OTP BANK

Annual Report

2000

NATIONAL SAVINGS AND COMMERCIAL BANK LTD.


Annual Report
2000

CONTENTS

FINANCIAL HIGHLIGHTS

PROFIT AND LOSS ACCOUNT	1999 HUF mn	2000 HUF mn	CHANGE %
Net interest income	84,002	86,853	3.4%
Non-interest income	30,291	38,964	28.6%
Total income	114,293	125,817	10.1%
Non-interest expenses	74,586	77,669	4.1%
Operating profits	39,707	48,148	21.3%
Provisioning	10,249	7,932	–22.6%
Profit before taxation	33,271	40,216	20.9%
Profit after taxation	28,337	32,483	14.6%

BALANCE SHEET*	1999 HUF bn	2000 HUF bn	CHANGE %
Total assets	1,767.5	1,931.3	9.3%
Loans and advances to customers	478.4	614.1	28.4%
Retail loans	150.8	180.2	19.5%
Corporate loans	291.4	393.2	35.0%
Municipal loans	36.2	40.7	12.4%
Interbank loans and advances	277.7	233.9	–15.8%
Government securities in the Bank's portfolio	300.9	439.0	45.9%
Deposits from customers	1,507.6	1,633.0	8.3%
Retail deposits	1,214.0	1,308.1	7.8%
Corporate deposits	189.9	210.9	11.1%
Municipal deposits	103.7	114.0	9.9%
Total loans and advances	791.0	881.7	11.5%
Performing loans	746.0	841.0	12.7%
Qualified loans	45.0	40.7	–9.6%
Provisions for possible loan losses	23.6	22.9	–3.0%
Shareholders' equity	100.7	127.5	26.7%

PERFORMANCE RATIOS	1999	2000
Cost/income ratio %	65.3	61.7
Return on average equity (ROAE) %	31.62	28.47
Return on average assets (ROAA) %	1.67	1.76
Capital adequacy ratio %	15.23	15.45
Undiluted EPS (HUF)	1,071.88	1,241.32
Diluted EPS (HUF)	1,012.06	1,160.11
Total assets per employee (HUF '000s)	208,020	237,344
Total income per employee (HUF '000s)	12,663	14,916

MARKET SHARE*	1999	2000
Retail deposits %	42	41
Retail loans %	47	34
Corporate deposits %	13	12
Corporate loans %	12	11
Municipal deposits %	82	81
Municipal loans %	72	72

* As at December 31

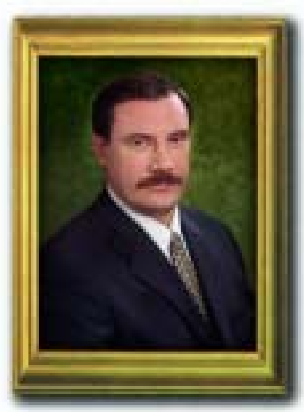
Senior management of OTP Bank Ltd.

Dr. Sándor Csányi
Chairman – CEO

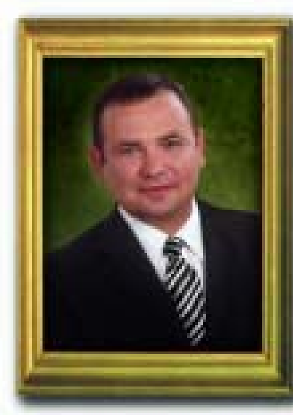
Dr. Zoltán Spéder
Vice Chairman, Deputy CEO
Strategic and Financial Division

