trends of Community and national regulations and, in keeping with the established tradition, contained annual work programmes.

As the new balance of payments data collection system was developed, an important goal was to eliminate overlaps in the national statistical service, thereby reducing the social costs incurred in the course of the compilation of statistics both for data suppliers and the producers of statistics. For this reason, the MNB and the CSO worked together to design and develop the new system.

During 2008 co-operation with the CSO intensified with respect to the harmonisation of the financial and non-financial accounts of the national accounts. Some of the results of the harmonisation process were published in the publications of the CSO and the MNB from September 2008, while another part was incorporated in the statistical data releases in 2009. The two institutions informed users and the general public – both national and international – in a joint press release presenting the details.

3.7 PRACTICAL PREPARATIONS FOR EURO CHANGEOVER

In September 2007, with the promulgation of Government Decree 1071/2007 (IX. 21.), the government established the National Euro Co-ordination Committee (NEC). The Minister of Finance acts as Chairman of the NEC, while the Governor of the MNB co-chairs this body, which implies that the MNB has a particularly important role in defining and conducting the national preparations for euro adoption.

Practical preparation tasks may be defined irrespective of a specified target date, thus practical preparations may commence even in the absence of such a date. It is obvious that meeting the convergence criteria alone will not suffice to establish the conditions required for the introduction of the euro. However, it would be unreasonable to postpone the identification of practical preparation tasks until macroeconomic criteria are met, as it would lead to further delays in the adoption of the euro. Thus it is crucial to

identify the various practical tasks as early as possible, and use them as groundwork for developing a national changeover plan, the execution of which will facilitate smooth currency changeover.

The Government therefore defined the main responsibilities of the NEC, according to which the NEC will:

- involve all relevant parties to develop a national changeover plan 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; review the plan on a regular basis but at least once a year and continuously monitor its completion;
- actively support the preparations of the public and private sectors for the adoption of the euro by providing professional recommendations, particularly in respect of the information, price display and accounting systems and the cash and non-cash changeover;
- provide guidance and information in relation to the early phase for the actual preparations of euro changeover through efficient communication methods; and
- elaborate 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 was recognised as an item of special significance in the MNB's six-year mid-term strategy, which was originally developed in 2007 and remained in effect throughout 2008:

- '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 the primary objective and interest of the MNB to ensure that the Hungarian financial system were 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 the 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’.

Following its foundation, the NEC distributed the workload among 7 sub-committees from the beginning of 2008, with the MNB invited to chair two of these: the Financial Sector Sub-Committee (FSSC) and the Communications Sub-Committee (CSC).

The financial sector will have a 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 FSSC and CSC, the MNB is aware of the fact that the financial sector will be in the front line during the changeover process and will have an important initiative role, as well as a role in raising awareness and providing information. The conversion of bank accounts, loans and other financial products into euro, the transformation of insurance products, the adjustment of retirement account services and the securities market to the future currency and the provision of information technology and infrastructure support for the euro changeover involve tasks in which society as a whole must be directly involved. While the identification and scheduling of tasks, the recognition of problem areas and issues and the development of a preliminary action plan may be a great challenge for the financial sector, the execution of this task will result in major benefits and opportunities. In addition, communication professionals will have to address the difficult task of providing timely information to all citizens, particularly underprivileged, vulnerable social groups.

In 2008, the most important task of the NEC and thus the MNB was to develop and compile the first draft of a national euro changeover plan (NCP). The wide range of experts involved in this work reviewed the national-level practical tasks which, in parallel with the future fulfilment of macroeconomic criteria, will have to be completed in Hungary as well in order to join the euro area and introduce the euro as the new currency. As a result of a joint effort of all seven sub-committees – including the Financial Sector Sub-Committee (FSSC) and Communication Sub-committee (CSC) chaired by the MNB – and participants from the central administration, NGOs, organisations for the protection of employees, and professional chambers representing the private sector, the national euro changeover

plan of Hungary was drawn up by the summer of 2008 and subsequently approved by the Government. Henceforth the NCP is the national working document providing guidelines for all relevant public and private organisations in their practical preparations for the introduction of the euro. The NCP is a public document, which can be accessed by all economic agents as well as the general public.³ In addition, the relevant parliamentary committees, the European Commission and the ECB received a copy of the national euro changeover plan for Hungary.

The first draft of the NCP identified a number of important strategic issues, which the NEC and its sub-committees will carefully examine during the year, and develop specific proposals to resolve these issues. The NCP will be revised and updated in 2009 on the basis of these results, amongst other things.

At the same time – and in line with the contents of NCP – the MNB regularly maintains its own responsibilities in the institutional euro changeover programme of the bank, and makes the appropriate preliminary decisions as required.

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 – can guarantee a smooth changeover to the new currency.

3.8 MNB ACTIVITIES AIMED AT IMPROVING THE FINANCIAL LITERACY OF CITIZENS

The effort to improve financial literacy, which includes raising the financial awareness of households, efficiently supports the central bank in achieving its key strategic objectives and carrying out its basic tasks. With a view to strengthening and integrating the efforts focusing on the improvement of financial literacy, the management of the central bank decided at the end of 2007 to implement an independent financial literacy project.

The central bank launched several new initiatives in 2008, and established efficient forms of cooperation with the relevant institutions and stakeholders. One of the most important developments in this regard was the memorandum of understanding concluded between the MNB and the HFSA to promote the improvement of financial literacy. The two

³ The NCP can be accessed on the official website of the MNB by means of the following link: http://www.mnb.hu/Resource.aspx?ResourceID=mnbfile&resourcename=nat_vegleges.

institutions drew up joint professional documentation outlining the conditions required for the introduction of finance in public education.

In March 2008, the MNB once again distributed its updated publication *Money speaks – do you understand?* (featuring an extended list of topics) to nearly 1,200 secondary schools and about 230,000 11th and 12th grade students and organised a total of three teacher seminars.

With a view to promoting the introduction of finance as a new subject in secondary schools, the central bank and the Self Care Foundation announced a joint invitation for bids on the experimental teaching of the Financial Education Programme developed for secondary schools. A total of 142 candidates submitted applications, of which 25 schools received a grant of HUF 1,000,000 to support the inclusion of the experimental subject in their 2008/2009 curriculum. A total of 60 teachers and nearly 1,000 students participate in the programme.

By the autumn of 2008, the MNB developed a financial educational home page presenting information on central bank-specific topics as well as general financial matters. The home page – which can be accessed at www.penziranytu.mnb.hu – was designed in consideration of the experiences of foreign central banks, as well as the findings of a preliminary focus group survey conducted among students.

Under the established professional co-operation between the MNB, the Ministry of Education and Culture and Educatio Kht, the www.sulinet.hu central education portal was supplemented by a separate finance and economy menu item, providing access to all the educational initiatives concerning finance and economy (quiz shows, competitions, etc.), the relevant links and informational materials in one location.

The Visitor Centre of the MNB received a total of 40,693 visitors in 2008, of which 20,302 visitors participated in the complimentary programmes providing basic financial education and information on the central bank. Besides providing a venue for educational activities and the permanent exhibition, the Visitor Centre continued to host the internal events of the MNB.

In 2008 1,275 students participated in the contest organised by the central bank for secondary school students to promote financial awareness and transfer central bank-specific knowledge.

Targeting a broader professional audience beside the general public, in 2008 the MNB launched its new publication series,

Payment System for Everybody. Focusing on bankcards and bank transfers, the first two publications of the series were issued at the beginning of 2008 and in the autumn of 2008, respectively.

In order to create an opportunity for co-operation and participate in the development of programmes focusing on the improvement of financial literacy, the MNB, the Hungarian Bank Association and the Student Loan Company established the Foundation for Financial Awareness. In addition to its founders, the strategic co-operators of the Foundation include the Hungarian Competition Authority (GVH), the Hungarian Financial Supervisory Authority (HFSA) and the Budapest Stock Exchange (BSE), moreover, the professional associations of the financial sector and other organisations provide active professional assistance in support of the foundation's activities.

On 2 October 2008, with the participation of the OECD, the European Commission and the relevant Hungarian institutions and organisations, the central bank organised a high-level conference on financial awareness. In addition to the remarkably well-prepared presenters representing Hungarian institutions, the Secretary-General of the OECD also gave a presentation. Initiated by the central bank, the participants published a letter of intent at the conference, in which the relevant domestic organisations declared that they proposed and supported the establishment of a national financial education strategy in accordance with the best international practices and the recommendations of the European Commission and the OECD. The OECD and all significant Hungarian public institutions concerned, as well as professional associations and key market players joined the letter of intent.

At the beginning of November 2008, the management of the central bank approved a mid-term functional strategy for the MNB's activities to improve financial literacy, and decided to establish a Financial Literacy Centre.

3.9 FACTORS SHAPING THE COMMUNICATIONS OF THE MNB IN 2008, TARGETS AND RESULTS

Amongst other things, the Central Bank set the following objectives for 2008: providing communication support in order to promote a successful inflation targeting regime and an efficient monetary policy decision support system; enhancing the public image, recognition and credibility of the MNB, and bridging the gap between the Central Bank and the general public. Managing the Communications Subcommittee of the National Euro Co-ordination Committee (NEC), producing the first draft of the Communication Plan

for the introduction of the euro, and communications in relation to the improvement of financial literacy were accorded equally high priority.

The Central Bank's success in meeting the above objectives (pro-active press relations, a series of analytical papers and publications intended for the general public, on-line tools, professional events, forums and media appearances) contributed to professionals' and the general public's better understanding and more transparent view of the operations and activities of the Central Bank and a recognition of the MNB as an organisation committed to improving financial literacy. The number of the Central Bank's press appearances exceeded that of the previous year by nearly 10% in 2008, and the tone of the messages was positive or neutral in 95% of the cases. The MNB issued nearly 40 press releases during the year, in addition to the mandatory releases. In other words, the MNB conveyed its messages to the target groups at least 3 times a month through the press, which contributed to a growing awareness and more positive attitude towards the institution.

In connection with the withdrawal of the 1- and 2-forint coins, the MNB conducted a comprehensive information campaign which facilitated the inflow of the coins to the Central Bank. Preparatory and introductory communications regarding replacement of 200-forint banknotes with coins were equally successful. As the institution in charge, the Central Bank engaged in a dialogue with a wide range of stakeholders, and in reaching its decision the Monetary Council considered the views expressed. For the first time in the history of coin issuance, after the technical parameters had been defined, the MNB invited the general public to vote (on-line or by telephone) on the image to be featured on the new coin. As a result, the new 200-forint coin will bear the image of the Chain Bridge.

On the whole, through the use of state-of-the-art tools of contemporary strategic communication, the MNB strives to ensure that all of 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 2008

In 2008 the MNB incurred a loss of HUF 5.5 billion, which represents a positive change amounting to HUF 11.1 billion in the total profit/loss of the bank compared to 2007.

The financial result and balance sheet structure of the Bank are primarily determined by the objectives and selected

measures of the monetary policy and domestic and international macroeconomic developments, which were as follows in 2008:

- The level and composition of foreign exchange reserves defined by monetary policy, and foreign currency purchases and sales affecting the level of reserves: net foreign exchange inflow deriving from bonds issued by the Government Debt Management Agency and from EU transfers, foreign exchange conversions performed by the Hungarian Treasury for purposes not related to debt-financing and international loan disbursements;
- Changes in the level of liquidity absorbing instruments triggered by changes in the level of foreign exchange reserves;
- Changes in forint interest rates and international foreign exchange interest rates; and
- Changes in the forint exchange rate.

Net interest and interest related income amounted to HUF 8.6 billion, reflecting an increase of HUF 8.3 billion compared to the previous year. Within this figure, net forint interest and interest related income decreased by HUF 11.7 billion, while foreign exchange interest and interest related income increased substantially, rising by HUF 20 billion.

Net forint interest and interest-related losses incurred in 2008 amounted to HUF 161.3 billion. While total income increased by HUF 10.2 billion, total expenditures increased by HUF 21.9 billion, which accounts for the overall deterioration of income. The growth in interest expenditure can be attributed to the central bank base rate on the one hand, which was raised by 88 basis points on a yearly average, and to the annual average stock of forint liabilities bearing a central bank base rate interest (forint deposits by the central government, minimum reserve requirements, liquidity absorbing instruments), which increased by nearly HUF 30 billion.

