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GOVERNMENT DEBT MANAGEMENT AGENCY PTE LTD.

# DEBT MANAGEMENT REPORT

▪ 2007 ▪

# FOREWORD

The objective of this report is to inform investors, market participants and decision makers about financing the central government, to give account of the government debt and to describe the developments in the Hungarian government securities market in 2007. A summary of the debt management strategy, as well as a description of the operations and tasks of the Government Debt Management Agency Pte. Ltd. (ÁKK) is also included.

From a financial point of view, the year 2007 can be characterized by two major trends: the substantial reduction of the financing needs of the central government resulted in lower net securities issuance during the year, and the lower demand for Hungarian government securities due to the sub-prime crisis. These two trends roughly balanced out each other, and as a result, ÁKK was able to reach its goals set for the year 2007.

Ferenc Szarvas
Chief Executive Officer

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# GENERAL INFORMATION

Both deficit and debt data are preliminary until the Act on Final Accounts of the relevant year is approved by the Parliament usually during the fourth quarter of the following year. Thus, fiscal data in this report are considered preliminary at the time when this report is produced.

While most of the data in this report are cash-flow based, some are accrual-based. Expenditures and revenues on a cash-flow basis are accounted for in the period when they are actually paid or received, regardless of which period the economic contents of the transaction relate to. On an accrual basis, the amount of an expenditure or revenue item that concerns several periods is divided pro rata among the periods.
Both methods can be used for calculating interest expenditures. In the case of a bond with annual interest payments, on cash-flow basis the total interest expenditure is stated for the year, in which it is actually paid. On an accrual basis, the interest paid is divided into two parts according to the proportion of the interest period falling on each year and accounted for respectively.

Data published by ÁKK are based on the Hungarian accounting standards, which differ from statistical standards used by the Statistical Office of the European Communities (Eurostat) and can be summarized as follows:

- Government bonds and retail government securities are recorded at nominal value.
- Discount Treasury bills are recorded at the average sales price (at discount value), which is recalculated daily if a transaction occurs with the given security.
- Repo and reverse repo transactions either increase or reduce outstanding government debt.
- Foreign currency debt is taken into account after swaps and converted into HUF at the official exchange rate (published by the National Bank of Hungary) at the end of the month or year.
- The debt recorded by ÁKK contains only the unconsolidated debt of the central government (i.e. it does not include either municipal debt, or the debt of state-owned enterprises and other public entities).

Public debt data calculated in accordance with ESA '95 principles are published by the Ministry of Finance, the Hungarian Central Statistical Office and the National Bank of Hungary, based partly on information provided by ÁKK.

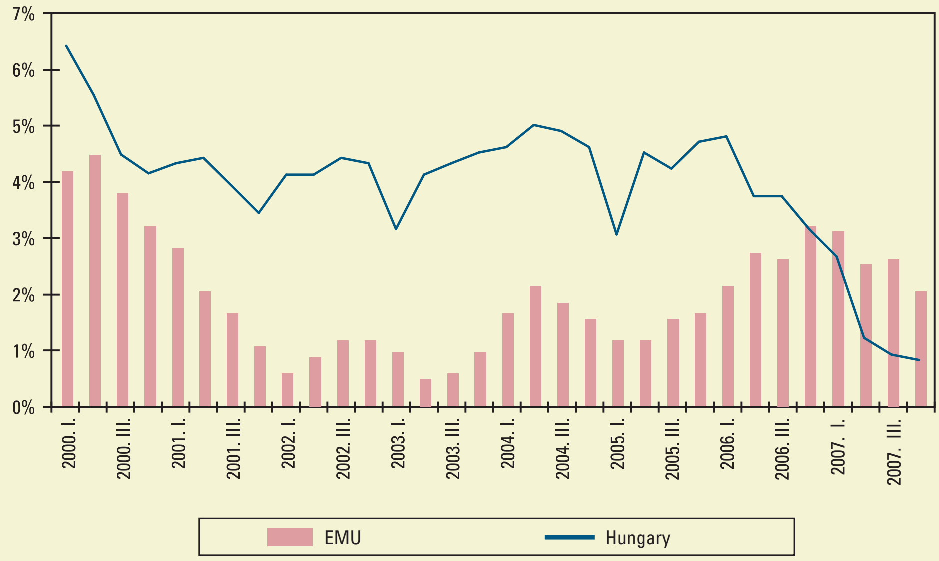
# I. MACRO-ECONOMIC DEVELOPMENTS IN 2007

## THE ECONOMY

Global economic growth reached 4.9% in 2007, driven by the 7.9% growth in emerging and developing countries, while the average growth of the developed countries stood at 2.7%. China and India continued to grow at 11.4% and 9.2% respectively, while growth in the United States of America slowed to 2.2%. The sub-prime mortgage crisis that exploded in the U.S. in July caused serious financial consequences, and as a result, liquidity in the financial markets substantially decreased. The effects spread to other geographic areas, affecting both real economic and monetary developments. Global risk appetite was significantly reduced and, as a result of the rising expected risk premium spreads on the Hungarian government securities widened out.

Economic growth in the European Union was just under 3%, unchanged from 2006. Growing investment activity and the improving employment increased domestic demand, while the slowdown in the United States and the strong euro had a negative effect on the economic performance of the Eurozone.

**Economic growth since 2000**




Source: Eurostat

As a consequence of the fiscal tightening started in 2006, the 4% growth that Hungary experienced in the first years of the century on average slowed to 1.3% in 2007. Falling domestic consumption and postponed public investments meant that Hungarian economic growth became much more reliant on the export performance. Household consumption, as a result of the decrease in real wages and government transfers, dropped by 1.9%. Meanwhile public consumption fell by 3.1%. Private investments in the manufacturing industry, however, counterbalanced the decline of investments in other sectors and state investments.

As a result of the high external demand, the manufacturing industry grew by 6.9%, contributing to the 6.3% growth of the industrial production. Construction decreased by 11.6%, primarily due to the decline in public road constructions. Agricultural output dropped by 14.0% due to the bad crop. In the service sector, logistics and

telecommunications services expanded at a rate of 4.1%, however, the government financed services fell by 2.7% due to budgetary constraints.
After a surplus of 0.5% in 2006, Hungary recorded a 2.3% surplus in international trade as the 14.2% exports growth outweighed the 12.0% increase in imports in 2007. The current account deficit decreased by EUR 400 million to EUR 5.0 billion or 5% of GDP.

## FISCAL AND MONETARY DEVELOPMENTS

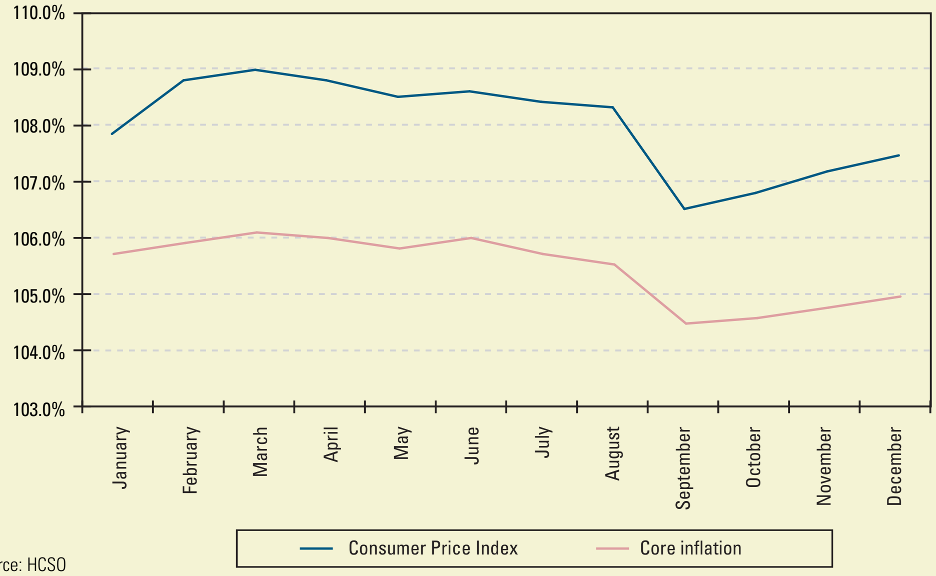
The budget deficit calculated according to ESA'95 methodology amounted to 5.5% of GDP, well below the original forecast, and 3.8 percentage points lower than in 2006. Debt of the general government ("Maastricht debt") grew by 0.4 percentage points to 65.9% of the GDP.

The cash flow based deficit totalled at HUF 1,291.4 billion in 2007, made up by the HUF 1,389.9 billion deficit of the central budget, the HUF 35.5 billion surplus of the Social Security funds and the HUF 63.0 billion surplus of the extrabudgetary funds. The debt of the central government managed by ÁKK decreased from 61.8% to 61.3% of the GDP.

The consumer price index fluctuated between 6.4-9.0%, reaching a highest point in March. After continuous decrease until October, inflation once again started to rise and reached 7.4% in December. The average yearly inflation picked up to 8.0% from the 3.9% in 2006, while the average core inflation reached 5.3%, up from 2.3% the year before. The increase in inflation was primarily caused by the growing oil and food prices, as well as hikes in administrative prices.

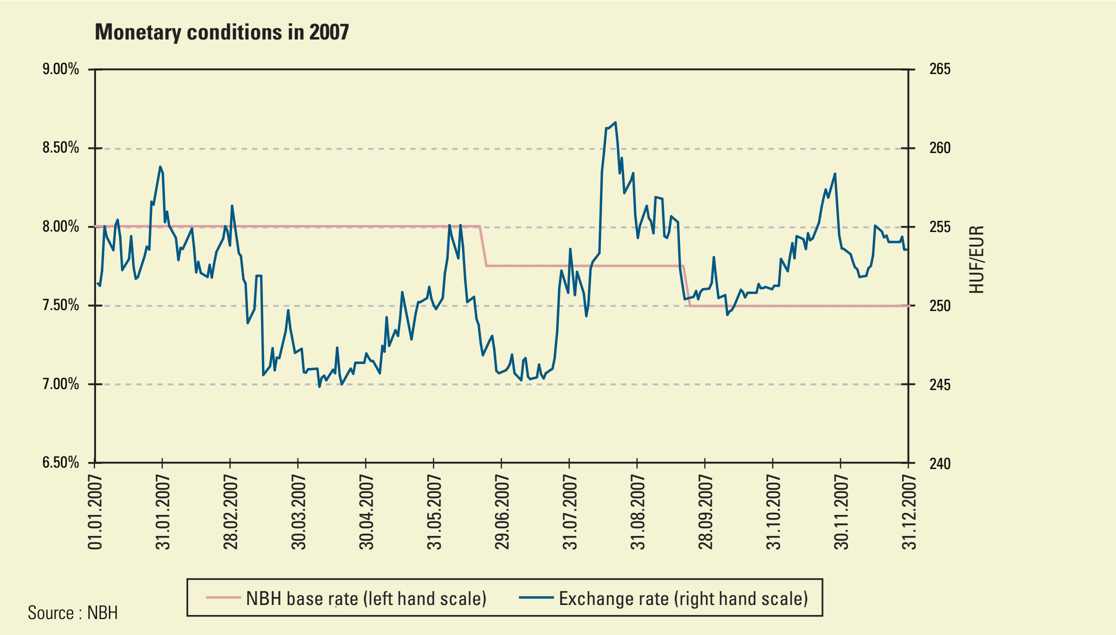
In the first half of the year, the HUF/Euro exchange rate fluctuated between 245-258, after which it significantly weakened and reached 261 HUF/Euro yearly high in August. By the end of September, the exchange rate once again fell below 250 HUF/Euro level, but after another weakening in November, the exchange rate closed the year at 253 HUF/Euro.

**The consumer price index and core inflation in 2007**




Source: HCSO

Hungarian monetary policy aimed in 2007 to prevent non-recurring price-increasing shocks from building into inflation expectations, and thus avoid sustained inflation.

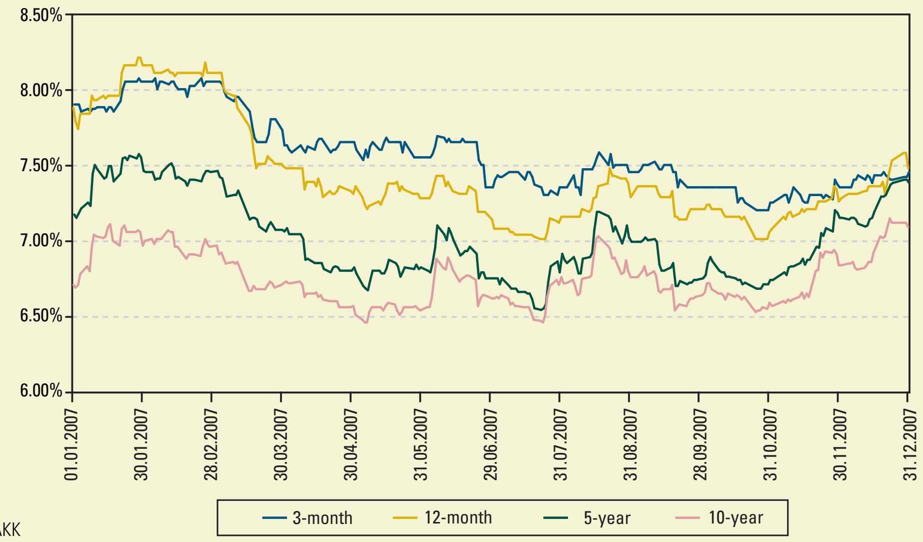



The fiscal austerity package, characterized mainly by tax increases, caused a dilemma for the monetary policy, since the economic deceleration and the improving international sentiment towards the country eased the inflationary pressure, but at the same time tax increases meant a non-recurring price-increasing shock, which could increase inflationary expectations. The National Bank of Hungary kept its base rate at 8.0% until June. Even though as regards inflation many adverse effects appeared during the second half of 2007, such as the increase in fuel and food prices, the National Bank of Hungary decreased the base interest rate by 25 basis points twice to 7.5% in the second half of the year based on the decreasing risk of inflationary effects in 2007.

## DEVELOPMENTS IN THE GOVERNMENT SECURITIES MARKET

Over the course of the year, short-term yields followed the central bank rate cuts, while medium- and long-term yields rose. The 3-month and 12-month reference yields decreased by 45 and 40 basis points to 7.45%, and 7.47% respectively. At the same time, the 5-year benchmark yield increased by 21 basis points to 7.38%, while the 10-year reference yield grew by 38 basis points to 7.08%. After the temporary increase in the beginning of the year, yields gradually decreased on all maturities. Several factors, such as the favourable global investing sentiment; the revision of the Convergence Programme after the 2006 elections and the fiscal austerity measures that came along with it and the improvement of the internal and external balance allowed a moderation of yields across the curve.

