



OXFORD ANALYTICA

HUNGARY

MONETARY TRANSPARENCY

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HUNGARY



COMPLIANCE RATINGS

<i>Monetary transparency</i>	2006	2005	2004	2003
.....				
Clarity of roles	●●●●	●●●●	●●●●	●●●●
Open decision process	●●●●	●●●●	●●●●	●●●●
Availability of information	●●●●	●●●●	●●●●	●●●●●
Central bank accountability	●●●●●	●●●●●	●●●●●	●●●●●
Score	4.25	4.25	4.25	4.50

OUTLOOK & COMMENTARY

The National Bank of Hungary (NBH) has carried out a more consistent and transparent communication strategy over the course of the last twelve months, thus continuing its progress towards the highest monetary transparency standards.

Constant efforts to reach Monetary Council decisions by consensus have helped reduce concerns of government influence raised by the prime ministerial appointment of four new Monetary Council members in 2005. Relations between the NBH and the Ministry of Finance have become increasingly cooperative and some commentators expect this cooperation to be strengthened further once a new NBH Governor takes office in 2007. The Ministry's decision to align its fiscal projections with those of the NBH is a good example of collaborative interaction between the two institutions.

While the official target date of 2010 for adopting the euro has been dropped, the NBH appears committed to policies aimed at meeting the Maastricht criteria soon, as shown by its decision to adopt a 3% medium-term inflation target starting in 2007.

EXECUTIVE SUMMARY

4.25 Compliance in progress

Largely compliant with the highest standards of monetary transparency, the National Bank of Hungary has made continuous progress in improving the communication of its policies to the public. A large range of high-quality publications is available on its website, including *Quarterly Reports on Inflation* which provide a concise description of economic conditions and forecasts.

Despite the amendments to the NBH Act approved in 2004, which increased governmental influence on the central bank by giving the prime minister almost exclusive responsibility for appointing four Monetary Council members, the NBH has been able to conduct monetary policy in an independent and cooperative fashion. The decision to publish minutes and voting records of Monetary Council meetings has contributed to the accountability of individual Monetary Council members. Most of the decisions taken by the Monetary Council in 2006 were reached by consensus, showing the willingness of the newly appointed members to compromise.

Relations between the NBH and the Ministry of Finance have become increasingly cooperative. The NBH worked jointly with the Convergence Council – an advisory body composed of three people appointed by the prime minister in 2006 to provide credibility to the government’s Convergence Programme – to ensure that correct data and forecasts on public deficit, public debt and inflation were included in the Programme. However, while recognising the reliability of forecasts, the NBH criticised the policy content of the Programme, stating that the proposed methods to reduce the public deficit could be harmful to potential growth and price stability.

Given the difficult fiscal situation, the 2010 target date for euro adoption was officially given up by the government. While the lack of a formal deadline might reduce disciplinary effects on government finances, the NBH is committed to ensuring that inflation is in line with the Maastricht criteria and has therefore adopted a 3% medium-term inflation target, which will be effective starting in 2007.

Hungary’s overall rating remains unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF CENTRAL BANKS

●●●● Compliance in Progress

The objectives and institutional framework of monetary policy

The institutional framework for monetary policy in Hungary is defined in the *Act LVIII:2001 on the Magyar Nemzeti Bank* (National Bank of Hungary, NBH) which complies with EU standards, although the *2004 Convergence Report* of the European Central Bank pointed out certain areas where further amendments will be needed in defining the NBH's relationship with the ECB.¹

Central bank objectives and responsibilities

The NBH is responsible for the formulation and conduct of monetary policy with the primary objective of achieving and maintaining price stability.²

The central bank is further required to contribute to the development of policies aimed at promoting the stability of the financial system and its prudential supervision, the main responsibility for which rests with the State Financial Institutions Commission.³ The NBH has the exclusive right to issue currency. It is further responsible for the management of foreign exchange and gold reserves. It serves as banker to the government and as fiscal agent of the government. It has an advisory function in economic and financial policy and in international cooperation.⁴

The exchange rate regime is set by the government in agreement with the central bank. However, the NBH Act stipulates that this has to be done “without prejudice to the primary objective of the NBH to achieve and maintain price stability.”⁵ The NBH alone is responsible for the implementation of exchange rate policy under the regime.⁶

Operational autonomy

The NBH's independence is explicitly established in the NBH Act, which states that the central bank shall “neither seek nor take instructions from the government or any other body.”⁷ The government sets the exchange rate regime in agreement with the NBH, although day-to-day exchange rate policy is managed purely by the NBH.⁸ In addition, the NBH and the government have since July 2003 jointly agreed on the inflation targets to be pursued, a task previously assigned exclusively to the NBH. In August 2005, the government and the NBH agreed to adopt a medium-term inflation target, expressed as a 3% increase in the CPI, starting in 2007.⁹

According to the NBH Act, the central bank is required to support the government's economic policy “without prejudice to its primary objective.”¹⁰ There have been repeated attempts to coordinate policy and in several cases, especially during financial market turmoil, the government has explicitly voiced support for decisions made by the Monetary Council. However, these positive steps have been at times undermined by an openly confrontational relationship between the two sides, which has taken place against the backdrop of a highly politicised and polarised public debate. Governor Zsigmond Járαι of the NBH was appointed in 2001 by a centre-right government in which he had previously served as a Minister of Finance. According to some commentators, his strong professional credentials notwithstanding, Járαι has done little to hide his political views and has favoured people of a similar persuasion in his appointment policy.