The Central Bank realised net foreign exchange interest and interest related income of HUF 169,9 billion in the period under review. On the balance sheet, foreign exchange reserves represent the item with the most significant impact on this income category.

In addition to foreign exchange conversions, the level of foreign exchange reserves largely depended on international loan disbursements in 2008. The Hungarian government and the MNB concluded an agreement with the IMF and the

Table 5
Abbreviated income statement and individual balance sheet items of the MNB

HUF billions

Nr	Description (P/L line)	2007	2008	Change
		1	2	3
1	Net interest and interest related income (I+II)-(X+XI)	0.3	8.6	8.3
2	– net forint interest and interest related income (I-X)	-149.6	-161.3	-11.7
3	– net foreign exchange interest and interest related income (II-XI)	149.9	169.9	20.0
4	Realised gains/losses arising from financial operations (IV-XIV)	-4.5	3.8	8.3
5	Income arising from exchange rate changes (III-XII)	9.0	9.2	0.2
6	Other constituents of net income* (V+...+VIII)-(XIII+XV+...+XVIII)	-21.4	-27.1	-5.7
7	Profit/loss for the year (1+4+5+6)	-16.6	-5.5	11.1
	Revaluation reserves in the balance sheet			
8	– due to unrealised foreign exchange gain/loss	49.9	236.3	186.4
9	– due to changes in the market value of the foreign currency securities**	-2.8	46.7	49.5

* Other constituents of net income consist of net expenses of money circulation and operations, net provision, and other income/expenses.

** The negative balance at the end of 2007 is stated under receivables from the central government in the year-end balance sheet.

European Commission on a stand-by credit facility, from which the Hungarian government disbursed a total amount of EUR 6.9 billion at the end of 2008. The disbursement from the IMF in the amount of EUR 4.9 billion was deposited to a foreign exchange account with the MNB, while the Hungarian government exchanged the EUR 2 billion loan amount granted by the European Commission into forint, which resulted in an increase in the net foreign exchange position.

As a combined result of loan disbursements, conversions and changes in the forint exchange rate:

- the MNB's net foreign exchange position increased by EUR 2.9 billion to EUR 18.3 billion in 2008,
- foreign exchange reserves excluding accrued interest increased more substantially, by EUR 7.6 billion to EUR 23.8 billion (HUF 6,296.7 billion).

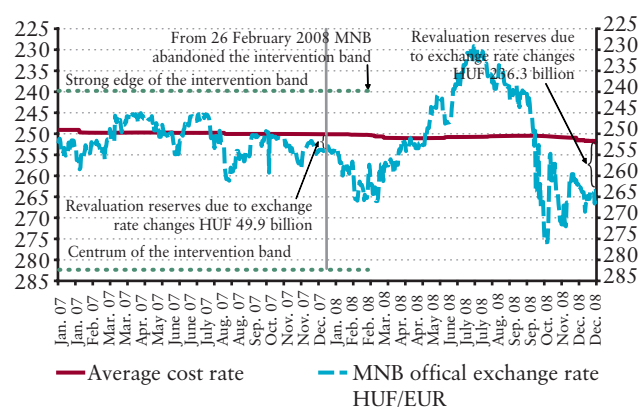
The change in the foreign exchange interest income is predominantly attributable to the increase in interest revenues on foreign exchange reserves of HUF 18.6 billion, which reflected the increase in the level of foreign exchange reserves and the higher average yields on the reserves.

In 2008, total gains realised on financial operations amounted to HUF 3.8 billion, compared to a loss of HUF 4.5 billion in 2007. The gains realised on the sale and maturity of securities in foreign exchange reserves resulting from market price changes significantly contributed to the HUF 8.3 billion improvement in profits.

Income arising from exchange rate changes is primarily determined by the difference between the official exchange rate and the cost rate, which nearly quadrupled by 31 December 2008, growing to 12.7 forint/euro from 3.25 forint/euro at the end of the previous year. The depreciation of the official forint exchange rate, which was observed at the beginning of 2008, was soon followed by a strong appreciation in the first half of the year after the intervention band was eliminated (26 February 2008). The forint exchange rate was subject to substantial depreciation pressure in October, but the pressure abated when the Central Bank raised the base rate and a substantial loan amount was granted under the credit facility agreement with international organisations (IMF, EU, World Bank). Overall, the forint depreciated by 4.5% against the euro during the year, and the exchange rate stood at 264.78 forint/euro on 31 December 2008.

Chart 8
Changes in the forint exchange rate

(1 January 2007–31 December 2008)



Foreign exchange profits realised in 2007 and 2008 were nearly the same, amounting to HUF 9 billion and HUF 9.2 billion, respectively. This reflects a remarkably strong EUR/HUF exchange rate through 2008 Q2 and particularly Q3, when the difference between the official exchange rate and the average cost rate was negative. In these two quarters, the MNB incurred exchange rate losses, while it realised profits from foreign exchange rate changes in Q1 and Q4.

Other income and expense items include general operating costs, expenses, income and expenditures, costs of issuing banknotes and coins, income/expenses from fees and commissions and from items other than fees and commissions. The net expenditures calculated from these items increased by HUF 5.7 billion compared to the previous year, primarily reflecting an increase in the level of provisions for potential future losses. Within this, the most significant item is a provision for the negative market value of investments associated with security lending.

Changes in the equity of the MNB are predominantly influenced by changes in the revaluation reserves. The MNB's equity at the end of 2007 amounted to HUF 74.8 billion, which increased to HUF 302.5 billion by the end of 2008.

Revaluation reserves of the forint exchange rate increased by HUF 186.4 billion compared to the end of 2007. This is primarily due to the growing gap between the official forint exchange rate and the average cost rate, however, the increasing stock of revaluated foreign currencies (net FX position) also contributed to this growth. Revaluation reserves of the forint exchange rate increased to HUF 236.3 billion at the end of 2008.

Reflecting a substantial year-on-year decline in euro yields, the revaluation reserves of foreign exchange securities indicated an unrealised gain of HUF 46.7 billion by the end of 2008.

Both revaluation reserves indicate a positive amount, and the retained earnings (HUF 14.9 billion) were sufficient to cover

the losses incurred in 2008, thus the central government does not have a reimbursement obligation for 2008 pursuant to the MNB Act.

Internal operations of the MNB in 2008

The internal operations of the Bank 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 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 2007 audit.

The 4.7% decline observed in personnel costs in 2008 resulted primarily from a lower average staff number compared to 2007, and the decline in termination costs and severance pay. Overall, general operating costs were 12% higher than in 2007, primarily resulting from the increased operating, IT and depreciation costs associated with the Logistics Centre, and from the one-off expense related to the cost-efficiency survey.

The financially realised value of investment projects implemented in 2008 was HUF 2,570 million, which significantly falls behind the previous year's figure in magnitude. 60% of investment expenses in 2008 were related to the ongoing implementation of the Logistics Centre. The project, which started several years ago, was completed on 30 June 2008, and the Bank took possession of the building and the technology systems. The more significant investment projects of 2008 include the enhancement of cash logistics systems, a part of which was upgrading the banknote processing machines to handle multiple denominations. In addition, modernisation of the IT infrastructure and enhanced integration of systems continued, and the data storage system of the Bank was updated.

Table 6

Operating costs of the MNB in 2008

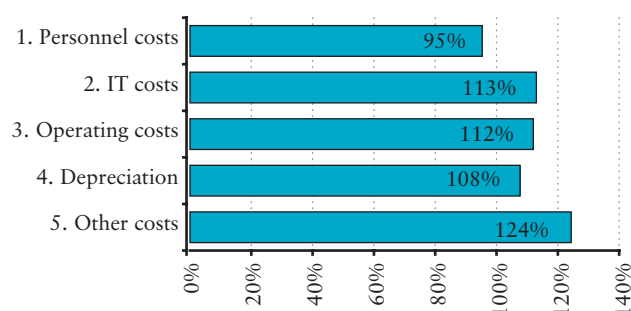
Description	Actual data for 2007	Budget for 2008	Actual data for 2008	Index (2008 actual / 2008 budgeted)	Index (2008 actual / 2007 actual)
	HUF millions			%	
Personnel expenses	8,464	8,485	8,068	95.1	95.3
General operation costs	6,112	7,465	6,843	91.7	112.0
Total	14,576	15,950	14,911	93.5	102.3

Operating costs

The approved operating cost budget for 2008 was HUF 16,189 million (including central reserves in the amount of HUF 239 million). In comparison, actual costs amounted to HUF 14,911 million. This figure exceeds the operating costs observed in 2007 by 2.3%, which is the net result of the diverse changes specific cost categories were subject to both in terms of magnitude and direction.

Chart 9

Ratio of operating costs in 2008 to actual data in 2007



Personnel costs

Overall, personnel costs in 2008 (HUF 8,068 million) fell by 4.7% compared to 2007. This decline in personnel costs primarily reflects a 7.1% decline in the Bank's average staff number (715 vs. 664 in 2007 and 2008, respectively), and a nearly 60% decline in the expenses related to employer-initiated termination of employment.

General operating costs

General operating costs in 2008 (HUF 6,843 million) increased by 12% compared to 2007.

The amount of *IT costs* incurred in 2008 (HUF 1,476 million) exceeded the amount observed in 2007 by 13.1%. The majority of these expenses are software operating costs (monitoring, support, maintenance and consulting costs) which are required primarily for guaranteeing the continuous and safe maintenance of infrastructure and data processing systems supporting the core activities of the Bank. Owing to the service level optimisation launched during the year, these costs were considerably lower in 2008 than planned.

The amount of *operating costs* (HUF 1,736 million) increased by 12.1% compared to the previous year. On the one hand, this growth reflects the additional expenses related to the operations of the Logistics Centre, which commenced during

the year (utility costs, and costs related to real estate maintenance, cleaning, security and protection and cash delivery), on the other hand, it resulted from the increased maintenance cost requirement of the cash logistics systems installed in the Logistics Centre. Within operating costs, rental fees and telephone charges decreased substantially.

The amount of the *depreciation* of tangible and intangible assets in 2008 (HUF 2,469 million) was 7.8% higher than in 2007, which also reflects the intra-year commencement of the Logistics Centre's operations and the installation of its different systems. In addition to the above, a depreciation cost of HUF 5 million was incurred in relation to VIBER, which was booked under expenditures, as stipulated by the relevant accounting rules.

The total amount of other costs was HUF 1,233 million in 2008, 24.4% higher than in 2007, which reflects the net effect of positive and negative changes in the components of the cost category. Primarily due to the systematic reduction of media appearances and advertisements, communication costs decreased significantly. Costs related to the purchases of journals and professional literature, economic consulting, data purchases, PR and conferences also decreased. However, the assignment fee of the cost-efficiency survey conducted in 2008 (which was payable in a lump sum) exceeded the level of the above savings, and resulted in a net increase in other costs.

Capital expenditure

For new investment launched in 2008 and for re-scheduled and value-updated ongoing investment projects, in December 2007 the Management Committee approved an investment plan for the period 2008-2010. It also acknowledged the total estimated expenditure of investments in progress, which included actual expenditure up to 2007 (which was partly projected), and expenditure budgeted for the years to follow. More than 90% of this was related to the implementation of the Logistics Centre.

In 2008 Q1, in light of the actual data for 2007 and taking account of the items carried forward, these budget estimates were revised.

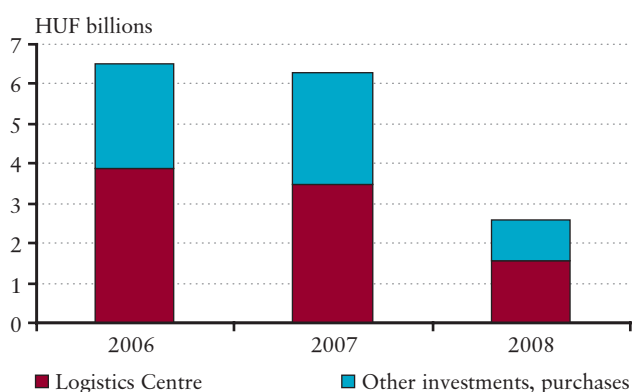
Based on decisions made in prior years, the majority of the investment expenditures of the MNB in 2008 was related to investments already in progress.