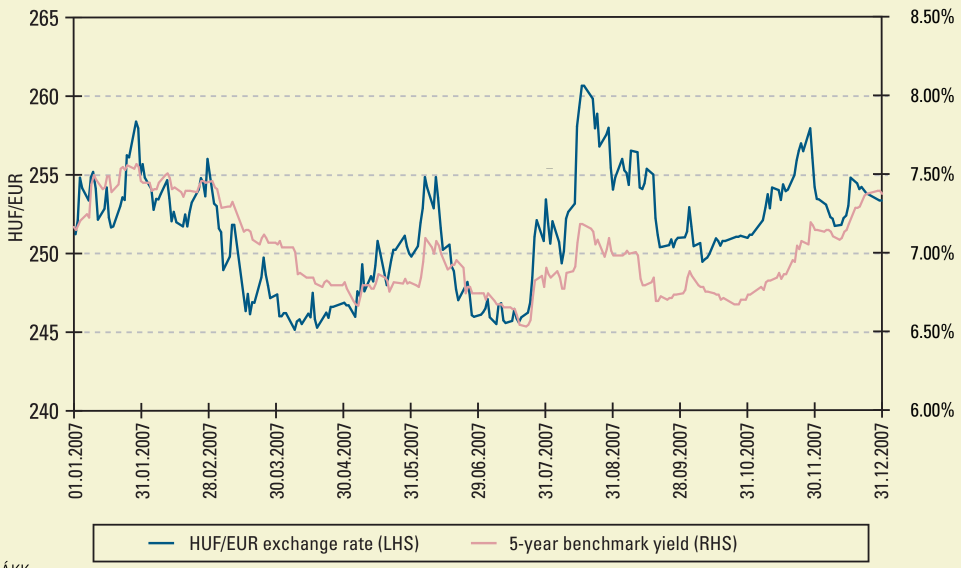
Government securities benchmark yields in 2007




Source: ÁKK

In the second half of the year, the government securities market was primarily influenced by international trends. The yields increased at the beginning of June, after which a correction followed, tracking international yield movements. However, intensifying global liquidity problems resulting in massive yield rises in November reached Hungary as well. Beside the deterioration of the international investors sentiment other domestic causes also contributed to the rise of yields. During this period, domestic private pension funds started to restructure their portfolios following the legislation that obliges them to increase the share of equities at the expense of government bonds until 30 June 2009 the latest. Thus, their government securities holdings did not increase in the second half of the year as opposed to their considerable demand shown in earlier years, which negatively affected the market demand.

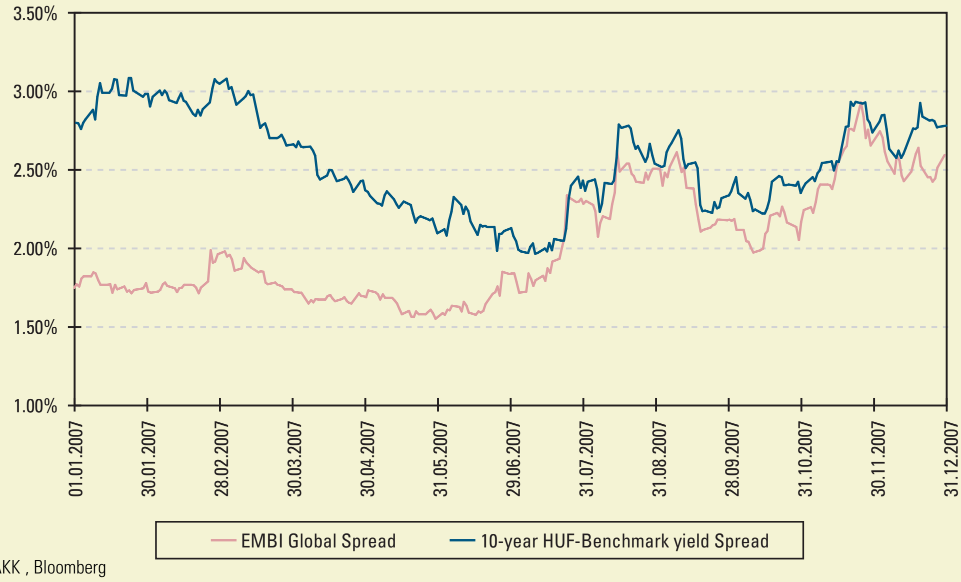
Government bond yields and the exchange rate in 2007




Source: ÁKK

The strong influence of the international capital markets is visible in the closely linked movements of the HUF bond yield spread and the EMBI yield spread[1] calculated from emerging countries' bond indices; whereas the divergence at times of the two data series shows the effects of the special domestic factors. After the fiscal restrictions taking effect, the improvement of the budgetary situation began in late 2006, and long-term Hungarian yield spreads declined steadily to a level of 200 basis points, while international spreads were relatively stable. In the second half of the year both the 10-year Hungarian and EMBI yield spreads moved parallel and gradually increased to about 250 basis points by the end of the year. The considerable rise of the long-term yields at the very end of the year was partly due to a domestic factor as well, namely the afore-mentioned change in the demand by pension funds because of the new legislation.

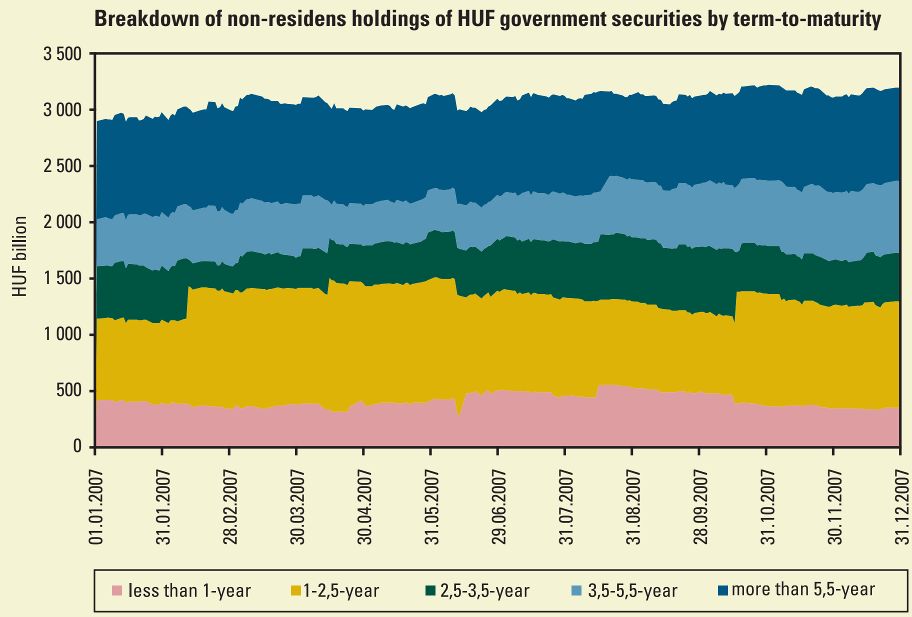
**Emerging market and Hungarian bond spreads over the euro benchmark in 2007**




Source: ÁKK , Bloomberg

The non-resident holdings of government securities rose by HUF 303.5 billion in 2007 and amounted to HUF 3,241 billion at the end of the year. The proportion of the foreign-owned HUF government debt increased from 28.6% to 29.4% over the course of the year. At the end of 2007, the total non-residents' HUF portfolio (including T-Bills) amounted to 20.7% of the total government debt, which, combined with the foreign-owned foreign exchange debt, means that 49.2% of the total government debt was owned by non-residents.

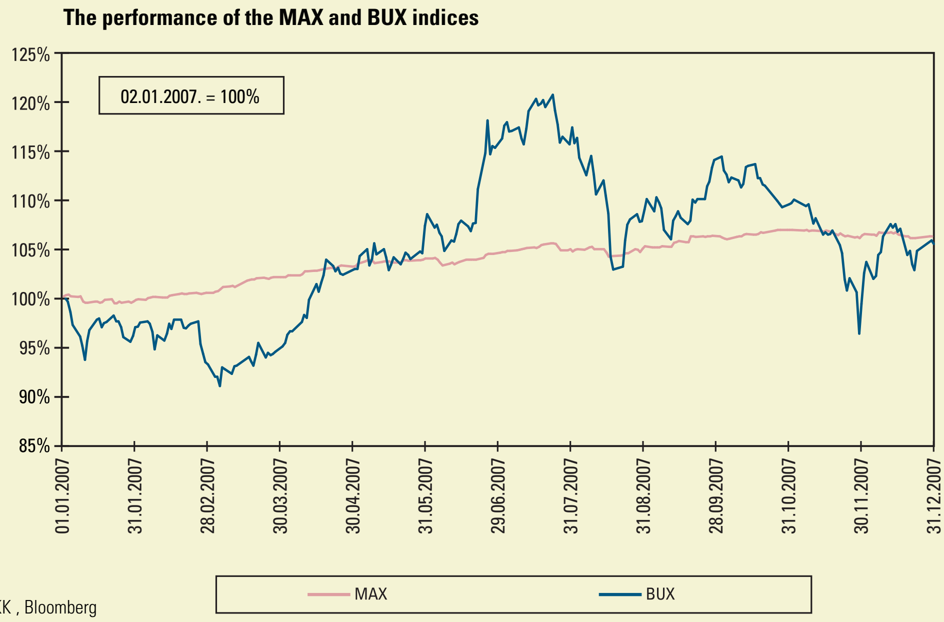
[1] Emerging market USD denominated bonds weighted average yields compared to corresponding US Treasury yields, calculated by JP Morgan.




Source: Central Clearing House and Depository (Budapest) Ltd. (KELER)

## STOCK MARKET

The Hungarian Stock market fluctuated substantially in 2007:




Source: ÁKK , Bloomberg

The movement of the Budapest Stock Exchange index (BUX) reflected the changes in global investor sentiment. The initial optimism based on improving fiscal data and the expectation of gradual monetary easing had disappeared by November by the wake of the sub-prime mortgage crisis. (See Chart X.) Still the BUX closed the year with a 5.75% rate of return.

# II. THE 2007 DEBT MANAGEMENT STRATEGY

Government debt management activities are based on the debt management strategy approved yearly by the Minister of Finance. The debt management strategy for 2007 was prepared on the basis of an optimal portfolio model developed in 2004.

**ÁKK's main objective is to finance the central government at the lowest costs in the long run, taking account of risks. Taking the economic policy as a framework, the strategy must focus on the best possible achievement of this objective.**

Both the size of public debt and the financing requirements of the budget are external factors for ÁKK, i.e. they are determined by the fiscal policy. ÁKK cannot have substantial influence on these figures, only the selection of the actual cost-risk profile of the debt may have a minor effect on them.

Due to the trade-off between costs and risks, the task is to develop a debt structure with the most favourable cost-risk ratio in the long term. The emphasis is on the long term: no transaction may be executed that creates lower costs or risks in the present at the expense of higher costs or risks in the future.

The most important risk factors are:

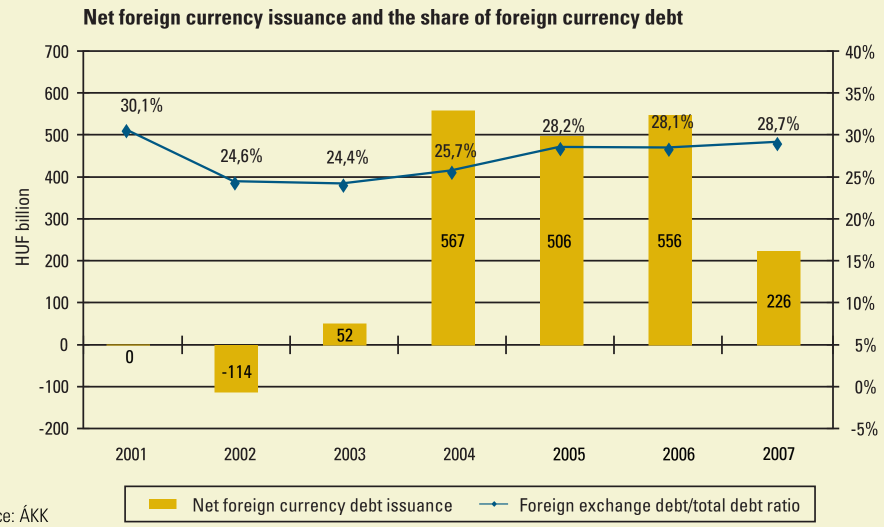
- Refinancing risk arises out of the renewal of maturing debt and meeting the net financing requirements. In extreme cases, the refinancing risk becomes liquidity risk, otherwise it is considered interest rate risk.
- Interest rate risk relates to the changes in the yield-curve.
- Liquidity risk appears in the fluctuation of the cash-flows of the central government and in the money market operations of debt management.
- The exchange rate risk arises out of changes in the exchange rates of the HUF and the euro and in the cross exchange rate of various other foreign currencies.
- Credit risk (counterparty risk) is an important risk factor in case of hedging operations concluded directly with partners in the international capital markets and the repo activity in the HUF market.

Between certain risks there is a trade-off, i.e. the decrease of one type of risks leads to the increase of an other (e.g. interest rate and exchange rate risk), or certain risk types can move parallel, meaning that if one risk increases, the other risk increases as well (for instance, between refinancing and interest rate risk). ÁKK had developed benchmarks reflecting its strategic objectives for certain segments of its activities by taking into account risks and costs together. For benchmark calculations ÁKK uses 90-day moving averages in order to reduce short-term effects. The benchmarks approved by the Minister of Finance also help to quantify strategic objectives and formulate intermediate targets. Over the course of 2007, the composition of central government debt was in full conformity with the approved benchmarks.

## THE HUF DEBT/FOREIGN CURRENCY DEBT COMPOSITION (HUF/CCY)

The HUF/CCY debt composition benchmark aims at containing the risks stemming from the interest rate and exchange rate fluctuations by creating a predetermined ratio of the HUF and foreign currency denominated debt within the total government debt.

The goal in 2007 was to keep the foreign currency debt ratio in the 25-32% range, which was achieved by a significantly lower amount (EUR 850 million) of net foreign exchange bond issuance than in previous years.



Source: ÁKK

The foreign currency debt ratio amounted to 28.7%, which was in the middle of the targeted optimal band at the end of 2007.

## THE CURRENCY COMPOSITION OF THE FOREIGN EXCHANGE DEBT PORTFOLIO

In order to minimize the cross-currency risk, the currency composition of the foreign exchange debt portfolio should correspond to the composition of the currency basket of the Hungarian forint, that is, it should consist entirely of euro obligations. If the government raises funds in a currency other than euros, ÁKK converts those into euros using cross-currency swaps. At the end of 2007, 100% of the foreign currency debt was in euros.

## FIXED/FLOATING RATE COMPOSITION OF THE FOREIGN EXCHANGE DEBT

The objective of the interest rate benchmark for the foreign exchange debt is to determine the optimal fixed/floating rate ratio, in order to reduce the interest expenses and avoid excessive interest rate risk. In order to reach the desirable interest composition, ÁKK also uses interest rate swap transactions. At the end of 2007, the share of fixed rate elements amounted to 65.4%, in conformity with the benchmark.

## FIXED/FLOATING RATE COMPOSITION OF THE HUF DEBT

ÁKK can primarily influence the fixed/floating interest rate ratio of the HUF debt portfolio by changing the weight of short and long-term instruments of issuances, as short-term ones are considered to be floating rate. The proportion of the fixed rate HUF debt stood at 73.0%, within the reference band at the end of 2007.

## DURATION OBJECTIVE

The average remaining term-to-maturity of the public debt is important for two reasons: first, large amount of debt expiring in a short time period carries financing (renewal) risk; second, it expresses the re-pricing of debt and the exposure to interest rate changes. As regards the debt portfolio, not only the average remaining term-to-maturity is calculated, but also the weighted term-to-maturity, the so-called (Macaulay) duration, as the latter one shows the portfolio's interest sensitivity, the re-pricing effect induced by a change in interest rates.