While cooperation between the NBH and the government is likely to be strengthened following the appointment of a new NBH Governor in 2007, effective cooperation was made difficult by the mutually critical statements made last year by the government and the NBH Governor on their respective policies.¹¹ Clearly frustrated with the situation, the government resorted to seeking ways of reducing Járαι's influence in 2004. An earlier attempt had been made by re-establishing the NBH's Supervisory Board in October 2002, even though it had been abolished in 2001. The Board consists of political appointees, although all major parties are represented and several members are professional economists. The move was strongly resisted by the NBH but its practical impact has been minimal. Under the NBH Act, the Board is unable to engage in monetary policy operations or influence the central bank in fulfilling its functions and does not appear to have done so even informally.¹²

In October 2004, however, three parliamentary deputies of the governing coalition proposed a revision to the NBH Act to change the appointment process and composition of the Monetary Council. Previously, the Council had been composed of seven to nine members, including the governor, the vice governors, and experts appointed by the president of the Republic, following a nomination by the governor in agreement with the prime minister and a subsequent evaluation by a relevant parliamentary committee. Under the amendment, the prime minister was empowered to directly nominate four of the members with the president of the Republic responsible for the formal appointment. While the government argued that the new procedure would enhance NBH independence, the central bank expressed strong opposition to the move. Similarly, the European Central Bank (ECB) commented that the pre-reform appointment process already provided an appropriate framework for the formulation of monetary policy and ensured the independence of the NBH. By implication, a change would be unnecessary. The government in response merely removed the most controversial part of the proposed amendment, which would have resulted in the removal of two of the current deputy governors of the NBH from the Council. When the terms of two of the current deputy governors expire in 2007, they will not be renewed and the Council will be composed of at least nine and at most eleven members. No member of the Council will be eligible for nomination for three years after the expiry of their mandate.¹³

Prime Minister Ferenc Gyurcsány, under the powers he gained under the amended NBH Act, appointed four new members of the Monetary Council in March 2005. All are professional economists who had most recently been active in scientific research or as in-house economists in the corporate sector. Since their appointment, the relationship between the NBH and the government has not been confrontational and collaboration at the expert level has improved. However, Hungary does not have a joint MoF-NBH working group for euro-zone entry and the government does not have plans to establish one in the near term.¹⁴

The 2004 Convergence Report of the European Central Bank criticised the NBH Act for a provision that allows the Ministry of Justice to review draft NBH legal acts. Although the provisions limit the review to ensuring the constitutionality and the technical aspects of the drafts, thus not including substantial clauses regarding interest rates and reserves requirements, the article was deemed to potentially contravene EU Treaty requirements on central bank independence. The government intends to revise the provision allowing the Ministry of Justice to review draft legal acts in order to comply with EU Treaty requirements.¹⁵ The ECB further questions the compliance of the legal requirement that the NBH governor and the Monetary Council members declare their wealth upon appointment and every two years thereafter. Under the NBH Act, a failure to do so, as well as significant inaccuracies, can be deemed to represent serious misconduct which would lead to the suspension from the Council.¹⁶

Institutional relationship between monetary and fiscal operations

Lending to government

The relationship between monetary and fiscal operations is explicitly defined in the NBH Act, which states that the NBH may not finance the deficit of the state budget, or any state debt. Accordingly, it is not permitted to purchase

securities from state institutions in the primary market. It is explicitly forbidden to issue credit to the government or any other public sector agency.¹⁷

Central bank involvement in the rest of the economy

Representatives of the NBH may express an opinion on the budget proposal – after its approval by the government and before its submission to the parliament – both to the government and to competent parliamentary committees. However, the opinion is not published as a separate document, as there is no legal provision requiring the NBH to formally comment on budget proposals. The NBH engages in quarterly reviews of potential budgetary outcomes, and its opinion on the budget is also expressed in *Quarterly Inflation Reports*.¹⁸ In addition, the government is required to invite the NBH governor to attend meetings of the Economic Cabinet where the agenda contains issues of relevance to the central bank's remit.¹⁹ The NBH provided the government with its formal opinion on the 2006 *Convergence Programme*, stating that the methods presented by the government to reduce the public deficit are not optimal in terms of potential growth and price stability.²⁰

