MAGYAR NEMZETI BANK

Annual Report

2013

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2013 BUSINESS REPORT AND FINANCIAL STATEMENTS OF THE MAGYAR NEMZETI BANK

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1 The Governor's foreword

Throughout 2013, the Monetary Council continued the easing cycle which had commenced in 2012. In the flexible inflation targeting system applied by the Magyar Nemzeti Bank (hereinafter: MNB), the easing of the monetary stance was warranted both by moderate medium-term inflationary pressures and the level of economic activity, which remained below its potential. By the end of July 2013, the Monetary Council had reduced the central bank base rate with 25 basis point rate cuts to 4 per cent. However, in line with the more volatile global money market sentiment observed in the second half of the year, the Monetary Council then decelerated the rate of the easing cycle in H2, deciding to cut the base rate by 20 basis points on five occasions. As a result, the main policy rate declined to 3 per cent by the end of 2013. Consumer price inflation also declined, and apart from the first month of the year, it stayed below the 3 per cent medium-term target throughout the year, falling outside of the (retrospectively acceptable) 3±1 per cent tolerance band after Q1. Average annual inflation was 1.7 per cent in 2013.

In order to facilitate the ability of small and medium-sized enterprises (hereinafter: SMEs) to access credit and to strengthen financial stability, the MNB announced the Funding for Growth Scheme (hereinafter: FGS) in April 2013. In Pillar I and II of the FGS, the MNB provides refinancing loans with a 0 per cent interest rate to credit institutions, which may use the facility to extend loans to SMEs with a maximum interest rate margin of 2.5 per cent and a maximum maturity of 10 years. In the first phase of the programme which lasted until 30 September 2013, of the HUF 750 billion available a total of nearly HUF 701 billion was disbursed to SMEs, corresponding to utilisation of 93.5 per cent. Thus, the programme had a significant impact on the activity of economic agents both on the demand side and on the supply side. It should be emphasised that new investment loans account for more than 60 per cent of the loans disbursed in Pillar I of the FGS, which is beneficial in respect of the programme's impact on growth. The loans disbursed by credit institutions in Pillar II were also primarily used to refinance investment loans. Refinancing of foreign currency loans reduced the SME sector's exposure to exchange rate risks, thereby mitigating the associated stability risks. In view of the success of the FGS, the Monetary Council decided to continue the programme from 1 October 2013 until the end of 2014 with an initial funding volume of HUF 500 billion, which may be raised by the Monetary Council up to HUF 2,000 billion, depending on macroeconomic, money market and lending developments.

The foreign currency liquidity problems prevailing in the forint FX swap market started to ease in 2013. Partly owing to this development, the banking sector's demand for traditional central bank FX swap transactions declined compared to the previous years. At the same time, the MNB introduced new FX swap tenders under Pillar III of the FGS, which were intended to reduce Hungary's vulnerability and mitigate the institution's interest rate risk. As a result of the new tenders, the portfolio of outstanding central bank swap contracts increased in 2013.

The new MNB Act entering into force on 1 October 2013 integrated financial supervision and consumer protection functions into the central bank, and vested the MNB with macroprudential powers and resolution functions. In the new, integrated organisation, the decision-making structure was also transformed, and a Financial Stability Council was set up to discuss micro and macroprudential issues.

As usual, the Magyar Nemzeti Bank issued its *Report on Financial Stability* twice in 2013, in which it published analyses regarding the risks jeopardising the smooth functioning of the financial intermediary system. In order to ensure the stability of the financial intermediary system, the MNB continuously explores and presents the risks jeopardising stability and participates in the prevention of systemic risks and in the mitigation or elimination of existing risks. The shock-absorbing capacity of the Hungarian banking sector is adequate both from the perspective of liquidity and capital adequacy. The marked procyclicality of the financial system continued to moderate in 2013, but the lending activity of domestic financial institutions is still not sufficient to adequately support economic growth. Procyclicality, which has been identified by the MNB as a major risk, has declined, primarily due to the MNB's rate-cutting cycle and the FGS.

At its session on 16 September 2013, the Parliament adopted the draft legislation on the Magyar Nemzeti Bank[1] which decided to integrate the financial market supervision function into the central bank. Having drawn conclusions from the financial crisis, with this Act the legislator created a central bank which, within the framework of a single institution, guarantees the stability of the financial system and the functioning of individual financial institutions. The negative repercussions of the financial crisis in Hungary and the best practices of several EU Member States have both demonstrated that the harmony between macro and micro level supervision is indispensable for the prevention and resolution of individual or systemic financial crises. As a result of this integration, the MNB acquired a comprehensive information base pertaining to individual institutions, which improved the conditions for macro-level decision-preparation and resolved the previous contradictions surrounding regulatory actions taken vis-à-vis the financial intermediary system. With the comprehensive set of instruments available to the MNB, the identification, prevention, monitoring and control of the systemic risk factors threatening the stability of the financial system and the individual risks of specific institutions have become more harmonised and thus more efficient. After the new MNB Act entered into force, in the context of its microprudential regulatory tasks, the MNB primarily worked on developing and calibrating the new set of instruments bestowed upon it by the law, and thus macroprudential aspects were also duly considered during the application of microprudential surveillance.

The strategic objectives of the MNB's professional area responsible for the supervision of financial organisations and consumer protection are in line with the tasks of the central bank as a whole. The integration of central bank and supervisory activities did not cause any disturbances in daily supervision; indeed, the efficiency of supervisory activities has improved. As a result, the area of supervision has taken an important step, even in the short term, towards its strategic objective: the establishment of an authority acknowledged and recognised in the supervisory community of the European Union, which leverages the synergies stemming from the integration and is capable of shaping the financial system systematically and efficiently. At the same time, the integration of the supervisory area provides an opportunity to review and reinforce the set of instruments intended to supervise the entire system of financial intermediation, including money, capital, insurance and fund markets. This includes the tasks of addressing prudential challenges related to the credit institution sector, the development of a methodology ensuring quick, resolute and efficient supervision that is also capable of responding flexibly to potential negative trends, and the efficient management of new tasks emerging in Hungarian legal practice and supervisory responsibilities. As regards market supervision, key tasks include the introduction of faster and more flexible early intervention practices and harmonisation of the work of all authorities cooperating with one another in the area of market supervision. In the field of consumer protection, the central bank expects market participants not only to comply with the letter of the law, but also to respect the aspects of fair service provider conduct; indeed, the MNB intends to take steps to strengthen this attitude. Consumer protection regulations are being reviewed and a more stringent sanctioning policy is being developed with a view to protecting consumers' interests.

In 2013, the MNB initiated and steered important changes in relation to the development and regulation of the domestic payment system and the supervision of payment and settlement systems. On the development and regulatory side, legislation has been adopted to regulate 'local currencies' and interbank fees charged on card transactions have been subject to statutory reduction; in addition, the MNB has launched a new statistical publication presenting the most important data on domestic payments. As regards activities related to the oversight of payment and settlement systems, noteworthy developments include that preparations have started for the inclusion of the forint in a CLS settlement and payment model, and that the re-licensing process of KELER Central Counterparty Ltd. has begun along with the designation of the systems operated by the company in order to ensure compliance with the relevant European Union regulation. In 2013, the MNB conducted payment inspections at 19 credit institutions and imposed penalties in the amount of HUF 19.1 million in total.

The amount of official foreign exchange reserves did not change notably during the year and stood at EUR 33.8 billion at the end of 2013. The primary reason behind the decline in foreign exchange reserves during the year lies in the government debt related payments of debt; however, these payments were almost entirely offset by EUR transfers from the European Commission and by bond issues of the Government Debt Management Agency.

At the end of 2013, the total value of currency in circulation amounted to HUF 3,189 billion, representing a 17 per cent year-on-year increase. The increase in the stock of currency in circulation was observed across all denominations, but mainly involved the two largest denominations. In 2013, the MNB performed cash transactions for its customers, credit institutions and the Hungarian Post Office with a value of HUF 3,248 billion.

[1] Act CCVIII of 2013 on the Magyar Nemzeti Bank.

The counterfeiting of forint banknotes remained in line with the trends of recent years. The 2,448 counterfeit banknotes withdrawn from circulation last year reflect a decline of 8 per cent compared to the previous year. Most counterfeit forint banknotes were once again found among 10,000 and 20,000-forint notes, accounting for 81.5 per cent of all counterfeits.

As a result of the integration of the supervisory functions exercised over the financial intermediary system as a whole into the organisational structure of the MNB along with the relevant competences, the statistical activity of the MNB expanded to include supervisory statistical tasks. In the course of 2013 two significant projects were launched, aimed at the harmonisation and integration of statistical and supervisory data collection and, over the long term, the development of a modern, European quality new data collection model and the integration of information systems of statistical and supervisory purposes. In line with other European Union Member States, the balance of payments and financial accounts statistics of the MNB will reflect the changes stemming from the comprehensive revision of international methodological standards from the summer of 2014. As in previous years, in 2013 preparations for the application of new methodological standards played an important role in the statistical activity of the MNB.

In 2013, the MNB recorded a profit of HUF 26.3 billion, representing an improvement of HUF 66.1 billion compared to the losses incurred in 2012. This favourable result can be mainly attributed to the decline in interest losses owing to the decline in the central bank base rate on the one hand, and to the increase in the profit from exchange rate changes on the other hand. The lower income from financial operations reflects developments in foreign exchange market yields.

In 2013, the operating costs of the MNB amounted to HUF 14.4 billion, affected primarily by the MNB's integration with the HFSA from 1 October 2013. The integration exerted upward pressure on costs, which was manifested primarily in staff costs, owing to the larger workforce (a statistical staff number increase of 502 persons) and the related employment termination costs along with their contribution implications. Overhead costs also increased, albeit to a lesser degree, mainly as a result of the leasing and operating expenditures of the rental property on Krisztina körút (the former HFSA building) in Q4.

The value of investment implemented in 2013 amounted to nearly HUF 565 million, which is considerably lower than the figure recorded for the previous year. The main reason for the decline is the cancellation of certain planned investment projects in the context of the future renovation of the main offices. The value of investment spending in 2013 was also influenced by the fact that, as a result of efforts to achieve lower prices, several assets were purchased at a price lower than originally planned. Most of the projects implemented involved IT development, linked, among other things, to the methodological changes aimed at compliance with international statistical reporting obligations.

The MNB's environmentally conscious operations continued to improve in 2013, and as a result of a successful external audit, the central bank renewed its EMAS certification. The first three-year cycle of the MNB's environmental management system (KÖVHIR) ended in 2013, and the MNB has made preparations for a comprehensive review of the system. The commitments undertaken for 2013 were realised; the main offices and the buildings of the Logistical Centre obtained an international environmental certification (BREEAM In-Use). Obtaining the certification for the main office is unique in Hungary where no other building subject to monument conservation has the same qualification. In the context of the integration, the migration of the environmental management system to the new site is in progress. In the period 2014–2016, the environmental strategy will focus on continuing the environmentally conscious development of the MNB's buildings and the cash supply chain.

One of the primary objectives of the MNB is to contribute, in support of its statutory duties, to improving the financial literacy of citizens. To that end, over the years it has organised numerous programmes for the population – in particular, for younger generations – focused on shaping financial attitudes and awareness. The central bank, as an institution with professional expertise enjoying public credibility, strives to fulfil an initiative, coordinating and leading role in society-wide programmes geared toward the development of financial literacy and with that in mind, it cooperates with the public, civilian and professional organisations committed to – and with a vested interest in – the financial awareness of the population.

In 2013, the communications of the MNB were determined by the fundamental personnel, institutional, organisational and attitudinal changes which, overall, resulted in a rejuvenated, more dynamic external image. Priority was given to measures and tasks facilitating more efficient central bank operations and economic growth, and to those serving the interests of the society at large. By selecting the appropriate communication tools, the professional activity of the central bank was communicated to the public in a scheduled and more targeted manner than before. The domestic and international relationships of the new central bank management underwent a transformation bringing about quality changes.

2 A brief overview of the Magyar Nemzeti Bank

Company name: Magyar Nemzeti Bank

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

Form of operation: company limited by shares. The form of operation, i.e. the designation 'company limited by shares' or its abbreviation need not be included in the company name of the Magyar Nemzeti Bank.

Year of foundation: 1924

Owner (shareholder): the Hungarian State, represented by the minister in charge of public finances

Scope of activities: as defined by Act CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter: MNB Act)

Subscribed capital: HUF 10 billion

2.1 OBJECTIVES AND BASIC TASKS OF THE MNB

The Magyar Nemzeti Bank (hereinafter: MNB, the central bank) is a legal entity operating as a special company limited by shares, which conducts its operations in accordance with the provisions of the MNB Act. Pursuant to the MNB Act entering into force on 1 October 2013, the basic tasks and other responsibilities of the MNB have been expanded. Replacing its former central bank responsibility of supporting the creation and enforcement of a policy aimed at ensuring the stability of the system of financial intermediation, as of 1 October 2013 the MNB assumed the role of an authority that shapes the primary macroprudential policy of Hungary. Moreover, with the elimination of the Hungarian Financial Supervisory Authority – the independent body supervising the system of financial intermediation – as of 1 October 2013, the tasks of the HFSA were assumed by the MNB, including the supervision of the system of financial intermediation and the operation of the Financial Arbitration Board. In addition, as part of its responsibilities, the MNB proceeds as a resolution authority.

In line with its responsibilities set forth in the MNB Act, besides being a member of the European System of Central Banks, as of 1 October 2013 the Magyar Nemzeti Bank is also a member of the European System of Financial Supervision. With regard to its membership of the latter institution, the MNB carries out the tasks arising from the scope of the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Securities and Markets Authority and – pursuant to the MNB Act as of its entry into force – the European Systemic Risk Board.

In accordance with Article 127 of the Treaty on the Functioning of the European Union, the MNB Act – which establishes the MNB's primary objectives and basic tasks as well as its institutional, operational, personnel and financial independence and operation – stipulates that the primary objective of the MNB is to achieve and maintain price stability. Without prejudice to its primary objective, the MNB supports the maintenance of the stability of the system of financial intermediation, the enhancement of its resilience and its sustainable contribution to economic growth, and the MNB shall support the economic policy of the government using the instruments at its disposal.

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

The basic tasks of the MNB are the following:

– it defines and implements monetary policy;

– it has the exclusive right to issue banknotes and coins, including commemorative banknotes and coins, in the official currency of Hungary;

– it has the exclusive right to hold and manage official reserves in foreign exchange and gold, in order to preserve the external stability of the Hungarian economy;

– it has the exclusive right to conduct foreign exchange operations in relation to the management of foreign exchange reserves and the implementation of the exchange rate policy;

– it has the exclusive right to oversee the domestic payment and settlement systems as well as the securities settlement systems and, as part of this oversight duty, monitors the operation of the system and the operation of the organisation performing central counterparty activities in order to ensure the sound and efficient operation of these systems and the smooth circulation of money. Within the scope of its powers set forth in the MNB Act, it participates in the development of payment and securities settlement systems;

– it collects and publishes the statistical information required for carrying out its tasks and fulfilling its statistical reporting obligations toward the European Central Bank as defined in Article 5 of Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank attached to the Treaty on the Functioning of the European Union;

– it establishes the macroprudential policy for the stability of the entire system of financial intermediation, with the objective of enhancing the resilience of the system of financial intermediation and ensuring its sustainable contribution to economic growth. To that end and within the limits specified in this Act, the MNB explores the business and economic risks threatening the system of financial intermediation as a whole, promotes the prevention of the development of systemic risks and the reduction or elimination of systemic risks which have evolved; furthermore, in the event of disturbances to the credit market it contributes to the balanced implementation of the function of the system of intermediation in financing the economy by stimulating lending and by restraining lending in the event of excessive credit outflow.

Tasks of the MNB beyond its basic tasks:

– it acts as a resolution authority;

– acting as a sole supervisor of the system of financial intermediation, it:

  - ensures the smooth, transparent and efficient functioning of the system of financial intermediation;

  - facilitates the prudent operation of the persons and organisations forming part of the system of financial intermediation and supervises the prudent exercise of owners' rights;

  - discovers undesirable business and economic risks to individual financial organisations or individual sectors thereof, reducing or eliminating specific or sectoral risks which have evolved, and taking preventive measures to ensure the prudent operation of individual financial organisations;

  - protects the interests of those using the services provided by financial institutions and strengthens public confidence in the system of financial intermediation.

– via the Financial Arbitration Board, it helps to settle – out of court – disputes arising from the establishment and performance of the legal relationship established between the consumer and the organisations of the system of financial intermediation in respect of the use of services.

Any further tasks of the MNB shall be defined by law and, in relation to the supervision of the system of financial intermediation, by legal regulations adopted pursuant to the authorisation of the act. Such tasks of the MNB shall comply with the basic tasks and responsibilities of the MNB as defined in the MNB Act.

2.2 THE BODIES AND MANAGEMENT OF THE MNB

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

The Hungarian State as shareholder is represented by the minister in charge of public finances. The MNB operates without a General Meeting.

The **shareholder** is entitled to pass decisions, by way of a shareholder's resolution, on the establishment of an amendment to the Statutes as well as the appointment, dismissal and remuneration of the auditor.

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

Similarly, bodies of the MNB are specified by the MNB Act as follows: the Monetary Council, the Executive Board, the Supervisory Board and, as from 1 October 2013, the Financial Stability Council.

The MNB's supreme decision-making body is the **Monetary Council**.

Until 30 September 2013, competence for all strategic decisions regarding the basic tasks of the MNB rested with the Monetary Council. Upon the establishment of the Financial Stability Council on 1 October 2013, this decision-making competence changed. From 1 October 2013, the scope of competence of the Monetary Council includes:

– strategic decisions concerning the monetary policy, the issue of legal tender, the holding and management of foreign exchange and gold reserves, as well as strategic decisions relating to foreign exchange transactions and statistical tasks in the context of foreign exchange reserve management and the implementation of the exchange rate policy including, in particular, decisions regarding the required reserve ratio, interest payable on the reserves, decisions on the exchange rate regime and determining the central bank base rate;

– in relation to macroprudential tasks, oversight, the supervision of the system of financial intermediation and the MNB's role as a resolution authority, decision on the strategic framework within which the Financial Stability Council is required to make decisions;

– establishing the rules of procedure;

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

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

At the first meeting of each year, the Monetary Council elects a Deputy Chairman from among the Deputy Governors of the MNB to substitute the Chairman – except in issuing decrees – if the latter is unable to attend. In 2013, the Monetary Council elected Deputy Governor Ferenc Karvalits and subsequently, following the expiry of his mandate, Deputy Governor Dr Ádám Balog as Deputy Chairman from 4 April 2013.

In 2013, the members of the Monetary Council were:

– András Simor, Governor, Chairman of the Monetary Council until 3 March 2013,
– Dr György Matolcsy, Governor, Chairman of the Monetary Council from 4 March 2013,
– Ferenc Karvalits, Deputy Governor, Deputy Chairman of the Monetary Council until 27 March 2013,
– Dr Ádám Balog, Deputy Governor from 6 March 2013, Deputy Chairman of the Monetary Council from 4 April 2013,
– Júlia Király, Deputy Governor until 22 April 2013,
– Dr Ferenc Gerhardt, Deputy Governor from 22 April 2013,
– Dr László Windisch, Deputy Governor from 2 October 2013,
– Andrea Bártfai-Mager, from 21 March 2011,
– Dr János Béla Cinkotai, from 22 March 2011,
– Dr György Kocziszky, from 5 April 2011,
– Gyula Pleschinger, from 5 March 2013,
– Dr Csaba Kandrács, from 30 September 2013.

Parallel to the tasks to be performed from 1 October 2013, the MNB Act stipulated the establishment of a new decision-making body. In accordance with this provision, the **Financial Stability Council** was set up on 1 October 2013, acting as the decision-making body of the MNB in relation to oversight, macroprudential tasks and resolution authority duties, as well as prudential supervision. Within this scope of competence, the Financial Stability Council:

– continuously monitors the stability of the system of financial intermediation as a whole and of the financial markets in order to maintain the stability of the system of financial intermediation as a whole;

– takes account of risk factors threatening the system of financial intermediation as a whole;

– analyses the risks related to certain types of institutions or products or to the spread of these which may represent a threat to the system of financial intermediation as a whole;

– monitors developments on international and European markets and risks which may represent a threat to the stability of the system of financial intermediation as a whole, and makes decisions on the necessary measures within the strategic framework defined by the Monetary Council;

– discusses strategic, regulatory and risk-related issues affecting the system of financial intermediation as a whole and issues opinions if necessary;

– in situations threatening the stability of the system of financial intermediation, assesses systemic risks and decides on the measures required to mitigate or eliminate such risks;

– places on its agenda, as necessary, the recommendations, opinions and risk warnings of the European Systemic Risk Board relevant to the system of financial intermediation as a whole;

– discusses the recommendations and decisions issued by the European Supervisory Authorities as needed, including decisions addressed to national supervisory authorities calling for specific measures in the event of serious risks to the stability of the European financial system and expresses its opinion on the tasks arising from such decisions;

– publishes non-binding recommendations for the organisations of the system of financial intermediation describing the grounds of the MNB's application of law;

– annually defines the priority target areas of the MNB's control activities; and

– makes decisions in administrative proceedings relating to the exercise of supervision over the system of financial intermediation.

Pursuant to the MNB Act, the Financial Stability Council is composed of the Governor of the MNB as its chairman, the Deputy Governor responsible for monetary policy, financial stability and lending incentives, the Deputy Governor responsible for the supervision of financial organisations and consumer protection and, as managers designated by the governor of the MNB, the Deputy Governor responsible for statistics, cash logistics and the financial infrastructure and the Executive Directors responsible for financial stability and lending incentives.

In accordance with the MNB Act, responsibility for implementing the Monetary Council's decisions and, from 1 October 2013, the Financial Stability Council's decisions, as well as for managing the operation of the MNB rests with the **Executive Board.**

The scope of competence of the Executive Board includes:

– managing the implementation of the decisions of the Monetary Council and the Financial Stability Council;

– establishing the accounting report of the MNB, issuing decisions on the payment of dividends;

– approving the draft report to be sent to the shareholder on the management and assets of the MNB;

– approving matters related to the organisation and internal management of the MNB;

– approving study plans and programmes relating to the operation of the MNB and the performance of its tasks, including the costs of the development and operational plan;

– managing the MNB's internal audit organisation in respect of tasks falling outside the scope of competence of the Supervisory Board, and discussing the observations and plans of the internal audit;

– amending the collective agreement in respect of employment rights and obligations, the exercise and performance of these rights and obligations, and the associated procedures; and

– adopting decisions in respect of the central bank's powers to perform account management and other financial and auxiliary financial services, as well as certain auxiliary services supplementing investment service activities.

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

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

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

The supervisory competence of the **State Audit Office** in relation to the MNB is set forth in the Act on the State Audit Office. The State Audit Office supervises the financial management of the Magyar Nemzeti Bank and activities under the MNB Act that are not included in its basic tasks. In this regard, the State Audit Office examines if the MNB operates in accordance with the applicable law, its Statutes and the shareholder's resolutions.

The **auditor** of the MNB can be appointed for a maximum of 5 years. The shareholder decides on the appointment, dismissal and remuneration of the auditor by way of a shareholder's

Members of the Executive Board and the Monetary Council of the Magyar Nemzeti Bank

Dr György Matolcsy
Governor,
Chairman of the Monetary Council

Dr Ádám Balog
Deputy Governor with general responsibilities,
Deputy Chairman of the Monetary Council

Dr Ferenc Gerhardt
Deputy Governor,
Member of the Monetary Council

Dr László Windisch
Deputy Governor,
Member of the Monetary Council

Members of the Monetary Council of the Magyar Nemzeti Bank

Andrea Bártfai-Mager
Member of the Monetary Council

Dr János Béla Cinkotai
Member of the Monetary Council

Dr Csaba Kandrács
Member of the Monetary Council

Dr György Kocziszky
Member of the Monetary Council

Gyula Pleschinger
Member of the Monetary Council

Members of the Supervisory Board of the Magyar Nemzeti Bank

Left to right: Gábor Orbán, Dr Péter Róna, István Varga, László Madarász, Zsigmond Járai (Chairman), Dr Gábor András Szényei, Dr Tamás Katona, Dr Attila Simon Tóth.

resolution. Prior to putting forward a proposal for the appointment or dismissal of the MNB's auditor, the Governor of the MNB consults with the President of the State Audit Office.

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 does not cover the supervision of the Bank's performance of its basic tasks, its actions as a resolution authority and its supervisory activity in respect of the financial intermediary system, or the impact of the aforementioned on the MNB's profit and loss. Accordingly, the Supervisory Board compiles the report required by the Act on Business Associations on the annual accounts as specified in the Act on Accounting subject to the above limitations.

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

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

In 2013, the members of the Supervisory Board of the MNB were:[2]

– Zsigmond Járai, Chairman,
– Dr Tamás Katona,
– László Madarász,

[2] Since, pursuant to Article 67(1) of Act CCVIII of 2011, the entry into force of the Act did not affect the mandate of the members of the Supervisory Board pursuant to Article 52/A(4) of Act LVIII of 2001 on the Magyar Nemzeti Bank, the mandate of the members elected by the Parliament also remained in effect.

– Dr Péter Róna,
– Dr Gábor András Szényei,
– István Varga,
– Dániel Palotai (representative of the minister responsible for the state budget) until 10 March 2013,
– Gábor Orbán (representative of the minister responsible for the state budget) from 4 May 2013,
– Dr Csaba Kandrács (expert appointed by the minister responsible for the state budget) until 3 May 2013,
– Dr Attila Simon Tóth (expert appointed by the minister responsible for the state budget) from 1 September 2013.

2.3 ORGANISATION OF THE MNB

Pursuant to the Statutes of the MNB entering into force on 4 March 2013, the Executive Board decided on the introduction of a new operational governance model as of 9 March 2013. The review of organisational solutions and – based on operational experiences – the optimisation of the processes took place on 1 July 2013, when the Executive Board renewed and, to a significant degree, transformed the organisational structure of the MNB. The operational procedures developed at that time constituted the basis for an additional restructuring which was necessitated by the entry into force of the MNB Act on 1 October 2013, in the context of which the Executive Board established the most important operational rules of the integrated organisation, the structure of the organisation, the division of labour between the organisational units and – by modifying the existing tasks and responsibilities of the deputy governor position – defined the new scope of competence of the deputy governors.

Based on the organisational structure of the MNB as at 31 December 2013, the MNB had 30 organisational units supervised by the Governor, the three Deputy Governors, the Director General and the Executive Directors reporting to them.

The organisational structure as at 31 December 2013 is shown in the following **organisation chart**.

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

Hungary's accession to the European Union also entailed the MNB's membership in the European System of Central Banks (ESCB). The ESCB comprises the European Central Bank (ECB), which was established in June 1998 with its seat in Frankfurt, and the national central banks of the 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 the 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. The General Council holds its meetings quarterly and consists of the President and the Vice-President of the European Central Bank and the respective governors of the central banks of all EU Member States. The key responsibilities of the General Council include consultancy concerning preparations for accession to the euro area, approval of the convergence reports of the ECB and monitoring the functioning of ERM II. Within the framework of the 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 comply with the prohibition of monetary financing of the budget and privileged access of the public sector to financial institutions. The General Council also contributes to the ECB's advisory functions and to the collection of statistical information; it must be consulted in respect of any changes in the rules of accounting and financial data supply, as well as issues related to the adjustment of the keys for subscriptions to the ECB's capital. The mandate of the General Council will expire on the date when all of the Member States have adopted the euro.

As a result of Croatia's accession to the EU in July 2013, the number of ESCB members rose from 27 to 28. In 2013, the number of euro-area Member States did not change, but on 9 July 2013 the Council of the EU approved Latvia's entry to the euro area, resulting in an increase in the number of euro-area Member States from 17 to 18 as of 1 January 2014.

The ESCB members are also the owners of the ECB. The respective ownership shares of Member States are determined according to their shares in GDP and total population of the EU (on the basis of statistical data compiled by the European Commission). As of 1 July 2013, the paid-up capital of the ECB increased from EUR 10.76 billion to EUR 10.825 billion.

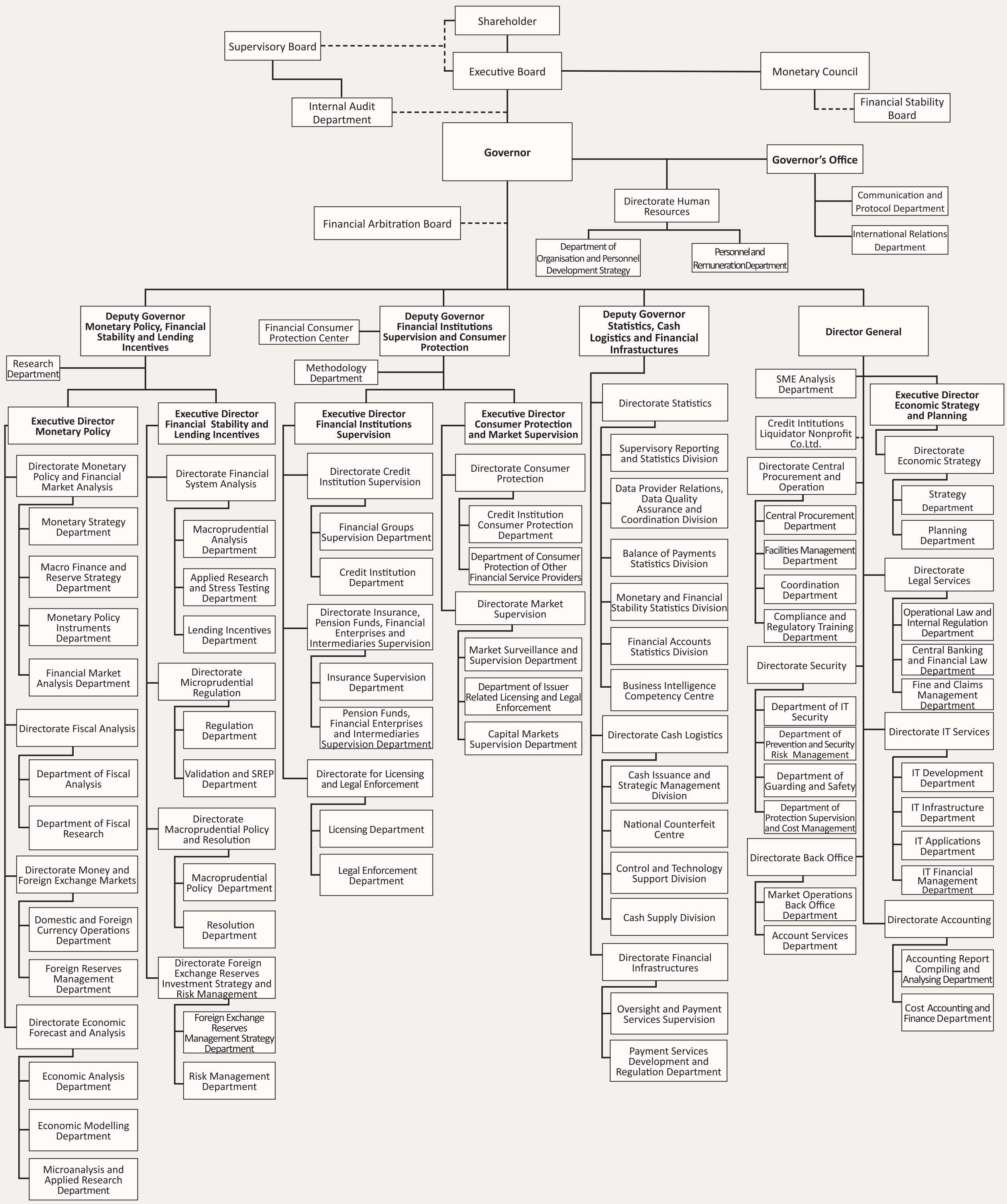
Currently, euro-area central banks subscribe to 70 per cent of the ECB's capital, while the remaining 30 per cent is divided among the central banks of non-euro area Member States. These latter central banks pay a pre-defined minimum percentage of their respective subscriptions to the ECB's capital as a contribution to the operational costs of the ECB which are incurred in connection with their ESCB membership. With effect from 29 December 2010, this contribution was defined as 3.75 per cent of the respective subscriptions (previously it had been 7 per cent). As set forth in the Statute of the ESCB and of the ECB, the capital keys are adjusted every five years, or whenever a new Member State joins the EU or the euro area. In 2013, the capital keys were adjusted twice, owing to the accession of Croatia to the EU and subsequently to the scheduled 5-year revision and Latvia's entry to the euro area. On 1 July 2013, the share of the MNB in the ECB's paid-up capital declined from 1.3856 per cent to 1.3740 per cent, and on 1 January 2014 it increased from 1.3740 per cent to 1.3798 per cent.

