DEBT MANAGEMENT REPORT

2003

MAGYAR ÁLLAMPAPÍR

ÁLLAMI GARANCIÁVAL

FOREWORD

2003 was a challenging but successful year for the Hungarian public debt management. For both market participants and external observers, last year's difficulties took the shape of repeated disturbances in the foreign exchange and government securities markets, which led to a significant increase in the yield of government securities and to a weakening demand for them by the end of the year. The main characteristic of the year 2003 was that the process of EU convergence, which had been unbroken in previous years, slowed down temporarily in Hungary, just as in other acceding countries as well.

On the other hand, 2003 was a successful year in several respects: despite the above-mentioned problems, financing the higher-than-planned deficit of the budget and servicing public debt did not present a problem at all. Another major result was that the strategic objectives set at the beginning of the year were met despite the large volume of government securities issuance: the average term-to-maturity of the public debt increased, the proportion of foreign exchange debt decreased, while expensive debt components were refinanced by cheaper loans.

The year 2003 was different from the previous year in one other respect. After a year-long break the Republic returned to the international capital markets in 2003 and refinanced foreign exchange debt falling due by issuing new foreign currency bonds. The international activity of the Republic made the Hungarian government securities better known to foreign (primarily European) investors just before the EU accession. The higher popularity among investors will most probably make the Republic's future accession to the Economic and Monetary Union smoother from the point of view of public debt management.

Finally, it must be mentioned that the increasing activity abroad was accompanied by decreasing interest from foreign investors towards domestic investments, thus the successful financing of government debt in 2003 was largely attributable to strong demand from domestic investors for government securities. The increasing interest of domestic institutional investors, banks and, last but not least, small investors was the decisive factor behind the successful financing of the public budget.

Ferenc Szarvas
Chief Executive Officer

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I. MACROECONOMIC DEVELOPMENTS

THE NATIONAL ECONOMY

The growth of the Hungarian economy slowed down slightly in 2003; the rate of GDP growth for the entire year decreased to 2.9%, which was still significantly higher than that of Western European countries. In the first half of the year, the economy was powered by the very strong growth of domestic demand. From the middle of the year, however, the structure of growth became healthier and in the fourth quarter, the rate of growth of exports outgrew that of imports, corporate investment picked up and consumer consumption dropped a little. The favourable development of the national economy was attested by the over 8% growth of industrial production and the fast expansion of investments in the manufacturing industry.

Household consumption increased by 6.5% in 2003, which was facilitated on the one hand by the rise in wages, which was still very fast, though it showed a decreasing tendency, and by the growth of household credit on the other. Over the whole of 2003, domestic consumption increased by 5.5%, which exceeded the growth rate of GDP.

The economic slowdown in 2003 was primarily caused by weak external demand, which was attributable to the economic downturn that characterised Hungary's primary export markets in the Western European region. However, export sales showed a strong recovery in the last months of the year. Imports grew at an increasing rate during 2003 as a result of strong domestic demand. During the first three quarters, this process was primarily driven by strong household demand, but in the fourth quarter the growth of imports attributable to consumption dropped somewhat, while imports for investment purposes grew stronger.

MONETARY DEVELOPMENTS

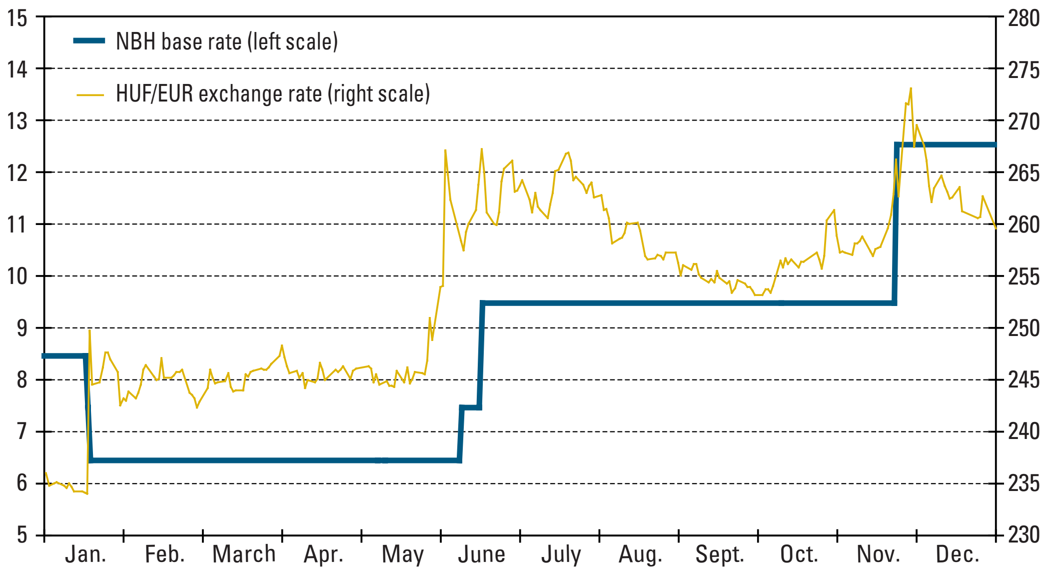
The economic circumstances were unfavourable again in 2003 from the perspective of government debt management. According to preliminary data[1], the central budget showed a deficit of HUF 1060 billion[2] in 2003, which was lower than the exceptionally high level a year earlier, but it still amounted to 5.7% of the GDP and still exceeded government expectations. In addition to the high level of deficit, the financing was made more difficult by the continuing increase of households' indebtedness in 2003, which sector even became net borrower in the second half of the year. As a result of the increase of inventories and investment expenditure, the corporate sector also reached a net debtor position.

In summary, the aggregate financing requirement of the domestic sectors reached 8.5% of the GDP over the entire year. As a result of domestic consumption exceeding the available revenues of the national economy, the deficit of the current balance of payments reached EUR 6.5 billion in 2003. Within the coverage of the external financing requirement, the proportion of long-term foreign investments (FDI, reinvested corporate profits) dropped to a minimal level, therefore the net foreign debt of the country increased to EUR 15.6 billion.

The year 2003 was characterised by several sudden and major changes in the monetary conditions. Rapid market movements of significant dimensions occurred three times during the year, provoking drastic reactions on the part of the National Bank of Hungary (NBH). At the beginning of the year, a high volume of speculative capital flowed into the country in the hope of a strengthening Forint, and in mid-January the NBH responded by reducing interest rates in two steps by a total of 200 basis points (bps). However, by changing temporarily the conditions of the central bank's set of instruments[3], the effective monetary easing reached 500 basis points.