There are two underlying reasons behind the discrepancy between total estimated expenditure and actual expenditure thus far:

Table 7**Investment of the MNB, 2008**

HUF millions

Description	Total budget	Actual		
		up to 2007	2008	Sum total
1. Investments started before 2008	13,192	10,030	1,786	11,816
<i>from this: Logistics Centre</i>	<i>11,400</i>	<i>9,523</i>	<i>1,544</i>	<i>11,067</i>
2. Investments started in 2008	2,099	0	783	783
Total (1+2)	15,291	10,030	2,569	12,599
<i>from this: investments finished in 2008</i>	<i>12,573</i>	<i>9,909</i>	<i>2,400</i>	<i>12,309</i>

Chart 10**Investment of the MNB, 2006–2008**

– First, a part of the total estimated expenditure of investment projects covers cost intensive projects continuing in 2009;

– Second, as a result of intra-year decisions, some of the investment projects scheduled for the beginning of 2008 were postponed or cancelled. Based on management decisions (e.g. elimination of the strategic cash storage) and intra-year revisions of scheduled IT investment projects, certain projects were cancelled. In addition, the implementation of some developments was postponed to 2009 due to the default of an external supplier. In the case of investment projects completed in 2008, the discrepancy between total estimated expenditure and actual expenditure is largely due to the residual amount remaining after the completion of the Logistics Centre project.

Establishment of the Logistics Centre

The MNB decided to build a Logistics Centre which would be a sophisticated, efficiently and securely operating facility of European standard, one that would also guarantee proper conditions for the future introduction of the euro. The Board of Directors approved the complete (projected) financial plan of

the facility in 2003 (with a total budget of HUF 11.4 billion). Implementation was in line with this concept. In order to ensure that a contemporary, efficient cash processing system was implemented and to exploit the most recent technical developments, additional enhancements took place and equipment was purchased. The most important of these items was the purchase of an integrated banknote processing system with a value of HUF 618 million in 2007, which was installed in the new Logistics Centre. In addition, the reconfiguration of the banknote processing systems into multi-denomination systems (see below) was a HUF 232 million project. The Logistics Centre project was completed on 30 June 2008, and the relevant organisational units of the MNB and Magyar Pénzverő Zrt. (Hungarian Mint, Ltd) occupied the building and took possession of the technology systems on site. The project was implemented within the approved budget, and the tangible assets and immaterial goods have been capitalised.

Additional investment

To facilitate state-of-the-art banknote processing, the banknote processing systems of the MNB have been reconfigured into multi-denomination systems, allowing the organisations responsible for market processing and packaging to place multiple denominations in one packaging unit, which simplified their cash management activities.

In 2008, an investment project was launched in the building at Szabadság tér 8-9 to develop new work areas on the site of the former cash logistics, and designs for the reconfiguration have been completed. Reconstruction work required for the reconfiguration of office space will be completed by the end of 2009. Parallel to this work, another project has been launched, aimed at the relocation of the computer room currently located in the building at Hold u. 7 to the building at Szabadság tér 8-9. The working drawings of the new computer room were prepared in 2008 and the project is also scheduled to be completed in 2009. The investment projects described above will enable the bank to cease use of the building at Hold u. 7, which is expected to take place in 2010.

As a result of management decisions necessitated by the current financial and economic situation, the furniture purchases planned for 2008 have only been partially accomplished.

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. As a result of the project completed in 2008 within the framework of the Integrated Statistical System Programme, a new application supporting balance of payments statistics has been implemented, and live operations have commenced. The new system is fast and flexible even in international comparison, and its capability to document processes is a significant added benefit.

Additional IT investment projects were aimed at supporting administrative processes (e.g. an IT Requirements Management System and an Electronic Attendance Register have been implemented), and ensuring the continuous and secure availability of technical infrastructure. The upgrade of the central data storage and the related technical architecture supporting data backup and recovery has been completed, and data storage capacity has been increased.

Other investment and purchases in 2008 were mainly related to the technological modernisation of real estate, and security technology enhancements.

Human resources management of the MNB

Staff number and personnel costs

In 2008, the average staff number of the MNB was 50.9 employees lower than in 2007 (663.9 employees). At the end of 2008, the total staff number of the MNB was 641 employees; 49 less (7.1%) than the number of employees at the end of 2006. In 2008, the employment status of 102 employees was terminated; termination was initiated by the employer in 59 cases, by employees in 36 cases, while 7 employees' employment was terminated due to retirement and other reasons (e.g. expiry of fixed-term contracts).

Some of the factors influencing the staff number of the MNB in 2008 included the following measures:

- Shutting down the regional currency branch offices in Debrecen and Székesfehérvár commenced in 2007 and finished in January 2008.
- Management measures aimed at improving efficiency and rationalising operations combined with the new technology supporting cash logistics activities resulted in a reduction of personnel.

In 2008, the ratio of employees with a college or university degree was 2.1% higher than in the previous year. The composition by age of the MNB personnel is still favourable; the average age of those employed remained the same in 2008 (41.1). In 2008, the average employment period at the MNB slightly increased, reaching 12.9 years.

New human resources strategy developed in 2008

In line with the institutional strategy developed in 2007, a new human resources strategy was developed in 2008, the aim of which is to determine the main directions of human resources management for the organisation until 2011. Over the past six years human resources strategy has focused on the development, introduction and institutionalisation of modern HR management systems. By contrast, during the next few years the Bank intends to concentrate on a successful and efficient application of existing HR systems. Main directions of the new human resources strategy are the following:

- Promoting personal development;
- Introducing the role of HR partner to facilitate a successful application of HR systems and best practices;
- Enhancing managerial initiatives and management skills to facilitate the ability to manage and motivate people successfully;
- Further enhancing the organisational culture and promoting a value-oriented organisational and management culture;
- Improving the ability to retain a talented, well-performing workforce;
- Improving a systematic performance management, assessment and measuring system, and maintaining performance-focused and result-oriented corporate culture and operations;
- Maintaining and improving the MNB's recruiting capability.

Improving the ability to retain key workforce and talent

In January 2008, the MNB introduced a new job classification system and new promotion principles, which had been designed with the intention of motivating employees. The new system allows for a greater flexibility in the appreciation and motivation of employees, and provides transparent development and career opportunities. When the system was introduced at the beginning of 2008, 84 employees were promoted either in the form of advancement

within a specific wage band or advancement between wage bands. The credibility, successful application and incentive power of the job classification system is confirmed by the fact that the promotions planned by the management for 2009 will be similar in magnitude to those in 2008. Initially involving 4 organisational units, the MNB started a project of drawing up career maps to facilitate an even more transparent and practical application of the new job classification and promotion system at the end of 2008.

An employee satisfaction survey was conducted in 2008 Q1, which was followed by an additional focus-group survey during the summer of 2008. The focus group drew attention to several areas that needed improvement; based on the feedback the MNB made plans for well-founded, target-oriented actions. The planned actions include short-term and long-term measures aimed at improving the organisational and management culture of the central bank. For the purpose of improving its ability to retain and motivate employees, the MNB has started to implement the action plans approved by the Management Committee.

Organisational development programmes

In 2008, two areas were subject to large-scale organisational development.

The reorganisation of the operations of IT Services began by the preparation of a diagnosis. The next step was to identify the development needs and actions required to achieve the following goals:

- Develop an organisational structure and provide human resources for the structural reorganisation;
- Change internal attitudes and culture;
- Apply the findings of business case studies;
- Personal development both in terms of professional and personal skills.

The opening of the Logistics Centre resulted in several changes affecting the working conditions and lifestyle of the MNB's employees. With a view to facilitating its employees' adaptation to the new conditions, the MNB developed a transportation support program.

As a result of consultations preceding the relocation, all of the employees with a key role in the smooth execution of the transition agreed to undertake the changed conditions. Only 4 employees decided to terminate their employment. Six employees were transferred to a new position with an

opportunity to pursue their career in banking in a position that is consistent with their professional progress. As a result of improved efficiency stemming from the application of new technology, the MNB terminated the employment of 13 employees. In order to assist departing employees in their job search, the MNB offered career counselling, which most of the affected employees attended.

In September 2008, the MNB conducted an internal customer satisfaction survey for 7 organisational units in a consistent format across the organisation. The objective of the survey was to improve internal service provider attitudes across the central bank based on feedback from partners. The respective areas analysed the findings of the survey and developed action plans to improve service quality. In the form of a questionnaire, members of the Monetary Council evaluated the activities of areas which participate regularly in developing preparatory documents for decision-making. The MNB intends to involve additional areas in the internal customer satisfaction survey in 2009.

Improving the objectivity of performance assessment

In 2008, the MNB designed a role model for managers, which was consistent with the strategy and values of the institution, reflected the expectations of its executive management, and served as a basis for a 360-degree performance evaluation of managers. With the introduction of the 360-degree evaluation, the MNB intends to ensure that managers receive regular, realistic feedback from their subordinates, peers and supervisors, support dialogue among the central bank's managers with respect to their work, and promote a feedback-oriented culture.

In the course of 2008, action plans supporting the implementation of strategic objectives were developed along with their schedules, and indicators were produced to support the process of target versus actual performance assessment for 2009.

In 2008, 62% of a total of 21 employees returned from maternity/parenting leave, of which 8 employees returned to their original organisation unit and position. An additional 5 employees participated in the maternity programme organised by the bank; their future employment is uncertain as yet. The MNB was able to offer part-time or telecommuting opportunities to three returning employees.

The maternity programme of the MNB was designed to assist employees returning to work and provide alternative hours to accommodate their needs; in addition, it offers development opportunities as well; six employees used the training assistance provided by the MNB in 2008.

Table 8**Changes in labour flow indicators**

Indicators	2008
Fluctuation	
Fluctuation rate (departing employees + new entries / 2x total headcount)	11.1%
Departure rate (departing employees / total headcount)	15.4%
Voluntary departure rate (ratio to total headcount)	4.4%
Voluntary departure of key employees	10 persons
Voluntary departure rate of key employees leaving the country	30.0%
Recruitment	
Recruitment needs	56 persons
Ratio of recruitments to replace departing employees to total recruitment needs	78.6%
Ratio of new entries to total headcount	6.9%
Open positions filled internally	30.7%

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 work together and formulate common positions, and this co-operation allows the representatives of individual national banks to obtain information about 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, 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 experience 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. It contributes to the harmonisation of practices applied in the euro area, the development of the

system which monitors counterfeiting, and the verification of statistics related to euro banknotes and coins.

Banking Supervision Committee (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. In the Committee, Hungary is represented jointly by the MNB and the Hungarian Financial Supervisory Authority (HFSA).

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.

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 the compliance of the Community and national authorities with their consultation obligations related to draft legislation in areas within the competence of the ECB, and publishes reports on its findings.

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

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.

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 Eurosystem 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): The 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.

3.12 PUBLICATIONS, CONFERENCES ORGANISED BY THE MNB IN 2008

Publications

Quarterly Report on Inflation

Published four times a year, the objective of the publication is to enable the public to understand and monitor the policy of the central bank. In this publication, the MNB regularly reports on past and expected developments in inflation and evaluates the macroeconomic trends affecting inflation. This publication also 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 2008 the publication was issued two times.

Report on the activity of the MNB

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).

Annual Report

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

Report on Convergence

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

MNB Occasional Papers

This series presents economic analyses related to monetary decisions of the MNB, and 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 present the results of analyses and research work 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 2008, the third 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 in which the central bank is involved.

Other publications

The MNB launched its series Payment System for Everybody in 2008. The first publication in the series presented an overview of practical information regarding the use of bankcards in an entertaining format, while the second

volume provided clear and comprehensible, useful information about money transfers.

All publications of the MNB are available on its official website: www.mnb.hu.