The ESCB Committees play an important role in the work of the ECB's decision-making bodies. The basic role of these committees is to prepare decisions and facilitate coordination as per the horizontal division of various central bank duties, covering all areas of central banking operations from monetary policy through communication to statistical data reporting. Experts from the central banks of non-euro area Member States attend those committee meetings whose agenda includes items affecting the ESCB as a whole and which fall within the competence of the General Council. (For a detailed description of the ESCB Committees and the activities of the various fora assisting them, see Chapter 3.12). With the participation of the central banks of non-euro area Member States, the committees meet and discuss current issues relevant to their professional areas 4-5 times a year on average, according to a schedule determined for a year in advance.

The senior executives and relevant experts of the MNB continue to play an active role in the activities of these committees and their working groups. In 2013, the ESCB committee work continued to be a very useful forum for the exchange of professional experience.

Organisation Chart

Organisation Chart of Magyar Nemzeti Bank
31 December 2013



3 Review of the MNB's performance in 2013

3.1 MONETARY POLICY

In 2013, the Monetary Council continued the easing cycle which had commenced in 2012. In the flexible inflation targeting system applied by the MNB, easing the monetary stance was warranted by moderate medium-term inflationary pressures and the level of economic activity, which remained below its potential. Leading global central banks maintained exceptionally loose monetary conditions, which was reflected in the risk assessment of domestic financial instruments, widening the scope for monetary policy manoeuvre.

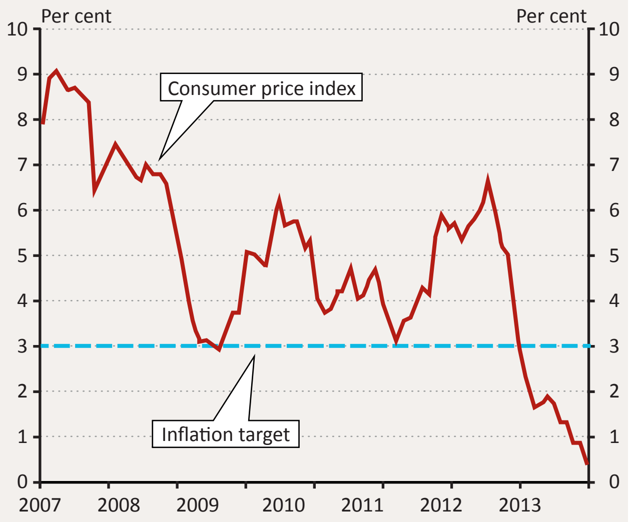
In the opinion of the Monetary Council, output remained below potential throughout 2013, and unemployment exceeded the long-term level determined by structural factors. In line with the assessment of the Monetary Council, as the cost shocks experienced in 2012 faded, the disinflationary impact of weak demand was increasingly perceivable, which was also reflected in underlying inflation trends. Firms had limited opportunities to price in the previous increases in production costs. These factors and government measures aimed at the reduction of administered prices pushed inflation below the 3 per cent target by the beginning of 2013, and the inflation rate continued to decline further during the year. In the judgement of the Monetary Council, against the backdrop of a continuing weak demand environment, inflationary pressure was likely to remain moderate even after the dissipation of transitional shocks. In view of the above factors and also in consideration of the gradually improving risk assessment of Hungary, achieving the medium-term inflation target in 2013 justified maintaining the cautious easing of monetary policy. By the end of July 2013, in 25-basis point rate cuts, the Monetary Council had reduced the central bank base rate to 4 per cent.

Global money market sentiment, however, became more volatile in the second half of the year, mainly due to increased uncertainty about the future of the quantitative easing programmes of leading global central banks. In its communications, the Monetary Council indicated that the more fragile international environment warranted increased caution and accordingly, in August it decided to continue the cutting cycle of the central bank base rate in more cautious, 20-basis point steps. In the second half of the year, on five occasions the Monetary Council decided to reduce the main policy rate by 20 basis points, bringing down the rate to 3 per cent. In December, the Monetary Council indicated that, based on the latest Report on Inflation, further policy easing was likely to be required in order to achieve medium-term price stability. The global financial environment, however, was deemed to be volatile. In consideration of this, as well as developments in Hungary's risk assessment and the improvement in economic growth, decision-makers expressed that further interest rate cuts could not be ruled out, but they also indicated that slowing down the pace of reductions may be warranted in the future.

Achievement of the inflation target in 2013

In the assessment of the Monetary Council, inflation trends in 2013 underwent marked changes compared to the previous period. Consumer price inflation declined significantly: apart from the first month of the year, it remained below the 3 per cent medium-term target throughout the year, falling outside

Chart 1
The inflation target and inflation developments since the setting of the continuous target



Source: HCSO, MNB.

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

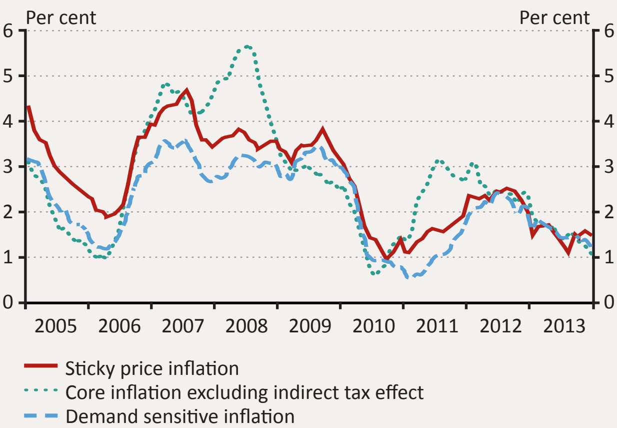
	2011	2012	2013	2013			
				Q1	Q2	Q3	Q4
Core inflation	2.7	5.1	3.3	3.6	3.2	3.1	3.5
Unprocessed food	4.3	6.8	6.1	10.7	9.6	4.7	-0.7
Fuel and market energy	13.8	11.9	-0.9	2.1	-3.0	-0.6	-2.3
Regulated prices	4.0	4.7	-3.7	-1.1	-2.8	-4.0	-6.8
Consumer price index	3.9	5.7	1.7	2.9	1.8	1.5	0.8
Consumer price index excluding indirect taxes	3.8	3.5	1.2	2.1	1.2	1.1	0.4

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

of the (retrospectively acceptable) ±1 per cent tolerance band after Q1, with average annual inflation standing at 1.7 per cent in 2013.

The inflation rate, which was significantly lower than the inflation target in 2013, was the net result of several factors. The deceleration in the growth rate of consumer prices observed at the beginning of the year resulted primarily from the VAT increase of January 2012 dropping out of the basis and a 10-per cent decline in regulated energy prices; in addition, the disinflationary impact of weak internal demand was also a contributor. The inflation rate continued to decrease during the spring, mainly owing to favourable cost shocks and the price-reducing effect of the demand environment. As there was little room for price increases in the weak demand environment, corporations primarily attempted to restore profitability by restraining labour costs.

Chart 2
Trend inflation indicators



Source: MNB.

In the second half of the year, even the central bank's indicators capturing underlying inflation trends pointed to historically low dynamics as the combined result of falling external market price pressures, declining commodity prices and the gradual adjustment of inflation expectations, in addition to the significant underutilisation of capacities and subdued domestic demand. To a considerable degree, the regulated price reductions carried out in several steps during the year also contributed to the evolution of a low inflation environment. Owing to the loose labour market conditions and declining inflation expectations, wage dynamics were subdued. The price dynamics of market services accelerated somewhat in H2, mainly due to the financial transaction levy, which raised the price index of banking services.

Looking ahead, inflationary pressures are likely to remain muted over the medium term. As the inflation reducing effect of administered prices fades, the consumer price index increase is expected to move into line with the target by the end of the horizon relevant for monetary policy. The Monetary Council will continue to conduct its monetary policy to ensure that the growth rate of consumer prices is consistent with the inflation target over the medium term. Over the long term, monetary policy can best contribute to economic growth and a predictable macroeconomic environment by achieving and maintaining price stability and by ensuring the stability of the financial system.

Changes in monetary policy instruments

First phase of the Funding for Growth Scheme successfully concluded

The MNB announced the Funding for Growth Scheme (FGS) in April 2013. The programme is intended to facilitate the access of small and medium sized enterprises (SMEs) to credit and to strengthen financial stability. In the Monetary Council's judgement, during the financial and economic crisis the chances of companies to access credit deteriorated significantly, especially in the case of small and medium-sized enterprises, which face even greater difficulties when trying to find alternative sources of finance. In Pillar I and II of the FGS, the MNB provided refinancing loans with a 0 per cent interest rate to credit institutions, which were expected to use the facility to extend loans to SMEs with a maximum interest rate margin of 2.5 per cent and a maximum maturity of 10 years.

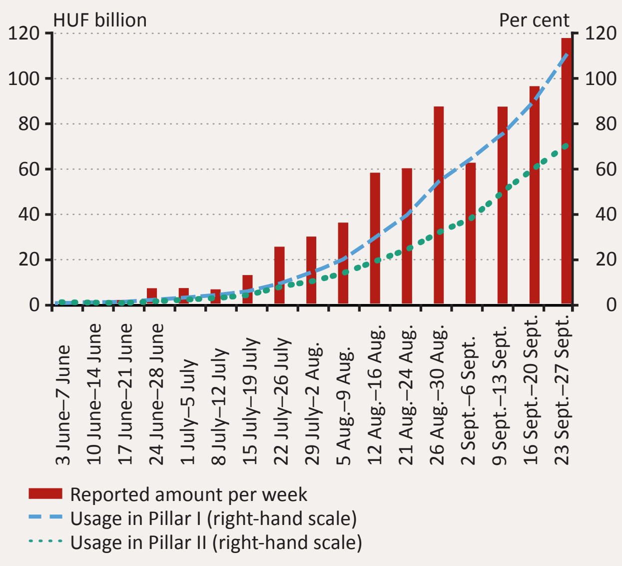
At the time of the announcement, the original available overall amount envisaged for the first two pillars of the programme was HUF 500 billion. Following the announcement, corporations expressed enormous interest in the loans available under the Scheme, which was also reflected in the participation application rate of credit institutions registered at the end of May. In order to make low-interest loans available to as many SMEs as possible in the FGS, even before the launch of the Scheme, the Monetary Council increased the limit amount of the facility by 50 per cent to HUF 750 billion. The originally announced availability period of the programme was between the beginning of June to the end of August 2013; however, in the case of investment loans companies have an additional 6-month period to draw down up to maximum 70 per cent of the contract amount. In view of the increased demand for Pillar I after commencement of the programme, on 1 August 2013 the Monetary Council enabled credit institutions to use their credit line allocated under Pillar II within the framework of Pillar I to improve the effective use of the overall amount, and extended the disbursement period by one month. Of the HUF 750 billion available under the FGS, credit institutions disbursed a total of nearly HUF 701 billion to SMEs, corresponding to a utilisation rate of 93.5 per cent. Contracts amounting to a total HUF 472 billion and HUF 229 billion were extended in Pillar I and Pillar II, respectively, corresponding to utilisation rates of 111 per cent and more than 70 per cent, respectively. The ratio of new loans, especially new investment loans, was high in Pillar I, which points to a favourable growth effect.

In view of the success of the first phase of the Scheme, on 11 September 2013 the Monetary Council of the MNB decided to continue the FGS. The second phase of the programme commenced at the beginning of October 2013, with SMEs able to apply for loans until the end of 2014. Credit institutions had funds available up to their outstanding loans to SMEs as at 30 September 2013, but in contrast to the first phase, this was not based on an initial allocation but rather according to the loan contracts concluded with SMEs, on a 'first-come first-serve' basis until the overall available amount was used up. The overall available amount of the programme is HUF 500 billion in the first round, which may be raised to up to HUF 2,000 billion by the Monetary Council, depending on the prevailing macroeconomic, financial and lending environment. Of the loans, 90 per cent may be disbursed in the form of new loans, while a maximum of 10 per cent may be used to refinance outstanding HUF or foreign currency loans. In view of the higher ratio of new loans, the beneficial impact of the programme on economic growth is expected to increase. In the second phase of the programme, new conditions will come into effect, which are designed to reduce the unintended uses of the loans which do not or only insufficiently serve the objectives of the Scheme.

At the end of 2013, based on the feedback from representatives of the private sector and credit institutions, the MNB fine-tuned the conditions of the programme once again. Amongst other changes, from 1 January 2014 financial enterprises may also provide financing and, in addition to loans, a new product – financial lease – can be also offered under the FGS.

With the announcement of the FGS, the two-year collateralised loan tender was suspended effective as of 4 April 2013.

Chart 3
Course and utilisation of the 1st phase of the FGS



Source: MNB.

Forint liquidity management of the banking system

In 2013, the forint liquidity of the banking sector was influenced by a number of factors. On the one hand, liquidity was boosted by the FGS and general government payments; on the other hand, liquidity was absorbed by the increase in cash in circulation and the central bank's outstanding swap contracts. By December 2013, total forint liquidity (central bank bills, the balance of settlement accounts and the overnight central bank deposit portfolio together) had risen by HUF 1,300 billion to HUF 6,000 billion.

Credit institutions required to hold reserves may choose from reserve ratios of 2, 3, 4 and 5 per cent semi-annually (in April and October). In 2013, the average required reserve ratio declined slightly, standing at 2.59 per cent in November 2013.

Starting from the second half of 2012, the cautious liquidity management typical of the banking sector previously appeared to ease somewhat. Nevertheless, the liquidity management of the banking sector became more cautious once again starting from August 2013. Compared to previous months, credit institutions' holding of excess reserves at the beginning of the month increased, and in addition, their portfolio of new overnight deposits with the central bank also rose. Between January and July 2013, credit institutions placed overnight deposits with the central bank in an amount of HUF 95 billion on average, compared to an average of HUF 140 billion between August and December of 2013. Owing to the rising central bank overnight deposit portfolio, the overnight interbank unsecured interest rate, i.e. the HUFONIA, declined slightly within the interest rate corridor. Whereas the HUFONIA was 30 basis points lower than the central bank base rate on average between January and July 2013, in the period from August to December 2013 the difference rose to 55 basis points on average. As the HUFONIA approached the bottom of the interest rate corridor, its volatility also declined.

Three-month interbank yields – the yields most relevant for interest rate transmission – moved in line with the reductions of the central bank base rate, and also reflected information pertaining to expected future cuts. Likewise, loans provided to households with short-term maturities and with a variable interest rate or an interest rate fixation of up to 1 year declined to a similar degree as the central bank base rate, and the same decline characterised the short-term deposits placed by households, as well as corporate loan and deposit rates.

After the integration of cooperative banks, the accounts of cooperative banks previously held by the MNB are held, as from 1 November 2013, by the Takarékbank. As a result, the cooperative banks concerned are now excluded from the counterparties of traditional central bank operations.

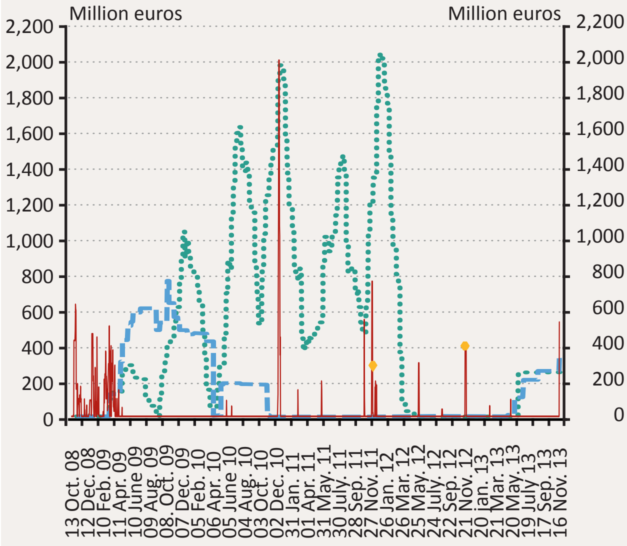
Instruments providing foreign exchange liquidity – central bank currency swap transactions

Currency swap spreads, which capture the extra costs of gaining access to foreign currency financing, declined in 2013. While overnight and three-month FX spreads stood at 55 and 125 basis points, respectively, in 2012, they fell to 20 and 40 basis points, respectively, in 2013. This decline took place in Q1, parallel to an increase in the foreign currency supply of foreign investors in the currency swap market. Another positive development was the fact that the temporary spread increases observed in previous years at the end of each quarter were less characteristic of the market in 2013. At the same time, however, the widening of the spreads was still typical at the end of the year.

Utilisation of the MNB's traditional (overnight and three-month) EUR/HUF currency swaps providing EUR liquidity declined compared to previous years. The banking sector only took recourse to the overnight instrument, on a total of three occasions (compared to 9 occasions in 2012). In December, in relation to end-of-year position closing activities, the MNB announced a one-off EUR/HUF swap tender providing two-week EUR liquidity; however, there was no demand for this instrument as tensions in the market had abated compared to previous years.

Under Pillar III of the FGS, the MNB announces currency swaps providing foreign currency liquidity to its credit institution partners. Pillar III is intended to mitigate the vulnerability of the country and the interest rate risks of the MNB. Since 3 June 2013, EUR/HUF FX swaps and CIRS (multi-currency interest rate swap) tenders have been announced on a weekly basis with eight different maturities. The forints

Chart 4
Recourse to the MNB's FX swap instruments – outstanding amounts



Source: MNB.

provided by the counterparties to the MNB on the spot leg of currency swaps reduce the counterparties' forint liquidity, thereby decreasing their stock of central bank bills. Since the EUR liquidity provided by the MNB to counterparties depletes its foreign currency reserves, in order to reduce vulnerability, credit institutions participating in the tenders are expected to reduce their short-term external liabilities in line with the foreign currency obtained. The programme, which was announced as lasting until end-August 2013 under the original conditions, was extended by the MNB from the beginning of September until cancellation. The MNB also determined that the maximum value of FX swaps that can be allocated within the programme was EUR 2.5 billion. On 31 December 2013, total outstanding FGS swap contracts amounted to EUR 568 million. The original maturity for a part of the outstanding portfolio was 3 months, and 30 months for the rest of the portfolio.

3.2 STABILITY OF THE FINANCIAL INTERMEDIARY SYSTEM

Pursuant to the MNB Act, without prejudice to its primary objective (price stability), the MNB supports the maintenance of the stability of the financial intermediary system, the enhancement of the system's resilience to shocks, sustainable economic growth and the economic policy of the Government. In addition, it develops the macroprudential policy pertaining to the stability of the system of financial intermediation as a whole and, from 1 October 2013, exercises supervision over the financial intermediary system and performs consumer protection functions.

In order to ensure the stability of the financial intermediary system, the MNB explores and presents the risks jeopardising stability, and participates in the prevention of systemic risks and in the reduction and elimination of existing risks. The Magyar Nemzeti Bank publishes its analyses on the risks jeopardising the smooth functioning of the financial intermediary system in its *Report on Financial Stability.*

In line with the practice of recent years, in 2013 the MNB published its *Report on Financial Stability* twice (21 May and 7 November), and issued its quarterly publication entitled *Trends in Lending* with the results of its surveys presenting the latest trends in lending. With respect to liquidity and capital adequacy, the resilience of the Hungarian financial intermediary system was adequate in 2013, while lending activity improved. The latter can be mainly attributed to the central bank's easing cycle and the FGS.

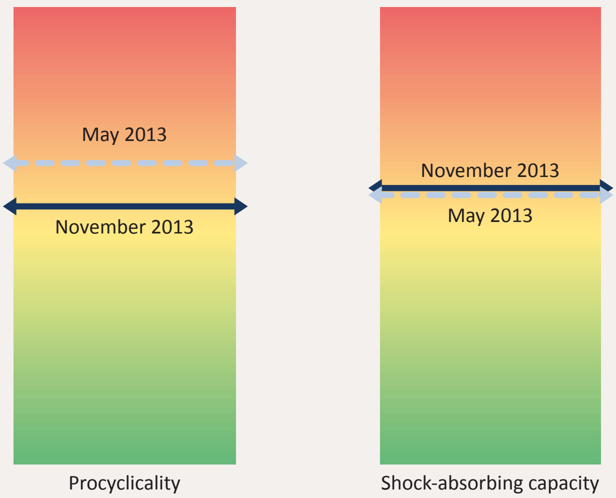
The new MNB Act coming into force on 1 October 2013 reinforced the central bank's macroprudential mandate, and provided it with the appropriate set of instruments as well. As a result of the supervisory integration, additional competences were conferred upon the MNB. In accordance with its reinforced and expanded powers, the MNB cooperates with the authorities of the European Union to develop its set of instruments and policy designed to ensure the stability of the domestic system of financial intermediation.

Role of the Financial Stability Council

The extended functions and competences of the organisation was supplemented by a new decision-making structure. The supreme decision-making body of the MNB remains the Monetary Council. Decision-making in respect of microprudential, macroprudential, consumer protection and the subsequently developed resolution functions is performed by the newly established Financial Stability Council. The Financial Stability Council is composed of the Governor of the MNB, as chairman of the Financial Stability Council, all three Deputy Governors, and the Executive Directors responsible for financial stability, lending incentives and the supervision of financial institutions. The Financial Stability Council makes decisions within the strategic framework defined by the Monetary Council.

The alignment of monetary policy and macroprudential policy decisions is ensured by the overlap between the personnel of the two councils on the one hand, and by the priority of monetary policy aspects during the preparations for macroprudential policy decisions on the other hand. Moreover, the balanced

Chart 5
Heat map of financial stability risks



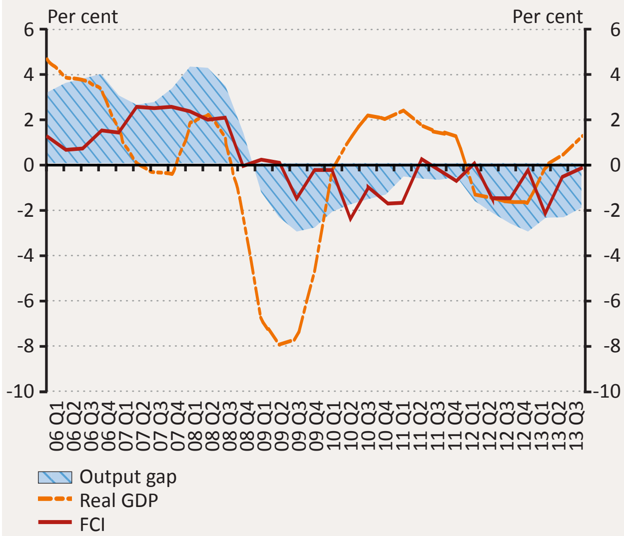
composition of the Financial Stability Council facilitates the realisation, at the highest possible level, of the organisational integration's priority targets, the alignment of macroprudential and microprudential policies and close, smooth cooperation in crisis management.

Key developments in the financial intermediary system

The financial intermediary system of a country fulfils its functions the best if it is capable of resisting shocks and supporting economic growth with the efficient allocation of resources. The shock-absorbing capacity of the Hungarian banking sector is adequate both from a liquidity and a capital adequacy perspective. The marked procyclicality of the financial system continued to decline in 2013, but the lending activity of domestic financial institutions still does not adequately support economic growth. However, procyclicality, which has been identified by the MNB as a major risk, has declined, primarily due to the MNB's rate-cutting cycle and the FGS.

In its Reports on Stability published in 2013, the MNB evaluated the stability of the Hungarian financial intermediary system using five key financial stability indicators[3]. As these indicators express a specific state, as regards future risks threatening the stability of the financial system, they are unable to capture all risks.

Chart 6
Financial Condition Index (FCI), real GDP and the output gap



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

The value of the FCI – which shows the extent to which the financial intermediary sector (banking system) contributes to the annual growth rate of real GDP – suggests that the operation of the banking system remained procyclical. Once again, the FCI exhibited a highly negative value in 2013, while the output gap was also negative. Therefore, the financial system remained contractionary and failed to spur economic growth due to its weak credit supply.

The objective of the publication *Trends in Lending* launched in 2013 is to present a comprehensive analysis of the latest trends in lending and to help to interpret these developments appropriately. To this end, it elaborates on the developments in credit aggregates and interest rates, and the results of the lending survey, namely the demand for loans perceived by banks and credit conditions.

Although the contraction of loans to the corporate sector did not stop in 2013, the decline was less pronounced, in which the FGS played a leading role. The high utilisation of the first phase of the FGS (see Chapter 3.1) and feedback from credit institutions and representatives of the private sector suggest that the FGS mobilised credit market participants both on the demand and on the supply side: several corporations reconsidered the financing of their business activity and applied for loans, which turned banks' attention to the SME sector. Under Pillar I, the contracts of credit institutions amounted to HUF 472 billion, while HUF 229 billion was disbursed in Pillar II. New loans account for more than 60 per cent of the loans disbursed in Pillar I, which is beneficial in respect of the programme's impact on growth. Likewise, the loans disbursed by credit institutions in Pillar II were primarily used to refinance investment loans. The refinancing of foreign currency loans reduced the SME sector's exposure to exchange rate risks and thus mitigated the associated stability risks. Within the minimum HUF 3 million and maximum HUF 3 billion contract amount limit, borrowers preferred smaller value loans: in terms of the number of contracts, 70 per cent of the loan amounts were below HUF 50 million.

Thanks to the FGS, the interest burden on corporations eased substantially, improving the financial position and creditworthiness of the firms concerned. In addition, in the case of refinancing, the FGS opened up an opportunity for switching banks, which boosted competition between credit institutions. In the case of refinanced loans, 20 per cent of customers opt to switch banks. Increased competition contributes to the easing of lending conditions and facilitates more efficient allocation of funds.

Access to longer-term loans deteriorated, especially during the years of the crisis. To a large degree, the FGS addressed

[3] The growth supporting function (procyclicality) of the financial system is approximated by the level of the Financial Condition Index (FCI) and the Early Warning Indicator (EWI), while resilience to shocks is approximated by the lowest value of three partial indicators (System-Wide Financial Stress Index [SWFSI], Liquidity Stress Index [LSI], and Solvency Stress Index [CSI].

this deficiency of the credit market as well. With the maximum ten-year maturity stipulated by the MNB, credit institutions were willing to provide long-term loans with an average maturity of nearly 7 years with a fixed, maximum interest rate of 2.5 per cent per annum until the end of the term. The FGS has reached every sector, with the majority of loans extended in the sectors of agriculture, trade and manufacturing. The FGS also reduced the level of concentration across the regions: relative to all SME loans outstanding, credit institutions disbursed more loans to companies in the Southern and Northern Great Plain regions, while the share of Central Hungary was significantly lower than it is in the overall portfolio.

In view of the success of the FGS, the Monetary Council decided to continue the Scheme. In the context of the extended programme (until the end of 2014), the MNB continues to provide refinancing loans with a 0 per cent interest rate, to which banks are allowed to add a maximum premium of 2.5 percentage points when they extend loans using this facility. Thanks to the FGS, the contraction of the corporate loan portfolio is expected to come to a halt in 2014 and 2015, and there may be a turnaround in lending to SMEs. This notwithstanding, a sustained recovery in lending will require further easing of credit conditions on the supply side, as even though conditions appeared to ease somewhat in 2013, they still remained tight.

As regards the household segment, the FX loan portfolio accumulated before the crisis continued to contract, while new disbursements hit a historical low in 2013 before an improvement began, thanks to loans provided with an interest rate subsidy.

The high share of non-performing loans represents a marked risk to the financial intermediary system. As regards the corporate portfolio, the non-performing loan ratio remained practically unchanged at extremely high levels in 2013, but the improvement in the economic growth outlook has a positive impact on the income position of the corporate sector. Although banks' portfolio cleaning accelerated somewhat compared to recent years, it is still considered slow. Amid the continued contraction of the corporate portfolio, the MNB expects the ratio of non-performing loans to remain high, at a level of around 18–20 per cent, in the next two years.

In the household loan segment, the non-performing loan ratio reached 18 per cent in 2013, but the MNB expects the ratio to decline in this sector over the next two years. The indebtedness of households in foreign currency continues to pose a significant financial stability risk. Swiss franc-denominated loans play a key role in the deterioration of the portfolio. Indebted households face increasing debt burdens and higher instalments owing to the appreciation of the Swiss franc and rising bank lending rates, leading to a decline in their consumption and, in the worst case, insolvency. Meanwhile, the increase in loan-loss provisions to cover the rising stock of non-performing loans poses a serious challenge to banks.

