



MAGYAR NEMZETI BANK

ANNUAL REPORT

2009

Annual Report

2009 Business Report and Financial Statements of the Magyar Nemzeti Bank



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Part A

**2009 Business Report
of the Magyar Nemzeti Bank**





1. The Governor's foreword

Overshooting the Bank's inflation target, average inflation reached 4.2% in 2009. Although the annual consumer price index was around 3% at the beginning of the year, it subsequently increased slightly above 5% on account of the tax changes adopted during the course of the year. As regards inflation developments, reflecting a positive side effect of the economic downturn, the inflation inertia observed in recent years has clearly come to an end. The unprecedented magnitude of economic contraction and thus the sharp decline in consumption put a downward pressure on prices. While the disinflationary trend may not be apparent at the level of the overall price index yet, due to indirect tax increases, month-on-month indices point to a low inflation environment after excluding the effect of the tax measures.

Within its inflation targeting system in 2009 a serious challenge the Bank had to face was the tension between real economic and financial stability considerations. Against the backdrop of a turbulent economic environment from autumn 2008, the key objective of the monetary policy was to sustain macroeconomic stability, ensure the financing of the country and temper its severe vulnerability.

In the context of a more pessimistic global money market and capital market environment, in February 2009 the Monetary Council decided to abandon the cycle of interest rate cuts it began after the base rate had been increased by 3 percentage points in autumn 2008. Central and East European currencies came under severe depreciation pressure, with the depreciation wave peaking in March. Moreover, central banks and financial supervisory bodies in the region adopted joint action in an attempt to stabilise the financial and macroeconomic outlook.

Improving global sentiment presented an opportunity from July on to proceed with the interest rate easing cycle, which was warranted by the domestic macroeconomic outlook on the one hand, and facilitated by positive developments in risk perception on the other. In the second half of the year the key policy rate was cut in six steps by a total of 3.25 percentage points, and by the end of the year it reached 6.25%. Since the interest rate cuts did not prompt notable fluctuations in the exchange rate, by the end of 2009 monetary conditions had eased substantially.

The monetary policy instruments at the MNB's disposal provide the best support to interest rate policy if they can facilitate an environment where the short-term money market yields approach the level of the key policy rate. Since this requires a sufficiently liquid forint money market, the Bank's

monetary policy instruments are most efficient in influencing the developments in forint rates if they also support the liquidity management of credit institutions.

The global financial crisis, which had spilled over to the Hungarian markets in autumn 2008, continued to exert an impact on domestic financial markets and their liquidity conditions in 2009, particularly in the first half of the year. With a view to ensuring better distribution of interbank forint and foreign currency liquidity and supporting the operation of domestic financial markets, in the first quarter of 2009 the MNB further expanded its set of monetary policy instruments. In the second half of 2009 the market tensions experienced from autumn 2008 abated gradually, allowing the Bank to approximate its monetary policy instruments to its pre-crisis practice.

During the year the greatest challenge for the MNB was to address financial stability risks, which intensified in the first half of 2009. While liquidity risks were dominant in the first quarter of 2009, credit risks also came to the foreground in the second quarter of 2009. Based on the stress test performed by the MNB, the capital position of the domestic banking sector is adequate, and its potential additional capital requirement would still be manageable under far more negative economic conditions than currently expected. In 2009 the MNB strengthened its instruments monitoring the risks of the domestic financial intermediary system, and financial stability considerations were given more emphasis in central bank decisions. Although the MNB lacks regulatory powers and instruments, it submitted to the government a number of proposals on regulations aimed at strengthening the financial stability of Hungary. In December 2009, in response to the MNB's initiative, the government adopted a decree on the conditions of prudent retail lending and on creditworthiness checks, which may prevent the repeated, excessive loosening of credit standards and reduce the risks of households' excessive indebtedness. Moreover, the reinforcement of the supervisory system provides the MNB and the Hungarian Financial Supervisory Authority with new tools to mitigate the risks affecting the financial system.

By the end of December 2009 official foreign currency reserves had increased by EUR 6.6 billion to EUR 30.7 billion compared with the end of the previous year. The growth was primarily a result of drawing down the IMF-EU credit line. As a result, foreign currency market transactions related to the debt management activities of ÁKK (Government Debt Management Agency) and the MNB increased the level of

reserves by around EUR 5.3 billion in net terms, while transfers from the European Union added EUR 2.7 billion to the reserves. By contrast, disbursements in foreign currency commissioned by budgetary institutions reduced the level of reserves by nearly EUR 0.9 billion. As stated in the press release issued by the Monetary Council on 8 March, the MNB channelled nearly EUR 1.2 billion of the transfers from the European Union to the foreign exchange market. Although debt indicators, which reflect the vulnerability of the country, increased substantially as a result of the crisis, the boost in foreign currency reserves surpassed the increase and thereby contributed to improving the country's resilience to external shocks. Departing from previous practice, as a consequence of the IMF loan, bonds denominated in Japanese yen and pound sterling now constitute a part of the reserves, in addition to euro and US dollar assets. The risk management policy associated with the management of foreign currency reserves has two main pillars: the two-tier benchmark system and the related limit system. The quality of foreign currency reserves did not experience significant negative changes in spite of the crisis, thanks to the conservative investment policy pursued by the Bank. Both in absolute terms and relative to the comparable benchmarks, the Bank performed well in 2009 with respect to foreign currency reserves. Exceeding the 2.78% return on the weighted benchmark by 21 basis points, the annual return on the euro-denominated portfolios weighted with market value amounted to 2.99%.

The real time gross settlement system (VIBER) operated with decreasing turnover and declining fees in 2009, while the system's availability exceed international standards. This system is operated by the MNB and performs the large-value payment transactions of the country. In autumn 2009 an agreement was concluded within the framework of the Payment System Forum on the introduction of intraday clearing in the Interbank Clearing System which, for the time being, clears retail payments at the end of the day only. The agreement also covered the domestic use of the SEPA (Single Euro Payments Area) credit transfer scheme. Several new or revised central bank decrees concerning payment services or payment and securities settlement systems were published in the previous year. In 2009 comprehensive, on-site inspections were conducted at 11 credit institutions. By improving legal compliance on the part of credit institutions, the payment inspections conducted by the Bank help ensure a more reliable operation of the financial intermediary system and predictable payment processes for clients, through which consumers using the services are served more efficiently. In line with the central banks' account keeping policy adopted in 2008, in 2009 the MNB terminated all 'correspondent bank-type' payment services, which could be provided more efficiently even for themselves by the clients of the Bank, being payment service providers themselves. As part of the implementation of the

account keeping policy, several savings cooperatives joined VIBER directly. The MNB continues to consider it important to disseminate information to the general public as well as the professional audience regarding topics related to payments, and payment and securities settlement systems. To this end, a number of publications were issued, including Payment Systems in Hungary 2009; the MNB Occasional Paper on Postal Payment Services in Hungary and Volume 3 of the series About Payments for Everybody, which focused on direct debits.

As regards the subject of cash, the new 200-forint coin quickly gained popularity among citizens following its smooth introduction in June, and it has been used intensively ever since.

By the end of 2009, the value of banknotes and coins in circulation decreased by 5% to 2,171 billion HUF. Cash volume declined gradually from the second quarter, which may have reflected the decline in household consumption due to the economic downturn.

In 2009 forint banknote counterfeiting increased significantly compared to the previous year. Counterfeiting markedly shifted toward high-denomination notes. 61% of all detected counterfeits were 10,000-forint and 20,000-forint denominations. The ratio of counterfeits does not jeopardise the safety of cash circulation.

To improve the credibility of statistics and the accuracy of data interpretation, in 2009 the MNB continued to pursue the elimination of the remaining methodological differences between statistical fields and to improve the consistency of published data. In this harmonisation, the MNB closely cooperated with partner institutions that are part of statistical services. As a result of the co-operation between the MNB and the Central Statistics Office, the discrepancy between the balances of the financial and non-financial accounts has decreased, and progress was made in other areas of the co-operation between the two institutions, including, for example, the harmonisation of revision policies.

At the end of 2008 the management of the Bank adopted a medium-term strategy for MNB's activities to improve financial literacy, and decided on establishing a Financial Literacy Centre to operate as part of the communication area. In 2009 the series of previous successful central bank programmes was expanded by several new initiatives, and last year, too, the Foundation for Financial Awareness brought to life by the MNB started its operation in earnest.

Although the number of Member States within the EU – and thus that of the European System of Central Banks (ESCB) –

did not change in 2009, an important event of the year was that with the entry of Slovakia, the number of euro area Member States increased to 16 as of 1 January 2009.

The General Council of the European Central Bank, the ESCB committees and the working groups established by the committees continued to be useful fora in 2009 for exchanging professional experience and contributing to Hungary's preparations for joining the Eurosystem.

In an attempt to ensure that taxpayers' funds were managed with fiscal responsibility, in 2009 the Bank launched several initiatives aimed at reducing operating costs, resulting in staff number reductions and the transformation of the remuneration structure in the area of human resources. Since these changes profoundly affected the atmosphere of the work environment as well as general employee satisfaction within the bank, our activities focused on improving and strengthening employee commitment. To this end, relying on the results of the employee commitment survey for 2008, we devoted special attention to improving employee and manager relationships, facilitating the personal development of associates and developing a motivated, result-oriented performance culture.

In 2009 the Magyar Nemzeti Bank generated a profit of HUF 65.5 billion compared to the loss of HUF 5.5 billion in 2008. The financial result of the Bank is primarily determined by the domestic and international macroeconomic developments and the objectives of the monetary policy along with the measures taken, consequently this figure is not a reliable tool for measuring the success of central bank operations. The improvement in the financial result can be attributed to the HUF 127.5 billion increase in profits from exchange rate changes with a parallel decrease of HUF 10.3 billion in net expenditures arising from other profit/loss factors. By contrast, net interest and interest-related income fell by HUF 72.3 billion and, unlike in previous years, the Bank incurred a net interest and interest-related loss in 2009.

Efforts aimed at sustaining reasonable cost-efficiency remained of key importance among the medium-term strategic objectives of MNB. With a view to improving the efficiency of its internal operations, in 2008 the Bank launched a project which, in addition to its efforts aimed at sustaining and possibly enhancing the quality of MNB's professional activity, also affected the cost management and the entire spectrum of investment projects. At the start of the project implementation the expected savings in annual operating costs amounted to HUF 1.7 billion.

In 2009 the project aimed at the improvement of efficiency also initiated the publication of regular cost-transparency

reports on specific operating cost items, which was intended to ensure transparency and contributed to strengthening responsible cost management behaviour among employees. Integrating the indices related to the approved financial plan into the management incentive system also supported the achievement of this goal.

Primarily as a result of the implementation of initiatives improving cost-efficiency and the adoption of the related measures, operating costs were cut by 7.9% (nearly HUF 1.2 billion) in the first year already, relative to the costs posted in 2008. These savings mainly reflected the decline in personnel expenditures resulting from the reduction of the average staff number by 8.9%; however, costs related to information technology (IT), and in particular the operating costs of software, also decreased significantly (by more than HUF 100 million). In addition, expenditures dropped in the areas of real estate maintenance, cash deliveries and communication.

The operating costs of the MNB in 2009 amounted to HUF 13.7 billion, which – in real terms – is lower than the operating cost reported for any year in the last decade.

With the intention of facilitating even more efficient operations in future, a concept has been developed for time-driven, activity-based process costing, which would allow the Bank to quantify the costs associated with its activities and processes based on requirements. This method will contribute to improving the accuracy of the analyses as well as efficiency and cost calculations, on which developments and decisions are based.

The volume of investment projects completed in 2009 declined relative to previous years. While investment projects in previous years were primarily related to the construction of the Logistics Centre handling cash logistics, the majority of investment expenditures in 2009 were incurred in relation to the implementation of the real estate and IT strategy. The relocation of employees based at the Hold utca building of the MNB to the building in Szabadság tér called for the construction of new workplaces and the establishment of a new, central computer room. Among the investment projects related to the implementation of the IT strategy, the server virtualisation investment was considered a key priority. Indeed, thanks to this project, computer room space utilisation and operating safety improved significantly, and electricity and cooling energy costs were cut. Moreover, in line with the medium-term strategic objective of improving the efficiency of the monetary decision support system, the integrated statistical system has been enhanced and licences have been obtained to provide IT support for research activities.

2 A brief overview of the Magyar Nemzeti Bank

Company name: Magyar Nemzeti Bank

Registered office: 1054 Budapest, Szabadság tér 8-9.

Form of operation: company limited by shares. Pursuant to the Act on the Magyar Nemzeti Bank, the form of operation, i.e. the designation ‘company limited by shares’ or its abbreviation, need not be indicated in the company name of the MNB.

Date of foundation: 1924

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

Scope of activities: as defined by the Act on the Magyar Nemzeti Bank

Subscribed capital: HUF 10 billion

2.1 OBJECTIVES AND BASIC TASKS OF THE MNB

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

In accordance with Article 127 of the Treaty on the Functioning of the European Union, the MNB Act, which establishes the Bank’s primary objectives and basic tasks as well as its institutional, organisational, personal and financial independence, stipulates that the primary objective of the MNB is to achieve and maintain price stability. Without prejudice to its primary objective, the MNB 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, and in order to achieve this objective, the Bank performs the following basic tasks specified in the MNB Act:

- it defines and implements the monetary policy;
- it has the exclusive right to issue banknotes and coins qualifying as the legal tender of the Republic of Hungary, including commemorative banknotes and coins;
- it holds and manages official reserves in foreign exchange and gold;

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

– it develops and regulates the domestic payment and settlement systems and securities settlement systems, and, as part of its oversight duties, monitors their operation in order to ensure their safe and efficient operation and for a 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 the central bank’s independence and within the framework provided by the MNB Act, the Bank independently defines the monetary policy aimed at achieving and sustaining price stability, and the instruments for implementing such policy. Such instruments include, within the scope of its bank account management services, accepting deposits and, subject to the restrictions set forth in the Act, lending against adequate collateral; buying, selling and mediating securities in open market transactions and under repurchase agreements in the spot and derivatives market; issuing its own securities; influencing and setting exchange rates and interest rates, discounting (rediscounting) securities and regulating minimum reserves.

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

the performance of its basic tasks for any other domestic or foreign organisations, and also for foreign organisations in respect of fulfilling obligations arising from international agreements.

2.2 THE BODIES AND MANAGEMENT OF THE MNB

The various bodies of the MNB are primarily governed by the MNB Act. The provisions of Act IV of 2006 on Business Associations apply to the MNB, with due consideration for the derogations set forth in the MNB Act.

The MNB operates as 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 Meeting or a Board of Directors. **The shareholder** is entitled to make decisions, by way of a shareholder's resolution, on the establishment and amendment of the Statutes, the approval of the balance sheet and the profit and loss statement, the dividend payment from the profit for the reference year or from the accumulated profit reserve and the election, dismissal and remuneration of the auditor, who guarantees statutory operations. In respect of the Annual Report of the Magyar Nemzeti Bank, which consists of two parts, namely the Business Report and the Financial Statements, the powers of the shareholder are separated. As regards the Financial Statements, the shareholder is entitled to exercise its right of approval, whereas in respect of the Business Report on the basic tasks, in view of the principle of central bank independence, its right is limited to the acknowledgement thereof.

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

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

of five and a maximum of seven members. The number of Monetary Council members may exceed the maximum of seven as long as the number of those who already held MC membership on 3 July 2003, i.e. at the time 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 substitutes the Chairman if the latter is unable to attend. In 2009 Deputy Governor Ferenc Karvalits was elected as Deputy Chairman.

In addition to the members, a representative of the Government as a permanent attendee must also be invited to the meetings of the Monetary Council. However, such representative shall not have voting rights, as, in accordance with European Union directives, the MNB Act stipulates that 'The Government may not instruct the MNB in relation to its scope of tasks as set forth in this Act'.

In 2009 the members of the Monetary Council were:

- András Simor, Governor, Chairman of the Monetary Council,
- Ferenc Karvalits, Deputy Governor, Deputy Chairman of the Monetary Council,
- Júlia Király, Deputy Governor, member of the Monetary Council,
- Dr. Tamás Bánfi, member of the Monetary Council,
- Dr. Péter Bihari, member of the Monetary Council,
- Vilmos Bihari, member of the Monetary Council,
- Dr. Csaba Csáki, member of the Monetary Council,
- Dr. Ilona Hardy, member of the Monetary Council,
- Dr. György Kopits, member of the Monetary Council (until 15 February 2009),
- Judit Neményi, member of the Monetary Council,
- Dr. Gábor Oblath, member of the Monetary Council (until 15 February 2009).

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

- supervise the performance of basic tasks;
- supervise the internal audit organisation of the MNB with regard to the responsibilities outside the competence of the Supervisory Board;
- exercise employer's rights over the employees of the MNB (excluding the non-deputy governor members of the

Members of the Monetary Council of the Magyar Nemzeti Bank



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



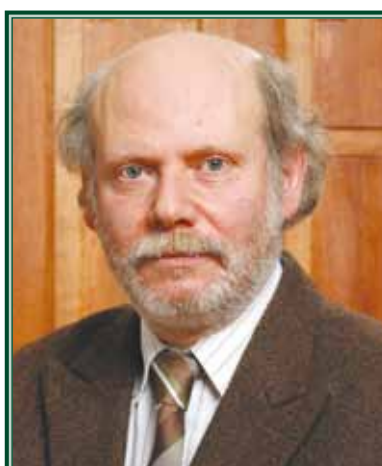
Dr. Ilona Hardy
member of the Monetary Council



György Kopits
member of the Monetary Council
(until 15 February 2009)



Judit Neményi
member of the Monetary Council



Dr. Gábor Oblath
member of the Monetary Council
(until 15 February 2009)

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

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

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

In addition to the auditor appointed by the shareholder, the Magyar Nemzeti Bank is also inspected by the State Audit Office (SAO) and the Supervisory Board.

The supervisory competence of the **State Audit Office** in relation to the MNB is set forth in the Act on the SAO. The State Audit Office supervises the financial management of the Magyar Nemzeti Bank and activities under the MNB Act that are not included in its basic tasks. The State Audit Office supervises the MNB's compliance with statutory regulations, its Statutes and the shareholder's resolutions.

Prior to putting forward a proposal for the election and dismissal of the MNB's **auditor**, the opinion of the President of the State Audit Office shall 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 the supervision of the Bank's performance of its basic tasks and the impact thereof on the MNB's profit and loss. Accordingly, the report 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 commissioned by the minister responsible for the state budget. The total number of the members of the Supervisory Board and its Chairman elected by Parliament shall be determined at the date of the commencement of the procedure for their election, by taking into consideration

the number of the parliamentary groups of the ruling parties and the opposition parties in Parliament. Members of the ruling party appoint the Chairman and 50% of the members, whereas the other 50% of the members are appointed by members of the opposition parties.

The members' term of office coincides with the Parliament's mandate. The Supervisory Board remains in office until a new Parliament elects 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 this time-limit, the Supervisory Board remains in office until the new Parliament elects the Supervisory Board members.

In 2009 the members of the Supervisory Board of the MNB were:

- Dr. Ákos Balassa, Chairman,
- László Baranyay,
- Dr. Gábor Csányi,
- Dr. József Kajdi,
- Mrs. Imre Karácsony (the representative of the minister responsible for the state budget; from 1 July 2009),
- Dr. Gábor András Szényei,
- Dr. László Urbán (the consultant commissioned by the minister responsible for the state budget),
- Dr. István Várfalvi (the representative of the minister responsible for the state budget; until 30 June 2009), and
- Dr. Éva Várhegyi.

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

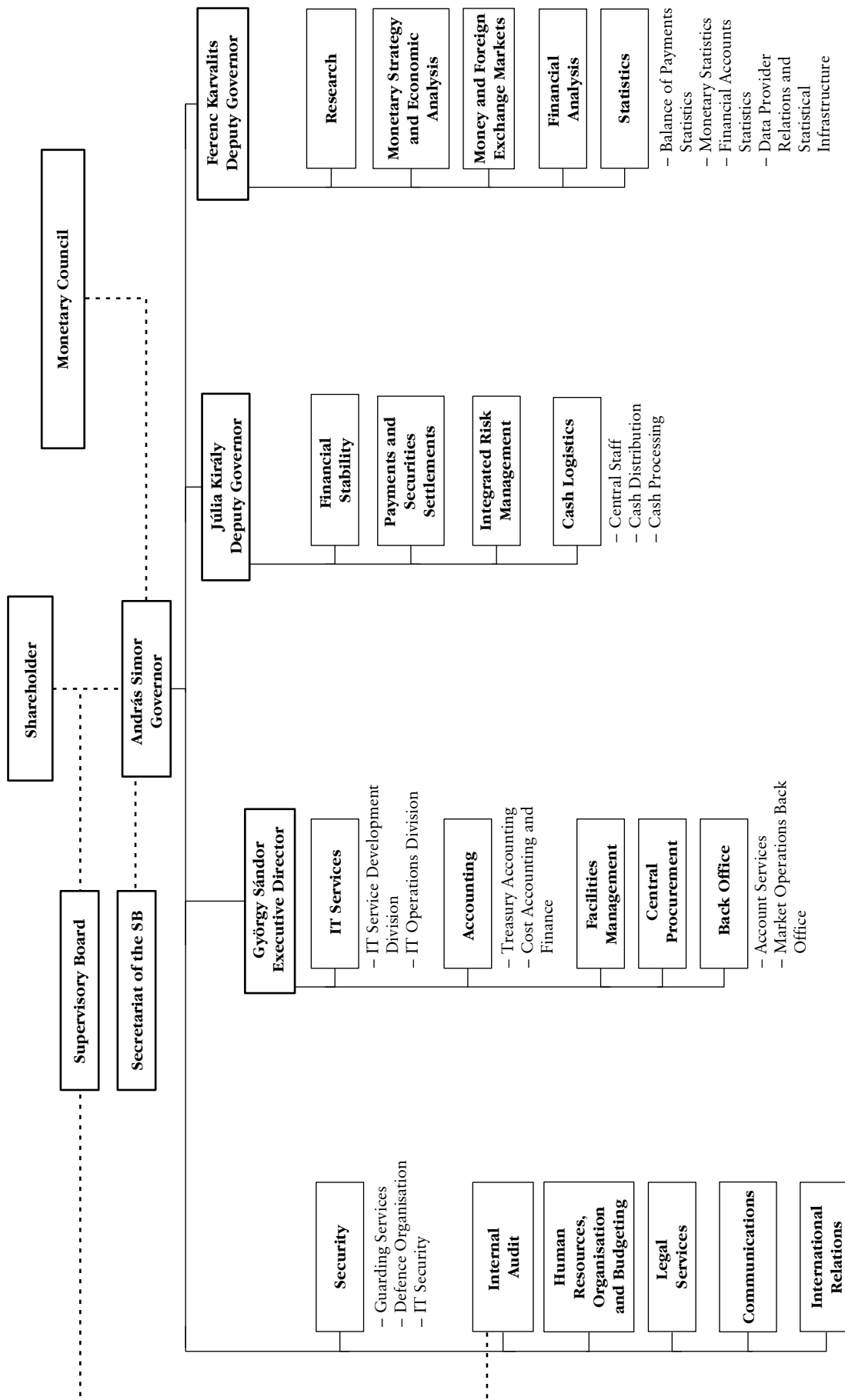
2.3 ORGANISATIONAL STRUCTURE OF THE BANK

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

The organisational and management system formulated in 2007 and the changes which took place therein in 2008-2009 also serve the successful and cost-effective attainment of these objectives.

Organisation chart

Organisation of Magyar Nemzeti Bank
31 December 2009



There were 21 organisational units operating within the Bank under the control of the Governor, the two Deputy Governors and the Executive Director on 1 January 2009, and 20 on 31 December 2009 (among them 15 departments within 6 organisational units).

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

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

The **Implementation Committee**, by performing the necessary preparatory work, putting forward proposals and 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 related to 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 performing the necessary preparatory work and putting forward proposals and opinions related to investments and cost management.

The **Asset Liability Committee (ALCO)**, by performing the necessary preparatory work, putting forward proposals and opinions, supports decision-making related to the Bank's foreign exchange activities, 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 2009 designed to ensure the fulfilment of tasks is shown in the organisational chart below.