The NBH monitors the financial sector and publishes its findings in the *Report on Financial Stability*. It further cooperates closely with the Hungarian Financial Supervisory Authority (HFSA) in the area of banking supervision, although the HFSA does not offer a formal contribution in terms of drafting or commenting on the *Report on Financial Stability*.²¹ High-level members of the NBH, the MoF and the HFSA take part in a Financial Stability Committee, where major issues connected to financial stability are discussed during regular meetings.²² Cooperation also takes place at the level of EU supervision, with members of the NBH and the HFSA taking part in committees such as the Expert Group on Capital Requirements. Information is increasingly shared between the NBH and the HFSA.²³

The NBH may not legally hold any ownership interests in either domestic or foreign business associations not related to the NBH's activities.²⁴

Central bank profit allocation

Up to December 2003, an annual dividend, equal to the average profit from three preceding years, was paid to the government, with any excess profit transferred to a profit reserve. This reserve was then made available to top-up the dividend payment should there have been a shortfall in earnings.²⁵ As of December 2003, the NBH Act states that the General Meeting of the NBH decides on the dividend payments based on the profits retained from the year or from the profit reserve. The NBH does not pay dividends in advance and their payment is supposed to be effected within eight days from the approval of the annual NBH account for the year. Where the losses incurred in a year exceed the balance of the profit reserve, the difference is expected to be paid by the government directly into the profit reserve.²⁶

Agency roles performed by the central bank on behalf of the government

The NBH serves as the banker to the government. Under the NBH Act, the central bank manages the accounts of the State Treasury (*Magyar Államkincstár*) and other government accounts specified by the minister of finance, as well as the accounts of the Hungarian Privatisation and State Holding Company (*Állami Privatizációs és Vagyonkezelő, ÁPV*) and of the Government Debt Management Agency (*Államadósság Kezelő Központ, ÁKK*).²⁷

A formal memorandum of understanding governs the relationship with ÁKK and the MoF. The NBH may also be mandated to raise loans in foreign exchange and securities and execute forward transactions (hedging) for the state. Ultimate responsibility for the management of state debt, however, rests with the government.²⁸ The key institution in this regard is ÁKK, which, since its establishment in 1995, has progressively taken over responsibility from the NBH for the issuing and management of Hungary's foreign debt, in addition to its responsibilities for domestic debt.

Since its separation from the State Treasury in 2001, the ÁKK operates as a joint-stock company under the supervision of the MoF but with a high degree of autonomy.²⁹ The NBH now acts as the paying agent for the insurance of foreign-currency denominated debt. The relationship between the two entities is good and, at MoF request, the NBH governor appoints a permanent representative -- typically a NBH deputy governor or managing director -- to the ÁKK board of directors. He is supplied with all documentation pertaining to debt management but has no voting rights. ÁKK consults with the NBH in formulating its strategy. There is no longer any ÁKK-NBH collaboration in the area of analytical research.³⁰

The NBH is allowed to act as an advisor and agent to the government in the securities market, and can be consulted before issuing securities on behalf of the state. ÁKK and the NBH both receive and review offers from investment banks for debt issues. They make independent choices and the ultimate responsibility goes to the MoF in the event of differences of opinion. Until 2005, the NBH did swaps for ÁKK as a constant counterparty but this is no longer the case. According to ECB accounting rules, the position as a market intermediary can no longer be used.³¹

The NBH is allowed to express opinions on ÁKK management of government debt and has done so in the past. There are weekly middle-level meetings with the NBH that cover a broad range of issues.

2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The NBH Act stipulates the achievement and maintenance of price stability as the primary policy objective of the NBH. In order to meet this goal, the NBH in 2001 adopted a formal inflation-targeting regime. The mechanism is designed to set clear and binding targets, the attainment of which becomes the central goal of the central bank's actions. With this in mind, the NBH publishes a staff inflation forecast in the *Quarterly Report on Inflation* in order to make the policy-making process more transparent. The central bank has clearly signalled that persistent deviations between the forecast and the inflation target will trigger a policy response taking the form of an interest rate adjustment designed to reduce the gap. At the same time, the NBH is seeking to establish the inflation target as a credible "nominal anchor" so as to guide inflationary expectations in a way that will minimise the costs of disinflation. In August 2005, the government and the NBH agreed to adopt a medium-term inflation target, expressed as a 3% increase in the CPI, starting in 2007. This medium-term target – which is expected to enhance the anchor role of the inflation target – is likely to be reviewed in three years, or at the time of Hungary's entry into the ERM2. The inflation target set for December 2006 is 3.5% with a tolerance band of +/-1 percentage point, which is expected to provide flexibility in the event of unforeseen shocks.³² No formal provisions exist for accountability and remedial action in the event of the NBH failing to achieve its inflation target.