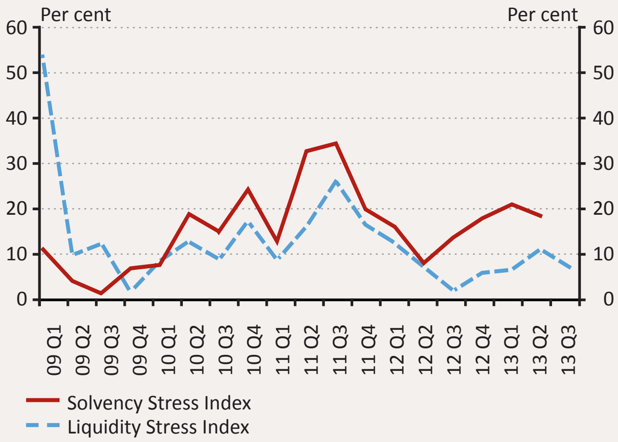
Government programmes contribute to reducing the ratio of non-performing loans, but the main programme, the exchange rate cap, is unable to fully address foreign currency indebtedness in its current form. Even following the significant extension of the deadline for entry, the utilisation rate of the exchange rate cap scheme does not substantially exceed 50 per cent. The questionnaire-based MNB–GfK survey conducted in 2013 revealed that half of those not participating in the exchange rate cap scheme explained their opt-out either with their lack of confidence in banks or the increase in the burden following the expiry of the grace period. One quarter of those not participating are hoping for a government measure more favourable than the exchange rate cap.

The profitability of the Hungarian banking sector remained low during 2013. Following years of heavy losses, the banking sector's pre-tax profits amounted to just HUF 143 billion at the end of December 2013. Another aspect of banks' profitability was the large degree of asymmetry in the performance of individual participants. The low profitability of the Hungarian banking sector and its subdued profitability outlook continue to be a competitive disadvantage in the allocation of parent bank funds – including capital – to the region.

Albeit with slowing dynamics, the outflow of foreign funds (primarily parent bank funds) from Hungary continued in 2013. The withdrawal of foreign funds was accompanied by a slight increase in swaps outstanding and the banking sector's parallel balance sheet adjustment. The fact that the loan-to-deposit ratio dropped below 110 per cent also points to reduced reliance on external financing, although this decline came to a halt in the second half of the year, mainly because of the outflow of household deposits. It is only due to the substantial amount of liquidity in the banking sector and the continued balance sheet adjustment of households that this large outflow of funds did not cause any material tension in banks' balance sheets.

In 2013, both the Liquidity Stress Index (LSI) and the Solvency Stress Index (SSI) showed low values. The Liquidity Stress Index is 10.7 per cent, which means that if the stress scenario materialised, only a few of the participants in the banking sector would fall below the regulatory minimum. It is also favourable that at the individual level, all banks would remain liquid even in a potential stress scenario. Banks' short-term liquidity is more than twice the regulatory requirement, meaning that their post-stress liquidity surplus would exceed the regulatory

Chart 7
Liquidity Stress Index and Solvency Stress Index



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

minimum, but this surplus is mainly available in forint. As a result, smooth functioning of the swap market is indispensable in a protracted stress scenario.

The capital adequacy ratio of the banking sector increased during the year, approaching 17 per cent. The significant losses incurred in 2012 were largely offset by the capital increases of parent banks, although several institutions suffered losses in 2013 H1 again. Therefore, in the 2013 stress test the banking sector's initial capital position and shock-absorbing capacity did not improve compared to the end of 2012. This is also confirmed by the Solvency Stress Index, the level of which remained almost unchanged compared to the end of 2012. Although average capital adequacy is satisfactory, the aggregate indicator conceals significant asymmetry. While expected losses declined somewhat in the stress scenario compared to our previous stress test, the earnings capacity of banks also deteriorated. Accordingly, two major banks may have additional need for capital over a two-year horizon. Even though the banking sector's total capital need of HUF 116 billion is considered significant, this risk is manageable with parent banks' continued commitment.

Macroprudential regulatory and resolution activity of the MNB

As regards financial regulation, the most significant event of the year was the implementation of the supervisory integration, in parallel with which the new MNB Act entering into force on 1 October 2013 reinforced the macroprudential mandate of the MNB, providing it with the appropriate set of instruments. In line with its reinforced mandate, the MNB establishes the macro-prudential policy for the stability of the entire system of financial intermediation, with the objective of enhancing the resilience of the system of financial intermediation and ensuring its sustainable contribution to economic growth. To that end and within the limits specified in the MNB Act, the MNB explores the business and economic risks threatening the system of financial intermediation as a whole, promotes the prevention of the development of systemic risks and the reduction or elimination of systemic risks which have evolved. Furthermore, in the event of disturbances to the credit market it contributes to the balanced functioning of the system of intermediation in financing the economy by stimulating lending or – in the event of excessive credit outflow – by restraining lending.

The staff of the MNB actively supported the supervisory integration by preparing professional materials and by offering opinions in respect of the new MNB Act. Before the commencement of the legislative work performed under the direction of the Ministry for National Economy, the experts of the MNB drew up professional discussion materials. On the one hand, this included the proposal for strengthening the macroprudential function of the central bank and the instruments to be deployed for this purpose, and on the other hand, it emphasised the importance of reinforcing the individual supervision of financial institutions, which could be achieved by integrating the Hungarian Financial Supervisory Authority (HFSA) – the authority responsible for microprudential duties – into the central bank.

Hosted by the MNB, the V6 Financial Stability Meeting was held on 2 September 2013 with the participation of the leaders of the central banks and supervisory authorities of Central and Eastern European countries. The current issues discussed at the meeting included, among other topics, the use of macroprudential policy and instruments in a central bank integrated with a supervisory authority; the effects and challenges of the banking union and close cooperation in non-euro area countries; issues concerning the financing of small and medium-sized enterprises with a special focus on the prospects and limitations of countercyclical policy, in the context of which the presentation of the FGS and its results were given special emphasis.

In the autumn, the experts of the MNB played a prominent role in providing opinions on the new Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises and the related amendments to existing acts on financial matters entering into force as of 2014. The new regulation was necessitated by the implementation of the European Union directive (CRD IV) on the prudential requirements for credit institutions and investment firms, as a result of which the macroprudential powers of the MNB were further reinforced as from 2014, as the macroprudential instruments of the MNB were clarified relative to the Act in force since October, and the central bank received new instruments starting from 2014.

In addition to the implementation of the supervisory integration and the reinforcement of the MNB's macroprudential function, as of 1 October 2013 the MNB Act designated the MNB as a future resolution authority. Based on the relevant European Union directive, the resolution framework will be defined by separate legislation, which is expected to be adopted by Parliament in the first half of 2014. Following the enactment of this legislation, the new resolution function will help ensure that the individual crisis of a credit institution or an investment company does not evolve into a systemic problem or impair the functions considered critical from the perspective of the financial system. Resolution may be viewed as an 'orderly alternative' of the liquidation procedure in cases when liquidation would not be a reasonable alternative due to the considerations outlined above, yet it will not be the state (taxpayers) that are expected to bear the brunt of the irresponsible financial management of the institution concerned because of the detrimental systemic effects. Resolution costs are primarily borne by the owners and creditors of the institution and the participants of the sector.

In 2013 Q4, in relation to its new resolution duties, the MNB commenced preparations for its role as a resolution authority. As part of this work, the Financial Stability Council adopted a resolution concept which defines, among other things, the framework for the application of resolution tools and the financing background of resolution. Thereafter, the Council laid down an implementation roadmap in line with the concept, detailing further future tasks for the MNB in relation to resolution. The MNB shared the proposed regulations approved by the Financial Stability Council with the Ministry for National Economy, i.e. the ministry responsible for making preparations for the future Hungarian act on resolution.

In 2013, the experts of the MNB monitored the international regulatory processes relevant to the financial system and actively participated in commenting on draft regulations being prepared in the European Union. The MNB's staff offered opinions on the directive and draft regulation on the prudential requirements for credit institutions and investment firms (CRD IV/CRR) implementing the proposed Basel III regulatory framework within the EU, which was eventually adopted in June 2013. The first pillar of the banking union, i.e. discussions on the Single Supervisory Mechanism (SSM), reached its final phase as well, and the related regulations were adopted by the European Parliament on 12 September 2013.

In the context of preparations for its resolution tasks, the MNB monitored amendments to the legislation harmonising national resolution authorities and instruments at the EU level (Bank Recovery and Resolution Directive, BRRD) and participated in the process of commenting on the related drafts, as coordinated by the Ministry for National Economy. In December 2013, the European Parliament and the Ecofin Council reached an agreement on the BRRD. Another noteworthy event in the European Union involved developments in the Single Resolution Mechanism (SRM) leg of the banking union, in respect of which Member States also reached a consensus at the end of the year. Both of these developments may have an impact on future resolution regulations in Hungary. On the one hand, from 2015 all Member States will be required to comply with the finalised BRRD (the version approved by the European Parliament), which therefore provides a clear basis for drawing up the Hungarian resolution framework and legislation. On the other hand, the SRM influences the decision on Hungary's accession to the banking union; therefore, upon developing and subsequently representing the discussion concept it is important to ensure that the developing system is also in line with Hungarian considerations.

As usual, the MNB represented itself in international organisations and institutions and, as an authority with a macroprudential mandate, it supported the work of the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA) by actively participating in the committees and working groups of these EU organisations.

3.3 FINANCIAL SUPERVISION AND CONSUMER PROTECTION

Integration of the Magyar Nemzeti Bank and the Hungarian Financial Supervisory Authority (HFSA)

In its session on 16 September 2013, the Parliament adopted the draft legislation on the Magyar Nemzeti Bank (MNB), which decided on the integration of the function of financial supervision into the central bank. The objective of the draft legislation was to ensure that, as in several other countries, central bank and supervisory activities are performed by a single organisation; i.e. the Hungarian financial sector is supervised by the harmonised application of interconnected micro- and macroprudential instruments. In line with the adopted legislation, the handover-acceptance procedure between the Hungarian Financial Supervisory Authority (HFSA) and the MNB took place on 1 October 2013. As of 1 October 2013, the former rights and obligations of the HFSA as defined in Article 176 of the MNB Act were conferred upon the MNB.

The handover-acceptance procedure was efficient and did not cause any disturbance in day-to-day work. As a result of the merger, the classical central bank mandate and functions were enhanced by the expanded dimensions of responsibility and instruments. The integrated MNB exercises macroprudential supervision, which is intended to ensure the stability of the entire financial system and a healthy contribution to economic growth; while on the other hand, it exercises microprudential supervision over the institutions constituting the system, thereby facilitating the enforcement of comprehensive system objectives at the individual level. The MNB also carries out market surveillance and financial consumer protection duties. These tasks are not independent of one another: they ensure the stability of the financial system and the efficient operation of the financial intermediary system together, in close interaction

Structure of the MNB's professional areas delegated to the Deputy Governor responsible for the supervision of financial institutions and consumer protection

As of 1 October 2013, the organisational units under the Deputy Governor responsible for the supervision of financial institutions and consumer protection assumed most of the previous tasks of the HFSA. The directorates established within the new organisational structure are responsible for the supervisory activities related to specific financial areas. The Executive Director of Financial Institutions Supervision supervises the Directorate for Credit Institution Supervision, the Directorate for Insurance, Pension Funds, Financial Enterprises and Intermediaries Supervision and the Directorate for Licensing and Legal Enforcement. The Executive Director responsible for consumer protection and market supervision oversees the activities of the Directorate for Consumer Protection and the Directorate for Market Supervision. In 2013, the Directorate for Methodology and the Financial Consumer Protection Centre reported directly to the Deputy Governor.

Development of the MNB's supervisory strategy

Following the integration, there was a need to develop a strategy built on the new organisational framework and employing the MNB's expanded set of instruments. In developing the supervisory strategy for the period of 2014–2019, the starting point was the vision of an ideal, smoothly functioning financial sector and a strong supervisory authority acknowledged and recognised in the supervisory community of the European Union, capable of consistently and efficiently shaping the financial system. During this work, the mission of the supervisory area was defined. The mission of the MNB is to maintain and support the stability of the financial system and to strengthen the confidence of participants both in the system and in one another with the assistance of the integrated supervisory instruments. The leadership of the MNB designated confidence and stability as priority values for the supervisory area. The renewed strategy sets a number of clearly defined objectives for the next five years which the MNB wishes to achieve in the supervised markets and with respect of itself as an institution, by taking advantage of the opportunities provided by the instruments at its disposal. The tasks required for the achievement of the long-term objectives have been designated for each supervised sector and supervisory area.

Micro-prudential supervision

Supervision of credit institutions

Micro-prudential supervision is intended to facilitate the prudent operation of credit institutions, to supervise the careful exercise of owners' rights, to identify and assess the risks associated with individual institutions, to mitigate or eliminate risks, and to take preventive measures in order to ensure prudent operations. Applying the framework renewed and determined by the methodology, the MNB conducted all scheduled inspections. Both in on-site and off-site microprudential supervision, priority inspection areas included the management and mitigation of high accumulated credit risk at credit institutions and the examination of the inspected institution's capital position, profitability and the sustainability of its business model. In addition, special focus was given to the evaluation of liquidity and, in case of large banking groups, recovery plans were requested and examined. In the cooperative bank sector, the integration of cooperative credit institutions called for non-standard licensing and supervisory tasks, which were addressed by the MNB with intensive professional attention. As the new EU requirements (CRD IV/CRR) for credit institutions and investment firms entered into force on 1 January 2014, preparations for these new regulations also played an important role, in addition to the supervisory work.

The supervisory colleges of financial conglomerates operating in several countries are cooperation forums for national supervisory authorities, and constitute a part of the European supervisory structure. In Central and Eastern Europe, only the MNB exercises leadership over a banking supervision college and it does so in relation to the OTP Group. The MNB participates in the rest of the EU supervisory colleges as a host authority supervising the subsidiary or the branch office. In period under review, the international tasks related to the colleges and to the European Banking Authority were completed

Table 2
Number of inspections at credit institutions, insurance companies, funds and intermediaries

Type of institution	Type of inspection	In progress on 1 Oct 2013	Launched after 1 Oct 2013
Insurance companies	Comprehensive	7	7
Pension funds	Comprehensive	8	2
Health funds	Comprehensive	7	3
Mutual aid funds	Comprehensive	1	–
Intermediaries	Target	–	2
Credit institutions	Comprehensive	30	4
Credit institutions	Target	2	–

as scheduled. On 23 October 2013, the European Central Bank published a communication on a comprehensive asset quality review (AQR) to be conducted in 2014 for the 130 largest banks of the euro area. Preparations for active participation in the international review commenced as early as 2013.

The phase scheduled for Q4 in the 2013 Inspection Plan was completed; on 1 October 2013 a total of 32 inspections were in progress, of which 13 inspections were completed by 31 December 2013.

Supervision of insurance companies, funds, financial institutions and intermediaries

Continuous risk-based supervision and cooperation with the affected sectors and supervised institutions proceeded smoothly in the period under review. With the implementation of the supervision plan developed to ensure the simultaneous enforcement of prudential and consumer protection aspects, the MNB successfully ensured the smooth progress of market trends while also taking into account broad-based customer interests, not only at the level of individual institutions, but also at the level of the entire market and market segments.

Focusing on priority inspection target areas, the comprehensive inspections of insurance companies and funds were completed in full. Deficiencies violating the law or consumers' interests were detected in several cases during the review of motor third-party liability insurance plans and unit-linked life insurance plans in respect of legal, actuary and consumer protection aspects, and during the examination of the stock management of policies. In addition, prudential risks were identified and addressed typically in relation to business registry systems, the adequacy of data supply and the formation of insurance technical reserves. In the on-site inspection of voluntary mutual insurance funds, priority aspects included the proper execution of member account settlements and the correct crediting of membership fees to individual accounts in accordance with the appropriate distribution ratio. As regards voluntary pension funds, priority was given to the examination of indirect investment costs versus direct costs. As part of the supervision of intermediaries, the scheduled targeted on-site inspection was completed, and additionally, targeted off-site inspections were conducted at several independent intermediaries. In order to eliminate the illegal practices found during the inspection, the MNB issued a resolution. The MNB participates actively in developing the regulations for the European insurance supervision; it has a permanent membership in the Board of Supervisors of the European Insurance and Occupational Pensions Authority (EIOPA) and in the most important EIOPA working groups responsible for working out quantitative and qualitative regulatory standards. The expected changes in the regulatory framework will imply new supervisory tasks as well. On the one hand, the rules of the Act on Insurance Institutions and the Insurance Business pertaining to the governance system – as amended in accordance with the preparations for Solvency II – will be introduced, and on the other hand, in the context of the Omnibus II Directive approved by the European Parliament in the spring of 2014, the finalisation and adoption of lower-level legislation can commence in the course of 2014 and 2015. The Solvency II Directive and the related regulations must be implemented into national law by 31 March 2015.

On 1 October 2013, a total of 23 inspections were in progress in the sector of insurance companies, funds and intermediaries, and 14 inspections were launched after 1 October.

Supervision of capital market institutions

In 2013 Q4, the MNB did not identify any circumstances entailing systemic risks or warranting immediate action among the supervised capital market institutions; consequently, there was no need for extraordinary targeted inspections or comprehensive reviews. In respect of institutions providing investment services, in the ongoing supervision and inspections the supervisory area focused mainly on provisions

Table 3
Number of inspections at capital market institutions

Type of institution	Type of inspection	In progress on 1 Oct 2013	Launched after 1 Oct 2013
Investment service providers	Comprehensive	1	–
Investment fund managers	Comprehensive	2	2
Venture capital funds	Comprehensive	–	2
Other (KELER, KELER KSZF)	Comprehensive	–	2

related to the protection of client claims and compliance with the requirements concerning the provision of information to clients. Based on the findings of the inspections, the service providers had adequate coverage for client claims, and the segregation derogations and insufficiencies in data supply which were found typically did not violate client interests. Deficiencies were detected in several cases in respect of the provision of information to clients, client account management and order management. The review of outsourced activities identified several inappropriate procedures particularly in the case of trading platforms.

An additional priority of the capital market area was to facilitate the preparations of the affected market participants for the application of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), and to address the supervisory authority tasks to be performed in order to ensure the compliance of KELER KSZF with the provisions of EMIR. The licensing procedure of KELER KSZF as a central counterparty pursuant to EMIR and the related comprehensive review and validation process started in September 2013 based on the previously developed methodology and risk management questionnaire. The licensing procedure (preparation of risk assessment, operation of supervisory college) is expected to be concluded in the first half of 2014. As the affected market participants seek guidance from the MNB during their preparations, the MNB provides assistance through information, presentations and consultations provided through various channels, as well as different guidelines published on the MNB's website.

Based on the experiences of previous inspections, as regards fund managers, priority target areas included the inspection of different charges, the portfolio and fund management fees applied, as well as other expenses. As regards the managed funds, deficiencies were identified in several cases in respect of compliance with the rules pertaining to the regular and extraordinary provision of information to investors (failure to publish portfolio reports; failure to send reports to the supervisory authority or delays in sending; substantive deficiencies in the reports; failure to update key investor information). In addition, on several occasions the net asset value calculation was incorrect and therefore the investor's compensation was late. In the case of real estate funds, observations were made about the person of the professional appraising the real estate or the lack of regularly updated appraisals. In several cases, regulations on liquid assets and real estate types were violated. Some asset managers engaged in portfolio management were found to have violated the rules pertaining to the gathering of advance information or to the composition of portfolios. Moreover, upon examining transactions between the managed portfolios, some transactions were found to be detrimental to one of the parties or gave rise to concerns in respect of fair market practices. During the review of venture capital fund managers, some minor deficiencies were identified in respect of the level of internal regulations and data supply.

Of the inspections conducted in 2013, 6 comprehensive reviews were launched at supervised capital market institutions in 2013 Q4; all of them are expected to be concluded in 2014 Q1. Of the inspections commenced before 1 October 2013, the comprehensive review of 2 fund managers continued into 2014. In 2013 Q4, a review of an investment company which had commenced earlier was concluded with a decision calling for measures, with no penalty imposed.

Market surveillance

The MNB takes action against unlicensed or unregistered business activities, insider trading or market manipulation within the framework of market surveillance procedures, and also verifies compliance with the rules pertaining to stock exchange acquisitions. For the more efficient execution of these tasks, the Financial Stability Council approved a new, standardised, predictable and consistent market surveillance policy defining the applicable measures and sanctions, which are guaranteed to have due restraining power over all participants of the money and capital market against activities giving rise to market deviancies.

The MNB identified unregistered intermediary (agency) services and unlicensed investment services as key market risks. Companies providing the above services were typically

Table 4
Number of market surveillance investigations

	13 Q4
Subject of investigation:	
Unlicensed activities	6
Market manipulation	3
Total fine imposed (in HUFm)	584.2

engaged in online forex trade and operated an extended agency network in order to reach a wide range of investors. In its market surveillance procedures conducted in 2013, the MNB rigorously investigated the companies engaged in the above activities, and applied more stringent sanctions and penalties than usual in order to curb this undesirable phenomenon. Rapid, immediate supervisory action was called for in several cases where prohibited market manipulation was suspected. The soundness of the supervisory decisions passed in the cases concerned was confirmed by the fact that market participants accepted the MNB's decisions concluding the investigations without exercising their right of judicial control, or, in the case of disputes, the court ruling confirmed the correctness of the MNB's decision.

The MNB took particular care to improve the transparency of the activity of stock exchange issuers; to that end, it evaluated and conducted targeted reviews of disclosures on a continuous basis. Upon examining regular disclosures, the MNB verified the application of international financial reporting standards (IFRS) among listed issuers in particular. After assuming market surveillance powers, in the period between 1 October 2013 and 31 December 2013, the MNB concluded 8 market surveillance procedures and 1 repeated market surveillance procedure, in which the market surveillance fine amounted to a total of HUF 584.2 million.

The MNB plays an important investor protection role in the licensing of capital market issuers by verifying compliance with statutory regulations for all initial public offerings. As part of the licensing of issuers, the MNB passed 227 resolutions and 7 rulings. Owing to legislative changes, around 75 per cent of the procedures were related to the sector of investment fund managers, while the remaining 25 per cent affected various other areas of the capital market (takeovers, security protection plans, approval of IPO prospectus, etc.). As a significant change, from 1 July 2013 all communications in respect of applications and submissions during the licensing of capital market products are conducted electronically.

Legal enforcement

In the context of its legal enforcement activity, in 2013 Q4 the MNB issued a total of 16 decisions concluding its inspections in the financial and capital markets. As a result, it concluded comprehensive reviews of nine cooperative banks, three banks, one banking group along with two related financial service providers, and an investment service provider with the application of various measures corresponding to the severity of the detected infringements, with the exception of one institution. Crisis management was required in the case of one cooperative bank, including the adoption of extraordinary measures and the delegation of a supervisory commissioner. In addition, the business licenses of one financial service provider and fourteen intermediaries were revoked either because they had no liability insurance, or because winding-up procedures were in progress against them.

As part of supervising the activities of credit institutions, the MNB applied measures against the inspected financial institutions mainly because of violations of statutory or internal regulations pertaining to risk-taking and risk management, client and partner ratings, collateral assessment, the maintenance of accounting and analytical records and the management and registry of restructured loans. A typical infringement was the violation of provisions pertaining to the contents of statutory data supply and the calculation of regulatory capital. In its decisions issued during the review period, the MNB called on several credit institutions to re-classify certain transactions in view of the inspection findings, and recognise in their books the correct values of impairment and provisioning. Upon determining the capital requirement for the credit risk concerned, the MNB called for a full harmonisation of regulation and practices in several cases and, in order to ensure the weighting of credit risks as per the regulations, it instructed the institution concerned to ensure that the information system in use is capable of maintaining an adequate registry of exposures and collateral and calculating the precise value of real estate collateral.

As regards legal enforcement in the sector of insurance companies and funds, in the context of its legal enforcement activity related to insurance intermediaries, the MNB imposed a supervisory fine of HUF 10 million on the online market leader of independent insurance intermediaries. The fine needed to be imposed as the intermediary concerned failed to assess and clarify the details of clients' needs and demands upon presenting the different motor third-party liability insurance options offered in conjunction with supplemental insurance and home insurance plans, and failed to analyse a sufficient number of insurance products available in the market. In other cases, measures were taken against independent insurance intermediaries because they did not or could not meet the requirements constituting conditions for their operation. Failure to meet these obligations for a protracted period of time resulted in the withdrawal of the business licenses of eight independent insurance intermediaries. Among these matters, a noteworthy case involved an independent insurance intermediary which, in addition to failing to meet its data reporting obligation and its obligation to employ a professional controller, pursued portfolio management activities without an official license. In the investment contracts it concluded, it provided professionally unsound information suitable for misleading potential clients both in respect of the contents of its insurance broker business license and of the risks covered by the broker's professional liability insurance.

In respect of legal enforcement in the sector of funds, in addition to the decisions concluding comprehensive inspections, decisions were issued in several cases where the MNB identified infringements based on the documents submitted by the funds, or where the measure was warranted by an internal regulation in violation of the law. This type of legal enforcement included, in particular, the instruction to modify the statutes, service policy and financial plans of the funds concerned.

Authorisation activity

In the final quarter of 2013, the MNB granted authorisation for the market entry of one new entity and the transformation of four cooperative banks into banks in the credit institution sector. The establishment and operating licence was also issued for one credit institution in the wake of its exit from integration in the final quarter of 2013. One bank exited the credit institution sector, continuing as a financial enterprise following the transfer of its assets and liabilities. Hanwha Bank Magyarország Zrt. changed its name to evoBank Zrt. following a change in ownership structure. A turnaround in the trend of previous years can be seen among financial enterprises, as reflected in the slow increase in the number of applications for establishment and operating licences.

Many applications continue to be filed for operating licences for independent financial intermediaries. In the field of capital market licencing, the MNB withdrew the licence of an investment firm ending its operation of a multilateral dealing system, a unique investment services activity, at the firm's request. A large volume of registration applications in the capital market intermediary (tied agent and further intermediary) registry are also continuously being submitted. In the field of insurance licencing, the major change in the last quarter of 2013 was the definitive exit of a non-life insurance sector player from the insurance market and the withdrawal of its operating licence upon request. Among independent insurance intermediaries, the number of resolutions to withdraw operating licences upon request far outstripped the number of new operating licences issued. In the field of fund licencing, the trend indicated market concentration among both private and voluntary pension funds in the fourth quarter, similarly to past years. The MNB authorised the termination of private pension fund operations for a mixed private pension fund in the form of dissolution, and also authorised a merger between two voluntary pension funds.

The MNB's consumer protection administrative activity

Overall, the MNB was able perform its consumer protection functions smoothly in 2013 Q4 and to react to the mounting challenges with suitable measures in a timely manner. Following the integration, there were 2,500 cases underway as at 1 October 2013, of which 2,400 were settled by the end of the year. Nearly 500 new claims requesting administrative inspections were filed in Q4, with approximately 75 per cent pertaining to credit institutions; on the last day of the year, there were nearly 600 individual claims underway.

Following the integration, the MNB's functions in the field of investigations consisted mainly of concluding the large number of pending cases transferred to it. This objective was met: on the last day of 2013, only a few particularly justified investigations launched in the previous quarter were still underway. Fines were levied in 138 cases processed in a total amount of HUF 44 million. Among the decisions issued following 1 October, legal proceedings for the judicial review of public administrative decisions were instituted in the case of 12 orders and 9 resolutions. Besides settling individual cases, the MNB also carried out a review of the ongoing targeted and thematic inspections in the last quarter. As a result of that, unjustified cases were closed, while merited ones were extended. Worth mentioning are the extended inspections linked to the raising of fees, affecting 164 financial organisations. Prior to the integration, consumer protection investigations primarily focused on examination of claims containing individual damages. Following the reorganisation, the emphasis of consumer protection activity shifted from the low-efficiency examination of individual complaints to prevention and a proactive approach. Accordingly, thematic and targeted inspections drawn up based on individual claims and launched ex officio, covering a wide range of consumers were initiated in order to give the MNB a comprehensive overview of the consumer protection efforts of the organisations under surveillance. These inspections allow consumer protection activities to be performed using resources more efficiently and allow systemic errors to be resolved as soon as possible. Investigations were usually carried out by on-site inspections, providing insight into the operations of the organisations under surveillance, and interviews provided a source of information that can only be obtained in person. Based on the investigations concluded, the most common infringements were related to compliance with complaint management deadlines, the content of information provided to customers or the lack thereof, and problems were also found in relation to adherence to codes of conduct.

Participation in international working groups was also a priority for the MNB in the field of consumer protection, and the integration did not cause any interruptions in international operations. Compared to earlier periods, the number of resolutions imposing fines increased by 4.5 per cent in the period under review in a year on year comparison, while the total amount of fines imposed was almost 29 per cent higher, due to changes in fining practice following the organisational restructuring. Under the new system, infringements result in higher fines in order to reduce their occurrence in the future.

Similarly to previous years, publicly accessible quarterly summary reports on consumer protection administrative activity were published throughout 2013 on the supervisory website, presenting in detail the activities and experiences for each period.

Financial Consumer Protection Centre

The Financial Consumer Protection Centre took charge of customer relationship and claim handing functions in October 2013 as a new organisational unit, developing and operating them in an integrated, customer-focused manner. In 2013 Q4, the Financial Consumer Protection Centre received a total of 8,564 customer requests, 7,112 of which were customer service requests and 1,452 of which were customer claims. The requests were lodged using three available channels: 3,922 by telephone, 1,032 in person and 3,610 in writing.

The Financial Consumer Protection Centre focused on the following areas in the fourth quarter:

- emphasis on consumer protection aspects and establishment of customer-focused service;
- reducing the turnaround time for customer requests and claims;
- developing civil relationships and establishing multilateral dialogue;
- updating consumer protection websites in a consumer-friendly manner;
- publication of information material in priority areas (such as free cash withdrawals or the exchange rate cap scheme).

The majority of customer service requests were linked to payments and insurance services. A high number of financial market sector requests were made regarding the financial transaction duty and its pass-through, along with many requests seeking information on free cash withdrawals. The number of requests pertaining to home loans and car purchase finance and issues of their recognition remained high. Multiple insurance sector related requests were filed in the field of motor third-party liability insurance, along with requests linked to home insurance claims and life insurance products. The most common capital market sector requests pertained to investment service providers and investment funds, while the majority of fund sector requests concerned pension funds.

The Financial Consumer Protection Centre passed on 35 per cent of customer claims processed in the fourth quarter to the administrative areas of the supervisory authority for inspection. 3 and 4 per cent of the cases were passed on to the Financial Arbitration Board or partner authorities, respectively. The Financial Consumer Protection Centre dismissed 58 per cent of claims on the grounds of the lack of subject matter or failure by the customer to rectify deficiencies. Many formally or substantively invalid claims were submitted, with one out of seven cases calling for rectification of deficiencies by the customer. Customer requests made in person, by telephone or in writing which did not meet the criteria for administrative procedure were given assistance by the Financial Consumer Protection Centre using every available communication channel to help meet the requirements to successfully launch the procedure.

3.4 PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

Development tendencies and effectiveness of payments

Initiatives to increase the efficiency of payment services in Hungary

In the first half of 2013, the MNB drafted a bill defining prudential and customer protection requirements for the regulation of negotiable vouchers, which was adopted by Parliament on 10 June. The regulation was warranted by the central bank's opinion that the absence of any regulation of Hungarian trade vouchers (colloquially known as 'local currency') presented a significant risk for both the consumers using them and the competent authorities in charge of the safety of financial services.