Géza Lenk
Deputy CEO
Credit Approval Division

László Wolf
Deputy CEO
Commercial Banking Division



Gyula Pap
Deputy CEO
IT and Logistic Division



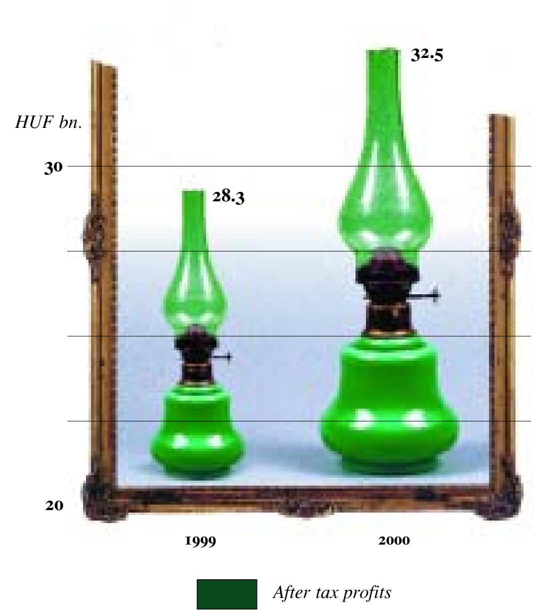
Csaba Lantos
Deputy CEO
Retail Banking Division

MESSAGE FROM THE CHAIRMAN

The year 2000 was one of innovative development for OTP Bank. At the beginning of a new millennium, the Bank must respond to the expectations of both its shareholders and its customers in an environment characterised by the accelerating pace of technological change and globalisation. It is an enormous challenge for every banking institution to formulate a strategy that will allow the provider of traditional financial services to also become competitive in the online world. This can only be achieved through continuous technological and product development, building an ever-closer relationship with customers, understanding and meeting their needs, and creating additional value. In 2000 OTP Bank Group took important steps towards meeting the objectives set out in its business strategy: to remain, over the long term, Hungary's leading universal financial services provider and the market leader in the development of electronic media and services.

Continuing the trend of the past years, the Bank again achieved outstanding results in 2000, especially with regard to the growth in its profitability. OTP Bank's pre-tax profits for 2000 were HUF 40.2 billion, 20.9% higher than in 1999. Profits after tax – partly due to the higher taxation bracket – were 14.6% higher than in the previous year, at HUF 32.5 billion. Dividends paid out of last year's profits amounted to HUF 5.3 billion, or HUF 200 per share. The significant increase in profits is thanks to the Bank's achieving the objectives outlined in its business policy for the year 2000. These included a dynamic increase in non-interest revenues, a strict control of, and relative decrease in operating costs, and an improvement in the quality of the outstanding debt balance. Profit and efficiency ratios in 2000 were also in line with the Bank's plans. The return on average assets (ROAA) was 1.76%, and the return on average equity (ROAE) was 28.5%, or 18.7% in real terms. There was an outstanding improvement in the ratio of non-interest type revenues to total revenue (up from 26.5% in 1999 to 31.0% in 2000), as there was in the cost/revenue ratio (down from 65.3% to 61.7%).

We have succeeded in increasing profitability, a trend that has been sustained over many years now, in a manner that enabled the Bank to preserve or, in some key areas, to actually improve its market position. OTP Bank, within the Hungarian banking system, is still the country's biggest bank. Its total assets of HUF 1,931 billion account for 23% of the total assets of the banking system, and are nearly two-and-a-half times higher than those of the second largest bank. At the end of 2000 the Bank's share of all deposits in the banking system was 32%, and its share of all loans was 15%. Maintaining our market share and increasing our profitability are both results of the work we undertake to ensure that we are able to respond to customers' demands more and more effectively every year. Also in 2000, significant progress was made in the areas of product development and the improvement of **bank-operation support systems.**



OTP Bank was among the first banks in Hungary to begin development of online services and today we can confidently assert that we provide the most versatile service in this rapidly developing area. Our customers now avail themselves of the Bank's services in countless ways. In 2000 the Bank's website was redesigned and the services of OTP HáziB@NK, TeleBANK and Mobil TeleBANK continued to expand. The number of customers utilising our electronic channels increased dramatically during the year. We are especially proud of the fact that through our HáziB@NK service the Bank's share of the Hungarian internet banking market is more than 80%.