Conferences and presentations*Conferences and scientific events*

21-22 February 2008: BIS Working Party on Monetary Policy in Central and Eastern Europe

6 June 2008: Budapest Round Table on Financial Stability

1-2 July 2008: EURO 50 Group Financial Stability Around the Eurozone in the Context of Global Market Turmoil

August 29 2008: Productivity and Economic Growth: Labour Market Challenges – Conference

9 September 2008: Cash-in Conference

2 October 2008: Conference on Financial Awareness

30-31 October 2008: 7th Macroeconomic Policy Research Workshop on Productivity, Trade and Development

Committee/working group meetings organised by the ECB at the MNB

11-12 September 2008: BANCO-SWG Meeting

Lectures

16 January 2008: Budapest Economic Seminar Series (BESS) at MNB – Tor Jacobson: Aggregate Shocks and Firm Default Risk

22 January 2008: BESS at MNB – Christina Felfe: Returning to Work – Mothers' Willingness to Pay for Amenities

23 January 2008: BESS at MNB – Günter Coenen: Conditional versus Unconditional Forecasting with the New Area-Wide Model of the Euro Area

24 January 2008: BESS at MNB – Alessandro Notarpietro: Credit Frictions and Household Debt in the U.S. Business Cycle: A Bayesian Approach

25 January 2008: BESS at MNB – Edgar Preugschat: Unionization Rate, Organizing, and Firm Turnover

29 January 2008: BESS at MNB – Alain Gabler: Sector-specific Markup Fluctuations and the Business Cycle

5 February 2008: BESS at MNB – José Dorich: The Welfare Losses of Price Rigidities

14 February 2008: BESS at MNB – Katrin Rabitsch: Capital liberalization and the U.S. external imbalance

12 March 2008: BESS at MNB – Michael Krause: Inflation Dynamics and Search Frictions

20 March 2008: BESS at MNB – Fabio Canova: Measurement with some Theory: Using Sign Restrictions to Evaluate Business Cycle Models

21 March 2008: BESS at MNB – Evi Pappa: To Target Inflation or Not: A Conditional Analysis

3 April 2008: BESS at MNB – Péter Gábor – Ádám Reiff: Price Setting in Hungary: a Store-Level Analysis

9 April 2008: BESS at MNB – Raphael Auer: Trade with Low Income Countries and US Industry and Inflation

17 December 2008: BESS at MNB – Michael Wickens: Optimal Monetary Policy using a Var

14 May 2008: BESS at MNB – Michele Boldrin Business cycles and asset pricing

21 May 2008: BESS at MNB – Péter Benczúr: The Elasticity of Taxable Income: Estimates and Flat Tax Predictions using the Hungarian Tax Changes in 2005

28 May 2008: BESS at MNB – Martin Gervais: First-Time Home Buyers and Residential Investment Volatility

9 June 2008: BESS at MNB – Michael Gordy: The Bank as Grim Reaper: Debt Composition and Recoveries on Defaulted Debt

18 June 2008: BESS at MNB – Klaus Adam: Monetary Policy and the Great Moderation

25 June 2008: BESS at MNB – Christian Julliard: Can Rare Events Explain the Equity Premium Puzzle?

17 September 2008: BESS at MNB – John Bluedorn: Heterogeneous Bank Lending Responses to Monetary Policy: New Evidence from a Real-Time Identification

24 September 2008: BESS at MNB – Marc Flandreau: Bonds and Brands: Foundation of Sovereign Debt Markets

30 September 2008: BESS at MNB – Juan Carlos Conesa: Generational Policy and the Measurement of Tax Incidence

7 October 2008: Bodnár Katalin: Exchange rate exposure of Hungarian enterprises – results of a survey

8 October 2008: BESS at MNB – Paul De Grauwe: Animal Spirits and Monetary Policy

15 October 2008: BESS at MNB – David Andolfatto: Essential Interest-Bearing Money

22 October 2008: BESS at MNB – Ester Faia: Optimal Monetary Policy with Credit Augmented Liquidity cycles

29 October 2008: BESS at MNB – Martin Gervais: Why Has Homeownership Fallen Among the Young?

5 November 2008: BESS at MNB – Carlos Thomas: Labor market reform and price stability: an application to the Euro Area

12 November 2008: BESS at MNB – Harald Fadinger: Productivity Differences in an Interdependent World

19 November 2008: BESS at MNB – Gianluca Benigno: Optimal Policy with Occasionally Binding Credit Constraints

3 December 2008: BESS at MNB – David Domeij: The Missing Swedish Skill Premium: Sweden versus the United States 1970-2002

17 December 2008: BESS at MNB – Michael Wickens: Optimal Monetary Policy using a Var

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)

BUCO: Budget Committee

- COMCO:** Committee on Cost Methodology (an ESCB committee)
- CSO:** Central Statistical Office
- ECB:** European Central Bank
- ECCO:** External Communications Committee (an ESCB committee)
- EIB:** European Investment Bank
- EISC:** Eurosystem IT Steering Committee
- EMU:** Economic and Monetary Union
- EPC:** European Payments Council
- ERM II:** An exchange rate mechanism starting from the third stage of EMU; it essentially links the currencies of non-euro area Member States to the euro.
- ESCB:** European System of Central Banks
- 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 Audit 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
- NSC:** National SEPA Committee (see also: SEPA)
- OECD:** Organisation for Economic Cooperation and Development
- O/N:** Overnight deposit/loan
- OSAP:** National Statistical Data Collection Programme
- 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

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 euro area 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, $\pm 15\%$ 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 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.

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.

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 the MNB. If they have a negative balance, the central government is liable to reimburse the negative portion, and credit the amount to the respective revaluation reserve account by 31 March of the year following the current year. 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 repurchased foreign exchange bonds) are to be indicated in the revaluation reserve of foreign exchange securities which, constitutes a part of the equity.

Repo and reverse repo 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).

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 Auditor's Report on the 2008 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 Auditor's Report

To the shareholder of Magyar Nemzeti Bank

We have audited the accompanying 2008 annual report of Magyar Nemzeti Bank (hereinafter referred to as "the Bank"), which comprises the balance sheet as at 31 December 2008, which shows total assets of MHUF 7,366,519 and retained loss for the year of MHUF 5,464, and the income statement for the year then ended, and the supplementary notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the annual report in accordance with the provisions of the Act on Accounting and accounting principles generally accepted in Hungary. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the annual report based on the audit and to assess whether the business report is consistent with the annual report. 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 relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. 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.

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 2008, and of its financial performance and of the result of its operations for the year then ended. The business report is consistent with the disclosures in the annual report.

Budapest, 15 April, 2009

KPMG Hungária Kft.
Chamber registration number: 000202

Henye István
Henye István
Partner, Registered Auditor
Identification number: 005674

2 Balance sheet of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	ASSETS	31. 12. 2007	31. 12. 2008	Change
	1	2	3	3-2
	I. RECEIVABLES DENOMINATED IN FORINT	149,512	536,526	387,014
4.3.	1. Receivables from the central government	149,511	360,005	210,494
4.17.	of which: receivables to refund the revaluation reserve of foreign currency securities*	2,799	0	-2,799
4.7.	2. Receivables from credit institutions	0	176,520	176,520
	3. Other receivables	1	1	0
	II. RECEIVABLES DENOMINATED IN FOREIGN CURRENCY	4,436,866	6,689,214	2,252,348
4.9.	1. Gold and foreign currency reserves	4,091,604	6,296,749	2,205,145
4.4.	2. Receivables from the central government	7,583	4,970	-2,613
	3. Receivables from credit institutions	0	0	0
4.10.	4. Other receivables	337,679	387,495	49,816
	III. BANKING ASSETS	36,764	36,587	-177
4.13.	of which: invested assets	36,101	36,418	317
4.15.	IV. PREPAID EXPENSES/ACCRUED INCOME	80,954	104,192	23,238
	V. TOTAL ASSETS (I+II+III+IV)	4,704,096	7,366,519	2,662,423
Reference number to notes on the Accounts	LIABILITIES AND EQUITY	31. 12. 2007	31. 12. 2008	Change
	1	2	3	3-2
	VI. LIABILITIES DENOMINATED IN FORINT	4,005,524	4,793,968	788,444
4.5.	1. Central government deposits	196,816	127,637	-69,179
4.8.	2. Deposits by credit institutions	1,062,380	1,121,287	58,907
	3. Banknotes and coins in circulation	2,188,951	2,294,106	105,155
4.11.	4. Other deposits and liabilities	557,377	1,250,938	693,561
	VII. LIABILITIES DENOMINATED IN FOREIGN CURRENCY	583,067	2,222,394	1,639,327
4.5.	1. Central government deposits	58,130	1,518,273	1,460,143
4.8.	2. Deposits by credit institutions	1,086	27,410	26,324
4.11.	3. Other deposits and liabilities	523,851	676,711	152,860
4.14.	VIII. PROVISIONS	1,740	9,157	7,417
	IX. OTHER BANKING LIABILITIES	15,999	16,963	964
4.15.	X. ACCRUED EXPENSES/DEFERRED INCOME	22,984	21,574	-1,410
4.16.	XI. EQUITY	74,782	302,463	227,681
	1. Share capital	10,000	10,000	0
	2. Retained earnings	31,507	14,925	-16,582
	3. Valuation reserves	0	0	0
4.17.	4. Revaluation reserves due to exchange rate changes	49,857	236,258	186,401
4.17.	5. Revaluation reserves of foreign currency securities	0	46,744	46,744
	6. Profit/Loss for the year	-16,582	-5,464	11,118
	XII. TOTAL EQUITY AND LIABILITIES (VI+VII+VIII+IX+X+XI)	4,704,096	7,366,519	2,662,423

* Pursuant to Article 17, par. (4) of the MNB Act, the receivables due to the negative balance of revaluation reserves of foreign currency securities was reimbursed by the central government by 31 March 2008.

15 April 2009



András Simor
Governor of the Magyar Nemzeti Bank

3 Income statement of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	INCOME	31. 12. 2007	31. 12. 2008	Change
	1	2	3	3-2
4.19.	I. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FORINT	12,167	22,337	10,170
	1. Interest on receivables from the central government	11,886	14,317	2,431
	2. Interest on receivables from credit institutions	271	6,188	5,917
	3. Interest on other receivables	0	0	0
	4. Interest related income	10	1,832	1,822
4.19.	II. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FOREIGN CURRENCY	209,002	204,446	-4,556
	1. Interest on foreign currency reserves	164,082	182,722	18,640
	2. Interest on receivables from the central government	5,199	0	-5,199
	3. Interest on receivables from credit institutions	6	2	-4
	4. Interest on other receivables	3,169	2,896	-273
	5. Interest related income	36,546	18,826	-17,720
4.20.	III. INCOME ARISING FROM EXCHANGE RATE CHANGES	13,482	26,404	12,922
4.19.	IV. REALISED GAINS ARISING FROM FINANCIAL OPERATIONS	2,298	12,140	9,842
4.22.	V. OTHER INCOME	5,182	4,333	-849
	1. Fees and commissions	981	891	-90
4.23.	2. Income other than fees and commissions	4,201	3,442	-759
4.14.	VI. PROVISIONS RELEASED	57	940	883
4.14.	VII. IMPAIRMENT RELEASED	192	1,385	1,193
4.24.	VIII. OPERATING INCOME	275	181	-94
	IX. TOTAL INCOME (I+II+III+IV+V+VI+VII+VIII)	242,655	272,166	29,511
Reference number to notes on the Accounts	EXPENSES	31. 12. 2007	31. 12. 2008	Change
	1	2	3	3-2
4.19.	X. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FORINT	161,781	183,687	21,906
	1. Interest on central government deposits	31,163	33,469	2,306
	2. Interest on deposits by credit institutions	55,326	80,860	25,534
	3. Interest on other deposits	75,292	69,358	-5,934
	4. Interest related expenses	0	0	0
4.19.	XI. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FOREIGN CURRENCY	59,067	34,468	-24,599
	1. Interest on central government deposits	2,910	5,120	2,210
	2. Interest on deposits of credit institutions	446	268	-178
	3. Interest on other liabilities	16,277	11,899	-4,378
	4. Interest related expenses	39,434	17,181	-22,253
4.20.	XII. EXPENSES RESULTING FROM EXCHANGE RATE CHANGES	4,470	17,220	12,750
4.21.	XIII. COST OF ISSUING BANKNOTES AND COINS	9,047	6,993	-2,054
4.19.	XIV. REALISED LOSSES ARISING FROM FINANCIAL OPERATIONS	6,805	8,298	1,493
4.22.	XV. OTHER EXPENSES	1,630	3,313	1,683
	1. Fees and commissions	511	434	-77
4.23.	2. Expenses other than fees and commissions	1,119	2,879	1,760
4.14.	XVI. PROVISIONS CHARGED	1,740	8,357	6,617
4.14.	XVII. IMPAIRMENT	0	0	0
4.24.	XVIII. OPERATING COSTS AND EXPENSES	14,697	15,294	597
	XIX. TOTAL EXPENSES (X+XI+XII+XIII+XIV+XV+XVI+XVII+XVIII)	259,237	277,630	18,393
	XX. PROFIT/LOSS BEFORE DIVIDENDS (IX-XIX)	-16,582	-5,464	11,118
	XXI. Dividends from retained earnings	0	0	0
	XXII. Dividends	0	0	0
	XXIII. PROFIT/LOSS FOR THE YEAR (XX+XXI-XXII)	-16,582	-5,464	11,118

15 April 2009



András Simor
Governor of the Magyar Nemzeti Bank

4 Notes to the financial statements

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 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 day 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 that 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 day entering into a transaction. The same procedure is applied to recording the translation difference in the balance sheet relating to derivative transactions for hedging purposes.