30 September 2013 marked the introduction of a new statistical publication by the MNB presenting key data on

payments in Hungary. The new data publication presents much broader payments data than before, in a consolidated structure and at quarterly intervals to market players and anyone interested in payments. One of the objectives of the new publication is to satisfy the need for data of payments analysts.

On 1 October 2013, a statute amending Act LXXXV of 2009 on the Provision of Payment Services came into effect, substantially reducing interchange fees on bank card payments as of 1 January 2014. The regulation aims to foster the spread of bankcard merchant networks and bankcard use in retail commerce. The MNB and the Hungarian Competition Authority contributed substantially to the elaboration of professional specifics and in the legislative process.

In the fourth quarter of 2013, a support programme was launched in Fejér County in order to develop the Hungarian payment card acceptance network by fostering the installation of card acceptance infrastructure among merchants. The programme, running until the end of the year, provided EUR 1 million to participants, which could be used to install POS terminals at discounted terms, allowing numerous smaller turnover merchants to implement bankcard acceptance.

European development trends

With the amendment to Act CCVIII of 2011 on the Magyar Nemzeti Bank adopted on 10 June, Parliament designated the MNB as the competent authority in respect of Article 10 of Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009. The central bank was designated as competent authority to oversee compliance with deadlines for the introduction of SEPA payment schemes, serving as the technical standard for euro payments and with other relevant requirements.

On 14 January 2013 and 12 December, the meeting of the Hungarian TARGET2-Securities (T2S) National User Group was held at the MNB. At the meeting, the central bank and Központi Elszámolóház és Értéktár Zrt. (KELER) presented information on the international project created for the introduction and launch of the T2S single pan-European platform for securities settlement and on the current state of consultations.

Statements

In 2013, the central bank issued 73 payments-related statements in response to household and public administrative requests, as well as legal interpretation enquiries. The resolutions and professional opinions were linked, amongst others, to draft legislation submitted for public administrative consultation and European Union legislation, or based on other household or institutional requests.

Payment inspections

The MNB conducted inspections regarding compliance with MNB Decree 18/2009 (VIII. 6.) at 19 credit institutions in 2013 and at one cash-in-transit company regarding compliance with Act CXXXVI of 2007 on the Prevention and Combatting of Money Laundering and Terrorist Financing. The central bank imposed a total of 107 tasks along with their respective deadlines in the context of on-site inspections in its resolutions issued to remedy the deficiencies identified or to conclude inspections. Fines were imposed in five of the credit institution control procedures launched in 2013, in a total amount of HUF 19.1 million.

The central bank devised a new control methodology to oversee compliance with Act LXXXV of 2009 on the Provision of Payment Services, which it will apply in its comprehensive payment inspections in the future. The MNB's Financial Stability Council has discussed and approved the 2014 inspection plan, which includes the scheduling of inspections.

Payment and settlement systems

Oversight evaluations

Based on the findings of the comprehensive oversight evaluations approved in 2012 Q4 and 2013 Q1, the systems overseen by the MNB – the real-time gross settlement system (VIBER), the Interbank Clearing System (ICS), and the securities settlement and clearing system operated by KELER and KELER Központi Szerződő Fél Zrt. (KELER KSZF) – essentially meet international requirements.

Interbank Clearing System

In order to clarify questions regarding oversight of the Interbank Clearing System, a one-day oversight forum was hosted on 14 February 2013 with the participation of GIRO Zrt., the operator of the ICS, and experts from the central bank. A decision was made to modify the internal regulations of GIRO Zrt. to ensure compliance with the amended provisions of Act XXIII of 2003 on Settlement Finality in Payment and Securities Settlement Systems.

The MNB authorised the amendment of GIRO Zrt.'s Operating Rules and Fee Schedule in December, allowing the company to handle insolvency proceedings more effectively and reducing the fee for settled basic transactions by HUF 1.

Securities clearing and settlement system

As of 1 January 2013, KELER KSZF is in charge of the clearing activities defined by Act CXX of 2001 on the Capital Market (Capital Market Act) on guaranteed markets, taking over the function from KELER. The Hungarian Financial Supervisory Authority issued the authorisation necessary for assuming the function, taking into consideration the MNB's statement as special authority.

The amendment of the Capital Market Act in June 2013 marked the conclusion in Hungary of the first phase of the legal harmonisation process related to Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories. In the context of the first phase of the legal harmonisation process, the central bank presented a detailed implementation proposal package to the Ministry for National Economy on legal harmonisation between European Union and Hungarian financial legislation. This continuous cooperation between the central bank and the ministry contributed to achieving complete compliance with European legislation.

The operations of KELER KSZF called for renewed licencing in order to comply with EMIR, conditional to notification on the qualification of KELER KSZF as a designated system pursuant to Directive 98/26/EC. The company submitted its designation application to the MNB and its licencing application to the HFSA, based on which the MNB designated KELER KSZF as system operator under Act XXIII of 2013 on Settlement Finality for the clearing of transactions concluded on the Budapest Stock Exchange's spot market, the BÉTa market and the MTS securities market, and designated the systems run by it performing the clearing of the transactions on the abovementioned markets as systems coming under the scope of Act XXIII of 2013 on Settlement Finality. Re-licencing of the company began in 2013 Q4 and is set to finish in 2014 Q1.

The central bank issued a total of 16 statements as a special authority by 1 October 2013 to the Hungarian Financial Supervisory Authority in relation to the amendment of KELER's Fee Schedule and General Operating Rules. The amendments were required due to the introduction of the financial transaction duty; the rollout of KELER's Wide Application Order Routing Platform supporting the trade and clearing of mutual fund shares; the launch of the re-licencing procedure in the wake of the entry into force of EMIR and the application of the umbrella term of structured products used by the Budapest Stock Exchange into KELER's documentation.

Continuous Linked Settlement (CLS)

In 2013, the MNB initiated talks on the introduction of the forint in the Continuous Linked Settlement clearing and settlement model. The model offered by CLS Bank International allows mitigation of the settlement risk associated with foreign exchange transactions using a 'Payment-versus-Payment (PvP)' settlement service. The MNB hosted a forum on 17 June with the participation of experts from CLS Bank International, the MNB and the Hungarian banking sector in order to reinforce professional cooperation and present the benefits and process of joining CLS. Based on the experiences, the central bank conducted bilateral consultations with several banks in 2013 Q3 on the introduction of the forint in CLS. The objective of the consultations was to allow the MNB to gain insight on the opinion of key foreign exchange market players in Hungary regarding accession and their intentions regarding the future use of the system.

Miscellaneous Information

The *Report on Payment Systems* was published for the second time in 2013. The Report provides a comprehensive overview of the trends and emerging risks in payments and the functioning of overseen payment and securities settlement systems in Hungary, and presents any measures taken by the MNB to foster the smooth functioning of payments and the reliable and efficient operation of the payment and settlement systems supporting them.

The article entitled *The effects of the introduction of the intraday credit transfer* published in January's MNB Bulletin presented the initial experiences in the wake of the introduction of intraday credit transfers on 1 July 2012.

The central bank held two presentations at the *Kártyapiac 2013* conference held on 26–27 March on the most recent developments of the Hungarian payment system and card market, and on central bank recommendations for the development of bank card infrastructure. The central bank held a presentation entitled *'The role of the MNB in the development of payments'* at the Pénzügyi IT (Financial IT) conference hosted by Portfolio.hu on 19 September.

In the context of the European Commission's Technical Assistance and Information Exchange (TAIEX), a series of presentations was held on 28 March for the payments experts of the Bank of Albania. The conference series, organised by the Ministry for National Economy, featured speakers from the Hungarian Financial Supervisory Authority and payments regulation and supervision experts from the central bank.

3.5. MANAGEMENT OF FOREIGN EXCHANGE RESERVES

Objectives of holding reserves

Similarly to other central banks, one of the most essential tasks of the MNB, as stipulated in the MNB Act , is the management of Hungary'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 monetary policy (ensuring intervention capacity and the banking system's foreign exchange liquidity);

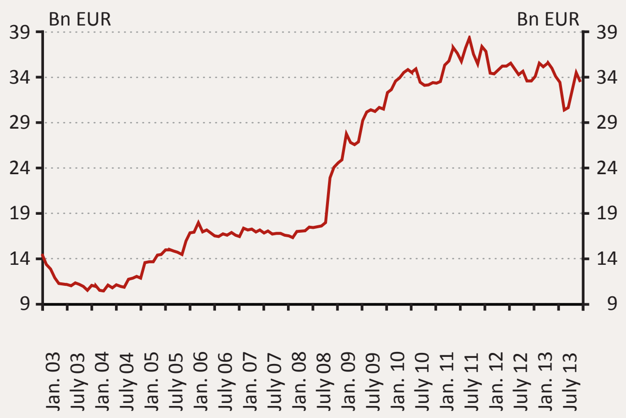
– to provide foreign exchange required for transactions (supporting government debt management, satisfying the Government's foreign currency payment obligations, etc.).

Market participants have been monitoring developments in foreign exchange reserves even more closely than before. The MNB itself regularly reviews the desired level of reserves and, as required and so far as possible, takes measures to ensure the appropriate level. Overall, in the course of 2013 reserves satisfied the role of 'international collateral'.

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

In terms of transaction goals, servicing the management of government debt continued to be the most important objective last year. In this regard, continuous provision of the foreign currency needs of budgetary organisations should also be considered. Transfers from the European Union are also received through the MNB. These transfers have been significant sources for the accumulation of reserves in recent years – and will continue to be in years to come. In the course of 2013, these transaction goals were once again accomplished smoothly.

Chart 8
Changes in foreign exchange reserves



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

Amount of reserves

With a decrease of EUR 98.8 million during the year, the official foreign exchange reserves amounted to EUR 33.8 billion at the end of 2013.

The main outstanding debt repayment items reducing the foreign exchange reserves were the repayment of the IMF loan in several instalments, totalling SDR 4.4 billion, as well as maturing bonds with face value of EUR 1 billion on 6 February, JPY 50 billion on 15 March, CHF 150 million on 21 May and USD 200 million on 1 November. Other debt management items and orders from budgetary institutions further reduced the reserves by EUR 1.4 billion. Similarly to earlier years, the most significant item increasing the reserves were incoming funds from the European Union, which amounted to EUR 4.7 billion in 2013. The Government Debt Management Agency issued bonds with 5- and 10-year maturities in February and November in a total amount of USD 5.25 billion. The own return on foreign exchange reserves was EUR 60 million. A total of EUR 568 million was paid out in the context of the FGS in 2013.

Performance and financial risks of foreign exchange reserves

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

The most important risk categories associated with the management of foreign exchange reserves are market risk, liquidity risk, credit risk and counterparty risk. The MNB applies limits to mitigate the financial risks related to the management of foreign exchange reserves. In line with the conservative reserve policy typical of central banks, in its reserve management the MNB applies a strict limit system, which takes account of market and other indicators as well, in addition to the required high-level credit ratings.The Monetary Council is the supreme decision-making board in respect of the management of foreign exchange reserves. Accordingly, it sets targets and requirements in relation to foreign exchange reserves, such as the reserve level and liquidity, makes decisions on numéraire, risk-taking strategy and the main strategic numeric parameters of reserve investments. The powers of making operational decisions are exercised and the foreign exchange reserve management strategy is implemented by the Executive Board within the frameworks specified by the Monetary Council. The Executive Board approves the limit system: the maximum deviations of risks of reserve portfolios permitted vis-à-vis the benchmarks, the partner limits and the scope of investment instruments permitted in reserve management.

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

As a consequence of the financial crisis, the role of the various risk-reducing instruments became more significant than before, with particular emphasis on contracts regulating financial market transactions and their execution. The MNB continued to conclude credit support (collateral) arrangements (Credit Support Annexes - CSA) attached to the standard master agreement elaborated by the International Swaps and Derivatives Association (ISDA) with its counterparties during the year, and operated continuously with collateral provided under the contracts concluded with the key counterparties over the past period. The execution of CLS-enabled FX transactions through the Continuous Linked Settlement (CLS) system complies with the majority of market standards, allowing the mitigation of counterparty risk. The settlement risk of FX transactions settled through the CLS system is much lower, which is of the utmost significance for the MNB due to the large-volume foreign exchange swap portfolio required for keeping the foreign exchange benchmark.

Starting from February 2012, the MNB built two index-tracking portfolios: one is denominated in pound sterling and the other in Japanese yen. However, the MNB undertakes exchange rate exposure only in euro, covering the risk of the foreign currencies/euro cross rate with derivative instruments. Holding other foreign exchange assets with exchange rate coverage is justified by the need to achieve a higher level of diversification and, in the case of the dollar, to provide increased liquidity. In addition to the index-tracking portfolios, the MNB actively manages five other euro and dollar portfolios, similarly to the previous year. In dollar, it holds a money market and an investment portfolio, and in euro it holds a so-called credit risk free portfolio and an investment portfolio in addition to the money market portfolio. The MNB manages the pound sterling and yen portfolios as index-tracking portfolios, with strict tracking of the benchmark. Furthermore, from end-2012, the MNB added U.S. agency mortgage-backed securities (MBS instruments) to its investment strategy in the form of a mandate given to an external asset manager and a custodian. The strategic target duration of the reserve portfolios was around one year.

The credit risk free euro portfolio, which constitutes the majority of the foreign exchange reserves, consists exclusively of high-rated government papers, high-rated government guaranteed securities and issuances of international (supranational) institutions. 100 per cent of the benchmark portfolio consisted of AAA to AA-rated euro-area government securities. In addition to the above, the euro investment portfolio can only include high-rated corporate and bank issuances as well as collateralised securities; in this portfolio, government securities typically serve the purpose of adjusting the maturity structure. Accordingly, the benchmark of the investment portfolio reflects of the performance of a broad range of euro-denominated market issuances with a high credit rating.

The benchmark of both the euro and the dollar-denominated investment portfolios contains high-rated government securities, corporate and bank bonds as well as money and capital market assets with a maximum remaining maturity of 7.5 years. The composition of the benchmark portfolios according to the credit ratings of assets and residual maturity reflects the conservative risk appetite typical of central banks.

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 an environment of falling yields due to the global crisis that unfolded from 2008, central banks broadly achieved profits on their foreign exchange reserves based on the generally rising prices of the bonds managed in central bank portfolios. The MNB also benefited from this process through its revalued position stemming from the high credit quality government and other bonds handled in its portfolios in the context of a decreasing yield environment. However, last year the opportunities for further revaluation gains narrowed, in light of the yield environment approaching zero, which explains its weaker performance compared to previous years. The uncertainty characterising the monetary policies of the main global central banks (Federal Reserve, ECB) in 2013 and the gradual reduction of monetary easing in the US announced at the end of the year also worked against central bank income, mainly through the rise in yields on longer maturities. Despite to the low yield environment, both in absolute terms and relative to the comparable benchmarks, the Bank achieved positive performance in 2013 with the foreign exchange reserves. The liquidity required for the achievement of monetary policy objectives was available throughout the year, with no credit risk incidents adversely affecting the reputation of the MNB. The annualised – weighted with market value and adjusted for costs of financing – yield achieved on foreign exchange reserves in 2013 was 0.2 per cent, outperforming the benchmark by 12 basis points.

As regards the future performance of the foreign exchange reserves, there is still a risk of the performance of reserve portfolios turning negative if the extremely low level of yields on high-rated instruments shifts in the wake of rising yields, which may undermine reserve performance as a result of the revaluation loss stemming from price declines on current bonds.

Chart 10
Breakdown of banknotes in circulation by number as at end-2013

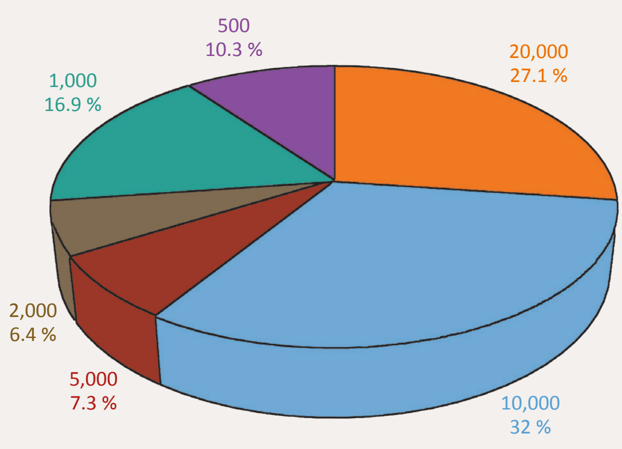
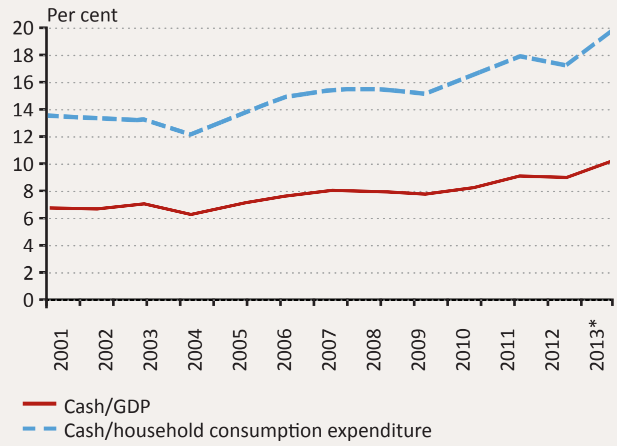


Chart 9
Cash/GDP and cash/ household consumption expenditure



**The 2013 GDP data and the data of household consumption expenditure are MNB estimates.*

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 57 million at the end of 2013 (95 per cent confidence level VaR over a one-month time horizon). The EUR 57 million Value at Risk represents approx. 2 thousandths of the reserve portfolio value.

3.6 CASH LOGISTICS ACTIVITIES

Currency in circulation

On 31 December 2013, the value of currency in circulation amounted to HUF 3,189 billion, up by 17 per cent, i.e. HUF 467 billion, compared to the end of the previous year.

Currency in circulation registered in HUF increased dynamically and exceeded 10 per cent of GDP at the end of the year. The increase in currency in circulation presumably stems mainly from the fall in deposit rates in the past year – parallel with a falling inflationary environment – and therefore the interest loss on currency holdings fell to a historical low. This fact led to lower incentives for households to invest their savings in interest-bearing assets. The fact that the rise in currency in circulation mainly affected the two largest denominations also suggests an increase in propensity to save in cash. In addition, changes in the regulatory environment may also have affected the rise in currency in circulation.

The volume in circulation in 2013 increased by 24 per cent for the HUF 20,000 denomination, by 10 per cent for the HUF 10,000 denomination, 3 per cent for the HUF 5,000 denomination, 7 per cent for the HUF 2,000 denomination

Table 5
Quantity and value of banknotes and coins in circulation on 31 December 2013

Banknotes	Volume (Million pieces)	Value (Billion HUF)	Ratio (%)	
			Volume	Value
20,000 forint	90.8	1,816.9	27.1	58.0
10,000 forint	107.5	1,074.4	32.0	34.3
5,000 forint	24.4	122.2	7.3	3.9
2,000 forint	21.6	43.1	6.4	1.4
1,000 forint	56.6	56.6	16.9	1.8
500 forint	34.4	17.2	10.3	0.6
Total	**335.3**	**3,130.4**	**100.0**	**100.0**
Coins	**Volume (Million pieces)**	**Value (Billion HUF)**	**Ratio (%)**	
			Volume	**Value**
200 forint	102.4	20.5	7.6	39.8
100 forint	147.3	14.7	10.9	28.7
50 forint	126.8	6.4	9.4	12.3
20 forint	240.5	4.8	17.9	9.4
10 forint	284.1	2.8	21.1	5.5
5 forint	446.5	2.2	33.1	4.3
Total	**1,347.6**	**51.4**	**100.0**	**100.0**

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

and 5 per cent each for the HUF 1,000 and HUF 500 denominations compared to end-2012.

The two highest denominations continued to dominate in the volume of cash, accounting for over 59 per cent of the total number of banknotes in circulation at the end of 2013. The reason for this is that besides their payment function they also have a wealth accumulation function, and they may play a key role in the operation of the illegal economy as well.

On the whole, the volume of coins in circulation was 5 per cent higher than in the previous year, with the volume of HUF 200, 50 and 5 coins increasing the most.

Cash distribution

In 2013, the MNB handled cash turnover in an amount of HUF 3,248 billion and provided 241 million banknotes to its account-holding clients, i.e. credit institutions and the Hungarian Post Office. At the same time, 209 million banknotes were delivered to the Bank.

Last year, the MNB qualified some 67 million banknotes as unfit for circulation and replaced them with new, high quality banknotes.

The MNB's cash controlling activity

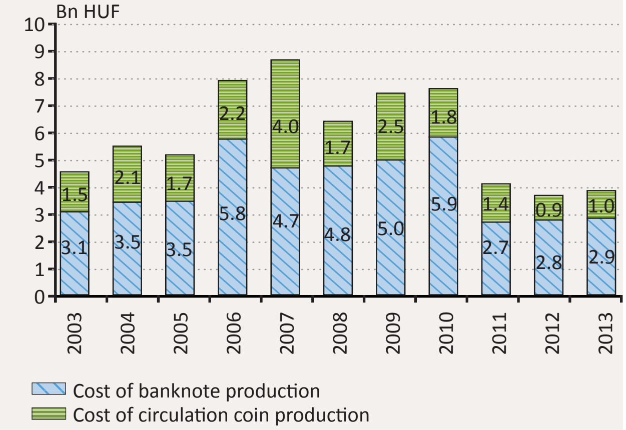
Credit institutions, the postal services and professional cash logistics service providers using up-to-date banknote processing technology play an increasingly crucial role in the reintroduction of banknotes into currency in circulation. The central bank conducts regulatory inspections with a view to ensuring the adequate quality of currency in circulation and maintaining the safety of cash circulation. The inspections conducted in 2013 focused on the following subject areas to assess compliance of cash distributing institutions and other economic agents with legislative requirements:

- verification of the authenticity and fitness of banknotes,
- verification of HUF banknotes distributed via banknote dispensers (ATMs),
- elaboration of action plans for handling emergencies affecting the distribution of cash,
- furnishing UV–A and UV–C lamps to credit institution and postal cash offices.

To ensure that cash payment services (exchange of denominations, management of incomplete banknotes) provided to household customers are of high quality, the MNB carries out regulatory inspections.

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

Chart 11
Production of banknotes and coins in circulation
(gross cost)



Banknote and coin production

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

In 2013, the cost of cash production was a gross amount of HUF 3.9 billion, which is almost 5 per cent more compared to the previous year.

In 2013, the average production cost of one banknote was gross HUF 57 and that of one coin amounted to gross HUF 32.

Prevention and reduction of counterfeiting

The counterfeiting of forint banknotes in 2013 followed the trends of previous years; the 2,448 counterfeit notes identified and removed from circulation in 2013 represents an 8 per cent decrease compared to 2012.

Chart 12
Developments by year in the number of counterfeit banknotes removed from circulation

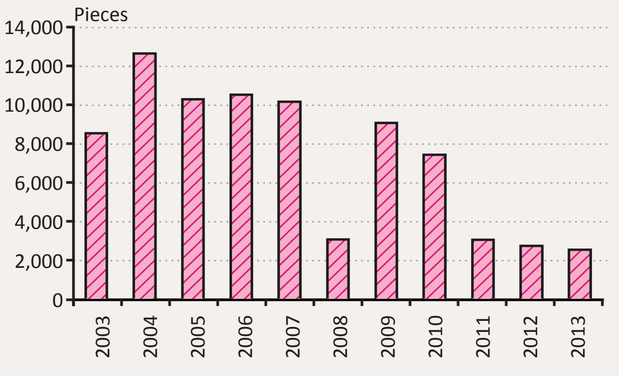
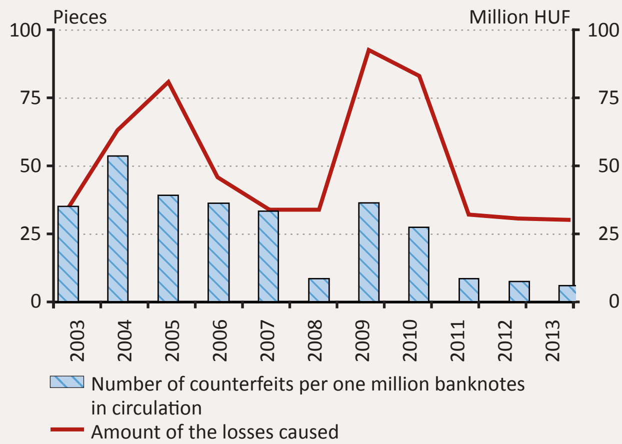


Chart 13
Changes in the number of counterfeits per one million genuine banknotes and the amount of losses caused



Accordingly, the number of counterfeit banknotes in circulation per 1 million genuine banknotes fell from 9 (2012 figure) to 7. The amount of loss caused by counterfeit banknotes decreased slightly to HUF 30 million in 2013. These data, positive even by international standards compared to countries with national currencies, are partly the outcome of the safeguards against typical forms of counterfeiting included on forint banknotes and partly of the MNB's awareness-raising efforts. In this context, the MNB's experts held direct training for nearly 4,000 cash register handling workers employed in commerce in 2013.

In line with the trends of recent years, the majority of counterfeit forint banknotes were higher denominations of HUF 10,000 and 20,000, which accounted for more than 80 per cent of total counterfeits.

No major changes occurred in counterfeiting methods, which are still characterised by the use of office reproduction equipment (colour photocopy machines and printers). The counterfeit banknotes, which may seem deceiving at first glance, can be easily identified using simple measures (touch, holding the banknote up to the light or moving it), or with UV–A or UV–C lamps.

The occurrence of counterfeit currencies fell by 16 per cent compared to 2012 and remains marginal. Central bank experts examined 1,203 counterfeit currency specimens in 2013. Of these, 925 were counterfeit euro banknotes, representing a 17 per cent decrease.

The exchange of 1 and 2 forint coins by the central bank has come to a close

On 1 March 2008, the MNB withdrew 2-forint and 1-forint coins from circulation. This step has generated significant

Table 6
Discovered counterfeit HUF banknotes in a breakdown by denomination in 2013

Denominations	500	1,000	2,000	5,000	10,000	20,000
Breakdown (%)	6.5	0.7	1.8	9.5	45.3	36.2

savings for the national economy (HUF 3-4 billion annually), and has also yielded a profit of HUF 2.1 billion on the withdrawal. The coins could be exchanged for legal tender until 28 February 2013.

The proportion of returned 1-forint and 2-forint coins in the five years since the announcement of their withdrawal is 24 per cent and 36 per cent, respectively, of their initial quantity, which is higher in international comparison than is customary for coins of such value. This is mainly the result of collections held by charity organisations.

Issue of commemorative coins

Under the MNB Act, the MNB has exclusive rights to issue banknotes and coins in the official currency of Hungary, including commemorative banknotes and coins which are also legal tender. The central bank issued eight coins in the context of its commemorative coin programme in 2013.

Continuing the 'Intangible Cultural Heritage' collector series, the MNB issued a silver commemorative coin called the 'Hungarian Táncház (dance-house) Method' in February 2013 to celebrate the addition of the method to the UNESCO's intangible and cultural heritage list in 2011. The movement received its certificate in 2012. The series was launched by the central bank in 2011; that year, the Busó festivities in Mohács were inscribed on the UNESCO's representative list. In June 2013, the central bank issued the 100th Anniversary of Birth of Sándor Weöres silver coin with a face value of HUF 5,000 as part of both the 'EUROPA' international collector series and the 'Hungarian Literature' collector series.

In commemoration of the 150th anniversary of the birthday of Géza Gárdonyi, a HUF 1,000 denomination copper alloy commemorative coin was issued by the central bank in August. The collector coin 'Géza Gárdonyi: Eclipse of the Crescent Moon' was issued as part of the 'youth literature' series. Earlier elements of the series paid homage to the following works: Sándor Petőfi: Sir John (2001); Ferenc Molnár: The Paul Street Boys (2001); János Arany: Toldi (2001); Mihály Fazekas: Lúdas Matyi (2001). Also in August, the second element of the 'Medieval Hungarian Gold Florins' was the issue of the Gold Florin of Louis I, a gold commemorative coin with a face value of HUF 50,000 both in 'standard', i.e. its original size, and in a so-called 'piedfort' version, which is four times the weight of the original.

Another four commemorative coins were issued in autumn of 2013. The silver commemorative coin celebrating the 200th anniversary of birth of statesman and writer József Eötvös, with a face value of HUF 3,000, and the '2014 FIFA World Cup Brazil' commemorative coin, part of the FIFA World Cup 2014 international collector series and the first forint-denominated football commemorative coin issued by the central bank. The gold coin commemorating the 100th anniversary of the birth of Robert Capa, is the fourth element of 'The smallest gold coin of the world' international collector series, and has a face value of HUF 5,000. Finally, on 11 November, as the second installation of the 'Hungarian Nobel Laureates' series, the central bank issued commemorative silver coins paying homage to Jenő Wigner, with a face value of HUF 3,000.

3.7 STATISTICAL SERVICE

Based on the authorisation granted by the MNB Act, along with its fundamental tasks, the Magyar Nemzeti Bank also collects statistical information as of 1 October 2013 for fulfilling its financial intermediary system supervisory tasks and publishes the statistics generated using this information.

The MNB prepares and publishes monetary, balance of payments and related international investment position, financial account and securities statistics, statistics on financial stability as well as time series on prices, exchange rate statistics, financial stability, the macroprudential and financial intermediary system on its website, for the most part according to the published release calendar. The MNB also publishes methodological documents related to the individual statistical areas.

Five MNB decrees were issued in 2013 regarding data supply in 2014: MNB Decree 23/2013 (XI. 6.) primarily defines data supply for the MNB's fundamental tasks, while the other four MNB decrees prescribe data supply for supervisory functions [MNB Decrees 37/2013 (XII. 29.), 38/2013 (XII. 29.), 42/2013 (XII. 29.) and 43/2013. (XII. 29.)].

MNB Decree 20/2012 (X. 15.) on data supply in 2013 was supplemented by virtue of MNB Decree 8/2013 (V. 27.) with two additional data supply requirements to compile data on the FGS.

The impact of integration on statistical activity

The termination of the Hungarian Financial Supervisory Authority and the full integration of supervisory functions and powers over the entire financial intermediary system into the MNB's organisational system from 1 October 2013 also generated new, long-term statistical tasks for the MNB. The supervisory statistical tasks were added to the MNB's statistical activity. Two priority statistical projects were launched in the wake of the integration. The objective of the priority project entitled 'Integration of statistical and supervisory data collection' was to harmonise and integrate data collection and to create a modern, new data collection model of European standard over the long run. The project entitled 'Integration of statistical and supervisory IT systems' aims to integrate parallel IT systems and to create a unified data reception system and data warehouse supporting micro and macro prudential supervisory functions and analyst needs, alongside the adjustment of the current statistical IT systems allowing the reception and processing of data defined in the new data collection model.