The NBH prepares its inflation forecast on the assumption of unchanged exchange rates, interest rates, and oil futures prices. Historically, the NBH's performance in inflation targeting has been successful by regional standards. The targets were reached in 2001, 2002, 2004, and 2005. A sharp fiscal easing in 2003 led to the only recent instance of the target being missed. The 3.5% target for 2006 is unlikely to be met, due to the inflationary pressure deriving from recent VAT increases.³³

Unlike most other countries in the region, the NBH also targets exchange rates, albeit officially subject to the primary goal of price stability. The current Hungarian exchange rate regime is compatible with, and modelled on, the ERM2 regime. The Hungarian forint is pegged to the euro around a central parity of 282.36 forints. The market rate is allowed to fluctuate within a +/-15% band currently set between 324.71 and 240.01 forints to the euro. In practice, the exchange rate fluctuated between the strong edge of the band and the central parity. The wider band was adopted in May 2001 and the central parity most recently modified (from 276.1 forints to the euro) in June 2003. Although market forces determine fluctuations within the band, interventions by the NBH are possible at any time. Such interventions are required when the exchange rate reaches the edge of the band. The minimum amount of an intervention is 4 million euros.³⁴

In practice, Hungary has had a very chequered record of trying to manage the system of dual targeting in the circumstances of relatively lax fiscal policy and an often-confrontational relationship between the government and the NBH. The struggle to reconcile the dual goals has repeatedly strained the credibility of Hungarian monetary policy, even if the situation has improved during 2004 with steady reductions in interest rates. Additional problems are created by communicating the inflation forecast, which is a staff projection that is not fully based on in-house models, and which is not explicitly endorsed by the Monetary Council.³⁵

There is widespread disillusionment in Hungary about the dual targeting regime and many now feel that the interests of the country would have been better served by a flexible exchange rate. The International Monetary Fund last year endorsed the latter position, although change at this point is seen as unlikely, not least because of the widespread reliance of Hungarian consumers on foreign currency-denominated borrowing.³⁶ The NBH still in 2003 favoured ERM2 accession at the earliest possible date and was in favour of remaining in the system for longer than two years. The position has been modified, however, and the NBH now advocates joining only if the government is seen as pursuing responsible policies. There is considerable support for allowing the exchange rate to find its market-determined level before ERM2 accession.³⁷

The government has repeatedly pushed back the target date for the adoption of the euro as the national currency, and the 2010 target date has been officially given up. While the government has not adopted a new official target date, the Convergence Programme presented to the EU on 1 September 2006 points out that the public deficit Maastricht criterion should be met by 2009. The public debt to GDP ratio is expected to be still higher than 60% by 2009 and, therefore, the actual date of euro adoption will depend on how strict the EU interpretation of the public debt to GDP ratio criterion will be at the time. If demonstrating a declining trend in this ratio were to be considered sufficient by the EU, the first possible date for euro adoption could be 2011.³⁸

Monetary instruments

The NBH uses all the standard monetary policy instruments: deposits from credit institutions, collateralised lending, open market operations, security emissions, foreign exchange market intervention, interest rates, refinancing, and minimum reserve requirements. The most widely used instrument is a two-week deposit facility. Through setting its base rate for such deposits, the NBH influences its operative target, the three-month money market rate. To help reduce volatility of inter-bank interest rates, the NBH maintains an overnight interest rate corridor of the base rates +/-1%. Occasionally, the top of the corridor is sometimes exceeded. As the overnight lending facility is a collateralised loan, the lack of collateral can prevent banks with liquidity shortage from making recurring use of the NBH lending facility. In such a case, the inter-bank interest rate is allowed to exceed the top of the corridor.³⁹ The central bank further uses quick tenders to reduce interest rate fluctuations. The reserve ratio currently stands at a relatively high 5%.

The monetary policy-making body

Monetary board

The NBH Act establishes the Monetary Council as the supreme decision making organ of the NBH with the sole responsibility for all monetary policy decisions. Most importantly, the Council decides on the NBH's monetary policy stance by setting the base rate.

Following an amendment to the NBH Act at the end of 2004, the size of the Monetary Council was expanded in 2005 by four new members nominated by the prime minister, albeit still appointed by the president of the Republic. Previously, the Governor had the right to initiate the appointment of Monetary Council members. However, the actual nomination of the members had to be done in agreement with the prime minister.⁴⁰ The Council had been composed of seven to nine members: the governor, the vice governors, and experts nominated by the NBH governor, vetted by a relevant parliamentary committee, and appointed by the President of the Republic. Under the amended NBH Act, the Council will now be composed of nine to eleven members, after the terms of the current deputy governors expire in 2007. The new Council will have a governor and one deputy governor in addition to its regular members.

All members of the Council are required to have “outstanding theoretical or practical professional knowledge related to monetary, financial, and banking activities” and serve as employees of the NBH during their term. The appointments are made for a period of six years and do not have to be simultaneous. Under the revised NBH Act, members of the Council cannot be appointed to the Council again for a period of three years following the end of their term.⁴¹ In spite of concerns about increased government influence on monetary policy through the appointments made by the prime minister, the individuals chosen are widely recognised for their professionalism and qualifications. At least to date, the appointments do not appear to have had a significant bearing on policy choices.

The minister of finance, or another duly authorised minister, can represent the government at Council meetings, albeit without voting rights. Voting at Council meetings is by simple majority and the Council is quorate when the majority of its members are present. The Council’s work is prepared by an internal monetary policy committee, which typically meets every week to assess recent developments and future prospects. The committee is made up of the Council members, NBH managing directors, and related staff.