On a daily basis the MNB records:

- the exchange rate differences arising from the revaluation of its foreign assets and liabilities and derivative transactions for hedging purposes recorded off-balance sheet, and
- the accrued/deferred interest arising from in- 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 parts of foreign exchange gains and losses deriving from the daily revaluation, and
- charging depreciation.

Upon the quarterly closing of accounts, the MNB qualifies its off-balance sheet contingent claims and liabilities, and future receivables arising from derivative transactions for other purposes and security-lending operations based on international

agreement, and at the end of the year the invested assets, claims and other off-balance sheet liabilities. As a result of this qualification, the Bank recognises impairment loss as necessary and makes provisions for liabilities and for expected losses.

The balance sheet preparation 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 of Finance, which, being in charge of public finances, exercises the rights of ownership as laid down in the Act on MNB. This is in 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 the supervisory board's approval. The Annual Report is published unabridged 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.

The financial statements of the MNB must be audited by 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 the accounting services is Gábor Kalina, Finance Ministry registration number: 176115.

4.1.2. Major principles of valuation

Receivables from the central government

The securities stated among the 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.

The 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.

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

The MNB records in its books all foreign currency assets and liabilities at the official exchange rate prevailing on the day of purchase. 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 as conversion income for that particular day and is stated 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. The banking assets and banking liabilities in foreign currencies (with the exception of foreign investments) and the 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 day.

Daily accounting for accrued income is preceded by reversing the accrued income on the previous day. This implies that 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 the daily revaluation, realised exchange rate gain 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 day of valuation and the book value is recorded in the revaluation reserve of foreign currency securities. Exchange rate gains or losses realised on selling and maturing are stated within 'Realised gains/losses arising from financial operations'.

The Magyar Nemzeti Bank values its securities on the basis of market prices prevailing on 31 December. Due to the fact that 31 December is not a trading day on European and Japanese stock exchanges, securities quoted there are valued on 30 December 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 valued 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.

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.

The other part of the quota, which does not have to be transferred to the IMF, is presented under 'Other foreign currency receivables' in the balance sheet. The related IMF forint deposit is presented in 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 identical to the forint equivalent of the SDR value of the unsubscribed part of its quota. As this deposit account is a HUF account only formally, it is shown under 'Other foreign currency receivables' in the balance sheet.

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 a 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 among 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 shall be made equalling 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, 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

Description	31. 12. 2007	31. 12. 2008
Concessions, licences and similar rights	17.0%	17.0%
Trade-marks patents and similar assets	20.0–50.0%	14.5–50.0%
Capitalized value of reorganization	20.0%	20.0%
Buildings	3.0%	3.0%
Vehicles	12.0–25.0%	10.0–25.0%*
Telecommunication devices, office equipment, machines	9.0–33.0%	9.0–50.0%
Computer hardware	14.5–33.0%	9.0–50.0%
Emission machinery	20.0–50.0%	5.0–50.0%
Instruments	14.5–33.0%	9.0–33.0%
Bank security devices	9.5–33.0%	2.0–33.0%
Other not specified devices**	14.5–33.0%	6.5–33.0%

* Residual value 25%.

** For example, office equipment, other equipment and devices.

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.

Depreciation rates applied by the MNB were changed significantly compared with 2007. These changes must be adopted in the case of new procurement after 31 January 2008. Depreciation rates of certain groups of assets became more sophisticated in terms of reflecting better the time of use of each property.

4.2 EFFECTS OF MACROECONOMIC TRENDS ON THE 2008 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 of monetary policy, as well as by domestic and international economic events.

Due to weakening of the forint exchange rate, the total net revaluation effect was a gain of HUF 195.6 billion in 2008. The official forint exchange rate against the EUR fluctuated in a rather wide band during the year. The difference between the official forint exchange rate and the average cost rate increased to 12.7 forint-euro by the end of the year and it was almost four times higher compared to the end of the previous year. Despite this, the net income arising from exchange rate changes was a gain of HUF 9.2 billion in the reference year, hardly larger than it was in the base year. This was the result of the strong forint exchange rate against the euro prevailing in the second and mainly in the third quarter of 2008 when the bank realised loss on exchange rate due to the negative difference between the official and the average cost rate. In the first and fourth quarters of 2008 inverse impacts were manifested, therefore the MNB earned profit from foreign exchange rate changes. The revaluation reserve due to exchange rate changes increased by HUF 186.4 billion to HUF 236.3 billion in 2008.

In 2008, the bank recorded a HUF 8.6 billion net interest and interest related gain, which was an increase of HUF 8.3 billion relative to the previous year. The net interest income was improved by the increase of interest income in foreign currency caused by the higher net foreign currency position and by the rise of the annual return on foreign currency reserves. The net interest income was worsened by the increase of forint interest expenses, because the average of central bank base rate in 2008 was higher by 88 basis points than that of the preceding year.

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

4.3 FORINT RECEIVABLES FROM THE CENTRAL GOVERNMENT

B/S line	Remaining maturity	Balance		Change
		HUF millions		
		31. 12. 2007	31. 12. 2008	
	Government bonds maturing within 1 year	1,449	51,749	50,300
	Government bonds maturing within 1 to 5 years	5,706	160,054	154,348
	Government bonds maturing over 5 years	139,557	148,202	8,645
	Securities	146,712	360,005	213,293
	Revaluation reserves of foreign exchange securities	2,799	0	-2,799
I.1.	Total receivables from the central government	149,511	360,005	210,494

For reducing the liquidity disturbance on the market of government securities the MNB bought bonds in the secondary market in the last quarter of 2008. Thus the amount of government securities increased by HUF 213.3 billion.

Receivables due to a negative balance of the revaluation reserve at the end of 2007 related to the market valuation of foreign currency securities amounted to HUF 2.8 billion, which the central government refunded by 31 March 2008 (based on the Act on MNB).

The balances of revaluation reserves due to exchange rate changes and of foreign currency securities were positive on 31 December 2008, therefore receivables against the central government were not arose.

In 2008, there was no profit from the withdrawal of notes and coins; therefore there was no change in the related receivables from the central government. (Pursuant to the Act on MNB 18.§ – which was repealed from 1 January 2009 – the profit from the withdrawal of notes and coins should be used to reduce any state debt vis-à-vis the MNB.)

4.4 FOREIGN CURRENCY RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Swap transactions with the central government	0	335	335
	Currency swaps with the central government	7,583	4,635	-2,948
II.2.	Foreign currency receivables from the central government	7,583	4,970	-2,613

The balance of foreign exchange swap transactions with the central government derive from a HUF/EUR swap, the deal date of which was 30 December 2008.

The balance of HUF 4.6 billion of foreign currency receivables from the central government contains currency swaps concluded with the ÁKK before June 2002 for adjusting the foreign currency and interest structure of the foreign debt. The decrease of HUF 2.9 billion compared to the previous year resulted from expiry of HUF 3.5 billion, but this was partly compensated by revaluation of HUF 0.6 billion on the remaining amount.

Foreign currency receivables from the central government by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2007	31. 12. 2008	
	- within 1 year	2,607	1,911	-696
	- within 1 to 5 years	4,589	3,059	-1,530
	- over 5 years	387	0	-387
II.2.	Foreign currency receivables from the central government	7,583	4,970	-2,613

Currency structure of swaps concluded with the central government

HUF millions

Nr	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
1.	- HUF	0	133,210	133,210
2.	- EUR currency group*	31,848	18,748	-13,100
3.	Swap receivables (1+2)	31,848	151,958	120,110
4.	- HUF	0	485	485
5.	- EUR currency group*	6,773	132,390	125,617
6.	- USD	17,492	14,113	-3,379
7.	Swap payables (4+5+6)	24,265	146,988	122,723
8.	Net swap receivables (3-7)	7,583	4,970	-2,613

* 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. 2007	31. 12. 2008	
	Single Treasury Account (KESZ)	196,401	127,203	-69,198
	Deposit by Government Debt Management Agency (ÁKK Zrt)	351	371	20
	Other	64	63	-1
VI.1.	Forint deposits of the central government (total)	196,816	127,637	-69,179

Foreign currency deposits of the central government

The balance of the foreign currency liabilities of the central government amounted to HUF 58,130 billion on 31 December 2007 and HUF 1,518,273 billion on 31 December 2008.

The expiry dates of all central government's foreign currency deposits are within a year. The balance significantly increased by HUF 1460.1 billion compared to the total amount of the previous year-end. The main reason of growth was that the foreign currency amount from IMF loan was not converted by the central government in the fourth quarter of 2008, but was placed to its foreign currency deposit.

4.6 NET POSITIONS VIS-À-VIS THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
I.1-VI.1.	Net forint position	-47,305	232,368	279,673
II.2-VII.1.	Net foreign currency position	-50,547	-1,513,303	-1,462,756
	Total	-97,852	-1,280,935	-1,183,083

4.7 FORINT RECEIVABLES FROM CREDIT INSTITUTIONS

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Security-backed loans	0	176,520	176,520
	Refinancing credit to credit institutions in liquidation/pending liquidation	1,384	0	-1,384
	Total receivables from credit institutions in gross value	1,384	176,520	175,136
	Impairment provision for claims on credit institutions	-1,384	0	1,384
I.2.	Total receivables from credit institutions	0	176,520	176,520

The security-backed loans were mainly collateralised loan tenders drawn down by domestic credit institutions in November and December.

The balance of receivables from a liquidated credit institution amounting to HUF 1.4 billion was booked out at the end of the liquidation process in 2008 and the related impairment loss in the same amount was taken into account as backmarking.

The expiry dates of forint receivables from credit institutions were within a year.

4.8 NET POSITIONS VIS-À-VIS CREDIT INSTITUTIONS

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
I.2–VI.2.	Net forint position	-1,062,380	-944,767	117,613
II.3–VII.2.	Net foreign currency position	-1,086	-27,410	-26,324
	Total	-1,063,466	-972,177	91,289

Net liabilities to credit institutions decreased by HUF 91.3 billion by the end of 2008. The net forint position increased by HUF 117.6 billion compared to the previous year-end. The change of net foreign currency position was caused by the HUF 26.3 billion increase of foreign currency deposits of credit institutions, of which the net swap liabilities of domestic credit institutions was HUF 19.1 billion. The credit institutions placed short-term money market deposits with the MNB in the amount of HUF 3.4 billion at the end of 2008.

4.9 GOLD AND FOREIGN EXCHANGE RESERVES OF THE CENTRAL BANK

Forint balances

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Gold reserve	14,136	16,130	1,994
	Reserve position in the IMF	19,391	21,475	2,084
	Foreign currency deposits	349,889	948,589	598,700
	Foreign currency securities	3,608,796	5,231,307	1,622,511
	Foreign currency repo transactions	99,392	79,248	-20,144
II.1.	Gold and foreign currency reserves (total)	4,091,604	6,296,749	2,205,145

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 2,205.1 billion to HUF 6,296.7 billion by the end of 2008. The change was caused by a rise of balances and depreciation of exchange rate as well.

Euro balances

EUR millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Gold reserve	56	61	5
	Reserve position in the IMF	77	81	4
	Foreign currency deposits	1,381	3,583	2,202
	Foreign currency securities	14,244	19,757	5,513
	Foreign currency repo transactions	392	299	-93
II.1.	Gold and foreign currency reserves (total)	16,150	23,781	7,631

The official exchange rate of the forint was 253.35 forint/euro on 31 December 2007 and 264.78 forint/euro on 31 December 2008.

The main causes of the increase of the amount of gold and foreign exchange reserves were the foreign currency loans drawn down by the Hungarian State at the end of 2008, the conversion of foreign currencies (into forint) with the MNB arising from the Hungarian government securities issued twice in 2008, net EU-transfers and market yields of the reserves.

Sales of euro in a price-taking manner (re-channelling) reduced the level of the gold and foreign exchange reserves, as did liabilities occurring due to expiration of JPY denominated securities issued by the MNB 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 the gold and foreign exchange reserves denominated in euro increased by EUR 7.6 billion by the end of 2008.