One key task in 2013 for the MNB related to the integration was to lay the groundwork for the introduction of reports with unified content and form at the European Union level. The Implementing Technical Standards on Supervisory Reporting (ITS) coming directly into force in member states will require unified data supply across the European Union. The unified reporting scheme applicable from 2014 is linked to new prudential regulation system governing credit institutions and investment firms effective from 1 January 2014, related to Regulation (EU) No. 575/2013 of the European Parliament and of the Council. The establishment of a new reporting scheme for insurance corporations will form part of the Solvency II project.

Preparation for changes in statistical methodology

In line with other EU member states, the MNB will implement the changes stemming from the new international methodological standards in its balance of payments statistics and financial accounts statistics from summer 2014. Similarly to previous years, preparations for the application of the new methodological standards was a key area within the MNB's statistical activity. In this context, methodological consultations with the Hungarian Central Statistical Office (HCSO) were finally concluded in 2013, and the modification of the affected statistical data collections and data processing systems were essentially wrapped up.

In line with the surveys, two new central bank data collections were introduced in 2013, and minor changes were implemented in a few data collection items in order to meet the data requirements of the new methodological standards. MNB Decree 23/2013 (XI. 6.), primarily stipulating the supply of data in 2014 required for the MNB's fundamental tasks, amends one more data supply as of 2014 due to the methodological change.

In the quarterly publications on the balance of payments statistics, asset portfolio restructurings, which predominantly appear as direct investment – besides capital flows which do not directly affect the external financing of the national economy (capital in transit) – were published separately, as well as foreign direct investment time series adjusted for these items.

VAT registrations handled on an ad-hoc basis were further expanded in the context of ongoing cooperation with CSO – in line with national accounts – and all modifications have been applied retroactively extending back to 2010.

In the field of monetary statistics, the decision was made that the MNB Decree would only be amended in 2015 due to the new ECB data requirements. Some of the new data requirements are already included in monetary statistics, with the remainder being estimates for 2013. New requirements with more detailed breakdowns and interest statistics will be implemented from 2015. A new balance structure has been implemented in publications from 2014, in keeping with international standards.

International data reporting and cooperation

The MNB complied with all of the reporting obligations pertaining to EU Member States in 2013. Accordingly, it provided regular data supplies to the statistical office of the European Union (Eurostat), the ECB, and the Bank of International Settlements (BIS). In accordance with its status as a central bank, and in line with the expectations arising from international cooperation as well as its membership obligations, the MNB provides data and information on a regular basis to the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Co-operation and Development (OECD). The MNB played an active role in international statistical working groups in 2013 as well.

3.8 MNB ACTIVITIES AIMED AT IMPROVING THE FINANCIAL LITERACY OF CITIZENS

One key element of the efforts aimed at the enhancement of financial literacy was the publication entitled 'Money talks - Do you understand?', issued again in 2013, also recognised by a survey of the European Commission, which was handed out to all, that is nearly 1,200 secondary schools in Hungary. The publication introduces students to the world of daily finances, presenting in plain language the key financial products and services that younger generations can expect to handle around the age of 17–18. The publication was handed out to some 112,000 11th grade students, and online educational material and a quiz for testing the knowledge acquired helped schools in processing the survey.

The MNB's Visitor Centre had hosted nearly 20,000 visitors by the middle of October 2013, many of whom took part in the programmes created to foster economic knowledge and financial literacy. Information dissemination programmes such as the Open Days held in May, the Night of the Museums held in June and public events linked to the National Heritage Days in September also contributed to promoting the establishment. The Visitor Centre also took part in local programmes at three events: May Day of Museums (with 1,000 attendees), the City Park Children's Day of the International Service for the Safety of Children (with 3,000 attendees). The public information dissemination programme held in the context of the Researchers' Night at the University of Miskolc also drew in thousands of people.

The Mobile Training Area is a new addition to the toolset used to enhance citizens' financial literacy, and accompanied the roadshow presenting the FGS in Miskolc and Debrecen, hosting nearly 300 secondary school students.

The MNB also provided funding for several local financial literacy development events. In this context, it helped in the execution of the awareness-raising campaign coordinated by the Hungarian Banking Association, aimed at presenting the exchange rate cap scheme created to help consumers with foreign currency mortgage loans, and also assisted in hosting the series of lectures on financialliteracy organised by the Federation of Economic and Scientific Societies at the University of Sciences of Pécs, attended by some 200 students.

Through the Foundation, established at the MNB's initiative, the central bank continued to offer professional and financial support to the Financial Education Programme (POP), which is intended to improve financial literary among secondary school students. A total of 69 secondary schools joined the programme during the 2012–2013 school year, representing 3,300 students and more than 113 teachers. Nearly 12,000 students and 300 teachers took part in the programme during the past five concluded programme years.

Spring 2013 saw the launch of a unique, comprehensive financial attitude-forming and information programme created through the exemplary partnership of the public sector and nearly two dozen financial institutions. The Financial Compass Programme, created under the supervision of the MNB and the HFSA and in cooperation with a consortium formed by several leading media firms in Hungary, gives regular access to nearly 5 million people. The programme aims to enhance financial culture in Hungary, to promote self-provision, responsible financial decision-making by citizens and to boost demand for financial products and services. In the context of the 12-month programme, nearly 450 articles and independent editorial pieces were published in 18 media outlets in 2013, presenting practical financial knowledge applicable in everyday life in different topics every month. As part of the programme, a website showcasing published content and related applications was also created (http://www.penziranytu.hu).

3.9 FACTORS SHAPING THE COMMUNICATION OF THE MNB

The communications of the MNB in 2013 were shaped by significant personnel, institutional, organisational and approach-based changes, resulting in a renewed and more intensive external representation overall. Greater emphasis was placed on measures and tasks supporting the more efficient operation of the central bank, fostering economic growth in Hungary and serving broad social interests. A transformation in quality was implemented in the Hungarian and international relationship network of the new central bank management. The choice of the right communication tools enhanced the presence of the MNB's professional activity in public opinion in a planned and more targeted manner than in the past.

Thought and action supportive of Hungary's economic growth has been established, as was clearly expressed in the Bank's communication. Communication in 2013 mainly comprised information on the FGS geared towards supporting SMEs in the form of press releases, online articles, presentations and radio and television interviews. News updates were continuously released on the objectives, features, scheduling and product information material specifying the detailed terms of the FGS, changes in terms, the extension and fine-tuning of funding options, the specification of credit objectives, national professional consultations promoting the scheme and consultations held with the financial and business sectors.

One key event was the integration of the Hungarian Financial Supervisory Authority into the central bank on 1 October 2013, in the context of which the protection of vulnerable consumers was made a priority, alongside organisational streamlining. The MNB also took action against unfair commercial practices and deficient, inaccurate or misleading information in the form of notices. Information on targeted inspections received positive feedback, as did the stricter market surveillance measures and fines implemented against infringing conduct. The MNB launched an article series on foreign currency loans held by households in order to establish an adequate set of criteria for resolving the issue. The rules of publication also changed in the wake of the integration of supervisory functions and powers into the MNB.

Information is regularly published on the Monetary Council's decisions, macroeconomic developments and monetary policy assessments. Replacing the former quarterly publication, the MNB now publishes core inflation measures on the working day following publication of the consumer price index statistics by the Central Statistical Office.

As part of this renewal process, a new logo and design was introduced on 20 August, to better represent the new management and values of the MNB. All communication mediums featuring the logo, along with the Bank's website and all publications were given a new, more transparent design.

3.10 THE MNB'S INCOME IN 2013

In 2013, the Magyar Nemzeti Bank earned a profit of HUF 26.3 billion. The financial result and balance sheet structure of the Bank are primarily determined by the domestic and international macroeconomic developments and the objectives and selected measures of monetary policy. In 2013, the following main developments had an effect on the balance sheet and the profit/loss:

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

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

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

– changes in the forint exchange rate.

The net interest and interest-related losses amounted to HUF 49.4 billion, improving by HUF 104.2 billion compared to one year earlier. The MNB's net interest loss stems from the MNB financing its foreign exchange reserves, which

Table 7
Abbreviated income statement and individual balance sheet items of the MNB

HUF billions

No.	Description (P/L line)	2012	2013	Change
1	Net interest and interest related income (I+II)-(X+XI)	-153.6	-49.4	104.2
2	*- net forint interest and interest related income (I-X)*	*-341.2*	*-231.4*	*109.8*
3	*- net foreign exchange interest and interest related income (II-XI)*	*187.6*	*182.0*	*-5.6*
4	Realised gains/losses arising from financial operations (IV-XIV)	-33.2	-112.6	-79.4
5	Income arising from exchange rate changes (III-XII)	158.3	200.3	42.0
6	Other constituents of net income* (V+VI+VII+VIII)-(XIII+XV+XVI+XVII+XVIII)	-11.3	-12.0	-0.7
7	**Profit/loss for the year (1+4+5+6)**	**-39.8**	**26.3**	**66.1**
	Revaluation reserves in the balance sheet			
8	*- due to unrealised foreign exchange gain/loss*	*564.0*	*509.6*	*-54.4*
9	*- due to changes in the market value of the foreign currency securities*	*-30.2*	*-91.1*	*-60.9*

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

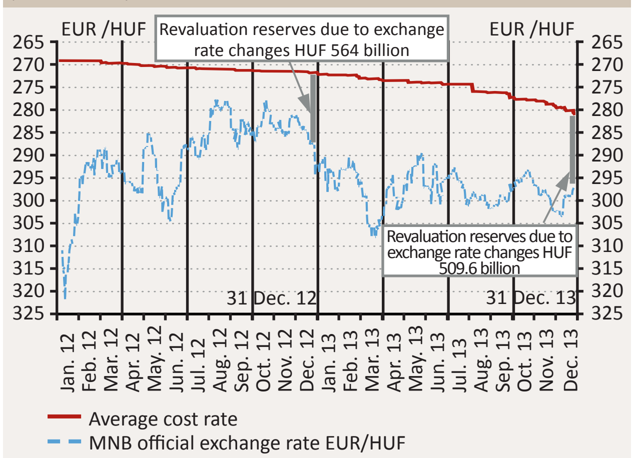
account for more than 90 per cent of its balance sheet total, predominantly from forint sources, and foreign exchange yields are lower than the average forint interest rates. The improvement in net interest income in 2013 resulted primarily from the narrowing gap between yield levels.

Net forint interest and interest-related losses amounted to HUF 231.4 billion, HUF 109.8 billion less than in 2012. The average central bank base rate weighted by calendar days was 240 basis points lower in 2013 than in the previous year. Forint liabilities where interest-bearing is pegged to the base rate (forint deposits of the central government, minimum reserves and liquidity absorbing instruments) rose over the year. The improvements in net interest income resulted from the falling base rate.

Net foreign exchange interest and interest-related profit amounted to HUF 182 billion, which was HUF 5.6 billion less than a year earlier, primarily owing to the lower interest income on foreign exchange reserves. The level of the reserve expressed in euro increased with minor fluctuations during the year, while euro yield levels continued to decline. As a result of the prepayment of the IMF loan, interest paid in foreign exchange was also lower.

The realised total loss arising from financial operations amounted to HUF 112.6 billion. This category of P&L mainly states gains and losses realised from changes in the market prices of securities included in the FX reserves as well as realised gains or losses on Hungarian government bonds and mortgage bonds in the case of maturing instruments or the sales of instruments. Fixed-income, high-coupon securities represent a substantial proportion of foreign exchange reserves, continuously earning above-market interest income. These securities are purchased above par value,

Chart 14
Changes in the forint exchange rate
(inverse scale)



incurring a loss upon maturity or sale. This is the reason behind the realised total loss on financial operations.

The two main factors determining income arising from exchange rate changes are the difference between the official and the cost rate, and the volume of foreign exchange sales. In 2013, the forint exchange rate was generally weaker than in 2012, therefore the difference between the official and the cost rate rose by HUF 3 on average for the year. The volume of foreign exchange sales was higher than in the previous year, which was required mainly due to the payment of the instalments of the IMF loan raised by the Hungarian government and the maturity of foreign currency bonds. In the course of the year, the exchange rate gains earned by the MNB amounted to HUF 200.3 billion, which was the Bank's most significant profit item in 2013 again.

Other constituents of net income include revenues from supervisory activity as a new item; this row also contains the general operating income, costs and expenses, costs of issuing banknotes and coins, creation and release of provisions, and income/expenses from fees and commissions and other income/expenses. Net expenses rose by HUF 0.7 billion in 2013.

The MNB's equity amounted to HUF 464.6 billion at the end of the year. Equity was basically shaped by the level of revaluation reserves – mainly by the reserves due to exchange rate changes – and the annual profit/loss also contributed to changes in the amount of equity.

Revaluation reserves due to exchange rate changes fell by HUF 54.4 billion compared to the end of 2012. This was because the difference between the official and the average cost rates was lower at the end of 2013 compared to the previous year. On 31 December 2013, the closing value of revaluation reserves due to exchange rate changes was HUF 509.6 billion.

On 31 December 2013, the MNB's balance sheet showed unrealised losses of HUF 91.1 billion on foreign currency securities marked to market, partly in connection with the aforementioned high-coupon securities, which was reflected in the revaluation reserves of foreign currency securities.

3.11 FINANCIAL PERFORMANCE OF THE MNB

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.

Operating costs amounted to HUF 14,352 million in 2013, which was 23.2 per cent (HUF 2,704 million) higher than in

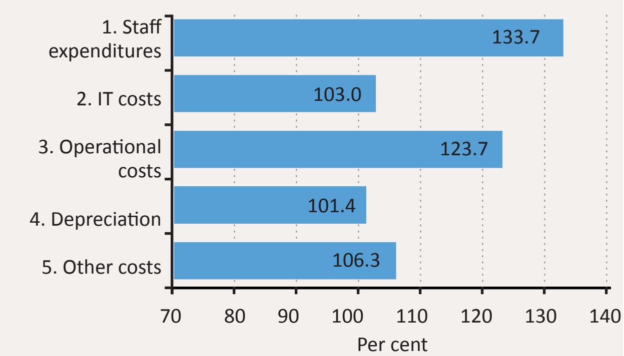
Table 8
Operating costs of the MNB in 2013

Description	2012	2013	Index (2013/2012)
	HUF millions		%
1. Staff expenditures	6,791	9,076	133.7
2. General operating costs	4,858	5,277	108.6
Total	**11,648**	**14,352**	**123.2**

2012. The growth compared to the previous year was mainly the result of the MNB-HFSA integration, the implementation of which started from 1 October 2013, which mainly showed up in staff expenditures because of the higher number of staff (the statistical staff number rose by 502) and the cost and contribution implications of the termination of employment. General operating costs also rose, albeit to a smaller extent, basically as a result of the leasing and operating expenses of the Krisztina körút property (the former building of the HFSA).

The financially realised value of investments implemented in 2013, together with the advance payments made for investment purposes, was HUF 995 million, nearly 7 per cent lower than in the previous year. The main reason for this was that certain planned investments in connection with the future renovation of the central building were not implemented and that the majority of the banking security investments was not realised, since based on the banking security strategy accepted during the year these will form part of the developments to be realised in the following year(s). The value of capital expenditure in 2013 was also influenced by the fact that as a result of the efforts made to achieve lower prices, several assets were purchased at lower-than-planned prices. At the same time, advance payments related to property purchases arose as new items in 2013 compared to the previous year.

Chart 15
Ratio of operating costs in 2013 to actual data in 2012



Operating expenditures

Operating expenditures of the HFSA[4] Operating expenditures amounted to HUF 9,055 million in 2012 and HUF 7,154 million in January-September 2013, while after the integration of October 1, the expenses of the last quarter were incorporated into the costs of the MNB, accounting for the lion's share of the rise in the Bank's operating expenditures. At the same time, the revenues of the MNB increased in the wake of the integration.

Staff expenditures

Staff expenditures rose by an overall 33.7 per cent (by nearly HUF 2.3 billion) in 2013 (HUF 9,076 million) relative to 2012. Due to the MNB-HFSA integration, in 2013 the annual average number of staff was 146 higher (25 per cent) compared to the previous year. Costs incurred by quality replacements and labour force turnover also rose. In addition, the costs of 2013 were also increased by the 1.1 per cent general and the 0.5 per cent promotion-related salary increases granted at the beginning of the year and due to changes in the composition of staff compared to the previous year. The six-month remuneration paid to the former governor and deputy governor in 2013 after the expiry of their mandates pursuant to the MNB Act also represented extra costs compared to the preceding year.

General operating costs

In 2013, general operating costs (HUF 5,277 million) rose by 8.6 per cent in comparison to 2012. Facility operation costs increased to the largest extent.

General operating costs were HUF 312 million (23.7 per cent) higher than in 2012. The majority of this increase showed

[4] With content complying with the operating expenditures of the MNB i.e. without investments and expenses, but supplemented with depreciation.

up in property costs, primarily due to the expenses of the building at Krisztina körút for the fourth quarter (e.g. rent, public utility, property maintenance and cleaning costs), as a consequence of the MNB-HFSA integration. In addition, security guarding costs also exceeded the expenses of the previous year due to the employment of the guarding and fire inspection services of the Police Reserve Force during the year under a new contract. Advisory costs rose because of the costs of the studies prepared in 2013 in connection with the planned renovation of the building in Szabadság tér. In addition to property costs, expenses on stationery, administrative materials and vehicles as well as telephone and postage costs all exceed the level of the previous year, even if to a smaller extent, essentially due to the integration of the HFSA; on the one hand, in line with the increase in the number of staff, and on the other hand, due to the costs of communication and correspondence connected to the larger clientele of the HFSA.

Compared to 2012, **IT costs** and **depreciation** rose to an extent that was smaller than that of the general operating costs (by 3.0 per cent and 1.4 per cent, respectively), mainly due to the costs of the integration again (contracts and assets taken over by the MNB from the HFSA).

Other costs also grew compared to the previous year (by nearly HUF 45 million) as a result of several conflicting factors. Primarily due to the integration of the Supervisory Authority, membership fees, secondment and legal expert fees exceeded the level of 2012 but training costs decreased significantly by way of the savings achieved in the case of the various training and team building programmes. HR-related expert and advisory costs and the advertisement costs related to recruitment were also higher than in the preceding year.

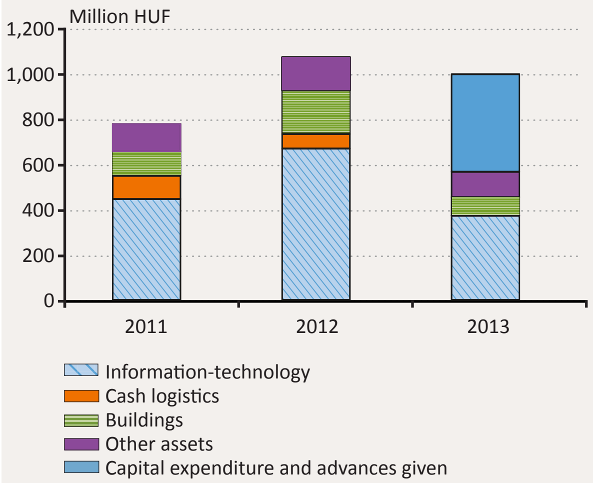
General operating costs were also reduced by the lease fee paid by Magyar Pénzverő Zrt. for using a part of the Logistics Centre, the operating costs of VIBER, and minor income from services related to welfare activities.

Capital expenditure

The capital expenditure budget for new investments in 2013 and investments with an updated value and schedule was HUF 1,156 million, taking account of appropriations for investments already in progress pursuant to earlier decisions. The MNB spent approximately half of the scheduled capital expenditure appropriations on the procurement of IT equipment.

The value of investments implemented in 2013, together with the advance payments made for investment purposes, was HUF 995 million, nearly 7 per cent lower than the value of investments in 2012. The reason for this was that certain

Chart 16
Trends in the MNB's capital expenditure



planned investments in connection with the renovation of the central building were not implemented and that the majority of the banking security investments was not realised since this will form part of the implementation of the banking security strategy accepted during the year. The value of capital expenditure in 2013 was also influenced by the fact that as a result of the efforts made by the cost bearers, several assets were purchased at a price lower than planned. Another contributor to savings was that some upgrades were carried out with a different technical content or were not implemented at all due to the interim changes in requirements. In addition, several extraordinary investments were realised, e.g. the advance payments related to property purchases in 2013, the development of the community space as well as the IT developments related to the Funding for Growth Scheme or stemming from the integration of the Supervisory Authority.

The majority of the capital expenditures implemented in 2013 were linked to upgrading IT infrastructure. Some of these expenses are made up of the advance payments related to the property purchases in 2013. Of the IT developments, the most significant was justified by the methodology change aimed at compliance with the international reporting obligations. The goal of the IT development tasks that arose in connection with the FGS is to enable the account management system to receive the data from the commercial banks and to transfer data for analysing and controlling purposes to the MNB's data warehouse. In the framework of the procurement of user workstations, the Bank purchased desktops and laptops to replace obsolete devices. The switch to a new version of the work process management software presented further significant expenses, with the purpose of improving system operation efficiency and making the new functions available in the process management applications. Some parts of the version upgrade to the Kondor+ sales system were implemented in 2013.

Of the investments related to properties, the most significant investment was to develop the community space in the building at Szabadság tér in 2013. Additionally, the upgrading and standardisation of the power distribution switchboards continued at the central building.

Personnel management at the MNB

In order to facilitate efficient and successful operations, the MNB regards personnel management as a strategic issue. To this end, in order to employ talented new staff members, to retain the current valuable workforce and to enhance their performance and maintain their motivation, the review of the systems affecting the staff of the MNB and their adjustment to the new central bank strategy was undertaken in several areas. Personnel management operations in 2013 were defined by the development of the future framework; its most important aspect was the transformation of the salary system, the integration of the HFSA and the development of the related new HR operations system.

Transformation of the salary system

A standard, clear and transparent salary structure forms an indispensable part of a well-outlined operating structure. It is based on the 'same salary for the same work and responsibility' principle. The transformation of the MNB's salary system was undertaken in light of this principle, according to the decision of the MNB's Executive Board. Thus, 75 per cent of the six-month bonus was automatically paid out to the employees who were entitled to it, in the first half of the year. With this, the bonus system was accounted for and derecognised.

As of July 1, 2013, the management of the MNB implemented a transparent salary system that is based on wages. Thus, nine salary bands were created.

Integration of the Hungarian Financial Supervisory Authority

Parliament passed Act CXXXIX of 2013 on the Magyar Nemzeti Bank on 16 September. This act terminated the Hungarian Financial Supervisory Authority and merged its functions into the MNB, and accordingly, starting from 1 October 2013, the latter supervises the money, capital and insurance markets and performs the HFSA's former consumer protection and market supervision functions.

According to the Act, the civil servants and staff of the HFSA were fully transferred to the MNB as of 1 October 2013. This meant the integration of hundreds of new staff members into the organisation of the central bank.

The Executive Board made the decisions on the changes affecting the organisational and operational structure and indispensable for smooth takeover prior to the integration, and also prepared the organisation of the MNB for receiving the new staff. The process and conditions of the takeover were regulated by Section 183 of the MNB Act, with tight deadlines. The takeover took place smoothly, in full compliance with the legal requirements which included the mandatory registration of staff with the tax authority, their inclusion in the corporate payroll system and the issuance of the documents related to their employment.

Developing the new operating framework for the Personnel unit

The MNB's new approach and attitude to the employees were not only expressed in the renaming of the HR organisational unit as the Personnel unit only but also in the expansion of the tasks. After the integration of the HFSA, the unit was transformed into the Personnel Directorate which has two divisions. In addition to the traditional labour, administrative and remuneration-related tasks, the development of the corporate structure and the staff became equally important.

Staff size and the utilisation of working hours

The average staff number of the MNB (727) was higher by 146 compared to the previous year. At the end of 2013, the total staff number of the MNB was 1,088, up by 515 compared to the end of 2012. The sharp quantitative difference between the average and the closing numbers of staff was caused by the HFSA integration, and thus the increased total number of staff is only represented in the annual average with a quarterly weight.

In 2013, 139 staff members were released, while 203 new employees were recruited for vacant or new positions, in addition to the 502 persons taken over in the context of the HFSA integration.

As regards the composition of staff by age, a slight increase can be observed: the average age of employees was 41.8 years in 2013.

Procurement

Similar to the other central banks in the European Union, the MNB conducts public procurement procedures in respect of acquisitions where the value reaches the value limits of international public procurements. The MNB is subject to the public procurement authority based on Commission Decision 2008/963 amending the Annexes to Directives 2004/17/EC and 2004/18/EC of the European Parliament and of the Council on public procurement procedures, as regards their lists of contracting entities and contracting authorities.

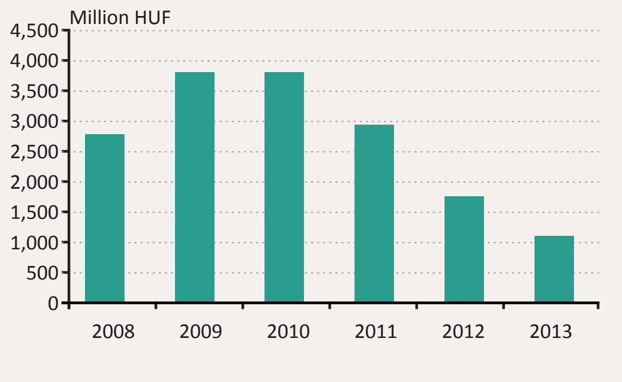
The procurement processes of the MNB are regulated by Chapter B of Order No 2013-308 of the Director General on the MNB's Internal Operations Manual, in line with the valid act on public procurement.

There are three types of procurement procedures at the MNB:

- Other procurement below net HUF 2 million;
- Other procurement reaching net HUF 2 million but not reaching the public procurement value limit (other procurement between net HUF 2 and 8 million); and
- Public procurement.

Procurement procedures below net HUF 2 million are conducted by the cost bearer organisational units within their own sphere of responsibility, while procurements and public procurements reaching the value of net HUF 2 million are arranged by the Central Procurement Department of the Central Procurement and Operation Directorate with support from the organisational units.

Chart 17
Total value at the MNB from procurement procedures in excess of net HUF 2 million



Number of procedures in 2013:

- Public procurement: 46
- Other procurement in excess of net HUF 2 million: 51.

The total value of the completed procedures with a value in excess of net HUF 2 million meant an expense of HUF 1,034.8 million for the central bank which reflects the success of the MNB's cost-cutting program since the total value of the procurements was significantly below the total value of the procurements of the former years.

Environmentally conscious operation

The first three-year cycle of the environmental management system introduced in 2011 was completed in 2013, and the MNB completed the goals elaborated in its Environmental Declaration. Electricity consumption at the headquarters in Szabadság tér and at the Logistics Centre continued to decrease by 3.4 per cent in 2013, and thus the 10 per cent goal was outperformed: consumption was 12.2 per cent lower than the basis in 2010. Total CO2 emission was 1.5 per cent lower in 2013 than the level a year before. The volume of communal waste continued to decline in 2013, while the recycling rate exceeded 35 per cent at the end of the year.

The total energy consumption of the MNB (the lighting of buildings, technological operation, cooling, heating, transport) decreased by 10.3 per cent in total in the period 2011-2013. In the area of electricity usage, it is important to emphasise that consumption was cut by nearly 20 per cent at the headquarters over a period of three years (614,853 kWh) which meant cost savings of HUF 21.8 million at the price level of 2013. The decrease in electricity consumption of the buildings was the result of the implementation of the various energy efficiency improving projects (e.g. transformation of the field lighting of the Logistics Centre, the usage of LED-based light sources and the application of remote light control at the headquarters, the replacement of laptops, virtual server).

The international environmental assessment *(BREEAM In-Use)* of the headquarters and the Logistics Centre was completed in 2013 and possibilities for moving forward were also identified. Currently, the headquarters is assessed as 'Good' and the Logistics Centre as 'Very good', ratings above 'Very good' are uncommon even outside Hungary. In light of the development opportunities, it is a realistic goal for the headquarters to achieve the 'Very good' category, which is one notch higher than the current assessment, within three years. The BREEAM In-Use assessment of the headquarters can be considered as exemplary since in local practice, the environmentally conscious development of buildings protected as monuments is uncommon, even though similar buildings offer extensive development opportunities in terms of environmental awareness.

The environmental management system was developed in a manner that – after having explored the factors with significant environmental impacts – the environmental performance that can be measured by indices improves year by year and the related goals and results are disclosed. The MNB's total energy use decreased by nearly 1 GWh by the end of the first three-year cycle which equals the annual energy consumption of 50 detached houses. The results achieved incentivise the Bank to continue to operate and develop the system and to extend it to the new properties where the environmental benefit can be felt. The integration of the site at Krisztina körút into the environmental management system was prepared accordingly, and the goal for 2014 is to obtain the EMAS certificate.

Managing operational risks

In the deteriorating external market environment resulting from the prolonged international financial crisis, the cost-effective management of operational risks remained a task of primary importance. The materialisation of operational risks may result in financial losses and increased use of the MNB's resources. In addition, however, the decrease in risks means direct costs. Therefore, it is important to ensure that conscious, focused and proportionate measures are taken in respect of the management of risks.

Structured registration and analysis of events with minor effects within the Bank's operation represent an important source for the objective assessment of operational risks. These events may highlight the vulnerability of banking processes and the risk exposure of their values, allowing timely and more successful preparations in order to avoid more serious losses.

The MNB has been continuously improving its ability to adequately react to events that jeopardise the smooth performance of its basic tasks. This is achieved through the preparation and the regular testing of business continuity plans. During the year, the Bank tested the management of the critical working processes related to the operation of the payment system and the management of the FX reserves as well as the management of the cash supply of the financial sphere, in case of a crisis.

3.12 INTRODUCTION OF THE ESCB COMMITTEES

Since Hungary's accession to the European Union, the MNB's management and experts have been participating in the work of ESCB committees and their working groups. These committees and working groups provide an opportunity for national central banks to work together and formulate joint positions. This cooperation also enables the representatives of national central banks to obtain information on the ECB's activities on a regular basis. As of 31 December 2013, fifteen ESCB committees and three other committees assisting the work of the ESCB were in operation. In order to prepare the tasks related to the so-called Single Supervisory Mechanism (SSM) to be launched in November 2014, it was included in the mandate of all the ESCB committees in 2013 that the given committee will support the work of the decision-making bodies of the ECB in respect of the topics falling into its own sphere of competence. Beside the two existing configurations (euro-area composition and ESCB composition), starting from 2014, some committees will hold meetings in SSM composition as well, where representatives of the supervisory authorities operating as organisations independent of the central banks of the Member States participating in the SSM will also partake.