[1] *Debt and deficit data are considered preliminary until approved by Parliament in the Act on Final Accounts.*
[2] *This amount does not contain the deficit of local governments.*
[3] *The ±2 percentage point widening of the central bank's interest rate corridor and the quantity constraint introduced for the 2-week central bank deposits.*

Development of monetary conditions in 2003

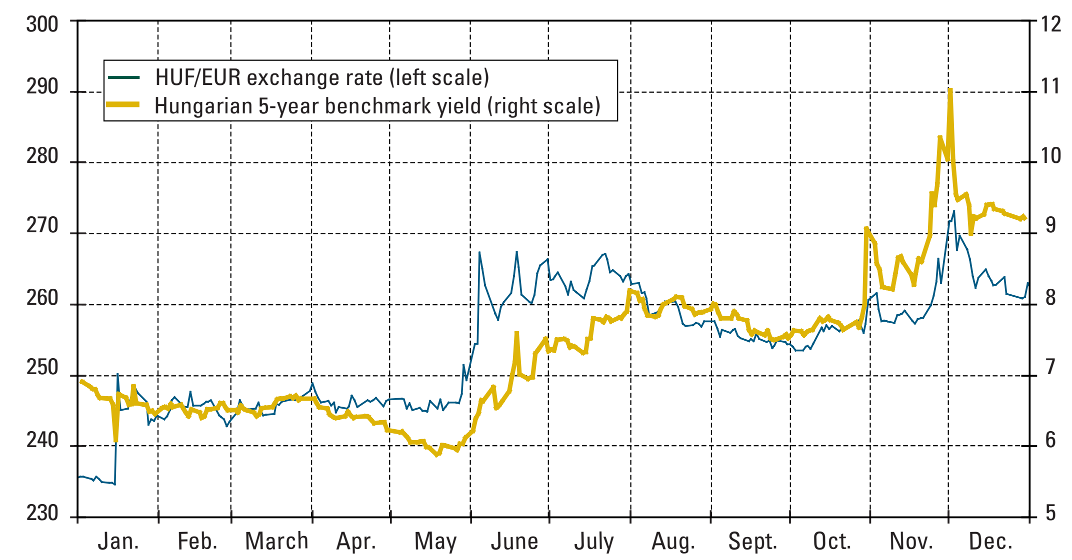


Source: NBH

In June, after the Government and the NBH shifted the intervention band of the Forint by 2.26% by a joint decision, a tense situation developed in the money markets. In an uncertain macroeconomic environment, this measure eroded the confidence of investors even further. In order to stop the capital outflow and the fast devaluation of the Forint, the central bank raised its base rate by a total of 300 basis points in two steps.

Towards the end of the year, the trust of foreign investors in the Hungarian financial markets was shaken again. The fiscal position, which showed no sign of improvement despite promises to the contrary, together with the expanding portfolio of household credit deteriorated the prospects of the current balance of payments even further. This led to

Government securities yields and the exchange rate in 2003



Source : NBH and ÁKK[4]

[4] *Government Debt Management Agency Ltd., hereinafter: ÁKK*

renewed withdrawal of capital and weakening of the foreign exchange rate, to which the National Bank of Hungary responded by raising interest rates by a further 300 basis points.

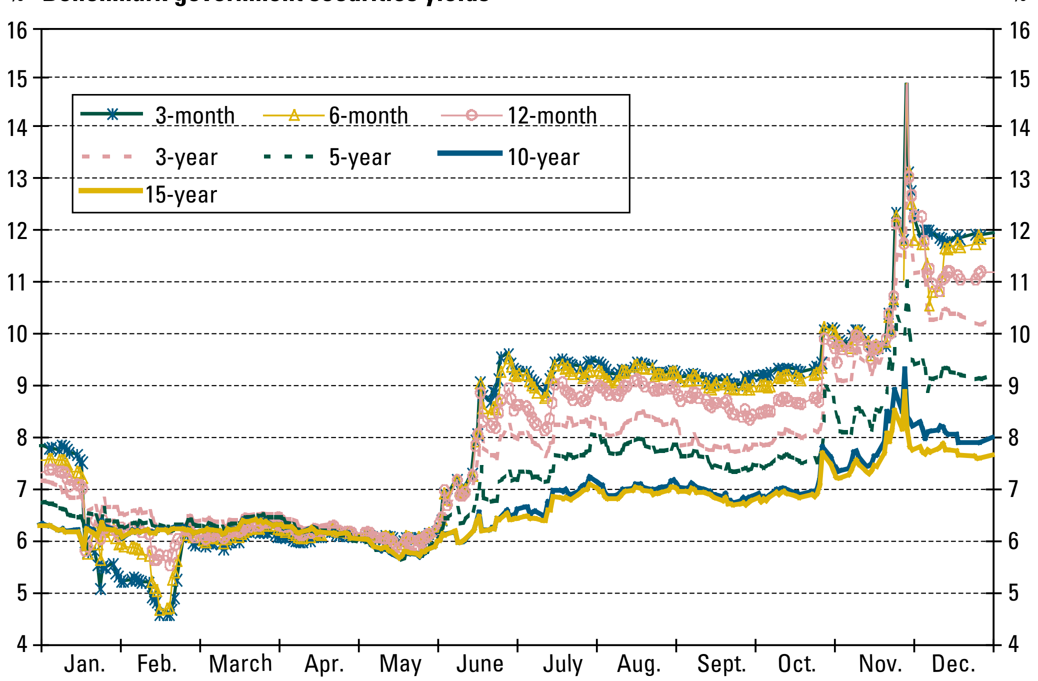
Regarding the whole year, conditions in the domestic financial markets changed in an unfavourable direction. International investors lost confidence in the Hungarian financial markets, both exchange rate and yield volatility increased, the interest rate premia on Forint securities also rose significantly. The central bank's base rate was raised from 8.5% at the beginning of the year to 12.5%, while the domestic currency lost over 10% of its value.

Inflation reached a 22-year minimum in mid-2003, but it began to rise again in the second half of the year as a result of increases of regulated prices and the weakening of the Forint. On the whole, however, inflation decreased, with the annual average inflation falling to 4.7% in 2003 compared to 5.3% in 2002.

The volatility of monetary conditions also affected the government securities market. Yield developments practically tracked the movements of the exchange rate. This is particularly true in respect to the yield of longer-term securities, as the yield of shorter-term ones shows a more marked dependence on the changes of the central bank's base rate.

Yields increased significantly over the entire year. At the end of 2003, shorter-term benchmark yields were 370 to 409 basis points higher than one year before. The increase of the longer than 1-year yields was more moderate, but even the yield of the 10-year securities increased by 1.5 percent.