4.10 OTHER FOREIGN CURRENCY RECEIVABLES

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Forint payment of IMF quota	261,523	280,544	19,021
	Repurchased bonds	72,301	74,244	1,943
	Foreign hedging transactions*	3,488	29,624	26,136
	Other	367	3,083	2,716
II.4.	Other foreign currency receivables	337,679	387,495	49,816

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

The HUF 49.8 billion increase of other foreign currency receivables was largely the consequence of changes in exchange rates that immediately affected the holdings of foreign currency and, on the other hand, the net differences between the claim and liability sides of foreign hedging transactions.

To reduce the risk arising from the exchange rate fluctuations, the number of swap transactions for hedging purposes with non-resident counterparts increased significantly in the last quarter of the year.

The amount of repurchased bonds issued abroad by the MNB decreased by HUF 10.1 billion because of expiry of a bond denominated in JPY; however, the weaker forint exchange rate against the American dollar and the Japanese yen caused a HUF 2 billion of increase of the balance.

The forint payment of IMF quota increased, mainly due to the depreciation of the forint exchange rate in comparison to SDR.

4.11 OTHER LIABILITIES

Other forint liabilities

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Two-week MNB bills	550,464	1,245,232	694,768
	International financial institutions forint deposits	6,036	4,960	-1,076
	Other liabilities	877	746	-131
VI.4.	Other forint deposits and liabilities	557,377	1,250,938	693,561

The other forint deposits and liabilities increased by HUF 693.6 billion compared to the previous year end, due to the significant growth of the amount of two-week MNB bills. The most important monetary policy instruments are these two-week MNB bills. The key policy rate is permanently equal to the current central bank base rate.

Other foreign currency liabilities

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Bonds	171,718	172,932	1,214
	Repo transactions	51,223	174,172	122,949
	IMF forint deposit	261,524	280,544	19,020
	Foreign deposits and loans	1,969	39,821	37,852
	Hedging transactions	37,077	8,610	-28,467
	Other liabilities	340	632	292
VII.3.	Other foreign currency liabilities	523,851	676,711	152,860

The HUF 152.9 billion increase of other foreign currency liabilities arose mainly from the rise of foreign currency liabilities of repo transactions amounting to HUF 122.9 billion. The year-end balance includes mainly the repo transactions with the ECB in a value of EUR 460 billion.

The line 'Hedging transactions' consists of net receivables of currency swap transactions with non-resident counterparts, which amount decreased by HUF 28.5 billion due to maturities and exchange rate changes.

Other foreign currency liabilities by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2007	31. 12. 2008	
	- within 1 year	361,766	496,785	135,019
	- within 1 to 5 years	97,961	159,103	61,142
	- over 5 years	64,124	20,823	-43,301
VII.3.	Other foreign currency liabilities	523,851	676,711	152,860

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

HUF millions

Nr	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
1.	- USD	35,230	56,434	21,204
2.	- EUR currency group*	65,572	195,546	129,974
3.	- JPY	126,306	135,576	9,270
4.	- Other	259,666	280,545	20,879
5.	Other foreign currency liabilities	486,774	668,101	181,327

* 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.

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

HUF millions

Nr	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
1.	– USD	52,014	56,409	4,395
2.	– EUR currency group*	10,293	1,657	–8,636
3.	– JPY	99,086	83,554	–15,532
4.	Hedging transactions receivables (1+2+3)	161,393	141,620	–19,773
5.	– USD	0	0	0
6.	– EUR currency group*	195,421	148,356	–47,065
7.	– JPY	3,049	1,874	–1,175
8.	Hedging transactions payables (5+6+7)	198,470	150,230	–48,240
9.	Net hedging transactions payables (8–4)	37,077	8,610	–28,467

* 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. 2007	31. 12. 2008	
from II.1.	IMF quota paid in SDR	19,391	21,475	2,084
from II.1.	Deposit with IMF	14,291	10,226	–4,065
from II.1.	Deposit with IMF for Fund's programme purposes	2,499	2,687	188
from II.4.	IMF quota paid in HUF	261,523	280,544	19,021
	Total receivables	297,704	314,932	17,228
from VII.3.	IMF Nr 2. account	1	1	0
from VII.3.	IMF Nr 1. account	261,523	280,544	19,021
	Total liabilities	261,524	280,545	19,021
	Total	36,180	34,387	–1,793

The forint-denominated promissory note related to the liability from Fund disbursements of the Hungarian State and placed with the MNB as fiscal agent is shown as an off-balance sheet item in the balance sheet of the MNB. The commitment amounted to HUF 1,107.5 billion.

4.13 INVESTED ASSETS

In addition to intangibles, tangibles and capital expenditure (HUF 18.6 billion), invested assets include shares in investments (HUF 6.7 billion foreign investments and HUF 11.1 billion 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. 2007	7,494	563	7,682	8,133	225	9,054	33,151
Installation/Repurchases	1,238	-32	6,641	4,226	0	-9,490	2,583
Scrapping	-176	0	-25	-651	0	-27	-879
Selling	0	0	0	-117	0	0	-117
Transfer free of charge	-1	0	-585	-313	0	0	-899
Other disposal	-1,167	-517	0	-23	0	531	-1,176
31. 12. 2008	7,388	14	13,713	11,255	225	68	32,663
Details of depreciation							
31. 12. 2007	5,625	0	2,287	6,363	0	0	14,275
Planned depreciation	1,002	0	317	1,155	0	0	2,474
Removal from the account	-175	0	-243	-1,065	0	0	-1,483
Decrease due to reclassification	-1,167	0	0	-23	0	0	-1,190
31. 12. 2008	5,285	0	2,361	6,430	0	0	14,076
Closing net value							
31. 12. 2007	1,869	563	5,395	1,770	225	9,054	18,876
31. 12. 2008	2,103	14	11,352	4,825	225	68	18,587
Change	234	-549	5,957	3,055	0	-8,986	-289

The setting into operation of the Logistics Centre made a significant change in the gross value of assets in 2008. The value of assets placed into service on 1 July 2008 was HUF 10.7 billion and at the end of the year this showed an increase of HUF 1.2 billion.

Foreign investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2007	31. 12. 2008	31. 12. 2007	31. 12. 2008	2007	2008
BIS (SDR millions, CHF millions)	1.43	1.43	4,766 10 13.5	5,313 10 13.5	604	556
European Central Bank (EUR thousands)	1.31	1.31	1,343 5,299	1,403 5,299	0	0
SWIFT (EUR thousands)	0.02	0.02	2 8.6	2 8.6	0	0
Total investments			6,111	6,718	604	556

* Dividends financially settled in the given year.

On 1 May 2004 Hungary joined the European Union. Consequently, the MNB became a member of the ESCB. The ESCB consists of 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 in 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.

Ownership distribution in the ECB as of 1 January 2008 (on 31 December 2008)

National Central Banks (NCBs)	Subscribed capital	Paid-up capital	Capital key
	EUR thousands		(%)
Nationale Bank van België / Banque Nationale de Belgique	142,334	142,334	2.4708
Deutsche Bundesbank	1,182,149	1,182,149	20.5211
Bank of Greece	104,660	104,660	1.8168
Banco de España	434,918	434,918	7.5498
Banque de France	828,814	828,814	14.3875
Central Bank and Financial Services Authority of Ireland	51,183	51,183	0.8885
Banca d'Italia	721,792	721,792	12.5297
Central Bank of Cyprus	7,195	7,195	0.1249
Banque centrale du Luxembourg	9,073	9,073	0.1575
Central Bank of Malta / Bank Centrali ta' Malta	3,583	3,583	0.0622
De Nederlandsche Bank	224,302	224,302	3.8937
Österreichische Nationalbank	116,129	116,129	2.0159
Banco de Portugal	98,720	98,720	1.7137
Banka Slovenije	18,400	18,400	0.3194
Suomen Pankki-Finlands Bank	71,709	71,709	1.2448
Subtotal for euro area NCBs	4,014,961	4,014,961	69.6963
Danmarks Nationalbank	87,205	6,104	1.5138
Sveriges Riksbank	134,298	9,401	2.3313
Bank of England	802,672	56,187	13.9337
Česká národní banka	79,958	5,597	1.3880
Eesti Pank	9,810	687	0.1703
Latvijas Banka	16,205	1,134	0.2813
Lietuvos bankas	24,068	1,685	0.4178
Magyar Nemzeti Bank	75,701	5,299	1.3141
Narodowy Bank Polski	280,820	19,657	4.8748
Národná banka Slovenska	38,971	2,728	0.6765
Bulgarian National Bank	50,884	3,562	0.8833
Banca Națională a României	145,099	10,157	2.5188
Subtotal for non-euro area NCBs	1,745,691	122,198	30.3037
Total NCBs	5,760,652	4,137,159	100.0000

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 is 1.3884%. On 1 January 2007 Bulgaria and Rumania joined the EU. As a consequence of this the central banks of these countries acquired part ownership of the subscribed capital of the ECB, and the total subscribed capital increased to EUR 5,760.7 million, in which the capital key of the MNB fell to 1.3141%, i.e. to EUR 75.7 million. Since there

was no new accession to the European Union on 1 January 2008, the subscribed capital did not change, but the sum of the paid-up capital grew as a result of the accession of Cyprus and Malta to the Eurosystem. In consequence of adjustment implemented every five years the capital key of the MNB increased to 1.3856% as of 1 January 2009.

As Hungary is not in the euro area, pursuant to Article 48 of the Statute, under transitional provisions it was required to contribute 7% of its share to the ECB's share capital. This contribution was EUR 5.3 million on 31 December 2008. The value of the MNB's investments changed to EUR 5.6 million after payment on 1 January 2009.

Since 1 January 2009 the legal tender of Slovakia has been the euro, thereby the Národná banka Slovenska already constitutes one of the euro area NCBs.

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.

Domestic investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2007	31. 12. 2008	31. 12. 2007	31. 12. 2008	2007	2008
Pénzjegynyomda Zrt.	100.0	100.0	8,927	8,927	800	750
MNB Üdültetési és Jóléti Szolgáltató Kft.	100.0	100.0	602	602	0	0
Magyar Pénzverő Zrt.	100.0	100.0	575	575	270	0
KELER Zrt.	53.3	53.3	643	643	983	1,115
GIRO Elszámolásforgalmi Zrt.	7.3	7.3	46	46	160	126
Budapesti Értéktőzsde Zrt.	6.9	6.9	321	321	167	179
Total investments			11,114	11,114	2,380	2,170

* Dividends financially settled in the given year.

Key indicators of domestic investments (preliminary data*)

HUF millions

Investment	Equity	Share capital	Reserves	Profit/loss for the year after taxation	Profit/loss for the year after taxation
	31. 12. 2008	31. 12. 2008	31. 12. 2008	2007	2008
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 13–17.	9,426	8,927	499	796	1,160
MNB Üdültetési és Jóléti Szolgáltató Kft. 1054 Budapest, Szabadság tér 8–9.	758	602	156	-19	-5
Magyar Pénzverő Zrt. 1089 Budapest, Könyves Kálmán krt. 38.	1,398	575	823	316	260
KELER Zrt. 1075 Budapest, Asbóth utca 9–11.	14,077	4,500	9,577	2,323	1,025
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	5,966	2,496	3,470	2,146	2,506
Budapesti Értéktőzsde Zrt. 1052 Budapest, Deák Ferenc u. 5.	7,684	541	7,143	2,586	2,276

* At the 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	
	2007	2008	2007	2008	2007	2008	2007	2008
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 13–17.	7,884	8,008	175	370	127	821	2	0
MNB Üdültetési és Jóléti Szolgáltató Kft. 1054 Budapest, Szabadság tér 8–9.	3	0	11	27	0	0	0	0
Magyar Pénzverő Zrt. 1089 Budapest, Könyves Kálmán krt. 38.	4,427	3,549	93	51	5	11	2	0
KELER Zrt. 1075 Budapest, Asbóth utca 9–11.	n. a.	n. a.	7,107	6,867	37	60	0	0
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	n. a.	n. a.	4,832	5,493	723	825	0	0
Budapesti Értéktőzsde Zrt. 1052 Budapest, Deák Ferenc u. 5.	3,916*	3,274*	1,066	1,217	31	18	0	0

N.a.: revenue is not applicable data.