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

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

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

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

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

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

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

International Relations Committee (IRC): It assists in carrying out those tasks of the ESCB that are related to international cooperation, and contributes to formulating the position of the Eurosystem regarding the various areas of relations with non-EU countries.

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

Legal Committee (LEGCO): It provides legal assistance for the work of the ESCB; in particular, it contributes to the maintenance of the regulatory framework of the Eurosystem and the ESCB and to the review of the transposition of legal regulations into national laws, and monitors and reports on how national authorities and EU institutions comply with their consultation obligations relating to draft legislation in areas falling within the ECB's competence.

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

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

Organisational Development Committee (ODC): The ECB approved the formation of this Committee in July 2013. The ODC has only euro-area members, and its task is to assist the work of ECB decision-makers with proposals regarding the planning and organisational issues related to the operation of the Eurosystem and the SSM. In addition, the ODC also coordinates the work of the Eurosystem Procurement Coordination Office (EPCO) and runs the operational risk management and business continuity system of the Eurosystem/ESCB.

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

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

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

Other committees assisting the work of the ESCB:

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

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

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

3.13 THE MNB'S RESEARCH ACTIVITIES IN 2013

Academic and basic research activities are typically performed by the Research Department, while applied research is mainly carried out by the Analysis departments. Fundamental research is ultimately published in international and domestic academic journals. Applied research is presented in the relevant publications of the MNB: the *MNB Working Papers* series (issued in English only), the *MNB Occasional Papers* series and the *MNB Bulletin*. In addition to the publications, participation in international conferences, the annual work meeting organised jointly by the MNB and the Centre for Economic Policy Research (CEPR, London) in Budapest as well as participation in the research networks and working groups coordinated by ECB all form part of the MNB's research activity.

Publications

2013 was an outstandingly successful year in the area of international publications. Seven articles were published in leading international journals *(Journal of International Economics, Journal of International Money and Finance, Journal of Econometrics, Econometric Theory, Review of Economics and Statistics, Macroeconomic Dynamics, B. E. Journal of Macroeconomics)*. In addition, two articles were published in the leading Hungarian journal Közgazdasági Szemle, one publication was printed in Society and Economics (Corvinus University) and another one in the journal Polgári Szemle.

The results of applied research were presented in the relevant publications of the MNB. Three articles were published in the *MNB Working Papers* series, four studies in the *MNB Occasional Papers* and twenty nine articles were published in the *MNB Bulletin* last year. In addition, in the area of applied research, one locally issued book chapter and a BIS study can be connected to authors from the MNB.

Conferences and lectures

In 2013, the Macroeconomic Work Meeting was jointly organised with CEPR at the MNB. The topic of the prestigious academic conference was *Growth, Rebalancing, and Macroeconomic Adjustment after Large Shocks* with senior lecturers Alan Taylor (University of California, Davis) and Michael Reiter (Institute for Advanced Studies, Vienna). In addition, twelve other academic lectures were delivered, three of which were presented by MNB staff.

MNB researchers delivered lectures at several international conferences, central banks and universities. The joint conference of the European Economic Association and the Econometric Society (EEA-ESEM) is worth special mention, as five MNB Occasional Papers were presented there. The researchers of the MNB presented articles at the most reputable macroeconomic conferences, held by the Society for Economic Dynamics and the Society for Computational Economics. In addition, the researchers held academic lectures at the Deutsche Bundesbank, the Sveriges Riksbank, the Narodowy Bank Polski, the BI Norwegian Business School in Oslo and the Academia Sinica in Taiwan. The MNB traditionally delegates many lecturers to the conference of the Hungarian Society for Economics (MKE) held in December.

Several staff members participated in the research network and working groups coordinated by the ECB. The corporate wage survey to be conducted in 2014 was prepared within the framework of the Wage Dynamics Network. The Competitiveness Network reviewed the competitiveness indices of the countries. MNB staff contributed to the work of the Macroprudential Research Network and the Household Financial and Consumption Survey. The MNB participates in the regular meeting of the Working Group on Econometric Modelling and an MNB lecture was delivered at the Technical Workshop of the ECB Working Group on Public Finance (WGPF).

3.14 PUBLICATIONS AND CONFERENCES ORGANISED BY THE MNB IN 2013

Publications

Quarterly Report on Inflation

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

Report on Financial Stability

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

Report on Payment Systems

Once a year, the Report provides a comprehensive review of the trends in payments and the functioning of the overseen payment and securities settlement systems in Hungary, the risks arising, and any measures taken by the MNB where necessary to maintain the smooth provision of payment services and facilitate the reliable and efficient operation of the supporting payment and settlement systems.

Interim Report: Quarterly report on the MNB's activities

The Interim Report is published twice a year, in April and November, between the annual and semi-annual reporting periods. It gives account of the basic activities of the operating units of the Bank stipulated in the MNB Act, in respect of the first and the third quarters: monetary policy, overview of the financial system, FX reserves, cash transactions, cash logistics activities, and statistical changes.

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

This Report is published once a year in September and is the Bank's business report for the first half of the year.

Annual Report

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

MNB Occasional Papers

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

MNB Working Papers

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

MNB Bulletin

In 2013, the eighth 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 the findings of research projects in which the Bank is involved. In 2013, the publication consisted of three normal issues and one special issue.

Senior loan officer survey on bank lending practices

In the spring of 2003, the MNB first published this survey in order to facilitate a better grasp of bank lending processes. It supports an understanding of the way in which key domestic banks perceive and evaluate market processes, formulate their respective strategies and, within that, their lending policies. To enable closer monitoring of the qualitative aspects in the development of credit supply, the Bank conducts the survey on a quarterly basis. The last survey was released in February 2013 with the results for the fourth quarter of 2012, and during the year it was replaced by the MNB's new publication titled 'Trends in Lending'.

Trends in Lending

The first Trends in Lending, which was issued in May 2013, replaced the publication *Senior loan officer survey on bank lending practices.* The objective of the publication is to present a detailed picture of the latest trends in lending and to facilitate the appropriate interpretation of these developments. To this end, it elaborates on the developments in credit aggregates, demand for loans perceived by banks and credit conditions. The first quarter of 2013 was already covered by the Trends in Lending.

Public Finance Review

An expert team from the MNB conducts regular analyses of fiscal processes in order for the Bank to be able to conduct its tasks relating to the definition and implementation of monetary policy at the highest professional standard. A new publication titled 'Public Finance Review' enables the wider public to familiarise itself with the main results of expert analyses.

Other publications

The Report on the MNB's medium-term institutional strategy for 2007-2012 was published in late February 2013 which, following the MNB's earlier tradition when there is a change of governor, summarised the Bank's activity and operations for the six-year period under the governance of András Simor.

A study by Dr János Cinkotai, an external member of the Monetary Council, was published in June 2013 with the title *Decreasing interest rates and inflation in Hungary.*

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

Events organised by the MNB

As for events, the MNB pursues a strategy of openness with its associate and partner institutions, which strengthens professional partnership. The events organised by the MNB include international conferences, internal events and so-called cultural events as well.

International events

The majority of the international, professional conferences that last for several days involve 50-60 persons, which predominantly include professional conferences, lunches and cultural programs. The majority of international conferences are held in the building of the MNB.

In 2013, these included, inter alia, the 12th Budapest Workshop on Macroeconomic Policy Research, the ECB Internal Audit Committee Meeting, and the MNB also held a conference for the FX reserve managers and risk managers of the central banks of the Eastern and Central European region. The annual economic policy consultation of the International Monetary Fund as per Article IV and, in connection with this, the high-level hosting of the EU delegation arriving in the framework of the Post Programme Surveillance of the EU loan agreement are of special importance.

MNB Club events

The MNB believes that the maintenance, transfer and creation of values are important. In addition to ensuring price stability, the MNB as a financial value centre also supports national stability by stimulating growth in the economy, investing in knowledge, promoting art and culture and fostering social responsibility. In light of this, a series of events started in 2013 under the name 'MNB Club', to which the MNB invites those who represent outstanding values in the country. The MNB supports development and value creation in all segments of life, be it entrepreneurial success, artistic expression, finding a global niche, reviving a tradition or creative work. The MNB Club is a special meeting place for people who are truly multifaceted. The invitees are all creators, who are able to create something that is globally unique, whether it is a new idea, endurance in work, technological innovation or the reinterpretation of our national traditions. They are creators who are connected by strength, bravery, desire to accomplish, perseverance, faith in success and the love of their country.

Conferences in Hungary

The Funding for Growth Scheme was approved by the MNB's Monetary Council on 4 April 2013 in order to mitigate the disturbances in lending to small and medium-sized enterprises, to strengthen financial stability and to reduce Hungary's external vulnerability. In order to popularise the FGS and to introduce it to entrepreneurs, the Bank organised a roadshow with four stations including Miskolc, Balatonfüred, Debrecen and Siófok.

The MNB held a large conference on the FGS in November in Budapest.

BESS at MNB lectures

23 January 2013 Daniele Siena (Department of Economics, Bocconi University) The European Monetary Union and Imbalances: Is it an Anticipation Story?

24 January 2013 Szabolcs Deák (Robert Schuman Centre, European University Institute) The Fiscal Multiplier and the State of Public Finances

28 January 2013 Claudia Lambert (Goethe University Frankfurt) How do banks react to increased asset risks? Evidence from Hurricane Katrina

30 January 2013 George Monokroussos (University at Albany, State University of New York) Forecasting the Distribution of Macroeconomic Aggregates in Real Time Using Large Data Sets

1 February 2013 Julia Schmidt (Graduate Institute of International and Development Studies) Technological Standardization, Endogenous Productivity and Transitory Dynamics

13 March 2013 Richard Blundell (University College London) Empirical Evidence and Tax Design: Lessons from the Mirrlees Review)

20 March 2013 Victor Rios-Rull (University of Minnesota) Engineering a Paradox of Thrift Recession

9 April 2013 Michal Brzoza-Brzezina (Narodowy Bank Polski) Macroprudential policy and imbalances in the euro area

20 November 2013 Hilde Bjornland (Norwegian Business School) Do central banks respond to exchange rate movements? A Markov-switching structural investigation

Courses of the Bank's Education Centre

Spring courses 2013

Fabio Canova (Research Professor at the European University Institute) **Time series methods** (2-5 April 2013)

– VARs, BVARs and structural VARs

– Factor models, FAVAR models

– Panel macro models, panel VARs and global VARs

– State space models: The Kálmán filter and the Gibbs sampler

– Time-varying coefficient models and stochastic volatility

Gianluca Benigno (London School of Economics) **Open economy macroeconomics** (8-10 April 2013)

– International real business cycles

– Exchange rate determination and monetary policy in open economy

– Financial crises and policy response

– Reserve accumulation and growth

Evi Pappa (European University Institute) **Fiscal and monetary policy** (10-12 April 2013)

– Empirics of fiscal shocks

– Fiscal policy in RBC models and New Keynesian models

– Fiscal policy in models with labour frictions

– Fiscal multipliers

– Open economy fiscal models

Summer courses 2013

Tao Zha (Federal Reserve Bank of Atlanta) **Markov switching VARs and DSGEs** (22-26 July 2013) (Hosted jointly with the EABCN)

– Local and global identification of structural VARs and DSGE models

– General approach to a wide class of Markov-switching models

– Estimation of Markov-switching BVARs (MSBVARs)

– Theory of Markov-switching rational expectation (MSRE) models

– Estimation of MSRE models

Enrique Mendoza (University of Maryland and University of Pennsylvania) **Financial Frictions in International Macroeconomics** (29 July 2 August 2013)

– Workhorse models of current account dynamics

– Real business cycle models of small open economies with incomplete markets

– Fisherian credit constraints, financial amplification and financial crises

– Macro-prudential policy

– Financial development and global imbalances

4 Explanation of abbreviations and terms specific to central banking

4.1 ABBREVIATIONS

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

BIS: Bank for International Settlements

BREEAM: Building Research Establishment Environmental Assessment Methodology

BRRD: Bank Recovery and Resolution Directive

CEBS: Committee of European Banking Supervisors

CRD IV: Capital Requirement Directive – EU directive on the access to the activity of and the prudential requirements for credit institutions and investment firms

CRR: Capital Requirement Regulation – a regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, applicable in the EU Member States.

CSO: Central Statistical Office

EBA: European Banking Authority

ECB: European Central Bank

EIOPA: European Insurance and Occupational Pensions Authority

EMU: Economic and Monetary Union

ESCB: European System of Central Banks

ESRB: European Systemic Risk Board

FCPC: Financial Consumer Protection Centre

FGS: Funding for Growth Scheme

FSB: Financial Stability Board

GIRO: Giro Clearing House Ltd.

HFSA: Hungarian Financial Supervisory Authority

ICS: Interbank Clearing System

IMF: International Monetary Fund

ISDA: International Swaps and Derivatives Association

KELER: Central Clearing House and Depository Ltd.

MNB: Magyar Nemzeti Bank

MNE: Ministry for National Economy

MTA: Mobile training area

OECD: Organisation for Economic Cooperation and Development

PIP ('FCP'): Financial Compass Programme

POP ('FTP'): Financial Training Programme

SRM: Single Resolution Mechanism

SSM: Single Supervisory Mechanism

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

4.2 GLOSSARY

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

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

CLS (Continuous Linked Settlement): A settlement model that enables the elimination of FX settlement risks. It is based on a multi-currency payment versus payment (PvP) mechanism. The CLS is operated by the CLS Bank.

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

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

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

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

FX swap: See Foreign exchange swap.

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 Rights).

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

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

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

MNB Act: Act CXXXIX of 2013 on the Magyar Nemzeti Bank.

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

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

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

O/N: Overnight deposit/loan.

Omnibus II directive: See Solvency II directive

Option: For the owner of the foreign exchange option this means a right, but not an obligation, to buy or sell a certain amount of currency against another currency at a pre-determined rate, at or before a pre-determined date. If the possessor of the option 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, open professional organisation with consultative character committed to the matters of the domestic payment system and operating at the MNB's initiative, with the support of the Hungarian Banking Association and the involvement of market participants that play a decisive role in payment transactions as well as the Hungarian State Treasury, GIRO Zrt. and KELER Zrt. The supreme body of the Forum is the Payment System Council, which consists of the representatives of the members and operates under the co-chairmanship of the MNB and the Hungarian Banking Association.

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

Revaluation reserve: The revaluation reserve of the forint exchange rate and the revaluation reserve of foreign exchange securities are reserves that are part of the 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 indicated in the forint exchange rate revaluation reserve, which constitutes a part of equity.

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

ROA: Return on assets.

ROE: Return on equity.

SEPA: Single Euro Payments Area, an area within which economic operators can effect and receive payments in euro anywhere, using one single payment account, in the same manner as in their own respective countries. Geographically, the Area covers the 28 EU Member States, Iceland, Liechtenstein, Norway, Switzerland and Monaco.

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

Solvency II directive (138/2009/EC): A new, risk-based regulatory framework for insurers which is based on three pillars, namely, quantitative requirements, qualitative requirements and public disclosure. It is a European standard based on which the supervisory authorities can create standard rules for capital in order to decrease/avoid the risk of insolvency. Applicable from 1 January 2016. The Omnibus II directive includes the amending provisions of the Solvency II directive, which has been approved but has not become valid and applicable yet, and the Prospectus directive (2003/71/EC).

TARGET2-Securities (T2S): The single technical platform of the Eurosystem through which central depositories and national central banks can provide basic, cross-border and neutral securities settlement services in central bank funds across all Europe.

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

Part B)

Audited financial statements of the Magyar Nemzeti Bank

1 Independent auditor's report

Ernst & Young Kft.
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Cg. 01-09-267553

This is a translation of the Hungarian Report

Independent Auditors' Report

To the Shareholder of Magyar Nemzeti Bank

Report on financial statements

1.) We have audited the accompanying 2013 annual financial statements of Magyar Nemzeti Bank ("the Company"), which comprise the balance sheet as at 31 December 2013 - showing a balance sheet total of HUF 11,437,974 million and a profit for the year of HUF 26,295 million -, the related profit and loss account for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

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

Building a better working world

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

Opinion

6.) In our opinion the annual financial statements give a true and fair view of the equity and financial position of Magyar Nemzeti Bank as at 31 December 2013 and of the results of its operations for the year then ended in accordance with the Hungarian Accounting Law.

Other reporting requirement- Report on the business report

7.) We have reviewed the business report of Magyar Nemzeti Bank for 2013. Management is responsible for the preparation of the business report in accordance with the Hungarian Accounting Law. Our responsibility is to assess whether the business report is consistent with the financial statements for the same financial year. Our work regarding the business report has been restricted to assessing whether the business report is consistent with the financial statements and did not include reviewing other information originated from non-audited financial records. In our opinion, the business report of Magyar Nemzeti Bank for 2013 corresponds to the disclosures in the 2013 financial statements of Magyar Nemzeti Bank.

Budapest, 9 April 2014

(The original Hungarian language version has been signed.)

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

Szabó Gergely
Registered auditor
Chamber membership No.: 005676

2 Balance sheet of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	ASSETS	31. 12. 2012	31. 12. 2013	Change
1	2	3	4	4-3
	I. RECEIVABLES DENOMINATED IN FORINT	**325,865**	**959,895**	**634,030**
4.3.	1. Receivables from the central government	142,212	138,380	-3,832
4.7.	2. Receivables from credit institutions	183,653	820,888	637,235
	3. Other receivables	0	627	627
	II. RECEIVABLES DENOMINATED IN FOREIGN CURRENCY	**10,186,382**	**10,308,536**	**122,154**
4.9.	1. Gold and foreign currency reserves	9,755,692	9,933,839	178,147
4.4.	2. Receivables from the central government	0	18,378	18,378
4.8.	3. Receivables from credit institutions	2,195	13	-2,182
4.10.	4. Other receivables	428,495	356,306	-72,189
	III. BANKING ASSETS	**33,437**	**33,431**	**-6**
4.13.	of which: invested assets	33,217	33,267	50
4.15.	**IV. PREPAID EXPENSES/ACCRUED INCOME**	**136,213**	**136,112**	**-101**
	V. TOTAL ASSETS (I+II+III+IV)	**10,681,897**	**11,437,974**	**756,077**

Reference number to notes on the Accounts	LIABILITIES AND EQUITY	31. 12. 2012	31. 12. 2013	Change
1	2	3	4	4-3
	VI. LIABILITIES DENOMINATED IN FORINT	**7,747,150**	**9,470,835**	**1,723,685**
4.5.	1. Central government deposits	442,829	242,019	-200,810
4.8.	2. Deposits by credit institutions	1,009,194	864,490	-144,704
	3. Banknotes and coins in circulation	2,721,674	3,188,994	467,320
4.11.	4. Other deposits and liabilities	3,573,453	5,175,332	1,601,879
	VII. LIABILITIES DENOMINATED IN FOREIGN CURRENCY	**2,342,660**	**1,455,590**	**-887,070**
4.5.	1. Central government deposits	935,756	509,886	-425,870
4.8.	2. Deposits by credit institutions	0	571	571
4.11.	3. Other deposits and liabilities	1,406,904	945,133	-461,771
4.14.	**VIII. PROVISIONS**	**4,291**	**4,075**	**-216**
	IX. OTHER BANKING LIABILITIES	**17,784**	**15,624**	**-2,160**
4.15.	**X. ACCRUED EXPENSES/DEFERRED INCOME**	**18,947**	**27,290**	**8,343**
4.16.	**XI. EQUITY**	**551,065**	**464,560**	**-86,505**
	1. Share capital	10,000	10,000	0
	2. Retained earnings	47,023	9,762	-37,261
	3. Valuation reserves	0	0	0
4.17.	4. Revaluation reserves due to exchange rate changes	564,041	509,603	-54,438
4.17.	5. Revaluation reserves of foreign currency securities	-30,188	-91,100	-60,912
	6. Profit/Loss for the year	-39,811	26,295	66,106
	XII. TOTAL EQUITY AND LIABILITIES (VI+VII+VIII+IX+X+XI)	**10,681,897**	**11,437,974**	**756,077**

9 April 2014, Budapest

Dr György Matolcsy
Governor of the Magyar Nemzeti Bank

3 Income statement of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	INCOME	2012	2013	Difference
1	2	3	4	4-3
4.19.	**I. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FORINT**	**25,907**	**19,227**	**-6,680**
	1. Interest on receivables from the central government	11,662	7,872	-3,790
	2. Interest on receivables from credit institutions	13,563	10,738	-2,825
	3. Interest on other receivables	0	0	0
	4. Interest related income	682	617	-65
4.19.	**II. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FOREIGN CURRENCY**	**245,446**	**239,164**	**-6,282**
	1. Interest on foreign currency reserves	224,631	191,986	-32,645
	2. Interest on receivables from the central government	0	0	0
	3. Interest on receivables from credit institutions	0	0	0
	4. Interest on other receivables	2,176	1,877	-299
	5. Interest related income	18,639	45,301	26,662
4.20.	**III. INCOME ARISING FROM EXCHANGE RATE CHANGES**	**166,531**	**233,602**	**67,071**
4.19.	**IV. REALISED GAINS ARISING FROM FINANCIAL OPERATIONS**	**31,833**	**26,221**	**-5,612**
4.22.	**V. OTHER INCOME**	**3,893**	**10,636**	**6,743**
	1. Fees and commissions	986	1,423	437
4.23.	2. Income other than fees and commissions	2,907	6,343	3,436
4.24.	3. Income from supervisory activities	0	2,870	2,870
4.14.	**VI. PROVISIONS RELEASED**	**3,242**	**1,777**	**-1,465**
4.14.	**VII. IMPAIRMENT RELEASED**	**1,950**	**3**	**-1,947**
4.25.	**VIII. OPERATING INCOME**	**163**	**332**	**169**
	IX. TOTAL INCOME (I+II+III+IV+V+VI+VII+VIII)	**478,965**	**530,962**	**51,997**

Reference number to notes on the Accounts	EXPENSES	2012	2013	Difference
1	2	3	4	4-3
4.19.	**X. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FORINT**	**367,130**	**250,677**	**-116,453**
	1. Interest on central government deposits	46,869	24,896	-21,973
	2. Interest on deposits by credit institutions	42,247	23,488	-18,759
	3. Interest on other deposits	277,691	202,076	-75,615
	4. Interest related expenses	323	217	-106
4.19.	**XI. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FOREIGN CURRENCY**	**57,773**	**57,145**	**-628**
	1. Interest on central government deposits	1,312	211	-1,101
	2. Interest on deposits of credit institutions	3	0	-3
	3. Interest on other liabilities	20,702	8,919	-11,783
	4. Interest related expenses	35,756	48,015	12,259
4.20.	**XII. EXPENSES RESULTING FROM EXCHANGE RATE CHANGES**	**8,261**	**33,263**	**25,002**
4.21.	**XIII. COST OF ISSUING BANKNOTES AND COINS**	**4,149**	**4,157**	**8**
4.19.	**XIV. REALISED LOSSES ARISING FROM FINANCIAL OPERATIONS**	**65,013**	**138,819**	**73,806**
4.22.	**XV. OTHER EXPENSES**	**1,205**	**3,300**	**2,095**
	1. Fees and commissions	780	755	-25
4.23.	2. Expenses other than fees and commissions	425	2,545	2,120
4.14.	**XVI. PROVISIONS CHARGED**	**3,367**	**1,562**	**-1,805**
4.14.	**XVII. IMPAIRMENT**	**0**	**985**	**985**
4.25.	**XVIII. OPERATING COSTS AND EXPENSES**	**11,878**	**14,759**	**2,881**
	XIX. TOTAL EXPENSES (X+XI+XII+XIII+XIV+XV+XVI+XVII+XVIII)	**518,776**	**504,667**	**-14,109**
	XX. PROFIT/LOSS BEFORE DIVIDENDS (IX-XIX)	**-39,811**	**26,295**	**66,106**
	XXI. Dividends from retained earnings	**0**	**0**	**0**
	XXII. Dividends	**0**	**0**	**0**
	XXIII. PROFIT/LOSS FOR THE YEAR (XX+XXI-XXII)	**-39,811**	**26,295**	**66,106**

9 April 2014, Budapest

Dr György Matolcsy
Governor of the Magyar Nemzeti Bank

4 Notes to the financial statements

4.1 THE MNB'S ACCOUNTING POLICY

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

The accounting policy of the Magyar Nemzeti Bank is based on the Act on Accounting (Act C of 2000), Act CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter: the MNB Act) and Government Decree 221/2000 (XII. 19) on the special reporting and accounting requirements applicable to the Magyar Nemzeti Bank (hereinafter: MNB Decree). Since the effective date of the Act promulgating the international treaty on the accession of Hungary to the EU, i.e. 1 May 2004, the Magyar Nemzeti Bank has been a member of the European System of Central Banks (ESCB).

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

4.1.1 The MNB's accounting framework

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

On a daily basis, the MNB records:

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

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

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

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

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

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

– charging of depreciation and amortisation.

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

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

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

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

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

The MNB presents the distinctions detailed in Section 4.27 between MNB's accounting policy and the Guideline of the European Central Bank on the legal framework for accounting and financial reporting in the European System of Central Banks ECB/2010/20 (hereinafter: ESCB Guideline) as well as the numeric effect of these differences in the notes to the financial statements.

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

The person authorised to sign the Annual Report is Dr György Matolcsy, Governor of the Magyar Nemzeti Bank.

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

4.1.2 Major principles of valuation

Receivables from the central government

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

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

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

Receivables from credit institutions

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

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

The interest-free refinancing loans and the base rate fixed security-backed loans provided to credit institutions within the framework of the Funding for Growth Scheme (FGS) must be recorded in the balance sheet at the disbursed amount and must be qualified at year-end.

Other receivables

Receivables from supervisory activities are recorded in the balance sheet with their impairment. The MNB books the supervisory fee prescriptions in line with the incoming data reported by the institutions and the penalty prescriptions are recorded in line with the finalised resolutions. The supervisory fees, levied and used penalties, as well as the received fees from public proceedings must be recorded as 'Income from supervisory activities'.

The balance of 'Other receivables' also contains the employee loans at the amount of the disbursements. The related interest income is shown as 'Interest on other receivables'.

'Other receivables' must be qualified at year-end and must be impaired if necessary.

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

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

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

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

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

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

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

Foreign currency securities

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

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

The foreign currency securities managed by external trustee and custodian on the grounds of a given mandate are also stated at a market price, applying the prices received from the custodian.

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

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

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

Accounting rules relating to the IMF quota

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

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

Accounting rules relating to derivatives

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

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

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

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

Banking assets and liabilities

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

- assets and liabilities not directly related to central bank functions and bank operations (such as settlements relating to taxes, contributions, payments to employees, creditors, unsold precious metals held for non-central bank purposes), as well as
- liabilities arising from banknotes no longer accepted as legal tender but not yet exchanged,
- investments, and
- assets required for operating the organisation (such as intangibles, tangibles and inventories).

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

Depreciation rates applied by the Magyar Nemzeti Bank:

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.

Per cent

Description	31. 12. 2013
Concessions, licences and similar rights	17
Trade-marks patents and similar assets	10–50
Capitalised value of reorganization	20
Owned and managed buildings*	2–3
Vehicles**	20
Telecommunication devices, office equipment, machines	9–50
Office equipment	14.5–33
Computer hardware	9–33
Emission machinery	5–33
Instruments	9–33
Bank security devices	2–33
Other equipment and devices	3–33

** The depreciation of buildings taken into property management during the HFSA integration is 2 per cent.*
***Residual value 20 per cent of the vehicles with 5-year time of use.*

4.2 EFFECTS OF MACROECONOMIC TRENDS ON THE 2013 BALANCE SHEET AND INCOME STATEMENT OF THE MAGYAR NEMZETI BANK

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

In 2013, the MNB recorded a profit of HUF 26.3 billion. In respect of macroeconomic events, changes in the forint exchange rate exerted the most important influence on the Bank's profit. In 2013, contrary to previous years, the official forint exchange rate against the euro fluctuated in a narrower, but weaker band. The average exchange rate was HUF 297.01 in 2013, i.e. HUF 7.71 higher than in 2012. The official exchange rate was weaker than the average cost rate during the entire year. The difference between the two rates was 19.55 forint/euro at 31 December 2012 and after fluctuating during 2013, decreased to 15.76 forint/euro at the year-end. The total net revaluation effect was a gain of HUF 145.9 billion in 2013. Besides the usual foreign currency transactions with the Hungarian State Treasury (MÁK), the volume of foreign currency sales increased mainly because of the hedging transactions related to the risk management of the government-issued foreign currency bonds in the first quarter, because of IMF loan repayments in the second and third quarter and because of the transactions with the Government Debt Management Agency (ÁKK), in the fourth quarter; due to this increase, the MNB realised a gain of HUF 200.3 billion during 2013.The balance of revaluation reserves due to exchange rate changes, as an unrealised foreign exchange loss, declined, decreasing by HUF -54.4 billion to HUF 509.6 billion by the end of 2013. In 2013, the net foreign currency position of the MNB increased by EUR 4.2 billion, its amount was EUR 32.3 billion (HUF 9,594.5 billion) at year-end.

The balance sheet total according to Hungarian Accounting Standards (HAS) was HUF 11,438 billion on 31 December 2013, increasing by about 7 per cent relative to end-2012. This was caused mainly by the balance-increasing effect of the refinancing loans disbursed in the framework of the FGS.

In 2013, the bank recorded a net interest and interest related loss of HUF 49.4 billion, representing an improvement of HUF 104.1 billion relative to the previous year. The HUF 109.8 billion decrease of the HUF interest loss was mainly generated by the 20-25 basis point cuts of the central bank base rate began in 2012 and continued in 2013. The average central bank base rate was 4.37 per cent in 2013, i.e. 240 basis points lower than the annual average in 2012. Net foreign currency interest income was determined mainly by the increase in the Bank's net foreign currency receivables and by foreign exchange yields.

As of 1 October 2013, the tasks of the MNB were broadened. The Hungarian Financial Supervisory Authority (HFSA), the independent body supervising the financial intermediary system, were terminated, and its tasks were taken by the MNB by virtue of the MNB Act in force. Accordingly, the MNB exercises the rights and discharges the obligations of the HFSA. As of 1 October 2013, the income and expense related to the supervisory activities are recorded in the income statement of the MNB.

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. 2012	31. 12. 2013	
	Government bonds maturing within 1 year	3,832	585	-3,247
	Government bonds maturing within 1 to 5 years	9,093	8,508	-585
	Government bonds maturing over 5 years	129,287	129,287	0
I.1.	**Total receivables from the central government**	**142,212**	**138,380**	**-3,832**

The amount of government bonds recorded at historic cost was HUF 138.4 billion at the end of 2013, a decrease of HUF 3.8 billion compared to end-2012. During the year there were no new purchases, but one bond matured out of the government bonds, causing a decrease in the balance.