Benchmark government securities yields

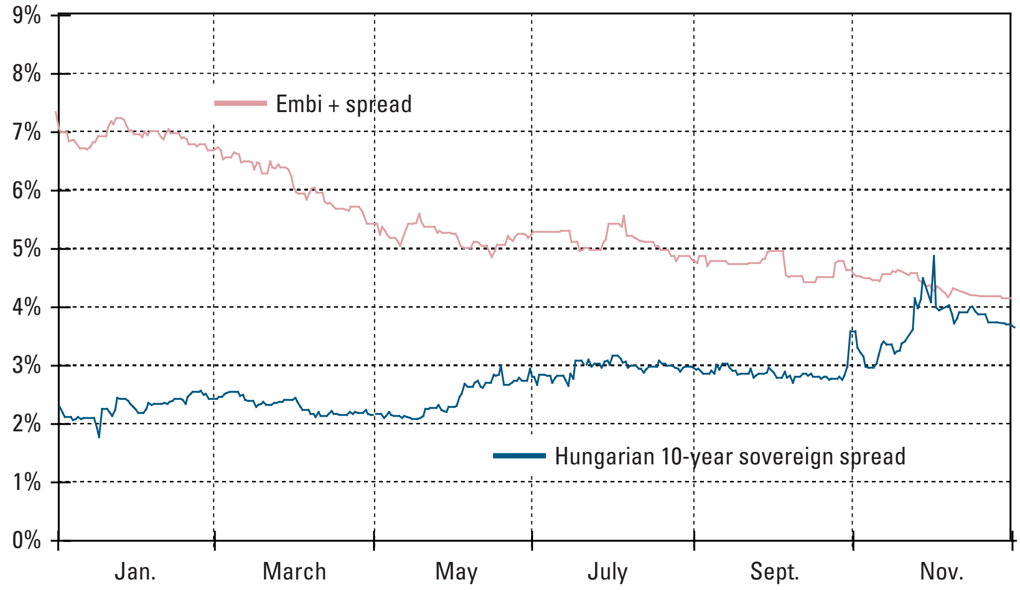


Source: ÁKK

The development of domestic yields did not follow international trends, which shows that their sudden increase was primarily attributable to domestic factors. While due to extremely low international interest rates, high liquidity and increasingly favourable economic indicators 2003 generally brought a significant reduction of interest rate spreads in the emerging economies, the Hungarian 10-year benchmark yield premium vs. the euro benchmark rose from a level near the Maastricht criterion (2%) to a steady level near 4% by the end of the year.

The performance of the Hungarian bond market was poor in 2003: the MAX Composite index increased only by 1% over the entire year and some investors even made losses on their government securities positions at the time when yields increased rapidly. Despite the repeated strong yield and exchange rate fluctuations, the presence of foreign investors

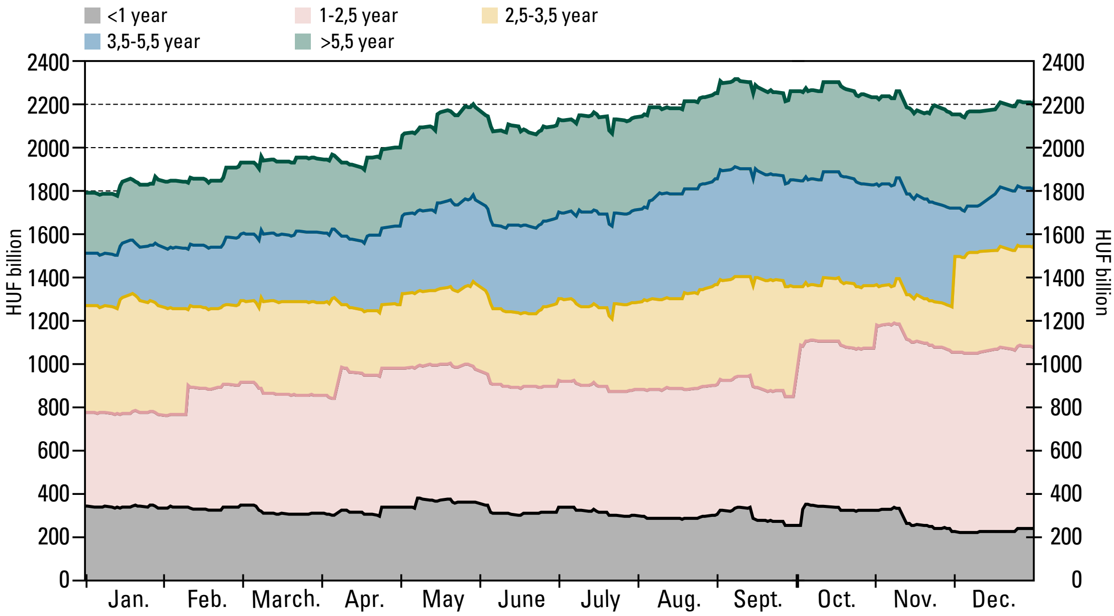
The EMBI premium and the yield spread of Hungarian 10-year government securities



Source: NBH, ÁKK, Bloomberg

increased further in the Hungarian government securities market. Non-resident holdings of Forint government securities rose, though with some temporary setbacks, by some HUF 420 billion in 2003, exceeding HUF 2200 billion by the end of the year. In the second half of the year, however, the weakening of investor confidence resulted in the breaking of previous trends, the volume of domestic government securities owned by foreigners stagnated and even decreased. In spite of these tendencies the Republic's credit ratings remained favourable, with the exception of Fitch having changed its outlook from "stable" to "negative".

Breakdown of the non-resident holdings of Forint government securities by term-to-maturity

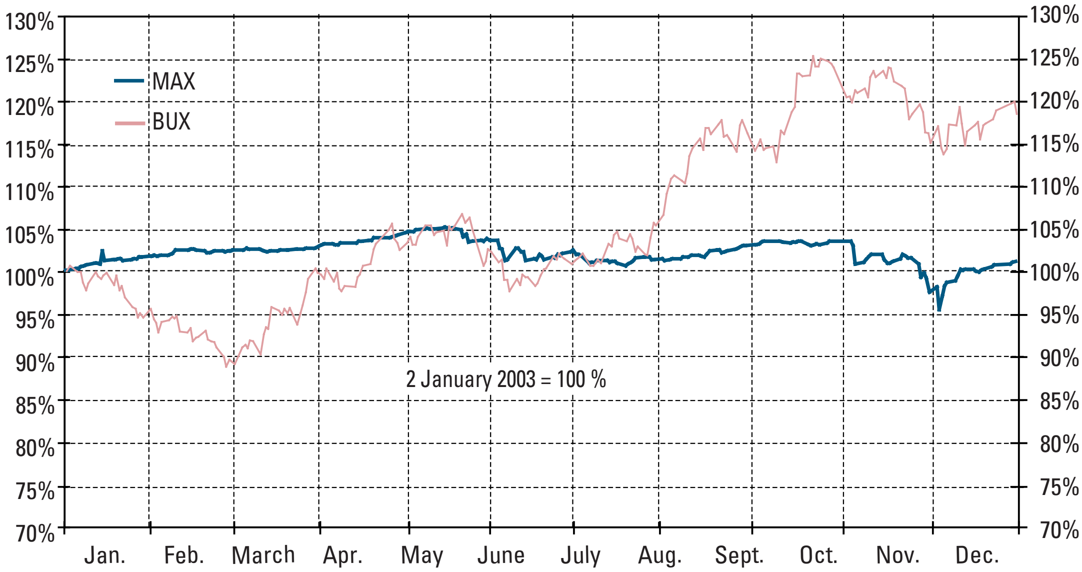


Source: ÁKK

THE STOCK MARKET

The Hungarian stock market – unlike the government securities market – performed well in 2003. The index of the Budapest Stock Exchange rose by 20% over the entire year. The movements of Hungarian share prices generally tracked the trends of the international capital markets.

The MAX and BUX indices in 2003



Source: ÁKK, Bloomberg

The beginning of the year was influenced by the poor performance of the global economy and uncertainty associated with the impending war in Iraq. However, in the second quarter, the decrease of global oil prices, then, in the second half of the year, the signs of a global recovery resulted in strong growth trends both in western capital markets and at the Budapest Stock Exchange. In the last quarter, the BUX index approached 10,000 points, ending at around 9400 points by the end of the year.