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

Hungary's accession to the European Union also entailed MNB's membership in the European System of Central Banks (ESCB). The ESCB comprises the European Central Bank (ECB), which was established in June 1998 with its seat in Frankfurt, and the national central banks of EU Member States. Its governing bodies are the Executive Board and the Governing Council, the latter consisting of the members of the ECB's Executive Board and the governors of the central banks of euro area Member States. The third decision-making body of the ECB is the General Council, which is responsible for maintaining an institutional relationship between the Eurosystem and the central banks of non-euro area Member States. Holding its meetings quarterly, the General Council comprises the President and the Vice-President of the ECB and the respective governors of the central banks of all EU Member States. The key responsibilities of the General Council include consultancy concerning preparation for joining the euro area, approval of the convergence reports stipulated by the EU Treaty and monitoring the functioning of ERM II. Within the framework of this latter activity, it assesses the sustainability of the bilateral exchange rate of non-euro currencies participating in ERM II against the euro, and provides a forum for the alignment of monetary and exchange rate policies and the management of intervention and financing mechanisms in ERM II. In addition, the General Council is involved in verifying whether the central banks of EU Member States and the ECB 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 must be sought regarding any changes in the rules of accounting and financial data supply, as well as issues related to the adjustment of the ECB's key for capital subscription. The mandate of the General Council will expire on the date when all Member States have adopted the euro.

In 2009 the number of ESCB members did not increase; however, the number of Member States using the euro expanded 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. Presently euro area central banks subscribe to 70% of the ECB's shareholder's equity, while the remaining 30% is divided among the central banks of non-euro area EU Member

States in a way that these central banks pay 7% of their respective subscriptions to the ECB's capital as a contribution to the operational costs of the ECB that are incurred in connection with their ESCB membership. Between 1 May 2004 and 31 December 2006 Hungary's ownership share in the ECB's capital amounted to 1.3884%. As a non-euro area EU Member State, upon accession to the EU and the ESCB (on 1 May 2004) 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-yearly 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 co-ordination 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 within the competence of the General Council. (For a detailed description of the 13 ESCB Committees and the activities of other fora providing assistance to these committees, 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 2009, contributing to Hungary's preparations for joining the Eurosystem.

3. Review of the MNB's performance in 2009

3.1 MONETARY POLICY

Monetary policy framework

Pursuant to the MNB Act, the primary objective of the Bank is to achieve and maintain price stability. To further the goal of price stability, monetary policy has been determined by the MNB within the framework of inflation targeting since 2001. Under the inflation targeting regime the Monetary Council of the MNB determines a numerical value for the inflation target in line with price stability, and the monetary policy it conducts is aimed at achieving the pre-defined inflation target. According to the calculations based on which the continuous target was set, a 3% inflation level is considered as optimal for the Hungarian economy, a value, which has been reconfirmed by the Monetary Council on the occasion of a subsequent revision. This level is in conformity with international practice, it minimises the costs generated by inflation, and at the same time provides protection against the risk of deflation. The conditions established by the floating exchange rate regime, which was adopted at the beginning of 2008, put the MNB in a better position to attain the inflation target and thus fulfil the nominal Maastricht criteria.

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 after the expiry of the mandate of current members. Accordingly, in 2009 the number of Monetary Council members decreased from 11 to 9.

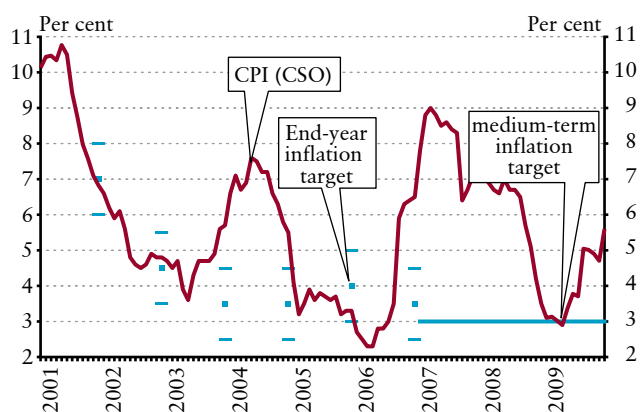
Trends in inflation in 2009

Average annual inflation was 4.2% in 2009. At the beginning of the year, the consumer price index approached the 3% target; however, it exceeded 5% in the second half of the year.

Although the inflation target was not attained in Hungary, inflation trends in 2009 have changed markedly relative to the previous period, and the achievement of the medium-term objective of 3% has become more realistic. Upon analysing the inflation performance it should be highlighted that, on account of tax changes, domestic prices have been subject to a series of unforeseen, major shocks in recent years, which rendered the achievement of price stability very difficult in and of itself.

Chart 1

Inflation target and inflation developments



Sources: CSO and MNB.

Table 1

The consumer price index and its components

(Percentage change, year on year)

	2007	2008	2009	2009			
				Q1	Q2	Q3	Q4
Core inflation	5.4	5.2	4.1	3.3	3.2	5.1	5.1
Unprocessed food	13.7	5.8	5.0	3.1	11.1	3.9	1.7
Vehicle fuel and market energy	2.2	9.9	-5.2	-11.5	-9.9	-5.0	5.5
Regulated prices	19.7	8.7	8.0	8.1	8.0	8.6	7.1
Consumer price index	8.0	6.1	4.2	3.0	3.6	5.0	5.2

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

Source: CSO.

The most significant conclusion drawn from inflation data for 2009 is the fact that inflation inertia – a typical trend in recent years – has clearly broken. This is distinctly reflected in the deceleration in the price dynamics of market services (excluding tax changes). While the price index of services fluctuated between 5% and 6% in previous years, in 2009 it fell close to 3%, excluding the effect of indirect tax increases. Another positive sign is the fact that the VAT and excise tax increases in July 2009 generated a lower increase in the price index than would be expected on the basis of previous experience.

The prices of tradable goods experienced wider swings than in previous years. This reflected the effect of high exchange rate volatility on the one hand, and short-term promotional sales announced in response to the contraction in demand, on the other.

In the course of 2009 the price index was also largely influenced – primarily through base effects – by items outside of core inflation. In line with the developments in global oil prices, fuel prices initially had a significant disinflationary effect at the beginning of the year. However, at the end of the year this effect reversed: as the impact of the price reduction at the end of 2008 dropped out of the annual indices, the annual price index for this component increased again. The sharp, significant rise observed in the spring in unprocessed food prices had a short-term impact only, followed by gradual adjustment during the summer months. By the end of the year the price level of unprocessed foods was practically the same as in the previous year.

On account of the tax increases it is more difficult than usual to capture trend inflation developments from the annual indices. In the second half of the year, even month-

on-month indices pointed to a low inflation environment after excluding the effect of the tax changes. Although the tax increases resulted in temporarily high inflation levels, in the context of a severe economic downturn the risk of inflation stickiness abated considerably.

Monetary policy

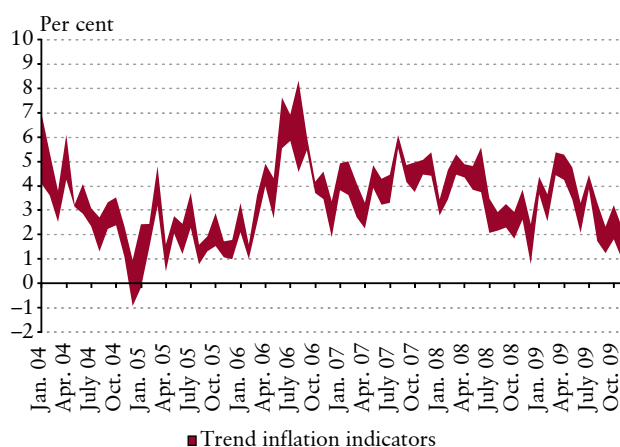
One of the basic characteristics of monetary policy decisions is the fact that they can affect consumer prices only with a lag of several quarters. Consequently, it is essential to have a forward-looking attitude in decision-making, in other words, to estimate the most probable outcome of economic developments. Under the inflation targeting regime, decision-makers primarily rely on the quarterly forecast.

The turnaround of the financial and economic crisis in September 2008 is the best starting point in understanding the considerations behind the measures of monetary policy in 2009. The deterioration of risk appetite on the back of the intensification of the crisis in autumn 2008 led to severe disruptions in the functioning of financial markets. The highly vulnerable position of Hungary posed a great challenge to fiscal policy and monetary policy alike. Amid this turbulent economic environment, the key objective of the monetary policy was to maintain macroeconomic stability, ensure the financiability of the country and temper its severe vulnerability.

In 2009 the Bank faced the serious challenge of addressing the tension between real economic and financial stability considerations in its inflation targeting system. The downturn in Hungary was deepened by the fact that projections about European economic activity sharply deteriorated at the beginning of the year. As the steeply declining demand broke the protracted trend of inflation persistency in the context of a recession environment, core inflation developments exhibited dynamics consistent with price stability. Over the time horizon relevant for monetary policy, the macroeconomic forecast published in February anticipated an undershooting of the inflation target in net terms (i.e. excluding the effect of indirect taxes) and a gradually deepening recession. On the other hand, there was uncertainty about the extent of the immediate price increasing effect – as well as the subsequent, pass-through effect – of the indirect tax increase implemented under the fiscal consolidation programme.

While the rather bleak global economic – and thus domestic – growth outlook clearly warranted lower interest rate levels, the unpredictability of global risk appetite combined with financial stability risks greatly restricted the room for interest rate cuts. In January 2009 the Monetary Council

Chart 2
Trend inflation indicators



Source: MNB.

was still of the opinion that it would be able to continue the cycle of interest rate cuts it began in November 2008 after it had increased the rate by 3 percentage points in autumn 2008. In February, however, the Czech, the Polish and the Hungarian currencies came under severe depreciation pressure as a result of the growing financial stability risks experienced in the region. The forint exchange rate weakened to HUF/EUR 300 compared with the range of HUF/EUR 265-270 recorded at the beginning of January 2009. The weakening wave peaked in early March when the forint traded at 310-320. Although the Monetary Council did not adjust the key policy rate in February, the depreciation pressure did not ease. By early March the Monetary Council was of the opinion that exchange rate expectations had departed from macroeconomic fundamentals, and at its extraordinary meeting it decided that the MNB would start converting the transfers received from the EU in the foreign exchange market to counteract these negative developments.

After having bottomed out in early spring, perceptions about the outlook of the central and eastern European region started to improve gradually; the joint action of the central banks and financial supervisory authorities of the region proved to be successful. Consolidation commenced in domestic financial markets as well, liquidity and stability risks reduced considerably, the exchange rate of the forint strengthened, and in May it fluctuated persistently within a range between HUF/EUR 270 and 290. From a macroeconomic perspective, however, the external deceleration of economic activity combined with a sharp contraction of credit supply and an inevitably pro-cyclical fiscal policy resulted in a downturn that surpassed the magnitude of the European average. Inflation forecasts continued to indicate that the consumer price index was likely to be below the target over the time horizon relevant for the monetary policy. Nevertheless, in view of the vulnerability of the Hungarian economy and the risk of considerable exchange rate depreciation, the Monetary Council did not adjust the key policy rate until June.

In the second quarter the global environment took a positive turn. As financial markets continued to stabilise gradually, the risk perception of the central and east European region improved notably. Nevertheless, domestic economic activity forecasts did not foresee a substantial recovery until 2011, and expected (net) inflation to be below the target over the time horizon relevant for the monetary policy. It was a positive development, even in terms of longer-term inflation expectations, that the inflationary impact of the indirect tax increases in the summer of 2009 proved to be more moderate than would have been expected on the basis of similar tax increases in

the past. As stability and sustainability risks eased, macroeconomic considerations gained priority, and the reduction of the base rate became possible.

In line with the improvement of the risk premium, the Monetary Council started the policy rate reductions with a 1% cut in July, followed by a series of 0.5% cuts each month until November, consistent with market expectations throughout. The rate reductions were executed on the basis of macroeconomic and risk perceptions, without any preliminary commitment. Halving the size of the interest rate cuts, the Monetary Council reduced the key policy rate by 0.25 of a percentage point in December. In the second half of the year the key policy rate was lowered in six steps by a total of 3.25 percentage points, bringing down the rate to 6.25% by the end of the year. Since the interest rate cuts did not prompt notable fluctuations in the exchange rate, by the end of 2009 monetary conditions had eased substantially.

Central bank measures aimed at supporting the foreign currency and forint liquidity of domestic banks

The global financial crisis, which had spilled over to the Hungarian markets in autumn 2008, continued to exert an impact on domestic financial markets and their liquidity conditions in 2009, particularly in the first half of the year. With a view to ensuring a better distribution of interbank forint and foreign currency liquidity and supporting the operation of domestic financial markets, in the first quarter of 2009 the MNB further expanded its set of monetary policy instruments. In the second half of 2009 the market tensions experienced from autumn 2008 abated gradually, allowing the Bank to approximate its monetary policy instruments to its pre-crisis practice.

Central bank measures aimed at supporting the foreign currency liquidity of domestic banks

With a view to supporting the distribution of foreign currency liquidity in domestic markets, on 28 January 2009 the MNB and the Swiss National Bank established a EUR/CHF swap agreement, which enabled MNB to provide Swiss franc liquidity through EUR/CHF fixed rate swap tenders with a maturity of one week from 2 February 2009. Eligible counterparties were invited to submit bids on the first trading day each week, with the MNB accepting all bids up to a total of EUR 5 billion on a weekly basis. In order to strengthen the short-term Swiss franc funding market, the agreement – which originally was to remain in effect until April 2009 – was extended several times during the year by the Swiss National Bank and the MNB until the tender was eventually discontinued at the end of January 2010.

The MNB introduced euro liquidity-providing EUR/HUF FX swap tenders against the forint with a 6-month maturity from 2 March 2009 and with a 3-month maturity from 9 March 2009, which was intended to serve two objectives. On the one hand, by helping establish equilibrium in the foreign exchange market, the MNB contributed to easing the foreign currency liquidity tensions of domestic banks and moderating their foreign exchange costs of funds, which, in turn, helped alleviate tensions in the area of corporate lending. On the other hand, facilitating equilibrium in the swap market implied that non-resident market participants faced significantly higher costs associated with their speculative positions against the forint. Only those domestic credit institutions have access to the six-month operation – which is offered with more favourable conditions – which agreed to at least maintain the level of their domestic corporate loan portfolio during 2009. With the introduction of the six-month operation, Hungarian banks have reliable, long-term access to euro funding at a maturity of six months. The seven banks which pledged to meet the conditions may utilise the new instrument up to the amount of EUR 2.81 billion. All domestic credit institutions meeting the required technical conditions may take part in the three-month EUR swap tenders up to the remaining amount available from the EUR 5 billion facility provided in the six-month tenders.

Seeking to provide further support to the FX liquidity management of domestic credit institutions, the Magyar Nemzeti Bank modified the technical conditions for the euro liquidity-providing swaps in the second quarter of 2009. Accordingly, as of 14 April 2009 the additional forint margin required on the euro liquidity-providing FX swap transactions was reduced from 10% to 5%. In addition, as from 11 May 2009 the Bank makes its margin account operations related to the daily revaluation of the three-month and six-month swap transactions symmetrical, i.e. in the case of excess margin the MNB releases the forint amount equal to the amount of the excess margin posted by the counterparties.

Owing to the improvement of the liquidity position of the domestic FX swap market in the first half of 2009 and the easing of the limits restricting the transactions of credit institutions vis-à-vis each other, recourse has become sparse to the two-way, overnight FX swap quick tenders (providing euro and forint liquidity) introduced by the MNB in October 2008. In view of the favourable market developments, the MNB discontinued its two-way FX swap quick tender on 18 May 2009.

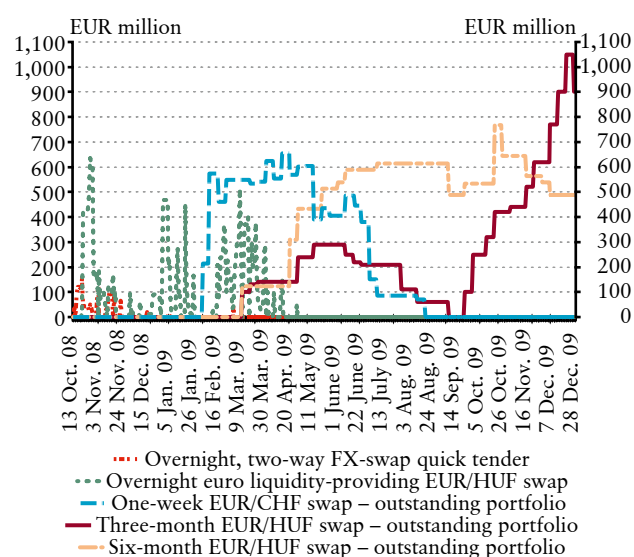
Market participants actively used the overnight central bank FX swap instruments until April 2009 and the one-

week EUR/CHF operation until mid-August 2009. Among the longer maturity EUR/HUF swaps, banks' recourse to the three-month instrument was intensive following its introduction and in the fourth quarter of 2009, while there was notable demand for the six-month instrument until the end of October; since then, outstanding portfolio has declined with the dropping out of maturing portfolio.

In order to support the liquidity needs of EUR/HUF swap instruments, the repo agreement of EUR 5 billion concluded by the MNB and the ECB in October 2008 was revised in January 2010. In line with the revised agreement, the MNB is entitled to also draw down half of the available facility from the ECB – EUR 2.5 billion – in the form of a EUR/HUF swap operation.

Chart 3

Recourse to the MNB's FX swap instruments – outstanding portfolio



Measures taken to support the liquidity of the forint interbank market

Through the use of a wide variety of forint money market instruments, the MNB took steps to improve the functioning of the forint market on several occasions.

Widening the interest rate corridor, changing the lending conditions of two-week and six-month loans

At the beginning of 2009 the MNB extended the range of eligible counterparties to participate in its six-month operation providing forint liquidity. Consequently, from 2 February 2009 the same counterparties had access to forint loans provided by the MNB against securities collateral as those having access to overnight loans. From 5 May 2009

the number of bids an individual bidder may submit for the loan tenders was increased from one to three. Moreover, the MNB committed to continue offering its six-month, variable rate, collateralised loan tender until at least 30 June 2010.

Effective from 24 November 2009, the MNB widened the interest rate corridor around the key policy rate from ± 0.5 percentage points to its pre-crisis level, ± 1 percentage point. At the same time it raised the interest rate on the two-week, fixed rate central bank loan to exceed the policy rate by 0.5 of a percentage point from the previously set 0.25 of a percentage point. In October 2008 the MNB reduced the width of the interest rate corridor in order to prevent credit institutions from incurring significant losses from managing liquidity in a more adverse environment, and to avoid an increase in the volatility of short-term interbank rates. However, the normalisation of market conditions in the second half of 2009 provided scope to restore the width of the interest rate corridor. The interbank overnight rate stayed significantly below the central bank base rate for a protracted period, which can be attributed to the fact that domestic banks continue to keep their counterparty limits very low and prefer to hold central bank deposits rather than lend in the interbank market even at the shortest, overnight maturity. With an unchanged strategy, a wider interest rate corridor will result in higher costs for the banking sector, and consequently it may encourage market participants to manage their liquidity through increased recourse to the interbank market and the two-week MNB bill. As a result, overnight interbank rates will more likely to be in alignment with the rate on the two-week MNB bill –

which is equal to the base rate – and the improvement in the liquidity of the interbank market is expected to leave more room for credit institutions to manage their liquidity.

Among the loan instruments introduced in autumn 2008 with the intention of supporting the forint liquidity management of banks, by the first quarter of 2009 recourse to the two-week central bank loan fell sharply from the high level observed in autumn 2008, and from the fourth quarter of the year banks ceased to use this facility altogether. Recourse to the six-month loan instrument peaked in mid-April 2009, with no new loans having been taken since the beginning of May.

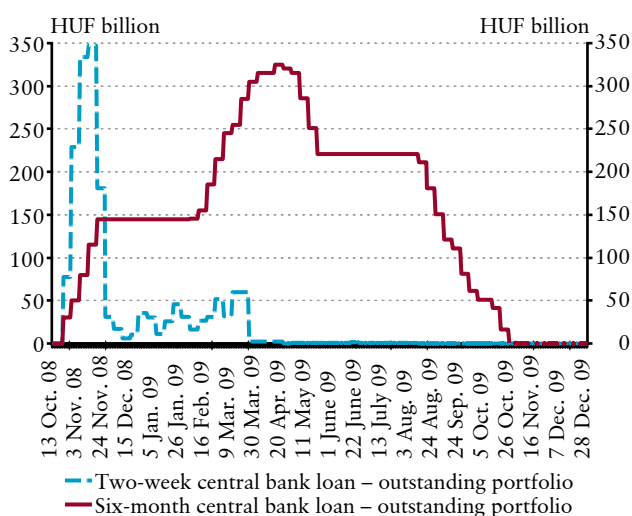
Extending the range of eligible collaterals and the applied haircuts

In order to ensure that the increased credit demand is not restricted by a shortage of securities collateral, in 2009 the MNB further expanded the range of collaterals eligible for credit operations. Effective from 20 February 2009, the MNB accepts as collateral forint, euro or Swiss-franc-denominated bonds issued by domestic local governments. In order to further harmonise the MNB's set of instruments with that of the ECB, from 30 July 2009 the MNB also accepts mortgage bonds of own issue from its counterparties as eligible collateral for their credit operations.

On a regular basis, the MNB reviews the risk management parameters applied for accepted collaterals. As a result, effective from 20 February 2009 the haircuts and acceptance ratios applied during the daily collateral valuation were revised.

Chart 4

Recourse to the two-week and six-month central bank loans – outstanding portfolios



Sale of government securities previously obtained at auctions to the Government Debt Management Agency (ÁKK Zrt.)

On two occasions, on 2 December and 16 December, the MNB sold securities maturing within a year in a sum of HUF 32.33 billion (nominal value) at market price to the Government Debt Management Agency from the portfolio it purchased in autumn 2008 at the secondary-market government securities auctions it held to support the undisturbed functioning of the domestic government securities market and to mitigate the liquidity problems of the banking sector. The sales took place following the repurchase auctions held by ÁKK Zrt. in the quantities offered by market participants at the repurchase auctions, with the average yields prevailing at the repurchase auctions.

Conversion of current and capital transfers from the European Union in the foreign exchange market

On 8 March 2009 the Monetary Council decided to start converting the net current and capital transfers from the European Union (gross transfers from the EU minus Hungary's contribution) in the foreign exchange market. In 2009 net transfers received by Hungary from the EU amounted to EUR 2.7 billion. The MNB spent a part of this sum to boost its foreign currency reserves, while the other part was converted in the interbank foreign exchange market in a discretionary manner in view of the regular OTC transactions. Potential counterparties to the transactions were domestic and foreign credit institutions with foreign exchange dealing limits with the MNB.

3.2 STABILITY OF THE FINANCIAL INTERMEDIARY SYSTEM

In 2009 the Magyar Nemzeti Bank focused on mitigating the risks threatening financial stability and reducing the real economic costs of the financial and economic crisis.

The primary challenge for the Bank in the first part of the year was to reinforce the liquidity position of financial markets and the banking sector. To this end, the Magyar Nemzeti Bank introduced the new monetary policy instruments described in detail in the previous chapter (including longer-term FX swap tenders providing euro liquidity, and the CHF/EUR swap tender) and broadened the range of eligible collaterals by accepting bonds issued by local governments. By introducing a new data collection and analytical framework, the MNB reinforced its monitoring system tracking the risks of the domestic financial intermediary system. Moreover, the Bank's opinion was sought in the evaluation of the applications for government loans of domestic banks without a non-resident parent bank.

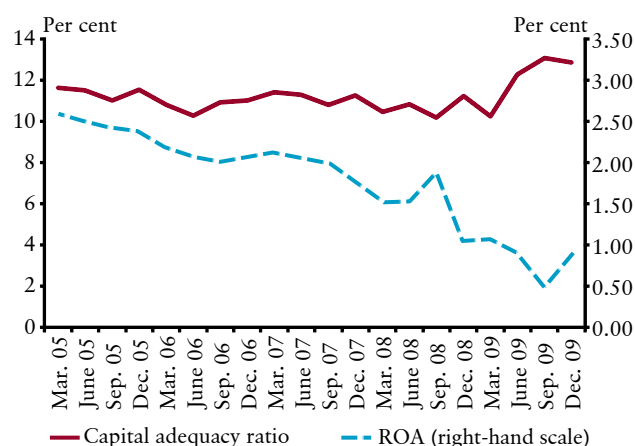
Non-resident parent banks expressed a strong commitment toward their domestic subsidiaries, which helped mitigate the liquidity risks of the banking sector. The behaviour of the parent banks this far, the active contribution of the Magyar Nemzeti Bank in the preparatory work, the coordination of international institutions (International Monetary Fund, European Commission) and the voluntary commitment signed within the framework the European Bank Coordination Initiative (EBCI) implemented by the parent banks of the six largest non-resident subsidiaries all confirmed that they were prepared to assist their subsidiary banks with liquidity and capital should it be required. The Magyar Nemzeti Bank welcomed the commitment of the parent banks as a factor that contributes to preserving the financial stability of Hungary.