The aggregate balance of revaluation reserves due to exchange rate changes and of revaluation reserves of foreign currency securities was positive on 31 December 2013, and therefore receivables from the central government did not arise in connection with reimbursement.

4.4 FOREIGN CURRENCY RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Swap transactions with the central government	0	0	0
	Currency swaps with the central government*	0	18,378	18,378
II.2.	**Foreign currency receivables from the central government**	**0**	**18,378**	**18,378**

** In 2012, the credit balance of HUF 691 million appeared as VII.1. Foreign currency liabilities of the central government, in line with its opposite sign.*

The HUF 18.4 billion balance of foreign currency receivables from the central government contained the net debit balance of the currency swaps with the central government. At end-2012, the net balance of currency swaps was stated as 'Foreign currency liabilities of the central government', in line with its sign (see Section 4.5).

Foreign currency receivables from the central government in a breakdown by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2012	31. 12. 2013	
	- within 1 year	0	345	345
	- within 1 to 5 years	0	7,816	7,816
	- over 5 years	0	10,217	10,217
II.2.	**Foreign currency receivables from the central government**	**0**	**18,378**	**18,378**

Currency structure of the swaps with the central government

HUF millions

No.	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
1.	- EUR	183,892	785,459	601,567
2.	**Swap receivables (1)**	**183,892**	**785,459**	**601,567**
3.	- JPY	10,226	0	-10,226
4.	- USD	174,357	767,081	592,724
5.	**Swap payables (3+4)**	**184,583**	**767,081**	**582,498**
6.	**Net swap receivables (2-5)**	**-691**	**18,378**	**19,069**

4.5 FORINT AND FOREIGN CURRENCY LIABILITIES OF THE CENTRAL GOVERNMENT

Forint deposits of the central government

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Single Treasury Account (KESZ)	442,481	241,678	-200,803
	Deposit by Government Debt Management Agency (ÁKK Zrt)	286	279	-7
	Other	62	62	0
VI.1.	**Forint deposits of the central government (total)**	**442,829**	**242,019**	**-200,810**

The total HUF 200.8 billion decrease in the balance of forint deposits of the central government relative to 2012 appeared due to seasonal effects. The annual average balance was HUF 567.7 billion in 2013, HUF 111.1 billion lower relative to 2012.

Foreign currency liabilities of the central government

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Foreign currency deposits of the central government	935,065	509,886	-425,179
	Currency swaps with the central government*	691	0	-691
VII.1.	**Foreign currency liabilities of the central government**	**935,756**	**509,886**	**-425,870**

** In 2013, the debit balance of HUF 18,378 million (net receivable amount) appeared as II.2. Foreign currency receivables from the central government, in line with its opposite sign.*

The end-2012 balance of the foreign currency deposits of the central government decreased by HUF 425.2 billion, mainly because of the prepayment (in August 2013) of the IMF loan taken by the Hungarian State. This reduced the average balance, but the impact was slightly moderated by the increase caused by the USD bond issue of the ÁKK in February and November, as well by the issue of the Premium Euro Hungarian Government Bond (PEMÁK).

At the end of 2012, the hedging transactions contained currency swaps concluded with the ÁKK in order to set the foreign currency and interest rate structure of the foreign exchange rate debt. In line with its opposite sign, the net balance of end-2013 appeared as receivable (see Section 4.4).

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

HUF millions

B/S line	Remaining maturity	Balance		Change
		31. 12. 2012	31. 12. 2013	
	- within 1 year	934,971	509,886	-425,085
	- within 1 to 5 years	785	0	-785
	- over 5 years	0	0	0
VII.1.	**Foreign currency liabilities of the central government**	**935,756**	**509,886**	**-425,870**

4.6 NET POSITIONS VIS-À-VIS THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
I.1.–VI.1.	Net forint position	-300,617	-103,639	196,978
II.2.–VII.1.	Net foreign currency position	-935,756	-491,508	444,248
	Total	**-1,236,373**	**-595,147**	**641,226**

4.7 FORINT RECEIVABLES FROM CREDIT INSTITUTIONS

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Security-backed loans	122,000	112,021	-9,979
	Covered mortgage bonds	61,653	41,496	-20,157
	FGS refinancing loans	0	667,342	667,342
	Other receivables	0	29	29
I.2.	**Total receivables from credit institutions**	**183,653**	**820,888**	**637,235**

The HUF 637.2 billion increase of the receivables from credit institutions is mainly caused by the introduction of the Funding for Growth Scheme (FGS) refinancing loans. The MNB launched its three-pillar Funding for Growth Scheme on 1 June 2013. To stimulate lending to small and medium-sized enterprises (under Pillar I.) and the redemption of existing foreign currency loans (under Pillar II.), a credit line with a total value of HUF 750 billion was allocated in the first phase of the FGS. In view of the success of the first phase, in September 2013 the Monetary Council decided to continue the Scheme. With this decision, the overall amount was expanded by HUF 500 billion in the second phase, which ran from 1 October 2013 to 31 December 2014, and this amount may be raised up to HUF 2,000 billion by the Monetary Council. The amount of refinancing loans granted in the first phase was HUF 646.7 billion and amounted to HUF 20.6 billion in the second phase at the end of 2013. As a result, at 31 December 2013, the balance of borrowing under Pillar I was HUF 449.3 billion, and HUF 218 billion under Pillar II.

The change in the balance of security-backed loans was mainly caused by the reduction of two-year loans, which were repaid in advance. This active monetary tool was introduced by the central bank in April 2012, in order to strengthen the banks' lending capacity and to promote corporate lending. The interest cost of the loan is equal to the prevailing central bank base rate.

Receivables in connection with mortgage bonds decreased by HUF 20.2 billion and amounted to HUF 41.5 billion at 31 December 2013. This value represents the balance of receivables in a gross value, which contains the cost price difference, in addition to the face value. The face value of mortgage bonds was HUF 62.5 billion at the end of 2012, four bonds from this stock matured in 2013, amounting to HUF 19.9 billion in total.

Forint receivables from credit institutions by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2012	31. 12. 2013	
1.	- within 1 year	20,157	150,097	129,940
2.	- within 1 to 5 years	153,842	281,246	127,404
3.	- over 5 years	9,654	389,545	379,891
4.	**Total receivables from credit institutions (1+2+3)**	**183,653**	**820,888**	**637,235**

In each maturity categories, the increase comes from the refinancing loans of the FGS.

4.8 NET POSITIONS VIS-À-VIS CREDIT INSTITUTIONS

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
I.2.–VI.2.	Net forint position	-825,541	-43,602	781,939
II.3.–VII.2.	Net foreign currency position	2,195	-558	-2,753
	Total	**-823,346**	**-44,160**	**779,186**

Net liabilities to credit institutions decreased by HUF 779.2 billion by 31 December 2013. Within this, the net forint liabilities decreased by HUF 781.9 billion compared to the previous year-end, and the balance was HUF 43.6 billion at 31 December 2013. The appearance of the FGS loans improved the net position, as well as the HUF 101 billion decrease of the balance of deposits of domestic credit institutions

Net foreign currency position was a liability of HUF 0.6 billion at end-2013, compared to the HUF 2.2 billion receivable balance at end-2012. The end-2012 balance contained swaps related to ensuring euro liquidity. The figure for end-2013 shows the net liability position of the newly opened swaps ensuring euro liquidity as well as the swap and currency swap transactions concluded under Pillar III of FGS, and almost the entire amount is related to the net balance of swaps concluded with the credit institutions under Pillar III.

Foreign currency receivables from and liabilities to credit institutions in a breakdown by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2012	31. 12. 2013	
1.	- within 1 year	2,195	0	-2,195
2.	- within 1 to 5 years	0	13	13
3.	- over 5 years	0	0	0
4.	**Total foreign currency receivables from credit institutions (1+2+3)**	**2,195**	**13**	**-2,182**
5.	- within 1 year	0	571	571
6.	- within 1 to 5 years	0	0	0
7.	- over 5 years	0	0	0
8.	**Total foreign currency liabilities to credit institutions (5+6+7)**	**0**	**571**	**571**
9.	**Net foreign currency position (4-8)**	**2,195**	**-558**	**-2,753**

4.9 GOLD AND FOREIGN EXCHANGE RESERVES OF THE CENTRAL BANK

Forint balances

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Gold reserve	36,268	25,623	-10,645
	Reserve position in the IMF	25,145	24,523	-622
	Foreign currency deposits	1,421,228	984,062	-437,166
	Foreign currency securities	7,801,021	8,599,519	798,498
	Foreign currency repo transactions	472,030	300,112	-171,918
II.1.	**Gold and foreign currency reserves (total)**	**9,755,692**	**9,933,839**	**178,147**

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

Foreign exchange reserves not including accrued interest decreased by HUF 178.1 billion to HUF 9,933.8 billion as at 31 December 2013. The change was caused mainly by the depreciation of the exchange rate relative to previous year-end.

The end-2013 balance of foreign currency securities contained only HUF 63.4 billion (less than 1 per cent) of securities managed by the external trustee and custodian on the grounds of the given mandate.

Euro balances

EUR millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Gold reserve	125	86	-39
	Reserve position in the IMF	86	83	-3
	Foreign currency deposits	4,879	3,314	-1,565
	Foreign currency securities	26,781	28,963	2,182
	Foreign currency repo transactions	1,620	1,011	-609
II.1.	**Gold and foreign currency reserves (total)**	**33,491**	**33,457**	**-34**

The official exchange rate of the forint was EUR/HUF 291.29 on 31 December 2012 and EUR/HUF 296.91 on 31 December 2013.

After the fluctuations during 2013, the stock of gold and foreign exchange reserves calculated in euro remained at level of the end-2012 amount, i.e. at EUR 33.5 billion. The net balance of EUR transfers from the European Commission and the security issues of the ÁKK increased the level of gold and foreign currency reserves, while this impact was compensated by payments made by the MÁK and the MNB for debt management purposes.

4.10 OTHER FORINT AND FOREIGN CURRENCY RECEIVABLES

Other forint receivables

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Receivables from supervisory activities	0	1,876	1,876
	Employee loans	0	479	479
	Total other receivables in HUF in gross value	**0**	**2,355**	**2,355**
	Impairment loss for receivables from supervisory activities	0	-1,728	-1,728
I.3.	**Other forint receivables**	**0**	**627**	**627**

The supervisory integration resulted new items on the 'Other forint receivables' line. The item 'Receivables from supervisory activities' includes supervisory fees, fines and default interest. This balance, corrected with overpayments, which amounted to HUF 1.9 billion at 31 December 2013 and was impaired by HUF 1.7 billion in line with the internal rules of the MNB. The stock of property loans formerly granted by the HFSA to its employees was HUF 0.5 billion at 31 December 2013.

Other foreign currency receivables

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Forint payment of IMF quota	328,493	320,361	-8,132
	Repurchased bonds	35,747	6,882	-28,865
	Foreign hedging transactions*	63,694	28,389	-35,305
	Other	561	674	113
II.4.	**Other foreign currency receivables**	**428,495**	**356,306**	**-72,189**

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

The forint payment of the IMF quota decreased due to the strengthening of the forint exchange rate in comparison to SDR by 2.5 per cent.

The amount of bonds issued abroad by the MNB and subsequently repurchased decreased mainly owing to the maturity of a bond repurchased from an USD bond issued 20 years before and partly owing to the strengthening of the forint exchange rate versus the Japanese yen.

The item 'Foreign hedging transactions' includes the net credit balance of swap and forward transactions with non-resident counterparties concluded by the MNB.

4.11 OTHER DEPOSITS AND LIABILITIES

Other forint liabilities

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Two-week MNB bills	3,563,712	5,169,021	1,605,309
	International financial institutions forint deposits	2,439	3,667	1,228
	Other liabilities	7,302	2,644	-4,658
VI.4.	**Other forint deposits and liabilities**	**3,573,453**	**5,175,332**	**1,601,879**

The end-2013 balance of other forint deposits and liabilities showed an increase of HUF 1,601.9 billion (up approximately 45 per cent) compared to the previous year-end, which was almost entirely due to the rise in the amount of two-week MNB bills. The two-week MNB bill is the most important monetary policy instrument of the MNB. The issue yield on bills is equal to the prevailing central bank base rate.

Other foreign currency liabilities

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Bonds	69,882	20,542	-49,340
	Repo transactions	291,290	246,193	-45,097
	IMF deposit	986,192	649,520	-336,672
	Foreign deposits and loans	44,521	28,560	-15,961
	Hedging transactions*	14,694	0	-14,694
	Other liabilities	325	318	-7
VII.3.	**Other foreign currency liabilities**	**1,406,904**	**945,133**	**-461,771**

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

The balance of other foreign currency liabilities fell by HUF 461.8 billion to HUF 945.1 billion as at 31 December 2013. The amount of IMF deposit declined in 2013, due to the two scheduled repayments and to the prepayment (in August) of the IMF loan granted to the MNB in June 2009, as well as due to the strengthening of the forint exchange rate versus the SDR. The amount of IMF deposits increased owing to a switch over to the new official exchange rate ordered by the IMF, which is due once a year (every April). One bond, issued by the MNB in 1993 with a face value of USD 200 million, matured in November. This caused a decrease of HUF 49.3 million, containing the effect of revaluation as well. The HUF 45.1 million decline in foreign currency liabilities related to repo transactions comes mainly from transaction effects. Between the repo transactions at end-2013, there was a significant repo transaction concluded with the ECB, which had a balance of EUR 0.5 billion (HUF 158.8 billion). The item ‘Hedging transactions’ mainly included the net liabilities of the IMF swap related to the IMF loan and of the currency swap transactions with non-resident counterparties concluded by the MNB at 31 December 2012, but these transactions matured as the related transactions (IMF loan and USD bond issued by the MNB) ceased.

Other foreign currency liabilities by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance 31. 12. 2012	Balance 31. 12. 2013	Change
	- within 1 year	1,042,765	595,433	-447,332
	- within 1 to 5 years	26,627	20,542	-6,085
	- over 5 years	0	0	0
	- without maturity	337,512	329,158	-8,354
VII.3.	**Other foreign currency liabilities**	**1,406,904**	**945,133**	**-461,771**

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

HUF millions

No.	Description	Balance 31. 12. 2012	Balance 31. 12. 2013	Change
1.	- USD	47,569	4,271	-43,298
2.	- EUR	332,753	270,800	-61,953
3.	- JPY	25,696	20,542	-5,154
4.	- SDR	337,513	329,158	-8,355
5.	- Other	648,679	320,362	-328,317
6.	**Other foreign currency liabilities**	**1,392,210**	**945,133**	**-447,077**

The item ‘Other’ amounted to HUF 320.4 billion at the end of 2013 and mainly contains the revaluation-corrected forint coverage of the IMF quota. The EUR-denominated items decreased by HUF 62 billion, mainly due to the falling stock of repo transactions.

4.12 NET POSITION VIS-À-VIS THE IMF

HUF millions

B/S line	Description	Balance 31. 12. 2012	Balance 31. 12. 2013	Change
from II.1.	IMF quota paid in SDR	25,145	24,523	-622
from II.1.	Deposit with IMF	80,784	4,569	-76,215
from II.1.	Deposit with IMF for Fund's programme purposes	3,146	3,068	-78
from II.4.	IMF quota paid in HUF	328,493	320,361	-8,132
	Total receivables	**437,568**	**352,521**	**-85,047**
from VII.3.	Liabilities arising from SDR Allocations	337,513	329,158	-8,355
from VII.3.	IMF No. 2. account	1	1	0
from VII.3.	IMF No. 1. account	648,678	320,361	-328,317
from VII.3.	Swap receivables from IMF	-320,186	0	320,186
from VII.3.	Swap payables to IMF	322,979	0	-322,979
	Total liabilities	**988,985**	**649,520**	**-339,465**
	Total	**-551,417**	**-296,999**	**254,418**

The IMF loan amounting to SDR 1.3 billion was drawn down by the MNB in 2009. According to the IMF’s regulations, disbursement was recorded in the form of a swap transaction, which meant forint receivables and SDR liabilities. This swap transaction appeared on the liability side due to revaluations in 2012: the amount of forint receivables is determined by the IMF, and the volume of liabilities depends on the foreign exchange rate of SDR. The loan granted by the IMF raises the amount of foreign exchange reserves and the balance of the IMF No. 1. account on the liability side (i.e. forint coverage of the IMF quota). The liability from the IMF shown in the item 'Swap payables to IMF' of the table decreased to nil as at 31 December 2013, because of the instalments repaid during the year and the prepayment in August 2013.

The item 'Liabilities arising from SDR allocations' represents the liability of HUF 329.2 billion (i.e. SDR 991.1 million) with no maturity, arising from the allocation distributed by the IMF in 2009 on the one hand. This amount raised the deposit with the IMF on the other hand. The SDR allocation may be used for repaying the capital amount and interest of the loan from the IMF. The allocation was appropriated in 2013 for interest payment, capital repayments and the prepayment in August.

The HUF-denominated promissory note related to the liability from the Fund disbursements of the Hungarian State and placed with the MNB as a fiscal agent was shown as an off-balance sheet item in the balance sheet of the MNB (see Section 4.18.). The commitment amounted to HUF 1,171 billion at 31 December 2012 and had changed to nil by the end of 2013 due to the repayments during the year.

4.13 INVESTED ASSETS

In addition to intangibles, tangibles and capital expenditure (HUF 14.2 billion), invested assets include shares in investments (HUF 8.3 billion in foreign investments and HUF 10.8 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. 2012	**8,246**	**8**	**12,135**	**10,732**	**236**	**76**	**31,433**
Commissioning / Acquisition	251	33	51	252	2	403	992
Other addition (from HFSA integration)	3,004	3	182	1,499	0	2	4,690
Scrapping	-180	0	0	-407	0	0	-587
Selling	0	0	0	-23	0	0	-23
Transfer free of charge	-1	0	0	-35	0	0	-36
Other disposal/reclassification	-5	0	0	-2	-1	0	-8
31. 12. 2013	**11,315**	**44**	**12,368**	**12,016**	**237**	**481**	**36,461**
Details of depreciation							
31. 12. 2012	**6,909**	**0**	**2,849**	**7,329**	**0**	**0**	**17,087**
Ordinary depreciation	487	0	380	868	0	0	1,735
Other addition (cumulated depreciation of assets taken from HFSA)	2,691	0	28	1,346	0	0	4,065
Derecognition	186	0	0	463	0	0	649
Decrease due to reclassification	0	0	0	0	0	0	0
31. 12. 2013	**9,901**	**0**	**3,257**	**9,080**	**0**	**0**	**22,238**
Balance							
31. 12. 2012	**1,337**	**8**	**9,286**	**3,403**	**236**	**76**	**14,346**
31. 12. 2013	**1,414**	**44**	**9,111**	**2,936**	**237**	**481**	**14,223**
Change	**77**	**36**	**-175**	**-467**	**1**	**405**	**-123**

The assets taken from the HFSA during the integration had a net balance of HUF 625 million. From this balance, HUF 316 million appeared as intangible assets, HUF 154 million as buildings, HUF 153 million as equipment and HUF 2 million as capital expenditure. The buildings taken during the integration also contained HUF 69 million net balance of managed, state-owned properties, these (3 buildings and 2 plots of land) remained managed property.

Foreign investment and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2012	31. 12. 2013	31. 12. 2012	31. 12. 2013	2012	2013
BIS	1.43	1.43	6,666	6,596	913	920
SDR millions			*10*	*10*		
CHF millions			*13.5*	*13.5*		
European Central Bank	1.39	1.37	1,629	1,656	0	0
EUR thousands			*5,591*	*5,578*		
SWIFT	0.02	0.02	2	2	0	0
EUR thousands			*8.6*	*8.6*		
Total investments			**8,297**	**8,254**	**913**	**920**

** Dividends financially settled in the given year.*

The Republic of Hungary joined the European Union on 1 May 2004. Consequently, the MNB became a member of the ESCB. The ESCB comprises the European Central Bank (ECB) and the national central banks of the 28 EU Member States. The Eurosystem is composed of the ECB and of the national central banks of Member States which have already adopted the euro.

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

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

Effective 29 December 2010, the ECB's subscribed capital increased by EUR 5 billion to EUR 10,761 million, and thus Hungary's share in the ECB's capital rose to EUR 149.1 million, while the capital key remained unchanged. The measure of the contribution to the ECB's operational cost to be paid up by non-euro area NCBs changed as well; 3.75 per cent of their share in the subscribed capital of the ECB shall be paid instead of the earlier 7 per cent, pursuant to Article 47 of the Statute. As of 1 July 2013, Croatia joined the EU, so the capital of the ECB increased from EUR 10,761 million to EUR 10,825 million, and the MNB's capital key reduced to 1.374 per cent and its subscribed capital decreased to EUR 148.7 million. The value of the investment (i.e. paid-up capital) amounted to EUR 5.6 million in the MNB's balance sheet as at 31 December 2013.

As of 1 January 2014, the capital keys were adjusted again because Latvia joined the euro area and due to the five-year adjustment mentioned above. The MNB's capital key rose to 1.3798 per cent, and its subscribed capital increased to EUR 149.4 million.

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. As membership required the investment of a mere GBP 1, it was not recorded in the MNB's books. The activities of CEBS were taken over by the European Banking Authority from 2011. Upon termination, the CEBS went under winding up; the EBA has no authority function, so investment was not required. In the EBA, Hungary was previously represented by the

HFSA until the supervisory integration, and the MNB participated as an observer in the EBA. The MNB became a member with voting rights after the integration. Members contribute their respective quotas to its operating costs according to an annual payment schedule.

Ownership distribution in the ECB at 31 December 2013

National Central Banks (NCBs)	Subscribed capital	Paid-up capital	Capital key (%)
	EUR thousands		
Nationale Bank van België / Banque Nationale de Belgique	261,705	261,705	2.4176
Deutsche Bundesbank	2,030,804	2,030,804	18.7603
Eesti Pank	19,268	19,268	0.1780
Banc Ceannais na hÉireann / Central Bank of Ireland	120,277	120,277	1.1111
Bank of Greece	210,904	210,904	1.9483
Banco de España	893,420	893,420	8.2533
Banque de France	1,530,028	1,530,028	14.1342
Banca d'Italia	1,348,471	1,348,471	12.4570
Central Bank of Cyprus	14,430	14,430	0.1333
Banque centrale du Luxembourg	18,825	18,825	0.1739
Bank Centrali ta' Malta / Central Bank of Malta	6,874	6,874	0.0635
De Nederlandsche Bank	429,352	429,352	3.9663
Oesterreichische Nationalbank	209,680	209,680	1.9370
Banco de Portugal	190,910	190,910	1.7636
Banka Slovenije	35,398	35,398	0.3270
Národná banka Slovenska	74,487	74,487	0.6881
Suomen Pankki – Finlands Bank	134,836	134,836	1.2456
Subtotal for euro area NCBs	**7,529,669**	**7,529,669**	**69.5581**
Bulgarian National Bank	93,571	3,509	0.8644
Česká národní banka	157,385	5,902	1.4539
Danmarks Nationalbank	159,712	5,989	1.4754
Hrvatska narodna banka	64,355	2,413	0.5945
Latvijas Banka	29,682	1,113	0.2742
Lietuvos bankas	44,307	1,661	0.4093
Magyar Nemzeti Bank	148,736	5,578	1.3740
Narodowy Bank Polski	525,890	19,721	4.8581
Banca Naţională a României	264,660	9,925	2.4449
Sveriges Riksbank	244,775	9,179	2.2612
Bank of England	1,562,265	58,585	14.4320
Subtotal for non-euro area NCBs	**3,295,338**	**123,575**	**30.4419**
Total NCBs	**10,825,007**	**7,653,244**	**100.0000**

Domestic investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31. 12. 2012	31. 12. 2013	31. 12. 2012	31. 12. 2013	2012	2013
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 17.	100.0	100.0	8,927	8,927	0	0
Magyar Pénzverő Zrt. 1239 Budapest, Európa u. 1.	100.0	100.0	575	575	285	104
Hitelintézeti Felszámoló Nkft. 1071 Budapest, Damjanich u. 11–15.	n. a.	100**	n. a.	50	n. a.	n. a.
KELER Zrt. 1075 Budapest, Asbóth utca 9–11.	53.3	53.3	643	643	0	0
KELER KSZF Zrt. 1075 Budapest, Asbóth utca 9–11.	13.6	0.2	62	7	0	0
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	7.3	8.1	46	266	120	123
Budapesti Értéktőzsde Zrt. 1062 Budapest, Andrássy út 93.	6.9	6.9	321	321	77	39
Total investments			**10,574**	**10,789**	**482**	**266**

** Dividends financially settled in the given year.*
*** As the MNB exercises the ownership rights, it reports the state-owned company in its financial accounting.*
n. a.: not applicable.

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

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

Hitelintézeti Felszámoló Nonprofit Kft. (Credit Institution Liquidator Non-profit LLC, Nonprofit Kft.) was a 100 per cent state-owned company at 31 December 2013. As of 1 October 2013, the ownership rights of the Nonprofit Kft. were exercised by the MNB by virtue of Article 177 paragraph (3) of the MNB Act. Before the integration, the HFSA exercised the ownership rights of the Nonprofit Kft. based on the contract with Hungarian National Asset Management Inc. (MNV Zrt.). As the new MNB Act came into force, the contract was terminated by mutual consent and the MNV Zrt. removed the HUF 50 million business share of the Nonprofit Kft. from its financials. The MNB recorded the business share of the Nonprofit Kft. in its financials as domestic investment at value of the share capital as reported book value. By virtue of Article 183/D of the MNB Act amended on 25 February 2014, the ownership rights were transferred to the MNB. The Nonprofit Kft. performs the liquidation and winding up proceedings of financial institutions defined in Article 39 paragraph (1) of the MNB Act, as well as the termination of venture capital funds and the duties of the supervisory commissioner defined in Article 79 of the MNB Act. Nonprofit Kft. performs all its duties as public service activities.

The ownership share of the MNB in **KELER KSZF Zrt.** decreased from 13.6 per cent to 1.2 per cent in the first half of 2013, because of the capital increase related to the clearing business taken from KELER Zrt. as contribution in kind. A further capital increase by the KELER Zrt., effective from 24 July 2013, caused the ownership share of the MNB to fall to 0.2 per cent, and the value of the investment in respect of the capital proportion dropped to HUF 7 million.

As a consequence of the pre-empted share transfer at end-2013, the ownership share of the MNB in **GIRO Elszámolásforgalmi Zrt.** rose to 8.1 per cent, and the book value of the investment increased to HUF 266 million.

Key indicators of domestic investments

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

HUF millions

Investment	Share capital	Reserves	Profit/loss for the year	Equity	Profit/loss for the year after taxation
	31. 12. 2013	31. 12. 2013	31. 12. 2013	31. 12. 2013	2013
Pénzjegynyomda Zrt.	8,927	1,110	769	10,806	769
Magyar Pénzverő Zrt.	575	469	0	1,044	52
Hitelintézeti Felszámoló Nkft.	50	3	0	53	0
KELER Zrt.	4,500	17,492	1,956	23,948	2,173
KELER KSZF Zrt.	1,823	3,262	123	5,208	123
GIRO Elszámolásforgalmi Zrt.	2,496	3,628	1,065	7,189	1,065
Budapesti Értéktőzsde Zrt.	541	4,924	565	6,030	565

HUF millions

Investment	Net sales revenue		Financial income		Other income		Extraordinary income	
	2012	2013	2012	2013	2012	2013	2012	2013
Pénzjegynyomda Zrt.	6,256	6,758	96	94	23	14	0	3
Magyar Pénzverő Zrt.	2,057	1,840	18	9	1	1	0	0
Hitelintézeti Felszámoló Nkft.	198	73	3	0	123	267	0	0
KELER Zrt.	n. a.	n. a.	15,225	10,655	352	316	0	513
KELER KSZF Zrt.	599	792	362	196	3	31	0	5
GIRO Elszámolásforgalmi Zrt.	n. a.	n. a.	4,902	4,234	1,576	1,529	0	0
Budapesti Értéktőzsde Zrt.	2,397*	2,281*	44	34	28	71	0	0

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

Persons

Investment	Average number of staff	
	31. 12. 2012	31. 12. 2013
Pénzjegynyomda Zrt.	301	298
Magyar Pénzverő Zrt.	38	38
Hitelintézeti Felszámoló Nkft.	24	24
KELER Zrt.	131	125
KELER KSZF Zrt.	1	10
GIRO Elszámolásforgalmi Zrt.	135	133
Budapesti Értéktőzsde Zrt.	56	53

The MNB's receivables from and liabilities to affiliated companies

HUF millions

Investment	Receivables	Liabilities
	31. 12. 2013	31. 12. 2013
Pénzjegynyomda Zrt.	0	114
Magyar Pénzverő Zrt.	5	60
Hitelintézeti Felszámoló Nkft.	0	0
KELER Zrt.	0	1
KELER KSZF Zrt.	0	0
GIRO Elszámolásforgalmi Zrt.	0	1
Budapesti Értéktőzsde Zrt.	0	0
Total	**5**	**176**

The above table presents short-term receivables and liabilities.

4.14 IMPAIRMENT LOSSES AND PROVISIONS

HUF millions

B/S line	Description	31. 12. 2012	Interim changes in 2013			31. 12. 2013
		Impairment losses / provisions	HFSA integration (+)	Increase (+)	Reversal (-)	Total impairment losses / provisions
1	2	3	4	5	6	3+4+5+6
from I.3.	Other forint receivables	0	801	927	0	1,728
from II.4.	Other foreign currency receivables	132	0	2	0	134
from III.	Other assets	16	12	55	-3	80
VIII.	Liabilities	4,291	0	1,561	-1,777	4,075
	- litigation related liabilities	0	0	1,433	0	1,433
	- derivatives	3,226	0	18	-1,151	2,093
	- bond lending	1,065	0	110	-626	549
	Total	**4,439**	**813**	**2,545**	**-1,780**	**6,017**

Impairment losses and provisions increased by HUF 1,578 million to HUF 6,017 million in 2013.

In the supervisory integration, an impairment balance of HUF 801 million was assumed in the other forint receivables from supervisory activities, and in the year-end qualification HUF 927 million in further impairment loss appeared.

The impairment loss on the other banking assets increased by HUF 12 million because of the integration, a balance of HUF 3 million was reversed as at 31 December 2013 and HUF 55 million more impairment loss was created for investments.

The MNB formed a provision of HUF 1,433 million in connection with litigation-related contingent liabilities at end-2013.

The additional provision created due to the changes in the market value of derivatives for purposes other than hedging amounted to HUF 18 million, while a provision of HUF 1,151 million was reversed in 2013.

According to the international securities lending contracts, the MNB is charged with the entire amount of potential losses arising from cash-hedge investments made by agents. Based on the principle of prudence, a provision must be created to cover this loss as a future liability. The end-2012 balance of provisions created for forint bond lending amounted to HUF 1,065 million and decreased to HUF 549 million up to the end of 2013, caused by the decrease in the balance of the securities for which the provisions were created on the one hand, and due to the better market qualification of most securities on the other hand.