II. STRATEGIC OBJECTIVES OF PUBLIC DEBT MANAGEMENT

According to the debt management strategy approved by the Minister of Finance *the main objective of public debt management is to finance the borrowing requirement of the central government with minimal costs in the long term, taking into consideration the risks involved in an integrated manner.*

Based on the combined analysis of risks and costs, the most important objectives specified in the strategy for 2003 were as follows:

- lengthening the term-to-maturity of the Forint denominated debt,
- increasing the share of fixed rate government securities,
- reducing the portfolio of non-marketable government debt.

According to the principle stipulated in the strategy – provided that there is no special economic policy decision affecting debt management – ÁKK finances the net borrowing requirement of the budget and the maturing Forint debt by issuing domestic securities, and refinances maturing foreign exchange debt by raising foreign currency debt.

In 2003, in contrast to 2002, the Republic's maturing foreign exchange debt was again refinanced from the international capital markets together with the replacement of some portfolio elements with unfavourable terms and conditions. For this purpose foreign exchange bonds were issued and foreign exchange loans were also raised during the year.

III. THE BORROWING REQUIREMENT

The aggregated deficit of the central government budget, the social security funds and the extrabudgetary funds was HUF 1,059.9 billion in 2003, 5.7% of the GDP. The deficit consisted of the HUF 733.6 billion deficit of the central government budget, the HUF 345.1 billion deficit of the social security system and the HUF 18.8 billion surplus of the extrabudgetary funds.

While the net financing requirement was increased by the HUF 82.9 billion capital transfer to the NBH to cover its exchange rate losses, it was decreased by privatisation revenues of HUF 42 billion, so the total net financing requirement reached HUF 1,100.8 billion. Together with the HUF 1799.1 billion redemptions of debt with a longer than one-year tenor, the gross financing requirement totalled HUF 2899.9 billion in 2003.

	2002	**2003***
Deficit of the central budget (excluding privatisation revenues)	-957.7	-733.6
Financing requirement of the Social Security Funds	100.9	-345.1
Financing requirement of the extrabudgetary funds	1.5	18.8
Net borrowing requirement	**-1,057.1**	**-1,059.9**
Funds covering the exchange rate losses of the NBH	-250.2	-82.9
Privatisation revenues	0.0	42.0
Total net borrowing requirement	**-1,307.3**	**-1,100.8**
Within-the-year redemptions (Treasury bills)	-1,005.6	-1,799.1
Over-the-year redemptions	-2,946.6	-3,693.3
Gross borrowing requirement	**-5,259.5**	**-6,593.2**

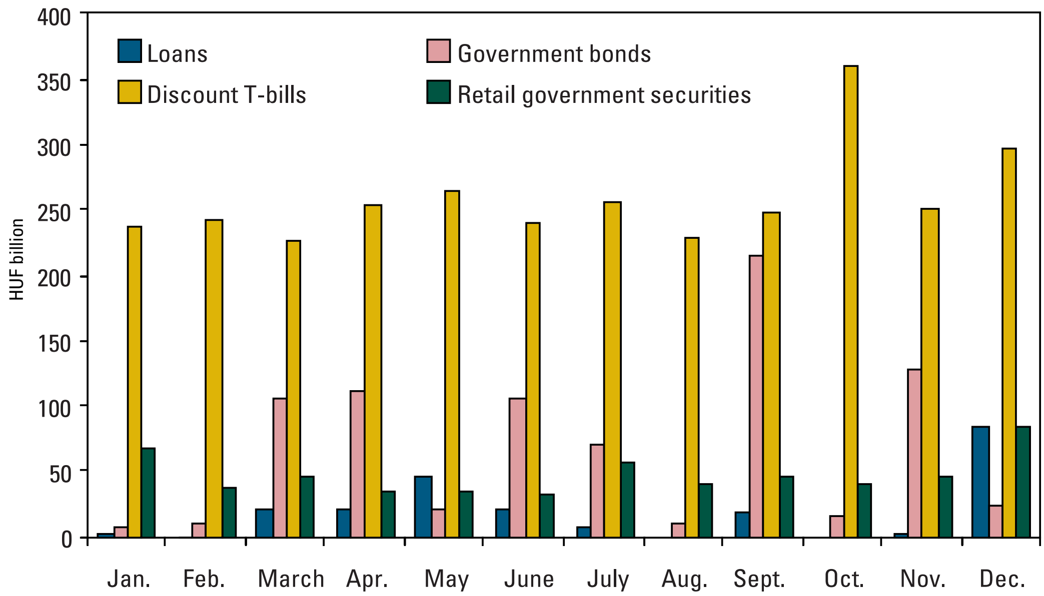
*Preliminary data

REDEMPTIONS

A total of HUF 5,492.4 billion of the central government debt fell due in 2003, of which HUF 1,799.1 billion were redemptions of longer than one-year debt and HUF 3,693.3 billion were repayments of short-term debt. Forint redemptions totalled HUF 4,775.9 while foreign exchange maturities, all of them of long-term debt, totalled HUF 716.5 billion.

Within the Forint redemptions, loans accounted for HUF 235.4 billion, while government bonds matured in an amount of HUF 838.7. Discount Treasury Bills accounted for HUF 3,118.5 within total redemptions, but they were renewed at more favourable terms relative to the previous year. The volume of discount Treasury bills grew only slightly, which was practically the result of the increase in the holdings of households, because the Issuer used primarily longer-term instruments for financing purposes while discount Treasury bills served mostly liquidity management purposes. Redemptions of retail government securities totalled HUF 583.3 billion in 2003, of which long-term Treasury Saving Bonds accounted for HUF 8.5 billion.

Monthly Forint redemptions in 2003



Total government securities redemptions included the buy-backs of government securities before their original maturity in order to reduce the fluctuation of the borrowing requirement caused by the maturity of large bond series. In 2003, ÁKK held buy-back auctions on nine occasions, buying back bonds in a total volume of HUF 80.7 billion. Government bond redemptions also included buy-backs in an amount of HUF 6.3 billion from six special bond series in accordance with Act LVI of 2001 and Act LXII of 2002 (public gas utility assets).

Out of the HUF 716.5 billion total foreign exchange redemptions direct foreign exchange loans, which consist of loans raised from international financing organisations, foreign banks, and assumed liabilities, accounted for HUF 258.8 billion (EUR 725 million and USD 288 million). The redemption of the foreign exchange loan that was raised through the debt-swap transaction between the central government and the NBH in 1997 amounted to HUF 457.6 billion in 2003, consisting of contractual repayments on a GBP 100 million loan, an USD 200 million loan, a DEM 1 billion loan and a JPY 50 billion loan together with the associated swaps, and the prepayment of a DEM 1 billion loan brought forward from 2004.

The repayments of both Forint loans and direct foreign exchange loans included the some HUF 300 billion prepayments of Forint and foreign exchange loans with unfavourable interest rates that were assumed in 2002, which this way were refinanced with more favourable terms.