The Bank also made significant improvements in the area of card services. The introduction of the **C-loan** saw the launch of the first revolving-credit card, which we also made available to customers who do not have an OTP retail current account. The success of the product is demonstrated by the fact that we sold nearly 23,000 cards in just six months. The business card range has also been extended, with a new product called OTP Bank-METRO. The introduction of new products, as well as technical improvements, resulted in the total number of issued cards increasing by 7.4% to 2.9 million. There was also a significant increase in the number and value of card transactions: there was a 17.5% increase year-on-year in the number of transactions, to almost 73 million, and the annual turnover was HUF 1,590.5 billion, a 33.2% increase compared with 1999.

Another contribution to the improvement in the level of customer service was the further increase in the number of ATMs and POS terminals. At the end of 2000 the Bank was operating 1,065 ATMs and 15,197 POS terminals. In addition, 24-hour automated zones were installed in the newer branches and the refurbishment programme for key high-turnover branches was continued. The latest phase in the IT-system development project begun in previous years aimed at increasing operational security and storage capacity.

The total satisfaction of customer needs cannot be imagined today without insurance, pension fund, investment and asset management services. The members of OTP Bank Group are active in these rapidly expanding markets, and its subsidiaries complement and assist the operation of the bank in several other areas. As at 31 December 2000, the Bank's consolidated total assets were HUF 2,077 billion, which is 10.9% more than a year earlier, and 7.6% more than the total assets of the parent company. Consolidated pre-tax profits in 2000 were HUF 47.6 billion, 26.9% higher than in 1999. Profits from subsidiaries represented 15.5% of the Bank's consolidated profit.

The most outstanding results – in line with the Bank's business policy objectives – were achieved in the markets for insurance and pension funds, and by the Bank Group in the areas of investment fund management, property development and vehicle financing. OTP-Garancia Insurance Ltd. continued to be one of the most dynamically expanding participants in the insurance market. Income from fees reached HUF 38.8 billion, which was 42.4% more than the year before. The growth in the life- and bank-insurance business was even stronger, at 68.1%. The insurance company increased its market share of total insurance fee revenue to 10%, and of life insurance fee revenue to 12%, at the same time more than doubling pre-tax profits and significantly increasing the size of its **reserves.**

The Bank Group is the market leader in the area of both private and voluntary pension fund services. In the year 2000 the membership of OTP Private Pension Fund increased from 509,000 to 568,000, with total assets increasing from HUF 19 billion to HUF 39 billion. During the same period the membership of OTP Voluntary Pension Fund increased from 91,000 to 117,000, with total assets up from HUF 16 billion to HUF 23 billion. The resulting market share of OTP Pension Fund Management Ltd. as at 31 December 2000, based on individual accounts under management, was 21%, while in terms of assets under management it was 16%.

The Bank Group's market share in investment fund management continued to increase, rising from the 42% of 1999 to 49% in 2000. OTP Fund Management Ltd. thereby consolidated its position as market leader. This success was partly due to an expansion in the product range (with the introduction of a domestic bond fund under the name OTP Maxima) and partly to an increase in product accessibility: in 2000 it became possible to buy and sell certain investment fund shares through the TeleBank Center or via the internet. The total assets of the investment funds managed by the company increased during the year by 44.8%, reaching HUF 273.4 billion by year-end. Pre-tax profits in 2000 were HUF 1.7 billion, which is 24.6% more than the year before.

OTP Real Estate Ltd. successfully made use of the revival in the property market to undertake a considerable amount of property development, thus maintaining its first place in new home construction. The company's sales revenue was HUF 7.9 billion and pre-tax profits were HUF 758 million. Just as it did in 1999, the Hungarian Real Estate Association awarded the title of 'Property Development Company of the Year' for 2000 to OTP Real Estate Ltd.

The results of the Bank and the Bank Group in 2000 are also reflected in the change in market-value indicators. Earnings per share at 31 December 2000 stood at HUF 1,475.38, up 31.5% on 1999. And during the year consolidated net assets per share (nominal value: HUF 1,000) increased by 30.2%, to HUF 5,111.

In preparing its medium-term strategy for the period 2001-2005, the main thrust of which is towards organic growth, the Bank has expressly included the possibility of an increase in acquisitions, both domestically and in the eastern European region. In the context of laying the emphasis on domestic growth, towards the end of 2000 we put Postabank under the microscope, but a takeover did not take place. In the future the Bank wishes to continue exploring possibilities for both national and regional acquisitions.