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

HUF millions

B/S line	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
	Due to banking transactions	136,094	136,015	-79
	Due to internal operation	119	97	-22
IV.	**Prepaid expenses/accrued income**	**136,213**	**136,112**	**-101**
	Due to banking transactions	18,145	27,176	9,031
	Due to internal operation	802	114	-688
X.	**Accrued expenses/deferred income**	**18,947**	**27,290**	**8,343**

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

4.16 CHANGES IN EQUITY

HUF millions

B/S line	Description	31. 12. 2012	Interim changes	31. 12. 2013
XI.1.	Share capital	10,000	0	10,000
XI.2.	Retained earnings*	47,023	-37,261	9,762
XI.3.	Valuation reserves	0	0	0
XI.4.	Revaluation reserves due to exchange rate changes	564,041	-54,438	509,603
XI.5.	Revaluation reserves of foreign currency securities	-30,188	-60,912	-91,100
XI.6.	Profit/Loss for the year	-39,811	66,106	26,295
XI.	**Equity**	**551,065**	**-86,505**	**464,560**

** The difference between the interim change of Retained earnings and the Profit for the year of 2012 is caused by the retained earnings arising from the integration of the HFSA and rounding.*

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

Pursuant to the MNB Act, the MNB's dividend is specified by the Board of Directors. According to the decision of the Board of Directors, in 2014 the MNB will not pay any dividend from the profit and retained earnings for the year 2013.

For more details on revaluation reserves, see Section 4.17.

Integration of the HFSA

HUF millions

Items from HFSA integration	
Cash	1,471
Tangible and intangible assets	625
Receivables from employee loan	510
Receivables from supervised companies	101
Receivables related to operation	52
Hitelintézeti Felszámoló Nonprofit Kft.	50
Inventory	2
Liabilities related to operation	-142
Total	**2,669**

HUF millions

Effects at the financials of the MNB	
Retained earnings	**2,549**
Liabilities related to property management	70
Investment received without reimbursement (Nonprofit Kft.)	50
Total	**2,669**

As of 1 October 2013, the HFSA was terminated and the MNB exercises the rights and discharges the obligations of the HFSA by virtue of the MNB Act. With the integration, the managed state-owned assets recorded in the HFSA's balance sheet, with the exception of the state-owned property, based on the MNB Act, became the properties of the MNB free of charge at book value at the date of transfer and increased the retained earnings of the MNB.

The state-owned property managed by the HFSA transferred to management by the MNB. The transferring book value of the managed land and buildings were recorded at the MNB against liabilities related to property management.

The receivables and payables recorded in the HFSA balance sheet at 30 September 2013 were recorded against the retained earnings of the MNB at book value at the date of transfer.

The cash transferred at the date of termination increased the retained earnings of the MNB.

By virtue of the MNB Act, ownership rights in the Nonprofit Kft. are exercised by the MNB starting from 1 October 2013. The 100 per cent state-owned business share of the Nonprofit Kft. was previously recorded in the balance sheet of the MNV Zrt., and not in the HFSA's balance. By virtue of the MNB Act, the business share of the Nonprofit Kft. was removed the records of the MNV Zrt., and was taken in the MNB financials against 'Income other than fees and commissions' at reported book value, i.e. at the value of the share capital.

4.17 REVALUATION RESERVES

HUF millions

B/S line	Description	31. 12. 2012	31. 12. 2013	Change
XI.4.	Revaluation reserves due to exchange rate changes	564,041	509,603	-54,438
XI.5.	Revaluation reserves of foreign currency securities	-30,188	-91,100	-60,912
	Total revaluation reserves	**533,853**	**418,503**	**-115,350**

The official forint exchange rate versus the euro fluctuated in a range between 288.15 and 307.85 in 2013. It reached its lowest value at the end of May and the highest in the second half of March. Compared to 31 December 2012, the exchange rate weakened by 1.9 per cent. The exchange rate was EUR/HUF 296.91 at 31 December 2013. The average cost rate weakened by HUF 9.41 to 281.15. The difference between the official and average cost rate was lower compared to end-2012 (a decrease from EUR/HUF 19.55 to EUR/HUF 15.76). Consequently the revaluation reserves due to exchange rate changes, calculated as the difference of foreign exchange items converted into forint using the official and average cost rate, decreased by HUF 54.4 billion to HUF 509.6 billion.

Revaluation reserves of foreign currency securities are calculated as the difference between the market value and the book value of securities. Market price differences on the foreign currency securities in the MNB's portfolio showed a negative balance of HUF 91.1 billion as at 31 December 2013. According to the MNB Act, the central government is not required to reimburse the negative balance, while the aggregated balance of the two revaluation reserves was positive.

Annual changes in the forint exchange rate

EUR/HUF

Date	MNB official exchange rate	Average cost rate
31. 12. 2012	291.29	271.74
31. 12. 2013	296.91	281.15
Annual appreciation (+) / depreciation (-)		
In 2012	+6.4%	
In 2013	-1.9%	

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

Liabilities arising from hedging and other forward transactions and related receivables

HUF millions

No.	Description	31. 12. 2012			31. 12. 2013		
		Receivables	Liabilities	Net market value	Receivables	Liabilities	Net market value
1.	Interest rate swap transactions	434,002	434,002	-4,442	1,120,668	1,120,668	-20,015
2.	Bond future transactions	0	244,092	-473	0	268,230	745
3.	FX swap and forward transactions	1,625,825	1,560,231	65,834	1,412,604	1,385,476	27,449
4.	Currency swap transactions (including transactions without capital replacement)	229,299	241,880	-13,058	1,365,134	1,360,789	21,552
5.	**Total hedging transaction (1+2+3+4)**	**2,289,126**	**2,480,205**	**47,861**	**3,898,406**	**4,135,163**	**29,731**
6.	CDS transactions	203,903	203,903	-3,226	178,146	178,146	-2,075
7.	FX swap and forward transactions	6,419	6,370	49	2,562	2,564	-2
8.	**Total other forward transactions (6+7)**	**210,322**	**210,273**	**-3,177**	**180,708**	**180,710**	**-2,077**
9.	**Total (5+8)**	**2,499,448**	**2,690,478**	**44,684**	**4,079,114**	**4,315,873**	**27,654**

The table above includes all types of the off-balance sheet liabilities arising from derivative transactions; it also includes FX swap, currency swap and forward transactions for hedging purposes, which are part of the foreign currency position and are recorded in the balance sheet, except the currency swaps without capital movement. Hedging transactions reduce risks related to the net foreign currency position and arising from cross rate fluctuations and interest rate changes. These transactions support the creation of the benchmark foreign currency structure determined by the Monetary Council.

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

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

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

37 per cent of the end-2013 balance of the currency swap transactions was made up by the transactions without capital replacement concluded in February and November 2013.

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

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

Liabilities from derivative transactions by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2012	31. 12. 2013	
	- within 1 year	2,003,133	1,683,756	-319,377
	- within 1 to 5 years	477,072	855,874	378,802
	- over 5 years	0	1,595,533	1,595,533
1.	**Hedging transactions**	**2,480,205**	**4,135,163**	**1,654,958**
	- within 1 year	6,370	2,564	-3,806
	- within 1 to 5 years	203,903	178,146	-25,757
	- over 5 years	0	0	0
2.	**Other forward transactions**	**210,273**	**180,710**	**-29,563**
3.	**Total (1+2)**	**2,690,478**	**4,315,873**	**1,625,395**

Other off-balance sheet liabilities

HUF millions

No.	Description	Balance		Change
		31. 12. 2012	31. 12. 2013	
1.	FGS residual drawable credit facilities	0	31,629	31,629
2.	Litigation related contingent liabilities	0	2,935	2,935
3.	Guarantees	1,398	1,364	-34
4.	Other off-balance sheet liabilities	3	11	8
5.	IMF security deposit account	1,170,998	0	-1,170,998
6.	**Total (1+2+3+4+5)**	**1,172,399**	**35,939**	**-1,136,460**

The balance of FGS residual drawable credit facilities shows the amount which is contracted with the commercial banks, but is not disbursed yet.

The litigation-related contingent liabilities are to record the legal proceedings for which provisions have been formed. The majority of the proceedings were transferred to the MNB with the HFSA integration and contain proceedings against penalty resolutions as well as indemnity cases.

The item 'Guarantees' consists of export guarantees, to which an irrevocable indemnity bond is always linked. When exercising a guarantee, the MNB has the right to a reverse guarantee if needed. In 2013, the balance of guarantees decreased due to exchange rate changes and the termination of one guarantee.

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; as the related loan was repaid, the deposit was terminated (see Section 4.12).

Other off-balance sheet liabilities by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31. 12. 2012	31. 12. 2013	
	- within 1 year	1,075,768	34,603	-1,041,165
	- within 1 to 5 years	95,301	38	-95,263
	- over 5 years	0	0	0
	- without maturity	1,330	1,298	-32
1.	**Total other liabilities**	**1,172,399**	**35,939**	**-1,136,460**

Recording off-balance sheet security transactions

HUF millions

No.	Description	Balance 31. 12. 2012	Balance 31. 12. 2013	Change
1.	Face value of securities lent	1,168,182	607,596	-560,586
2.	Purchase cost of the non-cash hedge arising from security lending transactions	453,402	133,544	-319,858
3.	Investment of cash hedge arising from security lending transactions			
	- at purchase cost	701,200	477,018	-224,182
	- at market value	700,135	476,469	-223,666
4.	Face value of securities bought under repo transactions	442,165	286,845	-155,320
5.	Face value of securities sold under reverse repo and blocked to ECB repo transactions	972,720	381,232	-591,488

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	2012	2013	Change
1	2	3	4	4-3
(I.1.+II.2.)—(X.1.+XI.1.)	Central government	-36,519	-17,235	19,284
(I.2.+II.3.)—(X.2.+XI.2.)	Credit institutions	-28,687	-12,750	15,937
(I.3.+II.1.+II.4.)—(X.3.+XI.3.)	Other	-71,586	-17,132	54,454
	Net profit/loss from interest	**-136,792**	**-47,117**	**89,675**
from lines (I.4.—X.4.)	Forint securities	359	400	41
from lines (II.5.—XI.4.)	Derivative transactions for hedging and other purposes*	-17,025	-2,696	14,329
from lines (II.5—XI.4.)	Other	-92	-18	74
(I.4.+II.5.)—(X.4.+XI.4.)	**Net interest related profit/loss**	**-16,758**	**-2,314**	**14,444**
(I.+II.)—(X.+XI.)	**Net interest and interest related income**	**-153,550**	**-49,431**	**104,119**

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

In 2013, the MNB recorded a net interest and interest related loss of HUF 49.4 billion, which was a decrease of HUF 104.1 billion compared to the figure for end-2012.

Net interest income improved by HUF 89.7 billion in comparison with end-2012, mainly due to the decrease of the average base rate.

Favourable factors on the net interest income:

– interest paid on the forint and foreign currency deposits of the central government was HUF 23.1 billion lower compared to 2012, due to the decreasing balance of deposits and lower interest rates,

– interest expenses on deposits of domestic credit institutions decreased by HUF 18.8 billion,

– interest expense on the two-week MNB bills was HUF 75.5 billion lower,

– interest expenses on other foreign currency liabilities decreased by HUF 11.8 billion; this was caused largely by repayment of the IMF loan.

Unfavourable factors on the net interest income:

– a decrease in interest income on foreign exchange reserves of HUF 32.6 billion relative to 2012,

– lower interest income on forint denominated government bonds of HUF 3.8 billion caused by the maturity of bonds on the one hand, and by the lower interest rates on the other hand,

– HUF 2.8 billion less interest income on loans to credit institutions and on mortgage bonds.

Net interest related income improved by HUF 14.4 billion, due mainly to the net gain or loss on derivative transactions which are not related to exchange rate changes.

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

HUF millions

No.	Description	2012	2013	Change
1.	- interest income on currency swaps	10,495	33,380	22,885
2.	- income like interest margin on hedge interest rate swaps	730	4,866	4,136
3.	- interest gains on hedge FX swaps	5,108	3,051	-2,057
4.	- interest gains on hedge futures transactions	2,032	2,621	589
5.	- interest related gains on hedge swap transactions	0	0	0
6.	- income from fees on hedge option transactions	0	0	0
7.	- interest income and interest related gains on other transactions	234	1,365	1,131
8.	**Income from derivative transactions (1+2+3+4+5+6+7)**	**18,599**	**45,283**	**26,684**
9.	- interest expenses on currency swaps	11,031	39,271	28,240
10.	- expense like interest margin on hedge interest rate swaps	256	0	-256
11.	- interest loss on hedge FX swaps	7,880	2,885	-4,995
12.	- interest loss on hedge futures transactions	15,205	791	-14,414
13.	- interest related losses on hedge swap transactions	998	4,147	3,149
14.	- expenses from fees on hedge option transactions	0	0	0
15.	- interest expenses and interest related losses on other transactions	254	885	631
16.	**Expenses on derivative transactions (9+10+11+12+13+14+15)**	**35,624**	**47,979**	**12,355**
17.	- net interest on currency swaps (1-9)	-536	-5,891	-5,355
18.	- interest margin on hedge interest rate swaps (2-10)	474	4,866	4,392
19.	- net interest gains on hedge FX swaps (3-11)	-2,772	166	2,938
20.	- net interest gains on hedge futures transactions (4-12)	-13,173	1,830	15,003
21.	- net interest related income on hedge swap transactions (5-13)	-998	-4,147	-3,149
22.	- net interest related income on hedge option transactions (6-14)	0	0	0
23.	- net interest and interest related income on other transactions (7-15)	-20	480	500
24.	**Net income from derivative transactions (8-16)**	**-17,025**	**-2,696**	**14,329**

Currency swap transactions include derivative transactions concluded with foreign partners and with the ÁKK. The transactions concluded with foreign partners serve to hedge exchange rate and interest rate risks arising from bonds issued in the past by the MNB abroad. The transactions concluded with the ÁKK increased due to the transactions related to the foreign currency bond issue in February. The net interest result of the currency swaps was a loss of HUF 5.9 billion, and accordingly there was a decline of HUF 5.4 billion compared to 2012.

The HUF 4.4 billion increase in the interest result on interest rate swaps was caused by the rising number of transactions and by the favourable changes in FX market yields.

Net interest gains on FX swaps for hedging purposes increased by HUF 2.9 billion caused mainly by the decreasing balance of FX swaps contracted with credit institutions.

Net interest gains on hedge futures transactions rose by HUF 15 billion, due to the lower interest expense on bond futures transactions.

Net interest related income on hedge swap transactions include the loss of HUF 4.1 billion resulted from the exchange loss on closing or on maturity of interest rate swaps.

Net interest and interest related income on other transactions increased by HUF 0.5 billion due to the increase of net interest on other futures transactions and on other interest rate swaps.

Realised gains/losses from financial operations

HUF millions

P/L line	Description	2012	2013	Change
IV.	Realised gains from financial operations	31,833	26,221	-5,612
XIV.	Realised losses from financial operations	65,013	138,819	73,806
IV.–XIV.	**Net financial gains/losses**	**-33,180**	**-112,598**	**-79,418**

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

Net realised losses from financial operations amounted to HUF 112.6 billion in 2013, a decline of HUF 79.4 billion compared to 2012. Losses mainly occurred upon the maturity of bonds with high coupons and bought over nominal value.

4.20 COMPONENTS OF INCOME FROM THE REVALUATION OF FOREIGN EXCHANGE HOLDINGS

HUF millions

Description	2012	2013
Net income from exchange rate changes (realised and conversion spread)*	158,269	200,339
Change in revaluation reserves in the balance sheet** (due to unrealised revaluation net income)	-760,922	-54,438
Total effect of exchange rate changes	**-602,653**	**145,901**

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

In 2013, the total exchange rate change effect was a gain of HUF 145.9 billion, due to the changes in the exchange rate of the forint. In the sales related to decreasing the daily net FX position, the MNB realised a gain of HUF 200.3 billion, while the amount of the revaluation reserve was decreased by the unrealised exchange rate changes losses of HUF 54.4 billion during the year.

For more details on revaluation reserves, see Section 4.17.

4.21 COST OF ISSUING BANKNOTES AND COINS

HUF millions

P/L line	Description	2012	2013	Change
	Cost of banknote production	2,796	2,864	68
	Cost of coin production	916	1,027	111
	Cost of production of commemorative and collector coins	437	266	-171
XIII.	**Cost of issuing banknotes and coins**	**4,149**	**4,157**	**8**

The cost of issuing banknotes and coins was HUF 4.2 billion in 2013, the same level as preceding year. The cost of banknote production increased by 2.4 per cent compared to 2012, because in 2013 the banknotes were produced at a higher unit price than in 2012. The increase in the cost of coin production was caused by the 32 per cent increase of the quantity of the produced coins. The lower production cost of commemorative coins comes from the halved quantity of coins produced and from the fact that in 2013 only 8 types of coins were issued, while in 2012 there were 10.

4.22 OTHER INCOME/EXPENSES

HUF millions

P/L line	Description	2012	2013	Change
V.1.	Income from fees and commissions	986	1,423	437
XV.1.	Expenses of fees and commissions	780	755	-25
	Net income from fees and commisssions	**206**	**668**	**462**
V.2.	Income from other than fees and commissions	2,907	6,343	3,436
XV.2.	Expenses of other than fees and commissions	425	2,545	2,120
	Net income from other than fees and commisssions	**2,482**	**3,798**	**1,316**
V.3.	**Income from supervisory activities**	**0**	**2,870**	**2,870**
V.–XV.	**Other net results**	**2,688**	**7,336**	**4,648**

Income from fees and commissions mainly relates to payment services. Higher income from fees and commissions stemmed from the commission related to the residual drawable FGS credit facilities.

With the integration of the supervisory activities to the MNB, fee and fine income from supervisory activities appeared as new item in the other income.

For more details on income other than fees and commissions, see Section 4.23; on income related to supervisory activities, see Section 4.24.

4.23 INCOME OTHER THAN FEES AND COMMISSIONS

HUF millions

P/L line	Description	2012	2013	Change
	Non-repayable money received	1,009	2,532	1,523
	Profit from the withdrawal of notes and coins	0	2,145	2,145
	Dividends from investments	1,395	1,187	-208
	Income related to coins and commemorative coins	420	419	-1
	Income from assets assigned free of charge	2	52	50
	Other income	81	8	-73
V.2.	**Income from other than commissions and charges**	**2,907**	**6,343**	**3,436**
	Financial money transfer	239	2,352	2,113
	Expenses related to coins and commemorative coins	168	176	8
	Expenses from assets assigned free of charge	7	3	-4
	Other expenditures	11	14	3
XV.2.	**Expenses from other than commissions and charges**	**425**	**2,545**	**2,120**
V.2.–XV.2.	**Net income/expenses from other than commissions and charges**	**2,482**	**3,798**	**1,316**

Income other than fees and commissions includes the following in 2013:

– The item 'Non-repayable money received' includes an amount of SDR 7.6 million (in 2012, it was more than SDR 3 million) received from the IMF. The IMF decided to distribute the remaining gold sales as windfall profit among its members in proportion to their quotas in the Fund. The aim of the decision was that members make a donation to low-income developing countries. The profit as the yield of the paid quota fell to the MNB. In accordance with the regulations concerning the prohibition on monetary financing, MNB is not allowed to make donation from its foreign currency reserves in the name of Hungary. The State has the right to decide on this donation. For the MNB, the HUF 2.5 billion (in 2012 HUF 1 billion) received from the IMF represents extraordinary income, which will not involve any expenses.

– Profit from the withdrawal of notes and coins arose because the HUF 1 and 2 coins withdrawn five years before. As the converting period of these coins ended on 28 February 2013, the amount of unchanged coins became a cancelled liability and appeared in March as other income.

– Dividends from investments decreased by HUF 0.2 billion compared to 2012. In June 2013, the BIS paid a dividend of HUF 920 million, Magyar Pénzverő Zrt of HUF 104 million and BÉT of HUF 39 million. GIRO Zrt. paid the dividend of HUF 123 million in July. Pénzjegynyomda Zrt., in line with the decision of the shareholder, KELER Zrt. and KELER KSZF Zrt., according to the decision of their general meeting, did not pay any dividend from their 2012 results, the whole amount became retained earnings.

The item 'Financial money transfer' includes final money transfers for financial and professional purposes mainly to foundations and to schools, as well as donations for charitable purposes. The majority of the balance is related to the Pallas Athena Public Thinking Programme launched by the MNB. The focus of the Programme is on the promotion and development of culture, education and science. Along with support for the training of economists and financial professionals, the endorsement of research is high on the MNB's agenda not only in the field of economics, but also in social sciences and other interdisciplinary areas. The MNB Act states that the MNB shall use the income related to fines from supervisory activity for defined purposes: for promoting and supporting the training of specialists in economics and finances, as well as research; for strengthening financial culture; for donations to foundations and for charitable purposes.

4.24 INCOME FROM SUPERVISORY ACTIVITIES

HUF millions

P/L line	Description	2012	2013	Change
	Supervisory fee	0	1,982	1,982
	Received penalties and reimbursement from public proceedings	0	862	862
	Administrative servicing fee from public proceedings	0	26	26
V.3.	**Income from supervisory activities**	**0**	**2,870**	**2,870**

The main item of income from supervisory activities is the supervisory fee received from the supervised institutions obliged to pay this fee. After the integration, the MNB had an income of almost HUF 1,982 million from the Q3 supervisory fees reported in October. The income from penalties that are imposed in MNB resolutions and became final, had a balance of HUF 862 million at end-2013

4.25 OPERATING INCOME AND EXPENSES

HUF millions

P/L line	Description	2012	2013	Change
	Income from assets and inventories	5	174	169
	Income from subcontracted services	28	24	-4
	Income from invoiced services	116	115	-1
	Other income	13	18	5
	Extraordinary income	1	1	0
VIII.	**Total operating income**	**163**	**332**	**169**
	Cost of materials	3,399	3,792	393
	Personnel-related costs	6,791	9,076	2,285
	Depreciation	1,708	1,733	25
	Transfer of costs of other activities	-250	-249	1
	Total operating costs	**11,648**	**14,352**	**2,704**
	Expenses incurred on assets and inventories	9	177	168
	Expenses incurred on subcontracted services	23	23	0
	Expenses incurred on invoiced services	118	115	-3
	Other expenses	80	92	12
	Total operating expenses	**230**	**407**	**177**
XVIII.	**Total operating costs and expenses**	**11,878**	**14,759**	**2,881**
VIII.–XVIII.	**Net operating expenses**	**-11,715**	**-14,427**	**-2,712**

Net operating expenses amounted to HUF 14.4 billion in 2013, an increase of HUF 2.7 billion (23.1 per cent) compared to the previous year. Operating costs were higher by 23.2 per cent (HUF 2,704 million) in 2013 relative to 2012.

The *cost of materials* in the reporting year increased by 11.6 per cent (HUF 393 million) compared to 2012, owing to the following:

– Operating costs increased by HUF 312 million in 2013 relative to the previous year. This was primarily the result of the integration of the supervisory functions into the central bank and mainly affected the costs of real estate due to the expenses of the building in the Krisztina körút building, Budapest in the fourth quarter of 2013 (e.g. rent, cost of public utility, cost of maintenance and cost of cleaning). The costs of security in 2013 materially exceeded the cost recorded in 2012, owing to the use of security guard and bomb-disposal services of the Riot Police from mid-year. Advisory costs increased because of costs of studies prepared in 2013 on the future modernisation of the Szabadság tér building. Expenditures related to stationery, administrative materials and vehicles also exceeded those for 2012. These also basically stem from the integration of the supervisory functions, on the one hand because of the increase in the number of stuff, and on the other hand as a result of the higher costs of communication and correspondence related to the large group of customers of the HFSA.

– IT costs increased by HUF 36 million compared to 2012, primarily due to expenditures connected with contracts taken over by the MNB from the HFSA in the fourth quarter of 2013.

– Other costs increased by HUF 45 million owing to several factors. Membership fees, subsistence allowances, legal advisory fees were higher than in 2012 primarily as a result of the integration of the supervisory functions. The cost of trainings declined sharply as a result of savings achieved in the area of education and team-building. The fees of experts and advisors related to human resources and the advertising costs for recruitment were also lower than in 2012.

The audit fee for the year 2013 amounted to HUF 33 million.

Personnel-related costs increased by 33.7 per cent (by HUF 2,285 million), mainly due to the integration of the supervisory functions from 1 October 2013, which caused an increase of the average number of staff by 502 and an increase in payments on termination and contributions. The general increase in salaries by 1.1 per cent and an additional rise by 0.5 per cent related to upgrades from the beginning of the year, moreover the composition of staff different from that of the preceding year also resulted in the increase in personnel-related costs for 2013. Additional expenditures in 2013 arose from the remuneration paid to the former governor and deputy governors: according to the MNB Act, after the termination of the mandate of the governor and the deputy governors, they are entitled to 6 months salary.

Depreciation increased by 1.4 per cent (by HUF 25 million in 2013 in comparison with the previous year, mainly as a result of the amortisation for the fourth quarter of 2013 of the assets taken over by the MNB from the HFSA.

Transfer of costs of other activities amounted to HUF 249 million, an item that reduces the operating costs. The majority of transfers consist of the rent paid by Magyar Pénzverő Zrt. for the partial use of the Logistics Centre and of the operational costs of VIBER (real-time gross settlement system).

Operating income from and expenses incurred on assets and inventories increased mainly due to the sale of coins and their derecognition.

4.26 INFORMATION ON PAYROLL AND NUMBER OF STAFF

HUF millions

Description	2012	2013	Change (%)
Payroll costs incurred on staff	4,399	5,580	27
Other staff costs*	218	599	175
Payroll	**4,617**	**6,179**	**34**
Other payments to personnel	**708**	**922**	**30**
Taxes on personnel related payments	**1,466**	**1,975**	**35**
Payments to personnel	**6,791**	**9,076**	**34**

** Other staff costs include payments on termination of employment, amounts paid to inactive staff and non-MNB workers.*

Persons

Description	2012	2013	Change (%)
Average number of staff	581	727	25.1

Remuneration of executive officers

HUF millions

Bodies	Fees
Monetary Council*	75
Supervisory Board	77

** Includes the salaries and employer's voluntary pension fund contributions of external members of the Monetary Council in an employment relationship with the MNB, pursuant to Article 9 (4) c) of the MNB Act.*

The senior officers, such as members of the Board of Directors and the Supervisory Board, had no loans outstanding vis-à-vis the Bank in 2013.

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

4.27 DISTINCTIONS BETWEEN THE ESCB GUIDELINE AND MNB ACCOUNTING POLICY

The distinctions between the accounting policy of the MNB and the ESCB guideline[5] originated from reclassifications, different principles of valuation and asymmetrical recognition of profit typical of the ESCB's accounting. The results of the differences relating to the balance sheet total and equity are prepared as if each business year would be the first one compiled according to ESCB rules, i.e. the effects of previous years are not calculated. Consequently tables do not contain data for the preceding year.

According to ESCB rules, the balance of the foreign currency bonds repurchased by the MNB reduced the amount of MNB bonds presented on the liabilities side of the balance sheet, while the MNB records them as receivables on the assets side. Moreover price differences related to repurchase are recorded in the income statement under ESCB rules.

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

A further distinction arising from the market valuation rules of securities is that under ESCB rules premiums and discounts are calculated as part of interest income and amortised over the remaining life of the security. Calculating market price differences, this amortised historic cost is the book value of the security. MNB uses this method only for discount securities, by contrast the guideline regulation relates to interest bearing securities as well.

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

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

[5] The application of the ESCB Guideline on accounting framework is compulsory for the central banks of those EU member states, which have adopted the euro already. The guideline establishes the necessary rules for standardising the accounting of the transactions executed by these central banks.

Factors adjusting the balance sheet total and equity in 2013

HUF millions

Description	Assets	Liabilities
Totals according to HAS	**11,437,974**	**11,437,974**
Reclassification of repurchased bonds in order to show the net amount of the issued bonds in liability side	0	0
Adjustments on market valuation of foreign currency securities		
Deduction of revaluation reserves of foreign currency securities due to HAS	91,100	91,100
Amortisation of premiums/discounts of interest bearing securities	-98,865	-98,865
Revaluation reserves of foreign currency securities according to ESCB rules	18,531	18,531
Unrealised loss on foreign currency securities according to ESCB rules	-10,766	-10,766
Adjustments on market valuation of derivatives	3,457	3,457
Adjustments on exchange rate changes		
Deduction of revaluation reserves due to exchange rate changes according to HAS		-509,603
Revaluation reserves of exchange rate changes		531,201
Unrealised loss on exchange rate changes		-21,598
Reclassification of loss for the year to the asset side	137,548	137,548
Total value of adjustments according to ESCB rules	**141,005**	**141,005**
Totals according to ESCB rules	**11,578,979**	**11,578,979**

HUF millions

Description	Revaluation reserves	Share capital	Retained earnings	Loss for the year	Total equity
Reference No. of HAS	**XI.4. + XI.5.**	**XI.1.**	**XI.2.+XI.3.**	**XI.6.**	**XI.**
Balance sheet data according to HAS	**418,503**	**10,000**	**9,762**	**26,295**	**464,560**
Market valuation of repurchased foreign currency securities				0	0
Adjustments on market valuation of foreign currency securities					
Deduction of revaluation reserves of foreign currency securities due to HAS	91,100				91,100
Amortisation of premiums/discounts of interest bearing securities				-98,865	-98,865
Revaluation reserves of foreign currency securities according to ESCB rules	18,531				18,531
Unrealised loss on foreign currency securities according to ESCB rules				-10,766	-10,766
Adjustments on market valuation of derivatives	3,457			-32,614	-29,157
Adjustments on exchange rate changes					
Deduction of revaluation reserves due to exchange rate changes according to HAS	-509,603				-509,603
Revaluation reserves of exchange rate changes	531,201				531,201
Unrealised loss on exchange rate changes				-21,598	-21,598
Total value of adjustments according to ESCB rules	**134,686**	**0**	**0**	**-163,843**	**-29,157**
Balance sheet data according to ESCB rules	**553,189**	**10,000**	**9,762**	**-137,548**	**435,403**

As a result of the application of ESCB rules, the 2013 balance sheet total changed by HUF 141 billion and the profit for the year changed by HUF -163.8 billion.

The market valuation of derivative transactions and the loss for the year to the asset side increased the balance sheet total by HUF 3.5 billion and by HUF 137.5 billion, respectively.

The result for the year changed to a loss of HUF 137.5 billion as a consequence of recording the unrealised loss due to the foreign exchange rate changes, the market valuation and the amortisation of premiums/ discounts. Revaluation reserves amounted to HUF 553.2 billion according to ESCB rules, due to settlement of unrealised profit.

9 April 2014, Budapest

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