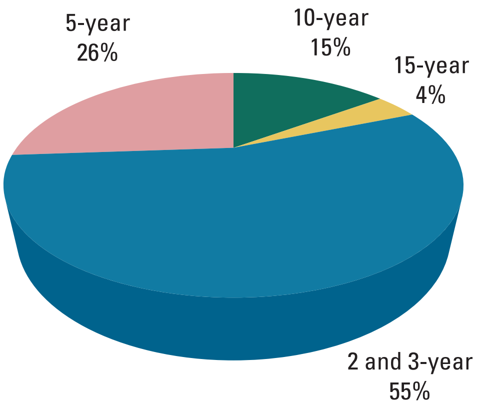
IV. ISSUANCE

1. DOMESTIC FINANCING

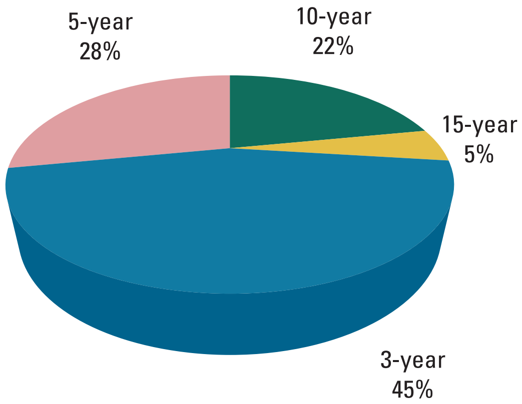
GROSS ISSUANCE

Gross domestic issuance of government securities amounted to HUF 5,828.1 billion in 2003.
Seven series of *government bonds* were sold during the year, in a total amount of HUF 2,048.0 billion, HUF 1,992.0 billion of which were issued at auctions while the remainder were sold through the Treasury's branch network. In accordance with the strategic targets, the bonds were fixed rate securities of 3, 5, 10 and 15-year tenor. The strategic objective of improving the average term-to-maturity of the government debt was achieved, as the proportion of longer-term government bonds within total issuance rose compared to 2002. Within total sales, the proportion of 10-year government bonds increased the most, the share of 5-year and 15-year bonds was also higher than in the previous year, in contrast to the shorter 3-year bonds.

Breakdown of gross domestic bond issuance by tenor, in 2002



Breakdown of gross domestic bond issuance by tenor, in 2003



In order to improve the secondary market liquidity of government securities, fewer bond series, but in larger volume were issued in 2003 in accordance with the debt management strategy. At the end of the year, the 3-year government bond marked 2006/F had the largest volume, totalling HUF 455.6 billion. On the longer end of the yield-curve, 15-year government bonds were issued in a total volume of HUF 110 billion at the six auctions in 2003, compared to HUF 60 billion in 2002.

The gross issuance of *discount Treasury* bills totalled HUF 3,224.3 billion. Similarly to bond issues, the longer-term discount Treasury bills were issued using the technique of reopening.

Retail government securities (Interest-bearing Treasury Bills and Treasury Saving Bills) brought in a total of HUF 555.8 billion in 2003. The 2-year Treasury Saving Bills were sold in an amount of HUF 42.7 billion.

NET ISSUANCE

In reaction to the strong demand for *government bonds* – which primarily characterised the first half of the year – the Issuer increased their sales significantly. Net bond issuance thus totalled HUF 1209.3 billion, composed of the HUF 1227.4 billion net issuance of marketable government bonds and the repayment of HUF 18.1 billion of non-marketable government bonds.

As no *Forint loans* were raised or assumed in 2003, there were only redemptions, the net balance amounted to HUF –235.4 billion.

In 2003, the issuance of *discount Treasury bills* served the renewal of maturing bills and the purpose of liquidity management and, moreover, the financing of the deficit overshootings within the year. Their net sales totalled HUF 105.7 billion.

The net issuance of *retail government securities* showed a negative balance of HUF 27.5 billion in 2003, which was HUF 43 billion less than in the previous year. At the beginning of the year, demand was lower than usual due to lower interest rates. But afterwards, as yields began to rise, demand for retail securities also increased significantly during the summer and by the end of the year. The net balance of the sales of Interest-bearing Treasury Bills was positive, amounting to HUF 10.3 billion for the entire year, however, the outstanding portfolio of Treasury Saving Bills declined by HUF 29.3 billion. The outstanding stock of Treasury Saving Bonds, which were on sale until May 2001, dropped by HUF 8.5 billion in 2003.

2. INTERNATIONAL BORROWING

GROSS ISSUANCE

According to one of the general strategic principles of debt management in 2003, foreign exchange redemptions were financed by foreign exchange borrowing.

Foreign exchange bonds were issued twice during 2003, in a volume of EUR 1 billion each. These issues in February and September contributed to financing the repayments by a total of HUF 497.7 billion during the year. The tenor of the bonds was 7 and 10 years, in line with the maturity profile of the existing portfolio of foreign currency bonds. In 2003, the Republic of Hungary tapped only the Euro bond market, where, in accordance with its principles of debt management, it aimed to sell liquid bond series of large volumes. Another important objective was to establish a Euro yield curve for the Hungarian government securities.

Both bond issues were successful: in the case of the 10-year bond issued on 6 February 2003, thanks to the 1.7 times over-subscription, the Issuer managed to price the bond at 27 bps over the Euribor benchmark, i.e. in the middle of the initial price talk and 2 bps below the prevailing secondary market premium on the 2011 bond; in the case of the 7-year bond issued on 18 September 2003, the premium was lower than previously (22 bps). The low yield level made it possible to launch the latter bond with the lowest coupon (4%) of all the Republic's bonds issued so far.

During 2003 a total amount of HUF 83.7 billion was drawn down in *project financing loans* from the Council of Europe Development Bank (CEB), the EIB and the EBRD. The loans were all based on contracts concluded previously, but the total sum and composition of the amounts borrowed diverged from plans. These loans were used to finance social housing projects, environmental projects, programmes of flood prevention and road construction projects.

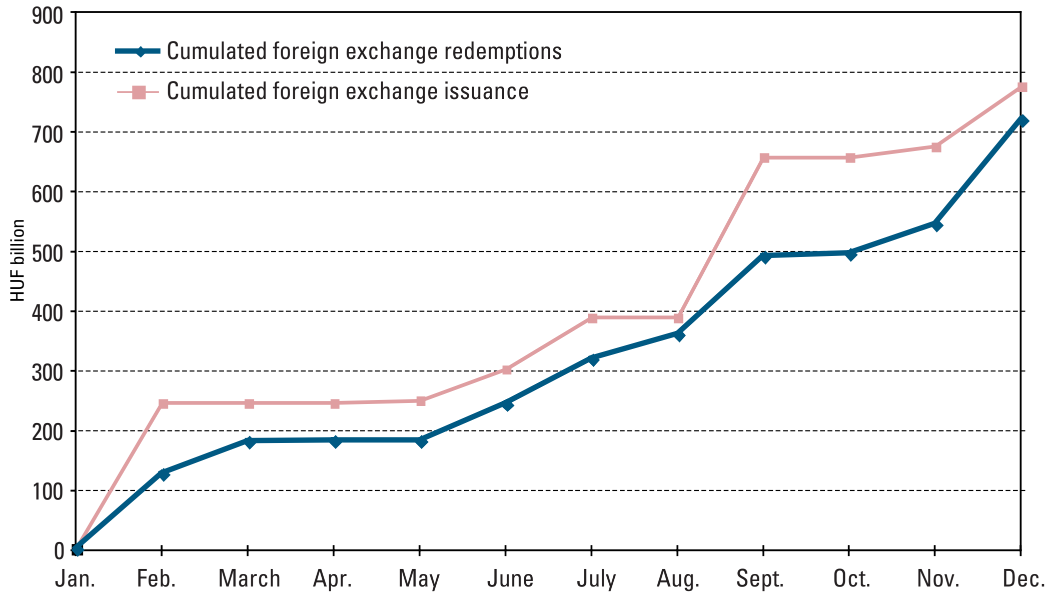
For the first time since 1999, 2003 ÁKK raised a EUR 500 million *syndicated loan* with a term of 5 years, in order to refinance the prepayments of the foreign exchange loans assumed in 2002, totalling HUF 131.2 billion.