Owing to the measures of the central banks, the government loans and the commitment of parent banks, the liquidity situation normalised, the liquidity reserves of the banking sector increased, and the operation of key markets returned to normal.

Financial stability was largely influenced by banks' adjustment to the economic recession. The Hungarian banking sector responded promptly to the new financial and macroeconomic environment. As the loan-to-deposit ratio declined, reliance on foreign funding moderated. Although liquidity improved continuously, in the context of the economic recession in 2009 banks faced – and continue to face in 2010 – sharply worsening credit quality and increasing loan losses. In line with the MNB's expectations, in the second half of 2009 the loan portfolio of the banking sector deteriorated further. The deteriorating portfolio quality of corporate loans can be attributed to the decline in profitability in the context of weakening economic performance, while that of household loans was determined by growing unemployment.

The banking sector handled the gradually increasing credit losses resulting from the deteriorating loan portfolio in a pro-active manner. Credit institutions reinforced their debt management activity and they moderated the risk of default by the restructuring of loans. Improving profitability helped absorb growing loan losses. Overall, the profit of the banking system in 2009 was similar to that realised in 2008, while the recorded loan impairment was 2.5 times higher than in the previous year. Meanwhile, the capital adequacy of the banking sector improved. According to the stress test

Chart 5
Return on assets (ROA) and capital adequacy ratio of the banking sector



Note: Capital adequacy ratio: (primary capital computable for risk coverage/capital requirement) *8%; ROA: pre-tax profit/average balance sheet total, annualised data; Pre-tax profit: rollover 12-month data; Average balance sheet total: rolling 12-month arithmetic average.

conducted by the experts of the MNB in autumn 2009, the additional capital requirement of the banking sector would be manageable even under far worse economic conditions than currently expected.

While the MNB lacks regulatory powers and instruments, with a view to strengthening financial stability it actively participated (often as an initiating party) in regulatory tasks aimed at moderating the risks of the financial system.

The MNB has drawn public attention to the increased risks associated with foreign currency lending on several occasions, including its reports on stability. Banks' fierce competition has resulted in the introduction of increasingly risky FX-based (euro, Swiss franc, then Japanese yen) loan products in recent years, while the gradual easing of credit standards – including lending with high LTV values or without the proof of income – led to an excessive indebtedness of households. Risks stemming from foreign currency lending were aggravated by the financial crisis. To contain risks and facilitate prudent lending practices, the MNB proposed the use of regulatory measures, including the tightening of bank-level risk-taking principles and credit conditions, i.e. restrictions on the loan-to-value (LTV) ratio, the payment-to-income (PTI) ratio, the currency denomination and the maximum term of vehicle loans. In recognition of the initiative, at the end of December 2009 the government adopted a decree on the conditions of prudent household lending and credit rating assessment. The application of the restrictions proposed by the MNB may prevent the loosening of credit standards and the excessive indebtedness of households, which may promote sustainable economic growth and moderate the external vulnerability of Hungary over the long term.

The MNB worked together with other institutions responsible for financial stability (such as the Ministry of Finance and the Hungarian Financial Supervisory Authority) to devise a supervisory structure with increased focus on monitoring and moderating the risks emerging at the level of the financial system. Act CXLVIII. of 2009 being effective from 1 January 2010 amended both the HFSA Act and the MNB Act. Pursuant to the stipulations effective from 1 January 2010, the Financial Stability Council, which is constituted by representatives of the MNB, the Ministry of Finance and the Hungarian Financial Supervisory Authority (HFSA), will convene regularly to review the stability of the financial system, approve the HFSA's supervisory target areas and initiate, as required, the formulation or amendment of legislation. As a result of the reinforcement of the systemic supervisory tools, the Bank

has the capacity to submit a proposal to the government or members of the government on the amendment or formulation of legislation, to which the addressee is required to respond within 15 business days by either commencing the preparatory work for the proposed legislation, or by providing reasonable justification for why it deems the legislation unnecessary. To ensure the safe operation of the financial intermediary system, in the case of systemic risks the HFSA is entitled, for a maximum of 90 days, to ban, restrict or impose conditions on the conduct of certain activities, the provision of services, the conclusion of deals or the distribution of products. The adopted Act stipulates that the HFSA must notify the MNB forthwith if it perceives any significant risk that may threaten the stability of the financial intermediary system.

As a result of the adopted amendments, the organisation of the HFSA will be reinforced, its operational efficiency is expected to improve (through a more flexible organisational structure and more efficient decision-making), and the MNB and the HFSA will have far more tools at their disposal to initiate and take measures to strengthen the stability of the financial system.

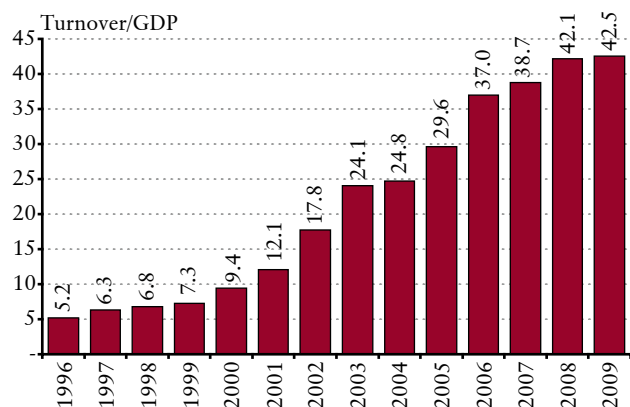
3.3 PAYMENTS AND SECURITIES SETTLEMENT SYSTEMS

The MNB plays various roles in the payments and securities settlement systems. As a neutral partner in terms of market competition and a catalyst for interbank co-operation, the MNB facilitates the development of infrastructure in areas which require the joint decision of stakeholders. As an overseer, the MNB performs regulatory, licensing and supervisory functions in respect of the clearing and settlement infrastructure. As a service provider, it keeps 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 majority owner of the Central Clearing House and Depository Ltd. (KELER Zrt.), co-owner of GIRO Clearing House Limited (GIRO Zrt.) and KELER Central Counterparty LLC. (KELER KSZF Kft.) and is a participant in all three payments and securities settlement systems.

Operation and development of VIBER

In 2009 the number of VIBER participants was 56, an increase of fourteen¹ compared to the end of the previous year. Of the total HUF 1,003.4 trillion (thousand billion) turnover of the Interbank Clearing System (ICS) and VIBER, 93.7% was settled in VIBER in value, while ICS

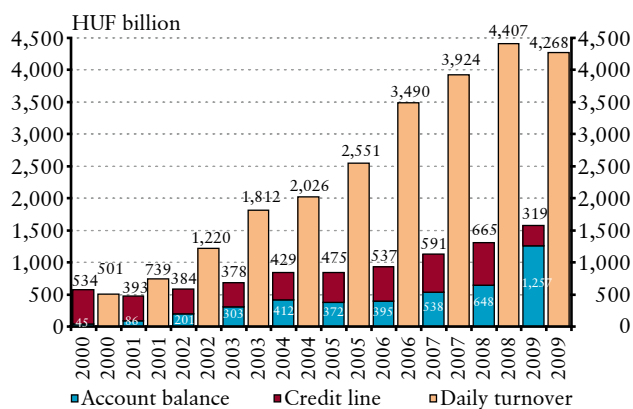
¹ The reasons for the growth are detailed below in the section describing changes in the account keeping activity of the MNB.

Chart 6
Annual turnover of the ICS and VIBER systems in absolute value and compared to GDP


accounted for a higher share in the volume of transactions (99.5%). The total turnover of the two systems was 42.5 times the projected Gross Domestic Product (GDP) figure for the year.

A total of 980.6 thousand payment transactions in the amount of HUF 939.9 trillion (thousand billion) were settled in VIBER during the year. The value of transactions increased by 7.1%, while the number of transactions decreased by 2.4% compared to the previous year. In 2009 the average value per item amounted to HUF 958.4 million, this being 4.7% lower than the average of the previous year. The average daily volume of transactions was 3,861, while average daily turnover amounted to HUF 3,700.5 billion. The highest turnover in terms of volume was the 5,743 transactions settled on 16 December 2009. The turnover value peaked with HUF 10,174 billion on 7 October 2009.

In international comparison, the liquidity available for the payments of VIBER participants continues to be high. Banks' average daily intraday credit line – which supplements the bank account balance and is provided by the MNB for the purposes of settling payments against blocked securities held as collateral – amounted to HUF 1,408.7 billion in 2009, i.e. 2.1 times the amount of 2008. Compared to the previous year, the combined average daily balance available on the account of banks decreased by 52% and stood at HUF 319.5 billion. Total liquidity for settlements – arising from the two sources described above – facilitated the settlement of the combined turnover of VIBER and ICS at an average daily value of HUF 4,268 billion, representing a 3.1% decline compared to the daily turnover in the previous year. The average daily turnover was 2.47 times the daily liquidity during the year, compared to previous year's average of 3.6 times.

Chart 7
Average daily interbank payment turnover and liquidity (account balance + credit line) between 2000 and 2009


Exceeding previous year's figure as well as international standards, VIBER's availability in 2009 was 99.996%. Only a total of 22 minutes of operating time was lost.

The MNB revises the fees charged for the payment services annually. Compared to 2008, the fee charged for one VIBER item decreased by HUF 70 to HUF 260 in 2009. Except for the transaction fee, no other system-related costs are imposed on VIBER participants.

Development of ICS

In autumn 2009 an agreement was reached within the framework of the Payment System Forum on the introduction of intraday clearing in the Interbank Clearing System and the domestic application of the SEPA (Single Euro Payments Area) credit transfer scheme. A decision was made to implement the two development projects simultaneously, as this would imply more favourable unit development costs and allow for the application of state-of-art standards in domestic payment systems even before the introduction of the euro. The Payment System Council approved the launch of the nationwide project. The Council will take a final decision on the proposed launch of operation in the middle of 2010, which is currently proposed for July 2012.

New MNB decrees

Several new or revised central bank decrees on payments and securities settlements were published last year.

In February 2009 a number of MNB decrees were published, including Decree No. 9/2009 (II. 27.) on the requirements for the General Terms and Conditions and operating rules of organisations providing clearing house activities under

the Act on Capital Markets² (Tpt.); Decree No. 10/2009 (II. 27.) on the requirements for the operating rules of the central securities depository; and Decree 11/2009 (II. 27.) on the requirements for the operating rules of organisations providing central counterparty activities under the Act on Capital Markets.

The reason for formulating the decrees was that, in consideration of the risks involved as well as the recommendation of the ECB, the MNB supported the separation of the central counterparty and central securities depository functions of KELER Zrt., for those to be performed by legally independent entities. Accordingly, from 1 January 2009 a new company – KELER Központi Szerződő Fél Kft. (KELER Central Counterparty LLC.) – acts as central counterparty, while KELER Zrt. retained its central securities depository and clearing house functions. Although in accordance with the provisions of the Tpt. it falls within the Hungarian Financial Supervisory Authority's competence to issue, modify or revoke the licence required for the application of the General Terms and Conditions and operating rules of these organisations, the MNB participates in the licensing procedure as a professional authority in issues regarding the efficient and reliable operation of the system.

MNB Decree No. 18/2009 (VIII. 6.) on the execution of payments came into force on 1 November 2009. The formulation of the new MNB decree was necessitated by the transposition of Directive 2007/64/EC on payment services in the internal market, as a new decree had to be issued by the MNB for it to be able to carry out its tasks under the provisions of the Directive. The amendments to the decree include provisions implementing the directive on the one hand, and provisions that are aimed at the enhancement and update of the former MNB decree on the other.

The provisions of the European Directive – on the rules for new, non-credit institution market participants (payment institutions) with respect to their activity, licensing and supervision, their obligations about informing customers, as well as the rules of their liability and the allocation of losses – were transposed by the adoption of Act LXXXV. of 2009 on Payment Services (hereinafter Pft.) and Act LXXXVI. of 2009 on the amendment of the Hpt³ related to payment institutions and payment services. As the Pft. introduced a modified terminology for payments, all MNB decrees including payment terminology had to be revised or republished; however, these modifications are merely of technical-legal character and did not change the content of the relevant decrees.

MNB Decree No. 34/2009 (XII. 28.) on the requirements for the General Terms and Conditions and operating rules of organisations operating the payment system and Decree No. 35/2009 (XII. 28.) on the material, technical, security and business continuity requirements of organisations providing clearing services for the payment system enter into effect on 1 July 2010. The revision of the previous decrees incorporated all domestic and international oversight and inspection experiences that have been accumulated since the formulation of the decrees. As regards the most important changes, in line with the requirements set forth by the Hpt, emphasis shifted from physical security to logical security in the decree on the material and technical requirements, and the main provisions of the ECB's business continuity oversight expectation requirement package were also incorporated.

Central bank inspection of payment services

On the basis of the inspection plan and methodology for 2009, comprehensive, on-site inspections were carried out at 11 credit institutions in the course of the previous year. In addition to credit institutions, the MNB performed regulatory inspection at the first three cash-in-transit companies (those provide cash processing activity) with the largest clientele aimed at the prevention and impeding of money laundering and the financing of terrorism.

The payment inspections found that credit institutions carried out the majority of their payment orders in compliance with central bank regulations; however, at every supervised institution the inspections revealed significant violations, which affected the predictability of payment turnover or generated some degree of financial loss to customers. In one case, due to the significance of the revealed breach, a supervisory penalty had to be imposed.

The inspections aimed at the prevention and impeding of money laundering and the financing of terrorism found deficiencies at each supervised cash-in-transit company regarding both their customer identification practice and their internal regulations. Measures were imposed in the case of all three institutions to remedy the revealed deficiencies; in addition, two of the institutions had to pay fines.

One of the main benefits of central bank inspections is the fact that the experiences gained are fed directly into – and

² Act CXX. of 2001 on Capital Markets.

³ Act CXII. of 1996 on Credit Institutions and Financial Enterprises.

are utilised by – the areas of oversight, payment system development and payment services regulations. The inspections provide useful information in the elaboration of the Bank's opinion on payment services and in the correct interpretation of the legislation concerning the prevention and impeding of money laundering and terrorism financing activities of cash-in-transit companies. By improving legal compliance on the part of credit institutions, the payment inspections conducted by the Bank contribute to ensuring more reliable operation of the financial intermediary system and predictable payment processes for clients, through which consumers using the services are served more efficiently.

Changes affecting the MNB's account keeping activity

As early as in 2008, the MNB reviewed its medium-term account keeping policy and, with a view to social efficiency, it decided to limit the payment services provided to credit institutions to the Bank's settlement role.⁴ As a result, in 2009 the MNB terminated all of those 'correspondent bank-type' payment services, which could be provided more efficiently by the Bank's clients – being payment service providers themselves. As part of the implementation of the account keeping policy, several savings cooperatives joined VIBER directly.

As from March 2009, the MNB is the settlement agent for domestic transactions made by Hungarian issued bank cards bearing the MasterCard logo. In addition, the MNB has been negotiating with Visa International to incorporate the settlement of the domestic Visa transactions into the central bank's real-time gross settlement system (VIBER). This would ensure that all domestic bankcard settlements (MasterCard, GBC,⁵ Visa range) are processed at a single place, i.e. at the MNB.

Publication of analyses and information booklets

The MNB continues to consider it important to disseminate information to the general public as well as the professional audience regarding topics related to payments, and payments and securities settlement systems. To this end, a number of publications were issued, including Payment Systems in Hungary 2009; the MNB Occasional Paper on Postal Payment Services in Hungary and Volume 3 of the series About Payments for Everybody, which focused on direct debits.

3.4 MANAGEMENT OF FOREIGN EXCHANGE RESERVES

Objectives of holding reserves

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

- to ensure the level of reserves expected by market participants ('international collateral'),
- to support the monetary policy (ensure intervention capacity),
- to ensure foreign currency transaction requirements (support government debt management, satisfy the government's foreign currency payment obligations, etc.).

One of the guarantees for a predictable and stable exchange rate regime is an adequate level of reserves, which, if necessary, allows for central bank intervention to protect the exchange rate and supports the fulfilment of the Maastricht exchange rate criterion for joining the Economic and Monetary Union (EMU). By means of its boosted foreign exchange reserves, in 2009 the Bank contributed efficiently to supporting the depleted foreign currency liquidity of the Hungarian financial markets in the wake of the financial crisis.

In terms of transaction goals, servicing the management of government debt continued to be the most important objective last year. In 2009 the substantial amount of foreign currency borrowed by the Hungarian State and the MNB posed a great challenge to reserve management. Transfers from the European Union are also received through the MNB, and in 2009 net inflows increased the level of reserves by EUR 2.7 billion.

The MNB still does not intend 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, as far as possible, attain extra return.

⁴ Provision of settlement services to payment systems performing their settlements in forint.

⁵ The clearing of the interbank card transactions between 5 domestic banks are performed by Bankkártya Zrt.

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. A conservative investment policy for MNB means, in view of the classical investment triad of return–safety–liquidity, that the emphasis is on the latter two, and thus the aim of holding reserves is to maximise return while maintaining safety and liquidity. The MNB has restricted its investment universe so that the maximum duration of bond market assets for purchase is 10.5 years, while their credit rating can be AA-AAA or, in the case of euro area countries, A.⁶ In addition to credit ratings, the liquidity requirements in place also demand securities purchased to be those issued by developed countries, major international financial institutions and government agencies, and rule out the purchase of securities with high price fluctuations. The crisis has greatly justified the employment of a conservative investment policy.

The euro continues to play a key role in the foreign currency structure of reserves. Its weight is warranted by the exchange rate regime of Hungary, the country's economic integration into the euro area and the foreign currency structure of government debt. In addition to euro, in 2009 the MNB held reserves in dollar and – due to the loan received from the IMF – Japanese yen and pound sterling.

Regarding the structure of the reserve portfolio, the MNB distinguishes money market, credit risk free and investment portfolios, based on their function. The aim of money market portfolios is to ensure daily liquidity needs (repayments of interest and principal, interventions, other transactions); thus, their value changes on a day-to-day basis with inflows and disbursed amounts. In the case of credit risk free and investment portfolios, which account for a higher share of total reserves, the greater emphasis is on return expectations. Although even in their case it is a basic requirement that securities be quickly and efficiently marketable, their stable composition also allows investments with longer average maturity depending on market outlook. The MNB determines the proportion of the portfolio types

relative to one another on the basis of the amount and dispersion of cash inflows and outflows observed in previous years. Accordingly, the MNB continues to hold approximately 20% of the reserves in the money market portfolio and 80% in the credit risk free and investment portfolios.

Amount of reserves

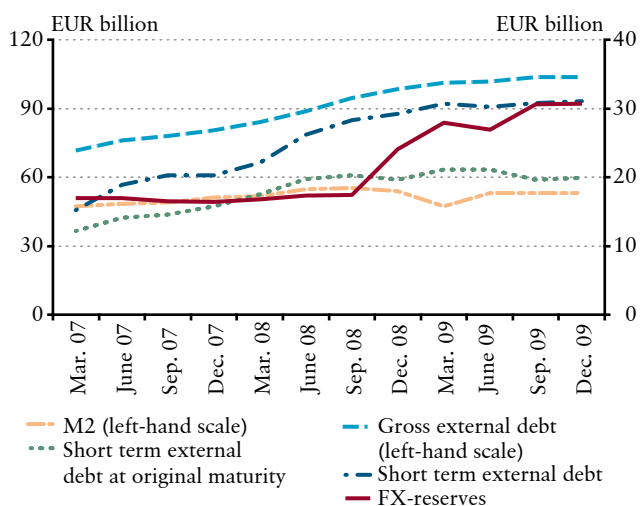
With an increase of EUR 6.6 billion during the year, the official foreign exchange reserves amounted to EUR 30.7 billion at end-2009.

The level of reserves was primarily influenced by the bond issues and borrowings of the Government Debt Management Agency (ÁKK Zrt.). The five-year foreign exchange bond issued in July and the loans from the IMF and the European Commission added nearly EUR 1 billion and EUR 5.9 billion to the foreign exchange reserves, respectively. Disbursements to domestic credit institutions under loan agreements amounted to EUR 2.4 billion, of which EUR 670 million was prepaid during the third quarter. EUR 2.3 billion was paid out for the purpose of other debt services. In June 2009 as the next instalment of the IMF loan the MNB borrowed EUR 1.4 billion. In accordance with the IMF's decision on granting an additional SDR allocation, Hungary received an SDR allocation in the total value of around EUR 1 billion in the months of August and September.

Transfers from the European Union resulted in an inflow of EUR 2.7 billion. The return on foreign exchange reserves contributed to the increment by nearly EUR 0.7 billion. Disbursements in foreign currency commissioned by budgetary institutions reduced the level of reserves by around EUR 0.9 billion. In line with the press release issued by the Monetary Council in March, the MNB channelled nearly EUR 1.2 billion to the foreign exchange market during the year.

Although debt indicators, which reflect the vulnerability of the country, increased substantially in the context of the crisis, the boost in foreign currency reserves surpassed that increase, and thereby contributed to improving the country's resilience to external shocks.

⁶ The major international credit rating institutions classify the sovereign securities or corporate securities of individual countries into the categories of AAA and C, based on the credit rating of the debtor. The least risky, 'investment grade' debtors have a credit rating of AAA, AA, A or BBB.

Chart 8
Developments in foreign exchange reserves, external debt indicators and the M2 monetary aggregate


Note: Data for end-2009 are partly estimates.

The MNB's financial risk management

Inevitably, the MNB faces financial risks in the course of carrying out its basic tasks. As a general principle, the degree of risks assumed should be obvious and visible, risk assumption should be purposeful and the extent of risks in question should be consistent with the objectives of the basic tasks. The MNB applies limits to mitigate the financial risks related to the management of foreign exchange reserves. As the return on the reserves primarily depends on the market performance of the specific investment asset class, its size only partly reflects the actual effectiveness of active reserve management. In order to measure the success of portfolio management, the performance of each reserve portfolio is compared to that of a benchmark (reference) portfolio. Benchmark portfolios are representative of the overall market with identical investment parameters, i.e. the performance of the MNB's portfolios can be compared to the market average. The performance of foreign exchange reserve management is measured against these benchmark portfolios.

As a rule, the framework of risk-taking is set by the Monetary Council. Accordingly, in 2009 the Monetary Council again determined the basic principles of reserve and risk management and the degree of market, liquidity and credit risks affecting individual portfolios. In addition, it made a decision on the benchmark policy, established strategic benchmarks and specified the currency denominations of the securities to be held in the foreign exchange reserves.

The limit system was approved – within the framework defined by the Monetary Council – by the Chairman of the MNB's Implementation Committee, including the maximum acceptable deviations of the risks affecting the reserve portfolios vis-à-vis the benchmarks, counterparty limits and the range of investment instruments accepted for the purpose of reserve management. Throughout the year, the Chairman of the Asset-Liability Committee (ALCO) reviewed market developments and the Bank's risks exposure with monthly regularity.

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

The MNB invests the foreign exchange reserves in two currencies: euro and US dollar. However, it takes exchange rate exposure in euro only – it covers the risk of the dollar/euro cross rate by derivative instruments. Holding dollar assets with exchange rate coverage is justified by two objectives: to achieve a higher level of diversification on the one hand, and to provide dollar liquidity on the other. The bank manages a total of five portfolios denominated in the two currencies, and each portfolio is based upon a different strategy. The MNB holds a money market portfolio and an investment portfolio in each currency. To ensure more efficient and specialised reserve management, in 2008 the euro-denominated investment portfolio – which accounts for the largest part of the reserves – was divided into two separate portfolios: a so-called credit risk free portfolio and an investment portfolio. The former portfolio, which constitutes the majority of the foreign exchange reserves, consists of investment grade government papers and the issuances of international (supranational) institutions only, and its benchmark only includes government securities of GMU Member States with a credit rating of at least AAA or AA. As regards the investment portfolio, it can only include investment grade corporate and bank issuances and collateralised securities; if this portfolio contains government securities, it is typically for liquidity management purposes. Accordingly, the benchmark of the investment portfolio is representative of the performance of a broad range of euro-denominated corporate issuances with a high credit rating.

In 2009 the benchmark of both the euro and the dollar-denominated investment and credit risk free portfolios contained investment grade government securities and corporate bonds, as well as money market and capital market assets with a maximum remaining maturity of 10.5 years. The composition of the benchmark portfolios

according to the credit ratings of assets and remaining maturity reflects the conservative risk appetite typical of central banks.