I am convinced that OTP Bank Group, building on the foundation of its able workforce, will maintain its position nationally, strengthen its position in Eastern Central Europe, and meet the new challenges that lie ahead. The optimism of the board is strengthened by the positive evaluation of the international rating agencies. Analysis by Moody's refers to OTP as the region's strongest banking institution, one that will remain, as it is today, a dominant participant in the Eastern Central European market. Special thanks should go to our shareholders, customers and employees for contributing to the success of the Bank and the Bank Group through their actions and loyalty.

Dr. Sándor Csányi
Chairman – CEO

ECONOMIC, MONETARY AND REGULATORY ENVIRONMENT IN 2000

Hungarian economic development in 2000 was characterised by a level of growth higher than any seen since the change of the economic system, as well as by stable balance-of-payments and public-finance conditions, rising demand from business and a falling unemployment rate. The excellent performance of the economy was the result of an extremely rapid improvement in industrial production, and from lively domestic demand and a dynamic growth in exports fuelled by a boom in the world's markets. However, the downward trend in inflation did decelerate, before coming to a complete halt in July, stopped by changes in prices and exchange rates on the world's markets and by the correction in Hungarian food prices.

In 2000 GDP increased by 5.2%, evincing faster economic growth than in the majority of EU and ex-Comecon countries. In the quarterly data, however, there are signs of a change of tendency. In the first quarter, GDP growth was 6.5% compared to the same quarter of the previous year, but this rate gradually decreased in the succeeding quarters.

Exports continued to be a driving force behind economic growth. The volume of exports on an annual level showed an increase in 2000 of 21.7% over the previous year. The increase in exports was helped by economic prosperity in the EU and by fluctuations in the exchange rate of the euro, and, together with it, the forint.

The supply of goods for the export drive was provided mainly by an 18.3% increase in industrial production. Within this, the 35% increase in machine production was outstanding, this sector now accounting for 60% of all goods exports. A positive development was discernible in domestic industrial sales, which grew by 9% (1999: 1.4%). At the same time export sales also moved ahead, increasing from 23% to 27.4%. In the construction industry the effects of the economic boom were felt less than in the engineering sector, although an increase in volume of around 6% should not be underrated. The change in the new housing support scheme will have a considerable effect on demand in the industry in the years to come. In 2000 there was no success in attempts to halt the decline in agricultural production.

Domestic use of GDP increased by 4.5% in 2000. Investment volume exceeded the previous year's level by 6.6%. Household consumption increased by 3.3%, i.e. at a slower rate than in 1999, and gross household savings rose by 16%. Average gross monthly wages among the employed increased by 13.5% over the year before, and average net wages by 11.4%. Since the annual average inflation rate was only 0.2 percentage points lower than the year before, real wages increased more modestly – by 1.5%. The five-year downward trend in inflation did carry on into 2000, albeit at a significantly slower rate. The annual average index fell from 10% to 9.8% and the 12-month consumer price index for December fell from 11.2% to 10.1%.

Developments in economic activity in 2000 were characterised by stable external and internal equilibrium.

The budget deficit, at HUF 449 billion, did not differ significantly from previous years, but expressed in terms of GDP it decreased from 3.7% to 3.5%. The central budget closed the year with a HUF 369 billion deficit, which is about HUF 30 billion more than the year before. Most of this increase resulted from extraordinary government expenditures at the end of the year.

The foreign trade deficit increased last year by USD 1 billion to stand at USD **4.0 billion** by year-end. The value of foreign trade expressed in dollars increased for exports by 12.3% and for imports by 14.5%. As a result of the significant weakening in the euro, the data present a much less attractive picture when measured in euros: an increase in the trade gap from EUR 2.8 billion to EUR 4.3 billion. The trend in the deficit is upwards not only in absolute terms but also in relation to exports.