* Income from Stock Exchange related activities.

Investment	Average number of staff	
	31. 12. 2007	31. 12. 2008
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 13–17.	458	444
MNB Üdültetési és Jóléti Szolgáltató Kft. 1054 Budapest, Szabadság tér 8–9.	0	0
Magyar Pénzverő Zrt. 1089 Budapest, Könyves Kálmán krt. 38.	70	63
KELER Zrt. 1075 Budapest, Asbóth utca 9–11.	115	121
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	128	128
Budapesti Értéktőzsde Zrt. 1052 Budapest, Deák Ferenc u. 5.	64	62

The MNB's receivables from and liabilities to affiliated companies

HUF millions

Investment	Receivables	Liabilities
Pénzjegynyomda Zrt.	0	236
MNB Üdültetési és Jóléti Szolgáltató Kft.	0	0
Magyar Pénzverő Zrt.	10	3
KELER Zrt.	0	4
GIRO Elszámolásforgalmi Zrt.	0	1
Budapesti Értéktőzsde Zrt.	0	0
Total	10	244

The above table presents short-term liabilities.

In addition to banknotes, Pénzjegynyomda Zrt. produces documents, tax stamps and securities, primarily for institutional clients. Developments have been implemented to ensure the secure production of banknotes up to 2012-14. Over the longer term, after adoption of the euro, forint banknotes will no longer be issued. 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.

The primary duty of **Magyar Pénzverő Zrt.** is, pursuant to the MNB's order, to produce circulation coins for cash turnover and commemorative coins emitted 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. Within the range of its commercial activity the company sells commemorative coins and collector banknotes issued by the MNB, both locally and internationally. The main task in 2008 was, as part of the Logistic Centre project, the putting into operation of the new site, moving there and the successful sale of the valuable stock of the previously emitted commemorative coins and numismatic items bought from the MNB. Preparatory work for the 200 forint coin and the production of the necessary volume of coins remain important objectives for 2009. Furthermore, a programme of structural modernization, organization and staff reduction for improving effectiveness will be implemented, based on the cash turnover forecast of the MNB. From 2009 the pricing and distribution of commemorative coins and the support of their market launch with the appropriate trade policy and organisational steps will change significantly. These arrangements were determined in 2008.

MNB Üdültetési és Jóléti Szolgáltató Kft. (Bankjóléti Kft.) was founded to attend to the MNB's social and welfare responsibilities. This company managed the summer resorts and sport facilities which were contributed to it by the MNB. The MNB's management made a decision in 2002 to liquidate the company. The liquidation process is underway.

The owners (MNB 53.3%, BÉT 46.7%) of **Központi Elszámolóház és Értéktár Zrt. (KELER Zrt.)** made a decision – linked to an ECB recommendation – about the segregation of the central counterparty (central guaranteeing) function of KELER Zrt. at their General Meeting on 25 April 2007. As a result of this decision, KELER Central Counterparty Kft (KELER KSZF Kft.) was established by KELER and BÉT on 6 June 2008 and it has been performing its tasks from 1 January 2009. Pursuant to the Act on MNB in force, the MNB was not able to acquire a direct part of the ownership of the newly established enterprise, therefore the MNB and BÉT concluded a contract on the purchase right of business share determining the arrangement of ownership ratios in the future. As of 1 January 2009 the Act on MNB allows the central bank to acquire direct business share in the new company, therefore the MNB exercised its purchase right. The direct membership of MNB was approved by the General Meeting of KELER KSZF Kft. on 26 February 2009, so the registration of the MNB's business share by the Court of Registry followed. The MNB acquired a 13.6% business share in KELER KSZF Kft., paying a HUF 6.8 million purchase price equivalent of the face value whereby the MNB as a direct and indirect owner (through KELER and BÉT) has restored the ownership rates of the pre-separation period in respect of all previous functions of KELER. With this the ratio of the business share of the MNB in KELER is unchanged.

4.14 IMPAIRMENT LOSS AND PROVISIONS

HUF millions

B/S line	Description	31. 12. 2007	Interim changes in 2008		31. 12. 2008
		Impairment loss / Provisions	Increase (+)	Reversal (-)	Total impairment loss / provisions (3+4+5)
1	2	3	4	5	6
from I.2.	Forint receivables from credit institutions	1,384	0	-1,384	0
from III.	Other assets	23	0	-1	22
VIII.	Liabilities	1,740	8,947	-1,530	9,157
	– severance pay	0	179	0	179
	– derivatives	433	589	-1,022	0
	– bond lending	1,307	8,179	-508	8,978
	Total	3,147	8,947	-2,915	9,179

Impairment loss and provisions increased by HUF 6 billion in 2008.

The HUF 1.4 billion previously recorded impairment loss for forint receivables from credit institutions was reversed in 2008, because the liquidation process against a credit institutions was concluded during the year. 97% of the claim became irrecoverable, thus it was recorded as credit loss.

At the end of 2008 there was no need for provision for any negative market value of derivatives for purposes other than hedging. Provisions for previous periods were utilized at the end of the transaction.

For severance pay the MNB created a provision of HUF 179 million.

In 2008 a HUF 8.2 billion provision became necessary because of MNB security lending activity, while HUF 0.5 billion was utilized and/or terminated from the provision in 2007. According to the security lending contracts, the potential risks of the investments – made by agents – of the obtained collaterals are undertaken by the MNB. For this loss as a contingent liability a provision was created based on the principle of prudence.

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

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
	Due to banking transactions	80,851	104,111	23,260
	Due to internal operation	103	81	-22
IV.	Prepaid expenses/accrued income	80,954	104,192	23,238
	Due to banking transactions	22,659	21,389	-1,270
	Due to internal operation	325	185	-140
X.	Accrued expenses/deferred income	22,984	21,574	-1,410

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. 2007	Interim changes	31. 12. 2008
XI.1.	Share capital	10,000	0	10,000
XI.2.	Retained earnings	31,507	-16,582	14,925
XI.3.	Valuation reserves	0	0	0
XI.4.	Revaluation reserves due to exchange rate changes	49,857	186,401	236,258
XI.5.	Revaluation reserves of foreign currency securities	0	46,744	46,744
XI.6.	Profit/Loss for the year	-16,582	11,118	-5,464
XI.	Equity	74,782	227,681	302,463

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 dividend from the retained earnings for the year 2008.

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

4.17 REVALUATION RESERVES

HUF millions

B/S line	Description	31. 12. 2007	31. 12. 2008	Change
XI.4.	Revaluation reserves due to exchange rate changes	49,857	236,258	186,401
XI.5.	Revaluation reserves of foreign currency securities*	0	46,744	46,744
	Total revaluation reserves	49,857	283,002	233,145

* The end-2007 balance on the revaluation reserves of foreign currency securities indicated a loss of HUF 2.8 billion, which the central government reimbursed by 31 March 2008. At 31 December 2007 it was no longer included among revaluation reserves but in the line 'Receivables from the central government'.

The official forint exchange rate against the euro experienced significant fluctuation in 2008. On 30 June 2008 it reached 237.03 HUF-EUR and by the end of the year had weakened to 264.78 HUF-EUR. The average cost rate rose by HUF 1.98 to HUF 252.08. The revaluation reserves due to exchange rate changes, calculated as a difference of foreign exchange items converted to forint by official and average cost rate, changed from its negative balance of HUF 314.6 billion in July to a positive balance by the end of October, and amounted HUF 236.3 billion at the end of 2008.

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. At end-2008, in contrast with 2007, market values of securities were higher than book values because of low yields on the market, which generated non-realised gains on foreign currency securities, and revaluation reserves had a positive balance of HUF 46.7 billion.

Annual changes in the forint exchange rate

forint/euro

Date	MNB official exchange rate	Average cost rate
31. 12. 2007	253.35	250.10
31. 12. 2008	264.78	252.08
Annual depreciation		
In 2007	0.4%	
In 2008	4.5%	

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

Nr	Description	31. 12. 2007			31. 12. 2008		
		Receivables	Liabilities	Net market value	Receivables	Liabilities	Net market value
1.	Interest rate swap transaction	366,855	366,855	5,898	317,741	317,741	9,579
2.	CDS transaction	2,533	2,533	12	15,887	15,887	376
3.	Total hedging transaction (1+2)	369,388	369,388	5,910	333,628	333,628	9,955

The aim of the hedging interest rate swap transactions linked to the given bond issuing is to set the desirable interest structure.

Among the interest rate swap transactions there are some made with ÁKK, which serve to limit the interest rate risks of foreign exchange debt. These are hedged by the MNB through reverse transactions on the capital market.

Under the line 'CDS transaction' (Credit Default Swap) three transactions are recorded, the aim of which is to decrease the credit risk of securities. Transactions will mature in 2009 and in 2013.

Liabilities arising from other forward transactions

HUF millions

Nr	Description	31. 12. 2007		31. 12. 2008	
		Balance	Market value	Balance	Market value
1.	Options	7,489	-38	763	0
2.	Future transaction	2,325	28	0	0
3.	Swap transaction	0	0	110,951	4,686
4.	Total other forward transactions (1+2+3)	9,814	-10	111,714	4,686

Breakdown of options

HUF millions

Nr	Description	Net market value	
		31. 12. 2007	31. 12. 2008
1.	Long call option	0	0
2.	Long put option	7	10
3.	Short call option	-44	0
4.	Short put option	-1	-10
5.	Total (1+2+3+4)	-38	0

Liabilities arising from derivative transactions by remaining maturity

HUF millions

Nr	Remaining maturity	Balance		Change
		31. 12. 2007	31. 12. 2008	
	- within 1 year	51,983	2,648	-49,335
	- within 1 to 5 years	199,126	298,967	99,841
	- over 5 years	118,279	32,013	-86,266
1.	Hedging transactions	369,388	333,628	-35,760
	- within 1 year	9,814	5,802	-4,012
	- within 1 to 5 years	0	52,956	52,956
	- over 5 years	0	52,956	52,956
2.	Other forward transactions	9,814	111,714	101,900
3.	Total (1+2)	379,202	445,342	66,140

Other off-balance sheet liabilities

HUF millions

Nr	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
1.	IMF security deposit account	0	1,107,503	1,107,503
2.	Liabilities from two-week MNB bills	382,764	0	-382,764
3.	Guarantees	1,934	2,086	152
4.	Severance pay	0	179	179
5.	Other off-balance sheet liabilities	2	2	0
6.	Total	384,700	1,109,770	725,070

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

The liabilities of the MNB related to two-week bill issuing are off-balance sheet items for a short (generally one day) period. The subscribed amount of HUF 382.8 billion on 29 December 2007 was recorded as an off-balance sheet item at the end of 2007. On 2 January 2008, when the aforementioned two-week bills were being issued, the total sum was already recorded under other forint liabilities in the balance sheet. In the last days of 2008 there was no subscription, therefore no off-balance sheet item was recorded.

The line 'Guarantees' consists of export and import guarantees, to which is always linked any irrevocable indemnity bond (without limitation of expiry date and amount) or government guarantee. When exercising a guarantee, the MNB has the right to a reverse guarantee if needed. In 2008, 2 guarantees ceased to exist, decreasing the amount of guarantees by HUF 13.5 billion. The increase in values of guarantees is the result of exchange rate changes.

In accordance with the plan for the number of staff in 2009 severance pay is expected to amount of HUF 179 million, for which 100% provision was created by the MNB in line with the accounting policy.

Other off-balance sheet liabilities by remaining maturity

HUF millions

Nr	Remaining maturity	Balance		Change
		31. 12. 2007	31. 12. 2008	
	– within 1 year	384,674	2,241	–382,433
	– within 1 to 5 years	26	1,107,529	1,107,503
	– over 5 years	0	0	0
1.	Total other liabilities	384,700	1,109,770	725,070

Recording of off-balance sheet security transactions

HUF millions

Nr	Description	Balance		Change
		31. 12. 2007	31. 12. 2008	
1.	Face value of securities lent	757,793	562,050	–195,743
2.	Face value of investment arising from security lending transactions	753,367	541,282	–212,085
3.	Face value of securities bought under repo transactions	100,601	81,273	–19,328
4.	Face value of securities sold under reverse repo transactions	50,670	325,680	275,010

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	2007	2008	Change
(I.1.+II.2.)–(X.1.+XI.1.)	Central government	–16,988	–24,272	–7,284
(I.2.+II.3.)–(X.2.+XI.2.)	Credit institutions	–55,495	–74,938	–19,443
(I.3.+II.1.+II.4.)–(X.3.+XI.3.)	Other	75,682	104,361	28,679
	Net profit from interest	3,199	5,151	1,952
from lines (I.4.–X.4.)	Forint securities	10	1,832	1,822
from lines (II.5.–XI.4.)	Derivative transactions for hedging and other purposes*	–1,892	1,217	3,109
from lines (II.5.–XI.4.)	Other	–996	428	1,424
(I.4.+II.5.)–(X.4.+XI.4.)	Net interest related profit	–2,878	3,477	6,355
(I.+II.)–(X.+XI.)	Net interest and interest related income	321	8,628	8,307

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

In 2008 the Bank recorded a HUF 8.6 billion net interest and interest related gain, an improvement of HUF 8.3 billion compared to the figure for end-2007, which amounted to a HUF 0.3 billion gain.