The shorter duration is, the sooner the effect of yield changes will appear in the interest expenditures. This means that in times of higher interest rate volatility the interest expenditures of the budget can also fluctuate rapidly. Longer duration means that the changes in interest expenditure will be slower, thus annual interest costs for the budget can be planned more precisely. The strategic objective of ÁKK is to keep the duration of the HUF debt portfolio in the range of 2.5 +/- 0.5 years. At the end of 2007, the duration of the HUF debt portfolio was 2.81 years.

## OPTIMAL BALANCE OF THE SINGLE TREASURY ACCOUNT (STA)

One of the debt management strategy objectives is to maintain a secure level of funds on the Single Treasury Account. In connection with this, ÁKK determines the optimal balance of the Single Treasury Account annually for the next year and aims to keep the day-end STA balance within a +/- HUF 50 billion range around the optimal level. (See chapter VI for details of the liquidity management activity).

## PRINCIPLES USED IN DEBT MANAGEMENT

In its activity ÁKK is guided by the principles of simplicity, transparency, and liquidity.

In order to maintain simplicity ÁKK only issues a limited number of plain vanilla instruments in a market conform way, i.e. at auctions, based on a pre-announced annual issuance calendar published in advance (transparency).

Liquidity is enhanced by two important factors: continuous two-way price quotation in the secondary market and the existence of sufficiently large volumes of government securities series (benchmarks). In order to achieve this, ÁKK reopens series of bonds and discount T-bills that are fungible with already outstanding securities. The targeted volume of bond series in 2007 was around HUF 400-600 billion, corresponding to about EUR 1.5-2.5 billion.

# III. THE FINANCING REQUIREMENTS IN 2007

The 2007 financing strategy and annual plan was approved by the Minister of Finance in January of 2007 and was published by ÁKK in its "Debt Management Outlook 2007" publication. The following chapters summarize the execution of this plan.

## THE COMPONENTS OF THE FINANCING REQUIREMENT

The Budget Act for the year 2007 (law no. CXXI of 2006) contained a planned cash flow based deficit of HUF 1,656.5 billion for the central government in 2007.

The financing of the central government means to continuously keep the balance of the Single Treasury Account at a level that ensures the state's solvency by covering all Treasury payments, as well as providing safety against unforeseen financing shocks (i.e. international financial crises). The Single Treasury Account is held by the National Bank of Hungary. According to the principles laid out in the Maastricht Treaty of the European Union, the central bank must not finance the government. Thus, the consolidated balance of the STA cannot have a negative end-of-day balance.

ÁKK ensures that there is an adequate balance of the Single Treasury Account based on liquidity forecasts by the Treasury and other institutions. It is also the task of ÁKK to manage the temporarily free liquid funds on the Single Treasury Account. (See chapter VI for details).

The total annual net financing requirement is the sum of the central government balance and other items including privatisation revenues, European Union transfers, special transfers to the National Bank of Hungary etc.. The gross financing requirement, in addition, includes the refinancing of maturing debt.

In 2007 the financing requirements were as follows:

**Cash-flow based borrowing requirement in 2002-2007**

HUF billion

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|
| Balance of the central government budget* | -957.7 | -733.6 | -890.0 | -544.7 | -1,958.4 | -1394.4 |
| Balance of the Social security funds | -100.9 | -342.9 | -422.9 | -469.8 | -124.7 | 35.6 |
| Balance of the Extrabudgetary funds | 1.4 | 18.8 | 27.9 | 30.4 | 50.1 | 63.0 |
| **Balance of the central government*** | **-1,057.1** | **-1.057.7** | **-1,285.1** | **-984.1** | **-2,033.0** | **-1295.8** |
| Capital transfer to the NBH | -250.2 | -82.9 | 0.0 | -1.1 | -14.8 | -20.6 |
| Privatisation revenues and capital transfers | 0.0 | 42.0 | 166.5 | 0.0 | 268.7 | 67.3 |
| Net pre-financing of European Union transfers | 0.0 | 0.0 | -12.8 | -169.0 | -35.8 | 217.8 |
| **Net financing requirement** | **-1,307.3** | **-1,098.6** | **-1,131.3** | **-1,154.2** | **-1,814.9** | **-1031.3** |
| Redemption of Treasury bills | -2,888.6 | -3,635.2 | -4,277.7 | -4,265.7 | -5,078.6 | -4424.9 |
| Long term debt redemption | -1,053.4 | -1,809.6 | -1,253.2 | -1,885.0 | -1,856.3 | -1817.5 |
| **Gross financing requirement** | **-5,249.3** | **-6,543.4** | **-6,662.2** | **-7,304.9** | **-8,749.7** | **-7273.7** |

* Excluding debt assumptions and bond transfers of HUF 512 billion at the end of 2002

Source: Hungarian State Treasury, ÁKK

## THE NET FINANCING REQUIREMENT

The total cash-flow based deficit of the central government in 2007 – including debt assumptions – amounted to HUF 1,296 billion (or 5.1% of the GDP) according to preliminary figures, while the total net financing requirement amounted to HUF 1,031 billion (or 4.1% of the GDP).

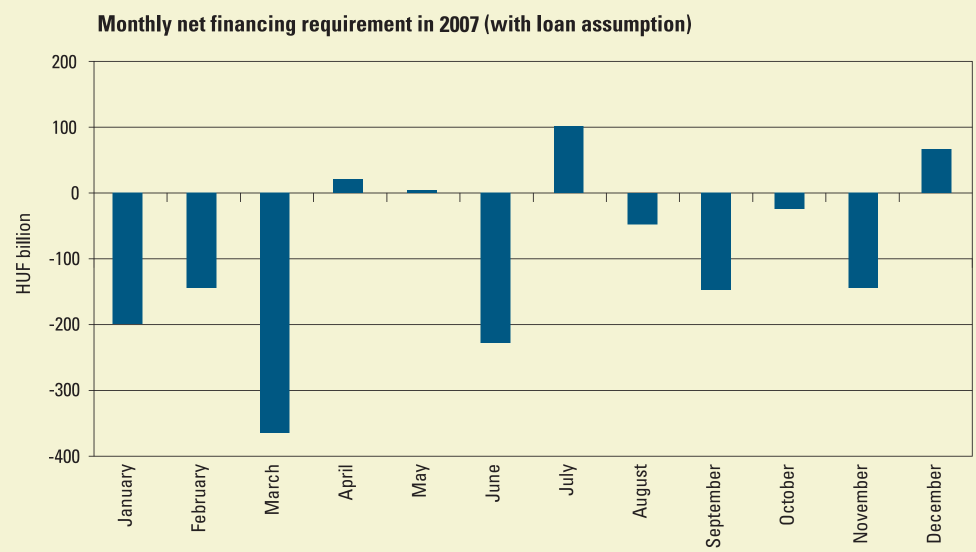
The net financing requirement was noticeably smaller than both the appropriation approved in the Budget Act of 2007, and the forecast published in the annual financing plan for 2007.

Cash-flow based borrowing requirement in 2007 - projection and outturn

| | Plan of January 2007 (HUF billion) | Outturn in 2007 (HUF billion) | Compared to plan (per cent) |
|---|---|---|---|
| Balance of the central government budget | -1,568.5 | -1,394.4 | 88.9% |
| Balance of the Social security funds | -27.5 | 35.6 | -129.5% |
| Balance of the Extrabudgetary funds | 16.0 | 63.0 | 394.1% |
| **Balance of the central government** | **-1,580.0** | **-1,295.8** | **82.0%** |
| Capital transfer to the NBH | 0.0 | -20.6 | 0.0% |
| Privatisation revenues and capital transfers | 150.0 | 67.3 | 44.9% |
| Net prefinancing of European Union transfers | 17.4 | 217.8 | 1251.6% |
| **Net financing requirement** | **-1,412.6** | **-1,031.3** | **73.0%** |
| Redemption of Treasury bills | -4,308.9 | -4,424.9 | 102.7% |
| Long term debt redemption | -1,701.6 | -1,817.5 | 106.8% |
| **Gross financing requirement** | **-7,423.2** | **-7,273.7** | **98.0%** |

Source: Hungarian State Treasury, ÁKK

The smaller than forecast net financing requirement was the result of a better than expected deficit of the central government, as well as a higher net surplus of other items. Among the latter was the balance of prefinancing the transfers from the European Union's budget, which temporarily improved the liquidity of the Single Treasury Account. At the same time, the privatisation revenues in 2007 totalled HUF 67 billion, which was significantly smaller than the plan.




Source: Hungarian State Treasury, ÁKK

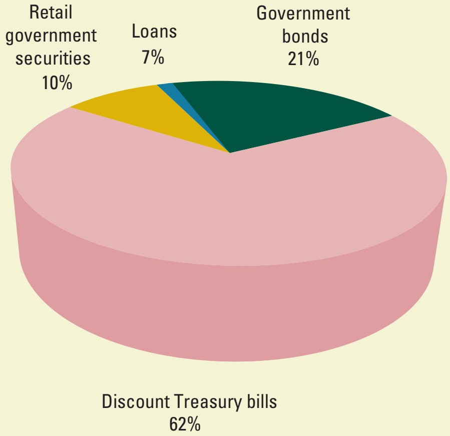
Though the monthly breakdown of the annual net financing requirement was more even than in previous years, the first quarter of the year was still characterized by a substantial deficit.

## REDEMPTIONS

Gross redemptions mean the repayment of debt elements issued earlier. The size of the actual repayments may change due to pre-payments (loans), buy-backs (bonds), as well as repurchasing/redeeming retail securities.

Within the domestic currency denominated debt, discount Treasury bills accounted for 62% of the HUF 6,116 billion repayments due to their renewal several times within the year.

**Composition of HUF debt redemptions in 2007**




Source: ÁKK

All redemptions of HUF government securities and loans, as well as foreign exchange debt redemptions were higher than planned.

Government debt redemptions in 2007

(HUF billion)

| | 2006 | 2007 planned | 2007 fact |
|---|---|---|---|
| **Redemption of domestic debt** | **6,704.4** | **5,997.8** | **6,116.1** |
| Government bonds | 1,467.6 | 1,157.7 | 1,254.5 |
| Discount treasury bills | 4,563.1 | 3,955.5 | 3,837.6 |
| Retail securities | 613.4 | 629.1 | 609.5 |
| Loans | 60.3 | 255.5 | 414.4 |
| **Redemption of foreign currency debt** | **231.0** | **29.5** | **126.3** |
| Bonds | 205.8 | 0.0 | 0.6 |
| Loans | 25.2 | 29.5 | 125.7 |
| **Total redemptions** | **6,935.4** | **6,027.3** | **6,242.4** |

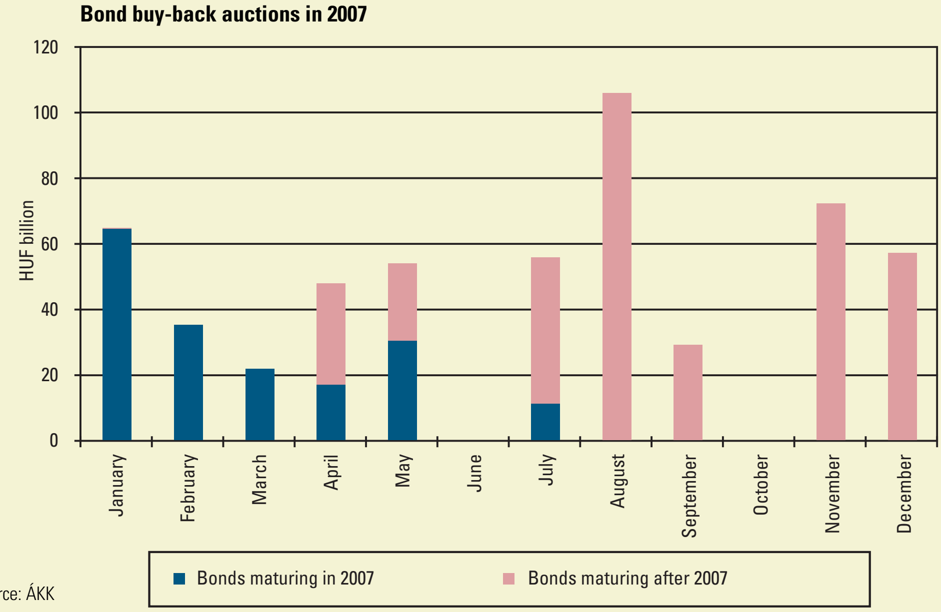
Source: ÁKK

As a result of higher volumes bought back at buy-back auctions, repayments of government bonds were higher than planned. The lower amount of repayments of discount Treasury bills was due to the fact that ÁKK issued less discount Treasury bills than originally planned.

The higher amount of total HUF debt repayments was due to the prepayment of the entire loan portfolio assumed from the National Motorway Company, totalling HUF 414.4 billion. Foreign currency debt redemptions included the prepayment of HUF 96.6 billion foreign currency debt to the NBH, HUF 29.1 billion worth of other foreign currency loan redemptions and the net balance of the cross-currency swap operations totalling HUF 0.6 billion.

## BOND BUY-BACKS

A large series of bonds maturing at a given time creates renewal risk. This renewal risk can be reduced by repurchasing a part of the bonds before maturity. ÁKK bought back HUF 543 billion worth of bonds before maturity at 19 reverse auctions in 2007. The original maturity of 67% of the bonds repurchased was after 2007, thus these buy-backs also helped to smooth maturities between years.




Source: ÁKK

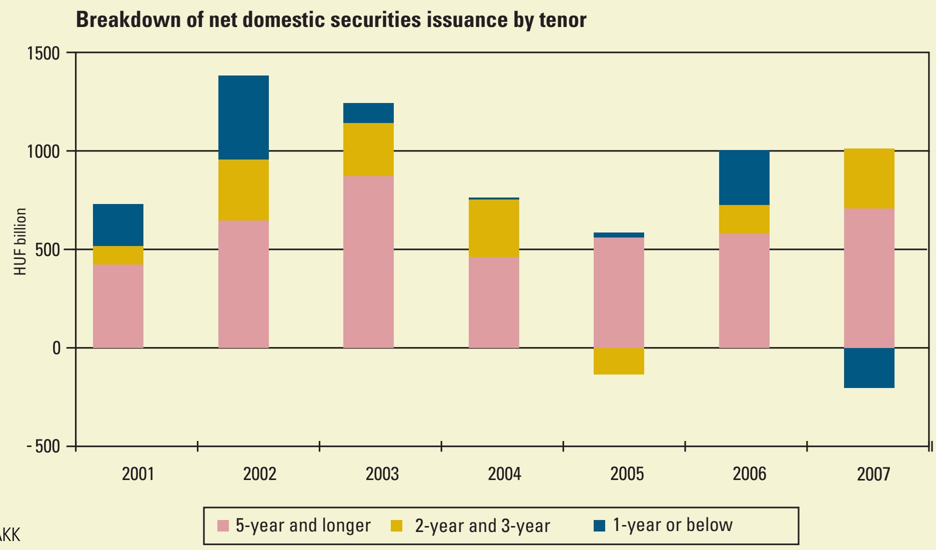
Bonds bought back in 2007 included the gas utility bonds in an amount of HUF 0.3 billion, in line with legal obligations (laws no. LVI. of 2001 and LXIII. of 2002).