The Monetary Council has, as of June 2004, considered interest rate decisions at only one of its two monthly meetings. The second monthly meeting is followed by a press release explaining the central bank’s decisions and the reasoning behind them. No press release is issued after the meetings that are not devoted to interest rates.⁴² In December 2004 the NBH decided to publish unattributed minutes of the Monetary Council meetings, along with a numerical division of votes, approximately three weeks after each meeting. The formal minutes are preceded by a brief overview of the current macroeconomic and financial market situation. A voting record of the Monetary Council meetings was made publicly available in October 2005.⁴³ The innovation is likely to increase the accountability of individual Council members and also represents convergence towards the standards of many other EU countries. Market analysts have welcomed the reform, although some of them have expressed the desire to access information describing decision-making processes within the NBH in more detail.⁴⁴ Statements by Monetary Council members to the media remain relatively infrequent.⁴⁵

Advance meeting schedule

The Council is required to meet twice a month, with additional meetings to be convened as necessary. An advance schedule is currently published for a full calendar year at a time and is available on the website.⁴⁶ Since July 2004, changes to the base rate are discussed only at the second scheduled meeting of each month. The decision was justified by international comparisons and the fact that the data bearing on interest rate decisions are seldom published more frequently than once a month.⁴⁷

Public statements on monetary policy

Periodic publications

The NBH has a wide-ranging series of periodic publications and views regular communications with the markets as a key element of its transparency strategy. The *Annual Report* details the evolving macroeconomic situation and its implications for monetary policy and the exchange rate regime, as well as presenting the central bank’s results.⁴⁸ It also outlines the NBH’s monetary policy agenda, reviews changes in monetary policy instruments, and anticipates future changes, which may include reductions in the reserve ratio and reform of the required reserves system. The *Report on Financial Stability* offers data pertaining to efforts to increase and maintain economic and financial stability. While the Report was previously released biannually, starting in 2006 it is published once a year in April.⁴⁹

Since June 2000, the central bank has also produced a *Quarterly Inflation Report*, which contains commentaries on the progress towards achieving its inflation target, inflation projections and considerations bearing on the decisions of the Monetary Council. The format of the *Quarterly Report on Inflation* was revised in August 2004 to make it

more compact and accessible and, since 2005, the *Report* also includes a detailed analysis of the fiscal situation in Hungary. Since 2006, detailed issues of the *Quarterly Report on Inflation* are published biannually in May and November, while shorter supplements containing updates of the main forecasts are published in February and August. These updates give full details on inflation forecasts, including CPI fan charts, and focus on presenting the factors driving inflation. Backward-looking macroeconomic analysis, as well as information less directly related to the inflation outlook, is left out of these updates, which are easier to understand for the general public, as well as analysts.⁵⁰ As of 2005, the NBH also publishes a monthly *Chart Pack of Recent Economic and Financial Market Developments*, which provides concise information on key macroeconomic and business indicators.⁵¹

The NBH has further published a comprehensive guide to *Monetary Policy in Hungary*. All these materials, including working papers and occasional papers containing detailed analyses of monetary and fiscal issues, are translated into English and available through the NBH website. Some occasional papers are available in Hungarian only, while some working papers are published in English only.⁵²

The central bank uses a range of methods in its macroeconomic forecasting. Elements of these models have been published and the main assumptions and other information are discussed in the *Quarterly Report on Inflation*. A non-technical summary of the comprehensive structural model known as the Quarterly Projection Model (NEM) is available on the website, and has been used to generate the projections included in the *Quarterly Report on Inflation* since February 2004. The NBH has plans to publish the entire model.⁵³

Since November 2005, the NBH also includes a regular *Report on Convergence* – released annually – on its publications site. Although formally prepared by the government, in pursuance of EU regulations, the NBH is consulted in the process of preparing the Convergence Programme. The objective of including the report on the website is to increase awareness of the preparations for euro adoption, a goal to which the central bank remains strongly committed.⁵⁴

The central bank has produced a range of more popular publications with the explicit aim of explaining key aspects of monetary policy to the general public in a non-technical manner.⁵⁵

Public hearings

Decisions by the Monetary Council are publicly announced. The *Quarterly Inflation Report* is presented to the public at a press conference. The NBH offers a variety of mechanisms for interaction with market actors and independent analysis, such as meetings following the publication of the *Quarterly Inflation Report*. Forecasting models are revised in consultation with experts from the European Central Bank and there is an open academic debate about the NBH's forecasts. However, no mechanism of formal hearings or other attempts to canvass opinions in preparation for policy changes exists. Although the availability of information is both timely and ample, some of the problems surrounding monetary policy credibility have often been attributed to ineffective and even inconsistent communication by the central bank leadership. According to some commentators, NBH communication has been increasingly less confusing over the last two years, although there is still some room for improvement.⁵⁶