Chart 9

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

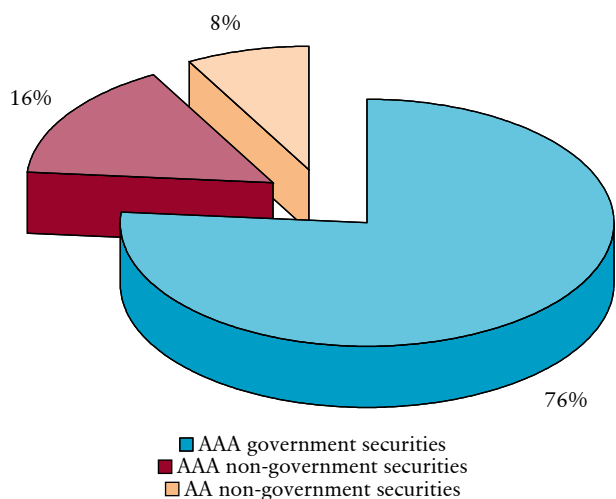
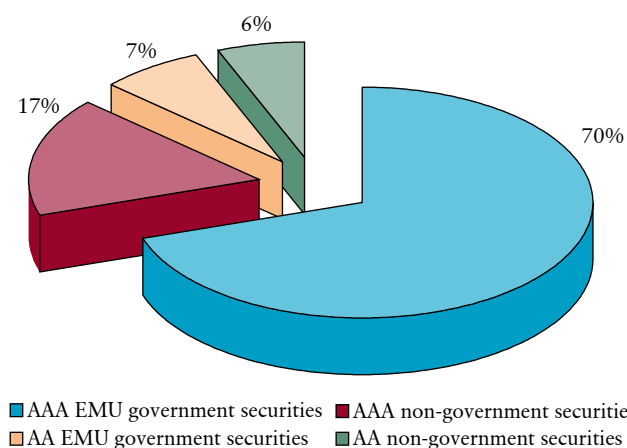


Chart 10

Structure of the overall euro-denominated benchmark portfolio

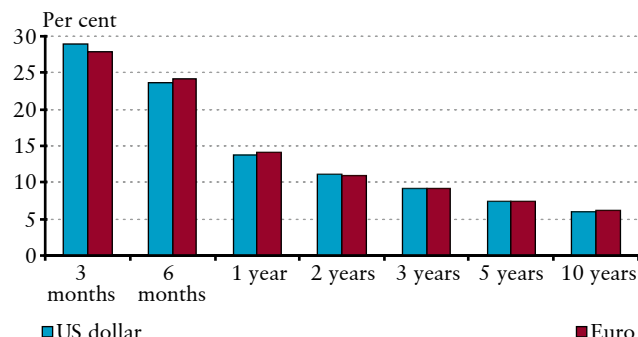


On 31 December 2009, 90% of the credit risk free euro-denominated benchmark portfolio consisted of AAA-rated GMU government securities, while the remaining 10% was composed of AA-rated government securities. As regards the euro-denominated investment benchmark portfolio, AAA-rated GMU government securities had a share of 18% in the portfolio, while AAA-rated and AA-rated other securities had a share of 60% and 22%, respectively.

Both in absolute terms and relative to the comparable benchmarks, the Bank performed well in 2009 with respect to foreign currency reserves. The liquidity required for the

Chart 11

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



attainment of monetary policy objectives was available throughout the entire year, with no credit risk incidents affecting the reputation of the MNB adversely. Exceeding the 2.18% yield on the benchmark portfolio by 42 basis points, the annualised performance of the so-called credit risk free portfolio was 2.6%. The euro-denominated investment portfolio yielded a return of 4.36%, 26 basis points below its benchmark. The annualised yield on the dollar-denominated investment portfolio – adjusted by the cost of the exchange rate hedging – exceeded its benchmark by 55 basis points and stood at 1.71%. The annual return of 1.6% on the euro-denominated money market portfolio exceeded the relevant benchmark by 61 basis points, while that on the dollar-denominated money market portfolio amounted to 0.5%, also exceeding – by 24 basis points – the 0.26% result of the benchmark. Exceeding the 2.78% return on the weighted benchmark by 21 basis points, the annual return on the portfolios weighted with market value amounted to 2.99%.

The environment of reserve management during the year was primarily determined by two factors: the impact of the financial crisis on the markets relevant to reserve management on the one hand, and the substantially increased level of reserves, attributable to the loans received from international institutions on the other. In the context of recession concerns, yields declined by 150 basis points on the euro-denominated government securities, corresponding to the 1.5-year strategic target duration of the investment portfolios that contributed to the favourable return both on the benchmarks and the portfolios.

The relatively high performance of the euro-denominated investment portfolio can be attributed to the downward shift of the yield curve, declining credit risk premia against the background of the partial normalisation of credit markets and, in addition to a careful selection of securities, it also reflects the longer duration purposefully undertaken in view

of the declining yields. Performance falling behind the relevant benchmark resulted from the higher weight of the increasingly poor performance of certain credit market segments relative to the benchmark. The dollar yield curve declined by 0.5% over the time horizon relevant for the MNB and, in this case, the achievement of a better performance relative to the benchmark was primarily attributable to the longer duration taken with the intention of exploiting the declining yields. In 2009 the level of reserves increased substantially, reflecting the EUR 7.3 billion disbursed during the year from the loan received from the international organisations (IMF, EU), of which the MNB drew down EUR 1.4 billion. The government deposited the amounts disbursed by the IMF with the Bank. While it maintained the prudent management of exchange rate and interest rate risks, the MNB incorporated these funds into the actively managed foreign exchange reserve portfolios. The level of reserves was further boosted by the SDR 1 billion allocated by the IMF in August and September, as well as the foreign exchange inflows resulting from the FX bond issuance of ÁKK Zrt. in July. Responding to the increased risks resulting from the financial crisis, the MNB tightened certain parameters of reserve management even further, and placed greater emphasis on security and the maintenance of continuous liquidity against the background of globally deteriorating market liquidity.

The value-at-risk of the items in the MNB's foreign exchange balance corresponding to the changes in the interest rate amounted to EUR 103 at the end of the year (95% confidence level VaR over a one-month time horizon). The average daily foreign exchange risk calculated for 2009 amounted to EUR 5,745 million (1-day VaR with a 95% confidence level). These values reflect the implementation of the conservative guiding principles laid down in the risk-taking policy.

Managing operational risks

Amid the global financial crisis, the cost-efficient management of operational risks is a key priority. On the

one hand, new risks emerged as a result of the crisis; on the other, the new tools and procedures introduced in relation to managing the crisis combined with the increased workload automatically elevated the level of operational risks. Consequently, the MNB placed increased focus on containing the risks associated with the newly introduced tools and the modified work processes.

The annual review of operational risks focuses on assessing the financial, reputational and business impact of the risks identified in banking processes and the probability of their materialisation. During the review the professional estimates of the experts interviewed are supplemented by internal data on operational risks, collected according to the standard methodology applied in the Bank.

A highly significant development of the MNB's business continuity system is the Disaster Recovery Centre established at the Logistics Centre. The Disaster Recovery Centre is intended to ensure that an IT backup is in place and available even during crisis situations for the continuous operation of critical work processes. During the year the MNB conducted a series of successful business continuity tests at this new location.

In 2009 business continuity planning placed great emphasis on the management of external risks related to the loss of human resources. During the summer the MNB drew up a detailed preparation and action plan designed to mitigate the impact of a potential flu pandemic.

3.5 CASH LOGISTICS ACTIVITIES

Currency in circulation

On 31 December 2009 the value of the currency in circulation amounted to HUF 2,165.1 billion, i.e. 5% less than a year earlier.

Table 2

Currency in circulation

(on the last day of the year)

Description	2008	2009	Change	
			Billion HUF	%
Banknotes	2,259.4	2,122.1	-137.3	-6%
Coins	29.5	43.0	13.5	+46%*
Banknotes and coins	2,288.9	2,165.1	-123.8	-5%
Collector coins	5.2	5.7	0.5	10%
Currency in circulation	2,294.1	2,170.8	-123.3	-5%

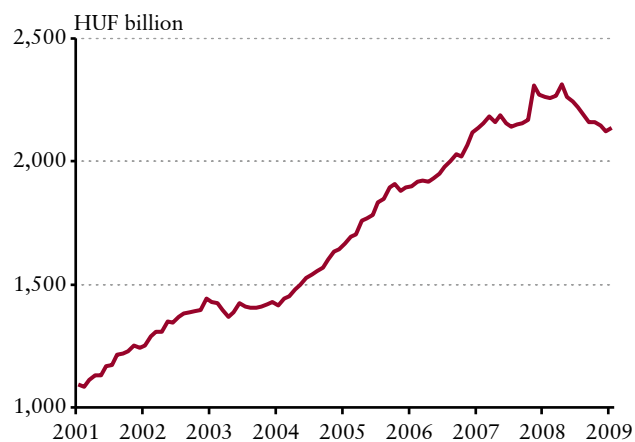
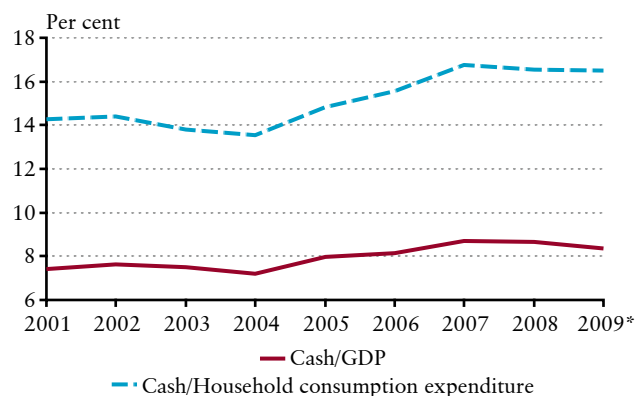
* The increase in the value of coins in circulation was resulted by the issue of 200 forint coin.

Table 3**Quantity and value of banknotes and coins in circulation on 31 December 2009**

Banknotes	Volume Million pieces	Value Billion HUF	Ratio (%)	
			Volume	Value
20 000 forint	54.9	1,098.8	21.8	51.8
10 000 forint	82.2	822.2	32.6	38.7
5 000 forint	20.6	103.2	8.2	4.9
2 000 forint	18.4	36.7	7.3	1.7
1 000 forint	46.4	46.4	18.4	2.2
500 forint	29.5	14.7	11.7	0.7
Sum	252.0	2,122.1	100	100

Coins	Volume Million pieces	Value Billion HUF	Ratio (%)	
			Volume	Value
200 forint	68.4	13.7	6.0	31.9
100 forint	152.2	15.2	13.3	35.3
50 forint	112.6	5.6	9.8	13.0
20 forint	207.7	4.2	18.1	9.8
10 forint	248.0	2.5	21.6	5.8
5 forint	358.3	1.8	31.2	4.2
Sum	1,147.2	43.0	100	100

In 2009, following a temporary, financial crisis related increase in March, a steady fall in the amount of cash in circulation was observed, which is presumably attributable to the decline in household consumption resulting from the economic downturn. However, relative to GDP or consumption, the cash demand of the Hungarian economy may still be considered high in international comparison.

Chart 12**The value of currency in circulation****Chart 13****Cash intensity of the Hungarian economy**

* The 2009 GDP and the data of household consumption expenditure are MNB estimates.

Cash distribution and processing

The MNB participates in the cash supply chain as a wholesale distributor via its bank account holders. Banknotes and coins reach the end users through the clients of the MNB, credit institutions and the Post Office.

In 2009, the cash turnover of the MNB amounted to a total HUF 3,265 billion,⁷ which represents a decline of HUF 84.9 billion compared with the previous year. In 2009, the MNB paid 251 million banknotes to its clients, while commercial banks and the Post Office paid 298 million banknotes to the Bank.

The MNB performs the automated processing of the deposited banknotes, i.e. it sorts them according to authenticity and fitness for circulation. Banknotes classified as unfit for circulation or defective are destroyed by the Bank in a high security system. Last year the Bank judged 24% of the banknotes it processed as unfit for circulation (approximately 68 million banknotes) and replaced them with new and good-quality banknotes.

Over the past decade the MNB has striven consistently to stimulate and support an increase in efficiency of the cash supply chain. One of the most important efficiency improving measures was to allow market participants – typically cash logistics service providers – to re-circulate banknotes. Professional standards and quality requirements in respect of this activity are regulated in a decree and checked by the Bank regularly. All the banknotes in circulation appear at the MNB approximately once a year on average, and a significant portion of these banknotes is already classified as unfit for circulation by commercial banks and the Post Office when they are received by the Bank. The quantity of banknotes paid annually to the MNB as a sample provides adequate information for the MNB about the quality of the banknotes in the economy.

Banknote and coin production

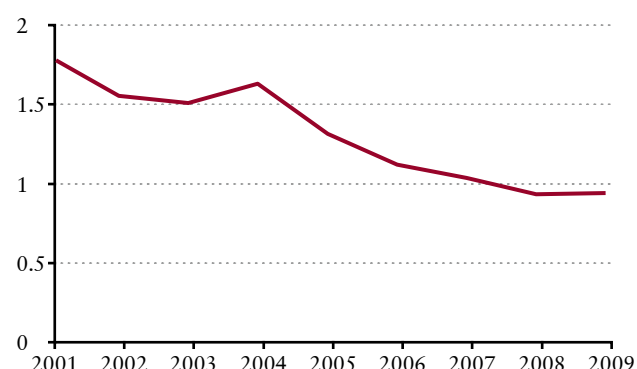
The objective of banknote and coin production is to meet the cash demand of the economy, to replace currency that has been found unfit for circulation and therefore destroyed, as well as for inventory holding purposes.

In 2009 the MNB had 101.8 million banknotes produced, i.e. 14 million fewer than in 2008. In 2009 the MNB had 86 million coins produced, which was 16 million pieces more than in the previous year. This increase – as a one-off effect – was the result of the production of the starting stock of the new two hundred forint coin, as this denomination accounted for more than 80% of the coins minted. The banknotes and coins were produced by the subsidiary companies of the MNB: Pénzjegynyomda Zrt. (Hungarian Banknote Printing Shareholding Company) and Magyar Pénzverő Zrt. (Hungarian Mint Ltd.).

Chart 14

Banknote turnover rate at annual level

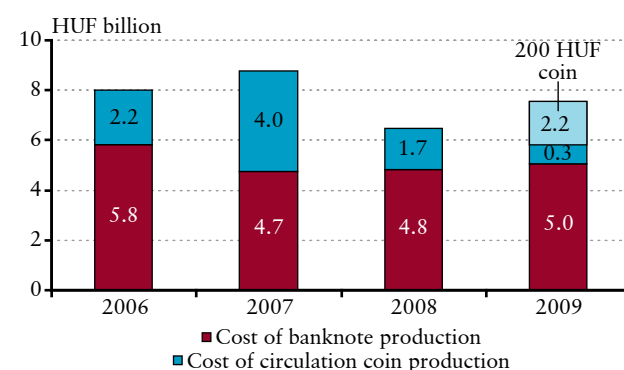
(banknotes delivered to the MNB/quantity of all banknotes in circulation)



In 2009 the MNB's total cost of cash production – excluding the production cost of collector coins – amounted to approximately HUF 7.5 billion. The withdrawal of the one- and two-forint coins from circulation and the replacement of the two hundred forint banknotes will reduce production costs in the long run.

Chart 15

The cost of banknote and coin production



Prevention and reduction of counterfeiting

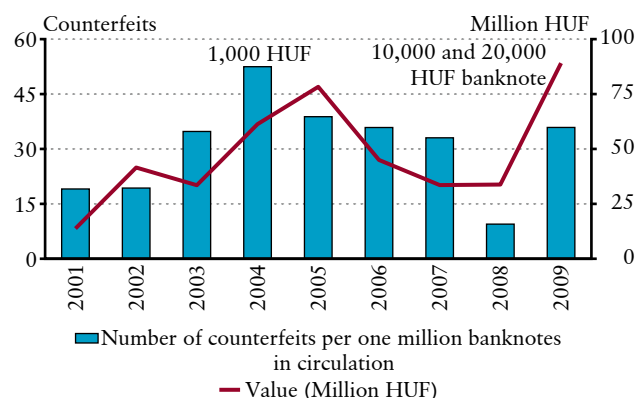
The MNB conducts a counterfeit test on suspected forint and foreign counterfeit banknotes and coins circulating in Hungary.

In 2009 the proportion of counterfeit forint banknotes increased significantly compared to 2008. The experts of the MNB recorded 9,041 counterfeit banknotes withdrawn from circulation. A shift towards higher-value banknote denominations was typical in counterfeiting last year; ten and twenty thousand forint banknotes accounted for 61% of all discovered counterfeits. Following 2008, which proved

⁷ The sum of payments to and from the Central Bank.

Table 4**Number of counterfeits per one million banknotes in circulation and the annual value of counterfeit forint banknotes**

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Number of counterfeits per one million banknotes in circulation	19.1	19.3	34.8	52.5	38.8	35.9	33.1	9.5	35.9
Value (Million HUF)	13.7	41.5	33.5	61.3	78.3	45.0	33.5	33.8	89.1
Annual value of counterfeit forint banknotes	4,118	4,369	8,504	12,638	10,257	10,507	10,139	2,986	9,041

Chart 16**Number of counterfeits per one million banknotes in circulation and the annual value of counterfeit forint banknotes**

to be temporarily favourable, the turnover-proportionate rate of counterfeiting rose to the high level of earlier years.

In order to mitigate the increasing damage resulting from the counterfeiting of high-value denominations, during the year the MNB put more emphasis than earlier on supporting the activity of the trade sector, which plays a significant 'filtering' role in cash circulation.

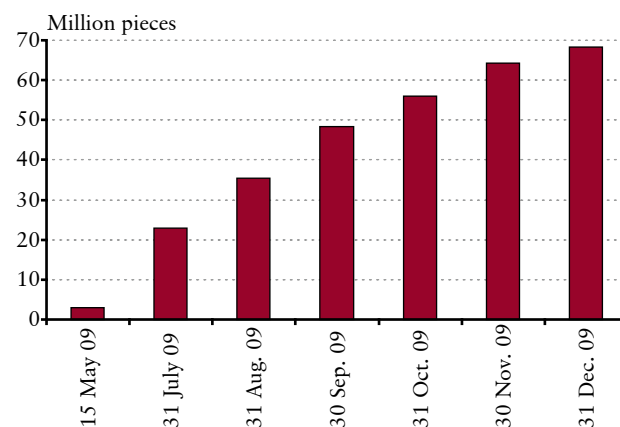
Apart from a small number of counterfeits prepared using typographic methods, forint counterfeits were typically produced with office reproduction equipment.

The number of foreign currency counterfeits did not change significantly during 2009 compared with the previous year; the experts of the MNB examined a total of 1,917 different currency counterfeits. Overall, the number of counterfeit euro banknotes found remains insignificant. In 2009 a total of 1,347 counterfeits were examined and withdrawn from circulation; most of them were fifty and one hundred euro banknotes.

Replacing the two hundred forint banknote with coin

The new two hundred forint coin was issued by the MNB on 15 June 2009. Since the introduction, 68.4 million two hundred forint coins have been put into circulation,

accounting for 6% of the number and 32% of the value of coins in circulation. Earlier, the number of the two hundred forint banknotes in circulation was approximately 20 million fewer than the number of the two hundred forint coins now, which shows that the coin has become popular quickly. The two hundred forint banknote was last accepted for payment on 15 November 2009. Until 31 December 2009, 16.2 million pieces of this banknote denomination had not been exchanged; this is approximately 34% of the quantity of the two hundred forint banknotes that had been in circulation before the withdrawal. However, this proportion is not unusual when banknotes with a low purchasing value are withdrawn, because in their case the chances of people having lost or accidentally destroyed them are higher.

Chart 17**Number of new two hundred forint coins in circulation from the date of issue until end-2009****Extension of the deadline for the exchange of old banknotes**

Members of the old series of banknotes were accepted for payment in 1999 for the last time, and according to earlier plans, the old five hundred, one thousand and five thousand forint banknotes were to have been exchanged for legal tender on 31 December 2009 at the latest. However, the Bank realised that even recently the population may have held a significant amount of withdrawn banknotes, so it decided to extend the deadline for exchanging the three

Table 5**Banknotes and coins that can still be exchanged and the respective deadlines for their exchange**

Denomination	Deadline for changing
	27. 07. 2019
	01. 09. 2019
	31. 08. 2027
	01. 09. 2019
	16. 11. 2029
 	01. 03. 2013
 	01. 03. 2013

denominations of the old banknote series that were last withdrawn. Pursuant to the decision, the purple ('Ady') five hundred forint banknote and the green ('Bartók') one thousand forint banknote can be exchanged until 2019 instead of 2009.

In addition to the MNB, prior to the expiration of the deadline for exchanging, withdrawn banknotes are also exchanged and accepted by some credit institutions and post offices.

Regulatory changes

Through its MNB Decree 2/2009. (I. 23.) and MNB Decree 3/2009. (I. 23.), the Bank updated the regulatory environment of cash circulation, and, in line with international regulations, it determined quality expectations and professional standards with respect to banknote recycling by market participants. The decrees also represent further progress in regulation in the sense that the MNB has separated the system of professional aspects of checking banknotes and coins according to authenticity and fitness for circulation, as well as laid down, by way of a statutory provision, the conditions of the denomination exchanging obligation of credit institutions and the Post Office.

In 2009 the MNB revised the provisions of MNB Decree 1/2006. (II. 15.) on the reproduction of the Hungarian legal tender and the euro, and, based on the revision, decided to update the regulations. With the new decrees drafted in 2009, simpler, better organised and more flexible rules entered into force in February 2010, in the drawing up of which the Bank took into account the opinions of those concerned. Compared with the previous regulations, the rules regarding the production, registration, safekeeping and destruction of imitations have eased.

Issue of collector coins

In 2009 the MNB issued seven collector coins (a gold one, five silver ones and one cupronickel coin), increasing the total value of collector coins and commemorative banknotes issued before end-2009 to HUF 5.8 billion.

The Bank issued silver collector coins with a face value of HUF 5,000 marking the centenary of the birth of Miklós Radnóti and the 500th anniversary of the birth of John Calvin, and paid tribute to Ferenc Kazinczy on the 250th anniversary of his birth by issuing a gold collector coin with a face value of HUF 50,000 and a silver one with a face value of HUF 3,000. In addition, the MNB continued its series presenting the masterpieces of church architecture and world heritage in Hungary by depicting the synagogue in Dohány utca, Budapest and Budapest itself on silver commemorative coins issued with a face value of HUF 5,000. The series commemorating the technical innovations and inventions of Hungarian engineers and inventors continued as well, this time with the Bánki water turbine, the invention of Donát Bánki, presented on a cupronickel coin with a face value of HUF 1,000.

The 'Tokaj historic wine growing region' collector coin issued in 2008 as a part of the 'World heritage in Hungary' series earned prestigious international recognition by winning the public award of the year 2009 'Coin of the Year' competition. This was already the third time that a Hungarian coin had won a public award.

3.6 STATISTICAL SERVICES

Pursuant to the MNB Act, in order to carry out its tasks – including the compilation of monetary, balance of payments and related international investment position, securities, financial accounts, financial stability, money circulation and payment system statistics – the Bank operates a central bank information system. For this, it collects statistical data (not qualifying as personal data) from organisations and natural persons determined by law, and takes data over from other institutions belonging to the statistical service (e.g. HFSA, CSO). The Bank's statistical activity comprises the collection, processing and publication of data, meeting the MNB's international data supplying obligations as well as the user support related to the statistics released.

In compliance with international standards and Community law, particularly the regulations of the ECB, while taking account of any changes in the conditions and requirements related to the performance of its duties, the MNB revises the collection of statistical data once each year, and specifies the reporting obligations for a given calendar year. Provisions for data reporting obligations for 2009 (the scope of information to be provided for the central bank information system and that of the reporting agents, the method and deadline of reporting) were stipulated by the Bank in its MNB Decree 13/2008. (XI. 18.).

Changes in 2009

In order to increase the credibility of statistics and to allow the most accurate interpretation of data, progressing in line with the schedule determined in the previous years, in 2009 the MNB's Statistics continued to lay special emphasis on handling the still existing methodological differences between statistical fields and increasing the harmony of special statistical publications. Harmonisation between statistics means creating harmony across the statistics prepared within the MNB (monetary, balance of payments and financial accounts) and between the statistics prepared by the MNB and the CSO (national accounts, EDP report).

Within the framework of harmonisation, in 2009 the standardisation of the settlement of EU transfers in connection with the balance of payments and the financial accounts was carried out retroactively to 2004. EU transfers

were already shown in a uniform manner in the publications of September 2009.

In the area of balance of payments statistics, further rationalisation took place on the basis of the first year of operational experiences of the new balance of payments statistical data collection system introduced in 2008. With the decision on the increasing of the value limit of data reporting, and preserving the quality of the statistics at the same time, it will be possible to ease the burden on reporting agents from 2010 on. Within the framework of data transfer among institutions new sources of data became involved, improving the quality of statistics.

Developments serving the improvement of data quality continued in the field of financial account statistics in 2009. Evaluation of loans and the distribution of cash in circulation across sectors were modified in the statistical data reports. The reasons for and effects of this latter change were described in an article published in the MNB Bulletin in December 2009.