# IV. FINANCING

The debt management strategy and the benchmarks set the framework for the financing. At the same time, the macroeconomic environment, the developments in the government securities market and the changes in the financing requirement within the year also significantly influenced financing activities.

In 2007, the gross HUF denominated issuance (excluding repos, but including debt assumptions) amounted to HUF 6,740.5 billion, gross foreign currency issuance made up HUF 352.6 billion. The total net issuance was HUF 850.7 billion (excluding repos), out of which the net HUF denominated issuance was HUF 624.4 billion and the net foreign currency denominated issuance was HUF 226.3 billion.

The main instruments in financing were government bonds, both in the domestic and international markets. Within the HUF issuance, the role of short-term funds noticeably diminished in 2007. The net issuance of both retail securities and discount Treasury bills was negative; HUF -112.6 billion, and HUF -103 billion respectively.



Source: ÁKK

In 2007, the HUF loan portfolio decreased by HUF 210.7 billion as a result of prepaying assumed loans, while the foreign currency loan portfolio increased by HUF 27.2 billion as a result of drawing down new project financing loans.

## THE PLANNED AND ACTUAL GROSS AND NET DOMESTIC FINANCING

The total amount of gross HUF issuance was below that of the announced plans. This was due to a lower than expected issuance of discount Treasury bills and a decline in demand for retail government securities.

Gross government debt issuance in 2007*

| | 2006 | 2007 planned | (HUF billion)<br>2007 fact |
|---|---|---|---|
| Issuance of domestic debt | 8,100.9 | 6,881.7 | 6,740.0 |
| Bonds | 2,207.2 | 2,247.8 | 2,305,7 |
| Discount treasury bills | 4,786.0 | 3,946.5 | 3,734.3 |
| Retail securities | 691.8 | 627.3 | 496.9 |
| Loans | 415.9 | 60.1 | 203.7 |
| Issuance of foreign currency debt | 787.1 | 635.0 | 352.6 |
| Bonds | 675.8 | 508.0 | 297.1 |
| Loans | 111.4 | 127.0 | 55.6 |
| Out of which: loan assumptions | 0.0 | 0.0 | 0.0 |
| Total issuance | 8,888.0 | 7,516.7 | 7,093.1 |

*Including repos

Source: ÁKK

## GOVERNMENT BONDS

ÁKK issued only fixed rate government bonds with 3, 5, 10 and 15-year tenor in 2007. Bond auctions were held every two weeks, and each type of bond was put up for auction every 4 weeks, except for the 15-year bond, which was sold every 8 weeks. A total of HUF 2,290 billion worth of bonds were sold via auctions, which was slightly higher than both the previous year's sales and the planned sales for 2007. The total issuance of government bonds, including sales in the Treasury network (HUF 16 billion) and excluding repos, amounted to HUF 2,306 billion.

With HUF 1,255 billion worth of debt repayments the net HUF denominated bond issuance in 2007 amounted to 1,051 billion, which means a 42 per cent increase from 2006 (HUF 740 billion).

Domestic bond series issued in 2007 at auctions (HUF billion)

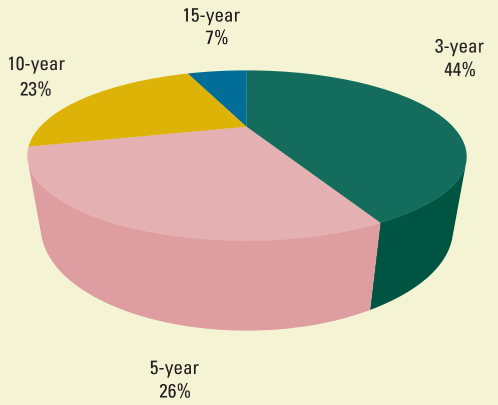
| | Tenor | No of auctions | Auctioned amount (HUF billion) | End-of-year series volume ( HUF billion) |
|---|---|---|---|---|
| 2010/C | 3-year | 6 | 495 | 497 |
| 2010/D | 3-year | 7 | 525 | 526 |
| 2012/B | 5-year | 8 | 380 | 525 |
| 2012/C | 5-year | 5 | 220 | 265 |
| 2017/B | 10-year | 13 | 520 | 670 |
| 2023/A | 15-year | 7 | 150 | 150 |

Source: ÁKK

ÁKK sold two series of 3 and 5-year bonds and only one series of 10 and 15-year bonds in 2007. According to the debt management strategy the targeted bond series volumes were between HUF 400-600 billion (EUR 1.5-2.5 billion) and in the case of the 15-year bond, HUF 250 billion (EUR 1 billion).

The structure of gross bond issuance by tenor was similar to that of 2006, however, the share of the 3-year bonds decreased a little, giving room for a higher share of bonds with at least 5-year tenor.

**Breakdown of gross domestic bond issuance at auctions by tenor in 2007**




Source: ÁKK

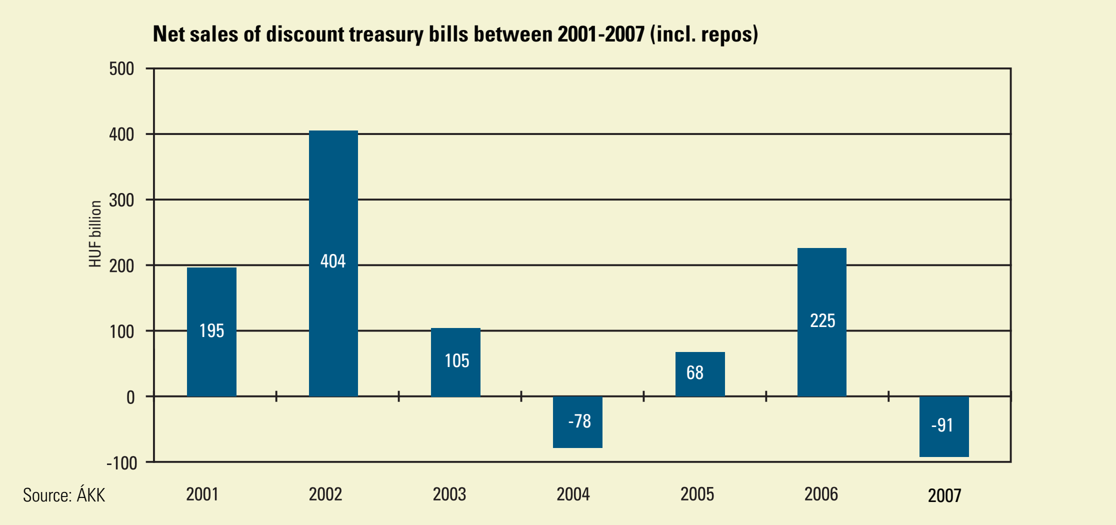
## HUF LOANS

In 2007, first time in many years, HUF loans were also drawn down. EIB extended loans in total of HUF 145.5 billion for infrastructure development and financing the M3 motorway project. As the ratio of floating rate debt within the HUF portfolio had been decreasing, these long-term, floating rate loans are useful for the management of the overall structure of the debt. There was HUF 58.2 billion worth of loans assumed from the State Motorway Management Company in 2007.

## DISCOUNT TREASURY BILLS

The 3, 6, and 12-month discount Treasury bills are used primarily for liquidity management purposes. The regular discount Treasury bills may be supplemented by an even shorter, so-called liquidity discount Treasury bill (i.e. reopening of an existing T-Bill series with a remaining maturity of 5-7 weeks).

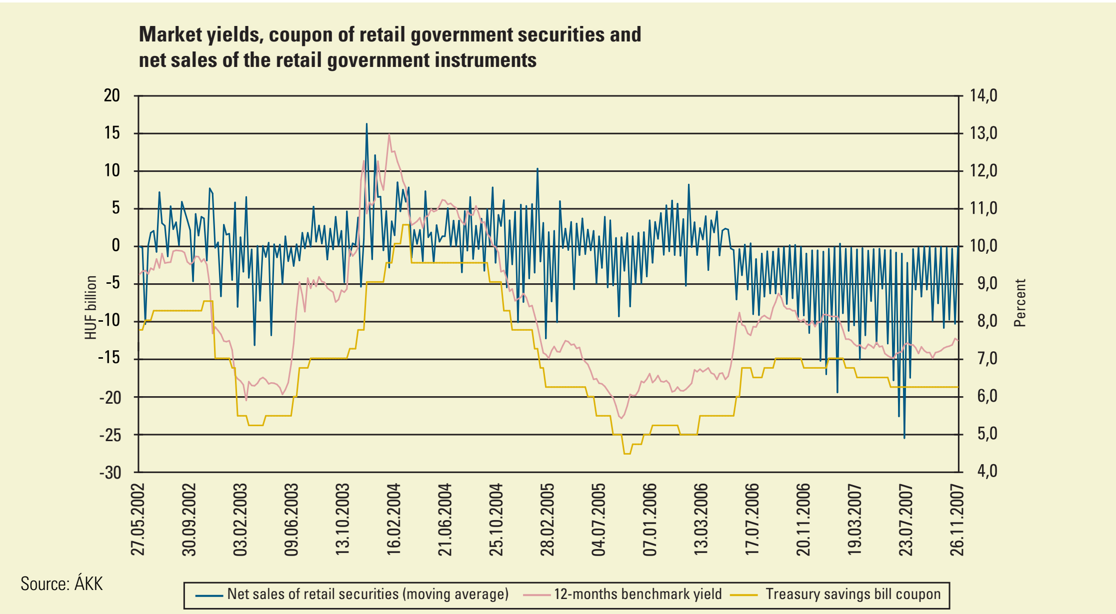
ÁKK sold HUF 3,734 billion worth of discount Treasury bills in 2007. Out of this amount HUF 3,470 billion were issued at auctions and HUF 264 billion were sold through the Treasury network. Due to their short duration discount Treasury bills are renewed several times over the year, which makes the net sales figures more useful for analysis than gross issuance numbers. According to the original plan, the outstanding volume (net issuance) of discount Treasury bills was supposed to be stable, thus the outturn of HUF 103 billion decrease in the outstanding amount was below initial projections.




Retail securities

One of ÁKK 's strategic aims is to maintain to issue retail government securities for small investors, using it as a channel to tap household savings into budget financing, while government bonds and discount Treasury bills are targeted primarily for institutional investors. Using special distribution channels, retail securities – a form of secure investments for the general public - are easily accessible all over the country.

According to past experience, retail securities have strategic importance because demand for such securities moves opposite to the demand for wholesale government securities. Retail investors, who are sensitive to nominal interest rates, increase their demand for retail securities when yields start to rise. When yields decline, their behaviour is just the opposite. Therefore, the combined use of the two markets (retail and wholesale) makes financing more balanced.




In 2007, both the 1-year yield and the stock of retail debt decreased, which again shows the above-mentioned correlation between the two. ÁKK sold HUF 229 billion worth of Interest Bearing Treasury Bills and HUF 268 billion worth of Treasury Savings Bills. The outstanding volume of Interest Bearing Treasury Bills decreased by HUF 78 billion, and that of Treasury Savings Bills by HUF 34 billion over the course of the year.

## THE PLANNED AND REALIZED GROSS AND NET FOREIGN EXCHANGE FINANCING

In 2007 ÁKK, on behalf of the Republic of Hungary, issued two foreign currency bonds in the international capital markets, raising a total of HUF 296.5 billion (1.2 billion euros).

Foreign exchange bond issuance of the Republic of Hungary in 2007

| Currency | Size | Date of issue | Maturity date | Maturity (years) | Coupon |
|---|---|---|---|---|---|
| EUR | 1,000,000,000 | 01.02.2007 | 04.07.2017 | 10 | 4.375% |
| JPY | 25,000,000,000 | 26.10.2006 | 26.10.2017 | 10 | 2.11% |

Source: ÁKK

Although the majority of foreign currency bond issues takes place in the euro market, which is the most important strategic market for the Republic, ÁKK also aims at broadening its investor base both geographically and institutionally, by issuing bonds in other markets.

New investors can be reached by issuing in currencies and markets other than the euro. In this regard, a new series of Samurai bonds were issued in 2007 alongside with the EUR 1 billion bond issued at the beginning of the year.

In 2007, the government took HUF 56.2 billion in foreign currency project financing loans from the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) for project financing purposes (environmental protection, infrastructure development and building the M3 motorway).

Out of the HUF 605 billion worth of net foreign currency debt issuance projected in the January financing plan, only HUF 226 billion (roughly EUR 0.9 billion) worth of net issuance was realized. Net bond issuance amounted to EUR 1.2 billion (HUF 297 billion), net drawdown of project financing loans totalled EUR 0.11 billion (HUF 26 billion) and loan repayments to the National Bank of Hungary was EUR 0.38 million (HUF 97 billion). Net loan repayments amounted to EUR 270 million (HUF 71 billion.) The smaller net issuance was the result of the improving fiscal conditions (lower financing needs) in the course of the year which allowed for smaller issuance and also non-planned repayments of debt to the National Bank of Hungary.

# V. THE GOVERNMENT DEBT IN 2007

The government debt, including debt assumptions and repo operations, grew by HUF 880 billion (or 6.0%) to HUF 15,586 billion in 2007. The smaller than originally planned growth was the result of the decreasing financing needs and the positive balance of certain special net financing requirement items.

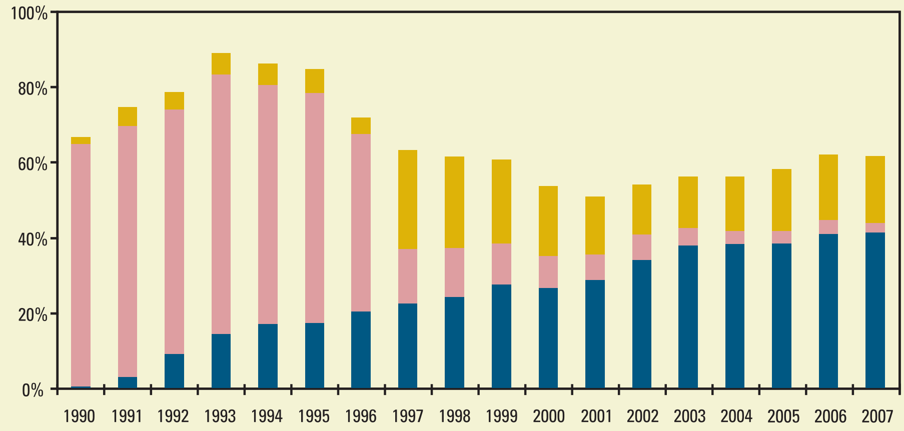
Central government gross debt

| | 2006 | | 2007 | | Change |
|---|---|---|---|---|---|
| **HUF-denominated debt** | **10,552.3** | **71.8%** | **11,103.8** | **71.2%** | **551.4** |
| Loans | 356.4 | 2.4% | 145.7 | 0.9% | -210.7 |
| Bonds | 7,772.5 | 52.9% | 8,738.0 | 56.1% | 965.4 |
| Discount treasury bills | 1,755.9 | 11.9% | 1,664.9 | 10.7% | -91.0 |
| Retail securities | 667.4 | 4.5% | 555.2 | 3.6% | -112.3 |
| **Foreign exchange denominated debt** | **4,124.4** | **28.0%** | **4,472.6** | **28.7%** | **348.2** |
| Loans | 803.7 | 5.5% | 846.5 | 5.4% | 42.8 |
| Bonds | 3,320.7 | 22.6% | 3,626.1 | 23.3% | 305.4 |
| **Total** | **14,676.7** | **99.8%** | **15,576.4** | **99.9%** | **899.7** |
| **Marked-to-market deposits at ÁKK** | **29.0** | **0.2%** | **9.1** | **0.1%** | **-19.9** |
| **Grand total** | **14,705.7** | **100.0%** | **15,585.5** | **100.0%** | **879.8** |

Source: ÁKK

The debt/GDP ratio (debt ratio) expresses the economic burden of public debt in comparison to the country's economic performance. Following an economic decline after the political transformation the debt ratio reached its highest value by 88.7% in 1993. The debt ratio started to decrease following the economic stabilization in the middle of the 1990's until 2001, at which point it started to rise. The rising trend of government debt stopped in 2007, as the debt ratio, according to preliminary data, fell from 61.8% in 2006 to 61.3% in 2007.