In accordance with international practice, a new liquidity management instrument was introduced, namely a stand-by credit facility signed at the end of 2003, with the primary objective of balancing the difference in the timing of foreign exchange revenues and expenditures within the year (e.g. EU transfers and foreign currency denominated debt transactions).

NET ISSUANCE

The net foreign exchange issuance totalled HUF 56.6 billion in 2003. As a result of the success of international issues, the proportion of marketable bonds and loans increased within the portfolio, while due to repayments, the share of the non-marketable foreign currency loan assumed from the NBH in 1997 continued to decrease.

Foreign currency issuance in 2003



V. DEVELOPMENT OF THE DEBT PORTFOLIO IN 2003

At the end of 2003, the gross debt of the central government totalled HUF 10,587.7 according to preliminary figures. By the end of 2003, the central government debt-to-GDP ratio rose to 57.0% from 55.1% at the end of 2002. The currency composition of the central government debt showed 75.6% Forint debt and 24.4% foreign exchange debt.

Central government gross debt as at end of 2003

	HUF billion
Government bonds	5,815.6
Discount Treasury bills	1,540.7
Retail government securities	532.3
Forint loans	117.9
International bond issues	1,467.1
Foreign exchange loans	1,048.4
Swaps	63.5
Matured, but unclaimed securities	*2.2*
Total	**10,587.7**

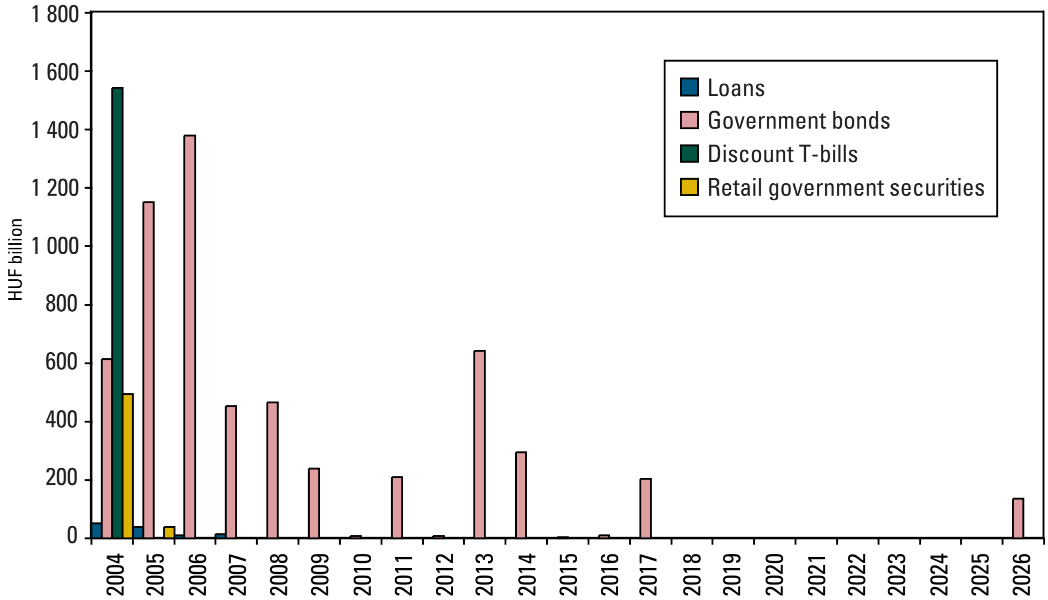
1. THE STRUCTURE OF FORINT DEBT

As regards the Forint debt portfolio, the debt management strategy aims at the further lengthening of the average term-to-maturity and duration - which is still low by international comparisons - by increasing the role of fixed rate bonds in financing.

A) AVERAGE TERM-TO-MATURITY AND MATURITY PROFILE

In the case of government bonds, the average term-to-maturity increased from 3.38 years to 3.97 years by the end of 2003, which was attributable to the increasing proportion of longer-term government bonds within financing. At the end of 2003, 34% of the total debt issued in Forints was maturing within one year, 15% in the second year and 29% in 3 to 5 years. The proportions have improved relative to the previous year (when they were 41%, 10% and 35%, respectively). The most efficient way of avoiding peaks in the repayment schedule is to increase the role of longer-term (5, 10 and 15-year) fixed rate securities further.

Maturity profile of the Forint debt outstanding at the end of 2003



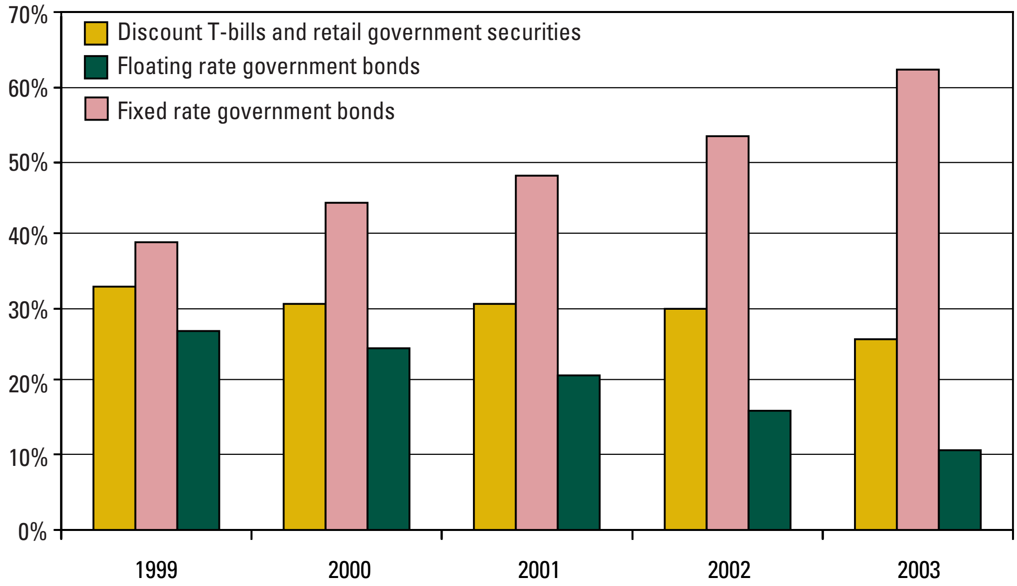
(B) TYPE OF DEBT INSTRUMENTS

Government bonds were sold in a higher than planned volume in 2003, making their proportion within the portfolio increase to 72.6% compared to 66.2% in 2002, while the share of Discount Treasury Bills dropped from 20.6% in 2002 to 19.2% by the end of 2003. The proportion of retail government securities (Interest-bearing Treasury Bills and Treasury Saving Bills) within the total Forint debt declined from 8.0% at the end of 2002 to 6.6% by the end of 2003. The share of Forint loans within all Forint debt, which increased significantly at the end of 2002 as a consequence of debt assumptions, reaching 5.1%, decreased to 1.5% by the end of 2003 due to prepayments.