The ECB issued a new regulation on data reporting regarding the statistical balance sheet of monetary financial institutions and interest rate statistics. In connection with the ECB's regulations entering into force as from 2010, the MNB amended its own data supplies set forth in an MNB Decree (with effect from 1 January 2010). The data releases complying with the new data content will be displayed on the MNB's website from mid-2010 on.

Co-operation with domestic institutions

In 2009 the close co-operation between the CSO and the MNB in the field of harmonising the financial and non-financial accounts of the national accounts continued, as a result of which the difference between the balances of the financial and non-financial accounts decreased. In November 2009 the CSO published the time series of the annual national accounts retroactively to 1995, and for the second time after 2008 in this publication it also indicated the data of the financial accounts calculated by the MNB. Therefore, it was the first time that users had had the opportunity to compare the balances of financial and non-financial accounts from 1995 on, because in the year 2009 issue the retroactive data were available only starting from 2004.

Progress was made in the co-operation of the two institutions in the field of harmonising their revision policies as well; in September 2009 the retroactive revision and correction of data was already carried out in accordance with a harmonised revision procedure both at the CSO and the MNB.

International reporting and global co-operation

The MNB complied with all the reporting obligations pertaining to EU Member States in 2009. Accordingly, it provided regular data supplies to the statistical office of the European Union (Eurostat), the European Central Bank and the Bank for International Settlements (BIS). In accordance with its status as a central bank, and in keeping with the expectations arising from global level of co-operation as well as its membership obligations, the MNB provides data and information on a regular basis to the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Co-operation and Development (OECD). The MNB also played an active role in international statistical working groups in 2009.

3.7 PRACTICAL PREPARATIONS FOR THE EURO CHANGEOVER

The National Euro Co-ordination Committee (NEC) was established by the government with Government Decree 1071/2007. (IX. 21.) in September 2007. The government appointed the Minister of Finance and the Governor of the MNB chairman and co-chairman of the NEC, respectively. Consequently, the MNB plays a prominent role in determining the practical preparations for the adoption of the euro in Hungary. It is possible to identify the practical tasks of the introduction of the euro irrespective of fixing a future target date of adoption, and the practical preparations may be launched even in the absence of a valid target date. It is also a fact that the financial crisis and its consequences somewhat postponed the possibility of fixing a target date for the adoption of the euro.

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

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

The main tasks of the NEC, responsible for guiding the national preparations, are as follows:

- involve all relevant parties to develop a National Changeover Plan (NCP) required for the practical adoption of the euro, which outlines the tasks and

schedules related to the changeover of the financial, corporate and public sectors, the legal and information technology areas, as well as consumer protection, accounting and statistics; 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 in respect of the information, price display and accounting systems as well as the currency and cash changeover;
- provide guidance and information in relation to the individual preparatory phases for the preparations of the euro changeover through efficient communication methods;
- 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 has been recognised as an item of special significance in the MNB's mid-term strategy, which was developed in 2007 and remains in effect until 2013:

- ‘Changeover to the euro is a significant milestone in the European integration process of the Hungarian national economy. Based on the basic tasks of the MNB as defined by the MNB Act, as well as its role in the ESCB, it is the primary objective and interest of the MNB to ensure that the Hungarian financial system is prepared for the adoption of the euro, regardless of the actual date of the changeover.’
- ‘In the course of preparations for the adoption of the euro, the MNB plays a role in analysing and monitoring the macroeconomic conditions of the changeover, and in supporting its macroeconomic foundation on the one hand, while, on the other, 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 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.’

It is obvious that the financial sector will have a key role in preparing the economy and society as a whole for

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

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

In 2009 the most important task of the NEC (and thus the MNB) was the revision and updating of the first version of the NCP. Following its establishment, the NEC organised its tasks in seven sub-committees, two of which – the FSSC and the CSC – are led by the MNB. During 2009 preparatory work continued in both sub-committees, mainly in order to update the NCP.

By the end of 2009 the second updated version of Hungary's national euro changeover plan was completed. It was adopted by the government in December 2009 as a current domestic working document to give guidance to the practical preparations for the adoption of the euro. Although there have been no fundamental changes in the main directions set forth in the NCP earlier, in some issues the tasks to be carried out have become more exact and better targeted as a result of the revision. The NCP is a public document, which is accessible to all economic agents as well as the general public.

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

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

The performance of the basic tasks of the Bank is efficiently supported by the development of financial literacy, which includes raising the financial awareness of households. At the end of 2008 the management of the Bank approved a medium-term functional strategy for the MNB's activities to improve financial literacy, and decided to establish a Financial Literacy Centre within Communications. In 2009 the series of earlier successful central bank programmes was expanded by numerous new initiatives, and the efficiency of inter-institutional co-operation continued to improve. The Foundation for Financial Awareness established at the MNB's initiative started its practical activity in 2009.

Supported by the Student Loan Centre, the Ministry of Education and Culture, the Ministry of Finance and the HFSA, the Bank prepared its information booklet 'Money speaks – do you understand?' in 2009 and forwarded it to all (nearly 1,200) secondary schools in Hungary. The publication was received by 130,000 11th grade students.

The 2008–2009 secondary-school contest 'Monetary' ended at the end of March. Out of 278 participating teams the winner took home the HUF 1 million grand prize of the contest. The contest was announced again in October 2009, with a record number of 440 teams registered as participants.

In 2009 the expansion of the general financial knowledge of a broad spectrum of households was served by a series of articles published with a weekly frequency in the economic column of a national daily newspaper, to which the MNB provided support by compiling the curriculum and background materials.

In 2009 the MNB's Visitor Centre received more than 44,000 visitors, a great number of whom participated in programmes to develop economic knowledge and financial awareness. Attendance was also increased by cultural events, such as the increasingly popular weekend Open Days organised traditionally in May and September, as well as the Museum Night held in June 2009. In 2009 the Visitor Centre participated in three events (May Festival of Museums, Children's Day in Városliget and Adolescent Festival) with on-the-spot programmes.

One result of the agreement aimed at developing the financial literacy of citizens concluded by the MNB, the Hungarian Competition Authority (GVH) and the HFSA,

was the joint support from February 2009 for an unlimited duration for the publication 'Money Compass' (Pénziránytű) of the special issue series of the Est papers distributed in Budapest and major county towns in May, and the one entitled 'Savings' (Megtakarítások), published in the same series in October on the occasion of the World Savings Day. The two free, topical information booklets published in 80,000 copies each provided information in a comprehensible manner about the most important financial services and relevant savings opportunities in certain situations of life.

Following the 2008/2009 test phase of the Financial Education Programme that had taken place with the material and professional support of the Self Care Foundation and the participation of 25 secondary schools, in June the Foundation for Financial Awareness once again announced the possibility for secondary schools to apply. A total of 40 applying secondary schools received grants, and some 90 teachers and almost 1,600 students have been participating in the programme since September 2009.

The MNB, the Foundation for Financial Awareness and the Ministry of Education and Culture established the 'Money Compass School' network membership and title, and announced it for the first time in 2009. This title signifies high-level recognition for schools that represent the values of economic education and propagation of financial knowledge within their school development and pedagogical work to an outstandingly high standard. The main objective of the school network is to facilitate the propagation of economic and financial literacy, as well as enterprise knowledge, in an indirect manner, within public education in a well-organised fashion. The title and the network membership could be won in the competition announced by the Foundation for Financial Awareness. As a first step, the 40 secondary schools participating in the Financial Education Programme had been given the opportunity, and another 21 secondary schools were allowed to join the network in October 2009.

As a result of the financial and economic crisis, more and more international institutions are becoming regularly engaged in activities aimed at improving financial literacy. At the OECD's request, experts of the MNB are participating in a working group set up in order to elaborate a standard research methodology and are taking part in the OECD's financial literacy development network (International Gateway for Financial Education) as permanent members. The European Commission (Internal Market and Services Directorate General) is regularly informed about the Hungarian initiatives, and the ECB also receives such information from time to time.

3.9 FACTORS SHAPING THE COMMUNICATION OF THE MNB IN 2009, TARGETS AND RESULTS

The Bank's main objectives for 2009 included maintaining and strengthening the success of the inflation targeting system, the efficiency of the monetary decision support system and, in connection with the international credit crisis, the stability of the Hungarian financial system, as well as their support by the means of communication. As in previous years, last year the MNB's communication activity centred on increasing the MNB's reputation, recognition and credibility, as well as on reducing the gap between the Bank and the general public.

As a result of the successful realisation of the aforementioned objectives (proactive relations with the press, analytical publications and publications for the general public, on-line means, meetings and fora for professionals, co-operation with the media, joint organisational appearances), the Bank's operation, activity and role played in managing the crisis have become more understandable and transparent for both the wider public and the professional audience. The MNB issued 61 press releases during the year (in addition to the mandatory ones); in other words, it relayed its messages to the various target groups this many times through the press, which contributed to the increase in central bank related knowledge and the strengthening of the positive attitude towards the institution. Both the campaign relating to the replacement of 200 forint banknotes and the one relating to the introduction of the new banknote security features took place successfully and in a cost-efficient manner. The target groups concerned accepted the fact of withdrawing the banknote, press appearances were active and positive in connection with both subjects, and payments by both the 200 forint coins and the new banknotes increased considerably. Communication activities with the public demonstrated well the Bank's responsibility as a public institution: during the cash logistics campaigns the MNB maintained a continuous dialogue with those concerned, organised a charity auction of the trial strikes of the 200 forint coin, and announced a tender for the charity utilisation of the approximately 40 tons of banknote briquettes produced from the withdrawn 200 forint banknotes for public benefit and priority public benefit foundations.

On the whole, through the use of the state-of-the-art tools of contemporary strategic communication, the MNB ensured that all of the complex activities it performed in the interest of the public good were transparent and effective, and its messages reached the target audiences efficiently.

3.10 FINANCIAL PERFORMANCE OF THE MNB

The MNB's income in 2009

In 2009 the Magyar Nemzeti Bank earned a profit of HUF 65.5 billion. The financial result and balance sheet structure of the Bank are primarily determined by the domestic and international macroeconomic developments and the objectives and selected measures of the monetary policy. In 2009 the following main issues had an effect on the balance sheet and the profit:

- changes in the forint exchange rate, which, in view of the foreign exchange structure of the balance sheet, has become a decisive factor in the total result of the profit and loss account;
- the level and composition of foreign exchange reserves defined by the monetary policy, and foreign currency purchases and sales affecting the level of reserves; net foreign exchange inflows originating from the foreign currency bond issues of the Government Debt Management Agency, EU transfers, drawings of international loans and the SDR allocation carried out by the IMF, as well as the foreign exchange conversions by the Hungarian State Treasury not related to debt financing;
- the developments in instruments absorbing forint liquidity, which are correlated with the changes in foreign currency reserves and the MNB's net foreign currency receivables; and

- changes in forint interest rates and international foreign exchange interest rates.

The year 2009 interest income was fundamentally determined by the increase in the Bank's net foreign currency receivables, which resulted in a growth in interest bearing forint liabilities, while the amount of currency in circulation declined to a minimum extent. Net interest and interest-related losses amounted to HUF 63.7 billion, which means a worsening of HUF 72.3 billion compared to the profit in the previous year. Within this figure the net forint interest and interest-related loss increased by HUF 115.3 billion, while the foreign exchange interest and interest-related profit was HUF 43 billion up.

The underlying reason for the substantial deterioration in the forint interest income was that the foreign exchange conversions carried out upon the use of the funds borrowed from abroad supplied the economy with significant additional forint liquidity, which was reflected in an increase in the two-week bonds at the Bank. The annual average stock of forint liabilities with interest rates tied to the central bank base rate (forint deposits by the central government, minimum reserve, liquidity absorbing instruments) increased by approximately HUF 1,700 billion.

The increase in foreign currency interest and interest-related income was connected with the increase in foreign currency reserves. In 2009 the amount of foreign currency reserves was determined by international borrowings of the MNB and the state, EU transfers, foreign exchange conversions, payments related to the bank supporting

Table 6

Abbreviated income statement and individual balance sheet items of the MNB

HUF billions

Nr	Description (P/L line)	2008	2009	Change
1	Net interest and interest related income (I+II)-(X+XI)	8.6	-63.7	-72.3
2	– net forint interest and interest related income (I-X)	-161.4	-276.7	-115.3
3	– net foreign exchange interest and interest related income (II-XI)	170.0	213.0	43.0
4	Realised gains/losses arising from financial operations (IV-XIV)	3.8	9.3	5.5
5	Income arising from exchange rate changes (III-XII)	9.2	136.7	127.5
6	Other constituents of net income* (V+...+VIII)-(XIII+XV+...+XVIII)	-27.1	-16.8	10.3
7	Profit/loss for the year (1+4+5+6)	-5.5	65.5	71.0
	Revaluation reserves in the balance sheet			
8	– due to unrealised foreign exchange gain/loss	236.3	230.8	-5.5
9	– due to changes in the market value of the foreign currency securities	46.7	21.5	-25.2

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

package and the SDR allocation performed by the IMF. In order to mitigate the impacts of the financial crisis, the IMF – supporting the increasing of foreign currency reserves of the Member States – carried out SDR allocations in August and September 2009, of which Hungary received SDR 991.1 million. As a result of all this

- foreign exchange reserves excluding accrued interest increased by EUR 6.5 billion to EUR 30.3 billion (to HUF 8,193.7 billion) during the year;
- while, in view of the decline in foreign exchange loans, the MNB's net foreign exchange position increased to a greater extent, by EUR 7.1 billion to EUR 25.3 billion.

In 2009 total gains realised on financial operations amounted to HUF 9.3 billion, which exceeded the year 2008 profit by HUF 5.5 billion. This item showed the gains or losses realised on the sale or maturity of securities in foreign exchange reserves resulting from market price changes, as well as the profit/loss originating from the difference between the buying and selling price of Hungarian government bonds during their selling and expiry.

The two main factors determining the income from exchange rate changes are the difference between the official and the average cost rate, as well as the magnitude of foreign exchange sales. In 2009 the official exchange rate of the forint fluctuated in a very wide range, between HUF 264.17 and 316 per EUR. In 2009 Q1 the exchange rate depreciated markedly; it was much weaker than the average cost rate, then it started to strengthen as of April and was already moving within a narrower band in the second half of the year. Furthermore, in March, pursuant to the decision of the Monetary Council, in addition to the usual volume of foreign currency sales, the MNB started to lead the net EU funds to the market, which resulted in outstanding

exchange rate gains at the given exchange rate levels. This explains the fact that the foreign exchange rate gain of HUF 136.7 billion in 2009 was several times larger than that of 2008.

Other income and expense items include general operating income, costs and expenses, costs of issuing banknotes and coins, income/expenses from fees and commissions and from items other than fees and commissions. The HUF 10.3 billion decline in net expenditures following from these items basically originated from releasing a portion of the provisioning carried out in 2008 to cover future potential losses. The greater part of provisions based on the changes in the market value of investments related to bond lending was released because of the improvement in the market perception of the papers, while a smaller part was due to the expiry of some of the papers.

Compared to the end of the previous year, the MNB's equity increased by HUF 34.8 billion to HUF 337.3 billion. The magnitude of the equity was fundamentally influenced by the level of revaluation reserves, and within that by that of revaluation reserves due to exchange rate changes in particular, but developments in the annual profit/loss also played an important role in its change.

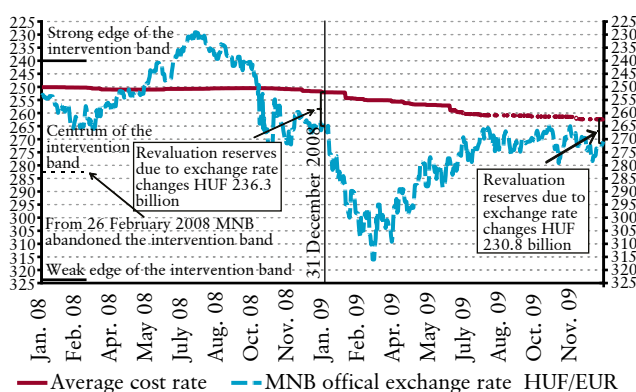
Revaluation reserves due to exchange rate changes declined by HUF 5.5 billion compared to the end of 2008, and amounted to HUF 230.8 billion on 31 December 2009. The difference between the official exchange rate and the cost rate was down compared to end-2008, which was offset by an increase in the revalued stocks of foreign exchange (net foreign exchange position).

Revaluation reserves of foreign currency securities fell by HUF 25.2 billion compared to the end of the previous year; on 31 December 2009 the MNB's balance sheet showed an unrealised gain of HUF 21.5 billion on the foreign currency securities.

Chart 18

Changes in the forint exchange rate

(2008–2009)



As the Bank's profit in the given year and the balances of both revaluation reserves were all positive, the central government did not have a reimbursement obligation pursuant to the MNB Act.

Internal operations of the MNB in 2009

The internal operations of the MNB are essentially aimed at providing the resources required for the efficient discharge of the duties stipulated by the MNB Act and facilitating risk-free operations in the most cost-effective manner. Upon inspection of the operation of the MNB, the SAO in fact verifies the institutional management's compliance with

Table 7**Operating costs of the MNB in 2009**

Description	Actual data for 2008	Budget for 2009	Actual data for 2009	Index (2009 actual / 2009 budgeted)	Index (2009 actual / 2008 actual)
	HUF millions			%	
1. Personnel expenses	8,068	7,843	7,661	97.7	95.0
2. General operation costs	6,843	6,505	6,066	93.3	88.6
Total	14,911	14,348	13,727	95.7	92.1

statutory regulations and internal rules, and checks whether the requirement of cost-effectiveness was observed in internal operations in terms of operating costs and investment. The SAO made no remarks or recommendations on these issues following the audit of the year 2008. Auditing year 2009 will be completed in 2010.

Mainly by implementing the initiatives of the project launched in 2008 aimed at the improvement of its operating efficiency and by introducing measures, in 2009 the MNB attained a 7.9% (nearly HUF 1.2 billion) reduction of operating costs compared to the expenditures in the previous year. As a result of an 8.9% decline in the average number of employees, the savings were attained predominantly in personnel costs. At the same time a significant reduction was also reached in general operating costs, and within them especially in the costs of information technology (IT), mainly in connection with software operation. The expenses related to operating the properties, cash transport and communications also declined. As a result, on the whole the MNB's operating costs in 2009 did not reach HUF 14 billion in nominal terms, which had not happened for five years.

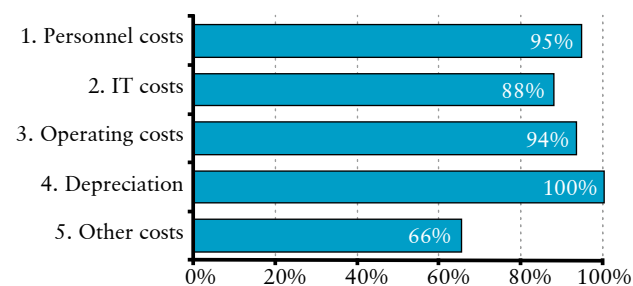
The financially realised value of investment implemented in 2009 was HUF 1,839 million, which is less than in the previous year. While in the previous years the value of investment was determined by the implementation of the Logistics Centre, investment expenditures in 2009 were mainly influenced by two factors: first, in conformity with the adopted real estate strategy, moving the computer room from the building in Hold utca to the building at Szabadság tér 8–9. (HUF 621 million) and setting up the workplaces (HUF 129 million); second, implementing the year 2009 investment relating to attainment of the targets of the adopted IT strategy amounted to HUF 987 million. The total amount of payments connected with the aforementioned investment projects accounted for 95% of the investment expenditures in 2009.

Operating costs

The approved operating cost budget for 2009 was HUF 14,563 million (including central reserves in the amount of HUF 215 million). In comparison, actual costs amounted to HUF 13,727 million. Compared to the operating costs in 2008, this amount reflects a 7.9% saving; the decline was observed in all major groups of costs.

Chart 19

Ratio of operating costs in 2009 to actual data in 2008



Personnel costs

In 2009 personnel costs (HUF 7,661 million) fell by a total 5% compared to 2008. This is basically the result of the decline in the MNB's average staff number by 8.9% (59 people) mainly as a consequence of the efficiency improving project. As a result, wages, optional fringe benefits and other personnel costs were also lower than in the previous year. The aforementioned savings were reduced by the fact that, in connection with the initiatives of the efficiency improving project, dismissal and severance pay costs were higher in 2009 than in 2008.

General operating costs

General operating costs in 2009 (HUF 6,066 million) fell by 11.4% compared to 2008.

The amount of IT costs incurred in 2009 (HUF 1,300 million) was 11.9% lower than in 2008. 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 infrastructural and data processing systems supporting the core activities of the Bank. The savings mainly resulted from the efficiency improving measures: the use of new services was lower than in previous years; moreover, some services were terminated, and the service level was optimised.

The amount of operating costs (HUF 1,625 million) declined by 6.4% compared to the previous year. Although compared to the 6-month partial operation of the Logistics Centre in 2008 the whole-year, full-scale operation in 2009 would justify an increase in operating costs, its effect was offset by several cost reducing factors. The modernisation of the operating tasks of the Logistics Centre and using the services of one service provider for all the activities that had earlier been separated by professions resulted in savings. The revision of the security level of the aforementioned facility within the framework of the efficiency improving project and its amendment from H2 on also resulted in savings in security and guarding costs. Cash transport costs fell considerably, partly because the Hungarian Mint Ltd. moved into the Logistics Centre, and partly because costs related to one-off transport needs incurred in 2008. In addition to the above, the decline in operating costs in 2009 was also attributable to the fact that the rent cost of the so-called disaster recovery centre was no longer incurred.

The amount of the depreciation of tangible and intangible assets in 2009 (HUF 2,479 million) remained unchanged compared to the previous year. Its value was mainly influenced by the higher, already whole-year depreciation of the Logistics Centre and the various systems operating therein compared to 2008, and in the case of some assets the increase of useful life. Moreover, the developments in depreciation were also affected by the increase in the worn-out assets written off to zero. In addition to the above-mentioned year 2009 amount, a depreciation cost of HUF 3 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 659 million in 2009, which is 43.3% lower than in 2008. The main

underlying reason is that the one-off fee for the cost efficiency survey is included in the 2008 base data of other costs. The termination of selling commemorative coins at face value resulted in a significant cost reduction; accordingly, in 2009 the commemorative coin distribution fee paid by the MNB arose only in connection with the sales carried forward. Communication costs also declined markedly, primarily as a result of issuing fewer publications, which can be explained with the crisis management related tasks of the organisational units engaged in analyses, and is connected with the release of some of the publications in electronic format.

Capital expenditure

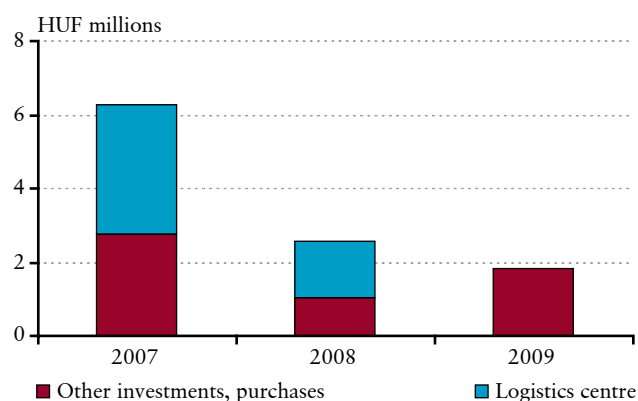
For new investment launched in 2009 and for value-updated and re-scheduled ongoing investment projects, in December 2008 the Chairman of the Executive Committee approved an investment plan for the period of 2009–2011. He also acknowledged the total estimated expenditure of investment in progress based on earlier decisions, which included actual expenditure up to 2008 (which was partly projected) and expenditure budgeted for the years to follow.

In 2009 Q1, in light of the actual data for 2008 and taking account of the items carried forward, these budget estimates were revised.

Chart 20

Investment of the MNB

(2007–2009)



More than half of the investment expenditures of the MNB in 2009 were related to investments already in progress based on decisions made in previous years.

Table 8**Investment of the MNB, 2009**

HUF millions

Description	Total budget	Actual		
		up to 2008	2009	Total
1. Investments started before 2009	1,377.4	175.5	984.7	1,160.2
2. Investments started in 2009	1,173.2	-	854.3	854.3
Total (1+2)	2,550.6	175.5	1,839.0	2,014.5
<i>of which: investments finished in 2009</i>	<i>631.1</i>	<i>26.5</i>	<i>638.2</i>	<i>664.7</i>

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

- first, a part of the total estimated expenditure of investment projects covers cost intensive projects continuing or to be completed in 2010 (e.g. the installation of workplaces in the former cash logistics area in the building at Szabadság tér 8–9., the delay of which was caused by the relevant provisions of law that had changed in the meantime and the unforeseeable replacement of security systems as well as electrical and mechanical lines, and the construction of openings for mechanical equipment);
- second, the implementation of some developments was postponed to 2010 (e.g. the separation of the IT network as a result of the failure of the procurement procedure).