The current account deficit in 2000 was EUR 1.6 billion, about 400 million less than the year before. Taking the year as a whole, this improvement is a result of the differential movement of components of the balance of payments. The positive balance in services and unilateral current-account transfers exhibited dynamic growth, while the negative balance in foreign-exchange traded goods and revenues increased at a more modest rate than in the previous year. About three-quarters of the increase in income from services came from tourism.

The so-called non-debt-generating net inflow of capital, in the form of working capital and portfolio investments, amounted to EUR 474 million, or one-fifth of the previous year's level. The country's gross external debt (including **loans from the owners of companies**) rose by EUR 4 billion to EUR 33.1 billion, and net debt increased by EUR 0.9 billion altogether, to EUR 12.2 billion. International reserves amounted to EUR 12.1 billion at year-end.

MONETARY POLICY

In the year 2000 the government made use of various monetary policy instruments in order to fulfil its objective of reducing inflation, but it considered that there were certain circumstances under which that objective could not be met. The instruments available to the central bank underwent major changes. The modifications were undertaken to simplify the instruments and make them conform more to the market.

In the area of the exchange-rate mechanism there were two significant moves last year. From January the US dollar was taken out of the basket of currencies that determines the level of the forint, with the result that the monthly devaluation now only **indicates a change relative** to the euro. As of 1 April 2000 the monthly rate of the crawling-peg devaluation of the forint was reduced from 0.4% to 0.3%. During the year no further exchange-rate modification was possible because of the faltering slowdown in inflation and the inflow of speculative capital awaiting the widening of the devaluation band. The forint stayed within the band throughout the year, mostly towards the top end of the range.

The central bank adjusted its interest-rate policy during the year in response to events in the money and capital markets. The sharp fall in interest rates at the beginning of the year was followed later by a more moderate reduction, and then from the autumn rates rose again.

The central bank base rate was reduced three times during the year, falling from 14.5% to 11% over the twelve months. The interest rate on the 14-day fixed-term deposit, **which is considered a guide to the direction of monetary policy,** was reduced by 3 percentage points in the first quarter of 2000, from 14.25% to 11.25%. While the overnight **interest corridor** was left unchanged, the active repo rates during this time were also reduced by 3 percentage points. The slowing down of the decrease in the inflation rate reduced real interest rates (which had risen in 1999) to around 2% by the middle of 2000, and to around 1% by September. In October rising prices made necessary a single 100-basis-point increase in nominal interest rates. In March the central bank introduced a 90-day fixed-term deposit, the aim of which was to stabilise market rates, create a longer term instrument to be used alongside the 14-day deposit, and influence the slope of the yield curve.

On 1 July 2000 fundamental changes were introduced to the mandatory reserve regulations. The new regulations concerned, in equal measure, the basis of the mandatory reserve, the range of instruments available for its implementation, and the level of the nominal reserve rate. From 1 July, provision has had to be made against 50% of liabilities originating from abroad that have a maturity of less than one year. Only 50% of HUF deposits can be taken into consideration in fulfilling the provisioning requirement. The nominal reserve rate was reduced from 12% to 11%. As a result of the modifications, the outflow of revenue – which imposes a heavy burden on HUF deposits and short-term FX deposits – was decreased. At the same time the Hungarian National Bank has paid, and will continue to pay, a higher rate of interest on reserves set aside for FX deposits (in the first instance 0.5 percentage points, then later 1.5 percentage points) than it pays on the reserve for HUF deposits.

Yields on short-term government bonds fell from 12.4% to between 11 and 11.5%. Yields of less than 10.5% were witnessed in the first half of the year, but by October typical yields had returned to approximately the same level they had experienced at the beginning of the year. Interest-rate fluctuations were characteristic mainly of short-term bonds. Interest rates of longer-term government bonds fluctuated between 8 and 9%, and the inverse character of the slope of the yield curve remained basically unchanged.

REGULATORY ENVIRONMENT

Among the major legal changes that had been expected to take place in 2000, the only significant event was the enacting of the new law on credit institutions. The preparation of the investment law package was not completed and the planned liberalisation of the foreign-exchange law did not materialise either.