The NBH governor appears before parliament to deliver the *Annual Report*. Additional appearances may be arranged as appropriate, as the Economic and Budget Committee of the Parliament can ask the governor to report at any time, as well as inviting experts on monetary policy to benefit from their detailed knowledge of technical issues.⁵⁷ This is generally deemed to constitute adequate oversight. However, commentators have often highlighted weak parliamentary interest in these issues.⁵⁸

Regulations on data reporting by financial institutions to the central bank

The NBH Act requires the central bank to “promote the stability of the financial system” and to “contribute to the development and smooth conduct of policies related to the prudential supervision of the financial system.”⁵⁹ The Act further requires that the central bank publish all information related to the operation of the banking system, and provide regular and detailed information to parliament and the government. The Act also empowers the NBH to request data, reports and balance sheets from financial institutions, and to conduct on-site inspections in the course of its data reporting activities. The NBH is authorised to initiate disciplinary, civil or criminal proceedings against institutions that it deems to have violated the law.⁶⁰ It publishes an annual *Report on Financial Stability* evaluating the situation in the sector.⁶¹

The NBH assesses systemic risks and monitors at least the largest financial institutions, thus contributing to the development of policies for the supervision of the financial system. However, the responsibility for financial supervision rests with the Hungarian Financial Supervisory Authority (*Pénzügyi Szervezetek Állami Felügyelete*, HFSA). HFSA was created in 1999 as an independent budgetary authority and started its operations in 2000. It is responsible for promoting transparency and the smooth operation of financial markets. It maintains competitive market conditions through regular supervision and periodic inspections. In practice, there is a high degree of coordination between the NBH and HFSA based on a formal memorandum of understanding that lays out the division of labour between the two bodies.⁶² Under the NBH Act, “The NBH and the HFSA shall exchange data and information which are necessary for the other organisation to perform its tasks.”⁶³ There is mutual reporting of findings from all on-site visits and regular joint meetings take place between the two organisations. The NBH and HSAF partially share a database and the central bank can initiate HFSA proceedings. Under the Act on Government Control of Financial Institutions, “Where so prescribed by law, the HFSA shall consult with or obtain the consent of the NBH prior to issuing or revoking authorisations or licenses.”⁶⁴ In addition to the regulatory framework, the high degree of foreign ownership of Hungarian banks -- some 80% of the capital of the sector -- will continue to promote compliance with international standards.⁶⁵

3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

●●●● Compliance in progress

Release of central bank data

Hungary subscribes to the IMF Special Data Dissemination Standard (SDDS), and meets its specifications for the coverage, periodicity and timeliness of monetary data. An advance release calendar is posted at the IMF website.⁶⁶

The analytical accounts of the NBH are derived from the central bank's balance sheet and show gross domestic and foreign assets and liabilities, including international reserves and claims on central government. The data are produced monthly, within one week of the reference period. An advance release calendar, giving six months notice, is also disseminated through the NBH website.⁶⁷

The central bank balance sheet

The NBH publishes its preliminary statistical balance sheet on its website on a monthly basis.⁶⁸ A consolidated balance sheet, together with an assessment by independent auditors, is included in the *Annual Report*.⁶⁹

Lender of last resort

The NBH Act establishes that the central bank may grant extraordinary credit to financial institutions in circumstances that it deems may jeopardise the stability of the financial system. While there are no legislative requirements to do so and the internal rules for extraordinary credit are not publicly available -- in order to avoid moral hazard problems -- the NBH has typically announced the details of such support shortly after the event.⁷⁰ All lending is fully collateralised and any securities used are valued daily. As an alternative measure, the NBH can exempt a bank in difficulties from complying with the standard reserve requirements for a period of three months. Support is always provided in coordination with the Hungarian Financial Supervisory Authority.⁷¹

Public information services

The NBH maintains high-quality public information services through its website. A comprehensive list of publications and data is available in both English and Hungarian. The central bank also disseminates press releases and the text of public statements. It also has a separate information services department.

Copies of relevant legislation, including English language texts of the NBH and Foreign Exchange Acts and the NBH Statutes, are available online and translations of other relevant legislation can be readily obtained through the central bank's information division.⁷²

All central bank decisions are announced at a press conference and the NBH operates an internet 'chat room' following the publication of its *Inflation Report*. The staff of the NBH Economic Department answers questions by registered participants.

The NBH has a specialised library open to the public.⁷³

4. ACCOUNTABILITY AND ASSURANCE OF INTEGRITY BY THE CENTRAL BANK

●●●●● Full Compliance

Accountability before a designated public authority

The NBH Act requires the governor to appear before the parliament annually for the purpose of presenting and discussing the *Annual Report*. Either the parliament or individual parliamentary committees may summon the NBH governor at will to discuss matters under his jurisdiction. He must, if so requested, present data on monetary and financial sector developments to the government. In 2004, the parliament rejected the 2002 and 2003 annual reports of the NBH for the first time. The votes, which largely reflected the political divisions in the legislature, were seen as politically motivated and effectively a protest against the high interest rates in the country. The reports submitted to the parliament had been approved by the State Audit Office, the NBH Supervisory Board, the then external auditor PriceWaterhouseCoopers, the minister of finance (who exercises the state's ownership rights in the NBH), and the parliamentary economic, budgetary, and finance committees.⁷⁴

Financial Statement

The NBH's full results are included in its *Annual Report*.