In the case of investment projects completed in 2009, the discrepancy between total estimated expenditure and actual expenditure is largely due to the costs of unplanned investment (e.g. smaller IT developments in relation to the economic crisis).

The major investment projects implemented in 2009 were as follows:

- In 2009, the works related to the relocation of the computer room from the building in Hold utca to the building at Szabadság tér 8–9. continued, and the relevant implementation and technical control works as well as the installation of the electrical power requirement of the IT units to be relocated extended to 2010. The completion of the workplaces and the new computer room will allow the MNB to stop using the building at Hold utca 7. This is expected for 2010.
- 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. Within the framework of the Integrated Statistical System Programme, the modernisation of the system providing the electronic data supply was implemented, and the development of the monetary statistical processing application was launched in 2009.

- Several investment projects aimed at the realisation of achievements and increased efficiency were completed in 2009. Of them, in the IT field the investment related to server virtualisation is worth mentioning, as a result of which the space utilisation and operational safety in the computer room improved significantly, and savings in electricity and cooling energy were achieved. In addition to increasing efficiency, environmental aspects also played a role in installing the ice battery system and changing the hot water supply system. With the construction of an energy storage system in the central building, the former allows reduction in the electricity consumption costs of the air-conditioning system in the summer period. The modification of the hot water supply system meant the installation of solar collectors on the territory of the Logistics Centre in order to save gas energy.
- Further investment was carried out for the IT support of various professional areas and administrative processes (e.g. the procurement workflow system was upgraded), while with regard to the development of application architecture server replacements were implemented. In addition, some investment projects were also completed in order to achieve the targets of the efficiency improving project (e.g. procurement of cost-effective photocopiers, software for monitoring printing, a system to oversee the use of landline telephones).
- Other investments and purchases in 2009 were mainly related to the technological modernisation of real estate and security technology enhancements.

Human resources management of the MNB

Support of the changes in the operating cost reducing project affecting human resources management

During the lay-offs determined within the framework of the operating cost reducing project the MNB paid special attention to carrying them out in a lawful, fair and benevolent manner. The MNB prepared its executives to support the process and provided for personal support for the dismissals. It helped the departure of the colleagues concerned with a career counselling programme, preparing them how to treat the changes in their personal life situations and how to find a new job. No legal proceeding was initiated against the MNB in connection with the dismissals in 2009; 75% of the colleagues who participated in the career counselling programme have found a job by now.

Tracking the actions of the employee commitment survey, implementation of development actions

The results of the employee commitment survey conducted in the autumn of 2008 designated longer-term development actions for the Bank, a significant portion of which were implemented in 2009. Among other things, the introduced changes aimed at the expansion of the scope of recognitions and the extensive communication of the recognitions within the Bank, the expansion of training and development opportunities and the implementation of programmes enhancing bank co-operation (for example 'community areas'). In order to develop co-operation, the internal customer satisfaction survey was also conducted (with more participants) in 2009. Its objective was to strengthen the internal service providing attitude using the feedback from the partners. The respective areas analysed the findings of the survey and developed action plans to improve service quality.

Increasing the transparency of promotion opportunities

The MNB introduced a new classification system and promotion principles designed with an intention to provide more flexibility in recognition and motivation in January 2008. In 2009 emphasis was laid on strengthening the predictability and awareness of individual development opportunities and bank careers and on the exploration of individual promotion ambitions. As a part of this, in order to plan the careers within the Bank, the development of career maps by organisational units commenced, a career training programme was organised on a voluntary basis with 50 participating employees within the framework of the personal career counselling, and individual career and

development consultations were conducted with prospective candidates for senior positions (16 people).

In order for purposeful talent management to be supported, means taking into account employee ambitions, development opportunities and performance were created, which provide concrete guidance for the managers in the fields of employee retention and motivation.

Support of manager and organisational development

In 2009 the MNB developed a two-year management development programme, the basis of which was constituted by the experiences of management development activity in the previous years, the findings of the 360-degree competence survey of managers conducted in 2008 and the current features of the organisation. Management development activity in 2009 focussed on the strengthening of the manager as 'coach' role and the development of feedback culture.

A 360-degree management competence survey based on the role model for managers was also conducted in 2009, providing multi-aspect feedback not only to the heads of organisational units but also to heads of department about the opinions formed of their managerial work.

In order to support their managerial work, the MNB provided coaching opportunity for several managers and teams of managers. In addition, to enhance the sharing of experiences and the dialogue between managers, it launched a Managers' Club programme.

Within the framework of the organisational development activity, the Bank supported the work of the Cash Logistics with the introduction of the quality circles methodology.

In order to strengthen feedback culture, a survey was launched to map the effect of the performance management system on staff motivation; the findings will be taken into account when elaborating the year 2010 development actions.

Improvement of the operation of Human Resources in the direction of a partner role

In line with the human resources strategy formulated in 2008, in order to make managers' human resources management activity more efficient and thus to strengthen employee commitment, the so-called HR partner role was created and introduced. Within this, upon handling both larger-scale human processes (e.g. dismissal, labour planning, career and replacement planning, organisational

development) and individual, ad-hoc situations and conflicts, the human resources staff, together with the managers, looks for constructive and humane solutions that take into account the demands of employees.

In 2009 the Bank paid special attention to increasing the transparency of human systems and provided extensive information to employees about several concrete subjects (such as classification system, compensation structure and promotion opportunities).

Staff number and fluctuation

In 2009 the average staff number of the MNB was 59 employees lower than in the previous year (604.9 employees). At the end of 2009 the total staff number was 593 people; the number of employees was 48 persons (7.5%) less than at the end of 2008. In 2009 the employment of 103 employees was terminated. Termination was initiated by the employer in 73 cases, by the employees in 24 cases, while the employment of 6 people was terminated due to retirement and other reasons (e.g. expiry of fixed-term contract).

The initiatives formulated by the project aiming at improving operating efficiency had the greatest impact on the changes in the number of employees of the MNB. Numerous rationalisation measures increasing employee efficiency and productivity were implemented, concerning mainly supporting activities. In the case of banking security activity the rationalisation relating to the guarding of the Bank's facilities, in operating the IT infrastructure the reorganisation of the control centre and the help desk, while in the field of cash logistics the rationalisation of wholesale coin distribution, the standardisation of incoming and outgoing transport of banknotes and the application of containers are worth mentioning. In addition to the

outsourcing of organisational activity, efficient work organisation solutions that reduced the human resources requirement of working processes were found in performing secretarial activity, the management of international relations and in the fields of accounting and statistics. Besides these efficiency improving opportunities, the number of the Bank's employees was reduced by the termination of the project organisation assigned with the task of the construction of the Logistics Centre and the introduction of operating the building with 'one service provider'.

As a result of these changes, the share of employees with higher education continued to increase in 2009, reaching a 1% higher ratio compared to the previous year. A slight decline was observed in the composition by age; the average age of employees was 40.8 years in 2009. Compared to the previous year, in 2009 the average employment period at the Bank changed from 12.9 years to 12.6 years.

In 2009 the fluctuation rate increased slightly as a result of the terminations of employment in connection with the project to improve operating efficiency. The voluntary departure rate was lower in 2009 compared to 2008 and fewer employees in key positions left the Bank. Recruitment to make up for leaving staff and to hire external experts with adequate competence required by new tasks arising during the year continued in 2009.

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

Table 9

Changes in labour flow indicators in 2009

Indicators	2008	2009
Fluctuation		
Fluctuation (departing employees + new entries/2x total headcount)	11.1%	12.8%
Departure rate (departing employees / total headcount)	15.4%	17.0%
Voluntary departure rate (ratio to total headcount)	4.4%	4.0%
Voluntary departure of key employees	10	6
Voluntary departure rate of key employees leaving the country	30.0%	0.0%
Recruitment		
Recruitment needs	56	54
Ratio of recruitments to replace departing employees to total recruitment needs	78.6%	72.2%
Ratio of new entries to total headcount	6.9%	8.6%
Open positions filled internally	30.7%	21.5%

the central banks of different nations have the opportunity to work together and formulate common positions. This co-operation allows the representatives of individual national banks to obtain information on the work of the ECB on a regular basis.

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

Accounting and Monetary Income Committee (AMICO): Develops and regularly reviews the accounting policy principles, which define the framework of financial statements in accordance with the Statute of the ESCB, 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 (BUCOM): 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 2009

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 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 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 2009 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 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 Bank’s business report on the previous year and its audited financial statements.

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 2009 the fourth 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 public interest of the research projects in which the Bank is involved. The Bulletin was published on four occasions in 2009.

Other publications

The MNB launched its series Payment System for Everybody in 2008. The new volume in the series issued in 2009 presented an overview of practical information regarding direct debit in an entertaining format. Another publication issued in 2009 was Payment System in Hungary, which presented the payment methods and the operation of payment transactions in Hungary in a comprehensive manner.

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

Conferences and presentations

Conferences and scientific events

19 to 20 March 2009: Meeting of 6 Central European NCB's

26 May 2009: Workshop for the CEE Stress Testing Exercise

4 to 6 June 2009: 10th IMF-WB Belgian Constituency Meeting at Deputies' Level

3 to 4 September 2009: 8th Macroeconomic Policy Research Workshop on Examining the Workhorses of Macroeconomics

24 to 25 September 2009: 27th Technical Advisory Group Meeting

6 October 2009: Meeting with crisis experts (Prof Barry Eichengreen and Prof Hyun Song Shin)

12 to 13 November 2009: European Winter Meeting of the Econometric Society

11 December 2009: Anchor: 2010 (central bank annual closing event)

Budapest Economic Seminar Series (BESS) at MNB

14 January 2009: Casper G. de Vries: The Credit Crunch: Causes, consequences & policy

21 January 2009: Philip Sauré: On Subsidies in Trade Agreements

26 January 2009: Filippo Ferroni: Trend agnostic one step estimation of DSGE models

28 January 2009: Lutz Weinke: Inflation and Labor Market Dynamics Revisited

11 February 2009: Sofia Bauducco: Seigniorage and distortionary taxation in a model with heterogeneous agents and idiosyncratic uncertainty

12 February 2009: Filippo Brutti: Legal Enforcement, Public Supply of Liquidity and Sovereign Risk

20 February 2009: Vitaliy Strohush: Can Uninsurable Idiosyncratic Shocks Lead to Global Imbalances?

4 March 2009: Péter Karádi: Inflation Asymmetry and Menu Costs – New Micro Data Evidence

11 March 2009: Raffaella Giacomini: Model selection and forecast evaluation in unstable environments

18 March 2009: John Hassler: Optimal taxes on fossil fuel in general equilibrium

25 March 2009: Philippe Martin: How do different firms react to exchange rate changes? Prices, quantities, entry and exit

1 April 2009: Gabriel Perez Quiros: Introducing the Euro-STING: Short-Term INDicator of Euro Area Growth

8 April 2009: Eric Bartelsman: Forecasting aggregate productivity using information from firm-level data

22 April 2009: Mikael Carlsson: Evaluating Microfoundations for Aggregate Price Rigidities: Evidence from Matched Firm-Level Data on Product Prices and Unit Labor Cost.

29 April 2009: Hans Dewachter: Bayesian Estimation of Extended Macro-Finance Models: The Role of Financial and Macroeconomic Shocks in Yield Curve Dynamics

6 May 2009: Patrick Minford: Two orthogonal continents; testing a two-country DSGE model of the US and the EU using indirect inference

8 May 2009: Igor Livshits: Costly Contracts and Consumer Credit

13 May 2009: Philip R. Lane: The Long or Short of it: Determinants of Foreign Currency Exposure in External Balance Sheets

20 May 2009: Chiara Forlati: Optimal Monetary and Fiscal Policy in the EMU: Does Fiscal Policy Coordination Matter?

27 May 2009: Astrid Dick: Personal Bankruptcy and Credit Market Competition

28 May 2009: Pedro Teles: Unique Monetary Equilibria with Interest Rate Rules

18 June 2009: Andrea Colciago: Endogenous Market Structures and the Business Cycle

24 June 2009: Mark Wright: Recovery Before Redemption: A Theory of Delays in Sovereign Debt Renegotiations

7 July 2009: Chris Carroll: A Tractable Model of Precautionary Reserves, Net Foreign Assets, or Sovereign Wealth Funds

15 July 2009: Adam Zawadowski: Entangled Financial Systems

17 September 2009: Giancarlo Corsetti: Demand Imbalances, Exchange Rate Misalignment and Monetary Policy

30 September 2009: Wouter den Haan: Inefficient employment decisions, entry costs, and the cost of fluctuations

7 October 2009: Botond Kőszegi: Consumer Policy toward Savings and Credit

21 October 2009: Kosuke Aoki: Central bank's two-way communication with the public and inflation dynamics

28 October 2009: Daniel Levy: Price Points and Price Rigidity

11 November 2009: Martin Ellison: A defence of the FOMC

25 November 2009: Ignazio Angeloni (Adviser to the Executive Board, ECB): A Tale of Two Policies: Prudential Regulation and Monetary Policy with Fragile Banks

3.13 EXPLANATION OF ABBREVIATIONS AND TERMS SPECIFIC TO CENTRAL BANKING

Abbreviations

ALCO: Asset-Liability Committee

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

BANCO: Banknote Committee (an ESCB committee)

BIS: Bank for International Settlements

BSC: Banking Supervision Committee (an ESCB committee)

BUCOM: Budget Committee

COMCO: Committee on Cost Methodology (an ESCB committee)

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

EISC: Eurosystem IT Steering Committee

EMU: Economic and Monetary Union

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

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 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 of the currencies again at the price determined in the contract by the cross rate and the interest rate of the currencies.

FX swap: See Foreign exchange swap.

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

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

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

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

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

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

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

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

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

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

Payment System Forum: an independent, self-organising, professional organisation with consultative character committed to the matters of the domestic payment system and operating on the MNB's initiative, with the support of the Hungarian Banking Association and the participation of banks playing a decisive role in payment transactions (OTP, MKB, CIB, CITI, ING, MTB, Raiffeisen, BB, K&H and HVB) as well as the Hungarian State Treasury, GIRO Zrt. and KELER Zrt.

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 re-purchased 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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Hungary

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This is an English translation of the Independent Auditor's Report on the 2009 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 2009 annual report of Magyar Nemzeti Bank (hereinafter referred to as "the Bank"), which comprises the balance sheet as at 31 December 2009, which shows total assets of MHUF 9,059,675 and retained profit for the year of MHUF 65,542, 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 2009, 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, 6 April, 2010

KPMG Hungária Kft.
Chamber registration number: 000202

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

KPMG Hungária Kft., a Hungarian limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Company registration: Budapest, Fővárosi Bíróság, no. 01-09-063183



2 Balance sheet of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	ASSETS	31. 12. 2008	31. 12. 2009	Change
1	2	3	4	4-3
	I. RECEIVABLES DENOMINATED IN FORINT	536,526	279,028	-257,498
4.3.	1. Receivables from the central government	360,005	279,027	-80,978
4.7.	2. Receivables from credit institutions	176,520	0	-176,520
	3. Other receivables	1	1	0
	II. RECEIVABLES DENOMINATED IN FOREIGN CURRENCY	6,689,214	8,592,938	1,903,724
4.9.	1. Gold and foreign currency reserves	6,296,749	8,193,669	1,896,920
4.4.	2. Receivables from the central government	4,970	4,497	-473
	3. Receivables from credit institutions	0	1,043	1,043
4.10.	4. Other receivables	387,495	393,729	6,234
	III. BANKING ASSETS	36,587	34,776	-1,811
4.13.	of which: invested assets	36,418	34,016	-2,402
4.16.	IV. PREPAID EXPENSES/ACCRUED INCOME	104,192	152,933	48,741
	V. TOTAL ASSETS (I+II+III+IV)	7,366,519	9,059,675	1,693,156
Reference number to notes on the Accounts	LIABILITIES AND EQUITY	31. 12. 2008	31. 12. 2009	Change
1	2	3	4	4-3
	VI. LIABILITIES DENOMINATED IN FORINT	4,793,968	6,320,547	1,526,579
4.5.	1. Central government deposits	127,637	247,858	120,221
4.8.	2. Deposits by credit institutions	1,121,287	755,154	-366,133
	3. Banknotes and coins in circulation	2,294,106	2,170,782	-123,324
	4. Other deposits and liabilities	1,250,938	3,146,753	1,895,815
	VII. LIABILITIES DENOMINATED IN FOREIGN CURRENCY	2,222,394	2,355,769	133,375
4.5.	1. Central government deposits	1,518,273	740,569	-777,704
4.8.	2. Deposits by credit institutions	27,410	21,763	-5,647
4.11.	3. Other deposits and liabilities	676,711	1,593,437	916,726
4.14.	VIII. PROVISIONS	9,157	5,283	-3,874
	IX. OTHER BANKING LIABILITIES	16,963	18,757	1,794
4.15.	X. ACCRUED EXPENSES/DEFERRED INCOME	21,574	22,009	435
4.16.	XI. EQUITY	302,463	337,310	34,847
	1. Share capital	10,000	10,000	0
	2. Retained earnings	14,925	9,461	-5,464
	3. Valuation reserves	0	0	0
4.17.	4. Revaluation reserves due to exchange rate changes	236,258	230,792	-5,466
4.17.	5. Revaluation reserves of foreign currency securities	46,744	21,515	-25,229
	6. Profit/Loss for the year	-5,464	65,542	71,006
	XII. TOTAL EQUITY AND LIABILITIES (VI+VII+VIII+IX+X+XI)	7,366,519	9,059,675	1,693,156

6 April 2010, Budapest



András Simor
Governor of the Magyar Nemzeti Bank

3 Income statement of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	INCOME	2008	2009	Difference
1	2	3	4	4-3
4.19.	I. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FORINT	22,337	52,856	30,519
	1. Interest on receivables from the central government	14,317	27,793	13,476
	2. Interest on receivables from credit institutions	6,188	17,883	11,695
	3. Interest on other receivables	0	0	0
	4. Interest related income	1,832	7,180	5,348
4.19.	II. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FOREIGN CURRENCY	204,446	282,066	77,620
	1. Interest on foreign currency reserves	182,722	200,721	17,999
	2. Interest on receivables from the central government	0	0	0
	3. Interest on receivables from credit institutions	2	0	-2
	4. Interest on other receivables	2,896	3,028	132
	5. Interest related income	18,826	78,317	59,491
4.20.	III. INCOME ARISING FROM EXCHANGE RATE CHANGES	26,404	143,613	117,209
4.19.	IV. REALISED GAINS ARISING FROM FINANCIAL OPERATIONS	12,140	46,069	33,929
4.22.	V. OTHER INCOME	4,333	6,197	1,864
	1. Fees and commissions	891	834	-57
4.23.	2. Income other than fees and commissions	3,442	5,363	1,921
4.14.	VI. PROVISIONS RELEASED	940	4,617	3,677
4.14.	VII. IMPAIRMENT RELEASED	1,385	1	-1,384
4.24.	VIII. OPERATING INCOME	181	1,738	1,557
	IX. TOTAL INCOME (I+II+III+IV+V+VI+VII+VIII)	272,166	537,157	264,991
Reference number to notes on the Accounts	EXPENSES	2008	2009	Difference
1	2	3	4	4-3
4.19.	X. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FORINT	183,687	329,581	145,894
	1. Interest on central government deposits	33,469	36,408	2,939
	2. Interest on deposits by credit institutions	80,860	67,338	-13,522
	3. Interest on other deposits	69,358	225,835	156,477
	4. Interest related expenses	0	0	0
4.19.	XI. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FOREIGN CURRENCY	34,468	68,995	34,527
	1. Interest on central government deposits	5,120	9,988	4,868
	2. Interest on deposits of credit institutions	268	62	-206
	3. Interest on other liabilities	11,899	19,933	8,034
	4. Interest related expenses	17,181	39,012	21,831
4.20.	XII. EXPENSES RESULTING FROM EXCHANGE RATE CHANGES	17,220	6,862	-10,358
4.21.	XIII. COST OF ISSUING BANKNOTES AND COINS	6,993	8,162	1,169
4.19.	XIV. REALISED LOSSES ARISING FROM FINANCIAL OPERATIONS	8,298	36,760	28,462
4.22.	XV. OTHER EXPENSES	3,313	5,357	2,044
	1. Fees and commissions	434	2,496	2,062
4.23.	2. Expenses other than fees and commissions	2,879	2,861	-18
4.14.	XVI. PROVISIONS CHARGED	8,357	743	-7,614
4.14.	XVII. IMPAIRMENT	0	0	0
4.24.	XVIII. OPERATING COSTS AND EXPENSES	15,294	15,155	-139
	XIX. TOTAL EXPENSES (X+XI+XII+XIII+XIV+XV+XVI+XVII+XVIII)	277,630	471,615	193,985
	XX. PROFIT/LOSS BEFORE DIVIDENDS (IX-XIX)	-5,464	65,542	71,006
	XXI. Dividends from retained earnings	0	0	0
	XXII. Dividends	0	0	0
	XXIII. PROFIT/LOSS FOR THE YEAR (XX+XXI-XXII)	-5,464	65,542	71,006

6 April 2010, Budapest



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 the shareholder).

The accounting policy of the Magyar Nemzeti Bank is based on the Act on Accounting (Act C of 2000), Act LVIII of 2001 on the Magyar Nemzeti Bank (hereinafter: Act on MNB) and Government Decree 221/2000 (XII.19.) on special reporting and accounting requirements applicable to the Magyar Nemzeti Bank (hereinafter: MNB Decree).

As of the effective date of the Act promulgating the international treaty on the accession of the Republic of Hungary to the EU, i.e. 1 May 2004, the Magyar Nemzeti Bank has been a member of the European System of Central Banks (ESCB).

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

4.1.1 The MNB's accounting framework

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

On a daily basis the MNB records:

- exchange rate differences arising from revaluation of its foreign assets and liabilities and derivative transactions for hedging purposes recorded off-balance sheet, and
- the accrued/deferred interest arising from on and off-balance sheet assets and liabilities from hedging transactions.

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

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

- market valuation of foreign currency securities, with the exception of foreign currency bonds issued and repurchased by the Bank,
- split and recording of realised and unrealised portions of foreign exchange gains and losses deriving from daily revaluation, and
- charging depreciation.

Upon the quarterly closing of accounts, the MNB qualifies its off-balance sheet contingent and future liabilities arising from derivative transactions for other purposes and securities lending operations based on international agreements (in this

case the liabilities are equal to the purchase value of the collateral received), and at the end of the year the invested assets, claims and other off-balance sheet liabilities. As a result of this qualification, the Bank recognises impairment losses as necessary and makes provisions for liabilities and expected losses.

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

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

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

In the course of its credit qualification process, the IMF ordered the MNB to present the distinctions detailed in Section 4.26 between MNB's accounting policy and the Guideline of the European Central Bank on the legal framework for accounting and financial reporting in the European System of Central Banks ECB/2006/16 (hereinafter: ESCB Guideline) as well as the numeric effect of these differences in the notes to the financial statements from 2009.

The financial statements of the MNB must be audited by the statutory auditor in compliance with the Act on Accounting. The registered auditor of the MNB is István Henye (KPMG Hungária Kft), Chamber membership number: 005674.

The person authorised to sign the Annual Report is:

András Simor, Governor of the Magyar Nemzeti Bank.

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

4.1.2 Major principles of valuation

Receivables from the central government

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

Receivables from the central government also include receivables associated with the reimbursement of revaluation reserves (due to their negative year-end balance).

No impairment loss may be recorded in connection with receivables from the central government.

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

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

The MNB carries out a daily revaluation of foreign currency assets and liabilities as well as off-balance sheet assets and liabilities arising from derivative transactions for hedging purposes, taking account of variations in the official exchange

rate. As a result of this revaluation, balance sheet items denominated in foreign currency are stated in an amount converted at the official exchange rate prevailing on 31 December. Banking assets and banking liabilities in foreign currencies (with the exception of foreign investments) and derivative transactions for purposes other than hedging do not form part of revaluation.

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

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

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

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

Foreign currency securities

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

The Magyar Nemzeti Bank measures its securities on the basis of market prices prevailing on 30 December, due to the fact that adequately liquid prices are not ensured on 31 December. As 31 December is not a trading day on European and Japanese stock exchanges, the valuation of securities is based on the latest available market prices.