(C) FIXED – FLOATING INTEREST RATE STRUCTURE

The interest rate structure of the debt portfolio shifted further towards the fixed rate component, as the share of fixed rate bonds within all domestic government securities grew from 53.8% at the end of 2002 to 62.6% by the end of the year (*see the next chart*). All of the bond series issued during the year had fixed coupons. Formerly, there were also floating-rate government bonds introduced to the market (floating interest rate, index-linked bonds and bonds with inflation-indexed principal), but their sale was discontinued due to lack of demand.

Interest rate structure of the Forint government securities portfolio



The *duration* of marketable debt increased from 1.95 years at the end of 2002 to 2.31 years by the end of 2003.

2. THE STRUCTURE OF THE FOREIGN EXCHANGE DEBT PORTFOLIO

The 24.4% proportion of foreign exchange debt within the portfolio – amounting to almost 14% of the GDP – was lower than the average of other countries in the region. Among the countries acceding to the European Union in May 2004, the ratio was lower only in Malta than in Hungary. The proportion of Hungary's foreign exchange debt has decreased continuously and rapidly from the 41% in1997.

(A) TYPE OF DEBT INSTRUMENTS

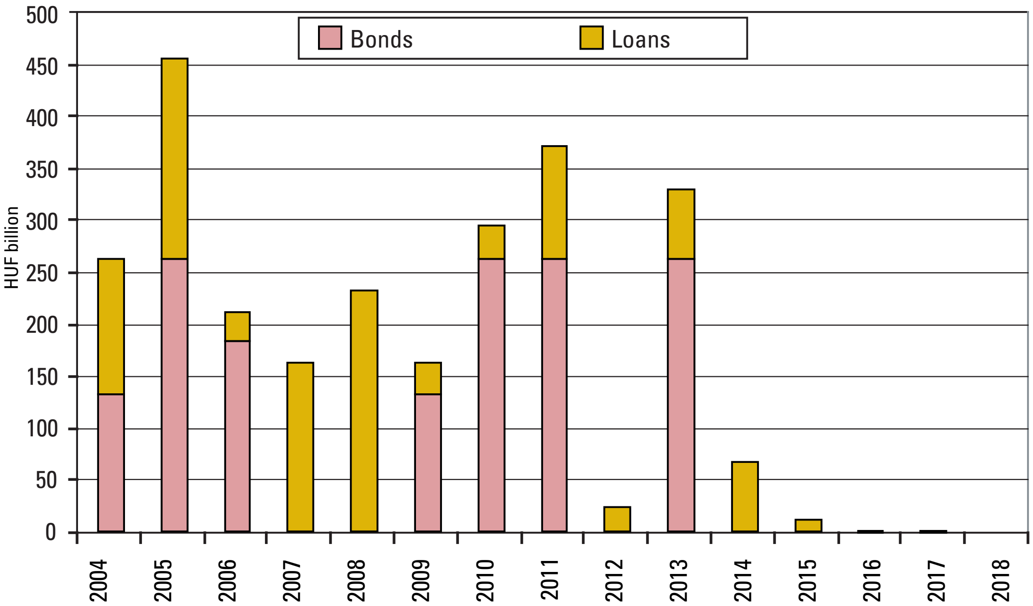
Since 1999, the Republic of Hungary has been borrowing directly from the international capital markets. Within the foreign exchange debt portfolio the proportion of *bonds* has been increasing gradually (58% at the end of 2003, 39% at the end of 2002), as bonds are the main instrument used for foreign currency financing. The funds raised by bond issuance were used for renewing the maturing components of the foreign exchange loan created by the debt swap between the central government and the National Bank of Hungary in 1997 with the same conditions as some foreign exchange bonds issued by the NBH abroad. As a result, the weight of the foreign currency debt owed to the NBH has gradually decreased, it constituted 18% of all foreign exchange debt at the end of 2003, compared to 37% at the end of 2002.

Direct foreign loans made up 24.0% of the total foreign exchange debt at the end of 2003, consisting of the portfolio of loans from international financial institutions (IFIs) and foreign banks as well as loans that were assumed from other debtors. Over the year 2003, the total portfolio of foreign currency loans increased by HUF 72.3 billion. Beside a syndicated loan, project financing loans were taken from the Council of Europe Development Bank (CEB), the EIB and the EBRD, however, the proportion of this type of loans within the foreign currency debt portfolio did not change relative to the end of 2002 owing to redemptions and exchange rate revaluation.

(B) MATURITY PROFILE

In the international capital markets – as opposed to the domestic securities market – the Republic issues only medium and long-term government securities, which provides a relatively balanced maturity structure in the long run. The annual amount of debt maturing in the next four years will be between 0.6 and 1.8 billion Euro (*see next chart*). The average term-to-maturity of the foreign exchange portfolio increased from 4.0 years at the beginning of the year 2003 to 4.8 years at the end of the year, while average duration increased from 2.4 to 3.4 years due to the refinancing of the redeemed foreign exchange debt by new foreign currency issues. The terms of financing for the Republic of Hungary have been continuously improving in the international markets, enabling prepayment and replacement of expensive foreign exchange debt by cheaper borrowing. Consequently, the costs of foreign debt service within the budget have been declining continuously.

Maturity profile of the foreign exchange debt outstanding at the end of 2003



(C) CURRENCY AND INTEREST RATE STRUCTURE

In accordance with the strategy and the approved benchmarks, the entire foreign exchange debt was in Euro after swaps during 2003, which meant that the exchange rate risk was limited to the changes of the exchange rate of the Forint against the Euro, i.e. its movements within the intervention band. The widening of the Forint exchange rate band to ±15% vs. the Euro in May 2001 allows wider fluctuations of the exchange rate, resulting in an increased risk level.

At the end of 2003, the interest rate benchmark for foreign currency debt contained fixed and variable interest rate components in proportions of 74% to 26%, respectively.

The definition of the interest-rate benchmark starts with the definition of the risks. The final composition of the benchmark mix of interest rates is determined using a model that takes into account the risk preferences. First, there is a possible overshooting of interest expenditure in the annual budget (Cash-Flow-at-Risk). Secondly, the increase in the value of the portfolio above a certain level also poses a risk for the budget (Value-at-Risk). There is of course a trade-off between those two types of risk. If the proportion of the fixed rate elements in the portfolio is increased, the Cash-Flow-at-Risk will decrease while Value-at-Risk will increase, and vice versa.