**The public debt/GDP ratio and its breakdown between 1990-2007**




Source: ÁKK

## CHARACTERISTICS OF THE HUF DEBT PORTFOLIO

The HUF denominated debt, which amounted to nearly three-quarters of the total, grew by HUF 551 billion (or 5.2%) to HUF 11,104 billion in 2007. Long-term domestic bonds amounted to 56% of the total government debt. The HUF 8,738 billion domestic bond portfolio consisted of 37 bond series, i.e. the average series size was HUF 236 billion. 10

bond series had an outstanding volume of more than HUF 400 billion (EUR 1.6 billion). For the sake of comparison, last year the same bond portfolio was worth HUF 7,772 billion and consisted of 40 bond series, with an average size of HUF 194 billion, and only 7 series were larger than HUF 400 billion. Thus, the concentration of the marketable bond portfolio continued in 2007.

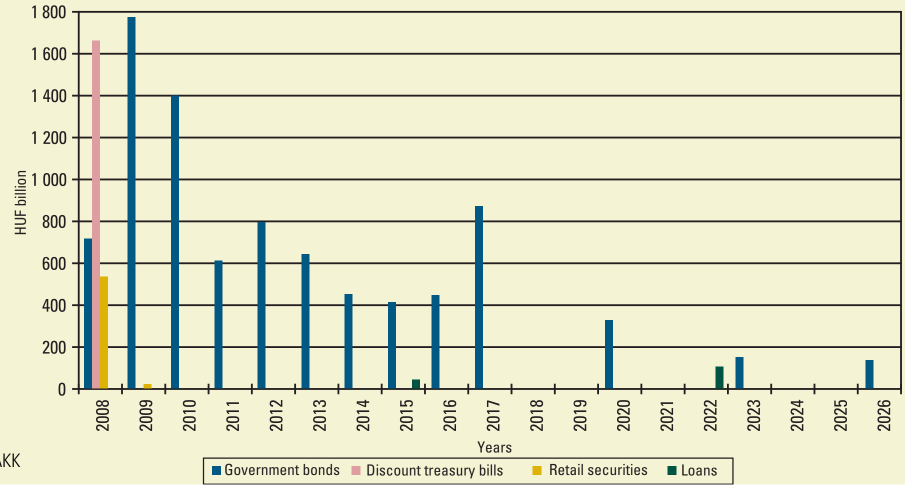
There were 20 series of discount Treasury bills outstanding at the end of 2007, with an average volume of HUF 83 billion. Out of these, 8 series had a volume larger than HUF 100 billion, and the average size of these 8 series was HUF 158 billion. The remaining 12 series, the majority of which was made up by 3-month discount Treasury bills, had an average of HUF 34 billion volume.

The retail securities portfolio decreased by HUF 112 billion in 2007 due to a decline in households' demand. Within the retail securities portfolio, the total volume of Interest Bearing Treasury Bills ended the year at HUF 228 billion, and the stock of the 1 and 2-year Treasury Savings Bills amounted to HUF 327 billion in 2007. The retail securities portfolio stood at HUF 555 billion at the end of the year, which represents 5% of the total HUF debt.

Due to repayments, the so-called non-marketable debt continued to decrease both in absolute and relative terms, and constituted HUF 493 billion (or 4.4% of the HUF-denominated debt) at the end of the year.

Out of the HUF debt portfolio, 26.3% expired within a year, another 16.2% in the second year and 39% had a tenor of at least 5 years at the end of 2007. Thus the maturity profile of the HUF debt improved significantly in 2007, and the renewal risk decreased, since the proportion of debt expiring within the year decreased by 6% while the proportion of debt due in at least 5 years increased by 5%.

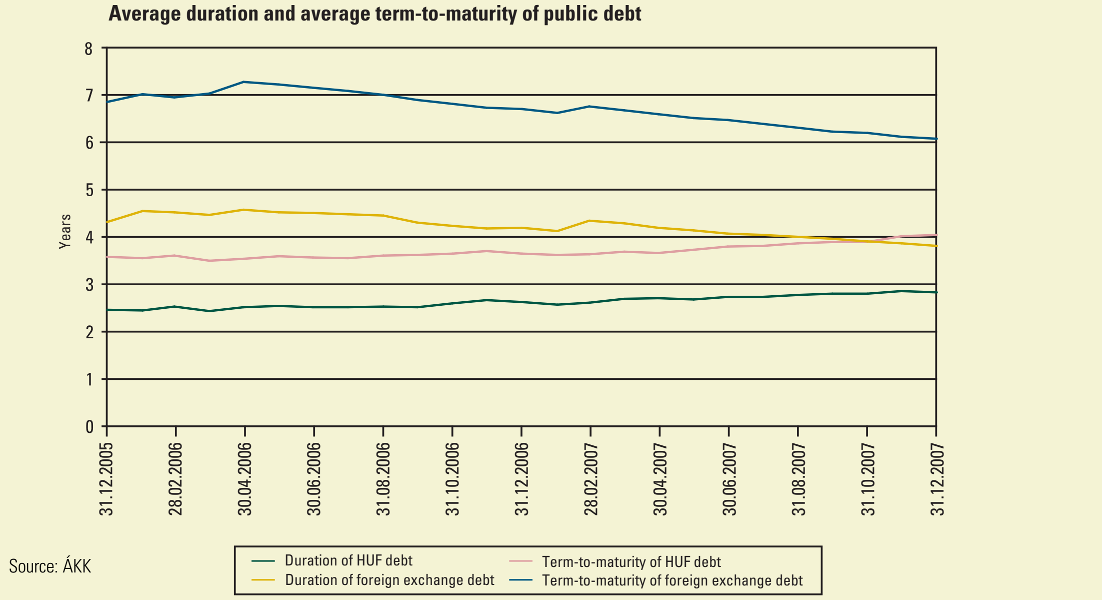
**Maturity profile of HUF-denominated government debt outstanding at the end of 2007**




Source: ÁKK

The proportion of fixed rate bonds within the HUF government securities portfolio was up by 2% to 73% against 2006, while the remaining 27% were made up by variable rate bonds.

The average remaining term-to-maturity of the HUF debt portfolio lengthened in 2007 as a result of an increase in the net issuance of long-term bonds and a small decrease in the discount Treasury bill portfolio. The effect was even more noticeable in the (Macaulay) duration of the HUF debt, which was close to the upper limit of the benchmark band. The duration of the HUF debt portfolio increased from 2.62 to 2.83 years in 2007, while the average remaining term-to-maturity rose from 3.64 to 4.04 years.

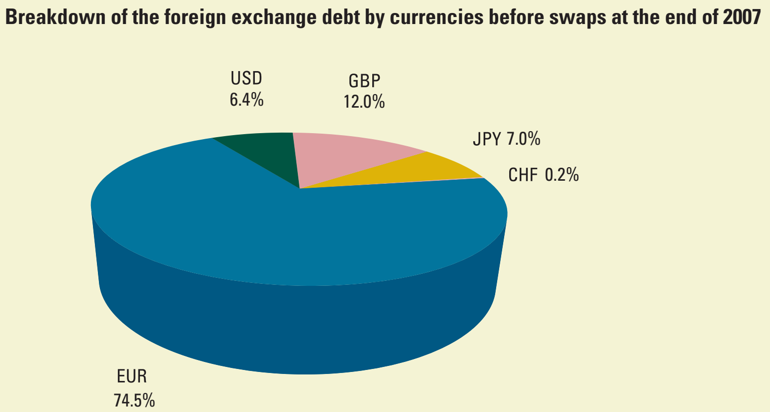



Source: ÁKK

## CHARACTERISTICS OF THE FOREIGN CURRENCY DEBT PORTFOLIO

The gross foreign currency debt of the central government increased by HUF 348 billion in 2007 and amounted to HUF 4,473 billion (EUR 17.6 billion) at the end of the year (28.7% of the gross government debt). Exchange rate movements increased the value of the foreign currency debt by HUF 14 billion in 2007.

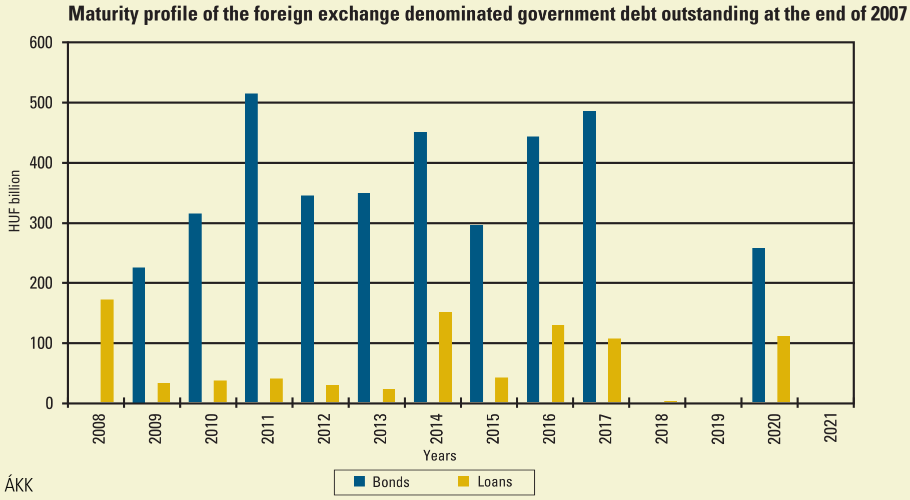
Bonds accounted for HUF 3.626 billion (or 81.1%) within the total foreign currency debt by the end of the year. At the end of 2007, there were 20 bonds outstanding issued since 1999, out of which 10 bonds were denominated in euro, 2 bonds in USD, 3 bonds in GBP, and 5 bonds in Japanese yen. All bonds issued in a currency other than euro were converted (using cross currency swaps) to euro.




Source: ÁKK

Due to regular redemptions, as well as prepayments, all foreign currency loan obligations toward the National Bank of Hungary were paid off in full by the end of 2007.

The proportion of foreign currency loans within the foreign currency debt increased from 17.2% to 18.9% in 2007. At present the foreign currency loan portfolio consists mainly of long-term project financing loans from international financing institutions (such as European Investment Bank and Council of Europe Development Bank). The foreign currency loan portfolio also includes revolving credit lines and a stand-by loan facility for liquidity management purposes. At the end of 2007 the stand-by loan facility was not drawn.



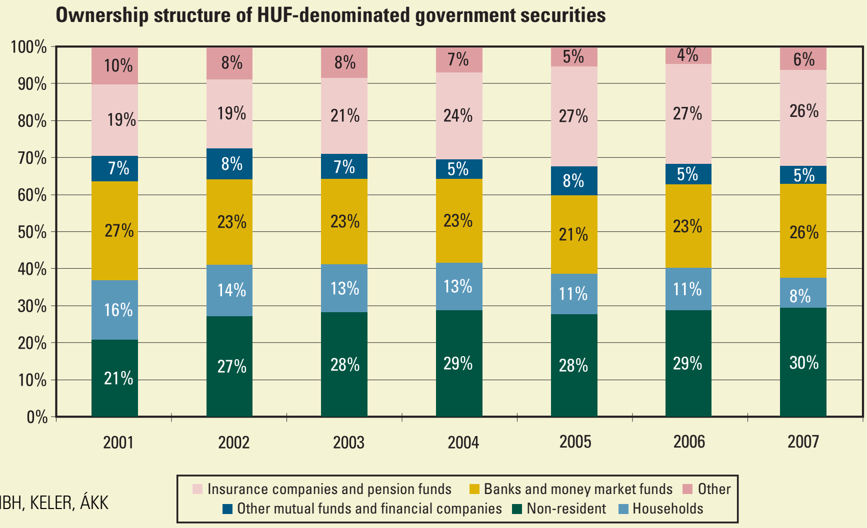

Source: ÁKK

ÁKK applies swap operations not only to set the foreign exchange structure, but also to optimize the interest rate composition of the foreign exchange debt. As a result, at the end of 2007, 65.4% of the foreign exchange debt was fixed rate, while 34.6% was floating rate. By the end of 2007, the average remaining term-to-maturity of the foreign exchange portfolio decreased by 0.6 years to 6.1 years and the average duration decreased by 0.4 years to 3.82 years.

## OTHER OBLIGATIONS

ÁKK has been performing swap operations since the end of 2004, and as a result, a special new element has been added to the government debt since 2005. In conformity with international market practice, the swap counterparties place collaterals covering the net value of their net swap position, in order to reduce the counterparty risk associated with swap operations. Since 2005 collateral (marked-to-market) deposits placed at ÁKK are accounted for as part of the debt portfolio, which, however, are not results of financing operations and thus are recorded as other obligations. At the end of 2007 the marked-to-market deposits placed with ÁKK totalled HUF 9.1 billion.

## THE OWNERSHIP STRUCTURE OF THE DOMESTIC GOVERNMENT DEBT




Source: NBH, KELER, ÁKK

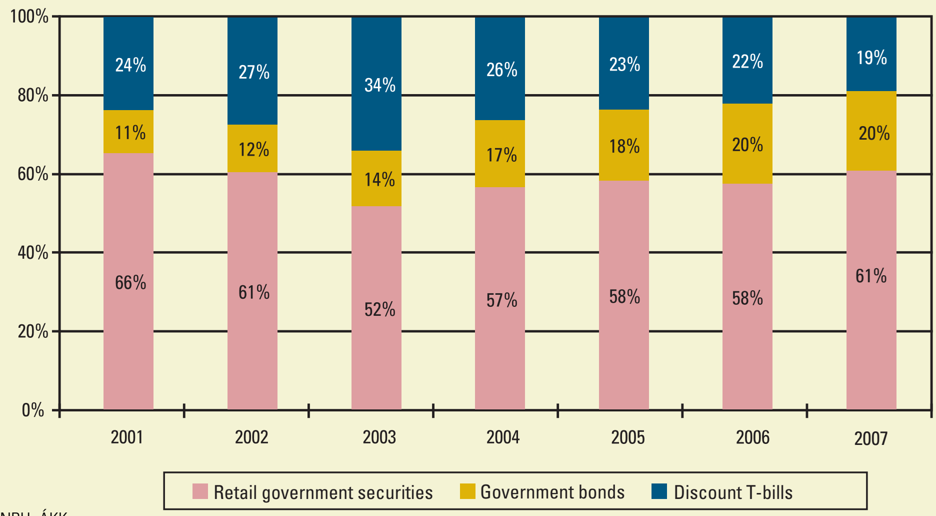
As regards the proprietary structure of the government debt, the largest proportion continues to be in the hands of non-resident investors, followed by pension funds and insurance companies, and finally the sector comprised by banks and money market funds. Households are still the fourth largest investor group. The most stable groups had been non-resident investors, insurance companies, and pension funds, though the latter decreased their government securities holdings in the fourth quarter of 2007 due to realignments within their investment portfolio.