The new act on credit institutions

The new law became necessary in part because of the change in the financial system and also because of the process of law harmonisation being carried out in preparation for membership of the EU. Therefore, built into the new law are sections that will come into effect upon accession. Regarding accession, the aim of the law is that Hungarian regulations should not be stricter than those of the EU, so that there should be no competitive disadvantage for financial institutions.

The key elements of the change in the law are as follows:
- From the date of the country's accession to the EU, it will no longer be possible to open accounts or make deposits anonymously, although already existing deposits will be allowed to remain open indefinitely.
- The law strengthens supervision, including the supervision of cross-border services.
- The barriers are removed to the public issue by non-financial enterprises of bonds in a value greater than their equity capital. The limits to this new right will be laid down in separate regulations.
- At the time of the country's accession to the EU, the deposit insurance limit will rise to HUF 6 million, with the part of the deposit above HUF 1 million **being subject to a 10% own risk.**
- The law renders consumer protection regulations more specific in the case of consumer loans.

The new housing support scheme

The most important changes to the scheme that came into effect in the year 2000 are as follows:
- Interest-rate subsidy was made generally available to assist in the obtaining of mortgages. The relief is available for a maximum of five years, on loans of up to HUF 30 million. The level of relief, originally 3 percentage points, will increase to 4.5 percentage points in 2001, at which time the maximum period of relief will also increase to ten years.
- Additional subsidy was introduced for young couples and people bringing up children, available for up to ten years, with total interest including costs not to exceed 8%. The original HUF 8 million limit on the size of the loan was raised to HUF 10 million on 1 July 2000.
- In order that they can increase their stock of rental accommodation, from 1 July 2000 the local authorities of smaller settlements have been able to apply to the government for cash grants.

INTERNATIONAL ECONOMY

In almost every part of the world 2000 was a year of increased economic prosperity. GDP grew at the fastest rate for 15 years, averaging 4.6% worldwide. Growth rates in developing countries averaged well in excess of 5%, but there was also dynamic growth – averaging around 4% – in the developed world. The volume of world trade increased by 11%.

Economic growth in the EU, which had accelerated in the second half of 1999, reached a 4% peak in the middle of 2000. The average year-on-year increase was 3.4%. The rate of growth in the euro-zone was even greater, reaching the highest level for a decade. During the year there were competing influences on the EU economy. Growth in the EU was encouraged by favourable external economic conditions, increasing demand in foreign markets, the ongoing decline in the euro, dynamic growth in investment and recovery in levels of consumption. At the same time, growth was slowed by the large jump in oil prices and the ECB's anti-inflationary interest-rate policy. The worldwide increase in oil prices worked its way through into a general increase in prices in western European countries. In 2000 retail prices in the EU rose by an average of 2.1% (1999: 1.2%); the rise in the EMU countries was 2.3% (1999: 1.1%).

The economic growth of over 4% per annum that the United States had experienced for the previous four years showed a further increase, approaching 5%. The boom was driven by consumer demand, high productivity levels and the investment activity taking place in the IT sector. The long-term expansion of the US economy has been based principally on an increase in productivity, but growth processes have had significant negative effects on economic equilibrium: the current account deficit has continuously worsened. In 2000 it stood at 4.3% of GDP. Households and businesses were seriously indebted and shares became overvalued.

The growth in the world economy, and in particular the boom in western Europe, had a positive effect on the economies of Central and Eastern Europe. Economic growth increased in most of the leading ex-Comecon countries. In Poland the increase was about 5%, in the Czech Republic 2.5% and even in Slovakia it was about 2%. The year 2000 was a successful one for the Bulgarian economy, although the pace of inflation quickened again and unemployment remained at a high level. GDP growth was about 5% and the country's balance of payments position is stable.

All the countries of the former Soviet Union saw their economies grow in the past year. Throughout most of the region growth was driven by a revival in industrial production and investment. In Russia industrial production grew by 9% and GDP by 7.7%. There was an improvement in the external and internal balances, with a current account surplus of about 18% of GDP. There were also signs of a reduction in the long-term budget deficit: there was a surplus, equivalent to 4% of GDP, in the first half of the year. The annual average inflation rate fell from 37% to 21%.