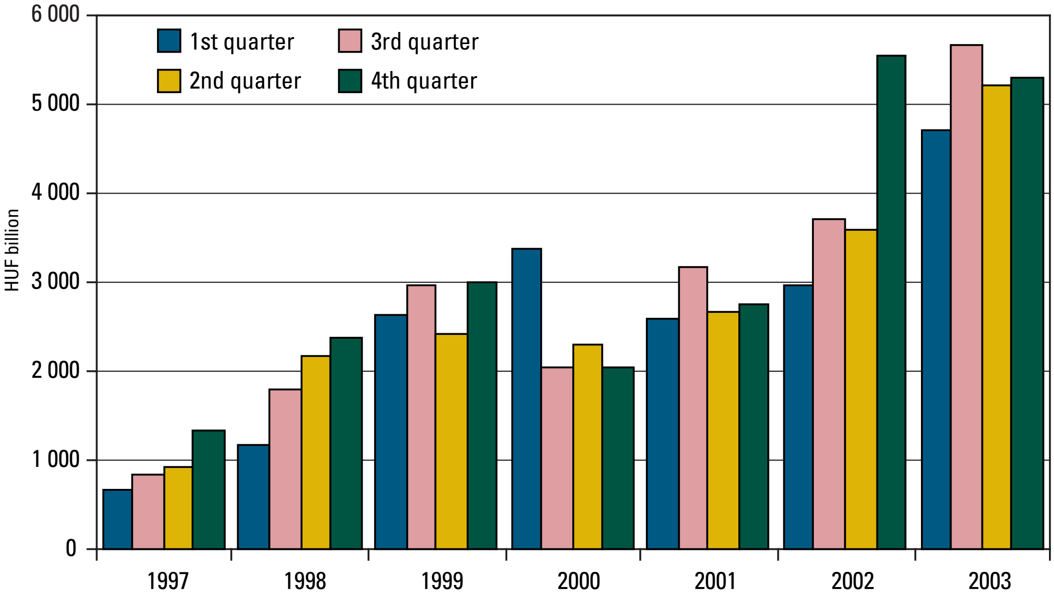
VI. THE SECONDARY MARKET AND MARKET CONVENTIONS

A) THE SECONDARY MARKET

Based on statistics of the Central Clearing House and Depository (KELER), the OTC turnover of government securities was HUF 20,619 billion in 2003, which represents an increase of HUF 4,804 billion relative to the previous year. 80% of that turnover was in government bonds.

The turnover of stock exchange trading of government securities was HUF 194 billion (non-duplicated figure). Government bonds accounted for 77% of the total stock exchange turnover.

Quarterly OTC and Stock Exchange trading of government securities (non-duplicated figures)



Source: KELER, Budapest Stock Exchange

In 2003, the 10-year bond marked 2013/D had the highest secondary market turnover, the outstanding volume of which exceeded HUF 430 billion (EUR 1.6 billion) by the end of 2003, reflecting the joint efforts of the Issuer and the dealers to increase secondary market liquidity. During 2003, the number of bond series included in the price quotation of primary dealers decreased from 24 to 20, while the average size of bond series increased from HUF 155 billion to HUF 250 billion. Primary dealers therefore quoted prices for 83% of the total portfolio of bonds.

In the Hungarian government securities market primary dealers are among the most important players and are the market makers as well. As of January 1, 2003 the group of primary dealers comprised of ten credit institutions and three investment companies. In 2003 a portfolio of HUF 5,116 billion worth of government securities– 89% of the total domestic issuance – was sold through them and they accounted for a significant part of the total secondary market turnover.

Primary dealers made 25% of their secondary market transactions with foreign investors, who accounted for only 19% in 2002. 22% of primary dealers' trading was done with institutional investors, 18% with other primary dealers and 16% with credit institutions.

The average deal size of the transactions of primary dealers (excluding transactions with households) was HUF 328 million in 2003. That was HUF 32 million higher than in 2002. The largest transactions were still those made with foreign investors, averaging HUF 614 million.

With the co-operation of the primary dealers several foreign investors were attracted to the domestic government securities market, but the rate of growth in 2003 lagged behind the figure for the previous year. In 2003, the non-resident holdings of domestic government securities increased by HUF 429 billion to 2,223.3 billion, out of which 2,155 billion (96.9%) were government bonds. That also meant that while at the end of 2002, 29.3% of the market portfolio of government securities were held by foreigners, that proportion increased to over 30.2% by the end of 2003. (That is equivalent to a 42.6% share in marketable government bonds.) The average term-to-maturity of foreign investors' domestic debt portfolio was 3.66 years.

Based on primary dealers' reports, they made repo transactions in a total volume of HUF 3,627 billion in 2003.

(B) GOVERNMENT SECURITIES MARKET CONVENTIONS

As the preparation for the entry to the Eurozone has been a priority objective within the strategy of ÁKK there have been significant changes introduced to the government securities market in recent years.

As of January 1, 2003 the yield-price calculation method (actual/360) used in the member states of the Economic and Monetary Union (EMU) and based on the recommendations of the International Securities Market Association (ISMA) was introduced for all discount T-bills. Moreover, as of the same day the calculation of accrued interest on floating rate Hungarian Government Bonds has also changed. In the case of bonds with coupon payments linked to discount T-bill yields the calculation follows that of the T-bills. In the case of bonds with coupon payments linked to the consumer price index, the method used in the calculation of the accrued interest is the same as in the case of fixed rate Hungarian Government Bonds (actual/actual).

The above-mentioned changes concluded the harmonisation of the financial calculations used in the Hungarian government securities market. As a result, the calculation methods for Hungarian government securities are fully compliant with those used in the markets of EMU member states. With these measures the intention of ÁKK was to ensure that Hungarian government securities are traded in a market that is competitive in comparison with the markets of the European Union and which is attractive to domestic and foreign investors alike. The decisive role that European investors play in the Hungarian government securities market indicates the success of previous efforts.

VII. MARKET INFORMATION

Investors may find the latest information concerning the auctions of government securities on the following pages:

ÁKK's website	www.allampapir.hu
	www.akk.hu
Reuters	HUTREASURY
Bloomberg	GDMA
Telerate	47184-47190

ÁKK announces the auction results through the MMTS, Reuters, Bloomberg and Telerate information systems and on its website directly after the closing of the auction, from 12:00^{h} CET. The results include the amount offered, the number and amount of bids submitted and accepted (at nominal value), the total amount issued, and the minimum, maximum and average prices.

PUBLICATIONS

Based on the information it produces and gathers, ÁKK issues monthly, quarterly and annual publications (Annual Debt Management Report; Debt Management Outlook Report etc.). In addition to issuance and secondary market information, the development of the debt portfolio and the major macroeconomic indicators, some of these reports include the issuance calendar, which highlights the events of the coming period. In case of events and measures that may have a major impact on its operations, ÁKK uses other means of communication too, such as press releases, press conferences and interviews.

These publications can be viewed at or downloaded from ÁKK's website (www.akk.hu or www.allampapir.hu). The website also provides further information about the current developments of the government securities market.

For further information concerning our publications, please contact:

Ms. Edit Huszti

Phone: (+361) 488-9438
E-mail: husztie@allampapir.hu

or

Mr. Ádám Mohai

Phone: (+361) 488-9436
E-mail: mohaia@allampapir.hu

H-1255 Budapest PO. Box 248.
Fax: +36-1-488-9445

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GOVERNMENT DEBT MANAGEMENT AGENCY LTD.

■ H–1027 Budapest, Csalogány utca 9–11. ■ H–1255 Budapest, P.O.B. 248 ■

■ Phone: (36-1) 488-9300 ■ Fax: (36-1) 488-9405 ■ E-mail: akk@allampapir.hu ■ More information: www.allampapir.hu, 06 40 24 24 24 ■