In 2007, non-resident holdings of HUF government securities grew both in absolute and relative terms, increasing by HUF 304 billion to HUF 3,241 billion. The duration of their government securities holdings decreased from 3.5 at end-2006 to 3.4 years in 2007, while the average remaining term-to-maturity remained the same at 4.3 years. Both figures substantially exceed similar indicators of the entire stock of marketable HUF government securities outstanding, meaning that non-residents preferred to invest in longer-term bonds.  Non-resident holdings within the total amount of HUF government bonds and discount Treasury bills increased to 31.2% in 2007 from 30.8% at the end of 2006.

The continuous growth of the insurance company and pensions fund holdings seen previously stopped in 2007, as their combined government bond holdings amounted to HUF 2,932 billion.[2]

Since 2002, households have been increasing their portfolio of government securities by HUF 100 billion per year. In 2007, this tendency stopped, as their portfolio decreased by HUF 191 billion in 2007 compared to 2006. Their holdings of retail government securities, government bonds and discount Treasury bills decreased by HUF 112; 19 and 60 billion respectively. Retail government securities still had the largest share in the government securities portfolios of households, but significant amounts of discount Treasury bills and government bonds were also owned directly by retail investors.

**Breakdown of the government securities portfolio of households**




Source: NBH, ÁKK

[2]Estimate based on NBH data and ÁKK calculations.

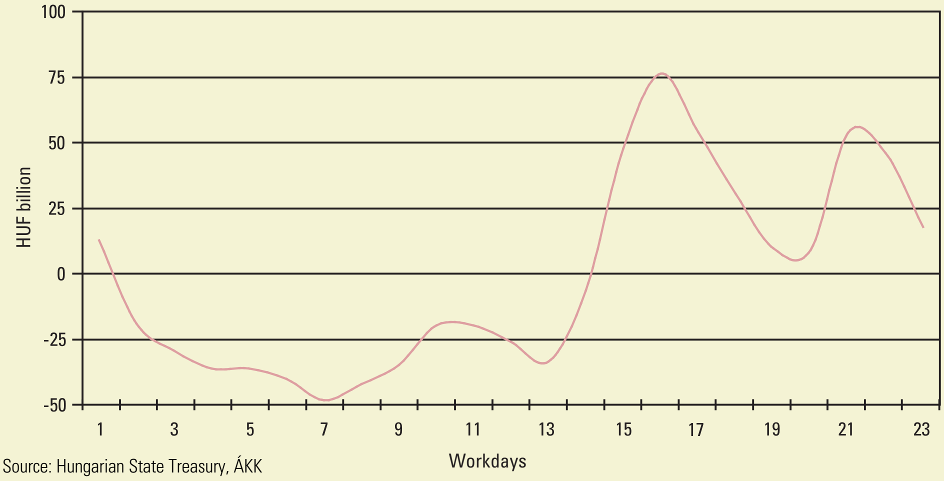
# VI. LIQUIDITY MANAGEMENT

The 2003 amendment to the Public Finances Act[3] assigned the task of liquidity management of the central government to ÁKK and provided the necessary instruments, such as repos for this purpose.

## THE OBJECTIVES OF LIQUIDITY MANAGEMENT

Due to the cyclical nature of budgetary incomes and expenses, as well as the effect of capital operations (such as issuing and paying off debts), the balance of the Single Treasury Account shows significant fluctuations (at times exceeding HUF 100 billion) on a daily basis.

**Monthly movement of the STA balance relative to the average in 2001-2007, excluding debt transactions**




Source: Hungarian State Treasury, ÁKK

As a result of the magnitude of the budgetary transactions on the Single Treasury Account, a significant amount of capital flows into and/or out from the economy daily. This in turn directly affects the amount of free liquidity in the banking system. The reduction of these fluctuations can greatly reduce the risks of financing. With the higher stability and predictability of the money market liquidity, the security of financing the budget increases and with more stable short-term interest rates the costs of financing may decrease as well. This is due to the fact that the volatility of the Single Treasury Account affects the "price" of liquidity, which is expressed in short-term (overnight) interest rates.

The correlation between the money market interest rates and the Single Treasury Account portfolio is the strongest during the time of tax payments at the end of the month and at the time of Treasury outlays at the beginning of each month. During tax payments, the liquidity in the banking system decreases and the Single Treasury Account balance increases. With the decrease of market liquidity, short-term interest rates also increase. The ensuing cash outflow via liquidity management instruments restores the needed liquidity to the money market. As a result, the short-term inter-bank interest rates increase only to a small extent. In times of decreasing STA balance (e.g. payment of wages) cash is raised via liquidity management instruments and the process has the opposite effect.

A majority of the EMU countries keep the end-of-day Treasury account balance at their central bank at a minimum level, thus ensuring fluctuations to be minimal. However, a low balance of the Treasury account does not mean that the government does not have sufficient amount of liquidity at its disposal, but rather that the majority of the cash funds is in the form of short-term investments in the banking sector, and, could be at the disposal of the government, if needed.

[3]Section 113/A. (1) paragraph b)

The goal of ÁKK is to maintain the end-of-day balance of the Single Treasury Account at the predetermined optimal level, and to keep its fluctuation within a limited range around this level. This is accomplished by placing the excessive cash into the market if the STA balance becomes too high and raising extra cash from the market if the balance is too low.

## LIQUIDITY MANAGEMENT INSTRUMENTS

The target range of the Single Treasury Account balance is +/- HUF 50 billion around the optimal balance.[4] The following instruments were used by the ÁKK in order to realize this goal.

- Repo and reverse repo transactions with government securities,
- The issuance of liquidity discount Treasury bills, usually with a 6-week tenor,
- Active use of bond buy-backs,
- Active adjustment of the volume of the 3-month and 6-month discount Treasury bills at auctions,
- A foreign currency stand-by facility.

These instruments have different time horizons in liquidity management. Bond buy-backs and discount Treasury bills are useful for smoothening fluctuations in the longer term, liquidity discount T-bills are effective in short term adjustments. ÁKK uses repo transactions to achieve very short-term goals (namely, to keep the end-of-day STA balance within the target range). If the balance is above the upper limit, ÁKK concludes reverse repo transactions and if the volume is expected to be below the lower limit it concludes repo transactions. The repo transactions used in 2007 had a tenor of one day (tom-next, spot-next) or one week (spot-week).

Drawdowns from the foreign currency stand-by loan facility are used in cases of a temporary need for a large amount of liquidity (i.e. in case of large bond maturities and transfers to and from the European Union).

## RESULTS IN 2007

In 2007, at 6 liquidity discount Treasury bill auctions ÁKK sold a total of HUF 245 billion, compared to HUF 836 billion at 23 auctions in 2006. The issuance of liquidity Treasury bills decreased the volatility of the unadjusted balance of the Single Treasury Account by 7%, i.e. they functioned effectively even though only a relatively small volume was used.

The major tool for fine-tuning the Single Treasury Account balance into the target range is the liquidity repo. Such repo transactions were concluded on 226 occasions in 2007. ÁKK used reverse repo (money placement) transactions more often (on 112 days) than repo (borrowing) transactions (on 97 days). The total amount of all repo transactions (HUF 10,038 billion) rose by 66% compared to the 2006 total of HUF 6,034 billion, demonstrating the development of the repo market in the previous years. However, roughly one out of every four repo transactions could not be concluded due to the lack of demand. Nevertheless, the repo transactions of ÁKK significantly contributed to the development of the domestic repo market.

The objective of maintaining the Single Treasury Account balance within the allowed range of fluctuation each day was accomplished on 194 of the 251 workdays in 2007 (77% an improvement from 69% in 2006). However, the daily balances outside the target range were usually over the upper edge of the range, i.e. in these cases there was extra liquidity on the STA.

The volatility (i.e. the standard deviation) of the Single Treasury Account balance would have been HUF 156 billion without repo transactions. However, using repo transactions the volatility decreased to HUF 77 billion, meaning a 13% improvement compared to 2006, while the relative standard deviation improved from 23% in 2006 to 19% in 2007.

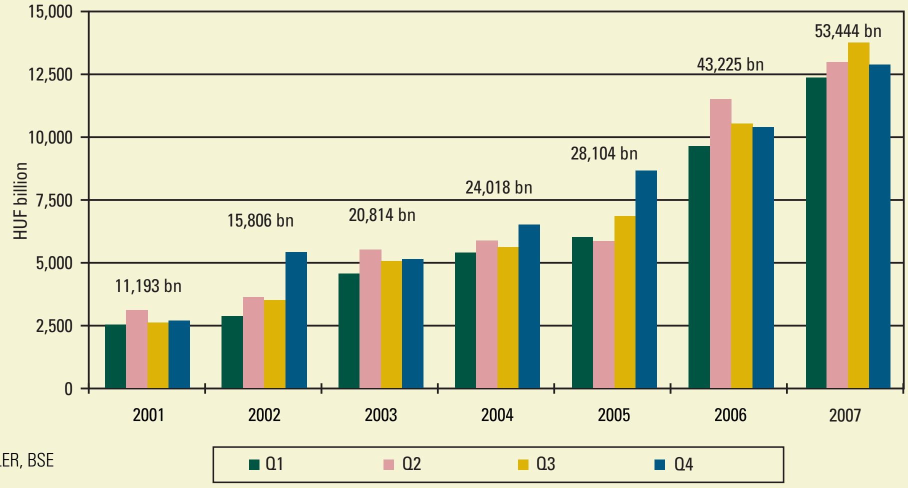
[4]In determining the target bands, the effect of certain debt operations must be taken into account, such as foreign currency funding and transactions with the NBH, which increase the balance of the STA, yet do not have the corresponding influence on the liquidity of the banking sector.

# VII. THE SECONDARY MARKET OF GOVERNMENT SECURITIES

## MARKET DATA

Primary dealers quote two-way prices both in the Budapest Stock Exchange's trading system (MMTS) and directly to investors in the over-the-counter (OTC) market and conclude government securities transactions on both markets. As in previous years, the majority of the secondary trading in government securities took place in the OTC market. The total OTC turnover of government securities amounted to HUF 53,444 billion with government bonds accounting for 92% and discount Treasury bills for 8%. That means that the existing HUF 10,400 billion HUF government securities portfolio was exchanged an average of 5 times. The dynamic growth of the secondary market trading continued in 2007, as the total OTC turnover in 2007 surpassed that of 2006 by HUF 10,219 billion, or 24%.
On the Budapest Stock Exchange (BSE), HUF 71 billion worth of government securities were traded in 2007.

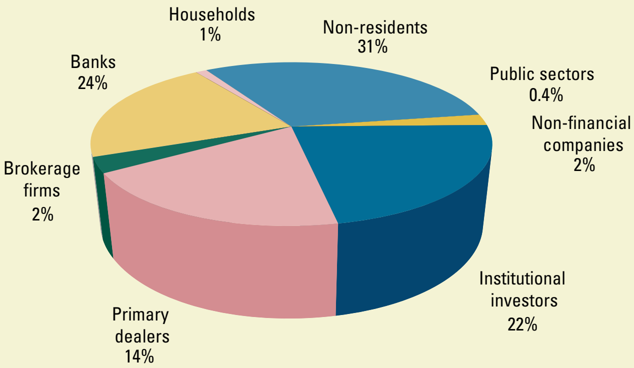
**Secondary market trading of domestic government securities (KELER OTC and stock exchange)**




Source: KELER, BSE

Primary dealers traded HUF 36,725 billion worth of Hungarian government securities, the vast majority of all trading in the Hungarian securities market. Roughly 35% of their government securities trading involved non-resident investors, which represents a growth compared to the 31% of 2006.

**Breakdown of primary dealers' secondary market turnover in government securities by investors in 2007**




Source: ÁKK

The average deal size, excluding retail deals, was HUF 625 million in 2007. As in the past, non-resident investors had the largest average deal size with HUF 1,170 million. Over the course of the year, the 5-year 2012/B bond had the largest turnover with HUF 4,070 billion, followed by the 3-year 2010/C bond and the 10-year 2017/B bond.

In January of 2008, ÁKK published the rankings of the primary dealers and its repo partners based on their activities in 2007. ÁKK awarded prizes in the following categories: the primary dealer with the largest market share in the primary market of Hungarian government bonds and that of discount Treasury bills; the primary dealer with the highest secondary market share; ÁKK 's repo partner with the largest repo turnover and the primary dealer with the most dynamic increase of its primary market share. The title of "Primary dealer of the year" was awarded for the fourth consecutive year to ING Bank.

## MARKET DEVELOPMENT

ÁKK concludes repo operations not only to manage liquidity, but also to develop the secondary market. For this purpose, ÁKK had introduced the stand-by repo facility in 2004 in order to support primary dealers' price quotation, to ensure smooth settlement of government securities transactions and to increase secondary market turnover. If a primary dealer needs government securities subject to price quotation but cannot obtain them in the market, ÁKK is ready to provide the needed government securities in a one-week repo transaction.

Stand-by repo transactions were used on more occasions, but in a lower total amount than in the year before: 1,202 transactions were concluded in an amount of HUF 449 billion (in 2006, 1,133 transactions totalled HUF 461 billion).

## THE SECONDARY MARKET OF GOVERNMENT SECURITIES ISSUED IN FOREIGN CURRENCIES

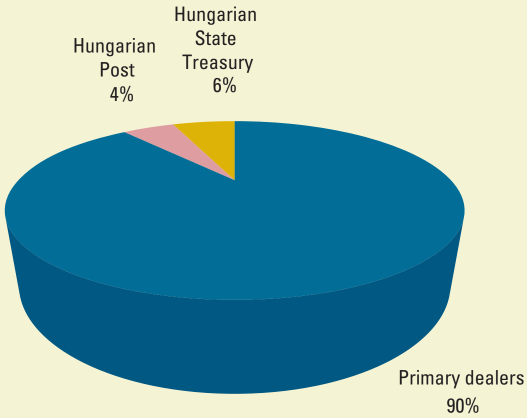
There is no special group of dealers in the secondary market for foreign currency bonds of the Republic of Hungary, but a number of banks make market in the New EuroMTS, a platform specially designed for trading the Euro-denominated bonds of the new EU-member states.

By the end of 2007, the Republic of Hungary had 9 bonds traded in the NewEuroMTS, while Poland had 8, Slovakia and Lithuania had 4, and Cyprus and the Czech Republic had two. Trading in Hungarian Eurobonds on the platform amounted to EUR 2.7 billion in 2007.

# VIII. THE INSTITUTIONAL FRAMEWORK OF THE ISSUANCE OF GOVERNMENT SECURITIES

ÁKK sells government securities through intermediaries. In the domestic market 90% of government securities were sold via the primary dealers in 2007.

**Intermediaries of domestic securities issuance in 2007**




Source: ÁKK

## THE PRIMARY DEALER SYSTEM

The primary dealer system was set up in 1996 in order to improve the transparency and liquidity of the issuance and trading of government securities.
Since May of 2004, any investment bank or credit institution that is registered in the European Union may become a primary dealer for Hungarian government securities if it meets the requirements and signs a primary dealer contract with ÁKK. The status of primary dealer guarantees exclusive rights, alongside with several obligations.