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

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

Securities lent through securities lending operations based on international agreements do not need to be removed from foreign exchange reserves; they are recorded as off-balance sheet items. Non-cash collateral and investments from cash collateral must be recorded as contingent liabilities under off-balance sheet items.

Accounting rules relating to the IMF quota

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

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

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

SDR allocation aims to increase the foreign exchange reserves of the IMF's members and creates an unmatured liability vis-à-vis the IMF on the liability side of the balance sheet. This transaction has no effect on profit or loss, if it is not utilised.

Accounting rules relating to derivatives

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

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

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

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

Banking assets and liabilities

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

- assets and liabilities not directly related to central bank functions and bank operations (such as settlements relating to taxes, contributions, payments to employees, creditors, unsold precious metals held for non-central bank purposes), as well as
- liabilities arising from banknotes no longer accepted as legal tender but not yet exchanged,
- investments, and
- assets required for operating the organisation (such as intangibles, tangibles, 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. 2008	31. 12. 2009
Concessions, licences and similar rights	17%	17%
Trade-marks patents and similar assets	14,5%-50%	14,5%-50%
Capitalized value of reorganization	20%	20%
Buildings	3%	3%
Vehicles*	10%-25%	10%-20%
Telecommunication devices, office equipment, machines	9%-50%	9%-50%
Computer hardware	9%-50%	9%-33%
Emission machinery	5%-50%	5%-33%
Instruments	9%-33%	9%-33%
Bank security devices	2%-33%	2%-33%
Other not specified devices**	6,5%-33%	6,5%-33%

* Residual value 20% and 25% of the vehicles with 4 or 5 year time of use.

** 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.

4.2 EFFECTS OF MACROECONOMIC TRENDS ON THE 2009 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.

In 2009, the MNB recorded a profit of HUF 65.5 billion. In respect of macroeconomic events, changes in the forint exchange rate exerted the most important influence on the Bank's profit. The total net revaluation effect was a gain of HUF 131.3 billion. The official forint exchange rate against the euro fluctuated in a rather wide band during the year and was weaker than the average cost rate until the end of the year. The difference between the official forint exchange rate and the average cost rate at the end of 2008 amounted to 12.70 forint/euro, which decreased to 8.28 forint/euro by the end of 2009. The volume of foreign currency sales was also high in the first half of the year, since – in addition to the usual volume of sales – the MNB began to re-channel the net EU funds (to convert the net EU funds in the market) from March 2009. Together, the development of the official forint exchange rate to the average cost rate and the higher level of foreign currency sales already resulted in a remarkably large foreign exchange gain in the first quarter of 2009. The realised foreign exchange gain amounted to HUF 136.8 billion in 2009, with 60% of this realised in the first quarter. The revaluation reserve due to exchange rate changes, as an unrealised foreign exchange gain, decreased by HUF 5.5 billion to HUF 230.8 billion by 31 December 2009.

In 2009, the bank recorded a HUF 63.7 billion net interest and interest-related loss, which was a decrease of HUF 72.3 billion relative to previous year. Net interest income was determined mainly by the increase in the Bank's net foreign currency receivables, which at the same time resulted in an increase in interest-bearing forint liabilities as well. Forint and foreign currency interest rates deviated from each other in the first half of the year, but this interest rate difference then declined because of the steady decrease in the central bank base rate in the second half of the year. The average central bank base rate was 8.63% in 2009, but hardly changed compared to the annual average of 2008, in spite of the decreases.

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

4.3 FORINT RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2008	31. 12. 2009	
	Government bonds maturing within 1 year	51,749	29,576	-22,173
	Government bonds maturing within 1 to 5 years	160,054	101,834	-58,220
	Government bonds maturing over 5 years	148,202	147,617	-585
I.1.	Total receivables from the central government	360,005	279,027	-80,978

The amount of government bonds recorded at historic cost was HUF 279 billion. There were no new purchases during the year. The decrease of HUF 81 billion in the value of securities was caused by the decrease of HUF 86.6 billion of the face value of matured and sold government bonds, and the difference of HUF 5.6 billion between the face value and the historic cost of the aforementioned bonds.

In order to support the normal operation of the domestic market for government securities and reinforce the liquidity of the banking sector, the MNB purchased bonds in the autumn of 2008. Of these bonds, one matured with a value of HUF 52.8 billion in August 2009, and two bonds were repurchased by ÁKK Zrt. with a value of HUF 32.4 billion altogether in December 2009. Scheduled repayment of an amortising bond (to be repaid annually over five years) resulted in a further decrease of HUF 1.4 billion.

The balances of revaluation reserves due to exchange rate changes and of foreign currency securities were positive on 31 December 2009, and therefore receivables from the central government did not arise.

4.4 FOREIGN CURRENCY RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
	Swap transactions with the central government	335	1,165	830
	Currency swaps with the central government	4,635	3,332	-1,303
II.2.	Foreign currency receivables from the central government	4,970	4,497	-473

The balance of foreign exchange swap transactions with the central government derive from several HUF/EUR swaps dated 30 December 2009.

The HUF 3.3 billion balance of currency swaps with the central government contains currency swaps concluded with the ÁKK before June 2002, in the interests of adjusting the foreign currency and interest structure of foreign debt. The decrease of HUF 1.3 billion compared to the previous year resulted from expiry of HUF 1.5 billion, but this was partly offset by revaluation of HUF 0.2 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. 2008	31. 12. 2009	
	- within 1 year	1,911	2,886	975
	- within 1 to 5 years	3,059	1,611	-1,448
	- over 5 years	0	0	0
II.2.	Foreign currency receivables from the central government	4,970	4,497	-473

Currency structure of swaps concluded with the central government

HUF millions

Nr	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
1.	– HUF	133,210	296,156	162,946
2.	– EUR currency group*	18,748	12,523	–6,225
3.	Swap receivables (1+2)	151,958	308,679	156,721
4.	– HUF	485	746	261
5.	– EUR currency group*	132,390	140,015	7,625
6.	– JPY	0	32,413	32,413
7.	– USD	14,113	131,008	116,895
8.	Swap payables (4+5+6+7)	146,988	304,182	157,194
9.	Net swap receivables (3-8)	4,970	4,497	–473

* 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. 2008	31. 12. 2009	
	Single Treasury Account (KESZ)	127,203	247,426	120,223
	Deposit by Government Debt Management Agency (ÁKK Zrt)	371	369	–2
	Other	63	63	0
VI.1.	Forint deposits of the central government (total)	127,637	247,858	120,221

Foreign currency deposits of the central government

The balance of the foreign currency liabilities of the central government amounted to HUF 1,518.3 billion on 31 December 2008 and HUF 740.6 billion on 31 December 2009.

The expiry dates of all central government foreign currency deposits are within a year, and the total amount of deposits halved compared to the end of the previous year. The foreign currency derived from the IMF loan drawn down in November 2008 and the EU loan drawn down in March 2009 was not converted by the central government, but rather placed on its foreign currency deposit kept by MNB, and its payment liabilities were fulfilled from this account in 2009. As a result of the high average stock in the first half of the year, the average stock in 2009 was HUF 998 billion, four times higher than it was in 2008. Further scheduled disbursements of the stand-by credit facility concluded with the IMF and the European Commission did not influence the stock of the government's foreign currency deposits.

4.6 NET POSITIONS VIS-À-VIS THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
I.1.–VI.1.	Net forint position	232,368	31,169	–201,199
II.2.–VII.1.	Net foreign currency position	–1,513,303	–736,072	777,231
	Total	–1,280,935	–704,903	576,032

4.7 FORINT RECEIVABLES FROM CREDIT INSTITUTIONS

The forint receivables from credit institutions include security-backed loans maturing within one year. Overnight loans are used by domestic credit institutions, primarily to fulfil their reserve requirement liabilities, while the two-week and six-month loan tenders were introduced during the financial crisis in 2008, in order to eliminate forint liquidity shortages at individual banks. Security-backed loans amounted to HUF 176.5 billion on 31 December 2008, but there was no stock on 31 December 2009, as there was no interest in loan tenders and no overnight loans either.

4.8 NET POSITIONS VIS-À-VIS CREDIT INSTITUTIONS

HUF millions				
B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
I.2.–VI.2.	Net forint position	-944,767	-755,154	189,613
II.3.–VII.2.	Net foreign currency position	-27,410	-20,720	6,690
	Total	-972,177	-775,874	196,303

Net liabilities to credit institutions decreased by HUF 196.3 billion by the end of 2009. The net forint position improved by HUF 189.6 billion compared to the previous year-end. The change in the net foreign currency position resulted in an increase of HUF 6.7 billion. Among foreign exchange liabilities, credit institutions placed short-term money market deposits with the MNB in the amount of HUF 21.3 billion at the end of 2009.

4.9 GOLD AND FOREIGN EXCHANGE RESERVES OF THE CENTRAL BANK

Forint balances

HUF millions				
B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
	Gold reserve	16,130	20,545	4,415
	Reserve position in the IMF	21,475	21,690	215
	Foreign currency deposits	948,589	582,636	-365,953
	Foreign currency securities	5,231,307	7,306,055	2,074,748
	Foreign currency repo transactions	79,248	262,743	183,495
II.1.	Gold and foreign currency reserves (total)	6,296,749	8,193,669	1,896,920

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

Foreign exchange reserves not including accrued interest rose by HUF 1,897 billion to HUF 8,193.7 billion by 31 December 2009. The change was caused both by the rise in balances and depreciation of the exchange rate as well.

Euro balances

EUR millions

B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
	Gold reserve	61	76	15
	Reserve position in the IMF	81	80	-1
	Foreign currency deposits	3,583	2,151	-1,432
	Foreign currency securities	19,757	26,976	7,219
	Foreign currency repo transactions	299	970	671
II.1.	Gold and foreign currency reserves (total)	23,781	30,253	6,472

The official exchange rate of the forint was 264.78 HUF/EUR on 31 December 2008 and 270.84 HUF/EUR on 31 December 2009.

The main causes of the increase in the amount of gold and foreign exchange reserves were the foreign exchange amount derived from loans drawn from the credit line provided by the EU and IMF, the IMF's SDR allocation, conversion of foreign currency (into forint) with the MNB arising from Hungarian government securities issued by ÁKK in July, 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 loans granted to domestic credit institutions by the Hungarian state within the scope of the financial stability package, payments by ÁKK in connection with debt management, and foreign currency conversion performed by the Hungarian State Treasury not related to debt-financing. As a consequence of the aforementioned effects, the stock of gold and foreign exchange reserves denominated in euro increased by EUR 6.5 billion by 31 December 2009.

4.10 OTHER FOREIGN CURRENCY RECEIVABLES

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
	Forint payment of IMF quota	280,544	283,351	2,807
	Repurchased bonds	74,244	73,133	-1,111
	Foreign hedging transactions*	29,624	36,794	7,170
	Other	3,083	451	-2,632
II.4.	Other foreign currency receivables	387,495	393,729	6,234

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

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

The amount of repurchased bonds issued abroad by the MNB did not change due to maturity; the decrease of HUF 1.1 billion resulted from strengthening of the forint exchange rate vis-à-vis the Japanese yen.

In 2009, the line 'Foreign hedging transactions' includes the swap transactions, which are related to the IMF loan.

4.11 OTHER LIABILITIES**Other forint liabilities**

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
	Two-week MNB bills	1,245,232	3,130,710	1,885,478
	International financial institutions forint deposits	4,960	15,390	10,430
	Other liabilities	746	653	-93
VI.4.	Other forint deposits and liabilities	1,250,938	3,146,753	1,895,815

Other forint deposits and liabilities increased by HUF 1,895.8 billion compared to the previous year-end, almost due to the growth in the amount of two-week MNB bills. The reason for this significant increase was the extra liquidity owing to the conversion of international loans, which was sterilised with an increasingly large volume of two-week bills. The two-week MNB bill is the most important monetary policy instrument. The issue yield on MNB bills is equal to the prevailing central bank base rate.

Other foreign currency liabilities

HUF millions				
B/S line	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
	Bonds	172,932	169,974	-2,958
	Repo transactions	174,172	405,629	231,457
	IMF forint deposit	280,544	982,736	702,192
	Foreign deposits and loans	39,821	16,558	-23,263
	Hedging transactions*	8,610	17,122	8,512
	Other liabilities	632	1,418	786
VII.3.	Other foreign currency liabilities	676,711	1,593,437	916,726

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

Two items played a decisive role in the HUF 916.7 billion increase in other foreign currency liabilities. An increase of HUF 231.5 billion in foreign currency liabilities from repo transactions was caused mainly by a change in volume. The IMF forint deposit grew by HUF 702.2 billion compared to the end of last year, because of the IMF loan and the SDR allocation (equivalent to EUR 1.4 billion and EUR 1.1 billion at the time of drawdown). The line 'Hedging transactions' mainly consists of net payables of currency swap transactions with non-resident counterparts.

Other foreign currency liabilities by remaining maturity

HUF millions				
B/S line	Remaining maturity	Balance		Change
		31. 12. 2008	31. 12. 2009	
	- within 1 year	496,785	1,152,890	656,105
	- within 1 to 5 years	159,103	129,052	-30,051
	- over 5 years	20,823	311,495	290,672
VII.3.	Other foreign currency liabilities	676,711	1,593,437	916,726

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

HUF millions				
Nr	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
1.	- USD	56,434	48,204	-8,230
2.	- EUR currency group*	195,546	411,874	216,328
3.	- JPY	135,576	132,360	-3,216
4.	- SDR	0	263,065	263,065
5.	- Other	280,545	720,812	440,267
6.	Other foreign currency liabilities	668,101	1,576,315	908,214

* 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. 2008	31. 12. 2009	
1.	– USD	56,409	46,805	–9,604
2.	– EUR currency group*	1,657	257,243	255,586
3.	– JPY	83,554	197,583	114,029
4.	Hedging transactions receivables (1+2+3)	141,620	501,631	360,011
5.	– USD	0	148,011	148,011
6.	– EUR currency group*	148,356	368,909	220,553
7.	– JPY	1,874	1,833	–41
8.	Hedging transactions payables (5+6+7)	150,230	518,753	368,523
9.	Net hedging transactions payables (8-4)	8,610	17,122	8,512

* 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. 2008	31. 12. 2009	
from II.1.	IMF quota paid in SDR	21,475	21,690	215
from II.1.	Deposit with IMF	10,226	277,139	266,913
from II.1.	Deposit with IMF for Fund's programme purposes	2,687	2,713	26
from II.4.	IMF quota paid in HUF	280,544	283,351	2,807
from II.4.	Swap receivables from IMF	0	408,254	408,254
from II.4.	Swap payables to IMF	0	–371,460	–371,460
	Total receivables	314,932	621,687	306,755
from VII.3.	Liabilities arising from SDR Allocations	0	291,131	291,131
from VII.3.	IMF Nr 2. account	1	1	0
from VII.3.	IMF Nr 1. account	280,544	691,604	411,060
	Total liabilities	280,545	982,736	702,191
	Total	34,387	–361,049	–395,436

The third instalment of the IMF Stand-By Arrangement amounting to SDR 1.3 billion was drawn down by the MNB in June 2009. According to the IMF's instructions, disbursement is recorded in form of a swap transaction, which means HUF receivables and SDR liabilities. The HUF 371.5 billion liability is shown in the line 'Swap payables to IMF'. The loan granted by the IMF raises the amount of foreign exchange reserves and the balance of the IMF Nr 1. account on the liability side (i.e. forint coverage of the IMF quota).

In 2009, SDRs were allocated to Hungary, in proportion to its quota, and to the other 185 Fund members by the IMF. The aim of this rarely applied instrument is to boost the foreign exchange reserves and liquidity of IMF members at no cost. The line 'Liabilities arising from SDR allocations' represents the unmatured liability of HUF 291.1 billion (i.e. SDR 991.1 million) arising from the allocation distributed in August and September in 2009. This amount raised the deposit with the IMF on the other hand. The SDR allocation may be used for repaying the capital amount and interest of the loan from the IMF. The allocation was appropriated for interest payment in 2009.

The forint-denominated promissory note related to the liability from Fund disbursements of the Hungarian State and placed with the MNB as a fiscal agent is shown as an off-balance sheet item in the balance sheet of the MNB (see Section 4.18.). The commitment amounted to HUF 1,107.5 billion as at 31 December 2008, rising to HUF 2057.4 billion as at 31 December 2009, owing to the new instalments and the valuation effect.

4.13 INVESTED ASSETS

In addition to intangibles, tangibles and capital expenditure (HUF 16.6 billion), invested assets include shares in investments (HUF 6.9 billion in foreign investments and HUF 10.5 billion in domestic investments).

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

HUF millions							
	Assets						Intangibles, tangibles and capital expenditure, total
	Immaterial goods		Tangible assets			Capital expenditure and advances given	
	Intangible assets	Software under development	Buildings	Equipment	Assets of banknote and coin		
Gross value							
31. 12. 2008	7,388	14	13,713	11,255	225	68	32,663
Installation/Repurchases	499	67	496	533	3	209	1,807
Scrapping	-6	0	0	-91	0	0	-97
Selling	0	0	0	-18	0	0	-18
Transfer free of charge	0	0	-2,139	-560	0	0	-2,699
Other disposal/reclassification	0	0	0	-3	-1	0	-4
31. 12. 2009	7,881	81	12,070	11,116	227	277	31,652
Details of depreciation							
31. 12. 2008	5,285	0	2,361	6,430	0	0	14,076
Planned depreciation	1,053	0	379	1,051	0	0	2,483
Removal from the account	-6	0	-820	-656	0	0	-1,482
Decrease due to reclassification	0	0	0	-3	0	0	-3
31. 12. 2009	6,332	0	1,920	6,822	0	0	15,074
Closing net value							
31. 12. 2008	2,103	14	11,352	4,825	225	68	18,587
31. 12. 2009	1,549	81	10,150	4,294	227	277	16,578
Change	-554	67	-1,202	-531	2	209	-2,009

The removal of the value of two buildings and related tangibles transferred free of charge to the Hungarian State Holding Company (MNV Zrt.) and amounted to HUF 2.7 billion, causing a significant change in the gross value of tangible assets.

Foreign investments and dividends from investments

HUF millions						
Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2008	31. 12. 2009	31. 12. 2008	31. 12. 2009	2008	2009
BIS	1.43	1.43	5,313	5,404	556	671
<i>SDR millions</i>			10	10		
<i>CHF millions</i>			13.5	13.5		
European Central Bank	1.31	1.39	1,403	1,513	0	0
<i>EUR thousands</i>			5,299	5,587		
SWIFT	0.02	0.02	2	2	0	0
<i>EUR thousands</i>			8.6	8.6		
Total investments			6,718	6,919	556	671

* 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 of the Statute of the ESCB and the ECB (hereinafter referred to as ‘the Statute’), the MNB has become a subscriber to the capital of the ECB.

Ownership distribution in the ECB after 1 January 2009 (on 31 December 2009)

National Central Banks (NCBs)	Subscribed capital	Paid-up capital	Capital key %
	EUR thousands		
Nationale Bank van België / Banque Nationale de Belgique	139,730	139,730	2.4256
Deutsche Bundesbank	1,090,912	1,090,912	18.9373
Bank of Greece	113,191	113,191	1.9649
Banco de España	478,365	478,365	8.3040
Banque de France	819,234	819,234	14.2212
Central Bank and Financial Services Authority of Ireland	63,984	63,984	1.1107
Banca d'Italia	719,886	719,886	12.4966
Central Bank of Cyprus	7,886	7,886	0.1369
Banque centrale du Luxembourg	10,064	10,064	0.1747
Central Bank of Malta / Bank Centrali ta' Malta	3,641	3,641	0.0632
De Nederlandsche Bank	229,746	229,746	3.9882
Österreichische Nationalbank	111,855	111,855	1.9417
Banco de Portugal	100,834	100,834	1.7504
Banka Slovenije	18,941	18,941	0.3288
Národná banka Slovenska	39,944	39,944	0.6934
Suomen Pankki-Finlands Bank	72,233	72,233	1.2539
Subtotal for euro area NCBs	4,020,446	4,020,446	69.7915
Danmarks Nationalbank	85,459	5,982	1.4835
Sveriges Riksbank	130,087	9,106	2.2582
Bank of England	836,285	58,540	14.5172
Česká národní banka	83,368	5,836	1.4472
Eesti Pank	10,312	722	0.1790
Latvijas Banka	16,343	1,144	0.2837
Lietuvos bankas	24,517	1,716	0.4256
Magyar Nemzeti Bank	79,820	5,587	1.3856
Narodowy Bank Polski	282,007	19,740	4.8954
Bulgarian National Bank	50,037	3,503	0.8686
Banca Națională a României	141,971	9,938	2.4645
Subtotal for non-euro area NCBs	1,740,206	121,814	30.2085
Total NCBs	5,760,652	4,142,260	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 was 1.3884% i.e. EUR 77.3 million at the time of accession. Shares can change in two ways, with a new accession to the EU or with the adjustment of capital key implemented in every five years. As a result of the adjustment, the MNB’s capital key increased to 1.3856% i.e. EUR 79.8 million 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. 2008	31. 12. 2009	31. 12. 2008	31. 12. 2009	2008	2009
Pénzjegynyomda Zrt.	100.0	100.0	8,927	8,927	750	1,120
MNB Üdültetési és Jóléti Szolg. Kft.	100.0	0.0	602	0	0	0
Magyar Pénzverő Zrt.	100.0	100.0	575	575	0	260
KELER Zrt.	53.3	53.3	643	643	1,115	0
KELER KSZF Kft.	0.0	13.6	0	7	0	0
GIRO Elszámolásforgalmi Zrt.	7.3	7.3	46	46	126	154
Budapesti Értéktőzsde Zrt.	6.9	6.9	321	321	179	158
Total investments			11,114	10,519	2,170	1,692

* 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	
	31. 12. 2009	31. 12. 2009	31. 12. 2009	2008	2009
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 17.	9,017	8,927	90	1,160	1,279
Magyar Pénzverő Zrt. 1239 Budapest, Európa u. 1.	921	575	346	260	334
KELER Zrt. 1075 Budapest, Asbóth utca 9-11.	15,796	4,500	11,296	1,025	1,718
KELER KSZF Kft. 1075 Budapest, Asbóth utca 9-11.	248	20	228	1	198
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	6,096	2,496	3,600	2,506	1,945
Budapesti Értéktőzsde Zrt. 1062 Budapest, Andrássy út 93.	6,801	541	6,260	2,276	1,391

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

HUF millions

Investment	Net sales revenue		Financial income		Other income		Extraordinary income	
	2008	2009	2008	2009	2008	2009	2008	2009
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 17.	8,008	7,642	370	472	821	20	0	0
Magyar Pénzverő Zrt. 1239 Budapest, Európa u. 1.	3,549	3,689	51	75	11	201	0	0
KELER Zrt. 1075 Budapest, Asbóth utca 9-11.	n.a.	n.a.	6,867	8,299	60	354	0	0
KELER KSZF Kft. 1075 Budapest, Asbóth utca 9-11.	0	595	1	10	0	0	0	0
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	n.a.	n.a.	5,493	4,687	825	1,268	0	0
Budapesti Értéktőzsde Zrt. 1062 Budapest, Andrásy út 93.	3,274*	3,193*	1,217	271	18	8	0	0

n.a.: revenue is not applicable data

* Income from Stock Exchange related activities.

Investment	Average number of staff	
	31. 12. 2008	31. 12. 2009
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 17.	444	435
Magyar Pénzverő Zrt. 1239 Budapest, Európa utca 1.	63	42
KELER Zrt. 1075 Budapest, Asbóth utca 9-11.	121	121
KELER KSZF Kft. 1075 Budapest, Asbóth utca 9-11.	0	4
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	128	128
Budapesti Értéktőzsde Zrt. 1062 Budapest, Andrásy út 93.	62	61

The MNB's receivables from and liabilities to affiliated companies

HUF millions

Investment	Receivables	Liabilities
Pénzjegynyomda Zrt.	0	0
Magyar Pénzverő Zrt.	10	477
KELER Zrt.	0	4
KELER KSZF Kft.	0	0
GIRO Elszámolásforgalmi Zrt.	0	0
Budapesti Értéktőzsde Zrt.	0	0
Total	10	481

The above table presents short-term receivables and liabilities. Magyar Pénzverő Zrt. paid advance dividend amounting to HUF 476.6 million in November 2009.

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 2012–2014. 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.

Pursuant to the MNB's order, the primary duty of **Magyar Pénzverő Zrt.** is to produce circulation coins for cash turnover and commemorative coins issued by the MNB. When its capacity allows, it produces non-legal tender commemorative coins and coins for foreign markets on the basis of its own coin programme. 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 tasks in 2009 were the technological preparation and production of newly issued 200 forint coin and implementation of the programme determined in 2008 for structural modernisation, organisation and staff reduction aimed at improving effectiveness. Upon market feedback, the installation of a new pricing and distribution system of commemorative coins resulted in profitability improvement and was completed without any difficulties. As a consequence of the above mentioned efforts, the company achieved high profit in 2009.

