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Mr Peter Szabó  
Director - National Accounts Department  
Hungarian Central Statistical Office  
Keleti K. u. 5-7  
H-1024 Budapest

**Subject: Methodological treatment of government injections in the revaluation reserves of the Magyar Nemzeti Bank**  
**Ref: Your note on this issue accompanying the October 2011 EDP notification**

Dear Mr Szabó,

In reply to the request for advice on the recording of capital injections into the central bank, I am in a position to inform you of Eurostat's observations.

### **The accounting issue**

The statistical authorities of Hungary are asking for further clarification on the application of the national accounting rules to the government injections in the revaluation reserves of the Magyar Nemzeti Bank (the Central Bank of Hungary).

### *Documentation provided*

The statistical authorities of Hungary submitted a note "Recording of capital injections into the central bank" together with the October 2011 EDP notification.

### *Description of the case*

The Central Bank of Hungary ("the bank") operates as a company limited by shares, owned by the Hungarian State, represented by the minister responsible for the state budget. The bank maintains its own accounting system and compiles its annual report according to the Hungarian regulation on business accounting. Realised holding gains or losses from financial operations appear in the profit and loss statement, while unrealised holding gains or losses are presented in the balance sheet in the revaluation reserves (part of own capital). Unrealised foreign exchange gain/losses and changes in the market value of foreign currency securities influence two separate revaluation accounts in the balance sheet. The government has a reimbursement obligation by law for each revaluation account which arrives at a negative year-end value.

The government has had to provide resources to the special revaluation reserves several times over the last 10 years. These capital injections have been recorded as equity transactions in national accounts.

In its note, the statistical authorities of Hungary sought clarification on the application of the capital injection rules on the injections into central banks. According to the statistical authorities, strict application of the rules as specified in the 2010 edition of the Manual on Government Deficit and Debt

(MGDD) would lead to recording of such capital injections as (government deficit increasing) capital transfers. In their view, this is a consequence of the strict application of the rules specified in MGDD IV.2.1 §1 and III.2.2.1 §8 (the first bullet point).

By the end of 2010 the revaluation reserve for foreign currency securities (part of the equity of the bank) became negative (-29.1 bn HUF) due to unrealised holding losses and the government made a payment for filling up this specific reserve in March 2011. When compiling the planned figures relating to 2011 for the March 2011 EDP notification, the statistical authorities of Hungary interpreted the rules laid down in the MGDD on capital injection for the central bank. They reasoned that the bank does not produce a "sufficient rate of return" (long-term government bond rate) on the funds invested by the state and the capital injection was made for covering "capital losses". For this reason the statistical authorities reclassified the capital injection as a capital transfer (29.1 bn HUF in 2011).

In the view of the statistical authorities, the MGDD chapter on capital injections into public corporations does not deal with the specific role and the financial status of central banks, which creates uncertainty in the classification of transactions between the government and the central bank. In their view, because of the special function of the central banks, the expectation for "sufficient rate of return" is not relevant in this case and holding gains and losses are normal consequences of the high open foreign currency position (and not the outcome of bad assets or loss-making regular operations). Also, government acts as "ultimate owner of gold and foreign exchange reserves" when it fills up the revaluation reserves of the bank and not as "supporter of economic and social policy" (see MGDD Part III. Overview). For this reason, in the view of the statistical authorities of Hungary, recording of a capital transfer in this case seems not to be in line with the economic nature of the transaction.

In order to clarify the issue, the statistical authorities sought the answer to the question whether there is any possibility to record a financial transaction (acquisition of equity) when government makes capital injection in the central bank. More specifically, regarding filling up of the revaluation reserve for foreign currency securities in 2011, they asked if it is necessary to reclassify this capital injection as a capital transfer. Finally, the statistical authorities raised the question if, due to the special role of the central banks, it is possible to add specific rules to the MGDD chapter III on capital injections into public corporations or to the chapter IV on payments between the central bank and government.

### **Methodological analysis by Eurostat**

After an examination of the provided documentation, Eurostat has reached the following provisional views.

#### *Applicable accounting rules*

MGDD IV.2.3.1 "Legal and economic ownership" §11, MGDD IV.2.3.1 "Valuation of government equity" §12 and MGDD IV.3.3.1 "The special nature of reserve assets" §7.

#### *Availability of national accounting analysis*

The note "Recording of capital injections into the central bank" submitted by the Hungarian statistical authorities together with the October 2011 EDP notification contains questions and proposals concerning the government injections in the revaluation reserves of the central bank together with references to the MGDD.

#### *Analysis*

Eurostat confirms that, according to the applicable rules specifying the calculation of government deficit and debt, the Hungarian statistical authorities should record the government injections in the

revaluation reserves of the central bank, which take place due to unrealised capital losses, as financial transactions (acquisitions of equity).

This is due to the specific nature of the reserve assets and the fact that a holding gain/loss in the revaluation account should not be included, by definition, in the operating income of the central bank. Concerning the specific nature of the reserve assets, the MGDD IV.3.3.1 §7 states that "*The role of the central bank concerning the management of foreign assets is fixed by specific legislation. They are managed for macro-economic purposes and for the public interest, in the framework of monetary policy. Thus, these assets are not really owned by the units that manage them. They are owned by the nation, represented in national accounts by general government*". The legal and economic ownership and the valuation of government equity as regards the reserve assets is clarified in MGDD IV.2.3.1 §11 and MGDD IV.2.3.1 §12.

Concerning the recording of holding gains/losses in the revaluation account, the MGDD IV.2.3 §7 states that holding gains/losses are not part of the income and are thus not relevant in the application of the capital injection test.

Thus, any change in the funds related to this revaluation account cannot be considered as revenue but should have an impact on the equity owned by government in the central bank, in the form of a financial transaction.

Finally, Eurostat considers that the coverage of capital losses related to foreign exchange should not be treated according to the normal rules on capital injections. Eurostat will also consider whether the MGDD IV.2 §1 should be made more explicit on this point.

## **Conclusion**

As the government injections in the revaluation reserves of the central bank, which take place due to unrealised capital losses, should be recorded as financial transactions, Eurostat requests the Hungarian statistical authorities to reclassify the 29.1 bn HUF capital injection made in 2011 as a financial transaction (equity injection).

## **Procedure**

This preliminary view of Eurostat is based on the information provided by the country authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on the Eurostat website. In case you have objections concerning this specific case, we would appreciate if you let us know before 3 February 2012.

Yours faithfully,



François Lequiller  
Director