Audited financial statement

Financial statements are included in the central bank's *Annual Report*, accompanied by an auditor's statement. A summary statement appears in the published *Annual Report*, while the version submitted to Parliament contains a more comprehensive account.

External and internal audit

The NBH Act stipulates that an external accounting firm, which is appointed under a five-year non-renewable contract, must audit the central bank's annual report. This contract used to be held by PriceWaterhouseCoopers but is currently held by Ernst & Young.

The NBH has its own 16-person Internal Audit Department that is controlled by the Supervisory Board and reports to the Audit Committee and the Board of Directors. The department follows an annual audit plan approved by the Supervisory Board. The plan can involve any area of the NBH's activities. The Audit Committee issues recommendations that are followed by the adoption of a schedule for implementation. Compliance is verified within a year.

The State Audit Office (*Állami Számvevőszék*) is responsible for tasks related to the inspection of internal NBH operations with the sole objective of ensuring compliance with laws and regulations. It cannot perform a financial audit, not review any activities connected with monetary policy. The SAO may submit proposals to the general meeting of the NBH for the appointment or dismissal of the independent auditor. There is no formal mechanism for follow-up.⁷⁵

Conduct of officials

The NBH Act details the obligation on employees and officials to avoid conflicts of interest, including those arising from political affiliation and relations with credit institutions. Employees sign a confidentiality agreement, and are regarded as public officials from the point of view of applying criminal law.⁷⁶ Protection from personal liability is not considered necessary since, under Hungarian law, liability does not extend to employees of public institutions.

The NBH Act lays down rules to govern the appointment and discharge of the central bank's governor and vice-governors.⁷⁷

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during visits to Hungary between 16 and 20 October 2006:

National Bank of Hungary

17 October 2006

András Kármán	Deputy Head of Department	Financial Analysis Department
Klára Pintér	Senior Economist	Financial Analysis Department

20 October 2006

István Hamecz	Director	Economics and Monetary Policy Directorate
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Ministry of Finance

16 October 2006

Balázs Romhányi	Deputy Head of Department	Directorate of Fiscal and Financial Policy Affairs
Gizella Csonka	Chief Advisor, Deputy Head	Directorate of Fiscal and Financial Policy Affairs
László Szabó	Counsellor	Division for Government Budget and Fiscal Policies

ADDITIONAL INTERVIEWS

17 October 2006

Gábor Pósch	Economist, Counsellor	State Audit Office
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18 October 2006

László Seregdi	Deputy Managing Director	Hungarian Financial Supervisory Authority Economics, Risk Assessment and Regulatory Directorate
Zsolt Wieland	Lawyer	Hungarian Financial Supervisory Authority Capital and Money Markets Issuance
Györgyi Joó Tóth	Head of Unit	Hungarian State Treasury International Department
Zsuzsanna Balogh	Advisor	Hungarian State Treasury Treasury Commissioner Office

19 October 2006

Dora Gyorffy	Assistant Professor	University of Debrecen
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László Csaba
András Oszlay