The MNB acquired a 13.6% direct business share in **KELER KSZF Kft.** on 26 February 2009, the book value of which amounted to HUF 6.8 million. The company has performed the central counterparty (central guaranteeing) function segregated organisationally from KELER Zrt – linked to an ECB recommendation – since 1 January 2009.

In 2002 the MNB's management decided to conduct the dissolution proceedings of **MNB Üdültetési és Jóléti Szolgáltató Kft.** The proceedings were closed on 7 December 2009 and, as a consequence, the book value of the investment was derecognised.

4.14 IMPAIRMENT LOSS AND PROVISIONS

HUF millions					
B/S line	Description	31. 12. 2008	Interim changes in 2009		31. 12. 2009
		Impairment loss / Provisions	Increase (+)	Reversal (-)	Total impairment loss / provisions
1	2	3	4	5	3+4+5
from III.	Other assets	22	0	-1	21
VIII.	Liabilities	9,157	5,222	-9,096	5,283
	- severance pay	179	0	-179	0
	- derivatives	0	320	-162	158
	- bond lending	8,978	4,902	-8,755	5,125
	Total	9,179	5,222	-9,097	5,304

Impairment losses and provisions increased by HUF 3.9 billion in 2009.

The HUF 179 million in provisions created at the end of 2008 for severance pay was utilised and/or released in 2009.

The net amount of the provision for the negative market value of derivatives for purposes other than hedging increased by HUF 158 million during the year.

In 2009, a HUF 4.9 billion provision became necessary because of the MNB's securities lending activity, in the course of quarterly qualifications, while HUF 8.8 billion was released from the provision in 2008 owing to maturity or better market valuation of some securities. Provisions were not utilised, because no loss was realised on the transactions. According to the securities lending contracts, the potential risks of the investments – made by agents – of the obtained collateral are borne 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

B/S line	Description	HUF millions		
		Balance		Change
		31. 12. 2008	31. 12. 2009	
	Due to banking transactions	104,111	152,797	48,686
	Due to internal operation	81	136	55
IV.	Prepaid expenses/accrued income	104,192	152,933	48,741
	Due to banking transactions	21,389	21,083	-306
	Due to internal operation	185	926	741
X.	Accrued expenses/deferred income	21,574	22,009	435

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

B/S line	Description	HUF millions		
		31. 12. 2008	Interim changes	31. 12. 2009
XI.1.	Share capital	10,000	0	10,000
XI.2.	Retained earnings	14,925	-5,464	9,461
XI.3.	Valuation reserves	0	0	0
XI.4.	Revaluation reserves due to exchange rate changes	236,258	-5,466	230,792
XI.5.	Revaluation reserves of foreign currency securities	46,744	-25,229	21,515
XI.6.	Profit/Loss for the year	-5,464	71,006	65,542
XI.	Equity	302,463	34,847	337,310

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

Pursuant to the Act on the MNB, the MNB's dividend is specified by the shareholder. According to the decision of the shareholder, in 2010 the MNB will not pay dividend from the retained earnings for the year and from the profit of 2009. For more details on revaluation reserves, see Section 4.17.

4.17 REVALUATION RESERVES

B/S line	Description	HUF millions		
		31. 12. 2008	31. 12. 2009	Change
XI.4.	Revaluation reserves due to exchange rate changes	236,258	230,792	-5,466
XI.5.	Revaluation reserves of foreign currency securities	46,744	21,515	-25,229
	Total revaluation reserves	283,002	252,307	-30,695

The official forint exchange rate against the euro fluctuated in a wide range in 2009: it weakened significantly in the first quarter of 2009 and strengthened from April, finally weakening on the whole by HUF 6.06 to 270.84 HUF/EUR as of 31 December 2009, in contrast with 2008. The average cost rate rose by HUF 10.48 to 262.56 HUF/EUR. The revaluation reserves due to exchange rate changes, calculated as a difference of foreign exchange items converted into forint using the official and average cost rate, increased by HUF 5.5 billion to HUF 230.8 billion.

Revaluation reserves of foreign currency securities include the difference between market value and book value of securities; these represent non-realised gains or losses for the Bank. Due to the effects of change of yields on the market, non-realised gains on foreign currency securities rose by HUF 25.2 billion to HUF 21.5 billion as of 31 December 2009.

Annual changes in the forint exchange rate

forint/euro

Date	MNB official exchange rate	Average cost rate
31. 12. 2008	264.78	252.08
31. 12. 2009	270.84	262.56
Annual depreciation		
In 2008	4.5%	
In 2009	2.3%	

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. 2008			31. 12. 2009		
		Receivables	Liabilities	Net market value	Receivables	Liabilities	Net market value
1.	Interest rate swap transaction	317,741	317,741	9,579	328,478	328,478	10,185
2.	CDS transaction	15,887	15,887	376	44,689	44,689	-148
3.	Total hedging transaction (1+2)	333,628	333,628	9,955	373,167	373,167	10,037

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

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

Under the line 'CDS transaction' (Credit Default Swap) seven transactions are recorded, the aim of which is to decrease the credit risk of securities. Transactions will mature in 2012 and in 2014.

Liabilities arising from other forward transactions

HUF millions

Nr	Description	31. 12. 2008		31. 12. 2009	
		Balance	Market value	Balance	Market value
1.	Options	763	0	3,072	90
2.	Future transaction	0	0	39,594	62
3.	Swap transaction	110,951	4,686	27,084	2,673
4.	Total other forward transactions (1+2+3)	111,714	4,686	69,750	2,825

Breakdown of options

HUF millions

Nr	Description	Net market value	
		31. 12. 2008	31. 12. 2009
1.	Long call option	0	0
2.	Long put option	10	90
3.	Short call option	0	0
4.	Short put option	-10	0
5.	Total (1+2+3+4)	0	90

Liabilities arising from derivative transactions by remaining maturity

HUF millions

Nr	Remaining maturity	Balance		Change
		31. 12. 2008	31. 12. 2009	
	– within 1 year	2,648	33,961	31,313
	– within 1 to 5 years	298,967	322,711	23,744
	– over five years	32,013	16,495	–15,518
1.	Hedging transactions	333,628	373,167	39,539
	– within 1 year	5,802	42,666	36,864
	– within 1 to 5 years	52,956	0	–52,956
	– over five years	52,956	27,084	–25,872
2.	Other forward transactions	111,714	69,750	–41,964
3.	Total (1+2)	445,342	442,917	–2,425

Other off-balance sheet liabilities

HUF millions

Nr	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
1.	IMF security deposit account	1,107,503	2,057,411	949,908
2.	Guarantees	2,086	2,004	–82
3.	Severance pay	179	0	–179
4.	Other off-balance sheet liabilities	2	2	0
5.	Total	1,109,770	2,059,417	949,647

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

The line ‘Guarantees’ consists of export and import guarantees, to which an irrevocable indemnity bond (without limitation of expiry date and amount) is always linked. When exercising a guarantee, the MNB has the right to a reverse guarantee if needed.

The HUF 179 million recorded as a contingent liability for severance pay in 2008 was derecognised and the related provision was released or utilised at the same time.

Other off-balance sheet liabilities by remaining maturity

HUF millions

Nr	Remaining maturity	Balance		Change
		31. 12. 2008	31. 12. 2009	
	– within 1 year	2,241	1,981	–260
	– within 1 to 5 years	1,107,529	2,057,436	949,907
	– over five years	0	0	0
1.	Total other liabilities	1,109,770	2,059,417	949,647

Recording of off-balance sheet security transactions

HUF millions

Nr	Description	Balance		Change
		31. 12. 2008	31. 12. 2009	
1.	Face value of securities lent	562,050	957,468	395,418
2.	Purchase cost of the non-cash hedge arising from security lending transactions	1,575	37,056	35,481
3.	Investment of cash hedge arising from security lending transactions			
	– at purchase cost	541,354	855,127	313,773
	– at market value	532,376	850,002	317,626
4.	Face value of securities bought under repo transactions	81,273	253,655	172,382
5.	Face value of securities sold under reverse repo transactions	325,680	611,262	285,582

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	2008	2009	Change
1	2	3	4	4-3
(I.1.+II.2.)–(X.1.+XI.1.)	Central government	–24,272	–18,603	5,669
(I.2.+II.3.)–(X.2.+XI.2.)	Credit institutions	–74,938	–49,517	25,421
(I.3.+II.1.+II.4.)–(X.3.+XI.3.)	Other	104,361	–42,019	–146,380
	Net profit from interest	5,151	–110,139	–115,290
from lines (I.4.–X.4.)	Forint securities	1,832	7,180	5,348
from lines (II.5.–XI.4.)	Derivative transactions for hedging and other purposes*	1,217	38,925	37,708
from lines (II.5.–XI.4.)	Other	428	380	–48
(I.4.+II.5.)–(X.4.+XI.4.)	Net interest related profit	3,477	46,485	43,008
(I.+II.)–(X.+XI.)	Net interest and interest related income	8,628	–63,654	–72,282

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

In 2009, the Bank recorded a HUF 63.7 billion net interest and interest related loss, a decline of HUF 72.3 billion compared to the figure for end-2008, which amounted to a gain of HUF 8.6 billion.

Net interest income was lower by HUF 115.3 billion in comparison with end-2008.

Net interest income was reduced by the following factors:

- an increase in interest expenses on two-week MNB bills of HUF 156.5 billion,
- an increase in interest expenses on government deposits denominated in forint and in foreign currency totalling HUF 7.8 billion.

Net interest income was increased by the following factors:

- an increase in interest income on foreign exchange reserves of HUF 18 billion compared to 2008,
- an increase in interest income on government bonds of HUF 13.5 billion,

- an increase in interest income on forint receivables from credit institutions of HUF 11.7 billion,
- a decrease in interest expenses on credit institutions' deposits of HUF 13.5 billion.

Net interest related income increased by HUF 43 billion in 2009. Interest related income on securities denominated in forint saw an increase of HUF 5.3 billion in 2009. 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 in interest related profit of HUF 37.7 billion was caused by net gains or losses on derivative transactions that are not related to exchange rate changes.

Realised gains/losses from financial operations

HUF millions				
P/L line	Description	2008	2009	Change
IV.	Realized gains from financial operations	12,140	46,069	33,929
XIV.	Realized losses from financial operations	8,298	36,760	28,462
IV.-XIV.	Net financial gains/losses	3,842	9,309	5,467

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

The net realised gains from financial operations amounted to HUF 9.3 billion in 2009, up HUF 5.5 billion on 2008. Changes resulted from 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	2008	2009	Change
1.	– interest income on currency swaps	9,897	9,657	–240
2.	– income like interest margin on over one year interest rate swaps	789	4,176	3,387
3.	– interest gains on hedge FX swaps	6,130	62,685	56,555
4.	– FX gains on derivative transactions	433	0	–433
5.	– interest income on other transactions	484	945	461
6.	Income from derivative transactions (1+2+3+4+5)	17,733	77,463	59,730
7.	– interest expenses on currency swaps	12,751	12,289	–462
8.	– expense like interest margin on over one year interest rate swaps	46	523	477
9.	– interest loss on hedge FX swaps	1,913	24,261	22,348
10.	– FX losses and other expenses on derivative transactions	265	123	–142
11.	– interest expenses on other transactions	1,541	1,342	–199
12.	Expenses on derivative transactions (7+8+9+10+11)	16,516	38,538	22,022
13.	– net interest on currency swaps (1–7)	–2,854	–2,632	222
14.	– interest margin on over one year interest rate swaps (2–8)	743	3,653	2,910
15.	– net interest gains on hedge FX swaps (3–9)	4,217	38,424	34,207
16.	– interest related income on derivative transactions, net (4–10)	168	–123	–291
17.	– net interest on other transactions (5–11)	–1,057	–397	660
18.	Net income from derivative transactions (6–12)	1,217	38,925	37,708

Currency swap transactions include derivative transactions concluded with foreign partners and with the ÁKK. The transactions with foreign partners mainly serve to hedge exchange rate and interest rate risks arising from bonds issued abroad by the MNB before 1999. Some of the currency swap transactions concluded with ÁKK matured in 2009. The net interest result of the currency swaps was a loss of HUF 2.6 billion, a decline of HUF 0.2 billion compared to 2008.

The HUF 2.9 billion increase in the interest result on over one year interest rate swaps was caused by changes in foreign exchange interest rates.

Net interest gains on FX swaps increased by HUF 34.2 billion in 2009, due to the significant rise in the number of transactions and changes in foreign exchange interest rates.

4.20 COMPONENTS OF INCOME FROM THE REVALUATION OF FOREIGN EXCHANGE HOLDINGS

HUF millions		
Description	2008	2009
Net income from exchange rate changes (realised and conversion spread)*	9,184	136,751
Change in revaluation reserves in the balance sheet** (due to unrealised revaluation net income)	186,401	-5,466
Total effect of exchange rate changes	195,585	131,285

*P/L line: III-XII.

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

In 2009, the total exchange rate change effect was a gain of HUF 131.3 billion, of which the Bank realised HUF 136.8 billion, while the amount of the revaluation reserve due to exchange rate changes (unrealised loss) decreased by HUF 5.5 billion during the year.

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

4.21 COST OF ISSUING BANKNOTES AND COINS

HUF millions				
P/L line	Description	2008	2009	Change
	Cost of banknote production	4,815	5,039	224
	Cost of coin production	1,672	2,501	829
	Cost of production of commemorative and collector coins	506	622	116
XIII.	Cost of issuing banknotes and coins	6,993	8,162	1,169

The cost of issuing banknotes and coins was HUF 8.2 billion in 2009, an increase of HUF 1.2 billion compared to the preceding year. This increase in cost stemmed on the one part from an increase of the quantity of coins produced, and on the other part from the higher costs of banknote production.

4.22 OTHER INCOME/EXPENSES

HUF millions				
P/L line	Description	2008	2009	Change
V.1.	Income from fees and commissions	891	834	-57
V.2.	Income from other than fees and commissions	3,442	5,363	1,921
V.	Total other income	4,333	6,197	1,864
XV.1.	Expenses of fees and commissions	434	2,496	2,062
XV.2.	Expenses of other than fees and commissions	2,879	2,861	-18
XV.	Total other expenses	3,313	5,357	2,044
V.-XV.	Other net results	1,020	840	-180

Income from fees and commissions, mainly related to payment services, decreased in 2009 by HUF 2 billion compared to 2008. An explanation for this is that expenses of fees and commissions rose by HUF 2.1 billion due to the one-off service fee related to the loan taken out from the IMF. Income from fees and commissions did not change materially in 2009 relative to the previous year.

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

4.23 INCOME OTHER THAN FEES AND COMMISSIONS

HUF millions				
Nr	Description	2008	2009	Change
1.	Dividends from investments	2,726	2,363	-363
2.	Income related to coins and commemorative coins	588	1,849	1,261
3.	Income from sales transaction of invested financial assets	0	1,105	1,105
4.	Paid-up bad debts	43	1	-42
5.	Other income	85	45	-40
6.	Income from other than commissions and charges (1+2+3+4+5)	3,442	5,363	1,921
7.	Losses from bad debts	1,384	0	-1,384
8.	Expenses related to coins and commemorative coins	767	670	-97
9.	Expenses from sales transaction of invested financial assets	0	602	602
10.	Final money transfer	237	171	-66
11.	Expenses from assets assigned free of charge	348	1,374	1,026
12.	Other expenditures	143	44	-99
13.	Expenses from other than commissions and charges (7+8+9+10+11+12)	2,879	2,861	-18
14.	Net income/expenses from other than commissions and charges (6-13)	563	2,502	1,939

Income other than fees and commissions includes the following:

- Dividends received from investments decreased by HUF 0.4 billion compared to 2008. In accordance with the decision of the Shareholders Meeting of KELER Zrt., the company made no dividend payment in 2009 from the profit for 2008. The decrease in dividends arising from this decision was not offset by the higher dividend from Pénzjegynyomda Zrt. and Magyar Pénzverő Zrt (for more details on dividends, see Section 4.13).
- Income related to coins and commemorative coins increased by HUF 1.3 billion in 2009, of which the income from sales of the waste-coin resulting from withdrawal of the 1 and 2 forint coins in 2008 amounted HUF 1.2 billion.
- The lines 'Income from sales transaction of invested financial assets' and 'Expenses from sales transaction of invested financial assets' include items in connection with the closing settlement of Bankjóléti Kft. Incomes include the market value of the real estate and liquid assets of the company which were taken over by MNB. Expenses include derecognition of the MNB's investment.
- The line 'Expenses from assets assigned free of charge' includes the book value of the buildings of the MNB's offices in Eger and in Budapest Hold utca transferred free of charge to the Hungarian State Holding Company (MNV Zrt.).
- The line 'Final money transfer' includes mainly donations to international and domestic organisations and to foundations.

4.24 OPERATING INCOME AND EXPENSES

HUF millions

P/L line	Description	2008	2009	Change
	Export sales	2	2	0
	Income from sales of assets and inventories	16	1,246	1,230
	Income from subcontracted services	75	30	-45
	Income from invoiced services	75	149	74
	Other income	11	310	299
	Extraordinary income	2	1	-1
VIII.	Total operating income	181	1,738	1,557
	Cost of materials	4,558	3,841	-717
	Personnel-related costs	8,068	7,661	-407
	Depreciation	2,474	2,482	8
	Transfer of costs of other activities	-189	-257	-68
	Total operating costs	14,911	13,727	-1,184
	Expenses incurred on assets and inventories	141	1,273	1,132
	Expenses incurred on invoiced services	70	146	76
	Income taxes	172	9	-163
	Total operating expenses	383	1,428	1,045
XVIII.	Total operating costs and expenses	15,294	15,155	-139
VIII-XVIII.	Net operating expenses	-15,113	-13,417	1,696

Net operating expenses amounted to HUF 13.4 billion in 2009, a decrease of HUF 1.7 billion (11.2%) compared to the previous year.

The cost of materials in the reporting year was HUF 717 million lower relative to the previous year, mainly due to the following base effects:

- Operating costs decreased significantly compared to the previous year, because in 2008 additional costs arose from disbursement of the semi-annual rent of the Disaster Recovery Site and the higher-than-budgeted costs related to relocation to the Logistics Centre. Another factor affecting the operating costs was the full-year operation of the Logistic Centre compared to the half-year operation in 2008. This was partly compensated by rationalisation of the operating functions of the Logistic Centre, i.e. the employment of one supplier instead of many different suppliers by type of services.
- IT costs decreased significantly, dropping by HUF 146 million compared to 2008. Mainly as a result of the operating cost rationalisation project in 2009, less new services were used, some services were terminated and in other cases optimisation of service levels resulted in lower costs.
- The commission fee for the survey analysing the cost-effectiveness of the Bank had an additional effect on costs in 2008; this did not impact 2009, causing a decrease in costs.

The audit fee amounted HUF 34.7 million.

Personnel-related costs decreased by HUF 407 million, mainly due to the 8.9% decline in the average number of staff, which resulted in a decrease in costs for wages, cafeteria and other social compensation. The bonus paid to the employees participated in operating cost-rationalisation project and in the Logistics Centre project, and the relatively higher payments on dismissals in 2009, in connection with the decisions of operating cost rationalisation project, slightly reduced the savings related to the lower number of staff.

Depreciation did not change significantly in 2009 relative to the preceding year. The value of depreciation was determined by the full-year amortisation of the Logistics Centre and the related systems operating there, compared to the half-year amortisation of these in 2008. Extension of the service life of some assets had also an impact on the value of depreciation.

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

Number of staff and wage information

HUF millions			
Description	2008	2009	Change (%)
Wage costs incurred on staff	4,737	4,471	-6
Other wage costs*	316	357	13
Wages	5,053	4,828	-4
Other personnel payments	1,103	1,061	-4
Taxes on wages	1,912	1,772	-7
Personnel-related costs	8,068	7,661	-5

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

Description	2008	2009	Change (%)
Average number of staff	664	605	-9

Remuneration of executive officers

HUF millions	
Bodies	Fees
Monetary Council*	212
Supervisory Board	82

* 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 loans outstanding in 2009.

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

4.26 DISTINCTIONS BETWEEN THE ESCB GUIDELINE AND THE MNB'S ACCOUNTING POLICY

In accordance with the closing document of the IMF's survey related to Hungary's creditworthiness on 28 January 2009, the MNB is obliged to present the quantified difference between its accounting policy and the ESCB guideline in its annual report. These distinctions originated from reclassifications, different principles of valuation and asymmetrical recognition of profit typical of the ESCB's accounting.

According to ESCB rules, the balance of the foreign currency bonds repurchased by the MNB reduced the amount of MNB bonds presented on the liabilities side of the balance sheet, while the MNB records them as receivables on the assets side.

According to ESCB valuation rules, in contrast with the MNB's accounting policy, market valuation is used for a broader field of securities and derivative transactions. As an exception, securities classified as held-to-maturity must be valued at amortised cost.

According to MNB accounting policy, non-realised gains and losses arising from market valuation and exchange rate changes shall be recognised in 'Revaluation reserves of foreign currency securities' and 'Revaluation reserves due to

exchange rate changes', respectively. By contrast, ESCB rules only non-realised gains as a kind of reserve in 'Revaluation accounts' are recognised on the liability side of the balance sheet. The character of revaluation accounts is similar to the revaluation reserves applied by the MNB, but they are not a part of equity according to ESCB rules, and provide cover solely for possible foreign exchange losses and negative market price differences of further periods. The not realised loss has to be taken account in the result for the year but this loss is reduced partly or as a whole by the not realised gain arising on the given instruments and positions, which has accumulated on the revaluation accounts in the previous years.

As a result of the principle of prudential valuation and profit recognition (the latter means the asymmetrical recognition of unrealised profit or loss), in the balance sheet according to the ESCB rules, a negative balance of the revaluation accounts not allowed, as opposed to the Hungarian methodology. The revaluation accounts recorded by ESCB rules show higher balances than the revaluation reserves recorded by MNB, but the realised profit for the year is lower at the same time.

Factors adjusting the balance sheet total and equity in 2009

HUF millions		
Description	Assets	Liabilities
Totals according to HAS	9,059,675	9,059,675
Reclassification of repurchased bonds in order to show the net amount of the issued bonds in liability side	-73,133	-73,133
Adjustments on market valuation of foreign currency securities		
Deduction of revaluation reserves of foreign currency securities due to HAS		-21,515
Revaluation reserves of foreign currency securities according to ESCB rules		44,537
Unrealised loss on foreign currency securities		-23,022
Adjustments on market valuation of derivatives	17,418	17,418
Adjustments on exchange rate changes		
Deduction of revaluation reserves due to exchange rate changes according to HAS		-230,792
Revaluation reserves of exchange rate changes according to ESCB rules		243,073
Unrealised loss on exchange rate changes		-12,281
Total value of adjustments according to ESCB rules	-55,715	-55,715
Totals according to ESCB rules	9,003,960	9,003,960

HUF millions					
Description	Revaluation reserves	Share capital	Retained earnings	Loss for the year	Total equity
Reference Nr. of HAS	XI.4 + XI.5	XI.1	XI.2	XI.6	XI.
Balance sheet data for 2009 according to HAS	252,307	10,000	9,461	65,542	337,310
Adjustments on market valuation of foreign currency securities					
Deduction of revaluation reserves of foreign currency securities due to HAS	-21,515				-21,515
Revaluation reserves of foreign currency securities according to ESCB rules	44,537				44,537
Unrealised loss on foreign currency securities				-23,022	-23,022
Adjustments on market valuation of derivatives	17,785			-6,892	10,893
Adjustments on exchange rate changes					
Deduction of revaluation reserves due to exchange rate changes according to HAS	-230,792				-230,792
Revaluation reserves of exchange rate changes according to ESCB rules	243,073				243,073
Unrealised loss on exchange rate changes				-12,281	-12,281
Total value of adjustments according to ESCB rules	53,088	0	0	-42,195	10,893
Balance sheet data for 2009 according to ESCB rules	305,395	10,000	9,461	23,347	348,203

As a result of the application of ESCB rules, the 2009 balance sheet total changed by HUF 55.7 billion and the profit for the year changed by HUF 42.2 billion.

Due to reclassification of the repurchased MNB foreign currency bonds (stated in net amount), the balance sheet total decreased by HUF 73.1 billion, whereas due to the market valuation of derivative transactions it increased by a total HUF 17.4 billion.

Unrealised loss due to the foreign exchange rate changes and market valuation resulted in a decline of HUF 23.3 billion in the balance sheet total. Revaluation reserves amounted to HUF 305.4 billion according to ESCB rules, due to settlement of unrealised profit.

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András Simor
Governor of the Magyar Nemzeti Bank

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