## THE GROUP OF PRIMARY DEALERS AT THE END OF 2007:

CIB Bank Zrt.
Citibank Zrt.
Deutsche Bank Zrt.
Dresdner Bank AG
Erste Befektetési Zrt.
UniCredit Bank Hungary Zrt.
ING Bank (Magyarország) Zrt.
Kereskedelmi és Hitelbank Nyrt.
MKB Bank Nyrt.
Magyar Takarékszövetkezeti Bank Zrt.
Országos Takarékpénztár és Kereskedelmi Bank Nyrt.

At the end of 2007, Raiffeisen Bank Zrt. became a primary dealer while Dresdner Bank AG left the group

The most important exclusive right and, at the same time, obligation of the primary dealers is to actively participate in the auctions of government bonds and discount Treasury bills. In this respect, ÁKK requires the primary dealers to buy a certain percentage of the auctioned amounts sold.

Another important task of primary dealers is to quote two-way (bid and ask) prices for government securities, thereby ensuring liquidity and transparency on the stock exchange and ease-of-access for investors.[5]

Primary dealers also have to report on their trading transactions of government securities and provide information about their financial position to ÁKK.

Exclusive rights of primary dealers:

- to submit bids directly at government bond and discount Treasury bill auction and offers at bond buy-back auctions[6] organized by ÁKK,
- to submit directly non-competitive bids at auctions,
- to make use of the stand-by repo[7] facility provided by ÁKK only for primary dealers,
- to participate at consultation meetings organized by ÁKK ,
- to use the title of "primary dealer".

Furthermore, primary dealers who have a broad distribution network may conclude a separate agreement with ÁKK in respect of issuance and trading of Interest Bearing Treasury Bills designed for retail investors.

## THE GROUP OF PRIMARY DEALERS WHERE RETAIL SECURITIES ARE AVAILABLE AT THE END OF 2007:

CIB Bank Zrt.
UniCredit Bank Hungary Zrt.
Kereskedelmi és Hitelbank Nyrt.
Magyar Takarékszövetkezeti Bank Zrt.
Országos Takarékpénztár és Kereskedelmi Bank Nyrt.

In addition to primary dealers, ÁKK also uses the branch network of the Hungarian State Treasury and the Hungarian Post for selling government securities to domestic investors.[8]

## THE BRANCH NETWORK OF THE HUNGARIAN STATE TREASURY

The most important function of the branch network of the Hungarian State Treasury with regards to government securities is to make them directly available to the general public and small investors. The Treasury network also performs depository tasks and redeems bonds already matured.

The branch offices constantly quote bid prices for publicly issued bonds, discount Treasury bills, and Interest Bearing Treasury Bills until the third workday before their maturity. They also quote offer prices for government bonds and discount Treasury bills until 14 days before their maturity.

[5] The obligation to quote prices applies to publicly issued government bonds and discount Treasury bills with a remaining term-to-maturity of at least 90 days, with the goal of having a continuous market-making both on and off the stock market.
[6] Any investor may submit an auctionary bid, but they must do so indirectly, through a primary dealer.
[7] ÁKK ensures government securities for primary dealers with a 1-week duration, within the framework of the stand-by repo facility. See also Market development in Chapter VII.
[8] Interest-Bearing Treasury Bills as well as the Treasury Saving Bills are continuously available government debt instruments developed for and sold specifically to retail investors.

## THE BRANCH NETWORK OF THE HUNGARIAN STATE TREASURY

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## THE BRANCH NETWORK OF THE HUNGARIAN POST

The Hungarian Post participates in the sale and redemption of Treasury Savings Bills, which are specifically developed for retail investors. The Treasury Savings Bills have a tenor of 1 or 2 years and in 2007 could be bought and redeemed at over 2,700 post offices throughout the country.

## INTERNATIONAL BOND ISSUES

Foreign investment banks and credit institutions are selected in a competitive manner to lead manage each separate foreign currency bond issue of the Republic of Hungary, and the placement of the bonds is usually supported by a syndicate group.

### IN 2007 THE LEAD MANAGERS FOR THE INTERNATIONAL ISSUES OF THE REPUBLIC WERE THE FOLLOWING*:

BNP Paribas (EUR)
Dresdner Kleinwort (EUR)
ING Bank (EUR)
Nikko Citigroup (JPY)
Mizuho Securities (JPY)

* In 2007, there were 2 international bond issues, one with 2 and one with 3 lead managers. In parenthesis is the foreign currency in which the corresponding bond was issued.

# IX. THE INSTITUTIONAL FRAMEWORK AND OBJECTIVES OF GOVERNMENT DEBT MANAGEMENT

The main legal framework of government debt management is set in Act No. XXXVIII. of 1992. on Public Finances (hereinafter: Public Finances Act). This law authorizes the Minister of Finance to ensure implementation of the budget, financing of the deficit, continuous solvency of the state budget, recording of the debt and debt service of the central budget, and repayments of debt. The annual Budget Acts specify this authorization by assigning the duties of financing and debt management in the current year to the Minister's scope of authority. The Minister of Finance performs these tasks through the Government Debt Management Agency Pte. Ltd. (ÁKK) based on the provisions of the Public Finances Act.[9]

Since March 1, 2001, following an amendment of the Public Finances Act, ÁKK is responsible for government debt management. ÁKK is a company limited by shares, where the sole shareholder is the Hungarian State, and the owner's rights are exercised by the Minister of Finance. The operation of the ÁKK as a company is governed by the general corporate law regulations. The management's activities are controlled by the Board of Directors while supervision is carried out by the Supervisory Board and the auditor pursuant to the corporate status. In addition to these internal management and audit mechanisms, the process of debt management is regularly audited by the State Audit Office.

According to regulations, the government debt management strategy, the annual financing plan and the benchmarks proposed by ÁKK are first submitted to the Board of Directors then to the Minister of Finance for approval and signing.

## THE FOUNDATION AND THE ORGANIZATIONAL STRUCTURE OF ÁKK

In May of 1995 ÁKK as a budgetary institution was founded and began working under the supervision of the Ministry of Finance, then in 1996 it was placed under the supervision of the Chairman of the State Treasury. The amendment of the Public Finances Act regarding the foundation of the ÁKK Zrt. allowed the debt management to operate in an organizational framework that is more flexible than before, is more easily able to react to market developments. The purpose of creating this separate institution was to make the responsibilities more clear and decision-making faster when implementing the debt management strategy. In this framework, the Minister of Finance approves the debt management strategy for the year, the benchmarks and the annual financing plan. The Board of Directors and the company's executives have the necessary powers to make all other decisions up to certain limitations.

The organizational structure of ÁKK is similar to that of banks and investment companies. The market operations are conducted by the front office; the deals are booked and settled by the back office. Planning, risk management and macroeconomic and market research is the task of the middle office which is separated from the previous two.

## RESPONSIBILITIES OF ÁKK

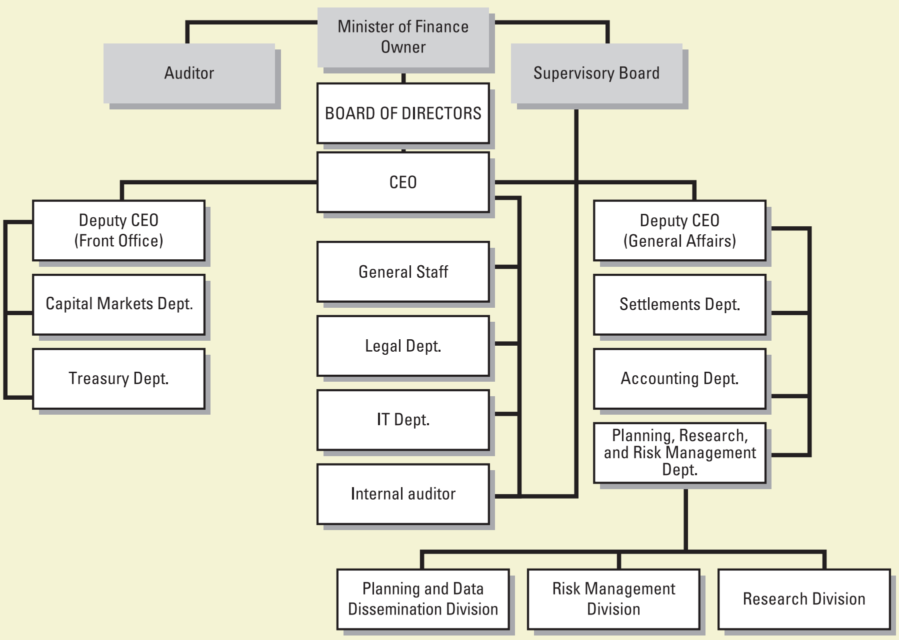
According to the Section 113/A., of Public Finances Act the responsibilities of ÁKK include the following major tasks:

- Elaboration of a long-term financing strategy in line with the economic policy, which determines the purpose of debt management and the means of its implementation.
- Preparation of the annual and medium-term financing plans based on the annual Budget Act and in line with the strategy.
- Performing the required financing operations, i.e. organizing and implementing both domestic and international government securities issuance and raising of foreign currency loans.

[9] The legislation in force at the end of 2006 concerning deficit financing, government debt management and the role of ÁKK can be found in part 4 of the Appendix.

- Managing the temporarily free cash funds of the state (liquidity management).
- Effecting debt redemptions and interest payments.
- Organization and continuous development of the government securities market (the primary dealer system, sales channels, secondary market, etc.).
- Cooperation in determining the financial terms and conditions of borrowings with a state guarantee; on request, organization of transactions with individual guarantees; keeping a secondary database of the state guarantees (the Hungarian State Treasury is primary registrar of such guarantees).

**Organisational structure of ÁKK**



# X. INFORMATION SERVICES OF ÁKK

The Public Finances Act makes ÁKK responsible for informing the general public about the developments of government debt and the government securities market. Therefore ÁKK publishes up-to-date, daily data on its Internet website and via other electronic communication systems.

## ÁKK'S INTERNET WEBSITE

ÁKK provides extensive information on its www.akk.hu website in order to inform all those interested in the government securities market and the government debt. ÁKK 's goal is to make sure that the most important data can be found easily on its home page, including the latest news, the volume of the public debt, information on the most recent and upcoming auctions, and the daily price quotations.

Other pages include information on the ÁKK as a company, the characteristics of government securities; a separate section is devoted to retail securities and there is detailed information on the issuance and trading of government securities.

The "Government securities" section includes the cash flows of outstanding government securities. The "Market information" menu contains the issuance calendar for the current year; the results of auctions and a wide range of secondary market information. Since the website uses databases, historical data and data series can also be found on most of these pages.

ÁKK's publications are available in electronic (PDF) format in the "Analyses, statistics" menu together with a number of statistical data series and the public analyses prepared by ÁKK.

A newsletter service is offered to the registered users of the website. By email newsletters users either receive certain contents attached as soon as they are published on the website or they get a notification about the publication of the given contents. Registration on the website and newsletters are free of charge.

## OTHER ELECTRONIC PLATFORMS

In addition to its website ÁKK publishes auction and price quotation data on the information pages of Bloomberg and Reuters.

## PRESS CONFERENCES, MARKETING

ÁKK also holds press conferences about annual financing, the ranking of primary dealers and other special topics. The promotion of retail securities sales is done by general marketing activities and PR articles are published for informing non-resident investors.

## PUBLICATIONS

The ÁKK also informs interested readers regularly in free publications. The following publications are available in hardcopy or can be downloaded from the website:

- Annual reports (from the middle of the year that follows the given year)
- Debt Management Outlook publications (from the beginning of the given year)
- Quarterly reports (from the second month after the given quarter)
- Desktop issuance calendar (from December of the year preceding the given year)

Monthly publications are accessible only in electronic form and they can be viewed and downloaded from ÁKK's website.

For further information concerning the publications, please contact:

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E-mail: husztie@akk.hu, rusznakf@akk.hu

# APPENDIX

## 1. CENTRAL GOVERNMENT DEBT

1. Central government gross debt as at 31.12.2007 (HUF million)

**HUF-denominated debt**

| Hungarian Government Bonds | Maturity | Coupon | Outstanding amount |
|---|---|---|---|
| 2008/A | 24.10.2008. | floating rate | 55,022.33 |
| 2008/B | 12.08.2008. | floating rate | 1,797.39 |
| 2008/C | 12.06.2008. | 6.25% | 269,596.12 |
| 2008/D | 24.04.2008. | 7.25% | 178,483.75 |
| 2008/E | 12.08.2008. | 6.50% | 283,458.83 |
| 2009/A | 12.08.2009. | floating rate | 1,901.90 |
| 2009/B | 12.02.2009. | 9.50% | 101,420.72 |
| 2009/C | 24.06.2009. | 7.00% | 305,485.03 |
| 2009/D | 12.10.2009. | 8.25% | 367,308.06 |
| 2009/E | 24.04.2009. | 6.25% | 456,494.56 |
| 2009/F | 12.08.2009. | 6.50% | 538,617.46 |
| 2010/A | 12.08.2010. | floating rate | 1,815.01 |
| 2010/B | 12.10.2010. | 6.75% | 371,939.52 |
| 2010/C | 12.04.2010. | 6.75% | 497,269.94 |
| 2010/D | 24.08.2010. | 6.25% | 525,800.26 |
| 2011/A | 12.02.2011. | 7.50% | 210,288.14 |
| 2011/B | 12.10.2011. | 6.00% | 396,277.51 |
| 2012/A | 31.12.2012. | 8.40% | 7,132.15 |
| 2012/B | 12.06.2012. | 7.25% | 525,403.53 |
| 2012/C | 24.10.2012. | 6.00% | 265,086.79 |
| 2013/A | 20.03.2013. | floating rate | 76,666.97 |
| 2013/C | 20.12.2013. | floating rate | 127,928.00 |
| 2013/D | 12.02.2013. | 6.75% | 435,630.96 |
| 2014/A | 02.05.2014. | floating rate | 29,576.06 |
| 2014/B | 20.12.2014. | floating rate | 16,612.00 |
| 2014/C | 12.02.2014. | 5.50% | 400,650.63 |
| 2015/A | 12.02.2015. | 8.00% | 411,462.88 |
| 2016/A | 31.12.2016. | floating rate | 30,060.00 |
| 2016/B | 02.01.2016. | floating rate | 9,000.00 |
| 2016/C | 12.02.2016. | 5.50% | 432,618.42 |
| 2017/A | 24.11.2017. | 6.75% | 203,455.47 |
| 2017/B | 24.02.2017. | 6.75% | 670,135.08 |
| 2020/A | 12.11.2020. | 7.50% | 325,760.39 |
| 2023/A | 24.11.2023. | 6.00% | 150,046.08 |
| 2026/A | 28.02.2026. | floating rate | 51,165.00 |
| 2026/B | 24.04.2026. | floating rate | 80,000.00 |
| 2026/C | 24.10.2026. | floating rate | 3,975.04 |
| Matured, but unclaimed government bonds | | | 285.63 |
| **Total** | | | **8,815,627.60** |
| Repos with government bonds (repos actually increase or decrease the total amount) | | | -77,660.92 |
| **Discount Treasury Bills** | | | **1,675,930.30** |
| Out of which matured, but unclaimed discount Treasury bills | | | 1 092,60 |
| Repos with discount Treasury bills (repos actually increase or decrease the total amount) | | | -10 999,98 |
| **Interest Bearing Treasury Bills** | | | **228,350.61** |
| Out of which matured, but unclaimed | | | 1 575,51 |
| **Treasury Savings Bills (1-year)** | | | **235,191.52** |
| **Treasury Savings Bills II (2-year)** | | | **91,585.26** |
| **HUF-loans** | | | **145,682.00** |
| Matured, but unclaimed other retail government securities | | | 57.54 |
| **Total HUF debt** | | | **11,103,763.92** |