Net interest income was higher by HUF 2 billion in comparison with end-2007.

The net interest income was increased by the following factors:

- an increase of the interest income on receivables from credit institutions by HUF 5.9 billion,
- an increase of the interest income on foreign exchange reserves by HUF 18.6 billion in 2008 compared to the preceding year,
- a decline of the interest expenses on two-week MNB bills by HUF 5.9 billion,

- a decline of the interest expenses on foreign currency denominated securities issued by the Bank by HUF 3.1 billion in 2008 relative to 2007.

The net interest income was decreased by the following factors:

- an increase of the interest expenses on government deposits denominated in forint and in foreign currency by HUF 4.5 billion,
- an increase of the interest expenses on credit institutions' deposits by HUF 25.5 billion in 2008 compared to the preceding year.

The net interest related income increased by HUF 6.4 billion in 2008. The interest related income on securities denominated in forint saw an increase of HUF 1.8 billion in 2008. This consists of the difference between the cost value and the face value of the securities recorded at cost, attributable to the reporting period. An increase of the interest related profit by HUF 3.1 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	2007	2008	Change
IV.	Realized gains from financial operations	2,298	12,140	9,842
XIV.	Realized losses from financial operations	6,805	8,298	1,493
IV.-XIV.	Net financial gains/losses	-4,507	3,842	8,349

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

The net realised gains from financial operations amounted to HUF 3.8 billion in 2008, they increased by HUF 8.3 billion in comparison to 2007. Changes were effected by higher gains realised on sales and maturities of securities

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

HUF millions

Nr	Description	2007	2008	Change
1.	- interest income on currency swaps	24,725	9,897	-14,828
2.	- income like interest margin on over one year interest rate swaps	2,855	789	-2,066
3.	- interest gains on hedge FX swaps	1,393	6,130	4,737
4.	- FX gains on derivative transactions	6,495	433	-6,062
5.	- interest income on other transactions	554	484	-70
6.	Income from derivative transactions (1+2+3+4+5)	36,022	17,733	-18,289
7.	- interest expences on currency swaps	30,584	12,751	-17,833
8.	- expense like interest margin on over one year interest rate swaps	1,983	46	-1,937
9.	- interest loss on hedge FX swaps	4,544	1,913	-2,631
10.	- FX losses on derivative transactions	0	265	265
11.	- interest expences on other transactions	803	1,541	738
12.	Expenses on derivative transactions (7+8+9+10+11)	37,914	16,516	-21,398
13.	- net interest on currency swaps (1-7)	-5,859	-2,854	3,005
14.	- interest margin on over one year interest rate swaps (2-8)	872	743	-129
15.	- net interest gains on hedge FX swaps (3-9)	-3,151	4,217	7,368
16.	- FX gains on derivative transactions, net (4-10)	6,495	168	-6,327
17.	- net interest on other transactions (5-11)	-249	-1,057	-808
18.	Net income from derivative transactions (6-12)	-1,892	1,217	3,109

The MNB hedged exchange rate and interest rate risks arising from bonds issued abroad with currency swaps (and with other derivative transactions).

Under the debt exchange implemented in 1997, the MNB converted a large part of its forint loans granted to the central government into foreign currency loans by making reverse transactions with the Government under same terms as those of the bonds issued by the MNB. The MNB has also concluded with the ÁKK the majority of the currency swaps linked to the bonds under nearly identical terms. Income from and expenses in connection with the currency swaps are stated in the income statement in gross. The income from and expenses in connection with swaps vis-à-vis both non-residents and the ÁKK are recorded in the net interest related income more than once. On 29 December 2007 the central government prepaid the remaining amount of its foreign exchange debt and connected currency swaps. The prepayment made at market value resulted in HUF 6.5 billion interest related income (line 4 in the table: FX gains on derivative transactions). The net profit and loss effect of the currency swaps is HUF 2.9 billion, a decrease of HUF 3 billion compared to 2007, due to the maturities of some foreign derivative transactions for hedging purposes.

Net interest gains in FX swaps increased by HUF 7.4 billion in 2008, in line with the changes of foreign exchange interest rates and with the higher number of transactions.

4.20 COMPONENTS OF INCOME FROM THE REVALUATION OF FOREIGN EXCHANGE HOLDINGS

Description	HUF millions	
	2007	2008
Net income from exchange rate changes (realised and conversion spread)*	9,012	9,184
Change in revaluation reserves in the balance sheet** (due to unrealised revaluation net income)	262	186,401
Total effect of exchange rate changes	9,274	195,585

*P/L line: III-XII.

**Revaluation reserves due to exchange rate changes (balance sheet line XI.4.).

In 2008 the total exchange rate change effect was a gain of HUF 195.6 billion, of which the Bank realised HUF 9.2 billion, while the amount of the revaluation reserve due to exchange rate changes (unrealised gains) increased by HUF 186.4 billion during the year.

For more details on the revaluation reserves see Section 4.17.

4.21 THE COST OF ISSUING BANKNOTES AND COINS

P/L line	Description	HUF millions		
		2007	2008	Change
	Cost of banknote production	4,743	4,815	72
	Cost of coin production	4,038	1,672	-2,366
	Cost of production of commemorative and collector coins	266	506	240
XIII.	Cost of issuing banknotes and coins	9,047	6,993	-2,054

The cost of issuing banknotes and coins was HUF 7 billion in 2008, a decrease of HUF 2 billion compared to the preceding year. The reduction of the cost arose from a drop in the cost of coin production in connection with the withdrawal of 1 and 2 forint coins. In 2007 the production of these coins with their high cost per unit accounted for 50% of the cost of coin production.

4.22 OTHER INCOME/EXPENSES

HUF millions

P/L line	Description	2007	2008	Change
V.1.	Income from fees and commissions	981	891	-90
V.2.	Income from other than fees and commissions	4,201	3,442	-759
V.	Total other income	5,182	4,333	-849
XV.1.	Expenses of fees and commissions	511	434	-77
XV.2.	Expenses of other than fees and commissions	1,119	2,879	1,760
XV.	Total other expenses	1,630	3,313	1,683
V.-XV.	Other net results	3,552	1,020	-2,532

Income from fees and commissions, those related to payment services, slightly decreased in 2008 in comparison with the data for 2007.

For more details on income other than fees and commissions, see Section 4.23.

4.23 INCOME OTHER THAN FEES AND COMMISSIONS

HUF millions

Nr	Description	2007	2008	Change
1.	Dividends from investments	2,984	2,726	-258
2.	Income related to coins and commemorative coins	1,213	588	-625
3.	Paid-up bad debts	4	43	39
4.	Other income	0	85	85
5.	Income from other than commissions and charges (1+2+3+4)	4,201	3,442	-759
6.	Losses from bad debts	174	1,384	1,210
7.	Expenses related to coins and commemorative coins	635	767	132
8.	Final money transfer	277	237	-40
9.	Expenses from assets assigned free of charge	6	348	342
10.	Other expenditure	27	143	116
11.	Expenses from other than commissions and charges (6+7+8+9+10)	1,119	2,879	1,760
12.	Net income/expenses from other than commissions and charges (5-11)	3,082	563	-2,519

Income other than fees and commissions includes the following:

- Dividends received from investments decreased by HUF 0.3 billion, since there was no dividend payment from the profit for the year 2007 of the Magyar Pénzverő Zrt.
- The increase in income related to coins and commemorative coins occurred mainly because of a transaction in 2007. The coin transfer to Magyar Pénzverő Zrt. in November 2007 caused an increase of income. The transaction included transfers of commemorative coins, commemorative banknotes, coins withdrawn from circulation and plaster models. The net gain related to coins and commemorative coins increased by HUF 0.5 billion arising from the transfer.
- The line 'Losses from bad debts' includes write-off of receivables from a credit institution, liquidation of which was closed in 2008. 100% of the loss was covered by the impairment loss accounted in the previous years. The line 'Paid-up bad debts' includes a small part of the above-mentioned claim, which was cleared.
- The line 'Final money transfer' includes mainly donations to international and domestic organisations and to foundations.

- The line 'Expenses from assets assigned free of charge' includes the book value of the buildings of the MNB's regional branch offices in Debrecen and Székesfehérvár transferred free of charge to the Hungarian State Treasury.
- The highest amount among other expenditures is a fine of HUF 127 million levied by the Hungarian Tax and Financial Control Administration (APEH) after the tax audit in 2007–2008.

4.24 OPERATING INCOME AND EXPENSES

HUF millions

P/L line	Description	2007	2008	Changes
	Export sales	20	2	-18
	Income from sales of assets and inventories	77	16	-61
	Income from subcontracted services	41	75	34
	Income from invoiced services	26	75	49
	Other income	109	11	-98
	Extraordinary income	2	2	0
VIII.	Total operating income	275	181	-94
	Cost of materials	3,969	4,558	589
	Personnel-related costs	8,464	8,068	-396
	Depreciation	2,307	2,474	167
	Transfer of costs of other activities	-164	-189	-25
	Total operating costs	14,576	14,911	335
	Expenses incurred on assets and inventories	97	141	44
	Expenses incurred on invoiced services	23	70	47
	Income taxes	1	172	171
	Total operating expenses	121	383	262
XVIII.	Total operating costs and expenses	14,697	15,294	597
VIII-XVIII.	Net operating expenses	-14,422	-15,113	-691

Net operating expenses amounted to HUF 15.1 billion in 2008, an increase of HUF 0.7 billion (4.8%) compared to the previous year.

The cost of materials in the reporting year was HUF 589 million higher relative to the previous year, due to the following effects:

- A significant increase of operating costs caused by additional expenditures connected to the setting into operation of the Logistics Centre during the year (e.g. facility costs of real estate, cost of cleaning, cost of security and guard services, cost of money transport) and the increase of maintenance costs related to the implementation of cash logistics systems in the Logistics Centre.
- IT costs also increased compared to 2007 mainly due to an increase of the maintenance cost (cost of upgrades, support, assistance) of software assuring the continuous and safe function of IT activities. These software items are infrastructural and data processing systems supporting basic functions. In addition, IT costs in connection with the Logistics Centre (e.g. cost of data transfer) were higher in 2008 compared to the previous year. Nevertheless, the increase of IT costs was lower than budgeted.
- The commission fee for the survey analysing the cost-effectiveness of the bank had an additional effect for costs in 2008; this will not influence other years.

The increase of aforementioned costs was reduced by the lower cost of other items (e.g. rent of real estate, cost of telephone calls, cost of communication).

The audit-fee amounted HUF 31.7 million.

Personnel-related costs decreased by HUF 396 million, caused mainly by the decline in average number of staff and the lower level of severance pay and compensation compared to the previous year.

Depreciation increased by HUF 167 million (7.2%) in 2008 relative to 2007, due to the setting into operation of the Logistics Centre and several systems operating there.

Value added tax related to previous years (2004–2005) amounted HUF 169 million among income taxes.

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	2007	2008	Change (%)
Wage costs incurred on staff	4,745	4,737	0
Other wage costs*	398	316	-21
Wages	5,143	5,053	-2
Other personnel payments	1,342	1,103	-18
Taxes on wages	1,979	1,912	-3
Personnel-related costs	8,464	8,068	-5

* 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	2007	2008	Change (%)
Average number of staff	715	664	-7

Remuneration of executive officers

HUF millions

Bodies	Fees
Monetary Council*	285
Supervisory Board	78

* 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 Steering Committee and the Supervisory Board, had no loan outstanding in 2008.

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

15 April 2009



András Simor
Governor of the Magyar Nemzeti Bank

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