Professor
Research Fellow

Central European University
ICEG European Center

NOTES

- ¹ Act LVIII on the National Bank of Hungary (2001); *Convergence Report 2004*, Frankfurt am Main: European Central Bank, 2004, pp. 410-413. www.ecb.int/pub/convergence/html/index.en.html
- ² NBH Act, Articles 3 and 4.
- ³ Interviews conducted in Budapest, 16-20 October 2006.
- ⁴ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ⁵ NBH Act, Article 11(2).
- ⁶ NBH Act, Article 4(4).
- ⁷ NBH Act, Article 1.
- ⁸ NBH Act, Article 11(3).
- ⁹ Interviews conducted in Budapest, 16-20 October 2006.
- ¹⁰ NBH Act, Article 3(2).
- ¹¹ Interviews conducted in Budapest, 16-20 October 2006.
- ¹² "Hungary: Government/NBH monetary policy tensions," *Oxford Analytica Daily Brief*, 27 January 27 2003.
- ¹³ www.ecb.int/ecb/legal/1341/1345/html/index.en.html: Opinion on a law amending the Law on Magyar Nemzeti Bank (CON/2004/35) Hungary, 4.11.2004.
- ¹⁴ Interviews conducted in Budapest, 16-20 October 2006.
- ¹⁵ Interviews conducted in Budapest, 16-20 October 2006.
- ¹⁶ *Convergence Report 2004*, pp. 410-411; NBH Act, Article 60.
- ¹⁷ NBH Act, Article 61 (1)-(4); "The role of the Magyar Nemzeti Bank in the EU accession process," www.mnb.hu
- ¹⁸ Interviews conducted in Budapest, 16-20 October 2006.
- ¹⁹ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ²⁰ Interviews conducted in Budapest, 16-20 October 2006.
- ²¹ NBH Act, Articles 43, 44.
- ²² Interviews conducted in Budapest, 16-20 October 2006.
- ²³ Interviews conducted in Budapest, 16-20 October 2006.
- ²⁴ NBH Act, Article 69.
- ²⁵ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ²⁶ Interviews conducted in Budapest, 16-20 October 2006.
- ²⁷ NBH Act, Article 15.
- ²⁸ Act on Public Finances (Act XXXVIII of 1992), Article 113/A.
- ²⁹ www.akk.hu
- ³⁰ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ³¹ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ³² http://english.mnb.hu/Engine.aspx?page=mnb_monetarispolitika&ContentID=3027; *Convergence Programme of Hungary 2004*, Budapest: Government of Hungary, 2004, p. 13.
- ³³ Interviews conducted in Budapest, 16-20 October 2006.
- ³⁴ http://english.mnb.hu/Engine.aspx?page=mnb_monetarispolitika&ContentID=3032
- ³⁵ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ³⁶ "Hungary: Selected Issues," *IMF Country Report*, No. 05/215, June 2005, International Monetary Fund, Washington, D.C.; "Hungary: 2005 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion," *IMF Country Report*, No. 05/213, June 2005, International Monetary Fund, Washington, D.C.
- ³⁷ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ³⁸ Interviews conducted in Budapest, 16-20 October 2006.
- ³⁹ Interviews conducted in Budapest, 16-20 October 2006.
- ⁴⁰ Interviews conducted in Budapest, 16-20 October 2006.
- ⁴¹ NBH Act, Article 46 (3), (5), (11).
- ⁴² http://english.mnb.hu/engine.aspx?page=mnb_monet_kozlem; *Quarterly Report on Inflation*, Budapest: National Bank of Hungary, August 2004, pp. 81-2; Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ⁴³ Interviews conducted in Budapest, 16-20 October 2006.
- ⁴⁴ Interviews conducted in Budapest, 16-20 October 2006.
- ⁴⁵ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ⁴⁶ http://english.mnb.hu/Engine.aspx?page=mnb_monetaristanacs&ContentID=2996

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- ⁴⁷ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ⁴⁸ http://english.mnb.hu/engine.aspx?page=mnben_evesjel
- ⁴⁹ http://english.mnb.hu/engine.aspx?page=mnben_stabil
- ⁵⁰ Interviews conducted in Budapest, 16-20 October 2006.
- ⁵¹ http://english.mnb.hu/Engine.aspx?page=mnben_egyebkiad_en&ContentID=0
- ⁵² Interviews conducted in Budapest, 16-20 October 2006.
- ⁵³ http://english.mnb.hu/Engine.aspx?page=mnben_elorejelzo_modszerek&ContentID=5056; Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ⁵⁴ http://english.mnb.hu/Engine.aspx?page=mnben_konvergenciajelentes&ContentID=0
- ⁵⁵ www.mnb.hu/engine.aspx?page=tanulmanyalyazat
- ⁵⁶ Interviews conducted in Budapest, 16-20 October 2006.
- ⁵⁷ Interviews conducted in Budapest, 16-20 October 2006.
- ⁵⁸ Interviews conducted in Budapest, 16-20 October 2006.
- ⁵⁹ NBH Act, Article 4 (7).
- ⁶⁰ NBH Act, Articles 28, 29.
- ⁶¹ http://english.mnb.hu/Engine.aspx?page=mnben_stabil&ContentID=0
- ⁶² NBH Act, Articles 43, 44.
- ⁶³ NBH Act, Article 44.
- ⁶⁴ Act CXXIV:1999 on Government Control of Financial Institutions, Article 6(c).
- ⁶⁵ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ⁶⁶ <http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=HUN>
- ⁶⁷ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005;
- ⁶⁸ http://english.mnb.hu/engine.aspx?page=mnben_statiztikak
http://english.mnb.hu/Engine.aspx?page=mnben_elozetes_statiztikai_merleg&ContentID=0;
http://english.mnb.hu/Engine.aspx?page=mnben_month_en&ContentID=0
- ⁶⁹ http://english.mnb.hu/engine.aspx?page=mnben_evesjel
- ⁷⁰ Interviews conducted in Budapest, 16-20 October 2006.
- ⁷¹ “Hungary: Financial System Stability Assessment Follows-up, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, Securities Regulation, Insurance Regulation, and Payment Systems,” *IMF Country Report*, No. 02/112, June 2002, International Monetary Fund, Washington, D.C.
- ⁷² http://english.mnb.hu/engine.aspx?page=mnben_1_jegybankrol
- ⁷³ www.mnb.hu/Engine.aspx?page=mnbhu_tudnivalok&ContentID=2224
- ⁷⁴ “Hungary Parliament rejects central bank annual reports,” *Portfolio.hu*, 28 September 2004.
- ⁷⁵ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005; Act XXXVIII:1989 on the State Audit Office, Articles 3, 16(2), 17(1), (4).
- ⁷⁶ NBH Act, Articles 54-58.
- ⁷⁷ NBH Act, Articles 49-52.