## Foreign currency debt



| | in HUF million | in EUR million |
|---|---|---|
| **Syndicated loan and loans drawn down from revolving credit facilities** | **235,172.14** | **928.25** |
| **Loans granted by International Financial Institutions*** | **546,478.91** | **2,157.01** |
| **Loans assumed from the market*** | **64,849.09** | **255.97** |

**Bonds***

| Code | Currency | Maturity date | Maturity (years) | Coupon | Outstanding amount (HUF million) | Outstanding amount (EUR million) |
|---|---|---|---|---|---|---|
| 105 | EUR | 16.02.2009 | 10 | 4.375% | 126,675.00 | 500.00 |
| 112 | EUR | 27.06.2011 | 10 | 5.625% | 253,350.00 | 1000.00 |
| 113 | EUR | 06.02.2013 | 10 | 4.50% | 253,350.00 | 1000.00 |
| 114 | EUR | 27.09.2010 | 7 | 4.00% | 253,350.00 | 1000.00 |
| 115 | EUR | 29.01.2014 | 10 | 4.50% | 253,350.00 | 1000.00 |
| 116 | GBP | 06.05.2014 | 10 | 5.50% | 172,420.00 | 680.56 |
| 117 | JPY | 18.06.2009 | 5 | 1.09% | 76,220.00 | 300.85 |
| 118 | EUR | 28.10.2011 | 7 | 3.625% | 253,350.00 | 1000.00 |
| 120 | USD | 03.02.2015 | 10 | 4.75% | 258,915.00 | 1021.97 |
| 121 | EUR | 24.02.2020 | 15 | 3.88% | 253,350.00 | 1000.00 |
| 122 | GBP | 09.05.2017 | 12 | 5.00% | 172,420.00 | 680.56 |
| 123 | JPY | 12.07.2010 | 5 | 0.62% | 45,732.00 | 180.51 |
| 124 | JPY | 12.07.2012 | 7 | 0.96% | 68,598.00 | 270.76 |
| 125 | EUR | 02.11.2012 | 7 | 3-month EURIBOR+0.05% | 253,350.00 | 1000.00 |
| 126 | EUR | 18.07.2016 | 10.5 | 3.50% | 253,350.00 | 1000.00 |
| 127 | JPY | 18.03.2013 | 7 | 1.67% | 76,220.00 | 300.85 |
| 128 | GBP | 30.03.2016 | 10 | 5.00% | 182,955.35 | 725.15 |
| 129 | EUR | 04.07.2017 | 10 | 4.375% | 253,350.00 | 1000.00 |
| 130 | JPY | 26.10.2017 | 10 | 2.11% | 38,110.00 | 150.42 |
| **Total** | | | | | **3,487,880.00** | **13,767.04** |
| **Out of which cross currency swaps** | | | | | **138,210.62** | |

| | |
|---|---|
| **Loans from the National Bank of Hungary from the debt swap in 1997** | **0.00** |
| **Kingdom of Hungary 1924 bond issue** | **41.24** |
| **Total foreign currency debt** | **4,472,632.00** |
| **Total central government debt** | **15,576,395.92** |
| Other obligations of ÁKK (marked-to-market deposits placed at ÁKK) | 9,105.01 |

* With swaps

| | |
|---|---|
| **Grand total** | **15,585,500.93** |

## 2. THE LONG-TERM DEBT CREDIT RATING HISTORY OF THE REPUBLIC OF HUNGARY

**Foreign currency denominated debt**

| Date of change | Moody's | Standard and Poor's | Fitch Ratings |
|---|---|---|---|
| 20.04.1992 | - | BB+ | - |
| 27.12.1993 | Ba1 | BB+ | - |
| 25.04.1996 | Ba1 | BB+ | BBB- |
| 28.10.1996 | Ba1 | BBB- | BBB- |
| 19.12.1996 | Baa3 | BBB- | BBB- |
| 24.06.1997 | Baa3 | BBB- | BBB |
| 08.05.1998 | Baa2 | BBB- | BBB |
| 11.12.1998 | Baa2 | BBB | BBB |
| 25.06.1999 | Baa1 | BBB | BBB |
| 29.10.1999 | Baa1 | BBB | BBB+ |
| 02.02.2000 | Baa1 | BBB+ | BBB+ |
| 14.11.2000 | A3 | BBB+ | BBB+ |
| 29.11.2000 | A3 | BBB+ | A- |
| 19.12.2000 | A3 | A- | A- |
| 12.11.2002 | A1 | A- | A- |
| 06.12.2005 | A1 | A- | BBB+ |
| 22.01.2006 | A1 | A- | BBB+ |
| 26.01.2006 | A1 | A- | BBB+ |
| 15.06.2006 | A1 | BBB+ | BBB+ |
| 22.12.2006 | A2 | BBB+ | BBB+ |

Stable rating outlook was assigned by all 3 rating agencies to the Republic of Hungary

**HUF denominated debt**

| Date of change | Moody's | Standard and Poor's | Fitch Ratings |
|---|---|---|---|
| 25.04.1996 | - | - | BBB+ |
| 28.10.1996 | - | A- | BBB+ |
| 24.06.1997 | - | A- | A- |
| 22.06.1998 | A1 | A- | A- |
| 02.07.1998 | A1 | A- | A |
| 11.12.1998 | A1 | A | A |
| 29.11.2000 | A1 | A | A+ |
| 19.12.2000 | A1 | A+ | A+ |
| 19.11.2002 | A1 | A | A+ |
| 12.01.2005 | A1 | A | A |
| 27.05.2005 | A1 | A- | A |
| 06.12.2005 | A1 | A- | A- |
| 22.01.2006 | A1 | A- | A- |
| 26.01.2006 | A1 | A- | A- |
| 15.06.2006 | A1 | BBB+ | A- |
| 22.12.2006 | A2 | BBB+ | A- |

Stable rating outlook was assigned by all 3 rating agencies to the Republic of Hungary

# 3. THE ADDRESSES OF PRIMARY DEALERS

| | |
|---|---|
| CIB Bank Zrt. | Budapest, H-1027 Medve utca 4-14. |
| Citibank Zrt. | Budapest, H-1054 Szabadság tér 7. |
| Deutsche Bank Zrt. | Budapest, H-1054 Hold u. 27. |
| ERSTE Befektetési Zrt. | Budapest, H-1138 Népfürdő u. 24-26. |
| ING Bank (Magyarország) Zrt. | Budapest, H-1068 Dózsa György út 84/b |
| Kereskedelmi és Hitelbank Zrt. | Budapest, H-1052 Vigadó tér 1. |
| MKB Bank Zrt. | Budapest, H-1056 Váci u. 38. |
| Magyar Takarékszövetkezeti Bank Zrt. | Budapest, H-1122 Pethényi köz 10. |
| OTP Bank Nyrt. | Budapest, H-1876 Nádor u. 16. |
| Raiffeisen Bank Zrt. | Budapest, H-1054 Akadémia u. 6. |
| UniCredit Bank Hungary Zrt. | Budapest, H-1054 Szabadság tér 5-6 |

# 4. THE RELEVANT LEGISLATION GOVERNING ÁKK AND GOVERNMENT DEBT MANAGEMENT

## ACT NO. XXXVIII OF 1992 ON PUBLIC FINANCES

(…)

18/F. § (1) The Government Debt Management Agency Ltd. (hereinafter: „ÁKK Rt.") is a single shareholder company (limited by shares). The company's shares are registered and non-negotiable securities.

(2) The Director of ÁKK is the Minister of Finance.

(3) The establishment and operation of ÁKK – unless otherwise provided by the Act on Public Finances – are governed by the Companies Act (Act No. CXLIV of 1997).

(4) The shareholder's rights are exercised by the Minister of Finance, with the difference, that the shareholder is not entitled to suspend the rights of the Board of Directors.

(5) State officials as specified in the Act on the Status and Responsibilities of the Members of the Government and State Secretaries (Act No. LXXIX of 1997) may hold positions on ÁKK 's Board of Directors and Supervisory Board.

18/G. § (1) ÁKK manages its assets autonomously within the framework of the applicable laws and regulations, the decisions of the shareholder and the decisions of the Board of Directors.

(2) The revenues of ÁKK are:

a) The appropriation assigned for this purpose in relation with government debt management in the Annual Budget Act, which is to be placed at the disposal of the company in equal monthly instalments;

b) Other revenues.

(4) The interests, costs, fees and other payments associated with government debt management are booked and paid by ÁKK to the charge of the government debt chapter of the current Budget.

(5) ÁKK is the general legal successor of the Hungarian State Treasury Government Debt Management Agency as regards all rights and liabilities.

(6) ÁKK holds a current bank account at the National Bank of Hungary (hereinafter: „NBH") for its operations specified in paragraphs (1)-(3).

(7) ÁKK holds a securities custody account and a securities account at the Central Clearing House and Depository (Budapest) Ltd. (hereinafter: „KELER") for its operations specified in section 113/A of the Act on Public Finances.

(8) ÁKK may open a foreign currency current account at the NBH for its operations specified in section 113/A of the Act on Public Finances.

(…)

## THE GOVERNMENT DEBT

110. § All such payment liabilities based on credit relationships that are payable by any subsystem of the general government are considered to be government debt.

111. § The subsystems of the general government are responsible for recording, managing and affecting the liabilities derived from their debts.

112. § (1) The government debt is to be recorded and presented to the Parliament divided to each subsystem of the general government.

(2) The government debt, payable by the budgetary central government within the total government debt, is to be managed and recorded in an integrated manner, after having executed the provisions rendered by paragraph (3) of section 124.

(3) The relationship and connection between the government debt of the subsystems of the general government and the public sector debt as specified by the Excessive Deficit Procedure of the European Union (Maastricht debt ratio) is to be presented.

113. § The subsystems of the general government have to manage and record their debts separately.

113/A. § (1) The Minister of Finance through ÁKK

a) Ensures the solvency of the so-called state budget on the basis of the annual Budget Act and by taking into account the forecast rendered in subsection p) of paragraph (1) of section 18/B;

b) Ensures that the central government deficit and debt redemptions are financed and the government debt and the temporarily free cash-funds of the state are properly managed;

c) Records the central government debt.

(2) In executing the above duties, ÁKK:

a) Elaborates the annual and medium-term financing plan of the central government, develops the government debt financing strategy;

b) Issues government securities and raises loans in compliance with the annual Budget Act, and organizes debt-assumptions from public institutions to the State;

c) Ensures that the government debt services are duly paid;

d) Organizes the secondary market of government securities;

e) Executes secondary market security operations, sells, buys and lends government securities, executes repo transactions; in performing debt management duties concludes spot, forward and hedging transactions to reduce exchange rate and interest rate risks, and executes custodial and other security tasks;

f) Analyzes the tendencies of the government debt service and the government securities market;

g) Provides information on the government debt and on the tendencies in the government securities market;

h) Is entitled to perform tasks related to the issuance and management of government guaranteed debt securities and loans;

i) Expresses opinions on the terms and conditions of government guaranteed debt securities and loans;

j) Performs loan and deposit operations.

(3) ÁKK may create debt securities on the separated sub-accounts of the accounts specified in paragraph (6) of section 18/G without outright issuance and underlying financial claims, which may become objects of transactions specified in subsection e) of paragraph (2).

(4) Related to the debt securities issued or guaranteed by the state, ÁKK and the Treasury may trade them on client and own account, may participate in administering their placement, and may provide services related to the placement, custody, security deposit account keeping, security account keeping, client's cash account keeping and lending of these securities. The provisions of Act CXX of 2001 on the Capital Markets shall mutatis mutandis apply to ÁKK 's and the Treasury's scope of activities in this regard.

## I) ACT NO. CXXVII. OF 2006 ON THE BUDGET OF THE REPUBLIC OF HUNGARY FOR THE YEAR 2007

(…)

3. § Parliament empowers the Minister of Finance to finance the deficit of the central government in 2007, to continuously ensure the liquidity of the Single Treasury Account (STA) and to manage the debt of the central government and the assets thereof administered by the Hungarian State Treasury.

# 5. THE FINANCIAL STATEMENTS OF ÁKK

## I. BALANCE SHEET

in HUF thousand

| | Assets | 2006 | 2007 |
|---|---|---|---|
| A) | Fixed assets | 117 815 | 84 436 |
| I. | Intangible assets | 47 031 | 30 865 |
| II. | Tangible assets | 62 974 | 49 578 |
| III. | Invested financial assets | 7 810 | 3 993 |
| B) | Current assets | 288 094 | 367 140 |
| I. | Inventories | | |
| II. | Receivables | 3 284 | 2 514 |
| III. | Securities | | |
| IV. | Cash and cash equivalents | 284 810 | 364 626 |
| C) | Assets of accruals | 12 867 | 16 305 |
| | Total assets | 418 776 | 467 881 |

in HUF thousand

| | Liabilities | 2006 | 2007 |
|---|---|---|---|
| D) | Capital and reserves | 335 886 | 354 914 |
| I. | Subscribed capital | 300 000 | 300 000 |
| VII. | Balance sheet profit or loss | 33 094 | 19 028 |
| E) | Provisions | 6 145 | 4 356 |
| F) | Liabilities | 67 035 | 76 710 |
| I. | Subordinated liabilities | | |
| II. | Long term liabilities | | |
| III. | Short term liabilities | 67 035 | 76 710 |
| G) | Liabilities of accruals | 9 710 | 31 901 |
| | Total liabilities | 418 776 | 467 881 |

## II. PROFIT AND LOSS ACCOUNT

in HUF thousand

| | | 2006 | 2007 |
|---|---|---|---|
| I. | Net sales revenues | 815 300 | 836 267 |
| III. | Other incomes | 15 153 | 5 669 |
| IV. | Material expenses | 152 059 | 160 367 |
| V. | Personnel expenses | 608 218 | 638 539 |
| VI. | Depreciation and amortisation | 42 524 | 44 492 |
| VII. | Other expenses | 8 626 | 4 882 |
| A) | Operating profit or loss | 19 026 | -6 344 |
| B) | Profit or loss from financial transactions | 22 180 | 29 929 |
| C) | Profit or loss on ordinary activities | 41 206 | 23 585 |
| D) | Extraordinary profit or loss | | -80 |
| E) | Profit or loss before taxation | 41 224 | 23 505 |
| XII. | Tax payable | 8 130 | 4 477 |
| F) | Profit or loss after taxation | 33 094 | 19 028 |
| 23 | Approved dividends | | |
| G) | Balance sheet profit or loss | 33 094 | 19 028 |

# 6. MEMBERS OF ÁKK'S BOARD OF DIRECTORS AND THE SUPERVISORY BOARD AT THE END OF 2007

The members of the Board of Directors:

Dr. Álmos Kovács chairman
Imréné Karácsony member
Ferenc Szarvas member

The members of the Supervisory Board:

Zoltán Sághy chairman
Balázs Romhányi member
Dr. Béla Jónás member

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